

FINANCIAL ACCOUNTING

IMDIEKE / SMITH



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FINANCIAL ACCOUNTING

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LEROY F. IMDIEKE

Arizona State University

RALPH E. SMITH

Arizona State University

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PREFACE

Financial Accounting presents a comprehensive, straightforward description of modern-day principles of financial accounting and reporting. It is a blend of the preparation and use of financial accounting information, designed for those who have not previously studied accounting. Special care has been taken to provide a realistic balance between the procedures used in accounting and the theory and concepts upon which they are based. As such, we have emphasized both the “how” and “why” aspects of accounting.

Our primary objective is to describe financial accounting fundamentals as they relate to today’s business environment, as we believe that this text is almost as much an introduction to business as it is to accounting. We have carefully selected the subject matter, its organization, and its description to ensure that the book fits the needs of all beginning business students. Consequently, the coverage is relevant for students interested in any type of business career. The book is intended for use in a one-semester or one-quarter accounting course at the undergraduate or MBA level.

WHY STUDY ACCOUNTING?

Practically every business administration program requires principles of financial accounting as an important prerequisite to other business courses and as an integral part of the preparation for a business career. During the twentieth century, accounting has become essential to the needs of our society. Every person and organization uses financial accounting information to make decisions. Many times we use accounting concepts and procedures without even realizing it. On a personal level, individuals maintain bank accounts, account for their income, and prepare income tax returns. Examples of other areas in which financial accounting information is useful are:

- Investors evaluate alternative investments such as bonds, stocks, and money market funds to decide how to invest their money.
- Individuals must often prepare personal financial statements to support applications for personal loans or home mortgages.
- Businesses need financial accounting information to determine if they are successful financially.

- Businesses must decide how to allocate scarce resources among their various activities.
- Boards of directors and owners use financial accounting information to evaluate management's performance.
- Creditors use financial accounting information to decide whether to lend money or to extend credit to a business.
- Governments use accounting procedures to plan and control the receipts and expenditures of public funds.

Accounting is often thought of as an information processing system because it is a means of social communication that involves a flow of information about a business. Like any form of communication, accounting has its own specialized terminology, concepts, procedures, and standards. Because of its essential role in our society, accounting as a means of communication must be continually modified and updated to satisfy the changing needs of the business world.

ORGANIZATION OF THE BOOK

The text is organized into five parts. Part I includes Chapters 1 and 2 consisting of an introduction to and overview of financial statements. Chapters 3, 4, and 5 constitute Part II and describe the data processing cycle. Part III discusses accounting for the control of assets (Chapters 6 through 10). Accounting for liabilities and owners' equity are described in Part IV, consisting of Chapters 11 through 13. Part V includes Chapters 14 through 17, where other financial accounting issues are discussed. The seventeen chapters represent a comprehensive, modern version of principles of financial accounting.

BASIC FEATURES OF THE BOOK

1. Each chapter begins with a concise description (overview) of the coverage of the chapter and a list of the learning objectives involved. The learning objectives are also repeated in the margins of the text next to the relevant subject material to assist the students through the chapters.
2. A glossary of key terms is presented at the end of each chapter. Each definition is keyed to a page within the chapter where the term is identified in boldface color.
3. A summary of the main points developed in the chapter concludes the textual material in each chapter.
4. Each chapter includes a demonstration problem to reinforce understanding of the basic concepts and procedures.
5. Discussion questions are included at the end of every chapter to emphasize major points.
6. Exercises pertaining to the chapter topics are presented in compact form.
7. Problems are included for more comprehensive homework assignments.
8. Each exercise and problem has a brief description of the topic(s) covered. The intent is to focus the student's attention on the main consideration being addressed.

9. Most chapters include a case requiring students to refer to the annual reports of Apple Computer, Inc. and Holiday Corporation, which are located in an appendix at the end of the text.
10. Illustrations of and references to real-world accounting applications are presented throughout the text.
11. Authoritative and informative references are made in nontechnical language throughout the text to such sources as the Accounting Principles Board, Financial Accounting Standards Board, Accounting Trends & Techniques, and specific firms' financial statements.
12. A comprehensive discussion of the time value of money is presented as Part II of chapter 11 (covering the general topic of accounting for liabilities).

SUPPLEMENTARY MATERIALS FOR THE STUDENT

Study Guide

Written by Bruce Baldwin of Portland State University, the Study Guide contains learning objectives, study tips, and chapter reviews organized by learning objectives, as well as matching questions, true-false questions, completion questions, multiple choice questions, short answer exercises, and crossword puzzles.

Practice Sets

Both manual and computerized practice sets are available to provide the student with opportunities to apply accounting concepts and procedures to specific situations.

Workpapers

Workpapers designed to minimize the "pencil-pushing" aspect of accounting for the student are available. The workpapers should also assist students in learning proper formats and procedures.

FOR THE INSTRUCTOR

Solutions Manual

The Solutions Manual, prepared by the authors, provides answers to discussion questions, and provides answers (as well as the procedures used to determine them) for all exercises and problems in the textbook.

Instructor's Manual

This manual identifies chapter learning objectives; keys discussion questions, exercises, and problems to the learning objectives; gives time for completion and difficulty level of problems; and contains chapter outlines with detailed teaching hints and examples.

Test Bank/Microtest

Available in traditional and computerized formats, the Test Bank consists of multiple choice questions, true-false questions, completion questions, and problems and exercises for each chapter.

Checklist of Key Figures

These are available in quantity for instructors to distribute as learning aids to students.

Overhead Transparencies

The transparency package contains transparencies for all exercises and problems as well as for certain text material.

Solutions to Practice Sets

Solutions are available for both the traditional and computerized practice sets.

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Leroy F. Imdieke
Ralph E. Smith

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PART 1

INTRODUCTION TO FINANCIAL STATEMENTS

THE NATURE OF FINANCIAL ACCOUNTING AND REPORTING

CHAPTER OVERVIEW AND OBJECTIVES

This chapter presents an overview of the purpose and nature of financial accounting. When this chapter is completed, you should understand:

1. What accounting information is.
2. The difference between recording and reporting accounting information.
3. The basic uses of accounting information.
4. The sources of accounting principles and practices.
5. The main fields of accounting and the type of work involved in each.
6. The different forms of business organization.
7. The names and functions of the basic financial statements.
8. The meaning of the terms *asset*, *liability*, *owners' equity*, *revenue*, and *expense*.

Accounting is a service activity. It provides financial information about economic activity that is intended to be useful in making economic decisions.¹ Business firms, governmental agencies, charitable foundations, nonprofit organizations, families, and individuals are all economic units engaged in economic activity. Most economic activity involves decisions about how to allocate available resources effectively among alternative needs. Economic units—that is, people—need relevant information to be able to make sound decisions. In our complex society, decision-makers rely on data supplied by specialists in various fields. For example, lawyers provide information about the ramifications of existing and proposed legislation, medical professionals

¹Accounting Principles Board, "Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises," APB Statement No. 4 (New York: AICPA, October, 1970), par. 9.