

# FINANCIAL ACCOUNTING

A DECISION-MAKING APPROACH



SECOND EDITION

KING • LEMBKE • SMITH

SECOND EDITION

# Financial Accounting

**A DECISION-MAKING APPROACH**

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# Preface

Relevant and reliable information has become the key to success, and even survival, in today's rapidly changing business world. In the competitive world of business, the decision maker with the best information, and the best understanding of that information, is likely to be the winner. All students of business and management will ultimately use accounting information, and the better they understand it, the better they will be able to use it to make wise decisions.

Although they won't necessarily need the detailed knowledge that an accountant is expected to have, students must gain more than just a working knowledge of accounting terminology. They need to understand what the accounting numbers are telling them and how that relates to their decisions.

## **USING ACCOUNTING INFORMATION WISELY: THE GOALS OF THIS TEXT**

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*Financial Accounting: A Decision-Making Approach* has been designed to provide students with a general perspective and knowledge of accounting that will support real-world decision making. Specifically, this text will

- Help students understand how events are currently reported in financial statements and how specific items of reported financial information are used for business decisions.
- Provide the means for students to link their understanding of accounting to the requirements of the specific financial decisions for which the information will be used.
- Help students understand the elements that make up external accounting reports, how the information is selected and recorded, and how the accounting process affects the way the information can be used for decisions.

Financial decision makers who understand how the accounting process measures real-world events and accumulates, classifies, summarizes, and reports information about these events can use financial accounting information wisely.



## THE FRAMEWORK FOR MAKING SUCCESSFUL BUSINESS DECISIONS: KEY FEATURES OF THIS TEXT

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We view *Financial Accounting: A Decision-Making Approach* as reflecting an evolutionary rather than revolutionary change in the approach used to help students understand accounting. Therefore, we have maintained the traditional focus on understanding the elements of the financial statements. However, we do not concentrate on the mechanics of the accounting process. Instead, we have carefully crafted this text to teach students how to use accounting information for making decisions. Here are some highlights of the Second Edition:

### DECISIONS LINKED TO FINANCIAL INFORMATION

Accounting comes alive when it is used rather than just studied. In each chapter after Chapter 1 (and excluding Chapter 7 on the accounting process), we have reinforced the link between business decisions and the need to understand accounting information. We begin each major topic with a feature new to the Second Edition called **Information for Decisions**, a summary of the accounting information that will be discussed and the types of decisions that business people make with that information. Several sample decision questions show students how financial decision makers benefit from understanding the material presented. This link between the topic and real decisions is continued into the end-of-chapter materials as well.

### ABUNDANT REAL-WORLD EXAMPLES

Never before in history has understanding the details of financial reports been so important before making business decisions. In the Second Edition more financial statements from actual companies have been introduced early in the book (Chapters 1 and 2) so students can begin focusing on the types of accounting reports they will be studying throughout the course. And throughout the text, accounting concepts are supported by examples from the current financial reports of real companies.

### UNDERSTANDING THE NEW INFORMATION AGE: GATEWAY, INC.

We have chosen Gateway, Inc.'s annual report to illustrate throughout the text how accounting information is used for decisions. Gateway is an excellent example of the new model of a flexible manufacturing company. For this type of company, the traditional measures of "return on investment" do not work very well and can be misleading. To understand Gateway, you must understand the detailed financial information it reports about its activities and its customer base.

### THE ROLE OF CASH FLOWS IN THE DECISION-MAKING PROCESS

To allow discussion of the importance of cash flows in decision making early in the discussion of accounting, the chapter on cash flows has been moved from Chapter 4 in the First Edition to Chapter 3 in the Second Edition. In doing this, we have also streamlined the discussion of cash flows and deleted some peripheral topics. This earlier placement also facilitates comparisons when accrual accounting is discussed in detail in Chapter 4.

The time-value of money discussion has been consolidated in the second half of Chapter 3 and separated as Part II. Although we have introduced the time-value concepts in a very simple, understandable way and think that students need to understand the importance of the timing of

cash flows in financial decisions early in the course, this arrangement of the chapter makes it possible to delay coverage of this topic until later in this course or to a subsequent course.

## **AN ACTIVE LEARNING ENVIRONMENT**

Throughout the text, students are encouraged to read actively. One way this is done is by posing questions for students to think about before reading, such as in the **Information for Decisions** feature. In addition, **You Decide** situations in each chapter reinforce an understanding of how accounting information is used or encourage students to think beyond the specifics of the chapter presentation. The end-of-chapter materials are designed to support and reinforce both the decision-making focus of the book and the active learning environment.

A significant new feature in the Second Edition is the **Annual Report Project**, in which students select a company of interest to them and follow it throughout their study of accounting. By answering questions on the chapter topic with information about the company they have chosen, students learn to apply accounting to real situations.

## **ACCOUNTING PROCEDURES**

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What do introductory accounting students need to know about the procedural system that generates the information used for business decisions? Do they need to know about journal entries? This is a difficult question on which many instructors disagree. As the features of our text show, we believe that the first course in financial accounting should emphasize the use of accounting information for making wise decisions. However, as in any other technical field, understanding the outcome that is reported often requires some understanding of the process that generated that outcome.

Our solution is to avoid detailed discussions of accounting mechanics in the first six chapters. In this way, students can focus on the general meaning of the accounting information and how it is linked to financial decisions without becoming bogged down in mechanics. Chapter 7 then provides a concise description of the mechanics of the accounting process, illustrated with journal entries. This chapter is largely self-contained and could be omitted. However, we believe that the procedural material in Chapter 7 strengthens the student's appreciation of the information reported in financial statements.

Subsequent chapters explore each of the financial statement elements in more detail, again focusing on using the information, and do not depend on Chapter 7 or the use of journal entries. All discussions are presented in terms of financial statement effects, with a visual presentation of the financial statement effects accompanying the discussion. However, for those who wish to use them, journal entries are presented within these chapters, set off from the main presentation so not to intrude on the discussion. However, they are readily available for those instructors who choose to use them.

## **THE BOOK AT A GLANCE**

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### **ORGANIZATION**

Several sections of the text were rearranged and shortened in the Second Edition to improve the flow of the discussion. For several topics, complex applications were moved to an appendix or, in some cases deleted, so that the main focus would remain on gaining a solid understanding of basic accounting.



The organization of the text provides flexibility in the choice of materials to be covered in a one-semester course, as follows:

Basic framework and key concepts, including cash flows	Chapters 1–3
Accrual accounting: reporting income and financial position	Chapters 4–6
The accounting process	Chapter 7
Financial statement elements	Chapters 8–13
Special topics	Chapters 14–16

We anticipate that most instructors will include Chapters 1 to 13 in a one-semester course. As mentioned previously, we discuss and illustrate the analysis of cash flows and the use of time value of money concepts in Part II of Chapter 3. These concepts are presented in the context of both business and personal decisions. Some faculty may prefer to cover this topic later in the course, and the organization of the text facilitates this choice. Chapter 7 is a relatively self-contained unit that provides coverage of the basic accounting process. Chapters 1–13 provide the basics of accounting and reporting. Chapters 14–16 cover selected topics in somewhat greater depth and may be used in total or in part, as time permits. Some instructors have used parts of these chapters in combination with earlier chapters. For example, the effects of the exchange of foreign currencies on accounts receivable, discussed in Chapter 16, may be covered with the material on accounts receivable in Chapter 8. Chapter 15 summarizes the financial ratios and techniques for analysis introduced in earlier chapters. Instructors may wish to use this part of Chapter 15 as a capstone for the course.

## LEARNING AIDS IN THE SECOND EDITION

The learning aids featured in the First Edition have been continued in this edition. Users of the text liked the way these features helped students focus on the links between financial decisions and reported accounting information. In the Second Edition, several pedagogical improvements have been made to guide and support students in their study.



**Where This Chapter Fits.** Each chapter begins with this new feature that places the chapter in the overall scheme of the book. Students see a brief review of the material from previous chapters, a quick overview of the chapter coverage, and a taste of what lies ahead.



**The Personal View and The Business View.** Next, **The Personal View** helps the students to relate to the chapter material on a personal level, and **The Business View** illustrates an aspect of real-world organizational decision making that is relevant to the chapter coverage.



**Information for Decisions.** New to the Second Edition, this important and unique feature begins the major topics of each chapter (excluding Chapters 1 and 7). It identifies the information to be discussed in the section and directly links this information to decisions by posing several questions that can be answered with the information. The direct link between accounting information and decision making is completed in the end-of-chapter materials, where students are asked to answer specific decision questions.



**You Decide.** Throughout the chapters, these active learning scenarios present students with a variety of situations in which to either apply the concepts discussed or go beyond the discussion. Most of these thinking exercises do not have a single correct answer but rather challenge students to be creative in addressing issues or making decisions. They make excellent starting points for class discussion.

**Company Financial Statements.** The financial statements of **Hewlett-Packard** are included in Chapter 1 to focus students on the importance of reported financial information. Many other examples of real-company financial statements are included throughout the text.

Updated in this edition, the **In Practice** feature offers many examples from companies' current financial reports to illustrate specific points and emphasize different aspects of financial reporting and the accounting process. Each example includes an *Analysis* section that helps students understand what lies beneath the reported numbers and ties the example to the concepts discussed in the chapter. Web addresses are included for all companies used in these illustrations and in examples throughout the text.

The full set of financial statements of **Gateway, Inc.**, along with other selected portions of Gateway's annual report, are included in an appendix to the text, and the individual financial statements are incorporated where relevant in selected chapters.

**Our Video Store.** This hypothetical example used in the First Edition is continued and expanded in this edition. It begins in Chapter 1 and is used throughout the early chapters to illustrate basic accounting principles and to provide students with an intuitive understanding of the need for accounting information. Discussions related to this example are marked with a logo in the margin.

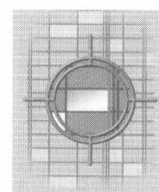
**A Closer Look At.** The text is richly illustrated with numerous focused examples. The many hypothetical examples, highlighted in **A Closer Look At** boxes, are spread throughout the text to clarify the discussion and illustrate specific points in greater detail. The use of hypothetical examples permits students to concentrate on the specific point being discussed without the complication of other factors.

**Financial Statement Effects.** In all hypothetical examples when an event or transaction would affect the financial statements, the effects are shown in the margin as increases or decreases in the balance sheet (assets, liabilities, and owners' equity) and income statement (revenue and expenses). This marginal notation provides the students with an easy way to see the link between financial transactions and financial statement reporting.

**End-of-Chapter Assignments.** The end-of-chapter materials have been revised and significantly expanded. Many new exercises have been added to focus on mastering basic concepts and their application throughout the text, and the link between the end-of-chapter materials and the text discussion has been strengthened. These extensive materials contain a wide variety of assignments and are grouped as follows to facilitate selection:

- **Examining the Concepts.** These questions review basic definitions, terminology, and concepts and how they relate to information in financial reports.
- **Understanding Accounting Information.** These are exercises in which students apply the basic concepts developed in the chapter and relate the material to financial statement information. The first several exercises in each chapter are decision focused and linked to each of the major chapter headings and to the questions in the **Information for Decisions** that follow each chapter heading. Multiple-choice exercises and individual-issue exercises help students understand the nature of the accounting information discussed in the chapter before they proceed to use the information for decision making. The number of exercises in this section has been increased significantly in this edition to 35–40 per chapter.
- **Using Accounting for Decision Making.** These problems provide an opportunity to deal with more complex issues and to apply accounting information to decision-making situations. A number of additional problems of this type have been added to this edition.
- **Expanding Your Horizons.** A variety of case materials, special team projects, and library or Internet assignments (marked with a research icon) help build further understanding of the ways financial information is presented by different companies and the

In Practice | - |





ways this information can be used in making decisions. Most chapters have an ethics case and cases using actual financial reports taken from the Internet or from companies' annual reports.



- **Internet Exercises.** Additional exercises can be found at [www.wiley.com/college/king](http://www.wiley.com/college/king).



- **Annual Report Project.** In this continuing project, students select a company of interest to them or one assigned by their instructor from the recommended list on the Web site and follow it throughout their study of accounting. At the end of each chapter, students learn to apply accounting to real situations by answering questions as they relate to the companies they have chosen.

**Appendices.** Selected chapters include appendices that contain topics that are less central to the study of accounting and that some, but not all, instructors may choose to cover. End-of-chapter materials relating to the chapter appendices are marked.

The financial statements and other excerpts from the annual report of Gateway, Inc., appear in Appendix A at the end of the book. Appendix B includes present value and future value tables.

**Glossary.** A comprehensive glossary is provided at the end of the text and includes all of the important terms highlighted in the book, as well as other terms that are useful in understanding accounting.

## SUPPLEMENTS

We have worked with contributors to develop a complete set of valuable supplemental materials to assist students and instructors. Following is a description of each of the available supplements.

**Web Site.** Recognizing that the Internet is a viable resource for students and instructors, we have developed a Web site at [www.wiley.com/college/king](http://www.wiley.com/college/king) to provide a variety of additional resources, including Internet exercises on current topics. Because the financial statements of actual companies are used extensively in the text, instructors and students may also wish to look at the Web sites of those companies for updates and more information. The Web address is provided, where available, for all company examples used in the text.

**Student Study Guide.** We have developed a comprehensive student guide that is closely coordinated with the text materials. Each chapter begins with a summary of key points in the chapter. Demonstration problems follow the key points. Numerous fill-in-the-blanks, true-false, and multiple-choice questions, along with short exercises, help students gain a better understanding of key points. These are followed by one or more comprehensive problems that students can use for review. Solutions are provided for all questions, exercises, and problems.

**WebCT.** Available to adopters of *Financial Accounting*, WebCT is an integrated set of course management tools that enable instructors to easily design, develop, and manage Web-based and Web-enhanced courses. The Wiley *Financial Accounting* WebCT course is the WebCT shell, with all its course management features, filled with Wiley content; it is an on-line learning and resource guide for the student. This WebCT course allows the instructor to present all or part of a course on-line and helps the student organize the course material, understand key concepts, and access additional on-line resources and tools. Your Wiley WebCT course can be customized by the instructor. Contact your Wiley representative for more information.

**Solutions Manual.** A comprehensive solutions manual prepared by the authors provides solutions to all end-of-chapter assignments. In many cases, the solutions manual goes well beyond the minimum answer needed to respond adequately to the item assigned. Answers include computations and detailed explanations that facilitate instructor use and can assist students in gaining mastery of the materials if the manual is placed in the library or otherwise made available to students. Instructors can prepare transparencies directly from the solutions manual or may choose from the transparency package.

**Test Bank and Computerized Test Bank.** A comprehensive set of test items consisting of both conceptual and applied questions has been prepared on a chapter-by-chapter basis and is available in either a hard copy or computerized format. True-false, multiple choice, and fill-in-the-blanks questions are provided, along with a series of short problems and cases. Where appropriate, one or more comprehensive problems have been provided.

**Instructor's Resource Guide.** This guide provides a variety of support materials for the instructor such as providing a consistent and thorough discussion of points to be considered for each *You Decide* situation presented in the text. In addition, outlines for the organization of lectures and the presentation of chapter materials are provided. More important, suggestions are provided throughout for ways to use the text and to present class materials more effectively. Additional examples for use in class are provided, along with aids to assist in the discussion and evaluation of assignments.

**Solutions Transparencies.** A package of solutions for selected exercises, problems, and cases is available to adopters.

**PowerPoint Slide Presentations.** A special electronic presentation package has been prepared to facilitate classroom instruction. The package includes both outline materials from the chapters and specific examples of accounting and reporting procedures. Instructors with a full version of PowerPoint can modify the presentations to match their own particular teaching styles. These presentations are available for download at the Web site (<http://www.wiley.com/college/king>).

**Nightly Business Report Video.** This video contains a series of clips from the highly respected *Nightly Business Report* that have been selected for their applicability to financial accounting and for their reinforcement of key concepts in the text. Each of the segments is approximately 3 to 5 minutes long and can be used to introduce topics to the students, enhance lecture material, and provide real-world examples. An Instructor's Manual with suggestions for using the material accompanies the video.

## ACKNOWLEDGMENTS

The development and completion of a project of this magnitude required the collaboration of many individuals and organizations, and we are very grateful to all who participated. The following individuals reviewed the text at various stages, and their creative suggestions and ideas significantly influenced the content, sequencing, and presentation of the current edition.

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 John H. Smith

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