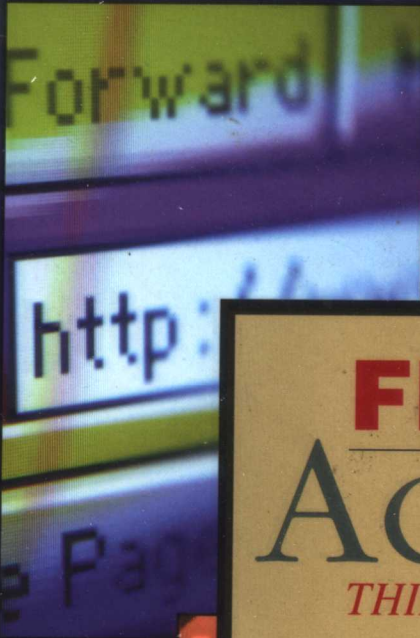


technology

economics

finance



sales

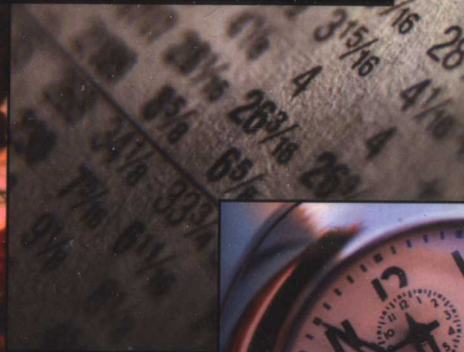
# **FINANCIAL** Accounting

THIRD EDITION

e-commerce



operations



marketing

management

*Robert Libby / Patricia A. Libby / Daniel G. Short*

# McGraw-Hill Higher Education

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## FINANCIAL ACCOUNTING

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To our parents:

**Herman and Doris Hargenrater**

**Oscar and Selma Libby**

**Bob and Mary Ann Short**

and our daughters:

**Laura Libby**

**Heather Short and Jenni Drago**



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Robert Libby is the David A Thomas Professor of Management at the Johnson Graduate School of Management at Cornell University. Bob teaches the introductory financial accounting course. He previously taught at the University of Illinois, Pennsylvania State University, the University of Texas, the University of Chicago, and the University of Michigan. He received his B.S. from Pennsylvania State University and his M.A.S. and Ph.D. from the University of Illinois; he is also a CPA. Bob is a widely published author specializing in behavioral accounting. He was selected as the AAA Outstanding Educator in 2000. His prior text, *Accounting and Human Information Processing* (Prentice Hall, 1981), was awarded the AICPA/AAA Notable Contributions to the Accounting Literature Award. He received this award again in 1996 for a paper. He has published numerous articles in the *Journal of Accounting Research*; *Accounting, Organizations, and Society*; and other accounting journals. He is an active member of the American Accounting Association and the American Institute of CPAs, and is a member of the editorial boards of the *Journal of Accounting Research*; *Accounting, Organizations, and Society*; *Journal of Accounting Literature*; and *Journal of Behavioral Decision Making*.

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Patricia Libby is Associate Professor of Accounting at Ithaca College where she teaches the undergraduate financial accounting course. She previously taught graduate and undergraduate financial accounting at Eastern Michigan University and the University of Texas. Before entering academe, she was an auditor with Price Waterhouse and a financial administrator at the University of Chicago. She received her B.S. from Pennsylvania State University, M.B.A. from DePaul University, and Ph.D. from the University of Michigan; she is also a CPA. Pat conducts research on how to use cases in the introductory course and in other parts of the accounting curriculum. She has published articles in *The Accounting Review*, *Issues in Accounting Education*, and *The Michigan CPA*. She also has conducted seminars nationally on active learning strategies, including cooperative learning methods.

## DANIEL G. SHORT



Dan Short is Dean of the Richard T. Farmer School of Business at Miami University. Previously, Dan was dean of the College of Business at Kansas State University and before that associate dean at the University of Texas at Austin, where he taught the undergraduate and graduate financial accounting courses. He also taught at the University of Chicago. He received his undergraduate degree from Boston University and his M.B.A. and Ph.D. from the University of Michigan. Dan has won numerous awards for his outstanding teaching abilities and has published articles in *The Accounting Review*, the *Journal of Accounting Research*, *The Wall Street Journal*, and other business journals. He has worked with a large number of Fortune 500 companies, commercial banks, and investment banks to develop and teach executive education courses on the effective use of accounting information. Dan has also served on the board of directors of several companies, including manufacturing, commercial banking, and medical services. He is currently chair of the audit committee of a large manufacturing company.

# Preface

The first edition of *Financial Accounting* was written based on our belief that the subject is inherently interesting but most textbooks are not. Furthermore, we found that most financial accounting textbooks failed to demonstrate that accounting is an exciting choice of major or important to future careers in marketing, finance, and other areas of management and beyond. The second edition was written based on these same principles: **career relevance** served as the guide for selection of textual material, and the need to **engage the student** was our guide to style, pedagogy, and design. Because of the success of the first two editions we have benefited from feedback of many faculty and students who have used our textbook in their financial accounting course.

This third edition remains focused on career relevance and engaging the student. However, we have enhanced this focus based on vast market feedback. We have:

- Added new focus companies (Papa John's, Harrah's, and Dow Jones).
- Added a wider range and level of assignment material, including Internet and Student CD-ROM applications.
- Enhanced the ratio and cash flow analysis coverage.
- Improved the chapter layout and design.

We are excited by the results and hope that this third edition adds value to your course whether you are a teacher or student. As always, we welcome your feedback.

## TARGET AUDIENCE

This text is for students with career interests in marketing, management, finance, banking, manufacturing, human resources, and, of course, accounting. We assume the student has had no prior exposure to accounting and financial statements, and has had little exposure to the business world. We have carefully designed the scope and depth of the text with these students in mind and so that most or all of it can be covered in a single term.

To ensure accessibility of the material, we employ a building block approach; we carefully cover the basics before we address more complex issues. As the student's sophistication develops throughout the term, so does the sophistication of the focus company and contrasting company illustrations.

The technical material is conveyed with clear step-by-step presentations within the realistic examples. For example, Chapters 2, 3, and 4 follow Papa John's International, through each step of the basic accounting process, ensuring that students are prepared for the later material. The emphasis on contrasting company practices is conveyed through side-by-side illustrations that punctuate the effects of differences in financial statement presentations and accounting methods. Numerous exhibits and other visual aids are included to enhance comprehension and learning.

## ESTABLISHED FEATURES AND BENEFITS OF FINANCIAL ACCOUNTING

- **Integration of real-world business and accounting practices by writing each chapter around the operations and actual financial statements of an interesting, real Focus Company.**

The introduction of the focus company concept to the market in the first edition proved to be highly successful. While many financial accounting textbooks rely on

contrived financial data combined with disjointed real-company vignettes, we strongly believe that students are best engaged through the integration of a single, real company's operations and financial disclosures to highlight important concepts. In addition to the **focus companies**, we reference **contrasting companies** when appropriate to illustrate the variety in real-world practices, and the effect of a company's particular circumstances on its accounting and reporting practices. Our selection of focus and contrast companies provides the proper balance of merchandising, manufacturing, and service companies because students need exposure to a variety of business settings. Studying accounting in the context of a real focus company's business decisions better prepares students, regardless of their major, to analyze and interpret real financial information to make better business decisions. Furthermore, they will view accounting as an interesting and important field of study.

- **Content selected for its managerial significance and its relevance to understanding and using real-company financial statements in a user orientation that benefits majors and nonmajors.**

In keeping with our philosophy that the first course should focus on the uses of accounting information, we have selected material based on its relevance to understanding real companies, financial statements, and actual management decisions. As a result, we have elected to omit unrealistic topics and minutiae that are rarely practiced in industry. LIFO applied on a perpetual basis has been eliminated. In keeping with the financial statement focus of the text, pure recordkeeping functions are provided on our website or reserved for future coursework. By eliminating the recordkeeping emphasis, we use basic transaction analysis, journal entries, and T-accounts to provide the structure for understanding the interplay between management decisions and the analysis of financial statements. We demonstrate how this structure is important to both future financial statement users as well as accountants.

The decision making focus encourages and develops critical thinking. At the same time, we cover the technical requirements for financial reporting format and content within a context that makes some of the most technical accounting material come alive. As a result, students will better remember the technical material and better understand its importance.

- **An early introduction to ratio analysis and cash flow analysis for better student comprehension through the use of *Key Ratio Analysis* and *Cash Flow Analysis* sections.**

Most financial accounting textbooks wait until the last few chapters to cover ratio analysis, which means that this important topic may receive incomplete coverage due to time constraints. Others introduce a barrage of ratios in the initial chapters before the students understand the numbers they are based on. We feel that both of these treatments are confusing to students because they are forced to absorb important ratio analysis all at once, if at all, so we have integrated ratio analysis throughout the text. The main benefit to the student is that they will learn ratio analysis in digestible parts and in the appropriate context.

We believe that students will be better prepared to use financial information if they learn to evaluate different elements of financial performance at the same time they are learning how to measure and report those elements. As a consequence, we introduce relevant key ratios in each chapter in **Key Ratio Analysis** sections.

Just as most textbooks slight the importance of ratio analysis, the same can be said for their coverage of cash flow analysis. This oversight means that students typically are not exposed to this important material until later in the text if at all. As with ratio analysis, we believe students should learn about the importance of cash flow analysis beginning in Chapter 1 and continuing throughout the text in the **Cash Flow Analysis** sections.

- **Inclusion of *Financial Analysis* sections to support the decision-making focus of the text.**

The **Financial Analysis** sections have proven popular because they tie important concepts covered in the chapter to real-world decision-making examples. They also highlight alternative viewpoints that aid in student comprehension and add to the critical thinking and decision-making focus of the text.

- **Inclusion of *International Perspective* sections throughout the text to highlight the emergence of global competition and resulting business issues.**

Because of the rapid increase in global competition, today's students must be aware of the differences in accounting methods used around the world. Understanding global accounting issues also increases student comprehension of domestic accounting practices. Because of the importance of international accounting issues, each chapter includes **International Perspective** sections. International issues are included in end-of-chapter problem material as well.

- **A *Question of Ethics* boxes throughout the chapters to convey the importance of acting responsibly.**

In every business, decision-makers are occasionally confronted with ethical dilemmas that require them to make choices that will impact various groups of people differently. We incorporate accounting ethics into each chapter in **A Question of Ethics** boxes to convey to students the importance of acting responsibly in business practice. It is our belief that the more students are exposed to ethical dilemmas in their studies, the more likely they will be to consider the impact of their choices.

- **Incorporated active learning features to engage the student, provide interactivity, and promote critical thinking.**

It has been our experience that students learn best when they are actively engaged in the learning process. Active learning creates attention and promotes retention. The integration of technical material in the real-world context produces major advantages under our approach. Unique **Self-Study Quizzes** have students pause at strategic points throughout each chapter to ensure they understand key points. These quizzes help students avoid reading the text in the same manner they would a novel; to understand accounting, students must be able to work with the numbers. Student feedback has indicated that in anticipation of the **Self-Study Quizzes**, they read the material more carefully, which enhances learning. The quizzes often require the student to prepare or use financial statement disclosures based on actual companies to reinforce what they are learning. The quizzes are part of our integrative approach and are followed by **Demonstration Cases** presented in the end-of-chapter materials. Students who have carefully worked with these two types of learning aids are ready to work the end-of-chapter homework assignments. Students are also encouraged throughout the textbook to explore actual Internet sites to experience the utilization of this powerful resource.

## **NEW TO THE THIRD EDITION OF FINANCIAL ACCOUNTING**

### **(NEW!) FOCUS COMPANIES**

In the third edition: Papa John's International, Inc. replaces Sbarro, Inc. in Chapters 2, 3, and 4, Harrah's Entertainment, Inc. replaces Showboat, Inc., in Chapter 10, and Dow Jones is the new focus company for Chapter 12, replacing General Electric.



**LEARNING OBJECTIVES**

After studying this chapter, you should be able to:

1. Explain the purpose of a trial balance. p. 168
2. Analyze the adjustments necessary at the end of the period to update balance sheet and income statement accounts. p. 170
3. Present a complete set of financial statements: income statement with earnings per share, statement of stockholders' equity, balance sheet, and statement of cash flows. p. 185
4. Compute and interpret net profit margin. p. 191
5. Explain the closing process. p. 192

**LEARNING OBJECTIVE 1**

Explain the purpose of a trial balance.

A **TRIAL BALANCE** is a list of all accounts with their balances to provide a check on the equality of the debits and credits.

**LO1**

Dell Computer Corporation

**(NEW!) LEARNING OBJECTIVES**

Outlined at the beginning of each chapter, these new Learning Objectives are cross-referenced to the end-of-chapter material. This allows students to track their understanding of the concepts as they are presented in the chapter.

**ORGANIZATION OF THE CHAPTER**

• **Players in the Accounting Communication Process**

Managers (CEO, CFO, and Accounting Staff)

Auditors

Information Intermediaries: Analysts and Information Services

Government Regulators

Users: Institutional and Private Investors, Creditors, and Others

Guiding Principles for Communicating Useful Information

• **The Disclosure Process**

Press Releases

Annual Reports

Quarterly Reports

SEC Reports

• **A Closer Look at Financial Statement Formats and Notes**

Classified Balance Sheet

Classified Income Statement

Statement of Stockholders' Equity

Statement of Cash Flow

Notes to Financial Statements

Voluntary Disclosures

Constraints of Accounting Measurement

• **ROE Analysis**

Profit Driver Analysis

Profit Drivers and Business Strategy

**(NEW!) ORGANIZATION OF THE CHAPTER SCHEMATIC**

Now shown as a graphic at the beginning of each chapter, this visual framework is a quick reference guide that helps students easily find a topic in the chapter.

March 1	Cash (+A)	2,120	
	Note receivable (–A)		2,000
	Accrued interest receivable (–A)		80
	Interest revenue (+R)		40

Assets		=	Liabilities	+	Stockholders' Equity
Cash	+2,120				Interest revenue +40
Note receivable	–2,000				
Accrued interest receivable	–80				

Equality checks: (1) Debits \$2,120 = Credits \$2,120; (2) the accounting equation is in balance.

The \$2,120 received in cash on March 1 includes \$2,000 in principal repayment and \$120 for interest. Four months of interest were recognized in the preceding year as interest revenue and the other two months of interest (\$40) will be recognized in the next

**(NEW!) ALL JOURNAL ENTRIES TIED TO THE ACCOUNTING EQUATION**

Journal entries marked with (A), (L), (SE), (R), (E), or (X—if a contra-account) and plus and minus signs in early chapters assist students in transaction analysis. In addition, following each journal entry is a summary of the effects of the transaction on the fundamental accounting equation.

**(EXPANDED) UTILIZATION OF THE INTERNET**

Throughout each chapter and its assignments, where appropriate, students are encouraged to explore actual Internet sites to experience how this powerful resource can be best utilized. At publication, all sites referenced were current and active. Because Internet sites are time and date sensitive, professors and students may need to use the Yahoo! search engine (<http://www.yahoo.com>) or a favorite search engine to locate the most current site.

**FINANCIAL ANALYSIS**

**THE FEEDBACK VALUE OF ACCOUNTING INFORMATION AND STOCK MARKET REACTION**

A net loss does not have to occur for a company to recognize that it is experiencing difficulty. Any unexpected variance in actual performance from the operating plan, such as lower than expected quarterly earnings, needs to be explained. Stock market analysts and investors use accounting information to make investment decisions. The stock market, which is based on investors' expectations about future company performance, often reacts to operating deviations in negative ways (that is, with a reduction in the company's stock price).

On December 9, 1999, Papa John's announced that it anticipated it would report a lower than expected increase in sales for the fourth quarter. Prior to the announcement, its stock had been selling at \$34.25 per share. Immediately after the announcement, the price dropped by \$7.375 to \$26.875 per share,\* a 22 percent decrease in one day. The explanation of the lower sales level was related to weaker than expected December sales and its recent decision to close its company-owned restaurants early on Christmas Eve.†

**(UPDATED) FINANCIAL ANALYSIS SECTIONS**

Nearly all of the **Financial Analysis** boxes in this edition have been rewritten to include up-to-date examples.



## (DRAMATICALLY ENHANCED) KEY RATIO ANALYSIS SECTIONS

The **Key Ratio Analysis** sections have been dramatically enhanced to help students understand and interpret ratios, and to allow professors the option of focusing more on decision analysis and less on bookkeeping procedures when teaching to non-accounting majors. Each **Key Ratio Analysis** box presents ratio analysis for the focus company in the chapter as well as for comparative companies. **Cautions** are also provided to help students understand the limitations of certain ratios. We use the KEY acronym to help structure use of financial ratios in performance assessment. The KEY indicates that there are three steps in ratio analysis:

**Know the decision question that the ratio addresses.**

Each ratio measures a different financial attribute. The educated user must know which attribute each ratio measures, and how that attribute relates to particular decisions.

**Examine the ratio using two techniques: comparisons over time and comparisons with competitors.**

Ratios can be interpreted only in the context of prior period's ratios or ratios produced by similar companies.

**You interpret the results carefully.** Simple rules of thumb rarely lead to accurate interpretation of ratios. As a consequence, you must carefully consider other related factors before drawing a conclusion.

### KEY RATIO ANALYSIS:



**LEARNING OBJECTIVE 3**  
Analyze and interpret the gross profit percentage.

#### GROSS PROFIT PERCENTAGE

**Know the decision question:**  
By what amount (percentage) did sales prices exceed the costs to purchase or produce the goods or services sold? It is computed as follows:

$$\text{Gross Profit Percentage} = \frac{\text{Gross Profit}}{\text{Net Sales}}$$

The 1998 ratio for Timberland:  
 $\frac{\$342,839}{\$862,168} = 0.398 \text{ (39.8\%)}$

**Examine the ratio using two techniques:**

① Comparisons over Time			
Timberland			
1996	1997	1998	
36.5%	39.2%	39.8%	

② Comparisons with Competitors	
Skechers U.S.A.	Wolverine World Wide
1998	1998
41.5%	31.8%

**You interpret the results carefully:**  
**IN GENERAL** → Gross profit percentage measures the ability to charge premium prices and produce goods and services at lower cost. All other things equal, a higher gross profit results in

Selected Focus

## (NEW!) FOCUS ON CASH FLOWS SECTIONS

Each chapter from one to twelve now includes a discussion and analysis of changes in the cash flow of the focus company and the decisions that caused those changes. The early and consistent coverage of cash flows encourages students to think more critically about the decisions they will be faced with as managers and the impact those decisions will have on the company's cash flow. This feature has been added to the third edition to further the discussion and importance of cash flows.

## (NEW!) END-OF-CHAPTER CONTENT AND ORGANIZATION

Each chapter is followed by an extensive selection of end-of-chapter assignments that examine single concepts or integrate multiple concepts presented in the chapter. To maintain the real-world flavor of the chapter material, they are often based on other real domestic and international companies, and require analysis, conceptual thought, calculation, and written communication. Assignments suitable for individual or group written projects and oral presentations are included in strategic locations. The end-of-chapter materials include the following:

- **Chapter Take-Aways (new to this edition):** Created to replace the paragraph form chapter summaries in the second edition, these are bulleted end-of-chapter summaries that coincide with the learning objectives outlined at the beginning of the chapter. They have been created in response to professors and students' calls for a more succinct summary of chapter concepts and objectives.
- **Key Ratios (updated):** Summary of the key ratios presented in the chapter.

### FOCUS ON CASH FLOWS

#### ACCOUNTS RECEIVABLE

The change in accounts receivable can be a major determinant of a company's cash flow from operations. The income statement reflects the revenues of the period, whereas the cash flow from operating activities must reflect the cash collections from customers for the same period. Since sales on account increase the balance in accounts receivable and cash collections from customers decrease the balance in accounts receivable, the change in accounts receivable from the beginning to the end of the period is the difference between the two.



#### EFFECT ON STATEMENT OF CASH FLOWS

##### IN GENERAL →

When a net decrease in accounts receivable for the period occurs, cash collected from customers is always more than revenue; thus, the decrease must be added in computing cash flows from operations.

When a net increase in accounts receivable occurs, cash collected from customers is always less than revenue; thus, the increase must be subtracted in computing cash flows from operations.

### CHAPTER TAKE-AWAYS

1. Define the objective of financial reporting, the elements of the balance sheet, and the related key accounting assumptions and principles. p. 53
  - The primary objective of external financial reporting is to provide useful economic information about a business to help external parties, primarily investors and creditors, make sound financial decisions.
  - Elements of the balance sheet:
    - a. Assets—probable future economic benefits owned by the entity as a result of past transactions.
    - b. Liabilities—probable debts or obligations of the entity as a result of past transactions, which will be paid with assets or services.
    - c. Stockholders' equity—the financing provided by the owners and the operations of the business.
  - Key accounting assumptions and principles:
    - a. Separate-entity assumption—transactions of the business are accounted for separately from transactions of the owner.
    - b. Unit-of-measure assumption—financial information is reported in the national monetary unit.
    - c. Continuity (going-concern) assumption—a business is expected to continue to operate into the foreseeable future.
    - d. Historical cost principle—financial statements elements should be recorded at the cash-equivalent cost on the date of the transaction.



- **Key Terms (new to this edition):** Key terms of the chapter page referenced to the chapter text; definitions also provided in the glossary.

## FINDING FINANCIAL INFORMATION

### BALANCE SHEET

**Current Assets**  
 Cash  
 Accounts and notes receivable  
 Inventory  
 Prepaid expense  
**Noncurrent Assets**  
 Long-term investments  
 Property and equipment  
 Intangibles

**Current Liabilities**  
 Accounts payable  
 Notes payable  
 Accrued liabilities payable  
**Noncurrent Liabilities**  
 Long-term debt  
**Stockholders' Equity**  
 Contributed capital  
 Retained earnings

### INCOME STATEMENT

*To Be Indicated in Chapter 3*

### STATEMENT OF CASH FLOWS

#### *Under Investing Activities*

- + Sales of noncurrent assets for cash
- Purchases of noncurrent assets for cash
- Loans to others
- + Receipt of cash on loans to others

#### *Under Financing Activities*

- + Borrowing from banks
- Repayment of loans from banks
- + Issuance of stock
- Repurchasing stock
- Payment of dividends

### NOTES

#### *Under Summary of Significant Accounting Policies*

- Description of management's choice for fiscal year

- **Finding Financial Information (new to this edition):** A **Finding Financial Information** section has been added at the end of each chapter to highlight the chapter's key concepts, numbers, and totals in an easy-to-review graphic. The graphic includes Balance Sheet, Income Statement, Statement of Cash Flows, and Note Information.
- **Questions (updated)**
- **Mini-Exercises (new to this edition):** Additional assignments illustrating the learning objectives of each chapter.
- **Exercises (updated)**

- **Problems (updated):** Cross-referenced in blue to the Alternative Problems.
- **Alternate Problems (new to this edition):** Provides professors and students with additional assignments similar in level and content to the end of chapter problems. Cross-referenced in blue to the Problems.
- **Cases and Projects (improved):** In most chapters, a project entitled **Interpreting the Financial Press** is presented to encourage students to look closely at various interpretations of accounting practices. Students are directed to a published article posted on our **Internet** website and are instructed to analyze this article. Also, in selected assignments, students are directed to **real company websites and other Internet resources** to gain experience in the utilization of this powerful tool. There are also one to three new cases/projects that utilize **Standard & Poor's™ Market Insight Service**. Students will access **Excel** files housed on the **Student CD** and, using the real annual reports in the textbook appendices, will manipulate real-world data to solve problems. These assignments make the students experience problem solving as it truly happens in real companies.

Also, in most chapters, a project entitled "Broadening Financial Research Skills" encourages students to access the internet and other sources to learn about and use several types of sources for analyzing financial information.

To assist instructors in identifying materials to use or assign and to provide students with information on similar assignments to work, at the end of each chapter we have:

- Added applicable Learning Objective numbers in the margin.
- Arranged assignments by level of difficulty in learning objective order.
- Included a number of assignments that do not rely on creating journal entries, but understanding the effects of transactions instead.
- Included an increased number of analytical user-oriented materials.
- Incorporated themes: International, ethics, cash flows, ratio analysis, real world, written communication, team project, broadening research skills, comparing companies within and across industries and over time, updating financial information on the focus company, finding financial information, and interpreting the financial press.

 **LO5** **LO1:** Learning Objective cross-reference.



**International:** Assignments that include international perspective.



**Ethics:** An ethical dilemma the student must resolve.



**Cash Flows:** Requires student to work cash flow analysis.



**Ratio Analysis:** Assignment includes ratio analysis.



**WWW:** Guides students to additional reference articles, exercises, and relevant Internet links.



**Written Communication:** Assignment requires the student to do written work.



**Team Project:** These assignments are done as a team.



**GLAS:** General Ledger Applications Software solves end-of-chapter assignments that call for journal entries.



**SPATS:** Spreadsheet Applications Template Software uses Excel templates to solve selected end-of-chapter assignments.

### **STANDARD & POOR'S**

**Standard & Poor's:** One to three end-of-chapter case/projects require the student to access and manipulate Excel files preloaded with Standard & Poor's data for Urban Outfitters and American Eagle.

### **(ENHANCED) ADDITIONAL MARGINAL GRAPHICS TO SUPPORT CONCEPTS**

For the third edition, approximately 250 new graphics and photos are used to help visually support the concepts presented.

### **(NEW!) TWO ANNUAL REPORTS AT THE END OF THE BOOK TO ENHANCE ANALYSIS AND LEARNING**

**American Eagle Outfitters** and **Urban Outfitters** annual reports are reprinted in the appendices for easy reference by the student, replacing the Toys R Us annual report used in the second edition.

### **(NEW!) THE FORMAL RECORDKEEPING SYSTEM APPENDIX NOW PUBLISHED ONLY ON OUR WEBSITE**

In keeping with the financial statement focus of the text, this material (formally Appendix C in the second edition) has been moved to our website for convenient accessibility if needed.

## **CHAPTER REVISIONS FOR THE THIRD EDITION OF FINANCIAL ACCOUNTING**

### **CHAPTER 1**

- Simplified Maxidrive example.
- Extensive instructions on how to use the features in the book.
- New improved **KEY** ratio feature.
- Simplified end-of-chapter material.

**CHAPTER 2**

- Integrated new focus company—Papa John's International Inc.—throughout the chapter.
- Modified Exhibit 2.1 on the conceptual framework to be more concise while adding explanation of the concepts in the text for clarity and understanding by students.
- Introduced current asset and current liability classifications (in Chapter 5 in 2e) in a simple and straightforward manner.
- Added a financial analysis block introducing franchising as used by Papa John's and many other well-known businesses.
- Added the effects on the accounting equation (assets=liabilities+stockholders' equity) in all chapters, for every journal entry to help students learn appropriate accounts titles and classifications and to deepen their understanding of transaction analysis.
- Simplified the Transaction Analysis Model in Exhibit 2.4, using + and - symbols with the abbreviations for debit and credit.
- Simplified the transactions analyzed by including only those that are classified as investing and financing activities.
- Illustrated analysis of the KEY ratio financial leverage by comparing Papa John's ratio over time and to Uno Restaurant Corporation (Chicago Bar and Grill) and CEC, Inc. (Chuck E. Cheese).
- Enhanced the discussion in the Focus on Cash Flows block by illustrating the reporting of investing and financing activities on the statement and analysis and interpretation of the information.

**CHAPTER 3**

- Integrated new focus company—Papa John's International Inc.—throughout the chapter.
- Shifted discussion of the operating cycle earlier in the chapter.
- Included marginal graphics on the primary operating activities generating revenue and expenses for Papa John's.
- Included marginal graphics summarizing cash basis versus accrual basis income measurement.
- Simplified the chapter by moving the discussion of the accounting cycle to Chapter 4.
- Expanded the new simplified graphic on the Transaction Analysis Model to include revenues and expenses.
- Added new financial analysis blocks on the effects of accounting information on stock prices, including an interesting Papa John's announcement.
- Illustrated the KEY ratio total asset turnover by comparing Papa John's ratio over time and to that of Pizza Hut and Domino's.

**CHAPTER 4**

- Integrated new focus company—Papa John's International Inc.—throughout the chapter.
- Enhanced Exhibit 4.2 to explain the structure of the trial balance and the relationship of long-lived assets and accumulated depreciation.
- Included a marginal graphic of a timeline to provide a visual tool on adjusting entries.
- Clarified the steps used in identifying and measuring adjusting entries, including adding a more concise timeline.



## **PREFACE**

- Revised discussion on financial statement preparation to include additional graphics.
- Illustrated the KEY ratio net profit margin by comparing Papa John's ratio over time and to that of Pizza Hut and Domino's.
- Expanded the closing process to include an adjusted trial balance and a post-closing trial balance.
- The end-of-book appendix on the formal recordkeeping process is now available to students as Appendix E on the Libby/Libby/Short website.

## **CHAPTER 5**

- Reorganized coverage of the accounting communication process including detailed analysis of Callaway's annual disclosure process.
- Updated discussion of web-based sources of company information.
- Illustrated analysis of KEY ratio return on equity (ROE) by comparing Callaway Golf ratio over time and to that of competitors and industry average.
- Added ROE profit driver analysis to summarize relationship among KEY ratios covered in Chapters 2 through 5 by tying ratios to business strategies aimed at improving ROE.
- Included new self-study quiz to take students through a step-by-step comparison of Dell and Gateway Computer's financial performance.
- Added many new exercises, cases and projects emphasizing company research, financial analysis, and writing skills.

## **CHAPTER 6**

- Changed coverage of sales and credit card discounts and returns and allowances to emphasize management decision making and reporting net sales. Moved journal entries to an end-of-chapter supplement.
- Illustrated analysis of KEY ratio gross profit percentage by comparing Timberland's ratio over time and to competitors Skechers and Wolverine World Wide.
- Added in all chapters, for every journal entry, the effects on the accounting equation ( $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$ ) to help students learn appropriate accounts titles and classifications and to deepen their understanding of transaction analysis.
- Illustrated analysis of KEY ratio receivables turnover ratio by comparing Timberland's ratio over time and to that of competitors Skechers and Wolverine World Wide.
- Expanded Focus on Cash Flows feature to examine the effects of changes in accounts receivable on Timberland's cash flow from operating activities.
- Added new mini-exercises, exercises, and cases to emphasize financial statement analysis, understanding the financial press, and financial decision making.

## **CHAPTER 7**

- Simplified coverage of lower-of-cost-or-market method.
- Illustrated analysis of KEY ratio inventory turnover ratio by comparing Harley-Davidson's ratio over time and to that of competitors Titan Motorcycle and Honda Motor.
- Expanded Focus on Cash Flows feature examines the effects of changes in inventory and accounts payable on Timberland's cash flow from operating activities.
- Moved journal entries for purchase discounts and returns and allowances to end-of-chapter supplement.

## **PREFACE**

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- Added new mini-exercises, exercises, problems, and cases emphasizing finding financial information, financial statement analysis, web-based research, and understanding the financial press.

### **CHAPTER 8**

- Continued the Delta Air Lines focus company, updated for recent equipment purchases.
- Changed use of the term *operational assets* to *long-lived assets*.
- Updated amortization of intangible assets as outlined in a recent FASB exposure draft.

### **CHAPTER 9**

- Improved ratio analysis discussion using current ratio and accounts payable turnover.
- Better graphics showing reporting practices of actual companies.
- Updated real-world excerpts for comparison of companies.
- Refocused discussion of payroll liabilities.
- Emphasized accounting principles and measurement issues with discussion of liabilities, which are often ignored in introductory texts, such as environmental remediation.
- Improved discussion of working capital management and reporting of cash flows.
- Improved discussions of present and future value concepts to show the power of compounding.
- Increased number of real-world exercises and problems.

### **CHAPTER 10**

- New focus company, Harrah's.
- Improved discussion of ratios with comparison to major competitors.
- New graphics to illustrate reporting practices.
- Updated discussion of a new bond issue with real-world example of key players.
- Updated real-world examples of comparison companies.
- Expanded discussion of cash flows.
- Reduced procedural discussion, including the elimination of accounting for bonds sold between interest dates.
- New graphic compares straight-line and effective-interest amortization.

### **CHAPTER 11**

- New graphics to illustrate issues involving stock.
- Expanded discussion of the reporting of financing activities on the SCF.
- Discussion of the role of IPOs and stock options to appeal to students' interest in current business headlines.
- Improved discussion of ratio analysis.
- New end-of-chapter material based on real companies.

### **CHAPTER 12**

- Integrated new focus company—Dow Jones and Co.—throughout the chapter with significant revision of the chapter.
- Provided marginal graphics on passive investments, investments for significant influence, and investments for control.

## **PREFACE**

- Discussed the accounting measurement and reporting issues for each type of investment in line with the graphic:
- Securities available for sale and the market value method provide the focus; discussion of trading securities as a comparison of the differences with securities available for sale.
- Investments for significant influence is organized similarly to securities available for sale.
- Revised the account titles used in the illustrative journal entries.
- Added exhibits summarizing the effects of the illustrations in T-account form.
- Illustrated the cash flow impact of buying, holding, and selling securities held as passive investments or for significant influence over another company in the new focus on cash flows block.
- Simplified the consolidation section by eliminating the discussion of consolidation in subsequent accounting periods, illustrating the consolidation worksheet as an Excel spreadsheet, and adding consolidated income statements.
- Illustrated the KEY ratio return on assets by comparing the Dow Jones ratio over time and to that of major competitors Knight-Ridder and *New York Times*.
- Expanded the demonstration case to include accounting for trading securities, on securities available for sale, applying the equity method, and one on consolidation.

## **CHAPTER 13**

- Simplified t-account illustration of cash flows from operating activities.
- Comparison of net income and cash flow from Operating Activities through KEY ratio quality of income by comparing Boston Beer over time and to that of its competitors Genesee and Coors.
- Illustrated business strategy differences illustrated through expanded KEY ratio illustration of capital acquisitions ratio comparing Boston Beer over time and to that of its competitors Minnesota Brewing and Redhook Ale.
- Added new financial analysis block on free cash flow analysis.

## **CHAPTER 14**

- New comparison companies.
- New discussion of the Du Pont model tied to a discussion of understanding business strategy.
- Simplification of return on investment ratios.
- New graphics used as financial analysis tool.
- Elimination of certain background information based on user suggestions.
- End-of-chapter material substantially revised to provide better balance of hypothetical and real-world companies.
- Expanded case material emphasizing use of the Internet.

## **ENHANCED APPENDICES**

Appendix A: Present and Future Value Tables  
Appendix B: American Eagle Outfitters full Annual Report  
Appendix C: Urban Outfitters Annual Report  
Appendix D: Standard and Poor's Industry Ratio Report  
Appendix E: The Formal Recordkeeping System available at  
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