

MEIGS & MEIGS

**FINANCIAL
ACCOUNTING**

EIGHTH EDITION

Financial Accounting

EIGHTH EDITION

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FINANCIAL ACCOUNTING

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Preface

Welcome to the first accounting course. This course provides an introduction to the field of accounting and to the development and use of financial accounting information in the business world.

There is more diversity today in the content of the first accounting course than at any time in the recent past. For example, the course may be structured to emphasize accounting techniques and procedures, accounting theory, or the interpretation and use of accounting information. There are many financial accounting textbooks available today, each with its own approach to the introductory course. Let us briefly explain ours.

OUR GOALS IN THIS EIGHTH EDITION

We have, of course, tried to improve this eighth edition in many ways. But three of our top priorities have been to:

1. Better develop the student's understanding of the business environment.
2. Increase emphasis upon the interpretation and use of accounting information.
3. Retain a course structure which is familiar to faculty and meets the technical content requirements of most colleges and universities.

Providing Students with a Business Background

If students are to appreciate the nature of accounting, they first must understand types of activities that accounting information describes. We find, however, that many introductory students lack this background. Often the introductory accounting course is also the students' first course in the business curriculum.

In this edition we give increased attention to explaining the nature of business activities before discussing the related accounting issues. Our focus is upon the **current and emerging** business environment, not that of the past.

Emphasizing the Interpretation and Use of Accounting Information

In today's business world, relatively few first-year accounting students will become professional preparers of accounting information. All, however, will become life-long users of this information. For this reason, we have reduced our emphasis on the preparation of accounting information, and increased our emphasis on its **interpretation and use**.

This shift in perspective affects the text in several ways. For example, the assignment materials place greater emphasis on developing students' analytical skills.

A more user-oriented perspective also affects topical content and emphasis. Topics of crucial importance to decision makers are addressed, even if these topics traditionally have been deferred to later accounting courses. Examples include post-

retirement costs, tax basis, audits, and the natural tendency toward “window dressing.”

The statement of cash flows and financial statement analysis both are introduced earlier in the course. Throughout the text, attention is given to analytical ratios and other financial relationships, and to both the accrual and cash effects of transactions. Increased attention also is given to the use of financial accounting information by **management**.

Some “traditional” accounting topics relate primarily to the preparation of accounting information and are of little significance to information users. Examples include the preparation of work sheets, reversing entries, and alternative methods of recording accruals and deferrals. In our user-oriented approach, such topics receive less emphasis.

Retaining a Familiar Course Structure

We regard our changes in this eighth edition as **evolutionary**, not revolutionary. This is a “traditional” textbook, dedicated to keeping pace with changes in accounting practices, students’ needs, and instructors’ desires for more relevant types of problem material. Instructors acquainted with our past editions will find much that is familiar. They will also find that the new edition supports—indeed encourages—the ongoing evolution of the introductory accounting course.

ELEMENTS OF THE TEXTBOOK

This eighth edition is accompanied by more in-the-text learning aids than ever before.

Chapter Introductions and Learning Objectives

Each chapter now includes a photograph as part of the general introduction. These photographs enable us to use non-technical images in describing each chapter’s theme. Each chapter also includes a short set of **Learning Objectives** which are integrated with the text discussions and assignment materials.

Cases in Point

A distinctive feature of past editions has been the use of short **Cases in Point**, based upon actual events. This edition makes far greater use of this feature—it is part of our effort to relate the study of accounting with today’s business environment.

Supplementary Topics and Appendixes

Several chapters are accompanied by ***Supplemental Topic** sections. These topics are not “optional” or unimportant. Rather, they relate closely to the chapter content. Students **always** should read the ***Supplemental Topic** sections. However, instructors should decide whether these topics are of sufficient general interest for inclusion in class discussions, homework assignments, and examinations.

In contrast to the ***Supplemental Topics**, the **Appendixes** at the end of the text

provide self-contained coverage of specialized topics. We consider coverage of these topics optional; students are not expected to read the appendixes unless they are assigned by the instructor.

End-of-Chapter Reviews

Each chapter is followed by a variety of learning aids. These include a *Summary of Learning Objectives*, a *Glossary of Key Terms*, *Self-Test Questions*, and a *Demonstration Problem*.

Assignment Material

One of the distinctive features of this eighth edition is the nature and variety of its assignment material. Increased emphasis is placed upon the development of students analytical, interpersonal, and communication skills. Much of the assignment material is based upon the operations of well-known companies.

There are five basic categories of assignments (1) Discussion Questions, (2) Exercises, (3) Problems, (4) Cases and Unstructured Problems, and (5) Comprehensive Problems.

Discussion Questions are short and usually call for expository answers. In addition to developing communication skills, these questions enhance students' conceptual understanding of accounting.

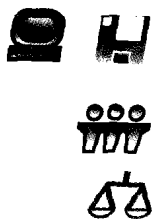
Exercises are short assignments, usually focusing upon a single concept. They are designed to illustrate basic concepts quickly, allowing more class time for discussing assignments such as the Cases and Unstructured Problems.

Problems are longer than the Exercises and address several concepts at one time. Many problems require students to explain, interpret, or make use of the information they produce.

Cases and Unstructured Problems are intended to develop students' analytical and communication skills. These assignments readily lend themselves to group analysis and to class discussions.

Comprehensive Problems tie together concepts presented over a span of chapters. The text includes seven of these problems, ranging in length from 40-minute assignments to term projects. These problems are described in detail in the prefaces to both the *Solutions Manual* and the *Instructor's Guide*.

A **checklist of key figures** for all Problems and Comprehensive Problems appears on the front and back inside covers of the text. The purpose of these figures is to aid students in verifying their solutions and discovering their own errors.



Logos in the Margins Many assignments have special characteristics which are indicated by logos appearing in the left margin. A red computer screen identifies problems that may be solved using the general ledger software; a blue computer disk indicates problems that may be solved using the spreadsheet program.

Assignments particularly well-suited to group solution are identified by the "group logo" shown at left. (Most of the Cases and Unstructured Problems also can be used as group assignments.) Assignments focusing upon ethical considerations are identified by the "scales of justice" logo.

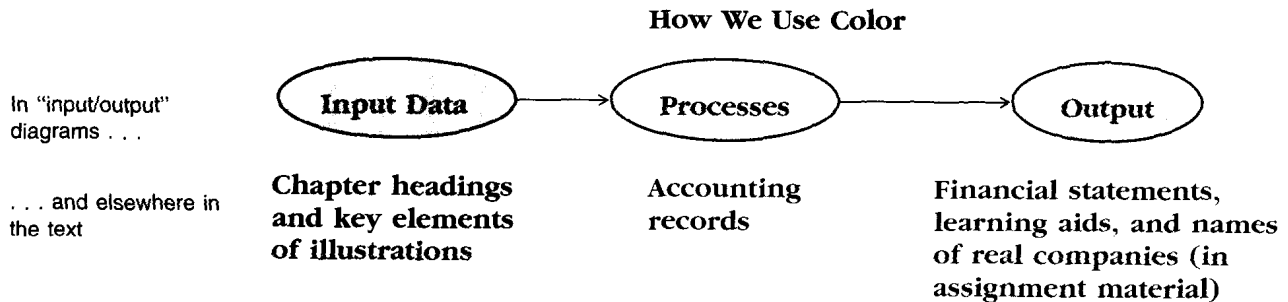
When assignments are based upon the operations of a real business organization, the company's name appears in **bold blue** type. (A special index at the back of the text identifies all references to real organizations.)

Pedagogical Use of Color

Our use of color is intended to assist readers in interpreting illustrations and in conveniently locating elements of the text. For example, red is used for **emphasis**—for chapter headings and to highlight key elements in some illustrations. We also use color to distinguish between accounting records and financial statements—*accounting records* appear in green, and *financial statements* in blue.

In diagrams depicting the “flow” of information, *inputs* appear in red, the *processes or activities* in green, and the final *output* is shown in blue. Blue also is used to identify learning aids, such as *learning objectives* and *key terms*, and the names of *real companies* used in the assignment material.

These uses of color are summarized below:



NEW OR EXTENSIVELY REVISED CHAPTERS

Several chapters in this eighth edition are substantially different from those in prior editions. Among the changes which will be noticed most readily are:

Chapter 1, “Accounting: The Language of Business,” has been revised to place greater emphasis upon career opportunities in accounting and the importance of ethical conduct in accounting practice.

We now complete our coverage of the accounting cycle in **Chapter 3**. The revised treatment of adjusting entries includes the recognition of corporate income taxes. This may seem a small change, but it is part of our concerted effort to better acquaint students with today’s business environment.

Chapter 4, “Year-End!,” provides a broader description of the many activities that make year-end the “busy season.” Substantially less emphasis is given to the work sheet, which now appears in a **Supplemental Topic* section.

Chapter 5, on merchandising activities, exemplifies many features of this eighth edition. The opening pages describes the operating cycle of merchandising companies before addressing the accounting issues. In keeping with contemporary business practices, we emphasize *perpetual* inventory systems (although our coverage of periodic systems has been extensively revised). The chapter also features new sections on selecting an appropriate inventory system and upon evaluating the profitability of merchandising operations.

Chapter 6, our accounting systems chapter, retains its focus on computer-based systems. However, the chapter is supplemented by a new **Appendix B** illustrating the use of manual special journals and by THE NEW DIMENSION—our most comprehensive *Comprehensive Problem*.

Chapter 7, “Introduction to Financial Statement Analysis and the Statement of Cash Flows,” will be the most noticed feature of this eighth edition. This all-new chapter provides an early and user-oriented introduction to both of these crucial topics. Also, this chapter serves as the foundation for increased emphasis of these topics throughout the text.

Following Chapter 7 is a new Comprehensive Problem involving the analysis of an actual annual report.

Chapter 8, “Financial Assets,” has been revised to better address the issues of both asset valuation and efficient asset management. And, of course, the chapter includes up-to-date coverage of *mark-to-market*.

Chapter 10, “Plant Assets and Depreciation,” emphasizes the depreciation methods that businesses *use most*—straight-line, declining balance, and MACRS. The chapter also introduces the concept of an asset’s *tax basis*—something that every business student should understand.

Our coverage of liabilities in **Chapter 11** differs substantially from past editions—and most accounting textbooks. For too long, coverage of this vital topic has centered upon the mechanics of amortizing bond discounts and premiums. But very few businesses ever issue bonds at a premium—and discounts generally are immaterial in dollar amount. Our liabilities chapter now focuses upon topics of greater importance in today’s business world, such as postretirement costs, present value, and the evaluation of credit risk.

SUPPLEMENTARY MATERIALS

This text is accompanied by a large number of supplementary learning and teaching aids. These supplements are described below, with emphasis upon the features new to this eighth edition.

For the Student:

- 1. Self-Study Guide.** The *Study Guide* enables students to measure their progress by immediate feedback. It includes a summary of the highlights of each chapter, and an abundance of objective questions and short exercises. Answers to all questions and exercises are provided immediately after each chapter. As an additional study aid, the reasoning behind the answer to each true-false and multiple-choice question is explained in detail.
- 2. Accounting Work Sheets.** This soft-cover booklet provides the appropriate type of columnar paper for each Problem and Comprehensive Problem in the text. These working papers provide students with guidance in setting-up their solution. In addition, problem headings and “given” data already are filled in to save students much of the copying and “pencil-pushing” otherwise inherent in some assignments. (Partially completed working papers are *not* provided for the Discussion Questions, Exercises, or Cases and Unstructured Problems. These categories of assignment material may be answered on ordinary notebook paper or by using a word processor.)
- 3. FAST (Financial Accounting Systems using Technology)** by Dilip D. Kare and Jeffrey E. Michelman. Using this software, students will be able to solve

exercises and problems from the text. This modern and user-friendly software runs directly from DOS on any IBM compatible computer. Available in IBM 3.5- and 5 1/4-inch formats.

4. **General Ledger Software** by Dilip D. Kare. This user-friendly general ledger software enables student to work many of the problems in the text. This software runs directly from DOS on any IBM compatible computer. Available in IBM 3.5- and 5 1/4-inch formats.
5. **McGraw-Hill Financial Statement Analysis for Accounting.** This accounting software program offers financial data from Standard & Poor's Compustat Services on 200 firms, along with a set of computerized financial accounting tools that enable users to make various comparisons among these items. The database consists of actual financial data for a 5-year period and selected portions of the annual report or 10k for 50 of the companies.

For the Instructor:

1. **Solutions Manual.** A comprehensive manual containing solutions to all Discussion Questions, Exercises, Problems, Cases and Unstructured Problems, and Comprehensive Problems. All assignment material and the solutions were developed by the authors of the text.

To assist faculty in selecting the most appropriate assignments, tables are provided in each chapter indicating the topical content and pedagogical nature of each assignment.

2. **Overhead Transparencies.** A complete set of acetates containing the solutions to all of the Exercises and Problems.
3. **Test Bank.** With an abundance of objective questions and short exercises, this supplement is a valuable resource for instructors who prepare their own quizzes and examinations. It is one of the largest test banks ever to accompany a financial accounting textbook. Other features include four **10-Minute Quizzes** and several short **essay questions** for each chapter.

Available as a printed manual or in computer-based formats (**RHTest** for IBM, and **MicroTest** for Macintosh). The *computerized test banks* may be edited and expanded.

4. **Achievement Tests and Comprehensive Examinations** (two parallel sets). Each set consists of three Achievement Tests, each covering four chapters, and a Comprehensive Examination covering all 15 chapters. (Appendixes and **Supplemental Topics* are not covered in Achievement Tests or Comprehensive Examinations. However, examination material on these topics is provided in the *Test Bank*.)
5. **Instructor's Guide** by David J. Marcinko. This guide includes for each chapter and appendix in the text:
 - a. A brief topical outline indicating the topics to discuss in class.
 - b. An assignment guide, providing at a glance the topical content of each Exercise, Problem, and Case.
 - c. Comments and observations concerning the chapter content, methods of presentation, and usefulness of specific assignment material. In addition, the *Instructor's Guide* includes many "real-world" examples not found in the text, sample assignment schedules, suggestions for using each element of the supplemental package, and solutions to the *Achievement Tests and Comprehensive Examinations*.
6. **Visual Classroom Displays.** A set of teaching transparencies also are available in the conventional acetate form.

7. Accounting Case Videotapes. This video package consists of eight vignettes covering various accounting topics. A correlation chart in the accompanying *Critical Thinking Guide* coordinates the various topics with the text chapters. The *Critical Thinking Guide* by Mark S. Bettner provides for each vignette: a brief summary, the key concepts and topics, suggested homework assignments, student handouts, small group activities, discussion questions, and teaching notes.

CONTRIBUTIONS BY OTHERS

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We want to thank Mark S. Bettner, Dilip D. Kare, David J. Marcinko, and Jeffrey E. Michelman, each of whom has authored elements of our supplemental package.

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The assistance of Margot Berg and Jill Baumgarten was invaluable in the preparation of the manuscript for the supplementary materials.

A NOTE TO STUDENTS: SOME GUIDELINES FOR CONDUCTING INTERVIEWS

Several of our Cases and Unstructured Problems call for you—or a member of your study group—to interview people in the business community. We ask you to appreciate that business people granting these interviews are donating their time for your benefit. For this reason, we ask that you observe a few basic guidelines:

- Please make an appointment for the interview, don't just walk in expecting to talk to someone. And be on time—recognize that time is a very valuable commodity in the business world.

- Dress appropriately and conduct yourself in a business-like manner.
- Learn the name of the person you will be interviewing, including the correct spelling and pronunciation, and his or her position within the organization.
- Plan and write down ***in advance*** all of the questions you plan to ask.
- Take notes during the interview. You should never attempt to quote the person's statements from memory.
- Realize that business people may not want certain information about their business "spread around town." Tell them ***in advance*** that the general content of the interview will be discussed within your study group and, perhaps, in your classroom. Respect any requests that specific comments be kept "off-the-record."

WE'D LIKE TO HEAR FROM YOU

We welcome questions, comments, suggestions, and criticism. You can reach us at:

PO Box 400, Solana Beach, California 92075

We won't "do your homework," but we are happy to answer questions about the assignment material.¹

The basic purpose of accounting is to provide decision makers with useful information. *Drop us a line and let us know how the first accounting course might be made more useful.*

Sincerely,

Robert F. Meigs
Walter B. Meigs
Mary A. Meigs

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