

高等院校双语教学适用教材·会计

第九版
Ninth Edition

财务会计

Introduction to Financial Accounting

Charles T. Horngren Gary L. Sundem John A. Elliott Donna R. Philbrick

〔美〕

查尔斯·T. 霍恩格伦

加利·L. 桑顿

约翰·A. 埃里奥特

唐娜·R. 菲尔布里克

著



东北财经大学出版社
Dongbei University of Finance & Economics Press

PEARSON
Prentice
Hall

高等院校双语教学适用教材·会计

财务会计

(第九版)

Introduction

ial Accounting

Charles T. Horngren Gary L. Sundem John A. Elliott Donna R. Philbrick

【美】

查尔斯·T. 霍恩格伦

加利·L. 桑顿

约翰·A. 埃里奥特

唐娜·R. 菲尔布里克

著



东北财经大学出版社
Dongbei University of Finance & Economics Press



© 东北财经大学出版社 2005

图书在版编目 (CIP) 数据

财务会计 (第九版) / (美) 霍恩格伦 (Horngren, C. T.) 等著; 一大连: 东北财经大学出版社, 2005. 12

(高等院校双语教学适用教材·会计)

书名原文: Introduction to Financial Accounting

ISBN 7-81084-716-3

I. 财… II. 霍 III. 财务会计—双语教学—高等学校—教材—英文 IV. F234.4

中国版本图书馆 CIP 数据核字 (2005) 第 090754 号

辽宁省版权局著作权合同登记号: 图字 06-2005-139 号

Charles T. Horngren, Gary L. Sundem, John A. Elliott, Donna R. Philbrick: Introduction to Financial Accounting, Ninth Edition

Original edition, entitled INTRODUCTION TO FINANCIAL ACCOUNTING, 9th Edition, 0131479725 by HORNGREN, CHARLES T.; SUNDEM, GARY L.; ELLIOTT, JOHN A.; PHILBRICK, DONNA, published by Pearson Education, Inc., publishing as Prentice Hall, Copyright © 2006, 2002 by Pearson Education, Inc., Upper Saddle River, New Jersey, 07458. Pearson Prentice Hall.

All rights reserved. No part of this book may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording or by any information storage retrieval system, without permission from Pearson Education, Inc.

China Adapted edition published by PEARSON EDUCATION ASIA LTD. and DONGBEI UNIVERSITY OF FINANCE & ECONOMICS PRESS Copyright © 2005.

This Adapted edition is manufactured in the People's Republic of China, and is authorized for sale only in the People's Republic of China excluding Hong Kong and Macau.

本书英文改编版由培生教育出版集团授权东北财经大学出版社独家出版发行。此版本仅限在中华人民共和国境内 (不包括中国香港、澳门特别行政区及中国台湾) 销售。未经出版者预先书面许可, 不得以任何方式复制或发行本书的任何部分。

版权所有, 侵权必究。

本书封底贴有 Pearson Education 培生教育出版集团防伪标签, 无标签者不得销售。

东北财经大学出版社出版
(大连市黑石礁尖山街 217 号 邮政编码 116025)

总编室: (0411) 84710523

营销部: (0411) 84710711

网址: <http://www.dufep.cn>

读者信箱: dufep@dufe.edu.cn

东北财经大学印刷厂印刷 东北财经大学出版社发行

幅面尺寸: 190mm × 246mm
2005 年 12 月第 1 版

印张: 30 插页: 1
2005 年 12 月第 1 次印刷

策 划: 方红星 高 鹏
封面设计: 冀贵收

责任编辑: 李智慧
责任校对: 孙冰洁

定价: 45.00 元

出版者的话

当前,在教育部的大力倡导下,财经和管理类专业的双语教学在我国各大高校已经逐步开展起来。一些双语教学开展较早的院校积累了丰富的经验,同时也发现了教学过程中存在的一些问题,尤其对教材提出了更高的要求;一些尚未进入这一领域的院校,也在不断探索适于自身的教学方式和方法以及适用的教材,以期时机成熟时加入双语教学的行列。总之,对各类院校而言,能否找到“适用”的教材都成为双语教学成功与否的关键因素之一。

然而,国外原版教材为国外教学量身定做的一些特点,如普遍篇幅较大、侧重于描述性讲解、辅助材料(如习题、案例、延伸阅读材料等)繁杂,尤其是许多内容针对性太强,与所在国的法律结构和经济、文化背景结合过于紧密等,却显然不适于国内教学采用,并成为制约国内双语教学开展的重要原因。因此,对国外原版教材进行本土化的精简改编,使之变成更加“适用”的双语教材,已然迫在眉睫。

东北财经大学出版社作为国内较早涉足引进版教材的一家专业出版社,秉承自己一贯服务于财经教学的宗旨,总结自身多年的出版经验,同培生教育出版集团和汤姆森学习出版集团等国外著名出版公司通力合作,在国内再次领先推出了会计、工商管理、经济学等专业的“高等院校双语教学适用教材”。这套丛书的出版经过了长时间的酝酿和筛选,编选人员本着“品质优先、首推名作”的选题原则,既考虑了目前我国财经教育的现状,也考虑了我国财经高等教育所具有的学科特点和需求指向,在教材的遴选、改编和出版上突出了以下一些特点:

- 优选权威的最新版本。入选改编的教材是在国际上多次再版的经典之作的最新版本,其中有些教材的以前版本已在国内部分高校中进行了试用,获得了一致的好评。
- 改编后的教材在保持英文原版教材特色的基础上,力求内容精要,逻辑严密,适合中国的双语教学。选择的改编人员既熟悉原版教材内容,又具有本书或本门课程双语教学的经验。
- 改编后的教材配有丰富的辅助教学支持资源,教师可在网上免费获取。
- 改编后的教材篇幅合理,符合国内教学的课时要求,价格相对较低。

本套教材是在双语教学教材出版方面的一次新的尝试。我们在选书、改编及出版的过程中得到了国内许多高校的专家、教师的支持和指导,在此深表谢意,也期待广大读者提出宝贵的意见和建议。

尽管我们在改编的过程中已加以注意,但由于各教材的作者所处的政治、经济和文化背景不同,书中的内容仍可能有不妥之处,望读者在阅读中注意比较和甄别。

导 读

《财务会计》(第九版)通过强调使用和分析财务报表提供的信息,论述最为通行的会计理论和实务。

本书的理念

本书的理念是先介绍简单的概念,在学生能够理解的前提下再介绍更为复杂的概念,并且在每个阶段为学生提供恰当而且真实的公司案例。本书的目标是让学生们具备理解和解释现实企业资产负债表、利润表和现金流量表等财务报表的能力。

本书要求学生将会计作为提高他们对经济事件理解力的一个工具。学生们不能孤立地去理解财务报表。相反,他们必须在企业的具体商业环境中去认识所有这些财务报表。他们有必要理解资产负债表和利润报表所反映的应计制会计,但他们同样必须了解现金流量表所反映的现金的重要性。本书在前5章演示了所有这些基本的财务报表。在介绍应计制会计的基础知识之后,本书介绍了现金流量表,使学生们了解这三种报表的重要性及各自所反映出的独一无二的信息,并可以通过随后的章节了解财务报告实务的细节。

目标读者

本书的读者对象是本科生和 MBA 学生,讨论的是所有商科的学生都必须学习的课题,内容主要针对财务报表使用者,但对于潜在的会计执业者也给予了充分的注意。

本书特色

更加强调财务报表分析:

- 新增财务报表组合(位于第2章之后)。插入的这一部分内容通过重点讲述财务比率以及如何从财务报表获取财务比率,为学生提供了如何进行财务报表分析的可视线路图。财务报表组合同时提示学生注意学习本书的其他章节,以便更深入地掌握这些比率。整个学期过程中学生们都可以很方便地浏览和参考财务报表组合。

- 每一章新增“解释财务报表”部分,使学生可以认真思考如何使用他们正在学习的信息,以便更好地了解一个企业的财务现状与预期。

ABOUT THE AUTHORS

Charles T. Horngren is the Edmund W. Littlefield Professor of Accounting, Emeritus, at Stanford University. A graduate of Marquette University, he received his MBA from Harvard University and his Ph.D. from the University of Chicago. He is also the recipient of honorary doctorates from Marquette University and DePaul University.

A Certified Public Accountant, Horngren served on the Accounting Principles Board for six years, the Financial Accounting Standards Board Advisory Council for five years, and the Council of the American Institute of Certified Public Accountants for three years. For six years, he served as a trustee of the Financial Accounting Foundation, which oversees the Financial Accounting Standards Board and the Government Accounting Standards Board.

Horngren is a member of the Accounting Hall of Fame.

A member of the American Accounting Association, Horngren has been its President and its Director of Research. He received its first annual Outstanding Accounting Educator Award. He also received its Lifetime Contribution to Management Accounting Award.

The California Certified Public Accountants Foundation gave Horngren its Faculty Excellence Award and its Distinguished Professor Award. He is the first person to have received both awards.

The American Institute of Certified Public Accountants presented its first Outstanding Educator Award to Horngren.

Horngren was named Accountant of the Year, Education, by the national professional accounting fraternity, Beta Alpha Psi.

Professor Horngren is also a member of the Institute of Management Accountants, where he received its Distinguished Service Award. He was a member of the Institute's Board of Regents, which administers the Certified Management Accountant examinations.

Horngren is the author of these books published by Prentice-Hall: *Cost Accounting: A Managerial Emphasis*, Tenth Edition, 2000 (with George Foster and Srikant Datar); *Introduction to Management Accounting*, Thirteenth Edition, 2006 (with Gary L. Sundem and William O. Stratton); *Introduction to Financial Accounting*, Eighth Edition, 2002 (with Gary L. Sundem, John A. Elliott, and Donna R. Philbrick); *Accounting*, Fifth Edition, 2002 (with Walter T. Harrison, Jr. and Linda Bamber); and *Financial Accounting*, Fourth Edition, 2001 (with Walter J. Harrison, Jr.).

Horngren is the Consulting Editor for the Charles T. Horngren Series in Accounting.

Gary L. Sundem is the Julius A. Roller Professor of Accounting and Co-Chair of the Department of Accounting at the University of Washington, Seattle. He received his B.A. degree from Carleton College and his MBA and Ph.D. degrees from Stanford University.

Professor Sundem was the 1992–93 President of the American Accounting Association. He was Executive Director of the Accounting Education Change Commission, 1989–91, and served as Editor of *The Accounting Review*, 1982–86.

A member of the National Association of Accountants, Sundem is past president of the Seattle chapter. He has served on IMA's national Board of Directors, the Committee on Academic Relations, and the Research Committee.

Professor Sundem has numerous publications in accounting and finance journals including *Issues in Accounting Education*, *The Accounting Review*, *Journal of Accounting Research*, and *The Journal of Finance*. He was selected as the Outstanding Accounting

Educator by the American Accounting Association in 1998 and by the Washington Society of CPAs in 1987. He has made more than 200 presentations at universities in the United States and abroad.

John A. Elliott is the Dean of the Zicklin School of Business at Baruch College and Vice President of Baruch College, which is part of the City University of New York (CUNY). He is the Irwin and Arlene Ettinger Professor of Accountancy. He received his B.S. and MBA degrees from the University of Maryland and his Ph.D. degree from Cornell University. Prior to accepting the Deanship at the Zicklin School, he spent 20 years on the faculty at Cornell University's Johnson Graduate School of Management, most recently as Associate Dean for Academic Affairs.

Dean Elliott is a certified public accountant with professional experience as an auditor and consultant for Arthur Andersen & Co. and in the controller's office of the Westinghouse Defense and Space Center. During his career he has taught at six different institutions. His responsibilities have included financial accounting, intermediate accounting, financial statement analysis, taxation, and extensive executive teaching. He is currently teaching introductory financial accounting in the Zicklin Honors MBA program.

His academic publications have appeared in the *Accounting Review*, the *Journal of Accounting Research*, *Accounting Horizons*, and the *Rand Journal* among others. In 2004 his recent paper on earnings management (with Nelson and Tarpley) received the award from the American Accounting Association for Notable Contributions to Accounting Literature. His research is concentrated on the role of accounting information in financial analysis and contracts.

Donna R. Philbrick is Professor of Accounting at Portland State University. She received her B.S. degree from the University of Oregon and her MBA and Ph.D. degrees from Cornell University.

Professor Philbrick is a certified public accountant and worked in public accounting prior to returning for her graduate degrees. Before joining the faculty at Portland State, she taught at the University of Oregon and Duke University. She currently teaches financial accounting and financial statement analysis. Professor Philbrick also teaches in the Oregon Executive MBA program and serves on the Academic Committee of that organization.

Professor Philbrick's research has been published in accounting journals including *The Accounting Review*, *Journal of Accounting Research*, and *Journal of Accounting and Economics*. She served on the Advisory Board of *Accounting Horizons* from 1994 to 2000 and as Associate Editor of that journal from 2000 to 2003.

BRIEF CONTENTS

1	Accounting: The Language of Business	2
2	Measuring Income to Assess Performance	38
3	Recording Transactions	74
4	Accrual Accounting and Financial Statements	110
5	Statement of Cash Flows	144
6	Accounting for Sales	176
7	Inventories and Cost of Goods Sold	212
8	Long-Lived Assets and Depreciation	252
9	Liabilities and Interest	288
10	Stockholders' Equity	336
11	Intercompany Investments and Consolidations	374
12	Financial Statement Analysis	410

GLOSSARY	G1
-----------------	-----------

CONTENTS

1 Accounting: The Language of Business 2

Chapter Opener: Starbucks 3

The Nature of Accounting 5

The Balance Sheet 8

Balance Sheet Transactions 10

Types of Ownership 17

Accounting Differences Between Proprietorships, Partnerships, and Corporations 20

Stockholders and the Board of Directors 23

Credibility and the Role of Auditing 24

The Accounting Profession 25

Career Opportunities for Accountants 31

Highlights to Remember 33

2 Measuring Income to Assess Performance 38

Chapter Opener: General Mills 39

Introduction to Income Measurement 40

Measuring Income 45

The Income Statement 51

Accounting for Dividends and Retained Earnings 55

Some Basic Concepts 60

Four Popular Financial Ratios 62

Highlights to Remember 66

Appendix 2: Cost-Benefit Criterion and Accounting Regulation 67

3 Recording Transactions 74

Chapter Opener: Gap Inc. 75

The Double-Entry Accounting System 76

Debits and Credits 79

The Recording Process 80

Analyzing, Journalizing, and Posting the Biwheels Transactions 84

Biwheels' Transactions in the Journal and Ledger 92

Preparing the Trial Balance 92

Effects of Errors 101

Incomplete Records 103

Data Processing and Accounting Systems 104

Highlights to Remember 106

4 Accrual Accounting and Financial Statements 110

Chapter Opener: Columbia Sportswear 111

Adjustments to the Accounts 112

I. Expiration of Unexpired Costs 113

II. Earning of Revenues Received in Advance 114

III. Accrual of Unrecorded Expenses 116

IV. Accrual of Unrecorded Revenues 119

The Adjusting Process in Perspective 121

Classified Balance Sheet 126

Income Statement 131

Profitability Evaluation Ratios 134

Highlights to Remember 138

5 Statement of Cash Flows 144**Chapter Opener: Nike 145**

- Overview of Statement of Cash Flows 147
- Preparing a Statement of Cash Flows 148
- Cash Flow from Operating Activities 155
- The Statement of Cash Flows and the Balance Sheet Equation 163
- Examples of Statements of Cash Flows 165
- The Importance of Cash Flow 167
- Highlights to Remember* 173

6 Accounting for Sales 176**Oracle Corporation 177**

- Recognition of Sales Revenue 178
- Measurement of Sales Revenue 179
- Cash 185
- Credit Sales and Accounts Receivable 187
- Measurement of Uncollectible Accounts 188
- Assessing the Level of Accounts Receivable 195
- Overview of Internal Control 197
- Highlights to Remember* 202
- Appendix 6: Bank Reconciliations* 203

7 Inventories and Cost of Goods Sold 212**Chapter Opener: Home Depot 213**

- Gross Profit and Cost of Goods Sold 214
- Perpetual and Periodic Inventory Systems 216
- Cost of Merchandise Acquired 218
- Comparing Accounting Procedures for Periodic and Perpetual Inventory Systems 220
- Principal Inventory Valuation Methods 222
- Characteristics and Consequences of LIFO 228
- Lower-of-Cost-or-Market Method 232
- Effects of Inventory Errors 234
- Cutoff Errors and Inventory Valuation 236
- The Importance of Gross Profits 237
- Gross Profit Percentages and Accuracy of Records 241
- Internal Control of Inventories 243
- Highlights to Remember* 245
- Appendix 7: Inventory In a Manufacturing Environment* 246

8 Long-Lived Assets and Depreciation 252**Chapter Opener: Gap Inc. 253**

- Overview of Long-Lived Assets 254
- Contrasting Long-Lived Asset Expenditures with Expenses 256
- Acquisition Cost of Tangible Assets 257
- Depreciation of Buildings and Equipment 259
- Changes In Estimated Useful Life or Residual Value 264
- Contrasting Income Tax and Shareholder Reporting 265
- Depreciation and Cash Flow 265
- Expenditures After Acquisition 268
- Gains and Losses on Sales of Tangible Assets 269
- Impairment of Tangible Assets 273
- Intangible Assets 275
- Goodwill 279
- Depletion of Natural Resources 280

Highlights to Remember 280

9 Liabilities and Interest 288

Chapter Opener: May Department Stores 289

- Liabilities In Perspective 290
- Accounting for Current Liabilities 291
- Long-Term Liabilities 296
- Bond Accounting 302
- Accounting for Leases 311
- Other Long-Term Liabilities, Including Pensions and Deferred Taxes 315
- Debt Ratios and Interest-Coverage Ratios 321
- Highlights to Remember* 323
- Appendix 9: Compound Interest, Future Value, and Present Value* 324

10 Stockholders' Equity 336

United Parcel Service 337

- Background on Stockholders' Equity 340
- Cash Dividends 342
- Preferred Stock 343
- Additional Stock Issuance 348
- Stock Splits and Stock Dividends 350
- Repurchase of Shares 358
- Other Issuances of Common Stock 362
- Retained Earnings Restrictions 364
- Other Components of Stockholders' Equity 365
- Financial Ratios Related to Stockholders' Equity 365
- Highlights to Remember* 367

11 Intercorporate Investments and Consolidations 374

Chapter Opener: Ford Motor Company 375

- An Overview of Corporate Investments 378
- Short-Term Investments 380
- Long-Term Investments in Bonds 384
- The Market and Equity Methods for Intercorporate Investments 386
- Consolidated Financial Statements 389
- Purchase Price Not Equal to Book Value 398
- Summary of Accounting for Equity Securities 405
- Highlights to Remember* 405

12 Financial Statement Analysis 410

Chapter Opener: Eli Lilly 411

- Sources of Information About Companies 413
- Objectives of Financial Statement Analysis 414
- Evaluating Trends and Components of the Business 416
- Financial Ratios 427
- Operating Performance and Financing Decisions 433
- Prominence of Earnings per Share 439
- Disclosure of Nonrecurring Items 441
- International Issues 445
- Valuation Issues 446
- Relating Cash Flow and Net Income 450
- Highlights to Remember* 454

Accounting: The Language of Business

1 CHAPTER

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Explain how accounting information assists in making decisions.
2. Describe the components of the balance sheet.
3. Analyze business transactions and relate them to changes in the balance sheet.
4. Compare the features of sole proprietorships, partnerships, and corporations.
5. Identify how the owners' equity section in a corporate balance sheet differs from that in a sole proprietorship or a partnership.
6. Describe auditing and how it enhances the value of financial information.
7. Explain the regulation of financial reporting.
8. Evaluate the role of ethics in the accounting process.

Accounting is the language of business. It is the method companies use to communicate financial information to their employees and to the public. Information is important for many decisions. You have probably bought a latte in, or at least walked by, one of Starbucks' 7,000 coffee stores throughout the world. Did you know that you could also buy a share of Starbucks stock, making you a part owner of Starbucks? To buy a latte, you want to know how it tastes. To buy a share of stock, you want to know about the financial condition and prospects of **Starbucks Corporation**. You would want to own part of Starbucks only if you think it will continue to be successful. To learn this, you need to know accounting. By the time you finish reading this book, you will be comfortable reading the financial reports of Starbucks and other companies. You will be able to use those reports to assess the financial health of these companies.

Starbucks first issued shares of stock to the public in 1992. If you had bought shares at that time, today your investment would be worth \$20 for every \$1 you invested. Will Starbucks continue to be a good investment? No one can predict with certainty the financial prospects of Starbucks. However, the financial statements can give you clues. A search of the Internet can provide more information. Yet, only if you understand accounting will you be able to make sense of this financial information.

Starbucks is a young, fast-growing company. It has established a worldwide reputation in a short time. Recently, it was named one of the Top 5 Global Brands of the Year by Brandchannel.com's Readers Choice survey. It has consistently been among *Fortune* magazine's 100 Best Companies to Work For. *Business Ethics* magazine

A group of Japanese teens gathers outside the world's busiest Starbucks in Tokyo's Shibuya shopping district. From Beijing to Bangkok, Starbucks is converting Asian tea lovers into fans of frappuccino and other frothy drinks. Starbucks reports its economic performance in its financial statements. As you read this text, you will learn how to read and analyze the financial statements of Starbucks and other companies, large and small, throughout the world.



selected it among its 100 Best Corporate Citizens. The former chief executive officer of Starbucks, Howard Schultz, was selected by *Business Week* as one of the Top 25 Best Managers in the country. Finally, *Fortune* named Starbucks the Most Admired Brand in the food services category 2 years in a row and ranked it America's eighth most admired company in 2004. Despite all these awards, it is important to know something about Starbucks' financial prospects. Let's look at a few financial facts. You will learn more about them as you proceed through this book.

In 2003, Starbucks' total revenues—the amount the company received for all the items sold—was \$4.1 billion, compared with only \$700 million in 1996. The net income—the profit that Starbucks made—was \$436 million, up from only \$42 million in 1996. Total assets—the value of the items owned by Starbucks—grew from less than \$900 million to more than \$2.7 billion from 1996 to 2003. You can see that the amount of business done by Starbucks has grown quickly. However, there is much more to be learned from the details in Starbucks' financial statements. You will learn about revenues, income, assets, and other details of accounting as you read this book. ■

As we embark on our journey into the world of financial accounting, we explore what it takes for a company such as Starbucks to manage its financial activities and how investors use this accounting information to better understand Starbucks. Keep this in mind: The same basic accounting framework that supported a small coffee company like Starbucks in 1992 supports the larger company today, and indeed it supports businesses big and small, old and new, worldwide.

This book is an introduction to financial accounting. **Accounting** is a process of identifying, recording, and summarizing economic information and reporting it to decision makers. **Financial accounting** focuses on the specific needs of decision makers external to the organization, such as stockholders, suppliers, banks, and government agencies. You probably expect to see a bunch of rules and procedures about how to record and report financial information. Well, you are correct. You will see all those. However, our philosophy about financial accounting goes beyond rules and procedures. To use your financial accounting training effectively, you must also understand the underlying business transactions that give rise to the economic information and why the information is helpful in making financial decisions.

We hope that you want to know how businesses work. When you understand that Starbucks' financial reports help its management make decisions about what products to produce and sell, as well as help investors to assess the performance and prospects of Starbucks, you will see why being able to read and interpret these reports is important. Both outside investors and internal managers need this information.

Our goal is to help you understand business transactions—to know how they create accounting information and how decision makers both inside the company (managers) and outside the company (investors) use this information in deciding how, when, and what to buy or sell. In the process, you get to learn about some of the world's premier companies. You may wonder about what it costs to open a new Starbucks store. Are these new stores worth that kind of huge investment? How many people visit each Starbucks store every year? Can Starbucks keep track of them all, and are there enough customers to make the stores profitable? If investors consider purchasing Starbucks stock, what do they need to know to decide whether the current price is a good one? We cannot answer every such question you might ask, but we explore some exciting aspects of business and use business examples to illustrate the uses of accounting information.

In pursuing actual business examples, we consider details about many of the 30 companies in the Dow Jones Industrial Average (the Dow), the most commonly reported stock market index in the world. Well-known companies, such as **Coca-Cola**, **Microsoft**, and **McDonald's**, are among these 30 companies, along with many other large but less familiar companies, such as **International Paper** and **SBC Communications**. Exhibit 1-1 lists the 30 Dow companies, and the Business First box on p. 6 describes the Dow Jones

accounting

The process of identifying, recording, and summarizing economic information and reporting it to decision makers.

financial accounting

The field of accounting that serves external decision makers, such as stockholders, suppliers, banks, and government agencies.

Symbol	Company	Total Sales	Symbol	Company	Total Sales
WMT	Wal-Mart Stores Inc.	\$244.5	JNJ	Johnson & Johnson	\$36.3
GM	General Motors Corp.	186.8	MSFT	Microsoft Corp.	32.2
XOM	ExxonMobil Corp.	178.9	UTX	United Technologies Corp.	28.0
GE	General Electric Co.	130.7	INTC	Intel Corp.	26.8
C	Citigroup Inc.	92.6	DIS	Walt Disney Co.	25.3
IBM	International Business Machines Corp.	81.2	IP	International Paper Co.	25.0
MO	Altria Group, Inc.	80.4	DD	E. I. DuPont de Nemours & Co.	24.0
HD	Home Depot Inc.	58.2	AXP	American Express Co.	23.8
HWP	Hewlett-Packard Co.	56.6	HON	Honeywell International Inc.	22.3
BA	Boeing Co.	54.1	AA	Alcoa Inc.	20.3
MRK	Merck & Co. Inc.	51.8	CAT	Caterpillar Inc.	20.2
JPM	JP Morgan Chase & Co.	43.4	KO	Coca-Cola Co.	19.6
PG	Procter & Gamble Co.	43.4	MMM	3M Company	16.3
SBC	SBC Communications Inc.	43.1	MCD	McDonald's Corp.	15.4
T	AT&T Corp.	37.8	EK	Eastman Kodak Co.	12.8

Exhibit 1-1

Dow Industrials

Ranked by Total 2002 Sales (\$ in billions)

Industrial Average. We also consider some younger and faster-growing companies, such as Starbucks, Cisco, Apple, and Timberland. For now, we start with the basics.

The Nature of Accounting

Accounting organizes and summarizes economic information so decision makers can use it. Accountants present this information in reports called financial statements. To prepare these statements, accountants analyze, record, quantify, accumulate, summarize, classify, report, and interpret economic events and their financial effects on the organization.

A company's accounting system is the series of steps by which it initially records information and converts it into financial statements. Accountants analyze the information needed by managers and other decision makers and create the accounting system that best meets those needs. Bookkeepers and computers then perform the routine tasks of collecting and compiling economic information. The real value of any accounting system lies in the information it provides.

Consider the accounting system at your school. It collects information about tuition charges and payments and tracks the status of each student. Your school must be able to bill individuals with unpaid balances. It must be able to schedule courses and hire faculty to meet the course demands of students. It must ensure that tuition and other cash inflows are sufficient to pay the faculty and keep the buildings warm (or cool) and well lit. If your experience is like that of most students, you can find some flaws with your school's accounting system. Perhaps there are too many waiting lines at registration or too many complicated procedures in filing for financial aid. If you are lucky, you have experienced electronic registration for courses and made all your tuition payments in response to bills received in the mail. The right information system can streamline your life. Every business maintains an accounting system, from the store where you bought this book to the company that issued the credit card you used. MasterCard and Visa maintain fast, complicated accounting systems. At any moment, thousands of credit card transactions occur around the globe, and accounting systems keep track of them all. When you use your charge card, a scanner reads it electronically and transmits the transaction amount over phone lines to the card company's central computer.

B U S I N E S S F I R S T

THE DOW JONES INDUSTRIAL AVERAGE

Why did the Dow Jones Industrial Average (DJIA) fall from nearly 12,000 in January 2000 to near 7,000 at the end of 2002 and then rise again to more than 10,500 by early 2004? What does this mean to investors? To explain this 40 percent drop followed by a large recovery, you need to understand the DJIA. However, to fully understand the reasons for the drop, you need to understand accounting—what the financial reports prepared by companies really mean.

The DJIA is one of many indices used to describe the performance of stock markets around the world. All indices provide a picture of what is happening on average to the value of securities owned by investors. The Dow began as the average value of an investment in one share of each of 12 stocks and was first published in 1896 by Charles Dow. To calculate it, he simply added the prices of the 12 stocks and divided by 12. It began at 40.94 but fell to an all-time low of 28.48 in August of that year. The calculation today is more complex, but the basic concept is unchanged. Since 1928, the number of stocks in the DJIA has been constant at 30, but there have been 41 changes in the composition of the average. These changes reflect the dynamic nature of American industry. The original DJIA had several auto and petroleum companies to capture the massive importance of these industries. Among the original twelve companies were **U.S. Leather**, **U.S. Rubber**, **American Tobacco**, **Tennessee Coal & Iron**, and **Laclede Gas**. Of these, only Laclede Gas, the Missouri utility, still exists—although it is not included in the Dow. Today, only **General Electric** remains from the original twelve, although predecessors of **ExxonMobil** and **General Motors** were also included. **McDonald's** replaced American Tobacco in 1985, **Wal-Mart** replaced Woolworth in 1997, and **Home Depot** replaced Sears in 1999. Technology companies have only

appeared in the DJIA in significant numbers recently with **Hewlett-Packard**, **Microsoft**, and **Intel** all added since 1997. Most recently, **Pfizer**, **Verizon**, and **AIG** replaced **Eastman Kodak**, **AT&T**, and **International Paper** in 2004. It is also interesting to note that the largest one-day Dow increase, 15 percent, was in October 1931. The largest drop was in October 1987 when the Dow fell 23 percent.

Although indices such as the DJIA give a picture of how stock prices have changed, they do not explain why those changes occurred. Researchers have shown that accounting results affect stock prices. Therefore, most financial analysts rely on companies' financial reports, along with other information, to explain movements in stock prices. For example, the *New York Times* focused on corporate profits in its report on October 6, 2003: "Stocks rose on Monday for the fourth session in a row as investors bet that the economy and corporate profits are on the mend and wait for the earnings season to heat up." Annual and quarterly reports, including balance sheets, income statements, and cash flow statements, provide much of the information investors use. They use this financial information to predict future financial positions and prospects of companies. In this way, they try to anticipate movements in stock prices. The classic advice to investors is to "buy low and sell high." Although this is never easy, accounting information can help investors to approach this ideal. The DJIA fell when the economy weakened and companies' profits declined. It rebounded when companies' financial reports indicated that financial results were on the upswing.

Sources: "Stocks Slide Amid Worries About Economy and Corporate Profits," *New York Times*, October 6, 2003; Dow Jones Indexes (<http://averages.dowjones.com/jsp/industrialAverages.jsp?sideMenu=true>); "The Motley Fool," *The Seattle Times* (February 15, 2004), p. E2.

OBJECTIVE 1

Explain how accounting information assists in making decisions.

The computer verifies that your charges are within acceptable limits and approves or denies the transaction. At the same time, the computer also conducts security checks. For example, if your credit card were being used simultaneously to buy groceries in Chicago and to make long distance phone calls in Korea, the system might sense that something is wrong and require you to call a customer service representative before the credit card company approves the charges. Without reliable accounting systems, credit cards simply could not exist.

Accounting as an Aid to Decision Making

Accounting information is useful to anyone making decisions that have economic consequences. Such decision makers include managers, owners, investors, and politicians. For example,