

9TH EDITION

STICKNEY & WEIL

FINANCIAL
ACCOUNTING

FACMU • 25TH ANNIVERSARY

AN INTRODUCTION TO
CONCEPTS, METHODS, AND USES

**NINTH
EDITION**

FINANCIAL ACCOUNTING

AN INTRODUCTION TO CONCEPTS, METHODS, AND USES

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FOR OUR STUDENTS, WITH THANKS

Whatever be the detail with which you cram your students, the chance of their meeting in after-life exactly that detail is infinitesimal; and if they do meet it, they will probably have forgotten what you taught them about it. The really useful training yields a comprehension of a few general principles with a thorough grounding in the way they apply to a variety of concrete details. In subsequent practice the students will have forgotten your particular details; but they will remember by an unconscious common sense how to apply principles to immediate circumstances.

Alfred North Whitehead

The Aims of Education and Other Essays

**FOR LEXIE, LACEY, LAUREN, AND LEIGH,
KATHY AND KATHERINE
WITH THANKS**

The ninth edition of “FACMU” (as we have come to know it) has the same principal objectives as the previous editions:

- To help students develop a sufficient understanding of the basic concepts underlying financial statements so that they can apply the concepts to new and different situations.
- To train students in accounting terminology and methods so that they can interpret, analyze, and evaluate financial statements currently published in corporate annual reports.

Most introductory financial accounting textbooks share these, or similar, objectives. The critical differences among textbooks are the relative emphases on concepts, methods, and uses.

1. Concepts This book emphasizes the rationale for, and implications of, important accounting concepts. To learn accounting, the student must develop the ability to conceptualize the transactions that accounting summarizes and the process of summarization. Without such conceptualization, students will have difficulty focusing on relevant issues in new and different situations.

Accordingly, each chapter begins by identifying important accounting concepts. Several numerical examples illustrating their application then follow. The end-of-chapter material includes numerous short exercises to check the students’ ability to apply the concepts to different problem situations.

2. Methods We place sufficient emphasis on accounting procedures so that students can interpret, analyze, and evaluate published financial statements. The text does not emphasize procedures to such an extent that students become bogged down in detail. All writers of accounting textbooks must decide just how much accounting procedure to include. We believe students will learn most effectively through practice and working the problems and exercises. Too much emphasis on accounting procedures, however, lulls students into the security of thinking they understand accounting concepts when they do not. We have for many years used the mixture of concepts and procedures in this book and have found it effective in the classroom.

Understanding the accounting implications of an event requires that students construct the journal entry for that event. Throughout this book we use journal entries in describing the nature of accounting events. Moreover, most chapters contain exercises and problems that require the analysis of transactions with debits and credits. Do not conclude by a glance at this text, however, that it is primarily procedural. We want students to learn concepts; the procedures enhance the learning of concepts.

3. Uses This book attempts to bridge the gap between the preparation of financial statements and their use in various decision situations. The chapters consider the effects of alternative accounting principles on the measurement of earnings and financial position and the appropriate and inappropriate interpretations of them. Numerous user-oriented problems and cases based on financial statement data of actual companies appear at the end of most chapters.

CHANGES IN THIS EDITION

The ninth edition represents the most significant revision yet of this book. Before describing these changes, we emphasize that we have not changed the basic philosophy of the book as described in the preceding section. We use accounting procedures to cement understanding of accounting concepts so that users of financial statements will make more intelligent interpretations and decisions.

- 1) Reorganization of Chapter Sequence. We have revised the sequence and content of chapters for a more effective conceptual and pedagogical flow. The placement of material in this edition as compared to the eighth edition is as follows:

Current Edition	Previous Edition
Chapter 1: Introduction to Business Activities and Overview of Financial Statements and the Reporting Process	Same
Chapter 2: Balance Sheet: Presenting the Investments and Financing of a Firm	Same
Chapter 3: Income Statement: Reporting the Results of Operating Activities	Chapter 3 plus parts of Chapter 4
Chapter 4: Statement of Cash Flows: Reporting the Effects of Operating, Investing, and Financing Activities on Cash Flows	Chapter 5
Chapter 5: Introduction to Financial Statement Analysis	Chapter 6
Chapter 6: Receivables and Revenue Recognition	Chapters 4 and 7
Chapter 7: Inventories: The Source of Operating Profits	Chapters 4 and 8
Chapter 8: Plant, Equipment, and Intangible Assets: The Source of Operating Capacity	Chapter 9
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Chapter 11: Marketable Securities and Investments	Chapters 7 and 13
Chapter 12: Earnings, Comprehensive Income, and Shareholders' Equity	Chapters 4 and 12
Chapter 13: Statement of Cash Flows: Another Look	Chapter 14
Chapter 14: Significance and Implications of Alternative Accounting Principles	Chapter 15

Our rationales for the principal changes to this edition are:

■ Reorganizing Chapter 4

Chapter 4 of the previous edition extended the accrual concept to manufacturers, long-term contractors, and other types of businesses. We found that students had difficulty grasping these extensions of the accrual concept so early in the course. Our new Chapter 6 includes a comprehensive discussion of revenue recognition and related receivables for various types of businesses. The application of accrual concepts to manufacturers now appears with inventories and cost of goods sold in Chapter 7. Chapter 4 of the eighth edition also included the reporting of non-recurring income

items, which this edition places in Chapter 12 in an expanded discussion of reporting comprehensive income and other income items.

■ Moving Marketable Securities

We have moved coverage of marketable securities from Chapter 7 of the eighth edition to Chapter 11 of this edition. The similar accounting for marketable securities available for sale and investments in securities available for sale suggest their coverage in the same chapter.

■ Sequence of Investments in Securities and Shareholders' Equity

We have switched the sequence of Investments in Securities (now in Chapter 11) and Shareholders' Equity (now in Chapter 12). Chapter 12's discussion of comprehensive income uses unrealized gains and losses on marketable equity securities, now discussed in Chapter 11, to illustrate the required disclosures.

- 2) The concept of the **quality of earnings** now provides a principal means for evaluating alternative accounting principles discussed in Chapters 6 to 12. Chapter 6 describes three avenues firms might use to manage their earnings: selecting their accounting principles, applying their accounting principles, and timing asset acquisitions and dispositions. Subsequent chapters discuss particular accounting principles in light of this quality-of-earnings framework.
- 3) Each chapter incorporates pronouncements of the Financial Accounting Standards Board for reporting in the United States as well as applicable pronouncements of the International Accounting Standards Committee.
- 4) **New to This Edition** We have incorporated in the text brief terminology notes, conceptual notes, or practical notes that enhance understanding of the topic being discussed.
- 5) **New to This Edition** Most chapters now include cases appropriate for MBA and executive programs in addition to many new exercises and problems. Examples of new cases are Computer Needs (case 3.49), Boston Chicken (case 6.36), America Online (case 8.50), Merck (case 12.43), Wendy's (case 12.44), Kellogg's (case 12.45), and Petite-Mart (case 14.19). In addition, this edition includes a revised version of the W.T. Grant case (case 5.33).
- 6) **New to This Edition** Advanced topics now appear on our Web Site for this book located at www.harcourtcollege.com for optional use in your course. Topics on the Web Site include:
 - foreign currency translation,
 - pension benefits,
 - consolidation when a minority interest is present,
 - a balance sheet approach to deferred tax accounting, and
 - general price-level accounting.

Each topic contains reading material and exercises or problems. Instructors desiring to include any of these topics in their courses can direct students to the Web Site to obtain reading and assignment material. Solutions to these exercises and problems are included in the Instructor's Manual. To visit the Web Site, (1) go to www.harcourtcollege.com; (2) go to the pull-down menu for disciplines and select "accounting"; (3) select the icon for *Financial Accounting* by Stickney and Weil; (4) select "Student." There you will find a variety of material we have designed to help you and we expect the amount of material there to grow over time.

- 7) **New to This Edition** The ninth edition is now in full color, designed to stimulate students and increase user friendliness.

ORGANIZATION

This book comprises four major parts:

- Part One: “Overview of Financial Statements,” consisting of Chapter 1.
- Part Two: “Accounting Concepts and Methods,” Chapters 2 through 5.
- Part Three: “Measuring and Reporting Assets and Equities,” Chapters 6 through 13.
- Part Four: “Synthesis,” Chapter 14.

In our view, the four parts are tiers, or steps, in the learning process. Part One presents a general overview of the principal financial statements. Part Two discusses the basic accounting model accountants use to generate the principal financial statements. Part Three considers the specific accounting principles or methods used in preparing the financial statements. Finally, Part Four synthesizes material covered in Chapters 1 to 13. This organization reflects the view that learning takes place most effectively when the student starts with a broad picture, then breaks up that broad picture into smaller pieces until achieving the desired depth, and finally synthesizing so that the relation between the parts and the whole retains its perspective.

Chapter 1 presents a brief description of the principal activities of a business firm (goal setting and strategy formulation, investing, financing, and operating) and shows how the three principal financial statements—the balance sheet, the income statement, and the statement of cash flows—report the results of these activities. Chapter 1 also provides an overview of the financial reporting environment. Many students feel deluged with the multitude of new terms and concepts after reading Chapter 1. However, most of these same students admit later that the broad overview helped piece material together as they later explored individual topics at greater length.

Chapters 2 through 4 present the basic accounting model that generates the three principal financial statements. In each case, the discussion begins with a description of the important concepts underlying each statement. The chapter then describes and illustrates procedures accountants use to generate the financial statements. Each chapter uses the balance sheet equation or changes in the balance sheet equation to motivate understanding of the preparation procedures. Although these chapters emphasize debit/credit procedures, instructors can use the balance sheet equation approach to communicate the basics of statement preparation. Each of these chapters includes one or more simple problems that students can work using the balance sheet approach to prepare the three principal financial statements. Chapter 3, unlike treatments in other texts, integrates the accounting entries for transactions during a period with the related adjusting entries at the end of the period. When textbooks discuss these two types of entries in separate chapters, students often lose sight of the fact that measurement of net income and financial position requires both kinds of entries.

We continue to put coverage of the statement of cash flows early in the text (Chapter 4). This placement serves two purposes. First, it elevates the statement to its rightful place among the three principal financial statements. Students can thereby integrate the concepts of profitability and cash flow more effectively and begin to understand that one does not necessarily accompany the other. Covering this statement at the end of the course (in many cases, when time is running out) can lead students to think the cash flow statement less important. Placing this chapter early in the book forces the student to cement understanding of the basic accounting model from Chapters 2 and 3. Preparing the statement of cash flows requires the student to “work backward” from

the balance sheet and income statement to reconstruct the transactions that took place. This edition includes *two new features* to its coverage of the statement of cash flows:

- 1) emphasis on both the indirect and the direct methods of calculating cash flow from operations
- 2) the use of both the columnar worksheet and the T-account worksheet for preparing the statement.

Chapter 5 describes and illustrates tools for analyzing the financial statements. The discussion structures the various financial statement ratios in a multi-level format that students have found minimizes the need to memorize formulas. Instructors who incorporate annual reports of actual companies throughout their course will find that analysis of the financial statements of such companies at this point in the course serves as an effective synthesis. An appendix to Chapter 5 illustrates procedures for preparing pro forma financial statements. This topic helps cement understanding of the relationship among the three principal financial statements.

Chapters 6 through 12 discuss the various generally accepted accounting principles that accountants use in generating the financial statements. Each chapter not only describes and illustrates the application of the various accounting methods but also considers their effects on the financial statements. This approach reflects the view that students should be able to interpret and analyze published financial statements and to understand the effect of alternative accounting methods on such assessments.

Some of the specific changes to Chapters 6–12 of this edition include:

- an integrated discussion of revenue recognition for various types of businesses along with the related treatment of receivables (Chapter 6),
- asset impairments related to goodwill (Chapter 8),
- constructive liabilities (Chapter 9),
- nature and accounting for derivatives (Chapter 10), and
- comprehensive income (Chapter 12).

Chapter 13 explores the statement of cash flows in greater depth by presenting a comprehensive illustration using transactions discussed in Chapters 6 through 12. Instructors have flexibility in structuring their coverage of the statement of cash flows by covering Chapter 4 early in the course and Chapter 13 at the end of the course or by covering both chapters at the end of the course.

Some students who have used the previous editions of this book report that Chapter 14, which synthesizes much of the material in the first thirteen chapters, is the most useful in the book. This chapter explicitly considers the combined effects of alternative accounting methods on the financial statements. The chapter also summarizes the effect of various accounting principles discussed in earlier chapters on the quality of earnings. The self-study problem and problems 16 and 17 at the end of Chapter 14 provide thorough review for the entire book. Case **14.19** requires students to evaluate the quality of earnings for many of the topics discussed throughout the book.

An appendix to the book describes compound interest and present value computations for students not previously exposed to this topic.

The end of the book includes a comprehensive glossary of accounting terms. It serves as a useful reference tool for accounting and other business terms and provides additional

descriptions of a few topics, such as accounting changes and inventory profit, considered only briefly in the text.

RELATED MATERIALS ACCOMPANYING THE TEXTBOOK

The following supplementary materials are available with the textbook:

Instructor's Manual The instructor's manual presents suggested outlines for courses of varying lengths, a list of chapter objectives, helpful teaching hints, detailed lecture and discussion outlines, including the numbers of particularly germane questions, exercises, problems, and cases.

Solutions Manual The solutions manual provides full solutions for all end-of-chapter and Web site assignment items, including questions, exercises, problems, and cases. We give computations wherever possible, allowing the instructor to show how to reach a particular answer.

Study Guide This study guide, by LeBrone C. Harris and James E. Moon, lists highlights from each chapter and provides numerous short true/false, matching, multiple-choice questions, and exercises, with answers.

Test Bank Prepared by Bobbe Barnes of the University of Colorado, the test bank is thoroughly expanded and revised and now includes multiple-choice items, matching questions, short essay questions, and problems.

Computerized Test Bank All items in the test bank are available in EXAMaster software format for Windows.

Lecture Presentation Software in PowerPoint Sample lectures have been created by Gordon Duke of the University of Minnesota to aid in lecture preparations using this text. Software is available on CD-ROM for a Windows format.

Spreadsheet Template Software At least three problems per chapter have a corresponding template where basic problem data appear on a Microsoft Excel® Spreadsheet to reduce tedium in solving problems and increase student awareness of basic software applications.

Solutions Transparencies Solutions acetates accompany all numerical end-of-chapter exercises, problems, and cases.

Teaching Transparencies A selection of 100 textbook illustrations are available in transparency acetate form.

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