

Accounting Principles

Jack L. Smith Robert M. Keith William L. Stephens

Second Edition



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SECOND EDITION

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ACCOUNTING PRINCIPLES

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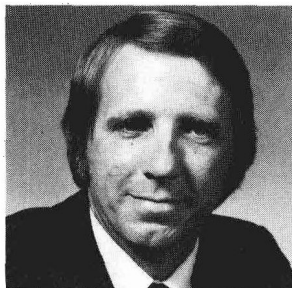
About the Authors



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Robert M. Keith is Professor of Accounting in the College of Business Administration at the University of South Florida. He received his Ph.D. in accounting from the University of Alabama and holds the CPA certificate. While his research interests center on financial accounting, Professor Keith also has a strong interest in accounting education at both the college and professional levels. He received the first Outstanding Accounting Faculty Award by the Delta Gamma Chapter of Beta Alpha Psi and was voted an outstanding discussion leader four years in a row by CPA participants in continuing professional education seminars sponsored by the Florida Institute of CPAs. In addition to papers presented at regional meetings of the AAA, Professor Keith's research has appeared in the *Journal of Accountancy* and *The Florida CPA*. He was also a coauthor with Jack L. Smith of *Accounting for Financial Statement Presentation*, published in 1979. Professor Keith is a member of the American Accounting Association, the AICPA, and the Florida Institute of Certified Public Accountants, and has served on the editorial board of *The Florida CPA*.



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To Diane, Kristie, and Scott

To Leanne and Rob

To my mother-in-law, Eunice Barner Kinsey, whose unwavering faith in the Lord was an inspiration to all who knew and loved her — throughout the good times and the bad, during her life and at her death.

Preface

The second edition of *Accounting Principles* is designed to be a comprehensive balanced approach to the community college or university student's first exposure to accounting. The text is intended for use in a two-semester or three-quarter sequence by those students who plan to enter the accounting profession, those who plan a business career, and those who have an interest in broadening their business background. Our assumption in writing this edition is that the student's exposure to business has been very limited. Therefore we have carefully explained and illustrated, where appropriate, all business terms and practices as they are first discussed.

We have planned the second edition to be a blend of accounting concepts and procedures. Students are informed why information is accounted for in a certain manner. The *why* is reinforced by illustrating *how* the accounting is accomplished. Students cannot grasp concepts without adequate attention to the procedures.

Numerous suggestions have been made by the many users of the first edition. We have considered these suggestions very carefully and adopted those that we feel will contribute to increasing the effectiveness of the text. We have incorporated in this edition numerous pedagogical devices and techniques to which we would like to call your attention. These are classified in the preface as general or specific. In the general category we include those items that are presented in all chapters of the text, while in the second category we highlight those features that are found only in specific chapters.

Retained in the second edition is the informal writing style that makes the material more real, more interesting, and certainly more helpful to the student. We have

- attempted to give the students a feeling that the instructor is with them while they are reading the text.

- A new feature added for the second edition is the short cases appearing with each chapter. These cases are extracted from sources such as *Fortune*, *Forbes*, *Harvard Business Review*, securities and exchange releases, and *The Wall Street Journal*. The cases provide the student with an opportunity to see how principles of accounting are embedded within the realities of the business world.

- Each of the six parts of the text is introduced by a section explaining the overall purpose of that part and briefly describing its contents.

IMPORTANT FEATURES OF THE SECOND EDITION

GENERAL

- Attractively arranged at the start of each chapter are the chapter objectives that serve to enhance student learning.
- Extensively used throughout each chapter are marginal notes to describe the text material and indicate the purpose of each exercise and problem.
- The text contains an abundance of well illustrated charts, diagrams, and figures designed to help the student easily and quickly visualize concepts, and relationships, and establish perspectives underlying the material as it is explained.
- Summaries and important terms are presented at the end of each chapter.
- Check figures are located with the exercises and problems, not on the end covers nor in a separate list.

SPECIFIC

The focus of the first half of the text is on asset, liability, expense, and revenue accounting. However, at the suggestion of many users we have introduced the

- corporate model in Chapter 4 and use it exclusively commencing in Chapter 5 and thereafter.

- Accounting principles and concepts are discussed and developed fully as they are introduced in the various chapters.
- An interlude in the form of a major section entitled GAAP: Generally Accepted Accounting Principles is located between Chapters 11 and 12 and presents a comprehensive discussion of generally accepted accounting principles. Many users separate the end of Principles I and the start of Principles II at this point.
- A second interlude has been added to the second edition. This is between Chapters 18 and 19 and it serves to provide a smooth transition from financial accounting to management accounting.
- The accounting cycle is reviewed by means of a detailed flowchart at the end of Chapters 3, 4, and 6; the chart is expanded as new procedures are presented.
- A full discussion of reversing entries for accruals and transactions initially recorded in nominal accounts is developed in Chapter 4.
- An extended discussion of the difference between the accrual and cash basis of accounting is located in Chapter 3.
- Chapter 5 from the first edition has been divided into two chapters. The new Chapter 5 deals with accounting for merchandise and includes a discussion of the periodic and perpetual inventory systems.
- A new Chapter 6 has been added. This chapter has an extensive section on the important topic of internal control (and the E. F. Hutton case) and covers the use of special journals.
- The chapter on cash, Chapter 7, has been revised, eliminating the discussion of bank-to-book reconciliations and providing realistic bank reconciliations in the problem material. The lower-of-cost-or-market technique has been expanded in the discussion of marketable securities.
- Chapter 8 on Receivables has been pruned to eliminate duplication of material on control and subsidiary ledgers.
- Included in Chapter 10, "Long-Lived Assets," is a discussion of the impact of income tax depreciation. Material from the first edition on changing prices is transferred to Chapter 18 where the topic is developed more fully.

- Chapter 11, “Current Liabilities and Payroll,” has undergone substantial change. Material located in this chapter from the first edition has been shifted to Chapter 27, “Income Taxes.” In addition, the material from the first edition found in a separate chapter on payrolls has been consolidated with the other current liability items and arranged in a more logical manner.
- Chapter 15, “Corporations: Long-Term Liabilities,” has been included in the corporation section in the second edition because of the input of many of the first edition adopters. This material is viewed as somewhat more difficult than the other material found in the first course and many users felt it would be more appropriate in the second course as well as more logically located with the corporate material. The discussion of the effective-interest method of amortizing premiums and discounts has been expanded to make it easier for the student to understand.
- At the suggestion of first edition users, the discussion of consolidations has been substantially modified in Chapter 16, “Corporations: Investments and Consolidations.” While the philosophy of both the purchase and pooling of interest methods is discussed, the procedural explanation is limited to the purchase method at the date of acquisition.
- Chapter 20, “Job Order Costing,” and Chapter 21, “Process Costing,” are two new chapters. In the first edition these topics were covered in one chapter. A major change from the first edition is that the second edition covers both the weighted-average and FIFO methods of process costing. The coverage of the two methods is completely independent; it is not necessary to understand one in order to cover the other method.
- Chapter 23 contains a comprehensive master budget that is fully discussed and illustrated. The example for the master budget is carried over to the chapter on flexible budgeting (Chapter 24) which compares and contrasts these two types of budgets. A clear, concise development of the relationship between the flexible budget and standard costing is given, contrasting the planning and control functions.
- Chapter 25 on relevant costing is logically placed after cost-volume-profit analysis, so that the contribution approach is a familiar tool, and prior to capital budgeting, so that short-run special decisions are discussed before long-run decisions.

SUPPLEMENTARY MATERIALS

For the Instructor

Accompanying the text are the following supplementary materials:

Solutions Manual. Answers to all the questions, exercises, and problems are contained in this comprehensive manual. The type is extra large so that any transparencies made from the manual will be clearly seen by the students in the last row of the classroom.

The questions, exercises, and problems follow closely the textual material. Time estimates, difficulty levels, and descriptions of all exercises and problems are provided as an aid to the instructor in selecting material appropriate for the level of course being taught.

■ *Teacher’s Manual.* Designed to aid primarily graduate teaching assistants, adjuncts, and other part-time instructors, the teacher’s manual contains comments, notes, illustrations, and examples that the authors have found useful in teaching the principles course.

■ *Tests and Exams.* Two completely different sets (Set A and Set B) are available to

provide the instructor with a number of testing options. Each package contains 20 of each test and exam. Each test covers two or three chapters. The four final exams cover Chapters 1–11, Chapters 12–27, Chapters 12–18, and Overview to Chapter 27.

- *Solutions for Practice Sets.* Contains all the answers for both print practice sets.
- *Test Bank.* For those instructors who wish to construct their own examinations, a manual containing over 2,250 true/false, multiple choice, and short problem test questions arranged by chapter is available. These questions are also available in a computerized test-generation system.
- *Overhead Transparencies.* The publisher has prepared for the instructor a complete set of exercise and problem solution transparencies for classroom use. These are available upon request to adopters of the text.
- *Teacher's Transparencies.* An extensive set of teaching transparencies is available for classroom use as an aid in illustrating many of the concepts discussed in the text.

For the Student

- *Study Guide.* A comprehensive study guide, prepared by Joseph Icerman of Florida State University and Paul Williams of North Carolina State University, contains chapter-by-chapter reviews together with an abundance of multiple-choice, fill-in, and true or false questions as well as numerous problems. Solutions to all items are displayed in the back of the *Study Guide*.

- *Practice Sets.* Two manual practice sets accompany the text. Both sets are prepared by the authors. The first set is to be used after the first six chapters and illustrates the basic system using a periodic inventory method and the special journals. The set is unique because it contains two beginning trial balances and two sets of amounts for each transaction, thus providing the instructor with the opportunity to assign effectively any one of four practice sets although the student purchases only one set.

The second manual practice set contains various source documents, business forms, and cancelled checks for the student to analyze and process.

- *Computerized Practice Set.* This practice set utilizes microcomputers to process data input by the student for a 2-month period of time.
- *Computerized Tutorial.* Reinforcing the text presentation through topic-specific exercises and short problems, this self-paced software is available for both semesters of principles.
- *Working Papers.* Partially filled-in working papers for all problems of the text are preprinted with the problem headings and preliminary data to help students save time and concentrate their energies on the essence of each problem.

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We appreciate the help and encouragement of our colleagues at the University of South Florida. Special thanks go to Bob West for his contribution on the effective-interest method and his support as department chairperson, to Jim Lasseter for his comments on the Tax chapter; and to Celina Jozsi for her numerous creative ideas on management accounting.

Once again Florida Steel Corporation provided the financial statements that are illustrated in the text. We appreciate the efforts of Thomas G. Creed, Vice-President, Structural Steel for obtaining permission to use the statements.

From among an enthusiastic McGraw-Hill field staff, we feel especially obligated to Scott Stratford and Frank Flynn for their comprehensive reports which helped us to shape this second edition.

We were again fortunate to have the assistance of two outstanding individuals from the McGraw-Hill editorial staff to guide us in this project. We deeply appreciate the creative abilities of Peggy Rehberger and Mike Elia and hope that we will work together on many more projects. Over the years our relationship with Mike Elia has developed from master and apprentices to a valued friendship.

Jack L. Smith
Robert M. Keith
William L. Stephens

1909-1910
Gain or Loss (-)

4,501.14

1,563.60

81.11

6,135.85

692.68

440.94

57.22

124.67

3.62

1,319.13

3,360.99

711.24

1,867.67

254.83

263.89

3,037.63

1,136.16

- 47.44

- 216.23

872.49

683.65

585.34

302.83

Balance Sheet

Assets:

Cash on hand

Bank accounts

Notes receivable

Furniture & fixture acct

Misc. expenses

Good will

Stocks & bonds

Paper stock

Deficit 1910

\$ 18,32

Liabilities:

Capital stock

Accounts payable

Net assets 1909

\$ 18,32

Part One

Financial Accounting: Its Structure and Environment

For many years to come you are going to make economic decisions. These decisions may be required of you in your role as a taxpayer, a voter, an employee, a church member, a business manager, and a husband or wife. To make the best economic decisions, you need the appropriate financial facts. Accounting is a service that provides these facts in the form of financial reports. But before you can use financial reports you need to know how accounting information is generated, processed, and presented. You should also have a basic understanding of accounting principles, be familiar with the terms used by accountants, and understand the limitations of financial reports. Part One of *Accounting Principles* is designed to provide you with this information.

In Part One you will learn that there are many kinds of accounting activities and what each of these activities involves. For the first two-thirds of this text you will be studying just one of these activities—general financial accounting—which is concerned with recording business transactions and preparing financial reports. You will learn how to record transactions for a business entity. And you will learn how to prepare three financial reports—the income statement, the statement of owners' equity, and the balance sheet.

Financial reports are useful to us only when they are reliable and comparable. Certain ground rules called generally accepted accounting principles have been developed over the years to assure us that business entities prepare financial reports that are reliable and comparable. We will tell you in Part One how these generally accepted accounting principles are developed and discuss with you five important principles that you will need to know even at this early stage in your course of study.

51

1910

1,106.35

6,135.67

47.84

642.20

14.54

5,000.00

2,985.42

355.74

\$16,285.76

15,000.00

1,285.76

\$16,285.76

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