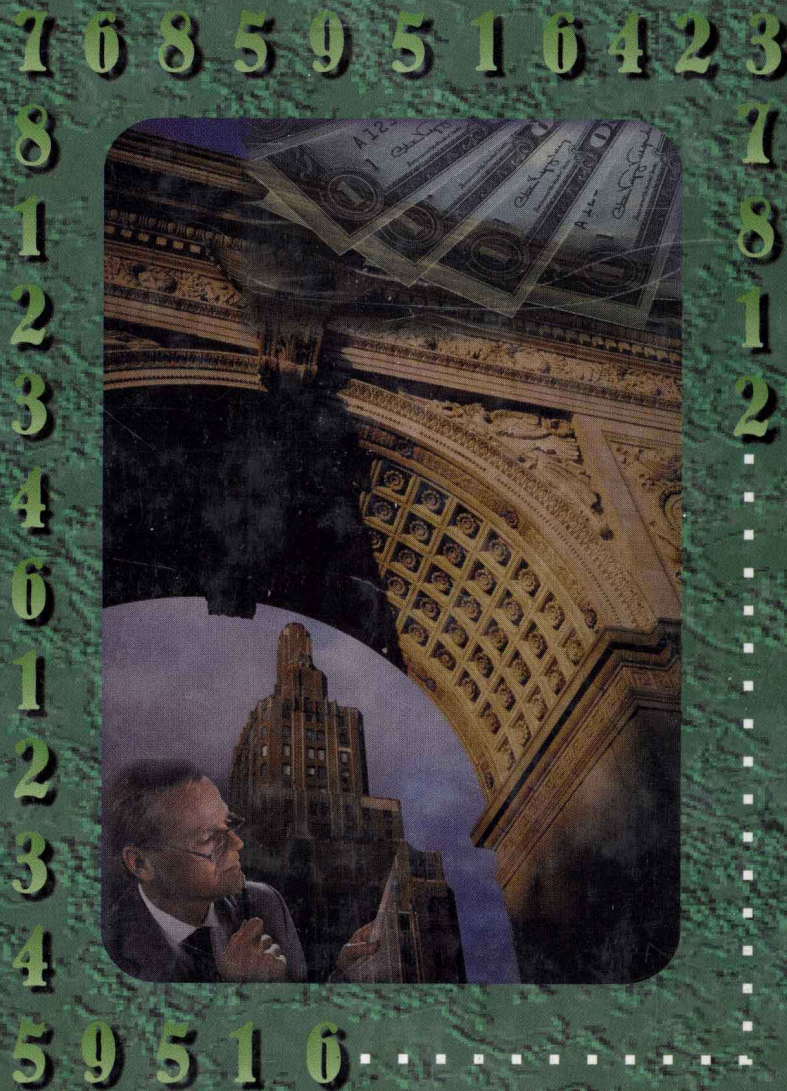


# **FINANCIAL** **ACCOUNTING**

A Focus on Analysis and Interpretation

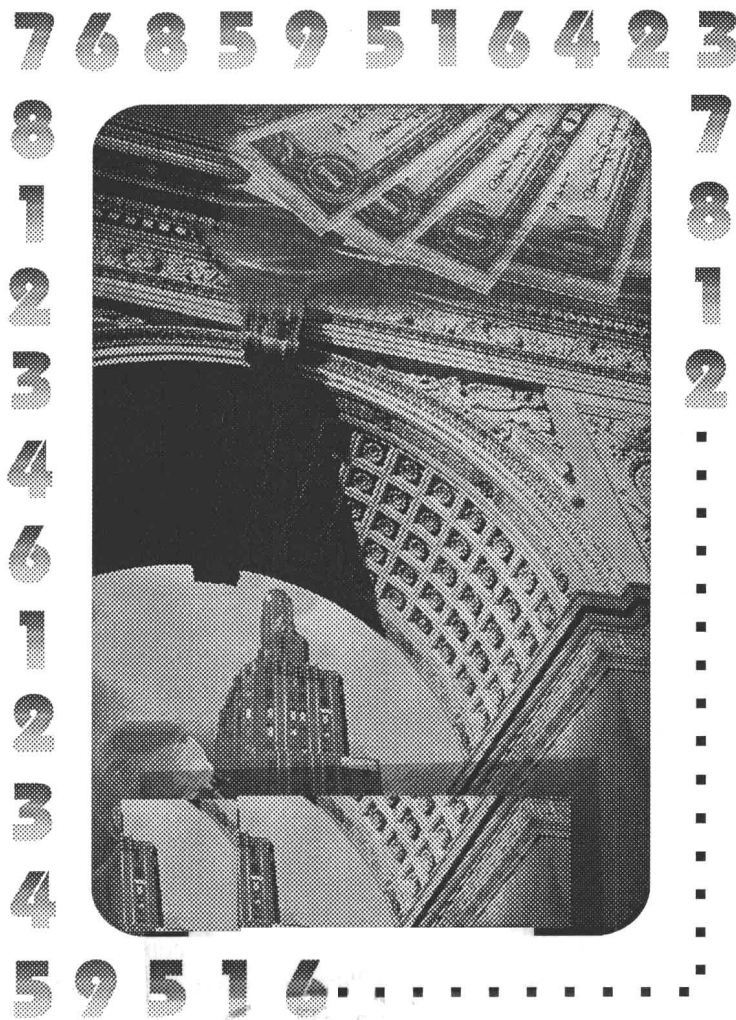


Fourth Edition

**Kochanek Hillman Barsky**

# **F**INANCIAL ACCOUNTING

A Focus on Analysis and Interpretation





TO: OUR STUDENTS

FROM: Dick Kochanek  
Doug Hillman  
Noah Barsky

Most texts begin with a preface describing features of the book. Before we do this, we want to begin by **welcoming you to the study of accounting!** Our primary purpose in writing this text is our concern for you, the student. The three authors of this text have over 75 years of combined teaching experience. We all teach the beginning classes in accounting. We also sincerely believe that the background in accounting will be useful to you in both your career and personal life. Some of you may even choose to select accounting as your major.

We have tried to make all of the concepts in this text as simple and direct to understand as possible. Also, we try to relate each concept to actual companies. Throughout this text, you will use accounting concepts to interpret information for companies like: Intel, Toys“R”Us, Circuit City, Wendy’s, Nike, Caterpillar, Microsoft, General Motors, and many others. We try very hard to bring a real-life dimension to each chapter.

Our experience is that the accounting professors you will meet are some of the most dedicated and concerned faculty you will have in college. The study of accounting requires daily work. This is not the type of course you can prepare for the night before an exam. However, the rewards are that you will be learning skills you can actually use to reach solutions to business problems.

The following list of 15 items represents advice for success in accounting we give our own students. We would like to share the list with you. It may be helpful to you in all of your college courses. As teachers, we wish each of you much success, both in your college studies and in your future careers. We hope you enjoy your study of accounting and thank you for using our text. We welcome any comments you have on making it even better.

## ADVICE FOR SUCCESS IN YOUR ACCOUNTING COURSE

### 1. PARTICIPATE ACTIVELY IN CLASS

(Learning is a two-way communication process. The more you contribute, the richer the learning experience becomes. In a job interview, you will typically have only 30 minutes to make a lasting impression. You need to get comfortable expressing your thoughts to others.)

### 2. VIEW YOUR PROFESSOR AS YOU WOULD A JOB SUPERVISOR

(You need to both learn from your professors and establish your own credibility as a professional. Very soon, you will need to request a faculty recommendation. Provide your professor with positive things to say.)

3. **MINIMIZE THE NUMBER OF TIMES YOU CANNOT MEET A DEADLINE**  
(As a professional, providing excuses as to why you missed a deadline is simply not acceptable. People are depending on you. Keep on top of your class work and realize that you cannot do your best work on a last minute basis.)
4. **ALWAYS BE ON TIME FOR CLASS, NEVER LEAVE CLASS EARLY**  
(Arriving late and leaving class early is both disrespectful and unacceptable. Let your professor know if you have an outside commitment that will make you miss class.)
5. **PRACTICE MEETING PEOPLE AND EXTENDING A WELCOME**  
(You need to learn to work with and obtain results from all types of people.)
6. **RESIST THE TEMPTATION TO SPEAK NEGATIVELY OF PEOPLE**  
(Many times, you will say something you will later regret.)
7. **ALWAYS STRIVE TO DO YOUR PERSONAL BEST**  
(If you are growing as a person, your personal best should constantly improve.)
8. **LEARN BY YOUR MISTAKES**  
(Channel feelings of disappointment into creative energy.)
9. **CONTINUALLY WORK ON IMPROVING COMMUNICATION SKILLS**  
(Many accounting graduates are technically competent. Often, writing and presentation skills distinguish star performers from average performers.)
10. **BE A GOOD LISTENER**  
(In the business world, you will encounter people who may not wish to repeat facts because you did not pay attention the first time.)
11. **ALWAYS BE PREPARED**  
(For class, complete assigned readings and homework. For interviews, obtain as much information as you can about the company you will visit. For your job, know your client and their business.)
12. **BE PROACTIVE RATHER THAN REACTIVE**  
(Volunteer for responsibilities and assignments when appropriate.)
13. **IF YOU PRESENT A PROBLEM, ALSO PRESENT A POSSIBLE SOLUTION**  
(Don't come to a professor or supervisor and say "I don't understand anything here". Rather, develop questions on the part of the problem you need assistance with.)
14. **BE SENSITIVE TO THE FEELINGS OF OTHERS**  
(Treat everyone like you wish to be treated.)
15. **DISCOVER AND DEVELOP YOUR PERSONAL UNIQUE TALENTS**  
(Don't spend too much time trying to emulate other people. Work instead to discover and develop qualities which are unique to you.)

# Preface

The Fourth Edition of Financial Accounting takes a broad new focus on analysis and interpretation while retaining the basics of relevant accounting processes. This revised edition uses the corporate form of business from the very beginning of the text. We introduce corporations very simply with only Common Stock and Retained Earnings.

We have incorporated significant amounts of real world data into the text and problems. In addition, we have increased our major thrust of user analysis in the text and problems. We have done a very careful review of comments from our users and taken a hard look at exactly what is important for the introductory student. Because of this, we have been able to add significantly to use of real- world companies for analysis while significantly shortening the length of chapters and the overall text.

Chapters 6 through 18 include a major new addition to the analysis and interpretation focus of the text called a "Comprehensive Analysis Problem." The first of these problems appears in Chapter 6. We present the systematic methodology for doing these problems in the body of Chapter 6 using Dell Computer. The analysis uses a "Linked Spreadsheet." Each chapter through 18 contains a problem based on an actual company with a "Linked Spreadsheet" designed to help the student develop their analytical skills. The companies used in this series of problems include many that are familiar to the students such as Coca-Cola, Nike, Harley-Davidson, Reebok, and Starbucks.

Chapters 1 through 18 each contain an "Analyzing Information" section. This section presents information from financial statements of real-life companies. Then, we raise sets of user-oriented questions about this information and develop answers to these questions. We lead the student through the thought process necessary to respond to the real-life questions. End-of-chapter problems based on actual companies allow students to practice their new skills. This was a well-accepted new feature in the Fourth Edition. We updated all of these sections with new companies and current financial data. We have used the experience and comments of our users to improve the "Analyzing Information" sections.

New also to the Fourth Edition are World-Wide-Web based problems. These are problems require the same analytical tools introduced in the "Analyzing Information" problems. The students will use the Web to secure the data. The problems will be on a Web site accessible by text users. These problems will have links to the appropriate business Web sites. By maintaining the problems on a Web site, we will be able to update them each year.

Our overall objective in our revisions is to focus on four standards of excellence: relevance, simplicity, clarity, and a vision of the future direction of accounting education.

## Relevance

- Is a topic worthy of student and instructor time?
- Does an issue recognize changes in the business world?
- Is there a real-life application that will add excitement and meaning to the presentation?

## Simplicity

- Are the chapters as concise as they can be with adequate coverage?
- Does an example or illustration cover all essential issues as simply and directly as possible?
- Are numbers easy to follow and understand?
- Are sections of the text written as simply and directly as possible?

## Clarity

- Does the writing style use active voice and short sentences to achieve readability?
- Are illustrations effectively integrated into and explained by the text material?
- Does the text design allow key elements to be easily identified?

## Vision

- Is the topic covered from a user perspective and supported by real-world examples?
- Are technical procedures linked to major business issues for a broader understanding of business and accounting concepts?
- Does the chapter pedagogy help students "learn to learn," enabling them to face future career demands?
- Do end-of-chapter materials include problems that require students to form judgments and interpretations?

For this important revision, we have added a new member to the author team. Noah Barsky joins Doug Hillman and Dick Kochanek. Noah is a professor of accounting at Villanova University. He brings to this revision a fresh look at both the financial and managerial sections of the text. Doug Hillman has been an author on the text since the Third Edition. He has been an instructor of Principles of Accounting for more than 35 years. He brings to the text a wealth of experience in the first-year classroom having been named teacher of the year by the undergraduate students in the College of Business at Drake. Dick Kochanek also brings significant experience in teaching introductory accounting. He has gained wide recognition as a superior instructor of introductory accounting, being named the outstanding professor at the University of Connecticut.

## RESPONSE TO CHANGES IN ACCOUNTING EDUCATION

We face a time of change in accounting education. From a pedagogical standpoint, the following are some of the most important overall changes in the Fourth Edition.

ONE OF THE MOST VISIBLE CHANGES YOU WILL NOTICE IS THE START OF THE TEXT. Most accounting texts begin with a long list of accounting concepts and analysis of business transactions. In our "Introduction to Using Accounting Information," we introduce students to planning, reporting, and assessment activities that each manager faces. To apply our discussion to real-life, we use 1998 data for Intel as an illustrative company in this introduction. **Our focus** is simple: total revenues and expenses on the income statement, and total assets, liabilities, and owners' equity on the balance sheet. **Our goal** is to create an interest in the uses of accounting *before* discussing the details. End-of-chapter problems in the Introduction involve analyzing H&R Block, Circuit City Stores, The GAP, The Limited, Safeway, Inc., Winn-Dixie Stores, Wal-Mart and K-Mart.

Developments in the Fourth Edition include:

1. The financial accounting section now includes a "Comprehensive Analysis Problem" in each chapter from 6 through 18. The first of these problems appears in Chapter 6. We present the systematic methodology for doing these problems in the body of Chapter 6 using Dell Computer. The analysis uses a "Linked Spreadsheet" contained on a diskette included with the text. Then each chapter through 18 contains a problem based on an actual company with a "Linked Spreadsheet" designed to help the student develop their analysis skills. The companies used in this series of problems include many that are familiar to the students such as Coca-Cola, Nike, Harley-Davidson, Reebok, and Starbucks.
2. Each financial accounting chapter includes a user perspective to analyzing financial information. In each "Analyzing Information" section, we present real-world data that highlights topics presented in that chapter. We then raise important questions about that data and take the student through an answer to each question. Walking through this analysis of real-world situations will help the student become a better user of financial statement information.
3. We have expanded real-life applications. *We now have a text that retains sound coverage of the accounting process but also includes an unprecedented amount of actual company data and a user orientation.*
4. Chapter introductions focus on the business issues underlying accounting concepts and applications that we will cover in that chapter. New data brings current real-world situations to the chapters.

5. We have continued to focus on readability and an active-voice writing style. We use short, concise sentences and text sections. This improves a text that students already rave about for its ease of learning.
6. We clearly identify major accounting issues in each chapter to focus on important concepts. After reading each chapter, students understand which issues are important.
7. We mark and integrate Learning Goals throughout the text and learning package. We mark all exercises and problems with the appropriate learning goals.
8. There is an extensive choice of assignment materials, including the following:
  - a. All new “*Analyzing Information*” problems require analysis of real-world financial statement data from a user perspective. These problems follow the analysis format developed in the “*Analyzing Information*” section of the chapter. Complimenting these problems are the brand new “*Comprehensive Analysis Problems*” with Linked Spreadsheets at the end of Chapters 6-18.
  - b. This edition adds new World-Wide-Web based problems that allow the student to use the web to obtain the data to do the analysis of the financial information. These problems follow the same analysis format studied in the “*Analyzing Information*” problems.
  - c. *Business Decision and Communication Problems* focus on forming judgments and developing writing skills.
  - d. *Ethical Dilemmas* are cases that encourage sensitivity to potential conflicts of interest.
  - e. *Summary Practice Cases* integrate accounting concepts for each chapter.
  - f. *Practice Sets* integrate accounting concepts for major sections of the textbook. It is no longer necessary to buy separate practice sets. We have included three practice sets in the text.
  - g. End-of-chapter exercises contain an extensive selection having a single Learning Goal. These allow each instructor to customize the course.
  - h. Problems have multiple Learning Goals, which integrate topics in each chapter.
9. An improved design that enhances the learning features.

## THE TEXTBOOK

The introductory accounting course is usually a student's first exposure to business terms and issues. Presenting accounting concepts in a logical and careful order is critical to capturing and enhancing student interest. Offering an extensive and varied set of self-test and end-of-chapter materials is essential to maximizing student learning. Each chapter of the Third Edition uses creative pedagogical features consistently to create student excitement about accounting.

## Pedagogical Features for Each Chapter

1. The textbook presents specific, clearly stated Learning Goals throughout. Each chapter begins with a list of the Learning Goals. Each Learning Goal appears next to the appropriate material in the chapter. The end-of-chapter items show the Learning Goals covered.
2. The Understanding Business Issues section helps students appreciate the *real-world significance* of each chapter.

3. We use an *active-voice writing style* that fosters reading interest and comprehension.
4. Pages are uncluttered and feature a design that draws attention to key concepts and highlights important relationships.
5. We continue to key text discussion and explanations to chapter illustrations by using boxed reference numbers. This permits students to link explanations and illustrations easily.
6. The “Analyzing Information” section of each chapter leads the student through a *user analysis* of real-world financial statement information.
7. *Real-life company* examples throughout apply the accounting concepts to actual practice.
8. An end-of-chapter Learning Goals Review captures the main points of each topic studied in the chapter.
9. Demonstration Problems contain *Solution Approach* sections, usually for each requirement. This is a unique feature of our text that we were the first to develop. Each Solution Approach contains hints and discussion of the logical thought process that students should use in solving the problem. This feature will help the student in learning-to-learn. Studying the Demonstration Problem is an excellent chapter review.

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### Learning Features for the Entire Text

1. The textbook uses a master chart of accounts for all illustrations and problems. We print this in the front and back endpapers for easy reference.
2. The Third Edition contains two Practice Sets (usable after Chapters 3 or 4, and 10) that integrate and review major sections of the text. This allows the potential use of three practice sets without the student purchasing extra materials. These are full feature practice sets, comparable in coverage to separately purchased practice sets.
3. Appendix B includes a summary set of financial statements and explanatory notes for a hypothetical company. In the margins are boxed explanations of all important items. In Appendix B, we emphasize a *user’s analysis* of published annual financial statements.
4. Appendix B also includes the 1998 Annual Report of Motorola Company. This further reinforces the analysis of information by users.

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### Chapter Organization and Content Changes

- A chapter “Introduction to Using Accounting Information” begins the financial section of the text.
- Chapters 1 through 18 contain a new “Analyzing Information” section using actual company data. The text guides students through raising questions appropriate to the material they have studied. Then we guide them through the development of answers to each of these questions. The end-of-chapter materials contain problems with the same questions based on different companies. Using financial statement information becomes an integral part of the text versus an afterthought.
- Chapter 14 covers “mark-to-market.” The chapter contains an exceptionally simplified coverage of this topic especially suited for the first-year student. It uses extensive real-life company illustrations.
- Chapter 16 is now a capstone chapter to the “Analyzing Information” skills that each chapter has developed. It uses one continuous example to show integrative presentation of horizontal, vertical, and ratio analysis. It includes a strong emphasis on significance, limitations, and interpretation of statement analysis.

## ORGANIZATION OF THE TEXTBOOK

### **Part I: "The Accounting Model"** (Chapters 1-5)

Part I develops the basic accounting model using a simplified corporate form. Chapters 1-4 explain and illustrate the concepts, techniques, and steps in the accounting cycle. We introduce the statement of cash flows early in the text.

### **Part II: "Internal Control and Income Measurement Issues"** (Chapters 6-10)

Part II introduces internal controls and cash accounting issues. Chapters then cover income measurement and valuation issues relating to receivables, short-term financing, inventories, and long-term assets.

### **Part III: "Organizational Forms and Reporting Issues"** (Chapters 11-18)

Chapters 11 and 12 discuss the corporation as a unique form of business organization. We discuss accounting for the issuance of bonds and investments in bonds and stocks (Chapters 13 and 14) using both the straight-line and the effective interest methods. Chapter 15 illustrates the statement of cash flows, using a unique introduction that shows interrelationships among the financial statements. Chapter 16 discusses financial statement analysis with an emphasis on the significance and interpretation of the results. Chapter 17 describes and illustrates consolidated statements. The section concludes with Chapter 18 on international accounting and financial reporting issues.

## End-of-Book Appendices

The textbook includes three appendixes. Appendix A considers basic income tax procedures, using flow diagrams to present an overview of income tax computations. It also introduces interperiod income tax allocation. Appendix B contains a summary of basic financial statements and explanatory notes for a hypothetical company. Then, we include the consolidated financial statements of Motorola Company and accompanying notes. Appendix C contains the coverage of present value concepts and tables for four basic present value techniques.

In addition to the textbook, the teaching package includes a remarkable set of teaching tools for the instructor and tools of learning for the student.

## FOR THE INSTRUCTOR

The textbook authors have taken primary responsibility for these parts of the package. This brings a consistency to these materials that cannot be achieved when nonauthors develop these supplementary materials.

## Instructor's Manual

The Instructor's Manual is a complete classroom resource for today's professional educator. It contains detailed teaching suggestions and aids for each chapter in the textbook:

- Concise Lecture Outline, with major topics listed in outline form.
- Detailed Lecture Outline, organized by Learning Goal with annotations, teaching tips, and a listing of new glossary terms for each Learning Goal.

- Review Quiz, which includes multiple-choice questions.
- Suggested Assignments by Learning Goal.
- Overview of Assignment Material, organized by learning goal, difficulty, and time required.
- Ethical Case Comments, with advice on approaching this sensitive topic.

Also included are major standalone sections on Learning to Learn, Teaching Communication Skills, and Sample Syllabi. The complete Instructor's Manual is available on disk for use with word processors for developing personalized course notes.

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## Solutions Manual

The text authors prepare the Solutions Manual. Included are solutions for Questions for Group Learning, Exercises, Problems, Practice Cases, Business Decision and Communication Problems, Ethical Dilemmas, and Practice Sets.

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## Solutions Transparencies

Solutions to all end-of-chapter exercises and problems are available on transparency acetates in a bold, easy-to-read format. Also included are solutions to Practice Cases, Business Decision and Communication Problems, Ethical Dilemmas, and Practice Sets.

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## Electronic Teaching Media

A series of electronic slide presentations developed using PowerPoint is available for many chapters. The presentations require PowerPoint version 4.0 or newer and an IBM PC or Macintosh and an appropriate visual display.

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## Test Resource Manual

The test bank includes 30 true/false, 50 multiple-choice questions, and 15-20 short problems for each chapter. We also include solutions with supporting computations for selected items. Approximately one-half of the multiple-choice items are conceptual and one-half are problem oriented. We reference all test items to chapter Learning Goals.

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## Computerized Test Bank

All test items are available in computerized format for use on Windows systems. The software can generate multiple versions of each exam with answer keys. The system also allows instructors to edit existing questions and add new ones.

## FOR THE STUDENT

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## Study Guide

**By Richard Kochanek (University of Connecticut)** More than ever before, the Study Guide's unique guided study approach helps students take active responsibility for learning and review. Each chapter reviews the Learning Goals and then directs student attention to learn the more difficult concepts in each chapter. Self-tests with answers help measure achievement. The unique feature of this study guide is the Guided Study section in programmed learning format that directs the student through a review of the chapter. We emphasize the chapter illustrations and computations in this Guided Study. This is an especially important feature for the part-time student.

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## Working Papers

Based on professional accounting forms, working papers are provided for each exercise and for each problem. Working papers in early chapters are partially filled in to provide help to the beginning student.

### ACKNOWLEDGMENTS

We would like to thank all text users (both professors and students) who have given us many valuable comments. Your ideas have contributed greatly to this significant revision. We also wish to express our thanks to our accounting professors who taught us both accounting concepts and professional/ethical responsibilities.

We would also like to express our very deep appreciation to the staff at Dame Publications, Inc. who have worked so diligently on this project. Developing and publishing a principles of accounting text is a tremendous undertaking. Jan Tiefel has been of extraordinary assistance in serving our many adopters. Bill McDowell has helped in gathering all of the input from our many users and potential users around the country. We extend a very big thanks to Sheryl New who has worked tirelessly as both editor and designer for this Third Edition. Sheryl's fresh ideas and devotion to this project were exceptional. Also thanks to Lisa Diemer and Kristi Diemer who have put in countless hours in preparing the text for publication.

**Douglas Hillman**  
Des Moines, Iowa

**Richard Kochanek**  
Storrs, Connecticut

**Noah Barsky**  
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## ABOUT THE AUTHORS

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Although he has taught a variety of undergraduate and graduate courses, his primary teaching responsibility has been the accounting principles course. Professor Kochanek has received every outstanding teaching award the University of Connecticut offers. These include outstanding accounting professor, outstanding professor in the School of Business, the United Technologies Corporation outstanding undergraduate teaching award, outstanding MBA professor, and the Alumni Award for the outstanding teacher at the University of Connecticut. He was one of the first four faculty named as "University Teaching Fellows".

Professor Kochanek has published in *The Accounting Review*, *Accounting Horizons*, *Management Accounting*, *The CPA Journal*, and *Financial Executive*. He is a recipient of the Competitive Manuscript Contest Award of the American Accounting Association. Professor Kochanek has been a faculty intern with Price Waterhouse, and has conducted executive seminars in financial reporting issues for banks, insurance companies, manufacturing companies, and public accounting firms.

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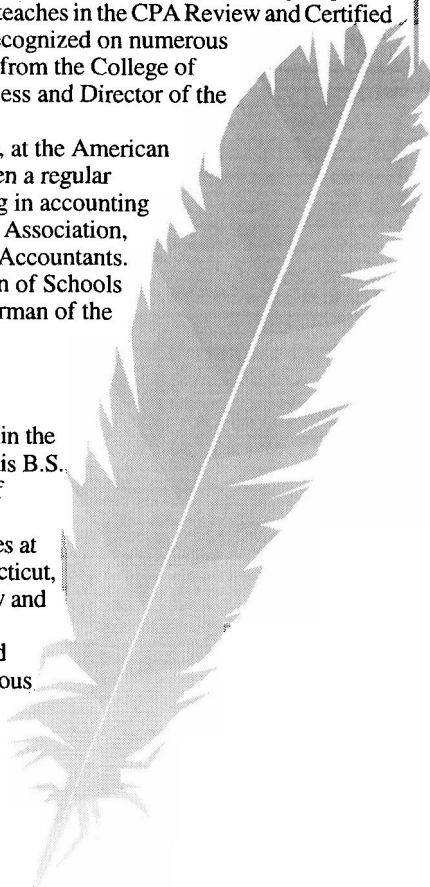
Professor Hillman's foremost teaching emphasis is in the principles of accounting course. His secondary teaching emphasis is in cost and managerial accounting at both undergraduate and graduate levels. He also teaches in the CPA Review and Certified Property and Casualty Underwriter Programs at Drake. Professor Hillman has been recognized on numerous occasions for his teaching excellence. He has received the outstanding teacher award from the College of Business at Drake University. He has served as Director of Graduate Studies in Business and Director of the School of Accounting while at Drake.

Professor Hillman has published and presented papers in the *Accounting Review*, at the American Accounting Association meetings, and at numerous regional meetings, and he has been a regular contributor to the Certified Management Accounting examination. He does consulting in accounting information systems for small business and is a member of the American Accounting Association, the Institute of Management Accountants, and the Institute of Certified Management Accountants. He has served on committees of the American Accounting Association, the Federation of Schools of Accounting, and the Institute of Management Accountants. And he is the past chairman of the Information System/MAS Section of the American Accounting Association.

**NOAH P. BARSKY**, Ph.D., CPA, CMA, is an assistant professor of accountancy in the College of Commerce and Finance at Villanova University. Professor Barsky received his B.S. and M.S. in accounting from Penn State University and his Ph.D. from the University of Connecticut. He joined the faculty at Villanova University in 1998.

Professor Barsky has taught a variety of financial and managerial accounting courses at four different universities. While he was a doctoral candidate at the University of Connecticut, he was recognized as an American Accounting Association Doctoral Consortium Fellow and a recipient of the Accounting Teaching Excellence Award.

Professor Barsky is an active member of the American Accounting Association and the Institute of Management Accountants. He has given research presentations at numerous national meetings of academic and professional associations. He has also authored two books and published articles in the *Journal of Accounting, Auditing and Accountability*, *The Pennsylvania CPA Journal* and *Managerial Finance*.



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