# Contents

## 1 The Role of Accounting as an Information System

### Part A: Financial Accounting Environment, 4
- The Economic Environment and Financial Reporting, 5
  - The Investment-Credit Decision—A Cash Flow Perspective, 6
  - Cash versus Accrual Accounting, 7
- The Development of Financial Accounting and Reporting Standards, 9
  - Historical Perspective and Standards, 9
  - The Establishment of Accounting Standards—A Political Process, 12
  - Our Global Marketplace, 13
  - The Role of the Auditor, 16
  - Financial Reporting Reform, 16
  - A Move Away from Rules-Based Standards, 18
- Ethics in Accounting, 19
  - Ethics and Professionalism, 19
  - Analytical Model for Ethical Decisions, 19

### Part B: The Conceptual Framework, 20
- Objective of Financial Reporting, 21
- Qualitative Characteristics of Financial Reporting Information, 22
  - Fundamental Qualitative Characteristics, 23
  - Enhancing Qualitative Characteristics, 24
- Practical Boundaries (Constraints) to Achieving Desired Qualitative Characteristics, 25
  - Cost Effectiveness, 25
  - Materiality, 25
  - Conservatism, 26
- Elements of Financial Statements, 26
- Recognition and Measurement Concepts, 27
  - Recognition, 27
  - Measurement, 28
  - Underlying Assumptions, 28
  - Broad Accounting Principles, 29
- Evolution of Accounting Principles, 33
  - The Asset/Liability Approach, 33
  - The Move toward Fair Value, 34
- Questions for Review of Key Topics, 38

### Brief Exercises, 38
### Exercises, 39
### CPA and CMA Review Questions, 43
### Broaden Your Perspective, 45

## 2 Review of the Accounting Process, 50

- The Basic Model, 52
  - The Accounting Equation, 52
  - Account Relationships, 53
- The Accounting Processing Cycle, 55
  - Concept Review Exercise: Journal Entries for External Transactions, 64
- Adjusting Entries, 66
  - Prepayments, 67
  - Accruals, 70
  - Estimates, 72
  - Concept Review Exercise: Adjusting Entries, 74
- Preparing the Financial Statements, 76
  - The Income Statement, 76
  - The Balance Sheet, 77
  - The Statement of Cash Flows, 78
  - The Statement of Shareholders’ Equity, 79
- The Closing Process, 79
  - Concept Review Exercise: Financial Statement Preparation and Closing, 81
- Conversion from Cash Basis to Accrual Basis, 83
  - Appendix 2A: Use of a Worksheet, 87
  - Appendix 2B: Reversing Entries, 88
  - Appendix 2C: Subsidiary Ledgers and Special Journals, 90
  - Questions for Review of Key Topics, 93
- Brief Exercises, 93
- Exercises, 94
- CPA Review Questions, 101
- Problems, 102
- Broaden Your Perspective, 109
CHAPTER
The Balance Sheet and Financial Disclosures, 112

Part A: The Balance Sheet, 115
Usefulness and Limitations, 115
Classifications, 116
Assets, 116
Liabilities, 120
Shareholders' Equity, 121
Concept Review Exercise: Balance Sheet Classification, 123

Part B: Financial Disclosures, 124
Disclosure Notes, 125
Summary of Significant Accounting Policies, 125
Subsequent Events, 125
Noteworthy Events and Transactions, 126
Management Discussion and Analysis, 128
Management's Responsibilities, 128
Auditors' Report, 129
Compensation of Directors and Top Executives, 131

Part C: Risk Analysis, 132
Using Financial Statement Information, 132
Liquidity Ratios, 133
Financing Ratios, 135
Appendix 3: Reporting Segment Information, 140
Questions for Review of Key Topics, 143
Brief Exercises, 144
Exercises, 145
CPA and CMA Review Questions, 153
Problems, 154
Broaden Your Perspective, 160

CHAPTER
The Income Statement and Statement of Cash Flows, 168

Part A: The Income Statement and Comprehensive Income, 170
Income from Continuing Operations, 170
Revenues, Expenses, Gains, and Losses, 170
Income Tax Expense, 172
Operating versus Nonoperating Income, 172
Income Statement Formats, 172
Earnings Quality, 175
Manipulating Income and Income Smoothing, 175
Operating Income and Earnings Quality, 176
Nonoperating Income and Earnings Quality, 179
Separately Reported Items, 180
Intraperiod Income Tax Allocation, 180
Discontinued Operations, 182
Extraordinary Items, 186
Unusual or Infrequent Items, 187
Accounting Changes, 188
Change in Accounting Principle, 188
Change in Depreciation, Amortization, or Depletion Method, 189
Change in Accounting Estimate, 190
Change in Reporting Entity, 191
Correction of Accounting Errors, 192
Prior Period Adjustments, 192
Earnings per Share Disclosures, 192
Comprehensive Income, 194
Other Comprehensive Income, 194
Flexibility in Reporting, 194
Accumulated Other Comprehensive Income, 196
Concept Review Exercise: Income Statement Presentation, 197
Part B: The Statement of Cash Flows, 198
Usefulness of the Statement of Cash Flows, 198
Classifying Cash Flows, 199
Operating Activities, 199
Investing Activities, 203
Financing Activities, 203
Noncash Investing and Financing Activities, 204
Concept Review Exercise: Statement of Cash Flows, 205
Questions for Review of Key Topics, 209
Brief Exercises, 209
Exercises, 211
CPA and CMA Review Questions, 218
Problems, 219
Broaden Your Perspective, 225
British Airways Case, 230
CPA Simulation 4-1, 231

CHAPTER
Income Measurement and Profitability Analysis, 232

Part A: Revenue Recognition, 234
Revenue Recognition at Delivery, 238
Product Revenue, 238
Service Revenue, 238
Revenue Recognition after Delivery, 239
Installment Sales, 239
Concept Review Exercise: Installment Sales, 243
Right of Return, 243
Consignment Sales, 245
Revenue Recognition Prior to Delivery, 245
A Comparison of the Completed Contract and Percentage-of-Completion Methods, 251
Concept Review Exercise: Long-Term Construction Contracts, 257
Industry-Specific Revenue Issues, 258
Software and Other Multiple-Deliverable Arrangements, 259
Franchise Sales, 260
Part B: Profitability Analysis, 263
Activity Ratios, 263
Profitability Ratios, 265
Profitability Analysis—An Illustration, 267
Appendix 5: Interim Reporting, 271
6 CHAPTER
Time Value of Money
Concepts, 298

Part A: Basic Concepts, 300
Time Value of Money, 300
Simple versus Compound Interest, 300
Valuing a Single Cash Flow Amount, 301
Future Value of a Single Amount, 301
Present Value of a Single Amount, 302
Solving for Other Values When FV and PV are Known, 304
Concept Review Exercise: Valuing a Single
Cash Flow Amount, 305
Preview of Accounting Applications of Present Value
Techniques—Single Cash Amount, 306

Expected Cash Flow Approach, 308
Part B: Basic Annuities, 309
Future Value of an Annuity, 310
Future Value of an Ordinary Annuity, 310
Future Value of an Annuity Due, 311
Present Value of an Annuity, 312
Present Value of an Ordinary Annuity, 312
Present Value of an Annuity Due, 313
Present Value of a Deferred Annuity, 314
Financial Calculators and Excel, 316
Solving for Unknown Values in Present
Value Situations, 316
Concept Review Exercise: Annuities, 319
Preview of Accounting Applications of Present Value
Techniques—Annuities, 320
Valuation of Long-Term Bonds, 320
Valuation of Long-Term Leases, 321
Valuation of Pension Obligations, 321
Summary of Time Value of Money Concepts, 322
Questions for Review of Key Topics, 324
Brief Exercises, 325
Exercises, 326
CPA and CMA Review Questions, 329
Problems, 331
Broaden Your Perspective, 334

2 Economic Resources

SECTION

7 CHAPTER
Cash and Receivables, 336

Part A: Cash and Cash Equivalents, 338
Internal Control, 338
Internal Control Procedures—Cash Receipts, 339
Internal Control Procedures—Cash Disbursements, 339
Restricted Cash and Compensating Balances, 340
Decision Makers’ Perspective, 341
Part B: Current Receivables, 342
Accounts Receivable, 342
Initial Valuation of Accounts Receivable, 342
Subsequent Valuation of Accounts Receivable, 344
Concept Review Exercise: Uncollectible Accounts
Receivable, 351
Notes Receivable, 352
Interest-Bearing Notes, 352
Noninterest-Bearing Notes, 353
Subsequent Valuation of Notes Receivable, 355

Financing with Receivables, 356
Secured Borrowing, 356
Sale of Receivables, 358
Transfers of Notes Receivable, 361
Deciding Whether to Account for a Transfer as a Sale
or a Secured Borrowing, 361
Disclosures, 362
Concept Review Exercise: Financing with Receivables, 365
Decision Makers’ Perspective, 365
Appendix 7A: Cash Controls, 369
Appendix 7B: Impairment of a Receivable Due
to a Troubled Debt Restructuring, 372
Questions for Review of Key Topics, 374
Brief Exercises, 375
Exercises, 376
CPA and CMA Review Questions, 382
Problems, 384
Broaden Your Perspective, 390
British Airways Case, 393
# Chapter 8
## Inventories: Measurement, 394

### Part A: Recording and Measuring Inventory, 396
- Types of Inventory, 396
  - Merchandising Inventory, 396
  - Manufacturing Inventories, 396
- Perpetual Inventory System, 397
- Periodic Inventory System, 398
- A Comparison of the Perpetual and Periodic Inventory Systems, 399

### What is Included in Inventory?, 400
- Physical Quantities Included in Inventory, 400
- Expenditures Included in Inventory, 401

### Inventory Cost Flow Assumptions, 404
- Specific Identification, 405
- Average Cost, 405
- First-In, First-Out (FIFO), 407
- Last-In, First-Out (LIFO), 408

### Comparison of Cost Flow Methods, 410

### Decision Makers' Perspective—Factors Influencing Method Choice, 411

### Concept Review Exercise: Inventory Cost Flow Methods, 414

### Part B: Methods of Simplifying LIFO, 420
- LIFO Inventory Pools, 420
- Dollar-Value LIFO, 421
  - Advantages of DVL, 422
  - Cost Indexes, 422
  - The DVL Inventory Estimation Technique, 422

### Concept Review Exercise: Dollar-Value LIFO, 423

### Questions for Review of Key Topics, 425

### Brief Exercises, 426

### CPA and CMA Review Questions, 433

### Problems, 435

### Broaden Your Perspective, 441

### British Airways Case, 445

# Chapter 9
## Inventories: Additional Issues, 446

### Part A: Reporting—Lower of Cost or Market, 448
- Determining Market Value, 449
  - Applying Lower of Cost or Market, 451
  - Adjusting Cost to Market, 452
- Concept Review Exercise: Lower of Cost or Market, 454

### Part B: Inventory Estimation Techniques, 455
- The Gross Profit Method, 456
  - A Word of Caution, 457
- The Retail Inventory Method, 458
  - Retail Terminology, 459
  - Cost Flow Methods, 460

### Other Issues Pertaining to the Retail Method, 462
- Concept Review Exercise: Retail Inventory Method, 463

### Part C: Dollar-Value LIFO Retail, 465
- Concept Review Exercise: Dollar-Value LIFO Retail Method, 468

### Part D: Change in Inventory Method and Inventory Errors, 469
- Change in Inventory Method, 469
  - Most Inventory Changes, 469
  - Change to the LIFO Method, 471
- Inventory Errors, 472
  - When the Inventory Error is Discovered the Following Year, 473
  - When the Inventory Error is Discovered Subsequent to the Following Year, 473
- Concept Review Exercise: Inventory Errors, 474

### Earnings Quality, 474

### Appendix 9: Purchase Commitments, 476

### Questions for Review of Key Topics, 478

### Brief Exercises, 479

### Exercises, 480

### CPA and CMA Review Questions, 487

### Problems, 489

### Broaden Your Perspective, 494

### British Airways Case, 497

### CPA Simulation 9-1, 498

### CPA Simulation 9-2, 498

# Chapter 10
## Property, Plant, and Equipment and Intangible Assets: Acquisition and Disposition, 500

### Part A: Valuation at Acquisition, 502
- Types of Assets, 502
- Costs to Be Capitalized, 504
  - Property, Plant, and Equipment, 504
  - Intangible Assets, 509
- Lump-Sum Purchases, 512
- Noncash Acquisitions, 512
  - Deferred Payments, 513
  - Issuance of Equity Securities, 515
  - Donated Assets, 515

### Decision Makers' Perspective, 516

### Part B: Dispositions and Exchanges, 517
- Dispositions, 517
- Exchanges, 518
  - Fair Value Not Determinable, 519
  - Exchange Lacks Commercial Substance, 519

### Concept Review Exercise: Exchanges, 521

### Part C: Self-Constructed Assets and Research and Development, 521
- Self-Constructed Assets, 521
  - Overhead Allocation, 522
  - Interest Capitalization, 522
  - Research and Development (R & D), 526

### Appendix 10: Oil and Gas Accounting, 534
11 CHAPTER
Property, Plant, and Equipment and Intangible Assets:
Utilization and Impairment, 556

Part A: Depreciation, Depletion, and Amortization, 558
Cost Allocation—An Overview, 558
Measuring Cost Allocation, 559
Service Life, 559
Allocation Base, 559
Allocation Method, 560
Depreciation, 560
Time-Based Depreciation Methods, 560
Activity-Based Depreciation Methods, 562
Decision Makers’ Perspective—Selecting a Depreciation Method, 563
Concept Review Exercise: Depreciation Methods, 565
Group and Composite Depreciation Methods, 566
Depletion of Natural Resources, 569
Amortization of Intangible Assets, 571

Part B: Additional Issues, 575
Partial Periods, 575
Changes in Estimates, 576
Change in Depreciation, Amortization, or Depletion Method, 577
Error Correction, 578
Impairment of Value, 580
Assets to Be Held and Used, 580
Assets to Be Sold, 587
Impairment Losses and Earnings Quality, 588

Part C: Subsequent Expenditures, 589
Expenditures Subsequent to Acquisition, 589
Repairs and Maintenance, 589
Additions, 590
Improvements, 590
Rearrangements, 590
Costs of Defending Intangible Rights, 591

Appendix 11A: Comparison with MACRS (Tax Depreciation), 594
Appendix 11B: Retirement and Replacement Methods of Depreciation, 594
Questions for Review of Key Topics, 596
Brief Exercises, 596
Exercises, 598
CPA and CMA Review Questions, 605
Problems, 607
Broaden Your Perspective, 612
British Airways Case, 616
CPA Simulation 11-1, 617

Financial Instruments and Liabilities

12 CHAPTER
Investments, 618

Part A: Investor Lacks Significant Influence, 620
Securities to Be Held to Maturity, 622
Trading Securities, 625
Securities Available-for-Sale, 629
Comparison of HTM, TS, and AFS Approaches, 635
Transfers between Reporting Categories, 637
Fair Value Option, 637
Impairment of Investments, 639

Concept Review Exercise: Various Investment Securities, 640
Financial Statement Presentation and Disclosure, 642
Part B: Investor Has Significant Influence, 644
How the Equity Method Relates to Consolidated Financial Statements, 644
What Is Significant Influence?, 645
A Single Entity Concept, 645
Further Adjustments, 647
Reporting the Investment, 649
What If Conditions Change?, 651
If an Equity Method Investment Is Sold, 652
13 CHAPTER
Current Liabilities and Contingencies, 690

Part A: Current Liabilities, 692
Characteristics of Liabilities, 692
What Is a Current Liability?, 693
Open Accounts and Notes, 693
  Accounts Payable and Trade Notes Payable, 694
  Short-Term Notes Payable, 694
  Commercial Paper, 697
Accrued Liabilities, 697
  Accrued Interest Payable, 698
  Salaries, Commissions, and Bonuses, 698
Liabilities from Advance Collections, 700
  Deposits and Advances from Customers, 700
  Gift Cards, 701
  Collections for Third Parties, 702
A Closer Look at the Current and Noncurrent Classification, 702
  Current Maturities of Long-Term Debt, 702
  Obligations Callable by the Creditor, 702
  When Short-Term Obligations Are Expected to Be Refinanced, 703
Concept Review Exercise: Current Liabilities, 704

Part B: Contingencies, 705
Loss Contingencies, 706
  Product Warranties and Guarantees, 708
  Premiums, 710
  Litigation Claims, 711
  Subsequent Events, 713
  Unasserted Claims and Assessments, 715
Gain Contingencies, 716
Concept Review Exercise: Contingencies, 717
Decision Makers’ Perspective, 719
Appendix 13: Payroll-Related Liabilities, 721
Questions for Review of Key Topics, 723
Brief Exercises, 724

Exercises, 725
CPA and CMA Review Questions, 731
Problems, 733
Broaden Your Perspective, 738
British Airways Case, 744

14 CHAPTER
Bonds and Long-Term Notes, 746

The Nature of Long-Term Debt, 747
Part A: Bonds, 748
  The Bond Indenture, 748
  Recording Bonds at Issuance, 749
    Determining the Selling Price, 750
  Determining Interest—Effective Interest Method, 752
    Zero-Coupon Bonds, 753
    Bonds Sold at a Premium, 754
    When Financial Statements Are Prepared between Interest Dates, 756
  The Straight-Line Method—A Practical Expediency, 756
Concept Review Exercise: Issuing Bonds and Recording Interest, 757
  Debt Issuance Costs, 758

Part B: Long-Term Notes, 759
  Note Issued for Cash, 760
  Note Exchanged for Assets or Services, 760
  Installment Notes, 762
  Financial Statement Disclosures, 763
  Decision Makers’ Perspective, 765
  Concept Review Exercise: Note with an Unrealistic Interest Rate, 767

Part C: Debt Retired Early, Convertible into Stock, or Providing an Option to Buy Stock, 769
  Early Extinguishment of Debt, 769
    When the Conversion Option Is Exercised, 771
    Induced Conversion, 772
  Bonds with Detachable Warrants, 772
Concept Review Exercise: Issuance and Early Extinguishment of Debt, 774

Part D: Option to Report Liabilities at Fair Value, 775
  Determining Fair Value, 775
  Reporting Changes in Fair Value, 775
  Mix and Match, 777
Appendix 14A: Bonds Issued between Interest Dates, 779
Appendix 14B: Troubled Debt Restructuring, 780
Questions for Review of Key Topics, 784
Brief Exercises, 785
Exercises, 786
CPA and CMA Review Questions, 792
Problems, 794
Broaden Your Perspective, 800
British Airways Case, 804
CPA Simulation 14–1, 805

Copyright © 2019, 2015, 2011, 2007, 2003, 1999, 1995, 1991 by The McGraw-Hill Companies, Inc. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or any information storage or retrieval system, without permission in writing from the publisher.

For permission to use material from this product, submit your request via Web at http://www.mheducation.com/permissions, or by writing to The Permissions Department, The McGraw-Hill Companies, Inc., 8787 Trinity Place, Suite 1500, New York, New York 10012- flatt04, or by fax at (212) 904-7936.
15  CHAPTER  Leases, 806

Part A: Accounting by the Lessor and Lessee, 808
Decision Makers’ Perspective—Advantages of Leasing, 808
Capital Leases and Installment Notes Compared, 809
Lease Classification, 810
Classification Criteria, 811
Additional Lessor Conditions, 813
Operating Leases, 815
Advance Payments, 815
Leasehold Improvements, 816
Capital Leases—Lessee and Lessor, 817
Depreciation, 819
Accrued Interest, 820
Concept Review Exercise: Direct Financing Lease, 821
Sales-Type Leases, 822
Part B: Bargain Purchase Options and Residual Value, 824
Bargain Purchase Options, 824
When a BPO is Exercisable Before the End of the Lease Term, 827
Residual Value, 827
Effect on the Lessee of a Residual Value, 828
Effect on the Lessor of a Residual Value, 828
Part C: Other Lease Accounting Issues, 832
Executory Costs, 832
Discount Rate, 832
When the Lessee’s Incremental Borrowing Rate is Less Than the Lessor’s Implicit Rate, 833
When the Lessor’s Implicit Rate is Unknown, 833
Lessor’s Initial Direct Costs, 834
Contingent Rentals, 835
A Brief Summary, 835
Lease Disclosures, 835
Decision Makers’ Perspective—Financial Statement Impact, 838
Balance Sheet and Income Statement, 838
Statement of Cash Flow Impact, 839
Concept Review Exercise: Various Lease Accounting Issues, 840
Part D: Special Leasing Arrangements, 842
Sale-Leaseback Arrangements, 842
Capital Leases, 843
Operating Leases, 844
Losses on Sale-Leasebacks, 845
Real Estate Leases, 846
Leases of Land Only, 846
Leases of Land and Building, 846
Leases of Only Part of a Building, 846
Leveraged Leases, 846
Questions for Review of Key Topics, 848
Brief Exercises, 849
Exercises, 850
CPA and CMA Review Questions, 857

16  CHAPTER  Accounting for Income Taxes, 872

Part A: Deferred Tax Assets and Deferred Tax Liabilities, 874
Conceptual Underpinning, 874
Temporary Differences, 875
Deferred Tax Liabilities, 875
The FASB’s Balance Sheet Approach, 877
Types of Temporary Differences, 878
Deferred Tax Assets, 882
Valuation Allowance, 885
Permanent Differences, 886
Concept Review Exercise: Temporary and Permanent Differences, 889
Part B: Other Tax Accounting Issues, 890
Tax Rate Considerations, 890
When Enacted Tax Rates Differ, 890
Changes in Tax Laws or Rates, 891
Multiple Temporary Differences, 892
Net Operating Losses, 894
Operating Loss Carryforward, 895
Operating Loss Carryback, 896
Financial Statement Presentation, 897
Balance Sheet Classification, 897
Disclosure Notes, 898
Coping with Uncertainty in Income Taxes, 900
Intraperiod Tax Allocation, 902
Decision Makers’ Perspective, 904
Concept Review Exercise: Multiple Differences and Operating Loss, 905
Questions for Review of Key Topics, 908
Brief Exercises, 909
Exercises, 911
CPA and CMA Review Questions, 918
Problems, 920
Broaden Your Perspective, 926
British Airways Case, 931
CPA Simulation 16-1, 970

17  CHAPTER  Pensions and Other Postretirement Benefits, 934

Part A: The Nature of Pension Plans, 936
Defined Contribution Pension Plans, 938
Defined Benefit Pension Plans, 939
Part B: The Pension Obligation and Plan Assets, 941

The Pension Obligation, 941
  Accumulated Benefit Obligation, 941
  Vested Benefit Obligation, 941
  Projected Benefit Obligation, 942
  Illustration Expanded to Consider the Entire Employee Pool, 947

Pension Plan Assets, 947
  Reporting the Funded Status of the Pension Plan, 949

Part C: Determining Pension Expense, 949

The Relationship between Pension Expense and Changes in the PBO and Plan Assets, 949
  Components of Pension Expense, 951
  Income Smoothing, 953

Part D: Reporting Issues, 955

Recording Gains and Losses, 955
Recording the Pension Expense, 956
Recording the Funding of Plan Assets, 958
Comprehensive Income, 960
Income Tax Considerations, 961
Putting the Pieces Together, 962
Decision Makers' Perspective, 963
Settlement or Curtailment of Pension Plans, 963

Concept Review Exercise: Pension Plans, 964

Part E: Postretirement Benefits Other Than Pensions, 966

What Is a Postretirement Benefit Plan?, 967
  Postretirement Health Benefits and Pension Benefits Compared, 967
  Determining the Net Cost of Benefits, 968

Postretirement Benefit Obligation, 969
  Measuring the Obligation, 969
  Attribution, 969
Accounting for Postretirement Benefit Plans Other Than Pensions, 970
  A Comprehensive Illustration, 972
Decision Makers' Perspective, 973

Concept Review Exercise: Other Postretirement Benefits, 974

Appendix 17: Service Method of Allocating Prior Service Cost, 977
Questions for Review of Key Topics, 978
Brief Exercises, 979
Exercises, 980
CPA and CMA Review Questions, 989
Problems, 990

Broaden Your Perspective, 998
British Airways Case, 1003
CPA Simulation 17–1, 1004

18 Chapter
Shareholders' Equity, 1006

Part A: The Nature of Shareholders’ Equity, 1008
Financial Reporting Overview, 1008
  Paid-in Capital, 1009
  Retained Earnings, 1010
  Treasury Stock, 1010
Accumulated Other Comprehensive Income, 1010
Reporting Shareholders' Equity, 1012

The Corporate Organization, 1015
  Limited Liability, 1015
  Ease of Raising Capital, 1015
  Disadvantages, 1015
Types of Corporations, 1016
Hybrid Organizations, 1016
The Model Business Corporation Act, 1016

Part B: Paid-In Capital, 1017
Fundamental Share Rights, 1017
Distinguishing Classes of Shares, 1017
  Typical Rights of Preferred Shares, 1018
Is It Equity or Is It Debt?, 1019
The Concept of Par Value, 1020

Accounting for the Issuance of Shares, 1020
  Shares Issued For Cash, 1020
  Shares Issued For Noncash Consideration, 1021
  More Than One Security Issued for a Single Price, 1021
  Share Issue Costs, 1022

Concept Review Exercise: Expansion of Corporate Capital, 1023
Share Buybacks, 1024
Decision Makers' Perspective, 1024

Shares Formally Retired or Viewed as Treasury Stock, 1025
Accounting for Retired Shares, 1026
Accounting for Treasury Stock, 1027
Resale of Shares, 1028

Concept Review Exercise: Treasury Stock, 1028

Part C: Retained Earnings, 1031
Characteristics of Retained Earnings, 1031
Dividends, 1031
  Liquidating Dividend, 1031
  Retained Earnings Restrictions, 1032
Cash Dividends, 1032
Property Dividends, 1033

Stock Dividends and Splits, 1033
  Stock Dividends, 1033
  Stock Splits, 1035
  Stock Splits Effected in the Form of Stock Dividends (Large Stock Dividends), 1035

Decision Makers' Perspective, 1037

Concept Review Exercise: Changes in Retained Earnings, 1038

Appendix 18: Quasi Reorganizations, 1042
Questions for Review of Key Topics, 1044
Brief Exercises, 1044
Exercises, 1046
CPA and CMA Review Questions, 1053
Problems, 1054

Broaden Your Perspective, 1060
British Airways Case, 1066
CPA Simulation 18–1, 1066
Additional Financial Reporting Issues

SECTION

19 CHAPTER
Share-Based Compensation and Earnings Per Share, 1068

Part A: Share-Based Compensation, 1070
Stock Award Plans, 1070
Stock Option Plans, 1071
Expense—The Great Debate, 1072
Recognizing the Fair Value of Options, 1073
When Options are Exercised, 1075
When Unexercised Options Expire, 1075
Plans with Graded Vesting, 1077
Plans with Performance or Market Conditions, 1079
Employee Share Purchase Plans, 1080
Decision Makers’ Perspective, 1080
Concept Review Exercise: Share-Based Compensation Plans, 1081
Part B: Earnings Per Share, 1082
Basic Earnings Per Share, 1083
Issuance of New Shares, 1083
Stock Dividends and Stock Splits, 1084
Reacquired Shares, 1085
Earnings Available to Common Shareholders, 1086
Diluted Earnings Per Share, 1087
Potential Common Shares, 1087
Options, Rights, and Warrants, 1087
Convertible Securities, 1088
Antidilutive Securities, 1092
Options, Warrants, Rights, 1092
Convertible Securities, 1093
Order of Entry for Multiple Convertible Securities, 1093
Concept Review Exercise: Basic and Diluted EPS, 1095
Additional EPS Issues, 1096
Components of the “Proceeds” in the Treasury Stock Method, 1096
Contingently Issuable Shares, 1097
Summary of the Effect of Potential Common Shares on Earnings Per Share, 1098
Actual Conversions, 1099
Financial Statement Presentation of Earnings Per Share Data, 1100
Decision Makers’ Perspective, 1102
Concept Review Exercise: Additional EPS Issues, 1104
Appendix 19A: Option-Pricing Theory, 1107

20 CHAPTER
Accounting Changes and Error Corrections, 1136

Part A: Accounting Changes, 1138
Change in Accounting Principle, 1139
Decision Makers’ Perspective—Motivation for Accounting Choices, 1139
The Retrospective Approach: Most Changes in Accounting Principle, 1141
The Prospective Approach, 1144
Change in Accounting Estimate, 1146
Changing Depreciation, Amortization, and Depletion Methods, 1147
Change in Reporting Entity, 1148
Error Correction, 1149
Concept Review Exercise: Accounting Changes, 1150
Part B: Correction of Accounting Errors, 1152
Prior Period Adjustments, 1152
Error Correction Illustrated, 1153
Error Discovered in the Same Reporting Period That It Occurred, 1153
Error Affecting Previous Financial Statements, but Not Net Income, 1154
Error Affecting a Prior Year’s Net Income, 1154
Concept Review Exercise: Correction of Errors, 1159
Questions for Review of Key Topics, 1161
Brief Exercises, 1161
Exercises, 1162
CPA and CMA Review Questions, 1168
Problems, 1170
Broaden Your Perspective, 1177
21  CHAPTER  The Statement of Cash Flows Revisited, 1182

Part A: The Content and Value of the Statement of Cash Flows, 1184
Decision Makers' Perspective—Usefulness of Cash Flow Information, 1184
Cash Inflows and Outflows, 1184
Role of the Statement of Cash Flows, 1185
The Importance of Cash Flows in an Economic Decline, 1187
Cash and Cash Equivalents, 1187
Primary Elements of the Statement of Cash Flows, 1188
Preparation of the Statement of Cash Flows, 1194

Part B: Preparing an SCF: The Direct Method of Reporting Cash Flows from Operating Activities, 1197
Using a Spreadsheet, 1197
Income Statement Accounts, 1199
Balance Sheet Accounts, 1207
Concept Review Exercise: Comprehensive Review, 1214

Part C: Preparing an SCF: The Indirect Method of Reporting Cash Flows from Operating Activities, 1218
Getting There through the Back Door, 1218
Components of Net Income That Do Not Increase or Decrease Cash, 1219
Components of Net Income That Do Increase or Decrease Cash, 1219
Comparison with the Direct Method, 1220
Reconciliation of Net Income to Cash Flows from Operating Activities, 1221
Decision Makers' Perspective—Cash Flow Ratios, 1223
Appendix 21A: Spreadsheet for the Indirect Method, 1225
Appendix 21B: The T-Account Method of Preparing the Statement of Cash Flows, 1229
Questions for Review of Key Topics, 1231
Brief Exercises, 1232
Exercises, 1233
CPA and CMA Review Questions, 1242
Problems, 1244
Broaden Your Perspective, 1256
British Airways Case, 1263
CPA Simulation 21–1, 1263

Appendix A: Derivatives, A–0
Appendix B: Dell Annual Report, B–1
Appendix C: IFRS Comprehensive Case, C–0
Glossary, G–0
Photo Credits, Cr–1
Index, I–0
Present and Future Value Tables, P–1