



FOURTH
EDITION

FINANCIAL ACCOUNTING

ROBERT K. ESKEW / DANIEL L. JENSEN

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PREFACE

Communication between teacher and student is perhaps the most critical element of the education process. Yet the ever-increasing number of students in our accounting classrooms makes it more and more difficult for teachers to reach their students. Students come to rely on texts more than on teachers, and teachers must spend increasing amounts of time explaining assigned texts, which leaves reduced amounts of time for discussion of what they view as really important. Recognizing this environment, we have endeavored to write a text that enables students to learn the fundamentals from the text, allowing the teacher to concentrate on particularly difficult areas and to elaborate on the basic material provided by the text. With the help of McGraw-Hill editors, we have made a special effort to present clearly understandable explanations of the fundamentals of financial accounting. We do not simply point to numerical examples and leave it at that. Rather, we explain basic issues thoroughly and demonstrate their applications. At the same time, we have tried to present the material in such a way as to communicate to the student the importance, pervasiveness, and dynamic nature of the financial accounting function.

Experience with the first three editions has confirmed our belief in this approach and has led to a significant number of refinements in the fourth edition. The principal changes are as follows:

- Every chapter and supplementary topic in the book has been edited for greater clarity and enhanced teaching effectiveness. Every effort has been made to use direct and simple wording, to provide concrete examples whenever possible, to define key accounting terms when first used, and to use terminology consistently from one chapter to another.
- A fifth supplementary topic, “Recognition and Measurement,” has been added. It can be used in conjunction with Chapter 2 or later as a stand-alone topic.
- Account titles used in journal entries and related discussions have been standardized throughout the text and in exercises, problems, and solutions. A list of these account titles is presented in the Instructor’s Resource Manual and as a supplement (see the Instructor Supplements section of this Preface). We believe that this standardization will help students understand accounting fundamentals by reducing one source of variation in terminology. However, we also believe that students should be prepared for the wide variation in terminology they will encounter in practice. Accordingly, alternative terminology is noted in discussions, and excerpts

from real financial statements are presented without alteration.

- A new category of assignment materials, “Analytical Opportunities,” has been added to every chapter. These additional assignment items, at least two of which are presented for each chapter, require students to prepare brief essays and analyses that address conceptual, institutional, and ethical issues related to the chapter.
- End-of-chapter materials have been significantly revised. Questions, exercises, and problems are each arranged in the order in which the related topics appear in the chapter.

SELF-TEACHING ASPECTS OF THE TEXTBOOK

Since the text and its accompanying materials must do much of the teaching in today’s accounting classes, the text needs to contain examples and demonstrations that will assist the student when learning concepts and procedures. Furthermore, it should contain examples of the use of accounting concepts and procedures in decision settings. In this edition, as in the previous editions, our writing has been guided by the manner in which a good teacher thinks and talks in class. When users identified sections of the text with which students experienced difficulty, we attempted to rework the material to make it easier for students to digest. If the section was of fundamental importance, we worked with it until a more straightforward treatment could be found. If the section was an extension of a fundamental point, we considered relocating the section to a footnote, an appendix, an analysis section, or a separate Supplementary Topic. In some cases we deleted difficult technical material that was not of fundamental importance to an introductory course.

The ancillary materials for this text augment the self-teaching ability of the book, both in the small classroom and in the large-course setting. These materials have been thoroughly revised.

HELPING STUDENTS DEVELOP ACCOUNTING SKILLS

Beyond the self-teaching aspects of the book, we hope to meet another more general need of the students in the

introductory accounting sequence. While the financial accounting function is an important and pervasive one, there is a tendency for introductory students not to appreciate its importance fully. For many students the course continues to be dull and without purpose. Our goal has been to present accounting as a dynamic field that performs important functions in our society and is a vital part of business activity. While the material covered in our text is primarily traditional, we present it in an issue-oriented atmosphere using the following tools:

- Analysis sections
- Conceptual framework for accounting procedures
- Examples from business environments
- Organizational and teaching flexibility
- Textual learning aids

Let us consider each of these tools in turn.

ANALYSIS SECTIONS

The analysis sections are discussions of factual situations that direct attention to issues that lie beyond the accounting concepts and procedures. Most chapters present three or four analysis sections to emphasize the interpretation of accounting issues in a decision-making environment, rather than the related calculations and procedures. Each analysis moves from a brief description of a business setting to a discussion of related issues of interest to an investor, lender, entrepreneur, manager, systems designer, or another user of accounting information. Some present judgments and inferences about the firm made by a user of accounting information. Others describe the organizational contexts in which accounting information arises. We have found that the analysis sections draw students into the chapter subject matter and stimulate them to think more carefully about its importance.

CONCEPTUAL FRAMEWORK FOR ACCOUNTING PROCEDURES

The discussion of accounting concepts is carefully woven into the fabric of the book. The conceptual framework for accounting is introduced gradually as the chapters unfold, and the discussion of concepts is integrated with the presentation of related accounting procedures. Chapter 1 describes the relationship between the conceptual framework for accounting and generally accepted accounting principles and procedures. Chapter 1 also presents the basic concepts of cost, asset, liability, and equity and demonstrates their interrelationship in the fundamental accounting model. The presentation of elements of financial

statements in Chapter 2 begins with a revised discussion of the concepts of the financing and operating cycles, periodicity, revenue recognition, and matching. A tabular summary of concepts is presented at the end of Chapters 1 and 2 to help students understand the conceptual framework. In a similar way, the accounting topics considered in subsequent chapters flow from a discussion of related aspects of the conceptual framework.

BUSINESS ENVIRONMENT

We attempt to make students feel comfortable with actual financial statements by introducing excerpts from carefully selected annual reports throughout the text. In each case we have chosen firms whose names and activities are familiar to students. For example, Chapter 2 presents a facsimile of the Wal-Mart Stores, Inc., financial statements to illustrate the form of financial statements and to provide a basis for a simple analysis of Wal-Mart's operating results and growth. In Chapter 15 we have reproduced the complete financial statements and accompanying notes for Compaq Computer Corporation as the basis for illustrating a variety of financial statement analyses. In this way, a student becomes increasingly at home with real-world financial statements and consequently more receptive to the accounting procedures and concepts on which they are built. In addition, we have drawn on the annual reports of many other companies to illustrate our discussions and to enhance further the students' awareness of current financial practices.

ORGANIZATIONAL AND TEACHING FLEXIBILITY

Recognizing that each instructor emphasizes different aspects of financial accounting, we have written our text with a high degree of organizational and teaching flexibility. For example, one instructor may emphasize students' understanding of financial statement content and organization; another instructor may stress accounting procedures. Chapters 2 through 5 are designed to accommodate both methods of teaching. In Chapter 2 we examine the content and organization of the income statement, balance sheet, and statement of changes in retained earnings with minimal attention to accounting procedures. In Chapters 3 through 5 we present the elements of the accounting cycle in three manageable increments. Chapter 3 examines the basic elements of the double-entry system and the recording of events. Chapter 4 is devoted exclusively to adjusting entries, and Chapter 5 discusses closing entries and the worksheet. In Chapters 3 through 5 we continue to emphasize the issues of financial statement

content and organization. Instructors desiring a financial statement focus for their course can emphasize Chapter 2 and the financial statement portions of Chapters 3 through 5. Instructors who wish to emphasize accounting procedures can focus on the material describing elements of the accounting cycle presented in Chapters 3 through 5.

Another measure of flexibility is provided for teaching long-term liabilities. Chapter 10, “Current Liabilities, Contingent Liabilities, and the Time Value of Money,” concludes with an optional section on the time value of money. If this section is not taught, students will go on to Chapter 11A, which teaches accounting for long-term liabilities using straight-line interest calculations. If the time value of money is covered, students will progress to Chapter 11B, which presents accounting for long-term liabilities using time-value-of-money calculations. In other words, students normally study *either* Chapter 11A or 11B, depending on whether or not the time-value-of-money section of Chapter 10 is covered.

Still more flexibility is provided for instructors who do not wish to give detailed consideration to topics such as the cash flow statement (Chapter 13) and long-term investments, consolidated financial statements, and business combinations (Chapter 14). To permit various levels of coverage for such topics, those chapters are divided into two parts. The first part presents basic issues. Subsequent parts present further development of these issues. Technical issues are reserved for appendixes. The first part of each chapter can be used alone to present the basic issues and, if additional coverage is required, subsequent parts and appendixes may be assigned as well. In addition, as mentioned earlier, the book concludes with five Supplementary Topics—nonbusiness entities, changing prices, international operations, personal income taxation, and recognition and measurement—which instructors may use to supplement and extend discussion in the main part of the text. The Instructor’s Resource Manual accompanying this text offers a number of alternative syllabi from which the instructor may select the one best suited to his or her needs.

LEARNING AIDS

Textual Aids

Every effort has been made to produce a text that is easy for students to follow and to learn from. Particular attention has been given to the readability of the text and to the smooth flow and development of ideas and examples. The following features are worthy of note:

LEARNING OBJECTIVES. Each chapter begins with a list of learning objectives that previews the content of the

chapter and stimulates the student to begin thinking about the material to come.

RUNNING GLOSSARY. Definitions of key terms are provided in the margins to facilitate retention and quick review. All these terms are compiled into a complete glossary, with chapter references, that appears at the end of the book.

NARRATIVE SUMMARIES. Chapter summaries highlight basic points and principles.

KEY-TERM REVIEW. Each chapter ends with a list of key terms, with page references, for quick review.

DISCUSSION QUESTIONS. Discussion questions are provided at the end of each chapter. These relate directly to the basic principles covered in the chapter and can be used for student review, class discussion, or homework assignments.

EXERCISES AND PROBLEMS. Exercises and problems are provided at the end of each chapter. Exercises are designed to illustrate basic issues in isolation, whereas problems are more comprehensive and more demanding. Each exercise and problem is labeled as to the topic it covers, making it easy for the instructor to select appropriate exercises and problems to address specific areas.

ANALYTICAL OPPORTUNITIES. At least two “analytical opportunities” are provided at the end of each chapter. These assignment items require students to prepare brief essays and analyses that address conceptual, institutional, and ethical issues related to the chapter.

DEMONSTRATION PROBLEMS. Many chapters contain demonstration problems, which are comprehensive recaps of the chapter’s main points. These demonstration problems serve as model solutions for students to refer to when working on assignment material, and they are also excellent means of reviewing the chapter’s most important topics.

Student Supplements

In addition to the learning aids contained in the text, the following supplements are also available to assist students in mastering concepts and procedures:


STUDENT MASTERY GUIDE—by Charles A. Neyhart, Jr., and Patrick S. Kemp (Oregon State University). Coordinated with the text, each chapter of this study guide contains review materials in the form of learning objectives, chapter reviews keyed to the learning objectives, and key-term review. Novel features are a diagnostic pre-test

(with solutions) and a common errors section. Two post-tests (with solutions) provide students with additional opportunities to check their mastery of chapter content.

PRACTICE SET—by Nancy O. Tang (Portland State University). Based on financial data for Tang's Toys, a hypothetical retail store organized as a corporation, this supplement gives students hands-on experience in applying the accounting data processing cycle procedures to the development of financial statements.

WORKING PAPERS—by Richard S. Webster (Ohio State University). This supplement provides students with all the forms needed for solving the exercises and problems at the end of each chapter.

ASHCO, FOURTH EDITION, FOR THE IBM PC, XT, AND PS/2—by Louis F. Biagioni (Indiana University). This revised package teaches the monthly accounting cycle of a corporation. Students generate financial reports by recording transactions in a general journal and a subsidiary ledger, with the option of using special journals. Two monthly cycles can be completed, one computerized, one manual. The program allows instructors and students to create their own accounts and also includes user-friendly HELP screens. This package is available for student purchase for use with the IBM PC, XT, and PS/2.

FINANCIAL ACCOUNTING TEMPLATES AND PROBLEMS FOR LOTUS 1-2-3, THIRD EDITION—by George F. Hanks and Paul W. Parkison (Ball State University). A set of spreadsheet templates to be used to solve problems and perform analyses for financial accounting using LOTUS 1-2-3. Available for student purchase for use with the IBM PC, XT, and PS/2 with LOTUS 1-2-3 software. Key features include a wide variety of problems, a flexible spreadsheet format that allows for "what-if" analysis, and the inclusion of a Lotus 1-2-3 tutorial. Problems in the text that are *similar* to those on the templates are designated by a computer icon () in the margin.

Instructor Supplements

A number of teaching aids are available to instructors as well. They are as follows:

INSTRUCTOR'S RESOURCE MANUAL—by Paul F. Williams and Kristine Lawyer (North Carolina State University) and Raymond J. Krasniewski (The Ohio State University). This manual offers recommendations on teaching the text. Chapter-by-chapter discussion includes suggestions on the presentation of difficult topics and alternative presentations of important issues. The manual also incorporates numerous large-type transparency masters designed for use with the text. This manual provides

an outline of each chapter and sample outlines for structuring a course around conceptual or procedural emphases and for organizing one-quarter, one-semester, and two-quarter courses. To help instructors enrich their lectures, conceptual and procedural extensions add depth to textual material. A long problem tied to a conceptual lecture topic is provided for each chapter.

SOLUTIONS MANUAL. Fully worked out solutions to all questions, exercises, problems, and analytical opportunities in the text are provided. The solutions are thoroughly explained and presented in a way that conveys the mental processes students go through in solving problems. The entire solutions manual is printed in large type to facilitate the production of transparencies. In addition, transparencies and transparency masters are available for exercises, problems, and analytical opportunities.

CHECK FIGURES. These are provided for end-of-chapter exercises and problems and are available (upon request) in quantity to instructors for distribution to their classes.

CHART OF ACCOUNTS. This list of account titles used throughout the text and in exercises, problems, and solutions is available (upon request) in quantity to instructors for distribution to their classes. It is also provided in the Instructor's Resource Manual.

TEST BANK—by Arnold Schneider (Georgia Institute of Technology). This balanced blend of conceptual and procedural questions has been thoroughly revised. Questions are coded by difficulty level and organized by chapter topic. The test bank now consists of over 1,400 multiple-choice questions and is available both in book form and in a computerized test-writing system.

COMPUTERIZED TEST BANK: RH TEST—The RH Test and MicroTest systems give access to a broad range of testmaking functions. With it, instructors can prepare tests quickly and easily. This powerful program allows instructors to view questions as they are selected for a test; scramble questions to create different versions of the test; add questions; edit questions; select questions by type (multiple-choice, true-false, matching, essay, or short answer), objective, and difficulty; and view and save a test. It includes all the questions available in the printed test bank. Available for the IBM PC/PC-XT and Macintosh and true compatibles.

OVERHEAD TRANSPARENCIES. These transparencies provide solutions to the end-of-chapter exercises and problems and many exhibits from the text.

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Robert K. Eskew

Daniel L. Jensen

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