



ACCOUNTING

WHAT THE NUMBERS MEAN

10E

Marshall

McManus

Viele



connect[®] plus+

ACCOUNTING

The integrated solutions for *Accounting: What the Numbers Mean, 10e*, have been proven to help you achieve your course goals of improving student readiness, enhancing student engagement, and increasing their comprehension of content.

Marshall continues to be the market-leading text for the Survey of Accounting course, helping students to succeed through clear and concise writing, a conceptual focus, and unparalleled technology support. The Marshall solution employs the use of current companies and instant feedback on practice problems to help students engage with course materials, comprehend the content, and achieve higher outcomes in the course.

McGraw-Hill *Connect* provides many valuable learning resources to students, including **Guided Examples**. These narrated and animated videos are available to students as they work through homework assignments and can be viewed anytime, anywhere.

Finally, our new **Intelligent Response Technology**-based content offers students an intelligent homework experience that helps them stay focused on learning instead of navigating the technology.



PROVEN EFFECTIVE



Get Connected.

FEATURES

Guided Examples

Problem Solution

- General model for analyzing labor variances:
 $\frac{AH \times AR}{140 \text{ hrs}}$ $\frac{AH \times SR}{140 \text{ hrs} \times \$25}$ $\frac{SH \times SR}{126 \text{ hrs} \times \$25}$

Labor Rate Variance

Calculation:
126 standard hours + 14 unfavorable efficiency variance hours

Step 3 – Calculate the actual hours used for the units produced. The labor efficiency variance was 14 hours unfavorable.

Guided Examples give you a narrated, animated, step-by-step walkthrough of an exercise similar to the one you've been assigned by your instructor, allowing you to identify, review, and reinforce the concepts and activities covered in class.

Intelligent Response Technology

Intelligent Response Technology (IRT) is *Connect Accounting's* new student interface for end-of-chapter assessment content. Intelligent Response Technology provides a general journal application that looks and feels more like what you would find in a general ledger software package, improves answer acceptance to reduce student 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.

view transaction list view general journal

Journal Entry Worksheet

1 2 3 4 5 6 7

Two-thirds of the work related to \$12,000 cash received in advance is performed this period.

Transaction	General Journal	Debit	Credit
a.	Unearned fee revenue	12,000	
	Fee revenue		12,000
	Unearned fee revenue		

*Enter debits before credits

done clear transaction record transaction

Get Engaged.

e-Books

Connect Plus includes a media-rich e-Book 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 e-Book with *Connect Plus* gives your students a complete digital solution that allows them to access their materials from any computer.

The screenshot shows a digital e-Book page. At the top, there's a navigation bar with 'show library menu', 'eBook', and search options. The main content area is titled 'Chapter 2. Financial Statements and Accounting Concepts/Principles'. Below the title, there are tabs for 'reading' and 'images'. The page content includes a section titled 'Financial Statements' and a sub-section 'From Transactions to Financial Statements'. A diagram illustrates the process: 'Transactions' lead to 'Procedures for sorting, classifying, and presenting (bookkeeping)', which then leads to 'Financial Statements'. A 'Learning Objective 1' box states: 'Understand what transactions are.' Below this, a question asks: '1. What does it mean to say that there has been an accounting transaction between you and your school?' A 'What Does it Mean?' callout box points to the answer on page 57. At the bottom, a note states: 'Transactions are summarized in accounts, and accounts are further summarized in the financial statements. In this sense, transactions can be seen as the bricks that build the financial statements. By learning about the form, content, and relationships among financial statements in this chapter, you will better understand the process of building those results—bookkeeping and transaction analysis—described in Chapter 4 and subsequent chapters.'

Lecture Capture

The screenshot shows a lecture capture software interface. The main window displays a slide titled 'Accruing Revenues'. The slide content includes: '\$320 Monthly Interest' at the top, with a bracket below it showing '\$170 Interest Revenue' and '\$150 Interest Revenue'. Below this, a timeline shows 'Saturday, Jan. 15', 'Monday, Jan. 31', and 'Tuesday, Feb. 15'. A yellow box at the bottom of the slide says 'Let's look at the entry for February 15th.' The interface also shows a 'Powered by egrity' logo, a 'Bookmarks and Notes' sidebar with URLs like 'http://www.aaahq.org/' and 'http://www.aicpa.org/', and a video player control bar at the bottom with a 'Playing' indicator and a progress bar.

Make your classes available anytime, anywhere. With simple, one-click recording, students can search for a word or phrase and be taken to the exact place in your lecture that they need to review.

Accounting



Tenth Edition

Accounting

What the Numbers Mean

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ACCOUNTING: WHAT THE NUMBERS MEAN, TENTH EDITION

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Meet the Authors

David H. Marshall is Professor of Accounting Emeritus at Millikin University. He taught at Millikin, a small, independent university located in Decatur, Illinois, for 25 years. He taught courses in accounting, finance, computer information systems, and business policy, and was recognized as an outstanding teacher. The draft manuscript of this book was written in 1986 and used in a one-semester course that was developed for the non-business major. Subsequently supplemented with cases, it was used in the business core accounting principles and managerial accounting courses. Concurrently, a one-credit hour accounting laboratory taught potential accounting majors the mechanics of the accounting process. Prior to his teaching career, Marshall worked in public accounting and industry and he earned an MBA from Northwestern University. Professor Marshall's interests outside academia include community service, woodturning, sailing, and travel.



Wayne W. McManus makes his home in Grand Cayman, Cayman Islands, BWI, where he worked in the private banking sector for several years and is now a semi-retired consultant. He maintains an ongoing relationship with the International College of the Cayman Islands as an adjunct Professor of Accounting and Law and as a member of the College's Board of Trustees. McManus now offers the Cayman CPA Review course through the Financial Education Institute Ltd. and several professional development courses through the Chamber of Commerce. He earned an MS in accounting from Illinois State University, an MBA from the University of Kansas, a law degree from Northern Illinois University, and a master's of law in taxation from the University of Missouri-Kansas City. He serves as an independent director and chairman of the audit committee for Endeavour Mining Corp. (EDV on the TSX exchange). He is an active member of the Cayman Islands Society of Professional Accountants and the local chapter of the CFA Institute. Professor McManus volunteers as a "professional" Santa each December, enjoys travel, golf, and scuba diving, and is an audio/video enthusiast.



Daniel F. Viele is Professor of Accounting and currently serves as Associate Vice President for Academic Affairs at Webster University. He teaches courses in financial, managerial, and cost accounting, as well as accounting information systems. He has developed and taught numerous online graduate courses, and for his leadership role in pioneering online teaching and learning, the university presented him with a Presidential Recognition Award. Professor Viele's students and colleagues have also cited his dedication to teaching and innovative use of technology, and in 2002 Webster awarded him its highest honor—the Kemper Award for Teaching Excellence. Prior to joining Webster University in 1998, he served as a systems consultant to the graphics arts industry, and his previous teaching experience includes 10 years at Millikin University with Professor Marshall. Professor Viele holds an MS in Accounting from Colorado State University and has completed the Information Systems Faculty Development Institute at the University of Minnesota and the Advanced Information Systems Faculty Development Institute at Indiana University. He is a member of the American Accounting Association and the Institute of Management Accountants, where he has served as President of the Sangamon Valley Chapter and as a member of the National Board of Directors. Professor Viele enjoys sports of all kinds, boating, and a good book.



Preface

Welcome to the Tenth Edition of *Accounting: What the Numbers Mean*. We are confident that this text and supplemental resources will permit the achievement of understanding the basics of financial reporting by corporations and other enterprises.

Accounting has become known as the language of business. Financial statements result from the accounting process and are used by owners/investors, employees, creditors, and regulators in their planning, controlling, and decision-making activities as they evaluate the achievement of an organization's objectives. Active study of this text will allow you to acquire command of the language and help you become an informed user of accounting information.

Accounting issues are likely to touch the majority of career paths in today's economy. Students whose principal academic interests are not in accounting, but who are interested in other areas of business or nonbusiness areas, such as engineering, behavioral sciences, public administration, and prelaw programs, will benefit from the approach used in this book. Individuals aspiring to an MBA degree or other graduate programs that focus on administration and management, who do not have an undergraduate business degree, will benefit from a course using this text.

Accounting: What the Numbers Mean takes the user through the basics: what accounting information is, how it is developed, how it is used, and what it means. Financial statements are examined to learn what they do and do not communicate, enhancing the student's decision-making and problem-solving abilities from a user perspective. Achieving expertise in the preparation of financial statements is not an objective of this text. In short, we have designed these materials to assist those who wish to learn "what the numbers mean" without concentrating on the mechanical aspects of the accounting process.

Best wishes for successful use of the information presented here.

David H. Marshall

Wayne W. McManus

Daniel F. Viele



Putting the Pieces Together

Named after a Chinese word meaning “sparrow,” mah-jongg is a centuries-old game of skill. The object of the game is to collect different tiles; players win points by accumulating different combinations of pieces and creating patterns. We’ve chosen mah-jongg tiles as our cover image for the tenth edition of *Accounting: What the Numbers Mean* because the authors show students how to put the pieces together and understand their relationship to one another to see the larger pattern. By focusing on the meaning of the numbers used in financial statements, students develop the crucial decision-making and problem-solving skills needed to succeed in any professional environment.

Marshall continues to be the market-leading text for the Survey of Accounting course, helping students to succeed through clear and concise writing, a conceptual focus, and unparalleled technology support.

Clear

Instructors and students alike have praised *Accounting: What the Numbers Mean* for its effectiveness in explaining difficult and important accounting concepts to all students, not just future accountants. Instructors consistently point out that students find this text much less intimidating and easier to follow than others they have used.

Concise

In concentrating on the basics—what accounting information is, what it means, and how it is used—*Accounting: What the Numbers Mean* does not overwhelm students with encyclopedic detail. The emphasis on discovering what financial statements communicate and how to better use them (as well as other pieces of accounting information) facilitates student comprehension of the big picture.

Conceptual

Accounting: What the Numbers Mean focuses on helping students understand the meaning of the numbers in financial statements, their relationship to each other, and how they are used in evaluation, planning, and control. Technical details are minimized wherever possible, allowing instructors to highlight the function of financial statements, as opposed to their formation.

Technology

To meet the evolving needs of instructors and students, the tenth edition features a far more extensive technology support package than ever before. An expanded Online Learning Center includes a wealth of self-study material for students. McGraw-Hill’s *Connect Accounting* lets instructors assign, collect, and grade homework online. In addition, McGraw-Hill’s *Connect Accounting Plus* gives students the ability to work with an integrated eBook while managing and completing homework online.

What Makes Accounting: What the Numbers Mean Such a Powerful Learning Tool?

Fiscal Year

A firm's **fiscal year** is the annual period used for reporting to owners, the government, and others. Many firms select the calendar year as their fiscal year, but other 12-month periods can also be selected. Some firms select a reporting period ending on a date when inventories will be relatively low or business activity will be slow because this facilitates the process of preparing financial statements.

Many firms select fiscal periods that relate to the pace of their business activity. Food retailers, for example, have a weekly operating cycle, and many of these firms select a 52-week fiscal year (with a 53-week fiscal year every five or six years so their year-end remains near the same date every year). **Campbell Soup Company** has adopted this strategy; note, on page 715 in the appendix, that Campbell's fiscal year ends on the Sunday nearest July 31 each year. (The next 53-week year will end on August 3, 2014).

For internal reporting purposes, many firms use periods other than the month (e.g., 13 four-week periods). Such firms wish to maintain the same number of operating days in each period so that comparisons between the same periods of different years can be made without having to consider differences in the number of operating days in the respective periods.



Business in Practice



2. What does it mean to refer to a balance sheet for the year ended August 31, 2014?
3. What does it mean when a balance sheet has been prepared for an organization?

What Does It Mean?
Answers on
pages 56–57

This is a difficult but important concept to grasp, so please consider the following example: Assume that Cruisers, Inc., sells a boat to a customer for \$2,000 and uses the FIFO assumption. For argument's sake, assume that the cost of goods sold for this boat is \$1,500 (taken from the beginning inventory); yet the current cost of replacing the boat has recently increased to \$1,850, and the tax rate is 30 percent. The income tax owed by Cruisers, Inc., from this sale would be \$150, computed as $(\$2,000 - \$1,500) \times 30\%$, and when this amount is added to the cost of replacing the boat, the company hasn't had any positive net cash flow! However, on the income statement, net income would be \$350 $(\$2,000 - \$1,500 - \$150)$.



Study Suggestion



The IFRS Approach

The LIFO inventory cost flow assumption is not permitted under international financial reporting standards. The primary reason for the disallowance of LIFO appears to be that international standards have a strong balance sheet measurement focus and efforts have been made to eliminate accounting methods such as LIFO that do not support this so-called "balance sheet approach." As discussed in the following sections, during inflationary times LIFO assigns to inventory the costs of the oldest items acquired by the company, thus causing balance sheet values to become "outdated" as the company grows. As you study this material, think about what the implications would be for U.S. companies if the LIFO cost flow assumption were no longer available as a reporting alternative under U.S. GAAP.



FYI

The Activity Based Costing Association (ABCA) is an association of companies and organizations with activity-based costing interests. The association conducts benchmarking studies to identify practices that improve the overall operations of the members. ABCA's mission is to identify "best in class" activity-based costing processes, which lead member companies to exceptional performance when implemented. See www.abcbenchmarking.com for additional information about the objectives, services, and activities of the association.



Excerpts from 2011
Annual Report of
Campbell Soup
Company

• Business in Practice

Throughout each chapter, these boxes highlight and discuss various business practices and their impact on financial statements. Seeing the real-world impact of these business practices helps students more completely understand financial statements in general.

• What Does It Mean?

As students progress through each chapter, *What Does It Mean?* questions prompt students to self-test their understanding following coverage of key topics. *What Does It Mean?* answers are provided in the end-of-chapter section.

• Study Suggestion

Here the authors offer advice and tips to students to help them better grasp specific chapter concepts.

• The IFRS Approach

New to this edition, these boxes highlight some of the key differences between U.S. generally accepted accounting principles and International Financial Reporting Standards.

• FYI

These boxes direct students' attention to a wide variety of helpful resources available on the Internet for a fresh perspective on how the concepts they've just learned in the managerial chapters are applied in a modern context.

• Campbell's 2011 Annual Report

Excerpts from Campbell Soup Company's annual report are included as an appendix at the back of the book. Frequent references to this material are made in the financial chapters of the text. The Campbell's icon is located in the margins next to relevant text and requires the student to call upon this real-world resource. The inclusion of annual report data piques student interest and provides valuable hands-on experience.

More great pedagogy to guide student learning, and extensive end-of-chapter material to challenge students in applying what they have learned.

Summary

Financial statements communicate economic information that helps individuals make decisions and informed judgments.

The bookkeeping and accounting processes result in an entity's numerous transactions with other entities being reflected in the financial statements. The financial statements presented by an entity are the balance sheet, income statement, statement of changes in stockholders' equity, and statement of cash flows.

The balance sheet is a listing of the entity's assets, liabilities, and stockholders' equity at a point in time. Assets are probable future economic benefits (things or claims against others) controlled by the entity. Liabilities are amounts owed by the entity. An entity's stockholders' equity is the difference between its assets and liabilities. This relationship is known as the accounting equation. Current assets are cash and those assets likely to be converted to cash or used to benefit the entity within one year of the balance sheet date, such as accounts receivable and inventories. Current liabilities are expected to be paid or otherwise satisfied within one year of the balance sheet date. The balance sheet as of the end of a fiscal period is also the balance sheet as of the beginning of the next fiscal period.

The income statement reports the results of an entity's operating activities for a period of time. Revenues are reported first, and expenses are subtracted to arrive at net income or net loss for the period.

The statement of changes in stockholders' equity describes changes in equity.

Self-Study Material

Visit the text website at www.mhhe.com/marshall10e to take an online self-study quiz for this chapter.

Matching Following is a list of the key terms and concepts introduced in the chapter, along with a list of corresponding definitions. Match the appropriate letter for the key term or concept to each definition provided (items 1-15). Note that not all key terms and concepts will be used. Answers are provided at the end of this chapter.

- | | |
|-----------------------------|---------------------------------------|
| a. Accumulated depreciation | i. Gains |
| b. Balance sheet | j. Losses |
| c. Accrued liabilities | k. Net sales |
| d. Current assets | l. Cost of goods sold |
| e. Current liabilities | m. Gross profit |
| f. Merchandise inventory | n. Income from operations |
| g. Revenues | o. Net income |
| h. Expenses | p. Earnings per share of common stock |

Mini-Exercises

All applicable Mini-Exercises are available with McGraw-Hill's Connect™ Accounting.

Mini-Exercise 2.1 Understanding financial statement relationships Total assets were \$48,000 and total liabilities were \$27,000 at the beginning of the year. Net income for the year was \$8,000, and dividends of \$2,000 were declared and paid during the year.

LO 2.1

Required:
Calculate total stockholders' equity at the end of the year.

Mini-Exercise 2.2 Understanding financial statement relationships Stockholders' equity totaled \$82,000 at the beginning of the year. During the year, net income was \$12,000, dividends of \$3,000 were declared and paid, and \$10,000 of common stock was issued at par value.

LO 2.2

Required:
Calculate total stockholders' equity at the end of the year.

Mini-Exercise 2.3 Understanding income statement relationships During the year, net sales were \$125,000, gross profit was \$50,000, net income was \$20,000, income tax expense was \$5,000, and selling, general, and administrative expenses were \$22,000.

LO 2.3

Required:
Calculate cost of goods sold, income from operations, income before taxes, and interest expense. (Hint: Exhibit 2-2 may be used as a solution model.)

Problems

All applicable Problems are available with McGraw-Hill's Connect™ Accounting.

Problem 2.15 Calculate cash available upon liquidation of business Circle-Square, Ltd., is in the process of liquidating and going out of business. The firm's balance sheet shows \$22,800 in cash, accounts receivable of \$14,200, inventory totaling \$61,400, plant and equipment of \$265,000, and total liabilities of \$305,600. It is estimated that the inventory can be disposed of in a liquidation sale for 80 percent of its cost, all but 5 percent of the accounts receivable can be collected, and plant and equipment can be sold for \$190,000.

LO 2.3, 6

Required:
Calculate the amount of cash that would be available to the owners if the accounts receivable are collected, the other assets are sold as described, and the liabilities are paid off in full.

Problem 2.16 Calculate cash available upon liquidation of business Kimber Co. is in the process of liquidating and going out of business. The firm's accountant has provided the following balance sheet and additional information:

LO 2.3, 6

Assets		
Cash	.....	\$ 98,800
Accounts receivable	.....	125,200
Merchandise inventory	.....	229,400
Total current assets		\$391,400
Land	.....	\$ 102,000
Buildings & equipment	.....	686,000
Less: Accumulated depreciation	.....	(650,000)
Total land, buildings, & equipment		\$188,000
Total assets		\$769,400

(continued)

- **Chapter Summaries and Key Terms and Concepts** promote greater retention of important points and definitions as well as facilitate review.
- **Demonstration Problems** drive students to the Marshall/McManus/Viele Online Learning Center (www.mhhe.com/marshall10e) to view a fully worked-out problem with solution.
- **Self-Study Material** is an additional online resource located on the Online Learning Center (www.mhhe.com/marshall10e). The quizzes help students test their knowledge and understanding of chapter concepts. Results are tabulated and can be routed to multiple e-mail addresses if necessary.
- **Self-Study Quizzes** feature multiple-choice and matching questions. Answers for this section are given on the final page of each chapter.
- **Mini-Exercises** are new to this edition and are designed to be used as simple in-class demos to highlight key relationships and calculations or as simple take-home assignments.
- **Exercises** give students a chance to practice using the knowledge gained from working through the chapter material.
- **Problems** challenge students to apply what they have learned. Specific problems are tied to the Campbell's 2011 Annual Report, excerpts of which are included at the back of the text, bringing a strong, real-world flavor to the assignment material.
- **Cases** allow students to think analytically about topics from the chapter and apply them to business decisions.
- **A Continuous Case** is provided for Chapters 4, 6, 8 and 11 to allow the student to link concepts learned in earlier chapters to what they learn in later chapters. It also allows for an understanding of how the material works together to form a larger picture.
- **Icons** identify exercises, problems, and cases involving Excel Templates, the Campbell's 2011 Annual Report, and Connect Accounting.



connect
ACCOUNTING

Excel

Campbell's

McGraw-Hill *Connect Plus Accounting* is a complete online assignment, learning, and textbook assessment solution that connects your students with the tools and resources needed to achieve success through faster learning, more efficient studying, and higher retention of knowledge. Key features found in *Connect Plus Accounting* include:

Intelligent Response Technology

Intelligent Response Technology is *Connect Accounting's* new student interface for end-of-chapter assessment content. Intelligent Response Technology provides a general journal application that looks and feels more like what you would find in a general ledger software package, improves answer acceptance to reduce student 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.

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Two-thirds of the work related to \$12,000 cash received in advance is performed this period.

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	Fee revenue		8,000
	Fee revenue		
	Unearned fee revenue		

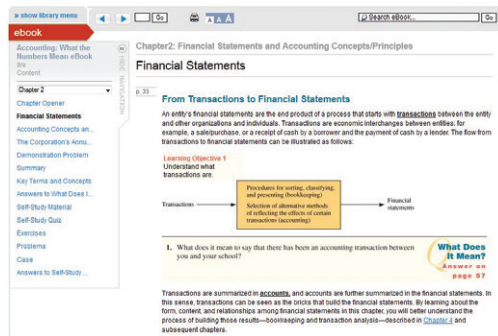
*Enter debits before credits

done
clear transaction
record transaction

view transaction list
journal entry worksheet

Transaction	General Journal	Debit	Credit
a.	Unearned fee revenue	8,000	
	Fee revenue		8,000
b.	Wages expense	10,000	
	Wages payable		10,000
c.	Depreciation expense	10,840	
	Accumulated depreciation		10,840

Connect Accounting helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. *Connect* grades homework automatically and gives immediate feedback on any questions students may have missed.



Integrated eBooks

Connect Plus includes a media-rich eBook. With it, you can share your notes with your students, and they can insert their own notes, highlight the text, search for specific information, and review their materials. Using an eBook with *Connect* gives your students a complete digital solution that allows them to access their materials from any computer. And over time, as more and more students use mobile devices, our eBooks will even enable them to learn on the go.

Guided Examples

Guided Examples provide narrated, animated, and step-by-step walkthroughs of algorithmic versions of assigned exercises in *Connect Accounting*, allowing the student to identify, review, or reinforce the concepts and activities covered in class. Guided Examples provide immediate feedback and focus on the areas where students need the most guidance.

Student Resource Library

The *Connect Accounting* Student Study Center gives access to additional resources such as recorded lectures, online practice materials, an eBook, and more.



The integrated solutions for *Accounting: What the Numbers Mean, 10e*, have been proven to help you achieve your course goals of improving student readiness, enhancing student engagement, and increasing their comprehension of content. Marshall continues to be the market-leading text for the Survey of Accounting course, helping students to succeed through clear and concise writing, a conceptual focus, and unparalleled technology support. The Marshall solution employs the use of current companies and instant feedback on practice problems to help students engage with course materials, comprehend the content, and achieve higher outcomes in the course.

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Simple Assignment Management and Smart Grading

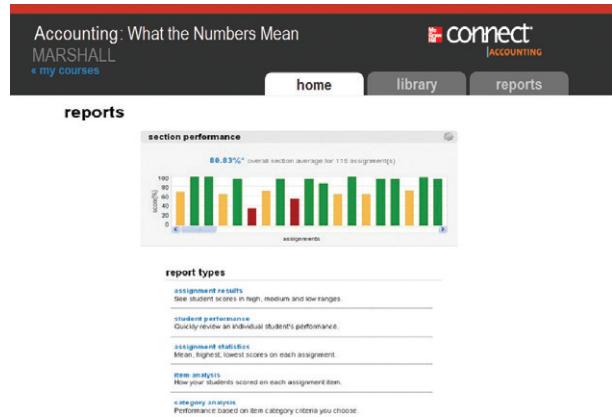
With *Connect Plus Accounting*, creating assignments is easier than ever, so you can spend more time teaching and less time managing. *Connect Accounting* enables you to:

- Create and deliver assignments easily with select end-of-chapter questions and test bank items.
- Go paperless with the eBook and online submission and grading of student assignments.
- Have assignments scored automatically, giving students immediate feedback on their work and side-by-side comparisons with correct answers.
- Reinforce classroom concepts with practice tests and instant quizzes.

Student Reporting

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

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



Instructor Library

The *Connect Accounting* Instructor Library is your repository for additional resources to improve student engagement in and out of class. You can select and use any asset that enhances your lecture. The *Connect Accounting* Instructor Library includes: access to the eBook version of the text, PowerPoint files, Solutions Manual, Instructor Resource Manual, and Test Bank.

Tegrity: Lectures 24/7

Make your classes available anytime, anywhere. With simple one-click recording, instructors can record lectures, presentations, and step-by-step problem solutions with Tegrity. Using Tegrity with *Connect Accounting*, instructors can post recordings directly to *Connect* for student viewing. Students can also search for a word or phrase and be taken to the exact place in your lecture that they need to review.



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

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At McGraw-Hill, we understand that getting the most from new technology can be challenging. That's why our services don't stop after you purchase our products. You can e-mail our Product Specialists 24 hours a day to get product training online. Or you can search our knowledge bank of Frequently Asked Questions on our support website. For Customer Support, call 800-331-5094 or visit www.mhhe.com/support. One of our Technical Support Analysts will be able to assist you in a timely fashion.

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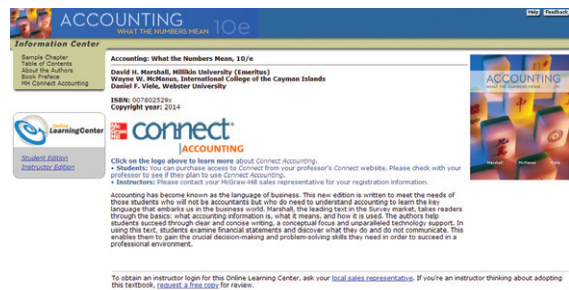
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Enhancements for This Edition

Chapter 1:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom's Taxonomy.
- New discussion of the *FASB Accounting Standards Codification* and the role of *Accounting Standards Updates (ASUs)*.
- Updated references to Campbell's annual report information.
- Expanded discussion of international financial reporting issues with emphasis on the progress made in recent years to achieve convergence of IFRS and U.S. GAAP.
- Streamlined discussion of the Conceptual Framework project with an integration of *FASB Concepts Statement No. 8* and the removal of the "Highlights" of *Concepts Statement No. 1* exhibit.
- Further clarification provided in the Plan of the Book section including a new "Resources for Students" subsection, highlighting the key features offered on our text's website.
- General update of all Exercises.
- Complete revision of all even-numbered Exercises.

Chapter 2:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom's Taxonomy.
- Updated terminology used in the financial statements from Owners' Equity to Stockholders' Equity to reflect the text's emphasis on corporate financial reporting.
- Updated references to Campbell's annual report information.
- Deleted the Cash Flows versus Accrual Accounting "Business in Practice" box, as well as the "Business on the Internet" box to improve the chapter's efficiency.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- General update of all Exercises, Problems, and Cases.

- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 3:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom's Taxonomy.
- Deleted the "Business on the Internet" box to improve the chapter's efficiency.
- Integration of Campbell's annual report information for the financial and graphical analyses of profitability and liquidity trends.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- New "Focus company" Case on the analysis of liquidity and profitability measures.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 4:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom's Taxonomy.
- Deleted the "Business on the Internet" box to improve the chapter's efficiency.
- Updated references to Campbell's annual report information.
- New Mini-Exercises (4) to emphasize computational-type learning objectives.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 5:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom's Taxonomy.

- Integration and analysis of Campbell’s annual report information for the accounting and presentation of current assets including cash, accounts receivable, and inventories.
- Reduced coverage of Short-Term Marketable Securities, deleted The Impact of Inventory Quantity Changes section, and deleted the Deferred Assets section to improve the chapter’s efficiency.
- New “The IFRS Approach” boxes (3) highlighting key differences between U.S. GAAP and IFRS with respect to the valuation and reporting of inventories.
- Simplified the discussion of inventory errors by including an illustration of “as reported” and “as corrected” data over a two-year period for self-correcting errors.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- New “Focus company” Case on accounts receivable and inventory disclosures.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 6:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Integration and analysis of Campbell’s annual report information for the accounting and presentation of property, plant, and equipment, and other noncurrent assets.
- New “The IFRS Approach” boxes (2) highlighting key differences between U.S. GAAP and IFRS with respect to the valuation and reporting of property, plant, and equipment.
- New Focus on the Big Picture “Study Suggestion” box.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- New “Focus company” Case on property, plant, and equipment disclosures.
- General update of all Exercises, Problems, and Cases.

- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 7:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Integration and analysis of Campbell’s annual report information for the accounting and presentation of liabilities.
- Deleted the Gross and Net Methods of Recording Purchases “Business in Practice” box, deleted the “Business on the Internet” box, and streamlined the Bond Discount and Premium exhibit to improve the chapter’s efficiency.
- New Mini-Exercises (4) to emphasize computational-type learning objectives.
- New “Focus company” Case on noncurrent liability disclosures.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 8:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Integration and analysis of Campbell’s annual report information for the accounting and presentation of stockholders’ equity.
- New Mini-Exercises (4) to emphasize computational-type learning objectives.
- New “Focus company” Case on stockholders’ equity disclosures.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 9:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.

Enhancements for This Edition

- Deleted the “Business on the Internet” box to improve the chapter’s efficiency.
- Integration and analysis of Campbell’s annual report information for the presentation and disclosure of income statement and statement of cash flows data.
- New “The IFRS Approach” boxes (3) highlighting key differences between U.S. GAAP and IFRS with respect to the valuation of revenues, expenses, gains, and losses.
- New Mini-Exercises (4) to emphasize computational-type learning objectives.
- New “Focus company” Cases (2) on income statement and statement of cash flows analysis.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 10:

- Chapter title changed to reflect updated terminology, with “Notes to the Financial Statements” replacing “Explanatory Notes.”
- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Corporate Governance discussion updated with references to the impact of the financial crisis of 2007–2008 and the key provisions of the Dodd–Frank Act of 2010.
- “Financial Shenanigans” exhibit expanded to include new categories and content.
- Deleted “Study Suggestion” box to improve the chapter’s efficiency.
- Integration and analysis of Campbell’s annual report information for the Notes to the Financial Statements section of the chapter.
- “Non-GAAP Financial Measures” described within the Management Discussion and Analysis section.
- New Mini-Exercises (2) to emphasize computational-type learning objectives.
- New “Focus company” Case to find various accounting policy disclosures.

- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 11:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Deleted “Study Suggestion” box to improve the chapter’s efficiency.
- Integration and analysis of Campbell’s annual report information for the performance of financial ratio analysis.
- New Mini-Exercises (4) to emphasize computational-type learning objectives.
- New “Focus company” Case on financial statement analysis.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 12:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Enhanced graphic and presentation of Expanded Contribution Margin Model.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 13:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Enhanced graphic of the Cost Accumulation and Assignment process.

- Integration and analysis of Campbell’s annual report information for manufacturing inventories, cost of products sold, and operating income performance.
- Conversion of “Business on the Internet” boxes to “FYI” boxes.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 14:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Conversion of “Business on the Internet” boxes to “FYI” boxes.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 15:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Revised complete presentation order of Standard Cost Variance Analysis in order to provide for a more natural conceptual flow.

- Created new graphical summary overview of the budget variance illustration.
- Conversion of “Business on the Internet” boxes to “FYI” boxes.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Chapter 16:

- Overall chapter content revisions for clarity and general updates.
- Refocused chapter learning objectives to align with Bloom’s Taxonomy.
- Enhanced graphical relationship presentation of the PV of expected cash flows, NPV, and IRR.
- Conversion of “Business on the Internet” boxes to “FYI” boxes.
- New Mini-Exercises (6) to emphasize computational-type learning objectives.
- General update of all Exercises, Problems, and Cases.
- Complete revision of all even-numbered Exercises and Problems.
- New guided example video demonstrations.

Epilogue:

- Overall content revisions for clarity and additions for current updates.
- New graphic updating IFRS adoption around the world.
- New graphics and presentation of accounting as an information system.
- Conversion of “Business on the Internet” boxes to “FYI” boxes.




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We Are Grateful . . . Although the approach to the material and the scope of coverage in this text are the results of our own conclusions, truly new ideas are rare. The authors whose textbooks we have used in the past have influenced many of our ideas for particular accounting and financial management explanations. Likewise, students and colleagues through the years have helped us clarify illustrations and teaching techniques. Many of the users of the first nine editions—both teachers and students—have offered comments and constructive criticisms that have been encouraging and helpful. All of this input is greatly appreciated. We extend special thanks to Helen Roybark of Radford University for her careful accuracy check of the text manuscript and solutions manual and ancillaries, and Jon A. Booker and Charles W. Caldwell of Tennessee Technological University, Cynthia J. Rooney of the University of New Mexico, and Susan C. Galbreath of Lipscomb University for a thorough revision of the PowerPoint presentations. Finally, we wish to thank our many colleagues at McGraw-Hill, who for more than 20 years have provided exceptional editorial assistance and product development guidance. Your collective efforts have helped to shape every aspect of this text, and it continues to be a pleasure to work with such a fine group of publishing professionals.

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Accounting— Present and Past

The worldwide financial and credit crisis that came to a head in the fall of 2008 was precipitated by many factors. Not the least of these factors were greed, inadequate market regulatory supervision, and an excess of “financial engineering” involved in the creation of financial instruments which almost defied understanding even by sophisticated investors. This crisis was preceded in the first decade of the century by the bankruptcy filings of two large, publicly owned corporations that resulted in billions of dollars of losses by thousands of stockholders. In 2001 it had been Enron Corporation, and a few months later, WorldCom, Inc. In each case a number of factors caused the precipitous fall in the value of the firms’ stock. The most significant factor was probably the loss of investor confidence in each company’s financial reports and other disclosures reported to stockholders and other regulatory bodies, including the Securities and Exchange Commission.

The Enron and WorldCom debacles, and other widely publicized breakdowns of corporate financial reporting, resulted in close scrutiny of such reporting by the accounting profession itself and also by the U.S. Congress and other governing bodies. The accounting practices that were criticized generally involved complex transactions.

Also contributing to the issue were aggressive attempts by some executives to avoid the spirit of sound accounting even though many of the reporting practices in question were not specifically forbidden by existing accounting pronouncements. To be sure, the financial reporting requirements faced by companies whose securities are publicly traded have now become more strenuously scrutinized under the Sarbanes–Oxley Act of 2002 (SOX) and the watchful eye of the Public Company Accounting Oversight Board (PCAOB), which is the regulatory body created under SOX to oversee the activities of the auditing profession and further protect the public interest. These enhanced regulatory efforts have helped to increase the transparency of the financial reporting process and the understandability of financial statements. Although the financial crisis that disrupted the financial world in 2008 has not been directly blamed on financial accounting or auditing weaknesses, some accounting and financial reporting practices have been severely criticized. This book will briefly address some of the more troublesome technical issues faced by the accounting profession today, but the elaborate attempts to embellish the financial image of the companies in question go well beyond the fundamentals described in the following pages.

The objective of this text is to present enough fundamentals of accounting to permit the nonaccountant to understand the financial statements of an organization operating in our society and to understand how financial information can be used in the management planning, control, and decision-making processes. Although usually expressed in the context of profit-seeking business enterprises, most of the material is equally applicable to not-for-profit social service and governmental organizations.

Accounting is sometimes called the *language of business*, and it is appropriate for people who are involved in the economic activities of our society—and that is just about everyone—to know at least enough of this language to be able to make decisions and informed judgments about those economic activities.

LEARNING OBJECTIVES (LO)

After studying this chapter you should understand and be able to

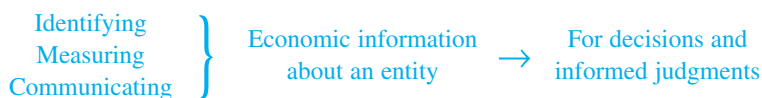
- LO 1-1** Explain the definition of *accounting*.
- LO 1-2** Identify who the users of accounting information are and explain why they find accounting information useful.
- LO 1-3** Identify the variety of professional services that accountants provide.
- LO 1-4** Summarize the development of accounting from a broad historical perspective.
- LO 1-5** Explain the role that the Financial Accounting Standards Board (FASB) plays in the development of financial accounting standards.
- LO 1-6** Generalize about how financial reporting standards evolve.
- LO 1-7** Identify the key elements of ethical behavior for a professional accountant.
- LO 1-8** Summarize the reasons for the FASB's Conceptual Framework project.
- LO 1-9** Summarize the objective of general purpose financial reporting.
- LO 1-10** Describe the plan of the book.

What Is Accounting?

In a broad sense, **accounting** is the process of identifying, measuring, and communicating economic information about an organization for the purpose of making decisions and informed judgments. (Accountants frequently use the term **entity** instead of *organization* because it is more inclusive.)

This definition of accounting can be expressed schematically as follows:

Accounting is the process of:



LO 1
Explain the definition of *accounting*.

Exhibit 1-1

Users and Uses of Accounting Information

LO 2

Identify who the users of accounting information are and explain why they find accounting information useful.

User	Decision/Informed Judgment Made
Management	When performing its functions of planning, directing, and controlling, management makes many decisions and informed judgments. For example, when considering the expansion of a product line, planning involves identifying and measuring costs and benefits; directing involves communicating the strategies selected; and controlling involves identifying, measuring, and communicating the results of the product line expansion during and after its implementation.
Investors/ shareholders	When considering whether to invest in the common stock of a company, investors use accounting information to help assess the amounts, timing, and uncertainty of future cash returns on their investment.
Creditors/ suppliers	When determining how much merchandise to ship to a customer before receiving payment, creditors assess the probability of collection and the risks of late (or non-) payment. Banks also become creditors when they make loans and thus have similar needs for accounting information.
Employees	When planning for retirement, employees assess the company's ability to offer long-term job prospects and an attractive retirement benefits package.
SEC (Securities and Exchange Commission)	When reviewing for compliance with SEC regulations, analysts determine whether financial statements issued to investors fully disclose all required information.

Who makes these decisions and informed judgments? Users of accounting information include the management of the entity or organization; the owners of the organization (who are frequently not involved in the management process); potential investors in and creditors of the organization; employees; and various federal, state, and local governmental agencies that are concerned with regulatory and tax matters. Exhibit 1-1 describes some of the users and uses of accounting information. Pause, and try to think of at least one other decision or informed judgment that each of these users might make from the economic information that could be communicated about an entity.

Accounting information is required for just about every kind of organization. When accounting is mentioned, most people initially think of the information needs and reporting requirements of business firms, but not-for-profit social service organizations, governmental units, educational institutions, social clubs, political committees, and other groups all require accounting for their economic activities as well.

Accounting is frequently perceived as something that others do, rather than as the process of providing information that supports decisions and informed judgments. Relatively few people actually become accountants, but almost all people use accounting information. The principal objective of this text is to help you become an informed user of accounting information, rather than to prepare you to become an accountant. However, the essence of this user orientation provides a solid foundation for students who choose to seek a career in accounting.

If you haven't already experienced the lack of understanding or confusion that results from looking at one or more financial statements, you have been spared one of life's frustrations. Certainly during your formal business education and early during your employment experience, you will be presented with financial data. Being an informed user means knowing how to use those data as information.

The following sections introduce the major areas of practice within the accounting discipline and will help you understand the types of work done by professional

accountants within each of these broad categories. The following Business in Practice discussion highlights career opportunities in accounting.

1. What does it mean to state that the accounting process should support decisions and informed judgments?

What Does It Mean?
Answer on
page 25

Career Opportunities in Accounting

Because accounting is a profession, most entry-level positions require a bachelor of science degree with a major in accounting. Individuals are encouraged to achieve CPA licensure as quickly as feasible. Persons who work hard and smart can expect to attain high professional levels in their careers. The major employers of accountants include public accounting firms, industrial firms, government, and not-for-profit organizations.

Public Accounting

The work done by public accountants varies significantly depending on whether they are employed by a local, regional, or international CPA firm. Small local firms concentrate on the bookkeeping, accounting, tax return, and financial planning needs of individuals and small businesses. These firms need generalists who can adequately serve in a variety of capacities. The somewhat larger, regional firms offer a broad range of professional services but concentrate on the performance of audits (frequently referred to as *attestation* or *compliance services*), corporate tax returns, and management advisory services. They often hire experienced financial and industry specialists to serve particular client needs, in addition to recruiting well-qualified recent graduates.

The large, international CPA firms also perform auditing, tax, and consulting services. Their principal clients are large domestic and international corporations. The “Big 4” CPA firms are [PricewaterhouseCoopers](#), [Deloitte Touche Tohmatsu](#), [Ernst & Young](#), and [KPMG International](#). These firms dominate the market in terms of total revenues, number of corporate audit clients, and number of offices, partners, and staff members. These international firms generally recruit outstanding graduates and highly experienced CPAs and encourage the development of specialized skills by their personnel. (Visit any of the Big 4 websites for detailed information regarding career opportunities in public accounting: www.pwc.com, www.deloitte.com, www.ey.com, or www.kpmg.com.)

Industrial Accounting

More accountants are employed in industry than in public accounting because of the vast number of manufacturing, merchandising, and service firms of all sizes. In addition to using the services of public accounting firms, these firms employ cost and management accountants, as well as financial accountants. Many accountants in industry start working in this environment right out of school; others get their start in public accounting as auditors but move to industry after getting at least a couple of years of experience.

Government and Not-for-Profit Accounting

Opportunities for accounting professionals in the governmental and not-for-profit sectors of the economy are constantly increasing. In the United States, literally thousands of state and local government reporting entities touch the lives of every citizen. Likewise, accounting specialists are employed by colleges and universities, hospitals, and voluntary health and welfare organizations such as the [American Red Cross](#), [United Way](#), and [Greenpeace](#).



**Business in
Practice**

Financial Accounting

LO 3

Identify the variety of professional services that accountants provide.

Financial accounting generally refers to the process that results in the preparation and reporting of financial statements for an entity. As will be explained in more detail, financial statements present the financial position of an entity at a point in time, the results of the entity's operations for some period of time, the **cash flow** activities for the same period, and other information (the notes to the financial statements or financial review) about the entity's financial resources, obligations, owners' interests, and operations.

Financial accounting is primarily oriented toward the external user. The financial statements are directed to individuals who are not in a position to be aware of the day-to-day financial and operating activities of the entity. Financial accounting is also primarily concerned with the historical results of an entity's performance. Financial statements reflect what has happened in the past. Although readers may want to project past activities and their results into future performance, financial statements are not a crystal ball. Many corporate annual reports refer to the historical nature of financial accounting information to emphasize the fact that users must make their own judgments about a firm's future prospects.

Bookkeeping procedures are used to accumulate the financial results of many of an entity's activities, and these procedures are part of the financial accounting process. Bookkeeping procedures have been thoroughly systematized using manual, mechanical, and computer techniques. Although these procedures support the financial accounting process, they are only a part of the process.

Financial accounting is done by accounting professionals who have generally earned a bachelor's degree with a major in accounting. The financial accountant is employed by an entity to use her or his expertise, analytical skills, and judgment in the many activities that are necessary for the preparation of financial statements. The title **controller** is used to designate the chief accounting officer of a corporation. The controller is usually responsible for both the financial and managerial accounting functions of the organization (as discussed later). Sometimes the title *comptroller* (the Old English spelling) is used for this position.

An individual earns the **Certified Public Accountant (CPA)** professional designation by fulfilling certain education and experience requirements and passing a comprehensive four-part examination. A uniform CPA exam is given nationally, although it is administered by individual states.¹ Some states require that candidates have accounting work experience before sitting for the exam. A total of 54 of the 55 U.S. jurisdictions, including all 50 states, have now enacted legislation increasing the educational requirements for CPA candidates from 120 semester hours of college study, or a bachelor's degree, to a minimum of 150 semester hours of college study to be granted licensure as a CPA.² Twenty-nine of these states allow candidates to sit for the CPA exam with 120 hours, but require 150 hours for certification.³ The American Institute of Certified Public Accountants (AICPA), the national professional organization of CPAs, has also endorsed this movement by requiring that an individual CPA

¹ Since 2004, CPA candidates have been allowed to schedule their own exam dates; they may sit for one part at a time because the examination is now computer-based. The former "pencil and paper" CPA exam has become a relic of the past.

² The U.S. Virgin Islands is the only jurisdiction that has not enacted the 150-hour education requirement as this text goes to print. See www.aicpa.org/Advocacy/State/DownloadableDocuments/SumState150Req.pdf for the effective date of the legislation in your state.

³ See www.becker.com/accounting/cpaexamreview/state for state-by-state details.

wishing to become a member must have met the 150-hour requirement. This increase in the educational requirements for becoming a CPA and for joining the AICPA reflects the increasing demands placed on accounting professionals to be both broadly educated and technically competent. Practicing CPAs work in all types of organizations, but as explained later, a CPA who expresses an auditor's opinion about an entity's financial statements must be licensed by the jurisdiction/state in which she or he performs the auditing service.

Managerial Accounting/Cost Accounting

Managerial accounting is concerned with the use of economic and financial information to plan and control many activities of the entity and to support the management decision-making process. **Cost accounting** is a subset of managerial accounting that relates to the determination and accumulation of product, process, or service costs. Managerial accounting and cost accounting have primarily an internal orientation, as opposed to the primarily external orientation of financial accounting. Many of the same data used in or generated by the financial accounting process are used in managerial and cost accounting, but the data are more likely to be used in a future-oriented way, such as in the preparation of budgets. A detailed discussion of the similarities and differences between financial and managerial accounting is provided in Chapter 12 and highlighted in Exhibit 12-1.

Managerial accountants and cost accountants are professionals who have usually earned a bachelor's degree with a major in accounting. Their work frequently involves close coordination with the production, marketing, and finance functions of the entity. The **Certified Management Accountant (CMA)** designation can be earned by a management accountant or cost accountant by passing a broad two-part examination. The CMA examination is given in a computer-based format using only objective questions.

Auditing—Public Accounting

Many entities have their financial statements reviewed or examined by an independent third party. In most cases, an audit (examination) is required by securities laws if the stock or bonds of a company are owned and publicly traded by investors. **Public accounting** firms and individual CPAs provide this **auditing** service, which constitutes an important part of the accounting profession.

The result of an audit is the **independent auditor's report**. The report usually has four relatively brief paragraphs. The first paragraph identifies the financial statements that were audited, explains that the statements are the responsibility of the company's management, and states that the auditor's responsibility is to express an opinion about the financial statements. The second paragraph explains that the audit was conducted "in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and describes briefly what those standards require and what work is involved in performing an audit. (In effect, they require the application of **generally accepted auditing standards**, or **GAAS**.) The third paragraph contains the auditor's opinion, which is usually that the named statements "present fairly, in all material respects" the financial position of the entity and the results of its operations and cash flows for the identified periods "in conformity with U.S. generally accepted accounting principles." This is an unqualified, or "clean," opinion. Occasionally the opinion will be qualified with respect to fair presentation, departure from **generally accepted**

accounting principles (GAAP), or the auditor's inability to perform certain auditing procedures. Similarly, an explanatory paragraph may be added to an unqualified opinion regarding the firm's ability to continue as a going concern (that is, as a viable economic entity) when substantial doubt exists. An unqualified opinion is not a clean bill of health about either the current financial condition or the future prospects of the entity. Readers must reach their own judgments about these and other matters after studying the **annual report**, which includes the financial statements and the notes to the financial statements, as well as management's extensive discussion and analysis. A final paragraph makes reference to the auditors' opinion about the effectiveness of the company's internal control over financial reporting. The entire auditors' report is further discussed in Chapter 10.

Auditors who work in public accounting are professional accountants who usually have earned at least a bachelor's degree with a major in accounting. The auditor may work for a public accounting firm (a few firms have several thousand partners and professional staff) or as an individual practitioner. Most auditors seek and earn the CPA designation; the firm partner or individual practitioner who actually signs the audit opinion must be a licensed CPA in the state in which she or he practices. To be licensed, the CPA must satisfy the character, education, examination, and experience requirements of the state or other jurisdiction.



To see an example of the independent auditors' report, refer to page 753 of the 2011 annual report of [Campbell Soup Company](#), which is reproduced in the appendix.

What Does It Mean?

Answers on page 25

2. What does it mean to work in public accounting?
3. What does it mean to be a CPA?

Internal Auditing

Organizations with many plant locations or activities involving many financial transactions employ professional accountants to do **internal auditing**. In many cases, the internal auditor performs functions much like those of the external auditor/public accountant, but perhaps on a smaller scale. For example, internal auditors may be responsible for reviewing the financial statements of a single plant or for analyzing the operating efficiency of an entity's activities. The qualifications of an internal auditor are similar to those of any other professional accountant. In addition to having the CPA and the CMA designation, the internal auditor may have also passed the examination to become a Certified Internal Auditor (CIA).

Governmental and Not-for-Profit Accounting

Governmental units at the municipal, state, and federal levels and not-for-profit entities such as colleges and universities, hospitals, and voluntary health and welfare organizations require the same accounting functions to be performed as do other accounting entities. Religious organizations, labor unions, trade associations, performing arts organizations, political parties, libraries, museums, country clubs, and many other not-for-profit organizations employ accountants with similar educational qualifications as those employed in business and public accounting.

Income Tax Accounting

The growing complexity of federal, state, municipal, and foreign income tax laws has led to a demand for professional accountants who are specialists in various aspects of taxation. Tax practitioners often develop specialties in the taxation of individuals, partnerships, corporations, trusts and estates, or in international tax law issues. These accountants work for corporations, public accounting firms, governmental units, and other entities. Many tax accountants have bachelor's degrees and are CPAs; some have a master's degree in accounting or taxation or are attorneys as well.

How Has Accounting Developed?

Accounting has developed over time in response to the needs of users of financial statements for financial information to support decisions and informed judgments such as those mentioned in Exhibit 1-1 and others that you were challenged to identify. Even though an aura of exactness is conveyed by the numbers in financial statements, a great deal of judgment and approximation is involved in determining the numbers to be reported. Although broad generally accepted principles of accounting exist, different accountants may reach different but often equally legitimate conclusions about how to account for a particular transaction or event. A brief review of the history of the development of accounting principles may make this often confusing state of affairs a little easier to understand.

LO 4

Summarize the development of accounting from a broad historical perspective.

Early History

It is not surprising that evidence of record keeping for economic events has been found in the earliest civilizations. Dating back to the clay tablets used by Mesopotamians in about 3000 B.C. to record tax receipts, accounting has responded to the information needs of users. In 1494, Luca Pacioli, a Franciscan monk and mathematics professor, published the first known text to describe a comprehensive double-entry bookkeeping system. Modern bookkeeping systems (as discussed in Chapter 4) have evolved directly from Pacioli's "method of Venice" system, which was developed in response to the needs of the Italian mercantile trading practices in that period.

The Industrial Revolution generated the need for large amounts of capital to finance the enterprises that supplanted individual craftsmen. This need resulted in the corporate form of organization marked by absentee owners, or investors, who entrusted their money to managers. It followed that investors required reports from the corporate managers showing the entity's financial position and results of operations. In mid-19th-century England, the independent (external) audit function added credence to financial reports. As British capital was invested in a growing U.S. economy in the late 19th century, British-chartered accountants and accounting methods came to the United States. However, no group was legally authorized to establish financial reporting standards. This led to alternative methods of reporting financial condition and results of operations, which resulted in confusion and, in some cases, outright fraud.

The Accounting Profession in the United States

Accounting professionals in this country organized themselves in the early 1900s and worked hard to establish certification laws, standardized audit procedures, and other attributes of a profession. However, not until 1932–1934 did the American