Horngren's

ACCOUNTING

THE FINANCIAL CHAPTERS

Miller-Nobles

Mattison

THIRTEENTH EDITION

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HORNGREN'S Accounting THE FINANCIAL CHAPTERS

THIRTEENTH EDITION

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Pearson

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Prof. Miller-Nobles is on the Board of Directors for the American Accounting Association (AAA) as Director-Focusing on Members. She has served in leadership roles for AAA's Teaching, Learning, and Curriculum section and AAA's Two Year College section and was a member of the Pathway's Commission on Accounting Higher Education. Prof. Miller-Nobles is also on the Board of Directors for Teachers of Accounting at Two Year Colleges (TACTYC) as Secretary/Webmaster. She is an active member of the American Institute of Certified Public Accountants (AICPA) Consumer Financial Education Advocates committee. At the state level, she serves on the Relations with Educational Institutes for the Texas Society of Certified Public Accountants (TXCPA).

Tracie has received several teaching and professional awards including the AAA J. Michael and Mary Anne Cook Prize, TXCPA Outstanding Accounting Educator, TXCPA Rising Star, and the TXCPA Austin Chapter CPA of the Year. In her spare time, Tracie enjoys spending time with her husband, Kevin, his three kids, Caleb, Josh, and Meggie, her parents, Kipp and Sylvia, and sister, Michelle. She believes that camping and hiking is restorative and calming and that life was meant for good friends and great adventures. Tracie has been mentored by many wonderful colleagues and inspired by her students.

Brenda L. Mattison, CMA, has a bachelor's degree in education and a master's degree in accounting, both from Clemson University. She is currently an Accounting Instructor at Tri-County Technical College in Pendleton, South Carolina. Brenda previously served as Accounting Program Coordinator at TCTC and has prior experience teaching accounting at Robeson Community College, Lumberton, North Carolina; University of South Carolina Upstate, Spartanburg, South Carolina; and Rasmussen Business College, Eagan, Minnesota. She also has accounting work experience in retail and manufacturing businesses and is a Certified Management Accountant.

Brenda is a member of the American Accounting Association, Institute of Management Accountants, South Carolina Technical Education Association, and Teachers of Accounting at Two Year Colleges. She is currently serving on the Board of Directors as Vice President of Conference Administration of Teachers of Accounting at Two Year Colleges.

Brenda previously served as Faculty Fellow at Tri-County Technical College. She has presented at state, regional, and national conferences on topics including active learning, course development, and student engagement.

In her spare time, Brenda enjoys reading and spending time with her family. She is also an active volunteer in the community, serving her church and other organizations.

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Horngren's Accounting . . . Expanding on Proven Success

What's New to the Edition

UPDATED! End of Chapter exercises and problems have been updated with new years and company financial information.

UPDATED! Chapter openers, Tying It All Together features, and financial statement analysis companies (Kohl's and Target) have been updated with current company financial information.

NEW FEATURE ON DATA ANALYTICS! Data Analytics is becoming critically important in business—specifically in accounting. A new feature called Data Analytics in Accounting has been integrated throughout the narrative. In an increasingly competitive environment, having the ability to harness information to make sound business decisions is becoming crucial. Throughout the chapters, this feature highlights how real companies use Data Analytics to track inventory, monitor cash flow, forecast sales, and maximize profits. This feature also discusses emerging technologies, such as robotic process automation and artificial intelligence, and how they relate to businesses.

NEW DATA ANALYTICS PROJECTS! Each project contains a list of requirements, a dataset, a tutorial video, and instructions for using software such as Excel, Power BI, or Tableau to offer students hands-on practice in analyzing and reporting data. Using these tools, students learn how to extract and examine key information about a company related to its products, operations, and consumer buying habits. With this experience and knowledge, students are able to make smarter business decisions and are better prepared for the workforce.

NEW COVERAGE ON EMPLOYABILITY! The first courses in accounting are a great place to discuss the importance of accounting credentials in today's job market. Throughout the narrative, we highlight the role of accounting in businesses including the most relevant accounting credentials, as well as some new ones for students beginning their study of accounting. When discussing accounting in the business environment, in addition to the traditional career path (CPA), we also provide information about additional certifications available to accounting majors including Certified Management Accounting (CMA), Chartered Global Management Accountant (CGMA), and Certified Financial Planner (CFP).

Chapter 1: Accounting and the Business Environment

- Added discussion on additional certifications available to accounting majors including Chartered Global Management Accountant and Certified Financial Planner.
- Added discussion on the need for technology skills and knowledge for accountants.
- Clarified the equity discussion to help students better understand the changes in equity based on customer feedback/requests.

Chapter 2: Recording Business Transactions

- Added Data Analytics in Accounting feature about the chart of accounts.

Chapter 5: Merchandising Operations

- Realigned the order of the purchase section to better explain how a company records purchase returns and corresponding payment.
- Realigned the order of sales section to better explain how a company records sales returns and corresponding receipt.
- Added T-accounts to help students understand the journal entries.
- Added customer and vendor names for Accounts Receivable and Accounts Payable.
- Moved adjusting sales revenue and merchandise inventory for estimated sales returns to LO4 which covers adjusting and closing entries for merchandisers.
- Realigned Appendix 5B purchases and sales sections to better explain how a company records these transactions.
- Clarified discussion of how a periodic inventory system records estimated sales returns.
- Modified Check Your Understanding F:5-2 to include the new accounts introduced under Revenue Recognition Standard.
- Reviewed EOC to ensure that all new accounts (Estimated Returns Inventory, Refunds Payable, and Sales Discounts Forfeited) were adequately covered in problems.

- Adjusted EOC to give options for professors who do not want to cover Sales Returns and Allowances (Estimated Returns Inventory and Refunds Payable).
- Optional online appendix (and associated End of Chapter exercises) available for faculty who would like to cover the gross method of recording accounting receivables.

Chapter 6: Merchandise Inventory

- Added Data Analytics in Accounting feature discussing how companies track inventory.
- Added more explanation for how to calculate inventory cost flow for FIFO, LIFO, and weighted average under perpetual method.

Chapter 8: Internal Control and Cash

- Added Data Analytics in Accounting feature on cryptocurrencies and blockchain.
- Added internal control procedures for accepting debit and credit card sales.
- Changed company used in Tying It All Together feature to Chipotle Mexican Grill and discussed the unauthorized malware activity that occurred in April 2017.

Chapter 9: Receivables

- Changed company used in Tying It All Together feature from Sears to Amazon.com, Inc.

Chapter 10: Plant Assets, Natural Resources, and Intangibles

- Added Data Analytics in Accounting feature on water and energy consumption.

Chapter 11: Current Liabilities and Payroll

- Updated payroll tax amounts for 2019 (current at time of printing).

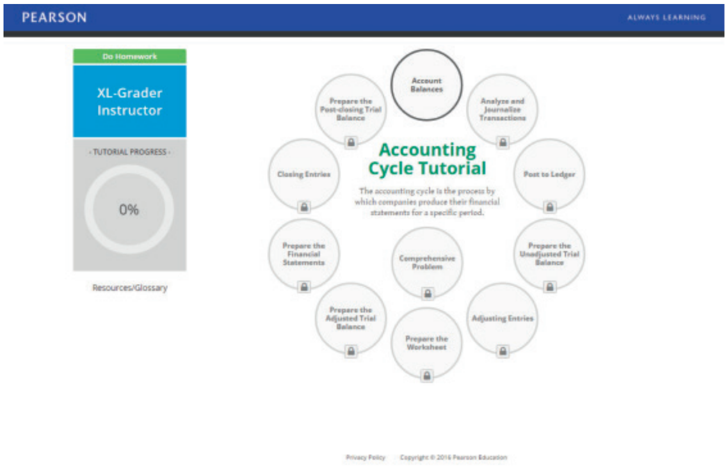
Chapter 16: The Statement of Cash Flows

- Added Data Analytics in Accounting feature on monitoring cash flow.

Solving Learning and Teaching Challenges

Accounting Cycle Tutorial

This interactive tutorial helps students master the Accounting Cycle for early and continued success in the Introduction to Accounting course. The tutorial, accessed by computer, smartphone, or tablet, provides students with brief explanations of each concept of the Accounting Cycle through engaging, interactive activities. Students are immediately assessed on their understanding and their performance is recorded. A built-in comprehensive problem can be assigned to reinforce the lessons learned in the accounting cycle tutorial. Whether the Accounting Cycle Tutorial is used as a remediation self-study tool or course assignment, students have yet another resource to help them be successful with the accounting cycle.



Chapter Openers

Chapter openers set up the concepts to be covered in the chapter using stories students can relate to. The implications of those concepts on a company's reporting and decision making processes are then discussed.

Tying It All Together

This feature ties together key concepts from the chapter using the company highlighted in the chapter opener. The in-chapter box feature presents scenarios and questions that the company could face and focuses on the decision-making process. The End of Chapter business case helps students synthesize the concepts of the chapter and reinforce critical thinking.

TYING IT ALL TOGETHER

Hyatt Hotels Corporation was founded in 1957 when Jay Pritzker purchased the first Hyatt hotel next to the Los Angeles International Airport. Today, Hyatt Hotels owns and operates hotels in 60 countries around the world. For the year ended December 31, 2018, the company reported revenues totaling $4.5 billion with net income of $769 million. (You can find Hyatt Hotels Corporation's annual report at **https://www.sec.gov/Archives/edgar/data/1468174/000146817419000009/h10-k123118.htm**)

Would Hyatt Hotels Corporation record closing entries and why?

Hyatt Hotels would record closing entries in order to get the accounts ready for next year. All companies record closing entries in order to zero out all revenue and expense accounts. In addition, the closing process updates the equity account balance for net income or loss during the period and any payments made to owners (stockholders).

Why are temporary accounts important in the closing process? What type of temporary accounts would Hyatt Hotels Corporation have?

Temporary accounts are important in the closing process because these accounts relate to a particular accounting period and are closed at the end of the period. Revenues, expenses, and withdrawals (called *dividends* for corporations) are all temporary accounts. Some examples of temporary accounts that Hyatt Hotels might have include Owned and Leased Hotels Revenue; Selling, General, and Administrative Expense; and Interest Expense.

When would Hyatt Hotels Corporation prepare its post-closing trial balance? What type of accounts would be reported on this trial balance?

A post-closing trial balance is a list of all permanent accounts and their balances at the end of the accounting period and is prepared after the closing process. Hyatt Hotels would report only permanent accounts on its post-closing trial balance. Some examples of permanent accounts that Hyatt Hotels might have include assets, such as Cash and Property; liabilities, such as Accounts Payable; and equity.

> Tying It All Together F:4-1

Before you begin this assignment, review the Tying It All Together feature in the chapter. It will also be helpful if you review Hyatt Hotels Corporation's 2018 annual report (**https://www.sec.gov/Archives/edgar/data/1468174/000146817419000009/h10-k123118.htm#sE3993A8AD84040710041937D19B26344**).

Hyatt Hotels Corporation is headquartered in Chicago and is a leading global hospitality company. The company develops, owns, and operates hotels, resorts, and vacation ownership properties in 60 different countries.

Requirements

1. Review Hyatt Hotels Corporation's income statement for year ended December 31, 2018. What does the income statement report? What was the amount of net income or loss for the year ending December 31, 2018?
2. Review the accounts that are listed on Hyatt Hotels Corporation's income statement and balance sheet. What are some examples of accounts that would be closed during the closing process?
3. Review the Hyatt Hotels Corporation's balance sheet. What does the balance sheet tell an investor? Did Hyatt Hotels Corporation present an unclassified or classified balance sheet? Explain.

Effect on the Accounting Equation

Next to every journal entry in both financial and managerial chapters, these illustrations help reinforce the connections between recording transactions and the effect those transactions have on the accounting equation.

On November 8, Smart Touch Learning collected cash of $5,500 for service revenue that the business earned by providing e-learning services for clients.

The asset Cash increased, so we debit Cash. Revenue increased, so we credit Service Revenue.

A↑	=	L	+	E↑
Cash↑				Service Revenue↑

Date	Accounts and Explanation	Debit	Credit
Nov. 8	Cash	5,500	
	Service Revenue		5,500
	Performed services and received cash.		

Instructor Tips & Tricks

Found throughout the text, these handwritten notes mimic the experience of having an experienced teacher walk a student through concepts on the "board." Many include mnemonic devices or examples to help students remember the rules of accounting.

A↓	=	L	+	E↓
Accumulated Depreciation—Building↑				Depreciation Expense—Building↑

Date	Accounts and Explanation	Debit	Credit
Dec. 31	Depreciation Expense—Building	250	
	Accumulated Depreciation—Building		250
	To record depreciation on building.		

Remember, an increase in a contra asset, such as Accumulated Depreciation, decreases total assets. This is because a contra asset has a credit balance and credits decrease assets.

Common Questions, Answered

Our authors have spent years in the classroom answering students' questions and have found patterns in the concepts or rules that consistently confuse students. These commonly asked questions are located in the margin of the text next to where the answer or clarification can be found highlighted in purple text.

Why was the account Patent credited instead of Accumulated Amortization—Patent?

Notice that Smart Touch Learning credited the amortization directly to the intangible asset, Patent, instead of using an Accumulated Amortization account. A company may credit an intangible asset directly when recording amortization expense, or it may use the account Accumulated Amortization. **Companies frequently choose to credit the asset account directly because the residual value is generally zero and there is no physical asset to dispose of at the end of its useful life, so the asset essentially removes itself from the books through the process of amortization.**

At the end of the first year, Smart Touch Learning will report this patent at $160,000 ($200,000 cost minus first-year amortization of $40,000), the next year at $120,000, and so forth. Each year for five years the value of the patent will be reduced until the end of its five-year life, at which point its book value will be $0.

Decision Boxes

This feature provides common questions and potential solutions business owners face. Students are asked to determine the course of action they would take based on concepts covered in the chapter and are then given potential solutions.

DECISIONS

What e-commerce internal controls should be put into place?

Jason Kane works as an information technology auditor for Netproducts, a retailer that sells merchandise over the Internet. Jason has been assigned the responsibility of reviewing the existing procedures and suggesting internal controls that could best protect the company. Netproducts sells all its merchandise over the Internet and accepts only credit card payments. Netproducts tracks trend information about its sales and maintains all customer, product, and pricing information on the company's intranet. In addition, Netproducts keeps employee information such as annual leave, payroll deposits, and Social Security numbers on its intranet. What e-commerce controls should Jason suggest?

Solution

Jason should suggest that specific controls be put into place, such as using encryption technology and firewalls, to protect customer and employee information. He should recommend that customers be required to create an online account with a password for the site and that the company only use secured Internet networks. In addition, Netproducts should ensure that the customer and employee data are physically secured and that access to the data can be obtained only by authorized individuals.

Things You Should Know

Provides students with a brief review of each learning objective presented in a question and answer format.

> Things You Should Know

1. How do we prepare financial statements?

- Financial statements are prepared from the adjusted trial balance in the following order:
  1. Income statement—reports revenues and expenses and calculates net income or net loss during the period
  2. Statement of owner's equity—shows how capital changed during the period due to net income or net loss, owner contributions, and owner withdrawals
  3. Balance sheet—reports assets, liabilities, and owner's equity as of the last day of the period
- A classified balance sheet classifies each asset and each liability into specific categories.

2. How could a worksheet help in preparing financial statements?

- The columns of a worksheet can be extended to help in preparing the financial statements.
- The income statement section will include only revenue and expense accounts.
- The balance sheet section will include asset and liability accounts and all equity accounts except revenues and expenses.

Using Excel Problems

This End-of-Chapter problem introduces students to Excel to solve common accounting problems as they would in the business environment. Students will work from a template that will aid them in solving the problem related to accounting concepts taught in the chapter. Each chapter focuses on different Excel skills.

End-of-Chapter Continuing and Comprehensive Problems

> Continuing Problem

P-F:1-55 is the first problem in a continuing problem that will be used throughout the chapters to reinforce the concepts learned.

P-F:1-55 Using the accounting equation for transaction analysis, preparing financial statements, and calculating return on assets (ROA)

Canyon Canoe Company is a service-based company that rents canoes for use on local lakes and rivers. Amber Wilson graduated from college about 10 years ago. She worked for one of the "Big Four" accounting firms and became a CPA. Because she loves the outdoors, she decided to begin a new business that will combine her love of outdoor activities with her business knowledge. Amber decides that she will create a new sole proprietorship, Canyon Canoe Company, or CCC for short. The business began operations on November 1, 2024.

Nov.	1	Received $16,000 cash to begin the company and gave capital to Amber.
	2	Signed a lease for a building and paid $1,200 for the first month's rent.
	3	Purchased canoes for $4,800 on account.
	4	Purchased office supplies on account, $750.
	7	Earned $1,400 cash for rental of canoes.

Continuing Problem—Starts in Chapter F:1 and runs through the financial chapters, exposing students to recording entries for a service company and then moving into recording transactions for a merchandiser later in the text.

Practice Set—Starts in Chapter F:2 and goes through the financial chapters and provides another opportunity for students to practice the entire accounting cycle. The Practice Set uses the same company in each chapter, but is often not as extensive as the continuing problem.

> Practice Set

P-F:4-42 Completing the accounting cycle from adjusted trial balance to post-closing trial balance with an optional worksheet

Refer to the Practice Set data provided in Chapters F:2 and F:3 for Crystal Clear Cleaning.

Requirements

1. Prepare a worksheet (optional) at November 30, 2024. Use the unadjusted trial balance from Chapter F:2 and the adjusting entries from Chapter F:3.
2. Prepare an income statement and statement of owner's equity for the month ended November 30, 2024. Also prepare a classified balance sheet at November 30, 2024, using the report format. Assume the Notes Payable is long-term. Use the worksheet prepared in Requirement 1 or the adjusted trial balance from Chapter F:3.
3. Prepare closing entries at November 30, 2024, and post to the accounts. Open T-accounts for Income Summary and Hideaway, Capital. Determine the ending balance in each account. Denote each closing amount as *Clos.* and each account balance as *Balance*.
4. Prepare a post-closing trial balance at November 30, 2024.

Comprehensive Problem 1 for Chapters F:1–F:4—Covers the entire accounting cycle for a service company.

Comprehensive Problem 2 for Chapters F:1–F:4—A continuation of Comprehensive Problem 1. It requires the student to record transactions for the month after the closing process.

Comprehensive Problem for Chapters F:5 and F:6—Covers the entire accounting cycle for a merchandising company, including analysis.

Comprehensive Problem for Chapter F:7—Uses special journals and subsidiary ledgers and covers the entire accounting cycle for a merchandising company. Students can complete this comprehensive problem using the MyAccountingLab General Ledger or Quickbooks® software.

Comprehensive Problem for Chapters F:8, F:9, and F:10—Covers cash, receivables, and long-term assets transactions and analysis.

Comprehensive Problem for Chapters F:11, F:13, and F:14—Covers payroll, other current liabilities, long-term liabilities, and stockholders' equity transactions and analysis.

COMPREHENSIVE PROBLEMS

> Comprehensive Problem F:4-1 for Chapters F:1–F:4

Murphy Delivery Service completed the following transactions during December 2024:

Dec. 1	Murphy Delivery Service began operations by receiving $13,000 cash and a truck with a fair value of $9,000 from Russ Murphy. The business issued Murphy capital in exchange for this contribution.
1	Paid $600 cash for a six-month insurance policy. The policy begins December 1.
4	Paid $750 cash for office supplies.
12	Performed delivery services for a customer and received $2,200 cash.
15	Completed a large delivery job, billed the customer $3,300, and received a promise to collect the $3,300 within one week.
18	Paid employee salary, $800.
20	Received $7,000 cash for performing delivery services.
22	Collected $2,200 in advance for delivery service to be performed later.
25	Collected $3,300 cash from customer on account.
27	Purchased fuel for the truck, paying $150 on account. (Credit Accounts Payable)
28	Performed delivery services on account, $1,400.
29	Paid office rent, $1,400, for the month of December.
30	Paid $150 on account.
31	Murphy withdrew cash of $2,500.

Dear Colleague,

Thank you for taking the time to review *Horngren's Accounting*. We are excited to share our most recent changes and innovations with you as we expand on the proven success of the Horngren family of textbooks. Using what we learned from market feedback, our colleagues, and our students, we've designed this edition to focus on several goals.

This edition we again focus on ensuring that we produce a textbook that provides students with the content and resources they need to be successful. We continually update our pedagogy and content to represent the leading methods and topics necessary for student success. As authors, we reviewed each and every component to ensure the textbook, student resources, and instructor supplements are clear, consistent, and accurate. We value our ongoing conversations with our colleagues and our time engaged at professional conferences to confirm that our textbook is up-to-date and we are providing resources for professors to create an active and engaging classroom.

We are excited to share with you some new features and changes in this latest edition. First, we have added a new Data Analytics in Accounting feature that highlights how companies used data analytics in the business environment. We also offer accompanying Data Analytics projects in MyLab Accounting for your students to learn how to apply data analytics to accounting problems. Financial Chapter 5 (Merchandising Operations) has been updated to provide better clarity and understanding based on the revised revenue recognition standard. All chapters went through a significant review with a focus of clarifying current coverage and expanding on content areas that needed more explanation.

We look forward to hearing from you and welcome your feedback and comments. Please do not hesitate to contact us at HorngrensAccounting@pearson.com or through our editor, Michael Trinchetto, Michael.Trinchetto@pearson.com.

Tracie L. Miller-Nobles, CPA Brenda Mattison, CMA

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Brenda Mattison appreciates the loving support of her family, especially from her husband, Grant. She also appreciates the support she receives from so many colleagues who share their experiences and encouragement. This book is dedicated to her students, who work hard to achieve their dreams, are a constant reminder of what's really important in our lives, and inspire her to continuously seek ways to improve her craft of teaching.

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Accounting and the Business Environment 1

Coffee, Anyone?

Aiden Jackson stared at the list the banker had given him during their meeting. *Business plan, cash flow projections, financial statements, tax returns*. Aiden had visited with the banker because he had a dream of opening a coffee shop near campus. He knew there was a need; students were always looking for a place to study and visit with their friends. He also had the experience. He had worked for the past three years as a manager of a coffee shop in a neighboring town. Aiden needed one thing, though—money. He had saved a small amount of money from his job and received several contributions from family and friends, but he still didn't have enough to open the business. He had decided the best option was to get a loan from his bank. After the meeting, Aiden felt overwhelmed and unsure of the future of his business.

You might think that Aiden was facing an impossible situation, but you'd be wrong. Almost every new business faces a similar situation. The owner starts with an inspiration, and then he or she needs to provide enough continuous cash flow to build the business. In addition, the owner has to make decisions such as: *Should we expand to another location? Do we have enough money to purchase a new coffee roaster? How do I know if the business made a profit?*

So how does Aiden get started? Keep reading. That's what accounting teaches you.

Why Study Accounting?

The situation that Aiden faced is similar to the situations faced in the founding of most businesses. **Starbucks Corporation**, for example, first opened its doors in Seattle, Washington, in 1971. Three partners, Jerry Baldwin, Zev Siegl, and Gordon Bowker, were inspired by a dream of selling high-quality coffee. We know their dream was successful because Starbucks currently has more than 22,000 stores in 67 countries. How did Starbucks grow from a small one-store shop to what it is today? The partners understood accounting—the language of business. They understood how to measure the activities of the business, process that information into reports (financial statements), and then use those reports to make business decisions. Your knowledge of accounting will help you better understand businesses. It will make you a better business owner, employee, or investor.

Chapter 1 Learning Objectives

1 Explain why accounting is important and list the users of accounting information

2 Describe the organizations and rules that govern accounting

3 Describe the accounting equation and define assets, liabilities, and equity

4 Use the accounting equation to analyze transactions

5 Prepare financial statements

6 Use financial statements and return on assets (ROA) to evaluate business performance

WHY IS ACCOUNTING IMPORTANT?

Learning Objective 1
Explain why accounting is important and list the users of accounting information

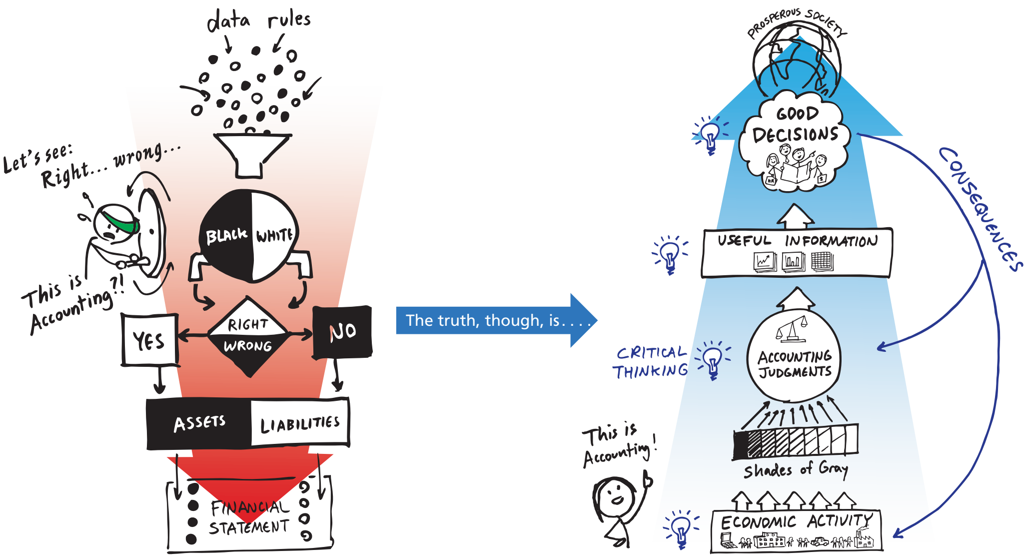
Accounting
The information system that measures business activities, processes the information into reports, and communicates the results to decision makers.

You've heard the term *accounting*, but what exactly is it? **Accounting** is the information system that measures business activities, processes the information into reports, and communicates the results to decision makers. Accounting is the language of business. The better you understand the language of business, the better you can manage your own business, be a valuable employee, or make wise investments.

We tend to think of accountants as boring and dry. However, accounting is much more than simple recordkeeping or bookkeeping. Today's accountants participate in a broad range of activities such as the investigation of financial evidence, the development of computer programs to process accounting information, and the communication of financial results to interested parties. The knowledge of accounting is used every day to help make business decisions.

The Pathways Vision Model (see Exhibit F:1-1), created by the Pathways Commission, provides a visual interpretation of what accountants really do. Accounting starts with

Exhibit F:1-1 | **Pathways Vision Model**



We tend to think of accountants as boring and dry.

Accountants are instrumental in helping to create a prosperous society.

economic activities that accountants review and evaluate using critical thinking and judgment to create useful information that helps individuals make good decisions. The model emphasizes that good decisions have an impact on accounting judgments and economic activity, thus creating a circular flow of cause and effect. Accountants are more than boring, tedious number crunchers. Instead, accountants play a critical role in supporting a prosperous society.

Decision Makers: The Users of Accounting Information

We can divide accounting into two major fields: financial accounting and managerial accounting. **Financial accounting** provides information for external decision makers, such as outside investors, lenders, customers, and the federal government. **Managerial accounting** focuses on information for internal decision makers, such as the company's managers and employees.

Exhibit F:1-2 illustrates the difference between financial accounting and managerial accounting. Regardless of whether they are external or internal to the company, all decision makers need information to make the best choices. The bigger the decision, the more information decision makers need. Let's look at some ways in which various people use accounting information to make important decisions.

Financial Accounting
The field of accounting that focuses on providing information for external decision makers.

Managerial Accounting
The field of accounting that focuses on providing information for internal decision makers.

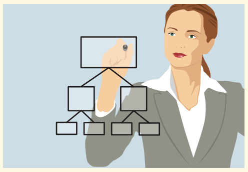
Exhibit F:1-2 | **Decision Making: Financial Versus Managerial Accounting**

Financial Accounting

External Decision Makers:

Should I invest in the business?
Is the business profitable?
Should we lend money to the business?
Can the business pay us back?

Managerial Accounting



Internal Decision Makers:

How much money should the business budget for production?
Should the business expand to a new location?
How do actual costs compare to budgeted costs?

IFRS

Accounting is alive! As businesses evolve and the types of business transactions change, so must the language of business. The most significant changes in the business world in the last decade have been the huge increases in international commerce. Because more business is conducted internationally, decision makers are looking for an international accounting language.

Look for more information about International Financial Reporting Standards (IFRS) anywhere you see the IFRS heading.

Individuals

How much cash do you have? How much do you need to save each month to retire at a certain age or pay for your children's college education? Accounting can help you answer questions like these. By using accounting information, you can manage your money, evaluate a new job, and better decide whether you can afford to buy a new computer. Businesses need accounting information to make similar decisions.

Businesses

Business owners use accounting information to set goals, measure progress toward those goals, and make adjustments when needed. The financial statements give owners the information they need to help make those decisions. Financial statements are helpful when, for example, a business owner wants to know whether his or her business has enough cash to purchase another computer.

Investors

Outside investors who have some ownership interest often provide the money to get a business going. Suppose you're considering investing in a business. How would you decide whether it is a good investment? In making this decision, you might try to predict the amount of income you would earn on the investment. Also, after making an investment, investors can use a company's financial statements to analyze how their investment is performing.

You might have the opportunity to invest in the stock market through your company's retirement plan. Which investments should you pick? Understanding a company's financial statements will help you decide. You can view the financial statements of large companies that report to the Securities and Exchange Commission (SEC) by logging on to **http://www.finance.yahoo.com**, **http://www.google.com/finance**, or the SEC's EDGAR database (**http://www.sec.gov/edgar.shtml**).

Creditors

Creditor
Any person or business to whom a business owes money.

Any person or business to whom a business owes money is a **creditor**. Before extending credit to a business, a creditor evaluates the company's ability to make the payments by reviewing its financial statements. Creditors follow the same process when you need to borrow money for a new car or a house. The creditor reviews accounting data to determine your ability to make the loan payments. What does your financial position tell the creditor about your ability to repay the loan? Are you a good risk for the bank?

Taxing Authorities

Local, state, and federal governments levy taxes. Income tax is calculated using accounting information. Good accounting records can help individuals and businesses take advantage of lawful deductions. Without good records, the Internal Revenue Service (IRS) can disallow tax deductions, resulting in a higher tax bill plus interest and penalties.

Accounting Matters

Certified Public Accountants (CPAs)
Licensed professional accountants who serve the general public.

Chartered Global Management Accountant (CGMA)
Professional accountant with advanced knowledge in finance, operations, strategy, and management.

What do businesses such as Amazon.com, Walmart, or even your local sandwich shop across from campus have in common? They all rely upon accounting information to make business decisions. Even if you don't plan on majoring in accounting, the knowledge of accounting helps all businesses plan for the future and evaluate past performance. The skills you learn in this class will help you be a better business professional. Businesses can't function, though, without accountants. That is why a degree in accounting opens so many doors upon graduation. A bachelor's degree in accounting could lead you to several different accounting careers.

What if I want more information about becoming a CPA or CMA?

You've probably heard of a CPA before. **Certified Public Accountants**, or **CPAs**, are licensed professional accountants who serve the general public. CPAs work for public accounting firms, businesses, government entities, or educational institutions. What does it take to be a CPA? Although requirements vary between states, to be certified in a profession, one must meet the educational and/or experience requirements *and* pass a qualifying exam. Accountants can also obtain a **Chartered Global Management Accountant (CGMA)** designation. This distinguishes accountants who have advanced knowledge in finance, operations, strategy, and management. **The American Institute of Certified Public Accountants (AICPA) Web site (http://www.thiswaytocpa.com) contains a wealth of information about becoming a CPA or CGMA, career opportunities, and exam requirements.**

Certified Management Accountants (CMAs)
Professional accountants who specialize in accounting and financial management knowledge.

Certified Management Accountants, or **CMAs**, are certified professionals who specialize in accounting and financial management knowledge. Generally, CMAs work for a single company. **You can find information about becoming a CMA, how a CMA differs from a CPA, and why employers are recognizing the CMA certification on the Institute of Management Accountants (IMA) Web site (http://www.imanet.org).**

Certified Financial Planner (CFP)
Certified professional who specializes in budgeting, planning for retirement, and managing finances.

Another specialization in accounting is a **Certified Financial Planner**, or **CFP**. CFPs work with individuals to help them budget, plan for retirement, save for education, and manage their finances. Individuals who want to obtain their CFP must have the four E's: education, examination, experience, and ethics. You can find out more about becoming a CFP on the following Web site: **https://www.cfp.net/home**.

Studying accounting and becoming certified professionally can lead to a financially secure job. It's worth it for an accountant to spend the time and energy to get certified—certified accountants generally make 10–15% more than their noncertified colleagues when they enter the workforce. According to Robert Half's *2019 Salary Guide*, the top in-demand positions that rely on accounting skills are controllers, financial analysts, tax accountants, auditors, cost accountants, accounting clerks/bookkeepers, and business systems analysts. How much do these types of accountants make? Exhibit F:1-3 provides a snapshot of the earning potential for key positions.

Exhibit F:1-3 | **Comparison of Accounting Positions**

Position	Job Description	Salary Range
Controllers	Compile financial statements, interact with auditors, and oversee regulatory reporting.	$92,000–$207,750
Financial analysts	Review financial data and help to explain the story behind the numbers.	$42,500–$201,250
Business systems analysts	Use accounting knowledge to create computer systems.	$42,500–$185,000
Tax accountants	Help companies navigate tax laws.	$39,500–$212,250
Auditors	Perform reviews of companies to ensure compliance to rules and regulations.	$39,500–$208,750
Cost accountants	Typically work in a manufacturing business. Help analyze accounting data.	$42,000–$143,750
Accounting clerks/ Bookkeepers	Record financial transactions and help prepare financial records.	$28,250–$65,750

Based on Robert Half's 2019 Salary Guide https://www.roberthalf.com/salary-guide

Accountants generally work either in corporate or industry accounting, public accounting, financial services, or governmental accounting. Corporate or industry accounting professionals are in demand in every sector of the business community, including manufacturing, construction, and healthcare. As the population of the world continues to age, accountants are in high demand in healthcare organizations to address billing and collections, data and business analysis, and changing revenue models. Corporate/industry accountants typically work for a single company, such as Amazon.com, Walmart, Dell, or UnitedHealthcare. Public accounting involves services such as auditing, tax preparation, and consulting. Well-known public accounting firms include Ernst & Young, Deloitte, PricewaterhouseCoopers (PwC), and KPMG. Accountants also work in financial services organizations such as banks. Other accountants work for federal, state, or local governments. Sought-after skills of accountants include being licensed or certified (e.g., CPA or CMA), data analytics, Excel, a strong work ethic, effective verbal and written communication, and leadership. Wherever accountants work, demand for their services is high. According to the U.S. Bureau of Labor Statistics, employment of accountants and auditors is expected to grow 10% (faster than average) from 2016–2026.

Data Analytics in Accounting

Today's accountants need to know more than just accounting knowledge. They also need to have an understanding of how technology is used to process financial information. Accounting and finance individuals actively work with information technology teams to develop accounting systems. Artificial intelligence, cloud-based systems, and robotic process automation are all changing the way companies handle financial information. Ideal accounting employees have knowledge in both accounting and technology.

Try It!

Match the accounting terminology to the definitions.

1. Certified management accountants	**a.** information system that measures business activities, processes that information into reports, and communicates the results to decision makers
2. Accounting	**b.** professional accountants who serve the general public
3. Managerial accounting	**c.** person or business to whom a business owes money
4. Certified public accountants	**d.** field of accounting that focuses on providing information for internal decision makers
5. Financial accounting	**e.** professionals who work for a single company
6. Creditor	**f.** field of accounting that focuses on providing information for external decision makers

Check your answers online in MyLab Accounting or at http://www.pearsonhighered.com/Horngren.

For more practice, see Short Exercise S-F:1-1. MyLab Accounting

Learning Objective 2

Describe the organizations and rules that govern accounting

WHAT ARE THE ORGANIZATIONS AND RULES THAT GOVERN ACCOUNTING?

All professions have regulations. Let's look at the organizations and rules that govern the accounting profession.

Governing Organizations

Financial Accounting Standards Board (FASB)
The private organization that oversees the creation and governance of accounting standards in the United States.

Securities and Exchange Commission (SEC)
U.S. governmental agency that oversees the U.S. financial markets.

In the United States, the **Financial Accounting Standards Board (FASB)**, a privately funded organization, oversees the creation and governance of accounting standards. The FASB works with governmental regulatory agencies like the **Securities and Exchange Commission (SEC)**. The SEC is the U.S. governmental agency that oversees the U.S. financial markets. It also oversees those organizations that set standards (like the FASB). The FASB also works with congressionally created groups like the Public Company Accounting Oversight Board (PCAOB) and private groups like the American Institute of CPAs (AICPA), Institute of Management Accountants (IMA), and International Accounting Standards Board (IASB).

Generally Accepted Accounting Principles

Generally Accepted Accounting Principles (GAAP)
Accounting guidelines, currently formulated by the Financial Accounting Standards Board (FASB); the main U.S. accounting rule book.

The guidelines for accounting information are called **Generally Accepted Accounting Principles (GAAP)**. GAAP is the main U.S. accounting rule book and is currently created and governed by the FASB. In order to use and prepare financial statements, it's important that we understand GAAP. GAAP rests on a conceptual framework that identifies the objectives, characteristics, elements, and implementation of financial statements and creates the acceptable accounting practices. The primary objective of financial reporting is to provide information useful for making investment and lending decisions. To be useful, information must be relevant and have **faithful representation**.[1] Relevant information allows users of the information to make a decision. Information that is faithfully representative is complete, neutral, and free from material error. These basic accounting assumptions and principles are part of the foundation for the financial reports that companies present.

Faithful Representation
Providing information that is complete, neutral, and free from error.

Economic Entity Assumption
An organization that stands apart as a separate economic unit.

Sole Proprietorship
A business with a single owner.

Partnership
A business with two or more owners and not organized as a corporation.

Corporation
A business organized under state law that is a separate legal entity.

Limited-Liability Company (LLC)
A company in which each member is only liable for his or her own actions.

The Economic Entity Assumption

The most basic concept in accounting is that of the **economic entity assumption**. An economic (business) entity is an organization that stands apart as a separate economic unit. We draw boundaries around each entity to keep its affairs distinct from those of other entities. An entity refers to one business, separate from its owners.

A business can be organized as a sole proprietorship, partnership, corporation, or limited-liability company (LLC). Exhibit F:1-4 summarizes the similarities and differences among the four types of business organizations.

In order to demonstrate the economic entity assumption and several other concepts in this chapter, we will use a fictitious business—Smart Touch Learning—an e-learning business that specializes in providing online courses in accounting, economics, marketing, and management. This fictitious business will be used often throughout the book.

Exhibit F:1-4 | **Business Organizations**

	Sole Proprietorship	Partnership	Corporation	Limited-Liability Company (LLC)
Definition	A business with a single owner	A business with two or more owners and not organized as a corporation	A business organized under state law that is a separate legal entity	A company in which each member is only liable for his or her own actions
Number of owners	One (called the *proprietor*)	Two or more (called *partners*)	One or more (called *stockholders*)	One or more (called *members* or *partners*)
Life of the organization	Terminates at owner's choice or death	Terminates at a partner's choice or death	Indefinite	Indefinite
Personal liability of the owner(s) for the business's debts	The owner is personally liable.	The partners are personally liable.	Stockholders are not personally liable.	Members are not personally liable.
Taxation	Not separate taxable entities. The owner pays tax on the proprietorship's earnings.	Partnership is not taxed. Instead partners pay tax on their share of the earnings.	Separate taxable entity. Corporation pays tax.	LLC is not taxed. Instead members pay tax on their share of earnings.
Type of business	Small businesses	Professional organizations of physicians, attorneys, and accountants	From small business to large multinational businesses	An alternative to the partnership

[1] This wording was changed from relevant and reliable by the *Statement of Financial Accounting Concepts No. 8*.

Assume Sheena Bright started the business by contributing cash of $30,000 (called *capital*). Following the economic entity assumption, the $30,000 is recorded separately from Sheena's personal assets, such as her clothing and car. To mix the $30,000 of business cash with Sheena's personal assets would make it difficult to measure the success or failure of Smart Touch Learning. The economic entity assumption requires that each entity be separate from other businesses and from the owners.

The Cost Principle

Cost Principle
A principle that states that acquired assets and services should be recorded at their actual cost.

The **cost principle** states that acquired assets and services should be recorded at their actual cost (also called *historical cost*). The cost principle means we record a transaction at the amount shown on the receipt—the actual amount paid. Even though the purchaser may believe the price is a bargain, the item is recorded at the price actually paid and not at the "expected" cost. For example, assume our fictitious company Smart Touch Learning purchased land for $20,000. The business might believe the land is instead worth $25,000. The cost principle requires that Smart Touch Learning record the land at $20,000, not $25,000.

IFRS
Under international reporting standards, the company would be allowed to restate and report the land at $30,000. The ability to report some assets and liabilities at their current fair value each year under international standards is a significant difference from U.S. rules.

The cost principle also holds that the accounting records should continue reporting the historical cost of an asset over its useful life. Why? Because cost is a reliable measure. Suppose Smart Touch Learning holds the land for six months. During that time land prices rise, and the land could be sold for $30,000. Should its accounting value—the figure on the books—be the actual cost of $20,000 or the current market value of $30,000? According to the cost principle, the accounting value of the land would remain at the actual cost of $20,000.

The Going Concern Assumption

Going Concern Assumption
Assumes that the entity will remain in operation for the foreseeable future.

Another reason for measuring assets at historical cost is the **going concern assumption**. This assumes that the entity will remain in operation for the foreseeable future. Under the going concern assumption, accountants assume that the business will remain in operation long enough to use existing resources for their intended purpose.

The Monetary Unit Assumption

In the United States, we record transactions in dollars because the dollar is the medium of exchange. The value of a dollar changes over time, and a rise in the price level is called *inflation*. During periods of inflation, a dollar will purchase less. But accountants assume that the dollar's purchasing power is stable. This is the basis of the **monetary unit assumption**, which requires that the items on the financial statements be measured in terms of a monetary unit.

Monetary Unit Assumption
The assumption that requires the items on the financial statements to be measured in terms of a monetary unit.

International Financial Reporting Standards

The concepts and principles that we have discussed so far apply to businesses that follow U.S. GAAP and are traded on a U.S. stock exchange, such as the New York Stock Exchange. The SEC requires that U.S. businesses follow U.S. GAAP. Companies who are incorporated in or do significant business in another country might be required to publish financial statements using **International Financial Reporting Standards (IFRS)**, which are published by the **International Accounting Standards Board (IASB)**. IFRS is a set of global accounting standards that are used by more than 166 nations/jurisdictions. They are generally less specific and based more on principle than U.S. GAAP. IFRS leaves more room for professional judgment. For example, unlike U.S. GAAP, IFRS allows periodic revaluation of certain assets and liabilities to restate them to market value, rather than keeping them at historical cost. At one point in time it was thought that the SEC would endorse IFRS. However, the SEC has backed away from this strategy and is currently considering whether a single set of global accounting standards is achievable.

International Financial Reporting Standards (IFRS)
A set of global accounting guidelines, formulated by the International Accounting Standards Board (IASB).

International Accounting Standards Board (IASB)
The private organization that oversees the creation and governance of International Financial Reporting Standards (IFRS).