Chapter 1

Uses of Accounting Information and the Financial Statements

Learning Objectives

1. Define accounting, and explain the concepts underlying accounting measurement, explain the three forms of business entities, and describe the characteristics of a corporation.

2. Define financial position, and state the accounting equation.

3. Identify the four basic financial statements and their interrelationships.

4. Explain how generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS) relate to financial statements and the independent CPA’s report, and identify the organizations that influence GAAP.

5. Identify the users of accounting information, and identify business goals, activities, and performance measures.

6. Explain the importance of ethics in financial reporting.

Section 1: Concepts

Concepts

 Accounting measurement

 Business transactions

 Money measure

 Separate entity

 Assets

 Liabilities

 Stockholders’ equity

Lecture Outline

I. Accounting is an information system that measures, processes, and communicates financial information.

A. Accounting is a link between business activities and decision makers.

B. Management must have a good understanding of accounting to set financial goals and make financial decisions.

C. Management must not only understand how accounting information is compiled and processed but also realize that accounting information is imperfect and should be interpreted with caution.

II. Categories of accounting

A. Financial accounting—accounting information for external decision makers; reports are called financial statements.

B. Managerial accounting—accounting information for internal decision makers

III. Four questions must be answered to make an accounting measurement.

A. What is measured?

B. When should the measurement be made?

C. What value should be placed on what is measured?

D. How should what is measured be classified?

IV. There are three basic forms of business organization.

A. Sole proprietorship—one owner

1. The owner takes all of the profits or losses of the business.

2. The owner also has unlimited liability.

B. Partnership—two or more owners

1. Two or more owners share profits or losses based on a predetermined arrangement.

2. Unlimited liability can be avoided by forming a limited liability partnership.

C. Corporation—owned by many owners (the stockholders) but managed by a board of directors

1. A corporation is a business unit chartered by the state (when articles of incorporation are filed) and considered a separate legal entity from its owners.

2. The liability of corporate stockholders is limited to their investment.

V. Corporations require a formal organization process, and possess unique features and operating characteristics.

A. Incorporators must sign an application with appropriate state officials.

1. Articles of incorporation

B. Stockholders hold a unit of ownership called a share of stock.

C. The corporation’s board of directors decide on major business polices.

1. Management is appointed by the board of directors.

VI. A balance sheet discloses a business’s financial position by showing the relationship among assets, liabilities, and stockholders’ equity.

A. The accounting equation is Assets = Liabilities + Stockholders’ Equity.

B. Assets are a company’s economic resources, such as cash, receivables, inventory, and equipment.

C. Liabilities are the present obligations of a business, such as amounts owed to banks, suppliers, employees, and others.

D. Stockholders’ equity represents the claims by the owners of a corporation to the assets of the business.

1. Net income is the excess of revenues over expenses; net loss is the excess of expenses over revenues. Retained earnings are the accumulated net income minus dividends over the life of the business.

2. Dividends are distributions of resources, generally in the form of cash, to stockholders, and only the board of directors has the authority to declare them.

Summary

**Accounting** is an information system that measures, processes, and communicates financial information about an economic entity. An **economic entity** is a unit that exists independently, such as a business, hospital, or a governmental body. Accounting is a link between business activities and decision makers.

The goal of accounting is to assist decision makers. **Managerial accounting** provides information to internal decision makers, such as managers, whereas **financial accounting** communicates financial information via **financial statements** to external decision makers. Most businesses publish financial statements that report their profitability and financial position.

It is important to distinguish accounting from bookkeeping and management information systems. **Bookkeeping** is the process of recording financial transactions and keeping financial records. It is mechanical and repetitive, yet an important part of accounting that is usually handled by computers. **Management information systems (MIS)** consist of the interconnected subsystems, including accounting, that provide the information needed to run a business.

Accounting includes the design of an information system that meets the user’s needs.

To make an accounting measurement, the accountant must answer the following questions:

 What is measured?

 When should the measurement be made?

 What value should be placed on what is measured?

 How should what is measured be classified?

Accounting is concerned with measuring specific transactions of specific business entities in terms of money. **Business transactions** are economic events that affect the financial position of the business. Business transactions may involve exchanges of value (e.g., sales, borrowings, and purchases) or nonexchanges (the physical wear and tear on machinery and losses resulting from fire or theft).

The **money measure** concept states that business transactions should be recorded in terms of money. Financial statements are normally prepared in terms of the monetary unit of the business’s country (dollars, pesos, etc.). When transactions occur between countries using different monetary units, the amounts must be translated from one currency to another using the appropriate **exchange rate***.*

For accounting purposes, a business is treated as a **separate entity***,* distinct from its owners, creditors, and customers.

The three basic forms of business organization are sole proprietorships, partnerships*,* and corporations*.* Accountants recognize each form as an economic unit separate from its owners. A **sole proprietorship** is an unincorporated business owned by one person. A **partnership** is much like a sole proprietorship, except that it has two or more owners. A **corporation***,* unlike a sole proprietorship or partnership, is a business unit chartered by the state and legally separate from its owners (the **stockholders**). In exchange for their limited involvement in the corporation’s operations, stockholders enjoy **limited liability;** that is, their risk of loss is limited to the amount they paid for their shares.

To form a corporation, most states require individuals, called incorporators, to sign an application and file it with the proper state official. This application contains the **articles of incorporation.** If approved by the state, these articles, which form the company charter, become a contract between the state and the incorporators. The company is then authorized to do business as a corporation. The authority to manage a corporation is delegated by its stockholders to a board of directors and by the board of directors to the corporation’s officers. The corporation’s officers, in turn, carry out the corporate policies in their management of the business.

A unit of ownership in a corporation is called a **share of stock.** To invest in a corporation, a stockholder transfers cash or other resources to the corporation. In return, the stockholder receives shares of stock representing a proportionate share of ownership. Corporations may have more than one kind of stock, but here we refer only to **common stock.**

A corporation’s **board of directors** decides on major business policies. Among the board’s specific duties are authorizing contracts, setting executive salaries, and arranging major loans with banks. The financial scandals at Enron and WorldCom highlight the importance of **corporate governance,** which is the oversight of a corporation’s management and ethics by its board of directors. To strengthen corporate governance, the Sarbanes-Oxley Act requires boards of directors to establish an **audit committee** made up of the independent directors who have financial expertise. The purpose of this provision is to ensure that boards of directors are objective in evaluating management’s performance.

In this book, we begin with accounting for the sole proprietorship because it is the simplest form of accounting. At critical points, however, we call attention to its essential differences from accounting for partnerships and corporations.

**Financial position** refers to the relationship between economic resources and equities at a given time, which is shown on the balance sheet. The **accounting equation** shows this relationship in mathematical form. The basic accounting equation is as follows:

Assets = Liabilities + Stockholders’ Equity

Other forms of the equation are:

Assets – Liabilities = Stockholders’ Equity

Assets – Stockholders’ Equity = Liabilities

The left side of the basic accounting equation shows the resources (assets) of the business; the right side shows who provided these resources. The resource provider consists of stockholders (listed under “stockholders’ equity”) and creditors (evidenced by the existence of “liabilities”). Therefore, it is logical that the total dollar amount of assets must equal the total dollar amount of liabilities plus stockholders’ equity.

**Assets** are the economic resources of a business. Examples of assets are cash, accounts receivable, inventory, buildings, equipment, patents, and copyrights.

**Liabilities** are the present obligations of a business. Examples of liabilities are money borrowed from banks, amounts owed to creditors for goods or services bought on credit, and taxes owed to the government.

**Stockholders’ equity** represents the claims of the owners of a corporation to the assets of the business, and is sometimes said to equal **net assets** (or net worth). Stockholders’ equity has two parts, contributed capital and retained earnings:

Stockholders’ Equity = Contributed Capital + Retained Earnings

**Contributed capital** is the amount that stockholders invest in the business. Typically, contributed capital is divided between par value and additional paid-in capital. **Par value** is an amount per share that when multiplied by the number of common shares becomes the corporation’s common stock amount. When the value received is greater than par value, the amount over par value is called **additional paid-in capital.**

**Retained earnings** are earnings of the corporation since its inception, less any losses, dividends, or transfers to contributed capital. Retained earnings are reinvested in the business. They are not a pool of funds to be distributed to the stockholders; instead, they represent the stockholders’ claim to assets resulting from profitable operations.

Stockholders’ equity consists of the initial investment made by the owner, any subsequent contributions or investments made into the business, and earnings not distributed back to the owner in the form of dividends since the business’s inception.

Stockholders’ equity is affected by three kinds of operating transactions: revenues, expenses, and dividends. **Revenues** are the increases in stockholders’ equity resulting from the operation of the business. **Expenses** are the decreases in stockholders’ equity that result from operating a business. When revenues exceed expenses, the difference is called **net income***;* when expenses exceed revenues, the difference is called **net loss***.*

**Dividends** are distributions of resources, generally in the form of cash, to stockholders, and only the board of directors has the authority to declare them. Paying dividends is one way of rewarding stockholders for their investment when the corporation has been successful in earning a profit.

Relevant Examples and Exhibits

 Exhibit 1 Accounting as an Information System

 Exhibit 2 Examples of Foreign Exchange Rates

 Exhibit 3 Number and Receipts (Revenues) of U.S. Proprietorships, Partnerships, and Corporations

 Business Perspective: Are Most Corporations Big or Small Businesses?

 Exhibit 4 The Corporate Organization

 Exhibit 5 The Accounting Equation

Teaching Strategy

A good place to begin is with a discussion of business goals and activities. Exhibit 1 in the text not only illustrates accounting as an information system but also indicates the measurement, processing, and communication functions of accounting.

Students may have difficulty distinguishing between accounting and bookkeeping. Perhaps the use of a Venn diagram, with bookkeeping as a small circle within a much larger circle identified as accounting within an even larger circle (MIS), will help them make the distinction. As they learn accounting, students will also tend to focus on the bookkeeping aspects only. Remind them that theory, terminology, financial statement disclosure, and other such topics also need to be learned.

Students often ask if computers have displaced accountants. Explain that although computers are a useful tool, particularly for routine, repetitive processing, higher-level analytical skills are required to interpret information, and professional judgment is required to make good decisions.

Distinguish between financial and managerial accounting. The discussion of internal versus external users can be integrated with learning objective 5 on the users of accounting information.

Short Exercise 1 can be used in class to test students’ knowledge of terminology.

List the four questions that must be answered before an accounting measurement can be made. Perhaps you can provide a sample transaction and have your students answer these questions. Students will already have a feel for what a business transaction is, but they probably will not know the difference between an exchange and a nonexchange transaction, so providing several examples may help. Refer to Exhibit 2 on exchange rates, explain how they are used, and point out that they change daily. Explain how euros are replacing many European currencies. Obtain copies of annual reports prepared in other currencies to show students. Asking students to supplement the list of countries and their respective currencies in Exhibit 2 may invite input from students of diverse backgrounds and is an opportunity to stress the global nature of business today.

Finally, explain that for accounting purposes, a business and its owner(s) are always considered separate entities. This concept can be reinforced by telling students that maintaining the separation between business and owner is often a challenge in a small family business when its owners write a check on the business’s account for groceries, take a computer home, or give their children a company automobile to drive. For legal purposes, a sole proprietorship or a partnership and its owners are *not* considered separate.

Point out that the sole proprietorship and the partnership are similar in many respects, but that the corporation is significantly different from the other two forms of business organization (in terms of formation, owners’ liability, duration, transfer of ownership, and legal entity). Students have difficulty understanding the difference between the concepts of separate legal entities and separate accounting entities. Students often think that corporations always have multiple owners.

Relate material to the traditional form of organization of CPA firms. Tell students that pending legislation would permit CPA firms to incorporate. Ask students why firms might prefer incorporation.

To explain the concepts of financial position, the accounting equation, and the balance sheet, you can point out that all three represent two ways of looking at the same company: the assets are the resources of the company (the essence of which is “expected future benefit”), and the liabilities and stockholders’ equity represent those who provided the resources (creditors and the stockholders).

To reinforce the elements of the accounting equation, refer to a corporation and ask students what assets and liabilities it is likely to have. Students have difficulty grasping the concept of equity. Explain that it represents the stockholders’ claims on the assets of the business or *net assets* after the creditors’ claims have been met.

To illustrate the effects of transactions on the accounting equation, you may wish to discuss an end-of-chapter problem in which the accounting equation is updated for each transaction. Be sure to total columns after each transaction to illustrate that the accounting equation must always be in balance. A common misconception is that each transaction must have an increase and a decrease.

Section 2: Accounting Applications

Accounting Applications

 Describe the income statement

 Describe the statement of retained earnings

 Describe the balance sheet

 Describe the statement of cash flows

Lecture Outline

I. There are four basic financial statements that are interrelated.

A. Income statement (also known as the statement of earnings or the profit and loss statement)

1. Shows revenues earned and expenses incurred for a period of time.

2. Indicates profit or loss for an accounting period.

B. Statement of retained earnings

1. Shows changes in retained earnings over an accounting period.

C. Balance sheet (also known as the statement of financial position)

1. Usually prepared as of the last day of the accounting period to show the organization’s financial position (or status) as of that specific date.

2. Reflects the accounting equation in its structure.

D. Statement of cash flows

1. Presents significant financing, investing, and operating activities (cash-generating and cash-using activities) during a given period.

2. Focuses on liquidity.

E. Relationships among financial statements

II. GAAP are the conventions, rules, and procedures that define acceptable accounting practice at a particular time.

A. CPAs perform independent audits of businesses’ financial statements.

B. An audit results in a professional opinion as to whether the financial statements are in accordance with GAAP.

III. Organizations that issue accounting standards

A. The FASB is responsible for developing GAAP.

B. The IASB sets international accounting standards.

IV. Other organizations that influence GAAP

A. The PCAOB is a governmental body created by the Sarbanes-Oxley Act to regulate the accounting profession.

B. The AICPA influences GAAP through advisory committees.

C. The SEC sets its own standards for companies whose securities are listed on the stock exchanges.

D. The GASB was established to issue accounting standards for state and local governments.

E. IRS guidelines are established to collect taxes but play an influential role in the establishment of accounting practices.

V. It is important for CPAs to conform to their code of professional ethics because the public relies on them for the following:

A. Integrity

B. Objectivity

C. Independence

D. Due care

E. Management accountants have a code of professional ethics that addresses competence, confidentiality, integrity, and objectivity.

Summary

Accountants communicate their information through financial statements. The four basic statements are the income statement, the statement of retained earnings, the balance sheet, and the statement of cash flows.

The **income statement***,* whose components are revenues and expenses, is perhaps the most important financial statement. Its purpose is to measure a business’s profitability during a given period of time. The net income or net loss is used to update retained earnings on the statement of retained earnings. Net income (loss) also appears on the statement of cash flows.

The **statement of retained earnings** shows changes in retained earnings over an accounting period. Retained Earnings at the beginning of the period is the first item on the statement, followed by an addition for net income and a deduction for dividends. The ending figure is transferred to the stockholders’ equity section of the balance sheet.

The **balance sheet** shows the financial position of a business on a specific date. The resources used in the business are called **assets***,* debts of the business are called **liabilities***,* and the stockholders’ financial interest in the business is called **stockholders’ equity***.* Changes that occur in these accounts are reflected in the statement of cash flows.

The **statement of cash flows** provides users with information about the business’s liquidity by disclosing all important financing, investing, and operating activities that affected its cash balance during the accounting period. **Cash flows** are the inflows and outflows of cash into and out of a business. Financing activities may include issuing or repaying debt. Investing activities may include selling a building or investing in stock. Operating activities include receipts from customers and payments to suppliers and others in the ordinary course of the business’s main operations.

Every financial statement has a three-line heading. The first line gives the name of the company, the second line gives the name of the statement, and the third line gives the relevant dates (the date of the balance sheet or the period of time covered by the other three statements).

**Generally accepted accounting principles (GAAP)** are the conventions, rules, and procedures that define acceptable accounting practice at a particular time. They arise from wide agreement on the theory and practice of accounting at a given time. These principles change continually as business conditions change and practices improve.

The financial statements of publicly held corporations are prepared by management but audited by a licensed professional, called a **certified public accountant (CPA)**, so that the statements can be made more believable to the users. Before the **audit** (examination) can take place, however, the CPA must be independent of (without financial or other ties to) the client. On completion of the audit, the CPA reports whether the audited statements are “presented fairly in all material respects” and are “in conformity with generally accepted accounting principles.” Because estimates and interpretations are made in the application of GAAP, auditors must employ their professional judgment in rendering an opinion.

The **Financial Accounting Standards Board (FASB)**, an independent body, is the authoritative body in the development of GAAP. The FASB issues *Statements of Financial Accounting Standards.*

Spurred by the growth of financial markets worldwide, the **International Accounting Standards Board (IASB)** develops international accounting standards known as **international financial reporting standards (IFRS)**.

The **Public Company Accounting Oversight Board (PCAOB)** is a governmental body created by the Sarbanes-Oxley Act to regulate the accounting profession.

The **American Institute of Certified Public Accountants (AICPA)***,* the professional association of CPAs, influences accounting practice through the activities of its senior technical committees.

The **Securities and Exchange Commission (SEC)** is an agency of the federal government that has the legal power to set and enforce accounting practices for companies whose securities are traded by the general public.

The **Governmental Accounting Standards Board (GASB)** was established in 1984 and is responsible for issuing accounting standards for state and local governments.

The **Internal Revenue Service (IRS)** has its own set of rules that govern the assessment and collection of taxes. These rules, while sometimes contrary to GAAP, are an important influence on accounting practice.

**Professional ethics** is the application of a code of conduct to the practice of a profession. The accounting profession has developed a code that is intended to guide the accountant in carrying out his or her responsibilities to the public. In conformity with the AICPA’s code for CPAs, the accountant must act with integrity, objectivity, independence, and due care.

1. **Integrity** means the accountant is honest, regardless of consequences.

2. **Objectivity** means the accountant is impartial and intellectually honest in performing his or her job.

3. **Independence** means the accountant avoids all relationships that could impair, or even appear to impair, his or her objectivity, such as owning stock in a company being audited.

4. **Due care** means carrying out professional responsibilities with competence and diligence.

The **Institute of Management Accountants (IMA)** has a code of professional ethics, which stipulates that managerial accountants are to be competent in their jobs, to keep information confidential, to maintain integrity and avoid conflicts of interest, and to communicate information objectively and without bias.

Relevant Examples and Exhibits

 Exhibit 6 Financial Statement Relationships

 Exhibit 7 Income Statement for Roland Consultancy

 Exhibit 8 Statement of Retained Earnings for Roland Consultancy

 Exhibit 9 Balance Sheet for Roland Consultancy

 Exhibit 10 Statement of Cash Flows for Roland Consultancy

 Exhibit 11 Income Statement, Statement of Retained Earnings, Balance Sheet and Statement of Cash Flows for Roland Consultancy

 Exhibit 12 Large International Certified Public Accounting Firms

 International Perspective: The Arrival of International Financial Reporting Standards in the United States

Teaching Strategy

Explain the purpose of each financial statement and discuss how each is used by various user groups in evaluating a company’s profitability and liquidity. Then refer to Exhibit 11 in the text as you discuss how these statements interrelate. For example, students need to know why the income statement must be prepared first. Point out the common elements that appear on more than one statement. Stress that it is the ending owner’s equity that appears on the balance sheet. Distinguish between a specific date and a period of time. Since the assets and liabilities of a business are changing from moment to moment, it is necessary to choose a cutoff date on which to measure them.

Distinguish between net income on the income statement and net cash flows from operating activities on the statement of cash flows.

Explain that GAAP are constantly evolving and are not like laws of science. Explain that GAAP are designed to “accurately measure the performance of businesses” and that the accountant, contrary to a common misconception, should not attempt to make a company look better on paper than it really is. Emphasize that GAAP are guidelines that require interpretation; they are not a rigid set of rules.

Be sure to explain that an audit report does not state whether the audited company is a good investment; it states only whether its financial statements are “presented fairly” in accordance with GAAP. Also discuss the importance of independence. Explain that an audit provides only reasonable, not absolute, assurance because it relies on test results from a sample of transactions.

An interesting discussion involves distinguishing between GAAP and tax law (Internal Revenue Code). Point out that the objective of tax law is to raise revenue for the government, not to accomplish the logical measurement of business income.

Explain the importance of ethics within the accounting profession and the possible consequences of being in violation of the professional code. The key terms *integrity, objectivity, independence,* and *due care* can help illustrate the concept. Describe some situations that typically create ethical dilemmas for accountants.

Section 3: Business Applications

Business Applications

 Profitability

 Liquidity

 Ethics

Lecture Outline

I. Three major groups use accounting information.

A. Management (internal users)

B. Outsiders with a direct financial interest

1. Present or potential investors

2. Present or potential creditors

C. People, organizations, and agencies with an indirect financial interest

1. Tax authorities

2. Regulatory agencies

a. Securities and Exchange Commission (SEC)

3. Other groups (labor unions, financial advisers, economic planners, etc.)

II. Government and not-for-profit organizations also use financial information.

III. A business is an economic unit that aims to sell goods and services to customers at prices that will provide an adequate return to its owners.

A. Goals

1. Profitability—earning a sufficient return to maintain owner interest

2. Liquidity—having enough cash to pay debts as they come due

B. Activities

1. Operating—selling goods and services to customers, employing managers and workers, buying and producing goods and services, and paying taxes

2. Investing—spending the capital a company receives in productive ways that help it achieve its objectives

3. Financing—obtaining funds to begin operations and to continue operating

C. Performance measures

1. Performance measures relate to achieving goals and assessing the management of business activities.

2. Financial analysis (ratios) is the evaluation and interpretation of the financial statements and related performance measures.

3. Performance measures must be crafted to motivate managers to make decisions that are in the best interest of the business.

IV. Ethical financial reporting

A. Ethics is a code of conduct that addresses whether actions are right or wrong.

1. Ethics in the preparation of financial reports is important because users of these reports must depend on the good faith of the people involved in their preparation.

2. The intentional preparation of misleading financial statements is called fraudulent financial reporting.

a. Fraudulent financial reporting can result from the distortion of records, falsified transactions, or the misapplication of various accounting principles.

3. The motivation for fraudulent financial reporting could be to inflate the perceived value of a business, meet stockholders’ and financial analysts’ expectations, obtain financing, or receive personal gain.

4. Recent scandals have spurred the growth of new legislation.

Summary

Basically, three groups use accounting information: management, outsiders with a direct financial interest, and outsiders with an indirect financial interest.

1. If a business is to survive, **management** must achieve profitability and liquidity. The company also has other goals, such as improving its products and expanding operations. Management directs the company toward these goals by making the right decisions.

2. Present or potential investors and present or potential creditors are considered outside users with a direct financial interest in a business. **Investors** use financial statements to assess the strength or weakness of the company, whereas **creditors** examine the financial statements to determine the company’s ability to repay loans at the appropriate time.

3. Society as a whole, through its government officials and public groups, may be viewed as a financial statement user with an indirect financial interest in a business. Specifically, society includes (a) tax authorities, (b) regulatory agencies, and (c) other groups (such as labor unions and financial analysts). The **Securities and Exchange Commission (SEC)**, a regulatory agency, has extensive reporting requirements for public companies.

Managers in government and not-for-profit organizations such as hospitals, universities, professional organizations, and charities also make extensive use of financial information. In addition to financing, investing, and operating activities, these organizations have reporting responsibilities to authoritative bodies that hold them accountable for their financial performance.

A **business** is an economic unit that aims to sell goods and services to customers at prices that will provide an adequate return to its owners. The two major goals of all businesses are profitability and liquidity. **Profitability** is the ability to earn enough income to attract and hold investment capital. **Liquidity** is the ability to have sufficient cash to pay debts as they fall due. Businesses pursue their goals by engaging in (1) **operating activities***,* which include selling goods and services to customers, employing managers and workers, and buying and producing goods and services; (2) **investing activities***,* which involve spending the capital a company receives in ways to help it achieve its objectives; and (3) **financing activities***,* which include obtaining funds to begin and sustain operations.

**Financial analysis** uses financial statements to determine how well a business is managed. An important function of accounting is to provide **performance measures**, which indicate whether managers are achieving their business goals and whether the business activities are well managed. **Financial ratios** can provide information on both how financial statement items relate to each other and allow for comparisons from one period to the next.

**Ethics** is the code of conduct that helps individuals in their everyday life distinguish right from wrong. Ethics is especially important in preparing financial reports because users of these reports must depend on the good faith of the people involved in their preparation. The intentional preparation of misleading financial statements is called **fraudulent financial reporting***.* It can result from the distortion of records, falsified transactions, or the misapplication of various accounting principles.

In 2002, Congress passed the **Sarbanes-Oxley Act** to regulate financial reporting in public corporations. This legislation requires the chief executives and chief financial officers of all publicly traded U.S. companies to attest to the accuracy and completeness of the quarterly statements and annual reports that their companies file with the SEC.

Relevant Examples and Exhibits

 Exhibit 13 The Users of Accounting Information

 Exhibit 14 Business Goals and Activities

 Business Perspective: What Does CVS Have to Say About Itself?

Teaching Strategy

An interesting way to present learning objective 5 is to ask students to name the many users of financial information while you keep a list on the board (or overhead transparency, etc.). Students should know that the list in Exhibit 13 of the text, although ambitious, is not exhaustive. At the same time, you may want to ask them why each user would seek a company’s financial information and whether each user is more interested in assessing profitability or liquidity.

Making the distinction between direct and indirect users, and between internal and external users, is helpful. Ask students how they have used accounting information.

Case 1 provides a good foundation for discussing business goals and activities. This sets the stage for a discussion of accounting and how it helps businesses achieve goals and perform activities.Exhibit 14 in the text illustrates business goals and activities. Distinguish between profitability and liquidity and explain why a business must maintain both if it is to survive. The key components of the AICPA’s definition of accounting are “useful,” “financial information,” and “decisions.”

Be sure to mention management’s responsibility for ethical financial reporting, including the definition of fraudulent financial reporting and the significance of the Sarbanes-Oxley Act.

Short Exercise 1 can be used in class to test students’ knowledge of terminology**.** Case 5 emphasizes the importance of cash flows and the goal of liquidity.

Student Engagement Tactics

1. Divide the class into small groups. One quick way to form groups is to divide the number of students in class by three or four (the most effective group size for this activity). Ask students to count off from 1 to the maximum number of groups. Remind them not to forget their number. Have students get together by number after you give complete instructions. It will encourage a speedy transition, as this activity has a time limit.

2. Assign one of the learning tools. (If one of the problems was done for homework, use another one in this activity; it will reinforce learning.)

3. The first group to correctly complete the task wins. As the groups complete the task, mark their completion time. (You may want to gather and keep their responses until the time limit has expired. See Step 4.) The time limit is 25 minutes. If, for some reason, no group has the correct response in 25 minutes, give them additional time as deemed appropriate.

4. The winning group could present the correct responses to the entire class using a solution transparency and answer student questions. You may prefer to debrief this activity if time is limited. If you have retained group responses, quickly check them to determine where additional review may be needed.

5. Reward each of the winning group members with one or two extra quiz points, fun-size candy bars, novelty erasers, or other small prizes.