

CHAPTERS 1-12

# College Accounting



Nobles  
Scott  
McQuaig  
Bille





# College Accounting

Chapters 1–12

11e

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**Eleventh Edition**

**Nobles, Scott, McQuaig, Bille**

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# About the Authors

## **Tracie L. Nobles**

Tracie L. Nobles, CPA, received her bachelor's and master's degrees in accounting from Texas A&M University. She has served as Department Chair of the Accounting, Business, Computer Information Systems, and Marketing/Management Department at Aims Community College, Greeley, Colorado, and is currently an Associate Professor of Accounting at Austin Community College, Austin, Texas. Professor Nobles has public accounting experience with Deloitte Tax LLP and Sample & Bailey, CPAs. She is a recipient of the Aims Community College Excellence in Teaching Award. Professor Nobles is a member of the Teachers of Accounting at Two-Year Colleges, the American Accounting Association, the American Institute of Certified Public Accountants, and the Texas Community College Teachers Association. She is currently serving as secretary/webmaster of Teachers of Accounting at Two-Year Colleges, as a member of the American Institute of Certified Public Accountants Pre-certification Education Executive Committee, as co-chair for the Conference on Teaching and Learning Accounting and as Two-Year College Section chair for the American Accounting Association. Professor Nobles has spoken on such topics as creating online web videos, motivating nonbusiness majors to learn accounting, and incorporating small business topics in college accounting at numerous conferences, including the Teachers of Accounting at Two-Year Colleges and the American Accounting Association. In her spare time, she enjoys camping and fishing with her husband, Trey, and spending time with her family and friends.



## **Cathy J. Scott**

Cathy J. Scott is currently an Associate Professor of Accounting and the Department Chair for Accounting, Business and Economics, at Navarro College. She is a proud recipient of Navarro College's Teaching of Excellence Award. Professor Scott received her bachelor's degree from Nazareth College, MBA from Amberton University, a post-graduate Accounting degree from Keller Graduate School of Management, and is currently ABD in her PhD program at Capella University. Professor Scott made a career shift into academics after a 25-year accounting and consulting career within the automotive industry. She has been a popular seminar speaker in the area of accounting and financial management for Automotive and Recreational Vehicle manufacturers, as well as dealer associations. She has also written numerous accounting related articles for various automotive publications. Professor Scott is a member of the Institute of Management Accountants, Teachers of Accounting at Two-Year Colleges, the American Accounting Association, and the Texas Community College Association. Professor Scott is currently the Southwest Regional Section Coordinator for Two-Year Colleges and for several years has been either the Chair and/or Co-chair for the Accounting section of the Texas Community College Association. In recent years, Professor Scott has become interested in improving online accounting education and has spoken on numerous occasions about effective online learning techniques and innovative technology in the area of accounting. In her free time, Professor Scott enjoys spending time with her family on her farm in North Texas, in addition to raising and showing her Arabian horses.



# Preface

College Accounting is a course for the times. The practical concepts and skills students take away from the College Accounting course have the power to launch new careers and bright futures. Students of College Accounting have many different goals: to train for accounting careers; to develop skills that lend themselves to technical, managerial, and executive positions; or to go on and earn Accounting or Business degrees. *College Accounting 11e*, maintains its dedicated emphasis on the significance of the College Accounting course as a launching pad for students' future classes, jobs, and careers. Like the previous editions, *College Accounting, 11e* provides an approach that builds students' business skills, accounting expertise, and confidence.

Accounting concepts and exercises are offered in a real-world context that encourages students to regard their coursework as true groundwork for their future classes, jobs, and careers. This edition builds student skills in the areas of accounting knowledge, technology, ethics, communication, and critical thinking—providing students with skills needed to be successful in life and work.

## CONNECTING THE CLASSROOM TO THE REAL WORLD

With a focus on small business, *College Accounting, 11e* provides real-world context that keeps chapter content relevant and vital. These are some of the activities that are designed to build student skills in the areas of accounting knowledge, technology, ethics, communication, and critical thinking.

### Chapter Email Openers

Every chapter begins with an email opener that simulates a mentor relationship between a student and her CPA friend. These emails set the stage for why the chapter content is important and provides a checklist of what students need to know from each chapter to succeed.

### Accounting in Your Future

This feature provides insight into possible careers that use accounting knowledge. This feature is designed to encourage students to think about their futures in accounting.

#### Learning Objectives

After you have completed this chapter, you will be able to do the following:

- 1 Recognize the role of income tax laws that affect payroll deductions and contributions.
- 2 Calculate total earnings based on an hourly, salary, piece-rate, or commission basis.
- 3 Determine deductions from gross pay, such as federal income tax withheld, Social Security tax, and Medicare tax, to calculate net pay.
- 4 Complete a payroll register.
- 5 Journalize the payroll entry from a payroll register.
- 6 Maintain employees' individual earnings records.

To: Amy Roberts, CPA  
Cc:  
Bcc:  
Subject: **Employee Earnings and Deductions**

Hi Amy,  
Thanks for all of your help with setting up my accounting system. Now I need some guidance on how to calculate and account for earnings, payroll taxes, and any other important deductions. I've been told that handling payroll in a timely and accurate manner is extremely important. Therefore, I want to make sure I know what to do. What do I need to know to calculate employee earnings and deductions?  
Thanks,  
Janie

To: **Janie Conner**  
Cc:  
Bcc:  
Subject: **RE: Employee Earnings and Deductions**

Hi Janie,  
You are right. Handling payroll in a timely and accurate manner is extremely important to your employees and your company. To gain an accurate understanding of payroll, you'll need to know the following:  
\_\_\_\_ 1. What tax laws affect payroll deductions and contributions  
\_\_\_\_ 2. How to calculate total earnings based on hourly, salary, piece-rate, or commission basis  
\_\_\_\_ 3. How to determine deductions and net pay  
\_\_\_\_ 4. How to set up and use a payroll register  
\_\_\_\_ 5. How to journalize payroll entries  
\_\_\_\_ 6. How to maintain individual employee earnings records  
Give me a call tomorrow and we can set up a meeting to discuss these items further.  
Amy



## ACCOUNTING IN YOUR FUTURE



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### PAYROLL DEPARTMENT

**T**he payroll department is an important part of the accounting and finance functions at companies. Payroll personnel are responsible for ensuring that all company employees receive compensation and benefits critical to maintaining a productive and motivated workforce. Some payroll departments work closely with Information Technology, Human Resources, and other departments to ensure that the company's payroll is accurate, is up-to-date, and is serving the company's current business objectives. For these reasons, it is important to understand how payroll is determined, whether you are directly responsible for processing payroll or you are employed in another business department.

## You Make the Call

These features sharpen critical-thinking and problem-solving skills by placing the student in a realistic accounting dilemma. These exercises provide students with the opportunity to apply their knowledge of individual topics within the chapter. Each scenario is followed by a detailed, clearly explained solution.

### YOU Make the Call

You are the owner of a small business whose balance sheet assets include Accounts Receivable, Notes Receivable, Merchandise Inventory, Prepaid Insurance, and Office Equipment. You find that you are having increasing difficulty meeting the payroll as well as being unable to do any business expansion. In other words, your cash flow and your working capital are stifling your ability to meet payable demands and to plan for the growth of your business. How might you make your assets work for you to begin to solve your cash flow and working capital shortfalls?

**SOLUTION**  
Included in your current assets are notes receivable—promises to pay you money but in future payments at a particular interest rate. At this point, you may choose not to wait for those payments to be received. In fact, if they are current notes receivable, you may be able to sell all or part of them to a bank or finance company for a percentage of their future value and receive the cash immediately.

## In the Real World

This new feature appears in every chapter and provides real-world facts about companies with which students are familiar. These features are related to the chapter material and bring the real-world into the classroom.



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### In the Real World

Publicly traded corporations such as Electronic Arts, Inc., a leading video game publisher, are required to file interim financial statements. These interim financial statements are filed using Form 10-Q and present the quarterly (every three months) financial position of the corporation. The interim financial statements are similar to the annual financial statements but are not as detailed and are typically not verified by an auditor.

## Small Business Success

Appearing in select chapters throughout the text, students will find this a motivating feature that emphasizes how accounting knowledge and best practices are critical to the success of a small business in a competitive environment.

SMALL BUSINESS SUCCESS

**Do I Need an Accountant?**

If you are not taking this class because you want to be an accountant or a bookkeeper, you might be taking the class because you plan on owning and operating a small business. Many new small business owners take on the responsibilities of being the accountant for their business. However, at some point, your business will begin to grow, and you may need to consider hiring someone to manage your accounting books so that your time is free to run the business.

An accountant can help you in many areas of your small business, such as:

- What should my business structure be—sole proprietorship, partnership, S corporation, or corporation?

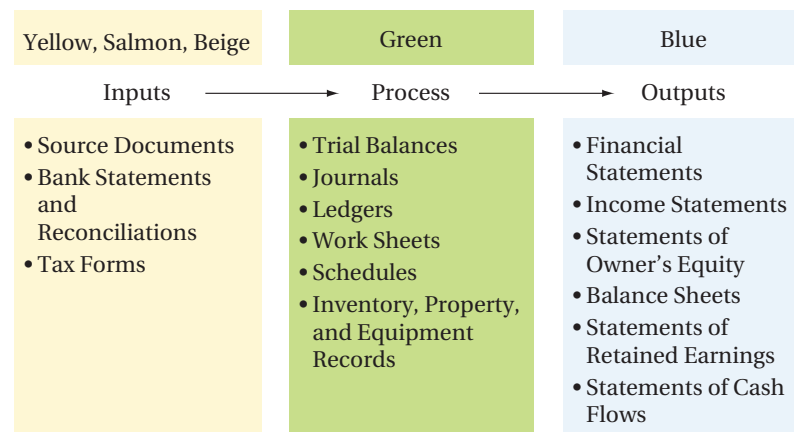
- What software should I use for my accounting?
- How do I handle the payroll for employees?
- What are my requirements for filing taxes?
- What expenses are deductible for tax purposes?
- How do I prepare financial statements when applying for a loan?

So how do you find an accountant? The best way is by referrals. Ask other businesses in your industry for references or visit your local Certified Public Accounting Society website for more recommendations ([www.aicpa.org/yellow/yypascpa.htm](http://www.aicpa.org/yellow/yypascpa.htm)).

## PROVEN PEDAGOGY

*College Accounting, 11e* is built on the solid pedagogical foundation created by Douglas McQuaig and appreciated by instructors and students through ten editions. The new author team of *College Accounting, 11e* has based the revision on their experience teaching college accounting and from instructor feedback. The 11th edition incorporates engaging, student-centered skills in the following areas: student success, real-world application, and teaching enhancements.

- **Learning Objectives** appear at the beginning of each chapter to help students focus on key learning outcomes. They are also highlighted in the margin alongside the related text discussion. A learning objective number serves as a reference to the objectives in the chapter review, exercises, and problems.
- **Key Terms** appear in blue and are defined in the text and repeated in the glossary at the end of each chapter. In addition, page numbers are included for each glossary term, making it easy for students to refer to a term in the chapter. This consistent emphasis on accounting terminology as the language of business is found throughout the text.
- **Remember** margin notes provide learning hints or summaries, often alerting students to common procedural pitfalls to help them complete their work successfully.
- **FYI** margin notes provide practical tips or information about accounting and business.
- **Color-Coding of Documents and Reports** continues in the eleventh edition of *College Accounting*. This tried and true visual system helps students recognize and remember key points. This use of color also helps students understand the flow of accounting data by clearly identifying the different documents and reports used in the accounting cycle. Students begin to visualize how accountants transform data into useful information.
  - Source documents, such as invoices, bank statements, tax forms, and other material that originates with outside sources, are shown in yellow, salmon, and beige.
  - Journals, ledgers, trial balances, work sheets, and other forms and schedules used as part of the internal accounting process are shown in green.
  - Financial statements, including balances sheets, income statements, statements of owner's equity, and statements of cash flows, are shown in blue.



## THOROUGHLY REVISED CHAPTERS

*College Accounting, 11e* has been thoroughly revised for clarity and relevance. Here is a list of the important revisions we have made in this edition based on customer feedback and reviews:

- **Chapter 3: The General Journal and the General Ledger** Added a new learning objective on the importance of source documents. Changed treatment of supplies so that it is now capitalized instead of expenses. Removed redundant coverage of the chart of accounts. Added section on computerized accounting to cover journal entries and posting.
- **Chapter 4: Adjusting Entries and the Work Sheet** Updated design of the work sheet to emphasize using spreadsheets to create a modernized work sheet.
- **Chapter 5: Closing Entries and the Post-Closing Trial Balance** Updated the section on closing entries in computerized accounting and changes to supplies. Updated the coverage on interim financial statements. New appendix on computerized accounting added.
- **Chapter 6: Bank Accounts, Cash Funds, and Internal Controls** Added new information for online banking and removed restricted, blank, and qualified endorsements.
- **Chapter 7: Employee Earnings and Deductions** Changed FICA employee withholding rate from 6.2% to 4.2% per the 2011 tax law change. Changed FUTA rate from 0.8% to 0.6% per July 2011 tax law change.
- **Chapter 8: Employer Taxes, Payments, and Reports** Updated all figures to show documents reflecting the latest tax forms.
- **Chapter 9: Sales and Purchases** Clarified use of periodic vs. perpetual inventory system within the text, moving the perpetual method out of the appendix and placing it within the chapter.
- **Chapter 11: Work Sheet and Adjusting Entries** Updated work sheets to look like a spreadsheet. Added new example on adjusting entries for supplies.

## ROBUST END-OF-CHAPTER ACTIVITIES

### Chapter Review: Study and Practice

- **Practice Exercises** keyed to the learning objectives, with solutions provided, aid in student comprehension and study.
- **Quiz Yourself** provides a new set of multiple-choice questions to be used as a self-quiz for students before they begin the chapter assignments. This is a great way for students to determine quickly if they “get it.”
- **Glossary** terms are listed in alphabetical order with page numbers for easy reference.
- **Before a Test Check** is a comprehensive chapter review feature that provides questions and brief application problems after every two to four chapters. The pre-test activities allow students to check their understanding of what they have read and practiced in the preceding chapters prior to taking a test.
- **Practice It More** reminds students of various study tools available on the textbook companion website and within CengageNOW.

# Chapter Review

## Study and Practice

- 1 Define and identify asset, liability, and owner's equity accounts.

### Learning Objective

**Assets** are cash, properties, or things of value owned by the business. **Liabilities** are amounts the business owes to creditors. **Owner's equity** is the owner's investment in or rights to the business. The **fundamental accounting equation** expresses the relationship of assets, liabilities, and owner's equity and is represented as:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$





## Chapter Assignments

A variety of study and homework assignments are provided at the end of each chapter and include:

- **Discussion Questions** can be used for class discussion or for individual practice.
- **Exercises** are provided to help students learn and apply new concepts. Each exercise includes margin references to the appropriate learning objective and Chapter Review practice exercises.
- **Problems** are found in every chapter. For those problems designed as a spreadsheet problem, students have access to Excel templates on the student website. Some problems can be completed using a variety of different applications including the following: Cengage Learning's Online General Ledger, QuickBooks, Peachtree or Excel. Each problem is designated with an icon to direct students to the correct application.

### Accounting Cycle Review Problem B

This problem is designed to enable you to apply the knowledge you have acquired in the preceding chapters. In accounting, the ultimate test is being able to handle data in real-life situations. This problem will give you valuable experience.

#### CHART OF ACCOUNTS

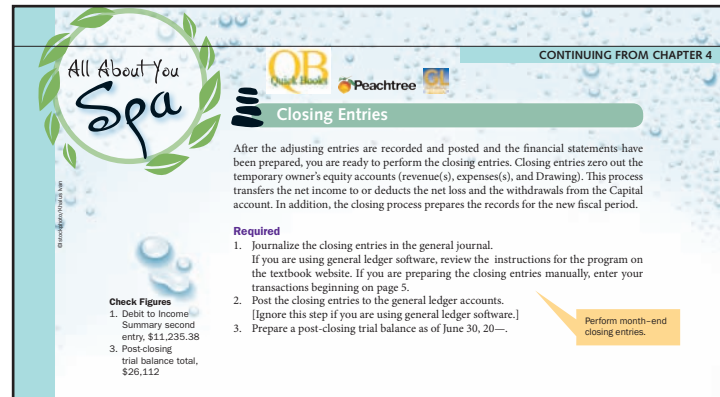
Assets	Revenue
111 Cash	411 Income from Services
112 Accounts Receivable	412 Concessions Income
114 Prepaid Insurance	
121 Land	Expenses
125 Pool Structure	511 Sailboat Rental Expense
126 Accumulated Depreciation, Pool Structure	512 Wages Expense
127 Fan System	513 Advertising Expense
128 Accumulated Depreciation, Fan System	514 Utilities Expense
129 Sailboats	515 Interest Expense
130 Accumulated Depreciation, Sailboats	516 Insurance Expense
Liabilities	517 Depreciation Expense, Pool Structure
221 Accounts Payable	518 Depreciation Expense, Fan System
222 Wages Payable	519 Depreciation Expense, Sailboats
223 Mortgage Payable	522 Miscellaneous Expense

Each chapter contains a minimum of four A and four B problems. The A and B problems are parallel in content and level of difficulty. They are arranged in order of difficulty, with Problems 1A and 1B in each chapter being the simplest, and the last problem in each series being the most comprehensive. Check Figures appear alongside every A and B problem's instructions in the text.

- **Technology** has been enhanced with the Accounting Cycle Review Problems and the Comprehensive Review Problem. Students have the opportunity to apply accounting procedures to help them understand the process they have just studied in a series of chapters (1–5) and (6–12). Accounting Cycle Review Problems A and B involve the full accounting cycle, one for Blast Off! and the other for Wind In Your Sails both sole proprietorship service businesses. The Comprehensive Review Problem following Chapter 12 involves the full accounting cycle for Fabulous Furnishings, a sole proprietorship merchandising business. This edition allows for more options when assigning these problems. These problems can be completed manually, with QuickBooks, Peachtree, Excel, or Cengage Learning's Online General Ledger.
- **Activities** at the end of each chapter hone students' problem-solving and communication skills. Why Does It Matter?, What Would You Say?, What Do You Think?, What Would You Do?, What's on the Internet?, and What's Wrong With this Picture? are a series of brief activities at the end of each chapter that help students keep the business perspective in mind.

## All About You Spa

**All About You Spa** designed to give students experience using computers to manage accounting transactions, a continuous general ledger problem features a sole proprietorship business. The All About You Spa problem is readily available to be solved manually, or in one of the following accounting software programs: Peachtree, QuickBooks, or Cengage Learning's Online General Ledger.



## INSTRUCTOR SUPPLEMENTS

*College Accounting, 11e* provides you with the robust and flexible teaching supplements you need to launch your course efficiently and successfully semester after semester.

### CengageNOW™ for *College Accounting, 11e*

CengageNOW offers:

- **Auto-graded Homework** (static and algorithmic varieties), test bank, Personalized Study Plan, and eBook are all in one resource.
- **Enhanced Feedback** for additional guidance to help complete an exercise or problem.
- **Assignment Options** are the most robust and flexible in the industry.
- **Smart Entry** helps eliminate common data entry errors and prevents students from guessing their way through homework.
- **Learning Outcomes Reporting** and the ability to analyze student work from the gradebook. Each problem is tagged by topic, learning objective, level of difficulty, Bloom's Taxonomy, AICPA, ACBSP, and other business program standards to allow greater guidance in developing assessments and evaluating student progress.
- **Animated Example Exercises** narrated by the authors, provide students with an illustrated example of how to work basic exercises for each learning objective.
- **Robust Study Tools** include a vast array of quizzing, puzzles, tutorials, and chapter videos.
- **Cengage Online General Ledger** is available within CengageNOW. Your students can solve selected end-of-chapter assignments in a format that emulates commercial general ledger software.

### Instructor's Resource Manual with Solutions

This helpful guide provides suggested homework check questions, teaching and learning objectives, key points, lecture outlines, demonstration problems, responses to discussion questions, and solutions to all text exercises, problems, and activities. New to this edition, more ideas for Group and Internet Activities are listed in each chapter for instructors.

Also included are transition guides from the 10th to 11th edition, reviews of T Account Placement and Representative Transactions, chart to gauge the difficulty levels of assignments, and estimate student completion time, and suggested abbreviations for account titles. Available in print, electronically on the Instructor's Resource CD, and on the password-protected section of the text's companion website.

### Test Bank

Revised and verified to ensure accuracy, the Test Bank includes questions clearly identified by topic, learning objectives, level of difficulty, Bloom's Taxonomy, AICPA, ACBSP, and other business program standards to allow greater guidance in developing assessments and evaluating student progress. The Test Bank has been increased by an average of 107%.



All multiple-choice questions were increased to 60 questions for Chapters 1–12. Available in print, electronically on the Instructor’s Resource CD, and on the password-protected section of the text’s companion website.

## Instructor’s Resource CD

This powerful resource tool contains:

- Content from the Instructor’s Resource Manual with Solutions
- PowerPoint® lecture slides—These slides enhance lectures and simplify class preparation. Each chapter contains the learning objectives along with figures directly from the text and practice exercises to help you create a powerful, customizable tool. The slides have an updated design, based on the interior of the textbook.
- Student PowerPoint slides—The student slides are modeled after the instructor slides and are created in a way that allows students to print the slides and write notes as the instructor is lecturing.
- Solutions to Excel template problems
- Teaching and Solutions Transparency Masters for transparency files.
- Achievement Tests with solutions
- ExamView® testing software—This computerized version of the test bank is available to adopters of *College Accounting, 11e*. The program is an easy-to-use test creation software compatible with Microsoft Windows. Instructors can add or edit questions, instructions, and answers, and select questions by previewing them on the screen, choosing them randomly, or choosing them by number. Instructors can also create and administer quizzes online, whether over the Internet, a local network (LAN), or a wide area network (WAN).
- Data Files—QuickBooks and Peachtree data files provided for completion of all All About You Spa Problems as well as both Accounting Cycle Review Problems A and B, and the Comprehensive Review Problem.

## Solutions Transparencies

Contains solutions for the Series A Problems, Accounting Cycle Review Problem A (Chapter 5), and Comprehensive Review Problem (Chapter 12). This product is printed on acetate for use on an overhead projector.

## Instructor Companion Site (<http://login.cengage.com>)

The companion site contains online versions of the Instructor’s Resource Manual with Solutions, PowerPoint Lecture Slides, Student PowerPoint slides, Errata Sheet, Excel Template Solutions, Teaching Transparency Masters, Data files, and Achievement Tests with solutions.

## STUDENT SUPPLEMENTS THAT LAUNCH SUCCESSFUL STUDENTS

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Preparing your students for the real world means giving them the confidence to tackle a variety of accounting challenges. Including Working Papers with Study Guides, and CengageNOW with your students’ course materials will give them the practical skills and employability they deserve.

### Study Guide with Working Papers, Chapters 1–12

The Study Guide and Working Papers are provided together in one convenient resource. The Study Guide portion reinforces learning with chapter outlines that are linked to chapter learning objectives. The Working Papers are tailored to the text’s end-of-chapter assignments.

### CengageNOW™ for *College Accounting, 11e*

CengageNOW allows students to test their mastery of new concepts through pre- and post-tests. Students engage with multimedia study tools via personalized study plans that target the areas on which they need to focus. Additional quizzes, games, tutorials and videos are available as study tools.

# Acknowledgments

We sincerely thank the editorial staff of South-Western/Cengage Learning for their continuous support. During the writing of the eleventh edition, we consulted many users of the text throughout the country. Their constructive suggestions are reflected in the changes that we have made. Unfortunately, space does not permit mention of all those who have contributed to this volume. Those reviewers and advisors who have contributed to *College Accounting, 11e* through their reviews, focus group attendance, class testing, market feedback, and accuracy checking are as follows:

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# College Accounting

11e

# Introduction to Accounting

## Learning Objectives

After you have completed this introduction to accounting, you will be able to do the following:

- 1 Define accounting.
  - 2 Explain the importance of accounting information.
  - 3 Describe the various career opportunities in accounting.
  - 4 Define ethics.
- .....

**To: College Accounting Students**

**Cc:**

**Bcc:**

**Subject: Welcome to the World of Accounting**

---

College Accounting Students,

Welcome to the *World of Accounting*. This book holds one of the keys to your future—knowledge of accounting and business! Throughout the pages of this text, you'll be introduced to individuals, just like yourself, who dreamed about working in, operating, or even owning a business. You will read about many real world companies and learn about the important role accounting plays in each.

We understand this may be a new experience for many of you, and thus, this book is designed to help you navigate and ultimately succeed. As you go through this book, you will find numerous tools and activities to help you understand accounting and how accounting impacts business success. We look forward to being your guides into the world of accounting. So let's get started on this great adventure!

Tracie Nobles and Cathy Scott





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## Accounting Language

Accounting is often called the *language of business* because when confronted with events of a business nature, all people in society—owners, managers, creditors, employees, attorneys, engineers, and so on—must use accounting terms and concepts to describe these events. Examples of accounting terms are *net, gross, yield, valuation, accrued, deferred*—the list goes on and on. So it is logical that anyone entering the business world should know enough of its *language* to communicate with others and to understand their communications.

As you acquire knowledge of accounting, you will gain an understanding of the way businesses operate and the reasoning involved in making business decisions. Even if you are not involved directly in accounting activities, you will certainly need to be sufficiently acquainted with the *language* in order to understand the meaning of accounting information and how it is compiled, how it can be used, and what its limitations are.

You may be surprised to find that you are already familiar with many accounting terms. Recalling your personal business activities and relating them to your study of accounting will be very helpful to you. For example, when you purchased this textbook, you exchanged cash or a promise to pay cash for the book. As you will see, this exchange is an accounting event. You are going to recognize many activities and terms as you begin your study of accounting.

## DEFINITION OF ACCOUNTING

**Accounting** is the process of analyzing, classifying, recording, summarizing, and interpreting business transactions in financial or monetary terms. A business **transaction** is an event that has a direct effect on the operation of an economic unit, is expressed in terms of money, and is recorded. Examples of business transactions are buying or selling goods, renting a building, paying employees, and buying insurance.

The primary purpose of accounting is to provide the financial information needed for the efficient operation of an economic unit. The term **economic unit** includes not only business enterprises but also not-for-profit entities such as government bodies, churches and synagogues, clubs, and public charities. Business enterprises or organizations may be called firms or companies.

- Accountant** (p. 4)
- Accounting** (p. 3)
- Economic unit** (p. 3)
- Ethics** (p. 8)
- Financial Accounting Standards Board (FASB)** (p. 4)
- Generally accepted accounting principles (GAAP)** (p. 4)
- International Accounting Standards Board (IASB)** (p. 4)
- International Financial Reporting Standards (IFRS)** (p. 4)
- Paraprofessional accountants** (p. 7)
- Sarbanes-Oxley Act** (p. 9)
- Securities and Exchange Commission (SEC)** (p. 4)
- Transaction** (p. 3)

- 1 Define accounting.

Another important purpose of accounting is to provide useful information for decision making in the business enterprise. Similar to decisions you must make in your daily life, accounting helps businesses make decisions. For example, knowing whether there is enough cash to purchase new equipment or whether the business is making a profit requires knowledge of accounting.

All business entities require some type of accounting records. Basically, an **accountant** is a person who keeps the financial history of the transactions of an economic unit in written or computerized form.

## Accounting Standards

Because it is important that everyone who receives accounting reports be able to interpret them, a set of rules or guidelines for the accounting process has been developed. These guidelines or rules are known as **generally accepted accounting principles (GAAP)** and are developed by the **Financial Accounting Standards Board (FASB)**.

The FASB was created by the **Securities and Exchange Commission (SEC)** in 1973. The SEC is the agency responsible for regulating public companies that are traded on a U.S. stock exchange. The SEC relies on the FASB to create accounting standards. However, the ultimate responsibility for setting and enforcing accounting standards for public companies lies with the SEC.

With the globalization of the world economy, an international standard-setting board, the **International Accounting Standards Board (IASB)**, has been created to provide guidelines or rules on international accounting standards known as **International Financial Reporting Standards (IFRS)**. The IASB and FASB are currently working to combine GAAP and IFRS into one set of standards.

## Bookkeeping and Accounting

While bookkeeping and accounting are closely related, there are differences between the two processes. Generally, bookkeeping involves the systematic recording of business transactions in financial terms. Accounting functions at a higher level. An accountant sets up the system that a bookkeeper uses to record business transactions. An accountant may supervise the work of the bookkeeper and prepare financial statements and tax reports. Although the bookkeeper's work is more routine, it is hard to draw a line where the bookkeeper's work ends and the accountant's begins.

## IMPORTANCE OF ACCOUNTING INFORMATION

Anyone who aspires to a position of leadership in business or government needs knowledge of accounting. A study of accounting gives a person the necessary background and gives him or her an understanding of the scope, functions, and policies of an organization. A person may not be doing the accounting work, but he or she will be dealing with accounting forms, language, and reports.

## Users of Accounting Information

There are many users of accounting information, as outlined below.

### OWNERS

Owners have invested their money or goods in a business organization. They want information regarding the company's earnings, its prospects for future earnings, and its ability to pay its debts.

- 2 Explain the importance of accounting information.



## MANAGERS

Managers and supervisors have to prepare financial reports, understand accounting data contained in reports and budgets, and express future plans in financial terms. People who have management jobs must know how accounting information is developed in order to evaluate performance in meeting goals.

## CREDITORS

Creditors lend money or extend credit to the company for the purchase of goods and services. The company's creditors include suppliers, banks, and other lending institutions, such as loan companies. Creditors are interested in the firm's ability to pay its debts.

## GOVERNMENT AGENCIES

Taxing authorities verify information submitted by companies concerning a variety of taxes, such as income taxes, sales taxes, and employment taxes. Public utilities, such as electric and gas companies, must provide financial information to regulatory agencies.

## Accounting and Technology

Before the invention of computers, all business transactions were recorded by hand. Now computers perform routine recordkeeping operations and prepare financial reports. Computers are used today in all types of businesses, both large and small. All accounting positions now require workers to use computers, have knowledge of word processing and spreadsheet software, and possess an understanding of accounting software, such as QuickBooks and Peachtree®.

Even though virtually all businesses now use computers to do their accounting, the nature of accounting is the same. The computer is a powerful tool of the accountant. However, as a tool, the computer is only as useful as the operator's ability and understanding of accounting. The operator must be skilled to key the correct information into the computer program; otherwise, as the saying goes, "garbage in, garbage out."

## CAREER OPPORTUNITIES IN ACCOUNTING

There are a number of career opportunities in accounting in every industry. To find job opportunities in accounting, browse Internet job sites or read the newspapers' classified advertisements. Although the jobs listed in these ads require varying amounts of education and experience, many of them are for positions as accounting and auditing clerks, general bookkeepers, and accountants. The Bureau of Labor Statistics *Occupational Outlook Handbook* estimates that employment is expected to grow faster than average for accountants, bookkeepers, clerks, and auditors. The number of accounting-related jobs is expected to grow by 12 percent between 2006 and 2016. The requirements and duties of these positions are discussed next. Figure 1, on page 6, provides a listing of the average salaries for some of these positions.

### Accounting Clerk/Technician

An accounting clerk/technician performs routine recording of financial information. The duties of accounting clerks vary with the size of the company. In small businesses, accounting clerks handle most of the recordkeeping functions. In large companies, clerks specialize in one part of the accounting system, such as payroll, accounts receivable, accounts payable, cash, inventory, or purchases. The minimum requirement for most accounting clerk positions is usually one term or semester of accounting courses. Having experience in a related job and working in an office environment is also recommended. In addition, knowledge of word processing and

- 3** Describe the various career opportunities in accounting.

**Figure 1**

Salary ranges for various accounting positions

TITLE	SALARY RANGE
ACCOUNTING CLERK	\$27,750–\$36,500
– Accounts receivable/Accounts payable clerk	\$30,000–\$41,000 <sup>a</sup>
	\$29,500–\$39,250 <sup>b</sup>
	\$27,500–\$36,250 <sup>c</sup>
– Inventory clerk	\$29,500–\$37,750 <sup>a</sup>
	\$28,000–\$36,500 <sup>b</sup>
– Payroll clerk	\$31,250–\$40,500 <sup>a</sup>
	\$30,350–\$39,750 <sup>b</sup>
	\$28,000–\$35,750 <sup>c</sup>
BOOKKEEPER	\$36,750–\$53,250
PARAPROFESSIONAL ACCOUNTANT	\$36,750–\$53,250
ACCOUNTANT	
– Chief financial officer	\$94,250–\$395,500
– Controller	\$67,000–\$175,250
– Financial analyst (entry level)	\$41,000–\$109,750 <sup>a</sup>
	\$39,500–\$95,000 <sup>b</sup>
	\$36,500–\$80,000 <sup>c</sup>
– Forensic accountant	\$61,250–\$98,000
– General accountant (entry level)	\$38,500–\$100,000 <sup>a</sup>
	\$36,500–\$83,500 <sup>b</sup>
	\$34,000–\$75,500 <sup>c</sup>
– Internal auditor (entry level)	\$53,250–\$121,000 <sup>a</sup>
	\$42,500–\$101,500 <sup>b</sup>

<sup>a</sup>Large companies

<sup>b</sup>Midsized companies

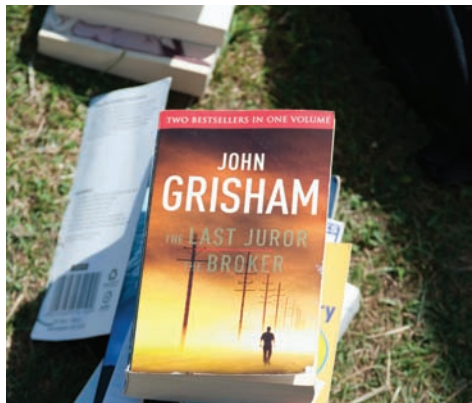
<sup>c</sup>Small companies

Source: Robert Half International, 2011 *Salary Guide—Accounting & Finance*, © 2011 Robert Half International.

spreadsheet software is helpful. Accounting clerks/technicians should be detail-oriented and have good communication skills.

## Auditing Clerk

Auditing clerks are an organization's financial recordkeepers. An auditing clerk's primary responsibility involves verifying transactions and records posted by other employees. Additional responsibilities include maintaining and updating individual or groups of accounting records, checking documents to ensure that they are mathematically correct,



Nigel Ferguson/Alamy

## In the Real World

Many famous people began their careers in accounting. For instance, author John Grisham received his undergraduate degree in accounting from Mississippi State University.

and correcting or noting errors for accountants or other workers to adjust. Most auditing clerks are required to have a high school degree at a minimum, while an associate degree in business or accounting is often preferred for some positions. Knowledge of word processing and spreadsheet software in addition to experience in a related job are also recommended.

## General Bookkeeper

Many small- and medium-sized companies employ one person to oversee their bookkeeping operations. This person is called a general or full-charge bookkeeper. The general bookkeeper supervises the work of accounting clerks. Requirements for this job vary with the size of the company and the complexity of the accounting system. The minimum requirement for most general bookkeeper jobs is one or two years of accounting education as well as experience as an accounting clerk. Many companies require a certificate in business or accounting and experience working with computers and accounting software.

## Paraprofessional Accountant

To bridge a gap between the general bookkeeper and the professional accountant, many firms are hiring **paraprofessional accountants**. They manage the duties of the general bookkeeper as well as many of the duties of a professional accountant. Paraprofessional accountants work under the direct supervision of a professional accountant. Qualifications generally include a two-year degree in accounting, knowledge of accounting software, and prior experience.

## Certifications Available

Several organizations offer certification for accounting and auditing clerks, bookkeepers, and paraprofessional accountants. The Certified Bookkeeper (CB) designation is awarded by the American Institute of Professional Bookkeepers ([www.aipb.org](http://www.aipb.org)) and certifies that an individual has the knowledge needed to carry out bookkeeping functions. For certification, candidates must have at least two years of bookkeeping experience, pass an examination, and adhere to a code of ethics. The Accreditation Council for Accountancy and Taxation ([www.acatcredentials.org](http://www.acatcredentials.org)) offers an Accredited Business Accountant® (ABA) certification designed for individuals who work with small- to medium-sized businesses in the areas of financial accounting, tax, and ethics. For accreditation, candidates must pass a one-day, seven-hour exam.

## Accountant

The term *accountant* describes a fairly broad range of jobs. The accountant may design and manage the entire accounting system for a business. The accountant may also prepare financial statements and tax returns and perform audits. Many accountants enter the field with a four-year college degree in accounting; however, it is not unusual for accountants to start at entry-level positions and work their way up to management positions. Although accountants are employed in every kind of economic unit, they are classified into one of four categories: public accounting, managerial or private accounting, government and not-for-profit accounting, and internal auditing. We'll briefly look at these categories.

### PUBLIC ACCOUNTING

Most public accountants are certified public accountants (CPAs). To become a CPA, a person must have a bachelor's degree, complete 150 hours of college course work (in most states), pass a rigorous examination, and complete a work experience requirement. CPAs design accounting systems, prepare tax returns, provide financial advice about business operations, and audit financial statements. Many CPAs work for a public accounting firm such as Deloitte LLP or own their own small business. CPAs can also be employed

by corporations in the private sector in finance positions such as chief financial officers (CFOs), controllers, and financial analysts.

A relatively new and upcoming career opportunity in public accounting is forensic accounting. Forensic accountants specialize in investigating business crimes such as fraud, embezzlement, and money laundering. Accountants in this area of specialty require knowledge of accounting, law, and finance and work closely with law enforcement personnel. Individuals wanting to specialize in forensic accounting can apply for a Certified Fraud Examiner (CFE) certificate ([www.acfe.com](http://www.acfe.com)). Requirements for CFE certification include a minimum of a bachelor's degree and two years of professional experience in a field directly or indirectly related to the detection or deterrence of fraud.

If you are interested in learning more about becoming a CPA or other public accounting jobs, the American Institute of Certified Public Accountants ([www.aicpa.org](http://www.aicpa.org)) has an excellent website called This Way to CPA ([www.thiswaytocpa.com](http://www.thiswaytocpa.com)), that describes accounting degrees and job opportunities. This site includes study information, simulation games, scholarship and internship listings, profiles of successful CPAs, and career opportunities.

### MANAGERIAL OR PRIVATE ACCOUNTING

Most people who are accountants are employed by private business organizations. These accountants (not necessarily CPAs) manage the accounting system, prepare budgets, determine costs of products, and provide financial information for managers and owners. Accountants have many opportunities to advance into top management positions. The Certified Management Accountant (CMA) has a solid understanding of financial planning and analysis, internal controls, decision making, and professional ethics. Requirements for CMA certification include having a bachelor's degree (in any area), passing the CMA exam, and having two years' experience in management accounting and/or financial management. You can find more information about the CMA exam at <http://imanet.org>.

### GOVERNMENT AND NOT-FOR-PROFIT ACCOUNTING

Not-for-profit accounting is used for government agencies, hospitals, churches and synagogues, and schools. Accountants for these organizations prepare budgets and maintain records of revenues and expenses. Local, state, and federal government bodies employ vast numbers of people in accounting positions. For example, a top federal government employer in the area of accounting is the Internal Revenue Service (IRS).

### INTERNAL AUDITING

Due to recent accounting regulations, the demand for internal auditors has increased. Internal auditors verify the effectiveness of an organization's accounting system and controls. They examine and ensure that the company's financial information is accurate and protected. Internal auditors also ensure that organizations are following government regulations and corporate policies. The Institute of Internal Auditors (<http://theiia.org>) sets international standards for internal auditors and offers a certification opportunity called the Certified Internal Auditor (CIA). Requirements for certification include having a bachelor's degree (in any area), having two years' experience in internal auditing, and passing the Certified Internal Auditor exam.

## ETHICS

**Ethics** is a philosophy or code or system of morality—that is, how we conduct ourselves from day to day in a variety of situations requiring a decision, usually of a right or wrong nature. Ethics, as it relates to accounting, is the way accountants and other keepers of

financial information conduct the business of accounting according to laws of the state and their own personal code or system of morality.

Many books, as well as classes, are available on the subject of ethics. All organizations provide a code of ethical conduct for their members. Your school may even have a Student Code of Conduct that discusses the ethical expectations and conduct of students. With mounting evidence of questionable business ethics reported in print and portrayed through visual media, understanding and learning about ethics is very important in the world of accounting.

Related to ethics, a recent change to the accounting profession is the **Sarbanes-Oxley Act**, commonly referred to as SOX. SOX was created as a response to various large-scale corporate accounting frauds, such as Enron and WorldCom. The Sarbanes-Oxley Act established a wide range of new rules related to the audit environment and internal controls.

# Chapter Review

## Study & Practice

1 Define accounting.

Learning Objective

**Accounting** is the process of analyzing, classifying, recording, summarizing, and interpreting business **transactions** in financial or monetary terms. It is also an information system and the language of business.

2 Explain the importance of accounting information.

Learning Objective

A study of accounting gives a person the necessary background to understand the scope, functions, and policies of an organization.

3 Describe the various career opportunities in accounting.

Learning Objective

Accounting and auditing clerks, bookkeepers, **paraprofessional accountants**, and **accountants** will find employment opportunities in several areas—in the public sector, the private sector, and not-for-profit organizations.

4 Define ethics.

Learning Objective

**Ethics** is a code of morality—that is, how we respond to a variety of situations on a daily basis that require a decision, usually of a right or wrong nature. Ethics, as it relates to accounting, is the way accountants and other keepers of financial information conduct themselves according to laws of the state and their own personal code or system of morality.