# **Chapter 1**

**The Financial Statements**

**Ethics Check**

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

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

**Short Exercises**

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

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

 ***Owners’ 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’ 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 1-2**

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

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

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

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

**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 1-5**

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

**2. Application of the entity assumption will separate Olson’s personal assets from the assets of Healthy Fast Foods. This will help Olson, 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 1-6**

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

**b. Entity assumption**

**c. Stable-monetary-unit assumption**

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

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

|  |
| --- |
| **Computed amounts in boxes** |
|  |  |  |  |  |  |
|  | **Total Assets** | **=** | **Total Liabilities** | **+** | **Stockholders’ Equity** |
|  |  |  |  |  |  |
| **a.** | **$610,000** | **=** | **$270,000** | **+** | **$340,000** |
|  |  |  |  |  |  |
| **b.** |  **95,000** | **=** |  **70,000** | **+** | **25,000** |
|  |  |  |  |  |  |
| **c.** | **420,000** | **=** |  **70,000** | **+** |  **350,000** |

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

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

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

 **This way of determining the amount of owners’ equity applies to any company, your household, or a single IHOP restaurant.**

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

**a. Accounts payable B**

**b. Inventory B**

**c. Interest revenue I**

**d. Long-term debt B**

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

**f. Salary expense I**

**g. Cash B, C**

**h. Dividends R, C**

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

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

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

**l. Retained earnings R, B**

**m. Sales revenue I**

**n. Common stock B**

**(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. B**

**b. R g. C**

**c. R h. I**

**d. B i. B**

**e. C**

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

|  |  |
| --- | --- |
| **O’Conner Services, Inc.** |  |
| **Income Statement** |  |
| **Year Ended December 31, 2016** |  |
|  | ***(millions)*** |
| **Revenues**  | **$397** |
| **Expenses**  |  **164** |
| **Net income**  | **$233** |

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

|  |  |
| --- | --- |
| **Roam Corp.** |  |
| **Statement of Retained Earnings** |  |
| **Year Ended December 31, 2016** |  |
|  | (millions) |
| **Retained earnings, December 31, 2015**  | **$230** |
| **Add: Net income ($490 − $340)**  | **150** |
| **Less: Dividends declared**  |  **(54)** |
| **Retained earnings, December 31, 2016**  | **$326** |

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

|  |
| --- |
| Aloha Enterprises |
| **Balance Sheet** |
| **December 31, 2016** |
| **ASSETS** | ***(in millions)*** |
| **Current assets:** |  |
| **Cash**  | **$ 50** |
| **Accounts receivable**  |  **19** |
| **Total current assets**  | **69**  |
| **Long-term assets**  |  **39** |
|  |  |
| **Total assets**  | **$108** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 13** |
|  **Total current liabilities**  | **13** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **25** |
| **Total liabilities**  |  **38** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **20** |
| **Retained earnings**  |  **50** |
| **Total stockholders’ equity**  |  **70** |
|  |  |
| **Total liabilities and stockholders’ equity**  | **$108** |

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

|  |
| --- |
| Harmon Corporation |
| **Balance Sheet** |
| **September 30, 2016** |
| **ASSETS** | ***(in millions)*** |
| **Current assets:** |  |
| **Cash**  | **$ 75** |
| **Accounts receivable**  |  **22** |
| **Total current assets**  | **97**  |
| **Property and equipment**  | **28** |
| **Other long-term assets**  |  **17** |
| **Total assets**  | **$142** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 33** |
|  **Total current liabilities**  | **33** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **15** |
| **Total liabilities**  |  **48** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **30** |
| **Retained earnings**  |  **64\*** |
| **Total stockholders’ equity**  |  **94** |
| **Total liabilities and stockholders’ equity**  | **$142** |

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**\*Computation of retained earnings: Total assets ($142) − total liabilities**

 **($48) − common stock ($30) = $64**

**Or, total stockholders’ equity ($94) – common stock ($30) = $64**

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

|  |
| --- |
| **Avalon Legal Services, Inc.** |
| **Statement of Cash Flows** |
| **Year Ended December 31, 2016** |
| **Cash flows from operating activities:** |  |
|  **Net income**  | **$105,000** |
|  **Adjustments to reconcile net income to net cash provided by operating activities provided by operating activities**  |  **(10,000)** |
|  **Net cash provided by operating activities**  | **95,000** |
|  |  |
| **Cash flows from investing activities:** |  |
|  **Purchases of equipment**  |  **$(32,000)** |  |
|  **Net cash used for investing activities**  | **(32,000)** |
|  |  |
| **Cash flows from financing activities:** |  |
|  **Payment of dividends**  |  **$(80,000)** |  |
|  **Net cash used for financing activities**  |  **(80,000)** |
| **Net decrease in cash**  | **(17,000)** |
| **Cash balance, December 31, 2015**  |  **18,000** |
| **Cash balance, December 31, 2016**  | **$ 1,000** |

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

**Solve in this order:**

1. **$81**
2. **$81**
3. **$143**

**f. $143**

**g. $168**

**h. $208**

**e. $208**

**d. $96**

 **(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?**

**Exercises**

**(10-15 min.) E 1-19A**

|  |
| --- |
| ***Amounts in billions; (computed amounts in boxes)*** |
|  |  |  |  |  | Stockholders’ |
|  | Assets | **=** | Liabilities | **+** | Equity |
| Preston Drycleaners | **$89** |  |  **$52** |  | **$37** |
| **First Street Bank** | **26** |  | **9** |  | **17** |
| **Pam’s Florals** | **36** |  | **10** |  | **26** |

Pam’s Florals appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ($10/$36 = .28). Stated differently, Pam’s Florals’ equity is the highest percentage of company assets ($26/$36 = .72).

Liabilities as a percent of total assets:

**Preston Drycleaners: $52/$89 = 0.58**

**First Street Bank: $9/$26 = 0.35**

**Pam’s Florals: $10/$36 = 0.28**

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

### Req. 1

|  |
| --- |
|  ***(Amounts in millions)*** |
|  | Assets | **=** | Liabilities | **+** | Stockholders’ Equity |
|  | **$200** |  | **$170** |  |  |
|  |  **350** |  |  **320** |  |  |
|  |  **160** |  |  |  |  |
| **Total** | **$710** | **=** | **$490** | **+** | **$220** |
|  |  |  |  |  |  |
| ***Req. 2*** | **Resources****to work with** | ***Req. 3* Amount**  owed to  creditors |  ***Req. 4* Actually** **owned by company**  **stockholders** |

 **(10-20 min.) E 1-21A**

|  |  |
| --- | --- |
|  | **Situation** |
|  | **1** | **2** | **3** |
|  | ***(Millions)*** |
| **Total stockholders’ equity,** |  |  |  |
|  **January 31, 2016 ($53 − $15)**  |  **$38** | **$38** | **$38** |
| **Add: Issuances of stock**  |  **12** |  **-0-** | **88** |
|  **Net income**  | **2\*** |  **26\*** | **-0-** |
| **Less: Dividends declared**  |  **-0-** |  **(12)** | **(30)** |
|  **Net loss**  | **-0-** | **-0-** | **(44)\*** |
| **Total stockholders’ equity,** |  |  |  |
|  **January 31, 2017 ($75 − $23)**  |  **$52** |  **$52** | **$52** |

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

**(10-15 min.) E 1-22A**

**a. Income statement**

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

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

**d. Balance sheet**

**e. Income statement**

**f. Statement of cash flows**

**g. Statement of cash flows**

**h. Balance sheet**

**i. Income statement**

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

**k. Balance sheet**

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

**m. Balance sheet**

**n. Balance sheet**

**(10-20 min.) E 1-23A**

|  |
| --- |
| Womack Products |
| **Balance Sheet** |
| **December 31, 2016** |
| **ASSETS** |  |
| **Current assets:** |  |
|  **Cash**  | **$ 23,000** |
|  **Receivables**  | **15,000** |
|  **Inventory**  |  **77,000** |
|  **Total current assets**  | **115,000** |
| **Equipment**  |  **184,000** |
| **Total assets**  | **$299,000** |
|  |  |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 24,000** |
|  **Total current liabilities**  | **24,000** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **165,000** |
| **Total liabilities**  |  **189,000** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **32,500** |
| **Retained earnings**  |  **77,500\*** |
| **Total stockholders’ equity**  |  **110,000** |
| **Total liabilities and stockholders’ equity**  | **$299,000** |

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**\*Computation of retained earnings:**

 **Total assets ($299,000) − current liabilities ($24,000) − long-term notes payable ($165,000) − common stock ($32,500) = $77,500**

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

***Req. 1***

|  |
| --- |
| **Ellen Samuel Realty Company** |
| **Balance Sheet**  |
| May 31, 2016 |
| *(Amounts in millions)* |
| ASSETS | **LIABILITIES** |
| **Cash** | **$ 1.6** | **Current liabilities** |  **$ 2.6** |
| **Receivables** | **0.5** | **Long-term liabilities** |  **102.8** |
| **Property and equipment, net** | **1.7** | **Total liabilities** |  **105.4** |
| **Investment assets** | **135.7** | STOCKHOLDERS’**EQUITY** |
| **Other assets** | **10.5** |
|  |  | **Common stock** |  **27.7** |
|  | **Retained earnings** |  **16.9\*** |
|  | **Total stockholders’ equity** |  **44.6** |
| **Total assets** | **$150.0** | **Total liabilities and stockholders’ equity** | **$150.0** |
|  |  |  |  |

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\*Computation of retained earnings:

**Total assets ($150.0) − Total liabilities ($105.4) − Common stock ($27.7) = $16.9**

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

***Req. 1***

|  |
| --- |
| **Ellen Samuel Realty Company** |
| **Income Statement**  |
| **Year Ended May 31, 2016** |
| ***(Amounts in millions)*** |
|  |  |
| **Total revenue**  |  | **$37.9** |
| **Expenses:** |  |  |
|  **Salary and other employee expenses**  | **$13.6** |  |
|  **Other expenses**  | **5.4** |  |
|  **Interest expense**  |  **0.4** |  |
|  **Total expenses**  |  |  **19.4** |
| **Net income**  |  | **$18.5** |

***Req. 2***

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

|  |
| --- |
| **Ellen Samuel Realty Company** |
| **Statement of Retained Earnings**  |
| **Year Ended May 31, 2016** |
| ***(Amounts in millions)*** |
|  |  |
| **Retained earnings, beginning of year**  |  **$16.8** |
| **Add: Net income for the year (Req. 1)**  |  **18.5** |
| **Subtotal** |  **35.3** |
| **Less: Dividends declared**  |  **18.4** |
| **Retained earnings, end of year (from Exercise 1-24A)**  |  **$16.9** |

**(15-20 min.) E 1-26A**

***Req. 1***

|  |
| --- |
| **Carson Coffee Roasters Corp.** |
| **Income Statement** |
| **For the Month Ended August 31, 2017** |
| **Revenue:** |  |  |
|  **Service revenue**  |  | **$279,600** |
| **Expenses:** |  |  |
|  **Salary expense**  |  **$78,400** |  |
|  **Utilities expense**  | **5,400** |  |
|  **Rent expense**  |  **1,900** |  |
|  **Total expenses**  |  |  **85,700**  |
| **Net income**  |  | **$193,900** |

|  |
| --- |
| **Carson Coffee Roasters Corp.** |
| **Statement of Retained Earnings** |
| **For the Month Ended August 31, 2017** |
| **Retained earnings, August 1, 2017**  |  **$ -0-**  |
| **Add: Net income for the month**  |  **193,900** |
| **Subtotal** |  **193,900**  |
| **Less: Dividends declared**  |  **(2,300)** |
| **Retained earnings, August 31, 2017**  |  **$191,600** |

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

***Req. 1***

|  |
| --- |
| **Carson Coffee Roasters Corp.** |
| **Balance Sheet** |
| **August 31, 2017** |
| Assets | Liabilities |
| **Cash**  | **$ 5,900** | **Accounts payable**  | **$ 9,000** |
| **Office supplies**  | **7,500** |  |  |
| **Equipment**  | **200,400** | **Stockholders’ Equity** |
|  |  | **Common stock**  | **13,200** |
|  |  | **Retained earnings**  |  **191,600** |
|  |  | **Total stockholders’ equity** | **204,800** |
|  |  | **Total liabilities and**  |  |
| **Total assets**  | **$213,800** |  **stockholders’ equity**  | **$213,800** |

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

***Req. 1***

|  |
| --- |
| **Carson Coffee Roasters Corp.** |
| **Statement of Cash Flows** |
| **For the Month Ended August 31, 2017** |
| **Cash flows from operating activities:** |  |  |
|  **Net income**  |  |  **$193,900** |
|  **Adjustments to reconcile net income to net** |  |  |
|  **cash provided by operating activities**  |  |  **1,500** |
|  **Net cash provided by operating activities**  |  |  **195,400** |
| **Cash flows from investing activities:** |  |  |
|  **Acquisition of equipment**  |  **$(200,400)** |  |
|  **Net cash used for investing activities**  |  | **(200,400)** |
| **Cash flows from financing activities:** |  |  |
|  **Issuance (sale) of stock to owners**  |  **$ 13,200** |  |
|  **Payment of dividends**  |  **(2,300)** |  |
|  **Net cash provided by financing activities**  |  |  **10,900** |
| **Net increase in cash**  |  |  **$ 5,900** |
| **Cash balance, August 1, 2017**  |  |  **0** |
| **Cash balance, August 31, 2017**  |  |  **$ 5,900** |

**(10-15 min.) E 1-29A**

**TO: Owner of Carson 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 $279,600 and net income was $193,900. These operating results look very strong.**

 **The company was able to pay a $2,300 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of $213,800 and liabilities of only $9,000. Your stockholders’ equity is $204,800.**

 **Operating activities generated cash of $195,400, 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 $5,900. Based on the above facts, I believe you should stay in business.**

**Student responses may vary.**

 **(20-25 min.) E 1-30A**

***Req. 1***

|  |
| --- |
| **McFall Company** |
| **Income Statement** |
| **For the Year Ended December 31, 2016** |
| **Revenue:** |  | ***(millions)*** |
|  **Revenues**  |  | **$140** |
| **Expenses:** |  |  |
|  **Salary expense**  |  **$31** |  |
|  **Rent expense**  | **16** |  |
|  **Utilities expense**  |  **22** |  |
|  **Total expenses**  |  |  **69**  |
| **Net income**  |  | **$ 71** |

***Req. 2***

|  |  |
| --- | --- |
| **McFall Company** |  |
| **Statement of Retained Earnings** |  |
| **Year Ended December 31, 2016** |  |
|  | (millions) |
| **Retained earnings, December 31, 2015**  | **$ 68** |
| **Add: Net income ($140 − $69)**  |  **71** |
| **Less: Dividends declared**  |  **(12)** |
| **Retained earnings, December 31, 2016**  | **$127** |

 **(continued) E 1-30A**

***Req. 3***

|  |
| --- |
| McFall Company |
| **Balance Sheet** |
| **December 31, 2016** |
| **ASSETS** | ***(in millions)*** |
| **Current assets:** |  |
| **Cash**  | **$150** |
| **Accounts receivable**  |  **55** |
| **Total current assets**  | **205**  |
| **Property and equipment**  | **32** |
| **Other long-term assets**  |  **17** |
| **Total assets**  | **$254** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 60** |
|  **Total current liabilities**  | **60** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **27** |
| **Total liabilities**  |  **87** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **40\*** |
| **Retained earnings**  |  **127** |
| **Total stockholders’ equity**  |  **167** |
| **Total liabilities and stockholders’ equity**  | **$254** |

\***Common stock = Total stockholders’ equity ($167) – Retained earnings ($127) = $40**

**(10-15 min.) E 1-31B**

|  |
| --- |
| *Amounts in billions; (computed amounts in boxes)* |
|  |  |  |  |  | Stockholders’ |
|  | Assets | **=** | Liabilities | **+** | Equity |
| Corner Grocery | **$88** |  | **$51** |  | **$37** |
| **Sixth Street Bank** | **21** |  | **1** |  | **20** |
| **Valerie’s Gifts** | **29** |  | **13** |  | **16** |

Sixth Street Bank appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ($1/$21 = .05). Stated differently, Sixth Street Bank’s equity is the highest percentage of company assets ($20/$21 = .95).

Liabilities as a percent of total assets:

Corner Grocery: $51/$88 = 0.58

Sixth Street Bank: $1/$21 = 0.05

Valerie’s Gifts: $13/$29 = 0.45

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

### Req. 1

|  |
| --- |
|  ***(Amounts in millions)*** |
|  | Assets | **=** | Liabilities | **+** | Stockholders’ Equity |
|  | **$240** |  | **$150** |  |  |
|  |  **350** |  |  **360** |  |  |
|  |  **170** |  |  |  |  |
| **Total** | **$760** | **=** | **$510** | **+** | **$250** |
|  |  |  |  |  |  |
| ***Req. 2*** | **Resources****to work with** | ***Req. 3* Amount**  owed to  creditors |  ***Req. 4* Actually** **owned by company**  **stockholders** |

**(10-20 min.) E 1-33B**

|  |  |
| --- | --- |
|  | **Situation** |
|  | **1** | **2** | **3** |
|  | ***Millions*** |
| **Total stockholders’ equity,** |  |  |  |
|  **January 31, 2016 ($51 − $12)**  | **$39** | **$39** | **$39** |
| **Add: Issuances of stock**  | **13** | **-0-** | **66** |
|  **Net income**  | **6\*** | **39\*** | **-0-** |
| **Less: Dividends declared**  | **-0-** |  **(20)** |  **(20)** |
|  **Net loss**  | **-0-** | **-0-** | **(27)\*** |
| **Total stockholders’ equity,** |  |  |  |
|  **January 31, 2017 ($77 − $19)**  | **$58** | **$58** | **$58** |

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

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

**(10-15 min.) E 1-34B**

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

**b. Balance sheet**

**c. Statement of cash flows**

**d. Statement of cash flows**

**e. Income statement**

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

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

**h. Income statement**

**i. Balance sheet**

**j. Income statement**

**k. Balance sheet**

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

**m. Balance sheet**

**n. Balance sheet**

**(10-20 min.) E 1-35B**

|  |
| --- |
| Robinson Products |
| **Balance Sheet** |
| **December 31, 2016** |
| **ASSETS** |  |
| **Current assets:** |  |
|  **Cash**  | **$ 18,000** |
|  **Receivables**  | **20,000** |
|  **Inventory**  |  **82,000** |
|  **Total current assets**  | **120,000** |
| **Equipment**  |  **183,000** |
| **Total assets**  | **$303,000** |
|  |  |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 29,000** |
|  **Total current liabilities**  | **29,000** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **171,000** |
| **Total liabilities**  |  **200,000** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **29,500** |
| **Retained earnings**  |  **73,500\*** |
| **Total stockholders’ equity**  |  **103,000** |
| **Total liabilities and stockholders’ equity**  | **$303,000** |

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

**\*Computation of retained earnings:**

 **Total assets ($303,000) − current liabilities ($29,000) − long-term notes payable ($171,000) − common stock ($29,500) = $73,500**

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

***Req. 1***

|  |
| --- |
| **David Austin Realty Company** |
| **Balance Sheet**  |
| January 31, 2016 |
| *(Amounts in millions)* |
| ASSETS | **LIABILITIES** |
| **Cash** | **$ 1.3** | **Current liabilities** | **$ 2.1** |
| **Receivables** | **.7** | **Long-term liabilities** |  **102.1** |
| **Property and**  **equipment, net**  | **1.8** | **Total liabilities** | **104.2** |
| **Investment assets****Other assets** | **135.6****9.9** | STOCKHOLDERS’ |
| EQUITY |
|  |  | **Common stock** |  **25.1** |
|  |  | **Retained earnings** |  **20.0\*** |
|  |  | **Total stockholders’ equity** |  **45.1** |
|  | **\_\_\_\_\_\_** | **Total liabilities and** |  |
| **Total assets** | **$149.3** |  **stockholders’ equity** | **$149.3** |

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

\*Computation of retained earnings:

**Total assets ($149.3) − Total liabilities ($104.2) − Common stock ($25.1) = $20.0**

**(15-25 min.) E 1-37B**

***Req. 1***

|  |
| --- |
|  **David Austin Realty Company** |
| **Income Statement**  |
| **Year Ended January 31, 2016** |
| ***(Amounts in millions)*** |  |
| **Total revenue**  |  | **$37.2** |
| **Expenses:** |  |  |
|  **Salary and other employee expenses**  | **$ 13.5** |  |
|  **Other expenses**  | **5.6** |  |
|  **Interest expense**  |  **0.5** |  |
|  **Total expenses**  |  |  **19.6** |
| **Net income**  |  | **$17.6** |

***Req. 2***

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

|  |
| --- |
|  **David Austin Realty Company** |
| **Statement of Retained Earnings****Year Ended January 31, 2016**  |
| **(*Amounts in millions*)** |  |
| **Retained earnings, beginning of year**  | **$16.9** |
| **Add: Net income for the year (*Req. 1*)**  |  **17.6** |
| **Subtotal** | **34.5** |
| **Less: Dividends declared**  |  **14.5** |
| **Retained earnings, end of year (from Exercise 1-36B)**  | **$20.0** |

 **(15-20 min.) E 1-38B**

***Req. 1***

|  |
| --- |
|  **Earl Coffee Roasters Corporation** |
| **Income Statement** |
| **For the Month Ended August 31, 2016** |
| **Revenue:** |  |  |
|  **Service revenue ………………………...** |  | **$270,800** |
| **Expenses:** |  |  |
|  **Salary expense ………………………….**  | **$78,700** |  |
|  **Utilities expense ………………………..**  | **5,900** |  |
|  **Rent expense ……………………………**  |  **1,900** |  |
|  **Total expenses ………………………….**  |  |  **86,500**  |
| **Net income ……………………………………...**  |  | **$184,300** |

|  |
| --- |
| **Earl Coffee Roasters Corporation** |
| **Statement of Retained Earnings** |
| **For the Month Ended August 31, 2016** |
| **Retained earnings, August 1, 2016**  |  **$ -0-** |
| **Add: Net income**  |  **184,300** |
| **Subtotal** |  **184,300** |
| **Less: Dividends declared**  |  **(3,000)** |
| **Retained earnings, August 31, 2016**  |  **$181,300** |

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

***Req. 1***

|  |
| --- |
| **Earl Coffee Roasters Corporation** |
| **Balance Sheet** |
| **August 31, 2016** |
| Assets | Liabilities |
| **Cash**  | **$ 5,300** | **Accounts payable**  | **$ 8,800** |
| **Office supplies**  | **7,300** | **Stockholders’ Equity** |
| **Equipment**  | **202,100** | **Common stock**  | **24,600** |
|  |  | **Retained earnings**  |  **181,300** |
|  |  | **Total stockholders’ equity**  | **205,900** |
| **Total assets**  | **$214,700** | **Total liabilities and**  **stockholders’ equity**  | **$214,700** |

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

***Req. 1***

|  |
| --- |
| **Earl Coffee Roasters Corporation** |
| **Statement of Cash Flows** |
| **For the Month Ended August 31, 2016** |
| **Cash flows from operating activities:****Net income**  |  | **$184,300** |
| **Adjustments to reconcile net income to net cash provided by operations**  |  |  **1,500** |
|  **Net cash provided by operating activities** |  |  **185,800** |
| **Cash flows from investing activities:** |  |  |
|  **Acquisition of equipment**  |  **$(202,100)** |  |
|  **Net cash used for investing activities**  |  |  **(202,100)** |
| **Cash flows from financing activities:** |  |  |
|  **Issuance (sale) of stock to owners**  |  **$ 24,600** |  |
|  **Payment of dividends**  |  **(3,000)** |  |
|  **Net cash provided by financing activities..** |  |  **21,600** |
| **Net increase in cash**  |  | **$ 5,300** |
| **Cash balance, August 1, 2016**  |  |  **0** |
| **Cash balance, August 31, 2016**  |  |  **$ 5,300** |

**(10-20 min.) E 1-41B**

**TO: Owner of Earl 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 $270,800 and net income was $184,300. These operating results look very strong.**

 **The company was able to pay a $3,000 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of $214,700 and liabilities of only $8,800. Your stockholders’ equity is $205,900.**

 **Operating activities generated cash of $185,800, 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 $5,300. Based on the above facts, I believe you should stay in business.**

**Student responses may vary.**

**(20-25 min.) E 1-42B**

***Req. 1***

|  |
| --- |
| **Young Company** |
| **Income Statement** |
| **For the Year Ended December 31, 2016** |
| **Revenue:** |  | ***(millions)*** |
|  **Revenues**  |  | **$150** |
| **Expenses:** |  |  |
|  **Salary expense**  |  **$30** |  |
|  **Rent expense**  | **14** |  |
|  **Utilities expense**  |  **29** |  |
|  **Total expenses**  |  |  **73**  |
| **Net income**  |  |  **$77** |

***Req. 2***

|  |  |
| --- | --- |
| **Young Company** |  |
| **Statement of Retained Earnings** |  |
| **Year Ended December 31, 2016** |  |
|  | (millions) |
| **Retained earnings, December 31, 2015**  | **$ 75** |
| **Add: Net income ($150 − $73)**  |  **77** |
| **Less: Dividends declared**  |  **(10)** |
| **Retained earnings, December 31, 2016**  |  **$142** |

 **(continued) E 1-42B**

***Req. 3***

|  |
| --- |
| Young Company |
| **Balance Sheet** |
| **December 31, 2016** |
| **ASSETS** | ***(in millions)*** |
| **Current assets:** |  |
| **Cash**  | **$160** |
| **Accounts receivable**  |  **62** |
| **Total current assets**  | **222**  |
| **Property and equipment**  | **34** |
| **Other long-term assets**  |  **19** |
|  |  |
| **Total assets**  | **$275** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable**  | **$ 63** |
|  **Total current liabilities**  | **63** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable**  |  **25** |
| **Total liabilities**  |  **88** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock**  | **45\*** |
| **Retained earnings**  |  **142** |
| **Total stockholders’ equity**  |  **187** |
|  |  |
| **Total liabilities and stockholders’ equity**  | **$275** |

\***Common stock = Total stockholders’ equity ($187) – Retained earnings ($142) = $45**

**Quiz**

|  |  |
| --- | --- |
| **Q1-43** | **c** |
| **Q1-44** | **b** |
| **Q1-45** | **b** |
| **Q1-46** | **a** |  **Stockholders’** |  |
|  |  |  **Assets = Liabilities + Equity** |  |
|  |  | **+ $87,000 = + $31,000 + + $56,000** |  |
| **Q1-47** | **c** |
| **Q1-48** | **a** |
| **Q1-49** | **b** |
| **Q1-50** | **a** |
| **Q1-51** | **a** |
| **Q1-52** | **d [$230,000 − $185,000 − $83,000 − $26,000 = $(64,000)]** |
| **Q1-53** | **d ($340,000 + $185,000 − $85,000 = $440,000)** |
| **Q1-54** | **d** |
| **Q1-55** | **d** |
| **Q1-56** | **c** |  |  |  |  |  | **Stockholders’** |  |
|  |  |  | **Assets** | **=** | **Liabilities** | **+** | **Equity** |  |
|  |  | **Beg.** | **$144,000**  | **=** | **$25,000\*** | **+** | **$119,000** |  |
|  |  | **Changes** |  |  | **+ 74,000** |  |  |  |
|  |  | **End.** | **$237,000\*** | **=** | **$99,000\*** | **+** | **$138,000** |  |
|  |  | **\_\_\_\_\_** |  |  |  |  |  |  |
|  |  | **\*Must solve for these amounts.** |  |
|  |  |  |
| **Q1-57** | **c** |  **Assets − Liabilities = Stockholders’ equity** |
|  |  |  **Beg. bal.** | **$330,000 − $25,000 =**  | **$305,000** |  |
|  |  | **+ Net income** |  | **+ X** |  |
|  |  | **− Dividends** |  | **− 70,000** |  |
|  |  |  **End. bal.** | **$560,000 − $35,000 =**  | **$525,000** |  |

**$305,000 + X – $70,000 = $525,000; X = $290,000**

**Problems**

 **(30 min.) P 1-58A**

**Computed amounts in boxes.**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Crystal** **Co.** | **Lowell,** **Inc.** | **Broom****Corp.** |
| **BALANCE SHEET** |  |  ***(Millions)*** |  |
| ***Beginning*:** |  |  |  |
|  **Assets**  | **$83** | **$43** | **$15** |
|  **Liabilities**  | **43** | **14** | **7** |
|  **Common stock**  | **6** | **3** | **7** |
|  **Retained earnings**  | **34** | **26** | **1** |
|  |  |  |  |
| ***Ending*:** |  |  |  |
|  **Assets**  | **$89** | **$61** | **$18** |
|  **Liabilities**  | **45** | **26** | **6** |
|  **Common stock**  | **6** | **12** | **9** |
|  **Retained earnings**  | **38** | **23** | **3** |
|  |  |  |  |
| **INCOME STATEMENT** |  |  |  |
|  **Revenues**  | **$228** | **$166** | **$22** |
|  **Expenses**  |  **222** | **156** |  **20** |
|  **Net income**  | **$ 6** | **$ 10** | **$ 2** |
|  |  |  |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |
|  **Beginning RE**  | **$34** | **$26** | **$ 1** |
|  **+ Net income**  | **6** | **10** | **2** |
|  **− Dividends declared**  |  **(2)** |  **(13)** |  **0** |
|  **= Ending RE**  | **$38** | **$23** | **$ 3** |

**(continued) P 1-58A**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **Crystal Co.** |  | **Lowell, Inc.** |  | **Broom Corp.** |
|  |  |  |  | ***Millions*** |  |  |
| **Net income**  |  | **$6** |  | **$10** |  | **$2** |
|  |  |  |  |  |  | ***Highest*** |  |  |
|  |  |  |  |  |  |  |  |  |
| **% of net income** |  | **$6** | **= 2.6%** |  | **$10** | **= 6.0%** |  | **$2** | **= 9.1%** |
|  **to revenues**  |  | **$228** |  | **$166** |  | **$22** |
|  |  |  |  |  |  | ***Highest*** |

**(20-25 min.) P 1-59A**

***Req. 1***

|  |
| --- |
| **Salem News, Inc.** |
| **Balance Sheet** |
| **October 31, 2016** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 10,500** | **Accounts payable** | **$ 5,000** |
| **Accounts receivable** | **2,800** | **Note payable** |  **55,000** |
| **Notes receivable** | **15,500** | **Total liabilities** | **60,000** |
| **Office supplies** | **1,300** | **STOCKHOLDERS’** |
| **Land** | **84,000** | **EQUITY** |
| **Equipment** | **35,000** | **Stockholders’ equity** | **89,100\*** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$149,100** |  **stockholders’ equity** |  **$149,100** |

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

**\*Total assets ($149,100) − Total liabilities ($60,000) = Stockholders’ equity ($89,100).**

***Req. 2***

**Salem News, Inc. is in *better (not worse)* financial position than the erroneous balance sheet reports. Total assets ($149,100) are $10,100 higher than originally reported ($139,000), liabilities are $16,600 lower than originally reported, and stockholders’ equity is $26,700 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 1-60A**

***Req. 1***

|  |
| --- |
| **Caden Healey Realtor, Inc.** |
| **Balance Sheet** |
| **December 31, 2017** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 48,000** | **Accounts payable** |  **$ 2,000** |
| **Office supplies** | **2,000** | **Note payable** |  **132,000** |
| **Land** | **168,000** | **Total liabilities** |  **134,000** |
| **Furniture** | **23,400** | **STOCKHOLDERS’** |
| **Franchise** | **15,000** | **EQUITY** |
|  |  | **Common stock** |  **60,000** |
|  |  | **Retained earnings** |  **62,400\*** |
|  |  | **Total stockholders’ equity** |  **122,400** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$256,400** |  **stockholders’ equity** | **$256,400** |

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

**\*Total assets ($256,400) − Total liabilities ($134,000) − Common stock ($60,000) = Retained earnings ($62,400).**

***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 ($12,000)**

 **b. Personal account payable ($6,800)**

 **g. Personal residence ($405,000) and mortgage payable ($190,000)**

**(30-45 min.) P 1-61A**

***Req. 1***

|  |
| --- |
| **Beckwith Garden Supply, Inc.** |
| **Income Statement** |
| **Year Ended December 31, 2016** |
| **Revenue** |  |  |
|  **Service revenue**  |  | **$457,600** |
| **Expenses** |  |  |
|  **Salary expense**  | **$108,500** |  |
|  **Rent expense**  **Interest expense**  **Utilities expense**  | **40,600****10,200****8,500** |  |
|  **Property tax expense**  |  **7,300** |  |
|  **Total expenses**  |  |  **175,100** |
| **Net income**  |  | **$282,500** |
|  |  |  |

***Req. 2***

|  |
| --- |
| **Beckwith Garden Supply, Inc.** |
| **Statement of Retained Earnings** |
| **Year Ended December 31, 2016** |
| **Retained earnings, December 31, 2015**  |  **$ 364,200** |
| **Add: Net income**  |  **282,500** |
| **Subtotal** |  **646,700** |
| **Less: Dividends declared**  |  **(106,000)** |
| **Retained earnings, December 31, 2016**  |  **$ 540,700** |

### (continued) P 1-61A

### Req. 3

|  |
| --- |
| **Beckwith Garden Supply, Inc.** |
| **Balance Sheet** |
| **December 31, 2016** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 41,000** | **Accounts payable** | **$ 24,000** |
| **Accounts receivable** | **84,600** | **Note payable**  |  **99,500** |
| **Supplies** | **6,800** | **Interest payable** |  **2,500** |
| **Land** | **27,000** | **Total liabilities** |  **126,000** |
| **Building** | **401,000** | **STOCKHOLDERS’** |
| **Equipment** | **119,000** | **EQUITY** |
|  |  | **Common stock** | **12,700** |
|  |  | **Retained earnings** |  **540,700** |
|  |  | **Total stockholders’ equity** |  **553,400**  |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$679,400** |  **stockholders’ equity** | **$679,400** |

***Req. 4***

**a. Beckwith Garden Supply was profitable; net income was $282,500.**

**b. Retained earnings increased by $176,500 — from $364,200 to $540,700.**

**c. Stockholders’ equity ($553,400) exceeds liabilities ($126,000).**

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

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

***Req. 1***

|  |
| --- |
| **Riley Company** |
| **Statement of Cash Flows** |
| **Year Ended March 31, 2017** |
|  | ***Millions*** |
| **Cash flows from operating activities:** |  |  |
|  **Net income**  |  | **$ 3,040** |
|  **Adjustments to reconcile net income to net cash** |  |  |
|  **provided by operating activities**  |  |  **2,410** |
|  **Net cash provided by operating activities**  |  |  **5,450** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
|  **Purchases of property, plant, and equipment**  | **$(3,505)** |  |
|  **Sales of property, plant, and equipment**  |  **45** |  |
|  **Other investing cash payments**  |  **(170)** |  |
|  **Net cash used for investing activities**  |  |  **(3,630)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
|  **Issuance of common stock**  |  **$ 165** |  |
|  **Payment of dividends**  |  **(270)** |  |
|  **Net cash used for financing activities**  |  |  **(105)** |
|  |  |  |
| **Net increase in cash**  |  | **$ 1,715** |
| **Cash, beginning**  |  |  **210** |
| **Cash, ending**  |  | **$ 1,925** |

***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 1-63A**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **NCOME STATEMENT** |  |  | **2017** | **2016** |  |  |
| **Revenues**  | **13,710** | **=** | **$ k** | **$15,000** |  |  |
| **Cost of goods sold**  |  |  | **(11,000)** |  **a** | **=** | **(11,820)** |
| **Other expenses**  |  |  |  **(1,210)** |  **(1,180)** |  |  |
| **Income before income taxes**  |  |  |  **1,500** | **2,000** |  |  |
| **Income taxes (35% tax rate)**  | **525** | **=** |  **l** |  **(700)** |  |  |
| **Net income**  | **975** | **=** | **$ m** | **$ b** | **=** | **1,300** |
|  |  |  |  |  |  |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |  |  |  |
| **Beginning balance**  | **3,840** | **=** | **$ n** | **$ 2,650** |  |  |
| **Net income**  | **975** | **=** |  **o** |  **c** | **=** | **1,300** |
| **Dividends declared**  |  |  |  **(90)** |  **(110)** |  |  |
| **Ending balance**  | **4,725** | **=** | **$ p** | **$ d** | **=** | **3,840** |
|  |  |  |  |  |  |  |
| **BALANCE SHEET** |  |  |  |  |  |  |
| **Assets:** |  |  |  |  |  |  |
|  **Cash**  | **1,140** | **=** | **$ q** | **$ e** | **=** | **1,320** |
|  **Property, plant and equipment**  |  |  | **1,507** |  **1,346** |  |  |
|  **Other assets**  | **11,553** | **=** |  **r** |  **11,799** |  |  |
|  **Total assets**  | **14,200** | **=** | **$ s** | **$14,465** |  |  |
| **Liabilities:** |  |  |  |  |  |  |
|  **Current liabilities**  | **3,625** | **=** | **$ t** | **$ 5,650** |  |  |
|  **Long-term debt**  **Other liabilities**  |  |  |  **4,450** **975** |  **3,380** **1,120** |  |  |
|  **Total liabilities**  |  |  | **9,050** |  **f** | **=** | **10,150** |
|  |  |  |  |  |  |  |
| **Stockholders’ Equity:** |  |  |  |  |  |  |
|  **Common stock**  |  |  | **$ 275** | **$ 275** |  |  |
|  **Retained earnings**  | **4,725** | **=** |  **u** |  **g** | **=** | **3,840** |
|  **Other stockholders’ equity**  |  |  |  **150** |  **200** |  |  |
|  **Total stockholders’ equity**  | **5,150** | **=** |  **v** |  **4,315** |  |  |
|  **Total liabilities and stockholders’ equity stockholders’ equity**  | **14,200** | **=** | **$ w** | **$ h** | **=** | **14,465** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CASH FLOWS**  |  |  |  |  |  |  |
|  **Net cash provided by operating activities**  | **650** | **=** | **$ x** |  **$ 975** |  |  |
|  **Net cash used for investing activities**  |  |  | **(260)** | **(375)** |  |  |
|  **Net cash used for financing activities**  |  |  |  **(570)** |  **(540)** |  |  |
|  **Increase (decrease) in cash**  |  |  |  **(180)** |  **i** | **=** |  **60** |
|  **Cash at beginning of year**  | **1,320** | **=** |  **y** |  **1,260** |  |  |
|  **Cash at end of year**  | **1,140** | **=** | **$ z** | **$ j** | **=** | **1,320** |

**(30 min.) P 1-64B**

**Computed amounts in boxes**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  **Pearl**  **Co.** | **Loomis** **Co.** | **Bryant Corp.** |
|  |  ***Millions***  |
| ***Balance sheets:*** |  |  |  |
| ***Beginning*:** |  |  |  |
|  **Assets**  | **$ 82** | **$ 42** | **$ 17** |
|  **Liabilities**  | **44** | **20** | **10** |
|  **Common stock**  | **3** | **2** | **3** |
|  **Retained earnings**  | **35** | **20** | **4** |
|  |  |  |  |
| **Ending:** |  |  |  |
|  **Assets**  | **$ 86** | **$ 62** | **$ 19** |
|  **Liabilities**  | **46** | **33** | **9** |
|  **Common stock**  | **3** | **15** | **7** |
|  **Retained earnings**  | **37** | **14** |  **3** |
|  |  |  |  |
| **Income statement:** |  |  |  |
|  **Revenues**  | **$223** | **$170** | **$ 26** |
|  **Expenses**  |  **216** |  **160** |  **25** |
|  **Net income**  | **$ 7** | **$ 10** | **$ 1** |
|  |  |  |  |
| **Statement of retained earnings:** |  |  |  |
|  **Beginning RE**  | **$ 35** | **$ 20** | **$ 4** |
|  **+ Net income**  | **7** | **10** | **1** |
|  **− Dividends declared**  |  **(5)** |  **(16)** |  **(2)** |
|  **= Ending RE**  | **$ 37** | **$ 14** | **$ 3** |

**(continued) P 1-64B**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Pearl Co.** | **Loomis Co.** | **Bryant Corp.** |
|  |  | ***Millions*** |  |
|  |  |  |  |
| **Net income**  | **$7** | **$10** | **$1** |
|  |  | ***Highest*** |  |
|  |  |  |  |
| **% of net income** | **$7** | **= 3.1%** | **$10** | **= 5.9%** | **$1** | **= 3.8%** |
|  **to revenues**  | **$223** | **$170** | **$26** |
|  |  |  ***Highest*** |  |

**(20-25 min.) P 1-65B**

***Req. 1***

|  |
| --- |
| **Candace Design, Inc.** |
| **Balance Sheet** |
| **June 30, 2016** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 8,500** | **Accounts payable** | **$ 2,500** |
| **Accounts receivable** | **3,800** | **Note payable** |  **54,500** |
| **Notes receivable** | **13,000** | **Total liabilities** |  **57,000** |
| **Office supplies** | **1,000** | **STOCKHOLDERS’** |
| **Land** | **76,000** | **EQUITY** |
| **Equipment**  | **35,600** | **Stockholders’ equity** |  **80,900\*** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$137,900** |  **stockholders’ equity** |  **$137,900** |

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

**\*Total assets ($137,900) − Total liabilities ($57,000) = Stockholders’ equity ($80,900).**

***Req. 2***

**Candace Design, Inc. is in a *better* financial position than the erroneous balance sheet reports. Assets are $10,700 greater and liabilities are $17,500 less than originally reported, and equity is $28,200 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 1-66B**

***Req. 1***

|  |
| --- |
| **Billy Higgins Realtor, Inc.** |
| **Balance Sheet** |
| **June 30, 2017** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 58,000** | **Accounts payable** | **$ 4,000** |
| **Office supplies** | **4,000** | **Note payable** |  **136,000** |
| **Land** | **157,000** | **Total liabilities** |  **140,000** |
| **Furniture** | **19,600** | **STOCKHOLDERS’** |
| **Franchise** | **15,000** | **EQUITY** |
|  |  | **Common stock** | **65,000** |
|  |  | **Retained earnings** |  **48,600\*** |
|  |  | **Total stockholders’ equity** |  **113,600** |
| **Total assets** | **$253,600** | **Total liabilities and stockholders’ equity** | **$253,600** |

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

**\*Total assets ($253,600) − Total liabilities ($140,000) − Common stock ($65,000) = Retained earnings ($48,600).**

***Req. 2***

**It appears that Billy Higgins’ 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 ($14,000)**

1. **Personal account payable ($5,200)**

**g. Personal residence ($423,000) and personal mortgage ($151,000)**

**(30-45 min.) P 1-67B**

***Req. 1***

|  |
| --- |
|  **Blue Moon Products, Inc.** |
| **Income Statement** |
| **Year Ended December 31, 2016** |
| **Revenue:** |  |  |
|  **Service revenue**  |  | **$458,600** |
| **Expenses:** |  |  |
|  **Salary expense**  | **$108,300** |  |
|  **Rent expense**  | **40,200** |  |
|  **Utilities expense**  | **8,100** |  |
|  **Interest expense**  |  **10,800** |  |
|  **Property tax expense**  |  **7,900** |  |
|  **Total expenses**  |  |  **175,300** |
| **Net income**  |  | **$283,300** |

***Req. 2***

|  |
| --- |
| **Blue Moon Products, Inc.** |
| **Statement of Retained Earnings** |
| **Year Ended December 31, 2016** |
| **Retained earnings, December 31, 2015**  |  **$364,500** |
| **Add: Net income**  |  **283,300** |
| **Subtotal** |  **647,800** |
| **Less: Dividends declared**  |  **(108,000)** |
| **Retained earnings, December 31, 2016**  | **$539,800** |

**(continued) P 1-67B**

***Req. 3***

|  |
| --- |
| **Blue Moon Products, Inc.** |
| **Balance Sheet** |
| **December 31, 2016** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 41,000** | **Accounts payable** | **$ 27,000** |
| **Accounts receivable** | **84,500** | **Interest payable** |  **2,300** |
| **Supplies** | **6,100** | **Note payable** |  **99,700** |
| **Land** | **28,000** | **Total liabilities** |  **129,000** |
| **Building** | **402,000** | **STOCKHOLDERS’** |
| **Equipment** | **111,000** | **EQUITY** |
|  |  | **Common stock** | **3,800** |
|  |  | **Retained earnings** |  **539,800** |
|  |  | **Total stockholders’ equity** | **543,600** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$672,600** |  **stockholders’ equity** | **$672,600** |

***Req. 4***

**a. Blue Moon Products was profitable; net income was $283,300.**

**b. Retained earnings increased by $175,300 — from $364,500 to $539,800.**

**c. Total equity ($543,600) exceeds total liabilities ($129,000).**

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

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

***Req. 1***

|  |
| --- |
| **Salem Water Company** |
| **Statement of Cash Flows** |
| **Year Ended March 31, 2017** |
|  | ***Millions*** |
| **Cash flows from operating activities:** |  |  |
|  **Net income**  |  | **$ 3,060** |
|  **Adjustments to reconcile net income to net cash** |  |  |
|  **provided by operating activities**  |  |  **2,350** |
|  **Net cash provided by operating activities**  |  | **5,410** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
|  **Purchases of property, plant, and equipment**  |  **$(3,515)** |  |
|  **Sales of property, plant, and equipment**  | **55** |  |
|  **Other investing cash payments**  |  **(190)** |  |
|  **Net cash used for investing activities**  |  |  **(3,650)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
|  **Issuance of common stock**  | **$ 205** |  |
|  **Payment of dividends**  |  **(285)** |  |
|  **Net cash used for financing activities**  |  |  **(80)** |
|  |  |  |
| **Net increase in cash**  |  |  **$1,680** |
| **Cash, beginning**  |  |  **230** |
| **Cash, ending**  |  | **$ 1,910** |

***Req. 2***

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

**(40-50 min.) P 1-69B**

|  |  |
| --- | --- |
|  | ***(Thousands)*** |
| **INCOME STATEMENT**  |  |  | **2017** | **2016** |  |  |
| **Revenues**  | **13,730** | **=** | **$ k** | **$16,175** |  |  |
| **Cost of goods sold**  |  |  | **(11,020)** | **a** | **=** | **(13,145)** |
| **Other expenses**  |  |  |  **(1,200)** |  **(1,210)** |  |  |
| **Income before income taxes**  |  |  | **1,510** |  **1,820** |  |  |
| **Income taxes (35% tax rate)**  | **529** | **=** |  **l** |  **637** |  |  |
|  **Net income**  | **981** | **=** | **$ m** | **$ b** | **=** | **1,183** |
|  |  |  |  |  |  |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |  |  |  |
| **Beginning balance**  | **3,783** | **=** | **$ n** |  **$ 2,740** |  |  |
| **Net income**  | **981** | **=** |  **o** |  **c** | **=** | **1,183** |
| **Dividends declared**  |  |  |  **(82)** |  **(140)** |  |  |
| **Ending balance**  | **4,682** | **=** | **$ p** | **$ d** | **=** | **3,783** |
|  |  |  |  |  |  |  |
| **BALANCE SHEET** |  |  |  |  |  |  |
| **Assets:** |  |  |  |  |  |  |
|  **Cash**  | **1,140** | **=** | **$ q** | **$ e** | **=** |  **1,220** |
|  **Property, plant and equipment**  |  |  | **1,567** | **1,306** |  |  |
|  **Other assets**  | **11,520** | **=** |  **r** |  **10,872** |  |  |
|  **Total assets**  | **14,227** | **=** | **$ s** | **$13,398** |  |  |
|  |  |  |  |  |  |  |
| **Liabilities:** |  |  |  |  |  |  |
|  **Current liabilities**  | **4,865** | **=** | **$ t** | **$ 5,660** |  |  |
|  **Long-term debt**  |  |  | **4,300** |  **3,370** |  |  |
|  **Other liabilities**  |  |  |  **35** |  **180** |  |  |
|  **Total liabilities**  |  |  |  **9,200** |  **f** | **=** | **9,210** |
|  |  |  |  |  |  |  |
| **Stockholders’ Equity:** |  |  |  |  |  |  |
|  **Common stock**  |  |  |  **$ 225** | **$ 225** |  |  |
|  **Retained earnings**  | **4,682** | **=** |  **u** |  **g** | **=** | **3,783** |
|  **Other stockholders’ equity**  |  |  |  **120** |  **180** |  |  |
|  **Total stockholders’ equity**  | **5,027** | **=** |  **v** |  **4,188** |  |  |
|  **Total liabilities and stockholders’ equity**  | **14,227** | **=** | **$ w** | **$ h** | **=** | **13,398** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CASH FLOWS** |  |  |  |  |  |  |
|  **Net cash provided by operating activities**  | **720** | **=** | **$ x** | **$ 900** |  |  |
|  **Net cash used for investing activities**  |  |  |  **(210)** | **(350)** |  |  |
|  **Net cash used for financing activities**  |  |  |  **(590)** |  **(550)** |  |  |
|  **Increase (decrease) in cash**  |  |  |  **( 80)** |  **i** | **=** |  **-0-** |
|  **Cash at beginning of year**  | **1,220** | **=** |  **y** |  **1,220** |  |  |
|  **Cash at end of year**  | **1,140** | **=** | **$ z** |  **$ j** | **=** |  **1,220** |

**Decision Cases**

**(30-40 min.) Decision Case 1**

***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.) Decision Case 2**

***Req. 1***

|  |  |  |
| --- | --- | --- |
| **Flowers Unlimited, Inc.** |  | **Flowers Unlimited, Inc.** |
| **Income Statement** |  | **Balance Sheet** |
| **Year Ended Dec. 31, 2016** |  | **Dec. 31, 2016** |
| **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**

**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) Ethical Issue**

***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) Ethical Issue**

**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) Ethical Issue**

**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.)**

**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 92,600 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) Apple Inc.**

**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 improved from $37.0 billion in 2013 to $39.5 billion in 2014, which is good news.**

**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 27, 2014.….$231,839 million**

 **Amount owed (total liabilities) at September 27, 2014….$120,292 million**

 **Portion of the company’s assets owned by the stockholders (stockholders’ equity) at September 27, 2014...……….. $111,547 million**

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

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **$231,839** | **=** | **$120,292** | **+** | **$111,547** |

**7. At September 28, 2013, Apple Inc. had $14,259 million of cash and cash equivalents. At September 27, 2014, Apple Inc. had $13,844 million of cash and cash equivalents.**

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

**(30 min.)**

**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) Under Armour, Inc.**

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

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Assets** | **=** | **Liabilities** | **+** | **Shareholders’ Equity** |
|  | **$2,095** | **=** | **$745** | **+** | **$1,350** |

 **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 2014 was a net income of $208,042 thousand. This is good news for Under Armour, Inc. Revenue exceeded expenses for fiscal 2014, and there is a positive trend in earnings over the past two years ($128,778 thousand, $162,330 thousand, and $208,042 thousand in fiscal 2012, 2013, and 2014, 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 2014 was comprehensive income of $208,042 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 $219,033 thousand, investing activities used $152,312 thousand, and financing activities provided $182,306 thousand.**

**Group Projects**

**Student responses will vary.**