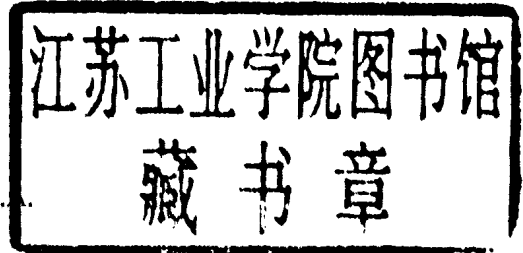


ACCOUNTING TEXT AND CASES

ROBERT N. ANTHONY, D.B.A.

Professor Emeritus
Graduate School of
Business Administration
Harvard University



JAMES S. REECE, D.B.A., C.M.A.

Professor
School of
Business Administration
The University of Michigan

JULIE H. HERTENSTEIN, D.B.A.

Associate Professor
College of Business Administration
Northeastern University

NINTH EDITION 1995

IRWIN

Chicago • Bogotá • Boston • Buenos Aires • Caracas
London • Madrid • Mexico City • Sydney • Toronto

**IRWIN Concerned about Our Environment**

In recognition of the fact that our company is a large end-user of fragile yet replenishable resources, we at IRWIN can assure you that every effort is made to meet or exceed Environmental Protection Agency (EPA) recommendations and requirements for a "greener" workplace.

To preserve these natural assets, a number of environmental policies, both companywide and department-specific, have been implemented. From the use of 50% recycled paper in out textbooks to the printing of promotional materials with recycled stock and soy inks to our office paper recycling program, we are committed to reducing waste and replacing environmentally unsafe products with safer alternatives.

© RICHARD D. IRWIN, INC., 1956, 1960, 1964, 1970, 1975, 1979, 1983, 1989, and 1994

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the copyright holder. The copyright on each case is held by the President and Fellows of Harvard College, Osceola Institute, by other institutions, or by individuals, and they are published herein by express permission.

Permission requests to use individual Harvard copyrighted cases should be directed to the Permissions Manager, Harvard Business School Publishing Division, Boston, MA 02163. Requests to reproduce cases copyrighted by Osceola Institute should be directed to Professor James S. Reece, School of Business Administration, The University of Michigan, Ann Arbor, MI, 48109-1234.

Case material of the Harvard Graduate School of Business Administration is made possible by the cooperation of business firms, who may wish to remain anonymous by having names, quantities and other identifying details disguised while basic relationships are maintained. Cases are prepared as the basis for class discussion rather than to illustrate either effective or ineffective handling of administrative situations.

Senior sponsoring editor: *Jeff Shelstad*
 Developmental editor: *Jackie Scruggs*
 Marketing manager: *Heather L. Woods*
 Project editor: *Stephanie M. Britt*
 Production supervisor: *Bette Ittersagen*
 Designer: *Heidi J. Baughman*
 Cover designer: *Tim Goldman*
 Art coordinator: *Heather Burbridge*
 Compositor: *Carlisle Communications, Ltd.*
 Typeface: *10/12 Melior*
 Printer: *R. R. Donnelley & Sons Company*

Library of Congress Cataloging-in-Publication Data

Anthony, Robert Newton

Accounting, text and cases / Robert N. Anthony, James S. Reece,
 Julie H. Hertenstein.—9th ed.

p. cm.

Includes bibliographical references and index.

ISBN 0-256-12372-1 International edition ISBN 0-256-16551-3

1. Accounting. 2. Accounting—Case studies. I. Reece, James S.
 II. Hertenstein, Julie Huffman. III. Title.

HF5635.A69 1995

658.15'11—dc20

94—21933

Printed in the United States of America

2 3 4 5 6 7 8 9 0 DO 1 0 9 8 7 6 5

Preface

An accounting text can be written with an emphasis on either of two viewpoints: (1) what the user of accounting information needs to know about accounting or (2) what the preparer of accounting reports needs to know about accounting. This book focuses on the user of accounting information. Because such a person needs to know enough about the preparation of accounting reports to use them intelligently, this text includes the technical material needed for this purpose. The book is aimed primarily, however, at the person who wants to be a knowledgeable user of accounting information. This focus is reinforced in the book's case studies, which help the student learn that accounting is not a cut-and-dried subject with all of its "answers" clearly indicated by the application of rules.

The focus of the book makes it particularly appropriate for required core courses in accounting, in which many of the students are not planning to take further elective accounting courses. First, we believe that if a core course stresses the more analytical uses of accounting information by managers and outside analysts rather than the procedural details that the practicing accountant needs to know, then those students who do not take further accounting courses will be left with a positive view of the importance of accounting rather than with the negative "bean counter" stereotype. Second, we feel that a user orientation in the core course actually is likely to generate a greater number of accounting majors from the class than if the course is oriented more toward the person who has already decided to

major in accounting. Similarly, in our experience the required accounting module in a management development program will generate little participant interest unless the module is oriented toward the nonaccountant user of accounting information. In sum, we think the book conveys the fact that accounting is interesting and fun, not dull and tedious.

Specifically, this book is used in at least the following four ways:

1. As an introductory course where most (if not all) of the students have no prior training in accounting. In many schools this introduction comprises two separate courses, one dealing with financial accounting and the other with management accounting. Many schools use this book for both such courses, whereas some use it only for financial accounting (Chapter 1 and Chapters 2–14) or for management accounting (Chapter 1 and Chapters 15–28). It is used in such introductory courses at both the upper undergraduate level and in graduate programs. In addition to its widespread use in schools of business and management, it is also used in introductory accounting courses in some law schools, education schools, and schools of public health.

2. As an elective course that builds on a required introductory course in accounting—particularly where the introductory course had more of a procedural orientation and the elective is intended to be more conceptual, analytical, and user-oriented.

3. As the accounting module in a management development program where the participants represent a variety of functional and technical backgrounds.

4. As a nontechnical accounting reference book for nonaccountants in business and other organizations.

Although designed for beginning students, the book does not contain enough “pencil-pushing” material to meet the needs of some instructors of introductory courses. Such instructors may wish to use the companion volume, *Accounting Principles Workbook*,¹ which, in addition to key terms and discussion questions, has more problem material (10–15 problems per chapter), a short practice set, and some cases that are not in this volume.

Many instructors also assign or recommend the programmed text *Essentials of Accounting*,² either as preliminary to study of the subject (it is often sent in advance to participants in M.B.A. and management development programs) or as a review device. It is a self-study introductory treatment of financial accounting, geared to Part 1 of this text.

The Cases

As in previous editions the cases have been selected because of their interest and educational value as a basis for class discussion. They are not

¹ *Accounting Principles Workbook*, 8th ed. (Homewood, Ill.: Richard D. Irwin, 1995).

² Robert N. Anthony, *Essentials of Accounting*, 5th ed. (Reading, Mass.: Addison-Wesley, 1993). This material is also available in the form of computer software for IBM-compatible and Apple computers, titled *Teach Yourself Essentials of Accounting*.

necessarily intended to illustrate either correct or incorrect handling of management problems. Skill in the management use of accounting information can be acquired, we believe, only through experience. Thinking about a case and discussing it in informal discussion groups and in the classroom require the student to do something—to analyze a problem, to weigh various factors involved in it, to make some calculations, to take a position, and so on. In class the student is required to explain her or his point of view, to defend it, to understand and appraise the arguments of colleagues, and to decide what arguments are the strongest. Practice in doing these things helps to increase skill and understanding; in fact, many educators believe that the really important parts of a subject can be learned only by experience of some sort, as opposed to merely hearing or reading about them. Thus, although the case material comprises less than half the pages in this book, the discussion of these cases is by far the more important part of the educational process. Of course, such discussions contribute to the students' communication skills as well as to their understanding of accounting.

This edition has a total of 121 cases. Some of these are new, and the majority of them that were carried over from the previous edition have been updated (in some instances with a change in case name).

Occasionally, a student or instructor questions our use of small business settings for many of the cases. Such cases often avoid certain complexities at a point when the student is not yet prepared to deal with them. We also would note that studies have reported that small businesses (those employing fewer than 500 people) represent over 99 percent of all U.S. businesses, provide about 50 percent of all private-sector jobs, generate almost 40 percent of the GNP, and contribute two out of three newly created jobs. We therefore feel that exposure to some small business cases is beneficial to students, many of whom will eventually work in such firms or work with them as auditors or consultants.

Changes in the Ninth Edition

Developments in accounting, particularly financial accounting, have continued to be rapid in the last five years. These have resulted in many updating changes in the text. (Part 1 reflects Financial Accounting Standards Board [FASB] pronouncements through mid-1994, as well as the 1993 tax act.) More specifically, Chapters 2–12 reflect evolutionary and updating changes, including the additions of sections on executory contracts in Chapter 8, ESOPs and nonprofit organizations' equity in Chapter 9, other postretirement benefits in Chapter 10, and ethical problems in Chapter 14. For simplification the T-account method of preparing a cash flow statement has been deleted from Chapter 11.

The structure of Part 2 on management accounting has been changed in recognition of some students' confusing different cost *constructs* with different cost *systems*. The new structure stresses that there is *one* management accounting system, which uses full cost information (as well as

information on revenues and assets) for various measurement purposes, and uses responsibility cost information for management control purposes. In addition to the two purposes of measurement and control, management accounting has a third purpose—to aid in choosing from among alternative courses of action; but information for this purpose cannot come directly from the management accounting *system* because each alternative choice problem requires its own arrangement of accounting information.

Chapter 15 presents this new structure. The cost behavior coverage in Chapter 16 has been expanded to place far more emphasis on step-function costs and on the importance of being explicit about the relevant time period when characterizing a cost's behavior. Activity-based costing has been added to Chapter 18, and a brief discussion of quality costs is included in Chapter 19.

With this new structure the analysis of nonproduction variances appears in Chapter 21, immediately following coverage of production cost variances in Chapter 20. (Formerly, the two aspects of variance analysis were separated by several chapters, which some instructors found undesirable.) This unified treatment of variance analysis provides a natural transition into the other management control topics in Chapters 22–25, which include expanded treatment of control reports and incentive compensation in a new Chapter 25. Then short-run and long-term alternative choice decisions are described in Chapters 26 and 27, with Chapter 28 providing a summary of Part 2.

Acknowledgments

We are grateful to the many instructors and students who have made suggestions for improving this book. Included among those people are our colleagues at the Harvard Business School and the schools of business administration at The University of Michigan and Northeastern University, as well as the anonymous reviewers who commented on the previous edition.

Robert N. Anthony
James S. Reece
Julie H. Hertenstein

Index and Source of Cases

The 121 cases included in this book are listed below in alphabetical order, together with their authors' names and the institution with which each author was affiliated at the time the case was written. Cases with no name shown were written by, or under the supervision of, Robert N. Anthony, James S. Reece, or Julie H. Hertenstein. Unless otherwise indicated on the first page of a case, the copyright on all cases herein is held by Osceola Institute. No case may be reproduced in any form or by any means without the permission of its copyright holder. Information on requesting permission to reproduce Harvard Business School or Osceola Institute cases is included on the copyright page of this book. We regret that we are unable to provide permission information for cases not copyrighted by Harvard or Osceola.

Comments on the text, cases, or instructor's manual, or new ideas for teaching the cases, would be welcomed and should be sent to Professor Reece at the School of Business Administration, The University of Michigan, Ann Arbor, MI 48109-1234.

<i>Title</i>	<i>Authors</i>
Amerbran Company (A)	
Amerbran Company (B)	
American Steel Corporation	Prof. R. F. Vancil, Harvard Business School
Amtrak Auto Ferry Service	Prof. W. Rotch and S. Allen, Darden Graduate Business School
Amurath Company	
Azienda Vinicola Italiana	Dr. E. de Gennaro, IPSOA (Turino)
Baldwin Bicycle Company	
Bartlett, John	
Bates Boatyard	Prof. C. B. Nickerson, Harvard Business School
Bennett Body Company	Profs. C. A. Bliss and R. N. Anthony, Harvard Business School
Birch Paper Company	W. Rotch and Profs. N. E. Harlan, Harvard Business School
Black Meter Company	
Brisson Company	
Brooks, Kim	
Campar Industries, Inc.	
Carter Corporation	
Church, C. F., Manufacturing	J. M. Baitsell and Profs. C. A. Bliss and R. N. Anthony, Harvard Business School
Climax Shipping Company	
Coburg, Baron	Prof. W. T. Andrews, Guilford College
Coffin, Jean, (A)	
Coffin, Jean, (B)	
Coffin, Jean, (C)	Profs. C. B. Nickerson and R. N. Anthony, Harvard Business School
Coffin, Jean, (D)	
Copies Express	
Cotter Company	Prof. R. F. Vancil, Harvard Business School
Craik Veneer Company	
Crompton, Ltd.	Prof. G. Shillinglaw, IMEDE
Dallas Consulting Group	R. A. Pearson and Prof. J. G. San Miguel, Harvard Business School
Darius Company	
Delaney Motors	Prof. A. Reinstein, University of Detroit, and Prof. R. N. Anthony, Harvard Business School
Depreciation at Delta and Pan Am	E. J. Petro and Prof. W. J. Bruns, Jr., Harvard Business School
Dhahran Roads	Prof. S. C. Frey, Jr., and M. Schlosser, Darden Graduate Business School
Digitrex Company	
Downtown Parking Authority	G. M. Taylor and Prof. R. F. Vancil
Empire Glass Company	Prof. D. F. Hawkins, Harvard Business School
Enager Industries, Inc.	
Fahning Manufacturing Company	
Financial Detective, The	C. S. Opitz and Prof. R. F. Bruner, Darden Graduate Business School
FMC Corporation Recapitalization (A)	S. S. Harmeling, M. Addonizio, and Profs. W. J. Bruns, Jr. and J. H. Hertenstein, Harvard Business School
FMC Corporation Recapitalization (B)	S. S. Harmeling, M. Addonizio, and Profs. W. J. Bruns, Jr. and J. H. Hertenstein, Harvard Business School
Forner Carpet Company	
French, Bill	R. C. Hill and Prof. N. E. Harlan, Harvard Business School
Freedom Technology Corporation	
Genmo Corporation	
Gentle Electric Company	Prof. W. E. Sasser, Jr., Harvard Business School

Grant, W. T., Company	Prof. J. W. Culliton, Harvard Business School
Hanson Manufacturing Company	
Hardin Tool Company	
Hospital Supply, Inc.	
Huron Automotive Company	
Import Distributors, Inc.	
KLS Steel Company	Prof. M. J. Sandretto, Harvard Business School
Landau Company	
Limited Editions, Inc.	D. P. Frolin, Harvard Business School
Lipman Bottle Company	Prof. M. J. Sandretto, Harvard Business School
Lipton, Thomas J., Inc.	E. Roberts and Prof. W. Rotch, Darden Graduate Business School
	Prof. D. Solomons, University of Bristol
Liquid Chemical Company	
Los Niños Day Care Center	
Lupton Company	
MacDonald's Farm	J. Brown and Prof. J. K. Shank, Harvard Business School
Major League Baseball (B)	Prof. G. H. Sorter, New York University, and Prof. T. I. Selling, Amos Tuck School
Martin Corporation (A)	
Martin Corporation (B)	
Maynard Company (A)	
Maynard Company (B)	
Medfield Corporation	
Medieval Adventures Company	
Medi-Exam Services, Inc.	
Megashye Engineering Company	
Middleburg Realty Company	
Midwest Ice Cream Company (A)	W. J. Rauwerdink and Prof. J. K. Shank, Harvard Business School
Midwest Ice Cream Company (B)	W. J. Rauwerdink and Prof. J. K. Shank, Harvard Business School
Morgan Manufacturing	
Morrin Aircraft Company	
Moyer Corporation (A)	
Moyer Corporation (B)	
Murray, Paul	
Music Mart, Inc.	
National Helontogical Association	
Nemad Company	
Olympic Lumber Company	S. E. Roulac, Stanford University
Payson Lunch	Profs. R. O. Schlaifer and R. N. Anthony, Harvard Business School
PC Depot	
Piedmont University	
Pinetree Motel	
Problems in Full Cost Accounting	
Problems in Variance Analysis	
Reading Manufacturing Company	
Redwood Cafe (A)	
Redwood Cafe (B)	
Reynolds, R. J., Tobacco Company	C. A. Nichols and Prof. W. J. Bruns, Jr., Harvard Business School
Riechel Company	
Rock Creek Golf Club	
Rosemont Hill Health Center	Prof. D. W. Young, Harvard School of Public Health
Royal Crest, Inc.	R. H. Grueter and Prof. J. G. San Miguel, Harvard Business School
SafeCard Services, Inc.	
Santa Fe Art Gallery	
Save-Mart	

Shuman Automobiles, Inc.	A. M. McCosh and Profs. D. F. Hawkins, J. R. Yeager, and J. S. Reece, Harvard Business School
Siemens Electric Motor Works (A)	Profs. R. Cooper and K. H. Wruck, Harvard Business School
Silver Appliance Company	
Sinclair Company	Prof. G. Shillinglaw, IMEDE
Società Rigazio	Prof. R. G. Stephens, Ohio State University
Springfield National Bank	
Stafford Press	
Statements of Cash Flows: Three Examples	Profs. W. J. Bruns, Jr., and J. H. Hertenstein, Harvard Business School
Stybel Industries, Inc.	Prof. R. Cooper, Harvard Business School
SunAir Boat Builders, Inc.	W. Earner and Profs. M. E. Barrett and J. S. Reece, Harvard Business School
Thomas, Jackson	
Trammel Snowmobile Company	
Trelease Industries, Inc.	
Trevino's Service Station	Profs. C. A. Bliss, R. W. Haigh, and R. N. Anthony, Harvard Business School
Tru-Fit Parts, Inc.	
Uncle Grumps Toys	Profs. K. Merchant and R. Cooper, Harvard Business School
Union Carbide Corporation	
United States Steel and Marathon Oil	
U.S. Windpower, Inc.	Prof. C. J. Christenson, Harvard Business School
Warren Agency	Prof. C. J. Christenson, Harvard Business School
Whiz Calculator Company	
Woodside Products, Inc.	
Xytech, Inc.	

Contents

PART 1

FINANCIAL ACCOUNTING

1 The Nature and Purpose of Accounting, 3

- The Need for Information, 3
 - Operating Information, 5
 - Financial Accounting, 5
 - Management Accounting, 6
 - Definition of Accounting, 7
- The Profession of Accounting 8
- Our Approach to Accounting, 9
 - Preconceptions about Accounting, 10
 - Plan of the Book, 10
- The Financial Accounting Framework, 11
- Accounting's Historical Antecedents, 12
- Accounting as a Language, 13
- Nature of Principles, 13
- Criteria, 14

Source of Accounting

Principles, 15

Financial Statements, 17

Financial Statement

Objectives, 17

Income Tax Reporting, 18

Case 1–1 Kim Brooks, 20

Case 1–2 Baron Coburg, 21

2 Basic Accounting Concepts: The Balance Sheet, 23

Basic Concepts, 23

The Money Measurement Concept, 24

The Entity Concept, 25

The Going-Concern Concept, 26

The Cost Concept, 27

The Dual-Aspect Concept, 29

The Balance Sheet, 30

An Overall View, 31

Account Categories, 34

Assets, 34

- Liabilities, 37
- Owners' Equity, 39
- Ratios, 42
- Balance Sheet Changes, 42
 - Original Capital Contribution, 43
 - Bank Loan, 43
 - Purchase of Merchandise, 43
 - Sale of Merchandise, 44
- Concluding Comment, 44
- Case 2-1, Maynard Company (A), 46
- Case 2-2, Music Mart, Inc., 47
- Case 2-3, Redwood Cafe (A), 47
- Case 2-4, Los Niños Day Care Center, 49

3 Basic Accounting Concepts: The Income Statement, 51

- The Nature of Income, 51
- The Accounting Period Concept, 53
 - Interim Reports, 54
 - Relation between Income and Owners' Equity, 54
 - Income Not the Same as Increase in Cash, 55
- The Conservatism Concept, 56
 - Application to Revenue Recognition, 57
- The Realization Concept, 59
- The Matching Concept, 60
- Recognition of Expenses, 61
 - Terminology, 61
 - Criteria for Expense Recognition, 61
 - Expenses and Expenditures, 63
 - Dividends, 63
 - Summary of Expense Measurement, 66
- Gains and Losses, 66
- The Consistency Concept, 66
- The Materiality Concept, 68
- The Income Statement, 69
 - Revenues, 70
 - Cost of Sales, 71
 - Gross Margin, 72
 - Expenses, 72

- Net Income, 73
- Statement of Retained Earnings, 73
- Relation between Balance Sheet and Income Statement, 73
- Income Statement Percentages, 75
- Other Concepts of Income, 75
 - Accrual versus Cash-Basis Accounting, 75
 - Income Tax Accounting, 76
 - Economic Income, 77
- Case 3-1 Maynard Company (B), 79
- Case 3-2 Santa Fe Art Gallery, 80
- Case 3-3 Redwood Cafe (B), 82
- Case 3-4 John Bartlett, 82
- Case 3-5 Pinetree Motel, 84
- Case 3-6 National Helontogical Association, 87

4 Accounting Records and Systems, 91

- Recordkeeping Fundamentals, 91
 - The Account, 92
 - Permanent Accounts and Temporary Accounts, 93
 - The Ledger, 94
 - The Chart of Accounts, 94
 - Debit and Credit, 95
- Transaction Analysis, 96
 - Example: Campus Pizzeria, Inc., 96
 - Balancing Accounts, 100
 - The Trial Balance, 101
- The Adjusting and Closing Process, 102
 - Adjusting Entries, 102
 - Closing Entries, 106
 - Statement Preparation, 108
 - The Journal, 109
 - Summary of the Accounting Process, 111
- Accounting Systems, 111
 - Special Journals, 112
 - Control Accounts and Subsidiary Ledgers, 113
 - Imprest Funds, 113

Internal Accounting Controls, 114
 Significant Recordkeeping
 Ideas, 115
 Computer-Based Accounting
 Systems, 115
 What a Computer-Based System
 Does, 116
 Relation to Manual Systems, 117
 Problems with Computer
 Systems, 117

Appendix: Additional Accounting
 Cycle Procedures, 118
 Locating Errors Revealed by the
 Trial Balance, 118
 The Worksheet, 119

Case 4-1, PC Depot, 121
 Case 4-2, Save-Mart, 122
 Case 4-3, Copies Express, 123
 Case 4-4, Trevino's Service Station,
 124

5 Revenue and Monetary Assets, 129

Timing of Revenue Recognition, 129
 Basic Recognition Criteria, 130
 Delivery Method, 130
 Percentage-of-Completion
 Method, 132
 Production Method, 134
 Installment Method, 134
 Amount of Revenue Recognized, 136
 Bad Debts, 136
 Sales Discounts, 139
 Credit Card Sales, 140
 Sales Returns and Allowances, 141
 Revenue Adjustment versus
 Expense, 141
 Warranty Costs, 142
 Interest Revenue, 143
 Monetary Assets, 145
 Difference in Reporting Monetary
 and Nonmonetary Assets, 146
 Cash, 146
 Receivables, 146
 Marketable Securities, 146
 Analysis of Monetary Assets, 147

Current Ratio, 148
 Acid-Test Ratio, 149
 Days' Cash, 149
 Days' Receivables, 150
 Case 5-1 Moyer Corporation (A), 152
 Case 5-2 MacDonald's Farm, 154
 Case 5-3 Middleburg Realty
 Company, 156
 Case 5-4 Jean Coffin (A), 157

6 Cost of Sales and Inventories, 161

Types of Companies, 161
 Supplies, 162
 Merchandising Companies, 163
 Acquisition Cost, 163
 The Basic Measurement
 Problem, 164
 Periodic Inventory Method, 165
 Perpetual Inventory Method, 167
 Comparison of Periodic and
 Perpetual Methods, 168
 Retail Method, 169
 Manufacturing Companies, 170
 Inventory Accounts, 170
 Materials Used, 172
 Cost of Goods Manufactured, 173
 Cost of Goods Sold, 174
 Product Costing Systems, 176
 Product Costs and Period
 Costs, 176
 Service Companies, 177
 Inventory Costing Methods, 178
 Specific Identification Method, 179
 Average Cost Method, 179
 First-In, First-Out Method, 180
 Last-In, First-Out Method, 180
 Comparison of Methods, 183
 Lower of Cost or Market, 186
 Analysis of Inventory, 187
 Inventory Turnover, 187
 Case 6-1, Riechel Company, 189
 Case 6-2, Fahning Manufacturing
 Company, 190
 Case 6-3, Medfield Corporation, 193
 Case 6-4, Morgan Manufacturing, 194

Case 6–5, R. J. Reynolds Tobacco

Company, 196

Case 6–6, Jean Coffin (B), 203

7 Long-Lived Assets and Their Amortization, 205

Nature of Long-Lived Assets, 205

Types of Long-Lived Assets, 206

Plant and Equipment:

Acquisition, 207

Distinction between Asset and

Expense, 207

Items Included in Cost, 208

Acquisitions Recorded at Other than
Cost, 209

Basket Purchases, 210

Plant and Equipment:

Depreciation, 210

Judgments Required, 211

Service Life, 212

Depreciation Method, 213

Choice of a Depreciation
Method, 215

Accounting for Depreciation, 216

Change in Depreciation Rates, 218

Partial Year Depreciation, 218

Disclosure, 218

Plant and Equipment: Disposal, 219

Exchanges and Trade-Ins, 220

Group Depreciation, 222

Significance of Depreciation, 222

Income Tax Considerations, 224

Income Tax Depreciation, 224

Investment Tax Credit, 225

Leased Assets, 227

Capital Leases, 228

Natural Resources, 229

Depletion, 230

Accretion and Appreciation, 230

Intangible Assets, 231

Goodwill, 231

Patents, Copyrights, Franchise
Rights, 232

Leasehold Improvements, 233

Deferred Changes, 233

Research and Development Costs, 234

Case 7–1 Moyer Corporation (B), 236

Case 7–2 Jean Coffin (C), 237

Case 7–3 Stafford Press, 239

Case 7–4 Digitrex Company, 241

Case 7–5 Depreciation at Delta and
Pan Am, 243

8 Sources of Capital: Debt, 249

Nature of Liabilities, 250

Executory Contracts, 250

Contingencies, 251

Liabilities as a Source of
Funds, 252

Debt Capital, 253

Term Loans, 253

Bonds, 253

Accounting for Bonds, 254

Recording a Bond Issue, 254

Balance Sheet Presentation, 257

Bond Interest Expense, 257

Retirement of Bonds, 259

Refunding a Bond Issue, 259

Other Liabilities, 260

Analysis of Capital Structure, 261

Debt Ratios, 261

Times Interest Earned, 263

Bond Ratings, 263

Appendix: Present Value, 264

Concept of Present Value, 264

Finding Present Values, 266

Present Value of a Series of
Payments, 267

Present Values and Liabilities, 268

Present Values and Assets, 270

Calculating Bond Yields, 270

Case 8–1, Martin Corporation
(A), 272

Case 8–2, Stybel Industries, Inc., 274

Case 8–3, Megashye Engineering
Company, 276

Case 8–4, Paul Murray, 278

Case 8–5, Jean Coffin (D), 279

- 9 Sources of Capital: Owners' Equity, 281**
 - Forms of Business Organization, 281
 - Sole Proprietorship, 281
 - Partnership, 282
 - Corporation, 282
 - Accounting for Proprietor's and Partners' Equity, 283
 - Proprietorship Equity, 283
 - Partnership Equity, 284
 - Ownership in a Corporation, 285
 - Preferred Stock, 285
 - Common Stock, 286
 - Treasury Stock, 288
 - Reserves, 288
 - Retained Earnings, 289
 - Dividends, 289
 - Warrants and Stock Options, 291
 - Employee Stock Ownership Plans, 292
 - Balance Sheet Presentation, 293
 - Earnings per Share, 293
 - Common Stock Equivalents, 294
 - The Line between Debt and Equity, 295
 - Zero-Coupon Bonds, 295
 - Redeemable Preferred Stock, 296
 - Equity in Nonprofit Organizations, 296
 - Case 9-1 Xytech, Inc., 298
 - Case 9-2 FMC Corporation Recapitalization (A), 299
 - Case 9-3 Trelease Industries, Inc. 306
- 10 Other Items That Affect Net Income, 309**
 - Personnel Costs, 309
 - Pensions, 311
 - Other Postretirement Benefits, 314
 - Compensated Absences, 314
 - Income Taxes, 314
 - Book-to-Tax Differences, 315
 - Deferred Taxes, 317
 - Accounting Entries, 320
 - Nonoperating Items, 324
 - Extraordinary Items, 325
 - Discontinued Operations, 326
 - Change in Accounting Principles, 326
 - Adjustments to Retained Earnings, 327
 - Foreign Currency Accounting, 328
 - Foreign Currency Transactions, 328
 - Foreign Currency Translation, 329
 - Net Income, 331
 - Accounting and Changing Prices, 331
 - Nature of the Problem, 331
 - Proposed Solutions, 332
 - Related Developments, 333
 - Case 10-1, Martin Corporation (B), 335
 - Case 10-2, Silver Appliance Company, 336
 - Case 10-3, Union Carbide Corporation, 338
 - Case 10-4, Major League Baseball (B), 341
 - Case 10-5, Freedom Technology Company, 350
- 11 The Statement of Cash Flows, 353**
 - The Concept of Flow Statements, 353
 - Purpose of the Cash Flow Statement, 354
 - Sources and Uses of Cash, 354
 - The Cash Flow Statement, 356
 - Statement Categories, 356
 - Investing Activities, 357
 - Financing Activities, 360
 - Noncash Transactions, 362
 - Cash Flow from Operating Activities, 362
 - Indirect Method Calculations, 363
 - Summary of the Cash Flow Statement, 368
 - Misconceptions About Depreciation, 369
 - Cash Flow Earnings, 370

- Preparation of the Cash Flow Statement, 370
- Cash Flow Worksheet, 371
- Worksheet Entries, 371
- Statement Preparation, 376
- Summary of Preparation Procedures, 376
- Analysis of the Cash Flow Statement, 377
- Ratios, 378
- Cash Flow Projections, 379
- Case 11-1 Medieval Adventures Company, 381
- Case 11-2 Amerbran Company (A), 382
- Case 11-3 Statements of Cash Flows: Three Examples, 384
- Case 11-4 FMC Corporation Recapitalization (B), 390
- Case 11-5 W. T. Grant Company, 392
- 12 Acquisitions and Consolidated Statements, 397**
 - Accounting for Investments, 397
 - Fair-Value Method, 397
 - Equity Method, 398
 - Consolidated Basis, 399
 - Business Combinations, 399
 - Purchase versus Pooling, 400
 - Accounting as a Pooling, 401
 - Accounting as a Purchase, 402
 - Impact on Balance Sheet, 403
 - Impact on Earnings, 403
 - Consolidated Statements, 405
 - Basis for Consolidation, 406
 - Consolidation Procedure, 406
 - Asset Valuation, 409
 - Minority Interest, 410
 - Case 12-1, Hardin Tool Company, 412
 - Case 12-2, Carter Corporation, 413
 - Case 12-3, United States Steel and Marathon Oil, 415
- 13 Financial Statement Analysis, 419**
 - Business Objectives, 419
 - Return on Investment, 420
 - Sound Financial Position, 422
 - Structure of the Analysis, 422
 - Overall Measures, 424
 - Return on Investment, 424
 - Investment Turnover and Profit Margin, 427
 - Price/Earnings Ratio, 428
 - Profitability Ratios, 429
 - Profit Margin, 429
 - Investment Utilization Ratios, 430
 - Investment Turnover, 430
 - Working Capital Measures, 431
 - Financial Condition Ratios, 432
 - Liquidity and Solvency, 432
 - Dividend Policy, 432
 - Growth Measures, 433
 - Making Comparisons, 436
 - Difficulties, 436
 - Possible Bases for Comparison, 438
 - Use of Comparisons, 439
 - Case 13-1 Genmo Corporation, 441
 - Case 13-2 Amerbran Company (B), 443
 - Case 13-3 The Financial Detective, 444
 - Case 13-4 Springfield National Bank, 445
- 14 Understanding Financial Statements, 453**
 - Additional Information in Annual Reports, 453
 - Auditors' Opinion, 454
 - Notes to Financial Statements, 457
 - Segment Reporting, 458
 - Full Disclosure, 458
 - Comparative Statements, 459
 - Securities and Exchange Commission (SEC) Reports, 460
 - Review of Criteria and Concepts, 460
 - Criteria, 461
 - Concepts, 462
 - Accounting Alternatives, 466
 - Regulatory Requirements, 466