

Financial Statements

Spotlight

The Walt Disney Company

Where is the happiest place on earth? Walt Disney World or Disneyland, of course! The Disney theme parks in Orlando, Florida, and Anaheim, California, are famous for providing the ultimate family entertainment experience. However, these two parks are only a small part of **The Walt Disney Company's** worldwide entertainment empire. The company owns vacation resorts, theme and water parks, hotels, motion-picture and recording studios, and cable TV networks throughout the world. Disney also sells billions of dollars of branded merchandise through retail, online, and wholesale distribution channels. How does Disney decide what to invest in and how to operate its businesses to maximize its profits? One way to find out is by studying its financial accounting information. ●

Most chapters of this text begin with a financial statement. **Financial statements** are the business documents companies use to report the results of their activities to people and groups that can include managers, investors, creditors, and regulatory agencies. These parties then use the reported information to make a variety of decisions, such as whether to invest in or loan money to the companies. The following four basic financial statements are used for these purposes:

- Income statement (sometimes known as the statement of operations)
- Statement of retained earnings (usually included in the statement of stockholders' equity)
- Balance sheet (sometimes known as the statement of financial position)
- Statement of cash flows

In this chapter, we will look at the contents of these statements using the Jovita Corporation, a fictitious apparel manufacturing company, as an example. For instance, the following financial statement is Jovita's income statement for the year ended December 31, 2023.

Chapter 1 also explains generally accepted accounting principles, their underlying assumptions and concepts, and the bodies responsible for issuing accounting standards. Last but not least, we examine the judgment process needed to make good accounting decisions. Later chapters explain financial statements in more detail as well as how the information contained in them is used to make business decisions.

Jovita's managers make lots of decisions. What new clothing styles should be produced, and how should they be advertised? Should the company acquire a manufacturing facility? Which styles are the hottest sellers? Which clothing lines are most and least profitable? Accounting information helps companies make these decisions.

Learning Objectives

- LO1 **Explain** why accounting is critical to businesses
- LO2 **Explain and apply** underlying accounting concepts, assumptions, and principles
- LO3 **Apply** the accounting equation to business organizations
- LO4 **Construct** financial statements and **analyze** the relationships among them
- LO5 **Evaluate** business decisions ethically
- LO6 **Identify** the role of accounting in environmental, social, and governance (ESG) practices
- LO7 **Describe** career paths and professional certifications in accounting
- LO8 **Identify** tools and technologies used in accounting and business

	A1		
	A	B	C
1	Jovita Corporation		
2	Income Statements		
3		For years ending	
4		12/31/2023	12/31/2022
5	Sales revenue	\$ 7,547,800	\$ 6,201,000
6	Cost of goods sold	5,840,100	4,943,500
7	Gross margin	\$ 1,707,700	\$ 1,257,500
8	General and administrative expenses	902,100	750,900
9	Operating income	\$ 805,600	\$ 506,600
10	Interest revenue (expense)	7,800	3,600
11	Income before taxes	\$ 813,400	\$ 510,200
12	Income tax expense	160,800	38,100
13	Net income (loss)	\$ 652,600	\$ 472,100
14			

Take a look at Jovita's income statement. In accounting, the word net refers to an amount after a subtraction. Focus on net income (the bottom line). Net income (profit) is the excess of revenues over expenses. You can see that Jovita earned \$652,600 of net income in the year ended December 31, 2023. That's good news because it means that the company had \$652,600 more revenues than expenses for the year. Total revenues (line 5) increased by about 21.7% during the period compared to the previous year (from \$6,201,000 to \$7,547,800). Net income increased by about 38.2% (from \$472,100 to \$652,600).

Suppose you have \$10,000 to invest. What information would you need before deciding to invest in a company? You can find some of that information in the company's financial statements, and to understand it, you must study accounting. In addition, accounting provides some critical information to managers within the organization.

Explain Why Accounting Is Critical to Businesses

LO1 Explain why accounting is critical to businesses

Accounting is an information system that measures business activities, processes data into financial statements and reports, and communicates results to decision makers. Why study accounting? Accounting is the "language of business." You wouldn't think of moving to a foreign country without planning to learn the language(s) spoken there. Likewise, you shouldn't spend your career not knowing the language needed to measure and communicate business information. The better you understand the language of accounting, the better you can manage your own finances as well as those of your business.

After you have completed this chapter, you'll begin to understand the nature of accounting, financial statements, and the relationships between them. By the end of Chapter 3, you'll understand the process by which a company's financial statements are prepared, called the **accounting cycle**.

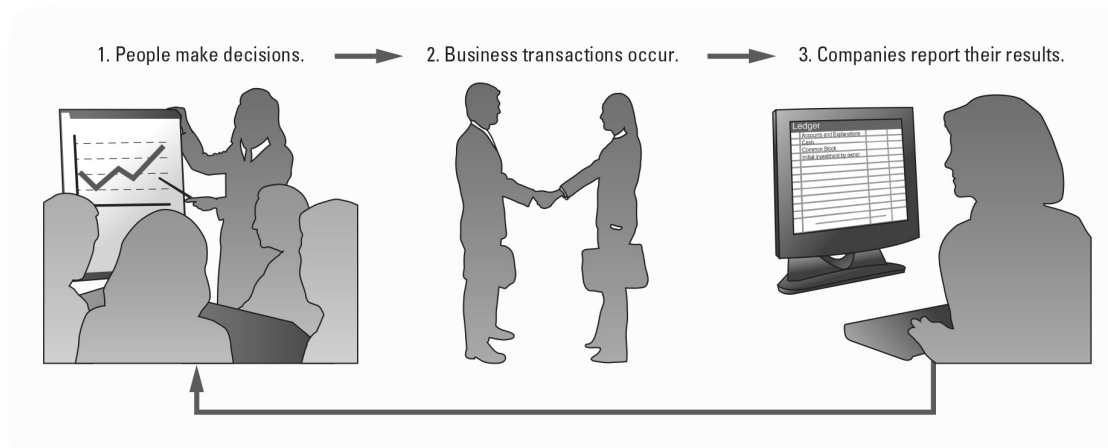
Don't confuse bookkeeping and accounting. Bookkeeping is a mechanical part of accounting, just as arithmetic is a part of mathematics. Exhibit 1-1 illustrates the flow of accounting information and its role in making business decisions.

Describe the Decision Makers Who Use Accounting

Decision makers use many types of information. For example, a banker needs financial information from an applicant to decide whether to grant a loan request. Managers at Disney use revenue forecasts along with design-and-engineering plans to decide where to locate new theme parks and how large they will be. Let's explore how decision makers use accounting information.

- **Individuals.** People like you manage their personal bank accounts, decide whether to rent an apartment or buy a house, and calculate the monthly income and expenditures of their businesses. Accounting provides the information people need to make these decisions.

Exhibit 1-1 The Flow of Accounting Information



- **Investors and creditors.** Investors and creditors provide the money to finance The Walt Disney Company. Investors want to know how much income they can expect to earn on an investment. Creditors want to know when and how the company is going to pay them back. These decisions also require accounting information.
- **Regulatory bodies.** All kinds of regulatory bodies use accounting information. For example, the Internal Revenue Service (IRS) and various state and local governments require businesses, individuals, and other types of organizations to pay income, property, excise, and other taxes. The Securities and Exchange Commission (SEC) requires companies with publicly traded stock to provide it with many kinds of periodic financial reports. All of these reports contain accounting information.
- **Nonprofit organizations.** Churches, hospitals, and charities such as Habitat for Humanity and the Red Cross base many of their operating decisions on accounting data. These nonprofit organizations also have to file periodic financial reports with the IRS and state governments, even though they will owe no income taxes.

Describe the Two Types of Accounting and Who Uses Each Type

People inside *and* outside an organization use accounting information. As a result, accounting has evolved into two branches: financial accounting and managerial accounting. **Financial accounting** provides relevant and accurate financial information to decision makers *outside* of an organization, such as investors, creditors, government agencies, and the public. This text focuses on financial accounting. **Managerial accounting** provides accurate and relevant information to people *inside* the organization, such as the managers of The Walt Disney Company. Examples of managerial accounting information include budgets, forecasts, and projections used to make strategic decisions. Managerial accounting is covered in a separate course that usually follows this one.

Explain How Businesses Are Organized

Accounting is used in every type of business. A business generally takes one of the following forms:

- Proprietorship
- Partnership
- Limited-liability company (LLC)
- Corporation

Exhibit 1-2 compares different ways to organize a business.

Exhibit 1-2 The Various Forms of Business Organization

	Proprietorship	Partnership	LLC	Corporation
1. <i>Owner(s)</i>	Proprietor—one owner	Partners—two or more owners	Members	Stockholders—generally many owners
2. <i>Personal liability of owner(s) for business's debts</i>	Proprietor is personally liable	General partners are personally liable; limited partners are not	Members are <i>not</i> personally liable	Stockholders are <i>not</i> personally liable

Proprietorship

A **proprietorship** has a single owner. Proprietorships tend to be small retail stores or solo providers of services—physicians, attorneys, artists, electricians, or accountants. Legally, the business *is* the proprietor, and the proprietor is personally liable for all the business's debts. But for accounting purposes, a proprietorship is a distinct entity, separate from its proprietor. Thus, the business records should be kept separate from the proprietor's personal finances.

Partnership

A **partnership** has two or more parties as co-owners, and each owner is a partner. Individuals, corporations, partnerships, or other types of entities can be partners. Income and losses of the partnership “flow through” to the partners, and they recognize them based on their agreed-upon percentage interest in the business. The partnership does not pay taxes. Instead, each partner pays taxes based on that partner's individual or corporate rate. Many retail establishments, professional service firms (law, accounting, etc.), real estate, and oil and gas exploration companies operate as partnerships. Many partnerships are small or medium-sized, but some are gigantic, with thousands of partners.

Partnerships are governed by an agreement, usually spelled out in writing in the form of a contract between the partners. In most partnerships, each partner can conduct business on behalf of the organization and can make agreements that legally bind all partners. Partnerships such as these are called *general partnerships*. They are risky because an irresponsible partner can create large debts for the other general partners without their knowledge or permission. This feature of general partnerships has led to the creation of limited-liability partnerships (LLPs). A *limited-liability partnership* is one in which a single partner cannot create a large liability for the other partners. In LLPs, each partner is liable for the partnership's debts only up to the extent of his or her investment in the partnership. However, each LLP must have one general partner with unlimited liability for all of the partnership debts.

Limited-Liability Company

A **limited-liability company (LLC)** is one in which the business (and not the owner) is liable for the company's debts. An LLC may have one owner or many owners, called *members*. Unlike a proprietorship or a general partnership, the members of an LLC have limited liability for the LLC's debts only up to the extent of their investment in the LLC. Similar to a partnership, the LLC's income “flows through” to the members, and they pay income taxes at their own tax rates. Because of these favorable features, many multiple-owner businesses are organized as LLCs.

Corporation

A **corporation** is a business owned by **stockholders**, or **shareholders**, who own **stock** representing shares of ownership in the corporation. Being able to raise large sums of capital by issuing shares of stock to the public is a major advantage of forming a corporation. All types of entities (individuals, partnerships, corporations, or other types) may be shareholders in a corporation. Even though proprietorships and partnerships are more numerous, corporations tend to be larger in terms of their assets, income, and number of employees. Most well-known companies, such as The Walt Disney Company, **Amazon.com, Inc.**, **Target Corporation**, **General Motors Company**, and **Apple Inc.**, are corporations. Unlike proprietorships and partnerships, a corporation must be formed under state law and is legally distinct

from its owners. The corporation is like an artificial person and possesses many of the same rights that a person has. The stockholders have no personal obligation for the corporation's debts. So stockholders of a corporation have limited liability, as do limited partners and members of an LLC. However, unlike partnerships or LLCs, a corporation pays a business income tax as well as many other types of taxes. So the shareholders of a corporation are effectively taxed twice on distributions received from the corporation (called dividends): (1) when the corporation pays income taxes and (2) when the shareholders pay taxes on the income distributed to them by the corporation. Thus, one of the major disadvantages of the corporate form of business is *double taxation of distributed profits*. The unique attributes of a corporation are covered in more detail in Chapter 10.

Explain and Apply Underlying Accounting Concepts, Assumptions, and Principles

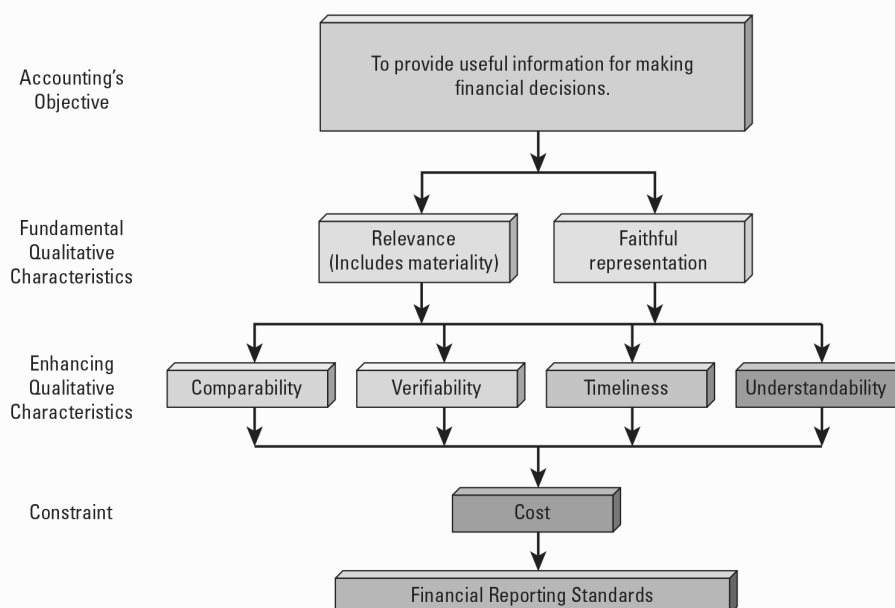
Accountants follow professional standards for measuring and disclosing financial information. The most common set of standards are called **generally accepted accounting principles (GAAP)**. In the United States, the **Financial Accounting Standards Board (FASB)** formulates the standards for U.S. GAAP. The **International Accounting Standards Board (IASB)** sets **International Financial Reporting Standards (IFRS)**, as discussed later in this section.

Exhibit 1-3 gives an overview of the joint conceptual framework of accounting developed by the FASB and the IASB. Financial reporting standards (whether U.S. or international), at the bottom, follow this conceptual framework. The top frame shows that the overall *objective* of accounting is to provide financial information about the reporting entity that existing and potential investors, lenders, and other creditors can use to make decisions. The second level in the exhibit indicates that to be useful, the information must have two fundamental qualitative characteristics:

- relevance and
- faithful representation.

LO2 Explain and apply underlying accounting concepts, assumptions, and principles

Exhibit 1-3 Conceptual Foundation of Accounting



To be relevant, the information must be useful to decision makers in terms of helping them predict or confirm an organization's value. In addition, the information must be *material*, which means it must be important enough that, if it were omitted or incorrect, it would affect a user's decision. Only information that is material needs to be separately *disclosed* (listed or discussed) in financial statements. If it's not material, it can be combined with other information and not separately disclosed. To make a faithful representation, the information must be complete, neutral (free from bias), and free from error (accurate). Faithful representation makes the information *reliable* to users.

The third level in the exhibit indicates that accounting information must also have a number of *enhancing qualitative characteristics*. These include

- comparability,
- verifiability,
- timeliness, and
- understandability.

Comparability means that accounting information must be prepared in a way that allows it to be compared with information from other companies in the same period. The information should also be *consistent* with similar information for that company in previous periods. For example, the methods used to calculate sales revenue should be consistent for each year presented in financial statements. *Verifiability* means that it must be possible to check the information for accuracy, completeness, and reliability. Verifiability enhances the reliability of information and thus makes the information more representative of economic reality. *Timeliness* means that the information must be made available to users early enough to help them make decisions. *Understandability* means the information must be transparent, or clear, enough so that it makes sense to reasonably informed users of the information (investors, creditors, regulatory agencies, and managers).

Cost is the fourth level in the exhibit. Because accounting information is costly to produce, the cost of disclosing it should not exceed its expected benefits to users. Managers must carefully decide what accounting costs the organization must incur to give users a good understanding of its financial situation and what accounting information is too costly to provide.

This course will expose you to U.S. GAAP as well as to relevant IFRS. We summarize U.S. GAAP in Appendix C and IFRS in Appendix D. In the following section, we briefly summarize some of the basic assumptions and principles that underlie these standards.

The Entity Assumption

The most basic accounting assumption (underlying idea) is the **entity**, which is any organization (or person) that stands apart as a separate economic unit. Sharp boundaries are drawn around each entity so as not to confuse its affairs with those of others. Consider Robert Iger, chief executive officer (CEO) of The Walt Disney Company. Iger likely owns several homes, automobiles, and other personal assets. In addition, he may owe money on some personal loans. All these assets and liabilities belong to Iger and have nothing to do with The Walt Disney Company. Likewise, Disney's media operations division's cash, computers, and inventories belong to the company and not to Iger. Why? The entity assumption draws a sharp boundary around each entity. In this case, The Walt Disney Company is one entity, and Robert Iger is a second, separate entity.

Let's consider the various types of businesses that make up The Walt Disney Company. The company operates four types of businesses, called **segments**: media networks; parks, experiences, and products; studio entertainment; and direct to consumer and international. Top managers evaluate the results of the parks, experiences, and products businesses separately from those of media networks. If theme park revenues were falling, the company should identify the reason. But if revenue figures from all the businesses were combined in a single total, managers couldn't tell how differently each business segment was performing. To correct the problem, managers need accounting information for each business segment (entity) in the company. They also need separate information for each geographic region (such as country). To accomplish this, each type of business and each region keeps its own records so it can be evaluated separately.

The Continuity (Going-Concern) Assumption

When measuring and reporting accounting information, we assume that the entity will continue to operate long enough to sell its inventories, convert any receivables to cash, use other existing assets (such as land, buildings, equipment, and supplies) for their intended purposes, and settle its obligations in the normal course of business. This is called the **continuity assumption (or going-concern assumption)**.

Consider the alternative to the **going-concern assumption**: the *quitting concern*, or going out of business assumption. An entity going out of business would have to sell all of its assets in the process. In that case, the most *relevant* measure of the value of the assets would be their liquidating values (or the amount the company can receive for the assets when sold in order to go out of business). But going out of business is the exception rather than the rule. Therefore, the continuity assumption says that a business should stay in business long enough to convert its inventories and receivables to cash and pay off its obligations in the ordinary course of business and to continue this process of operating into the future.

The Historical Cost Principle

The **historical cost principle** states that assets should be recorded at their actual cost, measured on the date of purchase as the amount of cash paid plus noncash types of compensation given in exchange. For example, suppose The Walt Disney Company wants to purchase a building for a new Disney Store. The building's current owner is asking \$6,000,000 for the building. Disney's managers believe the building is worth \$5,850,000 and offer that amount. Two real estate professionals appraise the building at \$6,100,000. The buyer and seller then compromise and agree on a price of \$5,900,000. The historical cost principle requires Disney to initially record the building at its actual cost of \$5,900,000—not at \$5,850,000, \$6,000,000, or \$6,100,000, even though those amounts were what some people believed the building was worth. The \$5,900,000 cost is both the *relevant* amount of the building's worth and the amount that *faithfully represents* a reliable figure for the price the company paid for it.

Based on the historical cost principle and the continuity assumption, The Walt Disney Company should continue to use historical cost to value the asset for as long as the business owns it. Why? Because cost is a *verifiable* measure that is relatively *free from bias*. Suppose that after the company has owned the building for six years, it can be sold for \$6,500,000 because real estate prices have gone up. Should Disney increase the value of the building on the company's books to \$6,500,000 at this point? No. According to the historical cost principle, the building remains on The Walt Disney Company's books at its historical cost of \$5,900,000, less accumulated depreciation. According to the continuity assumption, Disney intends to stay in business and use the building—not sell it—so its historical cost is the most relevant and the most faithful representation of its value. It is also the most easily verifiable amount. Should the company decide to sell the building later at a price above or below its value, it will record the cash received, remove the value of the building from the books, and record a gain or a loss for the difference at that time.

Although the historical cost principle is used widely in the United States to value assets, accounting is moving in the direction of reporting more assets and liabilities at their fair values. **Fair value** is the amount that the business could sell the asset for or the amount that the business could pay to settle the liability. The FASB has issued guidance for many companies to report many assets and liabilities at fair values. Moreover, in recent years, the FASB has agreed to “harmonize” U.S. GAAP with IFRS. IFRS generally allow more types of assets to be periodically adjusted to their fair values than U.S. GAAP. We will discuss the trend toward globalization of accounting standards in the following GlobalView feature, and we will illustrate it in later chapters throughout the text.

The Stable-Monetary-Unit Assumption

In the United States, we record transactions in dollars because that is our medium of exchange. British accountants record transactions in pounds sterling, Japanese in yen, and some continental Europeans in euros.

Unlike a liter or a mile, the value of a dollar changes over time. A rise in the general price level is called *inflation*. Inflation results in a dollar purchasing less food, less toothpaste, and less of other goods and services. When prices are stable—there is little inflation—a dollar's purchasing power is also stable.

Under the **stable-monetary-unit assumption**, accountants assume that the dollar's purchasing power is stable over time. We ignore inflation, and this allows us to add and subtract dollar amounts as though the dollar's purchasing power hasn't changed. This is important because businesses that report their financial information publicly usually report comparative financial information (that is, the current year along with one or more prior years). If we could not assume a stable monetary unit, assets and liabilities denominated in prior years' dollars would have to be adjusted to current-year price levels. In developed countries like the United States, inflation levels have been at relatively low levels for several decades and are expected to remain so for the foreseeable future. As a result, adjusting accounting information for inflation to make the information comparable over time isn't considered necessary.

Global View

International Financial Reporting Standards We live in a global economy: Investors in the United States can easily trade stocks on the Hong Kong, London, and Brussels stock exchanges over the internet. Each year, American companies such as **Starbucks**, **The Gap**, **McDonald's**, **Microsoft**, and **Disney** conduct billions of dollars of business around the globe. Conversely, foreign companies such as **Nokia**, **Samsung**, **Toyota**, and **Nestlé** conduct billions of dollars of business in the United States. American companies have merged with foreign companies to create international conglomerates such as **Pearson** (the publisher of this text) and **Anheuser-Busch InBev** (producers of alcoholic beverages). No matter where your career starts, it is very likely that it will involve global markets.

At one time, the major developed countries in the world (the United States, the United Kingdom, Japan, Germany, etc.) all had their own versions of GAAP. This made it difficult and expensive for users to compare financial results across entities from different countries. Why? It compelled users to restate and convert accounting data from one country to the next in order to make them comparable.

This problem has been largely solved by the IASB, which has developed International Financial Reporting Standards (IFRS) that are now being used by most countries around the world. IFRS have not been adopted in the United States because existing U.S. GAAP have long been considered the strongest single set of accounting standards in the world. In addition, the application of U.S. GAAP for public companies in the United States has been overseen carefully by the SEC, a body that at present has no global counterpart. Although it has taken measures to permit some types of U.S. companies that operate globally to use IFRS, the SEC has stopped short of requiring it. Thus, it appears that the FASB and IASB will continue to coexist in the future. The FASB and IFRS have ongoing projects to minimize the difference between their standards. The goal is to adopt a rather uniform set of high-quality global accounting standards, although some major differences remain.

In chapters that cover concepts where major differences between U.S. GAAP and IFRS exist, we will briefly discuss those differences. Appendix D includes a table, cross-referenced by chapter, that summarizes all of these differences as well as their impact on financial statements.

Apply the Accounting Equation to Business Organizations

LO3 Apply the accounting equation to business organizations

A company's financial statements tell us how the business is performing and where it stands. But how do we arrive at the financial statements? Let's examine the elements of financial statements, which are the building blocks from which statements are made. We will be using the financial statements from our fictitious apparel manufacturer, Jovita Corporation, to illustrate financial statement concepts.

Assets and Liabilities

The financial statements are based on the accounting equation. This equation presents the resources of a company and the claims to those resources.

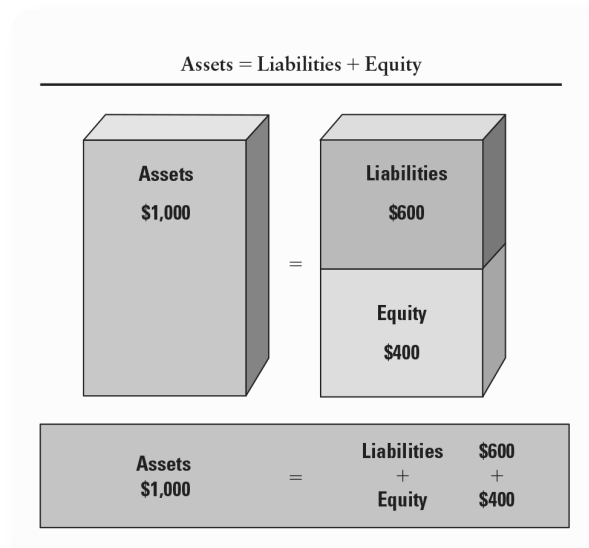
- **Assets** are economic resources that are expected to produce a benefit in the future. Jovita Corporation's cash, receivables, inventory, property and equipment, and intangible assets are examples of assets.

Claims on assets come from two sources:

- **Liabilities** are “outsider claims.” They are debts owed to people and organizations outside the business (creditors). For example, a creditor who has loaned money to Jovita Corporation has a claim—a legal right—to a part of the company's assets until the company repays the debt.
- **Equity** (also called **capital**, **owners' equity**, or **stockholders' equity** for a corporation) represents the “insider claims” of a business. Equity means ownership, so Jovita Corporation's equity is the stockholders' interest in the assets of the corporation. Throughout most of this text we will be discussing corporations, so the term *stockholders' equity* is most likely to be used.

The **accounting equation** shows the relationship among a company's assets, liabilities, and equity. Assets appear on the left side and liabilities and equity on the right. As Exhibit 1-4 shows, the two sides must be equal:

Exhibit 1-4 The Accounting Equation



What are some of Jovita Corporation's assets? As Exhibit 1-9 shows, the first asset is *cash and cash equivalents*. *Cash equivalents* are liquid assets that can be readily converted to cash. A certificate of deposit and a U.S. treasury bill are examples of cash equivalents. Another important asset is inventory (often called merchandise inventory or inventories)—the consumer products—that the company sells. The company also has assets in the form of property and equipment, which can also be referred to as *fixed assets*. These are the long-lived assets the company uses to do business—buildings, computers, and other equipment.

A company's liabilities may include a number of payables, such as accounts payable and accrued liabilities. The word *payable* always signifies a liability. An account payable is a liability for goods or services purchased on credit. Accounts payable typically have to be paid within 30 to 60 days. **Long-term debt** (borrowings) is a liability that's payable beyond one year from the date of the financial statements. The *current portion of long-term debt (borrowings)* is the amount due within the next year, and it has to be disclosed separately in the current liabilities section.

Equity

The equity (owners' interests) of any business is its assets minus its liabilities. We can write the accounting equation to show that owners' equity is what's left over when we subtract liabilities from assets.

$$\text{Asset} - \text{Liabilities} = \text{Equity}$$

A corporation's equity—called stockholders' equity—has two main subparts:

- Paid-in capital
- Retained earnings

The accounting equation for a corporation can be written as

$$\text{Asset} = \text{Liabilities} + \text{Stockholders' Equity}$$

$$\text{Asset} = \text{Liabilities} + \text{Paid-in Capital} + \text{Retained Earnings}$$

- **Paid-in capital** is the amount the stockholders have invested in the corporation. The basic component of paid-in capital is **common stock**, which the corporation issues to the stockholders as evidence of their ownership. All corporations issue common stock.
- **Retained earnings** is the amount earned by income-producing activities and kept for use by the business. Three major types of transactions affect retained earnings: revenues, expenses, and dividends.
- **Revenues** are inflows of resources that increase retained earnings as a result of the company delivering goods or services to customers. For example, sales of Jovita's apparel bring in revenue and increase the company's retained earnings.
- **Expenses** are resource outflows that decrease a company's retained earnings due to operations. Expenses represent the costs of doing business; they are the opposite of revenues. The wages and salaries Jovita pays its employees, the cost of the products it sells, and its utility and rent payments are expenses that decrease its retained earnings. The depreciation of Jovita's buildings and equipment is also an expense.
- **Dividends** decrease retained earnings because they are distributions to stockholders of assets (usually cash) generated by a company's operating activities. A successful business may pay dividends to shareholders as a return on their investments. Remember: *dividends are not expenses, and they never affect a company's net income*. Instead of being subtracted from revenues to calculate net income, dividends are recorded as direct reductions of retained earnings.

Businesses strive for *profits*, the excess of revenues over expenses.

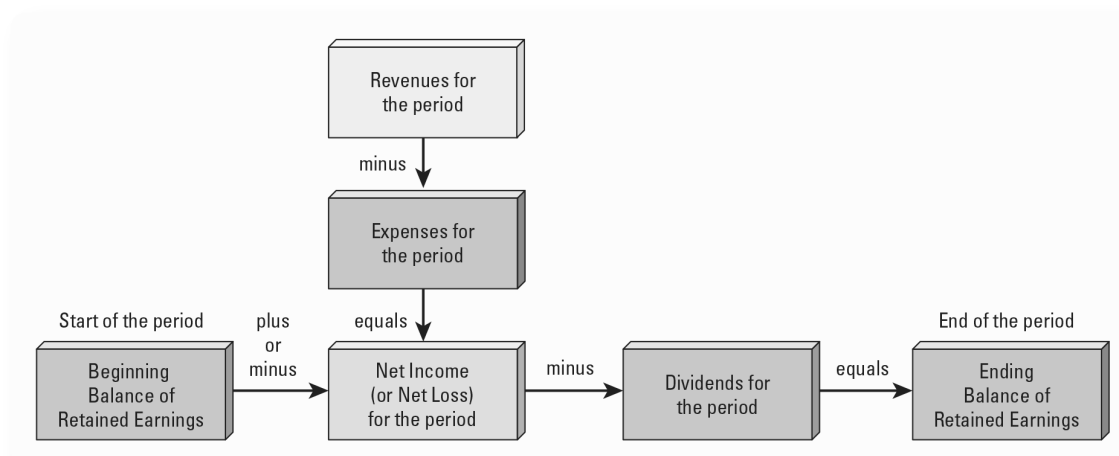
- When a company's total revenues exceed total expenses, the result is called **net income**, **net earnings**, or **net profit**.
- When a company's total expenses exceed total revenues, the result is a **net loss**.
- Net income or net loss is the "bottom line" on an income statement. Jovita Corporation's bottom line for the year ended December 31, 2023, was a net income of \$652,600 (bottom line on the income statements in Exhibit 1-7).

Exhibit 1-5 shows the relationships among the following:

- Retained earnings
- Revenues $-$ Expenses = Net income (or net loss)
- Dividends

The equity of proprietorships and partnerships is different from that of corporations. Proprietorships and partnerships don't identify paid-in capital and retained earnings separately. Instead, they use a single heading: Capital. Examples include "Randall Waller, Capital" (for a proprietorship) and "Powers, Capital" and "Salazar, Capital" (for a partnership).

Exhibit 1-5 The Components of Retained Earnings



Try It

(Answers are given on p. 58.)

1. If the assets of a business are \$480,000 and the liabilities are \$160,000, how much is the equity?
2. If the equity in a business is \$160,000 and the liabilities are \$100,000, how much are the assets?
3. A company reported monthly revenues of \$365,000 and monthly expenses of \$225,000. What is the result of operations for the month?
4. If the beginning balance of retained earnings is \$180,000, revenue is \$85,000, expenses total \$35,000, and the company declares and pays a \$20,000 dividend, what is the ending balance of retained earnings?

Construct Financial Statements and Analyze the Relationships Among Them

Financial statements present a company to the public in financial terms. Each financial statement relates to a specific date or time period. What would investors and other decision makers want to know about the company at the end of its fiscal year? Exhibit 1-6 lists four questions they should ask. Each answer comes from one of the financial statements.

To learn how to use financial statements, let's work through Jovita's financial statements for the year ended December 31, 2023. The following diagram shows how the data flow from one financial statement to the next. The order is important.

LO4 Construct
financial
statements and
analyze the
relationships
among them

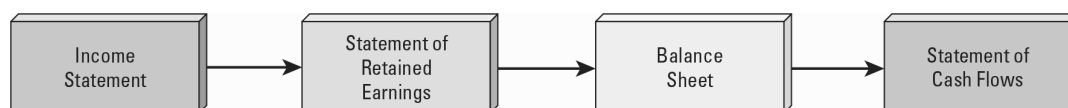


Exhibit 1-6 Information Reported in the Financial Statements

Question	Financial Statement	Answer
1. How well did the company perform during the year?	Income statement (also called the Statement of operations)	Revenues – Expenses Net income (or Net loss)
2. Why did the company's retained earnings change during the year?	Statement of retained earnings	Beginning retained earnings + Net income (or – Net loss) – Dividends declared Ending retained earnings
3. What is the company's financial position at fiscal year end?	Balance sheet (also called the Statement of financial position)	Assets = Liabilities + Stockholders' Equity
4. How much cash did the company generate and spend during the year?	Statement of cash flows	Net Operating cash flows ± Net Investing cash flows ± Net Financing cash flows Increase (decrease) in cash

The Income Statement

Exhibit 1-7 shows Jovita's **income statement**, or **statement of operations**, which reports revenues and expenses for the period. In other words, the income statement measures a company's operating performance. The bottom line in the statement is the net income or net loss for the period. At the top of Exhibit 1-7 is the company's name: Jovita Corporation. On the next line is the term "Income Statements."

Exhibit 1-7 Jovita Corporation's Statements of Income

	A1		
	A	B	C
1	Jovita Corporation		
2	Income Statements		
3		For years ending	
4		12/31/2023	12/31/2022
5	Sales revenue	\$ 7,547,800	\$ 6,201,000
6	Cost of goods sold	5,840,100	4,943,500
7	Gross margin	\$ 1,707,700	\$ 1,257,500
8	General and administrative expenses	902,100	750,900
9	Operating income	\$ 805,600	\$ 506,600
10	Interest revenue (expense)	7,800	3,600
11	Income before taxes	\$ 813,400	\$ 510,200
12	Income tax expense	160,800	38,100
13	Net income (loss)	\$ 652,600	\$ 472,100
14			

Companies can be made up of several corporations owned by a common group of shareholders. Commonly controlled corporations like this are required to combine, or consolidate, all of their revenues, expenses, assets, liabilities, and stockholders' equity and to report them all as one. If the company combines all of its corporations into one set of statements, each combined statement will have the word "consolidated" in front of each of the names of the financial statements. For instance, The Walt Disney Company's balance sheets have "Consolidated balance sheets" at the top of those statements.

The dates of Jovita Corporation's Consolidated Statements of Income are the years ended December 31, 2023, and December 31, 2022. A *fiscal year* is a 52-week period used for accounting purposes

and preparing financial statements that may or may not correspond to a calendar year. Companies often adopt a fiscal year that ends at the low point of their operations. Disney uses the 52 weeks ending closest to September 30 as its accounting year. This is because the summer vacation season is the busiest time of the year for the company, whereas September is typically a slower month, allowing the company time to get its books in order. **FedEx Corp.**'s fiscal year-end falls on May 31. Alternatively, about 60% of the largest companies, such as Amazon.com, Inc., use a fiscal year corresponding to the calendar year.

Jovita Corporation's income statements in Exhibit 1-7 report the results of its operations for two fiscal years in order to show trends for revenues, expenses, and net income. Some relatively simple analyses of the company's income statements will help us evaluate how well the company performed in 2023 versus fiscal 2022.

As you start evaluating the financial reports of large corporations, you will see that they don't use large numbers to show results in the billions or display dollar values on their financial statements with two decimal places to show cents, such as \$426,789.99. Reading such financial statements would be difficult with this much detail, and interpretation would be prone to error. Large companies will report monetary amounts on their financial statements in thousands or millions. They will then explicitly state on the financial statements that the dollar values are shown in thousands or millions.

An income statement reports two main categories:

- Revenues and gains
- Expenses and losses

Net income is the profit left over after subtracting expenses and losses from revenues and gains. We measure net income as follows:

$$\text{Net Income} = \text{Total Revenues and Gains} - \text{Total Expenses and Losses}$$

Net income is the single most important item in the financial statements. During the fiscal year ended December 31, 2023, Jovita earned total revenues of \$7,547,800 (line 5). The company earned net income (line 13) of \$652,600.

Revenues

The Jovita Corporation has sales revenue from selling apparel. Other companies may have service revenue in addition to or in place of sales revenue. For example, The Walt Disney Company earns significant revenues from performing services as well as selling products. Services revenue is generated in its media networks; parks, experiences, and products; and studio entertainment divisions. Product sales revenue is generated in its parks, experiences, and products as well as its direct-to-consumer divisions.

Expenses

Expenses are costs incurred by a corporation in the process of generating revenues and conducting business operations. These expenses are deducted from the company's revenues to arrive at its net income or loss.

The categories of expenses on a corporation's income statement can include the following:

- *Cost of Goods Sold* (line 6) represents the costs associated with manufacturing or purchasing the products that the company sells. Cost of goods sold can include raw materials, labor costs directly tied to production, and manufacturing overhead expenses. Cost of goods sold is usually the largest expense item on a manufacturer's or a retailer's income statement. Cost of goods sold can also be called cost of sales or cost of services sold in the case of an organization that sells its services.
- *Operating Expenses* are the indirect costs associated with running the business, which are not directly tied to the production of goods or services. Operating expenses are further divided into the following categories:
 - *General and Administrative Expenses* (line 8) include marketing and advertising expenses, salaries and wages of non-production employees, rent, utilities, office supplies, insurance, and professional fees, among others. Sometimes this expense can be referred to as Selling, General, and Administrative Expenses.

- *Research and Development (R&D) Expenses* represent the costs associated with the development of new products, services, or technologies and typically include salaries of R&D staff, materials and equipment costs, and related overheads.
- *Interest Revenue (Expense)* (line 10) is a line item on a corporation's income statement that captures the net effect of both interest income earned and interest expenses incurred during a specific period. Interest Revenue refers to the income a corporation earns from its cash holdings, investments, or loans extended to other parties. Examples include interest earned on bank deposits, corporate bonds, and loans to customers or other businesses. Interest revenue is considered a non-operating income because it arises from sources not directly related to the company's core business operations. Interest Expense refers to the cost of borrowing money, such as interest paid on loans, bonds, or lines of credit. Interest expense is typically associated with debt financing and is considered a non-operating expense, as it is not directly tied to the company's primary business activities. The "Interest Revenue (Expense)" line item represents the net result of interest revenue and interest expense. If the interest revenue is greater than the interest expense, the net amount will be positive, indicating a net interest income. Alternatively, if the interest expense is greater than the interest revenue, the net amount will be negative, indicating a net interest expense.
- *Income Tax Expense* (line 12) is a line item on a corporation's income statement that represents the estimated amount of taxes the company owes on its taxable income during a specific accounting period. Taxable income is the portion of the company's earnings subject to taxation, calculated by adjusting the pretax income for various deductions, exemptions, and allowances as per the applicable tax laws.

Net Income (Loss)

Net income (line 13), a key indicator of a corporation's profitability and overall financial performance, is calculated by subtracting total expenses from total revenues on the income statement. This figure, often referred to as the "bottom line," represents the company's net income (or loss) for the given period. If revenues exceed expenses, the company has a net income. If, however, expenses are greater than revenues in a given period, the company incurs a net loss for that period. To denote a net loss, parentheses enclose the negative number on the income statement. For Jovita Corporation, net income was \$652,600 in 2023 and \$472,100 in 2022, reflecting an annual increase of about 38% [$\$652,600 - \$472,100 / \$472,100$].

Now let's examine the statement of retained earnings in Exhibit 1-8.

The Statement of Retained Earnings

The **statement of retained earnings** shows what a company did with its earnings. *Retained earnings* means exactly what the term implies: It is that portion of net income the company has retained, or kept, over a period of years, after making deductions for dividends to shareholders. If, historically, revenues exceed expenses, the result will be a positive balance in retained earnings. In contrast, if, historically, expenses have exceeded sales revenues, the accumulation of these losses will result in an accumulated **deficit** in retained earnings, which is usually shown in parentheses. Net income for Jovita Corporation flows from the income statement (line 13 of Exhibit 1-7) to the statement of retained earnings (lines 6 and 9 in Exhibit 1-8).

Let's review Jovita Corporation's Statements of Retained Earnings for the two-year period ended December 31, 2023. This statement was excerpted from the company's Statements of Stockholders' Equity, which analyze all of the increases and decreases in every account in the stockholders' equity section of the balance sheet. At the beginning of 2022, Jovita had \$2,908,800 in retained earnings (line 6). During 2022, the company earned net income of \$472,100 (line 7) and declared dividends of \$8,100 to shareholders (line 8). The company ended the 2022 year with a retained earnings balance of \$3,372,800, which carried over and became the beginning balance of retained earnings in 2023 (line 6).

During 2023, the company earned net income of \$652,600 (line 7). As shown on line 8, the company had also declared dividends to shareholders in the amount of \$9,000. We will discuss dividends in greater depth in Chapter 10, but declared dividends reduce retained earnings.

Which item on the statement of retained earnings comes directly from the income statement? It is net income. Lines 6 and 9 of the retained earnings statement come directly from line 13 of the income statement (see Exhibit 1-7) for 2023 and 2022, respectively. Take a moment to trace this amount from one statement to the other.

After a company earns net income, the **board of directors** decides whether to pay a dividend to the stockholders. Corporations are not obligated to pay dividends unless their boards decide to (i.e., declare them). Usually, companies that are in a development stage or growth mode elect not to pay dividends, opting instead to plow resources back into the company to expand operations or purchase property and equipment. However, established companies like The Walt Disney Company, Target Corporation, Apple, Inc., and others usually have enough accumulated retained earnings (and cash) to pay dividends. Dividends decrease retained earnings because they represent a distribution of a company's assets (usually cash) to its stockholders.

Exhibit 1-8 Jovita Corporation's Statements of Retained Earnings

	A1		
	A	B	C
1	Jovita Corporation		
2	Statements of Retained Earnings		
3			
4		For years ending	
5		12/31/23	12/31/22
6	Beginning retained earnings	\$ 3,372,800	\$ 2,908,800
7	Net income	652,600	472,100
8	Dividends	(9,000)	(8,100)
9	Ending retained earnings	\$ 4,016,400	\$ 3,372,800
10			

The Balance Sheet

A company's **balance sheet**, also called the **statement of financial position**, reports three items: assets (line 18), liabilities (line 31), and equity (line 36). Jovita Corporation's Balance Sheets, shown in Exhibit 1-9, are dated at the moment in time when the accounting periods end (December 31, 2023, and December 31, 2022).

Assets

There are two main categories of assets: current and long-term. **Current assets** are assets expected to be converted to cash, sold, or consumed during the next 12 months or within the business's operating cycle if it's longer than a year. Jovita's current assets at December 31, 2023, totaled \$1,123,100 (line 12). Let's examine each of the company's current assets.

- *Cash and cash equivalents* (line 7) are always the first asset. Cash is a liquid asset, which means it can be immediately exchanged for goods and services. Cash equivalents include U.S. Treasury securities or other financial instruments that are easily convertible to cash. Jovita owned \$805,400 in cash and cash equivalents as of December 31, 2023. This was up from \$599,800 on December 31, 2022. We will discuss the statement of cash flows later; that statement gives information about changes in cash and cash equivalents.
- *Receivables* (line 8) are monetary claims a company has against organizations and customers, acquired mainly by performing services for them, selling goods to them, or loaning money to them. Jovita's receivables totaled \$110,000 at December 31, 2023, an increase over the balance of \$101,300 as of the end of 2022. The company expects to convert these receivables to cash within the next fiscal year, which is why they are classified as current assets.
- *Inventories* (line 9) include raw materials, work-in-process items (items that are partially complete), and finished goods. Jovita's inventories balance as of December 31, 2023, was \$150,700, which was up from the prior year-end's balance of \$124,300. The company expects to sell these inventories and convert them to cash within the next fiscal year.

Exhibit 1-9 Jovita Corporation's Balance Sheets

A1	A	B	C
1	Jovita Corporation		
2	Balance Sheets		
3	As of December 31, 2023 and 2022		
4			
5		12/31/23	12/31/22
6	Assets		
7	Cash and cash equivalents	\$ 805,400	\$ 599,800
8	Receivables	110,000	\$ 101,300
9	Inventories	150,700	\$ 124,300
10	Prepaid expenses	21,500	\$ 19,600
11	Other current assets	35,500	\$ 42,500
12	Total current assets	\$ 1,123,100	\$ 887,500
13	Property and equipment, net	4,770,000	4,585,000
14	Long-term investments	275,000	202,300
15	Intangible assets	22,100	21,900
16	Other long-term assets	550,050	388,300
17	Total long-term assets	\$ 5,617,150	\$ 5,197,500
18	Total assets	\$ 6,740,250	\$ 6,085,000
19			
20	Liabilities and Stockholders' Equity		
21	Liabilities		
22	Accounts payable	\$ 163,200	\$ 121,900
23	Accrued liabilities	162,400	157,000
24	Current portion of long-term liabilities	218,700	255,700
25	Unearned revenues	156,350	127,700
26	Contingent liabilities	173,100	164,700
27	Total current liabilities	\$ 873,750	\$ 827,000
28	Long-term bonds payable	3,301,600	2,952,300
29	Other long-term liabilities	180,300	188,200
30	Total long-term liabilities	\$ 3,481,900	\$ 3,140,500
31	Total liabilities	\$ 4,355,650	\$ 3,967,500
32	Stockholders' equity		
33	Common stock	1,729,700	1,550,900
34	Retained earnings	4,016,400	3,372,800
35	Treasury stock	(3,361,500)	(2,806,200)
36	Total stockholders' equity	\$ 2,384,600	\$ 2,117,500
37	Total liabilities and stockholders' equity	\$ 6,740,250	\$ 6,085,000
38			

- *Prepaid expenses* (line 10) are future expenses that the company has paid in cash already, but the item has not been used up. For example, if a company pays \$10,000 in December for one year of insurance starting the next month on January 1, the amount paid would be reported as prepaid expense, an asset, on the balance sheet. Jovita had prepaid expenses totaling \$21,500 as of December 31, 2023. This was an increase over 2022's balance of \$19,600.
- *Other current assets* (line 11) are additional assets that the company expects to convert to cash, sell, or use up during the next year that were not included in the previously listed current asset accounts. Jovita's other current assets totaled \$35,500 as of December 31, 2023. This balance was down from \$42,500 as of December 31, 2022.
- *Long-term (noncurrent) assets* (lines 13–17) are resources that are expected to benefit the company for longer periods of time, more than just the next fiscal year. Let's look at Jovita's long-term assets.
- *Property and equipment, net*, (line 13) are tangible assets such as buildings, machines, and vehicles owned by the company. Jovita's net property and equipment balance was \$4,770,000 as of December 31, 2023, which was up from \$4,585,000 at the end of 2022. The word net is used to signify that the property and equipment asset balances have been reduced by the associated accumulated depreciation contra-asset balances. We will learn more about accumulated depreciation in later chapters.

- *Long-term investments* (line 14) include ownership interests in other companies held for longer than one year by Jovita Corporation. These investments totaled \$275,000 as of December 31, 2023, up from \$202,300 as of the prior year-end.
- *Intangible assets* (line 15) are non-physical assets such as patents, copyrights, and trademarks. Jovita had \$22,100 in intangible assets as of December 31, 2023, up from the prior year's balance of \$21,900.
- *Other long-term assets* (line 16) are additional assets that were not included in any of the other long-term asset accounts. These assets totaled \$550,050 for the year ended December 31, 2023, up from \$388,300 at the end of 2022.
- *Total assets* (line 18) is calculated by adding the total current assets and the total long-term assets. Jovita had \$6,740,250 in total assets as of December 31, 2023, compared to \$6,085,000 in total assets as of December 31, 2022. Total assets represent the total resources available to the company.

Liabilities

Now let's look at Jovita's liabilities.

- **Current liabilities** (lines 22–27) are debts payable within one year of the balance sheet date during the next 12 months or within the business's operating cycle if it's longer than a year. Long-term liabilities are those debts due in more than one year.
- *Accounts payable* (line 22) represent debts to suppliers for goods purchased on credit. Jovita had \$163,200 in accounts payable as of December 31, 2023, up from the prior year-end balance of \$121,900.
- *Accrued liabilities* (line 23) are expenses that the company has incurred but has not yet paid.
- *Current portion of long-term liabilities* (line 24) is the amount of the loan principal that will be repaid in the next fiscal year or within the business's operating cycle if longer. Jovita's current portion of long-term liabilities totaled \$218,700 at December 31, 2023, compared to \$255,700 as of December 31, 2022.
- *Unearned revenues* (line 25) are liabilities resulting from cash payments received by the company for goods or services that have yet to be provided. Jovita had \$156,350 in unearned revenues at December 31, 2023, compared to \$127,700 as of the prior year-end.
- *Contingent liabilities* (line 26) are potential liabilities that may or may not materialize depending on the outcome of a future event. Examples of contingent liabilities include lawsuits, product warranties, and environmental liabilities. Contingent liabilities will be discussed in more depth in Chapter 9. Jovita had contingent liabilities totaling \$173,100 at December 31, 2023, and \$164,700 as of December 31, 2022.
- *Long-term liabilities* (lines 28–30) include all noncurrent liabilities of the company, or debts that will not be repaid within the next 12 months or operating cycle, whichever is longer. Jovita's long-term liabilities, which include long-term bonds payable and other long-term liabilities, totaled \$3,481,900 at the end of 2023, up from \$3,140,500 at the end of 2022.
- *Total liabilities* (line 31) is calculated by adding total current liabilities and total long-term liabilities. Jovita's total liabilities amounted to \$4,355,650 as of December 31, 2023, up from \$3,967,500 a year earlier.

Equity (Stockholders' Equity)

The accounting equation states that

$$\text{Asset} - \text{Liabilities} = \text{Equity}$$

Remember that a corporation's equity represents the stockholders' ownership of the business's assets. Jovita Corporation's equity consists of the following:

- *Common stock* (line 33) represents the amount paid by shareholders for their shares of the company's common stock. Jovita had \$1,729,700 in common stock as of December 31, 2023, up from \$1,550,900 at the end of 2022. This account represents the actual dollar amount printed on the stock certificates originally issued to Jovita's shareholders when the company incorporated and they bought them. The account also includes *additional paid-in capital*, which consists of the additional amounts shareholders paid in excess of the printed value on the certificates. In other words, additional paid-in capital represents the value, or worth, of a company's shares above the par or stated value. We discuss these topics in greater depth in Chapter 10.
- *Retained earnings* (line 34) are \$4,016,400 and \$3,372,800 at the ends of 2023 and 2022, respectively. We saw these figures on the statement of retained earnings in Exhibit 1-8 (line 9). Retained earnings' final resting place is the stockholders' equity section of the balance sheet.
- *Treasury stock, at cost* (line 35) represents amounts paid by the company to repurchase its own stock.
- At December 31, 2023, Jovita's total equity was \$2,384,600 (line 36). We can now prove that the company's total assets equaled its total liabilities and equity:

Total assets (line 18)	\$6,740,250	←
Total liabilities (line 31)	\$4,355,650	
+ Total equity (line 36).....	\$2,384,600	←
Total liabilities and stockholders' equity (line 37)	\$6,740,250	←

Must equal

The statement of cash flows is the fourth required financial statement.

Cash Flow: The Statement of Cash Flows

Companies engage in three basic types of activities:

- Operating activities
- Investing activities
- Financing activities

The **statement of cash flows** reports cash receipts and cash payments in each of these categories.

- *Companies operate by selling goods and services to customers.* **Operating activities** result in net income or net loss, and they either increase or decrease a company's cash. Whereas Jovita's income statement reveals whether the company is profitable, its statement of cash flows reveals whether its operations increased the company's cash balance. Operating activities are most important, and they should be the company's main source of cash. Ongoing negative net cash flows from operations can bankrupt the company.
- *Companies invest in long-term assets.* Jovita Corporation engages in **investing activities** by buying property for manufacturing facilities as well as other long-term assets. When these assets wear out, the company might sell them, which often increases the company's cash. Both purchases and sales of long-term assets result in outgoing and incoming cash flows from investments, respectively.
- *Companies need money for financing.* **Financing activities** include issuing stock, paying dividends, borrowing, and repaying borrowed funds. Jovita issues stock to its shareholders and borrows from banks, which are cash inflows from financing activities. The company may also pay loans, pay dividends, and repurchase its own stock, which are cash outflows from financing activities.

Overview

Each category of cash flows—operating, investing, and financing—either increases or decreases cash. On a statement of cash flows, cash receipts appear as positive amounts. Cash payments are negative amounts and are enclosed by parentheses.

Exhibit 1-10 shows Jovita Corporation's Statements of Cash Flows. Operating activities provided net cash of \$481,050 in the year ended December 31, 2023 (line 9). Notice that this is \$171,550 less than net income of \$652,600 in line 7. Why is this so? These are adjustments that companies calculate to convert their net income to net cash provided by operating activities. Investing activities for the fiscal year required a total of about a \$311,450 cash outlay (line 10). That indicates that Jovita was expanding. Financing activities provided \$36,000 during 2023 (line 11). We will discuss the statement of cash flows in detail in Chapter 11.

Exhibit 1-10 Jovita Corporation's Statements of Cash Flows

A1	A	B	C
1	Jovita Corporation		
2	Statements of Cash Flows		
3			
4		For years ending	
5		12/31/23	12/31/22
6	Operating Activities:		
7	Net income	\$ 652,600	\$ 472,100
8	Adjustments to reconcile net income to net cash provided by operating activities	(63,350)	1,100,200
9	Net cash provided by operating activities	\$ 589,250	\$ 1,572,300
10	Net cash provided by (used by) in investing activities	(419,650)	(1,081,000)
11	Net cash provided by (used by) in financing activities	36,000	(362,800)
12	Net change in cash and cash equivalents	\$ 205,600	\$ 128,500
13	Cash and cash equivalents, beginning of year	599,800	471,300
14	Cash and cash equivalents, end of year	\$ 805,400	\$ 599,800
15			

Overall, Jovita's cash and cash equivalents increased by \$205,600 during the year ended December 31, 2023 (line 12) and ended the year at \$805,400 (line 14). Trace the ending cash and cash equivalents back to the balance sheet in Exhibit 1-9 (line 7). Cash and cash equivalents links the statement of cash flows to the balance sheet. You've just performed more financial statement analysis!

Exhibit 1-11 summarizes the relationships among the financial statements of Jovita Corporation for the fiscal year ending December 31, 2023. These statements are condensed, so the details of Exhibits 1-7 through 1-10 are omitted. Study the exhibit carefully because these relationships apply to all organizations. Specifically, note the following:

- The income statement for the year ended December 31, 2023:
 - Reports total revenues and expenses of the year. Revenues and expenses are reported only on the income statement.
 - Reports net income if total revenues exceed total expenses. If total expenses exceed total revenues, there is a net loss.
- The statement of retained earnings for the year ended December 31, 2023:
 - Opens with the beginning retained earnings balance.
 - Adds net income (or subtracts net loss). Net income comes directly from the income statement (arrow 1 in Exhibit 1-11).
 - Subtracts dividends declared.
 - Reports the retained earnings balance at the end of the year.
- The balance sheet at December 31, 2023, end of the year:
 - Reports assets, liabilities, and stockholders' equity at the end of the year. Only the balance sheet reports assets and liabilities.
 - Reports that assets equal the sum of liabilities plus stockholders' equity. This balancing feature follows the accounting equation and gives the balance sheet its name.
 - Reports ending retained earnings, which comes from the statement of retained earnings (arrow 2 in Exhibit 1-11).

4. The statement of cash flows for the year ended December 31, 2023:
- Reports cash flows from operating, investing, and financing activities. Each category results in net cash provided (an increase) or used (a decrease).
 - Reports whether cash and cash equivalents increased (or decreased) during the year.
 - The statement shows the ending cash and cash equivalents balance, as reported on the balance sheet (arrow 3 in Exhibit 1-11).

Exhibit 1-11 Relationships Among the Financial Statements

A1	A	B	C	D	E
1	Jovita Corporation				
2	Statements of Income (condensed)				
3	Year Ended December 31, 2023				
4	Total revenues	\$ 7,547,800			
5	Total expenses	6,895,200			
6	Net income	\$ 652,600			
7					

A1	A	B	C	D	E
1	Statement of Retained Earnings				
2	Beginning retained earnings	\$ 3,372,800			
3	Net income	652,600			
4	Dividends declared	(9,000)			
5	Ending retained earnings	\$ 4,016,400			
6					
7					
8					

A1	A	B	C	D	E
1	Balance Sheet (condensed)				
2	Assets				
3	Cash and cash equivalents	\$ 805,400			
4	All other assets	5,934,850			
5	Total assets	\$ 6,740,250			
6	Liabilities				
7	Total liabilities	\$ 4,355,650			
8	Stockholders' Equity				
9	Common stock	1,729,700			
10	Retained earnings	4,016,400			
11	Treasury stock	(3,361,500)			
12	Total stockholders' equity	\$ 2,384,600			
13	Total liabilities and stockholders' equity	\$ 6,740,250			
14					

A1	A	B	C	D	E
1	Statement of Cash Flows (condensed)				
2	Net cash provided by operating activities	\$ 589,250			
3	Net cash used in investing activities	(419,650)			
4	Net cash used in financing activities	36,000			
5	Net increase in cash and cash equivalents	205,600			
6	Cash and cash equivalents, beginning of year	599,800			
7	Cash and cash equivalents, end of year	\$ 805,400			
8					
9					

Diagram illustrating the relationships among the financial statements:

- Arrow 1: From Net income (\$652,600) in the Statements of Income to Ending retained earnings (\$4,016,400) in the Statement of Retained Earnings.
- Arrow 2: From Ending retained earnings (\$4,016,400) in the Statement of Retained Earnings to Retained earnings (\$4,016,400) in the Balance Sheet.
- Arrow 3: From Cash and cash equivalents, end of year (\$805,400) in the Statement of Cash Flows to Cash and cash equivalents (\$805,400) in the Balance Sheet.

DECISION GUIDELINES

In Evaluating a Company, What Do Decision Makers Look For?

These Decision Guidelines illustrate how people use financial statements. Decision Guidelines appear throughout the text to show how accounting information aids decision making.

Suppose you are considering buying The Walt Disney Company's stock. How do you proceed? Where do you get the information you need? What do you look for?

Decision	Guidelines
1. Can the company sell its services or products?	1. Look at the net revenue on the income statement. Are revenues growing or falling?
2. What are the main income measures to watch for trends?	2. Look at the gross profit (sales – cost of goods sold), operating income (gross profit – operating expenses), and the net income (bottom line of the income statement). All three income measures should be increasing over time.
3. What percentage of revenue ends up as profit?	3. Divide net income by sales revenue. Examine the trend of the net income percentage from year to year.
4. Can the company collect its receivables?	4. From the balance sheet, compare the percentage increase in accounts receivable to the percentage increase in sales. If receivables are growing much faster than sales, collections may be too slow, and a cash shortage may result.
5. Can the company collect its receivables? a. current liabilities? b. current and long-term liabilities?	5. From the balance sheet, compare a. current assets to current liabilities. Current assets should be somewhat greater than current liabilities. b. total assets to total liabilities. Total assets must be somewhat greater than total liabilities.
6. Where is the company's cash coming from? How is cash being used?	6. On the cash flows statement, operating activities should provide the bulk of the company's cash during most years. Otherwise, the business will fail. Examine investing cash flows to see if the company is purchasing long-term assets—property, plant, and equipment and intangibles (this signals growth).

Evaluate Business Decisions Ethically

Good business requires decision making, which in turn requires the exercise of good judgment, at both the individual and the corporate level. For example, you may work for or eventually run a company like Starbucks that has decided to plow back a portion of its profits to support social development projects in the communities that produce its coffee, tea, and cocoa. Can that be profitable in the long run?

Perhaps as an accountant, you may have to decide whether to report a \$50,000 expenditure for a piece of equipment as an asset on the balance sheet or an expense on the income statement. Alternatively, as a sales manager for a company like **IBM**, you may have to decide whether \$25 million of goods and services shipped to customers in 2023 would be more appropriately recorded as revenue in 2023 or 2024. Depending on the type of business, the facts and circumstances surrounding accounting decisions may not always make them clear-cut, and yet the decision may determine whether the company shows a profit or a loss in a particular period! What are the factors that influence business and accounting decisions, and how should these factors be weighed? Generally, three types of factors influence business and accounting decisions: *economic*, *legal*, and *ethical*.

LO5 Evaluate business decisions ethically

The *economic* factor states that the decision being made should *maximize the economic benefits* to the decision maker. Based on economic theory, every rational person faced with a decision will choose the course of action that maximizes his or her own welfare, without regard to how that decision impacts others. In summary, the combined outcome of each person acting in his or her own self-interest will maximize the benefits to society as a whole.

The *legal* factor is based on the proposition that free societies are governed by laws. Laws are written to provide clarity and to prevent abuse of the rights of individuals or society. Democratically enacted laws both contain and express society's moral standards. Legal analysis involves applying the relevant laws to each decision and then choosing the action that complies with those laws. A complicating factor for a global business may be that what is legal in one country might not be legal in another. In that case, it is usually best to abide by the laws of the most restrictive country.

The *ethical* factor recognizes that while certain actions might be both economically profitable and legal, they may still not be right. Therefore, most companies, and many individuals, have established standards for themselves to enforce a higher level of conduct than that imposed by law. These standards govern how we treat others and the way we restrain our selfish desires. This behavior and its underlying beliefs are the essence of ethics. **Ethics** are shaped by our cultural, socioeconomic, and religious backgrounds. An *ethical analysis* is needed to guide our judgments when making decisions.

The decision rule in an ethical analysis is to choose the action that fulfills ethical duties—responsibilities of the members of society to each other. The challenge in an ethical analysis is to identify specific ethical duties and stakeholders to whom you owe these duties. As with legal issues, a complicating factor in making global ethical decisions may be that what is considered ethical in one country is not considered ethical in another.

Among the questions you may ask in making an ethical analysis are the following:

- Which options are most honest, open, and truthful?
- Which options are most kind and compassionate and will build a sense of community?
- Which options create the greatest good for the greatest number of stakeholders?
- Which options result in treating others as I would want to be treated?

Ethical training starts at home and continues throughout our lives. It is reinforced by the teaching that we receive in our churches, synagogues, and mosques; by the schools we attend; and by the people and companies we associate with.

A thorough understanding of ethics requires more study than we can accomplish in this text. However, remember that when you are making accounting decisions, you should not check your ethics at the door!

In the business setting, ethics work best when modeled “from the top.” The Ethisphere Institute (<http://www.ethisphere.com>) has established the Business Ethics Leadership Alliance (BELA), aimed at “reestablishing ethics as the foundation of everyday business practices.” BELA members agree to embrace and uphold four core values that incorporate ethics and integrity into all their practices: (1) legal compliance, (2) transparency, (3) conflict identification, and (4) accountability.

Each year, the Ethisphere Institute publishes a list of the World's Most Ethical Companies. The 2020 list includes corporations like **3M**, **AFLAC**, **Accenture**, and **AT&T**. As you begin to make your decisions about future employers, put these companies on your list! It's easier to act ethically when you work for companies that recognize the importance of ethics in business practices. These companies have learned from experience that, in the long run, ethical conduct pays big rewards—not only socially, morally, and spiritually but economically as well!

Association of International Certified Professional Accountants Code of Professional Conduct

The decision framework for making ethical judgments provides general guidance for everyone, regardless of one's profession or industry. Many professional organizations, businesses, and other entities adopt their own ethical guidelines or codes of conduct so their members have more specific guidance.

The Association of International Certified Professional Accountants (AICPA) is one such organization. The AICPA has a code of professional conduct that applies to all of its members.

Even though you may not become an accounting major and may never be a member of the AICPA and covered by the AICPA Code of Professional Conduct, the basic principles contained in it can be applied to a wide range of professions and organizations. In addition, you may in your future career have interactions with CPAs. It is helpful to understand the code of conduct to which CPAs must adhere if they are members of the AICPA.

You can review the AICPA Code of Professional Conduct by searching for it using your preferred internet search engine.

DECISION GUIDELINES

Decision Framework for Making Ethical Judgments

Weighing tough ethical judgments in business and accounting requires a decision framework. Answering the following four questions will guide you through tough decisions:

Decision	Guidelines
1. What is the issue?	1. The issue will usually require making a judgment about an accounting measurement or disclosure that results in economic consequences, often to numerous parties.
2. Who are the stakeholders, and what are the consequences of the decision to each?	2. Stakeholders are anyone who might be impacted by the decision—you, your company, and potential users of the information (investors, creditors, and regulatory agencies) are all stakeholders. The consequences can be economic, legal, or ethical in nature.
3. Weigh the alternatives.	3. Analyze the impact of the decision on all stakeholders, using economic, legal, and ethical criteria. Ask, "Who will be helped or hurt, whose rights will be exercised or denied, and in what way?"
4. Make the decision and be prepared to deal with the consequences.	4. Exercise the courage to either defend the decision or to change it, depending on its positive or negative impact. How does your decision make you feel afterward?

To simplify the analysis, ask yourself these three questions:

1. Is the action legal? If not, don't do it, unless you want to go to jail or pay monetary damages to injured parties. If the action is legal, go on to questions 2 and 3.
2. Who will be affected by the decision and how? Be as thorough about this analysis as possible, and analyze it from all three standpoints (economic, legal, and ethical).
3. How will this decision make me feel afterward? How would it make me feel if my family reads about it in the newspaper?

In later chapters throughout the text, we will apply this model to different accounting decisions.

Evaluate Environmental, Social, and Governance Practices

LO6 Identify the role of accounting in environmental, social, and governance (ESG) practices

You may have heard of ESG reporting. But what is it, and why is it so important? We will go through a brief overview of ESG reporting and how it's changing the accounting and business reporting landscape.

Definitions

ESG is short for *environment, social, and governance*. Sometimes those terms are expanded to *environmental protection, social inclusion, and governance*. These three aspects of society are closely related, as they all work toward ensuring that the environment remains sustainable for future generations. They also improve living conditions on our own planet by promoting good governance practices, which lead to efficient public policies with purposeful outcomes at home or abroad.

In 1987, the United Nations Brundtland Commission defined **sustainability** as “meeting the needs of the present without compromising the ability of future generations to meet their own needs.” While sustainability focuses on the environment, ESG is about more than the environment. It's also about focusing on ethical and sustainable outcomes that will benefit everyone in society, including future generations.

Reasons Why ESG Reporting Is Important

One reason why ESG reporting is so important is because it can help organizations discover new business opportunities. For example, let's say an organization wants to reduce its carbon footprint. To do this, the organization might need to invest in new technologies or change its manufacturing processes. By discovering these opportunities, organizations can save money and increase their competitiveness.

Another reason why ESG reporting is so important is because it helps organizations mitigate risks. For example, let's say an organization wants to avoid supply chain disruptions. To do this, it might need to map its supply chain and identify risks. By mitigating these risks, organizations can protect their reputation and bottom line.

Incorporating Sustainability into Missions and More

Businesses are now incorporating sustainability into their mission and everything they do. The shift has been from an emphasis on the “nice-to-have” to a holistic approach that includes social purpose and ESG in every decision made by these organizations. Many investors are interested in ESG data when considering where to invest their money.

The biggest firms in the world aren't the only ones responsible for this effort. For example, practically every company has the chance to make adjustments that lessen its carbon impact. Making adjustments like sourcing resources from ethical sources, conserving energy, and optimizing shipping procedures are positive steps in the right direction.

Adopting an ESG strategy may appear unrealistic to some in a society that prioritizes profit over meaning. But innovative businesses have repeatedly demonstrated that it's possible to make money while doing good. **Patagonia, Inc.**, and **Nike, Inc.**, are both examples of companies that prioritize ESG while maintaining profitability. The Patagonia Purpose Trust, which owns Patagonia, uses profits from the company to address climate change and protect land. Patagonia has several programs designed to further ESG efforts. For example, Patagonia restricts the distribution of its products to only firms committed to ESG initiatives. Patagonia also no longer puts corporate logos on its clothing to improve the garments' life spans. Nike is also known for its ESG efforts. For example, Nike's Tempo Short running shorts are made from at least 75% recycled polyester, with most models made from 100% recycled polyester. This one product has so far saved 112 million plastic bottles from being dumped into landfills and waterways. In terms of diversity, Nike is tying its executive compensation to its workforce composition, making progress in deepening diversity and inclusion throughout its workforce. Many other companies have successfully combined ESG initiatives with financial profitability.

Other ESG Terms

Other terms related to ESG that you may see include *CSR*, *triple bottom line*, and *integrated reporting*. *CSR* stands for *corporate social responsibility*. *CSR* is the concept that companies should consider how their actions may impact society and the environment rather than focus solely on profitability. The **triple bottom line** is an approach to business that emphasizes measuring social and environmental impact in addition to financial success rather than focusing solely on the traditional “bottom line,” or earning a profit. Profit, people, and the environment are the “three P’s” of the triple bottom line. **Integrated reporting** is a thorough examination of all the elements that affect a company’s ability to create value over the short, medium, and long terms. Through integrated reporting, both financial and nonfinancial measures that reflect the company’s efforts to create organizational value are communicated.

ESG Reporting Frameworks

The majority of publicly owned companies publish some kind of ESG report. Some of that reporting might be disclosed in integrated reporting, and some might be included in annual reports. Stand-alone sustainability reports account for most ESG reports. The reporting standards currently being used for ESG reporting are diverse, with most businesses relying on numerous standards and many employing one or more well-known frameworks. Frameworks you might see include GRI, ISSB, UNGC, and TCFD. We will talk briefly about each of these frameworks.

Global Reporting Initiative (GRI): The GRI is a global independent standards organization that helps businesses, governments, and other organizations understand and communicate their impacts on topics such as corruption, climate change, and human rights. GRI is the most widely used reporting framework at the present time.

International Sustainability Standards Board (ISSB): The ISSB is a newly formed board created by combining several existing sustainability reporting framework organizations, including the Sustainability Accounting Standards Board, the Climate Disclosure Standards Board, the Integrated Reporting Framework, and others. The ISSB will deliver comprehensive global sustainability-related disclosure standards that provide investors and others with information about companies’ sustainability-related risks and opportunities to help them make informed decisions.

United Nations Global Compact (UNGC): The UNGC is a mechanism for businesses to promote and advance the Sustainable Development Goals of the UN, which have been ratified by all UN member states. The UNGC is a voluntary project based on CEO promises to implement universal sustainability principles.

Task Force on Climate-related Financial Disclosures (TCFD): A voluntary framework of recommendations on climate-related financial disclosures that can be used by organizations in all industries and locations. The recommendations can be used by organizations to assist in the preparation of disclosures that are uniform and comparable.

ESG Report Comparability and Reliability

Because there is no single recommended ESG reporting framework, the comparability of ESG reports between companies is limited. Companies use different frameworks to report ESG information, making ESG information difficult to compare. ESG reporting standard setting organizations are making some progress on standardization, but ESG reports are difficult to compare currently.

One other issue impacting ESG reporting is the reliability of the reports. At this point, companies in the United States are not required to have third-party assurance for their ESG reports. What this means is that there is no independent verification of ESG reporting data. Hopefully companies are reporting reliable, quality information, but without third-party assurance, one cannot be sure.

Third-Party Assurance for ESG Reports

Accounting, engineering, and consulting firms can provide **third-party assurance** for ESG reports. When an ESG report specifies it has undergone third-party assurance, that means an independent party has checked the reliability of the report contents, so investors and others can be more confident that the reporting is consistent with reporting standards.

Examples of ESG Measures

Measures of ESG performance are generally categorized as *environmental*, *social*, and *governance*. The measures used vary by industry. Examples of environmental measures could include total energy consumed, total water withdrawn, percentage of renewable energy used, Gross global Scope 1 emissions, and amount of food waste generated. Examples of social measures include voluntary employee turnover rate, average annual volunteerism hours per employee, number of work-related injury claims filed, and ratio of basic salary of women to men. Finally, examples of governance measures include percentage of board members who are women or minorities, percentage of board members who have completed anti-corruption training, and percentage of employees completing customer privacy training.

Ratios for Comparing Companies of Different Sizes

Comparability among companies is important when evaluating ESG performance. Company size can impact comparability. For example, if the number of safety training hours was compared between two companies, we would expect a company with 20,000 employees would have more safety training hours than a company with just 1,000 employees.

To increase comparability among companies of different sizes, ratio analysis can be used. Instead of comparing the number of safety training hours, the number of training hours for each company could be divided by an activity base, such as the number of employees.

Comparing Companies of Different Sizes Example

Let's look at an example of this ratio analysis with ESG data. We have two companies: Company A with 20,000 employees and Company B with 1,000 employees. Company A reports that its employees completed 30,000 hours of safety training, while Company B reports that its employees completed 4,000 hours of safety training for the same period. We would expect Company A to have more safety training hours, just because of its size. Which company invested more heavily in safety training? To answer this question, we could take the total safety training hours for each company and divide those total hours by the number of employees at that company to get a per-employee safety training hours average. For Company A, we would take 30,000 hours and divide by 20,000 employees to get an average safety training hours of 1.5 hours per employee. For Company B, we would take 4,000 safety training hours and divide by 1,000 employees to get an average safety training hours of 4 hours per employee. On a per-employee basis, Company B actually invested more in safety training than Company A. That point would not have been obvious without creating the ratio for the average safety training hours per employee.

Ways Accountants Can Support ESG Efforts

Accountants who work at accounting firms can support ESG by working on third-party assurance for ESG reports. Accountants who work at companies can support ESG reporting efforts within their companies. An accountant could conduct an analysis of the company's carbon footprint and recommend ways to reduce it or evaluate the company's supplier diversity program and make recommendations for improvement. The accountant is also well positioned to help the company develop internal controls to prevent bribery and corruption and to assess the company's risk exposure to climate change and develop mitigation strategies. The accountant can also analyze the company's financial statements to identify areas where ESG reporting could be improved and participate in the disclosure of material ESG risks in SEC filings.

Careers in Accounting

LO7 Describe career paths and professional certifications in accounting

The study of accounting can help students develop essential analytical and problem-solving skills as well as the ability to make sound financial decisions. These are crucial abilities in many professional roles, making accounting a major that can lead to diverse career paths. With an accounting degree, you can start your career as an external auditor, management accountant, internal auditor, budget analyst, or financial analyst.

An **external auditor** is employed by an accounting firm. Auditors are responsible for ensuring that a company's financial records are accurate and in compliance with relevant laws and regulations. They also review a company's internal controls, investigate suspicious activity, and issue an opinion regarding the accuracy of these records. The largest auditing firms in the world are **Deloitte**, **EY**, **KPMG**, and **PwC**; collectively these audit firms are known as the Big Four.

A **management accountant** is also sometimes referred to as a cost accountant or controller. This role involves analyzing financial data and providing guidance on how to improve the performance of an organization. A management accountant may also be responsible for creating budgets, managing cash flow, and preparing financial reports. Virtually all companies employ management accountants, including **The J.M. Smucker Company, The Coca-Cola Company, Nike, Inc., Starbucks Corporation, and United Parcel Service, Inc.**

Internal auditors are employed by a company to review business processes and procedures. Internal auditors must have strong analytical skills to identify potential areas of risk and provide recommendations to reduce those risks.

Budget analysts are responsible for preparing, monitoring, and analyzing financial reports to ensure that a company's expenditures align with its strategic goals. Budget analysts also help develop sound fiscal policies and procedures to maximize organizational efficiency.

Lastly, **financial analysts** use data analysis tools to forecast future trends and advise clients on how to best manage their investments. Financial analysts must interpret complex financial data and make sound recommendations based on the analysis.

In addition to accounting careers in public accounting or at companies, accountants are also employed by governmental entities and nonprofit organizations. The **FBI, IRS, and Red Cross** are just a few examples of these type of organizations that employ accounting professionals.

No matter which career path you choose to pursue with an accounting degree, the skills you learn can serve you well in any professional environment. It is important to understand that a career in accounting does not involve sitting behind a desk and endlessly crunching numbers. Accountants interact with others from all over the organization and understand how the parts of the organization work together. Skills needed as an accountant include communication, problem solving, decision making, and critical thinking skills, in addition to technical accounting skills.

An accounting degree is a great place to start a career because it provides an individual with a solid base and skill set that can be a stepping stone leading to a variety of careers. Famous people who have an accounting degree include John Grisham (lawyer and best-selling author), Georgina Wilson (host of *Asia's Next Top Model*, season 3), Mick Jagger (lead singer of the Rolling Stones), Nikki Haley (past governor of South Carolina), Julia Sweeney (past cast member of *Saturday Night Live*), J. P. Morgan (banker and founder of J.P. Morgan & Co.), and D'Lo Brown (former professional wrestler).

The profession of accounting has a troubled history of racial prejudice in the United States. Strict guidelines for determining eligibility for admittance and practice in the accounting profession were kept in place for many years. It wasn't until 1921 that John W. Cromwell Jr., the first Black Certified Public Accountant (CPA), was permitted to take the CPA exam.

Cromwell, a distinguished scholar who earned an honors degree from Dartmouth in 1906, wanted to enter the accounting field but encountered significant challenges because no companies would hire a Black accountant. As a result, he was unable to gain experience or meet the requirements for CPA licensure. He was not eligible to take the exam until 1921, 15 years after receiving his undergraduate degree, when New Hampshire removed the experience requirement for CPA licensure. The first Black woman to become a CPA was Mary T. Washington in 1943, who faced significant barriers in finding employment. In 1969, nine Black CPAs met in New York to discuss the challenges of being a Black accountant. In that year, out of the 100,000 CPAs in the United States, just 136 were Black. That discussion led to the formation of the National Association of Black Accountants (NABA), which is a nonprofit organization dedicated to supporting Black business leaders in accounting, finance, and entrepreneurship. NABA provides resources such as scholarships and career development tools that support Black accountants in overcoming historical disparities.

Despite some progress, the accounting profession still lags in terms of diversity and inclusion. According to data from the U.S. Bureau of Labor and Statistics,¹ there were 1,630,000 accountants and auditors working in 2021. Of this group, 31.4% were of Asian, Black, or Hispanic descent, while 76.3% identified as white. Additionally, only 2% of CPAs and 1% of partners at CPA firms are Black, according to a 2019 report from the Association of International Certified Public Accountants.

¹ <https://www.bls.gov/cps/cpsaat11.htm>

The profession of accounting is working to increase the number of individuals from underrepresented groups in the profession. Black, Indigenous, and People of color, people from the LGBTQ+ community, and people with disabilities are all underrepresented in accounting. Professional organizations such as the Association of International Certified Professional Accountants (AICPA), the National Association of Black Accountants (NABA), and the Institute of Management Accountants (IMA) are working to increase visibility and representation of people from underrepresented groups in the profession, as are companies and accounting firms. In public accounting, there has been a strong commitment to tap into the talents of people with disabilities. Large public accounting firms, such as EY, KPMG, Deloitte, and PwC, all have innovative programs to recruit workers with disabilities and to support individuals who are neurodiverse through mentoring, training, and support. The PhD Project is dedicated to improving diversity in the accounting profession by preparing people from underrepresented groups to earn PhDs and become professors in business fields including accounting. This organization provides mentoring, training, and resources. Organizations gain from diversity and inclusiveness in various important ways, including increased profitability, enhanced teamwork, and retention of employees.

Aspiring accountants should also be aware that the profession is constantly evolving, which is both challenging and exciting. It is important to stay up-to-date with technology developments as well as changes in laws and regulations. The ability to adapt and remain knowledgeable about these changes will help ensure success in an accounting career.

The demand for skilled accountants is growing, and with an accounting degree, you can pursue a wide range of career options. Whether you want to become an auditor, analyst, or management accountant, there are countless opportunities in the industry. With hard work and dedication, you can build a successful career in accounting. If you're looking for a career that offers both challenge and opportunity, then accounting could be the perfect fit.

Professional Accounting Certifications

Several professional accounting certifications are available to accountants in the United States, including the CPA, CMA, CGMA, CIA, and CFE. A **Certified Public Accountant (CPA)** is a professional with extensive training and certification in accounting principles. A CPA will have a thorough understanding of accounting regulations and standards as well as the ability to properly analyze financial records and data. A CPA can provide various accounting services, such as auditing, accounting, bookkeeping, budgeting, payroll accounting, and financial statement preparation. A CPA is also qualified to provide tax advice and prepare tax returns for individuals and businesses. Becoming a CPA in the United States requires passing the Uniform CPA Examination, meeting work experience requirements, and earning a CPA license from a state board of accounting. A CPA is held to high ethical standards and is considered an expert in accounting.

The CPA exam has a four-section, 16-hour format. The three core sections of the CPA exam are accounting, auditing, and tax. In addition, each CPA candidate needs to have deeper knowledge of one of three primary disciplines:

- Business Analysis and Reporting (BAR),
- Information Systems and Controls (ISC), or
- Tax Compliance and Planning (TCP).

A CPA candidate needs to take and pass the three core sections plus one discipline of their choice. The discipline chosen does not change the type of CPA license granted; it is one CPA license regardless of the discipline chosen. The CPA Evolution initiative that took place from 2018 to 2024 transformed the CPA licensure model to include the three core exams and one discipline exam so that the CPA exam would better reflect the rapidly changing skills and competencies the practice of accounting requires today and will require in the future.

The CPA credential is the most widely recognized accounting certification in the United States and is held in high regard around the world. Having a CPA license demonstrates accounting expertise and credibility, so employers often seek CPAs. With the right accounting skills and experience, a CPA can open up career opportunities in accounting, finance, auditing, and other accounting-related fields.

The **Certified Management Accountant (CMA)** is another professional accounting certification. The CMA is designed for internal decision makers in organizations and focuses on understanding internal financial decisions, rather than public reporting. The CMA certification consists of two exams: Part 1, which focuses on financial planning, performance, and analytics, and Part 2, which covers strategic financial management. A CMA has expertise in the field of management accounting, such as financial forecasting, internal budgeting, cost accounting, performance measurement and reporting, internal auditing, and risk management.

To become a CMA, an individual must pass both parts of the CMA exam, hold a bachelor's degree from an accredited college/university or a related professional certification, and complete two years of professional experience in management accounting or financial management. The certification is administered by the Institute of Management Accountants (IMA). The CMA credential is becoming increasingly recognized among internal decision makers as it provides a comprehensive understanding of internal financial decisions and strategies. It can open up various career opportunities within internal accounting roles in various industries.

The **Chartered Global Management Accountant (CGMA)** is another professional accounting certification that focuses on management accounting. It is a much newer certification than the CMA, established in 2012 by the Association of International Certified Professional Accountants (AICPA) and the Chartered Institute of Management Accountants (CIMA). To earn the CGMA in North America, an individual must complete the AICPA CGMA Finance Leadership Program, pass a series of case study exams focusing on management accounting tasks, and complete three years of practical work experience.

Another professional accounting certification is the **Certified Internal Auditor (CIA)**. The CIA is administered by the Institute of Internal Auditors (IIA) and focuses on internal auditing, risk management, and control. To earn the CIA designation, one must pass a three-part exam focusing on internal controls and risk management, auditing processes, control frameworks, and more. Additionally, the individual must meet certain experience requirements and agree to the IIA code of professional conduct. A CIA is qualified to provide independent, objective assurance and consulting services to an organization.

Finally, the **Certified Fraud Examiner (CFE)** is a professional certification that focuses on fraud prevention, detection, deterrence, and investigation. The CFE is administered by the Association of Certified Fraud Examiners (ACFE). To earn the CFE credential, a candidate must pass a four-part exam focusing on fraud prevention and detection techniques, understand legal elements of fraud, meet experience requirements, and agree to abide by the ACFE code of ethics. A CFE is qualified to identify potential areas of fraud vulnerability and investigate allegations of fraud.

These are just a few professional accounting certifications available to qualified accountants. Each certification requires a specific set of skills and knowledge tailored to accounting professionals in a particular field. Those interested in advancing their career with one of these certifications are encouraged to research the requirements for each certification as well as any related continuing education requirements. Obtaining an accounting certification can open up various career opportunities and enhance your professional credentials.

These certifications are all important for professional accountants looking to advance their careers, increase their earning potential, and become more respected members of the accounting community. With the right combination of education, experience, and certification credentials, accountants can become highly sought-after professionals in their field. All of these certifications are widely recognized by employers, and having one or more of them on a résumé can be invaluable for any accountant looking to stand out from the crowd. Investing in professional certifications is key for accountants who wish to demonstrate mastery of their profession and become more marketable in the business world.

Identify Tools and Technologies Used in Accounting and Business

LO8 Identify tools and technologies used in accounting and business

The main tools of accountants for many decades were calculators and columnar paper. Computers and spreadsheets were added in the 1980s and 1990s. Today the tools and technologies used by members of the accounting profession are evolving rapidly, becoming intertwined throughout the accounting profession. Accounting is more than sitting at a desk and adding numbers. You cannot study accounting without looking at the tools and technologies that are used in the profession. These tools allow accountants and other professionals to make better decisions through more accurate data, more timely data, and/or more visual data. Technology is helping to add breadth and depth to the practice of accounting.

Spreadsheets

A spreadsheet is generated by a software program that allows data to be organized in rows and columns. Data can be entered into a spreadsheet, results can be calculated, and graphs can be generated. Spreadsheets are used by accountants and other business professionals alike. Whatever your major and your chosen profession, you are likely going to be using Microsoft Excel, Google Sheets, Apple Numbers, or other spreadsheet software.

Data Analytics

Data analytics is the process of taking raw data and putting it together to produce useful insights. Simply having a lot of data is overwhelming without a way to present it in a way that is understandable. Accountants can use data analytics to help discover valuable trends or insights within financial data and to help to identify process improvements that can increase efficiency. Tax accountants can use data analytics to analyze complex taxation questions related to investment scenarios and help companies make better investment decisions. Accountants can use data analytics to find consumer behavior and market trends in the market to help to build models that help companies generate higher profit margins.

Artificial Intelligence (AI) and Machine Learning

Artificial intelligence (AI) and machine learning are technologies that are significantly impacting accounting. Artificial intelligence is the science that studies ways to build programs and machines that can creatively solve problems in a human-like manner. Examples of AI in use today include Apple's personal assistant, Siri; Amazon's home hub, Alexa; and the technology used to classify images on Pinterest.

Machine learning is a subset of AI based on the idea that we can provide data to machines and let them learn for themselves without explicitly programming the machines. IBM's Watson, the computer that beat Ken Jennings at *Jeopardy!* to end Jennings's 74 consecutive game winning streak, is an example of a machine learning application. Netflix's predictive technology based on customer reactions to movies and Google's Nest, the thermostat that uses behavioral algorithms to learn and anticipate heating and cooling preferences in a home, are two additional examples of machine learning applications.

Robotic Process Automation (RPA)

Robotic process automation (RPA) is also impacting the accounting profession. Software bots are being developed to do the rote, routine work that bookkeeping clerks have done for many years. A bot can do much of the repetitive work with 100% accuracy and can work 24 hours a day without sick days or leave, nor does it need to be paid overtime.

The advantage of bots for accountants is that accounting work becomes much more interesting and engaging. Rather than performing repetitive tasks, accountants are freed to do value-added things like analyzing and interpreting data and trends.

You may have read stories about accountants being replaced by bots, but that's not likely to happen. The technology tools are allowing accountants to employ a higher level of thinking and become more valuable to their organizations.

Technology Risks

There are inherent risks with technology. Just as technology can facilitate better decisions, technology used improperly can also lead to catastrophic decisions. For example, an employee at a construction company underestimated the total cost of a contract bid by \$3.7 million because one cell in a worksheet was not included in the formula for total cost. The London Olympics incurred significant costs when an employee typed “20,000” into a spreadsheet cell containing the number of seats for four minor heats of synchronized swimming rather than the correct number of “10,000.” Because of this typo, 10,000 tickets for nonexistent seats were sold. The London Olympic Committee then had to upgrade the ticketholders for these nonexistent seats to tickets for major events, causing financial losses for the organization.

Throughout this text, we are going to discuss how technology tools can help accountants and others in investing, managing, and other types of decisions. At the end of every chapter will be a learning objective that will highlight how a technology tool can be used in relation to a topic within that chapter. In several of the chapters, we will be looking at how Excel can be used for some concept in that chapter. In other chapters, we will be highlighting how other technologies can be used in relation to some concept in the chapter.

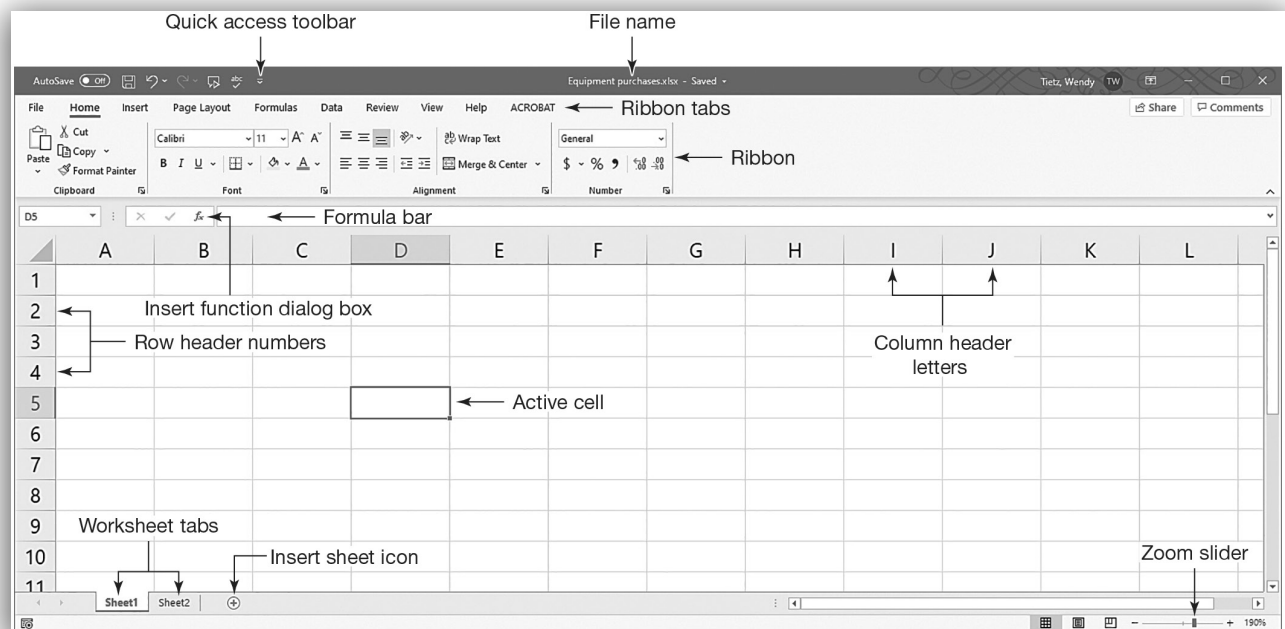
In the rest of this first chapter, we are going to introduce the basics of Microsoft Excel.

Introduction to Excel

Excel is a spreadsheet program that allows the numbers to be added, subtracted, and more. In this text, we will be using Microsoft Excel because it is the most widely used program in business for spreadsheets. Google Sheets and Apple Numbers can perform many of the same tasks in similar ways.

Exhibit 1-12 shows a screenshot of the home screen of Microsoft Excel for Windows.

Exhibit 1-12 Home Screen of Microsoft Excel for Windows



When you open a blank worksheet in Excel, there are some common parts of the worksheet. Here are the major items in the worksheet, as illustrated in Exhibit 1-12.

- **Quick Access tool bar:** Commonly used Excel commands.
- **File name:** Name of the file currently displayed.
- **Ribbon:** Display at the top of the Excel window that is the primary interface for Excel.
- **Ribbon tabs:** Main tabs on the ribbon are File, Home, Insert, Page layout, Formulas, Data, Review, View, and Help.
- **Insert Function dialog box:** Feature to find and select the function that you want to use and guidance for the various options or arguments for that selected function.

- **Formula bar:** Special toolbar used to enter a new formula or copy an existing one. Also where the contents for the active cell appear.
- **Row header numbers:** Gray-colored column located on the left side of the worksheet that contains the numbers (1, 2, 3, etc.) used to identify each row in the worksheet.
- **Column header letters:** Gray-colored row located at the top of the worksheet that contains the letters (A, B, C, etc.) used to identify each column in the worksheet.
- **Active cell:** Thick border gridlines around the cell indicate that this is the active cell inside the worksheet where data will be entered when a key is typed on the keyboard.
- **Worksheet tabs:** Tabs used to navigate among worksheets. Every workbook contains at least one worksheet.
- **Insert Sheet icon:** Button to add a new worksheet to the current workbook.
- **Zoom slider:** Sliding bar that allows the user to zoom in and zoom out of a document. Also known as Zoom bar.

In future chapters, we will be discussing different ways in which Excel can be used in accounting or other professions. We will also be covering a lot of different technologies as used in the profession of accounting. Technologies and tools in accounting are rapidly evolving, and it's an exciting time to be in accounting.

End-of-Chapter Summary Problem

Alladin Travel, Inc., began operations on April 1, 2024. During April, the business provided services for customers. It is now April 30 and Starr Williams, majority shareholder and manager, is trying to determine how well Alladin Travel performed during its first month. Ms. Williams also wants to know the company's financial position at the end of April and its cash flows during the month.

The following data are listed in alphabetical order.

Accounts payable	\$ 1,800	Land.....	\$18,000
Accounts receivable.....	2,000	Payments of cash:	
Adjustments to reconcile net		Acquisition of land.....	40,000
income to net cash provided		Dividends.....	2,100
by operating activities	(3,900)	Rent expense.....	1,100
Cash balance, April 1	0	Retained earnings, April 1.....	0
Cash balance, April 30.....	?	Retained earnings, April 30.....	?
Cash receipts:		Salary expense.....	1,200
Issuance (sale) of stock to owners...	50,000	Service revenue.....	10,000
Sale of land	22,000	Supplies.....	3,700
Common stock.....	50,000	Utilities expense	400

Requirements

1. Prepare the income statement, the statement of retained earnings, and the statement of cash flows for the month ended April 30, 2024, and the unclassified balance sheet at April 30, 2024. Draw arrows linking the statements.
2. Answer the following questions:
 - a. How well did Alladin Travel perform during its first month of operations?
 - b. Where does Alladin Travel stand financially at the end of April?

Answers

Requirement 1

Financial Statements of Alladin Travel, Inc. are shown on the next page.

A1	A	B	C	D
	Alladin Travel, Inc.			
	Income Statement			
	Month Ended April 30, 2024			
1				
2	Revenue:			
3	Service revenue		\$ 10,000	
4	Expenses:			
5	Salary expense	\$ 1,200		
6	Rent expense	1,100		
7	Utilities expense	400		
8	Total expenses		2,700	
9	Net Income		\$ 7,300	
10				

A1	A	B	C	D
	Alladin Travel, Inc.			
	Statement of Retained Earnings			
	Month Ended April 30, 2024			
1				
2	Retained earnings, April 1, 2024		\$ 0	
3	Net income for period		7,300	
4			\$ 7,300	
5	Less dividends declared		(2,100)	
6	Retained earnings, April 30, 2024		\$ 5,200	
7				

A1	A	B	C	D
	Alladin Travel, Inc.			
	Balance Sheet			
	April 30, 2024			
1				
2	Assets		Liabilities	
3	Cash	\$ 33,300	Accounts payable	\$ 1,800
4	Accounts receivable	2,000	Stockholders' equity	
5	Supplies	3,700	Common Stock	50,000
6	Land	18,000	Retained earnings	5,200
7			Total stockholders' equity	55,200
8			Total liabilities and	
9	Total assets	\$ 57,000	stockholders' equity	\$ 57,000
10				

A1	A	B	C
	Alladin Travel, Inc.		
	Statement of Cash Flows		
	Month Ended April 30, 2024		
1			
2	Cash flows from operating activities:		
3	Net income		\$ 7,300
4	Adjustments to reconcile net income to net cash provided by operating activities		(3,900)
5	Net cash provided by operating activities		3,400
6	Cash flows from investing activities:		
7	Acquisition of land	\$ (40,000)	
8	Sale of land	22,000	
9	Net cash used for investing activities		(18,000)
10	Cash flows from financing activities:		
11	Issuance (sale) of stock	\$ 50,000	
12	Payment of dividends	(2,100)	
13	Net cash provided by financing activities		47,900
14	Net increase in cash		\$ 33,300
15	Cash balance, April 1, 2024		0
16	Cash balance, April 30, 2024		\$ 33,300
17			

Requirement 2

- a. Alladin Travel performed rather well in April. Its service revenue was \$10,000, and its net income was \$7,300. The company was able to pay cash dividends of \$2,100.
- b. Alladin Travel ended April with cash of \$33,300. Total assets of \$57,000 far exceeded total liabilities of \$1,800. The stockholders' equity of \$55,200 provided a good cushion for borrowing. The business's financial position at April 30, 2024, was strong.

Review Financial Statements

Accounting Vocabulary

accounting The information system that measures business activities, processes data into financial statements and reports, and communicates results to decision makers.

accounting cycle The process by which financial statements are prepared.

accounting equation The most basic tool of accounting: Assets = Liabilities + Equity.

asset An economic resource that is expected to be of benefit in the future.

balance sheet A list of an entity's assets, liabilities, and equity as of a specific date. Also called the *statement of financial position*.

board of directors A group elected by the stockholders to set policy for a corporation and to appoint its officers.

budget analyst An accounting professional who is responsible for preparing, monitoring, and analyzing financial reports to ensure that a company's expenditures align with its strategic goals.

capital Another name for the *equity* of a business.

Certified Fraud Examiner (CFE) A professional certification administered by the Association of Certified Fraud Examiners (ACFE) that focuses on fraud prevention, detection, deterrence, and investigation.

Certified Internal Auditor (CIA) A professional accounting certification administered by the Institute of Internal Auditors that focuses on internal auditing, risk management, and control.

Certified Management Accountant (CMA) A professional accounting certification that focuses on understanding internal financial decisions rather than public reporting. Administered by the Institute of Certified Management Accountants (ICMA) and the Institute of Management Accountants (IMA).

Certified Public Accountant (CPA) A professional accounting certification that focuses on accounting regulations and standards. Someone who is certified as a CPA may be qualified to analyze financial records and data, provide tax advice, and prepare tax returns for individuals and businesses. Administered by the AICPA and CIMA.

Chartered Global Management Accountant (CGMA)

A professional accounting certification that focuses on management accounting and was established in 2012 by the Association of

International Certified Professional Accountants (AICPA) and the Chartered Institute of Management Accountants (CIMA).

common stock The most basic form of capital stock. The common stockholders own a corporation.

continuity assumption The assumption that an entity will remain in operation for the foreseeable future.

corporation A business owned by stockholders. A corporation is a legal entity, an "artificial person" in the eyes of the law.

CSR The concept that companies should consider how their actions may impact society and the environment rather than focusing solely on profitability.

current asset An asset that is expected to be converted to cash, sold, or consumed during the next 12 months or within the business's normal operating cycle if it's longer than a year.

current liability A debt due to be paid within one year or within the entity's operating cycle if the cycle is longer than a year.

deficit A debit balance in the Retained Earnings account.

dividends Distributions (usually cash) by a corporation to its stockholders.

entity An organization or a section of an organization that, for accounting purposes, stands apart from other organizations and individuals as a separate economic unit.

equity The claim of the owners of a business to the assets of the business. Also called *capital*, *owners' equity*, *stockholders' equity*, or *net assets*.

ESG Short for "environment social, and governance." These three aspects of organizations and society are all related to ensuring that the environment remains sustainable for future generations.

ethics Standards of right and wrong that transcend economic and legal boundaries. Ethical standards deal with the way we treat others and restrain our own actions because of the desires, expectations, or rights of others or because of our obligations to them.

expenses Decreases in retained earnings that result from operations; the cost of doing business; the opposite of revenues.

external auditor An accounting professional who is employed by an accounting firm and is responsible for ensuring that a company's financial records are accurate and in compliance with relevant laws and regulations.

fair value An asset's estimated market value at a particular date.

financial accounting The branch of accounting that provides relevant and accurate information to people outside the firm.

Financial Accounting Standards Board (FASB) The regulatory body in the United States that formulates generally accepted accounting principles (GAAP).

financial analyst An accounting professional who uses data analysis tools to forecast future trends and advise clients on how to best manage their investments.

financial statements Business documents that report financial information about a business entity to decision makers.

financing activities Activities that obtain from investors and creditors the cash needed to launch and sustain a business; a section of the statement of cash flows.

generally accepted accounting principles (GAAP) Accounting guidelines formulated by the Financial Accounting Standards Board that govern how accounting is practiced.

Global Reporting Initiative (GRI) A global independent standards organization that helps businesses, governments, and other organizations understand and communicate their impacts on topics such as corruption, climate change, and human rights.

going-concern assumption The assumption that an entity will remain in operation for the foreseeable future.

gross profit Revenue from a particular activity minus the direct costs associated with earning that revenue.

historical cost principle A principle that states that assets should be recorded at their actual cost.

income statement A financial statement listing an entity's revenues, expenses, and net income or net loss for a specific period. Also called the *statement of operations*.

intangible assets An asset with no physical form—a special right to current and expected future benefits.

integrated reporting A thorough examination of both financial and nonfinancial elements that affect a company's ability to create value over the short, medium, and long terms.

internal auditor An accounting professional who is employed by a company to review business processes and procedures.

International Accounting Standards Board (IASB) The independent accounting standard-setting body of the IFRS Foundation.

International Financial Reporting Standards (IFRS) Accounting guidelines, formulated by the International Accounting Standards Board (IASB).

International Sustainability Standards Board (ISSB) A recently formed board that is working to deliver a comprehensive global baseline of sustainability-related disclosure standards that will provide investors and the public with information about companies' sustainability-related risks and opportunities.

investing activities Activities that increase or decrease the long-term assets available to the business; a section of the statement of cash flows.

liability No personal obligation of an owner for the business entity's debts. An owner can therefore lose no more on an investment than the cost of the investment in the entity.

limited-liability company (LLC) A business organization in which the business (not the owner) is liable for the company's debts.

long-term assets Assets that are expected to benefit the entity for long periods of time, beyond the end of the next fiscal year. These usually include investments, property and equipment (plant assets), and intangible assets.

long-term debt A liability that falls due beyond one year from the date of the financial statements or after the business's operating cycle if the cycle is longer than a year.

management accountant An accounting professional who analyzes financial data and provides guidance on how to improve the performance of an organization; also referred to as a cost accountant or controller.

managerial accounting The branch of accounting that generates information for the internal decision makers of a business, such as top executives.

net earnings Another name for *net income*.

net income The excess of total revenues over total expenses. Also called *net earnings* or *net profit*.

net loss The excess of total expenses over total revenues.

net profit Another name for *net income*.

operating activities Activities that create revenues, expenses, gains, and losses; a section of the statement of cash flows. Operating activities affect the income statement.

owners' equity See *equity and stockholders' equity*.

paid-in capital The amount of stockholders' equity that stockholders have contributed to the corporation. Also called *contributed capital*.

partnership An association of two or more persons who co-own a business for profit.

proprietorship A business with a single owner.

retained earnings The amount of stockholders' equity that the corporation has earned through profitable operation of the business and has not paid back to stockholders in the form of dividends.

revenues Increases in retained earnings from delivering goods or services to customers or clients.

segment A division or subset of a business's operations.

shareholder People or other entities that own stock in a corporation. Also called *stockholders*.

stable-monetary-unit assumption The assumption that because the purchasing power of the dollar has been relatively stable, inflation's effect on accounting records can be ignored.

statement of cash flows A statement that reports cash receipts and cash payments classified according to a company's major activities: operating, investing, and financing.

statement of financial position Another name for the *balance sheet*.

statement of operations Another name for the *income statement*.

statement of retained earnings A summary of the changes in the retained earnings of a corporation during a specific period.

stock Shares into which the owners' equity of a corporation is divided.

stockholder A person who owns stock in a corporation. Also called a *shareholder*.

stockholders' equity The stockholders' ownership interest in the assets of a corporation.

sustainability The concept of meeting the needs of the present without compromising the ability of future generations to meet their own needs (United Nations Brundtland Commission, 1987).

Task Force on Climate-related Financial Disclosures (TCFD) A voluntary framework of recommendations on

climate-related financial disclosures that can be used by organizations in all industries and locations.

third-party assurance The use of an accounting, engineering, or consulting firm to check the reliability of a company's reports so investors and others can be confident that the report is accurate and consistent with reporting standards.

triple bottom line An approach to business that emphasizes measuring social and environmental impact in addition to financial success rather than solely focusing on the traditional "bottom line" of earning a profit.

United Nations Global Compact (UNGC) A voluntary framework for businesses to promote and advance the Sustainable Development Goals of the UN, based on CEO promises to implement universal sustainability principles.

Quick Check



ASSESS YOUR PROGRESS

Ethics Check

EC1-1. (Learning Objective 5: Identify ethical principle violated) For each of the situations listed, identify which of three principles (integrity, objectivity and independence, or due care) from the AICPA Code of Professional Conduct is violated. Assume all persons listed in the situations are members of the AICPA. (Note: In order to complete EC1-1, please use your preferred internet search engine to search for the AICPA Code of Professional Conduct.)

- Jazmyn is eager to please her supervisor and wants to earn a promotion at the CPA firm. When Jazmyn puts together her firm's financial statements and related information for the past year, she buries unfavorable results deep in the report and presents the good news prominently. She figures that by making the firm look good, it will make her case for promotion stronger.
- Wesley is in charge of putting together his company's financial statements but does not understand the newest financial reporting standard that went into effect last year. He decides to do the best he can with interpreting and applying the new standard because he does not have time right now to learn about the new standard in depth.
- Jay receives a large year-end bonus if his company's sales grow by 8% this year. Sales only grew by 7.5%, so Jay created false sales documentation to make it appear that the sales growth goal was met.
- This year Tamara's company incurred higher cost of goods sold than expected, which resulted in an overall net loss for the company. Tamara does not want the company to lose investors due to the net loss, so she adjusts cost of goods sold so that the company has a positive net income.

Short Exercises

S1-1. (Learning Objective 1: Explain and differentiate between business organizations) Hudson Signs, Inc., needs funds, and Alley Hudson, the president, has asked you to consider investing in the business. Answer the following questions about the different ways that Hudson might organize the business. Explain each answer.

- What forms of organization will enable the owners of Hudson Signs, Inc., to limit their risk of loss to the amounts they have invested in the business?
- What form of business organization will give Alley Hudson the most freedom to manage the business as she wishes?
- What form of organization will give creditors the maximum protection in the event that Hudson Signs, Inc., fails and cannot pay its debts?

S1-2. (Learning Objective 2: Identify relevant accounting assumptions) Fallon Osmond is chairperson of the board of Simple Treats, Inc. Suppose Osmond has just founded Simple Treats, and assume that she considers her home and other personal assets as part of Simple Treats. Answer these questions about the evaluation of Simple Treats, Inc.

- Which accounting assumption governs this situation?
- How can the proper application of this accounting assumption give Osmond and others a realistic view of Simple Treats, Inc.? Explain in detail.

S1-3. (Learning Objective 2: Identify underlying accounting concepts, assumptions, and principles)

Identify the accounting concept, assumption, or principle that best applies to each of the following situations:

- Inflation has been about 3.5% for some time. Village Realtors is considering measuring its land values in inflation-adjusted amounts.
- You get an especially good buy on a laptop, paying only \$300 when it normally costs \$800. What is your accounting value for this laptop?
- Burger King**, the restaurant chain, sold a store location to **McDonald's**. How can Burger King determine the sale price of the store—by a professional appraisal, Burger King's original cost, or the amount actually received from the sale?
- General Motors** wants to determine which division of the company—Chevrolet or Cadillac—is more profitable.

S1-4. (Learning Objective 3: Apply the accounting equation) Identify the missing amount for each of the following situations:

	Total Assets	=	Total Liabilities	+	Stockholders' Equity
a.	\$?		\$300,000		\$360,000
b.	85,000		50,000		?
c.	350,000		?		275,000

S1-5. (Learning Objective 3: Apply the accounting equation)

- If you know the assets and the equity of a business, how can you measure its liabilities? Give the equation.
- Use the accounting equation to show how to determine the amount of a company's stockholders' equity. How would your answer change if you were analyzing your own household?

S1-6. (Learning Objective 3: Identify assets, liabilities, and stockholders' equity accounts) Classify the following items as an asset (A), a liability (L), or stockholders' equity (S) for **Target Corporation**, a large retailer:

- Land
- Accrued expenses payable
- Supplies
- Equipment
- Notes payable
- Long-term debt
- Retained earnings
- Prepaid expenses
- Accounts payable
- Accounts receivable
- Merchandise inventory
- Common stock

S1-7. (Learning Objective 3: Accounting equation) Accounting definitions are precise, and you must understand the vocabulary to properly use accounting. Sharpen your understanding of key terms by answering the following questions:

- How do the assets and stockholders' equity of **Nike, Inc.**, differ from each other? Which one (assets or stockholders' equity) must be at least as large as the other? Which one can be smaller than the other?

2. How are Nike, Inc.'s liabilities and stockholders' equity similar? Different?

S1-8. (Learning Objective 4: Identify income statement components)

1. Identify the two basic categories of items on an income statement.
2. What do we call the bottom line of the income statement?

S1-9. (Learning Objective 4: Identify appropriate financial statement) Suppose you are analyzing the financial statements of Corley, Inc. Identify each item with its appropriate financial statement, using the following abbreviations: Income statement (I), Statement of retained earnings (R), Balance sheet (B), and Statement of cash flows (C). Three items appear on two financial statements, and one item shows up on three statements.

- a. _____ Salary expense
- b. _____ Dividends
- c. _____ Accounts payable
- d. _____ Net income
- e. _____ Common stock
- f. _____ Inventory
- g. _____ Interest revenue
- h. _____ Cash
- i. _____ Retained earnings
- j. _____ Long-term debt
- k. _____ Increase or decrease in cash
- l. _____ Net cash provided by operating activities
- m. _____ Sales revenue
- n. _____ Net cash used for financing activities

S1-10. (Learning Objective 4: Explain aspects of financial statements) Apply your understanding of the relationships among the financial statements to answer these questions.

- a. How can a business earn large profits but have a small balance of retained earnings?
- b. Give two reasons why a business can have a steady stream of net income over a five-year period and still experience a cash shortage.
- c. If you could pick a single source of cash for your business, what would it be? Why?
- d. How can a business be unprofitable several years in a row and still have plenty of cash?

S1-11. (Learning Objective 4: Identify appropriate financial statement use) For each of the following questions, indicate which financial statement would most likely be used to provide the information. Use the following abbreviations: Income statement (I), Statement of retained earnings (R), Balance sheet (B), and Statement of cash flows (C).

- a. What were the company's net sales for the year?
- b. What assets does the company have?
- c. How much cash was generated by operating activities?
- d. Why did the company's retained earnings change during the year?
- e. How much in total debt does the company have?
- f. How well did the company perform during the year?
- g. Did the company declare a dividend during the year?
- h. How much cash did the company generate and spend during the year?
- i. What is the company's financial position at the end of the year?

S1-12. (Learning Objective 4: Construct an income statement) MacKensie Services Corporation began 2024 with total assets of \$230 million and ended 2024 with total assets of \$365 million. During 2024, MacKensie earned revenues of \$394 million and had expenses of \$171 million. MacKensie declared and paid dividends of \$27 million in 2024. Prepare the company's income statement for the year ended December 31, 2024, complete with an appropriate heading.

S1-13. (Learning Objective 4: Construct a statement of retained earnings) Journey Corporation began 2024 with retained earnings of \$270 million. Revenues during the year were \$460 million, and expenses totaled \$380 million. Journey declared dividends of \$64 million. What was the company's ending balance of retained earnings? To answer this question, prepare Journey's statement of retained earnings for the year ended December 31, 2024, complete with its proper heading.

S1-14. (Learning Objective 4: Construct a balance sheet) At December 31, 2024, Jackson Corporation

has cash of \$52 million, accounts receivable of \$23 million, and long-term assets of \$45 million. The company owes accounts payable of \$21 million and has a long-term note payable of \$31 million. Jackson has common stock of \$28 million and retained earnings of \$40 million. Prepare Jackson Corporation's balance sheet at December 31, 2024, complete with its proper heading.

S1-15. (Learning Objective 4: Solve for retained earnings and construct a balance sheet) Sullivan Corporation ended its fiscal year on September 30, 2024, with cash of \$78 million, accounts receivable of \$27 million, property and equipment of \$27 million, and other long-term assets of \$21 million. The company's liabilities consist of accounts payable of \$34 million and long-term notes payable of \$17 million. Sullivan Corporation has total stockholders' equity of \$102 million; of this total, common stock is \$31 million. Solve for the company's ending retained earnings and then prepare Sullivan Corporation's balance sheet at September 30, 2024. Use a proper heading on the balance sheet.

S1-16. (Learning Objective 4: Construct a statement of cash flows) Python Legal Services, Inc., ended 2023 with cash of \$16,000. During 2024, Python earned net income of \$115,000 and had adjustments to reconcile net income to net cash provided by operations totaling \$9,000 (this is a negative amount). Python paid \$20,000 to purchase equipment during 2024. During 2024, the company declared and paid dividends of \$15,000. Prepare Python's statement of cash flows for the year ended December 31, 2024, complete with its proper heading.

S1-17. (Learning Objective 4: Construct an income statement, statement of retained earnings, and balance sheet) Following are partially completed financial statements (income statement, statement of retained earnings, and balance sheet) for Shaker Corporation. Complete the financial statements. All amounts are in millions.

A1					
	A	B	C	D	E
	Shaker Corporation				
	Income Statement				
1	for Year Ended December 31, 2024				
2	Net sales	\$ 183			
3	Expenses	101			
4	Net income	\$ a			
5					

A1						
		A	B	C	D	E
		Shaker Corporation				
		Statement of Retained Earnings				
		for Year Ended December 31, 2024				
1						
2	Beginning retained earnings		\$ 74			
3	Net income		b			
4	Cash dividends declared		(7)			
5	Ending retained earnings		\$ c			
6						

A1						
		A	B	C	D	E
		Shaker Corporation				
		Balance Sheet				
		December 31, 2024				
1						
2	Assets					
3	Cash		\$ 118			
4	All other assets		d			
5	Total assets		\$ e			
6	Liabilities					
7	Total liabilities		\$ 48			
8	Stockholders' equity					
9	Common stock		33			
10	Retained earnings		f			
11	Total stockholders' equity		g			
12	Total liabilities and stockholders' equity		\$ h			
13						

S1-18. (Learning Objective 5: Evaluate business decisions ethically) Good business and accounting practices require the exercise of good judgment. How should ethics be incorporated into making accounting judgments? Why is ethics important?

S1-19. (Learning Objectives 1, 2, 3, 4, 5: Match vocabulary terms with definitions) Match the following definitions with one of the terms listed here.

Asset	Expenses	Managerial accounting
Balance sheet	Financial accounting	Net income
Bookkeeping	Historical cost principle	Partnership
Corporation	Income statement	Proprietorship
Equity	Investors and creditors	Revenues
Ethical duties	Liability	Statement of cash flows
Item	Definition	
a.	Total revenues less total expenses	
b.	Provides information for decision makers outside of the organization	
c.	Provides information for managers of the organization	
d.	Responsibilities of the members of society to each other	
e.	Inflows of resources resulting from delivering goods or services to customers	
f.	Owned by stockholders whose liability is limited to the amount they have invested in the business	
g.	A debt payable to an outsider	
h.	Costs of doing business	
i.	A business organization form with a single owner who is personally liable for all of the business's debts	
j.	States that assets should be recorded at their actual cost on the date of purchase	
k.	Mechanical part of accounting	
l.	Also called the statement of financial position	
m.	Economic resources that are expected to produce benefits in the future	
n.	Entities that provide money to finance a company's operations	
o.	Answers the question "How well did the company perform during the period?"	
p.	Reports cash flows from operating, investing, and financing activities	
q.	A business organization form with two or more owners who are each personally liable for all of the business's debts	
r.	Insider claims of a business	

S1-20. (Learning Objective 6: Match ESG vocabulary terms with definitions) Complete the following statements with the corresponding term(s) from the list provided. Some terms may be used more than once, and other terms may not be used at all.

corporate social responsibility	governance	sustainability
economic	integrated reporting	third-party assurance
environment	International Sustainability Standards Board	triple bottom line
ESG	ratio analysis	United Nations Global Compact
Global Reporting Initiative	social	

1. The _____ is an approach to business that emphasizes measuring social and environmental impact in addition to financial success.
2. The _____ is a global independent standards organization to which organizations communicate their impacts on corruption, climate change, and human rights.
3. _____ is a thorough examination of both financial and nonfinancial elements that affect a company's ability to create value.
4. The United Nations Brundtland Commission defined _____ as "meeting the needs of the present without compromising the ability of future generations to meet their own needs."
5. _____ refers to the concept that companies should consider how their actions may impact society and the environment.
6. The _____ is a voluntary project based on CEO promises to implement universal sustainability principles.
7. One way to increase comparability among companies of different sizes when evaluating ESG performance is _____.
8. ESG is short for _____, _____, and _____.
9. The _____ is currently the most widely used reporting framework for corruption, climate change, and human rights.
10. An accounting, engineering, or consulting firm can provide _____ as a way to check the reliability of a company's reports.

S1-21. (Learning Objective 7: Match accounting career vocabulary terms with definitions) Match the following accounting career terms with the corresponding definitions.

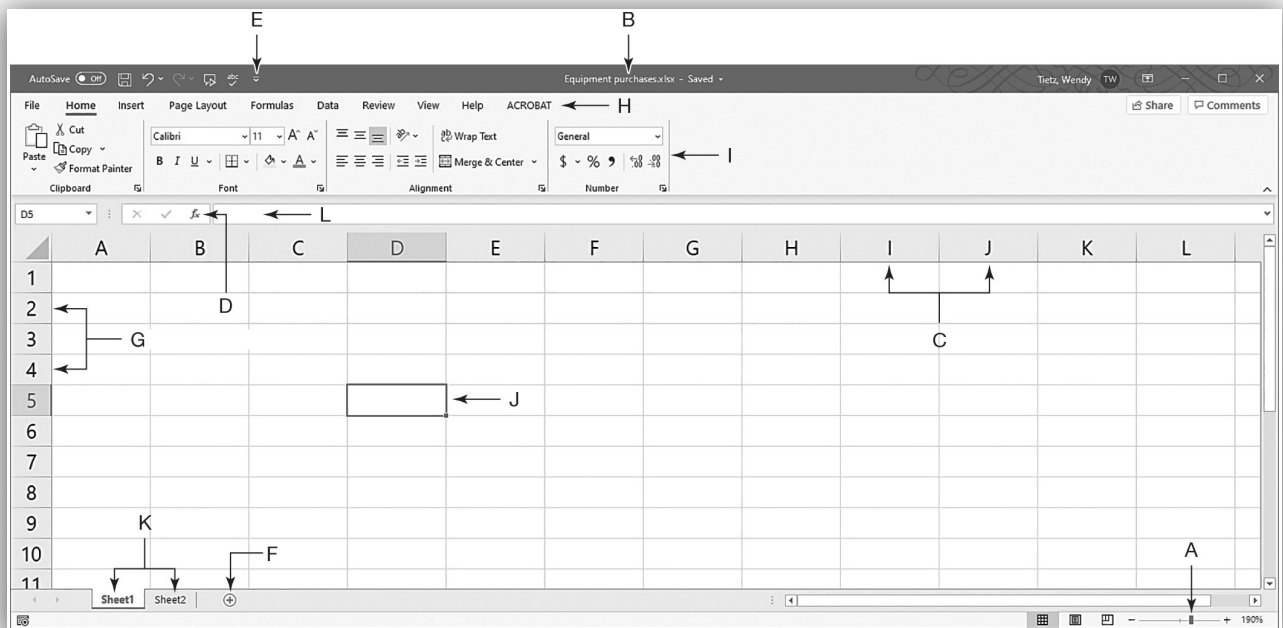
Term	Definition
1. Certified Internal Auditor	A. An accounting position that is sometimes also referred to as a cost accountant or controller.
2. National Association of Black Accountants	B. The collective title for the largest auditing firms in the world: Deloitte, EY, KPMG, and PwC.
3. Certified Public Accountant	C. A professional certification that focuses on fraud prevention, detection, deterrence, and investigation.
4. external auditor	D. An accounting professional who is employed by an accounting firm and is responsible for ensuring that a company's financial records are accurate.
5. financial analyst	E. A nonprofit organization dedicated to supporting Black business leaders in accounting, finance, and entrepreneurship.
6. budget analyst	F. An accounting professional who is employed by a company to review business processes and procedures.
7. the Big Four	G. A professional accounting certification that focuses on understanding internal financial decisions rather than public reporting.
8. management accountant	H. An accounting professional who uses data analysis tools to forecast future trends and advise clients on how to best manage their investments.
9. Certified Management Accountant	I. A professional accounting certification that focuses on internal auditing, risk management, and control.
10. Certified Fraud Examiner	J. An accounting professional who is responsible for preparing, monitoring, and analyzing financial reports to ensure that a company's expenditures align with its strategic goals.
11. internal auditor	K. A professional accounting certification that focuses on management accounting, established in 2012 by the AICPA and CIMA.
12. Chartered Global Management Accountant	L. An accounting professional certification that involves passing a four-section exam regarding accounting, auditing, tax, and another chosen discipline.

S1-22. (Learning Objective 8: Identify tools and technologies used in accounting and business) Listed are several terms. Match each term with the corresponding statement in the list provided. Some terms may be used more than once, and other terms may not be used at all.

active cell	formula bar	ribbon
artificial intelligence	Insert Function dialog box	robotic process automation
data analytics	machine learning	spreadsheet

1. The feature in Excel that is used to find and select the function that you want to use and provides guidance for the various options or arguments for that selected function is the _____.
2. The _____ displays the contents of the active cell in Excel.
3. Microsoft Excel, Google Sheets, and Apple Numbers are all examples of _____ software.
4. The process of taking raw data and putting it together to produce useful insights is _____.
5. Thick border gridlines surround the _____ in an Excel worksheet.
6. Apple's personal assistant, Siri, is an example of a(n) _____ application.
7. A _____ is generated by a software program in which data is organized in rows and columns.
8. Amazon's predictive technology that learns to make product recommendations based on prior purchases is an example of a(n) _____ application, which is a subset of the field of artificial intelligence.
9. Using software to perform routine bookkeeping tasks automatically is an example of _____.
10. The primary interface for Excel is the _____.

S1-23. (Learning Objective 8: Identify basic Excel components) Following is a screenshot of an Excel file.



Identify the letter on the screenshot that refers to each of the following features:

1. Active cell
2. Insert Sheet icon
3. Row header numbers
4. Worksheet tabs
5. Ribbon
6. File name
7. Column header letters
8. Zoom slider
9. Ribbon tabs
10. Quick Access tool bar
11. Insert Function dialog box
12. Formula bar

Exercises

Group A

E1-24A. (Learning Objectives 3, 4: Apply the accounting equation; evaluate business operations)

Calculate the missing amount in the accounting equation for each company (amounts in billions): Which company appears to have the strongest financial position? Explain your reasoning.

	Assets	Liabilities	Stockholders' Equity
Smythe Real Estate	\$?	\$41	\$32
Odessa Florals	26	?	15
Hometown Bank	29	14	?

E1-25A. (Learning Objectives 3, 4: Apply the accounting equation; evaluate business operations) Willow, Inc., has current assets of \$220 million; property, plant, and equipment of \$320 million; and other assets totaling \$130 million. Current liabilities are \$160 million and long-term liabilities total \$380 million.

Requirements

1. Use these data to write Willow's accounting equation.
2. How much in resources does Willow have to work with?
3. How much does Willow owe creditors?
4. How much of the company's assets do the Willow stockholders actually own?

E1-26A. (Learning Objectives 3, 4: Apply the accounting equation; evaluate business operations)

Collinswood Company's comparative balance sheet at January 31, 2025, and 2024, reports the following (in millions):

	2025	2024
Total assets	\$77	\$47
Total liabilities	25	19

Requirements

The following are three situations related to Collinswood Company's issuance of stock and declaration and payment of dividends during the year ended January 31, 2025. For each situation, use the accounting equation and what you know from the chapter about stockholders' equity, common stock, and retained earnings to calculate the amount of Collinswood's net income or net loss during the year ended January 31, 2025.

1. Collinswood issued \$11 million of stock and declared no dividends.
2. Collinswood issued no stock but declared dividends of \$20 million.
3. Collinswood issued \$15 million of stock and declared dividends of \$75 million.

E1-27A. (Learning Objective 4: Identify financial statement by type of information) Butler Tech, Inc., is expanding into India. The company must decide where to locate and how to finance the expansion. Identify the financial statement where these decision makers can find the following information about Butler Tech, Inc. In some cases, more than one statement will report the needed data.

- a. Revenue
- b. Common stock
- c. Current liabilities
- d. Long-term debt
- e. Dividends
- f. Ending cash balance
- g. Adjustments to reconcile net income to net cash provided by operations
- h. Cash spent to acquire the building

- i. Income tax expense
- j. Ending balance of retained earnings
- k. Selling, general, and administrative expense
- l. Total assets
- m. Net income
- n. Income tax payable

E1-28A. (Learning Objective 4: Construct a balance sheet) At December 31, 2024, Landy Products has cash of \$24,000, receivables of \$18,000, and inventory of \$80,000. The company's equipment totals \$182,000. Landy owes accounts payable of \$22,000 and long-term notes payable of \$172,000. Common stock is \$34,500. Prepare Landy's balance sheet at December 31, 2024, complete with its proper heading. Use the accounting equation to calculate retained earnings.

E1-29A. (Learning Objectives 3, 4: Apply the accounting equation; construct a balance sheet) The following are the assets and liabilities of Fernanda Carlson Realty Company, as of January 31, 2024. Also included are revenue, expense, and selected stockholders' equity figures for the year ended on that date (amounts in millions):

Total revenue	\$ 25.7	Investment assets (long-term)	\$ 79.4
Receivables.....	0.5	Property and equipment, net	1.6
Current liabilities	2.9	Other expenses.....	7.6
Common stock.....	39.2	Retained earnings, beginning.....	2.6
Interest expense.....	1.5	Retained earnings, ending	?
Salary and other employee expenses.....	13.7	Cash	57.2
Long-term liabilities	102.6	Other assets (long-term)	9.3

Requirement

1. Construct the balance sheet of Fernanda Carlson Realty Company at January 31, 2024. Use the accounting equation to calculate ending retained earnings.

E1-30A. (Learning Objective 4: Construct an income statement and a statement of retained earnings) This exercise should be used with Exercise 1-29A.

Requirements

1. Prepare the income statement of Fernanda Carlson Realty Company for the year ended January 31, 2024.
2. What amount of dividends did Fernanda Carlson declare during the year ended January 31, 2024? (*Hint:* Prepare a statement of retained earnings.)

E1-31A. (Learning Objective 4: Construct an income statement and a statement of retained earnings)

Assume the Giada Coffee Roasters Corp. ended the month of August 2025 with these data:

Payments of cash:			
Acquisition of equipment	\$201,500	Cash balance, August 1, 2025	\$ 0
Dividends	2,800	Cash balance, August 31, 2025 ..	5,300
Retained earnings		Cash receipts:	
August 1, 2025.....	0	Issuance (sale) of stock	
Retained earnings		to owners	14,900
August 31, 2025.....	?	Rent expense.....	1,800
Utilities expense	5,100	Common stock.....	14,900
Adjustments to reconcile		Equipment.....	201,500
net income to net cash		Office supplies.....	7,400
provided by operations.....	1,400	Accounts payable	8,800
Salary expense.....	78,500	Service revenue.....	278,700

1. Prepare the income statement and the statement of retained earnings for Giada Coffee Roasters Corp., for the month ended August 31, 2025.

E1-32A. (Learning Objective 4: Construct a balance sheet) Refer to the data in Exercise 1-31A.

Requirement

1. Prepare the balance sheet of Giada Coffee Roasters Corp., for August 31, 2025.

E1-33A. (Learning Objective 4: Construct a statement of cash flows) Refer to the data in Exercises 1-31A and 1-32A.

Requirement

1. Prepare the statement of cash flows of Giada Coffee Roasters Corp., for the month ended August 31, 2025. Using Exhibit 1-11 as a model, show with arrows the relationships among the income statement, statement of retained earnings, balance sheet, and statement of cash flows.

E1-34A. (Learning Objective 4: Evaluate business operations through the financial statements) This exercise should be used in conjunction with Exercises 1-31A through 1-33A.

The owner of Giada Coffee Roasters Corp. seeks your advice as to whether he should cease operations or continue the business. Complete the report, giving him your opinion of net income, dividends, financial position, and cash flows during his first month of operations. Cite specifics from the financial statements to support your opinion. Conclude your memo with advice on whether to stay in business or cease operations.

E1-35A. (Learning Objective 4: Construct an income statement, statement of retained earnings, and balance sheet) During 2024, Edwin Company earned revenues of \$150 million. Edwin incurred, during that same year, salary expense of \$34 million, rent expense of \$23 million, and utilities expense of \$16 million. Edwin declared and paid dividends of \$16 million during the year. At December 31, 2024, Edwin had cash of \$185 million, accounts receivable of \$70 million, property and equipment of \$35 million, and other long-term assets of \$22 million. At December 31, 2024, the company owed accounts payable of \$56 million and had a long-term note payable of \$26 million. Edwin began 2024 with a balance in retained earnings of \$73 million. At December 31, 2024, Edwin had total stockholders' equity of \$230 million, which consisted of common stock and retained earnings. Edwin has a year-end of December 31. Prepare the following financial statements (with proper headings) for 2024:

1. Income statement,
2. Statement of retained earnings,
3. Balance sheet.

Group B



Quiz

Test your understanding of the financial statements by answering the following questions. Select the best choice from among the possible answers given.

- Q1-48.** An organization's investors and creditors will primarily use information provided by
- the organization's financial accounting system.
 - the organization's managerial accounting system.
 - the Internal Revenue Service.
 - the Financial Accounting Standards Board.
- Q1-49.** The *primary* objective of financial reporting is to provide information
- useful for making investment and credit decisions.
 - on the cash flows of a company.
 - about the profitability of an enterprise.
 - to the federal government.
- Q1-50.** Which type of business organization provides the least amount of protection for bankers and other creditors of a company?
- Partnership
 - Corporation
 - Proprietorship
 - Both a and c
- Q1-51.** Assets are usually reported at their
- appraised value.
 - historical cost.
 - current market value.
 - none of the above
- Q1-52.** Assume that a business is headed for certain bankruptcy and it is evident that its liabilities greatly exceed its assets. Which principle would be violated if its financial statements were prepared using standard U.S. GAAP?
- Entity assumption
 - Continuity assumption
 - Historical cost principle
 - Stable-monetary-unit assumption
- Q1-53.** During February, assets increased by \$83,000 and liabilities increased by \$23,000. Equity must have
- increased by \$60,000.
 - increased by \$106,000.
 - decreased by \$106,000.
 - decreased by \$60,000.
- Q1-54.** The amount a company expects to collect from customers appears on the
- balance sheet in the current assets section.
 - balance sheet in the stockholders' equity section.
 - statement of cash flows.
 - income statement in the expenses section.
- Q1-55.** Revenues are
- decreases in liabilities resulting from paying off loans.
 - increases in retained earnings resulting from selling products or performing services.
 - increases in paid-in capital resulting from the owners investing in the business.
 - all of the above.
- Q1-56.** All of the following are current assets except
- prepaid expenses.
 - accounts payable.
 - inventory.
 - accounts receivable.
- Q1-57.** The financial statement that reports revenues and expenses is called the
- income statement.
 - statement of retained earnings.
 - statement of cash flows.
 - balance sheet.
- Q1-58.** Another name for the balance sheet is the
- statement of operations.
 - statement of profit and loss.
 - statement of earnings.
 - statement of financial position.
- Q1-59.** Maynard Corporation began the year with cash of \$135,000 and land that cost \$25,000. During the year, Maynard earned service revenue of \$260,000 and had the following expenses: salaries, \$185,000;

rent, \$81,000; and utilities, \$28,000. At year-end, Maynard's cash balance was down to \$31,000. How much net income (or net loss) did Maynard experience for the year?

- a. (\$138,000)
- b. \$75,000
- c. (\$34,000)
- d. (\$6,000)

Q1-60. Moody Instruments had retained earnings of \$300,000 at December 31, 2023. Net income for 2024 totaled \$200,000, and dividends declared for 2024 were \$55,000. How much retained earnings should Moody report at December 31, 2024?

- a. \$500,000
- b. \$445,000
- c. \$300,000
- d. \$355,000

Q1-61. Net income appears on which financial statement(s)?

- a. Balance sheet
- b. Income statement
- c. Statement of retained earnings
- d. Both b and c

Q1-62. Cash paid to purchase a building appears on the statement of cash flows among the

- a. financing activities.
- b. operating activities.
- c. investing activities.
- d. stockholders' equity.

Q1-63. The stockholders' equity of Kowalski Company at the beginning and end of 2024 totaled \$122,000 and \$140,000, respectively. Assets at the beginning of 2024 were \$149,000. If the liabilities of Kowalski Company increased by \$69,000 in 2024, how much were total assets at the end of 2024? Use the accounting equation.

- a. \$218,000
- b. \$62,000
- c. \$236,000
- d. \$220,000

Q1-64. Paulson Company had the following on the dates indicated:

	12/31/24	12/31/23
Total assets	\$ 530,000	\$ 350,000
Total liabilities	36,000	23,000

Paulson had no stock transactions in 2024, so the change in stockholders' equity for 2024 was due to net income and dividends. If dividends were \$75,000, how much was Paulson's net income for 2024? Use the accounting equation and the statement of retained earnings.

- a. \$92,000
- b. \$242,000
- c. \$167,000
- d. \$317,000

Q1-65. Which of the following factors should influence business and accounting decisions?

- a. Economic
- b. Legal
- c. Ethical
- d. All of the above

Problems

Group A

P1-66A. (*Learning Objectives 3, 4: Apply the accounting equation; evaluate business operations*)

Calculate the missing amount (?) for each company. (Amounts are in millions.)

	Kennedy Corp.	Caring Co.	Childress, Inc.
Beginning			
Assets	\$76	\$ 30	\$?
Liabilities	51	21	1
Common stock	7	7	6
Retained earnings.....	?	2	10
Ending			
Assets	\$?	\$ 48	\$20
Liabilities	53	32	?
Common stock	7	?	8
Retained earnings.....	26	?	?
Income statement			
Revenues	\$227	?	\$22
Expenses	218	157	?
Net income.....	?	?	?
Statement of retained earnings			
Beginning RE	\$ 18	\$ 2	\$10
+ Net income.....	?	8	4
– Dividends declared.....	(1)	(6)	(2)
= Ending RE.....	<u>\$ 26</u>	<u>\$ 4</u>	<u>\$12</u>

At the end of the year, which company had the

- highest net income?
- highest percent of net income to revenues?

P1-67A. (*Learning Objectives 3, 4: Apply the accounting equation; evaluate business operations; construct a balance sheet*)

The manager of City News, Inc., prepared the company's balance sheet as of May 31, 2024, while the company's accountant was ill. The balance sheet contains numerous errors. In particular, the manager knew that the balance sheet should balance, so she plugged in the stockholders' equity amount needed to achieve this balance. The stockholders' equity amount is *not* correct. All other amounts are accurate.

Requirements

1. Prepare the correct balance sheet and date it properly. Calculate total assets, total liabilities, and stockholders' equity.
2. Is City News actually in better (or worse) financial position than the erroneous balance sheet reports? Give the reason for your answer.
3. Identify the accounts listed on the incorrect balance sheet that should not be reported on the balance sheet. State why you excluded them from the correct balance sheet you prepared for Requirement 1. On which financial statement should these accounts appear?

P1-68A. (*Learning Objectives 2, 3, 4: Apply underlying accounting concepts; evaluate business operations; construct a balance sheet*)

Roberto Hilton is a realtor. He organized his business as a corporation on June 16, 2025. The business received \$65,000 cash from Hilton and issued common stock. Consider the following facts as of June 30, 2025:

- a. Hilton has \$15,000 in his personal bank account and \$55,000 in the business bank account.
- b. Hilton owes \$3,400 on a personal charge account at a local department store.

- c. Hilton acquired business furniture for \$30,000 on June 24. Of this amount, the business owes \$16,000 on accounts payable at June 30.
- d. Office supplies on hand at the real estate office total \$8,000.
- e. Hilton's business owes \$112,000 on a note payable for some land acquired for a total price of \$165,000.
- f. Hilton's business spent \$20,000 for a Realty Universe franchise, which entitles him to represent himself as an agent. Realty Universe is a national affiliation of independent real estate agents. This franchise is a business asset.
- g. Hilton owes \$182,000 on a personal mortgage on his personal residence, which he acquired in 2018 for a total price of \$334,000.

Requirements

1. Prepare the balance sheet of the real estate business of Roberto Hilton Realtor, Inc., at June 30, 2025.
2. Does it appear that the realty business can pay its debts? How can you tell?
3. Identify the personal items given in the preceding facts that should not be reported on the balance sheet of the business.

P1-69A. (Learning Objectives 3, 4: Evaluate business operations; construct and analyze an income statement, a statement of retained earnings, and a balance sheet) The assets and liabilities of Oak Hill Garden Supply, Inc., as of December 31, 2024, and revenues and expenses for the year ended on that date are as follows:

Beginning retained earnings was \$364,600, and dividends declared and paid totaled \$107,000 for the year.

Requirements

1. Prepare the income statement of Oak Hill Garden Supply, Inc., for the year ended December 31, 2024.
2. Prepare the company's statement of retained earnings for the year.
3. Prepare the company's balance sheet as of December 31, 2024.
4. Analyze Oak Hill Garden Supply, Inc., by answering these questions:
 - a. Was Oak Hill profitable during 2024? By how much?
 - b. Did retained earnings increase or decrease? By how much?
 - c. Which is greater, total liabilities or total stockholders' equity? Who has a greater claim to Oak Hill's assets: its creditors or its stockholders?

P1-70A. (Learning Objectives 3, 4: Evaluate business operations; construct a statement of cash flows) The following data come from the financial statements of Mitchell Company for the year ended March 31, 2025 (in millions):

Purchases of property, plant, and equipment for cash....	\$ 2,640	Other investing cash payments.....	\$ 195
Net income.....	3,020	Accounts receivable.....	650
Adjustments to reconcile net income to net cash provided by operating activities	2,420	Payment of dividends	265
Revenues	60,100	Common stock.....	4,900
Cash, beginning of year.....	220	Issuance of common stock.....	190
end of year	2,775	Cash proceeds on sale of property, plant, and equipment	25
Cost of goods sold.....	37,550	Retained earnings.....	12,830

Requirements

1. Prepare Mitchell Company's cash flow statement for the year ended March 31, 2025. Not all items listed will appear on the cash flow statement.
2. What activities provided the largest source of cash? Is this a sign of financial strength or weakness?

P1-71A. (Learning Objective 4: Construct financial statements) Summarized versions of Calabasa Corporation's financial statements for two recent years are as follows.

A1			
	A	B	C
1			
2		2025	2024
3	Income Statement	(in Thousands)	
4	Revenues	\$ k	\$ 14,750
5	Cost of goods sold	11,100	a
6	Other expenses	1,300	1,200
7	Income before income taxes	1,520	1,870
8	Income taxes (35%)	l	655
9	Net income	\$ m	\$ b
10	Statement of Retained Earnings		
11	Beginning balance	\$ n	\$ 2,680
12	Net income	o	c
13	Dividends declared	(92)	(70)
14	Ending balance	\$ p	\$ d
15	Balance Sheet		
16	Assets		
17	Cash	\$ q	\$ e
18	Property, plant, and equipment	1,547	1,316
19	Other assets	r	11,104
20	Total assets	\$ s	\$ 13,600
21	Liabilities		
22	Current liabilities	\$ t	\$ 5,660
23	Long-term debt	4,350	3,370
24	Other liabilities	35	180
25	Total liabilities	\$ 9,200	\$ f
26	Stockholders' equity:		
27	Common stock	\$ 425	\$ 425
28	Retained earnings	u	g
29	Other stockholders' equity	180	140
30	Total stockholders' equity	v	4,390
31	Total liabilities and stockholders' equity	\$ w	\$ h
32	Cash Flow Statement		
33	Net cash provided by operating activities	\$ x	\$ 875
34	Net cash used in investing activities	(270)	(425)
35	Net cash used in financing activities	(520)	(520)
36	Increase (decrease) in cash	(160)	i
37	Cash at beginning of year	y	1,250
38	Cash at end of year	\$ z	\$ j
39			

Requirement

1. Complete Calabasa Corporation's financial statements by determining the missing amounts denoted by the letters. If necessary, round numbers up to the nearest whole dollar.

Group B



APPLY YOUR KNOWLEDGE

Serial Case

C1-78. Analyze basic financial statement information (Learning Objectives 1, 3, 4)

Note: This mini-case is the first part of The Cheesecake Factory serial case contained in every chapter in this text.

The Cheesecake Factory Incorporated (NASDAQ: CAKE) was started by Evelyn Overton when she sold cheesecakes from her basement in Detroit in the 1940s. Its first restaurant opened in Beverly Hills, California, in 1978. The Cheesecake Factory has been a publicly held corporation since 1993 and currently operates over 300 restaurants under The Cheesecake Factory as well as several other brand names, both in the United States and abroad. Its fiscal year end is the Tuesday closest to December 31 each year.

To follow are Cheesecake Factory's four basic financial statements for its most recent year, the year ending January 3, 2023.²

	A	B	C
1	The Cheesecake Factory Incorporated		
2	Consolidated Statement of Income: Adapted for educational use		
3	For year ended January 3, 2023		
4			
5			<i>in thousands</i>
6	Revenues	\$	3,303,156
7	Costs and expenses:		
8	Cost of sales		810,926
9	Labor expenses		1,211,951
10	Depreciation and amortization expense		92,380
11	Other expenses		1,148,964
12	Total costs and expenses		3,264,221
13	Income from operations		38,935
14	Other income and (expenses), net		(6,043)
15	Income before income taxes		32,892
16	Income tax benefit		10,231
17	Net income	\$	43,123
18			
19	<i>Note: Information presented here should not be used for investment decisions.</i>		

Data from the U.S. Securities and Exchange Commission EDGAR Company Filings, www.sec.gov.

	A	B
1	The Cheesecake Factory Incorporated	
2	Statement of Retained Earnings (adapted for classroom use)	
3	For Year Ended January 3, 2023	
4	<i>(In thousands)</i>	
5		
6	Retained earnings balance, 12/28/2021	\$ 1,169,150
7	Add: Net income	43,123
8	Less: Dividends declared	(42,195)
9	Retained earnings balance, 1/3/2023	\$ 1,170,078
10		
11	<i>Note: Information presented here should not be used for investment decisions.</i>	

Data from the U.S. Securities and Exchange Commission EDGAR Company Filings, www.sec.gov.

² Please note that all statements have been adapted and condensed for educational use and should not be used for investment decisions.

	A	B	C
1		The Cheesecake Factory Incorporated	
2		Consolidated Balance Sheet: Adapted for educational use	
3		As of January 3, 2023	
4			<i>in thousands</i>
5		Assets	
6		Current assets:	
7		Cash and cash equivalents	\$ 114,777
8		Accounts receivable	105,511
9		Income tax receivable	21,522
10		Inventories	55,559
11		Prepaid expenses	48,399
12		Total current assets	345,768
13		Property and equipment, net	746,051
14		Other assets:	
15		Intangible assets, net	251,524
16		Operating lease assets	1,268,986
17		Other assets	162,891
18		Total other assets	1,683,401
19		Total assets	\$ 2,775,220
20			
21		Liabilities and Stockholders' Equity	
22		Current liabilities:	
23		Accounts payable	\$ 66,638
24		Other current liabilities	590,040
25		Total current liabilities	656,678
26		Noncurrent liabilities	1,826,539
27		Stockholders' equity:	
28		Common stock	1,063
29		Additional paid-in capital	887,485
30		Retained earnings	1,170,078
31		Treasury stock	(1,765,641)
32		Accumulated other comprehensive loss	(982)
33		Total stockholders' equity	292,003
34		Total liabilities and stockholders' equity	\$ 2,775,220
35			
36		<i>Note: Information presented here should not be used for investment decisions.</i>	

Data from the U.S. Securities and Exchange Commission EDGAR Company Filings, www.sec.gov.

	A	B
1	The Cheesecake Factory Incorporated	
2	Statement of Cash Flows (adapted for classroom use)	
3	For Year Ended January 3, 2023	
4	<i>(In thousands)</i>	
5		
6	Cash flows provided by operating activities	\$ 161,926
7	Cash flows used in investing activities	(112,815)
8	Cash flows used by financing activities	(123,636)
9	Foreign currency translation adjustment	(325)
10	Net change in cash and cash equivalents	\$ (74,850)
11	Cash and cash equivalents at beginning of period	189,627
12	Cash and cash equivalents at end of period	\$ 114,777
13		
14	<i>Note: Information presented here should not be used for investment decisions.</i>	

Data from the U.S. Securities and Exchange Commission EDGAR Company Filings, www.sec.gov.

Cheesecake Factory's complete, unabridged financial statements can be found on its investor relations website.

Requirements

1. What form of business organization is The Cheesecake Factory? How do you know?
2. Identify what line item flows from the fiscal 2022 income statement (year ended January 3, 2023) to the fiscal 2022 statement of retained earnings.
3. Identify the line item that flows from the statement of retained earnings to the January 3, 2023 balance sheet.
4. Identify the line item that flows from the statement of cash flows for the year ended January 3, 2023, to the January 3, 2023, balance sheet.
5. Did The Cheesecake Factory have net income or net loss for its fiscal year 2022? Over what period of time was this amount earned?
6. Write The Cheesecake Factory's accounting equation as of January 3, 2023.
7. How much in total resources does The Cheesecake Factory have to work with at January 3, 2023? How much does The Cheesecake Factory owe to creditors at January 3, 2023?

Decision Cases

C1-79. (Learning Objectives 1, 4: Explain accounting language; evaluate business operations through financial statements) Two businesses, Queens Service Corp. and Insley Sales Co., have sought business loans from you. To decide whether to make the loans, you have requested their balance sheets.

	A1			
	A	B	C	D
1	Queens Service Corp.			
2	Balance Sheet			
3	August 31, 2025			
4	Assets		Liabilities	
5	Cash	\$ 5,000	Accounts payable	\$ 50,000
6	Accounts receivable	10,000	Note payable	80,000
7	Land	75,000	Total liabilities	130,000
8	Furniture	15,000	Stockholders' Equity	
9	Equipment	45,000	Stockholders' equity	20,000
10			Total liabilities and	
11	Total assets	\$ 150,000	stockholders' equity	\$ 150,000
12				

A1			
	A	B	C
1	Insley Sales Co. Balance Sheet August 31, 2025		
2	Assets		Liabilities
3	Cash	\$ 5,000	Accounts payable
4	Accounts receivable	10,000	Note payable
5	Merchandise inventory	15,000	Total liabilities
6	Building	35,000	Stockholders' Equity
7			Stockholders' equity
8			Total liabilities and
9	Total assets	\$ 65,000	stockholders' equity
10			

Requirement

1. Using only these balance sheets, to which entity would you be more comfortable lending money? Explain fully, citing specific items and amounts from the respective balance sheets. (Challenge)

C1-80. (Learning Objectives 3, 4: Evaluate business operations through financial statements; correct errors; construct financial statements) A year out of college, you have \$10,000 to invest. A friend has started Flowers Unlimited, Inc., and he asks you to invest in his company. You obtain the company's financial statements, which are summarized at the end of the first year as follows:

A1		
	A	C
1	Flowers Unlimited, Inc. Income Statement Year Ended December 31, 2024	
2	Revenues	\$ 100,000
3	Expenses	80,000
4	Net income	\$ 20,000
5		

A1			
	A	B	D
1	Flowers Unlimited, Inc. Balance Sheet December 31, 2024		
2	Cash	\$ 6,000	Liabilities
3	Other assets	100,000	Stockholders' equity
4	Total assets	\$ 106,000	Total liabilities and stockholders' equity
5			

Visits with your friend turn up the following facts:

- Flowers Unlimited delivered \$140,000 of services to customers during 2024 and collected \$100,000 from customers for those services.
- Flowers Unlimited recorded a \$50,000 cash payment for software as an asset. This cost should have been an expense.
- To get the business started, your friend borrowed \$10,000 from his parents at the end of 2023. The proceeds of the loan were used to pay salaries for the first month of 2024. Because the loan was from his parents, your friend did not reflect the loan or the salaries in the accounting records.

Requirements

- Prepare corrected financial statements.
- Use your corrected statements to evaluate Flowers Unlimited's results of operations and financial position. (Challenge)
- Will you invest in Flowers Unlimited? Give your reason. (Challenge)

Ethical Issue

C1-81. (Learning Objective 5: Evaluate ethical decisions) You are studying frantically for an accounting exam tomorrow. You are having difficulty in this course, and the grade you make on this exam can make the difference between receiving a final grade of B or C. If you receive a C, it will lower your grade point average to the point that you could lose your academic scholarship. An hour ago, a friend, also enrolled in the course but in a different section under the same professor, called you with some unexpected news. In her sorority test files, she has just found a copy of an old exam from the previous year. In looking at the exam, it appears to contain questions that come right from the class notes you have taken, even the very same numbers. She offers to make a copy for you and bring it over.

You glance at your course syllabus and find the following: “You are expected to do your own work in this class. Although you may study with others, giving, receiving, or obtaining information pertaining to an examination is considered an act of academic dishonesty, unless such action is authorized by the instructor giving the examination. Also, divulging the contents of an essay or objective examination designated by the instructor as an examination is considered an act of academic dishonesty. Academic dishonesty is considered a violation of the student honor code and will subject the student to disciplinary procedures, which can include suspension from the university.” Although you have heard a rumor that fraternities and sororities have cleared their exam files with professors, you are not sure.

Requirements

1. What is the ethical issue in this situation?
2. Who are the stakeholders? What are the possible consequences to each?
3. Analyze the alternatives from the following standpoints: (a) economic, (b) legal, and (c) ethical.
4. What would you do? How would you justify your decision? How would your decision make you feel afterward?
5. How is this similar to a business situation?

Focus on Financials: Apple Inc.

C1-82. (Learning Objectives 3, 4: Apply the accounting equation; evaluate business operations) This and similar cases in succeeding chapters are based on the consolidated financial statements of **Apple Inc.** shown in Appendix A and online in the filings section of www.sec.gov.

Requirements

1. Go online and do some research on Apple Inc. and its industry. Use one or more popular websites such as Yahoo! Finance or Google Finance. Write a paragraph (about 100 words) that describes the industry, some current developments, and a projection for future growth.
2. Read Part I, Item 1 (Business) of Apple’s annual report. What do you learn here and why is it important?
3. Name at least one of Apple’s competitors. Describe the competitive nature of Apple’s industry. Why is this information important in evaluating Apple’s financial performance?
4. Suppose you own stock in Apple. If you could pick one item on the company’s Consolidated Statements of Operations to increase year after year, what would it be? Why is this item so important? Did this item increase or decrease during fiscal 2022? Is this good news or bad news for the company?
5. What was Apple’s largest expense in 2022? In your own words, explain the meaning of this item. Give specific examples of items that make up this expense. The chapter gives another title for this expense. What is it?
6. Use the Consolidated Balance Sheets of Apple in Appendix A to answer these questions: At the end of fiscal 2022, how much in total resources did Apple have to work with? How much did the company owe? How much of its assets did the company’s stockholders actually own? Use these amounts to write Apple’s accounting equation at September 24, 2022.
7. How much cash and cash equivalents did Apple have at September 24, 2022? How much cash and cash equivalents did Apple have at September 24, 2022?

Focus on Analysis: Under Armour, Inc.

C1-83. (Learning Objectives 3, 4: Apply the accounting equation; evaluate business operations) This and similar cases in each chapter are based on the 2021 consolidated financial statements of **Under Armour, Inc.** You can retrieve the 2021 Under Armour financial statements at www.sec.gov by clicking on Filings and then searching for “Under Armour” under Company Filings. When you see the list of filings for the company, select the Form 10-K for 2021. Be sure to retrieve the 2021 financial statements, not another year.

Requirements

1. Go online and do some research on Under Armour and its industry. Use one or more popular websites such as Yahoo! Finance or Google Finance. Write a paragraph (about 100 words) that describes the industry, some current developments, and a projection for where the industry is headed.
2. Read Note 1—(Description of Business) of Under Armour’s annual report. What do you learn here and why is it important?
3. Name two of Under Armour’s competitors. Why is this information important in evaluating Under Armour’s financial performance?
4. Write Under Armour’s accounting equation as of December 31, 2021 (express all items in millions and round to the nearest \$1 million). Does Under Armour’s financial condition look strong or weak? How can you tell?
5. What was the result of Under Armour’s operations during 2021? Identify both the name and the dollar amount of the result of operations for 2021. Does an increase (or decrease) signal good news or bad news for the company and its stockholders?
6. Examine retained earnings in the Consolidated Statements of Stockholders’ Equity. What caused retained earnings to increase during 2021?
7. Which statement reports cash and cash equivalents as part of Under Armour’s financial position? Which statement tells *why* cash and cash equivalents increased (or decreased) during the year? Which activities caused the company’s cash and cash equivalents to change during 2021, and how much did each activity provide or use?

Group Projects

Project 1. As instructed by your professor, obtain the annual report of a well-known company.

Requirements

1. Suppose you are a member of a loan committee at Bank of America. Assume a company has requested a loan from the bank. Analyze the company’s financial statements and any other information you need to decide how much money you would be willing to lend the firm. Specify the following:
 - a. The length of the loan period—that is, over what period will you allow the company to pay you back?
 - b. The interest rate you will charge on the loan. Will you charge the prevailing interest rate, a lower rate, or a higher rate? Why?
 - c. Any restrictions you will impose on the borrower as a condition for making the loan.

Note: The long-term debt note to the financial statements gives details of the company’s existing liabilities.

2. Write your group decision in a report addressed to the bank’s board of directors. Limit your report to 400 to 600 words.
3. If your professor directs, present your decision and your analysis to the class. Limit your presentation to 10 to 15 minutes.

Project 2. You are the owner of a company that is about to “go public,” that is, issue its stock to outside investors. You want to make your company look as attractive as possible to raise \$1 million to expand the business. At the same time, you want to give potential investors a realistic picture of your company.

Requirements

1. Design a prospectus (a report) to portray your company in a way that will enable outsiders to reach an informed decision as to whether to buy some of your stock. The prospectus should include the following:
 - a. Name and location of your company.
 - b. Nature of the company's business (be as detailed as possible).
 - c. How you plan to spend the money you raise.
 - d. The company's comparative income statement, statement of retained earnings, balance sheet, and statement of cash flows for two years: the current year and the preceding year. Make the data as realistic as possible with the intent of receiving \$1 million.
2. Create your prospectus using Word, Pages, or other similar tool. Do not exceed five pages.

Try It Solutions

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1. \$320,000 (\$480,000 – \$160,000)
2. \$260,000 (\$160,000 + \$100,000)
3. Net income of \$140,000 (\$365,000 – \$225,000); revenues minus expenses
4. \$210,000 [\$180,000 beginning balance + net income \$50,000 (\$85,000 – \$35,000) – dividends \$20,000]