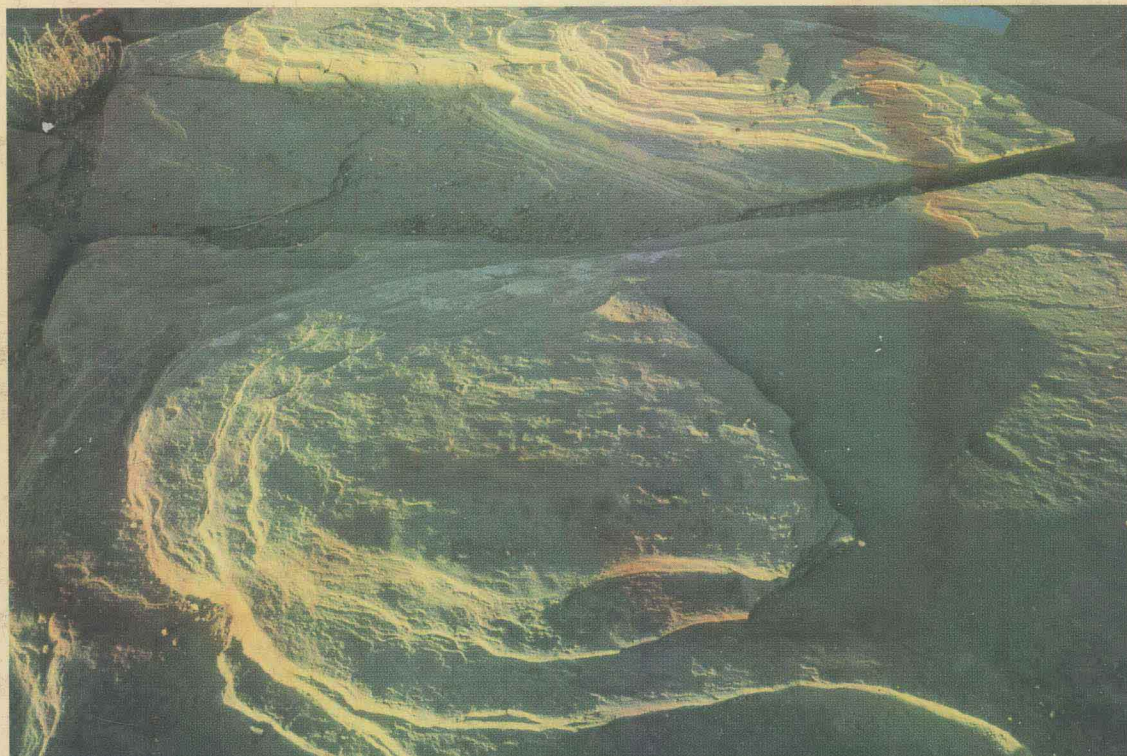


ACCOUNTING PRINCIPLES

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Fess • Warren



Fifteenth Edition

ACCOUNTING PRINCIPLES

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PREFACE

The fifteenth edition of ACCOUNTING PRINCIPLES is a student-oriented text. It presents the fundamental accounting concepts and principles in a logical, concise, and clear manner. ACCOUNTING PRINCIPLES provides a solid educational foundation that allows instructors to focus on clarifying issues and increasing the student's understanding of accounting and its uses. This student orientation is one of the principal reasons why this text has been used by more students than any other for more than 50 years and why it is still the leader in teaching principles of accounting.

Fundamental accounting concepts and principles are presented in the text in a business setting that allows students to understand accounting as it is applied in serving not only the business world but all of society. Such an approach meets the needs of students planning careers in accounting as well as in business administration, in liberal arts areas, in law, or in other disciplines.

IMPORTANT FEATURES OF THE FIFTEENTH EDITION

The basic foundation of ACCOUNTING PRINCIPLES, which has served instructors and students so well over the years, has been retained in the fifteenth edition. However, many new features have been added. These new features are based on extensive feedback from current users and on independent reviews by numerous scholars and educators. The most significant new features and the quality features introduced in previous editions are:

Chapter Objectives

The chapter objectives have been revised and expanded to enable students and instructors to integrate the chapter materials with the overall learning objectives more successfully.

Illustrations

Many additional charts, graphs, and diagrams have been added throughout the text to enable students to visualize important concepts and principles more efficiently. These charts, graphs, and diagrams are highlighted with color to enhance the learning process.

Real-World Examples

Real-world business examples have been integrated throughout the text to provide students with a flavor for the real-world impact of accounting. These examples add concrete meaning to concepts and principles which might otherwise appear abstract. Many of these examples were taken directly from the latest annual reports of companies such as PepsiCo and General Motors. In addition, the American Institute of Certified Public Accountants' publication, *Accounting Trends & Techniques*, is cited where appro-

prate to indicate the frequency with which alternative accounting presentations and methods are used in the real world.

Enrichment Material

Excerpts from well-known business periodicals, such as the *Journal of Accountancy*, the *Wall Street Journal*, and *Forbes*, have been added to each chapter. Each excerpt was adapted and designed to stir the students' interest and enrich their learning experience by providing real-world information relevant to the topics that are discussed in the chapter.

Chapter Reviews

A chapter review has been added at the end of each chapter. The chapter reviews are designed to increase and enhance student retention of important chapter concepts and principles. Each chapter review includes key points, key terms, self-examination questions, and an illustrative problem and solution.

- The **key points** summarize the major concepts presented in a chapter. By studying the key points, students can quickly review the major concepts and principles of each chapter.
- Each **key term** listed in the chapter review is followed by the page number indicating where the key term was first presented in color and discussed in the chapter. Students may also refer to Appendix A, where all the key terms in the text are listed alphabetically and defined.
- Five **self-examination questions** are provided for each chapter. After studying the chapter, students can answer these questions and compare their answers with the correct ones that appear in Appendix B. An explanation of both the correct and incorrect answers for each question is provided in order to increase students' understanding and enhance the learning process further.
- The **illustrative problem** with suggested solution focuses on the concepts and principles discussed in the chapter. Students can use these problems as a means of building confidence in their ability to apply a chapter's concepts and principles to a problem situation.

Real-World Focus Questions

A discussion question that requires students to interpret and respond to a real-world business situation is contained in each chapter. In some chapters, a real-world exercise is also included. These questions and exercises, which are labeled "Real World Focus," are based on actual business data.

Comprehensive Problems

Comprehensive problems have been added at appropriate points in the text. These problems integrate and summarize the concepts and principles of several chapters.

Series B Problems

The alternate Series B problems appear at the end of each chapter in order to facilitate student and instructor usage.

Accounting for Merchandise Inventory

The discussion of accounting for merchandise inventory has been revised to facilitate student understanding.

- The discussion of accounting for merchandise inventory has been expanded into two chapters, so that instructors can cover the material at a slower pace and in more depth.
- A unique presentation of the work sheet for financial statements enables students to follow easily the various steps in its preparation and use.
- The accounts *Purchases Returns and Allowances* and *Transportation In* are used in the discussion of accounting for merchandise enterprises.
- An alternate method of handling merchandise inventory at the end of an accounting period has been added as Appendix C. This method, sometimes referred to as the closing method, can be used instead of the method presented in the merchandising chapters. The Solutions Manual includes solutions for both approaches.

Deferrals and Accruals

The chapter covering deferrals and accruals has been revised. For example, several charts comparing the accounting entries under alternate methods of recording deferrals and accruals have been added.

Periodic and Perpetual Inventories

The discussion of the periodic and perpetual methods of accounting for merchandise inventories has been revised and expanded. A comparison of the journal entries under each method has been added. Also, a discussion of the use of the perpetual inventory system in computerized environments is included.

Price-Level Changes

The discussion of price-level changes has been condensed and is now integrated into Chapter 13, "Concepts and Principles."

Long-Term Liabilities and Investments in Stocks and Bonds

The discussion of accounting for investments in bonds has been separated from the discussion of accounting for investments in stocks, with the latter moved to the succeeding chapter, which also includes the discussion of consolidated statements and international accounting. The long-term liabilities and bond investments chapter has been revised to include a discussion of present value and the use of present value tables.

Statement of Cash Flows

The discussion of the statement of cash flows replaces the presentation of the statement of changes in financial position, in keeping with the Financial Accounting Standards Board pronouncement requiring a statement of cash flows.

Financial Statement Analysis

The financial statement analysis chapter has been revised to include a chart summarizing solvency and profitability measures. In addition, a section on corporate annual reports has been added.

Managerial Accounting

- The coverage of managerial accounting has been expanded and reorganized.
- Chapter 21, "Responsibility Accounting," emphasizes responsibility accounting for cost, profit, and investment centers. The discussion of branch accounting has been moved to Appendix E.
 - Chapter 24, "Budgeting and Standard Cost Systems," has been revised to include an integrated example of the master budget and a discussion of budgeting and human behavior. A problem that requires the preparation of all the budgets supporting a budgeted income statement has been added.
 - Chapter 25, "Profit Reporting for Management Analysis," has been revised and expanded to include a section describing the characteristics of managerial accounting reports. In addition, charts and illustrations have been added to the discussion of variable and absorption costing.
 - Chapter 26, "Cost-Volume-Profit Analysis," has been added. The presentation of cost-volume-profit analysis has been significantly expanded to include a more thorough discussion of variable and fixed costs, including graphs to illustrate the costs; the effects of changes in fixed costs, variable costs, and unit selling price on the break-even point; and sales mix considerations. A discussion and illustration of the profit-volume chart has been added. The chapter concludes with a brief discussion of the use of computers and quantitative techniques in managerial accounting.
 - Chapter 27, "Differential Analysis and Capital Investment Analysis," has been added. The discussion of capital investment analysis includes the use of present value tables. Coverage of the discounted internal rate of return is included, along with a discussion of the capital rationing process and methods of planning and controlling capital investment expenditures.

Income Taxes

The coverage of income taxes has been condensed and is presented in Appendix G. This appendix, which incorporates the 1986 changes in the tax law, provides students with an understanding of the basic nature of the federal income tax system and its effects on personal and business income.

End-of-Chapter Materials

The end-of-chapter exercises and problems have been carefully written and revised to be both practical and comprehensive. The variety and volume of the assignment materials presented at the end of each chapter provide a wide choice of subject matter and range of difficulty. In addition, selected problems may be solved using general ledger and spreadsheet software that is available from South-Western Publishing Co. As in previous editions, each chapter contains a mini-case for stimulating student interest. Each case, which presents situations with which students can easily identify, emphasizes important chapter concepts and principles.

SUPPLEMENTARY MATERIALS

ACCOUNTING PRINCIPLES is part of a well-integrated educational package that includes materials designed for the instructor's use and for the students' use. These materials are carefully prepared and reviewed to maintain consistency and high quality throughout.

Available to Instructors

Solutions Manual. This manual contains solutions to all end-of-chapter materials, including the discussion questions, exercises, problems, mini-cases, and comprehensive problems.

Instructor's Manual, prepared by Edward W. Scott, Jr. of Olympic College, Philip E. Fess, and Carl S. Warren. This manual contains a summary of the chapter objectives, terminology, and concepts. In a section organized according to chapter objectives, a basis for developing class lectures and assigning homework is provided. In addition, exercise and problem descriptions, estimated time requirements for the problems, suggestions for use of the appendixes and other supplementary items, and the solutions for the manual practice sets are included.

Transparencies. Transparencies of solutions to all exercises and problems, including the comprehensive problems, are available. The transparencies are packaged in two boxes, one for Chapters 1–14 and one for Chapters 15–28 and Appendixes E, F, and G.

Teaching Transparencies. The teaching transparencies are designed to aid the instructor's focus on key concepts and principles discussed in the text.

Test Bank, prepared by Charles Rohr of Mt. San Jacinto College, Philip E. Fess, and Carl S. Warren. A collection of examination problems, multiple-choice questions, and true or false questions for each chapter, accompanied by solutions, is available in both printed and microcomputer (MicroSWAT II) versions. The Test Bank is designed to save time in preparing and grading periodic and final examinations. Individual items may also be selected for use as short quizzes. The number of questions is sufficient to provide variety from year to year and from class section to class section. The printed version of the Test Bank also contains the solutions for the Achievement Tests.

Achievement Tests, prepared by Charles Rohr, Philip E. Fess, and Carl S. Warren. Three sets of preprinted objective tests are available. Each test in sets A and B covers a single chapter. Each test in set C contains 50 multiple-choice questions covering a group of chapters. Set C, which may be machine graded, also includes a comprehensive test covering each half of the text.

Demonstration Problems and Notes, prepared by L. Paden Neeley of North Texas State University. A set of special problems that emphasize the important accounting concepts and principles of the textbook are available, along with a set of correlating transparencies. As the instructor works through each problem on the transparencies, students can follow the solution as they complete each problem in their workbook.

The Administrator. A software management package is available to adopters. This package is specifically designed for use in maintaining a grade book, creating an interactive testing and/or study guide file, and generating tests.

Available to Students

Solutions: Applications Software, prepared by Warren W. Allen and Dale H. Klooster of Educational Technical Systems. This software, which may be ordered with the textbook, is a general ledger program tailored specifically to ACCOUNTING PRINCIPLES. It may be used with the Apple® //e™ and Apple® //c™,¹ the IBM PC and IBM PCjr,² and the Tandy® 1000³ microcomputers to solve selected end-of-chapter problems and the comprehensive problems, which are identified with the symbol at the right. It may also be used to solve the first two manual practice sets, so that they in effect become computerized practice sets.



Spreadsheet Applications, prepared by Gaylord N. Smith of Albion College. This template diskette is used with Lotus™ 1-2-3™⁴ for solving selected end-of-chapter exercises and problems that are identified with the symbol at the right. This diskette, which also provides for solving these problems using alternative data, may be ordered through your instructor.



Working Papers. Appropriate printed forms on which to work end-of-chapter problems and mini-cases are available in two bound volumes. The first volume is for use with Chapters 1–14, and the second volume is for use with Chapters 14–28.

Study Guides, prepared by James A. Heintz of Indiana University and Carl S. Warren. The Study Guides are designed to assist in comprehending the concepts and principles presented in the text. These publications, which are printed in two volumes (one for Chapters 1–14 and one for Chapters 15–28), include an outline and a glossary for each chapter as well as brief objective questions and problems. Solutions to these questions and problems are presented at the back of the Study Guides.

Microcomputer Study Guides. These microcomputer versions of the manual Study Guides may be used with the Apple //e and the Apple //c, the IBM PC and the IBM PCjr, and the Tandy 1000.

Audio-Cassette Study Guides, prepared by Wilbur F. Pillsbury of Knox College. Four study guides are available to be used with instructional cassette tapes. The material is self-paced, and immediate feedback is received after step-by-step exercises have been completed.

Check Figures. Instructors may order check figures for distribution to students. These check figures may be used by students in checking their solutions to end-of-chapter problems. Agreement with the check figures is an indication that a significant portion of the solution is basically correct.

Practice Sets, prepared by Herman R. Andress of Santa Fe Community College and Edward E. Stumpf of Fullerton College. Four short practice sets, each requiring the recording, analysis, interpretation, and reporting of accounting data, are available. Set 1, *Top Ten Sporting Goods Co.*, is available with business documents or with a narrative of transactions. The company is a sole proprietorship that uses special journals. Set 2, *Sierra Computer Systems*, is also available with business documents or with a

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narrative of transactions. This company is a sole proprietorship that uses a voucher system. Set 3, *Custom Interiors Inc.*, is available with a narrative of transactions for a corporation operating a departmentalized business. Set 4, *Sunrise Solar Inc.*, is available with a narrative of transactions for a manufacturing company using a job order cost system.

Microcomputer Practice Sets, prepared by Dale H. Klooster and Warren W. Allen. Two automated practice sets—*Custom Auto Parts* and *Sound Ideas*—are available with diskettes. These sets parallel the first two manual practice sets.

Integrated Accounting on Microcomputers, prepared by Dale H. Klooster and Warren W. Allen. This text-workbook with diskette is a stand-alone, automated accounting package that is intended for a first course in microcomputer accounting. Completion time is approximately 45–55 hours.

Electronic Spreadsheet Applications for Accounting Principles, Financial Accounting, and Managerial Accounting, prepared by Gaylord N. Smith. This supplemental text-workbook with template diskette includes accounting applications and a Lotus 1-2-3 tutorial. It requires approximately 20–25 hours for completion, and it requires access to Lotus 1-2-3.

ORGANIZATION OF THE FIFTEENTH EDITION

ACCOUNTING PRINCIPLES has been organized to facilitate the learning of accounting and the overall educational process. Concepts and principles are introduced in a logical, step-by-step way and are reinforced by applications from the business world.

Each chapter builds on the terminology, concepts, and principles introduced in previous chapters. The chapter objectives provide students with a basis for beginning their study of each chapter. In turn, each chapter is organized around the chapter objectives in an educationally sound approach. The chapter reviews provide students with a means for review and a basis for assessing their knowledge of each chapter. The end-of-chapter discussion questions, exercises, problems, and mini-cases provide a vehicle for the instructor to assess the students' knowledge of each chapter's concepts and principles. Periodic assigning of comprehensive problems and the giving of examinations provide instructors with a means for assessing students' cumulative knowledge.

The organization of the fifteenth edition of ACCOUNTING PRINCIPLES is briefly summarized in the following paragraphs.

Introduction: Evolution of Accounting

The introduction presents a summary of the beginnings of accounting in 1494 and its development to the present. This overview provides students of all backgrounds an excellent perspective on the importance and influence of accounting on all phases of society.

Part 1 — Basic Structure of Accounting

Chapters 1–6 focus on the basic concepts and principles of accounting, including accounting for both service enterprises and merchandise enterprises. These chapters are presented without the complexities of special journals and subsidiary ledgers. The emphasis on different forms of organization is minimized by presenting simple owner equity structures and deferring complex owner equity structures to later chapters. Chapter 6 is designed as a self-contained unit, so that instructors have flexibility as

to when they cover the chapter. For example, some instructors may prefer to omit the chapter in the first accounting course and include it as a review in beginning the second course.

Part 2—Accounting Systems

Chapter 7 emphasizes the qualities of a properly designed accounting system, including the principles of internal control and the use of special journals and subsidiary ledgers. Chapters 8–12 build on this systems foundation, beginning with cash in Chapter 8 and, in balance sheet order, proceeding with receivables and temporary investments (Chapter 9), inventories (Chapter 10), plant assets and intangible assets (Chapter 11), and current liabilities and payroll (Chapter 12).

Part 3—Accounting Principles

Chapter 13, “Concepts and Principles,” ties together the generally accepted accounting concepts and principles presented in the first 12 chapters, and expands the discussion to include additional accounting principles. Chapter 13 also includes a discussion of reporting changes in price levels.

Part 4—Partnerships

Chapter 14 discusses the characteristics of partnerships and the unique accounting concepts and principles related to partnerships.

Part 5—Corporations

Chapters 15–18 present the special accounting issues related to corporations. These chapters include discussions of stock issuances, dividends, bonds, long-term investments in bonds and stocks, consolidated financial statements, and international accounting.

Part 6—Additional Statements and Analyses

Chapter 19 presents the basic concepts and principles underlying the statement of cash flows. Chapter 20 presents a discussion of solvency and profitability and related analytical procedures useful in assessing these financial statement concepts. Chapter 20 concludes with a discussion of corporate annual reports.

Part 7—Accounting for Decentralized Operations and Manufacturing Operations

Chapters 21–23 are the beginning of the discussion of managerial accounting concepts and principles. Chapter 21 presents responsibility accounting in relation to cost, profit, and investment centers. Chapters 22 and 23 present accounting concepts and procedures for job order and process cost accounting systems.

Part 8—Planning, Control, and Decision Making

Chapters 24–27 present managerial accounting concepts and principles that are especially useful for planning, control, and decision making. Chapter 24 presents the

concepts of budgeting and standard costs. Chapter 25 presents profit reporting for management analysis, including gross profit analysis and variable and absorption costing. Chapter 26 focuses on cost-volume-profit analysis and quantitative techniques. Differential analysis and capital investment analysis are presented in Chapter 27.

Part 9—Individuals and Nonprofit Organizations

Chapter 28 presents accounting concepts and principles related to individuals and nonprofit organizations.

Appendixes

- Appendix A contains a glossary of the key terms.
- Appendix B contains the answers to the self-examination questions appearing at the end of each chapter.
- Appendix C presents an alternative method of recording merchandise inventory at the end of an accounting period. This method is sometimes referred to as the closing method. Solutions to problems using this method are presented in the Solutions Manual.
- Appendix D presents a work sheet approach to the preparation of the statement of cash flows. The Solutions Manual includes solutions to problems using the work sheet.
- Appendix E presents the accounting concepts and principles related to branch accounting. Problem materials are included with the appendix.
- Appendix F presents a work sheet approach to the preparation of financial statements for manufacturing enterprises using the periodic inventory method. Problem materials are included with the appendix.
- Appendix G discusses income taxes for individuals and business enterprises. Question and exercise materials are included with the appendix.
- Appendix H contains selected financial statements for real companies.

ACKNOWLEDGMENTS

Throughout the textbook, relevant professional statements of the Financial Accounting Standards Board and other authoritative publications are discussed, quoted, paraphrased, or footnoted. We are indebted to the American Accounting Association, the American Institute of Certified Public Accountants, the Financial Accounting Standards Board, and the National Association of Accountants for material from their publications.

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We continue to welcome your comments and suggestions.

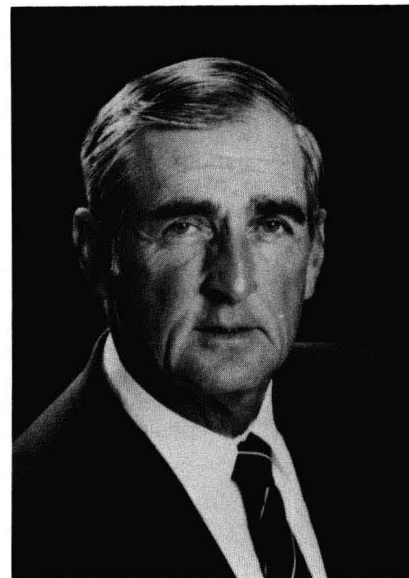
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Professor Fess is a CPA and a member of the American Institute of CPAs and the Illinois Society of CPAs. He has served many professional associations in a variety of ways, including a term as a member of the Auditing Standards Board, editorial advisor to the *Journal of Accountancy*, and chairperson of the American Accounting Association Committee on CPA Examinations. Professor Fess has written more than 100 books and articles, which have appeared in such journals as the *Journal of Accountancy*, the *Accounting Review*, the *CPA Journal*, and *Management Accounting*. He has also served as an expert witness before the U.S. Tax Court.

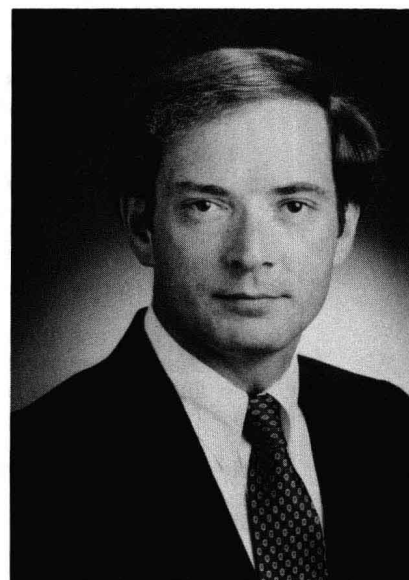
Professor Fess resides in Champaign, Illinois, with his wife, Suzanne. He has three daughters: Linda, who is completing a PhD in accounting at Arizona State University; Ginny, who is a CPA and is employed by Baxter-Travenol; and Martha, who is majoring in finance at the University of Illinois. Professor Fess' hobby is tennis, and he has represented the United States in international tennis competition.



Professor Carl S. Warren is the Arthur Andersen & Co. Alumni Professor of Accounting at the J. M. Tull School of Accounting at the University of Georgia, Athens. Professor Warren received his PhD from Michigan State University in 1973 and has taught accounting at the University of Iowa, Michigan State University, the University of Chicago, and the University of Georgia. He has received teaching awards from three different student organizations at the University of Georgia.

Professor Warren is a CMA and a CPA. He was awarded a Certificate of Distinguished Performance for his scores on the CMA examination and a Certificate of Honorable Mention for his scores on the CPA examination. He is a member of the National Association of Accountants, the American Institute of CPAs, the Georgia Society of CPAs, the American Accounting Association, the Georgia Association of Accounting Educators, and the Financial Executives Institute. Professor Warren has served on numerous professional committees and editorial boards, including a term as editor of the American Accounting Association publication *Auditing: A Journal of Practice and Theory*. He has written five textbooks and numerous articles in such journals as the *Journal of Accountancy*, the *Accounting Review*, the *Journal of Accounting Research*, the *CPA Journal*, *Corporate Accounting*, *Cost and Management*, and *Managerial Planning*. Professor Warren is also the Consulting Editor for South-Western Publishing Co.'s accounting series.

Professor Warren resides in Athens, Georgia, with his wife, Sharon, and two children, Stephanie (age 13) and Jeffrey (age 11). Professor Warren's hobbies include coaching Little League Baseball, golf, tennis, and fishing.



NOTE TO STUDENTS

This text was written with the objective of preparing you for your future professional career. Accounting is a stimulating, rewarding field of study. To be effective, professionals in all areas of business, such as finance, production, marketing, personnel, and general management, must have a good understanding of accounting. In addition, men and women whose careers are in nonbusiness areas can use a knowledge of accounting to perform more effectively in society.

As you begin your study of accounting, you may find the following suggestions helpful:

- Read each chapter objective before you begin studying a chapter.
- Take a few minutes and scan the chapter to get a flavor of the material before you begin a detailed reading of the chapter.
- As you read each chapter, you may wish to underline points that you feel are especially important. Also, you should give special attention to key terms which are identified in color when they first appear in the chapter.
- After reading the text of the chapter, carefully study the Chapter Review, giving special attention to the following items:

Key Points. You should thoroughly understand each of the key points presented in the chapter. If you have difficulty understanding any of the key points, review the section of the chapter where the key point is discussed and illustrated. The key points are organized as major chapter headings that appear sequentially throughout the chapter.

Key Terms. You should be able to define each key term. If you cannot, refer to the page of the chapter where the key term is first presented and discussed. You may also refer to Appendix A, where all of the key terms are listed in alphabetical order and defined.

Self-Examination Questions. Answer each of the self-examination questions and check your answers by referring to Appendix B. The answers appearing in Appendix B explain the correct response.

Illustrative Problem. Study the illustrative problem and its suggested solution. Each illustrative problem applies the concepts and principles discussed in the chapter to a problem situation. If you have difficulty understanding the illustrative problem, refer to the section of the chapter where the applicable concepts and principles are discussed and illustrated.

- Work all assigned homework. In many cases, the homework is related to specific chapter illustrations, and you may find it helpful to review the relevant chapter sections before you begin a homework assignment.
- Take notes during class lectures and discussions and give attention to the topics covered by your instructor.
- In reviewing for examinations, keep in mind those topics that your instructor has emphasized, and review your class notes and the text.
- If you feel you need additional aid, you may find the Study Guides that accompany this textbook helpful. The Study Guides can be ordered from South-Western Publishing Co. by your college or university bookstore.



TEXT OBJECTIVES

- Describe the evolution of accounting.
- Describe the basic structure of the accounting profession.
- Describe and illustrate the basic financial accounting concepts and principles.
- Describe and illustrate accounting systems for service and merchandising enterprises.
- Describe and illustrate accounting concepts and principles for sole proprietorships, partnerships, and corporations.
- Describe and illustrate financial accounting concepts and principles for analyzing business operations.
- Describe and illustrate managerial accounting concepts and principles for planning and controlling decentralized business operations.
- Describe and illustrate accounting systems for manufacturing enterprises.
- Describe and illustrate managerial accounting concepts and principles for planning, control, and decision making.
- Describe and illustrate the accounting concepts and principles for individuals and nonprofit organizations.

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