
INTERMEDIATE

ACCOUNTING

FOURTH EDITION

LANNY G. CHASTEEN

RICHARD E. FLAHERTY

MELVIN C. O'CONNOR

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Intermediate Accounting

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To our parents

and to

Jane

Jamie

Joey

Ricci

Kristin

Erin

Darlene

Kevin

PREFACE

The extremely favorable response to our first three editions indicates that our view of accounting education and of the role of intermediate accounting within the education process is shared by many accounting instructors. We continue to believe that accounting education should prepare students both to do accounting and to understand and critically evaluate accounting. Intermediate accounting should reflect these dual objectives. While most intermediate accounting textbooks share these two objectives and appear, on the surface, to be very similar in terms of content and organization, our text and supporting materials do have several distinctive characteristics.

ORGANIZATION AND COVERAGE

The chapter sequence has been altered somewhat from the third edition in order to achieve greater efficiency in covering the material. We describe the environment of financial accounting in Chapter 1 and present a conceptual framework for financial accounting and reporting in Chapter 2. The accounting process and the resulting financial statements are discussed in Chapters 3, 4, 5, and 6 (which covers the statement of cash flows, previously in Chapter 23). Revenue recognition is the subject of Chapter 7, which may be used at any point in the course. Asset accounting and reporting are covered in Chapters 8 through 12. Accounting for financial instruments is covered in Chapters 13 and 14. The special topics of leases, pensions, and other postretirement benefits, and income taxes are presented in Chapters 15, 16, and 17, respectively. Chapter 18 covers contributed capital and retained earnings. Earnings per share is the subject of Chapter 19. Accounting for price changes is presented in Chapter 20. Time value of money concepts and sample applications are presented in an appendix at the end of the text. FASB pronouncements and other FASB actions through late 1991 have been incorporated in the text. The major changes resulting from FASB activities since the publication of the third edition are presented in Chapters 16 (Pensions and Other Postretirement Benefits) and 17 (Accounting for Income Taxes).

CONCEPTUAL INTEGRATION WITH A STRONG PROCEDURAL ORIENTATION

We introduce and discuss in detail the conceptual framework of accounting in Chapters 1 and 2. This framework is used throughout the text to explain and evaluate accounting procedures. To further our objective of integrating the conceptual framework throughout the text, we include a summary of important topics and concept applications at the end of each chapter. These summaries reinforce the relationship between the conceptual framework and the procedures discussed in the chapter, in addition to providing a review of chapter highlights. Also, alternative accounting procedures and disclosure alternatives are evaluated routinely in terms of their usefulness in predicting and assessing cash flows to the company.

As in previous editions, we have made a major effort to enhance the presentation and readability of the material. Characteristics of the third edition which have

been favorably received have been retained and expanded. In addition, we have made several significant changes in the organization of material to facilitate the learning process.

PRESENTATION AND READABILITY

Most intermediate accounting textbooks do an adequate job of describing accounting procedures for the straightforward accounting topics, such as inventory cost flows, depreciation accounting, and accounting for receivables. However, our coverage of even these relatively simple topics stands out when compared to competing texts, because we do more than describe accounting procedures. Our presentation of procedures is amply illustrated, with many exhibits, margin notes, and references to real-world situations. Moreover, references to the conceptual framework are woven through our procedural discussions to emphasize the relationship between accounting concepts and procedures.

Users of the first three editions have reinforced our belief that we present the more complex accounting topics in a clear, concise, and thorough manner. Rather than shying away from controversial and difficult problem areas, we attack them head-on, using the conceptual framework to critically evaluate the accounting alternatives. We have added summary exhibits and illustrations of several key topics to clarify the issues discussed. In addition, we have again increased the number of margin notes in this edition. We have used appendixes to enhance the flow of the chapters and to improve instructor flexibility in terms of content coverage.

END-OF-CHAPTER MATERIAL

Our end-of-chapter material is unusually extensive and diverse. There are nearly 1,000 cases, exercises, and problems in the text. Virtually all of the problem material that appeared in the third edition has been revised, and many new items have been added. Much of the new end-of-chapter problem material is of moderate difficulty. The new material has been class-tested, and the solutions to all end-of-chapter material have been thoroughly reviewed by the authors and by outside reviewers.

OTHER IMPORTANT FEATURES

EARLY PRESENTATION OF REVENUE RECOGNITION A thorough understanding of revenue recognition criteria as a means of compensating for uncertainty about future cash flows is essential to understanding specific accounting procedures. Therefore, revenue recognition is presented early in the text (Chapter 7). This placement also reflects the authors' preference for introducing conceptual material early in the course. However, this chapter may be covered at any time after Chapter 2.

COMPLEX ISSUES TREATED IN A FLEXIBLE MANNER A building block approach is used to present accounting for leases (Chapter 15), pensions and other postretirement benefits (Chapter 16), income taxes (Chapter 17), earnings per share (Chapter 19), and price changes (Chapter 20). A conceptual introduction to these topics is followed by explanations of progressively more complex procedural issues. The presentation is organized so that the material may be covered in varying degrees of detail.

SHORT-TERM AND LONG-TERM INVESTMENTS COVERED IN ONE CHAPTER Because there are more similarities than differences between accounting for short-term and long-term investments, coverage within a single chapter is pedagogically sound and efficient.

PRESENT AND FUTURE VALUE COVERAGE Concepts of present and future value are discussed in an appendix at the end of the text and are used in several chapters. Time diagrams are used extensively throughout the text to clarify the concepts of present and future value.

RELATIONSHIP BETWEEN ACCOUNTING AND THE ENVIRONMENT Accounting issues are frequently evaluated in terms of their historical development and economic consequences. For example, the oil and gas accounting controversy is discussed in Chapter 12, the politics of accounting for leases is discussed in Chapter 15, and political influences on accounting for pensions and other postretirement benefits are described in Chapter 16.

ETHICS AND PROFESSIONALISM IN ACCOUNTING Ethics is a topic of growing concern to the general public, businesses, and the accounting profession. In fact, people speak of an “ethics crisis” in business, although many opinion polls indicate that the public’s perception of corporate ethics has not changed much in the last ten years. The accounting profession, in particular, is given high marks for ethical conduct. Nevertheless, sensing an obligation to promote high ethical standards, we include in Chapter 1 a section on the importance of ethics in financial accounting and reporting. Elsewhere in the text are illustrations that often have ethical implications. For example, the revenue recognition illustrations on pages 392 and 400 in Chapter 7 may have ethical considerations. As another example, the illustrations on pages 723 and 724 in Chapter 13 may raise ethical issues. In addition, we have added several cases throughout the text that deal with ethical issues.

INTERNATIONAL ACCOUNTING STANDARDS The globalization of business has led to an increased awareness of and interest in accounting standards in other countries. Also, the development of international accounting standards is beginning to have an impact on worldwide accounting standards. Throughout the text, to provide the student with some perspective from which to view U.S. accounting standards, we have added comparisons of U.S. accounting standards to those of other developed countries and to international accounting standards.

EXTENSIVE USE OF REAL-WORLD EXAMPLES Numerous excerpts from actual financial statements are presented to relate the text coverage to the practice of accounting. For example, a complete set of financial statements for the BFGoodrich Corporation is included in the appendix to Chapter 4 and is referenced in several chapters. We have drawn on the published financial statements of many other companies, such as IBM, Honeywell, and American Brands, to demonstrate reporting practices.

MAJOR CHANGES IN THE FOURTH EDITION

- Because of the global environment of business, the authors have attempted to sensitize students to international accounting and reporting issues throughout the text, beginning with substantial discussion in Chapter 1.
- In Chapter 1, there is an expanded discussion of ethics. Several cases in selected chapters provide students with an opportunity to consider professional and ethical issues.
- Chapter 3 has been divided into two parts. The first part presents the accounting cycle, which is similar to the third edition. The second part covers error analysis and correction. This change was made because we believe that error analysis and correction is a natural extension and application of accounting cycle concepts, including accrual accounting.
- Accounting changes, segment reporting, and interim reporting have been moved to Chapter 4. Financial statement analysis now appears in an appendix to Chapter 5. We believe this change will improve the focus on uses of financial information.

- The statement of cash flows, Chapter 23 in the third edition, has been moved to Chapter 6. This chapter and end-of-chapter materials have been revised in a manner conducive to early coverage. We believe that coverage of the primary financial statements should appear together early in the text.
- Concepts of present and future value, Chapter 7 in the third edition, have been moved to an appendix at the end of the text. This change allows users to cover these concepts at any point in a course.
- Cash, accounts receivable, and short-term liabilities are covered in Chapter 8. We believe that this change improves the balance of material that appeared in Chapters 8 and 15 in the third edition, given that notes receivable are covered in Chapter 14 on financial instruments in the fourth edition (see below).
- The three chapters on plant and equipment, depreciation, and intangibles in the third edition have been rearranged and combined into two chapters to eliminate duplication of concepts. Chapter 11 covers the acquisition of and subsequent expenditures for plant and equipment and intangibles. Chapter 12 covers depreciation, depletion, and amortization and disposal of plant and equipment and intangibles.
- Financial instruments are covered in a two-chapter sequence. Chapter 13 covers equity instruments (primarily investments in common stock), and Chapter 14 presents debt instruments. Both bonds and notes, from the standpoint of issuer and investor, are covered in Chapter 14. We believe that because similar accounting concepts apply to both bonds and notes, coverage in one chapter is conceptually preferable and more efficient.
- The effective interest method is emphasized in the fourth edition, especially with respect to bonds, notes, and leases. Additionally, where possible, we use a more standardized “schedule of interest and book value” to show periodic interest expense/revenue and book value for these monetary items. (The straight-line method is presented for bonds and notes but is deemphasized.)
- The pensions chapter, Chapter 16, has been revised substantially, including many new examples and exhibits. This chapter also includes thorough coverage of *Statement 106*, “Employers’ Accounting for Postretirement Benefits Other Than Pensions.”
- The income taxes chapter, Chapter 17, has been revised and simplified. As of our publication date, this chapter incorporates the FASB’s new *Exposure Draft* on income taxes, primarily the recording of deferred tax assets and the use of an aggregate approach for determining balance sheet amounts for deferred tax assets and liabilities.
- Stockholders’ equity, Chapters 20 and 21 in the third edition, has been streamlined and condensed into one chapter, Chapter 18. We believe that this change allows more efficient coverage of related topics.
- There has been a significant revision of assignment material at the end of each chapter, especially case materials. In addition, many new items have been added to the end-of-chapter assignment material.

SUPPLEMENTARY MATERIALS

SUPPLEMENTARY LEARNING AIDS

STUDENT MASTERY GUIDE by John Cumming and Clayton Hock (both at Miami University, Oxford, Ohio). Each chapter contains a list of chapter objectives and a

detailed chapter review. The Self-Study Learning section includes a review of key terms and concepts, true-false questions, multiple-choice questions, and extended problems—all with solutions. A final section discusses common errors.

WORKING PAPERS This supplement provides students with the forms necessary to work the problems and exercises at the ends of chapters in the text.

SAILS AWAY PRACTICE SET by Nancy O'Rourke Tang and Donald Tang (both at Portland State University). Based on a combined wholesaling, retailing, and service concern, the *Practice Set* is designed to provide students with a comprehensive review of the accounting process and practice in the application of concepts and skills. Students are given the opportunity to assess a series of complex events to determine year-end accrual, disclosure, or adjustment, and to complete a full set of financial statements, including all related footnotes.

COMPUTER-ASSISTED PRACTICE SET by Louis F. Biagioni (Indiana University). GEMCO, now in its third edition, is a challenging computer-assisted practice set available for use in the intermediate accounting course. Class-tested by the author, it teaches students the accounting cycle while familiarizing them with computer accounting systems. GEMCO requires students to record transactions, make adjusting entries, and generate the reports of the General Microcomputers Company, Inc. Transactions for two months are provided. Those for the first month are to be done manually. Three sets of transactions, ranging from simple to difficult, provided for the second month are to be done on computer. An electronic spreadsheet template is provided for the completion of the statement of cash flows. The package includes extensive HELP screens and tutorials that make the programs educational and unique. Available for use with the IBM PC/PC-XT and true compatibles.

TEMPLATES AND PROBLEMS FOR LOTUS 1-2-3® by George F. Hanks and Paul W. Parkison (both at Ball State University). The package is a collection of forty spreadsheet templates for Lotus 1-2-3, the widely accepted business package to solve problems and perform analyses. A student book with problems and worksheets for each spreadsheet and a Lotus 1-2-3 tutorial are included in each package. A computer symbol in the margin of the text identifies problems that can be solved with this software. The adopter's desk set includes an instructor's manual with solutions to the problems and worksheets. Available for IBM PC/PC-XT and true compatibles.

TEACHING AIDS

TEACHING AIDS **INSTRUCTOR'S RESOURCE MANUAL** by Janet Kimbrell (Oklahoma State University). This manual increases the breadth of teaching materials available to professors. Each chapter begins with a restatement of the chapter objective from the *Student Mastery Guide*. This section is followed by a detailed lecture outline and a point-by-point chapter review. Lecture topics are provided, as are issues for reflection and discussion. An annotated bibliography suggests extra reading materials. A summary of chapter and problem material coverage and tables of assignment characteristics also are provided. Much of the material is accompanied by detailed illustrations that expand the extensive visual exhibits in the text. Discussions of ethics and professionalism cases from the text are included in many of the chapters.

SOLUTIONS MANUAL This volume provides fully worked solutions to all questions, cases, exercises, and problems in the text. The solutions are thoroughly explained and each step is illustrated to enhance discussion of assignment and other materials.

SOLUTIONS MANUAL FOR SAILS AWAY PRACTICE SET by Nancy O'Rourke Tang and Donald Tang (both at Portland State University). This booklet contains completed journal entries, income statements, and worksheets for the manual practice set. A sample grading sheet is included.

CHECK FIGURES This booklet provides key figures in the solutions to the end-of-chapter assignments. These figures allow students to check the accuracy of their work at an intermediate stage in the solution process.

TRANSPARENCIES Solutions from the *Solutions Manual* for the end-of-chapter exercises and problems are available on transparencies for use as a classroom aid in reviewing homework assignments. Fifty exhibits from the text and chapter outlines are also included in the transparencies set.

TEST BANK by Alan A. Cherry and Alan H. Falcon (both at Loyola Marymount University). The *Test Bank* includes approximately 1,500 questions and problems. Each chapter offers multiple-choice questions, extended problems, and, in most chapters, essay questions. Also in this edition are guides to all questions indicating the topics tested by multiple-choice questions and the difficulty level of problems and essays.

COMPUTERIZED TEST BANK: RHTEST AND MICROTST RHTest and MicroTest give access to a broad range of testmaking functions. 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. RHTest is available for the IBM PC/PC-XT and true compatibles; MicroTest is available for the Macintosh.

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Lanny G. Chasteen
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