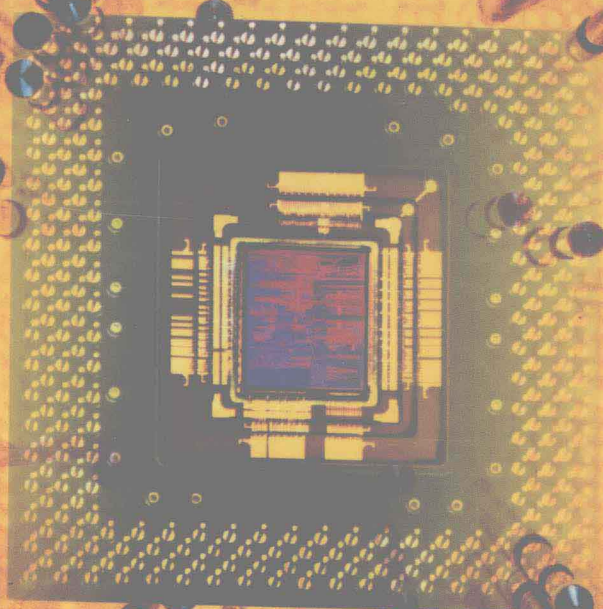


INTERMEDIATE ACCOUNTING

VOLUME 2



NINTH EDITION



KIESO & WEYGANDT

NINTH EDITION

INTERMEDIATE ACCOUNTING

VOLUME II

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INTERMEDIATE ACCOUNTING

*Dedicated to
Donna and Enid
for their
Love, Support, and Understanding
and
to the many
dedicated and talented teachers
who have brought our textbook
to life for their students.*

About the Authors

Donald E. Kieso, Ph.D., CPA, received his bachelor's degree from Aurora University and his doctorate in accounting from the University of Illinois. He has served as chairman of the Department of Accountancy and is currently the KPMG Peat Marwick Emeritus Professor of Accountancy at Northern Illinois University. He has public accounting experience with Price Waterhouse & Co. (San Francisco and Chicago) and Arthur Andersen & Co. (Chicago) and research experience with the Research Division of the American Institute of Certified Public Accountants (New York). He has done postdoctorate work as a Visiting Scholar at the University of California at Berkeley and is a recipient of NIU's Teaching Excellence Award and four Golden Apple Teaching Awards (1986, 1990, 1992, and 1994). Professor Kieso is the author of other accounting and business books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Illinois CPA Society. He has served as a member of the Board of Directors of the Illinois CPA Society, the Board of Governors of the American Accounting Association's Administrators of Accounting Programs Group, the AACSB's Accounting Accreditation and Visitation Committees, the State of Illinois Comptroller's Commission, as Secretary-Treasurer of the Federation of Schools of Accountancy, and as Secretary-Treasurer of the American Accounting Association. Professor Kieso is currently serving as vice-chairman of the Board of Trustees and Executive Committee of Aurora University, the Boards of Directors of Castle BancGroup Inc., the Sandwich State Bank, Treasurer and director of Sandwich Community Hospital and committees of the Illinois CPA Society. From 1989 to 1993 he served as a charter member of the national Accounting Education Change Commission. In 1988 he received the Outstanding Accounting Educator Award from the Illinois CPA Society, in 1992 he received the FSA's Joseph A. Silvano Award of Merit and the NIU Foundation's Humanitarian Award for Service to Higher Education, and in 1995 he received a Distinguished Service Award from the Illinois CPA Society.

Jerry J. Weygandt, Ph.D., CPA, is Arthur Andersen Alumni Professor of Accounting at the University of Wisconsin-Madison. He holds a Ph.D. in accounting from the University of Illinois. Articles by Professor Weygandt have appeared in the *Accounting Review*, *Journal of Accounting Research*, the *Journal of Accountancy*, and other professional journals. These articles have examined such financial reporting issues as accounting for price-level adjustments, pensions, convertible securities, stock option contracts, and interim reports. He is the author of three other textbooks, *Accounting Principles*, *Financial Accounting*, and *Cases in Financial Accounting*. He is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Wisconsin Society of Certified Public Accountants. He has served on numerous committees of the American Accounting Association, including Chair of the Financial Reporting Standards Committee. Professor Weygandt has also served as Secretary-Treasurer and President of the American Accounting Association and has been a member of the editorial board of the *Accounting Review*. In addition, he has been a member of the Accounting Standards Executive Committee of the American Institute of Certified Public Accounting and has served on task forces of that organization related to income taxes, stock options, and impairments. Presently he is chair of the AICPA's Financial Reporting Coordinating Committee related to business reporting. Professor Weygandt is currently serving as a trustee of the Financial Accounting Foundation, as a member of the Board of Directors of M&I Bank of Southern Wisconsin and the Board of Directors of the Dean Foundation. He has received various teaching awards including the Chancellor's Award for Excellence in Teaching. Recently he received the Wisconsin Institute of CPA's Outstanding Educator's Award and Lifetime Achievement Award.

In early 1996 we began working on the ninth edition of *Intermediate Accounting*. One of the many changes that we considered was finding and including a new, modern set of specimen financial statements for students to refer to and analyze. Out of the stack of hundreds of companies we examined one jumped out—Intel.

As Intel releases each new microchip, you can be sure that it reflects the industry's rapid-fire pace of change and increasingly diversified needs. This is also true of this new edition of *Intermediate Accounting*. We have conducted extensive market research, including instructor focus groups, student focus groups, telesessions, direct mail surveys, and one-on-one discussions with practitioners to help us focus on how this text should evolve. As a result, we have thoroughly revised and updated the text to include all the latest developments in the accounting profession. We have also addressed the important recommendations of the Accounting Education Change Commission for involving students more in the learning process.

Continuing to keep pace with the complexities of the modern business enterprise and professional accounting pronouncements, we have added new topics, deleted some obsolete material, clarified some of the existing coverage, added numerous illustrations, and updated material where necessary. To provide the instructor with greater flexibility in choosing topics to cover or omit, we have continued the use of judiciously selected appendices. The appendices are concerned primarily with complex subjects, less commonly used methods, or specialized topics.

Benefiting from the comments and recommendations of adopters of our eighth edition, we have made significant revisions. Explanations have been expanded where necessary, complicated discussions and illustrations have been simplified; realism has been integrated to heighten interest and relevancy; and new topics and coverage have been added to maintain currency. We have even deleted some eighth edition coverage and condensed the coverage of other topics.

Accountants must act as well as think; therefore, we believe it is important for students to understand the *how* as well as the *why*. The study of concepts develops an understanding of procedures, and the performance of procedures enriches an understanding of the concepts. We have therefore balanced our coverage so the conceptual discussion and procedural presentation are mutually reinforcing.

We believe that individuals learn to account for and analyze financial events and phenomena best if they fully understand the nature of the business transactions and comprehend the behavioral and economic consequences of the events for which firms account and report. The ability to critically evaluate accounting alternatives and their consequences is important. Throughout this revision, we have provided coverage to help students develop a real understanding of how accounting can be used to make effective financial decisions.

❖ NEW FEATURES

Based on extensive reviews, focus groups, and interactions with other intermediate accounting instructors and students, we have developed a number of new pedagogical features and content changes designed both to help students learn more effectively and to answer the changing needs of the course.

New Chapter Openings: We have revised the chapter openings to increase student interest and to draw readers into the chapter more quickly. These openings consist of two parts:

Chapter-opening vignettes: The chapter openings, most of which are new in this edition, tell stories about accounting experiences of real-world companies. These stories provide a real-world context that helps motivate student interest in the chapter topic.

Chapter preview and outline: A chapter preview further ties the chapter topic to the opening story and explains the importance of the chapter topic. A graphic outline presents a visual “roadmap” of the important topics covered in the chapter.

New “Using Your Judgment” Features: In the eighth edition, we introduced a new Using Your Judgment section in the end-of-chapter assignment materials. This section contains assignments that help develop students’ analytical, critical thinking, and interpersonal communication skills. These materials met with wide acceptance and praise in the market, and in this edition we have added some new features, which will give instructors even more choice of materials with which to develop student abilities. These include the following:

Financial Statement Analysis Case: Each case introduces a real-world company and discusses how financial transactions affect their financial statements. Often, an assessment of the company’s liquidity, solvency, or financial profitability is performed.

Comparative Analysis Case: The Coca-Cola Company and PepsiCo, Inc., are compared in relation to the topic(s) discussed in the chapter. Each comparative analysis case provides an opportunity to analyze two well-known companies. The Coca-Cola and PepsiCo. financial statements are available on our Web site encouraging students to use the Internet in this course.

Research Case: Each research case provides an opportunity for the student to conduct independent research into an accounting topic related to the chapter content. In many cases, the student must access a data base (sometimes involving use of the Internet) to find the necessary information.

Integration of Financial Statement Analysis: By understanding the accounting processes that generate statements and the tools required to analyze these statements, students learn to look beyond the numbers. Financial ratios are covered early in the text in an appendix to Chapter 5 to enhance teaching flexibility and enable instructors who want earlier coverage to have access to it when they need it. Ratio analysis is also woven throughout the text to expose students to the significance of economic events.

Conceptual Overview of the Statement of Cash Flows: An early conceptual overview of the statement of cash flows emphasizes the increasingly important role this statement is taking in today’s business and explains to students the reasons behind the mechanics, that is, the “why” behind the “how.” In addition, students will find comprehensive coverage of the statement in Chapter 24, “Statement of Cash Flows.”

Internet Resources: Together with Wiley, we have developed a new Web site dedicated to our users, both students and instructors. Using the address <http://www.wiley.com/college/kieso> you can access an array of valuable resources, including, but not limited to, the following:

Real company disclosures: Denoted by our Web site icon in the margin of the text, additional disclosures can be viewed and downloaded from our Web site. These disclosures relate directly to and help to illustrate topics discussed throughout the text.



Coca-Cola Company and PepsiCo, Inc.: Pertinent financial information related to these two companies can be found on our Web site for comparison and analysis purposes.

Expanded discussions: Amplified discussions of such subjects as interest capitalization and transfer of receivables can be found on our Web site.

Additional homework problems: Students will find additional problems to work, as well as their solution, on our site. Our Web site icon appears in the margin of the end-of-chapter material when additional problems are available on site.

Instructor's course management system: This system, provided by Of Course!, includes an on-line gradebook, a national bench marking and recognition system, a course opinion survey tool, and a web-based feedback mechanism that allows the instructor to collect feedback from students.

The Accounting Workshop: An on-line magazine aimed at the interests of both college students and professors, this feature is designed to entertain, stimulate, and inform by providing original articles relating to various accounting topics and current events.

Whitepeak Corporation Module: One of the recommendations of the Accounting Education Change Commission is that students become more involved in their own learning process. We thoroughly embrace this concept and provide a new simulation to address AECC recommendations. Several paragraphs at the end of most chapters tie into a computer simulation of a company called Whitepeak Corporation. This brief presentation explains Whitepeak's accounting situation as it relates to the chapter topic. Students can then complete the Whitepeak module on their own disk, applying intermediate accounting concepts to prepare, correct, adjust, analyze, and extend accounting procedures at Whitepeak. The simulation's programming allows instructors easily to grade and track students' progress from their own PC, making the assignment of computer problems simple to manage and flexible enough to use as group or individual self-paced exercises.



Brief Exercises: New exercises that focus students on one study objective or topic have been added to the end-of-chapter material.

❖ ENHANCED FEATURES

Real-World Emphasis: We believe that one of the goals of the Intermediate Accounting course is to orient students to the application of accounting principles and techniques in practice. Accordingly, we have continued our practice of using numerous examples from real corporations throughout the text. Many illustrations and exhibits are excerpts from actual financial statements of existing firms, including the 1995 annual report of Intel Corporation, in Appendix 5B. We believe Intel's financial statements are packed with important—and interesting—information that students will be motivated to analyze. We thought it appropriate to include Intel's newest product, the MMX pentium chip, on the cover of our text. In doing so, we welcome Intel to the book.

“Perspectives”: We have retained the interviews with prominent accounting and business personalities on relevant accounting topics, which give a real-world emphasis so important for students in the intermediate accounting course who are getting more serious about choosing accounting as a career. In the ninth edition, we have updated a number of interviews from the eighth edition and added new interviews with accounting professionals as well as with young accountants who describe their transitions from school into the business world in interviews entitled “From Classroom to Career.”



International Insights: In the eighth edition, we added marginal International Insight paragraphs that describe or compare the accounting practices in other countries. In this edition, we have continued this feature to bring them up to date with changing international accounting practices.

Streamlined Presentation: We have continued our efforts to keep the topical coverage of *Intermediate Accounting* in line with the way instructors are currently teaching the course. Accordingly, we have moved some optional topics into appendices and have omitted altogether some topics that formerly were covered in appendices, moving them to our Web site. Details are noted in the list of specific content changes below.

Currency and Accuracy: Accounting continually changes as its environment changes; an up-to-date book is therefore a necessity. As in past editions, we have striven to make this edition the most up-to-date and accurate text available.

❖ CONTENT CHANGES

The following list outlines the revisions and improvements made in chapters of the ninth edition.

Chapter 1 Financial Accounting and Accounting Standards

- ❖ New section on accounting and capital allocation
- ❖ New section on challenges facing accounting
- ❖ Revised and expanded discussion of international accounting standards

Chapter 2 Conceptual Framework Underlying Financial Accounting

- ❖ Increased emphasis on fair value accounting

Chapter 3 The Accounting Information System

- ❖ Revised discussion of the trial balance
- ❖ Revised and streamlined discussion of adjusting entries.

Chapter 4 Income Statement and Related Information

- ❖ New section on the statement of stockholders' equity, including subsections on the retained earnings statement and appropriations of retained earnings, and new material on other comprehensive income, with presentation of alternative formats

Chapter 5 Balance Sheet and Statement of Cash Flows

- ❖ New section on the usefulness of the cash flows statement, including two financial ratios and coverage of free cash flows
- ❖ Simplified discussion of contingencies
- ❖ Expanded discussion of disclosure of accounting policies, including addition of a sample disclosure of significant risks and uncertainties
- ❖ New chapter-ending appendix on ratio analysis

Chapter 6 Accounting and the Time Value of Money

- ❖ Variables standardized to be consistent with the notations used in finance and terminology simplified

Chapter 7 Cash and Receivables

- ❖ Discussion of cash controls moved to chapter appendix
- ❖ New integrated discussion of analysis of receivables (accounts receivable turnover ratio)
- ❖ Revised discussion of sales of receivables (specifically, transfers with recourse), with new illustration of accounting for transfers of receivables to reflect FASB 125

Chapter 8 Valuation of Inventories: A Cost Basis Approach

- ❖ LIFO reserve coverage moved from chapter appendix and integrated into the body of the chapter

Chapter 9 Inventories: Additional Valuation Issues

- ❖ New section on analysis of inventories

Chapter 10 Acquisition and Disposition of Property, Plant, and Equipment

- ❖ Appendix on special situation of interest capitalization has been deleted

Chapter 11 Depreciation, Impairments, and Depletion

- ❖ Simplified presentation of special depreciation methods by deleting the inventory method, the retirement and replacement methods (now covered in a footnote), and the compound interest methods
- ❖ Coverage of income tax depreciation moved to chapter appendix
- ❖ New (updated) illustration of disclosure of property, plant, and equipment
- ❖ New (updated) illustration of presentation of disclosure of natural resources
- ❖ New discussion of the effect of FASB No. 121 on U.S. oil companies

Chapter 12 Intangible Assets

- ❖ New vignette addressing the hot issue of valuing soft assets, such as knowledge
- ❖ Deleted section on property rights
- ❖ Deleted example of balance sheet presentation of intangibles with contra valuation account
- ❖ Updated appendix for new exposure draft on software accounting

Chapter 13 Current Liabilities and Contingencies

- ❖ Simplified discussion and coverage of short-term debt expected to be refinanced
- ❖ New material on gain contingencies, including an illustration
- ❖ Expanded discussion of self-insurance, including an illustration of self-insurance disclosure (merged from Chapter 16)
- ❖ Merged coverage of contingent liabilities from Chapter 5

Chapter 14 Long-Term Liabilities

- ❖ Streamlined coverage by deleting discussion of defeasance (in-coverage defeasance reduced and moved into a footnote) and moving coverage of financial instruments and derivatives to Chapter 18
- ❖ Revised presentation of long-term debt, including new headings for income statement and balance sheet presentation and note disclosure
- ❖ Added section on ratio analysis of long-term debt

Chapter 15 Stockholders' Equity: Contributed Capital

- ❖ Discussion of the corporate form of organization moved to the beginning of the chapter
- ❖ New illustration on corporate buybacks
- ❖ Revised and expanded discussion of cost method of accounting for treasury stock
- ❖ Par value method moved to chapter appendix; new illustrations to show stockholders' equity with and without treasury stock under par value method
- ❖ Simpler illustration of balance sheet presentation of redeemable preferred stock

Chapter 16 Stockholders' Equity: Retained Earnings

- ❖ Integrated analysis of stockholders' equity
- ❖ New, updated data on dividend payouts added as an illustration
- ❖ Section on self-insurance moved out of this chapter and combined with coverage in Chapter 13
- ❖ Added section on ratio analysis related to stockholders' equity
- ❖ New example of the columnar format for the statement of stockholders' equity

Chapter 17 Dilutive Securities and Earnings Per Share

- ❖ Chapter coverage updated for FASB No. 123, "Accounting for Stock-Based Compensation" and FASB No. 128 "Earnings per Share."

Chapter 18 Investments

- ❖ Moved transfers of investment securities between categories to appendix
- ❖ New appendix on financial instruments with emphasis on derivatives

Chapter 19 Revenue Recognition

Chapter 20 Accounting for Income Taxes

- ❖ Updated illustration of income taxes disclosure (PepsiCo)
- ❖ Updated to emphasize new research findings

Chapter 21 Accounting for Pensions and Postretirement Benefits

- ❖ Updated discussion of pensions plans, including updated statistical data
- ❖ New illustration of note disclosure for pensions
- ❖ Discussion of disclosure effectiveness related to pensions

Chapter 22 Accounting for Leases

- ❖ Discussion of sale-leaseback moved to chapter appendix
- ❖ Deleted appendix on leveraged leases

Chapter 23 Accounting Changes and Error Analysis

- ❖ Updated research and statistical data on types and disclosures of changes

Chapter 24 Statement of Cash Flows

- ❖ Condensed introductory historical discussion

Chapter 25 Full Disclosure in Financial Reporting

- ❖ New discussion of segment reportings, disaggregations
- ❖ Enhanced coverage of safe harbor provisions and financial instruments

❖ END-OF-CHAPTER ASSIGNMENT MATERIAL

At the end of each chapter we have provided a comprehensive set of review and homework material consisting of questions, exercises, problems, and short cases. For this edition, many of the exercises and problems have been revised, and a new feature—a separate category of brief exercises—has been added to each chapter. In addition, the Using Your Judgment sections, which include financial reporting problems, writing assignments, group assignments, and ethics cases, have been substantially revised and expanded with the addition of three new types of case studies: financial statement analysis cases, comparative analysis cases, and research cases. All of the assignment materials have been class tested and/or double checked for accuracy and clarity.

The questions are designed for review, self-testing, and classroom discussion purposes as well as homework assignments. Typically, a brief exercise covers one topic, an exercise one or two topics. Exercises require less time and effort to solve than cases and problems. The problems are designed to develop a professional level of achievement and are more challenging and time consuming to solve than the exercises. Those exercises and problems that are contained in the *Lotus Problems* supplements are identified by a blue computer disk icon in the margin. The cases generally require essay as opposed to quantitative solutions; they are intended to confront the student with situations calling for conceptual analysis and the exercise of judgment in identifying problems and evaluating alternatives. The Using Your Judgment assignments are designed to develop students' critical thinking, analytical, interpersonal, and communication skills.

The new Whitepeak Corporation computer-based simulation also provides an opportunity for students to apply intermediate accounting concepts to prepare, correct, adjust, analyze, and extend accounting procedures at Whitepeak, a fictional conglomerate. A narrative at the end of applicable chapters reminds the student to complete the computer module. The simulation's programming allows instructors to grade and track students' progress easily from their own PC, providing enough flexibility for use as group or individual self-paced exercises.

Probably no more than one-fourth of the total case, exercise, and problem material must be used to cover the subject matter adequately; consequently, problem assignment may be varied from year to year.

❖ COLOR DESIGN

The color design not only enlivens the textbook's appearance, but, through planned and consistent usage, eases learning. Note that financial statements are presented in blue-toned color with a beige header. Trial balances, work sheets, and large schedules and exhibits are presented in beige with blue headings. Most small illustrations, demonstrations, and excerpts from notes accompanying financial statements are beige colored/blue trim boxes. Significant amounts and descriptions within either blue or beige colored boxes are highlighted in solid blue color. All pages containing assignment ma-

terial are tabbed with a color bar, while the five interest and annuity tables in Chapter 6 have a beige triangle tab to make it easy to locate and identify them. The names of real-world companies as part of illustrations are red. The color design is summarized as follows:

- Red**—Real-world company names, secondary headings, and accents
- Blue**—Financial statements, highlighted amounts and descriptions in boxed illustrations
- Beige**—Exhibits, schedules, trial balances, work sheets, illustrations, and list of definitions

❖ SUPPLEMENTARY MATERIALS

Accompanying this textbook is an improved and expanded package of student learning aids and instructor teaching aids.

Instructor's Manual: Chs. 1–14
Instructor's Manual: Chs. 15–25

- ❖ Lecture outlines keyed to text learning objectives
- ❖ Updated Bibliography
- ❖ Teaching Transparency Masters
- ❖ Section on “How to assign and evaluate ethical issues in the course”
- ❖ Sections on “How to incorporate writing” and “How to incorporate group (collaborative) work”

Solutions Manual, Vol. I: Chs. 1–14
Solutions Manual, Vol. II: Chs. 15–25

- ❖ Answers to all questions, brief exercises, exercises, problems and case material provided
- ❖ Classification Tables categorize the end-of-chapter material by topic to assist in assigning homework
- ❖ Assignment Tables (characteristics) describe the end-of-chapter material, its difficulty level, and estimated completion time
- ❖ All solutions triple-checked to ensure accuracy

Test Bank, Vol. I: Chs. 1–14
Test Bank, Vol. II: Chs. 15–25

- ❖ Essay questions with solutions help you test students' communication skills
- ❖ Estimated completing times facilitate test planning
- ❖ Computations for multiple-choice problems assist you in giving partial credit

Computerized Test Bank IBM 3.5"

- ❖ A large collection of objective questions and exercises with answers for each chapter in the text
- ❖ Generate questions randomly or manually, and modify/customize tests with your own material
- ❖ Create multiple versions of the same text by scrambling by type, character, number, or Study Objective

Test Preparation Service

Simply call Wiley's Accounting Hotline (800)541-5602 with the questions you have selected for an exam. Wiley will provide a master exam within 24 hours.

Solution Transparencies, Vol. I: Chs. 1–14
Solution Transparencies, Vol. II: Chs. 15–25

- ❖ Provided in organizer box with chapter file folders
- ❖ Large, bold type size for easier class presentation
- ❖ Provided for all exercises, problems, and cases

Teaching Transparencies

- ❖ Over 100 color figure illustrations and exhibits
- ❖ 90% from outside the text

Checklist of Key Figures

Student Study Guide, Vol. I: Chs. 1–14
Student Study Guide, Vol. II: Chs. 15–25

- ❖ Chapter Learning Objectives
- ❖ Chapter Outline—a broad overview of general chapter content with space for note-taking in class
- ❖ Chapter Review with summary of key concepts
- ❖ Glossary of key terms
- ❖ Review Questions and Exercises—self-test items with supporting computations

Workpapers, Vol. I: Chs. 1–14
Workpapers, Vol. II: Chs. 15–25
Self-Study Problems/Solutions Book, Vol. I: Chs. 1–14
Self-Study Problems/Solutions Book, Vol. II: Chs. 15–25

- ❖ Provides additional questions and problems to develop students' problem-solving skills
- ❖ Explanations assist in the approach, set-up, and completion of problems
- ❖ Tips alert students to common pitfalls and misconceptions

Lotus Problems 3.5"
Excel Problems 3.5"

- ❖ Spreadsheet requirements range in difficulty (from data entry to developing spreadsheets)
- ❖ Review of immediate accounting and Lotus and Excel concepts
- ❖ Each chapter consists of a basic tutorial, a more advanced tutorial, and two or three problems from the text
- ❖ Each problem followed by "what-if" questions to build students' analytical skills

Rockford Corporation Computerized Practice Set

- ❖ This practice set has been designed as a students' review and update of the accounting cycle and the preparation of financial statements

PowerPoint Presentations

- ❖ Designed to enhance presentation of chapter topics and examples
- ❖ Separate presentation for each chapter

Instructor's Manual on Disk
Solutions Manual on Disk

- ❖ Allows you to project, print, and modify material for your course

Instructor's Resource System on CD-ROM

- ❖ Resource manager with friendly interface for course development and presentation
- ❖ Includes all instructor supplements, text art, and transparencies

Acknowledgments

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