

Student Study Resource

- Study Outlines
- Solutions to Odd-Numbered Problems
- PowerPoint® Notes

for use with

Accounting

What the Numbers Mean

6th edition



David H. Marshall • Wayne W. McManus • Daniel F. Viele

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Accounting What the Numbers Mean

Sixth Edition

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ACCOUNTING: WHAT THE NUMBERS MEAN

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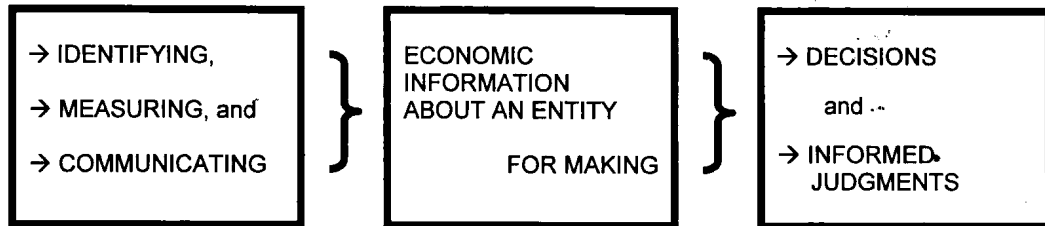
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ACCOUNTING IS THE PROCESS OF:



USERS OF ACCOUNTING INFORMATION

- MANAGEMENT
- INVESTORS
- CREDITORS
- EMPLOYEES
- GOVERNMENTAL AGENCIES

CLASSIFICATIONS OF ACCOUNTING

- FINANCIAL ACCOUNTING
- MANAGERIAL ACCOUNTING / COST ACCOUNTING
- AUDITING - PUBLIC / INTERNAL
- GOVERNMENTAL ACCOUNTING
- INCOME TAX ACCOUNTING

PROFESSIONAL CERTIFICATIONS

- CPA → CERTIFIED PUBLIC ACCOUNTANT
- CMA → CERTIFIED MANAGEMENT ACCOUNTANT
- CFM → CERTIFIED IN FINANCIAL MANAGEMENT
- CIA → CERTIFIED INTERNAL AUDITOR

FINANCIAL ACCOUNTING STANDARD SETTING

FASB (FINANCIAL ACCOUNTING STANDARDS BOARD)

- **STATEMENTS OF FINANCIAL ACCOUNTING STANDARDS**
OVER 145 ISSUED. DEAL WITH SPECIFIC
ACCOUNTING AND FINANCIAL REPORTING ISSUES.
- **STATEMENTS OF FINANCIAL ACCOUNTING CONCEPTS**
7 ISSUED. AN ATTEMPT TO PROVIDE A COMMON
FOUNDATION TO SUPPORT FINANCIAL ACCOUNTING
STANDARDS.
- **KEY OBJECTIVES OF FINANCIAL REPORTING (SFAC #1)**
 - ✓ RELATE TO EXTERNAL FINANCIAL REPORTING.
 - ✓ TO SUPPORT BUSINESS AND ECONOMIC
DECISIONS.
 - ✓ TO PROVIDE INFORMATION ABOUT CASH FLOWS.
 - ✓ PRIMARY FOCUS IS ON EARNINGS BASED ON
ACCRUAL ACCOUNTING.
 - ✓ NOT TO MEASURE DIRECTLY THE VALUE OF A
BUSINESS ENTERPRISE.
 - ✓ INFORMATION REPORTED SUBJECT TO
EVALUATION BY INDIVIDUAL FINANCIAL STATEMENT
USERS.
 - ✓ ACCOUNTING STANDARDS ARE STILL EVOLVING.

INTERNATIONAL ACCOUNTING STANDARDS

- IASB (INTERNATIONAL ACCOUNTING STANDARDS BOARD).
- STANDARDS DIFFER SIGNIFICANTLY AMONG COUNTRIES.
- INDIVIDUAL COUNTRY STANDARDS REFLECT LOCAL MARKET NEEDS AND COUNTRY REGULATION AND TAXATION PRACTICES.

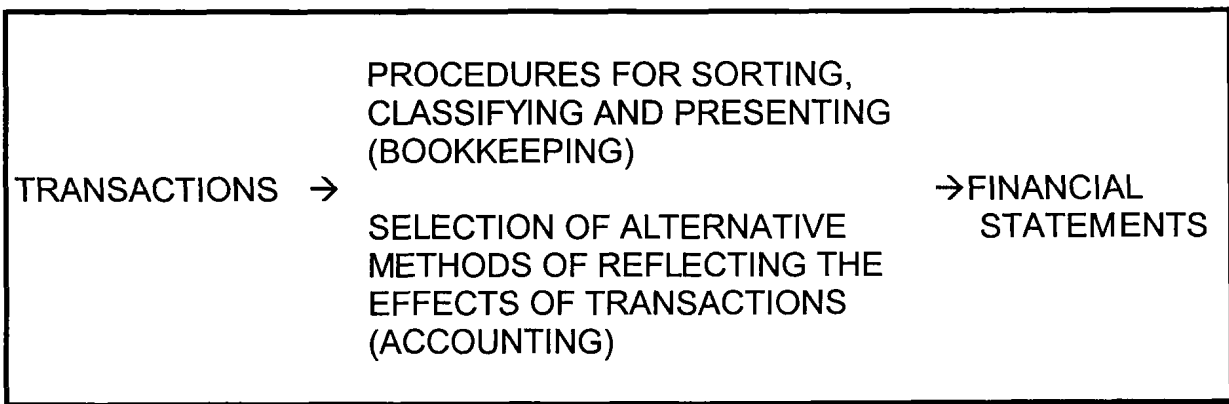
ETHICS AND THE ACCOUNTING PROFESSION

- AICPA CODE OF PROFESSIONAL CONDUCT
- IMA STANDARDS OF ETHICAL CONDUCT FOR MANAGEMENT ACCOUNTANTS

KEY ELEMENTS OF ETHICAL BEHAVIOR

- INTEGRITY
- OBJECTIVITY
- INDEPENDENCE
- COMPETENCE

TRANSACTIONS TO FINANCIAL STATEMENTS



TRANSACTIONS

ECONOMIC INTERCHANGES BETWEEN ENTITIES.

FINANCIAL STATEMENTS

- **BALANCE SHEET**
FINANCIAL POSITION AT A POINT IN TIME.
- **INCOME STATEMENT**
EARNINGS FOR A PERIOD OF TIME.
- **STATEMENT OF CASH FLOWS**
SUMMARY OF CASH FLOWS FOR A PERIOD OF TIME.
- **STATEMENT OF CHANGES IN OWNERS' EQUITY**
INVESTMENTS BY OWNERS, EARNINGS OF THE FIRM, AND
DISTRIBUTIONS TO OWNERS FOR A PERIOD OF TIME.

FINANCIAL STATEMENTS

BALANCE SHEET (AT A POINT IN TIME)

Exhibit 2-1 Balance Sheet

MAIN STREET STORE, INC.		Balance Sheet	
		August 31, 2004	
Assets		Liabilities and Owners' Equity	
Current assets:		Current liabilities:	
Cash	\$ 34,000	Short-term debt	\$ 20,000
Accounts receivable	80,000	Accounts payable	35,000
Merchandise inventory	170,000	Other accrued liabilities	12,000
Total current assets	\$284,000	Total current	
Plant and equipment:		liabilities	\$ 67,000
Equipment	40,000	Long-term debt	50,000
Less: Accumulated		Total liabilities	\$117,000
depreciation	(4,000)	Owners' equity	203,000
Total assets	\$320,000	Total liabilities and	
		owners' equity	\$320,000

KEY RELATIONSHIP

$$\mathbf{ASSETS = LIABILITIES + OWNERS' EQUITY}$$

KEY TERMINOLOGY

- ASSETS
- CURRENT ASSETS
- ACCUMULATED DEPRECIATION
- LIABILITIES
- CURRENT LIABILITIES
- OWNERS' EQUITY

FINANCIAL STATEMENTS

INCOME STATEMENT (FOR A PERIOD OF TIME)

Exhibit 2-2 Income Statement

MAIN STREET STORE, INC. Income Statement For the Year Ended August 31, 2004	
Net sales	\$1,200,000
Cost of goods sold	850,000
Gross profit	<u>\$ 350,000</u>
Selling, general, and administrative expenses	311,000
Income from operations	<u>\$ 39,000</u>
Interest expense	9,000
Income before taxes	<u>\$ 30,000</u>
Income taxes	12,000
Net income	<u><u>\$ 18,000</u></u>
Net income per share of common stock outstanding	<u><u>\$ 1.80</u></u>

KEY RELATIONSHIP

$$\text{REVENUES} - \text{EXPENSES} = \text{NET INCOME}$$

KEY TERMINOLOGY

- REVENUES (SALES)
- GROSS PROFIT
- EARNINGS BEFORE TAXES
- NET INCOME PER SHARE OF COMMON STOCK
- COST OF GOODS SOLD
- OPERATING INCOME
- NET INCOME

FINANCIAL STATEMENTS

STATEMENT OF CHANGES IN OWNERS' EQUITY (FOR A PERIOD OF TIME)

Exhibit 2-3 Statement of Changes in Owners' Equity

MAIN STREET STORE, INC. Statement of Changes in Owners' Equity For the Year Ended August 31, 2004	
Paid-In Capital:	
Beginning balance	\$ -0-
Common stock, par value, \$10; 50,000 shares authorized, 10,000 shares issued and outstanding	100,000
Additional paid-in capital	<u>90,000</u>
Balance, August 31, 2004	<u>\$190,000</u>
Retained Earnings:	
Beginning balance	\$ -0-
Net income for the year	18,000
Less: Cash dividends of \$.50 per share	<u>(5,000)</u>
Balance, August 31, 2004	<u>\$ 13,000</u>
Total owners' equity	<u><u>\$203,000</u></u>

TWO PRINCIPAL COMPONENTS

- PAID-IN CAPITAL CHANGES
- RETAINED EARNINGS CHANGES

KEY RELATIONSHIP

$$\begin{array}{r} \text{RETAINED EARNINGS BEGINNING BALANCE} \\ + \text{NET INCOME FOR THE PERIOD} \\ - \text{DIVIDENDS} \\ \hline = \text{RETAINED EARNINGS ENDING BALANCE} \end{array}$$

KEY TERMINOLOGY

- PAID-IN CAPITAL
- DIVIDENDS

FINANCIAL STATEMENTS

STATEMENT OF CASH FLOWS (FOR A PERIOD OF TIME)

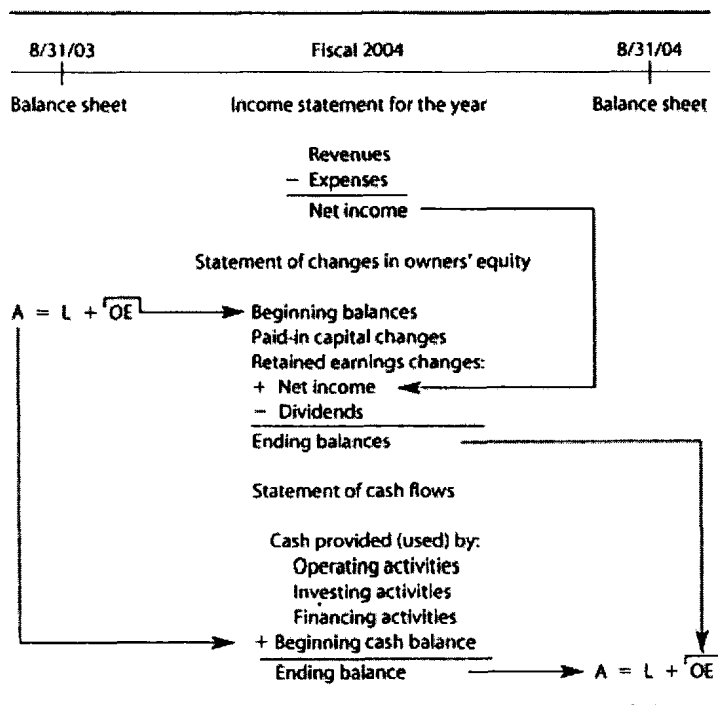
Exhibit 2-3 Statement of Cash Flows

MAIN STREET STORE, INC. Statement of Cash Flows For the Year Ended August 31, 2004	
Cash Flows from Operating Activities:	
Net income	\$ 18,000
Add (deduct) items not affecting cash:	
Depreciation expense	4,000
Increase in accounts receivable	(80,000)
Increase in merchandise inventory	(170,000)
Increase in current liabilities	67,000
Net cash used by operating activities	<u><u>\$ (161,000)</u></u>
Cash Flows from Investing Activities:	
Cash paid for equipment	<u><u>\$ (40,000)</u></u>
Cash Flows from Financing Activities:	
Cash received from issue of long-term debt	\$ 50,000
Cash received from sale of common stock	190,000
Payment of cash dividend on common stock	<u>(5,000)</u>
Net cash provided by financing activities	<u><u>\$ 235,000</u></u>
Net increase in cash for the year	<u><u>\$ 34,000</u></u>

KEY TERMINOLOGY

- CASH FLOWS FROM OPERATING ACTIVITIES
- CASH FLOWS FROM INVESTING ACTIVITIES
- CASH FLOWS FROM FINANCING ACTIVITIES
- CHANGE IN CASH FOR THE YEAR

FINANCIAL STATEMENT RELATIONSHIPS

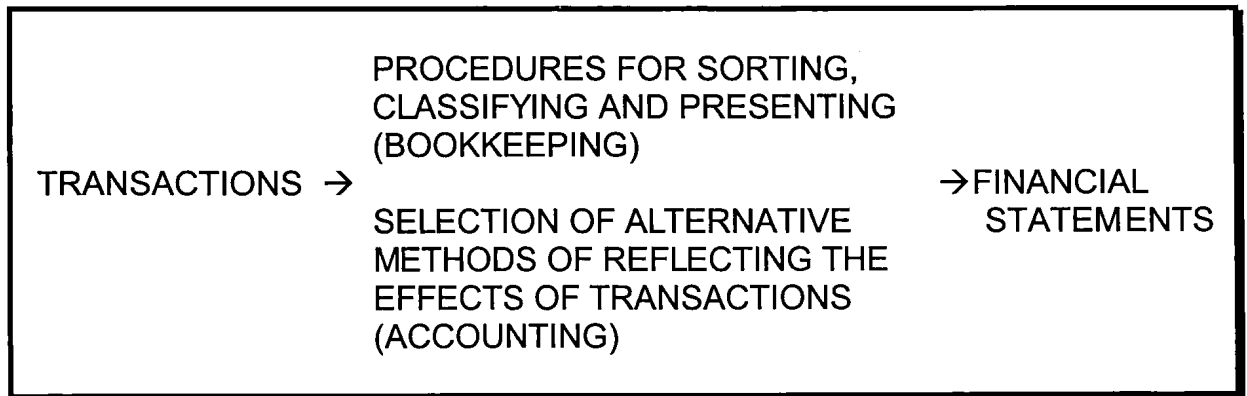


KEY IDEAS

- TRANSACTIONS AFFECTING THE INCOME STATEMENT ALSO AFFECT THE BALANCE SHEET.
- FOR THE BALANCE SHEET TO BALANCE, INCOME STATEMENT TRANSACTIONS MUST BE REFLECTED IN THE RETAINED EARNINGS PART OF OWNERS' EQUITY.
- THE STATEMENT OF CASH FLOWS EXPLAINS WHY THE CASH AMOUNT CHANGED DURING THE PERIOD.

ACCOUNTING CONCEPTS AND PRINCIPLES

- ACCOUNTING ENTITY
- ASSETS = LIABILITIES + OWNERS' EQUITY (ACCOUNTING EQUATION)
- GOING CONCERN (CONTINUITY)



- UNIT OF MEASUREMENT
- ACCOUNTING PERIOD
- CONSISTENCY
- COST PRINCIPLE
- MATCHING REVENUE AND EXPENSE
- FULL DISCLOSURE
- OBJECTIVITY
- REVENUE RECOGNIZED AT TIME OF SALE
- MATERIALITY
- ACCRUAL CONCEPT
- CONSERVATISM

KEY CLARIFICATION

- MATCHING OF REVENUE AND EXPENSE MEANS THAT ALL EXPENSES INCURRED IN GENERATING REVENUES FOR THE PERIOD ARE SUBTRACTED FROM THOSE REVENUES TO DETERMINE NET INCOME. MATCHING DOES NOT MEAN THAT REVENUES EQUAL EXPENSES.