

CONTENTS

CHAPTER 1 Accounting Standards and

Financial Reporting 2

Thinking Outside the Box

FINANCIAL STATEMENTS AND

FINANCIAL REPORTING 4

- Accounting and Capital Allocation 4
- What Do the Numbers Mean?* It's the Accounting 5
- The Challenges Facing Financial Accounting 5
- Objectives of Financial Reporting 6
- The Need to Develop Standards 7

PARTIES INVOLVED IN STANDARD-SETTING 7

- Securities and Exchange Commission (SEC) 7
- American Institute of Certified Public Accountants (AICPA) 9
- Financial Accounting Standards Board (FASB) 9
- Changing Role of the AICPA 12

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES 13

- FASB Codification 13
- What Do the Numbers Mean?* You Have to Step Back 15

ISSUES IN FINANCIAL REPORTING 15

- GAAP in a Political Environment 15
- What Do the Numbers Mean?* The Economic Consequences of Goodwill 16
- The Expectations Gap 17
- International Accounting Standards 18
- Ethics in the Environment of Financial Accounting 19
- Conclusion 19

CONVERGENCE CORNER INTERNATIONAL FINANCIAL REPORTING 20

FASB CODIFICATION 22

CHAPTER 2 Concepts Underlying

Financial Accounting 30

Is It an Asset or Not?

CONCEPTUAL FRAMEWORK 32

- The Need for a Conceptual Framework 32
- What Do the Numbers Mean?* What's Your Principle? 32
- Development of a Conceptual Framework 33

FIRST LEVEL: BASIC OBJECTIVES 34

SECOND LEVEL: FUNDAMENTAL CONCEPTS 35

- Qualitative Characteristics of Accounting Information 35
- What Do the Numbers Mean?* Show Me the Earnings! 37
- Basic Elements 38

THIRD LEVEL: RECOGNITION AND MEASUREMENT CONCEPTS 39

- Basic Assumptions 40
- What Do the Numbers Mean?* Whose Company Is It? 40
- Basic Principles of Accounting 42
- Constraints 46
- What Do the Numbers Mean?* You May Need a Map 47
- What Do the Numbers Mean?* Living in a Material World 49
- Summary of the Structure 50

CONVERGENCE CORNER THE CONCEPTUAL FRAMEWORK 51

FASB CODIFICATION 53

CHAPTER 3 Understanding the

Accounting Information System 66

Needed: A Reliable Information System

ACCOUNTING INFORMATION SYSTEM 68

- Basic Terminology 68
- Debits and Credits 69
- The Accounting Equation 70
- Financial Statements and Ownership Structure 72

THE ACCOUNTING CYCLE 73

- Identifying and Recording Transactions and Other Events 73
- Journalizing 75
- Posting 76
- Trial Balance 80
- Adjusting Entries 81
- What Do the Numbers Mean?* Am I Covered? 89
- Adjusted Trial Balance 90
- Preparing Financial Statements 91
- What Do the Numbers Mean?* 24/7 Accounting 92
- Closing 92
- Post-Closing Trial Balance 94
- Reversing Entries 95
- The Accounting Cycle Summarized 95
- What Do the Numbers Mean?* Statements, Please 96

FINANCIAL STATEMENTS FOR A MERCHANDISING COMPANY 96

- Income Statement 96
- Statement of Retained Earnings 97
- Balance Sheet 97
- Closing Entries 98

CONVERGENCE CORNER ACCOUNTING INFORMATION SYSTEMS 99**APPENDIX 3A CASH-BASIS ACCOUNTING VERSUS ACCRUAL-BASIS ACCOUNTING** 100**CONVERSION FROM CASH BASIS TO ACCRUAL BASIS** 102

- Service Revenue Computation 103
- Operating Expense Computation 103

THEORETICAL WEAKNESSES OF THE CASH BASIS 104**APPENDIX 3B USING REVERSING ENTRIES** 105**ILLUSTRATION OF REVERSING ENTRIES—ACCRUALS** 105**ILLUSTRATION OF REVERSING ENTRIES—DEFERRALS** 106**SUMMARY OF REVERSING ENTRIES** 107**APPENDIX 3C USING A WORKSHEET: THE ACCOUNTING CYCLE REVISITED** 107**WORKSHEET COLUMNS** 108

- Trial Balance Columns 108
- Adjustments Columns 108

ADJUSTMENTS ENTERED ON THE WORKSHEET 108

- Adjusted Trial Balance 109
- Income Statement and Balance Sheet Columns 110

PREPARING FINANCIAL STATEMENTS FROM A WORKSHEET 110**CHAPTER 4** Examining the Income**Statement** 130*Which Income Number?***INCOME STATEMENT** 132

- Usefulness of the Income Statement 132
- Limitations of the Income Statement 132
- Quality of Earnings 133
- What Do the Numbers Mean?* Manage Up, Manage Down 134

FORMAT OF THE INCOME STATEMENT 134

- Elements of the Income Statement 134
- Single-Step Income Statements 135
- Multiple-Step Income Statements 136
- Condensed Income Statements 138

REPORTING IRREGULAR ITEMS 139

- What Do the Numbers Mean?* Are One-Time Charges Bugging You? 140
- Discontinued Operations 141
- Extraordinary Items 142
- What Do the Numbers Mean?* Extraordinary Times 143
- Unusual Gains and Losses 144
- Changes in Accounting Principle 145
- Changes in Estimates 146
- Corrections of Errors 147
- Summary of Irregular Items 147

SPECIAL REPORTING ISSUES 148

- Intraperiod Tax Allocation 148
- Earnings per Share 150
- Retained Earnings Statement 151
- Comprehensive Income 152

CONVERGENCE CORNER INCOME STATEMENT 155**FASB CODIFICATION** 157**CHAPTER 5** Examining the Balance Sheet and Statement of Cash Flows 176*"There Ought to Be a Law"***SECTION 1 BALANCE SHEET** 178**USEFULNESS OF THE BALANCE SHEET** 178*What Do the Numbers Mean?* Grounded 178**LIMITATIONS OF THE BALANCE SHEET** 179**CLASSIFICATION IN THE BALANCE SHEET** 179

- Current Assets 181
- Noncurrent Assets 184
- Liabilities 186
- What Do the Numbers Mean?* "Show Me the Assets!" 187
- Owners' Equity 189
- Balance Sheet Format 189
- What Do the Numbers Mean?* Warning Signals 191

ADDITIONAL INFORMATION REPORTED 191

- Contingencies 192
- Accounting Policies 192
- Contractual Situations 192
- What Do the Numbers Mean?* What About Your Commitments? 193
- Fair Values 193

TECHNIQUES OF DISCLOSURE 194

- Parenthetical Explanations 194
- Notes 195
- Cross-Reference and Contra Items 196
- Supporting Schedules 196
- Terminology 197

SECTION 2 STATEMENT OF CASH FLOWS 197**PURPOSE OF THE STATEMENT OF CASH FLOWS** 197

What Do the Numbers Mean? Watch That Cash Flow 198

CONTENT AND FORMAT OF THE STATEMENT OF CASH FLOWS 198**OVERVIEW OF THE PREPARATION OF THE STATEMENT OF CASH FLOWS** 200

Sources of Information 200
Preparing the Statement of Cash Flows 200
Significant Noncash Activities 202

USEFULNESS OF THE STATEMENT OF CASH FLOWS 203

What Do the Numbers Mean? Cash Is King? 204
Financial Liquidity 204
Financial Flexibility 204
Free Cash Flow 204

CONVERGENCE CORNER BALANCE SHEET AND STATEMENT OF CASH FLOWS 206**APPENDIX 5A RATIO ANALYSIS—A REFERENCE** 208**USING RATIOS TO ANALYZE PERFORMANCE** 208**APPENDIX 5B SPECIMEN FINANCIAL STATEMENTS: THE PROCTER & GAMBLE COMPANY** 210

FASB CODIFICATION 239

CHAPTER 6 Present Value Concepts**and Measurement** 262

The Magic of Interest

BASIC TIME VALUE CONCEPTS 264

Applications of Time Value Concepts 264
The Nature of Interest 265
Simple Interest 266
Compound Interest 266
What Do the Numbers Mean? A Pretty Good Start 267
Fundamental Variables 270

SINGLE-SUM PROBLEMS 270

Future Value of a Single Sum 271
Present Value of a Single Sum 272
Solving for Other Unknowns in Single-Sum Problems 274

ANNUITIES 275

Future Value of an Ordinary Annuity 276
Future Value of an Annuity Due 278
Examples of Future Value of Annuity Problems 279
Present Value of an Ordinary Annuity 281

What Do the Numbers Mean? Up in

Smoke 283

Present Value of an Annuity Due 283

Examples of Present Value of Annuity Problems 284

MORE COMPLEX SITUATIONS 286

Deferred Annuities 286
Valuation of Long-Term Bonds 288
Effective-Interest Method of Amortization of Bond Discount or Premium 289

PRESENT VALUE MEASUREMENT 290

What Do the Numbers Mean? How Low Can They Go? 291
Choosing an Appropriate Interest Rate 291
Example of Expected Cash Flow 291

FASB CODIFICATION 294**CHAPTER 7** Understanding Cash and**Receivables** 318

No-Tell Nortel

SECTION 1 CASH 320**WHAT IS CASH?** 320**REPORTING CASH** 320

Cash Equivalents 320
Restricted Cash 321
Bank Overdrafts 322

SUMMARY OF CASH-RELATED ITEMS 322

What Do the Numbers Mean? Piling Up Cash 323

SECTION 2 RECEIVABLES 323**RECOGNITION OF ACCOUNTS RECEIVABLE** 324

Trade Discounts 324
Cash Discounts (Sales Discounts) 325
Nonrecognition of Interest Element 326

VALUATION OF ACCOUNTS RECEIVABLE 326

Uncollectible Accounts Receivable 326
What Do the Numbers Mean? "Too Generous"? 330
What Do the Numbers Mean? Collection Is a Click Away 331

RECOGNITION OF NOTES RECEIVABLE 331

Note Issued at Face Value 332
Note Not Issued at Face Value 332
Choice of Interest Rate 335

VALUATION OF NOTES RECEIVABLE 335

What Do the Numbers Mean? Economic Consequences and Write-Offs 337

DISPOSITION OF ACCOUNTS AND NOTES**RECEIVABLE** 337

- Secured Borrowing 338
- Sales of Receivables 339
- Secured Borrowing versus Sale 341
- What Do the Numbers Mean?* Return to Lender 342

PRESENTATION AND ANALYSIS 343

- Presentation of Receivables 343
- Analysis of Receivables 344

CONVERGENCE CORNER CASH AND RECEIVABLES 345**APPENDIX 7A CASH CONTROLS** 347**USING BANK ACCOUNTS** 347**THE IMPREST PETTY CASH SYSTEM** 348**PHYSICAL PROTECTION OF CASH BALANCES** 349**RECONCILIATION OF BANK BALANCES** 349

- What Do the Numbers Mean?* Bounce a Check, Get Banned 352

APPENDIX 7B IMPAIRMENTS OF RECEIVABLES 352**BACKGROUND** 353**IMPAIRMENT MEASUREMENT AND REPORTING** 354

- Impairment Loss Example 355
- Recording Impairment Losses 355
- What Do the Numbers Mean?* Lost in Translation 356

FASB CODIFICATION 357**CHAPTER 8 Accounting and Reporting****for Inventory: The Basics** 380*Inventories in the Crystal Ball***INVENTORY ISSUES** 382

- Classification 382
- Inventory Cost Flow 383
- Inventory Control 385
- What Do the Numbers Mean?* Staying Lean 386

BASIC ISSUES IN INVENTORY VALUATION 386**PHYSICAL GOODS INCLUDED IN INVENTORY** 386

- Goods in Transit 387
- Consigned Goods 387
- Special Sales Agreements 388
- What Do the Numbers Mean?* No Parking! 389
- Effect of Inventory Errors 389

COSTS INCLUDED IN INVENTORY 391

- Product Costs 391
- Period Costs 392

- Treatment of Purchase Discounts 392
- What Do the Numbers Mean?* You May Need a Map 393

WHICH COST FLOW ASSUMPTION TO ADOPT? 393

- Specific Identification 394
- Average Cost 395
- First-In, First-Out (FIFO) 396
- Last-In, First-Out (LIFO) 397

SPECIAL ISSUES RELATED TO LIFO 398

- LIFO Reserve 398
- What Do the Numbers Mean?* Comparing Apples to Apples 399
- LIFO Liquidation 399
- Dollar-Value LIFO 401
- What Do the Numbers Mean?* Quite a Difference 405
- Comparison of LIFO Approaches 405
- Major Advantages of LIFO 406
- Major Disadvantages of LIFO 407

BASIS FOR SELECTION OF INVENTORY METHOD 408

- Inventory Valuation Methods—Summary Analysis 410

FASB CODIFICATION 413**CHAPTER 9 Inventories: Valuation and****Estimation Concepts** 436*What Do Inventory Changes Tell Us?***LOWER-OF-COST-OR-MARKET** 438

- Ceiling and Floor 438
- How Lower-of-Cost-or-Market Works 440
- Methods of Applying Lower-of-Cost-or-Market 441
- Recording “Market” Instead of Cost 442
- What Do the Numbers Mean?* “Put It in Reverse” 444
- Evaluation of the Lower-of-Cost-or-Market Rule 444

VALUATION BASES 445

- Valuation at Net Realizable Value 445
- Valuation Using Relative Sales Value 446
- Purchase Commitments—A Special Problem 446

THE GROSS PROFIT METHOD OF**ESTIMATING INVENTORY** 449

- Computation of Gross Profit Percentage 450
- Evaluation of Gross Profit Method 451
- What Do the Numbers Mean?* The Squeeze 451

RETAIL INVENTORY METHOD 452

- Retail-Method Concepts 453
- Retail Inventory Method with Markups and Markdowns—Conventional Method 453

Special Items Relating to Retail Method 456
 Evaluation of Retail Inventory Method 457

PRESENTATION AND ANALYSIS 457

Presentation of Inventories 457
 Analysis of Inventories 459

CONVERGENCE CORNER INVENTORIES 460

APPENDIX 9A LIFO RETAIL METHODS 462

STABLE PRICES—LIFO RETAIL METHOD 462

**FLUCTUATING PRICES—DOLLAR-VALUE LIFO
 RETAIL METHOD** 463

**SUBSEQUENT ADJUSTMENTS UNDER DOLLAR-VALUE
 LIFO RETAIL** 464

CHANGING FROM CONVENTIONAL

RETAIL TO LIFO 465
FASB CODIFICATION 467

CHAPTER 10 Property, Plant, and
Equipment: Acquisition and Disposition 488
Where Have All the Assets Gone?

PROPERTY, PLANT, AND EQUIPMENT 490

**ACQUISITION OF PROPERTY, PLANT, AND
 EQUIPMENT** 490

Cost of Land 491
 Cost of Buildings 491
 Cost of Equipment 492
 Self-Constructed Assets 492
 Interest Costs During Construction 493
 Observations 498
*What Do the Numbers Mean? What's in Your
 Interest?* 498

**VALUATION OF PROPERTY, PLANT, AND
 EQUIPMENT** 498

Cash Discounts 499
 Deferred-Payment Contracts 499
 Lump-Sum Purchases 500
 Issuance of Stock 501
 Exchanges of Nonmonetary Assets 501
*What Do the Numbers Mean? About Those
 Swaps* 506
 Accounting for Contributions 506
 Other Asset Valuation Methods 507

COSTS SUBSEQUENT TO ACQUISITION 507

What Do the Numbers Mean?
 Disconnected 508
 Additions 509
 Improvements and Replacements 509
 Rearrangement and Reinstallation 510

Repairs 510
 Summary of Costs Subsequent to Acquisition 511

**DISPOSITION OF PROPERTY, PLANT, AND
 EQUIPMENT** 511

Sale of Plant Assets 511
 Involuntary Conversion 512
 Miscellaneous Problems 512

FASB CODIFICATION 514

CHAPTER 11 Property, Plant, and
Equipment: Cost Allocation and Impairment 538
Do They Matter?

DEPRECIATION—A METHOD OF COST ALLOCATION 540

Factors Involved in the Depreciation Process 540
What Do the Numbers Mean?
 Alphabet Dupe 542
 Methods of Depreciation 542
 Special Depreciation Methods 545
*What Do the Numbers Mean? Decelerating
 Depreciation* 547
 Special Depreciation Issues 548
*What Do the Numbers Mean? Depreciation
 Choices* 551

IMPAIRMENTS 551

Recognizing Impairments 551
 Measuring Impairments 552
 Restoration of Impairment Loss 553
 Impairment of Assets to Be Disposed Of 553

DEPLETION 554

Establishing a Depletion Base 554
 Write-Off of Resource Cost 555
 Estimating Recoverable Reserves 556
*What Do the Numbers Mean? Rah-Rah
 Surprise* 557
 Liquidating Dividends 557
 Continuing Controversy 557

PRESENTATION AND ANALYSIS 559

Presentation of Property, Plant, Equipment, and
 Natural Resources 559
 Analysis of Property, Plant, and Equipment 560

**CONVERGENCE CORNER PROPERTY, PLANT, AND
 EQUIPMENT** 562

APPENDIX 11A INCOME TAX DEPRECIATION 564

**MODIFIED ACCELERATED COST RECOVERY
 SYSTEM** 564

Tax Lives (Recovery Periods) 564
 Tax Depreciation Methods 565
 Example of MACRS System 565

OPTIONAL STRAIGHT-LINE METHOD 566

TAX VERSUS BOOK DEPRECIATION 566

FASB CODIFICATION 567

CHAPTER 12 Concepts and Reporting**Issues of Intangible Assets** 588*Measuring the Intangible***INTANGIBLE ASSET ISSUES** 590

Characteristics 590

Valuation 590

Amortization of Intangibles 591

What Do the Numbers Mean? Definitely

Indefinite 592

TYPES OF INTANGIBLE ASSETS 592

Marketing-Related Intangible Assets 593

Customer-Related Intangible Assets 593

Artistic-Related Intangible Assets 594

Contract-Related Intangible Assets 595

Technology-Related Intangible Assets 595

What Do the Numbers Mean? Patent Battles 596*What Do the Numbers Mean?* The Value of a

Secret Formula 597

Goodwill 597

IMPAIRMENT OF INTANGIBLE ASSETS 601

Impairment of Limited-Life Intangibles 601

Impairment of Indefinite-Life Intangibles Other
Than Goodwill 602

Impairment of Goodwill 602

Impairment Summary 603

What Do the Numbers Mean? What?

Me Impaired? 603

RESEARCH AND DEVELOPMENT COSTS 604

Identifying R&D Activities 604

Accounting for R&D Activities 605

Costs Similar to R&D Costs 606

What Do the Numbers Mean? Branded 608

Conceptual Questions 608

PRESENTATION OF INTANGIBLES AND**RELATED ITEMS** 609

Presentation of Intangible Assets 609

Presentation of Research and Development
Costs 609**CONVERGENCE CORNER INTANGIBLE ASSETS** 612**APPENDIX 12A ACCOUNTING FOR COMPUTER****SOFTWARE COSTS** 614

Diversity in Practice 614

The Profession's Position 615

Accounting for Capitalized Software Costs 615

Reporting Software Costs 616

Setting Standards for Software Accounting 616

FASB CODIFICATION 617

CHAPTER 13 Accounting and Reporting
of Current and Contingent Liabilities 636*Now You See It, Now You Don't***SECTION 1 CURRENT LIABILITIES** 638**WHAT IS A LIABILITY?** 638**WHAT IS A CURRENT LIABILITY?** 638

Accounts Payable 639

Notes Payable 639

Current Maturities of Long-Term Debt 641

Short-Term Obligations Expected to

Be Refinanced 641

What Do the Numbers Mean? What About That
Short-Term Debt? 643

Dividends Payable 643

Customer Advances and Deposits 643

Unearned Revenues 644

What Do the Numbers Mean? Microsoft's
Liabilities—Good or Bad? 645

Sales Taxes Payable 645

Income Taxes Payable 646

Employee-Related Liabilities 646

SECTION 2 CONTINGENCIES 651**GAIN CONTINGENCIES** 651**LOSS CONTINGENCIES** 652

Likelihood of Loss 652

Litigation, Claims, and Assessments 654

Guarantee and Warranty Costs 655

Premiums and Coupons 657

What Do the Numbers Mean? Frequent Flyers 658

Environmental Liabilities 658

What Do the Numbers Mean? More Disclosure,
Please 661

Self-Insurance 661

SECTION 3 PRESENTATION AND ANALYSIS 662**PRESENTATION OF CURRENT LIABILITIES** 662**PRESENTATION OF CONTINGENCIES** 664**ANALYSIS OF CURRENT LIABILITIES** 665

Current Ratio 665

Acid-Test Ratio 666

FASB CODIFICATION 667

CHAPTER 14 Accounting and Reporting
of Long-Term Liabilities 688*Your Debt Is Killing My Stock***SECTION 1 BONDS PAYABLE** 690**ISSUING BONDS** 690

TYPES AND RATINGS OF BONDS 690

What Do the Numbers Mean? All About Bonds 691

VALUATION OF BONDS PAYABLE—DISCOUNT AND PREMIUM 692

What Do the Numbers Mean? How's My Rating? 694
 Bonds Issued at Par on Interest Date 694
 Bonds Issued at Discount or Premium on Interest Date 695
 Bonds Issued Between Interest Dates 696

EFFECTIVE-INTEREST METHOD 697

Bonds Issued at a Discount 697
 Bonds Issued at a Premium 698
 Accruing Interest 699
 Classification of Discount and Premium 700

COSTS OF ISSUING BONDS 700**EXTINGUISHMENT OF DEBT** 701

What Do the Numbers Mean? Dead-Weight Debt 702

SECTION 2 LONG-TERM NOTES PAYABLE 703**NOTES ISSUED AT FACE VALUE** 703**NOTES NOT ISSUED AT FACE VALUE** 704

Zero-Interest-Bearing Notes 704
 Interest-Bearing Notes 705

SPECIAL NOTES PAYABLE SITUATIONS 706

Notes Issued for Property, Goods, or Services 706
 Choice of Interest Rate 707

MORTGAGE NOTES PAYABLE 708**SECTION 3 REPORTING AND ANALYZING****LONG-TERM DEBT** 709**OFF-BALANCE-SHEET FINANCING** 709

Different Forms 709
 Rationale 710
What Do the Numbers Mean? Obligated 711

PRESENTATION AND ANALYSIS OF**LONG-TERM DEBT** 711

Presentation of Long-Term Debt 711
 Analysis of Long-Term Debt 713

CONVERGENCE CORNER LIABILITIES 714**APPENDIX 14A TROUBLED-DEBT****RESTRUCTURINGS** 716**SETTLEMENT OF DEBT** 717

Transfer of Assets 717
 Granting of Equity Interest 718

MODIFICATION OF TERMS 718

Example 1—No Gain for Debtor 718
 Example 2—Gain for Debtor 721

CONCLUDING REMARKS 722

FASB CODIFICATION 723

CHAPTER 15 Accounting and Reporting of Stockholders' Equity 740

It's a Global Market

THE CORPORATE FORM OF ORGANIZATION 742

State Corporate Law 742
 Capital Stock or Share System 742
 Variety of Ownership Interests 743
What Do the Numbers Mean? A Class (B) Act 744

CORPORATE CAPITAL 744

Issuance of Stock 745
What Do the Numbers Mean? The Case of the Disappearing Receivable 749
 Reacquisition of Shares 749
What Do the Numbers Mean? Signals to Buy? 750

PREFERRED STOCK 754

Features of Preferred Stock 754
 Accounting for and Reporting Preferred Stock 755

DIVIDEND POLICY 756

Financial Condition and Dividend Distributions 757
 Types of Dividends 757
 Stock Split 762
What Do the Numbers Mean? Splitsville 763
 Disclosure of Restrictions on Retained Earnings 764

PRESENTATION AND ANALYSIS OF STOCKHOLDERS' EQUITY 765

Presentation 765
 Analysis 767

CONVERGENCE CORNER STOCKHOLDERS' EQUITY 769**APPENDIX 15A DIVIDEND PREFERENCES AND BOOK VALUE PER SHARE** 771**DIVIDEND PREFERENCES** 771**BOOK VALUE PER SHARE** 772

FASB CODIFICATION 774

CHAPTER 16 Accounting for Potential Equity Securities and EPS Reporting 794

Kicking the Habit

SECTION 1 DILUTIVE SECURITIES AND COMPENSATION PLANS 796**DEBT AND EQUITY** 796

ACCOUNTING FOR CONVERTIBLE DEBT 796

- At Time of Issuance 797
- At Time of Conversion 797
- Induced Conversions 797
- Retirement of Convertible Debt 798

CONVERTIBLE PREFERRED STOCK 798

- What Do the Numbers Mean? How Low Can You Go?* 799

STOCK WARRANTS 799

- Stock Warrants Issued with Other Securities 800
- Rights to Subscribe to Additional Shares 803
- Stock Compensation Plans 803

ACCOUNTING FOR STOCK COMPENSATION 805

- Stock-Option Plans 805
- Restricted Stock 807
- Employee Stock-Purchase Plans 808
- Disclosure of Compensation Plans 809
- Debate over Stock-Option Accounting 809
- What Do the Numbers Mean? A Little Honesty Goes a Long Way* 811

SECTION 2 COMPUTING EARNINGS PER SHARE 811**EARNINGS PER SHARE—SIMPLE CAPITAL STRUCTURE** 812

- Preferred Stock Dividends 812
- Weighted-Average Number of Shares Outstanding 813
- Comprehensive Example 815

EARNINGS PER SHARE—COMPLEX CAPITAL STRUCTURE 816

- Diluted EPS—Convertible Securities 817
- Diluted EPS—Options and Warrants 819
- Contingent Issue Agreement 820
- Antidilution Revisited 821
- EPS Presentation and Disclosure 821
- What Do the Numbers Mean? Pro Forma EPS Confusion* 823
- Summary of EPS Computation 823

CONVERGENCE CORNER DILUTIVE SECURITIES AND EARNINGS PER SHARE 825**APPENDIX 16A ACCOUNTING FOR STOCK-APPRECIATION RIGHTS** 827**SARS—SHARE-BASED EQUITY AWARDS** 827**SARS—SHARE-BASED LIABILITY AWARDS** 827**STOCK-APPRECIATION RIGHTS EXAMPLE** 828**APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE** 830**DILUTED EARNINGS PER SHARE** 831**FASB CODIFICATION** 835**CHAPTER 17** Debt and Equity**Investments** 856*Who's in Control Here?***INVESTMENT ACCOUNTING APPROACHES** 858**SECTION 1 INVESTMENTS IN DEBT SECURITIES** 858**HELD-TO-MATURITY SECURITIES** 859**AVAILABLE-FOR-SALE SECURITIES** 861

- Example: Single Security 862
- Example: Portfolio of Securities 863
- Sale of Available-for-Sale Securities 863
- Financial Statement Presentation 864
- What Do the Numbers Mean? What Is Fair Value?* 865

TRADING SECURITIES 865**SECTION 2 INVESTMENTS IN EQUITY SECURITIES** 866**HOLDINGS OF LESS THAN 20%** 867

- Available-for-Sale Securities 868
- Trading Securities 870

HOLDINGS BETWEEN 20% AND 50% 870

- Equity Method 870

HOLDINGS OF MORE THAN 50% 872

- What Do the Numbers Mean? Consolidate This!* 872

FAIR VALUE OPTION 873

- Available-for-Sale Securities 873
- Equity Method of Accounting 873
- Financial Liabilities 874

SECTION 3 OTHER REPORTING ISSUES 874**IMPAIRMENT OF VALUE** 875**RECLASSIFICATION ADJUSTMENTS** 876

- Comprehensive Example 877

TRANSFERS BETWEEN CATEGORIES 879**FAIR VALUE CONTROVERSY** 880

- Measurement Based on Intent 880
- Gains Trading 880
- Liabilities Not Fairly Valued 880
- Fair Values—Final Comment 880

SUMMARY OF REPORTING TREATMENT OF SECURITIES 880

- What Do the Numbers Mean? More Disclosure, Please* 881

CONVERGENCE CORNER INVESTMENTS 882**APPENDIX 17A ACCOUNTING FOR DERIVATIVE INSTRUMENTS** 884**DEFINING DERIVATIVES** 884

WHO USES DERIVATIVES, AND WHY? 885

- Producers and Consumers 885
- Speculators and Arbitrageurs 885

BASIC PRINCIPLES IN ACCOUNTING FOR**DERIVATIVES** 886

- Example of Derivative Financial Instrument—
Speculation 887
- Differences between Traditional and Derivative
Financial Instruments 889

DERIVATIVES USED FOR HEDGING 890

- What Do the Numbers Mean?* Risky
Business 890
- Fair Value Hedge 891
- Cash Flow Hedge 893

OTHER REPORTING ISSUES 895

- Embedded Derivatives 895
- Qualifying Hedge Criteria 895
- Summary of Derivatives Accounting 896

COMPREHENSIVE HEDGE ACCOUNTING EXAMPLE 897

- Fair Value Hedge 898
- Financial Statement Presentation of an Interest
Rate Swap 899

CONTROVERSY AND CONCLUDING REMARKS 900**APPENDIX 17B VARIABLE-INTEREST ENTITIES** 902**WHAT ABOUT GAAP?** 902**CONSOLIDATION OF VARIABLE-INTEREST ENTITIES** 903

- Some Examples 904
- What Is Happening in Practice? 904

**APPENDIX 17C FAIR VALUE MEASUREMENTS AND
DISCLOSURES** 905**DISCLOSURE OF FAIR VALUE INFORMATION:
FINANCIAL INSTRUMENTS—NO FAIR
VALUE OPTION** 905**DISCLOSURE OF FAIR VALUE INFORMATION:
FINANCIAL INSTRUMENTS—FAIR VALUE OPTION** 907**DISCLOSURE OF FAIR VALUES: IMPAIRED ASSETS
OR LIABILITIES** 907

FASB CODIFICATION 908

CHAPTER 18 Recognizing Revenue 930*It's Back***THE CURRENT ENVIRONMENT** 932

- What Do the Numbers Mean?* Grossed Out 932
- Guidelines for Revenue Recognition 933
- Departures from the Sale Basis 934

**REVENUE RECOGNITION AT POINT OF
SALE (DELIVERY)** 935

- Sales with Buyback Agreements 935
- Sales When Right of Return Exists 935
- Trade Loading and Channel Stuffing 936
- What Do the Numbers Mean?* No
Take-Backs 937

REVENUE RECOGNITION BEFORE DELIVERY 937

- Percentage-of-Completion Method 938
- Completed-Contract Method 943
- Long-Term Contract Losses 944
- Loss in Current Period 945
- Disclosures in Financial Statements 947
- What Do the Numbers Mean?* Less
Conservative 948
- Completion-of-Production Basis 948

REVENUE RECOGNITION AFTER DELIVERY 948

- Installment-Sales Method 949
- Cost-Recovery Method 956
- What Do the Numbers Mean?* Liability or
Revenue? 958
- Deposit Method 958
- Summary of Product Revenue Recognition
Bases 959

CONCLUDING REMARKS 959**CONVERGENCE CORNER REVENUE RECOGNITION** 960**APPENDIX 18A REVENUE RECOGNITION FOR SPECIAL
SALES TRANSACTIONS** 962**FRANCHISES** 962

- Initial Franchise Fees 963
- Continuing Franchise Fees 964
- Bargain Purchases 964
- Options to Purchase 965
- Franchisor's Cost 965
- Disclosures of Franchisors 965

CONSIGNMENTS 965**FASB CODIFICATION** 966**CHAPTER 19** Accounting and Reporting**Income Taxes** 990*Tax Uncertainty***FUNDAMENTALS OF ACCOUNTING FOR****INCOME TAXES** 992

- Future Taxable Amounts and Deferred Taxes 993
- What Do the Numbers Mean?*
"Real Liabilities" 996
- Future Deductible Amounts and Deferred
Taxes 997
- What Do the Numbers Mean?* "Real Assets" 999

Income Statement Presentation 1000
 Specific Differences 1001
 Tax Rate Considerations 1004
What Do the Numbers Mean? Sheltered 1005

ACCOUNTING FOR NET OPERATING LOSSES 1006

Loss Carryback 1006
 Loss Carryforward 1006
 Loss Carryback Example 1007
 Loss Carryforward Example 1007
What Do the Numbers Mean? Read Those
 Notes 1011

FINANCIAL STATEMENT PRESENTATION 1011

Balance Sheet 1011
 Income Statement 1013
What Do the Numbers Mean? NOLs: Good News
 or Bad? 1016
 Uncertain Tax Positions 1016

REVIEW OF THE ASSET-LIABILITY METHOD 1017

CONVERGENCE CORNER INCOME TAXES 1019

APPENDIX 19A COMPREHENSIVE EXAMPLE OF INTERPERIOD TAX ALLOCATION 1021

FIRST YEAR—2009 1021

Taxable Income and Income Tax
 Payable—2009 1022
 Computing Deferred Income Taxes—End of
 2009 1022
 Deferred Tax Expense (Benefit) and the Journal
 Entry to Record Income Taxes—2009 1023
 Financial Statement Presentation—2009 1024

SECOND YEAR—2010 1025

Taxable Income and Income Tax
 Payable—2010 1026
 Computing Deferred Income Taxes—End of
 2010 1026
 Deferred Tax Expense (Benefit) and the Journal
 Entry to Record Income Taxes—2010 1027
 Financial Statement Presentation—2010 1027

FASB CODIFICATION 1028

CHAPTER 20 Accounting for Pensions

and Other Postretirement Benefits 1048

Where Have All the Pensions Gone?

NATURE OF PENSION PLANS 1050

Defined-Contribution Plan 1051
 Defined-Benefit Plan 1051
What Do the Numbers Mean? Which Plan Is Right
 for You? 1052
 The Role of Actuaries in Pension
 Accounting 1053

ACCOUNTING FOR PENSIONS 1053

Alternative Measures of the Liability 1053
 Recognition of the Net Funded Status of the
 Pension Plan 1055
 Components of Pension Expense 1055

USING A PENSION WORKSHEET 1058

2010 Entries and Worksheet 1058
 Amortization of Prior Service Cost (PSC) 1060
 2011 Entries and Worksheet 1061
 Gain or Loss 1063
What Do the Numbers Mean? Pension Costs
 Ups and Downs 1064
 2012 Entries and Worksheet 1067
What Do the Numbers Mean? Bouncing
 Back 1069

REPORTING PENSION PLANS IN FINANCIAL STATEMENTS 1069

Within the Financial Statements 1070
 Within the Notes to the Financial Statements 1072
 Example of Pension Note Disclosure 1073
 2013 Entries and Worksheet—A Comprehensive
 Example 1075
 Special Issues 1076
What Do the Numbers Mean? Bailing Out 1079
 Concluding Observations 1079

CONVERGENCE CORNER POSTRETIREMENT BENEFITS 1080

APPENDIX 20A ACCOUNTING FOR POSTRETIREMENT BENEFITS 1082

ACCOUNTING GUIDANCE 1082

DIFFERENCES BETWEEN PENSION BENEFITS AND HEALTHCARE BENEFITS 1083

What Do the Numbers Mean? OPEBs—How Big
 Are They? 1084

POSTRETIREMENT BENEFITS ACCOUNTING PROVISIONS 1084

Obligations Under Postretirement Benefits 1085
 Postretirement Expense 1086

ILLUSTRATIVE ACCOUNTING ENTRIES 1086

2010 Entries and Worksheet 1087
 Recognition of Gains and Losses 1088
 2011 Entries and Worksheet 1088
 Amortization of Net Gain or Loss in 2012 1089

DISCLOSURES IN NOTES TO THE FINANCIAL STATEMENTS 1090

ACTUARIAL ASSUMPTIONS AND CONCEPTUAL ISSUES 1091

What Do the Numbers Mean? GASB Who? 1091

FASB CODIFICATION 1092

CHAPTER 21 Leasing: Accounting

Issues 1114

*More Companies Ask, "Why Buy?"***THE LEASING ENVIRONMENT** 1116

Who Are the Players? 1116

Advantages of Leasing 1118

What Do the Numbers Mean? Off-Balance-Sheet

Financing 1119

Conceptual Nature of a Lease 1119

ACCOUNTING BY THE LESSEE 1120

Capitalization Criteria 1121

Asset and Liability Accounted for Differently 1124

Capital Lease Method (Lessee) 1124

Operating Method (Lessee) 1127

What Do the Numbers Mean? Restatements on
the Menu 1127Comparison of Capital Lease with Operating
Lease 1128*What Do the Numbers Mean?* Are You
Liable? 1129**ACCOUNTING BY THE LESSOR** 1130

Economics of Leasing 1130

Classification of Leases by the Lessor 1131

Direct-Financing Method (Lessor) 1132

Operating Method (Lessor) 1135

SPECIAL ACCOUNTING PROBLEMS 1135

Residual Values 1136

Sales-Type Leases (Lessor) 1141

What Do the Numbers Mean? Xerox Takes On
the SEC 1144

Bargain-Purchase Option (Lessee) 1144

Initial Direct Costs (Lessor) 1145

Current versus Noncurrent 1145

Disclosing Lease Data 1146

LEASE ACCOUNTING—UNRESOLVED PROBLEMS 1148*What Do the Numbers Mean?* Swap Meet 1150**CONVERGENCE CORNER LEASE ACCOUNTING** 1151**APPENDIX 21A EXAMPLES OF LEASE****ARRANGEMENTS** 1153**EXAMPLE 1: HARMON, INC.** 1154**EXAMPLE 2: ARDEN'S OVEN CO.** 1155**EXAMPLE 3: MENDOTA TRUCK CO.** 1155**EXAMPLE 4: APPLELAND COMPUTER** 1156**APPENDIX 21B SALE-LEASEBACKS** 1157**DETERMINING ASSET USE** 1157

Lessee 1158

Lessor 1158

SALE-LEASEBACK EXAMPLE 1158

FASB CODIFICATION 1160

CHAPTER 22 Reporting Accounting**Changes and Error Analysis** 1180*In the Dark***SECTION 1 ACCOUNTING CHANGES** 1182**CHANGES IN ACCOUNTING PRINCIPLE** 1182*What Do the Numbers Mean?* Quite a

Change 1184

Retrospective Accounting Change Approach 1184

What Do the Numbers Mean? Change

Management 1186

Impracticability 1193

CHANGES IN ACCOUNTING ESTIMATE 1195

Prospective Reporting 1195

Disclosures 1196

CHANGE IN REPORTING ENTITY 1197**CORRECTION OF ERRORS** 1197

Example of Error Correction 1199

SUMMARY OF ACCOUNTING CHANGES AND**CORRECTION OF ERRORS** 1201*What Do the Numbers Mean?* Can I Get My
Money Back? 1202**MOTIVATIONS FOR CHANGE OF ACCOUNTING****METHOD** 1203**SECTION 2 ERROR ANALYSIS** 1204**BALANCE SHEET ERRORS** 1204**INCOME STATEMENT ERRORS** 1205**BALANCE SHEET AND INCOME STATEMENT ERRORS** 1205

Counterbalancing Errors 1205

Noncounterbalancing Errors 1207

COMPREHENSIVE EXAMPLE: NUMEROUS ERRORS 1208**PREPARATION OF FINANCIAL STATEMENTS WITH****ERROR CORRECTIONS** 1210**CONVERGENCE CORNER ACCOUNTING CHANGES AND**
ERRORS 1212**APPENDIX 22A CHANGING FROM OR TO THE****EQUITY METHOD** 1215**CHANGE FROM THE EQUITY METHOD** 1215

Dividends in Excess of Earnings 1215

CHANGE TO THE EQUITY METHOD 1216

FASB CODIFICATION 1218

CHAPTER 23 Cash Flow Reporting 1242*Don't Take Cash Flow for Granted***SECTION 1 PREPARATION OF THE STATEMENT OF CASH FLOWS** 1244**USEFULNESS OF THE STATEMENT OF CASH FLOWS** 1244**CLASSIFICATION OF CASH FLOWS** 1245
What Do the Numbers Mean? How's My Cash Flow? 1246**FORMAT OF THE STATEMENT OF CASH FLOWS** 1247**STEPS IN PREPARATION** 1247**FIRST EXAMPLE—2009** 1248
Step 1: Determine the Change in Cash 1249
Step 2: Determine Net Cash Flow from Operating Activities 1249
What Do the Numbers Mean? Pumping Up Cash 1251
Step 3: Determine Net Cash Flows from Investing and Financing Activities 1251**SECOND EXAMPLE—2010** 1253
Step 1: Determine the Change in Cash 1253
Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method 1253
Step 3: Determine Net Cash Flows from Investing and Financing Activities 1254
Statement of Cash Flows—2010 1255**THIRD EXAMPLE—2011** 1255
Step 1: Determine the Change in Cash 1256
Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method 1256
Step 3: Determine Net Cash Flows from Investing and Financing Activities 1257
Statement of Cash Flows—2011 1258**SOURCES OF INFORMATION FOR THE STATEMENT OF CASH FLOWS** 1259**NET CASH FLOW FROM OPERATING ACTIVITIES—INDIRECT VERSUS DIRECT METHOD** 1259
Indirect Method 1259
Direct Method—An Example 1260
Direct versus Indirect Controversy 1264
What Do the Numbers Mean? Not What It Seems 1266**SECTION 2 SPECIAL PROBLEMS IN STATEMENT PREPARATION** 1266**ADJUSTMENTS SIMILAR TO DEPRECIATION** 1266**ACCOUNTS RECEIVABLE (NET)** 1267
Indirect Method 1267
Direct Method 1268**OTHER WORKING CAPITAL CHANGES** 1269**NET LOSSES** 1269**GAINS** 1270**STOCK OPTIONS** 1270**POSTRETIREMENT BENEFIT COSTS** 1271**EXTRAORDINARY ITEMS** 1271**SIGNIFICANT NONCASH TRANSACTIONS** 1272
What Do the Numbers Mean?
Cash Flow Tool 1273**SECTION 3 USE OF A WORKSHEET** 1273**PREPARATION OF THE WORKSHEET** 1275**ANALYSIS OF TRANSACTIONS** 1277
Change in Retained Earnings 1277
Accounts Receivable (Net) 1277
Inventories 1278
Prepaid Expense 1278
Investment in Stock 1278
Land 1278
Equipment and Accumulated Depreciation 1279
Building Depreciation and Amortization of Trademark 1279
Other Noncash Charges or Credits 1279
Common Stock and Related Accounts 1280
Final Reconciling Entry 1280**PREPARATION OF FINAL STATEMENT** 1282**CONVERGENCE CORNER STATEMENT OF CASH FLOWS** 1283**FASB CODIFICATION** 1285**CHAPTER 24** Full Disclosure: Concepts and Practices 1312*High-Quality Financial Reporting—Always in Fashion***FULL DISCLOSURE PRINCIPLE** 1314
Increase in Reporting Requirements 1315
Differential Disclosure 1315
What Do the Numbers Mean? "The Heart of the Matter" 1316**NOTES TO THE FINANCIAL STATEMENTS** 1316
Accounting Policies 1316
Common Notes 1319
What Do the Numbers Mean?
Footnote Secrets 1321

DISCLOSURE ISSUES 1321
Disclosure of Special Transactions or Events 1321
Post-Balance-Sheet Events (Subsequent Events) 1323
Reporting for Diversified (Conglomerate)
Companies 1324
Interim Reports 1330
What Do the Numbers Mean? "I Want It Faster" 1335

AUDITOR'S AND MANAGEMENT'S REPORTS 1335
Auditor's Report 1335
Management's Reports 1338

CURRENT REPORTING ISSUES 1341
Reporting on Financial Forecasts and
Projections 1341
Internet Financial Reporting 1343
*What Do the Numbers Mean? New Formats, New
Disclosure* 1344
Fraudulent Financial Reporting 1344
What Do the Numbers Mean? Here's a Fraud 1346
Criteria for Making Accounting and Reporting
Choices 1346

CONVERGENCE CORNER DISCLOSURE 1347

**APPENDIX 24A BASIC FINANCIAL STATEMENT
ANALYSIS** 1349

**PERSPECTIVE ON FINANCIAL STATEMENT
ANALYSIS** 1349

RATIO ANALYSIS 1350
Limitations of Ratio Analysis 1351

COMPARATIVE ANALYSIS 1353

PERCENTAGE (COMMON-SIZE) ANALYSIS 1354

**APPENDIX 24B INTERNATIONAL ACCOUNTING
STANDARDS** 1356

THE PRESENT ENVIRONMENT 1356

**REASONS TO UNDERSTAND INTERNATIONAL
ACCOUNTING STANDARDS** 1356

**THE CHALLENGE OF INTERNATIONAL
ACCOUNTING** 1357

**WHO ARE THE KEY PLAYERS IN DEVELOPING
INTERNATIONAL STANDARDS?** 1358
IASB 1358
Other Organizations 1358

**ACCOUNTING STANDARD SETTING AND
INTERNATIONAL CONVERGENCE** 1359
Challenges to Convergence 1360

CONCLUDING REMARKS 1360
FASB CODIFICATION 1361

INDEX I-1
