

ACCOUNTING PRINCIPLES

Fifth Edition

Anthony and Reece

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FIFTH EDITION

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Preface

An accounting text can be written with an emphasis on either of two viewpoints: (1) what the user of accounting information needs to know about accounting or (2) what the preparer of accounting reports needs to know about accounting. This book has as its focus the user of accounting information. Of course, such a person needs to know enough about the preparation of accounting reports to be an intelligent user of them, and this text includes the technical material needed for this purpose. The text is aimed primarily, however, at the person who wants to understand accounting so that he or she can be a knowledgeable user of accounting information.

The focus of the book makes it particularly appropriate for required “core” courses in accounting, where many of the students in the course are not planning to take further elective accounting courses. First, we believe that if a core course stresses the more analytical uses of accounting information by managers and outside analysts rather than the procedural details that the practicing accountant needs to know, then those students who do not take further accounting courses will be left with a positive view of the importance of accounting, rather than with the negative “bean counter” stereotype. Second, we feel that a user orientation in the core course is actually likely to generate a greater number of accounting majors from the class than if the course is oriented more toward the person who has already decided to major in accounting.

Similarly, in our experience, the required accounting module in a management development program will generate little participant interest unless the module is oriented toward the nonaccountant user of accounting information. In sum, we think the book conveys the fact that accounting is *interesting and fun*, not dull and tedious.

More specifically, this book is used in at least the following four ways:

1. An introductory course where most (if not all) of the students have no prior training in accounting. In many schools, this introduction comprises two separate courses, one dealing with financial accounting and the other with management accounting. Many schools use this book for both such courses, whereas some use it only for financial accounting (Chapter 1 and Chapters 2–14) or for management accounting (Chapter 1 and Chapters 15–27). This book is used in such introductory courses at both the upper undergraduate level and in graduate programs. In addition to its widespread use in schools of business and management, it is also used in introductory accounting courses in some law schools, education schools, and schools of public health.

2. An elective course that builds on a required introductory course in accounting—particularly where the introductory course had more of a procedural orientation, whereas the elective is intended to be more conceptual, analytical, and user-oriented.

3. The accounting module in a management development program, where the participants represent a variety of functional and technical backgrounds.

4. As a nontechnical accounting reference book for nonaccountants in business and other organizations.

Because the book's use as a reference and in short courses for managers, it does not include questions or problem material. Accordingly, instructors of regular length courses will want to use the text's companion volume, *Accounting Principles Workbook*.¹ The *Workbook* contains key terms, discussion questions, problems, and short cases, as well as a short practice set. The combination of *Accounting Principles* and the *Accounting Principles Workbook* provides the instructor with a comprehensive and flexible instructional package that is not possible within the page limitation of a single volume. Instructors who want to pursue an in-depth case-study approach are referred to *Accounting: Text and Cases*,² which contains the same text material as this book but has over 100 cases bound-in at the ends of its chapters.

Many instructors also assign, or recommend, the programmed text, *Essentials of Accounting*,³ either as preliminary to study of the subject

¹James S. Reece and Robert N. Anthony, *Accounting Principles Workbook*, 6th ed. (Homewood, Ill.: Richard D. Irwin, 1983).

²Robert N. Anthony and James S. Reece, *Accounting: Text and Cases*, 7th ed. (Homewood, Ill.: Richard D. Irwin, 1983).

³Robert N. Anthony, *Essentials of Accounting*, 3d ed. (Reading, Mass.: Addison-Wesley, 1983).

(it is often sent in advance to participants in MBA and management development programs) or as a review device. It is a self-study introductory treatment of financial accounting, geared to Part 1 of this text.

Changes in the Fifth Edition

Developments in accounting, particularly financial accounting, have continued to be rapid in the last four years. These have resulted in many changes in the text, and an overall expansion of Part 1, Financial Accounting. (Part 1 reflects FASB pronouncements through January 1983, as well as the 1981 and 1982 tax acts.) We have also modified Part 2, with particular emphasis on improving the sequencing of topics and reorganizing the longer chapters of the previous edition into shorter ones. The net result is that this edition totals 27 chapters—one introductory and 13 each on financial reporting and management accounting—compared with the 23 chapters of the previous edition.

More specifically, some of the management accounting overview has been moved forward to Chapter 1, so that this chapter is more introductory to the entire book rather than just to Part 1. Chapters 2–7 reflect evolutionary and updating changes, including introduction of the debit-credit matrix in Chapter 4's discussion of computer-based recordkeeping systems; however, the basic thrust of these chapters remains the same. The former chapter, Other Expenses and Net Income, has been reorganized into two chapters: Chapter 8, Liabilities and Interest Expense, has expanded coverage of leases and contains an appendix explaining the concept of present value and its role in liability accounting; Chapter 9, Other expenses, Net Income, and Owners' Equity, completes the more detailed discussion of the income and balance sheet. The funds flow chapter now follows, expanded to include the net monetary asset concept of funds and new materials (including ratios) on how to analyze funds flow statement information. After the Acquisitions and Consolidated Statements chapter, a new Chapter 12, Accounting and Changing Prices, deals with inflation accounting concepts, FASB-33 requirements, and foreign currency transaction and translation problems. The final two chapters of Part 1 have been modified slightly, including a brief discussion of the role of the efficient markets hypothesis in choosing among accounting principle alternatives. In these later chapters of Part 1, where students can cope better with the complexities of the statements of real companies, we have made greater use of materials taken from actual company annual reports, as opposed to hypothetical financial statement data.

Part 2, on management accounting, begins with Chapter 15's expanded description of the contrast between financial reporting and management accounting. All discussion of cost behavior, formerly split between two chapters, is now consolidated in Chapter 16, prior to any detailed discussion of full costs, differential costs, or responsibility

costs. The previous edition's two long chapters on costing concepts and systems have been rearranged into three shorter chapters (17–19), the first of which emphasizes the uses made of full cost information in various kinds of organizations. Discussion of production cost variances (Chapter 20) still immediately follows the standard costing chapter, because most instructors seem to prefer this sequence; however, Chapter 20 can also be taught as a responsibility accounting chapter, just prior to Chapter 26, Analyzing and Reporting Performance. The consolidation of cost behavior materials in Chapter 16 also enabled us to present differential accounting concepts and techniques in two chapters (rather than three): Chapter 21 looks at short-run decisions, and Chapter 22 at longer-run (capital budgeting) decisions. The previous edition's lengthy chapter on responsibility accounting has been divided into two chapters, one dealing with the management control structure (23) and the other with management control processes (24). The previous edition's final two chapters on programming, budgeting, and the reporting and analysis of performance have been retained with no substantial changes but are now followed by a new concluding chapter called Management Accounting System Design, which summarizes the concepts discussed in Part 2 of the book.

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Robert N. Anthony
James S. Reece

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PART 1

FINANCIAL ACCOUNTING

The Nature and Purpose of Accounting

Most of the world's work is done through organizations—groups of people who work together to accomplish one or more objectives. In doing its work, an organization uses resources—material, labor, and various services. To work effectively, the people in an organization need information about these resources and the results achieved through using them. Parties outside the organization need similar information to make judgments about the organization. An important system that provides such information is called accounting.

Organizations can be classified broadly as either profit oriented or nonprofit. As these names suggest, a dominant purpose of organizations in the former category is to earn a profit, while organizations in the latter category have other objectives, such as governing, providing health care, providing education, and so on. Of the employed persons in the United States, approximately two thirds work in profit-oriented organizations and one third in government and other nonprofit organizations. Accounting is basically similar in both types of organizations.

THE NEED FOR INFORMATION

In its details, information differs greatly among organizations of various types. But viewed broadly, the information needs of most organizations are similar. We shall outline and illustrate these general infor-