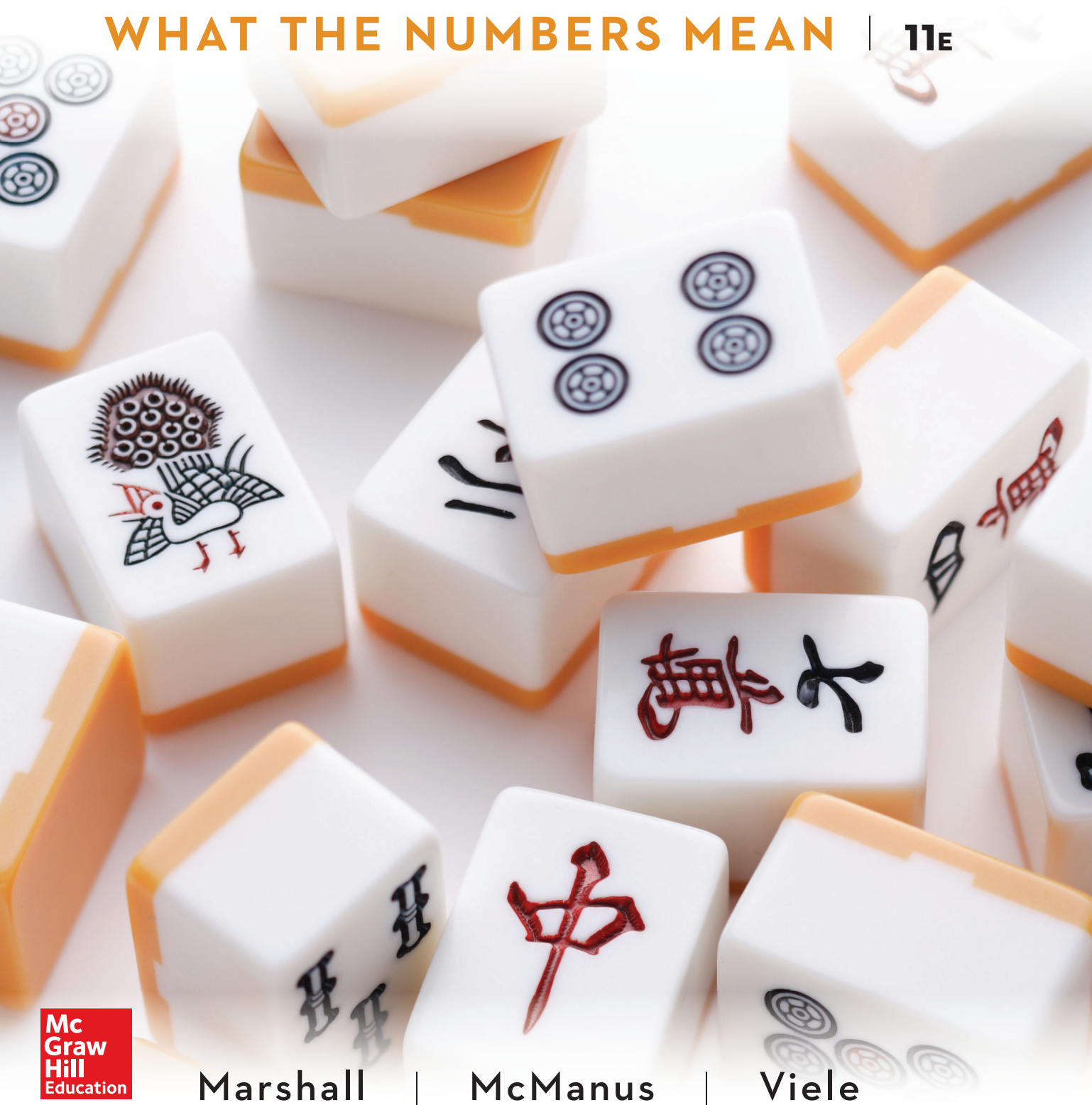


ACCOUNTING

WHAT THE NUMBERS MEAN | 11E



Mc
Graw
Hill
Education

Marshall

McManus

Viele

Eleventh Edition

Accounting

What the Numbers Mean

David H. Marshall, MBA, CPA, CMA

Professor of Accounting Emeritus
Millikin University

**Wayne W. McManus, LL.M., JD, MS,
MBA, CFA, CPA, CMA, CIA**

Professor of Accounting and Law
International College of the Cayman Islands

Daniel F. Viele, MS, CPA, CMA

Professor of Accounting
Dean, School of Adult & Online Education
Maryville University



**Mc
Graw
Hill**
Education



ACCOUNTING: WHAT THE NUMBERS MEAN, ELEVENTH EDITION

Published by McGraw-Hill Education, 2 Penn Plaza, New York, NY 10121. Copyright © 2017 by McGraw-Hill Education. All rights reserved. Printed in the United States of America. Previous editions © 2014, 2011, and 2008. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of McGraw-Hill Education, including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

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

This book is printed on acid-free paper.

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

ISBN 978-1-259-53531-4

MHID 1-259-53531-2

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

Vice President, General Manager, Products & Markets: *Marty Lange*

Vice President, Content Design & Delivery: *Kimberly Meriwether David*

Managing Director: *Tim Vertovec*

Brand Manager: *Steve Schuetz*

Director, Product Development: *Rose Koos*

Director of Digital Content: *Patricia Plumb*

Lead Product Developer: *Kristine Tibbetts*

Product Developer: *Michael McCormick*

Marketing Manager: *Michelle Nolte*

Digital Product Developer: *Kevin Moran*

Digital Product Analyst: *Xin Lin*

Director, Content Design & Delivery: *Linda Avenarius*

Program Manager: *Daryl Horrocks*

Content Project Managers: *Dana M. Pauley/Brian Nacik*

Buyer: *Sandy Ludovissy*

Design: *Srdjan Savanovic*

Content Licensing Specialists: *Lori Hancock/Shannon Manderscheid*

Cover Image: © *Hideki Yoshihara/Aflo/Getty Images*

Compositor: *Aptara®, Inc.*

Printer: *R. R. Donnelley*

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

Library of Congress Cataloging-in-Publication Data

Marshall, David H., author. | McManus, Wayne W., author. | Viele, Daniel F., author.

Accounting : what the numbers mean / David H. Marshall, Wayne W. McManus,

Daniel F. Viele.

Eleventh edition. | New York, NY : McGraw-Hill Education, [2017]

LCCN 2015036637 | ISBN 9781259535314 (alk. paper)

LCSH: Accounting. | Managerial accounting.

LCC HF5636 .M37 2017 | DDC 657—dc23 LC record available at

<http://lcn.loc.gov/2015036637>

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



Meet the Authors

David H. Marshall is Professor of Accounting Emeritus at Millikin University. He taught at Millikin, a small, independent university located in Decatur, Illinois, for 25 years. He taught courses in accounting, finance, computer information systems, and business policy, and was recognized as an outstanding teacher. The draft manuscript of this book was written in 1986 and used in a one-semester course that was developed for the nonbusiness major. Subsequently supplemented with cases, it was used in the business core accounting principles and managerial accounting courses. Concurrently, a one-credit-hour accounting laboratory taught potential accounting majors the mechanics of the accounting process. Prior to his teaching career, Marshall worked in public accounting and industry and he earned an MBA from Northwestern University. Professor Marshall's interests outside academia include community service, woodturning, sailing, and travel.



Wayne W. McManus makes his home in Grand Cayman, Cayman Islands, BWI, where he worked in the private banking sector for several years and is now a semiretired consultant. He maintains an ongoing relationship with the International College of the Cayman Islands as an adjunct Professor of Accounting and Law and as a member of the College's Board of Trustees. McManus offers the Cayman CPA Review course through the Financial Education Institute Ltd. and several professional development courses through the Chamber of Commerce. He earned an MS in accounting from Illinois State University, an MBA from the University of Kansas, a law degree from Northern Illinois University, and a master's of law in taxation from the University of Missouri–Kansas City. He serves as an independent director and chairman of the audit committee for Endeavour Mining Corp. (EDV on the TSX exchange). He is a member of the Cayman Islands Society of Professional Accountants and the local chapter of the CFA Institute. Professor McManus volunteers as a “professional” Santa each December, enjoys travel, golf, and scuba diving, and is an audio/video enthusiast.



Daniel F. Viele is Professor of Accounting and currently serves as Dean of the School of Adult and Online Education and directs the Office of Strategic Information at Maryville University of Saint Louis. He has taught courses in financial, managerial, and cost accounting, as well as accounting information systems. Prior to joining Maryville, Professor Viele's previous teaching experience includes 15 years at Webster University and 10 years at Millikin University with Professor Marshall. He has also served as a systems consultant to the graphics arts industry. Professor Viele has developed and taught numerous online graduate courses, and for his leadership role in pioneering online teaching and learning, he was presented a Presidential Recognition Award. His students and colleagues have also cited his dedication to teaching and innovative use of technology for which Webster awarded him its highest honor—the Kemper Award for Teaching Excellence. Professor Viele holds an MS in Accounting from Colorado State University and has completed the Information Systems Faculty Development Institute at the University of Minnesota and the Advanced Information Systems Faculty Development Institute at Indiana University. He is a member of the American Accounting Association and the Institute of Management Accountants, where he has served as President of the Sangamon Valley Chapter and as a member of the National Board of Directors. Professor Viele enjoys sports of all kinds, boating, and a good book.



Preface

Named after a Chinese word meaning “sparrow,” mah-jongg is a centuries-old game of skill. The object of the game is to collect different tiles; players win points by accumulating different combinations of pieces and creating patterns. We’ve chosen mah-jongg tiles as our cover image for the eleventh edition of *Accounting: What the Numbers Mean* because the text is designed to show students how to put the pieces together and understand their relationship to one another to see the larger pattern.

Accounting has become known as the language of business. Financial statements result from the accounting process and are used by owners/investors, employees, creditors, and regulators in their planning, controlling, and decision-making activities as they evaluate the achievement of an organization’s objectives.

Accounting: What the Numbers Mean takes the user through the basics: what accounting information is, how it is developed, how it is used, and what it means. Financial statements are examined to learn what they do and do not communicate, enhancing the student’s decision-making and problem-solving abilities from a user perspective. Achieving expertise in the preparation of financial statements is not an objective of this text. Instead, we have designed these materials to assist those who wish to learn “what the numbers mean” in a clear, concise, and conceptual manner, without focusing on the mechanical aspects of the accounting process.

The user-oriented approach taken by this text will benefit a variety of non-accounting majors, including students focusing on other areas of business or nonbusiness programs such as engineering, behavioral sciences, public administration, or prelaw. Aspiring MBA and other graduate management or administration students who do not have an undergraduate business degree will likewise benefit from a course using this text.

Best wishes for successful use of the information presented here.

David H. Marshall

Wayne W. McManus

Daniel F. Viele



connect[®]

Required=Results



McGraw-Hill Connect[®] Learn Without Limits

Connect is a teaching and learning platform that is proven to deliver better results for students and instructors.

Connect empowers students by continually adapting to deliver precisely what they need, when they need it, and how they need it, so your class time is more engaging and effective.

Course outcomes improve with Connect.



88% of instructors who use **Connect** require it; instructor satisfaction increases by 38% when **Connect** is required.

Using **Connect** improves passing rates by **10.8%** and retention by **16.4%**.

Analytics

Connect Insight[®]

Connect Insight is Connect’s new one-of-a-kind visual analytics dashboard—now available for both instructors and students—that provides at-a-glance information regarding student performance, which is immediately actionable. By presenting assignment, assessment, and topical performance results together with a time metric that is easily visible for aggregate or individual results, Connect Insight gives the user the ability to take a just-in-time approach to teaching and learning, which was never before available. Connect Insight presents data that empower students and help instructors improve class performance in a way that is efficient and effective.

Connect helps students achieve better grades



Based on McGraw-Hill Education Connect Effectiveness Study 2013

Students can view their results for any **Connect** course.

Adaptive



More students earn **A's** and **B's** when they use McGraw-Hill Education **Adaptive** products.

SmartBook®

Proven to help students improve grades and study more efficiently, SmartBook contains the same content within the print book, but actively tailors that content to the needs of the individual. SmartBook's adaptive technology provides precise, personalized instruction on what the student should do next, guiding the student to master and remember key concepts, targeting gaps in knowledge and offering customized feedback, and driving the student toward comprehension and retention of the subject matter. Available on smartphones and tablets, SmartBook puts learning at the student's fingertips—anywhere, anytime.

Over **4 billion** questions have been answered, making McGraw-Hill Education products more intelligent, reliable, and precise.

**THE FIRST AND ONLY
ADAPTIVE READING
EXPERIENCE DESIGNED
TO TRANSFORM THE
WAY STUDENTS READ**



of students reported **SmartBook** to be a more effective way of reading material



of students want to use the Practice Quiz feature available within **SmartBook** to help them study



of students reported having reliable access to off-campus wifi



of students say they would purchase **SmartBook** over print alone



reported that **SmartBook** would impact their study skills in a positive way

**Mc
Graw
Hill
Education**

*Findings based on a 2015 focus group survey at Pellissippi State Community College administered by McGraw-Hill Education

www.learnsmartadvantage.com

Enhancements for This Edition

Chapter 1

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Overall chapter content revisions for clarity and general updates.
- Updated references to Campbell's 2014 annual report information.
- Updated discussion of international financial reporting issues with emphasis on progress made in recent years to achieve the maximum possible convergence of IFRS and U.S. GAAP.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Exercises.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 2

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Updated references to Campbell's 2014 annual report information.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 3

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.

- Overall chapter content revisions for clarity and general updates.
- Reintegrated Campbell's 2014 annual report information for the financial and graphical analysis of liquidity and profitability trends.
- Deleted Campbell Soup Company and the Consumer Goods Industry return on investment (ROI) trend comparison to improve the chapter's efficiency.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 4

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 5

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Updated discussion and analysis of Campbell's 2014 annual report information for the accounting and presentation of current assets, including cash, accounts receivable, and inventories.

- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 6

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Updated discussion and analysis of Campbell's 2014 annual report information for the accounting and presentation of property, plant, and equipment, and other noncurrent assets.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 7

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Updated discussion and analysis of Campbell's 2014 annual report information for the accounting and presentation of liabilities.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.

- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 8

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Updated discussion and analysis of Campbell's 2014 annual report information for the accounting and presentation of stockholders' equity.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 9

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Updated discussion and analysis of Campbell's 2014 annual report information for the presentation and disclosure of income statement and statement of cash flows data.
- Revamped "The IFRS Approach" box to summarize the effects of the 2014 FASB and IASB converged standard on revenue recognition.
- Scaled back the coverage of extraordinary items, since they are no longer reported as a separate category under U.S. GAAP, but do have historical significance.

Enhancements for This Edition

- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 10

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Updated discussion and analysis of Campbell's 2014 annual report information for the Notes to the Financial Statements section of the chapter.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 11

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Updated discussion of Campbell's 2014 annual report information for the performance of financial ratio analysis.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.

- Complete revision of all odd and even-numbered Mini-Exercise, Exercises, Problems, and Cases.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 12

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Chapter Study Suggestion, FYI, and Business in Practice boxes updated or replaced.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd numbered Exercises and Problems.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 13

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Chapter Study Suggestion, FYI, and Business in Practice boxes updated or replaced.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd numbered Exercises and Problems.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.



Chapter 14

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Chapter Study Suggestion, FYI, and Business in Practice boxes updated or replaced.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd numbered Exercises and Problems.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 15

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Chapter Study Suggestion, FYI, and Business in Practice boxes updated or replaced.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.

- Complete revision of all odd numbered Exercises and Problems.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Chapter 16

- Created NEW LearnSmart assessments within each chapter learning objective to support our NEW SmartBook adaptive learning technology.
- Additional guided example video demonstrations.
- Overall chapter content revisions for clarity and general updates.
- Chapter Study Suggestion, FYI, and Business in Practice boxes updated or replaced.
- Chapter Summary content enhanced to identify and align with chapter learning objectives.
- General update of all Mini-Exercises, Exercises, Problems, and Cases.
- Complete revision of all odd numbered Exercises and Problems.
- General update and revision of test bank, adding ten percent new question and problem content.
- Self-Study Material removed from end of chapter content.

Epilogue:

- Overall content revisions for clarity and additions for current updates.
- New graphic updating IFRS adoption around the world.

Acknowledgments

The task of creating and revising a textbook is not accomplished by the work of the authors alone. Thoughtful feedback from reviewers is integral to the development process and gratitude is extended to all who have participated in earlier reviews of *Accounting: What the Numbers Mean* as well as to our most recent panel of reviewers. Your help in identifying strengths to further develop and areas of weakness to improve was invaluable to us. We are grateful to the following for their comments and constructive criticisms that helped us with development of the eleventh edition, and previous editions:

Janet Adeyiga, *Hampton University*
Gary Adna Ames, *Brigham Young University–Idaho*
Sharon Agee, *Rollins College*
Vernon Allen, *Central Florida Community College*
Tim Alzheimer, *Montana State University*
David Anderson, *Louisiana State University*
Susan Anderson, *North Carolina A&T State University*
Florence Atiase, *University of Texas–Austin*
Benjamin Bae, *Virginia Commonwealth University*
Linda T. Bartlett, *Bessemer State Technical College*
Jean Beau lieu, *Westminster College*
Robert Beebe, *Morrisville State College*
Jekabs Bikis, *Dallas Baptist University*
David Bilker, *Temple University*
Scott Butler, *Dominican University of California*
Marci L. Butterfield, *University of Utah*
Sandra Byrd, *Southwest Missouri State University*
Harlow Callander, *University of St. Thomas*
John Callister, *Cornell University*
Sharon Campbell, *University of North Alabama*
Elizabeth D. Capener, *Dominican University of CA*
Kay Carnes, *Gonzaga University*
Thomas J. Casey, *DeVry University*
Royce E. Chaffin, *University of West Georgia*
James Crockett, *University of Southern Mississippi*
Alan B. Czyzewski, *Indiana State University*
Weldon Terry Dancer, *Arkansas State University*
Thomas D'Arrigo, *Manhattan College*
Patricia Davis, *Keystone College*
Francis Dong, *DeVry University*
Martha Doran, *San Diego State University*
Robert Dunn, *Columbus State University*
Marthanne Edwards, *Colorado State University*
Craig Ehlert, *Montana State University–Bozeman*
John A. Elfrink, *Central Missouri State University*
Robert C. Elmore, *Tennessee Tech University*
Leslie Fletcher, *Georgia Southern University*
Norman Foy, *Mercy College*
Randy Frye, *Saint Francis University*
Harry E. Gallatin, *Indiana State University*
Regan Garey, *Immaculata University*
Terrie Gehman, *Elizabethtown College*
Daniel Gibbons, *Waubensee Community College*
Louis Gingerella, *Rensselaer–Hartford*
Dan Goldzband, *University of California–San Diego*
Kyle L. Grazier, *University of Michigan*
Alice M. Handlang, *Southern Christian University*
Betty S. Harper, *Middle Tennessee State University*
Elaine Henry, *Rutgers University*
William Hood, *Central Michigan University*
Fred Hughes, *Faulkner University*
Kim Hurt, *Central Community College*
Lori Jacobson, *North Idaho College*
Linda L. Kadlecek, *Central Arizona College*
Zulfikar Khan, *Benedictine University*
Charles Kile, *Middle Tennessee State University*
Nancy Kelly, *Middlesex Community College*
Ronald W. Kilgore, *University of Tennessee*
Bert Luken, *Wilmington College–Cincinnati*
Anna Lusher, *West Liberty State College*
Suneel Maheshwari, *Marshall University*
Gwen McFadden, *North Carolina A&T State University*
Tammy Metzke, *Milwaukee Area Technical College*
Melanie Middlemist, *Colorado State University*
Richard Monbrod, *DeVry University*
Murat Neset Tanju, *University of Alabama–Birmingham*
Eugene D. O'Donnell, *Harcum College*
William A. O'Toole, *Defiance College*
Sandra Owen, *Indiana University–Bloomington*
Carol Pace, *Grayson County College*
Robert Patterson, *Penn State–Erie*
Robert M. Peevy, *Tarleton State University*
Craig Pence, *Highland Community College*
Candace Person, *University of California–San Diego Extension*
David H. Peters, *Southeastern University*
Ronald Picker, *St. Mary of the Woods College*
Martha Pointer, *East Tennessee State University*
James Pofal, *University of Wisconsin–Oshkosh*
Shirley Powell, *Arkansas State University–Beebe*
Barbara Powers-Ingram, *Wytheville Community College*
M. Jeff Quinlan, *Madison College*
John Rush, *Illinois College*
Robert W. Rutledge, *Texas State University*
Robert E. Rosacker, *The University of South Dakota*
Paul Schwin, *Tiffin University*
Raymond Shaffer, *Youngstown State University*
Erin Sims, *DeVry University*
Forest E. Stegelin, *University of Georgia*
Mark Steadman, *East Tennessee State University*
Charles Smith, *Iowa Western Community College*
Ray Sturm, *University of Central Florida*
John Suroviak, *Pacific University*
Linda Tarrago, *Hillsborough Community College*
Judith A. Toland, *Bucks County Community College*
Catherine Traynor, *Northern Illinois University*
Michael Vasilou, *DeVry University*
David Verduzco, *University of Texas–Austin*
Joseph Vesci, *Immaculata University*
William Ward, *Mid-Continent University*
Kortney White, *Arkansas State University*
Dennis Wooten, *Erie Community College–North*



We Are Grateful . . . Although the approach to the material and the scope of coverage in this text are the results of our own conclusions, truly new ideas are rare. The authors whose textbooks we have used in the past have influenced many of our ideas for particular accounting and financial management explanations. Likewise, students and colleagues through the years have helped us clarify illustrations and teaching techniques. Many of the users of the first 10 editions—both teachers and students—have offered comments and constructive criticisms that have been encouraging and helpful. All this input is greatly appreciated.

We extend special thanks to Helen Roybark of Radford University for her careful accuracy check of the text manuscript and solutions manual; to Anna Boulware of St. Charles Community College for her careful accuracy check of the test bank and revision to the PowerPoint® presentations; to Ray Sturm of the University of Central Florida for his careful accuracy check of the end of chapter Connect assessments; to April L. Mohr of Jefferson Community and Technical College, SW, in Louisville, Kentucky for her invaluable assistance and guidance in the development of our text's LearnSmart content.

Finally, we wish to thank our many colleagues at McGraw-Hill, who for more than 25 years have provided exceptional editorial assistance and product development guidance. Your collective efforts have helped to shape every aspect of this text, and it continues to be a pleasure to work with such a fine group of publishing professionals.

David H. Marshall Wayne W. McManus Daniel F. Viele

Brief Contents

1. Accounting—Present and Past 2

Part 1:

Financial Accounting

2. Financial Statements and Accounting Concepts/Principles 28
3. Fundamental Interpretations Made from Financial Statement Data 68
4. The Bookkeeping Process and Transaction Analysis 94
5. Accounting for and Presentation of Current Assets 134
6. Accounting for and Presentation of Property, Plant, and Equipment, and Other Noncurrent Assets 182
7. Accounting for and Presentation of Liabilities 228
8. Accounting for and Presentation of Stockholders' Equity 270
9. The Income Statement and the Statement of Cash Flows 312
10. Corporate Governance, Notes to the Financial Statements, and Other Disclosures 360
11. Financial Statement Analysis 386

Part 2:

Managerial Accounting

12. Managerial Accounting and Cost–Volume–Profit Relationships 422
 13. Cost Accounting and Reporting 464
 14. Cost Planning 506
 15. Cost Control 546
 16. Costs for Decision Making 584
- Epilogue: Accounting—The Future 630**
- Appendix: Excerpts from the Campbell Soup Company 2014 Annual Report 640**
- Index 706**

Contents

Preface iv

1. Accounting—Present and Past 2

What Is Accounting? 3

- Financial Accounting 6
- Managerial Accounting/Cost Accounting 7
- Auditing—Public Accounting 7
- Internal Auditing 8
- Governmental and Not-for-Profit Accounting 8
- Income Tax Accounting 9

How Has Accounting Developed? 9

- Early History 9
- The Accounting Profession in the United States 9
- Financial Accounting Standard Setting at the Present Time 10
- Standards for Other Types of Accounting 12
- International Accounting Standards 13
- Ethics and the Accounting Profession 15
- The Conceptual Framework 16
- Summary of *Concepts Statement No.8*, Chapter 1: “The Objective of General Purpose Financial Reporting” 18
- Objectives of Financial Reporting for Nonbusiness Organizations 19

Plan of the Book 20

- Resources for Students 21

Part 1:

Financial Accounting

2. Financial Statements and Accounting Concepts/Principles 28

Financial Statements 29

- From Transactions to Financial Statements 29
- Financial Statements Illustrated 31

- Explanations and Definitions 32
- Comparative Statements in Subsequent Years 40
- Illustration of Financial Statement Relationships 41

Accounting Concepts and Principles 44

- Concepts/Principles Related to the Entire Model 44
- Concepts/Principles Related to Transactions 45
- Concepts/Principles Related to Bookkeeping Procedures and the Accounting Process 46
- Concepts/Principles Related to Financial Statements 46
- Limitations of Financial Statements 47

The Corporation’s Annual Report 49

3. Fundamental Interpretations Made from Financial Statement Data 68

Financial Ratios and Trend Analysis 69

- Return on Investment 70
- The DuPont Model: An Expansion of the ROI Calculation 73
- Return on Equity 75
- Working Capital and Measures of Liquidity 76
- Illustration of Trend Analysis 77

4. The Bookkeeping Process and Transaction Analysis 94

The Bookkeeping/Accounting Process 95

- The Balance Sheet Equation—A Mechanical Key 95
- Transactions 97
- Bookkeeping Jargon and Procedures 98
- Understanding the Effects of Transactions on the Financial Statements 102
- Adjustments 105

Transaction Analysis Methodology 109

5. Accounting for and Presentation of Current Assets 134

Cash and Cash Equivalents 137

The Bank Reconciliation as a Control over Cash 138

Short-Term Marketable Securities 140

Balance Sheet Valuation 140

Interest Accrual 142

Accounts Receivable 143

Bad Debts/Uncollectible Accounts 143

Cash Discounts 145

Notes Receivable 146

Interest Accrual 147

Inventories 148

Inventory Cost Flow Assumptions 149

The Impact of Changing Costs (Inflation/Deflation) 153

Selecting an Inventory Cost Flow Assumption 153

Inventory Accounting System Alternatives 156

Inventory Errors 158

Balance Sheet Valuation at the Lower of Cost or Market 159

Prepaid Expenses and Other Current Assets 160

6. Accounting for and Presentation of Property, Plant, and Equipment, and Other Noncurrent Assets 182

Land 183

Buildings and Equipment 186

Cost of Assets Acquired 186

Depreciation for Financial Accounting Purposes 187

Repair and Maintenance Expenditures 192

Disposal of Depreciable Assets 193

Assets Acquired by Capital Lease 195

Intangible Assets 198

Leasehold Improvements 199

Patents, Trademarks, and Copyrights 199

Goodwill 200

Natural Resources 202

Other Noncurrent Assets 202

Appendix—Time Value of Money 204

Future Value 204

Future Value of an Annuity 205

Present Value 206

Present Value of an Annuity 208

Impact of Compounding Frequency 211

7. Accounting for and Presentation of Liabilities 228

Current Liabilities 231

Short-Term Debt 231

Current Maturities of Long-Term Debt 234

Accounts Payable 235

Unearned Revenue or Deferred Credits 235

Payroll Taxes and Other Withholdings 236

Other Accrued Liabilities 237

Noncurrent Liabilities 239

Long-Term Debt 239

Deferred Tax Liabilities 248

Other Noncurrent Liabilities 249

Contingent Liabilities 251

8. Accounting for and Presentation of Stockholders' Equity 270

Paid-In Capital 272

Common Stock 272

Preferred Stock 276

Additional Paid-In Capital 279

Retained Earnings 279

Cash Dividends 280

Stock Dividends and Stock Splits 281

Accumulated Other Comprehensive Income (Loss) 284

Treasury Stock 287

Reporting Changes in Stockholders' Equity Accounts 289

Noncontrolling Interest 289

Owners' Equity for Other Types of Entities 291

Proprietorships and Partnerships 291

Not-for-Profit and Governmental Organizations 291

Appendix—Personal Investing 294

9. The Income Statement and the Statement of Cash Flows 312

Income Statement 316

Revenues	316
Expenses	320
Cost of Goods Sold	321
Gross Profit or Gross Margin	323
Operating Expenses	325
Income from Operations	326
Other Income and Expenses	327
Income before Income Taxes and Income Tax Expense	327
Net Income and Earnings per Share	327
Income Statement Presentation Alternatives	329
Unusual or Frequently Occurring Items Sometimes Seen on an Income Statement	331

Statement of Cash Flows 333

Content and Format of the Statement	333
Interpreting the Statement of Cash Flows	338

10. Corporate Governance, Notes to the Financial Statements, and Other Disclosures 360

Corporate Governance 361

Financial Reporting Misstatements	363
-----------------------------------	-----

General Organization of Notes to the Financial Statements 366

Notes to the Financial Statements 366

Significant Accounting Policies	366
Details of Other Financial Statement Amounts	369
Other Disclosures	370
Management's Statement of Responsibility	373

Management's Discussion and Analysis (MD&A) 373

Five-Year (or Longer) Summary of Financial Data 374

Independent Auditors' Report 375

Financial Statement Compilations 377

11. Financial Statement Analysis 386

Financial Statement Analysis Ratios 387

Liquidity Measures	387
Activity Measures	388
Profitability Measures	392
Financial Leverage Measures	397

Other Analytical Techniques 401

Book Value per Share of Common Stock	401
Common Size Financial Statements	402
Other Operating Statistics	404

Part 2:

Managerial Accounting

12. Managerial Accounting and Cost–Volume–Profit Relationships 422

Managerial Accounting Contrasted to Financial Accounting 423

Cost Classifications 426

Relationship of Total Cost to Volume of Activity	427
--	-----

Applications of Cost–Volume–Profit Analysis 429

Cost Behavior Pattern: The Key	429
Estimating Cost Behavior Patterns	431
A Modified Income Statement Format	431
An Expanded Contribution Margin Model	435
Multiple Products or Services and Sales Mix Considerations	438
Break-Even Point Analysis	439
Operating Leverage	444

13. Cost Accounting and Reporting 464

Cost Management 465

Cost Accumulation and Assignment 468

Cost Relationship to Products or Activity	469
Costs for Cost Accounting Purposes	470

Cost Accounting Systems 471

- Cost Accounting Systems—General Characteristics 471
- Cost Accounting Systems—Job Order Costing, Process Costing, and Hybrid Costing 482
- Cost Accounting Methods—Absorption Costing and Direct Costing 483
- Cost Accounting Systems in Service Organizations 485
- Activity-Based Costing 485

14. Cost Planning 506**Cost Classifications 508**

- Relationship of Total Cost to Volume of Activity 508
- Cost Classification According to a Time-Frame Perspective 509

Budgeting 509

- The Budgeting Process in General 509
- The Budget Time Frame 510
- The Budgeting Process 511
- The Purchases/Production Budget 515
- The Cost of Goods Sold Budget 518
- The Operating Expense Budget 518
- The Budgeted Income Statement 519
- The Cash Budget 520
- The Budgeted Balance Sheet 522

Standard Costs 524

- Using Standard Costs 524
- Developing Standards 525
- Costing Products with Standard Costs 526
- Other Uses of Standards 527

Budgeting for Other Analytical Purposes 528**15. Cost Control 546****Cost Classifications 547**

- Relationship of Total Cost to Volume of Activity 547
- Cost Classification According to a Time-Frame Perspective 548

Performance Reporting 549

- Characteristics of the Performance Report 549
- The Flexible Budget 551

Standard Cost Variance Analysis 552

- Analysis of Variable Cost Variances 552
- Analysis of Fixed Overhead Variance 558
- Accounting for Variances 561

Analysis of Organizational Units 562

- Reporting for Segments of an Organization 562
- The Analysis of Investment Centers 564
- The Balanced Scorecard 566

16. Costs for Decision Making 584**Cost Classifications 586**

- Cost Classifications for Other Analytical Purposes 586

Short-Run Decision Analysis 587

- Relevant Costs 587
- Relevant Costs in Action—The Sell or Process Further Decision 588
- Relevant Costs in Action—The Special Pricing Decision 589
- Relevant Costs in Action—The Target Costing Question 592
- Relevant Costs in Action—The Make or Buy Decision 593
- Relevant Costs in Action—The Continue or Discontinue a Segment Decision 595
- Relevant Costs in Action—The Short-Term Allocation of Scarce Resources 598

Long-Run Investment Analysis 599

- Capital Budgeting 599
- Investment Decision Special Considerations 599
- Cost of Capital 600
- Capital Budgeting Techniques 601
- The Investment Decision 607
- Integration of the Capital Budget with Operating Budgets 608

Epilogue: Accounting—The Future 630**Appendix: Excerpts from the Campbell Soup Company 2014 Annual Report 640****Index 706**



Accounting— Present and Past

The worldwide financial and credit crisis that came to a head in the fall of 2008 was precipitated by many factors. Not the least of these factors were greed, inadequate market regulatory supervision, and an excess of “financial engineering” involved in the creation of financial instruments that almost defied understanding even by sophisticated investors. This crisis was preceded in the first decade of the century by the bankruptcy filings of two large, publicly owned corporations, which resulted in billions of dollars of losses by thousands of stockholders. In 2001 it had been Enron Corporation, and a few months later, WorldCom, Inc. In each case a number of factors caused the precipitous fall in the value of the firms’ stock. The most significant factor was probably the loss of investor confidence in each company’s financial reports and other disclosures reported to stockholders and regulatory bodies, including the Securities and Exchange Commission.

The Enron and WorldCom debacles, and other widely publicized breakdowns of corporate financial reporting, resulted in close scrutiny of such reporting by the accounting profession itself and also by the U.S. Congress and other governing bodies. The accounting practices that were criticized generally involved complex transactions.

Also contributing to the issue were aggressive attempts by some executives to avoid the spirit of sound accounting, even though many of the financial reporting practices in question were not specifically forbidden by existing accounting pronouncements at that time. To be sure, the financial reporting requirements faced by companies whose securities are publicly traded have since become more strenuously scrutinized under the Sarbanes–Oxley Act of 2002 (SOX) and the watchful eye of the Public Company Accounting Oversight Board (PCAOB), which is the regulatory body created under SOX to oversee the activities of the auditing profession and further protect the public interest. These enhanced regulatory efforts have helped to increase the transparency of the financial reporting process and the understandability of financial statements. Although the financial crisis that disrupted the financial world in 2008 was not directly blamed on financial accounting or auditing weaknesses, some accounting and financial reporting practices that existed at that time were severely criticized. This book briefly addresses some of the more troublesome technical issues still faced by the accounting profession today, but the elaborate attempts to embellish the financial image of those companies in question certainly went beyond the fundamentals described in the following pages.

The objective of this text is to present enough of the fundamentals of accounting to permit the nonaccountant to understand the financial statements of an organization operating in our society and to understand how financial information can be used in the management planning, control, and decision-making processes. Although usually expressed in the context of profit-seeking business enterprises, most of the material presented here is equally applicable to not-for-profit social service and governmental organizations.

Accounting is sometimes called the *language of business*, and it is appropriate for people who are involved in the economic activities of our society—and that is just about everyone—to know at least enough of this language to be able to make decisions and informed judgments about those economic activities.

LEARNING OBJECTIVES (LO)

After studying this chapter you should understand and be able to

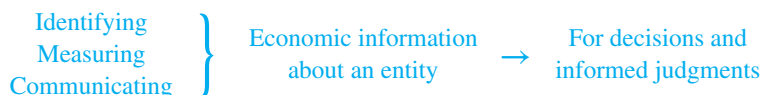
- LO 1-1** Explain the definition of *accounting*.
- LO 1-2** Identify who the users of accounting information are and explain why they find accounting information useful.
- LO 1-3** Identify the variety of professional services that accountants provide.
- LO 1-4** Summarize the development of accounting from a broad historical perspective.
- LO 1-5** Explain the role that the Financial Accounting Standards Board (FASB) plays in the development of financial accounting standards.
- LO 1-6** Generalize about how financial reporting standards evolve.
- LO 1-7** Identify the key elements of ethical behavior for a professional accountant.
- LO 1-8** Summarize the reasons for the FASB's Conceptual Framework project.
- LO 1-9** Summarize the objective of general purpose financial reporting.
- LO 1-10** Describe the plan of the book.

What Is Accounting?

In a broad sense, **accounting** is the process of identifying, measuring, and communicating economic information about an organization for the purpose of making decisions and informed judgments. (Accountants frequently use the term **entity** instead of *organization* because it is more inclusive.)

This definition of accounting can be expressed schematically as follows:

Accounting is the process of



LO 1
Explain the definition of *accounting*.

Exhibit 1-1

Users and Uses of Accounting Information

LO 2

Identify who the users of accounting information are and explain why they find accounting information useful.

User	Decision/Informed Judgment Made
Management	When performing its functions of planning, directing, and controlling, management makes many decisions and informed judgments. For example, when considering the expansion of a product line, planning involves identifying and measuring costs and benefits; directing involves communicating the strategies selected; and controlling involves identifying, measuring, and communicating the results of the product line expansion during and after its implementation.
Investors/ shareholders	When considering whether to invest in the common stock of a company, investors use accounting information to help assess the amounts, timing, and uncertainty of future cash returns on their investment.
Creditors/ suppliers	When determining how much merchandise to ship to a customer before receiving payment, creditors assess the probability of collection and the risks of late (or non-) payment. Banks also become creditors when they make loans and thus have similar needs for accounting information.
Employees	When planning for retirement, employees assess the company's ability to offer long-term job prospects and an attractive retirement benefits package.
SEC (Securities and Exchange Commission)	When reviewing for compliance with SEC regulations, analysts determine whether financial statements issued to investors fully disclose all required information.

Who makes these decisions and informed judgments? Users of accounting information include the management of the entity or organization; the owners of the organization (who are frequently not involved in the management process); potential investors in and creditors of the organization; employees; and various federal, state, and local governmental agencies that are concerned with regulatory and tax matters. Exhibit 1-1 describes some of the users and uses of accounting information. Pause, and try to think of at least one other decision or informed judgment that each of these users might make from the economic information that could be communicated about an entity.

Accounting information is required for just about every kind of organization. When accounting is mentioned, most people initially think of the information needs and reporting requirements of business firms, but not-for-profit social service organizations, governmental units, educational institutions, social clubs, political committees, and other groups all require accounting for their economic activities as well.

Accounting is frequently perceived as something that others who are good with numbers do, rather than as the process of providing information that supports decisions and informed judgments. Relatively few people become accountants, but almost all people use accounting information. The principal objective of this text is to help you become an informed user of accounting information, rather than to prepare you to become an accountant. However, the essence of this user orientation provides a solid foundation for students who choose to seek a career in accounting.

If you haven't already experienced the lack of understanding or confusion that results from looking at a set of financial statements, you have been spared one of life's frustrations. Certainly during your formal business education and early during your employment experience, you will be presented with financial data. Being an informed user means knowing how to use those data as information.

The following sections introduce the major areas of practice within the accounting discipline and will help you understand the types of work done by professional accountants within each of these broad categories. In a similar way, the

Business in Practice discussion shown below highlights career opportunities in accounting.

1. What does it mean to state that the accounting process should support decisions and informed judgments?

What Does It Mean?
Answer on
page 27

Career Opportunities in Accounting

Because accounting is a profession, most entry-level positions require at least a bachelor's degree with a major in accounting. Individuals are encouraged to achieve CPA licensure as quickly as feasible and/or to attend graduate school to pursue an area of specialization. Persons who work hard and smart can expect to attain high professional levels in their careers. The major employers of accountants include public accounting firms, industrial firms, government, and not-for-profit organizations.

Public Accounting

The work done by public accountants varies significantly depending on whether they are employed by a local, regional, or international CPA firm. Small local firms concentrate on the bookkeeping, accounting, tax return, and financial planning needs of individuals and small businesses. These firms need generalists who can adequately serve in a variety of capacities. The somewhat larger, regional firms offer a broad range of professional services but concentrate on the performance of audits (frequently referred to as *attestation* or *compliance services*), corporate tax returns, and management advisory services. They often hire experienced financial and industry specialists to serve particular client needs, in addition to recruiting well-qualified recent graduates.

The large, international CPA firms also perform auditing, tax, and consulting services. Their principal clients are large domestic and international corporations. The “Big 4” CPA firms are [PricewaterhouseCoopers](#) (known as PwC), [Deloitte Touche Tohmatsu](#) (Deloitte), [Ernst & Young Global](#) (EY), and [KPMG International](#) (KPMG). These firms dominate the market in terms of total revenues, number of corporate audit clients, and the number of offices, partners, and staff members. The Big 4 international firms generally recruit outstanding graduates and highly experienced CPAs and encourage the development of specialized skills by their personnel. (*Visit any of the Big 4 websites for detailed information regarding career opportunities in public accounting: [pwc.com](#), [deloitte.com](#), [ey.com](#), or [kpmg.com](#).*)

Industrial Accounting

More accountants are employed in industry than in public accounting because of the vast number of manufacturing, merchandising, and service firms of all sizes. In addition to using the services of public accounting firms, these firms employ cost and management accountants, as well as financial accountants. Many accountants in industry start working in this environment right out of school; others get their start in public accounting as auditors but move to industry after getting at least a couple of years of experience.

Government and Not-for-Profit Accounting

Opportunities for accounting professionals in the governmental and not-for-profit sectors of the economy are constantly increasing. In the United States, literally thousands of state and local government reporting entities touch the lives of every citizen. Likewise, accounting specialists are employed by colleges and universities, hospitals, and voluntary health and welfare organizations such as the [American Red Cross](#), [United Way](#), and [Greenpeace](#).



Business in Practice

Financial Accounting

LO 3

Identify the variety of professional services that accountants provide.

Financial accounting generally refers to the process that results in the preparation and reporting of financial statements for an entity. As will be explained in more detail, financial statements present the financial position of an entity at a point in time, the results of the entity's operations for some period of time, the **cash flow** activities for the same period, and other information (the notes to the financial statements or financial review) about the entity's financial resources, obligations, owners'/stockholders' interests, and operations.

Financial accounting is primarily oriented toward the external user. The financial statements are directed to individuals who are not in a position to be aware of the day-to-day financial and operating activities of the entity. Financial accounting is also primarily concerned with the historical results of an entity's performance. Financial statements reflect what has happened in the past. Although readers may want to project past activities and their results into future performance, financial statements are not a crystal ball. Many corporate annual reports refer to the historical nature of financial accounting information to emphasize that users must make their own judgments about a firm's future prospects.

Bookkeeping procedures are used to accumulate the financial results of many of an entity's activities, and these procedures are part of the financial accounting process. Bookkeeping procedures have been thoroughly systematized using manual, mechanical, and computer techniques. Although these procedures support the financial accounting and reporting process, they are only a part of the process.

Financial accounting is done by accounting professionals who have generally earned a bachelor's degree with a major in accounting. The financial accountant is employed by an entity to use her or his expertise, analytical skills, and judgment in the many activities that are necessary for the preparation of financial statements. The title **controller** is used to designate the chief accounting officer of a corporation. The controller is usually responsible for both the financial and managerial accounting functions of the organization (as discussed later). Sometimes the title *comptroller* (the Old English spelling) is used for this position.

An individual earns the **Certified Public Accountant (CPA)** professional designation by fulfilling certain education and experience requirements and passing a comprehensive four-part examination. A uniform CPA exam is given nationally, although it is administered by individual states.¹ Some states require that candidates have accounting work experience before sitting for the exam. A total of 54 of the 55 U.S. jurisdictions, including all 50 states, have now enacted legislation increasing the educational requirements for CPA candidates from 120 semester hours of college study, or a bachelor's degree, to a minimum of 150 semester hours of college study to be granted licensure as a CPA.² Thirty-two of these states allow candidates to sit for the CPA exam with 120 hours, but require 150 hours for certification.³ The American Institute of Certified Public Accountants (AICPA), the national professional organization of CPAs, has also endorsed this movement by requiring that an individual CPA

¹ Since 2004, CPA candidates have been allowed to schedule their own exam dates; they may sit for one part at a time because the examination is now computer-based. The former "pencil and paper" CPA exam has become a relic.

² The U.S. Virgin Islands is the only jurisdiction that has not enacted the 150-hour education requirement as this text goes to print.

³ See becker.com/cpa-review/resources/about-exam/requirements for the exam requirements of your state.

wanting to become a member must have met the 150-hour requirement. This increase in the educational requirements for becoming a CPA and for joining the AICPA reflects the increasing demands placed on accounting professionals to be both broadly educated and technically competent. Practicing CPAs work in all types of organizations, but as explained later, a CPA who expresses an auditor's opinion about an entity's financial statements must be licensed by the jurisdiction/state in which she or he performs the auditing service.

Managerial Accounting/Cost Accounting

Managerial accounting is concerned with the use of economic and financial information to plan and control many activities of the entity and to support the management decision-making process. **Cost accounting** is a subset of managerial accounting that relates to the determination and accumulation of product, process, or service costs. Managerial accounting and cost accounting have primarily an internal orientation, in contrast to the primarily external orientation of financial accounting. Many of the same data used in or generated by the financial accounting process are used in managerial and cost accounting, but the data are more likely to be used in a future-oriented way, such as in the preparation of budgets. A detailed discussion of the similarities and differences between financial and managerial accounting is provided in Chapter 12 and highlighted in Exhibit 12-1.

Managerial accountants and cost accountants are professionals who have usually earned a bachelor's degree with a major in accounting. Their work frequently involves close coordination with the production, marketing, and finance functions of the entity. The **Certified Management Accountant (CMA)** designation can be earned by a management accountant or cost accountant by passing a broad two-part examination. The CMA examination is given in a computer-based format using only objective questions.

Auditing—Public Accounting

Many entities have their financial statements reviewed or examined by an independent third party. In most cases, an audit (examination) is required by securities laws if the stock or bonds of a company are owned and publicly traded by investors. **Public accounting** firms and individual CPAs provide this **auditing** service, which constitutes an important part of the accounting profession.

The result of an audit is the **independent auditor's report**. The report usually has four relatively brief paragraphs. The first paragraph identifies the financial statements that were audited, explains that the statements are the responsibility of the company's management, and states that the auditor's responsibility is to express an opinion about the financial statements. The second paragraph explains that the audit was conducted "in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and describes briefly what those standards require and what work is involved in performing an audit. (In effect, they require the application of **generally accepted auditing standards**, or **GAAS**.) The third paragraph contains the auditor's opinion, which is usually that the named statements "present fairly, in all material respects" the financial position of the entity and the results of its operations and cash flows for the identified periods "in conformity with U.S. generally accepted accounting principles." This is an unqualified, or "clean," opinion. Occasionally the opinion will be qualified with respect to fair presentation, departure from **generally accepted**

accounting principles (GAAP), or the auditor's inability to perform certain auditing procedures. Similarly, an explanatory paragraph may be added to an unqualified opinion regarding the firm's ability to continue as a going concern (that is, as a viable economic entity) when substantial doubt exists. An unqualified opinion is not a clean bill of health about either the current financial condition or the future prospects of the entity. Readers must reach their own judgments about these and other matters after studying the **annual report**, which includes the financial statements and the notes to the financial statements, as well as management's extensive discussion and analysis. A final paragraph makes reference to the auditors' opinion about the effectiveness of the company's internal control over financial reporting. The entire auditors' report is further discussed in Chapter 10.

Auditors who work in public accounting are professional accountants who usually have earned at least a bachelor's degree with a major in accounting. The auditor may work for a public accounting firm (a few firms have several thousand partners and professional staff) or as an individual practitioner. Most auditors seek and earn the CPA designation; the firm partner or individual practitioner who signs the audit opinion must be a licensed CPA in the state in which she or he practices. To be licensed, the CPA must satisfy the character, education, examination, and experience requirements of the state or other jurisdiction.



To see an example of the independent auditors' report, refer to the 2014 annual report of [Campbell Soup Company](#), which is reproduced in the appendix.

What Does It Mean?

Answers on page 27

2. What does it mean to work in public accounting?
3. What does it mean to be a CPA?

Internal Auditing

Organizations with many plant locations or activities involving many financial transactions employ professional accountants to do **internal auditing**. In many cases, the internal auditor performs functions much like those of the external auditor/public accountant, but perhaps on a smaller scale. For example, internal auditors may be responsible for reviewing the financial statements of a single plant or for analyzing the operating efficiency of an entity's activities. The qualifications of an internal auditor are similar to those of any other professional accountant. In addition to having the CPA and the CMA designation, the internal auditor may have also passed the examination to become a Certified Internal Auditor (CIA).

Governmental and Not-for-Profit Accounting

Governmental units at the municipal, state, and federal levels and not-for-profit entities, such as colleges and universities, hospitals, and voluntary health and welfare organizations, require the same accounting functions to be performed as do other accounting entities. Religious organizations, labor unions, trade associations, performing arts organizations, political parties, libraries, museums, country clubs, and many other not-for-profit organizations employ accountants with similar educational qualifications as those employed in business and public accounting.

Income Tax Accounting

The growing complexity of federal, state, municipal, and foreign income tax laws has led to a demand for professional accountants who are specialists in various aspects of taxation. Tax practitioners often develop specialties in the taxation of individuals, partnerships, corporations, trusts and estates, or in international tax law issues. These accountants work for corporations, public accounting firms, governmental units, and other entities. Many tax accountants have bachelor's degrees and are CPAs; some have a master's degree in accounting or taxation or are attorneys as well.

How Has Accounting Developed?

Accounting has developed over time in response to the needs of users of financial statements for financial information to support decisions and informed judgments such as those mentioned in Exhibit 1-1 and others that you were challenged to identify. Even though an aura of exactness is conveyed by the numbers in financial statements, a great deal of judgment and approximation is involved in determining the numbers to be reported. Although broad, generally accepted principles of accounting exist, different accountants may reach different but often equally legitimate conclusions about how to account for a particular transaction or event. A brief review of the history of the development of accounting principles may make this often confusing state of affairs a little easier to understand.

LO 4

Summarize the development of accounting from a broad historical perspective.

Early History

It is not surprising that evidence of record keeping for economic events has been found in the earliest civilizations. Dating back to the clay tablets used by Mesopotamians in about 3000 B.C. to record tax receipts, accounting has responded to the information needs of users. In 1494, Luca Pacioli, a Franciscan monk and mathematics professor, published the first known text to describe a comprehensive double-entry bookkeeping system. Modern bookkeeping systems (as discussed in Chapter 4) have evolved directly from Pacioli's "method of Venice" system, which was developed in response to the needs of the Italian mercantile trading practices in that period.

The Industrial Revolution generated the need for large amounts of capital to finance the enterprises that supplanted individual craftsmen. This need resulted in the corporate form of organization marked by absentee owners, or investors, who entrusted their money to managers. It followed that investors required reports from the corporate managers showing the entity's financial position and results of operations. In mid-19th-century England, the independent (external) audit function added credence to financial reports. As British capital was invested in a growing U.S. economy in the late 19th century, British-chartered accountants and accounting methods came to the United States. However, no group was legally authorized to establish financial reporting standards. This led to alternative methods of reporting financial condition and results of operations, which resulted in confusion and, in some cases, outright fraud.

The Accounting Profession in the United States

Accounting professionals in this country organized themselves in the early 1900s and worked hard to establish certification laws, standardized audit procedures, and other attributes of a profession. However, not until 1932–1934 did the American Institute