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ACCOUNTING

TOOLS FOR BUSINESS DECISION MAKING

SIXTH EDITION

WILEY

ACCOUNT CLASSIFICATION AND PRESENTATION

Account Title	Classification	Financial Statement	Normal Balance
A			
Accounts Payable	Current Liability	Balance Sheet	Credit
Accounts Receivable	Current Asset	Balance Sheet	Debit
Accumulated Depreciation—Buildings	Plant Asset—Contra	Balance Sheet	Credit
Accumulated Depreciation—Equipment	Plant Asset—Contra	Balance Sheet	Credit
Administrative Expenses	Operating Expense	Income Statement	Debit
Allowance for Doubtful Accounts	Current Asset—Contra	Balance Sheet	Credit
Amortization Expense	Operating Expense	Income Statement	Debit
B			
Bad Debt Expense	Operating Expense	Income Statement	Debit
Bonds Payable	Long-Term Liability	Balance Sheet	Credit
Buildings	Plant Asset	Balance Sheet	Debit
C			
Cash	Current Asset	Balance Sheet	Debit
Common Stock	Stockholders' Equity	Balance Sheet	Credit
Copyrights	Intangible Asset	Balance Sheet	Debit
Cost of Goods Sold	Cost of Goods Sold	Income Statement	Debit
D			
Debt Investments	Current Asset/ Long-Term Investment	Balance Sheet	Debit
Depreciation Expense	Operating Expense	Income Statement	Debit
Discount on Bonds Payable	Long-Term Liability—Contra	Balance Sheet	Debit
Dividend Revenue	Other Income	Income Statement	Credit
Dividends	Temporary account closed to Retained Earnings	Retained Earnings Statement	Debit
Dividends Payable	Current Liability	Balance Sheet	Credit
E			
Equipment	Plant Asset	Balance Sheet	Debit
F			
Freight-Out	Operating Expense	Income Statement	Debit
G			
Gain on Disposal of Plant Assets	Other Income	Income Statement	Credit
Goodwill	Intangible Asset	Balance Sheet	Debit
I			
Income Summary	Temporary account closed to Retained Earnings	Not Applicable	(1)
Income Tax Expense	Income Tax Expense	Income Statement	Debit
Income Taxes Payable	Current Liability	Balance Sheet	Credit
Insurance Expense	Operating Expense	Income Statement	Debit
Interest Expense	Other Expense	Income Statement	Debit
Interest Payable	Current Liability	Balance Sheet	Credit
Interest Receivable	Current Asset	Balance Sheet	Debit
Interest Revenue	Other Income	Income Statement	Credit
Inventory	Current Asset	Balance Sheet (2)	Debit

Account Title	Classification	Financial Statement	Normal Balance
L			
Land	Plant Asset	Balance Sheet	Debit
Loss on Disposal of Plant Assets	Other Expense	Income Statement	Debit
M			
Maintenance and Repairs Expense	Operating Expense	Income Statement	Debit
Mortgage Payable	Long-Term Liability	Balance Sheet	Credit
N			
Notes Payable	Current Liability/ Long-Term Liability	Balance Sheet	Credit
P			
Patents	Intangible Asset	Balance Sheet	Debit
Paid-in Capital in Excess of Par Value—Common Stock	Stockholders' Equity	Balance Sheet	Credit
Paid-in Capital in Excess of Par Value—Preferred Stock	Stockholders' Equity	Balance Sheet	Credit
Preferred Stock	Stockholders' Equity	Balance Sheet	Credit
Premium on Bonds Payable	Long-Term Liability—Contra	Balance Sheet	Credit
Prepaid Insurance	Current Asset	Balance Sheet	Debit
Prepaid Rent	Current Asset	Balance Sheet	Debit
R			
Rent Expense	Operating Expense	Income Statement	Debit
Retained Earnings	Stockholders' Equity	Balance Sheet and Retained Earnings Statement	Credit
S			
Salaries and Wages Expense	Operating Expense	Income Statement	Debit
Salaries and Wages Payable	Current Liability	Balance Sheet	Credit
Sales Discounts	Revenue—Contra	Income Statement	Debit
Sales Returns and Allowances	Revenue—Contra	Income Statement	Debit
Sales Revenue	Revenue	Income Statement	Credit
Selling Expenses	Operating Expense	Income Statement	Debit
Service Revenue	Revenue	Income Statement	Credit
Stock Investments	Current Asset/Long-Term Investment	Balance Sheet	Debit
Supplies	Current Asset	Balance Sheet	Debit
Supplies Expense	Operating Expense	Income Statement	Debit
T			
Treasury Stock	Stockholders' Equity	Balance Sheet	Debit
U			
Unearned Service Revenue	Current Liability	Balance Sheet	Credit
Utilities Expense	Operating Expense	Income Statement	Debit

- (1) The normal balance for Income Summary will be credit when there is a net income, debit when there is a net loss. The Income Summary account does not appear on any financial statement.
- (2) If a periodic system is used, Inventory also appears on the income statement in the calculation of cost of goods sold.

The following is a sample chart of accounts. It does not represent a comprehensive chart of all the accounts used in this textbook but rather those accounts that are commonly used. This sample chart of accounts is for a company that generates both service revenue as well as sales revenue. It uses the perpetual approach to inventory. If a periodic system was used, the following temporary accounts would be needed to record inventory purchases: Purchases, Freight-In, Purchase Returns and Allowances, and Purchase Discounts.

CHART OF ACCOUNTS

CHART OF ACCOUNTS				
Assets	Liabilities	Stockholders' Equity	Revenues	Expenses
Cash	Notes Payable	Common Stock	Service Revenue	Administrative Expenses
Accounts Receivable	Accounts Payable	Paid-in Capital in Excess of Par Value—Common Stock	Sales Revenue	Amortization Expense
Allowance for Doubtful Accounts	Unearned Service Revenue	Preferred Stock	Sales Discounts	Bad Debt Expense
Interest Receivable	Salaries and Wages Payable	Paid-in Capital in Excess of Par Value—Preferred Stock	Sales Returns and Allowances	Cost of Goods Sold
Inventory	Interest Payable	Treasury Stock	Interest Revenue	Depreciation Expense
Supplies	Dividends Payable	Retained Earnings	Gain on Disposal of Plant Assets	Freight-Out
Prepaid Insurance	Income Taxes Payable	Dividends		Income Tax Expense
Prepaid Rent	Bonds Payable	Income Summary		Insurance Expense
Land	Discount on Bonds Payable			Interest Expense
Equipment	Premium on Bonds Payable			Loss on Disposal of Plant Assets
Accumulated Depreciation—Equipment	Mortgage Payable			Maintenance and Repairs Expense
Buildings				Rent Expense
Accumulated Depreciation—Buildings				Salaries and Wages Expense
Copyrights				Selling Expenses
Goodwill				Supplies Expense
Patents				Utilities Expense



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From the Authors

Dear Student,

Why This Course? Remember your biology course in high school? Did you have one of those “invisible man” models (or maybe something more high-tech than that) that gave you the opportunity to look “inside” the human body? This accounting course offers something similar. To understand a business, you have to understand the financial insides of a business organization. An accounting course will help you understand the essential financial components of businesses. Whether you are looking at a large multinational company like *Apple* or *Starbucks* or a single-owner software consulting business or coffee shop, knowing the fundamentals of accounting will help you understand what is happening. As an employee, a manager, an investor, a business owner, or a director of your own personal finances—any of which roles you will have at some point in your life—you will make better decisions for having taken this course.

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Good luck in this course. We hope you enjoy the experience and that you put to good use throughout a lifetime of success the knowledge you obtain in this course. We are sure you will not be disappointed.

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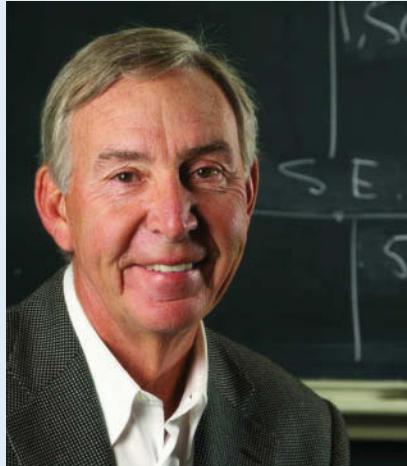
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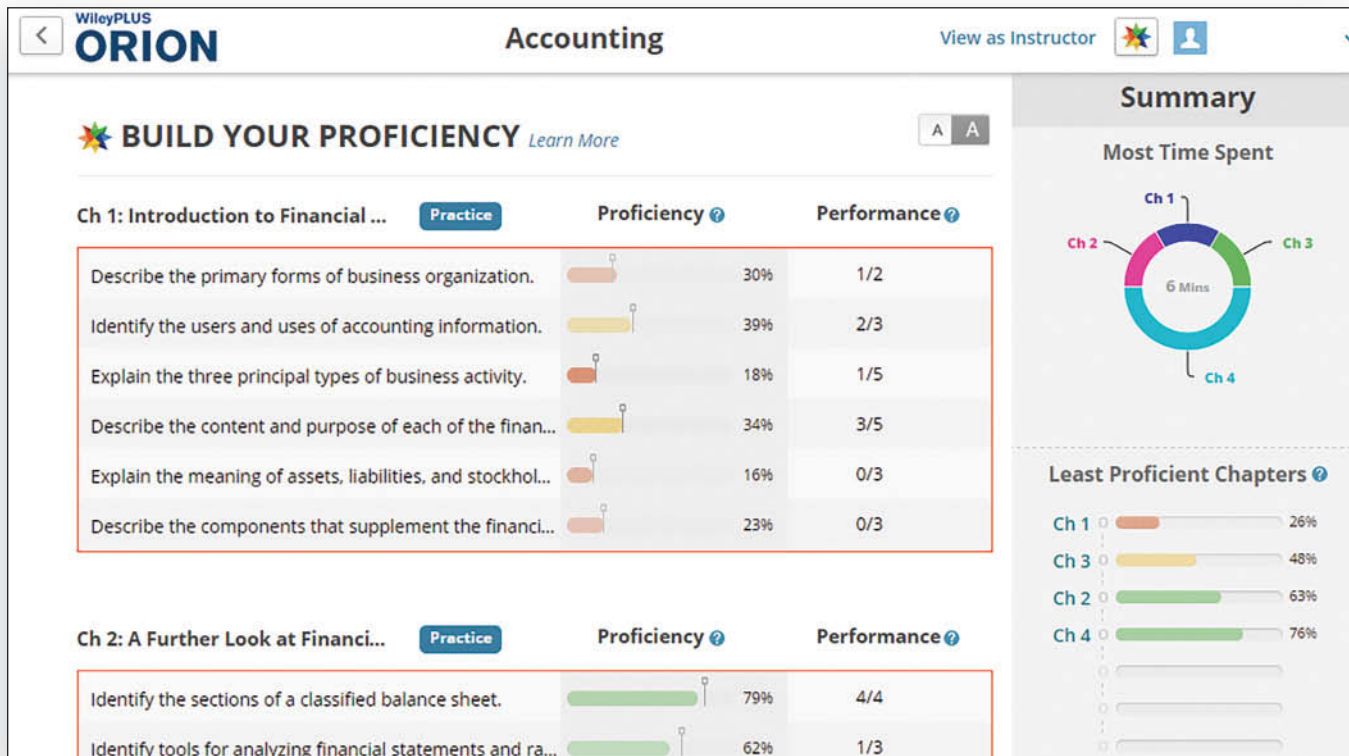
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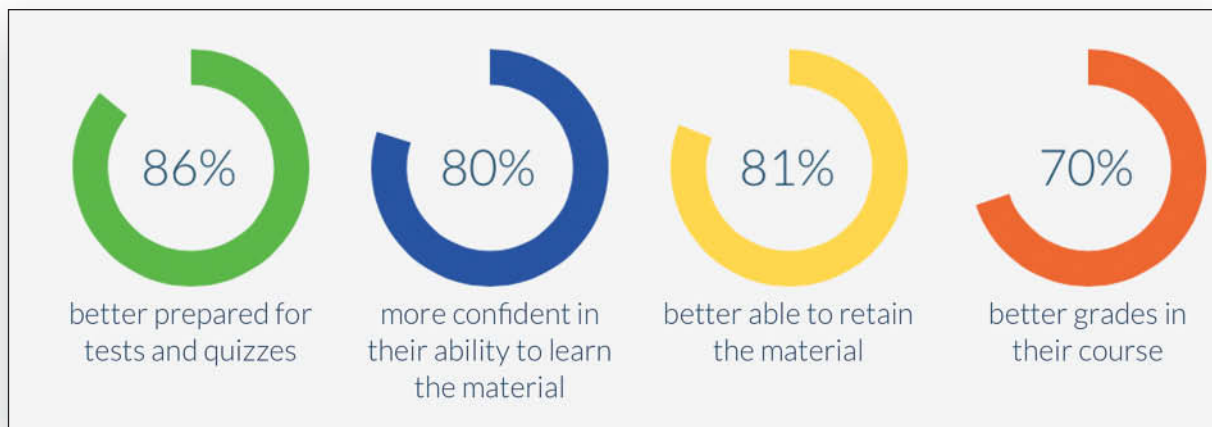


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More information about the Sixth Edition is available on the book's website at www.wiley.com/college/kimmel.

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1

Introduction to Financial Statements

CHAPTER PREVIEW

*The **Chapter Preview** describes the purpose of the chapter and highlights major topics.*

How do you start a business? How do you determine whether your business is making or losing money? How should you finance expansion—should you borrow, should you issue stock, should you use your own funds? How do you convince banks to lend you money or investors to buy your stock? Success in business requires making countless decisions, and decisions require financial information.

The purpose of this chapter is to show you what role accounting plays in providing financial information.

*The **Chapter Outline** presents the chapter's topics and subtopics, as well as practice opportunities.*

CHAPTER OUTLINE

LEARNING OBJECTIVES

1 Identify the forms of business organization and the uses of accounting information.

- Forms of business organization
- Users and uses of financial information
- Ethics in financial reporting

PRACTICE

DO IT!

1 Business Organization Forms

2 Explain the three principal types of business activity.

- Financing activities
- Investing activities
- Operating activities

DO IT!

2 Business Activities

3 Describe the four financial statements and how they are prepared.

- Income statement
- Retained earnings statement
- Balance sheet
- Statement of cash flows
- Interrelationships of statements
- Other annual report elements

DO IT!

3 3a Financial Statements
3b Components of Annual Reports

Go to the **REVIEW AND PRACTICE** section at the end of the chapter for a targeted summary and exercises with solutions.

Visit **WileyPLUS** for additional tutorials and practice opportunities.



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FEATURE STORY

The Feature Story helps you picture how the chapter topic relates to the real world of accounting and business.

Many students who take this course do not plan to be accountants. If you are in that group, you might be thinking, “If I’m not going to be an accountant, why do I need to know accounting?”

Well, consider this quote from Harold Geneen, the former chairman of **IT&T**: “To be good at your business, you have to know the numbers—cold.” In business, accounting and financial statements are the means for communicating the numbers. If you don’t know how to read financial statements, you can’t really know your business.

Knowing the numbers is sometimes even a matter of corporate survival. Consider the story of **Columbia Sportswear Company**, headquartered in Portland, Oregon. Gert Boyle’s family fled Nazi Germany when she was 13 years old and then purchased a small hat company in Oregon, Columbia Hat Company. In 1971, Gert’s husband, who was then running the company, died suddenly of a heart attack. The company was in the midst of an aggressive expansion, which had taken its sales above \$1 million for the first time but which had also left the company financially stressed. Gert took over the small, struggling company with help from her son Tim, who was then a senior at the University of Oregon. Somehow, they kept the company afloat.

Today, Columbia has more than 4,000 employees and annual sales in excess of \$1 billion. Its brands include Columbia, Mountain Hardwear, Sorel, and Montrail.

Gert still heads up the Board of Directors, and Tim is the company’s President and CEO.

Columbia doesn’t just focus on financial success. The company is very committed to corporate, social, and environmental responsibility. For example, several of its factories have participated in a project to increase

health awareness of female factory workers in developing countries. Columbia was also a founding member of the Sustainable Apparel Coalition, which is a group that strives to reduce the environmental and social impact of the apparel industry. In addition, it monitors all of the independent factories that produce its products to ensure that they comply with the company’s Standards of Manufacturing Practices. These standards address issues including forced labor, child labor, harassment, wages and benefits, health and safety, and the environment.

Employers such as Columbia Sportswear generally assume that managers in all areas of the company are “financially literate.” To help prepare you for that, in this textbook you will learn how to read and prepare financial statements, and how to use basic tools to evaluate financial results.

Knowing the Numbers

LEARNING
OBJECTIVE

1

Identify the forms of business organization and the uses of accounting information.

Suppose you graduate with a business degree and decide you want to start your own business. But what kind of business? You enjoy working with people, especially teaching them new skills. You also spend most of your free time outdoors, kayaking, backpacking, skiing, rock climbing, and mountain biking. You think you might be successful in opening an outdoor guide service where you grew up, in the Sierra Nevada mountains.

FORMS OF BUSINESS ORGANIZATION

Your next decision is to determine the organizational form of your business. You have three choices—sole proprietorship, partnership, or corporation.

SOLE PROPRIETORSHIP You might choose the sole proprietorship form for your outdoor guide service. A business owned by one person is a **sole proprietorship**. It is **simple to set up** and **gives you control** over the business. Small owner-operated businesses such as barber shops, law offices, and auto repair shops are often sole proprietorships, as are farms and small retail stores.

PARTNERSHIP Another possibility is for you to join forces with other individuals to form a partnership. A business owned by two or more persons associated as partners is a **partnership**. Partnerships often are formed because one individual does not have **enough economic resources** to initiate or expand the business. Sometimes **partners bring unique skills or resources** to the partnership. You and your partners should formalize your duties and contributions in a written partnership agreement. Retail and service-type businesses, including professional practices (lawyers, doctors, architects, and certified public accountants), often organize as partnerships.

CORPORATION As a third alternative, you might organize as a corporation. A business organized as a separate legal entity owned by stockholders is a **corporation**. Investors in a corporation receive shares of stock to indicate their ownership claim. Buying stock in a corporation is often more attractive than investing in a partnership because shares of stock are **easy to sell** (transfer ownership). Selling a proprietorship or partnership interest is much more involved. Also, individuals can become **stockholders** by investing relatively small amounts of money. Therefore, it is **easier for corporations to raise funds**. Successful corporations often have thousands of stockholders, and their stock is traded on organized stock exchanges like the **New York Stock Exchange**. Many businesses start as sole proprietorships or partnerships and eventually incorporate.

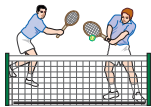
Other factors to consider in deciding which organizational form to choose are **taxes and legal liability**. If you choose a sole proprietorship or partnership, you generally receive more favorable tax treatment than a corporation. However, proprietors and partners are personally liable for all debts and legal obligations of the business; corporate stockholders are not. In other words, corporate stockholders generally pay higher taxes but have no personal legal liability. We will discuss these issues in more depth in a later chapter.

Finally, while sole proprietorships, partnerships, and corporations represent the main types of business organizations, hybrid forms are now allowed in all states. These hybrid business forms combine the tax advantages of partnerships with the limited liability of corporations. Probably the most common among these hybrids types are limited liability companies (LLCs) and subchapter S corporations. These forms are discussed extensively in business law classes.

The combined number of proprietorships and partnerships in the United States is more than five times the number of corporations. However, the revenue

**Sole Proprietorship**

- Simple to establish
- Owner controlled
- Tax advantages

**Partnership**

- Simple to establish
- Shared control
- Broader skills and resources
- Tax advantages

**Corporation**

- Easier to transfer ownership
- Easier to raise funds
- No personal liability

ALTERNATIVE TERMINOLOGY

Stockholders are sometimes called *shareholders*.

Alternative Terminology notes present synonymous terms that you may come across in practice.

produced by corporations is eight times greater. Most of the largest businesses in the United States—for example, **Coca-Cola**, **ExxonMobil**, **General Motors**, **Citigroup**, and **Microsoft**—are corporations. Because the majority of U.S. business is done by corporations, the emphasis in this textbook is on the corporate form of organization.

USERS AND USES OF FINANCIAL INFORMATION

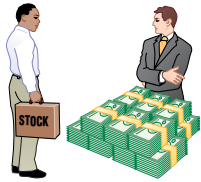


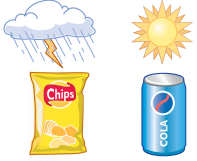
The purpose of financial information is to provide inputs for decision-making. **Accounting** is the information system that identifies, records, and communicates the economic events of an organization to interested users. **Users** of accounting information can be divided broadly into two groups: internal users and external users.

Internal Users

Internal users of accounting information are managers who plan, organize, and run a business. These include **marketing managers**, **production supervisors**, **finance directors**, and **company officers**. In running a business, managers must answer many important questions, as shown in Illustration 1-1.

ILLUSTRATION 1-1
Questions that internal users ask

Questions Asked by Internal Users

 <p>Finance</p> <p>Is cash sufficient to pay dividends to Microsoft stockholders?</p>	 <p>Marketing</p> <p>What price should Apple charge for an iPad to maximize the company's net income?</p>	 <p>Human Resources</p> <p>Can General Motors afford to give its employees pay raises this year?</p>	 <p>Management</p> <p>Which PepsiCo product line is the most profitable? Should any product lines be eliminated?</p>
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To answer these and other questions, you need detailed information on a timely basis. For internal users, accounting provides internal reports, such as financial comparisons of operating alternatives, projections of income from new sales campaigns, and forecasts of cash needs for the next year. In addition, companies present summarized financial information in the form of financial statements.

Accounting Across the Organization boxes show applications of accounting information in various business functions.

ACCOUNTING ACROSS THE ORGANIZATION

Clif Bar & Company



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Owning a Piece of the Bar

The original Clif Bar® energy bar was created in 1990 after six months of experimentation by Gary Erickson and his mother in her kitchen. Today, the company has almost 300 employees and is considered one of the leading Landor's Breakaway Brands®. One of **Clif Bar & Company's** proudest moments was the creation of an employee stock ownership plan

(ESOP) in 2010. This plan gives its employees 20% ownership of the company. The ESOP also resulted in Clif Bar enacting an open-book management program, including the commitment to educate all employee-owners about its finances. Armed with basic accounting knowledge, employees are more aware of the financial impact of their actions, which leads to better decisions.

What are the benefits to the company and to the employees of making the financial statements available to all employees? (Go to WileyPLUS for this answer and additional questions.)

External Users

There are several types of **external users** of accounting information. **Investors** (owners) use accounting information to make decisions to buy, hold, or sell stock. **Creditors** such as suppliers and bankers use accounting information to evaluate the risks of selling on credit or lending money. Some questions that investors and creditors may ask about a company are shown in Illustration 1-2.

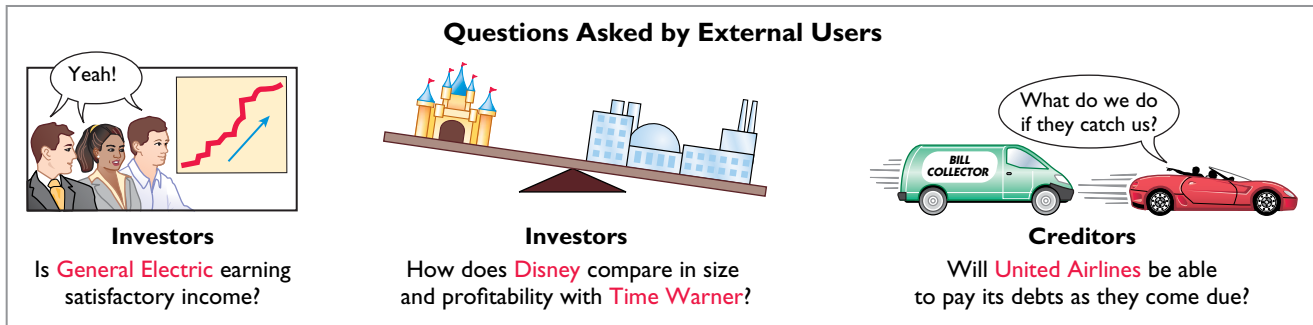


ILLUSTRATION 1-2
Questions that external users ask

The information needs and questions of other external users vary considerably. **Taxing authorities**, such as the Internal Revenue Service, want to know whether the company complies with the tax laws. **Customers** are interested in whether a company like **General Motors** will continue to honor product warranties and otherwise support its product lines. **Labor unions**, such as the Major League Baseball Players Association, want to know whether the owners have the ability to pay increased wages and benefits. **Regulatory agencies**, such as the Securities and Exchange Commission or the Federal Trade Commission, want to know whether the company is operating within prescribed rules. For example, **Enron**, **Dynegy**, **Duke Energy**, and other big energy-trading companies reported record profits at the same time as California was paying extremely high prices for energy and suffering from blackouts. This disparity caused regulators to investigate the energy traders to make sure that the profits were earned by legitimate and fair practices.

ACCOUNTING ACROSS THE ORGANIZATION



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Spinning the Career Wheel

How will the study of accounting help you? A working knowledge of accounting is desirable for virtually every field of business. Some examples of how accounting is used in business careers include the following.

General management: Managers of **Ford Motors**, Massachusetts General Hospital, California State University–Fullerton, a **McDonald's** franchise, and a **Trek** bike shop all need to understand

accounting data in order to make wise business decisions.

Marketing: Marketing specialists at **Procter & Gamble** must be sensitive to costs and benefits, which accounting helps

them quantify and understand. Making a sale is meaningless unless it is a profitable sale.

Finance: Do you want to be a banker for **Citicorp**, an investment analyst for **Goldman Sachs**, or a stock broker for **Merrill Lynch**? These fields rely heavily on accounting knowledge to analyze financial statements. In fact, it is difficult to get a good job in a finance function without two or three courses in accounting.

Real estate: Are you interested in being a real estate broker for **Prudential Real Estate**? Because a third party—the bank—is almost always involved in financing a real estate transaction, brokers must understand the numbers involved: Can the buyer afford to make the payments to the bank? Does the cash flow from an industrial property justify the purchase price? What are the tax benefits of the purchase?

How might accounting help you? (Go to WileyPLUS for this answer and additional questions.)

ETHICS IN FINANCIAL REPORTING

People won't gamble in a casino if they think it is "rigged." Similarly, people won't "play" the stock market if they think stock prices are rigged. At one time, the financial press was full of articles about financial scandals at **Enron**, **WorldCom**, **HealthSouth**, and **AIG**. As more scandals came to light, a mistrust of financial reporting in general seemed to be developing. One article in the *Wall Street Journal* noted that "repeated disclosures about questionable accounting practices have bruised investors' faith in the reliability of earnings reports, which in turn has sent stock prices tumbling." Imagine trying to carry on a business or invest money if you could not depend on the financial statements to be honestly prepared. Information would have no credibility. There is no doubt that a sound, well-functioning economy depends on accurate and dependable financial reporting.

United States regulators and lawmakers were very concerned that the economy would suffer if investors lost confidence in corporate accounting because of unethical financial reporting. Congress passed the **Sarbanes-Oxley Act (SOX)** to reduce unethical corporate behavior and decrease the likelihood of future corporate scandals. As a result of SOX, top management must now certify the accuracy of financial information. In addition, penalties for fraudulent financial activity are much more severe. Also, SOX increased both the independence of the outside auditors who review the accuracy of corporate financial statements and the oversight role of boards of directors.

Effective financial reporting depends on sound ethical behavior. To sensitize you to ethical situations and to give you practice at solving ethical dilemmas, we address ethics in a number of ways in this textbook. (1) A number of the *Feature Stories* and other parts of the text discuss the central importance of ethical behavior to financial reporting. (2) *Ethics Insight boxes* and marginal *Ethics Notes* highlight ethics situations and issues in actual business settings. (3) Many of the *People, Planet, and Profit Insight boxes* focus on ethical issues that companies face in measuring and reporting social and environmental issues. (4) At the end of each chapter, an *Ethics Case* simulates a business situation and asks you to put yourself in the position of a decision-maker in that case.

When analyzing these various ethics cases and your own ethical experiences, you should apply the three steps outlined in Illustration 1-3.


ETHICS NOTE

Circus-founder P.T. Barnum is alleged to have said, "Trust everyone, but cut the deck." What Sarbanes-Oxley does is to provide measures that (like cutting the deck of playing cards) help ensure that fraud will not occur.

Ethics Notes help sensitize you to some of the ethical issues in accounting.

ILLUSTRATION 1-3

Steps in analyzing ethics cases



Solving an Ethical Dilemma

1. Recognize an ethical situation and the ethical issues involved.
Use your personal ethics to identify ethical situations and issues. Some businesses and professional organizations provide written codes of ethics for guidance in some business situations.

2. Identify and analyze the principal elements in the situation.
Identify the **stakeholders**—persons or groups who may be harmed or benefited. Ask the question: What are the responsibilities and obligations of the parties involved?

3. Identify the alternatives, and weigh the impact of each alternative on various stakeholders.
Select the most ethical alternative, considering all the consequences. Sometimes there will be one right answer. Other situations involve more than one right solution; these situations require you to evaluate each alternative and select the best one.

ETHICS INSIGHT Dewey & LeBoeuf LLP

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**I Felt the Pressure—
Would You?**

"I felt the pressure." That's what some of the employees of the now-defunct law firm of **Dewey & LeBoeuf LLP** indicated when they helped to overstate revenue and use accounting tricks to hide losses and cover up cash shortages. These employees worked for the former finance director and former chief financial officer (CFO) of the firm. Here are some of their comments:

- "I was instructed by the CFO to create invoices, knowing they would not be sent to clients. When I created these invoices, I knew that it was inappropriate."

- "I intentionally gave the auditors incorrect information in the course of the audit."

What happened here is that a small group of lower-level employees over a period of years carried out the instructions of their bosses. Their bosses, however, seemed to have no concern as evidenced by various e-mails with one another in which they referred to their financial manipulations as accounting tricks, cooking the books, and fake income.

Source: Ashby Jones, "Guilty Pleas of Dewey Staff Detail the Alleged Fraud," *Wall Street Journal* (March 28, 2014).

Why did these employees lie, and what do you believe should be their penalty for these lies? (Go to WileyPLUS for this answer and additional questions.)

Insight boxes provide examples of business situations from various perspectives—ethics, investor, international, and corporate social responsibility. Guideline answers to the critical thinking questions are available in WileyPLUS and at www.wiley.com/college/wegandt. Additional questions are offered in WileyPLUS.

DO IT!**1****Business Organization Forms**

DO IT! exercises prompt you to stop and review the key points you have just studied. The Action Plan offers you tips about how to approach the problem.

Action Plan

- ✓ Know which organizational form best matches the business type, size, and preferences of the owner(s).

In choosing the organizational form for your outdoor guide service, you should consider the pros and cons of each. Identify each of the following organizational characteristics with the organizational form or forms with which it is associated.

1. Easier to raise funds.
2. Simple to establish.
3. No personal legal liability.
4. Tax advantages.
5. Easier to transfer ownership.

SOLUTION

1. Easier to raise funds: Corporation.
2. Simple to establish: Sole proprietorship and partnership.
3. No personal legal liability: Corporation.
4. Tax advantages: Sole proprietorship and partnership.
5. Easier to transfer ownership: Corporation.

Related exercise material: **BE1-1** and **DO IT! 1-1**.

**LEARNING
OBJECTIVE****2****Explain the three principal types of business activity.**

All businesses are involved in three types of activity—financing, investing, and operating. For example, Gert Boyle's parents, the founders of **Columbia Sportswear**, obtained cash through financing to start and grow their business. Some of

this **financing** came from personal savings, and some likely came from outside sources like banks. The family then **invested** the cash in equipment to run the business, such as sewing equipment and delivery vehicles. Once this equipment was in place, they could begin the **operating** activities of making and selling clothing.

The **accounting information system** keeps track of the results of each of the various business activities—financing, investing, and operating. Let’s look at each type of business activity in more detail.

FINANCING ACTIVITIES

It takes money to make money. The two primary sources of outside funds for corporations are borrowing money (debt financing) and issuing (selling) shares of stock in exchange for cash (equity financing).

Columbia Sportswear may borrow money in a variety of ways. For example, it can take out a loan at a bank or borrow directly from investors by issuing debt securities called bonds. Persons or entities to whom Columbia owes money are its **creditors**. Amounts owed to creditors—in the form of debt and other obligations—are called **liabilities**. Specific names are given to different types of liabilities, depending on their source. Columbia may have a **note payable** to a bank for the money borrowed to purchase delivery trucks. Debt securities sold to investors that must be repaid at a particular date some years in the future are **bonds payable**.

Corporations also obtain funds by selling shares of stock to investors. **Common stock** is the term used to describe the total amount paid in by stockholders for the shares they purchase.

The claims of creditors differ from those of stockholders. If you loan money to a company, you are one of its creditors. In lending money, you specify a payment schedule (e.g., payment at the end of three months). As a creditor, you have a legal right to be paid at the agreed time. In the event of nonpayment, you may legally force the company to sell property to pay its debts. In the case of financial difficulty, creditor claims must be paid before stockholders’ claims.

Stockholders, on the other hand, have no claim to corporate cash until the claims of creditors are satisfied. Suppose you buy a company’s stock instead of loaning it money. You have no legal right to expect any payments from your stock ownership until all of the company’s creditors are paid amounts currently due. However, many corporations make payments to stockholders on a regular basis as long as there is sufficient cash to cover required payments to creditors. These cash payments to stockholders are called **dividends**.

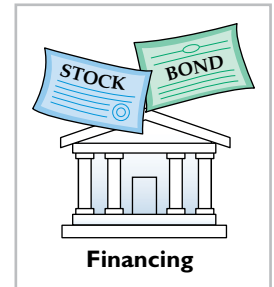
INVESTING ACTIVITIES

Once the company has raised cash through financing activities, it uses that cash in investing activities. Investing activities involve the purchase of the resources a company needs in order to operate. A growing company purchases many resources, such as computers, delivery trucks, furniture, and buildings. Resources owned by a business are called **assets**. Different types of assets are given different names. For example, Columbia Sportswear’s sewing equipment is a type of asset referred to as **property, plant, and equipment**.

Cash is one of the more important assets owned by Columbia or any other business. If a company has excess cash that it does not need for a while, it might choose to invest in securities (stocks or bonds) of other corporations. **Investments** are another example of an investing activity.

OPERATING ACTIVITIES

Once a business has the assets it needs to get started, it begins operations. Columbia Sportswear is in the business of selling outdoor clothing and footwear. It sells TurboDown jackets, Millenium snowboard pants, Sorel® snow boots,



ALTERNATIVE TERMINOLOGY
Property, plant, and equipment is sometimes called *fixed assets*.

