



a ACCOUNTING

CONCEPTS AND APPLICATIONS

7TH EDITION

SKOUSEN / ALBRECHT / STICE / STICE

ACCOUNTING

CONCEPTS & APPLICATIONS

7e

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f = Financial Accounting chapters

m = Management Accounting chapters

see HOW, know WHY

PREFACE



The Language of Business

Understanding the numbers—it's the essence of business. Understanding what the numbers reveal, and what they do not reveal, allows business managers and investors to make every type of business decision: expand, merge, close, launch, subcontract, downsize, invest, reposition, lease, replace. As the basis for all these decisions, accounting is the universal language of business.

Take, for instance, the case of Safeway, a major supermarket chain, as examined in the opening vignette of **Chapter 2: Financial Statements: An Overview**. In the last twenty years, Safeway has experienced, at various times, falling market share, challenging union demands, high overhead, significant job cuts, an aggressive construction and remodeling program, a leveraged buyout, and reintroduction of the firm as a public company.

While Safeway has the third largest sales of major supermarket chains, its sales today are down ten percent since 1986. But its current net income is higher than that of Kroger and American stores, which have higher sales volumes.

What does the Safeway experience tell us? It tells us that to truly comprehend what is going on in a business, whether in the grocery store or in the corporate boardroom, one must understand accounting data—both how it is prepared, and why it is meaningful.

A Proven Approach

During the past few years, there have been many calls for improving accounting education. The central themes in all these calls for change have been (1) that the business world and accounting professions are changing rapidly, (2) that accountants of the past must become the premier information professionals of the future, and (3) that accounting and business graduates need new skills and knowledge if they are to effectively meet tomorrow's professional demands. These are significant changes. As one person said, "There is a bulldozer of change moving across America and

“There is a bulldozer of change moving across America and if you are not part of the bulldozer, you will be part of the road.”

if you are not part of the bulldozer, you will be part of the road.”

In creating this Seventh Edition, we were very sensitive to these calls for change. Much of our basis for writing this text has come through our experience developing and deploying the innovative accounting curriculum at Brigham Young University, an original grant recipient from the Accounting Education Change Commission (AECC). While constantly looking for ways to improve the program, we consider the BYU accounting program to be a success. Employers seem to agree, creating great demand for graduates.

Our purpose here is not to extol the strengths of BYU’s program. Rather we wish to share what we learned in the process of improving that program. We learned a great deal about the needs of business, both within and beyond the accounting profession, about the way students prefer to learn, and about the way instructors prefer to teach. **Accounting: Concepts and Applications, 7e**, embodies the lessons we learned. It is written and organized in a manner that allows students and instructors at all institutions to capitalize on our positive curriculum development experience.



‘How’ Means Nothing Without ‘Why’

Students taking the accounting principles course need to understand the basics of accounting, regardless of their future career plans. Most will be users of accounting information rather than preparers, but even users need to understand the essentials of accounting. And those who plan to pursue the field as a career need a strong foundation upon which to build. Emphasis in **Accounting: Concepts and Applications** is on the “why” as well as the “how.” As such, it provides a proper balance between conceptual understanding and procedural training.

This text is intended to be the most innovative, interesting, and understandable accounting principles text on the market. It provides an appropriate mix between financial and management accounting topics. Because of the completeness of coverage, both the financial and management sections of the book are available as separate texts.

Our approach to this book is to introduce students to basic accounting concepts, excite them by using lots of real world examples (both U.S. and international), provide them with some basic accounting knowledge, and then show them how accounting is used and analyzed in actual case situations. This book does not take an encyclopedic approach to every possible nuance of financial statement preparation or alternative way to perform accounting functions. We know that the few students who desire that level of detail will find it in more advanced classes.

Focus on Business Activities

Every company, regardless of its industry or type, must manage its business to acquire and sell products or services, make financing decisions, and invest in assets that will help the company generate growth and income. In the Seventh Edition, we continue to use an organizational format that is consistent with business activities and cycles (as opposed to the more traditional financial statement organization). This same approach was used in the last edition of the book, which was well received by reviewers and adopters. Specifically, after introducing and explaining financial reporting and the accounting cycle in Part 1 (Chapters 1-5), we discuss the operating activities of a business in Part 2 (Chapters 6-8) and the investing and financing activities in Part 3 (Chapters 9-12). We conclude the financial portion of the text by discussing the statement of cash flows in Part 4 (Chapter 13). This focus on business activities helps students

The process view considers the planning, controlling, and evaluating that are contained in most management accounting texts. The icons at the right identify the three management processes as they are addressed throughout the text.



management CHAPTERS

understand functions of business and see accounting as a tool to assist in making business decisions, not as an end in itself.

More How, More Why: Expanded Material

To increase flexibility in how this text can be used, we have preserved the innovation of the last edition that divided most chapters into two parts. The first part includes material that needs to be covered to understand essential accounting concepts, while the second part features “expanded material” dealing with nonessential topics or additional complexities to be covered at the instructor’s discretion.

For example, in Chapter 7 on inventory, the basic inventory valuation methods (specific identification, average cost, FIFO, and LIFO) are explained fully in the first part of the chapter. The discussion of reporting inventory at amounts below cost (lower of cost or market) and the gross margin method for

estimating inventory are covered in the optional expanded material section of the chapter. This strategy of dividing chapters into basic and expanded material was universally applauded by users of our last edition. It allows significant flexibility in covering desired material, without the disruption of skipping to appendices for more advanced material. Also note that end-of-chapter materials are divided and labeled to coincide with the essential/expanded division in the chapters.

The Full Perspective: Management Accounting

Perhaps the most significant content enhancements to the Seventh Edition are found within the management accounting sections where several different perspectives are woven together. Specifically, Part 5 presents both a process and a strategic view of management accounting.

The strategic issues view, in contrast, considers how organizations must compete on issues of **quality** and **timeliness**, not just on price (i.e., **cost**). The traditional focus on cost opens doors for competitors, especially international competitors, to distinguish their product in other ways, thereby earning market share. This creates a new challenge for accounting—balancing quality and time information with traditional cost measures. Simply appending chapters to the end of the text to address these issues is not sufficient. Special icons are used to draw student attention to these important strategic issues as they appear within the discussion of traditional topics.

The Seventh Edition reflects the reality that the traditional **manufacturing** view in accounting is inadequate today. The growing importance of **merchandising** and **service** markets requires students to be conversant in issues relevant to all three. Hence, this edition includes a separate chapter on merchandising companies and service firms. In addition, all remaining chapters have been revised to incorporate important issues common to all three or specific to each. Three icons are used in the chapters to signal discussion of the different types of business organizations.

As a result of integrating the discussion of management process and strategic issues across manufacturing, merchandising, and service organizations, the Seventh Edition is able to smoothly introduce cutting-edge topics such as:

- activity-based costing and activity-based management
- costs of quality and six-sigma measures
- just-in-time management systems
- benchmarking
- continuous improvement
- the balanced scorecard
- technology issues such as electronic data interchange

show **HOW,** explain **WHY.**

PREFACE

7^E

Consider the following features:

Special Margin Features

FYI features provide relevant information for students, drawing from real business events or situations.

STOP&THINK

Students are encouraged to take a step back occasionally to consider thought-provoking issues.

CAUTIONS

These reminders speak directly to students, helping them avoid common mistakes or misconceptions.

NET WORK

exercises give students practice in seeking out information on the Internet.

LEARNING OBJECTIVES

SETTING THE STAGE

BUSINESS ENVIRONMENT ESSAYS

KEY TERMS

SUMMARIES

REVIEW PROBLEMS

COMPREHENSIVE PROBLEMS

FOCUS ON GLOBAL ECONOMY

FOCUS ON ETHICS

This edition connects to business with the use of many insightful pedagogical features and real-world examples. As real companies and current events are examined, the focus is not only on how business managers collect and record data, but also why the information is important as the basis for decisions. Microsoft's annual report is provided at the end of the text and referenced throughout.

Each chapter begins with specific learning objectives to guide students in their study of the chapter. Where applicable, chapters include expanded learning objectives.

An interesting, real-life scenario sets the stage for each chapter. These scenarios tie directly to materials covered in the chapter and help students relate chapter topics to actual business happenings.

The text contains numerous real-world vignettes, adapted from financial newspapers and business publications, that illustrate important concepts being discussed. These examples enable students to see how the accounting topics they are studying are applied and interpreted in real-world situations.

Throughout each chapter, key terms are defined in the margins. A list of key terms (with page references) is presented at the end of each chapter, and all key terms are defined in a comprehensive glossary at the end of the book.

Several concise summaries are presented within each chapter to help students remember the important points just discussed, and each chapter concludes with a comprehensive summary, organized by learning objectives.

A review problem is provided at the end of each chapter (where applicable). These review problems (with solutions) demonstrate the application of the major concepts and procedures covered in the chapter.

Five comprehensive problems, integrating multiple issues and methods, are found throughout the text.

As mentioned, the focus in today's business world is on a global economy. To help students develop this global perspective, many international examples are provided throughout the Seventh Edition. In addition, there is at least one International Case provided at the end of each chapter.

Ethical considerations are increasingly important in all aspects of business. A section in Chapter 1 introduces the topic of ethics in financial accounting. Chapter 14 emphasizes the importance of ethics in the management accounting profession. Each chapter contains an Ethics Case relating to the topics covered in the chapter. These cases present ethical dilemmas that require students to think about behavioral and moral issues in business and accounting. We believe these ethics cases will provide a basis for rich classroom discussions and more responsible business conduct by students exposed to them.

Practice How, Analyze Why: End-of-Chapter Material

Like most introductory texts, this book has all the traditional end-of-chapter assignments. Before describing the traditional material, however, we want you to understand our excitement for the “Competency Enhancement Opportunities” (CEO) that are included in the end-of-chapter material. Responding to well-justified calls for changes in accounting education, this new material is included to help students develop critical thinking, ethical perspectives, oral and written communication skills, experience with electronic research, and team skills.

In each chapter’s assignments, the CEO section begins with **Analyzing Real Company Information** exercises, based on actual company annual reports and data. CEO also includes:

- **International cases**, focusing on businesses that operate across international borders
- **Ethics cases**, examining issues of personal and business responsibilities
- **Writing assignments**, to be completed individually or in groups
- **Debates**, requiring two teams to argue the opposing sides of an accounting issue
- **Internet search exercises**, requiring students to find specific information on the Net

We believe students will find these assignments very relevant, interesting, and beneficial in their business careers.

Users have responded favorably to the traditional end-of-chapter assignments in previous editions. The **discussion questions** are intended to refine students’ understanding of specific accounting terms and concepts. New to this edition are **discussion cases** that encourage classroom discussion of real-world business situations. **Exercises** deal with single concepts, and each can be completed fairly quickly. **Problems** probe for a deeper level of understanding. Those problems identified as “Unifying Concepts” and those with “Interpretive Questions” require students to analyze or interpret the computed results.

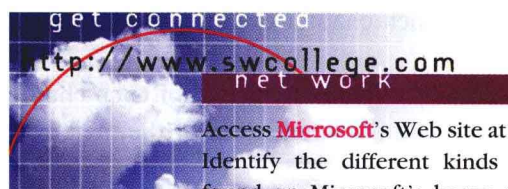
Modem Art

Technology is allowing—even forcing—business to be conducted in new and different ways. E-mail will soon be as ubiquitous as the phone and the fax. Millions of business transactions are conducted via the Internet each day. Web-based retailers such as bookseller Amazon.com and on-line financial service firms like E-trade have changed the entire customer contact model. Data stored in computer databases is often a firm’s most valuable asset. In short, managers in every industry, from paving to publishing, must capitalize on the power of technology to keep pace with the expectations of their customers and the efforts of their competitors.

Technology’s potential impact on accounting education is equally dramatic. Educators now have the opportunity to bring more information to students in more media than ever before.

Accounting: Concepts and Applications takes full advantage of these possibilities with a broad technology package:

- Comprehensive software supplements (see ancillaries section)
- NetWork and Internet Search Exercises in each chapter, directing students to various web resources to find solutions
- Virtual Community Web site at: skousen.swcollege.com



Access **Microsoft’s** Web site at **microsoft.com**. Identify the different kinds of information found on Microsoft’s home page, e.g., marketing, product information, etc.

Can you find any financial information?

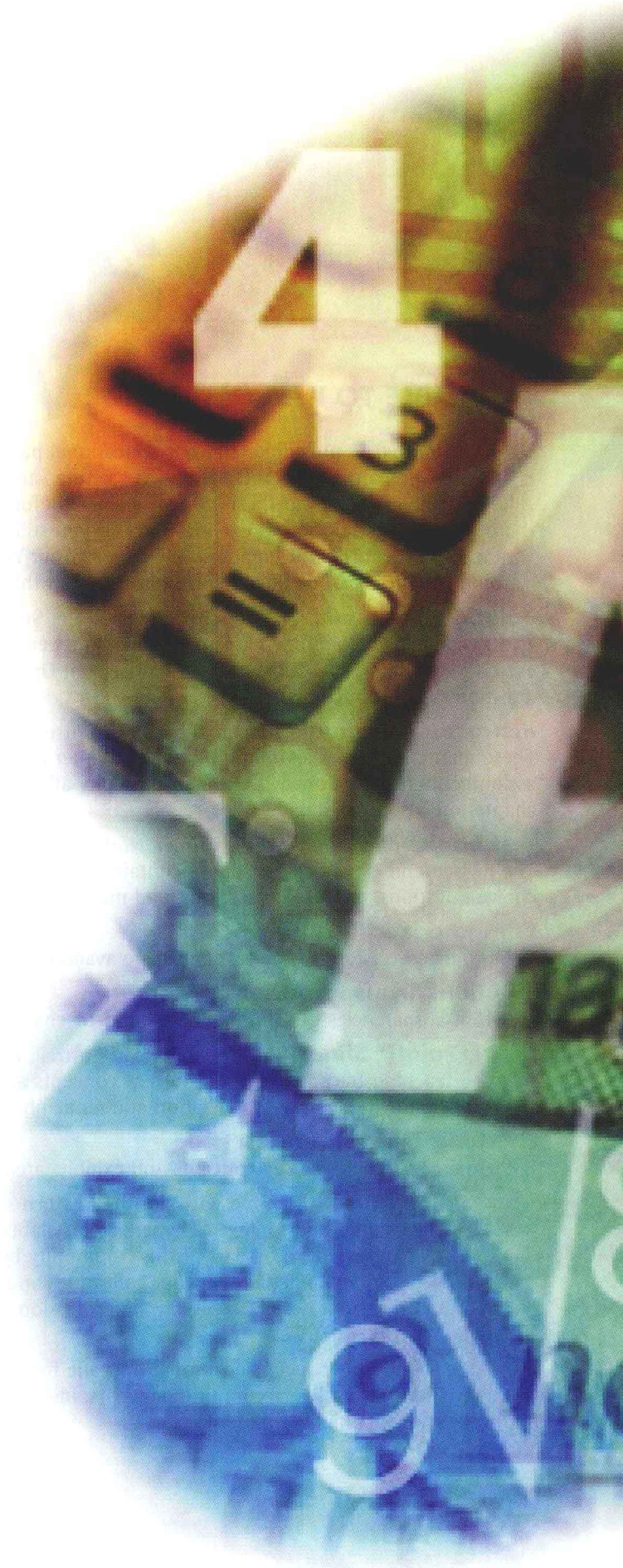
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FEATURING:

- **The Virtual Community** - This is where you will find the tools to take your course to the next level. Organized by chapter and topic, this hyperlinked syllabus offers PowerPoint™ slides, the Instructor's Manual, the Solutions Manual, relevant *Inc.* articles and recaps, software resources, and much more. A quick and easy registration process opens the door to special restricted material for text adopters.
- **The Community Commons** - Consider this your own town square. This is the place to share information and exchange tips with other instructors. Compare notes through discussion forums, learn how other instructors make the most of the Internet, subscribe to accounting-oriented listservs, or contact the authors or editors directly.
- **The Reserve Room** - This student resource provides additional study tools, available 24 hours a day. Here students have free access to hyperlink demo problems, Frequently Asked Questions, and downloadable spreadsheet templates. Organized by chapter, this page is extremely student-friendly.
- **The Reference Room** - Students click links here to access academic tips, financial research, newspapers and business periodicals, accounting firm sites, tax information and tools, and a variety of career and job search resources. Check the Reference Room for *The Wall Street Journal*, CNNfn, *American Employment Weekly*, the Coopers & Lybrand Accounting Library, and much more.
- **The Bookstore** - Students visit this page to conveniently order supplements at substantial discounts.

SUPPLEMENTS

This textbook is part of a comprehensive and carefully prepared educational package that offers various forms of assistance to both instructors and students. Each of the supplementary items available for use with the text is described briefly on the following pages. All supplements are divided into two volumes - Volume I, covering the financial chapters of the text (Chapters 1-13) and Volume II, covering the management chapters (Chapters 14-23).



ancillary MATERIALS

AVAILABLE TO INSTRUCTORS

ITP is committed to providing you, our educational partners, with the finest educational resources available. Because we prepare our instructor resources with a variety of teaching environments in mind, it is likely that you will need only a portion of these for your course. Before you request an item, we ask that you please read thoroughly the description of each resource. If you still need more information about resources, we urge you to contact your local ITP sales representative or visit our Web site at skousen.swcollege.com. Many teaching and learning resources can be downloaded directly from this site.

Solutions Manuals (Prepared by Fred Skousen, Steve Albrecht, Jim Stice, Kay Stice, and Monte Swain)
These manuals contain independently verified answers to all end-of-chapter discussion questions, discussion cases, exercises, problems, and Competency Enhancement Opportunities (CEO). Suggested solutions to the Stop & Think questions are also included.

Instructor's Manuals (Prepared by David Cottrell, Brigham Young University)
These manuals contain learning objectives, chapter outlines, topical overviews of end-of-chapter materials, and assignment classifications with level of difficulty and estimated completion time. Transparency masters for each chapter are also provided.

Test Banks (Prepared by Leslie Turner, Northern Kentucky University)
The revised and expanded test banks contain a collection of more than 2,000 examination problems, multiple-choice questions, true-false questions, and matching exercises, all accompanied by solutions.

Computerized Test Banks
Computerized versions of the test banks are available in both DOS and Windows formats.

Solutions Transparencies
Acetate transparencies of solutions for all end-of-chapter exercises and problems are available to text adopters.

PowerPoint™ Slides (Prepared by David Cottrell, Brigham Young University)
Selected teaching transparency slides of key concepts and exhibits are available in PowerPoint presentation software, improving lecture organization and reducing preparation time.

Teaching Transparencies
Acetate transparencies of key concepts and exhibits are available to text adopters.

Virtual Community: Online with South-Western skousen.swcollege.com
Organized by chapter and topic, this hyperlinked syllabus includes text-specific and other accounting-related resources. We invite you to be part of this community by sampling what we've provided and by sharing your own material, ideas, and comments with your colleagues and students. Visit our discussion forum and exchange information on current developments in the profession, and share ideas on the course and curriculum.

BusinessLink Videos
Two videos, one for financial accounting and one for management accounting, feature segments of actual companies illustrating key accounting concepts. Instructor's Manuals are available to assist in the use of the videos and the optional student workbooks.

AVAILABLE TO STUDENTS

Study Guides (Prepared by Fred Skousen, Steve Albrecht, Jim Stice, and Kay Stice)

The study guides provide a means for students to re-examine the concepts and procedures in each chapter from several different perspectives. These publications include learning objectives; detailed chapter summaries; discussions of topics that typically cause problems for students and suggestions for overcoming those problems; and tests for student self-assessment.

Working Papers

Forms for solving end-of-chapter exercises and problems are perforated for easy removal and use.

Homework Assistant and Tutor (HAT) Software (Prepared by Ray Meservy, Brigham Young University)

This user-friendly software for Windows visually teaches the relationships among journals, ledgers, and financial statements. A built-in tutor function offers numerous hints and help screens. The software can be used to solve selected end-of-chapter exercises and problems, identified with the HAT icon. It is also an ideal teaching aid.

General Ledger Software (Prepared by Warren Allen and Dale Klooster)

This best-selling educational general ledger package may be used to solve selected end-of-chapter problems, which are identified with the general ledger icon. Available for Windows only.

Spreadsheet Templates (Prepared by Leslie Turner, Northern Kentucky University)

Lotus 1-2-3 and Excel templates are provided for solving selected end-of-chapter exercises and problems, which are identified with the spreadsheet icon. Unlike traditional templates, these spreadsheets are colorful, interactive, and intuitive, many with the capability of performing “what-if” analysis.

BusinessLink™ Video Workbooks

These workbooks enrich understanding of the BusinessLink videos through questions and related activities.

AND
related

RELATED PRODUCTS PRODUCTS

Using QuickBooks 4.0 in the First Accounting Course (by Glenn Owen and Paul Solomon)

This is the first text of its kind to provide a self-paced environment where students use a commercially-available software product to analyze, interpret, and investigate accounting information to make business decisions. Managerial aspects of computerized accounting are also covered, such as financial analysis and comparisons.

The Financial Reporting Project (by Bruce Baldwin)

This highly popular project requires students to work with annual reports of real companies to understand, interpret, and analyze the information. Interesting readings from publications like *The Wall Street Journal*, along with supporting Questions for Consideration, provide additional material for discussion.

Hazzard Travel (by Donna Ulmer and M. Robert Carver)

Students maintain an accounting system for the first two months of operation of Hazzard Travel, providing them with an overview of an entire accounting system for a small business and familiarizing them with basic accounting documents, procedures, and concepts. Students make operating, financing, and investing decisions, resulting in different financial outcomes. The problems are unstructured, encouraging creativity and individual judgment.

CONTACCT II, Version 3 (by Dasaratha Rama and K. Raghunandan)

This accounting cycle software package contains tutorials, practice assignments, graded homework assignments, and a student instruction booklet.

acknowledgements

Throughout the textbook, relevant publications of standard-setting and professional organizations are discussed, quoted, or paraphrased. We are indebted to the American Accounting Association, the American Institute of Certified Public Accountants, the Financial Accounting Standards Board, and the Institute of Management Accountants for material from their publications.

The 7th edition of *Accounting: Concepts and Applications* reflects many comments and suggestions from colleagues and students, all of which are deeply appreciated. In particular, we wish to thank the following accounting educators who have served as reviewers, diary keepers, and focus group participants:

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Fred Skousen
Steve Albrecht
Jim Stice
Kay Stice

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The Right Team

Authors K. Fred Skousen, W. Steve Albrecht, and James D. Stice are all key players in the curriculum change process at BYU. As we created the plan for this edition, we decided to expand the author team to bring critical new skills to the book. Kay Stice, a professor at Hong Kong University of Science and Technology, was added to bring an international dimension to the book. Monte Swain, an outstanding young professor of management accounting, was added as a consulting editor to bring currency and relevance to the rapidly-changing management accounting chapters. Individually and as a team, we feel passionately about making this the most relevant and useful book you will ever use.

K. Fred Skousen

K. Fred Skousen is Advancement Vice President at Brigham Young University. Previously, he was Dean of the Marriott School of Management and Director of the School of Accountancy at BYU. He earned a bachelor's degree from BYU and master's and Ph.D. degrees from the University of Illinois. Dr. Skousen taught at the University of Illinois and the University of Minnesota prior to joining the faculty at Brigham Young University. In 1983, Dr. Skousen was awarded the Peat Marwick Professorship at BYU. In 1984, Dr. Skousen was elected to the AICPA Council, and in 1985, he received the UACPA Outstanding Faculty Award. Dr. Skousen has been a consultant to the Financial Executive Research Foundation, the Controller General of the United States, the Federal Trade Commission, and to several large companies. He currently serves on the Board of Directors of several corporations. Dr. Skousen is the author or co-author of more than 50 articles, research reports, and books, including *Intermediate Accounting*, 13th edition. Fred and his wife, Julie, have five sons, one daughter, and nine grandchildren.

W. Steve Albrecht

W. Steve Albrecht is the Arthur Andersen & Co. Alumni Professor of Accountancy and the Director of the School of Accountancy & Information Systems at Brigham Young University. He received a bachelor's degree in accounting from Brigham Young University and MBA and Ph.D. degrees from the University of Wisconsin at Madison. Dr. Albrecht, a certified public accountant, certified internal auditor, and certified fraud examiner, came to BYU in 1977 after teaching at Stanford and at the University of Illinois. Earlier in his career, he worked as a staff accountant for Deloitte & Touche. Dr. Albrecht has received numerous awards and honors, including the BYU School of Management's Outstanding Faculty Award, the BYU Outstanding Researcher Award, and was recognized, as part of Utah's Centennial Celebration, as one of 131 Utahians who have made outstanding contributions or brought unusual recognition to the state. Dr. Albrecht is currently President of the American Accounting Association and Past-President of Administrators of Accounting Programs. Dr. Albrecht has done extensive research on white-collar crime and business fraud. His research has resulted in the publication of over eighty articles in professional journals. He is the author or co-author of 16 books or monographs, three of which are on white-collar crime and fraud. Dr. Albrecht is married and has six children and two grandchildren.

MORE **about** THE AUTHORS

James D. Stice

James D. Stice is an Associate Professor in the School of Accountancy and Information Systems at Brigham Young University. He holds bachelor's and master's degrees from BYU and a Ph.D. from the University of Washington, all in accounting. Dr. Stice has been on the faculty at BYU since 1988. During that time, he has been selected by graduating accounting students as "Teacher of the Year" on numerous occasions, and he was selected by his peers in the Marriott School of Management at BYU to receive the "Outstanding Teaching Award" in 1995. In 1996, he was selected by BYU to receive a "University Young Scholar" fellowship. Dr. Stice has published articles in *The Accounting Review*, *Decision Sciences*, *Issues in Accounting Education*, *The CPA Journal*, and other academic and professional journals. He is also co-author on *Intermediate Accounting*, 13th edition. Jim and his wife, Kaye, have seven children: Crystal, J.D., Ashley, Whitney, Kara, Skyler, and Cierra.

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Monte R. Swain (Consulting Editor)

Monte R. Swain is an Assistant Professor of management accounting and information systems and the Price Waterhouse Research Fellow at Brigham Young University. He received his undergraduate degree in accounting and his master's degree in management accounting from Brigham Young University and was distinguished as the School of Accountancy's Outstanding Graduate. In 1992, Dr. Swain received his Ph.D. in management accounting and information systems from Michigan State University and was honored with the department's Outstanding Doctoral Scholar award. At BYU, he has received the Teaching Excellence Award for Management Skills in 1994 and 1995. Dr. Swain has published papers in a number of journals, including *Decision Sciences*, *Internal Auditor*, the *Journal of Accounting Case Research*, the *International Journal of Applied Quality Management*, and *Accounting Education: A Journal of Theory, Practice and Research*. He and his wife, Shannon, have five children.