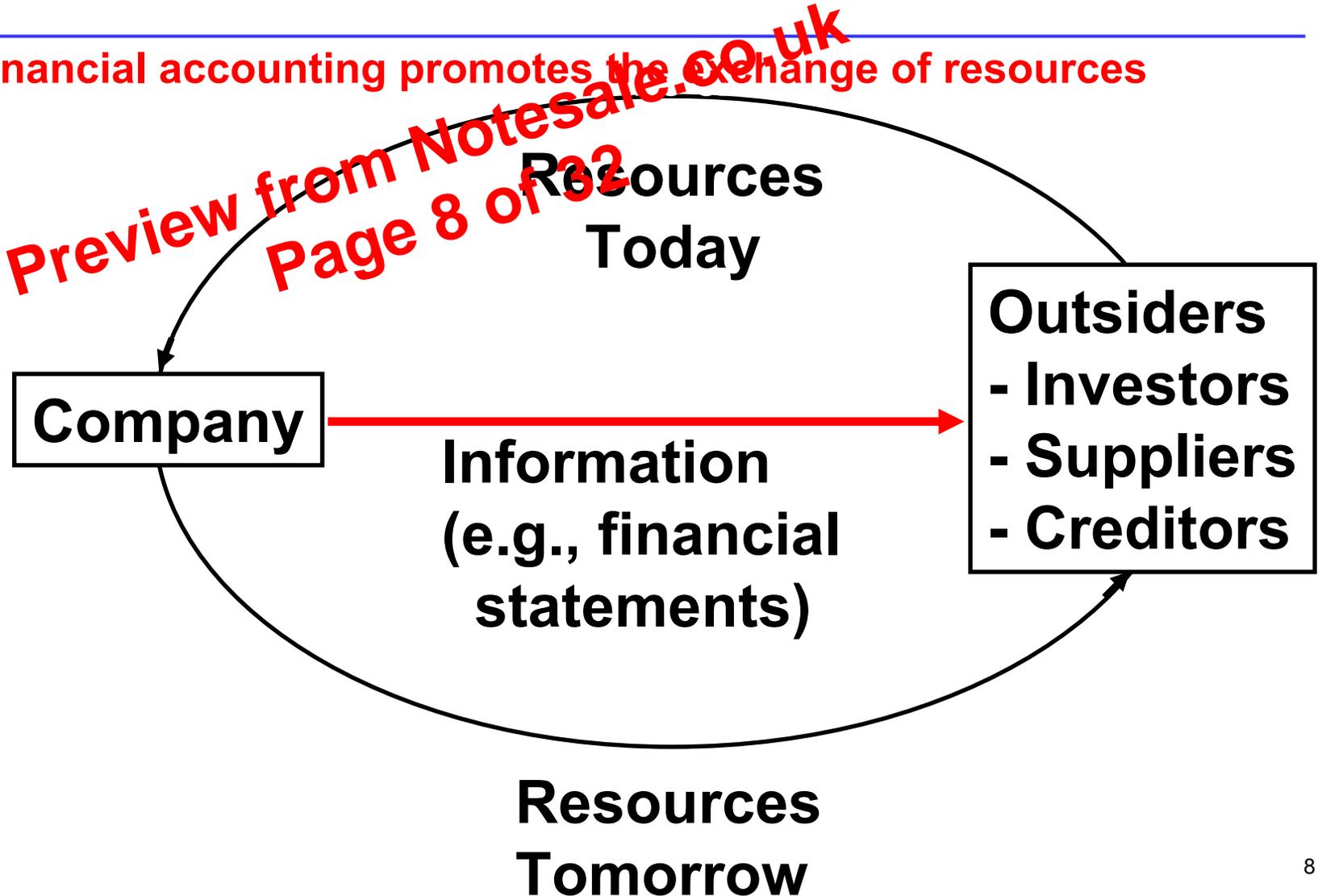


# Why do We Need Financial Accounting?

Financial accounting promotes the exchange of resources



# How important is this information?

## The Reaction of Wal-Mart Stock to Announcement of 3rd Quarter Earnings



# World of a Sophisticated Financial Statement User

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Events are occurrences that affect the firm.

Examples include:

- 1) Microsoft sued by the Justice Department
- 2) McDonald's sells hamburgers
- 3) United Airlines workers go on strike
- 4) The Gap announces a new marketing strategy for its Old Navy Clothing stores

# Understanding the genesis of the rules

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- Demand for independence: Accounting enters objective, verifiable information into accounting records
  - Information produced by managers alone is not believable. Outside investors demand independently audited financial information
  - In the process, accounting misses out on forward-looking information that might be valuable, but lacks objective evidence (e.g., research in progress)

# Financial Statements: Income Statement

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- Income statement measures the “performance” of a company over a period of time
- Revenues -- a measure of economic benefits generated by the sale of products or providing of services over a period of time
- Expenses -- a measure of economic sacrifices incurred to “earn” the revenues of a given period
- Examples of expenses -- cost of inventory sold, salaries to employees, rent and lighting, advertising, .....
- Net income = revenues (-) expenses