

weygandt
kimmel
kieso

team for success

FINANCIAL ACCOUNTING

NINTH EDITION

WILEY

ACCOUNT CLASSIFICATION AND PRESENTATION

Account Title	Classification	Financial Statement	Normal Balance
A			
Accounts Payable	Current Liability	Balance Sheet	Credit
Accounts Receivable	Current Asset	Balance Sheet	Debit
Accumulated Depreciation—Buildings	Plant Asset—Contra	Balance Sheet	Credit
Accumulated Depreciation—Equipment	Plant Asset—Contra	Balance Sheet	Credit
Advertising Expense	Operating Expense	Income Statement	Debit
Allowance for Doubtful Accounts	Current Asset—Contra	Balance Sheet	Credit
Amortization Expense	Operating Expense	Income Statement	Debit
B			
Bad Debt Expense	Operating Expense	Income Statement	Debit
Bonds Payable	Long-Term Liability	Balance Sheet	Credit
Buildings	Plant Asset	Balance Sheet	Debit
C			
Cash	Current Asset	Balance Sheet	Debit
Common Stock	Stockholders' Equity	Balance Sheet	Credit
Copyrights	Intangible Asset	Balance Sheet	Debit
Cost of Goods Sold	Cost of Goods Sold	Income Statement	Debit
D			
Debt Investments	Current Asset/Long-Term Investment	Balance Sheet	Debit
Depreciation Expense	Operating Expense	Income Statement	Debit
Discount on Bonds Payable	Long-Term Liability—Contra	Balance Sheet	Debit
Dividend Revenue	Other Income	Income Statement	Credit
Dividends	Temporary account closed to Retained Earnings	Retained Earnings Statement	Debit
Dividends Payable	Current Liability	Balance Sheet	Credit
E			
Equipment	Plant Asset	Balance Sheet	Debit
F			
Freight-Out	Operating Expense	Income Statement	Debit
G			
Gain on Disposal of Plant Assets	Other Income	Income Statement	Credit
Goodwill	Intangible Asset	Balance Sheet	Debit
I			
Income Summary	Temporary account closed to Retained Earnings	Not Applicable	(1)
Income Tax Expense	Income Tax Expense	Income Statement	Debit
Income Taxes Payable	Current Liability	Balance Sheet	Credit
Insurance Expense	Operating Expense	Income Statement	Debit
Interest Expense	Other Expense	Income Statement	Debit
Interest Payable	Current Liability	Balance Sheet	Credit
Interest Receivable	Current Asset	Balance Sheet	Debit
Interest Revenue	Other Income	Income Statement	Credit
Inventory	Current Asset	Balance Sheet (2)	Debit

Account Title	Classification	Financial Statement	Normal Balance
L			
Land	Plant Asset	Balance Sheet	Debit
Loss on Disposal of Plant Assets	Other Expense	Income Statement	Debit
M			
Maintenance and Repairs Expense	Operating Expense	Income Statement	Debit
Mortgage Payable	Long-Term Liability	Balance Sheet	Credit
N			
Notes Payable	Current Liability/ Long-Term Liability	Balance Sheet	Credit
P			
Patents	Intangible Asset	Balance Sheet	Debit
Paid-in Capital in Excess of Par— Common Stock	Stockholders' Equity	Balance Sheet	Credit
Paid-in Capital in Excess of Par— Preferred Stock	Stockholders' Equity	Balance Sheet	Credit
Preferred Stock	Stockholders' Equity	Balance Sheet	Credit
Premium on Bonds Payable	Long-Term Liability—Adjunct	Balance Sheet	Credit
Prepaid Insurance	Current Asset	Balance Sheet	Debit
Prepaid Rent	Current Asset	Balance Sheet	Debit
R			
Rent Expense	Operating Expense	Income Statement	Debit
Retained Earnings	Stockholders' Equity	Balance Sheet and Retained Earnings Statement	Credit
S			
Salaries and Wages Expense	Operating Expense	Income Statement	Debit
Salaries and Wages Payable	Current Liability	Balance Sheet	Credit
Sales Discounts	Revenue—Contra	Income Statement	Debit
Sales Returns and Allowances	Revenue—Contra	Income Statement	Debit
Sales Revenue	Revenue	Income Statement	Credit
Selling Expenses	Operating Expense	Income Statement	Debit
Service Revenue	Revenue	Income Statement	Credit
Stock Investments	Current Asset/Long-Term Investment	Balance Sheet	Debit
Supplies	Current Asset	Balance Sheet	Debit
Supplies Expense	Operating Expense	Income Statement	Debit
T			
Treasury Stock	Stockholders' Equity	Balance Sheet	Debit
U			
Unearned Service Revenue	Current Liability	Balance Sheet	Credit
Utilities Expense	Operating Expense	Income Statement	Debit
<p>(1) The normal balance for Income Summary will be credit when there is a net income, debit when there is a net loss. The Income Summary account does not appear on any financial statement.</p> <p>(2) If a periodic system is used, Inventory also appears on the income statement in the calculation of cost of goods sold.</p>			

The following is a sample chart of accounts. It does not represent a comprehensive chart of all the accounts used in this textbook but rather those accounts that are commonly used. This sample chart of accounts is for a company that generates both service revenue as well as sales revenue. It uses the perpetual approach to inventory. If a periodic system was used, the following temporary accounts would be needed to record inventory purchases: Purchases; Freight-In; Purchase Returns and Allowances; and Purchase Discounts.

CHART OF ACCOUNTS				
Assets	Liabilities	Stockholders' Equity	Revenues	Expenses
Cash	Notes Payable	Common Stock	Service Revenue	Amortization Expense
Accounts Receivable	Accounts Payable	Paid-in Capital in Excess of Par—Common Stock	Sales Revenue	Bad Debt Expense
Allowance for Doubtful Accounts	Unearned Service Revenue	Preferred Stock	Sales Discounts	Cost of Goods Sold
Interest Receivable	Salaries and Wages Payable	Paid-in Capital in Excess of Par—Preferred Stock	Sales Returns and Allowances	Depreciation Expense
Inventory	Interest Payable	Treasury Stock	Interest Revenue	Freight-Out
Supplies	Dividends Payable	Retained Earnings	Gain on Disposal of Plant Assets	Income Tax Expense
Prepaid Insurance	Income Taxes Payable	Dividends		Insurance Expense
Land	Bonds Payable	Income Summary		Interest Expense
Equipment	Discount on Bonds Payable			Loss on Disposal of Plant Assets
Accumulated Depreciation—Equipment	Premium on Bonds Payable			Maintenance and Repairs Expense
Buildings	Mortgage Payable			Rent Expense
Accumulated Depreciation—Buildings				Salaries and Wages Expense
Copyrights				Selling Expenses
Goodwill				Supplies Expense
Patents				Utilities Expense

weygandt
kimmel
kieso
team for success

FINANCIAL ACCOUNTING

NINTH EDITION

WILEY

WILEY

Jerry J. Weygandt PhD, CPA

University of Wisconsin—Madison
Madison, Wisconsin

Paul D. Kimmel PhD, CPA

University of Wisconsin—Milwaukee
Milwaukee, Wisconsin

Donald E. Kieso PhD, CPA

Northern Illinois University
DeKalb, Illinois

*Dedicated to
the Wiley sales representatives
who sell our books and service our
adopters in a professional and ethical
manner, and to
Enid, Merlynn, and Donna*

*Vice President & Executive Publisher
Senior Acquisitions Editor
Customer and Market Development Manager
Editorial Operations Manager
Project Editor
Senior Development Editor
Development Editor
Senior Content Manager
Senior Production Editor
Director, Marketing
Senior Marketing Manager
Senior Product Designer
Product Designer
Media Specialist
Design Director
Cover Design
Interior Design
Senior Photo Editor
Editorial Assistant
Marketing Assistant
Cover and title page*

George Hoffman
Michael McDonald
Christopher DeJohn
Yana Mermel
Ed Brislin
Terry Ann Tatro
Margaret Thompson
Dorothy Sinclair
Valerie A. Vargas
Amy Scholz
Karolina Zarychta Honsa
Allison Morris
Greg Chaput
Daniela DiMaggio
Harry Nolan
Maureen Eide
Kristine Carney
Mary Ann Price
Rebecca Constantini
Mia Brady
© Predrag Vuckovic/E+/Getty Images

This book was set in New Aster by Aptara[®], Inc. and printed and bound by Courier-Kendallville.
The cover was printed by Courier-Kendallville.

Founded in 1807, John Wiley & Sons, Inc. has been a valued source of knowledge and understanding for more than 200 years, helping people around the world meet their needs and fulfill their aspirations. Our company is built on a foundation of principles that include responsibility to the communities we serve and where we live and work. In 2008, we launched a Corporate Citizenship Initiative, a global effort to address the environmental, social, economic, and ethical challenges we face in our business. Among the issues we are addressing are carbon impact, paper specifications and procurement, ethical conduct within our business and among our vendors, and community and charitable support. For more information, please visit our website: www.wiley.com/go/citizenship.

Copyright © 2014, 2012, 2010, 2009 John Wiley & Sons, Inc. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning or otherwise, except as permitted under Sections 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc. 222 Rosewood Drive, Danvers, MA 01923, website www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030-5774, (201)748-6011, fax (201)748-6008, website <http://www.wiley.com/go/permissions>.

Evaluation copies are provided to qualified academics and professionals for review purposes only, for use in their courses during the next academic year. These copies are licensed and may not be sold or transferred to a third party. Upon completion of the review period, please return the evaluation copy to Wiley. Return instructions and a free of charge return shipping label are available at www.wiley.com/go/returnlabel. Outside of the United States, please contact your local representative.

ISBN-13 978-1-118-33432-4

Binder-Ready Version ISBN 978-1-118-33843-8

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1



Brief Contents

- 1 Accounting in Action 2
- 2 The Recording Process 54
- 3 Adjusting the Accounts 102
- 4 Completing the Accounting Cycle 164
- 5 Accounting for Merchandising Operations 220
- 6 Inventories 278
- 7 Fraud, Internal Control, and Cash 332
- 8 Accounting for Receivables 386
- 9 Plant Assets, Natural Resources, and Intangible Assets 428
- 10 Liabilities 480
- 11 Corporations: Organization, Stock Transactions, Dividends, and Retained Earnings 542
- 12 Investments 604
- 13 Statement of Cash Flows 648
- 14 Financial Statement Analysis 712

APPENDICES

- A** Specimen Financial Statements: **Apple Inc.** A1
- B** Specimen Financial Statements: **PepsiCo, Inc.** B1
- C** Specimen Financial Statements: **The Coca-Cola Company** C1
- D** Specimen Financial Statements: **Amazon.com, Inc.** D1
- E** Specimen Financial Statements: **Wal-Mart Stores, Inc.** E1
- F** Specimen Financial Statements: **Zetar plc** F1
- G** Time Value of Money G1
- *H** Payroll Accounting H1
- *I** Subsidiary Ledgers and Special Journals I1
- *J** Other Significant Liabilities J1

*Available at the book's companion website, www.wiley.com/college/wegandt.

From the Authors

Dear Student,

Why This Course? Remember your biology course in high school? Did you have one of those “invisible man” models (or maybe something more high-tech than that) that gave you the opportunity to look “inside” the human body? This accounting course offers something similar. To understand a business, you have to understand the financial insides of a business organization. An accounting course will help you understand the essential financial components of businesses. Whether you are looking at a large multinational company like **Apple** or **Starbucks** or a single-owner software consulting business or coffee shop, knowing the fundamentals of accounting will help you understand what is happening. As an employee, a manager, an investor, a business owner, or a director of your own personal finances—any of which roles you will have at some point in your life—you will make better decisions for having taken this course.

Why This Book? Hundreds of thousands of students have used this textbook. Your instructor has chosen it for you because of its trusted reputation. The authors have worked hard to keep the book fresh, timely, and accurate.

“Whether you are looking at a large multinational company like Apple or Starbucks or a single-owner software consulting business or coffee shop, knowing the fundamentals of accounting will help you understand what is happening.”

This textbook contains features to help you learn best, whatever your learning style. We invite you to browse through pages xiv–xviii. These pages describe the main features you will find in this textbook and explain their purpose.

How to Succeed? We’ve asked many students and many instructors whether there is a secret for success in this course. The nearly unanimous answer turns out to be not much of a secret: “Do the homework.” This is one course where doing is learning. The more time you spend on the homework assignments—using the various tools that this textbook provides—the more likely you are to learn the essential concepts, techniques, and methods of accounting. Besides the textbook itself, the book’s companion website also offers various support resources.

Good luck in this course. We hope you enjoy the experience and that you put to good use throughout a lifetime of success the knowledge you obtain in this course. We are sure you will not be disappointed.

Jerry J. Weygandt
Paul D. Kimmel
Donald E. Kieso

Your Team for Success in Accounting



Wiley Accounting is your partner in accounting education. We want to be the first publisher you think of when it comes to quality content, reliable technology, innovative resources, professional training, and unparalleled support for your accounting classroom.

Your Wiley Accounting Team for Success is comprised of three distinctive advantages that you won't find with any other publisher:



Author Commitment

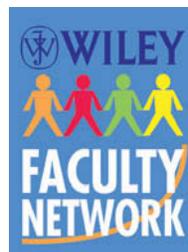
*A Proven Author Team
of Inspired Teachers*

The Team for Success authors bring years of industry and academic experience to the development of each textbook that relates accounting concepts to real-world experiences. This cohesive team brings continuity of writing style, pedagogy, and problem material to each course from Principles to Intermediate so you and your students can seamlessly progress from introductory through advanced courses in accounting.

WileyPLUS

*An Engaging System Plus an Experienced Team
of Support Professionals*

WileyPLUS is a research-based, online environment for effective teaching and learning. The WileyPLUS Account Managers understand the time constraints of busy instructors and act as your personal contact for training, course set-up, and other assistance.



Wiley Faculty Network

*A Team of Educators Dedicated
to Your Professional Development*

The Wiley Faculty Network (WFN) is a global group of seasoned accounting professionals who share best practices in teaching with their peers. Our Virtual Guest Lecture Series provides the opportunity you need for professional development in an online environment that is relevant, convenient, and collaborative. The quality of these seminars and workshops meets the strictest standards, so we are proud to be able to offer valuable CPE credits to attendees.

www.wileyteamforsuccess.com

Author Commitment

Collaboration. Innovation. Experience.

After decades of success as authors of textbooks like this one, Jerry Weygandt, Paul Kimmel, and Don Kieso understand that teaching accounting goes beyond simply presenting data. The authors are truly effective because they know that teaching is about telling compelling stories in ways that make each concept come to life.

Teacher / Author / Professional

Through their textbooks, supplements, online learning tools, and classrooms, these authors have developed a comprehensive pedagogy that engages students in learning and faculty with teaching.

These authors work together throughout the entire process. The end result is a true collaboration where each author brings his individual experience and talent to the development of every paragraph, page, and chapter, thus creating a well-rounded, thorough view on any given accounting topic.

Many Ways in One Direction

Our **Team for Success** has developed a teaching system that addresses every learning style. Each year brings new insights, feedback, ideas, and improvements on how to deliver the material to every student with a passion for the subject in a format that gives them the best chance to succeed.

The key to the team's approach is in understanding that, just as there are many different ways to learn, there are also many different ways to teach.

In Their Own Words

Visit the Wiley **Team for Success** website to hear from the authors first-hand as they discuss their teaching styles, collaboration, and the future of accounting.

www.wileyteamforsuccess.com

Author Commitment



Jerry Weygandt

Jerry J. Weygandt, PhD, CPA, is Arthur Andersen Alumni Emeritus Professor of Accounting at the University of Wisconsin—Madison. He holds a PhD in accounting from the University of Illinois. Articles by Professor Weygandt have appeared in the *Accounting Review*, *Journal of Accounting Research*, *Accounting Horizons*, *Journal of Accountancy*, and other academic and professional journals. These articles have examined such financial reporting issues as accounting for price-level adjustments, pensions, convertible securities, stock option contracts, and interim reports. Professor Weygandt is author of other accounting and financial reporting books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Wisconsin Society of Certified Public Accountants. He has served on numerous committees of the American Accounting Association and as a member of the editorial board of the *Accounting Review*; he also has served as President and Secretary-Treasurer of the American Accounting Association. In addition, he has been actively involved with the American Institute of Certified Public Accountants and has been a member of the Accounting Standards Executive Committee (AcSEC) of that organization. He has served on the FASB task force that examined the reporting issues related to accounting for income taxes and served as a trustee of the Financial Accounting Foundation. Professor Weygandt has received the Chancellor's Award for Excellence in Teaching and the Beta Gamma Sigma Dean's Teaching Award. He is the recipient of the Wisconsin Institute of CPA's Outstanding Educator's Award and the Lifetime Achievement Award. In 2001 he received the American Accounting Association's Outstanding Educator Award.



Paul Kimmel

Paul D. Kimmel, PhD, CPA, received his bachelor's degree from the University of Minnesota and his doctorate in accounting from the University of Wisconsin. He is an Associate Professor at the University of Wisconsin—Milwaukee, and has public accounting experience with Deloitte & Touche (Minneapolis). He was the recipient of the UWM School of Business Advisory Council Teaching Award, the Reggie Taite Excellence in Teaching Award, and a three-time winner of the Outstanding Teaching Assistant Award at the University of Wisconsin. He is also a recipient of the Elijah Watts Sells Award for Honorary Distinction for his results on the CPA exam. He is a member of the American Accounting Association and the Institute of Management Accountants and has published articles in *Accounting Review*, *Accounting Horizons*, *Advances in Management Accounting*, *Managerial Finance*, *Issues in Accounting Education*, *Journal of Accounting Education*, as well as other journals. His research interests include accounting for financial instruments and innovation in accounting education. He has published papers and given numerous talks on incorporating critical thinking into accounting education, and helped prepare a catalog of critical thinking resources for the Federated Schools of Accountancy.



Don Kieso

Donald E. Kieso, PhD, CPA, received his bachelor's degree from Aurora University and his doctorate in accounting from the University of Illinois. He has served as chairman of the Department of Accountancy and is currently the KPMG Emeritus Professor of Accountancy at Northern Illinois University. He has public accounting experience with Price Waterhouse & Co. (San Francisco and Chicago) and Arthur Andersen & Co. (Chicago) and research experience with the Research Division of the American Institute of Certified Public Accountants (New York). He has done postdoctorate work as a Visiting Scholar at the University of California at Berkeley and is a recipient of NIU's Teaching Excellence Award and four Golden Apple Teaching Awards. Professor Kieso is the author of other accounting and business books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Illinois CPA Society. He has served as a member of the Board of Directors of the Illinois CPA Society, then AACSB's Accounting Accreditation Committees, the State of Illinois Comptroller's Commission, as Secretary-Treasurer of the Federation of Schools of Accountancy, and as Secretary-Treasurer of the American Accounting Association. Professor Kieso is currently serving on the Board of Trustees and Executive Committee of Aurora University, as a member of the Board of Directors of Kishwaukee Community Hospital, and as Treasurer and Director of Valley West Community Hospital. From 1989 to 1993 he served as a charter member of the national Accounting Education Change Commission. He is the recipient of the Outstanding Accounting Educator Award from the Illinois CPA Society, the FSA's Joseph A. Silvos Award of Merit, the NIU Foundation's Humanitarian Award for Service to Higher Education, a Distinguished Service Award from the Illinois CPA Society, and in 2003 an honorary doctorate from Aurora University.

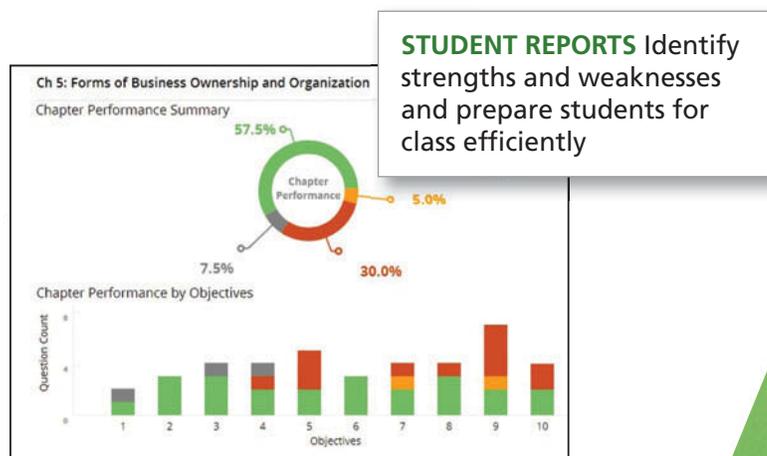
WileyPLUS with ORION

WileyPLUS with ORION helps students learn by learning about them.

Based on cognitive science, **WileyPLUS with ORION** provides students with a personal, adaptive learning experience so they can build their proficiency on topics and use their study time most effectively.

WileyPLUS with ORION is great as:

- An **adaptive pre-lecture** tool that assesses your students' conceptual knowledge so they come to class better prepared.
- A **personalized study guide** that helps students understand both their strengths and the areas where they need to invest more time, especially in preparation for quizzes and exams.



The Wiley Faculty Network

The Place Where Faculty Connect ...

The Wiley Faculty Network is a global community of faculty connected by a passion for teaching and a drive for learning and sharing. Connect with the Wiley Faculty Network to collaborate with your colleagues, find a mentor, attend virtual and live events, and view a wealth of resources all designed to help you grow as an educator. Embrace the art of teaching—great things happen where faculty connect!

Attend

Discover innovative ideas and gain knowledge you can use.

- Training
- Virtual Guest Lectures
- Live Events

View

Explore your resources and development opportunities.

- Teaching Resources
- Archived Guest Lectures
- Recorded Presentations
- Professional Development Modules

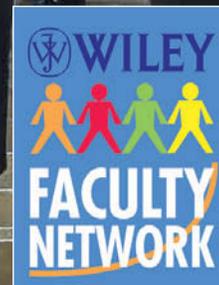
Collaborate

Connect with colleagues—your greatest resource.

- Find a Mentor
- Interest Groups
- Blog

Find out more at

www.wiley.com/college/wfn



Virtual Guest Lectures

Connect with recognized leaders across disciplines and collaborate with your peers on timely topics and discipline-specific issues. Many of these lectures offer CPE credit.

Live and Virtual Events

These invitation-only, discipline-specific events are organized through a close partnership between the WFN, Wiley, and the academic community near the event location.

Technology Training

Discover a wealth of topic- and technology-specific training presented by subject matter experts, authors, and faculty where and when you need it.

Teaching Resources

Propel your teaching and student learning to the next level with quality peer-reviewed case studies, testimonials, classroom tools, and checklists.

Connect with Colleagues

Achieve goals and tackle challenges more easily by enlisting the help of your peers. Connecting with colleagues through the WFN can help you improve your teaching experience.

What's New?

The Ninth Edition expands our emphasis on student learning and improves upon a teaching and learning package that instructors and students have rated the highest in customer satisfaction in the following ways:

Continued Emphasis on Helping Students Learn Accounting Concepts

Especially with this edition of the textbook, we carefully scrutinized all chapter material to help students learn accounting concepts. Throughout all chapters, we added more explanations, examples, and illustrations. For example, we added T-accounts in margins to illustrate the effect of accounting procedures, and we discussed how tight credit policies nearly prevented **Apple** from fulfilling its first sale. Existing explanations were revised and illustrations re-imagined to increase student engagement.

WileyPLUS Enhancements

Over 50 new videos are included in the *WileyPLUS* course for this Ninth Edition. New videos include skill-based videos, narrated PowerPoint presentations, and problem-walkthrough videos.

Orion Adaptive Learning

Available in *WileyPLUS*, Orion is an adaptive study and practice tool that helps students build proficiency in course topics.

Enhanced Homework Material

In each chapter, we updated Self-Test Questions, Questions, Brief Exercises, **DO IT!** Review, Exercises, Problems, and Research Cases. Financial analysis and reporting problems provide students the opportunity to interact with real-world financial statements of **Apple**, **PepsiCo**, **Coca-Cola**, **Amazon.com**, and **Wal-Mart**. Finally, Considering People, Planet, and Profit problems are included to offer students experience in evaluating corporate social responsibility.

Updated Illustrations

As over 50% of the textbook is visual, we especially focused on the illustrations in this edition. For example, we added cash flow effects to the transaction analyses as well as revised all of the infographics, which reinforce important textual concepts.

Student-Friendly Companies

One of the goals of this accounting course is to orient students to the application of accounting principles and techniques in practice. Accordingly, we expanded our practice of using numerous examples from real companies throughout the textbook to add more high-interest enterprises that we hope will increase student engagement, such as **Clif Bar**, **Groupon**, and **REI**.

Content Changes by Chapter

Chapter 1: Accounting in Action

- New Feature Story, on **Clif Bar** and its open-book management program.

Chapter 2: The Recording Process

- Heavily revised Feature Story, now on **MF Global's** failure to segregate company accounts from customer accounts.
- Added cash flow effects in transaction illustrations, to raise student awareness of how business activities also affect a company's cash.
- New Ethics Insight, on **Credit Suisse Group's** failure to properly write down the value of its securities.
- New BYP problems: Real-World Focus based on *New York Times* article discussing **Green Bay Packers'** annual report publication, Ethics Case on résumé fabrications, and Considering People, Planet, and Profit on the role of auditor certifications in the coffee business.

Chapter 3: Adjusting the Accounts

- New Feature Story, on **Groupon** and the complexity of accounting for its revenues.
- Updated Appendix 3B, Concepts in Action, to reflect current conceptual framework which only includes one constraint, that of cost. Materiality now discussed as an aspect of relevance.

Chapter 5: Accounting for Merchandising Operations

- New Feature Story, on **REI** and its unique business model.
- Revised Ethics Insight, on improving company clarity of financial disclosures, by citing **eBay's** sale of Skype.
- Significantly added material to Appendix 5B, Periodic Inventory System, to ensure comprehensive coverage and explanatory material.

Chapter 6: Inventories

- Revised the Accounting Across the Organization on JIT inventory, to illustrate how common events like snowstorms can seriously disrupt inventory levels.
- New Accounting Across the Organization, on **Sony's** inventory management practices.

Chapter 7: Fraud, Internal Control, and Cash

- New material about rising international economic crime in the *A Look at IFRS* section.

- Updated chapter throughout to include use of more recent technology, such as point-of-sale terminals instead of cash registers.

Chapter 8: Accounting for Receivables

- Added T-account in margin in Percentage-of-Receivables section to assist in student understanding.

Chapter 10: Liabilities

- Expanded discussion and new **DO IT!** in Payroll and Payroll Taxes Payable section.
- New Accounting Across the Organization, about advantages for companies of issuing 30-year bonds.
- Revised Analysis section, for improved discussion on debt to assets ratio and times interest earned.

Chapter 11: Corporations: Organization, Stock Transactions, Dividends, and Retained Earnings

- New Accounting Across the Organization, about **Facebook's** recent IPO.

Chapter 12: Investments

- Updated Categories of Securities section, to provide more specific information on account titles and debt/stock categories.

Chapter 13: Statement of Cash Flows

- Updated Feature Story, to include more recent information about **Apple's** cash flow status.
- New Accounting Across the Organization, about **Kodak's** need to sell plant assets to raise cash.
- Presented appendix on statement of cash flows—direct method before the appendix on preparing a worksheet for the statement of cash flows—indirect method, for improved presentation of topics.

Chapter 14: Financial Statement Analysis

- Revised Feature Story on Warren Buffett, to increase student engagement.
- Used **Macy's** as example company throughout chapter.

Appendices A-F: Specimen Financial Statements

Now include financial statements for five student-friendly companies—**Apple**, **PepsiCo**, **Coca-Cola**, **Amazon.com**, and **Wal-Mart**—as well as instructions for accessing and using their complete annual reports. Appendix F presents the financial statements for **Zetar plc**, a U.K. manufacturer of candy and natural snacks.

Active Teaching and Learning Supplementary Material

**WEYGANDT'S INTEGRATED TECHNOLOGY SOLUTIONS
HELPING TEACHERS TEACH AND STUDENTS LEARN**
www.wiley.com/college/weygandt

For Instructors

Textbook Companion Website. On this website, instructors will find electronic versions of the Solutions Manual, Test Bank, Instructor's Manual, Computerized Test Bank, and other resources.

Solutions Manual. The Solutions Manual contains detailed solutions to all questions, brief exercises, **DO IT!** review, exercises, and problems in the textbook as well as suggested answers to the questions and *Broadening Your Perspective* problems.

Instructor's Manual. Included in each chapter are lecture outlines, chapter reviews, and review quizzes.

Test Bank and Computerized Test Bank. The test bank and computerized test bank allow instructors to tailor examinations according to learning objectives and learning outcomes, including professional standards.

PowerPoint™. The PowerPoint™ presentations contain a combination of key concepts, images, and problems from the textbook.

For Students

Textbook Companion Website. On this website, students will find PowerPoint presentations, web quizzing, and other resources. In addition, students can access the B Exercises, Challenge Exercises, C Problems, and Appendices H–J at this site. Finally, a full version of the Continuing Cookie Chronicle problem is included at the student website.

Excel Templates. These spreadsheets allow students to complete select end-of-chapter exercises and problems identified by a spreadsheet icon in the textbook.



Study Guide. A useful tool for review, the Study Guide provides an opportunity for practice through problems and multiple-choice exercises. Demonstration problems, multiple-choice questions, true/false, matching, and other exercises are also included.

General Ledger Software. General ledger software allows students to solve select end-of-chapter text problems using a computerized accounting system. Problems are identified by an icon next to end-of-chapter textbook exercises and problems.



WileyPLUS. Includes numerous tools that help students review and practice for exams, such as Excel working papers, narrated PowerPoint presentations, videos, and more.

Text Options

The Ninth Edition is available in the following different textbook options:

- *Financial Accounting*, 9e (ISBN: 978-1-118-33432-4)
- *Financial Accounting*, 9e, Binder-Ready Version (ISBN: 978-1-118-33843-8)
- *All Access Pack* (ISBN: 978-1-118-84474-8)

Student success is a team effort.

The Team for Success is focused on helping you get the most out of your accounting courses in the digital age.

Students

read it

Access the right amount of information for each course anytime, anywhere, on any device.

Students

see it

Illustrations and interactive tutorials bring the content to life and make accounting concepts easier to understand.

Students

do it

The **DO IT!** exercises throughout the textbook will help you apply your understanding of accounting. The *WileyPLUS* homework format imitates a blank sheet of paper experience using type-ahead for account entry, and helps you catch mistakes early by providing feedback at the part-level.

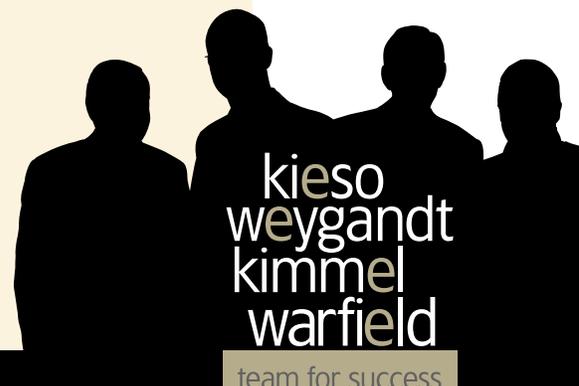
Students

get it

The powerful combination of quality text, visual approach to learning, and highly intuitive homework experience prepares you for class, exams, and future study.

www.wileyteamforsuccess.com

WILEY



read it!

REAL-WORLD CONTEXT

Real-world companies and business situations give you glimpses into how actual companies use accounting.

Feature Stories introduce chapter topics in fun ways using real-world companies that are engaging.

Issues that affect today's business world are highlighted in the textbook.



Comparative Analysis Problem: Amazon.com, Inc. vs. Wal-Mart Stores, Inc.

BYP2-3 Amazon.com, Inc.'s financial statements are presented in Appendix D. Financial statements for Wal-Mart Stores, Inc. are presented in Appendix E. Instructions for accessing and using the complete annual reports of Amazon and Wal-Mart, including the notes to the financial statements, are also provided in Appendices D and E, respectively.

Instructions

(a) Based on the information contained in the financial statements, determine the normal balance of the listed accounts for each company.

Amazon	Wal-Mart
1. Interest Expense	1. Net Sales Revenues
2. Cash and Cash Equivalents	2. Inventories
3. Accounts Payable	3. Cost of Sales

ANATOMY OF A FRAUD

Lawrence Fairbanks, the assistant vice-chancellor of communications at Aesop University, was allowed to make purchases of under \$2,500 for his department without external approval. Unfortunately, he also sometimes bought items for himself, such as expensive antiques and other collectibles. How did he do it? He replaced the vendor invoices he received with fake vendor invoices that he created. The fake invoices had descriptions that were more consistent with the communications department's purchases. He submitted these fake invoices to the accounting department as the basis for their journal entries and to the accounts payable department as the basis for payment.

Total take: \$475,000

THE MISSING CONTROL

Segregation of duties. The university had not properly segregated related purchasing activities. Lawrence was ordering items, receiving the items, and receiving the invoice. By receiving the invoice, he had control over the documents that were used to account for the purchase and thus was able to substitute a fake invoice.

Source: Adapted from Wells, *Fraud Casebook* (2007), pp. 3–15.

Financial Reporting and Analysis

Financial Reporting Problem: Apple Inc.

BYP3-1 The financial statements of Apple Inc. are presented in Appendix A at the end of this textbook. Instructions for accessing and using the company's complete annual report, including the notes to the financial statements, are also provided in Appendix A.

Insight Boxes highlight real-world company issues through international, ethical, and other examples.



ETHICS INSIGHT

Cooking the Books?

Allegations of abuse of the revenue recognition principle have become all too common in recent years. For example, it was alleged that *Krispy Kreme* sometimes doubled the number of doughnuts shipped to wholesale customers at the end of a quarter to boost quarterly results. The customers shipped the unsold doughnuts back after the beginning of the next quarter for a refund. Conversely, *Computer Associates International* was accused of backdating sales—that is, reporting a sale in one period that did not actually occur until the next period in order to achieve the earlier period's sales targets.

? What motivates sales executives and finance and accounting executives to participate in activities that result in inaccurate reporting of revenues? (See page 160.)

© Dean Turner/Stockphoto



A Look at IFRS

Fraud can occur anywhere. Because the three main factors that contribute to fraud are universal in nature, the principles of internal control activities are used globally by companies. While Sarbanes-Oxley (SOX) does not apply to non-U.S. companies, most large international companies have internal controls similar to those indicated in the chapter. IFRS and GAAP are also very similar in accounting for cash. *IAS No. 1 (revised)*, "Presentation of Financial Statements," is the only standard that discusses issues specifically related to cash.

LEARNING OBJECTIVE 9
Compare the accounting procedures for fraud, internal control, and cash under GAAP and IFRS.

see it

CONTENT FOR ALL LEARNING STYLES

In addition to a textbook consistently reviewed as very readable, over 50% of the textbook provides visual presentations and interpretations of content.

Equation Analysis Illustrations visually walk you through the steps of the recording process.

Basic Analysis The expense Insurance Expense is increased \$50, and the asset Prepaid Insurance is decreased \$50.

Equation Analysis

(2)	Assets	=	Liabilities	+	Stockholders' Equity
	Prepaid Insurance	=			Insurance Expense
	-50	=			-50

Debit-Credit Analysis

Debits increase expenses: debit Insurance Expense \$50.
Credits decrease assets: credit Prepaid Insurance \$50.

Journal Entry

Oct. 31	Insurance Expense	50	
	Prepaid Insurance		50
	(To record insurance expired)		

Posting

	Prepaid Insurance	130		Insurance Expense	722
Oct. 4	600	Oct. 31	Adj. 50	Oct. 31	Adj. 50
Oct. 31	Bal. 550			Oct. 31	Bal. 50

Cash Flow Analyses visually summarize the effects of transactions on cash flows.

A	=	L	+	SE
+200				
-200				
Cash Flows				
+200				




Infographics reinforce important textual concepts. All infographics are revised in the Ninth Edition.

Kildare Company has just signed a capitalizable lease contract for equipment that requires rental payments of \$6,000 each, to be paid at the end of each of the next 5 years. The appropriate discount rate is 12%. What is the present value of the rental payments—that is, the amount used to capitalize the leased equipment?

PV = ? \$6,000 \$6,000 \$6,000 \$6,000 \$6,000

← Today 1 2 3 4 5 years

$i = 12\%$
 $n = 5$

Answer: The present value factor from Table 4 is 3.60478 (5 payments at 12%). The present value of 5 payments of \$6,000 each discounted at 12% is **\$21,628.68** ($\$6,000 \times 3.60478$).

Illustrations are clearly identified and often present data in a real-world format.

Academy Company.xls

ACADEMY COMPANY													
Payroll Register													
For the Week Ending January 14, 2014													
Employee	Total Hours	Regular	Over-time	Gross	Deductions				Total	Net Pay	Check No.	Account Debited	Salaries and Wages Expense
					FICA	Federal Income Tax	State Tax	Union Dues					
Office Salaries													
Arnold, Patricia	40	580.00		580.00	44.37	61.00	11.60	15.00	131.97	448.03	998	580.00	
Canlon, Matthew	40	590.00		590.00	45.14	63.00	11.80	20.00	139.94	450.06	999	590.00	
Mueller, William	40	530.00		530.00	40.55	54.00	10.60	11.00	116.15	413.85	1000	530.00	



do it

KNOW THE FUNDAMENTALS

Knowing the fundamentals of accounting will help you understand what is happening in all areas of a business. **DO IT!** exercises throughout the textbook will help you practice your understanding of accounting.

DO IT! exercises in the textbook narrative provide step-by-step applications of a concept at the precise moment you acquire the knowledge. Each **DO IT!** in the textbook narrative includes an **Action Plan**, a **Solution**, and a path of related homework exercises.

> DO IT!

Adjusting Entries for Accruals

Micro Computer Services Inc. began operations on August 1, 2015. At the end of August 2015, management prepares monthly financial statements. The following information relates to August.

- At August 31, the company owed its employees \$800 in salaries and wages that will be paid on September 1.
- On August 1, the company borrowed \$30,000 from a local bank on a 15-year mortgage. The annual interest rate is 10%.
- Revenue for services performed but unrecorded for August totaled \$1,100.

Prepare the adjusting entries needed at August 31, 2015.

Solution

1. Salaries and Wages Expense	800	
Salaries and Wages Payable		800
(To record accrued salaries)		
2. Interest Expense	250	
Interest Payable		250
(To record accrued interest: \$30,000 × 10% × $\frac{1}{12}$ = \$250)		
3. Accounts Receivable	1,100	
Service Revenue		1,100
(To record revenue for services performed)		

Related exercise material: BE3-2, BE3-7, E3-5, E3-6, E3-7, E3-8, E3-9, and **DO IT!** 3-3.

Action Plan

- ✓ Make adjusting entries at the end of the period to recognize revenues for services performed and for expenses incurred.
- ✓ Don't forget to make adjusting entries for accruals. Adjusting entries for accruals will increase both a balance sheet and an income statement account.

The Navigator

Comprehensive DO IT! problems at the end of each chapter apply the **DO IT!** exercises and address **multiple** topics.

> Comprehensive DO IT!

The Green Thumb Lawn Care Inc. began operations on April 1. At April 30, the trial balance shows the following balances for selected accounts.

Prepaid Insurance	\$ 3,600
Equipment	28,000
Notes Payable	20,000
Unearned Service Revenue	4,200
Service Revenue	1,800

> DO IT! Review

Identify timing concepts. (LO 1, 2)

DO IT! 3-1 Several timing concepts are discussed on pages 104–105. A list of concepts is provided below in the left column, with a description of the concept in the right column. There are more descriptions provided than concepts. Match the description to the concept.

1. ___ Cash-basis accounting.	(a) Monthly and quarterly time periods.
2. ___ Fiscal year.	(b) Accountants divide the economic life of a business into artificial time periods.
3. ___ Revenue recognition principle.	(c) Efforts (expenses) should be matched with accomplishments (revenues).
4. ___ Expense recognition principle.	(d) Companies record revenues when they receive cash and record expenses when they pay out cash.

End-of-chapter **DO IT! Review** exercises provide further practice with alternate versions of the in-chapter **DO IT!** exercises.

get it

IMPROVE DECISION-MAKING SKILLS

As an employee, manager, or even a director of your own personal finances, you will make better decisions by learning how to analyze and solve business problems using materials provided at the end of each chapter.

Broadening Your Perspective questions help you pull together concepts from a particular chapter and apply them to real-world business situations. Critical thinking, communication, ethics, and other questions are included in this section at the end of each textbook chapter.

Broadening Your PERSPECTIVE

Financial Reporting and Analysis

Financial Reporting Problem: **Apple Inc.**

BYP3-1 The financial statements of **Apple Inc.** are presented in Appendix A at the end of this textbook. Instructions for accessing and using the company's complete annual report, including the notes to the financial statements, are also provided in Appendix A.

Critical Thinking

Decision-Making Across the Organization



BYP3-6 Happy Camper Park, Inc. was organized on April 1, 2014, by Barbara Evans. Barbara is a good manager but a poor accountant. From the trial balance prepared by a part-time bookkeeper, Barbara prepared the following income statement for the quarter that ended March 31, 2015.

Continuing Cookie Chronicle and **Comprehensive Problems** pull together concepts from multiple chapters and provide a macro perspective of accounting in action.

CONTINUING COOKIE CHRONICLE



(Note: This is a continuation of the Cookie Chronicle from Chapters 1 and 2.)

CCC3 It is the end of November and Natalie has been in touch with her grandmother. Her grandmother asked Natalie how well things went in her first month. Natalie, too, would like to know if she has been profitable or not during the month. Natalie realizes that in order to determine Cookie Creations' income, she needs to make some adjustments.

Go to the book's companion website, www.wiley.com/college/weygandt, to see the solution to this problem.

COMPREHENSIVE PROBLEM: CHAPTERS 3 TO 9

CP9 Hassellhouf Company's trial balance at December 31, 2015, is presented below and on page 471. All 2015 transactions have been recorded except for the items described on page 471.

	Debit	Credit
Cash	\$ 28,000	
Accounts Receivable	36,800	
Notes Receivable	10,000	
Interest Receivable	–0–	
Inventory	36,200	
Prepaid Insurance	3,600	
Land	20,000	

Contents

Chapter 1

Accounting in Action 2

Feature Story: Knowing the Numbers 2

What Is Accounting? 4

Three Activities 4

Who Uses Accounting Data? 5

The Building Blocks of Accounting 7

Ethics in Financial Reporting 7

Generally Accepted Accounting Principles 8

Measurement Principles 9

Assumptions 10

The Basic Accounting Equation 12

Assets 13

Liabilities 13

Stockholders' Equity 13

Using the Accounting Equation 15

Transaction Analysis 16

Summary of Transactions 21

Financial Statements 22

Income Statement 22

Retained Earnings Statement 24

Balance Sheet 24

Statement of Cash Flows 25

APPENDIX 1A Accounting Career Opportunities 30

Public Accounting 30

Private Accounting 30

Governmental Accounting 31

Forensic Accounting 31

"Show Me the Money" 31

A Look at IFRS 50

Chapter 2

The Recording Process 54

Feature Story: Accidents Happen 54

The Account 56

Debits and Credits 56

Summary of Debit/Credit Rules 60

Steps in the Recording Process 61

The Journal 62

The Ledger 65

Posting 66

The Recording Process Illustrated 68

Summary Illustration of Journalizing and Posting 74

The Trial Balance 75

Limitations of a Trial Balance 76

Locating Errors 77

Use of Dollar Signs 77

A Look at IFRS 100

Chapter 3

Adjusting the Accounts 102

Feature Story: Keeping Track of Goupons 102

Timing Issues 104

Fiscal and Calendar Years 104

Accrual- versus Cash-Basis Accounting 104

Recognizing Revenues and Expenses 105

The Basics of Adjusting Entries 106

Types of Adjusting Entries 107

Adjusting Entries for Deferrals 108

Adjusting Entries for Accruals 114

Summary of Basic Relationships 120

The Adjusted Trial Balance and Financial Statements 123

Preparing the Adjusted Trial Balance 123

Preparing Financial Statements 123

APPENDIX 3A Alternative Treatment of Prepaid Expenses and Unearned Revenues 128

Prepaid Expenses 129

Unearned Revenues 130

Summary of Additional Adjustment Relationships 131

APPENDIX 3B Concepts in Action 132

Qualities of Useful Information 132

Assumptions in Financial Reporting 133

Principles in Financial Reporting 133

Cost Constraint 134

A Look at IFRS 161

Chapter 4

Completing the Accounting Cycle 164

Feature Story: Everyone Likes to Win 164

Using a Worksheet 166

Steps in Preparing a Worksheet 167

Preparing Financial Statements from a Worksheet 169

Preparing Adjusting Entries from a Worksheet 171

Closing the Books 171

Preparing Closing Entries 172

Posting Closing Entries 174

Preparing a Post-Closing Trial Balance 176

Summary of the Accounting Cycle 178

Reversing Entries—An Optional Step 179

Correcting Entries—An Avoidable Step 180

The Classified Balance Sheet 181

Current Assets 182

Long-Term Investments 183

Property, Plant, and Equipment 184

- Intangible Assets 184
- Current Liabilities 186
- Long-Term Liabilities 187
- Stockholders' (Owners') Equity 187

APPENDIX 4A Reversing Entries 192

- Reversing Entries Example 192

A Look at IFRS 215

Chapter 5

Accounting for Merchandising Operations 220

Feature Story: Buy Now, Vote Later 220

Merchandising Operations 222

- Operating Cycles 222
- Flow of Costs 223

Recording Purchases of Merchandise 225

- Freight Costs 226
- Purchase Returns and Allowances 227
- Purchase Discounts 228
- Summary of Purchasing Transactions 229

Recording Sales of Merchandise 230

- Sales Returns and Allowances 231
- Sales Discounts 232

Completing the Accounting Cycle 234

- Adjusting Entries 234
- Closing Entries 234
- Summary of Merchandising Entries 235

Forms of Financial Statements 236

- Multiple-Step Income Statement 236
- Single-Step Income Statement 240
- Classified Balance Sheet 240

APPENDIX 5A Worksheet for a Merchandising Company—Perpetual Inventory 244

- Using a Worksheet 244

APPENDIX 5B Periodic Inventory System 246

- Determining Cost of Goods Sold Under a Periodic System 246
- Recording Merchandise Transactions 247
- Recording Purchases of Merchandise 247
- Recording Sales of Merchandise 248
- Journalizing and Posting Closing Entries 249
- Using a Worksheet 250

A Look at IFRS 275

Chapter 6

Inventories 278

Feature Story: "Where Is That Spare Bulldozer Blade?" 278

Classifying and Determining Inventory 280

- Classifying Inventory 280
- Determining Inventory Quantities 281

Inventory Costing 284

- Specific Identification 285
- Cost Flow Assumptions 285
- Financial Statement and Tax Effects of Cost Flow Methods 290
- Using Inventory Cost Flow Methods Consistently 292
- Lower-of-Cost-or-Market 293

Inventory Errors 294

- Income Statement Effects 294
- Balance Sheet Effects 295

Statement Presentation and Analysis 296

- Presentation 296
- Analysis 297

APPENDIX 6A Inventory Cost Flow Methods in Perpetual Inventory Systems 301

- First-In, First-Out (FIFO) 301
- Last-In, First-Out (LIFO) 302
- Average-Cost 302

APPENDIX 6B Estimating Inventories 305

- Gross Profit Method 305
- Retail Inventory Method 306

A Look at IFRS 328

Chapter 7

Fraud, Internal Control, and Cash 332

Feature Story: Minding the Money in Moose Jaw 332

Fraud and Internal Control 334

- Fraud 334
- The Sarbanes-Oxley Act 334
- Internal Control 335
- Principles of Internal Control Activities 336
- Limitations of Internal Control 342

Cash Controls 344

- Cash Receipts Controls 344
- Cash Disbursements Controls 347
- Petty Cash Fund 348

Control Features: Use of a Bank 352

- Making Bank Deposits 352
- Writing Checks 352
- Bank Statements 353
- Reconciling the Bank Account 355
- Electronic Funds Transfer (EFT) System 359

Reporting Cash 360

- Cash Equivalents 360
- Restricted Cash 361

A Look at IFRS 383

Chapter 8

Accounting for Receivables 386

Feature Story: A Dose of Careful Management Keeps Receivables Healthy 386

Types of Receivables 388

Accounts Receivable 388

- Recognizing Accounts Receivable 389
- Valuing Accounts Receivable 390
- Disposing of Accounts Receivable 396

Notes Receivable 399

- Determining the Maturity Date 400
- Computing Interest 401
- Recognizing Notes Receivable 401
- Valuing Notes Receivable 401
- Disposing of Notes Receivable 402

Statement Presentation and Analysis 405

- Presentation 405
- Analysis 405

A Look at IFRS 426

Chapter 9

Plant Assets, Natural Resources, and Intangible Assets 428

Feature Story: How Much for a Ride to the Beach? 428

Plant Assets 430

- Determining the Cost of Plant Assets 430
- Depreciation 433
- Expenditures During Useful Life 441
- Plant Assets Disposals 442

Natural Resources 444

- Depletion 445
- Presentation 445

Intangible Assets 446

- Accounting for Intangible Assets 447
- Research and Development Costs 449

Statement Presentation and Analysis 450

- Presentation 450
- Analysis 451

APPENDIX 9A Exchange of Plant Assets 455

- Loss Treatment 455
- Gain Treatment 456

A Look at IFRS 475

Chapter 10

Liabilities 480

Feature Story: Financing His Dreams 480

Current Liabilities 482

- Notes Payable 482
- Sales Taxes Payable 483
- Payroll and Payroll Taxes Payable 484
- Unearned Revenues 486
- Current Maturities of Long-Term Debt 487
- Statement Presentation and Analysis 488

Long-Term Liabilities 489

- Bond Basics 489
- Accounting for Bond Issues 494

Accounting for Bond Redemptions 498

Accounting for Long-Term Notes Payable 500

Statement Presentation and Analysis 502

APPENDIX 10A Present Value Concepts

Related to Bond Pricing 507

Present Value of a Single Amount 507

Present Value of Interest Payments (Annuities) 509

Time Periods and Discounting 510

Computing the Present Value of a Bond 510

APPENDIX 10B Effective-Interest Method of

Bond Amortization 512

Amortizing Bond Discount 512

Amortizing Bond Premium 514

APPENDIX 10C Straight-Line Amortization 516

Amortizing Bond Discount 516

Amortizing Bond Premium 517

A Look at IFRS 539

Chapter 11

Corporations: Organization, Stock Transactions, Dividends, and Retained Earnings 542

Feature Story: What's Cooking? 542

The Corporate Form of Organization 544

Characteristics of a Corporation 544

Forming a Corporation 546

Stockholder Rights 548

Stock Issue Considerations 548

Corporate Capital 551

Accounting for Stock Transactions 553

Accounting for Common Stock 553

Accounting for Treasury Stock 556

Accounting for Preferred Stock 560

Dividends 562

Cash Dividends 562

Stock Dividends 565

Stock Splits 567

Retained Earnings 569

Retained Earnings Restrictions 570

Prior Period Adjustments 571

Retained Earnings Statement 571

Statement Presentation and Analysis 573

Presentation 573

Analysis 574

APPENDIX 11A Stockholders' Equity

Statement 578

APPENDIX 11B Book Value—Another per Share

Amount 579

Book Value per Share 579

Book Value versus Market Price 580

A Look at IFRS 600

Chapter 12

Investments 604

Feature Story: "Is There Anything Else We Can Buy?" 604

Why Corporations Invest 606

Accounting for Debt Investments 607

Recording Acquisition of Bonds 607

Recording Bond Interest 607

Recording Sale of Bonds 608

Accounting for Stock Investments 609

Holdings of Less than 20% 609

Holdings Between 20% and 50% 610

Holdings of More than 50% 612

Valuing and Reporting Investments 614

Categories of Securities 614

Balance Sheet Presentation 618

Presentation of Realized and Unrealized Gain or Loss 619

Classified Balance Sheet 620

APPENDIX 12A Preparing Consolidated Financial Statements 624

Consolidated Balance Sheet 624

Consolidated Income Statement 627

A Look at IFRS 645

Chapter 13

Statement of Cash Flows 648

Feature Story: Got Cash? 648

The Statement of Cash Flows: Usefulness and Format 650

Usefulness of the Statement of Cash Flows 650

Classification of Cash Flows 650

Significant Noncash Activities 652

Format of the Statement of Cash Flows 652

Preparing the Statement of Cash Flows 654

Indirect and Direct Methods 654

Preparing the Statement of Cash Flows—Indirect Method 655

Step 1: Operating Activities 656

Summary of Conversion to Net Cash Provided by Operating Activities—Indirect Method 660

Step 2: Investing and Financing Activities 661

Step 3: Net Change in Cash 662

Using Cash Flows to Evaluate a Company 665

Free Cash Flow 665

APPENDIX 13A Statement of Cash Flows—Direct Method 670

Step 1: Operating Activities 671

Step 2: Investing and Financing Activities 675

Step 3: Net Change in Cash 677

APPENDIX 13B Using a Worksheet to Prepare the Statement of Cash Flows—Indirect Method 678

Preparing the Worksheet 679

APPENDIX 13C Statement of Cash Flows—T-Account Approach 684

A Look at IFRS 709

Chapter 14

Financial Statement Analysis 712

Feature Story: It Pays to Be Patient 712

Basics of Financial Statement Analysis 714

Need for Comparative Analysis 714

Tools of Analysis 714

Horizontal Analysis 715

Balance Sheet 716

Income Statement 716

Retained Earnings Statement 717

Vertical Analysis 718

Balance Sheet 718

Income Statement 719

Ratio Analysis 720

Liquidity Ratios 722

Profitability Ratios 725

Solvency Ratios 729

Summary of Ratios 730

Earning Power and Irregular Items 733

Discontinued Operations 733

Extraordinary Items 734

Changes in Accounting Principle 735

Comprehensive Income 736

Quality of Earnings 737

Alternative Accounting Methods 737

Pro Forma Income 737

Improper Recognition 738

A Look at IFRS 761

Appendix A

Specimen Financial Statements: Apple Inc. A1

Appendix B

Specimen Financial Statements: PepsiCo, Inc. B1

Appendix C

Specimen Financial Statements: The Coca-Cola Company C1

Appendix D

Specimen Financial Statements: Amazon.com, Inc. D1

Appendix E

Specimen Financial Statements:
Wal-Mart Stores, Inc. E1

Appendix F

Specimen Financial Statements:
Zetar plc F1

Appendix G

Time Value of Money G1

Nature of Interest G1

Simple Interest G1

Compounded Interest G2

Future Value Concepts G2

Future Value of a Single Amount G2

Future Value of an Annuity G4

Present Value Concepts G7

Present Value Variables G7

Present Value of a Single Amount G7

Present Value of an Annuity G9

Time Periods and Discounting G11

Computing the Present Value of a

Long-Term Note or Bond G11

Computing the Present Values in a Capital

Budgeting Decision G14

Using Financial Calculators G16

Present Value of a Single Sum G16

Present Value of an Annuity G17

Useful Applications of the Financial

Calculator G18

Appendix H (available online at
www.wiley.com/college/wegandt)

Payroll Accounting H1

Accounting for Payroll H1

Determining the Payroll H1

Recording the Payroll H5

Employer Payroll Taxes H8

FICA Taxes H9

Federal Unemployment Taxes H9

State Unemployment Taxes H9

Recording Employer Payroll Taxes H9

Filing and Remitting Payroll Taxes H10

Internal Control for Payroll H12

Appendix I (available online at
www.wiley.com/college/wegandt)

Subsidiary Ledgers and Special
Journals I1

Expanding the Ledger—Subsidiary Ledgers I1

Subsidiary Ledger Example I2

Advantages of Subsidiary Ledgers I3

Expanding the Journal—Special Journals I4

Sales Journal I4

Cash Receipts Journal I7

Purchases Journal I11

Cash Payments Journal I13

Effects of Special Journals on the General
Journal I16

Appendix J (available online at
www.wiley.com/college/wegandt)

Other Significant Liabilities J1

Contingent Liabilities J1

Recording a Contingent Liability J1

Disclosure of Contingent Liabilities J2

Lease Liabilities J3

Operating Leases J3

Capital Leases J4

Additional Liabilities for Employee

Fringe Benefits J5

Paid Absences J6

Postretirement Benefits J7

Company Index IN-1

Subject Index IN-3

Acknowledgments

Financial Accounting has benefited greatly from the input of focus group participants, manuscript reviewers, those who have sent comments by letter or e-mail, ancillary authors, and proofers. We greatly appreciate the constructive suggestions and innovative ideas of reviewers and the creativity and accuracy of the ancillary authors and checkers.

Ninth Edition

Shawn Abbott
College of the Siskiyous

Joseph Adamo
Cazenovia College

Pushpa Agrawal
University of Nebraska—Kearney

Sol Ahjarah
SUNY—Buffalo State

Lynn Almond
Virginia Polytechnic Institute

Elizabeth Ammann
Lindenwood University

Timothy Baker
California State University—Fresno

Lisa Banks
Mott Community College

Joyce Barden
DeVry University

Jeffrey Beatty
Fresno City College

Linda Bell
Park University

David Bojarsky
California State University—Long Beach

Jack Borke
University of Wisconsin—Platteville

Anna Boulware
St. Charles Community College

Linda Bressler
University of Houston—Downtown

Robert Brown
Evergreen Valley College

Amy Chang
San Francisco State University

Arthur College
Evergreen Valley College

Steven Day
Dixie State University

Frank Ehresmann
Mercy College

Lori Grady
Bucks County Community College

Andrew Griffith
Iona College

Jeffrey Haber
Iona College

Lynn Krausse
Bakersfield College

Jeffrey T. Kunz
Carroll University

Michael J. MacDonald
University of Wisconsin—Whitewater

Pam Meyer
University of Louisiana—Lafayette

Rosemary Nurre
College of San Mateo

Gary Olsen
Carroll University

Robert Russ
Northern Kentucky University

Susan Sandblom
Scottsdale Community College

Richard Sarkisian
Camden County College

Carl F. Shultz
Rider University

Gregory Sinclair
San Francisco State University

Kathleen J. Smith
University of Nebraska—Kearney

Suzanne Ward
University of Louisiana—Lafayette

Geri B. Wink
Colorado State University—Pueblo

Prior Editions

Dawn Addington
Central New Mexico Community College

Audrey Agnello
Niagara County Community College

John Ahmad
Northern Virginia Community College—Annandale

Matt Anderson
Michigan State University

Joe Anthony
Michigan State University

Art Baja
Ohlone College

Felicia Baldwin
City College of Chicago—Richard J. Daley

Colin Battle
Broward College

Beverly Beatty
Anne Arundel Community College

Jaswinder Bhangal
Chabot College

John Blahnik
Lorain County Community College

Brian Bratten
University of Kentucky—Lexington

Jerry Braun
Daytona State College

Leroy Bugger
Edison State College

Erin Burrell
University of Central Florida

Lisa Capozzoli
College of DuPage

Anne Cardozo
Broward College

Bruce Cassel
SUNY Dutchess Community College

Kimberly Charland
Kansas State University

Milton Chavez-Arias
Ohlone College

Kung Chen
University of Nebraska—Lincoln

Lisa Cole
Johnson County State College

Suzanne Counte
St. Louis Community College—Meramec

Kathy Crusto-Way
Tarrant County College

Robin D'Agati
Palm Beach State College

Karl Dahlberg
Rutgers University—Newark

Dori Danko
Grand Valley State University

Alan Davis
Community College of Philadelphia

Andrew DeJoseph
College of Mount Saint Vincent

Tony Dellarte
Luzerne County Community College

Naman Desai
University of Central Florida

Pam Donahue
Northern Essex Community College

Kathy Dunne
Rider University

Martin Epstein
Central New Mexico Community College

Ann Esarco
McHenry County College

Dora Estes
Volunteer State Community College

Caroline Falconetti
Nassau Community College

Mary Falkey
Prince George's Community College

Roger Gee
San Diego Mesa College

Severin Grabski
Michigan State University

Lori Grady
Bucks County Community College

Joyce Griffin
Kansas City Kansas Community College

Lester Hall
Danville Community College

Becky Hancock
El Paso Community College

Hassan Hefzi
California State Polytechnic University—Pomona

Janice Holmes
Louisiana State University—Baton Rouge

John Hoskins
University of Alabama—Huntsville

Leslie Hubbard
Solano Community College

Daniel Hunt
Ivy Tech Community College

Audrey Hunter
Broward College

John Illig
State College of Florida

Donna Johnston-Blair
Santa Clara University

Naomi Karolinski
Monroe Community College

Nancy Kelly
Middlesex Community College

Ridgway Knight
Santa Monica College

Kenneth Koerber
Bucks County Community College

Sandra Lang
McKendree University

Cathy Xanthaky Larson
Middlesex Community College

David Laurel
South Texas College

Michael Lawrence
Portland Community College

Pamela Legner
College of DuPage

Suneel Maheshwari
Marshall University

Lori Major
Luzerne County Community College

Linda Marquis
Northern Kentucky University

Jim Martin
University of Montevallo

Maureen McBeth
College of DuPage

Evelyn McDowell
Rider University

Jeanette Milius
Iowa Western Community College

Mary Beth Nelson
North Shore Community College

Oluwakemi Onwuchekwa
University of Central Florida

Hong Pak
California State Polytechnic University—Pomona

Glenn Pate
Palm Beach State College

Richard Pettit
Mountain View College

Yvonne Phang
Borough of Manhattan Community College

Mike Prockton
Finger Lakes Community College

Jessica Rakow
Louisiana State University

Raymond Reisig
Pace University—Pleasantville

Richard Sarkisian
Camden County College

Mark Savitskie
Wayne State University

Beth Secrest
Walsh University

William Serafin
Community College of Allegheny County

Walter Silva
Massachusetts Bay Community College

Lois Slutsky
Broward College

Chuck Smith
Iowa Western Community College

Ashley Soliz
Delta State University

Jalal Soroosh
Loyola University Maryland

Frank Stangota
Rutgers University

Dennis Stovall
Grand Valley State University

Grace Stuart-Tuggle
Palm Beach State College

Shafi Ullah
Broward College

Richard Van Ness
Schenectady County Community College

Cynthia Vanoosterum
Ivy Tech Community College

Robert Walsh
University of Dallas

Barbara Warschawski
Schenectady County Community College

Bob Willis
Rogers State University

Jeffrey Wong
Bellevue College

Marj Yuschak
Rutgers University—New Brunswick

WileyPLUS Developers and Reviewers

Carole Brandt-Fink
Laura McNally
Melanie Yon

Ancillary Authors, Contributors, Proofers, and Accuracy Checkers

Ellen Bartley
St. Joseph's College (New York)

LuAnn Bean
Florida Institute of Technology

Jack Borke
University of Wisconsin—Platteville

Sandra Cohen
Columbia College Chicago

Larry Falcetto
Emporia State University

Coby Harmon
*University of California—
Santa Barbara*

Derek Jackson
*Saint Mary's University of
Minnesota*

Douglas Kieso
Aurora University

Jill Misuraca
*Central Connecticut State
University*

Barbara Muller
Arizona State University

Yvonne Phang
*Borough of Manhattan Community
College*

Laura Prosser
Black Hills State University

Lynn Stallworth
Appalachian State University

Teresa Speck
Saint Mary's University of Minnesota

Domenico Tavella
Pittsburgh Technical Institute

Sheila Viel
University of Wisconsin—Milwaukee

Dick Wasson
San Diego State University

We appreciate the exemplary support and commitment given to us by senior acquisitions editor Michael McDonald, customer and market development manager Christopher DeJohn, senior marketing manager Karolina Zarychta Honsa, operations manager Yana Mermel, project editor Ed Brislin, development editors Terry Ann Tatro and Margaret Thompson, senior product designer Allie Morris, product designer Greg Chaput, designers Maureen Eide and Kristine Carney, photo editor Mary Ann Price, Denise Showers at Aptara, Cyndy Taylor, project manager Alverne Bell at Integra, and Steve Martel at SPI Global. All of these professionals provided innumerable services that helped the textbook take shape.

Finally, our thanks to Amy Scholz, Susan Elbe, George Hoffman, Tim Stookesberry, Joe Heider, and Steve Smith for their support and leadership in Wiley's College Division.

We will appreciate suggestions and comments from users—instructors and students alike. You can send your thoughts and ideas about the textbook to us via email at: wileyauthorfeedback@gmail.com.

Jerry J. Weygandt Paul D. Kimmel Donald E. Kieso
Madison, Wisconsin Milwaukee, Wisconsin DeKalb, Illinois

weygandt
kimmel
kieso
team for success

FINANCIAL ACCOUNTING

NINTH EDITION

WILEY

1

Accounting in Action

Feature Story

The Feature Story helps you picture how the chapter topic relates to the real world of accounting and business. You will find references to the story throughout the chapter.



Knowing the Numbers

Many students who take this course do not plan to be accountants. If you are in that group, you might be thinking, “If I’m not going to be an accountant, why do I need to know accounting?” Well, consider this quote from Harold Geneen, the former chairman of **IT&T**: “To be good at your business, you have to know the numbers—cold.” In business, accounting and financial statements are the means for communicating the numbers. If you don’t know how to read financial statements, you can’t really know your business.

Many businesses agree with this view. They see the value of their employees being able to read financial statements and understand how their actions affect the company’s financial results. For example, consider **Clif Bar & Company**. The original Clif Bar® energy bar was created in 1990 by Gary Erickson and his mother in her kitchen. Today, the company has almost 300 employees.

Clif Bar is guided by what it calls its Five Aspirations—Sustaining Our Business, Our Brands, Our People, Our Community, and the Planet. Its website documents its

efforts and accomplishments in these five areas. Just a few examples include the company’s use of organic products to protect soil, water, and biodiversity; the “smart” solar array (the largest in North America), which provides nearly all the electrical needs for its 115,000-square foot building; and the incentives Clif Bar provides to employees to reduce their personal environmental impact, such as \$6,500 toward the purchase of an efficient car or \$1,000 per year for eco-friendly improvements toward their homes.

One of the company’s proudest moments was the creation of an employee stock ownership plan (ESOP) in 2010. This plan gives its employees 20% ownership of the company (Gary and his wife Kit own the other 80%). The ESOP also resulted in Clif Bar enacting an open-book management program, including the commitment to educate all employee-owners about its finances. Armed with this basic financial knowledge, employees are more aware of the financial impact of their actions, which leads to better decisions.

Many other companies have adopted this open-book management approach. But even in companies that do

The Navigator is a learning system designed to prompt you to use the learning aids in the chapter and set priorities as you study.



Learning Objectives give you a framework for learning the specific concepts covered in the chapter.

- Scan Learning Objectives
- Read Feature Story
- Read Preview
- Read text and answer **DO IT!** p. 11
 - p. 14
 - p. 21
 - p. 26
- Work Comprehensive **DO IT!** p. 26
- Review Summary of Learning Objectives
- Answer Self-Test Questions
- Complete Assignments
- Go to **WileyPLUS** for practice and tutorials
- Read **A Look at IFRS** p. 50

Learning Objectives



After studying this chapter, you should be able to:

- [1]** Explain what accounting is.
- [2]** Identify the users and uses of accounting.
- [3]** Understand why ethics is a fundamental business concept.
- [4]** Explain generally accepted accounting principles.
- [5]** Explain the monetary unit assumption and the economic entity assumption.
- [6]** State the accounting equation, and define its components.
- [7]** Analyze the effects of business transactions on the accounting equation.
- [8]** Understand the four financial statements and how they are prepared.



©Dan Moore/iStockphoto

not practice open-book management, employers generally assume that managers in all areas of the company are “financially literate.”

Taking this course will go a long way to making you financially literate. In this textbook, you will learn how to read and prepare financial statements, and how to use

basic tools to evaluate financial results. Throughout this textbook, we attempt to increase your familiarity with financial reporting by providing numerous references, questions, and exercises that encourage you to explore the financial statements of well-known companies.

Preview of Chapter 1

The Preview describes and outlines the major topics and subtopics you will see in the chapter.



The opening story about **Clif Bar & Company** highlights the importance of having good financial information and knowing how to use it to make effective business decisions. Whatever your pursuits or occupation, the need for financial information is inescapable. You cannot earn a living, spend money, buy on credit, make an investment, or pay taxes without receiving, using, or dispensing financial information. Good decision-making depends on good information.

The purpose of this chapter is to show you that accounting is the system used to provide useful financial information. The content and organization of Chapter 1 are as follows.

ACCOUNTING IN ACTION				
What Is Accounting?	The Building Blocks of Accounting	The Basic Accounting Equation	Using the Accounting Equation	Financial Statements
<ul style="list-style-type: none"> • Three activities • Who uses accounting data 	<ul style="list-style-type: none"> • Ethics in financial reporting • Generally accepted accounting principles • Measurement principles • Assumptions 	<ul style="list-style-type: none"> • Assets • Liabilities • Stockholders' equity 	<ul style="list-style-type: none"> • Transaction analysis • Summary of transactions 	<ul style="list-style-type: none"> • Income statement • Retained earnings statement • Balance sheet • Statement of cash flows

What Is Accounting?

LEARNING OBJECTIVE

1

Explain what accounting is.

What consistently ranks as one of the top career opportunities in business? What frequently rates among the most popular majors on campus? What was the undergraduate degree chosen by Nike founder Phil Knight, Home Depot co-founder Arthur Blank, former acting director of the Federal Bureau of Investigation (FBI) Thomas Pickard, and numerous members of Congress? Accounting.¹ Why did these people choose accounting? They wanted to understand what was happening financially to their organizations. Accounting is the financial information system that provides these insights. In short, to understand your organization, you have to know the numbers.

Accounting consists of three basic activities—it **identifies**, **records**, and **communicates** the economic events of an organization to interested users. Let's take a closer look at these three activities.

Three Activities

As a starting point to the accounting process, a company **identifies** the **economic events relevant to its business**. Examples of economic events are the sale of snack chips by PepsiCo, the provision of telephone services by AT&T, and the payment of wages by Ford Motor Company.

Once a company like PepsiCo identifies economic events, it **records** those events in order to provide a history of its financial activities. Recording consists of keeping a **systematic, chronological diary of events**, measured in dollars and cents. In recording, PepsiCo also classifies and summarizes economic events.

Finally, PepsiCo **communicates** the collected information to interested users by means of **accounting reports**. The most common of these reports are called **financial statements**. To make the reported financial information meaningful, PepsiCo reports the recorded data in a standardized way. It accumulates information resulting from similar transactions. For example, PepsiCo accumulates all sales transactions over a certain period of time and reports the data as one amount in the company's financial statements. Such data are said to be reported **in the aggregate**. By presenting the recorded data in the aggregate, the accounting process simplifies a multitude of transactions and makes a series of activities understandable and meaningful.

A vital element in communicating economic events is the accountant's ability to **analyze and interpret** the reported information. Analysis involves use of ratios, percentages, graphs, and charts to highlight significant financial trends and relationships. Interpretation involves **explaining the uses, meaning, and limitations of reported data**. Appendices A–E show the financial statements of Apple Inc., PepsiCo, Inc., The Coca-Cola Company, Amazon.com, Inc., and Wal-Mart Stores, Inc., respectively. (In addition, in the *A Look at IFRS* section at the end of each chapter, the U.K. company Zetar plc is analyzed.) We refer to these statements at various places throughout the textbook. At this point, these financial statements probably strike you as complex and confusing. By the end of this course, you'll be surprised at your ability to understand, analyze, and interpret them.

Illustration 1-1 summarizes the activities of the accounting process.

¹The appendix to this chapter describes job opportunities for accounting majors and explains why accounting is such a popular major.

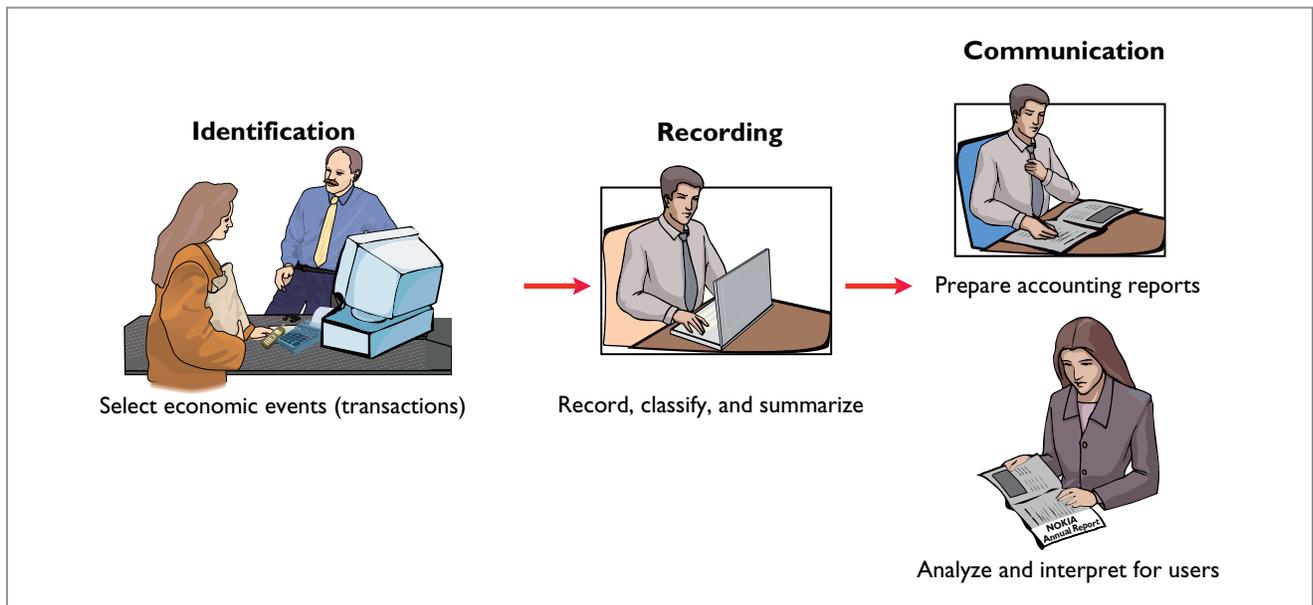


Illustration 1-1
The activities of the accounting process

You should understand that the accounting process **includes** the bookkeeping function. **Bookkeeping** usually involves **only** the recording of economic events. It is therefore just one part of the accounting process. In total, accounting involves **the entire process of identifying, recording, and communicating economic events.**²

Essential terms are printed in blue when they first appear, and are defined in the end-of-chapter glossary.

Who Uses Accounting Data

The financial information that users need depends upon the kinds of decisions they make. There are two broad groups of users of financial information: internal users and external users.

LEARNING OBJECTIVE	2
Identify the users and uses of accounting.	

INTERNAL USERS

Internal users of accounting information are managers who plan, organize, and run the business. These include marketing managers, production supervisors, finance directors, and company officers. In running a business, internal users must answer many important questions, as shown in Illustration 1-2.

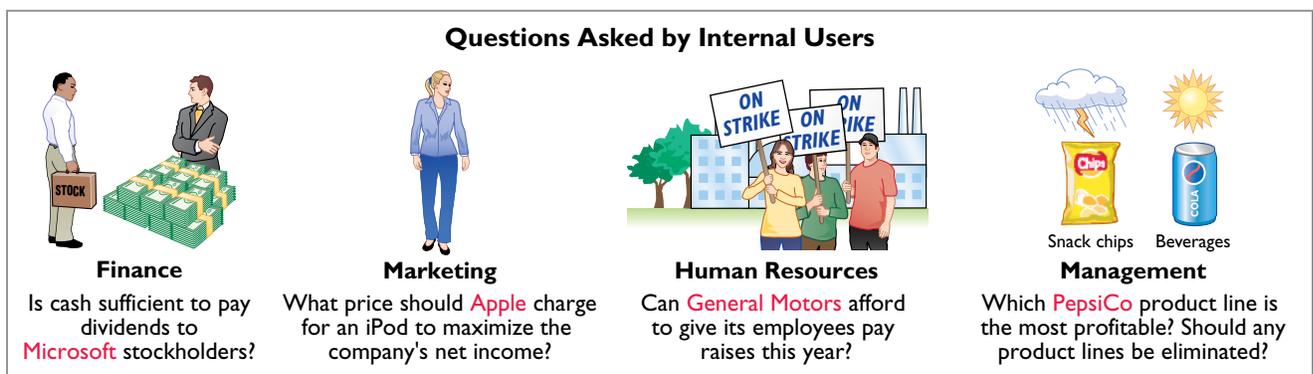


Illustration 1-2
Questions that internal users ask

²The origins of accounting are generally attributed to the work of Luca Pacioli, an Italian Renaissance mathematician. Pacioli was a close friend and tutor to Leonardo da Vinci and a contemporary of Christopher Columbus. In his 1494 text *Summa de Arithmetica, Geometria, Proportione et Proportionalite*, Pacioli described a system to ensure that financial information was recorded efficiently and accurately.

To answer these and other questions, internal users need detailed information on a timely basis. **Managerial accounting** provides internal reports to help users make decisions about their companies. Examples are financial comparisons of operating alternatives, projections of income from new sales campaigns, and forecasts of cash needs for the next year.



ACCOUNTING ACROSS THE ORGANIZATION



The Scoop on Accounting

Accounting can serve as a useful recruiting tool even for the human resources department. **Rhino Foods**, located in Burlington, Vermont, is a manufacturer of specialty ice cream. Its corporate website includes the following:

“Wouldn’t it be great to work where you were part of a team? Where your input and hard work made a difference? Where you weren’t kept in the dark about what management was thinking? . . . Well—it’s not a dream! It’s the way we do business . . . Rhino Foods believes in family, honesty and open communication—we really care about and appreciate our employees—and it shows. Operating results are posted and monthly group meetings inform all employees about what’s happening in the Company. Employees also share in the Company’s profits, in addition to having an excellent comprehensive benefits package.”

Source: www.rhinofoods.com/workforus/workforus.html.



What are the benefits to the company and to the employees of making the financial statements available to all employees? (See page 49.)

© Agnieszka Pastuszak-Maksim/iStockphoto

Accounting Across the Organization boxes demonstrate applications of accounting information in various business functions.

EXTERNAL USERS

External users are individuals and organizations outside a company who want financial information about the company. The two most common types of external users are investors and creditors. **Investors** (owners) use accounting information to decide whether to buy, hold, or sell ownership shares of a company. **Creditors** (such as suppliers and bankers) use accounting information to evaluate the risks of granting credit or lending money. Illustration 1-3 shows some questions that investors and creditors may ask.

Questions Asked by External Users

Investors
Is **General Electric** earning satisfactory income?

Investors
How does **Disney** compare in size and profitability with **Time Warner**?

Creditors
Will **United Airlines** be able to pay its debts as they come due?

Illustration 1-3
Questions that external users ask

Financial accounting answers these questions. It provides economic and financial information for investors, creditors, and other external users. The

information needs of external users vary considerably. **Taxing authorities**, such as the Internal Revenue Service, want to know whether the company complies with tax laws. **Regulatory agencies**, such as the Securities and Exchange Commission or the Federal Trade Commission, want to know whether the company is operating within prescribed rules. **Customers** are interested in whether a company like **General Motors** will continue to honor product warranties and support its product lines. **Labor unions** such as the **Major League Baseball Players Association** want to know whether the owners have the ability to pay increased wages and benefits.

The Building Blocks of Accounting

A doctor follows certain standards in treating a patient's illness. An architect follows certain standards in designing a building. An accountant follows certain standards in reporting financial information. For these standards to work, a fundamental business concept must be at work—ethical behavior.

LEARNING OBJECTIVE

3

Understand why ethics is a fundamental business concept.

Ethics in Financial Reporting

People won't gamble in a casino if they think it is "rigged." Similarly, people won't play the stock market if they think stock prices are rigged. In recent years, the financial press has been full of articles about financial scandals at **Enron**, **WorldCom**, **HealthSouth**, **AIG**, and other companies. As the scandals came to light, mistrust of financial reporting in general grew. One article in the *Wall Street Journal* noted that "repeated disclosures about questionable accounting practices have bruised investors' faith in the reliability of earnings reports, which in turn has sent stock prices tumbling." Imagine trying to carry on a business or invest money if you could not depend on the financial statements to be honestly prepared. Information would have no credibility. There is no doubt that a sound, well-functioning economy depends on accurate and dependable financial reporting.

United States regulators and lawmakers were very concerned that the economy would suffer if investors lost confidence in corporate accounting because of unethical financial reporting. In response, Congress passed the **Sarbanes-Oxley Act (SOX)**. Its intent is to reduce unethical corporate behavior and decrease the likelihood of future corporate scandals. As a result of SOX, top management must now certify the accuracy of financial information. In addition, penalties for fraudulent financial activity are much more severe. Also, SOX increased the independence requirements of the outside auditors who review the accuracy of corporate financial statements and increased the oversight role of boards of directors.

The standards of conduct by which actions are judged as right or wrong, honest or dishonest, fair or not fair, are **ethics**. Effective financial reporting depends on sound ethical behavior. To sensitize you to ethical situations in business and to give you practice at solving ethical dilemmas, we address ethics in a number of ways in this textbook:

1. A number of the *Feature Stories* and other parts of the textbook discuss the central importance of ethical behavior to financial reporting.

Ethics Note

Circus-founder P.T. Barnum is alleged to have said, "Trust everyone, but cut the deck." What Sarbanes-Oxley does is to provide measures that (like cutting the deck of playing cards) help ensure that fraud will not occur.

Ethics Notes help sensitize you to some of the ethical issues in accounting.

2. *Ethics Insight* boxes and marginal *Ethics Notes* highlight ethics situations and issues in actual business settings.
3. Many of the *People, Planet, and Profit Insight* boxes focus on ethical issues that companies face in measuring and reporting social and environmental issues.
4. At the end of the chapter, an *Ethics Case* simulates a business situation and asks you to put yourself in the position of a decision-maker in that case.

When analyzing these various ethics cases, as well as experiences in your own life, it is useful to apply the three steps outlined in Illustration 1-4.

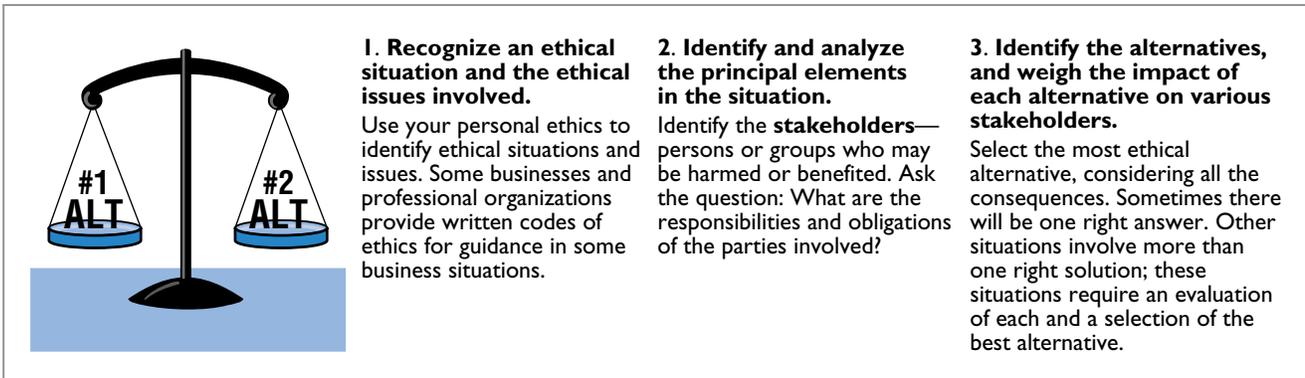


Illustration 1-4
Steps in analyzing ethics cases and situations

Insight boxes provide examples of business situations from various perspectives—ethics, investor, international, and corporate social responsibility. Guideline answers are provided near the end of the chapter.



Gemunu Amarasinghe/AP Photo

ETHICS INSIGHT

The Numbers Behind Not-for-Profit Organizations



Accounting plays an important role for a wide range of business organizations worldwide. Just as the integrity of the numbers matters for business, it matters at least as much at not-for-profit organizations. Proper control and reporting help ensure that money is used the way donors intended. Donors are less inclined to give to an organization if they think the organization is subject to waste or theft. The accounting challenges of some large international not-for-profits rival those of the world's largest businesses. For example, after the Haitian earthquake, the Haitian-born musician Wyclef Jean was criticized for the poor accounting controls in a relief fund that he founded. In response, he hired a new accountant and improved the transparency regarding money raised and spent.



What benefits does a sound accounting system provide to a not-for-profit organization? (See page 49.)

Generally Accepted Accounting Principles

LEARNING OBJECTIVE

4

Explain generally accepted accounting principles.

The accounting profession has developed standards that are generally accepted and universally practiced. This common set of standards is called **generally accepted accounting principles (GAAP)**. These standards indicate how to report economic events.

The primary accounting standard-setting body in the United States is the **Financial Accounting Standards Board (FASB)**. The **Securities and Exchange Commission (SEC)** is the agency of the U.S. government that oversees U.S. financial markets and accounting standard-setting bodies. The SEC relies on the FASB to develop accounting standards, which public companies must follow. Many countries outside of the United States have adopted the accounting standards issued by the **International Accounting Standards Board (IASB)**. These standards are called **International Financial Reporting Standards (IFRS)**.

As markets become more global, it is often desirable to compare the results of companies from different countries that report using different accounting standards. In order to increase comparability, in recent years the two standard-setting bodies have made efforts to reduce the differences between U.S. GAAP and IFRS. This process is referred to as **convergence**. As a result of these convergence efforts, it is likely that someday there will be a single set of high-quality accounting standards that are used by companies around the world. Because convergence is such an important issue, we highlight any major differences between GAAP and IFRS in *International Notes* (as shown in the margin here) and provide a more in-depth discussion in the *A Look at IFRS* section at the end of each chapter.

International Note



Over 100 countries use International Financial Reporting Standards (called IFRS). For example, all companies in the European Union follow international standards. The differences between U.S. and international standards are not generally significant.

International Notes highlight differences between U.S. and international accounting standards.

Measurement Principles

GAAP generally uses one of two measurement principles, the historical cost principle or the fair value principle. Selection of which principle to follow generally relates to trade-offs between relevance and faithful representation. **Relevance** means that financial information is capable of making a difference in a decision. **Faithful representation** means that the numbers and descriptions match what really existed or happened—they are factual.

Helpful Hint

Relevance and faithful representation are two primary qualities that make accounting information useful for decision-making.

HISTORICAL COST PRINCIPLE

The **historical cost principle** (or cost principle) dictates that companies record assets at their cost. This is true not only at the time the asset is purchased, but also over the time the asset is held. For example, if **Best Buy** purchases land for \$360,000, the company initially reports it in its accounting records at \$360,000. But what does Best Buy do if, by the end of the next year, the fair value of the land has increased to \$400,000? Under the historical cost principle, it continues to report the land at \$360,000.

Helpful Hints further clarify concepts being discussed.

FAIR VALUE PRINCIPLE

The **fair value principle** states that assets and liabilities should be reported at fair value (the price received to sell an asset or settle a liability). Fair value information may be more useful than historical cost for certain types of assets and liabilities. For example, certain investment securities are reported at fair value because market price information is usually readily available for these types of assets. In determining which measurement principle to use, companies weigh the factual nature of cost figures versus the relevance of fair value. In general, most companies choose to use cost. Only in situations where assets are actively traded, such as investment securities, do companies apply the fair value principle extensively.