Preface xix
  Objectives and Features of the 9th Edition xix
Acknowledgments xxi
About the Authors xxiii

1. An Introduction to Accounting Theory 1
  Accounting Theory and Policy Making 4
  The Role of Measurement in Accounting 6
    Direct and Indirect Measurements 6
    Assessment and Prediction Measures 7
    The Measurement Process 7
    Types of Measurements 8
    Quality of Measurements 9
  Plan of This Book 11
  Summary 12
Appendix 1-A: Valuation Systems 12
The Simple Company 13
Valuation Approaches to Accounting for the Simple Company 14
  Historical Cost 14
  General Price-Level Adjustment 14
  Current Value Systems 16
  Discounted Cash Flows 20
Questions 22
Cases, Problems, and Writing Assignments 23
Critical Thinking and Analysis 25

2. Accounting Theory and Accounting Research 27
  Accounting Research and Scientific Method 28
    Research Approaches 28
    Normative and Descriptive Theories 31
    Global and Particularistic Theories 33
    Complementary Nature of Deductive and Inductive Methods 33
  Is Accounting an Art or a Science? 34
    Econometrics 35
    Climatology 35
    Human Anthropology 36
    Summary of Accounting as a Science 36

Accounting in the United States Prior to 1930 50
Formative Years, 1930–1946 51
  NYSE/AICPA Agreement 51
  Formation of the SEC 52
  Committee on Accounting Procedure, 1936–1946 53
Postwar Period, 1946–1959 54
  ARB 32 and the SEC 55
  The Price-Level Problem 55
  Closing Years of the CAP 56
  A New Approach 57
Modern Period, 1959 to the Present 57
  Early Years of the APB 58
  The FASB: An Overview 62
  Sarbanes-Oxley Act (SOX) 71
  Comparability Across International Borders 72
  The Liability Crisis in Public Accounting 72
  Current Role of the AICPA 73
  Current Role of the SEC 74
  Other Groups 75

Summary 76
Questions 77
Cases, Problems, and Writing Assignments 78
Critical Thinking and Analysis 80

4. The Economics of Financial Reporting Regulation 81

The Case for Unregulated Markets for Accounting Information 82
  Agency Theory 82
  Competitive Capital Markets and Signaling Incentives 83
  Arguments in Favor of Private Contracting Opportunities 85
6. The Search for Objectives 135

ASOBAT 136
- Development of the User Approach 136
- Orientation to Theory 137
- Objectives of Accounting 138
- Standards for Accounting Information 140
- Guidelines for Communicating Accounting Information 141
- Concluding Remarks on ASOBAT 142

APB Statement 4 142
- Orientation to Definitions 143
- Other Aspects of APB Statement 4 144
- Concluding Remarks on APB Statement 4 144

The Trueblood Committee Report 145
- Objectives of Financial Statements 146
- Concluding Remarks on the Trueblood Committee Report 150

SATTA 151
- Theory Approaches in Accounting 151
- Concluding Remarks on SATTA 154

User Objectives and User Diversity 155
- User Objectives 155
- User Diversity 157

Summary 160
Questions 160
Cases, Problems, and Writing Assignments 162
Critical Thinking and Analysis 162

7. The FASB’s Conceptual Framework 163

The FASB’s Conceptual Framework 165
- Discussion Memorandum 165
- Statements of Financial Accounting Concepts 165
- Statement No. 1 (subsequently replaced by SFAC No. 8) 166
- Statement No. 2 (subsequently replaced by SFAC No. 8) 167
- Statement No. 3 (subsequently replaced by SFAC No. 6) 176
- Statement No. 4 176
- Statement No. 5 177
- Statement No. 6 182
- Statement No. 7 184
- Statement No. 8 185

The Conceptual Framework as a Codificational Document 187
- The Jurisprudential View 188

Empirical Research on the Conceptual Framework 190
Assessing the Conceptual Framework 191
Summary 191
8. Usefulness of Accounting

Information to Investors and Creditors 195

Earnings, Dividends, and Stock Prices 197
   Earnings and Dividends 197
   Predicting Dividends From Current Earnings 198
   Connecting the Dots: From Earnings to Stock Prices 198

Residual Income Models 199
   Economic Profit 199
   Residual Income and the Dividend Discount Model 202
   Residual Income and Performance Measurement: The Good and Bad 204

Background on Risk and Return 207
   Efficient-Markets Hypothesis (EMH) 207
   Portfolio Diversification 209
   Capital Asset Pricing Model (CAPM) 209

Introduction to Capital Markets Research in Accounting 212
   The Market Model 213
   Event Studies 214
   Overview of Capital Markets Research in Accounting 215

The Value of Accounting Information: Evidence From Return Data 218
   Information Contents of Earnings Announcements 218
   Market Reaction to Alternative Accounting Policies 218
   Alternatives With No Known Cash Flow Consequences 218
   An Alternative With Cash Flow Consequences: The LIFO Choice 219
   Alternatives With Indirect Cash Consequences 220
   Anomalies 221
   The Incomplete Revelation Hypothesis 224
   Accounting Information and Risk Assessment 225
   Summary of Capital Market Research 225
   Evidence From Survey Data 226

The Value of Accounting Information: Evidence From Direct Valuation 226
   Evidence From Pensions 226
   Evidence From Research and Development 227
   Evidence From Financial Services 227

Accounting Data and Creditors 228
   Evidence From Bankruptcies 228
   Evidence From Credit Ratings 228

Importance of Earnings Forecasting 229

Empirical Research and Standard Setting 230

Summary 231

Questions 232

What Underlies the Choice Among Accounting Methods? 239
Uniformity 240
  *The Nature and Complexity of Events* 241
  *Finite and Rigid Uniformity* 243
  *The Present Status of Uniformity* 245
The Usefulness of Accounting Allocations 249
Disclosure 250
  *The Disclosure Function of the SEC* 250
  *The Shift Toward Informative Disclosure* 251
  *Imperfections of the Disclosure Process* 251
  *Forms and Methods of Disclosure* 254
Improving Accounting Standards 258
Summary 259
Questions 259
Cases, Problems, and Writing Assignments 261
Critical Thinking and Analysis 263

10. International Accounting 265

National Accounting Differences 266
  *The Anglo-American Model* 267
  *The Continental Model* 271
  *Overview of National Profiles* 273
  *Problems Stemming From National Accounting Differences* 274
International Harmonization of Accounting Standards 275
  *The EU* 276
  *The International Accounting Standards Board* 278
  *International Federation of Accountants (IFAC)* 285
  *United Nations (UN)* 285
  *Organisation for Economic Co-operation and Development (OECD)* 285
Summary 286
Questions 286
Cases, Problems, and Writing Assignments 287
Critical Thinking and Analysis 288

11. The Balance Sheet 289

The Relationship Between the Balance Sheet and the
  *Income Statement* 290
  *Articulation* 290
  *The Nonarticulated Approach* 293
12. The Income Statement 337

Income Definitions 338
Revenues and Gains 339
  Revenue Recognition 340
Expenses and Losses 342
Future Events and Accounting Recognition 345
  Some Aspects of Future Events 345
  Summary of Future Events 347
Current Operating Versus All-Inclusive Income 347
  Comprehensive Income 349
Nonoperating Sections 350
  Extraordinary Items 350
  Accounting Changes 352
  Prior Period Adjustments 353
Earnings per Share 354
  SFAS No. 128 355
Specialized Subjects Concerning Income Measurement 355
  Development Stage Enterprises 356
  Troubled Debt Restructuring 356
  Early Extinguishment of Debt 357
  Stock Options 358
Earnings Management 362
Management Compensation 364
Income Smoothing 364
Income Statement Developments 366
Cash Earnings 366
Pro Forma Earnings and Offshoots 366
Matrix Approaches 367
Retrospective Reports 368
Quality of Earnings 368
Financial Statement Restatements 369
Summary 369
Questions 370
Cases, Problems, and Writing Assignments 371
Critical Thinking and Analysis 373

The Statement of Changes in Financial Position 376
The Motivation for a Cash Flow Statement 378
Objectives of Financial Reporting 379
Objectives of the Statement of Cash Flows 379
Requirements of the Cash Flow Statement 381
Structure of the SCF 381
The Nonarticulation Problem 384
Classification Problems of SFAS No. 95 385
International Accounting Standards (IAS) 386
Premium and Discount on Bonds and Notes 386
Increased Flexibility of Presentation 388
Analytical Usefulness of the Cash Flow Statement 388
Issues Relating to Rules for Classifying Cash Flows 389
The SCF Is More Than Cash Flow From Operating Activities 390
Cash Flow Needs of Different Users 391
Cash and Funds Flow Research 396
Improving the SCF 397
Summary 398
Questions 399
Cases, Problems, and Writing Assignments 400
Critical Thinking and Analysis 408

Income Tax Allocation 412
The Rationale of Income Tax Allocation 413
Tax Allocation and Accelerated Depreciation 414
15. Pensions and Other Postretirement Benefits 437

Overview of Pension Plans 438
- Defined Contribution and Defined Benefit Plans 438
- Vesting 439
- Single- and Multiemployer Plans 440
- Actuarial Funding of Defined Benefit Plans 440
- Funding Complexities 441
- Actuarial Funding Methods 441
- Employee Retirement Income Security Act of 1974 (ERISA) 442
- Cash Balance Plans 444
- Legal Relationships in Defined Benefit Plans 444
- Accounting Issues Relating to Defined Benefit Pension Plans 445

Development of Pension Accounting Standards 446
- ARB 36 (Codified as Chapter 13, Section A of ARB 43) 446
- ARB 47 447
- APB Opinion No. 8 447
- FASB Interpretation 3 448
- SFAS No. 35 448
- SFAS No. 36 449
- SFAS No. 87 and SFAS No. 88: Shifting to a Liability Orientation 449
- SFAS No. 132 453
- SFAS No. 158 453
- Empirical Research on Pensions 454

Postretirement Benefits Other Than Pensions 457
- Explicit Health Care Trending 457
- The Mechanics of OPEB 458
Major Features of SFAS No. 106  459
SFAS No. 112  462
Theoretical Aspects of OPEB Accounting  462
Economic Consequences of OPEB Recognition  462
Empirical Research on OPEBs  463
International Accounting Standards (IAS)  464
Improving Accounting Standards  464
Summary  465
Appendix 16-A: Illustration of Pension Expense Determination and Actuarial Funding Methods  465
Accounting for Defined Benefit Plans  467
Funding for Defined Benefit Plans  470
Questions  473
Cases, Problems, and Writing Assignments  474
Critical Thinking and Analysis  475

16. Leases  477

The Lease Contract  479
The Executory Nature of Lease Contracts  479
Leases Compared With Purchase Arrangements  481
Lease Capitalization  482
Capitalization for Lessees  482
Legal Approach  483
Material Equity  484
Transfer of the Benefits and Risks of Ownership  484
Capitalization for Lessors  484
The Evolution of Lease Accounting Standards  485
Lessees Accounting  485
Lessor Accounting  492
Sale and Leaseback  497
Leveraged Leases  498
Assessing SFAS No. 13  500
Economic Consequences of Lease Capitalization  501
The G4+1 Report on Leases  504
FASB and IASB Joint Exposure Drafts on Accounting for Leases  505
Exposure Draft 2010/9  506
Exposure Draft 2013  507
Post-Exposure Draft Deliberations  509
Improving Accounting Standards  509
Summary  509
Questions  510
Cases, Problems, and Writing Assignments  511
Critical Thinking and Analysis  515
17. Intercorporate Equity Investments  517

Relevant Circumstances  519
Consolidation  520
  Pooling of Interests  521
  The Purchase Method  523
  The New Entity Approach  525
  Proportionate Consolidation  525
  Research on Pooling and Purchase Accounting  527
The Equity Method  528
The Fair Value Method  529
Defining the Reporting Entity  530
Translation of Foreign Operations  533
  SFAS No. 8  534
  SFAS No. 52  535
IASB Standards  539
Improving Accounting Standards  539
Summary  539
Appendix 17-A: Special Purpose Entities, Variable Interest Entities, and the Downfall of Enron  540
  Special Purpose Entities (SPEs)  540
  Variable Interest Entities (VIEs)  541
  A Final Accounting of Enron’s Accounting  542
Questions  543
Cases, Problems, and Writing Assignments  544
Critical Thinking and Analysis  545

Notes  547
References  579
Name Index  625
Subject Index  629