Follow My Example 1-7

Chickadee Travel Service
Statement of Cash Flows
For the Year Ended April 30, 2016

Cash flows from operating activities:		
Cash received from customers	$ 251,000	
Deduct cash payments for expenses	(210,000)	
Net cash flows from operating activities		$ 41,000
Cash flows from investing activities:		
Cash payments for purchase of land		(80,000)
Cash flows from financing activities:		
Cash received from issuing common stock	$ 50,000	
Deduct cash dividends	(30,000)	
Net cash flows from financing activities		20,000
Net decrease in cash during year		$(19,000)
Cash as of May 1, 2015		72,050
Cash as of April 30, 2016		$ 53,050

Practice Exercises: PE 1-7A, PE 1-7B

Interrelationships Among Financial Statements

Financial statements are prepared in the order of the income statement, retained earnings statement, balance sheet, and statement of cash flows. This order is important because the financial statements are interrelated. These interrelationships for **NetSolutions** are shown in Exhibit 8 and are described in Exhibit 9.[5]

EXHIBIT 9 **Financial Statement Interrelationships**

Financial Statements	Interrelationship	NetSolutions Example (Exhibit 8)
Income Statement *and* Retained Earnings Statement	Net income or net loss reported on the income statement is also reported on the retained earnings statement as either an addition (net income) to or deduction (net loss) from the beginning retained earnings.	NetSolutions' net income of $3,050 for November is added to the beginning retained earnings on November 1, 2015, on the retained earnings statement.
Retained Earnings Statement *and* Balance Sheet	Retained earnings at the end of the period reported on the retained earnings statement is also reported on the balance sheet as retained earnings.	NetSolutions' retained earnings of $1,050 as of November 30, 2015, on the retained earnings statement also appears on the November 30, 2015, balance sheet as retained earnings.
Balance Sheet *and* Statement of Cash Flows	The cash reported on the balance sheet is also reported as the end-of-period cash on the statement of cash flows.	Cash of $5,900 reported on the balance sheet as of November 30, 2015, is also reported on the November statement of cash flows as the end-of-period cash.

The preceding interrelationships are important in analyzing financial statements and the impact of transactions on a business. In addition, these interrelationships serve as a check on whether the financial statements are prepared correctly. For example, if the ending cash on the statement of cash flows does not agree with the balance sheet cash, then an error has occurred.

[5] Depending on the method of preparing the cash flows from operating activities section of the statement of cash flows, net income (or net loss) may also appear on the statement of cash flows. This interrelationship or method of preparing the statement of cash flows, called the "indirect method," is described and illustrated in Chapter 14.

Example Exercise 1-8 Ratio of Liabilities to Stockholders' Equity

OBJ 6

The following data were taken from Hawthorne Company's balance sheet:

	Dec. 31, 2016	Dec. 31, 2015
Total liabilities	$120,000	$105,000
Total stockholders' equity	80,000	75,000

a. Compute the ratio of liabilities to stockholders' equity.

b. Has the creditors' risk increased or decreased from December 31, 2015, to December 31, 2016?

Follow My Example 1-8

a.

	Dec. 31, 2016	Dec. 31, 2015
Total liabilities	$120,000	$105,000
Total stockholders' equity	80,000	75,000
Ratio of liabilities to stockholders' equity	1.50	1.40
	($120,000 ÷ $80,000)	($105,000 ÷ $75,000)

b. Increased

Practice Exercises: PE 1-8A, PE 1-8B

At a Glance 1

OBJ 1

Describe the nature of a business and the role of accounting and ethics in business.

Key Points A business provides goods or services (outputs) to customers with the objective of earning a profit. Three types of businesses include service, merchandising, and manufacturing businesses.

Accounting is an information system that provides reports to users about the economic activities and condition of a business.

Ethics are moral principles that guide the conduct of individuals. Good ethical conduct depends on individual character and firm culture.

Accountants are engaged in private accounting or public accounting.

Learning Outcomes	Example Exercises	Practice Exercises
• Distinguish among service, merchandising, and manufacturing businesses.		
• Describe the role of accounting in business, and explain why accounting is called the "language of business."		
• Define ethics, and list two factors affecting ethical conduct.		
• Differentiate between private and public accounting.		

OBJ 5 Describe the financial statements of a corporation and explain how they interrelate.

Key Points The primary financial statements of a corporation are the income statement, the retained earnings statement, the balance sheet, and the statement of cash flows. The income statement reports a period's net income or net loss, which is also reported on the retained earnings statement. The ending retained earnings reported on the retained earnings statement is also reported on the balance sheet. The ending cash balance is reported on the balance sheet and the statement of cash flows.

Learning Outcomes	Example Exercises	Practice Exercises
• List and describe the financial statements of a corporation.		
• Prepare an income statement.	EE1-4	PE1-4A, 1-4B
• Prepare a retained earnings statement.	EE1-5	PE1-5A, 1-5B
• Prepare a balance sheet.	EE1-6	PE1-6A, 1-6B
• Prepare a statement of cash flows.	EE1-7	PE1-7A, 1-7B
• Explain how the financial statements of a corporation are interrelated.		

OBJ 6 Describe and illustrate the use of the ratio of liabilities to stockholders' equity in evaluating a company's financial condition.

Key Points A ratio useful in analyzing the ability of a business to pay its creditors is the ratio of liabilities to stockholders' equity. The lower the ratio of liabilities to stockholders' equity, the better able the company is to withstand poor business conditions and to pay its obligations to creditors.

Learning Outcomes	Example Exercises	Practice Exercises
• Describe the usefulness of the ratio of liabilities to stockholders' equity.		
• Compute the ratio of liabilities to stockholders' equity.	EE1-8	PE1-8A, 1-8B

Key Terms

account form (17)
account payable (11)
account receivable (12)
accounting (3)
accounting equation (9)
assets (9)
balance sheet (15)
business (2)
business entity concept (7)
business transaction (10)
Certified Public Accountant (CPA) (5)
common stock (10)
corporation (8)
cost concept (8)
dividends (13)
earnings (16)
ethics (4)
expenses (12)
fees earned (12)
financial accounting (4)
Financial Accounting Standards Board (FASB) (7)
financial statements (15)
generally accepted accounting principles (GAAP) (7)
general-purpose financial statements (4)
income statement (15)
interest revenue (12)
International Accounting Standards Board (IASB) (7)
liabilities (9)
limited liability company (LLC) (8)
management (or managerial) accounting (3)
manufacturing business (3)
matching concept (16)
merchandising business (2)

2.

	Assets				= Liabilities +				Stockholders' Equity							
	Cash	+ Accts. Rec.	+ Supp.	+ Land	= Accts Pay.	+ Common Stock	Retained Earnings	− Dividends	+ Fees Earned	− Paralegal Exp.	− Rent Exp.	− Wages Exp.	− Utilities Exp.	− Answering Service Exp.	− Supp. Exp.	− M E
Bal.	1,000	3,200	850	10,000	1,530	10,000	3,520									
a.	+3,928								3,928							
Bal.	4,928	3,200	850	10,000	1,530	10,000	3,520		3,928							
b.	−1,055				−1,055											
Bal.	3,873	3,200	850	10,000	475	10,000	3,520		3,928							
c.	+3,700					+3,700										
Bal.	7,573	3,200	850	10,000	475	13,700	3,520		3,928							
d.	−1,200										−1,200					
Bal.	6,373	3,200	850	10,000	475	13,700	3,520		3,928		−1,200					
e.		+ 2,025							+ 2,025							
Bal.	6,373	5,225	850	10,000	475	13,700	3,520		5,953		−1,200					
f.			+245		+245											
Bal.	6,373	5,225	1,095	10,000	720	13,700	3,520		5,953		−1,200					
g.	+3,000	−3,000														
Bal.	9,373	2,225	1,095	10,000	720	13,700	3,520		5,953		−1,200					
h.					+1,635					−1,635						
Bal.	9,373	2,225	1,095	10,000	2,355	13,700	3,520		5,953	−1,635	−1,200					
i.	−1,500											−850	−325	−250		
Bal.	7,873	2,225	1,095	10,000	2,355	13,700	3,520		5,953	−1,635	−1,200	−850	−325	−250		
j.			−115												−115	
Bal.	7,873	2,225	980	10,000	2,355	13,700	3,520		5,953	−1,635	−1,200	−850	−325	−250	−115	
k.	−1,000							−1,000								
Bal.	6,873	2,225	980	10,000	2,355	13,700	3,520	−1,000	5,953	−1,635	−1,200	−850	−325	−250	−115	

3.

Cecil Jameson, Attorney-at-Law
Income Statement
For the Month Ended July 31, 2015

Fees earned		$5,953
Expenses:		
Paralegal expense	$1,635	
Rent expense	1,200	
Wages expense	850	
Utilities expense	325	
Answering service expense	250	
Supplies expense	115	
Miscellaneous expense	75	
Total expenses		4,450
Net income		$1,503

Cecil Jameson, Attorney-at-Law
Retained Earnings Statement
For the Month Ended July 31, 2015

Retained earnings, July 1, 2015		$3,520
Net income for the month	$1,503	
Less dividends	1,000	
Increase in retained earnings		503
Retained earnings, July 31, 2015		$4,023

(*Continued*)

9. A business had revenues of $640,000 and operating expenses of $715,000. Did the business (a) incur a net loss or (b) realize net income?

10. The financial statements are interrelated. (a) What item of financial or operating data appears on both the income statement and the retained earnings statement? (b) What item appears on both the balance sheet and the retained earnings statement? (c) What item appears on both the balance sheet and the statement of cash flows?

Practice Exercises

EE 1-1 *p. 9*

SHOW ME HOW

PE 1-1A Cost concept

OBJ. 2

On February 22, Kountry Repair Service extended an offer of $200,000 for land that had been priced for sale at $250,000. On April 3, Kountry Repair Service accepted the seller's counteroffer of $230,000. On September 15, the land was assessed at a value of $185,000 for property tax purposes. On January 9 of the next year, Kountry Repair Service was offered $300,000 for the land by a national retail chain. At what value should the land be recorded in Kountry Repair Service's records?

EE 1-1 *p. 9*

SHOW ME HOW

PE 1-1B Cost concept

OBJ. 2

On March 31, Higgins Repair Service extended an offer of $415,000 for land that had been priced for sale at $460,000. On April 15, Higgins Repair Service accepted the seller's counteroffer of $437,500. On September 9, the land was assessed at a value of $375,000 for property tax purposes. On December 8, Higgins Repair Service was offered $475,000 for the land by a national retail chain. At what value should the land be recorded in Higgins Repair Service's records?

EE 1-2 *p. 10*

SHOW ME HOW

PE 1-2A Accounting equation

OBJ. 3

Dream-It LLC is a motivational consulting business. At the end of its accounting period, December 31, 2015, Dream-It has assets of $780,000 and liabilities of $150,000. Using the accounting equation, determine the following amounts:

a. Stockholders' equity as of December 31, 2015.

b. Stockholders' equity as of December 31, 2016, assuming that assets increased by $90,000 and liabilities increased by $25,000 during 2016.

EE 1-2 *p. 10*

SHOW ME HOW

PE 1-2B Accounting equation

OBJ. 3

Be-The-One is a motivational consulting business. At the end of its accounting period, December 31, 2015, Be-The-One has assets of $395,000 and liabilities of $97,000. Using the accounting equation, determine the following amounts:

a. Stockholders' equity as of December 31, 2015.

b. Stockholders' equity as of December 31, 2016, assuming that assets decreased by $65,000 and liabilities increased by $36,000 during 2016.

EE 1-3 *p. 15*

SHOW ME HOW

PE 1-3A Transactions

OBJ. 4

Arrowhead Delivery Service is owned and operated by Gates Deeter. The following selected transactions were completed by Arrowhead Delivery Service during August:

1. Received cash in exchange for common stock, $25,000.

2. Paid creditors on account, $3,750.

(*Continued*)