

LARSON ■ WILD ■ CHIAPPETTA



F A P 15  
EDITION

FUNDAMENTAL ACCOUNTING PRINCIPLES



# Fundamental Accounting Principles

Fifteenth Edition

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 **Irwin  
McGraw-Hill**

Boston Burr Ridge, IL Dubuque, IA Madison, WI  
New York San Francisco St. Louis  
Bangkok Bogotá Caracas Lisbon London Madrid Mexico City  
Milan New Delhi Seoul Singapore Sydney Taipei Toronto

## To the Instructor

Changes in accounting education have led to the most significant revision in the history of **Fundamental Accounting Principles**. The call for change in introductory accounting is upon us, and we responded. This fifteenth edition gives you more flexibility and options for innovation than preceding editions. At the same time, it maintains the rich content that has made it a market-leading textbook in accounting principles. See the Preface and its “To the Instructor” comments to learn more about this new and exciting edition and all its supporting materials. We know you will enjoy teaching from this new edition.

## To the Student

Accounting is one of the most valuable subjects you will study. Understanding accounting—the language of business—is essential for business success. **Fundamental Accounting Principles** gives you this understanding. Its content, features, and insights make learning accounting exciting and relevant. Please see the preface’s “To the Student” comments to learn more about this book and how it can help you achieve success. Described in the preface are many student supplements that will help you succeed. We are confident you will find this book relevant and fun.



To my wife **Nancy**.

To my wife **Gail** and children, **Kimberly, Jonathan, Stephanie, and Trevor**.

To my husband **Bob**, my sons **Michael** and **David**, and my **mother**.

**McGraw-Hill**



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FUNDAMENTAL ACCOUNTING PRINCIPLES

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This book is printed on acid-free paper.

International 2 3 4 5 6 7 8 9 0 VNH/VNH 9 3 2 1 0  
Domestic 5 6 7 8 9 0 VNH/VNH 9 3 2 1

ISBN 0-256-25534-2  
ISBN 0-07-366125-2  
ISBN 0-07-366126-0  
ISBN 0-07-366127-9  
ISBN 0-07-365857-X  
ISBN 0-07-365858-8  
ISBN 0-07-030722-9  
ISBN 0-07-030723-7  
ISBN 0-07-366315-8

Vice president and editorial director: *Michael W. Junior*

Publisher: *Jeffrey J. Shelstad*

Developmental editor: *Tracey Klein Douglas/Jackie Scruggs/Burrston House*

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Production supervisor: *Lori Koettters*

Interior Designer: *Ellen Pentengell*

Cover Design: *Z Graphics*

Cover photos: *Front image: © Tony Stone Images, Chris Specdic;*

*Back image: Tony Stone Images, David Madison*

Senior photo research coordinator: *Keri Johnson*

Supplement coordinator: *Rose Hepburn*

Compositor: *York Graphic Services, Inc.*

Typeface: *10.5/12 Times Roman*

Printer: *Von Hoffmann Press, Inc.*

INTERNATIONAL EDITION

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The International Edition is not available in North America.

When ordering the title, use ISBN 0-07-115818-9

<http://www.mhhe.com>





# About the Authors

*A progressive new authoring team further establishes F.A.P.'s market leadership . . .*



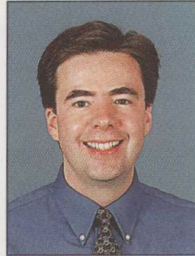
## **Kermit D. Larson**

**Kermit D. Larson** is the Arthur Andersen & Co. Alumni Professor of Accounting Emeritus at the University of Texas at Austin. He served as chairman of

the University of Texas, Department of Accounting and was visiting associate professor at Tulane University. His scholarly articles have been published in a variety of journals, including *The Accounting Review*, *Journal of Accountancy*, and *Abacus*. He is the author of several books, including *Financial Accounting* and *Fundamentals of Financial and Managerial Accounting*, both published by Irwin/McGraw-Hill.

Professor Larson is a member of the American Accounting Association, the Texas Society of CPAs, and the American Institute of CPAs. His positions with the AAA have included vice president, southwest regional vice president, and chairperson of several committees, including the Committee of Concepts and Standards. He was a member of the committee that planned the first AAA doctoral consortium and served as its director.

Professor Larson served as president of the Richard D. Irwin Foundation. He also served on the Accounting Accreditation Committee and on the Accounting Standards Committee of the AACSB. He was a member of the Constitutional Drafting Committee of the Federation of Schools of Accountancy and a member of the Commission on Professional Accounting Education. He has been an expert witness on cases involving mergers, antitrust litigation, consolidation criteria, franchise taxes, and expropriation of assets by foreign governments. Professor Larson served on the Board of Directors and Executive Committee of Tekcon, Inc., and on the National Accountants Advisory Board of Safe-Guard Business Systems. In his leisure time, he enjoys skiing and is an avid sailor and golfer.



## **John J. Wild**

**John J. Wild** is a professor of business and the Vilas Research Scholar at the University of Wisconsin at Madison. He has previously held appointments at Michigan State University and the University of Manchester in England. He received his BBA, MS, and PhD from the University of Wisconsin.

Professor Wild teaches courses at both the undergraduate and graduate levels. He has received the Mable W. Chipman Excellence-in-Teaching Award and the departmental Excellence-in-Teaching Award at the University of Wisconsin. He also received the Beta Alpha Psi and Roland F. Salmonson Excellence-in-Teaching Award from Michigan State University. Professor Wild is a past KPMG Peat Marwick National Fellow and is a recipient of fellowships from the American Accounting Association and the Ernst and Young Foundation.

Professor Wild is an active member of the American Accounting Association and its sections. He has served on several committees of these organizations, including the Outstanding Accounting Educator Award, National Program Advisory, Publications, and Research Committees. Professor Wild is author of *Financial Statement Analysis* published by Irwin/McGraw-Hill. His research appears in *The Accounting Review*, *Journal of Accounting Research*, *Journal of Accounting and Economics*, *Contemporary Accounting Research*, *Journal of Accounting, Auditing and Finance*, *Journal of Accounting and Public Policy*, and other business periodicals. He is associate editor of *Contemporary Accounting Research* and has served on several editorial boards including *The Accounting Review*.

Professor Wild, his wife, and four children enjoy travel, music, sports, and community activities.



## **Barbara Chiappetta**

**Barbara Chiappetta** received her BBA in Accountancy and MS in Education from Hofstra University and is a tenured full professor

at Nassau Community College. For the past 17 years, she has been an active executive board member of the Teachers of Accounting at Two-Year Colleges (TACTYC), serving 10 years as vice president and currently as president since the fall of 1993. As an active member of the American Accounting Association, she has served on the Northeast Regional Steering Committee, chaired the Curriculum Revision Committee of the Two-Year Section, and participated in numerous national committees.

In April 1998, Professor Chiappetta was inducted into the American Accounting Association Hall of Fame for the Northeast Region. She received the Nassau Community College dean of instruction's Faculty Distinguished Achievement Award in the spring of 1995. Professor Chiappetta was honored with the State University of New York Chancellor's Award for Teaching Excellence in 1997. As a confirmed believer in the benefits of the active learning pedagogy, Professor Chiappetta has authored *Student Learning Tools*, an active learning workbook for a first-year accounting course, published by Irwin/McGraw-Hill.

In her leisure time, Professor Chiappetta enjoys tennis and participates on a U.S.T.A. team. She also enjoys the challenge of bridge. Her husband, Robert, is an entrepreneur in the leisure sport industry. She has two sons — Michael, a lawyer, currently manages David's rock band called Blindman's Sun.





# About the Contributors

An expert set of contributors complements the authors' rich experiences and success . . .

## Jo Lynne Koehn

**Jo Lynne Koehn** received her PhD and Master's of Accountancy from the University of Wisconsin at Madison and is an associate professor at Central Missouri State University. Her scholarly articles have been published in a variety of journals including *The CPA Journal*, *Accounting Enquiries*, and *The MSCPA casebook*. Professor Koehn is a member of the American Accounting Association and the American Institute of CPAs. She also holds a Certified Financial Planning license and is active in developing a financial planning curriculum at Central Missouri State University. In the spring of 1997, she received the Faculty Excellence in Teaching Award from the Harmon College of Business Administration's Advisory Board. In her leisure time, Professor Koehn indulges her passion for golf and participates in the Executive Women's Golf Association of Kansas City. Professor Koehn also enjoys reading, traveling, and visiting bookstores.

## Suresh Kalagnanam

**Suresh Kalagnanam** is an associate professor of accounting at the University of Saskatchewan in Canada. He received his B.Eng. from the University of Madras, MBA from Gujarat

University (both in India), MBA and MSc in Accounting from the University of Saskatchewan, and PhD from the University of Wisconsin at Madison. His scholarly articles have been published in *Accounting, Organizations and Society*, *The Journal of Cost Management*, and *Management Accounting*. He has also written a teaching case which has been published by the Institute of Management Accountants. Dr. Kalagnanam is a member of the American Accounting Association, American Society for Quality, Canadian Academic Accounting Association, and the Institute of Management Accountants, and is an associate member of the Society of Management Accountants of Saskatchewan. Dr. Kalagnanam has two children, Pallavi and Siddharth. His wife, Viji, is a homemaker and a part-time university student.

## Thomas L. Zeller

**Thomas L. Zeller** is associate professor of accountancy and university scholar/teacher in the Department of Accounting at Loyola University, Chicago. He received his Doctor of Philosophy from Kent State University. He has published numerous articles addressing managerial accounting, financial statement analysis, and health care financial measurement issues. His research has appeared in several

journals, including *Business Horizons*, *Health-care Financial Management*, *Journal of Accounting and Public Policy*, *Business and Economic Review*, and *Journal of Applied Business Research*. Dr. Zeller is a member of the American Accounting Association and the American Institute of Certified Public Accountants.

## Carol Yacht

**Carol Yacht** received her MA in business and Economic Education from California State University, Los Angeles and BS in Business Education from the University of New Mexico. She is the author of Irwin/McGraw-Hill's *Computer Accounting with Peachtree for Microsoft Windows* books, and is a recognized expert in payroll accounting and reporting. She has worked as an educational consultant for IBM Corporation, an accounting instructor at Yavapai College, and a business education department chair at Beverly Hills High School in California. She chairs the Distance Learning Committee of the Computer Education Task Force, National Business Education Association. Professor Yacht's son, Matthew, is completing his accounting degree at Northern Arizona University. Her husband, Brice Wood, is an artist and part owner of a fine arts gallery. She is active in community activities and chairs the Planning and Zoning Commission of her town.



# Preface

## Let's Talk

Through extensive market-based surveys, focus groups, reviews, and personal correspondence with instructors and students, we discovered several interests and needs in accounting education today. In a nutshell, these desires can be grouped into eight pedagogical areas: (1) motivation, (2) organization, (3) preparation, analysis, and use; (4) ethics, (5) technology, (6) real world; (7) active learning, and (8) flexibility. Our main goal in this edition of *Fundamental Accounting Principles (F.A.P.)* is to address these needs and create the most contemporary, exciting, relevant, and flexible principles book in the market. A quick summary of these areas follows.

**Motivation.** Motivation drives learning. From the chapter's opening article and its focus on young entrepreneurs to the decision-making prompted by *You Make the Call*, **F.A.P.** motivates readers. It brings accounting and business to life and demonstrates that this material can make a difference in your life.

**Organization.** Organization serves the learning process, and **F.A.P.**'s outstanding organization aids that process. From "Chapter Linkages" and learning objectives organized by the *CAP Model*<sup>™</sup> to its chapter outline and Flashbacks, **F.A.P.** is the leader in lending readers a helping hand in learning about accounting and business.

**Preparation, Analysis, and Use.** Accounting involves preparing, analyzing, and using information. **F.A.P.** balances each of these important roles in explaining and illustrating topics. From the unique *Using the Information* section to the creative *Hitting the Road* projects, **F.A.P.** shows all aspects of accounting.

**Ethics.** Ethics is fundamental to accounting. **F.A.P.** highlights the roles of ethics and social responsibility in modern businesses. From the *Judgment and Ethics* decision-making feature to its *Ethics Challenge* assignments, **F.A.P.** alerts readers to relevant and important ethical concerns.

**Technology.** Technology continues to change business and accounting, creating new and exciting accounting opportunities. **F.A.P.** is the leader in applying and showing technology in accounting. From the innovative *Taking It to the Net* projects to its Web-based assignments, **F.A.P.** pushes the accounting frontiers.

**Real World.** Accounting is important to the information age. From features and assignments that highlight companies like NIKE, Reebok, and America Online to the *Teamwork in Action* and *Communication in Practice* activities, **F.A.P.** shows accounting in a modern, global context. It also engages both accountants and nonaccountants. From the exciting *Did You Know?* features to its *Business Week Activities*, **F.A.P.** shows accounting is relevant to everyone.

**Active Learning.** Active learning implies active inquiry and interaction. **F.A.P.**'s instructor's edition (*F.A.S.T.*) gives new annotated links to pedagogical materials for those interested in applying active learning activities. **F.A.P.** is the undisputed leader in offering a strong pedagogical support package for active learning. Also, the *MHLA* service is a new, special addition to our support package.

**Flexibility.** Accounting involves conceptual, analytical, and procedural aspects. **F.A.P.** offers a new *CAP Model* to help choose the preferred teaching or learning approach. The *CAP Model* establishes color-coded learning objectives as either Conceptual, Analytical, or Procedural, and assigns them to chapter content, assignments, and test items. This gives maximum flexibility and choice in teaching and learning structure.

This is just a sneak preview of **F.A.P.**'s new and exciting features. From communication, interpersonal, and critical thinking skills to the development of ethical and global awareness, **F.A.P.** is the leader. We invite you to take a complete look at these and other special features in the remainder of this preface to see why **F.A.P.** is the *first choice* in accounting principles books.



## To Instructor

**F.A.P.** gives Web addresses for current follow-ups to articles, excerpts, and financial statements, and for a real world flavor.

## To Student

The chapter's opening article and its *You Make the Call* features drive home the relevance of accounting and business.

## Motivation

Motivation is a main goal of **F.A.P.** We know information retention is selective—if it doesn't apply to the lives of readers, they typically aren't motivated to learn. **F.A.P.** explains and illustrates how accounting applies to the reader. Here is a sampling of materials that motivates the reader.

The **Chapter Opening Article** sets the stage and shows how the chapter's contents are relevant to the reader. Articles often focus on young entrepreneurs in business who benefit from preparing, analyzing, and using accounting information. These articles bring the material to life in concrete terms.

### Tax Cop



DETROIT, MI—Carmen Benish and her two comrades jump out of their battered Zhiguli and walk briskly to the door of a bicycle sales and services shop in the Moscow suburb of Podolsk. Ducking under bicycle frames hanging from the ceiling, they approach a salesclerk and flash their badges. A few days earlier, an undercover colleague made a purchase that wasn't reported. Benish, Mikail Nikolas, and Val Yaroslav are investigating whether the business is underreporting sales to avoid paying

**You Make the Call** features develop critical thinking and decision-making skills by requiring decisions using accounting information. Each chapter contains two to four of these features. They are purposely chosen to reflect different kinds of users. Examples are investors, consultants, programmers, financial planners, engineers, appraisers, and political and community activists. Guidance answers are provided.

#### Entrepreneur

You are the owner of a small retail store. You are considering allowing customers to purchase merchandise using credit cards. Until now, your store only accepted cash and checks. What form of analysis do you use to make this decision?

You Make the Call

**Company Excerpts** call attention to well-known organizations to illustrate accounting topics. These excerpts are often accompanied by a photo drawing attention to the nature of the business and its relevance to readers.

Sales are generally recorded by the Corporation when products are shipped to independent dealers.

General Motors

#### NIKE, INC. CONSOLIDATED STATEMENT OF INCOME

(in thousands, except per share data)

YEAR ENDED MAY 31,	1981	1981	1981
Revenues	\$9,186,539	\$6,470,625	\$4,760,834
Costs and expenses:			
Costs of sales	5,502,993	3,906,746	2,865,280
Selling and administrative	2,303,704	1,588,612	1,209,760
Interest expense (Notes 4 and 5)	52,343	39,498	24,208
Other income/expense, net (Notes 1, 9 and 10)	32,277	36,679	11,722

**Financial Statements** of familiar companies are used to acquaint readers with the format, content, and use of accounting information. The financial statements for NIKE, Reebok, and America Online are reproduced in the book and referenced often.



## Organization

Organization is crucial to effective learning. If it isn't well-organized or linked with previous knowledge, learning is less effective. **F.A.P.** helps readers organize and link accounting concepts, procedures, and analyses. A **Preview** kicks off each chapter. It introduces the importance and relevance of the materials. It also links these materials to the opening article to further motivate the reader. Here are some additional materials to enhance learning effectiveness.

### A Look Back

Chapter 1 began by considering the role of accounting in the information age. We described accounting for different organizations and identified users and uses of accounting. We saw that ethics and social responsibility are crucial to accounting.

### A Look Ahead

Chapter 3 explains the recording of transactions. We introduce the double-entry accounting system and show how T-accounts are helpful in analyzing transactions. Journals and trial balances are also identified and explained.

## Learning Objectives

### Conceptual

**C1** Identify and explain the content and reporting aims of financial statements.

**C2** Describe differences in financial statements across forms of business organization.

### Analytical

**A1** Analyze business transactions using the accounting equation.

**A2** Compute return on equity and use it to analyze company performance.

### Procedural

**P1** Prepare financial statements from business transactions.

## To Instructor

Use the *CAP Model*<sup>™</sup> and its link to learning objectives to help structure the course and assignment material to your instructional style.

## To Student

Study each of these helpful organizational aids to increase your understanding and learning of accounting and business.

## Flash back

10. Identify seven internal operating functions in organizations.
11. Why are internal controls important?

**Chapter linkages** launch a chapter and establish bridges between prior, current, and upcoming chapters. Linkages greatly assist readers in effectively learning the materials and help them link concepts across topics.

**Learning Objectives** are shown at the beginning of the chapter to help focus and organize the materials. Each objective is repeated in the chapter at the point it is described and illustrated. Self-contained summaries for learning objectives are provided at the end of the chapter.

A series of **Flashbacks** in the chapter reinforce the immediately preceding materials. Flashbacks allow the reader to momentarily stop and reflect on the topics described. They give immediate feedback on the reader's comprehension before going on to new topics. Answers are provided.

## Chapter Outline

### ► Communicating with Financial Statements

- Previewing Financial Statements
- Financial Statements and Forms of Organization

### ► Transactions and the Accounting Equation

- Transaction Analysis—Part I
- Transaction Analysis—Part II
- Summary of Transactions

A color-coded **Chapter Outline** is provided for the chapter. This gives a mental and visual framework to help readers learn the material.



## To Instructor

A focus on *Using the Information* section is a great way to develop analytical thinking.

## To Student

Learning accounting principles greatly increases your understanding of articles such as those in *Business Week*—the world's best-selling business magazine.

## Preparation, Analysis, and Use

Accounting is a service focused on preparing, analyzing, and using information. **F.A.P.** presents a balanced approach to these three crucial aspects of accounting. The preparation aspect of **F.A.P.** is well established and highly regarded. A new and progressive emphasis on analysis and use continues to put **F.A.P.** on the frontier of practice. Here's a sampling of new or revised textual materials on analysis and use:

The **Accounting Equation** (Assets = Liabilities + Equity) is used as a tool to evaluate each journal entry. The accounting equation is especially useful in learning and understanding the impacts of business transactions and events on financial statements. **F.A.P.** is a pioneer in showing this additional analysis tool.

Aug. 31	Cash .....	6,300		
	Sales .....		6,000	
	Sales Taxes Payable (\$6,000 × 0.05) .....		300	
	To record cash sales and 5% sales tax.			
				Assets = Liabilities + Equity
				+6,300    +300    +6,000

The **Using the Information** section wraps up each chapter and emphasizes critical-thinking and decision-making skills. Each section introduces one or more tools of analysis. It applies these tools to actual companies and interprets the results. The section often focuses on use of ratio analyses to study and compare the performance and financial condition of competitors.

### Return on Investment

We introduced return on investment in assessing return and risk earlier in the chapter. Return on investment is also useful in evaluating management, analyzing and forecasting profits, and planning future activities. **Dell Computer** has its marketing department compute return on investment for *every* mailing. "We spent 15 months educating people about return on invested capital," says Dell's Chief Financial Offi-

### USING THE INFORMATION

**A4** Compute and interpret return on investment.

**Hitting the Road** is a unique addition to the chapter's assignment material. This activity requires readers to work outside the book and often requires application of interpersonal and communication skills. Tasks range from visits to local merchandisers and Social Security headquarters to conducting phone interviews and Web searches. These activities help readers understand and appreciate the relevance of accounting.

### Hitting the Road

**C2**

Select a company in your community that you can visit in person or interview on the telephone. Call ahead to the company to arrange a time when you can interview an employee (often an accountant) who helps prepare the annual financial statements for the company. During the interview inquire about the following aspects of the company's accounting cycle:

A **Business Week Activity** requires the reader to apply the chapter's material to read and interpret a *Business Week* article. It also aids in developing reading comprehension skills and gives exposure to business happenings. Students can purchase **F.A.P.** with a special *Business Week* subscription package.

Read the article "Michael Dell: Whirlwind on the Web" in the April 7, 1997, issue of *Business Week*. Answer the following questions:

1. How many days of sales does Dell have in inventory?
2. How does Dell's days of sales in inventory compare with one of its chief competitors?

### Business Week Activity

**A3**



## Ethics

Ethics is the most fundamental accounting principle. Without ethics, information and accounting cease to be useful. **F.A.P.** is the leader in bringing ethics into accounting and demonstrating its importance. From the first chapter's opening article to the ethics codes at the end of the book, **F.A.P.** sets the standard in emphasizing ethical behavior and its consequences. Here's a sampling of how we sensitize readers to ethical concerns and decision making:

The **Judgment and Ethics** feature requires readers to make accounting and business decisions with ethical consequences. It uses role-playing to show the interaction of judgment and ethics, the need for ethical awareness, and the impact of ethics. Guidance answers are provided.

### To Instructor

The *Judgment and Ethics* feature raises the role of ethics in accounting and develops critical thinking skills.

### To Student

Use these features and book materials to remind us that accounting and business decisions affect peoples' lives.

#### Judgment and Ethics

##### Certified Public Accountant

You are a CPA consulting with a client. This client's business has grown to the point where its accounting system must be updated to handle both the volume of transactions and management's needs for information. Your client requests your advice in purchasing new software for its accounting system. You have been offered a 10% commission by a software company for each purchase of its system by one of your clients. Do you think your evaluation of software is affected by this commission arrangement? Do you think this commission arrangement is appropriate? Do you tell your client about the commission arrangement before making a recommendation?

A new **Ethics Challenge** is provided in the *Beyond the Numbers* section. It confronts ethical concerns based on material from the chapter. Many of these challenges involve actions where the ethical path is blurred.

#### Ethics Challenge P2

Randy Meyer is the chief executive officer of a medium-size company in Wichita, Kansas. Several years ago Randy persuaded the board of directors of his company to base a percent of his compensation on the net income the company earns each year. Each December, Randy estimates year-end financial figures in anticipation of the bonus he will receive. If the bonus is not as high as he would like he offers several accounting recommendations to his controller for year-end adjustments. One of his favorite recommendations is for the controller to reduce the estimate of doubtful accounts. Randy has used this

**Social Responsibility** is a major emphasis of progressive organizations. **F.A.P.** is unique in introducing this important topic in Chapter 1. We describe social responsibility and accounting's role in both reporting on and assessing its impact. **F.A.P.** also introduces social audits and reports on social responsibility.

#### Did You Know?

##### In Pursuit of Profit

How far can companies go in pursuing profits? **Converse** proposed to name a new footwear product Run N' Gun. This sparked debate on ethics, social responsibility, and profits. Converse says Run N' Gun is a basketball and football team. Critics claim it invites youth violence and links with the gun culture. To the credit of Converse, it changed the name from Run N' Gun to Run N' Slam prior to its sale to consumers.





## To Instructor

PowerPoint presentation slides can be customized for your instructional style and are great visual aids to lecture materials.

## To Student

Use **F.A.P.'s Home Page** for current updates, hot links to important sites, and much more ...

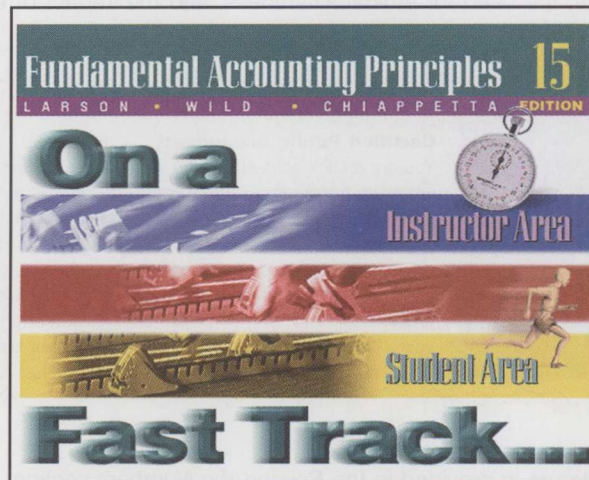


A **Student Software CD** provides several technology-assisted educational activities. These include (1) *Essentials*—reviewing the entire accounting cycle, (2) *PeachTree Templates*—uses leading software for accounting support, (3) *Tutorial*—interactive review of topics, and (4) *GLAS* and (5) *SPATS*—instructional software to solve problems.

## Technology

Technology and innovation can be exciting and fun. **F.A.P.** makes the transition to new technologies easy. It is the leader in demonstrating the relevance of technology and showing readers how to use it. Here's a sampling of items pushing the technology frontier:

**F.A.P.'s Home Page**, [www.mhhe.com/business/accounting/fap](http://www.mhhe.com/business/accounting/fap), is the starting point for accessing accounting and business resources on the Web. The book's Web site harnesses technological resources to provide the most up-to-date and powerful Web services available.



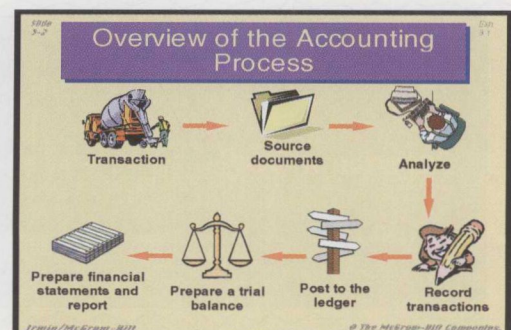
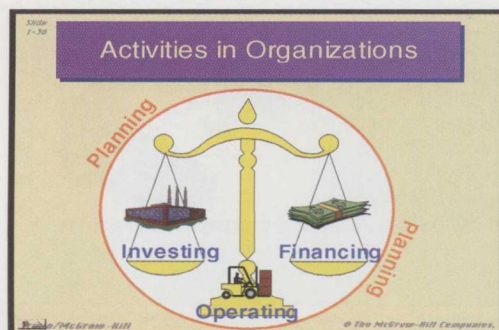
**Taking It to the Net** requires accessing a Web site and obtaining information relevant to the chapter. It aims to make readers comfortable with Web technology, familiar with information available, and aware of the power of Web technology.

### Taking It to the Net C1, A2

Access the **Cannondale** promotional Web site at <http://www.cannondale.com>. Visit several hotlinks on the site to get a feel for the company's products.

1. What is the primary product that Cannondale sells?
2. Review the Cannondale 10K—this is the annual financial data required by the SEC. You can access this from the SEC's Edgar system (see this book's Web page). (Hint: Edgar Web site lists numerous

**PowerPoint® Presentations and Supplements** augment each chapter with colorful graphics, interesting charts, innovative presentations, and interactive activities. The PowerPoint® materials are flexible and can be customized for any use.








## Real World

Showing readers that accounting matters is part of an effective learning package. **F.A.P.** is the leader in real world instructional materials. It offers unique assignments challenging the reader to apply knowledge learned in practical and diverse ways. These challenges include analytical problems, research requirements, comparative analysis, teamwork assignments, and communication exercises. They also allow greater emphasis on conceptual, analytical, communication, and interpersonal skills. Here's a sampling of these materials:

### Questions

13. Refer to **NIKE's** financial statements in Appendix A. On May 31, 1997 what percent of NIKE's current assets was represented by inventory? 
14. Refer to **Reebok's** financial statements in Appendix A. Calculate Reebok's cost of goods available for sale as of December 31, 1996. 
15. Refer to **AOL's** financial statements in Appendix A. Why does America Online fail to show inventory as a current asset as of June 30, 1996? 
16. Refer to the **Wired** article at the beginning of the chapter. What does Russo need to know about Wired to be able to calculate gross margin and inventory turnover?

### To Instructor and Student

The **glossary** gives complete and accurate definitions of key terms. A key term is set in bold when first introduced, and the glossary references this page number. It also gives synonyms for key terms.

A **summary** describes the chapter in terms of its learning objectives. It assists in understanding of key concepts, procedures, and analyses.

**Questions** give readers quick feedback on their understanding of key chapter topics.

**Quick studies** are effective checks on concepts, procedures, and analyses. They help build the reader's confidence with the material. Each are keyed to usually one learning objective.

**Exercises** focus on one or more learning objectives. They are mildly challenging and are an effective way to launch into more challenging problems.

**Check Figures** serve as an aid to readers.

**Reporting in Action** requires analysis and use of NIKE's annual report information. The unique *Swoosh Ahead* feature allows use of the most current information in the marketplace.

### Reporting in Action

A1, A3, A4



NIKE designs, produces, markets, and sells sports footwear and apparel. Key financial figures for NIKE's fiscal year ended May 31, 1997 are:

Key figure	In millions
Financing (liabilities + equity)	\$5,361
Profit	796
Sales	9,187

#### Required

1. What is the total amount of assets invested in NIKE?
2. What is NIKE's return on investment? NIKE's assets at May 31, 1996 equal \$3,952 (in millions).
3. How much are total expenses for NIKE?

*Analysis component:*

4. Does NIKE's return on investment seem satisfactory if competitors average a 5% return?

#### Swoosh Ahead

5. Obtain NIKE's most recent annual report. You can also access NIKE's annual report at its Web site ([www.nike.com](http://www.nike.com)) or at the SEC's Web site ([www.sec.gov](http://www.sec.gov)). Compute NIKE's return on investment using this updated annual report information you obtain. Compare the May 31, 1997, fiscal year-end return on investment to any subsequent years' returns you are able to compute.



**Comparative Analysis** compares the performance and financial condition of NIKE and Reebok using the accounting knowledge obtained from the chapter. These activities help develop analytical skills.

Both **NIKE** and **Reebok** design, produce, market, and sell sports footwear and apparel. Key comparative figures (\$ millions) for these two organizations follow:

Key figures*	NIKE	Reebok
Total liabilities	\$2,205	\$1,405
Total equity	\$3,156	\$ 381

\* NIKE figures are from its annual report for the fiscal year ended May 31, 1997. Reebok figures are from its annual report for the fiscal year ended December 31, 1996.

**Comparative Analysis**

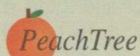
A2



**Comprehensive and Serial Problems** are included in several chapters and focus on multiple learning objectives from multiple chapters. They help integrate and summarize key principles.

**Comprehensive Problem**

**Alpine Company**



Assume it is Monday, May 1, the first business day of the month, and you have just been hired as the accountant for Alpine Corporation, which operates with monthly accounting periods. All of the company's accounting work has been completed through the end of April and its ledgers show April 30 balances. During your first month on the job, you record the following transactions:

- May 1 Issued Check No. 3410 to S&M Management Co. in payment of the May rent, \$3,710. (Use two lines to record the transaction. Charge 80% of the rent to Rent Expense—Selling Space and the balance to Rent Expense—Office Space.)
- 2 Sold merchandise on credit to Essex Company, Invoice No. 8785, \$6,100. (The terms of all credit sales are 2/10, n/30.)
- 2 Issued a \$175 credit memorandum to Nabors, Inc., for defective merchandise sold on April 28 and returned for credit. The total selling price (gross) was \$4,725.

**Problems** often cover multiple learning objectives and usually require preparing, analyzing, and using information. They are paired with **Alternate Problems** (at the end of the book) for further review of the same topics. Problems are supported with software and other technology options. Many include an **Analytical Component** focusing on financial statement consequences and interpretations.

**Problem 7-3<sup>A</sup>**

Income comparisons and cost flows—periodic

A1, P4

Green Jeans, Inc., sold 5,500 units of its product at \$45 per unit during 1999, and incurred operating expenses of \$6 per unit in selling the units. It began the year with 600 units and made successive purchases of the product as follows:

January 1 (beginning inventory) . . .	600 units @ \$18 per unit
Purchases:	
February 20 . . . . .	1,500 units @ \$19 per unit
May 16 . . . . .	700 units @ \$20 per unit
October 3 . . . . .	400 units @ \$21 per unit
December 11 . . . . .	3,300 units @ \$22 per unit
	6,500 units

**Required**

*Preparation Component*

- 1. Prepare a comparative income statement for the company, showing in adjacent columns the net incomes earned from the sale of the product, assuming the company uses a periodic inventory system and prices its ending inventory on the basis of: (a) FIFO, (b) LIFO, and (c) weighted average. Assume an income tax rate of 30%.

**Check Figure** Net income (LIFO), \$69,020



A **Demonstration Problem** is at the end of the chapter. It illustrates important topics and shows how to apply concepts in preparing, analyzing, and using information. A problem-solving strategy helps guide the reader.

On July 14, 1999, Tulsa Company paid \$600,000 to acquire a fully equipped factory. The purchase involved the following assets (we include additional facts related to each):

### Demonstration Problem

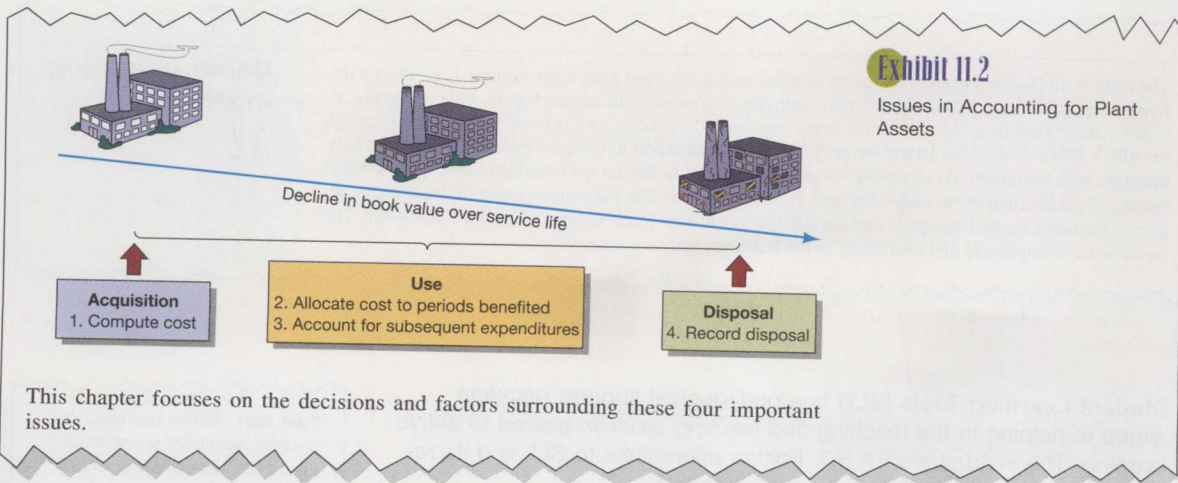
Asset	Appraised Value	Estimated Salvage Value	Estimated Useful Life	Depreciation Method
Land .....	\$160,000			Not depreciated
Land improvements ...	80,000	\$ -0-	10 years	Straight line
Building .....	320,000	100,000	10 years	Double-declining balance
Machinery .....	240,000	20,000	10,000 units	Units of production*
Total .....	<u>\$800,000</u>			

\*The machinery is used to produce 700 units in 1999 and 1,800 units in 2000.

**Required**

1. Allocate the total \$600,000 cost among the separate assets.

**Infographics and Artwork** aid in visual learning of key accounting and business topics. Photos, color, highlighting, and authentic documents all help with visual learning.





## To Instructor

Teamwork in Action and Communicating in Practice are excellent starting points in developing an active learning environment. Both develop communication and interpersonal skills.

## To Student

Team-building, collaborative effort skills are usually crucial to career success.

## Active Learning

Active learning requires effective assignments. **F.A.P.** is the student-proven and instructor-tested leader in assignment materials. Proven and thoughtful assignments not only facilitate but motivate effective and active learning. Many assignments include writing components. Here's a sampling of relevant assignment materials:

**Teamwork in Action** assignments require preparing, analyzing, and using information in teams. They can be completed in or outside of class. These active learning activities reinforce understanding of key topics and develop interpersonal skills.

A team will be called upon to personify the operation of a voucher system. Yet all teams must prepare for the potential to be selected by doing the following:

1. Each team is to identify the documents in a voucher system. The team leader will play the voucher, and each team member is to assume "the role" of one or more documents.
2. To prepare for your individual role you are to:
  - a. Find an illustration for the document within the chapter.
  - b. Write down your documents function, where you originate, and how you flow through the voucher system.
3. Rehearse the role playing of operating the system. You may use text illustrations as props, and for visual effect you may wear a nametag identifying the part you play.

### Teamwork in Action

P2

**Communicating in Practice** exercises aim at applying accounting knowledge to develop written and verbal communication skills.

The class is divided into teams. Teams are to select an industry, and each team member is to select a different company in that industry. Each team member is to acquire the annual report of the company selected. Annual reports can be obtained in many ways including accessing this book's Web page or through the SEC's EDGAR database [[www.sec.gov](http://www.sec.gov)]. Use the annual report to compute total asset turnover. Communicate with teammates via a meeting, e-mail, or telephone to discuss the meaning of this ratio, how different companies compare to each other, and the industry norm. The team must prepare a single memo reporting the ratios for each company and identify the conclusions reached during the team's discussion. The memo is to be duplicated and distributed to the instructor and all classmates.

### Communicating in Practice

A2

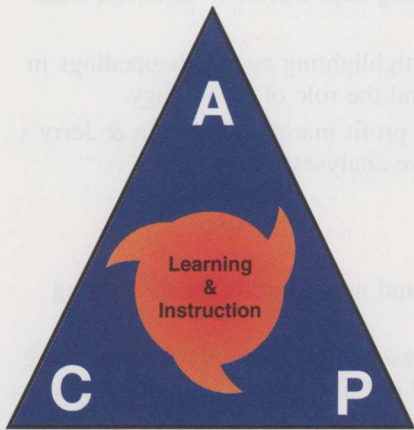
**Student Learning Tools (SLT)** is a pedagogical support package aimed at helping in the teaching and learning process geared to active learning. The instructor's F.A.S.T. Edition offers links to SLT and its related Instructor's Manual (IM) when appropriate.

**Fast Hint Active Learning:** *SLT* provides Activity 29 for introducing plant asset disposals in an active learning environment (see pp. 132–136 in *SLT* and notes in *IM*).



## Flexibility

Learning and instructing requires flexibility. **F.A.P.** offers flexibility in meeting the unique demands of individual students and teachers. From the conventional classroom to the active learning environment, **F.A.P.**'s new edition and its pedagogical package give more flexibility and options for innovation in learning and instruction. It does this while maintaining the rich content that has made it the market-leading book in accounting principles.



### CAP Model

The new **CAP Model**, as already discussed, allows courses to be specially designed to meet instructional and learning needs—whether they be conceptual, analytical, procedural, or some combination of the three. The CAP Model recognizes the strength of each approach. Its identification of learning objectives, textual material, assignments, and test material by **C**, **A**, or **P** provides the flexibility to readily adapt **F.A.P.** to the preferred instructional and learning emphasis. It also allows the instructor to vary the emphasis by topic.

## Packaging Options

Unique **packaging options** support **F.A.P.**'s flexibility. Nobody matches Irwin/McGraw-Hill when it comes to packaging options for accounting principles. Drawing on user feedback, we offer several new options with this edition:

- Hardcover splits—with a special introductory price and exciting packages. This new option is a hit with both instructors and students.
- *Business Week* Editions—The new *Business Week* Edition gives students a 16-week subscription for under \$10! *Business Week* excerpts in the book further peak student interest in both accounting and business.
- F.A.S.T. Edition splits—with a two-volume Instructor's Edition to “lighten the load”. The F.A.S.T. annotations have been revised by Barbara Chiappetta and offer added value.

## To Instructor

**F.A.P.** supports all instructional and learning styles.

Additional Supporting Materials:

*Instructor's Resource Manual*

*Solutions Manual*

*Test Bank*

Transparencies

*Student Learning Tools (SLT) and*

*its Instructor's Manual (IM)*

## To Student

Working Papers, Study Guide, and Ready Notes are helpful in your accounting course.



## Innovations and Enhancements

In preparing this edition, we asked questions of instructors and students. We asked what topics to add, delete, or change in emphasis. We asked what pedagogical aids would help in teaching and learning. We wanted to know what innovations and enhancements would help instructors and maintain **F.A.P.** leadership in accounting principles. From these questions came several requests. We listened, and this edition is the result. We've already described major content and pedagogical changes. This section identifies many other chapter-by-chapter innovations and enhancements:

### Chapter 1

- New focus on the information age and the relevance of accounting.
- Early introduction to income, revenues, and expenses using Nike.
- New discussion of return and risk as part of all business decisions.
- New introduction to the Web with reference to **F.A.P.**'s homepage.
- New description of business activities: financing, investing, and operating.
- New and unique presentation of ethics and social responsibility.

### Chapter 2

- **FASTForward**, an athletic service company, introduced as the new focus company for Chapters 2–5.
- New company transactions to add realism and interest.
- Revised discussion and presentation of accounting principles.
- Added analysis of each transaction using the accounting equation.
- New presentation and integration of cash flow statement with other financial statements.
- New description of reporting differences between proprietorships, partnerships, and corporations.

### Chapter 3

- Revised presentation of transactions and source documents.
- New exhibits on the accounting equation and double-entry accounting.
- New exhibits and discussion linking transactions to financial statements, including the statement of cash flows.
- Revised discussion and exhibits for recording transactions.
- Expanded discussion of debt ratio with new comparative analyses.

### Chapter 4

- New discussion of the accounting period and the motivation for adjusting accounts.
- New framework for preparing and analyzing adjustments.
- Several new exhibits and graphics illustrating adjusting accounts.

- New presentation linking adjustments to financial statements.
- Several new features highlighting current happenings in revenue recognition and the role of technology.
- Revised discussion of profit margin using Ben & Jerry's along with comparative analyses.

### Chapter 5

- Revised presentation and new exhibits for the closing process.
- New contemporary presentation of the work sheet using Excel<sup>®</sup>. [*A traditional acetate overlay presentation is available in full color teaching transparencies. PowerPoint slides mimic the overlay.*]
- Revised presentation and discussion of the statement of cash flows as an integral part of the full set of financial statements.
- New exhibits presenting the accounting cycle.
- New presentation of the classified balance sheet.
- Revised current ratio discussion using Harley-Davidson and industry analyses.

### Chapter 6

- New discussion comparing a service company and a merchandiser.
- New presentation of the operating cycle of a merchandiser with credit or cash sales.
- New design of source documents including an invoice and debit and credit memoranda.
- Revised presentation of merchandising sales and purchases using the perpetual inventory system.
- Revised discussion on the transfer of ownership for inventory.
- New discussion and presentation of merchandising cost flows across periods.
- New comparison of cash and accrual measures of sales and costs.
- Revised acid-test ratio and gross margin discussion using J.C. Penney and industry analyses.
- New appendix on accounting for merchandising sales and purchases under both the periodic and perpetual inventory systems.