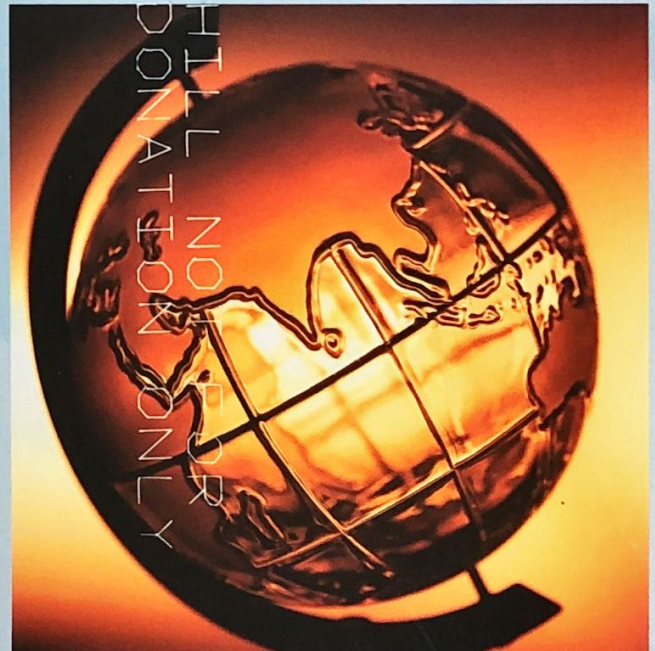
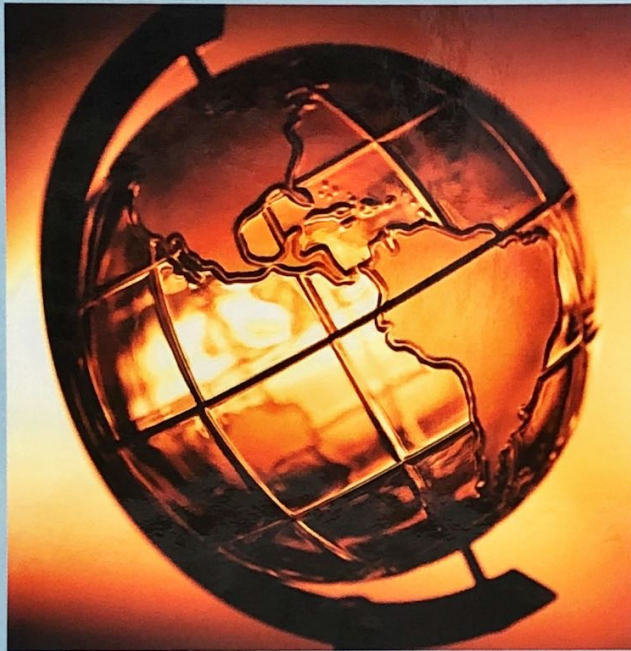


Thirteenth Edition

# ACCOUNTING

## Text and Cases



Robert N. Anthony | David F. Hawkins | Kenneth A. Merchant



# Accounting:

Text and Cases

Thirteenth Edition

**Robert N. Anthony**

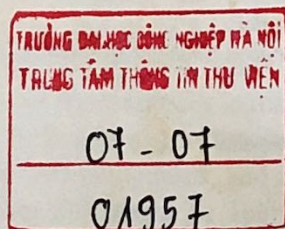
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# About the Authors

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## **Robert N. Anthony** *Harvard University*

Robert N. Anthony was the Ross Graham Walker Professor of Management Control Emeritus at Harvard Business School. Dr. Anthony joined the Harvard Business School staff in 1940 and, except for leaves of absence, was on its faculty until his retirement. From 1965 to 1968 he was Assistant Secretary of Defense, Controller, under the direction of Secretary Robert S. McNamara, responsible for preparing and defending the Department of Defense budgets. In World War II he was an officer in the Navy Supply Corps, with the final rank of Lt. Commander USNR.

He was the author or co-author of 27 books, with more than two million copies in print. They have been translated into 13 languages. Aside from *Accounting: Text and Cases*, which was the first text and case book that discussed management accounting separately from financial accounting, his *Management Control Systems*, now in its twelfth edition (with Govindarajan), and his *Management Control in Nonprofit Organizations*, now

in its seventh edition (with David Young), were the first text and case books on their respective subjects. His *Essentials of Accounting*, now in its tenth edition (with Leslie Breitner) is the most widely used programmed text on accounting. Dr. Anthony also authored a trade book called *Rethinking the Rules of Financial Accounting* and gave lectures or short courses in many American, as well as international, universities.

Dr. Anthony was a director of Warnaco, Inc., and Carborundum Company, both Fortune 500 companies, and a consultant to a number of other companies, including American Telephone & Telegraph Company; General Mills, Inc.; General Motors Corporation; and Union Pacific Railroad. He also served on committees of, or as a consultant to, many federal, state, and municipal government agencies.

For more than 25 years he was a trustee of Colby College; he was chairman of its budget and finance committee and its audit committee, and chairman of the Board of Trustees in 1978–83.

Dr. Anthony was awarded honorary M.A. and L.H.D. degrees and the Marriner Distinguished Service Award from Colby College. In 1986 he was elected the 46th member of the Accounting Hall of Fame. Among his other awards were the Distinguished Accounting Educator award from the American Accounting Association, Accounting Educator of the Year Award from Beta Alpha Psi (the national accounting fraternity), Meritorious Service Award from the Executive Office of the President, Fellow of the Academy of Management, Distinguished Public Service Medal of the U.S. Department of Defense, Distinguished Leadership Award of the Federal Government Accountants Association, CINCPAC Letter of Commendation, and several awards for books and articles.

Professor Anthony also received the Institute of Management Accountants' prestigious R. Lee Brummet award. This award is given to recognize outstanding educators in the field of Management Accounting who have had a significant impact on academia and the business world.





## David Hawkins *Harvard University*

David Hawkins has been a member of the Harvard Business School faculty since 1962. Currently, he is the Lovett-Learned Professor of Business Administration. Professor Hawkins has taught the second-year MBA courses Analysis of Corporate Financial Reports, Corporate Financial Reporting: A Global Perspective, and Managing Foreign Operations, as well as the first-year MBA course Financial Reporting and Control. He is the author of over 200 Harvard Business School cases. Professor Hawkins has acted as a consultant to numerous corporations including General Electric, Coca-Cola, Merrill Lynch, DuPont, American Express, and Honeywell. He also has been a member of the Financial Accounting Standards Advisory Committee and several Financial Accounting Standards Board Task Forces. Professor Hawkins received his bachelor's, master's, and doctorate degrees from Harvard University.

Professor Hawkins' research interests include the formulation of corporate financial reporting strategies, the role of earnings quality in equity security valuations, the harmonization of global financial reporting standards, and the management of corporations during periods of high inflation. For his research work, Professor Hawkins has received the *Business History Review's* Newcomen Society Award, the *California Management Review's* McKinsey Award, and the *Financial Analyst Journal's* Graham and Dodd Scroll. He has been selected as a member of the *Institutional Investor's* All American Research Team.

Professor Hawkins has published individually and with co-authors 16 books and monographs including *Computer Models for Business Case Analysis* (with Brandt Allen); *Corporate Financial Reporting: Text and Cases*; *Equity Valuation Models, Analysis and Valuation* (with Walter J. Campbell); *Accounting for Leases by Lessees* (with Mary Wehle); *Rating Industrial Bonds* (with Barbara A. Brown and Walter J. Campbell); *Corporate Financial Disclosure: 1900-1933*; *The Effectiveness of the Annual Report as a Communications Vehicle* (with Barbara A. Hawkins); and *Corporate Financial Reporting and Analysis*. In addition, he has published numerous articles and other materials directed at corporate managers, accounting standard setters, and institutional investors, and contributed to over 25 books published by others.





## **Kenneth A. Merchant** *University of Southern California*

Kenneth A. Merchant is the current holder of the Deloitte & Touche LLP Chair of Accountancy at the University of Southern California. He teaches in USC's executive, masters, and undergraduate programs. Previously he served as Senior Associate Dean—Corporate Programs in USC's Marshall School of Business (2003–2004) and as Dean of USC's Leventhal School of Accounting (1994–2001). Professor Merchant is also a research professor (part-time) at the University of Maastricht (the Netherlands). Before joining USC in 1990, he taught at Harvard University (1978–1990) and the University of California (Berkeley) (1976–77).

Earlier in his career, Professor Merchant was a department controller at Texas Instruments, Inc., and a senior consultant with Ernst & Ernst (now Ernst & Young). He also has worked as a freelance consultant/teacher for many organizations, including Amgen, Arco, AT&T, British Airways, Campbell Soup, Digital Equipment, IBM, McGraw-Hill, Novellus Systems, Occidental Petroleum, Philip Morris International, Tektronix, Toyota U.S.A., and World Bank. He has served on the boards

of directors of four corporations.

Professor Merchant's current research projects are focused on various issues related to the design and effects of performance measurement/evaluation/incentive systems and corporate governance systems. He has published nine books and numerous journal articles and teaching cases. Professor Merchant won the American Accounting Association's (AAA's) awards for Notable Contributions to both the Behavioral Accounting (2003) and Management Accounting Literatures (1991 and 2007), the AAA Outstanding Service Award (2003), the Institute of Management Accountants' Lybrand Gold Medal Award (best paper of the year published in *Management Accounting*) (1989–90) and James Bulloch award for Innovations in Management Accounting Education (2009). He is currently a member of the editorial boards of 11 academic journals.

Professor Merchant has served as president of three AAA sections: Accounting Program Leadership Group; Management Accounting; and Accounting, Behavior and Organizations. He is a current member of the Business and Industry Executive Committee of the American Institute of Certified Public Accountants (AICPA), the Research Board of the Chartered Institute of Management Account (UK) and the Research Committee of the Financial Executive Research Foundation.

Professor Merchant is a graduate of Union College (BA), Columbia University (MBA), and the University of California—Berkeley (PhD) and is a Certified Public Accountant (Texas).



# Preface

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An accounting text can be written with an emphasis on either of two viewpoints: (1) what the user of accounting information needs to know about accounting or (2) what the preparer of accounting reports needs to know about accounting. This book focuses on the user of accounting information. Because such a person needs to know enough about the preparation of accounting reports to use them intelligently, this text includes the technical material needed for this purpose. The book is aimed primarily, however, at the person who wants to be a knowledgeable user of accounting information. This focus is reinforced in the book's case studies, which help the student learn that accounting is not a cut-and-dried subject with all of its "answers" clearly indicated by the application of rules.

The focus of the book makes it particularly appropriate for required core courses in accounting, in which many of the students are not planning to take further elective accounting courses. We believe that if a core course stresses the more analytical uses of accounting information by managers and outside analysts rather than the procedural details that the practicing accountant needs to know, then those students who do not take further accounting courses will be left with a positive view of the importance of accounting rather than with the negative "bean counter" stereotype. We also feel that a user orientation in the core course actually is likely to generate a greater number of accounting majors from the class than if the course is oriented more toward the person who has already decided to major in accounting. Similarly, in our experience the required accounting module in a management development program will generate little participant interest unless the module is oriented toward the nonaccountant user of accounting information. In sum, we think the book conveys the fact that accounting is interesting and fun, not dull and tedious.

Specifically, this book is used in at least the following four ways:

1. As an introductory course where most (if not all) of the students have no prior training in accounting. In many schools this introduction comprises two separate courses, one dealing with financial accounting and the other with management accounting. Many schools use this book for both such courses, whereas some use it only for financial accounting (Chapter 1 and Chapters 2–14) or for management accounting (Chapter 1 and Chapters 15–28). It is used in such introductory courses both at the upper undergraduate level and in graduate programs. In addition to its widespread use in schools of business and management, it also is used in introductory accounting courses in some law schools, education schools, and schools of public health.
2. As an elective course that builds on a required introductory course in accounting—particularly where the introductory course had more of a procedural orientation and the elective is intended to be more conceptual, analytical, and user-oriented.
3. As the accounting module in a management development program where the participants represent a variety of functional and technical backgrounds.
4. As a nontechnical accounting reference book for nonaccountants in business and other organizations.

Many instructors assign or recommend the programmed text *Essentials of Accounting*,<sup>1</sup> either as preliminary to study of the subject (it is often sent in advance to participants in

<sup>1</sup> Robert N. Anthony and Leslie K. Breitner, *Essentials of Accounting*, 10th ed. (Upper Saddle River, NJ: Prentice Hall, 2009). This material is also available in the form of computer software titled *Teach Yourself Essentials of Accounting*.



MBA and management development programs) or as a review device. It is a self-study introductory treatment of financial accounting, geared to Part 1 of this text.

## THE CASES

As in previous editions, the cases have been selected because of their interest and educational value as a basis for class discussion. They are not necessarily intended to illustrate either correct or incorrect handling of management problems. Skill in the management use of accounting information can be acquired, we believe, only through experience. Thinking about a case and discussing it in informal discussion groups and in the classroom require the student to do something—to analyze a problem, to weigh various factors involved in it, to make some calculations, to take a position, and so on. In class the student is required to explain her or his point of view, to defend it, to understand and appraise the arguments of colleagues, and to decide what arguments are the strongest. Practice in doing these things helps to increase skill and understanding; in fact, many educators believe that the really important parts of a subject can be learned only by experience of some sort, as opposed to merely hearing or reading about them. Thus, although the case material constitutes less than half the pages in this book, the discussion of these cases is by far the more important part of the educational process. Of course, such discussions contribute to the students' communication skills as well as to their understanding of accounting.

This edition has a total of 109 cases, 12 of which are new. It is often difficult to judge when to replace an older time-tested case (a "classic" or an "old chestnut") with which instructors are comfortable with a case of more recent vintage. Each type of case has its advantages. In making changes, we endeavored to strike a balance. We retained some of the best, and most frequently used, older cases while replacing others with some new cases. We hope that these newer cases will become the next generation of classics.

Occasionally, a student or instructor questions our use of small business settings for many of the cases. Such cases often avoid certain complexities at a point when the student is not yet prepared to deal with them. We also would note that studies have reported that small businesses (those employing fewer than 500 people) represent over 99 percent of all U.S. businesses, provide about 50 percent of all private-sector jobs, generate almost 40 percent of the GNP, and contribute two out of three newly created jobs. We therefore feel that exposure to small business cases is beneficial to students, some of whom will one day own a small business while many others will eventually work in such firms or work with them as auditors or consultants. A number of the cases included in the book are copyrighted by the President and Fellows of Harvard College. They are included by express permission. These cases, along with all of the other cases in the book, have been developed solely for class discussion and do not necessarily illustrate effective or ineffective management.

## CHANGES IN THE THIRTEENTH EDITION

Part 1 reflects Financial Accounting Standards Board pronouncements through early 2010 and the important changes in financial accounting that are expected to occur during the following years. A number of new cases have been added, covering the politics and economics of standard setting, acquisition accounting, contingent liabilities, financial reporting fraud, fair value accounting, lease, revenue recognition, and several other contemporary accounting controversies and developments. A significant new addition is the inclusion of more International Financial Reporting Standards materials.



The basic structure of Part 2 remains intact. A discussion of time-driven activity-based costing was added, along with supporting examples and case materials. Other changes provide updated statistics, improved clarity of discussion, and new problems and cases.

## ACKNOWLEDGMENTS

We are grateful to the many instructors and students who have made suggestions for improving this book. Included among those people are our colleagues at the Harvard Business School and the Marshall School of Business, University of Southern California, as well as the following: Russ Olive, Massachusetts Institute of Technology; Pamela Stuerke, Case Western Reserve University; Marvin Carlson, Southern Methodist University; Alan Lord, Bowling Green State University; and Marc Manalastas, Mary Victoria D. Arce, and Jon Stuart Lim-Vaña, Ateneo de Manila University, the Philippines. We extend our thanks to the reviewers who commented on the twelfth edition, as well as previous editions: Timothy Moffit, Kalamazoo College; Michael Erler and Richard Rogers, Indiana University; Laurie Pant, Suffolk University; Claude Lanfranconi, Richard Ivey School of Business; Thomas Kam and Warren Wee, Hawaii Pacific University; Len Weld, Troy State University; Mehmet Kocaculah, University of Southern Indiana; Byron K. Henry, Howard University; Jeffery Kahn, Woodbury University; Pamela Rouse, Butler University; Linda Brown, Saint Ambrose University; Ann L. Watkins, High Point University; Saad Laraqui, Embry-Riddle Aeronautical University; Noel Addy, Mississippi State University; Philip Darcy, Regis University; Frances Lynn Telavera, National University; Patricia Cummins, Troy State University; Reba Cunningham, University of Dallas; Krishagopal Menon, Boston University; Leonardo Rodriguez, Florida International University; Robert Medden, St. Francis Xavier University; William S. Hopwood, Florida Atlantic University; Andrew Felo, Pennsylvania State University; David Hurtt and Jack Ruhl, Western Michigan University; Stan Davis, Wake Forest University; Tom Hrubec, Franklin University; Warren Wee, Hawaii Pacific University.

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*Robert N. Anthony*

*David F. Hawkins*

*Kenneth A. Merchant*



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