



Survey of
ACCOUNTING

THOMAS P. EDMONDS
CHRISTOPHER T. EDMONDS
PHILIP R. OLDS
FRANCES M. MCNAIR
BOR-YI TSAY

Fourth Edition

fourth edition

Survey of Accounting

Thomas P. Edmonds

University of Alabama—Birmingham

Christopher T. Edmonds

University of Alabama—Birmingham

Philip R. Olds

Virginia Commonwealth University

Frances M. McNair

Mississippi State University

Bor-Yi Tsay

Southern Polytechnic State University



SURVEY OF ACCOUNTING, FOURTH EDITION

Published by McGraw-Hill Education, 2 Penn Plaza, New York, NY 10121. Copyright © 2015 by McGraw-Hill Education. All rights reserved. Printed in the United States of America. Previous editions © 2012, 2010, and 2007. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of McGraw-Hill Education, including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

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

This book is printed on acid-free paper.

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

ISBN 978-0-07-786237-4

MHID 0-07-786237-6

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

Vice President, Content Production & Technology Services: *Kimberly Meriwether David*

Director: *Tim Vertovec*

Executive Brand Manager: *Steve Schuetz*

Executive Director of Development: *Ann Torbert*

Development Editor II: *Katie Jones*

Director of Digital Content: *Patricia Plumb*

Digital Development Editor: *Julie Hankins*

Digital Product Analyst: *Xin Lin*

Senior Marketing Manager: *Michelle Nolte*

Director, Content Production: *Terri Schiesl*

Content Project Manager: *Diane L. Nowaczyk*

Content Project Manager: *Rachel Townsend*

Senior Buyer: *Michael R. McCormick*

Design: *Matt Diamond*

Cover Image: *Simon Carter/Getty Images*

Senior Content Licensing Specialist: *Jeremy Cheshareck*

Typeface: *10.5/12 Times New Roman MT Std*

Compositor: *Aptara[®], Inc.*

Printer: *R. R. Donnelley*

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

Library of Congress Cataloging-in-Publication Data

Edmonds, Thomas P.

Survey of accounting / Thomas P. Edmonds [and four others]. — Fourth edition.

pages cm

Includes index.

Revised edition of: Survey of accounting / Thomas P. Edmonds ... [et al.]. 3rd ed.

ISBN 978-0-07-786237-4 (alk. paper) — ISBN 0-07-786237-6 (alk. paper)

1. Accounting. I. Title.

HF5636.E36 2015

657—dc23

2013041735

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

This book is dedicated to our students, whose questions have so frequently caused us to reevaluate our method of presentation that they have, in fact, become major contributors to the development of this text.

NOTE FROM THE AUTHORS



● LECTURE VIDEOS: A SEA CHANGE IN INSTRUCTIONAL METHODOLOGY

We are excited to announce the availability of instructional videos that explain the content associated with every learning objective introduced throughout the text. *These videos have been developed by a member of the author team and are available when assigned through McGraw-Hill Connect Accounting.* They have the touch and feel of a live lecture as opposed to a canned PowerPoint presentation. The benefits are enormous. Videos allow students to pause for contemplation and note-taking. They permit students to repeat difficult concepts or fast-forward through content they have mastered. In other words, videos enable self-paced learning. No longer is the lecture too fast for some and too slow for others. Now the lecture satisfies the needs of each individual student.

Many accounting educators have taught in professional exam prep courses that make extensive use of video lectures. Now you can bring that prep course learning approach into your everyday classroom. You can use the videos we provide to transform the traditional classroom from a passive listening exercise into an active learning experience. Here are some examples of how you can use instructional videos to improve the classroom environment.

Flip Courses

Instructional videos enable instructors to flip the traditional teaching model. Specifically, instead of providing a lecture in class and then assigning homework, **flip courses** deliver the lecture at home and use the classroom as a place for students to work problems and ask questions. The teacher's function moves from lecturer to coach and tutor. Without a requirement to deliver a lecture, the instructor is free to tutor students in small groups or individually. Instruction becomes more focused and individualized. Indeed, when coupled with *Connect*[®] technology, instructors can obtain real-time feedback that allows them to identify and approach specific students who are having difficulty without disturbing those students who are able to digest the material independently.

Competency-Based Learning Courses

Video instruction enables the implementation of a competency-based grading system. Since learning is self-paced, grades can be assigned on the basis of how deep students go into the content as opposed to an averaging approach. For example, content could be divided into modules. Grades could be assigned based on the number of modules completed successfully. Weaker students could repeat lower-level modules, while stronger students move on to more advanced topics. When you are no longer forced to move students through your class in a lock-step fashion, the potential for improving the learning environment is virtually limitless.

There are many different competency-based models that can be applied to introductory accounting. At this point, our objective is to introduce the general possibilities for improving learning. If you are interested in developing a specific competency-based approach for your classroom, you can speak directly with a member of the author team who has used videos in a variety of settings (contact information is provided on the following page). Standardized lesson plans that can be adapted for use in your individual classroom are available upon request.

Mass Section Courses

Many schools deliver live lectures to mass section classes. Students then break into small groups that are led by teaching assistants or adjunct faculty. While this approach is cost effective, it frequently results in dissatisfaction. Students often find it difficult to see and hear in large lecture halls. Also, the lecture must be set at an average pace which by its nature is too fast for many students and too slow for others. Prerecorded video lectures resolve these issues. They enable students to study the lecture before class. They can then bring questions about the lecture to the breakout sessions. Since videos eliminate the need for mass lectures, there is more time for students to meet in small groups where they are able to receive more individualized attention.

Distance Learning Courses

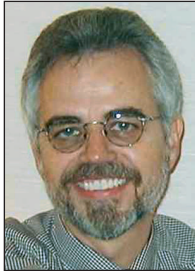
One of the fastest-growing markets in higher education today is Internet-based courses. Many students struggle with these courses. Generally, they would prefer to learn from a lecture but due to timing or location are unable to attend class. Prerecorded video lectures solve this problem by allowing students to access lectures on demand. Until now, the only way to provide video coverage was for the instructor to make personal recordings. Anyone who has tried this knows it is a time-consuming activity. We offer a standardized turn-key course that is composed of prerecorded instructional videos, self-assessment quizzes, and instructor-generated evaluative exams. The instructor simply selects the learning objectives to be covered. There is no simpler way to develop a distance learning course.

Supplement Your Traditional Lecture-Based Course

You do not have to change the way you teach your class to reap many of the benefits available from video instruction. Students who have to miss class or who have trouble comprehending certain concepts can benefit from watching video lectures. Also, many students who attend class will be able to build confidence by watching videos that reinforce the concepts presented in class. Since the videos are tied directly to the learning objectives, you can develop a specific plan for students who are struggling with specific topics. Alternatively, you may offer video instruction to enable advanced students to cover additional topics.

These are only a few opportunities made possible by video lectures. If you would like to discuss these or other possible applications, please contact Chris Edmonds at cedmonds@gmail.com.

ABOUT THE AUTHORS



Thomas P. Edmonds

Thomas P. Edmonds, Ph.D., is Professor Emeritus in the Department of Accounting at the University of Alabama at Birmingham (UAB). He has been actively involved in teaching accounting principles throughout his academic career. Dr. Edmonds has coordinated the accounting principles courses at the University of Houston and UAB. He has taught introductory accounting in mass sections and in distance learning programs. He has received five prestigious teaching awards, including the Alabama Society of CPAs Outstanding Educator Award, the UAB President's Excellence in Teaching Award, and the distinguished Ellen Gregg Ingalls Award for excellence in classroom teaching. He has written numerous articles that have appeared in many publications, including *Issues in Accounting*, the *Journal of Accounting Education*, *Advances in Accounting Education*, *Accounting Education: A Journal of Theory, Practice and Research*, the *Accounting Review*, *Advances in Accounting*, the *Journal of Accountancy*, *Management Accounting*, the *Journal of Commercial Bank Lending*, the *Banker's Magazine*, and the *Journal of Accounting, Auditing, and Finance*. Dr. Edmonds has served as a member of the editorial board for *Advances in Accounting: Teaching and Curriculum Innovations* and *Issues in Accounting Education*. He has published five textbooks, five practice problems (including two computerized problems), and a variety of supplemental materials including study guides, work papers, and solutions manuals. Dr. Edmonds' writing is influenced by a wide range of business experience. He is a successful entrepreneur. He has worked as a management accountant for Refrigerated Transport, a trucking company. Dr. Edmonds also worked in the not-for-profit sector as a commercial lending officer for the Federal Home Loan Bank. In addition, he has acted as a consultant to major corporations, including First City Bank of Houston (now Citi Bank), AmSouth Bank in Birmingham (now Wachovia Bank), Texaco, and Cortland Chemicals. Dr. Edmonds began his academic training at Young Harris Community College in Young Harris, Georgia. He received a B.B.A. degree with a major in finance from Georgia State University in Atlanta, Georgia. He obtained an M.B.A. degree with a concentration in finance from St. Mary's University in San Antonio, Texas. His Ph.D. degree with a major in accounting was awarded by Georgia State University. Dr. Edmonds' work experience and academic training have enabled him to bring a unique user perspective to this textbook.



Christopher T. Edmonds

Christopher T. Edmonds is an Assistant Professor of Accounting at the University of Alabama at Birmingham (UAB). His focus is on new teaching pedagogies such as "flipping the classroom," competency learning, and online education. In his classes, students watch lectures at home and come to class to work with others and practice skills. Although early in his career, Dr. Edmonds has received multiple teaching awards and published several articles in the area of accounting education. He has written articles that appeared in *Issues in Accounting Education*, *Advances in Accounting Education*, *AIS Educators Journal*, and *Advances in Accounting*.

Philip R. Olds

Professor Olds is Associate Professor of Accounting at Virginia Commonwealth University (VCU). He serves as the coordinator of the introduction to accounting courses at VCU. Professor Olds received his A.S. degree from Brunswick Junior College in Brunswick, Georgia (now Coastal Georgia Community College). He received a B.B.A. in accounting from Georgia Southern College (now Georgia Southern University) and his M.P.A. and Ph.D. degrees are from Georgia State University. After graduating from Georgia Southern, he worked as an auditor with the U.S. Department of Labor in Atlanta, Georgia. A former CPA in Virginia, Professor Olds has published articles in various professional journals and presented papers at national and regional conferences. He also served as the faculty adviser to the VCU chapter of Beta Alpha Psi for five years. In 1989, he was recognized with an Outstanding Faculty Vice-President Award by the national Beta Alpha Psi organization. Professor Olds has received both the Distinguished Teaching Award and the Distinguished Service Award from the VCU School of Business.



Frances M. McNair

Frances M. McNair holds the KPMG Peat Marwick Professorship in Accounting at Mississippi State University (MSU). She has been involved in teaching principles of accounting for the past 12 years and currently serves as the coordinator for the principles of accounting courses at MSU. She joined the MSU faculty in 1987 after receiving her Ph.D. from the University of Mississippi. The author of various articles that have appeared in the *Journal of Accountancy*, *Management Accounting*, *Business and Professional Ethics Journal*, *The Practical Accountant*, *Taxes*, and other publications, she also coauthored the book *The Tax Practitioner* with Dr. Denzil Causey. Dr. McNair is currently serving on committees of the American Taxation Association, the American Accounting Association, and the Institute of Management Accountants as well as numerous School of Accountancy and MSU committees.



Bor-Yi Tsay

Bor-Yi Tsay, Ph.D., CPA, is Professor of Accounting at Southern Polytechnic State University (SPSU). He has taught principles of accounting courses at the University of Houston and University of Alabama at Birmingham. He currently teaches a graduate managerial accounting course for SPSU's MBA program and an advanced management accounting course for the Master of Science in Accounting program. Dr. Tsay received the 1996 Loudell Ellis Robinson Excellence in Teaching Award. He has also received numerous awards for his writing and publications, including the John L. Rhoads Manuscripts Award, John Pugsley Manuscripts Award, Van Pelt Manuscripts Award, and three certificates of merit from the Institute of Management Accountants. His articles have appeared in *Journal of Accounting Education*, *Management Accounting*, *Journal of Managerial Issues*, *CPA Journal*, *CMA Magazine*, *Journal of Systems Management*, and *Journal of Medical Systems*. Dr. Tsay received a B.S. degree in Agricultural Economics from National Taiwan University, an M.B.A. degree from Eastern Washington University, and a Ph.D. degree in Accounting from the University of Houston.

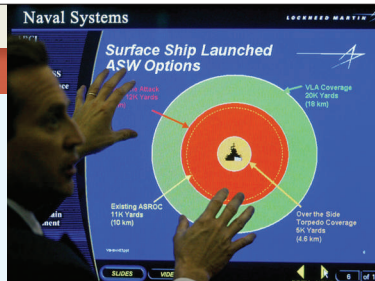


HOW DOES THE BOOK

The Curious Accountant

Lockheed Martin develops and maintains various types of technology related to security. Its biggest customer, by far, is the U.S. government for whom it provides aeronautics and space-system products and services. In 2012, 82 percent of its revenue came from sales to the U.S. government, and another 17 percent came from sales to governments of other countries. Suppose the U.S. government contracted with **Lockheed Martin Corporation** to provide management services related to a governmental hardware and software system, and that the cost of these services will be \$10 million per month. Assume the government offers to pay for the services on the day they are provided (a cash purchase) or 30 days later (a purchase on account).

Assume that Lockheed Martin is absolutely sure the government will pay its account when due. Do you think the company should care whether the government pays for the services upon delivery or 30 days later? Why? (Answer on page 165.)



Answers to The Curious Accountant

Lockheed Martin would definitely prefer to make the sale to the government in cash rather than on account. Even though it may be certain to collect its accounts receivable, the sooner the company gets its cash the sooner the cash can be reinvested.

The interest cost related to a small account receivable of \$50 that takes 30 days to collect may seem immaterial; at 6 percent the lost interest amounts to \$.25. However, when one considers that Lockheed Martin had approximately \$6.6 billion of accounts receivable on December 31, 2012, and took an average of 51 days to collect them, the cost of financing receivables for a real-world company becomes apparent. At 6 percent the cost of waiting 51 days to collect \$6.6 billion of cash is \$55.3 million ($\$6.6 \text{ billion} \times .06 \times 51/365$). For a full year, the cost to Lockheed Martin would be \$396 million ($\$6.6 \text{ billion} \times .06$). In 2012 the weighted-average interest rate on Lockheed Martin's debt was approximately 6 percent.

FOCUS ON INTERNATIONAL ISSUES

LIFO IN OTHER COUNTRIES

This chapter introduced a rather strange inventory cost flow assumption called LIFO. As explained, the primary advantage of LIFO is to reduce a company's income taxes. Given the choice, companies that use LIFO to reduce their taxes would probably prefer to use another method when preparing their GAAP-based financial statements, but the IRS does not permit this. Thus, they are left with no choice but to use the seemingly counterintuitive LIFO assumption for GAAP as well as tax reporting.

What happens in countries other than the United States? International Financial Reporting Standards (IFRS) do not allow the use of LIFO. Most industrialized nations are now using IFRS. You can see the impact of this disparity if you review the annual report of a U.S. company that uses LIFO and has significant operations in other countries. Very often it will explain that LIFO is used to calculate inventory (and cost of goods sold) for domestic operations, but another method is used for activities outside the United States.

For example, here is an excerpt from **General Electric's** 2012 Form 10-K, Note 1.

All inventories are stated at the lower of cost or realizable values. Cost for a significant portion of GE U.S. inventories is determined on a last-in, first-out (LIFO) basis. Cost of other GE inventories is determined on a first-in, first-out (FIFO) basis. LIFO was used for 37% and 38% of GE inventories at December 31, 2012 and 2011, respectively.

If the company has its headquarters in the United States, why not simply use LIFO in its foreign operations? In addition to having to prepare financial statements for the United States, the company probably has to prepare statements for its local operations using the reporting standards of the local country.

Prior to the establishment of IFRS each country was responsible for issuing its own, local GAAP. Even then, most countries did not allow for the use of LIFO.



Real-World Examples

The text provides a variety of thought-provoking, real-world examples of financial and managerial accounting as an essential part of the management process. There are descriptions of accounting practices from Zales. These companies are highlighted in blue in the text.

The Curious Accountant

Each chapter opens with a short vignette that sets the stage and helps pique student interest. These pose a question about a real-world accounting issue related to the topic of the chapter. The answer to the question appears in a separate sidebar a few pages further into the chapter.

Focus on International Issues

These boxed inserts expose students to international issues in accounting.

“The Curious Accountant and Real-World Examples, all make the text better and would make it a pleasure to teach from.”

VIVIAN WINSTON, INDIANA UNIVERSITY

MOTIVATE STUDENTS?

Check Yourself

These short question/answer features occur at the end of each main topic and ask students to stop and think about the material just covered. The answer follows to provide immediate feedback before students go on to a new topic.

Reality Bytes

This feature provides examples or expansions of the topics presented by highlighting companies and showing how they use the accounting concepts discussed in the chapter to make business decisions.

A Look Back/A Look Forward

Students need a roadmap to make sense of where the chapter topics fit into the whole picture. A Look Back reviews the chapter material and a Look Forward introduces new material to come in the next chapter.

✓ CHECK YOURSELF 2.1

During 2014, Anwar Company earned \$345,000 of revenue on account and collected \$320,000 cash from accounts receivable. Anwar paid cash expenses of \$300,000 and cash dividends of \$12,000. Determine the amount of net income Anwar should report on the 2014 income statement and the amount of cash flow from operating activities Anwar should report on the 2014 statement of cash flows.

Answer Net income is \$45,000 (\$345,000 revenue – \$300,000 expenses). The cash flow from operating activities is \$20,000, the amount of revenue collected in cash from customers (accounts receivable) minus the cash paid for expenses (\$320,000 – \$300,000). Dividend payments are classified as financing activities and do not affect the determination of either net income or cash flow from operating activities.

REALITY BYTES

“Closed for Inventory Count” is a sign you frequently see on retail stores sometime during the month of January. Even if companies use a perpetual inventory system, the amount of inventory on hand may be unknown because of lost, damaged, or stolen goods. The only way to determine the amount of inventory on hand is to count it. Why count it in January? Christmas shoppers and many after-Christmas sales shoppers are satiated by mid-January, leaving the stores low on both merchandise and customers. Accordingly, stores have less merchandise to count and “lost sales” are minimized during January. Companies that do not depend on seasonal sales (e.g., a plumbing supplies wholesale business) may choose to count inventory at some other time during the year. Counting inventory is not a revenue-generating activity; it is a necessary evil that should be conducted when it least disrupts operations.



<< A Look Back

This chapter introduced the role of accounting in society and business: to provide information helpful to operating and evaluating the performance of organizations. Accounting is a measurement discipline. To communicate effectively, users of accounting must agree on the rules of measurement. *Generally accepted accounting principles (GAAP)* constitute the rules used by the accounting profession in the United States to govern financial reporting. GAAP is a work in progress that continues to evolve.

>> A Look Forward

To keep matters as simple as possible and to focus on the interrelationships among financial statements, this chapter considered only cash events. Obviously, many real-world events do not involve an immediate exchange of cash. For example, customers use telephone service throughout the month without paying for it until the next month. Such phone usage represents an expense in one month with a cash exchange in the following month. Events such as this are called *accruals*. Understanding the effects that accrual events have on the financial statements is included in Chapter 2.

“The Reality Bytes and Check Yourself sections in the chapters enhance the presentation.”

ROBERT PATTERSON, PENN STATE-ERIE

“I like the Check Yourself examples.”

BRUCE DARLING, UNIVERSITY OF OREGON

HOW ARE CHAPTER CONCEPTS

Regardless of the instructional approach, there is no shortcut to learning accounting. Students must practice to master basic accounting concepts. The text includes a prodigious supply of practice materials and exercises and problems.



Video lectures and accompanying self-assessment quizzes are available for all learning objectives through McGraw-Hill Connect® Accounting.

SELF-STUDY REVIEW PROBLEM

During 2015 Rustic Camp Sites experienced the following transactions.

1. RCS acquired \$32,000 cash by issuing common stock.
2. RCS received \$116,000 cash for providing services to customers (leasing camp sites).
3. RCS paid \$13,000 cash for salaries expense.
4. RCS paid a \$9,000 cash dividend to the owners.
5. RCS sold land that had cost \$100,000 for \$100,000 cash.
6. RCS paid \$47,000 cash for other operating expenses.

Required

- a. Record the transaction data in a horizontal financial statements model like the following one. In the Cash Flow column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The beginning balances have been recorded as an example. They are the ending balances shown on RCS's December 31, 2014, financial statements illustrated in the chapter. Note that the revenue and expense accounts have a zero beginning balance. Amounts in these accounts apply only to a single accounting period.

CHECK FIGURES

Net Income: \$1,600
Ending Retained Earnings: \$20,300

Cash received from common stock issued during 2013	\$ 4,500
Cash	10,500
Revenue	18,000
Salary expense	13,000
Cash flow from operating activities	4,500
Notes payable	6,000
Utility expense	1,800
Dividends	1,000
Cash flow from financing activities	5,000
Rent expense	1,600
Land	25,000
Retained earnings, January 1, 2014	19,700
Common stock, December 31, 2014	20,000

Required

- a. Prepare the income statement Black would include in its 2014 annual report.
- b. Identify the accounts that should be closed to the Retained Earnings account.
- c. Determine the Retained Earnings account balance at December 31, 2014. Identify the reasons for the difference between net income and the ending balance in Retained Earnings.
- d. What are the balances in the Revenue, Expense, and Dividend accounts on January 1, 2015? Explain.

LO 2-1, 2-2, 2-3, 2-4,
2-5, 2-6

CHECK FIGURES

b. \$55,000
h. \$(20,000)

Problem 2-35 Effect of events on financial statements

Davis Company had the following balances in its accounting records as of December 31, 2013:

Assets		Liabilities and Equity	
Cash	\$ 60,000	Accounts Payable	\$ 32,000
Accounts Receivable	45,000	Common Stock	60,000
Land	35,000	Retained Earnings	48,000
Totals	\$140,000	Totals	\$140,000

The following accounting events apply to Davis for 2014:

- | | | |
|-------|----|-------------------------------------------------------------------------------------------------------------------|
| Jan. | 1 | Acquired an additional \$30,000 cash from the issue of common stock. |
| April | 1 | Paid \$7,200 cash in advance for a one-year lease for office space. |
| June | 1 | Paid a \$5,000 cash dividend to the stockholders. |
| July | 1 | Purchased additional land that cost \$40,000 cash. |
| Aug. | 1 | Made a cash payment on accounts payable of \$21,000. |
| Sept. | 1 | Received \$9,600 cash in advance as a retainer for services to be performed monthly during the next eight months. |
| Sept. | 30 | Sold land for \$20,000 cash that had originally cost \$20,000. |
| Oct. | 1 | Purchased \$1,200 of supplies on account. |
| Dec. | 31 | Earned \$75,000 of service revenue on account during the year. |
| | 31 | Received \$62,000 cash collections from accounts receivable. |
| | 31 | Incurred \$27,000 other operating expenses on account during the year. |
| | 31 | Recognized accrued salaries expense of \$18,000. |
| | 31 | Had \$100 of supplies on hand at the end of the period. |
| | 31 | The land purchased on July 1 had a market value of \$56,000. |
| | 31 | Recognized \$120 of accrued interest revenue. |

Required

Based on the preceding information for Davis Company answer the following questions. All questions pertain to the 2014 financial statements. (*Hint:* Record the events in general ledger accounts under an accounting equation before answering the questions.)

- a. What two additional adjusting entries need to be made at the end of the year?
- b. What amount would be reported for land on the balance sheet?
- c. What amount of net cash flow from operating activities would be reported on the statement of cash flows?

Self-Study Review Problem

These sections offer problems and solutions of major chapter concepts.

Exercise and Problem Sets

• Check figures

The figures provide a quick reference for students to check on their progress in solving the problem.

REINFORCED?

Analyze, Think, Communicate (ATC)

Each chapter includes an innovative section entitled Analyze, Think, Communicate (ATC). This section contains:

- Business application cases related to the annual report for Target Company

- Writing Assignments



- Group Exercises



- Ethics Cases



- Internet Assignments



- Real Company Examples



- Target Corp.



ANALYZE, THINK, COMMUNICATE

ATC 2-1 Business Applications Case Understanding real-world annual reports

Required

Use the [Target Corporation's](#) Form 10-K to answer the following questions related to Target's 2012 fiscal year (year ended February 2, 2013). Target's Form 10-K is available on the company's website or through the SEC's EDGAR database. Appendix A provides instructions for using the EDGAR database.



- Which accounts on Target's balance sheet are accrual-type accounts?
- Which accounts on Target's balance sheet are deferral-type accounts?
- Compare Target's 2012 *net earnings* (the year ended February 2, 2013) to its 2012 *cash provided by operating activities*. Which is larger?
- First, compare Target's 2011 net income to its 2012 net income. Next, compare Target's 2011 cash provided by operating activities to its 2012 cash provided by operating activities. Which changed the most from 2011 to 2012, net earnings or cash provided by operating activities?

ATC 2-2 Group Assignment Financial reporting and market evaluation

The following financial highlights were drawn from the 2012 annual reports of [Exxon Mobil Corporation](#) and [Apple Inc.](#)



	Exxon	Apple
Revenue	\$492.3 Billion	\$156.5 Billion
Net income	\$ 44.9 Billion	\$ 41.7 Billion
Cash and short-term investments	\$ 38.1 Billion	\$ 29.1 Billion

ATC 4-3 Research Assignment Investigating cash and management issues at Smucker's



Using the most current Form 10-K available on EDGAR, or the company's website, answer the following questions about the [J. M. Smucker Company](#). Instructions for using EDGAR are in Appendix A. *Note: In some years the financial statements, footnotes, etc., portion of Smucker's annual report have been located at the end of the Form 10-K, in or just after "Item 15."*

Required

- Instead of "Cash," the company's balance sheet uses the account name "Cash and cash equivalents." How does the company define cash equivalents?
- The annual report has two reports in which management clearly acknowledges its responsibility for the company's financial reporting and internal controls. What are the names of these reports and on what pages are they located?

ATC 4-4 Writing Assignment Internal control procedures



Sarah Johnson was a trusted employee of Evergreen Trust Bank. She was involved in everything. She worked as a teller, she accounted for the cash at the other teller windows, and she recorded many of the transactions in the accounting records. She was so loyal that she never would take a day off, even when she was really too sick to work. She routinely worked late to see that all the day's work was posted into the accounting records. She would never take even a day's vacation because they might need her at the bank. Adam and Jammie, CPAs, were hired to perform an audit, the first complete audit that had been done in several years. Johnson seemed somewhat upset by the upcoming audit. She said that everything had been properly accounted for and that the audit was a needless expense. When Adam and Jammie examined some of the bank's internal control procedures, it discovered problems. In fact, as the audit progressed, it became apparent that a large amount of cash was missing. Numerous adjustments had been made to customer accounts with credit memorandums, and many of the transactions had been posted several days late. In addition, there were numerous cash payments for "office expenses." When the audit was complete, it was determined that more than \$100,000 of funds was missing or improperly accounted for. All fingers pointed to Johnson. The bank's president, who was a close friend of Johnson, was bewildered. How could this type of thing happen at this bank?

Required

Prepare a written memo to the bank president, outlining the procedures that should be followed to prevent this type of problem in the future.

ATC 4-5 Ethical Dilemma I need just a little extra money



John Riley, a certified public accountant, has worked for the past eight years as a payroll clerk for Southeast Industries, a small furniture manufacturing firm in the Northeast. John recently experienced unfortunate circumstances. His teenage son required major surgery and the medical bills not covered by John's insurance have financially strained John's family.

"I like the real life examples; I like the Analyze, Think and Communicate."

DEBBIE GAHR, WAUKESHA COUNTY TECHNICAL COLLEGE

WHAT WE DID TO MAKE IT BETTER!

As discussed in the “Note from the Authors” this text has been revised to include video lectures that provide coverage of all of the learning objectives included in the text. These videos have been developed by a member of the author team and have the touch and feel of a live lecture as opposed to a canned PowerPoint presentation with scripted narration. The videos provide unparalleled opportunities for instructional innovation including the development of flip courses, distance learning courses, and competency-based teaching. The videos can also be used in traditional courses to help students who need additional instruction. For example, students who are unable to keep up in class or who have to miss class now have a video lecture that can be used to catch up. The videos can be assigned to individual students or to the class as a whole through McGraw-Hill Connect. The instructor has complete control over student access to video content and the accompanying self-assessment quizzes.

Beyond the lecture videos we have reorganized Chapters 1 and 2 to provide greater flexibility in establishing the pace of coverage. The proper pace is, of course, dependent on student aptitude. Since student aptitude varies widely across schools, the pace of coverage must also vary. To enhance flexibility, we divided Chapters 1 and 2 into sections.

Chapter 1, Section 1 covers basic terminology, introduces the accounting equation, and demonstrates how business events are recorded under the accounting equation. Section 2 introduces financial statements. The end-of-chapter exercises and problems are also segregated in separate sections. With this arrangement it is easy for instructors to treat the chapter as two separate chapters, thereby slowing the pace and allowing more time to cover key conceptual issues. Chapter 2 has also been divided into two sections: Chapter 2, Section 1 covers accruals, while Section 2 covers deferrals.

Breaking the chapters into sections offers an added benefit of promoting a stepwise learning environment. The primary concepts are isolated and introduced in a simple environment. More complex relationships and details are then added to the basic foundation. Stepwise learning is a hallmark of our teaching strategy.

The revision also includes many more detailed changes for each chapter. These changes are described below:

● CHAPTER SPECIFIC CHANGES

Chapter 1 An Introduction to Accounting

- Added video lectures and self-assessment quizzes for each learning objective.
- Divided chapter into two sections thereby providing more flexibility to set the pace of instruction.
- New *Curious Accountant* featuring new high-profile companies and products.
- Updated *Focus on International Issues* textbox that includes IFRS coverage.
- New *Reality Bytes*.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 2 Accounting for Accruals and Deferrals

- Added video lectures and self-assessment quizzes for each learning objective.
- Divided chapter into two sections thereby providing more flexibility to set the pace of instruction.
- Revised learning objectives.

- New *Curious Accountant* featuring new high-profile companies and products.
- New *Reality Bytes*.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 3 Accounting for Merchandising Businesses

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* featuring new high-profile companies and products.
- Updated *The Financial Analyst* content.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 4 Internal Control, Accounting for Cash, and Ethics

- Added video lectures and self-assessment quizzes for each learning objective.
- Added coverage of the framework for internal controls and enterprise risk management developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).
- Updated *Curious Accountant*.
- Updated *Focus on International Issues* textbox that includes IFRS coverage.
- Updated exercises, problems, and cases.

Chapter 5 Accounting for Receivables and Inventory Cost Flow

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* featuring new high-profile companies and products.
- Updated *Reality Bytes*.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 6 Accounting for Long-Term Operational Assets

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* featuring new high-profile companies and products.
- Updated *Focus on International Issues* textbox that includes IFRS coverage.
- New *Reality Bytes*.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 7 Accounting for Liabilities

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* featuring new high-profile companies and products.
- Updated *Reality Bytes*.

- Updated *Focus on International Issues* textbox that includes IFRS coverage.
- Updated *The Financial Analyst* content.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 8 Proprietorships, Partnerships, and Corporations

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* featuring new high-profile companies and products.
- New Reality Bytes.
- Updated *Focus on International Issues* textbox that includes IFRS coverage.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 9 Financial Statement Analysis

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 10 An Introduction to Management Accounting

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* feature.
- Updated *Focus on International Issues* feature.
- Updated Self-Study Review Problem.
- Updated exercises, problems, and cases.

Chapter 11 Cost Behavior, Operating Leverage, and Profitability Analysis

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- Reorganized chapter content.
- New *Curious Accountant* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 12 Cost Accumulation, Tracing, and Allocation

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- Reorganized chapter content.

- Revised *Curious Accountant* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 13 Relevant Information for Special Decisions

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- Revised *Curious Accountant* feature.
- New *Reality Bytes* feature.
- Updated *Focus on International Issues* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 14 Planning for Profit and Cost Control

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- Revised *Curious Accountant* feature.
- New *Reality Bytes* feature.
- Revised *Focus on International Issues* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 15 Performance Evaluation

- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- New *Curious Accountant* feature.
- Revised *Reality Bytes* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

Chapter 16 Planning for Capital Investments

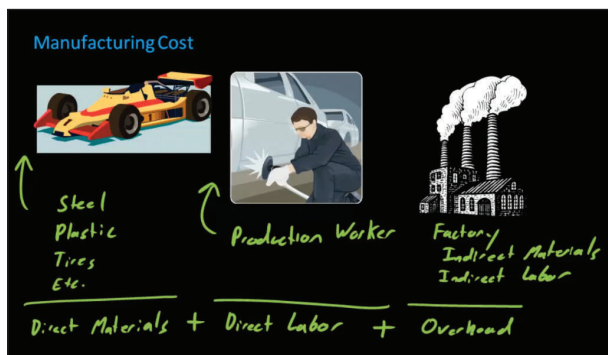
- Added video lectures and self-assessment quizzes for each learning objective.
- Revised learning objectives.
- Revised *Curious Accountant* feature.
- Revised *Reality Bytes* feature.
- Reorganized exercises and problems to match the sequence learning objectives are presented in text.
- Updated exercises, problems, and cases.

HOW CAN TECHNOLOGY HELP



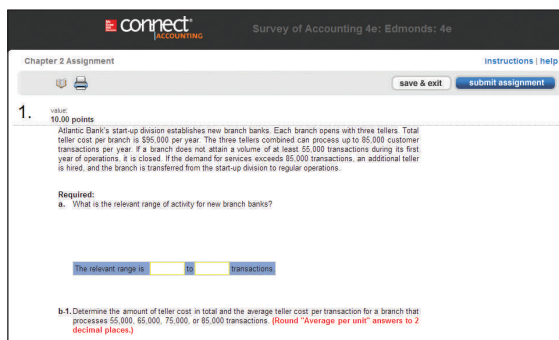
● McGRAW-HILL *CONNECT*[®] *ACCOUNTING*

McGraw-Hill *Connect*[®] *Accounting* is an online assignment and assessment solution that connects you with the tools and resources necessary to achieve success through faster learning, more efficient studying, and higher retention of knowledge.



Lecture Videos

One or more lecture videos are available for every learning objective introduced throughout the text. The videos have been developed by a member of the author team and have the touch and feel of a live lecture. The videos are accompanied by a set of self-assessment quizzes. Students can watch the videos and then test themselves to determine if they understand the material presented in the video. Students can repeat the process, switching back and forth between the video and self-assessment quizzes, until they are satisfied that they understand the material.



Online Assignments

McGraw-Hill *Connect*[®] *Accounting* helps students learn more efficiently by providing feedback and practice material when and where they need it. *Connect*[®] *Accounting* grades homework automatically and students benefit from the immediate feedback that they receive, particularly on any questions they may have missed. Furthermore, algorithmic questions provide students with unlimited opportunities for practice.

Curtis Salter, the president of Kasimer Computer Services, needs your help. He wonders about the potential effects on the firm's net income if he changes the service rate that the firm charges its customers. The following basic data pertain to fiscal year 2015.

Standard rate and variable costs	
Service rate per hour	\$ 75.00
Labor cost	40.00
Overhead cost	7.20
Selling, general, and administrative cost	4.30
Expected fixed costs	
Facility maintenance	\$400,000
Selling, general, and administrative	150,000

Required:

a. Prepare the pro forma income statement that would appear in the master budget if the firm expects to provide 30,000 hours of services in 2015.

KASIMER COMPUTER SERVICES	
Pro Forma Income Statement	
Master Budget	
Services revenue	\$ 2,250,000
Variable costs:	
Labor cost	(1,200,000)
Overhead cost	
Facility maintenance	400,000
Labor cost	
Overhead cost	
Selling, general, and administrative costs	
Services revenue	\$ 1,920,000

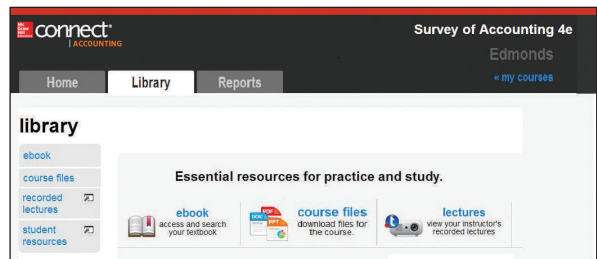
Intelligent Response Technology (IRT)

IRT is a redesigned student interface for our end-of-chapter assessment content. The benefits include improved answer acceptance to reduce students' frustration with formatting issues (such as rounding) and a general journal application that looks and feels more like what you would find in a general ledger software package. Also, select questions have been redesigned to test students' knowledge more fully. They now include tables for students to work through rather than requiring that all calculations be done offline.

IMPROVE STUDENT SUCCESS?

Student Library

The *Connect*[®] Accounting Student Library gives students access to additional resources such as recorded lectures, online practice materials, and a searchable, media-rich eBook, which students can use to highlight, take, and share notes and study assets from the Online Learning Center—all from one convenient location.



● MCGRAW-HILL *CONNECT*[®] ACCOUNTING FEATURES

Less Managing. More Teaching. Greater Learning.

McGraw-Hill *Connect*[®] Accounting offers a number of powerful tools and features to make managing assignments easier, so faculty can spend more time teaching. With *Connect*[®] Accounting, students can engage with their coursework anytime, anywhere, making the learning process more accessible and efficient.

McGraw-Hill *Connect*[®] Accounting for Instructors Simple Assignment Management and Smart Grading

Connect[®] Accounting enables you to:

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

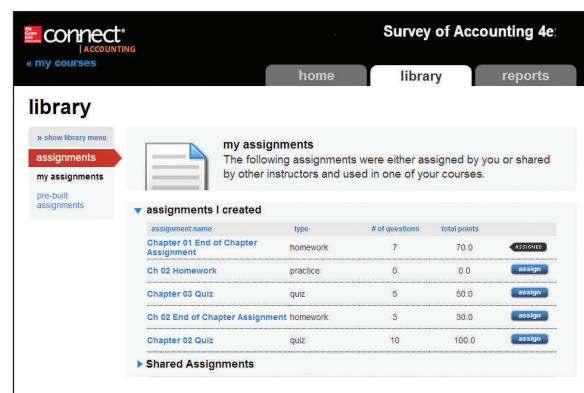
Instructor Library

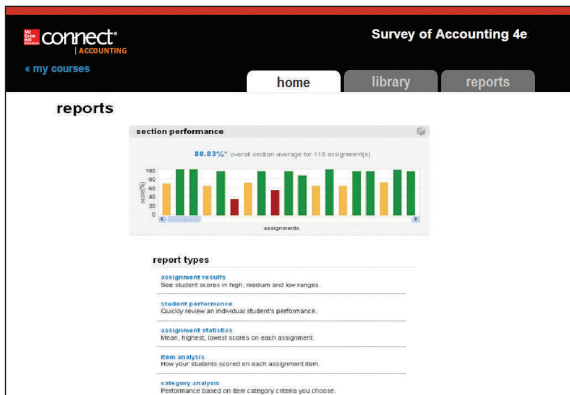
The *Connect*[®] Accounting Instructor Library is your repository for additional resources to improve student engagement in and out of class. You can select and use any asset that enhances your lecture. The *Connect*[®] Accounting Instructor Library includes access to the textbook's:

- Solutions Manual
- Test Bank
- Instructor PowerPoint slides
- Instructor's Manual
- Text exhibits
- Media-rich eBook

"A well-designed textbook with a variety of in-class and online activities and practice problems. Also has a nice accompanying website that students can access. Clear examples, good Excel practice exercises, nice structure. The Instructor's Manual and the text are tightly integrated and well laid out (the instructor can easily and quickly choose practice activities for in-class assignments and homework).

KRISTEN BALL, DODGE CITY COMMUNITY COLLEGE

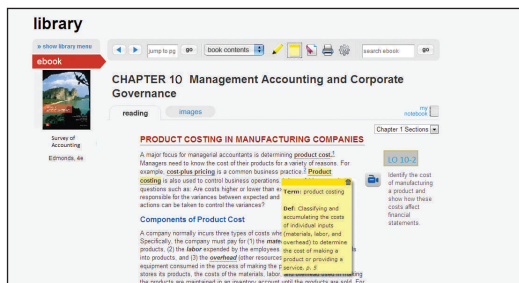




Student Reports

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

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



McGraw-Hill *Connect® Plus Accounting*

McGraw-Hill reinvents the textbook learning experience for the modern student with *Connect® Plus Accounting*, which provides a seamless integration of the eBook and *Connect® Accounting*. *Connect® Plus Accounting* provides all of the *Connect® Accounting* features, as well as:

- An integrated eBook, allowing for anytime, anywhere access to the textbook.
- Dynamic links between the problems or questions you assign to your students and the location in the eBook where the concept related to that problem or question is covered.

- A powerful search function to pinpoint and connect key concepts in a snap.
- Highlighting, note-taking, and sharing, and other media-rich capabilities.

For more information about *Connect® Accounting*, go to www.mcgrawhillconnect.com, or contact your local McGraw-Hill sales representative.

●TEGRITY CAMPUS: LECTURES 24/7



Tegrity Campus, a new McGraw-Hill company, provides a service that makes class time available 24/7 by automatically capturing every lecture.

With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio in a format that is easily searchable, frame by frame. Students can replay any part of any class with easy-to-use browser-based viewing on a PC or Mac, an iPod, or other mobile device. Educators know that the more students can see, hear, and experience class resources, the better they learn. In fact, studies prove it. Tegrity Campus' unique search feature helps students efficiently find what they need, when they need it, across an entire semester of class recordings. Help turn your students' study time into learning moments immediately supported by your lecture. With Tegrity Campus, you also increase intent

listening and class participation by easing students' concerns about note-taking. Lecture Capture will make it more likely you will see students' faces, not the tops of their heads.

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

● **McGRAW-HILL CAMPUS™**



McGraw-Hill Campus™ is a new one-stop teaching and learning experience available to users of any learning management system. This institutional service allows faculty and students to enjoy single sign-on (SSO) access to all McGraw-Hill Higher Education materials, including the award-winning McGraw-Hill *Connect*® platform, from directly within the institution's website. McGraw-Hill Campus™ provides faculty with instant access to all McGraw-Hill Higher Education teaching materials (e.g., eTextbooks, test banks, PowerPoint slides, animations, and learning objects), allowing them to browse, search, and use any instructor ancillary content in our vast library. Students enjoy SSO access to a variety of free (e.g., quizzes) and subscription-based products (e.g., McGraw-Hill *Connect*®). With McGraw-Hill Campus™, faculty and students will never need to create another account to access McGraw-Hill products and services.

● **McGRAW-HILL CUSTOMER EXPERIENCE**

At McGraw-Hill, we understand that getting the most from new technology can be challenging. That's why our services don't stop after you purchase our book. You can e-mail our product specialists 24 hours a day, get product training online, or search our knowledge bank of Frequently Asked Questions on our support website. For Customer Support, call 800-331-5094 or visit www.mhhe.com/support. One of our Technical Support Analysts will assist you in a timely fashion. You also can take advantage of the new "Contact Publisher" link within *Connect*® Accounting.

● **McGRAW-HILL CREATE™**



Your course evolves over time. Shouldn't your course material? Customize your own high-quality, well-designed, full-color textbook in print or eBook format in a few simple steps at <http://create.mcgraw-hill.com>. Search thousands of textbooks, articles, and cases to rearrange, add, and/or remove content to better match the way you teach your course. You even can add your own material, such as a syllabus or handout. Personalize your book's appearance by selecting the cover and adding your name, school, and course information. Order a *Create*™ book and you'll receive a complimentary print review copy in three to five business days or a complimentary electronic review copy (eComp) via e-mail in about one hour.

INSTRUCTOR SUPPLEMENTS

Assurance of Learning Ready

Many educational institutions today are focused on the notion of assurance of learning, an important element of some accreditation standards. *Survey of Accounting, 4e*, is designed specifically to support your assurance of learning initiatives with a simple, yet powerful, solution. Each test bank question for *Survey of Accounting, 4e*, maps to a specific chapter learning outcome/objective listed in the text. You can use our test bank software, EZ Test, and *Connect*[®] to easily query for learning outcomes/objectives that directly relate to the learning objectives for your course. You can then use the reporting features of EZ Test and *Connect*[®] to aggregate student results in similar fashion, making the collection and presentation of assurance of learning data simple and easy.

AACSB Statement

The McGraw-Hill Companies, Inc., is a proud corporate member of AACSB International. Recognizing the importance and value of AACSB accreditation, we have sought to recognize the curricula guidelines detailed in AACSB standards for business accreditation by connecting selected questions in Edmonds 4e with the general knowledge and skill guidelines found in the AACSB standards. The statements contained in Edmonds 4e are provided only as a guide for the users of this text. The AACSB leaves content coverage and assessment clearly within the realm and control of individual schools, the mission of the school, and the faculty. The AACSB does also charge schools with the obligation of doing assessment against their own content and learning goals. While Edmonds 4e and its teaching package make no claim of any specific AACSB qualification or evaluation, we have labeled selected questions according to the six general knowledge and skills areas. The labels or tags within Edmonds 4e are as indicated. There are, of course, many more within the test bank, the text, and the teaching package which might be used as a “standard” for your course. However, the labeled questions are suggested for your consideration.

McGraw-Hill *Connect*[®] Accounting



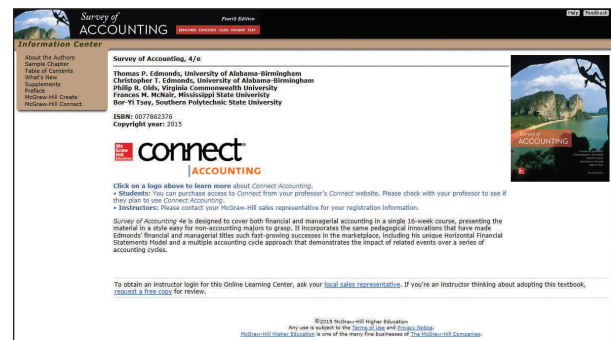
McGraw-Hill *Connect*[®] Accounting offers a number of powerful tools and features to make managing your classroom easier. *Connect*[®] Accounting with Edmonds 4e offers enhanced features and technology to help both you and your students make the most of your time inside and outside the classroom. See page xvi for more details.

Online Learning Center (www.mhhe.com/edmondssurvey4e)

The password-protected instructor side of the book's Online Learning Center (OLC) houses all the instructor resources you need to administer your course, including:

- Solutions Manual
- Test Bank
- Instructor PowerPoint[®] slides
- Instructor's Manual
- Text exhibits
- Sample syllabus

If you choose to use *Connect*[®] Accounting with Edmonds 4e, you will have access to these same resources via the Instructor Library.



Instructor's Manual

This comprehensive manual includes step-by-step, explicit instructions on how the text can be used to implement teaching methods. The guide includes lesson plans and demonstration problems with student work papers, as well as solutions. Available on the password-protected Instructor side of the Online Learning Center and the *Connect*[®] Instructor Library.

STUDENT SUPPLEMENTS

Solutions Manual

Prepared by the authors, the solutions manual contains complete solutions to all the text's end-of-chapter review questions, exercises, problems, and cases. Available on the password-protected Instructor side of the Online Learning Center and the *Connect*[®] Instructor Library.

PowerPoint Presentations

This resource includes a complete set of Instructor PowerPoints, following the chapter-by-chapter content.

Available on the password-protected Instructor side of the Online Learning Center and the *Connect*[®] Instructor Library.

Test Bank

This test bank contains multiple-choice questions, essay questions, and short problems. Each test item is coded for level of difficulty, learning objective, AACSB, AICPA, and Bloom's.

EZ Test Online

McGraw-Hill's EZ Test is a flexible electronic testing program. The program allows instructors to create tests from book-specific items. It accommodates a wide range of question types.



McGraw-Hill *Connect*[®] Accounting and *Connect*[®] Plus Accounting

McGraw-Hill *Connect*[®] Accounting helps prepare you for your future by enabling faster learning, more efficient studying, and higher retention of knowledge. See page xvi for more details.

CourseSmart

CourseSmart is a new way to find and buy eTextbooks. At Course-



Smart you can save up to 60 percent off the cost of a print textbook, reduce your impact on the environment, and gain access to powerful web tools for learning. CourseSmart has the largest selection of eTextbooks available anywhere, offering thousands of the most commonly adopted textbooks from a wide variety of higher education publishers. CourseSmart eTextbooks are available in one standard online reader with full text search, notes and highlighting, and e-mail tools for sharing notes between classmates.

Online Learning Center and *Connect*[®] Student Library

www.mhhe.com/edmondssurvey4e

The Online Learning Center (OLC) and *Connect*[®] Student Library follow *Survey of Accounting* chapter by chapter, offering all kinds of supplementary help for you as you read. The following resources are available to help you study more efficiently:

- Online quizzes
- Student PowerPoint presentations
- Check figures
- Review problems

Student PowerPoint Presentations

Presentation slides are located on the text's Online Learning Center and the *Connect*[®] Library.

McGraw-Hill's *Connect*[®] Accounting

See page xvi for details.

ACKNOWLEDGMENTS

We would like to express our appreciation to the people who have provided assistance in the development of this textbook.

We recognize the following instructors for their invaluable feedback and involvement in the development of *Survey of Accounting*, Fourth Edition. We are thankful for their feedback and suggestions.

Reviewers

Our appreciation to those who reviewed previous editions:

Wafeek Abdelsayed, *Southern Connecticut State University*

Khaled Abdou, *Penn State University-Berks Campus*

Mollie Adams, *Virginia Polytechnic Institute*

Gary Ames, *Brigham Young University-Idaho*

David Bukovinsky, *Wright State University*

Susan Cain, *Southern Oregon University*

Alvaro Carreras, *Barry University*

Thomas Casey, *DeVry University—Tinley Park*

Suzanne Cercone, *Keystone College*

Al Chen, *North Carolina State University*

Cheryl Corke, *Genesee Community College*

Terry Dancer, *Arkansas State University*

Bruce Darling, *University of Oregon*

Harry Davis, *Baruch College*

Julie Dilling, *Fox Valley Technical College*

Timothy Dimond, *Northern Illinois University*

Edwin A. Doty, Jr., *East Carolina University*

Barbara Fox, *Northern Illinois University*

Debbie Gahr, *Waukesha County Technical College*

Dana Garner, *Virginia Polytechnic Institute*

John Giles, *North Carolina State University*

Gladys Gomez, *University of Mary Washington*

Robert Holtfreter, *Central Washington University*

Harry Hughes, *University of Tennessee, Knoxville*

Kim Hurt, *Central Community College*

Constance Hylton, *George Mason University*

Ronald Jastrzebski, *Penn State University—Berks Campus*

Tammy Kowalczyk, *Appalachian State University*

John Markert, *Utica College*

Gwendolyn McFadden-Wade, *North Carolina A & T State University*

Christopher McKittrick, *North Carolina State University*

Melanie Middlemist, *Colorado State University*

Gay Mills, *Amarillo College*

Brian O'Doherty, *East Carolina State University*

Sandra Owen, *Indiana University Bloomington*

Lolita Paff, *Penn State University-Berks*

Robert Patterson, *Penn State-Erie, the Behrend College*

Vanda Pauwels, *Texas Tech University*

Daniel Ricigliano, *Buffalo State College*

Jacci Rodgers, *Oklahoma City University*

Shiv Sharma, *Robert Morris University*

Jim Shelton, *Harding University*

George Smith, *Newman University*

Hans Sprohge, *Wright State University*

Lynn Trent, *Golden Gate University*

Vivian Winston, *Indiana University Bloomington*

Special thanks to the talented people who prepared the supplements. These take a great deal of time and effort to write and we appreciate their efforts. We want to thank LuAnn Bean of Florida Institute of Technology for preparing the PowerPoints and Instructor's Manual; Rebecca Toledo of Alverno College for the Test Bank; and Kristine Palmer for accuracy checking the text, solutions manual, and Test Bank. Thank you to Molly Brown of James Madison University for reviewing the Connect Video Lecture assignments for accuracy and consistency. A special thanks to Linda Bell of William Jewell College for her contribution to the Financial Statement Analysis material that appears in the Instructor Manual and text Web site.

In addition to the helpful and generous colleagues listed above, we thank the entire McGraw-Hill Education *Survey of Accounting, 4e*, team, including Tim Vertovec, Steve Schuetz, Katie Jones, Diane Nowaczyk, Julie Hankins, Pat Plumb, Xin Lin, Michelle Nolte, Michael McCormick, Matt Diamond, Jeremy Cheshareck, Joyce Chappetto, and Rachel Townsend. We deeply appreciate the long hours that you committed to the formation of a high-quality text.

Thomas P. Edmonds • Christopher T. Edmonds • Philip R. Olds • Frances M. McNair • Bor-Yi Tsay



BRIEF CONTENTS

Chapter 1	An Introduction to Accounting 2
Chapter 2	Accounting for Accruals and Deferrals 48
Chapter 3	Accounting for Merchandising Businesses 92
Chapter 4	Internal Controls, Accounting for Cash, and Ethics 130
Chapter 5	Accounting for Receivables and Inventory Cost Flow 162
Chapter 6	Accounting for Long-Term Operational Assets 206
Chapter 7	Accounting for Liabilities 246
Chapter 8	Proprietorships, Partnerships, and Corporations 292
Chapter 9	Financial Statement Analysis 324
Chapter 10	An Introduction to Management Accounting 362
Chapter 11	Cost Behavior, Operating Leverage, and Profitability Analysis 402
Chapter 12	Cost Accumulation, Tracing, and Allocation 436
Chapter 13	Relevant Information for Special Decisions 468
Chapter 14	Planning for Profit and Cost Control 504
Chapter 15	Performance Evaluation 536
Chapter 16	Planning for Capital Investments 568
	<i>Appendix A Accessing the EDGAR Database through the Internet 601</i>
	<i>Appendix B The Double-Entry Accounting System 602</i>
	<i>Glossary 610</i>
	<i>Photo Credits 621</i>
	<i>Index 622</i>

CONTENTS

Walkthrough viii



Chapter 1 An Introduction to Accounting 2

Section 1: Collecting and Organizing Information 3

Role of Accounting in Society 4

Using Free Markets to Set Resource Priorities 4

Accounting Provides Information 5

Types of Accounting Information 6

Nonbusiness Resource Usage 6

Careers in Accounting 6

Measurement Rules 8

Reporting Entities 8

Elements of Financial Statements 10

Using Accounts to Gather Information 11

Accounting Equation 11

Recording Business Events under the Accounting Equation 13

Asset Source Transactions 13

Asset Exchange Transactions 14

Another Asset Source Transaction 14

Asset Use Transactions 15

Summary of Transactions 16

Interpreting Information Shown in the Accounting Equation 17

The Left versus the Right Side of the Accounting Equation 17

Two Views of the Right Side of the Accounting Equation 18

Cash and Retained Earnings 18

Distributions in Business

Liquidations 19

Recap: Types of Transactions 20

Section 2: Reporting Information 21

Preparing Financial Statements 21

Income Statement and the Matching Concept 21

Statement of Changes in Stockholders' Equity 23

Balance Sheet 23

Statement of Cash Flows 24

The Closing Process 25

The Horizontal Financial Statements Model 26

Real-World Financial Reports 27

Annual Report for Target Corporation 28

Special Terms in Real-World Reports 29

A Look Back 30

A Look Forward 30

Self-Study Review Problem 30

Key Terms 32

Questions 32

Multiple-Choice Questions 33

Section 1 Exercises 33

Section 2 Exercises 36

Sections 1 and 2 Problems 41

Analyze, Think, Communicate 45



Chapter 2 Accounting for Accruals and Deferrals 48

Section 1: Accounting for Accruals 49

Accrual Accounting 50

Accounting for Accounts Receivable 50

Other Events 51

Accounting for Accrued Salary Expense (Adjusting Entry) 52
Summary of Events and General Ledger 53
Vertical Statements Model 53
The Closing Process 56
Steps in an Accounting Cycle 56
The Matching Concept 56
The Conservatism Principle 58

Section 2: Accounting for Deferrals 58

Second Accounting Cycle 58

Accounting for Supplies Purchase 58
Prepaid Items (Cost versus Expense) 59
Accounting for Receipt of Unearned Revenue 60
Other 2015 Events 60
Adjusting Entries 62
Accounting for Supplies (Adjusting Entry) 62

Accounting for Prepaid Rent (Adjusting Entry) 62
Accounting for Unearned Revenue (Adjusting Entry) 63
Accounting for Accrued Salary Expense (Adjusting Entry) 66
Summary of Events and General Ledger 66
Vertical Statements Model 66

Transaction Classification 70

A Look Back 70
A Look Forward 71
Self-Study Review Problem 72
Key Terms 73
Questions 74
Multiple-Choice Questions 74
Section 1 Exercises 74
Section 2 Exercises 77
Sections 1 and 2 Problems 84
Analyze, Think, Communicate 89



Chapter 3 Accounting for Merchandising Businesses 92

Product Costs versus Selling and Administrative Costs 95
Allocating Inventory Cost between Asset and Expense Accounts 95
Perpetual Inventory System 96
Effects of 2014 Events on Financial Statements 96
Financial Statements for 2014 98
Transportation Cost, Purchase Returns and Allowances, and Cash Discounts Related to Inventory Purchases 98
Effects of 2015 Events on Financial Statements 99
Accounting for Purchase Returns and Allowances 99

Purchase Discounts 100
The Cost of Financing Inventory 100
Accounting for Transportation Costs 101
Adjustment for Lost, Damaged, or Stolen Inventory 104

Recognizing Gains and Losses 105

Multistep Income Statement 105

Events Affecting Sales 107

Accounting for Sales Returns and Allowances 108
Accounting for Sales Discounts 109

Common Size Financial Statements 109



A Look Back	111	Questions	115
A Look Forward	112	Multiple-Choice Questions	116
Appendix	112	Exercises	116
Self-Study Review Problem	113	Problems	123
Key Terms	115	Analyze, Think, Communicate	127



Chapter 4 Internal Controls, Accounting for Cash, and Ethics 130

Key Features of Internal Control Systems 132

<i>Separation of Duties</i>	132
<i>Quality of Employees</i>	133
<i>Bonded Employees</i>	133
<i>Required Absences</i>	133
<i>Procedures Manual</i>	133
<i>Authority and Responsibility</i>	133
<i>Prenumbered Documents</i>	134
<i>Physical Control</i>	134
<i>Performance Evaluations</i>	134
<i>Limitations</i>	134

Accounting for Cash 135

<i>Controlling Cash</i>	135
<i>Checking Account Documents</i>	136

Reconciling the Bank Account 137

<i>Determining True Cash Balance</i>	137
<i>Illustrating a Bank Reconciliation</i>	140

Importance of Ethics 143

<i>Common Features of Criminal and Ethical Misconduct</i>	143
-----------------------------------------------------------	-----

Role of the Independent Auditor 145

<i>The Financial Statement Audit</i>	146
<i>Materiality and Financial Audits</i>	146
<i>Types of Audit Opinions</i>	147
<i>Confidentiality</i>	147

A Look Back	148
A Look Forward	149
Self-Study Review Problem	149
Key Terms	150
Questions	150
Multiple-Choice Questions	151
Exercises	151
Problems	155
Analyze, Think, Communicate	159



Chapter 5 Accounting for Receivables and Inventory Cost Flow 162

Allowance Method of Accounting for Uncollectible Accounts 164

<i>Accounting Events Affecting the 2014 Period</i>	164
<i>Accounting Events Affecting the 2015 Period</i>	167

Estimating Uncollectible Accounts Expense Using the Percent of Revenue (Sales) Method 169

<i>Analysis of Financial Statements</i>	169
-----------------------------------------	-----

Estimating Uncollectible Accounts Expense Using the Percent of Receivables Method 170

Matching Revenues and Expenses versus Asset Measurement 172

Accounting for Notes Receivable (Promissory Notes) 172

How Accounting for Notes Receivable Affects Financial Statements 173

Financial Statements 175

Accounting for Credit Card Sales 176

Inventory Cost Flow Methods 177

Specific Identification 178

First-In, First-Out (FIFO) 178

Last-In, First-Out (LIFO) 178

Weighted Average 178

Physical Flow 178

Effect of Cost Flow on Financial Statements 178

Effect on Income Statement 178

Effect on Balance Sheet 179

Multiple Layers with Multiple Quantities 180

Allocating Cost of Goods Available for Sale 180

Effect of Cost Flow on Financial Statements 181

A Look Back 185

A Look Forward 185

Self-Study Review Problem 1 186

Self-Study Review Problem 2 187

Key Terms 188

Questions 188

Multiple-Choice Questions 189

Exercises 189

Problems 197

Analyze, Think, Communicate 203



Chapter 6 Accounting for Long-Term Operational Assets 206

Tangible versus Intangible Assets 208

Tangible Long-Term Assets 208

Intangible Assets 208

Determining the Cost of Long-Term Assets 209

Basket Purchase Allocation 209

Methods of Recognizing Depreciation Expense 210

Dryden Enterprises Illustration 211

Straight-Line Depreciation 211

Financial Statements 213

Double-Declining-Balance Depreciation 213

Units-of-Production Depreciation 216

Comparing the Depreciation Methods 217

Revision of Estimates 219

Revision of Life 219

Revision of Salvage 219

Continuing Expenditures for Plant Assets 219

Costs That Are Expensed 219

Costs That Are Capitalized 220

Natural Resources 222

Intangible Assets 222

Trademarks 222

Patents 222

Copyrights 223

Franchises 223

Goodwill 224



Expense Recognition for Intangible Assets 225

Expensing Intangible Assets with Identifiable Useful Lives 225

Impairment Losses for Intangible Assets with Indefinite Useful Lives 225

Balance Sheet Presentation 226

Effect of Judgment and Estimation 226

Effect of Industry Characteristics 227

A Look Back 228

A Look Forward 229

Self-Study Review Problem 229

Key Terms 230

Questions 230

Multiple-Choice Questions 231

Exercises 231

Problems 237

Analyze, Think, Communicate 243



Chapter 7 Accounting for Liabilities 246

Accounting for Current Liabilities 248

Accounting for Notes Payable 248

Accounting for Sales Tax 249

Contingent Liabilities 250

Warranty Obligations 251

Financial Statements 252

Accounting for Long-Term Debt 253

Installment Notes Payable 254

Line of Credit 257

Bond Liabilities 257

Bonds Issued at Face Value 258

Amortization Using the Straight-Line Method 262

Bonds Issued at a Discount 262

Bonds Issued at a Premium 266

Security for Loan Agreements 267

Current versus Noncurrent 267

A Look Back 269

A Look Forward 269

Appendix 270

Self-Study Review Problem 274

Key Terms 275

Questions 275

Multiple-Choice Questions 275

Exercises 276

Problems 283

Analyze, Think, Communicate 289



Chapter 8 Proprietorships, Partnerships, and Corporations 292

Forms of Business Organizations 294

Advantages and Disadvantages of Different Forms of Business Organization 294

Regulation 294

Double Taxation 295

Limited Liability 295

Continuity 296

Transferability of Ownership 296

Management Structure 296

Ability to Raise Capital 297

Appearance of Capital Structure in Financial Statements 297

Presentation of Equity in Proprietorships 297

<i>Presentation of Equity in Partnerships</i>	298	<i>Stock Dividend</i>	306
<i>Presentation of Equity in Corporations</i>	299	<i>Stock Split</i>	307
Characteristics of Capital Stock	299	<i>Appropriation of Retained Earnings</i>	307
<i>Par Value</i>	299	Financial Statement Presentation	308
<i>Stated Value</i>	299	Investing in Capital Stock	309
<i>Other Valuation Terminology</i>	299	<i>Receiving Dividends</i>	309
<i>Stock: Authorized, Issued, and Outstanding</i>	299	<i>Increasing the Price of Stock</i>	309
<i>Classes of Stock</i>	300	<i>Exercising Control through Stock Ownership</i>	310
Accounting for Stock Transactions on the Day of Issue	302	A Look Back	310
<i>Issuing Par Value Stock</i>	302	A Look Forward	311
<i>Stock Classification</i>	302	Self-Study Review Problem	312
<i>Stock Issued at Stated Value</i>	302	Key Terms	312
<i>Stock Issued with No Par Value</i>	303	Questions	313
<i>Financial Statement Presentation</i>	303	Multiple-Choice Questions	313
Stockholders' Equity Transactions after the Day of Issue	304	Exercises	314
<i>Treasury Stock</i>	304	Problems	318
<i>Cash Dividend</i>	305	Analyze, Think, Communicate	321



Chapter 9 Financial Statement Analysis 324

Factors in Communicating Useful Information	326	Measures of Profitability	337
<i>The Users</i>	326	<i>Measures of Managerial Effectiveness</i>	337
<i>The Types of Decisions</i>	326	<i>Stock Market Ratios</i>	339
<i>Information Analysis</i>	326	Limitations of Financial Statement Analysis	342
Methods of Analysis	326	<i>Different Industries</i>	342
<i>Horizontal Analysis</i>	327	<i>Changing Economic Environment</i>	343
<i>Vertical Analysis</i>	329	<i>Accounting Principles</i>	343
Ratio Analysis	330	A Look Back	344
<i>Objectives of Ratio Analysis</i>	330	A Look Forward	344
Measures of Debt-Paying Ability	331	Self-Study Review Problem	345
<i>Liquidity Ratios</i>	331		
<i>Solvency Ratios</i>	335		



Key Terms 347
Questions 347
Multiple-Choice Questions 347

Exercises 347
Problems 352
Analyze, Think, Communicate 358



Chapter 10 An Introduction to Management Accounting 362

Differences between Managerial and Financial Accounting 364

Users and Types of Information 364
Level of Aggregation 364
Regulation 365
Information Characteristics 365
Time Horizon and Reporting Frequency 365

Product Costing in Manufacturing Companies 365

Components of Product Cost 365
Tabor Manufacturing Company 366
Average Cost per Unit 366
Costs Can Be Assets or Expenses 367
Effect of Product Costs on Financial Statements 368
Overhead Costs: A Closer Look 371
Manufacturing Product Cost Summary 372

Schedule of Cost of Goods Manufactured and Sold 373

Upstream and Downstream Costs 375
Product Costing in Service and Merchandising Companies 375

Just-in-Time Inventory 376

Just-in-Time Illustration 376

Statement of Ethical Professional Practice 378

A Look Back 380
A Look Forward 380
Appendix 381
Self-Study Review Problem 382
Key Terms 385
Questions 385
Multiple-Choice Questions 386
Exercises 386
Problems 393
Analyze, Think, Communicate 397



Chapter 11 Cost Behavior, Operating Leverage, and Profitability Analysis 402

Fixed Cost Behavior 404

Operating Leverage 404

Calculating Percentage Change 405
Risk and Reward Assessment 406

Variable Cost Behavior 406

Risk and Reward Assessment 406

An Income Statement under the Contribution Margin Approach 408

Measuring Operating Leverage Using Contribution Margin 408

Cost Behavior Summarized 409

Mixed Costs (Semivariable Costs) 410
The Relevant Range 411



Context-Sensitive Definitions of Fixed and Variable 411

Determining the Break-Even Point 412

Equation Method 412

Contribution Margin per Unit Method 413

Determining the Sales Volume Necessary to Reach a Desired Profit 414

Calculating the Margin of Safety 416

A Look Back 417

A Look Forward 417

Self-Study Review Problem 1 418

Self-Study Review Problem 2 420

Key Terms 421

Questions 421

Multiple-Choice Questions 421

Exercises 422

Problems 427

Analyze, Think, Communicate 432



Chapter 12 Cost Accumulation, Tracing, and Allocation 436

Determine the Cost of Cost Objects 438

Estimated versus Actual Cost 438

Assignment of Costs to Objects in a Retail Business 438

Identifying Direct and Indirect Costs 439

Cost Classifications—Independent and Context Sensitive 440

Allocating Indirect Costs to Objects 440

Determining the Cost to Be Allocated Using Cost Pools 442

Selecting the Cost Driver 443

Cause and Effect versus Availability of Information 443

Behavioral Implications 445

Cost Drivers for Variable Overhead Costs 447

Cost Drivers for Fixed Overhead Costs 449

The Human Factor: A Comprehensive Example 451

Using Cost Allocations in a Budgeting Decision 451

Using Cost Drivers to Make Allocations 452

Choosing the Best Cost Driver 453

Controlling Emotions 453

A Look Back 454

A Look Forward 454

Self-Study Review Problem 454

Key Terms 456

Questions 456

Multiple-Choice Questions 457

Exercises 457

Problems 461

Analyze, Think, Communicate 464



Chapter 13 Relevant Information for Special Decisions 468

Relevant Information 470

Sunk Cost 470

Opportunity Costs 470

Relevance Is an Independent Concept 471

Relevance Is Context Sensitive 471

Relationship between Relevance and Accuracy 471



Quantitative versus Qualitative Characteristics of Decision Making 472

Differential Revenue and Avoidable Cost 472

Relationship of Cost Avoidance to a Cost Hierarchy 472

Relevant Information and Special Decisions 473

Special Order Decisions 474

Outsourcing Decisions 476

Segment Elimination Decisions 479

Summary of Relationships between Avoidable Costs and the Hierarchy of Business Activity 482

Equipment Replacement Decisions 482

A Look Back 483

A Look Forward 484

Self-Study Review Problem 485

Key Terms 487

Questions 487

Multiple-Choice Questions 488

Exercises 488

Problems 495

Analyze, Think, Communicate 499



Chapter 14 Planning for Profit and Cost Control 504

The Planning Process 506

Three Levels of Planning for Business Activity 506

Advantages of Budgeting 507

Budgeting and Human Behavior 507

The Master Budget 508

Hampton Hams Budgeting Illustration 509

Sales Budget 509

Inventory Purchases Budget 511

Selling and Administrative Expense Budget 513

Cash Budget 515

Pro Forma Financial Statements 517

Pro Forma Income Statement 517

Pro Forma Balance Sheet 518

Pro Forma Statement of Cash Flows 518

A Look Back 519

A Look Forward 520

Self-Study Review Problem 520

Key Terms 522

Questions 522

Multiple-Choice Questions 522

Exercises 523

Problems 528

Analyze, Think, Communicate 532



Chapter 15 Performance Evaluation 536

Decentralization Concept 538

Responsibility Centers 538

Controllability Concept 538

Preparing Flexible Budgets 539

Determining Variances for Performance Evaluation 540

Sales and Variable Cost Volume Variances 541

Interpreting the Sales and Variable Cost Volume Variances 541

Fixed Cost Considerations 542

Flexible Budget Variances 542

*Calculating the Sales Price
Variance 543*

*The Human Element Associated with
Flexible Budget Variances 544*

Need for Standards 545

**Managerial Performance
Measurement 545****Return on Investment 546**

Qualitative Considerations 547

*Factors Affecting Return on
Investment 547*

Residual Income 548

*Calculating Multiple ROIs and/or
RIs for the Same Company 550*

*Responsibility Accounting and the
Balanced Scorecard 551*

A Look Back 551

A Look Forward 552

Self-Study Review Problem 1 552

Self-Study Review Problem 2 554

Key Terms 555

Questions 555

Multiple-Choice Questions 556

Exercises 556

Problems 561

Analyze, Think, Communicate 564

**Chapter 16 Planning for Capital Investments 568****Capital Investment Decisions 570**

Time Value of Money 570

*Determining the Minimum Rate of
Return 570*

*Converting Future Cash Inflows to
Their Equivalent Present Values 571*

**Techniques for Analyzing Capital
Investment Proposals 575**

Net Present Value 575

Internal Rate of Return 576

**Techniques for Measuring Investment
Cash Flows 577**

Cash Inflows 577

Cash Outflows 578

**Techniques for Comparing Alternative
Capital Investment Opportunities 578**

Net Present Value 578

Internal Rate of Return 580

*Relevance and the Time Value of
Money 582*

Tax Considerations 583

**Techniques that Ignore the Time Value
of Money 584**

Payback Method 584

Unadjusted Rate of Return 585

Real-World Reporting Practices 587**Postaudits 587**

A Look Back 588

Appendix 588

Self-Study Review Problem 589

Key Terms 590

Questions 590

Multiple-Choice Questions 591

Exercises 591

Problems 595

Analyze, Think, Communicate 598

Appendix A Accessing the EDGAR Database through the Internet 601

Appendix B The Double-Entry Accounting System 602

Glossary 610

Photo Credits 621

Index 622

fourth edition

Survey of Accounting



An Introduction to Accounting

LEARNING OBJECTIVES

After you have mastered the material in this chapter, you will be able to:

SECTION 1: COLLECTING AND ORGANIZING INFORMATION

- LO 1-1** Explain the role of accounting in society.
- LO 1-2** Construct an accounting equation and show how business events affect the equation.
- LO 1-3** Interpret information shown in an accounting equation.
- LO 1-4** Classify business events as asset source, use, or exchange transactions.

SECTION 2: REPORTING INFORMATION

- LO 1-5** Use general ledger account information to prepare four financial statements.
- LO 1-6** Explain the closing process.
- LO 1-7** Record business events using a horizontal financial statements model.



Video lectures and accompanying self-assessment quizzes are available for all learning objectives through McGraw-Hill Connect® Accounting.

The Curious Accountant

Who owns **Google**? Who owns the **American Heart Association** (AHA)? Many people and organizations other than owners are interested in the operations of Google and the AHA. These parties are called *stakeholders*. Among others, they include lenders, employees, suppliers, customers, benefactors, research institutions, local governments, heart patients, lawyers, bankers, financial analysts, and government agencies such as the Internal Revenue Service and the Securities and Exchange Commission. Organizations communicate information to stakeholders through *financial reports*.

How do you think the financial reports of Google differ from those of the AHA? (Answer on page 11.)



SECTION 1:

COLLECTING AND ORGANIZING INFORMATION

Why should you study accounting? You should study accounting because it can help you succeed in business. Businesses use accounting to keep score. Imagine trying to play football without knowing how many points a touchdown is worth. Like sports, business is competitive. If you do not know how to keep score, you are not likely to succeed.

Accounting is an information system that reports on the economic activities and financial condition of a business or other organization. Do not underestimate the importance of accounting information. If you had information that enabled you to predict business success, you could become a very wealthy Wall Street investor. Communicating economic information is so important that accounting is frequently called the *language of business*.

LO 1-1



Explain the role of accounting in society.

ROLE OF ACCOUNTING IN SOCIETY

How should society allocate its resources? Should we spend more to harvest food or cure disease? Should we build computers or cars? Should we invest money in IBM or General Motors? Accounting provides information that helps answer such questions.

Using Free Markets to Set Resource Priorities

Suppose you want to start a business. You may have heard “you have to have money to make money.” In fact, you will need more than just money to start and operate a business. You will likely need such resources as equipment, land, materials, and employees. If you do not have these resources, how can you get them? In the United States, you compete for resources in open markets.

A **market** is a group of people or entities organized to exchange items of value. The market for business resources involves three distinct participants: consumers, conversion agents, and resource owners. *Consumers* use resources. Resources are frequently not in a form consumers want. For example, nature provides trees but consumers want furniture. *Conversion agents* (businesses) transform resources such as trees into desirable products such as furniture. *Resource owners* control the distribution of resources to conversion agents. Thus resource owners provide resources (inputs) to conversion agents who provide goods and services (outputs) to consumers.

For example, a home builder (conversion agent) transforms labor and materials (inputs) into houses (output) that consumers use. The transformation adds value to the inputs, creating outputs worth more than the sum of the inputs. A house that required \$220,000 of materials and labor to build could have a market value of \$250,000.



Common terms for the added value created in the transformation process include **profit**, **income**, or **earnings**. Accountants measure the added value as the difference between the cost of a product or service and the selling price of that product or service. The profit on the house described above is \$30,000, the difference between its \$220,000 cost and \$250,000 market value.

Conversion agents who successfully and efficiently (at low cost) satisfy consumer preferences are rewarded with high earnings. These earnings are shared with resource owners, so conversion agents who exhibit high earnings potential are more likely to compete successfully for resources.

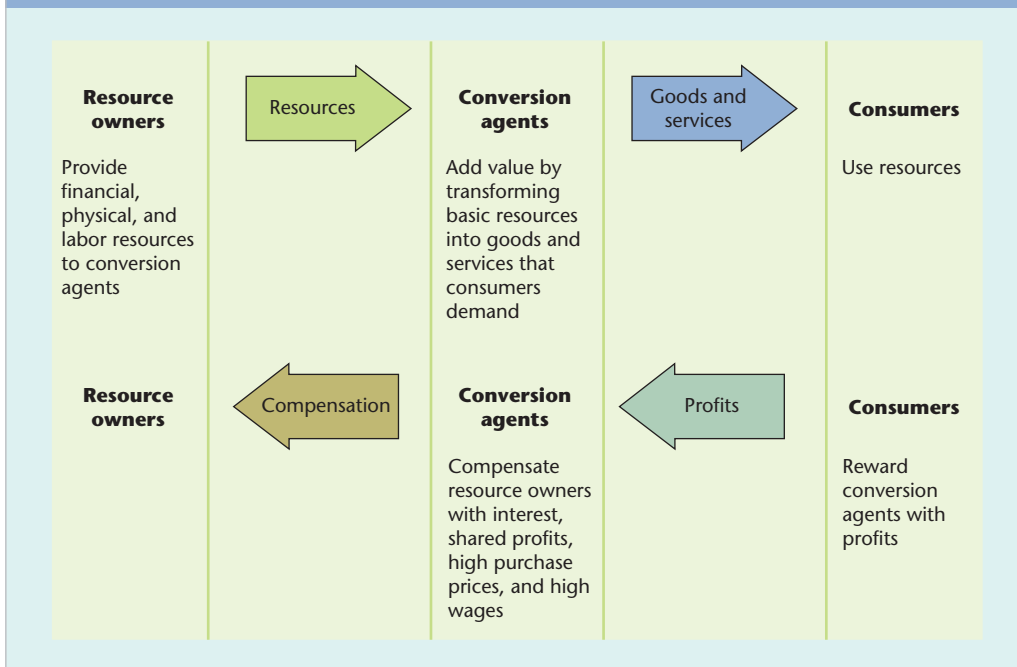
Return to the original question. How can you get the resources you need to start a business? You must go to open markets and convince resource owners that you can produce profits. Exhibit 1.1 illustrates the market trilogy involved in resource allocation.

The specific resources businesses commonly use to satisfy consumer demand are financial resources, physical resources, and labor resources.

Financial Resources

Businesses (conversion agents) need **financial resources** (money) to get started and to operate. *Investors* and *creditors* provide financial resources.

- **Investors** provide financial resources in exchange for ownership interests in businesses. Owners expect businesses to return to them a share of the business including a portion of earned income.
- **Creditors** lend financial resources to businesses. Instead of a share of the business, creditors expect the businesses to repay borrowed resources plus a specified fee called **interest**.

EXHIBIT 1.1**Market Trilogy in Resource Allocation**

Investors and creditors prefer to provide financial resources to businesses with high earnings potential because such companies are better able to share profits and make interest payments. Profitable businesses are also less likely to experience bankruptcy.

Physical Resources

In their most primitive form, **physical resources** are natural resources. Physical resources often move through numerous stages of transformation. For example, standing timber may be successively transformed into harvested logs, raw lumber, and finished furniture. Owners of physical resources seek to sell those resources to businesses with high earnings potential because profitable businesses are able to pay higher prices and make repeat purchases.

Labor Resources

Labor resources include both intellectual and physical labor. Like other resource providers, workers prefer businesses that have high income potential because these businesses are able to pay higher wages and offer continued employment.

Accounting Provides Information

How do providers of financial, physical, and labor resources identify conversion agents (businesses) with high profit potential? Investors, creditors, and workers rely heavily on accounting information to evaluate which businesses are worthy of receiving resources. In addition, other people and organizations have an interest in accounting information about businesses. The many **users** of accounting information are commonly called **stakeholders**. Stakeholders include resource providers, financial analysts, brokers, attorneys, government regulators, and news reporters.

The link between conversion agents (businesses) and those stakeholders who provide resources is direct: businesses pay resource providers. Resource providers use accounting information to identify companies with high earnings potential because those

companies are more likely to return higher profits, make interest payments, repay debt, pay higher prices, and provide stable, high paying employment.

The link between conversion agents and other stakeholders is indirect. Financial analysts, brokers, and attorneys may use accounting information when advising their clients. Government agencies may use accounting information to assess companies' compliance with income tax laws and other regulations. Reporters may use accounting information in news reports.

Types of Accounting Information

Stakeholders such as investors, creditors, lawyers, and financial analysts exist outside of and separate from the businesses in which they are interested. The accounting information these *external users* need is provided by **financial accounting**. In contrast, the accounting information needed by *internal users*, stakeholders such as managers and employees who work within a business, is provided by **managerial accounting**.

The information needs of external and internal users frequently overlap. For example, external and internal users are both interested in the amount of income a business earns. Managerial accounting information, however, is usually more detailed than financial accounting reports. Investors are concerned about the overall profitability of **Wendy's** versus **Burger King**; a Wendy's regional manager is interested in the profits of individual Wendy's restaurants. In fact, a regional manager is also interested in nonfinancial measures, such as the number of employees needed to operate a restaurant, the times at which customer demand is high versus low, and measures of cleanliness and customer satisfaction.

Nonbusiness Resource Usage

The U.S. economy is not *purely* market based. Factors other than profitability often influence resource allocation priorities. For example, governments allocate resources to national defense, to redistribute wealth, or to protect the environment. Foundations, religious groups, the **Peace Corps**, and other benevolent organizations prioritize resource usage based on humanitarian concerns.

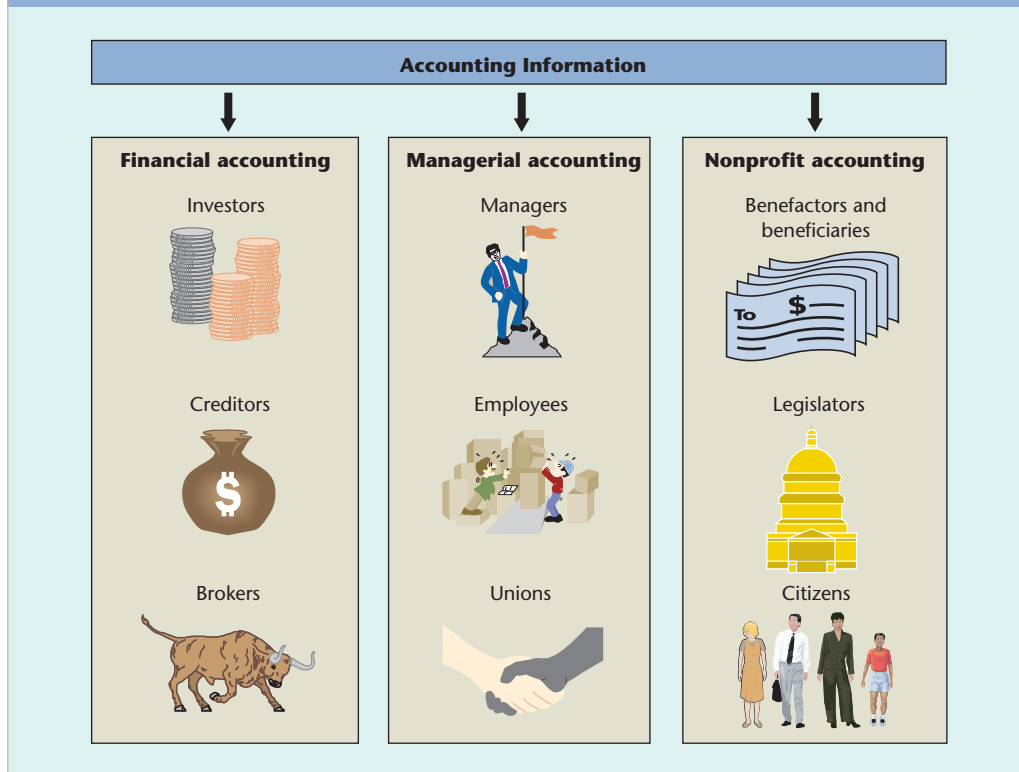
Like profit-oriented businesses, civic or humanitarian organizations add value through resource transformation. For example, a soup kitchen adds value to uncooked meats and vegetables by converting them into prepared meals. The individuals who consume the meals, however, are unable to pay for the kitchen's operating costs, much less for the added value. The soup kitchen's motivation is to meet humanitarian needs, not to earn profits. Organizations that are not motivated by profit are called **not-for-profit entities** (also called *nonprofit* or *nonbusiness organizations*).

Stakeholders interested in nonprofit organizations also need accounting information. Accounting systems measure the cost of the goods and services not-for-profit organizations provide, the efficiency and effectiveness of the organizations' operations, and the ability of the organizations to continue to provide goods and services. This information serves a host of stakeholders, including taxpayers, contributors, lenders, suppliers, employees, managers, financial analysts, attorneys, and beneficiaries.

The focus of accounting, therefore, is to provide information that is useful to a variety of business and nonbusiness user groups for decision-making. The different types of accounting information and the stakeholders that commonly use the information are summarized in Exhibit 1.2.

Careers in Accounting

An accounting career can take you to the top of the business world. *Bloomberg Businessweek* studied the backgrounds of the chief executive officers (CEOs) of the 1,000 largest public corporations. More CEOs had backgrounds in finance and accounting than any other field. Exhibit 1.3 provides additional detail regarding the career paths followed by these executives.

EXHIBIT 1.2**Accounting as Information Provider**

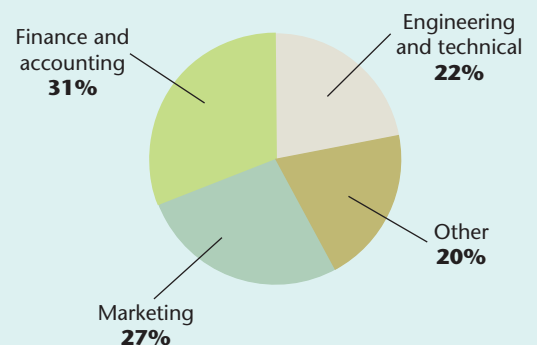
What do accountants do? Accountants identify, record, analyze, and communicate information about the economic events that affect organizations. They may work in either public accounting or private accounting.

Public Accounting

You are probably familiar with the acronym CPA. CPA stands for certified *public* accountant. Public accountants provide services to various clients. They are usually paid a fee that varies depending on the service provided. Services typically offered by public accountants include (1) audit services, (2) tax services, and (3) consulting services.

- *Audit services* involve examining a company's accounting records in order to issue an opinion about whether the company's financial statements conform to generally accepted accounting principles. The auditor's opinion adds credibility to the statements, which are prepared by the company's management.
- *Tax services* include both determining the amount of tax due and tax planning to help companies minimize tax expense.
- *Consulting services* cover a wide range of activities that includes everything from installing sophisticated computerized accounting systems to providing personal financial advice.

All public accountants are not certified. Each state government establishes certification requirements applicable in that state. Although the requirements vary from state to state, CPA candidates normally must have a college education, pass a demanding technical examination, and obtain work experience relevant to practicing public accounting.

EXHIBIT 1.3**Career Paths of Chief Executive Officers**

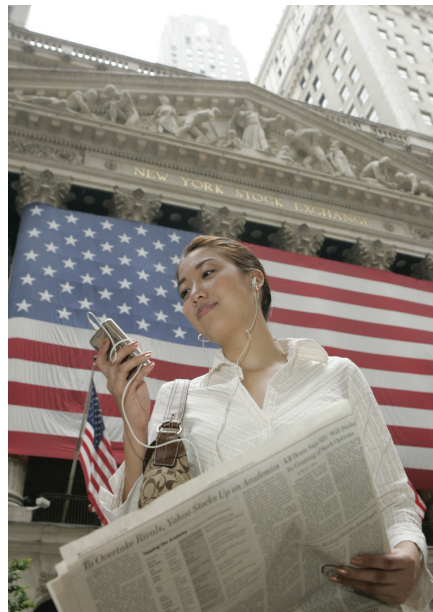
Private Accounting

Accountants employed in the private sector usually work for a specific company or nonprofit organization. Private sector accountants perform a wide variety of functions for their employers. Their duties include classifying and recording transactions, billing customers and collecting amounts due, ordering merchandise, paying suppliers, preparing and analyzing financial statements, developing budgets, measuring costs, assessing performance, and making decisions.

Private accountants may earn any of several professional certifications. For example, the Institute of Management Accountants issues the *Certified Management Accounting (CMA)* designation. The Institute of Internal Auditors issues the *Certified Internal Auditor (CIA)* designation. These designations are widely recognized indicators of technical competence and integrity on the part of individuals who hold them. All professional accounting certifications call for meeting education requirements, passing a technical examination, and obtaining relevant work experience.

Measurement Rules

Suppose a store sells an MP3 player in December to a customer who agrees to pay for it in January. Should the business *recognize* (report) the sale as a December transaction or as a January transaction? It really does not matter as long as the storeowner discloses the rule the decision is based on and applies it consistently to other transactions. Because businesses may use different reporting rules, however, clear communication also requires full and fair disclosure of the accounting rules chosen.



Communicating business results would be simpler if each type of business activity were reported using only one measurement method. World economies and financial reporting practices, however, have not evolved uniformly. Even in highly sophisticated countries such as the United States, companies exhibit significant diversity in reporting methods. Providers of financial reports assume that users are educated about accounting practices.

The **Financial Accounting Standards Board (FASB)**¹ is a privately funded organization with the primary authority for establishing accounting standards in the United States. The measurement rules established by the FASB are called **generally accepted accounting principles (GAAP)**. Financial reports issued to the public must follow GAAP. This textbook introduces these principles so you will be able to understand business activity reported by companies in the USA.

Companies are not required to follow GAAP when preparing *management accounting* reports. Although there is considerable overlap between financial and managerial accounting, managers are free to construct internal reports in whatever fashion best suits the effective operation of their companies.

Reporting Entities

Think of accountants as you would of news reporters. A news reporter gathers and discloses information about some person, place, or thing. Likewise, an accountant gathers and discloses financial information about specific people or businesses. The

¹The FASB consists of seven full-time members appointed by the supporting organization, the Financial Accounting Foundation (FAF). The FAF membership is intended to represent the broad spectrum of individuals and institutions that have an interest in accounting and financial reporting. FAF members include representatives of the accounting profession, industry, financial institutions, the government, and the investing public.

FOCUS ON INTERNATIONAL ISSUES

IS THERE GLOBAL GAAP?

As explained in this chapter, accounting is a measurement and communication discipline based on rules referred to as *generally accepted accounting principles (GAAP)*. The rules described in this text are based on GAAP used in the United States, but what rules do the rest of the world use? Is there a global GAAP, or does each country establish its own unique GAAP?

Until recently, each country developed its own unique GAAP. Global companies were required to prepare multiple sets of financial statements to satisfy each country's GAAP. The use of multiple accounting standards across the globe made comparing company performance difficult and expensive. To address the need for a common set of financial standards, the International Accounting Standards Committee was formed in 1973. The committee was reorganized as the **International Accounting Standards Board (IASB)** in 2001. The IASB issues **International Financial Reporting Standards (IFRS)**, which are rapidly gaining support worldwide. In 2005,

companies in the countries who were members of the European Union were required to use the IFRS as established by the IASB, which is headquartered in London. Today, over 100 countries require or permit companies to prepare their financial statements using IFRS.

As of 2013 most of the major economic countries had switched from their local GAAP to IFRS. One notable exception is the United States, but even here, the Securities and Exchange Commission announced in 2008 that it was seriously considering adopting rules that would allow our companies to use either GAAP or IFRS. Although not finalized when this book was being prepared, many accountants in the United States believe this will occur. Additionally, there is an active process in place to reduce the differences between IFRS and U.S. GAAP.

There are many similarities between the IASB and the FASB. Both the FASB and the IASB are required to include members with a variety of backgrounds, including auditors, users of financial information, academics, and so forth. Also, both groups primarily require that their members work full-time for their respective boards; they cannot serve on the board while being compensated by another organization. (The IASB does allow up to three of its members to be part-time.) Members of each board serve five-year terms, and can be reappointed once. The funds to support both boards, and the large organizations that support them are obtained from a variety of sources, including selling publications and private contributions. To help maintain independence of the board's members, fundraising is performed by separate sets of trustees.

There are significant differences between the IASB and the FASB, and one of these relates to size and geographic diversity. The FASB has only seven members, all from the United States. The IASB has sixteen members, and these must include at least four from Asia, four from Europe, four from North America, one from Africa, and one from South America.

Not only is the structure of the standards-setting boards different but the standards and principles they establish may also differ significantly. In this chapter, you will learn that GAAP employs the *historical cost concept*. This means that the assets of most U.S. companies are shown on the balance sheet at the amount for which they were purchased. For example, land that has a market value of millions of dollars may be shown on US Steel's financial statements with a value of only a few hundred thousand dollars. This occurs because GAAP requires US Steel to show the land at its cost rather than its market value. In contrast, IFRS permits companies to show market values on their financial statements. This means that the exact same assets may show radically different values if the statements are prepared under IFRS rather than GAAP.

Throughout this text, where appropriate, we will note the differences between U.S. GAAP and IFRS. However, by the time you graduate, it is likely that among the major industrialized nations, there will be a global GAAP.



people or businesses accountants report on are called **reporting entities**. When studying accounting you should think of yourself as the accountant. Your first step is to identify the person or business on which you are reporting. This is not always as easy as it may seem. To illustrate, consider the following scenario.

Jason Winston recently started a business. During the first few days of operation, Mr. Winston transferred cash from his personal account into a business account for a company he named Winston Enterprises. Mr. Winston's brother, George, invested cash in Winston Enterprises for which he received an ownership interest in the company. Winston Enterprises borrowed cash from First Federal Bank. Winston Enterprises paid cash to purchase a building from Commercial Properties, Inc. Winston Enterprises earned cash revenues from its customers and paid its employees cash for salaries expense.

How many reporting entities are described in this scenario? Assuming all of the customers are counted as a single entity and all of the employees are counted as a single