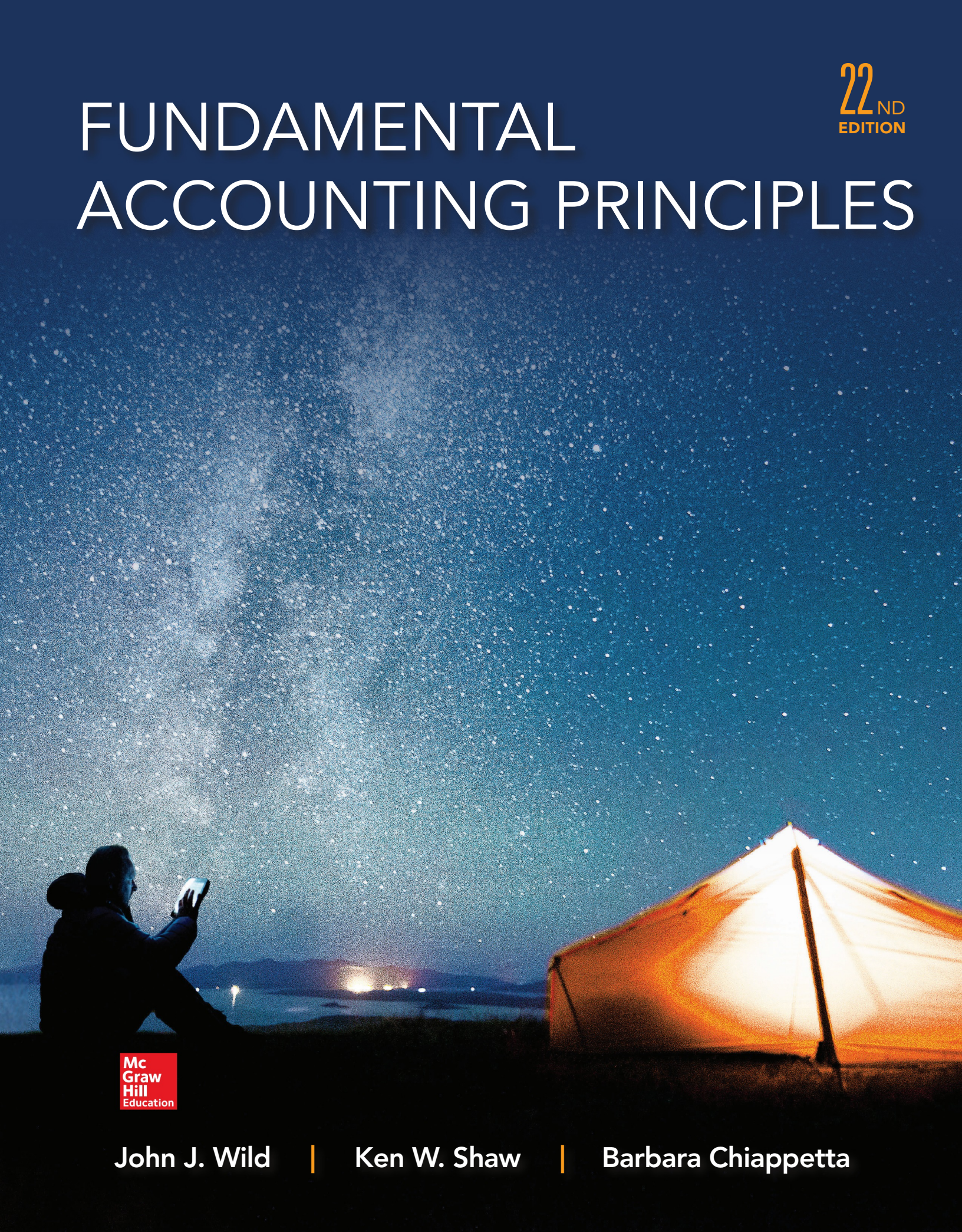


22ND
EDITION

FUNDAMENTAL ACCOUNTING PRINCIPLES



Mc
Graw
Hill
Education

John J. Wild

Ken W. Shaw

Barbara Chiappetta

Fundamental Accounting Principles

22nd
edition

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University of Wisconsin at Madison

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University of Missouri at Columbia

Barbara Chiappetta

Nassau Community College

**Mc
Graw
Hill**
Education



To my students and family, especially **Kimberly, Jonathan, Stephanie and Trevor.**
To my wife **Linda** and children **Erin, Emily and Jacob.**
To my mother, husband **Bob** and sons **Michael and David.**

FUNDAMENTAL ACCOUNTING PRINCIPLES, TWENTY-SECOND EDITION

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Adapting to the Needs of Today's Students

Fundamental Accounting Principles, 22e

Enhancements in technology have changed how we live and learn. Working with learning resources across devices, whether smartphones, tablets, or laptop computers, empowers students to drive their own learning by putting increasingly intelligent technology into their hands.

Whether the goal is to become an accountant, a businessperson, or simply an informed consumer of accounting information, *Fundamental Accounting Principles (FAP)* has helped generations of students succeed. Its leading-edge accounting content, paired with state-of-the-art technology, supports student learning and elevates understanding of key accounting principles.

FAP excels at **engaging students** with content that will help them see the relevance of accounting. Its chapter-opening vignettes showcase dynamic, successful entrepreneurial individuals and companies and **highlight the usefulness of accounting to business owners**. This edition's featured companies—**Apple, Google, and Samsung**—capture student interest with their products, and their annual reports serve as a pathway for learning financial statements. New in this edition, Need-to-Know illustrations in each chapter demonstrate how to apply key accounting procedures. They are supported by guided video presentations.

FAP also delivers innovative technology to help student performance. **Connect Plus Accounting** provides students with a media-rich eBook version of the textbook and offers instant grading and feedback for assignments that are completed online. Our system for completing exercise and problem material takes accounting content to the next level, delivering assessment material in a **more intuitive, less restrictive** format that adapts to the needs of today's students.

This technology features:

- a **general journal interface** that looks and feels more like that found in practice.
- an **auto-calculation** feature that allows students to focus on concepts rather than rote tasks.
- a **smart (auto-fill) drop-down design**.

The end result is content that better prepares students for the real world.

Connect Plus Accounting also includes digitally based, interactive, adaptive learning tools that provide an opportunity

to engage students more effectively by offering varied instructional methods and more personalized learning paths that build on different learning styles, interests, and abilities.

The revolutionary technology of the LearnSmart Advantage Series—consisting of **LearnSmart™, SmartBook™, and SmartBook Achieve™**—is available only from McGraw-Hill Education. All three products are based on an intelligent learning system that uses a series of adaptive questions to pinpoint each student's knowledge gaps and then provides an optimal learning path. Students spend less time in areas they already know and more time in areas they don't. The result: Students study more efficiently, learn faster, and retain more knowledge. Valuable reports provide insights into how students are progressing through textbook content and information useful for shaping in-class time or assessment.

Interactive Presentations teach each chapter's core learning objectives in a rich, multimedia format, bringing the content to life. Your students will come to class prepared when you assign Interactive Presentations. Students can also review the Interactive Presentations as they study. Further, **Guided Examples** provide students with narrated, animated, step-by-step walk-throughs of algorithmic versions of assigned exercises. Students appreciate the Guided Examples, which help them learn accounting and complete assignments outside of class.

A **General Ledger (GL) application**, new to 22e, offers students the ability to see how transactions post from the general journal all the way through the financial statements. It uses the intuitive, less restrictive format as that used for other homework, and it adds critical thinking components to each GL question, to ensure understanding of the entire process.

The first and only analytics tool of its kind, **Connect Insight™** is a series of visual data displays—each framed by an intuitive question—to provide at-a-glance information about how your class is doing. Connect Insight provides a quick analysis on five key dimensions, available at a moment's notice from a tablet device: *How are my students doing? How is my section doing? How is this student doing? How are my assignments going?* and *How is this assignment going?*

"I believe that *FAP* is the best intro accounting text on the market—clear, concise, complete. . . . Additionally, it is clear that the authors stay in touch with the 'times'."

— JAMES L. LOCK, Northern Virginia Community College

About the Authors



JOHN J. WILD is a distinguished professor of accounting at the University of Wisconsin at Madison. He previously held appointments at Michigan State University and the University of Manchester in England. He received his BBA, MS, and PhD from the University of Wisconsin.

Professor Wild teaches accounting courses at both the undergraduate and graduate levels. He has received numerous teaching honors, including the Mabel W. Chipman Excellence-in-Teaching Award, the departmental Excellence-in-Teaching Award, and the Teaching Excellence Award from the 2003 and 2005 business graduates at the University of Wisconsin. He also received the Beta Alpha Psi and Roland F. Salmonson Excellence-in-Teaching Award from Michigan State University. Professor Wild has received several research honors and is a past KPMG Peat Marwick National Fellow and is a recipient of fellowships from the American Accounting Association and the Ernst and Young Foundation.



KEN W. SHAW is an associate professor of accounting and the Deloitte Professor of Accounting at the University of Missouri. He previously was on the faculty at the University of Maryland at College Park. He has also taught in international programs at the University of Bergamo (Italy) and the University of Alicante (Spain). He received an accounting degree from Bradley University and an MBA and PhD from the University of Wisconsin. He is a Certified

Public Accountant with work experience in public accounting.

Professor Shaw teaches accounting at the undergraduate and graduate levels. He has received numerous School of Accountancy, College of Business and university-level teaching awards. He was voted the “Most Influential Professor” by three School of Accountancy graduating classes, and is a two-time recipient of the O’Brien Excellence in Teaching Award. He is the advisor to his school’s chapter of the Association of Certified Fraud Examiners.



BARBARA CHIAPPETTA received her BBA in Accountancy and MS in Education from Hofstra University and is a tenured full professor at Nassau Community College. For the past two decades, she has been an active executive board member of the Teachers of Accounting at Two-Year Colleges (TACTYC), serving 10 years as vice president and as president from 1993 through 1999. As an active

member of the American Accounting Association, she has served on the Northeast Regional Steering Committee, chaired the Curriculum Revision Committee of the Two-Year Section, and participated in numerous national committees. Professor Chiappetta has been inducted into the American Accounting Association Hall of Fame for the

Professor Wild is an active member of the American Accounting Association and its sections. He has served on several committees of these organizations, including the Outstanding Accounting Educator Award, Wildman Award, National Program Advisory, Publications, and Research Committees. Professor Wild is author of *Financial Accounting*, *Managerial Accounting*, and *College Accounting*, each published by McGraw-Hill Education. His research articles on accounting and analysis appear in *The Accounting Review*; *Journal of Accounting Research*; *Journal of Accounting and Economics*; *Contemporary Accounting Research*; *Journal of Accounting, Auditing and Finance*; *Journal of Accounting and Public Policy*; and other journals. He is past associate editor of *Contemporary Accounting Research* and has served on several editorial boards including *The Accounting Review*.

In his leisure time, Professor Wild enjoys hiking, sports, travel, people, and spending time with family and friends.

Professor Shaw is an active member of the American Accounting Association and its sections. He has served on many committees of these organizations and presented his research papers at national and regional meetings. Professor Shaw’s research appears in the *Journal of Accounting Research*; *The Accounting Review*; *Contemporary Accounting Research*; *Journal of Financial and Quantitative Analysis*; *Journal of the American Taxation Association*; *Strategic Management Journal*; *Journal of Accounting, Auditing, and Finance*; *Journal of Financial Research*; and other journals. He has served on the editorial boards of *Issues in Accounting Education*; *Journal of Business Research*; and *Research in Accounting Regulation*. Professor Shaw is co-author of *Financial and Managerial Accounting*, *Managerial Accounting*, and *College Accounting*, all published by McGraw-Hill Education.

In his leisure time, Professor Shaw enjoys tennis, cycling, music, and coaching his children’s sports teams.

Northeast Region. She had also received the Nassau Community College dean of instruction’s Faculty Distinguished Achievement Award. Professor Chiappetta was honored with the State University of New York Chancellor’s Award for Teaching Excellence in 1997. As a confirmed believer in the benefits of the active learning pedagogy, Professor Chiappetta has authored *Student Learning Tools*, an active learning workbook for a first-year accounting course, published by McGraw-Hill Education.

In her leisure time, Professor Chiappetta enjoys tennis and participates on a U.S.T.A. team. She also enjoys the challenge of bridge. Her husband, Robert, is an entrepreneur in the leisure sport industry. She has two sons—Michael, a lawyer, specializing in intellectual property law in New York, and David, a composer, pursuing a career in music for film in Los Angeles.

Dear Colleagues and Friends,

As we roll out the new edition of *Fundamental Accounting Principles*, we thank each of you who provided suggestions to improve the textbook and its teaching resources. This new edition reflects the advice and wisdom of many dedicated reviewers, symposium and workshop participants, students, and instructors. Throughout the revision process, we steered this textbook and its teaching tools in the manner you directed. As you'll find, the new edition offers a rich set of features—especially digital features—to improve student learning and assist instructor teaching and grading. We believe you and your students will like what you find in this new edition.

Many talented educators and professionals have worked hard to create the materials for this product, and for their efforts, we're grateful. **We extend a special thank-you to our contributing and technology supplement authors**, who have worked so diligently to support this product:

Contributing Author: Kathleen O'Donnell, *Onondaga Community College*

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Test Bank Contributors: Anna Boulware, *St. Charles Community College*, and Brenda J. McVey, *University of Mississippi*

Digital Contributor, Connect Content, General Ledger Problems, and Exercise PowerPoints: Kathleen O'Donnell, *Onondaga Community College*

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John J. Wild Ken W. Shaw Barbara Chiappetta

McGraw-Hill **CONNECT PLUS ACCOUNTING**

McGraw-Hill *Connect Plus Accounting* is a digital teaching and learning environment that gives students the means to better connect with their coursework, with their instructors, and with the important concepts they will need to know for success now and in the future. With *Connect Plus Accounting*, instructors can easily deliver assignments, quizzes, and tests online. Students can review course material and practice important skills.

McGraw-Hill *Connect Plus Accounting* provides all of the following learning and teaching resources:

- SmartBook, powered by LearnSmart
- SmartBook Achieve
- Auto-graded online homework
- General ledger problems
- Auto-graded Excel simulations
- Interactive Presentations
- Guided Examples

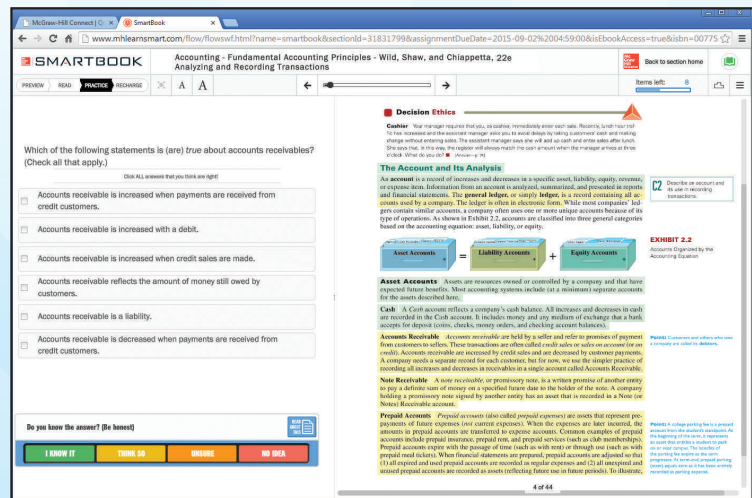
In short, *Connect Plus Accounting* offers students powerful tools and features that optimize their time and energy, enabling them to focus on learning.

SmartBook, Powered by LearnSmart

SMARTBOOK LearnSmart™ is the market-leading adaptive study resource that is proven to strengthen memory recall, increase class retention, and boost grades. LearnSmart allows students to study more efficiently because they are made aware of what they know and don't know.

SmartBook™, which is powered by LearnSmart, is the first and only adaptive reading experience designed to change the way students read and learn. It creates a personalized reading experience by highlighting the most impactful concepts a student needs to learn at that moment in time. As a student engages with SmartBook, the reading experience continuously adapts by highlighting content based on what the student knows and doesn't know. This ensures that the focus is on the content he or she needs to learn, while simultaneously promoting long-term retention of material.

Use SmartBook's real-time reports to quickly identify the concepts that require more attention from individual students—or the entire class. The end result? Students are more engaged with course content, can better prioritize their time, and come to class ready to participate.



SmartBook Achieve

SmartBook Achieve™—a revolutionary study and learning experience—pinpoints an individual student's knowledge gaps and provides targeted, interactive learning help at the moment of need. The rich, dynamic learning resources delivered in that moment of need help students learn the material, retain more knowledge, and earn better grades. The program's continuously adaptive learning path ensures that every minute a student spends with Achieve is returned as the most value-added minute possible.

Tailored to You.

Online Assignments

Connect Plus Accounting helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. *Connect Plus* grades homework automatically and gives immediate feedback on any questions students may have missed. Our assignable, gradable end-of-chapter content includes a general journal application that looks and feels more like what you would find in a general ledger software package. Also, select questions have been redesigned to test students' knowledge more fully. They now include tables for students to work through rather than requiring that all calculations be done off-line. McGraw-Hill's redesigned student interface provides a real-world feel to interactive assignments and end-of-chapter assessment content. This robust accounting software allows for flexibility in learning styles and provides opportunities for courses to be delivered in traditional, online, and blended settings.

General Ledger Problems

New General Ledger problems for select questions enable students to see how transactions post from the general journal all the way through the financial statements. It provides a much-improved experience for students working with accounting cycle questions. Students' work in the general journal is automatically posted to the ledger, navigation is much simpler, scrolling is no longer an issue, and students can easily link back to their original entries simply by clicking the ledger if edits are needed. Many questions now have critical thinking components added, to maximize students' foundational knowledge of accounting concepts and principles.

The screenshot displays the 'connect+' Accounting 101 interface. It shows a 'Balance Sheet Assignment' with a question about a consulting firm named 'Real Answers'. Below the question is a table of account balances as of October 31. The user is instructed to prepare an October 31 balance sheet. The interface shows a 'REAL ANSWERS Balance Sheet As of October 31' with columns for Assets and Liabilities. The Assets side includes Cash (\$11,360), Accounts receivable (14,000), Office supplies (3,250), Land (48,000), Office equipment (18,000), and Accounts payable (8,500). The Liabilities side includes Cash withdrawals by owner (\$2,000), Consulting fees earned (14,000), Rent expense (3,550), Salaries expense (7,000), Telephone expense (750), and Miscellaneous expenses (580). Below this, a 'General Ledger Account' is shown for 'Cash' and 'Accounts receivable - Art', with columns for Date, Debit, Credit, and Balance. The 'Cash' ledger shows transactions from June 30 to July 16. The 'Accounts receivable - Art' ledger shows transactions from July 19 to July 19.

Interactive Presentations

Interactive Presentations provide engaging narratives of all chapter learning objectives in an assignable interactive online format. They follow the structure of the text and are organized to match the specific learning objectives within each chapter. While the Interactive Presentations are not meant to replace the textbook, they provide additional explanation and enhancement of material from the text chapter, allowing students to learn, study, and practice at their own pace, with instant feedback.

Guided Examples

The Guided Examples in *Connect Plus Accounting* provide a narrated, animated, step-by-step walk-through of select exercises similar to those assigned. These short presentations, which can be turned on or off by instructors, provide reinforcement when students need it most.

Excel Simulations

Simulated Excel questions, assignable within *Connect Plus Accounting*, allow students to practice their Excel skills—such as basic formulas and formatting—within the context of accounting. These questions feature animated, narrated Help and Show Me tutorials (when enabled), as well as automatic feedback and grading for both students and professors.

The screenshot shows an interactive presentation slide titled 'Receive Investment by Owner'. It includes a '1. Identify' step where the user identifies a \$15,000 cash investment by the owner. A '2. Analyze' step shows a T-account for Cash (debit) and Owner, Capital (credit), both with a balance of \$15,000. A '3. Record' step shows the journal entry: Cash (debit) 15,000 and Owner, Capital (credit) 15,000. A '4. Post' step shows the updated T-accounts. The slide also contains explanatory text about double-entry accounting and the impact of the transaction on the balance sheet.

The screenshot shows an Excel simulation with a trial balance for 'Salskins Marketing Co.' and a post-closing trial balance. The trial balance table has columns for No., Account Title, Adjusted Trial Balance, and Post-Closing Trial Balance. The post-closing trial balance table has columns for No., Account Title, and Post-Closing Trial Balance. A blue arrow points to the 'All balance sheet accounts and amounts' in the post-closing trial balance table. Below the tables, a text box states: 'The post-closing trial balance includes all balances that will appear on the balance sheet.'

The screenshot shows an Excel simulation for a 'Cost of Goods Manufactured' schedule. It includes a table with columns for 'Cost' and 'Units'. The table lists various cost components such as Raw materials (all direct), Work in process, Finished goods, and Manufacturing overhead applied. The total cost of goods manufactured is calculated as \$395,750. The simulation also includes a 'Schedule of Cost of Goods Manufactured' table with columns for 'Cost' and 'Units'.

McGraw-Hill **CONNECT PLUS ACCOUNTING** Features

Simple Assignment Management and Smart Grading

With *Connect Plus Accounting*, creating assignments is easier than ever, enabling instructors to spend more time teaching and less time managing. Simple assignment management and smart grading allow you to:

- Create and deliver assignments easily with selectable end-of-chapter questions and Test Bank items.
- Have assignments scored automatically, giving students immediate feedback on their work and side-by-side comparisons with correct answers.
- Access and review each response, manually change grades, or leave comments for students to review.
- Reinforce classroom concepts with practice assignments and instant quizzes and exams.

Student	Total 710 pts	Chapter 2 Practice 150 pts	Chapter 2 Homework 50 pts	Chapter 2 Quiz 100 pts	Chapter 3 LearnSmart 100 pts
Adani, Nikki	691.65	145.50 (97.27 %)	49.23 (98.46 %)	100.00 (100.00 %)	100.00 (100.00 %)
Augle, Mark	429.90	82.80 (55.20 %)	25.00 (50.00 %)	70.00 (70.00 %)	100.00 (100.00 %)
Banks, Gideon	601.92	131.60 (87.73 %)	21.22 (42.44 %)	90.00 (90.00 %)	100.00 (100.00 %)
Basa, Malik	697.60	148.00 (98.67 %)	50.00 (100.00 %)	100.00 (100.00 %)	100.00 (100.00 %)
Bell, George	524.30	102.50 (68.33 %)	35.00 (70.00 %)	70.00 (70.00 %)	100.00 (100.00 %)
Bhaisakheh, Janam	615.00	130.00 (86.67 %)	45.00 (90.00 %)	90.00 (90.00 %)	100.00 (100.00 %)
Binbaum, Bill	620.00	130.00 (86.67 %)	40.00 (80.00 %)	90.00 (90.00 %)	100.00 (100.00 %)
Brown, Daniel	640.71	135.00 (90.00 %)	44.71 (89.42 %)	100.00 (100.00 %)	100.00 (100.00 %)
Castaldo, Irene	610.00	130.00 (86.67 %)	40.00 (80.00 %)	80.00 (80.00 %)	100.00 (100.00 %)

Assignments	Score	Date	Submitted	Time spent (min:sec)	Date viewed
Chapter 2 LearnSmart Total Value (Points): 100.00, Average Score: 1.00 (1.00%)	0.00 (0.00%)	10/14/15 12:28:48 EDT	10/14/15 12:28:48 EDT	0:00	10/14/15 12:28:48 EDT
Chapter 2 Practice Total Value (Points): 150.00, Average Score: 145.50 (97.00%)	145.50 (97.00%)	10/13/15 05:41:44 EDT	10/13/15 05:41:44 EDT	0:11	10/14/15 11:22:04 EDT
Chapter 2 Homework Total Value (Points): 50.00, Average Score: 52.00 (104.00%)	52.00 (104.00%)	10/13/15 05:54:48 EDT	10/13/15 05:54:48 EDT	0:39	10/13/15 05:54:48 EDT
Chapter 2 Quiz Total Value (Points): 100.00, Average Score: 100.00 (100.00%)	100.00 (100.00%)	10/13/15 08:33:44 EDT	10/13/15 08:33:44 EDT	0:36	10/13/15 08:33:44 EDT
Chapter 3 LearnSmart Total Value (Points): 100.00, Average Score: 100.00 (100.00%)	100.00 (100.00%)	10/13/15 08:33:44 EDT	10/13/15 08:33:44 EDT	0:37	10/13/15 08:33:44 EDT
Chapter 3 Practice Total Value (Points): 150.00, Average Score: 140.00 (93.33%)	140.00 (93.33%)	10/13/15 05:10:48 EDT	10/13/15 05:10:48 EDT	0:10	10/13/15 05:10:48 EDT
Chapter 3 Homework Total Value (Points): 50.00, Average Score: 52.00 (104.00%)	52.00 (104.00%)	10/13/15 08:21:44 EDT	10/13/15 08:21:44 EDT	0:37	10/13/15 08:21:44 EDT
Chapter 3 Quiz Total Value (Points): 100.00, Average Score: 100.00 (100.00%)	100.00 (100.00%)	10/13/15 05:27:44 EDT	10/13/15 05:27:44 EDT	0:38	10/13/15 05:27:44 EDT

Powerful Instructor and Student Reports

Connect Plus Accounting keeps instructors informed about how each student, section, and class is performing, allowing for more productive use of lecture and office hours. The progress-tracking function enables you to:

- View scored work immediately and track individual or group performance with assignment and grade reports.
- Access an instant view of student or class performance relative to learning objectives.
- Collect data and generate reports required by many accreditation organizations, such as AACSB and AICPA.

Connect Insight

The first and only analytics tool of its kind, *Connect Insight™* is a series of visual data displays—each framed by an intuitive question—to provide at-a-glance information about how your class is doing.

Connect Insight provides a quick analysis on five key insights, available at a moment's notice from your tablet device:

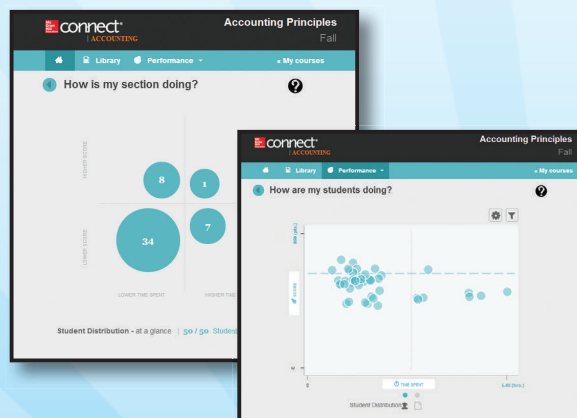
- How are my students doing?
- How are my assignments going?
- How is my section doing?
- How is this assignment going?
- How is this student doing?

Instructor Library

The *Connect Plus Accounting* Instructor Library is a repository for additional resources to improve student engagement in and out of class. You can select and use any asset that enhances your lecture. The *Connect Plus Accounting* Instructor Library includes:

- Presentation slides.
- Animated PowerPoint exhibits and exercises.
- Solutions Manual.
- Test Bank.
- Instructor's Resource Manual.

The *Connect Plus Accounting* Instructor Library also allows you to upload your own files.



For more information about *Connect Plus Accounting*, go to www.connect.mheducation.com, or contact your local McGraw-Hill Higher Education representative.

Tailored to You.

Other Technology Offered by McGraw-Hill

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Tegrity Campus is a service that makes class time available 24/7 by automatically capturing every lecture. With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio in a format that is easily searchable, frame by frame. Students can replay any part of any recorded class with easy-to-use browser-based viewing on a PC, Mac, or mobile device.

Help turn your students' study time into learning moments immediately supported by your lecture. With Tegrity Campus, you also increase intent listening and class participation by easing students' concerns about note-taking.

To learn more about Tegrity, watch a two-minute Flash demo at <http://tegritycampus.mhhe.com>.

McGraw-Hill Campus™



McGraw-Hill Campus™ is a new one-stop teaching and learning experience available to users of any learning management system. This institutional service allows faculty and students to enjoy single sign-on (SSO) access to all McGraw-Hill Higher Education materials, including the award-winning McGraw-Hill *Connect Plus* platform, from directly within the institution's website. To learn more about McGraw-Hill Campus, visit <http://mhcampus.mhhe.com>.

Custom Publishing through Create™

McGraw-Hill Create™ is a self-service website that allows instructors to create custom course materials by drawing upon McGraw-Hill's comprehensive, cross-disciplinary content. Instructors can add their own content quickly and easily and tap into other rights-secured, third-party sources as well, then arrange the content in a way that makes the most sense for their course.

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Innovative Textbook Features . . .

Using Accounting for Decisions

Whether we prepare, analyze, or apply accounting information, one skill remains essential: decision making. To help develop good decision-making habits and to illustrate the relevance of accounting, we use a pedagogical framework we call the Decision Center. This framework encompasses a variety of approaches and subject areas, giving students insight into every aspect of business decision making; see the four nearby examples for the different types of decision boxes, including those that relate to fraud. Answers to Decision Maker and Ethics boxes are at the end of each chapter.

Decision Analysis
 Current Ratio

A1 Compute the current ratio and describe what it reveals about a company's financial condition.

An important use of financial statements is to help assess a company's ability to pay its debts in the near future. Such analysis affects decisions by suppliers when allowing a company to buy on credit. It also affects decisions by creditors when lending money to a company, including loan terms such as interest rate, due date, and collateral requirements. It can also affect a manager's decisions about using cash to pay debts when they come due. The **current ratio** is one measure of a company's ability to pay its short-term obligations. It is defined in Exhibit 4.10 as current assets divided by current liabilities.


EXHIBIT 4.10
Current Ratio

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Decision Insight

Women Entrepreneurs SPANX has given more than \$20 million to charity. The Center for Women's Business Research reports that women-owned businesses, such as SPANX (owner Sara Blakely in photo), are growing and that they:

- Total approximately 11 million and employ nearly 20 million workers.
- Generate \$2.5 trillion in annual sales and tend to embrace technology.
- Are philanthropic—70% of owners volunteer at least once per month.
- Are more likely funded by individual investors (73%) than venture firms (15%).



Paul Morigi/Getty Images for FORTUNE

Decision Ethics

Payables Manager As a new accounts payable manager, you are being trained by the outgoing manager. She explains that the system prepares checks for amounts net of favorable cash discounts, and the checks are dated the last day of the discount period. She also tells you that checks are not mailed until five days later, adding that "the company gets free use of cash for an extra five days, and our department looks better. When a supplier complains, we blame the computer system and the mailroom." Do you continue this payment policy? [Answers follow the chapter's Summary.]

Decision Maker

Supplier A retailer requests to purchase supplies on credit from your company. You have no prior experience with this retailer. The retailer's current ratio is 2.1, its acid-test ratio is 0.5, and inventory makes up most of its current assets. Do you extend credit? [Answers follow the chapter's Summary.]

"Authors do a good job of relating material to real-life situations and putting students in the decision-maker role."

—Morgan Rockett, Moberly Area Community College

Chapter Preview

Each chapter opens with a visual chapter preview. Students can begin their reading with a clear understanding of what they will learn and when, allowing them to stay more focused and organized along the way. Learning objective numbers highlight the location of related content.

Chapter Preview

MERCHANDISING ACTIVITIES	MERCHANDISING PURCHASES	MERCHANDISING SALES	MERCHANDISE REPORTING AND ANALYSIS
C1 Reporting income and inventory C2 Operating cycles and inventory system	P1 Accounting for: Purchase discounts Purchase returns and allowances Transportation costs	P2 Accounting for: Sales of merchandise Sales discounts Sales returns and allowances	P3 Adjusting and closing for merchandisers P4 Multiple-step and single-step income statements A1 Acid-test analysis A2 Gross margin analysis

Learning Objectives

CONCEPTUAL C1 Explain the steps in processing transactions and the role of source documents. C2 Describe an account and its use in recording transactions. C3 Describe a ledger and a chart of accounts.	C4 Define <i>debits</i> and <i>credits</i> and explain double-entry accounting. ANALYTICAL A1 Analyze the impact of transactions on accounts and financial statements. A2 Compute the debt ratio and describe its use in analyzing financial condition.	PROCEDURAL P1 Record transactions in a journal and post entries to a ledger. P2 Prepare and explain the use of a trial balance. P3 Prepare financial statements from business transactions.
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CAP Model

The Conceptual/Analytical/Procedural (CAP) Model allows courses to be specially designed to meet the teaching needs of a diverse faculty. This model identifies learning objectives, textual materials, assignments, and test items by C, A, or P, allowing different instructors to teach from the same materials, yet easily customize their courses toward a conceptual, analytical, or procedural approach (or a combination thereof) based on personal preferences.

Bring Accounting to Life

NEED-TO-KNOW 1-5 Prepare the (a) income statement, (b) statement of owner's equity, and (c) balance sheet, for **Apple** using the following condensed data from its fiscal year ended September 28, 2013. (All \$ are in millions.)

Financial Statements

Accounts payable	\$ 22,367	Investments and other assets	\$163,042
Other liabilities	61,084	Land and equipment	16,597
Cost of sales and other expenses	119,724	Selling and other expenses	14,149
Cash	14,259	Accounts receivable	13,102
Owner, Capital, Sep. 29, 2012	118,210	Net income	37,037
Withdrawals in fiscal year 2013	31,698	Owner, Capital, Sep. 28, 2013	123,549
Revenues	170,910		

Solution

APPLE	
Income Statement	
For Fiscal Year Ended September 28, 2013	
Revenues	\$170,910
Expenses	
Cost of sales and other expenses	119,724
Selling and other expenses	15,149

Need-to-Know Illustrations

New in this edition are several Need-to-Know illustrations located at key junctures in each chapter. These illustrations pose questions about the material just presented—content that students “need to know” to successfully learn accounting. Accompanying solutions walk students through key procedures and analysis necessary to be successful with homework and test materials. Need-to-Know illustrations are supplemented with narrated, animated, step-by-step walk-through videos led by an instructor and available via *Connect Plus*.

Global View

The Global View section explains international accounting practices relating to the material covered in that chapter. The aim of this section is to describe accounting practices and to identify the similarities and differences in international accounting practices versus those in the United States. As we move toward global convergence in accounting practices, and as we witness the likely convergence of U.S. GAAP to IFRS, the importance of student familiarity with international accounting grows. This innovative section helps us begin down that path. This section is purposefully located at the end of each chapter so that each instructor can decide what emphasis, if at all, is to be assigned to it.



GLOBAL VIEW

This section discusses similarities and differences between U.S. GAAP and IFRS regarding the recognition, measurement, and disposition of receivables.

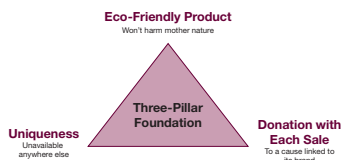
Recognition of Receivables Both U.S. GAAP and IFRS have similar asset criteria that apply to recognition of receivables. Further, receivables that arise from revenue-generating activities are subject to broadly similar criteria for U.S. GAAP and IFRS. Specifically, both refer to the realization principle and an earnings process. The realization principle under U.S. GAAP implies an *arm's-length transaction* occurs, whereas under IFRS this notion is applied in terms of reliable measurement and likelihood of economic benefits. Regarding U.S. GAAP's reference to an earnings process, IFRS instead refers to risk transfer and ownership reward. While these criteria are broadly similar, differences do exist, and they arise mainly from industry-specific guidance under U.S. GAAP, which is very limited under IFRS.

Valuation of Receivables Both U.S. GAAP and IFRS require that receivables be reported net of estimated uncollectibles. Further, both systems require that the expense for estimated uncollectibles be recorded in the same period when any revenues from those receivables are recorded. This means that for accounts receivable, both U.S. GAAP and IFRS require the allowance method for uncollectibles (unless uncollectibles are immaterial). The allowance method using percent of sales, percent of receivables, and aging was explained in this chapter. **Nokia** reports the following for its allowance for uncollectibles:

NOKIA

Management specifically analyzes accounts receivables and historical bad debt, customer concentrations, customer creditworthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance.

Sustainability and Accounting The founders of **Proof Eyewear**, as introduced in this chapter's opening feature, assert that “sustainability is a key test in every product decision . . . it has to have an aspect of sustainability to it or we just won't develop it.” This level of commitment to sustainability is impressive. The founders also impose a “three-pillar foundation” in everything they do, which is graphically portrayed below. Some of their recent activities include: (1) planting a tree for each pair of sunglasses sold on Earth Day, (2) financing a portion of sight-saving surgeries for each pair of frames purchased, (3) using only wood from sustainably managed forests and rejecting endangered wood, and (4) contributing to reforestation efforts.



Sustainability and Accounting

New in this edition are brief sections that highlight the importance of sustainability within the broader context of global accounting (and accountability). Companies increasingly address sustainability in their public reporting and consider the sustainability accounting standards (from the Sustainability Accounting Standards Board) and the expectations of our global society. These boxes, located near the end of the Global View section, cover different aspects of sustainability, often within the context of the chapter's featured entrepreneurial company.

“High-quality book that provides coverage of essential content to aid student learning in a manner that students understand.”

—Steve Ludwig, Northwest Missouri State University

Outstanding Assignment Material . . .

Once a student has finished reading the chapter, how well he or she retains the material can depend greatly on the questions, exercises, and problems that reinforce it. This book leads the way in comprehensive, accurate assignments.

Comprehensive Need-to-Know Problems present both a problem and a complete solution, allowing students to review the entire problem-solving process and achieve success.

Chapter Summaries provide students with a review organized by learning objectives. Chapter Summaries are a component of the CAP model (see page x), which recaps each conceptual, analytical, and procedural objective.

Water Sports Company (WSC) patented and successfully test-marketed a new product. To expand its ability to produce and market the new product, WSC needs to raise \$800,000 of financing. On January 1, 2015, the company obtained the money in two ways:

NEED-TO-KNOW
COMPREHENSIVE

- WSC signed a \$400,000, 10% installment note to be repaid with five equal annual installments to be made on December 31 of 2015 through 2019.
- WSC issued five-year bonds with a par value of \$400,000. The bonds have a 12% annual contract rate and pay interest on June 30 and December 31. The bonds' annual market rate is 10% as of January 1, 2015.

Required

- For the installment note, (a) compute the size of each annual payment, (b) prepare an amortization table such as Exhibit 14.14, and (c) prepare the journal entry for the first payment.
 - For the bonds, (a) compute their issue price; (b) prepare the January 1, 2015, journal entry to record their issuance; (c) prepare an amortization table using the straight-line method; (d) prepare the June 30, 2015, journal entry to record the first interest payment; and (e) prepare a journal entry to record retiring the bonds at a \$416,000 call price on January 1, 2017.
- 3P Redo parts 2(c), 2(d), and 2(e) assuming the bonds are amortized using the effective interest method.

PLANNING THE SOLUTION

- For the installment note, divide the borrowed amount by the annuity factor (from Table B.3) using the 10% rate and five payments to compute the amount of each payment. Prepare a table similar to Exhibit 14.14 and use the numbers in the table's first line for the journal entry.
- Compute the bonds' issue price by using the market rate to find the present value of their cash flows (use tables found in Appendix B). Then use this result to record the bonds' issuance. Next, prepare an amortization table like Exhibit 14.11 (and Exhibit 14B.2) and use it to get the numbers needed for the journal entry. Also use the table to find the carrying value as of the date of the bonds' retirement that you need for the journal entry.

SOLUTION

Part 1: Installment Note

- Annual payment = Note balance/PV Annuity factor = \$400,000/3.7908 = \$105,519 (The present value annuity factor is for five payments and a rate of 10%.)
- An amortization table for the long-term note payable follows.

Key Terms		
Account	Debit	Posting
Account balance	Debit ratio	Posting reference (PR) column
Balance column account	Double-entry accounting	Source documents
Chart of accounts	General journal	T-account
Compound journal entry	General ledger	Trial balance
Credit	Journal	Unearned revenue
Creditors	Journalizing	

Key Terms are bolded in the text and repeated at the end of the chapter. A complete glossary of key terms is available online through *Connect Plus Accounting*.

Multiple Choice Quiz		Answers at end of chapter	
1. G. Venda, owner of Venda Services, withdrew \$25,000 from the business during the current year. The entry to close the withdrawals account at the end of the year is:		a. G. Venda, Withdrawals	25,000
		G. Venda, Capital	25,000
		b. Income Summary	25,000
		G. Venda, Capital	25,000
		c. G. Venda, Withdrawals	
		Cash	

Multiple Choice Quiz questions quickly test chapter knowledge before a student moves on to complete Quick Studies, Exercises, and Problems.

QUICK STUDY
OS 3-1
Periodic reporting
C1

Choose from the following list of terms/phrases to best complete the statements below.

a. Fiscal year	d. Accounting period	g. Natural business year
b. Timeliness	e. Annual financial statements	h. Time period assumption
c. Calendar year	f. Interim financial statements	i. Quarterly statements

- _____ presumes that an organization's activities can be divided into specific time periods.
- Financial reports covering a one-year period are known as _____.
- A _____ consists of any 12 consecutive months.
- A _____ consists of 12 consecutive months ending on December 31.
- The value of information is often linked to its _____.

Quick Study assignments are short exercises that often focus on one learning objective. Most are included in *Connect Plus Accounting*. There are at least 10–15 Quick Study assignments per chapter.

Exercises are one of this book's many strengths and a competitive advantage. There are at least 10–15 per chapter, and most are included in *Connect Plus Accounting*.

EXERCISES
Exercise 4-1
Extending adjusted account balances on a work sheet
P1

These 16 accounts are from the Adjusted Trial Balance columns of a company's 10-column work sheet. In the blank space beside each account, write the letter of the appropriate financial statement column (A, B, C, or D) to which a normal account balance is extended.

A. Debit column for the Income Statement columns.	9. Accounts Receivable
B. Credit column for the Income Statement columns.	10. Accumulated Depreciation
C. Debit column for the Balance Sheet and Statement of Owner's Equity columns.	11. Office Supplies
D. Credit column for the Balance Sheet and Statement of Owner's Equity columns.	12. Insurance Expense

_____ 1. Interest Revenue	_____ 9. Accounts Receivable
_____ 2. Machinery	_____ 10. Accumulated Depreciation
_____ 3. Owner, Withdrawals	_____ 11. Office Supplies
_____ 4. Depreciation Expense	_____ 12. Insurance Expense
_____ 5. Accounts Payable	_____ 13. Interest Receivable
_____ 6. Service Fees Revenue	_____ 14. Cash
_____ 7. Owner, Capital	_____ 15. Rent Expense
_____ 8. Interest Expense	_____ 16. Wages Payable

PROBLEM SET A
Problem 2-1A
Preparing and posting journal entries; preparing a trial balance
C3 C4 A1 P1 P2

Karla Tanner opens a work sheet in its first month of operation. On April 1, Tanner invests \$25,000 in the company. These transactions in September:

_____ 1. Tanner invests \$25,000 in the company.	PROBLEM SET B
_____ 2. The company purchases office equipment valued at \$15,000.	Problem 2-1B
_____ 3. The company purchases office space. (Hint: Debit Prepaid Rent.)	Preparing and posting journal entries; preparing a trial balance
_____ 4. The company purchases office equipment and \$2,400 in office supplies.	C3 C4 A1 P1 P2
_____ 5. The company receives \$3,280 cash.	

Problem Sets A & B are proven problems that can be assigned as homework or for in-class projects. All problems are coded according to the CAP model (see page x), and Set A is included in *Connect Plus Accounting*.

Helps Students Master Key Concepts

Beyond the Numbers exercises ask students to use accounting figures and understand their meaning. Students also learn how accounting applies to a variety of business situations. These creative and fun exercises are all new or updated and are divided into sections:

- Reporting in Action
- Comparative Analysis
- Ethics Challenge
- Communicating in Practice
- Taking It to the Net
- Teamwork in Action
- Hitting the Road
- Entrepreneurial Decision
- Global Decision

Beyond the Numbers

REPORTING IN ACTION
C1 C2 A1 A2 ⓘ

APPLE

BTN 3-1 Refer to **Apple's** financial statements in Appendix A to answer the following.

1. Identify and write down the revenue recognition principle as explained in the chapter.
2. Review Apple's footnotes (in Appendix A and/or from its 10-K on its website) to discover how it applies the revenue recognition principle and when it recognizes revenue. Report what you discover.
3. What is Apple's profit margin for fiscal years ended September 28, 2013, and September 29, 2012.

Fast Forward

4. Access Apple's annual report (10-K) for fiscal years ending after September 28, 2013, at its website (Apple.com) or the SEC's EDGAR database (www.SEC.gov). Assess and compare the September 28, 2013, fiscal year profit margin to any subsequent year's profit margin that you compute.

SERIAL PROBLEM
Business Solutions
P2 P3

(This serial problem began in Chapter 1 and continues through most of the book. If previous chapter segments were not completed, the serial problem can begin at this point. It is helpful, but not necessary, to use the Working Papers that accompany the book.)

SP 4 The December 31, 2015, adjusted trial balance of Business Solutions (reflecting its transactions from October through December of 2015) follows.

No.	Account Title	Debit	Credit
101	Cash		\$ 48,372
106	Accounts receivable		5,668
126	Computer supplies		580
128	Prepaid insurance		1,665
131	Prepaid rent		825
143	Office equipment		6,000
164	Accumulated depreciation—Office equipment		\$ 400
167	Computer equipment	20,000	
168	Accumulated depreciation—Computer equipment		1,250
201	Accounts payable		1,100

Serial Problems use a continuous running case study to illustrate chapter concepts in a familiar context. The Serial Problem can be followed continuously from the first chapter or picked up at any later point in the book; enough information is provided to ensure students can get right to work.

"I have used many editions of this text and have been very happy with the text and all of the supplementary materials. The textbook is kept current, and is straightforward, and very usable by students. The online resources get better with each edition."

—Susan Cordes, Johnson County Community College

General Ledger Problems New General Ledger problems enable students to see how transactions post. Students can track an amount in any financial statement all the way back to the original journal entry. Critical thinking components then challenge students to analyze the business activities in the problem.

Using transactions from the following assignments, prepare journal entries for each transaction and identify the financial statement impact of each entry. The financial statements are automatically generated based on the journal entries recorded.

GL 2-1 Transactions from the FastForward illustration in this chapter

GL 2-2 Based on Exercise 2-9

GL 2-3 Based on Exercise 2-12

GL 2-4 Based on Problem 2-1A

Using transactions from the following assignments, record journal entries, create financial statements, and assess the impact of each transaction on financial statements.

GENERAL LEDGER PROBLEM

Available only in **Connect Plus**

connect ACCOUNTING


view transaction list view general journal


Journal Entry Worksheet


The cost of the merchandise sold to Art Co. was \$800.

Date	Account Title	Debit	Credit
Jul 19	Cost of goods sold	800	
			800
	120: Merchandise inventory		
	307: Common stock		
	700: Income summary		

The End of the Chapter Is Only the Beginning Our valuable and proven assignments aren't just confined to the book. From problems that require technological solutions to materials found exclusively online, this book's end-of-chapter material is fully integrated with its technology package.







- Quick Studies, Exercises, and Problems available in *Connect* are marked with an icon.
- Assignments that focus on global accounting practices and companies are often identified with an icon.
- Assignments that involve decision analysis are identified with an icon.

Content Revisions Enhance Learning

This edition's revisions are driven by feedback from instructors and students.

- Many new, revised, and updated assignments throughout, including serial problem and entrepreneurial assignments.
- New Need-to-Know illustrations added to each chapter, at key junctures to reinforce key topics.
- New Sustainability section for each chapter, with examples linked to the company featured in the chapter opener.
- New annual reports and comparison assignments: **Apple**, **Google**, and **Samsung**.
- New streamlined opening layout for each chapter.
- Revised art program, visual infographics, and text layout.
- Updated ratio/tool analysis, using data from well-known firms.
- New General Ledger questions added to most chapters.
- New material on International Financial Reporting Standards (IFRS).
- New and revised entrepreneurial examples and elements.
- New technology content integrated and referenced in the book.
- Revised terminology from *goods in process* to *work in process*.
- Changed the title of *Manufacturing Statement* to *Schedule of Cost of Goods Manufactured* due to its use in practice.

Chapter 1

Apple NEW opener.
Added titles to revenue and expense entries in columnar layout of transaction analysis.
Streamlined section on Dodd-Frank.
Bulleted presentation of accounting principles and fraud triangle.
Deleted world map of IFRS coverage.
Updated salary information.
New discussion of FASB and IASB convergence.
Updated return on assets for Dell.

Chapter 2

Akola Project NEW opener.
New layout showing financial statements drawn from trial balance.
New preliminary coverage of classified and unclassified balance sheets.
Changed selected numbers for FastForward.
Revised Piaggio's (IFRS) balance sheet.
Updated debt ratio section using Skechers.

Chapter 3

International Princess Project NEW opener.
Enhanced the innovative three-step process for adjusting accounts.
Changed selected numbers for FastForward.
Updated profit margin section using Limited Brands.

Chapter 4

The Naked Hippie NEW opener.
New multicolor-coded five-step layout for work sheet preparation and use.
Updated current ratio section using Limited Brands.

Chapter 5

Sseko Designs NEW opener.
Enhanced exhibit on transportation costs and FOB terms.
New T-accounts to highlight inventory flow.
Enhanced two-step process for recording merchandise sales.
Updated gross margin and quick ratios section using JCPenney.

Chapter 6

Proof Eyewear NEW opener.
Streamlined inventory presentation.
Added several new T-accounts to facilitate learning of inventory flow.
New explanatory notes added to exhibits as learning aids.
Updated inventory ratios section using Toys "R" Us.
Simplified presentation and exhibits for periodic inventory methods.

Chapter 7

Oimei Company NEW opener.
Streamlined several sections.
Updated segment analysis using Callaway Golf.

Chapter 8

Dandelion Chocolate NEW opener.
New learning notes added to bank reconciliation.
New chart for timing differences for bank reconciliation.
Updated receivables analysis using Hasbro and Mattel.

Chapter 9

Skai Blue Media NEW opener.
Enhanced three-step process for estimating allowance for uncollectibles.
New T-accounts to enhance learning of receivables.
Enhanced infographic on methods to estimate bad debts.

New notes on pros/cons of allowance vs. direct write-off.
Updated receivables analysis using Dell and HP.

Chapter 10

New Glarus Brewing Co. NEW opener.
Rearranged presentation of plant assets.
New learning notes on book value and depreciation.
Updated asset turnover analysis using Boston Beer and Molson Coors.
New goodwill example using Facebook's purchase of WhatsApp.

Chapter 11

Uncharted Play NEW opener.
Updated payroll rates to 2014.
New explanation of *Additional Medicare Tax*.
Updated FUTA rate.
Clarified bonus explanation and computations.
Enhanced payroll reports and exhibits.

Chapter 12

EcoScraps NEW opener.
New LLC example using STARZ.
New T-accounts to enhance learning of partnership capital.

Chapter 13

Alibaba Group NEW opener.
New dividend taxation information.
New learning notes for computations.
Updated PE and dividend yield ratios for Amazon and Altria.

Chapter 14

Stone + Cloth NEW opener.
New learning notes for bond interest computations.
New color highlighting for learning amortization.

New T-accounts for bond amortization.
Updated debt-to-equity analysis using Amazon.

Chapter 15

BANGS NEW opener.
New three-step process for fair value adjustment.
New learning note for investee vs. investor securities.
New Google example for comprehensive income.
Updated return analysis using Gap.

Chapter 16

LSTN NEW opener.
New infographics for operating, investing, and financing activities.
New linkage of cash flow classifications to balance sheet.
Simplified discussion of noncash investing and financing.
New, simplified preparation steps for statement of cash flows.
New, overall summary T-account for preparing statement of cash flows.
New reconstruction entries to help determine cash.
Updated cash flow analysis using Nike.
3 new Quick Studies and 3 revised Exercises.

Chapter 17

Motley Fool REVISED opener.
New companies—Apple, Google, and Samsung—throughout the text and exhibits.
New boxed discussion of the role of financial statement analysis to fight and prevent fraud.
Enhanced horizontal and vertical ratio analysis using new companies and industry data.
New analysis for segment data.

Chapter 18

SunSaluter NEW opener.

Revised discussions of the purpose of managerial accounting and cost classifications and their uses. Reduced number of cost classifications from five to three. Revised exhibit and example of direct vs. indirect costs. Added new exhibit comparing the balance sheet and income statement for different types of companies. Reduced level of detail in exhibit on income statement reporting. Revised discussion of the flow of manufacturing costs. New four-step process to illustrate the schedule of cost of goods manufactured (COGM). Added T-accounts to show the flow of costs for the COGM. Added a third column to the schedule of COGM, for enhanced presentation. Simplified exhibit on cost flows across the financial statements. New discussion of corporate social responsibility. Added 6 Quick Studies and 4 Exercises.

Chapter 19

Middleton Made Knives NEW opener.

New discussion of differences between job order and process operations. Moved discussion of job order costing for services to later in chapter. Revised/simplified discussions of cost flows and job cost sheets. Simplified journal entries for labor costs. New exhibits to show postings of product cost journal entries to general ledger accounts and to job cost sheets. Revised exhibits on materials and labor cost flows. Revised text and new exhibit on four-step process to record overhead. Revised discussion of applying overhead and recording actual overhead. Added new discussion and presentation of journal entries for indirect materials and indirect labor. Added new exhibit showing calculations for overhead applied to individual jobs. Added new exhibit on the flow of costs to general ledger accounts, the manufacturing statement, and the financial statements. Added new schedule of cost of goods manufactured exhibit. Added 2 Quick Studies and 2 Exercises.

Chapter 20

Kar's Nuts NEW opener.

Major change: Revised the overview exhibit of process operations and expanded the illustration to show *two departments*.

Major change: Combined coverage of direct labor and overhead into *conversion costs*.

Revised exhibits/examples to show fewer processes and simpler, more engaging products (tennis balls and trail mix). Added discussion, with journal entries, of transfers of costs across departments. Added discussion of multiple work in process (WIP) inventory accounts. Revised discussion of job order vs. process costing. Revised discussion, with new exhibit, on computation of equivalent units. Added conversion costs per unit to equivalent units discussion. Added a section differentiating the weighted-average and FIFO methods. New exhibit showing units transferred out and units remaining in ending work in process inventory. Added formula for computing equivalent units under the weighted-average method. Moved discussion of journal entries to later in the chapter. Revised the process costing summary report to focus on direct materials and conversion costs. Revised journal entries to show two WIP Inventory accounts and to eliminate the Factory Payroll account. Added discussion of Volkswagen's use of robotics in process operations. Revised and added Comprehensive Need-to-Knows to reflect changes in chapter (including *two processes*). New exhibits showing transfer of units and costs across departments, using T-accounts. In the FIFO method appendix:

- Added discussion of differences between FIFO and weighted-average approaches to computing equivalent units.
- Added exhibits on computing equivalent units and cost per equivalent unit under FIFO.
- Revised discussion of applying four-step process using FIFO.

Added 16 Quick Studies and 7 Exercises.

Chapter 21

Fast Yeti Custom Tees NEW opener.

Revised discussion of fixed and variable costs. Revised discussion of *relevant range*. Reorganized discussion of the high-low method as a three-step process. Enhanced exhibit on high-low method. Revised discussion of how changes in estimates affect break-even points. Revised *target income* discussion to focus on pretax income. Simplified exhibit on using the contribution margin income statement to compute sales needed for target income.

Revised discussion of sensitivity analyses, with examples of buying a new machine or increasing advertising. Added exhibit on using the contribution margin income statement in sensitivity analysis. Eliminated the *weighted-average contribution margin* method of computing multiproduct break-even. Added two exhibits on calculations of *operating leverage*. Added appendix on variable costing. Added 5 Quick Studies and 6 Exercises.

Chapter 22

Solben NEW opener.

Major change: Uses a *manufacturing company* as the example within the chapter. Budgeting for a *merchandising company* now appears in the chapter-end appendix. Shortened/tightened section on budget process and administration. Added section on the benefits of budgeting. New section on the master budget differences between manufacturers and merchandisers. Revised exhibit on the sequence of preparing the master budget for a *manufacturer*. Reformatted sales budget exhibit. Streamlined and reformatted several exhibits in Excel format. Rewrote sections on preparing the direct materials, direct labor, and factory overhead budgets. Clarified explanation of capital expenditures budget. Slightly expanded section on preparation of the cash budget. Added section on using the master budget. In appendix, added new exhibit on the master budget sequence for a merchandiser. Added 5 Quick Studies and 6 Exercises.

Chapter 23

Niner Bikes NEW opener.

Revised discussions of fixed and flexible budget performance reports. Revised several flexible budget exhibits. Revised discussion of setting standard costs. Revised discussion of computing and analyzing cost variances. Revised exhibits on computing direct materials and direct labor variances. Revised sections on analyzing materials, labor, and overhead variances. Simplified discussion of setting overhead standards. Revised discussion of computing the predetermined overhead rate.

Revised exhibits on overhead variances and overhead variance report. Revised discussion of sales variances in Decision Analysis. Added learning objective for overhead spending and efficiency variances (in appendix). In the appendix, added discussion, with an exhibit, on the standard costing income statement. Added 7 Exercises.

Chapter 24

United by Blue UPDATED opener.

Added discussion of advantages and disadvantages of decentralization. Reorganized discussion of cost, profit, and investment centers into a bulleted list, with examples using Kraft Foods Group. Revised discussion and exhibit of responsibility accounting for cost centers. Streamlined and clarified discussion and exhibits in the allocation of indirect expenses example. Added discussion of the usefulness of departmental income statements in decision making. Revised discussion of the use of return on investment and residual income in decision making. Revised example of profit margin and investment turnover calculations, using Walt Disney Company. Added 3 Quick Studies, 5 Exercises, and 1 Problem.

Chapter 25

Adafruit Industries NEW opener.

Revised separate discussions of the accounting rate of return, net present value, and internal rate of return. Updated graphic showing cost of capital estimates by industry. Revised discussion of profitability index, with new exhibit. Expanded discussion and exhibits for short-term decisions, including additional business, make or buy, scrap or rework, sell or process further, sales mix, and segment elimination. Added 11 Quick Studies and 8 Exercises.

Appendix C

Revised discussion of advantages and disadvantages of activity-based costing. Moved some end-of-chapter items out of the print book, to shorten. (All end-of-chapter assignments appear in the eBook.)

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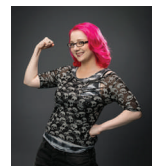
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Fundamental Accounting Principles

chapter 1

Accounting in Business

Chapter Preview

IMPORTANCE OF ACCOUNTING

- C1** Purpose of accounting
- C2** Accounting information users
Opportunities in accounting

FUNDAMENTALS OF ACCOUNTING

- C3** Ethics—key concept
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TRANSACTION ANALYSIS

- A1** Accounting equation and its components
- P1** Transaction analysis—illustrated

FINANCIAL STATEMENTS

- P2** Income statement
Statement of owner's equity
Balance sheet
Statement of cash flows
- A2** Financial analysis

*Chapter Preview is organized by key topics and includes learning objectives
Learning Objectives are classified as conceptual, analytical, or procedural*

Learning Objectives

CONCEPTUAL

- C1** Explain the purpose and importance of accounting.
- C2** Identify users and uses of, and opportunities in, accounting.
- C3** Explain why ethics are crucial to accounting.
- C4** Explain generally accepted accounting principles and define and apply several accounting principles.
- C5** *Appendix 1B*—Identify and describe the three major activities of organizations.

ANALYTICAL

- A1** Define and interpret the accounting equation and each of its components.
- A2** Compute and interpret return on assets.
- A3** *Appendix 1A*—Explain the relation between return and risk.

PROCEDURAL

- P1** Analyze business transactions using the accounting equation.
- P2** Identify and prepare basic financial statements and explain how they interrelate.



Big Apple

A **Decision Feature** launches each chapter showing the relevance of accounting for a real entrepreneur. An **Entrepreneurial Decision** assignment returns to this feature with a mini-case

CUPERTINO, CA—"When I designed the Apple stuff," says Steve Wozniak (a.k.a. the *Wizard of Woz*), "I never thought in my life I would have enough money to fly to Hawaii or make a down payment on a house." But some dreams do come true. Woz, along with Steve Jobs and Ron Wayne, founded Apple on April 1, 1976. Today, **Apple (Apple.com)** boasts a value of over \$500 billion and revenues of over \$170 billion. Along the way, the young entrepreneurs faced many challenges, including accounting issues such as how to properly read and interpret accounting data. The first challenge was how to finance the new company, which they did by selling some of their prized possessions, such as Woz's Hewlett-Packard scientific calculator and Jobs's Volkswagen van. The \$1,300 they raised helped them purchase the electronic equipment Woz used to build the first Apple computer.

In setting up their company, the two young entrepreneurs also had to decide what type of entity to form—a partnership or a corporation. They decided on a partnership, and Ron Wayne "sat down at a typewriter and typed our partnership contract right out of his head," recalls Woz. "He did an etching of Newton under the apple tree for the cover of our Apple I manual [and] he wrote the manual." The original partnership agreement included Wayne as a third partner with 10% ownership. However, a few days later, Wayne had a change of heart when he considered the unlimited liability of a partnership.

He pulled out, leaving Woz and Jobs holding 50 percent each. Within nine months, Woz and Jobs identified some advantages to the corporate form of business organization, and they converted Apple to a corporation on January 3, 1977.

As their company grew, Woz and Jobs had to learn more accounting, along with details of preparing and interpreting financial statements. Important questions involving transaction analysis and financial reporting arose, and the owners took care to do things right. "Everything we did," asserts Woz, "we were setting the tone for the world." Still, there were some doubters, including Woz's father who worried about his cash controls. "A person like him shouldn't have that much money," said his father after finding \$250,000 of uncashed checks lying around in Woz's Porsche.

Woz and Jobs tightened the accounting system and focused it on providing information for Apple's business decisions. Today, Woz believes that Apple is integral to the language of technology, just as accounting is the language of business. In retrospect, Woz says, "Every dream I have ever had in life has come true ten times over." He adds: "In the end, I hope there's a little note somewhere that says I designed a good computer."

Sources: *Woz website*, Woz.org, September 2014; *iWoz: From Computer Geek to Cult Icon*, W.W. Norton & Co., 2006; *Founders at Work*, Apress, 2007; *Apple website*, September 2014.

IMPORTANCE OF ACCOUNTING

C1

Explain the purpose and importance of accounting.

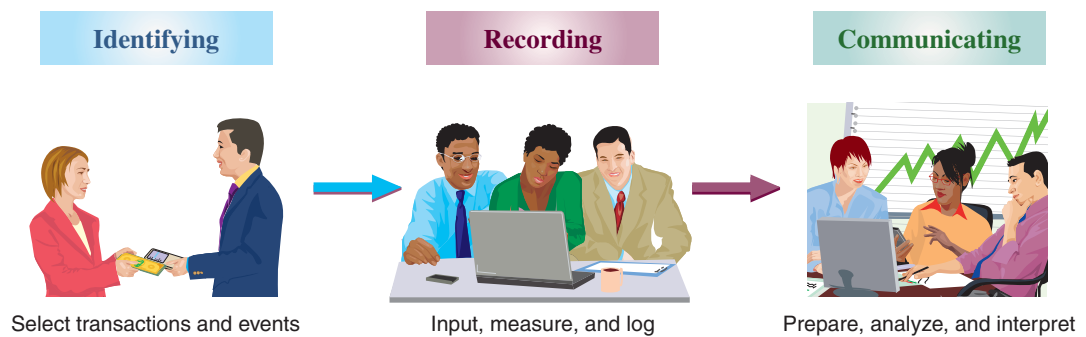
Why is accounting so popular on campus? Why are there so many openings for accounting jobs? Why is accounting so important to companies? Why do politicians and business leaders focus on accounting regulations? The answer is that we live in an information age, where that information, and its reliability, impacts us all.

Accounting is an information and measurement system that identifies, records, and communicates relevant, reliable, and comparable information about an organization's business activities. *Identifying* business activities requires that we select relevant transactions and events. Examples are the sale of iPhones by **Apple** and the receipt of ticket money by **TicketMaster**. *Recording* business activities requires that we keep a chronological log of transactions and events measured in dollars. *Communicating* business activities requires that we prepare accounting reports such as financial statements, which we analyze and interpret. (The financial statements and notes of Apple are shown in Appendix A near the end of this book. This appendix also shows the financial statements of **Google** and **Samsung**.) Exhibit 1.1 summarizes accounting activities.

Real company names are printed in bold magenta

EXHIBIT 1.1

Accounting Activities



Accounting is part of our everyday lives. Our most common contact with accounting is through credit approvals, checking accounts, tax forms, and payroll. These experiences tend to focus on the recordkeeping parts of accounting. **Recordkeeping**, or **bookkeeping**, is the recording of transactions and events, either manually or electronically. This is just one part of accounting. Accounting also identifies and communicates information on transactions and events, and it includes the crucial processes of analysis and interpretation.

Technology is a key part of modern business and plays a major role in accounting. Technology reduces the time, effort, and cost of recordkeeping while improving clerical accuracy. Some small organizations continue to perform various accounting tasks manually, but even they are impacted by technology. As technology makes more information available, the demand for accounting increases and so too the skills for applying that information. Consulting, planning, and other financial services are now closely linked to accounting. These services require sorting through data, interpreting their meaning, identifying key factors, and analyzing their implications.

Users of Accounting Information

Accounting is called the *language of business* because all organizations set up an accounting information system to communicate data to help people make better decisions. Exhibit 1.2 shows that accounting serves many users (this is a partial listing) who can be divided into two groups: external users and internal users.

External Information Users External users of accounting information are *not* directly involved in running the organization. They include shareholders (investors), lenders, directors, customers, suppliers, regulators, lawyers, brokers, and the press. External users have limited access to an organization's information. Yet their business decisions depend on information that is reliable, relevant, and comparable. **Financial accounting** is the area of accounting aimed at serving external users by providing them with *general-purpose financial statements*. The term

Point: Technology is only as useful as the accounting data available, and users' decisions are only as good as their understanding of accounting. The best software and recordkeeping cannot make up for lack of accounting knowledge.

C2

Identify users and uses of, and opportunities in, accounting.

External users



- Lenders
- Shareholders
- Governments
- Consumer groups
- External auditors
- Customers

Internal users



- Officers
- Managers
- Internal auditors
- Sales staff
- Budget officers
- Controllers

EXHIBIT 1.2
Users of Accounting Information

Infographics reinforce key concepts through visual learning

general-purpose refers to the broad range of purposes for which external users rely on these statements. Following is a partial list of external users and some decisions they make with accounting information.

- *Lenders* (creditors) loan money or other resources to an organization. Banks, savings and loans, co-ops, and mortgage and finance companies are lenders. Lenders look for information to help them assess whether an organization is likely to repay its loans with interest.
- *Shareholders* (*investors*) are the owners of a corporation. They use accounting reports in deciding whether to buy, hold, or sell stock.
- *Directors* are typically elected to a *board of directors* to oversee their interests in an organization. Since directors are responsible to shareholders, their information needs are similar.
- *External* (independent) *auditors* examine financial statements to verify that they are prepared according to generally accepted accounting principles.
- *Nonexecutive employees* and *labor unions* use financial statements to judge the fairness of wages, assess job prospects, and bargain for better wages.
- *Regulators* often have legal authority over certain activities of organizations. For example, the Internal Revenue Service (IRS) and other tax authorities require organizations to file accounting reports in computing taxes. Other regulators include utility boards that use accounting information to set utility rates and securities regulators that require reports for companies that sell their stock to the public.
- *Voters, legislators, and government officials* use accounting information to monitor and evaluate government receipts and expenses.
- *Contributors* to nonprofit organizations use accounting information to evaluate the use and impact of their donations.
- *Suppliers* use accounting information to judge the soundness of a customer before making sales on credit.
- *Customers* use financial reports to assess the staying power of potential suppliers.

Internal Information Users **Internal users** of accounting information are those directly involved in managing and operating an organization such as the chief executive officer (CEO), chief financial officer (CFO), chief audit executive (CAE), treasurer, and other executive and managerial-level employees. They use the information to help improve the efficiency and effectiveness of an organization. **Managerial accounting** is the area of accounting that serves the decision-making needs of internal users. Internal reports are not subject to the same rules as external reports and instead are designed with the special needs of internal users in mind. Following is a partial list of internal users and some decisions they make with accounting information.

- *Research and development managers* need information about projected costs and revenues of any proposed changes in products and services.
- *Purchasing managers* need to know what, when, and how much to purchase.

- *Human resource managers* need information about employees’ payroll, benefits, performance, and compensation.
- *Production managers* depend on information to monitor costs and ensure quality.
- *Distribution managers* need reports for timely, accurate, and efficient delivery of products and services.
- *Marketing managers* use reports about sales and costs to target consumers, set prices, and monitor consumer needs, tastes, and price concerns.
- *Service managers* require information on the costs and benefits of looking after products and services.

Opportunities in Accounting

Accounting information is in all aspects of our lives. When we earn money, pay taxes, invest savings, budget earnings, and plan for the future, we use accounting. Accounting has four broad areas of opportunities: financial, managerial, taxation, and accounting-related. Exhibit 1.3 lists selected opportunities in each area.

EXHIBIT 1.3

Accounting Opportunities

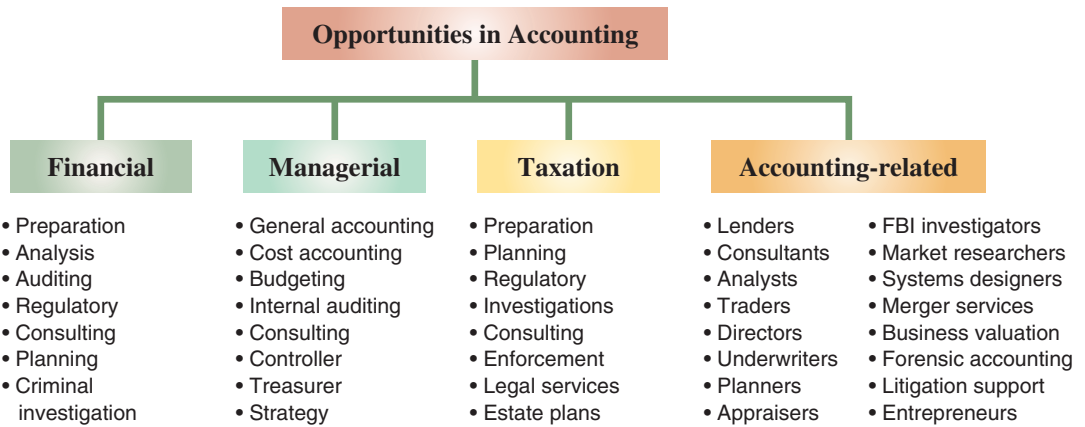
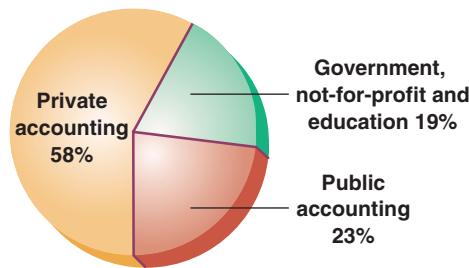


Exhibit 1.4 shows that the majority of opportunities are in *private accounting*, which are employees working for businesses. *Public accounting* offers the next largest number of opportunities, which involve services such as auditing and tax advice. Still other opportunities exist in government and not-for-profit agencies, including business regulation and investigation of law violations.

EXHIBIT 1.4

Accounting Jobs by Area



Point: The largest accounting firms are Ernst & Young, KPMG, PricewaterhouseCoopers, and Deloitte.

Margin notes further enhance textual material

Point: Census Bureau (2011) reports that for workers 25 and over, higher education yields higher average pay:

Advanced degree	\$81,568
Bachelor's degree	57,326
High school degree	36,876
No high school degree	26,124

Accounting specialists are highly regarded and their professional standing is often denoted by a certificate. Certified public accountants (CPAs) must meet education and experience requirements, pass an examination, and exhibit ethical character. Many accounting specialists hold certificates in addition to or instead of the CPA.

Two of the most common are the certificate in management accounting (CMA) and the certified internal auditor (CIA). Employers also look for specialists with designations such as certified bookkeeper (CB), certified payroll professional (CPP), personal financial specialist (PFS), certified fraud examiner (CFE), and certified forensic accountant (CrFA).

Demand for accounting specialists is strong. Exhibit 1.5 reports average annual salaries for several accounting positions. Salary variation depends on location, company size, professional designation, experience, and other factors. For example, salaries for chief financial officers (CFOs) range from under \$100,000 to more than \$1 million per year. Likewise, salaries for bookkeepers range from under \$30,000 to more than \$80,000.

Field	Title (experience)	2014 Salary	2019 Estimate*
Public Accounting	Partner	\$239,000	\$264,000
	Manager (6–8 years)	107,500	118,500
	Senior (3–5 years)	84,000	92,500
	Junior (0–2 years)	59,500	65,500
Private Accounting	CFO	282,000	311,500
	Controller/Treasurer	177,500	196,000
	Manager (6–8 years)	95,500	105,500
	Senior (3–5 years)	79,500	88,000
Recordkeeping	Junior (0–2 years)	57,000	63,000
	Full-charge bookkeeper	59,500	65,500
	Accounts manager	57,000	63,000
	Payroll manager	58,500	64,500
	Accounting clerk (0–2 years)	38,500	42,500

* Estimates assume a 2% compounded annual increase over current levels (rounded to nearest \$500).

EXHIBIT 1.5

Accounting Salaries for Selected Fields

Point: U.S. Bureau of Labor (June 2011) reports higher education is linked to a lower unemployment rate:
 Bachelor's degree or more . . . 4.4%
 High school degree 10.0%
 No high school degree 14.3%

Point: For updated salary info: Abbott-Langer.com
www.AICPA.org
Kforce.com

NEED-TO-KNOWs highlight key procedures and concepts in learning accounting

Identify the following users of accounting information as either an (a) external or (b) internal user.

- | | | |
|--------------------|---------------------------|------------------------------|
| 1. ___ Regulator | 4. ___ Controller | 7. ___ Production Manager |
| 2. ___ CEO | 5. ___ Executive Employee | 8. ___ Nonexecutive Employee |
| 3. ___ Shareholder | 6. ___ External Auditor | |

Solution

1. a 2. b 3. a 4. b 5. b 6. a 7. b 8. a

NEED-TO-KNOW 1-1

Accounting Users

C1 C2

Do More: QS 1-1, QS 1-2, E 1-1, E 1-2, E 1-3

QC1

QC icon indicates Quick Check self-review questions available in the eBook

FUNDAMENTALS OF ACCOUNTING

Accounting is guided by principles, standards, concepts, and assumptions. This section describes several of these key fundamentals of accounting.

Ethics—A Key Concept

The goal of accounting is to provide useful information for decisions. For information to be useful, it must be trusted. This demands ethics in accounting. **Ethics** are beliefs that distinguish right from wrong. They are accepted standards of good and bad behavior.

Identifying the ethical path is sometimes difficult. The preferred path is a course of action that avoids casting doubt on one's decisions. For example, accounting users are less likely to trust an auditor's report if the auditor's pay depends on the client's success. To avoid such concerns, ethics rules are often set. For example, auditors are banned from direct investment in their client and cannot accept pay that depends on figures in the client's reports. Exhibit 1.6 gives a three-step process for making ethical decisions.

C3

Explain why ethics are crucial to accounting.

Point: Sarbanes-Oxley Act requires each issuer of securities to disclose whether it has adopted a code of ethics for its senior officers and the contents of that code.

1. Identify ethical concerns



Use personal ethics to recognize an ethical concern.

2. Analyze options



Consider all good and bad consequences.

3. Make ethical decision



Choose best option after weighing all consequences.

EXHIBIT 1.6

Guidelines for Ethical Decision Making

Point: The American Institute of Certified Public Accountants' Code of Professional Conduct is available at www.AICPA.org.

Accountants face many ethical choices as they prepare financial reports. These choices can affect the price a buyer pays and the wages paid to workers. They can even affect the success of products and services. Misleading information can lead to a wrongful closing of a division that harms workers, customers, and suppliers. There is an old saying: *Good ethics are good business.*

Fraud Triangle

The fraud triangle is a model created by a criminologist that asserts the following *three* factors must exist for a person to commit fraud: opportunity, pressure, and rationalization.



- **Opportunity.** A person must envision a way to commit fraud with a low perceived risk of getting caught. Employers can directly reduce this risk. An example of some control on opportunity is a pre-employment background check.
- **Pressure,** or incentive. A person must have some pressure to commit fraud. Examples are unpaid bills and addictions.
- **Rationalization,** or attitude. A person who rationalizes fails to see the criminal nature of the fraud or justifies the action.

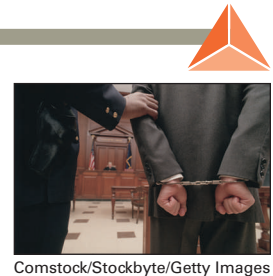
It is important to recognize that all three factors of the fraud triangle must usually exist for fraud to occur. The absence of one or more factors suggests fraud is unlikely. The key to dealing with fraud is to focus on prevention. It is less expensive and more effective to prevent fraud from happening than it is to try to detect the crime. By the time the fraud is discovered, the money is gone and chances are slim that it will be recovered. Additionally, it is costly and time-consuming to investigate a fraud.

Both internal and external users rely on internal controls to reduce the likelihood of fraud. *Internal controls* are procedures set up to protect company property and equipment, ensure reliable accounting reports, promote efficiency, and encourage adherence to company policies. Examples are good records, physical controls (locks, passwords, guards), and independent reviews.

Decision Insight

Decision Insight boxes highlight relevant items from practice

Cooking the Books Our economic and social welfare depends on reliable accounting. Some individuals forgot that and are now paying their dues. They include Tsuyoshi Kikukawa of **Olympus**, guilty of hiding \$1.7 billion in losses; Bernard Madoff of **Madoff Investment Securities**, convicted of falsifying securities records; Bernard Ebbers of **WorldCom**, convicted of an \$11 billion accounting scandal; Andrew Fastow of **Enron**, guilty of hiding debt and inflating income; and Ramalinga Raju of **Satyam Computers**, accused of overstating assets by \$1.5 billion. ■



Comstock/Stockbyte/Getty Images

C4

Explain generally accepted accounting principles and define and apply several accounting principles.

Point: State ethics codes require CPAs who audit financial statements to disclose areas where those statements fail to comply with GAAP. If CPAs fail to report noncompliance, they can lose their licenses and be subject to criminal and civil actions and fines.

Generally Accepted Accounting Principles

Financial accounting is governed by concepts and rules known as **generally accepted accounting principles (GAAP)**. We must understand these principles to best use accounting data. GAAP aims to make information *relevant*, *reliable*, and *comparable*. Relevant information affects decisions of users. Reliable information is trusted by users. Comparable information is helpful in contrasting organizations.

In the United States, the **Securities and Exchange Commission (SEC)**, a government agency, has the legal authority to set GAAP. The SEC also oversees proper use of GAAP by companies that raise money from the public through issuances of their stock and debt. Those companies that issue their stock on U.S. exchanges include both *U.S. SEC registrants* (companies incorporated in the United States) and *non-U.S. SEC registrants* (companies incorporated under non-U.S. laws). The SEC has largely delegated the task of setting U.S. GAAP to the **Financial Accounting Standards Board (FASB)**, which is a private-sector group that sets both broad and specific principles.

International Standards

In today's global economy, there is increased demand by external users for comparability in accounting reports. This demand often arises when companies wish to raise money from lenders and investors in different countries. To that end, the **International Accounting Standards Board (IASB)**, an independent group (consisting of individuals from many countries), issues **International Financial Reporting Standards (IFRS)** that identify preferred accounting practices.

If standards are harmonized, one company can potentially use a single set of financial statements in all financial markets. Differences between U.S. GAAP and IFRS are decreasing as the FASB and IASB pursue a *convergence* process aimed to achieve a single set of accounting standards for global use. More than 115 countries now require or permit companies to prepare financial reports following IFRS. Further, non-U.S. SEC registrants can use IFRS in financial reports filed with the SEC (with no reconciliation to U.S. GAAP). This means there are *two* sets of accepted accounting principles in the United States: (1) U.S. GAAP for U.S. SEC registrants and (2) either IFRS or U.S. GAAP for non-U.S. SEC registrants.

The SEC is encouraging the FASB to change U.S. GAAP over a period of several years by endorsing, and thereby incorporating, individual IFRS standards into U.S. GAAP. This *endorsement process* would still allow the FASB to modify IFRS when necessary. The SEC would:

- Maintain its statutory oversight of the FASB, including authority to prescribe accounting principles and standards for U.S. issuers.
- Contribute to oversight and governance of the IASB through its involvement on the IFRS Foundation Monitoring Board.

The FASB would continue, but its role would be to provide input and support to the IASB in crafting high-quality, global standards. The FASB is to develop a transition plan to effect these changes over the next five years or so. For updates on this roadmap, we can check with the AICPA (IFRS.com), FASB (FASB.org), and IASB (ifrs.org).

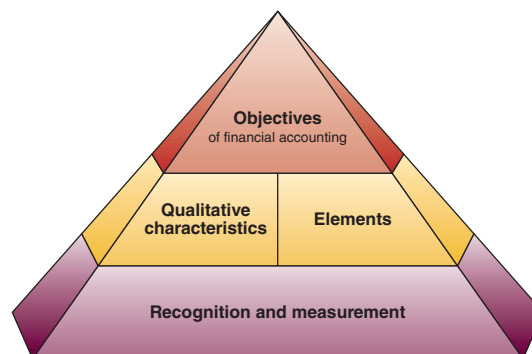
IFRS

Like the FASB, the IASB uses a conceptual framework to aid in revising or drafting new standards. However, unlike the FASB, the IASB's conceptual framework is used as a reference when specific guidance is lacking. The IASB also requires that transactions be accounted for according to their substance (not only their legal form), and that financial statements give a fair presentation, whereas the FASB narrows that scope to fair presentation *in accordance with U.S. GAAP*. ■

Conceptual Framework and Convergence

The FASB and IASB are attempting to converge and enhance the **conceptual framework** that guides standard setting. The FASB framework consists broadly of the following:

- **Objectives**—to provide information useful to investors, creditors, and others.
- **Qualitative Characteristics**—to require information that is *relevant*, *reliable*, and *comparable*.
- **Elements**—to define items that financial statements can contain.
- **Recognition and Measurement**—to set criteria that an item must meet for it to be recognized as an element; and how to measure that element.



For updates on this joint FASB and IASB conceptual framework convergence we can check the FASB.org or ifrs.org websites. We must remember that U.S. GAAP and IFRS are two similar, but not identical, systems. However, their similarities greatly outweigh any differences. The remainder of this section describes key principles and assumptions of accounting.