FINANCIAL ACCOUNTING: BASIC CONCEPTS

SPILLER AND GOSMAN

FOURTH EDITION

FINANCIAL ACCOUNTING: Basic Concepts

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PREFACE

In this fourth edition of *Financial Accounting: Basic Concepts,* we have endeavored to retain the strengths of prior editions and improve the weaknesses. We have tried to resist making changes just to be different.

The overall purpose of the text and its main features remain the same. The book is intended for a one-semester introductory financial accounting course to be offered to MBA students or to highly motivated undergraduates. The text assumes no prior knowledge of accounting so it can also be used in Executive MBA programs and has been used successfully in management development programs.

This edition maintains the same conceptual-analytical approach that was the hallmark of previous editions. The book stresses more than just an "appreciation" of accounting. Both the "why" and the "how" are emphasized in the chapter discussions and problem material. The attention given to theoretical considerations and analytical operations is significant. They will require a mature, intelligent, and motivated readership.

The primary aim is to develop the reader's ability to understand, interpret, and analyze the financial statements of business organizations. Several secondary objectives support the achievement of this overall goal.

1. Familiarity with accounting terminology, so as to communicate using accounting as a language.
2. Knowledge of the measurement rules and disclosure regulations governing the recording and reporting of business activity.
3. Understanding of the impact of alternative accounting principles on the financial statements, so as to know what the statements mean and do not mean.
4. Ability to use the conceptual structure of financial accounting, both extant and prospective, as a benchmark for evaluation.
5. Acquisition of a working knowledge of the accounting process, so as to reason using accounting as a logical framework.

CHANGES IN THE FOURTH EDITION

We have tried to accomplish these objectives with a clear and direct writing style, challenging problem material, interesting and up-to-date discussions, and an improved explication of our ideas. Perhaps the greatest innovation has been the inclusion of the 1981 Annual Report of Armco, Inc., as an *integrated* teaching device. The entire financial section of the report is reproduced in an appendix to Chapter 5. Each chapter thereafter ends with a discussion that relates the material discussed in that chapter to the reporting practices of Armco in 1981. These Armco sections in Chapters 5–19 feature a detailed, in-depth analysis (two to seven pages) of Armco's financial statements and notes. They help to relate the textbook concepts and procedures to real-world situations and greatly increase the reader's confidence in his or her ability to understand actual corporate financial reports.

Other important changes in the fourth edition include the following:

1. Rewriting of all chapters to improve clarity and to incorporate the latest accounting thought and authoritative pronouncements.
2. Updating of Chapters 1–2 in particular to tie the definitions and discussion to the conceptual framework statements issued by the Financial Accounting Standards Board.
3. Inclusion of credit card sales and long-term service contracts in the discussion of revenue recognition in Chapter 6.
4. Elimination of the appendix to Chapter 7, which covered detailed cost accounting procedures. This material was rarely used by adopters. The space has been devoted to an expansion of the discussion and examples in Chapter 7 concerning marketable equity securities and capitalization of interest.
5. Incorporation of the highlights of the disclosures of *FASB Statement No. 33* within Chapters 8 and 9 dealing with inventories and plant assets.
6. Introduction of the accelerated cost recovery system (ACRS) mandated for tax purposes in Chapter 9 and a thorough discussion of it in Chapter 13.
7. Coverage of bonds as an investment in Chapter 10 to tie in with the chapter's discussion of bond liabilities.
8. Reorganization of Chapter 11 on leases to facilitate a comparison of the recording by lessees and lessors for each of the major types of leases.
9. Inclusion in Chapter 12 on pensions of a discussion of reporting problems of defined-benefit pension plans. This chapter also received extensive rewriting to incorporate recent pronouncements and discussions of proposed pronouncements.
10. Revision of the discussion of the various disclosure issues in Chapter 16 to reflect new principles and procedures. Particular subjects receiving extensive updating include extraordinary items and prior period adjustments, earnings per share, and foreign currency adjustments. The discussion of the auditor's role in accounting is also expanded.
11. Creation of a new appendix to Chapter 17 to cover some of the more

difficult material related to the funds statement. This change increases the usefulness of the chapter to some adopters who do not assign all chapters or who do not want an in-depth discussion of the more theoretical areas.

12. Inclusion in Chapter 18 of a description of research on the predictive ability of financial ratios and the use of ratios by credit evaluators.
13. Extensive rewriting of Chapter 19 on income measurement and changing prices to explain the disclosure requirements of *FASB Statement No. 33* and their relationship to a complete set of constant dollar or current cost statements.

In this fourth edition we also have included a glossary at the end of the text. The glossary contains the names and definitions of almost 300 technical terms and phrases used in financial accounting. The items are arranged in alphabetical order for easy reference by the user. Not only are clear, concise definitions provided for each item, but also the reader is directed to the first text chapter in which the item is discussed in greater depth.

A well-written accounting text without an adequate number of suitable problems accomplishes only half its intended purpose. We have tried to keep that idea paramount in our revision of the problem material. The number of problems is about the same as in the prior edition. Almost 50 percent of the problems in this edition are totally new, and many more have been significantly changed. The number of problems which follow fairly directly from text discussions and illustrations has been increased so the user can better see if he or she has mastered the basic material.

The great majority of problem material in this text stresses the application of conceptual knowledge and the development of analytical skills. They will require thought but should prove to be interesting, relevant, and challenging.

A significant number of them (over 25 percent of the problems in Chapters 5–19) comes from the annual reports of actual companies. Many chapters contain a number of problems of this nature. Also we have included some problems taken from the CPA and CMA examinations. These often have been tailored to the specific discussions in the text.

The basic organization of the book remains as in prior editions. Section One contains the first five chapters. These establish the fundamental concepts and procedures, including the accounting cycle. The emphasis, however, remains on understanding procedures as an aid in analysis and communication. Sections Two and Three discuss selected areas involved in the measurement of assets and equities. The material in these sections builds on the conceptual framework presented in Chapter 1. Current accounting principles and procedures are critically examined. Section Four contains five chapters which concern problems of analysis, disclosure, and interpretation in the financial statements.

ACKNOWLEDGMENTS

A successful revision results only when users of prior editions are willing to share their experiences and ideas with the authors. We have been fortunate to receive numerous suggestions for improvements, both large and small, in this edition. Some of this information was solicited in a survey of users; other suggestions came from adopters who were kind enough to write about their specific satisfactions and complaints. The list is too long to mention each one individually. Hopefully, they will recognize some changes made in response to their advice.

James M. Fremgen of the Naval Postgraduate School deserves a special mention of appreciation. He made the suggestion that we include an annual report in the book and use it as a formal part of the textual discussion. We believe this feature adds significantly to the relevance, clarity, and challenge of the book. We would also thank Marsha Murphy of Armco, Inc., for her assistance. She supplied supplementary information, clarified our misunderstandings, and corroborated many of our analyses.

Professors Michael L. Fetters (Babson College), James J. Linn (Tulane University), and Phillip T. May (Wichita State University) read the entire manuscript. They were of great help in suggesting material in need of clarification and/or revision and in evaluating our implementation of changes in this edition.

As she had in the two preceding editions, Jane Warren reviewed the entire manuscript for grammar, punctuation, consistency in style, and overall readability. It never ceased to amaze us how much better our material read after it had emerged from under the scrutiny of her pencil.

We also were aided by some very able graduate assistants. Marilyn Hill at Boston University and Chuu-Yun (Nancy) Yin at Indiana University verified references and numbers, critiqued text and problem material, assisted in the preparation of the index, and provided other valuable help.

We are grateful to the American Institute of Certified Public Accountants and the Institute of Management Accounting for allowing us to adapt problem material from their uniform examinations.

Last, but certainly not least (although it may have seemed that way to them for the last two years), we express great appreciation to our families. Their understanding, encouragement, and support have made our efforts worthwhile.

All of the foregoing people share in the completion of this book and in any improvements that it contains. The remaining deficiencies are ours alone. Comments and suggestions from users are most welcome.

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