

Financial Accounting

Fifth Edition

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New York, NY

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The authors and Pearson Education, Inc. wish to thank Susan and Brian Miller, owners of Bold City Brewery, for their contributions to this edition of *Financial Accounting*. They and their team have helped us make accounting come alive for students by showing the importance of financial accounting in making any business a success.

Dedication

I dedicate this book to my beloved children: Adam, Meg, and Sarah.
I also dedicate this book to their spouses and children. They give
meaning to my life, and are my dream come true.

Robert Kemp

I dedicate this edition to my wife, Lynne (aka Buttercup). You are such
a special gift to me.

Jeffrey Waybright

About the Authors



Robert Kemp, DBA, CPA, is the Ramon W. Breeden, Sr., Research Professor at the McIntire School of Commerce in the University of Virginia. He is a certified public accountant and possesses baccalaureate, master's, and doctorate degrees in business administration.

Professor Kemp is an accomplished scholar who conducts research and writing in the theory and practice of contemporary business. He currently is conducting research in the funding of pensions, the management of financial institutions, and corporate finance. His scholarly works include 70 completed projects, including monographs, articles, cases, research presentations, and working papers. His work is published in, among other places, *The Financial Review*; *The Journal of Financial Research*; *Advances in Accounting, A Research Journal*; *Benefits Quarterly*; *The Journal of Mathematics Applied in Business and Industry*; *The Journal of Accountancy*; *The Journal of Commercial Bank Lending*; *The Journal of Bank Accounting and Auditing*; and *The Journal of Business Economics*.

Professor Kemp is an accomplished teacher to university students and executives throughout the world. During his 36 years at the University of Virginia, he has taught numerous undergraduate and graduate courses using lectures, case studies, discussion groups, and distance learning. His consistently high evaluations by students reflect his devotion to the classroom. This high quality is also seen in his teaching of business executives. He has worked with and taught for organizations such as Bank of America, the FDIC, Navigant—Tucker Alan, the Siberian Banking Institute, the Barents Group, KPMG, Gerson Lehrman, Wellington Management, the Russian Bankers Association, the Central Asian American Enterprise Fund, the American Institute of Certified Public Accountants, and the Consumer Bankers Association.



Jeffrey Waybright teaches accounting at Spokane Community College, which is part of a multi-college district in eastern Washington. He has been a full-time, tenured, community college instructor for more than 25 years, and has also taught upper division courses for Linfield College. He is a co-recipient of the Washington Society of CPA's Outstanding Educator Award.

Mr. Waybright received his bachelor of arts degree in business administration (with an emphasis in accounting) and master's of arts degree from Eastern Washington University. Before becoming a professor, he spent eight years as a practicing CPA in Washington state, and still holds his license. During his teaching career, he has taught many disciplines of accounting, including financial, managerial, computerized, and payroll accounting, as well as the disciplines of entrepreneurship, economics, business math, and general business. Mr. Waybright developed online courses in accounting, teaches online and traditional courses for financial and managerial accounting, and advises students. He is passionate about teaching students the subject of accounting.



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Preface

Changes to This Edition

Chapter 1 Business, Accounting, and You

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 2 Analyzing and Recording Business Transactions

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 3 Adjusting and Closing Entries

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 4 Accounting for a Merchandising Business

- Fully integrated the new revenue recognition standard in text, exercises and problems.
- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.

- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 5 Inventory

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 6 The Challenges of Accounting: Standards, Internal Control, Audits, Fraud, and Ethics

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the auditor’s responsibilities with regard to auditing internal controls.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 7 Cash and Receivables

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 8 Long-Term and Other Assets

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 9 Current Liabilities and Long-Term Debt

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 10 Corporations: Paid-In Capital and Retained Earnings

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 11 The Statement of Cash Flows

- Expanded the use of Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Chapter 12 Financial Statement Analysis

- Expanded the use of the Bold City Brewery, a real-life successful entrepreneurial venture, to demonstrate the use and importance of accounting.
- Updated the “Try It!” problem.
- Updated the examples used in “How They Do It: A Look at Business.”
- Updated the Continuing Financial Statement Analysis Problem featuring Dick’s Sporting Goods using the 2016 annual report.
- Updated end-of-chapter material related to Columbia Sportswear and Under Armour using the 2016 annual reports.

Solving Teaching and Learning Challenges

Dear Colleagues,

We are very excited about the newest edition of Kemp and Waybright's *Financial Accounting*. After you have had a chance to look at this edition's changes, we think you will be as excited about our latest edition as we are.

Practical Approach: Accounting from a Business Perspective

As has been our goal in past editions, the fifth edition of *Financial Accounting* is all about helping students learn. We believe the text and supporting materials tackle challenging topics in a pragmatic, easily understood manner so that students understand not only accounting but its critical role in the business world. We want to help you help your students master the basic concepts of financial accounting and apply them to everyday business decisions.

To help with this goal, we've focused the fifth edition on businesses to which students can better relate. First, we use Bold City Brewery—a successful, entrepreneurial business—to introduce, develop, and demonstrate the topic of each chapter. We conclude each chapter by showing the importance of the chapter topic to Bold City Brewery and larger firms. Second, throughout the chapter and at the end of the chapter, we use examples and problems that reflect typical businesses that students encounter in their real lives. This means smaller and more manageable numbers.

Execution: Ensuring Student Success

Every feature in *Financial Accounting* is about helping you, the faculty, help your students achieve this goal. Based on our years of teaching, we believe we have created a complete package of instructional materials using traditional and digital methods. For example, examine how each topic is introduced, explained, and demonstrated. Notice how students not only learn the topic, but also see how it is applied in the real world. Moreover, the end-of-chapter exercises, problems, and cases, all prepared by us, create a progressive and appropriately challenging learning experience. Included in this edition are more than 18 live examples so students can test their understanding of the relationship between the general journal, journal entries, and the impact on the accounting equation. These materials were all crafted carefully to help you ensure your students have more of those “I get it” moments.

Assessment: Ensuring Your Success

We are first and foremost teachers. It's our passion. We understand the challenges you face as teachers. For example, to assure continuity between the text and the assessments, we prepared the solutions manual and contributed to the algorithmic test bank, which we also checked for accuracy. In addition to these supplements, there are automatically graded homework assignments in MyLab Accounting.

We believe in this text. Every day, we see how this text and supporting materials help students learn in and out of the classroom. We believe you too will love this text. We believe you will quickly see how *Financial Accounting*, with all of its supporting materials, creates success in your students.

Thank you for looking at *Financial Accounting*. We believe that the fifth edition of *Financial Accounting* is unique. It's special. We hope you'll look at it, compare it to other books, and think about what is best for your students and you. If you do, we think there is one obvious choice: Kemp and Waybright's *Financial Accounting*. It's all about success for you and your students.

Best wishes,

Bob Kemp

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Deliver trusted content

You deserve teaching materials that meet your own high standards for your course. That's why we partner with highly respected authors to develop interactive content and course-specific resources that you can trust—and that keep your students engaged.

Chapter Openers

Bold City Brewery is discussed at the beginning of each chapter in the Business, Accounting, and You feature. This feature motivates students by tying the business concept directly to the chapter's accounting topics and demonstrating the importance and usefulness of the chapter's topics.

CHAPTER 3
Adjusting and Closing Entries

Learning Objectives

- 1 Understand the revenue recognition and matching principles
- 2 Understand the four types of adjustments, and prepare adjusting entries
- 3 Prepare financial statements from an adjusted trial balance
- 4 Prepare closing entries and a post-closing trial balance

Business, Accounting, and You

It's closing time on December 31, and Susan and Brian Miller, the owners of the Bold City Brewery,¹ are meeting to discuss the past year. Brian says to Susan, "Well, we made it through another year. I think we've done a terrific job. We're growing, we have thousands of happy customers, and we've always paid our obligations on time. We've really worked hard this year, but I wonder, are we better off? I mean, it's time to take a look at what we've done and see whether we really made money for ourselves. We need to pull everything together and see what we look like. Did we make a profit? It's like the sport teams we love to follow: it's the end of the game and time to find out whether we've won or lost."

Susan smiled and said, "I agree. However, for us to know how we are really doing, we need to have our accounting staff ensure that our accounting records are up to date by preparing adjusting entries. Only after they do that can they prepare accurate financial statements for the year. If we don't have accurate financial statements, we can't effectively manage Bold City Brewery now and into the future. Our accountants will also need to conclude this year and prepare for next year by preparing closing entries so we are ready to start the new year. If they don't do that, we won't be able to keep track of how we are doing from one year to the next."

Whether you are an accountant or a manager who uses accounting information, you need to understand the process used by accountants to adjust and conclude (close) a business's financial records. Why? Because these records affect the reports used to manage the business. They affect the final score used to judge a business's success.

In Chapter 2, we learned about journalizing and posting transactions and how to prepare a trial balance and

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financial statements. These are steps one, two, three, and six of the accounting cycle. Once again, the accounting cycle looks like this:

```

graph TD
    S1[Step One: Recognize, measure and journalize transactions] --> S2[Step Two: Post transactions to the general ledger]
    S2 --> S3[Step Three: Prepare an unadjusted trial balance]
    S3 --> S4[Step Four: Journalize and post adjusting entries]
    S4 --> S5[Step Five: Prepare an adjusted trial balance]
    S5 --> S6[Step Six: Prepare financial statements]
    S6 --> S7[Step Seven: Journalize and post closing entries]
    S7 --> S8[Step Eight: Prepare a post-closing trial balance]
    S8 --> S1
    
```

Here in Chapter 3, we learn how to perform steps four, five, seven, and eight. The accounting cycle is repeated for every accounting period. The accounting period can be defined as a month, a quarter, or a year. The annual accounting period for most large companies runs the calendar year from January 1 through December 31, although some companies use a **fiscal year** that does not coincide with the calendar year. A fiscal year is any consecutive 12-month period that a business chooses. It may begin on any day of the year and end 12 months later. Usually, the fiscal year-end date is the low point in business activity for the year. Although we focus primarily on an annual time period, financial statements are also prepared monthly, quarterly, or semiannually. A business's managers and other stakeholders need to know how the business is doing before the year ends.

1 Understand the revenue recognition and matching principles

Accrual accounting Accounting method that records revenues when earned and expenses when incurred without regard to when cash is exchanged.

Revenue recognition principle Recording revenues when they are earned by providing goods or services to customers.

How Does a Company Accurately Report Its Income?

Revenue Recognition and Matching Principles

In Chapter 1, we learned that financial statements are prepared to provide useful information to various users. However, for financial statements to be useful, they must be accurate and up to date. To ensure that financial statements are up to date, GAAP requires the use of **accrual accounting**. To practice accrual accounting, a business must follow the next two accounting principles:

- The **revenue recognition principle** states that revenues should be recognized, or recorded, when they are earned, regardless of when cash is received.

What Are the Rules That Govern Accounting?

1 Understand the importance of US GAAP and how it differs from accounting standards in other countries (IFRS)

Generally Accepted Accounting Principles (GAAP) The rules, principles, and concepts established by the accounting profession that govern financial accounting.

In Chapter 1, we saw that accountants need rules. **Generally Accepted Accounting Principles (GAAP)** are the set of rules used by accountants. GAAP is intended to make accounting information useful and help decision makers make good decisions. For accounting information to be useful, it must be:

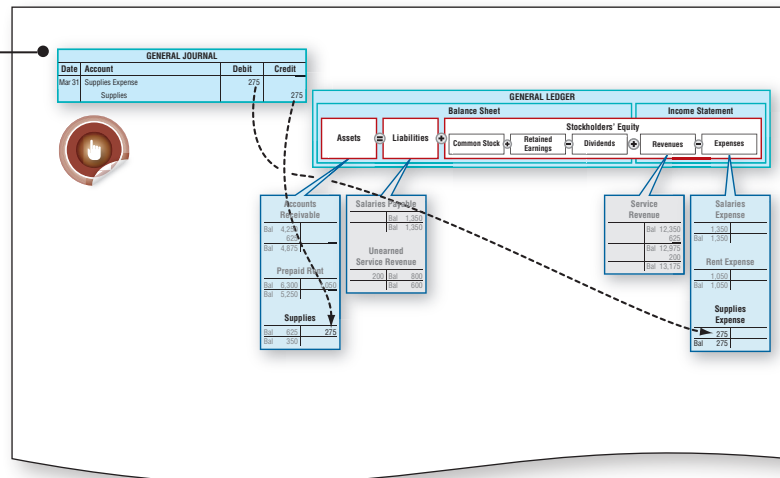
- Understandable
- Relevant
- Reliable

Understandable

Accounting information should be understandable. Accountants do not want users to make bad decisions. They work hard so a company's financial information is clear and comprehensible. They know business is complex and that understanding financial information is challenging. For that reason, accountants try to explain what they have done in notes to the financial statements. Look at Appendix A and the financial statements of Columbia Sportswear. The balance sheet, income statement, and other statements are shown. Now look at the pages immediately following these statements. You will find pages of notes that explain the numbers found in the financial statements.

Question-and-Answer Format mirrors those valuable, teachable moments in the classroom when a student asks a question that gets straight to the heart of the topic.

Live Examples Approach The authors introduce unique live examples to illustrate the connection between the accounting equation and journalizing transactions. In Chapters 2 and 3 of the Pearson eText, students can journalize transactions, create T-Accounts, and test their understanding of the relationship between journal entries and the accounting equation. Eighteen live examples allow students to practice over and over again until they comprehend these critical accounting concepts.



Case 8. You are the controller for Pro Clean Services, a company that provides janitorial services to large commercial customers. The company has been very successful during its first two years of operations, but to expand its customer base, the company is in need of additional capital to be used for equipment purchases. The two brothers who started the business, Adam and Tim Olson, invested their life savings in the business, so they have contacted a local bank about securing a loan for \$175,000.

The bank has asked for a set of financial statements, and Adam, being a businessperson, knows that the bank is going to be looking for a growth in earnings each year. Although the company's earnings have increased, Adam would like the past year to look better than it does now. Adam stops by your office late in the afternoon on December 31 to find out when the financial statements will be ready. You explain that you still have to close out the end of the year but should have them ready by the end of the week. Adam tells you he is aware of a major contract Tim is working on that it will be signed on January 3 and asks you to delay the closing process a few days so the new contract can be included in this year's operating results. You attempt to explain to Adam that you cannot do that, but you can tell he is not listening to you. Adam interrupts by saying, "I don't know why you accountants get so worked up over a few days. Let me just say that it would be in your best interest to include this contract in the current year's operating results." Adam leaves your office in a hurry, and you hear him mutter under his breath as he turns the corner, "That accountant—who does he think he is trying to tell me how to run my business?"

- Requirements**
1. What are the accounting issues related to Adam's request?
 2. What is the ethical issue involved in this case?
 3. What would be the appropriate course of action for you to take?

Know Your Business

Financial Analysis

Purpose: To help familiarize you with the financial reporting of a real company in order to further your understanding of the chapter material you are learning.

The annual report of Columbia Sportswear in Appendix A contains much more information than what is reported in the financial statements and related footnotes. In this case, you will explore other information presented in the annual report in order to determine the responsibilities of both management and the independent auditors as they relate to annual report content. In addition, you will investigate the respective roles of both management and the auditors in the company's internal control system.

Refer to the Columbia Sportswear Annual Report in Appendix A. You will need to find and then read the following reports:

- Management's Report on the Consolidated Financial Statements (Item 8)
- Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements (Item 8)

was the auditor's opinion regarding the management assessment of internal control effectiveness?

Industry Analysis

Purpose: To help you understand and compare the performance of two companies in the same industry.

Find the Columbia Sportswear Company Annual Report located in Appendix A and go to the section titled "Design and Evaluation of Internal Control Over Financial Reporting" in Item 9A starting on page 000. Now access the online 2016 Annual Report for Under Armour, Inc. For instructions on how to access the report online, see the Industry Analysis in Chapter 1. Go to the section in Item 8 on page 55 of the annual report titled "Report of Management on Internal Control over Financial Reporting."

Requirement

1. Compare the two annual reports as they relate to their disclosure of internal control procedures and the system of internal control.

Small-Business Analysis

Purpose: To help you understand the importance of cash flows in the operation of a small business.

You own a business, like the Millers of the Bold City Brewery. You're having a tough time figuring out why your actual cash is always coming up less than the amount the general ledger says should be there. You would hate to think that any of your employees would be stealing from you, because they have all been with you since you opened the business five years ago. But maybe it's time to do a little investigative work. After all, cash is the lifeblood of the business, and if it's being misappropriated, you need to find out fast!

You think back over some of your recent observations and some of the conversations you've overheard. One startling conclusion is staring you in the face: Julie's been a good employee, but lately she's been bragging about her wild weekends and some of the gambling casinos she's been going to. Julie never used to be like that. You overheard one of her fellow employees ask her where she's getting all this money, and she said that her husband just got a really good raise at his job and they're celebrating. Then just last week, Julie drove to work in a new sports car, and again you overheard her tell someone about the great deal her brother-in-law got for her on this car.

Julie is in charge of accounts payable, billing, and collections. Because your office is so small, you always felt like these jobs could be done more efficiently by the same person. You also remember that Julie's uncle is one of your vendors, and there was that situation last year where you discovered a double billing from her uncle's company. When you brought it to Julie's attention, she immediately admitted her error and took care of it.

The Perfect Balance of Small Business Perspective and Corporate Coverage Not every student will graduate and become part of a large corporation, which is why it's important for students to understand how financial accounting applies in small business scenarios as well as corporate ones.



Focus on Decision Making

“Who Owns Net Income and Where Does Net Income Go?”

What is net income? You can't touch it. You can't see it. You can't spend it. There's not even an account in the general ledger called Net Income. You can touch, see, and spend cash. But using accrual accounting, net income is not cash. So, what is net income? Net income is the net of revenues less expenses. But who gets the net income? Who owns net income?

The answer is that owners own net income. Think of revenues as something that benefits owners. Think of expenses as something that takes away some of that benefit that revenues provide. The net—whether net income or loss—belongs to the owners.

At the end of each accounting period, we want to close out the old measures and start new measures of revenues, expenses, and net income. We have closing entries that zero out all the revenue and expense accounts so they start with a zero balance. However, we do not zero out the impact that revenues and expenses had on balance sheet accounts such as cash, accounts receivable, and accounts payable. To get this to work, we must recognize that the net income belongs to the business's owners. It's a part of the owners' equity. If the business does not distribute it to the owners, the net income is retained in the business. Earnings over time can be retained in the business or distributed to owners.

How They Do It: A Look at Business

During a period of time, a business sells products and earns revenue. In doing so, it incurs expenses. Revenue less expenses is net income (or net loss). Think about a microbrewery such as the Bold City Brewery.² Remember in Chapter 1 that our dream brewery started with \$1,500,000 in assets. It financed \$1,500,000 in assets with \$750,000 in liabilities and \$750,000 in stockholders' equity. What did it do with its assets? During the year, it used the assets to make and sell beer. Sales were \$3,000,000. It incurred expenses in making and selling the beer of \$2,700,000. During the year, the brewery made its owners \$300,000 in net income. The owners started with \$750,000 in stockholders' equity. It increased its stockholders' equity by adding \$300,000 in net income to retained earnings. Thus, at the end of the year, the \$300,000 in additional retained earnings increased stockholders' equity from \$750,000 to \$1,050,000. If the brewery does not pay a dividend to its owners, the brewery will have ending stockholders' equity of \$1,050,000. The brewery will start the next year with \$1,050,000 in stockholders' equity.

Now let's look at the Walt Disney Company. Disney operates amusement parks, makes movies, sells clothing, and does many other things related to the entertain-

Focus on Decision Making shows students how to make financially sound business decisions and to evaluate risk and the impact of those decisions on a company.

Decision Guidelines focus students on key business decisions that require a firm understanding of the accounting concepts in each chapter.



Decision Guidelines

Decision

How can I tell how well a business is performing?

Guideline

A company's financial statements provide information regarding its performance.

Analyze

The income statement reflects how profitable a business has been for a specified period of time. The statement of retained earnings shows how much of a company's earnings have been distributed to the stockholders during the period. And the balance sheet reflects the business's financial position on a given date. In other words, it shows what assets the business has and who has rights to those assets.



Try It!

Jane Richards is the accountant for Crazy Curls, Inc., a local salon. After Jane finished preparing the financial statements for the year, she realized that she failed to make an adjusting entry to record \$975 of depreciation expense on equipment. What effect did this error have on Crazy Curls' financial statements?

Answer

To determine the effect of omitting an adjusting entry, we must examine what the adjusting entry should have been. Jane should have made the following adjusting entry:

DATE	ACCOUNTS	POST REF.	DR.	CR.
	Depreciation Expense, Equipment		975	
	Accumulated Depreciation, Equipment			975

As we can see from the journal entry, Depreciation Expense, Equipment should have been debited (increased), which would have increased total expenses for the year. An increase in total expenses causes a decrease in Net Income. So, the omission of the adjusting entry for depreciation expense causes Net Income, and therefore Retained Earnings, to be overstated. We also see that the Accumulated Depreciation, Equipment account should have been credited (increased), which would cause total assets to decrease because Accumulated Depreciation, Equipment is a contra-asset account. So, the omission of the adjusting entry for depreciation expense also causes the total assets to be overstated.

Try It! gives students the opportunity to apply the concept they just learned to an accounting problem.

Stop and Think includes a question-and-answer snapshot asking students to apply what they just learned.



Stop and Think . . .

If cash is so important to the well-being of a business, why does US GAAP require the use of accrual accounting instead of cash accounting?

Answer

The goal of US GAAP is for financial statements to reflect accurate information regarding the performance of a business. The fact that a business has received cash from customers does not necessarily mean that the business is performing well. For example, let's assume that during the year a business received \$95,000 from customers for services it had provided during the same year. The business also received another \$15,000 from customers for services that will not be provided until the following year. Under cash accounting, the business would report \$110,000 of revenues in the first year. Now, suppose during the second year the customers asked for (and received) a refund of the \$15,000 before the services were provided. The \$110,000 in revenues originally reported under cash accounting during the first year now seem inaccurate because the business only ended up with revenues of \$95,000. Under accrual accounting, the business would have reported only \$95,000 of revenues in the first year, which would have reflected a more accurate picture of the business's performance. This is because, under accrual accounting, revenues are recorded when they are earned instead of when cash is received.

Continuing Financial Statement Analysis Problem

Let's look at Dick's Sporting Goods (Dick's) some more. Think about Dick's. Think about accountants reporting what Dick's has, where it got its money, and what it has been doing to create value. Is Dick's earning net income or loss? What resources did Dick's need to operate? Think about the business of Dick's.

Return to Dick's financial statements, which are contained in its Annual Report (see the Continuing Financial Statement Analysis Problem in Chapter 2 for instructions on how to access the Annual Report). Go to page 40, where you will find Dick's income statement for the year ending January 28, 2017 (called the Consolidated Statement of Income). On page 42, you'll find Dick's balance sheet as of January 28, 2017. Now answer the following questions:

1. What makes up Dick's inventory? See footnote 1 of the financial statements (page 45 in Dick's 2016 annual report). What inventory method does Dick's use, for example, FIFO or LIFO?
2. Look at Dick's balance sheet. How much has Dick's invested in inventory as of January 28, 2017, and January 30, 2016?
3. Look at Dick's balance sheet. How much inventory does Dick's have per store as of January 28, 2017, and January 30, 2016? (Divide the total inventory by the number of stores Dick's operated in each of these years: 797 in 2016 and 741 in 2015.) Is inventory per store increasing or decreasing?
4. Look at Dick's balance sheet and income statement. What is Dick's inventory turnover rate for the year ending January 28, 2017? What does this tell you?
5. Look at Dick's balance sheet and income statement. What is Dick's days-sales-inventory for the year ending January 28, 2017? What does this tell you?
6. Looking back over your answers to questions 1 through 5, how do you think Dick's is performing?

Continuing Financial Statement Analysis Problem uses the Dick's Sporting Goods 2016 annual report to familiarize students with reading and interpreting financial statements in each chapter. By the end of the text, they have completely analyzed the financial statements.

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TUTORIAL PROGRESS

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Resources/Glossary

Accounting Cycle Tutorial

The accounting cycle is the process by which companies produce their financial statements for a specific period.

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Accounting Cycle Tutorial (ACT) with Comprehensive Problem

MyLab Accounting's new interactive tutorial helps students master the accounting cycle for early and continued success in the Introduction to Accounting course. The tutorial—accessed by computer, smartphone, or tablet—provides students with brief explanations of each concept of the accounting cycle through engaging videos and animations. Students are immediately assessed on their understanding, and their performance is recorded in the MyLab Accounting grade book. Whether the Accounting Cycle Tutorial is used as a remediation self-study tool or course assignment, students have yet another resource within MyLab Accounting to help them be successful with the accounting cycle. This updated version includes a new comprehensive problem.

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Session 71590166

many choice question

Choose all of the accounts that would be listed on the balance sheet:

A. Revenues
B. Losses
C. Assets
D. Liabilities
E. Expenses
F. Stockholders' equity
G. Gains

You may select zero, one, or many answers.

Submit response

Refresh Send a message to the instructor Join another session

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Created by Jeffrey Waybright

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Created by Stephanie Swaim, Dallas
County Community College District

Course Content

- Introduction to the Instructor's Resource Manual with a list of resources and a roadmap to help navigate MyLab Accounting
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- Chapter overview and teaching outline that includes a brief synopsis and overview of each chapter
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- Key topics that walk instructors through what material to cover and what examples to use when addressing certain items within the chapter
- Student chapter summary handout to assist students in taking notes on the chapter
- Assignment grid that outlines all end-of-chapter exercises, problems, and cases; the topic of a particular exercise, problem, or case; estimated completion time; level of difficulty; and availability in General Ledger or Excel templates
- Ten-minute quizzes that quickly assess students' understanding of the chapter material

Test Bank

Created by Lauren Psomostithis,
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Includes more than 1,500 questions; both objective-based questions and computational problems are available. Algorithmic test bank is available in MyLab Accounting.

Algorithmic test bank is available in MyLab Accounting. Most computational questions are formulated with an algorithm so that the same question is available with unique values. This offers instructors a greater pool of questions to pull from, and will help ensure each student has a different test.

All questions include the following annotations:

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- Type (Multiple-choice, true/false, short-answer, essay)
- Learning objective
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Created by Stephanie Swaim, Dallas County Community College District

Available in both Excel and PDF format, these documents can be used for completing end-of-chapter questions in preformatted templates.

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This website contains the following:

- The Excel in Practice Data Files, related to select end-of-chapter problems
- Working Papers, for completing end-of-chapter questions in preformatted templates
- Student PowerPoint® Presentations



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