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Robert F. Meigs

Third Edition

# Financial Accounting

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**THIRD EDITION**

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# Financial Accounting

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# Financial Accounting

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# Preface

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The environment of accounting is changing fast, and these environmental changes, such as continued inflation and the critical financial problems of many cities, affect the goals and the content of an introductory text in accounting. In order to function intelligently as a citizen, as well as in a business of any size or type, every individual needs more than ever before a clear understanding of basic accounting concepts. In this third edition, we have tried to reflect the impact of inflation on accounting measurements and to suggest the direction of needed changes in accounting concepts and methods. The importance of adequate disclosure in the system of financial reporting is stressed, and attention is drawn to the need for improved accounting controls in all sectors of society. We have emphasized the responsibility of the modern corporation to do an adequate job of financial reporting to investors and others outside the corporate entity. However, management's internal use of accounting data is by no means neglected.

This third edition of *Financial Accounting* is designed as a one-semester introduction to accounting. It is suitable for courses of three to four semester-hours' credit; or in the case of schools on the quarter system, for courses of four to six quarter-hours' credit. In these courses, instructors often recognize three general groups of students: those who stand at the threshold of preparation for a career in accounting, students of business administration who need a good understanding of accounting as an important element of the total business information system, and students from a variety of other disciplines who will find the ability to use and interpret accounting information a valuable accomplishment. During the process of revision we have tried to keep in mind the needs and interests of all three groups.

A new edition provides authors with an opportunity to add new material, to condense the coverage of topics that have declined in relative importance, to reorganize portions of the book to improve instructional efficiency, and to refine and polish the treatment of basic subject matter. We have tried to do all these things in this third edition.

### **New features of this edition**

Among the many new features of this edition are:

- 1** A glossary at the end of each chapter, with concise explanations of key terms introduced or emphasized in that chapter.
- 2** An increase of over 30% in the number of questions, exercises, and problems throughout the book.
- 3** A discussion of the impact of inflation on the measurement of profits, on inventories, and on plant and equipment.
- 4** The concept of present value, presented in clear understandable terms, integrated into discussions of the valuation of assets and liabilities.
- 5** People-oriented problems which depict the hard decisions that must be made by men and women acting as managers, investors, and in other roles.
- 6** Increased attention to perpetual inventory systems.
- 7** Increased emphasis on internal control—how a business can strengthen its system of internal control.
- 8** Evaluation of corporate profits. Are they adequate? Are they reasonable? What are the appropriate yardsticks?
- 9** New emphasis on replacement cost and the implied move from historical cost to current-value accounting.
- 10** Careful integration into the text and problems of the pronouncements of the Financial Accounting Standards Board.
- 11** Attention to the increased activity of the SEC in establishing accounting standards.
- 12** An examination booklet, with test material arranged chapter by chapter for the entire text.
- 13** Improved format for supplementary materials. Partially filled-in working papers and practice sets appear in a new improved format, with wider rulings and printed in color.

## Features carried forward from prior editions

Special qualities that are carried forward from prior editions include:

- 1** The only introductory accounting book that is part of an integrated series of introductory, intermediate, and advanced accounting textbooks with continuity of authorship. This established series concept provides assurance that students finishing the introductory course will be prepared to move readily into intermediate accounting without gaps or unnecessary overlaps.
- 2** Respect for the needs of the student. Topics are covered in a depth which will qualify the student for subsequent course work in accounting.
- 3** Provocative problems that raise a variety of interesting questions and carry the student far beyond routine drill.
- 4** Problem material developed and tested firsthand by the authors in their own classes for introductory accounting students.
- 5** A good blend of **(a)** the theoretical and conceptual aspects of accounting and **(b)** the realities of applying these concepts to everyday practical business situations.

## New and extensively revised chapters

Chapter 5, "Merchandising Transactions and Internal Control," contains much new material. It explains the purpose and nature of internal control and illustrates the methods of achieving good internal control. Also discussed is the Foreign Corrupt Practices Act of 1977, which makes an adequate system of internal control legally mandatory. Chapter 8, dealing with such topics as earnings per share, extraordinary items, and discontinued operations, is extensively revised to emphasize the interpretation of this information by users of financial statements. The concepts of primary and fully diluted earnings per share are illustrated and discussed in clear understandable terms. Chapter 9 is updated to reflect the new position of the FASB with respect to the valuation of marketable equity securities. Alternative valuation models, including the use of market prices and the equity method, also are illustrated and discussed. Chapter 10, "Receivables and Payables," includes a discussion of the concept of present value in

terms that students will find readily understandable. Chapter 11, on the subject of inventories, contains much new material on the impact of inflation upon the measurement of cost of goods sold and the valuation of inventories. The topic of inventory profits is related to recent official pronouncements pointing to the need for considering replacement costs when measuring the profit realized on sales transactions. Chapter 12, covering plant assets, presents the problems arising from an environment of inflation. Attention is focused on the rules issued by the SEC requiring large corporations to disclose the replacement cost of plant and equipment and to show what depreciation would amount to computed on a replacement cost basis. Chapter 13, on the subject of long-term liabilities, includes new up-to-date coverage of leases. Amortization of bond premium and discount is illustrated using both the straight-line and effective interest methods, and problem material is supplied covering both methods. Chapter 14, "Accounting Principles," pulls together the theoretical concepts covered in preceding chapters and gives further attention to the problems created by rising prices. The dramatic change in the position of many of the large international CPA firms which are now advocating current-value accounting as the wave of the future is related to the increasingly active role of the SEC. Chapter 16, "Analysis and Interpretation of Financial Statements," invites students to use the accounting expertise they have acquired to evaluate the adequacy or inadequacy of corporate profits in relation to sales volume, to total assets of the firm, to invested capital, and to other yardsticks. The last chapter, "Income Taxes and Business Decisions," is extensively revised to include the many recent changes in tax law affecting both individuals and corporations. Increased emphasis is given to tax planning and the impact of taxes upon business decisions.

### **Supplementary materials**

A full assortment of supplementary materials accompanies this text:

**1 A set of four *Achievement Tests* and a *Comprehensive Examination*.**

Each test covers three or four chapters; the Comprehensive Examination covers the entire text, and may be used as a final examination.

**2 An *examination booklet*.** With an abundance of test questions and exercises arranged chapter by chapter for the entire text, this examination booklet will be a most useful source for instructors who prefer to assemble their own examinations. The questions in this book are

printed in an  $8\frac{1}{2} \times 11$  format on one side of a page. They can be torn out and copied to prepare individual examinations.

**3 A self-study guide.** Written by the authors of the textbook, the **Study Guide** enables students to measure their progress by immediate feedback. This self-study guide includes an outline of the most important points in each chapter, an abundance of objective questions, and several short exercises for each chapter. In the back of the self-study guide are answers to questions and solutions to exercises to help students evaluate their understanding of the subject. The self-study guide will also be useful in classroom discussions and for review by students before examinations.

**4 Working papers.** A soft-cover book of **partially filled-in working papers** for the problem material is published separately from the text. On these work sheets, the problem headings and some preliminary data have been entered to save students much of the mechanical pencil-pushing inherent in problem assignments. All the working papers are in a new improved format featuring wider margin columns and the use of color

**5 Practice set.** The practice set available with the preceding edition has been completely revised and appears in convenient bound form with improved format. It is designed for use after covering the first six chapters of the book.

**6 Checklist of key figures for problems.** This list appears on the front and back inside covers of this book. The purpose of the checklist is to aid students in verifying their problem solutions and in discovering their own errors.

**7 Transparencies of problem solutions.** This is a visual aid prepared by the publisher for the instructor who wishes to display in a classroom the complete solutions to problems.

In the development of problem material for this book, special attention has been given to the inclusion of problems of varying length and difficulty. By referring to the time estimates, difficulty ratings, and problem descriptions in the **Solutions Manual**, instructors can choose problems that best fit the level, scope, and emphasis of the course they are offering.

**8 Additional transparencies for classroom illustrations.** Sixteen special transparencies have been produced for use in the classroom to

illustrate such concepts as closing entries, the preparation of a work sheet, and the use of special journals, subsidiary ledgers, and controlling accounts. These transparencies contain original material and do not duplicate illustrations contained in the text.

**9 A booklet of learning objectives.** This brief statement of learning objectives for each chapter is designed to focus the student's attention on key principles and procedures. A clear understanding of these points will be especially helpful in directing attention to the most fundamental concepts in each chapter.

### **Contributions by others**

We want to express our sincere thanks to the many users of preceding editions who offered helpful suggestions for this edition. Especially helpful was the advice received from Professors Larry P. Bailey, Temple University; Francis A. Bird, University of Richmond; Harold L. Cannon, State University of New York; Victoria L. Carvey, Indiana University; Harold Cook, Central Michigan University; Larry Godwin, Oregon State University; William C. Lins, Rutgers University; Frank C. Lordi, Widener College; Lawrence H. Malchman, Northeastern University; G. Kenneth Nelson, Pennsylvania State University; Richard A. Samuelson, San Diego State University; R. W. Schneider, Winona State University; and Edwin E. Thele, University of Wisconsin.

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