



FOURTH EDITION

# ACCOUNTING

What the Numbers Mean

DAVID H. MARSHALL • WAYNE W. MCMANUS

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EDITION**

# Accounting

What the Numbers Mean

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In loving memory of  
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1973–1998

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### **ACCOUNTING: WHAT THE NUMBERS MEAN**

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# Preface

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The word *accounting* most often conjures up images of tedious figures, thick glasses, and headaches. However, the savvy businessperson realizes that accounting has come to be known as the *language of business* with good reason. Accounting conveys important financial information that is used in the management planning, control, and decision-making processes integral to achieving organizational objectives. Some command of this language is a necessity for those who wish to participate in these processes.

This text takes the reader through the basics: what accounting information is, what it means, and how it is used. Students examine financial statements and discover what they do and do not communicate. This knowledge will help them gain the decision-making and problem-solving abilities so crucial outside the academic environment. In short, this text is for the benefit of the many who simply want to know “what the numbers mean.”

In 1989 the Accounting Education Change Commission was formed “to foster changes in the academic preparation of accountants consistent with the goal of improving their capabilities for successful professional careers.” In Position Statement No. Two, “The First Course in Accounting,” (June 1992) the commission stated:

The primary objective of the first course in accounting is for students to learn about accounting as an information development and communication function that supports economic decision-making. The knowledge and skills provided by the first course in accounting should facilitate subsequent learning even if the student takes no additional academic work in accounting or directly related disciplines. For example, the course should help students perform financial analysis; derive information for personal or organizational decisions; and understand business, governmental, and other organizational entities.<sup>1</sup>

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<sup>1</sup>Accounting Education Change Commission, Position Statement No. Two, “The First Course in Accounting” (Torrance, CA, 1992), p. 2.

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## Business Majors and Non-Business Majors

We believe that this text permits students to achieve this objective. Typical undergraduate business students are required to complete two entry-level accounting courses covering topics in financial and managerial accounting. The authors of this text believe that over the years, many of the textbooks used in those courses have become increasingly encyclopedic. The result has been the teaching of a great deal of accounting detail without having students obtain a “big picture” of financial statement and accounting information use. One of the objectives of this text is to provide that “big picture” while meeting the objective for a first course in accounting identified by the Accounting Education Change Commission. When supplemented with appropriate cases and other materials, this text can be used in both the financial accounting and managerial accounting entry-level courses taken by undergraduate business majors. Students who intend to pursue an accounting major will also have to learn the procedures of accounting, which can be taught in courses or with laboratory cases (e.g., practice sets) designed for those students. The majority of students in the entry-level courses will not become accounting majors. This text is aimed at helping them learn how to become effective users of accounting information while providing a solid foundation for those students who will pursue advanced study in accounting.

Many students whose academic interests are not in the business field can also benefit from exposure to accounting. These students, however, often have a restricted curriculum and may simply not be interested in investing two elective courses in acquiring some basic accounting tools. The structure of this text lends itself to a one-semester course that provides a basic understanding of accounting information. Students who could benefit from this approach include undergraduate majors in the following areas:

- Engineering
- Behavioral sciences
- Public administration
- Prelaw programs

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## MBA Students

Professionals in any of these broad disciplines are likely to be confronted with financial management issues early in their careers. In fact, accounting issues are likely to touch the majority of career paths open to a student today. MBA students who do not have a background in undergraduate business study or feel the need for a refresher course can use this text to gain or revive certain key business skills.

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## Organization and Approach

Chapter 1 presents a basic description of accounting and its evolution. Emphasis is placed on developments that have occurred to meet the needs of



the users of accounting information and on dispelling the misconception that accounting standards are just a code of rules. The remainder of the text is divided into two major topic areas: financial accounting topics (Chapters 2 through 11) and managerial accounting topics (Chapters 12 through 16).

In presenting these two aspects of accounting, the **spiral approach** is used. In this teaching method, a general sketch is presented, and each chapter fills in a few of the finishing details until the reader possesses the full picture. The spiral approach is based on the belief that students can better navigate a subject matter if they are given a glimpse of the big picture first. Thus the objectives of the course are clear from the beginning, and the student can keep them in sight throughout the learning process.

Following this model, the first chapter of each section outlines the pertinent fundamental relationships and presents appropriate terminology so the student is given an overview before exposure to details. In the following chapters, the fundamentals are elaborated and developed until the picture is sufficiently fleshed out. The focus throughout the presentation is on understanding the meaning of the numbers in financial statements, their relationship to each other, and how they are used in evaluation, planning, and control. In taking the spiral approach, an instructor focuses on the function, not the formation, of the financial statements.

### ***Highlights and Enhancements in This Edition***

In this edition, every effort has been made to retain the straightforward style that has been a popular feature of prior editions. Wherever possible, technical details are avoided as a financial statement user approach is emphasized. End-of-chapter problem materials have been expanded and revised.

- **Chapter 1**—Two new Business in Practice boxes added; topics are Career Opportunities in Accounting and Business Ethics.

FASB Conceptual Framework section reworked, with a plain English explanation in the text and with quotes from the highlights in an exhibit.

The financial accounting portion (Chapters 2 through 11):

- **Chapter 2**—Getting the big picture.

A model of the accounting process and the role of financial statements. The introduction of a schematic diagram that illustrates the interrelationship of various financial statements and facilitates understanding the effects of various transactions.

- **Chapter 3**—Introducing basic concepts.

Return on investment.

Return on equity.

Liquidity.

- **Chapter 4**—Understanding the method.

The bookkeeping system in general terms.

A powerful transaction analysis scheme featuring the “horizontal model,” which builds on the schematic diagram presented in Chapter 2.

Introduction of journal entries and T-accounts with emphasis on the horizontal model as the way to understand the effect of transactions on the balance sheet and income statement.

A new Business in Practice box about computerized bookkeeping systems.

- **Chapters 5 through 10**—Examining the specifics.

The elements of the balance sheet, income statement, and statement of cash flows in relation to the schematic diagram.

The *unique* and valuable explication of Explanatory Notes in Chapter 10, crucial to understanding financial statements as a whole.

Knowledge of business practices as a foundation for an understanding of accounting for transactions.

A rewrite of the Business in Practice box about Internal Control in Chapter 5.

A new section about payroll taxes and other withholdings in Chapter 7.

A new section describing owners’ equity for organizations other than corporations in Chapter 8.

A rewrite of the section about earnings per share reflecting FASB 128 in Chapter 9, updated with references to “Notes to the Consolidated Financial Statements” of Intel Corporation’s annual report, and an expanded discussion of pension-related disclosures in Chapter 10.

- **Chapter 11**—Using the knowledge.

Financial statement analysis: from financial data to decision making.

Revised and updated coverage of the price/earning ratio, and expanded discussion of common size financial statements to include both vertical and horizontal analysis. Several new application-oriented problems added to the end of chapter materials.

The managerial accounting portion (Chapters 12–16):

- **Chapter 12**—Getting the big picture.

An introduction to cost accounting systems and cost classifications.

Diagrams of cost flow, cost systems, and cost behavior.

Exhibit 12–7 (Income Statement) added to the discussion of cost accounting systems to help students understand the link between financial and managerial accounting. New problem materials with income statement requirements were added to complement this addition.

- **Chapters 13 through 16**—Examining the specifics and putting them to use.

An in-depth look at the specific uses of cost data in the planning, control, and decision-making processes.

The relationship between cost data and other factors involved in these processes.

The operating leverage material moved to the end of Chapter 13 and problem materials highlighting the effects of operating leverage on a firm's operating income added.

Substantial revisions to the end-of-chapter materials made in Chapter 14, including the addition of comprehensive cash budgeting problems (14-11 and 14-12) and integrated sales/purchases/cash budgeting problems (14-13 and 14-14).

In Chapter 15, new references made to alternative measurement approaches to developing "standards" in both manufacturing and non-manufacturing environments, including organizational goals related to continual improvement, increased throughput, and reduced downtime.

In Chapter 16, a challenging case study using net present value analysis added to the problem materials (16-13) to emphasize the importance of professional judgment in the capital budgeting process.

## Notable Features

### Text

- **Business in Practice** boxes are used throughout the chapters to highlight and discuss various business practices and their financial statement impact. Understanding these business practices facilitates a more complete understanding of financial statements in general.
- **Learning Objectives** guide students conceptually by providing a framework for each chapter. In addition to being stated at the beginning of each chapter, each learning objective is shown in the margin at the beginning of the text material that relates to it.
- **What Does It Mean** questions that permit the student to self-test her understanding of key points are presented at the end of related sections of each chapter. The answers are presented near the end of each chapter before the Exercises and Problems.
- **Chapter Summaries and Key Terms and Concepts** promote greater retention of important points and definitions.
- **The 1996 Annual Report of Intel Corporation** is presented in the Appendix. Frequent reference to this material is made in the financial accounting portion of the text. This real-world example piques student interest and gives students a hands-on experience. In addition, students are asked to obtain their own example of an actual annual report.
- **Updated End-of-Chapter Exercises and Problems** illustrate important concepts and applications. Problems that require the use of Intel Corporation financial statements and other financial information from the Appendix are identified with the Intel name shown here in the margin. The writing assignment logo, also shown in the margin, identifies questions requiring written answers.



**Intel**



### Supplements

The supplements were prepared by the textbook authors.



### For the Student

- **Study Guide and Working Papers** for student use includes several hundred matching, true/false, and multiple-choice review questions with annotated answers, and working papers laid out for all problems.
- **Student Supplement: Study Outlines, Solutions to Odd-Numbered Problems, and Ready Notes.** (Shrink-wrapped with text.) Study Outlines are copies of the Teaching Acetates (transparency masters), with space for students to take class notes. Solutions are provided for all odd-numbered problems. Even-numbered problems are usually similar to the preceding odd-numbered problem. Having the full solution (not just a check figure) of the preceding problem available as a model provides additional examples beyond those in the text, reinforces learning, minimizes frustration, and facilitates the use of the text as self-study or Continuing Professional Educational resource. Ready Notes are copies of the Ready Shows (PowerPoint® slides) with space for students to take notes.

### For the Instructor

- **Instructor's Manual, Solutions and Test Bank** featuring teaching/learning objectives, chapter outlines, teaching observations, exercise and problem solutions, quiz/exam questions, and take-home quizzes.
- **Teaching Acetates** provide instructors with a framework for chapter-by-chapter discussions. Some are figures lifted from the text, others simply organize the material under discussion.
- **Ready Shows**, prepared by Douglas Cloud of Pepperdine University, is a package of multimedia enhancement aids that uses PowerPoint® software to illustrate chapter concepts.
- **CompuTest**, an advanced-feature test generator, allows the user to add and edit questions; save and reload tests; create up to 99 different versions of each test; attach graphics to questions; import and export ASCII files; and select questions based on type, level of difficulty, or keyword. This software provides password protection of saved tests and question databases, and can run on a network.
- A **World Wide Web** site for this text is at <http://www.mhhe.com/business/accounting/marshall>. Instructors and students are encouraged to visit this site and others for text updates and other information that may be helpful to both the teacher and students.




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### Additional Notes from the Authors

In this text, we have followed a pragmatic approach in explaining the information content and use of financial statements and financial data. Students should be encouraged to read *The Wall Street Journal* and other business publications regularly, and instructors should attempt to call students' attention to current developments relating to the course material.

In several places in the text, reference is made to World Wide Web sites, which students are encouraged to visit. Instructors are encouraged to suggest that students use this medium to reference real-world illustrations of the concepts presented in the text.

Users of the text are cautioned that accounting is not a spectator sport and that comprehension of the material does require actually working through the problems. Reviewing solutions to odd-numbered problems that are in the Student Supplement without first attempting the problems will significantly dilute the learning process.

We hope the approach and scope of coverage in this text have achieved the previously identified objectives and, in addition, have filled the user's need. Any ideas for increasing the effectiveness of this text are welcome.

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## Acknowledgments

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 three editions—both teachers and students—have offered comments and constructive criticisms that have been encouraging and helpful. All of this input is greatly appreciated.

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