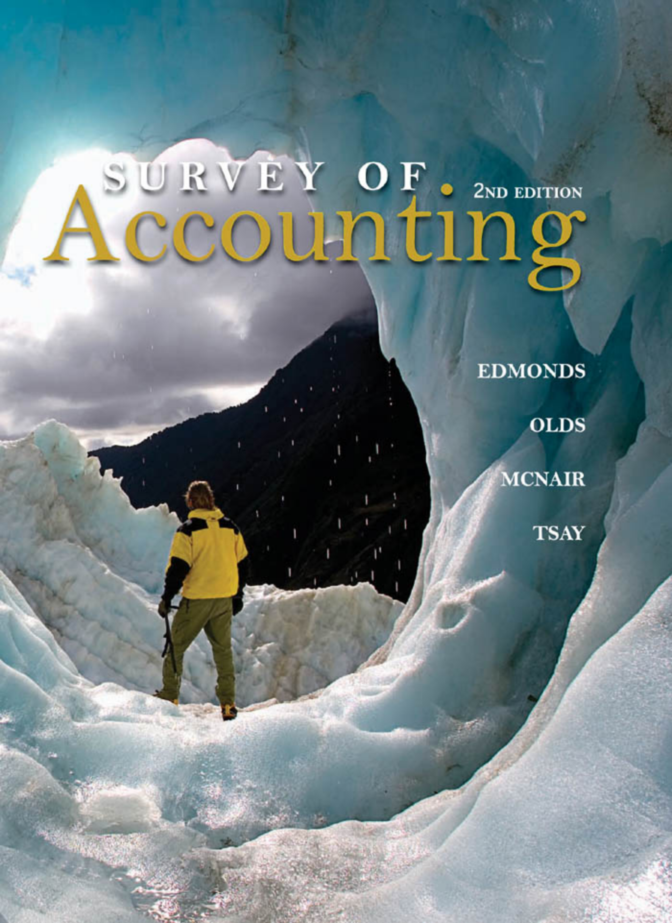
SURVEY OF
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Accounting
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Second Edition

Survey *of* Accounting

Thomas P. Edmonds
University of Alabama—Birmingham

Philip R. Olds
Virginia Commonwealth University

Frances M. McNair
Mississippi State University

Bor-Yi Tsay
University of Alabama—Birmingham

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Publisher: *Tim Vertovec*
Executive editor: *Steve Schuetz*
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This book is dedicated to our students, whose questions have so frequently caused us to reevaluate our method of presentation that they have, in fact, become major contributors to the development of this text.

NOTE FROM AUTHORS

Over the past 17 years, major changes in accounting education have impacted the way most college and university professors teach introductory accounting. We are gratified that our concepts approach has been so effective that it has become a market leader in the change movement.

How have we become market leaders?

We look at ourselves as innovative traditionalists. We don't aim to radically transform accounting education, but to make it more effective. With the concepts approach, students follow a different path toward the accomplishment of a conventional set of learning objectives. However, the path is easier to walk and students complete the journey with a far greater understanding of accounting.

In contrast to traditional textbooks, this is a **concepts-based approach** that **focuses on the big picture.** Details are presented after a conceptual foundation has been established. This approach enables students to understand rather than memorize. What do we mean by a concepts-based textbook? We mean the text stresses the relationships between business events and financial statements. The primary objective is to develop students who can explain how business events affect the income statement, balance sheet, and statement of cash flows. Do assets increase, decrease or remain unchanged? What effect does each event have on liabilities, equity, revenue, expense, gains, losses, net income, and dividends? Furthermore, how does the event affect cash flows? **The focus is on learning how business events affect financial statements.**

Implementing the concepts approach is surprisingly simple.

Instead of teaching students to record transactions in journals or T-accounts, teach them to record transactions directly into financial statements. While this shift is easy for instructors, it represents a dramatic improvement in how students have traditionally studied accounting. Making a direct connection between business events and financial statements encourages students to analyze conceptual relationships rather than memorize procedures.

This text helps teachers move from the traditional educational paradigm more easily than you might imagine. The content focuses on essential concepts, reducing the amount of material you must cover, and giving you more time to work on skill development. The Instructor's Resource Manual provides step-by-step instructions for implementing innovative teaching methods such as active learning and group dynamics. It offers enticing short discovery learning cases which provide class-opening experiences that effectively stimulate student interest and help develop critical thinking skills.

But don't take our word for it.

With over 200 colleges and universities successfully making the change to the concepts approach, we feel confident you will experience the same success as many of your colleagues. We would like to thank all of those who have been supportive of our teaching philosophy, and we highly encourage you to contact the author team or your local McGraw-Hill/Irwin representative to learn more about our texts.

Tom Edmonds • Phil Olds • Frances McNair • Bor-Yi Tsay

"I would say it is a positive, new approach to teaching an old subject."

Frank Bagan, County College of Morris

"I couldn't recommend this text too highly to any of my colleagues. It literally puts the 'sizzle' back into the teaching process!"

Michael R. Dodge, Coastal Carolina Community College

"I heartily applaud the authors' goal of providing students with a concepts-based approach rather than a strictly procedure-based approach to be an important contribution to improving accounting education, one that appeals to both users and preparers and that enables students to 'read between the lines.'"

Michael R. Dodge, Coastal Carolina Community College

"Clear and concise. The best book I have seen for use by non-accounting majors!"

Thomas Casey, DeVry University

"This book is very well written, comprehensive, student-friendly, and provides relevant instruction to students."

J. Gay Mills, Amarillo College

"Very clear, concise, yet sophisticated treatment of topics."

Nicholas P. Marudas, Auburn University at Montgomery

Thomas P. Edmonds

Thomas P. Edmonds, Ph.D., is the Friends and Alumni Professor of Accounting at the University of Alabama at Birmingham (UAB). Dr. Edmonds has taught in the introductory area throughout his career. He has coordinated the accounting principles courses at the University of Houston and UAB. He currently teaches introductory accounting in mass sections and in UAB's distance learning program. He is actively involved in the accounting education change movement. He has conducted more than 50 workshops related to teaching introductory accounting during the last decade. Dr. Edmonds has received numerous prestigious teaching awards including the Alabama Society of CPAs Outstanding Educator Award and the UAB President's Excellence in Teaching Award. Dr. Edmonds's current research is education based. He has written articles that have appeared in many publications including the *Accounting Review, Issues in Accounting, Journal of Accounting Education,* and *Advances in Accounting Education*. Dr. Edmonds has been a successful entrepreneur. He has worked as a management accountant for a transportation company and as a commercial lending officer for the Federal Home Loan Bank. Dr. Edmonds began his academic training at Young Harris Community College. His Ph.D. degree was awarded by Georgia State University. Dr. Edmonds's work experience and academic training have enabled him to bring a unique perspective to the classroom.

Philip R. Olds

Professor Olds is Associate Professor of Accounting at Virginia Commonwealth University (VCU). He serves as the coordinator of the introduction to accounting courses at VCU. Professor Olds received his A.S. degree from Brunswick Junior College in Brunswick, Georgia (now Costal Georgia Community College). He received a B.B.A. in accounting from Georgia Southern College (now Georgia Southern University) and his M.P.A. and Ph.D. degrees are from Georgia State University. After graduating from Georgia Southern, he worked as an auditor with the U.S. Department of Labor in Atlanta, Georgia. A CPA in Virginia, Professor Olds has published articles in various professional journals and presented papers at national and regional conferences. He also served as the faculty adviser to the VCU chapter of Beta Alpha Psi for five years. In 1989, he was recognized with an Outstanding Faculty Vice-President Award by the national Beta Alpha Psi organization.

Frances M. McNair

Frances M. McNair holds the KPMG Peat Marwick Professorship in Accounting at Mississippi State University (MSU). She has been involved in teaching principles of accounting for the past 12 years and currently serves as the coordinator for the principles of accounting courses at MSU. She joined the MSU faculty in 1987 after receiving her Ph.D. from the University of Mississippi. The author of various articles that have appeared in the *Journal of Accountancy, Management Accounting, Business and Professional Ethics Journal, The Practical Accountant, Taxes,* and other publications, she also coauthored the book *The Tax Practitioner* with Dr. Denzil Causey. Dr. McNair is currently serving on committees of the American Taxation Association, the American Accounting Association, and the Institute of Management Accountants as well as numerous School of Accountancy and MSU committees.

Bor-Yi Tsay

Bor-Yi Tsay, Ph.D., CPA is Professor of Accounting at the University of Alabama at Birmingham (UAB) where he has taught since 1986. He has taught principles of accounting courses at the University of Houston and UAB. Currently, he teaches an undergraduate cost accounting course and an MBA accounting analysis course. Dr. Tsay received the 1996 Loudell Ellis Robinson Excellence in Teaching Award. He has also received numerous awards for his writing and publications including the John L. Rhoads Manuscripts Award, John Pugsley Manuscripts Award, Van Pelt Manuscripts Award, and three certificates of merits from the Institute of Management Accountants. His articles have appeared in *Journal of Accounting Education, Management Accounting, Journal of Managerial Issues, CPA Journal, CMA Magazine, Journal of Systems Management,* and *Journal of Medical Systems.* He currently serves as a member of the board of the Birmingham Chapter, Institute of Management Accountants. He is also a member of the American Institute of Certified Public Accountants and Alabama Society of Certified Public Accountants. Dr. Tsay received a B.S. in agricultural economics from National Taiwan University, an M.B.A. with a concentration in accounting from Eastern Washington University, and a Ph.D. in accounting from the University of Houston.

HOW DOES THIS BOOK HELP

STUDENTS SEE THE BIG PICTURE?

"[The Horizontal Financial Statements Model is] well organized and a straightforward way to show the effects of transactions."

Andy Williams, Edmonds Community College

"I think the authors have an original and understandable approach to financial accounting."

Ed Doty, East Carolina University

"I really like this approach of bringing the conceptual framework up front, helping students see the big picture before they find themselves bogged down in details. I find that students who have the clearest appreciation of the conceptual framework early have the greatest chance of mastering the details later on."

Michael R. Dodge, Coastal Carolina Community College

Horizontal Financial Statements Model

A horizontal financial statements model replaces the accounting equation as the predominant teaching platform in this text. The model arranges the balance sheet, income statement, and statement of cash flows horizontally across a single line of text as shown below.

Assets	=	Liabilities	+	Stockholders' Equity	Rev.	−	Exp.	=	Net Inc.	Cash Flow

The statements model approach enables students to see how accounting relates to real-world decision making. The traditional approach teaches students to journalize a series of events and to present summarized information in financial statements. They never see how individual transactions affect financial statements. In contrast, when students record transactions into a statements model, they see a direct connection between business events and financial statements. Most business people think "if I take this particular action, how will it affect my financials," not "if I do these fifteen things, how will they be journalized." Accordingly, the statements model approach provides a learning experience that is more intuitive and relevant than the one provided by traditional teaching methodology.

Establishing The Conceptual Framework

Chapter 1 introduces the key components of the conceptual framework for financial accounting. We expect students to master not only the definitions of financial statement elements but also the relationships between those elements. For example, the term "asset" is defined and then the term "revenue" is defined as an increase in assets. The definitions are expanded in a logical stepwise fashion. Once students have learned the elements, the text explains how to organize those elements into a set of financial statements. The financial statements model is introduced toward the end of the first chapter.

Accruals and deferrals are introduced in **Chapter 2** and it not only introduces new concepts but reinforces the core concepts introduced in Chapter 1. The basic conceptual components of the income statement are reinforced through repetition. By the time students have completed the first two chapters, they have a strong conceptual foundation.

The Effects of Cash Flows Are Shown Through the Entire Text.

The statement of cash flows is introduced in the first chapter and included throughout the text. Students learn to prepare a statement of cash flows by learning to analyze each increase and decrease in the cash account and by classifying each entry in the cash account as an operating, investing, or financing activity. This logical approach helps students understand the essential differences between cash flows and accrual-based income.

Managerial Accounting Concepts

Traditional texts have emphasized accounting practices for manufacturing companies, while the business environment has shifted toward service companies. This text recognizes this critical shift by emphasizing decision-making concepts applicable to both service and manufacturing companies.

A Consistent Point of Reference

Why do good students sometimes have so much trouble grasping the simplest concepts? A recent introductory accounting workshop participant supplied the answer. Most accounting events are described from the perspective of the business entity. For example, we say the business borrowed money, purchased assets, earned revenue, or incurred expenses. However, we usually shift the point of reference when describing equity transactions. We say the owners contributed capital, provided cash, or invested assets in the business. This reference shift confuses an entry-level accounting student. Your students will appreciate the fact that this text uses the business entity as a consistent point of reference in describing all accounting events. This text makes a conscious effort to minimize the road blocks that are frequently raised by the inconsistent use of technical terminology.

Focus on Corporate Form of Organization

We want students to learn that businesses acquire assets from three primary sources: from creditors, from investors, and from earnings. The corporate organization structure highlights these three asset sources by using separate account categories for liabilities, contributed capital, and retained earnings. We have found the corporate form to be pedagogically superior to the proprietorship form in the educational setting.

Less Is More

Many educators recognize the detrimental effect of information overload. Research suggests that students resort to memorization when faced with too much content, and are unable to comprehend basic concepts. We make a conscious choice to reduce the breadth of content coverage in order to enhance student comprehension of concepts. For example, you don't need to teach both the net and gross methods to explain how cash discounts affect financial statements. Demonstrating just one method is sufficient to demonstrate the critical interrelationships.

Excel Spreadsheets

Spreadsheet applications are essential to contemporary accounting practice. Students must recognize the power of spreadsheets and know how accounting data are presented in spreadsheets. We discuss Excel applications where appropriate throughout the text. In most instances, the text illustrates actual spreadsheets. End-of-chapter materials include problems students can complete using spreadsheet software.

Required

Show the effects of the events on the financial statements using a horizontal statements model like the following one. In the Cash Flows column, use the letters OA to designate operating activity, IA for investing activity, FA for financing activity, and NC for net change in cash. Use NA to indicate accounts not affected by the event. The first event is recorded as an example.

	Assets			= Liabilities		+ Stockholders' Equity		Rev. − Exp. = Net Inc.			Cash Flows
Event No.	Cash	+ Accts. Rec.	+ Supp.	= Accts. Pay.	+ Unearn. Rev.	+ Com. Stk.	+ Ret. Earn.	Rev.	− Exp.	= Net Inc.	
1	15,000	+ NA	+ NA	= NA	+ NA	+ 15,000	+ NA	NA	− NA	= NA	15,000 FA

Problem 2-28 ***Effect of deferrals on financial statements: three separate single-cycle examples***

Required

a. On February 1, 2010, Moore, Inc., was formed when it received $70,000 cash from the issue of common stock. On May 1, 2010, the company paid $42,000 cash in advance to

CHECK FIGURES

a. Net Income: $52,000

"I wish I had learned it (cash flows) this way. This helps our accounting students tremendously as they have a smoother transition into intermediate accounting. You make a difficult topic much easier to understand!"

Sondra Smith, University of West Georgia

HOW DOES THE BOOK

Real-World Examples

The text provides a variety of thought-provoking, real-world examples of financial and managerial accounting as an essential part of the management process. There are descriptions of accounting practices from Coca-Cola, Chevron, Zales, Albertsons, and CBS Corporation. These companies are highlighted in blue in the text.

The *Curious* Accountant

Suppose the U.S. government purchases $10 million of fuel from **Chevron**. Assume the government offers to pay for the fuel on the day it receives it from Chevron (a cash purchase) or 30 days later (a purchase on account).

Assume that Chevron is absolutely sure the government will pay its account when due. Do you think Chevron should care whether the government pays for the goods upon delivery or 30 days later? Why? (Answers on page 173.)

The Curious Accountant

Each chapter opens with a short vignette that sets the stage and helps pique student interest. These pose a question about a real-world accounting issue related to the topic of the chapter. The answer to the question appears in a separate sidebar a few pages further into the chapter.

Answers to The *Curious* Accountant

Chevron would definitely prefer to make the sale to the government in cash rather than on account. Even though it may be certain to collect its accounts receivable, the sooner Chevron gets its cash, the sooner the cash can be reinvested.

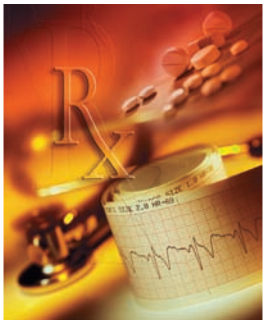
The interest cost related to a small account receivable of $50 that takes 30 days to collect may seem immaterial; at 4 percent, the lost interest amounts to less than $.20. However, when one considers that Chevron had approximately $17.2 billion of accounts receivable, the cost of financing receivables for a real-world company becomes apparent. At 4 percent, the cost of waiting 30 days to collect $17.2 billion of cash is $56.5 million ($17.2 billion × .04 × [30 ÷ 365]). For one full year, the cost to Chevron would be more than $688 million ($17.2 billion × 0.04). In 2005, it took Chevron approximately 32 days to collect its accounts receivable, and the weighted-average interest rate on its debt was approximately 4.2 percent.

Focus on International Issues

These boxed inserts expose students to international issues in accounting.

Focus On INTERNATIONAL ISSUES

U.S. GAAP: A COMPETITIVE DISADVANTAGE?



As discussed earlier in this textbook, the diversity of accounting rules is decreasing among industrialized nations. This is due in large part to the fact that so many countries require their publicly listed companies to follow the accounting rules of the International Accounting Standards Board (IASB) and the efforts between the FASB and the IASB to bring their rules into closer agreement. However, there continue to be areas where significant differences exist between the accounting rules for companies in the United States and companies in other countries. Furthermore, in the opinion of the managers of some companies involved in global competition, these differences put U.S. companies at a competitive disadvantage. Accounting for research and development costs (R&D) is a good example of this situation.

Suppose that Microbiotech, Inc., is a pharmaceutical company that spent $10 million in 2011 on R&D of a new drug. If Microbiotech is a U.S. company, it is required to expense the $10 million immediately under U.S. GAAP. However, if Microbiotech is a Japanese company, using Japanese GAAP, it is allowed to capitalize the costs in an asset account and then expense it gradually, through amortization, over the useful life of the asset. As a result, in the year the R&D costs are incurred a U.S. company reports more expense, and less earnings, than its Japanese counterpart.

MOTIVATE STUDENTS?

CHECK *Yourself* **2.1**

During 2010, Anwar Company earned $345,000 of revenue on account and collected $320,000 cash from accounts receivable. Anwar paid cash expenses of $300,000 and cash dividends of $12,000. Determine the amount of net income Anwar should report on the 2010 income statement and the amount of cash flow from operating activities Anwar should report on the 2010 statement of cash flows.

Answer Net income is $45,000 ($345,000 revenue − $300,000 expenses). The cash flow from operating activities is $20,000, the amount of revenue collected in cash from customers (accounts receivable) minus the cash paid for expenses ($320,000 − $300,000). Dividend payments are classified as financing activities and do not affect the determination of either net income or cash flow from operating activities.

Check Yourself

These short question/answer features occur at the end of each main topic and ask students to stop and think about the material just covered. The answer follows to provide immediate feedback before students go on to a new topic.

Reality **BYTES**

"Closed for Inventory Count" is a sign you frequently see on retail stores sometime during the month of January. Even if companies use a perpetual inventory system, the amount of inventory on hand may be unknown because of lost, damaged, or stolen goods. The only way to determine the amount of inventory on hand is to count it. Why count it in January? Christmas shoppers and many after-Christmas sales shoppers are satiated by mid-January, leaving the stores low on both merchandise and customers. Accordingly, stores have less merchandise to count and "lost sales" are minimized during January. Companies that do not depend on seasonal sales (e.g., a plumbing supplies wholesale business) may choose to count inventory at some other time during the year. Counting inventory is not a revenue-generating activity; it is a necessary evil that should be conducted when it least disrupts operations.

Reality Bytes

This feature provides examples or expansions of the topics presented by highlighting companies and showing how they use the accounting concepts discussed in the chapter to make business decisions.

THE FINANCIAL ANALYST

This section of each chapter introduces topics related to analyzing real world financial reports. We focus first on the types of businesses that operate in the real world. We also discuss the annual report that is used to communicate information to stakeholders.

Real-World Financial Reports

As previously indicated, organizations exist in many different forms, including *business* entities and *not-for-profit* entities. Business entities are typically service, merchandising,

The Financial Analyst

Financial statement analysis is highlighted in each chapter under this heading.

A Look Forward >>

Chapters 1 and 2 focused on businesses that generate revenue by providing services to their customers. Examples of these types of businesses include consulting, real estate sales, medical services, and legal services. The next chapter introduces accounting practices for businesses that generate revenue by selling goods. Examples of these companies include Wal-Mart, Circuit City, Office Depot, and Lowes.

A Look Back/A Look Forward

Students need a roadmap to make sense of where the chapter topics fit into the whole picture. A Look Back reviews the chapter material and a Look Forward introduces new material to come in the next chapter.

Regardless of the instructional approach, there is no shortcut to learning accounting. Students must practice to master basic accounting concepts. The text includes a prodigious supply of practice materials and exercises and problems.

Self-Study Review Problem

These sections offer problems and solutions of major chapter concepts.

SELF-STUDY REVIEW PROBLEM

Gifford Company experienced the following accounting events during 2010.

1. Started operations on January 1 when it acquired $20,000 cash by issuing common stock.
2. Earned $18,000 of revenue on account.
3. On March 1 collected $36,000 cash as an advance for services to be performed in the future.
4. Paid cash operating expenses of $17,000.
5. Paid a $2,700 cash dividend to stockholders.
6. On December 31, 2010, adjusted the books to recognize the revenue earned by providing services related to the advance described in Event 3. The contract required Gifford to provide services for a one-year period starting March 1.
7. Collected $15,000 cash from accounts receivable.

Exercise and Problem Sets

• Check figures

The figures provide a quick reference for students to check on their progress in solving the problem.

• Excel

Many exercises and problems can be solved using the Excel™ spreadsheet templates contained on the text's Online Learning Center. A logo appears in the margins next to these exercises and problems for easy identification.

	Assets					=	Liabilities			+	Stockholders' Equity			Rev.	−	Exp.	=	Net Inc.	Cash Flows	
Event No.	Cash	+	Accts. Rec.	+	Supp.	=	Accts. Pay.	+	Unearn. Rev.	+	Com. Stk.	+	Ret. Earn.							
1	15,000	+	NA	+	NA	=	NA	+	NA	+	15,000	+	NA	NA	−	NA	=	NA	15,000	FA

Problem 2-28 ***Effect of deferrals on financial statements: three separate single-cycle examples***

excel

Required

a. On February 1, 2010, Moore, Inc., was formed when it received $70,000 cash from the issue of common stock. On May 1, 2010, the company paid $42,000 cash in advance to rent office space for the coming year. The office space was used as a place to consult with clients. The consulting activity generated $80,000 of cash revenue during 2010. Based on this information alone, record the events and related adjusting entry in the general ledger accounts under the accounting equation. Determine the amount of net income and cash flows from operating activities for 2010.

b. On January 1, 2010, the accounting firm of Wayne & Associates was formed. On August 1, 2010, the company received a retainer fee (was paid in advance) of $36,000 for services to be performed monthly during the next 12 months. Assuming that this was the only transaction completed in 2010, prepare an income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows for 2010.

c. Hal Company had $1,250 of supplies on hand on January 1, 2011. Hal purchased $6,500 of supplies on account during 2011. A physical count of supplies revealed that $1,500 of supplies was on hand as of December 31, 2011. Determine the amount of supplies expense that should be recognized in the December 31, 2011 adjusting entry. Use a financial statements model to show how the adjusting entry would affect the balance sheet, income statement, and statement of cash flows.

CHECK FIGURES
a. Net Income: $52,000
b. Net Income: $15,000

Problem 2-29 ***Effect of adjusting entries on the accounting equation*** LO 2

Required

Each of the following independent events requires a year-end adjusting entry. Show how each event and its related adjusting entry affect the accounting equation. Assume a December 31 closing date. The first event is recorded as an example.

CHECK FIGURE
b. adjustment amount: $1,500