



Ainsworth • Deines

INTRODUCTION TO ACCOUNTING

An Integrated Approach

Third Edition

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INTRODUCTION TO ACCOUNTING: AN INTEGRATED APPROACH

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First and foremost, we dedicate this text to our families without whose love and support we never could have completed this project. To our spouses, Scott Ainsworth and Linda Deines, to our children and their spouses, and to our precious grandchildren, Jackson, Jakob, and Julia, we love you and we thank you. Second, we would like to thank Kelly Odom, Melody Marcus, and the production and marketing departments at McGraw-Hill/Irwin. Finally, we thank the accuracy checkers Jason Fink and Barbara A. Schnathorst, who helped polish this project.

Penne Ainsworth
Dan Deines

To the Instructor

Why Integrate?

The primary reason to integrate financial and managerial accounting is that it mirrors the way businesses operate. In addition, having as many as 85 percent non-accounting majors in a first accounting course is not unusual. These students need to understand that accounting is an information system that serves a wide variety of stakeholders, both internal and external to the organization. Rather than separating financial accounting from managerial accounting, we emphasize the business processes, and how to plan and evaluate the related activities from both a financial (external reporting) and a managerial (internal reporting) perspective.

Understanding the Integrated Approach

The Third Edition of *Introduction to Accounting: An Integrated Approach* revolves around three major themes:

- The overriding theme of the text is that accounting is **an information system** that serves many stakeholders, some internal and some external to the organization. Traditionally, *Introduction to Accounting* has been taught as two separate and distinct segments: financial accounting and managerial accounting. Consequently, many of our non-accounting students never gain an understanding of accounting as a process of providing information about business to both internal and external stakeholders. An understanding of why and how accounting information is used by internal and external stakeholders is vital, regardless of a student's major.
- The second theme is **business processes**. We introduce the four major business processes in the second chapter and use these processes to divide content between the first and second halves of the text (courses). The four business processes are (1) business organization and strategy, (2) operating, (3) capital resources, and (4) performance measurement and management. We describe how the business organization and strategy process provide a long-term direction for the company and how the performance measurement and management process provides the evaluation of the company. Then we divide content into operating processes (first half) and capital resources processes (second half). This mirrors the operating, investing, and financing activities on the statement of cash flows.

We chose to cover operating processes first for two reasons: First, these activities are more intuitive to students—they have been customers and employees, now we must get them to think like businesspeople. Second, investing and financing activities require the time-value-of-money, a somewhat complex topic. Our classroom experience shows that investing and financing

activities are more easily understood after learning about operating activities.

- The final theme is the **balanced scorecard**. The balanced scorecard is a holistic approach to planning and evaluating that translates a company's strategy (from the business organization and strategy process) into measurable objectives (for the operating and capital resources processes) organized into four perspectives: (1) financial, (2) internal, (3) customer, and (4) learning and growth. That is, the balanced scorecard approach plans and evaluates business success using financial *and other measures* of success. The balanced scorecard approach provides a number of measures of success that, in turn, managers use to evaluate performance and plan for the future. This is important because these other measures impact the financial performance of the company in future periods. Thus, the balanced scorecard approach is a forward-looking planning and evaluating tool, in that we begin by planning the activities in the operating and capital resources processes, then we record and evaluate the results to provide feedback to the next planning phase. Therefore, in each half of the text, we examine planning activities followed by recording and evaluating activities.

By concentrating on these three themes, students learn why and how activities are planned and evaluated by different stakeholders. In addition, students gain a greater understanding of business, which will certainly help them in whatever careers they may choose.

What Are the Main Objectives of this Unique Approach?

Introduction to Accounting: An Integrated Approach is designed to benefit everyone, regardless of major. We consciously integrated life skills into the content along with business skills. In designing the text, we incorporated three objectives:

1. **To focus on accounting as an information system used in each business process to provide information to holistically plan and evaluate activities.** As outlined above we believe that students must understand that accounting is the information infrastructure of business, that it serves a wide variety of stakeholders, and that it is used for both planning and evaluating business activities. We believe that content organized around business processes provides students with linkages often missing when financial accounting is separated from managerial accounting. Finally we believe that planning, recording, and evaluating activities involve more than financial information.

2. **To stimulate interest in the field of accounting.** Classroom experience has shown that *Introduction to Accounting: An Integrated Approach* serves as a way to increase interest in the discipline of accounting. As students gain an understanding and appreciation of the broader role of accounting in the business world, they are more likely to express interest in accounting as a major field of study. In addition, we have seen the drop-out rates in our introductory accounting courses decline from almost 50 percent to less than 20 percent.
3. **To promote active and cooperative learning.** Various pedagogical devices in this book stimulate active and cooperative learning for the students. Most obvious are the Pause and Reflect questions posed throughout the text. These questions serve as checkpoints for students as well as stimulate their critical thinking. Additionally, the Cases, Computer Applications, Critical Thinking, and Ethical Challenge materials provide opportunities for teamwork. The Instructor's Resource Manual provides additional cooperative learning experiences for students. We have found that active and cooperative learning promotes retention of the material and deeper learning.

Integrate Third Edition Features into Your Course

Pause and Reflect

These boxed features get students thinking about key chapter concepts. A question is posed and its suggested solution is listed below so that students can immediately compare their resolution to the authors'.

Pause and Reflect

If, on December 30, 2000, Dreyer's had sold all its assets and then paid all its obligations, would the stockholders have received the amount shown on the balance sheet as "total stockholders' equity?"

Answer: It is doubtful that Dreyer's could have sold its assets for the exact amounts represented on the balance sheet. The balance sheet, in general, represents the amounts incurred to receive the asset, not the asset's current worth. Therefore stockholders could receive more or less than the amount shown as stockholders' equity on the balance sheet.

Fast Fact

New to the Third Edition, these features tie chapter contents to business events or product trivia. These interesting real-world scenarios show students how course topics are related to events outside of the classroom.

FAST FACT

By November 28, 2001, Enron Corporation's credit rating had been downgraded by Standard & Poor's to junk bond status. This meant that \$3.9 billion in debt was due immediately and up to \$16 million could come due earlier than anticipated. Subsequently, Dynegy, a potential buyer of Enron, believed that Enron was too risky and pulled out of the proposed takeover.

Source: Associated Press, November 28, 2001.

Of Interest

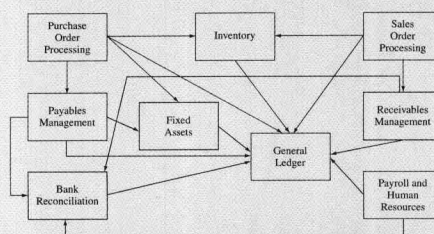
These features, which were well-received in the previous editions, supplement the chapter with additional information. Professors can use Of Interest features to get students talking about the current issues in accounting.

OF INTEREST Great Plains Dynamics

Great Plains Dynamics is the leading software package for the mid-sized market and it is growing. Fast! Great Plains features an accounting system that integrates across the business through a series of modules as illustrated below. Great Plains does operate on the debit/credit system so a working knowledge of accounting terminology is necessary to use this system. Great Plains defines ac-

counting as: An activity designed to identify, measure and communicate information about an entity that will help users such as shareholders, bankers and managers make better decisions.

Source: Dynamics Orientation, Microsoft Great Plains Business Solutions.





Learning Objectives

After being presented at the beginning of the chapter, learning objectives are linked to end-of-chapter material. Icons next to questions or problems indicate the learning objectives to which they are related.

End-of-Chapter Material

Much of the end-of-chapter material can and should be used to enhance students' written and oral communication skills.

- For easy reference, each end-of-chapter section begins with a list of **Key Terms** and definitions.
- **Questions, Exercises, and Problems** follow to test how much of the chapter's content students recall.
- **Cases, Computer Applications, Critical Thinking, and Ethical Challenge** sections give students the opportunity to apply their accounting knowledge in a broader business setting. These problems almost always required learning and exploring outside of the text.
- An additional problem set for each chapter is available on the book's Online Learning Center at www.mhhe.com/ainsworth3e.

Excel Spreadsheet Assignments

These are tied to the Computer Application Problems and are located on the text website at www.mhhe.com/ainsworth3e. Excel icons appear next to problems that have corresponding spreadsheet assignments.

Supplements to Help Implement the Integrated Approach

For the Student:

Study Guide (0-07-247395-9)

Prepared by Debra Kerby and Scott Fouch of Truman State University, this manual reinforces the concepts in the text through chapter-by-chapter review, additional Pause and Reflect questions, and short essay assignments.

Online Learning Center

www.mhhe.com/ainsworth3e

The Student Center on the text's website provides several features to enhance course content:

- PowerPoint presentations created by Penne Ainsworth are on the website to highlight and elaborate key chapter concepts.
- Excel template exercises prepared by Jack Terry are referenced in the text and posted on the Student Center on the website.
- Internet projects.
- The site also features additional review material by chapter such as flash card exercises, online quizzes, and a practice case.
- Links to text-referenced and other useful websites.
- Additional end-of-chapter problem set for each chapter.

For the Instructor: Instructor's Resource Manual (0-07-247401-7)

Designed by Penne Ainsworth, the Instructor's Resource Manual provides information to ease your transition to *Introduction to Accounting: An Integrated Approach*. Based on user comments and interviews conducted by Penne Ainsworth as she worked with teachers on their classroom issues, this manual contains these learning aids for each chapter: Discussion Outline—to promote active learning; Test/Retest Quizzes—to promote cooperative learning (at least two per chapter); In-Class Cases—to promote cooperative learning (at least two per chapter); Start-to-Finish—to promote active learning.

Test Bank (on the Instructor's Resource CD-ROM)

Prepared by Dan Deines, this manual consists of virtually all new multiple choice, matching, problem, and essay exercises to accompany every chapter of the text.

Diploma Computerized Text Bank (on the Instructor's Resource CD-ROM)

The text test bank is delivered in the latest version of Diploma from Brownstone. It can be used to make different versions of the same test, change the answer order, edit and add questions, and conduct online testing. Technical support for this software is available at 800-331-5094.

Instructor's Resource CD-ROM (0-07-247398-3)

This includes electronic versions of the Resource Manual, Solutions Manual, Test Bank, and Computerized Test Bank as well as PowerPoint presentations and Excel problems and solutions.

Online Learning Center www.mhhe.com/ainsworth3e

The Instructor Center on the book's website offers downloadable files of the Instructor's Resource Manual, Solutions Manual, PowerPoint slides, Excel templates and solutions, Web-based problems and solutions, and links to professional resources—all in a password-protected environment.

New to the Third Edition: Even More Integration

Introduction to Accounting: An Integrated Approach, Third Edition, has been completely rewritten by Penne Ainsworth and Dan Deines after collecting an immense amount of reviewer feedback on the Second Edition. The changes made to the Third Edition result in an even more integrated, condensed presentation. The incorporation of Dreyer's Grand Ice Cream is new to this edition and brings chapter concepts to life with a consistent real-world example. Dreyer's complete 2000 annual report is included in the book's Appendix so that students understand the look and feel of these reports. To see just how much has changed with this Third Edition, please refer to the following annotated table of contents:

Prologue: Dreyer's

Dreyer's Grand Ice Cream Inc. is the featured company throughout the text. Although other companies are introduced, Dreyer's ties the chapters together.

Part 1: Introduction: Business Operating Activities

Chapter 1 Accounting and Business

Added financial statements and some ratios to illustrate financial relationships.

Chapter 2 Business Processes and Accounting Information

Added content on the four business processes, quality, and the balanced scorecard. In response to reviewer feedback, internal controls are covered later in the chapter.

Chapter 3 Operating Processes: Planning and Control

Continuing with the concepts illustrated in Chapter 2, this chapter deals with operating processes and cost/revenue behavior.

Part 2: Planning: Operating Activities

Chapter 4 Short-Term Decision Making

The Cost-Volume-Profit Analysis model and relevant variable analysis model.

Chapter 5 Strategic Planning Regarding Operating Processes

Integrated selling prices, EOQ and JIT, and bonuses. Linear programming was removed from this chapter, as many reviewers and the authors felt this topic was too advanced for a principles course.

Chapter 6 Planning, the Balanced Scorecard, and Budgeting

Chapter topics have been toned down.

Part 3: Recording and Evaluating: Operating Activities

The accounting equation is carried throughout the recording chapters; this visual approach is intended to appeal to visual learners, which is how many students tend to learn today.

Chapter 7 Accounting Information Systems

The authors combined and updated the most relevant topics from the Second Edition's Chapters 7 and 8.

This chapter covers the Expenditure Process (purchase through payment), which was covered in Chapter 9 in the Second Edition.

Chapter 8 Purchasing/Human Resources/Payment Process: Recording and Evaluating Expenditure Process Activities

This chapter covers the Conversion Process, which is a combination of materials from Chapters 11 and 13 in the Second Edition.

Chapter 9 Recording and Evaluating Conversion Process Activities

This chapter covers Revenue Process (marketing through receipts), which is a combination of materials from Chapters 9, 10, and 13 in the Second Edition.

Chapter 10 Marketing/Sales/Collection/Customer Support Process: Recording and Evaluating Revenue Process Activities

Part 4: Introduction: Capital Resource Process Activities

Revamped material from Chapter 14 in the Second Edition focusing on time value of money concepts rather than time value of money tables.

Chapter 11 Time Value of Money

Part 5: Planning: Capital Resource Process Activities

Revamped material from Chapter 15 in the Second Edition

Chapter 12 Planning Investments: Capital Budgeting

Revamped material from Chapter 17 in the Second Edition. In response to reviewer feedback, a section on the Debt to Equity Ratio was added.

Chapter 13 Planning Equity Financing

Revamped material from Chapter 18 in the Second Edition.

Chapter 14 Planning Debt Financing

Part 6: Recording and Evaluating Capital Resource Processes

Reduced from four chapters in the Second Edition to two chapters in the Third Edition. Investments in securities was removed in response to reviewers' comments that the material was too difficult for an introductory course.

The authors combined and updated the most relevant topics from the Second Edition's Chapters 19 and 20.

Chapter 15 Recording and Evaluating Capital Resource Process Activities: Financing

Revamped material from Chapter 21 in the Second Edition.

Chapter 16 Recording and Evaluating Capital Resource Process Activities: Investing

Part 7: Evaluating: Operating and Capital Resource Processes

Revamped materials from Chapter 23 in the Second Edition.

Chapter 17 Company Performance: Profitability

Revamped materials from Chapter 24 in the Second Edition.

Chapter 18 Company Performance: Owners' Equity and Financial Position

Revamped materials from Chapter 25 in the Second Edition.

Chapter 19 Company Performance: Cash Flows

Revamped materials from Chapter 26 in the Second Edition.

Chapter 20 Company Performance: Comprehensive Evaluation

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About the Authors

Penne Ainsworth

University of Wyoming

Penne Ainsworth, Ph.D., CMA, CIA, and CPA (inactive). Penne received her Ph.D. from the University of Nebraska and is a professor in the accounting department and Associate Dean for Assessment at the University of Wyoming. She received the *Senior Teaching Award* in the College of Business in 1998 and 2000 and the *John P. Ellbogen Meritorious Classroom Teaching Award* for the University of Wyoming in 2001. She also won the *Kansas State Bank Outstanding Teacher Award* in 1993. Penne co-authored the original application for the grant Kansas State University received from the Accounting Education Change Commission (AECC) and authored two additional grants for accounting education and assessment. Her research focuses on managerial accounting, accounting education, and assessment. Penne's work has been published in *Issues in Accounting Education* and other journals. She is a member of the AAA, the IMA, and the AAHE.

Dan Deines

Kansas State University

Dan Deines received his undergraduate degree in history from Fort Hays State University, a masters in business from Emporia State University, and his Ph.D. in accounting from the University of Nebraska. He has been at Kansas State University since 1982 and currently holds the Ralph Crouch, KPMG Peat Marwick Chair. Dan received the College of Business's *Outstanding Educator Award* in 1987 and in 1994 received the College of Business *Outstanding Advising Award*. He was the co-coordinator for Kansas State University's accounting curriculum revision sponsored by the American Education Change Commission. Dan has been elected president of the Kansas Society of CPAs for the 2003–2004 term; he was designated an academic pathfinder by the AICPA and is a member of the AAA. Dan was the chairman of the AICPA's Accounting Careers Subcommittee and was a member of the Accounting Education Executive Committee.

Prologue

Throughout this textbook we use Dreyer's Grand Ice Cream to illustrate the concepts we examine and the issues we address. Dreyer's annual report for fiscal 2000 is included, in its entirety, in the appendix to this textbook. We refer to this report and discuss specific parts of it throughout the text. For now you might want to glance through the annual report to get a feel for what is included in it. Throughout the text we refer to the notes that accompany the financial statements. Dreyer's did not include these notes in the annual report, but as noted in the annual report, these notes (and additional information) can be found in their 10-K filed with the SEC and located on the SEC's Edgar database (www.sec.gov/edgar).

WHO IS DREYER'S

Dreyer's Grand Ice Cream (referred to as Dreyer's throughout) is an international ice cream manufacturer and distributor. Its brands include Edy's, Dreyers, Dreamery, Starbucks, Godiva, and M&M/Mars. In 2000, Dreyer's estimated that its products were consumed in 48 million American homes and that its distribution system served 59,000 retail stores. It desires to be the preeminent ice cream company in the country. In 2000, Dreyer's sales were \$1,194,356,000 and it had total assets of \$468,451,000 and total stockholders' equity of \$100,372,000. Its 2000 sales grew by 15 percent over 1999 and its share of the superpremium ice cream market was 25 percent in 2000, led by sales of the Dreamery and Godiva brands. In 1999, Dreyer's bid to buy Ben & Jerry's ice cream but lost to Unilever, who purchased Ben & Jerry's in 2000 and still owns the Ben & Jerry's brand along with Breyer's Ice Cream.

According to Dreyer's:

The U.S. ice cream category is large and fragmented, with roughly \$13 billion in sales of packaged ice cream and novelties. Data collected nationally by Information Resources, Inc. (IRI) for traditional grocery stores shows that a total of \$4.7 billion of packaged ice cream and \$1.9 billion of novelty products were sold through the retail grocery channel in 2000. We estimate that the combined non-grocery and foodservice segment of the category is as large as the traditional grocery business.

Thus it would seem that American's love affair with ice cream continues and that sales of ice cream and other novelty products will increase in the coming years. Dreyer's believes it can succeed with four growth strategies:

1. Grow premium brands ("Dreyer's will continue to leverage its distribution clout and national brand-building campaigns to grow share for its premium portfolio.")
2. Grow superpremium brands. ("While significant growth opportunities for these young superpremium brands remain there, the portfolio's indulgent flavors and smaller packaging make it attractive to the non-grocery channels of distribution—especially convenience stores.")
3. Develop new channels. (Dreyer's plans to continue leveraging its existing DSD [direct-store-distribution] systems by expanding its reach to serve more nongrocery retailers.)
4. Reduce total delivered cost. ("The company is undertaking a comprehensive and continual review of all costs, 'from cow to consumer' to identify and eliminate non-value added activities across all operations.")

BRIEF HISTORY OF DREYER'S

William Dreyer began making ice cream in 1906 in New York. Later he moved to California, where he opened his own ice creamery in Visalia and won first prize at the 1921 Pacific Slope Dairy Show. He also taught ice cream courses at the University of California.

After moving to Oakland, California, Dreyer found a business partner, Joseph Edy, a candy maker. They began an ice creamery in 1928 on Grand Avenue (this is why “Grand” is part of the company name even today) and invented Rocky Road ice cream.

In 1946, William Dreyer's son joined the business and Joseph Edy left to focus on candy making. In 1977, Dreyer's was purchased by T. Gary Rogers and William F. Cronk. They expanded the company into the national ice cream manufacturer it is today. Prior to merger, Dreyer's had over 4,300 employees and was traded on the NASDAQ under the ticker symbol DRYR. (See below).

WHY WE CHOSE DREYER'S

We chose to focus on Dreyer's because, as the statistics show, it seems that everyone loves ice cream and Dreyer's is one of the few ice cream manufacturers that is a public corporation and thus has publicly available information. We chose to include the 2000 annual report of Dreyer's for illustrative purposes for two reasons. First, the 2000 report also shows 1998 data when Dreyer's suffered a sizable loss. Second, in Chapter 20 we compare Dreyer's with its competitors in the same time period and 2000 data were available for all companies.

For additional information about Dreyer's, see: www.dreyers.com

All quotes are from the 2000 Annual Report or the company's website.

A NOTE FROM THE CFO OF DREYER'S

On June 16, 2002, Dreyer's Grand Ice Cream, Inc., and Nestlé S.A. announced a broad new strategic alliance in which Dreyer's will acquire Nestlé's U.S. ice cream business for 55 million shares of new Dreyer's stock. This transaction will increase Nestlé's holding in Dreyer's to 67% of fully diluted shares.

In addition, Dreyer's shareholders will receive the right to sell (put) their stock to the company for \$83 per share, during certain periods between January and May 2006, as part of an agreement between Nestlé S.A., Nestlé Holdings, Inc. and Dreyer's. Outstanding Dreyer's shares could also be called for redemption for \$88 during certain periods between January and June 2007, under the same agreement. Upon the close of the transaction, Dreyer's currently outstanding common stock will be exchanged on a share for share basis for new common stock that will carry these put and call features.

Upon the merger announcement, T. Gary Rogers, chairman and CEO of Dreyer's Grand Ice Cream, commented that “For 75 years the people at Dreyer's have delighted consumers with quality ice cream. Dreyer's is recognized for its innovation—begun with the creation of Rocky Road ice cream by Bill Dreyer in 1929—which has resulted in a diverse offering of favorite premium and superpremium ice cream brands today. This alliance with Nestlé, including the addition of the Haagen-Dazs and Drumstick brands, enables us to retain our entrepreneurial culture and spirit, and continue our commitment to brand building, innovation, and world class direct store delivery.”

Upon the merger announcement, Peter Brabeck-Letmathe, CEO of Nestlé, commented that “Dreyer's has one focus, quality ice cream. That commitment, Dreyer's enterprising culture, its strong portfolio of trusted brands, and its premier distribution system is [sic] well-served by continued autonomy. Our long-term investment in Dreyer's speaks to the tremendous upside we see in the ice cream business in North America and our confidence that Dreyer's has the right team in place to lead the industry.”