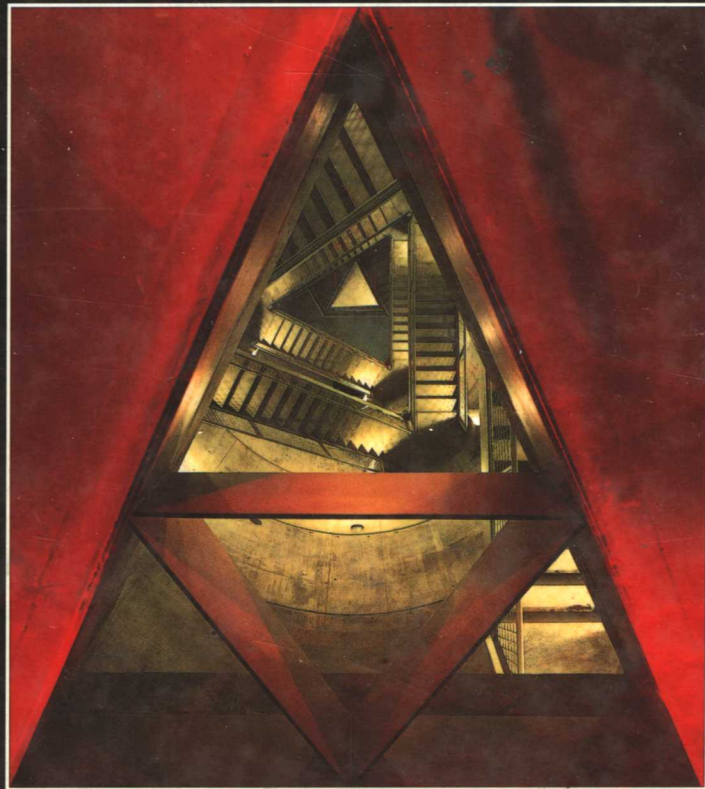


SIXTH EDITION



# PRINCIPLES *of* ACCOUNTING



NEEDLES • ANDERSON • CALDWELL

**SIXTH EDITION**

# *Principles of Accounting*

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## **Belverd E. Needles, Jr.**

Ph.D., C.P.A., C.M.A.

Arthur Andersen & Co. Alumni  
Distinguished Professor of Accounting  
DePaul University

## **Henry R. Anderson**

Ph.D., C.P.A., C.M.A.

KPMG Peat Marwick Professor of Accounting  
University of Central Florida

## **James C. Caldwell**

Ph.D., C.P.A.

Managing Partner  
Andersen Consulting  
Dallas/Fort Worth

## **Sherry K. Mills**

Ph.D., C.P.A.

Associate Professor of Accounting  
New Mexico State University

**Houghton Mifflin Company**

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## **PREFACE**

This textbook is intended for use in the first course in accounting, at the undergraduate or graduate level. It is designed for both business and accounting majors, and requires no previous training in either area. It is part of a well-integrated learning package that includes numerous print and computerized supplements. It has proven successful in a variety of quarter or semester course sequences.

### **FOCUS ON DECISION MAKING AND THE USES OF ACCOUNTING INFORMATION**

Through the previous editions, we approached the writing of this book with the recognition that the majority of students who take the beginning accounting course are business and management majors who will read, analyze, and interpret financial statements and internal managerial documents throughout their careers, and that the fundamental purpose of accounting is to provide information for decision making. While not neglecting topics important for accounting majors, our goal was for all students to become intelligent *users* of financial as well as nonfinancial information. We have striven to make the content authoritative, practical, and contemporary and to apply rigorously a system of integrated learning objectives that enhances the role of the overall package, and particularly that of the textbook, by fostering complete and thorough coordination between the instructor and the student. The success of the previous editions has justified our confidence in this fundamental approach. In fact, this approach is being adopted at more and more colleges and universities.

### **DESIGNED TO DEVELOP A BROAD SKILL SET IN STUDENTS**

This edition represents a major expansion of the fundamental ideas upon which the book is built. The pedagogical system underlying the text is the Learning Improvement Model, which encompasses an enlarged set of instruc-



tional strategies designed to achieve a broad skill set in students. This model, which includes the Teaching/Learning Cycle™, cognitive levels of learning, output skills, instructional strategies, and evaluation and feedback, is described in the special new Course Manual that accompanies this text. Among the goals of this edition that result from the application of this model are to (1) develop a much stronger user orientation and reduce the procedural detail, (2) increase the real-world emphasis, (3) reorganize and expand the assignment material to develop a broad set of skills, including critical thinking, communication, interpersonal, financial statement analysis, and interpretation of nonfinancial information skills, and (4) make the book more visually interesting. How these goals are achieved is described in the following sections.

## A MUCH STRONGER USER ORIENTATION

We have always emphasized the use of accounting information by both internal and external users. This edition places additional emphasis on the uses of accounting information by management and on decisions that management makes regarding accounting information.

### FINANCIAL ACCOUNTING TOPICS

*New Management Sections* New sections on management's use of accounting information appear at or near the beginning of chapters covering the following topics:

- Uses of accounting information
- Accounting for merchandising operations
- Short-term liquid assets
- Inventories
- Long-term assets
- Current liabilities
- Long-term liabilities

*Financial Ratios* Beginning with Chapter 6, financial analysis ratios are introduced and are integrated in subsequent chapters at appropriate points. These ratios are usually discussed in the "management issues" section at the beginning of the chapters.

*Reduced Procedural Detail* Many chapters have been substantially revised to reduce procedural detail. Unnecessary topics are deleted, and procedures that are not essential to conceptual understanding are treated as supplemental objectives at chapter's end. The extent of change resulting from increased emphasis on management's use of accounting information and decreased emphasis on procedural detail throughout the text can be seen in the following detailed descriptions of the revisions in two sample chapters:

- **CHAPTER 1 Uses of Accounting Information and the Financial Statements** Rewritten and reorganized to reflect its new title, this chapter contains new material that emphasizes business and management uses of accounting information. All-new illustrations highlight the business goals of profitability and liquidity and the activities of financing, investing, and operating. A new section discusses the use of accounting information in all management functions. The section on the basic financial statements has been rewritten and is accompanied by a new illustration to underscore the interrelationship of the state-

ments. The section on GAAP and organizations that influence GAAP has been moved toward the end of the chapter to smooth the flow of information earlier in the chapter. The section on professional ethics and the accounting profession has been rewritten and, through more concise writing, shortened.

- **CHAPTER 5 Accounting for Merchandising Operations** Rewritten to focus on the merchandising income statement, to provide increased coverage of the perpetual inventory system, and to remove much of the procedural detail usually associated with the topic of merchandising, Chapter 5 now contains a new opening section that focuses on management issues related to merchandising businesses, including the concept of the operating cycle and its relationship to cash flows. The structure of the merchandising income statement is presented early in the chapter, and a new illustration of the components of cost of goods sold is included. The chapter now offers equal and parallel coverage of the periodic and perpetual inventory systems. Since sales discounts and purchases discounts are usually immaterial and add procedural complexity to the problems, these topics have been transferred from the discussion of merchandising transactions to the end of the chapter and treated as a supplemental objective.

**Eliminated Procedural Topics** Other examples of eliminated procedural topics are:

- Sum-of-the-years'-digits method
- Methods of computing goodwill
- Accounting for assets of low unit cost
- Employee payroll records

**New or Revised Conceptual and Analytical Topics** Examples of new or substantially revised conceptual or analytical topics are:

- The use of the chart of accounts as a data base for accounting information
- The relationships of cash flows to accrual accounting
- Management's responsibility for ethical reporting
- Components of an annual report (using Toys "R" Us)
- Parallel presentation of inventory pricing methods for both the periodic and the perpetual inventory systems
- Integration of the concepts of capital and revenue expenditures into the section on acquisition cost
- Analysis of cash flows
- Nature of nonoperating items under quality of earnings
- Comprehensive illustration of ratio analysis using the financial statements of Apple Computer, Inc.
- Ratios related to cash flow adequacy

Sections about accounting for marketable securities and bond investments have been updated for the effects of SFAS No. 115.

**Supplemental Objectives** Some topics are treated under supplemental objectives so they can be covered at the instructor's discretion. Exercises and problems that cover supplemental topics are identified and placed at the end of their respective assignment sets. Examples of topics that have been made supplemental objectives include:

- Sales discounts and purchases discounts
- Merchandising work sheet and closing entries
- Credit card sales
- Valuing inventories by estimation
- Special problems of depreciating plant assets
- Workbook approach to statement of cash flows

## MANAGERIAL ACCOUNTING TOPICS

*New Management Sections* In this edition, we continue to develop our coverage of the usefulness of accounting in helping managers. Every managerial accounting chapter begins with a learning objective that stresses the importance and use of the chapter's subject matter in the day-to-day responsibilities of managers. For example, we explain how managers obtain and use decision support information. We also describe how changes in managers' information needs cause management accounting systems to adapt in a globally competitive environment.

This emphasis on managers' uses of accounting information is apparent in the chapter assignment materials. Specific questions, short exercises, exercises, and skills development exercises are designed to make students think about and discuss the importance and use of internal accounting information.

In addition to being the focal point of the opening learning objective in each chapter, uses of internal accounting information are also highlighted throughout the managerial chapters. Students learn how to create accounting analyses and reports and how to interpret business information. Each chapter offers short cases designed specifically to help students formulate and interpret managerial accounting reports and analyses. These cases point out that most business problems have several answers, depending on how the manager interprets the circumstances.

*Reduced Procedural Detail* Procedural aspects have been lessened to yield a more relevant exposure of managerial accounting to the nonaccounting major. Emphasis on the development of analyses needed to identify and provide information to managers has been increased. The use of journal entries has been reduced but not eliminated because all business students should be aware of how business data enter the accounting records. Entries also provide the link between internal accounting analyses and external financial reporting.

*New or Revised Conceptual and Analytical Topics* Service types of businesses are featured in discussions of appropriate managerial topics, as well as in the exercise, problem, and case materials. One integrated decision case, *McHenry Hotels, Inc.*, deals with the hotel service business and can be used over a four-to six-week time span during the last half of the managerial accounting portion of the principles course.

Managerial accounting can no longer be studied without linking it to the changes resulting from global competition. As management philosophies evolve, so must the information supporting management decisions. The new operating environment has had a significant impact on managerial accounting practices, and so influences from the globally competitive business environment have been integrated into all of the managerial accounting chapters. In addition, specific chapters focus on the just-in-time operating environment, activity-based costing, and total quality management and measures of quality.

## INCREASE IN REAL-WORLD EMPHASIS

Many steps have been taken to increase the real-world emphasis of the text, including the following:

**Decision Points** Every chapter contains at least one Decision Point based on a real company. Decision Points present a situation requiring a decision by management or other users of accounting information and then show how the decision can be made using accounting information.

**Business Bulletins** Also new in this edition are features called Business Bulletins—short items related to chapter topics that show the relevance of accounting in four areas: Business Practice, International Practice, Technology in Practice, and Ethics in Practice.

**Other Real-World Topics** Information from actual annual reports and articles from such periodicals as *Business Week*, *Forbes*, the *Wall Street Journal*, and *Management Accounting* enhances students' appreciation for the usefulness and relevance of accounting information. In total, more than one hundred fifty publicly held companies have been used as examples. In addition, the financial statements of Apple Computer, Inc. are presented to demonstrate comprehensive financial statement analysis. Among the real-world topics introduced in this edition are:

- Business strategies, goals, and activities
- Complete and parallel coverage of the perpetual and the periodic inventory systems
- Banking and electronic funds transfer
- Relationship of interest rates to length of maturities and risk for U.S. Treasury debt and corporate debt
- Financial leverage
- Initial public offerings and "tombstone" advertisements
- The segment information of PepsiCo, Inc.
- Target costing approach to pricing
- Linking the accounting system to automated production facilities
- Activity-based costing practices
- Nonfinancial performance measures such as throughput time, flexibility, and quality
- Just-in-time operating environment, total quality management, and continuous improvement

**Real Companies in Assignments** The use of real companies in the assignment materials has been greatly increased.

**International Accounting** In recognition of the global economy in which all businesses operate today, international accounting examples are introduced in Chapter 1 and integrated throughout the text. Among the foreign companies mentioned in the text and assignments are Takashimaya Co. (Japanese), Wellcome (British), Mitsubishi (Japanese), and Groupe Michelin (French).

**REORGANIZED AND EXPANDED ASSIGNMENT MATERIAL  
TO EMPHASIZE CRITICAL THINKING, COMMUNICATION,  
FINANCIAL STATEMENT ANALYSIS, INTERPERSONAL, AND  
INTERPRETATION OF NONFINANCIAL INFORMATION SKILLS**

To accommodate students' need for an expanded skill set and instructors' need for greater pedagogical flexibility, the assignments and accompanying materials have been reorganized and greatly expanded. Our objective has been to provide the most comprehensive and flexible set of assignments available and to include more cases that involve real companies. Because students



need to be better prepared in writing and communication skills, we have provided ample assignments to enhance student communication skills. In the new organization, each type of assignment has a specific title and purpose. The assignments and principal accompanying materials are as follows:

### **QUESTIONS, SHORT EXERCISES, AND EXERCISES**

*Questions* Fifteen to twenty-five review questions that cover the essential topics of the chapter.

*Short Exercises* Eight to ten brief exercises suitable for classroom use that cover the key points of the chapter.

*Exercises* Ten to fifteen single-topic exercises that stress the application of all topics in the chapter.

### **SKILLS DEVELOPMENT EXERCISES**

*Conceptual Analysis* Designed so a written solution is appropriate, but usable in other communication modes, these short cases address conceptual accounting issues and are based on real companies and situations.

*Ethical Dilemma* In recognition that accounting and business students need to be exposed in all their courses to ethical considerations, every chapter has a short case, often based on a real company, in which students must address an ethical dilemma directly related to the chapter content.

*Research Activity* These exercises are designed to acquaint students with the use of business periodicals, annual reports and business references, and the library. Through field activities at actual businesses, students can improve interviewing and observation skills.

*Decision-Making Practice* In the role of decision maker, the student is asked to extract relevant data from a longer case, make computations as necessary, and arrive at a determination. The decision maker may be a manager, an investor, an analyst, or a creditor.

### **PROBLEMS**

*Problem Set A* Five or more extensive applications of chapter topics, often covering more than one learning objective. Selected problems in each chapter contain writing components.

*Problem Set B* An alternative set of problems.

### **FINANCIAL AND MANAGERIAL REPORTING AND ANALYSIS CASES**

*Interpreting Financial and Management Reports* Short cases abstracted from business articles and annual reports of well-known corporations and organizations such as Kmart, Sears, IBM, Toys "R" Us, Chrysler, and UAL (United Airlines), as well as specially designed internal management scenarios, that require students to extract relevant data, make computations, and interpret the results.

**Formulating Management Reports** Students strengthen analytical, critical thinking, and written communication skills with these cases. They teach students how to examine, synthesize, and organize information with the object of preparing reports such as a memo to a company president identifying sources of waste, outlining performance measures to account for the waste, and estimating the current costs associated with the waste.

**International Company** Short cases similar to the Interpreting Financial and Management Reports, but involving companies from other countries.

**Toys "R" Us Annual Report** Cases that emphasize the reading and analysis of the actual annual report of Toys "R" Us contained in an appendix at the end of the book.

### **COMPUTER ASSIGNMENTS**

Exercises, cases, and problems that can be solved with Lotus® or General Ledger Software are identified by icons in the text.

## **SUPPLEMENTARY LEARNING AIDS**

### **Study Guide**

**Business Readings in Financial and Managerial Accounting**

**Working Papers for Exercises and A Problems**

**Blank Working Papers**

**Accounting Transaction Tutor**

**General Ledger Software**

**Lotus® Templates with Student Manual**

**Moody's Company Data™ Software and Assignment Booklet**

**Student Resource Videos**

### **Financial Decision Cases and Practice Cases:**

**Micro-Tec, Fourth Edition**

**Collegiate Ts**

**College Words and Sounds Store, Fourth Edition**

**General Mills, Inc. Annual Report, Second Edition**

**Heartland Airways, Inc., Third Edition**

**Richland Home Centers, Inc., Third Edition**

**Soft-Tec, Inc., Fifth Edition**

### **Managerial Decision Cases:**

**Aspen Food Products Company**

**McHenry Hotels, Inc., Second Edition**

**The Windham Company, Second Edition**

**Callson Industries, Inc.**

## INSTRUCTOR'S SUPPORT MATERIALS

Instructor's Solutions Manual  
Course Manual  
Test Bank  
Computerized Test Bank  
*E.L.M.: Electronic Lecture Manager*  
Solutions Transparencies  
Teaching Transparencies  
Videodisc  
Master Teacher Videos  
Business Bulletin Videos

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*University of Central Florida*

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*Texas A&I University*

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*Tarrant County Junior College—  
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*University of Central Oklahoma*

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*SUNY, Brockport*

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*Modesto Junior College*

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*Clarion University of Pennsylvania*

Michael F. Monahan

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*Clark College*

Jenine Moscové

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*Monroe Community College*

Professor C. Lynn Murray  
*Florida Community College at Jacksonville*

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*Garland County Community College*

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*University of North Carolina at Charlotte*

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*North Harris County College*

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*Mankato State University*

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*College of the Mainland*

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*Montgomery College—Rockville*

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## *How to Study Accounting Successfully*

Whether you are majoring in accounting or in another business discipline, your introductory accounting course is one of the most important classes you will take, because it is fundamental to the business curriculum and to your success in the business world beyond college. The course has multiple purposes because its students have diverse interests, backgrounds, and purposes for taking it. What are your goals in studying accounting? Being clear about your goals can contribute to your success in this course.

Success in this class also depends on your desire to learn and your willingness to work hard. And it depends on your understanding of how the text complements the way your instructor teaches and the way you learn. A familiarity with how this text is structured will help you to study more efficiently, make better use of classroom time, and improve your performance on examinations and other assignments.

To be successful in the business world after you graduate, you will need a broad set of skills, which may be summarized as follows:

*Technical/Analytical Skills* A major objective of your accounting course is to give you a firm grasp of the essential business and accounting terminology and techniques that you will need to succeed in a business environment. With this foundation, you then can begin to develop the higher-level perception skills that will help you to acquire further knowledge on your own.

An even more crucial objective of this course is to help you develop analytical skills that will allow you to evaluate data. Well-developed analytical and decision-making skills are among the professional skills most highly valued by employers, and will serve you well throughout your academic and professional careers.

*Communication Skills* Another skill highly prized by employers is the ability to express oneself in a manner that is understood correctly by others. This can include writing skills, speaking skills, and presentation skills. Communication skills are developed through particular tasks and assignments and are improved through constructive criticism. Reading skills and listening skills support the direct communication skills.

*Interpersonal Skills* Effective interaction between two people requires a solid foundation of interpersonal skills. The success of such interaction depends on empathy, or the ability to identify with and understand the problems, concerns, and motives of others. Leadership, supervision, and interviewing skills also facilitate a professional's interaction with others.



**Personal/Self Skills** Personal/self skills form the foundation for growth in the use of all other skills. To succeed, a professional must take initiative, possess self-confidence, show independence, and be ethical in all areas of life. Personal/self skills can be enhanced significantly by the formal learning process and by peers and mentors who provide models upon which you can build. Accounting is just one course in your entire curriculum, but it can play an important role in your development of the above skills. Your instructor is interested in helping you gain both a knowledge of accounting and the more general skills you will need to succeed in the business world. The following sections describe how you can get the most out of this course.

### THE TEACHING/LEARNING CYCLE™

Both teaching and learning have natural, parallel, and mutually compatible cycles. This teaching/learning cycle, as shown in Figure 1, interacts with the basic structure of learning objectives in this text.

**The Teaching Cycle** The inner (blue) circle in Figure 1 shows the steps an instructor takes in teaching a chapter. Your teacher *assigns* material, *presents* the subject in lecture, *explains* by going over assignments and answering questions, *reviews* the subject prior to an exam, and *tests* your knowledge and understanding using examinations and other means of evaluation.

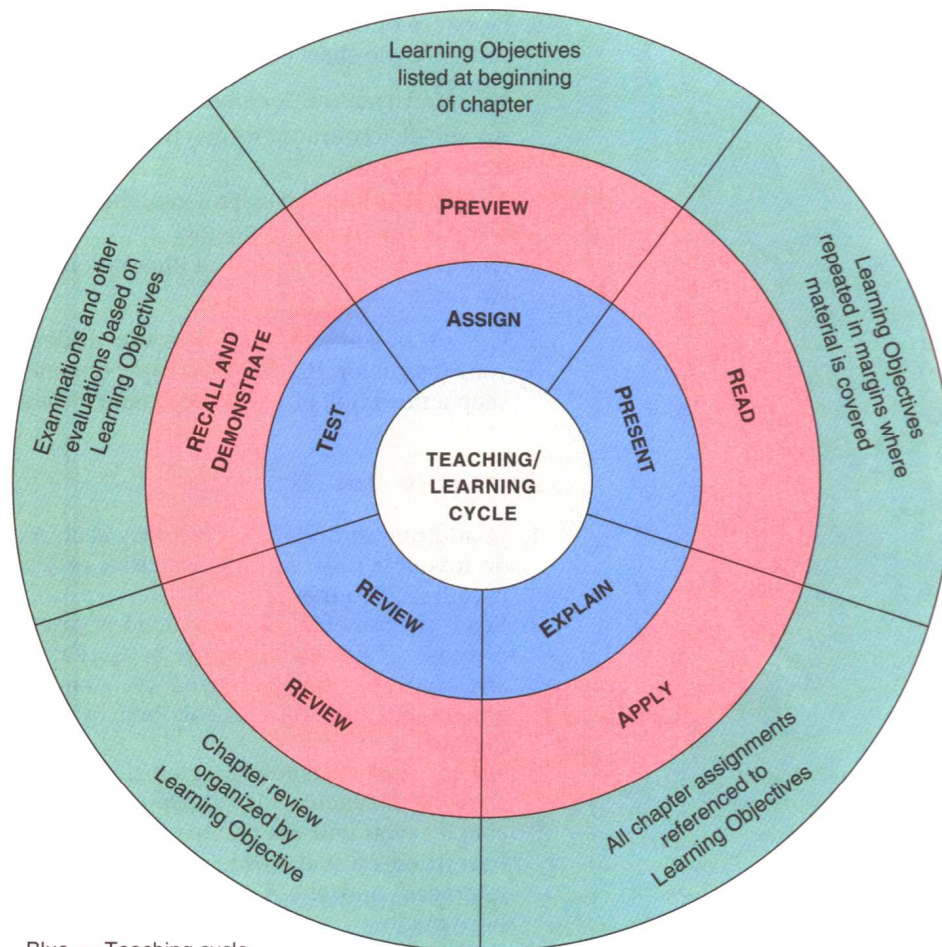
**The Learning Cycle** Moving outward, the next circle (pink) in Figure 1 shows the steps you should take in studying a chapter. You should *preview* the material, *read* the chapter, *apply* your understanding by working the assignments, *review* the chapter, and *recall* and *demonstrate* your knowledge and understanding of the material on examinations and other assessments.

**Integrated Learning Objectives** Your textbook supports the teaching/learning cycle through the use of integrated learning objectives. Learning objectives are simply statements of what you should be able to do after you have completed a chapter. In Figure 1, the outside (green) circle shows how learning objectives are integrated into your text and other study aids and how they interact with the teaching/learning cycle.

1. Learning objectives appear at the beginning of the chapter, as an aid to your teacher in making assignments and as a preview of the chapter for you.
2. Each learning objective is repeated in the text at the point where that subject is covered to assist your teacher in presenting the material and to help you organize your thoughts as you read the material.
3. Every exercise, problem, and case in the chapter assignments shows the applicable learning objective(s) so you can refer to the text if you need help.
4. A summary of the key points for each learning objective, a list of new concepts and terms referenced by learning objectives, and a review problem covering key learning objectives assist you in reviewing each chapter. Your Study Guide, also organized by learning objectives, provides for additional review.

**Why Students Succeed** Students succeed in their accounting course when they coordinate their personal learning cycle with their instructor's cycle. Students who do a good job of previewing their assignments, reading the chapters before the instructor is ready to present them, preparing homework assignments before they are discussed in class, and reviewing carefully will ultimately achieve their potential on exams. Those who get out of phase with their instructor, for whatever reason, will do poorly or fail. To ensure that your learning cycle is synchronized with your instructor's teaching cycle, check your study habits against these suggestions.

**Figure 1. The Teaching/Learning Cycle™ with Integrated Learning Objectives**



Blue — Teaching cycle  
 Pink — Learning cycle  
 Green — Learning Objectives structure

### PREVIEWING THE CHAPTER

1. Read the learning objectives at the beginning of the chapter. These learning objectives specifically describe what you should be able to do after completing the chapter.
2. Study your syllabus. Know where you are in the course and where you are going. Know the rules of the course.
3. Realize that in an accounting course, each assignment builds on previous ones. If you do poorly in Chapter 1, you may have difficulty in Chapter 2 and be lost in Chapter 3.

### READING THE CHAPTER

1. As you read each chapter, be aware of the learning objectives in the margins. They will tell you why the material is relevant.
2. Allow yourself plenty of time to read the text. Accounting is a technical subject. Accounting books are so full of information that almost every sentence is important.
3. Strive to understand why as well as how each procedure is done. Accounting is

logical and requires reasoning. If you understand why something is done in accounting, there is little need to memorize.

4. Relate each new topic to its learning objective and be able to explain it in your own words.
5. Be aware of colors as you read. They are designed to help you understand the text. (See the chart on the back of your textbook.)

**Yellow:** All source documents and inputs are in yellow.

**Aqua:** All accounting forms, working papers, and accounting processes are shown in aqua.

**Purple:** All financial statements, the output or final product of the accounting process, are shown in purple.

**Gray:** In selected tables and illustrations, gray is used to heighten contrasts and aid understanding.

6. If there is something you do not understand, prepare specific questions for your instructor. Pinpoint the topic or concept that confuses you. Some students keep a notebook of points with which they have difficulty.

### APPLYING THE CHAPTER

1. In addition to understanding why each procedure is done, you must be able to do it yourself by working exercises, problems, and cases. Accounting is a “do-it-yourself” course.
2. Read assignments and instructions carefully. Each assignment has a specific purpose. The wording is precise, and a clear understanding of it will save time and improve your performance. Acquaint yourself with the end-of-chapter assignment materials in this text by reading the description of them in the Preface.
3. Try to work exercises, problems, and cases without referring to their discussions in the chapter. If you cannot work an assignment without looking in the chapter, you will not be able to work a similar problem on an exam. After you have tried on your own, refer to the chapter (based on the learning objective reference) and check your answer. Try to understand any mistakes you may have made.
4. Be neat and orderly. Sloppy calculations, messy papers, and general carelessness cause most errors on accounting assignments.
5. Allow plenty of time to work the chapter assignments. You will find that assignments seem harder and that you make more errors when you are feeling pressed for time.
6. Keep up with your class. Check your work against the solutions presented in class. Find your mistakes. Be sure you understand the correct solutions.
7. Note the part of each exercise, problem, or case that causes you difficulty so you can ask for help.
8. Attend class. Most instructors design classes to help you and to answer your questions. Absence from even one class can hurt your performance.

### REVIEWING THE CHAPTER

1. Read the summary of learning objectives in the chapter review. Be sure you know the definitions of all the words in the review of concepts and terminology.
2. Review all assigned exercises, problems, and cases. Know them cold. Be sure you can work the assignments without the aid of the book.
3. Determine the learning objectives for which most of the problems were assigned. They refer to topics that your instructor is most likely to emphasize