

Financial and Managerial Accounting



INFORMATION FOR DECISIONS

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To my students and family, especially Kimberly, Jonathan, Stephanie, and Trevor. To my wife Linda and children Erin, Emily, and Jacob.

FINANCIAL AND MANAGERIAL ACCOUNTING: INFORMATION FOR DECISIONS, NINTH EDITION

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About the Authors



Courtesy of John J. Wild

JOHN J. WILD is a distinguished professor of accounting at the University of Wisconsin at Madison. He previously held appointments at Michigan State University and the University of Manchester in England. He received his BBA, MS, and PhD from the University of Wisconsin.

John teaches accounting courses at both the undergraduate and graduate levels. He has received numerous teaching honors, including the Mabel W. Chipman Excellence-

in-Teaching Award and the departmental Excellence-in-Teaching Award, and he is a two-time recipient of the Teaching Excellence Award from business graduates at the University of Wisconsin. He also received the Beta Alpha Psi and Roland F. Salmonson Excellence-in-Teaching Award from Michigan State University. John has received several research honors, is a past KPMG Peat Marwick National Fellow, and is a recipient of fellowships from the American Accounting Association and the Ernst and Young Foundation.



Courtesy of Ken W. Shaw

KEN W. SHAW is the KPMG/Joseph A. Silvoso Distinguished Professor of Accounting at the University of Missouri at Columbia. He previously was on the faculty at the University of Maryland at College Park. He has also taught in international programs at the University of Bergamo (Italy) and the University of Alicante (Spain). He received a B.S. in accounting from Bradley University and an MBA and PhD from the University of Wisconsin. He is a

Certified Public Accountant with audit experience at KPMG.

Ken teaches managerial and financial accounting. He teaches in online, flipped classroom, and face-to-face modes. He has received numerous School of Accountancy, College of Business, and university-level awards for teaching excellence and for teaching

John is an active member of the American Accounting Association and its sections. He has served on several committees of these organizations, including the Outstanding Accounting Educator Award, Wildman Award, National Program Advisory, Publications, and Research Committees. John is author of Financial Accounting Fundamentals, Managerial Accounting, Fundamental Accounting Principles, and Financial and Managerial Accounting, all published by McGraw Hill.

John's research articles on accounting and analysis appear in The Accounting Review; Journal of Accounting Research; Journal of Accounting and Economics; Contemporary Accounting Research; Journal of Accounting, Auditing and Finance; Journal of Accounting and Public Policy; Accounting Horizons; and other journals. He is past associate editor of Contemporary Accounting Research and has served on several editorial boards including The Accounting Review and the Journal of Accounting and Public Policy.

In his leisure time, John enjoys hiking, sports, boating, travel, and spending time with family and friends.

with technology. He is the past advisor to his school's Beta Alpha Psi and Association of Certified Fraud Examiners chapters.

Ken is an active member of the American Accounting Association and its sections. He has served on many committees of these organizations. Ken has presented his research papers at international and national conferences and workshops. Ken's research appears in the Journal of Accounting Research; The Accounting Review; Contemporary Accounting Research; Journal of Financial and Quantitative Analysis; Journal of the American Taxation Association; Strategic Management Journal; Journal of Accounting, Auditing, & Finance; and other journals. He has served on the editorial boards of Issues in Accounting Education; Journal of Business Research; and Research in Accounting Regulation. Ken is co-author of Fundamental Accounting Principles, and Managerial Accounting, all published by McGraw Hill.

In his leisure time, Ken enjoys tennis, cycling, music, and travel.

Author note

Applying Learning Science and Data Analytics

Learning science reveals that students better learn and retain information when text is presented in a direct, concise, and systematic manner within a blocked format. Our new edition delivers the content in that format and in fewer pages. Visual aids and numerous demonstrations and videos offer additional learning support. Summary *Cheat Sheets* conclude each chapter to visually reinforce key concepts and procedures, and provide a mapping for students as they search and learn.

Our new edition has over 1,500 videos aimed to captivate students and improve outcomes.

- Concept Overview Videos—cover each chapter's learning objectives with multimedia presentations that include interactive Knowledge Checks to engage students and assess comprehension.
- Need-to-Know Demos—walk-through demonstrations of key procedures and analysis for each text block to ensure success with assignments and tests.
- Hint (Guided Example) Videos—step-by-step walk-through of assignments that mimic Quick Studies, Exercises, and General Ledger assignments. Instructors can turn the Hint on or off for each assignment.

Data analytics and visualizations skills are increasingly in demand. Our new edition has 3 Tableau Dashboard Activities per chapter to develop those skills. They are in Connect and are auto-graded. No knowledge of Tableau or analytics is required. Introductory students can begin immediately.









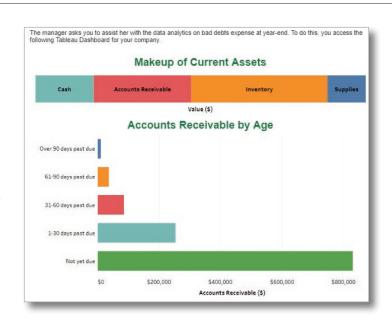


Developing Career Readiness...

Tableau Dashboard Activities

Tableau Dashboard Activities expose students to accounting analytics using visual displays. These assignments (1) do not require instructors to know Tableau, (2) are accessible to introductory students, (3) do not require Tableau software, and (4) run in Connect. All analytics and visualization activities are familiar to instructors as they consist of introductory accounting concepts and procedures applied in our current assignments.

A quick study, exercise, and mini-case are available for each chapter. All are auto-gradable. Tableau is a great tool to excite students and show the relevance of accounting.



Blockchain Ledger Blockchain, the technology used to authenticate and track Bitcoin transactions, could radically change accounting systems. This technology unlocks the potential for a new type of ledger that is constantly verified, and one that cannot be changed without others noticing. Blockchain presents a unique opportunity for those with accounting knowledge, as they are highly desired to help build, implement, maintain, and audit this new technology.

Buy Now, Pay Later Companies have been hiring accounting analytics experts to identify ways to shorten the operating cycle. Their aim is to increase cash available for use in expanding operations or acquiring other businesses. One area that analytics has impacted is the timing of cash payments. The Hackett Group reports that the largest 1,000 U.S. companies have extended their timing of payments from an average of 40.1 days to 56.7 days in the past 10 years.

NEW! Analytics Insight

In an NVP survey of executives, 97% report they are investing in data analytics, big data, and Al. In a Robert Half survey of CFOs, 61% felt that knowledge of data analytics and visualization is mandatory for some or all of their accounting employees. Accounting students with analytics skills are highly sought after and are commanding higher salaries.

Analytics Insight boxes show students the importance of accounting analytics and visualization in business. These boxes educate students on how businesses are utilizing these competencies to improve business decisions.

Accounting Analysis

Accounting Analysis assignments have students evaluate the most current financial statements from Apple, Google, and Samsung. Students compute key metrics and compare performance across companies and the industry.

These three types of assignments— Company Analysis, Comparative Analysis, Extended Analysis—are auto-gradable in Connect and are included after Problem Set B in each chapter.



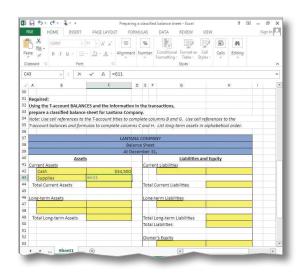


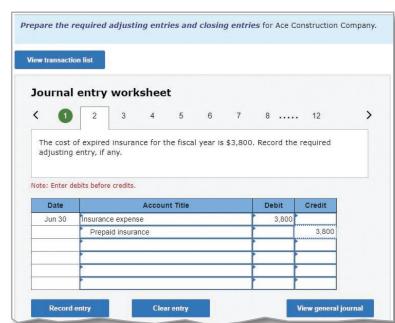




General Ledger Problems

General Ledger Problems expose students to general ledger software similar to that in practice, without the expense and hassle of downloading additional software. They offer students the ability to record financial transactions and see how these transactions flow into financial statements. Easy minimal-scroll navigation, instant "Check My Work" feedback, and fully integrated hyperlinking across tabs show how inputted data affect each stage of the accounting process. Algorithmic versions are available. All are auto-gradable.





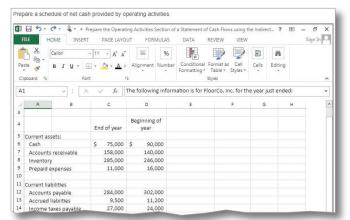
Applying Excel

Applying Excel enables students to work select chapter problems or examples in Excel. These problems are assignable in Connect and give students instant feedback as they work through assignments in Excel

Accompanying Excel videos teach students how to use Excel and the primary functions needed to complete each assignment. Short assessments can be assigned to test student comprehension of key Excel skills.

Excel Simulations

Excel Simulations, assignable in Connect, allow students to practice their Excel skills—such as basic formulas and formatting—within the context of 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. These questions differ from Applying Excel in that students work in a simulated version of Excel. Downloading the Excel application is not required to complete Excel Simulations.











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Enhancing Learning...

Learning Science

Learning science shows that students learn better when material is broken into "blocks" of content. Each chapter opens with a visual preview of the content blocks. Learning objectives highlight the location of content. Each "block" of content concludes with a Need-to-Know (NTK) demo to aid and reinforce student learning. Visual aids along with concise, bullet-point discussions further help students learn.







Flexible Revenue Recognition Coverage

- This text uses the widely-popular gross method for merchandising transactions (net method is covered in an appendix). The gross method (1) complies with new revenue recognition rules, (2) is used widely in practice, and (3) is easier and less costly to apply.
- Adjusting entries for specialized revenue recognition cases are included in an appendix. Assignments are clearly marked and separated. This approach is fully GAAP compliant.

Up-to-Date

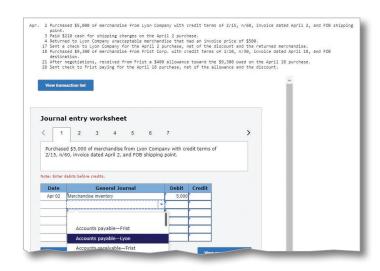
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This text reflects new standards in accounting for revenue recognition, investments, leases, and extraordinary items. It is important that students learn accounting according to GAAP.

Assignments in Connect with Algos

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.

- Wild has auto-gradable and algorithmic assignments; most focus on one learning objective and are targeted at introductory students.
- 99% of Wild's Quick Study, Exercise, and Problem Set A assignments are available with algorithmic options.
- 100% of Wild's Accounting Analysis assignments are in Connect.
- Over 211 assignments are new to this edition—all available in Connect with algorithmic options. Most are Quick Studies and Exercises.

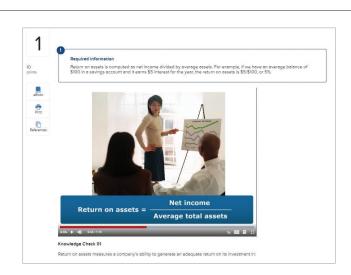






Updated Learning Videos

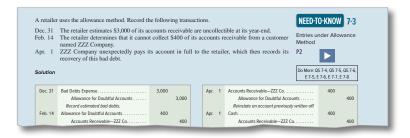
- Wild offers over 1,500 videos that increase student engagement and improve outcomes.
- Hundreds of Hint videos or Guided Examples provide a narrated, animated, step-by-step walk-through of most Quick Studies and Exercises similar to those assigned. These short presentations, which can be turned on or off by instructors, provide reinforcement when students need it most. (Exercise PowerPoints are available for instructors.)
- Concept Overview Videos cover each chapter's learning objectives with narrated, animated presentations that frequently assess comprehension using interactive Knowledge Checks. Grading of Knowledge Checks can be turned on or off by instructors.

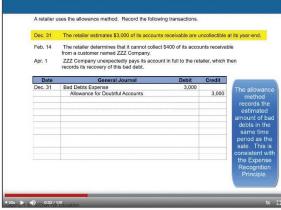


Need-to-Know Demos

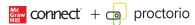
Need-to-Know demonstrations are located at the end of each learning block. There are multiple learning blocks within each chapter. These demonstrations pose questions about the material just presented—content that students "need to know" to learn accounting. Accompanying solutions walk students through key procedures and analyses necessary to be successful with homework and test materials.

Need-to-Know demonstrations are supplemented with narrated, animated, step-bystep walk-through videos led by an instructor, which are available via **Connect**.





Remote Proctoring & Browser-Locking



New remote proctoring and browser-locking capabilities, hosted by Proctorio within Connect, provide control of the assessment environment by enabling security options and verifying the identity of the student.

Seamlessly integrated within Connect, these services allow instructors to control students' assessment experience by restricting browser activity, recording activity during assessment, and verifying students are doing their own work.

Instant and detailed reporting gives instructors an at-a-glance view of potential academic integrity concerns, thereby avoiding personal bias and supporting evidence-based claims.



vii









Engaging Content...

Business Decisions

Whether we prepare, analyze, or apply accounting information, one skill remains essential: decision making. To help develop good decision-making habits and to show the relevance of accounting, we use a decision-learning framework.

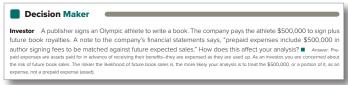
- · Decision Insight offers context for business decisions.
- Decision Ethics and Decision Maker are role-playing scenarios that show the relevance of accounting.
- Decision Analysis provides key tools and ratios to assess company performance.



Decision Insight

Big Data The SEC keeps an online database called EDGAR (sec.gov/edgar) that has accounting information for thousands of companies, such as Columbia Sportswear, that issue stock to the public. The annual report filing for most publicly traded U.S. companies is known as Form 10-K, and the quarterly filing is Form 10-Q. Information services such as Finance.Yahoo.com offer online data and analysis.

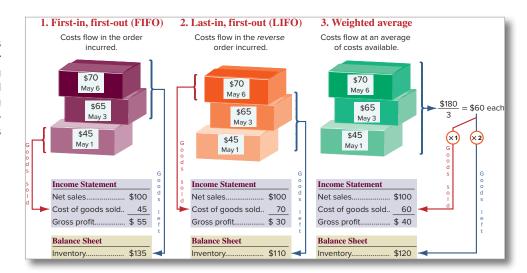
Decision Ethics Financial Officer At year-end, the president instructs you, the financial officer, not to record accrued expenses until next year because they will not be paid until then. The president also directs you to record in current year sales a recent purchase order from a customer that requires merchandise to be delivered two weeks after the year-end. Your company would report a net income instead of a net loss if you follow these instructions. What do you do? ■ Answer Omitting accrued expenses and recognizing revenue early mislead financial statement users. One action is to explain to the president what is required. If the president persists, you might talk to keyers and any auditors involved.



Visual Learning

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Learning science tells us today's students learn better with visual aids supporting blocks of text. Wild has adapted to student needs by having informative visual aids throughout. Many visuals and exhibits are new to this edition.



Exercise Presentations

Animated PowerPoints, created from text assignments, enable instructors to be fully prepared for in-class demonstrations. Instructors can use these animated PowerPoints along with their own audio to record personalized online lectures.

Less Is More

Wild is more direct, concise, and systematic than competing books covering the same content.

- · The text is to the point and uses visuals to aid student learning.
- Bullet-point discussions and active writing aid learning.

viii



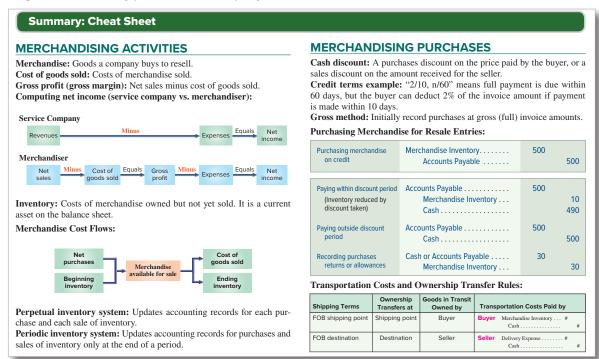






Cheat Sheets

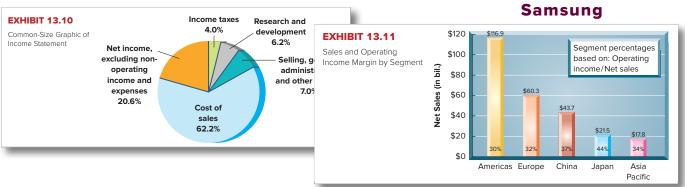
Cheat Sheets are provided at the end of each chapter to reinforce student learning. Cheat Sheets are roughly one page in length and include key procedures, concepts, journal entries, and formulas.

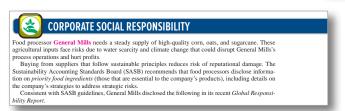


Keep It Real

Research shows that students learn best when using current data from real companies. Wild uses the most current data from real companies for assignments, examples, and analysis in the text. See Chapter 13 for samples on the use of real data.







Doing What's Right

Companies increasingly issue corporate social responsibility reports, and accountants are being asked to prepare, analyze, and audit them. Wild includes brief Corporate Social Responsibility sections in the managerial chapters that show the importance of corporate social responsibility.









EQA

FINAL PAGES





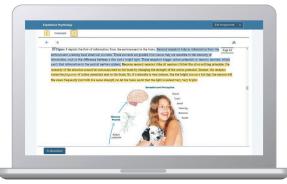


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FOR STUDENTS

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

- Jordan Cunningham, Eastern Washington University



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Leading Edge Content . . .

Instructors and students guided this edition's revisions. Those revisions include the following.

- New Tableau Dashboard Activities expose students to accounting analytics and visualizations with 3 assignments per chapter.
- New Analytics Insight boxes highlight accounting analytics in business.
- New coverage of artificial intelligence, Bitcoin, data analytics, blockchain, and other emerging topics.
- New Applying Excel and Excel Simulations enhance skills for career readiness.
- Expanded General Ledger assignments let students engage with general ledger software tools similar to those in practice.
- Content is up-to-date for GAAP, including revenue recognition, investments, and leases.
- Content is concise and succinct; new edition has fewer pages with no loss of content and text organized into learning blocks.
- More than 211 new assignments—all in Connect with static and algorithmic options.
- Gross method used for merchandising transactions, reflecting practice; adjusting entries for full revenue recognition in appendix.
- Cheat Sheets at each chapter-end visually reinforce key chapter content and provide a search map for students.
- Updated Accounting Analysis assignments—all in Connect and autogradable—use data from Apple, Google, and Samsung.
- Auto-gradable Concept Overview Videos for each learning objective.

Chapter 1

NEW opener—Netflix and entrepreneurial assignment. Streamlined conceptual learning objectives. New sections on AI and analytics in

accounting.

Coverage of SOX Act moved to Chapter 6.

New and improved NTK 1-2. New and simplified NTK 1-5. Appendices 1A and 1B are now by request only.

Updated return on assets analysis using Nike and Under Armour.
Added five new Quick Studies.
Added six new Exercises.
Updated analysis assignments:
Company Analysis, Comparative
Analysis, and Extended

Analysis.

Chapter 2

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NEW opener—Stitch Fix and entrepreneurial assignment. Streamlined learning objectives. New and enhanced Exhibit 2.1 shows the relation between balance sheet accounts.

New Analytics Insight on blockchain ledger.

New and improved NTK 2-4. Updated debt ratio analysis using

Costco and Walmart. Added four new Quick Studies. Added six new Exercises. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 3

NEW opener—Sword & Plough and entrepreneurial assignment.
Combined learning objectives on adjusted trial balance and financial statements.

New Analytics Insight on accounting for Bitcoin.

Revised and improved NTK 3-6. Enhanced Exhibit 3.21 simplifies a classified balance sheet. Revised NTK 3-7 for clarity. Added twelve new Quick Studies.
Added twenty new Exercises.
Added four new Problems.
Updated profit margin analysis using
Visa and Mastercard.
Updated current ratio analysis using
Costco and Walmart.
Updated analysis assignments.

Content complies with revenue

Chapter 4

recognition rules according to GAAP. NEW opener-Kendra Scott and entrepreneurial assignment. Streamlined learning objectives. New Analytics Insight box on extending timing of payments. Coverage of defective returned goods left to advanced courses. Updated acid-test ratio and gross margin analysis using Nike and Under Armour. Entries for net method of periodic inventory left to advanced courses. Added four new Quick Studies. Added one new Exercise Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 5

NEW opener—Amazon and entrepreneurial assignment.
Streamlined conceptual learning objectives.

New Exhibit 5.1 on shipping terms. Revised Exhibit 5.4 so that format is consistent for all inventory calculations (which matches Connect).

Revised NTK 5-2 and NTK 5-6 solutions on specific identification for consistency with text and Connect.
Removed income taxes from Exhibits 5.8 and 5A.6 to focus on cost of goods sold impact.

Revised Exhibits 5A.2, 5A.3, 5A.4, and 5A.5 for consistency with Connect and accounting software.

Revised NTK 5-5 and NTK 5-7 solutions for consistency with text. Updated inventory turnover and the days' sales in inventory analysis using **Costco** and **Walmart**.

Added three new Quick Studies. Added two new Exercises. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 6

NEW opener—**Didi** and entrepreneurial assignment.

New section on blockchain and its implications for accounting. Revised and improved NTK 6-1. Enhanced and modernized Exhibit 6.5.

Enhanced and modernized Exhibit 6.6 to be consistent with online banking. Removed collection expenses and NSF fees—most are immaterial and covered in advanced courses.

Updated days' sales uncollected analysis using **Starbucks** and **Jack in the Box**.

Added five new Quick Studies.
Added one new Exercise.
New Tableau Dashboard Activities:
Quick Study, Exercise, and Mini-Case.
Updated analysis assignments:
Company Analysis, Comparative
Analysis, and Extended Analysis.

Chapter 7

NEW opener—Credit Karma and entrepreneurial assignment.
Removed coverage of store credit cards as nearly all are now managed by banks and accounted for as bank credit cards.
New Analytics Insight on predicting bad debts.

debts.

Excel demos to compute maturity dates.

Updated accounts receivable analysis using Visa and Mastercard.

Added four new Quick Studies.

Added six new Exercises.

Updated analysis assignments:

Company Analysis, Comparative

Analysis, and Extended Analysis.

Chapter 8

NEW opener—SpaceX and entrepreneurial assignment.
Plant asset impairments left to advanced courses.

Added simple exhibit on reporting natural resources.

Updated asset turnover analysis using **Starbucks** and **Jack in the Box**. Simplified NTK 8-6 by removing part 6.

Added seven new Quick Studies. Added two new Exercises. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 9

NEW opener—Zumba and entrepreneurial assignment. Updated payroll tax rates and explanations.

New employee and employer payroll taxes summary table. Revised and simplified NTK 9-3. Simplified NTK 9-5 by removing part g.

Updated Forms 941, W-2, and W-4 in Appendix 9A.

Added five new Quick Studies. Added three new Exercises. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 10

NEW opener—Airbnb and entrepreneurial assignment. Streamlined learning objectives. Enhanced explanation of relation between bond issue price, contract rate, and market rate. Simplified numbers in Exhibit 10.7.

Simplified Exhibit 10.10 on premium bonds.
Simplified numbers in Exhibit 10.11.

Coverage of convertible bonds left to advanced courses.

New section on Installment Notes with

Monthly Payments.
Updated debt-to-equity analysis using

Updated debt-to-equity analysis using **Nike** and **Under Armour**.

Bond pricing demos are consistent with text and covered in Appendix 10A. Simplified numbers in Exhibits 10B.1 and 10B.2.

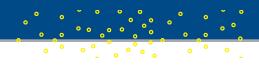
xii











Added four new Quick Studies. Added one new Exercise. Added two new Problems. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 11

NEW opener—**Eventbrite** and entrepreneurial assignment. Streamlined analytical learning objectives.

New Analytics Insight on bots investing in stocks based on erroneous news. Coverage of retained earnings deficit and liquidating cash dividends left to advanced courses.

Coverage of participating or nonparticipating left to advanced courses.

Revised and simplified statement of equity in Exhibit 11.10. Updated PE ratio and dividend yield using Amazon, Altria, Visa, and Mastercard.

Book value per share computation left to advanced courses.

Revised NTK 11-5 by removing part 2. Added two new Quick Studies. Added four new Exercises. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 12

Slightly revised infographics on cash flows from operating, investing, and financing.

Updated cash flow on total assets analysis using **Nike** and **Under Armour**. Added one new Quick Study. Added two new Exercises. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 13

Streamlined conceptual learning objectives.

Updated data for all analyses of **Apple** using horizontal, vertical, and ratio analysis.

Updated comparative analysis using **Google** and **Samsung**.

Updated data visualizations with current data.

Added gross margin ratio to profitability analysis.

Revised and simplified return on equity calculation.

Added seven new Quick Studies. Added one new Exercise. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 14

NEW Opener—Sweet Tea Cosmetics and entrepreneurial assignment.

Streamlined learning objectives. NEW Analytics Insight on **Kickstarter** crowdfunding.

Postponed fixed vs variable cost classifications to later chapters. NEW Exhibit 14.6 on prime and conversion costs.

Improved Exhibits 14.7 and 14.8 on product versus period costs.

NEW Exhibit 14.9 on cost

classifications for service company. Simplified Exhibit 14.12 on reporting Cost of Goods Sold.

NEW NTK 14-3 on reporting for manufacturers.

Simplified Exhibits 14.13 and 14.15 on cost flows.

Simplified Schedule of Cost of Goods Manufactured in Exhibit 14.14 and 14.15. New Part B to NTK 14-4 on preparing schedule of cost of goods manufactured.

NEW coverage of digital manufacturing, data analytics, and data visualization. Revised NTK 14-5.

Added four new Quick Studies, one new Exercise, and one new Problem. Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 15

NEW Opener—Wallace Detroit Guitars and entrepreneurial assignment. Combined C1 and C2 LOs. Simplified job order costing example from five jobs to three jobs. Revised Exhibits 15.2, 15.3, 15.5, 15.6, 15.7, 15.9, 15.10, 15.13, 15.14, 15.16, and 15.17. Revised NTK 15-1, 15-2 and 15-3.

Revised NTK 15-1, 15-2 and 15-3. NEW systematic way to apply estimated overhead costs.

Enhanced Exhibit 15.15 on cost flows. NEW coverage of financial statements. Revised Adjusting Overhead section for consistency with Road Warriors example.

NEW Analytics Insight on risk scores for health-care providers.
Revised Decision Analysis section and added *gross profit ratio*.
Enhanced and clarified NTK 15-7.
Added five new Quick Studies, seven new Exercises, one new Problem.
Revised analysis assignments: Company Analysis, Comparative Analysis, and

Chapter 16

Extended Analysis.

UPDATED Opener—Azucar Ice Cream Company.
Streamlined learning objectives.
Modernized Exhibit 16.1.
NEW Exhibit 16.2 is simple overview of GenX operations.
Moved coverage of EUP to step 2 of process costing demo.

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Simplified process costing demo into 4-steps.

Revised Exhibits 16.7, 16.10 and 16.11 to match Connect assignments.
Simplified Exhibit 16.8 on cost data.
Improved NTKs 16-2, 16-3, 16-5, 16-6 to match Connect assignments.
Renamed Process Cost Summary to Production Cost Report for consistency with practice.

Simplified Production Cost Report in Exhibit 16.11.

NEW coverage of reporting on financial statements.

NEW discussion of computing cost per completed unit.

NEW Analytics Insight on machine learning at **Hershey**.

Revised hybrid costing systems and added manufacturing *yield* to Decision Analysis.

Simplified FIFO process costing demo into 4-steps in Appendix 16A. NEW section on determining units started and completed for FIFO. Revised Exhibits 16A.3, 16A.6, and 16A.9 to match Connect assignments. Simplified Exhibit 16A.7 on cost data. Improved NTKs 16-8 and 16-9 to match Connect assignments.

Renamed (FIFO) Process Cost Summary to Production Cost Report. Simplified Production Cost Report in Exhibit 16A.10.

Added three new Quick Studies and five new Exercises.

Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 17

NEW Opener—Grimm Artisanal Ales and entrepreneurial assignment. Streamlined learning objectives. Revised Exhibit 17.4 (previously 17.5). Enhanced NTK 17-1 for consistency with assignment materials. Simplified and improved ABC section.

Simplified and improved ABC section. NEW Exhibit 17.10 gives a step-by-step allocation table for ABC. Revised NTK 17-2 using new step-by-step allocation approach for ABC. Postponed Cost of Quality and Lean Manufacturing coverage to later

Supported ABC for Service Providers with step-by-step allocation example. NEW NTK 17-3 on ABC for Service Providers.

NEW Analytics Insight on cost allocation at **DHL Express**. Improved NTK 17-4 using step-by-step ABC allocation approach.

Enhanced and revised multiple choice quiz.

Three new Ouick Studies and eight new

Exercises.
Revised analysis assignments: Company
Analysis, Comparative Analysis, and
Extended Analysis.

Chapter 18

NEW opener—SmartSweets and entrepreneurial assignment.
Streamlined procedural learning objectives.

Removed income taxes and pretax income for clarity.

Postponed coverage of curvilinear costs to advanced courses.

Simplified Exhibit 18.2 on step-wise costs.

Added examples of step-wise costs to Exhibit 18.3.

Revised formula for variable cost per unit using high-low method. Enhanced NTK 18-2 to show solution in

steps Added NEW alternative to compute contribution margin ratio. Simplified Exhibit 18.13 on contribution margin in reporting. Streamlined CVP changes in estimates for Exhibits 18.15, 18.16 and 18.17. NEW coverage of sales mix and breakeven using Weighted-Average Contribution Margin per Unit. Revised Exhibits 18.27, 18.28, 18.29 for weighted-average contribution margin per unit and contribution margin in dollars. Revised NTK 18-5 for weighted-average contribution margin per unit. NEW Analytics Insight on big data at

Amazon. Simplified degree of operating leverage formulas in Exhibits 18.31 and 18.32.

Simplified NTK 18-6. Added six new Quick Studies and four new Exercises.

Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 19

NEW Opener—Da Bomb and Entrepreneurial assignment. Streamlined learning objectives. Revised account titles in Exhibit 19.4, 19.5, and 19.6 for consistency and simplicity.

Removed *previous edition* Exhibits 19.5, 19.7, and 19.9 based on student and instructor feedback.

Improved NTK 19-2 with more

consistent terminology.
Moved 'Converting Income from

Variable Costing to Absorption Costing' to Appendix 19A. Simplified Exhibit 19.9 by shortening

the selling and administrative expenses section.

Moved Analyzing Special Orders into text following Setting Target Price section.

Postponed CVP analysis coverage to later chapters.

NEW Decision Analysis section on using Contribution Margin Ratio to make decisions.

Simplified computations in NTK 19-4 to focus on the accounting.

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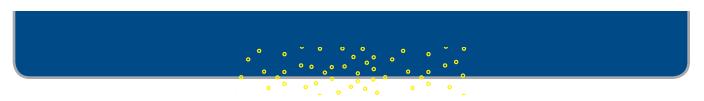


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Six new Quick Studies and six new Exercises.

Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 20

NEW opener—Ellis Island Tropical Tea and entrepreneurial assignment. NEW LO on direct labor budget for a service firm and revenue per employee. Simplified Production Budget in Exhibit 20.6.

Slightly revised direct materials budget in Exhibit 20.7.

Slightly revised direct labor budget in Exhibit 20.8.

Revised NTK 20-3 solution formatting. Simplified factory overhead budget in Exhibit 20.9.

NEW cost of goods sold budget. Revised NTK 20-4 solution for consistency with Connect assignments. Improved schedule of cash receipts from sales in Exhibit 20.14.

NEW table for capital expenditures budget.

NEW tables to budget cash receipts of credit sales and with uncollectibles. Enhanced schedule of cash payments for direct materials in Exhibit 20.15. Revised NTK 20-5 solution for consistency with Connect assignments. NEW Decision Analysis on direct labor budget for service firms and revenue per employee.

Revised NTK 20-6 and 20-7. Improved merchandise purchases budget in Exhibit 20A.3.

NEW schedule of cash payments for merchandise purchases in Exhibit 20A.4. Added one new Exercise.

Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 21

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NEW opener—True Fit and entrepreneurial assignment. Revised Exhibit 21.1 to better show fixed vs flexible budgets. Simplified Exhibit 21.2 for a fixed budget performance report. Simplified Exhibits 21.3 and 21.4. Added Part B to Need-to-Know 21-1. Modernized Exhibit 21.5. Revised cost variance example and tables. Revised NTK 21-2. Modified direct labor variances example from 1 direct labor variances example

from 1 direct labor hour per unit to ½ direct labor hour per unit to clarify steps.

NEW Analytics Insight on predictive analysis.

Enhanced and revised NTK 21-4.

Revised Exhibit 21.12 on Flexible Overhead Budget, so that variable overhead rate per unit differs from \$1. NEW section on overhead controllable and volume variances.

NEW formulas for Variable overhead rate and Fixed overhead rate.

Revised Exhibit 21.15 to show volume

and controllable variances for overhead. Revised Exhibit 21.16 to better explain the overhead variance report. Simplified NTK 21-6.

NEW numbers and exhibits in Appendix 21A.

Expanded and improved NTK 21-7. Added five new Exercises. Revised analysis assignments: Comp.

Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 22

NEW opener—**Teysha** and entrepreneurial assignment. Streamlined conceptual learning objectives.

Removed Appendix A; cost allocations simplified and moved into chapter. Removed Appendix B; transfer pricing streamlined and moved into chapter. NEW demo company, Outdoor Gal, with new department examples beginning with Exhibit 22.8. Reduced five departments to three departments in Departmental Income Statement to simplify demonstration. Revised Exhibits 22.9, 22.10, 22.11 and 22.12.

Simplified return on investment example and formula in Exhibit 22.13. Simplified residual income example and formula in Exhibit 22.14. Combined and updated NTKs 22-3 and

Combined and updated NTKs 22-3 ar 22-4.

Postponed Measurement Issues to advanced courses.

Simplified profit margin and investment turnover examples and formulas in Exhibits 22.15 and 22.16.

Refined balance scorecard in Exhibit 22.18. Changed joint cost demonstration in Appendix 22A to milk types. Postponed physical basis allocation to

advanced courses.

Added three new Quick Studies and one

Added three new Quick Studies and on new Exercise.

Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 23

NEW opener—**Eye Symmetry** and entrepreneurial assignment.
Added *avoidable cost* in distinguishing between relevant and irrelevant costs.
Improved NTK 23-1.

Enhanced Make or Buy analysis with a decision row in Exhibit 23.2. Revised NTK 23-2.

Enhanced Sell or Process Further demo to focus on one product and to include a decision row in Exhibit 23.3.

Improved Scrap or Rework analysis with a decision row in Exhibit 23.4. Revised NTK 23-3

Revised Sales Mix section with electric scooters example.

Updated Exhibit 23.5 to apply new scooters example.

NEW Exhibits 23.6 and 23.7 for sale

NEW Exhibits 23.6 and 23.7 for sales mix decisions with unlimited and limited demand.

Revised NTK 23-4.

NEW and improved Segment Elimination with Exhibits 23.8, 23.9 and 23.10.

NEW and improved Keep or Replace with Exhibit 23.11.

Revised NTK 23-5.

New visual aid for price takers versus price setters.

New formula for selling price per unit. New illustration of three-step total cost method to determine price. Simplified Special Offer analysis and

Exhibits 23.12 and 23.13. Revised NTK 23-6.

Revised and improved Decision Analysis section on Time and Materials Pricing.

Improved NTK 23-7 to include all decision scenarios.

Added two new Quick Studies and three new Problems.

Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Chapter 24

NEW opener-Gecko Robotics and entrepreneurial assignment. Removed income taxes and pretax income for clarity. Simplified Payback Period with numbers not requiring rounding. Simplified Payback Period with unequal cash flows from 8 to 5 years. Revised accounting rate of return formula in Exhibit 24.6. Simplified calculations for accounting rate of return in Exhibit 24.7. Revised NTK 24-2 to not require rounding. Simplified NPV demo from 8 to 3 years in Exhibit 24.8. Simplified numbers in NPV of annuity in Exhibit 24.9. Streamlined NPV with unequal cash flows in Exhibit 24.10 by removing

NEW table on NPV for investments with salvage value.

Postponed accelerated depreciation, inflation, and capital rationing in NPV to advanced courses.

Revised IRR to simplify calculations, limit rounding, and work with App B present value tables.

Postponed Postaudit coverage to advanced courses.

Simplified Break-even time demo from 8 to 5 years in Exhibit 24.14.

Added one new Quick Study, one new

Exercise, two new Problems. Revised analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Appendix A

New financial statements for **Apple**, **Google**, and **Samsung**.

Appendix C

All content updated for new investment rules per GAAP. Revised and simplified Exhibit C.2 for

new standard on investments.
Updated component-returns analysis

using Costco and Walmart.
New Cheat Sheet reinforces chapter content.

Added two new Quick Studies. Added two new Exercises. Updated analysis assignments: Company Analysis, Comparative Analysis, and Extended Analysis.

Appendix D

Revised Exhibit D.1 on lean business model.

Updated coverage of lean principles. Added P2 learning objective on costs of quality and cost of quality report. Revised Exhibit D.3 on push versus pull production.

NEW section on Lean Overhead Costs and the 80-20 rule.

NEW exhibit with real-world example of using lean techniques to reduce overhead costs.

Revised exhibit on components of cycle efficiency.

NEW example of computing revised days' sales in WIP from lean techniques. NEW section on costs of quality and cost of quality report.

New Exhibit D.8 on quality costs. New Exhibit D.9 on a Cost of Quality

Added two new Quick Studies and two new Exercises.









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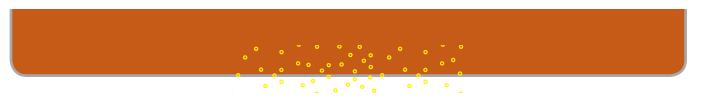
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xviii

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Brief Contents

- 1 Accounting in Business 2
- 2 Accounting for Business Transactions 44
- 3 Adjusting Accounts for Financial Statements 84
- 4 Accounting for Merchandising Operations 152
- 5 Inventories and Cost of Sales 200
- 6 Cash, Fraud, and Internal Control 244
- 7 Accounting for Receivables 280
- 8 Accounting for Long-Term Assets 312
- 9 Accounting for Current Liabilities 346
- Accounting for Long-Term Liabilities 386
- 11 Corporate Reporting and Analysis 422
- 12 Reporting Cash Flows 458
- 13 Analysis of Financial Statements 502
- Managerial Accounting Concepts and Principles 540
- 15 Job Order Costing 574
- 16 Process Costing and Analysis 618

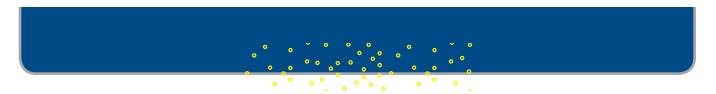
- 17 Activity-Based Costing and Analysis 666
- 18 Cost Behavior and Cost-Volume-Profit Analysis 704
- 19 Variable Costing and Analysis 740
- Master Budgets and Planning 772
- 21 Flexible Budgets and Standard Costs 820
- Performance Measurement and Responsibility Accounting 864
- Relevant Costs for Managerial Decisions 902
- 24 Capital Budgeting and Investment Analysis 932
- A Financial Statement Information A
- B Time Value of Money B-1
- C Investments C-1
- D Lean Principles and Accounting D-1
 Index IND
- CA Chart of Accounts CA-1
- **BR** Brief Review BR-1



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Contents

Preface iv

1 Accounting in Business 2

Importance of Accounting 3

Users of Accounting Information 4 Opportunities in Accounting 4

Fundamentals of Accounting 6

Ethics—A Key Concept 6 Generally Accepted Accounting Principles 6 Conceptual Framework 7

Business Transactions and Accounting 9

Accounting Equation 9 Transaction Analysis 10 Summary of Transactions 14

Financial Statements 15

Income Statement 15 Statement of Retained Earnings 17 Balance Sheet 17 Statement of Cash Flows 17

Decision Analysis—Return on Assets 18

2 Accounting for Business Transactions 44

Basis of Financial Statements 45

Source Documents 45 "Account" Underlying Financial Statements 45 Ledger and Chart of Accounts 48

Double-Entry Accounting 49

Debits and Credits 49 Double-Entry System 49

Analyzing and Processing Transactions 50

Journalizing and Posting Transactions 50 Processing Transactions—An Example 52 Summarizing Transactions in a Ledger 57

Trial Balance and Financial Statements 58

Preparing a Trial Balance 58 Financial Statements Prepared from Trial Balance 59 Decision Analysis—Debt Ratio 61

3 Adjusting Accounts for Financial Statements 84

Timing and Reporting 85

The Accounting Period 85 Accrual Basis versus Cash Basis 86 Recognizing Revenues and Expenses 86 Framework for Adjustments 87

Deferral of Expense 87

Prepaid Insurance 87 Supplies 88 Other Prepaid Expenses 88 Depreciation 88

Deferral of Revenue 91

Unearned Consulting Revenue 91

Accrued Expense 92

Accrued Salaries Expense 93 Accrued Interest Expense 93 Future Cash Payment of Accrued Expenses 94

Accrued Revenue 94

Accrued Services Revenue 95 Accrued Interest Revenue 95 Future Cash Receipt of Accrued Revenues 95 Links to Financial Statements 96

Trial Balance and Financial Statements 97

Adjusted Trial Balance 97 Preparing Financial Statements 98

Closing Process 100

Temporary and Permanent Accounts 100 Recording Closing Entries 100 Post-Closing Trial Balance 103

Accounting Cycle 103

Classified Balance Sheet 104

Classification Structure 104 Classification Categories 105 Decision Analysis—Profit Margin and

Current Ratio 107

Appendix 3A Alternative Accounting for Prepayments 110

Appendix 3B Work Sheet as a Tool 111 **Appendix 3C Reversing Entries 113**

4 Accounting for Merchandising **Operations 152**

Merchandising Activities 153

Reporting Income for a Merchandiser 153 Reporting Inventory for a Merchandiser 154 Operating Cycle for a Merchandiser 154 Inventory Systems 154



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Contents

xxi

Merchandise Purchases 155

Purchases without Cash Discounts 155
Purchases with Cash Discounts 155
Purchases with Returns and Allowances 157
Purchases and Transportation Costs 158

Merchandise Sales 160

Sales <u>without</u> Cash Discounts 160
Sales <u>with</u> Cash Discounts 160
Sales <u>with</u> Returns and Allowances 161

Adjusting and Closing for Merchandisers 162

Adjusting Entries for Merchandisers 163 Closing Entries for Merchandisers 163 Summary of Merchandising Entries 164

More on Financial Statement Formats 166

Multiple-Step Income Statement 166 Single-Step Income Statement 167 Classified Balance Sheet 167

Decision Analysis—Acid-Test and Gross

Margin Ratios 168 Appendix 4A Periodic Inventory System 172 Appendix 4B Adjusting Entries under New Revenue

Recognition Rules 176
Appendix 4C Net Method for Merchandising 178

5 Inventories and Cost of Sales 200

Inventory Basics 201

Determining Inventory Items 201 Determining Inventory Costs 202 Internal Controls and Taking a Physical Count 202

eventory Costing under a Downstral System 202

Inventory Costing under a Perpetual System 203

Inventory Cost Flow Methods 203
Inventory Costing Illustration 204
Specific Identification 204
First-In, First-Out 205
Last-In, First-Out 205
Weighted Average 206
Financial Statement Effects of Costing Methods 207
Tax Effects of Costing Methods 208

Valuing Inventory at LCM and Analyzing Inventory Errors 210

Lower of Cost or Market 210

Financial Statement Effects of Inventory Errors 211

Decision Analysis—Inventory Turnover and Days' Sales in Inventory 213

Appendix 5A Inventory Costing under a Periodic System 219

Appendix 5B Inventory Estimation Methods 224

6 Cash, Fraud, and Internal Control 244

Fraud and Internal Control 245

Purpose of Internal Control 245 Principles of Internal Control 246 Technology, Fraud, and Internal Control 247 Blockchain as a Control 247 Limitations of Internal Control 247

Control of Cash 248

Cash, Cash Equivalents, and Liquidity 248
Cash Management 249
Control of Cash Receipts 249
Control of Cash Payments 251

Banking Activities as Controls 255

Basic Bank Services 255
Bank Statement 256
Bank Reconciliation 257

Decision Analysis—Days' Sales Uncollected 260 Appendix 6A Documentation and Verification 262

7 Accounting for Receivables 280

Valuing Accounts Receivable 281
Direct Write-Off Method 283
Allowance Method 285
Estimating Bad Debts for Allowance
Method 287

Percent of Sales Method 287
Percent of Receivables Method 287
Aging of Receivables Method 288

Notes Receivable 291

Computing Maturity and Interest 291 Recording Notes Receivable 292 Valuing and Settling Notes 293 Disposal of Receivables 294

Decision Analysis—Accounts Receivable
Turnover 295

8 Accounting for Long-Term Assets 312

Cost Determination 314

Machinery and Equipment 314
Buildings 314
Land Improvements 314
Land 314
Lump-Sum Purchase 315

Depreciation 315

Factors in Computing Depreciation 315 Depreciation Methods 316 Partial-Year Depreciation 319 Change in Estimates 319

Additional Expenditures 321

Ordinary Repairs 321

Betterments and Extraordinary Repairs 321

Disposals of Plant Assets 322

Discarding Plant Assets 322 Selling Plant Assets 323 Cost Determination and Depletion 324 Plant Assets Tied into Extracting 325





EOA



Types of Intangibles 326 Decision Analysis—Total Asset Turnover 329 Appendix 8A Exchanging Plant Assets 331

9 Accounting for Current Liabilities 346

Known Liabilities 347

Characteristics of Liabilities 347 Examples of Known Liabilities 348 Accounts Payable 349 Sales Taxes Payable 349 Unearned Revenues 349 Short-Term Notes Payable 349

Payroll Liabilities 352

EMPLOYEE Payroll and Deductions 352 EMPLOYER Payroll Taxes 353 Employee and Employer Payroll Taxes Summary 354 Internal Control of Payroll 354 Multi-Period Known Liabilities 355

Estimated Liabilities 355

Health and Pension Benefits 356 Vacation Benefits 356 Bonus Plans 356 Warranty Liabilities 356 Multi-Period Estimated Liabilities 357

Contingent Liabilities 358

Accounting for Contingent Liabilities 358 Applying Rules of Contingent Liabilities 359 Uncertainties That Are Not Contingencies 359

Decision Analysis—Times Interest Earned Ratio 359 Appendix 9A Payroll Reports, Records, and Procedures 362

Appendix 9B Corporate Income Taxes 367

10 Accounting for Long-Term Liabilities 386

Basics of Bonds 387

Bond Financing 387 Bond Issuing 388 Bond Trading 388

Par Bonds 388

Discount Bonds 389

Bond Discount or Premium 389 Issuing Bonds at a Discount 390

Premium Bonds 392

Issuing Bonds at a Premium 392 Bond Retirement 394

Long-Term Notes Payable 395

Installment Notes 395

Mortgages 397

Decision Analysis—Debt Features and the Debt-to-Equity Ratio 398

Appendix 10A Bond Pricing 401

Appendix 10B Effective Interest Amortization 403

Appendix 10C Leases and Pensions 404

11 Corporate Reporting and Analysis 422

Corporate Form of Organization 423

Corporate Advantages 423 Corporate Disadvantages 423 Corporate Organization and Management 424 Corporate Stockholders 424 Corporate Stock 425

Common Stock 426

Issuing Par Value Stock 426 Issuing No-Par Value Stock 427 Issuing Stated Value Stock 427 Issuing Stock for Noncash Assets 427

Dividends 428

Cash Dividends 428 Stock Dividends 429 Stock Splits 431 Financial Statement Effects of Dividends and Splits 431

Preferred Stock 432

Issuance of Preferred Stock 432 Dividend Preference of Preferred Stock 432 Reasons for Issuing Preferred Stock 433

Treasury Stock 434

Purchasing Treasury Stock 434 Reissuing Treasury Stock 435

Reporting of Equity 436

Statement of Retained Earnings 436 Statement of Stockholders' Equity 437

Decision Analysis—Earnings per Share, Price-Earnings Ratio, and Dividend Yield 438

12 Reporting Cash Flows 458

Basics of Cash Flow Reporting 459

Purpose of the Statement of Cash Flows 459 Importance of Cash Flows 459 Measurement of Cash Flows 459 Classification of Cash Flows 460 Noncash Investing and Financing 461 Format of the Statement of Cash Flows 461 Preparing the Statement of Cash Flows 462

Cash Flows from Operating 463

Indirect and Direct Methods of Reporting 463 Applying the Indirect Method 463 Summary of Adjustments for Indirect Method 466

Cash Flows from Investing 467

Three-Step Analysis 467 Analyzing Noncurrent Assets 467

Cash Flows from Financing 469

Three-Step Analysis 469 Analyzing Noncurrent Liabilities 469 Analyzing Equity 470 Proving Cash Balances 470





EQA





Contents

xxiii

Summary Using T-Accounts 472

Decision Analysis—Cash Flow Analysis 473 Appendix 12A Spreadsheet Preparation of the **Statement of Cash Flows 475 Appendix 12B Direct Method of Reporting Operating Cash Flows 477**

13 Analysis of Financial Statements 502

Basics of Analysis 503

Purpose of Analysis 503 Building Blocks of Analysis 503 Information for Analysis 504 Standards for Comparisons 504 Tools of Analysis 504

Horizontal Analysis 504

Comparative Statements 504 Trend Analysis 507

Vertical Analysis 508

Common-Size Statements 508 Data Visualizations 510

Ratio Analysis 512

Liquidity and Efficiency 512 Solvency 514 Profitability 515 Market Prospects 516 Summary of Ratios 517

Decision Analysis—Analysis Reporting 518 Appendix 13A Sustainable Income 521

14 Managerial Accounting Concepts and Principles 540

Managerial Accounting Basics 541

Purpose of Managerial Accounting 541 Nature of Managerial Accounting 542 Fraud and Ethics in Managerial Accounting 543 Career Paths 543

Cost Concepts 544

Direct versus Indirect 544 Manufacturing Costs 545 Prime and Conversion Costs 545 Product versus Period Costs 546 Cost Concepts for Service Companies 546

Reporting 547

Reporting Inventory on the Balance Sheet 548 Reporting Cost of Goods Sold on the Income Statement 548

Cost Flows and Cost of Goods

Manufactured 550

Flow of Manufacturing Activities 550

Schedule of Cost of Goods Manufactured 551 Trends in Managerial Accounting 553

Decision Analysis—Raw Materials Inventory Turnover and Days' Sales in Raw Materials Inventory 556

15 Job Order Costing 574

Job Order Costing 575

Job Order Production 575 Job Order vs. Process Operations 575 Production Activities in Job Order Costing 576 Cost Flows 576 Job Cost Sheet 576

Materials and Labor Costs 578

Materials Cost Flows and Documents 578 Labor Cost Flows and Documents 580

Overhead Costs 582

Set Predetermined Overhead Rate 582 Apply Estimated Overhead to Jobs 583 Record Actual Overhead 584 Cost Flows to Financial Statements 585 Using Job Cost Sheets for Managerial Decisions 586 Schedule of Cost of Goods Manufactured 587 Financial Statements 588

Closing Overhead 588

Factory Overhead Account 588 Close Underapplied or Overapplied Overhead 589 Job Order Costing of Services 589

Decision Analysis—Pricing for Services 590

16 Process Costing and Analysis 618

Process Operations 619

Organization of Process Operations 619 Comparing Process and Job Order Costing Systems 620

Process Costing Demonstration 621

Step 1: Determine Physical Flow of Units 621 Step 2: Compute Equivalent Units of Production 622

Step 3: Compute Cost per Equivalent Unit 624 Step 4: Assign and Reconcile Costs 625

Production Cost Report 626

Accounting for Process Costing 627

Accounting for Production Costs 628 Accounting for Transfers 630 Trends in Process Operations 632

Decision Analysis—Hybrid Costing System 633

Appendix 16A FIFO Method of Process

Costing 637







17 Activity-Based Costing and Analysis 666

Overhead Cost Allocation Methods 667

Plantwide Overhead Rate Method 668

Applying Plantwide Overhead Rate Method 668

Departmental Overhead Rate Method 669

Activity-Based Costing 672

Applying Activity-Based Costing 672 Activity Levels and Cost Management 676 Assessing Activity-Based Costing 677

ABC for Service Providers 678

Activities for Service Providers 678

Applying Activity-Based Costing to a Service

Provider 678

Decision Analysis—Customer Profitability 681

18 Cost Behavior and Cost-Volume-Profit Analysis 704

Identifying Cost Behavior 705

Fixed Costs 706 Variable Costs 706 Graphing Fixed and Variable Costs 706 Mixed Costs 707 Step-wise Costs 707

Measuring Cost Behavior 708

Scatter Diagram 708
High-Low Method 709
Regression 709
Comparing Cost Estimation Methods 709

Contribution Margin and Break-Even Analysis 710

Contribution Margin 710 Break-Even Point 711 Changes in Estimates 712

Applying Cost-Volume-Profit Analysis 714

Margin of Safety 714
Computing Income from Expected Sales and Costs 714
Computing Sales for a Target Income 714
Evaluating Business Strategies 715
Sales Mix and Break-Even 716

Assumptions in Cost-Volume-Profit Analysis 718

Decision Analysis—Degree of Operating Leverage 718

Appendix 18A Using Excel for Cost Estimation 720 Appendix 18B Variable Costing and Performance Reporting 721

19 Variable Costing and Analysis 740

Introducing Variable Costing and Absorption Costing 741

Computing Unit Product Cost 742

Income Reporting 743

Units Produced Equal Units Sold 743 Units Produced Exceed Units Sold 744 Units Produced Are Less Than Units Sold 745 Summarizing Income Reporting 745

Production and Pricing 746

Planning Production 746
Setting Target Price 748
Analyzing Special Orders 749
Variable Costing for Services 749
Decision Analysis—Contribution Margin Ratio 751
Appendix 19A Converting Income from Variable

20 Master Budgets and Planning 772

Budget Process and Administration 773

Costing to Absorption Costing 754

Budgeting Process 773
Benefits of Budgeting 774
Budgeting and Human Behavior 774
Budget Reporting and Timing 774

Operating Budgets 775

Master Budget Components 775
Sales Budget 776
Production Budget 776
Direct Materials Budget 777
Direct Labor Budget 778
Factory Overhead Budget 779
Budgeted Cost of Goods Sold 779
Selling Expense Budget 780
General and Administrative Expense Budget 780

Investing and Financing Budgets 781

Capital Expenditures Budget (Investing Budget) 781 Cash Budget (Financing Budget) 781

Budgeted Financial Statements 785

Budgeted Income Statement 785 Budgeted Balance Sheet 786

Decision Analysis—Direct Labor Budget and Revenue per Employee 787

Appendix 20A Merchandise Purchases Budget 795

21 Flexible Budgets and Standard Costs 820

Fixed and Flexible Budgets 821

Fixed Budget Performance Report 822 Flexible Budget Reports 822

Standard Costing 825

Standard Costs 825 Setting Standard Costs 826 Cost Variance Analysis 826

Direct Materials and Direct Labor Variances 828

Direct Materials Variances 829 Direct Labor Variances 830



EQA





Contents

1

Overhead Standards and Variances 831

Flexible Overhead Budgets 831 Standard Overhead Rate 831 Computing Overhead Variances 832 Overhead Variance Report 834 **Decision Analysis—Sales Variances 836**

Appendix 21A Expanded Overhead Variances and Standard Cost Accounting System 840

22 Performance Measurement and Responsibility Accounting 864

Responsibility Accounting 865

Performance Evaluation 865 Controllable versus Uncontrollable Costs 866 Responsibility Accounting for Cost Centers 866

Profit Centers 868 Expenses 868

Expense Allocations 868 Departmental Income Statements 870 Departmental Contribution to Overhead 872

Investment Centers 873

Return on Investment and Residual Income 873 Profit Margin and Investment Turnover 874

Balanced Scorecard and Transfer Pricing 875

Balanced Scorecard 875 Transfer Pricing 876

Decision Analysis—Cash Conversion Cycle 878 Appendix 22A Joint Costs and Their Allocation 882

23 Relevant Costs for Managerial **Decisions 902**

Decisions and Information 903

Decision Making 903 Relevant Costs and Benefits 903

Production Decisions 904

Make or Buy 904 Sell or Process 905 Scrap or Rework 906

Sales Mix When Resources Constrained 906

Capacity Decisions 908

Segment Elimination 908 Keep or Replace 909

Pricing Decisions 910

Normal Pricing 910 Special Pricing 912

Decision Analysis—Time and Materials Pricing 914

24 Capital Budgeting and Investment Analysis 932

Payback Period 933

Payback Period with Equal Cash Flows 934 Payback Period with Unequal Cash Flows 935

Accounting Rate of Return 936

Net Present Value (NPV) 937

Internal Rate of Return (IRR) 940 Comparing Capital Budgeting Methods 941

Decision Analysis—Break-Even Time (BET) 942 **Appendix 24A Using Excel to Compute Internal Rate**

of Return 944

Financial Statement Information A Appendix A

> Apple A-1 Google A-9 Samsung A-13

Time Value of Money B-1 Appendix B

Investments C-1 Appendix C

Lean Principles and Accounting D-1 Appendix D

Index IND

Chart of Accounts CA-1

Brief Review Managerial Analyses and Reports BR-1

> Financial Reports and Tables BR-2 Selected Transactions and Relations BR-3

Fundamentals and Analyses BR-4

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Chapter Preview

ACCOUNTING USES

C1 Purpose of accounting

Accounting users

Opportunities in accounting

Al and data analytics

NTK 1-1

ETHICS AND ACCOUNTING

C2 Ethics

Generally accepted accounting principles

Business types

NTK 1-2

TRANSACTION ANALYSIS

A1 Accounting equation and its components

> Expanded accounting equation

P1 Transaction analysis— Illustrated

NTK 1-3, 1-4

FINANCIAL STATEMENTS

P2 Income statement

Statement of retained earnings

Balance sheet

Statement of cash flows

A2 Financial analysis

NTK 1-5

Chapter Preview is organized by "blocks" of key content and learning objectives followed by Need-to-Know (NTK) guided examples (with video)

Learning Objectives are classified as conceptual, analytical, or procedural

Learning Objectives

CONCEPTUAL

- C1 Explain the importance of accounting and identify its users.
- C2 Describe the importance of ethics and GAAP.

ANALYTICAL

- A1 Define and interpret the accounting equation and each of its components.
- **A2** Compute and interpret return on assets.

PROCEDURAL

- P1 Analyze business transactions using the accounting equation.
- P2 Identify and prepare basic financial statements and explain how they interrelate.







🐗 aptara

Decision Feature launches each chapter showing the relevance of accounting for a real entrepreneur; Entrepreneurial Decision assignment returns to this feature with a mini-case

By the Numbers

"Learn from others' failures"—REED HASTINGS

SAN JOSE, CA-Reed Hastings recalls he got the idea for Netflix (Netflix.com) after paying a \$40 late fee on the movie Apollo 13. "I was embarrassed . . . and it got me thinking that there's a big market out there," says Reed. While Netflix started out delivering movies and shows by mail, Reed's college coursework convinced him that Internet streaming was the future. Today, Netflix's video-streaming service accounts for 40% of Internet traffic in the evening hours.

While some of Netflix's success is attributed to a good business idea, much of it is a result of execution. In the early stages, Netflix invested heavily in accounting and data analytics systems. These systems track everything from detailed sales information to how long a customer watches a show. "Being an entrepreneur is about patience and persistence, not the quick buck," claims

Accounting and data analytics help Netflix make key decisions. For example, Netflix spent \$140 million for one season of The Crown, which was the most expensive show ever produced. Using sales data and analytics on viewing habits, Netflix predicted the show would be a hit and generate additional sales.

Netflix's accounting analytics also enable it to target customers with personalized content suggestions. Some estimate that



Gabriel Aponte/Stringer/Getty Images

this accounting-driven strategy to customer retention adds an additional \$1 billion in revenue each year.

While accounting analytics have contributed to success for Netflix, Reed insists business is fun: "For some people, high school graduation is the peak . . . but I find running a company to be a lot more fun and exciting."

Sources: Netflix website, January 2021; Quartz, August 2017 and February 2017; Inc.com,

IMPORTANCE OF ACCOUNTING

Select transactions and events

Examples are Apple's sale of iPhones and

TicketMaster's receipt of ticket money.

Why is accounting so popular on campus? Why are there so many openings for accounting jobs? Why is accounting so important to companies? The answer is that we live in an information age in which accounting information impacts us all.

Accounting is an information and measurement system that identifies, records, and communicates an organization's business activities. Exhibit 1.1 shows these accounting functions.

Explain the importance of accounting and identify its

Identifying Recording Communicating

Input, measure, and loa

Examples are dated logs of

transactions measured in dollars.

Prepare, analyze, and interpret Examples are reports that we analyze

and interpret.

EXHIBIT 1.1 Accounting Functions

Our most common contact with accounting is through credit checks, checking accounts, tax forms, and payroll. These experiences focus on recordkeeping, or bookkeeping, which is the recording of transactions and events. This is just one part of accounting. Accounting also includes analysis and interpretation of information.







Users of Accounting Information

Accounting is called the *language of business* because it communicates data that help people make better decisions. People using accounting information are divided into two groups: *external users* and *internal users*. **Financial accounting** focuses on the needs of external users, and **managerial accounting** focuses on the needs of internal users.

External Users External users of accounting information do *not* directly run the organization and have limited access to its accounting information. These users get accounting information from general-purpose financial statements. Following is a partial list of external users and decisions they make with accounting information.



Point: The largest accounting firms are **EY, KPMG, PwC,** and **Deloitte.**

- Lenders (creditors) loan money or other resources to an organization. Banks, savings and loans, and mortgage companies are lenders. Lenders use information to assess if an organization will repay its loans.
- *Shareholders* (*investors*) are the owners of a corporation. They use accounting reports to decide whether to buy, hold, or sell stock.
- External (independent) auditors examine financial statements to verify that they are prepared according to generally accepted accounting principles.
- Nonmanagerial and nonexecutive employees and labor unions use external information to bargain for better wages.
- Regulators have legal authority over certain activities of organizations. For example, the Internal Revenue Service (IRS) requires accounting reports for computing taxes.
- Voters and government officials use information to evaluate government performance.
- Contributors to nonprofits use information to evaluate the use and impact of donations.
- Suppliers use information to analyze a customer before extending credit.
- Customers use financial reports to assess the stability of potential suppliers.

Internal Users Internal users of accounting information directly manage the organization. Internal reports are designed for the unique needs of managerial or executive employees, such as the chief executive officer (CEO). Following is a partial list of internal users and decisions they make with accounting information.



- Purchasing managers need to know what, when, and how much to purchase.
- Human resource managers need information about employees' payroll, benefits, and performance.
- Production managers use information to monitor costs and ensure quality.
- Distribution managers need reports for timely and accurate delivery of products and services.
- Marketing managers use reports to target consumers, set prices, and monitor consumer needs.
- *Service managers* use reports to provide better service to customers.
- Research and development managers use information on projected costs and revenues of innovations.

Opportunities in Accounting

Accounting has four areas of opportunities: financial, managerial, taxation, and accounting-related. Exhibit 1.2 lists selected opportunities in each area.

Exhibit 1.3 shows that the majority of opportunities are in *private accounting*, which are employees working for businesses. *Public accounting* involves accounting services such as auditing, taxation, and advisory services. Opportunities also exist in government and not-for-profit agencies, including business regulation and law enforcement.



• Entrepreneurs

5



EXHIBIT 1.2

Accounting Opportunities

Accounting specialists are highly regarded, and their professional standing is often denoted by a certificate. Certified public accountants (CPAs) must meet education and experience requirements, pass an exam, and be ethical. Many accounting specialists hold certificates in addition to or instead of the CPA. Two of the most common are the certificate in management accounting (CMA) and the certified internal auditor (CIA). Employers want specialists with designations such as certified bookkeeper (CB), certified payroll professional (CPP), certified fraud examiner (CFE), and certified forensic accountant (CrFA).

• Estate plans

Accounting specialists are in demand. Exhibit 1.4 reports average annual salaries for several accounting positions. Salaries vary based on location, company size, and other factors.

EXHIBIT 1.3

Accounting Jobs by Area

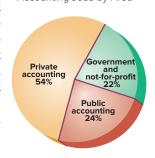


EXHIBIT 1.4

Accounting Salaries

Public Accounting	Salary
Partner	\$245,000
Manager (6–8 years)	112,000
Senior (3–5 years)	90,000
Junior (0–2 years)	62,500

Strategy

investigation

Private Accounting	Salary
CFO	\$290,000
Controller/Treasurer	180,000
Manager (6–8 years)	98,500
Senior (3–5 years)	81,500
Junior (0–2 years)	60,000

Appraisers

Recordkeeping	Salary
Full-charge bookkeeper	\$60,500
Accounts manager	58,000
Payroll manager	59,500
Accounting clerk (0–2 years)	39,500

Artificial Intelligence in Accounting Some estimate that artificial intelligence (AI) could replace 40% of today's workforce in the next decade. Repetitive tasks such as entering invoice and transaction data will be done by AI and software. This trend toward more AI integration bodes well for those with accounting knowledge. Accountants will be needed to help develop advanced AI systems and to analyze reports and graphics created by AI systems. Because employers recognize these valuable skills, accounting is consistently ranked among the top professions in terms of both future demand and future earnings.

Data Analytics and Visualization in Accounting Data analytics and data visualization are among the top skills sought by employers. **Data analytics** is a process of analyzing data to identify meaningful relations and trends. **Data visualization** is a graphical presentation of data to help people understand their significance. In accounting, data analytics and visualization help individuals make informed business decisions. **Dr Pepper Snapple Group** uses data analytics and visualization to send accounting information to its sales route staff via an app in real time. Staff then make data-driven decisions on what sales and promotions to offer retailers. **Tableau Dashboard Activities** in Connect offer the opportunity to begin developing such skills.







Chapter 1 Accounting in Business

NEED-TO-KNOWs have students apply key procedures and concepts; each NTK has a video walkthrough



Identify the following users of accounting information as either an (a) external or (b) internal user.

Accounting Users

1. Regulator

4. Marketing manager

7. Production manager

C1

6

2. CEO

5. Executive employee

8. Nonexecutive employee

3. Shareholder

6. External auditor

9. Bank lender

Do More: QS 1-1, QS 1-2, E 1-1 E 1-2, E 1-3 Solution

1. a **2.** b **3.** a **4.** b **5.** b **6.** a **7.** b **8.** a **9.** a

FUNDAMENTALS OF ACCOUNTING



Ethics—A Key Concept

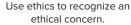
Describe the importance of ethics and GAAP. For information to be useful, it must be trusted. This demands ethics in accounting. **Ethics** are beliefs that separate right from wrong. They are accepted standards of good and bad behavior.

Accountants face ethical choices as they prepare financial reports. These choices can affect the salaries and bonuses paid to workers. They even can affect the success of products and services. Misleading information can lead to a bad decision that harms workers and the business. There is an old saying: *Good ethics are good business*. Exhibit 1.5 gives a three-step process for making ethical decisions.

EXHIBIT 1.5

Ethical Decision Making





Consider all consequences.

Choose best option after weighing all consequences.



Pressure

Fraud Triangle: Ethics under Attack The fraud triangle shows *three* factors that push a person to commit fraud.

- Opportunity. A person must be able to commit fraud with a low risk of getting caught.
- Pressure, or incentive. A person must feel pressure or have incentive to commit fraud.
- Rationalization, or attitude. A person justifies fraud or does not see its criminal nature.

The key to stopping fraud is to focus on prevention. It is less expensive and more effective to prevent fraud from happening than it is to detect it.

To help prevent fraud, companies set up internal controls. **Internal controls** are procedures to protect assets, ensure reliable accounting, promote efficiency, and uphold company policies. Examples are good records, physical controls (locks), and independent reviews. **Auditors** verify the effectiveness of internal controls.

Generally Accepted Accounting Principles

Financial accounting is governed by concepts and rules known as **generally accepted accounting principles (GAAP).** GAAP wants information to have *relevance* and *faithful representation*. Relevant information affects decisions of users. Faithful representation means information accurately reflects the business results.

💋 aptara

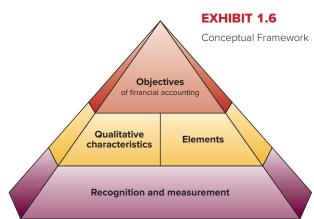
The **Financial Accounting Standards Board (FASB)** is given the task of setting GAAP from the **Securities and Exchange Commission (SEC).** The SEC is a U.S. government agency that oversees proper use of GAAP by companies that sell stock and debt to the public. An **audit** examines whether financial statements are prepared using GAAP.

International Standards Our global economy demands comparability in accounting reports. The **International Accounting Standards Board (IASB)** issues **International Financial Reporting Standards (IFRS)** that identify preferred accounting practices. These standards are similar to, but sometimes different from, U.S. GAAP. The FASB and IASB are working to reduce differences between U.S. GAAP and IFRS.

Conceptual Framework

The FASB **conceptual framework** in Exhibit 1.6 consists of the following.

- **Objectives**—to provide information useful to investors, creditors, and others.
- **Qualitative characteristics**—to require information that has *relevance* and *faithful representation*.
- **Elements**—to define items in financial statements.
- **Recognition and measurement**—to set criteria for an item to be recognized as an element; and how to measure it.



Principles, Assumptions, and Constraint There are two types of accounting principles (and assumptions). *General principles* are the assumptions, concepts, and guidelines

for preparing financial statements; these are shown in purple font in Exhibit 1.7, along with key assumptions in red font. *Specific principles* are detailed rules used in reporting business transactions and events; they are described as we encounter them.

Accounting Principles There are four general principles.

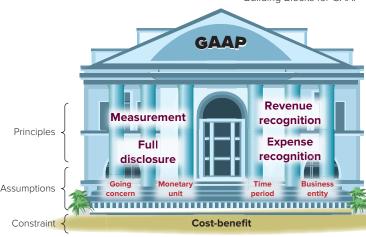
Measurement principle (cost principle)
 Accounting information is based on actual cost.
 Cost is measured on a cash or equal-to-cash basis. This means if cash is given for a service, its cost is measured by the cash paid. If something besides cash is exchanged (such as a car traded for a truck), cost is measured as the cash value of what is given up or received. Information

based on cost is considered objective. *Objectivity* means that information is supported by independent, unbiased evidence. Later chapters cover adjustments to market and introduce *fair value*.

- **Revenue recognition principle** Revenue is recognized (1) when goods or services are provided to customers and (2) at the amount expected to be received from the customer. Revenue (sales) is the amount received from selling products and services. The amount received is usually in cash, but it can also be a customer's promise to pay at a future date, called credit sales. (To *recognize* means to record it.)
- Expense recognition principle (matching principle) A company records the expenses it incurred to generate the revenue reported. An example is rent costs of office space.

EXHIBIT 1.7

Building Blocks for GAAP



Point: A company pays \$500 for equipment. The cost principle requires it be recorded at \$500 It makes no difference if the owner thinks this equipment is worth \$700.

Example: A lawn service bills a customer \$800 on June 1 for two months of mowing (June and July). The customer pays the bill on July 1 When is revenue recorded?

Answer: It is recorded over time as it is earned; record \$400 revenue for June and \$400 for July.





8

Chapter 1 Accounting in Business

Example: Credit cards are used to pay \$200 in gas for a lawn service during June and July. The cards are paid in August. When is expense recorded? Answer: If revenue is earned over time, record \$100 expense in June and \$100 in July.

• Full disclosure principle A company reports the details behind financial statements that would impact users' decisions. Those disclosures are often in footnotes to the statements.

Accounting Assumptions There are four accounting assumptions.

- Going-concern assumption Accounting information presumes that the business will continue operating instead of being closed or sold. This means, for example, that property is reported at cost instead of liquidation value.
- **Monetary unit assumption** Transactions and events are expressed in monetary, or money, units. Examples of monetary units are the U.S. dollar and the Mexican peso.
- **Time period assumption** The life of a company can be divided into time periods, such as months and years, and useful reports can be prepared for those periods.
- **Business entity assumption** A business is accounted for separately from other business entities and its owner. Exhibit 1.8 describes four common business entities.

EXHIBIT 1.8

Attributes of Businesses

	Sole Proprietorship Tax Services	Partnership	Corporation	Limited Liability Company (LLC)
Number of owners	1 owner; easy to set up.	2 or more, called <i>partners</i> ; easy to set up.	1 or more, called <i>shareholders</i> ; can get many investors by selling stock or shares of corporate ownership.*	1 or more, called <i>members</i> .
Business taxation	No additional business income tax.	No additional business income tax.	Additional corporate income tax.	No additional business income tax.
Owner liability	Unlimited liability. Owner is personally liable for proprietorship debts.	Unlimited liability. Partners are jointly liable for partnership debts.	Limited liability. Owners, called shareholders (or stockholders), are not liable for corporate acts and debts.	Limited liability. Owners, called members, are not personally liable for LLC debts.
Legal entity	Not a separate legal entity.	Not a separate legal entity.	A separate entity with the same rights and responsibilities as a person.	A separate entity with the same rights and responsibilities as a person.
Business life	Business ends with owner death or choice.	Business ends with a partner death or choice.	Indefinite.	Indefinite.

^{*}When a corporation issues only one class of stock, it is called **common stock** (or *capital stock*).

Accounting Constraint The **cost-benefit constraint**, or **cost constraint**, says that information disclosed by an entity must have benefits to the user that are greater than the costs of providing it. *Materiality*, or the ability of information to influence decisions, is also sometimes mentioned as a constraint. *Conservatism* and *industry practices* are sometimes listed as well.

Decision Ethics boxes are role-playing exercises that stress ethics in accounting



Entrepreneur You and a friend develop a new design for ice skates that improves speed but increases risk of injury. You plan to form a business to manufacture and sell the skates. You and your friend want to minimize taxes, but your big concern is potential lawsuits from customers who might be injured on these skates. What form of organization do you set up?

Answer: You should probably form an LLC. An LLC helps protect personal property from lawsuits directed at the business. Also, an LLC is not subject to an additional business income tax. You must also examine the ethics of starting a business where injuries are expected.





9

Part 1: Identify the accounting principle or assumption that best reflects each situation.

- **1.** AAA Painting performs services for a customer this period. AAA records revenue for this period even though the customer is not billed until next period.
- **2.** Ming Studios purchases camera equipment for \$12,000 cash. The owner thinks the equipment is worth \$18,000. The equipment is recorded at \$12,000.
- 3. Alfonso owns Consulting LLC. Alfonso keeps personal expenses separate from LLC expenses.

Solution

1. Revenue recognition principle **2.** Measurement principle **3.** Business entity assumption

Part 2: Recommend a business entity type in each situation.

- **a.** An entrepreneur is deciding between a sole proprietorship and an LLC. Two goals are to pay no additional business income tax and to have limited liability.
- **b.** An entrepreneur is deciding between a partnership and a corporation. Two goals are the ability to add many investors by selling shares of ownership and a business with an indefinite life.

Solution

a. LLC **b.** Corporation



Accounting Guidance

C2



Do More: QS 1-3, QS 1-4, QS 1-5, QS 1-6, E 1-4, E 1-5, E 1-6, E 1-7, E 1-8

BUSINESS TRANSACTIONS AND ACCOUNTING

Accounting shows two basic aspects of a company: what it owns and what it owes. *Assets* are resources a company owns or controls. The claims on a company's assets—what it owes—are separated into owner (equity) and nonowner (liability) claims. Together, liabilities and equity are the source of funds to acquire assets.

A I ______ Define and in

Define and interpret the accounting equation and each of its components.

Assets Assets are resources a company owns or controls. These resources are expected to yield future benefits. Examples are web servers for an online services company, musical instruments for a rock band, and land for a vegetable grower. Assets include cash, supplies, equipment, land, and accounts receivable. A *receivable* is an asset that promises a future inflow of resources. A company that provides a service or product on credit has an account receivable from that customer.

Point: "On credit" and "on account" mean cash is received or paid at a future date.

Liabilities Liabilities are creditors' claims on assets. These claims are obligations to provide assets, products, or services to others. A *payable* is a liability that promises a future outflow of resources. Examples are wages payable to workers, accounts payable to suppliers, notes (loans) payable to banks, and taxes payable.

Equity Equity is the owner's claim on assets and is equal to assets minus liabilities. Equity is also called *net assets* or *residual equity*.

Accounting Equation

The relation of assets, liabilities, and equity is shown in the following accounting equation. The accounting equation applies to all transactions and events, to all companies and organizations, and to all points in time.

Assets = Liabilities + Equity

Point: This equation can be rearranged. Example: Assets – Liabilities = Equity



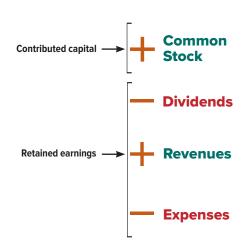




aptara

We can separate equity into four parts to get the expanded accounting equation.

We see that equity increases from **owner investments**, called *stock issuances*, and from revenues. It decreases from dividends and from expenses. These four parts of equity follow.



Common stock reflects inflows of cash and other net assets from shareholders in exchange for stock (stock is part of contributed capital and covered in later chapters).

Dividends are outflows of cash and other assets to shareholders that reduce equity.

Revenues increase equity (via net income) from sales of products and services to customers; examples are sales of products, consulting services provided, facilities rented to others, and commissions from services.

Expenses decrease equity (via net income) from costs of providing products and services to customers; examples are costs of employee time, use of supplies, advertising, utilities, and insurance fees.



Part 1: Use the *accounting equation* to compute the missing financial statement amounts.

Accounting Equation

A1



.

 Company
 Assets
 Liabilities
 Equity

 Bose
 \$150
 \$ 30
 \$ (a)

 Vogue
 \$ (b)
 \$100
 \$300

Solution

a. \$120 **b.** \$400

Part 2: Use the expanded accounting equation to compute the missing financial statement amounts.

Company	Assets	Liabilities	Common Stock	Dividends	Revenues	Expenses
Tesla	\$200	\$ 80	\$100	\$ 5	\$_(a)_	\$40
YouTube	\$400	\$160	\$220	\$ <u>(b)</u>	\$120	\$90

Do More: QS 1-7, QS 1-8, E 1-9, E 1-10, E 1-11 Solution

a. \$65 **b.** \$10

Transaction Analysis

P1

Analyze business transactions using the accounting equation.

Business activities are described in terms of transactions and events. **External transactions** are exchanges of value between two entities, which cause changes in the accounting equation. An example is the sale of the *AppleCare Protection Plan* by **Apple**. **Internal transactions** are exchanges within an entity, which may or may not affect the accounting equation. An example is **Target**'s use of its supplies, which are reported as expenses when used. **Events** are happenings that affect the accounting equation *and* are reliably measured. They include business events



 \bigoplus



11

such as changes in the market value of certain assets and liabilities and natural events such as fires that destroy assets and create losses.

This section uses the accounting equation to analyze 11 transactions and events of FastForward, a start-up consulting (service) business, in its first month of operations. Remember that after each transaction and event, assets always equal liabilities plus equity.

Transaction 1: Investment by Owner On December 1, Chas Taylor forms a consulting business named FastForward and it is set up as a corporation. FastForward evaluates the performance of footwear and accessories. Taylor owns and manages the business, which will publish online reviews and consult with clubs, athletes, and others who purchase **Nike** and **Adidas** products.

Taylor invests \$30,000 cash in the new company in exchange for its common stock, and deposits the cash in a bank account opened under the name of FastForward. After this transaction, cash (an asset) and equity each equals \$30,000. Equity is increased by the owner's investment (stock issuance), which is included in that column and titled Common Stock. The effect of this transaction on FastForward is shown in the accounting equation as follows (we label equity entries).

Real companies are in bold magenta





Transaction 2: Purchase Supplies for Cash FastForward uses \$2,500 of its cash to buy supplies of Nike and Adidas footwear for performance testing over the next few months. This transaction is an exchange of cash, an asset, for another kind of asset, supplies. It simply changes the form of assets from cash to supplies. The decrease in cash is exactly equal to the increase in supplies. The supplies of footwear are assets because of the expected future benefits from performance tests.

	Assets				Liabilities	+	Equity
	Cash	+	Supplies				Common Stock
Old Bal.	\$30,000			=			\$30,000
(2)	-2,500	+	\$2,500				
New Bal.	\$27,500	+	\$ 2,500	=			\$30,000
		\$30,000			\$	\$30,000	

Transaction 3: Purchase Equipment for Cash FastForward spends \$26,000 to acquire equipment for testing footwear. Like Transaction 2, Transaction 3 is an exchange of one asset, cash, for another asset, equipment. The equipment is an asset because of its expected future benefits from testing footwear. This purchase changes the makeup of assets but does not change the asset total. The accounting equation remains in balance.

			Assets		=	Liabilities	+	Equity	
	Cash	+	Supplies	+	Equipment	=			Common Stock
Old Bal.	\$27,500	+	\$2,500			=			\$30,000
(3)	-26,000			+	\$26,000				
New Bal.	\$ 1,500	+	\$2,500	+	\$ 26,000	=			\$30,000
			\$30,000				\$3	30,000	

Transaction 4: Purchase Supplies on Credit Taylor decides more supplies of footwear and accessories are needed. These additional supplies cost \$7,100, but FastForward has only \$1,500 in cash. Taylor arranges to purchase them on credit from CalTech Supply

Point: Supplies bought "on credit" are received now and then cash is paid for them later.





Chapter 1 Accounting in Business

Point: Accounts payable are amounts owed to others for items purchased on credit.

Company. Thus, FastForward acquires supplies in exchange for a promise to pay for them later. This purchase increases assets by \$7,100 in supplies, and liabilities (called *accounts payable* to CalTech Supply) increase by the same amount.

			Assets		=	Liabilities	+	Equity	
	Cash	Cash + Supplies + Equipment		=	Accounts Payable	+	Common Stock		
Old Bal.	\$1,500	+	\$2,500	+	\$26,000	=			\$30,000
(4)		+	7,100				+\$7,100		
New Bal.	\$1,500	+	\$9,600	+	\$26,000	=	\$ 7,100	+	\$30,000
	\$37,100						\$3	37,100	

Transaction 5: Provide Services for Cash FastForward plans to earn revenues by selling online ad space and consulting with clients about footwear and accessories. In its first job, FastForward provides consulting services and immediately collects \$4,200 cash. The accounting equation reflects this increase in cash of \$4,200 and in equity of \$4,200. This increase in equity is shown in the far right column under Revenues because the cash received is earned by providing consulting services.

			Assets			=	Liabilities	+	Equity			
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Common Stock	+	Revenues	
Old Bal.	\$1,500	+	\$9,600	+	\$26,000	=	\$7,100	+	\$30,000			
(5)	+4,200									+	\$4,200 Consulting	
New Bal.	\$5,700	+	\$9,600	+	\$26,000	=	\$7,100	+	\$30,000	+	\$4,200	
			\$41,300						\$41,300			

Point: Expense recognition principle requires that expenses are recognized when the revenue they help generate is recorded.

Transactions 6 and 7: Payment of Expenses in Cash FastForward pays \$1,000 to rent facilities for the month of December. The rental payment is shown in the following accounting equation as Transaction 6. FastForward also pays the biweekly \$700 salary of the company's only employee. This is shown in the accounting equation as Transaction 7. Both Transactions 6 and 7 are December expenses for FastForward. The costs of both rent and salary are expenses, not assets, because their benefits are used in December (they have no future benefits after December). The accounting equation shows that both transactions reduce cash and equity. The far right column shows these decreases as Expenses.

						Expenses decrease equity.													
	Assets						Liabilities	+			Equity								
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Common Stock	+	Revenues	Ā	Expenses						
Old Bal.	\$5,700	+	\$9,600	+	\$26,000	=	\$7,100	+	\$30,000	+	\$4,200								
(6)	-1,000											_	\$1,000 Rent						
Bal.	4,700	+	9,600	+	26,000	=	7,100	+	30,000	+	4,200	_	1,000						
(7)	-700											_	700 Salaries						
New Bal.	\$4,000	+	\$9,600	+	\$26,000	=	\$7,100	+	\$30,000	+	\$4,200	_	\$1,700						
	\$39,600								\$	39,600									





Transaction 8: Provide Services and Facilities for Credit FastForward provides consulting services of \$1,600 and rents its test facilities for an additional \$300 to Adidas on credit. Adidas is billed for the \$1,900 total. This transaction creates a new asset, called *accounts receivable*, from Adidas. Accounts receivable is increased instead of cash because the payment has not yet been received. Equity is increased from the two revenue components shown in the Revenues column of the accounting equation.

Point: Accounts receivable are amounts owed by customers for services or items sold on credit.

Point: Transaction 8, like 5, records revenue when work is performed, not necessarily when cash is received.

				Asset	ts			=	Liabilities	+			Equity		
_	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Common Stock	+	Revenues	-	Expenses
Old Bal.	\$4,000			+	\$9,600	+	\$26,000	=	\$7,100	+	\$30,000	+	\$4,200	_	\$1,700
(8)		+	\$1,900									+	1,600 Consu	lting	
												+	300 Renta	I	
New Bal.	\$4,000	+	\$ 1,900	+	\$9,600	+	\$26,000	=	\$7,100	+	\$30,000	+	\$6,100	_	\$1,700
			\$4	11,500							\$41,	500			

Transaction 9: Receipt of Cash from Accounts Receivable The client in

Transaction 8 (Adidas) pays \$1,900 to FastForward 10 days after it is billed for consulting services. Transaction 9 does not change the total amount of assets and does not affect liabilities or equity. It converts the receivable (an asset) to cash (another asset). It does not create new revenue. Revenue was recognized when FastForward performed the services in Transaction 8, not when the cash is collected.

Point: Transaction 9 involved no added client work, so no added revenue is recorded.

Point: Receipt of cash is not always a revenue.

				Asset	ts			=	Liabilities	+			Equity		
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Common Stock	+	Revenues	-	Expenses
Old Bal.	\$4,000	+	\$1,900	+	\$9,600	+	\$26,000	=	\$7,100	+	\$30,000	+	\$6,100	_	\$1,700
(9)	+1,900	-	1,900												
New Bal.	\$5,900	+	\$ 0	+	\$9,600	+	\$26,000	=	\$7,100	+	\$30,000	+	\$6,100	-	\$1,700
			\$4	1,500							\$41	1,500			

Transaction 10: Payment of Accounts Payable FastForward pays CalTech Supply \$900 cash as partial payment for its earlier \$7,100 purchase of supplies (Transaction 4), leaving \$6,200 unpaid. This transaction decreases FastForward's cash by \$900 and decreases its liability to CalTech Supply by \$900. Equity does not change. This event does not create an expense even though cash flows out of FastForward (instead the expense is recorded when FastForward uses these supplies).

				Asset	S			=	Liabilities	+			Equity		
	Cash	+	ounts eivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Common Stock	+	Revenues	-	Expenses
Old Bal. (10)	\$5,900 -900	+	\$ 0	+	\$9,600	+	\$26,000	=	\$7,100 -900	+	\$30,000	+	\$6,100	-	\$1,700
New Bal.	\$5,000	+	\$ 0	+	\$9,600	+	\$26,000	=	\$6,200	+	\$30,000	+	\$6,100	-	\$1,700
			\$	40,600	1				`		\$40	,600			-



Transaction 11: Payment of Cash Dividend FastForward declares and pays a \$200 cash dividend to its owner (the only shareholder). Dividends (decreases in equity) are not reported as expenses because they do not help earn revenue. Because dividends are not expenses, they are not used in computing net income.

													Ī	Dividends de	crec	ase equity.		
				А	sset	S			=	Liabilities	+			Eq	uity			
	Cash	+	Accour		+	Supplies	+	Equipment	=	Accounts Payable	+	Common Stock	<u>*</u>	Dividends	+	Revenues	-	Expenses
Old Bal. (11)	\$5,000 -200	+	\$ 0		+	\$9,600	+	\$26,000	=	\$6,200	+	\$30,000	_	\$200 Dividends	+	\$6,100	-	\$1,700
New Bal.	\$4,800	+	\$ 0		+	\$9,600	+	\$26,000	=	\$6,200	+	\$30,000	_	\$200	+	\$6,100	_	\$1,700
				\$4	40,4	00								\$40,400				

EXHIBIT 1.9

14

Summary of Transactions

Summary of Transactions Using the Accounting Equation

Exhibit 1.9 shows the effects of these 11 transactions of FastForward using the accounting equation. Assets equal liabilities plus equity after each transaction.

				Asset	ts			=	Liabilities	+				Equi	ty		
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses
(1)	\$30,000							=			\$30,000						
(2)	- 2,500			+	\$2,500												
Bal.	27,500			+	2,500			=			30,000						
(3)	-26,000					+	\$26,000										
Bal.	1,500			+	2,500	+	26,000	=			30,000						
(4)				+	7,100			=	+\$7,100								
Bal.	1,500			+	9,600	+	26,000	=	7,100	+	30,000						
(5)	+ 4,200													+	\$4,200		
Bal.	5,700			+	9,600	+	26,000	=	7,100	+	30,000			+	4,200		
(6)	_ 1,000															-	\$1,000
Bal.	4,700			+	9,600	+	26,000	=	7,100	+	30,000			+	4,200	-	1,000
(7)	_ 700															-	700
Bal.	4,000			+	9,600	+	26,000	=	7,100	+	30,000			+	4,200	_	1,700
(8)		+	\$1,900											+	1,600		
														+	300		
Bal.	4,000	+	1,900	+	9,600	+	26,000	=	7,100	+	30,000				6,100	-	1,700
(9)	+ 1,900	_	1,900														
Bal.	5,900	+	0	+	9,600	+	26,000	=	7,100	+	30,000			+	6,100	_	1,700
(10)	- 900								- 900								
Bal.	5,000	+	0	+	9,600	+	26,000	=	6,200	+	30,000			+	6,100	_	1,700
(11)	_ 200											-	\$200				
Bal.	\$ 4,800	+	\$ 0	+	\$ 9,600	+	\$ 26,000	=	\$ 6,200	+	\$ 30,000	-	\$ 200	+	\$6,100	_	\$ 1,700



Larry W. Smith/EPA-EFE/Shutterstock

Decision Insight

Measurement and Recognition Revenues for the **Kansas City Chiefs, Los Angeles Rams, Green Bay Packers,** and other professional sports teams include ticket sales, television broadcasts, concessions, and advertising. Revenues from ticket sales are earned when the team plays each game. Advance ticket sales are not revenues; instead, they are a liability until the team plays the game for which the ticket was sold. At that point, the liability is removed and revenues are reported.





🐗 aptara

EQA



Assume Tata Company began operations on January 1 and completed the following transactions during its first month of operations. Show the effects of each transaction in a table like Exhibit 1.9.

Jan. 1 Jamsetji Tata invested \$4,000 cash in Tata Company in exchange for its common stock.

- 5 The company purchased \$2,000 of equipment on credit.
 - 14 The company provided \$540 of services for a client on credit.
 - 21 The company paid \$250 cash for an employee's salary.

Solution



			Assets			=	Liabilities	+				Equity			
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses
Jan. 1	\$4,000					=	,		\$4,000						
Jan. 5				+	\$2,000		+\$2,000								
Bal.	4,000			+	2,000	=	2,000	+	4,000						
Jan. 14		+	\$540									+	\$540		
Bal.	4,000	+	540	+	2,000	=	2,000	+	4,000			+	540		
Jan. 21	_250													_	\$250
Bal.	3,750	+	540	+	2,000	=	2,000	+	4,000			+	540	_	250
			\$6,290								\$6,290				

FINANCIAL STATEMENTS

Financial statements are prepared in the order below using the 11 transactions of FastForward. (These statements are *unadjusted*—we explain this in Chapters 2 and 3.) The four financial statements and their purposes follow.

P2

Identify and prepare basic financial statements and explain how they interrelate.

Financial Statement	Layout	Purpose
Income statement	Revenues - Expenses Net income	Describes a company's revenues and expenses and computes net income or loss over a period of time.
Statement of retained earnings	Beg. retained earnings + Net income - Dividends End. retained earnings	Explains changes in retained earnings from net income (or loss) and any dividends over a period of time.
Balance sheet	Assets = Liabilities + Equity	Describes a company's financial position (types and amounts of assets, liabilities, and equity) at a point in time.
Statement of cash flows	+/- Operating C.F. +/- Investing C.F. +/- Financing C.F. Change in cash	Identifies cash inflows (receipts) and cash outflows (payments) over a period of time.

Income Statement

FastForward's income statement for December is shown at the top of Exhibit 1.10. Information about revenues and expenses is taken from the Equity columns of Exhibit 1.9. Revenues are reported first on the income statement. They include consulting revenues of \$5,800 from Transactions 5 and 8 and rental revenue of \$300 from Transaction 8. Expenses are reported after





(1)

(2)

FASTFORWARD

Income Statement

For Month Ended December 31, 2021

Chapter 1 Accounting in Business

Revenues

EXHIBIT 1.10

Financial Statements and Their Links

Point: A statement's heading identifies the company, the statement title, and the date or time period.

Point: Arrow lines show how the statements are linked.

① Net income is used to compute retained earnings.
② Retained earnings is used to prepare the balance sheet.
③ Cash from the balance sheet is used to reconcile the statement of cash flows.

Point: The income statement, the statement of retained earnings, and the statement of cash flows are prepared for a *period* of time. The balance sheet is prepared as of a *point* in time.

Rental revenue \$ 6,100 Expenses 1,000 Salaries expense 700 Total expenses 1,700 \$ 4,400 **FASTFORWARD** Statement of Retained Earnings For Month Ended December 31, 2021 0 Retained earnings, December 1, 2021..... \$ Add: Net income 4,400 ◀ 4,400 200 \$4,200 **FASTFORWARD Balance Sheet** December 31, 2021 Liabilities **Assets** \$ 4,800 Cash \$ 6,200 Supplies 9,600 Total liabilities 6,200 Equipment 26,000 Equity 30,000 Retained earnings 4,200 34,200 Total assets \$40,400 Total liabilities and equity \$40,400 **FASTFORWARD** Statement of Cash Flows For Month Ended December 31, 2021 Cash flows from operating activities 3 \$ 6,100 Cash paid for expenses (\$2,500 + \$900 + \$1,000 + \$700).... (5,100) \$ 1,000 Net cash provided by operating activities Cash flows from investing activities Cash paid for equipment (26,000)(26,000)Cash flows from financing activities 30,000 (200)Net cash provided by financing activities 29,800 Net increase in cash \$ 4,800 Cash balance, December 1, 2021 0 Cash balance, December 31, 2021 4,800

Point: A single ruled line means an addition or subtraction. Final totals are double underlined. Negative amounts may or may not be in parentheses.







revenues. Rent and salary expenses are from Transactions 6 and 7. Expenses are the costs to generate the revenues reported. **Net income** occurs when revenues exceed expenses. A **net loss** cocurs when expenses exceed revenues. Net income (or loss) is shown at the bottom of the statement and is the amount reported in December. Shareholders' investments and dividends are *not* part of income.

Key **terms** are in bold and defined again in the **glossary**

Point: Net income is sometimes called *earnings* or *profit*.

Statement of Retained Earnings

The statement of retained earnings reports how retained earnings changes over the reporting period. This statement shows beginning retained earnings, events that increase it (net income), and events that decrease it (dividends and net loss). Ending retained earnings is computed in this statement and is carried over and reported on the balance sheet. FastForward's statement of retained earnings is the second report in Exhibit 1.10. The beginning balance is measured as of the start of business on December 1. It is zero because FastForward did not exist before then. An existing business reports a beginning balance equal to the prior period's ending balance (such as from November 30). FastForward's statement shows the \$4,400 of net income for the period, which links the income statement to the statement of retained earnings (see line ①). The statement also reports the \$200 cash dividend and FastForward's end-of-period retained earnings balance.



teekid/iStockphoto

Balance Sheet

FastForward's balance sheet is the third report in Exhibit 1.10. This statement shows FastForward's financial position at the end of the business day on December 31. The left side of the balance sheet lists FastForward's assets: cash, supplies, and equipment. The upper right side of the balance sheet shows that FastForward owes \$6,200 to creditors. Any other liabilities (such as a bank loan) would be listed here. The equity balance is \$34,200. Line ② shows the link between the ending balance of the statement of retained earnings and the retained earnings balance on the balance sheet. (This presentation of the balance sheet is called the *account form:* assets on the left and liabilities and equity on the right. Another presentation is the *report form:* assets on top, followed by liabilities and then equity at the bottom. Both are acceptable.) As always, the accounting equation balances: Assets of \$40,400 = Liabilities of \$6,200 + Equity of \$34,200.

Statement of Cash Flows

FastForward's statement of cash flows is the final report in Exhibit 1.10. The first section reports cash flows from *operating activities*. It shows the \$6,100 cash received from clients and the \$5,100 cash paid for supplies, rent, and employee salaries. Outflows are in parentheses to denote subtraction. Net cash provided by operating activities for December is \$1,000. The second section reports *investing activities*, which involve buying and selling assets such as land and equipment that are held for *long-term use* (typically more than one year). The only investing activity is the \$26,000 purchase of equipment. The third section shows cash flows from *financing activities*, which include *long-term* borrowing and repaying of cash from lenders and the cash investments from, and dividends to, shareholders. FastForward reports \$30,000 from the owner's initial investment and a \$200 cash dividend. The net cash effect of all financing transactions is a \$29,800 cash inflow. The final part of the statement shows an increased cash balance of \$4,800. The ending balance is also \$4,800 as it started with no cash—see line ③.

Point: Payment for supplies is an operating activity because supplies are expected to be used up in short-term operations (typically less than one year).



Decision Insight

Big Data The SEC keeps an online database called **EDGAR** (sec.gov/edgar) that has accounting information for thousands of companies, such as **Columbia Sportswear**, that issue stock to the public. The annual report filing for most publicly traded U.S. companies is known as Form 10-K, and the quarterly filing is Form 10-Q. Information services such as **Finance.Yahoo.com** offer online data and analysis. ■



Greg Epperson/Shutterstock







Chapter 1 Accounting in Business

NEED-TO-KNOW

Prepare the (a) income statement, (b) statement of retained earnings, and (c) balance sheet for Accel using the following information from its current year ended December 31.

Financial Statements

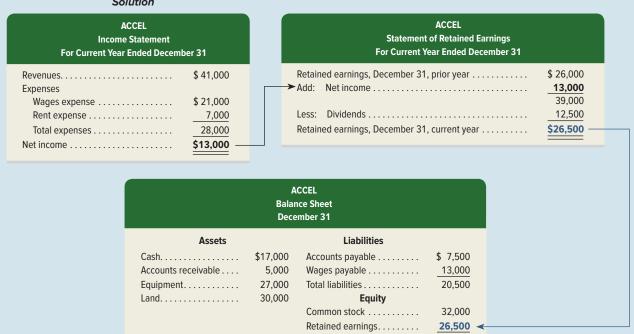
P2

18



Cash	\$17,000	Common stock	\$32,000
Accounts receivable	5,000	Retained earnings, Dec. 31, prior year	26,000
Equipment	27,000	Dividends	12,500
Land	30,000	Revenues	41,000
Accounts payable	7,500	Wages expense	21,000
Wages payable	13,000	Rent expense	7,000

Solution



Do More: QS 1-12 through QS 1-19, E 1-16 through E 1-24

> Decision Analysis (at the end of each chapter) covers ratios for decision-making using real company data. Instructors can skip this section and cover all ratios in Chapter 13

\$79,000

Decision Analysis



Return on Assets

Compute and interpret return on assets.

We organize financial statement analysis into four areas: (1) liquidity and efficiency, (2) solvency, (3) profitability, and (4) market prospects—Chapter 13 has a ratio listing with definitions and groupings by area. When analyzing ratios, we use a company's prior year ratios and competitor ratios to evaluate performance.

Total liabilities and equity...

58,500

\$79,000

This chapter presents a profitability measure: return on assets. Return on assets helps evaluate if management is effectively using assets to generate net income. Return on assets (ROA), also called return on investment (ROI), is defined in Exhibit 1.11.

EXHIBIT 1.11

Return on Assets

Net income Return on assets = Average total assets





EQA

Net income is from the annual income statement, and average total assets is computed by adding the beginning and ending amounts for that same period and dividing by 2. Nike reports total net income of \$4,029 million for the current year. At the beginning of the current year its total assets are \$22,536 million, and at the end of the current year assets total \$23,717 million. Nike's return on assets for the current year is

Return on assets =
$$\frac{\$4,029 \text{ million}}{(\$22,536 \text{ million} + \$23,717 \text{ million})/2} = 17.4\%$$

Is a 17.4% return on assets good or bad for Nike? To help answer this question, we compare (benchmark) Nike's return with its prior performance and the return of its competitor, **Under Armour** (see Exhibit 1.12). Nike shows a pattern of positive returns that reflects effective use of assets. Nike has outperformed Under Armour in each of the last three years. Under Armour had a negative ROA in the previous two years due to net losses.

Return on Assets	Current Year	1 Year Ago	2 Years Ago
Nike	17.4%	8.4%	19.0%
Under Armour	2.0%	(1.1)%	(1.3)%

EXHIBIT 1.12

Nike and Under Armour Returns



Decision Maker requires critical thinking to make decisions

Business Owner You own a winter ski resort that earns a 21% return on its assets. An opportunity to purchase a winter ski equipment manufacturer is offered to you. This manufacturer earns a 14% return on its assets. The industry return for competitors of this manufacturer is 9%. Do you purchase this manufacturer?

Answer: The 14% return on assets for the manufacturer exceeds the 9% industry return. This is positive for a potential purchase. Also, this purchase is an opportunity to spread your risk over two businesses. Still, you should hesitate to purchase a business whose 14% return is lower than your current 21% return. You might better direct efforts to increase investment in your resort if it can earn more than the 14% alternative.

Comprehensive Need-to-Know is a review of key chapter content

Jasmine Worthy started a haircutting business called Expressions. The following events occurred during its first month of business.

- a. Dec. 1 Worthy invested \$3,000 cash and \$15,000 of equipment in Expressions in exchange for its common stock.
- **b.** Dec. 2 Expressions paid \$600 cash for furniture for the shop.
- **c.** Dec. 3 Expressions paid \$500 cash to rent space in a strip mall for December.
- **d.** Dec. 4 Purchased \$1,200 of equipment on credit (recorded as accounts payable).
- e. Dec. 15 Expressions opened for business on December 5. Cash received from haircutting services in the first week and a half of business (ended December 15) was \$825.
- **f.** Dec. 16 Expressions provided \$100 of haircutting services on credit.
- **g.** Dec. 17 Expressions received a \$100 check for services previously rendered on credit.
- **h.** Dec. 18 Expressions paid \$125 cash to an assistant for hours worked for the grand opening.
- **i.** Dec. 31 Cash received from services provided during the second half of December was \$930.
- **j.** Dec. 31 Expressions paid \$400 cash toward the accounts payable from December 4.
- **k.** Dec. 31 Expressions paid a \$900 cash dividend to Worthy (sole shareholder).

Required

- **1.** Show the effects of each transaction in a table like Exhibit 1.9.
- **2.** Prepare an income statement for December.
- **3.** Prepare a statement of retained earnings for December.
- **4.** Prepare a balance sheet as of December 31.
- **5.** Prepare a statement of cash flows for December.
- **6.** Determine the return on assets ratio for December.



COMPREHENSIVE

Transaction Analysis, Statement Preparation, and Return on Assets





SOLUTION

1.

				Asse	ts			=	Liabilities	+				Equity			
	Cash	+	Accounts Receivable	+	Furniture	+	Equipment	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses
a.	\$3,000						\$15,000				\$18,000						
b.	– 600			+	\$600												
Bal.	2,400			+	600	+	15,000	=			18,000						
C.	– 500															-	\$500
Bal.	1,900			+	600	+	15,000	=			18,000					-	500
d.						+	1,200		+\$1,200								
Bal.	1,900			+	600	+	16,200	=	1,200	+	18,000					-	500
e.	+ 825													+	\$ 825		
Bal.	2,725			+	600	+	16,200	=	1,200	+	18,000			+	825	-	500
f.		+	\$100											+	100		
Bal.	2,725	+	100	+	600	+	16,200	=	1,200	+	18,000			+	925	-	500
g.	+ 100	-	100														
Bal.	2,825	+	0	+	600	+	16,200	=	1,200	+	18,000			+	925	-	500
h.	– 125															-	125
Bal.	2,700	+	0	+	600	+	16,200	=	1,200	+	18,000			+	925	-	625
i.	+ 930													+	930		
Bal.	3,630	+	0	+	600	+	16,200	=	1,200	+	18,000			+	1,855	-	625
j.	<u> </u>								<u> </u>								
Bal.	3,230	+	0	+	600	+	16,200	=	800	+	18,000			+	1,855	-	625
k.	<u> </u>											-	\$900				
Bal.	\$ 2,330	+	0	+	\$ 600	+	\$ 16,200	=	\$ 800	+	\$ 18,000	-	\$ 900	+	\$1,855	-	\$625

2. 3. **EXPRESSIONS EXPRESSIONS** Income Statement **Statement of Retained Earnings** For Month Ended December 31 For Month Ended December 31 \$ 0 Retained earnings, December $1^* \dots$ Revenues \$ 1,855 Services revenue..... 1,230 Expenses 1,230 Rent expense \$500 900 \$ 330 Wages expense 125 Retained earnings, December 31 . . . 625 Total expenses *If Expressions had existed before December 1, the beginning \$1,230 retained earnings would equal the prior period's ending balance. 4. **EXPRESSIONS Balance Sheet** December 31 Assets Liabilities Accounts payable \$ 800 Furniture 600 Equipment 16,200 Common stock 18,000 Retained earnings 330 ◀ Total equity..... 18,330

Total liabilities and equity

\$19,130





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EQA



5.

	EXPRESSIONS Statement of Cash Flows For Month Ended December 31		
	Cash flows from operating activities		
	Cash received from customers	\$1,855	
	Cash paid for expenditures (\$500 + \$125 + \$400)	(1,025)	\$ 830
	Net cash provided by operating activities		\$ 03(
	Cash paid for furniture	(600)	
	Net cash used by investing activities	(000)	(60)
	Cash flows from financing activities		
	Cash investments from shareholders	3,000	
	Cash dividends to shareholders	(900)	
	Net cash provided by financing activities		2,10
	Net increase in cash		\$2,33
	Cash balance, December 1		
-	Cash balance, December 31		\$2,33

6. Return on assets =
$$\frac{\text{Net income}}{\text{Average assets}} = \frac{\$1,230}{(\$18,000^* + \$19,130)/2} = \frac{\$1,230}{\$18,565} = \frac{\textbf{6.63\%}}{\$18,565}$$

Summary: Cheat Sheet

ACCOUNTING USES

External users: Do not directly run the organization and have limited access to its accounting information. Examples are lenders, shareholders, external auditors, nonexecutive employees, labor unions, regulators, voters, donors, suppliers, and customers.

Internal users: Directly manage organization operations. Examples are the CEO and other executives, research and development managers, purchasing managers, production managers, and other managerial-level employees.

Private accounting: Accounting employees working for businesses. **Public accounting:** Offering audit, tax, and advisory services to others.

ETHICS AND ACCOUNTING

Fraud triangle: Three factors that push a person to commit fraud.

- Opportunity: Must be able to commit fraud with a low risk of getting caught.
- **Pressure**, or incentive: Must feel pressure or have incentive to commit fraud.
- Rationalization, or attitude: Justifies fraud or does not see its criminal nature.

Common business entities:

	Sole Proprietorship	Partnership
Number of owners	1 owner; easy to set up.	2 or more, called <i>partners</i> ; easy to set up.
Business taxation	No additional business income tax.	No additional business income tax.
Owner liability	Unlimited liability. Owner is personally liable for proprietorship debts.	Unlimited liability. Partners are jointly liable for partnership debts.
Legal entity	Not a separate legal entity.	Not a separate legal entity.
Business life	Business ends with owner death or choice.	Business ends with a partner death or choice.

	Corporation	Limited Liability Company (LLC)		
	Corporation	Limited Liability Company (LLC)		
Number of owners	1 or more, called <i>shareholders</i> ; can get many investors by selling stock or shares of corporate ownership.	1 or more, called <i>members</i> .		
Business taxation	Additional corporate income tax.	No additional business income tax.		
Owner liability	Limited liability. Owners, called shareholders (or stockholders), are not liable for corporate acts and debts.	Limited liability. Owners, called members , are not personally liable for LLC debts.		
Legal entity	A separate entity with the same rights and responsibilities as a person.	A separate entity with the same rights and responsibilities as a person.		
Business life	Indefinite.	Indefinite.		

TRANSACTION ANALYSIS

Assets: Resources a company owns or controls that are expected to yield future benefits.

Liabilities: Creditors' claims on assets. These are obligations to provide assets, products, or services to others.

Equity: Shareholder claim on assets. It consists of:

_	Commo
T	Stock

Common stock reflects inflows of cash and other net assets from shareholders in exchange for stock



Dividends are outflows of cash and other assets to shareholders that reduce equity.



Revenues increase equity (via net income) from sales of products and services to customers; examples are sales of products, consulting services provided, facilities rented to others, and commissions from services.



Expenses decrease equity (via net income) from costs of providing products and services to customers; examples are costs of employee time, use of supplies, advertising, utilities, and insurance fees.

Accounting equation: Applies to all transactions and events, to all companies and organizations, and to all points in time.

Expanded accounting equation:

Equity
Assets = Liabilities + Common Stock - Dividends + Revenues - Expenses

Summary of transactions:

Financial effects of the following transactions are shown in the table using the expanded accounting equation.

Transaction 1: Investment by owner

Transaction 2: Purchase supplies for cash

Transaction 3: Purchase equipment for cash

Transaction 4: Purchase supplies on credit

Transaction 5: Provide services for cash

Transactions 6 and 7: Payment of expenses in cash

Transaction 8: Provide services and facilities for credit

Transaction 9: Receipt of cash from accounts receivable

Transaction 10: Payment of accounts payable

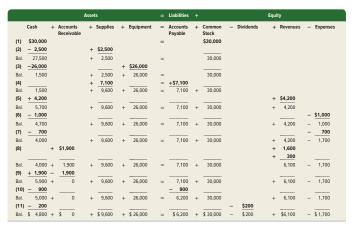
Transaction 11: Payment of cash dividends



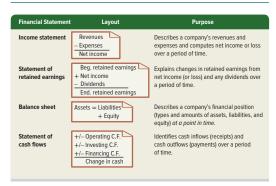




^{*}Uses the initial \$18,000 investment as the beginning balance for the start-up period only.



FINANCIAL STATEMENTS



Key Terms conclude each chapter (a complete glossary is available in Connect)

Key Terms

Accounting (3)

Accounting equation (9)

Assets (9)

Audit (7)

Auditors (6)

Balance sheet (15)

Bookkeeping (3)

Business entity assumption (8)

Common stock (8)

Conceptual framework (7)

Corporation (8)

Cost constraint (8)

Cost principle (7)

Cost-benefit constraint (8)

Data analytics (5)

Data visualization (5)

Equity (9)

Ethics (6)

Events (10)

Expanded accounting equation (10)

Expense recognition principle (7)

Expenses (10)

External transactions (10)

External users (4)

Financial accounting (4)

Financial Accounting Standards

Board (FASB) (7)

Full disclosure principle (8)

Generally accepted accounting

principles (GAAP) (6) Going-concern assumption (8)

Income statement (15)

Internal controls (6)

Internal transactions (10)

Internal users (4)

International Accounting Standards

Board (IASB) (7)

International Financial Reporting

Standards (IFRS) (7)

Liabilities (9)

Limited liability company (LLC) (8)

Managerial accounting (4)

Matching principle (7)

Measurement principle (7)

Members (8)

Monetary unit assumption (8)

Net income (17)

Net loss (17)

Owner investments (10)

Partnership (8)

Proprietorship (8)

Recordkeeping (3)

Retained earnings (10)

Return on assets (ROA) (18)

Revenue recognition principle (7)

Revenues (10)

Securities and Exchange

Commission (SEC) (7)

Shareholders (8)

Shares (8)

Sole proprietorship (8)

Statement of cash flows (15)

Statement of retained earnings (15)

Stock (8)

Stockholders (8)

Time period assumption (8)

Multiple Choice Quiz

- **1.** A building is offered for sale at \$500,000 but is currently assessed at \$400,000. The purchaser of the building believes the building is worth \$475,000, but ultimately purchases the building for \$450,000. The purchaser records the building at:
 - **a.** \$50,000.
- **c.** \$450,000.
- **e.** \$500,000.

- **b.** \$400,000.
- **d.** \$475,000.
- **2.** On December 30 of the current year, **KPMG** signs a \$150,000 contract to provide accounting services to one of its clients in the next year. KPMG has a December 31 year-end. Which accounting principle or assumption requires KPMG to record the accounting services revenue from this client in the next year and not in the current year?
 - a. Business entity assumption
 - **b.** Revenue recognition principle

- c. Monetary unit assumption
- d. Cost principle
- e. Going-concern assumption
- 3. Brunswick borrows \$50,000 cash from Third National Bank. How does this transaction affect the accounting equation for Brunswick?
 - **a.** Assets increase by \$50,000; liabilities increase by \$50,000; no effect on equity.
 - **b.** Assets increase by \$50,000; no effect on liabilities; equity increases by \$50,000.
 - **c.** Assets increase by \$50,000; liabilities decrease by \$50,000; no effect on equity.
 - **d.** No effect on assets; liabilities increase by \$50,000; equity increases by \$50,000.





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- **e.** No effect on assets; liabilities increase by \$50,000; equity decreases by \$50,000.
- **4.** Geek Squad performs services for a customer and bills the customer for \$500. How would Geek Squad record this transaction?
 - a. Accounts receivable increase by \$500; revenues increase by \$500.
 - **b.** Cash increases by \$500; revenues increase by \$500.
 - c. Accounts receivable increase by \$500; revenues decrease by \$500.
- **d.** Accounts receivable increase by \$500; accounts payable increase by \$500.
- e. Accounts payable increase by \$500; revenues increase by \$500.
- **5.** If the assets of a company increase by \$100,000 during the year and its liabilities increase by \$35,000 during the same year, then the change in equity of the company during the year must have been a(n):
 - **a.** Increase of \$135,000.
- **c.** Decrease of \$65,000.
- **b.** Decrease of \$135,000.
- **d.** Increase of \$65,000.

ANSWERS TO MULTIPLE CHOICE QUIZ

- 1. c; \$450,000 is the actual cost incurred.
- **2.** b; revenue is recorded when services are provided.
- **3.** a
- **4.** a

Assets	=	Liabilities	+	Equity
+\$100,000	=	+\$35,000	+	?

Change in equity = \$100,000 - \$35,000 = \$65,000

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Select Quick Study and Exercise assignments feature Guided Example videos, called "Hints" in Connect. Hints use different numbers, and instructors can turn this feature on or off.



Choose the term or phrase below that best completes each statement.

- a. Accounting
- **c.** Recording
- **e.** Governmental
- **g.** Language of business

- **b.** Identifying
 - **d.** Communicating
- **f.** Artificial intelligence
- **h.** Recordkeeping (bookkeeping)

1. _____ helps accountants by performing repetitive tasks such as entering invoice data.

___ requires that we input, measure, and log transactions and events. **3.** _____ is the recording of transactions and events, either manually or electronically.



QS 1-1

Understanding accounting

C1

Identify the following users as either External users or Internal users.

e. Managers

a. Customers **b.** Suppliers

c. External auditors

d. Business press

f. District attorney

g. Shareholders

i. Controllers

h. Lenders

- j. FBI and IRS
- k. Consumer group
- **I.** Voters

QS 1-2

Identifying accounting users

C1

Identify the fraud triangle risk factor (Opportunity, Pressure, or Rationalization) in each situation.

- 1. The business has no cameras or security devices at its warehouse.
- 2. Managers are expected to grow business or be fired.
- **3.** A worker sees other employees regularly take inventory for personal use.
- **4.** No one matches the cash in the register to receipts when shifts end.
- **5.** Officers are told to report rising income or risk layoffs.
- **6.** A worker feels that fellow employees are not honest.

QS 1-3

Applying the fraud triangle

C2

Identify each of the following as an accounting Principle, Assumption, or Constraint.

- 1. Full disclosure
- 2. Time period
- **3.** Going-concern
- 4. Revenue recognition

QS 1-4 Identifying principles,

assumptions, and constraints C2





Chapter 1 Accounting in Business

QS 1-5

Identifying attributes of businesses

Complete the following table with either a *yes* or *no* regarding the attributes of a sole proprietorship, partnership, corporation, and limited liability company (LLC).

C

Attribute Present	Sole Proprietorship	Partnership	Corporation	LLC
1. Business taxed				
2. Limited liability				
3. Legal entity				

QS 1-6

Identifying accounting principles and assumptions

C₂

Identify the accounting principle or assumption that best explains each situation.

- **1.** In December of this year, Chavez Landscaping received a customer's order and cash prepayment to install sod at a house that would not be ready for installation until March of *next year*. Chavez should record the revenue from the customer order in March of *next year*, not in December of this year.
- 2. If \$51,000 cash is paid to buy land, the land is reported on the buyer's balance sheet at \$51,000.
- **3.** Mike Derr owns both Sailing Passions and Dockside Digs. In preparing financial statements for Dockside Digs, Mike makes sure that the expense transactions of Sailing Passions are kept separate from Dockside Digs's transactions and financial statements.

QS 1-7

Applying the accounting equation A1

- **a.** Total assets of Charter Company equal \$700,000 and its equity is \$420,000. What is the amount of its liabilities?
- **b.** Total assets of Martin Marine equal \$500,000 and its liabilities and equity amounts are equal to each other. What is the amount of its liabilities? What is the amount of its equity?

QS 1-8

Applying the accounting equation

A1

1.	Use the accounting equation t	to compute the missing	financial statement amounts	(a), (b), and (c)).

А		В	С	D
1	Company	Assets =	= Liabilities -	+ Equity
2	1	\$ 75,000	\$ (a)	\$ 40,000
3	2	(b)	25,000	70,000
4	3	85,000	20,000	(c)

2. Use the expanded accounting equation to compute the missing financial statement amounts (a) and (b).

	Α	В	С	D	E	F	G
1				Common			
2	Company	Assets	Liabilities	Stock	Dividends	Revenues	Expenses
3	1	\$ 40,000	\$ 16,000	\$ 20,000	\$ 0	(a)	\$ 8,000
4	2	\$80,000	\$ 32,000	\$ 44,000	(b)	\$ 24,000	\$ 18,000

QS 1-9

Determining effects of transactions on equity

Р1

Determine whether each of the following transactions increases or decreases equity.

- **a.** Owner invested cash in the company.
- **b.** Incurred maintenance expenses.
- **c.** Performed services for a client.
- **d.** Incurred employee wage expenses.

QS 1-10

Identifying effects of transactions using accounting equation revenues and expenses P1 Create a table similar to Exhibit 1.9. Then use additions and subtractions to show the dollar effects of each transaction on individual items of the accounting equation.

Assets		=	Liabilities	+				Equity					
Cash	+	Accounts	=	Accounts	+	Common	_	Dividends	+	Revenues	_	Expenses	
		Receivable		Payable		Stock							





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- a. The company completed consulting work for a client and immediately collected \$5,500 cash.
- b. The company completed commission work for a client and sent a bill for \$4,000 to be received within 30 days.
- **c.** The company paid an assistant \$1,400 cash as wages for the period.
- **d.** The company collected \$1,000 cash as a partial payment for the amount owed by the client in transaction b.
- **e.** The company paid \$700 cash for this period's cleaning services.

Create a table similar to Exhibit 1.9. Then use additions and subtractions to show the dollar effects of each transaction on individual items of the accounting equation.

Assets = Liabilities + Equity Cash + Supplies + Equipment + Land = Accounts + Common -Dividends + Revenues - Expenses Payable Stock

QS 1-11

Identifying effects of transactions using accounting equation assets and liabilities

P1

- **a.** The owner invested \$15,000 cash in the company in exchange for its common stock.
- **b.** The company purchased supplies for \$500 cash.
- **c.** The owner invested \$10,000 of equipment in the company in exchange for more common stock.
- **d.** The company purchased \$200 of additional supplies on credit.
- **e.** The company purchased land for \$9,000 cash.

Indicate in which financial statement each item would most likely appear: income statement, balance sheet, or statement of cash flows.

- a. Assets
- **b.** Cash from operating activities
- c. Equipment
- d. Expenses

- e. Liabilities
- f. Net decrease (or increase) in cash
- g. Revenues
- h. Total liabilities and equity

QS 1-12

QS 1-13

Identifying items with financial statements

P2

Classify each of the following items as revenues, expenses, or dividends.

- 1. Utilities expense
- **4.** Cash dividends
- **7.** Insurance expense 8. Consulting revenue
- Identifying income and equity accounts

P2

- 2. Service revenue **3.** Wages expense
- **5.** Rent expense 6. Rental revenue

Classify each of the following items as assets, liabilities, or equity.

1. Land

- **3.** Equipment
- **5.** Accounts receivable

QS 1-14

2. Wages payable

4. Accounts payable

6. Supplies

Identifying assets, liabilities, and equity P2

On December 31, Hawkin's records show the following accounts. Use this information to prepare a December income statement for Hawkin.

Cash	\$ 5,100	Accounts payable	\$6,000	Services revenue	\$16,000
Accounts receivable	600	Common stock	6,900	Wages expense	8,000
Supplies	2,000	Retained earnings, December 1	4,000	Rent expense	1,500
Equipment	14,000	Dividends	1,000	Utilities expense	700

QS 1-15

Preparing an income statement

P2

Use the information in QS 1-15 to prepare a statement of retained earnings for Hawkin for the month ended December 31. Hint: Net income is \$5,800.

QS 1-16

Preparing a statement of retained earnings P2

Use the information in QS 1-15 to prepare a December 31 balance sheet for Hawkin. Hint: Retained Earnings on December 31 equals \$8,800.

QS 1-17

Preparing a balance sheet P2







26 Chapter 1 Accounting in Business

QS 1-18

Preparing a statement of cash flows

P2

Use the following information to prepare a statement of cash flows for Studio One for the month ended December 31. The cash balance at the start of December 1 was \$1,000.

Cash dividends to shareholders	\$ 2,000	Cash paid for equipment	\$ 3,000
Cash received from customers	23,500	Cash paid for truck	22,000
Cash investments from shareholders	11,000	Cash paid for expenditures	6,000

QS 1-19

Classifying items on the statement of cash flows

P2

Identify the following cash flows as reported under either operating activities, investing activities, or financing activities.

- 1. Cash purchase of equipment
- 2. Cash paid for land
- 3. Cash paid for advertising
- **4.** Cash paid for wages

- **5.** Cash paid on account payable to supplier
- **6.** Cash received from clients
- 7. Cash paid for rent
- **8.** Cash investment by owner

QS 1-20

Interpreting return on assets

A2

Return on assets for Deutsche Auto for each of the last three years follows. Over the three-year period shown, did the company's return on assets improve or worsen?

	Current Year	1 Year Ago	2 Years Ago
Return on assets	13.5%	11.2%	8.9%

QS 1-21

Computing and interpreting return on assets

A2

Home Demo's return on assets the following results. (a) Compute Home Demo's return on assets. (b) Is Home Demo's return on assets better than the 11% return of Lows Hardware (a competitor)?

Classify the following activities as part of the Identifying, Recording, or Communicating aspects of



Select Exercises and Quick Studies have Guided Example videos, called "Hints" in Connect. Hints use different numbers, and instructors can turn this feature on or off.



EXERCISES

Exercise 1-1

Classifying activities reflected in the accounting system **C1**

1. Analyzing and interpreting reports.

- **2.** Presenting financial information.
- **3.** Keeping a log of service costs.
- **4.** Measuring the costs of a product.
- **5.** Preparing financial statements.
- **6.** Acquiring knowledge of revenue transactions.
- **7.** Observing transactions and events.
- **8.** Registering cash sales of products sold.

Exercise 1-2

Identifying accounting users and uses

C.1

Part A. Identify the following questions as most likely to be asked by an Internal user or an External user of accounting information.

- 1. Which inventory items are out of stock?
- **2.** Should we make a five-year loan to that business?
- **3.** What are the costs of our product's ingredients?
- **4.** Should we buy, hold, or sell a company's stock?
- **5.** Should we spend additional money for redesign of our product?
- **6.** Which firm reports the highest sales and income?
- **7.** What are the costs of our service to customers?

Part B. Identify the following users as either an Internal user or an External user.

- 1. Research and development executive
- 2. Human resources executive
- 3. Politician
- **4.** Shareholder

- **5.** Distribution manager
- 6. Creditor
- **7.** Production supervisor
- **8.** Purchasing manager





Chapter 1 Accounting in Business

Determine whether each of the following accounting duties mainly involves financial accounting, managerial accounting, or tax accounting.

1. Internal auditing.

2. External auditing.

3. Cost accounting.

4. Budgeting.

5. Enforcing tax laws.

6. Planning transactions to minimize taxes.

7. Preparing external financial statements.

8. Analyzing external financial reports.

Exercise 1-3

Describing accounting responsibilities

C1

Match each of the descriptions with the term or phrase it best reflects.

A. Audit

C. Ethics

E. SEC

G. Net income

B. GAAP

D. FASB

F. Public accountants

H. IASB

1. An assessment of whether financial statements follow GAAP.

2. Amount a business earns in excess of all expenses and costs associated with its sales and revenues.

3. A group that sets accounting principles in the United States.

4. Accounting professionals who provide services to many clients.

5. Principles that determine whether an action is right or wrong.

Exercise 1-4

Learning the language of business

C1 C2

Match each of the descriptions with the term or phrase it best reflects.

A. Ethics

C. Prevention

E. Audit

B. Fraud triangle **D.** Internal controls

1. Examines whether financial statements are prepared using GAAP.

2. Procedures set up to protect company property and equipment, ensure reliable accounting, promote efficiency, and encourage adherence to policies.

3. A less expensive and more effective means to stop fraud.

4. Three factors push a person to commit fraud: opportunity, pressure, and rationalization.

5. Beliefs that distinguish right from wrong.

Exercise 1-5

Identifying ethical terminology

C2

Determine whether each description best refers to a sole proprietorship, partnership, corporation, or limited liability company (LLC).

a. Micah and Nancy own Financial Services, which pays a business income tax. Micah and Nancy do not have personal responsibility for the debts of Financial Services.

b. Riley and Kay own Speedy Packages, a courier service. Both are personally liable for the debts of the business.

c. IBC Services does not have separate legal existence apart from the one person who owns it.

d. Trent Company is owned by Trent Malone, who is personally liable for the company's debts.

e. Ownership of Zander Company is divided into 1,000 shares of stock. The company pays a business income tax.

f. Physio Products does not pay a business income tax and has one owner. The owner has unlimited liability for business debt.

g. AJ Company pays a business income tax and has two owners.

h. Jeffy Auto is a separate legal entity from its owner, but it does not pay a business income tax.

Exercise 1-6

Distinguishing business organizations

C2

Identify the accounting principle or assumption that best reflects each situation.

1. A company reports details behind financial statements that would impact users' decisions.

2. Financial statements reflect the assumption that the business continues operating.

3. A company records the expenses incurred to generate the revenues reported.

4. Each business is accounted for separately from its owner or owners. **5.** Revenue is recorded when products and services are delivered.

6. Information is based on actual costs incurred in transactions.

Exercise 1-7

Identifying accounting principles and assumptions

C2







Exercise 1-8

Applying measurement principle and revenue recognition principle

C2

a. Byrde Co. purchased a truck. The seller asked for \$11,000, but Byrde paid only \$10,000 after negotiation. The owner of Byrde Co. believes he got a great deal and the truck is really worth \$15,000. What amount does Byrde record on its financial statements for the truck?

b. Snell Co. performs services for a client in May and bills the client \$1,000. In June, Snell receives a partial payment of \$300 cash. In July, the remaining \$700 cash is received. Determine the monthly revenue recorded in May, June, and July applying revenue recognition principle.

Exercise 1-9

Using the accounting equation

A1

	А	В	С
1	Assets =	Liabilities	+ Equity
2	\$ (a)	\$ 20,000	\$ 45,000
3	100,000	34,000	(b)
4	154,000	(c)	40,000

Determine the missing amount from each of the separate situations a, b, and c below.

Exercise 1-10

Using the accounting equation

A1

Check (c) Beg. equity, \$60.000

Answer the following questions. Hint: Use the accounting equation.

- **a.** At the beginning of the year, Addison Company's assets are \$300,000 and its equity is \$100,000. During the year, assets increase \$80,000 and liabilities increase \$50,000. What is the equity at year-end?
- **b.** Office Store Co. has assets equal to \$123,000 and liabilities equal to \$47,000 at year-end. What is the equity for Office Store Co. at year-end?
- **c.** At the beginning of the year, Quaker Company's liabilities equal \$70,000. During the year, assets increase by \$60,000, and at year-end assets equal \$190,000. Liabilities decrease \$5,000 during the year. What are the beginning and ending amounts of equity?

Exercise 1-11

Determining effect of transactions on accounting equation

A1

Answer the following questions. *Hint:* Use the accounting equation.

- **a.** On January 1, Lumia Company's liabilities are \$60,000 and its equity is \$40,000. On January 3, Lumia purchases and installs solar panel assets costing \$10,000. For the panels, Lumia pays \$4,000 cash and promises to pay the remaining \$6,000 in six months. What is the total of Lumia's assets after the solar panel purchase?
- **b.** On March 1, ABX Company's assets are \$100,000 and its liabilities are \$30,000. On March 5, ABX is fined \$15,000 for failing emission standards. ABX immediately pays the fine in cash. After the fine is paid, what is the amount of equity for ABX?
- **c.** On August 1, Lola Company's assets are \$30,000 and its liabilities are \$10,000. On August 4, Lola issues a sustainability report. On August 5, ownership invests \$3,000 cash and \$7,000 of equipment in Lola. After the investment, what is the amount of equity for Lola?

Exercise 1-12

Analysis using the accounting equation

P1

Zen began a new consulting firm on January 5. Following is a financial summary, including balances, for each of the company's first five transactions (using the accounting equation form).

		А	=	Liabilities	+	E	quit	у					
Transaction	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Common Stock	+	Revenues
1.	\$40,000	+	\$ 0	+	\$ 0	+	\$ 0	=	\$ 0	+	\$40,000	+	\$ 0
2.	38,000	+	0	+	3,000	+	0	=	1,000	+	40,000	+	0
<i>3</i> .	30,000	+	0	+	3,000	+	8,000	=	1,000	+	40,000	+	0
4.	30,000	+	6,000	+	3,000	+	8,000	=	1,000	+	40,000	+	6,000
5.	31,000	+	6,000	+	3,000	+	8,000	=	1,000	+	40,000	+	7,000

Identify the explanation from a through j that best describes each transaction l through s.

- **a.** The company purchased equipment for \$8,000 cash.
- **b.** The company received \$40,000 cash from a bank loan.
- **c.** The owner invested \$1,000 cash in the business in exchange for its common stock.
- **d.** The owner invested \$40,000 cash in the business in exchange for its common stock.
- e. The company purchased supplies for \$3,000 by paying \$2,000 cash and putting \$1,000 on credit.
- **f.** The company billed a customer \$6,000 for services provided.

[continued on next page]





- g. The company purchased equipment worth \$8,000 on credit.
- h. The company provided services for \$1,000 cash.
- i. The company sold supplies for \$3,000 and received \$2,000 cash and \$1,000 on credit.
- **j.** The company provided services for \$6,000 cash.

The following table shows the effects of transactions *I* through *5* on the assets, liabilities, and equity of Mulan's Boutique.

Assets								=	Liabilities	+	Equity			
	Cash	+	Accounts Receivable	+	Supplies	+	Land	=	Accounts Payable	+	Common Stock	+	Revenues	
	\$21,000	+	\$ 0	+	\$3,000	+	\$19,000	=	\$ 0	+	\$43,000	+	\$ 0	
1.	-4,000					+	4,000							
2.				+	1,000				+1,000					
3.		+	1,900									+	1,900	
4.	-1,000								-1,000					
5.	+1,900	_	1,900											
	<u>\$17,900</u>	+	<u>\$ 0</u>	+	\$4,000	+	<u>\$23,000</u>	=	<u>\$ 0</u>	+	<u>\$43,000</u>	+	<u>\$1,900</u>	

Exercise 1-13

Identifying effects of transactions on the accounting equation

P1

Identify the explanation from a through j that best describes each transaction I through 5.

- **a.** The company purchased \$1,000 of supplies on credit.
- **b.** The company collected \$1,900 cash from an account receivable.
- **c.** The company sold land for \$4,000 cash.
- d. The company paid \$1,000 cash for land.
- e. The company purchased supplies for \$1,000 cash.
- **f.** The company purchased land for \$4,000 cash.
- **g.** The company billed a client \$1,900 for services provided.
- **h.** The company paid \$1,000 cash toward an account payable.
- i. The owner invested \$1,900 cash in the business in exchange for its common stock.
- **j.** The company sold supplies for \$1,900 on credit.

For each transaction a through f, identify its impact on the accounting equation (select from I through 5 below).

- 1. Decreases an asset and decreases equity.
- 2. Increases an asset and increases a liability.
- **3.** Decreases an asset and decreases a liability.
- **a.** The company pays cash toward an account payable.
- **b.** The company purchases equipment on credit.
- **c.** The owner invests cash in the business
- 4. Increases an asset and decreases an asset.
- **5.** Increases an asset and increases equity.
- **d.** The company pays workers for wages earned.
- e. The company purchases supplies for cash.
- **f.** The company provides services for cash.

Exercise 1-14

Identifying effects of transactions on the accounting equation

P1

Ming Chen started a business and had the following transactions in June. Create the following table similar to Exhibit 1.9 and use additions and subtractions to show the dollar effects of the transactions on individual items of the accounting equation. Show new balances after each transaction.



- **a.** Owner invested \$60,000 cash in the company along with \$15,000 of equipment in exchange for its common stock.
- **b.** The company paid \$1,500 cash for rent of office space for the month.
- **c.** The company purchased \$10,000 of additional equipment on credit (payment due within 30 days).
- **d.** The company completed work for a client and immediately collected \$2,500 cash. [continued on next page]

Exercise 1-15

Identifying effects of transactions using the accounting equation

P1

Check Ending balances: Cash, \$46,000; Expenses, \$4,500





Chapter 1 Accounting in Business

[continued from previous page]

- e. The company completed work for a client and sent a bill for \$8,000 to be received within 30 days.
- **f.** The company purchased additional equipment for \$6,000 cash.
- **g.** The company paid an assistant \$3,000 cash as wages for the month.
- **h.** The company collected \$5,000 cash as a partial payment for the amount owed by the client in transaction e.
- **i.** The company paid \$10,000 cash to settle the liability created in transaction c.
- **j.** The company paid \$1,000 cash in dividends to the owner (sole shareholder).

Exercise 1-16

Computing net income using accounting equation

P2

Shep Company's records show the following information for the current year.

	Beginning of Year	End of Year
Total assets	\$50,000	\$80,000
Total liabilities	\$22,000	\$35,000

Determine net income (loss) for each of the following separate situations.

- a. Additional common stock of \$3,000 was issued, and dividends of \$7,000 were paid during the current year.
- **b.** Additional common stock of \$15,000 was issued, and no dividends were paid during the current year.
- c. No additional common stock was issued, and dividends of \$12,000 were paid during the current year.

Exercise 1-17

Reporting cash flows and determining effects

P2

For each transaction, (a) determine whether the transaction appears on the statement of cash flows under cash flows from operating activities, cash flows from investing activities, or cash flows from financing activities and (b) indicate whether the transaction is a cash outflow or cash inflow.

- **1.** Cash received from client for performing services.
- **2.** Cash investment from the owner.
- **3.** Cash paid for this month's rent.

- **4.** Cash paid for equipment.
- **5.** Cash paid for employee wages.
- **6.** Cash paid to settle long-term loan.

Exercise 1-18

Preparing an income statement

P2

On December 1, Jasmin Ernst organized Ernst Consulting. On December 3, the owner contributed \$84,000 in assets in exchange for its common stock to launch the business. On December 31, the company's records show the following items and amounts. Use this information to prepare a December income statement for the business.

Cash	\$11,360	Cash dividends	\$ 2,000	
Accounts receivable	14,000	Consulting revenue	14,000	
Office supplies	3,250	Rent expense	3,550	
Office equipment	18,000	Salaries expense	7,000	
Land	46,000	Telephone expense	760	
Accounts payable	8,500	Miscellaneous expenses	580	
Common stock	84,000			

Check Net income, \$2,110

Exercise 1-19

Preparing a statement of retained earnings **P2**

Use the information in Exercise 1-18 to prepare a December statement of retained earnings for Ernst Consulting. *Hint:* Retained Earnings on December 1 was \$0.

Exercise 1-20

Preparing a balance sheet **P2**

Use the information in Exercise 1-18 to prepare a December 31 balance sheet for Ernst Consulting. *Hint:* The solution to Exercise 1-19 can help.







🐗 aptara

Use the information in Exercise 1-18 to prepare a December statement of cash flows for Ernst Consulting. Assume the following additional information.

- a. The owner's initial investment consists of \$38,000 cash and \$46,000 in land in exchange for its common stock.
- **b.** The company's \$18,000 equipment purchase is paid in cash.
- **c.** Cash paid to employees is \$1,750. (The accounts payable balance of \$8,500 consists of the \$3,250 office supplies purchase and \$5,250 in employee salaries yet to be paid.)
- **d.** The company's rent expense, telephone expense, and miscellaneous expenses are paid in cash.
- e. No cash has yet been collected on the \$14,000 consulting revenue earned.

Exercise 1-21

Preparing a statement of cash flows

P2

Check Net increase in cash, \$11.360

Jarvis began operations on January 1, Year 1, and its Retained Earnings balance on that date was \$0. In its first two years of operations, it reported the following at its December 31 year-end. Prepare the statement of retained earnings for (a) Year 1 and (b) Year 2.

	Year 1	Year 2
Net income	\$30,000	\$50,000
Dividends	\$ 8,000	\$14,000

Exercise 1-22

Preparing consecutive statements of retained earnings

P2

Terrell Co. reported the following data at the end of its first year of operations on December 31. (a) Prepare its year-end income statement. (b) Prepare its year-end statement of retained earnings using net income calculated in part a. Hint: Retained Earnings on January 1 was \$0.

Equipment	. \$18,000	Dividends	\$ 5,000	Salaries expense	\$37,000
Accounts payable	. 7,000	Services revenue	48,000	Advertising expense	3,000
Common stock	. 22,000	Rent revenue	9,000	Utilities expense	1,000

Exercise 1-23

Linking the income statement and statement of retained earnings

P2

Mahomes Co. reported the following data at the end of its first year of operations on December 31. (a) Prepare its year-end statement of retained earnings. (b) Prepare its year-end balance sheet using retained earnings calculated in part a. Hint: Retained Earnings on January 1 was \$0.

Cash	\$6,000	Land	\$34,000	Dividends	\$22,000
Accounts receivable	7,000	Accounts payable	3,000	Net income	60,000
Equipment	9,000	Common stock	15,000		

Exercise 1-24

Linking the statement of retained earnings and balance sheet

P2

Swiss Group reports net income of \$40,000 for the year. At the beginning of the year, Swiss Group had \$200,000 in assets. By the end of the year, assets had grown to \$300,000. What is Swiss Group's return on assets for the current year? Did Swiss Group perform better or worse than its competitors if competitors average an 11% return on assets?

Exercise 1-25

Analyzing return on assets

Problem Set B, located at the end of Problem Set A, is provided for each. problem to reinforce the learning process



Identify how each of the following separate transactions 1 through 10 affects financial statements. For increases, place a "+" and the dollar amount in the column or columns. For decreases, place a "-" and the dollar amount in the column or columns. Some cells may contain both an increase (+) and a decrease (-) along with dollar amounts. The first transaction is completed as an example.

Required

- a. For the balance sheet, identify how each transaction affects total assets, total liabilities, and total equity. For the income statement, identify how each transaction affects net income.
- **b.** For the statement of cash flows, identify how each transaction affects cash flows from operating activities, cash flows from investing activities, and cash flows from financing activities.

[continued on next page]

PROBLEM SET A

Problem 1-1A

Identifying effects of transactions on financial statements

P1