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Financial Accounting

Sixth Edition

SIXTH EDITION

Financial Accounting

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Ithaca College

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FINANCIAL ACCOUNTING

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Robert Libby is the David A. Thomas Professor of Accounting at Cornell University, where he teaches the introductory financial accounting course. He previously taught at the University of Illinois, Pennsylvania State University, the University of Texas at Austin, the University of Chicago, and the University of Michigan. He received his BS from Pennsylvania State University and his MAS and PhD from the University of Illinois. He is also a CPA.

Bob is a widely published author and researcher specializing in behavioral accounting. He was selected as the AAA Outstanding Educator in 2000, received the AAA Outstanding Service Award in 2006 and received the AAA Notable Contributions to the Literature Award in 1985 and 1996. He is the only person to have received all three of the Association's highest awards for teaching, service, and research. He has published numerous articles in *The Accounting Review*; *Journal of Accounting Research*; *Accounting, Organizations, and Society*; and other accounting journals. He has held a variety of offices including vice president in the American Accounting Association and is a member of the American Institute of CPAs and the editorial boards of *The Accounting Review*; *Accounting, Organizations and Society*; *Journal of Accounting Literature*; and *Journal of Behavioral Decision Making*.

Patricia A. Libby

Patricia Libby is associate professor of accounting at Ithaca College, where she teaches the undergraduate financial accounting course. She previously taught graduate and

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and her PhD from the University of Michigan. She is also a CPA.

Pat conducts research on using cases in the introductory course and other parts of the accounting curriculum. She has published articles in *The Accounting Review*, *Issues in Accounting Education*, and *The Michigan CPA*.

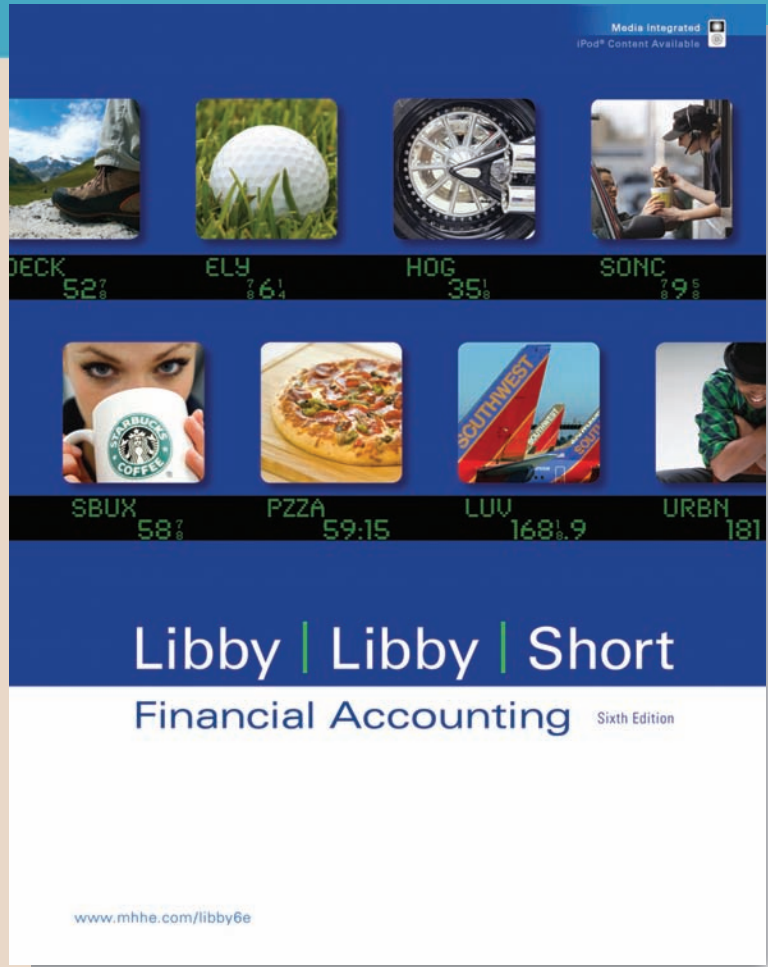
Daniel G. Short

Daniel Short is professor of accounting and former dean of the M.J. Neeley School of Business at Texas Christian University in Fort Worth, Texas. Before he joined TCU, he was dean at the Richard T. Farmer School of Business at Miami University and the College of Business at Kansas State University. Prior to that, he was 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 Michigan and the University of Chicago. He received his undergraduate degree from Boston University and his MBA and PhD from the University of Michigan.

Dan has won numerous awards for his outstanding teaching abilities and has published articles in *The Wall Street Journal*, *The Accounting Review*, the *Journal of Accounting Research*, and other business journals. He has worked with a 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 boards of directors in several industries, including manufacturing, commercial banking, and medical services. He is currently on the economic development committee of the Fort Worth Chamber of Commerce.

A trusted leader

Since it was first published, *Financial Accounting* has grown to be the market-leading financial accounting textbook on which both students and instructors rely. The award-winning author team of Bob Libby, Pat Libby, and Dan Short has made it a best-selling textbook by helping the instructor and student become partners in learning. The Libby/Libby/Short authors use a remarkable learning approach that keeps students engaged and involved in the material from the first day of class.



Financial Accounting's pioneering “focus company approach” involves students in the business decisions of real companies, demonstrating how financial accounting makes a difference in the success of a firm. That, combined with pedagogical features and technology assets that serve a variety of learning styles, makes *Financial Accounting* the textbook that both students and instructors agree is the best of its kind on the market today.

“ . . . It systematically guides readers through financial statements with focus companies and, at the same time, integrates the transaction analysis and journal entries in every chapter.” Haihang He, California State University

for both students and instructors

Libby/Libby/Short's *Financial Accounting* maintains its leadership by focusing on three key attributes:

RELEVANCY—THE PIONEERING FOCUS COMPANY

APPROACH: The Libby/Libby/Short authors first introduced their focus company approach as the best method for helping students understand financial statements and real-world implications of financial accounting for future managers. **This approach shows that accounting is relevant and motivates students by explaining accounting in a real-world context.** Throughout each chapter, the material is focused around a familiar Real company, its decisions, and its financial statements. This provides the perfect setting for discussing the importance of accounting and how businesses use accounting information. Furthering its real-world applicability, the end-of-chapter cases tie directly to the American Eagle Outfitters Annual Report in Appendix B and the contrasting report from Urban Outfitters Form 10-K in Appendix C. This gives students valuable practice reading and interpreting real financial data. In addition, real-world excerpts expand on important chapter topics with insight into how real firms use financial accounting to their competitive advantage.

CLARITY—A BUILDING-BLOCK APPROACH TO TEACHING TRANSACTION ANALYSIS:

Most faculty agree that mastery of the accounting cycle is critical to success in financial accounting. And yet all other financial books introduce and develop transaction analysis in one chapter, bombarding a student early in the course with an overload of new concepts and terms. The authors believe that most faculty take more time with the accounting cycle, but other financial accounting textbooks don't. **By slowing down the introduction of transactions and giving students time to practice and gain mastery, this building-block approach leads to greater student success in their study of later topics in financial accounting such as adjusting entries.**

TECHNOLOGY—POWERFUL TOOLS FOR TEACHING

AND STUDY: Students have different learning styles and conflicting time commitments, so they want technology tools that help them study more efficiently and effectively. **McGraw-Hill's Homework Manager and Homework Manager Plus, iPod downloadable content, and ALEKS for Financial Accounting provide students with three powerful tools tied directly to *Financial Accounting, 6e*,** which will help them maximize their study time and make their learning experience more enjoyable. In addition, the Algorithmic Test Bank allows instructors to create an infinite number of algorithm-generated quizzes and test assignments and gives students an endless number of problems with which to practice.

Libby/Libby/Short's *Financial Accounting* is the proven choice for presenting financial accounting in a clear, relevant manner that keeps students engaged throughout your course. Read on for more insight into what has made this textbook such a success with faculty and students.

What's New in the 6th Edition?

One reason Libby/Libby/Short's *Financial Accounting* is a best-selling textbook is because instructors can trust the flexibility in key topical coverage, the simplified explanations of complex topics, and end-of-chapter material that relates directly to the chapter's text and engages the students with concepts and decision making using details from the chapter. Eighty percent of the end-of-chapter material throughout the sixth edition has been thoroughly revised with new companies and numerical data. Previous users will find familiar problem structures, making transition into this edition easier.

Chapter 1

- Shortened and simplified "Correcting Maxidrive's Statements" section.
- Updated material on Corporate Governance and IFRS.
- New demonstration case based on Apple Computer.
- Simplified cash flow self-study quiz.
- Substantial revision of end-of-chapter material: new numerical data for 75 percent of mini-exercises, exercises, and problems; three new alternate problems; and all new annual report cases.

Chapter 2

- New simplified Exhibit 2.1.
- Additional account title simplification in the balance sheet.
- Modified International Perspective to introduce IFRS.
- Updated Financial Analysis and Ethics features.
- Modified transaction analysis illustration to be clearer and more systematic.
- Revised Exhibits 2.4, 2.5, and 2.6 for improved clarity.
- Added explanation boxes for analytical tools (journal entries and T-accounts).
- Modified solutions to self-study quizzes to be consistent with presentation of journal entries and equation effects.

- Substantial revision of end-of-chapter material: multiple choice section now includes three computational questions, new numerical data for 60 percent of mini-exercises, exercises, and problems and all new annual report cases.

Chapter 3

- Updated International Perspective with another focus on IFRS.
- Continued simplification of the account titles in financial statements.
- New exhibit on revenue recognition with clearer explanation to follow exhibit.
- New exhibit on expense matching with clearer explanation to follow exhibit.
- Updated Question of Ethics feature.
- Clearer exhibit on the transaction analysis model.
- Clarified discussion on preparing the financial statements and their relationships.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 65 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 4

- Reorganized discussion of the adjustment process.

- New visuals for adjusting entries.
- Clarified and simplified illustration of the adjustment process.
- Modified self-study quiz on adjusting entries.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 5

- Updated focus and comparison companies.
- New graphic reflecting changes in accounting regulation.
- Updated coverage of the effects of accounting restatements and fraud on accountants, company management, and investors.
- Updated coverage of the importance of international accounting standards.
- New Financial Analysis feature on stock market reaction to earnings announcements.
- New exhibit illustrating information on reuters.com.
- New ROE Self-Study Quiz based on Apple Computer and HP.
- Updated Microsoft Demonstration Case.
- Updated discussion and illustration of nonrecurring items.

- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 60 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 6

- Updated focus and comparison companies.
- Revised example of aging of accounts receivable.
- Updated coverage of electronic cash transactions.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 7

- Updated focus and comparison companies.
- Modified inventory graphics illustrating cost flow assumptions.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; and all new annual report cases.

What's New?

Chapter 8

- New focus company—Southwest Airlines replaces Delta Airlines—and comparison companies.
- New International Perspective feature on IFRS.
- Updated financial disclosure examples.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 9

- New comparison companies.
- Expanded discussion of lease liabilities.
- Updated focus company information.
- Addition of fractional year interest.
- Addition of demonstration case.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 80 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 10

- Updated information for focus company.
- Inclusion of fractional year interest.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 11

- New focus company—Sonic Drive-In Restaurant replaces Outback Steakhouse—and comparison companies.
- Elimination of actual statement of stockholders' equity due to increasing complexity of the statement.
- Elimination of discussion of restriction on retained earnings.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 12

- New focus company—Washington Post Companies replaces Dow Jones—and comparison companies.
- New financial analysis feature on fair value for investments.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; and all new annual report cases.

Chapter 13

- Updated focus and comparison companies.
- Transfer of coverage of gains and losses on sale of property, plant and equipment from an end of chapter supplement to the chapter itself.
- Transfer of detailed discussion of preparation of the direct method operating activities section to end of chapter supplement.
- Addition of new exhibit at the end of the chapter summarizing the preparation process (indirect method).

- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; additional exercise, problem, and alternate problem involving preparation of complete cash flow statement; and all new annual report cases.

Chapter 14

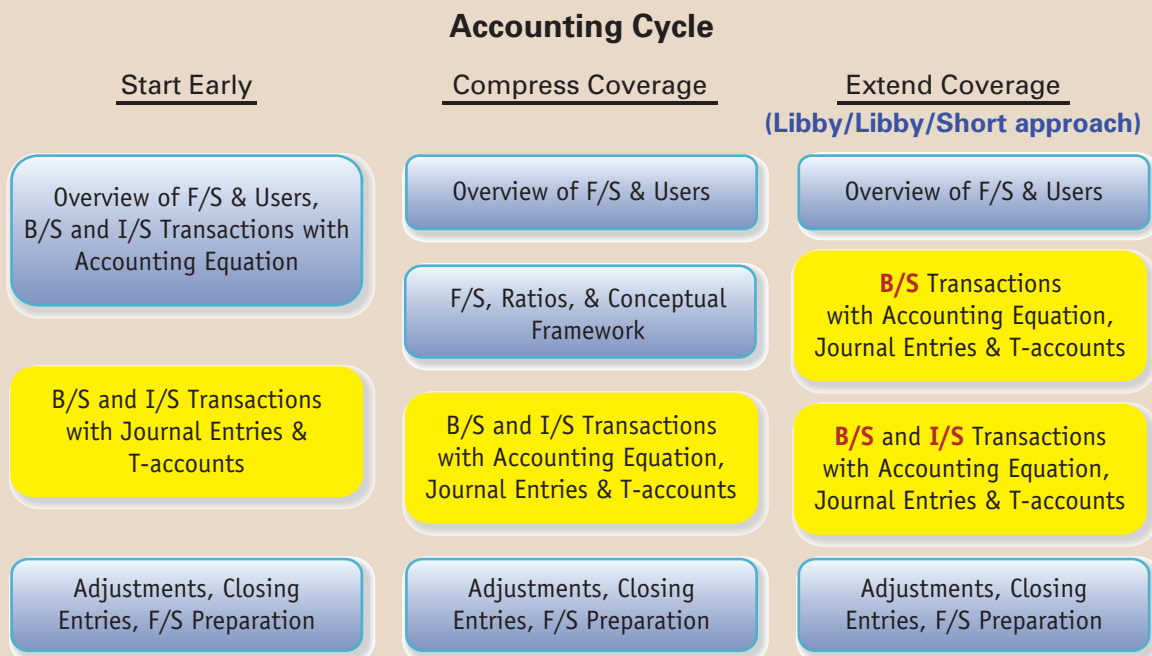
- Revised financial analysis for Home Depot and Lowe's.
- Updated comparison companies and financial examples.
- Substantial revision of end-of-chapter material: three computational questions added to the multiple choice section; new numerical data for 75 percent of mini-exercises, exercises, and problems; and all new annual report cases.

A proven approach to

Faculty agree the accounting cycle is the most critical concept to learn and master for students studying financial accounting. The Libby/Libby/Short authors agree the accounting cycle is a critical concept. They believe students struggle with the accounting cycle when transaction analysis is covered in one chapter. If students are exposed to the accounting equation, journal entries, and T-accounts for both balance sheet and income statement accounts in a single chapter, many are left behind and are unable to grasp material in the next chapter which covers adjustments and financial statement preparation.

The market-leading Libby/Libby/Short approach covers transaction analysis over two chapters so that students have the time to master the material. In Chapter 2 of *Financial Accounting*, students are exposed to the accounting equation and transaction analysis for investing and financing transactions that only affect balance sheet accounts. This provides students with the opportunity to learn the basic structure and tools used in accounting in a simpler setting. In Chapter 3, students are exposed to more complex operating transactions that also affect income statement accounts. As a result of this slower building-block approach to transaction analysis, students are better prepared and ready to learn adjustments, financial statement preparation, and more advanced topics. After the students have developed an understanding of the complete accounting cycle and the resulting statements, Chapter 5 takes students through the corporate reporting and analysis process.

The graphic below shows a detailed comparison of the Libby/Libby/Short approach to the accounting cycle chapters compared to the approach taken by other market-leading financial accounting text books.



transaction analysis and the accounting cycle

The Libby/Libby/Short approach is **better** because it gives students more time to master transaction analysis, which is the foundation for the rest of the course.

- Students have more time to practice and feel less overwhelmed.
- Allows students to develop comfort with simpler transactions in Chapter 2 before they move onto more complex transactions in Chapter 3.
- It's intuitive and matches the sequence of establishing and then operating a business
- Builds on itself which allows more time and practice where it is needed.

“Solid presentation of t-accounts. Good that you use the same transactions in general journal format so students can see the transactions both ways. I like the transactions shown and that they reflect what is occurring in the Papa John’s case.”

Phil Lewis, Eastern Michigan University

“A fairly thorough overview of the adjusting and closing processes . . . The book provides a nice linkage between the closing process and the preparation of the financial statements.”

Peter Woodlock Youngstown State University

“The adjusting entry process is clearly presented, which makes it easier for the students to grasp the concepts.”

Rada Brooks, University of California at Berkeley

“The use of parenthesis in each journal entry is an excellent approach... Very useful for engaging non-accounting majors.”

Michael Ulinski, Pace University

“I like the fact that when preparing adjusting entries that students have to calculate.... It is important for students to have to think through this process—which doesn’t occur when the amount is provided.”

Brian Nagel, Duquesne University