FINANCIAL ACCOUNTING

Information for Decisions

8e | John J. Wild

Mc Graw Hill Education

Financial Accounting

INFORMATION FOR DECISIONS

8th edition

John J. Wild

University of Wisconsin at Madison

McGraw Hill Education

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

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Adapting to Today's Students

Financial Accounting, 8e

Enhancements in technology have changed how we live and learn. Working with learning resources across devices, whether smartphones, tablets, or laptop computers, empowers students to drive their own learning by putting increasingly intelligent technology into their hands.

Whether the goal is to become an accountant, a businessperson, or simply an informed consumer of accounting information, *Financial Accounting (FA)* has helped generations of students succeed. Its leading-edge accounting content, paired with state-of-the-art technology, supports student learning and elevates understanding of key accounting principles.

FA excels at **engaging students** with content that will help them see the relevance of accounting. Its chapter-opening vignettes showcase dynamic, successful entrepreneurial individuals and companies and **highlight the usefulness of accounting.** This edition's featured companies—**Apple, Google,** and **Samsung**—capture student interest with their products, and their annual reports serve as a pathway for learning financial statements. Need-to-Know illustrations in each chapter demonstrate how to apply key accounting concepts and procedures. The illustrations are supported by guided video presentations.

FA also delivers innovative technology to help student performance. ***Connect*** provides students with a media-rich eBook version of the textbook and offers instant grading and feedback for assignments that are completed online. Our system for completing exercise and problem material takes 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.

This technology features:

- **a general journal interface** that looks and feels more like that found in practice.
- **an auto-calculation** feature that allows students to focus on concepts rather than rote tasks.
- **a smart (auto-fill) drop-down design.**

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Connect 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.

The revolutionary technology of **SmartBook®** is available only from McGraw-Hill Education. Based on an intelligent learning system, Smartbook uses a series of adaptive questions to pinpoint each student's knowledge gaps and then provides an optimal learning path. Students spend less time in areas they already know and more time in areas they don't. The result: Students study more efficiently, learn faster, and retain more knowledge. Valuable reports provide insights into how students are progressing through textbook content and information useful for shaping in-class time or assessment.

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The first and only analytics tool of its kind, **Connect Insight®** is a series of visual data displays—each framed by an intuitive question—to provide at-a-glance information about how your class is doing. Connect Insight provides a quick analysis on five key dimensions, available at a moment's notice from a tablet device.

> "A great enhancement! I love the fact that GL makes the student choose from an entire chart of accounts."
>
> **—TAMMY METZKE, Milwaukee Area Technical College**

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 (multiple times) from the 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, 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,* and *College Accounting,* each published by McGraw-Hill Education. 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.* Professor Wild is a recognized expert in accounting and financial analysis, and is known for his teaching innovations within an active learning classroom environment.

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

Dear Colleagues and Friends,

As I roll out the new edition of *Financial Accounting,* I thank each of you who provided suggestions to improve the textbook and its teaching resources. This new edition reflects the advice and wisdom of many dedicated reviewers, symposium and workshop participants, students, and instructors. Throughout the revision process, I steered this textbook and its teaching tools in the manner you directed. As you'll find, the new edition offers a rich set of features—especially digital features—to improve student learning and assist instructor teaching and grading. I believe you and your students will like what you find in this new edition.

Many talented educators and professionals have worked hard to create the materials for this textbook, and for their efforts, I'm grateful. **I extend a special thank-you to our contributing and technology supplement authors,** who have worked so diligently to support this textbook and its teaching aids:

Contributing Author: Kathleen O'Donnell, *Onondaga Community College*

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John J. Wild

Innovative Textbook Features . . .

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, we use a learning framework we call the Decision Center. This framework encompasses a variety of approaches and subject areas, giving students insight into every aspect of business decision making; see the four nearby examples for the different types of decision boxes, including those that relate to fraud. Answers to Decision Maker and Ethics boxes are at the end of each chapter.

Decision Insight

Women Entrepreneurs Sara Blakely (in photo), the billionaire entrepreneur/owner of **SPANX**, has promised to donate half her wealth to charity. The Center for Women's Business Research reports that women-owned businesses are growing and that they:

- Total more than 11 million and employ nearly 20 million workers.
- Generate $2.5 trillion in annual sales and tend to embrace technology.
- Are philanthropic—70% of owners volunteer at least once per month.
- Are more likely funded by individual investors (73%) than venture firms (15%). ■


Paul Morigi/Getty Images for FORTUNE

Decision Ethics

Financial Officer At year-end, the president instructs you, the financial officer, not to record accrued expenses until next year because they will not be paid until then. The president also directs you to record in current-year sales a recent purchase order from a customer that requires merchandise to be delivered two weeks after the year-end. Your company would report a net income instead of a net loss if you carry out these instructions. What do you do? ■ [Answers follow the chapter's Summary.]

invaluable degree of goodwill and good karma.

© Ashley Cooper/Corbis

Profit margin and current ratio **Decision Analysis**

Profit Margin

A useful measure of a company's operating results is the ratio of its net income to net sales. This ratio is called **profit margin,** or *return on sales,* and is computed as in Exhibit 3.22.

$$\text{Profit margin} = \frac{\text{Net income}}{\text{Net sales}}$$

EXHIBIT 3.22
Profit Margin

This ratio is interpreted as reflecting the percent of profit in each dollar of sales. To illustrate how we compute and use profit margin, let's look at the results of **Limited Brands, Inc.**, in Exhibit 3.23 for its fiscal years 2010 through 2014.

A1 Compute profit margin and describe its use in analyzing company performance.

Decision Maker

Analyst You are analyzing the financial condition of a company to assess its ability to meet upcoming loan payments. You compute its current ratio as 1.2. You also find that a major portion of accounts receivable is due from one client who has not made any payments in the past 12 months. Removing this receivable from current assets lowers the current ratio to 0.7. What do you conclude? ■ [Answers follow the chapter's Summary.]

"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. I'm a 'Wild' fan!"

—RITA HAYS, Southwestern Oklahoma State University

Chapter Preview

Each chapter opens with a visual chapter preview. Students can 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. Learning objective numbers highlight the location of related content.

Chapter Preview

BASICS OF ANALYSIS	HORIZONTAL ANALYSIS	VERTICAL ANALYSIS	RATIO ANALYSIS AND REPORTING
C1 Analysis: Its purpose, building blocks, and information needs C2 Standards for comparisons, and analysis tools	P1 Application of: Comparative balance sheets Comparative income statements Trend analysis	P2 Application of: Common-size balance sheet Common-size income statement Common-size graphics	P3 Liquidity and efficiency Solvency Profitability Market prospects A1 Analysis reports

Learning Objectives

CONCEPTUAL	ANALYTICAL	PROCEDURAL
C1 Explain the purpose and identify the building blocks of analysis.	A1 Summarize and report results of analysis.	P1 Explain and apply methods of horizontal analysis.
C2 Describe standards for comparisons in analysis.	A2 *Appendix 13A*—Explain the form and assess the content of a complete income statement.	P2 Describe and apply methods of vertical analysis.
		P3 Define and apply ratio analysis.

CAP Model

The Conceptual/Analytical/Procedural (CAP) model allows courses to be specially designed to meet the teaching needs 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.

Bring Accounting to Life

Prepare the (a) income statement, (b) statement of retained earnings, and (c) balance sheet for **Apple** using the following *condensed* data from its fiscal year ended September 27, 2014 ($ in millions). (Its prior fiscal year ended September 28, 2013.)

NEED-TO-KNOW 1-5

Financial Statements

P2

APPLE

Accounts payable	$ 30,196	Investments and other assets	$179,911
Other liabilities	90,096	Land and equipment (net)	20,624
Cost of sales	112,258	Selling, general, and other expenses	31,027
Cash	13,844	Accounts receivable	17,460
Retained earnings, Sep. 28, 2013	104,256	Net income	39,510
Dividends in fiscal year 2014	56,614	Retained earnings, Sep. 27, 2014	87,152
Revenues	182,795	Common stock	24,395

Solution ($ in millions)

APPLE
Income Statement
For Fiscal Year Ended September 27, 2014

Revenues		$182,795
Expenses		
Cost of sales	$112,258	
Selling, general, and other expenses	31,027	
Total expenses		143,285

Need-to-Know Illustrations

Need-to-Know illustrations are located at key junctures in each chapter. These illustrations pose questions about the material just presented—content that students "need to know" to successfully learn accounting. Accompanying solutions walk students through key procedures and analysis necessary to be successful with homework and test materials. Need-to-Know illustrations are supplemented with narrated, animated, step-by-step walk-through videos led by an instructor and available via *Connect*.

Global View

The Global View section explains international accounting practices relating to the material covered in that chapter. The aim of this section is to describe accounting practices and to identify the similarities and differences in international accounting practices versus those in the United States. As we move toward global convergence in accounting practices, and as we witness the likely convergence of U.S. GAAP to IFRS, the importance of student familiarity with international accounting grows. This innovative section helps us begin down that path. 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.

GLOBAL VIEW

Financial accounting according to U.S. GAAP is similar, but not identical, to IFRS. This section discusses differences in analyzing and recording transactions, and with the preparation of financial statements.

Analyzing and Recording Transactions Both U.S. GAAP and IFRS include broad and similar guidance for financial accounting. Further, both U.S. GAAP and IFRS apply transaction analysis and recording as shown in this chapter—using the same debit and credit system and accrual accounting. Although some variations exist in revenue and expense recognition and other accounting principles, all of the transactions in this chapter are accounted for identically under these two systems.

PIAGGIO

Financial Statements Both U.S. GAAP and IFRS prepare the same four basic financial statements. A few differences within each statement do exist and we will discuss those throughout the book. For example, both U.S. GAAP and IFRS require balance sheets to separate current items from noncurrent items. However, while U.S. GAAP balance sheets report current items first, IFRS balance sheets normally (but are not required to) present noncurrent items first, and equity before liabilities. To illustrate, a condensed version of **Piaggio**'s balance sheet follows. Piaggio is an Italian manufacturer of scooters and compact vehicles.

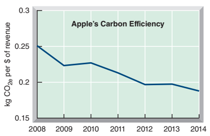
PIAGGIO
Balance Sheet (in thousands of euros)
December 31, 2014

Assets		Equity and Liabilities	
Noncurrent assets	€1,079,117	Total equity	€ 413,069
Current assets	477,491	Noncurrent liabilities	581,366
		Current liabilities	562,173
Total assets	€1,556,608	Total equity and liabilities	€1,556,608

Sustainability and Accounting The **Sustainability Accounting Standards Board (SASB)** is a nonprofit entity engaged in creating and disseminating sustainability accounting standards for use by companies. Sustainability refers to *environmental*, *social*, and *governance* (*ESG*) aspects of a company. A company's social aspects include donations to hospitals, colleges, community programs, and law enforcement. Environmental aspects include programs to reduce pollution, increase product safety, improve worker conditions, and support "green" activities. Governance aspects include social responsibility programs, community relations, and use of sustainable materials. Sustainability accounting standards are intended to complement financial accounting standards. The SASB has its own *Conceptual Framework* to guide the development of sustainability standards. It has also developed a set of *principles*, which serve as a set of minimum criteria.

© Xinhua/Alamy

Apple, as introduced in this chapter's opening feature, focuses on sustainability. Apple hired a Vice President of Environmental Initiatives, Lisa Jackson (in photo), to oversee its sustainability initiative. Lisa has set high goals for Apple, including powering all of its facilities with 100% renewable energy and making its products 100% recyclable. "We are swinging for the fences [on sustainability]," proclaims Lisa, which has resulted in some home runs for Apple. In Apple's sustainability report, Lisa points out that it powers data centers with 100% renewable energy and relies solely on renewable energy to power 80% of its corporate facilities and 50% of its retail stores. As Lisa stresses, "[Sustainability] is really important at Apple." Apple is also committed to reducing carbon emissions. "We would like to eliminate certain toxins," explains Lisa. Apple's sustainability report asserts that it has markedly improved its carbon efficiency and reduced the amount of carbon dioxide produced per dollar of revenue—see graphic. Lisa insists, "Leave the world better than how we found it . . . this is what really inspires people at Apple."



Source: Greenbiz, October 2014; *Apple Sustainability Report,* January 2015

Sustainability and Accounting

New in this edition are brief sections that highlight the importance of sustainability within the broader context of global accounting (and accountability). Companies increasingly address sustainability in their public reporting and consider the sustainability accounting standards (from the Sustainability Accounting Standards Board) and the expectations of our global society. These boxes, located near the end of the Global View section, cover different aspects of sustainability, often within the context of the chapter's featured entrepreneurial company.

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 present both a problem and a complete solution, allowing students to review the entire problem-solving process and achieve success. The problems draw on material from the entire chapter.

NEED-TO-KNOW 10-4

COMPREHENSIVE

Water Sports Company (WSC) patented and successfully test-marketed a new product. To expand its ability to produce and market the new product, WSC needs to raise $800,000 of financing. On January 1, 2016, the company obtained the money in two ways:

a. WSC signed a $400,000, 10% installment note to be repaid with five equal annual installments to be made on December 31 of 2016 through 2020.

b. WSC issued five-year bonds with a par value of $400,000. The bonds have a 12% annual contract rate and pay interest on June 30 and December 31. The bonds' annual market rate is 10% as of January 1, 2016.

Required

1. For the installment note, (*a*) compute the size of each annual payment, (*b*) prepare an amortization table similar to Exhibit 10.14, and (*c*) prepare the journal entry for the first payment.

2. For the bonds, (*a*) compute their issue price; (*b*) prepare the January 1, 2016, journal entry to record their issuance; (*c*) prepare an amortization table using the straight-line method; (*d*) prepare the June 30, 2016, journal entry to record the first interest payment; and (*e*) prepare a journal entry to record retiring the bonds at a $416,000 call price on January 1, 2018.

3.[B] Redo parts 2(*c*), 2(*d*), and 2(*e*) assuming the bonds are amortized using the effective interest method.

PLANNING THE SOLUTION

- For the installment note, divide the borrowed amount by the annuity factor (from Table B.3) using the 10% rate and five payments to compute the amount of each payment. Prepare a table similar to Exhibit 10.14 and use the numbers in the table's first line for the journal entry.
- Compute the bonds' issue price by using the market rate to find the present value of their cash flows (use tables found in Appendix B). Then use this result to record the bonds' issuance. Next, prepare an amortization table like Exhibit 10.11 (and Exhibit 10B.2) and use it to get the numbers needed for the journal entry. Also use the table to find the carrying value as of the date of the bonds' retirement that you need for the journal entry.

SOLUTION

Part 1: Installment Note

a. Annual payment = Note balance/PV annuity factor = $400,000/3.7908 = $105,519 (The present value annuity factor is for five payments and a rate of 10%.)

Summary

C1 Explain the importance of periodic reporting and the role of accrual accounting. The value of information is often linked to its timeliness. To provide timely information, accounting systems prepare periodic reports at regular intervals. The time period assumption presumes that an organization's activities can be divided into specific time periods for periodic reporting. Accrual accounting recognizes revenue when earned and expenses when incurred—not necessarily when cash inflows and outflows occur.

C2 Identify steps in the accounting cycle. The accounting cycle consists of 10 steps: (1) analyze transactions, (2) journalize, (3) post, (4) prepare an unadjusted trial balance, (5) adjust accounts, (6) prepare an adjusted trial balance, (7) prepare statements, (8) close, (9) prepare a post-closing trial balance, and (10) prepare (optional) reversing entries.

C3 Explain and prepare a classified balance sheet. Classified balance sheets report assets and liabilities in two categories: current and noncurrent. Noncurrent assets often include long-term investments, plant assets, and intangible assets. A corporation separates equity into common stock and retained earnings.

accounts. *Prepaid expenses* refer to items paid for in advance of receiving their benefits. Prepaid expenses are assets. Adjusting entries for prepaids involve increasing (debiting) expenses and decreasing (crediting) assets. *Unearned* (or *prepaid*) *revenues* refer to cash received in advance of providing products and services. Unearned revenues are liabilities. Adjusting entries for unearned revenues involve increasing (crediting) revenues and decreasing (debiting) unearned revenues. *Accrued expenses* refer to costs incurred in a period that are both unpaid and unrecorded. Adjusting entries for recording accrued expenses involve increasing (debiting) expenses and increasing (crediting) liabilities. *Accrued revenues* refer to revenues earned in a period that are both unrecorded and not yet received in cash. Adjusting entries for recording accrued revenues involve increasing (debiting) assets and increasing (crediting) revenues.

P2 Explain and prepare an adjusted trial balance. An adjusted trial balance is a list of accounts and balances prepared after recording and posting adjusting entries. Financial statements are often prepared from the adjusted trial balance.

P3 Prepare financial statements from an adjusted trial balance. Revenue and expense balances are reported on

Chapter Summaries provide students with a review organized by learning objectives. Chapter Summaries are a component of the CAP model (as discussed in the "Innovative Textbook Features" section), which recaps each conceptual, analytical, and procedural objective.

Key Terms are bolded in the text and repeated at the end of the chapter. A complete glossary of key terms is available online through *Connect.*

Key Terms

Annuity	**Debt-to-equity ratio**	**Pension plan**
Bearer bonds	**Discount on bonds payable**	**Premium on bonds**
Bond	**Effective interest method**	**Registered bonds**
Bond certificate	**Fair value option**	**Secured bonds**
Bond indenture	**Installment note**	**Serial bonds**
Callable bonds	**Lease**	**Sinking fund bonds**
Capital leases	**Market rate**	**Straight-line bond amortization**
Carrying (book) value of bonds	**Mortgage**	**Term bonds**
Contract rate	**Off-balance-sheet financing**	**Unsecured bonds**
Convertible bonds	**Operating leases**	
Coupon bonds	**Par value of a bond**	

Helps Students Master Key Concepts

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

Multiple Choice Quiz Answers at end of chapter

1. A company forgot to record accrued and unpaid employee wages of $350,000 at period-end. This oversight would
   - **a.** Understate net income by $350,000.
   - **b.** Overstate net income by $350,000.
   - **c.** Have no effect on net income.
   - **d.** Overstate assets by $350,000.
   - **e.** Understate assets by $350,000.
2. Prior to recording adjusting entries, the Supplies account has a $450 debit balance. A physical count of supplies shows $125 of unused supplies still available. The required adjusting entry is:
   - **a.** Debit Supplies $125; Credit Supplies Expense $125.
   - **b.** Debit Supplies $325; Credit Supplies Expense $325.
   - **c.** Debit Supplies Expense $325; Credit Supplies $325.
   - **d.** Debit Supplies Expense $325; Credit Supplies $125.
4. On November 1, 2016, Stockton Co. receives $3,600 cash from Hans Co. for consulting services to be provided evenly over the period November 1, 2016, to April 30, 2017—at which time Stockton credited $3,600 to Unearned Consulting Fees. The adjusting entry on December 31, 2016 (Stockton's year-end), would include a
   - **a.** Debit to Unearned Consulting Fees for $1,200.
   - **b.** Debit to Unearned Consulting Fees for $2,400.
   - **c.** Credit to Consulting Fees Earned for $2,400.
   - **d.** Debit to Consulting Fees Earned for $1,200.
   - **e.** Credit to Cash for $3,600.
5. If a company had $15,000 in net income for the year, and its sales were $300,000 for the same year, what is its profit margin?
   - **a.** 20% **c.** $285,000 **e.** 5%
   - **b.** 2,000% **d.** $315,000

Vodafone Group Plc reports the following information among its bonds payable as of March 31, 2015 (pounds in millions).

QS 10-19
International liabilities disclosures
P1

Financial Long-Term Liabilities Measured at Amortized Cost

£ millions	Nominal (par) Value	Carrying Value	Fair Value
4.625% (US dollar 500 million) bond due July 2018. . . .	£337	£375	£367

a. What is the par value of the 4.625% bond issuance? What is its book (carrying) value?
b. Was the 4.625% bond sold at a discount or a premium? Explain.

Quick Study assignments are short exercises that often focus on one learning objective. Most are included in *Connect.* There are at least 10–15 Quick Study assignments per chapter.

Exercises are one of this book's many strengths and a competitive advantage. There are at least 10–15 per chapter, and most are included in *Connect.*

Following are **Nintendo**'s revenue and expense accounts for a recent calendar year (yen in millions). Prepare the company's closing entries for its revenues and its expenses.

Exercise 3-8
Preparing closing entries
P4

Net sales	¥571,726
Cost of sales	408,506
Advertising expense.	70,264
Other expense, net	156,786

connect

Karla Tanner opens a web consulting business called Linkworks and completes the following transactions in its first month of operations.

PROBLEM SET A

Problem 2-1A
Preparing and posting journal entries; preparing a trial balance
C3 C4 A1 P1 P2

April 1 Tanner invests $80,000 cash along with office equipment valued at $26,000 in the company in exchange for common stock.
2 The company prepaid $9,000 cash for twelve months' rent for office space. (*Hint:* Debit Prepaid Rent for $9,000.)
3 The company made credit purchases for $8,000 in office equipment and $3,600 in office supplies. Payment is due within 10 days.

PROBLEM SET B

Problem 2-1B
Preparing and posting journal entries; preparing a trial balance
C3 C4 A1 P1 P2

Humble Management Services opens for business and completes these transactions in September.

Sept. 1 Henry Humble, the owner, invested $38,000 cash along with office equipment valued at $15,000 in the company in exchange for common stock.
2 The company prepaid $9,000 cash for 12 months' rent for office space. (*Hint:* Debit Prepaid Rent for $9,000.)
4 The company made credit purchases for $8,000 in office equipment and $2,400 in office supplies. Payment is due within 10 days.
8 The company completed work for a client and immediately received $3,280 cash.
12 The company completed a $15,400 project for a client, who must pay within 30 days.

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 the "Innovative Textbook Features" section), and Set A is included in *Connect.*

"I like the layout of the text and the readability. The illustrations and comics in the book make the text seem less intimidating and boring for students. The PowerPoint slides are easy to understand and use, the pictorials are great, and the text has great coverage of accounting material. The addition of IFRS information and the updates to the opening stories are great. I like that the Decision Insights are about businesses the students can relate to."

—JEANNIE LIU, Chaffey College

Outstanding Assignment Material . . .

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

Beyond the Numbers

REPORTING IN ACTION

A1 P4

APPLE

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 and/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 27, 2014, and September 28, 2013?
4. For the fiscal year ended September 27, 2014, what amount is credited to Income Summary to summarize its revenues earned?
5. For the fiscal year ended September 27, 2014, what amount is debited to Income Summary to summarize its expenses incurred?
6. For the fiscal year ended September 27, 2014, what is the balance of its Income Summary account before it is closed?

Fast Forward

7. Access Apple's annual report (10-K) for fiscal years ending after September 27, 2014, at its website (Apple.com) or the SEC's EDGAR database (www.SEC.gov). Assess and compare the September 27, 2014, fiscal year profit margin to any subsequent year's profit margin that you compute.

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 still begin at this point. It is helpful, but not necessary, to use the Working Papers that accompany the book.

SERIAL PROBLEM

Business Solutions

P1 P2 P3 P4 P5

SP 3 After the success of the company's first two months, Santana Rey continues to operate Business Solutions. (Transactions for the first two months are described in the Chapter 2 serial problem.) The November 30, 2016, unadjusted trial balance of Business Solutions (reflecting its transactions for October and November of 2016) follows.

No.	Account Title	Debit	Credit
101	Cash	$38,264	
106	Accounts receivable	12,618	
126	Computer supplies	2,545	
128	Prepaid insurance	2,220	
131	Prepaid rent	3,300	
163	Office equipment	8,000	
164	Accumulated depreciation—Office equipment		$ 0
167	Computer equipment	20,000	
168	Accumulated depreciation—Computer equipment		0
201	Accounts payable		0
210	Wages payable		0
236	Unearned computer services revenue		0
307	Common stock		73,000
318	Retained earnings		0
319	Dividends	5,600	
403	Computer services revenue		25,659
612	Depreciation expense—Office equipment	0	
613	Depreciation expense—Computer equipment	0	
623	Wages expense	2,625	
637	Insurance expense	0	
640	Rent expense	0	
652	Computer supplies expense	0	
655	Advertising expense	1,728	
676	Mileage expense	704	
677	Miscellaneous expenses	250	
684	Repairs expense—Computer	805	
	Totals	$98,659	$98,659

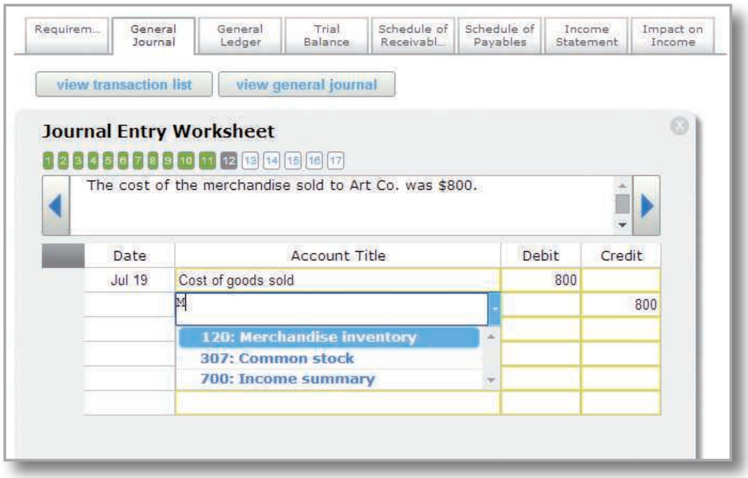
Serial Problems use a continuous running case study to illustrate chapter concepts in a familiar context. The Serial Problem can be followed continuously from the first chapter or picked up at any later point in the book; enough information is provided to ensure students can get right to work.

"The Serial Problems are excellent. . . . I like the continuation of the same problem to the next chapters if applicable. I use the Quick Studies as practice problems. . . . Students have commented that this really works for them if they work (these questions) before attempting the assigned exercises and problems. I also like the discussion (questions) and make this an assignment. You have done an outstanding job presenting accounting to our students."

—JERRI TITTLE, Rose State College

Helps Students Master Key Concepts

General Ledger Problems enable students to see how transactions post. Students can track an amount in any financial statement all the way back to the original journal entry. Critical thinking components then challenge students to analyze the business activities in the problem.



GENERAL LEDGER PROBLEMS

Available in Connect

The **General Ledger** tool in *Connect* allows students to immediately see the financial statements as of a specific date. Each of the following questions begins with an unadjusted trial balance. Using transactions from the following assignment, prepare the necessary adjustments and determine the impact each adjustment has on net income. The financial statements are automatically populated.

GL 3-1 Based on the FastForward illustration in this chapter

Using transactions from the following assignments, prepare the necessary adjustments, create the financial statements, and determine the impact each adjustment has on net income.

GL 3-2 Based on Problem 3-3A

GL 3-3 Extension of Problem 2-1A

GL 3-4 Extension of Problem 2-2A

GL 3-5 Based on Problem 3-6A

GL 3-6 Based on Serial Problem SP 3

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.
- Assignments that involve decision analysis are identified with an icon.

Content Revisions Enhance Learning

This edition's revisions are driven by feedback from instructors and students. They include the following:

- Many new, revised, and updated assignments throughout, including serial problem and entrepreneurial assignments.
- Many Need-to-Know demonstrations added to each chapter at key junctures to reinforce key topics.
- New Sustainability section for each chapter, with examples linked to the company featured in the chapter opener.
- New annual reports and comparative (BTN) assignments: Apple, Google, and Samsung.
- Revised opening layout for each chapter.
- Revised art program, visual infographics, and text layout.
- Updated ratio/tool analysis, using data from well-known firms.
- Revised General Ledger assignments for most chapters.
- Revised material on International Financial Reporting Standards (IFRS).
- New and revised entrepreneurial examples and elements.
- New technology content integrated and referenced in the book.

Chapter 1

Updated opener—Apple.
Updated salary info for accountants and for those with higher degrees.
Streamlined "Fraud Triangle" section.
Updated "Cooking the Books" Fraud box.
Streamlined the "Fundamentals of Accounting" section, including the conceptual framework.
Removed the "Principles and Scruples" box.
Removed the "Economic Downturn" box.
New graphic to launch "Communicating with Users" section on financial statements.
New margin point to highlight layout of income statement.
Streamlined Global View section by removing world map of IFRS coverage.
New discussion of FASB and IASB convergence.
New Sustainability section for **Apple**'s environmental efforts, including SASB.
Updated Decision Insights box on sustainability returns.
New company, **Verizon**, for Decision Analysis section.
Streamlined Appendix 1B.

Chapter 2

NEW opener—Twitter.
Simplified discussion on analyzing and recording process.
Streamlined discussion of classified vs. unclassified balance sheet.
Updated **SPANX** Decision Insight box.
Enhanced Exhibit 2.2 on expanded accounting equation.
Changed selected numbers for FastForward transactions.
Enhanced Exhibit 2.15 on financial links across time.
New layout for Exhibit 2.16 showing financial statements drawn from trial balance.
Updated **Piaggio**'s (IFRS) balance sheet.
Updated "Data Quality" Fraud box with new information from KPMG.
New Sustainability section on **Twitter**'s environmental efforts.
Updated **Skechers**'s ratio analyses.

Chapter 3

NEW opener—GoPro.
Added partial income statement to margins of Exhibits 3.2 and 3.3.
New box on **Saba** accounting fraud and clawbacks.
Enhanced Exhibit 3.4 with added entries and financial statement effects.
Simplified depreciation illustration under "Prepaid Expenses."
New art added to introduce accrued revenues.
Changed selected numbers for FastForward in Exhibits 3.13 through 3.18.
Updated **Piaggio**'s classified balance sheet.
New Sustainability section on **GoPro**'s environmental efforts.
Updated **Limited Brands**'s ratio analyses.
Enhanced Exhibit 3B.1 with explanatory notes at bottom of Excel screen to aid learning.

Chapter 4

NEW opener—Chipotle.
Added T-account to Exhibit 4.4 to aid student understanding.
Enhanced explanation, including entries, for cash and credit purchases.
Simplified purchase returns illustration.
Enhanced explanation to section on transportation costs.
New column added to Exhibit 4.7 to show who owns goods in transit.
Sales entries reflect new revenue recognition rules.
New adjusting entries for future sales discounts and sales returns and allowances.
New Decision Insight box highlights three new accounts.
New NTK 4-2, Part 1 to illustrate sales transactions.
New NTK 4-2, Part 2 to illustrate new adjusting entries.
Revised Exhibit 4.12 covers new revenue recognition rules.
Updated "Merchandising Shenanigans" Fraud box with new data from KPMG.
New Sustainability section for **Chipotle**'s four keys.
Updated gross margin and quick ratios using **JCPenney**.
New Appendix 4C showing entries for gross (and net) method.
Numerous revised and new assignments.
Revised assignments for new revenue recognition rules for sales discounts and sales returns and allowances.

Chapter 5

NEW opener—Tesla Motors.
Updated box on wireless inventory scans.
Updated box on employees receiving kickbacks or gifts from suppliers.
Updated global accounting to remove convergence project reference.
New Sustainability section on **Tesla**'s new-age manufacturing.
Updated inventory ratios section using **Toys "R" Us**.
Appendix 5A: Simplified by deleting detailed review of entries with each method.
Appendix 5B: Revised to be consistent with new revenue recognition rules.

Chapter 6

UPDATED opener—Google.
New image included for bonding certificate.
New discussion of controls over social media with reference to **Facebook**'s "mood" posts.
New discussion of how fraud is detected.
New evidence on how cash is stolen from companies.

Added T-account in margin of bank statement to aid learning.
New table to identify five common items for bank reconciliation.
New discussion of control weaknesses contributing to fraud.
New section on cash spent for **Google's** sustainable initiatives.
Updated receivables analysis using **Hasbro** and **Mattel**.
New learning notes added to bank reconciliation.
New chart for timing differences for bank reconciliation.
Deleted Appendix 6B (now Appendix 4C).
Added several new Quick Study assignments.

Chapter 7

NEW opener—**GrubHub**.
Updated data in Exhibit 7.1.
Updated credit card processing explanation, including links to more explanations.
New list on pros/cons of allowance vs. direct write-off.
New three-step process to estimate bad debts.
New marginal T-accounts to show impact of estimating bad debts.
Expanded Exhibit 7.13 to include the adjusting entry amount.
New Sustainability section on **GrubHub's** efforts.
Revised analysis section with new companies: **IBM** and **Oracle**.

Chapter 8

NEW opener—**Kate Spade**.
Updated data in Exhibit 8.1.
Added info boxes to Exhibits 8.8, 8.10, and 8.12.
New margin notes added for SL and DDB rates.
Updated **Dale Jarrett Racing Adventure** asset listing.
Revised "In Control" Fraud box with new information from KPMG.
New goodwill references to **Facebook** and **WhatsApp**.
New Sustainability section on **Kate Spade's** efforts.
Updated analysis section for **Molson Coors** and **Boston Beer**.

Chapter 9

NEW opener—**Noodles & Co.**
Updated data in Exhibit 9.2.
Clarified bonus explanation and computations.
Updated payroll rates to 2015.
New explanation of *Additional Medicare Tax*.
Updated FUTA rate.
Updated "False Move" Fraud box using new information.
Enhanced payroll reports and related exhibits.
New Sustainability section on **Noodles & Co.'s** environmental initiatives.

Chapter 10

NEW opener—**Box**.
Simplified Exhibit 10.1 for ease of learning.
Reported largest bond offerings in history—**Verizon** and **Apple**.
New bond image from the **Minnesota Vikings**.
Added T-accounts for bond payable and related discounts and premiums to demonstrate pattern over bond life.
New Point explaining what determines bond payments and interest expense.
Updated "Missing Debt" Fraud box using new data from KPMG.
Added T-accounts for bond discounts and premium over bond life in Appendix 10B.
New Decision Insight box on equivalent payments concept to aid learning.
Updated learning notes for bond interest computations.
New Decision Insight box on junk bonds and investment strategy.
New color highlighting for learning amortization.
New Sustainability section on **Box's** nonprofit activities.
Revised analysis section with new company: **Amazon**.

Chapter 11

NEW opener—**Alibaba**.
Updated dividend tax rates.
Updated the **Target** stock quote data.
New five-step process for help in learning accounting for dividends.
Enhanced Exhibit 11.8 to include *declaration* and *issuance* effects.
New reference to **Apple's** 7-for-1 split.
Updated the **Apple** statement of equity.
New Sustainability section on **Alibaba's** program.
Updated learning notes for computations.
Updated PE and dividend yield ratios for **Amazon** and **Altria**.

Chapter 12

NEW opener—**Amazon**.
New infographics for operating, investing, and financing activities.
New Exhibit 12.4 linking cash flow classifications to balance sheet.
Simplified discussion of noncash investing and financing.
New, simplified five-step process for preparing the statement of cash flows.
Streamlined the categories from *three* to *two* for adjustment to income to get operating cash flow.
Simplified cash flows from investing presentation.
New summary T-account for learning statement of cash flows.
New *reconstruction entries* to aid student learning.
New Sustainability section on **Amazon's** initiatives.
Updated cash flow analysis using **Nike**.
Three new Quick Studies and three new Exercises.

Chapter 13

Revised opener—**Morgan Stanley**.
Updated data for analysis of **Apple** throughout using horizontal, vertical, and ratio analysis.
Updated comparative analysis with **Google** and **Samsung**.
New evidence on accounting ruses by CFOs.
Revised "All Else Being Equal" Fraud box to incorporate new data.
Revised Appendix 13A to reflect new rules that eliminate the separate disclosure of *extraordinary items*.
New Sustainability section on **Morgan Stanley's** initiatives.
Revised assignments for new standard on extraordinary items.

Appendix C

New three-step process for fair value adjustment.
New learning note for investee vs. investor securities.
Updated **Google** example for comprehensive income.
Updated returns analysis using **Gap**.

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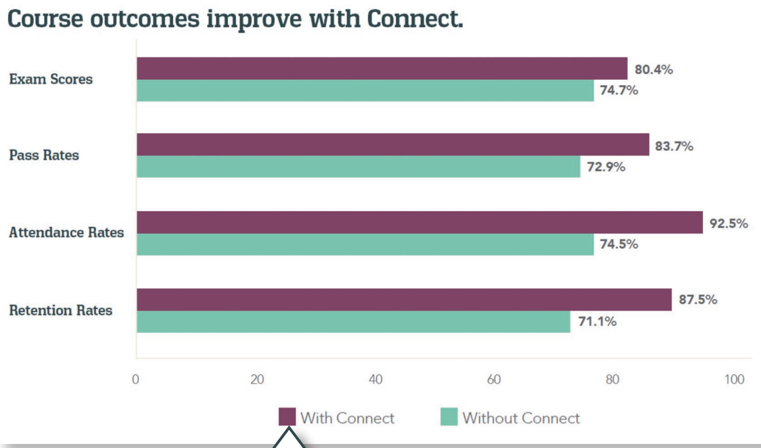

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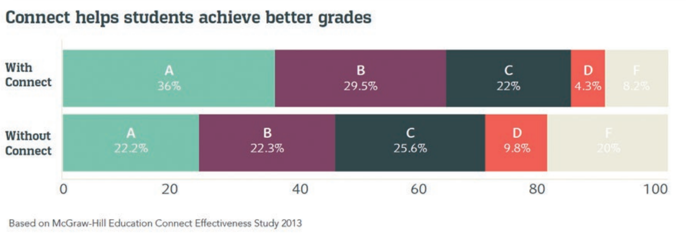

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*Findings based on a 2015 focus group survey at Pellissippi State Community College administered by McGraw-Hill Education

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Brief Contents

*Appendix D is available in McGraw-Hill Connect and as a print copy from a McGraw-Hill Education representative.

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grubHub
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Financial Accounting

chapter 1

Introducing Financial Statements

Chapter Preview

IMPORTANCE OF ACCOUNTING	FUNDAMENTALS OF ACCOUNTING	BUSINESS TRANSACTIONS	FINANCIAL COMMUNICATIONS
C1 Purpose of accounting	**C3** Ethics—Key concept	**A1** Accounting equation and its components	**P2** Income statement
C2 Accounting information users	**C4** Generally accepted accounting principles	Key financial measures	Statement of retained earnings
Opportunities in accounting	Conceptual framework	**P1** Transaction analysis—Illustrated	Balance sheet
	Regulatory setting		Statement of cash flows
			A2 Financial analysis

***Chapter Preview** is organized by key topics and includes learning objectives*
***Learning Objectives** are classified as conceptual, analytical, or procedural*

Learning Objectives

CONCEPTUAL

C1 Explain the purpose and importance of accounting.

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

C3 Explain why ethics are crucial to accounting.

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

C5 *Appendix 1B*—Identify and describe the three major activities of organizations.

ANALYTICAL

A1 Define and interpret the accounting equation and each of its components.

A2 Compute and interpret return on assets.

A3 *Appendix 1A*—Explain the relation between return and risk.

PROCEDURAL

P1 Analyze business transactions using the accounting equation.

P2 Identify and prepare basic financial statements and explain how they interrelate.

ChinaFotoPress/ChinaFotoPress via Getty Images

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

One Smart Apple

"Wherever smart people work, doors are unlocked"—**Steve Wozniak**

CUPERTINO, CA—"When I designed the Apple stuff," says Steve Wozniak (a.k.a. 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." But some dreams do come true. Woz, along with Steve Jobs and Ron Wayne, founded Apple. Today, **Apple** (**Apple.com**) boasts a value of over $700 billion and revenues of over $180 billion—recent revenues and income follow.

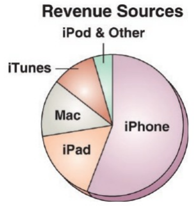
($ billions)	2011	2012	2013	2014
Revenues	$108.2	$156.5	$170.9	$182.8
Net income . . .	25.9	41.7	37.0	39.5

Along the way, the young entrepreneurs faced many challenges, including accounting issues such as how to properly read and interpret accounting data. The first challenge was how to finance the new company, which they did by selling some of their prized possessions, such as Woz's Hewlett-Packard scientific calculator and Jobs's Volkswagen van. The $1,300 they raised helped them purchase the electronic equipment Woz used to build the first Apple computer.

Apple Inc.
NASDAQ: AAPL

$231,839 mil. assets
93,000 employees

Revenue Sources



In setting up their company, the two young entrepreneurs had to decide what type of entity to form—a partnership or a corporation. They decided on a partnership, and Ron Wayne "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." The original partnership agreement included Wayne as a third partner with 10% ownership. However, a few days later, Wayne had a change of heart when he considered the unlimited liability of a partnership. He pulled out, leaving Woz and Jobs holding 50% each. Within nine months, Woz and Jobs identified some advantages to the corporate form of business organization, and they converted Apple to a corporation.

As their company grew, Woz and Jobs had to learn more 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 doubters, including Woz's father, who worried about his son's cash controls. "A person like him shouldn't have that much money," said his father after finding $250,000 worth of uncashed checks in Woz's Porsche.

Woz and Jobs enhanced their accounting system and focused it on providing information for business decisions. Today, 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 2016; *iWoz: From Computer Geek to Cult Icon,* W.W. Norton & Co., 2006; *Founders at Work,* Apress, 2007; *Apple website,* January 2016

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 in which accounting information 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. Exhibit 1.1 portrays these accounting functions.

EXHIBIT 1.1

Accounting Functions

Identifying	Recording	Communicating

Select transactions and events	Input, measure, and log	Prepare, analyze, and interpret
Examples are **Apple**'s sale of iPhones and **TicketMaster**'s receipt of ticket money.	Examples are chronological logs of transactions measured in dollars.	Examples are reports such as financial statements that we analyze and interpret.

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 includes the analysis and interpretation of information.

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.

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 perform various accounting tasks manually, but even they are impacted by technology. As technology makes more information available, the demand for accounting knowledge increases. Consulting, planning, and other financial services are now closely linked to accounting.

Users of Accounting Information

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

Accounting is called the *language of business* because all organizations set up an accounting system to communicate data that help people make better decisions. Exhibit 1.2 divides these people into two user groups, *external users* and *internal users,* and provides examples of each.

EXHIBIT 1.2

Users of Accounting Information

External users

Infographics reinforce key concepts through visual learning

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

Internal users

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

External Information Users **External users** of accounting information do *not* directly run the organization and have limited access to its accounting information. They include shareholders (investors), lenders, directors, customers, suppliers, regulators, lawyers, brokers, and the press. Their business decisions depend on information that is reliable, relevant, and comparable. **Financial accounting** is the area of accounting aimed at serving 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 use information to assess whether an organization will 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 elected to a *board of directors* that oversees an organization. Directors report to shareholders and they hire top executive management.
- *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* have legal authority over certain activities of organizations. For example, the Internal Revenue Service (IRS) requires accounting reports in computing taxes. Other regulators include utility boards that use accounting 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 directly manage and operate the organization such as the chief executive officer (CEO), chief financial officer (CFO), chief audit executive (CAE), treasurer, and other executive or managerial-level employees. **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 unique 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 innovations.
- *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 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

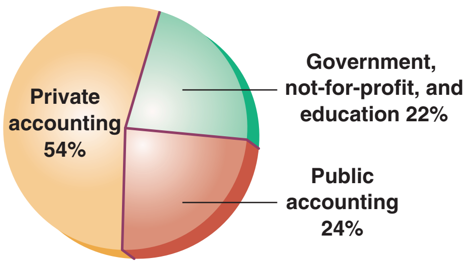
Opportunities in Accounting

Financial	Managerial	Taxation	Accounting-related	
• Preparation	• General accounting	• Preparation	• Lenders	• FBI investigators
• Analysis	• Cost accounting	• Planning	• Consultants	• Market researchers
• Auditing	• Budgeting	• Regulatory	• Analysts	• Systems designers
• Regulatory	• Internal auditing	• Investigations	• Traders	• Merger services
• Consulting	• Consulting	• Consulting	• Directors	• Business valuation
• Planning	• Controller	• Enforcement	• Underwriters	• Forensic accounting
• Criminal investigation	• Treasurer	• Legal services	• Planners	• Litigation support
	• Strategy	• Estate plans	• Appraisers	• Entrepreneurs

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 accounting services such as auditing and taxation. Opportunities also exist in government and not-for-profit agencies, including business regulation and investigation of law violations.

EXHIBIT 1.4

Accounting Jobs by Area



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).

Point: The largest accounting firms are EY, KPMG, PwC, and Deloitte.

***Margin notes** further enhance textual material*

Point: Census Bureau reports that for workers 18 and over, higher education yields higher average pay:

Master's degree	$73,738
Bachelor's degree	56,665
Associate's degree	39,771
High school degree	30,627
No high school degree	20,241

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 (CFOs) 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.

EXHIBIT 1.5

Accounting Salaries for Selected Positions

Field	Title (experience)	2015 Salary	2020 Estimate*
Public Accounting	Partner	$240,000	$265,000
	Manager (6–8 years)	109,500	121,000
	Senior (3–5 years)	88,000	97,000
	Junior (0–2 years)	60,500	67,000
Private Accounting	CFO	290,000	320,000
	Controller/Treasurer	180,000	199,000
	Manager (6–8 years)	98,500	109,000
	Senior (3–5 years)	81,500	90,000
	Junior (0–2 years)	58,000	64,000
Recordkeeping	Full-charge bookkeeper	60,500	67,000
	Accounts manager	58,000	64,000
	Payroll manager	59,500	65,500
	Accounting clerk (0–2 years)	39,500	43,500

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

Point: U.S. Bureau of Labor reports higher education is linked to a lower unemployment rate:

Bachelor's degree or more	3.2%
Associate's degree	4.5%
High school degree	6.0%
No high school degree	9.0%

Point: For updated salary info:
Abbott-Langer.com
www.AICPA.org
Kforce.com

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

NEED-TO-KNOW 1-1

Accounting Users

C1 C2

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

1. ____ Regulator
2. ____ CEO
3. ____ Shareholder
4. ____ Controller
5. ____ Executive employee
6. ____ External auditor
7. ____ Production manager
8. ____ Nonexecutive employee

Solution

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

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

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

C3 Explain why ethics are crucial to accounting.

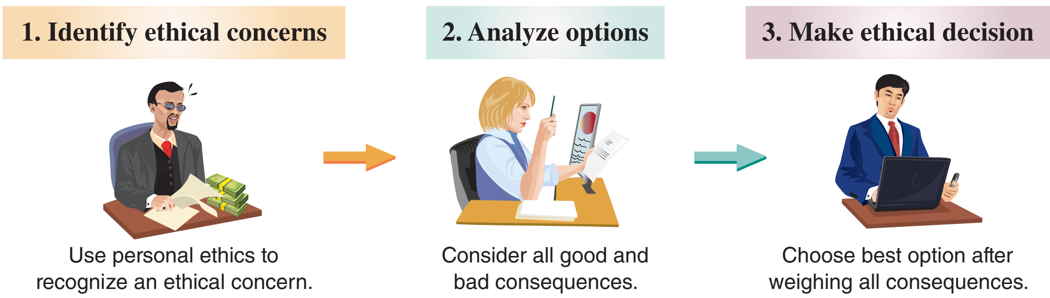
For information to be useful, it must be trusted. This demands ethics in accounting. **Ethics** are beliefs that distinguish right from wrong. They are accepted standards of good and bad behavior.

Identifying the ethical path is 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 that 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.

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

EXHIBIT 1.6

Ethical Decision Making



Accountants face 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.*

Point: A *Code of Professional Conduct* is available at www.AICPA.org.

Fraud Triangle

The fraud triangle asserts that *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 risk of getting caught.
- *Pressure,* or incentive. A person must feel pressure to commit fraud.
- *Rationalization,* or attitude. A person rationalizes the fraud and fails to see its criminal nature or justifies the fraud.

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 detect it. By the time a fraud is discovered, the money is often gone and chances for recovery are slim.

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, promote efficiency, and encourage adherence to policies. Examples are good records, physical controls (locks, passwords, guards), and independent reviews.

Fraud

Cooking the Books Our economic and social welfare depends on reliable accounting. Some individuals forgot that and are now paying their dues. They include Hisao Tanaka (in photo) of **Toshiba**, guilty of inflating income by $1.2 billion over five years; Tsuyoshi Kikukawa of **Olympus**, guilty of hiding $1.7 billion in losses; 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.

KAZUHIRO NOGI/AFP/
Getty Images

Generally Accepted Accounting Principles

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.

Financial accounting is governed by concepts and rules known as **generally accepted accounting principles (GAAP).** We must understand these principles when using 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 aids 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 oversees proper use of GAAP by companies that raise money from the public through issuance of stock and debt. 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

Our global economy creates demand by external users for comparability in accounting reports. 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 global standards were harmonized, one company could potentially use a single set of financial statements across financial markets.

Differences between U.S. GAAP and IFRS have been decreasing in recent years as the FASB and IASB pursued a *convergence* process aimed at reducing inconsistencies. Further, more than 115 countries now require or permit companies to follow IFRS. However, it is clear that convergence will not be achieved anytime soon. More recently, the FASB said it will work on global accounting issues with the IASB through its membership in the Accounting Standards Advisory Forum (ASAF).

The SEC encourages the FASB, when possible, to converge U.S. GAAP to IFRS by endorsing, and thereby incorporating, individual IFRS standards into U.S. GAAP. This process still permits the FASB to modify IFRS when necessary. The SEC maintains its oversight of the FASB, including authority to prescribe accounting principles and standards for U.S. issuers. The SEC also has a role in oversight and governance of the IASB through its involvement on the IFRS Foundation Monitoring Board. For updates on global accounting issues, we can check with the AICPA (**IFRS.com**), FASB (**FASB.org**), and IASB (**ifrs.org**).

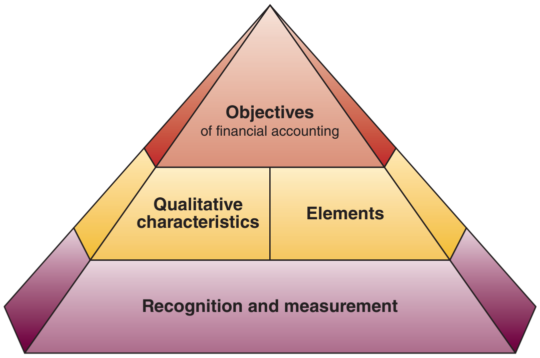
IFRS

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.*
- **Elements**—to define items that financial statements can contain.
- **Recognition and Measurement**—to set criteria that an item must meet for it to be recognized as an element and how to measure that element.



For updates on this joint FASB and IASB conceptual framework convergence we can check the FASB.org or ifrs.org websites. We must remember that U.S. GAAP and IFRS are two similar, but not identical, systems. However, their similarities greatly outweigh differences. The remainder of this section describes key principles and assumptions of accounting.

Principles and Assumptions of Accounting Accounting principles (and assumptions) are of two types. *General principles* are the basic assumptions, concepts, and guidelines for preparing financial statements. *Specific principles* are detailed rules used in reporting business transactions and events. General principles stem from long-used accounting practices. Specific principles arise more often from the rulings of authoritative groups.

We need to understand both general and specific principles to effectively use accounting information. Several general principles are described in this section that are relied on in later chapters. General principles (in purple font with white shading) and assumptions (in red font with white shading) are portrayed as building blocks of GAAP in Exhibit 1.7. The specific principles are described as we encounter them in the book.

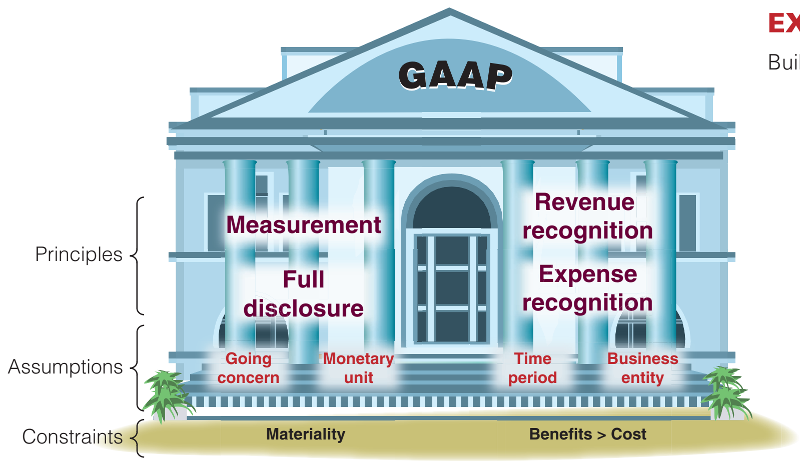


EXHIBIT 1.7
Building Blocks for GAAP

Accounting Principles General principles consist of at least four basic principles, four assumptions, and two constraints.

- *Measurement* The **measurement principle,** also called the **cost principle,** prescribes that accounting information is based on actual cost (with a potential for subsequent adjustments to market). Cost is measured on a cash or equal-to-cash basis. This means if cash is given for a service, its cost is measured by the cash paid. If something besides cash is exchanged (such as a car traded for a truck), cost is measured as the cash value of what is given up or received. The cost principle emphasizes reliability and verifiability, and information based on cost is considered objective. *Objectivity* means that information is supported by independent, unbiased evidence; it demands more than a person's opinion. To illustrate, suppose a company pays $5,000 for equipment. The cost principle requires that this purchase be recorded at $5,000. It makes no difference if the owner thinks this equipment is worth $7,000. Later in the book we introduce *fair value* measures.

Point: The cost principle is also called the *historical cost principle.*