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SURVEY OF ACCOUNTING

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Paul D. Kimmel PhD, CPA
University of Wisconsin—Milwaukee
Milwaukee, Wisconsin

Jerry J. Weygandt PhD, CPA
University of Wisconsin—Madison
Madison, Wisconsin

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From the Authors

Dear Student,

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

Why This Book? Your instructor has chosen this textbook for you because of the authors’ trusted reputation. The authors have worked hard to write a book that is engaging, timely, and accurate.

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

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

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

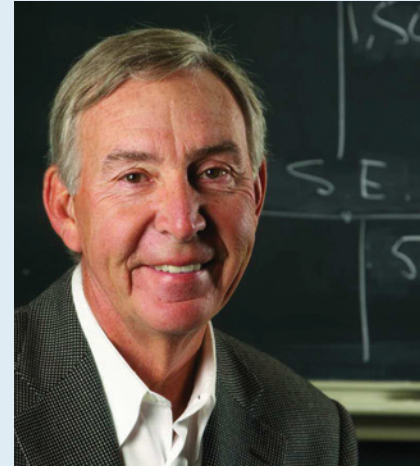
Paul D. Kimmel
Jerry J. Weygandt

Author Commitment



Paul Kimmel

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



Jerry Weygandt

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

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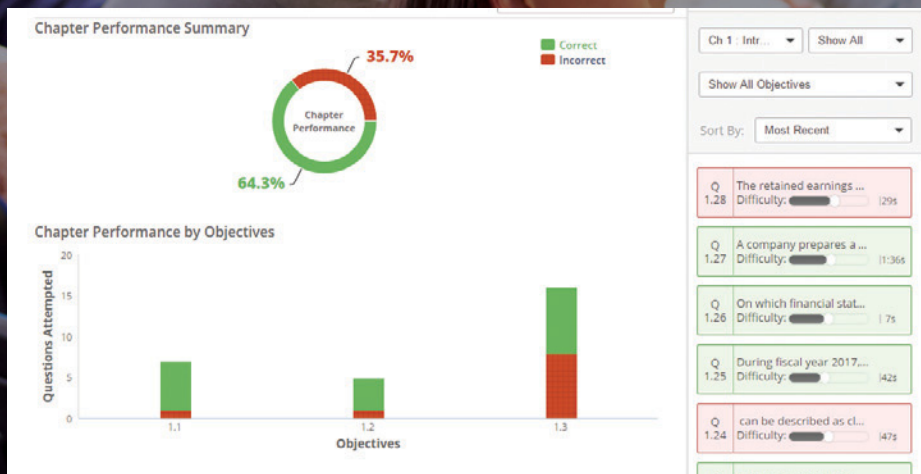


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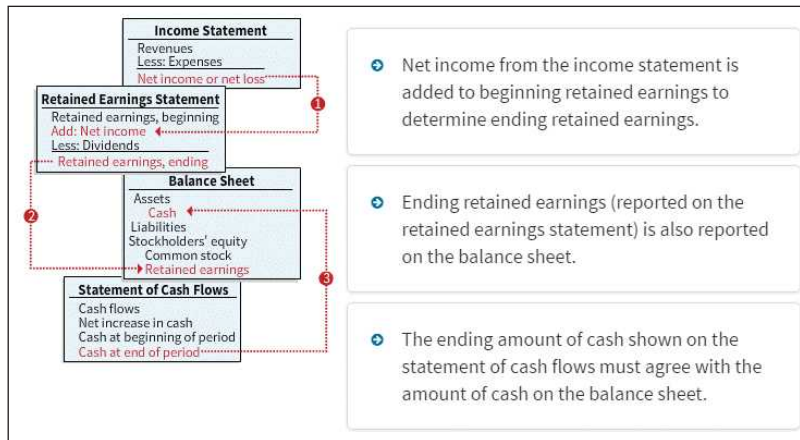
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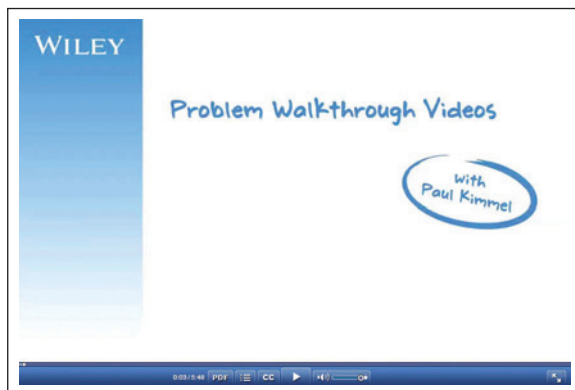
With visual reports, it's easy for both students and educators to gauge problem areas and act on what's most important.

Interactive Tutorials



Interactive mobile videos allow students to review content and respond to interactive questions in the video anywhere, anytime.

Solution Walkthrough Videos



Step-by-step walkthroughs of solutions to exercises similar to those in homework assignments.

Multiple Practice Opportunities

Practice Exercise 2 (Part Level Submission)
Waterway Industries is a private camping ground near the Mount Miguel Recreation Area. It has compiled the following financial information as of December 31, 2017.

Service revenue (from camping fees)	\$179,520	Dividends	\$12,240
Sales revenue (from general store)	34,000	Notes payable	68,000
Accounts payable	14,960	Expenses during 2017	171,360
Cash	11,560	Supplies	7,480
Equipment	155,040	Common stock	54,400
		Retained earnings (1/1/2017)	6,800

▼ (a)
Determine Waterway Industries's net income for 2017.

Waterway Industries's net income for 2017 \$

In addition to WileyPLUS with Orion practice questions, students can assess their understanding of accounting with algorithmic versions of questions similar to those in homework assignments.

Hallmark Features

Survey of Accounting, 1st Edition, provides a simple and practical introduction to financial and managerial accounting. It explains accounting concepts without the use of debits and credits, while emphasizing the importance of financial statements and decision-making.

Financial Statement Transaction Illustrations

Throughout the textbook, carefully crafted illustrations demonstrate the analysis of business transactions. Each illustration shows the effect that a transaction has on (1) the basic accounting equation, (2) individual accounts, (3) the balance sheet and the income statement, and (4) cash.

Basic Analysis: The asset Cash is decreased \$4,000; the expense account Salaries and Wages Expense is increased \$4,000.

CASH FLOW	BALANCE SHEET											INCOME STATEMENT		
	Assets				=	Liabilities			+	Stockholders' Equity				
			Prepd. Equip-							Retained Earnings				
	Cash	+ Supplies	+ Insur.	+ ment	=	Notes Pay.	+ Accts. Pay.	+ Unearned Serv. Rev.	+ Common Stock	+ Rev.	- Exp.	- Div.		
↓ \$4,000	\$19,200	+ \$2,500	+ \$600	+ \$5,000	=	\$5,000	+ \$2,500	+ \$1,200	+ \$10,000	+ \$10,000	- \$900	- \$500	Sal./Wages Expense	
(1) -4,000	\$15,200	+ \$2,500	+ \$600	+ \$5,000	=	\$5,000	+ \$2,500	+ \$1,200	+ \$10,000	+ \$10,000	- \$4,900	- \$500		
	\$23,300					\$23,300								

DO IT! Exercises and Solutions

DO IT! exercises and solutions in the body of the textbook prompt students to stop and review key concepts. They are also available as algorithmic practice questions in WileyPLUS.

DO IT!
▶
1
Types of Costs

Helena Company reports the following total costs at two levels of production.

	10,000 Units	20,000 Units
Direct materials	\$20,000	\$40,000
Maintenance	8,000	10,000
Direct labor	17,000	34,000
Indirect materials	1,000	2,000
Depreciation	4,000	4,000
Utilities	3,000	5,000
Rent	6,000	6,000

Action Plan

- ✓ Recall that a variable cost varies in total directly and proportionately with each change in activity level.
- ✓ Recall that a fixed cost remains the same in total with each change in activity level.
- ✓ Recall that a mixed cost changes in total but not proportionately with each change in activity level.

SOLUTION

Direct materials, direct labor, and indirect materials are variable costs. Depreciation and rent are fixed costs. Maintenance and utilities are mixed costs.

Classify each cost as variable, fixed, or mixed.

Related exercise material: **BE11-1, BE11-2, BE11-3, DO IT! 11-1, E11-1, E11-2, E11-4, and E11-6.**

Review Exercises and Solutions

Each textbook chapter concludes with multiple-choice questions, exercises, and a comprehensive problem. Detailed solutions are provided.

INSTRUCTIONS
Prepare the assets section of a classified balance sheet, listing the items in proper sequence and including a statement heading.

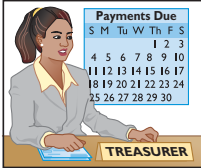
SOLUTION
1.

H. J. HEINZ COMPANY		
Partial Balance Sheet		
April 30, 2017		
(in thousands)		
<u>Assets</u>		
Current assets		
Cash	\$ 617,687	
Accounts receivable	1,161,481	
Inventory	1,378,216	
Prepaid insurance	<u>168,182</u>	
Total current assets		\$ 3,325,566
Property, plant, and equipment		
Land	56,007	


Infographic Learning

Over half of the textbook is visual, providing students alternative ways of learning about accounting.

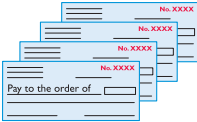
Cash Disbursements Controls



Establishment of Responsibility
Only designated personnel are authorized to sign checks (treasurer) and approve vendors



Segregation of Duties
Different individuals approve and make payments; check-signers do not record disbursements




Documentation Procedures
Use prenumbered checks and account for them in sequence; each check must have an approved invoice; require employees to use corporate credit cards for reimbursable expenses; stamp invoices "paid"

Real-World Decision-Making

Real-world examples and decision-making tips are integrated throughout the textbook.

ETHICS INSIGHT



© Christy Thompson/Shutterstock

Cookie Jar Allowances

There are many pressures on companies to achieve earnings targets. For managers, poor earnings can lead to dismissal or lack of promotion. It is not surprising then that management may be tempted to look for ways to boost their earnings number.

One way a company can achieve greater earnings is to lower its estimate of what is needed in its Allowance for Doubtful Accounts (sometimes referred to as "tapping the cookie jar"). For example, suppose a company has an Allowance for Doubtful Accounts

of \$10 million and decides to reduce this balance to \$9 million. As a result of this change, Bad Debt Expense decreases by \$1 million and earnings increase by \$1 million.

Large banks such as **JP Morgan Chase**, **Wells Fargo**, and **Bank of America** recently decreased their Allowance for Doubtful Accounts by over \$4 billion. These reductions came at a time when these big banks were scaling back their lending and trading activities. They justified these reductions by noting that credit quality had improved. This may be so, but it is also true that there is a risk that credit quality might be tapped when a recession hits.

How might investors determine if a company is managing its earnings? (Go to the end of the chapter for additional questions.)

DECISION TOOLS

Free cash flow helps users determine the amount of cash a company generated to expand operations, pay off debts, or increase dividends.

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Ellen Bartley
St. Joseph's College

LuAnn Bean
Florida Institute of Technology

Swati Bhandarkar
University of Georgia

Jack Borke
University of Wisconsin—Platteville

Elizabeth Briggs
Louisiana State University

C. Catherine Chiang
Elon University

Sandee Cohen
Columbia College—Chicago

Cari Edison
Baylor University

Jim Emig
Villanova University

Larry Falcetto
Emporia State University

Heidi Hansel
Kirkwood Community College

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University of California—Santa Barbara

James Holland
Virginia Commonwealth University

Maggie Houston
Wright State University

Constance Hylton
George Mason University

Surya Janakiraman
University of Texas—Dallas

Joseph Lipari
Montclair State University

Cynthia Lovick
Austin Community College

Kirk Lynch
Sandhills Community College

Anthony Masino
East Tennessee State University

Jill Misuraca
University of Tampa

Kenneth Muccino
Central Connecticut State University

Barb Muller
Arizona State University

Roshelle Overton
Central New Mexico Community College

Yvonne Phang
Borough of Manhattan Community College

Jean Price
Marshall University

Laura Prosser
Black Hills State University

Reza Rafi
University of Phoenix

Timothy Schultz

Lloyd Seaton
Northern Colorado University

Kathleen Simons
Bryant University

Alice Sineath
Forsyth Technical Community College

Lynn Stallworth
Appalachian State University

Jill Trucke
University of Nebraska—Lincoln

Sheila Viel
University of Wisconsin—Milwaukee

Dick Wasson
Southwestern College

Bruce Wright
Loyalist College

James Yang
Montclair State University

Melanie Yon

Lori Grady Zaher
Bucks County Community College

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

Paul D. Kimmel
Milwaukee, Wisconsin

Jerry J. Weygandt
Madison, Wisconsin



kimmel
weygandt

team for success

SURVEY OF ACCOUNTING

WILEY

1

Introduction to Financial Statements

CHAPTER PREVIEW

The **Chapter Preview** describes the purpose of the chapter and highlights major topics.

How do you start a business? How do you determine whether your business is making or losing money? How should you finance expansion—should you borrow, should you issue stock, should you use your own funds? How do you convince banks to lend you money or investors to buy your stock? Success in business requires making countless decisions, and decisions require financial information.

The purpose of this chapter is to show you what role accounting plays in providing financial information.

The **Chapter Outline** presents the chapter's topics and subtopics, as well as practice opportunities.

CHAPTER OUTLINE

LEARNING OBJECTIVES

1 Identify the forms of business organization and the uses of accounting information.

- Forms of business organization
- Users and uses of financial information
- Ethics in financial reporting

PRACTICE

DO IT!

1 Business Organization Forms

2 Explain the three principal types of business activity.

- Financing activities
- Investing activities
- Operating activities

DO IT!

2 Business Activities

3 Describe the four financial statements and how they are prepared.

- Income statement
- Retained earnings statement
- Balance sheet
- Statement of cash flows
- Interrelationships of statements
- Other annual report elements

DO IT!

3 3a Financial Statements
3b Components of Annual Reports

Go to the **REVIEW AND PRACTICE** section at the end of the chapter for a targeted summary and exercises with solutions.

Visit **WileyPLUS** for additional tutorials and practice opportunities.



FEATURE STORY

The Feature Story helps you picture how the chapter topic relates to the real world of accounting and business.

Many students who take this course do not plan to be accountants. If you are in that group, you might be thinking, “If I’m not going to be an accountant, why do I need to know accounting?”

Well, consider this quote from Harold Geneen, the former chairman of **IT&T**: “To be good at your business, you have to know the numbers—cold.” In business, accounting and financial statements are the means for communicating the numbers. If you don’t know how to read financial statements, you can’t really know your business.

Knowing the numbers is sometimes even a matter of corporate survival. Consider the story of **Columbia Sportswear Company**, headquartered in Portland, Oregon. Gert Boyle’s family fled Nazi Germany when she was 13 years old and then purchased a small hat company in Oregon, Columbia Hat Company. In 1971, Gert’s husband, who was then running the company, died suddenly of a heart attack. The company was in the midst of an aggressive expansion, which had taken its sales above \$1 million for the first time but which had also left the company financially stressed. Gert took over the small, struggling company with help from her son Tim, who was then a senior at the University of Oregon. Somehow, they kept the company afloat.

Today, Columbia has more than 4,000 employees and annual sales in excess of \$1 billion. Its brands include Columbia, Mountain Hardwear, Sorel, and Montrail.

Gert still heads up the Board of Directors, and Tim is the company’s President and CEO.

Columbia doesn’t just focus on financial success. The company is very committed to corporate, social, and environmental responsibility. For example, several of its factories have participated in a project to increase

health awareness of female factory workers in developing countries. Columbia was also a founding member of the Sustainable Apparel Coalition, which is a group that strives to reduce the environmental and social impact of the apparel industry. In addition, it monitors all of the independent factories that produce its products to ensure that they comply with the company’s Standards of Manufacturing Practices. These standards address issues including forced labor, child labor, harassment, wages and benefits, health and safety, and the environment.

Employers such as Columbia Sportswear generally assume that managers in all areas of the company are “financially literate.” To help prepare you for that, in this textbook you will learn how to read and prepare financial statements, and how to use basic tools to evaluate financial results.

Knowing the Numbers

LEARNING
OBJECTIVE

1

Identify the forms of business organization and the uses of accounting information.

Suppose you graduate with a business degree and decide you want to start your own business. But what kind of business? You enjoy working with people, especially teaching them new skills. You also spend most of your free time outdoors, kayaking, backpacking, skiing, rock climbing, and mountain biking. You think you might be successful in opening an outdoor guide service where you grew up, in the Sierra Nevada mountains.

FORMS OF BUSINESS ORGANIZATION

Your next decision is to determine the organizational form of your business. You have three choices—sole proprietorship, partnership, or corporation.

SOLE PROPRIETORSHIP You might choose the sole proprietorship form for your outdoor guide service. A business owned by one person is a **sole proprietorship**. It is **simple to set up** and **gives you control** over the business. Small owner-operated businesses such as barber shops, law offices, and auto repair shops are often sole proprietorships, as are farms and small retail stores.

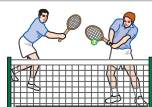
PARTNERSHIP Another possibility is for you to join forces with other individuals to form a partnership. A business owned by two or more persons associated as partners is a **partnership**. Partnerships often are formed because one individual does not have **enough economic resources** to initiate or expand the business. Sometimes **partners bring unique skills or resources** to the partnership. You and your partners should formalize your duties and contributions in a written partnership agreement. Retail and service-type businesses, including professional practices (lawyers, doctors, architects, and certified public accountants), often organize as partnerships.

CORPORATION As a third alternative, you might organize as a corporation. A business organized as a separate legal entity owned by stockholders is a **corporation**. Investors in a corporation receive shares of stock to indicate their ownership claim. Buying stock in a corporation is often more attractive than investing in a partnership because shares of stock are **easy to sell** (transfer ownership). Selling a proprietorship or partnership interest is much more involved. Also, individuals can become **stockholders** by investing relatively small amounts of money. Therefore, it is **easier for corporations to raise funds**. Successful corporations often have thousands of stockholders, and their stock is traded on organized stock exchanges like the **New York Stock Exchange**. Many businesses start as sole proprietorships or partnerships and eventually incorporate.

Other factors to consider in deciding which organizational form to choose are **taxes and legal liability**. If you choose a sole proprietorship or partnership, you generally receive more favorable tax treatment than a corporation. However, proprietors and partners are personally liable for all debts and legal obligations of the business; corporate stockholders are not. In other words, corporate stockholders generally pay higher taxes but have no personal legal liability. We will discuss these issues in more depth in a later chapter.

Finally, while sole proprietorships, partnerships, and corporations represent the main types of business organizations, hybrid forms are now allowed in all states. These hybrid business forms combine the tax advantages of partnerships with the limited liability of corporations. Probably the most common among these hybrids types are limited liability companies (LLCs) and subchapter S corporations. These forms are discussed extensively in business law classes.

The combined number of proprietorships and partnerships in the United States is more than five times the number of corporations. However, the revenue



ALTERNATIVE TERMINOLOGY

Stockholders are sometimes called *shareholders*.

Alternative Terminology notes present synonymous terms that you may come across in practice.

produced by corporations is eight times greater. Most of the largest businesses in the United States—for example, **Coca-Cola**, **ExxonMobil**, **General Motors**, **Citigroup**, and **Microsoft**—are corporations. Because the majority of U.S. business is done by corporations, the emphasis in this textbook is on the corporate form of organization.

USERS AND USES OF FINANCIAL INFORMATION

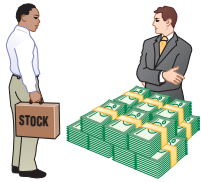


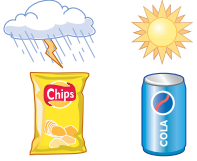
The purpose of financial information is to provide inputs for decision-making. **Accounting** is the information system that identifies, records, and communicates the economic events of an organization to interested users. **Users** of accounting information can be divided broadly into two groups: internal users and external users.

Internal Users

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

ILLUSTRATION 1-1
Questions that internal users ask

Questions Asked by Internal Users

 <p>Finance</p> <p>Is cash sufficient to pay dividends to Microsoft stockholders?</p>	 <p>Marketing</p> <p>What price should Apple charge for an iPad to maximize the company's net income?</p>	 <p>Human Resources</p> <p>Can General Motors afford to give its employees pay raises this year?</p>	 <p>Management</p> <p>Which PepsiCo product line is the most profitable? Should any product lines be eliminated?</p>
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To answer these and other questions, you need detailed information on a timely basis. For internal users, accounting provides internal reports, such as financial comparisons of operating alternatives, projections of income from new sales campaigns, and forecasts of cash needs for the next year. In addition, companies present summarized financial information in the form of financial statements.

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

ACCOUNTING ACROSS THE ORGANIZATION

Clif Bar & Company



© Dan Moore/iStockphoto

Owning a Piece of the Bar

The original Clif Bar® energy bar was created in 1990 after six months of experimentation by Gary Erickson and his mother in her kitchen. Today, the company has almost 300 employees and is considered one of the leading Landor's Breakaway Brands®. One of **Clif Bar & Company's** proudest moments was the creation of an employee stock ownership plan

(ESOP) in 2010. This plan gives its employees 20% ownership of the company. The ESOP also resulted in Clif Bar enacting an open-book management program, including the commitment to educate all employee-owners about its finances. Armed with basic accounting knowledge, employees are more aware of the financial impact of their actions, which leads to better decisions.

What are the benefits to the company and to the employees of making the financial statements available to all employees? (Go to WileyPLUS for this answer and additional questions.)

External Users

There are several types of **external users** of accounting information. **Investors** (owners) use accounting information to make decisions to buy, hold, or sell stock. **Creditors** such as suppliers and bankers use accounting information to evaluate the risks of selling on credit or lending money. Some questions that investors and creditors may ask about a company are shown in Illustration 1-2.

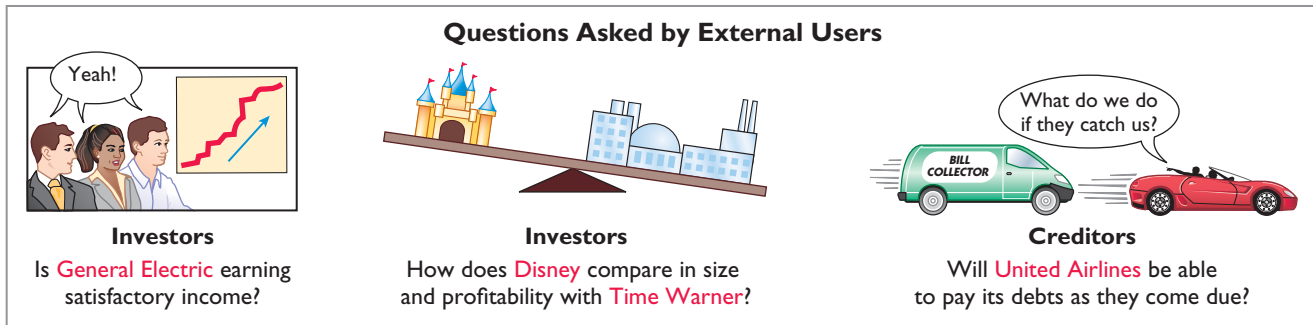


ILLUSTRATION 1-2
Questions that external users ask

The information needs and questions of other external users vary considerably. **Taxing authorities**, such as the Internal Revenue Service, want to know whether the company complies with the tax laws. **Customers** are interested in whether a company like **General Motors** will continue to honor product warranties and otherwise support its product lines. **Labor unions**, such as the Major League Baseball Players Association, want to know whether the owners have the ability to pay increased wages and benefits. **Regulatory agencies**, such as the Securities and Exchange Commission or the Federal Trade Commission, want to know whether the company is operating within prescribed rules. For example, **Enron**, **Dynegy**, **Duke Energy**, and other big energy-trading companies reported record profits at the same time as California was paying extremely high prices for energy and suffering from blackouts. This disparity caused regulators to investigate the energy traders to make sure that the profits were earned by legitimate and fair practices.

ACCOUNTING ACROSS THE ORGANIZATION



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Spinning the Career Wheel

How will the study of accounting help you? A working knowledge of accounting is desirable for virtually every field of business. Some examples of how accounting is used in business careers include the following.

General management: Managers of **Ford Motors**, Massachusetts General Hospital, California State University–Fullerton, a **McDonald's** franchise, and a **Trek** bike shop all need to understand

accounting data in order to make wise business decisions.

Marketing: Marketing specialists at **Procter & Gamble** must be sensitive to costs and benefits, which accounting helps

them quantify and understand. Making a sale is meaningless unless it is a profitable sale.

Finance: Do you want to be a banker for **Citicorp**, an investment analyst for **Goldman Sachs**, or a stock broker for **Merrill Lynch**? These fields rely heavily on accounting knowledge to analyze financial statements. In fact, it is difficult to get a good job in a finance function without two or three courses in accounting.

Real estate: Are you interested in being a real estate broker for **Prudential Real Estate**? Because a third party—the bank—is almost always involved in financing a real estate transaction, brokers must understand the numbers involved: Can the buyer afford to make the payments to the bank? Does the cash flow from an industrial property justify the purchase price? What are the tax benefits of the purchase?

How might accounting help you? (Go to WileyPLUS for this answer and additional questions.)

ETHICS IN FINANCIAL REPORTING

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

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

Effective financial reporting depends on sound ethical behavior. To sensitize you to ethical situations and to give you practice at solving ethical dilemmas, we address ethics in a number of ways in this textbook. (1) A number of the *Feature Stories* and other parts of the text discuss the central importance of ethical behavior to financial reporting. (2) *Ethics Insight boxes* and marginal *Ethics Notes* highlight ethics situations and issues in actual business settings. (3) Many of the *People, Planet, and Profit Insight boxes* focus on ethical issues that companies face in measuring and reporting social and environmental issues. (4) At the end of each chapter, an *Ethics Case* simulates a business situation and asks you to put yourself in the position of a decision-maker in that case.

When analyzing these various ethics cases and your own ethical experiences, you should apply the three steps outlined in Illustration 1-3.


ETHICS NOTE

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

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

ILLUSTRATION 1-3

Steps in analyzing ethics cases



Solving an Ethical Dilemma

1. Recognize an ethical situation and the ethical issues involved.
Use your personal ethics to identify ethical situations and issues. Some businesses and professional organizations provide written codes of ethics for guidance in some business situations.

2. Identify and analyze the principal elements in the situation.
Identify the **stakeholders**—persons or groups who may be harmed or benefited. Ask the question: What are the responsibilities and obligations of the parties involved?

3. Identify the alternatives, and weigh the impact of each alternative on various stakeholders.
Select the most ethical alternative, considering all the consequences. Sometimes there will be one right answer. Other situations involve more than one right solution; these situations require you to evaluate each alternative and select the best one.

ETHICS INSIGHT Dewey & LeBoeuf LLP

Alliance/Shutterstock

**I Felt the Pressure—
Would You?**

"I felt the pressure." That's what some of the employees of the now-defunct law firm of **Dewey & LeBoeuf LLP** indicated when they helped to overstate revenue and use accounting tricks to hide losses and cover up cash shortages. These employees worked for the former finance director and former chief financial officer (CFO) of the firm. Here are some of their comments:

- "I was instructed by the CFO to create invoices, knowing they would not be sent to clients. When I created these invoices, I knew that it was inappropriate."

- "I intentionally gave the auditors incorrect information in the course of the audit."

What happened here is that a small group of lower-level employees over a period of years carried out the instructions of their bosses. Their bosses, however, seemed to have no concern as evidenced by various e-mails with one another in which they referred to their financial manipulations as accounting tricks, cooking the books, and fake income.

Source: Ashby Jones, "Guilty Pleas of Dewey Staff Detail the Alleged Fraud," *Wall Street Journal* (March 28, 2014).

Why did these employees lie, and what do you believe should be their penalty for these lies? (Go to WileyPLUS for this answer and additional questions.)

Insight boxes provide examples of business situations from various perspectives—ethics, investor, international, and corporate social responsibility. Guideline answers to the critical thinking questions are available in WileyPLUS and at www.wiley.com/college/weygandt. Additional questions are offered in WileyPLUS.

DO IT!**1****Business Organization Forms**

*DO IT! exercises prompt you to stop and review the key points you have just studied. The **Action Plan** offers you tips about how to approach the problem.*

Action Plan

- ✓ Know which organizational form best matches the business type, size, and preferences of the owner(s).

In choosing the organizational form for your outdoor guide service, you should consider the pros and cons of each. Identify each of the following organizational characteristics with the organizational form or forms with which it is associated.

1. Easier to raise funds.
2. Simple to establish.
3. No personal legal liability.
4. Tax advantages.
5. Easier to transfer ownership.

SOLUTION

1. Easier to raise funds: Corporation.
2. Simple to establish: Sole proprietorship and partnership.
3. No personal legal liability: Corporation.
4. Tax advantages: Sole proprietorship and partnership.
5. Easier to transfer ownership: Corporation.

Related exercise material: **BE1-1** and **DO IT! 1-1**.

**LEARNING
OBJECTIVE****2****Explain the three principal types of business activity.**

All businesses are involved in three types of activity—financing, investing, and operating. For example, Gert Boyle's parents, the founders of **Columbia Sports-wear**, obtained cash through financing to start and grow their business. Some of

this **financing** came from personal savings, and some likely came from outside sources like banks. The family then **invested** the cash in equipment to run the business, such as sewing equipment and delivery vehicles. Once this equipment was in place, they could begin the **operating** activities of making and selling clothing.

The **accounting information system** keeps track of the results of each of the various business activities—financing, investing, and operating. Let’s look at each type of business activity in more detail.

FINANCING ACTIVITIES

It takes money to make money. The two primary sources of outside funds for corporations are borrowing money (debt financing) and issuing (selling) shares of stock in exchange for cash (equity financing).

Columbia Sportswear may borrow money in a variety of ways. For example, it can take out a loan at a bank or borrow directly from investors by issuing debt securities called bonds. Persons or entities to whom Columbia owes money are its **creditors**. Amounts owed to creditors—in the form of debt and other obligations—are called **liabilities**. Specific names are given to different types of liabilities, depending on their source. Columbia may have a **note payable** to a bank for the money borrowed to purchase delivery trucks. Debt securities sold to investors that must be repaid at a particular date some years in the future are **bonds payable**.

Corporations also obtain funds by selling shares of stock to investors. **Common stock** is the term used to describe the total amount paid in by stockholders for the shares they purchase.

The claims of creditors differ from those of stockholders. If you loan money to a company, you are one of its creditors. In lending money, you specify a payment schedule (e.g., payment at the end of three months). As a creditor, you have a legal right to be paid at the agreed time. In the event of nonpayment, you may legally force the company to sell property to pay its debts. In the case of financial difficulty, creditor claims must be paid before stockholders’ claims.

Stockholders, on the other hand, have no claim to corporate cash until the claims of creditors are satisfied. Suppose you buy a company’s stock instead of loaning it money. You have no legal right to expect any payments from your stock ownership until all of the company’s creditors are paid amounts currently due. However, many corporations make payments to stockholders on a regular basis as long as there is sufficient cash to cover required payments to creditors. These cash payments to stockholders are called **dividends**.

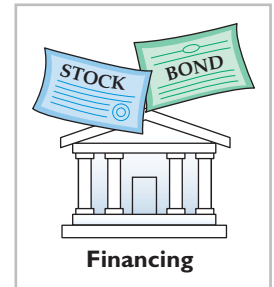
INVESTING ACTIVITIES

Once the company has raised cash through financing activities, it uses that cash in investing activities. Investing activities involve the purchase of the resources a company needs in order to operate. A growing company purchases many resources, such as computers, delivery trucks, furniture, and buildings. Resources owned by a business are called **assets**. Different types of assets are given different names. For example, Columbia Sportswear’s sewing equipment is a type of asset referred to as **property, plant, and equipment**.

Cash is one of the more important assets owned by Columbia or any other business. If a company has excess cash that it does not need for a while, it might choose to invest in securities (stocks or bonds) of other corporations. **Investments** are another example of an investing activity.

OPERATING ACTIVITIES

Once a business has the assets it needs to get started, it begins operations. Columbia Sportswear is in the business of selling outdoor clothing and footwear. It sells TurboDown jackets, Millenium snowboard pants, Sorel® snow boots,



ALTERNATIVE TERMINOLOGY
Property, plant, and equipment is sometimes called *fixed assets*.

