

**Week 3 DQ 1**  
**Due Tuesday, Day 2**

Post your answer to Problem 3.5 on p. 109 (Ch. 3). How might the information contained within the stockholder equity statement be used for management and investor decision-making? Provide specific examples of situations in which the stockholder equity information might be used.

The statement of stockholders' equity provides the changes in the equity accounts during the accounting period more in depth than the balance sheet. The information found on the statement of stockholders' equity includes retained earnings, common and preferred stock, and additional paid in capital. Management uses the statement of stockholders' equity to ensure they are reaching their goal of maximizing shareholder's equity. The use of market ratios help with the analysis of the statement of stockholders' equity, such as earnings per share, price-to-earnings, dividend payout, and dividend yield. These ratios will help both management and investors in analyzing the company. For example, if I were looking to invest in a company's stocks I would utilize all of the financial ratios, as well as the market ratios. The earnings per share ratio is calculated before the price to earnings ratio, P/E, because the earnings per share ratio is used in the second. If a company pays dividends, the dividend payout ratio will come in handy. It tells us "The percentage of [earnings](#) paid to shareholders in dividends" (Investopedia, 2010, p. 1).

#### References

Investopedia. (2010). *Dividend Payout Ratio*. Retrieved August 3, 2010, from  
Investopedia: <http://www.investopedia.com/terms/d/dividendpayoutratio.asp>

#### Response 2

**Explain what can be found on a statement of stockholders' equity.**

The major elements of stockholders' equity include capital stock, paid-in capital, retained earnings, treasury stock, unrealized loss on long-term investments, and foreign currency translation gains and losses.

**How might the information contained within the stockholder equity statement be used for management and investor decision-making? Provide specific examples of situations in which the stockholder equity information might be used.**

Management may look at the stockholder's equity statement retained earnings section to determine if company should borrow money for capital investments or finance it through various forms of equity. It may also be used by the stockholder to evaluate the compensation paid to the company officers. Investors may also look at the statement for cumulative net unrealized gains and losses before purchasing stock in the company. Investors are also interested in the paid in capital because they can compare it to the additional paid in capital and the difference between the two values will equal the premium paid by [investors](#) over and above the par value of the shares.

DQ 2

**Week 3 DQ 2**  
**Due Thursday, Day 4**

Provide an example from the text or the Internet that demonstrates a situation in which a company's net profits appeared good in the statements, but the gross or operating profits presented a different picture. Discuss how this might have occurred. Respond to the following question, addressed in Problem 3.6 on p. 109 (Ch. 3): "Why is the bottom-line figure, net income, not necessarily a good indicator of a firm's financial success?" Look for indicators like liquidity or solvency to answer this discussion question.

An example that demonstrates the situation is Enron. Enron's financial statements did not show all the expenses and costs. Instead of showing them on the income statement they made entries so the cost and expenses would post in the balance sheet. The same was done with the revenues. This way it would be less expenses and the net profit appeared good. Many debts and losses were not reported in the financial

statements. From the third quarter of 2000 through the third quarter of 2001, the directors fraudulently used reserve accounts within Enron Wholesale to mask the extent and volatility of its windfall trading profits, particularly its profits from the California energy markets; avoid reporting large losses in other areas of its business; and preserve the earnings for use in later quarters. By early 2001, Enron Wholesale's undisclosed reserve accounts contained over \$1 billion in earnings. The head of the company improperly used hundreds of millions of dollars of these reserves to ensure that analysts' expectations were met. In addition, Skilling and others improperly used the reserves to conceal hundreds of millions of dollars in losses within Enron's EES business unit from the investing public. This would show the creditors that Enron was making profits and its position was solid.

The net income is not necessarily a good indicator of a firm's financial success because the income statement only shows the profit or loss at a period of time and does not show the whole picture of the company. The Balance Sheet, Statement of cash flow, Statement of shareholders' equity and the Income Statement all together give the real picture of the business. Each one of them shows different aspects of the business. These statements show where the income is actually coming from; is it from sales or from loans the company is borrowing? If the company is selling a building or any other asset but that does not mean that it is selling more products and making profit. Looking at the Income Statements the company might be making profit but at the same time it is extremely leveraged.

#### Response 2

A company's net income is not the whole picture, just part of it. There are lots of things that contribute to the net income that may not be significant to the company's success. If the value of a dollar has a sudden change that can affect the bottom line if the company happens to hold the medium of exchange that can benefit by the change that might occur. The company can falsely inflate the bottom line. A company's net income is coupled with liabilities, cash flow, and selects financial ratios. Looking at it this way is a much better way of seeing what the company's success is like. A company can change up many things to make it look like their income is better. These things that can be changed are single sales events, cash infusion, or false financial statements. Some things like debt that a company has, the company's cash on hand, their capital assets conditions, or even their sales trends. To figure the success of the company, you must look at the whole picture. One thing cannot tell you all the facts of the company's affairs. You cannot tell the net income of the company just from the bottom line. Look at all the financial records.

#### Response 3