

Volume II

Chapters 15-25



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INTERMEDIATE

ACCOUNTING

INTERMEDIATE ACCOUNTING

Fifth Edition

Volume II

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To our wives and families:
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INTERMEDIATE ACCOUNTING

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PREFACE

INTRODUCTION

We continue to revise *Intermediate Accounting* with the student in mind. Our mission is to present critical concepts in a clear, concise way that is most helpful to learning and to enhancing the student's interest. The major changes we have made have this goal in mind. This revision continues to reflect the fact that instructors tell us they prefer a text that is user-friendly and that fosters the learning process.

We believe this edition reflects the views of both non-adopters and our faithful group of repeat users. We have learned a great deal. We thank them for their support and their suggestions. Our hope is that our text truly is a book that students will want to read and one from which they will learn a great deal.

As the authors of this text, we have put our many years of practical experience in teaching intermediate accounting to work in designing what we feel is an outstanding text for intermediate accounting. We have learned what works and what does not in the classroom and have exercised special care when covering those areas that are especially troubling for students. We involve the student in the learning process by developing the logic for important and controversial principles and by integrating real-world examples of financial reporting into the text.

By starting each chapter with a short introduction involving the main issues of the chapter in a real-world context, we first catch the student's interest and then hold it to the end of the chapter. We welcome your comments on how to improve continually the learning process for our students and add value for our adopters.

OVERALL OBJECTIVES AND CHANGES FOR THE FIFTH EDITION

The fifth edition builds on the foundation of the fourth edition and maintains its:

- Comprehensive and up-to-date coverage of accounting principles.
- Use of examples to illustrate procedure.
- Clear writing style.
- Thorough end-of-chapter material.
- Emphasis on critical thinking.
- Real-world emphasis in both text and end-of-chapter material.
- Flexible organizational structure.
- Diverse set of pedagogical features.

Curriculum Concerns We believe that the curriculum should respond to issues pertaining to encouraging students to learn how to learn. Rather than emphasize rote learning of rules and regulations, we underscore how important it is for users and preparers of financial statements to understand accounting principles and how they are applied in financial reporting decisions. We also believe that without a firm grounding in accounting principles, the more user-oriented features would be of little value. Once the basics are internalized, the focus is on the process of inquiry in which the student learns to identify problem situations, search for relevant information, analyze and interpret the information, and reach valid conclusions.

The text presents GAAP as the current solution to a continually evolving host of financial reporting questions. By acquainting the student with the political nature of standard setting, the reader becomes aware that both users and preparers are affected by the outcome of the standard-setting process. Therefore, each should have input into the deliberations that establish reporting standards. A fair number of the end-of-chapter cases require students to adopt this perspective in making recommendations on reporting issues. We hope this text stimulates a more interactive and involved learning process on the part of students.

Appearance and Exposition The design of this text should make reading and learning more interesting and pleasant for the student. More important, we have continued to make extensive use of examples, diagrams, tables, flowcharts, and other visuals in an effort to include graphical material as much as possible in place of pure textual discussion to facilitate the learning process. A short example is often better than using a verbal approach. We have introduced the "Crystal Clear Connections" icon to help show the integration of critical topics throughout the text.

We have found in our teaching that visual aids and examples help students get over the initial introduction to new material, increase their interest and enthusiasm, and improve retention. Use of graphical material also is more efficient in terms of the space required to present a concept. The interaction of several components of a complex procedure often is more easily assimilated visually.

Critical Chapters From discussions with our users and colleagues at several universities across the country, we have identified eight topics that are critical to understanding intermediate accounting. These are integrated throughout the text and are clearly indicated by the use of linking icons. The topics are *cash flows*, *pensions*, *inven-*

tory, leases, revenue recognition, taxes, bonds, and earnings per share, which are concentrated in nine chapters:

Chapter	Topic
7	Revenue and Expense Recognition
10	Inventory: Alternative Valuation Methods
14	Investments in Debt and Equity Securities
16	Long-Term Liabilities
17	Accounting for Leases
18	Accounting for Pensions and Other Postemployment Benefits
19	Accounting for Income Taxes
22	Earnings per Share
23	Statement of Cash Flows

We have made a special effort in these chapters to proceed from the less difficult and more conceptual material to the more complex procedural and technical material. Our aim here is to build the student's confidence while emphasizing the conceptual and theoretical underpinnings. We believe that with this foundation, the student is better equipped to tackle the more difficult accounting procedures and longer examples that characterize the material in each of these chapters. An added benefit of this approach is that instructors who wish to deemphasize the more complex mechanics of applying GAAP to practical situations can do so without compromising accounting theory. To provide complete coverage and to help students master the more difficult technical material, review problems follow major sections within each of these chapters.

User Emphasis Where appropriate, we have added a short section on financial ratio effects to selected chapters. Rather than devote an entire chapter to financial statement analysis and the use of financial statement information (as was the case in a previous edition of this text), we have integrated the discussion of ratios in relevant chapters. By integrating ratio coverage and specific GAAP, we are able to discuss the effects of GAAP choices and other aspects of financial reporting in a more dynamic context. We believe that the student learns more about the usefulness and limitations of ratios while simultaneously studying the major substantive issues of a chapter.

Up-to-Date Coverage Another goal of this edition is to maintain up-to-date and comprehensive coverage of accounting principles while not significantly increasing the size of the text. The coverage of relevant professional pronouncements is current as of the date of publication. It includes discussion of all recently published FASB statements and exposure drafts that affect intermediate accounting. However, while recognizing the necessity of maintaining comprehensive coverage, the realities of the marketplace and the ever-increasing number of professional standards have caused us to reevaluate the relative importance of certain topics, resulting in occasional deletions and reductions of coverage in other areas.

In addition, we have updated most introductions, often shortening them to focus on the chapter issues within a real-world context. Most of the real-world examples within the text and end-of-chapter material have been updated. Global views were rewritten where necessary to reflect major changes in international accounting.

End-of-Chapter Material The problem material for each chapter is organized into two parts:

Part I: Understanding and Applying Concepts and Standards.

This part includes questions, exercises, and problems and stresses the basic understanding of relevant GAAP and application of those standards. These items typically are more straightforward and structured than those in Part II.

Part II: Analysis, Judgment, and Communication

This part includes cases, financial statement analysis problems, and comparative analysis problems. As such, this part of the end-of-chapter material stresses more open-ended situations, writing, and real-world contexts. One of the benefits of real-world problems is that students are exposed to more complex and realistic situations. These contexts often do not lend themselves as readily to solution as do the items in Part I. Significant exposure to this type of material is, we believe, an important part of the education of an accountant.

Specific end-of-chapter changes include:

1. **Quantity of items.** The quantity of exercises and problems has remained constant in this edition, and users will find their favorite choices remain available. The total coverage should equal or exceed the coverage in other intermediate texts in terms of the quantity and variety of end-of-chapter material. Other exercises and problems, and especially our cases and analysis problems, probe more conceptual issues.

We are grateful to Professor Loyd Heath of the University of Washington, who contributed problems to selected chapters. His problems are typically longer writing cases involving more complex financial reporting situations.

2. **Financial statement analysis.** Several problems addressing ratio analysis and financial statement analysis are available. A common theme of these problems is to ask the student to address the effects of alternative measurement choices on financial ratios. These problems require a broader knowledge of the effects of GAAP choice because aggregate measures typically are involved in the ratios considered in these problems. These ratio problems complement the chapters that have sections devoted to ratio analysis in them but also appear in other chapters.

3. **Group items.** Each chapter contains at least one item that is amendable to a team solution. The goal of these problems is to encourage students to work together, share ideas, and learn from one another.

We suggest that the instructor plan the group work before assigning these items. For example, the instructor can assign primary responsibility for one part of these items to each class group. Each group then reports to the class. Each group also should be aware of the remaining parts of the problem and evaluate other groups' reports. Another strategy for group application is for each group to perform all parts of each item, then have the leader of each group provide a brief report on the answer. After each group reports, the groups re-form and discuss the aspects of the discussion they missed and what aspects they alone discovered. For additional strategies on group work, see Peek, Winking, and Peek, "Cooperative Learning Activities: Managerial Accounting," *Issues in Accounting Education*, Spring 1995, v. 10, no. 1, pp. 111–125.

4. World Wide Web problems. In several selected chapters there are problems that make use of the World Wide Web portion of the Internet. As such, students can put the Web to work in the context of an intermediate accounting issue. These problems provide an important exposure to actual financial statements because the entire statement is at their disposal. None of the data is given in the text. The student retrieves the 10-K report of the firm identified in the problem from the SEC's EDGAR database. The so-

lutions given in the answer manual reflect the most recent statements available. We would appreciate your comments on this and other possible uses of information technology for improving the text.

5. Accuracy. We have checked and rechecked each end-of-chapter item. In addition, to increase the accuracy of the problems and solutions, Jim Emig of Villanova University checked each item independently. Finally, the fact that the problems and exercises, as well as some of the cases and analysis items, have not been fundamentally changed from the fourth edition assures that new errors have not been introduced. We are confident that you will find the text essentially error-free.


TOPICAL CHANGES IN THE FIFTH EDITION

The fifth edition has been updated to reflect changes in accounting and reporting principles since the previous edition and to fine-tune the coverage. For example, the discussion of comprehensive income in Chapter 2 has been updated and the discussion of derivatives in Chapter 14 now reflects the changes under *SFAS No. 133*.

KEY PEDAGOGICAL FEATURES

We continue the pedagogical features from the previous edition that have received positive reviews from current adopters. The purpose of these features is to facilitate the learning process and to provide variety in the text and end-of-chapter material. Also, the previous section on changes to the fifth edition highlights several more. A brief discussion of each follows. Many of these are denoted with an icon in either the text or the end-of-chapter material. The icons for those features are shown in the list below.

Text Features

 **Crystal Clear Connections.** The crystal clear icon indicates the integrated treatment of topics throughout the text.


Ratio Analysis. Sections covering ratio and financial statement analysis in selected chapters integrate the effects of major accounting principle choices on financial ratios. This feature is discussed in greater length in the section on changes to the fifth edition.

Review Problems. Each chapter ends with a solved review problem to provide additional practice on the technical aspects in that chapter. In addition, the nine critical chapters also have review problems after each major section, adding further reinforcement to more complex topics.


Real-World Examples. We use examples of financial reporting practices of actual companies throughout the

text. These examples not only place the subject matter squarely in the real world but also illustrate how firms interpret GAAP and put these principles into practice. To catch the student's interest, we start each chapter with a short introduction. The foundation of each is related to an actual reporting situation. In addition, we make liberal use of the financial press, including *The Wall Street Journal*, *Financial Executive*, and other publications. Frequent use of the AICPA's *Accounting Trends and Techniques* brings further real-world perspective to the text.

Coca-Cola Financial Statement. The 1998 statements and footnotes of the Coca-Cola Company appear in an appendix to the text. These statements are integrated throughout the text discussion.

 **Global Views.** This boxed element provides insights into international accounting issues pertaining to main issues in the chapter. Students learn that most countries have their own set of accounting

principles, that groups of countries such as the European Union have other principles, and that the International Accounting Standards Committee is yet another source for accounting principles.

 **On the Horizon.** This boxed element appears in several chapters and summarizes issues in progress and those that are just emerging. These elements connect to and extend the subject matter and remind the student that the process of generating accounting principles is never complete.

Concept Reviews. To reinforce major concepts, we have placed three short review questions at the end of each major section of each chapter. The questions are answerable directly from the text and serve the same function as a short quiz. The answers are provided in the solutions manual for the convenience of the instructor.

Learning Objectives. Each chapter starts with a list of the objectives for the chapter. The objectives are the key recognition, measurement, and reporting issues for the chapter area. The summaries and end-of-chapter material are tied back to the learning objectives.

Summary of Key Points. Each chapter ends with a list of major points discussed in the chapter. The summary is in list form. Each summary is keyed to the appropriate learning objective from the beginning of the chapter.


End-of-Chapter Material Features


Ratio Problems. Many chapters have one or more problems or exercises that require the student to analyze the effect of major measurement rules and GAAP choices on ratios most affected by the rules and choices. We believe a more meaningful coverage of ratios is possible by integrating the coverage of ratios throughout the chapters. A closer linking of topical area with relevant ratios is thereby achieved.




Group Problems. Many chapters use longer problems and cases as a context for group work. This feature is discussed in greater length in the section on end-of-chapter material.

Analysis of Financial Statements. Several of these problems appear in almost every chapter and help bring the subject matter to life within the context of an actual firm. These typically are less structured, and the data is less organized relative to the exercises and problems in Part I of the end-of-chapter material.

 **Comprehensive Problems.** Found in most chapters, these problems cover several of the chapters' learning objectives and bring together several issues in one problem. These problems help reduce the inherent modularization in coverage of intermediate accounting topics.

 **Writing Cases.** Appearing in every chapter, these cases require students to write specific documents such as memos and reports. The solutions to several of the writing cases have been rewritten to exemplify a more conversational tone and to add realism to the exchange of ideas between the writer and the audience.

 **You Make the Call.** These appear in several chapters and present a reporting issue that has yet to be considered by the FASB or that continues to provide an excellent context for students to develop their own analysis of the appropriate accounting treatment.

Ethics Problems. These cases appear in several chapters and focus on the ethical implications of particular actions and reporting decisions.

Coca-Cola Problems. Similar to Analysis of Financial Statement problems, these problems use the Coke financial statements as the database. Often, these items are more involved because we can draw on a much larger database of financial statement and footnote information. Also, more years of data are present than can be provided in other real-world problems in this text.

World Wide Web Problems. The Web provides the data for these problems similar to Analysis of Financial Statement problems. But as in the Coca-Cola problems, a richer database can be used to develop more elaborate items. This feature is discussed in greater length in the section on changes to the fifth edition.



Spreadsheet Problems. Called SPATS problems, these problems and exercises are designed so that they may be solved with a computer spreadsheet. Templates are provided for these problems.

ANCILLARIES AND SUPPLEMENTARY MATERIALS

For the Professor:

We have provided you with two different ways to purchase *Intermediate Accounting*. You can purchase *Intermediate*

Accounting, Chapters 1–14 and Chapters 15–25 in two separate volumes, or **Chapters 1–25** in one volume.

Intermediate Accounting, Fifth Edition, offers numerous teaching aids to assist the instructor.

Solutions Manual, Chapters 1–14 and 15–25 Done in two volumes, this comprehensive solutions manual provides complete solutions and explanations for all end-of-chapter questions, cases, exercises, and problems. The estimated completion time for each item is given in the assignment assistance schedule at the beginning of each chapter. Answers to the concept review questions are included at the end of each volume of the solutions manual.

Test Bank, Chapters 1–14 and 15–25 Prepared by Doris deLespinasse of Adrian College and revised and expanded with this edition, the test bank offers approximately 4,000 questions and problems from which to choose in preparing examinations. This test bank contains true-false questions, short-answer questions, problems, and cases.

Solutions Transparencies, Chapters 1–14 and 15–25 Acetate transparencies of solutions to all exercises, problems, and cases are free to adopters. Now increased in clarity, these transparencies are especially useful when covering problems in large classroom settings.

Teaching Transparencies, Chapters 1–14 and 15–25 Selected lecture transparencies based on material from the textbook and based on material from outside the book.

Instructor's Resource Manual, Chapters 1–14 and 15–25 This manual includes overviews, learning objectives, lecture outlines, problem analysis, and transparency masters. It was prepared by Craig Bain, Northern Arizona University.

Computerized Testing Software This microcomputer test generator program allows the instructor to select and edit exam questions from the test bank database. Questions can be selected using several criteria, such as chapter, type of question (e.g., multiple-choice, true-false, problem solving), and level of difficulty. The software is menu-driven, requiring little computer knowledge. It comes with a program disk, data disks containing the test bank database, and clearly written documentation. It provides password protection, can be used on a network, and is available on both 5.25" and 3.5" diskettes for IBM-compatible microcomputers.

Teletest Irwin/McGraw-Hill is happy to serve those customers without access to administrative support or a computer system. Simply choose your questions from the test bank and call Irwin/McGraw-Hill College New Media. By calling a toll-free number, users can specify the content of exams and have a laser-printed copy of the exam mailed to them within one day.

Ready Shows Ready Shows is a package of multimedia lecture enhancement aids that uses PowerPoint® software to illustrate chapter concepts.

The following item is intended for student use at the option of the instructors.

Spreadsheet Applications Template Software (SPATS)

Selected exercises and problems in each chapter, identified by a spreadsheet symbol, can be solved by using SPATS. The software contains innovatively designed templates based on Lotus 1-2-3 and includes a very effective Lotus 1-2-3 tutorial. SPATS is available on 5.25" and 3.5" disks. Upon adoption, this package is available for classroom or laboratory use.

For the Student:

Several support materials have been designed especially for the student.

Study Guides, Chapters 1–14 and Chapters 15–25 The study guides provide the student with a summarized look at each chapter's issues. Included are outlines, chapter overviews, key concepts, review questions, true-false questions, multiple-choice questions, and critical thinking exercises. The study guides were prepared by Craig Bain of Northern Arizona University.

Working Papers, Chapters 1–14 and Chapters 15–25 Two sets of working papers are available for completing assigned problems and exercises. In many instances, the working papers are partially filled in to reduce the "pencil pushing" required to solve the problems, yet they are not so complete as to reduce the learning impact.

Manual Practice Set Video One Wholesalers, a manual practice set, can be assigned after Chapter 6 as a review of the accounting cycle.

Computer Supplement Wild Goose Marina, Inc., offers a complete corporate simulation and is intended for use after coverage of stocks, bonds, and cash flows. The corporate simulation is prepared by Leland Mansuetti and Keith Weidkamp, both of Sierra College.

Ready Notes This booklet of Ready Show screen printouts enables students to take notes during Ready Show presentations.

Check Figures A list of check figures for selected end-of-chapter items is available.

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Their contributions have made it possible for us to feel confident in assuring you of the highest quality of this text.

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[NOTE TO THE STUDENT

The most important goal of a text is to assist you in learning the material of the course. The learning process is more effective when the ideas are presented in real-world contexts. Thus, each chapter begins with an actual situation.

The subject matter of this book, financial accounting, is critically important to many of the major decisions made in this country and abroad. Financial accounting information impacts the decisions that lead to resource allocation, the distribution of wealth, and the comparative competitive strengths of firms, industries, and economies.

Financial accounting is the study of the public information that organizations publish about their economic performance. This information is disseminated to those outside the organization for evaluation and action. Investors decide which firms' stocks or bonds they will buy. Other organizations use the data to decide whether to acquire them. Unions use the data in contract negotiations. Governments develop tax and trade policies based in part on financial reporting information, and these are only a few of the major types of decisions that rely heavily on accounting data.

It is our aim to develop the subject matter of this area so that you will be aware of the types of information that are made available, the rules that govern its composition and disclosure, and the limitations to current financial reporting practice.

Financial reporting is a dynamic field. It is changing daily. Issues of comparability, relevance, reliability, and practicality underlie the choices that must be made in preparing financial statements. Critical thinking and judgment are essential. Ethical and international considerations are often involved. We will be considering all these issues in the chapters ahead and in the problems, cases, and exercises you will be asked to complete.

Our adventure through the window of this book into the world of financial accounting will, we hope, be exciting, challenging, and rewarding. With your instructor's help, you should be able to master the material soon to be placed at your fingertips. Let the voyage begin!

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