



FINANCIAL ACCOUNTING

3e

IFRS Edition

Earl K. Stice • James D. Stice • W. Steve Albrecht
Monte R. Swain • Rong-Ruey Duh • Audrey Wenhsin Hsu

FINANCIAL ACCOUNTING

3e

IFRS Edition

Earl K. Stice • James D. Stice • W. Steve Albrecht
Monte R. Swain • Rong-Ruey Duh • Audrey Wenhsin Hsu



**Financial Accounting:
IFRS Edition, Third Edition**

Earl K. Stice, James D. Stice, W. Steve
Albrecht, Monte R. Swain, Rong-Ruey Duh,
and Audrey Wenhsin Hsu

Regional Director, Marketing:
Melissa Chan

Senior Marketing Manager:
Charles Ho

Senior Editorial Manager:
Lian Siew Han

Assistant Editorial Manager:
Tanmayee Bhatwadekar

Senior Development Editor:
Kenneth Chow

Development Editors:
Ng Wei Yi
Elaine Chew
Iris Poh
Cecile Zhang

Senior Editor (Taiwan):
Sophie Wu

Senior Production Executive (Taiwan):
Evan Wu

Senior Regional Manager, Production & Rights:
Pauline Lim

Production Executive:
Rachael Tan

Cover Designer:
Foo Toon Check

© 2021 Cengage Learning Asia Pte Ltd

ALL RIGHTS RESERVED. No part of this work covered by the copyright herein may be reproduced, transmitted, stored or used in any form or by any means graphic, electronic, or mechanical, including but not limited to photocopying, recording, scanning, digitizing, taping, Web distribution, information networks, or information storage and retrieval systems, without the prior written permission of the publisher.

For product information and technology assistance, contact us at
Cengage Learning Asia Customer Support, 65-6410-1200

For permission to use material from this text or product,
submit all requests online at **www.cengageasia.com/permissions**
Further permissions questions can be emailed to
asia.permissionrequest@cengage.com

ISBN: 978-981-49-6258-2

Cengage Learning Asia Pte Ltd, Taiwan Branch

3F-1, No. 129, Sec. 2, Zhongshan North Road
Zhongshan Dist., Taipei 10448, Taiwan (R.O.C.)

Cengage Learning Asia Pte Ltd

151 Lorong Chuan, #02-08
New Tech Park
Singapore 556741

Cengage Learning is a leading provider of customized learning solutions with office locations around the globe, including Singapore, the United Kingdom, Australia, Mexico, Brazil, and Japan. Locate your local office at **www.cengage.com**

To learn more about Cengage Learning Solutions, visit **www.cengageasia.com**

Every effort has been made to trace all sources and copyright holders of news articles, figures and information in this book before publication, but if any have been inadvertently overlooked, the publisher will ensure that full credit is given at the earliest opportunity.

Brief Contents

PART ONE

Financial Reporting and the Accounting Cycle 1

- 1 Accounting Information: Users and Uses 2
- 2 Financial Statements: An Overview 25
- 3 The Accounting Cycle: The Mechanics of Accounting 70
- 4 Completing the Accounting Cycle 132
- 5 Internal Controls: Ensuring the Integrity of Financial Information 193

PART TWO

Operating Activities 227

- 6 Cash 228
- 7 Receivables 254
- 8 Inventory and the Cost of Sales 298
- 9 Completing the Operating Cycle 359

PART THREE

Investing and Financing Activities 405

- 10 Investments: Property, Plant, and Equipment and Intangible Assets 406
- 11 Financing: Long-Term Liabilities 475
- 12 Financing: Equity 528
- 13 Investments: Debt and Equity Securities 576

PART FOUR

Other Dimensions of Financial Reporting 645

- 14 Statement of Cash Flows 646
- 15 Analyzing Financial Statements 713

Contents

PART ONE

Financial Reporting and the Accounting Cycle 1

Chapter 1 Accounting Information: Users and Uses 2

What's the Purpose of Accounting?	4
The Relationship of Accounting to Business	6
Who Uses Accounting Information?	8
Lenders	9
Investors	9
Management	10
Other Users of Financial Information	10
Within What Kind of Environment Does Accounting Operate?	12
The Significance and Development of Accounting Standards	12
The International Accounting Standards Board	13
The Financial Accounting Standards Board	13
Other Organizations	14
International Business	15
Ethics in Accounting	15
Technology	16
So, Why Should I Study Accounting?	17
End-of-Chapter Materials	18

Chapter 2 Financial Statements: An Overview 25

The Balance Sheet	27
Accounting Equation	29
The Statement of Comprehensive Income	33
The Statement of Changes in Equity	38
The Statement of Cash Flows	40
How the Financial Statements Tie Together	42
Notes to the Financial Statements	43
Summary of Significant Accounting Policies	43

Additional Information about Summary Totals	44
Disclosure of Information Not Recognized	44
Supplementary Information	44
The External Audit	44
Fundamental Concepts and Assumptions	47
The Separate Entity Concept	47
The Time-Period Assumption	47
The Assumption of Arm's-Length Transactions	47
The Cost Principle	48
The Fair Value Principle	48
The Monetary Measurement Concept	48
The Going Concern Assumption	48
End-of-Chapter Materials	49

Chapter 3 The Accounting Cycle: The Mechanics of Accounting 70

How Can We Collect All This Information?	71
How Do Transactions Affect the Accounting Equation?	73
The Accounting Equation	74
Using Accounts to Categorize Transactions	75
Expanding the Accounting Equation to Include Revenues, Expenses, and Dividends	78
How Do We Record the Effects of Transactions?	79
A Note on Journal Entries	91
Posting Journal Entries and Preparing a Trial Balance	93
Determining Account Balances	95
Illustration of the First Three Steps in the Accounting Cycle	98
Where Do Computers Fit in All This?	103
End-of-Chapter Materials	104

Chapter 4 Completing the Accounting Cycle 132

Accrual Accounting	133
Periodic Reporting	134
Accrual-versus Cash-Basis Accounting	135
Adjusting Entries	138
Unrecorded Receivables	139
Unrecorded Liabilities	140
Prepaid Expenses	141
Unearned Revenues	143
Preparing Financial Statements	146
Financial Statement Preparation	147
The Notes	149
Closing the Books	150

Real and Nominal Accounts	150
Closing Entries	151
Preparing a Post-Closing Trial Balance	152
A Summary of the Accounting Cycle	154
Illustration of the Last Step in the Accounting Cycle	154
End-of-Chapter Materials	161

Chapter 5

Internal Controls: Ensuring the Integrity of Financial Information 193

The Types of Problems That Can Occur	194
Types of Errors in the Reporting Process	196
Disagreements in Judgment	196
Fraudulent Financial Reporting	197
Safeguards Designed to Minimize Problems	198
The Control Environment	201
Control Activities (Procedures)	201
Reasons for Earnings Management	203
Meet Internal Targets	204
Meet External Expectations	204
Income Smoothing	204
Window Dressing for an IPO or a Loan	205
Is Earnings Management Ethical?	205
Personal Ethics	206
The Sarbanes-Oxley Act	207
Public Company Accounting Oversight Board	207
Constraints on Auditors	208
Constraints on Management	208
Regulatory Reactions of Other Countries	208
The Role of Auditors in the Accounting Process	209
Internal Auditors	210
External Auditors	210
Are External (Independent) Auditors Independent?	212
The Securities and Exchange Commission	213
End-of-Chapter Materials	214

PART TWO

Operating Activities 227

Chapter 6

Cash 228

Major Activities of a Business	230
--------------------------------	-----

Cash and Internal Control	231
Cash and Business Activities	231
Internal Control of Cash	232
Cash Disbursements for Operating Activities	233
Payment by Checks	233
Petty Cash Funds	236
Reconciling the Bank Account	239
End-of-Chapter Materials	243

Chapter 7 Receivables 254

Types of Receivables	256
Accounts Receivable	257
Revenue Recognition	257
Accounting for Accounts Receivable	259
Valuing and Reporting Receivables	260
The Allowance Method	261
Presentation on Financial Statements	263
Real-World Illustration of Accounting for Loss Allowance	265
Assessing How Well Companies Manage Their Receivables	266
Notes Receivable	268
Characteristics of Notes Receivable	268
Accounting for Notes Receivable	269
Foreign Currency Transactions	271
Foreign Currency Transaction Example	271

EXPANDED MATERIAL

Variable Consideration	273
End-of-Chapter Materials	278

Chapter 8 Inventory and the Cost of Sales 298

Inventory and Cost of Goods Sold	300
What Is Inventory?	301
What Costs Are Included in Inventory Cost?	301
Who Owns the Inventory?	301
Ending Inventory and Cost of Goods Sold	302
Accounting for Inventory Purchases and Sales	303
Overview of Perpetual and Periodic Systems	303
Perpetual and Periodic Journal Entries	304
Counting Inventory and Calculating Cost of Goods Sold	309
Taking a Physical Count of Inventory	309

Cost Formulas for Inventory	313
Specific Identification Cost Formula	314
FIFO Cost Formula	315
Weighted Average Cost Formula	316
A Comparison of FIFO and Weighted Average Cost Formulas	316
Valuing and Reporting Inventory at the Lower of Cost or Net Realizable Value	318
Inventory Valued at Net Realizable Value	318
Assessing How Well Companies Manage Their Inventories	320
Evaluating the Level of Inventory	320
Number of Days' Purchases in Accounts Payable	321

EXPANDED MATERIAL

LIFO Cost Formula	323
A Comparison of All Cost Formulas for Inventory	324
Complications of the Perpetual System with LIFO and Weighted Average Cost	326
Methods of Estimating Inventories	328
The Gross Margin Method	328
The Retail Inventory Method	329
End-of-Chapter Materials	331

Chapter 9 Completing the Operating Cycle 359

Employee Compensation	361
Payroll	361
Compensated Absences (Sick Leave)	365
Compensated Absences (Vacation Pay)	366
Bonuses	367
Post-employment Benefits	367
Post-retirement Benefits Other Than Pensions	367
Taxes	368
Sales Taxes (Business Taxes)	368
Value-Added and Non-Value-Added Business Tax	369
Property Taxes	370
Income Taxes	370
Deferred Tax Example	371
Provisions and Contingent Liabilities	374
Provisions	375
Contingent Liabilities	375
Capitalize versus Expense	377
Research and Development	378
Advertising	379
Summarizing Operations on a Statement of Comprehensive Income	380
Other Revenues and Expenses	380
Earnings per Share	380

EXPANDED MATERIAL

Computational Details of Labor Insurance and Health Insurance Premiums	382
End-of-Chapter Materials	384

**PART
THREE****Investing and Financing Activities 405****Chapter 10****Investments: Property, Plant, and Equipment and Intangible Assets 406**

Nature of Long-Term Operating Assets	408
Accounting for Acquisition of Property, Plant, and Equipment	409
Assets Acquired by Purchase	410
Acquisition of Several Assets at Once	410
Calculating and Recording Depreciation Expense	412
Straight-Line Method of Depreciation	412
Units-of-Production Method of Depreciation	415
A Comparison of Straight-Line and Units-of-Production Methods	416
Units-of-Production Method with Natural Resources	416
Accelerated Depreciation: Declining-Balance Method	417
A Comparison of Depreciation Methods	419
Partial-Year Depreciation Calculations	420
Changes in Depreciation Estimates and Methods	422
Repairing and Improving Property, Plant, and Equipment	424
Recording Impairments of Asset Value	426
Recording an Impairment Loss of Property, Plant, and Equipment	427
Reporting Property, Plant, and Equipment	430
Disposal of Property, Plant, and Equipment	430
Discarding Property, Plant, and Equipment	431
Selling Property, Plant, and Equipment	432
Accounting for Intangible Assets	433
Amortization of Intangible Assets	436
Impairment of Intangible Assets	436
Measuring Property, Plant, and Equipment Efficiency	438
Evaluating the Level of Property, Plant, and Equipment	438
Industry Differences in Fixed Asset Turnover	438

EXPANDED MATERIAL

Exchanging Property, Plant, and Equipment	440
The Revaluation Model	442

Assets Acquired by Leasing and/or Self-Construction	443
Assets Acquired by Leasing	444
Assets Acquired by Self-Construction	446
End-of-Chapter Materials	448

Chapter 11 Financing: Long-Term Liabilities 475

Measuring Long-Term Liabilities	477
Present Value and Future Value Concepts	477
Computing the Present Value of an Annuity	479
Accounting for Long-Term Liabilities	482
Interest-Bearing Notes	482
Mortgages Payable	483
The Nature of Bonds	485
Types of Bonds	486
Characteristics of Bonds	486
Determining a Bond's Issuance Price	487
Accounting for Bonds Payable Issued at Face Value	490
Bond Retirements before Maturity	491
Using Debt-Related Financial Ratios	493
Debt Ratio and Debt-to-Equity Ratio	493
Times Interest Earned Ratio	494

EXPANDED MATERIAL

Bonds Issued at a Discount or at a Premium	495
Accounting for Bonds Issued at a Discount	496
Accounting for Bonds Issued at a Premium	499
Accounting for Lease Obligations	502
Short-term Leases and Leases of Low-valued Assets	504
End-of-Chapter Materials	505

Chapter 12 Financing: Equity 528

Raising Equity Financing	531
Difference between a Loan and an Investment	531
Proprietorships and Partnerships	532
Corporations and Corporate Stock	533
Starting a Corporation	534
Common Stock	535
Preferred Stock	535
Accounting for Stock	536
Issuance of Stock	536
Issuing Par-Value Common Stock at a Premium	537

Issuing No Par-Value Shares	537
Issuing Par-Value Preferred Stock at a Premium	537
Issuing Shares for Noncash Assets	538
Accounting for Stock Repurchases	538
Purchasing Treasury Stock	539
Reissuing Treasury Stock above Cost	539
Reissuing Treasury Stock below Cost	540
Balance Sheet Presentation	540
Retained Earnings	542
Cash Dividends	542
Dividend Payout Ratio	545
Stock Dividends	546
Stock Split	547
Other Equity Items	549
Equity Items That Constitute Other Comprehensive Income	549
Statement of Changes in Equity	551
End-of-Chapter Materials	552

Chapter 13 Investments: Debt and Equity Securities 576

Why Companies Invest in Other Companies	578
Earning a Return on Excess Cash	578
Strategic Purpose	579
Classifying a Security	580
Classification of Debt Securities	581
Classification of Equity Securities	582
The Amortized Cost Financial Assets at Par	584
Accounting for the Purchase of Securities	585
Accounting for the Investment Revenue	585
No Adjustments of AC Financial Assets to Fair Values	586
Accounting for the Maturity of Bond Investment	586
Accounting for Bonds Purchased between Interest Dates	586
Financial Statement Presentation	587
Debt Investments: Fair Value through Other Comprehensive Income (FVTOCI) Financial Assets—Debt	589
Accounting for the Purchase of Securities	589
Accounting for the Investment Revenue	589
Adjusting FVTOCI Financial Assets—Debt to Fair Values	590
Financial Statement Presentation	590
Accounting for the Sale of FVTOCI Financial Assets—Debt	592
Fair Value through Profit or Loss (FVTPL) Financial Assets	594
Accounting for the Purchase of Securities	594
Accounting for the Investment Revenue	594
Adjusting FVTPL Financial Assets to Fair Values	595
Financial Statement Presentation	596
Accounting for the Sale of FVTPL Financial Assets	597

Equity Investments: Fair Value through Other Comprehensive Income (FVTOCI) Financial Assets—Equity	598
Accounting for the Purchase of Securities	599
Accounting for the Investment Revenue	599
Adjusting FVTOCI Financial Assets—Equity to Fair Values	599
Financial Statement Presentation	600
Accounting for the Sale of FVTOCI Financial Assets—Equity	600
Accounting for Investment in Associates Using the Equity Method	603
Illustrating the Equity Method	604
Accounting for the Purchase of Securities	604
Accounting for the Investment Revenue	604
Accounting for Dividends Received	605
Financial Statement Presentation	605
Accounting for the Sale of Investment	606
Comparing Equity Method with Fair Value Approach	606

EXPANDED MATERIAL

Consolidated Financial Statements	608
Accounting for Amortized Cost Financial Assets at a Discount	610
Accounting for the Purchase of Securities	611
Accounting for the Investment Revenue and the Amortization of Bond Discounts	611
Accounting for Amortized Cost Financial Assets at a Premium	614
Accounting for the Purchase of Securities	615
Accounting for the Investment Revenue and the Amortization of Bond Premiums	615
End-of-Chapter Materials	617

PART FOUR

Other Dimensions of Financial Reporting 645

Chapter 14 Statement of Cash Flows 646

What's the Purpose of a Statement of Cash Flows?	648
What Information Is Reported in the Statement of Cash Flows?	648
Major Classifications of Cash Flows	649
Non-cash Investing and Financing Activities	651
Cash Flow Patterns	651
Preparing a Statement of Cash Flows—A Simple Example	652
Acquire Cash Flow Information through the Cash Account	653
Acquire Cash Flow Information through Non-cash Accounts	656
Cash Flows from Operating Activities: Indirect Method	658
The Indirect Method of Cash Flows From Operating Activities	658
Converting from an Accrual Basis to a Cash Basis	660
Some Rules of Thumb	666

Summary of Three Accrual Adjustments	666
Cash Flows from Investing Activities and Financing Activities	668
Investing Activities	668
Financing Activities	670
Summarize the Cash Flows and Check the Balance	671
Any Significant Investing or Financing Transactions That Does Not Involve Cash	672
Using Information from the Statement of Cash Flows to Make Decisions	672
Cash Flows from Operating Activities: Direct Method	674
End-of-Chapter Materials	680

Chapter 15 Analyzing Financial Statements 713

The Need for Financial Statement Analysis	714
Vertical and Horizontal Analyses	716
Vertical Analysis	716
Horizontal Analysis	719
Financial Ratios	723
Liquidity and Efficiency	723
Solvency	728
Profitability	730
Cash Flow	736
Summary of Ratios	739
DuPont Framework	741
Potential Pitfalls	744
Financial Statements Don't Contain All Information	745
Lack of Comparability	745
Search for the Smoking Gun	745
Anchoring, Adjustment, and Timeliness	746
End-of-Chapter Materials	746

APPENDICES

Appendix A: Taiwan Semiconductor Manufacturing Company Limited and Subsidiaries Consolidated Financial Statements for the Years Ended December 31, 2019 and 2018 and Independent Auditors' Report	A-1
Appendix B: Philips 2019 Financial Statements	A-10
Appendix C: Carrefour 2019 Financial Statements	A-19
Appendix D: Present Value Tables	A-30

Glossary G-1

Index I-1

Preface to the Third Edition of *Financial Accounting: IFRS Edition*

It has been four years since the publication of the second edition of *Financial Accounting: IFRS Edition*. This book is intended to be used by accounting and finance majors. We are grateful to the users for adopting this book and for their feedback, which we have carefully considered and incorporated into the third edition of this book. In the past years, there were important events that happened in and around the companies illustrated in this book that could make their operating performance, financial position and cash flows differently. These possible changes are included in this edition.

More importantly, IASB issued new financial reporting standards that had become effective starting on January 1, 2018 and 2019, respectively. They are IFRS 15 (Revenue from Contracts with Customers), IFRS 9 (Classification of Financial Instruments), and IFRS 16 (Leases). We incorporated the new IFRSs and their respective accounting treatments as well as financial reporting into this edition so that our users can stay updated.

The following changes have also been made to the third edition:

First, the implementation of IFRS 15 which was effective on or after 1 January 2018 has made the recognition of revenue in terms of both timing and amount much less straightforward than earlier practices. Since the entire standard covers several topics, we selected only the issues that were covered in the previous edition for revision in the third edition. These issues encompass variable consideration that may arise from quantity discount, sales (cash) discount, sales return, and performance bonus. Chapters 7 and 8 are changed following IFRS 15 for revenue recognition pertaining to variable consideration.

Second, the implementation of IFRS 16 which was effective for annual reporting periods beginning on or after 1 January 2019, with earlier application permitted (as long as IFRS 15 is also applied) has treated virtually all leases as finance leases (previously termed “capital lease”). Such a treatment not only avoids the possible categorical (operating lease versus finance lease) manipulation but also shows the liabilities associated with the lease on the balance sheet (or the statement of financial position). In Chapters 10 and 11 of the third edition, we made such changes following IFRS 16.

Third, following IFRS 9, the accounting items (titles) such as “Bad Debt Expense”, and “Allowance for Bad Debts” are changed to “Expected Credit Loss” and “Loss Allowance”, respectively. We made these changes in Chapter 7 and related chapters where appropriate.

Fourth, we updated the related regulations and the related accounting treatments by illustrating examples. Chapter 9 is changed to accommodate individual income tax, labor insurance and related regulations.

Fifth, in almost every chapter, we updated the real-world examples by using the latest financial statements that were publicly available when we undertook this revision. The appendices (TSMC, Phillips, and Carrefour) are all updated in this way. Note that due to space constraints, the notes, which are an integral part of financial statements, are not included. Readers can access to the notes via the websites of the companies.

Sixth, we added new questions, exercises and problems both in the textbook and in the test bank. We also undertook a thorough review and made changes to all types of questions, exercises and problems at the end of each chapter to make them clearer. We hope that such an effort can help the readers, especially the beginners, focus on how to answer the questions and solve the problems, rather than spending time on comprehending the meaning of the questions or problems.

We hope these changes will help to make the learning of financial accounting more effective and enjoyable.

Finally, but not the least, we are particularly thankful to the following individuals (in alphabetical order) for their assistance and suggestions in undertaking the revision project: Ivy Chen, Li-Chun Kuo, Chi-Chun Liu, Hsuan Wang, Sophie Wu, Meng-Ping Yang, and Sin-Hui Yen.

Preface

Financial Accounting: IFRS Edition, 3e:

Tackling the What, Why, and How of Accounting

Financial Accounting: IFRS Edition, 3e guides you through the what, why, and how of financial accounting in today's business world. Through a solid presentation of concepts and procedures blended with a wealth of real company examples and solved exercises, you can ensure your success!

This edition continues to build a stronger foundation with its new what, why, how framework. At the beginning of each learning objective, you are shown *what* each section will teach you, *why* it is important, and *how* to use the related accounting practices or methods.

LO2

Who Uses Accounting Information?

- ▶ **WHAT** Identify the primary users of accounting information.
- ▶ **WHY** To understand the variety of ways in which accounting information is used.
- ▶ **HOW** Consider internal and external stakeholders who would benefit from having accounting information.

Praised for their emphasis on decision-making and the real-world, the authors continue to present features that encourage critical thinking, highlight ethical considerations, and consider global implications by showcasing real companies. Emphasizing the relevancy of accounting to the business world, this edition is designed to address your diverse learning styles and career needs.

By combining the pedagogical features that help you grasp the numbers with the many opportunities for critical thinking and applying the knowledge you have learned, you will leave your course ready to compete in the business world!

What

Students like you have told us they benefit from a structured, clear presentation of material. Too much information at once or an ill-defined learning path can get you off track. If information is instead provided in digestible chunks and the organization sets the expectation for what you should learn in each section, you'll be able to absorb more information.

Streamlined Presentation for Superior Readability

This textbook has always engaged its readers with a lively and accessible writing style, and in this edition, the authors have carefully edited the text to further enhance the presentation of the material. This edition now provides you with a more concise explanation of accounting principles without sacrificing topical coverage or quantity of examples.

Visual Presentation

In addition to tightening the writing style, the book has been redesigned to make your job of navigating through the content even easier. The clean, fresh design allows you to focus on the most important elements and color-coded exhibit references make flipping through the text to find information a breeze.

Learning Objective Framework

Now in an easy-to-read what, why, how format, learning objectives strategically guide you through mastering the chapter material while reinforcing the relevance and application of these fundamental concepts. With each learning objective, you understand exactly what you are expected to learn from each section.

A Review of Learning Objectives

This review is located at the end of the chapter to give you a big-picture glance at the chapter's topics. This gives you a valuable starting point for your study and review.

Caution Boxes

Caution boxes highlight important points to consider when contemplating more complex concepts and emphasize the typical pitfalls associated with those types of decisions.

CAUTION

In considering revenues and expenses, remember that not all inflows of assets are revenues; nor are all outflows of assets considered to be expenses. For example, cash may be received by borrowing from a bank, which is an increase in a liability, not revenues. Similarly, cash may be paid for supplies, which is an exchange of one asset for another asset, not an expense. The details of properly identifying revenues and expenses will be discussed further in Chapter 3.

WHY

Understanding *why* a financial accounting concept is important, *why* it's necessary, and *why* it's done the way it is allows you to be fully engaged with the topic. Instead of memorizing equations, this textbook will challenge you to think conceptually and consider how accounting relates to the business world.

Relevancy in Today's Business World

This text offers multiple features to relate core accounting concepts to real life. Its unique and realistic approach provides a solid framework for understanding how an organization performs its primary business activities and accounting's role in those functions. Every chapter begins with a **Setting the Stage** narrative that provides a real business example as a jumping-off point for the rest of the chapter concepts.

Updated Real Company Examples

Real company data and examples are interspersed throughout the chapters. Assignable **Real Company** Analysis questions appear in the end of chapter as well.

FYI

FYI boxes point out interesting facts about the current business environment that relate to the topics being discussed.

Ethics and Critical Thinking Skills

The need for you to be able to analyze business situations and make informed, ethical decisions is essential in today's world. Ethical considerations are woven throughout the text and in the end-of-chapter materials. **Ethics** and **Judgment Call** questions train you to respond to various business situations and provide your recommendation, encouraging independent decision making. In addition, Chapter 5 is solely devoted to the importance of ethical behavior.

STOP & Think

Why is it important for the FASB to remain completely independent?

Stop and Think

These reminders provide thought-provoking real business issues and ask you to analyze the situation and comment with your evaluation.

International Feature

As businesses increasingly operate in a global economy, new International boxes have been included in this edition to compare U.S. accounting standards with practices abroad and highlight shifts in ideology.

**INTERNATIONAL**

As we have seen, the accounting standards produced by the IASB are referred to as **International Financial Reporting Standards (IFRS)**. IFRS is envisioned to be a set of standards that can be used by all companies regardless of where they are based. In 2008, the SEC began allowing non-U.S. companies with shares trading on U.S. stock exchanges to issue their financial reports using IASB standards. Before this change, all non-U.S. companies wishing to have their shares traded in the United States were required to provide financial statements in accordance with U.S. GAAP. With the new SEC rule, the number of non-U.S. companies listed on U.S. stock exchanges may increase dramatically. The SEC had been considering whether to allow U.S. companies to use IFRS in the financial reports that they provide to their U.S. shareholders. However, in a speech at the 14th Baruch College Financial Reporting Conference on May 7, 2015, James Schnurr, the chief accountant of the SEC, said that "There is virtually no support to have the SEC mandate IFRS for all registrants."

HOW

After you have learned the conceptual meaning behind a topic and have seen how it relates to the real world, you need to be able to complete calculations and apply what you have learned in a practical sense. The actual repetition and practice of accounting close the gap, solidifying your knowledge of accounting principles.

Remember This

These summary boxes at the conclusion of each section provide an effective checkpoint to ensure understanding. Summaries use bulleted lists to focus on key information and lead into a **QUIZ YOURSELF** exercise (where applicable).

> REMEMBER THIS

- ▶ *Management accounting focuses on providing reports for INTERNAL use by management to assist in making operating decisions and in planning and controlling a company's activities.*
- ▶ *Financial accounting provides information to meet the needs of EXTERNAL users.*
- ▶ *The four general-purpose financial statements are the balance sheet, the statement of comprehensive income, the statement of changes in equity, and the statement of cash flows.*
- ▶ *The financial statements are used by interested external parties such as investors, creditors, suppliers, customers, competitors, the government, and the press.*

Quiz Yourself

This edition now directly connects concepts with application by including brief solved exercises at the end of relevant sections. You are asked to work out a problem and check your work against the solution. This provides you with an effective framework to apply to similar exercises or problems in homework assignments.

QUIZ YOURSELF

Review Philips' balance sheet in Appendix B and answer the following questions:

- 1 What is the amount of Philips' total reported assets?
- 2 What is the amount of Philips' total reported liabilities?
- 3 Are Philips' assets financed more through liabilities or through equity?
- 4 What is Philips' largest reported asset?
- 5 What is Philips' largest reported current liability and what does that amount represent?

SOLUTION

- 1 Philips' total reported assets on December 31, 2019, were €27,016 million.
- 2 Philips' total reported liabilities on December 31, 2019, were €14,391 (€6,978 + €7,413) million.
- 3 Philips' assets are financed primarily using liabilities.
- 4 Philips' largest reported asset category was Goodwill.
- 5 Philips' largest current liability is Accounts Payable with a balance of €2,089 million.

This text's superior end-of-chapter materials are the best tools to help you understand the *what* of accounting. Practice and application are key to your success in accounting!

End-of-Chapter Content

The end-of-chapter material is consistent with the what, why, how framework—further tightening the connection between concepts and practice.

- ▶ **WHAT** Explain the fundamental concepts and assumptions that underlie financial accounting.
- ▶ **WHY** Users of financial information must understand the concepts and assumptions underlying financial accounting if they are to appropriately use the resulting financial statements.
- ▶ **HOW** These concepts and assumptions are explained in the accounting literature and are fundamental to business activities.

Pedagogical EOC

Practice Exercises

Practice Exercises offer quick concept checks ideal for in-class practice or quick reviews before exams.

PE 1-4

LO 1

Allocation of Limited Resources

Assume you are a small business owner trying to increase your company's profits. How can accounting information help you efficiently allocate your limited resources to maximize your business profit?

Exercises & Problems

Exercises and Problems delve deeper into concepts, testing your retention of critical topics and procedures. Assignments utilizing Excel software are marked with an icon.

E 2-7 **Balance Sheet Preparation**

From the following data, prepare a classified balance sheet for Taylorsville Construction Company on December 31, 2022.

Accounts payable	\$ 74,300	Supplies	\$ 4,250
Accounts receivable	113,500	Land	90,000
Buildings	512,000	Mortgage payable	423,400
Equity, 1/1/22	314,300	Net income for 2022	109,450
Cash	153,600	Equity, 12/31/22	?
Distributions to owners during 2022	48,100		

Cumulative Spreadsheet Projects

Cumulative Spreadsheet Projects allow you to build your spreadsheet proficiency with assignments that progress in difficulty as they move through the text.

Analytical Assignments

Discussion Questions

Discussion Questions ask you how you would tackle a particular situation—giving you real-world practice.

Judgment Call Questions

Judgment Call Questions get you to go beyond memorization to critically analyze a situation and provide your recommended course of action.

Real Company Analysis Questions

Real Company Analysis Questions ask you to review real financial information to answer questions and make decisions.

AA 3-6 **TSMC**

Real Company Analysis

Locate the financial statements for the year of 2019 for TSMC and consider the following questions:

1. Find TSMC's statement of comprehensive income. Assume that research and development, general and administrative, and marketing expenses were paid in cash. What journal entry did TSMC make in 2019 to record these expenses?
2. Find TSMC's cash flow statement. Did TSMC issue bonds in 2019?
3. Again, looking at the cash flow statement, what journal entry did TSMC make in 2019 to record the purchase of property, plant, and equipment?

International Questions

International Questions ask you to review the financial information or philosophy of an international company.

Ethics Questions

Ethics Questions direct you to read a situation, consider the ethical implications, and make decisions based on your analysis.

AA 3-9*Ethics***Should You Go the Extra Mile?**

You work in a small convenience store. The store is very low-tech; you ring up the sales on an old-style cash register that merely records the amount of the sale. The store owner uses this cash register tape at the end of each day to verify that the correct amount of cash is in the cash register drawer. On a day-to-day basis, no other financial information is collected about store operations.

Since you started studying accounting, you see many ways that store operations could be improved through the gathering and use of financial information. Even though you are not an expert, you are quite certain that you could help the store owner set up an improved information system. However, you also know that this will take extra effort on your part, with no real possibility of receiving an increase in pay.

Should you say anything to the store owner, or should you just keep quiet and save yourself the trouble?

Delivering a Flexible Presentation to Fit Your Needs

Always a hallmark of this text, expanded coverage within each chapter, in addition to solid basic coverage of essential accounting concepts, allows you to learn more complex concepts.

New to this edition, the corresponding Expanded Materials questions in the end of chapter, which provide a variety of related assignments, have been placed together in one section for ease of use so that you can test your comprehension of the additional material.

EXPANDED MATERIAL

Key Terms & Concepts

- variable consideration, 274

PUT IT ON PAPER *Discussion Questions*

20. Which cost formula for inventory results in paying the least amount of taxes when prices are rising?
21. Why do the LIFO and weighted average cost formula for inventory result in different inventory numbers for the perpetual and periodic inventory systems?
22. When firms cannot count their inventory, how do they determine how much inventory is on hand for the financial statements?

About the Authors

▶ Pictured left to right are W. Steve Albrecht, Earl K. Stice, James D. Stice, and Monte R. Swain



Earl K. Stice

Earl K. Stice is the PricewaterhouseCoopers Professor of Accounting in the School of Accountancy at Brigham Young University, where he has been on the faculty since 1998. He holds bachelor's and master's degrees from Brigham Young University and a PhD from Cornell University. Dr. Stice has taught at Rice University, the University of Arizona, Cornell University, and the Hong Kong University of Science and Technology (HKUST). He won the Phi Beta Kappa teaching award at Rice University, was twice selected as one of the ten best lecturers on campus at HKUST, and has won the Marriott School Teaching Award at BYU. Dr. Stice also has taught in a variety of executive education and corporate training programs in the United States, Hong Kong, China, Malaysia, and South Africa, and he has been on the executive MBA faculty of the China Europe International Business School in Shanghai, HKUST, the University of Illinois, and INSEAD (in Singapore). He has published papers in the *Journal of Financial and Quantitative Analysis*, *The Accounting Review*, *Review of Accounting Studies*, *Journal of Business, Finance, and Accounting*, and *Issues in Accounting Education*. Dr. Stice has presented his research results at seminars in the United States, Finland, Taiwan, Australia, and Hong Kong. He has coauthored several accounting texts including *Intermediate Accounting, 17th edition*. Dr. Stice and his wife, Ramona,

have seven children—Derrald, Han, Ryan Marie, Lorien, Lily, Taraz, and Kamila—and one adorable granddaughter.

James D. Stice

James D. Stice is the Distinguished Teaching Professor in the Marriott School of Management at Brigham Young University. He is currently Associate Dean of the Marriott School. Dr. Stice served for eight years as the director of BYU's MBA Program. He holds bachelor's and master's degrees in accounting from BYU and a PhD in accounting from the University of Washington. Professor Stice has been on the faculty at BYU since 1988. During that time, he has been selected by graduating accounting students as "Teacher of the Year" on numerous occasions; he was selected by his peers in the Marriott School at BYU to receive the "Outstanding Teaching Award" and he was selected by the University to receive its highest teaching award, the Maeser Excellence in Teaching Award. Professor Stice has taught in academic and executive education programs in the United States, Europe, South Africa and China for such companies as IBM, Bank of America, and Ernst & Young. Professor Stice has published articles in *Journal of Accounting Research*, *The Accounting Review*, *Decision Sciences*, *Issues in Accounting Education*, *The CPA Journal*, and other academic and professional journals and has written several accounting textbooks. In addition to his teaching and research, he currently serves on the board of directors of Nutraceutical Corporation. Dr. Stice and his wife, Kaye, have seven children and eight grandchildren.

W. Steve Albrecht

W. Steve Albrecht is the Andersen Alumni Professor of Accountancy in the Marriott School of Management at Brigham Young University. Dr. Albrecht, a certified public accountant (CPA), certified internal auditor (CIA), and certified fraud examiner (CFE), came to BYU in 1977 after teaching at Stanford and at the University of Illinois. Earlier, he worked as a staff accountant for Deloitte & Touche. Until July 1, 2008, he was the associate dean of the Marriott School, a position he held for 10 years. For the previous nine years, Dr. Albrecht was director of the School of Accountancy at BYU.

Dr. Albrecht received a bachelor's degree in accounting from Brigham Young University and his MBA and PhD degrees from the University of Wisconsin. He is past President of the American Accounting Association, the Association of Certified Fraud Examiners, Beta Alpha Psi and the Accounting Program Leadership Group. Until recently, he served as the U.S. representative on the International Federation of Accountants (IFAC) Education Committee and as a trustee of the Financial Accounting Foundation. Dr. Albrecht has done extensive research on business fraud and ethics. His research has resulted in the publication of over one hundred articles in professional and academic journals. He is the author or co-author of 20 books or monographs. In 2000, he completed a major study (*Accounting Education: Charting the Course through a Perilous Future*) on the future of accounting education in the U.S.

Dr. Albrecht has received numerous awards and honors, including BYU's highest faculty honor, the Karl G. Maeser Distinguished Faculty Lecturer Award, for superior scholarship and teaching. He has also received the BYU School of Management's Outstanding Faculty Award. He has been recognized by Beta Alpha Psi, the Federation

of Schools of Accountancy, the Auditing Section of the American Accounting Association, the Utah Association of CPAs and the AICPA as Educator of the Year. He also received awards for outstanding teaching at Stanford University, the University of Illinois, and the University of Wisconsin. In 1997, 2001, 2002 and 2003, and 2004 he was chosen as one of the 100 most influential accounting professionals in the United States by Accounting Today magazine. In 1998, he received the Cressey Award from the Association of Certified Fraud Examiners, the highest award given for a lifetime of achievement in fraud detection and deterrence. In 2002, in honor of his contribution in fighting fraud, the Association of Certified Fraud Examiners named one of its headquarter buildings in Austin, Texas after Dr. Albrecht. In 2001, in recognition of his contributions to BYU and to academia, an anonymous donor endowed the W. Steve Albrecht Professorship in Accounting and the LeAnn Albrecht fellowship in accounting.

Dr. Albrecht has consulted with numerous organizations, including Fortune 500 companies, major financial institutions, the United Nations, FBI, and other organizations, and has been an expert witness in over 35 major fraud cases. Dr. Albrecht is married to the former LeAnn Christiansen and they have six children and sixteen grandchildren.

Monte R. Swain

Monte R. Swain is the Deloitte Professor of Accounting in the School of Accountancy at Brigham Young University. He received his PhD in managerial accounting and information systems from Michigan State University and joined the BYU faculty in 1991. His dissertation, which examined the impact of information load on capital budgeting decision processes, was awarded an Institute of Management Accountants Dissertation Grant. At BYU, Dr. Swain has received the Teaching Excellence Award for Management Skills in 1994, 1995, and 1997; the Marriott School of Management Outstanding Teacher in 1999. In addition to his research work involving human decision processes, Dr. Swain studies and writes on activity-based costing, the Balanced Scorecard, and the Theory of Constraints in management information systems. He has published papers in leading academic and practitioner journals such as *Behavioral Research in Accounting*, *Decision Sciences*, *Strategic Finance*, and *The Internal Auditor*. In addition, Dr. Swain is deeply committed to the scholarship of teaching and has published a number of papers and cases on education in *Issues in Accounting Education*, *Journal of Accounting Education*, *The Journal of Accounting Case Research*, *Journal of Education for Business*, and the *Case Research Journal*. He serves as an associate editor for *Issues in Accounting Education*. Dr. Swain has spent significant time working with or researching organizations such as IBM, Clorox, and Deere and Company. He is a Certified Public Accountant and a Certified Management Accountant. Dr. Swain took an academic leave from BYU from July 1999 to July 2000 to serve as the Chief Financial officer for Authorize.Net (payment-processing service for e-commerce). As a result of that experience, he has published papers and cases on the impact of eCommerce on financial and managerial accounting. Dr. Swain is active in the American Accounting Association where he serves in various capacities helping to promote the objectives of that organization. He and his wife, Shannon, have seven children.

About the Adaptors

Rong-Ruey Duh 杜榮瑞

Rong-Ruey Duh is a professor at the Department of Accounting, National Taiwan University (NTU). He earned his PhD from the University of Minnesota, Minneapolis. Dr. Duh was President of Taiwan Accounting Association and Chair of the Board of Directors for Accounting Research and Development Foundation, a nonprofit organization responsible for setting financial accounting and auditing standards in Taiwan. He also served as Chair of Financial Accounting Standards Committee in Taiwan for nine years, during which Taiwanese financial accounting standards started to converge with the then International Accounting Standards (IAS). Dr. Duh has published numerous books and articles in academic journals such as *Accounting and Business Research*, *Auditing: A Journal of Practice & Theory*, *Behavioral Research in Accounting*, *Corporate Governance: An International Review*, *Information & Management*, *Journal of International Accounting Research*, *Journal of Management Accounting Research*, *Review of Quantitative Finance and Accounting*, and *The International Journal of Accounting*.



Audrey Wenhsin Hsu 許文馨

Audrey Wenhsin Hsu is a professor at the Department of Accounting, National Taiwan University (NTU). Dr. Hsu earned her PhD from Lancaster University, U.K. Her area of research includes international accounting standards, financial reporting quality, and corporate governance. Her research has appeared in numerous journals such as *Abacus*, *Accounting Horizons*, *Asia Pacific Journal of Accounting and Economics*, *Contemporary Accounting Research*, *Corporate Governance: An International Review*, *European Accounting Review*, *Journal of Business Finance & Accounting*, *Journal of Contemporary Accounting and Economics*, *Omega*, *The International Journal of Management*, *The International Journal of Accounting*, *Total Quality Management & Business Excellence*, and *Review of Quantitative Finance and Accounting*.



PART
ONE

Financial Reporting and the Accounting Cycle

- 1 Accounting Information: *Users and Uses*
- 2 Financial Statements: *An Overview*
- 3 The Accounting Cycle: *The Mechanics of Accounting*
- 4 Completing the Accounting Cycle
- 5 Internal Controls: *Ensuring the Integrity of Financial Information*

Accounting Information: Users and Uses



LEARNING OBJECTIVES

After studying this chapter, you should be able to:

LO1 Describe the purpose of accounting and explain its role in business and society.

LO2 Identify the primary users of accounting information.

LO3 Describe the environment of accounting, including the effects of generally accepted accounting principles, IFRS, international business, ethical considerations, and technology.

LO4 Analyze the reasons for studying accounting.

SETTING THE STAGE

In his bestselling book *The World Is Flat: A Brief History of the Twenty-First Century*, Thomas Friedman observed and argued that the world is getting flatter than ever before. The key tone of the book is globalization that no one can resist. Because the world has become a level playing field, there is no (or should not be any) obstacle due to geographical, cultural, or historical divisions to global commerce and competition.

Extending Friedman's argument, there shouldn't be differences in financial reporting standards that could create a barrier to the cross listing of a company's stock. And yet, in the playing field of accounting, each country issues accounting standards for the companies under its jurisdiction to follow, leading to many sets of generally accepted accounting principles (GAAP) in the world. Thus, if your company wanted to raise capital in Taiwan, it would have to follow the GAAP in Taiwan; but your company would also have to follow the U.S. GAAP if your company also wanted to be listed on the New York Stock Exchange (NYSE).

For example, **Taiwan Semiconductor Manufacturing Company Limited (TSMC)**, the world's first dedicated and largest semiconductor foundry service provider, was founded in 1987 and is headquartered in Hsinchu, Taiwan. TSMC is listed on both the Taiwan Stock Exchange (TSE) and the NYSE via American Depositary Receipts (ADR). TSMC prepares consolidated financial statements in

accordance with the GAAP in Taiwan, and is also required to file a form 20-F to the U.S. Securities and Exchange Commission (SEC). As the GAAP in Taiwan differs in certain aspects from the U.S. GAAP, TSMC has to include a discussion of material differences in the accounting principles, practices, and methods used in preparing the financial statements between Taiwan and the United States. TSMC also needs to provide a tabular reconciliation for the differences in net income and stockholders' equity under the GAAP in Taiwan and in the United States.

Will it be too inconvenient for multinational companies in raising capital across borders? Similarly, it may also cause inconvenience in interpreting the financial statements based on different sets of GAAP when a company wants to invest capital across borders.

To give a level playing field, an idea has been implemented to issue a set of GAAP that can be followed by the companies in the world. The International Financial Reporting Standards (IFRS) is a set of GAAP that has been endorsed by many countries. Starting in 2013, all publicly traded companies based in Taiwan, including TSMC, are required to prepare financial statements in accordance with IFRS issued by International Accounting Standards Board (IASB) and endorsed for use in Taiwan. This book follows IFRS when explaining and illustrating the concepts.

In this textbook, you will begin your study of accounting. You will learn to speak and understand accounting, "the language of business." Without an understanding of accounting, business investments, taxes, and money management will be like a foreign language to you. In brief, an understanding of accounting facilitates the interpretation of financial information, which allows for better economic decisions.

The major objectives of this text are to provide you with a basic understanding of the language of accounting and with the ability to interpret and use financial information prepared using accounting techniques and procedures. With the knowledge you obtain from this exposure to accounting, you will be able to "read" the financial statements of companies, understand the information that is being conveyed, and use accounting information to make good business decisions. Also, through discussion of the business environment in which accounting is used, you will increase your understanding of general business concepts such as corporations, leases, annuities, leverage, investments, and so forth.

You will become convinced that accounting is not "bean counting." Time after time, you will see that accountants must exercise judgment about how to best summarize and report the results of business transactions. You will gain a respect for the complexity of accounting and develop a healthy skepticism about the precision of any financial reports you see.

Finally, you will see the power of accounting. Financial statements are not just paper reports that get filed away and forgotten. As an example, **Philips Electronics**, a Dutch multinational electronic company and the world's biggest maker of light bulbs, cut 4,500 jobs worldwide in 2011 after quarterly profit fell to the lowest in two years. During the same time, **Carrefour**, the French retailer, reported a growth in sales in 2011 because of strong demand in Asia and Latin America. The news was encouraging because Europe's debt crisis in that year had caused a decline in consumption in Carrefour's largest market. You will see that financial statement numbers and, indirectly, the accountants who prepare them, determine who receives loans and who doesn't, which companies attract investors and which don't, which managers receive salary bonuses and which don't, and which companies are praised in the financial press and which aren't.

So, let's get started.