

TENTH EDITION

# Accounting

The Basis for Business Decisions

**MEIGS & MEIGS**

**BETTNER**

**WHITTINGTON**

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# Accounting: The Basis for Business Decisions

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T E N T H                      E D I T I O N



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## ACCOUNTING: THE BASIS FOR BUSINESS DECISIONS

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# PREFACE

*Welcome* to the first accounting course. This course provides an introduction to the field of accounting and to the development and use of accounting information in the business world. It is intended for **everyone**, not just those students who may pursue careers in accounting. Today's students are tomorrow's decision makers. And as we say in the title of this textbook, **accounting is the basis for business decisions**.

There is more diversity today in the content of introductory accounting courses than at any time in the recent past. For example, the course may be structured to emphasize accounting techniques and procedures, accounting theory, or the interpretation and use of accounting information. There are many accounting textbooks available today, each with its own approach to the introductory course. Let us briefly explain ours.

## OUR GOALS IN THIS TENTH EDITION

We have tried to improve this tenth edition in many ways. But three of our top priorities have been to:

1. Better develop the student's understanding of today's business environment.
2. Increase emphasis upon the **interpretation** and **use** of accounting information.
3. Retain a course structure which is familiar to faculty and meets the content requirements of most colleges and universities.

## Providing Students with a Better "Business Background"

If students are to appreciate the nature of accounting, they first must understand the activities that accounting information describes. We find, however, that many introductory students lack this background. Often the introductory accounting course is also the students' first course in the business curriculum. In this edition, we give increased attention to explaining the nature of business activities before discussing the related accounting issues.

Our focus is upon the **current and emerging** business environment, not that of the past. We recognize the challenging reality that today's students will be **just beginning** their careers as we enter the twenty-first century.

## Emphasizing the Interpretation and Use of Accounting Information

In today's business world, relatively few first-year accounting students will become professional preparers of accounting information. All, however, will become life-long **users** of this information. For this reason, we have reduced our emphasis on the techniques of preparing information, and increased our emphasis on its **interpretation** and **use**.

This shift in perspective affects the text in several ways. For example, the assignment materials place greater emphasis on developing students' analytical skills.

A more "user-oriented" approach also affects topical content and emphasis. Topics of crucial importance to decision makers are addressed, even if these topics traditionally have been deferred to later accounting courses. Examples include postretirement costs, income tax considerations, audits, transfer prices, and how different accounting methods affect key financial ratios.

The statement of cash flows and the basic techniques of financial statement analysis both are introduced earlier in the course. Throughout the text, attention is given to analytical ratios and other financial relationships, both the accrual and cash effects of transactions, and the use of accounting information by management.

Some “traditional” accounting topics relate primarily to the preparation of accounting information and are of little significance to information users. Examples include the preparation of work sheets, reversing entries, and alternative methods of recording accruals and deferrals. In our more user-oriented approach, such topics receive less emphasis.

### Retaining a Familiar Course Structure

We regard our changes in this tenth edition as *evolutionary*, not revolutionary. Instructors who have used our past editions will find much that is familiar. They will also find that this tenth edition supports—indeed encourages—evolutionary change from one semester to the next.

## ELEMENTS OF THE TEXTBOOK

This tenth edition is accompanied by a wide variety of in-the-text learning aids.

### Chapter Introductions and Learning Objectives

Each chapter now starts with a “photo-opener.” These photographs enable us to use non-technical images in describing each chapter’s theme. Each chapter also includes a short set of *learning objectives* which are integrated with the text discussions and assignment materials.

### Cases in Point

A distinctive feature of our text is the use of short *Cases in Point* based upon actual events. This edition makes far greater use of this feature—it is part of our effort to more closely relate the study of accounting with today’s business world.

### \**Supplemental Topics and Appendixes*

Several chapters are accompanied by \**Supplemental Topic* sections. These topics are not “optional” or unimportant. Rather, they relate closely to the chapter content. Students *always* should read the \**Supplemental Topic* sections. However, instructors may decide whether these topics are of sufficient general interest for inclusion in class discussions, homework assignments, and examinations.

In contrast to the \**Supplemental Topics*, our seven *Appendixes* provide self-contained coverage of specialized topics. We consider these topics optional; students are *not* expected to read the appendixes unless they are assigned by the instructor.

## End-of-Chapter Reviews

Each chapter is followed by a variety of learning aids. These include a *Summary of Learning Objectives*, a *Glossary of Key Terms*, *Self-Test Questions*, and a *Demonstration Problem*.

## Assignment Materials

One of the distinctive features of this tenth edition is the nature and variety of its assignment material. Increased emphasis is placed upon the development of students' analytical, communication, and interpersonal skills. Many of the assignments are based upon the operations of well-known companies.

There are five basic categories of assignments (1) *Discussion Questions*, (2) *Exercises*, (3) *Problems*, (4) *Cases and Unstructured Problems*, and (5) *Comprehensive Problems*.

**Discussion Questions** are short and usually call for expository answers. In addition to developing communication skills, these questions enhance students' conceptual understanding of accounting.

**Exercises** are short assignments, usually focusing upon a single concept. They are designed to illustrate basic concepts quickly, allowing more class time for discussing assignments such as the *Cases and Unstructured Problems*.

**Problems** are longer than the *Exercises* and address several concepts at one time. Many problems require students to explain, interpret, or make use of the information they produce.

Users of prior editions will notice that we now have a single series of problems, rather than the traditional *A* and *B* sets. This single series enables us to offer **greater variety** in our assignment material.

**Cases and Unstructured Problems** are intended to develop students' analytical and communication skills. These assignments readily lend themselves to group analysis and to class discussions.

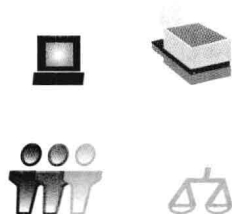
**Comprehensive Problems** tie together concepts presented over a span of chapters. The text includes **seven** of these problems, ranging in length from 50-minute assignments to term projects. These problems are described in detail in the prefaces to both the *Solutions Manual* and the *Instructor's Guide*.

A **checklist of key figures** for all *Problems* and *Comprehensive Problems* appears on the front and back inside covers of the text. The purpose of these figures is to aid students in verifying their solutions and discovering their own errors. Also, a supplemental package of **partially completed work sheets** supporting all *Problems* and *Comprehensive Problems* is available through campus bookstores.

**Logos in the Margins** Many assignments have special characteristics which are indicated by logos appearing in the left margin. A **computer terminal** identifies problems well-suited to the use of general ledger software; a **printer** indicates problems suited to the use of the problem-solver software.

Assignments particularly well-suited to group solution are identified by the **group logo** shown at left. (Most of the *Cases and Unstructured Problems* also can be used as group assignments.) Assignments focusing upon **ethical** considerations are identified by the **scales of justice** logo.

When assignments are based upon the operations of a real business organization, the company's name appears in **bold blue type**. (A special index at



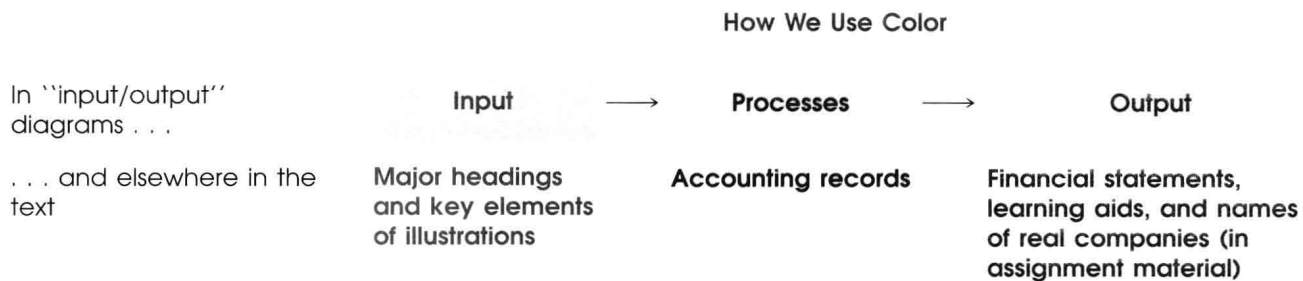
the back of the text identifies all references to actual organizations and individuals.)

### Use of Color

Our use of color is intended to assist readers in interpreting illustrations and in conveniently locating elements of the text. For example, red used for *emphasis*—for major chapter headings and to highlight key elements in some illustrations. We also use color to distinguish between accounting records and financial statements—accounting records appear in *green*, and financial statements in *blue*.

In diagrams depicting the “flow” of information, inputs appear in *red*, the processes or activities in *green*, and the final output is shown in *blue*. Blue also is used to identify learning aids, such as *learning objectives* and *key terms*, and the names of *real companies* used in the assignment material.

These uses of color are summarized below:



### NEW FEATURES AND SUPPLEMENTARY MATERIALS

Traditionally, we have included in our *Preface* brief descriptions of new and extensively revised chapters and of the many supplemental materials which accompany this text. As these discussions are of greater interest to faculty than to students, we have moved them to the several pages immediately following the *Preface*.

### A NOTE TO STUDENTS: SOME GUIDELINES ON CONDUCTING INTERVIEWS

Several of our Cases and Unstructured Problems call for you—or a member of your study group—to interview people in the business community. Please appreciate that business people granting these interviews are donating their time for your benefit. For this reason, we ask that you observe a few basic guidelines:

- Please make an appointment for the interview, don’t just walk in expecting to talk to someone. And be on time—recognize that time is a very valuable commodity in the business world.
- Dress appropriately and conduct yourself in a business-like manner.
- Learn the name of the person you will be interviewing, including the



correct spelling and pronunciation, and his or her position within the organization.

- Plan and write down *in advance* all of the questions you plan to ask.
- Take notes during the interview. You should never attempt to quote the person's statements from memory.
- Realize that business people may not want certain information about their business "spread around town." Tell them *in advance* that the general content of the interview will be discussed within your study group and, perhaps, in your classroom. Respect any requests that specific comments be kept "off-the-record."

## CONTRIBUTIONS BY OTHERS

This tenth edition has benefited from a number of perceptive reviews. We wish to express our sincere appreciation to these reviewers, who are listed immediately following this *Preface*. In addition, we want to thank the many users of this text—both faculty and students—who have offered helpful suggestions.

We also want to acknowledge the following individuals, each of whom has authored supplements which accompany the text: **Douglas Cloud**, Pepperdine University; **Christie W. Johnson**, Montana State University; **Dilip D. Kare**, University of North Florida; **David J. Marcinko**, SUNY at Albany; **Glenn E. Owen**, University of California, Santa Barbara; **Richard A. Wright**, Professor Emeritus, American River College.

Our special thanks go to **James M. Emig**, Villanova University, and **Michael Claire**, College of San Mateo for assisting us with detailed reviews of text examples and end-of-chapter problem material.

We appreciate the expert attention given to this project by the staff of McGraw-Hill, especially **Alan Sachs**, **Ira Roberts**, and **Judy Howarth**. Two extraordinary proofreaders, **Kalista Johnston-Nash** and **Michelle Lulos** also deserve special recognition.

The assistance of **Margot Berg** and **Robin Klein** was invaluable in the preparation of the manuscript for many of the supplementary materials.

Finally, we wish to acknowledge the innumerable contributions of **Walter B. Meigs**, Professor Emeritus, University of Southern California. Professor Meigs is the founding author of this textbook and has participated in all of the preceding editions. Although he is now retired, his philosophy, perspective, and unique authorship skills remain apparent throughout the text.

*Robert F. Meigs  
Mary A. Meigs  
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# SOME ADDITIONAL INFORMATION

## NEW OR EXTENSIVELY REVISED CHAPTERS

Many chapters in this tenth edition are either new or have been extensively revised. Among the changes which will be noticed most readily are:

The first four chapters utilize a new continuing example, are less procedural, and place more emphasis on the interpretation and use of accounting information. We now complete our coverage of the accounting cycle in Chapter 3, and our coverage of adjusting entries in that chapter has been expanded. Chapter 4, “Year-End!,” provides a broader description of the many activities that make year-end the “busy season.” Substantially less emphasis is given to the work sheet, which now appears in a *\*Supplemental Topic* section.

Chapter 5 now focuses exclusively upon merchandising activities, with the material on financial statement analysis deferred to an all-new Chapter 8. Chapter 5 continues to emphasize perpetual inventory systems, but the coverage of periodic systems has been expanded. Appendix A, “More About Periodic Inventory Systems,” now immediately follows this chapter.

Chapter 6, “Forms of Business Organization,” is new to this edition. Introducing the corporate form earlier in the course paves the way for using “real-world” examples and increasing the emphasis upon financial statement analysis.

Chapter 7, our accounting systems chapter, retains its focus on computer-based systems. However the chapter now is supplemented by Appendix B, illustrating the use of manual special journals, and by *THE NEXT DIMENSION*, which is our most challenging *Comprehensive Problem*. (NEXT makes an excellent group term project.)

Chapter 8, “Introduction to Financial Statement Analysis and the Statement of Cash Flows,” will be the most noticed feature of this tenth edition. This all-new chapter provides an early and user-oriented introduction to both of these crucial topics. Also, this chapter serves as the foundation for increased emphasis on these topics throughout the text.

Following Chapter 8 is the new **Toys “R” Us** *Comprehensive Problem* involving the analysis of an actual annual report.

Chapter 9, “Financial Assets,” has been revised to better address the issues of both asset valuation and efficient asset management. And, of course, the chapter includes up-to-date coverage of **mark-to-market**.

Chapter 11, “Plant Assets and Depreciation,” emphasizes the depreciation methods that businesses use most—straight-line, declining balance, and MACRS. The chapter also introduces the concept of an asset’s **tax basis**—something that every business student should understand.

Due to “truth-in-lending” laws, we find that notes payable seldom are drawn with interest included in the face amount. Thus, Chapter 12, “Liabilities Common to Most Business Organizations,” has been shortened and simplified by eliminating the lengthy coverage of this form of note.

Chapter 13, “Accounting Concepts, Professional Judgment, and Ethical Conduct,” is quite similar to that in our preceding edition. But we want to remind instructors that this chapter is at once a review of the first semester and an introduction to the second. It may well be worth repeating at the beginning of the second semester—particularly if students are returning from a long summer vacation.

Our coverage of bonds payable, in Chapter 16, differs substantially from past editions and from most accounting textbooks. For too long, coverage of long-term liabilities has focused upon the mechanics of amortizing bond dis-

counts and premiums. But we find that bonds are almost never issued at a premium, and discounts generally are immaterial in dollar amount. Therefore, Chapter 16 now focuses upon topics of greater importance in today's business world, such as postretirement costs and the evaluation of credit risk. Bonds are addressed thoroughly in the chapter, but amortization of discount and premium is treated as a *\*Supplemental Topic*.

Chapter 17, our final chapter on cash flows, reflects our increased coverage of this topic throughout the text. It also includes a new *\*Supplemental Topic* illustrating the "work sheet approach" to preparing a statement of cash flows.

Chapter 18, on income taxes, has been revised to more clearly explain the general **theory** underlying tax laws. Thus, the usefulness of this chapter is not limited to a particular "tax year."

Our coverage of managerial accounting topics has been extensively revised and expanded from six chapters to **eight**. Thus, users of our earlier editions will find that Chapters 19 through 26 contain new and enhanced materials. The content and scope of these chapters go far beyond a purely accounting perspective. Indeed, many of our revised illustrations and end-of-chapter materials challenge students to address important **nonfinancial issues**, including environmental, political, ethical, legal, and quality concerns.

Users of this text will also discover that our new chapter illustrations are very "student friendly" and focus on interesting and familiar business enterprises, such as a mountain bike manufacturer (Chapter 19), an in-line skate company (Chapter 22), a soft drink bottling plant (Chapter 20), a computer hardware developer (Chapter 25), a stereo shop (Chapter 24), and a minor league baseball team (Chapter 26).

We have also expanded and better integrated our coverage of the **new manufacturing environment**. For instance, Appendix C, which immediately follows Chapter 19, provides a comprehensive discussion of activity-based costing (ABC), and illustrates how an ABC system can help managers to price products more competitively without sacrificing product quality. Likewise, Chapter 21 combines coverage of standard costing, quality control, and just-in-time (JIT) inventory systems to provide a total quality management (TQM) approach to manufacturing efficiency.

Several of our revised managerial chapters contain **innovations** which better facilitate the changing needs of modern managers. For instance, we are particularly pleased with the coverage of process costing in Chapter 20. Our research has convinced us that we can appropriately do away with cumbersome cost summary reports and complex computations of equivalent full-units of production. **What a difference!** Other innovations include our coverage of transfer pricing in Chapter 24 and our budgeting coverage in Chapter 25 of a rapidly growing company that has become profit rich, yet cash poor.

Finally, we have made several revisions to the appendixes which appear at the end of the text. Appendix E, on the "time-value" of money, now includes the determination of **future** amounts, as well as present values. The new Appendix F, "Another Look at Financial Statement Analysis," is intended primarily as a review. The topics addressed in this appendix have been discussed at various points throughout the text.

## SUPPLEMENTARY MATERIALS

The text is accompanied by a large number of supplementary learning and teaching aids. These supplements are described below, with emphasis upon the features new to this tenth edition.



### For the Student

1. **Self-Study Guide.** The *Study Guide* enables students to measure their progress by immediate feedback. It includes a summary of the highlights of each chapter, and an abundance of objective questions (true-false, completion, and multiple-choice) and short exercises. The solutions are included at the end of each chapter with full explanations and worked-out solutions.
2. **Accounting Work Sheets.** These books, one for Chapters 1–15 and one for Chapters 14–26, provide the appropriate type of columnar paper for each Problem and Comprehensive Problem in the text. Problem headings and “given” data already are filled in to save students much of the copying and “pencil-pushing” otherwise inherent in some assignments.
3. **Blank Forms.** This book contains a variety of blank accounting work sheets that may be used by students for completing the solutions to the end-of-chapter exercises, problems, and cases.
4. **General Ledger/Problem-Solver Software** (Packaged with the Text) by Dilip Kare. This software contains two separate programs. The problem solving software may be used by students to solve 140 of the end-of-chapter exercises and problems. The general ledger software may be used to solve 25 end-of-chapter exercises and problems. All of the text’s comprehensive problems are included on either the problem-solver or GL program. Available for IBM computers.
5. **Student Interactive Software** by Glenn Owen. This software will assist students in learning accounting topics by representing a selection of accounting problems in an interactive format. Students choose a topic and then solve the problems in an interactive setting by inputting the various formulas. Any graphic illustrations will be updated accordingly. This software consists of a series of text-specific problems followed by generic enhancement problems on a variety of topics. Excel 4.0 is required.
6. **Echo Paint Co.** by Richard Wright. This is an accounting cycle practice set that utilizes actual business forms. This practice set is available in both print and computerized form.
7. **Premium Foods Corporation** by Christie Johnson. This is a financial statement analysis case based upon a simulated annual report. This practice set is available in print form only. A computer disk is available to instructors for use by their students to assist them in solving many of the problems associated with the practice set.
8. **Printer Recharge, Inc.** by Phillip Ricci and Wanda G. Spruill. This is a corporate accounting practice set available in print form only.

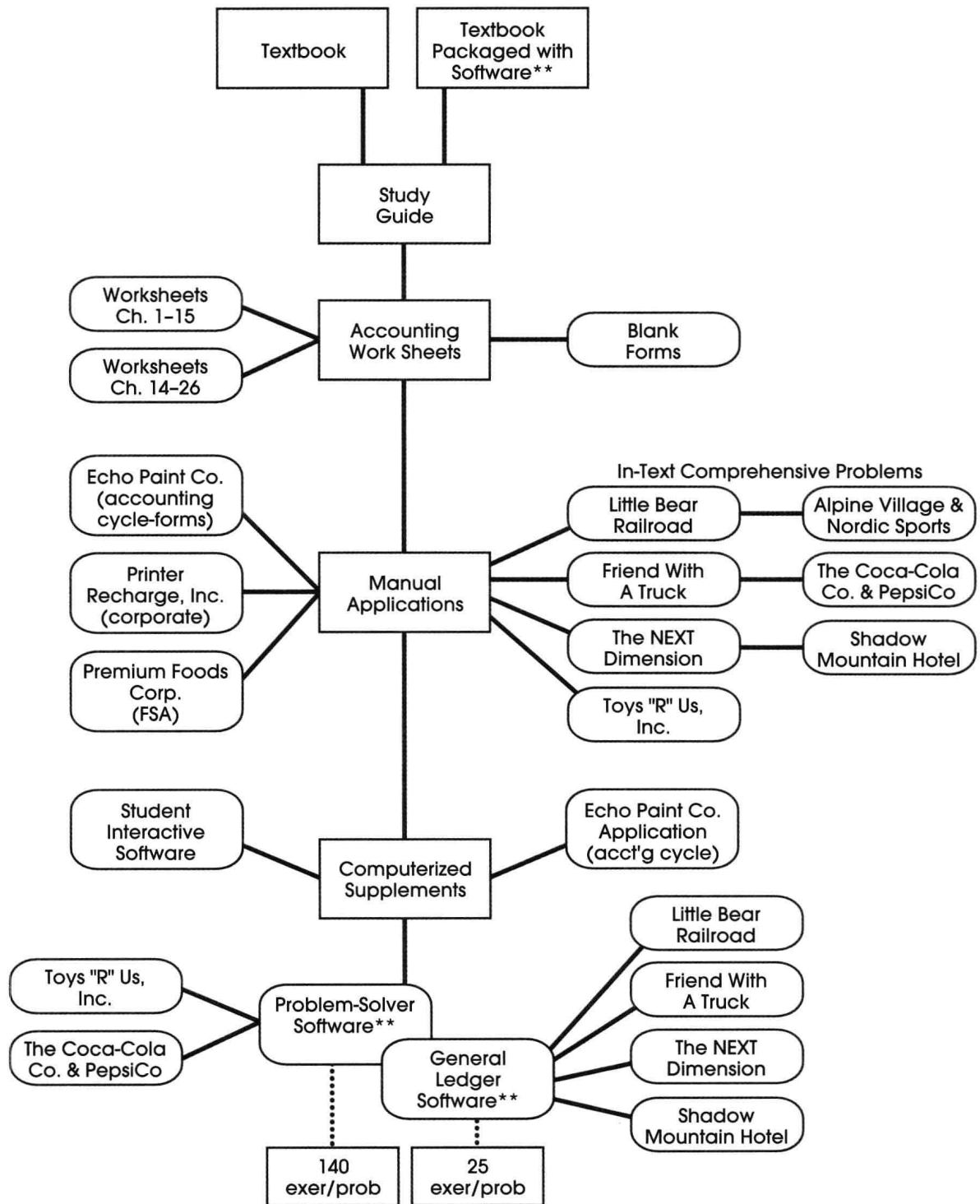
### For the Instructor

1. **Solutions Manual.** A comprehensive manual containing descriptions of each problem and case with the estimated time for completion and difficulty rating; suggested answers to the discussion questions; and solutions to the exercises, problems, cases, and comprehensive problems. All assignment material and the solutions were developed by the authors of the text.
2. **Instructors Guide** by David Marcinko. For each text chapter, the IM contains a brief topical outline, suggested assignment and topic coverage chart, teaching objectives, descriptions of the new features, general comments regarding the chapter’s content and the teaching of the

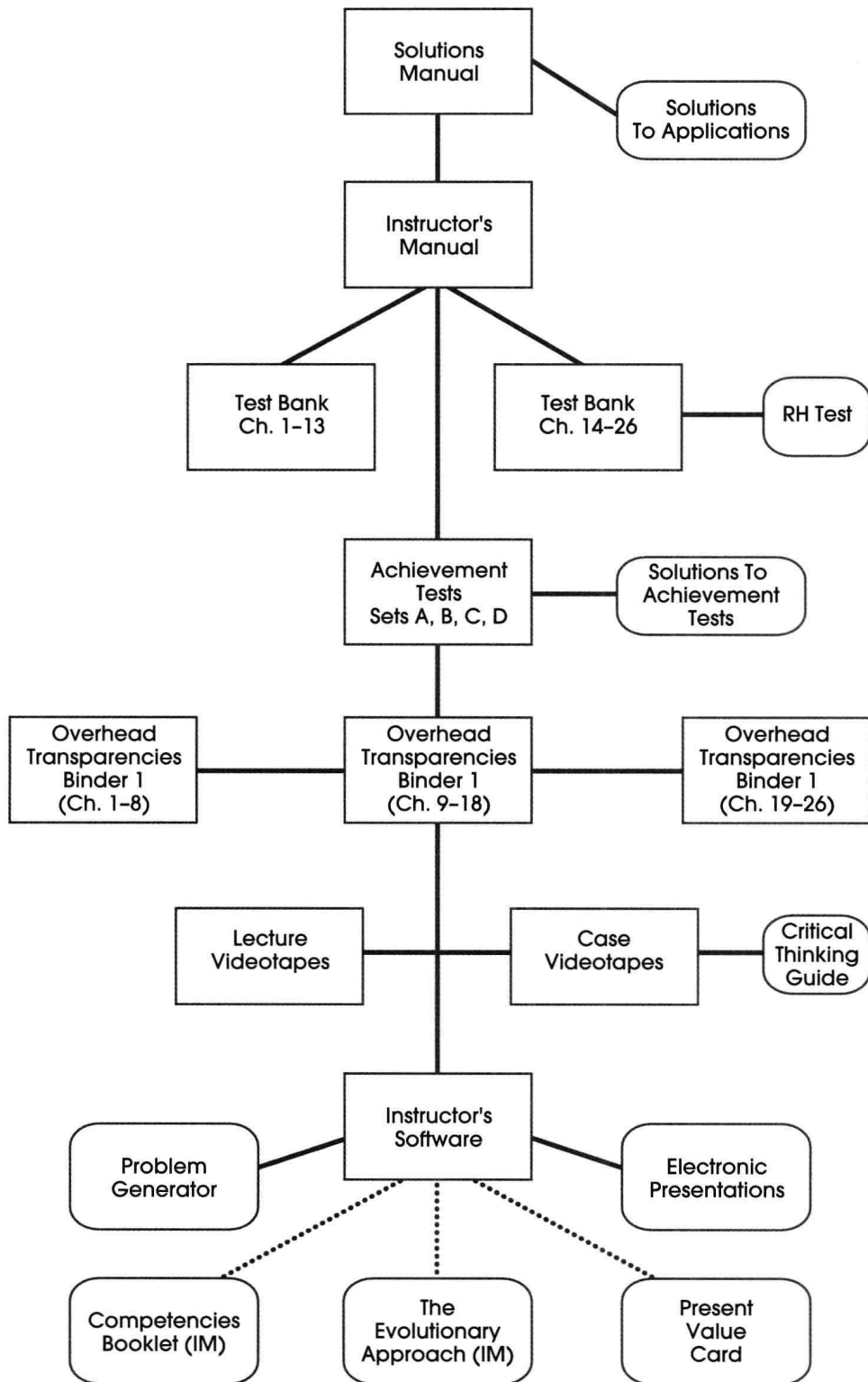
material, and an assignment guide. New material, written by the text authors, describes the evolutionary approach to accounting and the California core competency model for the first course in accounting.

3. **Test Bank, Chapters 1–13 and Chapters 14–26.** Bound in two volumes, the test bank has for each text chapter and appendix a large variety of true-false questions, multiple-choice questions, exercises, four 10-minute quizzes, the self-test questions from the text, and several short essay questions. Questions are arranged in the same sequence as the learning objectives; multiple-choice questions are divided into conceptual and quantitative groups. All answers are provided in the book including worked-out solutions to the exercises.
4. **Computerized Test Bank, RHTest.** All of the test questions included in the print test bank are available in this computerized format. Professors may use this software to create, edit, and print a variety of tests.
5. **Achievement Tests, Sets A, B, C, and D.** Four sets of pre-printed tests are available. Sets A and B consist of twelve 50-minute tests covering every two chapters. Sets C and D consist of six 50-minute tests covering every four chapters. Two comprehensive exams, one for each half of the text, are included in each set. Each package contains twenty copies of each test.
6. **Solutions to Achievement Tests Series A, B, C and D.** This book contains a copy of each achievement test with all of the solutions.
7. **Overhead Transparencies.** Packaged in three separate binders, the OHTs consist of the solutions to all of the end-of-chapter exercises, problems, cases, and comprehensive problems, and approximately 100 full-color text exhibits. Tab dividers, consecutively numbered acetates, and a complete contents page make locating a particular acetate easy.
8. **Solutions to Applications.** This book contains the solutions to our print and computerized applications, many of them generic applications.
9. **Lecture Videotapes.** This package consists of seven videotapes that contain segments, approximately 30 minutes in length, for each chapter of the text. Each segment has been carefully scripted to cover the learning objectives in the chapter and include selected exercises, problems, and cases to emphasize the important areas of study. The tapes are narrated by two moderators and feature electronic graphics and live action business footage from the real world. A Guide to Student Resource Videos booklet is packaged with the tapes.
10. **Case Videotapes.** This videotape includes eight case studies focusing on critical thinking in key areas such as business ethics, alternative accounting principles, and investment decisions. The tape is packaged with a critical thinking guide that provides an overview of the cases, discussion questions, and class handouts.
11. **PowerPoint Presentations** by Douglas Cloud. This software may be used by instructors to help them teach a variety of accounting concepts and problems in a graphic and animated style. Once a topic is chosen and the presentations begin, the instructor can manipulate the presentations for a variety of teaching options. Thirty topics are included, each with a full presentation. No additional software required.
12. **Problem Generator.** This software developed by Glenn Owen will help instructors generate accounting problems. Instructors can generate an unlimited number of unique problems and solutions on a variety of accounting topics. Excel 5.0 required.

## TEXTBOOK AND STUDENT SUPPLEMENTS



## INSTRUCTOR'S SUPPLEMENTS





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