

100+ Years Teaching Financial and Intermediate Accounting Suggestions for Change

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Abstract

In today's educational environment, many students have grown accustomed to memorizing their textbook and class notes. The students then parrot back the material when taking an exam. Their goal is not to learn, but rather to get a good grade. In this paper, we show examples and illustrations of how we teach financial accounting in a manner so that students learn and become adaptive problem solvers, not human parrots. We show how we simplify accounting presentations so that students more easily learn the concepts being taught. The goal is to get students to understand what they are doing so that they are not blindly following instructions in the text. Specifically, we show how we: 1.) Expose our students to some of the controversial items facing the accounting/business world in a rapidly changing environment, 2.) Stress the "Whys" – not simply the "Hows", and 3.) State when and why we don't always agree with the textbook.

Keywords: Transaction Worksheet, Fair Value Accounting, Historical Cost, Closing Journal Entries, Understanding versus Memorizing, Introductory Financial Accounting Course

Introduction

We show students the current issues confronting the accounting/business world. We share "the Good, the Bad, & the Ugly" with our students (Flynn, et.al. 2020). Our objective is to get students to realize multiple positions can exist. In our opinion, accounting is still more of an art than a science and is often influenced by political pressure from the various views of accounting stakeholders. Accounting is a lot more than memorizing debit and credit journal entries, GAAP pronouncements, and fancy terminology.

In Chapter One of our introductory financial accounting courses, we do not use the terms debits and credits. Many – often most – of our introductory accounting students have zero plans to major in accounting and thus make it a career after graduation. We structure the course FOR all students, regardless of their view towards a major and their early thoughts of career choice. Understanding what the numbers mean and what they do not mean – NOT memorizing – will be crucial to their future decision-making.

Initially, we use a Plus/Minus Transaction Worksheet – illustrated on page 5, and used by most introductory financial accounting textbooks – so that students can understand transactions and their impact on the accounting equation, the financial statements, and the resulting accounting ratios. This worksheet serves as a bridge to learning the concepts of debits and credits, which are introduced in Chapter Two. Therefore, our introductory accounting course becomes an “Introduction to Business” course – with an emphasis that if you UNDERSTAND the numbers – you have power.

In both introductory accounting and intermediate accounting, we replace fancy terminology with short concise alternatives that we believe are more understandable and useful. For example, we do not use the following terms that are typically used by textbooks: “nominal accounts” and “Income Summary account”. We replace “nominal accounts” with “Temporary Retained Earnings Accounts”, and then show students how to close the Temporary Retained Earnings Accounts directly into the Retained Earnings account without using the “Income Summary” account.

We often remind students that we do not do things differently from the textbook just to be different, but rather to make concepts easier (simpler) to understand. We will ‘correct’ something in the textbook that in our opinion is ‘wrong’ and thus is hindering student understanding.

Examples/Illustrations

We have links embedded in our Voice-Over PowerPoint Slides and or Videos, which could be used when teaching distance learning financial accounting courses. For this version of our paper, we have replaced the links with an ‘*’ indicating where links to embedded/animated Voice-Over PowerPoint Slides and/or Videos should be used to enhance the learning process. The PowerPoint Slides and/or Videos are available upon request.

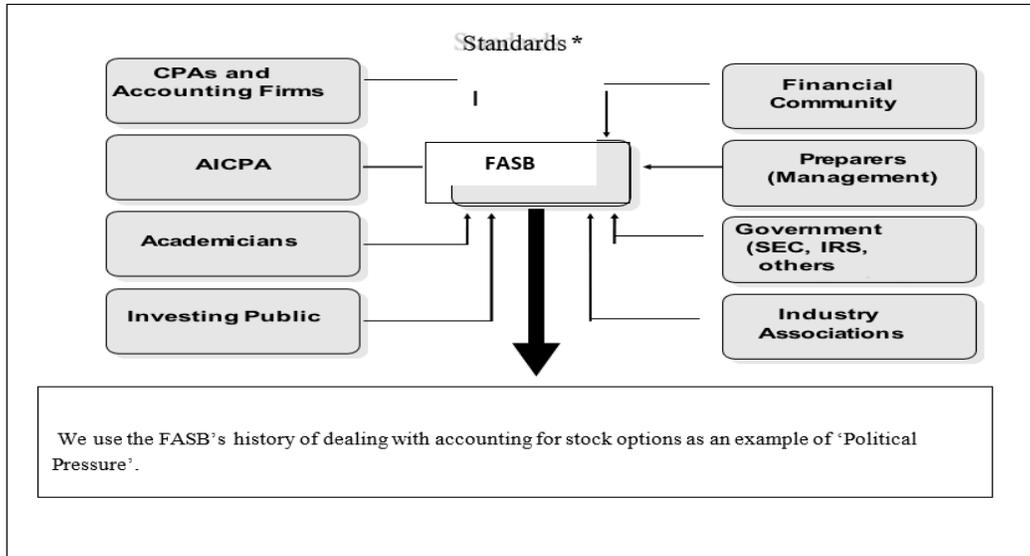
Current Issues Facing the Accounting/Business World and Political Pressures of Accounting Rulemaking

GAAP, FASB, and ‘Political’ Pressure

Good, Bad, & Ugly – Share with Students?

<p style="text-align: center;">Need to Develop Standards *</p> <p style="text-align: center;">The accounting profession has attempted to develop a set of standards that are generally accepted and ‘universally’ practiced.</p> <p style="text-align: center;">“Generally Accepted Accounting Principles” (<u>GAAP</u>)</p> <p style="text-align: center;">aka. “Cleverly Rigged Accounting Ploys” (<u>CRAP</u>)</p> <p style="text-align: center;">aka. "Preposterous Old Obsolete Principles" (<u>POOP</u>)</p>

Political Pressure Influencing Accounting Rulemaking



We Stress the ‘Whys’, Not Just the ‘Hows’

The Transition from the Plus/Minus Transaction Worksheet to a Debit/Credit scheme

First, we require the students to determine which accounts would be affected by a transaction, “how” those accounts would be affected —increase or decrease in account balance—, and “why” those accounts would be affected. We also ask whether the Accounting Equation will remain in balance and “why”?

After, recording impact of a transaction on the Plus/Minus portion of the worksheet, we then ask the students for the debit/credit journal entry.

On page 5 are views of the Transaction Worksheet at four separate stages.

The beginning of the period balances – with the accounting equation in balance at \$103,000

The first completed transaction – issuing additional shares of stock

A yet unrecorded transaction for the paying of 1/2 of previous incurred Accounts Payable. It is awaiting students to first provide the plus/minus entry for the ‘right side’ of the Transaction Worksheet – and then the required journal entry in debit/credit format.

The Transaction Worksheet’s ‘Total Assets = Total Liabilities + Stockholders’ Equity’ at the end of the

The accounting period – a de-facto Trial Balance.

EXHIBIT #1--ROUTINE ENTRIES

	JOURNAL ENTRIES		TRANSACTION WORKSHEET													
			ASSETS					=	LIABILITIES			+	STOCKHOLDERS' EQUITY			
Debit	Credit	Cash	Accts. Rec.	Land	Ppd. In.	Supplies	Accts. Pay.	Sal. Pay.	Common Stck.	Account	Ret. Earnings	Revenue	Expense	Accounts*		
Beginning Balances--January 1, 20x2		\$100,000	\$3,000	\$-0-	\$-0-	\$-0-	\$-0-	\$-0-	\$-0-	\$90,000	\$13,000	\$-0-	\$-0-			
		Total Assets = \$103,000					=	Total Liabilities and Stockholders' Equity = \$103,000								
1.) Issued shares of stock for \$40,000																
	Cash	40,000														
	Common Stock									40,000						
2.) Purchased land for \$10,000																

JOURNAL ENTRIES		TRANSACTION WORKSHEET											
		ASSETS					LIABILITIES			STOCKHOLDERS' EQUITY			
										Retained Earnings			
										Cost. Capital			
Debit	Credit	Cash	Accts. Pay.	Land	Ppd. Exp.	Supplies	Accts. Pay.	Sal. Pay.		Common Stk.	Ret. Earnings Account	Revenue Accounts	Expense Accounts
3. ACCOUNTING EQUATION IN BALANCE (DE FACTO UNADJUSTED TRIAL BALANCE)		\$131,150	\$5,000	\$10,000	\$2,400	\$900	\$450	\$-0-	\$130,000	\$13,000	\$12,000		(\$6,000)
		Total Assets = \$149,450					Total Liabilities and Stockholders' Equity = \$149,450						

Alternatives to FASB’s ‘Fancy Terminology’

We read from the textbook – something we rarely do – the technically correct definitions taken from the FASB’s Conceptual Framework Statement on ‘Elements’. *

We state to the class, you already ‘know’ nine of the ten elements. Then facetiously ask the students after we have read the FASB’s definitions of the elements -- “You understand them, right?” After the laughter dies down, we give the students our simple (but hopefully more understandable) definitions.

Two examples are given here.

- 1) FASB Definition of Revenues – “Inflows or other enhancements of assets of an entity or settlement of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities” (FASB No. 8, 2021, paragraph E80).

Our Definition of Revenues – “Selling price of goods sold or services rendered.”

Also, at the beginning of our Intermediate Accounting I course, we briefly mention the “satisfied our performance obligation under the contract” – with a statement that we will cover the 5-steps in the revenue recognition process later in the course.

- 2) FASB Definition of Distributions to Owners – “Decreases in equity of an entity resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners” (FASB No. 8, 2021, paragraph E72).

Our Definition of Distributions to Owners – “Dividends for a corporation.”

FASB Qualitative Characteristics Making Information Useful – Relevance vs. Faithful Representation

Investment in Manhattan Island Example *

Faithful Representation and Relevance supposedly make accounting information useful for decision-making

However, faithful representation often clashes with relevance.

Our example: Peter Minuit’s purchase of Manhattan Island in the year 1626 from the Native Americans for 60 Guilders – \$24 historical cost vs. an estimated market value in 2014 of \$1.74 trillion (Florida, 2018).

Assume the Peter Minuit Investment Company still owned all of Manhattan Island today and went to the bank to borrow some money with its only asset – Investment in Manhattan Island – to pledge as collateral. Peter Minuit Investment Company presents to the bank loan officer the company’s audited current Balance Sheet, plus audited Income Statements from 1626 to the current date. The bank loan officer reads the accompanying auditor’s report stating, “the financial statements are fairly presented in all material respects in accordance with U.S. GAAP.”

We ask the class the following two questions and await a student response:

- 1.) What dollar amount would the bank loan officer see on the audited Balance Sheet for the company’s sole asset — Investment in Manhattan Island?
- 2.) From their investment in Manhattan Island, what would be the company’s profit for the current year, and what would be the company’s total profit for the last 396 years, as indicated on the audited Income Statements?

It often takes a while, but eventually, one brave student will guess \$24, the GAAP historical cost valuation. Subsequently, a student will guess zero net income for the audited Income Statements presented in accordance with GAAP. We tentatively agree with both students answers as being ‘correct’.

We wrap up our story with the bank loan manager's decision. Since the bank's policy is to loan 80% of 'value', if the company puts up its Investment in Manhattan Island as collateral, the bank will loan \$19.20 – 80% times the \$24 GAAP asset valuation. Because of the small risk involved, the bank loan manager agrees to ignore the ZERO total profits for the last 396 years.

With GAAP showing the Investment in Manhattan Island as a \$24 asset on the current Balance Sheet, and zero cumulative profits on the Income Statements for the last 396 years from the Investment – Hopefully students will recognize the conflict between 'faithful representation' and 'relevance'.

Time to make our points

- 1.) Present the other side of the issue – Why use historical cost? What are the significant dangers in presenting Investment in Manhattan Island at estimated current fair market value? This is an opportunity to discuss the fair value hierarchy, the International Financial Reporting Standards' position on the extent of using fair value, and the financial statement audit opinion paragraph (IFRS 13, 2011).
- 2.) Reiterate the importance of understanding what the numbers mean and what they do not mean.
- 3.) Realizing accounting is an 'art' – not a science – and is subject to political pressure and constant change. Memorizing current GAAP and resultant debit/credit journal entries may help a student play the 'human parrot role' as a contestant on a television trivia quiz show, but a student needs more understanding to move up the ladder to becoming an adaptive problem solver.
- 4.) Finally, we ask our students: Who got the better of the deal – Peter Minuit or the Native Americans? That initiates a quick discussion of 'time-value-of-money'.

When and why we disagree with most textbooks

To promote UNDERSTANDING, we do a few things differently than most textbooks.

Eliminate the use of the "Income Summary" Account from the Closing Journal Entry Process *

Most professors use a textbook for financial accounting that uses the term "nominal account" (sometimes being replaced with the term "temporary account"). In addition, the textbooks use an "Income Summary" account in the closing journal entry process. **With the professor using the textbook's approaches, do students Understand?**

We ask our intermediate accounting students to explain a nominal account. A few will correctly describe what nominal accounts are, but rarely does a student ever link them to Retained Earnings. We ask our students what type of account is the "Income Summary" account? Then we ask on which financial statement does the "Income Summary" Account appear? We have never received a "correct answer" from a student to those two questions. Further, we then inform the students that in our combined over 100+ years of teaching accounting, we also have not figured out answers to those two questions.

Then, as previously discussed and illustrated in our "Transition from Plus/Minus to the Debit/Credit System",

we explain and illustrate why we use the term "Temporary Retained Earnings" accounts, and do NOT make any journal entries during the accounting period directly into the Retained Earnings account. Instead, we record revenue and expenses, (you could add dividends, gains, losses) in their own "Temporary Retained Earnings" account. This concept is reinforced when we get to the 'closing journal entry process' and we close (i.e., reduce to a zero balance) each Temporary Retained Earnings account (i.e., revenues, expenses, gains, losses, and dividends) by transferring its balance into the permanent Retained Earnings account without using an "Income Summary" account.

Our approach to teaching the closing journal entry process.

We present a short lecture showing the reasons for closing journal entries and the steps students must follow without using an Income Summary account in this process.

Closing Journal Entries – After the adjusting journal entries and the financial statements for the current accounting period have been prepared, it is necessary to get the accounting records ready to start the next

accounting period by transferring the current period's balances in the Revenue, Expense, and Dividends Declared accounts (i.e., the Temporary Retained Earnings accounts) into the permanent Retained Earnings account.

We explain the two “WHY’s”:

- 1.) Revenues, expenses, and dividends declared are ‘temporary.’ The dollar amounts are only for the current accounting period’s financial statements. They should NOT be the beginning balances in the next period’s financial statements. Therefore, the first objective is to “close out” (i.e., reduce the balance to zero) for each temporary retained earnings account. At this point, we like to draw the analogy between the Temporary Retained Earnings accounts and a scorecard – every game starts with a 0-0 score and does not carry over from game to game (accounting period to accounting period). This analogy has truly helped students UNDERSTAND the difference between the Balance Sheet accounts and the Income Statement accounts.
- 2.) Update the permanent Retained Earnings account from the beginning balance (beginning of the current period) to the ending balance that appears on this period’s Retained Earnings Statement and the Balance Sheet.

Next, we illustrate for our students HOW they are required to prepare the closing journal entries by doing a class problem with the students.

- 1.) We present an adjusted trial balance and require students to identify the revenue accounts, the expense accounts, gains and losses, and the dividends declared account (i.e., the Temporary Retained Earnings Accounts).
- 2.) To make sure the students UNDERSTAND before proceeding we facetiously ask students the closing journal entries to close out the Cash account, close out the Accounts Payable account; etc.
- 3.) Steps to closing out the Temporary Retained Earnings account without using ‘Income Summary’:
 - a.) Close each revenue account – increase in Retained Earnings – directly to Retained Earnings
 - b.) Close each expense account – decrease in Retained Earnings – directly to Retained Earnings
 - c.) Close other temporary retained earnings accounts (e.g., gains and losses) directly to Retained Earnings
 - d.) Close Dividends Declared account – decrease in Retained Earnings – directly to Retained Earnings
- 4.) After each journal entry above, we ask our students if the closing journal entry will accomplish the two ‘Why’s’ of closing journal entries – Getting the Temporary Retained Earnings accounts to zero balances to start the next accounting period, and updating the balance in Retained Earnings to the correct end of period balance.
- 5.) To wrap-up our closing journal entries approach and our use of the term “Temporary Retained Earnings Accounts” we emphasize the ‘WHYS’ one more time – by presenting the Post-Closing Trial Balance and asking the students:
 - a.) Which accounts are correctly NOT shown on the Post-Closing Trial Balance and WHY?
 - b.) Which single account has a different balance on the Post-Closing Trial Balance than it had on the Adjusted Trial Balance and WHY?

In our opinion, our alternative closing journal entry process will make things easier (simpler) for students to understand, and thus promote learning.

When, and Why, We Believe that Textbooks are wrong

Accountant’s End of Period Worksheet *

The Accountant’s End of the Period Worksheet is a trial run through the end of the period accounting process – including a preliminary look at the financial statements.

When preparing the worksheet, each account balance is copied from the ‘Adjusted Trial Balance’ set of columns on the worksheet and recorded in the ‘Financial Statement’ set of columns in which the account balance would appear on the financial statements – either the Income Statement, the Retained Earnings Statement, or the Balance Sheet. In addition, the worksheet shows the calculation of both the Net Income for the period and the ending Retained Earnings balance.

We believe that some textbooks' – and thus the instructors' – presentation of the Accountant's End of Period Worksheet can confuse students and be a detriment to student learning.

To get our students to recognize the “errors”, we present a copy of a textbook's illustration of its completed worksheet, and we ask our students to identify any ‘errors’. From previous coverage of the topics in our course, students are willing to question some items on the worksheet – but are reluctant to outright say the textbook worksheets are not correct. This provides us with a smooth transition to a brief introduction to the concept of auditor's professional skepticism.

In presenting our version for the Accountant's End-of-Period Worksheet, we confirm our students' suspicions and add a Retained Earnings set of columns to our worksheet. (Textbook examples typically do not have a set of columns for Retained Earnings.)

- a.) We put the beginning Retained Earnings balance in the Retained Earnings Statement columns on the worksheet-- NOT in the Balance Sheet set of columns on the worksheet as is done in textbooks.
- b.) We put the Dividends Declared balance in the Retained Earnings Statement columns on the worksheet - NOT in the Balance Sheet set of columns on the worksheet as is done in textbooks.
- c.) We put the Net Income in the Income Statement columns and Retained Earnings Statement columns. Textbooks examples do have Net Income in the Income Statement set of columns on the worksheet, but then put Net Income in the Balance Sheet set of columns on the worksheet.
- d.) Our version of the worksheet will show the ending Retained Earning Balance in both the Retained Earnings set of columns and the Balance Sheet set of columns. The textbook examples do not directly show the ending Retained Earnings balance anywhere on their Accountant's End-of-Period-Worksheet.

Summary

In today's and tomorrow's world, many careers, not only accounting careers, are undergoing significant changes with the technology takeover. The Illinois CPA Society recently remarked: “It's time for CPAs to rechart their path forward as not only the most trusted business advisors but as the most valued and strategic business advisors... CPAs must proactively educate and redefine themselves. Improving their skillsets, business acumen, and strategic thinking is of paramount importance” (Lilly, 2019). The reeducation starts at the grass roots level, when future accountants (students) are taking financial accounting courses. It's at this point that we can make a difference. In summary, we encourage students to ‘think’ and become adaptive problem-solvers — not human parrots.

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