



Intermediate Accounting

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PREFACE

The subject of *Intermediate Accounting* is primarily financial reporting for corporate enterprises. Financial reporting practices of U.S. corporations involve a complicated but interesting array of principles and procedures that have emerged over several decades. Most procedures can be explained by a few broad accounting principles; some can only be justified by their having been used for many years.

In this book we have attempted to strike a balance between a detailed explanation of accounting procedures and a discussion of the theoretical foundation of those procedures. Serious accounting students must understand both theory and practice in order to enter the accounting profession and meet the challenges facing them in the future. We have also attempted to strike a balance between current generally accepted accounting principles and alternatives to these principles. Again, the serious student must understand alternatives to current practice in order to understand accounting as it exists and as it may evolve.

Organization of the Text

The text is organized into six major sections:

1. Theoretical Foundation for Financial Reporting (Chapters 1–4)
2. Tools of Accounting (Chapters 5–6)
3. Asset Accounting (Chapters 7–13)
4. Liability and Stockholders' Equity Accounting (Chapters 14–17)
5. Additional Financial Reporting Issues (Chapters 18–24)
6. Financial Reporting by Publicly Held Companies (Chapters 25–27)

In the first section, Theoretical Foundation for Financial Reporting, we prepare the student for the remainder of the text by providing the conceptual

background necessary to understand generally accepted accounting principles and alternatives to those principles. Chapter 1 discusses the environment of corporate financial reporting. Chapter 2 presents the current conceptual framework of corporate financial reporting. This chapter is important because it explains the accounting principles for many specific procedures currently used to prepare financial statements. These principles are emphasized in Chapter 2, then highlighted throughout the text as they relate to the discussion of specific reporting practices. Chapter 3 introduces the student to the nature and measurement of the elements of financial statements, stressing alternatives to current practice in a way that is understandable at this early point in the student's study of financial accounting. Chapter 4 reviews the four basic financial statements at the level of understanding that the student should have when entering intermediate accounting. By discussing all of the financial statements in a single chapter, we can stress an important feature of financial statements—*articulation*.

The second section of the text, Tools of Accounting, covers two major topics. Chapter 5 reviews the accounting cycle, and Chapter 6 explains compound interest concepts in depth. Both tools are used frequently throughout the text.

The third section, Asset Accounting, includes seven chapters (Chapters 7–13) which deal with the major asset categories typically found on corporate balance sheets: cash, receivables, inventories, investments, plant assets, and intangible assets. Throughout these chapters, material that students have studied in introductory accounting courses is reviewed and new, more advanced topics are discussed. Care has been taken to thoroughly explain new material, and extensive use has been made of examples and illustrations to enhance student understanding.

The fourth section, Liability and Stockholders' Equity Accounting, encompasses four chapters. Chapter 14 addresses current and contingent liabilities. Chapter 15 discusses long-term debt. Chapters 16 and 17 cover a variety of topics related to stockholders' equity. The purpose of this section is to make students aware of the alternative methods of corporate financing and the many accounting practices that underlie the liability and stockholders' equity sections of corporate balance sheets.

The fifth section, Additional Financial Reporting Issues, covers many advanced topics that are essentially new to accounting students. It includes chapters on financial reporting of income taxes (Chapter 18), accounting for changes and error correction (Chapter 19), revenue measurement and income presentation (Chapter 20), accounting for leases and pensions (Chapters 21 and 22), reporting funds-flow information and changes in financial position (Chapter 23), and financial-statement disclosure and analysis (Chapter 24). These chapters require students to recall and apply material from earlier chapters. They also require students to integrate subjects studied earlier and to understand their new, more advanced applications.

The final section of the text includes three chapters that present financial reporting requirements which, at the present time, apply only to publicly held companies. Chapter 25 introduces the concept of reporting responsibilities of publicly held companies and the current deliberations about accounting standards overload. This chapter also introduces interim reporting and segment reporting. Chapter 26 describes the complexities of earnings per share presentations, with emphasis on companies with complex capital structures. Finally, Chapter 27 discusses constant dollar and current cost disclosures, approaches designed to communicate information about the impact of changing prices on a company's financial position and results of operations.

End-Of-Chapter Material

Questions, cases, exercises, and problems appear at the end of each chapter. They offer a variety of opportunities for students to continue the learning process by applying concepts presented in the text.

Questions are typically short-discussion type and emphasize the major points of the chapter. Some questions are multiple-choice.

Cases are generally more extended discussion questions, often involving in-depth consideration of

the issues emerging from topics covered in the chapter. Sometimes the cases require the student to make and support decisions based on logical reasoning and a knowledge of current accounting principles. Cases enable students to develop written communication skills in a context similar to what they may encounter in the accounting profession.

Exercises typically involve computations and usually focus on a major point.

Problems require computations and, often, discussion. Problems usually require the student to relate major points discussed in the text.

Where appropriate, questions, cases, exercises, and problems have been adapted from CPA and CMA examinations.

Features

A brief review of *Intermediate Accounting* reveals many features that will help students understand the text. Each chapter begins with objectives that preview the chapter and ends with key points that highlight the most important subjects in the chapter.

The basic accounting principles discussed in Chapter 2 are highlighted in the margin throughout the text. This feature is designed to clearly demonstrate how important accounting principles, such as revenue realization, matching, historical cost, and consistency, are applied in practice.

Throughout the text, short readings are provided to expand the student's understanding of accounting principles and the issues and controversies surrounding those principles. Most readings are taken from business periodicals and provide insight into the importance of corporate financial reporting to investors and creditors.

At appropriate points in the text, diagrams and flowcharts follow discussions and examples in order to summarize complex procedures, such as accounting for current and noncurrent marketable equity securities, accounting for leases, and preparing earnings-per-share figures for companies with complex capital structures.

End-of-chapter appendixes are designed to present specialized subjects, complex topics, and less frequently used accounting methods.

Throughout the text, excerpts from published financial statements of major U.S. corporations illustrate how various accounting principles are applied. These excerpts are usually preceded by a brief description of the company to familiarize the student with the nature of the reporting enterprise.

The annual report and basic financial statements of one major U.S. corporation, Kroger Company, are reproduced in their entirety and are cited throughout the text. The annual report is presented as an appendix, and three financial statements are printed on the inside front and back covers (endpapers).

Supplements

A variety of supplements have been prepared for use with this text. The following supplements are available as instructional aids *for students*: (1) student study guide (prepared by James M. Reeve); (2) two practice sets—one devoted to the accounting cycle, to be used in conjunction with Chapter 5; the other encompassing the entire text, to be used at or near the end of the text (prepared by Thomas J. Beirne, Jr.); (3) ruled working papers for all problems in the text; and (4) a professional examination manual (prepared by Sharon M. Lightner).

The following supplements are available *for instructors*: (1) solutions manual for all end-of-chapter material (prepared by the authors); (2) instructor's manual, which includes checklist of key figures in the text and solutions to the practice sets (prepared by Jan R. Williams); (3) overhead projector transparencies for all text problems; (4) test book (prepared by Jan R. Williams, Keith G. Stanga, and Thomas A. Gavin); (5) computerized format of the test book; and (6) checklist of key figures in the text available *free* in quantity.

Acknowledgments

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William A. Knowles assumed Steve Dowling's position and immediately began to work with us in completing the manuscript. He has helped us in a number of important ways and has encouraged us in the final stages of this project.

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James Reeve reviewed the manuscript in its early stages and assisted in the final revision of several chapters and in the preparation of end-of-chapter material for those chapters. Jim is also the author of the student study guide. However, his contribution has extended far beyond the study guide and text chapters. He has been and remains a valued consultant.

Thomas Beirne's contribution centers on the two practice sets which accompany the text. We appreciate Tom's efforts and think that these practice sets go far in our attempt to help students understand intermediate accounting. Tom has been extremely cooperative in working with us to coordinate the practice sets and the text.

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Throughout the text, we cite authoritative accounting literature published by the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board. We are grateful for the work done by these organizations. We also acknowledge and thank the AICPA and the Institute of Management Accounting of the National Association of Accountants for allowing us to adapt material from past CPA and CMA examinations.

Our text includes many financial reporting examples taken from the published financial statements of U.S. corporations. We have also included a number of articles from business publications. We appreciate the willingness of these organizations for us to use this material, which greatly enriches the technical content of the text.

Finally, we wish to acknowledge the contributions of our families during the five years required to complete this book. Perhaps their greatest contribution has been their patience and understanding during the many hours we were unable to be with them because we were working on the book. We recognize and appreciate their support and feel that much of this text belongs to them.

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Theoretical Foundation for Financial Reporting

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