

USING FINANCIAL ACCOUNTING

A N I N T R O D U C T I O N

Dennis Murray • Bruce R. Neumann \ Pieter Elgers

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DEDICATION

To Lucy and

In memory of Mary, Francis, and Anastasia

D. M.

This text is dedicated in honor of my children:

Elizabeth and Del Shannon

Rebecca Neumann

Susan Neumann

David Neumann

to whom it may be said, as it was said of the Rector of Albermarlia at St. John's Church, England, 1741:

"was exerted with uncommon penetration and judgment upon their proper object without noise or ostentation."

B. R. N.

To May and Dorian Elgers-Lo

P. E.

PREFACE

This is an exciting time in accounting education. Various constituencies have emphasized the need for change and accounting educators have been quick to respond. Colleges and universities have developed innovations in their curricula, methods of instructional delivery, and course materials. We believe this book will assist those students and faculty members seeking an innovative approach to introductory financial accounting.

For several years now, nearly all introductory texts have offered new and various pedagogical features that proclaim to follow a “user” approach. We have attempted to advance this trend. *Using Financial Accounting* is truly written from the user’s perspective. We emphasize (1) the effects of transactions on financial statements, (2) the interrelationships among the financial statements, and (3) the interpretation of financial statement information.

The mechanical aspects of the accounting process, such as journals, ledgers, debits/credits, trial balances, etc., are virtually eliminated from the text. Beginning students too frequently become immersed in detailed bookkeeping procedures and lose sight of the underlying objective of accounting: to assist in making business and economic decisions.

By taking an analytical and interpretative approach, students are able to understand and use financial statements. They will retain this ability longer than the knowledge of detailed accounting procedures. This approach “adds value” to students’ potential contributions as business professionals.

TARGET AUDIENCE

This text is intended to serve both accounting majors and nonmajors. Nonmajors view a rules-based presentation as procedural rather than conceptual. Majors are also limited by a mechanical approach in that they do not really understand the goals and purposes of financial accounting until much later in their academic or professional careers. The target audience for this text includes:

1. Undergraduate accounting majors
2. Students other than accounting majors who want to interpret financial statements and interact with accounting professionals (this student group includes business majors and students in nonbusiness disciplines, such as engineering, health services, and law)
3. MBA students, who are particularly well served by an interpretative approach.

FEATURES

This text’s distinctive combination of features enhances value to students. These features include (1) the use of transaction analysis, rather than journal entries, to describe

business events; (2) incorporation of “Reality Checks” that relate the text material to current real-world companies; (3) attention to international issues and accounting conventions for non-U.S. firms; (4) discussions and problem materials dealing with ethical issues facing managers and accountants; (5) evaluations of economic consequences associated with accounting policy decisions; (6) inclusion of an unusually large, diverse, and flexible set of end-of-chapter assignment material; and (7) a host of Internet-based problems in each chapter and an appendix showing students how to access financial accounting information on the Internet.

Transaction Analysis

To understand and interpret financial statements, students must gain an understanding of how transactions affect financial statements. This is accomplished by using the basic accounting equation:

$$\text{ASSETS} = \text{LIABILITIES} + \text{SHAREHOLDERS' EQUITY}$$

Transaction analysis, using the accounting equation, provides students with the background and tools to analyze financial statements. In addition to showing how business events affect the accounting equation, significant parts of each chapter are devoted to analysis and interpretation. Ratio analysis is introduced as early as Chapter 3 (The Balance Sheet) and appears in every subsequent chapter.

Reality Checks

Because we focus on the uses of financial accounting information, each chapter includes numerous real-world illustrations. These illustrations show how financial statements provide insights into a firm's performance. As part of this real-world orientation, Reality Checks are interspersed throughout the text. Reality Checks are self-contained, limited-scope problems based on actual financial statements and other disclosures. They help students see how financial statements can be used to answer important questions. Solutions to Reality Checks are included at the end of each chapter.

International Coverage

Many chapters also address international issues. These topics are interwoven into the discussion of financial statement analysis. The reader is shown how international differences in accounting standards can affect the inferences drawn from financial statements. For example, the discussion of noncurrent assets indicates that firms in some countries (e.g., Australia) report the market value of property, plant, and equipment. Moreover, case problems involving non-U.S. firms are included at the ends of several chapters. International accounting issues are summarized in Chapter 13.

● Ethics

Ethical issues are considered throughout the text. Ethical dilemmas are presented in each chapter and the reader is asked to identify the proper course of action. We use a flag called “What Would You Do?” to alert readers to these ethical issues as they arise.

● Economic Consequences

During the past 20 years, we have become more aware of the economic consequences and managerial motivations related to accounting policy decisions. Sophisticated users of financial statements should know that motivations stemming from compensation plans and debt covenants can affect the relevance and reliability of financial accounting information. These discussions are relatively self-contained so that they can be included at the instructor’s option.

● End-of-Chapter Material

Each chapter ends with (1) questions, (2) exercises, (3) problems, and (4) cases and extensions. The questions and exercises are relatively short, straightforward applications of the text material. Problems are straightforward, yet longer and more involved than the exercises.

Most chapters also contain sets of alternative problems or exercises. It is the authors’ intent that students only complete one of the alternatives available. While most such sets contain two alternatives, noted as Problem A or B, some contain three alternatives (noted as A, B, or C). Please see Problem 2–29 for the first such example of how these alternatives are listed. In addition, some problems and cases are presented in a multi-part format noted as a “continuation.” Please see Problem 2–25 through 2–28 for the first example of multi-part problems. The authors would suggest that these multi-part problems might be used profitably for class discussion or examination purposes. If so, the instructor might assign the first part as homework and the second or later parts can then be used for discussion or examination purposes.

Cases and other extended discussion questions have been included to challenge students’ understanding of how financial statements can be used. They often require qualitative, narrative responses; some require research and writing. Our focus on the user orientation, real-world information, international issues, and ethics is carried through to the end-of-chapter material. Much of this material is based on actual financial statements from companies from around the world. The end-of-chapter material also contains situations requiring the application of ethics and Internet exercises.

ORGANIZATION

This book is arranged into four major components that make it readily adaptable for use in quarter, semester, or modular-type programs.

Part 1 consists of Chapters 1 through 5. This part is an introduction to financial accounting and the three primary financial statements: the balance sheet, the income statement, and the statement of cash flows.

Part 2 is comprised of Chapters 6 through 10. These chapters examine in more detail current and noncurrent assets, current and noncurrent liabilities, and shareholders' equity.

Part 3 consists of Chapter 11. This chapter is a synthesis of financial statement analysis. Although all chapters focus on the analysis and interpretation of financial statements, Chapter 11 provides an overall framework for financial statement analysis. Most instructors will use this chapter to unify the topics covered earlier in the text.

Part 4 consists of Chapters 12 through 14. These chapters consist of several self-contained modules that explore relatively complex topics such as leases, pensions, consolidated reporting, and international reporting. Many instructors will choose to cover only a subset of these topics.

Finally, *Using Financial Accounting* has seven appendixes. Appendix A contains an overview of the accounting process. Journal entries, adjusting entries, closing entries, and other procedural aspects of accounting are discussed. This appendix is intended primarily for those students (e.g., accounting majors) who wish to engage in further study of financial accounting. Most instructors who elect to utilize this appendix would likely use it in an end-of-course module to prepare students for intermediate financial accounting.

Appendix B examines various career options in accounting. This material would be of interest to a wide array of readers.

In keeping with our real-world approach, Appendixes C through F contain the annual reports of OshKosh B'Gosh, Inc., Wendy's International, Inc., Bristol-Myers Squibb Company, and Reebok International Limited, respectively. These reports serve as the basis for a number of exercises and problems.

Appendix G, prepared by W. David Albrecht of Bowling Green State University and Niranjan Chipalkatti of Ohio Northern University, shows students how to access information on the Internet. The Securities and Exchange Commission database and corporate home pages contain volumes of extremely up-to-date financial information. Each chapter also includes several problems based on accessing the Internet.

The following supplements are available for use with this text.

Instructor's Manual. Prepared by Linda Kidwell of Niagara University, this ancillary provides chapter overviews, learning objectives, and material designed to encourage group work.

Test Bank. Prepared by Lola F. Rhodes of Southern Methodist University, this text bank provides a variety of true/false, multiple-choice, matching, fill-in, and essay problems, 80 to 100 per chapter. Each chapter includes a page linking the problems to the learning objectives and providing a difficulty level for each problem.

Study Guide. Cecelia M. Fewox, CPA, of Trident Technical College, provides an overview for each chapter, a review of each specific chapter objective, and self-test material that utilizes matching, completion, and multiple-choice formats, as well as demonstration problems.

Solutions Manual. Prepared by Elizabeth C. Conner, of the University of Colorado at Denver, provides solutions to the text's extensive end-of-chapter review material.

Acetates. Approximately 80 four-color teaching acetates are available.

WESTEST 3.1. This computerized testing software provides the entire written test bank in a computerized format to facilitate test preparation in a DOS or Macintosh environment.

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