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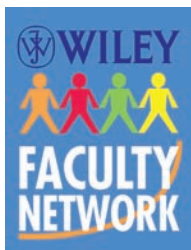


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Jerry Weygandt

Jerry J. Weygandt, PhD, CPA, is Arthur Andersen Alumni Emeritus Professor of Accounting at the University of Wisconsin—Madison. He holds a Ph.D. in accounting from the University of Illinois. Articles by Professor Weygandt have appeared in the *Accounting Review*, *Journal of Accounting Research*, *Accounting Horizons*, *Journal of Accountancy*, and other academic and professional journals. These articles have examined such financial reporting issues as accounting for price-level adjustments, pensions, convertible securities, stock option contracts, and interim reports. Professor Weygandt is author of other accounting and financial reporting books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Wisconsin Society of Certified Public Accountants. He has served on numerous committees of the American Accounting Association and as a member of the editorial board of the *Accounting Review*; he also has served as President and Secretary-Treasurer of the American Accounting Association. In addition, he has been actively involved with the American Institute of Certified Public Accountants and has been a member of the Accounting Standards Executive Committee (AcSEC) of that organization. He has served on the FASB task force that examined the reporting issues related to accounting for income taxes and served as a trustee of the Financial Accounting Foundation. Professor Weygandt has received the Chancellor's Award for Excellence in Teaching and the Beta Gamma Sigma Dean's Teaching Award. He is on the board of directors of M & I Bank of Southern Wisconsin. He is the recipient of the Wisconsin Institute of CPA's Outstanding Educator's Award and the Lifetime Achievement Award. In 2001 he received the American Accounting Association's Outstanding Educator Award.



Paul Kimmel

Paul D. Kimmel, PhD, CPA, received his bachelor's degree from the University of Minnesota and his doctorate in accounting from the University of Wisconsin. He is an Associate Professor at the University of Wisconsin—Milwaukee, and has public accounting experience with Deloitte & Touche (Minneapolis). He was the recipient of the UWM School of Business Advisory Council Teaching Award, the Reggie Taite Excellence in Teaching Award and a three-time winner of the Outstanding Teaching Assistant Award at the University of Wisconsin. He is also a recipient of the Elijah Watts Sells Award for Honorary Distinction for his results on the CPA exam. He is a member of the American Accounting Association and the Institute of Management Accountants and has published articles in *Accounting Review*, *Accounting Horizons*, *Advances in Management Accounting*, *Managerial Finance*, *Issues in Accounting Education*, *Journal of Accounting Education*, as well as other journals. His research interests include accounting for financial instruments and innovation in accounting education. He has published papers and given numerous talks on incorporating critical thinking into accounting education, and helped prepare a catalog of critical thinking resources for the Federated Schools of Accountancy.



Don Kieso

Donald E. Kieso, PhD, CPA, received his bachelor's degree from Aurora University and his doctorate in accounting from the University of Illinois. He has served as chairman of the Department of Accountancy and is currently the KPMG Emeritus Professor of Accountancy at Northern Illinois University. He has public accounting experience with Price Waterhouse & Co. (San Francisco and Chicago) and Arthur Andersen & Co. (Chicago) and research experience with the Research Division of the American Institute of Certified Public Accountants (New York). He has done post doctorate work as a Visiting Scholar at the University of California at Berkeley and is a recipient of NIU's Teaching Excellence Award and four Golden Apple Teaching Awards. Professor Kieso is the author of other accounting and business books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Illinois CPA Society. He has served as a member of the Board of Directors of the Illinois CPA Society, then AACSB's Accounting Accreditation Committees, the State of Illinois Comptroller's Commission, as Secretary-Treasurer of the Federation of Schools of Accountancy, and as Secretary-Treasurer of the American Accounting Association. Professor Kieso is currently serving on the Board of Trustees and Executive Committee of Aurora University, as a member of the Board of Directors of Kishwaukee Community Hospital, and as Treasurer and Director of Valley West Community Hospital. From 1989 to 1993 he served as a charter member of the national Accounting Education Change Commission. He is the recipient of the Outstanding Accounting Educator Award from the Illinois CPA Society, the FSA's Joseph A. Silvoso Award of Merit, the NIU Foundation's Humanitarian Award for Service to Higher Education, a Distinguished Service Award from the Illinois CPA Society, and in 2003 an honorary doctorate from Aurora University.

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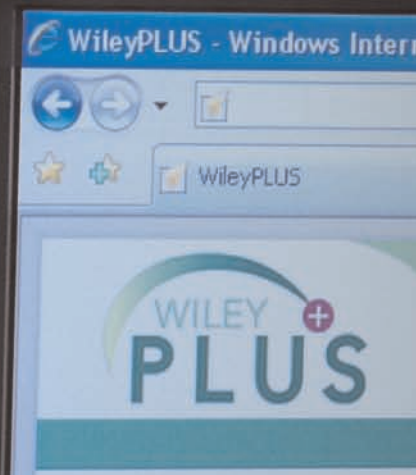
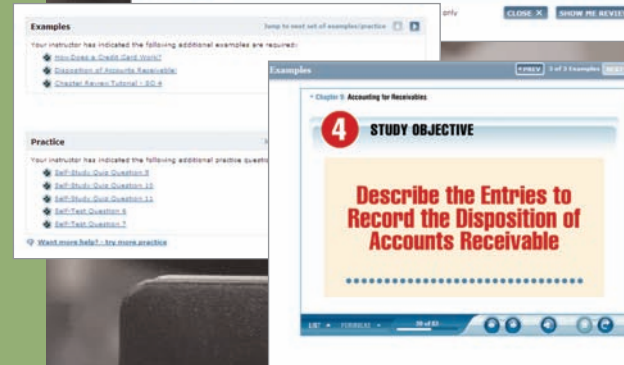
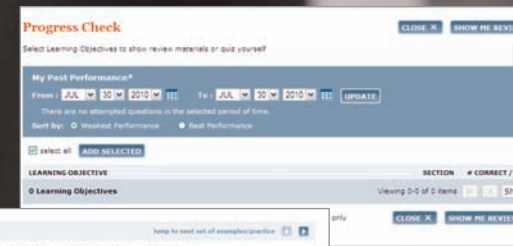
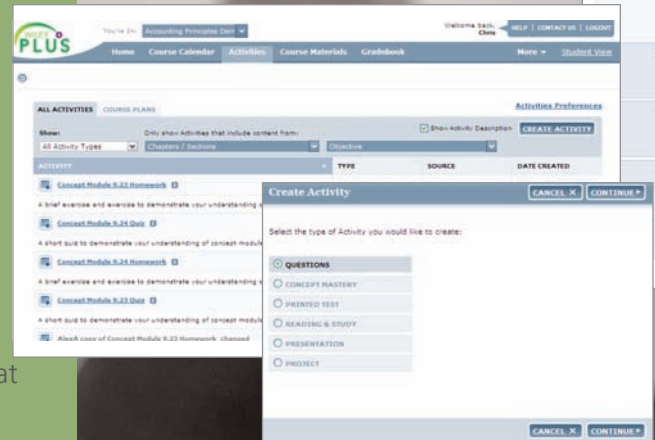
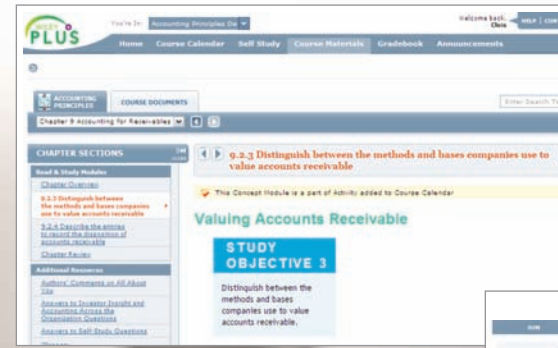
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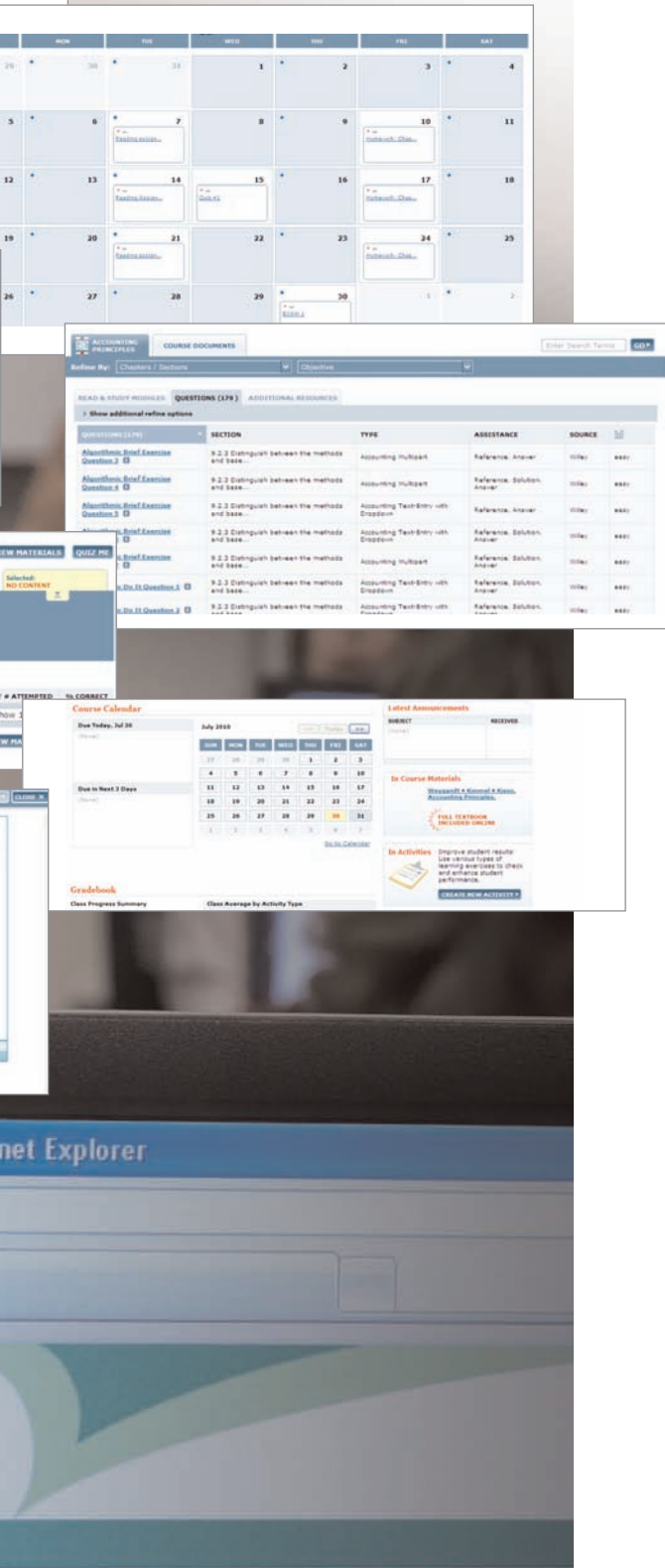
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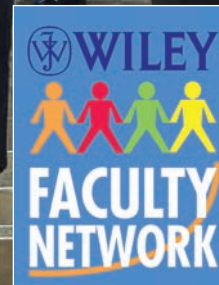
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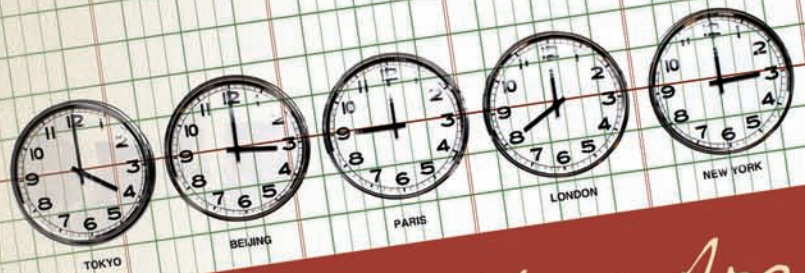
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The Accounting Cycle

For many students, success in an introductory accounting course hinges on developing a sound conceptual understanding of the accounting cycle. In the past, we have received positive feedback regarding the framework that we have employed to introduce the recording process in Chapter 3. In this edition, we have expanded our use of this framework to cover the entire accounting cycle in Chapters 3 and 4.

Anatomy of a Fraud

In the Fifth Edition, we added a new feature, called *Anatomy of a Fraud*, to Chapter 7 to illustrate how the lack of specific internal controls resulted in real-world frauds. Many users responded favorably to this new feature and requested that we expand it throughout the textbook to demonstrate the importance of internal controls to all assets and liabilities. Accordingly, in this edition, we have expanded the *Anatomy of a Fraud* feature to Chapters 5–13.

Chart of Accounts

It is important to always try to eliminate unnecessary barriers to student understanding. Sometimes, the accounting course can seem unnecessarily complicated to students because so many account titles are used. In order to reduce possible confusion, and to keep students focused on those concepts that really matter, in this edition of the textbook we undertook to reduce the number of account titles used. In some chapters, we were able to cut the number of accounts used by more than half. See inside the front cover of the textbook for a sample chart of accounts, which represents the majority of account titles used in the text.

Enhanced Homework Material

In each chapter, we have revised all Self-Test Questions, Questions, Brief Exercises, Do it! Review, Exercises, Problems, and Research Cases. New *Challenge Exercises* are available online at the textbook companion website and offer another resource for students to practice chapter concepts. Bloom's taxonomy codes have been added to end-of-chapter material. Financial analysis and reporting problems have been updated in accordance with the new **Tootsie Roll** and **Hershey** financial statements. Finally, new *FASB Codification Activities* now appear at the end of every chapter and offer students experience in using this system.

Updated International Financial Reporting Standards (IFRS) Content

As we continue to strive to reflect the constant changes in the accounting environment, we have added new material on International Financial Reporting Standards (IFRS). A new end-of-chapter section, *A Look at IFRS*, includes an overview section, differences between GAAP and IFRS, IFRS/GAAP convergence efforts, and IFRS Self-Test Questions and IFRS Concepts and Applications. An international financial reporting problem is also included, based on **Zetar plc** (a U.K. candy company) financial statements, provided in a new Appendix C of the textbook. This will allow students to compare Zetar with U.S. companies Tootsie Roll and Hershey.

This edition was also subject to an overall, comprehensive revision to ensure that it is technically accurate, relevant, and up-to-date. A chapter-by-chapter summary of content changes is provided in the chart on the next page.

Chapter 1 Introduction to Financial Statements

- More background information/student involvement with hypothetical company Sierra Corporation.
- Interrelationships of Statements illustration rewritten, using Tootsie Roll instead of Sierra Corporation as example. As a result, A Quick Look at **Tootsie Roll's** Financial Statements section deleted.
- Updated end-of-chapter material with new data.

Chapter 2 A Further Look at Financial Statements

- Use of **hhgregg** instead of **Circuit City**, as comparison to **Best Buy** performance.
- Using the Statement of Cash Flows section deleted, as material covered in following *Keeping an Eye on Cash* section.
- Financial Reporting Concepts section heavily rewritten. The Standard-Setting Environment now includes IASB/IFRS discussion, as well as most recent conceptual framework material (e.g., fundamental and enhancing qualities of useful accounting information). Measurement principles now include cost and fair value; constraints are now materiality and cost (instead of conservatism).
- Updated end-of-chapter material with new data.

Chapter 3 The Accounting Information System

- For all transaction events, have reformatted to be consistent, that is, have added Basic Analysis and Equation Analysis sections.
- Updated end-of-chapter material with new data and a new Exercise.

Chapter 4 Accrual Accounting Concepts

- Terminology changes: Matching principle to expense recognition principle; time period assumption to periodicity assumption.
- 2 new *Insight* boxes: one *Business Insight* on iPhone/**Apple**, other *Int'l Insight* on China's inconsistent use of accrual/cash basis of accounting.
- Consistent use of transaction analysis format (e.g., Basic Analysis, Equation Analysis, Debit-Credit Analysis, Journal Entry, and Posting) for Adjusting Entries examples, carried over from Chapter 3.
- Updated end-of-chapter material with new data and added a new Research Case.

Chapter 5 Merchandising Operations and the Multiple-Step Income Statement

- Addition of *Anatomy of a Fraud* box (previously only included in Chapter 7).
- Updated end-of-chapter material with new data and added a new Research Case.

Chapter 6 Reporting and Analyzing Inventory

- Addition of *Anatomy of a Fraud* box.
- Updated end-of-chapter material with new data and added a new Research Case.

Chapter 7 Fraud, Internal Control, and Cash

- Replaced Investor Insight box with new one on Madoff's Ponzi scheme.
- Updated end-of-chapter material and added a new Research Case, new Ethics Case on NFIC.

Chapter 8 Reporting and Analyzing Receivables

- More journal entry detail in the Recognizing Accounts Receivable section.
- Additional explanation about percentage of receivables basis.

- New *Anatomy of a Fraud* box.
- Explanation of maturity date of promissory note, in *Determining the Maturity Date* section.
- New *Int'l Insight* box on fair value, and new AATO box on eBay for receivables (Receivables Exchange).
- Updated end-of-chapter material and added 2 new Brief Exercises and a new Research Case.

Chapter 9 Reporting and Analyzing Long-Lived Assets

- Expanded explanation for how to determine revised depreciation, including new *Do it!* box.
- New *Anatomy of a Fraud* box about **WorldCom**.
- Updated end-of-chapter material and added a new *Do it!* Review.

Chapter 10 Reporting and Analyzing Liabilities

- Heavy edit of Feature Story, about U.S. auto industry.
- New *Anatomy of a Fraud* box about school district substitute-teacher fraud scheme.
- New *Investor Insight* box on debt masking.
- Updated end-of-chapter material and added 1 new Self-Test Question, 3 new Brief Exercises, 1 new Exercise, and a new Research Case.

Chapter 11 Reporting and Analyzing Stockholders' Equity

- Replaced AATO box with box on **Facebook** maintaining its private-company status.
- New *Anatomy of a Fraud* box on **SafeNet's** stock options being misused by top officers.
- New *Investor Insight* box on Warren Buffett's philosophy of keeping **Berkshire Hathaway's** stock prices high as well as avoiding stock splits.
- Updated end-of-chapter material and added 1 new Brief Exercise and a new Research Case.

Chapter 12 Statement of Cash Flows

- New *Anatomy of a Fraud* box, about **Parmalat's** multiple frauds.
- **New Appendix 12B**, on preparing statement of cash flows using T accounts.
- Updated end-of-chapter material and added a new Research Case.

Chapter 13 Financial Analysis: The Big Picture

- New Feature Story with profile of Warren Buffett.
- Replaced financial data with hypothetical company, as better basis for later comparison with **General Mills**.
- New *Anatomy of a Fraud* box, about how relationships between numbers can be used to detect fraud.
- New *Investor Insight* box, about credit rating agencies.
- Updated end-of-chapter material and added a new Research Case.

End-of-Textbook

New Appendix C, financial statements of **Zetar plc** (U.K. candy company).

Appendix D: Updated end-of-chapter material.

Acknowledgments

Financial Accounting has benefited greatly from the input of focus group participants, manuscript reviewers, those who have sent comments by letter or e-mail, ancillary authors, and proofers. We greatly appreciate the constructive suggestions and innovative ideas of reviewers and the creativity and accuracy of the ancillary authors and checkers.

Prior Editions

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Textbook Companion Website

On this website, instructors will find electronic versions of the Solutions Manual, Test Bank, Instructor's Manual, Computerized Test Bank, and other resources.

Wiley Faculty Network

When it comes to improving the classroom experience, there is no better source of ideas and inspiration than your fellow colleagues. The Wiley Faculty Network connects teachers with technologies, facilitates the exchange of best practices, and helps to enhance instructional efficiency and effectiveness. For details, visit www.wherefacultyconnect.com.

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An extensive support package, including print and technology tools, helps you maximize your teaching effectiveness. We offer useful supplements for instructors with varying levels of experience and different instructional circumstances.

Instructor's Resource CD.

The Instructor's Resource CD (IRCD) contains an electronic version of all instructor supplements. The IRCD gives you the flexibility to access and prepare instructional materials based on your individual needs.

Solutions Manual.

The Solutions Manual contains detailed solutions to all questions, brief exercises, exercises, and problems in the textbook as well as suggested answers to the questions and cases.

Solution Transparencies.

The solution transparencies feature detailed solutions to brief exercises, exercises, problems, and "Broadening Your Perspectives" activities. Transparencies can be easily ordered from the Instructor's textbook companion website.

Instructor's Manual.

Included in each chapter are lecture outlines with teaching tips, chapter reviews, illustrations, and review quizzes.

Teaching Transparencies.

The teaching transparencies are 4-color acetate images of the illustrations found in the Instructor's Manual. Transparencies can be easily ordered from the Instructor's textbook companion website.

Test Bank and Computerized Test Bank.

The test bank and computerized test bank allow instructors to tailor examinations according to study objectives and Bloom's taxonomy. Achievement tests, comprehensive examinations, and a final exam are included.

PowerPoint™.

The new PowerPoint™ presentations contain a combination of key concepts, images and problems from the textbook. Review exercises and "All About You" summaries are included in each chapter to encourage classroom participation.

WebCT and Desire2Learn.

WebCT or Desire2Learn offer an integrated set of course management tools that enable instructors to easily design, develop, and manage Web-based and Web-enhanced courses.

For Students

Active-Learning Aids

Textbook Companion Website.

The Financial Accounting student website provides a wealth of support materials that will help students develop their conceptual understanding of class material and increase their ability to solve problems. On this website, students will find Excel templates, PowerPoint presentations, web quizzing, and other resources. In addition, students can access the new B Exercises and C Problems at this site. Finally, full versions of the Continuing Cookie Chronicle problem are included at the student website.

Working Papers.

Working papers are partially completed accounting forms (templates) for all end-of-chapter brief exercises, exercises, problems, and cases. They are a convenient resource for organizing and completing homework assignments, and they demonstrate how to correctly set up solution formats. Also available on CD-ROM and within *WileyPLUS* is an electronic version of the print working papers, which are Excel-formatted templates that will help you learn to properly format and present end-of-chapter textbook solutions.

Study Guide.

The Study Guide is a comprehensive review of accounting. It guides you through chapter content, tied to study objectives. Each chapter of the Study Guide includes a chapter review and for extra practice, true/false, multiple-choice, matching questions, and problems, with solutions. The Study Guide is an excellent tool for use on a regular basis during the course and also when preparing for exams.

Primer on Using Excel in Accounting.

This online manual and collection of Excel templates allow students to complete select end-of-chapter exercises and problems identified by a spreadsheet icon in the textbook.

Mobile Applications.

Quizzing and reviewing content is available for download to an iPod and/or other mobile devices.



Student Owner's Manual

Using Your Textbook Effectively

Helpful Hints in the margins further clarify concepts being discussed. They are like having an instructor with you as you read.

Ethics Note Managers who are not owners are often compensated based on the performance of the company. They thus may be tempted to exaggerate company performance by inflating income figures.

The chief executive officer (CEO) has overall responsibility for the business. As the organization chart shows, the CEO delegates responsibilities to other officers. The chief accounting officer is the **controller**. The controller's responsibilities are to (1) maintain the accounting records, (2) coordinate the internal control system of internal control, and (3) prepare financial statements, tax returns, and internal reports. The **treasurer** has custody of the corporation's funds and is responsible for maintaining the company's cash position.

The organizational structure of a corporation enables a company to hire professional managers to run the business. On the other hand, the separation of ownership and management often reduces an owner's ability to actively manage the company.

Helpful Hint Stock is sometimes issued in exchange for services (payment to attorneys or consultants, for example) or for noncash assets (land or buildings). The value recorded for the shares issued is determined by either the market value of the shares or the value of the good or service received, depending upon which value the company can more readily determine.

we discuss the accounting for paid-in capital. In a later section, we discuss retained earnings.

Let's now look at how to account for new issues of common stock. The primary objectives in accounting for the issuance of common stock are (1) to identify the specific sources of paid-in capital and (2) to maintain the distinction between paid-in capital and retained earnings. As shown below, **the issuance of common stock affects only paid-in capital accounts.**

As discussed earlier, par value does not indicate a stock's market value. The cash proceeds from issuing par value stock may be equal to, greater than, or less than par value. When a company records the issuance of common stock for cash, it credits the par value of the shares to Common Stock, and records in a separate paid-in capital account the portion of the proceeds that is above or below par value.

Ethics Notes and International Notes point out ethical and international points related to the nearby text discussion.

Insight examples give you more glimpses into how actual companies make decisions using accounting information. These high-interest boxes focus on various themes—ethics, international, and investor concerns.

A **critical thinking question** asks you to apply your accounting learning to the story in the example. *Guideline Answers* appear at the end of the chapter.



Investor Insight

How to Read Stock Quotes

Organized exchanges trade the stock of publicly held companies at dollar prices per share established by the interaction between buyers and sellers. For each listed security, the financial press reports the high and low prices of the stock during the year, the total volume of stock traded on a given day, the high and low prices for the day, and the closing market price, with the net change for the day. Nike is listed on the New York Stock Exchange. Here is a recent listing for Nike:

Stock	52 Weeks		Volume	High	Low	Close	Net Change
	High	Low					
Nike	78.55	48.76	5,375,651	72.44	69.78	70.61	-1.69

These numbers indicate the following: The high and low market prices for the last 52 weeks have been \$78.55 and \$48.76. The trading volume for the day was 5,375,651 shares. The high, low, and closing prices for that date were \$72.44, \$69.78, and \$70.61, respectively. The net change for the day was a decrease of \$1.69 per share.

? For stocks traded on organized exchanges, how are the dollar prices per share established? What factors might influence the price of shares in the marketplace? (See page 619.)



Accounting Across the Organization

Wall Street No Friend of Facebook

In the 1990s, it was the dream of every young technology entrepreneur to start a company and do an initial public offering (IPO), that is, list company shares on a stock exchange. It seemed like there was a never-ending supply of 20-something year-old technology entrepreneurs that made millions doing IPOs of companies that never made a profit and eventually failed. In sharp contrast to this is Mark Zuckerberg, the 25-year-old founder and CEO of Facebook. If Facebook did an IPO, he would make billions of dollars. But, he is in no hurry to go public. Because his company doesn't need to invest in factories, distribution systems, or even marketing, it doesn't need to raise a lot of cash. Also, by not going public, Zuckerberg has more control over the direction of the company. Right now, he and the other founders don't have to answer to outside shareholders, who might be more concerned about short-term investment horizons rather than long-term goals. In addition, publicly traded companies face many more financial reporting disclosure requirements.

Source: Jessica E. Vascellaro, "Facebook CEO in No Rush to 'Friend' Wall Street," *Wall Street Journal Online* (March 4, 2010).

? Why has Mark Zuckerberg, the CEO and founder of Facebook, delayed taking his company's shares public through an initial public offering (IPO)? (See page 618.)



Accounting Across the Organization examples show the use of accounting by people in non-accounting functions—such as finance, marketing, or management.

Guideline Answers to the critical thinking questions appear at the end of the chapter.

Anatomy of a Fraud boxes illustrate how the lack of specific internal controls resulted in real-world frauds.

ANATOMY OF A FRAUD

The president, chief operating officer, and chief financial officer of SafeNet, a software encryption company, were each awarded employee stock options by the company's board of directors as part of their compensation package. Stock options enable an employee to buy a company's stock sometime in the future at the price that existed when the stock option was awarded. For example, suppose that you received stock options today, when the stock price of your company was \$30. Three years later, if the stock price rose to \$100, you could "exercise" your options and buy the stock for \$30 per share, thereby making \$70 per share. After being awarded their stock options, the three employees changed the award dates in the company's records to dates in the past, when the company's stock was trading at historical lows. For example, using the previous example, they would choose a past date when the stock was selling for \$10 per share, rather than the \$30 price on the actual

Brief **Do it!** exercises ask you to put to work your newly acquired knowledge. They outline an **Action Plan** necessary to complete the exercise, and they show a **Solution**.

before you go on...

Do it! Indicate whether each of the following statements is true or false.

- ___ 1. Similar to partners in a partnership, stockholders of a corporation have unlimited liability.
- ___ 2. It is relatively easy for a corporation to obtain capital through the issuance of stock.
- ___ 3. The separation of ownership and management is an advantage of the corporate form of business.
- ___ 4. The journal entry to record the authorization of capital stock includes a credit to the appropriate capital stock account.
- ___ 5. All states require a par value per share for capital stock.

CORPORATE ORGANIZATION

Action Plan

- Review the characteristics of a corporation and understand which are advantages and which are disadvantages.
- Understand that corporations

Solution

1. False. The liability of stockholders is normally limited to their investment in the corporation.
2. True.

Comprehensive Do it!

Rolman Corporation is authorized to issue 1,000,000 shares of \$5 par value common stock. In its first year, the company has the following stock transactions.

Jan. 10 Issued 400,000 shares of stock at \$8 per share.
 Sept. 1 Purchased 10,000 shares of common stock for the treasury at \$9 per share.
 Dec. 24 Declared a cash dividend of 10 cents per share on common stock outstanding.

Instructions

- (a) Journalize the transactions.
- (b) Prepare the stockholders' equity section of the balance sheet, assuming the company had retained earnings of \$150,600 at December 31.

Comprehensive Do it! problem with **Action Plan**- gives students an opportunity to see a detailed solution to a representative problem before they do their homework. Coincides with the Do it! problems within the chapter.

Do it! Review problems appear in the homework material and provide another way for students to determine whether they have mastered the content in the chapters.

Accounting equation analyses appear next to key journal entries. They will help students understand the impact of an accounting transaction on the components of the accounting equation, on the stockholders' equity accounts, and on the company's cash flows.

Declaration Date

Dec. 1	Cash Dividends Dividends Payable (To record declaration of cash dividend)	50,000	50,000	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 20%; text-align: center;">A</td> <td style="width: 10%; text-align: center;">=</td> <td style="width: 20%; text-align: center;">L</td> <td style="width: 10%; text-align: center;">+</td> <td style="width: 30%; text-align: center;">SE</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">-50,000 Div</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">+50,000</td> </tr> </table>	A	=	L	+	SE					-50,000 Div					+50,000
A	=	L	+	SE															
				-50,000 Div															
				+50,000															

Cash Flows
no effect

In Chapter 3, we used an account called Dividends to record a cash dividend. Here, we use the more specific title Cash Dividends to differentiate from other types of dividends, such as stock dividends. Dividends Payable is a current liability: It will normally be paid within the next several months.

At the **record date**, the company determines ownership of the outstanding shares for dividend purposes. The stockholders' records maintained by the corporation supply this information.

For Media General, the record date is December 22. No entry is required on the record date.

Helpful Hint: The record date is important in determining the dividend to be paid to each stockholder.

Illustration 11-15
Disclosure of unrestricted retained earnings

TEKTRONIX INC.
Notes to the Financial Statements

Certain of the Company's debt agreements require compliance with debt covenants. The Company had unrestricted retained earnings of \$223.8 million after meeting those requirements.

Financial Statements appear regularly. Those from actual companies are identified by a company logo or a photo.

Decision Toolkits highlight the important analytical tools integrated throughout the textbook, designed to assist students in evaluating and using the information at hand.

DECISION TOOLKIT A SUMMARY

DECISION CHECKPOINTS	INFO NEEDED FOR DECISION	TOOL TO USE FOR DECISION	HOW TO EVALUATE RESULTS
Should the company incorporate?	Capital needs, growth expectations, type of business, tax status	Corporations have limited liability, easier capital raising ability, and professional managers; but they suffer from additional taxes, government regulations, and separation of ownership from management.	Must carefully weigh the costs and benefits in light of the particular circumstances.

USING THE DECISION TOOLKIT

adidas is one of Nike's fiercest competitors. In such a competitive and rapidly changing environment, one wrong step can spell financial disaster.

Instructions

The following facts are available from adidas's annual report. As a German company, adidas reports under International Financial Reporting Standards (IFRS). Using this information, evaluate its (1) dividend record and (2) earnings performance, and contrast them with those for Nike for 2009 and 2008. Nike's earnings per share were \$3.07 in 2009 and \$3.80 in 2008.

(in millions)*	2008	2007	2006
Dividends declared	€99	€85	€66
Net income	€642	€551	€496
Preferred stock dividends	0	0	0
Shares outstanding at end of year	204	204	203
Common stockholders' equity	€3,400	€3,034	€2,836

*Nike has a year-end of May 31, 2009. For comparative purpose, we used adidas's December 31, 2008, data since that represents the closest year-end.

A **Using the Decision Toolkit** exercise, just before the chapter summary, asks students to use the decision tools presented in the chapter and takes them through the problem-solving steps.

KEEPING AN EYE ON CASH

The balance sheet presents the balances of a company's stockholders' equity accounts at a point in time. Companies report in the "Financing Activities" section of the statement of cash flows information regarding cash inflows and outflows during the year that resulted from equity transactions. The excerpt below presents the cash flows from financing activities from the statement of cash flows of **Sara Lee Corporation** in a recent year. From this information, we learn that the company's purchases of

Keeping an Eye on Cash sections highlight differences between accrual accounting and cash accounting while increasing students' understanding of the statement of cash flows.

Exercises: Set B and Challenge Exercises are available online at www.wiley.com/college/kimmel.

In the textbook, two similar sets of **Problems —A and B—**are keyed to the same study objectives.

Selected problems, identified by this icon, can be solved using the **General Ledger Software (GLS)** package.

An icon identifies **Exercises and Problems** that can be solved using Excel templates at the student website.

Exercises: Set B and Challenge Exercises

Visit the book's companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Exercise Set B and Challenge Exercises.

Problems: Set A

P11-1A Whitten Corporation was organized on January 1, 2012. It is authorized to issue 20,000 shares of 6%, \$50 par value preferred stock and 500,000 shares of no-par common stock with a stated value of \$1 per share. The following stock transactions were completed during the first year:

Jan.	10	Issued 70,000 shares of common stock for cash at \$4 per share.
Mar.	1	Issued 12,000 shares of preferred stock for cash at \$53 per share.
May	1	Issued 120,000 shares of common stock for cash at \$6 per share.
Sept.	1	Issued 5,000 shares of common stock for cash at \$5 per share.

Journalize stock transactions, post, and prepare paid-in capital section.

(SO 2, 4, 7), AN



Prepare a stockholders' equity section.

(SO 7), AP



P11-6A On January 1, 2012, Neville Inc. had these stockholders' equity balances.

Common Stock, \$1 par (2,000,000 shares authorized, 600,000 shares issued and outstanding)	\$ 600,000
Paid-in Capital in Excess of Par Value	1,500,000
Retained Earnings	700,000

Problems: Set C

Visit the book's companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Problem Set C.

An additional parallel set of **C Problems** appears at the textbook companion website.

The **Continuing Cookie Chronicle** exercise follows the continuing saga of accounting for a small business begun by an entrepreneurial student.

Continuing Cookie Chronicle

(Note: This is a continuation of the Cookie Chronicle from Chapters 1 through 10.)

CCC1

Part 1 Because Natalie has been so successful with Cookie Creations and her friend Curtis Lesperance has been just as successful with his coffee shop, they conclude that they could benefit from each other's business expertise. Curtis and Natalie next evaluate the different types of business organization. Because of the advantage of limited personal liability, they decide to form a corporation.

Natalie and Curtis are very excited about this new business venture. They come to you



The **Broadening Your Perspective** section helps to pull together concepts from the chapter and apply them to real-world business situations.

The **Financial Reporting Problem** focuses on reading and understanding the financial statements of **Tootsie Roll**, which are printed in Appendix A.

broadening your perspective

Financial Reporting and Analysis

FINANCIAL REPORTING PROBLEM: Tootsie Roll Industries, Inc.

BYP11-1 The stockholders' equity section of **Tootsie Roll Industries'** balance sheet is shown in the Consolidated Statement of Financial Position in Appendix A. You will also find data relative to this problem on other pages of Appendix A. (Note that **Tootsie Roll** has two classes of common stock. To answer the following questions, add the two classes of stock together.)

Instructions

Answer the following questions.

- What is the par or stated value per share of Tootsie Roll's common stock?
- What percentage of Tootsie Roll's authorized common stock was issued at December 31, 2009? (Round to the nearest full percent.)
- How many shares of common stock were outstanding at December 31, 2008, and at December 31, 2009?
- Calculate the payout ratio, earnings per share, and return on common stockholders' equity ratio for 2009.

COMPARATIVE ANALYSIS PROBLEM: Tootsie Roll vs. Hershey

COMPARATIVE ANALYSIS PROBLEM: Tootsie Roll vs. Hershey

BYP11-2 The financial statements of **The Hershey Company** are presented in Appendix B, following the financial statements for **Tootsie Roll** in Appendix A.



A **Comparative Analysis Problem** compares and contrasts the financial reporting of **Tootsie Roll** and **Hershey**.

FINANCIAL ANALYSIS ON THE WEB

BYP11-5 Purpose: Use the stockholders' equity section of an annual report and identify the major components.

Address: www.annualreports.com, or go to www.wiley.com/college/kimmel

Steps

- Select a particular company.
- Search by company name.
- Follow instructions below.

Exploring the Web exercises guide students to websites where they can find and analyze information related to the chapter topic.

RAPID REVIEW

Chapter Content

ACCOUNTING CONCEPTS (Chapters 2-4)

Fundamental Qualities	Enhancing Qualities	Assumptions	Principles	Constraints
Relevance Faithful representation	Comparability Consistency Verifiability Timeliness Understandability	Monetary unit Economic entity Periodicity Going concern Accrual basis	Cost Fair value Full disclosure Revenue recognition Expense recognition	Materiality Cost

BASIC ACCOUNTING EQUATION (Chapter 3)

Basic Equation	Assets		=	Liabilities		+	Stockholders' Equity									
Expanded Basic Equation	Assets		=	Liabilities		+	Common Stock		Retained Earnings		- Dividends		+ Revenues		- Expenses	
Debit / Credit Rules	Dr. +	Cr. -		Dr. -	Cr. +		Dr. -	Cr. +	Dr. -	Cr. +	Dr. +	Cr. -	Dr. -	Cr. +	Dr. +	Cr. -

INVENTORY (Chapters 5 and 6)

Ownership

Freight Terms	Ownership of goods on public carrier resides with:
FOB Shipping point	Buyer
FOB Destination	Seller

ADJUSTING ENTRIES (Chapter 4)

Type	Adjusting Entry
Deferrals	1. Prepaid expenses 2. Unearned revenues
Accruals	1. Accrued revenues 2. Accrued expenses

Note: Each adjusting entry will affect one or more income statement accounts and one or more balance sheet accounts.

Interest Computation

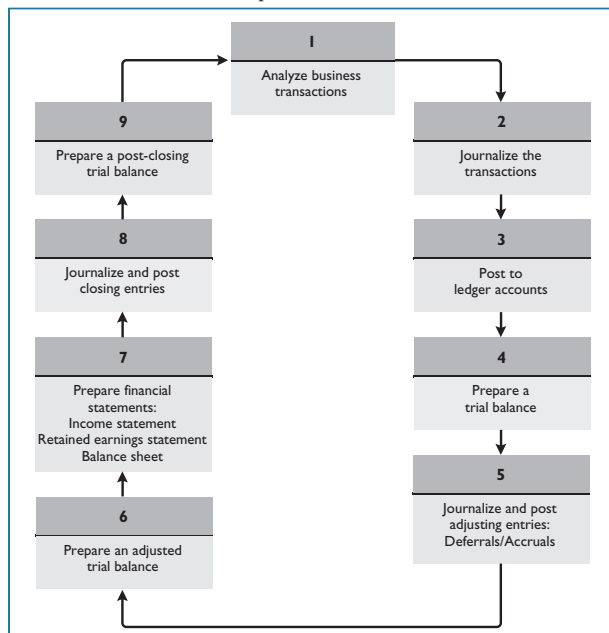
Interest = Face value of note × Annual interest rate × Time in terms of one year

CLOSING ENTRIES (Chapter 4)

Purpose

- Update the Retained Earnings account in the ledger by transferring net income (loss) and dividends to retained earnings.
- Prepare the temporary accounts (revenue, expense, dividends) for the next period's postings by reducing their balances to zero.

ACCOUNTING CYCLE (Chapter 4)



Perpetual vs. Periodic Journal Entries

Event	Perpetual	Periodic
Purchase of goods	Inventory Cash (A/P)	Purchases Cash (A/P)
Freight (shipping point)	Inventory Cash	Freight-in Cash
Return of goods	Cash (or A/P) Inventory	Cash (or A/P) Purchase Returns and Allowances
Sale of goods	Cash (or A/R) Sales Cost of Goods Sold Inventory	Cash (or A/R) Sales No entry
End of period	No entry	Closing or adjusting entry required

FRAUD, INTERNAL CONTROL, AND CASH (Chapter 7)

Principles of Internal Control

- Establishment of responsibility
- Segregation of duties
- Documentation procedures
- Physical controls
- Independent internal verification
- Human resource controls

The Fraud Triangle



Bank Reconciliation

Bank
Balance per bank statement
Add: Deposits in transit
Deduct: Outstanding checks
Adjusted cash balance

Books
Balance per books
Add: Unrecorded credit memoranda from bank statement
Deduct: Unrecorded debit memoranda from bank statement
Adjusted cash balance

- Note:
- Errors should be offset (added or deducted) on the side that made the error.
 - Adjusting journal entries should only be made for items affecting books.

STOP AND CHECK: Does the adjusted cash balance in the Cash account equal the reconciled balance?

RAPID REVIEW

Chapter Content

RECEIVABLES (Chapter 8)

Two Methods to Account for Uncollectible Accounts

Direct write-off method	Record bad debts expense when the company determines a particular account to be uncollectible.
Allowance method	At the end of each period, estimate the amount of uncollectible receivables. Debit Bad Debts Expense and credit Allowance for Doubtful Accounts in an amount that results in a balance in the allowance account equal to the estimate of uncollectibles. As specific accounts become uncollectible, debit Allowance for Doubtful Accounts and credit Accounts Receivable.

Steps to Manage Accounts Receivable

- Determine to whom to extend credit.
- Establish a payment period.
- Monitor collections.
- Evaluate the receivables balance.
- Accelerate cash receipts from receivables when necessary.

PLANT ASSETS (Chapter 9)

Computation of Annual Depreciation Expense

Straight-line	$\frac{\text{Cost} - \text{Salvage value}}{\text{Useful life (in years)}}$
Declining-balance	Book value at beginning of year \times Declining balance rate *Declining-balance rate = $1 \div \text{Useful life (in years)}$
*Units-of-activity	$\frac{\text{Depreciable cost}}{\text{Useful life (in units)}} \times \text{Units of activity during year}$

Note: If depreciation is calculated for partial periods, the straight-line and declining-balance methods must be adjusted for the relevant proportion of the year. Multiply the annual depreciation expense by the number of months expired in the year divided by 12 months.

BONDS (Chapter 10)

Premium	Market interest rate < Contractual interest rate
Face Value	Market interest rate = Contractual interest rate
Discount	Market interest rate > Contractual interest rate

Computation of Annual Bond Interest Expense

Interest expense = Interest paid (payable) + Amortization of discount
(OR - Amortization of premium)

*Straight-line amortization	Bond discount (premium) Number of interest periods	
*Effective-interest amortization (preferred method)	Bond interest expense	Bond interest paid
	Carrying value of bonds at beginning of period \times Effective-interest rate	Face amount of bonds \times Contractual interest rate

STOCKHOLDERS' EQUITY (Chapter 11)

No-Par Value vs. Par Value Stock Journal Entries

No-Par Value	Par Value
Cash Common Stock	Cash Common Stock (par value) Paid-in Capital in Excess of Par Value

Comparison of Dividend Effects

	Cash	Common Stock	Retained Earnings
Cash dividend	↓	No effect	↓
Stock dividend	No effect	↑	↓
Stock split	No effect	No effect	No effect

*Items with asterisk are covered in appendix.

STATEMENT OF CASH FLOWS (Chapter 12)

Cash flows from operating activities (indirect method)

Net income		
Add:	Amortization and depreciation	\$ X
	Losses on disposals of assets	X
	Decreases in current assets	X
	Increases in current liabilities	X
Deduct:	Increases in current assets	(X)
	Decreases in current liabilities	(X)
	Gains on disposals of assets	(X)
Cash provided (used) by operating activities		<u>\$ X</u>

Cash flows from operating activities (direct method)

Cash receipts		
	(Examples: from sales of goods and services to customers, from receipts of interest and dividends)	\$ X
Cash payments		
	(Examples: to suppliers, for operating expenses, for interest, for taxes)	(X)
Cash provided (used) by operating activities		<u>\$ X</u>

FINANCIAL STATEMENT ANALYSIS (Chapter 13)

Discontinued operations	Income statement (presented separately after "Income from continuing operations")
Extraordinary items	Income statement (presented separately after "Discontinued operations")
Changes in accounting principle	In most instances, use the new method in current period and restate previous years' results using new method. For changes in depreciation and amortization methods, use the new method in the current period, but do not restate previous periods.

Income Statement and Comprehensive Income

Sales	\$ XX
Cost of goods sold	<u>XX</u>
Gross profit	XX
Operating expenses	<u>XX</u>
Income from operations	XX
Other revenues (expenses) and gains (losses)	<u>XX</u>
Income before income taxes	XX
Income tax expense	<u>XX</u>
Income before irregular items	XX
Irregular items (net of tax)	<u>XX</u>
Net income	XX
Other comprehensive income items (net of tax)	<u>XX</u>
Comprehensive income	<u>\$ XX</u>

INVESTMENTS (Appendix E)

Comparison of Long-Term Bond Investment and Liability Journal Entries

Event	Investor	Investee
Purchase / issue of bonds	Debt Investments Cash	Cash Bonds Payable
Interest receipt / payment	Cash Interest Revenue	Interest Expense Cash

Comparison of Cost and Equity Methods of Accounting for Long-Term Stock Investments

Event	Cost	Equity
Acquisition	Stock Investments Cash	Stock Investments Cash
Investee reports earnings	No entry	Stock Investments Investment Revenue
Investee pays dividends	Cash Dividend Revenue	Cash Stock Investments

RAPID REVIEW

Financial Statements

Order of Preparation	Date
1. Income statement	For the period ended
2. Retained earnings statement	For the period ended
3. Balance sheet	As of the end of the period
4. Statement of cash flows	For the period ended

Income Statement (perpetual inventory system)

Name of Company Income Statement For the Period Ended			
Sales revenues			
Sales	\$ X		
Less: Sales returns and allowances	X		
Sales discounts	<u>X</u>		
Net sales		\$ X	
Cost of goods sold		<u>X</u>	
Gross profit		X	
Operating expenses			
(Examples: store salaries, advertising, delivery, rent, depreciation, utilities, insurance)		<u>X</u>	
Income from operations			X
Other revenues and gains			
(Examples: interest, gains)	X		
Other expenses and losses			
(Examples: interest, losses)	<u>X</u>	<u>X</u>	
Income before income taxes			X
Income tax expense		<u>X</u>	
Net income			<u>\$ X</u>

Income Statement (periodic inventory system)

Name of Company Income Statement For the Period Ended			
Sales revenues			
Sales	\$ X		
Less: Sales returns and allowances	X		
Sales discounts	<u>X</u>		
Net sales		\$ X	
Cost of goods sold			
Beginning inventory		X	
Purchases	\$ X		
Less: Purchase returns and allowances	<u>X</u>		
Net purchases	X		
Add: Freight in	<u>X</u>		
Cost of goods purchased		<u>X</u>	
Cost of goods available for sale		X	
Less: Ending inventory		<u>X</u>	
Cost of goods sold			X
Gross profit			X
Operating expenses			
(Examples: store salaries, advertising, delivery, rent, depreciation, utilities, insurance)		<u>X</u>	
Income from operations			X
Other revenues and gains			
(Examples: interest, gains)	X		
Other expenses and losses			
(Examples: interest, losses)	<u>X</u>	<u>X</u>	
Income before income taxes			X
Income tax expense		<u>X</u>	
Net income			<u>\$ X</u>

Retained Earnings Statement

Name of Company Retained Earnings Statement For the Period Ended	
Retained earnings, beginning of period	\$ X
Add: Net income (or deduct net loss)	<u>X</u>
	X
Deduct: Dividends	<u>X</u>
Retained earnings, end of period	<u>\$ X</u>

STOP AND CHECK: Net income (loss) presented on the retained earnings statement must equal the net income (loss) presented on the income statement.

Balance Sheet

Name of Company Balance Sheet As of the End of the Period			
Assets			
Current assets			
(Examples: cash, short-term investments, accounts receivable, inventory, prepaids)			
			\$ X
Long-term investments			
(Examples: investments in bonds, investments in stocks)			
			X
Property, plant, and equipment			
Land			\$ X
Buildings and equipment	\$ X		
Less: Accumulated depreciation	<u>X</u>	<u>X</u>	
Intangible assets			<u>X</u>
Total assets			<u>\$ X</u>
Liabilities and Stockholders' Equity			
Liabilities			
Current liabilities			
(Examples: notes payable, accounts payable, accruals, unearned revenues, current portion of notes payable)			
			\$ X
Long-term liabilities			
(Examples: notes payable, bonds payable)			
			<u>X</u>
Total liabilities			X
Stockholders' equity			
Common stock			X
Retained earnings			<u>X</u>
Total liabilities and stockholders' equity			<u>\$ X</u>

STOP AND CHECK: Total assets on the balance sheet must equal total liabilities plus stockholders' equity; and, ending retained earnings on the balance sheet must equal ending retained earnings on the retained earnings statement.

Statement of Cash Flows

Name of Company Statement of Cash Flows For the Period Ended	
Cash flows from operating activities	
Note: May be prepared using the direct or indirect method	
Cash provided (used) by operating activities	\$ X
Cash flows from investing activities	
(Examples: purchase / sale of long-term assets)	
Cash provided (used) by investing activities	X
Cash flows from financing activities	
(Examples: issue / repayment of long-term liabilities, issue of stock, payment of dividends)	
Cash provided (used) by financing activities	<u>X</u>
Net increase (decrease) in cash	X
Cash, beginning of the period	<u>X</u>
Cash, end of the period	<u>\$ X</u>

STOP AND CHECK: Cash, end of the period, on the statement of cash flows must equal cash presented on the balance sheet.

TOOLS FOR ANALYSIS

Liquidity

Working capital	Current assets – Current liabilities	p. 59
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	p. 59
Current cash debt coverage ratio	$\frac{\text{Cash provided by operations}}{\text{Average current liabilities}}$	p. 643
Inventory turnover ratio	$\frac{\text{Cost of goods sold}}{\text{Average inventory}}$	p. 297
Days in inventory	$\frac{365 \text{ days}}{\text{Inventory turnover ratio}}$	p. 297
Receivables turnover ratio	$\frac{\text{Net credit sales}}{\text{Average net receivables}}$	p. 415
Average collection period	$\frac{365 \text{ days}}{\text{Receivables turnover ratio}}$	p. 415

Solvency

Debt to total assets ratio	$\frac{\text{Total liabilities}}{\text{Total assets}}$	p. 60
Cash debt coverage ratio	$\frac{\text{Cash provided by operations}}{\text{Average total liabilities}}$	p. 644
Times interest earned ratio	$\frac{\text{Net income} + \text{Interest expense} + \text{Tax expense}}{\text{Interest expense}}$	p. 529
Free cash flow	Cash provided by operations – Capital expenditures – Cash dividends	p. 62

Profitability

Earnings per share	$\frac{\text{Net income} - \text{Preferred stock dividends}}{\text{Average common shares outstanding}}$	p. 56
Price-earnings ratio	$\frac{\text{Stock price per share}}{\text{Earnings per share}}$	p. 703
Gross profit rate	$\frac{\text{Gross profit}}{\text{Net sales}}$	p. 246
Profit margin ratio	$\frac{\text{Net income}}{\text{Net sales}}$	p. 247
Return on assets ratio	$\frac{\text{Net income}}{\text{Average total assets}}$	p. 467
Asset turnover ratio	$\frac{\text{Net sales}}{\text{Average total assets}}$	p. 468
Payout ratio	$\frac{\text{Cash dividends declared on common stock}}{\text{Net income}}$	p. 593
Return on common stockholders' equity ratio	$\frac{\text{Net income} - \text{Preferred stock dividends}}{\text{Average common stockholders' equity}}$	p. 594

Critical Thinking

DECISION MAKING ACROSS THE ORGANIZATION

BYP11-6 During a recent period, the fast-food chain **Wendy's International** purchased many treasury shares. This caused the number of shares outstanding to fall from 124 million to 105 million. The following information was drawn from the company's financial statements (in millions).

	Information for the Year after Purchase of Treasury Stock	Information for the Year before Purchase of Treasury Stock
Net income	\$ 193.6	\$ 123.4
Total assets	2,076.0	1,837.9
Average total assets	2,016.9	1,889.8
Total common stockholders' equity	1,029.8	1,068.1
Average common stockholders' equity	1,078.0	1,126.2
Total liabilities	1,046.3	769.9
Average total liabilities	939.0	763.7
Interest expense	30.2	19.8
Income taxes	113.7	84.3
Cash provided by operations	305.2	233.8
Cash dividends paid on common stock	26.8	31.0
Preferred stock dividends	0	0
Average number of common shares outstanding	109.7	119.9

Decision Making Across the Organization cases help students build decision-making skills by analyzing accounting information in a less structured situation. These cases require teams of students to evaluate a manager's decision or lead to a decision among alternative courses of action.

Ethics Cases ask students to reflect on typical ethical dilemmas, analyze the stakeholders and the issues involved, and decide on an appropriate course of action.

ETHICS CASES



BYP11-8 The R&D division of Mozy Corp. has just developed a chemical for sterilizing the vicious Brazilian "killer bees" which are invading Mexico and the southern United States. The president of Mozy is anxious to get the chemical on the market because Mozy profits need a boost—and his job is in jeopardy because of decreasing sales and profits. Mozy has an opportunity to sell this chemical in Central American countries, where the laws are much more relaxed than in the United States.

The director of Mozy's R&D division strongly recommends further research in the laboratory to test the side effects of this chemical on other insects, birds, animals, plants, and even humans. He cautions the president, "We could be sued from all sides if the chemical has tragic side effects that we didn't even test for in the lab." The president answers, "We can't wait an additional year for your lab tests. We can avoid losses from such lawsuits by establishing a separate wholly owned



IFRS A Look at IFRS

It is often difficult for companies to determine in what time period they should report particular revenues and expenses. Both the IASB and FASB are working on a joint project to develop a common conceptual framework, as well as a revenue recognition project, that will enable companies to better use the same principles to record transactions consistently over time.

KEY POINTS


- In this chapter, you learned accrual-basis accounting applied under GAAP. Companies applying IFRS also use accrual-basis accounting to ensure that they record transactions that change a company's financial statements in the period in which events occur.
- Similar to GAAP, cash-basis accounting is not in accordance with IFRS.
- IFRS also divides the economic life of companies into artificial time periods. Under both GAAP and IFRS, this is referred to as the *periodicity assumption*.
- IFRS requires that companies present a complete set of financial statements, including comparative information annually.
- GAAP has more than 100 rules dealing with revenue recognition. Many of these rules are industry-specific. In contrast, revenue recognition under IFRS is determined primarily by a single standard. Despite this large disparity in the amount of detailed guidance devoted to revenue recognition, the **general** revenue recognition principles required by GAAP that are used in this textbook are similar to those under IFRS.
- As the Feature Story illustrates, revenue recognition fraud is a major issue in U.S. financial reporting. The same situation occurs in other countries, as evidenced by revenue recognition breakdowns of Dutch software company *Repsol NV*, Japanese electronics giant *NFC*, and Dutch

A Look at IFRS provides an overview of the International Financial Reporting Standards (IFRS) that relate to the chapter topics, highlights the differences between GAAP and IFRS, discusses IFRS/GAAP convergence efforts, and tests students' understanding through *IFRS Self-Test Questions* and *IFRS Concepts and Application*.

INTRODUCTION TO FINANCIAL STATEMENTS



the navigator

- Scan Study Objectives
- Read Feature Story
- Scan Preview
- Read Text and Answer **Do it!**
p. 5 p. 11 p. 18 p. 20
- Work Using the Decision Toolkit
- Review Summary of Study Objectives
- Work Comprehensive **Do it!** p. 23
- Answer Self-Test Questions
- Complete Assignments
- Go to WileyPLUS for practice and tutorials
-  Read A Look at IFRS p. 42

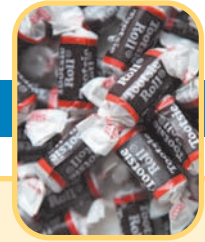
study objectives

After studying this chapter, you should be able to:

- 1 Describe the primary forms of business organization.
- 2 Identify the users and uses of accounting information.
- 3 Explain the three principal types of business activity.
- 4 Describe the content and purpose of each of the financial statements.
- 5 Explain the meaning of assets, liabilities, and stockholders' equity, and state the basic accounting equation.
- 6 Describe the components that supplement the financial statements in an annual report.



The Navigator is a learning system designed to prompt you to use the learning aids in the chapter and to set priorities as you study.



Many students who take this course do not plan to be accountants. If you are in that group, you might be thinking, “If I’m not going to be an accountant, why do I need to know accounting?” In response, consider this quote from Harold Geneen, the former chairman of **IT&T**: “To be good at your business, you have to know the numbers—cold.” Success in any business comes back to the numbers. You will rely on them to make decisions, and managers will use them to evaluate your performance. That is true whether your job involves marketing, production, management, or information systems.

In business, accounting and financial statements are the means for communicating the numbers. If you don’t know how to read financial statements, you can’t really know your business.

Many companies spend significant resources teaching their employees basic accounting so that they can read financial statements and understand how their actions affect the company’s financial results. One such company is **Springfield ReManufacturing Corporation (SRC)**. When Jack Stack and 11 other managers purchased SRC for 10 cents a share, it was a failing division of **International Harvester**. Jack’s 119 employees were counting on him for their livelihood. He decided that for the company to survive, every employee needed to think like a businessperson and to act like an owner. To accomplish this, all employees at SRC took basic accounting courses and participated in weekly reviews of the company’s financial statements. SRC survived, and eventually thrived. To this day, every employee (now numbering more than 1,000) undergoes this same training.

KNOWING THE NUMBERS

Many other companies have adopted this approach, which is called “open-book management.” Even in companies that do not practice open-book management, employers generally assume that managers in all areas of the company are “financially literate.”

Taking this course will go a long way to making you financially literate. In this book you will learn how to read and prepare financial statements, and how to use basic tools to evaluate financial results. In this first chapter we will introduce you to the financial statements of a real company whose

products you are probably familiar with—**Tootsie Roll**. Tootsie Roll’s presentation of its financial results is complete, yet also relatively easy to understand.

Tootsie Roll started off humbly in 1896 in a small New York City candy shop owned by an Austrian immigrant, Leo Hirshfield. The candy’s name came from his five-year-old daughter’s nickname—“Tootsie.” Today the Chicago-based company produces more than 49 million Tootsie Rolls and 16 million Tootsie Pops *each day*. In fact, Tootsie Pops are at the center of one of science’s most challenging questions: How many licks does it take to get to the Tootsie Roll center of a Tootsie Pop? The answer varies: Licking machines created at Purdue University and the University of Michigan report an average of 364 and 411 licks, respectively. In studies using human lickers, the answer ranges from 144 to 252. We recommend that you take a few minutes today away from your studies to determine your own results.

Source: Tootsie Roll information adapted from www.tootsie.com.



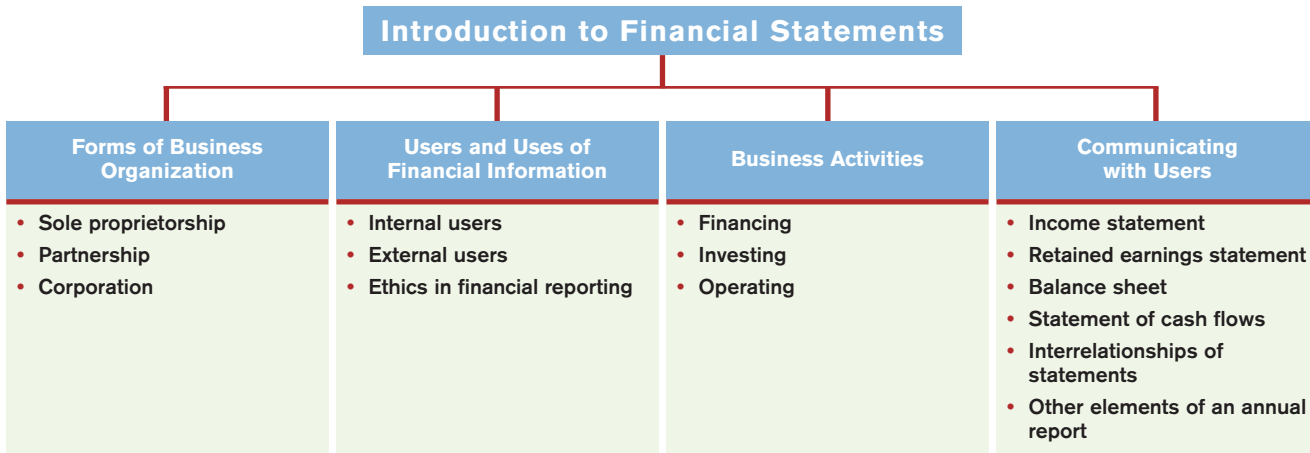
INSIDE CHAPTER 1 ...

- **The Scoop on Accounting** (p. 6)
- **Spinning the Career Wheel** (p. 7)
- **The Numbers Behind Not-for-Profit Organizations** (p. 8)
- **Rocking the Bottom Line** (p. 15)

preview of chapter 1

How do you start a business? How do you determine whether your business is making or losing money? How should you finance expansion—should you borrow, should you issue stock, should you use your own funds? How do you convince lenders to lend you money or investors to buy your stock? Success in business requires making countless decisions, and decisions require financial information.

The purpose of this chapter is to show you what role accounting plays in providing financial information. The content and organization of the chapter are as follows.



Forms of Business Organization

study objective 1

Describe the primary forms of business organization.



Sole Proprietorship

- Simple to establish
- Owner controlled
- Tax advantages



Partnership

- Simple to establish
- Shared control
- Broader skills and resources
- Tax advantages



Corporation

- Easier to transfer ownership
- Easier to raise funds
- No personal liability

Suppose you graduate with a business degree and decide you want to start your own business. But what kind of business? You know that you enjoy working with people, especially teaching them new skills. And, ever since you were young, you have spent most of your free time outdoors, kayaking, backpacking, skiing, rock climbing, and mountain biking. You therefore realize that you might be most successful in opening an outdoor guide service where you grew up, in the Sierra Nevada mountains.

Your next decision is to determine what organizational form your business will have. You have three choices—sole proprietorship, partnership, or corporation.

You might choose the sole proprietorship form for your outdoor guide service. A business owned by one person is a **sole proprietorship**. It is **simple to set up and gives you control** over the business. Small owner-operated businesses such as barber shops, law offices, and auto repair shops are often sole proprietorships, as are farms and small retail stores.

Another possibility is for you to join forces with other individuals to form a partnership. A business owned by two or more persons associated as partners is a **partnership**. Partnerships often are formed because one individual does not have **enough economic resources** to initiate or expand the business. Sometimes, **partners bring unique skills or resources** to the partnership. You and your partners should formalize your duties and contributions in a written partnership agreement. Retail and service-type businesses, including professional practices (lawyers, doctors, architects, and certified public accountants), often organize as partnerships.

As a third alternative, you might organize as a corporation. A business organized as a separate legal entity owned by stockholders is a **corporation**. Investors in a corporation receive shares of stock to indicate their ownership claim. Buying stock in a corporation is often more attractive than investing in a partnership because shares of stock are **easy to sell** (transfer ownership). Selling a proprietorship or partnership interest is much more involved. Also, individuals

can become **stockholders** by investing relatively small amounts of money. Therefore, it is **easier for corporations to raise funds**. Successful corporations often have thousands of stockholders, and their stock is traded on organized stock exchanges like the **New York Stock Exchange**. Many businesses start as sole proprietorships or partnerships and eventually incorporate. For example, in 1896 Leo Hirshfield started Tootsie Roll as a sole proprietorship, and by 1919 the company had incorporated.

Other factors to consider in deciding which organizational form to choose are **taxes and legal liability**. If you choose a sole proprietorship or partnership, you generally receive more favorable tax treatment than a corporation. However, proprietors and partners are personally liable for all debts of the business; corporate stockholders are not. In other words, corporate stockholders generally pay higher taxes but have no personal liability. We will discuss these issues in more depth in a later chapter.

The combined number of proprietorships and partnerships in the United States is more than five times the number of corporations. However, the revenue produced by corporations is eight times greater. Most of the largest enterprises in the United States—for example, **Coca-Cola**, **ExxonMobil**, **General Motors**, **Citigroup**, and **Microsoft**—are corporations. Because the majority of U.S. business is transacted by corporations, the emphasis in this book is on the corporate form of organization.

Do it!

In choosing the organizational form for your outdoor guide service, you should consider the pros and cons of each. Identify each of the following organizational characteristics with the organizational form or forms with which it is associated.

1. Easier to raise funds
2. Simple to establish
3. No personal legal liability
4. Tax advantages
5. Easier to transfer ownership

Solution

1. Easier to raise funds: Corporation.
2. Simple to establish: Sole proprietorship and partnership.
3. No personal legal liability: Corporation.
4. Tax advantages: Sole proprietorship and partnership.
5. Easier to transfer ownership: Corporation.

Related exercise material: **BE1-1** and **Do it!** 1-1.

Alternative Terminology

Stockholders are sometimes called *shareholders*.

Alternative Terminology

notes present synonymous terms that you may come across in practice.

before you go on...

BUSINESS ORGANIZATION FORMS

Do it! exercises prompt you to stop and review the key points you have just studied.

Action Plan

- Know which organizational form best matches the business type, size, and preferences of the owner(s).

Action Plans give you tips about how to approach the problem.



Users and Uses of Financial Information

The purpose of financial information is to provide inputs for decision making. **Accounting** is the information system that identifies, records, and communicates the economic events of an organization to interested users. **Users** of accounting information can be divided broadly into two groups: internal users and external users.

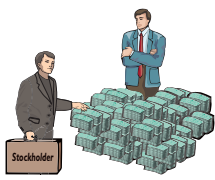
INTERNAL USERS

Internal users of accounting information are managers who plan, organize, and run a business. These include **marketing managers, production supervisors, finance directors, and company officers**. In running a business, managers must answer many important questions, as shown in Illustration 1-1 (page 6).


study objective 2

Identify the users and uses of accounting information.


Questions Asked by Internal Users



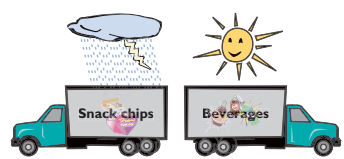
Finance
Is cash sufficient to pay dividends to **Microsoft** stockholders?



Marketing
What price for an **Apple** iPod will maximize the company's net income?



Human Resources
Can we afford to give **General Motors** employees pay raises this year?



Management
Which **PepsiCo** product line is the most profitable? Should any product lines be eliminated?

Illustration 1-1

Questions that internal users ask

Illustrations like this one convey information in pictorial form to help you visualize and apply the ideas as you study.

To answer these and other questions, you need detailed information on a timely basis. For internal users, accounting provides internal reports, such as financial comparisons of operating alternatives, projections of income from new sales campaigns, and forecasts of cash needs for the next year. In addition, companies present summarized financial information in the form of financial statements.



Accounting Across the Organization

The Scoop on Accounting

Accounting can serve as a useful recruiting tool even for the human resources department. **Rhino Foods**, located in Burlington, Vermont, is a manufacturer of specialty ice cream. Its corporate website includes the following:

“Wouldn't it be great to work where you were part of a team? Where your input and hard work made a difference? Where you weren't kept in the dark about what management was thinking? . . . Well—it's not a dream! It's the way we do business . . . Rhino Foods believes in family, honesty and open communication—we really care about and appreciate our employees—and it shows. Operating results are posted and monthly group meetings inform all employees about what's happening in the Company. Employees also share in the Company's profits, in addition to having an excellent comprehensive *benefits* package.”

Source: www.rhinofoods.com/workforus/workforus.html.


? What are the benefits to the company and to the employees of making the financial statements available to all employees? (See page 41.)

Accounting Across the Organization stories show applications of accounting information in various business functions.

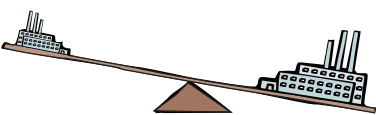
Illustration 1-2

Questions that external users ask

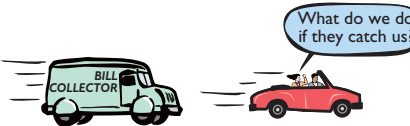
Questions Asked by External Users



Investors
Is **General Electric** earning satisfactory income?



Investors
How does **Disney** compare in size and profitability with **Time Warner**?



Creditors
Will **United Airlines** be able to pay its debts as they come due?

The information needs and questions of other external users vary considerably. **Taxing authorities**, such as the Internal Revenue Service, want to know whether the company complies with the tax laws. **Customers** are interested in whether a company like **General Motors** will continue to honor product warranties and otherwise support its product lines. **Labor unions**, such as the Major League Baseball Players Association, want to know whether the owners have the ability to pay increased wages and benefits. **Regulatory agencies**, such as the Securities and Exchange Commission or the Federal Trade Commission, want to know whether the company is operating within prescribed rules. For example, **Enron**, **Dynegy**, **Duke Energy**, and other big energy-trading companies reported record profits at the same time as California was paying extremely high prices for energy and suffering from blackouts. This disparity caused regulators to investigate the energy traders to make sure that the profits were earned by legitimate and fair practices.



Accounting Across the Organization

Spinning the Career Wheel

One question that business students frequently ask is, “How will the study of accounting help me?” It should help you a great deal, because a working knowledge of accounting is desirable for virtually every field of business. Some examples of how accounting is used in business careers include:

General management: Imagine running **Ford Motors**, Massachusetts General Hospital, California State University–Fullerton, a **McDonald’s** franchise, a **Trek** bike shop. All general managers need to understand accounting data in order to make wise business decisions.

Marketing: A marketing specialist at a company like **Procter & Gamble** develops strategies to help the sales force be successful. But making a sale is meaningless unless it is a profitable sale. Marketing people must be sensitive to costs and benefits, which accounting helps them quantify and understand.

Finance: Do you want to be a banker for **Citicorp**, an investment analyst for **Goldman Sachs**, a stock broker for **Merrill Lynch**? These fields rely heavily on accounting. In all of them you will regularly examine and analyze financial statements. In fact, it is difficult to get a good job in a finance function without two or three courses in accounting.

Real estate: Are you interested in being a real estate broker for **Prudential Real Estate**? Because a third party—the bank—is almost always involved in financing a real estate transaction, brokers must understand the numbers involved: Can the buyer afford to make the payments to the bank? Does the cash flow from an industrial property justify the purchase price? What are the tax benefits of the purchase?

? How might accounting help you? (See page 41.)



ETHICS IN FINANCIAL REPORTING

People won’t gamble in a casino if they think it is “rigged.” Similarly, people won’t “play” the stock market if they think stock prices are rigged. In recent years the financial press has been full of articles about financial scandals at **Enron**, **WorldCom**, **HealthSouth**, and **AIG**. As more scandals came to light, a mistrust of financial reporting in general seemed to be developing. One article in the *Wall Street Journal* noted that “repeated disclosures about questionable accounting practices have bruised investors’ faith in the reliability of earnings reports, which in turn has sent stock prices tumbling.”¹ Imagine trying to carry on a business or invest money if you could not depend on the financial statements to be honestly prepared.

¹“U.S. Share Prices Slump,” *Wall Street Journal* (February 21, 2002).

Ethics Note Circus-founder P.T. Barnum is alleged to have said, “Trust everyone, but cut the deck.” What Sarbanes-Oxley does is to provide measures that (like cutting the deck of playing cards) help ensure that fraud will not occur.


Information would have no credibility. There is no doubt that a sound, well-functioning economy depends on accurate and dependable financial reporting.

United States regulators and lawmakers were very concerned that the economy would suffer if investors lost confidence in corporate accounting because of unethical financial reporting. In 2002, Congress passed the **Sarbanes-Oxley Act (SOX)** to reduce unethical corporate behavior and decrease the likelihood of future corporate scandals. As a result of SOX, top management must now certify the accuracy of financial information. In addition, penalties for fraudulent financial activity are much more severe. Also, SOX increased the independence of the outside auditors who review the accuracy of corporate financial statements, and increased the oversight role of boards of directors.

Effective financial reporting depends on sound ethical behavior. To sensitize you to ethical situations and to give you practice at solving ethical dilemmas, we address ethics in a number of ways in this book: (1) A number of the *Feature Stories* and other parts of the text discuss the central importance of ethical behavior to financial reporting. (2) *Insight boxes* with an ethics perspective highlight ethics situations and issues in actual business settings. (3) At the end of the chapter, an *Ethics Case* simulates a business situation and asks you to put yourself in the position of a decision maker in that case.

When analyzing these various ethics cases and your own ethical experiences, you should apply the three steps outlined in Illustration 1-3.

Illustration 1-3 Steps in analyzing ethics cases



Solving an Ethical Dilemma

1. Recognize an ethical situation and the ethical issues involved.

Use your personal ethics to identify ethical situations and issues. Some businesses and professional organizations provide written codes of ethics for guidance in some business situations.

2. Identify and analyze the principal elements in the situation.

Identify the *stakeholders*—persons or groups who may be harmed or benefited. Ask the question: What are the responsibilities and obligations of the parties involved?

3. Identify the alternatives, and weigh the impact of each alternative on various stakeholders.

Select the most ethical alternative, considering all the consequences. Sometimes there will be one right answer. Other situations involve more than one right solution; these situations require you to evaluate each alternative and select the best one.



Insights provide examples of business situations from various perspectives—ethics, investor, and international.



Ethics Insight

The Numbers Behind Not-for-Profit Organizations

Accounting plays an important role for a wide range of business organizations worldwide. Just as the integrity of the numbers matters for business, it matters at least as much for not-for-profit organizations. Proper control and reporting help ensure that money is used the way donors intended. Donors are less inclined to give to an organization if they think the organization is subject to waste or theft. The accounting challenges of some large international not-for-profits rival those of the world's largest businesses. For example, after the Haitian earthquake, the Haitian-born musician Wyclef Jean was criticized for the poor accounting controls in a relief fund that he founded. Since then, he has hired a new accountant and improved the transparency regarding funds raised and spent.



What benefits does a sound accounting system provide to a not-for-profit organization? (See page 41.)

Business Activities

All businesses are involved in three types of activity—financing, investing, and operating. For example, Leo Hirshfield, the founder of Tootsie Roll, obtained cash through financing to start and grow his business. Some of this **financing** came from personal savings, and some likely came from outside sources like banks. Hirshfield then **invested** the cash in equipment to run the business, such as mixing equipment and delivery vehicles. Once this equipment was in place, he could begin the **operating** activities of making and selling candy.

The **accounting information system** keeps track of the results of each of the various business activities—financing, investing, and operating. Let's look in more detail at each type of business activity.

FINANCING ACTIVITIES

It takes money to make money. The two primary sources of outside funds for corporations are borrowing money and issuing (selling) shares of stock in exchange for cash.

Tootsie Roll Industries may borrow money in a variety of ways. For example, it can take out a loan at a bank or borrow directly from investors by issuing debt securities called bonds. Persons or entities to whom Tootsie Roll owes money are its **creditors**. Amounts owed to creditors—in the form of debt and other obligations—are called **liabilities**. Specific names are given to different types of liabilities, depending on their source. Tootsie Roll may have a **note payable** to a bank for the money borrowed to purchase delivery trucks. Debt securities sold to investors that must be repaid at a particular date some years in the future are **bonds payable**.

A corporation may also obtain funds by selling shares of stock to investors. **Common stock** is the term used to describe the total amount paid in by stockholders for the shares they purchase.

The claims of creditors differ from those of stockholders. If you loan money to a company, you are one of its creditors. In lending money, you specify a payment schedule (e.g., payment at the end of three months). As a creditor, you have a legal right to be paid at the agreed time. In the event of nonpayment, you may legally force the company to sell property to pay its debts. In the case of financial difficulty, creditor claims must be paid before stockholders' claims.

Stockholders, on the other hand, have no claim to corporate cash until the claims of creditors are satisfied. If you buy a company's stock instead of loaning it money, you have no legal right to expect any payments until all of its creditors are paid. However, many corporations make payments to stockholders on a regular basis as long as there is sufficient cash to cover required payments to creditors. These payments to stockholders are called **dividends**.

INVESTING ACTIVITIES

Once the company has raised cash through financing activities, it will then use that cash in investing activities. Investing activities involve the purchase of the resources a company needs in order to operate. A growing company purchases many resources, such as computers, delivery trucks, furniture, and buildings. Resources owned by a business are called **assets**. Different types of assets are given different names. Tootsie Roll's mixing equipment is a type of asset referred to as **property, plant, and equipment**.

Cash is one of the more important assets owned by Tootsie Roll or any other business. If a company has excess cash that it does not need for a while, it might

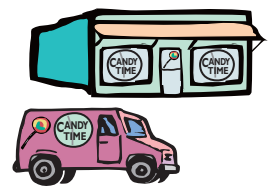
study objective 3

Explain the three principal types of business activity.



Financing

Essential terms are printed in blue. They are defined again in the **glossary** at the end of the chapter.



Investing

Alternative Terminology

Property, plant, and equipment is sometimes called *fixed assets*.

choose to invest in securities (stocks or bonds) of other corporations. **Investments** are another example of an investing activity.

OPERATING ACTIVITIES



Operating

Once a business has the assets it needs to get started, it can begin its operations. Tootsie Roll is in the business of selling all things that taste, look, or smell like candy. It sells Tootsie Rolls, Tootsie Pops, Blow Pops, Caramel Apple Pops, Mason Dots, Mason Crows, Sugar Daddy, and Sugar Babies. We call amounts earned on the sale of these products *revenues*. **Revenue** is the increase in assets resulting from the sale of a product or service in the normal course of business. For example, Tootsie Roll records revenue when it sells a candy product.

Revenues arise from different sources and are identified by various names depending on the nature of the business. For instance, Tootsie Roll's primary source of revenue is the sale of candy products. However, it also generates interest revenue on debt securities held as investments. Sources of revenue common to many businesses are **sales revenue**, **service revenue**, and **interest revenue**.

The company purchases its longer-lived assets through investing activities as described earlier. Other assets with shorter lives, however, result from operating activities. For example, supplies are assets used in day-to-day operations. Goods available for future sales to customers are assets called **inventory**. Also, if Tootsie Roll sells goods to a customer and does not receive cash immediately, then the company has a right to expect payment from that customer in the near future. This right to receive money in the future is called an **account receivable**.

Before Tootsie Roll can sell a single Tootsie Roll, Tootsie Pop, or Blow Pop, it must purchase sugar, corn syrup, and other ingredients, mix these ingredients, process the mix, and wrap and ship the finished product. It also incurs costs like salaries, rents, and utilities. All of these costs, referred to as *expenses*, are necessary to produce and sell the product. In accounting language, **expenses** are the cost of assets consumed or services used in the process of generating revenues.

Expenses take many forms and are identified by various names depending on the type of asset consumed or service used. For example, Tootsie Roll keeps track of these types of expenses: **cost of goods sold** (such as the cost of ingredients); **selling expenses** (such as the cost of salespersons' salaries); **marketing expenses** (such as the cost of advertising); **administrative expenses** (such as the salaries of administrative staff, and telephone and heat costs incurred at the corporate office); **interest expense** (amounts of interest paid on various debts); and **income taxes** (corporate taxes paid to government).

Tootsie Roll may also have liabilities arising from these expenses. For example, it may purchase goods on credit from suppliers; the obligations to pay for these goods are called **accounts payable**. Additionally, Tootsie Roll may have **interest payable** on the outstanding amounts owed to the bank. It may also have **wages payable** to its employees and **sales taxes payable**, **property taxes payable**, and **income taxes payable** to the government.

Tootsie Roll compares the revenues of a period with the expenses of that period to determine whether it earned a profit. When revenues exceed expenses, **net income** results. When expenses exceed revenues, a **net loss** results.

*before you go on...***Do it!**

Classify each item as an asset, liability, common stock, revenue, or expense.

1. Cost of renting property
2. Truck purchased
3. Notes payable
4. Issuance of ownership shares
5. Amount earned from providing service
6. Amounts owed to suppliers

Solution

1. Cost of renting property: Expense.
2. Truck purchased: Asset.
3. Notes payable: Liabilities.
4. Issuance of ownership shares: Common stock.
5. Amount earned from providing service: Revenue.
6. Amounts owed to suppliers: Liabilities.

Related exercise material: **BE1-3**, **Do it!** 1-2, and **E1-3**.

BUSINESS ACTIVITIES**Action Plan**

- Classify each item based on its economic characteristics. Proper classification of items is critical if accounting is to provide useful information.



Communicating with Users

Assets, liabilities, expenses, and revenues are of interest to users of accounting information. This information is arranged in the format of four different **financial statements**, which form the backbone of financial accounting:

- To present a picture at a point in time of what your business owns (its assets) and what it owes (its liabilities), you prepare a **balance sheet**.
- To show how successfully your business performed during a period of time, you report its revenues and expenses in an **income statement**.
- To indicate how much of previous income was distributed to you and the other owners of your business in the form of dividends, and how much was retained in the business to allow for future growth, you present a **retained earnings statement**.
- To show where your business obtained cash during a period of time and how that cash was used, you present a **statement of cash flows**.

To introduce you to these statements, we have prepared the financial statements for your outdoor guide service, Sierra Corporation, after your first month of operations. To summarize, you officially started your business in Truckee, California, on October 1, 2012. Sierra provides guide services in the Lake Tahoe area of the Sierra Nevada mountains. Its promotional materials describe outdoor day trips, such as rafting, snowshoeing, and hiking, as well as multi-day backcountry experiences. To minimize your initial investment, at this point the company has limited outdoor equipment for customer use. Instead, your customers either bring their own equipment or you arrange for them to rent equipment through local outfitters. The financial statements for Sierra's first month of business are provided in the following pages.

INCOME STATEMENT

The **income statement** reports the success or failure of the company's operations for a period of time. To indicate that its income statement reports the

study objective 4

Describe the content and purpose of each of the financial statements.

International Note The primary types of financial statements required by International Financial Reporting Standards (IFRS) and U.S. generally accepted accounting principles (GAAP) are the same. Neither IFRS nor GAAP is very specific regarding format requirements for the primary financial statements. However, in practice, some format differences do exist in presentations commonly employed by IFRS companies compared to GAAP companies.

results of operations for a **period of time**, Sierra dates the income statement “For the Month Ended October 31, 2012.” The income statement lists the company’s revenues followed by its expenses. Finally, Sierra determines the net income (or net loss) by deducting expenses from revenues. Sierra Corporation’s income statement is shown in Illustration 1-4. Congratulations, you are already showing a profit!

Illustration 1-4 Sierra Corporation’s income statement



SIERRA CORPORATION
Income Statement
For the Month Ended October 31, 2012

Revenues		
Service revenue		\$10,600
Expenses		
Salaries expense	\$5,200	
Supplies expense	1,500	
Rent expense	900	
Insurance expense	50	
Interest expense	50	
Depreciation expense	40	
Total expenses		7,740
Net income		\$ 2,860

Helpful Hint The heading identifies the company, the type of statement, and the time period covered. Sometimes, another line indicates the unit of measure, e.g., “in thousands” or “in millions.”

Ethics Note When companies find errors in previously released income statements, they restate those numbers. Perhaps because of the increased scrutiny shortly after Sarbanes-Oxley was implemented, companies filed a record 1,195 restatements.

Why are financial statement users interested in net income? **Investors are interested in a company’s past net income because it provides useful information for predicting future net income.** Investors buy and sell stock based on their beliefs about a company’s future performance. If investors believe that Sierra will be successful in the future and that this will result in a higher stock price, they will buy its stock. Creditors also use the income statement to predict future earnings. When a bank loans money to a company, it believes that it will be repaid in the future. If it didn’t think it would be repaid, it wouldn’t loan the money. Therefore, prior to making the loan the bank loan officer uses the income statement as a source of information to predict whether the company will be profitable enough to repay its loan. Thus, reporting a strong profit will make it easier for Sierra to raise additional cash either by issuing shares of stock or borrowing.

Amounts received from issuing stock are not revenues, and amounts paid out as dividends are not expenses. As a result, they are not reported on the income statement. For example, Sierra Corporation does not treat as revenue the \$10,000 of cash received from issuing new stock, nor does it regard as a business expense the \$500 of dividends paid.

Decision Toolkits summarize the financial decision-making process.



DECISION TOOLKIT

DECISION CHECKPOINTS	INFO NEEDED FOR DECISION	TOOL TO USE FOR DECISION	HOW TO EVALUATE RESULTS
Are the company’s operations profitable?	Income statement	The income statement reports on the success or failure of the company’s operations by reporting its revenues and expenses.	If the company’s revenue exceeds its expenses, it will report net income; otherwise it will report a net loss.

RETAINED EARNINGS STATEMENT

If Sierra is profitable, at the end of each period it must decide what portion of profits to pay to shareholders in dividends. In theory, it could pay all of its

current-period profits, but few companies do this. Why? Because they want to retain part of the profits to allow for further expansion. High-growth companies, such as **Google** and **Cisco Systems**, often pay no dividends. **Retained earnings** is the net income retained in the corporation.

The **retained earnings statement** shows the amounts and causes of changes in retained earnings during the period. The time period is the same as that covered by the income statement. The beginning retained earnings amount appears on the first line of the statement. Then the company adds net income and deducts dividends to determine the retained earnings at the end of the period. If a company has a net loss, it deducts (rather than adds) that amount in the retained earnings statement. Illustration 1-5 presents Sierra Corporation's retained earnings statement.



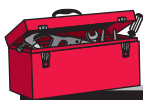
SIERRA CORPORATION
Retained Earnings Statement
For the Month Ended October 31, 2012

Retained earnings, October 1	\$ 0	
Add: Net income	2,860	
	2,860	
Less: Dividends	500	
	500	
Retained earnings, October 31	\$2,360	

Illustration 1-5 Sierra Corporation's retained earnings statement

Helpful Hint The heading of this statement identifies the company, the type of statement, and the time period covered by the statement.

By monitoring the retained earnings statement, financial statement users can evaluate dividend payment practices. Some investors seek companies, such as **Dow Chemical**, that have a history of paying high dividends. Other investors seek companies, such as **Amazon.com**, that reinvest earnings to increase the company's growth instead of paying dividends. Lenders monitor their corporate customers' dividend payments because any money paid in dividends reduces a company's ability to repay its debts.



DECISION TOOLKIT

DECISION CHECKPOINTS	INFO NEEDED FOR DECISION	TOOL TO USE FOR DECISION	HOW TO EVALUATE RESULTS
What is the company's policy toward dividends and growth?	Retained earnings statement	How much of this year's income did the company pay out in dividends to shareholders?	A company striving for rapid growth will pay a low (or no) dividend.

BALANCE SHEET

The **balance sheet** reports assets and claims to assets at a specific **point** in time. Claims to assets are subdivided into two categories: claims of creditors and claims of owners. As noted earlier, claims of creditors are called **liabilities**. Claims of owners are called **stockholders' equity**.

Illustration 1-6 shows the relationship among the categories on the balance sheet in equation form. This equation is referred to as the **basic accounting equation**.

study objective 5

Explain the meaning of assets, liabilities, and stockholders' equity, and state the basic accounting equation.

Assets = Liabilities + Stockholders' Equity


Illustration 1-6 Basic accounting equation

This relationship is where the name “balance sheet” comes from. Assets must balance with the claims to assets.

Alternative Terminology
Liabilities are also referred to as *debt*.

As you can see from looking at Sierra’s balance sheet in Illustration 1-7, the balance sheet presents the company’s financial position as of a specific date—in this case, October 31, 2012. It lists assets first, followed by liabilities and stockholders’ equity. Stockholders’ equity is comprised of two parts: (1) common stock and (2) retained earnings. As noted earlier, common stock results when the company sells new shares of stock; retained earnings is the net income retained in the corporation. Sierra has common stock of \$10,000 and retained earnings of \$2,360, for total stockholders’ equity of \$12,360.

Illustration 1-7 Sierra Corporation’s balance sheet



SIERRA CORPORATION		
Balance Sheet		
October 31, 2012		
Assets		
Cash		\$15,200
Accounts receivable		200
Supplies		1,000
Prepaid insurance		550
Equipment, net		<u>4,960</u>
Total assets		<u>\$21,910</u>
Liabilities and Stockholders’ Equity		
Liabilities		
Notes payable	\$ 5,000	
Accounts payable	2,500	
Salaries payable	1,200	
Unearned service revenue	800	
Interest payable	<u>50</u>	
Total liabilities		\$ 9,550
Stockholders’ equity		
Common stock	10,000	
Retained earnings	<u>2,360</u>	
Total stockholders’ equity		<u>12,360</u>
Total liabilities and stockholders’ equity		<u>\$21,910</u>

Helpful Hint The heading of a balance sheet must identify the company, the statement, and the date.

Creditors analyze a company’s balance sheet to determine the likelihood that they will be repaid. They carefully evaluate the nature of the company’s assets and liabilities. In operating the Sierra Corporation guide service, the balance sheet will be used to determine whether cash on hand is sufficient for immediate cash needs. The balance sheet will also be used to evaluate the relationship between debt and stockholders’ equity to determine whether the company has a satisfactory proportion of debt and common stock financing.



DECISION TOOLKIT

DECISION CHECKPOINTS	INFO NEEDED FOR DECISION	TOOL TO USE FOR DECISION	HOW TO EVALUATE RESULTS
Does the company rely primarily on debt or stockholders’ equity to finance its assets?	Balance sheet	The balance sheet reports the company’s resources and claims to those resources. There are two types of claims: liabilities and stockholders’ equity.	Compare the amount of debt versus the amount of stockholders’ equity to determine whether the company relies more on creditors or owners for its financing.

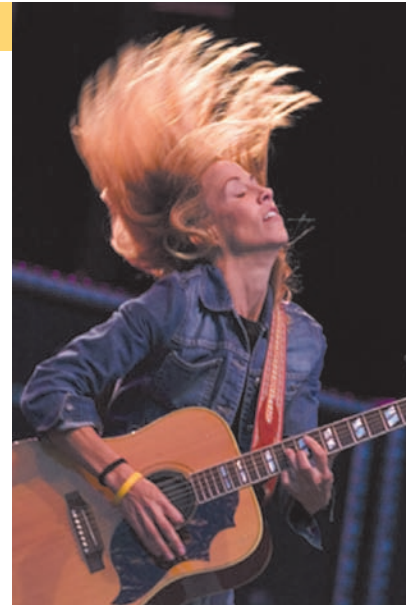


Ethics Insight

Rocking the Bottom Line

What topic has performers such as Tom Waits, Clint Black, Sheryl Crow, and Madonna so concerned that they are pushing for new laws regarding its use? Accounting. Recording-company accounting to be more precise. Musicians receive royalty payments based on the accounting done by their recording companies. Many performers say that the recording companies—either intentionally or unintentionally—have very poor accounting systems, which, the performers say, has resulted in many inaccurate royalty payments. They would like to see laws created that would hit the recording companies with stiff fines for accounting errors.

? What is one way that some of these disputes might be resolved? (See page 41.)



STATEMENT OF CASH FLOWS

The primary purpose of a **statement of cash flows** is to provide financial information about the cash receipts and cash payments of a business for a specific period of time. To help investors, creditors, and others in their analysis of a company’s cash position, the statement of cash flows reports the cash effects of a company’s **operating**, **investing**, and **financing** activities. In addition, the statement shows the net increase or decrease in cash during the period, and the amount of cash at the end of the period.

Users are interested in the statement of cash flows because they want to know what is happening to a company’s most important resource. In operating Sierra, the statement of cash flows will provide answers to these simple but important questions:

- Where did cash come from during the period?
- How was cash used during the period?
- What was the change in the cash balance during the period?

The statement of cash flows for Sierra, in Illustration 1-8, shows that cash increased \$15,200 during the month. This increase resulted because operating



SIERRA CORPORATION
Statement of Cash Flows
For the Month Ended October 31, 2012

Cash flows from operating activities		
Cash receipts from operating activities	\$11,200	
Cash payments for operating activities	(5,500)	
Net cash provided by operating activities		\$ 5,700
Cash flows from investing activities		
Purchased office equipment	(5,000)	
Net cash used by investing activities		(5,000)
Cash flows from financing activities		
Issuance of common stock	10,000	
Issued note payable	5,000	
Payment of dividend	(500)	
Net cash provided by financing activities		14,500
Net increase in cash		15,200
Cash at beginning of period		0
Cash at end of period		<u>\$15,200</u>

Illustration 1-8 Sierra Corporation’s statement of cash flows

Helpful Hint The heading of this statement identifies the company, the type of statement, and the time period covered by the statement. Negative numbers are shown in parentheses.

activities (services to clients) increased cash \$5,700, and financing activities increased cash \$14,500. Investing activities used \$5,000 of cash for the purchase of equipment.



DECISION TOOLKIT

DECISION CHECKPOINTS	INFO NEEDED FOR DECISION	TOOL TO USE FOR DECISION	HOW TO EVALUATE RESULTS
Does the company generate sufficient cash from operations to fund its investing activities?	Statement of cash flows	The statement of cash flows shows the amount of cash provided or used by operating activities, investing activities, and financing activities.	Compare the amount of cash provided by operating activities with the amount of cash used by investing activities. Any deficiency in cash from operating activities must be made up with cash from financing activities.



Tootsie Roll Annual Report Walkthrough

INTERRELATIONSHIPS OF STATEMENTS

Illustration 1-9 shows simplified financial statements of **Tootsie Roll Industries, Inc.** (We have simplified the financial statements to assist your learning.) Tootsie Roll's **actual financial statements** are presented in **Appendix A**, at the end of the textbook. Note that the numbers in Tootsie Roll's statements are presented in thousands—that is, the last three 000s are omitted. Thus, Tootsie Roll's net income in 2009 is \$53,475,000, not \$53,475. Because the results on some financial statements become inputs to other statements, the statements are interrelated. These interrelationships can be seen in Tootsie Roll's financial statements, as follows.

1. The retained earnings statement depends on the results of the income statement. Tootsie Roll reported net income of \$53,475,000 for the period. It adds the net income amount to the beginning amount of retained earnings in order to determine ending retained earnings.
2. The balance sheet and retained earnings statement are also interrelated. Tootsie Roll reports the ending amount of \$145,928,000 on the retained earnings statement as the retained earnings amount on the balance sheet.
3. Finally, the statement of cash flows relates to information on the balance sheet. The statement of cash flows shows how the Cash account changed during the period. It shows the amount of cash at the beginning of the period, the sources and uses of cash during the period, and the \$90,990,000 of cash at the end of the period. The ending amount of cash shown on the statement of cash flows must agree with the amount of cash on the balance sheet.

Study these interrelationships carefully. To prepare financial statements, you must understand the sequence in which these amounts are determined and how each statement impacts the next.



TOOTSIE ROLL INDUSTRIES, INC.
Income Statement
For the Year Ended December 31, 2009 (in thousands)

Revenues		\$499,331
Expenses		
Cost of goods sold	\$319,497	
Selling, marketing, and administrative expense and other	115,655	
Income tax expense	<u>10,704</u>	
Total expenses		445,856
Net income		<u>\$ 53,475</u>

Illustration 1-9 Tootsie Roll Industries, Inc.'s financial statements

Helpful Hint Note that final sums are double-underlined, and negative amounts (in the statement of cash flows) are presented in parentheses.



TOOTSIE ROLL INDUSTRIES, INC.
Retained Earnings Statement
For the Year Ended December 31, 2009 (in thousands)

Retained earnings, January 1, 2009		\$142,872
Add: Net income		<u>53,475</u>
		196,347
Less: Dividends and other (net)		<u>50,419</u>
Retained earnings, December 31, 2009		<u>\$145,928</u>

①

Helpful Hint The arrows in this illustration show interrelationships of the four financial statements.



TOOTSIE ROLL INDUSTRIES, INC.
Balance Sheet
December 31, 2009 (in thousands)

<u>Assets</u>		
Cash		\$ 90,990
Investments		8,663
Accounts receivable		45,909
Inventories		56,387
Prepaid expenses		8,562
Property, plant and equipment, net		220,721
Other assets		<u>407,015</u>
Total assets		<u>\$838,247</u>
<u>Liabilities and Stockholders' Equity</u>		
Liabilities		
Accounts payable	\$ 9,140	
Dividends payable	4,458	
Accrued liabilities	42,468	
Deferred income taxes payable	44,582	
Bonds payable	7,500	
Employee benefits payable and other	<u>77,614</u>	\$185,762
Stockholders' equity		
Common stock	506,557	
Retained earnings	<u>145,928</u>	<u>652,485</u>
Total liabilities and stockholders' equity		<u>\$838,247</u>

②

③



TOOTSIE ROLL INDUSTRIES, INC.
Statement of Cash Flows
For the Year Ended December 31, 2009 (in thousands)

Cash flows from operating activities		
Cash receipts from operating activities	\$491,344	
Cash payments for operating activities	<u>(416,063)</u>	
Net cash provided by operating activities		\$ 75,281
Cash flows from investing activities		
Capital expenditures and acquisitions	(20,831)	
Net purchases/sales of investment securities and other	<u>6,180</u>	
Net cash used by investing activities		(14,651)
Cash flows from financing activities		
Repurchase of common stock	(20,723)	
Dividends paid in cash	<u>(17,825)</u>	
Net cash used by financing activities		<u>(38,548)</u>
Net increase (decrease) in cash		22,082
Cash at beginning of year		68,908
Cash at end of year		<u>\$ 90,990</u>

←

before you go on...**FINANCIAL STATEMENTS****Action Plan**

- Report the revenues and expenses for a period of time in an income statement.
- Show the amounts and causes (net income and dividends) of changes in retained earnings during the period in the retained earnings statement.
- Present the assets and claims to those assets at a specific point in time in the balance sheet.

Do it!

CSU Corporation began operations on January 1, 2012. The following information is available for CSU Corporation on December 31, 2012:

Accounts receivable	1,800	Retained earnings	?	Supplies expense	200
Accounts payable	2,000	Equipment	16,000	Cash	1,400
Building rental expense	9,000	Insurance expense	1,000	Dividends	600
Notes payable	5,000	Service revenue	17,000		
Common stock	10,000	Supplies	4,000		

Prepare an income statement, a retained earnings statement, and a balance sheet.

Solution**CSU CORPORATION**

Income Statement

For the Year Ended December 31, 2012

Revenues		
Service revenue		\$17,000
Expenses		
Rent expense	\$9,000	
Insurance expense	1,000	
Supplies expense	200	
Total expenses		<u>10,200</u>
Net income		<u>\$ 6,800</u>

CSU CORPORATION

Retained Earnings Statement

For the Year Ended December 31, 2012

Retained earnings, January 1	\$ 0
Add: Net income	<u>6,800</u>
	6,800
Less: Dividends	<u>600</u>
Retained earnings, December 31	<u>\$6,200</u>

CSU CORPORATION

Balance Sheet

December 31, 2012

<u>Assets</u>		
Cash		\$ 1,400
Accounts receivable		1,800
Supplies		4,000
Equipment		<u>16,000</u>
Total assets		<u>\$23,200</u>
<u>Liabilities and Stockholders' Equity</u>		
Liabilities		
Notes payable	\$ 5,000	
Accounts payable	<u>2,000</u>	
Total liabilities		\$ 7,000
Stockholders' equity		
Common stock	10,000	
Retained earnings	<u>6,200</u>	
Total stockholders' equity		<u>16,200</u>
Total liabilities and stockholders' equity		<u>\$23,200</u>



Related exercise material: **BE1-5, BE1-6, BE1-7, BE1-8, BE1-9, BE1-10, Do it!** 1-3, E1-4, E1-5, E1-6, E1-7, E1-8, E1-9, E1-10, E1-11, and E1-14.

OTHER ELEMENTS OF AN ANNUAL REPORT

U.S. companies that are publicly traded must provide shareholders with an **annual report**. The annual report always includes the financial statements introduced in this chapter. The annual report also includes other important information such as a management discussion and analysis section, notes to the financial statements, and an independent auditor's report. No analysis of a company's financial situation and prospects is complete without a review of these items.

Management Discussion and Analysis

The **management discussion and analysis (MD&A)** section covers various financial aspects of a company, including **its ability to pay near-term obligations, its ability to fund operations and expansion, and its results of operations**. Management must highlight favorable or unfavorable trends and identify significant events and uncertainties that affect these three factors. This discussion obviously involves a number of subjective estimates and opinions. A brief excerpt from the MD&A section of Tootsie Roll's annual report is presented in Illustration 1-10.



TOOTSIE ROLL INDUSTRIES, INC. Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company has a relatively straightforward financial structure and has historically maintained a conservative financial position. Except for an immaterial amount of operating leases, the Company has no special financing arrangements or "off-balance sheet" special purpose entities. Cash flows from operations plus maturities of short-term investments are expected to be adequate to meet the Company's overall financing needs, including capital expenditures, in 2010.

study objective 6

Describe the components that supplement the financial statements in an annual report.

Illustration 1-10 Tootsie Roll's management discussion and analysis

Notes to the Financial Statements

Explanatory notes and supporting schedules accompany every set of financial statements and are an integral part of the statements. The **notes to the financial statements** clarify the financial statements, and provide additional detail. Information in the notes does not have to be quantifiable (numeric). Examples of notes are descriptions of the significant accounting policies and methods used in preparing the statements, explanations of uncertainties and contingencies, and various statistics and details too voluminous to be included in the statements. The notes are essential to understanding a company's operating performance and financial position.

Illustration 1-11 is an excerpt from the notes to Tootsie Roll's financial statements. It describes the methods that Tootsie Roll uses to account for revenues.



TOOTSIE ROLL INDUSTRIES, INC. Notes to Financial Statements

Revenue recognition

Revenue, net of applicable provisions for discounts, returns, allowances, and certain advertising and promotional costs, is recognized when products are delivered to customers based on a customer purchase order, and collectibility is reasonably assured.

Illustration 1-11 Notes to Tootsie Roll's financial statements

Auditor's Report

An **auditor's report** is prepared by an independent outside auditor. It states the auditor's opinion as to the fairness of the presentation of the financial position and results of operations and their conformance with generally accepted accounting standards.

An **auditor** is an accounting professional who conducts an independent examination of a company's financial statements. Only accountants who meet certain criteria and thereby attain the designation **Certified Public Accountant (CPA)** may perform audits. If the auditor is satisfied that the financial statements provide a fair representation of the company's financial position and results of operations in accordance with generally accepted accounting principles, then the auditor expresses an **unqualified opinion**. If the auditor expresses anything other than an unqualified opinion, then readers should only use the financial statements with caution. That is, without an unqualified opinion, we cannot have complete confidence that the financial statements give an accurate picture of the company's financial health. For example, in April 2009 **Blockbuster, Inc.**'s auditor stated that its financial situation raised "substantial doubt about the Company's ability to continue as a going concern."

Illustration 1-12 is an excerpt from the auditor's report from Tootsie Roll's 2009 annual report. Tootsie Roll received an unqualified opinion from its auditor, **PricewaterhouseCoopers**.

Illustration 1-12 Excerpt from auditor's report on Tootsie Roll's financial statements



TOOTSIE ROLL INDUSTRIES, INC.
Excerpt from Auditor's Report

To the Board of Directors and Shareholders of Tootsie Roll Industries, Inc.

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of earnings, comprehensive earnings and retained earnings, and of cash flows present fairly, in all material respects, the financial position of Tootsie Roll Industries, Inc. and its subsidiaries at December 31, 2009 and December 31, 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

before you go on...

COMPONENTS OF ANNUAL REPORTS

Action Plan

- Realize that financial statements provide information about a company's performance and financial position.
- Be familiar with the other elements of the annual report in order to gain a fuller understanding of a company.

Do it!

State whether each of the following items is most closely associated with the management discussion and analysis (MD&A), the notes to the financial statements, or the auditor's report.

1. Descriptions of significant accounting policies
2. Unqualified opinion
3. Explanations of uncertainties and contingencies
4. Description of ability to fund operations and expansion
5. Description of results of operations
6. Certified Public Accountant (CPA)

Solution

1. Descriptions of significant accounting policies: Notes.
2. Unqualified opinion: Auditor's report.
3. Explanations of uncertainties and contingencies: Notes.
4. Description of ability to fund operations and expansion: MD&A.
5. Description of results of operations: MD&A.
6. Certified Public Accountant (CPA): Auditor's report.



Related exercise material: **BE1-11**, **Do it!** 1-4, and **E1-17**.



USING THE DECISION TOOLKIT

The Hershey Company, located in Hershey, Pennsylvania, is the leading North American manufacturer of chocolate—for example, Hershey’s Kisses, Reese’s Peanut Butter Cups, Kit Kat, and Take 5 bars. Imagine that you are considering the purchase of shares of Hershey’s common stock.

Instructions

Answer these questions related to your decision whether to invest.

- What financial statements should you request from the company?
- What should these financial statements tell you?
- Should you request audited financial statements? Explain.
- Appendix B at the end of this book contains financial statements for Hershey. What comparisons can you make between Tootsie Roll and Hershey in terms of their respective results from operations and financial position?

Solution

- Before you invest, you should investigate the income statement, retained earnings statement, statement of cash flows, and balance sheet.
- You would probably be most interested in the income statement because it tells about past performance and thus gives an indication of future performance. The retained earnings statement provides a record of the company’s dividend history. The statement of cash flows reveals where the company is getting and spending its cash. This is especially important for a company that wants to grow. Finally, the balance sheet reveals the relationship between assets and liabilities.
- You would want audited financial statements. These statements indicate that a CPA (certified public accountant) has examined and expressed an opinion that the statements present fairly the financial position and results of operations of the company. Investors and creditors should not make decisions without studying audited financial statements.
- Many interesting comparisons can be made between the two companies. Tootsie Roll is smaller, with total assets of \$838,247,000 versus \$3,675,031,000 for Hershey, and it has lower revenue—\$499,331,000 versus \$5,298,660,000 for Hershey. In addition, Tootsie Roll’s cash provided by operating activities of \$75,281,000 is less than Hershey’s \$1,065,749,000.

While useful, these basic measures are not enough to determine whether one company is a better investment than the other. In later chapters, you will learn of tools that will allow you to compare the relative profitability and financial health of these and other companies.



Using the Decision Toolkit exercises ask you to use information from financial statements to make financial decisions.

Summary of Study Objectives

1 Describe the primary forms of business organization.

A sole proprietorship is a business owned by one person. A partnership is a business owned by two or more people associated as partners. A corporation is a separate legal entity for which evidence of ownership is provided by shares of stock.

2 Identify the users and uses of accounting information.

Internal users are managers who need accounting information to plan, organize, and run business operations. The primary external users are investors and creditors. Investors (stockholders) use accounting information to help them decide whether to buy, hold,

or sell shares of a company’s stock. Creditors (suppliers and bankers) use accounting information to assess the risk of granting credit or loaning money to a business. Other groups who have an indirect interest in a business are taxing authorities, customers, labor unions, and regulatory agencies.

3 Explain the three principal types of business activity.

Financing activities involve collecting the necessary funds to support the business. Investing activities involve acquiring the resources necessary to run the business. Operating activities involve putting the resources of the business into action to generate a profit.

- 4 Describe the content and purpose of each of the financial statements.** An income statement presents the revenues and expenses of a company for a specific period of time. A retained earnings statement summarizes the changes in retained earnings that have occurred for a specific period of time. A balance sheet reports the assets, liabilities, and stockholders' equity of a business at a specific date. A statement of cash flows summarizes information concerning the cash inflows (receipts) and outflows (payments) for a specific period of time.
- 5 Explain the meaning of assets, liabilities, and stockholders' equity, and state the basic accounting equation.** Assets are resources owned by a business. Liabilities are the debts and obligations of the business. Liabilities represent claims of creditors on the assets of the business. Stockholders' equity represents the claims of

owners on the assets of the business. Stockholders' equity is subdivided into two parts: common stock and retained earnings. The basic accounting equation is: $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.

- 6 Describe the components that supplement the financial statements in an annual report.** The management discussion and analysis provides management's interpretation of the company's results and financial position as well as a discussion of plans for the future. Notes to the financial statements provide additional explanation or detail to make the financial statements more informative. The auditor's report expresses an opinion as to whether the financial statements present fairly the company's results of operations and financial position.



DECISION TOOLKIT A SUMMARY

DECISION CHECKPOINTS	INFO NEEDED FOR DECISION	TOOL TO USE FOR DECISION	HOW TO EVALUATE RESULTS
Are the company's operations profitable?	Income statement	The income statement reports on the success or failure of the company's operations by reporting its revenues and expenses.	If the company's revenue exceeds its expenses, it will report net income; otherwise it will report a net loss.
What is the company's policy toward dividends and growth?	Retained earnings statement	How much of this year's income did the company pay out in dividends to shareholders?	A company striving for rapid growth will pay a low (or no) dividend.
Does the company rely primarily on debt or stockholders' equity to finance its assets?	Balance sheet	The balance sheet reports the company's resources and claims to those resources. There are two types of claims: liabilities and stockholders' equity.	Compare the amount of debt versus the amount of stockholders' equity to determine whether the company relies more on creditors or owners for its financing.
Does the company generate sufficient cash from operations to fund its investing activities?	Statement of cash flows	The statement of cash flows shows the amount of cash provided or used by operating activities, investing activities, and financing activities.	Compare the amount of cash provided by operating activities with the amount of cash used by investing activities. Any deficiency in cash from operating activities must be made up with cash from financing activities.

Glossary

Accounting (p. 5) The information system that identifies, records, and communicates the economic events of an organization to interested users.

Annual report (p. 19) A report prepared by corporate management that presents financial information including financial statements, notes, a management discus-

sion and analysis section, and an independent auditor's report.

Assets (p. 9) Resources owned by a business.

Auditor's report (p. 19) A report prepared by an independent outside auditor stating the auditor's opinion as

to the fairness of the presentation of the financial position and results of operations and their conformance with generally accepted accounting standards.

Balance sheet (p. 13) A financial statement that reports the assets and claims to those assets at a specific point in time.

Basic accounting equation (p. 13) $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.

Certified Public Accountant (CPA) (p. 20) An individual who has met certain criteria and is thus allowed to perform audits of corporations.

Common stock (p. 9) Term used to describe the total amount paid in by stockholders for the shares they purchase.

Corporation (p. 4) A business organized as a separate legal entity having ownership divided into transferable shares of stock.

Dividends (p. 9) Payments of cash from a corporation to its stockholders.

Expenses (p. 10) The cost of assets consumed or services used in the process of generating revenues.

Income statement (p. 11) A financial statement that presents the revenues and expenses and resulting net income or net loss of a company for a specific period of time.

Liabilities (p. 9) The debts and obligations of a business. Liabilities represent the amounts owed to creditors.

Management discussion and analysis (MD&A) (p. 19) A section of the annual report that presents management's views on the company's ability to pay near-term obligations, its ability to fund operations and expansion, and its results of operations.

Net income (p. 10) The amount by which revenues exceed expenses.

Net loss (p. 10) The amount by which expenses exceed revenues.

Notes to the financial statements (p. 19) Notes that clarify information presented in the financial statements, as well as expand upon it where additional detail is needed.

Partnership (p. 4) A business owned by two or more persons associated as partners.

Retained earnings (p. 13) The amount of net income retained in the corporation.

Retained earnings statement (p. 13) A financial statement that summarizes the amounts and causes of changes in retained earnings for a specific period of time.

Revenue (p. 10) The increase in assets that result from the sale of a product or service in the normal course of business.

Sarbanes-Oxley Act (p. 8) Regulations passed by Congress in 2002 to try to reduce unethical corporate behavior.

Sole proprietorship (p. 4) A business owned by one person.

Statement of cash flows (p. 15) A financial statement that provides financial information about the cash receipts and cash payments of a business for a specific period of time.

Stockholders' equity (p. 13) The owners' claim to assets.

Comprehensive **Do it!**

Jeff Andringa, a former college hockey player, quit his job and started Ice Camp, a hockey camp for kids ages 8 to 18. Eventually, he would like to open hockey camps nationwide. Jeff has asked you to help him prepare financial statements at the end of his first year of operations. He relates the following facts about his business activities.

In order to get the business off the ground, he decided to incorporate. He sold shares of common stock to a few close friends, as well as buying some of the shares himself. He initially raised \$25,000 through the sale of these shares. In addition, the company took out a \$10,000 loan at a local bank.

Ice Camp purchased, for \$12,000 cash, a bus for transporting kids. The company also bought hockey goals and other miscellaneous equipment with \$1,500 cash. The company earned camp tuition during the year of \$100,000 but had collected only \$80,000 of this amount. Thus, at the end of the year its customers still owed \$20,000. The company rents time at a local rink for \$50 per hour. Total rink rental costs during the year were \$8,000, insurance was \$10,000, salary expense was \$20,000, and supplies used totaled \$9,000, all of which were paid in cash. The company incurred \$800 in interest expense on the bank loan, which it still owed at the end of the year.

The company paid dividends during the year of \$5,000 cash. The balance in the corporate bank account at December 31, 2012, was \$49,500.

The Comprehensive Do it! is a final review before you begin homework.

Instructions

Using the format of the Sierra Corporation statements in this chapter, prepare an income statement, retained earnings statement, balance sheet, and statement of cash flows. (*Hint:* Prepare the statements in the order stated to take advantage of the flow of information from one statement to the next, as shown in Illustration 1-9 on page 17.)

Action Plan

- On the income statement: Show revenues and expenses for a period of time.
- On the retained earnings statement: Show the changes in retained earnings for a period of time.
- On the balance sheet: Report assets, liabilities, and stockholders' equity at a specific date.
- On the statement of cash flows: Report sources and uses of cash from operating, investing, and financing activities for a period of time.

Solution to Comprehensive Do it!

ICE CAMP
Income Statement
For the Year Ended December 31, 2012

Revenues		
Service revenue		\$100,000
Expenses		
Salaries and wages expense	\$20,000	
Insurance expense	10,000	
Supplies expense	9,000	
Rent expense	8,000	
Interest expense	<u>800</u>	
Total expenses		<u>47,800</u>
Net income		<u><u>\$ 52,200</u></u>

ICE CAMP
Retained Earnings Statement
For the Year Ended December 31, 2012

Retained earnings, January 1, 2012		\$ 0
Add: Net income		<u>52,200</u>
		52,200
Less: Dividends		<u>5,000</u>
Retained earnings, December 31, 2012		<u><u>\$47,200</u></u>

ICE CAMP
Balance Sheet
December 31, 2012

<u>Assets</u>		
Cash		\$49,500
Accounts receivable		20,000
Equipment		<u>13,500</u>
Total assets		<u><u>\$83,000</u></u>
<u>Liabilities and Stockholders' Equity</u>		
Liabilities		
Notes payable	\$10,000	
Interest payable	<u>800</u>	
Total liabilities		\$10,800
Stockholders' equity		
Common stock	25,000	
Retained earnings	<u>47,200</u>	
Total stockholders' equity		<u>72,200</u>
Total liabilities and stockholders' equity		<u><u>\$83,000</u></u>

ICE CAMP
Statement of Cash Flows
For the Year Ended December 31, 2012

Cash flows from operating activities		
Cash receipts from operating activities	\$80,000	
Cash payments for operating activities	<u>(47,000)</u>	
Net cash provided by operating activities		\$33,000
Cash flows from investing activities		
Purchase of equipment	<u>(13,500)</u>	
Net cash used by investing activities		(13,500)
Cash flows from financing activities		
Issuance of common stock	25,000	
Issuance of notes payable	10,000	
Dividends paid	<u>(5,000)</u>	
Net cash provided by financing activities		<u>30,000</u>
Net increase in cash		49,500
Cash at beginning of period		<u>0</u>
Cash at end of period		<u><u>\$49,500</u></u>



This would be a good time to look at the **Student Owner's Manual** in the Preface to the book. Knowing the purpose of the different types of homework will help you understand what each contributes to your accounting skills and competencies.

The tool icon  indicates that an activity employs one of the decision tools presented in the chapter. The  indicates that an activity relates to a business function beyond accounting. The pencil icon  indicates that an activity requires written communication.





Self-Test, Brief Exercises, Exercises, Problem Set A, and many more resources are available for practice in WileyPLUS

Self-Test Questions

Answers are on page 42.






- (S0 1) 1. Which is *not* one of the three forms of business organization?
 (a) Sole proprietorship. (c) Partnership.
 (b) Creditorship. (d) Corporation.
- (S0 1) 2. Which is an advantage of corporations relative to partnerships and sole proprietorships?
 (a) Lower taxes.
 (b) Harder to transfer ownership.
 (c) Reduced legal liability for investors.
 (d) Most common form of organization.
- (S0 2) 3. Which statement about users of accounting information is *incorrect*?
 (a) Management is considered an internal user.
 (b) Taxing authorities are considered external users.
 (c) Present creditors are considered external users.
 (d) Regulatory authorities are considered internal users.
- (S0 2) 4. Which of the following did *not* result from the Sarbanes-Oxley Act?
 (a) Top management must now certify the accuracy of financial information.
 (b) Penalties for fraudulent activity increased.
 (c) Independence of auditors increased.
 (d) Tax rates on corporations increased.
5. Which is *not* one of the three primary business activities? (S0 3)
 (a) Financing. (c) Advertising.
 (b) Operating. (d) Investing.
6. Which of the following is an example of a financing activity? (S0 3)
 (a) Issuing shares of common stock.
 (b) Selling goods on account.
 (c) Buying delivery equipment.
 (d) Buying inventory.
7. Net income will result during a time period when: (S0 4)
 (a) assets exceed liabilities.
 (b) assets exceed revenues.
 (c) expenses exceed revenues.
 (d) revenues exceed expenses.





- (S0 4) 8. The financial statements for Joseph Corporation contained the following information.
- | | |
|----------------------------|----------|
| Accounts receivable | \$ 5,000 |
| Sales revenue | 75,000 |
| Cash | 15,000 |
| Salaries and wages expense | 20,000 |
| Rent expense | 10,000 |
- What was Joseph Corporation's net income?
- (a) \$60,000. (c) \$65,000.
(b) \$15,000. (d) \$45,000.
- (S0 4, 5) 9.  What section of a statement of cash flows indicates the cash spent on new equipment during the past accounting period?
- (a) The investing section.
(b) The operating section.
(c) The financing section.
(d) The cash flow statement does not give this information.
- (S0 4, 5) 10. Which statement presents information as of a specific point in time?
- (a) Income statement.
(b) Balance sheet.
(c) Statement of cash flows.
(d) Retained earnings statement.
- (S0 5) 11. Which financial statement reports assets, liabilities, and stockholders' equity?
- (a) Income statement.
(b) Retained earnings statement.
(c) Balance sheet.
(d) Statement of cash flows.
12. Stockholders' equity represents: (S0 5)
- (a) claims of creditors.
(b) claims of employees.
(c) the difference between revenues and expenses.
(d) claims of owners.
13. As of December 31, 2012, Stoneland Corporation (S0 5) has assets of \$3,500 and stockholders' equity of \$1,500. What are the liabilities for Stoneland Corporation as of December 31, 2012?
- (a) \$1,500. (c) \$2,500.
(b) \$1,000. (d) \$2,000.
14.  The element of a corporation's annual report that describes the corporation's accounting methods is the: (S0 6)
- (a) notes to the financial statements.
(b) management discussion and analysis.
(c) auditor's report.
(d) income statement.
15. The element of the annual report that presents an opinion regarding the fairness of the presentation of the financial position and results of operations is/are the: (S0 6)
- (a) income statement.
(b) auditor's opinion.
(c) balance sheet.
(d) comparative statements.

Go to the book's companion website, www.wiley.com/college/kimmel, to access additional Self-Test Questions.



Questions

1.  What are the three basic forms of business organizations?
2. What are the advantages to a business of being formed as a corporation? What are the disadvantages?
3. What are the advantages to a business of being formed as a partnership or sole proprietorship? What are the disadvantages?
4. "Accounting is ingrained in our society and is vital to our economic system." Do you agree? Explain.
5.  Who are the internal users of accounting data? How does accounting provide relevant data to the internal users?
6. Who are the external users of accounting data? Give examples.
7. What are the three main types of business activity? Give examples of each activity.
8. Listed here are some items found in the financial statements of Ellyn Toth, Inc. Indicate in which financial statement(s) each item would appear.
- (a) Service revenue. (d) Accounts receivable.
(b) Equipment. (e) Common stock.
(c) Advertising expense. (f) Interest payable.
9.   Why would a bank want to monitor the dividend payment practices of the corporations it lends money to?
10. "A company's net income appears directly on the income statement and the retained earnings statement, and it is included indirectly in the company's balance sheet." Do you agree? Explain.
11.  What is the primary purpose of the statement of cash flows?
12. What are the three main categories of the statement of cash flows? Why do you think these categories were chosen?
13. What is retained earnings? What items increase the balance in retained earnings? What items decrease the balance in retained earnings?
14. What is the basic accounting equation?
15. (a) Define the terms *assets*, *liabilities*, and *stockholders' equity*.
(b) What items affect stockholders' equity?
16. Which of these items are liabilities of White Glove Cleaning Service?
- (a) Cash. (c) Dividends.
(b) Accounts payable. (d) Accounts receivable.

- (e) Supplies. (h) Service revenue.
 - (f) Equipment. (i) Rent expense.
 - (g) Salaries and wages payable.
17. How are each of the following financial statements interrelated? (a) Retained earnings statement and income statement. (b) Retained earnings statement and balance sheet. (c) Balance sheet and statement of cash flows.
18.  What is the purpose of the management discussion and analysis section (MD&A)?
19.  Why is it important for financial statements to receive an unqualified auditor's opinion?
20.  What types of information are presented in the notes to the financial statements?
21.  The accounting equation is: Assets = Liabilities + Stockholders' Equity. Appendix A, at the end of this book, reproduces Tootsie Roll's financial statements. Replacing words in the equation with dollar amounts, what is Tootsie Roll's accounting equation at December 31, 2009?



Brief Exercises

- BE1-1** Match each of the following forms of business organization with a set of characteristics: sole proprietorship (SP), partnership (P), corporation (C). *Describe forms of business organization. (SO 1), K*
- (a) ____ Shared control, tax advantages, increased skills and resources.
 - (b) ____ Simple to set up and maintains control with founder.
 - (c) ____ Easier to transfer ownership and raise funds, no personal liability.
- BE1-2** Match each of the following types of evaluation with one of the listed users of accounting information. *Identify users of accounting information. (SO 2), K*
- 1. Trying to determine whether the company complied with tax laws.
 - 2. Trying to determine whether the company can pay its obligations.
 - 3. Trying to determine whether a marketing proposal will be cost effective.
 - 4. Trying to determine whether the company's net income will result in a stock price increase.
 - 5. Trying to determine whether the company should employ debt or equity financing.
- (a) ____ Investors in common stock. (d) ____ Chief Financial Officer.
 - (b) ____ Marketing managers. (e) ____ Internal Revenue Service.
 - (c) ____ Creditors.
- BE1-3** Indicate in which part of the statement of cash flows each item would appear: operating activities (O), investing activities (I), or financing activities (F). *Classify items by activity. (SO 3, 4), K*
- (a) ____ Cash received from customers.
 - (b) ____ Cash paid to stockholders (dividends).
 - (c) ____ Cash received from issuing new common stock.
 - (d) ____ Cash paid to suppliers.
 - (e) ____ Cash paid to purchase a new office building.
- BE1-4** Presented below are a number of transactions. Determine whether each transaction affects common stock (C), dividends (D), revenue (R), expense (E), or does not affect stockholders' equity (NSE). Provide titles for the revenues and expenses. *Determine effect of transactions on stockholders' equity. (SO 4), C*
- (a) Costs incurred for advertising.
 - (b) Assets received for services performed.
 - (c) Costs incurred for insurance.
 - (d) Amounts paid to employees.
 - (e) Cash distributed to stockholders.
 - (f) Assets received in exchange for allowing the use of the company's building.
 - (g) Costs incurred for utilities used.
 - (h) Cash purchase of equipment.
 - (i) Issued common stock for cash.
- BE1-5** In alphabetical order below are balance sheet items for Wyoming Company at December 31, 2012. Prepare a balance sheet following the format of Illustration 1-7. *Prepare a balance sheet. (SO 4, 5), AP*

Accounts payable	\$65,000
Accounts receivable	71,000
Cash	22,000
Common stock	28,000

Determine where items appear on financial statements.

(SO 4, 5), K

BE1-6 Eskimo Pie Corporation markets a broad range of frozen treats, including its famous Eskimo Pie ice cream bars. The following items were taken from a recent income statement and balance sheet. In each case, identify whether the item would appear on the balance sheet (BS) or income statement (IS).

- | | |
|---|-------------------------------|
| (a) _____ Income tax expense. | (f) _____ Net sales. |
| (b) _____ Inventories. | (g) _____ Cost of goods sold. |
| (c) _____ Accounts payable. | (h) _____ Common stock. |
| (d) _____ Retained earnings. | (i) _____ Receivables. |
| (e) _____ Property, plant, and equipment. | (j) _____ Interest expense. |

Determine proper financial statement.

(SO 4), K



BE1-7 Indicate which statement you would examine to find each of the following items: income statement (I), balance sheet (B), retained earnings statement (R), or statement of cash flows (C).

- Revenue during the period.
- Supplies on hand at the end of the year.
- Cash received from issuing new bonds during the period.
- Total debts outstanding at the end of the period.

Use basic accounting equation.

(SO 5), AP

BE1-8 Use the basic accounting equation to answer these questions.

- The liabilities of Daley Company are \$90,000 and the stockholders' equity is \$230,000. What is the amount of Daley Company's total assets?
- The total assets of Laven Company are \$170,000 and its stockholders' equity is \$80,000. What is the amount of its total liabilities?
- The total assets of Peterman Co. are \$800,000 and its liabilities are equal to one-fourth of its total assets. What is the amount of Peterman Co.'s stockholders' equity?

Use basic accounting equation.

(SO 5), AP

BE1-9 At the beginning of the year, Peale Company had total assets of \$800,000 and total liabilities of \$500,000.

- If total assets increased \$150,000 during the year and total liabilities decreased \$80,000, what is the amount of stockholders' equity at the end of the year?
- During the year, total liabilities increased \$100,000 and stockholders' equity decreased \$70,000. What is the amount of total assets at the end of the year?
- If total assets decreased \$80,000 and stockholders' equity increased \$110,000 during the year, what is the amount of total liabilities at the end of the year?

Identify assets, liabilities, and stockholders' equity.

(SO 5), K

BE1-10 Indicate whether each of these items is an asset (A), a liability (L), or part of stockholders' equity (SE).

- | | |
|---------------------------------|--------------------|
| (a) Accounts receivable. | (d) Supplies. |
| (b) Salaries and wages payable. | (e) Common stock. |
| (c) Equipment. | (f) Notes payable. |

Determine required parts of annual report.

(SO 6), K



BE1-11 Which is *not* a required part of an annual report of a publicly traded company?

- Statement of cash flows.
- Notes to the financial statements.
- Management discussion and analysis.
- All of these are required.

Do it! Review

Identify benefits of business organization forms.

(SO 1), C

Do it! 1-1 Identify each of the following organizational characteristics with the organizational form or forms with which it is associated.

- | | |
|----------------------------------|---------------------------------|
| (a) Easier to transfer ownership | (d) Tax advantages |
| (b) Easier to raise funds | (e) No personal legal liability |
| (c) More owner control | |

Classify business activities.

(SO 3), K

Do it! 1-2 Classify each item as an asset, liability, common stock, revenue, or expense.

- Issuance of ownership shares
- Land purchased
- Amounts owed to suppliers
- Bonds payable
- Amount earned from selling a product
- Cost of advertising

Do it! 1-3 Gould Corporation began operations on January 1, 2012. The following information is available for Gould Corporation on December 31, 2012.

Accounts payable	\$ 5,000	Notes payable	\$ 7,000
Accounts receivable	2,000	Rent expense	10,000
Advertising expense	4,000	Retained earnings	?
Cash	3,100	Service revenue	25,000
Common stock	15,000	Supplies	1,900
Dividends	2,500	Supplies expense	1,700
Equipment	26,800		

Prepare financial statements.
(SO 4), AP

Prepare an income statement, a retained earnings statement, and a balance sheet for Gould Corporation.

Do it! 1-4 Indicate whether each of the following items is most closely associated with the management discussion and analysis (MD&A), the notes to the financial statements, or the auditor's report.

Identify components of annual reports.
(SO 6), C

- Description of ability to pay near-term obligations
- Unqualified opinion
- Details concerning liabilities, too voluminous to be included in the statements
- Description of favorable and unfavorable trends
- Certified Public Accountant (CPA)
- Descriptions of significant accounting policies

Exercises

E1-1 Here is a list of words or phrases discussed in this chapter:

- | | | |
|------------------------|-----------------|----------------------|
| 1. Corporation | 4. Partnership | 7. Accounts payable |
| 2. Creditor | 5. Stockholder | 8. Auditor's opinion |
| 3. Accounts receivable | 6. Common stock | |

Match items with descriptions.
(SO 1, 2, 4, 6), K

Instructions

Match each word or phrase with the best description of it.

- _____ (a) An expression about whether financial statements conform with generally accepted accounting principles.
- _____ (b) A business enterprise that raises money by issuing shares of stock.
- _____ (c) The portion of stockholders' equity that results from receiving cash from investors.
- _____ (d) Obligations to suppliers of goods.
- _____ (e) Amounts due from customers.
- _____ (f) A party to whom a business owes money.
- _____ (g) A party that invests in common stock.
- _____ (h) A business that is owned jointly by two or more individuals but does not issue stock.

E1-2 All businesses are involved in three types of activities—financing, investing, and operating. Listed below are the names and descriptions of companies in several different industries.

Identify business activities.
(SO 3), C

- Abitibi Consolidated Inc.**—manufacturer and marketer of newsprint
Cal State–Northridge Stdt Union—university student union
Oracle Corporation—computer software developer and retailer
Sportsco Investments—owner of the Vancouver Canucks hockey club
Grant Thornton LLP—professional accounting and business advisory firm
Southwest Airlines—discount airline

Instructions

- For each of the above companies, provide examples of (1) a financing activity, (2) an investing activity, and (3) an operating activity that the company likely engages in.
- Which of the activities that you identified in (a) are common to most businesses? Which activities are not?

Classify accounts.
(SO 3, 4), C

E1-3 The Fair View Golf & Country Club details the following accounts in its financial statements.

	(a)	(b)
Accounts payable	_____	_____
Accounts receivable	_____	_____
Equipment	_____	_____
Sales revenue	_____	_____
Service revenue	_____	_____
Inventory	_____	_____
Mortgage payable	_____	_____
Supplies expense	_____	_____
Rent expense	_____	_____
Salaries and wages expense	_____	_____

Instructions

- (a) Classify each of the above accounts as an asset (A), liability (L), stockholders' equity (SE), revenue (R), or expense (E) item.
- (b) Classify each of the above accounts as a financing activity (F), investing activity (I), or operating activity (O). If you believe a particular account doesn't fit in any of these activities, explain why.

Prepare income statement and retained earnings statement.
(SO 4), AP

E1-4 This information relates to Alexis Co. for the year 2012.

Retained earnings, January 1, 2012	\$67,000
Advertising expense	1,800
Dividends paid during 2012	6,000
Rent expense	10,400
Service revenue	58,000
Utilities expense	2,400
Salaries and wages expense	30,000

Instructions

After analyzing the data, prepare an income statement and a retained earnings statement for the year ending December 31, 2012.

Prepare income statement and retained earnings statement.
(SO 4), AP

E1-5 The following information was taken from the 2009 financial statements of pharmaceutical giant Merck and Co. All dollar amounts are in millions.

Retained earnings, January 1, 2009	\$43,698.8
Materials and production expense	9,018.9
Marketing and administrative expense	8,543.2
Dividends	3,597.7
Sales revenue	27,428.3
Research and development expense	5,845.0
Tax expense	2,267.6
Other revenue	11,147.7

Instructions

- (a) After analyzing the data, prepare an income statement and a retained earnings statement for the year ending December 31, 2009.
- (b) Suppose that Merck decided to reduce its research and development expense by 50%. What would be the short-term implications? What would be the long-term implications? How do you think the stock market would react?

Prepare a retained earnings statement.
(SO 4), AP

E1-6 Presented here is information for Packee Inc. for 2012.

Retained earnings, January 1	\$130,000
Revenue from legal services	400,000
Total expenses	175,000
Dividends	65,000

Instructions

Prepare the 2012 retained earnings statement for Packee Inc.

Interpret financial facts.
(SO 4), AP

E1-7 Consider each of the following independent situations.

- (a) The retained earnings statement of Scott Corporation shows dividends of \$68,000, while net income for the year was \$75,000.

- (b) The statement of cash flows for Silberman Corporation shows that cash provided by operating activities was \$10,000, cash used in investing activities was \$110,000, and cash provided by financing activities was \$130,000.



Instructions

For each company provide a brief discussion interpreting these financial facts. For example, you might discuss the company's financial health or its apparent growth philosophy.

E1-8 The following items and amounts were taken from Linus Inc.'s 2012 income statement and balance sheet.

Identify financial statement components and prepare income statement.

_____ Cash	\$ 84,700	_____ Accounts receivable	88,419
_____ Retained earnings	123,192	_____ Sales revenue	584,951
_____ Cost of goods sold	438,458	_____ Income taxes payable	6,499
_____ Salaries and wages expense	115,131	_____ Accounts payable	49,384
_____ Prepaid insurance	7,818	_____ Service revenue	4,806
_____ Inventory	\$ 64,618	_____ Interest expense	1,882

(SO 4), C

Instructions

- (a) In each case, identify on the blank line whether the item is an asset (A), liability (L), stockholder's equity (SE), revenue (R), or expense (E) item.
 (b) Prepare an income statement for Linus Inc. for the year ended December 31, 2012.

E1-9 Here are incomplete financial statements for Liam, Inc.

Calculate missing amounts.

(SO 4, 5), AP

**LIAM, INC.
Balance Sheet**

<u>Assets</u>		<u>Liabilities and Stockholders' Equity</u>	
Cash	\$ 7,000	Liabilities	
Inventory	10,000	Accounts payable	\$ 5,000
Buildings	45,000	Stockholders' equity	
Total assets	<u>\$62,000</u>	Common stock	(a)
		Retained earnings	<u>(b)</u>
		Total liabilities and stockholders' equity	<u>\$62,000</u>

Income Statement

Revenues	\$85,000
Cost of goods sold	(c)
Salaries and wages expense	<u>10,000</u>
Net income	<u>\$ (d)</u>

Retained Earnings Statement

Beginning retained earnings	\$12,000
Add: Net income	(e)
Less: Dividends	<u>5,000</u>
Ending retained earnings	<u>\$27,000</u>

Instructions

Calculate the missing amounts.

E1-10 Deer Track Park is a private camping ground near the Lathom Peak Recreation Area. It has compiled the following financial information as of December 31, 2012.

Compute net income and prepare a balance sheet.

Revenues during 2012: camping fees	\$132,000	Dividends	\$ 9,000
Revenues during 2012: general store	25,000	Notes payable	50,000
Accounts payable	11,000	Expenses during 2012	126,000
Cash	8,500	Supplies	5,500
Equipment	114,000	Common stock	40,000
		Retained earnings (1/1/2012)	5,000

(SO 4, 5), AP

