



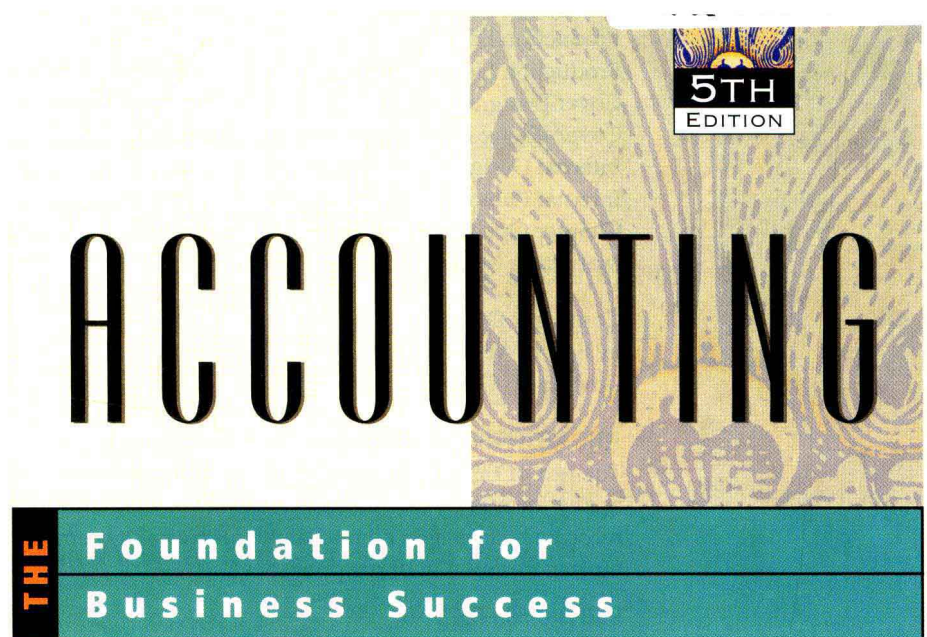
ACCOUNTING

THE

Foundation for
Business Success



SOLOMON, WALTHER, VARGO, AND PLUNKETT



Lanny M. Solomon
The University of Texas
at Arlington

Larry M. Walther
The University of Texas
at Arlington

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This book is dedicated to the memory and spirit of

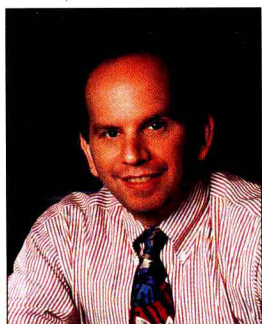
Amanda Welling Dykes
September 3, 1980 – March 3, 1995

Scholar, musician, friend

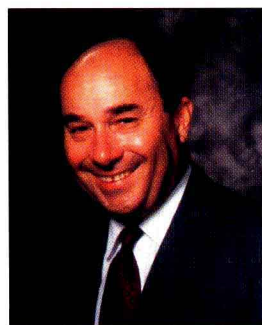
and beloved daughter of Linda Plunkett



ABOUT THE AUTHORS



Lanny M. Solomon is currently a professor of accounting at The University of Texas at Arlington. He holds a Ph.D. in accounting and information systems from Case Western Reserve University and is a certified management accountant. Professor Solomon has published articles in *The Accounting Review*, *Journal of Accountancy*, *Cost and Management*, and various journals of state CPA societies. In addition, he has presented numerous papers at technical accounting meetings. Professor Solomon is an active member of the American Accounting Association and the Institute of Certified Management Accountants, has public and industrial accounting experience, and has been the recipient of several outstanding teaching awards.



Richard J. Vargo, currently a professor at the University of the Pacific, received his doctorate in accounting from the University of Washington. He has experience with an international public accounting firm. Articles by Professor Vargo have appeared in the *Journal of Accountancy*, *CPA Journal*, and other professional publications. He is the author of several other accounting and business books, including one prepared for the American Institute of Certified Public Accountants. Professor Vargo lectures internationally on a variety of financial and managerial topics and has received recognition from the California Society of CPAs for his contributions to the development of accounting education. He has also acted as a consultant to a number of businesses.



Larry M. Walther is an associate professor of accounting at The University of Texas at Arlington. He received his doctorate in accounting from Oklahoma State University and has experience with an international public accounting firm. Professor Walther is both a certified public accountant and a certified

management accountant. Articles by Professor Walther have appeared in *The Accounting Review*, *Journal of Accountancy*, *Management Accounting*, *The Practical Accountant*, and other professional journals. He is a member of the American Accounting Association, Texas Society of Certified Public Accountants, and other professional organizations. Professor Walther has provided consulting services to a number of businesses on accounting and financial reporting matters and serves as a director of a corporation that operates in the Dallas-Fort Worth area.



Linda M. Plunkett, professor of accounting at the University of Charleston, SC, received her doctorate from Georgia State University. She is a third-generation certified public accountant, with professional experience in both public accounting and private industry. Professor Plunkett has published arti-

cles in a variety of publications including *Accounting Horizons*, *Journal of Accountancy*, and *Accounting Historians Journal*. In addition, she has presented numerous papers at regional and national accounting meetings. She is a member of the American Accounting Association, American Institute of CPAs, Academy of Accounting Historians, and other professional and academic organizations. Professor Plunkett is regarded as being very student-oriented and has won several awards for her teaching and scholarship.



PREFACE

Accounting education has undergone considerable change in recent years. Students have been asked to comprehend a growing number of complex pronouncements; professorial complaints regarding students' reading and analytical abilities have increased; and there is evidence that we are losing our brightest classroom performers to other disciplines on campus. Furthermore, classes often contain a substantial number of students who quickly lose interest in the subject matter, which is often regarded as time consuming and somewhat dry and boring. These are the very problems that prompted us to write the first edition of *Accounting Principles* in 1983.

A primary emphasis on these issues was sufficient for the 1980s and the very early 1990s. Further refinements are needed and have been made, however, in this, the fifth edition. Ethics, the impact of computers, globalization, high-tech manufacturing, interdisciplinary perspectives, the role of information in decision making, financial statement interpretation and use, communication skills, concept application (rather than procedure), and group work are collectively the current focus—key elements required to train the managers of tomorrow (accounting or otherwise). A review of the text's 27 chapters and accompanying package will find numerous revisions that reflect contemporary business practices and the thinking of prominent educators. The book's new title, *Accounting: The Foundation for Business Success*, is indicative of this changing emphasis.

The authors completely agree with a recent statement of the Accounting Education Change Commission, which noted that:

The knowledge and skills provided by the first course in accounting should facilitate subsequent learning even if the student takes no additional academic work in accounting or directly related disciplines.¹

We feel that our new edition accomplishes this objective. Discussions of the concepts and rationale that underlie accounting practices are integrated at appropriate points throughout the text. There is an added focus on what is

¹ "The First Course in Accounting," *Position Statement No. Two*, Accounting Education Change Commission, *Issues in Accounting Education*, Fall 1992, pp. 249–250.

increasingly becoming known as the “user orientation.” Recognizing that there is more to accounting than just calculations, our end-of-chapter problem material asks students to reason, justify, explain, and apply. Combining this approach with a clear, readable, and accurate presentation results in what we believe is an enlightening overview—one that will create a stimulating educational experience for both students *and* faculty.

Additionally, we have monitored readability throughout the text and have strived to make troublesome topics (such as adjusting entries, corporate equity, bonds, and the statement of cash flows) especially understandable to students. To eliminate differences in writing styles, one of the authors has spent countless hours integrating the same tone, approach, and manner of presentation in all 27 chapters. Accounting is a rigorous subject for most individuals. The authors recognize this fact and have worked hard to produce a clear and usable volume. Comments from instructors *and* students indicate that we have, in fact, generated a readable book.

SIGNIFICANT CHANGES IN THE FIFTH EDITION

We have always characterized our approach to accounting subject matter as being balanced and traditional. Recent studies indicate a growing number of instructors who believe that accounting education would be improved if students receive a heavier dose of the “general business side of accounting” and a lighter exposure to journal entries and many of the related procedures. Some books have even gone so far as to eliminate debits and credits from the introductory course.

As authors, we have a duty to monitor market conditions and produce the very best textbook possible. On the basis of user feedback, survey polls, and editorial guidance, we have made a number of changes in the organization and content of our fifth edition. Many of the modifications reflect the shift in thinking just noted; however, the revisions are *not* radical and fit nicely in the confines of this traditional volume. The major changes are summarized in the sections that follow.

CHAPTER/SUBJECT MATTER REORGANIZATION

- We are excited about a new chapter entitled “Understanding and Using Financial Information” (Chapter 7). Positioned early in the text for those instructors who desire to set a financial-statement theme for their courses, this material focuses on how to read and interpret a basic annual report. Key portions of Microsoft’s annual report are reproduced to enhance the presentation. The chapter also takes a look at the purpose of financial statement footnotes, the role of auditing, and the financial statements of different entity forms (e.g., banks, utilities, and governmental and not-for-profit organizations).
- Because of a new ruling by the Financial Accounting Standards Board, we have extensively revised the bond chapter (Chapter 18) to better reflect the contemporary topic of financial instruments. The bond discussion has been simplified and includes several new exhibits that better illustrate this complex subject matter for students.
- Ratio material (formerly in the financial statement analysis chapter) is now covered throughout the text. For example, inventory turnover is discussed

with inventories, the current and quick ratios with liquidity, and accounts receivable turnover with receivables. This holistic type of presentation allows for an increased focus on analysis while a topic is still fresh in a student's mind. The ratios are brought together in a summary chart that appears in Appendix B, which also contains a typical investment analyst's report.

SUBJECT MATTER ADDITIONS

A number of new topics have been added to the text. These topics, generally approached from a nonprocedural viewpoint, are relevant for accounting *and* nonaccounting majors. Typical examples (along with the associated chapter reference) include:

- Electronic data interchange (Ch. 5)
- Cash management practices (Ch. 8)
- Asset impairment (Ch. 12)
- Fringe benefits and employee leasing (Ch. 13)
- Revenue recognition practices in different industries (Ch. 14)
- Foreign currency fluctuations (Ch. 14)
- Limited liability partnerships (Ch. 15)
- Reading a stock page (Ch. 16)
- Initial public stock offerings (Ch. 16)
- Bankruptcy/business failure (Ch. 19)
- The value chain (Ch. 20)
- Benchmarking (Ch. 22)
- A focus on speed (Ch. 22)
- Nonfinancial performance measures (Ch. 25)
- Standards in nonmanufacturing firms (Ch. 25)
- Transfer pricing (Ch. 26)
- Capital budgeting in a competitive business climate (Ch. 27).

THE "MORE-IS-NOT-BETTER" PHILOSOPHY

Many accounting textbooks have become mini-encyclopedias, containing more information than can reasonably be covered by even the most efficient and effective instructors. In recent years we have tended to lose sight of the fact that students—more specifically, introductory students—can only absorb so much in the way of subject matter.

In the previous edition of the text we deleted several topics that had either "grown old" or were relatively unimportant in the overall scheme of things. Recognizing that more is not necessarily better, we continued this process in the fifth edition to a somewhat greater degree. The following topics, among others, have been dropped from the text: the adjusting entry method of handling inventory on a merchandising work sheet; voucher systems; discounting of notes receivable; payroll registers; large stock dividends; sinking funds; procedures related to convertible bonds, deferred taxes, and the preparation of consolidated financial statements; horizontal analysis; journal entries for variances; and individual federal income tax regulations. Generally speaking, these changes are consistent with our objective of producing a volume that has an

increased user orientation when compared with its predecessor (i.e., addition by subtraction).

BOXED FEATURES

We have modified the boxed features that appear throughout the book.

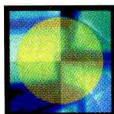
- Each chapter now begins with an opening vignette that focuses on George Faris and Banner Advertising. The firm, an actual small business based in Texas, has opened its doors to us, allowing students to see various facets of the company's operations and financial activities. The use of one business throughout the book's twenty-seven chapters adds continuity to presentations.
- Boxes labeled "A Further Focus" lend additional insight to discussions by, in many cases, focusing on the experiences of well-known, real-world companies. *The Wall Street Journal*, *Forbes*, and other popular periodicals serve as typical sources for this series of examples.
- Perspective boxes are also new to this edition. Knowing that many accounting topics impact other business disciplines, we secured the services of experts in related fields to discuss the associated interaction(s). Boxes focus on such professions as finance, marketing, human resources, law, economics, health care, music, information systems, and computers.
- Business Briefings (entitled Executive Briefings in the previous edition) look at a topic from a businessperson's perspective and highlight how that topic affects the individual's firm. We have broadened this series to include not only "name brand" corporate giants (General Motors, Wendy's, and AT&T) but much smaller entities as well (San Joaquin Regional Transit District and La Bistro Italian Restaurant). Also, we now feature professionals who occupy vastly different types of positions within an organization (e.g., chief financial officer, plant manager, and a county agricultural extension agent).

END-OF-CHAPTER MATERIALS

Aside from normal revisions, we have made three basic changes to the end-of-chapter assignment material. First, consistent with a user orientation, many of the new exercises focus on business practices and concepts rather than on computations and procedure.



Second, we have reoriented many of our more difficult problems (formerly called Beyond the Basics) into true decision cases (indicated by an icon). The cases are not necessarily more difficult than the regular Series A and Series B problem sets, nor are they just traditional problems with a disproportionate amount of narrative. Instead, these items are introductory cases that focus on a variety of financial and managerial issues and contain a minimal amount of procedure.



Finally, in keeping with contemporary educational processes, we have designed a set of individual and group projects that allow students to expand greatly beyond the material contained in the text. These projects (identified by an icon) include library research, a review of published financial statements,

and business interviews. The projects and decision cases, along with our electronic data base problem set (to be discussed shortly), are found under the heading of Expanding Your Horizons.

FOURTH EDITION FEATURES RETAINED

Many features in the fourth edition proved popular with users. Those features, repeated in this edition, include a true managerial section, a heavy use of real-world firms and data, and solid problem material.

A TRUE MANAGERIAL SECTION

The final chapters of an introductory accounting text are normally devoted to cost and managerial accounting topics. The usual approach is to have students calculate this and calculate that, while paying very little attention to the use or impact of the data they are producing. Our approach is to focus on the how and why of planning, control, performance evaluation, and decision making and to present practical applications whenever possible. This balanced presentation should appeal to a wide range of instructors, including those who currently use a separate text for managerial coverage.

HEAVY REAL-WORLD EMPHASIS

Many accounting texts use hypothetical firms in their illustrations and examples. The authors have found that students show an increased interest in the subject matter when exposed to the accounting and financial reporting practices of real businesses. Thus, we include annual report data and “war stories” of over 200 different companies, including McDonald’s, American Airlines, Apple Computer, NIKE, and The Coca-Cola Company. We have carefully selected firms from industries with which students themselves have contact. All examples were screened for appropriateness at the introductory level.

SOLID PROBLEM MATERIAL

All problem material contained in this text was carefully designed to reflect current accounting principles and practices. Questions, exercises, and problems range in scope from the simple to the complex; they were written and solved by the authors to assure total coordination with the text presentation. To further ensure accuracy and reliability, we have triple-checked the *Instructor’s Solutions Manual*. We are confident the end-of-chapter materials are as trouble-free as repeated multiple checking can make them. These items will provide a solid, well-rounded foundation for accounting students and a varied resource for instructors.

The problem material is divided into Series A and Series B. Instructors can therefore use one problem for illustration purposes and assign another as homework or use different problem sets in alternating semesters or quarters. Although duplication is important, the authors have not lost sight of the need for variety. Both sets contain an ample variety of material to allow instructors to approach a given topic from varying perspectives.

SUPPLEMENTARY MATERIALS

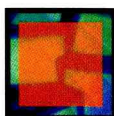
A complete set of supplementary materials for both student and instructor accompanies this text to help facilitate the learning and teaching of accounting.

FOR THE STUDENT—PRINTWARE

- **Study Guide.** A study guide, available in two volumes, has been written by Larry Walther to reinforce the material presented in the text. The Study Guide contains chapter learning objectives; a detailed chapter synopsis; multiple-choice, two-response, and completion questions; exercises; and answers *with specific explanations*, as well as computer software that provides step-by-step instruction on key accounting topics.
- **Working Papers.** Two volumes of working papers have been prepared: Volume I covers Chapters 1–15 and Appendix A; Volume II covers Chapters 15–27. The inclusion of Chapter 15 (Partnerships) in both volumes recognizes that this topic is covered in the first Principles course at some schools and in the second course at others. Many of the working papers are partially filled in, thereby allowing students to concentrate on accounting concepts as opposed to the pencil pushing associated with problem setup.

FOR THE STUDENT—SOFTWARE

- **Computer-Assisted Accounting Tutorials.** Contained in the Study Guide, these tutorials present essential accounting material on a step-by-step basis. As they proceed through the lesson, students are queried on subject matter presentations through a series of two-response (e.g., yes/no, agree/disagree, logical/illogical), multiple-choice, and computational questions.
- **Homework Assistant Tutorial (HAT).** This new Windows-based tutorial software, by Ray Meservi of Brigham Young University, visually teaches the relationships between T-accounts, journals, ledgers, and financial statements in solving selected end-of-chapter problems. A built-in tutor function includes numerous hints and help screens. HAT is also ideal as a classroom teaching aid. An icon designates specific assignments for use with HAT.
- **Spreadsheet Application Software.** Dozens of exercises and problems can be solved using most standard spreadsheet packages, such as Lotus 1-2-3®, Quattro®, or Excel®. Specific assignments can be easily identified by the icon shown.
- **Solutions Software.** This best selling educational general ledger software, prepared by Dale H. Klooster and Warren W. Allen of Educational Technical Systems, is tailored specifically to Chapters 2–6 of the text. Related end-of-chapter assignments are identified by the icon shown. This software is available in both Windows and MS-DOS versions.
- **Financial Statement Database Software.** Annual report information for over three dozen corporations is provided in easily accessible form for student research.



ADDITIONAL ITEMS TO ASSIST STUDENTS

CONTACT II. This computer-assisted instruction package consists of tutorials, assignments, and graded homework problems on various topics related to the accounting cycle. These topics include the accounting equation, transaction analysis, journalizing and posting transactions, cash vs. accrual basis accounting, financial statements, and adjusting and closing entries. The assignments and tutorials can be used as a stand-alone course or lab, or with any principles/financial textbook where the instructor desires more procedural coverage. Windows format.

Annual Report Projects and Readings. Written to accommodate either an individual-based or team-based approach, this text helps students make the transition from the classroom to the business world by exposing them to real financial reports. Students request annual reports, proxy statements, and SEC 10-Ks from real companies and analyze financial information using workbook assignments.

Practice Sets. Eleven practice sets tie together various issues discussed in the text.

Larry's Landscape. Appropriate after Chapter 4, this set is available with transactions in narrative form. It provides practice in accounting for a sole proprietorship service business. It may also be solved using the Solutions Software.

Poolside Products. Upon completing Chapter 10 and Appendix A, students will find this set, which is available with business documents, helpful. An optional narrative of transactions may be used. The set provides practice in accounting for a merchandising sole proprietorship that uses a perpetual inventory system and special journals. It may also be solved using the Solutions Software.

Cool Company. This is an interactive, computer-based set that gives immediate feedback as it is being solved. It provides practice in accounting for a merchandising sole proprietorship that uses a perpetual inventory system and a general journal.

Electronic Supply. This is a computerized practice set that covers two months of activity for a merchandising business, spanning Chapters 1–10. A periodic inventory system is featured. Some “what-if” analysis may be employed, and a grading disk is provided for the instructor.

Waterworks. This set is available with business documents. An optional narrative of transactions may be used. The set, for use after Chapter 13, provides practice in accounting (including payroll) for a merchandising sole proprietorship that uses special journals. It may also be solved using the Solutions Software.

First Designs Inc. Appropriate after Chapter 17, this set is available with transactions in narrative form. It provides practice in accounting for a merchandising corporation that operates a departmentalized business and uses a periodic inventory system and special journals. It may also be solved using the Solutions Software.

Compsoft Inc. Students will find this set helpful upon completing Chapter 18. It is available with transactions in narrative form and provides practice in accounting (including corporate debt) for a merchandising corporation that uses a general journal. It may also be solved using the Solutions Software.

SEMO Sporting Goods Supply Inc. This set requires locating errors in recording and posting transactions, preparing correcting entries, and preparing financial statements for a wholesaling corporation.

Ice Inc. This is an interactive, computer-based set that gives immediate feedback as it is being solved. It provides practice in accounting for a merchandising corporation that uses a perpetual inventory system and a general journal. It is appropriate for use with Chapter 19.

Highpoint Solar Inc. For use after Chapter 21, this set is available with transactions in narrative form. It provides practice in accounting for a manufacturing corporation that uses a job order cost system. It may also be solved using the Solutions Software.

Allied Manufacturing. For use with the managerial chapters, this set has students perform some basic transaction processing as well as several spreadsheet applications.

FOR THE INSTRUCTOR—PRINTWARE

- **Instructor's Solutions Manual.** A comprehensive, two-volume manual is available that contains the solutions to all questions, exercises, and problems. In addition, a suggested completion time and difficulty index is provided for each problem along with check figures for distribution to students.
- **Solution Transparencies.** The transparencies contain solutions to all exercises and problems. All are prepared in large, easy-to-read type.
- **Teaching Transparencies.** A set of over 100 teaching transparencies is free to adopters. These helpful color acetates include summaries of key narrative discussions raised in the chapter and various examples, with an emphasis on those that are too time-consuming to present on a chalkboard. A special group of "layered" transparencies is included, allowing the instructor to demonstrate, one step at a time, the completion of a work sheet, the construction of a production cost report, and other troublesome tasks.
- **Test Bank.** A thoroughly revised test bank has been prepared. Each chapter of the text is covered via an ample selection of multiple-choice, true-false, and matching questions, along with a series of multipart exer-

cises and essay questions. The Test Bank is available in printed and micro-computer versions. We have also included various achievement tests that take 40 to 60 minutes to complete and examine a student on approximately three chapters at a given sitting. In addition, there are two comprehensive tests.

FOR THE INSTRUCTOR—SOFTWARE AND OTHER MEDIA

- **Instructor's Resource Manual.** The Instructor's Resource Manual in WordPerfect contains detailed lecture outlines that parallel the text's discussion. These outlines are especially useful for part-time instructors and graduate teaching assistants. The manual also includes suggested homework assignments and a series of short quizzes. A printed copy is available.
- **MicroExam 4.** MicroExam is a microcomputer test-generation package that consists of item banks on disks and the software necessary to create instructor-customized examinations. Random selection of questions is available and, if desired, multiple tests may be generated simultaneously. The software also allows for the import of instructor-created items in ASCII format for more customized testing. MicroExam can be used on the IBM PC and compatible machines.
- **PowerPoint Teaching Transparencies.** These lecture presentation slides are an alternative to the teaching transparencies in acetate form.
- **Video.** A case-study video contains a variety of topics, with each segment featuring the use of accounting information in a service organization.
- **Inspector Disk.**

ADDITIONAL ITEMS TO ASSIST INSTRUCTORS

CONTACCT II. Instructor's Manual and Test Bank Disk.

Annual Report Project and Readings. Instructor's Manual.

Practice Set Keys.

Online with South-Western and Software Technical Support. Instructor resources and software technical support are now available on-line. Check your *Instructor's Resource Manual* for details.

Preferred Accounting Customer (PAC) Hotline. Special benefits and services to assist instructors in course preparation are available through the PAC hotline (800/342-8798).

ACKNOWLEDGMENTS

A project of this nature and magnitude is a team effort, entailing much cooperation, thoughtfulness, and patience. To our team members we owe a tremendous debt of gratitude. Those persons who responded to surveys and reviewed chapters were especially helpful with their comments and suggestions. Therefore, many thanks to the following people:

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And finally, we are deeply appreciative of the support of our families that allowed us to pursue this project. In view of the time commitment and constant deadlines, their patience went above and beyond the call of duty. To Nancy, Scott, and Deborah Solomon; Laurie, Corbett, and Russell Walther; Melinda, Matthew, Blaine, and Mike Vargo; and Ron Plunkett—we love you.

Comments from users are welcomed and appreciated.

Lanny M. Solomon
Larry M. Walther
Richard J. Vargo
Linda M. Plunkett



BANNER ADVERTISING, INC. OUTDOOR ADVERTISING SPECIALISTS

Dear Accounting Student,

I am pleased to have the opportunity to tell you the story of my business, Banner Advertising, as you study this text. Actually, each chapter opens with a short story that presents some information about my company and shows how the accounting material included in the chapter applies to the firm.

Not so long ago, I was a business student, just like you. Let's just say I am still well under forty, so it seems like only yesterday that I was struggling through introductory accounting. I got by alright, but really was not that interested in the material. Why? In retrospect, I failed to see its relevance. About the only thing that mattered at the time was doing well enough to complete the course and get on with "my life." What I soon found out was that "my life" would require a day-to-day working knowledge of almost every aspect of accounting—and I am certainly not an accountant.

My life's story is relatively simple to tell. I graduated with a degree in marketing, made a few "swings" at a pro golf career, then took an entry level management position with a major construction company. The economy almost immediately plummeted (Need I say more?), and I was left scrambling for a way to survive. It quickly became clear to me that the "old ways" of finding a secure job with a big company and looking forward to a generous retirement program were gone. It was also clear that a college degree was no longer a guarantee of anything. In short, I was hungry. I was forced to find a way to survive on my own—I always have to grin when someone refers to this predicament as entrepreneurship!

At least my brief stint in the construction business afforded me a few business relationships, and I did gain a little useful knowledge about construction. I had become aware of a good location to construct an outdoor advertising sign, and felt like I knew how to get it done. I believed it would generate enough rent to pay for itself and give me a little income. But, I had to convince a banker, a landowner, and a construction crew to have confidence in my plan. Obviously, I had to show them all a few (accounting) numbers. One thing led to another, and, suddenly I found that I was in business for myself—and also beginning to appreciate the accounting knowledge I should have learned better in the first place. The rest of my story is told in the text, but suffice it to say that the past decade has involved a lot of hard work and good fortune.

Clearly, in today's world, the value of your education is found, not in the degree you seek, but in the knowledge you acquire along the way. Your situation, upon graduation, is likely to be much like mine. You are going forth into a world where success and failure are no longer judged by the ability to climb a corporate ladder, but instead by your individual ability to identify opportunity *and* capture it.

In this regard, my advice to you is threefold: starting right now, never underestimate the value of relationships, consistent ethical behavior, and a strong understanding of accounting information. The first two items are hopefully apparent; the third may take some convincing. That is why I have agreed to allow my story to be told in this text. Hopefully, by showing you the relevance of the text's material to a real-world setting, you will better appreciate your authors' presentations and be more motivated in your approach to the course.

Good luck and best wishes,

George Faris

George Faris
President, Banner Advertising, Inc.

