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Financial Accounting, v4.0

Chapter 1 Solutions

Answers to Questions

1) Financial accounting is the communication of information about a business or other type of organization (such as a charity or government) so that individuals and any other interested groups can evaluate its financial health and future prospects. Financial accounting provides data needed by decision makers to arrive at wise decisions about an organization as a whole.

2) Former secretary-general of the United Nations, Kofi Annan, has stated, “Knowledge is power. Information is liberating.” Financial accounting information is important to many individuals who want to evaluate an organization and then make good decisions. Often in business, being successful results from being able to make appropriate decisions. Those decisions frequently depend on a person’s ability to understand and make use of financial information about organizations.

3) Financial accounting information is used to assess the financial health and future prospects of an organization. Therefore, this information is often analyzed by investors as part of the process of deciding whether to buy (or possibly sell) the capital (ownership) shares of a business. Strong financial results often lead to an increase in the market price of such shares and additional dividend distributions. Financial accounting information can also help determine whether an organization deserves to receive a loan or other forms of credit. If cash inflows seem adequate, a bank or creditor can hope to receive repayment of a loan or liability when due plus a reasonable rate of interest. Financial accounting helps such lenders judge the risk they are taking.

4) Financial accounting encompasses all steps in the process of providing information to those outside of an organization so that they can make decisions about that entity when viewed as a whole. Financial accounting decisions are rather limited—should capital shares be bought or sold and should a loan or other credit be extended? Managerial accounting provides information for those inside of an organization so that they can make decisions on behalf of that organization. There are hundreds, if not thousands, of decisions that can be made using managerial accounting information. Should a new truck be bought with cash or by taking out a loan? Should employee pay raises this year be 3 percent or 4 percent? Should a new computer system be acquired immediately or in two years?

5) Possible users of financial accounting information include potential and current shareholders, potential and current lenders and creditors, potential and current employees of the organization, governments, customers, contractors, and suppliers.

6) Any person can find value in reading and understanding what is contained within a company's financial statements. Although financial accounting information is focused on communicating information to those outside of an organization, many individuals within that organization will find it helpful as well. Employees appreciate knowing the financial health of the company that employs them, while managers and leaders often need to know the financial results for a period of time for performance and budget purposes.

7) Ligando and Zvyvco have been told that they should incorporate their new business. They need to understand the ramifications of that decision so they can make it appropriately. A corporation is a business or other organization that has been formally recognized by a state government as a separate legal entity. It has certain rights such as the right to sell stock to raise funds and the right to form contracts. Therefore, for example, a corporation can borrow money from a bank and not create a liability for its owners.

8) An unincorporated business with more than one owner is automatically labeled as a partnership. Partnerships have certain advantages. For example, they are simple to create, often requiring no more than a general understanding between the partners. In addition, as discussed later in the textbook, they provide certain income tax advantages. However, each partner has what is referred to as "unlimited liability." In other words, each partner might be held personally liable for all debts and other obligations incurred by the business. There is no monetary limit to what that amount might be. In addition, because of unlimited liability, partnerships often have difficulty getting new owners unless the person can work as part of management to oversee operations and ensure that liabilities remain reasonable. Thus, partnerships rarely grow into large businesses.

9) In order to become a corporation, the owners of a business must apply to a state government for recognition. A business in the state of Missouri, for example, will probably incorporate according to the laws of Missouri although that does not always happen. Many larger companies incorporate in Delaware because of the simplicity of the process and because of favorable laws.
Articles of Incorporation and other required documentation are filed with the state to disclose specific information about such things as the capital stock to be issued and the line of business. Rules for incorporation vary by state. Information about forming a corporation in the state of Illinois can be found at http://www.citmedialaw.org/legal-guide/illinois/forming-corporation-illinois. Most states have similar information available.

10) The owners of a business would want to become a corporation for several reasons. The corporation can issue capital shares to bring in money from new owners and help the business grow. In addition, the owners of a corporation are not faced with unlimited liability like the owners of a partnership or sole proprietorship.

11) For an organization that operates as a sole proprietorship or a partnership, the owners are the individuals who started it with contributed capital, operate it, and are responsible for the business. For a corporation, the owners of the organization are the shareholders. The managers and leaders within the organization have been tasked with the responsibility to serve as the day-to-day operators of the organization on behalf of the shareholders.

12) A board of directors is a representative group elected by the shareholders to oversee the management of the business. The board reviews operating, financing, and investing activities and their approval may be required for a number of actions. Future plans and other significant events might also require approval of the board. The distribution of dividends can only be made through the authorization of the board.

13) Waters probably hopes to make an investment because he believes that the stock price of the shares issued by the chosen organization (such as Walmart) will go up in value. He could then sell some or all of the shares and earn a profit. He might also believe that the corporation is in a strong financial position and will pay a large cash dividend in the future. Perhaps by studying the financial accounting information published by the business, he has come to believe that a good rate of return can be earned through stock price appreciation and/or through dividends.

14) A dividend is a distribution from a corporation to its shareholders from any profits earned by that business. Basically, the corporation earns a profit as a result of operations and then shares a portion with the owners of the company. Dividends can only be distributed by approval of a corporation's board of directors. A dividend is a payment made to the owners of the capital stock of a corporation as a reward for investing in a business that proves to be profitable. It is not a required payment so the board of directors chooses to distribute the wealth in the form of dividends or to leave it within the business to stimulate future growth and additional profits.

15) Tattaro earned a profit on the savings account of $15 ($515 less $500) in one year from an investment of $500. That is an annual return of 3 percent ($15/$500). In connection with the capital shares, he now has $642 ($4 dividend plus the $638 received from the sale of the investment). That is a total profit of $42 over the original investment of $600 or a 7 percent annual rate of return ($42/$600).

16) The rate of return is a quantifiable measure of the financial benefit earned in the past and can be used to help predict future benefits. Ideally, investors should choose the investment that provides the highest anticipated rate of return.

17) An investor in a corporation's capital stock is looking for the possibility of stock price appreciation and/or cash dividends. Thus, an investor hopes to find financial accounting information that indicates future growth or profitability that will cause the stock price to rise or put the business into a position where additional dividends are likely. A creditor or lender simply wants to be paid the amount owed when the debt comes due plus the required amount of interest. Therefore, a creditor or lender is interested in the business's ability to generate adequate cash inflows in the future to satisfy debt requirements. Growth potential and profitability are only interesting to the creditor or lender in that they can affect the rate of future cash flows.

18) Financial information is data that can be measured in monetary terms.

19) Although financial accounting starts by reporting balances as monetary amounts, the communication process does not stop there. Extensive verbal explanations, as well as additional numerical data, are also provided to clarify or expand the monetary information where necessary.

20) An annual report is the most common vehicle for distributing financial accounting information to owners and other outside parties interested in assessing the financial health and future prospects of an organization. An annual report often contains additional information such as the identity of management and the board of directors. However, the most important section of the annual report is the financial information and the verbal explanations to accompany those monetary balances.

21) Often, the annual report of an organization will contain the following items: A letter to the shareholders, the management's discussion and analysis of operations, financial accounting information, the notes of explanation to the financial statements, and lists of executive members of management and board of directors.

Answers to True or False Questions

__F__ **1)**

Financial accounting provides information to individuals and groups outside of an organization to help them make decisions about that organization. Managerial accounting helps with decisions that are made inside an organization.

__F__ **2)**

Financial information is used by many different individuals and entities including potential and current creditors, potential and current stockholders, potential and current employees, and governments. Accountants help to convey the information but they certainly are not the only users of that data.

__T__ **3)**

Financial information is important for any organization, regardless of size.

__F__ **4)**

The financial information of a company communicates a great deal of information. This information can be widely used in decision making regarding the company's financial health and future prospects.

__T__ **5)**

Although both financial and managerial accounting information is extremely important and helpful, they serve different purposes. The objective of managerial accounting is to assist management in making the best decisions regarding daily operations of the company. The objective of financial accounting information is to communicate to outside individuals what has occurred within the organization. It assists those interested parties in making the best decisions regarding the financial health and future prospects of the company.

__F__ **6)**

Individuals within an organization, such as employees, are also interested in reading and understanding more about the organization in which they are employed. For example, employees may have their compensation tied to performance measures. Another possibility may be that the employee has the opportunity to move upward within the organization or switch employers. The individual would be interested in understanding the financial health and future prospects of the company when making these decisions.

__T__ **7)**

A corporation is a legal entity that is separate from its owners. This means the organization can continue to exist in perpetuity apart from the owners. It exists legally as a completely distinct entity from the multitude of individuals that possess their ownership shares (capital shares).

__F__ **8)**

One of the advantages of incorporating is increasing the ease of raising money from the selling of capital shares. The businesses that issue stock which is traded on a stock exchange are almost always corporations rather than partnerships or sole proprietorships.

__F__**9)**

An entity that loans money to a business or provides credit in some other fashion is known as a lender or creditor. A shareholder is an individual or group that holds the ownership or capital shares of a corporation.

__F__ **10)**

Virtually all of the shares of the corporations that trade each day on the New York Stock Exchange and other stock markets are bought as investments. The stockholders rarely have any interest in actually being involved with daily operations.

__T__ **11)**

Shareholders elect the Board of Directors to oversee management, set policy, and approve decisions for the corporation.

__F__ **12)**

There are many active markets in which to buys and sell stocks around the globe. The New York Stock Exchange and the NASDAQ (National Association of Securities Dealers Automated Quotations) are two U.S. examples of the exchanges. Other countries have their own markets as well.

__T__ **13)**

An investment in capital stock shares that are held longer than a year may be subject to lower capital gains tax rates. This tax advantage encourages more people to invest money in stocks which helps make businesses bigger and aids the economy.

__F__ **14)**

The Board of Directors of a corporation must choose whether or not to distribute dividends to shareholders. There is no requirement that they do so. Different businesses have different philosophies about the payment of dividends. Some prefer to leave money within the business to stimulate future growth and additional profits. Others choose to distribute the earnings to the owners through dividends.

__F__ **15)**

The annual rate of return is an important calculation that helps quantify the financial benefit earned in the past while helping to predict future benefits. The focus of the computation is the increase in stock price and dividends distributed. It is not a great indicator of cash flow for an organization. To determine the ability of a company to pay its debts in the coming year, the reader would be interested in the current ratio or working capital, which will be explained in more detail in later chapters.

__F__ **16)**

The calculation for annual rate of return takes the profit for the year (stock appreciation and dividends) and divides it by the amount of the investment at the start of the period. The statement omitted considering dividends when computing the annual rate of return. Additionally, the statement used the current stock prices as the numerator when in fact it is the increase/decrease in stock price over time.

__T__ **17)**

While no investment is completely free of risk, opening a savings account involves little risk of loss to the account holder. Profits are limited but losses should be close to nonexistent. In contrast, investments in stock are considered much riskier as the stock price could decrease just as easily as increase.

__T__ **18)**

Investors have two goals when reading financial accounting information: (1) predicting the price of the corporation's capital stock in the future and (2) predicting the amount of cash dividends that will be paid over time by the business.

__F__ **19)**

Lenders and other creditors are most interested in information about future cash flows that indicate the possibility of payments being made when due. Drops in stock price can have some potential impact on these cash flows but that is not of primary concern to the lender.

__T__ **20)**

By definition, financial information is measured in monetary terms. Such a presentation, though, has many limitations. Therefore, verbal clarification is often included to make the information more understandable.

__T__ **21)**

Businesses need a structure for conveying financial accounting information to all interested parties. An annual report serves that purpose. The monetary amounts along with verbal explanations are distributed each year as part of the businesses annual report. The annual report does contain extensive information.

Answers to Multiple Choice Questions

1) Answer is B

Financial accounting is the communication of information about a business or other type of organization so that individuals can assess its financial health and future prospects. Readers of financial information may also find some clues to new products rollouts and competition but that is not the focus of financial accounting.

2) Answer is C

Production decisions are made inside of a business by employees and members of management. Managerial accounting provides the information for these decisions. Decisions on granting credit, investing in the corporation's capital stock, and providing loans are made externally—by individuals working outside of the business. They need information on which to base those decisions and financial accounting provides that information.

3) Answer is C

Financial accounting focuses to convey relevant data primarily to external parties for decision making regarding the financial health and future prospects. Managerial accounting communicates information within an organization for internal decisions.

4) Answer is A

Individuals employed by an organization will have interest in the financial accounting data of that organization. Reasons include, but are not limited to the following:

- Future employment prospects
- Compensation
- Anticipation of additional hires, new equipment, or new initiatives within the organization
- Anticipated layoffs, pay cuts, or reductions in resources

5) Answer is D

The quick buying and selling of the ownership of a business is most indicative of a corporation. The capital shares make the exchange of corporate ownership interests easier and quicker. The restaurant could have been structured as a sole proprietorship or a partnership but the quickness that took place in switching ownership is more likely to reflect a corporation.

6) Answer is C

Often, the process to incorporate is more complex and expensive than retaining the organizational structure as a sole proprietorship or a partnership. There are benefits associated with incorporating, and for many business, those benefits often outweigh the time and expense it takes to incorporate.

7) Answer is B

For large corporations, shareholders are not actively involved in the day-to-day operations and decisions of the company. Shareholders elect a board of directors who hire managers to run the business on a daily basis.

8) Answer is A

The board of directors is made up of approximately ten to twenty-five knowledgeable individuals. They are elected by the shareholders and are responsible for hiring managers to run the business on a daily basis. Additionally, they make policy decisions for the organization.

9) Answer is D

For relatively large corporations, the vast majority of stockholders do not anticipate participating in day-to-day operations. The business is simply too large and the number of shareholders makes such an arrangement almost impossible to control. Instead, the shareholders elect a Board of Directors to assume the responsibility of watching over the management, the group that is responsible for day-to-day operations.

10) Answer is B

Members of the Board of Directors are elected by the stockholders of a corporation specifically to overview management and set policy for the business.

11) Answer is A

Shareholders generally do not have involvement in the daily operations of a corporation. The motivation for most shareholders to invest in capital stock is due to the potential for an increase in the market price, the potential for dividend payments and possible tax benefits if the investment is held for more than a year.

12) Answer is C

A dividend is a reward to shareholders for being an owner of a business that is prospering. Dividends are determined by the board of directors but are not a required payment. Some companies elect to reinvest the earnings into the organization in the hopes of anticipated appreciation of stock prices. As we will see in future chapters, a dividend is not an expense, but rather it is a transfer of wealth.

13) Answer is D

Williams gains value in two ways from this investment: (1) the stock price increases and (2) he collects dividends paid by the corporation on its stock. His initial investment cost $6,750 (150 shares × $45 per share). By the end of the year, the stock price had risen to $47 per share or $7,050 in total. He had also received a $1.50 per share dividend or $225 in total. Thus, he had received $7,275 ($7,050 + $225) His profit for the year was $525 ($7,275 less $6,750). His annual rate of return was $525/$6,750 or 7.8 percent.

At the per share level, a $2 increase in stock price plus $1.50 in dividends equals a profit of $3.50 on the investment. That profit divided by the initial investment amount, or $3.50/$45 is 7.8 percent.

14) Answer is D

Investors and creditors use the same financial accounting information of an organization but their focus will be on different areas within the statements. An investor is interested in the company's ability to increase the stock market prices of the capital shares as well as future dividends. Creditors are concerned with the company's cash flow and ability to meet future obligations. The future ability to hire more employees may be an interesting piece of information, but it is not central to the predictions made by either group.

15) Answer is A

Creditors and other lenders are primarily concerned with a client's ability to repay loan balances along with accompanying interest. To gauge a corporation's chances of making those payments, Sanchez will most likely look at Medlock's past cash flow information for an indication of the amount of future positive cash flows that will be available for repayment. Having generated positive cash flows in the past is one sign that the company will be able to continue earning cash so that it can pay its debts as they come due.

16) Answer is B

The loan officer is primarily interested in the company's ability to repay the bank loan when it comes due plus an appropriate amount of interest. The increase in the price of the stock is certainly a good indication of financial health. However, the employee, the member of the board of directors, and the investment advisor are more interested in the future growth and prosperity of the business because of the direct effect on them. The loan officer only cares about the business generating enough cash to pay its debts as they come due.

17) Answer is C

The annual report is the delivery mechanism for financial accounting information, monetary balances and verbal explanations that reflect the business as a whole. The decision to rent the airplane rather than buy it is internal in nature. The information to assist in that decision comes from managerial accounting.

Answers to Problems

1)

a. Financial accounting is the communication of information about a business or other type of organization so that individuals can assess its financial health and future prospects.

b. Anyone interested in knowing more about an organization can be a user of financial accounting information. Common examples of interested parties are investors, creditors, employees, government agencies, donors, potential employees, students, and neighbors.

c. This list of possible decisions made using financial accounting information is almost limitless. Some specific examples may include:
   - Should an individual invest money to become an owner of an organization?
   - Should another business make sales on credit to a company?
   - Should a bank loan money to a company?
   - Should an individual take a job at a particular company?
   - Should an individual switch jobs?

2)

a. A bank loan officer is primarily concerned with Nguyen Company's ability to pay back a loan with interest when the debts come due. Thus, the loan officer is going to analyze Nguyen's past cash flows to help determine future cash flows and whether they will be adequate.

b. A current employee will be interested in the financial health and future prospects of Nguyen. The employee will want to know the likelihood of bonuses if the company is doing well or the risk that the company will eventually have to lay off workers due to poor financial performance. The current employee will also be interested in the financial resources that should be available in the future to help employees do their job efficiently and effectively.

c. A potential employee is interested in the same information as a current employee, but from a different perspective. The potential employee will want to gauge the financial health of Nguyen against other companies to which he or she might also be seeking employment.

d. A current investor is interested in how the financial status of Nguyen is likely to affect its stock price in both the near and long term. The current investor will also be interested in whether Nguyen has sufficient cash flows to pay dividends.

e. Like the current investor, the potential investor is also interested in how the financial health of Nguyen might impact the stock price and the company's ability to pay dividends in the future. However, the potential investor is more likely to use this information to compare Nguyen to other possible investments.

f. A credit analyst working for a potential supplier will be interested in Nguyen Company's ability to pay for any inventory that it purchases on credit. The credit analyst will look at Nguyen's liquidity or, in other words, the company's ability to pay off short-term debts. The analyst wants to see cash flow information but the predictions do not have to be too far into the future since supply payments are usually made within a month or two after purchase.

3) Accounting can be subdivided into two major categories: financial accounting and managerial accounting. Both communicate financial information for decision-making purposes. Financial accounting focuses on conveying relevant data about an organization primarily to external parties. On the other hand, managerial accounting focuses on communicating information within an organization so that internal decisions can be made.

a. __M__ managerial accounting information
b. __F__ financial accounting information
c. __M__ managerial accounting information
d. __M__ managerial accounting information
e. __M__ managerial accounting information
f. __F__ financial accounting information
g. __F__ financial accounting information

4) Accounting can be subdivided into two major categories: financial accounting and managerial accounting. Both communicate financial information for decision-making purposes. Financial accounting focuses on conveying relevant data about an organization primarily to external parties. On the other hand, managerial accounting focuses on communicating information within an organization so that internal decisions can be made.

a. The decisions Ella could make using managerial accounting are almost limitless. Examples of such decisions may include: product pricing, hiring decisions, product mix decisions, budget decisions, etc.

b. Again, the decision possibilities are endless. The theme of the decisions made by those outside the organization using financial accounting information include: whether to invest and become part owners, whether to extend credit for sales to Moonbeam Coffee Company, and whether to loan money to Moonbeam Coffee.

c. Ella will certainly use financial accounting information on a daily basis. Financial accounting information is used both inside as well as outside of an organization. Managerial accounting information is not distributed to those outside of an organization since those groups are generally not responsible for daily operational decisions. Financial accounting information is available for anyone and everyone to use.

5)

a. Employees have a personal interest in the financial health and future prospects of their employers. Their paychecks and their livelihood often depend on that organization thriving. One way to assess the financial health is to read and understand the financial accounting information.

b. Employees are interested in studying the financial accounting information of their employer to judge future employment prospects. Employees will be impacted by the financial health of an organization in many ways, some of which include: pay raises, pay cuts, end-of-year bonuses, additional hiring of employees, expansion of operations, layoffs, and cutbacks.

6)

a. Capital shares of Ford Motor Co. are the ownership interests of this corporation. Each share of this capital stock represents one unit of ownership. Thus, for example, the investor gets to participate in any dividend distributions and can vote for the members of the board of directors. The amount of dividends received and the number of votes that can be cast depends on the number of shares being held. The rights conveyed by the ownership of a share of capital stock depend on the laws of the state of incorporation. As will be learned later in this textbook, the rights for some shares of capital stock are determined based on the terms of the stock contract.

b. The acquisition of shares of capital stock normally takes place because the investor has studied the financial accounting information presented by this corporation and believes that the price of the stock should rise over time. This appreciation usually takes place as a business grows or makes exceptionally good use of its resources. The investor might also expect to receive a substantial amount of dividends from Ford Motor Co. in the future.

c. Typically, shares of one corporation rather than another are acquired because of one of two reasons. First, the investor might believe that the annual rate of return will be highest for Ford. Between estimated stock appreciation and cash dividends, the investor may well believe that none of these other corporations offer as much potential profit as does

Ford. Second, the investor might believe that Ford has the least amount of risk of loss. Perhaps one of the other investments might seem likely to generate a higher rate of return but Ford has a lower level of risk. Investors make decisions to maximize profits and minimize risks. Some investors emphasize one goal whereas others focus more on the other.

d. Each of these businesses will produce and distribute an annual report containing a significant amount of financial information and verbal explanations. Investors should use this information to assess past operational success and the possibility of profits and dividends in the future.

7) The following answers pertain to Thatcher Ray's questions.

a. Oliver was referring to the fact that when Thatcher invests money in an organization, the possibility exists for the original $1,000 to become a larger amount, thus "grow" over time. In financial accounting, we call this growth a return on investment.

b. The two ways Thatcher can earn a return on his investment are:
   - The value of the stock can increase.
   - The company will pay the stockholders a dividend.

c. When investing in capital shares, nothing is guaranteed. There is always a risk that the expected growth will not be met, or possibly, the investment will sustain a loss. To help minimize these risks, investors should thoroughly read and understand the financial information presented. Additionally, the payment of dividends is not required.

d. When growth occurs on an investment, tax is assessed on the earnings. When an individual holds the investment for a period longer than 12 months, the tax assessed on the earnings may be substantially less than if the investment had been held for a shorter period of time. For Thatcher, he may want to consider holding his investment for a period longer than 12 months if he is able.

8) The following answers are related to the operational structure of an organization.

a. The shareholders are the owners of an organization. Each capital share is the equivalent of one unit of ownership.

b. Shareholders do not expect to have operational duties. There can be millions of shareholders for just one company so it is not practical for individuals to have that expectation. Because of this, they appoint others to take that responsibility.

c. The board of directors are elected and appointed by the shareholders. They are a representative group elected to oversee the operations of the business. They will meet periodically to review operations and provide direction on new initiatives.

d. Below are the different roles for groups within a company's operational structure:
Owners: Each capital share is equal to one unit of ownership of the organization. Owners do not have a role in the day-to-day operations of the organization.
Board of Directors: Elected by shareholders to hire and oversee the management of the company and make policy decisions.
Management: Officials such as the president, the chief financial officer, and the director of marketing who are in charge of daily operations.
Employees: All individuals who work for a company who are not deemed to be members of the management. These individuals conduct the daily operations of the organization.

9)

a. The formula takes the profit for the year (stock appreciation and dividends) and divides it by the amount of the investment at the start of the period.
b. Lena's annual rate of return on the Lucille Cosmetics, Inc was 9 percent. This is found by taking the $9 profit per share for the year ($7 is stock appreciation and $2 in dividends) and dividing it by the amount of the investment at the start of the period ($100).
c. Nate's annual rate of return on the Ninvecto Gaming Company was 12 percent. This is found by taking the $6 profit per share for the year ($5 is stock appreciation and $1 in dividends) and dividing it by the amount of the investment at the start of the period ($50).

d. The wise investor will select the highest annual rate of return in order to maximize growth. In this case, investing as Nate did in Ninvecto Gaming Company would be the investment to give the greatest return. Although not indicated in the problem, other factors such as risk should be considered when making investment decisions.

10)

a. In simple terms, a creditor is someone who loans money to another person. In this scenario, First Bank of Illinois could loan money to Jeffrey Carlos so First Bank of Illinois would be the creditor and to whom money is owed.

b. Creditors use financial accounting information to help make decisions. This group will focus much of their attention on information relating to issues such as the amount of debt owed, when that debt is scheduled to come due, and the perceived ability to generate sufficient cash to meet those demands in a timely manner.

c. Jeremy has to decide if he will loan the money to Jeffrey. If he loans the money, the agreement will be for Jeffrey to repay the money with interest. The bank will make a profit and Jeffrey will be able to accomplish his goal of expanding his business. But if Jeffrey is unable to repay the loan, the bank loses the profit and potentially the original loan amount. This presents a significant risk. In order to bring the risk possibility down to an acceptable level, Jeremy is gathering useful information to help make the decision. He will analyze Jeffrey's ability to generate sufficient cash to meet debts as they mature.

11) Mark each of the following with an (F) to indicate if it is financial information or an (N) to indicate if it is non-financial information.

Metro Corporation has:

a. _F__ Cash of $4,000,000
b. _F__ A building that cost $50,000,000
c. _N__ 2,000 employees
d. _F__ Inventory costing $16,000,000
e. _N__ 500 shares of capital stock
f. _F__Value of 500 shares is $50,000
g. _N__1,000 trucks
h. _F__ Sales of merchandise for $45,000,000
i. _N_ 2,000 cans of beans for resale purposes
j. _N_ 2,000 cans of beans to be used in the employee cafeteria

Financial information is designated by monetary amounts.

12) The following answers relate to the delivery of financial accounting information.

a. Most companies prepare and distribute an annual report after each accounting year.

b. Although there are numerous things found in an annual report, some of the highlights include a letter from an executive officer, management's discussion and analysis of their operations, letter from the auditors, the financial statements, and notes to the financial statements.

c. The financial statements themselves make up only a small part of the annual report. A lot of interest and attention is given to these pages. But to ignore other parts of the annual report is to miss other critical information that could be important in the decision-making process. All of the other information supports and enhances the financial accounting information and should therefore be read and understood.

Answers to Research Assignments

1) The chapter introduced several forms of business including corporations, sole proprietorships, and partnerships. Here is information on those three as well as other forms of business as well.

Sole Proprietorship: A sole proprietorship is defined as an unincorporated business with one owner, who is also likely to manage day-to-day operations. A sole proprietorship is quite easy to start as the only filing requirements include obtaining proper licenses and permits from the local government. It is also easy to get out of business; the owner may just decide to close up shop. The business also ends upon the death of the owner. The owner is liable for all debts incurred by the business. Sole proprietorships are not taxed as a separate entity. Instead, the profits or losses of the business are reported on the owner's personal tax return, and any taxes are paid by the owner based on that return. The sole proprietorship often experiences troubles when it comes to funding sources. The owner typically makes an investment and may persuade family and friends to invest also. A loan is also possible if the owner has personal or business collateral.

Partnership: A partnership is similar in many ways to a sole proprietorship. The most significant difference is that there are at least two owners. To start the partnership, these owners should develop a written agreement, which details investments by the partners as well as how profits and losses will be divided. However, an agreement is not required legally. The partnership will be dissolved if a partner leaves or dies unless the partnership agreement states otherwise. The partners are liable for the debts of the business and the actions of the other partners. The partners report profits and losses on their personal tax returns as described in the partnership agreement. In the same manner as a sole proprietorship, funding sources include the partners, their friends and family, and bank loans.

Limited Partnership: This is a partnership in which some of the partners have limited liability. The partnership agreement has been written so that one or more of the partners can only lose the amount invested. At least one partner must serve as a general partner whose liability is not limited.

C Corporation: A C Corporation (so called because of the appropriate section of the tax code) is formed when Articles of Incorporation are filed with a state government. C Corporations will typically have many owners. Entities and individuals become owners when they purchase stock in the corporation. Because a C Corporation is a separate entity from its owners, it does not cease to exist upon the death or departure of an owner. This separation between a corporation and its owners also greatly limits the liability of the owners. They can lose the amount of their investment but nothing more. The owners are not typically involved in the day-to-day management of the corporation. This responsibility is left to management and the board of directors elected by the stockholders. The corporation is considered a separate entity for tax purposes. It files its own tax return and pays taxes on its profits. If it chooses to distribute those profits to its owners in the form of dividends, the owners are taxed but only on those distributions. In most cases, the corporation has the easiest time raising needed money because it can issue stock in itself as well as obtain loans and lines of credit.

S Corporation: Like a C Corporation, an S Corporation (so called because of the relevant section of the tax code) is formed when Articles of Incorporation are filed with its state. However, because of the method used for taxing S Corporations, the Internal Revenue Service must also grant approval. Unlike a C Corporation, an S Corporation has a limited number of owners. Currently, this limit is 100 owners. Because an S Corporation is a separate entity apart from its owners, it does not cease to exist upon the death or departure of an owner. This separation between corporation and owners also greatly limits the liability of the owners. The main difference between an S Corporation and a C Corporation is taxation. Like a partnership, an S Corporation pays no income taxes. Instead, the owners pay taxes on their share of profits or losses on their personal tax returns. An S Corporation is more limited in funding than a C Corporation because it cannot sell stock to more than 100 individuals or entities.

Limited Liability Corporation (LLC): A limited liability corporation is a combination of a corporation and a partnership. Like a corporation, the proper filings must be made with the state to set up the LLC. The LLC must have at least one owner (called a member), but can have more. Often, the owners will sign an agreement similar to that of a partnership. Unlike a partnership, though, the LLC can continue to exist even upon the death or departure of an owner. Some of the owners will most likely be involved in the day-to-day operations of the LLC, but not all have to be. An LLC has the freedom to choose how it is taxed. It can be taxed like a partnership or S Corporation where the owners will pay taxes on their share of profits or losses on their personal return. It can also choose to file a corporate tax return like a C Corporation.

2) Answers about Starbucks as found at www.google.com/finance on June 7, 2023

a) The price of a share of the capital stock of Starbucks Corporation on June 7, 2023, was $98.22.

b) The capital stock issued by Starbucks is traded on NASDAQ.

c) The ticker symbol used to identify Starbucks is SBUX.

d) The 52 week range for the price of Starbucks' stock is a low of $70.95 to a high of $114.56. At the current price of $98.22, the stock is selling at an average cost between its high and low points for that period of time.

e) Businesses that are viewed as being in a related industry to Starbucks include Einstein Noah Restaurant Group, Panera Bread Company, and Caribou Coffee Co.

f) Numerous interesting pieces of information can be found in the description of the company. Those include that (1) the company operates in more than 33,833 locations worldwide, (2) they are the world's largest coffeehouse chain, and (3) the company sells a variety of ready to drink items such their own bottled water, teas, energy drinks, fruit juices, etc.

g) Officers of the company include Howard Schultz (Interim Chief Executive Officer), Laxman Narasimhan (Chief Executive Officer - elect), Michael Conway (Group President, International and Channel Development), Zabrina Jenkins (Acting Executive Vice President and General Counsel), Rachel Ruggeri (Executive Vice President, Chief Financial Officer), Directors of the company include Richard Allison, Jr., Andrew Campion, Isabel Ge Mahe, Mellody Hobson, Jorgen Vig Knudstorp, Satya Nadella, Joshua Cooper Ramo, Clara Shih

3)

a) Accountants perform a wide variety of functions including financial record keeping, the filing of taxes, analysis of financial information, budgeting, investment planning and information system consulting.

b) The various types of accountants include all of the following.

1) Public accountants: primarily engaged in accounting, auditing, tax, and consulting services. Many are CPAs and work for themselves or public accounting firms.
2) Management accountants: record, analyze, and report financial information for their employers.
3) Government accountants: record, analyze, and report financial information for the governmental body where they work as well as auditing organizations subject to government regulation.
4) Internal auditors and auditors: analyze internal controls and look for waste and fraud in their organizations.

c) Most jobs in accounting require, at least, a 4 year baccalaureate degree in accounting or a related field. Many states require that a person have 150 hours of college credit (and often specific courses) to serve as an independent auditor.

d) A CPA is a Certified Public Accountant. A CPA is licensed by the state government and provides a wide range of work. Traditionally, the CPA serves as an independent auditor to examine the financial information released by a business or other organization. The CPA's report adds credibility to the reported numbers and assures readers that the financial information contains no material misstatements.

e) CPAs are licensed by state governments and, therefore, eligibility requirements are set by the individual states. A CPA must pass a national exam (the CPA Exam) plus meet specified education and experience requirements. Most states require CPAs to possess at least 150 hours of college coursework.

f) Accountants can obtain many additional certifications beyond the CPA. Some of the most common include: Certified Management Accountants (CMAs), Certified Internal Auditors (CIAs), and Certified Fraud Examiner (CFE).

g) The job outlook in accounting is currently strong. Increased regulation has led to an increase in the demand for accounting and finance professionals.

4) The Letter to Shareholders of Target contains a wide array of interesting information. Here are a few of the interesting aspects of the letter that was included in the 2022 annual report.

1) Target made continued to grow through the pandemic and beyond

2) Target is more than $30 billion bigger than it was in 2019
3) Traffic to Target has continued to consistently grow over the past six years.
4) Target anticipates streamlining and simplifying their operations which is anticipated to save money and fuel additional growth.
5) Some key growth drivers for the future will be digital growth, loyalty ecosystems, and enterprise sustainability strategies.

Despite being only one page, the letter provides a good starting spot for learning about the financial health and future prospects of Target.

Chapter 1

What Is Financial Accounting, and Why Is It Important?

Section 1.1. Making Good Financial Decisions about an Organization

1. Define "financial accounting."
2. Understand the connection between financial accounting and the communication of information about an organization.
3. Explain the importance of gaining an understanding of financial accounting.
4. List decisions that an individual might make about an organization.
5. Differentiate between financial accounting and managerial accounting.
6. Provide reasons for individuals to study the financial accounting information supplied by their employers.

1.1—Financial Accounting and Information [PowerPoint 1-5]

Financial accounting is the communication of information about a business or other type of organization (such as a charity or a government) so that individuals can assess its financial health and future prospects. Financial accounting provides the rules and structure for the conveyance of financial information about businesses (and other organizations) to maximize clarity and understanding.

The organization has reportable events occur during the year → the organization reports this information based on the principles of financial accounting → interested individuals assess financial health and future prospects

1.2—Financial Accounting and Wise Decision Making [PowerPoint 1-6]

Many possible benefits can be gained from acquiring a strong knowledge of financial accounting because it provides the accepted methods for communicating relevant information about an organization. Developing the ability to analyze financial information and then making use of that knowledge to arrive at sound decisions can be critically important.

Example: A recent college graduate looking at full-time employment opportunities might want to determine the probability that Company A will have a brighter economic future than Company B.

1.3—Common Decisions about Organizations **[PowerPoint 1-7]**

Many decisions deal with the organization's current financial condition and its future prospects. Having knowledge of the principles of financial accounting can help an individual make better decisions.

Examples of individuals using financial information include:

- Loan officers, who must make decisions about loaning money to companies, are concerned with the companies' ability to repay the money plus interest in the future.
- Credit analysts must decide whether to extend credit to customers. Companies need to find new customers to whom to sell their products, but they do not make money if those customers do not pay.
- Investment counselors advise clients about making investments in companies. These individuals need to understand the financial situation of the investment opportunities if they are going to help their clients make wise decisions.

1.4—Financial Accounting versus Managerial Accounting **[PowerPoint 1-8]**

Examples:

- Should a business buy or rent its headquarters?
- What price should a business charge for its services?
- Should a business advertise on television or the Internet?

Decisions like these are made *within* the organization, not *about* the organization.

1.4.1—Managerial Accounting **[PowerPoint 1-9]**

Managerial accounting refers to the communication of information within an organization so that internal decisions can be made in an appropriate manner.

1.4.2—Financial Accounting versus Managerial Accounting **[PowerPoint 1-9]**

Financial accounting is not better, more useful, or more important than managerial accounting. They have been created to achieve different objectives.

1.5—Financial Accounting Information and Company Employees **[PowerPoint 1-10]**

Every employee should be interested in studying information produced by financial accounting to judge future employment prospects.

- A business that is doing well will possibly award larger pay raises or perhaps significant end-of-year cash bonuses.
- A financially healthy organization can afford to hire new employees, buy additional equipment, or pursue major new initiatives.
- A business that is struggling might anticipate layoffs, pay cuts, or reductions in resources.

1.5.1—Teaching Tip: Value of Information [PowerPoint 1-11]

You might want to mention a quote by Kofi Annan, former secretary-general of the United Nations: “Knowledge is power. Information is liberating.”

Section 1.2. Incorporation and the Trading of Capital Shares

1. Define “incorporation.”
2. Explain the popularity of investing in the capital stock of a corporation.
3. Discuss the necessity and purpose of a board of directors.
4. List the potential benefits gained from acquiring capital stock.

2.1—The Ownership Shares of an Incorporated Business [PowerPoint 1-13]

2.1.1—The Ownership Shares of an Incorporated Business [PowerPoint 1-13]

Incorporation is the process undertaken by owners of a business or other type of organization where they apply to the state government to become identified as an entity legally set apart from its owners.

A *corporation* is an organization that has been formally recognized by the state government as a separate legal entity that can act independently of its owners.

A corporation has the ability to obtain monetary resources by selling (also known as issuing) capital shares that allow investors to become owners. They are then known as stockholders or shareholders. One of the great advantages of incorporation is the ease by which most capital stock can be exchanged.

A business that has not been incorporated is either a *sole proprietorship* (one owner) or a *partnership* (more than one owner). Without the separation provided by incorporation, a clear distinction between owner and business does not exist. For example, debts incurred by a business that is a sole proprietorship or partnership may ultimately have to be satisfied by the owner personally. Thus, individuals tend to avoid making investments in unincorporated businesses unless they can be directly involved in the management. However, partnerships and sole proprietorships remain popular because they are easy to create and offer income tax benefits.

2.1.2—Trading Shares of Stock [PowerPoint 1-14]

Often, capital stock is sold on a public exchange like the New York Stock Exchange or NASDAQ (National Association of Securities Dealers Automated Quotations).

If traded on a stock exchange, shares of the capital stock of a corporation continually go up and down in value based on myriad factors, including the perceived financial health and future prospects of the organization.

2.1.3—Teaching Tip: Global Stock Exchanges [PowerPoint 1-14]

A good opportunity to introduce the global nature of business is to introduce students to stock exchanges around the world. Bring the focus back to the U.S. exchanges at the end as you transition into the In-Class Activity.

2.1.2—In-Class Activity

Movement of Stock Prices

Description: Before class, assign two publicly traded companies to each student or allow them to choose their own. Have them find each company's high and low stock price during the past year. Potential websites to use include http://finance.yahoo.com and http://moneycentral.msn.com. During class, divide students into groups to discuss how widely their companies' stock prices have varied over the year. Have them brainstorm potential reasons for these variations.

2.1.2—Appropriate In-Class Use				
Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√	√	10 Minutes	Students will need to look up stock prices prior to class

2.2—The Operational Structure of a Corporation [PowerPoint 1-15]

Obviously, a great many corporations like The Coca-Cola Company have an enormous quantity of capital shares held by tens of thousands of investors. Virtually none of these owners can expect to have any impact on the daily operations of the business. In a vast number of such organizations, stockholders elect board of directors who in turn hires the members of management who run the business on a daily basis.

2.2.1—Board of Directors [PowerPoint 1-16]

The board of directors is a representative group voted to this position by stockholders to oversee the management of a corporation. The board meets periodically (often quarterly) to review operating, investing, and financing results as well as to approve strategic policy initiatives.

2.2.2—Teaching Tip: Board of Directors on NPR

If your classroom has internet and speaker capability, take a few minutes to listen to a story produced by National Public Radio on the roles played by a board of directors. It can be found at http://www.npr.org/templates/story/story.php?storyId=105576374.

Running time: 4 minutes, 24 seconds

2.2.3—Company Operational Structure [PowerPoint 1-17]

The following list demonstrates the hierarchy of authority and responsibility in a typical corporation.

Ownership	Each capital share is the equivalent of one unit of ownership.
Board of Directors	Elected by shareholders to hire and oversee the management of the company and make policy decisions
Management	Officials such as the president, the chief financial officer, and the director of marketing who are in charge of daily operations
Employees	All individuals who work for a company who are not deemed to be members of the management

2.3—Predicting the Appreciation of Capital Stock Values [PowerPoint 1-18]

Capital shares of thousands of corporations trade each day on markets around the world such as the New York Stock Exchange or NASDAQ. One party is looking to sell shares, whereas another is seeking shares to buy. Stock markets match up these buyers and sellers so that a mutually agreed-upon price can be negotiated.

Investors believe that a company is financially healthy and future prospects are good—stock price rises
Investors predict that a company will not remain financially healthy—stock price drops

Factors Affecting Stock Price **[PowerPoint 1-19]**

- Perceived quality of management

- Historical trends in profitability
- Viability of company's industry
- Health of economy
- Other factors

2.3.1—Financial Accounting and the Stock Market [PowerPoint 1-20]

Investors attempt to assess the financial condition and prospects of various business organizations on an ongoing basis. Being able to understand and make use of reported financial data helps improve the investor's knowledge of corporation and, thus, the chance of making wise decisions about the buying and selling of capital shares. Ignorance often leads to poor decisions and much less lucrative outcomes.

2.3.2—Long-Term Capital Gain or Loss [PowerPoint 1-21]

This pertains to gain or loss on sale of stock held for longer than one year. Significant tax savings may result over selling stock held for less than one year.

2.3.3—Teaching Tip: U.S. Tax Policy

For those with time, you may want to give a brief introduction to the U.S. Tax System. Students may question why long-term stock gains are taxed differently than short-term ones. Discussing Congress' wish to encourage investing so that businesses can get needed capital should give them an interesting connection between business and government about which they may never have thought.

2.4—The Receipt of Dividends [PowerPoint 1-22]

Many corporations pay cash dividends to their stockholders periodically.

Dividend: A dividend is a reward for being an owner of a business that is prospering.

- Reward for being an owner
- Distribution of income
- Not required by law
- Set by board of directors

2.5—Annual Rate of Return on an Investment in Capital Stock

2.5.1—Work Through an Example of Computing Annual Rate of Return on Stock [PowerPoint 1-23, 24]

January 1, Year One, Investor buys stock in both Company A and Company B

	Company A	**Company B**
Price per share, 1/1:	\$100	\$100
Dividend during year:	\$1.00 per share	\$5.00 per share

Price per share, 12/31:	$108	$91

Value of Company A: $108 + $1 = $109
Annual Rate of Return = ($109 – $100)/$100 = **9%**

Value of Company B: $91 + $5 = $96
Annual Rate of Return = ($96 – $100)/$100 = **–4%**

2.5.2—Have Students Work Through an Example of Computing Annual Rate of Return on Stock, Either Individually or in Teams [PowerPoint 1-25, 26]

January 1, Year One, Investor buys stock in both Company S and Company T

	Company S	Company T
Price per share, 1/1:	$10	$10
Dividend during year:	$.50 per share	$2.00 per share
Price per share, 12/31:	$12	$7

Value of Company S: $12 + $.50 = $12.50
Annual Rate of Return = ($12.50 – $10)/$10 = **25%**

Value of Company T: $7 + $2 = $9
Annual Rate of Return = ($9 – $10)/$10 = **–10%**

2.5.3—Teaching Tip: Tie It All Together

A good way to wrap up the first two sections is to point out that a careful analysis of the available data might have helped this investor to choose Company A rather than Company B. The data is a result of financial accounting. A careful analysis of it can only result when the user has knowledge of financial accounting.

Estimating the annual rate of return is important for investors because it helps them select from among multiple investment opportunities. This computation provides a method for quantifying the financial benefit earned in the past and expected in the future.

Section 1.3. Using Financial Accounting for Wise Decision Making

1. List the predictions that investors and potential investors want to make about a business organization.
2. List the predictions that creditors and potential creditors want to make about a business organization.
3. Explain the reporting of monetary amounts as a central focus of financial accounting.
4. Explain how financial accounting information is enhanced and clarified by verbal explanations.
5. Understand the function played by the annual report published by many businesses and other organizations.

3.1—Financial Accounting Information and Investments in Capital Stock [PowerPoint 1-28]

Investors wish to estimate:

1. The future price of a corporation's capital stock
2. The future amount of cash dividends that will be paid by the business

3.2—Financial Accounting Information and Other Interested Parties [PowerPoint 1-29]

Sizeable portions of the parties that study the financial information reported by an organization are probably most interested in the likelihood that money will be available in the future to pay its debts.

What information interests creditors and potential creditors?

1. Amount of debt a company already has
2. When debt is coming due
3. Perceived ability of company to meet obligations as they come due

Ultimately, creditors attempt to anticipate the organization's future cash flows to measure the risk that debt principal and interest payments might not be forthcoming when due.

3.3—The Nature of Financial Information [PowerPoint 1-30]

Financial information are data that can be measured in monetary terms.

Examples:

- Company owes bank $400,000
- Company owns equipment worth $20,000
- Company made sales of $5,900,000

Non-financial information:

- Company has 7,890 employees
- Company operates in 23 states

3.4—Financial Accounting and Verbal Explanations [PowerPoint 1-31]

Although financial accounting starts by reporting balances as monetary amounts, the communication process does not stop there. Extensive verbal explanations as well as additional numerical data are also provided to clarify or expand the monetary information where necessary.

Example: Company reports pending lawsuit with probable loss of $750,000. This is the communication of financial information. The company will also communicate verbal explanations, which provide the user with more information such as cause of the lawsuit and the likelihood of loss.

Steps in Providing Information [PowerPoint 1-32]
Step One: Financial information is provided in monetary terms
Step Two: Further explanation is given to clarify and expand on those monetary balances

3.5—The Annual Report [PowerPoint 1-33]

Most companies, regardless of size, prepare and distribute an annual report shortly after the end of each year.