

Preface:

Goals, Game Plan & Conceptual Framework

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GOALS

Three Goals and Their Relevance to Your Career

You may not become an accountant, but accounting reports likely will affect or be affected by many of your decisions. The quality of these decisions will be enhanced by your understanding of accounting.

Moreover, during your careers, as educators or managers, you will collectively make decisions that affect the flow of billions of dollars worth of resources around the globe and the lives of countless individuals. Our humble hope is the quality of your decisions can be improved, in part, by what you learn from *Navigating Accounting*.

Navigating Accounting's purpose is to help you attain three overarching goals that will give you a solid understanding of accounting fundamentals and thus help you make better business decisions regardless of your career choice:

1. Acquire a broad conceptual framework for understanding and preparing financial, managerial, and tax reports that will serve as a solid foundation for your career and other courses.
2. Understand how information about economic activities is measured, recorded, aggregated, and affects financial statements and performance metrics. This will help you understand how activities you are involved with on the job affect the ways you, your managers, and your company are evaluated.
3. Become reasonably proficient at interpreting numbers in financial statements and assessing their usefulness for your decisions.

“Reasonably proficient at interpreting reported numbers and assessing their usefulness” means the goal is to help you understand:

- the primary elements in financial statements (e.g., assets, liabilities, income, and expenses);
- the major accounting entries behind reported numbers;
- the measurement objectives of the financial measures associated with these entries (and thus what the numbers are intended to measure);
- the relevance of these measurement objectives to your decisions;
- how reliably the measures likely meet these objectives;
- the extent to which information is likely lost through aggregation when measures are combined in financial reports.

By attaining these goals, you will be comfortable with financial statements and other reports, you will be prepared to have more informed discussions with experts, and you will make better decisions.

Moreover, you will have a sturdy foundation for a successful career in accounting or finance. Who knows, with several more years of course work and practical experience, you could become a top-flight Wall Street analyst, chief financial officer at a Fortune 500 company, or senior partner at a major public accounting firm.

Navigating Accounting's third goal would be much easier to attain if it did not include the part about assessing usefulness. To be sure, learning the major events behind reported numbers is no small feat. But, as we shall see, this task is considerably less ambitious than assessing usefulness.

As you progress through *Navigating Accounting's* content, you will likely have a much different image of accountants than you started with, and hopefully you will begin to entertain the idea that you should learn to think like an accountant, even if you choose not to become one.

You will learn that accounting is the language of business and that the public's image of record keeping and other procedures associated with accounting is only the grammar. In particular, a subtle aspect of accounting, like nuances in other languages, is that it both depicts and influences business reality and culture.

Questions You Will be Ready to Address

To preview your journey, here are some progressively tougher questions that you will learn how to answer as you work your way through *Navigating Accounting*:

- What are the purposes and structures of the primary financial statements — balance sheets, income statements, statements of changes in owners' equity, and statements of cash flows? What do they tell you about companies? What events and decisions likely gave rise to the numbers reported in them? How were the related accounting entries recorded?
- What are the major events and accounting decisions behind the numbers reported in financial statements?
- Where do you learn about the choices management had under Generally Accepted Accounting Principles (GAAP) when they made accounting decisions related to reported numbers?
- Where do you look for the economic, social, and political considerations that standard setters and regulators considered when they imposed restrictions related to reported numbers?
- Where do you learn about management's incentives and opportunities to honestly report or misrepresent their private information?
- What accounting decisions and alternatives are likely related to the reported numbers?
- What business decisions or other economic outcomes were likely inputs into these accounting decisions?
- How difficult would it be for an honest and competent person to make these accounting decisions and, in particular, to measure the related economic outcomes using GAAP?
- How difficult would it be for auditors, regulators, and other unrelated parties to validate the reliability of reported numbers with a reasonable degree of confidence?
- To what extent is it likely that management intentionally manipulated the reported numbers?

As you shall see through numerous exercises, there are seldom definitive answers to many of these questions.



GAME PLAN

Frameworks

We will use three frameworks to reach *Navigating Accounting's* goals:

1. Conceptual framework
2. Applications framework
3. Learning framework

Navigating Accounting's **conceptual framework** explains how accounting reports affect and are affected by the environments in which they are prepared and used. This framework will facilitate your learning in two ways: first, it will allow you to focus on a few concepts that link several issues, rather than to skim rapidly over these issues and treat them as if they have nothing in common; second, it will prepare you for new accounting issues that can be understood in terms of existing concepts.

Navigating Accounting's **applications framework** is comprised of well-known real companies' annual reports and fictitious companies with similar financial statements. The fictitious company examples and exercises provide insights that connect what you see on real companies' reports to the accounting and business decisions behind the numbers.

Navigating Accounting's **learning framework** has many resources that will help you master the concepts and applications in the other two frameworks. In particular, these resources will help you meet five common learning challenges: searching for real company information, computing measures, record keeping and reporting, using information, and judgment as a user and preparer of accounting reports. The learning framework provides content to meet diverse aptitudes, experiences, and aspirations with detailed maps to help you navigate your learning path.

Strategy

The strategy has three elements:

1. You will study real companies to understand what you see on financial reports and other disclosures and how to apply your understanding in basic analysis.
2. You will study fictitious companies to understand the business events and accounting entries behind real companies' reported numbers and, when appropriate, estimate the measures and judgments related to these entries.
3. You will then analyze real companies' financial reports and other disclosures by applying your deeper understanding from learning related events, entries, measures, and judgments.

You will begin each topic as an outsider, meaning you are outside the company and only using public information. In this role, the "What Do I See?" videos, readings, and exercises will help you learn to identify and interpret issues that are pertinent to the topics you are studying.

To gain a general understanding about related real company decisions, you will then assume the role of an insider. An insider is someone who is inside the company and knows more about the events and decisions behind reported numbers than an outsider. In this

insider role, the “What’s Behind the Numbers?” videos, readings, and exercises will help you gradually gain a clearer picture of business and accounting decisions and, thus, of the events and judgments behind numbers reported by real companies.

To close the loop, you will then return to your role as an outsider. The “How Do I Use the Numbers?” videos, readings, and exercises will help you learn to identify and interpret real company’s disclosures and make conjectures about the events behind their numbers.

Next, we’ll give you an overview of *Navigating Accounting’s* Conceptual Framework that connects insiders and outsiders.

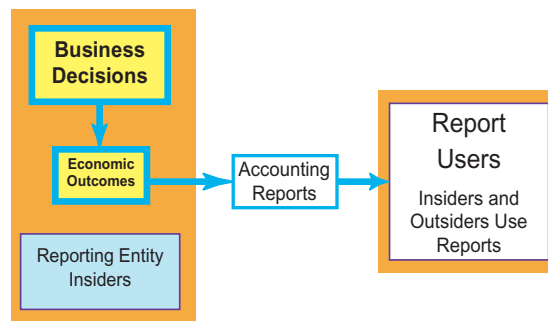
CONCEPTUAL FRAMEWORK

Three types of decisions are central to *Navigating Accounting's* conceptual framework: business decisions, accounting decisions, and user decisions. These decisions are defined in terms of their relationships to reporting entities' insiders and outsiders.

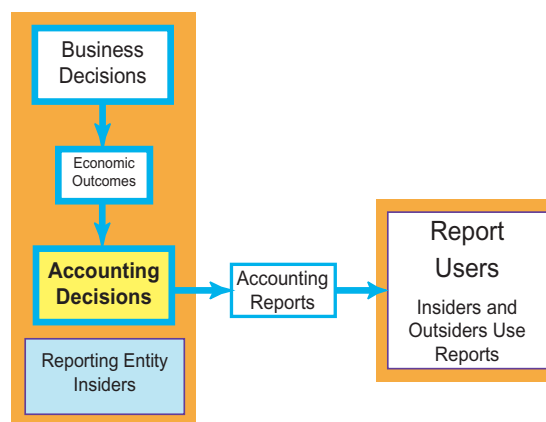
A reporting entity is any entity that issues accounting reports. They can be legal entities that are defined by the laws in the jurisdictions (cities, states, countries) where they reside. Examples of legal entities include corporations, partnerships, trusts, and government agencies. Reporting entities also can be parts of a company's management structure that may or may not be legal entities, including departments, product development teams, divisions, lines of business, and geographic segments.

Reporting entity "insiders" prepare accounting reports that are used by insiders and outsiders. For example, corporations issue financial statements to investors who use them to make investment decisions. Similarly, product development teams issue accounting reports to senior managers who use them to assess performance and determine the resources that will be committed to programs. Those who use reports are called, naturally enough, "users".

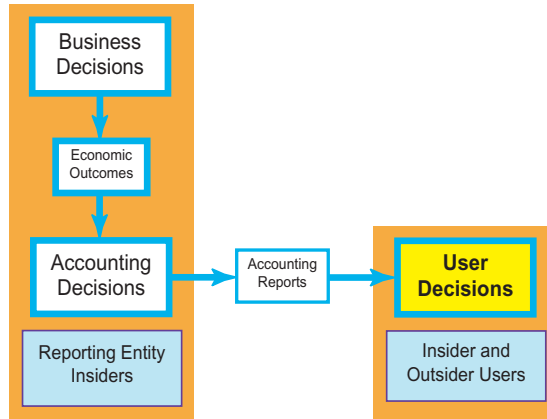
Corporations such as Intel, or smaller reporting entities such as Intel's departments and divisions, make numerous **business decisions**. These decisions, and other factors such as the general economic climate, lead to economic outcomes. These outcomes, or events, affect the reporting entity's resources, obligations, and performance. These effects are measured and reported to users.



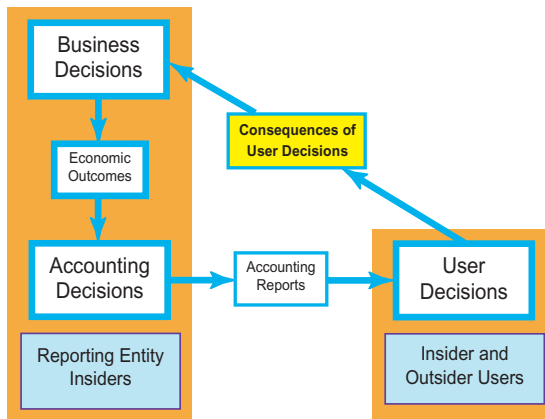
Accounting decisions determine how information about economic events is transformed into accounting reports. They determine which events are measured, how they are measured, when they are measured, and whether these measures are included in accounting reports.



These reports and information from other sources are inputs to **user decisions** — that is, decisions made by users of accounting reports that pertain to the reporting entity. While most of the controversial and interesting issues in accounting arise when the users are outsiders, insiders often use accounting reports when making business decisions. In these situations, subtle distinctions between user and business decisions are not important.



User decisions can affect business decisions to various degrees, depending on the reporting context. We will refer to these effects as the **consequences of user decisions** on the reporting entity. Sometimes these consequences are in the reporting entity’s best interest, and other times there are conflicts of interest between outsider-users and insider-managers.



Anticipating the consequences of users’ decisions can often cause insider-preparers to change their business and accounting decisions. Thus, the consequent connection in the above figure between outsiders and insiders establishes a circular flow, indicating that business, accounting, and user decisions are intertwined — each can influence the others to various degrees, for better or worse, depending on the context.

For example, managers who own shares of stock in their companies have incentives to work harder (business decisions) to produce better results (economic outcomes) in anticipation that the stock market will react favorably to their accounting reports and, thus, that the value of their shares will increase. Hence, anticipating the positive consequences of user decisions on share prices gives them an incentive to work harder.

Unfortunately, as demonstrated repeatedly by the 2002 accounting scandals, anticipating the favorable consequences of the stock market can also give managers an incentive to misrepresent accounting numbers through their accounting decisions.



After you learn about financial statements, we will dig much more deeply into the framework's three decisions and their consequences. For now, here are the key lessons:

- Insiders at reporting entities make business decisions that lead to economic outcomes that affect the entities' resources and obligations.
- Accounting decisions determine whether, where, when, and how these events are measured and reported. The resulting accounting reports help individuals and organizations (who are often outsiders) make user decisions, meaning decisions made by users of accounting reports.
- Users' decisions can affect their own welfare and the welfare of other stakeholders, including the insiders who make accounting and business decisions.
- The anticipated consequences of users' decisions on various stakeholders can cause insiders to change their business and accounting decisions.

Again, you may not become an accountant, but accounting reports likely will affect or be affected by many of your decisions. Moreover, during your career, you and others will collectively make decisions that will affect the flow of billions of dollars of resources and the lives of countless individuals. Our hope is that the quality of these decisions are improved, in part, by what you learn from studying *Navigating Accounting*.