

PORTER NORTON



Financial Accounting

The Impact on Decision Makers

Fifth Edition



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The Impact on Decision Makers

Fifth Edition

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Financial Accounting: The Impact on Decision Makers, 5th Edition

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To those who really “count”:


Melissa

Kathy, Amy, Andrew

Balance of *Preparer Perspective* and *User Focus*. Discover the Best of Both with Porter/Norton!

Anyone who works out regularly appreciates the need to maintain a healthy balance between cardiovascular/aerobic training and muscular/strength training. Likewise, the study of accounting requires a balance between an understanding of the preparation of financial statements and the use of those statements in decision making.

A STUDENT finishing a financial accounting course needs to be able to *read and understand* an annual report. At the same time, he or she needs a solid understanding of the *preparation* of financial statements from transactions. This is why, from the very first edition, we have pursued a balance between a **Preparer Perspective** and a **User Focus**. From our experience, students need to understand both how transactions are recorded and statements are prepared and also how accounting information is used and why it is important for financial decision making.

WE INVITE you to discover the best of both with *Financial Accounting: The Impact on Decision Makers*, 5e. 

REVISION GOALS

Based on extensive feedback from both students and educators, we revised *Financial Accounting* with the following convictions in mind:

Students succeed when they know why accounting is important. Using real-world, relevant companies like Life Time Fitness, The Finish Line, and Coca-Cola helps demonstrate why accounting is important to a business. Experience has shown that “knowing why” helps students succeed.

A book should motivate and focus students. Based on extensive discussions with students and instructors, the fifth edition adopts a more streamlined approach that emphasizes key points, study highlights, and pedagogy focused on efficient learning. By streamlining complex accounting topics and emphasizing readability and usefulness, the result is an uncluttered, straightforward financial accounting textbook that will help your students succeed.

Getting an “A” in accounting is still about homework. Even with all of the recent innovation in accounting education, experience has shown that student success is still largely a measure of doing homework. That is why this book contains a range of end-of-chapter material—including single- and multi-concept exercises, A and B problems, and cases—that is designed to motivate and build skills in a systematic, step-by-step way. Enhancing this emphasis on student success are homework aids—warm-up exercises and solutions, review problems and solutions, key terms quizzes and solutions, among others—that help prepare students to turn in homework of the highest quality.

The following goals are consistent with and complement the approach we adopted in the first edition and have maintained through each revision:

- 1. To emphasize both the *preparation of financial statements and the use of financial statement information*.** As in past editions, the fifth edition prides itself on full coverage of the accounting cycle, debits and credits, journalizing, worksheets, and the application of accounting procedures to business transactions and the preparation of financial statements. We also embrace the use of ratios and ratio analysis at topically key points within chapters; the inclusion of information in the text about how users of financial information read and understand an annual report; and user-oriented text features and requirements for most end-of-chapter items.
- 2. To demonstrate accounting by using actual public companies.** Each chapter features an actual public company as the central example for topics along with key industry competitive companies in selected chapters.
- 3. To enhance decision making.** For the fifth edition we have added three new decision-making models that will help students throughout their accounting and business careers: the **Ratio Decision Model** introduced in Chapter 2 and appearing in most subsequent chapters; a **Financial Decision Framework** for making business decisions, in Chapter 1; and an **Ethical Decision-Making Model**, also in Chapter 1. Decision Cases in the end-of-chapter material focus on Reading and Interpreting Financial Statements, Making Financial Decisions, and Ethical Decision Making. In these and many other ways, we continue to be dedicated to guiding students’ acquisition of decision skills.
- 4. To create a book that accommodates students’ changing learning styles.** Students will benefit directly from our new design featuring visual enhancement of key topics, use of bulleted lists, a new Study Highlights format, a new Study Links feature at the start of each chapter—all designed to make studying more effective, efficient, and tailored to students’ time constraints.

NEW TO THIS EDITION

The fifth edition carries on a tradition of focusing on the preparation and use of financial information so students understand how and why financial statements drive business decision making. Specific changes include:

- **Financial Decision Framework.** Chapter 1 introduces a framework for financial decision making as a process that illustrates how to use financial information to make business and investment decisions:

1. Formulate the Question
2. Gather Information
3. Read the Financials
4. Analyze the Financials
5. Make the Decision
6. Assess the Decision

Using this model, students learn not only what accounting is and who uses financial information, but also how that information is the basis for decision making.

- **Ratio Decision Model.** Using the framework in Chapter 1 as a guide, this new feature, introduced in Chapter 2 and used in subsequent chapters, walks students through the steps to develop and use a financial ratio, using financial statement excerpts from real companies. The model depicts the financial statement line items that actually make up the ratio, to help students understand where the numbers come from, the interrelationship of the statements and the numbers, as well as how ratios can be used to make business and investment decisions. Using this model, students learn to understand and apply relationships among financial statement items and use these relationships to understand real company financials over time and in the context of their industry competitors.

**USING THE RATIO DECISION MODEL:
ANALYZING THE PROFIT MARGIN**

Use the following Ratio Decision Process to evaluate the profit margin for Life Time Fitness or any other public company.

- 1. Formulate the Question**
Managers, investors and creditors are all interested in a company's profitability. They must be able to answer the following question:
How profitable has the company been in recent years?
- 2. Gather the Information from the Financial Statements**
The profit margin is a measure of a company's profitability. To calculate the ratio it is essential to know a company's revenues and expenses and the difference between the two, net income.
 - Net income—from the income statement
 - Revenues—from the income statement
Be aware that many financial statements use alternate terminology. In the case of Life Time Fitness, the income statement is also known as the consolidated statement of operations.
- 3. Calculate the Ratio**

$$\text{Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}}$$

**Life Time Fitness
Partial Income Statement**

For the year ending December 31, 2004 2004

Revenue:	
Total revenue	312,033
Net income	28,908

$$\text{Profit Margin} = \frac{28,908}{312,033} = 9.3\%$$

The Ratio Decision Model on profit margin excerpted here is introduced in Chapter 2. The Model appears in most chapters to help focus on ratios as a tool for decision making and to show where in the financial statements the ratio items are found.

- **Ethical Decision Model within a new section on ethics in Chapter 1.** In the wake of accounting and business scandals of the last few years, the fifth edition provides a step-by-step ethical analysis and decision tool that students can rely on to help them base their business decisions on ethical and social principles throughout their careers.
- **Concentration on fewer real-world financial statements.** The Getting Started module and the first four chapters use the financial statements of a single service company, **Life Time Fitness**, to minimize distracting and complicated alternative financial formats and numbers. In subsequent chapters, examples are for the most part generated from one chapter-opening company to reinforce concepts with clear, easy-to-follow examples. The use of a few real-world companies lets students concentrate on one business with a single set of financial statements that apply to the company example within the chapter.
- **Coverage of the PCAOB, Sarbanes-Oxley, and auditing standards for internal control.** In response to the accounting and reporting scandals that have occurred in the last few years, the fifth edition introduces the role of Sarbanes-Oxley and the PCAOB in Chapter 1. Chapter 6 devotes an entire section to Sarbanes-Oxley in the context of internal control. Students are exposed to Section 404 of SOX and the the new management report on internal control required by this monumental legislation.
- **Emphasis on service companies rather than manufacturing companies in the early chapters.** Life Time Fitness, Inc., the flagship company used in Chapters 1–4, operates fitness centers and provides various services to its members. The company generates a majority of its revenues from membership dues and enrollment fees and this allows instructors to emphasize basic concepts concerned with revenue and expense recognition. Once students have mastered the basics, instructors can turn attention to the complexities involved in accounting for inventory and cost of goods sold in Chapter 5.
- **New chapter organization.** A significant change to this edition is the consolidation of accounting for inventory to a single chapter. Once students understand how companies account for inventory in Chapter 5, Chapter 6 looks at not only the accounting for cash but also internal control with an emphasis on a company that sells a product. Chapter 7 completes this section on accounting for assets by examining the accounting for investments and receivables. Another important change in this edition of the book was the movement of much of the material on accounting for stocks and bonds to an appendix to Chapter 7, another indication of our attempt to streamline the coverage whenever possible.
- **Study Highlights.** Key concepts highlighted by Learning Outcomes make it easier than ever for students to review the key ideas in the chapter.
- **Study Links.** This feature, found in earlier editions of the text, returns for the fifth edition to help students keep the big picture of the course in mind as they study. Study Links let them look back at the main concepts of the prior chapter, preview the concepts of the chapter under study, and look ahead to the chapter they will study next.
- **Learning Outcomes Approach.** A change from “Learning Objectives” to “Learning Outcomes” reflects a fundamental shift in our philosophy about how instructors should be able to access and use quizzing and testing for pre-testing, post-testing, and assessment. Changing to Learning Outcomes is backed up by a sophisticated new integrated homework, learning, and teaching platform . . . **ThomsonNOW™**.

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INTRODUCING ThomsonNOW

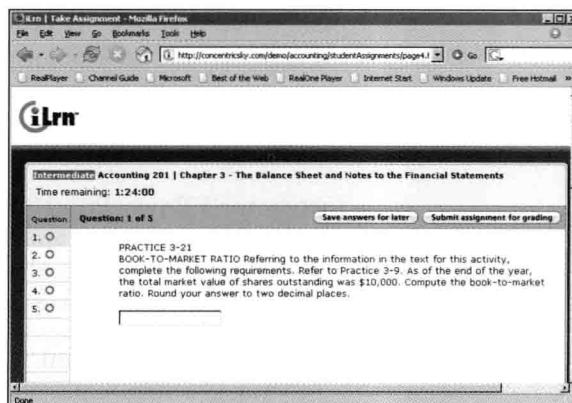
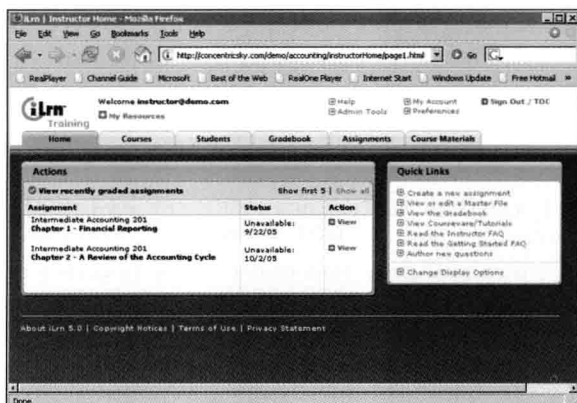
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HELPING STUDENTS SUCCEED

Student Learning Guide (ISBN 0-324-30318-1) The Student Learning Guide, by Coby Harmon and Mary Nisbet (both of the University of California, Santa Barbara), was revised with today's students in mind. The initial guide focuses on

fostering student success through a section on success strategies and a review of basic mathematics concepts. In addition, the Guide continues to review each chapter's main focus, key concepts, and key terms, as well as providing opportunities to brush up on homework and test-taking skills. Solutions are provided.

Working Papers (ISBN 0-324-30309-2) These pages save time by providing all the forms needed to manually prepare the homework assignments from the text.



General Ledger Software (ISBN 0-324-30317-3) Developed for the learning environment, this resource uses homework for this text adapted by Mark D. Beck. The software helps students understand the use of a general ledger system. Those selected assignments that may be solved using the general ledger software are identified by icons in the text.



Excel® Templates (ISBN 0-324-30317-3) Many problems in each chapter may be solved on a Microsoft Excel spreadsheet to increase student awareness of basic software applications. Those selected assignments that may be solved using the Excel spreadsheets are identified by icons in the text.

HELPING INSTRUCTORS SHINE

An unsurpassed package of supplementary resources helps you **plan**, **manage**, and **teach** your course. Additionally, special resources are available to help **assess** the progress of your students.

Instructor's Resource CD-ROM (ISBN 0-324-30315-7) This all-in-one resource contains all of the key instructor ancillaries (solutions manual, instructor's manual, test item files, ExamView® test bank, and PowerPoint® presentation slides), giving instructors the ultimate tool for customizing lectures and presentations.

Instructor's Resource Manual (ISBN 0-324-30314-9) This resource helps you **plan** for your course by providing detailed chapter outlines, lecture topics, and suggestions for classroom activities. Composed of the **Instructor's Manual**, by Catherine Lumbattis (Southern Illinois University), and the **Solutions Manual**, by the text authors, this material is also available in electronic form on the Instructor's Resource CD-ROM and (restricted) on the product support Web site.

Instructor's PowerPoint® Slides Located on the Instructor's Resource CD-ROM and on the text's Web site, these colorful slides, by Michael Tydlaska (Mountain View College), reinforce chapter content and provide a rich tool for in-class lectures and out-of-class reviewing.

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Assessment Tools The testing materials accompanying the fifth edition were revised to accommodate your need to accurately **assess** student performance and measure progress towards achieving departmental and college objectives. Each test item is linked to nationally recognized assessment frameworks.

Printed Test Bank (ISBN 0-324-30307-6) The Test Bank, by John W. Hatcher (Purdue University), is a complete and plentiful set of newly revised test items that is also available in electronic form (using ExamView® software), provided on the Instructor's Resource CD-ROM.

Algorithmic Test Bank For each quantitative learning outcome, this additional test bank provides algorithmic variations of key questions. These algorithms allow for a virtually unlimited bank of questions that an instructor may use when creating quizzes or tests.

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Developing a successful text requires extensive feedback and a commitment to listening to that feedback. Over an almost two-year period, the authors and publisher received many helpful comments and suggestions from both students and instructors. We are grateful for the thoughtful and insightful comments and hope you are pleased by the changes we implemented as a result.

DIARY KEEPERS

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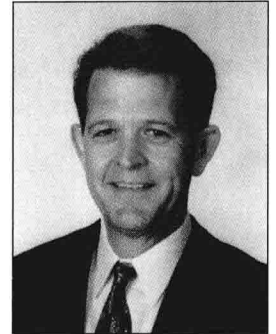
*Gary A. Porter
Curtis L. Norton
December 2005*

M E E T T H E A U T H O R S

Gary A. Porter is Professor of Accounting at the University of St. Thomas—Minnesota. He earned Ph.D. and M.B.A. degrees from the University of Colorado and his B.S.B.A. from Drake University. He has published in the *Journal of Accounting Education*, *Journal of Accounting, Auditing & Finance*, and *Journal of Accountancy*, among others, and has conducted numerous workshops on the subjects of introductory accounting education and corporate financial reporting.

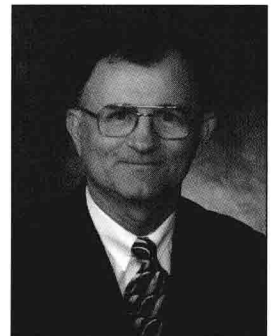
Dr. Porter's professional activities include experience as a staff accountant with Deloitte & Touche in Denver, a participant in KPMG Peat Marwick Foundation's Faculty Development program, and a leader in numerous bank training programs. He has won an Excellence in Teaching Award from the University of Colorado and Outstanding Professor Awards from both San Diego State University and the University of Montana.

He served on the Illinois CPA Society's Innovations in Accounting Education Grants Committee, the steering committee of the Midwest region of the American Accounting Association, and the board of directors of the Chicago chapter of Financial Executives International.



Curtis L. Norton has been a professor at Northern Illinois University in DeKalb Illinois since 1976. He earned his Ph.D. from Arizona State University, his M.B.A. from the University of South Dakota, and his B.S. from Jamestown College, North Dakota. His extensive list of publications include articles in *Accounting Horizons*, *The Journal of Accounting Education*, *Journal of Accountancy*, *Journal of Corporate Accounting*, *Journal of the American Taxation Association*, *Real Estate Review*, *The Accounting Review*, *CPA Journal*, and many others. In 1988–89, Dr. Norton received the University Excellence in Teaching Award, the highest university-wide teaching recognition at NIU. He is also a consultant and has conducted training programs for governmental authorities, bank, utilities, and other entities.

Dr. Norton is a member of the American Accounting Association and a member and officer of Financial Executives International.



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