

Ninth Edition

Fundamental
**FINANCIAL
ACCOUNTING**
Concepts

Edmonds

Edmonds

McNair

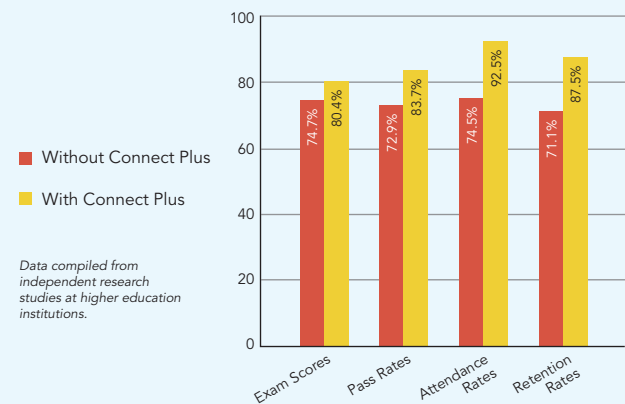
Olds

**Mc
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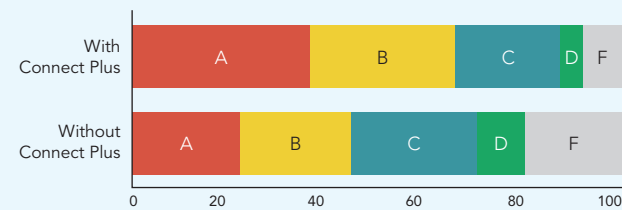
Edmonds/Edmonds/McNair/Olds: Fundamental Financial Accounting Concepts, 9e, offers a seamless content and technology solution to improve student engagement and comprehension, automation of assignments and grading, and easy reporting to ensure that learning objectives are being met.

Connect® Plus Accounting provides a wide array of tools and content to improve instructor productivity and student performance. In fact, the aggregated results of 34 Connect Plus adoptions showed an 11% improvement in pass rates, a 16% improvement in retention, two times as many students receiving an A, and a 77% reduction in instructor grading time.

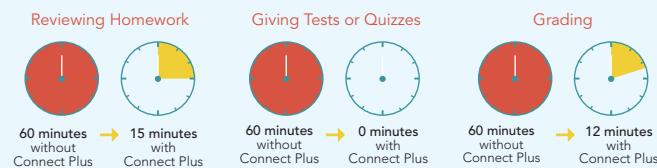
Connect Plus Performance Metrics



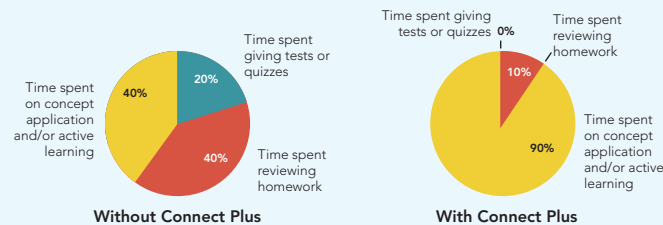
Average Grade Distribution



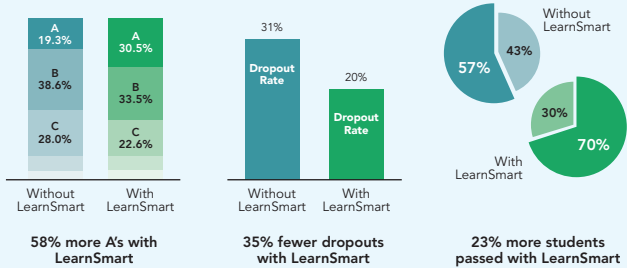
Connect Plus reduces time spent on administrative tasks...



...allowing for more time to focus on concept application and other learning.



Grade Distribution Student Retention Rate Student Pass Rate



LEARNSMART ADVANTAGE

LearnSmart®

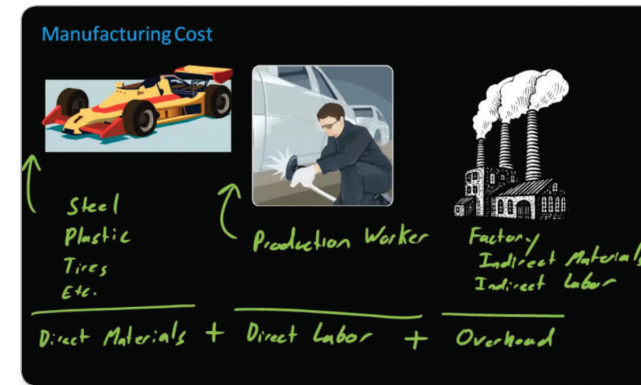
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SmartBook®

SmartBook—an extension of LearnSmart—is an adaptive eBook that helps students focus their study time more effectively. As students read, SmartBook assesses comprehension and dynamically highlights where they need to study more.



CONNECT PLUS FEATURES



Lecture Videos

Edmonds' Connect Plus Accounting Lecture Videos, new to this edition, teach each chapter's core learning objectives and concepts through an engaging, hands-on presentation, bringing the text content to life. The videos have been developed by the author team and have the touch and feel of a live lecture, as opposed to a canned presentation. Paired with self assessment questions, students can learn at their own pace. Harnessing the full power of technology to truly engage and appeal to all learning styles, the lecture videos are ideal in all class formats—online, face-to-face, flipped, and hybrid.

End-of-Chapter Material

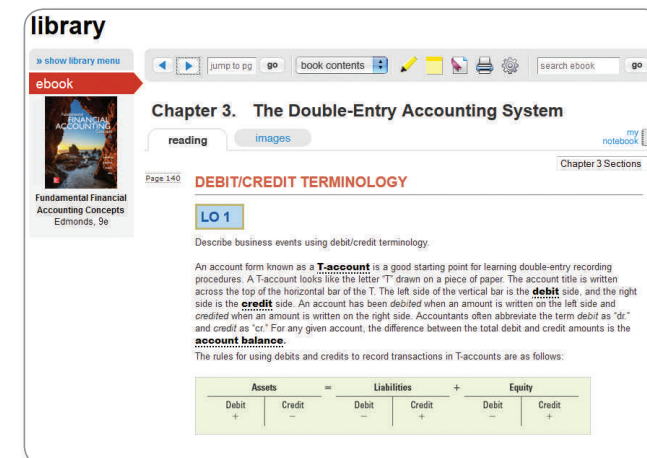
McGraw-Hill Education redesigned the student interface for our end-of-chapter assessment content. The new interface provides improved answer acceptance to reduce students' frustration with formatting issues (such as rounding), and, for select questions, provides an expanded table that guides students through the process of solving the problem. Many questions have been redesigned to more fully test students' mastery of the content.

The following information was taken from the accounts of Healthy Eats, a delicatessen, at December 31, 2014. The accounts are listed in alphabetical order, and each has a normal balance.

| | |
|-----------------------|---------|
| Accounts payable | \$1,200 |
| Accounts receivable | 800 |
| Advertising expense | 400 |
| Cash | 820 |
| Common stock | 400 |
| Cost of goods sold | 1,200 |
| Interest expense | 140 |
| Merchandise inventory | 900 |
| Prepaid rent | 80 |
| Retained earnings | 1,000 |
| Sales revenue | 2,000 |
| Salaries expense | 260 |
| Rent expense | 220 |
| Loss on sale of land | 50 |

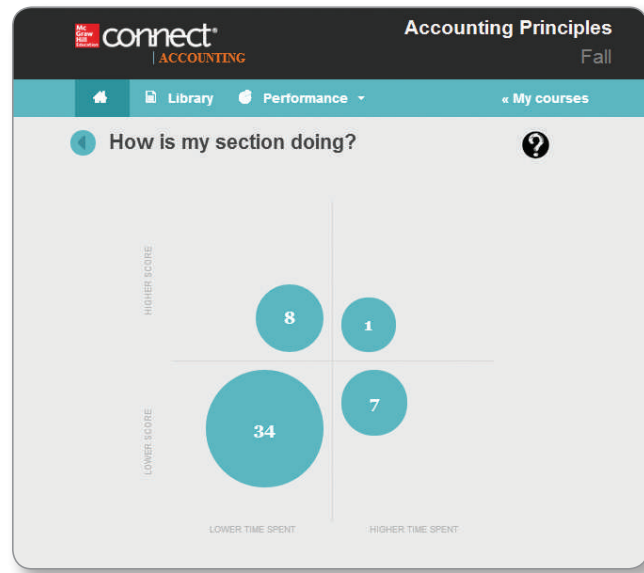
Required
Prepare an income statement for the year using the single-step and multi-step approach. (Loss amounts should be indicated by minus sign.)

| HEALTHY EATS | |
|--------------------------------------|----------|
| Single-Step Income Statement | |
| For the Year Ended December 31, 2014 | |
| Sales revenue | \$ 2,000 |
| Expenses | |
| Advertising expense | |
| Cost of goods sold | |



eBook

Connect Plus includes a media-rich eBook that allows you to share your notes with your students. Your students can insert and review their own notes, highlight the text, search for specific information, and interact with media resources. Using an eBook with Connect Plus gives your students a complete digital solution that allows them to access their materials from any computer.



Connect Insight

The first and only analytics tool of its kind, Connect Insight is a series of visual data displays that are each framed by an intuitive question and provide at-a-glance information regarding how an instructor's class is performing. Connect Insight is available through Connect or Connect Plus titles.



EASY TO USE

Learning Management System Integration

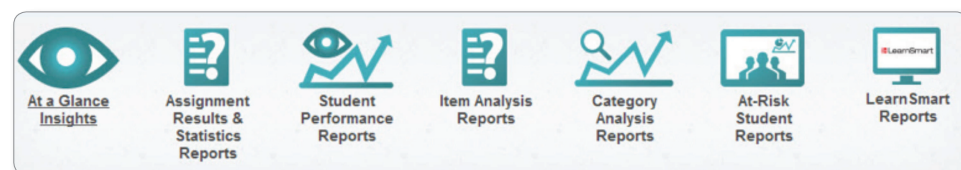
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Blackboard users also benefit from McGraw-Hill's industry-leading integration, providing single sign-on to access all Connect Plus assignments and automatic feeding of assignment results to the Blackboard grade book.



POWERFUL REPORTING

Connect Plus generates comprehensive reports and graphs that provide instructors with an instant view of the performance of individual students, a specific section, or multiple sections. Since all content is mapped to learning objectives, Connect Plus reporting is ideal for accreditation or other administrative documentation.



ninth edition

Fundamental Financial Accounting Concepts

Thomas P. Edmonds

University of Alabama–Birmingham

Christopher T. Edmonds

University of Alabama–Birmingham

Frances M. McNair

Mississippi State University

Philip R. Olds

Virginia Commonwealth University



FUNDAMENTAL FINANCIAL ACCOUNTING CONCEPTS, NINTH EDITION

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This book is printed on acid-free paper.

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This book is dedicated to our students, whose questions have so frequently caused us to reevaluate our method of presentation that they have, in fact, become major contributors to the development of this text.

NOTE FROM THE AUTHORS



● LECTURE VIDEOS: A SEA CHANGE IN INSTRUCTIONAL METHODOLOGY

We are excited to announce the availability of instructional videos that explain the content associated with every learning objective introduced throughout the text. *These videos have been developed by a member of the author team and are available when assigned through McGraw-Hill Connect Plus Accounting.* They have the touch and feel of a live lecture as opposed to a canned PowerPoint presentation. The benefits are enormous. Videos allow students to pause for contemplation and note-taking. They permit students to repeat difficult concepts or fast-forward through content they have mastered. In other words, videos enable self-paced learning. No longer is the lecture too fast for some and too slow for others. Now the lecture satisfies the needs of each individual student.

Many accounting educators have taught in professional exam prep courses that make extensive use of video lectures. Now you can bring that prep course learning approach into your everyday classroom. You can use the videos we provide to transform the traditional classroom from a passive listening exercise into an active learning experience. Here are some examples of how you can use instructional videos to improve the classroom environment.

● Flip courses

Instructional videos enable instructors to flip the traditional teaching model. Specifically, instead of providing a lecture in class and then assigning homework, *flip courses* deliver the lecture at home and use the classroom as a place for students to work problems and ask questions. The teacher's function moves from lecturer to coach and tutor. Without a requirement to deliver a lecture, the instructor is free to tutor students in small groups or individually. Instruction becomes more focused and individualized. Indeed, when coupled with *Connect*[®] technology, instructors can obtain real-time feedback that allows them to identify and approach specific students who are having difficulty without disturbing those students who are able to digest the material independently.

● Competency-based learning courses

Video instruction enables the implementation of a competency-based grading system. Since learning is self-paced, grades can be assigned on the basis of how deep students go into the content as opposed to an averaging approach. For example, content could be divided into modules. Grades could be assigned based on the number of modules completed successfully. Weaker students could repeat lower-level modules, while stronger students move on to more advanced topics. When you are no longer forced to move students through your class in a lock-step fashion, the potential for improving the learning environment is virtually limitless.

There are many different competency-based models that can be applied to introductory accounting. At this point, our objective is to introduce the general possibilities for improving learning. If you are interested in developing a specific competency-based approach for your classroom, you can speak directly with a member of the author team who has used videos in a variety of settings (contact information is provided on the following page). Standardized lesson plans that can be adapted for use in your individual classroom are available upon request.

- **Mass section courses**

Many schools deliver live lectures to mass section classes. Students then break into small groups that are led by teaching assistants or adjunct faculty. While this approach is cost-effective, it frequently results in dissatisfaction. Students often find it difficult to see and hear in large lecture halls. Also, the lecture must be set at an average pace which by its nature is too fast for many students and too slow for others. Prerecorded video lectures resolve these issues. They enable students to study the lecture before class. They can then bring questions about the lecture to the breakout sessions. Since videos eliminate the need for mass lectures, there is more time for students to meet in small groups where they are able to receive more individualized attention.

- **Distance learning courses**

One of the fastest-growing markets in higher education today is Internet-based courses. Many students struggle with these courses. Generally, they would prefer to learn from a lecture but due to timing or location are unable to attend class. Prerecorded video lectures solve this problem by allowing students to access lectures on demand. Until now, the only way to provide video coverage was for the instructor to make personal recordings. Anyone who has tried this knows it is a time-consuming activity. We offer a standardized turnkey course that is composed of prerecorded instructional videos, self-assessment quizzes, and instructor-generated evaluative exams. The instructor simply selects the learning objectives to be covered. There is no simpler way to develop a distance learning course.

- **Supplement your traditional lecture-based course**

You do not have to change the way you teach your class to reap many of the benefits available from video instruction. Students who have to miss class or who have trouble comprehending certain concepts can benefit from watching video lectures. Also, many students who attend class will be able to build confidence by watching videos that reinforce the concepts presented in class. Since the videos are tied directly to the learning objectives, you can develop a specific plan for students who are struggling with specific topics. Alternatively, you may offer video instruction to enable advanced students to cover additional topics.

These are only a few opportunities made possible by video lectures. If you would like to discuss these or other possible applications, please contact Chris Edmonds at cedmonds@gmail.com.

ABOUT THE AUTHORS



Thomas P. Edmonds

Thomas P. Edmonds, Ph.D., is Professor Emeritus in the Department of Accounting at the University of Alabama at Birmingham (UAB). He has been actively involved in teaching accounting principles throughout his academic career. Dr. Edmonds has coordinated the accounting principles courses at the University of Houston and UAB. He has taught introductory accounting in mass sections and in distance learning programs. He has received five prestigious teaching awards, including the Alabama Society of CPAs Outstanding Educator Award, the UAB President's Excellence in Teaching Award, and the distinguished Ellen Gregg Ingalls Award for excellence in classroom teaching. He has written numerous articles that have appeared in many publications, including *Issues in Accounting*, the *Journal of Accounting Education*, *Advances in Accounting Education*, *Accounting Education: A Journal of Theory, Practice and Research*, the *Accounting Review*, *Advances in Accounting*, the *Journal of Accountancy*, *Management Accounting*, the *Journal of Commercial Bank Lending*, the *Banker's Magazine*, and the *Journal of Accounting, Auditing, and Finance*. Dr. Edmonds has served as a member of the editorial board for *Advances in Accounting: Teaching and Curriculum Innovations* and *Issues in Accounting Education*. He has published five textbooks, five practice problems (including two computerized problems), and a variety of supplemental materials including study guides, work papers, and solutions manuals. Dr. Edmonds's writing is influenced by a wide range of business experience. He is a successful entrepreneur. He has worked as a management accountant for Refrigerated Transport, a trucking company. Dr. Edmonds also worked in the not-for-profit sector as a commercial lending officer for the Federal Home Loan Bank. In addition, he has acted as a consultant to major corporations, including First City Bank of Houston (now Citi Bank), AmSouth Bank in Birmingham (now Regions Bank), Texaco, and Cortland Chemicals. Dr. Edmonds began his academic training at Young Harris Community College in Young Harris, Georgia. He received a B.B.A. degree with a major in finance from Georgia State University in Atlanta, Georgia. He obtained an M.B.A. degree with a concentration in finance from St. Mary's University in San Antonio, Texas. His Ph.D. degree with a major in accounting was awarded by Georgia State University. Dr. Edmonds's work experience and academic training have enabled him to bring a unique user perspective to this textbook.



Christopher T. Edmonds

Christopher T. Edmonds is an Assistant Professor of Accounting at the University of Alabama at Birmingham (UAB). His focus is on new teaching pedagogies such as "flipping the classroom," competency learning, and online education. In his classes, students watch lectures at home and come to class to work with others and practice skills. Although early in his career, Dr. Edmonds has received multiple teaching awards and published several articles in the area of accounting education. He has written articles that appeared in *Issues in Accounting Education*, *Advances in Accounting Education*, *AIS Educators Journal*, and *Advances in Accounting*.

Frances M. McNair

Frances M. McNair holds the KPMG Peat Marwick Professorship in Accounting at Mississippi State University (MSU). She has been involved in teaching principles of accounting for the past 20 years and currently serves as the coordinator for the principles of accounting courses at MSU. Dr. McNair was selected by the Mississippi Society of CPAs as outstanding educator for 2014. She joined the MSU faculty in 1987 after receiving her Ph.D. from the University of Mississippi. The author of various articles that have appeared in the *Journal of Accountancy*, *Management Accounting*, *Business and Professional Ethics Journal*, *The Practical Accountant*, *Taxes*, and other publications, she also coauthored the book *The Tax Practitioner* with Dr. Denzil Causey. Dr. McNair is currently serving on committees of the American Taxation Association, the American Accounting Association, and the Institute of Management Accountants as well as numerous School of Accountancy and MSU committees.



Philip R. Olds

Professor Olds is Associate Professor of Accounting at Virginia Commonwealth University (VCU). He serves as the coordinator of the introduction to accounting courses at VCU. Professor Olds received his A.S. degree from Brunswick Junior College in Brunswick, Georgia (now Coastal Georgia Community College). He received a B.B.A. in accounting from Georgia Southern College (now Georgia Southern University) and his M.P.A. and Ph.D. degrees are from Georgia State University. After graduating from Georgia Southern, he worked as an auditor with the U.S. Department of Labor in Atlanta, Georgia. A former CPA in Virginia, Professor Olds has published articles in various professional journals and presented papers at national and regional conferences. He also served as the faculty adviser to the VCU chapter of Beta Alpha Psi for five years. In 1989, he was recognized with an Outstanding Faculty Vice-President Award by the national Beta Alpha Psi organization. Professor Olds has received both the Distinguished Teaching Award and the Distinguished Service Award from the VCU School of Business.



WHAT WE DID TO MAKE IT BETTER

As discussed in the “Note from the Authors” this text has been revised to include video lectures that provide coverage of all of the learning objectives included in the text. These videos have been developed by a member of the author team and have the touch and feel of a live lecture as opposed to a canned PowerPoint presentation. The videos provide unparalleled opportunities for instructional innovation including the development of flip courses, distance learning courses, and competency-based teaching. The videos can also be used in traditional courses to help students who need additional instruction. For example, students who are unable to keep up in class or who have to miss class now have a video lecture that can be used to catch up. The videos can be assigned to individual students or to the class as a whole through McGraw-Hill *Connect Plus*. The instructor has complete control over student access to video content and the accompanying self-assessment quizzes.

Specific chapter changes:

Chapter 1 An Introduction to Accounting

- Added video lectures and self-assessment quizzes for each learning objective.
- Organized coverage of the statement of cash flows into a separate learning objective.
- Revised coverage of the closing process. Developed a modular approach that allows you to skip coverage of the subject or to place greater emphasis on the topic depending on your preference.
- Revised the *Curious Accountant* feature using new high-profile companies and products.
- Updated *Focus on International Issues* textbox with new high-profile companies.
- New *Reality Bytes* content.
- Updated real-world financial statements in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 2 Accounting for Accruals and Deferrals

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives and content to more equally distribute material between Sections 1 and 2.
- Revised content to highlight the relationship between the initial transaction and the associated adjusting entries for supplies, prepaid items, and unearned revenues. The revised content also eliminated redundancies and improved clarity.
- Revised the *Curious Accountant* feature using new high-profile companies and products.
- New *Reality Bytes* content.
- Reorganized exercises and problems to match the sequence of learning objectives as presented in the chapter.
- Updated exercises, problems, and cases.

Chapter 3 The Double-Entry Accounting System

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised the *Curious Accountant* feature using new high-profile companies and products.
- Updated industry ratios and other real-world data in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 4 Accounting for Merchandising Businesses

- Added video lectures and self-assessment quizzes for each learning objective.
- Combined the learning objective associated with gains and losses with the learning objective related to the multistep income statement. Also, combined the learning objective associated with inventory shrinkage with the learning objective related to transportation cost, cash discounts, and purchase returns and allowances. Related content was moved to appropriate parts of the chapter.
- New *Reality Bytes* content.
- Updated real-world financial statements associated with *The Curious Accountant* content.
- Reorganized exercises and problems to match the sequence of learning objectives as presented in the chapter.
- Updated exercises, problems, and cases.

Chapter 5 Accounting for Inventories

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised the *Curious Accountant* feature using new high-profile companies and products.
- Updated *Focus on International Issues* content.
- Updated industry ratios and other real-world data in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 6 Internal Control and Accounting for Cash

- Added video lectures and self-assessment quizzes for each learning objective.
- New *Curious Accountant* content.
- New *Reality Bytes* content.
- Updated exercises, problems, and cases.

Chapter 7 Accounting for Receivables

- Added video lectures and self-assessment quizzes for each learning objective.
- Updated *Curious Accountant* content.
- Combined the learning objective associated with the introduction of the allowance method with the learning objective related to estimating uncollectible accounts expense using the percent of revenue method. Related content was rewritten.

- Created a separate learning objective for aging of accounts receivable.
- New *Reality Bytes* content.
- Updated industry ratios and other real-world data in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 8 Accounting for Long-Term Operational Assets

- Added video lectures and self-assessment quizzes for each learning objective.
- New *Curious Accountant* content.
- Created separate learning objectives for straight-line, double-declining-balance, and units-of-production depreciation methods. Also, created separate learning objectives for identifying and determining the cost of intangible assets versus recognizing amortization expense.
- Created a separate learning objective for aging of accounts receivable.
- Updated *Reality Bytes* content.
- Updated industry ratios and other real-world data in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 9 Accounting for Current Liabilities and Payroll

- Added video lectures and self-assessment quizzes for each learning objective.
- Updated *Curious Accountant* content.
- Updated *Reality Bytes* content.
- Updated industry ratios and other real-world data in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 10 Accounting for Long-Term Debt

- Added video lectures and self-assessment quizzes for each learning objective.
- Created separate learning objectives for the treatment of bond discounts and premiums under both the straight-line and the effective interest rate methods of amortization.
- New *Curious Accountant* content.
- Updated *Reality Bytes* content.
- Updated industry ratios and other real-world data in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 11 Proprietorships, Partnerships, and Corporations

- Added video lectures and self-assessment quizzes for each learning objective.
- Created separate learning objectives for the treatment of bond discounts and premiums under both the straight-line and the effective interest rate methods of amortization.
- Revised the *Curious Accountant* feature using new high-profile companies and products.
- New *Reality Bytes* content.
- Updated *Focus on International Issues* content.
- Updated real-world data in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 12 Statement of Cash Flows

- Added video lectures and self-assessment quizzes for each learning objective.
- New *Curious Accountant* content.
- New *Reality Bytes* content.
- Updated real-world data in *The Financial Analyst* content.
- Updated exercises, problems, and cases.

Chapter 13 Financial Statement Analysis (Available online in the *Connect Library*)

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* content.
- Reorganized exercises and problems to match the sequence of learning objectives as presented in the chapter.
- Updated exercises, problems, and cases.

HOW DOES THE BOOK

The Curious Accountant

Jason recently purchased a new Ford automobile from a dealer near his home. When he told his friend Ryan that he was able to purchase the car for \$1,000 less than the sticker price, Ryan told Jason he had gotten a lousy deal. "Everybody knows there is a huge markup on cars," Ryan said. "You could have gotten a much lower price if you'd shopped around."

Jason responded, "If there is such a big profit margin on cars, why did so many of the car manufacturers get into financial trouble?" Ryan told him that he was confusing the maker of the car with the dealer. Ryan argued that although the manufacturers may not have high profit margins, the dealers do, and told him again that he had paid too much.

Exhibit 4.1 presents the income statements for **AutoNation, Inc.** and **Ford Motor Company**. Based on these statements, do you think Ryan is right? Also, how much profit did the dealership operated by AutoNation earn on the sale of the car? (See page 236.)



● REAL-WORLD EXAMPLES

The text provides a variety of real-world examples of financial accounting as an essential part of the management process. There are descriptions of accounting practices from real organizations such as Coca-Cola, Enron, General Motors, and Amazon.com. These companies are highlighted in blue in the text.

Answers to The Curious Accountant

As data from the income statement for **AutoNation** show, automobile dealers

do not have big markups on the cars they sell. The new vehicles the company sold for \$9,949.6 million in 2013 cost the company \$9,333.2 to purchase, resulting in a gross margin of \$616.4, or 6.2 percent. In other words, if you bought an "average" car from AutoNation for \$20,000, the company's gross profit on it was only \$1,240 ($\$20,000 \times .062$), meaning it paid Ford \$18,760 ($\$20,000 - \$1,240$). Furthermore, the company still had other expenses to pay besides its cost of goods sold. In 2013, only 2.1 percent of each dollar of AutoNation's sales was net profit ($\$374.9 \div \$17,517.6$). Remember, the amount shown for sales on AutoNation's income statement is based on what customers actually paid for the cars the company sold, not the "sticker price."

Meanwhile, if Ford sold the car to AutoNation for \$18,760, it earned a 10.1 percent gross margin on the sale, or \$1,895 ($[\$14,135 - \$139,369] \div 10.1\%$; $[\$139,369 - \$125,234] \div \$14,135$) [$\$18,760 \times .101 = \$1,895$]. Like AutoNation, Ford still had other expenses to pay for besides the cost of goods sold. In 2013, Ford earned 4.9 percent of net profit on each dollar of sales ($\$7,155 \div \$146,917$).

● THE CURIOUS ACCOUNTANT

Each chapter opens with a short vignette. These pose a question about a real-world accounting issue related to the topic of the chapter. The answer to the question appears in a separate sidebar a few pages further into the chapter.

FOCUS ON INTERNATIONAL ISSUES

HOW DOES IFRS DIFFER FROM U.S. GAAP?

Chapter 1 discussed the progression toward a single global GAAP in the form of International Financial Reporting Standards (IFRS). That discussion noted that the United States does not currently allow domestic companies to use IFRS; they must follow GAAP. Let's briefly consider just how U.S. GAAP differs from IFRS.

The differences can be summarized in a few broad categories. First, some differences are relatively minor. Consider the case of bank overdrafts. Under IFRS, some bank overdrafts are included as a cash inflow and reported on the statement of cash flows. U.S. GAAP does not permit this. Conversely, some differences relate to very significant issues. Both IFRS and GAAP use historical cost as their primary method for reporting information on financial statements, but both allow exceptions in some circumstances. However, IFRS permits more exceptions to historical cost than GAAP does. Some of these differences will be discussed in later chapters.

Some of the differences affect how financial statements are presented in annual reports. IFRS requires companies to report all financial statements for the current year and the prior year—two years of comparative data. Rules of the Securities and Exchange Commission require U.S. companies to report two years of balance sheets, the current and prior year, and three years of all other financial statements.

Some of the differences affect how financial statements are presented in annual reports. IFRS requires companies to report all financial statements for the current year and the prior year—two years of comparative data. Rules of the Securities and Exchange Commission require U.S. companies to report two years of balance sheets, the current and prior year, and three years of all other financial statements.



● FOCUS ON INTERNATIONAL ISSUES

These boxed inserts expose students to IFRS and other international issues in accounting.

CORPORATE GOVERNANCE

THE FINANCIAL ANALYST

Corporate governance is the set of relationships between the board of directors, management, shareholders, auditors, and other stakeholders that determine how a company is operated. Clearly, financial analysts are keenly interested in these relationships. This section discusses the key components of corporate governance.

● THE FINANCIAL ANALYST

Financial statement analysis is highlighted in each chapter under this heading.

CHECK YOURSELF 3.1

What are the three sources of assets? Which accounts are debited and credited when a business acquires an asset?

Answer The three sources of assets are creditors, investors, and earnings. When a company acquires an asset, the asset account is debited and the source account is credited. For example, if a company earns revenue on account, the Receivables account is debited and the Revenue account is credited.

● CHECK YOURSELF

These short question/answer features occur at the end of each main topic and ask students to stop and think about the material just covered. The answer follows to provide immediate feedback before students go on to a new topic.

REALITY BYTES

Do all accounting systems require using debits and credits? The answer is a definite no. Many small businesses use a single-entry system. A checkbook constitutes a sufficient accounting system for many business owners. Deposits represent revenues, and payments constitute expenses. Many excellent automated accounting systems do not require data entry through a debit/credit recording system. QuickBooks is a good example of this type of system. Data are entered into the QuickBooks software program through a user-friendly computer interface that does not require knowledge of debit/credit terminology. Even so, the QuickBooks program produces traditional financial reports such as an income statement, balance sheet, and statement of cash flows. How is this possible? Before you become too ingrained in the debit/credit system, recall that throughout the first two chapters of this text, we illustrated accounting records without using debits and credits. Financial reports can be produced in many ways without using a double-entry system. Having recognized this point, we also note that the vast majority of medium- to large-size companies use the double-entry system. Indeed, debit/credit terminology is a part of common culture. Most people have an understanding of what is happening when a business tells them that their account is being debited or credited. It is important for you to embrace the double-entry system as well as other financial reporting systems.



● REALITY BYTES

This feature expands on the topics by showing how companies use the concepts discussed in the chapter to make real-world business decisions.

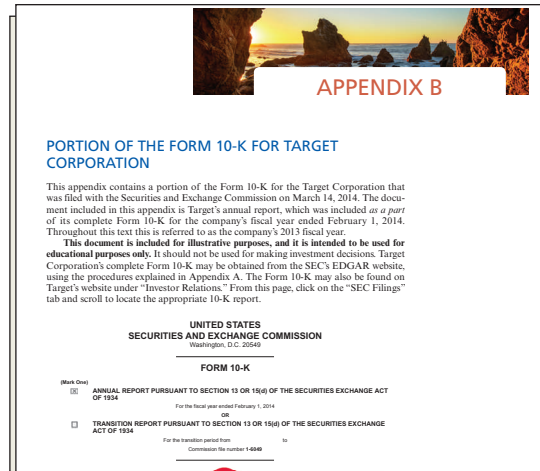
MOTIVATE STUDENTS?

● ANNUAL REPORTS

The 2013 annual report for Target Corporation is shown in Appendix B.

Business Application Problems related to the annual report are included at the end of each chapter.

A financial statement analysis project for the annual report is located in Appendix D. Also, a general purpose annual report project is included for instructors to assign for any company.



● CHAPTER FOCUS COMPANY

Each chapter introduces important managerial accounting topics within the context of a realistic company. Students see the impact of managerial accounting decisions on the company as they work through the chapter. When the Focus Company is presented in the chapter, its logo is shown so the students see its application to the text topics.

| Name and Type of Company Used as Main Chapter Example | | | |
|---|--------------------------------------|--------------|------------------------------|
| Chapter Title | Company Used as Main Chapter Example | Company Logo | Type of Company |
| 1. An Introduction to Accounting | Rustic Camp Sites | | Rents land |
| 2. Accounting for Accruals and Deferrals | Cato Consultants | | Provides training services |
| 3. The Double-Entry Accounting System | Collins Brokerage Services, Inc. | | Investment consulting firm |
| 4. Accounting for Merchandising Businesses | June's Plant Shop | | Sells gardening supplies |
| 5. Accounting for Inventories | The Mountain Bike Company | | Sells bicycles |
| 6. Internal Control and Accounting for Cash | Green Shades Resorts, Inc. | | Rents resort facilities |
| 7. Accounting for Receivables | Allen's Tutoring Services | | Provides tutoring services |
| 8. Accounting for Long-Term Operational Assets | Dryden Enterprises | | Van rental company |
| 9. Accounting for Current Liabilities and Payroll | Herrera Supply Company | | Supply company |
| 10. Accounting for Long-Term Debt | Mason Company | | Leases land |
| 11. Proprietorships, Partnerships, and Corporations | Nelson Incorporated | | Software development company |
| 12. Statement of Cash Flows | New South Corporation | | Retail gift shop |

● A LOOK BACK/A LOOK FORWARD

Students need a roadmap to make sense of where the chapter topics fit into the "whole" picture. A Look Back reviews the chapter materials and a Look Forward introduces students to what is to come.

A Look Back <<


Merchandising companies earn profits by selling inventory at prices that are higher than the cost paid for the goods. Merchandising companies include *retail companies* (companies that sell goods to the final consumer) and *wholesale companies* (companies that sell to other merchandising companies). The products sold by merchandising companies are called *inventory*. The costs to purchase inventory, to receive it, and to ready it for

>> **A Look Forward**

To this point, the text has explained the basic accounting cycle for service and merchandising businesses. Future chapters more closely address specific accounting issues. For example, in Chapter 5 you will learn how to deal with inventory items that are purchased at differing prices. Other chapters will discuss a variety of specific practices that are widely used by real-world companies.

HOW ARE CHAPTER CONCEPTS

Regardless of the instructional approach, there is no shortcut to learning accounting. Students must practice to master basic accounting concepts. The text includes a prodigious supply of practice materials and exercises and problems.


 **SELF-STUDY REVIEW PROBLEM**

A step-by-step audio-narrated series of slides is available in the Connect library.

Academy Sales Company (ASC) started the 2016 accounting period with the balances given in the financial statements model shown below. During 2016 ASC experienced the following business events.

1. Purchased \$16,000 of merchandise inventory on account, terms 2/10, n/30.
2. The goods that were purchased in Event 1 were delivered FOB shipping point. Freight costs of \$600 were paid in cash by the responsible party.
3. Returned \$500 of goods purchased in Event 1.
- 4a. Recorded the cash discount on the goods purchased in Event 1.
- 4b. Paid the balance due on the account payable within the discount period.
- 5a. Recognized \$21,000 of cash revenue from the sale of merchandise.
- 5b. Recognized \$15,000 of cost of goods sold.
6. The merchandise in Event 5a was sold to customers FOB destination. Freight costs of \$950 were paid in cash by the responsible party.
7. Paid cash of \$4,000 for selling and administrative expenses.
8. Sold the land for \$5,600 cash.

PROBLEMS—SERIES A

 All applicable Problems in Series A are available with McGraw-Hill's Connect Plus Accounting.

Problem 7-17A Accounting for uncollectible accounts: two cycles using the percent of revenue allowance method LO 7-1

The following transactions apply to Jova Company for 2016, the first year of operation:

1. Issued \$10,000 of common stock for cash.
2. Recognized \$210,000 of service revenue earned on account.
3. Collected \$162,000 from accounts receivable.
4. Paid \$125,000 cash for operating expenses.
5. Adjusted the accounts to recognize uncollectible accounts expense. Jova uses the allowance method of accounting for uncollectible accounts and estimates that uncollectible accounts expense will be 1 percent of sales on account.

The following transactions apply to Jova for 2017:

1. Recognized \$320,000 of service revenue on account.
2. Collected \$335,000 from accounts receivable.
3. Determined that \$2,150 of the accounts receivable were uncollectible and wrote them off.
4. Collected \$800 of an account that had previously been written off.
5. Paid \$205,000 cash for operating expenses.
6. Adjusted the accounts to recognize uncollectible accounts expense for 2017. Jova estimates uncollectible accounts expense will be 0.5 percent of sales on account.

Required

Complete the following requirements for 2016 and 2017. Complete all requirements for 2016 prior to beginning the requirements for 2017.

- a. Identify the type of each transaction (asset source, asset use, asset exchange, or claims exchange).
- b. Show the effect of each transaction on the elements of the financial statements, using a horizontal statements model like the one shown here. Use + for increase, - for decrease, and NA

CHECK FIGURES

- a. Ending Accounts Receivable, 2016: \$48,000
- b. Net Income, 2017: \$113,400

● SELF-STUDY REVIEW PROBLEM

These example problems include a detailed, worked-out solution and provide support for students before they work problems on their own. These review problems are included in an animated audio presentation in the *Connect Library*.

● EXERCISE SERIES A & B AND PROBLEM SERIES A & B

There are two sets of problems and exercises, Series A and B. Instructors can assign one set for homework and another set for classwork.

● Check Figures

The figures provide key answers for selected problems.

● Excel

Many problems can be solved using the Excel™ templates available in the *Connect Library*. A logo appears in the margins next to these problems.

“The self-study problems and supplements on the web are very useful for students.”

BARRY BUCHOFF,
TOWSON UNIVERSITY

“Exercises and problems are great and provide a variety as well as multiple examples for students to practice.”

PATRICIA BANCROFT,
BRIDGEWATER STATE UNIVERSITY

REINFORCED?

● ANALYZE, THINK, COMMUNICATE (ATC)

Each chapter includes an innovative section entitled Analyze, Think, Communicate (ATC). This section offers Business Applications Cases, Group Assignments, Real-World Cases, Writing Assignments, Ethical Dilemma Problems, Research Assignments, and Spreadsheet Assignments.

We use logos to help students identify the type of question being asked.



• Target Corp.



• Group Work



• Excel



• Real World Company



• Ethics



• Research



• Writing

● COMPREHENSIVE PROBLEM

Beginning in Chapter 1, a comprehensive problem builds in each successive chapter, with the ending account balances in one chapter becoming the beginning account balances in the next chapter.

● MASTERING EXCEL AND USING EXCEL

The Excel applications are used to make students comfortable with this analytical tool and to show its use in accounting.

“Lots of good exercises and problems at the end of each chapter with A and B choices.”

CAROL SHAVER,
LOUISIANA TECH UNIVERSITY

“I love the spreadsheet assignments and the comprehensive problems at the end of each chapter. I love the check figures that are available on some of the problems.”

JANE GARVIN,
IVY TECH COMMUNITY COLLEGE

ANALYZE, THINK, COMMUNICATE

ATC 2-1 Business Applications Case Understanding real-world annual reports

Required

Use the **Target Corporation** annual report in Appendix B to answer the following questions:

- Which accounts on Target's balance sheet are accrual type accounts?
- Which accounts on Target's balance sheet are deferral type accounts?
- Compare Target's *net income to its cash provided by operating activities* for the fiscal-year ended February 1, 2014 (2013). Which is larger?
- First, compare Target's 2012 net income to its 2013 net income. Next, compare Target's 2012 cash provided by operating activities to its 2013 cash provided by operating activities. Which changed the most from 2012 to 2013, net income or cash provided by operating activities?

ATC 2-2 Group Assignment Missing information

Verizon Communications, Inc., is one of the world's largest providers of communication services. The following information, taken from the company's annual reports, is available for the years 2013, 2012, and 2011:

ing those cell addresses to the respective cell in the Cash column. Notice that the formula in cell O6 (statement of cash flows) is set equal to cell B6 (cash on the balance sheet). Once the formula is completed for cell O6, it can be easily copied to cells O7 through O11.)

- Using formulas, sum each of the quantitative columns to arrive at the end-of-month amounts reported on the financial statements.

Spreadsheet Tips

- Center the heading *Balance Sheet* across columns by entering the entire heading in cell B1. Position the cursor on B1 until a fat cross appears. Click and drag the cursor across B1 through G1. Click on the Merge and Center icon (it is highlighted in the screen in the toolbar).
- Enter arithmetic signs as headings by placing an apostrophe in front of the sign. For example, to enter the equal sign in cell D4, enter '='.
- Copy cells by positioning the cursor in the bottom right corner of the cell to copy from (such as cell O6) until a thin cross appears. Click and drag the cursor down through the desired locations to copy to (through cell O11).
- To enter the dollar sign, choose Format, Cells, and Currency.

COMPREHENSIVE PROBLEM

The following information is available for Pacilio Security Services Inc. for 2011, its first year of operations. Pacilio provides security services for local sporting events.

The following summary transactions occurred during 2011:

- Acquired \$6,000 from the issue of common stock.
- Borrowed \$5,000 from the Small Business Government Agency. The loan is interest free.

- Rows and columns can be inserted by positioning the mouse on the immediate row or column after the desired position. Click on the *right* mouse button. With the *left* mouse button, choose Insert and then either Entire Column or Entire Row. Use the same method to delete columns or rows.
- Enter the sequential numbering of the adjusting entries as labels rather than values by positioning an apostrophe in front of each entry. The first adjusting entry should be labeled '(1).

ATC 3-10 Spreadsheet Assignment Mastery of Excel

At the end of the accounting period, Adams Company's general ledger contained the following adjusted balances:

| Account Titles | Adjusted Trial Balance | Corrects Entries | Ending Trial Balance |
|--------------------------|------------------------|------------------|----------------------|
| | Debit | Credit | Debit |
| Cash | 10000 | | |
| Certificate of Deposit | 10000 | | |
| Interest Receivable | 200 | | |
| Accounts Receivable | 12000 | | |
| Supplies | 1500 | | |
| Prepaid Rent | 6000 | | |
| Motor Equipment | 9000 | | |
| Accumulated Depreciation | | 1000 | |
| Accounts Payable | | 2000 | |
| Salaries Payable | | 1500 | |
| Unearned Revenue | | 2000 | |
| Common Stock | | 20000 | |
| Retained Earnings | | 0 | |
| Service Revenue | | 30000 | |
| Interest Revenue | | 200 | |
| Salaries Expense | 19000 | | |
| Rent Expense | 6000 | | |
| Utilities Expense | 150 | | |
| Supplies Expense | 600 | | |
| Depreciation Expense | 1000 | | |
| Operating Expense | 4500 | | |
| Totals | 65000 | 65000 | |

HOW CAN TECHNOLOGY HELP



● 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, their instructors, and the important concepts that they will need to know for success now and in the future. With *Connect Plus Accounting*, instructors can deliver assignments, quizzes, and tests easily online. Students can review course material and practice important skills. *Connect Plus Accounting* provides the following features:

Problem 6-25 Accounting for depreciation over multiple accounting cycles: Straight-line depreciation LO 6-3, 6-4

Zhao Company began operations when it acquired \$40,000 cash from the issue of common stock on January 1, 2014. The cash acquired was immediately used to purchase equipment for \$40,000 that had a \$4,000 salvage value and an expected useful life of four years. The equipment was used to produce the following revenue stream (assume all revenue transactions are for cash). At the beginning of the fifth year, the equipment was sold for \$4,500 cash. Zhao uses straight-line depreciation.

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|---------|---------|----------|----------|---------|------|
| Revenue | \$9,500 | \$10,000 | \$10,500 | \$8,500 | \$0 |

Required

Prepare an income statements for each of the five years. (Loss amounts should be indicated with a minus sign.)

| ZHAO COMPANY | | | | | |
|--------------------------------|----------|-----------|-----------|----------|------|
| Income Statement | | | | | |
| For the Year Ended December 31 | | | | | |
| | 2014 | 2015 | 2016 | 2017 | 2018 |
| Revenue | \$ 9,500 | \$ 10,000 | \$ 10,500 | \$ 8,500 | |
| Dep | | | | | |
| Depreciation expense | 9,500 | 10,000 | 10,500 | 8,500 | |
| Net income (loss) | | | | | |

- SmartBook and LearnSmart.
- Auto-graded Online Homework.
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- Dynamic links between the problems or questions you assign to your students and the location in the eBook where that concept is covered.
- A powerful search function to pinpoint and connect key concepts to review.

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

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

● 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.

The screenshot shows the SmartBook interface for a problem on the perpetual inventory system. On the left, there are multiple-choice options for the effect of a purchase on the balance in the inventory account. On the right, there is a text explanation of the perpetual inventory system and a table showing the effects of 2014 events on financial statements. The table includes columns for Assets, Liabilities, and Shareholders' Equity, with sub-columns for Cash, Inventory, Land, Accounts Payable, Cash Paid, and Retained Earnings.

IMPROVE STUDENT SUCCESS?

• Online assignments

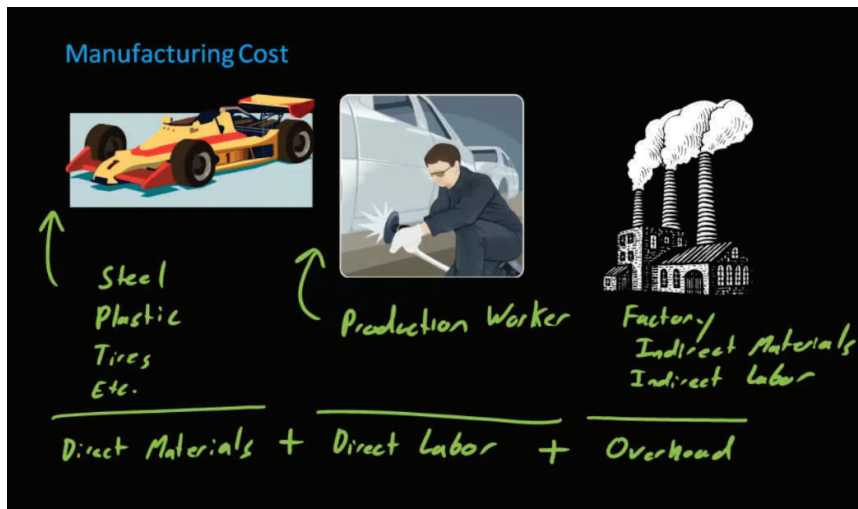
Connect Plus Accounting helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. *Connect Plus* grades homework automatically and gives immediate feedback on any questions students may have missed. Our assignable, gradable end-of-chapter content includes a general journal application that looks and feels 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 offline.

• Lecture videos

One or more lecture videos are available for every learning objective introduced throughout the text. The videos have been developed by a member of the author team and have the touch and feel of a live lecture. The videos are accompanied by a set of self-assessment quizzes. Students can watch the videos and then test themselves to determine if they understand the material presented in the video. Students can repeat the process, switching back and forth between the video and self-assessment quizzes, until they are satisfied that they understand the material.

"The Lecture Videos are outstanding for online courses and as a tutorial for face-to-face presentation."

PHILIP LITTLE, COASTAL CAROLINA UNIVERSITY



• Student Resource Library

The *Connect Plus Accounting* Student Resources give students access to additional resources such as recorded lectures, online practice materials, an eBook, and more.

1. Compute a predetermined overhead rate.
2. Prepare schedules of cost of goods manufactured and cost of goods sold.
3. Compute underapplied or overapplied overhead cost to close the balance in Manufacturing Overhead to the appropriate accounts.

| | Beginning | Ending |
|------------------------------------|-----------|-----------|
| Actual manufacturing overhead cost | | |
| Predetermined overhead rate | \$11.00 | |
| Actual direct labor hours | | 27,760 |
| Manufacturing overhead applied | | \$307,172 |

• 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 content of financial 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.

● MCGRAW-HILL *CONNECT PLUS* ACCOUNTING FEATURES

Connect Plus Accounting offers powerful tools, resources, and features to make managing assignments easier, so faculty can spend more time teaching.

Simple Assignment Management and Smart Grading With *Connect Plus Accounting*, students can engage with their coursework anytime, anywhere, making the learning process more accessible and efficient.

- 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 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, instant quizzes, and exams.

connect ACCOUNTING **Fundamental Accounting**
Accounting 101

edit assignment / set policies / review & assign

Chapter 3 Assignment rename ?

edit

15/15 questions assigned 150.00 points

add questions organize assignment view: list individually

Fundamental Managerial Accounting Concepts (Edmonds, Edmonds, Tsay, Olds, 7e) > Chapter 03: Analysis of Cost, Volume, and Pricing to Increase Profitability > Chapter 03 Problems - Static

select a different question source or create a question

filter results ? results: 9

add random selection... add (0) checked question

| questions | question type |
|--|---------------|
| Problem 3-17A Determining the break-even point and preparing a contribution margin income statement LO 3-1 | Worksheet |
| Problem 3-18A Analyzing change in sales price using the contribution margin ratio LO 3-1, 3-2 | Worksheet |
| Problem 3-19A Effect of converting variable to fixed costs LO 3-2 | Worksheet |
| Problem 3-20A Determining the break-even point and preparing a break-even graph LO 3-1, 3-3 | Worksheet |
| Problem 3-21A Margin of safety and operating leverage LO 3-4 | Worksheet |
| Problem 3-22A Analyzing sales price and fixed cost using the equation method LO 3-5 | Worksheet |

filter results + question type: select all Worksheet

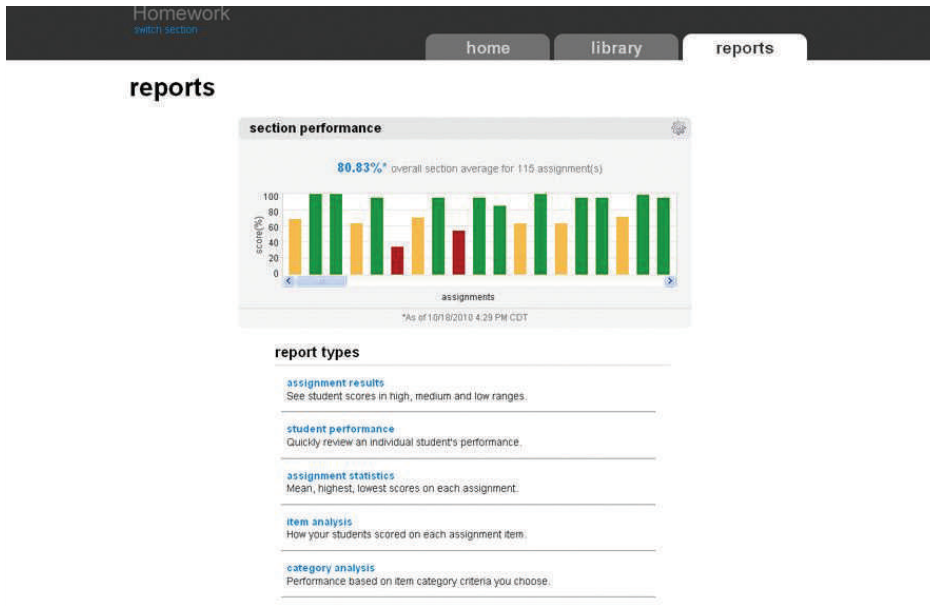
filter results + Gradable: select all automatic

filter results + AACSB AICPA Bloom's

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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 reports tab 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.

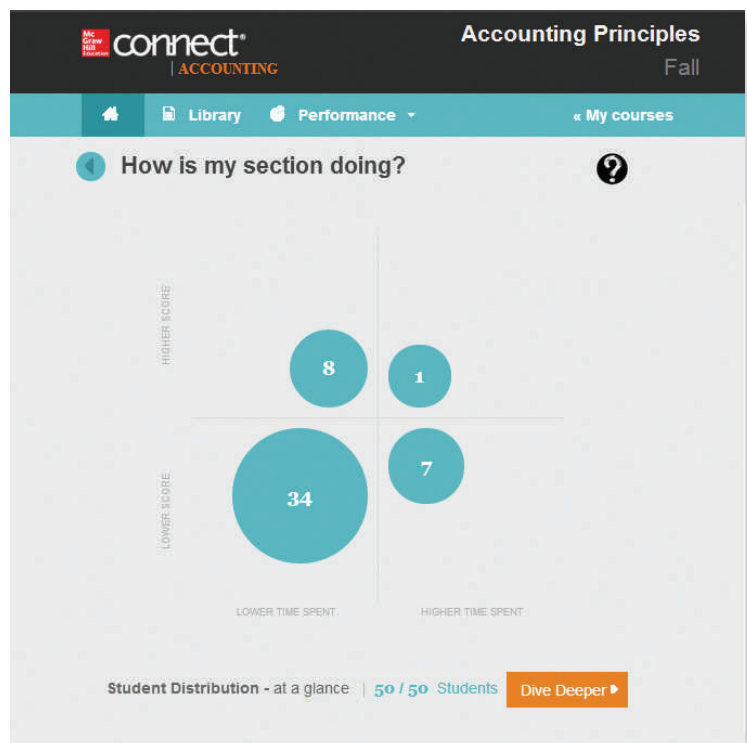


- **Connect Insight**

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 regarding how your class is doing.

Connect Insight™ provides an at-a-glance analysis on five key insights, available at a moment's notice from your tablet device.

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



• Instructor Library

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- Instructor's Manual
- Test Bank
- Instructor PowerPoint® slides
- Media-rich eBook

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| ACCOUNTING

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- bank**
create an assignment from our question banks
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record and view your lectures

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pre-made assignment collections

Explore our collections of pre-made assignments. Use them as is or edit them to create your own custom assignments

- pre-built assignments**
These assignments have been created from the end of chapter questions in your textbook. Use them as-is or edit them to create your own custom assignments.

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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 class with easy-to-use browser-based viewing on a PC, Mac, or other 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. Lecture Capture will make it more likely you will see students' faces, not the tops of their heads. To learn more about Tegrity, watch a 2-minute Flash demo at <http://tegritycampus.mhhe.com>.

- **McGraw-Hill Campus**



Campus

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SUPPLEMENTS FOR INSTRUCTORS

Assurance of Learning Ready

Many educational institutions today are focused on the notion of *assurance of learning*, an important element of many accreditation standards. *Fundamental Financial Accounting Concepts 9e* is designed specifically to support your assurance of learning initiatives with a simple, yet powerful, solution.

Each chapter in the book begins with a list of numbered learning objectives, which appear throughout the chapter as well as in the end-of-chapter assignments. Every Test Bank question for *Fundamental Financial Accounting Concepts* maps to a specific chapter learning objective in the textbook. Each Test Bank question also identifies topic area, level of difficulty, Bloom's Taxonomy level, and AICPA and AACSB skill area. You can use our Test Bank software, *EZ Test Online*, or *Connect Plus Accounting* to easily search for learning objectives that directly relate to the learning objectives for your course. You can then use the reporting features of *EZ Test* to aggregate student results in similar fashion, making the collection and presentation of Assurance of Learning data simple and easy.

AACSB Statement

McGraw-Hill/Irwin is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, *Fundamental Financial Accounting Concepts 9e* recognizes the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in the text and the Test Bank to the general knowledge and skill guidelines in the revised AACSB standards.

The statements contained in *Fundamental Financial Accounting Concepts 9e* are provided only as a guide for the users of this textbook. The AACSB

leaves content coverage and assessment within the purview of individual schools, the mission of the school, and the faculty. While *Fundamental Financial Accounting Concepts 9e* and the teaching package make no claim of any specific AACSB qualification or evaluation, we have, within the text and test bank, labeled selected questions according to the eight general knowledge and skill areas.

McGraw-Hill's *Connect Plus Accounting*



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ACCOUNTING

Connect Plus Accounting offers a number of powerful tools and

features to make managing your classroom easier. *Connect Plus Accounting* with Edmonds 9e offers enhanced features and technology to help both you and your students make the most of your time inside and outside the classroom. See page 000 for more details.

EZ Test Online

This test bank in Word format contains multiple-choice questions, essay questions, and short problems. Each test item is coded for level of difficulty, learning objective, AACSB and AICPA skill area, and Bloom's Taxonomy level.

McGraw-Hill's EZ Test Online is a flexible and easy-to-use electronic testing program that allows instructors to create tests from book-specific items. EZ Test Online accommodates a wide range of question types and allows instructors to add their own questions. Multiple versions of the test can be created and any test can be exported for use with course management systems such as BlackBoard/WebCT. EZ Test Online gives instructors a place to easily administer exams and quizzes online. The program is available for Windows and Macintosh environments.

SUPPLEMENTS FOR STUDENTS

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Study Guide

ISBN-10: 1259296784 ISBN-13: 9781259296789

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These templates allow students to develop spreadsheet skills to solve selected assignments identified by an icon in the end-of-chapter material.

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Reviewers

Stacey Adams, *Antelope Valley College*

Charles Richard Aldridge, *Western Kentucky University*

Mary Allen, *Boise State University*

Sheila Ammons, *Austin Community College*

Susan Anderson, *Appalachian State University*

Marie Archambault, *Marshall University*

Kashi Balachandran, *Stern School, New York University*

Patricia Bancroft, *Bridgewater State University*

Debra Barbeau, *Southern Illinois University-Carbondale*

Charles Baril, *James Madison University*

Beryl Barkman, *University of Massachusetts-Dartmouth*

Cheryl Bartlett, *Albuquerque TVI Community College*

Ira Bates, *Florida A&M University*

Jim Bates, *Mountain Empire Community College*

Deborah Beard, *Southeast Missouri State University*

Judy Beebe, *Western Oregon University*

Linda Bell, *William Jewell College*

Judy Benish, *Fox Valley Tech*

Debbie Benson, *Kennesaw State University*

J. Lawrence Bergin, *Winona State University*

Wilbur Berry, *Jacksonville State University*

Eddy Birrer, *Gonzaga University*

Nancy Bledsoe, *Millsaps College*

Amy Bourne, *Oregon State University*

Cendy Boyd, *Northeast Louisiana State*

Lindsey Boyer, *Central Piedmont Community College*

Arthur Boyett, *Francis Marion University*

Cassie Bradley, *Troy State University*

Rodger Brannan, *University of Minnesota, Duluth*

Roscoe Eugene Bryson, *University of Alabama in Huntsville*

Connie Buchanan, *Southwest Texas Junior College*

Barry Buchoff, *Towson University*

Georgia Buckles, *Manchester Community College*

Radie Bunn, *Southwest Missouri State University*

Jackie Burke, *Hofstra University*

Gregory Bushong, *Wright State University*

Sandra Byrd, *Missouri State University*

Judith Cadle, *Tarleton State University*

James Cahsell, *Miami University*

Scott Cairns, *Shippensburg College*

Mark Camma, *Atlantic Cape Community College*

Elizabeth Cannata, *Johnson & Wales University*

Eric Carlsen, *Kean University*

Frederic J. Carlson, *LeTourneau University*

Joan Carroll, *SUNY-College at Oswego*

Valrie Chambers, *Texas A&M University, Corpus Christi*

Bruce Chase, *Radford University*

Alan Cherry, *Loyola Marymount University*

Bea Chiang, *College of New Jersey*

Ginger Clark, *University of Cincinnati*

Paul Clikeman, *University of Richmond*

Ronald Colley, *State University of West Georgia*

Cheryl Corke, *Genesse Community College*

Samantha Cox, *Wake Technical Community College*

William Cress, *University of Wisconsin-La Cross*

Kathy Crusto-Way, *Tarrant County College Southeast*

Sue Cullers, *Tarleton State University*

Jill D'Aquila, *Iona College*

Wagih Dafashy, *College of William & Mary*

Laura DeLaune, *Louisiana State University*

Guenther Dermanelian, *Johnson & Wales University*

Robert Derstine, *Villanova University*

Walter Doehring, *Genesee Community College*

George Dow, *Valencia Community College*

Lola Dudley, *Eastern Illinois University*

Melanie Earls, *Mississippi State University*

Catherine Eason, *Queens University of Charlotte*

Alan Eastman, *Indiana University of Pennsylvania*

M. J. Edwards, *Adirondack Community College*

Susan Eldridge, *University of Nebraska, Omaha*

Terry Elliott, *Morehead State University*

Tom English, *Boise State University*

Denise English, *Boise State University*

Ruth Epps, *Virginia Commonwealth University*

Caroline Falconetti, *Nassau Community College*

John Farlin, *Ohio Dominican University*

Philip Fink, *University of Toledo*

David Fordham, *James Madison University*

Lou Fowler, *Missouri Western State College*

Ken Fowler, *San Jose State University*

Peter Frischmann, *Idaho State University*

Ralph Fritzsich, *Midwestern State University*

Mark Fronke, *Cerritos College*

Ross Fuerman, *Suffolk University*

Mary Anne Gaffney, *Temple University*

David Ganz, *University of Missouri-Saint Louis*

Michael Garner, *Salisbury State University*

Jane Garvin, *Ivy Tech Community College*

William T. Geary, *College of William and Mary*

Lucille Genduso, *Nova Southeastern University*

Frank Gersich, *Gustavus Adolphus College*

Daniel Gibbons, *Waubonsee Community College*

Claudia Gilbertson, *North Hennepin Community College*

Frank Giove, *Niagara University*

Lorraine Glasscock, *University of North Alabama*

Diane Glowacki, *Tarrant County College*

John Gould, *Western Carolina University*

Joseph Guardino, *Kingsborough Community College*

Jeffrey Haber, *Iona College*

Abo-El-Yazeed Habib, *Minnesota State University, Mankato*

Larry Hagler, *East Carolina University*

Penny Hanes, *Virginia Tech University*

Deborah Hanks, *Cardinal Stritch University*

Leon Hanouille, *Syracuse University*

Coby Harmon, *University of California, Santa Barbara*

Judith Harris, *Nova Southeastern University*

Phillip Harsha, *Southwest Missouri State University*

Charles Hart, *Copiah-Lincoln Community College*

Paul Haugen, *Wisconsin Indianhead Technical College*

Thomas Hayes, *University of Louisiana, Monroe*

Inez Heal, *Youngstown State University*

Kenneth Hildebeitel, *Villanova University*

Nitham Hindi, *Shippensburg College*

Jan Holmes, *Louisiana State University*

Bambi Hora, *University of Central Oklahoma*

M. A. Houston, *Wright State University*

Susan Hughes, *Butler University*

Kurt Hull, *California State University, Los Angeles*

Karen Hull, *Kansas Wesleyan University*

Richard Hulme, *California State Polytechnic University-Pomona*

Gary Todd Jackson, *Northeastern State University*

Sharon Jackson, *Samford University*

Agatha Jeffers, *Montclair State University*

Scott Jerris, *San Francisco State University*

Pamela Jones, *Mississippi State University*

David Juriga, *Saint Louis Community College*

Shelley Stall Kane, *Wake Technical Community College*

Khondkar Karim, *Monmouth University*

Cindi Khanlarian, *University of North Carolina Greensboro*

Bonita Kramer, *Montana State University*

Nathan Kranowski, *Radford University*

Leah Kratz, *Eastern Mennonite University*

Joan Lacher, *Nassau Community College*

Steven LaFave, *Augsburg College*

Helen LaFrancois, *University of Massachusetts-Dartmouth*

Ellen Landgraf, *Loyola University, Chicago*

Robert Landry, *Massasoit Community College*

Joseph Larkin, *Saint Joseph's University*

Laurie Larson, *Valencia Community College*

William Lathen, *Boise State University*

Doug Laufer, *Metropolitan State College of Denver*

Daniel Law, *Gonzaga University*

David Law, *Youngstown State University*

Marilynn Leathart, *John Carroll University*

Patsy Lee, *University of Texas, Arlington*

June Li, *University of Minnesota, Duluth*

William Link, *University of Missouri-Saint Louis*

Philip Little, *Coastal Carolina University*

Larry Logan, *University of Massachusetts-Dartmouth*

Patricia Lopez, *Valencia Community College*

Angelo Luciano, *Columbia College—Chicago*

James Lukawitz, *University of Memphis*

Catherine Lumbattis, *Southern Illinois University-Carbondale*

Nancy Lynch, *West Virginia University*

Mary MacAusland, *Reading Area Community College*

Mostafa Maksy, *Northeastern Illinois University*

Mary Manktelow, *James Madison University*

Joseph Marcheggiani, *Butler University*

Herb Martin, *Hope College*

Elizabeth Matz, *University of Pittsburgh, Bradford*

Alan Mayer-Sommer, *Georgetown University*

Lynn Mazzola, *Nassau Community College*

Ruth Ann McEwen, *Suffolk University*

Dwight McIntyre, *Clemson University*

Dawn McKinley, *William Rainey Harper College*

Shaen McMurtrie, *Northern Oklahoma College*

Nancy Meade, *Radford University*

Trini Melcher, *California State University, San Marcos*

Sara Melendy, *Gonzaga University*

Pam Meyer, *University of Louisiana, Lafayette*

R. L. C. Miller, *California State University, Fullerton*

Elizabeth Minbiole, *Northwood University*

Susan Minke, *Indiana University-Purdue University, Ft. Wayne*

George Minmier, *University of Memphis*

Cheryl Mitchem, *Virginia State University*

Patrick Montgomery, *University of Wisconsin, Platteville*

Lu Montondon, *Southwest Texas State University*

Gerald Motl, *Xavier University*

Elizabeth Mulig, *Columbus State University*

Steve Muller, *Valencia Community College*

Steven Muller, *Valencia Community College*

Carol Murphy, *Quinsigamond Community College*

Irvin Nelson, *Utah State University*

Bruce Neumann, *University of Colorado, Denver*

Christine Noel, *Colorado State University—Pueblo*

Tim Nygaard, *Madisonville Community College*

Ron O'Brien, *Fayetteville Technical Community College*

Brian O'Doherty, *East Carolina University*

Bruce Oliver, *Rochester Institute of Technology*

Joseph Onyeocha, *South Carolina State University*

Ashton Oravetz, *Tyler Junior College*

Stephen Owusu-Ansah, *University of Texas, Pan American*

Lawrence Ozzello, *University of Wisconsin-Eau Claire*

Eileen Peacock, *Oakland University*

Kathy Perdue, *DeVry Institute of Technology at Decatur*

Viola Persia, *SUNY Stony Brook*

Jack Peterson, *Utah State University*

Thomas Phillips, Jr., *Louisiana Tech University*

Cynthia Phipps, *Lake Land College*

Ronald Pierno, *Florida State University*

Cathy Pitts, *Highline Community College*

Atul Rai, *Wichita State University*

Mary Raven, *Mount Mary College*

Thomas Rearick, *Indiana University*

Craig Reeder, *Florida A&M University*

Jane Reimers, *Florida State University*

Ann Rich, *Quinnipiac University*

Laura Rickett, *Kent State University*

Michael Riordan, *James Madison University*

Patricia Robinson, *Johnson and Wales University*

Luther Ross, *Central Piedmont Community College*

Pamela Rouse, *Butler University*

Ann Rowell, *Central Piedmont Community College*

Ken Ruby, *Idaho State University*

Nadine Russell

P. N. Saksena, *Indiana University, South Bend*

Nancy Schneider, *Lynchburg College*

Henry Schulman, *Grossmont College*

Jeffrey Schwartz, *Montgomery College*

Joanne Segovia, *Minnesota State University, Moorhead*

Cindy Seipel, *New Mexico State University*

Suzanne Sevalstad, *University of Nevada-Las Vegas*

Kim Shaughnessy, *James Madison University*

Carol Shaver, *Louisiana Tech University*

John Shaver, *Louisiana Tech University*

Lewis Shaw, *Suffolk University*

Mary Sheil, *Kennesaw State University*

Eileen Shifflett, *James Madison University*

Nathan Slavin, *Hofstra University*

Talitha Smith, *Auburn University*

Jill Smith, *Idaho State University*

Sondra Smith, *University of West Georgia*

Nancy Snow, *University of Toledo*

Paul E. Solomon

Mary Soroko, *St. Cloud State University*

Linda Specht, *Trinity University*

John Sperry, *Virginia Commonwealth University*

Barbara Squires, *Corning Community College*

Vic Stanton, *University of California Berkeley*

Paul Steinbart, *Saint Louis University-Saint Louis*

Scott Steinkamp, *College of Lake County*

Tim Stephens, *DeVry Institute of Technology at Addison*

Mary Stevens, *University of Texas-El Paso*

Sue Stickland, *University of Texas, Arlington*

Leonard Stokes, *Siena College*

Ronald Strittmater, *North Hennepin Community College*

Gloria Stuart, *Georgia Southern University*

Janice Swanson, *Southern Oregon University*

James Swayze, *University of Nevada, Las Vegas*

Ellen Sweatt, *Georgia Perimeter College*

Jan Sweeney, *Baruch College CUNY*

Rasoul Taghizadeh, *Lexington Community College*

Bill Talbot, *Montgomery College*

Maurice Tassin, *Louisiana Tech University*

Kerri Tassin, *Missouri State University*

Steve Teeter, *Utah Valley State College*

Kim Temme, *Maryville University*

Peter Theuri, *Northern Kentucky University*

James Thompson, *Oklahoma City University*

Ada Till, *Prairie View A&M University*

Karen Turner, *University of Northern Colorado*

Suneel Udpa, *St. Mary's College of California*

Donna Ulmer, *St. Louis Community College, Meramec*

Denise Dickins Veitch, *Florida Atlantic University*

George Violette, *University of Southern Maine*

Beth Vogel, *Mount Mary College*

Sharon Walters, *Morehead State University*

Andrea Weickgenannt, *Northern Kentucky University*

J. D. Weinhold, *Concordia College*

Judith Welch, *University of Central Florida*

T. Sterling Wetzel, *Oklahoma State University, Stillwater*

Thomas Whalen, *Suffolk University*

Thomas Whitacre, *University of South Carolina*

Jennifer Wilbanks, *State Fair Community College*

Macil C. Wilkie, Jr., *Grambling State University*

Marvin Williams, *University of Houston*

Stephen Willits, *Bucknell University*

Marie Winks, *Lynchburg College*

Kenneth Winter, *University of Wisconsin-La Crosse*

Alan Winters, *Clemson University*

Gail Wright, *Bryant University*

Marjorie Yuschak, *Rutgers University*

Judith Zander, *Grossmont College*

Haiwen Zhang, *University of Minnesota*

Ping Zhon, *Baruch College*

Focus Group Participants

Mark Anderson, *University of Texas at Dallas*

Brenda Benson, *Blinn College*

Anna Marie Boulware, *St. Charles Community College*

Norris Dorsey, *California State University, Northridge*

Caroline Falconetti, *Nassau Community College*

Judith Harris, *Nova Southeastern University*

Carol Hutchinson, *AB Tech*

Douglas Larson, *Salem State College*

Joseph Lupino, *St. Mary's College of California*

Al Nagy, *John Carroll University*

Ron Pierno, *Florida State University*

Linda Poulson, *Elon University*

Atul Rai, *Wichita State University*

Gayle Richardson, *Bakersfield College*

Dwight Riley, *Richland College*

Megan Schaupp, *West Virginia University—Morgantown*

Rex Schildhouse, *Miramar College*

Virginia Smith, *Saint Mary's College of California*

Warren Smock, *Ivy Tech Community College*

Kathy Sobieralski, *University of Maryland, University College*

Rasoul Taghizadeh, *Bluegrass Community and Technical College*

LaVerne Thomas-Vertrees, *St. Louis Community College*

Al Wallace, *Owensboro Community & Technical College*

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Fundamental Financial Accounting Concepts



An Introduction to Accounting

LEARNING OBJECTIVES

After you have mastered the material in this chapter, you will be able to:

SECTION 1: COLLECTING AND ORGANIZING INFORMATION

- LO 1-1 Explain the role of accounting in society.
- LO 1-2 Construct an accounting equation and show how business events affect the equation.
- LO 1-3 Interpret information shown in an accounting equation.
- LO 1-4 Classify business events as asset source, use, or exchange transactions.

SECTION 2: REPORTING INFORMATION

- LO 1-5 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.
- LO 1-6 Prepare a statement of cash flows.
- LO 1-7 Explain the closing process.
- LO 1-8 Record business events using a horizontal financial statements model.



Video lectures and accompanying self-assessment quizzes are available for all learning objectives through McGraw-Hill Connect® Plus Accounting.

The Curious Accountant

Who owns **McDonald's**? Who owns the **American Red Cross** (ARC)? Many people and organizations other than owners are interested in the operations of McDonald's and the ARC. These parties are called *stakeholders*. Among others, they include lenders, employees, suppliers, customers, benefactors, research institutions, local governments, flood victims, lawyers, bankers, financial analysts, and government agencies such as the Internal Revenue Service and the Securities and Exchange Commission. Organizations communicate information to stakeholders through *financial reports*.

How do you think the financial reports of McDonald's differ from those of the ARC? (Answer on page 11.)



SECTION 1:

COLLECTING AND ORGANIZING INFORMATION

Why should you study accounting? You should study accounting because it can help you succeed in business. Businesses use accounting to keep score. Imagine trying to play football without knowing how many points a touchdown is worth. Like sports, business is competitive. If you do not know how to keep score, you are not likely to succeed.

Accounting is an information system that reports on the economic activities and financial condition of a business or other organization. Do not underestimate the importance of accounting information. If you had information that enabled you to predict business success, you could become a very wealthy Wall Street investor. Communicating economic information is so important that accounting is frequently called the *language of business*.

LO 1-1



Explain the role of accounting in society.

ROLE OF ACCOUNTING IN SOCIETY

How should society allocate its resources? Should we spend more to harvest food or cure disease? Should we build computers or cars? Should we invest money in IBM or General Motors? Accounting provides information that helps answer such questions.

Using Free Markets to Set Resource Priorities

Suppose you want to start a business. You may have heard “you have to have money to make money.” In fact, you will need more than just money to start and operate a business. You will likely need such resources as equipment, land, materials, and employees. If you do not have these resources, how can you get them? In the United States, you compete for resources in open markets.

A **market** is a group of people or entities organized to exchange items of value. The market for business resources involves three distinct participants: consumers, conversion agents, and resource owners. *Consumers* use resources. Resources are frequently not in a form consumers want. For example, nature provides trees but consumers want furniture. *Conversion agents* (businesses) transform resources such as trees into desirable products such as furniture. *Resource owners* control the distribution of resources to conversion agents. Thus resource owners provide resources (inputs) to conversion agents who provide goods and services (outputs) to consumers.

For example, a home builder (conversion agent) transforms labor and materials (inputs) into houses (output) that consumers use. The transformation adds value to the inputs, creating outputs worth more than the sum of the inputs. For example, a house that required \$220,000 of materials and labor to build could have a market value of \$250,000.



Common terms for the added value created in the transformation process include **profit, income, or earnings**. Accountants measure the added value as the difference between the cost of a product or service and the selling price of that product or service. The profit on the house described above is \$30,000, the difference between its \$220,000 cost and \$250,000 market value.

Conversion agents who successfully and efficiently (at low cost) satisfy consumer preferences are rewarded with high earnings. These earnings are shared with resource owners, so conversion agents who exhibit high earnings potential are more likely to compete successfully for resources.

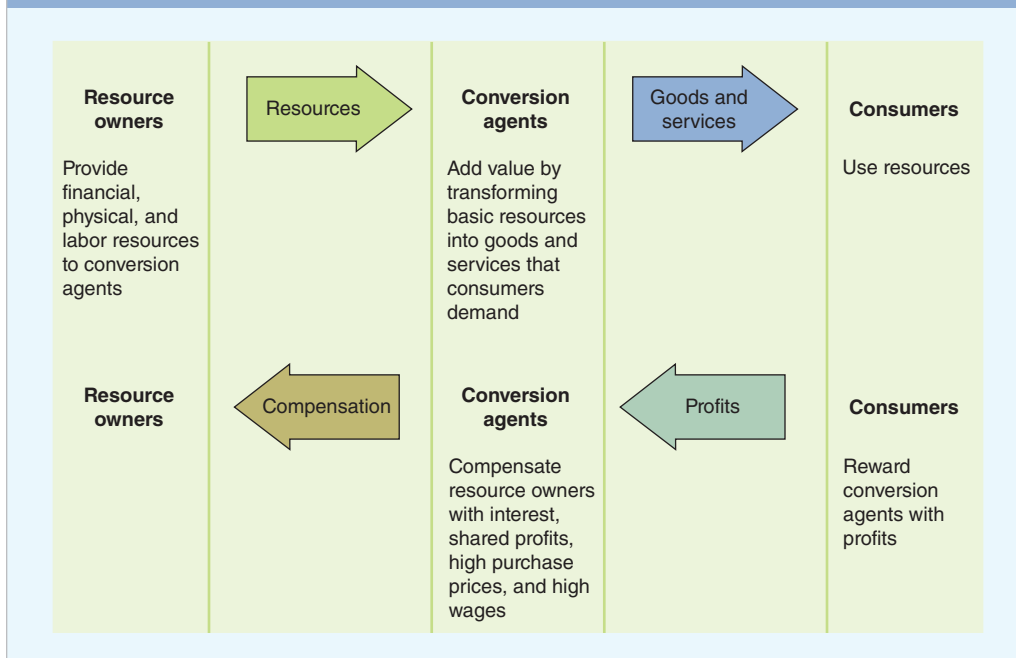
Return to the original question. How can you get the resources you need to start a business? You must go to open markets and convince resource owners that you can produce profits. Exhibit 1.1 illustrates the market trilogy involved in resource allocation.

The specific resources businesses commonly use to satisfy consumer demand are financial resources, physical resources, and labor resources.

Financial Resources

Businesses (conversion agents) need **financial resources** (money) to get started and to operate. *Investors* and *creditors* provide financial resources.

- **Investors** provide financial resources in exchange for ownership interests in businesses. Owners expect businesses to return to them a share of the business, including a portion of earned income.
- **Creditors** lend financial resources to businesses. Instead of a share of the business, creditors expect the businesses to repay borrowed resources plus a specified fee called **interest**.

EXHIBIT 1.1**Market Trilogies in Resource Allocation**

Investors and creditors prefer to provide financial resources to businesses with high earnings potential because such companies are better able to share profits and make interest payments. Profitable businesses are also less likely to experience bankruptcy.

Physical Resources

In their most primitive form, **physical resources** are natural resources. Physical resources often move through numerous stages of transformation. For example, standing timber may be successively transformed into harvested logs, raw lumber, and finished furniture. Owners of physical resources seek to sell those resources to businesses with high earnings potential because profitable businesses are able to pay higher prices and make repeat purchases.

Labor Resources

Labor resources include both intellectual and physical labor. Like other resource providers, workers prefer businesses that have high income potential because these businesses are able to pay higher wages and offer continued employment.

Accounting Provides Information

How do providers of financial, physical, and labor resources identify conversion agents (businesses) with high profit potential? Investors, creditors, and workers rely heavily on accounting information to evaluate which businesses are worthy of receiving resources. In addition, other people and organizations have an interest in accounting information about businesses. The many **users** of accounting information are commonly called **stakeholders**. Stakeholders include resource providers, financial analysts, brokers, attorneys, government regulators, and news reporters.

The link between conversion agents (businesses) and those stakeholders who provide resources is direct: businesses pay resource providers. Resource providers use accounting information to identify companies with high earnings potential because those companies are more likely to return higher profits, make interest payments, repay debt, pay higher prices, and provide stable, high-paying employment.

The link between conversion agents and other stakeholders is indirect. Financial analysts, brokers, and attorneys may use accounting information when advising their clients. Government agencies may use accounting information to assess companies' compliance with income tax laws and other regulations. Reporters may use accounting information in news reports.

Types of Accounting Information

Stakeholders such as investors, creditors, lawyers, and financial analysts exist outside of and separate from the businesses in which they are interested. The accounting information these *external users* need is provided by **financial accounting**. In contrast, the accounting information needed by *internal users*, stakeholders such as managers and employees who work within a business, is provided by **managerial accounting**.

The information needs of external and internal users frequently overlap. For example, external and internal users are both interested in the amount of income a business earns. Managerial accounting information, however, is usually more detailed than financial accounting reports. For example, investors are concerned about the overall profitability of **Wendy's** versus **Burger King**; whereas a Wendy's regional manager is interested in the profits of individual Wendy's restaurants. In fact, a regional manager is also interested in nonfinancial measures, such as the number of employees needed to operate a restaurant, the times at which customer demand is high versus low, and measures of cleanliness and customer satisfaction.

Nonbusiness Resource Usage

The U.S. economy is not purely market based. Factors other than profitability often influence resource allocation priorities. For example, governments allocate resources for national defense, to redistribute wealth, or to protect the environment. Foundations, religious groups, the Peace Corps, and other benevolent organizations prioritize resource usage based on humanitarian concerns.

Organizations that are not motivated by profit are called **not-for-profit entities** (also called *nonprofit* or *nonbusiness organizations*). Stakeholders interested in nonprofit organizations also need accounting information. Accounting systems measure the cost of the goods and services not-for-profit organizations provide, the efficiency and effectiveness of the organizations' operations, and the ability of the organizations to continue to provide goods and services. This information serves a host of stakeholders, including taxpayers, contributors, lenders, suppliers, employees, managers, financial analysts, attorneys, and beneficiaries.

The focus of accounting, therefore, is to provide information that is useful to a variety of business and nonbusiness user groups for decision making. The different types of accounting information and the stakeholders that commonly use the information are summarized in Exhibit 1.2.

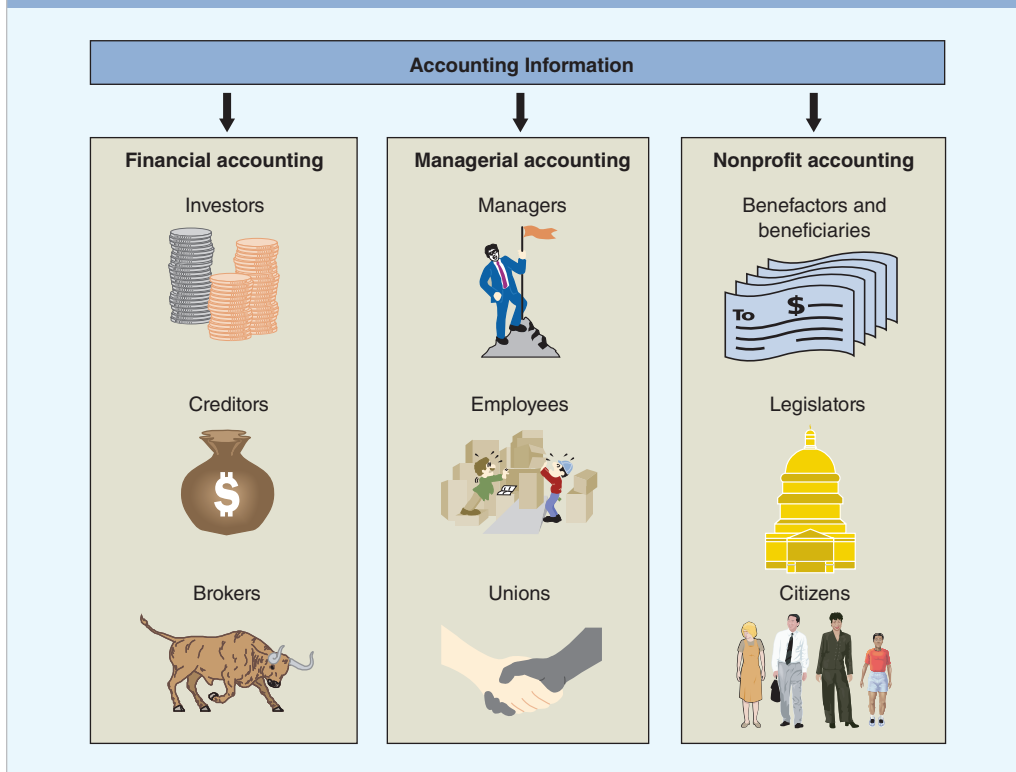
Careers in Accounting

An accounting career can take you to the top of the business world. In a recent *Forbes* article Jeffery Sanders reveals that a significantly higher percentage of Fortune 500 CEOs advance from financial backgrounds than any other discipline. Sanders notes that large companies prefer CEOs who understand the financial ramifications of business decisions.

What do accountants do? Accountants identify, record, analyze, and communicate information about the economic events that affect organizations. They may work in either public accounting or private accounting.

Public Accounting

You are probably familiar with the acronym CPA. CPA stands for certified *public* accountant. Public accountants provide services to various clients. They are usually

EXHIBIT 1.2**Accounting as Information Provider**

paid a fee that varies depending on the service provided. Services typically offered by public accountants include (1) audit services, (2) tax services, and (3) consulting services.

- *Audit services* involve examining a company's accounting records in order to issue an opinion about whether the company's financial statements conform to generally accepted accounting principles. The auditor's opinion adds credibility to the statements, which are prepared by the company's management.
- *Tax services* include both determining the amount of tax due and tax planning to help companies minimize tax expense.
- *Consulting services* cover a wide range of activities that include everything from installing sophisticated computerized accounting systems to providing personal financial advice.

All public accountants are not certified. Each state government, as well as Washington, DC, and four U.S. territories, establish certification requirements applicable in that jurisdiction. Although the requirements vary from jurisdiction to jurisdiction, CPA candidates normally must have a college education, pass a demanding technical examination, and obtain work experience relevant to practicing public accounting.

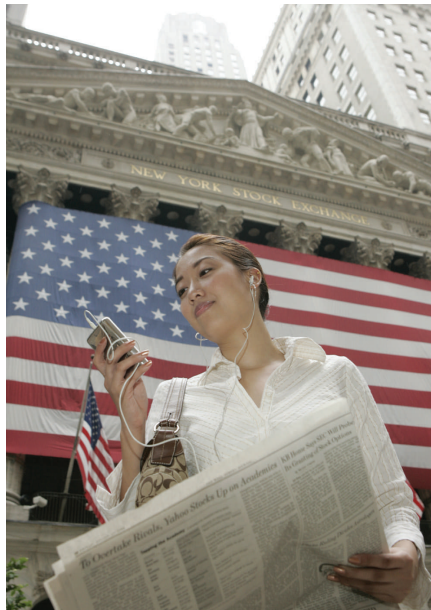
Private Accounting

Accountants employed in the private sector usually work for a specific company or nonprofit organization. Private sector accountants perform a wide variety of functions for their employers. Their duties include classifying and recording transactions, billing customers and collecting amounts due, ordering merchandise, paying suppliers, preparing and analyzing financial statements, developing budgets, measuring costs, assessing performance, and making decisions.

Private accountants may earn any of several professional certifications. For example, the Institute of Management Accountants issues the *Certified Management Accounting (CMA)* designation. The Institute of Internal Auditors issues the *Certified Internal Auditor (CIA)* designation. These designations are widely recognized indicators of technical competence and integrity on the part of individuals who hold them. All professional accounting certifications call for meeting education requirements, passing a technical examination, and obtaining relevant work experience.

Measurement Rules

Suppose a store sells an MP3 player in December to a customer who agrees to pay for it in January. Should the business *recognize* (report) the sale as a December transaction or as a January transaction? It really does not matter as long as the storeowner discloses the rule the decision is based on and applies it consistently to other transactions. Because businesses may use different reporting rules, however, clear communication also requires full and fair disclosure of the accounting rules chosen.



Communicating business results would be simpler if each type of business activity were reported using only one measurement method. World economies and financial reporting practices, however, have not evolved uniformly. Even in highly sophisticated countries such as the United States, companies exhibit significant diversity in reporting methods. Providers of financial reports assume that users are educated about accounting practices.

The **Financial Accounting Standards Board (FASB)**¹ is a privately funded organization with the primary authority for establishing accounting standards in the United States. The measurement rules established by the FASB are called **generally accepted accounting principles (GAAP)**. Financial reports issued to the public must follow GAAP. This textbook introduces these principles so you will be able to understand business activity reported by companies in the United States.

Companies are not required to follow GAAP when preparing *management accounting* reports. Although there is considerable overlap between financial and managerial accounting, managers are free to construct internal reports in whatever fashion best suits the effective operation of their companies.

Reporting Entities

Think of accountants in the same way you would think of news reporters. A news reporter gathers and discloses information about some person, place, or thing. Likewise, an accountant gathers and discloses financial information about specific people or businesses. The people or businesses accountants report on are called **reporting entities**. When studying accounting you should think of yourself as the accountant. Your first step is to identify the person or business on which you are reporting. This is not always as easy as it may seem. To illustrate, consider the following scenario.

¹The FASB consists of seven full-time members appointed by the supporting organization, the Financial Accounting Foundation (FAF). The FAF membership is intended to represent the broad spectrum of individuals and institutions that have an interest in accounting and financial reporting. FAF members include representatives of the accounting profession, industry, financial institutions, the government, and the investing public.

FOCUS ON INTERNATIONAL ISSUES

IS THERE GLOBAL GAAP?

As explained in this chapter, accounting is a measurement and communication discipline based on rules referred to as *generally accepted accounting principles (GAAP)*. The rules described in this text are based on GAAP used in the United States, but what rules do the rest of the world use? Is there a global GAAP, or does each country establish its own unique GAAP?

Until recently, each country developed its own unique GAAP. Global companies were required to prepare multiple sets of financial statements to satisfy each country's GAAP. The use of multiple accounting standards across the globe made comparing company performance difficult and expensive. To address the need for a common set of financial standards, the International Accounting Standards Committee was formed in 1973. The committee was reorganized as the **International Accounting Standards Board (IASB)** in 2001. The IASB issues **International Financial Reporting Standards (IFRS)**, which are rapidly gaining support worldwide. In 2005,

companies in the countries who were members of the European Union were required to use the IFRS as established by the IASB, which is headquartered in London. Today, over 100 countries require or permit companies to prepare their financial statements using IFRS.

As of 2014, most of the major economic countries have switched from their local GAAP to IFRS. One notable exception is the United States, but even here, the Securities and Exchange Commission announced in 2008 that it was seriously considering adopting rules that would allow our companies to use either GAAP or IFRS. Although not finalized when this book was being prepared, many accountants in the United States believe this will occur. Additionally, there is an active process in place to reduce the differences between IFRS and U.S. GAAP.

There are many similarities between the IASB and the FASB. Both the FASB and the IASB are required to include members with a variety of backgrounds, including auditors, users of financial information, academics, and so forth. Also, both groups primarily require that their members work full-time for their respective boards; they cannot serve on the board while being compensated by another organization. (The IASB does allow up to three of its members to be part-time.) Members of each board serve five-year terms and can be reappointed once. The funds to support both boards, and the large organizations that support them, are obtained from a variety of sources, including selling publications and private contributions. To help maintain independence of the board's members, fund-raising is performed by separate sets of trustees.

Despite their similarities, there are significant differences between the IASB and the FASB. One of these relates to size and geographic diversity. The FASB has only seven members, all from the United States. The IASB has sixteen members, and these must include at least four from Asia, four from Europe, four from North America, one from Africa, and one from South America.

Not only is the structure of the standards-setting boards different but the standards and principles they establish may also differ significantly. In this chapter, you will learn that GAAP employs the *historical cost concept*. This means that the assets of most U.S. companies are shown on the balance sheet at the amount for which they were purchased. For example, land that has a market value of millions of dollars may be shown on **Ford's** financial statements with a value of only a few hundred thousand dollars. This occurs because GAAP requires Ford to show the land at its cost rather than its market value. In contrast, IFRS permits companies to show market values on their financial statements. This means that the exact same assets may show radically different values if the statements are prepared under IFRS rather than GAAP.

Throughout this text, where appropriate, we will note the differences between U.S. GAAP and IFRS. However, by the time you graduate, it is likely that among the major industrialized nations, there will be a global GAAP.



Jason Winston recently started a business. During the first few days of operation, Mr. Winston transferred cash from his personal account into a business account for a company he named Winston Enterprises. Mr. Winston's brother, George, invested cash in Winston Enterprises for which he received an ownership interest in the company. Winston Enterprises borrowed cash from First Federal Bank. Winston Enterprises paid cash to purchase a building from Commercial Properties, Inc. Winston Enterprises earned cash revenues from its customers and paid its employees cash for salaries expense.

How many reporting entities are described in this scenario? Assuming all of the customers are counted as a single entity and all of the employees are counted as a single entity, there are a total of seven entities named in the scenario. These entities include: (1) Jason Winston, (2) Winston Enterprises, (3) George Winston, (4) First Federal