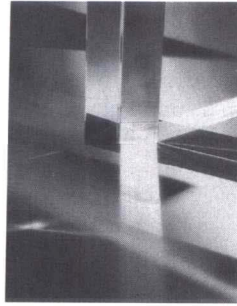




Michael A. Diamond

FINANCIAL
ACCOUNTING

Third Edition



Gary Peroni

Third Edition

Financial Accounting

Michael A. Diamond
University of Southern California



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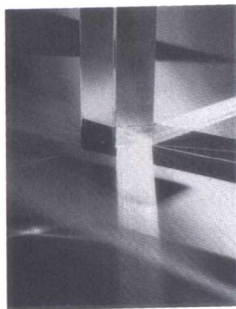
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Preface

Financial Accounting is designed to be used in first-year accounting courses that cover one or two quarters or one semester. It presumes that the student has had no previous exposure to accounting. Because of the book's flexible organization, it can be used in introductory accounting at either the undergraduate or graduate level.

The third edition of *Financial Accounting* represents a major revision in both structure and content. This revision was prompted (1) by the need to keep the text current in its content and, more important, (2) by the significant changes that are now taking place in accounting education. These changes are best summarized by the following excerpt from the Accounting Education Change Commission's (AECC) Position Statement on the "First Accounting Course":

The two primary objectives of the first course in accounting are (1) to make clear the ways in which accounting is an information development and communication function that supports economic decision-making and (2) to prepare students to obtain additional knowledge. The knowledge and skills provided by the first course in accounting should facilitate subsequent learnings even if the student takes no additional academic work in accounting or directly related disciplines.

*For example, the course should help those who complete it in performing financial analysis; in deriving information for personal or organizational decisions; and in understanding business, governmental, and other organizational entities.*¹

The two premises upon which *Financial Accounting* is based reflect the viewpoint expressed in the AECC position statement. First, knowledge of accounting is important for *all* members of today's complex international business community, whether they are in industry, government, or the professions. Therefore, this book is written to meet the needs of general students as well as of those who are prospective accounting majors. In designing and writing this textbook, I am well aware that it must meet the needs of a wide range of students with varying interests and goals. For those who are potential accounting majors a solid foundation in accounting concepts and practices is important so that they can apply that knowledge in their various careers. Those choosing nonaccounting majors need a basic knowledge of accounting to assist them in the many financial decision-making situations that they will encounter in their future professional positions. To meet the needs of these diverse groups, I have chosen the goal that after completing their study of this text all students should be able to read, understand, and reasonably interpret financial statements contained in annual reports of major companies.

Second, accounting is an interesting subject, and I believe that the time spent in learning its concepts and practices should be enjoyable. For this reason, *Financial Accounting* is written in a highly readable, conversational style that will appeal to students. In addition to being an essential topic, I believe that accounting is fascinating. To complete successfully their first accounting courses, students spend many hours reading the text and preparing class materials. I have gone to considerable lengths to make this process interesting. The text includes 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 Albertson's, a large retail grocery chain, are used as an integrating force throughout the text. Further, each chapter begins with a short scenario which sets up a situation that students can easily relate to.

▼
CHANGES IN
THE THIRD
EDITION

This edition of *Financial Accounting* differs from the others in two important ways: (1) organizational structure and (2) the deletion of a significant amount of procedural material and the corresponding addition of conceptual and decision-making material.

Organizational
Structure

Traditional introductory accounting texts take a balance sheet approach to organizing the material. That is, after discussing the accounting cycle, the table of contents basically works its way down the balance sheet. Students tend to view each chapter as completely independent of those that precede and/or follow. As a result, students often are unable to integrate the material and make logical conceptual connections.

1. Accounting Education Change Commission, "The First Accounting Course," Position Statement No. 2, June 1992.

The third edition of *Financial Accounting* is organized in a completely different manner. (Please see the Contents on page xvii.) First the student is introduced to the uses and functions of accounting and what information is and is not contained in the basic financial statements. Included in this first part of the book is a unique chapter entitled The Accounting Profession: Ethics, Management Controls, and Fraudulent Financial Reporting (Chapter 4). The four chapters in Part 1 are meant to meet the AECC's view that the first course in accounting should:

*provide students with a broad view of accounting's role in satisfying society's needs for information and its function in business, in government, in other organizations, and in public accounting. This should include an overview of the accounting profession, encompassing its history, its ethics, and its public responsibilities.*²

The accounting information system is covered in Part 2. Students are introduced to the accounting cycle without being burdened with unnecessary procedures. Parts 3, 4, and 5 are organized to match the structure and format of the statement of cash flows. That is, these three parts cover operating, investing, and financing activities, respectively.

Following the introduction to Part 4, a module introduces students to present value techniques and applications, thus allowing ease of inclusion or omission according to the needs of each school's curriculum.

Part 6 concludes the text with the interpretation of financial information. In a sense, the chapters in Part 6 are in the nature of summary and review; the material in this part has been introduced to the student in appropriate places throughout the text. For example, the statement of cash flows was first introduced in Chapter 2 and discussed in more detail in Chapter 3. In a similar manner, international topics are discussed at appropriate places throughout the text. (For example, the coverage of inventories in Chapter 10 contains a discussion of international accounting standards related to inventory costing methods. Similarly, Chapters 11 and 12 contain discussions relating to international accounting standards for goodwill and consolidations.) Lastly, financial statement analysis and the use of accounting information for decision making are stressed through all the chapters. Thus, by the time the student reaches Chapter 18 (interpreting financial data), most of the ratios are familiar.

Reduced Coverage of Procedural Material

The least important procedural material has either been deleted or the coverage reduced substantially. For example, such topics as bank reconciliations, petty cash funds, and specialized journals have been eliminated from the third edition. Other advanced topics, such as earnings per share, which often are found in introductory texts receive substantially reduced coverage.

Essential procedures are presented in a concise and relevant manner. They often are used to enhance student understanding of a particular concept and standard. For example, in Chapter 11, the concepts behind long-lived assets are fully explained before various depreciation methods are illustrated. In Chapter 16, the uses and purposes of the statement of cash flows are explained completely before the student is led carefully through an example illustrating its preparation.

2. Ibid.

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FEATURES

Emphasis on Using Accounting Information in Decision Making

The third edition of *Financial Accounting*, like its predecessor, has several features that aid student learning and understanding: (1) emphasis on the use of accounting information in decision making; (2) contemporary theory and practice; (3) organizational flexibility; and (4) a complete and integrated learning package.

In this text, I consistently approach accounting as an information system that provides useful financial data for decision making. This concept of accounting emphasizes its purpose in providing information for decisions rather than solely for its measurement procedures in recording, classifying, and summarizing information. This view is in line with the AECC's statement that the first course in accounting should "make clear the ways in which accounting is an information development and communication function that supports economic decision-making."³

This emphasis on decision making is reflected in many of the features incorporated in the third edition of *Financial Accounting*. Ratios and other analytical tools are introduced at appropriate points in the specific chapter dealing with the related accounting concept. Chapter 18, Interpreting Financial Data, 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 the financial statements of companies.

At the end of each chapter, in addition to a wide variety of other assignment material, I have added an entirely new section entitled Discussion, Interpretation, and Computer Problems. The problems in this new section are of five types:

- Understanding Financial Statements
- Financial Decision Cases
- Research Assignments
- Ethical Issues
- Using the Computer⁴

Problems in *understanding financial statements* ask students to interpret and analyze information from the financial statements of real domestic and, where appropriate, foreign companies. *Financial decision cases* place students in the role of decision makers and ask them to analyze and interpret financial and other quantitative data. *Research assignments* are short cases that require students to use outside sources available in university and college libraries. They ask students to extend the material introduced in the text. These research assignments are ideal for individual and group written and oral presentations. *Ethical issues* are problems and cases that ask students to face realistic ethical dilemmas and develop a response. Many of these cases require the student to reason through situations that do not have one "correct" solution. Again, these cases are ideal for individual and group written and oral presentations. Finally, problems in *using the computer* are straightforward exercises specifically designed to be worked on any available spreadsheet program.

The problems in this new section are a response to the AECC's view that beginning accounting students should have experience in solving unstructured problems. Again, in its Position Statement No. 2, the AECC states that the first course in accounting should "enhance students' analytical skills by presenting them with

3. Ibid.

4. These begin in Chapter 8.

unstructured problems that yield to decision-making skills—that is, problems with more than one defensible solution.”⁵

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 may have on a firm’s financial statements. These are realistic considerations that management must take into account when choosing among the different approaches.

Seven accounting professionals, each in a position of responsibility, are profiled at selected locations throughout the text. These professionals are featured to assist students in visualizing themselves as decision makers using financial information.

Contemporary Theory and Practice

The third edition of *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 of this text. The globalization of our economic environment is reflected throughout. In addition to a separate chapter on financial accounting issues facing multinational corporations, international accounting practices are introduced in various chapters, such as the chapters on inventories, property, plant, and equipment and intangibles, and investments.

Students are briefly introduced to some of the most important financial accounting issues facing U.S. and foreign companies not normally discussed in introductory texts. For example, such topics as financial instruments, post-retirement benefits, loan losses of financial institutions, and accounting for income taxes are addressed in appropriate chapters. These topics, however, are covered with the full understanding of both their complex nature and the fact that this is an introductory textbook. Thus, students will gain an understanding of the importance of these topics to financial reporting and management decision making without becoming overburdened by detail more appropriate to intermediate and advanced texts.

The treatment of corporate income taxes is an excellent example of how these topics are introduced to the beginning accounting student. The effects of taxes on the firm’s financial statements are discussed in the various chapters in which relevant accounting principles are presented. Thus the concept of interperiod income tax allocation based on FASB Statement No. 109 is introduced in Chapter 9 with payable generation, recognition, and measurement. The effects of income taxes on management decisions are discussed again along with coverage of inventories (Chapter 10) and of long-lived assets (Chapter 11). The appendix to Chapter 3 (Corporate Income Statements) presents a brief overview of intraperiod income tax allocation. This treatment reflects my view that income tax considerations play an important role in management decisions and should be discussed when those decisions are covered, not isolated in a separate chapter.

Examples in the text and end-of-chapter materials all reflect our current economic environment, with emphasis on global service and technology companies. Where appropriate, reference is made to current economic events such as the crisis faced by U.S. financial institutions and corporate restructurings that became common in 1991 and 1992.


5. Ibid.

Organizational Flexibility

The third edition of *Financial Accounting* is written with the full understanding and appreciation 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 such changes.

In this edition the material on the accounting cycle is not introduced until Part 2. This follows the complete discussion of financial statements and the concepts behind those statements contained in Part 1. However, if desired, the material in Chapters 3 and 4 containing in-depth discussion of financial statements and the accounting profession can be delayed until after the accounting cycle is covered.

Depending upon the preference of the instructor and the amount of time available, some or all of the topics in Part 6 can be omitted. As previously noted, relevant discussions of ratio analysis and international accounting are contained in other chapters, and the statement of cash flows is introduced in Chapters 2 and 3. 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.



A COMPLETE AND INTEGRATED LEARNING PACKAGE

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

Pedagogical Features

I have gone to great lengths to design a pedagogically sound textbook. Each of the chapters contains a set of learning objectives at the beginning and a summary of these objectives at the end along with a list of Key Terms, Problem or Problems for Your Review, Questions, Exercises, Problems, and Discussion, Interpretation, and Computer Problems. At the end of each part a set of Comprehensive Problems has been added.

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. Each of these objectives is summarized in paragraph form at the end of the chapter.

KEY TERMS AND GLOSSARY

Following the summary is a list of key terms discussed in the chapter. These terms are highlighted in boldface where they are introduced in the chapter. At the end of the book, Appendix D is a complete glossary of these key terms, arranged alphabetically for easy use.

PROBLEMS FOR YOUR REVIEW

At the end of each chapter one or more review problems emphasize key points in the chapter. These problems are followed by detailed solutions, so that the students can compare their solutions with the correct one. 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* involve single concepts and provide the student with practice in applying those concepts. Throughout the text, and easily identified by the Albertson's logo, are exercises related to that company's financial statements. The end-of-chapter problems are more complex and usually cover several related topics. The exercises, the questions, and generally the problems are arranged to follow the order in which material is introduced in the chapter. Permission has been received from the Institute of Certified Management Accountants of the Institute of Management Accountants to use questions and/or unofficial answers from past CMA examinations.

In the third edition, the end-of-chapter material has been expanded. Many items have been revised, and new ones have been added. When an important topic needs to be emphasized two alternative problems relating to that material are presented.

As noted earlier, each chapter now contains a section called Discussion, Interpretation, and Computer Problems. These are less structured problems which can be used for individual and group written and oral presentations.

COMPREHENSIVE PROBLEMS

At the end of each part, comprehensive problems highlight significant elements the students have covered. In alignment with the theme of this text, those problems focus on understanding the role of accounting information in decision making.

The Student's Support Package

The student's support package contains a *Study Guide* and *Working Papers*.

STUDY GUIDE

Prepared by Lawrence A. Klein and Elliott Levy of Bentley College, the Study Guide helps students develop the ability to apply concepts and techniques discussed in the main text. Each chapter corresponds to a text chapter, and contains an extensive chapter review as well as fill-in-the-blanks, multiple choice, and short answer problems that students can use to test their knowledge of text topics. The answers to all these questions and exercises, with explanations, are provided for the student.

WORKING PAPERS

Partially completed working papers are provided where appropriate. They are designed to reduce the amount of nonproductive pencil work required of the student.

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*, *Check Figures*, updating *Annual Reports*, and *Videos*.

SOLUTIONS MANUAL

Prepared by Raj Iyengar, the Solutions Manual contains detailed solutions to all questions, exercises, problems, and other end-of-chapter materials. Complete solu-

tions, including all intermediate calculations, are provided. These all have been independently verified to ensure accuracy.

INSTRUCTOR'S MANUAL

Prepared by Raj Iyengar, the Instructor's Manual has been designed as a useful teaching aid and resource guide for the instructor. A flow chart diagram approach is taken to illustrate concepts, with examples for class use provided. A matrix of end-of-chapter material, organized by learning objective, is included for each text chapter. Included in the matrix are all questions, exercises, and problems, with their estimated level of difficulty and time required for completion.

An overview of the end-of-chapter material is followed by a chapter outline, also organized by learning goals. Additional examples of key computations and illustrations have been developed for selected chapters.

TEST BANK

Prepared by Donna Ulmer of Southern Illinois University-Edwardsville, the Test Bank contains approximately 1,200 test items, including fill-in-the-blanks, multiple choice, matching, short problems, and short essay questions. Detailed solutions to all questions are included at the end, along with explanations and computations where applicable.

COMPUTERIZED TEST BANK

The same test material appearing in the printed Test Bank is available on disk.

TRANSPARENCIES

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

CHECK FIGURES

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

ANNUAL REPORTS

Copies of Albertson's annual reports for fiscal years 1992 and 1993 are free to adopters who request them from South-Western Publishing Co. These reports are expected to be available in late spring, 1993 and 1994, respectively.

VIDEOS

Following closely the approach of the profiles, the videos feature professionals who are involved in the creation and/or application of accounting information. The videos are free to adopters.

ACKNOWLEDGMENTS

The third edition of this text would not have been completed successfully without the help of many of my colleagues and friends. Although it is impossible to list all who have made contributions, I would like to acknowledge those who have provided so much help and insight.

To Eric and Diana Flamholtz, a thank you is extended for their involvement in the initial edition of this book. Appreciation is extended to Raj Iyengar for carefully preparing the solutions manual and instructor's manual, to Donna Ulmer for her conscientious revision of the test bank, and to Larry Klein and Elliott Levy for

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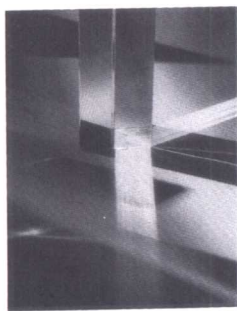
I would also like to thank those individuals who graciously consented to appear in the profiles used throughout the book. Their willingness to participate has improved the quality of the third edition. Further, I appreciate Albertson's allowing me to use a large portion of their annual report, along with their logo, for illustrative purposes.

Finally, this project would never have been completed without the assistance of the outstanding editorial staff of South-Western. Those who contributed mightily to the production of this book include Sara Bates, Shelley Brewer, Mary Draper, Lynn Huber, and Cindy Laufenberg.

A special note of thanks goes to Elaine and Jacob Diamond, who provided the emotional support required for the completion of this text.

Notwithstanding the assistance of all of these individuals, I am solely responsible for the final product. Any suggestions for improvement would be greatly appreciated.

Michael A. Diamond



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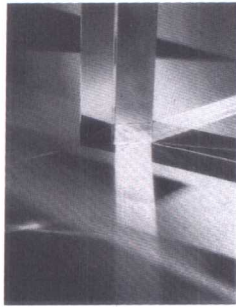
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