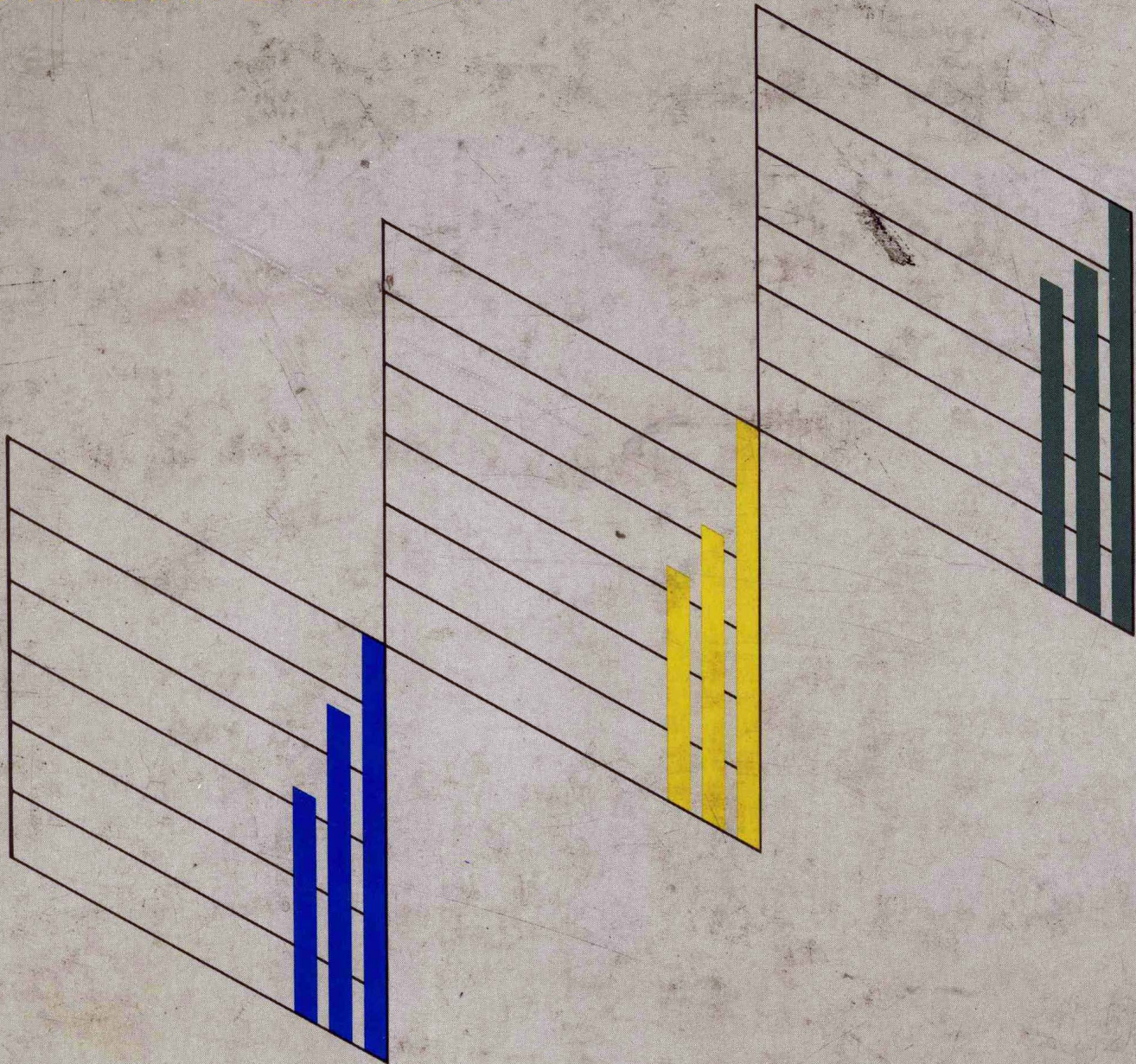


# FINANCIAL ACCOUNTING

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# FINANCIAL ACCOUNTING

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COLLIER MACMILLAN PUBLISHERS

London

**About the Cover:** The graphic on the front cover is adapted from the annual report of Macmillan, Inc., for the calendar year 1984. It shows the changes in Earnings Per Share, Operating Income, and Sales of Products and Services from 1982 through 1984. The relevant data is filled in on the back cover of the text.

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Printed in the United States of America

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Macmillan Publishing Company  
866 Third Avenue, New York, New York 10022

Collier Macmillan Canada, Inc.

**Library of Congress Cataloging in Publication Data**

Flamholtz, Eric.

Financial accounting.

Includes index.

1. Accounting. I. Diamond, Michael A. II. Flamholtz,  
Diana Troik. III. Title.

HF5635.F564 1986 657 85-23852

ISBN 0-02-338150-7

Printing: 1 2 3 4 5 6 7 8

Year: 6 7 8 9 0 1 2 3 4 5

ISBN 0-02-338150-7

# **FINANCIAL ACCOUNTING**



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# Preface

*Financial Accounting* is designed to be used in the first-year accounting course that covers either one or two quarters or one semester. It presumes that the student has had no previous exposure to accounting. Because of this book's organizational flexibility, it can be used in either undergraduate or graduate introductory courses.

This book is based upon two premises. First, knowledge of accounting is important for all members of today's complex economy, whether they are in industry, government, or professional accountancy. As such, this book is written to meet the needs of the general student as well as those who are prospective accounting majors. Second, accounting is an interesting subject, and we believe that the time spent in learning its concepts and practices can be enjoyable. As a result, this book is presented in a highly readable and conversational style that will appeal to those students who often enter introductory accounting with a measure of trepidation.

In designing and writing this textbook, we were well aware that it must meet the needs of a wide range of students with varying interests and goals. Potential accounting majors must have a solid foundation in accounting concepts and practices that will enable them to complete successfully their major requirements. Other business majors, as well as nonbusiness majors, must be introduced to accounting concepts and practices in such a way that they can apply this knowledge to their various careers. To meet the needs of this diverse group, we have chosen the goal that all students should be able to read, understand, and reasonably interpret financial statements contained in annual reports of major companies after completing their study of this text.

The authors believe that accounting is an interesting as well as an essential topic. To complete successfully their first accounting courses, students spend many hours reading the text and preparing class materials. We have gone to considerable lengths to make this process interesting and enjoyable. There are extensive quotes from business journals such as *Forbes* and the *Wall Street Journal*, as well as many excerpts from actual financial statements and annual reports, to add realism and spark student interest. The financial statements of Safeway Stores, Incorporated, are used as an integrating force throughout the text. In addition, we demonstrate whenever possible the usefulness of specific accounting techniques to further motivate study.

This book has several features that aid student learning and understanding. Such features include (1) balance between theory and practice; (2) emphasis on the use of

accounting information in decision making; (3) contemporary theory and practice; (4) organizational flexibility; and (5) a complete and integrated learning package.

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## **Balance Between Theory and Practice**

In writing this textbook, we carefully planned a blend of theory and practice that meets the needs of all its users. Financial statements and major accounting concepts are introduced in Chapter 1 before students are exposed to the mechanics of the accounting cycle. Details of the accounting cycle are explained patiently in Chapters 2 through 4. In Chapter 5, attention is turned back to the financial statements, and the actual financial statements of Safeway Stores, Incorporated, are first introduced to explain and illustrate key points. Throughout these accounting cycle chapters, the ongoing example of the Hartman Flower Company is used to illustrate relevant accounting concepts and procedures.

The remaining chapters are designed to reflect the proper balance between concepts and practice. For example, in Chapter 10, "Property, Plant, and Equipment; Natural Resources; and Intangible Assets," the concepts behind these topics are explained fully before the various depreciation methods are illustrated. In Chapter 17, "Statement of Changes in Financial Position," the uses and purposes of this statement are explained completely before the student is led carefully through an example illustrating its preparation. Other chapters are designed in a similar fashion.

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## **Emphasis on Using Accounting Information in Decision Making**

In this text we consistently approach accounting as an information system that provides useful financial data. This concept of accounting emphasizes its purpose in providing information for decisions rather than solely for its measurement procedures in recording, classifying, and summarizing financial information.

This emphasis on decision making is reflected in many of the features incorporated in the text. Ratios and other analytic tools are introduced at appropriate points in the specific chapter where the related accounting concept is discussed. Chapter 18, "Interpreting Financial Statements," then draws all these ratios and tools together. However, this chapter does more than summarize ratio analysis; it shows students how they can use data from a variety of sources to analyze and interpret financial statements from companies.

At the end of each chapter, in addition to a wide variety of other assignment material, we have added an "Understanding Financial Statements Problem" and a "Financial Decision Case." In these problems and cases, students are placed in the role of decision makers and are asked to analyze and interpret financial statements and quantitative data.

Management's role in the selection of accounting principles and in the preparation of the firm's financial statements is emphasized throughout the text. For example, the chapters that cover inventory methods, depreciation methods, leases, and purchase versus pooling all discuss the various effects that different methods can have on a firm's financial statements, and the consideration that management then faces when choosing among these different approaches.

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## **Contemporary Theory and Practice**

*Financial Accounting* is contemporary in all respects. Where appropriate, current official pronouncements of authoritative accounting bodies are referenced. Because of its predominance in our economic system, the corporate form of business is the focus throughout. Problem material reflects our current economic environment with emphasis on service and technology companies. Where appropriate, reference is made to

current economic events such as mergers of major companies, the breakup of AT&T, and the General Motors–Toyota joint venture.

The treatment of four particular topics—accounting for changing prices, international accounting, taxation, and computers—reflects the current nature of the text. Chapter 16 contains a clear, concise, and up-to-date coverage of two of the most perplexing problems facing the accounting profession—accounting for changing prices and international accounting. The coverage of inflation accounting in Chapter 16 reflects the changes made by FASB Statement No. 82. However, the effects of changing prices are not treated as an isolated subject and are discussed also in other parts of the book, such as the chapter on inventories (Chapter 9) and the chapter on property, plant, and equipment (Chapter 10).

The second part of Chapter 16 discusses international accounting. The particular topics covered include accounting for foreign currency transactions, the translation of foreign currency statements, and harmonization of accounting standards. The coverage of these topics helps schools to meet current standards of the American Assembly of Collegiate Schools of Business relating to the coverage of international topics. However, these topics are covered with the full understanding of both their complex nature and the fact that this is an introductory textbook. Thus, the students will gain an understanding of these international topics, as well as accounting for changing prices, without being overburdened with detail more appropriate to intermediate and advanced courses.

The effects of taxes on the firm's financial statements are discussed in the various chapters in which the relevant accounting principle is discussed. Thus, the effects of income taxes are discussed in the chapter on inventories (Chapter 9) and in the chapter on property, plant, and equipment (Chapter 10). Chapter 11, on current liabilities, contains a discussion of interperiod income tax allocation appropriate to an introductory textbook. Chapter 14 contains a discussion of intraperiod income tax allocation. This treatment reflects our view that income tax consideration plays an important role in management decisions and should be discussed when those decisions are covered, not in a separate chapter.

Throughout this book, we recognize the expanding role that computers play in accounting. Chapter 7, "Accounting Systems," first provides a brief overview of manual accounting systems and then focuses on computerized accounting systems. Special attention is given to the impact of microcomputers. Topics such as computer hardware configurations are deemphasized, while contemporary issues such as software packages and internal control are emphasized.

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## Organizational Flexibility

*Financial Accounting* is written with the full understanding that accounting instructors have various teaching styles and different approaches to the subject. Also, even over a short period of time, the makeup of individual classes changes, and a text must have the flexibility to meet these changes.

The eighteen chapters in this book can be divided easily into three primary parts. The first fifteen chapters make up Parts I and II and contain the essential elements of an introductory course. Chapters 1 through 7 contain a complete explanation of the accounting cycle, as well as a chapter on accounting for merchandising firms (Chapter 6) and a chapter on internal control, special journals, and computers (Chapter 7). These last two chapters can be omitted or covered in part without interrupting the flow of the text. However, as noted, Chapter 7 is quite contemporary in nature and contains a discussion of software packages and the role of microcomputers in accounting.

The next eight chapters contain a comprehensive discussion of the various financial accounting concepts and practices that both accounting and nonaccounting majors should know. However, a considerable amount of flexibility is built into these chapters. For example, the end of Chapter 11, on current liabilities, contains a com-



plete discussion of compound interest and present value topics. If the instructor desires, this part of the chapter can be omitted. The following chapter, on long-term liabilities, is written in such a way that these present value topics can be omitted without interrupting the flow of the chapter.

The third part of this book contains chapters on: (1) accounting for changing prices and international accounting; (2) the statement of changes of financial position; and (3) interpreting financial statements. Depending on the preference of the instructor and the amount of time available, some or all of the topics in the last three chapters can be covered. As we noted, relevant discussions of ratio analysis and accounting for changing prices is contained in the other chapters. The statement of changes in financial position is introduced in Chapter 1 and discussed again in Chapter 5. Therefore, if there is not enough time available to cover these last three chapters, the student still will have been introduced to some of the topics contained in them.

Finally, two appendixes cover more procedural matters. One contains a discussion of payroll accounting and the voucher system; the second contains an overview of accounting for sole proprietorship and partnerships.

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## A Complete and Integrated Learning Package

This text and the complete student's and instructor's support packages have been designed as an integrated unit.

### Pedagogical Features

The authors have gone to great lengths to design a pedagogically sound textbook. Each of the chapters contains a set of learning objectives at the beginning of the chapter and a summary of these objectives at the end of the chapter. Each chapter concludes with the following end-of-chapter material: a list of Key Terms, Self-Review Problem or Problems, Questions, Exercises, Problems, Understanding Financial Statement Problems, and Financial Decision Cases. Beginning with Chapter 7, Using the Computer Problems are introduced.

### Learning Objectives

Each chapter is preceded by a concise set of learning objectives. These objectives clearly indicate to the students what they should be able to accomplish after studying the chapter. Then each of these objectives is summarized in paragraph form at the end of the chapter.

### Key Terms and Glossary

At the end of each chapter is a list of key terms discussed in that chapter. These terms are highlighted in **boldface** where they are introduced in the chapter. At the end of the book in Appendix E is a complete glossary of these key terms arranged by chapter, alphabetically, for easy use.

### Self-Review Problems

At the end of each chapter is at least one and in many cases two or three self-review problems that emphasize key points in the chapter. These problems are followed by detailed solutions that allow the student to compare their solutions with the correct solution. Many review problems contain notes that anticipate student questions or problem areas.

### End-of-Chapter Assignment Materials

This text contains a varied set of end-of-chapter assignment materials. *Questions* relate to the major concepts and key terms introduced in the chapter. *Exercises* relate to single concepts and provide the student with practice in applying these concepts. These Exercises, as well as the Questions, are arranged in the same order in which the material is introduced in the chapter.

Exercises are followed by *Problems*. These end-of-chapter Problems are more complex and usually cover several related topics. They are generally arranged in the order the topics are presented in the chapter.

As noted, each chapter also contains an *Understanding Financial Statements Problem*, *Financial Decision Case*, and beginning with Chapter 7, *Using the Computer Problems*. Understanding Financial Statements Problems are based on actual financial statements of major corporations. Students are asked to interpret these statements and relate subjects learned in the chapter to realistic situations. In the Financial Decision Cases, students are asked to analyze and interpret financial data and address business decisions based on this data. Using the Computer Problems are straightforward exercises that are especially designed to be worked on any available spreadsheet. These problems introduce students to the number of accounting calculations and problems that are readily adaptable to the power of spreadsheet programs.

### **The Student Support Package**

The student support package contains a *Study Guide*, *Working Papers*, *Manual Practice Set*, and a *Computerized Accounting Simulation*.

#### **The Study Guide**

Prepared by Lawrence Klein of Bentley College, the Study Guide provides an extensive chapter-by-chapter summary and review. Each chapter in the guide summarizes and reviews, in outline form, the major topics in the text chapter. After this summary and review are a series of short-answer and multiple-choice questions that students can use to test their knowledge of the concepts and procedures. Finally, there is a selection of exercises for each chapter. The answers to all these questions and exercises with complete explanations are provided for the student.

#### **Working Papers**

Prepared by Mark S. Bettner, working papers are provided for each problem. They are designed to reduce the amount of nonproductive pencil work required of the student.

#### **The Practice Set**

Prepared by Antoine Jabbour of California Polytechnic University, Pomona, the practice set is designed to be used after completing Chapter 7. The practice set provides a complete review of the accounting cycle concepts and procedures for the Oakwood Drug Company.

#### **ON GUARD INC.: A Computerized Accounting Information System Simulation**

Prepared by Earl Weiss and Don Raun of California State University, Northridge, this unique microcomputer supplement provides a flexible set of eleven modules tied to the text. Students are required to analyze transactions, enter items into the microcomputer general ledger accounting system, and output financial statements. The modules are designed to enable instructors either to use the program throughout the entire course as an ongoing supplement or to assign a traditional accounting cycle practice set. In addition, students may use "WHAT-IF" questions to see the effect of various changes on the outputs of the accounting system.

### **The Instructor's Support Package**

The instructor's support package includes a *Solutions Manual*, an *Instructor's Manual*, a *Test Bank* (in book and microcomputer forms), *Transparencies*, and a *List of Key Figures*.

#### **Solutions Manual**

The Solutions Manual contains detailed solutions to all questions, exercises, problems, and other end-of-chapter materials. Complete solutions, including all in-

intermediate calculations, are provided (and have been completely reviewed) by the authors. Solutions were class tested at the authors' schools, and the problems and exercises were solved independently by students from five different Beta Alpha Psi chapters and also by the firm of Peat, Marwick, Mitchell & Co.

### **Instructor's Manual**

The Instructor's Manual has been designed as a useful teaching aid and resource guide for the instructor. It contains a matrix of end-of-chapter material by learning goals for each chapter in the text. Included in the matrix are all the questions, exercises, and problems. In addition, each problem is described fully with an estimate of its level of difficulty and time needed for completion.

Following the overview of the end-of-chapter materials is an outline of the chapter for use by the instructor, organized by learning goals. In addition to these outlines, additional examples of key computations and illustrations have been developed. These examples follow the same format as the text.

### **Test Bank**

Prepared by Mark S. Bettner, the test bank contains over 1,000 test items. Included for each chapter are approximately 10 true-false, 25 multiple choice, 15 fill-ins, and 16 problems. The test bank is also available to adopters on Macmillan's computerized testing system, MicroTest, or in IBM® PC, Apple®, or TRS-80® formats. Detailed solutions of all computational problems are provided for instructors.

### **Transparencies**

Acetate transparencies for problems are in oversized type for easy readability and are available from the publisher to adopters of the text.

### **Checklist of Key Figures**

For the instructor, a list of key figures for appropriate exercises and problems is available in quantity from the publisher.

E.G.F.  
M.A.D.  
D.T.F.



# Acknowledgments

This text would not have been completed successfully without the help of many of our colleagues and friends. Although it is impossible to list all who have made a contribution, we would like to acknowledge those who have provided so much help and insight.

We would like to acknowledge the help of Peat, Marwick, Mitchell & Co., New York, and in particular, Bill Hannon and David Hollister, for their review of the complete text and Solutions Manual. Upon completion of the review and revision process, the following opinion was issued:



Peat, Marwick, Mitchell & Co.  
Certified Public Accountants  
345 Park Avenue  
New York, NY 10154

November 8, 1985

Macmillan Publishing Company  
College Division  
866 Third Avenue  
New York, New York 10022

We have reviewed the text of FINANCIAL ACCOUNTING by Flamholtz, Diamond and Flamholtz, including its Solutions Manual. Our review was intended to determine the accuracy of the material presented as well as its consistency and the appropriateness of references to authoritative literature. We discussed our comments and recommendations with you and assured ourselves that all necessary changes were made before the book was published. In our opinion, FINANCIAL ACCOUNTING presents a text which is mathematically accurate, technically consistent with generally accepted accounting principles, and conceptually appropriate for an introductory text on financial accounting principles.

*Peat, Marwick, Mitchell & Co.*

PEAT, MARWICK, MITCHELL & CO.

In addition, we would like to cite the following companies, the financial statements of which are referenced and discussed at various points throughout the text:

Anheuser-Busch Companies, Inc.  
 ARCO  
 Braniff Airlines  
 Bristol Meyers  
 Caesar's World  
 Carter Hawley Hale Stores, Inc.  
 General Electric  
 General Motors  
 Hersheys Foods  
 J.C. Penney  
 Kellogg Company  
 Kroger Company  
 Lucky Stores, Inc.  
 Macmillan, Inc.  
 Nabisco Brands  
 Pacific Gas and Electric Company  
 Pacific Lighting Corporation  
 Priam Corporation  
 Safeway Stores, Incorporated  
 Sears, Roebuck and Co.  
 Stop and Shop Companies, Inc.  
 Sunshine Mining Company  
 Times Mirror Company  
 United Technologies  
 Walt Disney Productions, Inc.

We would like to thank the many individuals at California State University, Los Angeles, who provided support during the writing of this text. Special mention goes to Mahmoud Nourayi, Dennis Murphy, and Henry Lee, who provided help in many ways; and to Mark Bettner of Texas Tech who, in addition to working on many of the supplements, provided a detailed critique of the entire manuscript. We would also like to thank the following Beta Alpha Psi chapters for their help in testing the exercises and problems:

California State University, Los Angeles, Beta Lambda Chapter  
 Faculty Advisor: Michael Davidson  
 Florida State University, Beta Rho Chapter  
 Faculty Advisor: Homer Black  
 Northern Illinois University, Gamma Pi Chapter  
 Faculty Advisor: Cindy Johnson  
 Oregon State University, Epsilon Chapter  
 Faculty Advisor: Bob Shirley  
 Syracuse University, Xi Chapter  
 Faculty Advisor: Leon Hanouille  
 University of Iowa, Alpha Psi Chapter  
 Faculty Advisor: Val Lembke

We have benefited from the detailed and constructive reviews from many individuals including:

Hobart W. Adams, *University of Akron*  
 Norman D. Berman, *New York University*

David M. Buehlmann,	<i>University of Nebraska at Omaha</i>
Harold Cannon,	<i>State University of New York at Albany</i>
Anthony P. Curatola,	<i>Louisiana State University</i>
Harry D. Dickinson,	<i>University of Virginia</i>
John A. Elliot,	<i>Cornell University</i>
Patricia C. Elliot,	<i>University of New Mexico</i>
Clarence E. Fries,	<i>University of Arkansas–Fayetteville</i>
Martin L. Gosman,	<i>Boston University</i>
Abo-El-Yazeed T. Habib,	<i>University of Central Arkansas</i>
Stanley H. Helm,	<i>University of Florida</i>
David E. Hoffman,	<i>University of North Carolina</i>
Merle Hopkins,	<i>University of Southern California</i>
W. Elbert Jones,	<i>University of South Carolina</i>
James M. Krueger,	<i>University of Missouri–St. Louis</i>
LaVern Krueger,	<i>University of Missouri–Kansas City</i>
Horace J. Landry,	<i>Syracuse University</i>
Larry Lookabill,	<i>Western Washington University</i>
Russell Peterson,	<i>University of Iowa</i>
Don Rice Richards,	<i>James Madison University</i>
Barbara Schirappa,	<i>Trenton State College</i>
Linda Ellison Sugarman,	<i>University of Akron</i>
Roy C. Weatherwax,	<i>University of Wisconsin–Whitewater</i>

Finally, this project never would have been completed without the assistance and prodding of two individuals, Chip Price of Macmillan Publishing Company and Kate Aker. Others at Macmillan contributed mightily to the production of the book, including Andrea Goodman, Aliza Greenblatt, Robert Hunter, Gwen Larson, Bob Pirrung, Katherine Speyer, and Andy Zutis. Also, we want to thank Laura McGill, Gary McGill, and Joyce Martin of Lubbock, Texas for their extraordinary efforts on the Solutions Manual. A special note of thanks goes to Elaine and Jacob Diamond, who provided the emotional support required for the completion of this text. We also wish to express our thanks to several individuals who have been supportive both personally and professionally, including John W. Buckley, Paul Kircher, Jack McDonough, Bruce Miller, and Dean Clay LaForce, all of the Graduate School of Management, UCLA, and Richard Williamson and John Wholihan, of the College of Business Administration, Loyola Marymount University.

Notwithstanding the assistance of all of these individuals, we are solely responsible for the final product. Any suggestions for improvements would be greatly appreciated.



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