



4th EDITION

FINANCIAL ACCOUNTING

WEYGANDT • KIESO • KIMMEL

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Financial Accounting

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In the previous edition of *Financial Accounting*, we sought to create a book about business that made the subject clear and fascinating to beginning students. And that is still our passion: to provide a link between accounting principles, student learning, and the real world.

STUDENT EMPOWERMENT AND SUCCESS

In our effort to create an even more effective text, we surveyed the market, talked personally to instructors, and held focus groups with professors and students. We heard again and again that the biggest challenges students face are to become motivated, to learn how to study, and to manage their tasks. We were gratified to learn that our text has helped empower students to meet these challenges and has been rated highest in customer satisfaction by both instructors and students.

We have responded to this information by making the pedagogical framework of the Fourth Edition of *Financial Accounting* even stronger and the presentation even clearer. We continue to give students the tools and the motivation they need to succeed in subsequent accounting courses and in their future business careers.

GOALS AND FEATURES OF THE FOURTH EDITION

The Fourth Edition of *Financial Accounting* provides an opportunity to improve a textbook that has set high standards for quality. Users and reviewers continue to comment positively on the writing style, the use of real-world examples, pedagogical features, and the fact that the textbook is not only about accounting but about business as well.

The primary purpose of this revision was to maintain these successful features and improve on them. We gathered four consistent messages from all our developmental research:

- Some topics that were beyond the scope of the introductory accounting course needed to be eliminated. We've carefully evaluated all topics regarding their suitability for and relevance to beginning accounting students. Those topics more suitable for an advanced course in accounting were deleted from this edition. Topics of declining relevance in this electronic age were either deleted or moved to an appendix or to our CD-ROM. We added features and topics more relevant to today's Internet and e-business environment.
- A student's textbook should be as pedagogically effective as possible. Our Third Edition was a leader in pedagogical effectiveness. *The Navigator*, our guide to the learning process in the Third Edition, has been well received and has proven effective for students seeking to improve their study skills. New in this edition are *Action Plans*, which accompany mini-demonstrations ("Do It") and Demonstration Problems in each chapter to help students develop their problem-solving skills.
- The book continues to involve the student in the learning process and to ensure that the student understands the *why* as well as the *how*. The message is consistent with the

Accounting Education Change Commission recommendations which encourage an emphasis on communication skills, critical thinking and decision-making skills, ethics, international accounting, and real-world emphasis.

- This edition continues the inclusion of user-oriented material. Our reasons were twofold: (1) to accomplish the objectives of the Accounting Education Change Commission, and (2) to demonstrate the relevance of accounting to all students, no matter what their area of study. Most of the new user material is in the *Broadening Your Perspective* section of the end-of-chapter material. These learning activities are designed to develop many skills that will be of use to students in other courses and in life after college, including financial statement analysis skills, awareness of international business ("Global Focus" assignments), and the ability to use the Internet. In addition, to give students the opportunity to follow an extended real-world example, we have integrated references to Lands' End Inc.'s financial statements throughout the book, including Review It questions, ratio presentations, and end-of-chapter assignment materials.

TAKE ACTION! CD



A very exciting new element with this edition of *Financial Accounting* is the interactive CD-ROM, which accompanies every textbook. It has three main sections to address the needs and interests of today's students.

- **Learning Techniques** contains resources to improve the student's study skills. It includes a *Learning Styles Quiz* and an *Interactive Study Skills Chart*.
- **Course Materials** contains resources that either reinforce materials covered in the text or go beyond activities covered in the text. An exciting feature in this section of the CD is the *Accounting Cycle Tutorial*. This is an interactive, self-paced tutorial aimed at strengthening the student's basic understanding of this very important element of the course. It employs audio, graphics, and additional lecture video, and directly parallels the presentation in the text. In addition, to provide additional practice, the CD contains an interactive *Self-Test* with feedback, and a *Key Term Matching Activity*. Finally, the inclusion of the *Database of Real Companies*, *Real-World Cases*, and *Interpreting Financial Statement activities* will enable the instructor to assign user-oriented activities that investigate real-world situations. This section of the CD also has a *Writing Handbook* and a *Surviving the Group Project* primer.
- **Career Paths** contains resources, such as a section called *Why Accounting Is Important*, that demonstrate that accounting knowledge is important to people in all lines of business and illustrate the many opportunities available to people who pursue an accounting career. The *Careers in Accounting* section discusses the role of accounting in society. The *Professional Profiles* section includes audio interviews with accounting professionals as well as non-accountants.

ABOUT THE AUTHORS

Jerry J. Weygandt, PhD, CPA, is Arthur Andersen Alumni Professor of Accounting at the University of Wisconsin-Madison. He holds a Ph.D. in accounting from the University of Illinois. Articles by Professor Weygandt have appeared in the *Accounting Review*, *Journal of Accounting Research*, *Accounting Horizons*, *Journal of Accountancy*, and other academic and professional journals. These articles have examined such financial reporting issues as accounting for price-level adjustments, pensions, convertible securities, stock option contracts, and interim reports. Professor Weygandt is author of other accounting and financial reporting books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Wisconsin Society of Certified Public Accountants. He has served on numerous committees of the American Accounting Association and as a member of the editorial board of the *Accounting Review*; he also has served as President and Secretary-Treasurer of the American Accounting Association. In addition, he has been actively involved with the American Institute of Certified Public Accountants and has been a member of the Accounting Standards Executive Committee (AcSEC) of that organization. He has served on the FASB task force that examined the reporting issues related to accounting for income taxes and is presently a trustee of the Financial Accounting Foundation. Professor Weygandt has received the Chancellor's Award for Excellence in Teaching and the Beta Gamma Sigma Dean's Teaching Award. He is on the board of directors of M & I Bank of Southern Wisconsin and the Dean Foundation. He is the recipient of the Wisconsin Institute of CPAs Outstanding Educator's Award and the Lifetime Achievement Award. In 2001 he received the American Accounting Association's Outstanding Accounting Educator Award.

Donald E. Kieso, PhD, CPA, received his bachelor's degree from Aurora University and his doctorate in accounting from the University of Illinois. He has served as chairman of the Department of Accountancy and is currently the KPMG Peat Marwick Emeritus Professor of Accounting at Northern Illinois University. He has public accounting experience with Price Waterhouse & Co. (San Francisco and Chicago) and Arthur Andersen & Co. (Chicago) and research experience with the Research Division of the American Institute of Certified Public Accountants (New York). He has done postdoctorate work as a Visiting Scholar at the University of California at Berkeley and is a recipient of NIU's Teaching Excellence Award and four Golden Apple Teaching Awards. Professor Kieso is the author of other accounting and business books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Illinois CPA Society. He has served as a member of the Board of Directors of the Illinois CPA Society, the AACSB's Accounting Accreditation Committees, the State of Illinois Comptroller's Commission, as Secretary-Treasurer of the Federation of Schools of Accountancy, and as Secretary-Treasurer of the American Accounting Association. Professor Kieso served as a charter member of the national Accounting Education Change Commission. He is the recipient of the Outstanding Accounting Educator Award from the Illinois CPA Society, the FSA's Joseph A. Silvos Award of Merit, and the NIU Foundation's Humanitarian Award for Service to Higher Education.

Paul D. Kimmel, PhD, CPA, received his bachelor's degree from the University of Minnesota and his doctorate in accounting from the University of Wisconsin. He is an Associate Professor at the University of Wisconsin-Milwaukee, and has public accounting experience with Deloitte & Touche (Minneapolis). He was the recipient of the UWM School of Business Advisory Council Teaching Award, the Reggie Taite Excellence in Teaching Award, and a three-time winner of the Outstanding Teaching Assistant Award at the University of Wisconsin. He is also a recipient of the Elijah Watts Sells Award for Honorary Distinction for his results on the CPA exam. He is a member of the American Accounting Association and has published articles in *Accounting Review*, *Accounting Horizons*, *Advances in Management Accounting*, *Managerial Finance*, *Issues in Accounting Education*, *Journal of Accounting Education*, as well as other journals. His research interests include accounting for financial instruments and innovation in accounting education. He has published papers and given numerous talks on incorporating critical thinking into accounting education, and helped prepare a catalog of critical thinking resources for the Federated Schools of Accountancy.

SIMPLIFIED PRESENTATION

As in the Third Edition, we continue to simplify and condense the textual material. To achieve this goal, the text was reviewed and carefully edited to ensure its clarity and exposition. The changes that were made can be characterized into four types:

Condensations and Deletions. We either condensed or deleted material that was better suited for more advanced-level courses, along with concepts and procedures that are little used. We made these decisions after gathering a great deal of information from instructors on how they teach the course and what they think today's beginning accounting students need to know.

Organizational Changes. The most significant organizational changes were made in Chapters 3, 5, 6, 9, and 10. For details, see Key Changes, below.

Additions. In a very few cases, we added new material to the textbook. These topics had to pass a strict test to warrant their inclusion: they were added only if they represented a major concept, issue, or procedure that a beginning student should understand. In nearly every chapter, we added an e-Business Insight within the chapter and a Global Focus problem to the Broadening Your Perspective section.

Updates. This edition was subject to comprehensive updating to ensure that it is relevant and fresh. Updating involved replacing Accounting in Action boxes, problem material, real-world examples cited in the text, infographic illustrations, and chapter-opening Feature Stories (of which we replaced five). All exercises and problems that were carried forward from the previous edition have received name, date (year), and minimal number changes.

A chapter-by-chapter summary of these changes is provided below.

KEY CHANGES IN EACH CHAPTER

CHAPTER 1 Accounting in Action

- New Feature Story on Lands' End, Inc. and related "A Look Back" exercise with solution.
- New Accounting in Action (AIA) e-Business Insight on e-business consulting.
- New definitions of financial and managerial accounting.
- Revised all end-of-chapter exercises and problems—changed names, dates (years), and numbers.
- Revised and replaced all financial and comparative analysis problems in the Broadening Your Perspectives (BYP) section using Lands' End, Inc. and Abercrombie & Fitch Co.
- New Research Case in BYP section.
- New Interpreting Financial Statements assignment in BYP using The North Face, Inc.
- To increase global exposure, added a new Global Focus assignment to the BYP section—in this chapter, Nestlé, a Swiss company.

CHAPTER 2 The Recording Process

- New AIA e-Business Insight on a data-exchange framework for business.

- Renumbered the chart of accounts in this chapter and the accounts throughout the text to agree with the end-of-chapter general ledger software assignments.
- Deleted two pages on electronic data processing.

CHAPTER 3 Adjusting the Accounts

- Moved discussion of accrual-basis versus cash-basis accounting from the end of the chapter to the beginning.
- New AIA e-Business Insight on revenue from a Web-site ad space.
- New Research Case in BYP section.
- New Global Focus assignment—Hoescht Marion Roussel, a German company.
- New Group Decision Case.

CHAPTER 4 Completion of the Accounting Cycle

- New Feature Story on Rhino Foods, Inc.
- Accounts renumbered for greater realism and for conformity with accompanying general ledger software package.
- New AIA e-Business Insight on Cisco System's virtual closing.
- New presentation of both account form and report form of balance sheet.
- New Comprehensive Problem covering Chapters 2–4.
- New Global Focus assignment—MO-DO, a Swedish company.

CHAPTER 5 Accounting for Merchandising Operations

- Reorganized and revised chapter, emphasizing and simplifying the perpetual inventory system coverage.
- Revised and streamlined presentations on freight costs, recording sales, measuring net income, and adjusting and closing entries for a merchandiser.
- New discussion added on the classified balance sheet.
- New Technology in Action on bar codes.
- New AIA e-Business Insight on Borders' e-commerce.
- New Business Insights on Estee Lauder and Intel.
- Moved the work sheet coverage to a chapter appendix.
- New Global Focus problem—Carrefour SA and Promodes SA, French companies.

CHAPTER 6 Inventories

- Moved comparison of perpetual and periodic inventory entries to a chapter appendix.
- Enhanced illustration of effects of inventory errors on two years' income statements.
- New Global Focus problem—Fuji Photo Film Company, a Japanese company.
- New Group Decision case involving inventory fire loss.

CHAPTER 7 Accounting Principles

- New Feature Story on revenue and expense recognition and reporting.

CHAPTER 8 Internal Control and Cash

- New AIA e-Business Insight on electronic funds transfer.
- New Global Focus on foreign money-laundering curbs.

CHAPTER 9 Accounting for Receivables

- Moved the direct write-off method coverage ahead of the allowance method coverage.
- Expanded the discussion and illustration of the direct write-off method.

- New Before You Go On review of valuing accounts receivable.
- New AIA e-Business Insight on tracking billable activities electronically.
- New Financial Reporting Problem.
- New Interpreting Financial Statements—Arvada Company Ltd.

CHAPTER 10 Plant Assets, Natural Resources, and Intangible Assets

- New Feature Story on Rent-A-Wreck.
- New graphic illustration on plant assets as a percentage of total assets for six companies.
- New Technology in Action on asset accounting software packages.
- New Before You Go On added after coverage of cost of plant assets and of depreciation.
- Deleted full-cost and successful efforts methods, to simplify the chapter.
- Updated coverage of accounting for goodwill and other intangible assets, to conform with recent changes in GAAP.
- Deleted average life and average age formulas, to simplify the section on analysis of plant assets.
- New Global Focus problem—J Sainsbury PLC, a British company.

CHAPTER 11 Liabilities

- New AIA e-Business Insight on sales taxes on Internet book sales.
- New AIA e-Business Insight on Internet mortgage transactions.
- New Comprehensive Problem covering Chapters 6–11.

CHAPTER 12 Corporations: Organization, Stock Transactions, Dividends, and Retained Earnings

- New AIA e-Business Insight on online proxy solicitation.
- New AIA Business Insight on Reebok's stock repurchases.
- New Interpreting Financial Statements using BFGoodrich Company financials.
- New Global Focus problem on emerging markets in Latin America.

CHAPTER 13 Investments

- Coverage of balance sheet presentation revised to use short-term and long-term terminology.
- New AIA Business Insight on the Time Warner/Turner merger.
- New AIA e-Business Insight on ad revenue at Amazon.com.
- New Comprehensive Problem covering Chapters 11–13.
- New Exploring the Web assignment using the SEC site.

CHAPTER 14 The Statement of Cash Flows

- Revised illustration on types of cash inflows and outflows.
- Updated Business Insights and real-world illustrations.
- New Global Focus problem—Saint-Gobain Group, a French company.
- Two new Exploring the Web assignments on the Securities and Exchange Commission.

CHAPTER 15 Financial Statement Analysis

- New Feature Story on day-trading cab driver.
- Updated horizontal, vertical, and ratio analysis using Sears, Roebuck and Co.'s most recent financial data.
- Revised Business Insights with new-company recent financial data.
- New AIA e-Business Insight on SEC's new corporate disclosure requirements.
- New Global Focus problem—Railtrack Group PLC, a British company, compared with Burlington Northern Railroad.

APPENDIX A Specimen Financial Statements

- Lands' End, Inc.'s financial statements, in place of Kellogg's.

APPENDIX B Specimen Financial Statements

- Abercrombie & Fitch's financial statements, in place of General Mills's.

APPENDIX C Time Value of Money

APPENDIX D Payroll Accounting

APPENDIX E Subsidiary Ledgers and Special Journals

- New set of B problems.
- New Comprehensive Problem covering Appendix E and Chapters 3–7.

APPENDIX F Other Significant Liabilities

- New Exploring the Web assignment on automobile leasing.

PROVEN PEDAGOGICAL FRAMEWORK

Financial Accounting has always provided tools to help students learn accounting concepts and procedures and apply them to the real world. The Fourth Edition places increased emphasis on the processes students undergo as they learn.

Learning How to Use the Text

- A **Student Owner's Manual** begins the text to help students understand the value of the text's learning aids and how to use them.
- After becoming familiar with the text, students can take a **Learning Styles Quiz** to help them identify how they learn best (visually, aurally, through reading and writing, kinesthetically, or through a combination of those styles). They then get tips on in-class and at-home learning strategies, as well as help in identifying the text features that would be most useful to them when they study.
- Chapter 1 contains **notes** that explain each learning aid the first time it appears.
- Finally, **The Navigator** pulls all the learning aids together into a learning system designed to guide students through each chapter and help them succeed in learning the material. It consists of (1) a checklist at the beginning of the chapter, which outlines text features and study skills they will need, and (2) a series of check boxes that prompt students to use the learning aids in the chapter and set priorities as they study. At the end of the chapter, students are reminded to return to The Navigator to check off their completed work. An example of The Navigator opposite.

THE NAVIGATOR ✓

- | | |
|---|--------------------------|
| • Understand <i>Concepts for Review</i> | ☐ |
| • Read <i>Feature Story</i> | ☐ |
| • Scan <i>Study Objectives</i> | ☐ |
| • Read <i>Preview</i> | ☐ |
| • Read text and answer <i>Before You Go On</i>
p. 51 ☐ p. 55 ☐ p. 65 ☐ p. 69 ☐ | |
| • Work <i>Demonstration Problem</i> | ☐ |
| • Review <i>Summary of Study Objectives</i> | ☐ |
| • Answer <i>Self-Study Questions</i> | ☐ |
| • Complete <i>Assignments</i> | ☐ |

Understanding the Context

- **Concepts for Review**, listed at the beginning of each chapter, identify concepts that will apply in the chapter to come. In this way, students see the relevance to the current chapter of concepts covered earlier.
- The **Feature Story** helps students picture how the chapter topic relates to the real world of accounting and business. It also serves as a running example in the chapter and is the topic of a series of review questions called **A Look Back at Our Feature Story**, toward the end of the chapter.
- **Study Objectives** form a learning framework throughout the text, with each objective repeated in the margin at the appropriate place in the main body of the chapter and again in the **Summary**. Further, end-of-chapter assignment materials are linked to the Study Objectives.
- A chapter **Preview** links the chapter-opening Feature Story to the major topics of the chapter. First, an introductory paragraph explains how the Feature Story relates to the topic to be discussed, and then a graphic outline of the chapter provides a “visual road map,” useful for seeing the big picture as well as the connections between subtopics.

Learning the Material

- **Financial statements** appear regularly throughout the book. Those from real companies are usually identified by a logo or related photo. Often, numbers or categories are highlighted in colored type to draw students’ attention to key information.
- **Key ratios**, using data from **Lands’ End, Inc.’s 2001 Annual Report**, are examined in appropriate spots throughout the text. Integration of ratios enables students to see in a single presentation two important pieces of information about financial data: how they are presented in financial statements, and how they are analyzed by users of financial in-

formation. In addition, a complete presentation of ratio analysis is included in Chapter 15 on financial statement analysis.

- **The Accounting Equation** appears in the margin next to key journal entries throughout the text. This feature reinforces the students’ understanding of the impact of an accounting transaction on the financial statements.
- **Key terms** and concepts are printed in blue where they are first explained in the text and are defined again in the end-of-chapter glossary.
- **Helpful Hints** in the margins help clarify concepts being discussed.



A **CD icon** alerts students to further discussion and examples, the **Accounting Cycle Tutorial**, and other resources found on the CD that came with their textbook.

- **Accounting in Action** boxes give students insight into how real companies use accounting in practice. The AIA boxes, highlighted with striking photographs, cover business, ethics, and international issues. Of particular interest are the new **e-Business Insight** boxes reporting on how business technology is expanding the services provided by accountants.
- **Technology in Action** boxes show how computers are used by accountants and users of accounting information.
- **Color illustrations** visually reinforce important concepts of the text.
- **Infographics**, a special type of illustration, help students visualize and apply accounting concepts to the real world. They provide entertaining and memorable visual reminders of key concepts.
- **Marginal Alternative Terminology** notes present synonymous terms, since terminology may differ in the business world.
- **Before You Go On** sections occur at the end of each key topic and often consist of two parts:
 - * **Review It** questions serve as a learning check by asking students to stop and answer questions about the material just covered. **Review It** questions marked with the **Lands’ End** icon (see right) send students to find information in Lands’ End’s 2001 Annual Report (packaged with the text and excerpted in Appendix A at the end of the text). These exercises help cement students’ understanding of how topics covered in the chapter are reported in real-world financial statements. Answers appear at the end of the chapter.
 - * A mini-demonstration problem, in a section called **Do It**, gives immediate practice of the material just covered and is keyed to homework exercises. An **Action Plan** lists the steps necessary to complete the task, and a **Solution** is provided to help students understand the reasoning involved in reaching an answer.
 - * The last **Before You Go On** exercise in the chapter takes students back for a critical look at the chapter-opening Feature Story.
- Marginal **International Notes** introduce international issues and problems in accounting.
- Marginal **Ethics Notes** help sensitize students to the real-world ethical dilemmas of accounting and business.

Putting It Together

- **Demonstration Problems** give students the opportunity to refer to a detailed solution to a representative problem as they do homework assignments. **Action Plans** list strategies to assist students in understanding the solution and establishing a logic for approaching similar types of problems. A **Web icon** tells students there is an additional, interactive Demonstration Problem (powered by eGrade) that they can work on the book's Web site.
- The **Summary of Study Objectives** relates the study objectives to the key points of the chapter. It gives students another opportunity to review, as well as to see how all the key topics within the chapter are related.
- The **Glossary** defines all the key terms and concepts introduced in the chapter. A **CD icon** tells students that there is an interactive Key Term Matching Activity on the CD that came with their textbook.

Developing Skills Through Practice

- **Self-Study Questions** are a practice test that enables students to check their understanding of important concepts. With questions keyed to the Study Objectives, students can go back and review sections of the chapter in which they find they need further work. Answers appear on the last page of the chapter. A **Web** and a **CD icon** tell students that they can answer the Self-Study Questions in an interactive format on the text's CD or at its Web site. They also can take an additional **Self-Test** at the Web site to further help them master the material.
- **Questions** provide a full review of chapter content and help students prepare for class discussions and testing situations.
- **Brief Exercises** build students' confidence and test their basic skills. Each Brief Exercise focuses on one of the **Study Objectives**.
- Each of the **Exercises** focuses on one or more **Study Objectives**. These tend to take a little longer to complete, and they present more of a challenge to students than Brief Exercises. The **Exercises** help instructors and students make a manageable transition to more challenging problems. Certain exercises, marked with a , help students practice business writing skills.
- **Problems** stress the application of the concepts presented in the chapter. Two sets—**A** and **B**—have corresponding problems keyed to the same **Study Objectives**, thus giving instructors greater flexibility in assigning homework. Certain problems, marked with a , help build business writing skills.
- Each **Brief Exercise**, **Exercise**, and **Problem** has a description of the concept covered and is keyed to **Study Objectives**.
- We also added **Comprehensive Problems** that cover concepts presented in multiple chapters.
- **General Ledger Problems**, identified by an icon, , are selected problems that can be solved using the General Ledger Software package.
-  Problems marked with the **Peachtree** icon can be worked using *Peachtree Complete® Accounting to Accompany Financial Accounting, Fourth Edition*. A separate workbook that includes the newly released software is available.

- **Spreadsheet Problems**, identified by an icon, , are selected exercises and problems that can be solved using *Solving Financial Accounting Problems Using Excel for Windows*.

Expanding and Applying Knowledge

Broadening Your Perspective is a unique section at the end of each chapter that offers a wealth of resources to help instructors and students pull together the learning for the chapter. This section offers problems and projects for those instructors who want to broaden the learning experience by bringing in more real-world decision-making and critical thinking activities. The elements of the Broadening Your Perspective section are described below.

- A **Financial Reporting Problem** directs students to study various aspects of the financial statements in Lands' End Inc.'s 2001 Annual Report, which is packaged with the text and excerpted in Appendix A at the end of the text.
- A **Comparative Analysis Problem** offers the opportunity to compare and contrast Lands' End's financial reporting with that of a competitor, Abercrombie & Fitch Co. (whose 2001 financial statements are in Appendix B at the end of the book.)
- **Research Cases** lead students to reports and articles published in various popular business periodicals for further study and analysis of key topics.
- **Interpreting Financial Statements** ask students to read parts of financial statements of actual companies and to interpret that information in light of concepts presented in the chapter.
- **Global Focus** problems ask students to read parts of financial statements of actual foreign or international companies and to interpret that information in light of concepts presented in the chapter and in contrast to domestic U.S. companies.
- **Exploring the Web** exercises guide students to Internet Web sites where they can find and analyze information related to the chapter topic.
- The **Group Decision Case** helps build decision-making skills by analyzing accounting information in a less structured situation. These cases require evaluation of a manager's decision or lead to a decision among alternative courses of action. As group activities, they promote teamwork.
- **Communication Activities** ask students to engage in real-world business situations using writing, speaking, or presentation skills.
- **Ethics Cases** describe typical ethical dilemmas and ask students to analyze the situation, identify the stakeholders and the ethical issues involved, and decide on an appropriate course of action.

ACCOUNTING EDUCATION CHANGE COMMISSION RECOMMENDATIONS APPLIED

As indicated earlier, we seek to involve the student in the learning process and ensure that he or she understands the *why* as well as the *how*. We therefore have provided material

that should help students in the following areas, as recommended by the Accounting Education Change Commission.

Communication Skills. Each chapter requires answers to certain exercises and problems, identified by a pencil icon, to be in the form of written business communications such as memos or reports. In addition, we have provided an entire section called Broadening Your Perspective, which includes a Group Decision Case, Communication Activity, Ethics Case, and many other activities. Also, the CD that accompanies each text includes a *Writing Handbook* and a *Surviving the Group Project* primer. Each of these items provides the student with an opportunity to use both written and oral communication skills.

Critical Thinking and Decision-Making Skills. At the end of every chapter, the Broadening Your Perspective section offers a variety of critical thinking activities. In addition, before the end of the chapter proper, students are asked to recall the opening Feature Story of each chapter in a critical thinking exercise. There is also at least one Group Decision Case per chapter. These cases require an evaluation of a manager's decision or lead to a decision concerning alternative courses of action. In addition, many exercises and problems require analysis and interpretation of financial statements.

Ethics. A discussion of ethics appears in Chapter 1 of the text. Each chapter has an Ethics Case that is relevant to the chapter topic. In addition, selected real-world "Accounting in Action: Ethics Insights" are provided in the text, and ethics notes are provided in the margins.

International Accounting. This topic is covered in a section in Chapter 7 and in examples throughout the book. In Chapter 7, the importance of international trade is explained, and the magnitude of foreign sales for major U.S. companies is illustrated. The section concludes with an explanation of financial statements and the setting of uniform international accounting standards. In addition, "Accounting in Action: International Insights" are provided in the text, and International Notes are provided in the margins to illustrate interesting international accounting issues. The Global Focus in the Broadening Your Perspective section reinforces international issues and insights.

Real-World Emphasis. *Financial Accounting* has been the leader in the use of real-world vignettes. The vignettes, called Accounting in Action, are classified as (1) Business Insight, (2) International Insight, (3) Ethics Insight, and (4) new in this edition, e-Business Insight. In the Fourth Edition, we continue to use real-world vignettes extensively in every chapter. We have also included foreign companies in the Global Focus problem in the end-of-chapter material in each chapter, which addresses an accounting issue faced by a real corporation. In addition, the chapter-opening Feature Stories focus on accounting issues in the business world.

As in earlier editions, Appendix A at the end of the text includes the annual report of a major U.S. corporation. In this edition, we chose Lands' End, Inc. In addition, to allow for comparison, we have added, in Appendix B, the financial statements of one of Lands' End's competitors, Abercrombie & Fitch.

In the Broadening Your Perspective activities at the end of each chapter we have a comprehensive selection of real-world activities. They include a Financial Reporting Problem (an analysis of financial statements); a Comparative Analysis Problem (comparison of the financial results of Lands' End and Abercrombie & Fitch); a Research Case (assignment that asks students to read and analyze published articles from business periodicals); Interpreting Financial Statement (analysis of financial statements of real companies); a Global Focus problem (activities that focus on financial analysis of real international companies); and Exploring the Web (activities designed to illustrate the variety of accounting issues and financial information that can be obtained on the Internet). In addition, financial ratios for Sears as well as department store industry data from Dun & Bradstreet are provided in Chapter 15, Financial Statement Analysis.

Technology Vignettes. Real-world vignettes called Technology in Action give students an opportunity throughout the text to see how computers are used in the accounting business world.

SUPPLEMENTARY MATERIALS AND TEACHING AIDS

Financial Accounting, Fourth Edition, features a full line of teaching and learning resources developed and revised to help you create a more dynamic and innovative learning environment.

The success of students is a major theme of the entire supplements package. Vital current topics such as communication skills, critical thinking and decision making, ethics, and real-world emphasis are integrated throughout. These resources—including print, software, and Internet-based materials—also take an *active learning approach* to help build students' skills and analytical abilities.

Web Site at www.wiley.com/college/weygandt. Recognizing that the World Wide Web is a valuable resource for students and instructors, we have developed a Web Site at www.wiley.com/college/weygandt to provide a variety of additional resources. Internet cases, company Web sites and useful accounting links will be included. Students will also be provided with an e-mail feedback form that, when sent, goes to the authors.

Instructor's Resources

For the instructor, we have designed an extensive support package to help you maximize your teaching effectiveness. We offer useful supplements for instructors with various levels of experience and different instructional circumstances.

Instructor's Resource System on CD-ROM. Responding to the changing needs of instructors and to developments in distance learning and electronic classrooms, a CD-ROM provides all instructor support material in an electronic format that is easy to navigate and use. This CD-ROM contains print supplements, as well as the electronic ones, for use in the classroom, for printing out material, for uploading to your own Web site, or for downloading and modifying. The CD-ROM gives you the flexibility to access and prepare instructional material based on your individual needs.

Solutions Manual. The Solutions Manual contains detailed solutions to all exercises and problems in the textbook and suggested answers to the questions and cases. Print is large and bold for easy readability in lecture settings. Each chapter includes an *assignment classification table* (identified end-of-chapter items by study objectives), an *assignment characteristics table* (describes each problem and alternate problem), a *Bloom's taxonomy table* (classifies end-of-chapter items by Bloom's taxonomy of learning skills and objectives), and identifies difficulty level and estimated completion time.

Examination Book and Test Bank. The Examination Book and Test Bank is a comprehensive testing package that allows instructors to tailor examinations according to study objectives, learning skills, and content. It contains over 2,000 examination questions and exercises accompanied by answers and solutions. Each chapter includes tools effective in linking test items to study objectives as well as a chart indicating the placement of questions in Bloom's taxonomy.

The Examination Book and Test Bank provides an achievement test and solutions bank for every two chapters in the textbook. Comprehensive tests and a Final Exam are also included. The tests, easy to photocopy and distribute to students, consist of problems and exercises as well as multiple-choice, matching, and true/false questions. (Also available at www.wiley.com/college/weygandt.)

Test Preparation Service. Simply call Wiley's special number (1-800-541-5602) with the questions you want on an examination. Wiley will provide a customized master exam within 24 hours. If you prefer, random selection from a number of chapters is possible.

Solutions Transparencies. Packaged in an organizer box with chapter file folders, these transparencies feature detailed solutions to all exercises and problems in the textbook, and suggested answers to the cases. They feature large, bold type for better projection and easy readability in large classroom settings. Accuracy is assured—all solutions were extensively checked by the authors and reviewers.

Teaching Transparencies. The authors have selected these illustrations from the text and from original exhibits outside the text as well. Designed to support and clarify concepts in the text, the Teaching Transparencies will enhance lectures. Suggestions on how to integrate the Teaching Transparencies are included in the Instructor's Manual. A number of illustrations are available in four-color format.

Instructor's Manual. The Instructor's Manual is a comprehensive resource guide designed to assist professors in preparing lectures and assignments, and includes sample syllabi for preparing the course. The print is set in a size large enough for easy reading or use as transparency masters.

Included in each chapter are an *assignment classification table*, an *assignment characteristics table*, a *list of study objectives* in extra large, bold-face print for transparencies; a *chapter review* of the significant topics and points contained in the chapter; *enhanced lecture outlines* with teaching tips and references to text material; *suggestions for integrating supplements* into the classroom; a *20-minute quiz* in the form of 10 true/false and 5 multiple-choice questions (with solutions); and illustra-

tions, including diagrams, graphs, questions and exercises, for use as classroom hand-outs, overhead transparencies, in-class quizzes, or demonstrations (solutions are provided). (Also available at www.wiley.com/college/weygandt.)

Checklist of Key Figures. A listing of key amounts for textbook problems, allowing students to verify the accuracy of their answers as they work through the assignments, is available at the *Financial Accounting* Web site at www.wiley.com/college/weygandt.

Additional Solutions Manuals. Solutions Manuals are also available for the following:

- University Bookstore, Inc.: A Corporate Practice Set
- Solving Financial Accounting Problems Using Excel and Lotus 1-2-3

Technology Supplements for Instructors

Computerized Test Bank. Available for use with IBM and IBM true-compatibles running Windows 3.1 or higher, the Computerized Test Bank offers a number of valuable options that allow instructors to customize their own exam from the Test Bank materials. Instructors can create multiple versions of the same test by manually or randomly scrambling questions as well as content within each individual question. New questions can also be imported into the Computerized Test Bank. Quick and easy to use, files can be exported into other word-processing applications.

PowerPoint Presentation Material. This PowerPoint lecture aid contains a combination of key concepts, images, and problems from the textbook for use in the classroom. Designed according to the organization of the material in the textbook, this series of electronic transparencies can be used to reinforce financial accounting principles visually and graphically. (Also available at www.wiley.com/college/weygandt.)

General Ledger Software Evaluator. This program is a simple way to evaluate students' answers prepared using the General Ledger Software. It evaluates both the transactions that were posted and the ending balances for each of the accounts. The program also includes many reporting options, allowing instructors to print detailed or summary reports for a student or a class using a variety of sort sequences. Available at www.wiley.com/college/weygandt.

Wiley Nightly Business Report Video. This video contains segments from the highly respected *Nightly Business Report*, which have been selected for their applicability to accounting financial and for their reinforcement of key concepts in the text. Each of the segments is approximately 3 to 5 minutes long and can be used to introduce topics to the students, enhance lecture material, and provide real-world context for related concepts. Suggestions for integrating the material into the classroom are included in the Video Instructor's Manual.

Technical Support. If you need assistance for any Wiley technology product, please contact Wiley at one of these addresses:

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Student Active Learning Aids

In addition to the innovative pedagogy included in the text, we offer a number of valuable learning aids for the student. These are intended to enhance true understanding so that students will be able to apply financial accounting concepts.

Working Papers. Working Papers are accounting forms for all end-of-chapter exercises, problems, and cases. A convenient resource for organizing and completing homework assignments, they demonstrate how to correctly set up solution formats and are directly tied to textbook assignments.

Excel Working Papers. Available on CD-ROM, these Excel-formatted forms can be used for end-of-chapter exercises, problems, and cases. The Excel Working Papers provide you with the option of printing forms and completing them manually, or entering data electronically and then printing out a completed form. By entering data electronically, you can paste homework to a new file and e-mail the worksheet to your instructor.

Student Study Guide. The Student Study Guide is a comprehensive review of accounting and a powerful tool for students to use in the classroom. Tied to study objectives, it guides students through chapter content and is a resource for in-class lectures. **This is an excellent resource when preparing for exams.**

Each chapter of the Student Study Guide includes study objectives and a chapter review consisting of 20–30 key points; a demonstration problem linked to study objectives in the textbook; and additional opportunities for students to practice their knowledge and skills through true/false, multiple-choice, and matching questions related to key terms and exercises linked to study objectives. Solutions to the exercises explain the hows and whys so students get immediate feedback.

Take Note! This handy note-taking guide includes all the PowerPoint presentations printed out three to a page, with spaces next to them for you to take notes. Take Note! allows you to focus on the discussions at hand, instead of focusing on copying down slides projected in class.

Problem-Solving Survival Guide. The Problem-Solving Survival Guide tutorial is designed to improve your success rate in solving financial accounting homework assignments and exam questions. The Problem-Solving Survival Guide also provides additional insight and tips on how to study accounting. Each chapter includes an overview of key chapter topics and a review of chapter study objectives. Also included are purpose statements for each question, case, or exercise and a direct link to study objectives. Tips to alert you to common pitfalls and misconceptions as well as reminders of concepts and principles to help solve problems are very helpful. A selection of multiple-choice exercises and cases representative of common exam questions or homework assignments enhances your proficiency, and detailed solutions and explanations assist you in the approach, setup, and completion of problems.



General Ledger Software. The General Ledger Software (GLS) program allows you to solve select end-of-chapter text problems, identified by an icon in the margin of the

text, using a computerized accounting system. Easy to use, GLS demonstrates the immediate effects of each transaction, helping students understand the use of computers in a real-world accounting environment. Also available for use with University Bookstore, Inc. Practice Set.



Peachtree Complete® Accounting Software, Problems & Workbook. The Peachtree Complete® Accounting Problems are select problems denoted by the Peachtree logo that can be solved using the Peachtree Complete® Accounting Software to accompany *Financial Accounting*, Fourth Edition. The problems and software are downloaded from a CD that is attached to the workbook. The workbook explains how to use Peachtree and how to solve the select problems from *Financial Accounting*, Fourth Edition.



Solving Financial Accounting Problems Using Excel for Windows. This workbook explains how to use Excel when applying financial accounting concepts. It guides you step-by-step from an introduction to computers and Excel to completing preprogrammed spreadsheets, to designing your own spreadsheets. The accompanying Excel spreadsheet templates allow you to complete select end-of-chapter exercises and problems, identified by an icon in the margin of the text.

University Bookstore Computerized Practice Set. This package includes both the University Bookstore print practice set as well as the general ledger software. Students read the practice set but input material into GLS. Screens for inputting data closely resemble those of general ledger packages that students will encounter in real-world business settings. The program will automatically post, close, and generate all financial statements.

Financial Accounting Tutor (FAcT). FAcT is a self-paced CD-ROM tutorial designed to review financial accounting concepts. It uses simple examples that have been carefully crafted to introduce concepts gradually. Throughout, the program emphasizes the logic underlying the accounting process. FAcT uses interactive and graphical tools to enhance the learning process. Intuitive navigation and a powerful search mechanism allow you to easily follow the tutorial from start to finish or skip to the topics you want to complete. The discussions and examples are followed by brief, interactive problems that provide immediate feedback. Built-in tools, such as an on-line financial calculator, help solve the problems.

Business Extra Web Site at www.wiley.com/college/businessextra. The Business Extra Web Site gives you instant access to a wealth of current articles dealing with all aspects of financial accounting. The articles are organized by topic, and discussion questions follow each article. You will need to purchase Business Extra.

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Suggestions and comments from users are encouraged and appreciated. Please feel free to contact any one of us.

Jerry J. Weygandt
Donald E. Kieso
Paul D. Kimmel

HOW TO USE THE STUDY AIDS IN THIS BOOK

THE RECORDING PROCESS

THE NAVIGATOR ✓

- Understand Concepts for Review ☐
- Read Feature Story ☐
- Scan Study Objectives ☐
- Read Preview ☐
- Read text and answer Before You Go On
p. 51 ☐ p. 55 ☐ p. 65 ☐ p. 69 ☐
- Work Demonstration Problem ☐
- Review Summary of Study Objectives ☐
- Answer Self-Study Questions ☐
- Complete Assignments ☐

The Navigator is a learning system designed to guide you through each chapter and help you succeed in learning the material. It consists of (1) a checklist at the beginning of the chapter, which outlines text features and study skills you will need, and (2) a series of check boxes that prompt you to use the learning aids in the chapter and set priorities as you study.

The Feature Story helps you picture how the chapter topic relates to the real world of accounting and business. Throughout the chapter, references to the Feature Story will help you put new ideas in context, organize them, and remember them. The problem called **A Look Back at Our Feature Story** toward the end of the chapter helps you pull together the ideas learned in the chapter. Many Feature Stories end with the **URL** of the company cited in the story.

CONCEPTS FOR REVIEW

Before studying this chapter, you should know or, if necessary, review:

- a. What are assets, liabilities, stockholders' equity, retained earnings, dividends, revenues, and expenses. (Ch. 1, pp. 11–13)
- b. Why assets equal liabilities plus stockholders' equity. (Ch. 1, p. 11)
- c. What transactions are and how they affect the basic accounting equation. (Ch. 1, pp. 14–20)



Concepts for Review, listed at the beginning of each chapter, are the accounting concepts you learned in previous chapters that you will need to know in order to understand the topics you are about to learn. Page references are provided if you need to review before reading the chapter.

FEATURE STORY

No Such Thing As a Perfect World

When she got a job doing the accounting for **Forster's Restaurants**, Tanis Anderson had almost finished her business administration degree at Simon Fraser University. But even after Tanis completed her degree requirements, her education still continued—this time, in the real world.

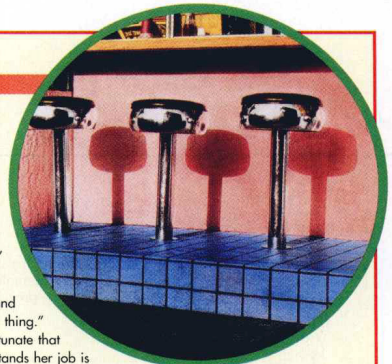
Tanis's responsibilities include paying the bills, tracking food and labor costs, and managing the payroll for **The Mug and Musket**, a popular destination restaurant in Surrey, British Columbia. "My title is Director of Finance," she laughs, "but really that means I take care of whatever needs doing!"

The use of judgment is a big part of the job. As Tanis says, "I learned all the fundamentals in my business classes, but school prepares you for a perfect world, and there is no such thing."

She feels fortunate that her boss understands her job is a learning experience as well as a responsibility. "Sometimes he's let me do something he knew perfectly well was a mistake so I can learn something through experience," she admits.

To help others gain the benefits of her real-world learning, Tanis is

always happy to help students in the area who want to use Forster's as the subject of a project or report. "It's the least I can do," she says.



Study Objectives at the beginning of each chapter give you a framework for learning the specific concepts and procedures covered in the chapter. Each study objective reappears in the margin at the point where the concept is discussed. Finally, you can review all the study objectives in the **Summary** at the end of the chapter.

STUDY OBJECTIVES

After studying this chapter, you should be able to:

1. Explain what an account is and how it helps in the recording process.
2. Define debits and credits and explain how they are used to record business transactions.
3. Identify the basic steps in the recording process.
4. Explain what a journal is and how it helps in the recording process.
5. Explain what a ledger is and how it helps in the recording process.
6. Explain what posting is and how it helps in the recording process.
7. Prepare a trial balance and explain its purposes.



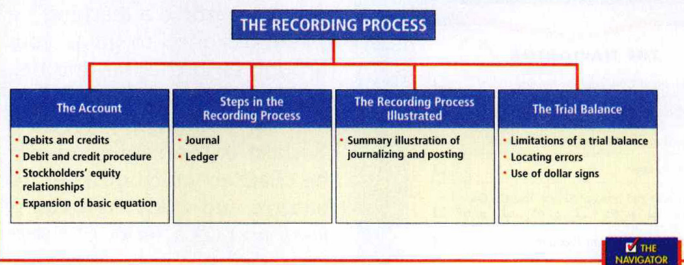
The **Preview** begins by linking the Feature Story with the major topics of the chapter. It is followed by a graphic outline of major topics and subtopics that will be discussed. This narrative and visual preview gives you a mental framework upon which to arrange the new information you are learning.

A **CD icon** at various places throughout the book refers you to the CD that came with your textbook. On the CD, you will find *further discussion and examples*, an *Accounting Cycle Tutorial*, additional *Demonstration Problems*, *Self-Tests*, and *Key Term Matching Activities* to help you study, and additional *real-world cases*.

PREVIEW OF CHAPTER 2

In Chapter 1, we analyzed business transactions in terms of the accounting equation. The cumulative effects of these transactions were presented in tabular form. Imagine a restaurant and gift shop such as **The Mug and Musket** using the same tabular format as Softbyte Inc. to keep track of every one of its transactions. In a single day, this restaurant and gift shop engages in hundreds of business transactions. To record each transaction this way would be impractical, expensive, and unnecessary. Instead, a set of procedures and records are used to keep track of transaction data more easily.

This chapter introduces and illustrates these basic procedures and records. The content and organization of Chapter 2 are as follows.



STUDY OBJECTIVE 1

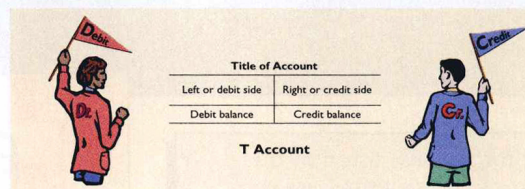
Explain what an account is and how it helps in the recording process.

THE ACCOUNT

An **account** is an individual accounting record of increases and decreases in a specific asset, liability, or stockholders' equity item. For example, Softbyte Inc. (the company discussed in Chapter 1) would have separate accounts for Cash, Accounts Receivable, Accounts Payable, Service Revenue, Salaries Expense, and so on. In its simplest form, an account consists of three parts: (1) the title of the account, (2) a left or debit side, and (3) a right or credit side. Because the alignment of these parts of an account resembles the letter T, it is referred to as a **T account**. The basic form of an account is shown in Illustration 2-1.



Illustration 2-1
Basic form of account



Steps in the Recording Process 53

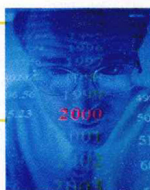
The basic steps in the recording process occur repeatedly. The analysis of transactions was illustrated in Chapter 1. Further examples will be given in this and later chapters. The other steps in the recording process are explained in the next sections.

TECHNOLOGY IN ACTION



Computerized and manual accounting systems basically parallel one another. Most of the procedures are handled by electronic circuitry in computerized systems. They seem to occur invisibly. But, to fully comprehend how computerized systems operate, you need to understand manual approaches for processing accounting data.

Technology in Action examples show how computer technology is used in accounting and business.



THE JOURNAL

Transactions are initially recorded in chronological order in a **journal** before being transferred to the accounts. Thus, the journal is referred to as the book of original entry. For each transaction the journal shows the debit and credit effects on specific accounts. Companies may use various kinds of journals, but every company has the most basic form of journal, a **general journal**. Typically, a general journal has spaces for dates, account titles and explanations, references, and two amount columns. Whenever we use the term journal in this textbook without a modifying adjective, we mean the general journal.

The journal makes several significant contributions to the recording process.

1. It discloses in one place the complete effects of a transaction.
2. It provides a chronological record of transactions.
3. It helps to prevent or locate errors because the debit and credit amounts for each entry can be readily compared.

Journalizing

Entering transaction data in the journal is known as **journalizing**. Separate journal entries are made for each transaction. A complete entry consists of: (1) the date of the transaction, (2) the accounts and amounts to be debited and credited, and (3) a brief explanation of the transaction.

Illustration 2-14 shows the technique of journalizing, using the first two transactions of Softbyte Inc. These transactions were: September 1, stockholders invested \$15,000 cash in the corporation in exchange for shares of stock, and com-

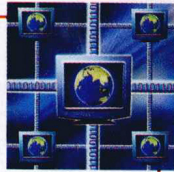
Technology in Action boxes show how computers are used by accountants and by users of accounting information.

Study Objectives reappear in the margins at the point where the topic is discussed. End-of-chapter assignments are keyed to study objectives.

Key Terms and concepts are printed in blue where they are first explained in the text, and they are defined again in the end-of-chapter glossary.

ACCOUNTING IN ACTION A Business Insight

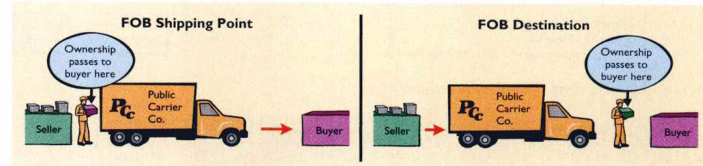
 E-business is having a tremendous impact on how companies share information within the company, and with people outside the company, such as suppliers, creditors, and investors. A new type of software, Extensible Markup Language (XML), is enabling the creation of a universal way to exchange data. An organization called XBRL.org is using XML to develop an internally accepted framework called the Extensible Business Reporting Model (XBRL). The organization is comprised of representatives from industry, accounting firms, investment houses, bankers, regulators, and others. The goal of this organization is to establish a framework that "the global business information supply chain will use to create, exchange, and analyze financial reporting information including, but not limited to, regulatory filings such as annual and quarterly financial statements, general ledger information, and audit schedules."



Accounting in Action boxes give you more glimpses into the real world of business. These high-interest boxes are classified by three types of issues—business, ethics, and international—each identified by its own icon. New in this edition, **e-Business Insights** describe how e-business technology is expanding the services provided by accountants.

Infographics, a special type of illustration, pictorially link concepts to the real world and provide visual reminders of key concepts.

Illustration 6-1
Terms of sale



GOODS IN TRANSIT. Goods are considered **in transit** when they are in the hands of a public carrier (such as a railroad, trucking, or airline company) at the statement date. Goods in transit should be included in the inventory of the party that has legal title to the goods. Legal title is determined by the terms of sale, as shown in Illustration 6-1 and described below.

1. **FOB (free on board) shipping point:** Ownership of the goods passes to the buyer when the public carrier accepts the goods from the seller.
2. **FOB destination:** Legal title to the goods remains with the seller until the goods reach the buyer.

Color illustrations visually reinforce important concepts and therefore often contain material that may appear on exams.

In summary, the principal sources (increases) of stockholders' equity are (1) investments by stockholders and (2) revenues from business' operations. In contrast, reductions (decreases) in stockholders' equity are a result of (1) expenses and (2) dividends. These relationships are shown in Illustration 1-6.

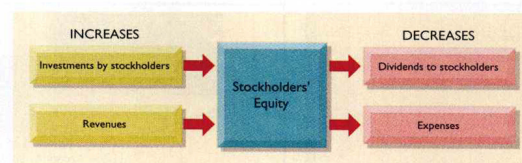


Illustration 1-6
Increases and decreases in stockholders' equity

Before You Go On sections follow each key topic. **Review It** questions prompt you to stop and review the key points you have just studied. If you cannot answer these questions, you should go back and read the section again.

Review It questions marked with the Lands' End icon ask you to find information in Lands' End's 2001 Annual Report, which is packaged with this text and excerpted in Appendix A at the end of the text.

Brief **Do It** exercises ask you to put your newly acquired knowledge to work. They outline an **Action Plan** necessary to complete the exercise, and the accompanying **Solution** helps you see how the problem should be solved. (The **Do It** exercises are keyed to similar homework exercises.)

BEFORE YOU GO ON...

REVIEW IT

1. Why is ethics a fundamental business concept?
2. What are generally accepted accounting principles? Give an example.
3. Explain the monetary unit and the economic entity assumptions.
4. The accounting equation is: Assets = Liabilities + Stockholders' Equity. Replacing the words in that equation with dollar amounts, what is **Lands' End's** accounting equation at January 28, 2001? (The answer to this question is provided on page 42.)
5. What are assets, liabilities, and stockholders' equity?



DO IT

Classify the following items as issuance of stock (I), dividends (D), revenues (R), or expenses (E). Then indicate whether the following items increase or decrease stockholders' equity: (1) rent expense, (2) service revenue, (3) dividends, and (4) salaries expense.

ACTION PLAN

- Review the rules for changes in stockholders' equity: Investments and revenues increase stockholders' equity. Expenses and dividends decrease stockholders' equity.
- Understand the sources of revenue: the sale of merchandise, performance of services, rental of property, and lending of money.
- Understand what causes expenses: the consumption of assets or services.
- Recognize that dividends are distributions of cash or other assets to stockholders.

SOLUTION

1. Rent expense is classified as an expense (E); it decreases stockholders' equity.
2. Service revenue is classified as revenue (R); it increases stockholders' equity.
3. Dividends is classified as stockholders' drawings (D); it decreases stockholders' equity.
4. Salaries expense is classified as an expense (E); it decreases stockholders' equity.

Related exercise material: BE1-1, BE1-2, BE1-3, BE1-4, BE1-5, BE1-6, BE1-7, BE1-9, E1-1, E1-2, E1-3, E1-4, E1-6, and E1-7.



revenue to another company. For example, the \$200 accrual of fees by Pioneer is an accrued expense to the client that received the service.

Adjustments for accrued expenses are needed for two purposes: (1) to record the obligations that exist at the balance sheet date, and (2) to recognize the expenses that apply to the current accounting period. Prior to adjustment, both liabilities and expenses are understated. Thus, **the adjusting entry for accrued expenses results in a debit (increase) to an expense account and a credit (increase) to a liability account.**

ACCURED INTEREST. Pioneer Advertising Agency Inc. signed a \$5,000, 3-month note payable on October 1. The note requires interest at an annual rate of 12%. The amount of the interest accumulation is determined by three factors: (1) the face value of the note, (2) the interest rate, which is always expressed as an annual rate, and (3) the length of time the note is outstanding. In this instance, the total interest due on the \$5,000 note at its due date 3 months hence is \$150 (\$5,000 $\times$ 12% $\times$ 3/12), or \$50 for one month. The formula for computing interest and its application to Pioneer Advertising Agency Inc. for the month of October² are shown in Illustration 3-12. Note that the time period is expressed as a fraction of a year.

HELPFUL HINT

Interest is a cost of borrowing money that accumulates with the passage of time.

Helpful Hints in the margins are like having an instructor with you as you read. They further clarify concepts being discussed.

Face Value of Note	x	Annual Interest Rate	x	Time in Terms of One Year	=	Interest
\$5,000	x	12%	x	1/12	=	\$50

Illustration 3-12
Formula for computing interest

The accrued expense adjusting entry at October 31 is:

Oct. 31	Interest Expense	50	
	Interest Payable		50
	(To record interest on notes payable)		

$$A = L + SE$$

$$+50 \quad -50$$

After this adjusting entry is posted, the accounts show:

Interest Expense		Interest Payable	
10/31 Adj.	50	10/31 Adj.	50

Illustration 3-13
Interest accounts after adjustment

Interest Expense shows the interest charges for the month. The amount of interest owed at the statement date is shown in Interest Payable. It will not be paid until the note comes due at the end of 3 months. The Interest Payable account is used instead of crediting (increasing) Notes Payable. The reason for using the two accounts is to disclose the two types of obligations (interest and principal) in the accounts and statements. **If this adjusting entry is not made, liabilities and interest expense will be understated, and net income and stockholders' equity will be**

Accounting equation analyses have been inserted in the margin next to key journal entries. They help you understand the impact of an accounting transaction on the financial statements.

Financial statements appear throughout the book. Those from real companies are identified by a logo or related photo. Often, numbers or categories are highlighted in colored type to draw your attention to key information.



DELTA AIR LINES, INC. Balance Sheet (partial) (in millions)

Property, plant, and equipment			
Flight equipment	\$9,619		
Less: Accumulated depreciation	3,510	\$6,109	
Ground property and equipment	3,032		
Less: Accumulated depreciation	1,758	1,274	\$7,383

Illustration 4-20
Property, plant, and equipment section

Intangible Assets

Intangible assets are noncurrent resources that do not have physical substance. They are recorded at cost, and this cost is expensed over the useful life of the intangible asset. Intangible assets include patents, copyrights, and trademarks or

For example, **Lands' End** reported in its 2001 Annual Report a beginning inventory of \$162,193,000, and cost of goods sold for the year ended January 26, 2001, of \$728,446,000. The inventory turnover formula and computation for Lands' End are shown below.

Illustration 6-28

Inventory turnover formula and computation for **Lands' End**



Cost of Goods Sold	÷	Average Inventory	=	Inventory Turnover
\$728,446,000	÷	$\frac{\$162,193,000 + \$188,211,000}{2}$	=	4.2 times

A variant of the inventory turnover ratio is the **average days to sell inventory**. For example, the inventory turnover for Lands' End of 4.2 times divided into 365 is approximately 87 days. This is the approximate age of the inventory.

There are typical levels of inventory in every industry. Companies that are able to keep their inventory at lower levels and higher turnovers and still satisfy customer needs are the most successful.

One technique for determining the meaning of the information on financial statements is **ratio analysis**. Throughout this text, you will analyze key financial ratios using data from Lands' End's financial statements. (Also, Chapter 15 addresses the topic of financial statement analysis in detail.)