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28E

ACCOUNTING

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28e

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Preface

Roadmap for Success

Warren's *Accounting 28e* makes it easy for you to give students a solid foundation in accounting without overwhelming students. Warren covers the fundamentals AND motivates students to learn by showing how accounting is important to a business.

The Warren presentation style provides content in a way that this generation reads and assimilates information.

- Short, concise paragraphs and bullets
- Stepwise progression
- Meaningful illustrations and graphs

Hallmarks

Schemas provide a roadmap of accounting that emphasizes the big picture. Each chapter begins with a graphic Schema, or Roadmap of Accounting, that shows readers how the chapter material fits within the larger context of the overall book. With this approach, students view chapter concepts as part of a larger whole rather than as mere independent pieces of knowledge, for a truly functional understanding of accounting.

Financial and managerial sections use separate schemas. A four-part schema (Chs. 1–4) demonstrates how chapter content integrates within the accounting cycle. The financial accounting chapters' schema (Chs. 5–17) highlights chapter content within a set of integrated financial statements. A separate managerial accounting schema (Chs. 18–26) shows how chapter content integrates within the managerial accounting functions.

CHAPTER 6 Accounting for Merchandising Businesses

Owner's capital, Jan. 1, 20Y6	\$XXX	\$XXX
Net income	\$ XXX	
Withdrawals	(XXX)	
Increase in equity	XXX	
Owner's capital, Dec. 31, 20Y6	XXX	\$XXX

Cash flows from (used for) operating activities	\$XXX
Cash flows from (used for) investing activities	XXX
Cash flows from (used for) financing activities	XXX
Net increase (decrease) in cash	\$XXX
Cash balance, January 1, 20Y6	XXX

Sales	\$XXX
Cost of merchandise sold	XXX
Gross profit	\$XXX
Operating expenses:	
Advertising expense	\$XXX
Depreciation expense	XXX
Amortization expense	XXX
Depletion expense	XXX
...	XXX
XXX	XXX
Total operating expenses	XXX
Income from operations	\$XXX
Other revenue and expenses	XXX
Net income	\$XXX

Current assets:	
Cash	\$XXX
Accounts receivable	XXX
Merchandise inventory	XXX
Total current assets	\$XXX
Property, plant, and equipment	\$XXX
Intangible assets	XXX
Total long-term assets	XXX
Total assets	\$XXX
Liabilities:	
Current liabilities	\$XXX
Long-term liabilities	XXX
Total liabilities	\$XXX
Owner's equity	XXX
Total liabilities and owner's equity	\$XXX

CHAPTER 18

Introduction to Managerial Accounting

Concepts and Principles

Chapter 18 Introduction to Managerial Accounting

↓ ↓

Developing Information

COST SYSTEMS

Chapter 19 Job Order Costing

Chapter 20 Process Cost Systems

COST BEHAVIOR

Chapter 21 Cost-Volume-Profit Analysis

↓ ↓

Decision Making

EVALUATING PERFORMANCE

Chapter 22 Budgeting

Chapter 23 Variances from Standard Costs

COMPARING ALTERNATIVES

Chapter 24 Decentralized Operations

Chapter 25 Differential Analysis, Product Pricing, and Activity-Based Costing

Chapter 26 Capital Investment Analysis

Revised and refreshed real company chapter openers engage readers from the start. Chapter openers introduce and briefly describe a real company and how its challenges relate to the chapter content. Links to this opening company appear throughout the chapter to reinforce the importance of what readers are learning.



CHAPTER 7

Best Buy

Link to Best Buy

Best Buy values its inventory at lower of cost or market based upon cost and the amount it expects to realize from the sale.

Link to Best Buy Pages 349, 350, 382, 384

Revised end-of-chapter assignments (homework) provide important hands-on practice. Refined, meaningful review and applications at the end of each chapter include Discussion Questions, Practice Exercises (A and B versions), Exercises, Problems (Series A and B), and Cases & Projects that emphasize ethics, teamwork, and communication skills.



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New to This Edition

- Updated dates and real company information for currency.
- Refreshed end-of-chapter assignments with different numerical values and updated information.
- A new “Time Period Concept” discussion has been added to the “Generally Accepted Accounting Principles” section of Chapter 1. This discussion defines and illustrates the natural business year and fiscal year accounting periods.
- The fiscal year discussion was moved from the prior edition’s Chapter 4. In addition, the notation of 20Y1, 20Y2, ... is introduced for indicating years throughout the text.
- In Chapter 2, the discussion on “Errors Not Affecting the Trial Balance” has been revised to better aid student understanding and to simplify the preparation of correcting journal entries.
- In Chapter 4, the Accounting Cycle illustration in Exhibit 8 has been revised to facilitate student review.
- In Chapter 4, the “Fiscal Year” discussion has been moved to Chapter 1.
- In Chapter 4, the “Reversing Entry” appendix has been moved to an online appendix.
- A new “Why Is the Accrual Basis of Accounting Required by GAAP?” discussion has been added as Appendix 2 to Chapter 4. The understanding of why accrual accounting is required by GAAP is important for students’ ability to analyze and evaluate financial statements. Why accrual accounting is required is illustrated by comparing NetSolutions’ financial statements under the accrual basis (Chapters 1–4) with related cash basis financial statements.
- To simplify and give the instructor more flexibility in Chapter 6, the discussion of the accounting for customer merchandise refunds, including the related adjusting entries, has been moved to Appendix 2 at the end of the chapter.
- For those instructors who prefer to cover sales discounts using the gross method, Appendix 1, “Gross Method of Recording Sales Discounts,” has been added to the end of Chapter 6.

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Dr. Carl S. Warren is Professor Emeritus of Accounting at the University of Georgia, Athens. Dr. Warren has taught classes at the University of Georgia, University of Iowa, Michigan State University, and University of Chicago. He focused his teaching efforts on principles of accounting and auditing. Dr. Warren received his PhD from Michigan State University and his BBA and MA from the University of Iowa. During his career, Dr. Warren published numerous articles in professional journals, including *The Accounting Review*, *Journal of Accounting Research*, *Journal of Accountancy*, *The CPA Journal*, and *Auditing: A Journal of Practice & Theory*. Dr. Warren has served on numerous committees of the American Accounting Association, the American Institute of Certified Public Accountants, and the Institute of Internal Auditors. He also has consulted with numerous companies and public accounting firms. His outside interests include handball, golf, skiing, backpacking, and fly-fishing.



Terry R. Spray/InHimage Studios

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Courtesy of Christine Jonick

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Courtesy of Jennifer Schneider

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Mornin' Joe MJ-1

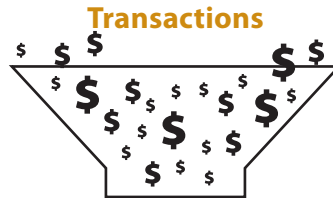
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Introduction to Accounting and Business

Chapter 1



Accounting System

Accounting Equation

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

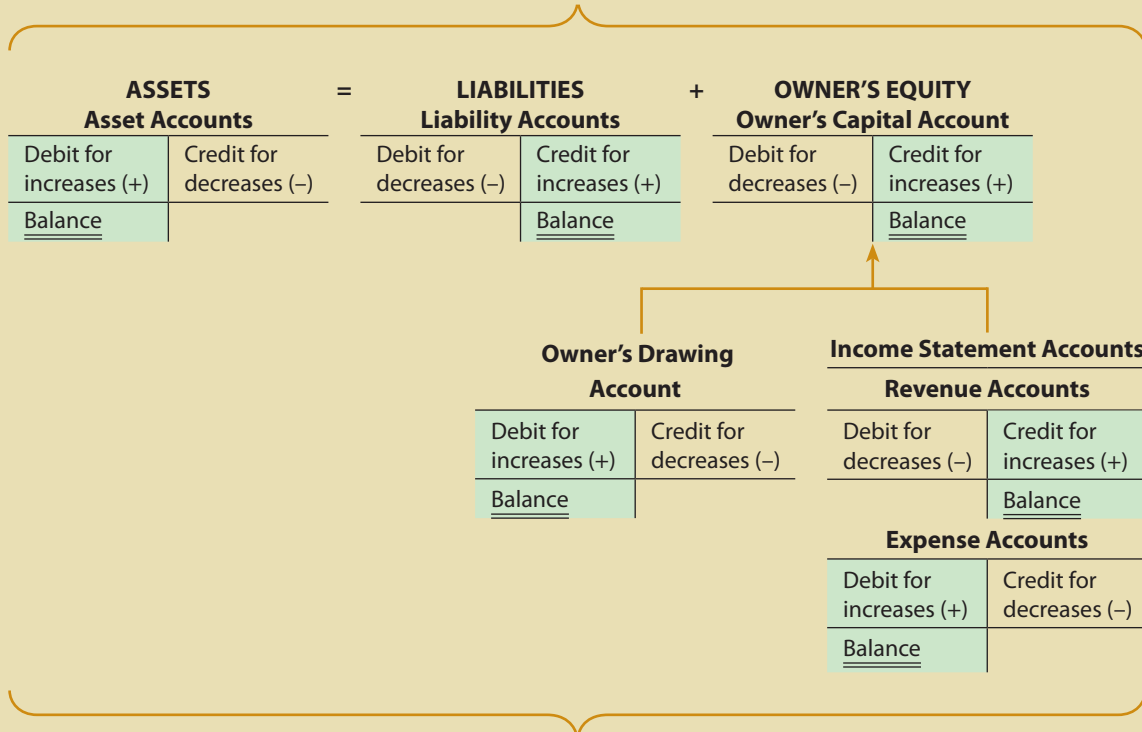
Chapter 2

Account

Debits | Credits

Rules of Debit and Credit

BALANCE SHEET ACCOUNTS

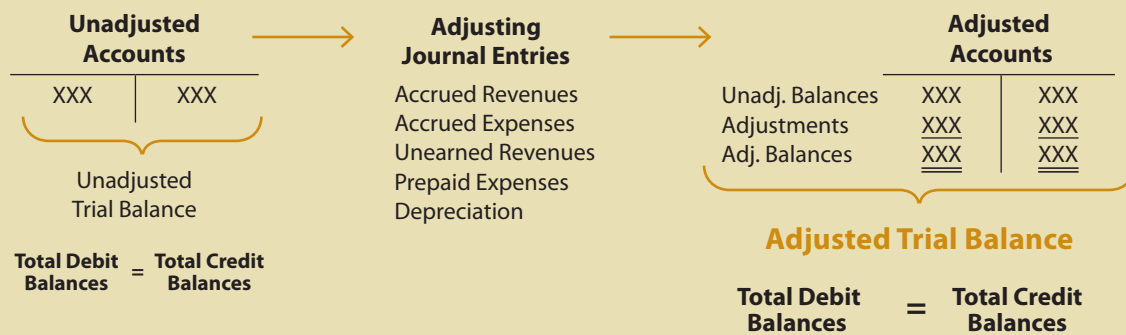


Unadjusted Trial Balance

$$\text{Total Debit Balances} = \text{Total Credit Balances}$$

Chapter 3

Adjusting Entries



Chapter 4

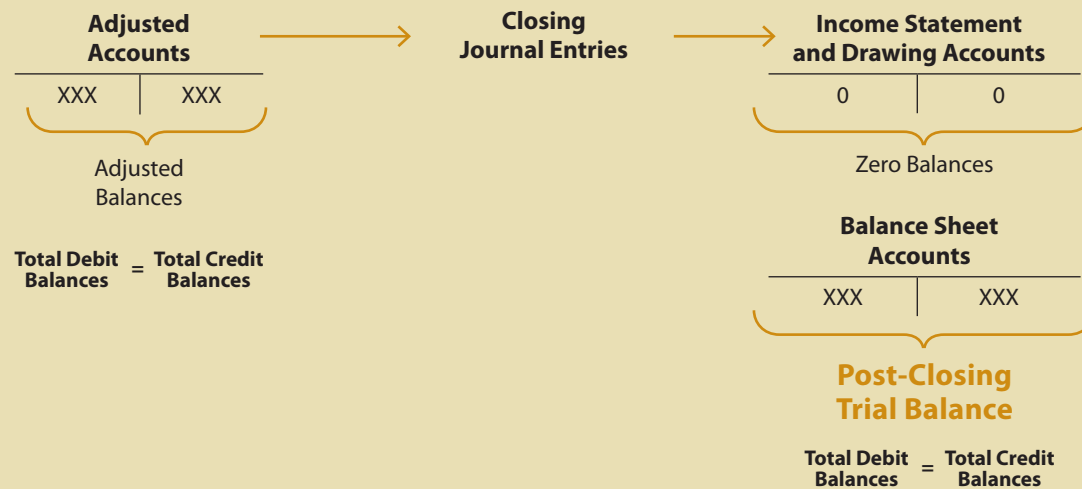
Adjusted Accounts
XXX | XXX
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Financial Statements

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Statement of Owner's Equity

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Closing Entries





PHOTOMIX-COMPANY/PIXABAY

Twitter

When two teams pair up for a game of football, there is often a lot of noise. The band plays, the fans cheer, and fireworks light up the scoreboard. Obviously, the fans are committed and care about the outcome of the game. Just like fans at a football game, the owners of a business want their business to “win” against their competitors in the marketplace. While having your football team win can be a source of pride, winning in the marketplace goes beyond pride and has many tangible benefits. Companies that are winners are better able to serve customers, provide good jobs for employees, and make money for their owners.

Twitter, Inc. is one of the most visible companies on the Internet. It provides a real-time information network where members can post messages, called *tweets*, for free. Millions post tweets every day throughout the world.

Do you think Twitter is a successful company? Does it make money? How would you know? Accounting helps to answer these questions.

This textbook introduces you to accounting, the language of business. Chapter 1 begins by discussing what a business is, how it operates, and the role that accounting plays.

Link to Twitter Pages 6, 12, 14, 20, 24

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

Example Exercises (EE) are shown in **red**.

OBJ. 1 Describe the nature of business and the role of accounting and ethics in business.

Nature of Business and Accounting

Types of Businesses
Role of Accounting in Business
Role of Ethics in Accounting and Business
Opportunities for Accountants

OBJ. 2 Summarize the development of accounting principles and relate them to practice.

Generally Accepted Accounting Principles

Business Entity Concept
Time Period Concept
Cost Concept

EE 1-1

OBJ. 3 State the accounting equation and define each element of the equation.

The Accounting Equation

Solving the Accounting Equation

EE 1-2

OBJ. 4 Describe and illustrate how business transactions can be recorded in terms of the resulting change in the elements of the accounting equation.

Business Transactions and the Accounting Equation

Recording Transactions

EE 1-3

OBJ. 5 Describe the financial statements of a proprietorship and explain how they interrelate.

Financial Statements

Income Statement EE 1-4
Statement of Owner's Equity EE 1-5
Balance Sheet EE 1-6
Statement of Cash Flows EE 1-7
Interrelationships Among
Financial Statements

OBJ. 6 Describe and illustrate the use of the ratio of liabilities to owner's equity in evaluating a company's financial condition.

Financial Analysis and Interpretation: Ratio of Liabilities to Owner's Equity

Computing and Interpreting Ratio
of Liabilities to Owner's Equity

EE 1-8

At a Glance 1

Page 28

Nature of Business and Accounting

A **business**¹ is an organization in which basic resources (inputs), such as materials and labor, are assembled and processed to provide goods or services (outputs) to customers. Businesses come in all sizes, from a local coffee house to **Starbucks**, which sells over \$24 billion of coffee and related products each year.

The objective of most businesses is to earn a **profit**. Profit is the difference between the amounts received from customers for goods or services and the amounts paid for the inputs used to provide the goods or services. This text focuses on businesses operating to earn a profit. However, many of the same concepts and principles also apply to not-for-profit organizations such as hospitals, churches, and government agencies.

Types of Businesses

Three types of businesses operating for profit include service, merchandising, and manufacturing businesses. Some examples of each type of business follow:

- **Service businesses** provide services rather than products to customers.
Delta Air Lines (transportation services)
The Walt Disney Company (entertainment services)

¹ A complete glossary of terms appears at the end of the text.

OBJ. 1 Describe the nature of business and the role of accounting and ethics in business.

Link to Twitter

Twitter is a service company that provides a platform for individuals to send text messages called *tweets*.

Note

Accounting is an information system that provides reports to users about the economic activities and condition of a business.

- **Merchandising businesses** sell products they purchase from other businesses to customers.
 - Wal-Mart Stores, Inc.** (general merchandise)
 - Amazon.com** (general merchandise)
- **Manufacturing businesses** convert basic inputs into products that are sold to customers.
 - Ford Motor Co.** (cars, trucks, vans)
 - Dell Inc.** (personal computers)

Role of Accounting in Business

The role of accounting in business is to provide information for managers to use in operating the business. In addition, accounting provides information to other users in assessing the economic performance and condition of the business.

Thus, **accounting** can be defined as an information system that provides reports to users about the economic activities and condition of a business. You could think of accounting as the “language of business.” This is because accounting is the means by which businesses’ financial information is communicated to users.

The process by which accounting provides information to users is as follows:

1. Identify users.
2. Assess users’ information needs.
3. Design the accounting information system to meet users’ needs.
4. Record economic data about business activities and events.
5. Prepare accounting reports for users.

As illustrated in Exhibit 1, users of accounting information can be divided into two groups: internal users and external users.

Managerial Accounting Internal users of accounting information include managers and employees. These users are directly involved in managing and operating the business. The area of accounting that provides internal users with information is called **managerial accounting** or **management accounting**.

The objective of managerial accounting is to provide relevant and timely information for managers’ and employees’ decision-making needs. Oftentimes, such information is sensitive and is not distributed outside the business. Examples of sensitive information might include information about customers, prices, and plans to expand the business. Managerial accountants employed by a business are employed in **private accounting**.

Financial Accounting External users of accounting information include investors, creditors, customers, and the government. These users are not directly involved in managing and operating the business. The area of accounting that provides external users with information is called **financial accounting**.

The objective of financial accounting is to provide relevant and timely information for the decision-making needs of users outside the business. For example, financial reports on the operations and condition of the business are useful for banks and other creditors in deciding whether to lend money to the business. **General-purpose financial statements** are one type of financial accounting report that is distributed to external users. The term *general-purpose* refers to the wide range of decision-making needs that these reports are designed to serve. Later in this chapter, general-purpose financial statements are described and illustrated.

Link to Twitter

One of the ways **Twitter** provides information to its investors is by publishing an annual report, which includes general-purpose financial statements.



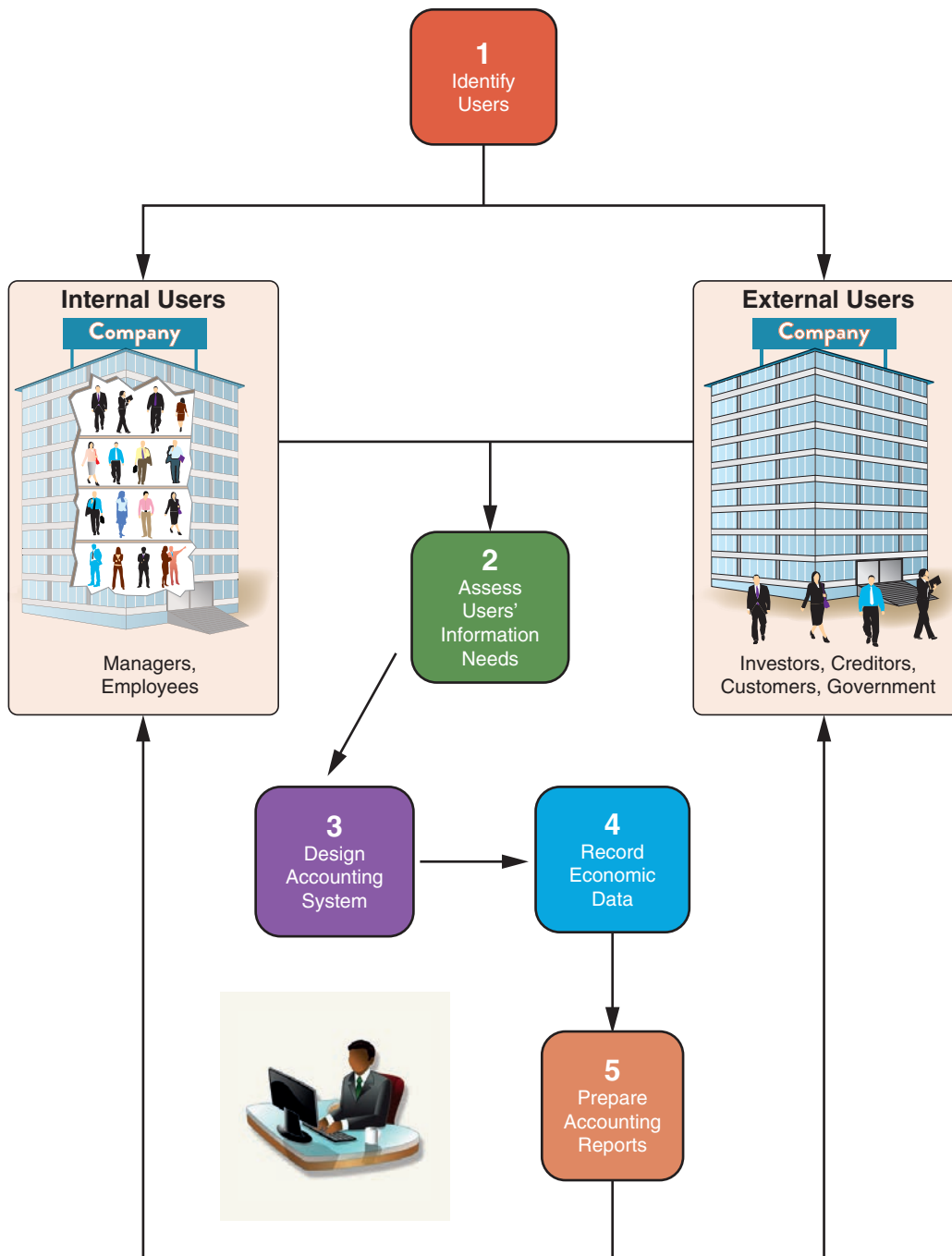
ETHICS

Role of Ethics in Accounting and Business

The objective of accounting is to provide relevant, timely information for user decision making. Accountants must behave in an ethical manner so that the information they provide users will be trustworthy and, thus, useful for decision making. Managers and employees must also behave in an ethical manner in managing and operating a business. Otherwise, no one will be willing to invest in or loan money to the business.

Accounting as an Information System

EXHIBIT 1



Ethics are moral principles that guide the conduct of individuals. Unfortunately, business managers and accountants sometimes behave in an unethical manner. Many of the managers of the companies listed in Exhibit 2 engaged in accounting or business fraud. These ethical violations led to fines, firings, and lawsuits. In some cases, managers were criminally prosecuted, convicted, and sent to prison.

EXHIBIT 2 Accounting and Business Frauds

Company	Nature of Accounting or Business Fraud	Result
Computer Associates International, Inc.	Fraudulently reported its financial results.	CEO and senior executives indicted. Five executives pled guilty. \$225 million fine.
Enron	Fraudulently reported its financial results.	Bankruptcy. Senior executives criminally convicted. More than \$60 billion in stock market losses.
HealthSouth	Overstated performance by \$4 billion in false entries.	Senior executives criminally convicted.
Qwest Communications International, Inc.	Improperly reported \$3 billion in false receipts.	CEO and six other executives criminally convicted of "massive financial fraud." \$250 million SEC fine.
Xerox Corporation	Recognized \$3 billion in revenue prior to when it should have been recorded.	\$10 million fine to SEC. Six executives forced to pay \$22 million.

What went wrong for the managers and companies listed in Exhibit 2? The answer normally involved one or both of the following factors:

- **Failure of Individual Character.** Ethical managers and accountants are honest and fair. However, managers and accountants often face pressures from supervisors to meet company and investor expectations. In many of the cases in Exhibit 2, managers and accountants justified small ethical violations to avoid such pressures. However, these small violations became big violations as the company's financial problems became worse.
- **Culture of Greed and Ethical Indifference.** By their behavior and attitude, senior managers set the company culture. In most of the companies listed in Exhibit 2, the senior managers created a culture of greed and indifference to the truth.

As a result of the accounting and business frauds shown in Exhibit 2, Congress passed laws to monitor the behavior of accounting and business. For example, the **Sarbanes-Oxley Act (SOX)** was enacted. SOX established a new oversight body for the accounting profession called the **Public Company Accounting Oversight Board (PCAOB)**. In addition, SOX established standards for independence, corporate responsibility, and disclosure.

How does one behave ethically when faced with financial or other types of pressure? Guidelines for behaving ethically follow:²

1. Identify an ethical decision by using your personal ethical standards of honesty and fairness.
2. Identify the consequences of the decision and its effect on others.
3. Consider your obligations and responsibilities to those who will be affected by your decision.
4. Make a decision that is ethical and fair to those affected by it.

² Many companies have ethical standards of conduct for managers and employees. In addition, the Institute of Management Accountants and the American Institute of Certified Public Accountants have professional codes of conduct, which can be obtained from their websites at www.imanet.org and www.aicpa.org, respectively.

Integrity, Objectivity, and Ethics in Business



BERNIE MADOFF

In June 2009, Bernard L. “Bernie” Madoff was sentenced to 150 years in prison for defrauding thousands of investors in one of the biggest frauds in American history. Madoff’s fraud started several decades earlier when he began a Ponzi scheme in his investment management firm, **Bernard L. Madoff Investment Securities LLC**.

In a Ponzi scheme, the investment manager uses funds received from new investors to pay a return to

existing investors, rather than basing investment returns on the fund’s actual performance. As long as the investment manager is able to attract new investors, he or she will have new funds to pay existing investors and continue the fraud. While most Ponzi schemes collapse quickly when the investment manager runs out of new investors, Madoff’s reputation, popularity, and personal contacts provided a steady stream of investors, which allowed the fraud to survive for decades.

Opportunities for Accountants

Numerous career opportunities are available for students majoring in accounting. Currently, the demand for accountants exceeds the number of new graduates entering the job market. This is partly due to the increased regulation of business caused by the accounting and business frauds shown in Exhibit 2. Also, more and more businesses have come to recognize the importance and value of accounting information.

As indicated earlier, accountants who work for a business are employed in private accounting. Private accountants have a variety of possible career options within a company. Some of these career options are shown in Exhibit 3 along with their starting salaries. Accountants who provide audit services, called auditors, attest to the accuracy of financial records, accounts, and systems. As shown in Exhibit 3, several private accounting careers have certification options.

Accounting Career Paths and Salaries

EXHIBIT 3

Accounting Career Track	Description	Career Options	Annual Starting Salaries*	Certification
Private Accounting	Accountants employed by companies, government, and not-for-profit entities.	Bookkeeper Payroll clerk General accountant Budget analyst Cost accountant Internal auditor Information technology auditor	\$43,000 \$39,000 \$47,000 \$51,000 \$49,000 \$46,000 \$51,000	Certified Payroll Professional (CPP) Certified Management Accountant (CMA) Certified Internal Auditor (CIA) Certified Information Systems Auditor (CISA)
Public Accounting	Accountants employed individually or within a public accounting firm in audit, tax, or management advisory services.		\$47,000	Certified Public Accountant (CPA)

*Average salaries rounded to the nearest thousand. Salaries may vary by size of company and region.

Source: Robert Half 2019 *U.S. Salary Guide (Finance and Accounting)*, Robert Half International, Inc. (www.roberthalf.com/workplace-research/salary-guides).