

Week 7 discussion question 2 retained earnings

[Finance](#)



Week 7 Discussion Question 2 “ Retained Earnings The items contained in the Retained Earnings section of a balance sheet are often complex and confusing. Suggest an improvement for the reporting on this information that will help the users of the statement to have a better understanding of the activity. Provide support for your suggestion.

The retained earnings section contains net income that a company would have otherwise distributed as dividend to its shareholders. Retained earnings are usually calculated from the following formulae. $\text{Retained earnings} = \text{net income} + \text{existing retained earnings} - (\text{dividend payment} + \text{net losses})$. Items contained in this section are usually complex to various audiences (Greiner, 2002). To prepare a balance sheet that serves its purpose, accountants should make orderly arrangement of items contained in the section according to people’s knowledge. For instance, entries in the section should correspond to easily identifiable items (Weygandt, Kimmel, & Kieso, 2010). Accountants should also refrain from using complex terminologies when creating entries for the section.

2. Evaluate what a cumulative loss in the retained earnings section of a company’s balance sheet might indicate about the financial performance in the future, indicating how this may influence decisions made about the company. Provide support for your answer.

The retained earnings section indicates a company’s success through a comparison of its income and expenses. Cumulative loss in the retained earning section indicates poor performance of the company (Greiner, 2002). This implies that the company is not creating sufficient net profit to cater for its losses. In addition cumulative losses also indicate postponed payments to the company’s creditors. This indicates that the company is operating on <https://assignbuster.com/week-7-discussion-question-2-retained-earnings/>

borrowed credit and, therefore at risk of bankruptcy.

References

Greiner, E. (2002). Evolution and revolution as organizations grow. *Harvard Business Review*. July-August, 37-47

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Weygandt, J., Kimmel, P. D., & Kieso, D. (2010). *Accounting Principles*. New York: John Wiley and Sons.