SURVEY OF ACCOUNTING

Fifth Edition

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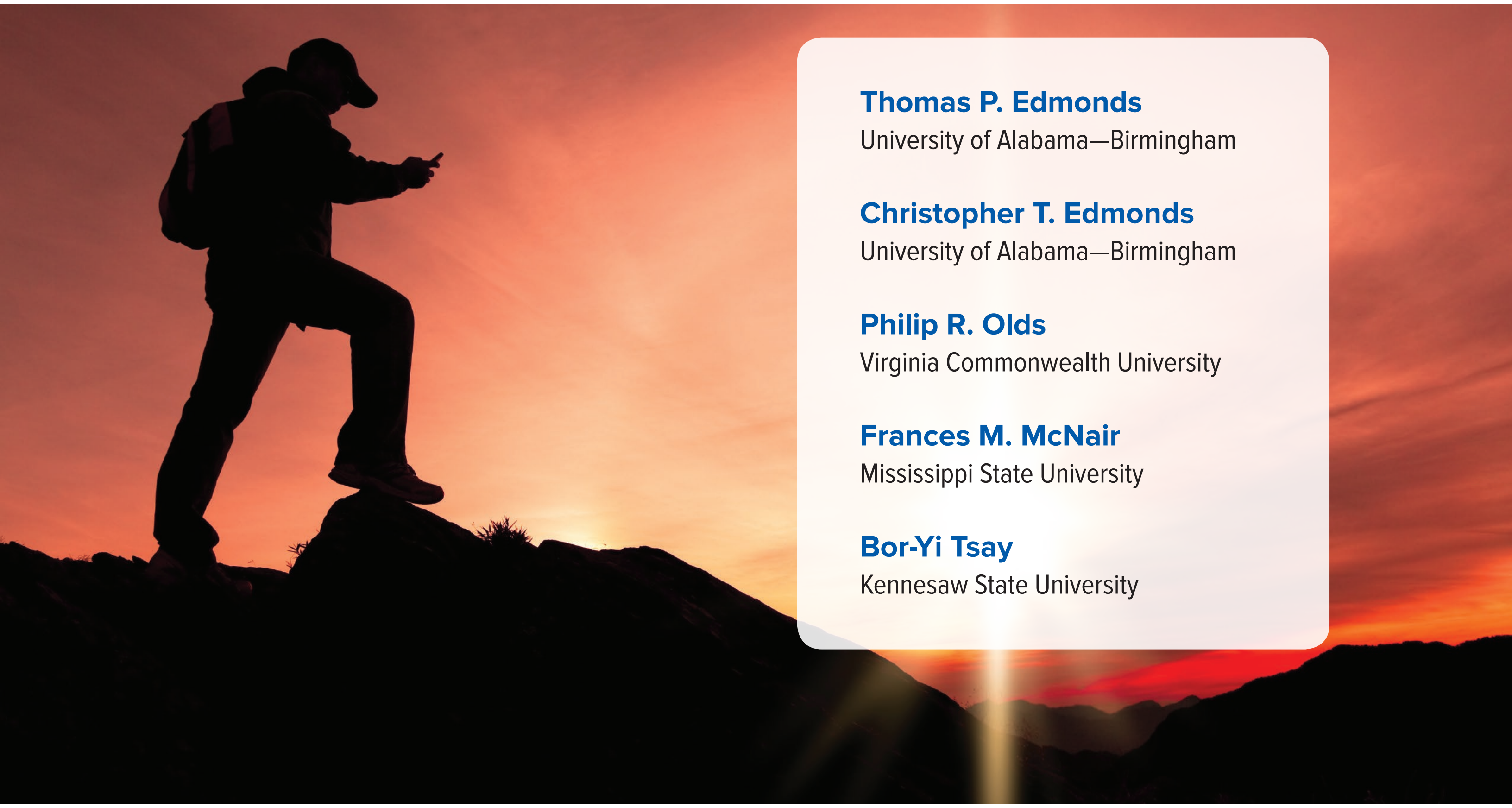
McGraw Hill Education

fifth edition

Survey of Accounting



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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

INNOVATIVE INSTRUCTIONAL METHODOLOGY

We are very pleased with the enthusiastic reception accorded to the comprehensive set of instructional videos we provided with the last edition of the text. If you have not had the opportunity to examine these videos we encourage you to do so at your earliest convenience. The videos provide a brief lecture for every learning object in the text. ***The lectures have been developed and recorded by a member of the author team.*** 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.

Each video can be delivered to students through *Connect* assignments. They can be assigned independently or with a corresponding set of assessment questions. The assessment questions keep the student actively engaged in the learning process. Students receive immediate feedback, thereby enabling them to assess their comprehension of the content presented in each video. Detailed explanations are provided to further student understanding and to minimize the need for instructors to answer repetitive questions. In addition, *Connect* provides reports that identify areas where students are struggling, thereby allowing the maximum utilization of class time.

INSTRUCTORS' RESOURCE KIT (IRK)

In this edition we have expanded our highly successful video lecture tool kit. We now offer an ***Instructors' Resource Kit (IRK).*** The IRK includes a general set of instructions for how to conduct flipped, online, and hybrid classes. It also solves two major frustrations instructors frequently encounter with virtually all textbooks.

First, when making presentations instructors find that exercises and problems are located in separate documents, requiring the instructor to flip back and forth between documents when making classroom presentations. The IRK solves this issue by providing a chapter-by-chapter document that contains an ***instructor version*** of exercises and problems. The corresponding solution is shown directly below each exercise, problem, and case. Placing the exercises and problems and corresponding solution in the same document eliminates the frustration associated with preparing and delivering content to students.

The IRK also recognizes and solves another major frustration faced by many instructors today. To obtain lower prices and greater functionality many students prefer to purchase only the electronic material set. Since students may not have computer access during class, they do not have access to the exercises, problems, and cases while they are in class. No longer can the instructor say "class turn your book to exercise . . . ." The IRK solves this frustration. It includes a separate chapter-by-chapter Word document that contains a ***student version*** of the same exercises and problems that are shown in the ***instructor version.*** However, instead of showing the solution, the student version contains a corresponding working paper directly below it. Accordingly, students can easily follow the lecture regardless of whether they are using a hard cover text or an electronic version of the text.

A WORLD OF POSSIBILITIES

We highly encourage you to examine these innovative tools. They offer a world of opportunities to improve the learning process for your students. Some of the possibilities are discussed as follows.

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 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.

Hybrid Courses

Many instructors are developing hybrid classes where some classes involve face-to-face time with the instructor; other class time is devoted to group work, individualized instruction, case study, or other activities. This means there is less time for traditional lectures. Instructional videos are ideal for filling the lecture gap. Instructors can cover the key concepts in their lectures and leave the detailed presentation to the video lectures.

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 turn-key course that is composed of prerecorded instructional videos, student-directed 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 highly effective distance learning course.

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.

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 far 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 lockstep fashion, the potential for improving the learning environment is virtually limitless.

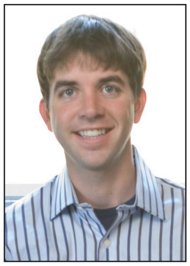
There are many different competency-based models that can be applied to introductory accounting. At this point our objective is to introduce the general possibilities for improving learning. If you are interested in developing a specific competency-based approach for your classroom, you can speak directly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

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, PhD, 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 BBA degree with a major in finance from Georgia State University in Atlanta, Georgia. He obtained an MBA degree with a concentration in finance from St. Mary's University in San Antonio, Texas. His PhD 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, PhD, is an associate professor in the Department of Accounting and Finance at the UAB Collat School of Business. He coordinates the mass section face-to-face and online principles of accounting courses. Dr. Edmonds specializes in developing flipped and online accounting courses and frequently speaks on these topics at universities and conferences. His passion for helping students learn inspired him to create hundreds of short videos teaching the fundamental concepts of accounting. Dr. Edmonds has received five prestigious teaching awards including the UAB Transformative Online Course Award, UAB Loudell Ellis Robinson Classroom Teaching Award, UAB Disability Support Recognition Award, Virginia Tech Favorite Faculty Award, and Virginia Tech Outstanding Graduate Student Teaching Award. He has published three textbooks where he is the lead video author and has written numerous articles that have appeared in publications including *The Accounting Review*, *Issues in Accounting Education*, *Advances in Accounting Education*, *Advances in Accounting*, *AIS Educators Journal, Research in Accounting Regulation,* and *Review of Quantitative Finance and Accounting.* Dr. Edmonds began his academic training at Colorado State University. He obtained an MBA degree from UAB. His PhD degree with a major in accounting was awarded by Virginia Polytechnic Institute and State University.

Philip R. Olds

Professor Olds, PhD, 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 AS degree from Brunswick Junior College in Brunswick, Georgia (now College of Coastal Georgia). He received a BBA in accounting from Georgia Southern College (now Georgia Southern University); his MPA and PhD 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. Most recently he received the university's award for maintaining High Ethical and Academic Standards While Advocating for Student-Athletes and Their Quest Towards a Degree.

Frances M. McNair

Frances M. McNair, PhD, CPA, 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 12 years and currently serves as the coordinator for the principles of accounting courses at MSU. Dr. McNair was selected as Accounting Educator of the year by the Mississippi Society of CPAs in 2014. She joined the MSU faculty in 1987 after receiving her PhD 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.

Bor-Yi Tsay

Bor-Yi Tsay, PhD, CPA, is professor of accounting at Kennesaw State University (Kennesaw). He has taught principles of accounting courses at the University of Houston and University of Alabama at Birmingham. He currently teaches principles of accounting courses in Kennesaw. Dr. Tsay received the 1996 Loudell Ellis Robinson Excellence in Teaching Award. He has also received numerous awards for his writing and publications, including the John L. Rhoads Manuscripts Award, John Pugsley Manuscripts Award, Van Pelt Manuscripts Award, and three certificates of merit from the Institute of Management Accountants. His articles have appeared in *Journal of Accounting Education, Management Accounting, Journal of Managerial Issues, CPA Journal, CMA Magazine, Journal of Systems Management,* and *Journal of Medical Systems*. Dr. Tsay received a BS degree in agricultural economics from National Taiwan University, an MBA degree from Eastern Washington University, and a PhD degree in accounting from the University of Houston.

HOW DOES EDMONDS

Real-World Examples

The text provides a variety of thought-provoking, real-world examples of financial and managerial accounting as an essential part of the management process. The names of the real-world companies used in these examples are highlighted in blue font to facilitate their identification.

The Curious Accountant

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General Dynamics Corporation is an aerospace and defense company that provides both products and services in business aviation; combat vehicles, weapons systems, and munitions; shipbuilding; and communications and information technology. Its products include Gulfstream business jet airplanes. In 2015, 57 percent of its revenues were earned from the U.S. government, 17 percent from commercial customers in the United States, 13 percent from international commercial customers, and the remaining 13 percent from international government defense customers.

Suppose the U.S. government contracted with General Dynamics to purchase four Gulfstream airplanes at a total cost of $200 million. Assume the government offers to pay for the airplanes the day they are delivered (a cash purchase) or 30 days later (a purchase on account). Assume that General Dynamics is absolutely sure the government will pay its account when due.

Do you think the company should care whether the government pays for the services upon delivery or 30 days later? Why? (Answer on page 165.)

The Curious Accountant

Each chapter opens with a short vignette that sets the stage and helps pique student interest. 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.

Answers to The Curious Accountant

General Dynamics would definitely prefer to make the sale to the government in cash rather than on account. Even though it may be certain to collect its accounts receivable, the sooner the company gets its cash, the sooner the cash can be reinvested.

The interest cost related to a small account receivable of $50 that takes 30 days to collect may seems immaterial; at 3 percent the lost interest amounts to $0.13. However, when one considers that General Dynamics had approximately $3.4 billion of accounts receivable on December 31, 2015, and took an average of 40 days to collect them, the cost of financing receivables for a real-world company becomes apparent. In 2015, the weighted-average interest rate on General Dynamics's debt was only around 2.6 percent. But, even at 2.6 percent the cost of waiting 40 days to collect $3.4 billion of cash is $9.7 million ($3.4 billion × 0.026 × 40/365). For a full year, the cost to General Dynamics would be $88.4 million ($3.4 billion × 0.026).

Focus on International Issues

These boxed inserts expose students to international issues in accounting.

FOCUS ON INTERNATIONAL ISSUES

LIFO IN OTHER COUNTRIES


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This chapter introduced a rather strange inventory cost flow assumption called LIFO. As explained, the primary advantage of LIFO is to reduce a company's income taxes. Given the choice, companies that use LIFO to reduce their taxes would probably prefer to use another method when preparing their GAAP-based financial statements, but the IRS does not permit this. Thus, they are left with no choice but to use the seemingly counterintuitive LIFO assumption for GAAP as well as tax reporting.

What happens in countries other than the United States? International Financial Reporting Standards (IFRS) do not allow the use of LIFO. Most industrialized nations are now using IFRS. You can see the impact of this disparity if you review the annual report of a U.S. company that uses LIFO *and* has significant operations in other countries. Very often it will explain that LIFO is used to calculate inventory (and cost of goods sold) for domestic operations, but another method is used for activities outside the United States.

For example, here is an excerpt from **General Electric**'s 2014 Form 10-K, Note 1.

> *All inventories are stated at the lower of cost or realizable values. Cost for a significant portion of GE U.S. inventories is determined on a last-in, first-out (LIFO) basis. Cost of other GE inventories is determined on a first-in, first-out (FIFO) basis. LIFO was used for 40% and 39% of GE inventories at December 31, 2014 and 2013, respectively.*

If the company has its headquarters in the United States, why not simply use LIFO in its foreign operations? In addition to having to prepare financial statements for the United States, the company probably has to prepare statements for its local operations using the reporting standards of the local country.

Prior to the establishment of IFRS each country was responsible for issuing its own, local GAAP. Even then, most countries did not allow for the use of LIFO.

"The Curious Accountant and Real-World Examples, all make the text better and would make it a pleasure to teach from."

VIVIAN WINSTON, INDIANA UNIVERSITY

MOTIVATE STUDENTS?

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.

CHECK YOURSELF 2.1

During 2018, Anwar Company earned $345,000 of revenue on account and collected $320,000 cash from accounts receivable. Anwar paid cash expenses of $300,000 and cash dividends of $12,000. Determine the amount of net income Anwar should report on the 2018 income statement and the amount of cash flow from operating activities Anwar should report on the 2018 statement of cash flows.

Answer Net income is $45,000 ($345,000 revenue − $300,000 expenses). The cash flow from operating activities is $20,000, the amount of revenue collected in cash from customers (accounts receivable) minus the cash paid for expenses ($320,000 − $300,000). Dividend payments are classified as financing activities and do not affect the determination of either net income or cash flow from operating activities.

Reality Bytes

This feature provides examples or expansions of the topics presented by highlighting companies and showing how they use the accounting concepts discussed in the chapter to make business decisions.

REALITY BYTES

Good inventory management is essential for merchandising and manufacturing companies. Even if a company uses a perpetual inventory system, the amount of inventory believed to be on hand may be incorrect because of lost, damaged, or stolen goods, so a physical count is still required. Unfortunately, counting inventory is not a revenue-generating activity. If a company's employees are used to conduct the physical count, it takes time that may be better used for other activities. In fact, it may be so time-consuming that the business must close temporarily so employees will have the time to complete the inventory count.

To avoid this problem many businesses hire outside companies to count their inventory. These outside vendors can bring in a large crew of specially trained workers and complete a count very quickly. There are many companies that provide inventory counting services, but **RIGIS, LLC** claims to be the world's largest. RIGIS reports that its 34,000 employees have counted over 400 billion items in the more than 4 million inventory counts it has conducted since beginning operations in 1958. On second thought, counting inventory is a revenue-producing activity if you are a company that counts inventory for others.

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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 material, and a Look Forward introduces new material to come in the next chapter.

<< A Look Back

Financial statement analysis involves many factors, among them user characteristics, information needs for particular types of decisions, and how financial information is analyzed. Analytical techniques include *horizontal, vertical,* and *ratio analysis.* Users commonly calculate ratios to measure a company's liquidity, solvency, and profitability. The specific ratios presented in this chapter are summarized in Exhibit 9.6. Although ratios are easy to calculate and provide useful insights into business operations, when interpreting analytical results, users should consider limitations resulting from differing industry characteristics, differing economic conditions, and the fundamental accounting principles used to produce reported financial information.

>> A Look Forward

This chapter concludes the *financial* accounting portion of the text. Beginning with Chapter 10, we introduce various tools from a branch of the field called *managerial* accounting. Managerial accounting focuses on meeting the accounting information needs of decision makers inside, rather than outside, a company. In addition to financial statement data, inside users require detailed, forward-looking information that includes nonfinancial as well as financial components. We begin with a chapter that discusses the value management accounting adds to the decision-making process.

"The Reality Bytes and Check Yourself sections in the chapters enhance the presentation."

ROBERT PATTERSON, PENN STATE-ERIE

"I like the Check Yourself examples."

BRUCE DARLING, UNIVERSITY OF OREGON

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.

Video lectures and accompanying self-assessment quizzes are available in *Connect* for all learning objectives.

SELF-STUDY REVIEW PROBLEM

During 2019 Rustic Camp Sites experienced the following transactions:

1. RCS acquired $32,000 cash by issuing common stock.
2. RCS received $116,000 cash for providing services to customers (leasing campsites).
3. RCS paid $13,000 cash for salaries expense.
4. RCS paid a $9,000 cash dividend to the owners.
5. RCS sold land that had cost $100,000 for $100,000 cash.
6. RCS paid $47,000 cash for other operating expenses.

Required

a. Record the transaction data in a horizontal financial statements model like the following one. In the Cash Flow column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The beginning balances have been recorded as an example. They are the ending balances shown on RCS's December 31, 2018, financial statements illustrated in the chapter. Note that the revenue and expense accounts have a zero beginning balance. Amounts in these accounts apply only to a single accounting period. Revenue and expense account balances are not carried forward from one accounting period to the next.

Self-Study Review Problem

These sections offer problems and solutions of major chapter concepts.

CHECK FIGURES
Net Income: $3,100
Ending Retained Earnings: $15,300

Consulting revenue	$18,200
Cash	35,600
Cash received from common stock issued during 2017	6,000
Travel expense	2,100
Dividends	4,000
Cash flow from investing activities	5,200
Rent expense	3,500
Payment to reduce debt principal	10,000
Retained earnings, January 1, 2018	16,200
Salary expense	7,200
Cash flow from operating activities	2,600
Common stock, December 31, 2018	16,000
Other operating expenses	2,300

Required

a. Prepare the income statement Nowell would include in its 2018 annual report.
b. Identify the accounts that should be closed to the Retained Earnings account.
c. Determine the Retained Earnings account balance at December 31, 2018. Identify the reasons for the difference between net income and the ending balance in Retained Earnings.
d. What are the balances in the Revenue, Expense, and Dividend accounts on January 1, 2019? Explain.

LO 2-8

Problem 2-35 ***Effect of events on financial statements***

CHECK FIGURES
b. $36,000
h. $15,000

Waddell Company had the following balances in its accounting records as of December 31, 2018:

Assets		Liabilities and Equity	
Cash	$35,000	Accounts Payable	$ 7,500
Accounts Receivable	9,000	Common Stock	40,000
Land	51,000	Retained Earnings	47,500
Totals	$95,000		$95,000

The following accounting events apply to Waddell Company's 2018 fiscal year:

Jan.	1	Acquired $20,000 cash from the issue of common stock.
Feb.	1	Paid $6,000 cash in advance for a one-year lease for office space.
Mar.	1	Paid a $2,000 cash dividend to the stockholders.
April	1	Purchased additional land that cost $15,000 cash.
May	1	Made a cash payment on accounts payable of $5,500.
July	1	Received $9,600 cash in advance as a retainer for services to be performed monthly over the coming year.
Sept.	1	Sold land for $30,000 cash that had originally cost $30,000.
Oct.	1	Purchased $2,500 of supplies on account.
Dec.	31	Earned $58,000 of service revenue on account during the year.
	31	Received cash collections from accounts receivable amounting to $46,000.
	31	Incurred other operating expenses on account during the year that amounted to $28,000.
	31	Recognized accrued salaries expense of $6,500.
	31	Had $50 of supplies on hand at the end of the period.
	31	The land purchased on April 1 had a market value of $20,000.
	31	Recognized $500 of accrued interest revenue.

Required

Based on the preceding information, answer the following questions for Waddell Company. All questions pertain to the 2018 financial statements. (*Hint:* Enter items in general ledger accounts under the accounting equation before answering the questions.)

a. Based on the preceding transactions, identify two additional adjustments and describe them.
b. What amount would Waddell report for land on the balance sheet?
c. What amount of net cash flow from operating activities would be reported on the statement of cash flows?

Exercise and Problem Sets

• Check figures

The figures provide a quick reference for students to check on their progress in solving the problem.

REINFORCED?

Analyze, Think, Communicate (ATC)

Each chapter includes an innovative section titled Analyze, Think, Communicate (ATC). This section contains:

- Business application cases related to the annual report for Target Company
- **Writing Assignments**
- **Group Exercises**
- **Ethics Cases**
- **Internet Assignments**
- **Real Company Examples**
- **Target Corp.**

Target Corporation

ANALYZE, THINK, COMMUNICATE

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

Required

Use the Target Corporation's Form 10-K to answer the following questions related to Target's 2015 fiscal year (year ended January 30, 2016). Target's Form 10-K is available on the company's website or through the SEC's EDGAR database. Appendix A provides instructions for using the EDGAR database.

Target Corporation

a. Which accounts on Target's balance sheet are accrual-type accounts?
b. Which accounts on Target's balance sheet are deferral-type accounts?
c. Compare Target's 2015 *net earnings* (the year ended January 30, 2016) to its 2015 *cash provided by operating activities.* Which is larger?
d. First, compare Target's 2014 net income to its 2015 net income. Next, compare Target's 2014 cash provided by operating activities to its 2015 cash provided by operating activities. Which changed the most from 2014 to 2015, net earnings or cash provided by operating activities?
e. Why did Target's net earnings change so much from 2014 to 2015?

ATC 2-2 Group Assignment *Financial reporting and market evaluation*

The following financial highlights were drawn from the 2014 annual reports of **ExxonMobil Corporation** and **Apple Inc.**

	Exxon Mobil	Apple
Revenue	$411.9 Billion	$182.8 Billion
Net income	$ 32.5 Billion	$ 39.5 Billion
Cash and short-term investments	$ 4.6 Billion	$ 41.6 Billion

ATC 4-3 Research Assignment *Investigating cash and management issues at Smucker's*

Using the most current Form 10-K available on EDGAR, or the company's website, answer the following questions about the **J. M. Smucker Company**. Instructions for using EDGAR are in Appendix A. *Note: In some years the financial statements, footnotes, etc., portion of Smucker's annual report have been located at the end of the Form 10-K, in or just after "Item 15."*

Required

a. Instead of "Cash," the company's balance sheet uses the account name "Cash and cash equivalents." How does the company define cash equivalents?
b. The annual report has two reports in which management clearly acknowledges its responsibility for the company's financial reporting and internal controls. What are the names of these reports and on what pages are they located?

ATC 4-4 Writing Assignment *Internal control procedures*

Sarah Johnson was a trusted employee of Evergreen Trust Bank. She was involved in everything. She worked as a teller, she accounted for the cash at the other teller windows, and she recorded many of the transactions in the accounting records. She was so loyal that she never would take a day off, even when she was really too sick to work. She routinely worked late to see that all the day's work was posted into the accounting records. She would never take even a day's vacation because they might need her at the bank. Adam and Jammie, CPAs, were hired to perform an audit, the first complete audit that had been done in several years. Johnson seemed somewhat upset by the upcoming audit. She said that everything had been properly accounted for and that the audit was a needless expense. When Adam and Jammie examined some of the bank's internal control procedures, it discovered problems. In fact, as the audit progressed, it became apparent that a large amount of cash was missing. Numerous adjustments had been made to customer accounts with credit memorandums, and many of the transactions had been posted several days late. In addition, there were numerous cash payments for "office expenses." When the audit was complete, it was determined that more than $100,000 of funds was missing or improperly accounted for. All fingers pointed to Johnson. The bank's president, who was a close friend of Johnson, was bewildered. How could this type of thing happen at this bank?

Required

Prepare a written memo to the bank president, outlining the procedures that should be followed to prevent this type of problem in the future.

ATC 4-5 Ethical Dilemma *I need just a little extra money*

John Riley, a certified public accountant, has worked for the past eight years as a payroll clerk for Southeast Industries, a small furniture manufacturing firm in the Northeast. John recently experienced unfortunate circumstances. His teenage son required major surgery and the medical bills not covered by John's insurance have financially strained John's family.

"I like the real life examples; I like the Analyze, Think, and Communicate."

DEBBIE GAHR, WAUKESHA COUNTY TECHNICAL COLLEGE

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 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 with scripted narration. 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 *Connect*. The instructor has complete control over student access to video content and the accompanying self-assessment quizzes.

Beyond the lecture videos, we have reorganized Chapters 1 and 2 to provide greater flexibility in establishing the pace of coverage. The proper pace is, of course, dependent on student aptitude. Since student aptitude varies widely across schools, the pace of coverage must also vary. To enhance flexibility, we divided Chapters 1 and 2 into sections.

Chapter 1, Section 1 covers basic terminology, introduces the accounting equation, and demonstrates how business events are recorded under the accounting equation. Section 2 introduces financial statements. The end-of-chapter exercises and problems are also segregated in separate sections. With this arrangement it is easy for instructors to treat the chapter as two separate chapters, thereby slowing the pace and allowing more time to cover key conceptual issues. Chapter 2 has also been divided into two sections: Chapter 2, Section 1 covers accruals, while Section 2 covers deferrals.

Breaking the chapters into sections offers an added benefit of promoting a stepwise learning environment. The primary concepts are isolated and introduced in a simple environment. More complex relationships and details are then added to the basic foundation. Stepwise learning is a hallmark of our teaching strategy.

The revision also includes many more detailed changes for each chapter. These changes are described as follows.

CHAPTER-SPECIFIC CHANGES

Chapter 1 An Introduction to Accounting

- Revised learning objectives. Added learning objective for entity concept. Developed separate learning objective for statement of cash flows.
- Revised coverage of closing process.
- Revised *Curious Accountant* featuring new high-profile companies and products.
- Updated *Focus on International Issues* box that includes IFRS coverage.
- New *Reality Bytes*.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 2 Accounting for Accruals and Deferrals

- Added video lectures and self-assessment quizzes for each learning objective.
- Divided chapter into two sections thereby providing more flexibility to set the pace of instruction.
- Revised learning objectives.
- Updated *Curious Accountant* content.
- New *Reality Bytes*.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 3 Accounting for Merchandising Businesses

- Revised learning objectives.
- Revised chapter opening to comply with FASB-issued Accounting Standards Update (ASU) No. 2014-09
- New *Curious Accountant* featuring new high-profile companies and products.
- Updated *The Financial Analyst* content.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 4 Internal Control, Accounting for Cash, and Ethics

- Divided learning objective one into two objectives, thereby separating coverage of general internal control procedures for the special procedures related to internal controls for cash.
- New *Curious Accountant* featuring new high-profile companies and products.
- Revised Exhibit 4.1 with data drawn from the companies that comprise the Dow Jones Industrial Average.
- Updated exercises, problems, and cases.

Chapter 5 Accounting for Receivables and Inventory Cost Flow

- Revised learning objectives.
- New *Curious Accountant* featuring new high-profile companies and products.
- Revised Exhibit 5.7 with data drawn from the companies that comprise the Dow Jones Industrial Average.
- Updated *Reality Bytes*.
- Updated *Focus on International Issues*.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 6 Accounting for Long-Term Operational Assets

- Revised learning objectives.
- Updated *Curious Accountant* featuring new high-profile companies and products.
- Revised Exhibit 6.2 with data drawn from the companies that comprise the Dow Jones Industrial Average.
- New *Reality Bytes*.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 7 Accounting for Liabilities

- Revised learning objectives.
- New *Curious Accountant* featuring new high-profile companies and products.
- Revised Exhibit 7.5 with data drawn from the companies that comprise the Dow Jones Industrial Average.
- Updated *Reality Bytes*.
- Updated *Focus on International Issues* box that includes IFRS coverage.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 8 Proprietorships, Partnerships, and Corporations

- Revised learning objectives.
- Updated *Curious Accountant*.
- Updated *Focus on International Issues* box that includes IFRS coverage.
- Revised Exhibit 8.3 with data drawn from the companies that comprise the Dow Jones Industrial Average.
- Updated *Reality Bytes.*
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 9 Financial Statement Analysis

- New *Curious Accountant* feature.
- Updated exercises, problems, and cases.

Chapter 10 An Introduction to Management Accounting

- Revised learning objectives.
- Updated *Curious Accountant* feature.

- Added content related to upstream and downstream costs.
- Updated exercises, problems, and ATC cases and added new exercises related to upstream and downstream costs.

Chapter 11 Cost Behavior, Operating Leverage, and Profitability Analysis

- Updated *Curious Accountant* feature.
- Updated exercises, problems, and cases.

Chapter 12 Cost Accumulation, Tracing, and Allocation

- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 13 Relevant Information for Special Decisions

- Updated *Focus on International Issues* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 14 Planning for Profit and Cost Control

- Revised *Curious Accountant* feature.
- New *Reality Bytes* feature.
- Revised *Focus on International Issues* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 15 Performance Evaluation

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* feature.
- Revised *Reality Bytes* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 16 Planning for Capital Investments

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- Revised *Curious Accountant* feature.
- Revised *Reality Bytes* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Assurance of Learning Ready

Many educational institutions today are focused on the notion of assurance of learning, an important element of some accreditation standards. *Survey of Accounting,* 5e, is designed specifically to support your assurance of learning initiatives with a simple, yet powerful, solution. Each test bank question for *Survey of Accounting,* 5e, maps to a specific chapter learning outcome/objective listed in the text. You can use our test bank software, EZ Test, and *Connect* to easily query for learning outcomes/objectives that directly relate to the learning objectives for your course. You can then use the reporting features of EZ Test and *Connect* to aggregate student results in similar fashion, making the collection and presentation of assurance of learning data simple and easy.

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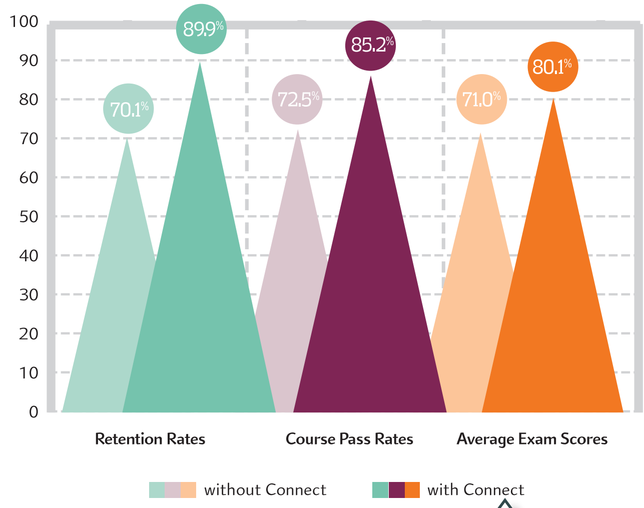

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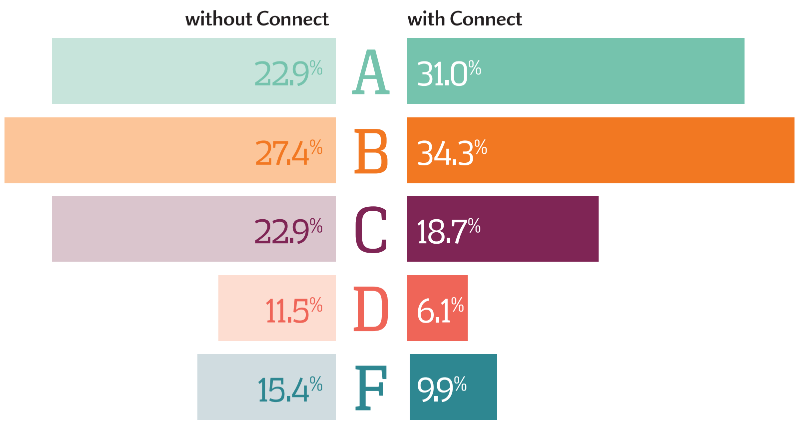

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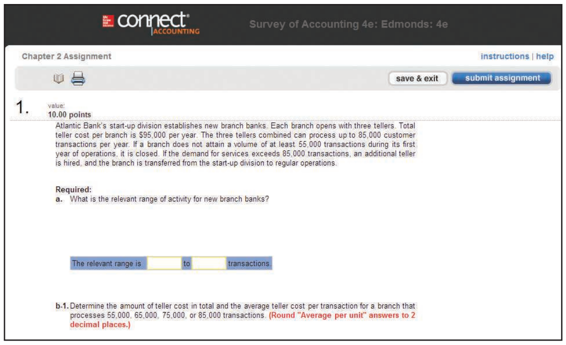


Online Assignments

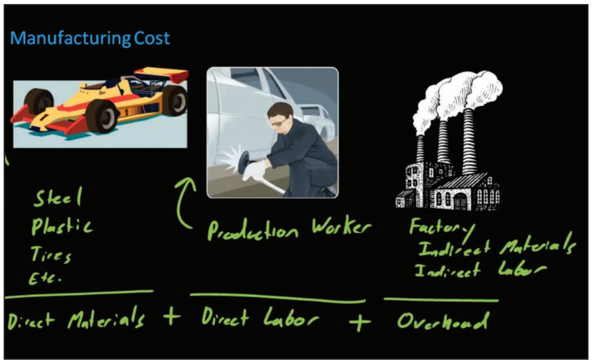
Connect helps students learn more efficiently by providing feedback and practice material when and where they need it. *Connect* grades homework automatically and students benefit from the immediate feedback that they receive, particularly on any questions they may have missed. Also, select questions 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.

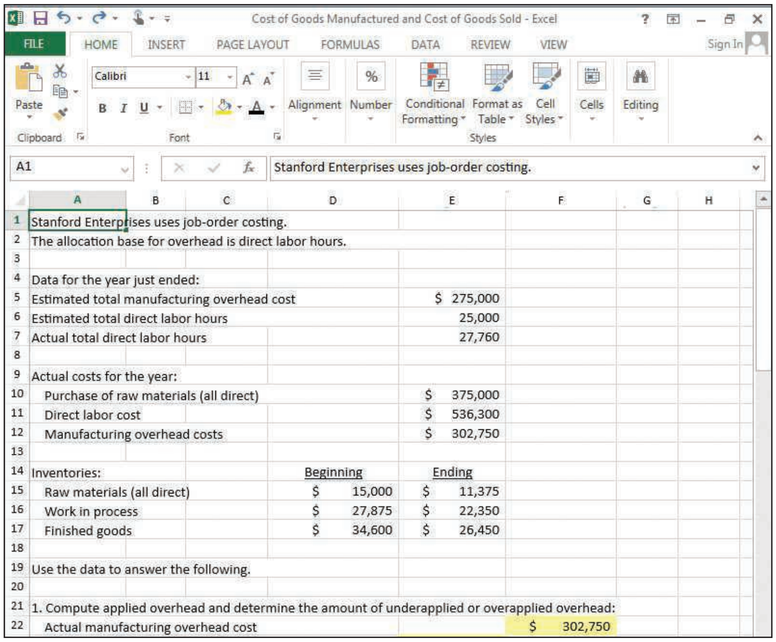
End-of-chapter questions in *Connect* include:

- Exercises
- Problems
- Multiple-Choice Questions
- Analyze, Think, Communicate

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.





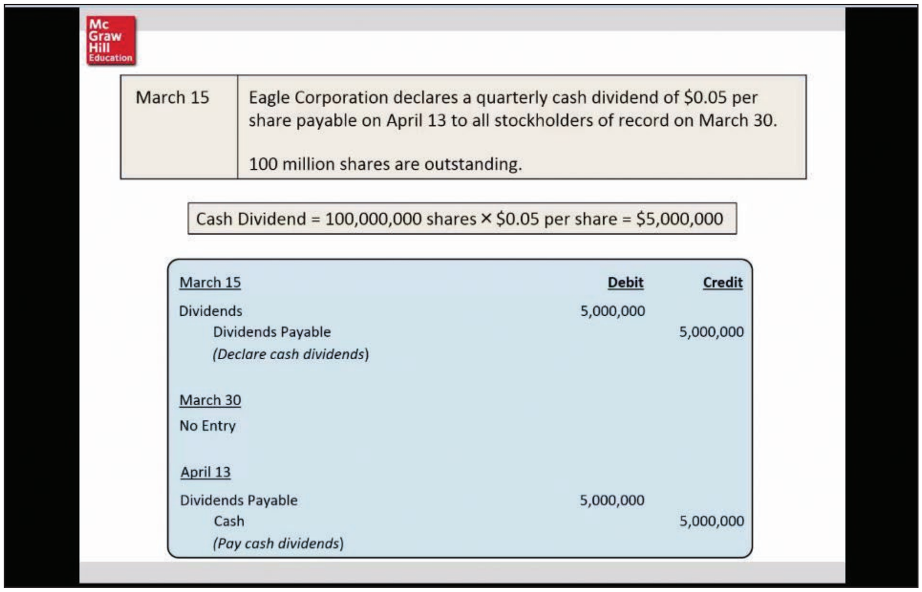
NEW! Excel Simulations

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

IMPROVE STUDENT SUCCESS?

NEW! Guided Examples

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



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"A well-designed textbook with a variety of in-class and online activities and practice problems. Also has a nice accompanying website that students can access. Clear examples, good Excel practice exercises, nice structure. The Instructor's Manual and the text are tightly integrated and well laid out (the instructor can easily and quickly choose practice activities for in-class assignments and homework).

KRISTEN BALL, DODGE CITY COMMUNITY COLLEGE

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We would like to express our appreciation to the people who have provided assistance in the development of this textbook.

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Our appreciation to those who reviewed the current and previous editions:

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Thomas P. Edmonds • Christopher T. Edmonds • Philip R. Olds • Frances M. McNair • Bor-Yi Tsay

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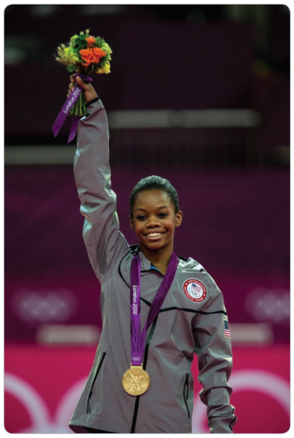

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CHAPTER 1

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 Identify the ways accounting benefits society.

LO 1-2 Identify reporting entities.

LO 1-3 Identify the components of the accounting equation.

LO 1-4 Show how business events affect the accounting equation.

LO 1-5 Interpret information shown in an accounting equation.

LO 1-6 Classify business events as asset source, use, or exchange transactions.

SECTION 2: REPORTING INFORMATION

LO 1-7 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

LO 1-8 Prepare a statement of cash flows.

LO 1-9 Distinguish between permanent and temporary accounts.

LO 1-10 Record business events using a horizontal financial statements model.

Video lectures and accompanying self-assessment quizzes are available in Connect *for all learning objectives.*

The Curious Accountant

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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.*

ROLE OF ACCOUNTING IN SOCIENTY

LO 1-1

Identify the ways accounting benefits 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.

Accounting Facilitates Resource Allocation

Suppose you want to start a business. You may have heard the adage "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.

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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 previously 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.

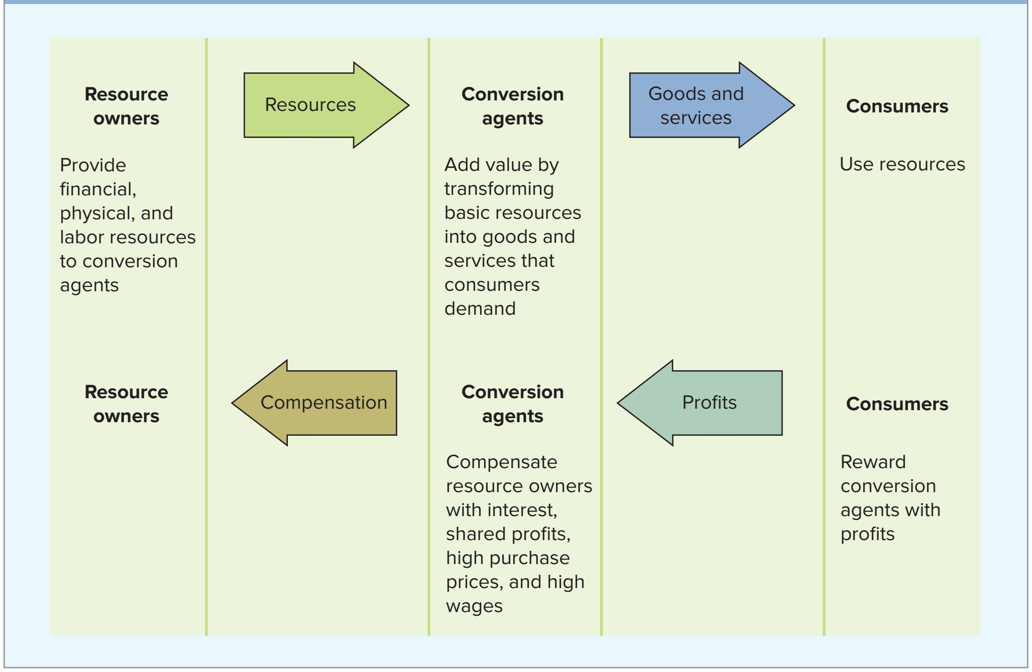
Financial Resources

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 Trilogy 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.**

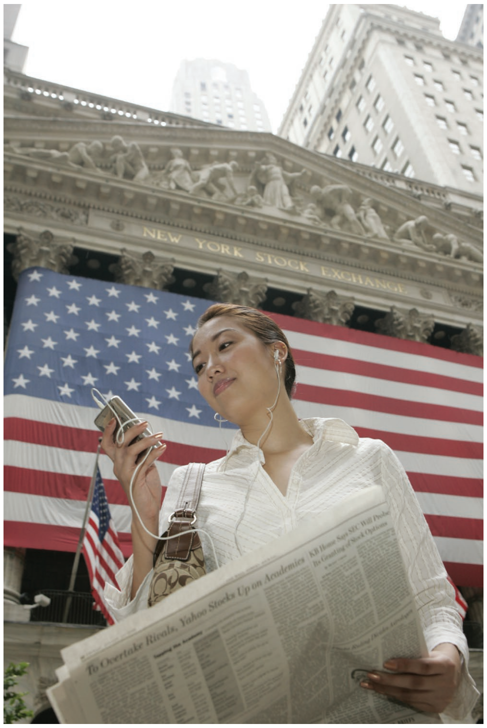
The information needs of external and internal users frequently overlap. For example, external and internal users are both interested in the amount of income a business earns. Managerial accounting information, however, is usually more detailed than financial accounting reports. For example, investors 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.



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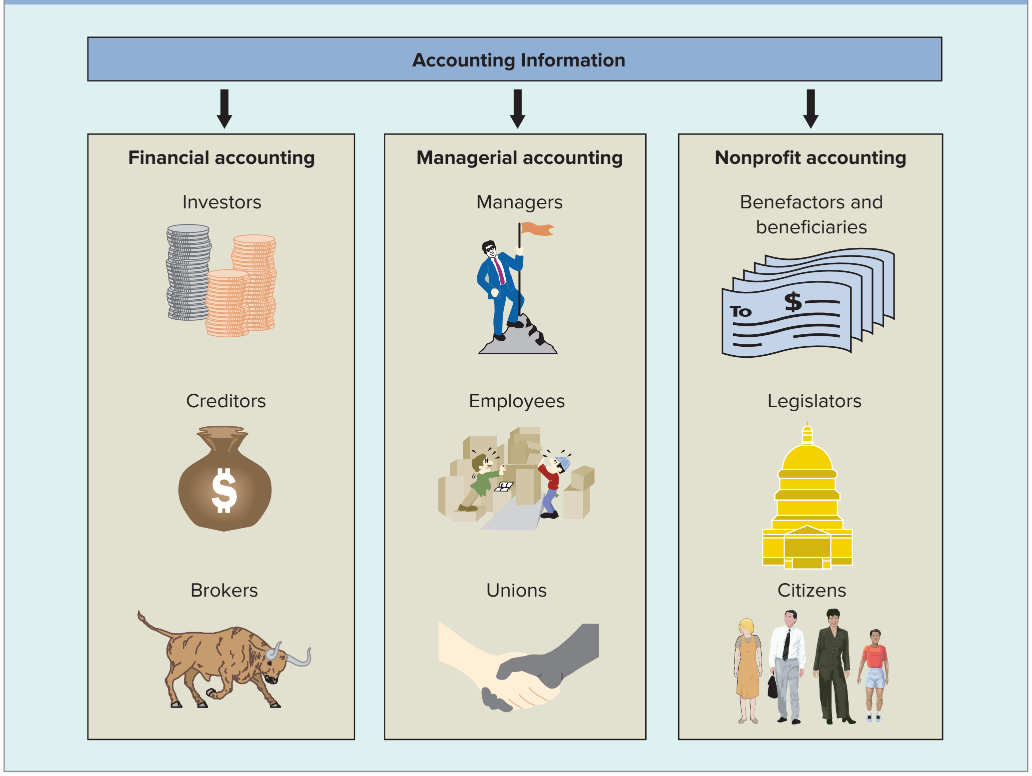
Accounting Improves Communication

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

EXHIBIT 1.2

Accounting as Information Provider



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.

Accounting Provides Jobs

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 chief executive officers (CEOs) advance from financial backgrounds than any other discipline. Sanders notes that large companies prefer CEOs who understand the financial ramifications of business decisions.

[1]The 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.

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 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.

REPORTING ENTITIES

LO 1-2

Identify 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.

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. The company then paid cash to purchase

FOCUS ON INTERNATIONAL ISSUES

IS THERE GLOBAL GAAP?

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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 2016, 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 U.S. 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 7 members, all from the United States. The IASB has 16 members, and these must include at least 4 from Asia, 4 from Europe, 4 from North America, 1 from Africa, and 1 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.

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 Bank, (5) Commercial Properties, Inc., (6) the customers, and (7) the employees. A separate set of accounting records would be maintained for each entity.

Your ability to learn accounting will be greatly influenced by how you approach the entity concept. Based on your everyday experiences you likely think from the perspective of a customer. In contrast, this text is written from the perspective of a business entity. These opposing perspectives dramatically affect how you view business events. For example, as a