# **Chapter 1**

**The Financial Statements**

**Ethics Check**

**(5-10 min.) EC 1-1**

1. **Objectivity and independence**
2. **Due care**
3. **Integrity**
4. **Integrity**

**Short Exercises**

**(10 min.) S 1-1**

**a. *Corporation, limited partners of a Limited-liability partnership (LLP) and Limited-liability company (LLC).* If any of these businesses fails and cannot pay its liabilities, creditors cannot force the owners to pay the business’s debts from the owners’ personal assets. Creditors can go after the general partner of a limited liability partnership.**

**b. *Proprietorship*. There is a single owner of the business, so the owner is answerable to no other owner.**

**c. *Partnership*. If the partnership fails and cannot pay its liabilities, creditors can force the partners to pay the business’s debts from their personal assets. A partnership affords more protection for creditors than a proprietorship because there are two or more owners to share this liability.**

**(5 min.) S 1-2**

**1. The *entity assumption* applies.**

**2. Application of the entity assumption will separate Osmond’s personal assets from the assets of Simple Treats, Inc. This will help Osmond, investors, and lenders know how much assets, liabilities and equity the business has, and this knowledge will help all parties evaluate the business realistically.**

**(5-10 min.) S 1-3**

**a. Stable-monetary-unit assumption**

**b. Historical cost principle; $300 is the accounting value of the laptop**

**c. Historical cost principle; the sale price is the amount actually received from the sale**

**d. Entity assumption**

**(10 min.) S 1-4**

|  |
| --- |
| **Computed amounts in boxes** |
|  |  |  |  |  |  |
|  | **Total Assets** | **=** | **Total Liabilities** | **+** | **Stockholders’ Equity** |
|  |  |  |  |  |  |
| **a.** | **$660,000** | **=** | **$300,000** | **+** | **$360,000** |
|  |  |  |  |  |  |
| **b.** |  **85,000** | **=** |  **50,000** | **+** | **35,000** |
|  |  |  |  |  |  |
| **c.** | **350,000** | **=** |  **75,000** | **+** |  **275,000** |

 **(5 min.) S 1-5**

**1. Liabilities = Assets − Owners’ Equity**

**2. Owners’ Equity = Assets − Liabilities**

 **This way of determining the amount of owners’ equity applies to any company or your household.**

**(5-10 min.) S 1-6**

|  |  |  |  |
| --- | --- | --- | --- |
| **a.** | **Land A** | **g.** | **Retained earnings   S** |
|  |  |  |  |
| **b.** | **Accrued expenses payable L** | **h.** | **Prepaid expenses   A**  |
|  |  |  |  |
| **c.** | **Supplies A** | **i.** | **Accounts payable L**  |
|  |  |  |  |
| **d.** | **Equipment A** | **j.** | **Accounts receivable A** |
|  |  |  |  |
| **e.** | **Notes payable L** | **k.** | **Merchandise inventory A**  |
|  |  |  |  |
| **f.** | **Long-term debt L** | **l.** | **Common stock S**  |

**(5-10 min.) S 1-7**

**1. *Assets* are the *economic resources* of a business that are expected to produce a benefit in the future.**

 ***Owners’ (stockholders’) equity* represents the *insider claims* of a business, the owners’ interest in its assets.**

 **Assets and owners’ equity *differ* in that assets are *resources* and owners’ equity is a *claim to assets*.**

 **Assets must be at least as large as owners’ equity, so equity can be smaller than assets.**

**2. Both liabilities and owners’ (stockholders’) equity are *claims to assets*.**

 **Liabilities are the *outsider* claims to the assets of a business; they are obligations to pay creditors.**

**Owners’ equity represents the *insider* claims to the assets of the business; they are the owners’ interest in its assets.**

 **(5 min.) S 1-8**

**1. Revenues and expenses 2. Net income (or net loss)**

**(10 min.) S 1-9**

**a. Salary expense I**

**b. Dividends R, C**

**c. Accounts payable B**

**d. Net income I, R, C**

**e. Common stock B**

**f. Inventory B**

**g. Interest revenue I**

**h. Cash B, C**

**i. Retained earnings R, B**

**j. Long-term debt B**

**k. Increase or decrease in cash C**

**l. Net cash provided by operating activities C**

**m. Sales revenue I**

**n. Net cash used for financing activities C**

**(15-20 min.) S 1-10**

**a. *Paying large dividends* will cause retained earnings to be low.**

**b. Heavy *investing activity* and *paying off debts* can result in a cash shortage even if net income has been high.**

**c. The single best source of cash for a business is operating activities. This source of cash is best because it results from the core operations of the business. Operating activities should be the main source of cash for a business.**

1. **Borrowing, issuing stock, and selling land, buildings, and equipment can bring in cash even when the company has experienced losses. Reducing accounts receivable and inventory can also increase cash flow.**

**(5 min.) S 1-11**

**a. I f. I**

**b. B g. R**

**c. C h. C**

**d. R i. B**

**e. B**

 **(5 min.) S 1-12**

|  |  |
| --- | --- |
| **MacKensie Services, Inc.** |  |
| **Income Statement** |  |
| **Year Ended December 31, 2018** |  |
|  | ***(millions)*** |
| **Revenues**  | **$394** |
| **Expenses**  |  **171** |
| **Net income**  | **$223** |

**(5 min.) S 1-13**

|  |  |
| --- | --- |
| **Journey Corporation** |  |
| **Statement of Retained Earnings** |  |
| **Year Ended December 31, 2018** |  |
|  | (millions) |
| **Retained earnings, December 31, 2017**  | **$270** |
| **Add: Net income ($460 − $380)**  | **80** |
| **Less: Dividends declared**  |  **(64)** |
| **Retained earnings, December 31, 2018**  | **$286** |

 **(10-15 min.) S 1-14**

|  |
| --- |
| Jackson Corporation |
| **Balance Sheet** |
| **December 31, 2018** |
| **ASSETS** | ***(in millions)*** |
| **Current assets:** |  |
| **Cash**  | **$ 52** |
| **Accounts receivable**  |  **23** |
| **Total current assets**  | **75**  |
| **Long-term assets**  |  **45** |
|  |  |
| **Total assets**  | **$120** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 21** |
|  **Total current liabilities**  | **21** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **31** |
| **Total liabilities**  |  **52** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **28** |
| **Retained earnings**  |  **40** |
| **Total stockholders’ equity**  |  **68** |
|  |  |
| **Total liabilities and stockholders’ equity**  | **$120** |

**(10-15 min.) S 1-15**

|  |
| --- |
| Sullivan Corporation |
| **Balance Sheet** |
| **September 30, 2018** |
| **ASSETS** | ***(in millions)*** |
| **Current assets:** |  |
| **Cash**  | **$ 78** |
| **Accounts receivable**  |  **27** |
| **Total current assets**  | **105**  |
| **Property and equipment**  | **27** |
| **Other long-term assets**  |  **21** |
| **Total assets**  | **$153** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 34** |
|  **Total current liabilities**  | **34** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **17** |
| **Total liabilities**  |  **51** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **31** |
| **Retained earnings**  |  **71\*** |
| **Total stockholders’ equity**  |  **102** |
| **Total liabilities and stockholders’ equity**  | **$153** |

**\_\_\_\_\_**

**\*Computation of retained earnings: Total assets ($153) − total liabilities**

 **($51) − common stock ($31) = $71**

**Or, total stockholders’ equity ($102) – common stock ($31) = $71**

**(10-15 min.) S 1-16**

|  |
| --- |
| **Python Legal Services, Inc.** |
| **Statement of Cash Flows** |
| **Year Ended December 31, 2018** |
| **Cash flows from operating activities:** |  |
|  **Net income**  | **$115,000** |
|  **Adjustments to reconcile net income to net cash provided by operating activities**  |  **(9,000)** |
|  **Net cash provided by operating activities**  | **106,000** |
|  |  |
| **Cash flows from investing activities:** |  |
|  **Purchases of equipment**  |  **$(20,000)** |  |
|  **Net cash used for investing activities**  | **(20,000)** |
|  |  |
| **Cash flows from financing activities:** |  |
|  **Payment of dividends**  |  **$(15,000)** |  |
|  **Net cash used for financing activities**  |  **(15,000)** |
| **Net increase in cash**  | **71,000** |
| **Cash balance, December 31, 2017**  |  **16,000** |
| **Cash balance, December 31, 2018**  | **$ 87,000** |

**(10-15 min.) S 1-17**

**Solve in this order:**

1. **$82**
2. **$82**
3. **$149**

**f. $149**

**g. $182**

**h. $230**

**e. $230**

**d. $112**

 **(5 min.) S 1-18**

**Ethics is a factor that should be included in every business and accounting decision, beyond the potential economic and legal consequences. Ideally, for each decision, honesty and truthfulness should prevail, considering the rights of others. The decision guidelines at the end of the chapter spell out the considerations we should take when making decisions. Simply, we might ask ourselves three questions: (1) Is the action legal? (2) Who will be affected by the decision? (3) How will the decision make me feel afterward?**

**(10-15 min.) S 1-19**

**Asset (m) Economic resources that are**

 **expected to produce a benefit in the**

 **future**

**Balance sheet (l) Also called the statement of financial**

 **Position**

**Bookkeeping (k) Mechanical part of accounting**

**Corporation (f) Owned by stockholders whose liability is limited to the amount they have invested in the business**

**Equity (r) Insider claims of a business**

**Ethical duties (d) Responsibilities of the members of**

 **society to each other**

**Expenses (h) Costs of doing business**

**Financial accounting (b) Provides information for decision**

 **makers outside of the organization**

**Historical cost principle (j) States that assets should be**

 **recorded at their actual cost on the**

 **date of purchase**

**Income statement (o) Answers the question “How well did**

 **the company perform during the**

 **period?”**

**Investors and creditors (n) Entities that provide money to**

 **finance a company’s operations**

**Liability (g) A debt payable to an outsider**

**(continued) S 1-19**

**Managerial accounting (c) Provides information for managers of**

 **the organization**

**Net income (a) Total revenues minus total expenses**

**Partnership (q) A business organization form with**

**two or more owners who are each personally liable for all of the business’s debts**

**Proprietorship (i) A business organization form with a single owner who is personally liable for all of the business’s debts**

**Revenues (e) Inflows of resources resulting from delivering goods or services to customers**

**Statement of cash flows (p) Reports cash flows from operating, investing, and financing activities**

**Exercises**

**(10-15 min.) E 1-20A**

|  |
| --- |
| ***Amounts in billions; (computed amounts in boxes)*** |
|  |  |  |  |  | Stockholders’ |
|  | Assets | **=** | Liabilities | **+** | Equity |
| Smythe Real Estate | **$73** |  |  **$41** |  | **$32** |
| **Odessa Florals** | **26** |  | **11** |  | **15** |
| **Hometown Bank** | **29** |  | **14** |  | **15** |

Odessa Florals appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ($11/$26 = .42). Stated differently, Odessa Florals’ equity is the highest percentage of company assets ($15/$26 = .58).

Liabilities as a percent of total assets:

**Smythe Real Estate: $41/$73 = 0.56**

**Odessa Florals: $11/$26 = 0.42**

**Hometown Bank: $14/$29 = 0.48**

**(10-15 min.) E 1-21A**

### Req. 1

|  |
| --- |
|  ***(Amounts in millions)*** |
|  | Assets | **=** | Liabilities | **+** | Stockholders’ Equity |
|  | **$220** |  | **$160** |  |  |
|  |  **320** |  |  **380** |  |  |
|  |  **130** |  |  |  |  |
| **Total** | **$670** | **=** | **$540** | **+** | **$130** |
|  |  |  |  |  |  |
| ***Req. 2*** | **Resources****to work with** | ***Req. 3* Amount**  owed to  creditors |  ***Req. 4* Actually** **owned by company**  **stockholders** |

 **(10-20 min.) E 1-22A**

|  |  |
| --- | --- |
|  | **Situation** |
|  | **1** | **2** | **3** |
|  | ***(Millions)*** |
| **Total stockholders’ equity,** |  |  |  |
|  **January 31, 2018 ($47 − $19)**  |  **$28** | **$28** | **$28** |
| **Add: Issuances of stock**  |  **11** |  **-0-** | **15** |
|  **Net income**  | **13\*** |  **44\*** | **84\*** |
| **Less: Dividends declared**  |  **-0-** |  **(20)** | **(75)** |
|  **Net loss**  | **-0-** | **-0-** | **-0-** |
| **Total stockholders’ equity,** |  |  |  |
|  **January 31, 2019 ($77 − $25)**  |  **$52** |  **$52** | **$52** |

**\_\_\_\_\_**

**\*Must solve for these amounts.**

**(10-15 min.) E 1-23A**

**a. Income statement**

**b. Balance sheet**

**c. Balance sheet**

**d. Balance sheet**

**e. Statement of retained earnings, Statement of cash flows**

**f. Balance sheet, Statement of cash flows**

**g. Statement of cash flows**

**h. Statement of cash flows**

**i. Income statement**

**j. Balance sheet, Statement of retained earnings**

**k. Income statement**

**l. Balance sheet**

**m. Income statement, Statement of retained earnings, Statement of cash flows**

**n. Balance sheet**

**(10-20 min.) E 1-24A**

|  |
| --- |
| Landy Products |
| **Balance Sheet** |
| **December 31, 2018** |
| **ASSETS** |  |
| **Current assets:** |  |
|  **Cash**  | **$ 24,000** |
|  **Receivables**  | **18,000** |
|  **Inventory**  |  **80,000** |
|  **Total current assets**  | **122,000** |
| **Equipment**  |  **182,000** |
| **Total assets**  | **$304,000** |
|  |  |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 22,000** |
|  **Total current liabilities**  | **22,000** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **172,000** |
| **Total liabilities**  |  **194,000** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **34,500** |
| **Retained earnings**  |  **75,500\*** |
| **Total stockholders’ equity**  |  **110,000** |
| **Total liabilities and stockholders’ equity**  | **$304,000** |

**\_\_\_\_\_**

**\*Computation of retained earnings:**

 **Total assets ($304,000) − current liabilities ($22,000) − long-term notes payable ($172,000) − common stock ($34,500) = $75,500**

**(10-20 min.) E 1-25A**

***Req. 1***

|  |
| --- |
| **Jill Carlson Realty Company** |
| **Balance Sheet**  |
| January 31, 2018 |
| *(Amounts in millions)* |
| ASSETS | **LIABILITIES** |
| **Cash** | **$ 57.2** | **Current liabilities** |  **$ 2.9** |
| **Receivables** | **0.5** | **Long-term liabilities** |  **102.6** |
| **Investment assets (long-term)** | **79.4** | **Total liabilities** |  **105.5** |
| **Property and equipment, net** | **1.6** | STOCKHOLDERS’**EQUITY** |
| **Other assets (long-term)** | **9.3** |
|  |  | **Common stock** |  **39.2** |
|  | **Retained earnings** |  **3.3\*** |
|  | **Total stockholders’ equity** |  **42.5** |
| **Total assets** | **$148.0** | **Total liabilities and stockholders’ equity** | **$148.0** |
|  |  |  |  |

**\_\_\_\_\_**

\*Computation of retained earnings:

**Total assets ($148.0) − Total liabilities ($105.5) − Common stock ($39.2) = $3.3**

**(15-25 min.) E 1-26A**

***Req. 1***

|  |
| --- |
| **Jill Carlson Realty Company** |
| **Income Statement**  |
| **Year Ended January 31, 2018** |
| ***(Amounts in millions)*** |
|  |  |
| **Total revenue**  |  | **$25.7** |
| **Expenses:** |  |  |
|  **Salary and other employee expenses**  | **$13.7** |  |
|  **Other expenses**  | **7.6** |  |
|  **Interest expense**  |  **1.5** |  |
|  **Total expenses**  |  |  **22.8** |
| **Net income**  |  | **$2.9** |

***Req. 2***

**The statement of retained earnings helps to compute dividends, as follows:**

|  |
| --- |
| **Jill Carlson Realty Company** |
| **Statement of Retained Earnings**  |
| **Year Ended January 31, 2018** |
| ***(Amounts in millions)*** |
|  |  |
| **Retained earnings, beginning of year**  |  **$2.6** |
| **Add: Net income for the year (Req. 1)**  |  **2.9** |
| **Subtotal** |  **5.5** |
| **Less: Dividends declared\*\***  |  **2.2** |
| **Retained earnings, end of year (from Exercise 1-25A)**  |  **$3.3** |

**\*\*($5.5 – $3.3 = $2.2)**

**(15-20 min.) E 1-27A**

***Req. 1***

|  |
| --- |
| **Giada Coffee Roasters Corp.** |
| **Income Statement** |
| **For the Month Ended August 31, 2019** |
| **Revenue:** |  |  |
|  **Service revenue**  |  | **$278,700** |
| **Expenses:** |  |  |
|  **Salary expense**  |  **$78,500** |  |
|  **Utilities expense**  | **5,100** |  |
|  **Rent expense**  |  **1,800** |  |
|  **Total expenses**  |  |  **85,400**  |
| **Net income**  |  | **$193,300** |

|  |
| --- |
| **Giada Coffee Roasters Corp.** |
| **Statement of Retained Earnings** |
| **For the Month Ended August 31, 2019** |
| **Retained earnings, August 1, 2019**  |  **$ -0-**  |
| **Add: Net income for the month**  |  **193,300** |
| **Subtotal** |  **193,300**  |
| **Less: Dividends declared**  |  **(2,800)** |
| **Retained earnings, August 31, 2019**  |  **$190,500** |

**(15-20 min.) E 1-28A**

***Req. 1***

|  |
| --- |
| **Giada Coffee Roasters Corp.** |
| **Balance Sheet** |
| **August 31, 2019** |
| Assets | Liabilities |
| **Cash**  | **$ 5,300** | **Accounts payable**  | **$ 8,800** |
| **Office supplies**  | **7,400** |  |  |
| **Equipment**  | **201,500** | **Stockholders’ Equity** |
|  |  | **Common stock**  | **14,900** |
|  |  | **Retained earnings**  |  **190,500** |
|  |  | **Total stockholders’ equity** | **205,400** |
|  |  | **Total liabilities and**  |  |
| **Total assets**  | **$214,200** |  **stockholders’ equity**  | **$214,200** |

**(15-20 min.) E 1-29A**

***Req. 1***

|  |
| --- |
| **Giada Coffee Roasters Corp.** |
| **Statement of Cash Flows** |
| **For the Month Ended August 31, 2019** |
| **Cash flows from operating activities:** |  |  |
|  **Net income**  |  |  **$193,300** |
|  **Adjustments to reconcile net income to net** |  |  |
|  **cash provided by operating activities**  |  |  **1,400** |
|  **Net cash provided by operating activities**  |  |  **194,700** |
| **Cash flows from investing activities:** |  |  |
|  **Acquisition of equipment**  |  **$(201,500)** |  |
|  **Net cash used for investing activities**  |  | **(201,500)** |
| **Cash flows from financing activities:** |  |  |
|  **Issuance (sale) of stock to owners**  |  **$ 14,900** |  |
|  **Payment of dividends**  |  **(2,800)** |  |
|  **Net cash provided by financing activities**  |  |  **12,100** |
| **Net increase in cash**  |  |  **$ 5,300** |
| **Cash balance, August 1, 2019**  |  |  **0** |
| **Cash balance, August 31, 2019**  |  |  **$ 5,300** |

**(10-15 min.) E 1-30A**

**TO: Owner of Giada Coffee Roasters Corp.**

**FROM: Student Name**

**SUBJECT: Opinion of net income, dividends, financial position, and cash flows**

 **Your first month of operations was successful. Revenues totaled $278,700 and net income was $193,300. These operating results look very strong.**

 **The company was able to pay a $2,800 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of $214,200 and liabilities of only $8,800. Your stockholders’ equity is $205,400.**

 **Operating activities generated cash of $194,700, which is outstanding. Operating activities are the main source of cash, which is expected for a thriving company. You ended the month with cash of $5,300. Based on the above facts, I believe you should stay in business.**

**Student responses may vary.**

 **(20-25 min.) E 1-31A**

***Req. 1***

|  |
| --- |
| **Edwin Company** |
| **Income Statement** |
| **For the Year Ended December 31, 2018** |
| **Revenue:** |  | ***(millions)*** |
|  **Revenues**  |  | **$150** |
| **Expenses:** |  |  |
|  **Salary expense**  |  **$34** |  |
|  **Rent expense**  | **23** |  |
|  **Utilities expense**  |  **16** |  |
|  **Total expenses**  |  |  **73**  |
| **Net income**  |  | **$ 77** |

***Req. 2***

|  |  |
| --- | --- |
| **Edwin Company** |  |
| **Statement of Retained Earnings** |  |
| **Year Ended December 31, 2018** |  |
|  | (millions) |
| **Retained earnings, December 31, 2017**  | **$ 73** |
| **Add: Net income ($150 − $73)**  |  **77** |
| **Less: Dividends declared**  |  **(16)** |
| **Retained earnings, December 31, 2018**  | **$134** |

 **(continued) E 1-31A**

***Req. 3***

|  |
| --- |
| Edwin Company |
| **Balance Sheet** |
| **December 31, 2018** |
| **ASSETS** | ***(in millions)*** |
| **Current assets:** |  |
| **Cash**  | **$185** |
| **Accounts receivable**  |  **70** |
| **Total current assets**  | **255**  |
| **Property and equipment**  | **35** |
| **Other long-term assets**  |  **22** |
| **Total assets**  | **$312** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 56** |
|  **Total current liabilities**  | **56** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **26** |
| **Total liabilities**  |  **82** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **96\*** |
| **Retained earnings**  |  **134** |
| **Total stockholders’ equity**  |  **230** |
| **Total liabilities and stockholders’ equity**  | **$312** |

\***Common stock = Total stockholders’ equity ($230) – Retained earnings ($134) = $96**

**(10-15 min.) E 1-32B**

|  |
| --- |
| *Amounts in billions; (computed amounts in boxes)* |
|  |  |  |  |  | Stockholders’ |
|  | Assets | **=** | Liabilities | **+** | Equity |
| Water Street Bank | **$78** |  | **$43** |  | **$35** |
| **Pufferbelly Restaurant** | **30** |  | **7** |  | **23** |
| **Blake Gift Shop** | **34** |  | **7** |  | **27** |

Blake Gift Shop appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ($7/$34 = .21). Stated differently, Blake Gift Shop’s equity is the highest percentage of company assets ($27/$34 = .79).

Liabilities as a percent of total assets:

Waterstreet Bank: $43/$78 = 0.55

Pufferbelly Restaurant: $7/$30 = 0.23

Blake Gift Shop: $7/$34 = 0.21

**(10-15 min.) E 1-33B**

### Req. 1

|  |
| --- |
|  ***(Amounts in millions)*** |
|  | Assets | **=** | Liabilities | **+** | Stockholders’ Equity |
|  | **$240** |  | **$100** |  |  |
|  |  **390** |  |  **360** |  |  |
|  |  **130** |  |  |  |  |
| **Total** | **$760** | **=** | **$460** | **+** | **$300** |
|  |  |  |  |  |  |
| ***Req. 2*** | **Resources****to work with** | ***Req. 3* Amount**  owed to  creditors |  ***Req. 4* Actually** **owned by company**  **stockholders** |

**(10-20 min.) E 1-34B**

|  |  |
| --- | --- |
|  | **Situation** |
|  | **1** | **2** | **3** |
|  | ***Millions*** |
| **Total stockholders’ equity,** |  |  |  |
|  **January 31, 2018 ($49 − $17)**  | **$32** | **$32** | **$32** |
| **Add: Issuances of stock**  | **3** | **-0-** | **20** |
|  **Net income**  | **14\*** | **21\*** | **5\*** |
| **Less: Dividends declared**  | **-0-** |  **(4)** |  **(8)** |
|  **Net loss**  | **-0-** | **-0-** | **-0-** |
| **Total stockholders’ equity,** |  |  |  |
|  **January 31, 2019 ($72 − $23)**  | **$49** | **$49** | **$49** |

**\_\_\_\_\_**

**\*Must solve for these amounts.**

**(10-15 min.) E 1-35B**

**a. Balance sheet, Statement of cash flows**

**b. Statement of cash flows**

**c. Balance sheet**

**d. Balance sheet**

**e. Income statement, Statement of retained earnings, Statement of cash flows**

**f. Income statement**

**g. Balance sheet**

**h. Income statement**

**i. Balance sheet**

**j. Statement of cash flows**

**k. Income statement**

**l. Balance sheet**

**m. Statement of retained earnings, Statement of cash flows**

**n. Balance sheet, Statement of retained earnings**

**(10-20 min.) E 1-36B**

|  |
| --- |
| Patterson Products |
| **Balance Sheet** |
| **December 31, 2018** |
| **ASSETS** |  |
| **Current assets:** |  |
|  **Cash**  | **$ 20,000** |
|  **Receivables**  | **17,600** |
|  **Inventory**  |  **78,000** |
|  **Total current assets**  | **115,600** |
| **Equipment**  |  **186,000** |
| **Total assets**  | **$301,600** |
|  |  |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 22,000** |
|  **Total current liabilities**  | **22,000** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **173,000** |
| **Total liabilities**  |  **195,000** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **28,500** |
| **Retained earnings**  |  **78,100\*** |
| **Total stockholders’ equity**  |  **106,600** |
| **Total liabilities and stockholders’ equity**  | **$301,600** |

**\_\_\_\_\_**

**\*Computation of retained earnings:**

 **Total assets ($301,600) − current liabilities ($22,000) − long-term notes payable ($173,000) − common stock ($28,500) = $78,100**

**(10-20 min.) E 1-37B**

***Req. 1***

|  |
| --- |
| **Mary Burke Realty Company** |
| **Balance Sheet**  |
| March 31, 2018 |
| *(Amounts in millions)* |
| ASSETS | **LIABILITIES** |
| **Cash** | **$ 1.6** | **Current liabilities** | **$ 2.7** |
| **Receivables** | **.1** | **Long-term liabilities** |  **102.3** |
| **Investment assets****Property and**  **equipment, net**  | **135.1****1.4** | **Total liabilities**  **STOCKHOLDERS’** | **105.0** |
| **Other assets** | **10.3** | EQUITY |
| Common stock 27.9 |
|  |  | **Retained earnings** |  **15.6\*** |
|  |  | **Total stockholders’ equity** |  **43.5** |
|  | **\_\_\_\_\_\_** | **Total liabilities and** |  |
| **Total assets** | **$148.5** |  **stockholders’ equity** | **$148.5** |

**\_\_\_\_\_**

\*Computation of retained earnings:

**Total assets ($148.5) − Total liabilities ($105.0) − Common stock ($27.9) = $15.6**

**(15-25 min.) E 1-38B**

***Req. 1***

|  |
| --- |
| **Mary Burke Realty Company** |
| **Income Statement**  |
| **Year Ended March 31, 2018** |
| ***(Amounts in millions)*** |  |
| **Total revenue**  |  | **$40.4** |
| **Expenses:** |  |  |
|  **Salary and other employee expenses**  | **$ 15.2** |  |
|  **Other expenses**  | **6.6** |  |
|  **Interest expense**  |  **0.4** |  |
|  **Total expenses**  |  |  **22.2** |
| **Net income**  |  | **$18.2** |

***Req. 2***

**The statement of retained earnings helps to compute dividends, as follows:**

|  |
| --- |
|  **Mary Burke Realty Company** |
| **Statement of Retained Earnings****Year Ended March 31, 2018**  |
| **(*Amounts in millions*)** |  |
| **Retained earnings, beginning of year………………………..** | **$17.2** |
| **Add: Net income for the year (*Req. 1*)………………………..** |  **18.2** |
| **Subtotal** | **35.4** |
| **Less: Dividends declared\*\*…………………………………….** |  **19.8** |
| **Retained earnings, end of year (from Exercise 1-37B)……** | **$15.6** |

 **\*\*($35.4 – $15.6 = $19.8)**

 **(15-20 min.) E 1-39B**

***Req. 1***

|  |
| --- |
|  **Island Coffee Roasters Corporation** |
| **Income Statement** |
| **For the Month Ended August 31, 2019** |
| **Revenue:** |  |  |
|  **Service revenue ………………………...** |  | **$279,300** |
| **Expenses:** |  |  |
|  **Salary expense ………………………….**  | **$78,100** |  |
|  **Utilities expense ………………………..**  | **5,800** |  |
|  **Rent expense ……………………………**  |  **1,800** |  |
|  **Total expenses ………………………….**  |  |  **85,700**  |
| **Net income ……………………………………...**  |  | **$193,600** |

|  |
| --- |
| **Island Coffee Roasters Corporation** |
| **Statement of Retained Earnings** |
| **For the Month Ended August 31, 2019** |
| **Retained earnings, August 1, 2019**  |  **$ -0-** |
| **Add: Net income**  |  **193,600** |
| **Subtotal** |  **193,600** |
| **Less: Dividends declared**  |  **(2,700)** |
| **Retained earnings, August 31, 2019**  |  **$190,900** |

**(15-20 min.) E 1-40B**

***Req. 1***

|  |
| --- |
| **Island Coffee Roasters Corporation** |
| **Balance Sheet** |
| **August 31, 2019** |
| Assets | Liabilities |
| **Cash**  | **$ 6,000** | **Accounts payable**  | **$ 8,900** |
| **Office supplies**  | **7,500** | **Stockholders’ Equity** |
| **Equipment**  | **200,000** | **Common stock**  | **13,700** |
|  |  | **Retained earnings**  |  **190,900** |
|  |  | **Total stockholders’ equity**  | **204,600** |
| **Total assets**  | **$213,500** | **Total liabilities and**  **stockholders’ equity**  | **$213,500** |

**(15-20 min.) E 1-41B**

***Req. 1***

|  |
| --- |
| **Island Coffee Roasters Corporation** |
| **Statement of Cash Flows** |
| **For the Month Ended August 31, 2019** |
| **Cash flows from operating activities:****Net income**  |  | **$193,600** |
| **Adjustments to reconcile net income to net cash provided by operations**  |  |  **1,400** |
|  **Net cash provided by operating activities** |  |  **195,000** |
| **Cash flows from investing activities:** |  |  |
|  **Acquisition of equipment**  |  **$(200,000)** |  |
|  **Net cash used for investing activities**  |  |  **(200,000)** |
| **Cash flows from financing activities:** |  |  |
|  **Issuance (sale) of stock to owners**  |  **$ 13,700** |  |
|  **Payment of dividends**  |  **(2,700)** |  |
|  **Net cash provided by financing activities..** |  |  **11,000** |
| **Net increase in cash**  |  | **$ 6,000** |
| **Cash balance, August 1, 2019**  |  |  **0** |
| **Cash balance, August 31, 2019**  |  |  **$ 6,000** |

**(10-20 min.) E 1-42B**

**TO: Owner of Island Coffee Roasters Corporation**

**FROM: Student Name**

**SUBJECT: Opinion of net income, dividends, financial position, and cash flows**

 **Your first month of operations was successful. Revenues totaled $279,300 and net income was $193,600. These operating results look very strong.**

 **The company was able to pay a $2,700 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of $213,500 and liabilities of only $8,900. Your stockholders’ equity is $204,600.**

 **Operating activities generated cash of $195,000, which is respectable. Operating activities are the main source of cash, which is expected for a thriving company. You ended the month with cash of $6,000. Based on the above facts, I believe you should stay in business.**

**Student responses may vary.**

**(20-25 min.) E 1-43B**

***Req. 1***

|  |
| --- |
| **Brewster Company** |
| **Income Statement** |
| **For the Year Ended December 31, 2018** |
| **Revenue:** |  | ***(millions)*** |
|  **Revenues**  |  | **$146** |
| **Expenses:** |  |  |
|  **Salary expense**  |  **$28** |  |
|  **Rent expense**  | **23** |  |
|  **Utilities expense**  |  **19** |  |
|  **Total expenses**  |  |  **70**  |
| **Net income**  |  |  **$76** |

***Req. 2***

|  |  |
| --- | --- |
| **Brewster Company** |  |
| **Statement of Retained Earnings** |  |
| **Year Ended December 31, 2018** |  |
|  | (millions) |
| **Retained earnings, December 31, 2017**  | **$ 76** |
| **Add: Net income ($146 − $70)**  |  **76** |
| **Less: Dividends declared**  |  **(15)** |
| **Retained earnings, December 31, 2018**  |  **$137** |

 **(continued) E 1-43B**

***Req. 3***

|  |
| --- |
| Brewster Company |
| **Balance Sheet** |
| **December 31, 2018** |
| **ASSETS** | ***(in millions)*** |
| **Current assets:** |  |
| **Cash**  | **$175** |
| **Accounts receivable**  |  **85** |
| **Total current assets**  | **260**  |
| **Property and equipment**  | **39** |
| **Other long-term assets**  |  **25** |
|  |  |
| **Total assets**  | **$324** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 56** |
|  **Total current liabilities**  | **56** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **33** |
| **Total liabilities**  |  **89** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **98\*** |
| **Retained earnings**  |  **137** |
| **Total stockholders’ equity**  |  **235** |
|  |  |
| **Total liabilities and stockholders’ equity**  | **$324** |

\***Common stock = Total stockholders’ equity ($235) – Retained earnings ($137) = $98**

**Quiz**

|  |  |
| --- | --- |
| **Q1-44** | **a** |
| **Q1-45** | **a** |
| **Q1-46** | **b** |
| **Q1-47** | **b** |
| **Q1-48** | **b** |
| **Q1-49** | **a** |  **Stockholders’** |  |
|  |  |  **Assets = Liabilities + Equity** |  |
|  |  | **+ $83,000 = + $23,000 + + $60,000** |  |
| **Q1-50** | **a** |
| **Q1-51** | **b** |
| **Q1-52** | **b** |
| **Q1-53** | **a** |
| **Q1-54** | **d**  |
| **Q1-55** | **c [$260,000 − $185,000 − $81,000 − $28,000 = $(34,000)]** |
| **Q1-56** | **b ($300,000 + $200,000 − $55,000 = $445,000)** |
| **Q1-57** | **d** |
| **Q1-58** | **c** |
| **Q1-59** | **c** |  |  |  |  |  | **Stockholders’** |  |
|  |  |  | **Assets** | **=** | **Liabilities** | **+** | **Equity** |  |
|  |  | **Beg.** | **$149,000**  | **=** | **$27,000\*** | **+** | **$122,000** |  |
|  |  | **Changes** |  |  | **+ 69,000** |  |  |  |
|  |  | **End.** | **$236,000\*** | **=** | **$96,000\*** | **+** | **$140,000** |  |
|  |  | **\_\_\_\_\_** |  |  |  |  |  |  |
|  |  | **\*Must solve for these amounts.** |  |
|  |  | **Quiz (continued)** |
| **Q1-60** | **b** |  **Assets − Liabilities = Stockholders’ equity** |
|  |  |  **Beg. bal.** | **$350,000 − $23,000 =**  | **$327,000** |  |
|  |  | **+ Net income** |  | **+ X** |  |
|  |  | **− Dividends** |  | **− 75,000** |  |
|  |  |  **End. bal.** | **$530,000 − $36,000 =**  | **$494,000** |  |

**$327,000 + X – $75,000 = $494,000; X = $242,000**

|  |  |
| --- | --- |
| **Q1-61** | **d**  |

**Problems**

 **(30 min.) P 1-62A**

**Computed amounts in boxes.**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Kennedy** **Corp.** | **Caring****Co.** | **Childress,****Inc.** |
| **BALANCE SHEET** |  |  ***(Millions)*** |  |
| ***Beginning*:** |  |  |  |
|  **Assets**  | **$76** | **$30** | **$17** |
|  **Liabilities**  | **51** | **21** | **1** |
|  **Common stock**  | **7** | **7** | **6** |
|  **Retained earnings**  | **18** | **2** | **10** |
|  |  |  |  |
| ***Ending*:** |  |  |  |
|  **Assets**  | **$86** | **$48** | **$20** |
|  **Liabilities**  | **53** | **32** | **0** |
|  **Common stock**  | **7** | **12** | **8** |
|  **Retained earnings**  | **26** | **4** | **12** |
|  |  |  |  |
| **INCOME STATEMENT** |  |  |  |
|  **Revenues**  | **$227** | **$165** | **$22** |
|  **Expenses**  |  **218** | **157** |  **18** |
|  **Net income**  | **$ 9** | **$ 8** | **$ 4** |
|  |  |  |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |
|  **Beginning RE**  | **$18** | **$ 2** | **$ 10** |
|  **+ Net income**  | **9** | **8** | **4** |
|  **− Dividends declared**  |  **(1)** |  **(6)** |  **(2)** |
|  **= Ending RE**  | **$26** | **$ 4** | **$ 12** |

**(continued) P 1-62A**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **Kennedy Corp.** |  | **Caring Co.** |  | **Childress, Inc.** |
|  |  |  |  | ***Millions*** |  |  |
| **Net income**  |  | **$9** |  | **$8** |  | **$4** |
|  |  |  |  | ***Highest*** |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| **% of net income** |  | **$9** | **= 4.0%** |  | **$8** | **= 4.8%** |  | **$4** | **= 18.2%** |
|  **to revenues**  |  | **$227** |  | **$165** |  | **$22** |
|  |  |  |  |  |  | ***Highest*** |

**(20-25 min.) P 1-63A**

***Req. 1***

|  |
| --- |
| **City News, Inc.** |
| **Balance Sheet** |
| **May 31, 2018** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 10,000** | **Accounts payable** | **$ 6,500** |
| **Accounts receivable** | **2,600** | **Note payable** |  **50,000** |
| **Notes receivable** | **15,800** | **Total liabilities** | **56,500** |
| **Office supplies** | **700** | **STOCKHOLDERS’** |
| **Land** | **81,000** | **EQUITY** |
| **Equipment** | **35,600** | **Stockholders’ equity** | **89,200\*** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$145,700** |  **stockholders’ equity** |  **$145,700** |

**\_\_\_\_\_**

**\*Total assets ($145,700) − Total liabilities ($56,500) = Stockholders’ equity ($89,200).**

***Req. 2***

**City News, Inc. is in *better (not worse)* financial position than the erroneous balance sheet reports. Total assets ($145,700) are $7,800 higher than originally reported ($137,900), liabilities are $14,700 lower than originally reported, and stockholders’ equity is $22,500 higher than reported originally.**

***Req. 3***

**The following accounts are not reported on the balance sheet because they are expenses. These accounts are reported on the *income statement*.**

 **Utilities expense**

 **Advertising expense**

 **Salary expense**

 **Interest expense**

**(20-25 min.) P 1-64A**

***Req. 1***

|  |
| --- |
| **Brandon Hilton Realtor, Inc.** |
| **Balance Sheet** |
| **June 30, 2019** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 55,000** | **Accounts payable** |  **$ 16,000** |
| **Office supplies** | **8,000** | **Note payable** |  **112,000** |
| **Land** | **165,000** | **Total liabilities** |  **128,000** |
| **Furniture** | **30,000** | **STOCKHOLDERS’** |
| **Franchise** | **20,000** | **EQUITY** |
|  |  | **Common stock** |  **65,000** |
|  |  | **Retained earnings** |  **85,000\*** |
|  |  | **Total stockholders’ equity** |  **150,000** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$278,000** |  **stockholders’ equity** | **$278,000** |

**\_\_\_\_\_**

**\*Total assets ($278,000) − Total liabilities ($128,000) − Common stock ($65,000) = Retained earnings ($85,000).**

***Req. 2***

**It appears that the business can pay its debts. Total assets exceed total liabilities.**

***Req. 3***

**Personal items not reported on the *balance sheet* of the business:**

 **a. Personal cash ($15,000)**

 **b. Personal account payable ($3,400)**

 **g. Personal residence ($334,000) and mortgage payable ($182,000)**

**(30-45 min.) P 1-65A**

***Req. 1***

|  |
| --- |
| **Oak Hill Garden Supply, Inc.** |
| **Income Statement** |
| **Year Ended December 31, 2018** |
| **Revenue** |  |  |
|  **Service revenue**  |  | **$452,600** |
| **Expenses** |  |  |
|  **Salary expense**  | **$108,400** |  |
|  **Rent expense**  **Interest expense**  **Utilities expense**  | **41,200****10,300****8,800** |  |
|  **Property tax expense**  |  **7,400** |  |
|  **Total expenses**  |  |  **176,100** |
| **Net income**  |  | **$276,500** |
|  |  |  |

***Req. 2***

|  |
| --- |
| **Oak Hill Garden Supply, Inc.** |
| **Statement of Retained Earnings** |
| **Year Ended December 31, 2018** |
| **Retained earnings, December 31, 2017**  |  **$ 364,600** |
| **Add: Net income**  |  **276,500** |
| **Subtotal** |  **641,100** |
| **Less: Dividends declared**  |  **(107,000)** |
| **Retained earnings, December 31, 2018**  |  **$ 534,100** |

### (continued) P 1-65A

### Req. 3

|  |
| --- |
| **Oak Hill Garden Supply, Inc.** |
| **Balance Sheet** |
| **December 31, 2018** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 44,000** | **Accounts payable** | **$ 26,000** |
| **Accounts receivable** | **84,900** | **Interest payable**  |  **2,700** |
| **Supplies** | **6,300** | **Note payable** |  **99,600** |
| **Land** | **25,000** | **Total liabilities** |  **128,300** |
| **Building** | **406,000** | **STOCKHOLDERS’** |
| **Equipment** | **110,000** | **EQUITY** |
|  |  | **Common stock** | **13,800** |
|  |  | **Retained earnings** |  **534,100** |
|  |  | **Total stockholders’ equity** |  **547,900**  |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$676,200** |  **stockholders’ equity** | **$676,200** |

***Req. 4***

**a. Oak Hill Garden Supply was profitable; net income was $276,500.**

**b. Retained earnings increased by $169,500 — from $364,600 to $534,100.**

**c. Stockholders’ equity ($547,900) exceeds liabilities ($128,300).**

**The stockholders have a greater claim against Oak Hill Garden Supply’s assets than do the company’s creditors.**

**(20 min.) P 1-66A**

***Req. 1***

|  |
| --- |
| **Mitchell Company** |
| **Statement of Cash Flows** |
| **Year Ended March 31, 2019** |
|  | ***Millions*** |
| **Cash flows from operating activities:** |  |  |
|  **Net income**  |  | **$ 3,020** |
|  **Adjustments to reconcile net income to net cash** |  |  |
|  **provided by operating activities**  |  |  **2,420** |
|  **Net cash provided by operating activities**  |  |  **5,440** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
|  **Purchases of property, plant, and equipment**  | **$(2,640)** |  |
|  **Sales of property, plant, and equipment**  |  **25** |  |
|  **Other investing cash payments**  |  **(195)** |  |
|  **Net cash used for investing activities**  |  |  **(2,810)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
|  **Issuance of common stock**  |  **$ 190** |  |
|  **Payment of dividends**  |  **(265)** |  |
|  **Net cash used for financing activities**  |  |  **(75)** |
|  |  |  |
| **Net increase in cash**  |  | **$ 2,555** |
| **Cash, beginning**  |  |  **220** |
| **Cash, ending**  |  | **$ 2,775** |

***Req. 2***

**Operating activities provided the largest amount of cash. This signals financial strength because operations should be the main source of cash.**

 **(40-50 min.) P 1-67A**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **INCOME STATEMENT** |  |  | **2019** | **2018** |  |  |
| **Revenues**  | **13,920** | **=** | **$ k** | **$14,750** |  |  |
| **Cost of goods sold**  |  |  | **(11,100)** |  **a** | **=** | **(11,680)** |
| **Other expenses**  |  |  |  **(1,300)** |  **(1,200)** |  |  |
| **Income before income taxes**  |  |  |  **1,520** | **1,870** |  |  |
| **Income taxes (35% tax rate)**  | **532** | **=** |  **l** |  **(655)** |  |  |
| **Net income**  | **988** | **=** | **$ m** | **$ b** | **=** | **1,215** |
|  |  |  |  |  |  |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |  |  |  |
| **Beginning balance**  | **3,825** | **=** | **$ n** | **$ 2,680** |  |  |
| **Net income**  | **988** | **=** |  **o** |  **c** | **=** | **1,215** |
| **Dividends declared**  |  |  |  **(92)** |  **(70)** |  |  |
| **Ending balance**  | **4,721** | **=** | **$ p** | **$ d** | **=** | **3,825** |
|  |  |  |  |  |  |  |
| **BALANCE SHEET** |  |  |  |  |  |  |
| **Assets:** |  |  |  |  |  |  |
|  **Cash**  | **1,020** | **=** | **$ q** | **$ e** | **=** | **1,180** |
|  **Property, plant and equipment**  |  |  | **1,547** |  **1,316** |  |  |
|  **Other assets**  | **11,959** | **=** |  **r** |  **11,104** |  |  |
|  **Total assets**  | **14,526** | **=** | **$ s** | **$13,600** |  |  |
| **Liabilities:** |  |  |  |  |  |  |
|  **Current liabilities**  | **4,815** | **=** | **$ t** | **$ 5,660** |  |  |
|  **Long-term debt**  **Other liabilities**  |  |  |  **4,350** **35** |  **3,370** **180** |  |  |
|  **Total liabilities**  |  |  | **9,200** |  **f** | **=** | **9,210** |
|  |  |  |  |  |  |  |
| **Stockholders’ Equity:** |  |  |  |  |  |  |
|  **Common stock**  |  |  | **$ 425** | **$ 425** |  |  |
|  **Retained earnings**  | **4,721** | **=** |  **u** |  **g** | **=** | **3,825** |
|  **Other stockholders’ equity**  |  |  |  **180** |  **140** |  |  |
|  **Total stockholders’ equity**  | **5,326** | **=** |  **v** |  **4,390** |  |  |
|  **Total liabilities and stockholders’ equity**  | **14,526** | **=** | **$ w** | **$ h** | **=** | **13,600** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CASH FLOWS**  |  |  |  |  |  |  |
|  **Net cash provided by operating activities**  | **630** | **=** | **$ x** |  **$ 875** |  |  |
|  **Net cash used for investing activities**  |  |  | **(270)** | **(425)** |  |  |
|  **Net cash used for financing activities**  |  |  |  **(520)** |  **(520)** |  |  |
|  **Increase (decrease) in cash**  |  |  |  **(160)** |  **i** | **=** |  **(70)** |
|  **Cash at beginning of year**  | **1,180** | **=** |  **y** |  **1,250** |  |  |
|  **Cash at end of year**  | **1,020** | **=** | **$ z** | **$ j** | **=** | **1,180** |

**(30 min.) P 1-68B**

**Computed amounts in boxes**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  **Babble** **Co.** | **Floralties,** **Inc.** | **Drake** **Co.** |
|  |  ***Millions***  |
| **Balance Sheet** |  |  |  |
| ***Beginning*:** |  |  |  |
|  **Assets**  | **$ 79** | **$ 35** | **$ 13** |
|  **Liabilities**  | **51** | **15** | **5** |
|  **Common stock**  | **1** | **5** | **2** |
|  **Retained earnings**  | **27** | **15** | **6** |
|  |  |  |  |
| ***Ending:*** |  |  |  |
|  **Assets**  | **$ 88** | **$ 53** | **$ 15** |
|  **Liabilities**  | **52** | **27** | **4** |
|  **Common stock**  | **1** | **12** | **5** |
|  **Retained earnings**  | **35** | **14** |  **6** |
|  |  |  |  |
| **INCOME STATEMENT** |  |  |  |
|  **Revenues**  | **$227** | **$163** | **$ 27** |
|  **Expenses**  |  **218** |  **153** |  **23** |
|  **Net income**  | **$ 9** | **$ 10** | **$ 4** |
|  |  |  |  |
| **STMT. OF RETAINED EARNINGS** |  |  |  |
|  **Beginning RE**  | **$ 27** | **$ 15** | **$ 6** |
|  **+ Net income**  | **9** | **10** | **4** |
|  **− Dividends declared**  |  **(1)** |  **(11)** |  **(4)** |
|  **= Ending RE**  | **$ 35** | **$ 14** | **$ 6** |

**(continued) P 1-68B**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Babble Co.** | **Floralties, Inc.** | **Drake Co.** |
|  |  | ***Millions*** |  |
|  |  |  |  |
| **Net income**  | **$9** | **$10** | **$4** |
|  |  | ***Highest*** |  |
|  |  |  |  |
| **% of net income** | **$9** | **= 4.0%** | **$10** | **= 6.1%** | **$4** | **= 14.8%** |
|  **to revenues**  | **$227** | **$163** | **$27** |
|  |  |  | ***Highest*** |

**(20-25 min.) P 1-69B**

***Req. 1***

|  |
| --- |
| **Parker Design, Inc.** |
| **Balance Sheet** |
| **March 31, 2018** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 8,000** | **Accounts payable** | **$ 3,500** |
| **Accounts receivable** | **3,900** | **Note payable** |  **53,000** |
| **Notes receivable** | **13,000** | **Total liabilities** |  **56,500** |
| **Office supplies** | **1,400** | **STOCKHOLDERS’** |
| **Land** | **86,000** | **EQUITY** |
| **Equipment**  | **39,000** | **Stockholders’ equity** |  **94,800\*** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$151,300** |  **stockholders’ equity**  |  **$151,300** |

**\_\_\_\_\_**

**\*Total assets ($151,300) − Total liabilities ($56,500) = Stockholders’ equity ($94,800).**

***Req. 2***

**Parker Design, Inc. is in a *better* financial position than the erroneous balance sheet reports. Assets are $9,800 greater and liabilities are $16,300 less than originally reported, and equity is $26,100 greater than reported originally.**

***Req. 3***

**The following accounts are not reported on the balance sheet because they are expenses. Expenses are reported on the *income statement*.**

 **Utilities expense**

 **Advertising expense**

 **Salary expense**

 **Interest expense**

**(20-25 min.) P 1-70B**

***Req. 1***

|  |
| --- |
| **Hudson Alvarez Realtor, Inc.** |
| **Balance Sheet** |
| **June 30, 2019** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 44,000** | **Accounts payable** | **$ 9,000** |
| **Office supplies** | **4,000** | **Note payable** |  **102,000** |
| **Land** | **162,000** | **Total liabilities** |  **111,000** |
| **Furniture** | **17,600** | **STOCKHOLDERS’** |
| **Franchise** | **16,000** | **EQUITY** |
|  |  | **Common stock** | **75,000** |
|  |  | **Retained earnings** |  **57,600\*** |
|  |  | **Total stockholders’ equity** |  **132,600** |
| **Total assets** | **$243,600** | **Total liabilities and stockholders’ equity** | **$243,600** |

**\_\_\_\_\_**

**\*Total assets ($243,600) − Total liabilities ($111,000) − Common stock ($75,000) = Retained earnings ($57,600).**

***Req. 2***

**It appears that Hudson Alvarez’s business can pay its debts. Total assets far exceed total liabilities.**

***Req. 3***

**Personal items not reported on the *balance sheet* of the business:**

 **a. Personal cash ($17,000)**

1. **Personal account payable ($6,500)**

**g. Personal residence ($419,000) and personal mortgage ($179,000)**

**(30-45 min.) P 1-71B**

***Req. 1***

|  |
| --- |
|  **Full Moon Products, Inc.** |
| **Income Statement** |
| **Year Ended December 31, 2018** |
| **Revenue:** |  |  |
|  **Service revenue**  |  | **$451,600** |
| **Expenses:** |  |  |
|  **Salary expense**  | **$108,900** |  |
|  **Rent expense**  | **41,000** |  |
|  **Interest expense**  | **10,000** |  |
|  **Utilities expense**  |  **8,100** |  |
|  **Property tax expense**  |  **7,300** |  |
|  **Total expenses**  |  |  **175,300** |
| **Net income**  |  | **$276,300** |

***Req. 2***

|  |
| --- |
| **Full Moon Products, Inc.** |
| **Statement of Retained Earnings** |
| **Year Ended December 31, 2018** |
| **Retained earnings, December 31, 2017**  |  **$364,800** |
| **Add: Net income**  |  **276,300** |
| **Subtotal** |  **641,100** |
| **Less: Dividends declared**  |  **(108,000)** |
| **Retained earnings, December 31, 2018**  | **$533,100** |

**(continued) P 1-71B**

***Req. 3***

|  |
| --- |
| **Full Moon Products, Inc.** |
| **Balance Sheet** |
| **December 31, 2018** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 46,000** | **Accounts payable** | **$ 25,000** |
| **Accounts receivable** | **85,000** | **Interest payable** |  **2,800** |
| **Supplies** | **6,200** | **Note payable** |  **99,200** |
| **Land** | **29,000** | **Total liabilities** |  **127,000** |
| **Building** | **405,000** | **STOCKHOLDERS’** |
| **Equipment** | **115,000** | **EQUITY** |
|  |  | **Common stock** | **26,100** |
|  |  | **Retained earnings** |  **533,100** |
|  |  | **Total stockholders’ equity** | **559,200** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$686,200** |  **stockholders’ equity** | **$686,200** |

***Req. 4***

**a. Full Moon Products was profitable; net income was $276,300.**

**b. Retained earnings increased by $168,300 — from $364,800 to $533,100.**

**c. Total equity ($559,200) exceeds total liabilities ($127,000).**

 **Therefore, the stockholders have a greater claim against the company’s assets than do the creditors.**

**(20 min.) P 1-72B**

***Req. 1***

|  |
| --- |
| **Tidal Wave Company** |
| **Statement of Cash Flows** |
| **Year Ended March 31, 2019** |
|  | ***Millions*** |
| **Cash flows from operating activities:** |  |  |
|  **Net income**  |  | **$ 3,050** |
|  **Adjustments to reconcile net income to net cash** |  |  |
|  **provided by operating activities**  |  |  **2,380** |
|  **Net cash provided by operating activities**  |  | **5,430** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
|  **Purchases of property, plant, and equipment**  | **$(3,500)** |  |
|  **Sales of property, plant, and equipment**  | **60** |  |
|  **Other investing cash payments**  |  **(200)** |  |
|  **Net cash used for investing activities**  |  |  **(3,640)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
|  **Issuance of common stock**  | **$ 200** |  |
|  **Payment of dividends**  |  **(360)** |  |
|  **Net cash used for financing activities**  |  |  **(160)** |
|  |  |  |
| **Net increase in cash**  |  |  **$1,630** |
| **Cash, beginning**  |  |  **270** |
| **Cash, ending**  |  | **$ 1,900** |

***Req. 2***

**Operating activities provided the bulk of Tidal Wave Company's cash. This is a sign of strength because operations should be the main source of cash.**

 **(40-50 min.) P 1-73B**

|  |  |
| --- | --- |
|  | ***(Thousands)*** |
| **INCOME STATEMENT**  |  |  | **2019** | **2018** |  |  |
| **Revenues**  | **13,800** | **=** | **$ k** | **$16,175** |  |  |
| **Cost of goods sold**  |  |  | **(11,020)** | **a** | **=** | **(13,115)** |
| **Other expenses**  |  |  |  **(1,250)** |  **(1,220)** |  |  |
| **Income before income taxes**  |  |  | **1,530** |  **1,840** |  |  |
| **Income taxes (35% tax rate)**  | **536** | **=** |  **l** |  **644** |  |  |
|  **Net income**  | **994** | **=** | **$ m** | **$ b** | **=** | **1,196** |
|  |  |  |  |  |  |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |  |  |  |
| **Beginning balance**  | **3,726** | **=** | **$ n** |  **$ 2,670** |  |  |
| **Net income**  | **994** | **=** |  **o** |  **c** | **=** | **1,196** |
| **Dividends declared**  |  |  |  **(98)** |  **(140)** |  |  |
| **Ending balance**  | **4,622** | **=** | **$ p** | **$ d** | **=** | **3,726** |
|  |  |  |  |  |  |  |
| **BALANCE SHEET** |  |  |  |  |  |  |
| **Assets:** |  |  |  |  |  |  |
|  **Cash**  | **980** | **=** | **$ q** | **$ e** | **=** |  **1,090** |
|  **Property, plant and equipment**  |  |  | **1,487** | **1,316** |  |  |
|  **Other assets**  | **12,205** | **=** |  **r** |  **12,060** |  |  |
|  **Total assets**  | **14,672** | **=** | **$ s** | **$14,466** |  |  |
|  |  |  |  |  |  |  |
| **Liabilities:** |  |  |  |  |  |  |
|  **Current liabilities**  | **3,955** | **=** | **$ t** | **$ 5,610** |  |  |
|  **Long-term debt**  |  |  | **4,450** |  **3,360** |  |  |
|  **Other liabilities**  |  |  |  **995**  |  **1,140** |  |  |
|  **Total liabilities**  |  |  |  **9,400** |  **f** | **=** | **10,110** |
|  |  |  |  |  |  |  |
| **Stockholders’ Equity:** |  |  |  |  |  |  |
|  **Common stock**  |  |  |  **$ 450** | **$ 450** |  |  |
|  **Retained earnings**  | **4,622** | **=** |  **u** |  **g** | **=** | **3,726** |
|  **Other stockholders’ equity**  |  |  |  **200** |  **180** |  |  |
|  **Total stockholders’ equity**  | **5,272** | **=** |  **v** |  **4,356** |  |  |
|  **Total liabilities and stockholders’ equity**  | **14,672** | **=** | **$ w** | **$ h** | **=** | **14,466** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CASH FLOWS** |  |  |  |  |  |  |
|  **Net cash provided by operating activities**  | **700** | **=** | **$ x** | **$ 875** |  |  |
|  **Net cash used for investing activities**  |  |  |  **(300)** | **(575)** |  |  |
|  **Net cash used for financing activities**  |  |  |  **(510)** |  **(500)** |  |  |
|  **Increase (decrease) in cash**  |  |  |  **( 110)** |  **i** | **=** |  **(200)** |
|  **Cash at beginning of year**  | **1,090** | **=** |  **y** |  **1,290** |  |  |
|  **Cash at end of year**  | **980** | **=** | **$ z** |  **$ j** | **=** |  **1,090** |

**Serial Case**

**(15-20 min) C1-74**

1. **The Cheesecake Factory is organized as a corporation, per the name of the business (“Incorporated”).**
2. **Net income flows from the Income Statement to the Statement of Retained Earnings.**
3. **Ending retained earnings flows from the Statement of Retained Earnings to the Balance Sheet**
4. **Ending cash and cash equivalents flows from the Statement of Cash Flows to the Balance Sheet**
5. **The Cheesecake Factory earned net income of $139,494 (in thousands) in fiscal 2016. This income was earned from December 29, 2015 to January 3, 2017.**
6. **The Cheesecake Factory’s accounting equation (in thousands)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Assets** | **=** | **Liabilities** | **+** | **Shareholders’ Equity** |
|  | **$1,293,319** | **=** | **$690,112\*** | **+** | **$603,207** |

1. **Cheesecake Factory had $1,293,319 (Total Assets) to work with and owes $690,112\* (Total Liabilities) to creditors. (Numbers in thousands)**

**\*($376,526 + $313,586 = $690,112)**

**Decision Cases**

**(30-40 min.) C1-75**

***Req. 1***

**Based solely on these balance sheets, Insley Sales Co. appears to be the better credit risk because:**

**1. Queens Service has more assets ($150,000) than Insley Sales ($65,000), but Queens Service owes much more in liabilities ($130,000 versus $15,000 for Insley Sales). Insley Sales’ stockholders’ equity is far greater than that of Queens Service ($50,000 compared to $20,000). Insley Sales is not heavily in debt, but Queens Service is.**

**2. You would be better off granting the loan to Insley Sales. You should consider what will happen if the borrower cannot pay you back as planned. Queens Service has far more liabilities to pay, and it may be hard for Queens Service to come up with the money to pay you. On the other hand, Insley Sales has little debt to pay to others before paying you.**

 **Student responses may vary.**

**(20-30 min.) C1-76**

***Req. 1***

|  |  |  |
| --- | --- | --- |
| **Flowers Unlimited, Inc.** |  | **Flowers Unlimited, Inc.** |
| **Income Statement** |  | **Balance Sheet** |
| **Year Ended Dec. 31, 2018** |  | **Dec. 31, 2018** |
| **Revenue…………** |  **$140,0001** |  | **Cash……………** | **$ 6,000** | **Liabilities………** | **$70,0004** |
| **Expenses………..** |  **140,0002** |  | **Other assets….** |  **90,0003** | **S/H Equity……..** |  **26,0005** |
|  |  |  |  |  | **Total liabilities** |  |
| **Net income………** |  **$ -0-**  |  | **Total assets…...** | **$96,000** | **and S/H equity** | **$96,000** |

**\_\_\_\_\_**

**1$100,000 + $40,000 = $140,000**

**2$80,000 + $50,000 + $10,000 = $140,000**

**3$100,000 − $50,000 + $40,000 = $90,000**

**4$60,000 + $10,000 = $70,000**

**5$96,000 − $70,000 = $26,000**

***Req. 2***

**The company’s *financial position* is much *weaker* than originally reported. Assets and stockholders’ equity are lower and liabilities are higher. *Results of operations* are *worse* than reported. The company did not earn any profit.**

***Req. 3***

**Based on the actual figures, I would *not* invest in Flowers Unlimited for reasons given in *Req. 2*.**

**Ethical Issue**

 **(40-50 min) C1-77**

**Note to instructor: student responses will vary on this problem. Keep the discussion pointed toward use of the multiple-criteria model for making good ethical decisions, pointing out elements of students’ reasoning that may be faulty or incomplete. It might be useful to have a debate or role play, assigning students to different sides of the issue (for or against accepting a copy of the exam).**

***Req. 1***

**The fundamental ethical issue in this situation is whether you should accept a copy of the old exam from your friend.**

***Req. 2***

**The stakeholders are:**

1. **You**
2. **Your friend**
3. **The remainder of the students in the class**
4. **The professor**
5. **The University**
6. **Your family**

**(This may not be a complete list; you may think of more.)**

**Consequences are discussed in requirement 3.**

**(continued) C1-77**

***Req. 3***

**Analysis of the problem:**

**Economic perspective: If use of the old exam turns out to help you (it may not) you might improve your grade and allow you to retain your scholarship. This might help you and your family financially. If you use the exam to your unfair advantage, and you are reported, you and possibly your friend might receive grades of F in the class although you might otherwise have passed. This could cause adverse economic consequences to you, your friend and your families.**

**Legal perspective: Although it may not violate local or federal law, giving or accepting copies of old exams may violate the university’s honor code, which serves the same purpose as a legal code in this case. If you use the old exam and it turns out that you violated the University’s honor code, both you and your friend could be in trouble. Your family and your friend’s family could also be impacted by any adverse consequences to you or her. Academic institutions establish policies against academic dishonesty because cheating hurts everyone—the student who commits the act, the other students in the class whose rights to fair treatment are violated by cheating, and the professor who must endure hours of investigating, reporting, and perhaps testifying.**

**Ethical perspective: Receiving questionable help from others in the face of policies that prohibit it is, at best, risky, and at worst, downright wrong. Cheating is similar to stealing, since it is stealing**

**(continued) C1-77**

**the work of another without their permission. It is usually accompanied by lying to cover it up, or at least, not revealing the truth. Cheating violates other students’ rights to fair and equal treatment. It violates the instructor’s rights to run a course as a “fair game” for all participants. Because the students and faculty are hurt by cheating, the university is hurt too. If cheating goes unpunished, grades are inflated, ultimately damaging the academic reputation of the institution and eroding the value of its degrees. Parents of students who are caught cheating have to endure the agony of working through the problem with their son or daughter, and perhaps the social stigma that comes from adverse publicity.**

**These are just some of the arguments against cheating. Of course, there is a question in this case as to whether taking the test actually violates the professor’s or the university’s policies.**

***Req. 4***

**It would be helpful to find out what the professor’s policies are with respect to the use of fraternity and sorority test files. The university might have a blanket policy on this. (Some students might spend a little time researching this by reading the university’s honor code on their web site; just reading the honor code will be an eye-opening experience for most students). Advise your students to research the use of fraternity and sorority test files on the university web site, or to**

**(continued) C1-77**

**discuss the issue with the head of the department or the chair of the university honor council.**

**Unfortunately, in this case, there is not much time. Researching the issue in the university’s honor code takes valuable time away from studying for the exam, which, if you do, could help you raise your grade and solve the whole problem!**

**Probably the best solution to this problem is “when in doubt, don’t.” You may not do well on the test, but at least you won’t have to live with the terrible consequences of being accused as a cheater. It should make you feel better in the long run that, although you may not make the highest grades in the class, at least you are not a cheater.**

***Req. 5***

**Cheating is very closely related to stealing, which is a form of fraud. When employees steal from their companies, they steal property that belongs to others. There are economic, legal, and ethical consequences to the company, the employee and their families, and customers (who ultimately have to pay for fraud through higher prices). We will study fraud in depth in Chapter 4.**

**Focus on Financials: Apple Inc.**

**(20-30 min.) C1-78**

**1. Students can emphasize a variety of points regarding Apple Inc., and its industry. For example, a discussion on the product innovation and competitive changes in technology would be appropriate. Additionally, discussing recent news articles related to Apple or its competitors would also be appropriate. Student answers will vary.**

**2. Some important information in this portion of the financials is the description of their distribution channels (third-party resellers), competitors (product innovation, market opportunities, etc.), and supply chain (shortages, component availability, outsourcing, etc). Additionally, the seasonality of Apple’s business is important to note given that it has higher sales in its first quarter relative to the last three. Lastly, it may come as a surprise that Apple employs approximately 116,000 full-time employees. (Student answers will vary.)**

**3. Samsung, Google, Sony, or HP are some of Apple Inc.’s competitors. It is important to identify competitors because competitors tend to have similar business dynamics to one another, meaning that their financial statements can be compared to and benchmarked against each other. Student answers will vary.**

 **(continued) C1-78**

**4. *Net income*, because it shows the overall result of all the revenues minus all the expenses for a period. In effect, net income gives the results of operations in a single figure and shows whether the company has been profitable. Apple’s net income after taxes decreased from $53.4 billion in 2015 to $45.7 billion in 2016, which is unfavorable.**

**5. Apple Inc.’s largest expense is cost of sales. This is the cost of the products that the company sells, such as iPhones, iPads, Apple TVs, software, and Mac desktops. Another title of this account is *cost of goods sold*.**

**6. Total resources (total assets) at September 24, 2016.….$321,686 million**

 **Amount owed (total liabilities) at September 24, 2016….$193,437 million**

 **Portion of the company’s assets owned by the stockholders (stockholders’ equity) at September 24, 2016...………….$128,249 million**

 **Apple Inc.’s accounting equation *(in millions)*:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **$321,686** | **=** | **$193,437** | **+** | **$128,249** |

**7. At September 26, 2015, Apple Inc. had $21,120 million of cash and cash equivalents. At September 24, 2016, Apple Inc. had $20,484 million of cash and cash equivalents.**

**Focus on Analysis: Under Armour, Inc.**

**(30 min.) C1-79**

**1. Under Armour, Inc. is an athletic apparel company. Students can emphasize a variety of points regarding Under Armour, Inc. and its industry. For example, a discussion on the brand, new product development, etc. would be appropriate. Additionally, discussing recent news articles related to Under Armour or its competitors would also be appropriate. (Student answers will vary.)**

**2. Note 1 states Under Armour is a developer, marketer and distributor of branded performance apparel, footwear, and accessories. These products are sold worldwide and worn by athletes of all levels and consumers with active lifestyles.**

**3. Nike, Adidas, and Columbia Sportswear are some of Under Armour, Inc.’s competitors. It is important to identify competitors because competitors tend to have similar business dynamics to one another, meaning that their financial statements can be compared to and benchmarked against each other. (Student answers will vary.)**

**(continued) C1-79**

**4. Under Armour, Inc.’s Accounting Equation (*in millions*):**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Assets** | **=** | **Liabilities** | **+** | **Shareholders’ Equity** |
|  | **$3,644** | **=** | **$1,613** | **+** | **$2,031** |

 **Under Armour, Inc. appears to be in strong financial condition. Total assets are significantly higher than the amount of total liabilities. This suggests that the company will have no difficulty paying its debts and will have money to expand.**

**5. The result of operations for 2016 was a net income of $256,979 thousand. This is good news for Under Armour, Inc. Revenue exceeded expenses for fiscal 2016, and there is a positive trend in earnings over the past two years ($208,042 thousand, $232,573 thousand, and $256,979 thousand in fiscal 2014, 2015, and 2016, respectively). The increase in net income signals good news.**

**6. According to Under Armour, Inc.’s Consolidated Statements of Stockholders’ Equity, the cause of the company’s large increase in retained earnings during 2016 was comprehensive income of $256,979 thousand. (Comprehensive income is closely related to net income.)**

**7. The Consolidated Balance Sheets report cash and cash equivalents as part of the company’s financial position. The Consolidated Statements of Cash Flows tell why cash and cash equivalents increased or decreased. Operating activities provided $304,487 thousand, investing activities used $381,139 thousand, and financing activities provided $205,995 thousand.**

**Group Projects**

**Student responses will vary.**

**Chapter 1 - The Financial Statements**

**Directed Reading Worksheet**

**Part I: Explain why accounting is critical to businesses (LO1)**

1. What are financial statements?
2. List the basic financial statements.
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	4. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
3. What does the word *net* refer to in accounting?
4. What is net income (profit)?
5. What were net sales for The Walt Disney Company, for its year ended October 1, 2016? For its year ended October 3, 2015? On what statement do you find this information?
6. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ is an information system that measures business activities, processes data into financial statements and reports, and communicates results to decision makers.
7. What is the accounting cycle?
8. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ is a mechanical part of accounting, just as arithmetic is a part of mathematics; accounting as a field is much more than this mechanical part.
9. Who uses accounting information?
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	4. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
10. What two branches of accounting are based on whether the user is external or internal?
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
11. A \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ form of business organization consists of a single owner and the owner is personally liable for all the business’s debts.
12. Income from the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ form of business organization “flows through” to the owners; each owner can legally bind all partners into unlimited debt.
13. When organized as a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_, the owners are not personally liable for the business’s debts and the business’s income “flows through” to the owners to be taxed at the owners’ own tax rates.
14. Although its advantages include the ability to raise large sums of capital and the no personal liability for its owners, one potential disadvantage of the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ form of business organization is that its income is subject to double taxation.
15. Who (or what) ultimately controls a corporation?

**Part II: Explain and apply underlying accounting concepts, assumptions, and principles (LO2)**

1. Two professional frameworks for the measurement and disclosure of financial information are:
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
2. What regulatory bodies formulate the standards for each respective framework in Question 16 above?
3. Fill in the conceptual foundation of accounting in the following diagram. Also draw arrows where appropriate to show relationships.



1. In your own words, describe the difference between relevance and faithful representation.
2. List and describe the four enhancing qualitative characteristics for accounting information.
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	4. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
3. List and describe the four accounting assumptions/principles.
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	4. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
4. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ is the amount that the business could sell the asset for, or the amount that the business could pay to settle the liability.
5. Why did the International Accounting Standards Board (IASB) develop International Financial Reporting Standards (IFRS)?

**Part III: Apply the accounting equation to business organizations (LO3)**

1. Assets are economic resources that are expected to produce a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ in the future. Liabilities are debts that are payable to \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. Owners’ equity represents the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ claims of a business.

1. What is the accounting equation?
2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ are liquid assets that can be readily converted to cash. Give 2 examples.
3. Liabilities payable beyond \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ from the date of the financial statements are long-term. Liabilities payable within \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ from the date of the financial statements are short-term.
4. What are the two main subparts of stockholders’ equity and what is the difference between them?
5. Dividends (ARE or ARE NOT) expenses. They (NEVER or ALWAYS) affect net income

1. When a company’s total revenues exceed total expenses, what is the result? When total expenses exceed total revenues?
2. How is retained earnings calculated?

**Part IV: Construct financial statements and analyze the relationships among them (LO4)**

1. You can determine how well the company performed during the year by looking at its \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. You can determine a company’s financial position by looking at its \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.
2. A company’s fiscal year always corresponds to a calendar year (January 1—December 31). TRUE or FALSE
3. An income statement reports two main categories. What are they?
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
4. What is the single most important item in the financial statements?
5. Selling, general, administrative, and other expenses are the costs of everyday operations that are not directly related to performing services or selling products. TRUE or FALSE
6. Income taxes are not taken into consideration on the income statement. TRUE or FALSE
7. What does the statement of the retained earnings show about a company?
8. Who decides whether to pay a dividend to the stockholders?
9. List the three items (sections) on a balance sheet
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
10. Put the following assets in order of liquidity: equipment, cash, inventory, and short-term investments.
11. When the term “net” is used on a financial statement regarding property and equipment, it means that the historical acquisition cost of the assets has been reduced by \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.
12. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ assets have no physical substance; you can neither see nor touch them.
13. Unearned royalties (revenues) represents cash received in advance of performing services or shipping goods and is a liability account. TRUE or FALSE
14. Describe additional paid-in capital in your own words.
15. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ stock represents amounts paid by the company to repurchase its own stock.
16. Operating activities show how the company operates by selling \_\_\_\_\_\_\_\_\_\_\_ and \_\_\_\_\_\_\_\_\_\_\_ to customers. Investing activities show a company’s investment in \_\_\_\_\_\_-\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_. Financing activities include \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.
17. How is a cash payment indicated on the statement of cash flows?
18. If you were considering investing in The Walt Disney Company, what should you look for?

**Part V: Evaluate business decisions ethically (LO5)**

1. Describe ethics in your own words.
2. List and describe the three types of factors that influence business and accounting decisions.
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
3. Ethics is a practice that does not have to be taken seriously in accounting. TRUE or FALSE
4. The four core values of the Business Ethics Leadership Alliance include \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_, transparency, \_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_, and accountability.
5. A good decision framework for making ethical judgements would be the following:
6. List the basic principles of the American Institute of Certified Public Accountants Code of Professional Conduct.
	1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	4. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	5. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
	6. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Chapter 1 - The Financial Statements**

**Directed Reading Worksheet Answer Key**

**Part I: Explain why accounting is critical to businesses (LO1)**

1. What are financial statements?

Business documents companies use to report the results of their activities to people and groups that can include managers, investors, creditors, and regulatory agencies

1. List the basic financial statements.

a. Income statement

b. Statement of retained earnings

c. Balance sheet

d. Statement of cash flows

1. What does the word net refer to in accounting?

An amount after a subtraction

1. What is net income (profit)?

The excess of revenues (net sales) over expenses

1. What were net sales for The Walt Disney Company, for its year ended October 1, 2016? For its year ended October 3, 2015? On what statement do you find this information?

2016: $55,632 million

2015: $52,465 million

Income Statement

1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ is an information system that measures business activities, processes data into financial statements and reports, and communicates results to decision makers.

Accounting

1. What is the accounting cycle?

The process by which a company’s financial statements are prepared

1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ is a mechanical part of accounting, just as arithmetic is a part of mathematics; accounting as a field is much more than this mechanical part.

Bookkeeping

1. Who uses accounting information?

a. Individuals

b. Investors and creditors

c. Regulatory bodies

d. Nonprofit organizations

1. What two branches of accounting are based on whether the user is external or internal?

a. Financial accounting (external)

b. Managerial accounting (internal)

1. A \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ form of business organization consists of a single owner and the owner is personally liable for all the business’s debts.

Proprietorship

1. Income from the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ form of business organization “flows through” to the owners; each owner can legally bind all partners into unlimited debt.

Partnership

1. When organized as a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_, the owners are not personally liable for the business’s debts and the business’s income “flows through” to the owners to be taxed at the owners’ own tax rates.

Limited-Liability Company

1. Although its advantages include the ability to raise large sums of capital and the no personal liability for its owners, one potential disadvantage of the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ form of business organization is that its income is subject to double taxation.

Corporation

1. Who (or what) ultimately controls a corporation?

Stockholders or shareholders who own stock in the corporation

**Part II: Explain and apply underlying accounting concepts, assumptions, and principles (LO2)**

1. Two professional frameworks for the measurement and disclosure of financial information are:

a. Generally Accepted Accounting Principles (GAAP)
b. International Financial Reporting Standards (IFRS)

1. What regulatory bodies formulate the standards for each respective framework in Question 16 above?

Financial Accounting Standards Board (FASB); International Accounting Standards Board (IASB)

1. Fill in the conceptual foundation of accounting in the following diagram. Also draw arrows where appropriate to show relationships.



1. In your own words, describe the difference between relevance and faithful representation.

**Relevance** means that the information could change the outcome or make a decision maker chose a different path. If information would have no impact on the decision, then it is not relevant. If the information could change the decision makers mind, it is relevant.

**Faithful representation** means that the information is accurate. Faithful representation makes the information reliable for decision makers to use it.

1. List and describe the four enhancing qualitative characteristics for accounting information.

a. **Comparability:** capable of being compared with information from other companies in the same period

b. **Verifiability:** capable of being checked for accuracy, completeness, and reliability

c. **Timeliness:** made available to users early enough to help them make decisions

d. **Understandability:** transparent and clear enough so that it would make sense to the reasonably informed user of information

1. List and describe the four accounting assumptions/principles.

a. **Entity Assumption:** This is the idea that the entity (organization or person) stands apart as a separate economic unit. It is to keep entities and their affairs separate from others.b. **Continuity (Going-Concern Assumption):** This says that a business should stay in business long enough to convert its inventories and receivables to cash, pay off liabilities regularly, and continue operations in the future.c. **Historical Cost Principle:** This states that assets should be recorded at the cost paid for them in cash and noncash compensation on the date of purchase.d. **Stable-Monetary-Unit Assumption:** This ignores inflation and change in purchasing power to assume that the value of the dollar is stable over time. This helps with comparability from year to year.

1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ is the amount that the business could sell the asset for, or the amount that the business could pay to settle the liability.

Fair value

1. Why did the International Accounting Standards Board (IASB) develop International Financial Reporting Standards (IFRS)?

The purpose was to create a uniform set of principles across the developed world and make comparability of financial results simple and inexpensive.

**Part III: Apply the accounting equation to business organizations (LO3)**

1. Assets are economic resources that are expected to produce a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ in the future. Liabilities are debts that are payable to \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. Owners’ equity represents the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ claims of a business.

Benefit; Outsiders/Creditors; Insider

1. What is the accounting equation?

Assets = Liabilities + Owners’ (Stockholders’) Equity

1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ are liquid assets that can be readily converted to cash. Give 2 examples.

Cash equivalents
Certificate of deposit, U.S. treasury bill

1. Liabilities payable beyond \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ from the date of the financial statements are long-term. Liabilities payable within \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ from the date of the financial statements are short-term.

One year; One year

1. What are the two main subparts of stockholders’ equity and what is the difference between them?

**Paid-in capital:** the amount the stockholders have invested in the corporation

**Retained earnings:** the amount earned by income-producing activities and kept for use in the business

The main difference is that paid-in capital comes from the stockholders while retained earnings is from the operations of the business.

1. Dividends (ARE or ARE NOT) expenses. They (NEVER or ALWAYS) affect net income

ARE NOT; NEVER

1. When a company’s total revenues exceed total expenses, what is the result? When total expenses exceed total revenues?

Net income/net earnings/net profit; Net loss

1. How is retained earnings calculated?

Retained earnings = Revenues – Expenses – Dividends

Or

Retained earnings = Net income (net loss) – Dividends

**Part IV: Construct financial statements and analyze the relationships among them (LO4)**

1. You can determine how well the company performed during the year by looking at its \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. You can determine a company’s financial position by looking at its \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

Income statement; balance sheet

1. A company’s fiscal year always corresponds to a calendar year (January 1—December 31). TRUE or FALSE

False

1. An income statement reports two main categories. What are they?

Revenues and gains; expenses and losses

1. What is the single most important item in the financial statements?

Net income

1. Selling, general, administrative, and other expenses are the costs of everyday operations that are not directly related to performing services or selling products. TRUE or FALSE

True

1. Income taxes are not taken into consideration on the income statement. TRUE or FALSE

False

1. What does the statement of the retained earnings show about a company?

The statement of retained earnings shows the portion of net income that a company has retained over the years. If the company has been profitable, it will have a positive balance in retained earnings. If it has had losses, then its retained earnings will be in a deficit. The statement of retained earnings also shows if the company has distributed dividends.

1. Who decides whether to pay a dividend to the stockholders?

The board of directors

1. List the three items (sections) on a balance sheet

a. Assets
b. Liabilities

c. Stockholders’ Equity

1. Put the following assets in order of liquidity: equipment, cash, inventory, and short-term investments.

Cash, Short-term investments, Inventory, Equipment

1. When the term “net” is used on a financial statement regarding property and equipment, it means that the historical acquisition cost of the assets has been reduced by \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

Accumulated depreciation

1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ assets have no physical substance; you can neither see nor touch them.

Intangible

1. Unearned royalties (revenues) represents cash received in advance of performing services or shipping goods and is a liability account. TRUE or FALSE

True

1. Describe additional paid-in capital in your own words.

**Additional paid-in capital** is the excess amount over par shareholders pay for securities of a company.

1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ stock represents amounts paid by the company to repurchase its own stock.

Treasury

1. Operating activities show how the company operates by selling \_\_\_\_\_\_\_\_\_\_\_ and \_\_\_\_\_\_\_\_\_\_\_ to customers. Investing activities show a company’s investment in \_\_\_\_\_\_-\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_. Financing activities include \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

Goods; services; long-term assets; issuing stock, paying dividends, borrowing, and repaying borrowed funds.

1. How is a cash payment indicated on the statement of cash flows?

They are enclosed by parentheses to show a negative amount.

1. If you were considering investing in The Walt Disney Company, what should you look for?

Students’ answers will vary. Possibilities include:

* Can the company sell its services and products? 🡪 Look at revenue on the income statement
* What are the main income measures and trends? 🡪 Calculate and analyze gross profit, operating income, and net income
* What percentage of revenue ends up as profit? 🡪 Divide net income by sales revenue
* Can the company pay its current and long-term liabilities? 🡪 Compare assets to liabilities on the balance sheet (both current and long-term)
* Where is the company’s cash coming from and how is it being used? 🡪 Examine the statement of cash flows

**Part V: Evaluate business decisions ethically (LO5)**

1. Describe ethics in your own words.

Answers will vary. Ethics are shaped by our own background and experiences. They are like our morals. What is legal may not always be the most ethical thing to do.

1. List and describe the three types of factors that influence business and accounting decisions.

a. Economic factor: the decision should be made to maximize economic benefits to the decision maker

b. Legal factor: based on the proposition that free societies are governed by laws

c. Ethical factor: recognizes that while certain actions might be both economically profitable and legal, they still may not be right

1. Ethics is a practice that does not have to be taken seriously in accounting. TRUE or FALSE

False

1. The four core values of the Business Ethics Leadership Alliance include \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_, transparency, \_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_, and accountability.

Legal compliance; conflict identification

1. A good decision framework for making ethical judgements would be the following:
* Ask yourself, what is the issue?
* Identify who the stakeholders are and what the consequence of the decision would be to each of them.
* Weigh the alternatives.
* Make the decision and prepare yourself to deal with the consequences.

This can be simplified into three questions. (1) Is the action legal? (2) Who will be affected and how? (3) How will this decision make me feel after? How would it make me feel if my family reads about it in the newspaper?

1. List the basic principles of the American Institute of Certified Public Accountants Code of Professional Conduct.

a. **Responsibilities principle**b. **Public interest principle**c. **Integrity principle**
d. **Objectivity and independence principle**e. **Due care principle**f. **Scope and nature of services**

