

PRINCIPLES OF ACCOUNTING

SIXTH EDITION



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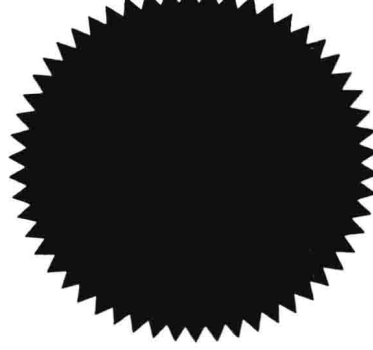
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PREFACE

The Sixth Edition of *Principles of Accounting* constitutes a major revision. The authors and editorial staff at Harcourt Brace Jovanovich reexamined every aspect of the text and learning package. Many sections of the textbook and parts of the learning package are completely new. Our overall objective in this revision was to focus on four standards of excellence: relevance, simplicity, clarity, and a vision of the future direction of accounting education.

RELEVANCE

- Is a topic worthy of student and instructor time?
- Does an issue recognize changes in the business world?
- Is there a real-life application that will add excitement and meaning to the presentation?

SIMPLICITY

- Does an example or illustration cover all key issues as simply and directly as possible?
- Are numbers easy to follow and understand?
- Are sections of the text written as simply and directly as possible?

CLARITY

- Does the writing style use active voice and short sentences to achieve readability?
- Are illustrations effectively integrated into text material?
- Does the four-color text design allow key elements to be easily identified?

VISION

- Are technical procedures linked to major business issues for a broader understanding of accounting concepts?
- Does the chapter pedagogy help students “learn to learn,” enabling them to face future career demands?
- Do end-of-chapter materials include problems that require students to form judgments and interpretations?

For this important revision, we added a new author. Corine Norgaard (University of Connecticut) brings more than 25 years of teaching, research, and consulting experience in both financial and managerial accounting. As Director of Education for the American Accounting Association and member of the Accounting Education Change Commission, she understands the critical issues facing both educators and students. As an outstanding teacher, Corine has a deep concern for preparing students to enter an ever-changing business world.

RESPONSE TO CHANGES IN ACCOUNTING EDUCATION

We face a time of change in accounting education. From a pedagogical standpoint, the following are some of the most important overall changes in the Sixth Edition:

1. A new four-color design that enhances the learning features.
2. Chapter introductions that focus on the business issues underlying accounting concepts and applications.
3. An active-voice writing style and short, concise sentences and text sections. This improves readability and lowers the reading level throughout. (The Instructor's Manual includes reading level analyses.)
4. Clear identification of major accounting issues in each chapter to focus on important concepts.
5. Integration of Learning Goals throughout the textbook and learning package.
6. Numerous illustrations and real-life applications.
7. Extensive choice of assignment materials, including the following:
 - *New Business Decision and Communication Problems*, which focus on forming judgments and developing writing skills.
 - *New Ethical Dilemmas*, which are cases that encourage sensitivity to potential conflicts of interest.
 - *New summary Practice Cases*, which integrate accounting concepts for each chapter.
 - *New Mini Practice Sets*, which integrate accounting concepts for major sections of the textbook.
 - *New extensive selection of exercises having a single Learning Goal*. These allow each instructor to customize the course.
 - *New problems having multiple Learning Goals*, which integrate topics in each chapter.

THE TEXTBOOK

The introductory accounting course is usually a student's first exposure to business terms and issues. Presenting accounting concepts in a logical and careful order is critical to capturing and enhancing student interest. Offering an extensive and varied set of self-test and end-of-chapter materials is essential to maximizing student learning. Each chapter of the Sixth Edition uses creative pedagogical features consistently to create student excitement about accounting.

PEDAGOGICAL FEATURES FOR EACH CHAPTER

1. The textbook presents specific, clearly stated Learning Goals throughout. Each chapter begins with a list of the Learning Goals and their page references. Each Learning Goal

appears next to the appropriate material in the chapter. The end-of-chapter items indicate the Learning Goals covered.

2. The Understanding Business Issues section helps students appreciate the real-world significance of each chapter.
3. We use an active-voice writing style that fosters reading interest and comprehension.
4. Pages are uncluttered and feature a creative four-color design that draws attention to key concepts and highlights important relationships. Backgrounds of exhibits are color-keyed to reflect the broad categories of accounting information covered in the textbook: green ■ for internal *processing* of accounting information, wine ■ for *reporting* of financial statements, and tan ■ for *explaining* or displaying in charts, graphs, and tables.
5. We continue to key text discussion and explanations to chapter illustrations by using large boxed reference numbers. This permits students to easily link explanations and illustrations.
6. Real-life company examples throughout apply the accounting concepts to actual practice.
7. An end-of-chapter Learning Goals Review captures the main points of each topic studied in the chapter.
8. An end-of-chapter Self-Test (with answers at the end of the chapter) contains at least one question for each Learning Goal.
9. Demonstration Problems contain Solution Approach sections, usually for each requirement. This is a feature unique to this book. Each Solution Approach contains hints and discussion of the logical thought process that students should use in solving the problem.
10. Each chapter includes extensive end-of-chapter assignment materials:
 - Discussion Questions (12–18) for class discussion.
 - Exercises (11–16), most of which focus on a single Learning Goal.
 - A and B Problems (7 each). Many B Problems present the opposite side of an accounting issue from the A Problem—for example, net income in the A problem versus net loss in the B problem. Many problems require an interpretation of the information in addition to a numerical answer.
 - A Practice Case, which integrates the major Learning Goals of the chapter.
 - A Business Decision and Communication Problem, which requires students to use chapter concepts to analyze a situation, form a judgment, and prepare a written recommendation on an accounting issue.
 - An Ethical Dilemma, which requires a written analysis of a potential conflict of interest and a recommendation for the ethical response.
11. A number of chapter problems may be solved with the general ledger and spreadsheet software provided free to the textbook's adopters.

LEARNING FEATURES FOR THE ENTIRE TEXT

1. The textbook uses a master chart of accounts for all illustrations and problems. This is printed in the front and back endpapers for easy reference.
2. The Sixth Edition introduces three new Mini Practice Sets (to be used after Chapters 3 or 4, 12, and 26) that integrate and review major sections of the text.
3. Appendix B includes a summary set of financial statements and explanatory notes for a hypothetical company. In the margins are boxed explanations of all important items.

4. Appendix B also includes an application of all accounting concepts in the textbook to the 1990 *Annual Report* of The Procter & Gamble Company. Review questions for each chapter ask students to apply the accounting concepts to this annual report.

HIGHLIGHTS OF CHANGES IN THE SIXTH EDITION

OVERALL CHANGES

- A record number of illustrations and real-life examples provide useful summaries and applications.
- A focus on the meaning and significance of the numbers calculated as well as on the computations emphasizes the development of students' judgment.
- A new Business Decision and Communication Problem, an Ethical Dilemma, a Practice Case, and applications problems in each chapter offer extensive opportunities for developing judgment, interpretation, and communication skills.
- A focus on "Understanding Business Issues" begins each chapter. Many introductions include examples from real-life companies familiar to students.
- A creative four-color design adds interest and excitement to enhance the pedagogy.
- The combination of active voice and short sentences allows the Sixth Edition to achieve a nearly ideal level of readability.
- The use of one continuous example in each chapter to illustrate major concepts allows an easy comparison of alternative accounting methods.
- The use of numerous exercises that focus on a single Learning Goal enables instructors to customize the course to meet their own teaching objectives.
- A modular coverage of topics in each chapter allows customized coverage of course topics.
- The use of round numbers in text and end-of-chapter materials simplifies calculations.

CHAPTER ORGANIZATION AND CONTENT CHANGES

- Presentation of the accounting cycle in the first four chapters of the Sixth Edition, versus the first five in the Fifth Edition. Extensive reorganization and the addition of new illustrations for the accounting cycle. Introduction to the statement of cash flows early in text. Alternative treatment of deferrals and accruals in Appendix 3A (following Chapter 3). Reversing entries in Appendix 4A.
- Simplified special journal format in Chapter 6.
- New coverage of internal control issues in Chapter 8.
- Discussion of uncollectible loans by banks in Chapter 9.
- Simplified numbers in Chapter 10.
- New inventory computation illustrations in Chapter 11.
- New illustrations and simplified numbers in Chapter 12.
- New Chapter 13 integrates coverage of generally accepted accounting principles, price-level accounting, and information in published financial reports. Selected end-of-chapter problems review and integrate accounting concepts covered in the first twelve chapters.

- New real-life company examples in Chapters 15 and 16 on corporations. A new section in Chapter 16 on reporting results from discontinued operations, extraordinary items, and changes in accounting principles. Integration of all dividend coverage in Chapter 16.
- Revision of Chapter 17 to reorganize coverage of premiums and discounts on long-term bonds. This permits easier coverage of either or both straight-line and effective interest amortization methods. Also, new illustrations use a five-year bond life so that amortization tables can show the complete discount or premium amortization. This enhances students' understanding of the amortization concept.
- Integration in Chapter 18 of lower-of-cost-or-market issues into presentation of short-term and long-term investments in stocks and bonds. Extensive real-life company illustrations.
- Simplified examples and the use of T accounts in Chapter 19 to show cash flows from operating activities.
- Complete rewrite of Chapter 20. Use of one continuous example to show integrative presentation of horizontal, vertical, and ratio analysis. Strong emphasis on significance, limitations, and interpretation of statement analysis.
- Complete rewrite of Chapter 21. Simplified and continuous chapter illustrations show major aspects of consolidated statements. Coverage now includes purchase at more than book value and minority interest. Increased coverage of international accounting.
- Complete rewrite of Chapter 22. Focus on the flow of costs in a manufacturing firm using a product with which students can identify. Discussion and integration of modern manufacturing concepts such as the just-in-time (JIT) production philosophy into the text. Coverage of the impact of new methods of accounting.
- Chapter 23 introduces cost allocation techniques as a necessary step in determining manufacturing overhead. In keeping with modern manufacturing practices, we discuss activity-based costing and the use of bases other than direct labor for applying overhead to products.
- New format for the cost of production report in Chapter 24 for a process cost system.
- A revised and simplified budgeting illustration in Chapter 25. Expanded discussion of the importance of the budgetary process. Illustration of the impact of JIT and conventional inventory practices on related budget schedules.
- The addition to Chapter 28 of the process of decision making and the role information plays in that process. Added coverage of sell-now-or-process-further decisions. Simplified numbers in examples.

ORGANIZATION OF THE TEXTBOOK

PART I: "THE ACCOUNTING INFORMATION SYSTEM" (CHAPTERS 1–5)

Part I develops the basic accounting model step by step. Chapters 1–4 explain and illustrate the concepts, techniques, and steps in the accounting cycle using a series of fictional firms owned by a sole proprietor, Debbie Starr. A series of diagrams highlighting the portion of the accounting cycle covered summarize each chapter. The statement of cash flows is introduced early in the text (Chapter 1). Appendix 4B shows how the financial statements differ for a corporation. Chapter 4 includes end-of-chapter problems based on a corporation.

**PART II:
“ACCOUNTING
SYSTEMS”
(CHAPTERS 6–8)**

Part II introduces accounting systems and internal controls. Chapter 7 discusses the payroll system, and Chapter 8 explains the control of cash and the voucher system as internal control devices.

**PART III: “INCOME
MEASUREMENT AND
FINANCIAL REPORTING
ISSUES”
(CHAPTERS 9–13)**

Part III covers income measurement and valuation issues relating to receivables, inventories, and long-term assets. It concludes with a chapter on financial reporting issues.

**PART IV:
“ORGANIZATIONAL
FORMS AND
REPORTING ISSUES”
(CHAPTERS 14–21)**

Part IV opens with a description of the accounting for partnerships in Chapter 14. Chapters 15 and 16 discuss the corporation as a unique form of business organization. We discuss accounting for the issuance of bonds and investments in bonds and stocks (Chapters 17 and 18) using both the straight-line and the effective interest methods. Chapter 19 illustrates the statement of cash flows, using a unique introduction that shows interrelationships among the financial statements. Chapter 20 discusses financial statement analysis with an emphasis on the significance and interpretation of the results. Chapter 21 describes and illustrates consolidated statements and international accounting.

**PART V: “COST
ACCUMULATION AND
CONTROL”
(CHAPTERS 22–28)**

Part V describes the accounting for general manufacturing operations and for job order and process cost systems. We cover job order and process cost systems in Chapters 23 and 24. Chapter 25 covers planning, including cost-volume-profit analysis and budgeting. Chapter 26 covers controlling, including flexible budgeting and standard costing. Chapter 27 introduces managerial reporting with variable costing and segment reporting. Part V concludes with Chapter 28’s discussion of nonroutine decision making using accounting information. Boxed items in these chapters discuss managerial accounting changes in the modern manufacturing environment, such as just-in-time management and total quality management.

**END-OF-BOOK
APPENDIXES**

The textbook includes three appendixes. Appendix A considers basic income tax procedures, using flow diagrams to present an overview of income tax computations. It also introduces interperiod income tax allocation. Appendix B contains a summary of basic financial statements and explanatory notes for a hypothetical company. Then, we include the consolidated financial statements of The Procter & Gamble Company and accompanying notes. A series of questions for each chapter based on Procter & Gamble’s statements and notes follows. Appendix C contains the coverage of present value concepts and tables for four basic present value techniques.

THE TEACHING PACKAGE

In addition to the textbook, the teaching package includes a remarkable set of teaching tools for the instructor and tools of learning for the student. The authors of these items are outstanding educators in their own right.

FOR THE INSTRUCTOR

INSTRUCTOR'S EDITION

Fully annotated by the textbook authors, this edition provides Instructor's Notes, Lecture Notes, Lecture Examples, and Teaching Tips. These provide a valuable guide for instructors in developing their course lectures.

INSTRUCTOR'S MANUAL

BY LYNN MAZZOLA PALUSKA (NASSAU COMMUNITY COLLEGE) The Instructor's Manual is a complete classroom resource for today's professional educator. Completely rewritten, it contains detailed teaching suggestions and aids for each chapter in the textbook:

- Grammatik IV Reading Level Analysis.
- Concise Lecture Outline, with major topics listed in outline form.
- Detailed Lecture Outline, organized by Learning Goal with annotations, teaching tips, and a listing of new glossary terms for each Learning Goal.
- Review Quiz, which includes multiple-choice questions.
- Suggested Assignments by Learning Goal.
- Overview of Assignment Material, organized by learning goal, difficulty, and time required.
- Ethical Case Comments, with advice on approaching this sensitive topic.

Also included are major stand-alone sections on Learning to Learn, Teaching Communication Skills, and Sample Syllabi. The complete Instructor's Manual is available on disk for use with word processors for developing personalized course notes.

SOLUTIONS MANUAL

The Solutions Manual, prepared by the textbook authors, consists of two volumes (Chapters 1–14 and Chapters 15–28) with answers for all assignment material in a bold, easy-to-read format. Included are solutions for Discussion Questions, Exercises, A and B Problems, Practice Cases, Business Decision and Communication Problems, Ethical Dilemmas, and Mini Practice Sets.

SOLUTIONS TRANSPARENCIES

Solutions to all end-of-chapter exercises and problems are available on transparency acetates in a bold, easy-to-read format. Also included are solutions to Practice Cases, Business Decision and Communication Problems, Ethical Dilemmas, and Mini Practice Sets.

TEACHING TRANSPARENCIES

A newly expanded package includes 150 one-, two-, and four-color transparency acetates that highlight selected text exhibits and reinforce accounting concepts through step-by-step illustrations. Also new are blank accounting forms for journals, ledgers, and financial statements.

ELECTRONIC TEACHING TRANSPARENCIES

The contents of many of the teaching transparency acetates have been converted into electronic format for classroom presentation. The software requires an IBM PC and an appropriate visual display.

TEST RESOURCE MANUAL

BY BEN SHLAES AND PATRICIA HOLMES (DES MOINES AREA COMMUNITY COLLEGE) This test bank in manual form has been revised and expanded by 35%. Each chapter now includes 30 true/false, 50 multiple-choice questions, and 15–20 short problems. Solutions with supporting computations for selected items are also included. Approximately one-half of the multiple-choice items are conceptual and one-half are problem oriented. All tests items are referenced to chapter Learning Goals.

ACHIEVEMENT TESTS A & B

Also by Shlaes and Holmes, this manual includes two alternate sets of 14 tests each. Each test covers two chapters from the textbook.

COMPUTERIZED TEST BANK

All test items are available in computerized format for use on the IBM PC or Apple Macintosh systems. The software can generate multiple versions of each exam with answer keys. The system also allows instructors to edit existing questions and add new ones.

SOLUTIONS TO PRACTICE SETS 1–5

Full solutions to two newly revised and three all-new practice sets are printed on the same accounting forms given to the students for easy grading.

VIDEOTAPE PACKAGE

This package of videotapes consists of 30 half-hour lessons that are correlated to the *Principles of Accounting* textbook. Accounting principles and concepts are demonstrated through stimulating visual examples applied to real-world business situations, showing how a growing business comes to require multiple accounting tools. Contact your Dryden sales representative for further details and minimum adoption requirements.

FOR THE STUDENT

STUDY GUIDE

BY A. DOUGLAS HILLMAN (DRAKE UNIVERSITY) More than ever before, the Study Guide's unique guided study approach helps students take active responsibility for learning and review. Each chapter reviews the Learning Goals and then programs student attention to learn the more difficult concepts in each chapter. Self-tests with answers help measure achievement.

WORKING PAPERS

Based on professional accounting forms, working papers are provided for each exercise and for each pair of A and B Problems. Volume I covers Chapters 1–16 and Volume II covers Chapters 14–28. Working papers in early chapters are partially filled in to provide help to the beginning student.

PRACTICE SET ONE

BY DONALD R. DAVIS *Complete Computers*, for a computer wholesaler, is a sole-proprietorship practice set with realistic documents or business papers. It covers textbook Chapters 1–6. *It is also available in a computerized form for the IBM PC by Kent Finkle.* Available in an Apple Macintosh® version by Don Davis.

PRACTICE SET TWO

BY DONALD R. DAVIS *Sports Source*, for a sporting goods wholesaler, is a sole-proprietorship practice set with a narrative of transactions. It also covers textbook Chapters 1–6. *And it is also available in a computerized form for the IBM PC by Kent Finkle.* Available in an Apple Macintosh® version by Don Davis.

PRACTICE SET THREE

BY SHARYLL A. B. PLATO (UNIVERSITY OF CENTRAL OKLAHOMA) *Sunset Hills Community Country Club* is a sole-proprietorship practice set that features realistic transactions and provides practice in such accounting procedures as payroll and inventory. The country club has elements of both a service and (through its pro shop) a merchandising concern. Substantial enough for a major project, it covers Chapters 1–13.

PRACTICE SET FOUR

BY ANITA V. HOPE (TARRANT COUNTY JUNIOR COLLEGE) *Rent-A-Ride, Incorporated* is a service corporation practice set that covers equity and nonequity transactions with an optional module on financial statement analysis. It covers Chapters 1–16 (or Chapters 1–20 with optional module).

PRACTICE SET FIVE

BY KATHERINE A. LONGBOTHAM (RICHLAND COLLEGE) *Bookshelf Manufacturing Company* is a manufacturing practice set that includes truly managerial accounting topics, such as budgeting and break-even analysis. Optional modules cover presentations to management and cost accounting. It covers Chapters 1–25 or 1–28 with the cost accounting module.

MONOPOLY PRACTICE SET

BY ROBERT J. KNECHEL (UNIVERSITY OF FLORIDA) This open-ended, creative practice set teaches students about accounting by having them journalize their turns while playing *Monopoly*®, the popular Parker Brothers board game. Optional modules adjust the difficulty of assignments. Separate Solutions Manual for instructors; game not included.

PROBLEMS DISK



BY KENT FINKLE This free general and special ledger software works selected problems (marked by a special logo) in end-of-chapter material. Operating instructions appear in the Working Papers. For the IBM PC.

ELECTRONIC SPREADSHEET TEMPLATES



BY DONALD R. DAVIS This free collection of spreadsheet templates works selected problems (marked by a special logo) in end-of-chapter material. Operating instructions appear in the Working Papers. For the IBM PC and the Apple Macintosh®.

THE REAL-TIME ADVANTAGE



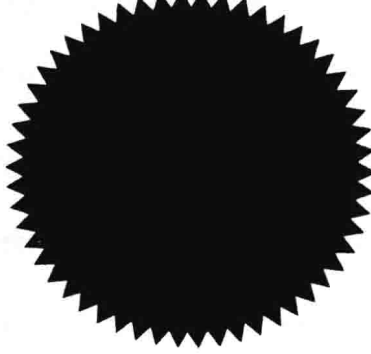
BY PHYLLIS S. YASUDA AND JOHN WANLASS (DE ANZA COLLEGE) This for-sale *Introduction to Computerized Accounting* includes powerful general ledger software with full operating instructions. The software works selected problems (marked by a special logo) in end-of-chapter material. By exploiting the software's real-time capabilities, this package helps students improve their understanding of the impact of individual transactions.

MICROSTUDY

BY DELTA SOFTWARE This free computerized tutorial is keyed to chapter Learning Goals for quick, graded study. For the IBM PC.

STUDY GUIDE FOR
THE TELECOURSE

BY WILLIAM G. ENGELBRET (THE PENNSYLVANIA STATE UNIVERSITY) For students enrolled in the Telecourse, this guide correlates the video lessons to the textbook and provides tailored assignment material. (Campus administrators interested in learning more about the telecourse should write to Dallas Telecourses, 9596 Walnut Street, Dallas, Texas 75243-2112.)



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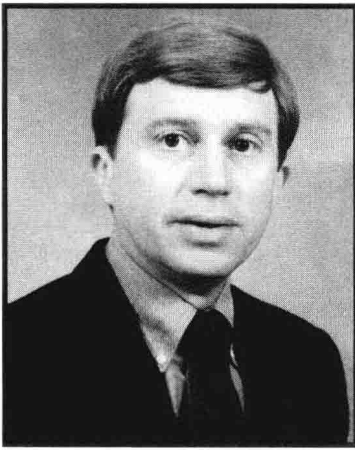
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Although he has taught a variety of undergraduate and graduate courses, his primary teaching responsibility has been the accounting principles course. Professor Kochanek has received every outstanding teaching award the University of Connecticut offers. These include outstanding accounting professor, outstanding professor in the School of Business, the United Technologies Corporation outstanding undergraduate teaching award, outstanding MBA professor, and the Alumni Award for the outstanding teacher at the University of Connecticut.

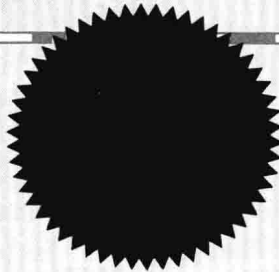
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CORINE T. NORGAARD, Ph.D., CPA, is a professor of accounting and Director of External Affairs and Development at the University of Connecticut's School of Business Administration. She is also director of education for the American Accounting Association and is a member of the Accounting Education Change Commission. Professor Norgaard has had experience in both public and private accounting and was formerly on the faculty of the Graduate School of Management at the University of California, Los Angeles. For two years she was a visiting professor at Yale University's School of Organization and Management.

Professor Norgaard has written numerous articles appearing in professional journals and is the author of a textbook, *Management Accounting*. She has also written numerous professional development courses for organizations such as the American Institute of Certified Public Accountants and the Institute of Management Accountants.

Professor Norgaard is an active member of the American Institute of Certified Public Accountants, the American Accounting Association, the Institute of Management Accountants, and the Connecticut Society of CPAs. She was president of the Northeast Section of the AAA, a member of the Board of Governors of the Connecticut Society of CPAs, a member of the editorial boards of the *Accounting Review* and *The Connecticut CPA*, and was the editor of the AAA Auditing Section's *The Auditor's Report*.



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