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SMITH, KEITH, AND STEPHENS

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**A C C O U N T I N G**

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**P R I N C I P L E S**

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## ACCOUNTING PRINCIPLES

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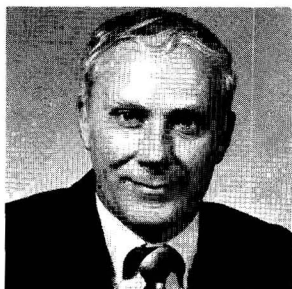
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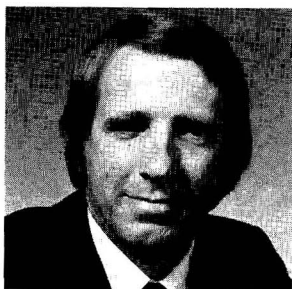
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*To Diane, Kristie, and Scott*

*To Leanne and Rob*

*To Brenda, Cindy K, and the Good Lord  
Who helped make this project possible,  
bearable, and enjoyable*

# PREFACE

*Accounting Principles* is designed to be a comprehensive balanced approach to the college or university student's first exposure to accounting. The text is intended for use in a two-semester or three-quarter sequence by those college students who plan to enter the accounting profession, those who plan a business career, and those who have an interest in broadening their business background. Our assumption in writing this text is that the student's exposure to business has been very limited. Therefore we have carefully explained and illustrated, where appropriate, all business terms and practices as they are first discussed.

We view our text as being neither conceptual nor procedural but a balanced blend of the two. Students are informed *why* information is accounted for in a certain manner. The why is reinforced by illustrating *how* the accounting is accomplished. Students cannot grasp concepts without adequate attention to the procedures.

In response to the growing need for a knowledge of management accounting in the undergraduate accounting curriculum and business world, we have emphasized this important area—achieving what we believe to be an appropriate balance in the text between the financial and managerial subjects.

## IMPORTANT FEATURES OF THIS TEXT

We have incorporated in our text numerous pedagogical devices and techniques to which we would like to call your attention. We have classified them in this preface as general or specific. In the general category we include those items that are presented in all chapters of the text, while in the second category we highlight those features that are found only in specific chapters.

### GENERAL

- We have written this book in a lively style with extensive use of the active voice which we believe makes the material more real and interesting and certainly more helpful to the student in learning and understanding it.
- Each of the seven parts of the text is introduced by a section explaining the overall purpose of that part and briefly describing its contents.
- Chapter objectives are given for each of the 27 chapters and are attractively arranged to enhance learning.



- A theme photo introduces each chapter to pique the student's curiosity. For example Chapter One has a photo of a tennis player's arm in the act of serving—a tennis pro shop is the business used for the analysis of transactions in the chapter.
- Margin notes are used extensively throughout each chapter to describe text material and to briefly indicate the purpose of each exercise and problem.
- The text contains an abundance of well illustrated charts, diagrams, and figures (eleven appear in Chapter One alone) designed to help the student easily and quickly visualize concepts, relationships, and establish perspectives underlying the material as it is explained.
- Summaries are presented at the end of each chapter.
- Important terms used in the chapters are presented at the end of each chapter together with page references indicating where the term was first introduced.
- Check figures are located with the exercises and problems, not on the end covers or in a separate list.
- The chapters are organized in a logical manner: the accounting model, the cycle, assets, liabilities, owners' equity, statement analysis, and management accounting.

## **SPECIFIC**

- The first half of the text uses the proprietorship form of business organization so that the focus can be placed on asset, liability, expense, and revenue accounting.
- Accounting principles and concepts are discussed and developed fully as they are introduced in the various chapters.
- An interlude in the form of a major section entitled *GAAP: Generally Accepted Accounting Principles* is located between Chapters 12 and 13 and presents a comprehensive discussion of generally accepted accounting principles.
- The accounting cycle is reviewed by means of a detailed flowchart at the end of Chapters 3, 4 and 5; the chart is expanded as new procedures are presented.
- A full discussion of reversing entries for accruals and transactions initially recorded in nominal accounts is developed in Chapter 4.
- An extended discussion (with a clear concise example) of the difference between the accrual and cash basis of accounting is located in Chapter 3.
- Features of the new tax law are incorporated in several appropriate chapters and related exercises and problems.
- A complete set of filled-in tax returns including Schedules A and C is presented in Chapter 10. The forms are developed from the continuing example found in the chapter.
- Chapter 11 contains an extended, easy to follow treatment of present value analysis. These techniques are then used in finding bond values, amortizing bond premiums and discounts, and accounting for leases. The basics of PV are reviewed again in Chapter 26 prior to their use in capital budgeting.
- Chapter 17 emphasizes the "all financial resources concept" using both the working capital approach and the cash approach. T-account analysis is used to develop the working papers for the statement of changes in financial position.
- Chapter 18 contains a discussion of the traditional ratio analyses as well as footnote disclosures, and outside sources of financial information.

- The important topic of inflation accounting in Chapter 18 includes a discussion of both constant dollar adjusted statements and current value accounting.
- A complete payroll system flow chart is located in Chapter 12, together with a discussion of control procedures.
- The discipline of management accounting is introduced in a separate chapter (19) providing a smooth transition from financial accounting.
- The important concept of different costs for different purposes and the role of activity and activity centers are introduced in Chapter 20, prior to discussing the details of manufacturing accounting.
- A comprehensive master budget is discussed and fully illustrated. The example for the master budget is also used in the chapter on flexible budgeting which compares and contrasts these two types of budgets.
- A clear, concise development of the relationship between the flexible budget and standard costing is given, contrasting the planning and control functions.
- The chapter on relevant cost is logically placed after cost-volume-profit analysis (so that the contribution approach is a familiar tool) and prior to capital budgeting (so that short-run special decisions are discussed before long-run special decisions).
- A complete discussion of all discounted and nondiscounted cash flow methods of capital budgeting is given for both even and uneven cash flow situations. In addition to explaining the mechanics of each method we also discuss their uses and shortcomings.
- Front end covers contain a list of accounts commonly used in financial accounting, their financial statement classifications, and normal balances.
- Back end covers contain many of the important equations, graphs, and diagrams regularly used in managerial accounting.

## SUPPLEMENTARY MATERIALS

Accompanying the text are the following supplementary materials:

### For the instructor

- *Solutions Manual.* Answers to all the questions, exercises, and problems are contained in this comprehensive manual. The type is extra large so that any transparencies made from the manual will be clearly seen by the students in the last row of the classroom.  
The questions, exercises, and problems follow closely the textual material. Time estimates, difficulty levels, and descriptions of all exercises and problems are provided as an aid to the instructor in selecting material appropriate for the level of course being taught.
- *Teacher's Manual.* Designed to aid primarily graduate teaching assistants, adjuncts, and other part-time instructors, the teacher's manual contains comments, notes, illustrations, and examples that the authors have found useful in teaching the principles of accounting course. The solutions to the *Tests and Exams* are also included in the Teacher's Manual.

- *Tests and Exams.* Two completely different sets (*Set A* and *Set B*) are available to provide the instructor with a number of testing options. Each package contains 20 of each test and each exam.
- *Tests and Exams, Set A.* Each test covers two or three chapters. The four examinations cover Chapter 1–12, Chapters 13–27, Chapters 13–18, and Chapters 19–27 (managerial chapters).
- *Tests and Exams, Set B.* Again, each test covers two or three chapters; the four examinations cover Chapters 1–12, 13–18, 13–27, and 19–27; however, all the questions for the tests and examinations in this package are completely different from those in *Set A*.
- *Solutions for Practice Sets.* Contains answers for each of the four practice sets.
- *Test Bank.* For those instructors who wish to construct their own examinations, a manual containing over 2,200 test questions arranged by chapter is available. These questions are also available in a computerized test-generation system.
- *Overhead Transparencies.* The publisher has prepared for the instructor a complete set of problem solution transparencies for classroom use. These are available upon request to adoptors of the text.
- *Teacher's Transparencies.* An extensive set of teaching transparencies is available for classroom use as an aid in illustrating many of the concepts discussed in the text.

### For the student

- *Study Guide.* A comprehensive study guide, prepared by Celina Jozsi, contains chapter-by-chapter reviews together with an abundance of multiple-choice, fill-in, and true-false questions as well as numerous problems. Solutions to all items are displayed in the *Study Guide* and the correct multiple-choice answers are fully explained.

Four practice sets, prepared by Celina Jozsi, are available:

- *Practice Set One: Better Deals Company* is to be used after the first five chapters of the text. It illustrates the basic accounting system using a periodic inventory and the special journals. In addition, *Better Deals* contains two different beginning trial balances, so that the practice set can be alternated between sections or terms.
  - *Practice Set Two: Good Living Corporation* is to be used after Chapter 17 and deals with corporate accounting utilizing the perpetual inventory system.
  - *Practice Set Three: Tampa Bay Jewelry*, for use after Chapter 5, is an alternative to *Better Deals* and contains various source documents, business forms, and cancelled checks for the student to analyze and process.
  - *Computerized Practice Set: Better Deals Company* utilizes microcomputers to process data inputted by the student for a 3-month period of time.
- Partially filled-in working papers for all problems in the text. Two booklets are available:

- *Accounting Worksheets, A & B Problems, Chapters 1–12*
- *Accounting Worksheets, A & B Problems, Chapters 13–27*

Each worksheet has been preprinted with the problem headings and preliminary data to help students save time and concentrate their energies on the essence of each problem.

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**Jack L. Smith**  
**Robert M. Keith**  
**William L. Stephens**

# **PART**

# **ONE**

**FINANCIAL ACCOUNTING:  
ITS STRUCTURE AND ENVIRONMENT**

**For many years to come you are going to make economic decisions. These decisions may be required of you in your role as a taxpayer, a voter, an employee, a church member, a business manager, and a husband or wife. To make the best economic decisions, you need the appropriate financial facts. Accounting is a service that provides these facts in the form of financial reports. But before you can use financial reports you need to know how accounting information is generated, processed, and presented. You should also have a basic understanding of accounting principles, be familiar with the terms used by accountants and understand the limitations of financial reports. Part One of *Accounting Principles* is designed to provide you with this information.**

**In Part One you will learn that there are many kinds of accounting activities and what each of these activities involves. For the first two-thirds of this text you will be studying just one of these activities—general financial accounting—which is concerned with recording business transactions and preparing financial reports. You will learn how to record transactions for a business entity. And you will learn how to prepare three financial reports—the income statement, the statement of owners' equity, and the balance sheet.**

**Financial reports are useful to us only when they are reliable and comparable. Certain ground rules called generally accepted accounting principles have been developed over the years to assure us that business entities prepare financial reports that are reliable and comparable. We will tell you in Part One how these generally accepted accounting principles are developed and discuss with you five important principles that you will need to know even at this early stage in your course of study.**

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## **PART ONE**

### **FINANCIAL ACCOUNTING: ITS STRUCTURE AND ENVIRONMENT**

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