



# Financial Accounting <sup>7e</sup>

Information for Decisions

John J. Wild



# Financial Accounting

7<sup>th</sup>  
edition

INFORMATION FOR DECISIONS

**John J. Wild**

*University of Wisconsin at Madison*

Mc  
Graw  
Hill  
Education



To my students and family, especially **Kimberly, Jonathan, Stephanie, and Trevor.**

FINANCIAL ACCOUNTING: INFORMATION FOR DECISIONS, SEVENTH EDITION

Published by McGraw-Hill Education, 2 Penn Plaza, New York, NY 10121. Copyright © 2015 by McGraw-Hill Education. All rights reserved. Printed in the United States of America. Previous editions © 2013, 2011, and 2008. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of McGraw-Hill Education, including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

Some ancillaries, including electronic and print components, may not be available to customers outside the United States.

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 0 DOW/DOW 1 0 9 8 7 6 5 4

ISBN 978-0-07-802589-1

MHID 0-07-802589-3

Senior Vice President, Products & Markets: *Kurt L. Strand*  
Vice President, Content Production

& Technology Services: *Kimberly Meriwether David*

Managing Director: *Tim Vertovec*

Executive Brand Manager: *Steve Schuetz*

Executive Director of Development: *Ann Torbert*

Managing Development Editor: *Christina A. Sanders*

Director of Digital Content: *Patricia Plumb*

Digital Development Editor: *Julie Hankins*

Digital Product Analyst: *Xin Lin*

Senior Marketing Manager: *Kathleen Klehr*

Director, Content Production: *Terri Schiesl*

Content Project Manager: *Lori Koetters*

Content Project Manager: *Brian Nacik*

Senior Buyer: *Carol A. Bielski*

Design: *Matthew Baldwin*

Cover Images: *Apple store: © McGraw-Hill Companies/*

*Jill Braaten, photographer: Annie's: © Bloomberg via*

*Getty Images. Groupon: © Bloomberg via Getty*

*Images. Bull statue: © Royalty-Free/CORBIS.*

Senior Content Licensing

Specialist: *Jeremy Cheshareck*

Typeface: *10.5/12 Times Roman*

Compositor: *Aptara®, Inc.*

Printer: *R. R. Donnelley*

All credits appearing on page or at the end of the book are considered to be an extension of the copyright page.

**Library of Congress Cataloging-in-Publication Data**

Wild, John J.

Financial accounting : information for decisions / John J. Wild, University of Wisconsin at Madison.

—7th edition.

pages cm

Includes index.

ISBN 978-0-07-802589-1 (alk. paper) — ISBN 0-07-802589-3 (alk. paper)

1. Accounting. I. Title.

HF5635.W695 2015

657—dc23

2013042296

The Internet addresses listed in the text were accurate at the time of publication. The inclusion of a website does not indicate an endorsement by the authors or McGraw-Hill Education, and McGraw-Hill Education does not guarantee the accuracy of the information presented at these sites.

# Adapting to Today's Students

## ***Financial Accounting, 7e***

Enhancements in technology have changed the spectrum of how we live and learn in the world today. Being able to download and work with learning tools on smart phones, tablets, or laptop computers empowers students to drive their own learning by putting increasingly intelligent technology into their hands.

No two students are alike, and whether the goal is to become an accountant or a businessperson or simply to be an informed consumer of accounting information, *Financial Accounting (FA)* has helped generations of students succeed by giving them support in the form of leading-edge accounting content that engages students, paired with state-of-the-art technology that elevates their understanding of key accounting principles.

With *FA* on your side, you'll be provided with **engaging content** in a **motivating style** to help students see the relevance of accounting. Students are motivated when reading materials that are clear and pertinent. *FA* excels at engaging students. Its chapter-opening vignettes showcase dynamic, successful companies guaranteed to **interest and excite students, and highlights the usefulness of accounting to those business owners**. This edition's featured companies—**Apple, Google, and Samsung**—captivate students with their products and annual reports, which are a pathway for learning financial statements. Further, this book's coverage of the accounting cycle fundamentals is widely praised for its clarity and effectiveness.

*FA* also delivers innovative technology to help student performance. ***Connect Accounting*** provides students with instant grading and feedback for assignments that are completed online. With our **Intelligent Response Technology**, we have taken our accounting content to the next level, delivering assessment material in a **more intuitive, less restrictive** format that adapts to the needs of today's students.

Our content features:

- **general journal interface** that looks and feels more like that found in practice.
- **auto-calculation** feature that allows students to focus on concepts rather than rote tasks.
- **smart (auto-fill) drop-down design**.
- **NEW General Ledger multi-tab format for select questions**.

The end result is content that better prepares students for the real world. *Connect Accounting* also includes digitally based, interactive adaptive learning tools that provide an opportunity to engage students more effectively by offering varied instructional methods and more personalized learning paths that build on different learning styles, interests, and abilities, allowing students to work at their own pace.

**McGraw-Hill LearnSmart™** is an intelligent learning system that uses a series of adaptive questions to pinpoint each student's knowledge gaps. LearnSmart then provides an optimal learning path for each student, so that they spend less time in areas they already know and more time in areas they don't. The result is LearnSmart's adaptive learning path that helps students retain more knowledge, learn faster, and study more efficiently.

Our **Interactive Presentations** teach each chapter's core learning objectives in a rich multimedia format, bringing the content to life. Your students will come to class prepared when you assign Interactive Presentations. Students can also review the Interactive Presentations as they study.

**Guided Examples** provide students with narrated, animated, step-by-step walkthroughs of exercises similar to those assigned in *Connect*. Students appreciate the Guided Examples because they can help students learn accounting and complete assignments when outside of class.

***Connect Plus Accounting*** integrates a media-rich online version of the textbook with *Connect Accounting*.

# About the Author

---



**JOHN J. WILD** is a distinguished professor of accounting at the University of Wisconsin at Madison. He previously held appointments at Michigan State University and the University of Manchester in England. He received his BBA, MS, and PhD from the University of Wisconsin.

Professor Wild teaches accounting courses at both the undergraduate and graduate levels. He has received numerous teaching honors, including the Mabel W. Chipman Excellence-in-Teaching Award, the departmental Excellence-in-Teaching Award, and the Teaching Excellence Award from the 2003 and 2005 business graduates at the University of Wisconsin. He also received the Beta Alpha Psi and Roland F. Salmonson Excellence-in-Teaching Award from Michigan State University. Professor Wild has received several research honors and is a past KPMG Peat Marwick National Fellow and is a recipient of fellowships from the American Accounting Association and the Ernst and Young Foundation.

Professor Wild is an active member of the American Accounting Association and its sections. He has served on several committees of these organizations, including the Outstanding Accounting Educator Award, Wildman Award, National Program Advisory, Publications, and Research Committees. Professor Wild is author of *Fundamental Accounting Principles*, *Financial and Managerial Accounting*, *Financial Accounting Fundamentals*, *Managerial Accounting*, and *College Accounting*, each published by McGraw-Hill/Irwin. His research articles on accounting and analysis appear in *The Accounting Review*, *Journal of Accounting Research*, *Journal of Accounting and Economics*, *Contemporary Accounting Research*, *Journal of Accounting, Auditing and Finance*, *Journal of Accounting and Public Policy*, and other journals. He is past associate editor of *Contemporary Accounting Research* and has served on several editorial boards including *The Accounting Review*.

In his leisure time, Professor Wild enjoys hiking, sports, travel, people, and spending time with family and friends.

Dear Colleagues/Friends,

As we roll out the new edition of *Financial Accounting*, I thank each of you who provided suggestions to improve the textbook. As teachers, we know how important it is to select the right book for our course. This new edition reflects the advice and wisdom of many dedicated reviewers, symposium and workshop participants, students, and instructors. This book consistently rates number one in customer loyalty because of you. Together, we have created the most readable, concise, current, accurate, and innovative accounting book available today.

Throughout the writing process, I steered this book in the manner you directed. Reviewers, instructors, and students say this book's enhanced presentation, graphics, and technology cater to different learning styles and helps students better understand accounting. *Connect Plus Accounting* offers new features to improve student learning and to assist instructor teaching and grading. You and your students will find all these tools easy to apply.

I owe the success of this book to you and other instructors who graciously took time to help me focus on the changing demands of today's students and their learning needs. I feel fortunate to have witnessed our profession's extraordinary devotion to teaching. Your feedback and suggestions are reflected in everything I write. Please accept my heartfelt thanks for your dedication in helping today's students learn, understand, and appreciate accounting.

With kindest regards,

*John J. Wild*

# Leading Technology Extends Learning

## McGraw-Hill Connect Accounting Get Connect Accounting. Get Results.

McGraw-Hill *Connect Accounting* is a digital teaching and learning environment that gives students the means to better connect with their coursework, with their instructors, and with the important concepts that they will need to know for success now and in the future. With *Connect Accounting*, instructors can deliver assignments, quizzes, and tests easily online. Students can practice important skills at their own pace and on their own schedule.

### Online Assignments

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

### Intelligent Response Technology (IRT)

IRT is a redesigned student interface for our end-of-chapter assessment content. The benefits include improved answer acceptance to reduce students' frustration with formatting issues (such as rounding). Also, select questions have been redesigned to test students' knowledge more fully. They now include tables for students to work through rather than requiring that all calculations be done offline.

### General Ledger Simulation

New **general ledger simulation** for select questions provides a much-improved student experience when working with accounting cycle questions. Students' work in the general journal is automatically posted to the ledger, navigation is much simpler, scrolling is no longer an issue, and students can easily link back to their original entries simply by clicking in the ledger if edits are needed. Many questions now have critical thinking components added, to maximize students' foundational knowledge of accounting concepts and principles.

**Journal Entry Worksheet**

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

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

a. Prepaid Insurance. The Prepaid Insurance account has a \$4,700 debit balance to start the year. A review of insurance policies and payments shows that \$900 of unexpired insurance remains at year-end.

Step 1: Determine what the current account balance equals. **\$ 4,700 Debit**

Step 2: Determine what the current account balance should equal. **\$ 900 Debit**

Step 3: Record an adjusting entry to get from step 1 to step 2.

Adjusting Entry		Debit	Credit
Insurance Expense		3,800	
Prepaid Insurance			3,800

Each journal entry is posted automatically to the general ledger.

Adjusted  Dates: Dec 31 to: Dec 31

Cash				Accounts receivable			
Date	Debit	Credit	Balance	Date	Debit	Credit	Balance
			34,000				0
				Dec 31	7,500		7,500

Using the dropdown buttons, select the account types and titles that should be reported on the Income Statement. The dollar amounts will be populated based on the type of trial balance selected on the Trial Balance tab (Unadjusted, Adjusted, Post-closing). (10% of available points)

Adjusted

Wells Technical Institute		Income Statement	
For Month ended December 31, 2013			
<b>Revenues</b>			
Tuition revenue		131,400	
Training fees revenue		45,000	
		0	
<b>Total revenues</b>			\$ 176,400
<b>Expenses</b>			
Depreciation expense - Professional library		7,200	
Depreciation expense - Equipment		13,200	
Salaries expense		50,000	

"I love how the general journal was set up. It felt like what I would be filling out if I had an accounting job."  
—Student, Chabot Community College

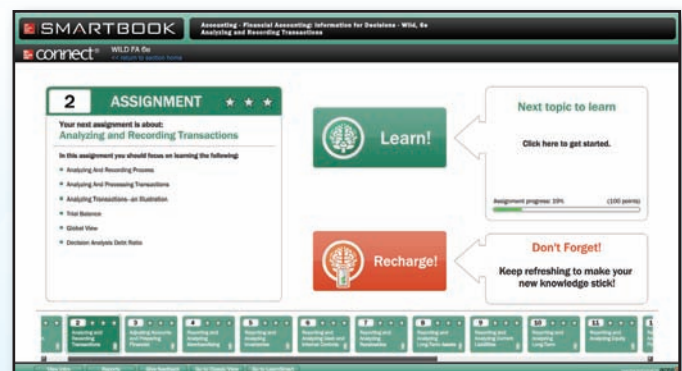
# Learn with Adaptive Tools



Fueled by LearnSmart—the most widely used and intelligent adaptive learning resource—SmartBook is the first and only adaptive reading experience available today.

Distinguishing what a student knows from what they don't, and honing in on concepts they are most likely to forget, SmartBook personalizes content for each student in a continuously adapting reading experience. Reading is no longer a passive and linear experience, but an engaging and dynamic one where students are more likely to master and retain important concepts, coming to class better prepared. Valuable reports provide instructors insight as to how students are progressing through textbook content, and are useful for shaping in-class time or assessment. As a result of the adaptive reading experience found in SmartBook, students are more likely to retain knowledge, stay in class, and get better grades.

This revolutionary technology is available only from McGraw-Hill Education and for hundreds of course areas as part of the LearnSmart Advantage series.



## How Does SmartBook Work?

Each SmartBook contains four components: Preview, Read, Practice, and Recharge. Starting with an initial preview of each chapter and key learning objectives, students read the material and are guided to topics that need the most practice based on their responses to a continuously adapting diagnostic. Read and practice continue until SmartBook directs students to recharge important material they are most likely to forget to ensure concept mastery and retention.

**SMARTBOOK** Accounting - Financial Accounting: Information for Decisions - Wild, Ed. Analyzing and Recording Transactions

Assignment Progress

From the following lists of accounts, choose the list(s) which contains *only* expense accounts.

Click the answer you think is right!

- Rent expense, dividends, insurance expense
- Wages expense, unearned revenue, supplies expense
- Rent expense, supplies expense, accounts payable
- Rent expense, wages expense, insurance expense

Do you know the answer? (Be honest) [Read about this](#)

I know it Think so Unsure No idea

**Equity Accounts** The owner's claim on a company's assets is called *equity*, or *stockholders' equity*, or *shareholders' equity*. Equity is the owners' *residual interest* in the assets of a business after deducting liabilities. Equity is impacted by four types of accounts: common stock, dividends, revenues, and expenses. We show this visually in Exhibit 2.3 by expanding the accounting equation. (As Chapter 1 explains, the accounts for dividends, revenues, and expenses are reflected in the retained earnings account, and that account is reported in the balance sheet.)

**EXHIBIT 2.3** Expanded Accounting Equation

When an owner invests in a company in exchange for common stock, the invested amount is recorded in an account titled **Common Stock**. Any further owner investments are recorded in this account. When the company pays any cash dividends, it decreases both the company's assets and its total equity. Dividends are not expenses of the business. They are simply the opposite of owner investments. A **Dividends** account is used in recording asset distributions to stockholders (owners).

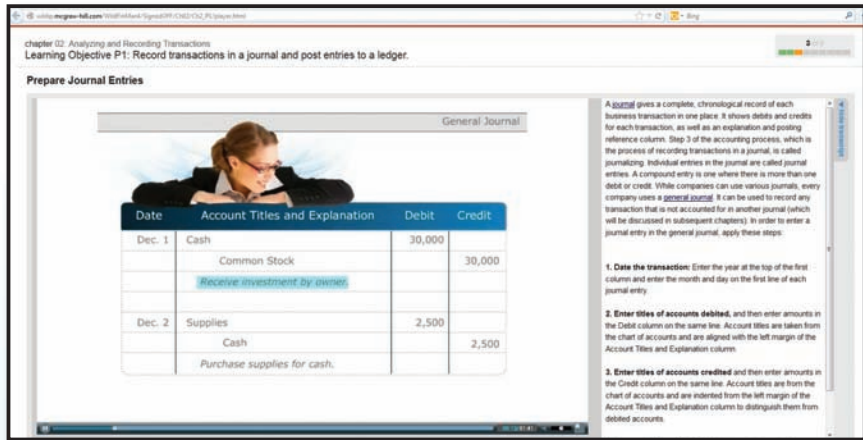
Revenues and expenses also impact equity. Examples of revenue accounts are Sales, Commissions Earned, Professional Fees Earned, Rent Revenue, and Interest Revenue. *Revenues increase equity* and result from products and services provided to customers. Examples of expense accounts are Advertising Expense, Store Supplies Expense, Office Salaries Expense, Office Supplies Expense, Rent Expense, Utilities Expense, and Insurance Expense. *Expenses decrease equity* and result from assets and services used in a company's operations. The variety of revenues and expenses can be seen by looking at the *chart of accounts* that follows the index at the

\* In practice, account titles vary. As one example, Subscription Fees is sometimes called Subscription Fees Revenue, Subscription Fees Earned, or Earned Subscription Fees. As another example, Rent Earned is sometimes called Rent Revenue, Rental Revenue, or Earned Rent Revenue. We must use good judgment when reading financial statements because titles can differ even within the same industry. For example, product sales are called *revenue at Research In Motion*, but *net sales at Apple*. Generally, the term *revenue or fees* is more commonly used with service businesses, and *net sales or sales* with product businesses.

6 of 44



**Interactive Presentations** *Connect Accounting's* Interactive Presentations teach each chapter's core learning objectives and concepts through an engaging, hands-on presentation, bringing the text content to life. Interactive Presentations harness the full power of technology to truly engage and appeal to all learning styles. Interactive Presentations are ideal in all class formats—online, face-to-face, or hybrid.



## LEARNSMART

**LearnSmart** is one of the most effective and successful adaptive learning resources available on the market today. More than 2 million students have answered more than 1.3 billion questions in LearnSmart since 2009, making it the most widely used and intelligent adaptive study tool that's proven to strengthen memory recall, keep students in class, and boost grades. Students using LearnSmart are 13% more likely to pass their classes and 35% less likely to drop out.

Distinguishing what students know from what they don't, and honing in on concepts they are most likely to forget, LearnSmart continuously adapts to each student's needs by building an individual learning path so they study smarter and retain more knowledge. Turnkey reports provide valuable insight to instructors, so precious class time can be spent on higher-level concepts and discussion.

This revolutionary learning resource is available only from McGraw-Hill Education, and because LearnSmart is available for most course areas, instructors can recommend it to students in almost every class they teach.

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

# Today's Students!

Date	General Journal	Debit	Credit
Nov. 05	Accounts Receivable - Ski Shop	4,554	
	Sales		4,554
Nov. 10	Accounts Receivable - Welcome Enterprises	2,881	
	Sales		2,881
Nov. 13	Accounts Receivable - Zia Natara	1,689	
	Sales		1,689
Nov. 21	Sales Returns and Allowances	436	
	Accounts Receivable - Zia Natara		436
Nov. 30	Accounts Receivable - Ski Shop	6,006	
	Sales		6,006

Accounts Receivable		Sales		Sales Returns and Allowances	
Nov. 05	4,554	Nov. 05	4,554		

On November 5, debit Accounts Receivable and credit Sales.

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

**Need-to-Know Videos** Provide narrated, animated, step-by-step walkthroughs of the Need-to-Know learning activities presented for key concepts in each chapter. These tutorial presentations are directed to maximize student learning and retention of key chapter concepts, procedures, and analyses. Presentations are teacher-structured and student-focused, and are especially beneficial for students outside of the regular classroom.

### Need to Know

**Supplies.** The Supplies account has a \$1,000 debit balance to start the year. Supplies of \$2,000 were purchased during the current year and debited to the Supplies account. A December 31 physical count shows \$500 of supplies remaining.

Step 1: Determine what the current account balance equals: \$3,000  
 Step 2: Determine what the current account balance should be: \$500  
 Step 3: Record an adjusting entry to get from step 1 to step 2. \$2,500

Supplies			Supplies expense		
Step 1	Unadjusted	3,000	Adj.	2,500	
Step 2	Dec. 31	500	Adj.	2,500	Dec. 31

Date	General Journal	Debit	Credit
Dec. 31	Supplies expense	2,500	
	Supplies		2,500

The purpose of adjusting entries is to ensure that the balance in every asset and liability account, and the resulting revenue and expense, is correct prior to the preparation of financial statements.

© McGraw-Hill Education - 2014

# Adapting to the Needs of

## MCGRAW-HILL *CONNECT ACCOUNTING* FEATURES

*Connect Accounting* offers a number of powerful tools and features to make managing assignments easier, so faculty can spend more time teaching.

### Simple Assignment Management and Smart Grading

With *Connect Accounting*, creating assignments is easier than ever, so instructors can spend more time teaching and less time managing.

- Create and deliver assignments easily with selectable end-of-chapter questions and Test Bank items.
- Go paperless with the eBook and online submission and grading of student assignments.
- Have assignments scored automatically, giving students immediate feedback on their work and side-by-side comparisons with correct answers.
- Access and review each response; manually change grades or leave comments for students to review.
- Reinforce classroom concepts with practice tests and instant quizzes.

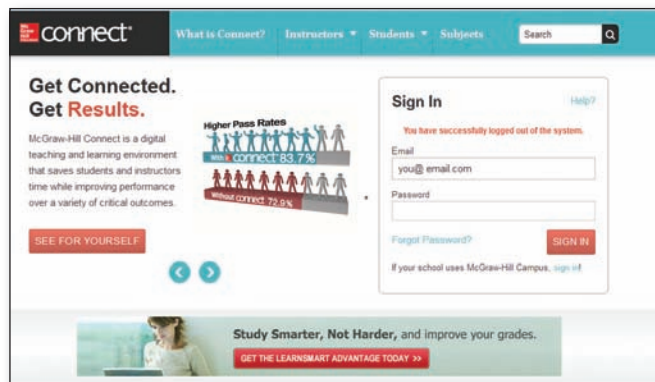
### Student Reporting

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

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

### Instructor Library

The *Connect Accounting* Instructor Library is a repository for additional resources to improve student engagement in and out of class. You can select and use any asset that enhances your lecture. The *Connect Accounting* Instructor Library includes access to the eBook version of the text, videos, slide presentations, Solutions Manual, Instructor's Manual, and Test Bank. The *Connect Accounting* Instructor Library also allows you to upload your own files.



“Connect certainly offers so much for the students and at the same time helps the professors. The professors can offer more learning opportunities to the students without intensive time investment.”

—Constance Hylton, George Mason University

# Today's Instructors

## McGraw-Hill **CONNECT** **PLUS ACCOUNTING**



McGraw-Hill reinvents the textbook learning experience for the modern student with *Connect Plus Accounting*.

A seamless integration of an eBook and *Connect Accounting*, *Connect Plus Accounting* provides all of the *Connect Accounting* features plus the following:

- An integrated, media-rich eBook, allowing for anytime, anywhere access to the textbook.
- Media-rich capabilities like embedded audio/visual presentations, highlighting, and sharing notes.
- Dynamic links between the problems or questions you assign to your students and the location in the eBook where that concept is covered.
- A powerful search function to pinpoint key concepts for review.

In short, *Connect Plus Accounting* offers students powerful tools and features that optimize their time and energy, enabling them to focus on learning.

For more information about *Connect Plus Accounting*, go to [www.mcgrawhillconnect.com](http://www.mcgrawhillconnect.com), or contact your local McGraw-Hill sales representative.

### Tegrity Campus: Lectures 24/7



Tegrity Campus is a service that makes class time available 24/7 by automatically capturing every lecture. With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio in a format that is easily searchable, frame by frame. Students can replay any part of any class with easy-to-use browser-based viewing on a PC, Mac, iPod, or other mobile device.

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

### McGraw-Hill Customer Experience Group Contact Information

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

Financial Accounting  
WILD  
my courses

connect ACCOUNTING

home library reports

show library menu

ebook

jump to pg go book contents search ebook go

Chapter 2. Analyzing and Recording Transactions

reading images my notebook

Chapter 2 Sections

**ANALYZING AND RECORDING PROCESS**

The accounting process identifies business transactions and events, analyzes and records their effects, and summarizes and presents information in reports and financial statements. These reports and statements are used for making investing, lending, and other business decisions. The steps in the accounting process that focus on *analyzing and recording* transactions and events are shown in **Exhibit 2.1**.

Analyze each transaction and event from source documents

Record relevant transactions and events in a journal

Post journal information to ledger accounts

Prepare and analyze the trial balance

**EXHIBIT 2.1**  
The Analyzing and Recording Process

**C1** Explain the steps in processing transactions and the role of source documents.

[Interactive Presentation for 2-C1](#)

Business transactions and events are the starting points. Relying on source documents, the transactions and events are analyzed using the accounting equation to understand how they affect company performance and financial position. These effects are recorded in accounting records, informally referred to as the *accounting books* or simply the *books*. Additional steps such as *noting* and then *reversing* a trial

## Online Learning Center (OLC)

We offer an Online Learning Center (OLC) that follows *Financial Accounting* chapter by chapter. It doesn't require any building or maintenance on your part. It's ready to go the moment you and your students type in the URL:

[www.mhhe.com/wildFA7e](http://www.mhhe.com/wildFA7e)

As students study and learn from *Financial Accounting*, they can visit the Student Edition of the OLC Website to work with a multitude of helpful tools:

- Generic Template Working Papers
- Chapter Learning Objectives
- Interactive Chapter Quizzes
- PowerPoint® Presentations
- Quick Check Exercises

A secured Instructor Edition stores essential course materials to save you prep time before class. Everything you need to run a lively classroom and an efficient course is included. All resources available to students, plus . . .

- Instructor's Resource Manual
- Solutions Manual
- Test Bank

The OLC Website also serves as a doorway to other technology solutions, like course management systems.

## Online Course Management



### McGraw-Hill Higher Education and Blackboard have teamed up. What does this mean for you?

- 1. Single sign-on.** Now you and your students can access McGraw-Hill's *Connect*™ and *Create*™ right from within your Blackboard course—all with one single sign-on.
- 2. Deep integration of content and tools.** You get single sign-on with *Connect* and *Create*, you also get integration of McGraw-Hill content and content engines right in Blackboard. Whether you're choosing a book for your course or building *Connect* assignments, all the tools you need are right where you want them—inside Blackboard.
- 3. One grade book.** Keeping several grade books and manually synchronizing grades in Blackboard is no longer necessary. When a student completes an integrated *Connect* assignment, the grade for that assignment automatically (and instantly) feeds your Blackboard grade center.
- 4. A solution for everyone.** Whether your institution is already using Blackboard or you just want to try Blackboard on your own, we have a solution for you. McGraw-Hill and Blackboard can now offer you easy access to industry-leading technology and content, whether your campus hosts it, or we do. Be sure to ask your local McGraw-Hill representative for details.



### McGraw-Hill Campus™

McGraw-Hill Campus™ is a new one-stop teaching and learning experience available to users of any learning management system. This complimentary integration allows faculty and students to enjoy single sign-on (SSO) access to all McGraw-Hill Higher Education materials and synchronized grade-book with our award-winning McGraw-Hill *Connect* platform. McGraw-Hill Campus provides faculty with instant access to all McGraw-Hill Higher Education teaching materials (eTextbooks, test banks, PowerPoint slides, animations and learning objects, and so on), allowing them to browse, search, and use any instructor ancillary content in our vast library at no additional cost to instructor or students. Students enjoy SSO access to a variety of free and subscription-based products (McGraw-Hill *Connect*). With this integration enabled, faculty and students will never need to create another account to access McGraw-Hill products and services. For more information on McGraw-Hill Campus please visit our website at [www.mhcampus.com](http://www.mhcampus.com).



## CourseSmart

CourseSmart is a new way to find and buy eTextbooks. CourseSmart has the largest selection of eTextbooks available anywhere, offering thousands of the most commonly adopted textbooks from a wide variety of higher education publishers. CourseSmart eTextbooks are available in one standard online reader with full text search, notes, highlighting, and email tools for sharing between classmates. Visit [www.CourseSmart.com](http://www.CourseSmart.com) for more information on ordering.

# Instructor Supplements

## Online Learning Center Instructor's Library

- **Instructor's Resource Manual**

*Written by April Mohr, Jefferson Community and Technical College, SW.*

This manual contains (for each chapter) a Lecture Outline, a chart linking all assignment materials to Learning

Objectives, and additional visuals with transparency masters.

- **Solutions Manual**

*Written by John J. Wild, and Anita Kroll, University of Wisconsin–Madison.*

- **Test Bank**

*Revised by Jeannie Folk, College of DuPage.*

- **PowerPoint® Presentations**

*Prepared by Anna Boulware, St. Charles Community College.*

Presentations allow for revision of lecture slides, and includes a viewer, allowing screens to be shown with or without the software.

# Student Supplements

## Working Papers

*Available through Create. Contact your publisher representative for details.*

*Written by John J. Wild.*

## Connect Accounting with LearnSmart One Semester Access Code Card

*ISBN13: 9780077847869*

*ISBN10: 0077847865*

## Connect Plus Accounting with LearnSmart One Semester Access Code Card

*ISBN13: 9780077844028*

*ISBN10: 0077844025*

# Innovative Textbook Features

## Topic Flowchart

**New!** A **Topic Flowchart** is added to provide a handy textual/visual guide at the very start of each chapter to enhance student learning. Students can now begin their reading with a clear understanding of what they will learn and when, allowing them to stay more focused and organized along the way. The new Flowchart also integrates Learning Objectives tied to the CAP Model of learning, which shows the sequencing of learning objectives.

ANALYZING AND RECORDING PROCESS	ANALYZING AND PROCESSING TRANSACTIONS	TRIAL BALANCE AND THE FINANCIAL STATEMENTS
Using financial statements C1 Source documents C2 The account and its analysis Types of accounts Unclassified vs Classified	C3 General ledger C4 Double-entry accounting P1 Journalizing and posting A1 Processing transactions—An illustration	P2 Trial balance preparation & use P3 Financial statement preparation Reading an annual report A2 Analysis of financing sources

## CAP Model

The **Conceptual/Analytical/Procedural (CAP) Model** allows courses to be specially designed to meet your teaching needs or those of a diverse faculty. This model identifies learning objectives, textual materials, assignments, and test items by C, A, or P, allowing different instructors to teach from the same materials, yet easily customize their courses toward a conceptual, analytical, or procedural approach (or a combination thereof) based on personal preferences.

Learning Objectives		
C1 Explain the steps in processing transactions and the role of source documents. (p. 56)	C4 Define <i>debits</i> and <i>credits</i> and explain double-entry accounting. (p. 61)	P2 Prepare and explain the use of a trial balance. (p. 71)
C2 Describe an account and its use in recording transactions. (p. 57)	P1 Record transactions in a journal and post entries to a ledger. (p. 63)	P3 Prepare financial statements from business transactions. (p. 73)
C3 Describe a ledger and a chart of accounts. (p. 60)	A1 Analyze the impact of transactions on accounts and financial statements. (p. 65)	A2 Compute the debt ratio and describe its use in analyzing financial condition. (p. 77)


## Using Accounting for Decisions

Whether we prepare, analyze, or apply accounting information, one skill remains essential: decision-making. To help develop good decision-making habits and to illustrate the relevance of accounting, our book uses a unique pedagogical framework we call the **Decision Center**. This framework is comprised of a variety of approaches and subject areas, giving students insight into every aspect of business decision-making. Answers to **Decision Maker** and **Ethics** boxes are at the end of each chapter.

**Decision Insight** Decision Insight boxes include interesting happenings from the world of business that relate to accounting.

**Decision Insight**

**Revenue Spread** The **New York Giants** have *Unearned Revenues* of over \$100 million in advance ticket sales. When the team plays its home games, it settles this liability to its ticket holders and then transfers the amount earned to *Ticket Revenues*.



**Decision Maker** Decision Maker boxes are active learning opportunities for students to take on the persona of a professional who uses accounting information to help resolve practical questions of importance.

**Decision Maker**

**Investor** A small publishing company signs an aspiring Olympic gymnast to write a book. The company pays the gymnast \$500,000 to sign plus future book royalties. A note to the company's financial statements says that "prepaid expenses include \$500,000 in author signing fees to be matched against future expected sales." Is this accounting for the signing bonus acceptable? How does it affect your analysis? [Answer—p. 138]

**Decision Ethics** Decision Ethics boxes are active learning opportunities for students to take the perspective of a professional who uses accounting information to help resolve a practical situation that involves issues of ethics.

**Decision Ethics**

**Payables Manager** As a new accounts payable manager, you are being trained by the outgoing manager. She explains that the system prepares checks for amounts net of favorable cash discounts, and the checks are dated the last day of the discount period. She also tells you that checks are not mailed until five days later, adding that "the company gets free use of cash for an extra five days, and our department looks better. When a supplier complains, we blame the computer system and the mailroom." Do you continue this payment policy? [Answer—p. 171]

**Decision Analysis** Decision Analysis is a separate section at the end of each chapter that introduces important analysis tools/ratios to provide insight into the financial performance or condition of a major corporation.

**Decision Analysis**

An important business objective is gathering information to help assess a company's risk of failing to pay its debts. Companies finance their assets with either liabilities or equity. A company that finances a relatively large portion of its assets with liabilities is said to have a high degree of *financial leverage*. Higher financial leverage involves greater risk because liabilities must be repaid and often require regular interest payments (equity financing does not). The risk that a company might not be able to meet such required payments is higher if it has more liabilities (is more highly leveraged). One way to assess the risk associated with a company's use of liabilities is to compute the **debt ratio** as in Exhibit 2.17.

**A2** Compute the debt ratio and describe its use in analyzing financial condition.

$$\text{Debt ratio} = \frac{\text{Total liabilities}}{\text{Total assets}}$$

**EXHIBIT 2.17**  
Debt Ratio

# Bring Accounting To Life



## Fraud

**They Fought the Law** Our economic and social welfare depends on reliable accounting. Some individuals forgot that and are now paying their dues. They include Raj Rajaratnam (in photo), an investor, convicted of trading stocks using inside information; Bernard Madoff of **Madoff Investment Securities**, convicted of falsifying securities records; Bernard Ebbers of **WorldCom**, convicted of an \$11 billion accounting scandal; Andrew Fastow of **Enron**, guilty of hiding debt and inflating income; and Ramalinga Raju of **Satyam Computers**, accused of overstating assets by \$1.5 billion.



## Fraud Boxes

Stewardship is a crucial part of modern business and accounting. Fraud is a gross violation of stewardship. Each chapter introduces one or more new features devoted to accounting's role in fraud detection and prevention. These features describe, or relate to, provocative real-life scenarios of people who pursued fraudulent accounting activities for personal gain.

### NEED-TO-KNOW 1.3

Use the *accounting equation* to compute the missing financial statement amounts.

Company	Assets	Liabilities	Equity
BOSE	\$150	\$ 30	\$_(a)_
VOGUE	\$_(b)_	\$100	\$300

#### Solution

a. \$120 b. \$400

Use the *expanded accounting equation* to compute the missing financial statement amounts.

Company	Assets	Liabilities	Common Stock	Dividends	Revenues	Expenses
Nikon	\$200	\$ 80	\$100	\$0	_(a)_	\$40
YouTube	\$400	\$160	\$220	_(b)_	\$120	\$90

#### Solution

a. \$60 b. \$10

Do More: QS 1-7, QS 1-8, E 1-8, E 1-9

## NEW Need-to-Know

This new feature asks the key questions that students "need-to-know" to successfully navigate the chapter, and provides solutions to allow students to practice.

The Need-to-Know questions are supplemented with a narrated, animated, step-by-step walkthrough video available via Connect Student Resources for additional reinforcement.

**Point:** The sender (maker) of a *debit memorandum* will debit the account payable of the memo's receiver. The memo's receiver will credit the sender's account receivable.

acquires. Buyers often keep defective but acceptable allowance. When a buyer returns issues a **debit memorandum** to inform the sender in the buyer's records.

**Purchase Allowances** To illustrate purchase allowances, Z-Mart (buyer) issues a \$300 debit memorandum for defective merchandise. Z-Mart's November 15 entry to record the purchase allowance is

## Marginal Student Annotations

These annotations provide students with additional hints, tips, and examples to help them more fully understand the concepts and retain what they have learned. The annotations also include notes on global implications of accounting and further examples.



### GLOBAL VIEW

We explained that accounting under U.S. GAAP is similar, but not identical, to that under IFRS. This section discusses differences in adjusting accounts, preparing financial statements, and reporting liabilities on a balance sheet.

**Adjusting Accounts** Both U.S. GAAP and IFRS include broad and similar adjusting accounts. Although some variations exist in revenue and expense recognition, all of the adjustments in this chapter are accounted for identically under the two systems. We describe how certain assets and liabilities can result in different adjusted value measurements.

**Preparing Financial Statements** Both U.S. GAAP and IFRS require the same process for preparing financial statements following the same process discussed in this chapter. Chapter 2 explains that U.S. GAAP and IFRS require current items to be separated from noncurrent items on the balance sheet. U.S. GAAP balance sheets report current items first, followed by noncurrent items. IFRS balance sheets report noncurrent items first (and equity last). This is not a requirement. Other differences with financial statements exist, which are discussed in the chapters. Piaggio, which manufactures two-, three-, and four-wheel vehicles and is a manufacturer of motorcycles and scooters, provides the following example of IFRS reporting liabilities, and equity within the balance sheet.

PIAGGIO

## Global View

This section explains international accounting practices relating to the material covered in that chapter. This section is purposefully located at the end of each chapter so that each instructor can decide what emphasis, if at all, is to be assigned to it. The aim of this Global View section is to describe accounting practices and to identify the similarities and differences in international accounting practices versus that in the United States. As we move toward global convergence in accounting practices, and as we witness the evolution of U.S. GAAP and IFRS, the importance of student familiarity with international accounting grows. This innovative section helps us begin down that path of learning and teaching global accounting practices.



# Outstanding Assignment Material

Once a student has finished reading the chapter, how well he or she retains the material can depend greatly on the questions, exercises, and problems that reinforce it. This book leads the way in comprehensive, accurate assignments.

**Comprehensive Need-to-Know Problems** are located at the end of each chapter and present both a problem and a complete solution, allowing students to review the entire problem-solving process.

**Chapter Summaries** provide students with a review organized by learning objectives. Chapter Summaries are a component of the CAP model (see page xiv), which recaps each conceptual, analytical, and procedural objective.

**COMPREHENSIVE... NEED-TO-KNOW 1**

The following information relates to Fanning's Electronics on December 31, 2013. The company uses the calendar year as its annual reporting period, initially records prepaid and unearned items in asset and liability accounts, respectively.

**PLANNING THE SOLUTION**

- Analyze each situation to determine which accounts need to be updated with an adjustment.
- Calculate the amount of each adjustment and prepare the necessary journal entries.
- Show the amount of each adjustment in the designated accounts, determine the adjusted balance, and identify the balance sheet classification of the account.

**SOLUTION TO COMPREHENSIVE NEED-TO-KNOW 1**

1. Adjusting journal entries.

(a) Dec 31	Wages Expense ..... Wages Payable ..... To accrue wages for the last day of the year (\$8,750 × 1/5).	1,750 1,750	1,750
(b) Dec 31	Depreciation Expense—Equipment ..... Accumulated Depreciation—Equipment ..... To record depreciation expense for the year (\$20,000 ÷ 5 years = \$4,000 per year).	4,000 4,000	4,000
(c) Dec 31	Unearned Services Revenue ..... Services Revenue ..... To recognize services revenue earned (\$120,000 × 20/24).	100,000 100,000	100,000
(d) Dec 31	Insurance Expense ..... Prepaid Insurance ..... To adjust for expired portion of insurance (\$1,800 × 4/12).	600 600	600
(e) Dec 31	Accounts Receivable ..... Services Revenue ..... To record services revenue earned.	7,000 7,000	7,000

Key Terms		
Accounting cycle (p. 122)	Current liabilities (p. 125)	Post-closing trial balance (p. 122)
Accounting periods (p. 102)	Current ratio (p. 128)	Prepaid expenses (p. 105)
Accrual basis accounting (p. 102)	Depreciation (p. 106)	Profit margin (p. 127)
Accrued expenses (p. 111)	Expense recognition (or matching) principle (p. 103)	Pro forma financial statements (p. 134)
Accrued revenues (p. 113)		Reversing entries (p. 135)
Adjusted trial balance		
Adjusting entry (p. 113)		

**Key Terms** are bolded in the text and repeated at the end of the chapter with page numbers indicating their location. The book also includes a complete Glossary of Key Terms.

**Multiple Choice Quiz** Answers on p. 163 [mhhe.com/wildFA7e](http://mhhe.com/wildFA7e)

Additional Quiz Questions are available at the book's Website.

1. A company forgot to record accrued and unpaid employee wages of \$350,000 at period-end. This oversight would

- Understate net income by \$350,000.
- Overstate net income by \$350,000.
- Have no effect on net income.
- Overstate assets by \$350,000.
- Understate assets by \$350,000.

Stockton credited \$3,600 to Unearned Consulting Fees. The adjusting entry on December 31, 2013 (Stockton's year-end) would include a

- Debit to Unearned Consulting Fees for \$1,200.
- Debit to Unearned Consulting Fees for \$2,400.
- Credit to Consulting Fees Earned for \$2,400.
- Debit to Consulting Fees Earned for \$1,200.

**Multiple Choice Quiz** questions quickly test chapter knowledge before a student moves on to complete Quick Studies, Exercises, and Problems.

**QUICK STUDY**

**QS 3-1** Adjusting prepaid expenses **PI**

a. On July 1, 2013, Lamis Company paid \$1,200 for six months of insurance coverage. The company has been making payments to the Prepaid Insurance account, and it is now December 31, 2013. Prepare the adjusting entry to reflect expiration of the insurance as of December 31, 2013.

b. Shandi Company has a Supplies account balance of \$5,000 on January 1, 2013. It purchased \$2,000 of supplies. As of December 31, 2013, a supplies inventory shows \$1,000 of supplies available. Prepare the adjusting journal entry to correctly report the balance of the Supplies account and the Supplies Expense account as of December 31, 2013.

**QS 3-2** a. Barozzine Company purchases \$20,000 of equipment on January 1, 2013. The equipment is depreciated over 5 years.

**Quick Study** assignments are short exercises that often focus on one learning objective. Most are included in *Connect Accounting*. There are usually 8-10 Quick Study assignments per chapter.

**Exercises** are one of this book's many strengths and a competitive advantage. There are about 10-15 per chapter and are included in *Connect Accounting*. The Exercises cover all learning objectives and all key topics in each chapter.

**EXERCISES**

**Exercise 3-1** Preparing adjusting entries **PI**

**Check** (a) Dr. Office Supplies Expense, \$3,882; (e) Dr. Insurance Expense, \$5,800

Prepare adjusting journal entries for the year ended (date of) December 31, 2013, in the following situations. Assume that prepaid expenses are initially recorded in asset accounts and unearned revenues are initially recorded in liability accounts.

- Depreciation on the company's equipment for 2013 is computed to be \$18,000.
- The Prepaid Insurance account had a \$6,000 debit balance at December 31, 2013. The costs of any expired coverage. An analysis of the company's insurance of unexpired insurance coverage remains.
- The Office Supplies account had a \$700 debit balance on December 31, 2013. Supplies were purchased during the year. The December 31, 2013, physical inventory shows \$1,500 of supplies available.
- Two-thirds of the work related to \$15,000 of cash received in advance was completed during the year.
- The Prepaid Insurance account had a \$6,800 debit balance at December 31, 2013. The costs of any expired coverage. An analysis of insurance policies shows that \$1,000 of coverage had expired.
- Wage expenses of \$3,200 have been incurred but are not paid as of December 31, 2013.

**Problem Sets A & B** are proven problems that can be assigned as homework or for in-class projects. All problems are coded according to the CAP model (see page xiv), and Set A is included in *Connect Accounting*.

**PROBLEM SET A**

For each of the following situations, prepare the adjusting journal entry in the space provided. Explain the effect of each entry on the accounting equation.

**Problem 3-1A** Identifying adjusting entries with explanations **PI**

**PROBLEM SET B**

For each of the following situations, prepare the adjusting journal entry in the space provided. Explain the effect of each entry on the accounting equation.

**Problem 3-1B** Identifying adjusting entries with explanations **PI**

# Helps Students Master Key Concepts

**Beyond the Numbers** exercises ask students to use accounting figures and understand their meaning. Students also learn how accounting applies to a variety of business situations. These creative and fun exercises are all new or updated, and are divided into sections:

- Reporting in Action
- Comparative Analysis
- Ethics Challenge
- Communicating in Practice
- Taking It To The Net
- Teamwork in Action
- Hitting the Road
- Entrepreneurial Decision
- Global Decision

*(This serial problem began in Chapter 1 and continues through most of the book. If previous chapter segments were not completed, the serial problem can begin at this point. It is helpful, but not necessary, to use the Working Papers that accompany the book.)*

**SERIAL PROBLEM**  
Success Systems  
P1 P2 P3 P4

**SP 4** Adria Lopez created Success Systems on October 1, 2013. The company has been successful, and its list of customers has grown. To accommodate the growth, the accounting system is modified to set up separate accounts for each customer. The following chart of accounts includes the account number used for each account and any balance as of December 31, 2013. Adria Lopez decided to add a fourth digit with a decimal point to the 106 account number that had been used for the single Accounts Receivable account. This change allows the company to continue using the existing chart of accounts.

No.	Account Title	Dr.	Cr.	No.	Account Title	Dr.	Cr.
101	Cash		\$58,160	210	Wages payable		\$ 500
106.1	Alex's Engineering Co.	0		236	Unearned computer services revenue		1,500
106.2	Wildcat Services	0		307	Common stock		83,000
106.3	Easy Leasing	0		318	Retained earnings		7,148
106.4	IFM Co.	3,000		319	Dividends	\$0	
106.5	Liu Corp.	0		403	Computer services revenue		0
106.6	Gomez Co.	2,668		413	Sales		0

**New General Ledger Problems—Only Available in Connect.** Every transaction affects one or more financial statements. This General Ledger simulation automates many of the steps in the accounting cycle, which allows students to see the impact each transaction has on the financial statements in real-time. Students can easily link back to their original entries simply by clicking in the ledger if edits are needed. Many questions now have critical thinking components added to maximize the student's foundational knowledge of accounting concepts and principles.

**Beyond the Numbers**

**BTN 3-1** Refer to Apple's financial statements in Appendix A to answer the following.

1. Identify and write down the revenue recognition principle as explained in the chapter.
2. Review Apple's footnotes (in Appendix A or from its 10-K on its Website) to discover how it applies the revenue recognition principle and when it recognizes revenue. Report what you discover.
3. What is Apple's profit margin for fiscal years ended September 29, 2012 and September 24, 2011.
4. For the fiscal year ended September 29, 2012, what amount is credited to Income Summary to summarize its revenues earned?
5. For the fiscal year ended September 29, 2012, what amount is debited to Income Summary to summarize its expenses incurred?
6. For the fiscal year ended September 29, 2012, what is the balance of its Income Summary account before it is closed?

**REPORTING IN ACTION**  
C1 C2 A1 A2 P4

**APPLE**

**Serial Problem** uses a continuous running case study to illustrate chapter concepts in a familiar context. The Serial Problem can be followed continuously from the first chapter or picked up at any later point in the book; enough information is provided to ensure students can get right to work.

**GENERAL LEDGER PROBLEM**  
Available in Connect Only  
**connect**  
ACCOUNTING

Accounting professionals utilize many technology tools to aid them in their everyday tasks and decision making. The **General Ledger** tool in *Connect* automates several of the procedural steps in the accounting cycle so that the accounting professional can focus on the impacts of each transaction on the full set of financial statements. Chapter 2 is the first chapter to employ this tool in helping students see the advantages of technology and, in particular, the power of the General Ledger tool in accounting practice, including financial analysis.

**GL 2-1** Using transactions from the FastForward illustration in this chapter, prepare journal entries for each transaction and identify the financial statement impact of each entry. The financial statements are automatically generated based on the journal entries recorded.

**GL 2-2** Use the transactions in Problem 2-2A to record journal entries, create financial statements, and assess the impact of each transaction on financial statements.

**GL 2-3** Use the transactions in Problem 2-6A to record journal entries, create financial statements, and assess the impact of each transaction on financial statements.

**GL 2-4** Use the transactions in SP 2, the Serial Problem, to record journal entries, create financial statements, and assess the impact of each transaction on financial statements.

**The End of the Chapter Is Only the Beginning.** Our valuable and proven assignments aren't just confined to the book. From problems that require technological solutions to materials found exclusively online, this book's end-of-chapter material is fully integrated with its technology package.



- Quick Studies, Exercises, and Problems available in *Connect* are marked with an icon.
- Assignments that focus on global accounting practices and companies are often identified with an icon.
- The QC icon in the margin indicates that Quick Check questions with solutions are available via the text Website for additional practice.

# Enhancements in This Edition

This edition's revisions are driven by instructors and students. General revisions to the entire book follow (including chapter-by-chapter revisions):

- Revised and updated assignments throughout
- Updated ratio/tool analysis and data for each chapter
- New and revised entrepreneurial examples and elements
- Revised serial problem through nearly all chapters
- New Need-to-Know examples added to each chapter
- New **Apple** annual report with comparisons to competitors, including **Google** and **Samsung** (IFRS), with new assignments
- Updated graphics added to each chapter's analysis section
- New technology content integrated and referenced in the book
- Updated Global View section in each chapter
- New innovative assignments sprinkled throughout the book
- New General Ledger questions added to most chapters

## Chapter 1

**Apple NEW opener** with new entrepreneurial assignment

Streamlined and reorganized discussion of the users of accounting information

New discussion on the joint role of the FASB and IASB in standard setting

Revised layout for accounting principles and assumptions

Updated accounting salary information

Added titles to revenue and expense entries in columnar layout of transaction analysis

Streamlined section on Dodd-Frank act

New survey data from executives on the impact of fraud

## Chapter 2

**LinkedIn NEW opener** with new entrepreneurial assignment

Reorganized discussion and presentation of assets, liabilities, and equity accounts

Enhanced 4-step process of journalizing and posting transactions

New Section on Using Financial Statements, including ratio analysis

New coverage of classified and unclassified balance sheets

Revised global view and new Samsung's (abbreviated) balance sheet

Updated debt ratio discussion using recent Skechers's information

## Chapter 3

**Facebook NEW opener** with new entrepreneurial assignment

Updated innovative 3-step process for adjusting accounts

New example of unearned revenues using USA Today

Updated IFRS and FASB revenue recognition convergence

Added new Quick Studies to directly apply the three-step adjustment process

## Chapter 4

**Buffalo Wild Wings NEW opener** with new entrepreneurial assignment

Enhanced exhibit on transportation costs and FOB terms, with inclusion of entries

Highlight two-step explanation of recording merchandise sales

New discussion of online ordering, tracking numbers, RFID, and FOB

Revised visual display of a sales invoice

Revised discussion of merchandising purchases and sales

New Volkswagen example of IFRS income statement

## Chapter 5

**Boston Beer Company NEW opener** with new entrepreneurial assignment

New focus on periodic valuation (perpetual in appendix)

New exhibits visually show cost flows for each method

New explanatory boxes added to selected exhibits as learning aids

Expanded assignments covering periodic and perpetual inventory measurement

## Chapter 6

**Google NEW opener** with new entrepreneurial assignment

Expanded presentation of 'Hacker's Guide'

New discussion of the lock box and its purpose

New data on sources of fraud complaints

New evidence on methods to override controls

New visual on document to bond (insure) an employee

New example of MLB controls, and lack thereof

## Chapter 7

**Under Armour NEW opener** with new entrepreneurial assignment

New discussion of mobile payment systems using mini-card-readers and iPads

New illustration comparing bad debts recognition under the allowance method versus the direct write-off method

Revised exhibit on aging of accounts receivable, including all detailed accounts

New illustration on why the banker's rule is commonly applied

## Chapter 8

**Nathan's Famous NEW opener** with new entrepreneurial assignment

New learning boxes added to selected exhibits identifying salvage value

New explanation on how asset purchases occurring on different days of the month are commonly processed

New example of extraordinary repairs applied to the stealth bomber

New notes added to emphasize that depreciation is cost allocation, and not valuation

New explanation on how drugmakers fight patent expirations

New information on the Mickey Mouse Protection Act for intangibles

New goodwill example using Google's purchase of YouTube

## Chapter 9

**Annie's, Inc. NEW opener** with new entrepreneurial assignment

Revised unearned revenues example based on Rihanna ticket sales

# For Better Learning and Retention

Added explanation on the role of sellers as tax collection ‘agents’ for the government  
New information on franchise costs and how they are accounted for  
Added select formulas to enhance the exhibit on payroll deductions  
Updated payroll rates to 2013 with discussion on likely adjustments for 2014  
Added discussion on maximum withholding allowances claimed  
New discussion on IRS actions against companies that fail to pay employment taxes  
New evidence on payroll fraud, its median loss, and time taken to uncover such frauds

## Chapter 10

**Zynga NEW opener** with new entrepreneurial assignment  
New explanation on why debt (credit) financing is less costly than equity financing  
New margin graphics (four) illustrating how a debt’s carrying value is periodically adjusted until it equals maturity value at the end of its life  
New margin boxes on calculator functions to compute the price of bonds  
New explanation of what is investment grade debt  
New discussion on the role of unreported liabilities and the financial crisis  
Reference to changes in lease accounting  
New discussion of collateral and its role in debt financing  
New separate appendix learning objectives on amortizing a discount or a premium using effective interest

## Chapter 11

**Groupon NEW opener** with new entrepreneurial assignment  
Revised presentation of corporate form  
New discussion of Facebook’s IPO and the role of accounting information  
New reference to corporate governance  
New reference to state laws and where companies incorporate  
New examples using Target for stock quotes and Google for stock splits  
New discussion of fraudulent information dissemination and stock prices  
Updated the global view on equity accounting

## Chapter 12

**Salesforce.com NEW opener** with new entrepreneurial assignment  
Revised graphics to better illustrate cash inflows and outflows for operating, investing, and financing activities  
Revised graphic to better reflect cash and cash equivalents  
Added discussion on the use of T-accounts for reconstructing transactions impacting cash  
New margin clarification for computing free cash flow  
New discussion on the potential for IASB and FASB to issue guidance for the statement of cash flow that would require the direct method... stay tuned

## Chapter 13

**Morgan Stanley NEW opener** with new entrepreneurial assignment  
New companies—Apple, Google, and Samsung—data throughout the chapter, exhibits, and illustrations

New boxed discussion on the role of financial statement analysis to fight and prevent fraud

Enhanced horizontal, vertical, ratio analysis using new companies and industry data

New analysis of segment data  
Streamlined global view section

## Appendix C

New discussion of the two optional presentations for comprehensive income  
Revised discussion of accounting for securities  
New reference to Greek debt in the context of international operations  
New Google example of comprehensive income

## Appendix D

New examples of LLPs and their prevalence among professional services  
New discussion of the potential for multiple drawing accounts in practice  
Revised and streamlined three-step process to liquidate a partnership

## Appendix E

Expanded discussion and examples of hackers and internal controls  
New mnemonic tool for system principles  
Enhanced exhibit on system components  
New discussion on voice recognition controls  
New discussion on cloud computing, its implications to accounting, and its risks  
New references to XBRL, Dynamics GP, and QuickBooks in accounting  
Updated discussion and examples for ERP

### New! Corporate / Entrepreneurial Flavor

This edition marries three motivating factors. First, we know that student learning increases when students are engaged. Second, students tell us that entrepreneurial stories of success motivate them. Third, students say that reports of how accounting helps those entrepreneurs motivate them to study accounting. In response, we made several key decisions:

- Each chapter launches with an entrepreneur who uses accounting and has achieved success
- Each entrepreneurial company is publicly traded, meaning that students can access its accounting data
- “Decision” features (see page xiv) introduce business decisions, ethics, ratios, and real world events in accounting
- Real world assignments give students hands-on experience with data from practice
- Other elements, such as excerpts from Apple and Google, combine to create our new corporate/entrepreneurial flavor!



### Assurance of Learning Ready

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

"This textbook does address many learning styles and at the same time allows for many teaching styles ... our faculty have been very pleased with the continued revisions and supplements. From working papers ... to continually improved homework sites and e-books. I'm a 'Wild' fan!"

—Rita Hays, Southwestern Oklahoma State University



### AACSB Statement

The McGraw-Hill Companies is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, *Financial Accounting* recognizes the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in the test bank to the six general knowledge and skill guidelines in the AACSB standards. The statements contained in *Financial Accounting* are provided only as a guide for the users of this textbook. The AACSB leaves content coverage and assessment within the purview of individual schools, the mission of the school, and the faculty. While *Financial Accounting* and the teaching package make no claim of any specific AACSB qualification or evaluation, we have within *Financial Accounting* labeled select questions according to the six general knowledge and skills areas.

# Acknowledgments

John J. Wild and McGraw-Hill/Irwin would like to recognize the following instructors for their valuable feedback and involvement in the development of *Financial Accounting, 7e*. We are thankful for their suggestions, counsel, and encouragement.

**Thomas Arcuri**, Florida State University

**Sidney Askew**, Borough of Manhattan Community College

**Richard Barnhart**, Grand Rapids Community College

**Jaswinder Bhangal**, Chabot College

**Patrick Borja**, Citrus College

**Anna Boulware**, St. Charles Community College

**Billy Brewster**, University of Texas at Arlington

**Marci Butterfield**, University of Utah

**Colleen Chung**, Miami Dade College-Kendall

**Kwang-Hyun Chung**, Pace University

**Robert Churchman**, Harding University

**Marilyn Ciolino**, Delgado Community College

**Robin Clement**, University of Oregon

**Ken Couvillion**, Delta College

**Karen Crisonino**, County College of Morris

**Stan Davis**, University of Tennessee at Chattanooga

**Walter DeAguero**, Saddleback College

**Stephanie and Mike Derr**, Derr Properties

**Mike Deschamps**, MiraCosta College

**Ron Dustin**, Fresno City College

**Magdy Farag**, California State Polytechnic University-Pomona

**Albert Fisher**, College of Southern Nevada

**Linda Flowers**, Houston Community College

**Jeannie Folk**, College of DuPage

**Ernesto Gonzalez**, Florida National College

**Ann Gregory**, South Plains College

**Rebecca Hancock**, El Paso Community College-Valley Verde

**Laurie Hays**, Western Michigan University

**Rita Hays**, Southwestern Oklahoma State University

**Bambi Hora**, University of Central Oklahoma

**Constance Hylton**, George Mason University

**Todd Jensen**, Sierra College

**Gina M. Jones**, Aims Community College

**Jeff Jones**, College of Southern Nevada

**Sandra Jordan**, Florida State College at Jacksonville

**Dmitriy Kalyagin**, Chabot College

**Thomas Kam**, Hawaii Pacific University

**Ann Kelley**, Providence College

**Shirly A. Kleiner**, Johnson County Community College

**Jo Koehn**, University of Central Missouri

**Sudha Krishnan**, California State University-Long Beach

**Anita Kroll**, University of Wisconsin-Madison

**David Krug**, Johnson County Community College

**Christopher Kwak**, DeAnza College

**David Laurel**, South Texas College

**Charles Lewis**, Houston Community College

**Jeannie Liu**, Chaffey College

**Thomas S. Marsh**, Northern Virginia Community College-Annandale

**Stacie Mayes**, Rose State College

**Donald McWilliams**, Jackson State University

**Jeanine Metzler**, Northampton Community College

**Edna C. Mitchell**, Polk State College

**Kathleen O'Donnell**, Onondaga Community College

**Yvonne Phang**, Borough of Manhattan Community College

**James Racic**, Lakeland Community College

**Ruthie Reynolds**, Howard University

**Helen Roybark**, Radford University

**Richard Sarkisian**, Camden County College

**Linda Schain**, Hofstra University

**Tracy Schmeltzer**, Wayne Community College

**Debbie Schmidt**, Cerritos College

**Raymond Shaffer**, Youngstown State University  
**Geeta Shankhar**, University of Dayton  
**Regina Shea**, Community College of Baltimore County—Essex  
**Jaye Simpson**, Tarrant County College  
**Erik Slayter**, California Polytechnic State University  
San Luis Obispo  
**Gerald Smith**, University of Northern Iowa  
**Dominique Svarc**, William Rainey Harper College  
**Ulysses Taylor**, Fayetteville State University  
**Anthony Teng**, Saddleback College  
**Teresa Thompson**, Chaffey Community College  
**Tom Thompson**, Madison College  
**Jerri Tittle**, Rose State College

**Bob Urell**, Irvine Valley College  
**Patricia Walczak**, Lansing Community College  
**Dave Welch**, Franklin University  
**Jean Wells-Jessup**, Howard University  
**Christopher Widmer**, Tidewater Community College  
**Gayle Williams**, Sacramento City College  
**Kenneth L. Wild**, University of London  
**Jonathan M. Wild**, University of Wisconsin  
**John Woodward**, Polk State College  
**Wanda Wong**, Chabot College  
**Qiang Wu**, Rensselaer Polytechnic Institute  
**Judy Zander**, Grossmont College

**The author extends a special thank you to our contributing and technology supplement authors:**

**Contributing Authors:** Anita Kroll, University of Wisconsin; Jo Lynne Koehn, University of Central Missouri; Kathleen O'Donnell, Onondaga Community College

**Accuracy Checkers:** Dave Krug, Johnson County Community College; Albert Fisher, College of Southern Nevada; Judy Zander, Grossmont College; Ann McCarthy, Eastern Carolina University; Mark McCarthy, East Carolina University; Helen Roybark, Radford University; Beth Woods; and Barbara Schnathorst

**LearnSmart Author:** April Mohr, Jefferson Community and Technical College, SW

**Online Quizzes:** Constance Hylton, George Mason University

**Interactive Presentations:** Jeannie Folk, College of DuPage

**PowerPoint:** Anna Boulware, St. Charles Community College

**Instructor Resource Manual:** April Mohr, Jefferson Community and Technical College, SW

**Test Bank:** Jeannie Folk, College of DuPage

In addition to the helpful and generous colleagues listed above, I thank the entire McGraw-Hill/Irwin *Financial Accounting, 7e* team, including Tim Vertovec, Steve Schuetz, Christina Sanders, Lori Koettters, Matthew Baldwin, Carol Bielski, Patricia Plumb, Jeremy Cheshareck, Ron Nelms, Xin Lin, Julie Hankins, and Brian Nacik. I also thank the great marketing and sales support staff, including Michelle Nolte and Kathleen Klehr. Many talented educators and professionals worked hard to create the supplements for this book, and for their efforts I'm grateful. Finally, many more people I either did not meet or whose efforts I did not personally witness nevertheless helped to make this book everything that it is, and I thank them all.

*John J. Wild*

# Brief Contents

- 1** Introducing Financial Accounting 2
- 2** Accounting System and Financial Statements 52
- 3** Adjusting Accounts for Financial Statements 100
- 4** Reporting and Analyzing Merchandising Operations 164
- 5** Reporting and Analyzing Inventories 212
- 6** Reporting and Analyzing Cash and Internal Controls 262
- 7** Reporting and Analyzing Receivables 308
- 8** Reporting and Analyzing Long-Term Assets 344
- 9** Reporting and Analyzing Current Liabilities 388
- 10** Reporting and Analyzing Long-Term Liabilities 434
- 11** Reporting and Analyzing Equity 478
- 12** Reporting and Analyzing Cash Flows 522
- 13** Analyzing and Interpreting Financial Statements 576
- Appendix A** Financial Statement Information A-1
- Appendix B** Applying Present and Future Values B
- Appendix C** Investments and International Operations C
- \*Appendix D** Reporting and Analyzing Partnerships
- \*Appendix E** Reporting and Preparing Special Journals

\* Appendixes D & E are available on the book's Website, [mhhe.com/wildFA7e](http://mhhe.com/wildFA7e), and as print copy from a McGraw-Hill representative.



# Contents

## Preface v

## 1 Introducing Financial Accounting 2

### Importance of Accounting 4

*Users of Accounting Information 4*  
*Opportunities in Accounting 6*

### Fundamentals of Accounting 7

*Ethics—A Key Concept 7*  
*Fraud Triangle 8*  
*Generally Accepted Accounting Principles 9*  
*International Standards 9*  
*Conceptual Framework and Convergence 9*  
*Sarbanes–Oxley (SOX) 13*  
*Dodd-Frank 14*

### Transaction Analysis and the Accounting Equation 15

*Accounting Equation 15*  
*Transaction Analysis 16*  
*Summary of Transactions 20*

### Financial Statements 21

*Income Statement 21*  
*Statement of Retained Earnings 21*  
*Balance Sheet 23*  
*Statement of Cash Flows 23*

### Global View 24

### Decision Analysis—Return on Assets 25

### Appendix 1A Return and Risk Analysis 29

### Appendix 1B Business Activities and the Accounting Equation 29

## 2 Accounting System and Financial Statements 52

### Using Financial Statements 54

*Using Ratios to Analyze Financial Statements 54*  
*Liquidity (and Efficiency) 55*  
*Solvency 55*  
*Profitability 55*  
*Market Prospects 55*  
*Summarizing Ratios 55*



## Analyzing and Reporting Accounts 56

*Source Documents 56*  
*The Account and Its Analysis 57*

## Analyzing and Processing Transactions 60

*Ledger and Chart of Accounts 60*  
*Debits and Credits 61*  
*Double-Entry Accounting 61*  
*Journalizing and Posting Transactions 63*  
*Analyzing Transactions—An Illustration 65*  
*Accounting Equation Analysis 70*

## Trial Balance 71

*Preparing a Trial Balance 72*  
*Using a Trial Balance to Prepare Financial Statements 73*

## Global View 76

## Decision Analysis—Debt Ratio 77

## 3 Adjusting Accounts for Financial Statements 100

### Timing and Reporting 102

*The Accounting Period 102*  
*Accrual Basis versus Cash Basis 102*  
*Recognizing Revenues and Expenses 103*

### Adjusting Accounts 104

*Frameworks for Adjustments 104*  
*Prepaid (Deferred) Expenses 105*  
*Unearned (Deferred) Revenues 109*  
*Accrued Expenses 111*  
*Accrued Revenues 113*  
*Links to Financial Statements 115*  
*Adjusted Trial Balance 116*

### Preparing Financial Statements 116

### Closing Process 118

*Temporary and Permanent Accounts 118*  
*Recording Closing Entries 119*  
*Post-Closing Trial Balance 120*  
*Accounting Cycle 122*

### Classified Balance Sheet 123

*Classification Structure 123*  
*Classification Categories 124*



Global View 126  
 Decision Analysis—Profit Margin and Current Ratio 127  
 Appendix 3A Alternative Accounting for Prepayments 131  
 Appendix 3B Work Sheet as a Tool 133  
 Appendix 3C Reversing Entries 135

## 4 Reporting and Analyzing Merchandising Operations 164



### Merchandising Activities 166

*Reporting Income for a Merchandiser 166*  
*Reporting Inventory for a Merchandiser 166*  
*Operating Cycle for a Merchandiser 167*  
*Inventory Systems 167*

### Accounting for Merchandise Purchases 168

*Purchase Discounts 169*  
*Purchase Returns and Allowances 170*  
*Transportation Costs and Ownership Transfer 171*

### Accounting for Merchandise Sales 173

*Sales of Merchandise 173*  
*Sales Discounts 173*  
*Sales Returns and Allowances 174*

### Completing the Accounting Cycle 176

*Adjusting Entries for Merchandisers 176*  
*Preparing Financial Statements 177*  
*Closing Entries for Merchandisers 177*  
*Summary of Merchandising Entries 177*

### Financial Statement Formats 179

*Multiple-Step Income Statement 179*  
*Single-Step Income Statement 180*  
*Classified Balance Sheet 180*

### Global View 182

Decision Analysis—Acid-Test and Gross Margin Ratios 183

Appendix 4A Periodic Inventory System 188

Appendix 4B Work Sheet—Perpetual System 192

## 5 Reporting and Analyzing Inventories 212



### Inventory Basics 214

*Determining Inventory Items 214*  
*Determining Inventory Costs 214*  
*Internal Controls and Taking a Physical Count 214*

### Inventory Costing under a Periodic System 215

*Inventory Cost Flow Assumptions 216*  
*Inventory Costing Illustration 217*  
*Specific Identification 217*  
*First-In, First-Out 218*  
*Last-In, First-Out 219*  
*Weighted Average 220*  
*Financial Statement Effects of Costing Methods 221*  
*Consistency in Using Costing Methods 222*

### Valuing Inventory at LCM and the Effects of Inventory Errors 223

*Lower of Cost or Market 223*  
*Financial Statement Effects of Inventory Errors 225*

### Global View 227

Decision Analysis—Inventory Turnover and Days' Sales in Inventory 227

Appendix 5A Inventory Costing under a Perpetual System 234

Appendix 5B Inventory Estimation Methods 240

## 6 Reporting and Analyzing Cash and Internal Controls 262



### Internal Control 264

*Purpose of Internal Control 264*  
*Principles of Internal Control 264*  
*Technology and Internal Control 266*  
*Limitations of Internal Control 267*

### Control of Cash 269

*Cash, Cash Equivalents, and Liquidity 269*  
*Cash Management 270*  
*Control of Cash Receipts 270*  
*Control of Cash Disbursements 272*

**Banking Activities as Controls 277**

*Basic Bank Services 277*  
*Bank Statement 279*  
*Bank Reconciliation 279*

**Global View 284**

**Decision Analysis—Days' Sales Uncollected 285**  
**Appendix 6A Documentation and Verification 287**  
**Appendix 6B Control of Purchase Discounts 290**

## 7 Reporting and Analyzing Receivables 308

**Accounts Receivable 310**

*Recognizing Accounts Receivable 310*  
*Valuing Accounts Receivable—Direct Write-Off Method 314*  
*Valuing Accounts Receivable—Allowance Method 315*  
*Estimating Bad Debts—Percent of Sales Method 318*  
*Estimating Bad Debts—Percent of Receivables Method 318*  
*Estimating Bad Debts—Aging of Receivables Method 319*

**Notes Receivable 322**

*Computing Maturity and Interest 322*  
*Recognizing Notes Receivable 323*  
*Valuing and Settling Notes 323*

**Disposal of Receivables 325**

*Selling Receivables 325*  
*Pledging Receivables 325*

**Global View 326**

**Decision Analysis—Accounts Receivable Turnover 327**

## 8 Reporting and Analyzing Long-Term Assets 344

**SECTION 1—PLANT ASSETS 346****Cost Determination 347**

*Machinery and Equipment 347*  
*Buildings 347*  
*Land Improvements 347*  
*Land 347*  
*Lump-Sum Purchase 348*

**Depreciation 348**

*Factors in Computing Depreciation 349*  
*Depreciation Methods 349*  
*Partial-Year Depreciation 354*  
*Change in Estimates for Depreciation 354*  
*Reporting Depreciation 355*

**Additional Expenditures 356**

*Ordinary Repairs 357*  
*Betterments and Extraordinary Repairs 357*

**Disposals of Plant Assets 358**

*Discarding Plant Assets 358*  
*Selling Plant Assets 359*

**SECTION 2—NATURAL RESOURCES 361**

*Cost Determination and Depletion 361*  
*Plant Assets Tied into Extracting 362*

**SECTION 3—INTANGIBLE ASSETS 362**

*Cost Determination and Amortization 363*  
*Types of Intangibles 363*

**Global View 366**

**Decision Analysis—Total Asset Turnover 367**  
**Appendix 8A Exchanging Plant Assets 370**



## 9 Reporting and Analyzing Current Liabilities 388

**Characteristics of Liabilities 390**

*Defining Liabilities 390*  
*Classifying Liabilities 390*  
*Uncertainty in Liabilities 391*

**Known Liabilities 392**

*Accounts Payable 392*  
*Sales Taxes Payable 392*  
*Unearned Revenues 392*  
*Short-Term Notes Payable 393*  
*Payroll Liabilities 396*  
*Multi-Period Known Liabilities 399*

**Estimated Liabilities 400**

*Health and Pension Benefits 400*  
*Vacation Benefits 400*  
*Bonus Plans 401*  
*Warranty Liabilities 401*  
*Multi-Period Estimated Liabilities 402*

**Contingent Liabilities 402**

*Accounting for Contingent Liabilities 402*  
*Reasonably Possible Contingent Liabilities 402*  
*Uncertainties that Are Not Contingencies 403*

Global View 405  
 Decision Analysis—Times Interest Earned Ratio 405  
 Appendix 9A Payroll Reports, Records,  
 and Procedures 408  
 Appendix 9B Corporate Income Taxes 414

## 10 Reporting and Analyzing Long-Term Liabilities 434



### Basics of Bonds 436

*Bond Financing* 436  
*Bond Trading* 437  
*Bond-Issuing Procedures* 437

### Bond Issuances 438

*Issuing Bonds at Par* 438  
*Bond Discount or Premium* 438  
*Issuing Bonds at a Discount* 439  
*Issuing Bonds at a Premium* 442  
*Bond Pricing* 444

### Bond Retirement 446

*Bond Retirement at Maturity* 446  
*Bond Retirement before Maturity* 446  
*Bond Retirement by Conversion* 446

### Long-Term Notes Payable 447

*Installment Notes* 447  
*Mortgage Notes and Bonds* 449

Global View 450

Decision Analysis—Debt Features and the Debt-to-Equity Ratio 451

Appendix 10A Present Values of Bonds and Notes 455

Appendix 10B Effective Interest Amortization 457

Appendix 10C Issuing Bonds between Interest Dates 458

Appendix 10D Leases and Pensions 460

## 11 Reporting and Analyzing Equity 478



### Corporate Form of Organization 480

*Characteristics of Corporations* 480  
*Corporate Organization and Management* 481  
*Stockholders of Corporations* 481  
*Basics of Capital Stock* 482

### Common Stock 484

*Issuing Par Value Stock* 484  
*Issuing No-Par Value Stock* 485  
*Issuing Stated Value Stock* 485  
*Issuing Stock for Noncash Assets* 485

### Dividends 487

*Cash Dividends* 487  
*Stock Dividends* 488  
*Stock Splits* 489

### Preferred Stock 491

*Issuance of Preferred Stock* 491  
*Dividend Preference of Preferred Stock* 492  
*Convertible Preferred Stock* 493  
*Callable Preferred Stock* 493  
*Reasons for Issuing Preferred Stock* 493

### Treasury Stock 495

*Purchasing Treasury Stock* 495  
*Reissuing Treasury Stock* 496  
*Retiring Stock* 497

### Reporting of Equity 498

*Statement of Retained Earnings* 498  
*Statement of Stockholders' Equity* 499  
*Reporting Stock Options* 499

Global View 499

Decision Analysis—Earnings per Share, Price-Earnings Ratio, Dividend Yield, and Book Value per Share 500

## 12 Reporting and Analyzing Cash Flows 522



### Basics of Cash Flow Reporting 524

- Purpose of the Statement of Cash Flows* 524
- Importance of Cash Flows* 524
- Measurement of Cash Flows* 524
- Classification of Cash Flows* 525
- Noncash Investing and Financing* 526
- Format of the Statement of Cash Flows* 527
- Preparing the Statement of Cash Flows* 527

### Cash Flows from Operating 530

- Indirect and Direct Methods of Reporting* 530
- Application of the Indirect Method of Reporting* 532
- Summary of Adjustments for Indirect Method* 535

### Cash Flows from Investing 537

- Three-Stage Process of Analysis* 537
- Analysis of Noncurrent Assets* 537
- Analysis of Other Assets* 538

### Cash Flows from Financing 539

- Three-Stage Process of Analysis* 539
- Analysis of Noncurrent Liabilities* 539
- Analysis of Equity* 540
- Proving Cash Balances* 541

### Global View 542

### Decision Analysis—Cash Flow Analysis 542

### Appendix 12A Spreadsheet Preparation of the Statement of Cash Flows 546

### Appendix 12B Direct Method of Reporting Operating Cash Flows 549

## 13 Analyzing and Interpreting Financial Statements 576



### Basics of Analysis 578

- Purpose of Analysis* 578
- Building Blocks of Analysis* 578
- Information for Analysis* 579
- Standards for Comparisons* 579
- Tools of Analysis* 580

### Horizontal Analysis 580

- Comparative Statements* 580
- Trend Analysis* 583

### Vertical Analysis 585

- Common-Size Statements* 585
- Common-Size Graphics* 585

### Ratio Analysis 588

- Liquidity and Efficiency* 589
- Solvency* 592
- Profitability* 594
- Market Prospects* 595
- Summary of Ratios* 596

### Global View 598

### Decision Analysis—Analysis Reporting 599

### Appendix 13A Sustainable Income 602

### Appendix A Financial Statement Information A-1

Apple A-2

Google A-10

Samsung A-14

### Appendix B Applying Present and Future Values B

### Appendix C Investments and International Operations C

### \*Appendix D Reporting and Analyzing Partnerships

### \*Appendix E Reporting and Preparing Special Journals

### Glossary G

### Credits CR-1

### Index IND

### Chart of Accounts CA

# Financial Accounting



# 1 Introducing Financial Accounting

*Chapter Flowchart is organized by key topics and includes key learning objectives*

IMPORTANCE OF ACCOUNTING	FUNDAMENTALS OF ACCOUNTING	TRANSACTION ANALYSIS	FINANCIAL STATEMENTS
<b>C1</b> Purpose of accounting <b>C2</b> Accounting information users Opportunities in accounting	<b>C3</b> Ethics—key concept <b>C4</b> Generally accepted accounting principles International standards Conceptual framework	<b>A1</b> Accounting equation and its components <b>P1</b> Transaction analysis—illustrated	<b>P2</b> Income statement Statement of retained earnings Balance sheet Statement of cash flows <b>A2</b> Financial analysis

*Learning Objectives are classified as conceptual, analytical, or procedural (and are listed in the order covered as shown in the Flowchart above)*

## Learning Objectives

- |   |   |  |
|---|---|--|
| <b>C1</b> Explain the purpose and importance of accounting. (p. 4)  | <b>A1</b> Define and interpret the accounting equation and each of its components. (p. 15)          | <b>A2</b> Compute and interpret return on assets. (p. 25)  |
| <b>C2</b> Identify users and uses of, and opportunities in, accounting. (p. 4)  | <b>P1</b> Analyze business transactions using the accounting equation. (p. 16)                      | <b>A3</b> Appendix 1A—Explain the relation between return and risk. (p. 29)                      |
| <b>C3</b> Explain why ethics are crucial to accounting. (p. 7)  | <b>P2</b> Identify and prepare basic financial statements and explain how they interrelate. (p. 21) | <b>C5</b> Appendix 1B—Identify and describe the three major activities of organizations. (p. 29) |
| <b>C4</b> Explain generally accepted accounting principles and define and apply several accounting principles. (p. 9) |   |  |



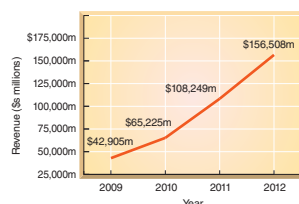
A **Decision Feature** launches each chapter showing the relevance of accounting for a real entrepreneur. An **Entrepreneurial Decision problem** at the end of the assignments returns to this feature with a mini-case.

## Wizard of Woz

*"Wherever smart people work, doors are unlocked . . ."*

—STEVE WOZNIAK

CUPERTINO, CA—"When I designed the Apple stuff," says Steve Wozniak (a.k.a. Woz, also known as the *Wizard of Woz*), "I never thought in my life I would have enough money to fly to Hawaii or make a down-payment on a house." Today, **Apple (Apple.com)** boasts a value of over \$400 billion and revenues of over \$156 billion (recent years' revenues follow).

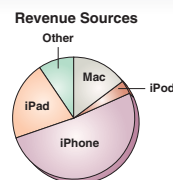


Woz, along with Steve Jobs, founded Apple on April 1, 1976. Immediately, Woz and Jobs confronted many accounting issues, including how to finance their new company. Their decision was to sell some of their prized possessions, such as Woz's HP scientific calculator and Jobs's Volkswagen van, thereby raising \$1,300 to launch Apple. They quickly spent the funds on electronic equipment for Woz to build the first Apple computer.

### Apple Inc.

NASDAQ: AAPL

\$176,064 mil. assets  
73,000 employees



In setting up their company, the two young entrepreneurs had to make a decision on what type of entity to form: partnership or corporation. They decided on a partnership and had Ron Wayne type it. "He sat down at a typewriter and typed our partnership contract right out of his head," recalls Woz. "He did an etching of Newton under the apple tree for the cover of our Apple I manual [and] he wrote the manual." Interestingly, the original partnership agreement included Wayne as a third partner with 10% ownership. However, 10 days later, Wayne had a change of heart when he considered the unlimited liability of a partnership and he pulled out, leaving Woz and Jobs holding 50% each. Within nine months, Woz and Jobs saw advantages to the corporate form of business organization, and they converted Apple to a corporation on January 3, 1977.

As the new company grew, Woz and Steve had to learn some accounting along with details of preparing and interpreting financial statements. Important questions involving transaction analysis and financial reporting arose, and the owners took care to do things right. "Everything we did," asserts Woz, "we were setting the tone for the world." Still, there were some doubters, including Woz's father. "A person like him shouldn't have that much money," said his father after finding \$250,000 of uncashed checks lying around in Woz's Porsche.

Information for business decisions is the focus of Apple's accounting records. Woz believes that Apple is integral to the language of technology, just as accounting is the language of business. In retrospect, Woz says, "every dream I have ever had in life has come true ten times over." He adds: "in the end, I hope there's a little note somewhere that says I designed a good computer."

Sources: *Woz Website*, Woz.org, January 2014; *iWoz: From Computer Geek to Cult Icon*, W.W.Norton & Co., 2006; *Founders at Work*, Apress, 2007; *Apple Website*, January 2014



## IMPORTANCE OF ACCOUNTING

**C1** Explain the purpose and importance of accounting.

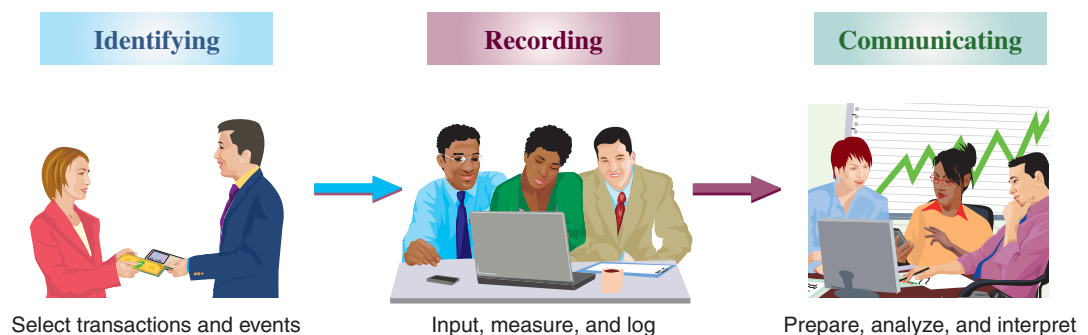
Why is accounting so popular on campus? Why are there so many openings for accounting jobs? Why is accounting so important to companies? Why do politicians and business leaders focus on accounting regulations? The answer is that we live in an information age, where that information, and its reliability, impacts us all.

**Accounting** is an information and measurement system that identifies, records, and communicates relevant, reliable, and comparable information about an organization's business activities. *Identifying* business activities requires that we select relevant transactions and events. Examples are the sale of iPads by **Apple** and the receipt of ticket money by **TicketMaster**. *Recording* business activities requires that we keep a chronological log of transactions and events measured in dollars. *Communicating* business activities requires that we prepare accounting reports such as financial statements, which we analyze and interpret. (The financial statements and notes of Apple are shown in Appendix A near the end of this book. This appendix also shows the financial statements of **Google** and **Samsung**.) Exhibit 1.1 summarizes accounting activities.

Real company names are printed in bold magenta.

### EXHIBIT 1.1

Accounting Activities



Accounting is part of our everyday lives. Our most common contact with accounting is through credit approvals, checking accounts, tax forms, and payroll. These experiences tend to focus on the recordkeeping parts of accounting. **Recordkeeping**, or **bookkeeping**, is the recording of transactions and events, either manually or electronically. This is just one part of accounting. Accounting also identifies and communicates information on transactions and events, and it includes the crucial processes of analysis and interpretation.

Technology is a key part of modern business and plays a major role in accounting. Technology reduces the time, effort, and cost of recordkeeping while improving clerical accuracy. Some small organizations continue to perform various accounting tasks manually, but even they are impacted by technology. As technology makes more information available, the demand for accounting increases and so too the skills for applying that information. Consulting, planning, and other financial services are now closely linked to accounting. These services require sorting through data, interpreting their meaning, identifying key factors, and analyzing their implications.

### Users of Accounting Information

Accounting is called the *language of business* because all organizations set up an accounting information system to communicate data to help people make better decisions. Exhibit 1.2 shows that accounting serves many users (this is a partial listing) who can be divided into two groups: external users and internal users.

**External Information Users** External users of accounting information are *not* directly involved in running the organization. They include shareholders (investors), lenders, directors, customers, suppliers, regulators, lawyers, brokers, and the press. External users have limited access to an organization's information. Yet their business decisions depend on information that is reliable, relevant, and comparable. **Financial accounting** is the area of accounting aimed at

**Point:** Technology is only as useful as the accounting data available, and users' decisions are only as good as their understanding of accounting. The best software and recordkeeping cannot make up for lack of accounting knowledge.

**C2** Identify users and uses of, and opportunities in, accounting.

## External users



A	000027	521	-012	521	521	521	521
A	000028	789	003	789	789	789	789
A	000029	508	-005	508	508	508	508
A	000030	505	-009	505	505	505	505
A	000031	567	-013	567	567	567	567
A	000032	152	003	152	152	152	152
A	000033	726	-001	726	726	726	726
A	000034			0			
A	000035		-003	359	359	359	359
A	000036		01	57	57	57	57
A				54	54	54	54
A				23	23	23	23

- Lenders
- Shareholders
- Governments
- Consumer groups
- External auditors
- Customers

## Internal users



- Officers
- Managers
- Internal auditors
- Sales staff
- Budget officers
- Controllers

## EXHIBIT 1.2

Users of Accounting Information

Infographics reinforce key concepts through visual learning.

servicing external users by providing them with *general-purpose financial statements*. The term *general-purpose* refers to the broad range of purposes for which external users rely on these statements. Following is a partial list of external users and some decisions they make with accounting information.

- *Lenders* (creditors) loan money or other resources to an organization. Banks, savings and loans, co-ops, and mortgage and finance companies are lenders. Lenders look for information to help them assess whether an organization is likely to repay its loans with interest.
- *Shareholders (investors)* are the owners of a corporation. They use accounting reports in deciding whether to buy, hold, or sell stock.
- *Directors* are typically elected to a *board of directors* to oversee their interests in an organization. Since directors are responsible to shareholders, their information needs are similar.
- *External (independent) auditors* examine financial statements to verify that they are prepared according to generally accepted accounting principles.
- *Nonexecutive employees and labor unions* use financial statements to judge the fairness of wages, assess job prospects, and bargain for better wages.
- *Regulators* often have legal authority over certain activities of organizations. For example, the Internal Revenue Service (IRS) and other tax authorities require organizations to file accounting reports in computing taxes. Other regulators include utility boards that use accounting information to set utility rates and securities regulators that require reports for companies that sell their stock to the public.
- *Voters, legislators, and government officials* use accounting information to monitor and evaluate government receipts and expenses.
- *Contributors* to nonprofit organizations use accounting information to evaluate the use and impact of their donations.
- *Suppliers* use accounting information to judge the soundness of a customer before making sales on credit.
- *Customers* use financial reports to assess the staying power of potential suppliers.

**Internal Information Users** **Internal users** of accounting information are those directly involved in managing and operating an organization such as the chief executive officer (CEO), chief financial officer (CFO), chief audit executive (CAE), treasurer, and other executive and managerial-level employees. They use the information to help improve the efficiency and effectiveness of an organization. **Managerial accounting** is the area of accounting that serves the decision-making needs of internal users. Internal reports are not subject to the same rules as external reports and instead are designed with the special needs of internal users in mind. Following is a partial list of internal users and some decisions they make with accounting information.

- *Research and development managers* need information about projected costs and revenues of any proposed changes in products and services.
- *Purchasing managers* need to know what, when, and how much to purchase.

- *Human resource managers* need information about employees’ payroll, benefits, performance, and compensation.
- *Production managers* depend on information to monitor costs and ensure quality.
- *Distribution managers* need reports for timely, accurate, and efficient delivery of products and services.
- *Marketing managers* use reports about sales and costs to target consumers, set prices, and monitor consumer needs, tastes, and price concerns.
- *Service managers* require information on the costs and benefits of looking after products and services.

### Opportunities in Accounting

Accounting information is in all aspects of our lives. When we earn money, pay taxes, invest savings, budget earnings, and plan for the future, we use accounting. Accounting has four broad areas of opportunities: financial, managerial, taxation, and accounting-related. Exhibit 1.3 lists selected opportunities in each area.

#### EXHIBIT 1.3

Accounting Opportunities



#### EXHIBIT 1.4

Accounting Jobs by Area

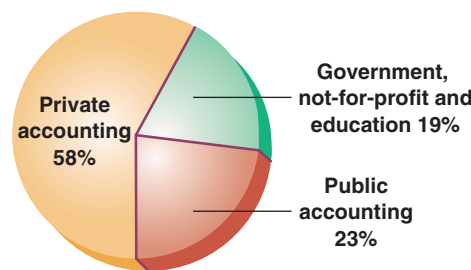


Exhibit 1.4 shows that the majority of opportunities are in *private accounting*, which are employees working for businesses. *Public accounting* offers the next largest number of opportunities, which involve services such as auditing and tax advice. Still other opportunities exist in government and not-for-profit agencies, including business regulation and investigation of law violations.

Accounting specialists are highly regarded and their professional standing is often denoted by a certificate. Certified public accountants (CPAs) must meet education and experience requirements, pass an examination, and exhibit ethical character. Many accounting specialists hold certificates in addition to or instead of the CPA. Two of the most common are the certificate in management accounting (CMA) and the certified internal auditor (CIA). Employers also look for specialists with designations such as certified bookkeeper (CB), certified payroll professional (CPP), personal financial specialist (PFS), certified fraud examiner (CFE), and certified forensic accountant (CrFA).

Demand for accounting specialists is strong. Exhibit 1.5 reports average annual salaries for several accounting positions. Salary variation depends on location, company size, professional designation, experience, and other factors. For example, salaries for chief financial officers (CFO) range from under \$100,000 to more than \$1 million per year. Likewise, salaries for bookkeepers range from under \$30,000 to more than \$80,000.

**Point:** The largest accounting firms are Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers.

**Margin notes further enhance the textual material.**

**Point:** Census Bureau (2011) reports that for workers 25 and over, higher education yields higher average pay:

Advanced degree . . . . .	\$81,568
Bachelor’s degree . . . . .	57,326
High school degree . . . . .	36,876
No high school degree . . . . .	26,124

**Point:** U.S. Bureau of Labor (June 2011) reports higher education is associated with a lower unemployment rate:

Bachelor’s degree or more . . . . .	4.4%
High school degree . . . . .	10.0%
No high school degree . . . . .	14.3%

Field	Title (experience)	2011 Salary	2016 Estimate*
<b>Public Accounting</b>	Partner . . . . .	\$202,000	\$223,000
	Manager (6–8 years) . . . . .	97,500	107,500
	Senior (3–5 years) . . . . .	75,000	83,000
	Junior (0–2 years) . . . . .	57,500	63,500
<b>Private Accounting</b>	CFO . . . . .	242,000	267,000
	Controller/Treasurer . . . . .	157,500	174,000
	Manager (6–8 years) . . . . .	91,500	101,000
	Senior (3–5 years) . . . . .	74,500	82,000
<b>Recordkeeping</b>	Junior (0–2 years) . . . . .	53,000	58,500
	Full-charge bookkeeper . . . . .	59,500	65,500
	Accounts manager . . . . .	52,000	57,500
	Payroll manager . . . . .	55,500	61,000
	Accounting clerk (0–2 years) . . . . .	38,500	42,500

**EXHIBIT 1.5**

Accounting Salaries for Selected Fields

**Point:** For updated salary information: [Abbott-Langer.com](http://Abbott-Langer.com), [www.AICPA.org](http://www.AICPA.org), [Kforce.com](http://Kforce.com)

\* Estimates assume a 2% compounded annual increase over current levels (rounded to nearest \$500).

**NEED-TO-KNOWs** highlight key procedures and concepts in learning accounting.

Identify the following users of accounting information as either an (a) external, or (b) internal user.

- |                    |                           |                              |
|--------------------|---------------------------|------------------------------|
| 1. ___ Regulator   | 4. ___ Controller         | 7. ___ Production Manager    |
| 2. ___ CEO         | 5. ___ Executive Employee | 8. ___ Nonexecutive Employee |
| 3. ___ Shareholder | 6. ___ External Auditor   |                              |

**NEED-TO-KNOW 1.1**

C1 C2

Do More: QS 1-1, QS 1-2, E 1-1, E 1-2, E 1-3

**Solution**

1. a 2. b 3. a 4. b 5. b 6. a 7. b 8. a

**QC1**

**QC icon** indicates Quick Check self-review questions available on text Website

**FUNDAMENTALS OF ACCOUNTING**

Accounting is guided by principles, standards, concepts, and assumptions. This section describes several of these key fundamentals of accounting.

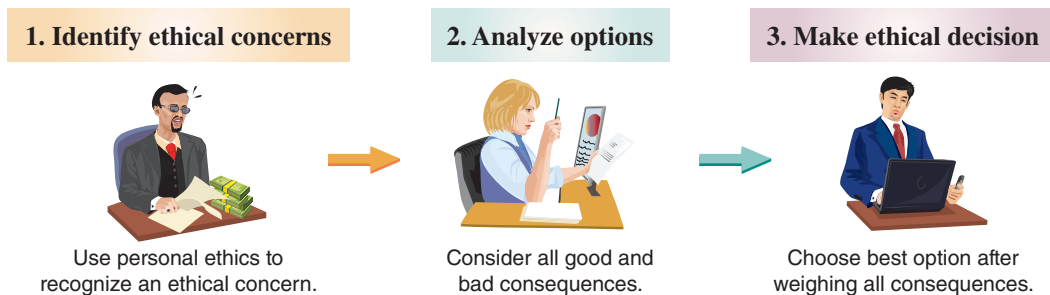
**Ethics—A Key Concept**

The goal of accounting is to provide useful information for decisions. For information to be useful, it must be trusted. This demands ethics in accounting. **Ethics** are beliefs that distinguish right from wrong. They are accepted standards of good and bad behavior.

Identifying the ethical path is sometimes difficult. The preferred path is a course of action that avoids casting doubt on one’s decisions. For example, accounting users are less likely to trust an auditor’s report if the auditor’s pay depends on the client’s success. To avoid such concerns, ethics rules are often set. For example, auditors are banned from direct investment in their client and cannot accept pay that depends on figures in the client’s reports. Exhibit 1.6 gives a three-step process for making ethical decisions.

**C3** Explain why ethics are crucial to accounting.

**Point: Sarbanes-Oxley Act** requires each issuer of securities to disclose whether it has adopted a code of ethics for its senior officers and the contents of that code.



**EXHIBIT 1.6**

Guidelines for Ethical Decision Making

Accountants face many ethical choices as they prepare financial reports. These choices can affect the price a buyer pays and the wages paid to workers. They can even affect the success of products and services. Misleading information can lead to a wrongful closing of a division that harms workers, customers, and suppliers. There is an old saying: *Good ethics are good business.*

Some people extend ethics to *social responsibility*, which refers to a concern for the impact of actions on society. An organization's social responsibility can include donations to hospitals, colleges, community programs, and law enforcement. It also can include programs to reduce pollution, increase product safety, improve worker conditions, and support continuing education. These programs are not limited to large companies. For example, many small businesses offer discounts to students and senior citizens. Still others help sponsor events such as the Special Olympics and summer reading programs.

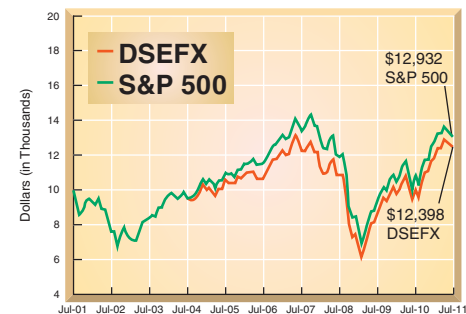
**Point:** The American Institute of Certified Public Accountants' Code of Professional Conduct is available at [www.AICPA.org](http://www.AICPA.org).

**Decision Insight** boxes highlight relevant items from practice.

## Decision Insight



**Virtuous Returns** Virtue is not always its own reward. Compare the S&P 500 with the Domini Social Index (DSI), which covers 400 companies that have especially good records of social responsibility. We see that returns for companies with socially responsible behavior are roughly on par with those of the S&P 500 for the past 10-year period (Domini.com, 2011 Annual Report). Copyright © 2005 by KLD Research & Analytics, Inc. The "Domini 400 Social Index" is a service mark of KLD Research & Analytics. ■



## Fraud Triangle

The fraud triangle is a model created by a criminologist that asserts the following *three* factors must exist for a person to commit fraud: opportunity, pressure, and rationalization.



- **Opportunity.** A person must envision a way to commit fraud with a low perceived risk of getting caught. Employers can directly reduce this risk. An example of some control on opportunity is a pre-employment background check.
- **Pressure,** or incentive. A person must have some pressure to commit fraud. Examples are unpaid bills and addictions.
- **Rationalization,** or attitude. A person who rationalizes fails to see the criminal nature of the fraud or justifies the action.

It is important to recognize that all three factors of the fraud triangle must usually exist for fraud to occur. The absence of one or more factors suggests fraud is unlikely. The key to dealing with fraud is to focus on prevention. It is less expensive and more effective to prevent fraud from happening than it is to try to detect the crime. By the time the fraud is discovered, the money is gone and chances are slim that it will be recovered. Additionally, it is costly and time-consuming to investigate a fraud.

Both internal and external users rely on internal controls to reduce the likelihood of fraud. *Internal controls* are procedures set up to protect company property and equipment, ensure reliable accounting reports, promote efficiency, and encourage adherence to company policies. Examples are good records, physical controls (locks, passwords, guards), and independent reviews.



## Fraud

**They Fought the Law** Our economic and social welfare depends on reliable accounting. Some individuals forgot that and are now paying their dues. They include Raj Rajaratnam (in photo), an investor, convicted of trading stocks using inside information; Bernard Madoff of **Madoff Investment Securities**, convicted of falsifying securities records; Bernard Ebbers of **WorldCom**, convicted of an \$11 billion accounting scandal; Andrew Fastow of **Enron**, guilty of hiding debt and inflating income; and Ramalinga Raju of **Satyam Computers**, accused of overstating assets by \$1.5 billion.



## Generally Accepted Accounting Principles

Financial accounting is governed by concepts and rules known as **generally accepted accounting principles (GAAP)**. We must understand these principles to best use accounting data. GAAP aims to make information *relevant*, *reliable*, and *comparable*. Relevant information affects decisions of users. Reliable information is trusted by users. Comparable information is helpful in contrasting organizations.

In the United States, the **Securities and Exchange Commission (SEC)**, a government agency, has the legal authority to set GAAP. The SEC also oversees proper use of GAAP by companies that raise money from the public through issuances of their stock and debt. Those companies that issue their stock on U.S. exchanges include both *U.S. SEC registrants* (companies incorporated in the United States) and *non-U.S. SEC registrants* (companies incorporated under non-U.S. laws). The SEC has largely delegated the task of setting U.S. GAAP to the **Financial Accounting Standards Board (FASB)**, which is a private-sector group that sets both broad and specific principles.

## International Standards

In today's global economy, there is increased demand by external users for comparability in accounting reports. This demand often arises when companies wish to raise money from lenders and investors in different countries. To that end, the **International Accounting Standards Board (IASB)**, an independent group (consisting of individuals from many countries), issues **International Financial Reporting Standards (IFRS)** that identify preferred accounting practices.

If standards are harmonized, one company can potentially use a single set of financial statements in all financial markets. Differences between U.S. GAAP and IFRS are decreasing as the FASB and IASB pursue a *convergence* process aimed to achieve a single set of accounting standards for global use. More than 115 countries now require or permit companies to prepare financial reports following IFRS. Further, non-U.S. SEC registrants can use IFRS in financial reports filed with the SEC (with no reconciliation to U.S. GAAP). This means there are *two* sets of accepted accounting principles in the United States: (1) U.S. GAAP for U.S. SEC registrants and (2) either IFRS or U.S. GAAP for non-U.S. SEC registrants.

The SEC is encouraging the FASB to change U.S. GAAP over a period of several years by endorsing, and thereby incorporating, individual IFRS standards into U.S. GAAP. This endorsement process would still allow the FASB to modify IFRS when necessary. The SEC would:

- Maintain its statutory oversight of the FASB, including authority to prescribe accounting principles and standards for U.S. issuers.
- Contribute to oversight and governance of the IASB through its involvement on the IFRS Foundation Monitoring Board.

The FASB would continue, but its role would be to provide input and support to the IASB in crafting high-quality, global standards. The FASB is to develop a transition plan to effect these changes over the next five years or so. For updates on this roadmap, we can check with the AICPA ([IFRS.com](http://IFRS.com)), FASB ([FASB.org](http://FASB.org)), and IASB ([ifrs.org](http://ifrs.org)).



### IFRS

Like the FASB, the IASB uses a conceptual framework to aid in revising or drafting new standards. However, unlike the FASB, the IASB's conceptual framework is used as a reference when specific guidance is lacking. The IASB also requires that transactions be accounted for according to their substance (not only their legal form), and that financial statements give a fair presentation, whereas the FASB narrows that scope to fair presentation *in accordance with U.S. GAAP*. ■

## Conceptual Framework and Convergence

The FASB and IASB are attempting to converge and enhance the **conceptual framework** that guides standard setting. The FASB framework consists broadly of the following:

- **Objectives**—to provide information useful to investors, creditors, and others.
- **Qualitative Characteristics**—to require information that is *relevant*, *reliable*, and *comparable*.

**C4** Explain generally accepted accounting principles and define and apply several accounting principles.

**Point:** State ethics codes require CPAs who audit financial statements to disclose areas where those statements fail to comply with GAAP. If CPAs fail to report noncompliance, they can lose their licenses and be subject to criminal and civil actions and fines.