



*3rd Edition*

# Financial Accounting

■ | *Kermit D. Larson*  
*William W. Pyle*



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1986 Third Edition

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## **Preface**

*Financial Accounting* and its companion materials are designed to be a complete textual package for the first accounting course at the college and university level. This course enrolls students with varied backgrounds and educational goals. In this course, many students gain their first educational exposure to business topics such as alternative forms of business organization; typical business practices; legal instruments such as notes, bonds, and stocks; and financial statements and analysis. Objectives of the course generally include: (1) developing a general understanding of financial reports and analyses that students will find useful in their personal affairs regardless of their fields of specialization, (2) providing a strong foundation for subsequent courses in business and finance, and (3) initiating the coursework leading to a career in accounting. *Financial Accounting* is designed to serve all of these objectives.

As in previous editions, the central orientation of the third edition is to show how financial accounting data are accumulated and how periodic financial statements are prepared so that students can interpret and use accounting information intelligently and effectively. The concepts and principles that guide financial accounting are persistently emphasized and explained so that students will be able to generalize and apply their knowledge to a variety of new situations.

A hallmark of *Financial Accounting* is the careful integration of conceptual principles and their applications to specific business situations. Throughout the book, the definitions and explanations of important concepts and principles are presented in close proximity to illustrations and practical applications of those concepts and principles. As a result, students need not hold abstract concepts in limbo before they see how the concepts are applied.

### ***New Features and Important Changes in the Third Edition***

Numerous changes have been introduced in the third edition. Some of the more significant include the following:

1. One of the most noticeable changes is a dramatic increase in the number of exercises and problems at the end of each chapter. The number of exercises has been increased by more than 52

percent, and the total increase in problem assignments is approximately one third. The result is a much more diverse set of assignment materials.

2. All of the exercises, problems, and provocative problems have been revised, and the number of questions for class discussion has been substantially expanded.
3. The much larger Solutions Manual for the third edition is only partially due to the expansion of assignment material. In response to adopters' requests, the solutions now include many more supporting calculations.
4. Greater attention to the role of computers in accounting is provided in several chapters. For example, a new section discusses the effect of computers on internal control. The discussion of cash controls explains the linking of cash registers directly with the computer. And the section on control of plant assets was rewritten to be consistent with computerized accounting systems.
5. This third edition reflects a substantially increased use of real company financial information in illustrations and particularly in the provocative problems. For example, factual data has been drawn from the annual reports of companies such as Adolph Coors, Black and Decker, CBS, Apple Computers, Chrysler, Time, Crown Cork & Seal, etc.
6. Chapter 6 contains an expanded discussion of internal control. Also, the reconciliation of bank statements is based on a new, up-to-date bank statement. The illustration of a Petty Cash record has been replaced by an informal calculation or summary of petty cash payments.
7. Chapter 7 includes a thoroughly new, more complete, and easier to understand discussion of bad debts. Both the income statement and balance sheet approaches to estimating bad debts are explained. Discussion of the balance sheet approach includes both a simplified version and an improved treatment of aging.
8. Chapter 7 also contains new discussions of credit card sales and of installment accounts receivable.
9. The coverage of perpetual inventory systems has been rewritten and expanded. Included are journal entries comparing periodic and perpetual. LIFO under perpetual is discussed and illustrated, as is the difference between LIFO periodic and LIFO perpetual. The usefulness of the perpetual method in computerized accounting systems has also been clarified.
10. The discussion of inventory valuation under lower of cost or market has been completely rewritten. The new version is easier to understand, has better illustrations, and includes more descriptive headings.
11. Chapter 10 contains a new section on the definition and classifica-

tion of liabilities. In addition to the distinction between current and long-term liabilities, the difference between definite and estimated liabilities is explained. New coverage of property taxes payable and product warranty liabilities is used to illustrate estimated liabilities.

12. A new section in Chapter 10 covers contingent liabilities and expands on the Chapter 8 introduction to this topic.
13. The discussion of mortgages has been totally rewritten to more accurately describe mortgages as a form of security that may apply to both notes payable and bonds.
14. A new section of Chapter 11 explains installment notes payable with two alternative payment patterns.
15. Chapter 14 has been very substantially revised so that the statement of changes in financial position is presented on both a working capital basis and on a cash basis. The differences between the two alternative formats are reconciled.
16. Over half of the material in Chapter 15 is new. The first portion of the chapter explains the income and retained earnings presentations of items that are unrelated to continuing operations. These items include discontinued operations; unusual, infrequent, and extraordinary items; changes in accounting principles; and prior period adjustments. New material also includes a concise introduction to the problems of accounting for international operations.
17. The material on accounting for price changes has been compressed, simplified, and updated.
18. A completely new discussion of earnings per share is presented in Chapter 16. Calculations for companies with simple capital structures are illustrated, and the concepts of primary and fully diluted earnings per share are developed without requiring complex calculations.
19. A new Appendix at the end of the book provides an expanded analysis of present and future values. Instructors may choose to restrict the present value coverage to the material contained in Chapter 10. Or they may also assign the Appendix and expand the coverage to include future values and a more detailed analysis of present values. The Appendix concludes with large tables of present and future values and 19 exercises.
20. Numerous additional changes and editorial refinements have been made to increase clarity and provide a thoroughly current exposition. Some examples include: sharpened glossary definitions of many terms, new introductions to several chapters, an updated discussion of conservatism, a change in terminology from "premium on stock" to "contributed capital in excess of par value," an updated discussion of accelerated depreciation for tax purposes, more realistic interest rates and dollar amounts, increased

use of headings in selected areas, a new discussion of capital and revenue expenditures, a concise discussion of investments in bonds, a change in footnote citations to *Accounting Standards, Current Text*, an expanded number of problems in the Study Guide, and clearer discussions of employment taxes and of bond characteristics.

### ***A Word about the Provocative Problems***

Among the sharply expanded array of assignment material in *Financial Accounting*, the third edition includes approximately 50 homework assignments that are described as *provocative problems*. This description stems from the fact that they are somewhat more thought provoking than other problem assignments. Provocative problems are more like the real world, confronting students with somewhat more complexity and often requiring students to reach decisions about the illustrated situations. Many of the provocative problems in the third edition are based on factual situations drawn from the financial reports of real companies. Provocative problems tend to be more challenging than other problem assignments. Although the working papers are plentiful enough to allow adaptation to the provocative problems, they have not been specifically designed to fit these problems. Students are therefore required to take greater responsibility for organizing their solutions.

We encourage instructors to include several provocative problems in their teaching plan as a means of enriching the diversity of assignment material and exposing students to the real-world applicability of accounting issues. Provocative problems can help instructors challenge their best students and demonstrate to the entire class the contemporary relevance of the course.

Six computerized items are available to support the teaching effectiveness of *Financial Accounting*. Three items for student use were written by Christine Sprenger, Keith Weidkamp, and Clifford Burns. They are:

1. *Hanalai Bay Wind and Surf*, a microcomputer practice set that may be assigned after Chapter 7.
2. *dBug Computers, Inc.*, a microcomputer practice set with expanded features that may be assigned after Chapter 9.
3. *Microcomputer Study Guide*, a tutorial for student use in private study and review.

For instructor use, the computerized testing material includes:

4. Computest, an enlarged bank of examination materials that now includes exercise-type problems as well as multiple-choice and true-false questions.

5. Teletest, a system for drawing objective questions from the computerized test bank via telephone requests to the publisher.
6. Compugrade, a program for recording and weighting exam grades.

In addition to the computerized supplements, the teaching package for *Financial Accounting* includes a book of Working Papers, a comprehensive Study Guide, a List of Check Figures, a complete Solutions Manual, a manual practice set, transparencies of the solutions to all exercises and problems, and a special set of teaching transparencies.

In preparing the third edition, the constructive input from numerous adopters has been the cornerstone of the revision plan. We are indebted to many individuals who have contributed comments, criticisms, and suggestions. Extremely helpful reviews were provided by Melvin Auerbach of California State University, Dominguez Hills, Anthony Curatola of Louisiana State University, Baton Rouge, Ruth Jones of East Carolina University, and Elizabeth Darr of Marquette University. The assistance of Patricia Kardash in preparing the manuscript was invaluable.

*Kermit D. Larson*  
*William W. Pyle*



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## Practice Set

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## **Practice Set**

*dBug Computers, Inc.*  
(A Microcomputer Set)

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