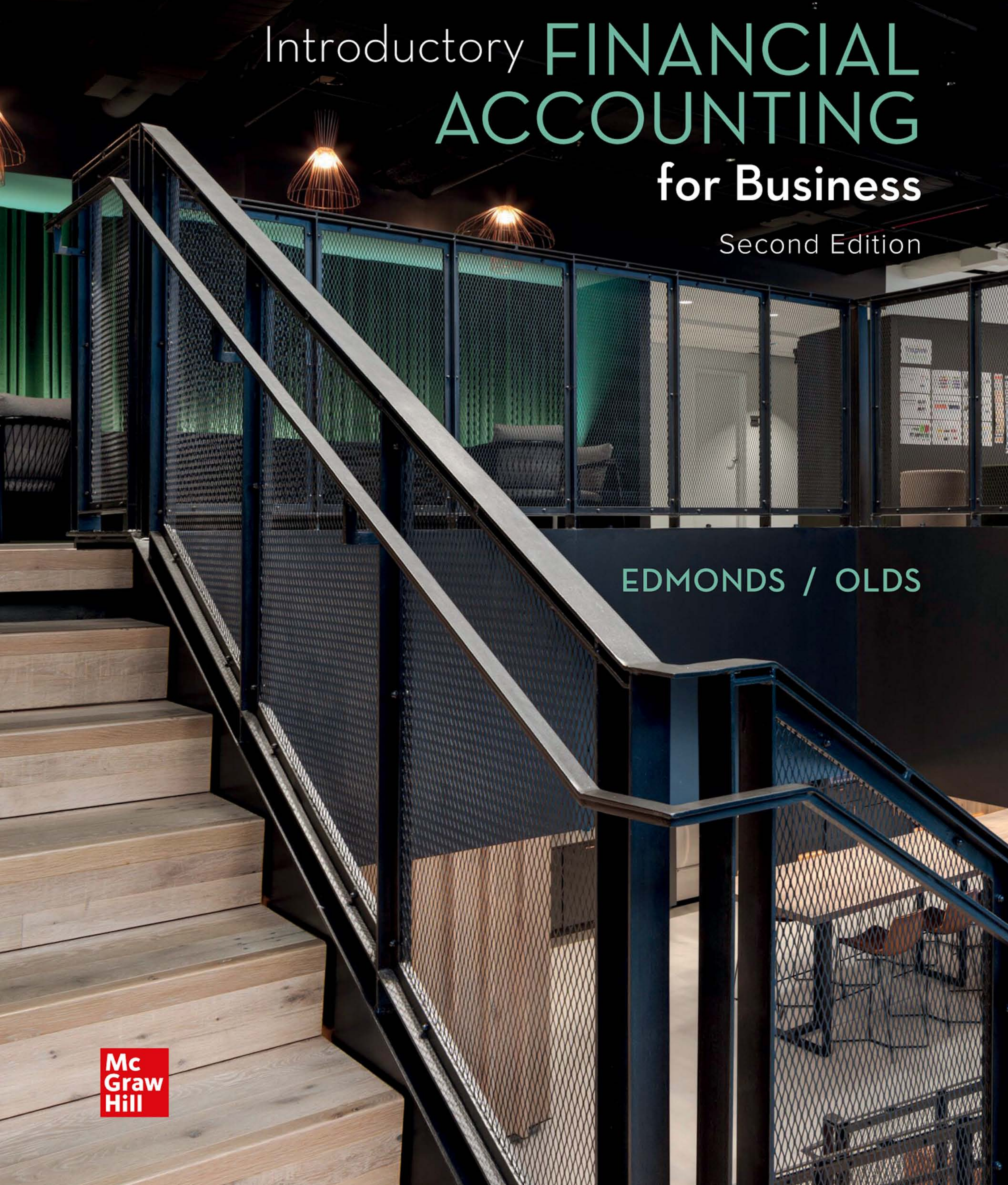
Introductory FINANCIAL ACCOUNTING for Business

Second Edition



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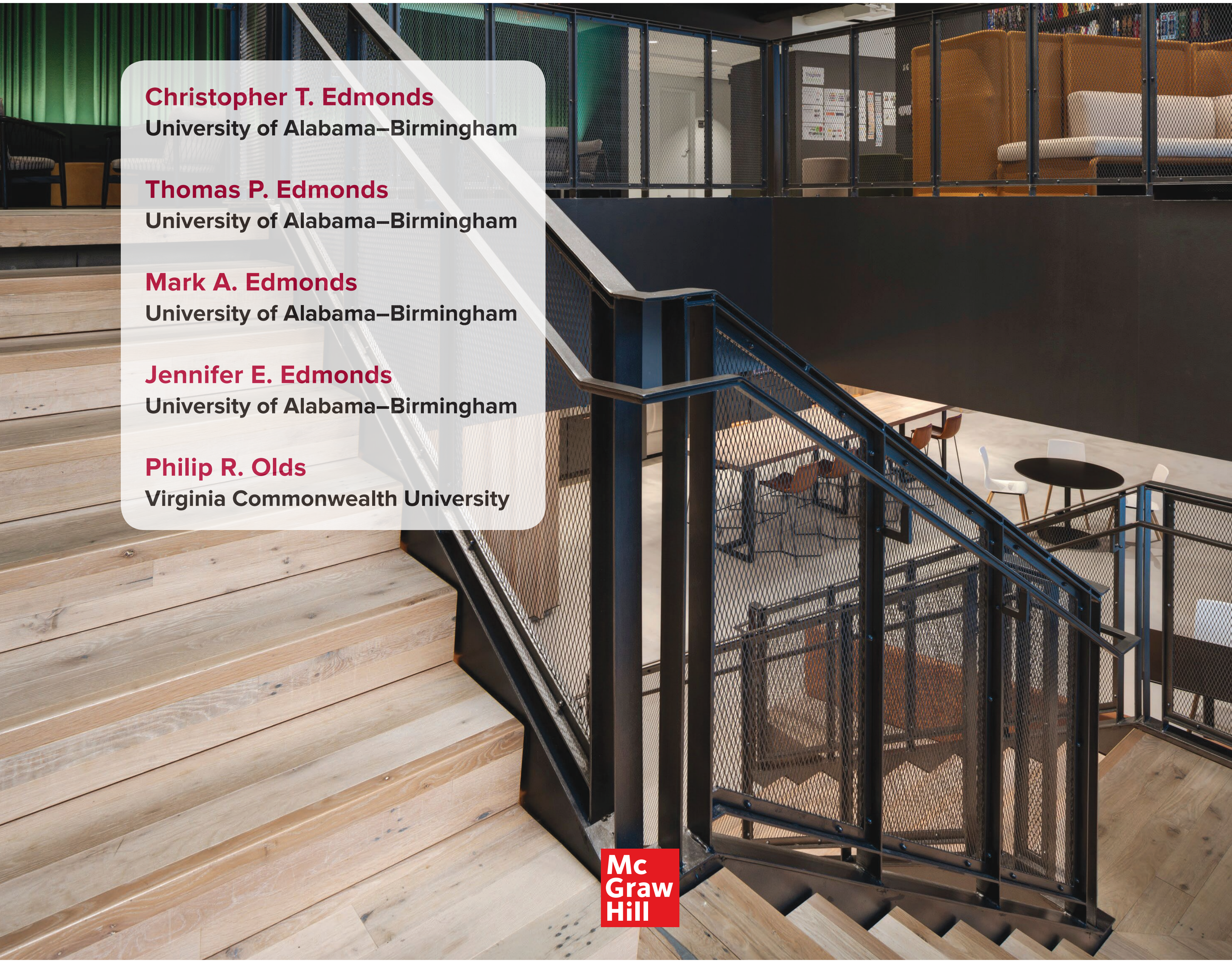

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INTRODUCTORY FINANCIAL ACCOUNTING FOR BUSINESS

This book is printed on acid-free paper.

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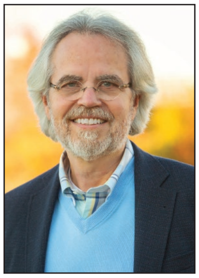
This book is dedicated to our students, whose questions have so frequently caused us to reevaluate our method of presentation that the students themselves have become major contributors to the development of this text.

ABOUT THE AUTHORS

Courtesy of
Christopher Edmonds

Christopher T. Edmonds

Christopher T. Edmonds, PhD, is an Associate Professor in the Department of Accounting and Finance at the UAB Collat School of Business. He is the course coordinator for the face-to-face and online principles of accounting courses. Dr. Edmonds specializes in teaching and developing engaging face-to-face and online introductory accounting courses. He is a frequent speaker at conferences and universities on best teaching practices and has delivered over 30 professional teaching workshops. His passion for helping students learn inspired him to create hundreds of short videos teaching the fundamental concepts of accounting. This work led to the publication of the first interactive video textbook for introductory accounting. Dr. Edmonds has received numerous prestigious teaching awards, including the UAB President's Award for Excellence in Teaching, UAB Faculty Student Success Award, UAB Transformative Online Course Award, UAB Loudell Ellis Robinson Classroom Teaching Award, UAB Disability Support Recognition Award, and the Virginia Tech Favorite Faculty Award. He has published four textbooks and has written numerous articles that have appeared in publications, including *The Accounting Review, Auditing: A Journal of Practice & Theory, Journal of Accounting and Public Policy, Issues in Accounting Education, Advances in Accounting Education, Advances in Accounting,* and *Review of Quantitative Finance and Accounting*. Dr. Edmonds started his career as a web application developer creating software solutions to put newspapers online. He began his academic training at Colorado State University. He obtained an MBA from UAB. His PhD with a major in accounting was awarded by Virginia Polytechnic Institute and State University. Check out his blog at **www.accountingstepbystep.com**.



Courtesy of
Thomas Edmonds

Thomas P. Edmonds

Thomas P. Edmonds, PhD, 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 several 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's 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 Regions Bank), Texaco, and Cortland Chemicals. Dr. Edmonds began his academic training at Young Harris Community College in Young Harris, Georgia. He received a BBA degree with a major in finance from Georgia State University in Atlanta, Georgia. He obtained an MBA with a concentration in finance from St. Mary's University in San Antonio, Texas. His PhD with a major in accounting was awarded by Georgia State University. Dr. Edmonds's work experience and academic training have enabled him to bring a unique user perspective to this textbook.

Mark A. Edmonds

Courtesy of Mark Edmonds

Mark A. Edmonds, PhD, CPA, is an Assistant Professor in the Department of Accounting and Finance at the University of Alabama at Birmingham. He has taught principles and advanced accounting classes in face-to-face, flipped, and online formats. He is the recipient of the Loudell Ellis Robinson excellence in teaching award. Dr. Edmonds began his career providing assurance services for the internationally recognized accounting firm Ernst & Young. At the conclusion of his professional service, he obtained his PhD from Southern Illinois University Carbondale. He serves as the education adviser on the board of the Institute of Internal Auditors Birmingham Chapter. Dr. Edmonds's research focuses on alternative learning strategies and auditor decision making.

Jennifer E. Edmonds

Courtesy of Jennifer Edmonds

Jennifer Echols Edmonds, PhD, is an Associate Professor at the University of Alabama at Birmingham (UAB) Collat School of Business. Her primary teaching areas are financial and managerial accounting. She has experience teaching in the undergraduate, MAC, and MBA programs and currently serves as the course coordinator for the managerial accounting sequence at UAB. She has received the UAB Loudell Ellis Robinson Classroom Teaching Award, as well as teaching grants from Deloitte, UAB, and Virginia Tech. She created teaching resources for incorporating International Financial Reporting Standards into Intermediate Accounting that were published online at the American Accounting Association. Dr. Edmonds is also active in the research community. She has published articles in prominent journals such as *Journal of Accounting and Public Policy, Advances in Accounting, Research in Accounting Regulation*, and *The CPA Journal*. Dr. Edmonds received a bachelor's degree in accounting from Birmingham-Southern College and completed her master's and PhD degrees in accounting at Virginia Polytechnic Institute and State University.

Philip R. Olds

Courtesy of Philip 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 AS degree from Brunswick Junior College in Brunswick, Georgia (now College of Coastal Georgia). He received a BBA in accounting from Georgia Southern College (now Georgia Southern University), and his MPA and PhD 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. Most recently, he received the university's award for maintaining High Ethical and Academic Standards While Advocating for Student-Athletes and Their Quest Towards a Degree.

AUTHORS' VIEW OF

PREPARING ACCOUNTING STUDENTS FOR A CHANGING BUSINESS ENVIRONMENT

Automated data capture, data analytics, and artificial intelligence are transforming the business environment. Technology has greatly reduced or, in some cases, eliminated the need for humans to be involved in recording and reporting procedures. Rather than gathering information, today's students will be required to analyze and interpret information. They will have to make decisions early and often. In summary, instead of memorizing recording procedures, today's students must learn to think like business professionals.

Business professionals tend to think about bottom-line consequences: If I do this or that, how will it affect my company's net income, total assets, cash flow, and so on? We use a financial statements model to teach students how to mimic this thought process. The model arranges the balance sheet, income statement, and statement of cash flows horizontally across a single line of text, as shown here:

Balance Sheet					Income Statement					Statement of Cash Flows
Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	

Throughout the text, students are taught to show how accounting events affect the statements represented in the model. For example, an $8,400 cash payment to settle an interest payable liability would require the student to show the effects as follows:

Balance Sheet					Income Statement					Statement of Cash Flows
Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	
(8,400)		(8,400)		NA	NA		NA		NA	(8,400) OA

In the statement of cash flows, the student is required not only to identify the item as an inflow or outflow, but also to classify the item as an operating activity (OA), investing activity (IA), or financing activity (FA).

WITHOUT DEBITS AND CREDITS, IMPLEMENTATION AND LEARNING ARE EASY

Instructors have little difficulty implementing the statements model approach. Indeed, it is easier to show students how a single event affects financial statements than it is to show them how a series of events are recorded and then summarized in financial statements. Instead of using confusing debit/credit terminology, common increase/decrease terminology is all that is necessary to explain the interrelationships between business events and how they affect financial statements. This is analogous to skipping the middleman: instead of going from events to financial statements through a set of recording procedures, you skip the recording procedures and focus on a direct link between events and statement effects. Accounting comes alive with purpose, rather than being reduced to a boring memorization task. Student comprehension and motivation increase, with virtually no learning curve for instructors.

The business-oriented statements model approach does not require knowledge of debit and credit terminology. Indeed, early exposure to debit and credit terminology can hinder learning. After all, a debit or a credit is just a confusing way of saying an increase or a decrease. We believe that students should learn the essential relationships between events and statements before technical jargon is used to describe those relationships. The appropriate place to introduce debits and credits is at the end, rather than the beginning, of the text.

Some worry that accounting majors will not get enough exposure to recording procedures to prepare them for intermediate accounting. We provide a solution to this dilemma. Specifically, we offer two capstone course projects. These projects are designed to be covered during the last two weeks of class. By this time, students will have enough exposure to accounting to classify themselves as accounting majors or general business students. Those who consider themselves accounting majors should be assigned the General Ledger Capstone Project, while other students should be assigned the Financial Statement Analysis Capstone Project. The General Ledger Capstone Project provides instructors with a mechanism to drill students about debits and credits, while the Financial Statement Analysis Capstone Project teaches students how to use financial information to make management and investment decisions. These projects let instructors solve the age-old problem of accommodating the differing needs of accounting majors versus general business students. You can find a detailed discussion of these capstone course projects in the "How Are Chapter Concepts Reinforced?" section of this book's front matter.

This text includes all topics that are normally covered in a traditional introductory financial accounting book, including debits, credits, and all of the typical recording procedures associated with double-entry accounting. As a result, any questions that might be raised regarding accreditation and transfer credit can be easily answered.

"Sequential approach evident throughout the chapters. Building . . . building . . . building. . . . done!"

—NANCY SNOW
UNIVERSITY OF TOLEDO

EMPIRICAL EVIDENCE SUPPORTING A DELAYED DEBITS/CREDITS APPROACH FOR ACCOUNTING MAJORS

Shifting the focus from debits and credits to financial statement impacts does not mean that accounting majors will be ill-prepared for intermediate. We compared student performance under the "traditional" approach of introducing debits and credits early in the course (Chapter 3) to the "delayed" approach of introducing debits and credits at the end of the course (Chapter 13). Across a sample of 773 introductory students, we compared students' ability to 1) recognize financial statement impacts and 2) record journal entries at the end of the introductory accounting course. We found that students in the "delayed" group did significantly better in their ability to recognize the impact of accounting events on financial statements. Interestingly, we found no difference in their ability to record journal entries even though the "delayed" group was only exposed to this material briefly at the end of the course. In fact, students in the "delayed" group actually scored higher on the journal entry assessment, although the difference was not statistically significant.

A firm understanding of the relationship between accounting events and the accounting equation facilitates the process of learning debits/credits. Since students in the delayed group had more exposure to these relationships, they were able to grasp debit/credit terminology quickly. This conclusion is consistent with the education literature that shows knowledge retention improves when material is introduced in a sequential fashion. For more information on this study contact Chris Edmonds, cedmonds@gmail.com.

EXPOSURE TO DATA ANALYTICS

Beyond learning to think like business professionals, students need exposure to data analytics software. Just as spreadsheet software transformed accounting practice, data analytics is likely to have a similar impact. While there is general agreement that introductory accounting students need exposure to data analytics, agreement regarding the level and type of exposure is evolving. Do students need to know how to use the software or will the ability to interpret the output of the software be sufficient? We offer opportunities for you to expose your students to either or both options.

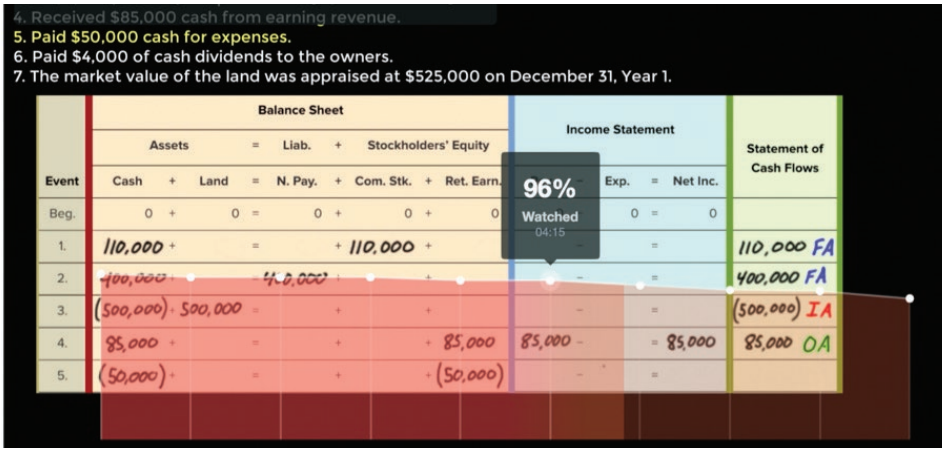
For those looking to give their students a deeper dive into data analytics, we offer an in-depth project, Applying Tableau, where students get hands-on operational experience with the software to answer a variety of business type questions. The answers to Applying Tableau are auto-gradable in *Connect*, saving you valuable time. Applying Tableau includes a tutorial video that walks students through the Tableau software and demonstrates the basic skills students need to get started using the software. A thorough description of this project is located in Appendix H at the end of the text.

For those who prefer to focus their students on understanding outputs rather than learning software, we have included short exercises, called Tableau Dashboard Activities, at the end of each chapter requiring students to make decisions using Tableau dashboards. These Tableau Dashboard Activities do not require students to learn Tableau. Instead, the Tableau dashboards are served up directly within *Connect* and accompanied by auto-gradable questions that students must answer based on the visualizations. The use of these Tableau Dashboard Activities creates a streamlined, integrated experience and allows students to focus on interpreting the outputs rather than creating them.

Having multiple options for teaching data analytics to your students gives you flexibility in how you want to incorporate these resources into your classroom. As data analytics trends continue to evolve, these resources should keep your curriculum current and your students up to date.

USING ANALYTICS TO IMPROVE VIDEO QUALITY

We know that there are a lot of videos out there, but all videos are not equal. In order for a video to be successful, students must watch it. If students stop watching in the early stages of a video, you know that they are not getting the content exposure they need and you can rest assured that failure is just around the corner. Based on this rationale, we have implemented a continuous quality improvement program for the videos that accompany our texts. Specifically, we analyze drop and finish rates to determine which videos are working and which ones are not. A typical analytical report is shown here:



This report shows that the video kept 96 percent of students tuned-in at the halfway point and 85 percent of students completed the entire video. While there is always room for improvement, this video produced a high-quality result. We completed an extensive analysis of all first edition videos and replaced select videos that had a finish rate of less than 80 percent. The results of this analysis lead us to create new and/or improved videos for learning objectives 1-1, 4-1, 4-7, 7-1, 7-2, 7-3, 8-2, 8-5, and 8-8.

If you have questions or comments regarding the lecture videos, please contact Chris Edmonds at cedmonds@gmail.com.

STEP-BY-STEP LEARNING APPROACH

The order in which material is presented can strongly influence what is learned, how fast it is learned, and even whether the material is learned at all. (1) Traditionally, teaching the first course in accounting starts with an overview of a full set of financial statements. However, many introductory students are not equipped to comprehend the items shown in the financial statements. Since terms such as *accounts receivable, accumulated depreciation, prepaid expenses,* etc. are not easily explained to a beginner, students are forced to memorize. Confusion and boredom follow in quick pursuit.

In contrast, this text employs a sequential, or step-by-step, learning approach. The text begins with the events rather than the statements that result from the events. Each time a new event is introduced, the terms presented in the event are defined and the effects of the event on the accounting equation are explained. Finally, students are shown how the information in the accounting equation is used to prepare financial statements. At no time are students exposed to terms that have not been fully explained. In other words, information is presented in a step-wise fashion with each new step following logically from the previous one. This sequential approach is used throughout the text. For example, cash transactions are introduced in Chapter 1, accrual events in Chapter 2, and deferral transactions in Chapter 3. Other texts traditionally tend to introduce these events simultaneously, which can result in information overload and lead to memorization. In contrast, our step-by-step approach gradually introduces concepts in a logical sequence that promotes understanding and stimulates interest while increasing motivation and engagement.

STATEMENT OF CASH FLOWS COVERED THROUGHOUT THE TEXT

The transaction-by-transaction analysis we use in the financial statements model enables an early introduction to the statement of cash flows. While the statement of cash flows is critically important in the real world, coverage of this statement in traditional textbooks is usually slighted and relegated to the last chapter of the text. The usual justification for this treatment is that teaching students to convert accrual accounting data into cash flow is complicated. In fact, it does not have to be this way. We removed the complexity by implementing a more direct method: a transaction-by-transaction teaching strategy.

We begin by defining the terms *operating*, *investing*, and *financing activities*. Thereafter, students are required to classify individual cash events as belonging to one of the three categories. As shown earlier, we implement this strategy via the financial statements model. The last column of the statements model represents the statement of cash flows. In this column, students distinguish between cash inflows and outflows and classify each cash flow as being an operating activity (OA), an investing activity (IA), or a financing activity (FA). See the entry for the $8,400 cash payment to settle an interest payable liability that was shown in the statements model earlier as an example.

This teaching strategy is applied consistently through the first 11 chapters. As a result, students develop the ability to distinguish between operating, investing, and financing activities and to prepare a statement of cash flows. This knowledge base provides the foundation for grasping the more complicated process of converting accrual accounting numbers to their cash flow equivalents, which is presented in Chapter 12.

FINANCIAL STATEMENT ANALYSIS

The text provides extensive coverage of financial statement analysis. A separate section titled "The Financial Analyst" is included in each chapter. This section covers the financial ratios related to the topics covered in the chapter. For example, the *accounts receivable turnover ratio* and *number of days to collect receivables* are covered in the receivables chapter. Likewise, *inventory turnover* and *number of days to sell inventory* are covered in the merchandise inventory chapter. We not only provide coverage of how to calculate the ratios but also provide real-world industry data to help students identify benchmarks and learn how to make meaningful comparisons of financial performance. In other words, the text shows students how to interpret ratios, as well as how to calculate them.

In addition, the text includes a separate chapter, Chapter 14, which provides in-depth coverage of the analysis of financial statements. This chapter includes two full sets of exercises, problems, and test bank material, along with all the *Connect* features. Finally, the appendices of the text include two comprehensive financial statement analysis projects. One pertains to Target's 10K annual report, which is included in the text. The other is an open-ended project that allows the instructor or the student to choose the company to be analyzed.

Once students understand how events affect financial statements, the next step is understanding how to analyze statements. The choice to cover financial statement analysis (FSA) at the introductory level really depends on the level of your students. We provide thorough coverage of FSA for the introductory level, but we separate it in such a way that covering this topic is left to the discretion of the professor.

(1) Frank E. Ritter; et al., eds. (2007). *In order to learn: How the sequence of topics influences learning*. Oxford series on cognitive models and architectures. Oxford/ New York: Oxford University Press.

WHAT WE DID TO MAKE IT BETTER

We profoundly appreciate the comments and suggestions provided by so many of the first edition adopters and reviewers of *Introductory Financial Accounting for Business*. In response, we made the following three major enhancements to the text and supporting materials.

Response to Adopter/Reviewer Suggestions

Data Analytics

Until recently data analytics, business intelligence, and big data were only buzz words that have now become essential components of the accounting curriculum at virtually all forward-thinking business schools. This edition offers a convenient way to address this subject matter in your introductory accounting course. Specifically, we offer a data analytics project that requires students to create data visualizations from a large data set in Tableau. Tableau is widely recognized as one of the leading business intelligence software packages in practice today. The details of this project can be found in Appendix H located in the end-of-text materials. Instructors can find more information in the Instructor Resource Center.

Test bank enhancements

Many of our adopters and reviewers recommended that we expand the test bank to include questions that specifically address the horizontal financial statements model. In response, we have added multiple-choice questions in each chapter that directly relate to this model. Here is an example:

Jantzen Company recorded employee salaries earned but not yet paid. Which of the following represents the effect of this transaction on the financial statements?

	Balance Sheet					Income Statement					Statement of Cash Flows
	Assets	=	Liab.	+	Stk. Equity	Rev.	−	Exp.	=	Net Inc.	
a.	+		+		n/a	+		n/a		+	OA
b.	n/a		+		−	n/a		+		−	IA
c.	−		n/a		−	n/a		+		−	n/a
d.	n/a		+		−	n/a		+		−	n/a

The correct answer is “d”. Liabilities (Salaries Payable) increase. Expenses (Salaries Expense) increase thereby decreasing net income and retained earnings. Cash flow is not affected. Overall, the test bank revision includes more than 50 new questions. We have also worked to make sure that consistent terminology is used across the text and test bank. We understand that assessment is an important part of teaching and hope that these changes will improve teaching and learning with the text.

Student Active Learning Worksheets

An increasing number of students are choosing to adopt the electronic version of textbooks. Since many students do not bring computers to class, working a particular exercise or problem in class is frustrated by the fact that students may not have access to the exercise or problem being worked. To resolve this issue, we provided a set of Active Learning Worksheets that included copies of the Set B exercises and problems. The blank forms include guidance and check figures designed to facilitate student engagement in the classroom. These Active Learning Worksheets are available as downloadable Word documents via McGraw-Hill *Connect*. An example is shown next.

Exercise 2-1B, Requirement a, Appears as Follows:

Exercise 2-1B *Recording events in a horizontal financial statements model*

The Bruce Spruce Co. experienced the following events during its first year of operations, Year 1:

1. Acquired $75,000 cash by issuing common stock.
2. Earned $48,000 cash revenue.
3. Paid $34,000 cash for operating expenses.
4. Borrowed $20,000 cash from a bank.
5. Paid $38,000 cash to purchase land.
6. Paid a $2,000 cash dividend.

Required

a. Use a horizontal financial statements model to show how each event affects the balance sheet, income statement, and statement of cash flows. More specifically, record the amounts of the events into the model. Also, in the Statement of Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first transaction is shown as an example.

	Balance Sheet									Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stk. Equity									
Event	Cash	+	Land	=	Notes Pay.	+	Com. Stk.	+	Ret. Earn.	Rev.	−	Exp.	=	Net Inc.		
1.	75,000	+	NA	=	NA	+	75,000	+	NA	NA	−	NA	=	NA	75,000	FA

Student Active Learning Worksheet for Exercise 2-1B, Requirement a, Appears as Follows:

Exercise 2-1B *Requirement An Active Learning Worksheet*

The Bruce Spruce Co. Horizontal Statements Model for Year 1																
	Balance Sheet									Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stockholders' Equity									
Event	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings	Rev.	−	Exp.	=	Net Inc.		
1.	75,000	+	NA	=	NA	+	75,000	+	NA	NA	−	NA	=	NA	75,000	FA
2.																
3.																
4.																
5.																
6.																
	69,000	+	38,000	=	20,000	+	75,000	+	12,000	48,000	−	34,000	=	14,000	69,000	NC

Instructor Active Learning Worksheets

We also provide an instructor version of the Active Learning Worksheets. The instructor version shows exercises and problems along with the corresponding solution. Matching the exercises and problems with solutions avoids the necessity of flipping back and forth between the textbook and the solutions manual. It is now possible to display both the exercise or problem and the corresponding solution simultaneously. An example of the solution for Exercise 2-1B instructor version appears next. Although a copy of the exercise also appears in the instructor version, we do not show that here due to space limitations.

Instructor Active Learning Worksheet (Solution)

The Bruce Spruce Co.
Horizontal Statements Model for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stockholders' Equity									
Event	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings	Rev.	−	Exp.	=	Net Inc.		
1.	75,000	+	NA	=	NA	+	75,000	+	NA	NA	−	NA	=	NA	75,000	FA
2.	48,000	+	NA	=	NA	+	NA	+	48,000	48,000	−	NA	=	48,000	48,000	OA
3.	(34,000)	+	NA	=	NA	+	NA	+	(34,000)	NA	−	34,000	=	(34,000)	(34,000)	OA
4.	20,000	+	NA	=	20,000	+	NA	+	NA	NA	−	NA	=	NA	20,000	FA
5.	(38,000)	+	38,000	=	NA	+	NA	+	NA	NA	−	NA	=	NA	(38,000)	IA
6.	(2,000)	+	NA	=	NA	+	NA	+	(2,000)	NA	−	NA	=	NA	(2,000)	FA
	69,000	+	38,000	=	20,000	+	75,000	+	12,000	48,000	−	34,000	=	14,000	69,000	NC

The instructor version of the Active Learning Worksheets is provided in an electronic format using Microsoft Word documents. The Active Learning Worksheets provide innovative opportunities to improve classroom presentations. Just open a Word document and display any Set B exercise or problem along with the corresponding solutions. With a couple of keystrokes, you can hide any portion of a solution. The hidden data can be made to reappear as the instructor discusses the solution. Not only will you avoid the annoying chalk dust, but your students will appreciate a presentation that perfectly matches their working paper forms. A short video that shows you how to implement this very attractive feature is available in the instructor resources section of *Connect*.

Other Improvements

In addition to the three major enhancements described above we made several other changes as described below:

Improved Readability — Improved readability through the use of more consistent terminology and the reduction of duplicate terminology. In Chapters 1 through 12 we removed all references to terms such as ledger, journals, and entries. This allowed us to improve our focus on conceptual issues prior to the introduction of recording procedures. Procedural issues including debit/credit terminology, journals, ledgers, closing, and other recording practices are introduced in Chapter 13.

Reorganized Coverage of Business Liquidations — To reduce the possibility of information overload in Chapter 1, we moved the coverage of business liquidations to Chapter 11.

Debit/Credit Decision Aid — Employed a three-step decision aid to teach students to use debit/credit terminology to describe increases and decreases in account balances.

Added content related to end-of-period adjustments — In Chapter 2, relabeled "Event 6" and "Adj. 1" and added a discussion of the adjusting process. All other events related to adjustments were labeled with the "Adj." prefix. The goal here was to explain the need for end-of-period adjustments and to label events so as to distinguish between those occurring during an accounting period from the adjustments required at the end of an accounting period.

Redesigned Exhibits 3.2 and 3.7 — Replaced the display containing ledger accounts with a display that shows data in an accounting equation. The change results in consistency in the way content is shown across Chapters 1, 2, and 3.

Improved coverage of freight terms — In Chapter 5 we added content (text and new Exhibits 4-3 and 4-4) to better explain freight terms (FOB Shipping Point and FOB Destination).

Uncollectible accounts expense versus bad debts expense — While the account title ***bad debts expense*** is frequently used in practice, the term is a misnomer because it is a receivable rather than a debt that has turned bad. To avoid confusion in the early stages of the learning process the author team has chosen to use the term uncollectible accounts expense, which provides an accurate description of the actual expense. Even so, we have added a footnote in Chapter 7 that alerts instructors to the term and provides an explanation as to why we use uncollectible accounts expense rather than bad debts expense.

Double taxation — In Chapter 11 we revised the discussion regarding double taxation to reflect the new 21% corporate rates.

Maintaining Currency

As with all new editions, we conducted a thorough review of all features and made extensive changes to ensure that all content is current and relevant. The specific changes we made are highlighted here.

Chapter 1 An Introduction to Accounting

- Revised *The Curious Accountant* 1 & 2 content
- Revised *Focus on International Issues* text box that includes IFRS coverage
- Updated Exhibit 1.18 with new real-world data
- Updated exercises, problems, and cases

Chapter 2 Accounting for Accruals

- Updated *The Curious Accountant* content
- Added new International Issues feature
- Updated exercises, problems, and cases

Chapter 3 Accounting for Deferrals

- Updated *The Curious Accountant* content
- Revised *Reality Bytes* feature
- Updated Exhibit 3.6 with new real-world data
- Updated Exhibit 3.10 with new real-world data
- Updated exercises, problems, and cases

Chapter 4 Accounting for Merchandising Businesses

- Updated *The Curious Accountant* content.
- Updated Exhibit 4.1 with new real-world data
- Updated Exhibit 4.11 with new real-world data
- Updated exercises, problems, and cases

Chapter 5 Accounting for Inventories

- Revised *The Curious Accountant* content
- Updated the *Focus on International Issues* feature
- Revised *Reality Bytes* feature
- Updated Exhibit 5.6 with new real-world data
- Updated exercises, problems, and cases

Chapter 6 Internal Control and Accounting for Cash

- Updated *The Curious Accountant* content
- Updated exercises, problems, and cases

Chapter 7 Accounting for Receivables

- Revised *The Curious Accountant* content
- Updated *Reality Bytes* feature.
- Updated Exhibit 7.7 with new real-world data
- Updated Exhibit 7.8 with new real-world data
- Updated exercises, problems, and cases

Chapter 8 Accounting for Long-Term Operational Assets

- Updated *The Curious Accountant* content
- Updated Exhibit 8.8 with new real-world data
- Updated exercises, problems, and cases

Chapter 9 Accounting for Current Liabilities and Payroll

- Revised *The Curious Accountant* content
- Updated *Reality Bytes* feature
- Updated Exhibit 9.6 with new real-world data
- Updated exercises, problems, and cases

Chapter 10 Accounting for Long-Term Debt

- Revised *The Curious Accountant* content
- Updated *Reality Bytes* feature
- Updated the new real-world data in *The Financial Analysis*
- Updated exercises, problems, and cases

Chapter 11 Proprietorships, Partnerships, and Corporations

- Updated *The Curious Accountant* content
- Updated two *Reality Bytes* features
- Updated exercises, problems, and cases

Chapter 12 Statement of Cash Flows

- Revised *The Curious Accountant* content
- Updated *Reality Bytes* feature
- Updated Exhibit 12.16 with new real-world data
- Updated exercises, problems, and cases

Chapter 13 The Double-Entry Accounting System

- Revised *The Curious Accountant* content
- Added a new decision aid to assist students with debits/credits
- Updated exercises, problems, and cases

Chapter 14 Financial Statement Analysis

- Revised *The Curious Accountant* content
- Updated all real-world ratio data
- Updated exercises, problems, and cases

New Appendix H

- New Data Analytics Project

HOW DOES THE BOOK

The Curious Accountant


Sergey Tikhomirov/123RF

Katie recently purchased a new Ford automobile from a dealer near her home. When she told her friend George that she was able to purchase the car for $1,000 less than the sticker price, George told Katie she had gotten a lousy deal. "Everybody knows there's a huge markup on cars," George said. "You could have gotten a much lower price if you'd shopped around."

Katie responded, "If there's such a big profit margin on cars, why did so many of the car manufacturers get into financial trouble?" George told her that she was confusing the maker of the car with the dealer. George argued that although the manufacturers may not have high profit margins, the dealers do, and told her again that she had paid too much.

Exhibit 4.1 presents the income statements for **AutoNation, Inc.** and **Ford Motor Company**. Based on these statements, do you think either of these friends is correct? For example, if you pay

Sergey Tikhomirov/123RF

REAL-WORLD EXAMPLES

The text provides a variety of real-world examples of financial accounting as an essential part of the management process. There are descriptions of accounting practices from real organizations such as **Coca-Cola**, **Enron**, **General Motors**, and **Amazon.com**. These companies are highlighted in blue in the text.

"Relating this material to real life is key to get the students interested and make it applicable regardless of the major. This does a great job."

—ROB STUSSIE, UNIVERSITY OF ARIZONA

Answers to The Curious Accountant

As data from the income statement for **AutoNation** show, automobile dealers do not have big markups on the cars they sell. The new vehicles the company sold for $12,180.8 million in 2017 cost the company $11,592.4 to purchase, resulting in a gross margin of $588.4, or 4.8 percent. In other words, if you bought an "average" car from AutoNation for $20,000, the company's gross profit on it was only $960 ($20,000 × .048), meaning it paid **Ford** $19,040 ($20,000 – $960). Furthermore, the company still had other expenses to pay besides its cost of goods sold. In 2017, only 2.0 percent of each dollar of AutoNation's sales was net profit ($434.6 ÷ $21,534.6). Remember, the amount shown for sales on AutoNation's income statement is based on what customers actually paid for the cars the company sold, not the "sticker price."

Meanwhile, if Ford sold the car to AutoNation for $19,040, it earned a 10.5 percent gross margin on the sale, or $1,866 [$14,321 ÷ $145,653 = 9.8%; ($145,653 – $131,332 = $14,321)] [$19,040 × .098

THE CURIOUS ACCOUNTANT

Each chapter opens with a short vignette. 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 farther into the chapter.

FOCUS ON INTERNATIONAL ISSUES

HOW DOES IFRS DIFFER FROM U.S. GAAP?

Chapter 1 discussed the progression toward a single global GAAP in the form of International Financial Reporting Standards (IFRS). That discussion noted that the United States does not currently allow domestic companies to use IFRS; they must follow GAAP. Let's briefly consider just how U.S. GAAP differs from IFRS.

The differences can be summarized in a few broad categories. First, some differences are relatively minor. Consider the case of bank overdrafts. Under IFRS, some bank overdrafts are included as a cash inflow and are reported on the statement of cash flows. U.S. GAAP does not permit this. Conversely, some differences relate to very significant issues. Both IFRS and GAAP use historical cost as their primary method for reporting information on financial statements, but both allow exceptions in some circumstances. However, IFRS permits more exceptions to historical cost than GAAP does. Some of these differences will be discussed in later chapters.

Some of the differences affect how financial statements are presented in annual reports. IFRS requires companies to report all financial statements for the current year and the prior year—two years of comparative data. Rules of the Securities and Exchange Commission require U.S. companies to report two years of balance sheets (the current and

The Financial Analyst

Corporate governance is the set of relationships between the board of directors, management, shareholders, auditors, and other stakeholders that determine how a company is operated. Clearly, financial analysts are keenly interested in these relationships. This section discusses the key components of corporate governance.

Corbis/Getty Images

FOCUS ON INTERNATIONAL ISSUES

These boxed inserts expose students to IFRS and other international issues in accounting.

THE FINANCIAL ANALYST

Financial statement analysis is highlighted in each chapter under this heading.

CHECK YOURSELF 3.1

Treadmore Company started the Year 4 accounting period with $580 of supplies on hand. During Year 4, the company paid cash to purchase $2,200 of supplies. A physical count of supplies indicated that there were $420 of supplies on hand at the end of Year 4. Treadmore pays cash for supplies at the time they are purchased. Based on this information alone, determine the amount of supplies expense to be recognized on the income statement and the amount of cash flow to be shown in the operating activities section of the statement of cash flows.

Answer The amount of supplies expense recognized on the income statement is the amount of supplies used during the accounting period. This amount is computed next:

$580 Beginning balance + $2,200 Supplies purchases = $2,780 Supplies

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.

If you follow business news, which you should if you are a business major, you have probably heard about a company reporting a big write-off of assets, sometimes called a "special charge." Such an announcement sends a signal to readers that the company's earnings will decrease as a result of the write-off. However, in many cases, this seemingly bad news does not cause the company's stock price to fall; in fact, it sometimes causes it to increase. Why?

Consider the following January 27, 2018, announcement from **General Motors Company (GM)** related to its plans to close several plants and eliminate almost 15,000 jobs:

Katherine Welles/Shutterstock

> *On November 20, 2018, the General Motors Company . . . Board of Directors approved a plan to accelerate the Company's transformation for the future (the "Plan"). The Plan is expected to strengthen the Company's core business, capitalize on the future of personal mobility, and drive significant cost efficiencies, and it consists, in relevant part, of (i) restructuring the Global Product Development Group, (ii) realigning current manufacturing capacity and utilization, and (iii) reducing salaried and contract staff and capital expenditures. These actions are expected to be substantially completed by the end of 2019.*
>
> *The Company expects to record pre-tax charges of $3.0 billion to $3.8 billion related to these actions, including up to $1.8 billion of non-cash accelerated asset write-downs and pension charges, and up to $2.0 billion of employee-related and*

©Paul Sakuma/AP Images

REALITY BYTES

This feature expands on the topics by showing how companies use the concepts discussed in the chapter to make real-world business decisions.

MOTIVATE STUDENTS?

ANNUAL REPORTS

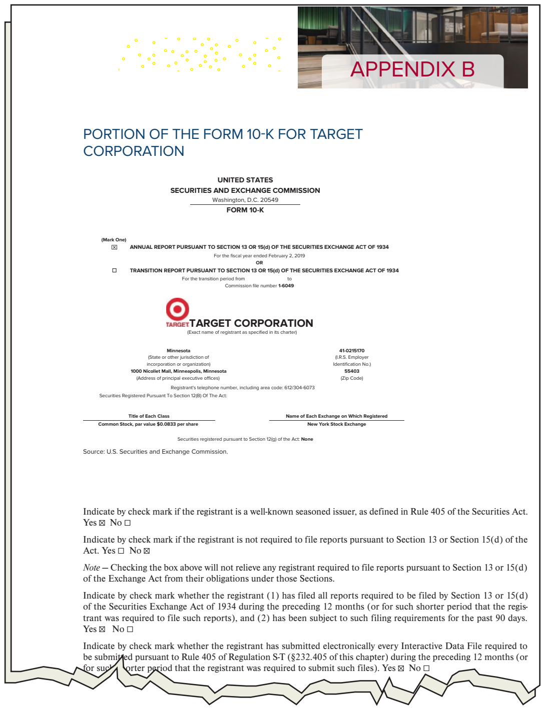
Excerpts from the 2018 annual report for Target Corporation are shown in Appendix B.

Business Applications Cases related to the annual report are included at the end of each chapter.

A Capstone Financial Statement Analysis Project for the annual report is located in Appendix E. Also, a general purpose annual report project is included for instructors to assign for any company.

"I like the way the book stresses real world applications and makes the transactions and discussions meaningful and engaging."

—STACY KLINE,
DREXEL UNIVERSITY



APPENDIX B

PORTION OF THE FORM 10-K FOR TARGET CORPORATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)
☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended February 2, 2019
OR
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number **1-6049**

TARGET CORPORATION
(Exact name of registrant as specified in its charter)

Minnesota (State or other jurisdiction of incorporation or organization)	**41-0215170** (I.R.S. Employer Identification No.)
1000 Nicollet Mall, Minneapolis, Minnesota (Address of principal executive offices)	**55403** (Zip Code)

Registrant's telephone number, including area code: 612/304-6073
Securities Registered Pursuant To Section 12(B) Of The Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.0833 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Source: U.S. Securities and Exchange Commission.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

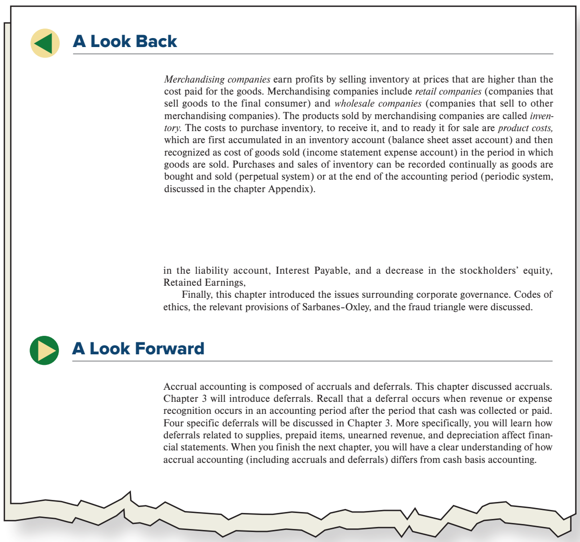
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Source: U.S. Securities and Exchange Commission

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 materials and a Look Forward introduces students to what is to come.



A Look Back

Merchandising companies earn profits by selling inventory at prices that are higher than the cost paid for the goods. Merchandising companies include *retail companies* (companies that sell goods to the final consumer) and *wholesale companies* (companies that sell to other merchandising companies). The products sold by merchandising companies are called *inventory.* The costs to purchase inventory, to receive it, and to ready it for sale are *product costs,* which are first accumulated in an inventory account (balance sheet asset account) and then recognized as cost of goods sold (income statement expense account) in the period in which goods are sold. Purchases and sales of inventory can be recorded continually as goods are bought and sold (perpetual system) or at the end of the accounting period (periodic system, discussed in the chapter Appendix).

in the liability account, Interest Payable, and a decrease in the stockholders' equity, Retained Earnings,

Finally, this chapter introduced the issues surrounding corporate governance. Codes of ethics, the relevant provisions of Sarbanes-Oxley, and the fraud triangle were discussed.

A Look Forward

Accrual accounting is composed of accruals and deferrals. This chapter discussed accruals. Chapter 3 will introduce deferrals. Recall that a deferral occurs when revenue or expense recognition occurs in an accounting period after the period that cash was collected or paid. Four specific deferrals will be discussed in Chapter 3. More specifically, you will learn how deferrals related to supplies, prepaid items, unearned revenue, and depreciation affect financial statements. When you finish the next chapter, you will have a clear understanding of how accrual accounting (including accruals and deferrals) differs from cash basis accounting.

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.

Tableau Dashboard Activity is available in *Connect* for this chapter.

SELF-STUDY REVIEW PROBLEM

A step-by-step audio-narrated series of slides is available in *Connect*.

During Year 4, Calico Company experienced the following accounting events:

1. Provided $120,000 of services on account.
2. Collected $85,000 cash from accounts receivable.
3. Wrote off $1,800 of accounts receivable that were uncollectible.
4. Loaned $3,000 to an individual, Emma Gardner, in exchange for a note receivable.
5. Paid $90,500 cash for operating expenses.
6. Estimated that uncollectible accounts expense would be 2 percent of credit sales. Recorded the year-end adjustment.
7. Recorded the year-end adjustment for accrued interest on the note receivable (see Event 4). Calico made the loan on August 1. It had a six-month term and a 6 percent rate of interest.

PROBLEMS—SERIES A

connect All applicable Problems in Series A are available in Connect.

Problem 7-17A ***Accounting for uncollectible accounts: two cycles using the percent of revenue allowance method*** LO 7-1

The following transactions apply to Jova Company for Year 1, the first year of operation:

1. Issued $10,000 of common stock for cash.
2. Recognized $210,000 of service revenue earned on account.
3. Collected $162,000 from accounts receivable.
4. Paid operating expenses of $125,000.
5. Adjusted accounts to recognize uncollectible accounts expense. Jova uses the allowance method of accounting for uncollectible accounts and estimates that uncollectible accounts expense will be 1 percent of sales on account.

CHECK FIGURES
c. Ending Accounts Receivable, Year 1: $48,000
d. Net Income, Year 2: $113,400

The following transactions apply to Jova for Year 2:

1. Recognized $320,000 of service revenue on account.
2. Collected $335,000 from accounts receivable.
3. Determined that $2,150 of the accounts receivable were uncollectible and wrote them off.
4. Collected $800 of an account that had previously been written off.
5. Paid $205,000 cash for operating expenses.
6. Adjusted the accounts to recognize uncollectible accounts expense for Year 2. Jova estimates uncollectible accounts expense will be 0.5 percent of sales on account.

Required

Complete the following requirements for Year 1 and Year 2. Complete all requirements for Year 1 prior to beginning the requirements for Year 2.

a. Identify the type of each transaction (asset source, asset use, asset exchange, or claims exchange).
b. Show the effect of each transaction on the elements of the financial statements, using a horizontal statements model like the one shown here. Use + for increase, − for decrease, and NA for not affected. Also, in the Statement of Cash Flows column, indicate whether the item is an operating

"There is a rich variety of material of all levels of complexity. Between the wide variety of problems and the algorithmic versions in *Connect*, I doubt I would ever run out of homework problems."

—EDWARD R. WALKER,
UNIVERSITY OF CENTRAL OKLAHOMA

SELF-STUDY REVIEW PROBLEM

These example problems include a detailed, worked-out solution and provide support for students before they work problems on their own. These review problems are included in an animated audio presentation in the *Connect* Library.

EXERCISE SERIES A & B AND PROBLEM SERIES A & B

There are two sets of problems and exercises: Series A and B. Instructors can assign one set for homework and another set for classwork.

• Check Figures

The figures provide key answers for selected problems.

• Excel

Many problems can be solved using the Excel™ templates available in the *Connect* Library. A logo appears in the margins next to these problems.

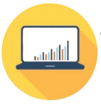
REINFORCED?

ANALYZE, THINK, COMMUNICATE (ATC)

Each chapter includes an innovative section titled Analyze, Think, Communicate (ATC). This section offers Business Applications Cases, Group Assignments, Real-World Cases, Writing Assignments, Ethical Dilemmas, Research Assignments, and Spreadsheet Assignments.

We use icons to help students identify the type of question being asked.

- **Writing assignments**

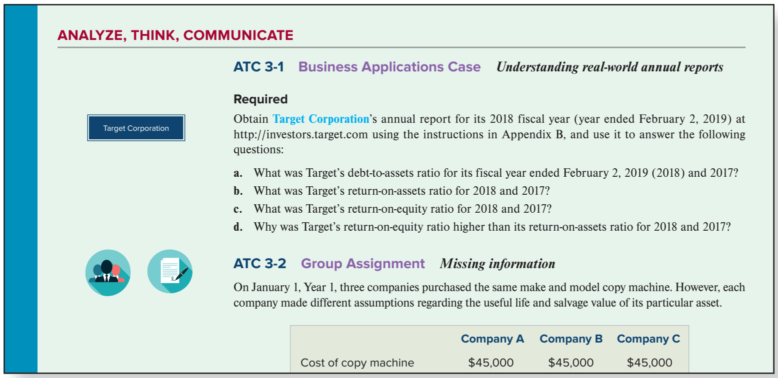


- **Internet assignments**

- **Group exercises**

- **Real company examples**

- **Ethics cases**



ANALYZE, THINK, COMMUNICATE

ATC 3-1 Business Applications Case *Understanding real-world annual reports*

Target Corporation

Required

Obtain Target Corporation's annual report for its 2018 fiscal year (year ended February 2, 2019) at http://investors.target.com using the instructions in Appendix B, and use it to answer the following questions:

a. What was Target's debt-to-assets ratio for its fiscal year ended February 2, 2019 (2018) and 2017?
b. What was Target's return-on-assets ratio for 2018 and 2017?
c. What was Target's return-on-equity ratio for 2018 and 2017?
d. Why was Target's return-on-equity ratio higher than its return-on-assets ratio for 2018 and 2017?

ATC 3-2 Group Assignment *Missing information*

On January 1, Year 1, three companies purchased the same make and model copy machine. However, each company made different assumptions regarding the useful life and salvage value of its particular asset.

	Company A	Company B	Company C
Cost of copy machine	$45,000	$45,000	$45,000

"The strong Analyze, Think, Communicate section promotes judgment, decision making, and critical thinking."

—ANGELA WOODLAND
MONTANA STATE UNIVERSITY

"The number and coverage of the end of chapter material is one of the strong selling points of the text."

—WENDY POTRATZ
UNIVERSITY OF WISCONSIN—OSHKOSH

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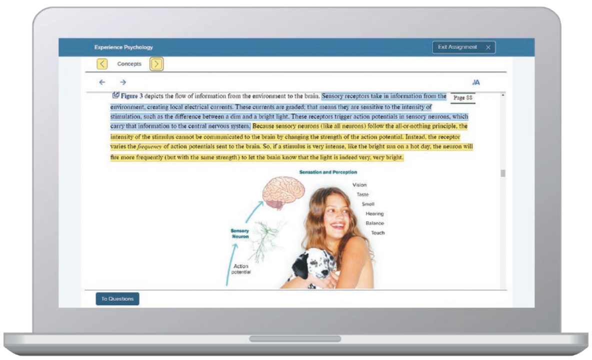

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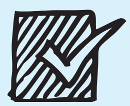

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"I really liked this app—it made it easy to study when you don't have your text-book in front of you."

- Jordan Cunningham,
Eastern Washington University

Calendar: owattaphotos/Getty Images

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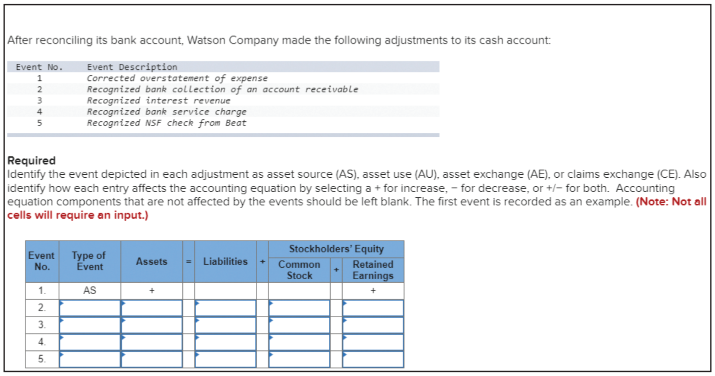
HOW CAN TECHNOLOGY HELP

MCGRAW-HILL *CONNECT*

McGraw-Hill *Connect* is a digital teaching and learning environment that gives students the means to better connect with their coursework, their instructors, and the important concepts they will need to know for success both now and in the future. With *Connect*, instructors can deliver assignments, quizzes, and tests easily online. Students can review course material and practice important skills. *Connect* provides the following features:



- SmartBook 2.0
- Auto-graded Online Homework.
- Using McGraw-Hill's free ReadAnywhere App, access your media-rich eBook anywhere, even offline.
- Dynamic links between the problems or questions you assign to your students and the location in the eBook where that concept is covered.
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In short, *Connect* offers students powerful tools and features that optimize their time and energy, enabling them to focus on learning.

For more information about *Connect*, go to www.mheducation.com/highered/connect, or contact your local McGraw-Hill Higher Education representative.

• SmartBook

Within *Connect*, Smartbook brings these features to life by interleaving reading with active practice. As students read, Smartbook encourages them to answer questions to demonstrate their knowledge—then, based on their answers, highlights those areas where students need more practice.

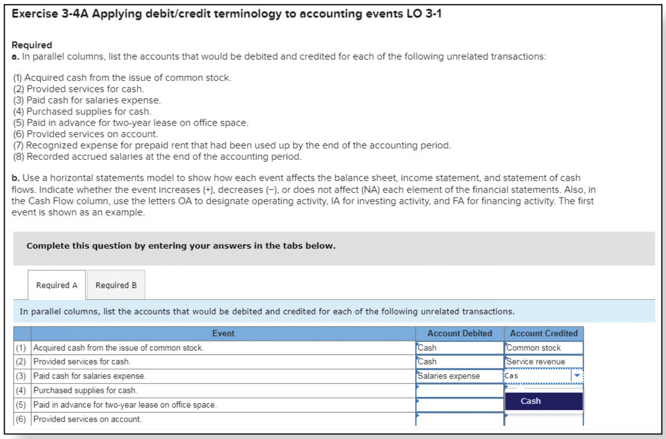
IMPROVE STUDENT SUCCESS?

• Online assignments

Connect helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. *Connect* grades homework automatically and gives immediate feedback on any questions students may have missed. Our assignable, gradable end-of-chapter content includes a general journal application that looks and feels 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.

End-of-chapter content in *Connect* includes:

- Quizzes (multiple-choice questions)
- Exercises
- Problems
- Analyze, Think, Communicate Cases
- Comprehensive Problems



Exercise 3-4A Applying debit/credit terminology to accounting events LO 3-1

Required

a. In parallel columns, list the accounts that would be debited and credited for each of the following unrelated transactions:

(1) Acquired cash from the issue of common stock.
(2) Provided services for cash.
(3) Paid cash for salaries expense.
(4) Purchased supplies for cash.
(5) Paid in advance for two-year lease on office space.
(6) Provided services on account.
(7) Recognized expense for prepaid rent that had been used up by the end of the accounting period.
(8) Recorded accrued salaries at the end of the accounting period.

b. Use a horizontal statements model to show how each event affects the balance sheet, income statement, and statement of cash flows. Indicate whether the event increases (+), decreases (−), or does not affect (NA) each element of the financial statements. Also, in the Cash Flow column, use the letters OA to designate operating activity, IA for investing activity, and FA for financing activity. The first event is shown as an example.

Complete this question by entering your answers in the tabs below.

Required A | Required B

In parallel columns, list the accounts that would be debited and credited for each of the following unrelated transactions.

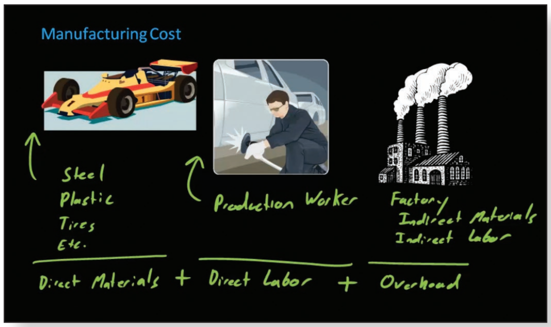
	Event	Account Debited	Account Credited
(1)	Acquired cash from the issue of common stock.	Cash	Common stock
(2)	Provided services for cash.	Cash	Service revenue
(3)	Paid cash for salaries expense.	Salaries expense	Cas
(4)	Purchased supplies for cash.		Cash
(5)	Paid in advance for two-year lease on office space.		
(6)	Provided services on account.		

"Using the Lecture Videos would allow me to delve deeper into the subject in class."

—LINDA TARRAGO, HILLSBOROUGH COMMUNITY COLLEGE

• 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.



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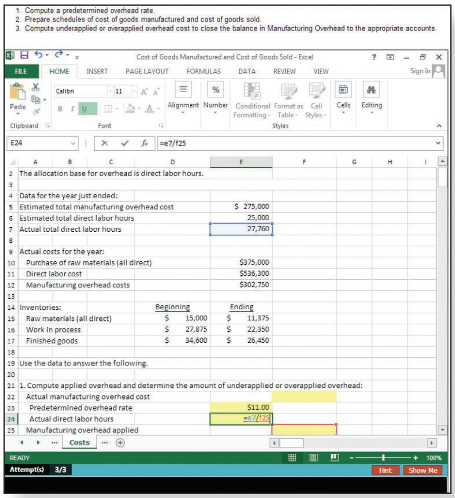
• Excel simulations

Simulated Excel questions, assignable within *Connect,* allow students to practice their Excel skills—such as basic formulas and formatting—within the content of financial accounting. These questions feature animated, narrated Help and Show Me tutorials (when enabled), as well as automatic feedback and grading for both students and professors.

• Guided Examples/Hint Videos

The Guided Examples/Hints videos in *Connect* provide a video-based, step-by-step walkthrough of select exercises similar to those assigned. These short videos can be made available to students as hints by instructors and provide reinforcement when students need it most.



1. Compute a predetermined overhead rate.
2. Prepare schedules of cost of goods manufactured and cost of goods sold.
3. Compute underapplied or overapplied overhead cost to close the balance in Manufacturing Overhead to the appropriate accounts.

Cost of Goods Manufactured and Cost of Goods Sold - Excel

E24 =e7/f25

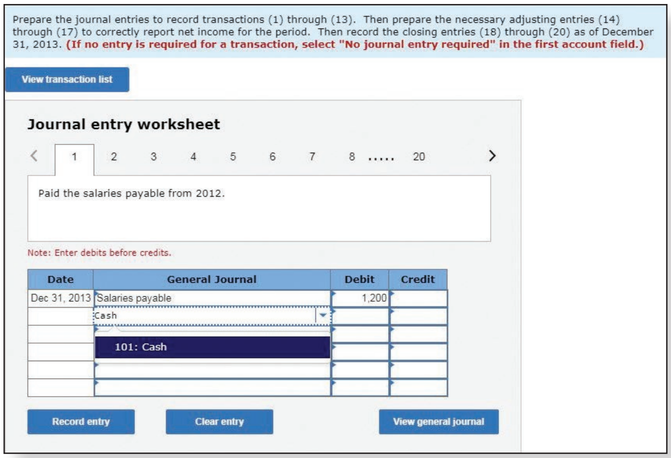
	A–C	D	E	F
2	The allocation base for overhead is direct labor hours.			
3				
4	Data for the year just ended:			
5	Estimated total manufacturing overhead cost		$ 275,000	
6	Estimated total direct labor hours		25,000	
7	Actual total direct labor hours		27,760	
8				
9	Actual costs for the year:			
10	Purchase of raw materials (all direct)		$375,000	
11	Direct labor cost		$536,300	
12	Manufacturing overhead costs		$302,750	
13				
14	Inventories:	Beginning	Ending	
15	Raw materials (all direct)	$ 15,000	$ 11,375	
16	Work in process	$ 27,875	$ 22,350	
17	Finished goods	$ 34,600	$ 26,450	
18				
19	Use the data to answer the following.			
20				
21	1. Compute applied overhead and determine the amount of underapplied or overapplied overhead:			
22	Actual manufacturing overhead cost			
23	Predetermined overhead rate		$11.00	
24	Actual direct labor hours		=e7/f25	
25	Manufacturing overhead applied			

Costs

READY

Attempt(s) 3/3 Hint Show Me

Microsoft Corporation



• Capstone General Ledger Project

General Ledger Problems provide a much-improved student experience when working with accounting cycle questions, offering improved navigation and less scrolling. Students can audit their mistakes by easily linking back to their original entries and can see how the numbers flow through the various financial statements. Many General Ledger Problems include an analysis tab that allows students to demonstrate their critical thinking skills and a deeper understanding of accounting concepts.

• Instructor Resources

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- Instructor's Manual
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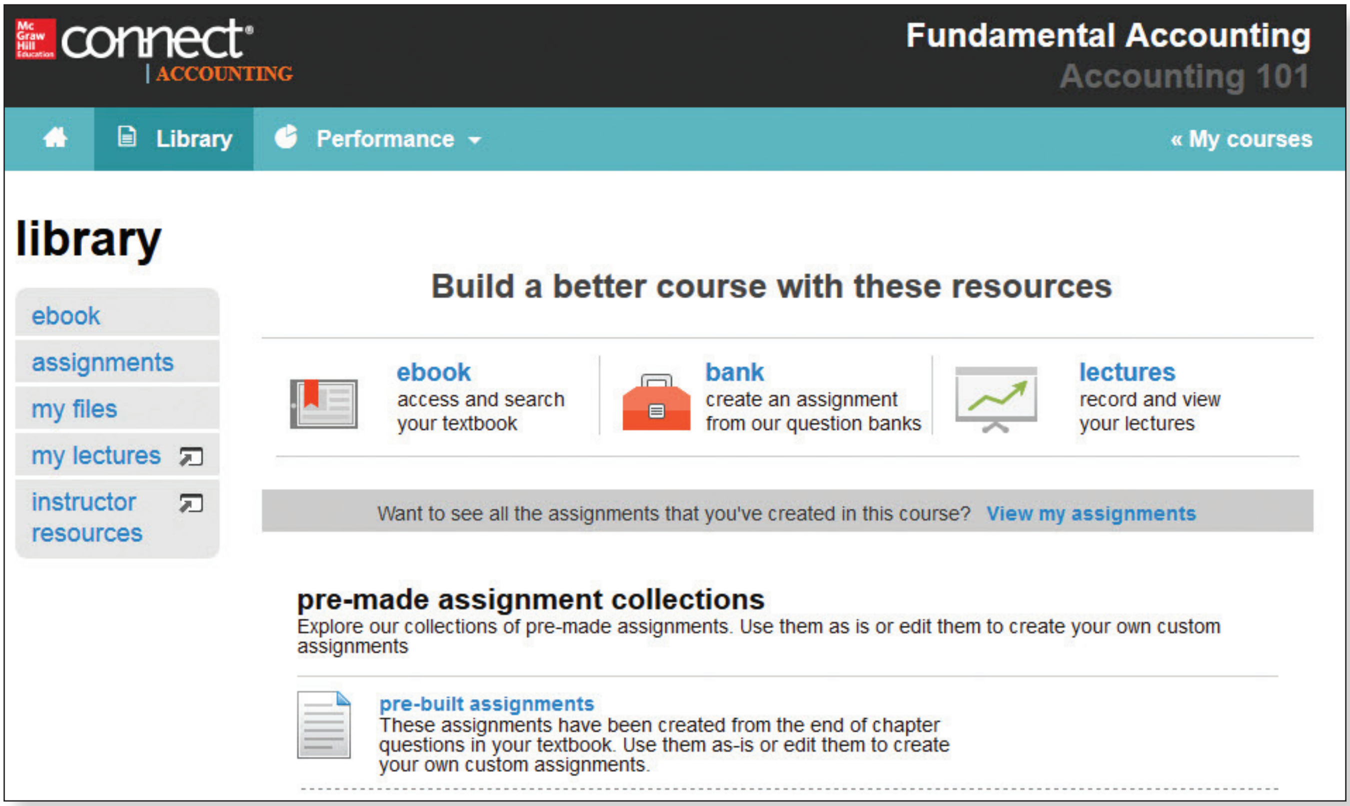

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Many educational institutions today are focused on the notion of *assurance of learning*, an important element of many accreditation standards. *Introductory Financial Accounting for Business 2e* is designed specifically to support your assurance of learning initiatives with a simple, yet powerful, solution.

Each chapter in the book begins with a list of numbered learning objectives, which appear throughout the chapter, as well as in the end-of-chapter assignments. Every Test Bank question for *Introductory Financial Accounting for Business* maps to a specific chapter learning objective in the textbook. Each Test Bank question also identifies topic area, level of difficulty, Bloom's Taxonomy level, and AICPA and AACSB skill area. You can use *Connect* to easily search for learning objectives that directly relate to the learning objectives for your course.

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• Jennifer Edmonds • Philip R. Olds

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Introductory Financial Accounting for Business

Second Edition

CHAPTER 1

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 Identify the ways accounting benefits society.

LO 1-2 Identify reporting entities.

LO 1-3 Identify the components of the accounting equation.

LO 1-4 Classify business events as asset source, asset use, asset exchange, or claims exchange transactions.

LO 1-5 Show how business events affect the accounting equation.

LO 1-6 Prepare and interpret balance sheets for multiple accounting cycles.

SECTION 2: REPORTING INFORMATION

LO 1-7 Prepare and interpret information shown in an income statement.

LO 1-8 Prepare and interpret a statement of changes in stockholders' equity.

LO 1-9 Prepare and interpret a statement of cash flows.

LO 1-10 Identify the ways financial statements interrelate.

Video lectures and accompanying self-assessment quizzes are available in *Connect* for all learning objectives.

Tableau Dashboard Activity is available in *Connect* for this chapter.

The Curious Accountant

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Who owns **Apple, Inc.**? Who owns the **American Cancer Society** (ACS)? Many people and organizations other than owners are interested in the operations of Apple and the ACS. These parties are called *stakeholders*. Among others, they include lenders, employees, suppliers, customers, benefactors, research institutions, local governments, cancer 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 Apple differ from those of the ACS? (Answer on page 10.)

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. Indeed, communicating economic information is so important that accounting is frequently called the *language of business.*

ROLE OF ACCOUNTING IN SOCIETY

LO 1-1

Identify the ways accounting benefits 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, businesses, and resource owners. *Consumers* use resources. Resources are frequently not in a form consumers want. For example, nature provides trees but consumers want houses. Businesses transform resources such as trees into desirable products such as houses. *Resource owners* control the distribution of resources to businesses. Thus, resource owners provide resources (inputs) to businesses that provide goods and services (outputs) to consumers.

For example, a home builder (a business) 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. Suppose a house that required $220,000 of materials and labor to build could have a market value of $250,000.

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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 earlier is $30,000, the difference between its $220,000 cost and $250,000 market value.

Businesses that successfully and efficiently (at low cost) satisfy consumer preferences are rewarded with high earnings. These earnings are shared with resource owners, so businesses that 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 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.**

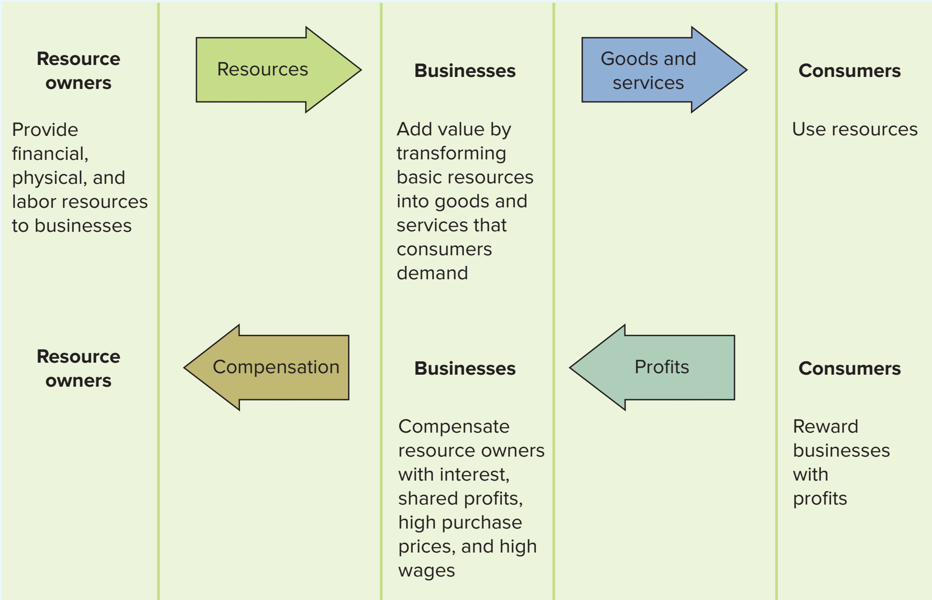
Investors and creditors prefer to provide financial resources to businesses with high earnings potential because such companies are better able to share profits and make interest payments. Profitable businesses are also less likely to experience bankruptcy.

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 houses. Owners of physical resources seek to sell those resources to businesses with high earnings

EXHIBIT 1.1

Market Trilogy in Resource Allocation



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 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 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 businesses 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. For example, investors are concerned about the overall profitability of **Wendy's** versus **Burger King**; whereas 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

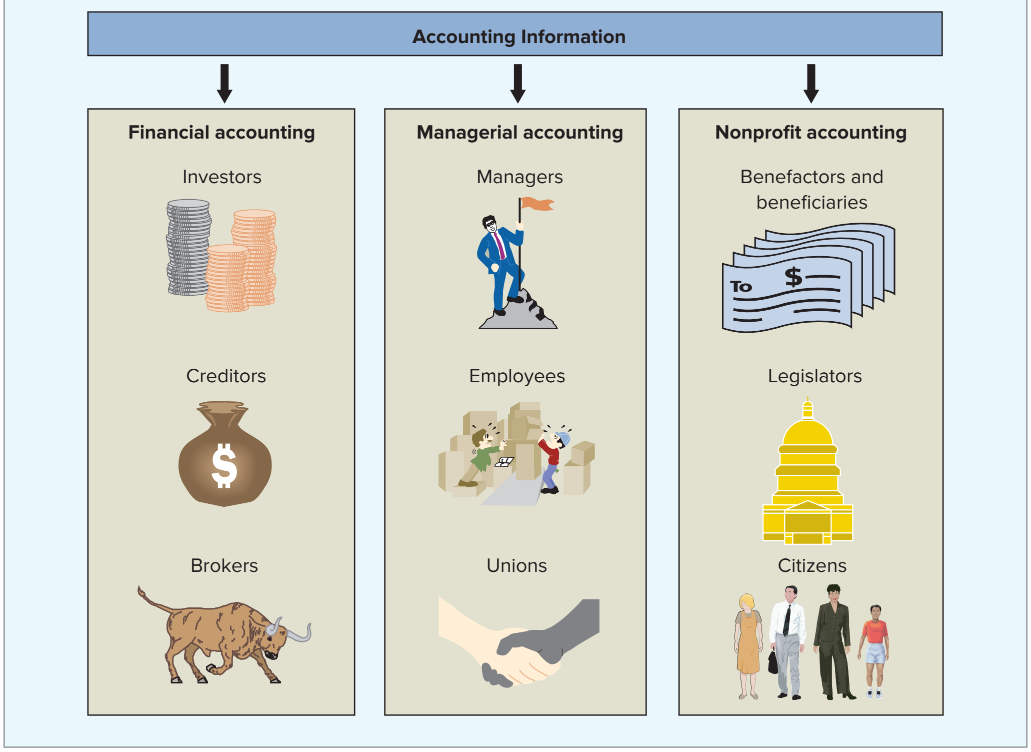
The U.S. economy is not purely market-based. Factors other than profitability often influence resource allocation priorities. For example, governments allocate resources for national defense, to redistribute wealth, or to protect the environment. Foundations, religious groups, the Peace Corps, and other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

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.

EXHIBIT 1.2

Accounting as Information Provider



Careers in Accounting

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.

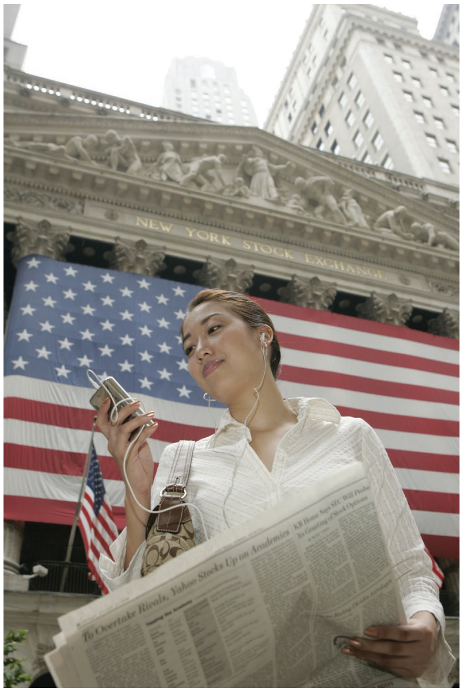
- *Audit services* involve examining a company's accounting records in order to issue an opinion about whether the company's financial statements conform to generally accepted accounting principles. The auditor's opinion adds credibility to the statements, which are prepared by the company's management.
- *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 include everything from installing sophisticated computerized accounting systems to providing personal financial advice.

All public accountants are not certified. Each state government, as well as Washington, DC, and four U.S. territories, establish certification requirements applicable in that jurisdiction. Although the requirements vary from jurisdiction to jurisdiction, CPA candidates normally must have a college education, pass a demanding technical examination, and obtain work experience relevant to practicing public accounting.

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.



Lars A. Niki

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

[1]The 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.

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 United States.

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

LO 1-2

Identify reporting entities.

Think of accountants in the same way you would think 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 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 entity, there are a total of seven entities named in the scenario. These entities include: (1) Jason Winston, (2) Winston Enterprises, (3) George Winston, (4) First Federal Bank, (5) Commercial Properties, Inc., (6) the customers, and (7) the employees. A separate set of accounting records would be maintained for each entity.

Your ability to learn accounting will be greatly influenced by how you approach the entity concept. Based on your everyday experiences you likely think from the perspective of a customer. In contrast, this text is written from the perspective of a business entity. These opposing perspectives dramatically affect how you view business events. For example, as a customer, you consider a sales discount a great bargain. The view is different from the perspective of the business granting the discount. A sales discount means an item did not sell at the expected price. To move the item, the business had to accept less money than it originally planned to receive. From this perspective, a sales discount is not a good thing. To understand accounting, train yourself to interpret transactions from the perspective of a business rather than a consumer. Each time you encounter an accounting event, ask yourself: How does this affect the business?

CHECK YOURSELF 1.1

In a recent business transaction, land was exchanged for cash. Did the amount of cash increase or decrease?

Answer The answer depends on the reporting entity to which the question pertains. One entity sold land. The other entity bought land. For the entity that sold land, cash increased. For the entity that bought land, cash decreased.

FOCUS ON INTERNATIONAL ISSUES

IS THERE GLOBAL GAAP?

Kristi Blokhin/Kevin Roche John Dinkeloo and Associates/Shutterstock

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 2019, most of the major economic countries had switched from their local GAAP to IFRS. One notable exception is the United States, but even here, 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, fund-raising is performed by separate sets of trustees.

Despite their similarities, there are significant differences between the IASB and the FASB. One of these relates to size and geographic diversity. The FASB has only seven members, all from the United States. The IASB has 16 members, and these must include at least 4 from Asia, 4 from Europe, 4 from North America, 1 from Africa, and 1 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 **Ford**'s financial statements with a value of only a few hundred thousand dollars. This occurs because GAAP requires Ford 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.

CREATING AN ACCOUNTING EQUATION

LO 1-3

Identify the components of the accounting equation.

The Accounting Equation is composed of three **elements** called assets, liabilities, and stockholders' equity. Stockholders' equity may be subdivided into two additional elements called common stock and retained earnings. Each of these elements is discussed in this section of the chapter.

Businesses use resources to conduct their operations. For example, **Carmike Cinemas, Inc.** uses buildings, seating, screens, projection equipment, vending machines, cash registers, and so on in order to make money from ticket sales. The resources a business uses to make money are called **assets.** So, where do businesses get assets? There are three distinct sources:

1. *A business can borrow assets from creditors.* Usually a business acquires cash from creditors and then uses the cash to purchase the assets it needs to conduct its operations.