

FUNDAMENTAL

Financial Accounting CONCEPTS

Edmonds / McNair / Milam / Olds

Third Edition



Balance Sheet				
= Liabilities		+	Equity	
ct.	Acct.	+	Cont.	Ret.
ec.	Pay		Cap.	Ear.
00	= n/a	+	n/a	+ 500
/a	= n/a	+	n/a	+ 500
/a	= n/a	+	n/a	+ (800)
/a	= n/a	+	800	+ (800)

Income Statement		
Rev.	Exp.	= Net Inc.
500	- n/a	= 500
500	- n/a	= 500
n/a	- n/a	= n/a
n/a	- n/a	= n/a

Cash Statement	
Cash Flow	
n/a	
500	
(800)	



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FUNDAMENTAL FINANCIAL ACCOUNTING CONCEPTS

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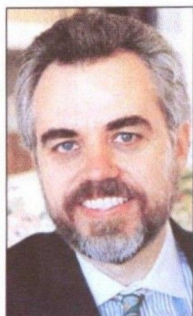
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MEET THE AUTHORS



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Dr. Edmonds holds the Friends and Alumni Professorship in the Department of Accounting at the University of Alabama at Birmingham (UAB). He has been actively involved in teaching accounting principles throughout his academic career. Dr. Edmonds has **coordinated the accounting principles courses at the University of Houston and UAB**. He currently teaches introductory accounting in mass sections that frequently include more than 180 students. Dr. Edmonds has received five prestigious teaching awards including the UAB President's Excellence in Teaching Award and the distinguished Ellen Gregg Ingalls Award for excellence in classroom teaching. He has written a number of articles for many publications including *Issues in Accounting*; the *Journal of Accounting Education*; *Advances in Accounting Education*; *Accounting Education: A Journal of Theory, Practice and Research*; the *Accounting Review*; *Advances in Accounting*; the *Journal of Accountancy*; *Management Accounting*; the *Journal of Commercial Bank Lending*; the *Banker's Magazine*; and the *Journal of Accounting, Auditing, and Finance*. He has published four textbooks, five practice problems (including two computerized problems), and a variety of supplemental materials including study guides, working papers, and solutions manuals. Dr. Edmonds's writing is influenced by a wide range of business experience. He was a successful entrepreneur, worked as a management accountant for Refrigerated Transport, a trucking company, and worked in the not-for-profit sector as a commercial lending officer for the Federal Home Loan Bank. In addition, he has acted as a consultant to major corporations including First City Bank of Houston, AmSouth Bank in Birmingham, Texaco, and Cortland Chemicals. Dr. Edmonds began his academic training at Young Harris Community College in Young Harris, Georgia. He received a B.B.A. degree with a major in finance from Georgia State University in Atlanta, Georgia. He obtained an M.B.A. degree with a concentration in finance from St. Mary's University in San Antonio, Texas. His Ph.D. degree with a major in accounting was awarded by Georgia State University. Dr. Edmonds's work experience and academic training have enabled him to bring a unique user perspective to this textbook.



Frances M. McNair, Ph.D., CPA

Dr. McNair holds the KPMG Peat Marwick Professorship in Accounting at Mississippi State University (MSU). She has been involved in teaching principles of accounting for the past 12 years and currently serves as the **coordinator for the principles of accounting courses at MSU**. She joined the MSU faculty in 1987 after receiving her Ph.D. from the University of Mississippi. The author of various articles that have appeared in the *Journal of Accountancy*, *Management Accounting*, *Business and Professional Ethics Journal*, *The Practical Accountant*, *Taxes*, and other publications, she also coauthored the book *The Tax Practitioner* with Dr. Denzil Causey. Dr. McNair is currently serving on committees of the

American Taxation Association, the American Accounting Association, and the Institute of Management Accountants as well as numerous School of Accountancy and MSU committees.

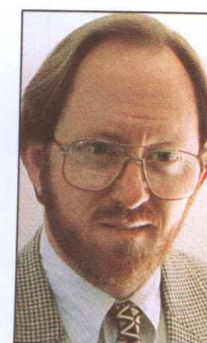
Edward E. Milam, Ph.D., CPA

Dr. Milam is Professor of Accounting at Mississippi State University (MSU). In 1995, the Federation of Schools of Accountancy selected him for its *Outstanding Educator Award*, and he was named Mississippi's 1994 *Educator of the Year* by the Mississippi Society of CPAs. In 1993, he was named the Outstanding Graduate Teacher of the Year in the College of Business and Industry at MSU. Prior to joining the MSU faculty, Dr. Milam served on the accounting faculty at the University of Mississippi from 1971 to 1990. He was chair of the accounting department when the School of Accountancy was established. He became the first dean of the School of Accountancy and during his tenure, the School of Accountancy became 1 of the first 20 schools in the nation to receive separate accounting accreditation. In 1989, he was selected as the Outstanding Teacher in the School of Accountancy at the University of Mississippi. In the fall of 1990, Dr. Milam joined the accounting faculty at MSU and assisted MSU in obtaining separate accounting accreditation. Also at MSU, he has been instrumental in designing, developing, and implementing a graduate program in taxation. Dr. Milam has served as president of the Federation of Schools of Accountancy (FSA), on the Standards Committee of the American Academy of Collegiate Schools of Business (Business and Accounting Accrediting Association), as treasurer/secretary of the American Taxation Association (ATA), on the Mississippi Tax Institute Board of Directors, and on various committees of the ATA, FSA, American Institute of Certified Public Accountants, American Accounting Association, and the Mississippi Society of Certified Public Accountants. He authored numerous articles that appeared in publications including *Journal of Accountancy*, *Taxes*, *Management Accounting*, *Financial Executive*, *Estate Planning*, *Trusts and Estates*, the *CPA Journal*, and others. He also coauthored seven books.



Philip R. Olds, Ph.D., CPA

Professor Olds is Associate Professor of Accounting at Virginia Commonwealth University (VCU) where he has taught since 1981. He serves as the **coordinator of the introduction to accounting courses at VCU**. Professor Olds received his A.S. degree from Brunswick Junior College in Brunswick, Georgia (now Brunswick College). He received a B.B.A. in Accounting, at Georgia Southern College (now Georgia Southern University), and his M.P.A. and Ph.D. degrees are from Georgia State University. After graduating from Georgia Southern, he worked as an auditor with the U.S. Department of Labor in Atlanta, Georgia. A CPA in Virginia, Professor Olds has published articles in various professional journals and presented papers at national and regional conferences. He also served as the faculty adviser to the VCU chapter of Beta Alpha Psi for 5 years. In 1989, he was recognized with an Outstanding Faculty Vice-President Award by the national Beta Alpha Psi organization.



This is a conceptually based/user-oriented book that stresses meaningful learning over rote memorization. More specifically, the text focuses on the relationships between business events and financial statements. **The primary objective is to develop students who can explain how any given business event will affect the income statement, balance sheet, and the statement of cash flows.** Did the event cause assets to increase, decrease, or stay the same? Similarly, what was the effect on liabilities, equity, revenue, expense, gains, losses, net income, and distributions? Furthermore, how did the event affect cash flows? These are the *big picture* relationships that both accounting majors and general business students need to understand to function effectively in the business world. The text contains numerous innovative features that are designed to facilitate the students' comprehension of the *events affect statements* paradigm.

Innovative Features

A Horizontal Financial Statements Model Is the Teaching Platform

A **horizontal financial statements model** replaces the accounting equation as the predominant teaching platform. The model enables students to visualize the simultaneous effects of a single business event on the income statement, balance sheet, and statement of cash flows by arranging the statements horizontally across a single line of text in the following manner:

Assets	=	Liabilities	+	Equity	Revenue	-	Expense	=	Net Income	Cash Flow
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One of the more powerful explanatory features of the horizontal statements model stems from the fact that individual events are recorded directly in financial statements that are visually adjacent to their discussions. Traditionally, a series of events is recorded in accounts and summative information is presented in the statements. Accordingly, students do not observe the **effects of individual events on financial statements**. The horizontal statements model remedies this condition by requiring students to record statement effects transaction by transaction. For example, Event No. 1 in Exhibit 1 demonstrates that the recognition of revenue on account affects the balance sheet and income statement but not the statement of cash flows. These effects are *visibly* isolated from the effects of other events. Accordingly, students can see how a particular event affects the financial statements. The horizontal statements model also provides an effective means for comparing the effects of one transaction with the effects of another transaction. By comparing Event No. 1 with Event No. 2 in Exhibit 1, students can see how the recognition of cash revenue differs from the recognition of

EXHIBIT 1

Financial Statements Model

	Balance Sheet						Income Statement			Cash Statement
Event No.	Assets		=	Liabilities		+ Equity	Rev.	Exp.	= Net Inc.	Cash Flow
	Cash	+ Acct. Rec.	=	Acct. Pay.	+ Con. Cap.	+ Ret. Ear.				
1.	n/a	+ 500	=	n/a	+ n/a	+ 500	500	- n/a	= 500	n/a
2.	500	+ n/a	=	n/a	+ n/a	+ 500	500	- n/a	= 500	500 OA
3.	(800)	+ n/a	=	n/a	+ n/a	+ (800)	n/a	- n/a	= n/a	(800) FA
4.	n/a	+ n/a	=	n/a	+ 800	+ (800)	n/a	- n/a	= n/a	n/a

EXHIBIT 2

Horizontal Statements Models

	Balance Sheet					Income Statement			Cash Statement
	Asset			Equity					
Type	Investment Securities	= Liab.	+	Retained Earnings	+ Unreal. Gain	Rev./ Gain	Exp./ Loss	= Net Inc.	Cash Flow
Held	n/a	n/a	=	n/a	+ n/a	n/a	- n/a	= n/a	n/a
Trading	700	n/a	=	700	+ n/a	700	- n/a	= 700	n/a
Available	700	n/a	=	n/a	+ 700	n/a	- n/a	= n/a	n/a

revenue on account. Similarly, a comparison of Events No. 3 and 4 highlights differences between the effects of cash dividends versus stock dividends. Also, note that students are required to identify cash flows as being financing activities (FA), investing activities (IA), or operating activities (OA) by placing the appropriate letters in the cash statement column.

The horizontal model also can be used to demonstrate how alternative accounting procedures affect financial statements. For example, the recognition of unrealized gains on investment securities affects financial statements differently, depending on whether the securities are classified as (1) held to maturity, (2) trading, or (3) available for sale. Exhibit 2 demonstrates how the recognition of a \$700 unrealized gain affects financial statements under each of the three alternative accounting treatments.

When reviewing the text, you will notice that the statements model is introduced gradually with increasing emphasis after Chapter 3. One of the more destructive forces in the learning process is the temptation to move too far too fast. When you overload the students' ability to understand, they retreat to the safe confines of memorization. The statements model cannot serve as an effective instructional tool until the students have fully grasped the rudiments of the accounting cycle. A student who does not recognize the difference between an expense and a liability is not likely to find the statements model insightful.

Accordingly, the model should be used sparingly until the student gains a thorough understanding of the elements of financial statements and the cyclical nature of the accounting discipline. Thereafter, it constitutes an extremely effective teaching tool with abundant applications.

A Separate Section of Innovative End-of-Chapter Materials Encourages Students to Analyze, Communicate, Think

An innovative *activities* section entitled *Analyze, Communicate, Think (ACT)* has been added to the end of chapter materials. This section is composed of business applications cases, group exercises, writing assignments, ethics cases, Excel spreadsheet applications, and Internet assignments. These *activities* let you decide the appropriate level of emphasis between a user- versus a preparer-oriented approach to accounting education. Furthermore, the material in this section permits you to stress computer applications to the extent you deem appropriate. Although the text is not designed to teach spreadsheet technicalities, Excel problems and exercises do include instructional tips that facilitate the students' ability to use spreadsheets. Spreadsheet problems were created by Linda Bell of William Jewell College.

By focusing on the materials in the ACT section, you can place heavy emphasis on a user orientation or on computer technology. Indeed, you can even teach the course without debits and credits if you are inclined to do so. However, the text includes a healthy supply of problems that require the use of debits and credits, journal entries, T-accounts, and other technical recording procedures. Accordingly, you can emphasize the preparer approach by selectively choosing the end-of-chapter materials that contain traditional requirements. The ACT section of the end-of-chapter materials permits you to emphasize those areas that you consider to be most important for your particular academic environment. An example of an ACT case from Chapter 2 is shown below; and an example of an ACT Excel assignment from Chapter 5 is shown on the following page.

ACT 2-3



REAL-WORLD CASE Unusual Types of Liabilities

In the liabilities section of its 1997 balance sheet, First Union Corporation reported "non-interest-bearing deposits" of almost \$22 billion. First Union is a very large banking company. In the liabilities section of its 1997 balance sheet, Newmont Mining Corporation reported "reclamation and remediation liabilities" of almost \$89 million. Newmont Mining is involved in gold mining and refining activities. In the accrued liabilities reported on its 1997 balance sheet, Phillips Petroleum Company included \$83 million for "environmental accruals."

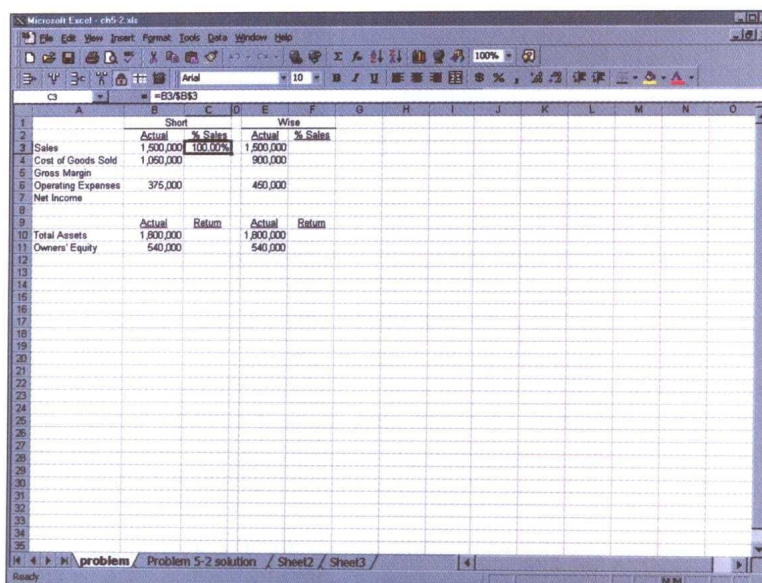
Required

- a. For each of the preceding liabilities, write a brief explanation of what you believe the nature of the liability to be and how the company will pay off the liability. To develop your answers, think about the nature of the industry in which each of the companies operates.
- b. Of the three liabilities described, which do you think poses the most risk for the company? In other words, which liability is likely to have actual cost that exceed the reported cost shown on the balance sheet? Uncertainty creates risk.

ACT 5-10

SPREADSHEET ANALYSIS Mastery of Excel

At the end of 20X4, the following information is available for Short and Wise Companies:



	Short		Wise	
	Actual	% Sales	Actual	% Sales
Sales	1,500,000	100.00%	1,500,000	
Cost of Goods Sold	1,050,000		900,000	
Gross Margin				
Operating Expenses	375,000		450,000	
Net Income				
Total Assets	1,500,000		1,500,000	
Owners' Equity	540,000		540,000	

Required

- Set up the spreadsheet shown here. Complete the income statements by using Excel formulas.
- Prepare a common size financial statement for each company by completing the % Sales columns.

A variety of writing, group, technology, and ethics assignments are included. These problems are marked appropriately for easy identification.



Writing



Group



Technology



Ethics

Financial Statement Effects Are Demonstrated over Multiple Accounting Cycles

The text also employs the use of a **vertical statements model**, which presents the statements in an upright pattern from the top to the bottom of the page. The income statement is presented first, the balance sheet directly below the income statement; and the statement of cash flows directly below the balance sheet. Financial data for a sequence of accounting cycles are displayed in adjacent columns. An example of a vertical statements model from Chapter 9 is shown on the following page.

EXHIBIT 9-5					
Financial Statements under Double-Declining Balance Depreciation					
DRYDEN ENTERPRISES Financial Statements					
Income Statements					
	20X1	20X2	20X3	20X4	20X5
Rent Revenue	\$15,000	\$ 9,000	\$ 5,000	\$ 3,000	\$ 0
Depreciation Expense	(12,000)	(6,000)	(2,000)	0	0
Operating Income	3,000	3,000	3,000	3,000	0
Gain	0	0	0	0	500
Net Income	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 500
Balance Sheets					
Assets					
Cash	\$16,000	\$25,000	\$30,000	\$33,000	\$37,500
Van	24,000	24,000	24,000	24,000	0
Accumulated Depreciation	(12,000)	(18,000)	(20,000)	(20,000)	0
Total Assets	\$28,000	\$31,000	\$34,000	\$37,000	\$37,500
Equity					
Contributed Capital	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000
Retained Earnings	3,000	6,000	9,000	12,000	12,500
Total Equity	\$28,000	\$31,000	\$34,000	\$37,000	\$37,500
Statements of Cash Flows					
Operating Activities					
Inflow from Customers	\$15,000	\$ 9,000	\$ 5,000	\$ 3,000	\$ 0
Investing Activities					
Outflow to Purchase Van	(24,000)				
Inflow from Sale of Van					4,500
Financing Activities					
Inflow from Capital Acquisition	25,000				
Net Change in Cash	16,000	9,000	5,000	3,000	4,500
Beginning Cash Balance	0	16,000	25,000	30,000	33,000
Ending Cash Balance	\$16,000	\$25,000	\$30,000	\$33,000	\$37,500

The vertical statements model enables the instructor to link related events **over multiple accounting cycles**. A student can see how expense recognition is spread over an asset's useful life. Furthermore, since a full set of statements is presented on a single page, the student can visually contrast expense recognition with cash flow. Similarly, the vertical statements model enables a student to observe the multicycle effects of accumulating depreciation or amortizing a bond discount. An important difference between a vertical statements model and the traditional comparative financial statements is that the vertical statements model is presented in a simplified form on a single page of paper. Students cannot comprehend the linkage between financial statements as easily when the statements and/or accounting periods are shown on separate pages.

The statements models are presented for instructional purposes. They are very helpful in understanding how accounting events affect financial statements.

Accordingly, statements models are used extensively in this text. Notice, however, that the models are not intended to represent the formal presentation formats that appear in annual reports. For example, although a full set of four financial statements is normally presented in published financial statements, the horizontal model shows only a partial set of statements. Similarly, the vertical instructional model may vary in form and content, depending on the learning task. Since the statements are presented in aggregate, the description of dates (i.e., “as of” versus “for the period ended”) cannot be used to distinguish periodic from cumulative data. When using this text, keep in mind that statement models are intended to facilitate learning tasks. They do not conform to the detailed requirements of formal reporting practices.

Effects of Cash Flows Are Shown throughout the Entire Text

Coverage of the statement of cash flows begins in the first chapter and continues throughout the text. Students can be taught to prepare a statement of cash flows in the first chapter of an introductory accounting text by having them analyze the Cash account. When the Cash account is used as the data source, preparing a statement of cash flows is simply a matter of learning how to classify events as operating, investing, or financing activities. The easy to use classification scheme is summarized in Exhibit 1-4 which is shown below. This approach provides a logical learning environment that facilitates an understanding of the essential differences between cash flow and accrual-based income. More complicated topics such as the indirect method and a T-account approach for the conversion of accruals to cash are covered in a separate chapter at the end of the text.

EXHIBIT 1-4			
Classification Scheme for Cash Inflows and Outflows			
	Type of Activity		
	Financing	Investing	Operating
Cash Inflows from	(1) Creditors (2) Owners	(1) Sale of Long-Term Assets* (2) Collections of Loans	(1) Collections of Revenue
Cash Outflows for	(1) Repayment of Debt (2) Distributions to Owners	(1) Purchase of Long-Term Assets* (2) Loans to Debtors	(1) Payments for Expenses

*Long-term assets include productive assets and long-term investments in the equity of other companies.

Accounting Concepts Are Introduced in a Logical Stepwise Fashion

Students are confused when too many new concepts are introduced simultaneously. Most books overwhelm students by introducing cash, accrual, and deferral events in the first chapter. This text introduces these components in a logical stepwise manner. Cash transactions are discussed in Chapter 1. Accruals are introduced in Chapter 2, and deferrals are covered in Chapter 3. Nontechnical terminology (i.e., increase/decrease) is used to discuss the effects of events on the elements of financial statements in the first three chapters of the text. Recording

procedures including debits and credits are demonstrated in Chapter 4. Accordingly, technical details are delayed until students have grasped the *big picture* relationships associated with articulating financial statements.

An Appropriate Balance between Theory and Practice Is Maintained

A conceptual foundation enables students to think instead of memorize. Students who understand concepts are better able to communicate ideas and are more effective at solving unstructured problems. Accordingly, **this text addresses the issues raised by the Accounting Education Change Commission**. It is important to note, however, that the call for change in accounting education is not a call for the abandonment of technical competence. Instead, the enhancement of communication and thinking skills must accompany technical proficiency. Practicing accountants continue to book transactions, and real-world communication requires nonaccountants to possess an adequate technical vocabulary. Although the coverage of recording procedures has been significantly curtailed, it has not been eliminated. We continue to cover the basic components of double-entry bookkeeping including debits and credits, journal entries, T-accounts, and trial balances. Accordingly, **it is not necessary to change your intermediate accounting course if you adopt this book**. Indeed, users of previous editions have consistently reported that their students are better prepared for intermediate accounting than they were under the traditional approach. This edition of the text continues to maintain the delicate balance between enhanced relevance and technical competence.

Business Transactions Are Classified into Four Logical Categories

Instead of attempting to memorize transactions, students learn to identify events as belonging to one of four conceptual categories. More specifically, students learn to classify transactions as being (1) asset sources, (2) asset uses, (3) asset exchanges, or (4) claims exchanges. This classification approach encourages students to think about the effects of events rather than to memorize recording procedures.

A Consistent Point of Reference Is Provided

Do you ever wonder why good students sometimes have so much trouble grasping the simplest concepts? For example, why do so many students have difficulty distinguishing the effects of an owner investment from those of a business investment? A participant in a recent introductory accounting workshop provided the answer that enabled us to avoid a common pitfall that needlessly confuses so many students. Normally, accounting events are described from the perspective of the business entity. For example, we say that the business borrowed money, purchased assets, earned revenue, or incurred expenses. For some unknown reason, however, we usually shift the point of reference when we

speak of equity transactions. We say that the owners contributed capital, provided cash, or invested assets in the business. From the perspective of the business, these are capital acquisitions, not owner investments. To understand how this *reference shift* affects the entry-level accounting student, try it on a different type of transaction. Suppose that we say, "A customer purchased services from the business." What kind of transaction is this? It is a revenue transaction, of course. How about "a supplier provides services to the business?" This is just a more confusing way of saying the business incurred an expense. Likewise, an owner investment is just a more confusing way of saying the business acquired assets from the owner. Your students will certainly appreciate the fact that this text uses the business entity as a consistent point of reference in the description of all accounting events. We steadfastly use the term *capital acquisition* rather than *owner investment* when describing equity events.

Content That Is Manageable and Relevant Has Been Maintained

Accounting is a dynamic discipline. It changes to reflect new and emerging business practices. As academicians, we are certainly obligated to keep current and to introduce our students to the latest developments. As teachers, however, we must also recognize the limited ability of our students to meaningfully process an ever increasing supply of information. **Remember that information overload equals memorization.** Although we have found it necessary to add new material, we determined that eliminating the older, less relevant subject matter is equally important. The first editions of our text made real progress toward the elimination of alternative recording procedures, meaningless details, and subject matter that is too advanced for introductory accounting students. Like its predecessors, the new edition contains only 12 chapters.

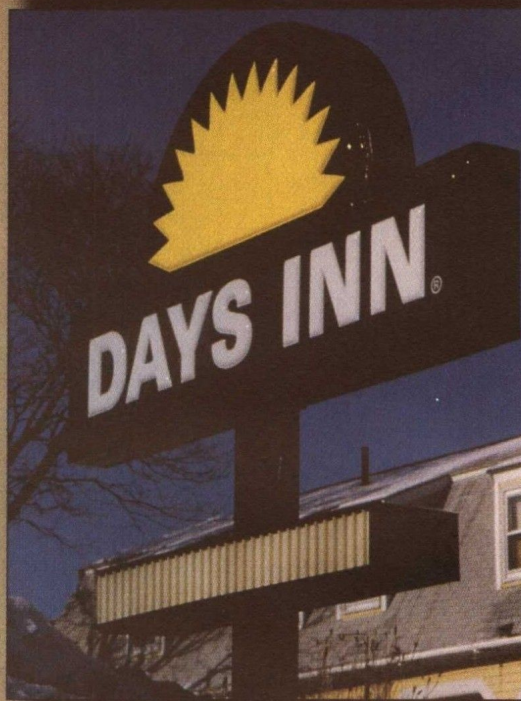
Stimulating Student Interest

A good textbook must be more than pedagogically sound. It must be designed in a manner that motivates student interest. Toward this end, we have added several features that highlight real-world applications. Each chapter of the revised text opens with a sidebar entitled **The Curious Accountant**. The sidebar poses a question regarding a real-world accounting issue. The question is answered in a separate sidebar located a few pages after the question. Pictures that stimulate interest are attached to each sidebar. An example of the Curious Accountant feature is shown on the following two pages. The new edition contains other real-world features such as actual financial statements, footnote quotations, and management analyses drawn from the **annual reports of well-known companies**. Most chapters now contain a sidebar that discusses interesting **international accounting issues**. In addition, most chapters include colorful graphs that provide summary facts about financial reporting. The data source for these graphs is the AICPA's source book *Accounting Trends and Techniques*. Finally, the end-of-chapter material includes real-world cases requiring the use of the **World Wide Web**.

the curious accountant

In 1997 CUC and HFS merged to form Cendant Corporation. Cendant operates numerous businesses in different industries, including Avis rental cars, Century 21 Real Estate, and Days Inn. Its businesses also include discount shopping and travel clubs.

On April 15, 1998, the company announced that earnings of the then combined companies had been overstated during the prior three years. At that time, it estimated that 1997 net income would need to be restated downward by \$100 to \$115 million. In July, the company reported that nonexistent revenues had been recorded from 1995 to 1997 for an estimated \$300 million; by September, this estimate had increased to \$500 million. After a thorough review of its accounting records, Cendant revised its 1997 earnings downward by approximately \$272.6 million; what had originally been reported as \$55.4 million of net income became \$217.2 million of net loss. Within six months of the initial disclosure of accounting irregularities, the price of Cendant's stock had declined by approximately 75% of its previous value. How could the accounting system at such a large and sophisticated company allow such large misstatements of revenues and earnings?



©Tom Pantages

The successful operation of a business enterprise requires control. How can upper management of a major retailer such as Wal-Mart know that all its stores will open at a certain time? How can the president of General Motors rest assured that the numbers in the company's financial reports accurately reflect the company's operating activities? How can the owner of a small restaurant be confident that the wait staff is not

giving food to friends and relatives? The answer to each of these questions is "by exercising effective control over the enterprise." The policies and procedures used to provide *reasonable assurance* that the objectives of an enterprise will be accomplished are called **internal controls**.¹

Internal controls can be divided into two categories: accounting controls and administrative controls. **Accounting**

controls are composed of procedures designed to safeguard the assets and ensure that the accounting records contain reliable information. **Administrative controls** concern the evaluation of performance and the assessment of the degree of compliance with company policies and public laws.

¹AICPA Professional Standards, vol. 1, sec. 320, par. 6 (June 1, 1989).

an answer for the curious accountant

Based on the company's public disclosures, many inappropriate accounting practices were used at the CUC portion of Cendant Corporation. On October 15, 1998, Henry R. Silverman, CEO of Cendant, was interviewed on CNN. When he was asked how the fraudulent activities were not detected before the merger of the two companies was finalized, he responded, "Our financial system is based on trust. . . . We have to rely upon, really, the honor system. . . . Our system is very vulnerable to fraud because it is based on trust. . . . We can't do . . . polygraphs of every management that you happen to do business with. . . ."

Perhaps some or all of the irregularities at CUC and Cendant should have been detected earlier

by the companies' internal controls and/or independent auditors; the courts will answer those questions ultimately. Nevertheless, Mr. Silverman's answer has a certain degree of truth. No system of internal controls can prevent all fraud from occurring if several members of management decide to work together to circumvent those controls.

If you wish to read a detailed report by Cendant's audit committee regarding these matters, using EDGAR, download Cendant's 8-K report that was filed with the SEC on August 28, 1998. Instructions for using EDGAR are contained in Appendix A of this book.

Financial ratios introduced throughout the book are logically related to the chapter material. For example, accounts receivable turnover is introduced in the chapter that covers bad debts, and the times-interest-earned ratio is discussed in the bonds chapter. Industry data are shown to provide students with a basis for establishing a sense of normalcy regarding business practice. The 1997 annual report for Gateway 2000 is included in Appendix B, and the "Analyze, Communicate, Think" section that relates directly to the annual report are in the end-of-chapter material.

Supplemental Materials

The text is supported by a complete package of supplements. **Rather than farming the supplements out, we have prepared these materials ourselves.** Accordingly, you can rest assured that the supplements match the text. The package includes the following items.

Instructors' Guide: Prepared by Thomas P. Edmonds (ISBN 0-07-229907-X)

The text is suitable to new teaching approaches such as group dynamics and active pedagogy. The Instructors' Guide provides step-by-step, explicit instructions as to how the text can be used to implement these alternative teaching methodologies. Guidance is also provided for instructors who choose to use the

traditional lecture method. The guide includes lesson plans and demonstration problems with student work papers, and solutions for them.

Solutions Manual: Prepared by Edmonds, McNair, Milam, and Olds (ISBN 0-07-229908-8)

The Solutions Manual has been prepared by the authors and contains complete answers to all questions, exercises, problems, and cases. The manual has been tested using a variety of quality control procedures to ensure accuracy. After the initial preparation of the *solutions*, the problems and exercises were reworked "blind." An independent reviewer then compared the second set of answers with the previous solutions. Any differences were reconciled. After this process, the solutions manual was again proofed and checked for accuracy by two independent error checkers including Barbara Schnathorst of the Write Solution, Inc., and Bruce Duckworth of the University of Wisconsin-Baraboo. Although the author team retains the responsibility for any errors that may occur, we express our appreciation for the individuals who have exhibited a zero tolerance attitude that is required to maintain the highest standards of excellence.

Check Figures (ISBN 0-07-234389-3)

Check figures are available for selected exercises and problems.

Annotated Instructor's Edition (ISBN 0-07-232804-5)

New marginal annotations provide additional support for instructors, including Teaching Strategies, Real-World References, Key Concepts, and suggestions for additional group and communications activities. Annotations were created by Philip R. Olds, Eric Carlsen (Kean University), and Kathleen Sevigny (Bridgewater State College).

Working Papers: Prepared by Frances M. McNair and Edward E. Milam (ISBN 0-07-229904-5)

The working papers provide forms that are useful in the completion of both exercises and problems. Working papers for the exercises provide headings and pre-recorded example transactions that enable students to get started quickly and to work in an efficient manner. The forms provided for the problems can be used with either series A or B problems.

Solutions Transparencies: Prepared by Frances M. McNair and Edward E. Milam (ISBN 0-07-229909-6)

Transparencies are prepared in easy-to-read 14-point bold type. They are mirror images of the answers provided in the solutions manual and are consistent with the forms contained in the working papers. This ensures congruence between your in-class presentations and the follow-up exposure that students attain when they view the solutions manual or use the working papers.

Test Bank: Prepared by Thomas P. Edmonds, Cindy D. Edmonds, Bor-Yi Tsay, Alan Falcon (Loyola Marymount University), John Marts (North Carolina at Wilmington), and David L. Davis (Tallahassee Community College)
(ISBN 0-07-229910-X)

The Test Bank has been significantly revised and expanded. It includes true/false, multiple-choice, and short discussion questions as well as open-ended problems. The testing material is coded by learning objective and level of difficulty.

Computest (ISBN 0-07-234390-7)

A computerized version of the test bank for more efficient use is available in a Windows platform.

Teletest

By calling a toll-free number, users can specify the content of exams and have a laser-printed copy of the exams mailed to them.

Study Guide: Prepared by Philip R. Olds (ISBN 0-07-229906-1)

Each chapter of the Study Guide includes a review and an explanation of the chapter's learning objectives, as well as multiple-choice problems and short exercises. Unique to this Study Guide is a series of articulation problems that require students to indicate how accounting events affect (i.e., increase, decrease, no effect) the elements of financial statements. They not only reinforce the student's understanding of how events affect statements but also help them to understand how the income statement, balance sheet, and statement of cash flows interrelate. The guide contains approximately 200 pages and includes appropriate working papers and a complete set of solutions.

Computerized Practice Problem: *Broadway Babies, Inc.*: Prepared by Thomas P. Edmonds and Bor-Yi Tsay (ISBN 0-07-844325-3)

Broadway Babies, Inc., is a computerized practice problem. Beginning account balances are presented in a trial balance. Students record accounting events including appropriate *adjusting* entries in general journal format. The software program automatically updates the beginning balances and provides students with an adjusted trial balance. Students use the adjusted trial balance to manually prepare a complete set of financial statements. The software is a DOS-based program designed to operate on IBM-compatible systems using DOS versions of 3.0 or higher.

Manual Practice Problem: *Mark's Racquets, Inc.*: Prepared by Cindy D. Edmonds (ISBN 0-07-021399-2)

Mark's Racquets, Inc., is a manual practice problem that can be introduced approximately two-thirds of the way through the course. Students record accounting events in general journal format and post transaction data to running balance general ledger accounts. They prepare unadjusted, adjusted, and post-closing trial