Financial Accounting 12th edition Libby Solutions Manual

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Chapter 1
Financial Statements and Business Decisions

ANSWERS TO QUESTIONS

1. Accounting is a system that collects and processes (analyzes, measures, and records) financial information about an organization and reports that information to decision makers.

2. Financial accounting involves preparation of the four basic financial statements and related disclosures for external decision makers. Managerial accounting involves the preparation of detailed plans, budgets, forecasts, and performance reports for internal decision makers.

3. Financial reports are used by both internal and external groups and individuals. The internal groups are comprised of the various managers of the entity. The external groups include the owners, investors, creditors, governmental agencies, other interested parties, and the public at large.

4. Investors purchase all or part of a business and hope to gain by receiving part of what the company earns and/or selling their ownership interest in the company in the future at a higher price than they paid. Creditors lend money to a company for a specific length of time and hope to gain by charging interest on the loan.

5. In a society, each organization can be defined as a separate accounting entity. An accounting entity is the organization for which financial data are to be collected. Typical accounting entities are a business, a church, a governmental unit, a university, and other nonprofit organizations such as a hospital and a welfare organization. A business typically is defined and treated as a separate entity because the owners, creditors, investors, and other interested parties need to evaluate its performance and its potential separately from other entities and from its owners.

6.

Name of Statement	*Alternative Title*
(a) Income statement	(a) Statement of earnings; Statement of income; Statement of operations
(b) Balance sheet	(b) Statement of financial position
(c) Cash flow statement	(c) Statement of cash flows

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7. The heading of each of the four required financial statements should include the following:
   (a) Name of the entity
   (b) Name of the statement
   (c) Date of the statement, or the period of time
   (d) Unit of measure

8. (a) The purpose of the income statement is to present information about the revenues, expenses, and net income of an entity for a specified period of time.
   (b) The purpose of the balance sheet is to report the financial position of an entity at a given date, that is, to report information about the assets, liabilities and stockholders' equity of the entity as of a specific date.
   (c) The purpose of the statement of cash flows is to present information about the flow of cash into the entity (sources), the flow of cash out of the entity (uses), and the net increase or decrease in cash during the period.
   (d) The statement of stockholders' equity reports the changes in each of the company's stockholders' equity accounts during the accounting period, including the issue and repurchase of stock and the way that net income and distribution of dividends affected the retained earnings of the company during that period.

9. The income statement and the statement of cash flows are dated "For the Year Ended December 31" because they report the inflows and outflows of resources during a period of time. In contrast, the balance sheet is dated "At December 31" because it represents the resources, obligations, and stockholders' equity at a specific date.

10. Assets are important to creditors and investors because assets provide a basis for judging whether sufficient resources are available to operate the company. Assets are also important because they could be sold for cash in the event the company goes out of business. Liabilities are important to creditors and investors because the company must be able to generate sufficient cash from operations or further borrowing to meet the payments required by debt agreements. If a business does not pay its creditors, the law may give the creditors the right to force the sale of assets sufficient to meet their claims.

11. Net income is the excess of total revenues over total expenses. Net loss is the excess of total expenses over total revenues.

12. The equation for the income statement is Revenues - Expenses = Net Income (or Net Loss if the amount is negative). Thus, the three major items reported on the income statement are (1) revenues, (2) expenses, and (3) net income.

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13. The equation for the balance sheet (also known as the basic accounting equation) is: Assets = Liabilities + Stockholders' Equity. Assets are the probable (expected) future economic benefits owned by the entity as a result of past transactions. They are the resources owned by the business at a given point in time such as cash, receivables, inventory, machinery, buildings, land, and patents. Liabilities are probable (expected) debts or obligations of the entity as a result of past transactions that will be paid with assets or services in the future. They are the obligations of the entity such as accounts payable, notes payable, and bonds payable. Stockholders' equity is financing provided by owners of the business and operations. It is the claim of the owners to the assets of the business after the creditors' claims have been satisfied. It may be thought of as the residual interest because it represents assets minus liabilities.

14. The equation for the statement of cash flows is: Cash flows from operating activities + Cash flows from investing activities + Cash flows from financing activities = Change in cash for the period. The net cash flows for the period represent the increase or decrease in cash that occurred during the period. Cash flows from operating activities are cash flows directly related to earning income (normal business activity including interest paid and income taxes paid). Cash flows from investing activities include cash flows that are related to the acquisition or sale of productive assets used by the company and investments. Cash flows from financing activities are directly related to the financing of the enterprise itself.

15. The retained earnings equation is: Beginning Retained Earnings + Net Income - Dividends = Ending Retained Earnings. It starts with beginning-of-the-year Retained Earnings which is the prior year's ending retained earnings reported on the balance sheet. The current year's Net Income reported on the income statement is added and the current year's Dividends are subtracted from this amount. The ending Retained Earnings amount is reported on the end-of-period balance sheet.

16. Marketing managers and credit managers use customers' financial statements to decide whether to extend them credit for their purchases. Purchasing managers use potential suppliers' financial statements to judge whether the suppliers have the resources necessary to meet current and future demand. Human resource managers use financial statements as a basis for contract negotiations, to determine what pay rates the company can afford. The net income figure even serves as a basis to pay bonuses not only to management, but to other employees through profit sharing plans.

17. The Securities and Exchange Commission (SEC) is the U.S. government agency which determines the financial statements that public companies must provide to stockholders and the measurement rules used in producing those statements. The Financial Accounting Standards Board (FASB) is the private sector body given the primary responsibility to work out the detailed rules which become generally accepted accounting principles (GAAP).

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18. Management is responsible for preparing the financial statements and other information contained in the annual report and for the maintenance of a system of internal accounting policies, procedures, and controls. These measures are intended to provide reasonable assurance, at appropriate cost, that transactions are processed in accordance with company authorization as well as properly recorded and reported in the financial statements, and that assets are adequately safeguarded. Independent auditors examine the financial reports (prepared by management) and the underlying records to assure that the reports represent what they claim and conform with generally accepted accounting principles (GAAP).

19. A sole proprietorship is an unincorporated business owned by one individual. A partnership is an unincorporated association of two or more individuals to carry on a business. A corporation is a business that is organized under the laws of a particular state whereby a charter is granted and the entity is authorized to issue shares of stock as evidence of ownership by the owners (i.e., stockholders).

20. A CPA firm normally renders three services: auditing, management advisory services, and tax services. Auditing involves examination of the records and financial reports to determine whether they “fairly present” the financial position and results of operations of the entity. Management advisory services involve management advice to individual business enterprises and other entities, much like those provided by a consulting firm. Tax services involve providing tax planning advice to clients (both individuals and businesses) and preparation of their tax returns.

ANSWERS TO MULTIPLE CHOICE

1. b)	2. d)	3. d)	4. c)	5. a)
6. d)	7. a)	8. a)	9. c)	10. b)

Authors' Recommended Solution Time

(Time in minutes)

Mini-exercises		*Exercises*		*Problems*		*Alternate Problems*		*Cases and Projects*	
No.	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*
1	5	1	12	1	45	1	45	1	20
2	5	2	12	2	45	2	45	2	30
3	5	3	12	3	45	3	45	3	30
4	5	4	20					4	45
5	5	5	25					5	60
6	5	6	20					6	30
		7	15					7	20
		8	25			Continuing Problem		8	*
		9	25						
		10	25			1	45		
		11	30						

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		12 13 14 15	30 15 35 12						

* Due to the nature of these cases and projects, it is very difficult to estimate the amount of time students will need to complete the assignment. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear. For example, when our goal is to sharpen research skills, we devote class time to discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

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MINI-EXERCISES

M1–1.

	Financial Statement	Information Reported
B	(1) Income statement	A. Economic resources and sources of financing for those resources
D	(2) Statement of stockholders' equity	B. Resources earned less resources used to produce and sell goods/services
A	(3) Balance sheet	C. Receipts and payments of cash
C	(4) Statement of cash flows	D. Amounts invested by and past earnings not distributed to stockholders

M1–2.

	Element	Financial Statement
B	(1) Expenses	A. Balance sheet
D	(2) Cash flow from investing activities	B. Income statement
A	(3) Assets	C. Statement of stockholders' equity
C*	(4) Dividends	D. Statement of cash flows
B	(5) Revenues	
D	(6) Cash flow from operating activities	
A	(7) Liabilities	
D	(8) Cash flow from financing activities	

*Dividends paid in cash are also subtracted in the Financing section of the Statement of Cash Flows

M1–3.

SE	(1) Retained earnings
A	(2) Accounts receivable
R	(3) Sales revenue
A	(4) Property, plant, and equipment
E	(5) Cost of goods sold expense
A	(6) Inventories
E	(7) Interest expense
L	(8) Accounts payable
A	(9) Land

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M1-4.

Assets = Liabilities + Stockholders' Equity
$90,000 = $50,000 + $40,000

Revenues – Expenses = Net Income
$10,000 – $4,000 = $6,000

M1-5.

Beginning Retained Earnings	$100,000
+ Net Income	13,000
- Dividends	(7,000)
Ending Retained Earnings	$106,000

M1–6.

	Abbreviation	Full Designation
(1)	CPA	Certified Public Accountant
(2)	GAAP	Generally Accepted Accounting Principles
(3)	SEC	Securities and Exchange Commission
(4)	FASB	Financial Accounting Standards Board

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EXERCISES

E1–1.

	Term or Abbreviation	Definition
J	(1) SEC	A. A system that collects and processes financial information about an organization and reports that information to decision makers.
F	(2) Audit	B. Information that helps evaluate the company's past behavior and predict its future.
H	(3) Sole proprietorship	C. An unincorporated business owned by two or more persons.
E	(4) Corporation	D. The organization for which financial data are to be collected (separate and distinct from its owners).
A	(5) Accounting	E. An incorporated entity that issues shares of stock as evidence of ownership.
D	(6) Accounting entity	F. An examination of the financial reports to ensure that they represent what they claim and conform with generally accepted accounting principles.
I	(7) Audit report	G. Certified Public Accountant.
L	(8) Publicly traded	H. An unincorporated business owned by one person.
C	(9) Partnership	I. A report that describes the auditor's opinion of the fairness of the financial statement presentations and the evidence gathered to support that opinion.
K	(10) FASB	J. Securities and Exchange Commission.
G	(11) CPA	K. Financial Accounting Standards Board.
B	(12) Relevant information	L. A company with stock that can be bought and sold by investors on established stock exchanges.
M	(13) GAAP	M. Generally accepted accounting principles.

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E1–2.

A	(1)	Accounts receivable
A	(2)	Cash and cash equivalents
R	(3)	Net sales
L	(4)	Debt due within one year
L	(5)	Taxes payable
SE	(6)	Retained earnings
E	(7)	Cost of products sold
E	(8)	Selling, general, and administrative expense
E	(9)	Income taxes
L	(10)	Accounts payable
A	(11)	Trademarks and other intangible assets
A	(12)	Property, plant, and equipment
L	(13)	Long-term debt
A	(14)	Inventories
E	(15)	Interest expense

E1–3.

L	(1)	Bank loans	A	(10)	Machinery and equipment
E	(2)	Selling, marketing, and administrative expenses	R	(11)	Net product sales
L	(3)	Accounts payable	A	(12)	Inventories
L	(4)	Dividends payable	A	(13)	Trademarks
SE	(5)	Retained earnings	A	(14)	Buildings
A	(6)	Cash and cash equivalents	A	(15)	Land
A	(7)	Accounts receivable	L	(16)	Income taxes payable
E	(8)	Provision for income taxes*	E	(17)	Rental and royalty costs
E	(9)	Product cost of goods sold	A	(18)	Investments (in other companies)

*Note that “Provision for income taxes” is a common synonym for “Income tax expense.”

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E1–4.

Honda Motor Corporation
Balance Sheet
As of March 31, Current Year
(in billions of Yen)

Assets	
Cash and cash equivalents	¥ 2,106
Trade accounts, notes, and other receivables	3,085
Inventories	1,364
Investments	597
Net property, plant, and equipment	3,200
Other assets	8,606
Total assets	¥18,958
Liabilities	
Accounts payable and other current liabilities	¥ 5,429
Long-term debt	4,022
Other liabilities	1,938
Total liabilities	11,389
Stockholders' Equity	
Common stock	231
Retained earnings	7,338
Total stockholders' equity	7,569
Total liabilities and stockholders' equity	¥18,958

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E1–5.

Req. 1

COLE VALLEY BOOK STORE
Balance Sheet
At December 31, Current Year

ASSETS		**LIABILITIES**	
Cash	$ 75,600	Accounts payable	$ 12,000
Accounts receivable	39,000	Note payable	3,000
Store and office equipment	73,000	Interest payable	300
		Total liabilities	15,300
		STOCKHOLDERS' EQUITY	
		Common stock	160,000
		Retained earnings	12,300
		Total stockholders' equity	172,300
Total assets	$187,600	Total liabilities and stockholders' equity	$187,600

Req. 2
Net income for the year was $12,300. This is the first year of operations and no dividends were declared or paid to stockholders; therefore, the ending retained earnings of $12,300 includes net income for one year.

E1–6.

CAMPUS CONNECTION
Income Statement
For the Month of January, Current Year

Revenues:		
Sales: Cash	$150,000	
On credit	2,500	
Total sales revenue		$152,500
Expenses:		
Cost of goods sold	70,000	
Salaries, rent, supplies, and other expenses (paid in cash)	37,000	
Utilities	900	
Total expenses		107,900
Net Income		$ 44,600

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E1–7.

SYSCO CORP.
Income Statement
For the Year Ended June 30, Current Year
(in millions)

Revenues:		
Sales	$55,371	
Other revenues	16	
Total revenues		$55,387
Expenses:		
Cost of sales	44,814	
Selling, general and administration expense	8,504	
Interest expense	303	
Total expenses		53,621
Earnings before income taxes		1,766
Income taxes		371
Net earnings		$ 1,395

E1–8.

NEIGHBORHOOD REALTY, INCORPORATED
Income Statement
For the Year Ended December 31, Current Year

Revenues		
Commissions earned ($150,900 + $16,800)	$167,700	
Rental service fees	20,000	
Total revenues		$187,700
Expenses		
Salaries expense	62,740	
Commission expense	35,330	
Payroll tax expense	2,500	
Rent expense ($2,475 + $225)*	2,700	
Utilities expense	1,600	
Promotion and advertising expense	7,750	
Miscellaneous expenses	500	
Total expenses (excluding income taxes)		113,120
Pretax income		74,580
Income tax expense		15,660
Net Income		$ 58,920

*$2,475 has been paid for 11 months ($225 per month) plus $225 owed for December.

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E1–9.

Net Income (or Loss) = Revenues - Expenses
Assets = Liabilities + Stockholders' Equity

A. Net Income = \$93,500 - \$75,940 = \$17,560;
Stockholders' Equity = \$140,200 - \$56,500 = \$83,700.

B. Total Revenues = \$75,834 + \$14,740 = \$90,574;
Total Liabilities = \$107,880 - \$77,500 = \$30,380.

C. Net Loss = \$68,120 - \$76,430 = (\$8,310);
Stockholders' Equity = \$98,200 - \$69,850 = \$28,350.

D. Total Expenses = \$55,804 - \$21,770 = \$34,034;
Total Assets = \$20,300 + \$78,680 = \$98,980.

E. Net Income = \$84,840 - \$75,320 = \$9,520;
Total Assets = \$25,520 + \$80,000 = \$105,520.

E1–10.

Net Income (or Loss) = Revenues - Expenses
Assets = Liabilities + Stockholders' Equity

A. Net Income = \$242,300 - \$196,700 = \$45,600;
Stockholders' Equity = \$253,500 - \$75,000 = \$178,500.

B. Total Revenues = \$186,500 + \$29,920 = \$216,420;
Total Liabilities = \$590,000 - \$350,600 = \$239,400.

C. Net Loss = \$73,500 - \$91,890 = (\$18,390);
Stockholders' Equity = \$260,400 - \$190,760 = \$69,640.

D. Total Expenses = \$35,840 - \$9,840 = \$26,000;
Total Assets = \$190,430 + \$97,525 = \$287,955.

E. Net Income = \$224,130 - \$209,500= \$14,630;
Total Assets = \$173,650 + \$360,100 = \$533,750.

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E1–11.

PAINTER CORPORATION
Income Statement
For the Month of January, Current Year

Total revenues	$305,000
Less: Total expenses (excluding income tax)	189,000
Pretax income	116,000
Less: Income tax expense	25,000
Net income	$ 91,000

PAINTER CORPORATION
Balance Sheet
At January 31, Current Year

Assets	
Cash	$ 65,150
Receivables from customers	44,700
Merchandise inventory	94,500
Total assets	$204,350
Liabilities	
Payables to suppliers	$ 25,950
Income taxes payable	25,000
Total liabilities	50,950
Stockholders' Equity	
Common stock	62,400
Retained earnings *(from income statement above)*	91,000
Total stockholders' equity	153,400
Total liabilities and stockholders' equity	$204,350

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E1–12.

ANALYTICS CORPORATION
Income Statement
For the Year Ended December 31, Current Year

Total revenues	$299,000
Less: Total expenses (excluding income tax)	184,000
Pretax income	115,000
Less: Income tax expense	34,500
Net income	$ 80,500

ANALYTICS CORPORATION
Balance Sheet
At December 31, Current Year

Assets	
Cash	$ 70,150
Receivables from customers	34,500
Merchandise inventory	96,600
Total assets	$201,250
Liabilities	
Payables to suppliers	$ 26,450
Income taxes payable	34,500
Total liabilities	60,950
Stockholders' Equity	
Common stock	59,800
Retained earnings *(from income statement above)*	80,500
Total stockholders' equity	140,300
Total liabilities and stockholders' equity	$201,250

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E1–13.

PLUMMER STONEWORK CORPORATION
Statement of Stockholders' Equity
For the Year Ended December 31, 2023

	Common Stock	Retained Earnings
Balance December 31, 2022*	$100,000	$16,800
Net income		42,000
Dividends	$100,000	(18,700)
Balance December 31, 2023	$100,000	$40,100

* Beginning retained earnings + Net income – Dividends = Ending retained earnings
For 2022: $0 + $31,000 – $14,200 = $16,800;
Ending retained earnings for 2022 becomes beginning retained earnings for 2023.

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E1-14

BENNETT INC.
Income Statement
For the Year Ended December 31, Current Year

Revenues	$1,401
Expenses	1,301
Net income	$ 100

BENNETT INC.
Statement of Stockholders' Equity
For the Year Ended December 31, Current Year

	Common Stock	Retained Earnings
Beginning	$120	$193
+Net income	-	100
-Dividends	-	(20)
Ending	$120	$273

BENNETT INC.
Balance Sheet
December 31, Current Year

Cash	$ 281
Other assets	443
Total assets	$ 724
Liabilities	$ 331
Common stock	120
Retained earnings	273
Total liabilities and stockholders' equity	$ 724

E1–15.

__(I)__ (1) Purchases of property, plant, and equipment
__O__ (2) Cash received from customers
__(F)__ (3) Cash paid for dividends to stockholders
__(O)__ (4) Cash paid to suppliers
__(O)__ (5) Income taxes paid
__(O)__ (6) Cash paid to employees
__I__ (7) Cash proceeds received from sale of investment in another company

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__(F)__ (8) Repayment of borrowings

PROBLEMS

(**Note to the instructor**: Most students find the Problems in this chapter to be quite challenging.)

P1–1.

Req. 1

HIGHLIGHT CONSTRUCTION COMPANY
Income Statement
For the Year Ended December 31, Current Year

Total sales revenue (given)	$128,400
Total expenses (given)	80,200
Pretax income	48,200
Income tax expense ($48,200 x 30%)	14,460
Net income	$ 33,740

Req. 2

HIGHLIGHT CONSTRUCTION COMPANY
Statement of Stockholders' Equity
For the Year Ended December 31, Current Year

	Common Stock	Retained Earnings
Balance January 1, Current year	$ 0	$ 0
Stock issuance (given)	87,000	
+Net income (from req. 1)		33,740
–Dividends (given)	$ 87,000	(10,000)
Balance December 31, Current year	$ 87,000	$ 23,740

Req. 3

HIGHLIGHT CONSTRUCTION COMPANY
Balance Sheet
At December 31, Current Year

Assets		
Cash (given)		$ 25,600
Receivables from customers (given)		10,800
Inventory of merchandise (given)		81,000
Equipment (given)		42,000
Total assets		$159,400
Liabilities		
Accounts payable (given)	$46,140	
Salary payable (given)	2,520	
Total liabilities		$ 48,660

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Stockholders' Equity		
Common stock (given)	87,000	
Retained earnings (from req. 2)	23,740	
Total stockholders' equity		110,740
Total liabilities and stockholders' equity		$159,400

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P1–2.

Req. 1

JAMES COOK LAWN SERVICE
Income Statement
For the Three Months Ended August 31

Revenues from Services		
Lawn service–cash	$15,000	
–credit	700	
Total revenues		$15,700
Expenses		
Gas, oil, and lubrication ($1,050 + $180)	1,230	
Pickup repairs	250	
Mower repair	110	
Miscellaneous supplies used	80	
Helpers (wages)	5,400	
Payroll taxes	190	
Preparation of payroll tax forms	25	
Insurance	125	
Telephone	110	
Interest expense on note paid	78	
Equipment use cost (depreciation)	600	
Total expenses		8,198
Net Income		$ 7,502

Req. 2

Because the above report reflects only revenues, expenses, and net income, it is reasonable to suppose that James would need the following:

(1) A balance sheet–that is, a statement that reports for the business, at the end of August, each asset (name and amount, such as Cash, $XX), each liability (such as Wages Payable, $XX), and stockholders' equity.

(2) A statement of stockholders' equity that shows how income and dividends (if any) affect retained earnings on the balance sheet.

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P1–3.

	Req. 1		*Req. 2–Explanation*
Transaction	*Income*	*Cash*	
(a)	+$66,000	+$55,000	All services performed increase income; cash received during the period: $66,000 – $11,000 = $55,000.
(b)	–0–	+56,000	Cash borrowed is not income.
(c)	–0–	–12,500	Purchase of the truck does not represent an expense until the truck is used (it is an asset); cash outflow was $12,500.
(d)	–25,000	–12,500	All of the wages incurred reduce income, $25,000; cash paid during the quarter: $25,000 x 1/2 = $12,500. The $12,500 owed will be paid on the next payroll date.
(e)	–2,900	–3,800	Not all of the supplies were used; expense is the amount used: $3,800 – $900 = $2,900. Cash paid during the quarter was $3,800.
(f)	–38,000	–31,500	All expenses incurred reduce income; cash expended: $38,000 – $6,500 = $31,500.
(g) Based only on the above:			
Income (loss)	$ 100		
Cash inflow (outflow)		$ 50,700	

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ALTERNATE PROBLEMS

AP1–1.

Req. 1

INFLUENCE CORPORATION
Income Statement
For the Year Ended December 31, Current Year

Total sales revenue (given)	$100,000
Total expenses (given)	68,500
Pretax income	31,500
Income tax expense ($31,500 x 30%)	9,450
Net income	$ 22,050

Req. 2

INFLUENCE CORPORATION
Statement of Stockholders' Equity
For the Year Ended December 31, Current Year

	Common Stock	Retained Earnings
Balance, January 1, Current year	$ 0	$ 0
Common stock issuance (given)	62,000	
+Net income (from req. 1)		22,050
–Dividends (given)	$ 62,000	0
Balance, December 31, Current year	$ 62,000	$ 22,050

Req. 3

INFLUENCE CORPORATION
Balance Sheet
At December 31, Current Year

Assets		
Cash (given)		$ 13,150
Receivables from customers (given)		10,900
Inventory of merchandise (given)		27,000
Equipment (given)		66,000
Total assets		$117,050
Liabilities		
Accounts payable (given)	$31,500	
Salary payable (given)	1,500	
Total liabilities		$ 33,000
Stockholders' Equity		
Common stock (given)	62,000	
Retained earnings (from req. 2)	22,050	
Total stockholders' equity		84,050

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Total liabilities and stockholders' equity	$117,050

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AP1–2.

Req. 1

LIST ELECTRIC REPAIR COMPANY, INC.
Income Statement
For the Three Months Ended December 31

Revenues from Services		
Electric repair services–cash	$32,000	
–credit	3,500	
Total revenues		$35,500
Expenses		
Electrician's assistant (wages)	7,500	
Payroll taxes	175	
Supplies used on jobs	9,500	
Oil, gas, and maintenance on truck	1,200	
Insurance	700	
Rent ($500 + $250)	750	
Utilities and telephone	825	
Miscellaneous expenses	600	
Depreciation of truck and tools (use)	1,200	
Total expenses		22,450
Pretax Income		13,050
Income taxes		3,930
Net Income		$ 9,120

Req. 2

Because the above report reflects only revenues, expenses, and net income, it is reasonable to suppose that Sam would have need for the following:

(1) A statement that reports for the business, on December 31, each asset (name and amount such as Cash, $XX), and each liability (such as rent payable, $XX), and stockholders' equity; that is, a balance sheet.

(2) A statement of the sources and uses of cash during the period; that is, a statement of cash flows.

(3) A statement of stockholders' equity that shows the change in common stock and how net income and dividends affect retained earnings on the balance sheet.

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AP1–3.

	Req. 1		***Req. 2–Explanation***
Transaction	*Income*	*Cash*	
(a)	+$85,000	+$70,000	All services performed increase income; cash received during the period was: $85,000 – $15,000 = $70,000.
(b)	–0–	+25,000	Cash borrowed is not income.
(c)	–0–	–8,000	Purchase of the truck does not represent an expense until the truck is used (it is an asset); cash outflow was $8,000.
(d)	–36,000	–30,000	All of the wages incurred reduce income, $36,000; cash paid during the quarter was: $36,000 x 5/6 = $30,000. The $6,000 owed will be paid on the next payroll date.
(e)	–3,000	–4,000	Not all of the supplies were used; expense is the amount used: $4,000 – $1,000 = $3,000. Cash paid during the quarter was $4,000.
(f)	–31,000	–15,500	All expenses incurred reduce income; cash expended was: $31,000 – $15,500 = $15,500.
(g) Based only on the above:			
Income (loss)	$15,000		
Cash inflow (outflow)		$37,500	

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CONTINUING PROBLEM

CON1–1.

Req. 1

Penny's Pool Service & Supply, Inc.
Income Statement
For the Year Ended December 31, Current Year

Revenues	
Sales revenue	$ 60,000
Expenses	
Cost of supplies used	8,200
Wage expense	24,000
Other administrative expenses	4,500
Total expenses	36,700
Pretax income	23,300
Income tax expense	4,000
Net income	$19,300

Req. 2

Penny's Pool Service & Supply, Inc.
Statement of Stockholders' Equity
For the Year Ended December 31, Current Year

	Common Stock	Retained Earnings
Balance January 1, Current Year	$ 0	$ 0
Issue common stock	20,000	
Net income for Current Year		19,300
Dividends for Current Year		(10,000)
Balance December 31, Current Year	$ 20,000	$ 9,300

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CON1–1. (continued)

Req. 3

Penny's Pool Service & Supply, Inc.
Balance Sheet
At December 31, Current Year

Assets:	
Cash	$ 2,900
Accounts receivable	2,300
Inventories	4,600
Equipment	28,000
Total assets	$ 37,800
Liabilities and Stockholders' Equity:	
Liabilities	
Accounts payable	$ 3,500
Note payable to bank	5,000
Total liabilities	8,500
Stockholders' equity	
Common stock (1,000 shares)	20,000
Retained earnings	9,300
Total stockholders' equity	29,300
Total liabilities and stockholders' equity	$ 37,800

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CASES AND PROJECTS

CP1–1.

1. c.
2. c.
3. b.
4. a.
5. a.
6. d.
7. a.

CP1–2.
(dollars in millions)

1. Consolidated net income was $16,270.

2. Revenue was $648,125.

3. Inventories is $54,892.

4. Cash and cash equivalents increased by $1,242.

5. The auditor is Ernst & Young LLP.

CP1–3.
1. b. Walmart.
2. b. Walmart
3. d. Inventory or Inventories

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FINANCIAL REPORTING AND ANALYSIS CASES

CP1–4.

Req. 1
The personal residences of the organizers are not resources of the business entity. Therefore, they should be excluded.

Req. 2
What do the amounts for service trucks ($57,000) and service equipment ($30,000) represent? It is not indicated whether the $87,000 is their cost when acquired or the current market value on December 31 of the current year.

Req. 3
The lists of company resources (i.e., assets) and company obligations suggests the following areas of concern:

Company resources:

(1) Cash, inventories, and bills due from customers (i.e., accounts receivable)–these items tend to fluctuate; they may be significantly more or less at the date of the loan and during the term of the loan.

(2) Service trucks and equipment–as noted above, it is not indicated whether the $87,000 is cost when acquired or current market value on December 31 of the current year.

(3) Personal residences–as noted above, these items are not resources of the business entity and should be excluded.

Company obligations:

(4) Unpaid wages of $19,000, which are now due, pose a serious problem because only $12,000 of cash is currently available.

(5) Unpaid taxes and accounts payable to suppliers–it is not clear when these payments of $8,000 and $10,000, respectively, are due (cash needed to pay them is a problem).

(6) The $45,000 owed on the service trucks probably is long term; however, short-term installments may be required–these details are very important to the bank.

(7) Loan from organizer–the expected payment date and interest rate are important issues for which details are not provided. This is a major cash demand.

In general, the bank should request more details about the specific resources and debts. The personal residences are not a part of the resources of the business entity.

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The bank should request that the owners provide audited information about the entity's assets and debts.

CP1–4. (continued)

Req. 4

The amount of stockholders' equity (i.e., assets minus liabilities) for Northwest Company, assuming the amounts provided by the owners are acceptable, would be:

Assets ($311,000 – $190,000)	$121,000
Liabilities	92,000
Stockholders' equity	$ 29,000

CP1–5.

Req. 1–Deficiencies:

(1) Heading: titles of the reports are missing and dates are not in proper form.
(2) Income statement should show revenues and expenses separately and provide the amount of net income.
(3) Income from sales of merchandise should be "Sales revenue" or "Merchandise sales revenue."
(4) Balance sheet should separately report assets, liabilities, and stockholders' equity. Resources and Debts are not appropriate captions for the balance sheet.
(5) Retained earnings, $32,250, and Common stock, $65,000, should be reported under stockholders' equity.
(6) Due from customers, $13,000, should be reported under assets.
(7) Supplies on hand, $15,000, should be reported under assets.
(8) Accumulated depreciation, $12,000, should be subtracted from service vehicles.

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CP1–5. (continued)

Req. 2–Financial Statements:

PRECISION CORPORATION
Income Statement
For the Year Ended December 31, 2023

Revenues:		
Sales	$180,000	
Services	52,000	
Total revenues		$232,000
Expenses:		
Cost of goods sold	90,000	
Selling expenses	25,000	
Depreciation expense	12,000	
Salaries and wages	62,000	
Total expenses (excluding income tax)		189,000
Pretax income		43,000
Income tax expense		10,750
Net income		$ 32,250

PRECISION CORPORATION
Balance Sheet
At December 31, 2023

Assets		
Cash		$ 32,000
Accounts receivable (from customers)		13,000
Merchandise inventory (for resale)		42,000
Supplies inventory (for use in rendering services)		15,000
Service vehicles	$50,000	
Less accumulated depreciation	(12,000)	38,000
Total assets		$140,000
Liabilities		
Accounts payable (to suppliers)		$ 17,750
Note payable (to bank)		25,000
Total liabilities		42,750
Stockholders' equity		
Common stock, 6,500 shares	$65,000	
Retained earnings	32,250	
Total stockholders' equity		97,250
Total liabilities and stockholders' equity		$140,000

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CRITICAL THINKING CASES

CP1–6.

Req. 1 You should forcefully assert the need for an independent audit of the financial statements each year because this is the best way to assure credibility–conformance with GAAP, completeness and absence of bias.

You should firmly reject "Uncle Ray" as the auditor because there is no evidence about his competence as an accountant or auditor. Also, he is related to the partner who prepares the financial statements; there is a conflict of interest.

Req. 2 You should strongly recommend the selection of an independent CPA in public practice because the financial statements should be audited by a competent and independent professional who must follow prescribed accounting and auditing standards on a strictly independent basis. An audit by "Uncle Ray" would not meet any of these requisites, particularly the important one in this case–independence (and absence of bias).

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CP1–7.

The textbook does not explicitly cover the elements of independence. The case is designed to permit the students to develop their own values. We have found that it is useful to emphasize the difference between independence in fact and in appearance during these discussions.

1. Most students feel that there is no problem with independence if the stock held is immaterial in amount. When asked about a possible headline that might read “Auditor who was shareholder is accused of fraud,” most students see a problem with the appearance. In fact, the AICPA does not apply a materiality threshold where there is a direct financial interest. Any holding of stock is a problem.

2. This is an example of an indirect holding of stock. A materiality threshold is applied in these situations. There could be a question of independence if the auditor held a material interest in the mutual fund (relative to her net worth) and the mutual fund held a material interest in the company that she audited.

3. The AICPA Code of Professional Conduct applies only to audit professionals who are members (though most state laws incorporate similar rules). Bob's employers may want to assign him to a different company but there is no conflict with the Code.

4. Clearly there is an ethics violation in this case because she would audit statements that covered a period of time where she was responsible for the accounting operations of the company. This is a problem both in appearance and in fact.

5. The Code indicates that a mortgage loan made to the partner in charge would be an ethics violation unless all of the following four conditions were met: (1) that the loan was made under normal lending procedures, terms, and requirements, (2) it was obtained before the bank became an audit client, (3) the loan is kept current at all times, and (4) the fair value of the collateral equals or exceeds the outstanding balance. This issue is an excellent example of how ethics rules can change over time. The savings and loan debacle and the banking crisis caused the profession to reconsider the issue of loans to auditors.

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YOU AS ANALYST: ONLINE COMPANY RESEARCH (an individual or team project)

CP1–8.

The solutions to this case will depend on the company(ies) and/or accounting periods selected for analysis.

BUSINESS ANALYTICS AND DATA VISUALIZATION WITH EXCEL AND TABLEAU

The solutions to these exercises are auto graded on Connect, as assigned by the instructor.

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CHAPTER 1
FINANCIAL STATEMENTS AND BUSINESS DECISIONS

Learning Objectives and Related Assignment Materials

Learning Objectives	*Mini-Exercises*	*Exercises*	*Problems*	*Alternate Problems*	*Cont. Prob.*	*Cases and Projects*
1-1 Recognize the information conveyed in each of the four basic financial statements and the way that it is used by different decision makers (investors, creditors, and managers).	1, 2	1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15	1, 2, 3	1, 2, 3	1	1, 2, 3, 4, 5, 8
1-2 Identify the role of generally accepted accounting principles (GAAP) in determining financial statement content and managers', directors', and auditors' responsibilities for ensuring the accuracy of the financial statements.	3	1				1, 2, 6, 7, 8
Chapter Supplement A: Types of Business Entities						
Chapter Supplement B: Employment in the Accounting Profession Today						

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Synopsis of Chapter Revisions

- ***New*** simplified mini-exercises providing early practice with the structure and content of the income statement, statement of stockholders' equity, and balance sheet.
- ***New*** Guided Help video on the structure of the income statement, statement of stockholders' equity, and balance sheet.

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PowerPoint Slides

Learning Objectives	*PowerPoint® Slides*
1-1 Recognize the information conveyed in each of the four basic financial statements and the way that it is used by different decision makers (investors, creditors, and managers).	1-8 through 1-29
1-2 Identify the role of generally accepted accounting principles (GAAP) in determining the content of financial statements.	1-30 through 1-39
Chapter Supplement A: Types of Business Entities	1-40
Chapter Supplement B: Employment in the Accounting Profession Today	1-41

Chapter Take-Aways

1-1 Recognize the information conveyed in each of the four basic financial statements and the way that it is used by different decision makers (investors, creditors, and managers).

The **balance sheet** is a statement of financial position that reports dollar amounts for the assets, liabilities, and stockholders' equity at a specific point in time.
The **income statement** is a statement of operations that reports revenues, expenses, and net income for a stated period of time.
The **statement of stockholders' equity** explains changes in stockholders' equity accounts (common stock and retained earnings) that occurred during a specific period of time.
The **statement of cash flows** reports inflows and outflows of cash for a stated period of time.
The statements are used by investors and creditors to evaluate different aspects of the firm's financial position and performance.

1-2 Identify the role of generally accepted accounting principles (GAAP) in determining financial statement content and managers', directors', and auditors' responsibilities for ensuring the accuracy of the financial statements.

GAAP refers to the measurement rules used to develop the information in financial statements. Knowledge of GAAP is necessary for accurate interpretation of the numbers in financial statements.
Management has primary responsibility for the accuracy of a company's financial information. Auditors are responsible for expressing an opinion on the fairness of the financial statement presentations based on their examination of the reports and records of the company.
Users will have confidence in the accuracy of financial statement numbers only if the people associated with their preparation and audit have reputations for ethical behavior and competence. Management and auditors can also be held legally liable for fraudulent financial statements.

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Finding Financial Information

Balance Sheet	**Income Statement**
Assets = Liabilities + Stockholders' Equity	Revenues − Expense Net Income
Statement of Stockholders' Equity	**Statement of Cash Flows**
Beginning balance + Increases − Decreases Ending balance	+/− Cash Flow from Operating Activities +/− Cash Flow from Investing Activities +/− Cash Flow from Financing Activities Net Change in Cash

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Chapter Outline

Teaching Notes

Provide a learning strategy:
Overview of the textbook:
☑ *Marginal information*
☑ *Pause for Feedback (Self-Study Quizzes)*
☑ *Demonstration Case*
☑ *Chapter Take-Aways*
☑ *Guided Help Step-by-Step Video Instruction*
☑ *Finding Financial Information*
☑ *Key Ratio(s)*
☑ *Key Terms*
See also the instructor resources in the Connect library

LO 1-1 Recognize the information conveyed in each of the four basic financial statements and the way that it is used by different decision makers (investors, creditors, and managers).

I. Understanding the Business
   A. Accounting System—collects and processes financial information about an organization and reports that information to decision makers:
      1. Business activities
         a. Financing Activities—borrowing or paying back money to lenders and receiving additional funds from stockholders or paying them dividends.
         b. Investing Activities—buying or selling items such as plant and equipment used in the production.
         c. Operating Activities—the day-to-day process of purchasing from suppliers, manufacturing, delivering to customers, collecting cash from customers, and paying suppliers.
      2. Managerial accounting—accounting for internal decision makers.
      3. Financial accounting—accounting for external decision makers (focus of this text).
   B. Why Study Financial Accounting?

Illustrated in Exhibit 1.1

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1. Regardless of the functional area of management in which business professionals are employed, they will use financial statement data.

C. Goals for Chapter 1—Areas of Focus:
   1. Content (i.e., categories of items or elements) reported on each of the four statements.
   2. Structure (the equations that organize and relate the elements in each statement).
   3. Use (how the information is used by stockholders and creditors to make investment and lending decisions).

II. The Four Basic Financial Statements: An Overview

Use Supplemental Enrichment Activity #1

A. Balance Sheet—reports the financial position (assets, liabilities, and stockholders' equity) of an accounting entity at a point in time.

Illustrated in Exhibit 1.2

   1. Structure
      a. Heading includes: name of the entity, title of the statement, specific date of the statement, and unit of measure.
      b. Accounting entity—organization for which financial data are to be collected; must be precisely defined.
      c. Basic accounting equation: Assets = Liabilities + Stockholders' Equity.

Use Supplemental Enrichment Activity #2

   2. Elements
      a. Assets—the economic resources owned by the company; initially measured at total cost incurred to acquire it.

See Financial Analysis feature "Interpreting Assets, Liabilities, and Stockholders' Equity on the Balance Sheet"

      b. Liabilities—amount of financing provided by creditors; the company's debts or obligations.
      c. Stockholders' equity—the amount of financing provided by the owners or the business and reinvested earnings.
         i. Common stock—the investment of cash and other assets in the business by the owners.
         ii. Retained earnings—the amount of earnings (profits) reinvested in the business (and thus not distributed to stockholders in the form of dividends).

Refer students to Pause for Feedback – Self-Study Quiz

B. Income Statement (statement of income, statement of earnings, or statement of operations)—reports the revenues less the expenses of the accounting period.
   1. Structure

Illustrated in Exhibit 1.3

      a. Heading includes: name of the entity, title of the statement, specific period of time covered by the statement, and unit of measure.
      b. Accounting period—time period covered by the financial statements.
      c. Income statement equation: Revenues − Expenses = Net Income.
   2. Elements

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a. Revenues—earned from sale of goods or services to customers, whether or not the customer has paid for the goods or services.
b. Expenses—dollar amount of resources the entity used to earn revenues during the period.

See Financial Analysis feature "Analyzing the Income Statement: Beyond the Bottom Line"

c. Net income (or net earnings or the "bottom line")—excess of total revenues over total expenses.
   i. Net loss reported if total expenses exceed total revenues.
   ii. Net income does not normally equal the net cash generated by operations.

Refer students to Pause for Feedback – Self-Study Quiz

C. Statement of Stockholders' Equity—reports the changes in each of the company's stockholders' equity accounts during that period.

Illustrated in Exhibit 1.4

1. Structure
   a. Heading includes: name of the entity, title of the statement, specific period of time covered by the statement, and unit of measure.
   b. Same time period as income statement.
   c. Statement of stockholders' equity equation: Beginning balance + Increases − Decreases = Ending balance.
2. Elements
   a. Starts with beginning balances in the stockholders' equity accounts, lists the increases and decreases, and reports the resulting ending balances.

See Financial Analysis feature "Interpreting Retained Earnings"

   b. Retained earnings portion:
      i. Begins with beginning-of-the year retained earnings.

Refer students to Pause for Feedback – Self-Study Quiz

      ii. Current year net income reported on the income statement is added.

Refer students to Guided Help 1-1

      iii. Current year dividends are subtracted.
      iv. Ending retained earnings is same as that reported on balance sheet.

D. Statement of Cash Flows—reports inflows and outflows of cash during the accounting period in the categories of operations, investing, and financing.

Illustrated in Exhibit 1.5

1. Structure
   a. Heading includes: name of the entity, title of the statement, specific period of time covered by the statement, and unit of measure.
   b. Same time period as income statement.
   c. Prepared because the income statement does not provide information concerning cash flows.
   d. Statement of cash flows equation: +/− Cash Flows from Operating Activities +/− Cash Flows from Investing Activities +/− Cash Flows from Financing Activities = Change in Cash + Beginning Cash Balance = Ending Cash Balance.

See Financial Analysis feature "Interpreting the Cash Flow Statement"

2. Elements

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a. Cash Flows from Operating Activities—cash flows that are directly related to earning income.	*Use Supplemental Enrichment Activity #3*
b. Cash Flows from Investing Activities—cash flows related to the acquisition or sale of the company's plant and equipment and investments.	
c. Cash Flows from Financing Activities—cash flows directly related to the financing of the enterprise itself; they involve the receipt or payment of money to investors and creditors (except for suppliers).	*Refer students to Pause for Feedback – Self-Study Quiz*
E. Relationship Among the Statements	*Illustrated in Exhibit 1.6*
1. Net income from the income statement results in an increase in ending retained earnings on the statement of stockholders' equity.	*Refer students to Pause for Feedback – Self-Study Quiz*
2. Ending retained earnings from the statement of stockholders' equity is one of the two components of stockholders' equity on the balance sheet.	
3. The change in cash on the cash flow statement added to the beginning-of-the-year balance in cash equals the end-of-year balance in cash on the balance sheet.	
F. Notes and Financial Statement Formats	
1. Notes provide supplemental information about the financial condition of a company without which the financial statements cannot be fully understood.	
2. Additional formatting conventions for all four basic financial statements:	
i. Assets are listed on the balance sheet by ease of conversion to cash; liabilities are listed by their maturity (due date).	
ii. A monetary unit sign (in the U.S., the \$) is included beside the first dollar amount in a group of items.	
iii. It is common to place a single underline below the last item in a group before the total or subtotal	
iv. A dollar sign is also placed beside group totals and a double underline below.	
G. Summary of the Four Basic Financial Statements	

LO 1-2 Identify the role of generally accepted accounting principles (GAAP) in determining financial statement content and managers', directors', and auditors' responsibilities for ensuring the accuracy of the financial statements.

III. Responsibilities for the Accounting Communication Process	
A. Generally Accepted Accounting Principles (GAAP)—measurement and disclosure rules used to develop the information in financial statements.	*Summarized in Exhibit 1.7* *Use Supplemental Enrichment Activity #4*
1. How Are Generally Accepted Accounting Principles Determined?	
a. Securities and Exchange Commission (SEC)—the U.S. government agency that determines the financial statements that public companies must provide to stockholders and the measurement rules that they must use in producing those statements.	*See International Perspective feature "The International Accounting Standards Board and Global Accounting Standards"*

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b. Financial Accounting Standards Board (FASB)—the private sector body given the primary responsibility to work out the detailed rules that become generally accepted accounting principles.
c. The official pronouncements of the FASB are called the FASB Accounting Standards Codification.

2. What Concepts Guide the Setting of Accounting Standards?
   a. The primary objective of financial reporting is to provide useful information to investors, lenders, and creditors.
   b. Fundamental characteristics of useful information include relevance and faithful representation with enhancing characteristics of timeliness, verifiability, comparability, and understandability.
3. Why is GAAP Important to Managers and External Users?
   a. Companies incur the cost of preparing the statements.
   b. Companies bear the major economic consequences of their publication including:
      i. Effects on the selling price of a company's stock.
      ii. Effects on the amount of bonuses received by management and employees.
      iii. Loss of competitive information to other companies.
   c. Changes in GAAP are actively debated, political lobbying takes place, and final rules are a compromise among the wishes of interested parties.

B. Ensuring the Accuracy of Financial Statements
1. What if the Numbers are Wrong?
2. Ethical Conduct
   a. Ethics are standards of conduct for judging right from wrong, honest from dishonest, and fair from unfair.
   b. Three step process to be followed when you are faced with an ethical dilemma.
      i. Identify the benefits of a decision and who will be harmed.
      ii. Identify alternative courses of action.
      iii. Choose the one you would like your family and friends to see reported on your local news; this is usually the ethical choice.
3. Responsibility and the Need for Internal Controls
   a. Primary responsibility for the information in the financial statements lies with management (represented by the highest officer of the company and the highest financial officer).
   b. Three important steps to assure investors that the company's records are accurate:
      i. Maintain a system of controls over both the records and the assets of the company.

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ii. Hire outside independent auditors to verify the fairness of the financial statements. iii. Form a committee of the board of directors to oversee the integrity of these other safeguards.	*Refer students to Best Buy Co. Inc. Demonstration Case*

IV. Chapter Supplement A: Types of Business Entities	
A. Sole proprietorship—an unincorporated business owned by one person; usually small in size and common in service, retailing, and farming industries. 1. Legally, the business and the owner are not separate entities. 2. Business is a separate entity for accounting purposes. B. Partnership—an unincorporated business owned by two or more persons known as partners. 1. Agreements between the owners are specified in a partnership contract, which deals with division of income and distribution upon termination of operations. 2. Partnership is not legally separate from its owners. 3. Each partner in a general partnership is responsible for the debts of the business (unlimited liability). 4. Partnership is a separate entity for accounting purposes. C. Corporation—business incorporated under the laws of a particular state. 1. Ownership is represented by shares of capital stock. 2. Stockholders enjoy limited liability and are liable for the corporation's debts only to the extent of their investments. 3. Stockholders elect a board of directors, which in turn employs managers and exercises general supervision of the corporation. 4. Corporation is a separate entity for accounting purposes. 5. Dominant form of business organization in the U.S. a. Advantages include: i. Limited liability for the stockholders. ii. Continuity of life. iii. Ease in transferring ownership (stock). iv. Opportunities to raise large amounts of money by selling shares to a large number of people. b. Primary disadvantage is income may be subject to double taxation (it is taxed when it is earned and again when it is distributed to stockholders as dividends).	

V. Chapter Supplement B: Employment in the Accounting Profession Today	
A. Professional designations: 1. Certified Public Accountant (CPA). a. CPA designation is granted only on completion of requirements specified by the state that issues the license. b. Requirements generally include college degree with a specified number of accounting courses, good character, one to five years of professional experience, and successful completion of the CPA exam.	*Use Supplemental Enrichment Activity #5*

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2. Certified Management Accountant (CMA).
3. Certified Internal Auditor (CIA).

Use Supplemental Enrichment Activity #6

B. Practice of Public Accounting
   1. Audit or assurance services—independent professional services that improve the quality of information, or its content, for decision makers.
   2. Management consulting services—usually accounting based
      a. Encompass such activities as the design and installation of accounting, data processing, and profit-planning and control systems; financial advice; forecasting; inventory controls; cost-effectiveness studies; and operational analysis.
      b. To maintain independence, CPAs are prohibited from performing certain consulting services for the public companies they audit.
   3. Tax services.

C. Employment by Organizations
   1. Depending on size and complexity, an organization may employ from a few to hundreds of accountants.
   2. Accountants are typically engaged in a wide variety of activities; primary function is to provide data useful for internal managerial decision making and for controlling operations.

D. Employment in the Public and Not-for-Profit Sector
   1. Perform functions similar to those performed by those in private organizations.
   2. Government Accountability Office (GAO) and regulatory agencies also use the services of accountants.

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Supplemental Enrichment Activities

Note: These activities would be suitable for individual or group activities.

1. Handout 1-1

   Use this handout for an in-class activity designed to review the individual financial statements and the relationships among the financial statements. The solution follows the handout master.

2. Handout 1-2

   Use this handout for an in-class activity designed to review the classification of various account names on the balance sheet. The solution follows the handout master.

3. Handout 1-3

   Use this handout for an in-class activity designed to review the classification of various transactions on the statement of cash flows. The solution follows the handout master.

4. Handout 1-4

   Use this handout for an in-class activity designed to review the classification of various accounts, elements, or transactions on the financial statements. The solution follows the handout master.

5. Handouts 1-5 and 1-6

   "Acronym" Game – The business and accounting arenas are inundated with acronyms. Use Handout 1-5, which contains the list of names/terms, and ask them to derive the acronyms. During the next class, use handout 1-6, which lists the acronyms and ask them to give the name/term represented by each. This may help them learn these important terms and acronyms without just sitting down to memorize them. The solution follows the handout masters.

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HANDOUT 1 – 1

TEAM PROJECT – OVERVIEW OF FINANCIAL STATEMENTS

Complete the following table.

Financial Statement	Purpose	Equation
Income Statement		
Statement of Stockholders' Equity		
Balance Sheet		
Statement of Cash Flows		

RELATIONSHIPS AMONG FINANCIAL STATEMENTS

Then, answer the following questions:

1. How does the income statement tie into the statement of stockholders' equity?
2. How does the statement of stockholders' equity tie into the balance sheet?
3. How does the balance sheet tie into the statement of cash flows?

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HANDOUT 1 – 1 SOLUTION

TEAM PROJECT – OVERVIEW OF FINANCIAL STATEMENTS

Complete the following table.

Financial Statement	Purpose	Equation
Income Statement	Reports the financial performance of the business during the current accounting period.	Revenues − Expenses = Net Income
Statement of Stockholders' Equity	Explains changes in stockholders' equity accounts (common stock and retained earnings) for a stated period of time.	Beginning balance + Increases − Decreases = Ending balances
Balance Sheet	Reports the financial position of a business at a point in time.	Assets = Liabilities + Stockholders' Equity
Statement of Cash Flows	Reports the inflows (receipts) and outflows (payments) for a stated period of time.	+/− Cash Flows from Operating Activities +/− Cash Flows from Investing Activities +/− Cash Flows from Financing Activities = Change in Cash + Beginning Cash = Ending Cash

RELATIONSHIPS AMONG FINANCIAL STATEMENTS

Then, answer the following questions:

1. How does the income statement tie into the statement of stockholders' equity?

   Net income, from the income statement, is a component in determining ending retained earnings on the statement of stockholders' equity.

2. How does the statement of stockholders' equity tie into the balance sheet?

   The amount of ending retained earnings is then reported on the balance sheet.

3. How does the balance sheet tie into the statement of cash flows?

   Cash on the balance sheet is equal to the ending cash reported on the statement of cash flows.

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HANDOUT 1 – 2

BASIC BALANCE SHEET ELEMENTS

Match each account to its classification on the balance sheet:

Account	Asset	Liability	Stockholders' Equity
a. Notes Payable			
b. Cash			
c. Common Stock			
d. Inventories			
e. Accounts Receivable			
f. Accounts Payable			
g. Property, Plant, & Equipment			
h. Notes Payable			
i. Retained Earnings			

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HANDOUT 1 – 2 SOLUTION

BASIC BALANCE SHEET ELEMENTS

Match each account to its classification on the balance sheet:

Account	Asset	Liability	Stockholders' Equity
a. Notes Payable		X	
b. Cash	X		
c. Common Stock			X
d. Inventories	X		
e. Accounts Receivable	X		
f. Accounts Payable		X	
g. Property, Plant, & Equipment	X		
h. Notes Payable		X	
i. Retained Earnings			X

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HANDOUT 1 – 3

STATEMENT OF CASH FLOWS

Match each activity to its classification on the statement of cash flows:

Activity	Operating	Investing	Financing
a. Cash paid to suppliers and employees			
b. Cash paid to purchase equipment and other assets			
c. Cash paid for dividends			
d. Cash collected from customers			
e. Cash received from selling equipment and other long-term assets			
f. Cash paid on notes payable and other financing			

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HANDOUT 1 – 3 SOLUTION

STATEMENT OF CASH FLOWS

Match each activity to its classification on the statement of cash flows:

Activity	Operating	Investing	Financing
a. Cash paid to suppliers and employees	X		
b. Cash paid to purchase equipment and other assets		X	
c. Cash paid for dividends			X
d. Cash collected from customers	X		
e. Cash received from selling equipment and other long-term assets		X	
f. Cash paid on notes payable and other financing			X

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HANDOUT 1 – 4

COMPONENTS OF FINANCIAL STATEMENTS

Match each account, element, or transaction to the financial statement(s) on which it would be reported.

Account or Element	Income Statement	Statement of Stockholders' Equity	Balance Sheet	Statement of Cash Flows
a. The amount of cash paid for equipment				
b. Cash				
c. Notes Payable				
d. Common Stock				
e. Inventories				
f. Cost of Goods Sold				
g. The amount of cash collected from customers				
h. Accounts Receivable				
i. Notes Payable				
j. Marketing Expense				
k. Property, Plant, & Equipment				
l. Dividends paid to stockholders				
m. Net Income				

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HANDOUT 1 – 4 SOLUTION

COMPONENTS OF FINANCIAL STATEMENTS

Match each account, element, or transaction to the financial statement(s) on which it would be reported.

Account or Element	Income Statement	Statement of Stockholders' Equity	Balance Sheet	Statement of Cash Flows
a. The amount of cash paid for equipment				X
b. Cash			X	X
c. Notes Payable			X	
d. Common Stock		X	X	
e. Inventories			X	
f. Cost of Goods Sold	X			
g. The amount of cash collected from customers				X (1)
h. Accounts Receivable			X	
i. Notes Payable			X	
j. Marketing Expense	X			
k. Property, Plant, & Equipment			X	
l. Dividends paid to stockholders		X		X
m. Net Income	X	X		X (2)

(1) Reported on the statement of cash flows when the direct method is used.

(2) Reported on the statement of cash flows when the indirect method is used.

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HANDOUT 1 – 5

ACRONYMS

Professional Organizations	Acronyms
American Accounting Association	
American Institute of Certified Public Accountants	
Financial Accounting Foundation	
Financial Accounting Standards Board	
Governmental Accounting Standards Board	
Internal Accounting Standards Board	
Institute of Management Accountants	
National Association of State Boards of Accountancy	
Federal Government Agencies	
Federal Communications Commission	
Federal Deposit Insurance Corporation	
Federal Trade Commission	
General Accounting Office	
Internal Revenue Service	
Public Company Accounting Oversight Board	
Small Business Administration	
Securities & Exchange Commission	
Standards	
Accounting Principles Board (1959-1973)	
Accounting Research Bulletins (1939-1959)	
Accounting Series Release (SEC)	
Generally Accepted Accounting Principles	
Generally Accepted Auditing Standards	
International Financial Reporting Standards	
Statement on Auditing Standards (AICPA)	
Statement of Financial Accounting Concepts (FASB)	
Statement of Financial Accounting Standards (FASB)	
Selected Professional Certifications	
Certified Public Accountant	
Certified Fraud Examiner	
Certified Internal Auditor	
Certified Management Accountant	
Certified Public Accountant	
Miscellaneous Terms in Accounting, Business, and Economics	
Consumer Price Index	
Continuing Professional Education	
Earnings Per Share	
Federal Insurance Contributions Act	
Federal Unemployment Tax Act	
Gross National Product	

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HANDOUT 1 – 6

ACRONYMS

Professional Organizations	Acronyms
	AAA
	AICPA
	FAF
	FASB
	GASB
	IASB
	IMA
	NASBA
Federal Government Agencies	
	FCC
	FDIC
	FTC
	GAO
	IRS
	PCAOB
	SBA
	SEC
Standards	
	APB
	ARBs
	ASR
	GAAP
	GAAS
	IFRS
	SAS
	SFAC
	SFAS
Selected Professional Certifications	
	CPA
	CFE
	CIA
	CMA
	CPA
Miscellaneous Terms in Accounting, Business, and Economics	
	CPI
	CPE
	EPS
	FICA
	FUTA
	GNP

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HANDOUTS 1 – 5 and 1 – 6 SOLUTIONS

ACRONYMS

Professional Organizations	Acronyms
American Accounting Association	AAA
American Institute of Certified Public Accountants	AICPA
Financial Accounting Foundation	FAF
Financial Accounting Standards Board	FASB
Governmental Accounting Standards Board	GASB
Internal Accounting Standards Board	IASB
Institute of Management Accountants	IMA
National Association of State Boards of Accountancy	NASBA
Federal Government Agencies	
Federal Communications Commission	FCC
Federal Deposit Insurance Corporation	FDIC
Federal Trade Commission	FTC
General Accounting Office	GAO
Internal Revenue Service	IRS
Public Company Accounting Oversight Board	PCAOB
Small Business Administration	SBA
Securities & Exchange Commission	SEC
Standards	
Accounting Principles Board (1959-1973)	APB
Accounting Research Bulletins (1939-1959)	ARBs
Accounting Series Release (SEC)	ASR
Generally Accepted Accounting Principles	GAAP
Generally Accepted Auditing Standards	GAAS
International Financial Reporting Standards	IFRS
Statement on Auditing Standards (AICPA)	SAS
Statement of Financial Accounting Concepts (FASB)	SFAC
Statement of Financial Accounting Standards (FASB)	SFAS
Selected Professional Certifications	
Certified Public Accountant	CPA
Certified Fraud Examiner	CFE
Certified Internal Auditor	CIA
Certified Management Accountant	CMA
Certified Public Accountant	CPA
Miscellaneous Terms in Accounting, Business, and Economics	
Consumer Price Index	CPI
Continuing Professional Education	CPE
Earnings Per Share	EPS
Federal Insurance Contributions Act	FICA
Federal Unemployment Tax Act	FUTA
Gross National Product	GNP

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