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The Financial Statements

Learning Objective

5. **Construct** financial statements and **analyze** the relationships among them

CONSTRUCT FINANCIAL STATEMENTS AND ANALYZE THE RELATIONSHIPS AMONG THEM

Income Statement

- ◆ Reports revenues (net sales) and expenses of the year
- ◆ Reports net income or net loss
 - ▶ If revenues exceed expenses, there is net income
 - ▶ If expenses exceed revenues, there is a net loss

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Balance Sheet

- ◆ Reports assets, liabilities, and stockholders' equity at the end of the year
- ◆ Reports that assets equal the sum of liabilities plus stockholders' equity
- ◆ Reports retained earnings, which comes from the statement of retained earnings

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Statement of Cash Flows

- ◆ 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
- ◆ Shows the ending cash and cash equivalents balance

Illustration 2.6

Define and provide an example of each of the following

Account	Definition	Example
Asset		
Revenue		
Liability		

► Decision Guidelines

What Do Decision Makers Look For?

Question/Decision	What to look for
Can the company sell its products?	Sales revenue Increasing or Decreasing?
What are the main income measures to watch for trends?	Gross profit, Operating income, and Net income
What percentage of sales revenue ends up as profit?	Divide net income by sales revenue
Can the company collect its receivables?	Compare % increase in receivables to % increase in sales
Can the company pay its liabilities?	Compare assets to liabilities
Where is the company's cash coming from?	Observe the line items on the cash flow statement

Ethics in business and accounting decisions

- ✓ Ethics道德 are shaped by our cultural 文化, socioeconomic社會經濟and religious backgrounds 宗教背景
- ✓ Ethics training starts at home and continues throughout our lives
- ✓ In business, ethics work best when modeled from仿照 the top. Ethical guidelines affect business decisions.

Summary

- ✓ Flow of accounting starts with business transactions 商業交易
- ✓ Users of financial information include investors 投資者, creditors 債權人, government 政府 agencies 代理人, etc.;
- ✓ The conceptual framework 概念框架 of financial accounting is the foundation of the preparation of financial statements;
- ✓ Two accounting equations can be applied to business organizations;
- ✓ Information in financial statements is used to make business decisions, which are informed by economic, legal, and ethical guidelines