# **Chapter 1**

**The Financial Statements**

**Short Exercises**

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

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Computed amounts in boxes** | | | | | |
|  |  |  |  |  |  |
|  | **Total Assets** | **=** | **Total Liabilities** | **+** | **Stockholders’ Equity** |
|  |  |  |  |  |  |
| **a.** | **$660,000** | **=** | **$320,000** | **+** | **$340,000** |
|  |  |  |  |  |  |
| **b.** | **135,000** | **=** | **57,000** | **+** | **78,000** |
|  |  |  |  |  |  |
| **c.** | **401,000** | **=** | **45,000** | **+** | **356,000** |

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

**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 min.) S 1-3**

**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 1-4**

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

**2. Application of the entity assumption will separate Wallace’s personal assets from the assets of New Age Foods. This will help Wallace, 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 1-5**

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

**b. Historical cost principle; $300 is value of FAX machine**

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

**d. Entity assumption**

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

**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.**

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

**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.**

**(5-10 min.) S 1-8**

|  |  |  |  |
| --- | --- | --- | --- |
| **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 1-9**

**1. Revenues and expenses**

**2. Net income (or net loss)**

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

|  |  |  |
| --- | --- | --- |
| **O’Malley Services, Inc.** | |  |
| **Income Statement** | |  |
| **Year Ended December 31, 2014** | |  |
|  | ***(millions)*** | |
| **Revenues** | **$398** | |
| **Expenses** | **167** | |
| **Net income** | **$231** | |

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

|  |  |  |  |
| --- | --- | --- | --- |
| **Canada Corp.** | |  | |
| **Statement of Retained Earnings** | |  | |
| **Year Ended December 31, 2014** | |  | |
|  | (millions) | |
| **Retained earnings, December 31, 2013** | **$286** | |
| **Add: Net income ($482 − $337)** | **145** | |
| **Less: Dividends declared** | **(59)** | |
| **Retained earnings, December 31, 2014** | **$372** | |

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

|  |  |
| --- | --- |
| Washington Products | |
| **Balance Sheet** | |
| **December 31, 2014** | |
| **ASSETS** |  |
| **Current assets:** |  |
| **Cash** | **$ 21,000** |
| **Receivables** | **17,600** |
| **Inventory** | **79,000** |
| **Total current assets** | **117,600** |
| **Equipment** | **185,000** |
|  |  |
| **Total assets** | **$302,600** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
| **Accounts payable** | **$ 25,000** |
| **Total current liabilities** | **25,000** |
| **Long-term liabilities:** |  |
| **Long-term notes payable** | **169,000** |
| **Total liabilities** | **194,000** |
|  |  |
| **STOCKHOLDERS’ EQUITY** |  |
| **Common stock** | **30,500** |
| **Retained earnings** | **78,100\*** |
| **Total stockholders’ equity** | **108,600** |
|  |  |
| **Total liabilities and stockholders’ equity** | **$302,600** |

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**\*Computation of retained earnings:**

**Total assets ($302,600) − current liabilities ($25,000) − long-term notes payable ($169,000) − common stock ($30,500) = $78,100**

**(10-15 min.) S 1-13**

|  |  |  |
| --- | --- | --- |
| **Guling Legal Services, Inc.** | | |
| **Statement of Cash Flows** | | |
| **Year Ended December 31, 2014** | | |
| **Cash flows from operating activities:** | |  |
| **Net income** | | **$ 75,000** |
| **Adjustments to reconcile net income to net cash provided by operating activities .. provided by operating activities** | | **(8,000)** |
| **Net cash provided by operating activities** | | **67,000** |
|  | |  |
| **Cash flows from investing activities:** | |  |
| **Purchases of equipment** | **$(29,000)** |  |
| **Net cash used for investing activities** | | **(29,000)** |
|  | |  |
| **Cash flows from financing activities:** | |  |
| **Payment of dividends** | **$(31,000)** |  |
| **Net cash used for financing activities** | | **(31,000)** |
| **Net increase in cash** | | **7,000** |
| **Cash balance, December 31, 2013** | | **15,000** |
| **Cash balance, December 31, 2014** | | **$ 22,000** |

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

**a. Accounts payable BS**

**b. Inventory BS**

**c. Interest revenue IS**

**d. Long-term debt BS**

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

**f. Salary expense IS**

**g. Cash BS, SCF**

**h. Dividends SRE, SCF**

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

**j. Net income IS, SRE, SCF**

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

**l. Retained earnings SRE, BS**

**m. Sales revenue IS**

**n. Common stock BS**

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

**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.**

**Exercises**

**(10-15 min.) E 1-16A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| ***Amounts in billions; (computed amounts in boxes)*** | | | | | |
|  |  |  |  |  | Stockholders’ |
|  | Assets | **=** | Liabilities | **+** | Equity |
| Beautiful Florals | **$83** |  | **$ 47** |  | **$36** |
| **Corner Groceries** | **26** |  | **7** |  | **19** |
| **State Bank** | **33** |  | **11** |  | **22** |

Corner Groceries appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ($7/$26 = .27). Stated differently, Corner Groceries’ equity is the highest percentage of company assets ($19/$26 = .73).

Liabilities as a percent of total assets:

**Beautiful Florals $47/$83 = 0.57**

**Corner Groceries $7/$26 = 0.27**

**State Bank $11/$33 = 0.33**

**(10-15 min.) E 1-17A**

### Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| ***(Amounts in millions)*** | | | | | |
|  | Assets | **=** | Liabilities | **+** | Stockholders’ Equity |
|  | **$180** |  | **$105** |  |  |
|  | **300** |  | **280** |  |  |
|  | **110** |  |  |  |  |
| **Total** | **$590** | **=** | **$385** | **+** | **$205** |
|  |  |  |  |  |  |
| ***Req. 2*** | **Resources**  **to work with** | ***Req. 3* Amount** owed tocreditors | | ***Req. 4* Actually**  **owned by company**  **stockholders** | |

**(10-20 min.) E 1-18A**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Situation** | | |
|  | **1** | **2** | **3** |
|  | ***(Millions)*** | | |
| **Total stockholders’ equity,** |  |  |  |
| **January 31, 2014 ($52 − $14)** | **$38** | **$38** | **$38** |
| **Add: Issuances of stock** | **7** | **-0-** | **29** |
| **Net income** | **8\*** | **20\*** | **-0-** |
| **Less: Dividends declared** | **-0-** | **(5)** | **(8)** |
| **Net loss** | **-0-** | **-0-** | **(6)\*** |
| **Total stockholders’ equity,** |  |  |  |
| **January 31, 2015 ($76 − $23)** | **$53** | **$53** | **$53** |

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

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

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

**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 1-20A**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Alan Sanders Realty Company** | | | | |
| **Balance Sheet** | | | | |
| July 31, 2014 | | | | |
| *(Amounts in millions)* | | | | |
| ASSETS | | **LIABILITIES** | | |
| **Cash** | **$ 1.8** | **Current liabilities** | **$ 2.1** | |
| **Receivables** | **0.6** | **Long-term liabilities** | **102.2** | |
| **Investment assets** | **135.6** | **Total liabilities** | **104.3** | |
| **Property and equipment, net** | **1.9** | STOCKHOLDERS’ **EQUITY** | | |
| **Other assets** | **10.7** |
|  |  | **Common stock** | | **21.8** |
|  | | **Retained earnings** | | **24.5\*** |
|  | | **Total stockholders’ equity** | | **46.3** |
| **Total assets** | **$150.6** | **Total liabilities and stockholders’ equity** | | **$150.6** |
|  |  |  | |  |

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\*Computation of retained earnings:

**Total assets ($150.6) − Total liabilities ($104.3) − Common stock ($21.8) = $24.5**

**(15-25 min.) E 1-21A**

***Req. 1***

|  |  |  |
| --- | --- | --- |
| **Alan Sanders Realty Company** | | |
| **Income Statement** | | |
| **Year Ended July 31, 2014** | | |
| ***(Amounts in millions)*** | | |
|  |  | |
| **Total revenue** |  | **$37.8** |
| **Expenses:** |  |  |
| **Salary and other employee expenses** | **$13.8** |  |
| **Other expenses** | **5.3** |  |
| **Interest expense** | **0.6** |  |
| **Total expenses** |  | **19.7** |
| **Net income** |  | **$18.1** |

***Req. 2***

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

|  |  |
| --- | --- |
| **Alan Sanders Realty Company** | |
| **Statement of Retained Earnings** | |
| **Year Ended July 31, 2014** | |
| ***(Amounts in millions)*** | |
|  |  |
| **Retained earnings, beginning of year** | **$16.9** |
| **Add: Net income for the year (Req. 1)** | **18.1** |
| **Subtotal** | **35.0** |
| **Less: Dividends declared** | **10.5** |
| **Retained earnings, end of year (from Exercise 1-20A)** | **$24.5** |

**(15-20 min.) E 1-22A**

|  |  |  |
| --- | --- | --- |
| **Island Coffee Roasters Corp.** | | |
| **Income Statement** | | |
| **For the Month Ended August 31, 2015** | | |
| **Revenue:** |  |  |
| **Service revenue** |  | **$272,600** |
| **Expenses:** |  |  |
| **Salary expense** | **$78,500** |  |
| **Utilities expense** | **5,200** |  |
| **Rent expense** | **1,800** |  |
| **Total expenses** |  | **85,500** |
| **Net income** |  | **$187,100** |

|  |  |
| --- | --- |
| **Island Coffee Roasters Corp.** | |
| **Statement of Retained Earnings** | |
| **For the Month Ended August 31, 2015** | |
| **Retained earnings, August 1, 2015** | **$ -0-** |
| **Add: Net income for the month** | **187,100** |
| **Subtotal** | **187,100** |
| **Less: Dividends declared** | **(2,400)** |
| **Retained earnings, August 31, 2015** | **$184,700** |

**(15-20 min.) E 1-23A**

|  |  |  |  |
| --- | --- | --- | --- |
| **Island Coffee Roasters Corp.** | | | |
| **Balance Sheet** | | | |
| **August 31, 2015** | | | |
| Assets | | Liabilities | |
| **Cash** | **$ 5,500** | **Accounts payable** | **$ 8,800** |
| **Office supplies** | **7,400** |  |  |
| **Equipment** | **205,000** | **Stockholders’ Equity** | |
|  |  | **Common stock** | **24,400** |
|  |  | **Retained earnings** | **184,700** |
|  |  | **Total stockholders’ equity** | **209,100** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$217,900** | **stockholders’ equity** | **$217,900** |

**(15-20 min.) E 1-24A**

|  |  |  |
| --- | --- | --- |
| **Island Coffee Roasters Corp.** | | |
| **Statement of Cash Flows** | | |
| **For the Month Ended August 31, 2015** | | |
| **Cash flows from operating activities:** |  |  |
| **Net income** |  | **$187,100** |
| **Adjustments to reconcile net income to net** |  |  |
| **cash provided by operating activities** |  | **1,400** |
| **Net cash provided by operating activities** |  | **188,500** |
| **Cash flows from investing activities:** |  |  |
| **Acquisition of equipment** | **$(205,000)** |  |
| **Net cash used for investing activities** |  | **(205,000)** |
| **Cash flows from financing activities:** |  |  |
| **Issuance (sale) of stock to owners** | **$ 24,400** |  |
| **Payment of dividends** | **(2,400)** |  |
| **Net cash provided by financing activities** |  | **22,000** |
| **Net increase in cash** |  | **$ 5,500** |
| **Cash balance, August 1, 2015** |  | **0** |
| **Cash balance, August 31, 2015** |  | **$ 5,500** |

**(10-15 min.) E 1-25A**

**TO: Owner of Island 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 $272,600 and net income was $187,100. These operating results look very strong.**

**The company was able to pay a $2,400 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of $217,900 and liabilities of only $8,800. Your stockholders’ equity is $209,100.**

**Operating activities generated cash of $188,500, 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 $5,500. Based on the above facts, I believe you should stay in business.**

**Student responses may vary.**

**(10-15 min.) E 1-26B**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| *Amounts in billions; (computed amounts in boxes)* | | | | | | |
|  |  | |  |  |  | Stockholders’ |
|  | | Assets | **=** | Liabilities | **+** | Equity |
| Clayton Homes | | **$38** |  | **$ 17** |  | **$21** |
| **Howard Automotive** | | **70** |  | **24** |  | **46** |
| **Bella Boutique** | | **51** |  | **15** |  | **36** |

Bella Boutique appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ($15/$51 = .29). Stated differently, Bella Boutique’s equity is the highest percentage of company assets ($36/$51 = .71).

Liabilities as a percent of total assets:

Clayton Homes $17/$38 = 0.45

Howard Automotive $24/$70 = 0.34

Bella Boutique $15/$51 = 0.29

**(10-15 min.) E 1-27B**

### Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| ***(Amounts in millions)*** | | | | | |
|  | Assets | **=** | Liabilities | **+** | Stockholders’ Equity |
|  | **$208** |  | **$156** |  |  |
|  | **338** |  | **100** |  |  |
|  | **107** |  |  |  |  |
| **Total** | **$653** | **=** | **$256** | **+** | **$397** |
|  |  |  |  |  |  |
| ***Req. 2*** | **Resources**  **to work with** | ***Req. 3* Amount** owed tocreditors | | ***Req. 4* Actually**  **owned by company**  **stockholders** | |

**(10-20 min.) E 1-28B**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Situation** | | |
|  | **1** | **2** | **3** |
|  | ***Millions*** | | |
| **Total stockholders’ equity,** |  |  |  |
| **January 31, 2014 ($29 − $11)** | **$18** | **$18** | **$18** |
| **Add: Issuances of stock** | **6** | **-0-** | **31** |
| **Net income** | **11\*** | **22\*** | **-0-** |
| **Less: Dividends declared** | **-0-** | **(5)** | **(3)** |
| **Net loss** | **-0-** | **-0-** | **(11)\*** |
| **Total stockholders’ equity,** |  |  |  |
| **January 31, 2015 ($48 − $13)** | **$35** | **$35** | **$35** |

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

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

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

**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 1-30B**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Diaz Design Company** | | | | |
| **Balance Sheet** | | | | |
| July 31, 2014 | | | | |
| *(Amounts in millions)* | | | | |
| ASSETS | | **LIABILITIES** | | |
| **Cash** | **$ 4.7** | **Current liabilities** | **$ 5.3** | |
| **Receivables** | **1.6** | **Long-term liabilities** | **99.5** | |
| **Investment assets** | **108.9** | **Total liabilities** | **104.8** | |
| **Property and**  **equipment, net** | **57.6** | STOCKHOLDERS’ | | |
| EQUITY | | |
| **Other assets** | **31.7** | **Common stock** | | **21.5** |
|  |  | **Retained earnings** | | **78.2\*** |
|  |  | **Total stockholders’ equity** | | **99.7** |
|  | **\_\_\_\_\_\_** | **Total liabilities and** | |  |
| **Total assets** | **$204.5** | **stockholders’ equity** | | **$204.5** |

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

\*Computation of retained earnings:

**Total assets ($204.5) − Total liabilities ($104.8) − Common stock ($21.5) = $78.2**

**(15-25 min.) E 1-31B**

***Req. 1***

|  |  |  |
| --- | --- | --- |
| **Diaz Design Company** | | |
| **Income Statement** | | |
| **Year Ended July 31, 2014** | | |
| ***(Amounts in millions)*** |  | |
| **Total revenue** |  | **$41.4** |
| **Expenses:** |  |  |
| **Salary and other employee expenses** | **$ 13.6** |  |
| **Other expenses** | **2.9** |  |
| **Interest expense** | **0.3** |  |
| **Total expenses** |  | **16.8** |
| **Net income** |  | **$24.6** |

***Req. 2***

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

|  |  |
| --- | --- |
| **Diaz Design Company** | |
| **Statement of Retained Earnings**  **Year Ended July 31, 2014** | |
| **(*Amounts in millions*)** |  |
| **Retained earnings, beginning of year** | **$55.1** |
| **Add: Net income for the year (*Req. 1*)** | **24.6** |
| **Subtotal** | **79.7** |
| **Less: Dividends declared** | **1.5** |
| **Retained earnings, end of year (from Exercise 1-30B)** | **$78.2** |

**(15-20 min.) E 1-32B**

|  |  |  |
| --- | --- | --- |
| **Office Plus Copy Center, Inc.** | | |
| **Income Statement** | | |
| **For the Month Ended May 31, 2014** | | |
| **Revenue:** |  |  |
| **Service revenue ………………………...** |  | **$450,300** |
| **Expenses:** |  |  |
| **Salary expense ………………………….** | **$230,000** |  |
| **Utilities expense ………………………..** | **10,500** |  |
| **Rent expense ……………………………** | **3,700** |  |
| **Total expenses ………………………….** |  | **244,200** |
| **Net income ……………………………………...** |  | **$206,100** |

|  |  |
| --- | --- |
| **Office Plus Copy Center, Inc.** | |
| **Statement of Retained Earnings** | |
| **For the Month Ended May 31, 2014** | |
| **Retained earnings, May 1, 2014** | **$ -0-** |
| **Add: Net income** | **206,100** |
| **Subtotal** | **206,100** |
| **Less: Dividends declared** | **(12,500)** |
| **Retained earnings, May 31, 2014** | **$193,600** |

**(15-20 min.) E 1-33B**

|  |  |  |  |
| --- | --- | --- | --- |
| **Office Plus Copy Center, Inc.** | | | |
| **Balance Sheet** | | | |
| **May 31, 2014** | | | |
| Assets | | Liabilities | |
| **Cash** | **$ 20,300** | **Accounts payable** | **$ 33,800** |
| **Office supplies** | **4,400** | **Stockholders’ Equity** | |
| **Equipment** | **402,700** | **Common stock** | **200,000** |
|  |  | **Retained earnings** | **193,600** |
|  |  | **Total stockholders’ equity** | **393,600** |
| **Total assets** | **$427,400** | **Total liabilities and**  **stockholders’ equity** | **$427,400** |

**(15-20 min.) E 1-34B**

|  |  |  |
| --- | --- | --- |
| **Office Plus Copy Center, Inc.** | | |
| **Statement of Cash Flows** | | |
| **For the Month Ended May 31, 2014** | | |
| **Cash flows from operating activities:**  **Net income** |  | **$206,100** |
| **Adjustments to reconcile net income to net cash provided by operations** |  | **29,400** |
| **Net cash provided by operating activities** |  | **235,500** |
| **Cash flows from investing activities:** |  |  |
| **Acquisition of equipment** | **$(402,700)** |  |
| **Net cash used for investing activities** |  | **(402,700)** |
| **Cash flows from financing activities:** |  |  |
| **Issuance (sale) of stock to owners** | **$ 200,000** |  |
| **Payment of dividends** | **(12,500)** |  |
| **Net cash provided by financing activities..** |  | **187,500** |
| **Net increase in cash** |  | **$ 20,300** |
| **Cash balance, May 1, 2014** |  | **0** |
| **Cash balance, May 31, 2014** |  | **$ 20,300** |

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

**TO: Owner of Office Plus Copy Center, Inc.**

**FROM: Student Name**

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

**Your first month of operations was successful. Revenues totaled $450,300 and net income was $206,100. These operating results look very strong.**

**The company was able to pay a $12,500 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of $427,400 and liabilities of only $33,800. Your stockholders’ equity is $393,600.**

**Operating activities generated cash of $235,500, 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 $20,300. Based on the above facts, I believe you should stay in business.**

**Student responses may vary.**

**Quiz**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Q1-36** | **a** | | | | | | | | | | | | |
| **Q1-37** | **b** | | | | | | | | | | | | |
| **Q1-38** | **a** | | | | | | | | | | | | |
| **Q1-39** | **d** | | **Stockholders’** | | | | | | | |  | | |
|  |  | | **Assets = Liabilities + Equity** | | | | | | | |  | | |
|  |  | | **+ $84,000 = + $26,000 + + $58,000** | | | | | | | |  | | |
| **Q1-40** | **c** | | | | | | | | | | | | |
| **Q1-41** | **c** | | | | | | | | | | | | |
| **Q1-42** | **b** | | | | | | | | | | | | |
| **Q1-43** | **d** | | | | | | | | | | | | |
| **Q1-44** | **b** | | | | | | | | | | | | |
| **Q1-45** | **c [$285,000 − $209,000 − $86,000 − $27,000 = $(37,000)]** | | | | | | | | | | | | |
| **Q1-46** | **a ($350,000 + $183,750 − $78,750 = $455,000)** | | | | | | | | | | | | |
| **Q1-47** | **d** | | | | | | | | | | | | |
| **Q1-48** | **c** | | | | | | | | | | | | |
| **Q1-49** | **a** |  | |  | |  |  |  | **Stockholders’** | | | |  |
|  |  |  | | **Assets** | | **=** | **Liabilities** | **+** | **Equity** | | | |  |
|  |  | **Beg.** | | **$150,000** | | **=** | **$24,000\*** | **+** | **$126,000** | | | |  |
|  |  | **Changes** | |  | |  | **+ 70,000** |  |  | | | |  |
|  |  | **End.** | | **$232,000\*** | | **=** | **$94,000\*** | **+** | **$138,000** | | | |  |
|  |  | **\_\_\_\_\_** | |  | |  |  |  |  | | | |  |
|  |  | **\*Must solve for these amounts.** | | | | | | | | | | |  |
|  |  |  | | | | | | | | | | | |
| **Q1-50** | **b** | **Assets − Liabilities = Stockholders’ equity** | | | | | | | | | | | |
|  |  | **Beg. bal.** | | | **$350,000 − $126,000 =** | | | | | **$224,000** | |  | |
|  |  | **+ Net income** | | |  | | | | | **+ X** | |  | |
|  |  | **− Dividends** | | |  | | | | | **− 56,000** | |  | |
|  |  | **End. bal.** | | | **$570,000 − $229,000 =** | | | | | **$341,000** | |  | |

**$224,000 + X - $56,000 = $341,000; X = $173,000**

**Problems**

**(30 min.) P 1-51A**

***Req. 1***

**Computed amounts in boxes.**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Diamond Co.** | **Hagar Inc.** | **Lowell Corp.** |
| **BALANCE SHEET** |  | *Millions* |  |
| ***Beginning*:** |  |  |  |
| **Assets** | **$101** | **$54** | **$13** |
| **Liabilities** | **63** | **22** | **4** |
| **Common stock** | **6** | **5** | **3** |
| **Retained earnings** | **32** | **27** | **6** |
|  |  |  |  |
| ***Ending*:** |  |  |  |
| **Assets** | **$108** | **$85** | **$16** |
| **Liabilities** | **65** | **32** | **3** |
| **Common stock** | **6** | **18** | **4** |
| **Retained earnings** | **37** | **35** | **9** |
|  |  |  |  |
| **INCOME STATEMENT** |  |  |  |
| **Revenues** | **$340** | **$170** | **$21** |
| **Expenses** | **331** | **156** | **18** |
| **Net income** | **$ 9** | **$ 14** | **$ 3** |
|  |  |  |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |
| **Beginning RE** | **$32** | **$27** | **$ 6** |
| **+ Net income** | **9** | **14** | **3** |
| **− Dividends declared** | **(4)** | **(6)** | **0** |
| **= Ending RE** | **$37** | **$35** | **$ 9** |

**(continued) P 1-51A**

***Req. 2***

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | |  | **Diamond Co.** | |  | **Hagar Inc.** | |  | **Lowell Corp.** | |
|  | | |  |  | |  | ***Millions*** | |  |  | |
| **Net income** | | |  | **$9** | |  | **$14** | |  | **$3** | |
|  |  |  |  |  | |  | ***Highest*** | |  |  | |
|  |  |  |  |  | |  |  | |  |  | |
| **% of net income** | | |  | **$9** | **= 2.6%** |  | **$14** | **= 8.2%** |  | **$3** | **= 14.3%** |
| **to revenues** | | |  | **$340** |  | **$170** |  | **$21** |
|  | | |  |  | |  |  | |  | ***Highest*** | |

**(20-25 min.) P 1-52A**

***Req. 1***

|  |  |  |  |
| --- | --- | --- | --- |
| **Philly Automotive, Inc.** | | | |
| **Balance Sheet** | | | |
| **June 30, 2014** | | | |
| **ASSETS** | | **LIABILITIES** | |
| **Cash** | **$ 44,100** | **Accounts payable** | **$ 18,800** |
| **Accounts receivable** | **5,800** | **Note payable** | **122,400** |
| **Notes receivable** | **33,400** | **Total liabilities** | **141,200** |
| **Office supplies** | **1,700** | **STOCKHOLDERS’** | |
| **Land** | **184,700** | **EQUITY** | |
| **Equipment** | **78,300** | **Stockholders’ equity** | **206,800\*** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$348,000** | **stockholders’ equity** | **$348,000** |

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

**\*Total assets ($348,000) − Total liabilities ($141,200) = Stockholders’ equity ($206,800).**

***Req. 2***

**Philly Automotive, Inc. is in *better (not worse)* financial position than the erroneous balance sheet reports. Although total assets ($348,000) are $19,900 lower than originally reported ($367,900), liabilities are substantially lower than originally reported, and stockholders’ equity is $7,500 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*.**

**Advertising expense**

**Utilities expense**

**Salary expense**

**Interest expense**

**(20-25 min.) P 1-53A**

***Req. 1***

|  |  |  |  |
| --- | --- | --- | --- |
| **Jose Alvarado, Realtor, Inc.** | | | |
| **Balance Sheet** | | | |
| **April 30, 2015** | | | |
| **ASSETS** | | **LIABILITIES** | |
| **Cash** | **$ 43,000** | **Accounts payable** | **$ 15,000** |
| **Office supplies** | **2,000** | **Note payable** | **128,000** |
| **Land** | **150,000** | **Total liabilities** | **143,000** |
| **Furniture** | **19,800** | **STOCKHOLDERS’** | |
| **Franchise** | **16,000** | **EQUITY** | |
|  |  | **Common stock** | **60,000** |
|  |  | **Retained earnings** | **27,800\*** |
|  |  | **Total stockholders’ equity** | **87,800** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$230,800** | **stockholders’ equity** | **$230,800** |

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

**\*Total assets ($230,800) − Total liabilities ($143,000) − Common stock ($60,000) = Retained earnings ($27,800).**

***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 ($18,000)**

**b. Personal account payable ($7,500)**

**g. Personal residence ($361,000) and mortgage payable ($197,000)**

**(30-45 min.) P 1-54A**

***Req. 1***

|  |  |  |
| --- | --- | --- |
| **Cameron Services Inc.** | | |
| **Income Statement** | | |
| **Year Ended December 31, 2014** | | |
| **Revenue** |  |  |
| **Service revenue** |  | **$457,600** |
| **Expenses** |  |  |
| **Salary expense** | **$108,700** |  |
| **Rent expense**  **Interest expense**  **Utilities expense** | **41,600**  **10,800**  **8,500** |  |
| **Property tax expense** | **7,700** |  |
| **Total expenses** |  | **177,300** |
| **Net income** |  | **$280,300** |
|  |  |  |

***Req. 2***

|  |  |
| --- | --- |
| **Cameron Services Inc.** | |
| **Statement of Retained Earnings** | |
| **Year Ended December 31, 2014** | |
| **Retained earnings, December 31, 2013** | **$ 364,800** |
| **Add: Net income** | **280,300** |
| **Subtotal** | **645,100** |
| **Less: Dividends declared** | **(105,000)** |
| **Retained earnings, December 31, 2014** | **$ 540,100** |

### (continued) P 1-54A

### Req. 3

|  |  |  |  |
| --- | --- | --- | --- |
| **Cameron Services Inc.** | | | |
| **Balance Sheet** | | | |
| **December 31, 2014** | | | |
| **ASSETS** | | **LIABILITIES** | |
| **Cash** | **$ 46,800** | **Accounts payable** | **$ 28,900** |
| **Accounts receivable** | **84,800** | **Note payable** | **99,300** |
| **Supplies** | **6,100** | **Interest payable** | **3,100** |
| **Land** | **26,200** | **Total liabilities** | **131,300** |
| **Building** | **401,000** | **STOCKHOLDERS’** | |
| **Equipment** | **112,000** | **EQUITY** | |
|  |  | **Common stock** | **5,500** |
|  |  | **Retained earnings** | **540,100** |
|  |  | **Total stockholders’ equity** | **545,600** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$676,900** | **stockholders’ equity** | **$676,900** |

***Req. 4***

**a. Cameron Services was profitable; net income was $280,300.**

**b. Retained earnings increased by $175,300 — from $364,800 to $540,100.**

**c. Stockholders’ equity ($545,600) exceeds liabilities ($131,300).**

**The stockholders own more of Cameron Service’s assets than do the company’s creditors.**

**(20 min.) P 1-55A**

***Req. 1***

|  |  |  |
| --- | --- | --- |
| **Mitchell Company** | | |
| **Statement of Cash Flows** | | |
| **Year Ended March 31, 2015** | | |
|  | ***Millions*** | |
| **Cash flows from operating activities:** |  |  |
| **Net income** |  | **$ 2,287** |
| **Adjustments to reconcile net income** |  |  |
| **to net cash provided by operating activities** |  | **1,778** |
| **Net cash provided by operating activities** |  | **4,065** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
| **Purchases of property, plant, and equipment** | **$(2,640)** |  |
| **Sales of property, plant, and equipment** | **26** |  |
| **Other investing cash payments** | **(120)** |  |
| **Net cash used for investing activities** |  | **(2,734)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
| **Issuance of common stock** | **$ 154** |  |
| **Payment of dividends** | **(199)** |  |
| **Net cash used for financing activities** |  | **(45)** |
|  |  |  |
| **Net increase in cash** |  | **$ 1,286** |
| **Cash, beginning** |  | **203** |
| **Cash, ending** |  | **$ 1,489** |

***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 1-56A**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **INCOME STATEMENT** |  |  | **2015** | **2014** |  |  |
| **Revenues** | **23,880** | **=** | **$ k** | **$28,300** |  |  |
| **Cost of goods sold** |  |  | **(18,090)** | **a** | **=** | **(19,950)** |
| **Other expenses** |  |  | **(1,210)** | **(3,590)** |  |  |
| **Income before income taxes** |  |  | **4,580** | **4,760** |  |  |
| **Income taxes (35% tax rate)** | **1,603** | **=** | **l** | **(1,666)** |  |  |
| **Net income** | **2,977** | **=** | **$ m** | **$ b** | **=** | **3,094** |
|  |  |  |  |  |  |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |  |  |  |
| **Beginning balance** | **9,861** | **=** | **$ n** | **$ 6,907** |  |  |
| **Net income** | **2,977** | **=** | **o** | **c** | **=** | **3,094** |
| **Dividends declared** |  |  | **(94)** | **(140)** |  |  |
| **Ending balance** | **12,744** | **=** | **$ p** | **$ d** | **=** | **9,861** |
|  |  |  |  |  |  |  |
| **BALANCE SHEET** |  |  |  |  |  |  |
| **Assets:** |  |  |  |  |  |  |
| **Cash** | **4,490** | **=** | **$ q** | **$ e** | **=** | **4,505** |
| **Property, plant and equipment** |  |  | **14,870** | **13,760** |  |  |
| **Other assets** | **10,879** | **=** | **r** | **9,541** |  |  |
| **Total assets** | **30,239** | **=** | **$ s** | **$27,806** |  |  |
| **Liabilities:** |  |  |  |  |  |  |
| **Current liabilities** | **9,695** | **=** | **$ t** | **$10,590** |  |  |
| **Long-term debt**  **Other liabilities** |  |  | **7,100**  **110** | **6,420**  **255** |  |  |
| **Total liabilities** |  |  | **16,905** | **f** | **=** | **17,265** |
|  |  |  |  |  |  |  |
| **Stockholders’ Equity:** |  |  |  |  |  |  |
| **Common stock** |  |  | **$ 500** | **$ 500** |  |  |
| **Retained earnings** | **12,744** | **=** | **u** | **g** | **=** | **9,861** |
| **Other stockholders’ equity** |  |  | **90** | **180** |  |  |
| **Total stockholders’ equity** | **13,334** | **=** | **v** | **10,541** |  |  |
| **Total liabilities and stockholders’ equity stockholders’ equity** | **30,239** | **=** | **$ w** | **$ h** | **=** | **27,806** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CASH FLOWS** |  |  |  |  |  |  |
| **Net cash provided by operating activities** | **745** | **=** | **$ x** | **$ 3,050** |  |  |
| **Net cash used for investing activities** |  |  | **(200)** | **(325)** |  |  |
| **Net cash used for financing activities** |  |  | **(560)** | **(500)** |  |  |
| **Increase (decrease) in cash** |  |  | **( 15)** | **i** | **=** | **2,225** |
| **Cash at beginning of year** | **4,505** | **=** | **y** | **2,280** |  |  |
| **Cash at end of year** | **4,490** | **=** | **$ z** | **$ j** | **=** | **4,505** |

**(30 min.) P 1-57B**

***Req. 1***

**Computed amounts in boxes**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Kenley Corp.** | **Verde Co.** | **Thompson Inc.** |
|  | ***Millions*** | | |
| ***Balance sheets:*** |  |  |  |
| ***Beginning*:** |  |  |  |
| **Assets** | **$ 87** | **$ 52** | **$ 28** |
| **Liabilities** | **59** | **24** | **2** |
| **Common stock** | **4** | **3** | **12** |
| **Retained earnings** | **24** | **25** | **14** |
|  |  |  |  |
| **Ending:** |  |  |  |
| **Assets** | **$ 90** | **$ 60** | **$ 44** |
| **Liabilities** | **50** | **17** | **10** |
| **Common stock** | **4** | **3** | **12** |
| **Retained earnings** | **36** | **40** | **22** |
|  |  |  |  |
| **Income statement:** |  |  |  |
| **Revenues** | **$228** | **$174** | **$ 29** |
| **Expenses** | **214** | **156** | **16** |
| **Net income** | **$ 14** | **$ 18** | **$ 13** |
|  |  |  |  |
| **Statement of retained earnings:** |  |  |  |
| **Beginning RE** | **$ 24** | **$ 25** | **$ 14** |
| **+ Net income** | **14** | **18** | **13** |
| **− Dividends declared** | **(2)** | **(3)** | **(5)** |
| **= Ending RE** | **$ 36** | **$ 40** | **$ 22** |

**(continued) P 1-57B**

***Req. 2***

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Kenley Corp.** | | **Verde Co.** | | **Thompson Inc.** | |
|  |  | | ***Millions*** | |  | |
|  |  | |  | |  | |
| **Net income** | **$14** | | **$18** | | **$13** | |
|  |  | | ***Highest*** | |  | |
|  |  | |  | |  | |
| **% of net income** | **$14** | **= 6.1%** | **$18** | **= 10.3%** | **$13** | **= 44.8%** |
| **to revenues** | **$228** | **$174** | **$29** |
|  |  | |  | | ***Highest*** | |

**(20-25 min.) P 1-58B**

***Req. 1***

|  |  |  |  |
| --- | --- | --- | --- |
| **Fast Break Sports, Inc.** | | | |
| **Balance Sheet** | | | |
| **March 31, 2014** | | | |
| **ASSETS** | | **LIABILITIES** | |
| **Cash** | **$ 20,500** | **Accounts payable** | **$ 14,500** |
| **Accounts receivable** | **2,700** | **Note payable** | **49,000** |
| **Notes receivable** | **16,000** | **Total liabilities** | **63,500** |
| **Office supplies** | **1,600** | **STOCKHOLDERS’** | |
| **Land** | **83,000** | **EQUITY** | |
| **Equipment** | **47,000** | **Stockholders’ equity** | **107,300\*** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$170,800** | **stockholders’ equity** | **$170,800** |

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

**\*Total assets ($170,800) − Total liabilities ($63,500) = Stockholders’ equity ($107,300).**

***Req. 2***

**Fast Break Sports, Inc. is in a *better* financial position than the erroneous balance sheet reports. Assets are $900 less and liabilities are $8,900 less than originally reported, but equity is $8,000 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 1-59B**

***Req. 1***

|  |  |  |  |
| --- | --- | --- | --- |
| **Nancy Boyd, Realtor, Inc.** | | | |
| **Balance Sheet** | | | |
| **September 30, 2015** | | | |
| **ASSETS** | | **LIABILITIES** | |
| **Cash** | **$ 56,000** | **Accounts payable** | **$ 41,000** |
| **Office supplies** | **3,000** | **Note payable** | **86,000** |
| **Land** | **117,000** | **Total liabilities** | **127,000** |
| **Furniture** | **50,000** | **STOCKHOLDERS’** | |
| **Franchise** | **25,000** | **EQUITY** | |
|  |  | **Common stock** | **80,000** |
|  |  | **Retained earnings** | **44,000\*** |
|  |  | **Total stockholders’ equity** | **124,000** |
| **Total assets** | **$251,000** | **Total liabilities and stockholders’ equity** | **$251,000** |

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

**\*Total assets ($251,000) − Total liabilities ($127,000) − Common stock ($80,000) = Retained earnings ($44,000).**

***Req. 2***

**It appears that Nancy Boyd’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 ($22,000)**

1. **Personal account payable ($2,000)**

**g. Personal residence ($375,000) and personal mortgage ($124,000)**

**(30-45 min.) P 1-60B**

***Req. 1***

|  |  |  |
| --- | --- | --- |
| **Weston, Inc.** | | |
| **Income Statement** | | |
| **Year Ended December 31, 2014** | | |
| **Revenue:** |  |  |
| **Service revenue** |  | **$161,000** |
| **Expenses:** |  |  |
| **Salary expense** | **$30,800** |  |
| **Rent expense** | **17,000** |  |
| **Utilities expense** | **8,700** |  |
| **Interest expense** | **2,900** |  |
| **Property tax expense** | **2,100** |  |
| **Total expenses** |  | **61,500** |
| **Net income** |  | **$ 99,500** |

***Req. 2***

|  |  |
| --- | --- |
| **Weston, Inc.** | |
| **Statement of Retained Earnings** | |
| **Year Ended December 31, 2014** | |
| **Retained earnings, December 31, 2013** | **$109,600** |
| **Add: Net income** | **99,500** |
| **Subtotal** | **209,100** |
| **Less: Dividends declared** | **(28,000)** |
| **Retained earnings, December 31, 2014** | **$181,100** |

**(continued) P 1-60B**

***Req. 3***

|  |  |  |  |
| --- | --- | --- | --- |
| **Weston, Inc.** | | | |
| **Balance Sheet** | | | |
| **December 31, 2014** | | | |
| **ASSETS** | | **LIABILITIES** | |
| **Cash** | **$ 17,000** | **Accounts payable** | **$ 9,000** |
| **Accounts receivable** | **25,000** | **Interest payable** | **1,200** |
| **Supplies** | **2,300** | **Note payable** | **54,000** |
| **Land** | **68,000** | **Total liabilities** | **64,200** |
| **Building** | **123,000** | **STOCKHOLDERS’** | |
| **Equipment** | **37,100** | **EQUITY** | |
|  |  | **Common stock** | **27,100** |
|  |  | **Retained earnings** | **181,100** |
|  |  | **Total stockholders’ equity** | **208,200** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$272,400** | **stockholders’ equity** | **$272,400** |

***Req. 4***

**a. Weston was profitable; net income was $99,500.**

**b. Retained earnings increased by $71,500 — from $109,600 to $181,100.**

**c. Total equity ($208,200) exceeds total liabilities ($64,200).**

**Therefore, the stockholders own more of the company’s assets than do the creditors.**

**(20 min.) P 1-61B**

***Req. 1***

|  |  |  |
| --- | --- | --- |
| **Fun Gun Sales Co.** | | |
| **Statement of Cash Flows** | | |
| **Year Ended May 31, 2015** | | |
|  | ***Millions*** | |
| **Cash flows from operating activities:** |  |  |
| **Net income** |  | **$ 4,050** |
| **Adjustments to reconcile net income** |  |  |
| **to net cash provided by operating activities** |  | **2,860** |
| **Net cash provided by operating activities** |  | **6,910** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
| **Purchases of property, plant, and equipment** | **$(5,305)** |  |
| **Sales of property, plant, and equipment** | **165** |  |
| **Other investing cash payments** | **(155)** |  |
| **Net cash used for investing activities** |  | **(5,295)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
| **Issuance of common stock** | **$ 1,180** |  |
| **Payment of dividends** | **(145)** |  |
| **Net cash provided by financing activities** |  | **1,035** |
|  |  |  |
| **Net increase in cash** |  | **$ 2,650** |
| **Cash, beginning** |  | **230** |
| **Cash, ending** |  | **$ 2,880** |

***Req. 2***

**Operating activities provided the bulk of Fun Gun Sale's cash. This is a sign of strength because operations should be the main source of cash.**

**(40-50 min.) P 1-62B**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | ***(Thousands)*** | | | | | | |
| **INCOME STATEMENT** |  |  | **2015** | **2014** |  |  | |
| **Revenues** | **11,870** | **=** | **$ k** | **$14,600** |  | |  |
| **Cost of goods sold** |  |  | **(8,050)** | **a** | **=** | | **(10,550)** |
| **Other expenses** |  |  | **(1,230)** | **(1,180)** |  | |  |
| **Income before income taxes** |  |  | **2,590** | **2,870** |  | |  |
| **Income taxes (35% tax rate)** | **907** | **=** | **l** | **1,005** |  | |  |
| **Net income** | **1,683** | **=** | **$ m** | **$ b** | **=** | | **1,865** |
|  |  |  |  |  |  | |  |
| **STATEMENT OF RETAINED EARNINGS** |  |  |  |  |  | |  |
| **Beginning balance** | **4,485** | **=** | **$ n** | **$ 2,690** |  | |  |
| **Net income** | **1,683** | **=** | **o** | **c** | **=** | | **1,865** |
| **Dividends declared** |  |  | **(96)** | **(70)** |  | |  |
| **Ending balance** | **6,072** | **=** | **$ p** | **$ d** | **=** | | **4,485** |
|  |  |  |  |  |  | |  |
| **BALANCE SHEET** |  |  |  |  |  | |  |
| **Assets:** |  |  |  |  |  | |  |
| **Cash** | **1,070** | **=** | **$ q** | **$ e** | **=** | | **1,130** |
| **Property, plant and equipment** |  |  | **10,500** | **9,750** |  | |  |
| **Other assets** | **5,778** | **=** | **r** | **5,381** |  | |  |
| **Total assets** | **17,348** | **=** | **$ s** | **$16,261** |  | |  |
|  |  |  |  |  |  | |  |
| **Liabilities:** |  |  |  |  |  | |  |
| **Current liabilities** | **5,271** | **=** | **$ t** | **$ 4,640** |  | |  |
| **Long-term debt** |  |  | **5,400** | **6,691** |  | |  |
| **Other liabilities** |  |  | **90** | **110** |  | |  |
| **Total liabilities** |  |  | **10,761** | **f** | **=** | | **11,441** |
|  |  |  |  |  |  | |  |
| **Stockholders’ Equity:** |  |  |  |  |  | |  |
| **Common stock** |  |  | **$ 325** | **$ 225** |  | |  |
| **Retained earnings** | **6,072** | **=** | **u** | **g** | **=** | | **4,485** |
| **Other stockholders’ equity** |  |  | **190** | **110** |  | |  |
| **Total stockholders’ equity** | **6,587** | **=** | **v** | **4,820** |  | |  |
| **Total liabilities and stockholders’ equity** | **17,348** | **=** | **$ w** | **$ h** | **=** | | **16,261** |
|  |  |  |  |  |  | |  |
| **STATEMENT OF CASH FLOWS** |  |  |  |  |  | |  |
| **Net cash provided by operating activities** | **740** | **=** | **$ x** | **$ 1,050** |  | |  |
| **Net cash used for investing activities** |  |  | **(230)** | **(350)** |  | |  |
| **Net cash used for financing activities** |  |  | **(570)** | **(550)** |  | |  |
| **Increase (decrease) in cash** |  |  | **( 60)** | **i** | **=** | | **150** |
| **Cash at beginning of year** | **1,130** | **=** | **y** | **980** |  | |  |
| **Cash at end of year** | **1,070** | **=** | **$ z** | **$ j** | **=** | | **1,130** |

**Decision Cases**

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

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

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

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

**(20-30 min.) Decision Case 2**

***Req. 1***

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Hunters Unlimited, Inc.** | |  | **Hunters Unlimited, Inc.** | | | |
| **Income Statement** | |  | **Balance Sheet** | | | |
| **Year Ended Dec. 31, 2014** | |  | **Dec. 31, 2014** | | | |
| **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 Hunters 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 the work of another without their permission. It is usually**

**(continued) Ethical Issue**

**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: Amazon.com, Inc.**

**(20-30 min.)**

**1. Students can emphasize a variety of points regarding Amazon.com, Inc., and its industry. For example, a discussion on the growth and recent changes in e-commerce would be appropriate. Additionally, discussing recent news articles related to Amazon, its competitors, or e-commerce/physical retailing would also be appropriate. Student answers will vary.**

**2. Some important information in this portion of the financials is the description of their competitors (physical-world retailers, other e-commerce sites, etc.). Additionally, the seasonality of Amazon’s business is important to note given that they have higher sales in the fourth quarter relative to the first three. Lastly, it may come as a surprise that Amazon employs approximately 88,400 full-time employees. Student answers will vary.**

**3. EBay and Overstock.com are competitors of Amazon.com, Inc., because all three derive their revenue online from a variety of products. 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.**

**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.**

**(continued) Amazon.com, Inc.**

**During fiscal 2012, a net loss of $39 million is reported. The company had reported net income of $631 million in fiscal 2011. This is bad news because the company’s reported a net loss from operations in fiscal 2012.**

**5. Amazon.com’s largest expense is cost of sales. This is Amazon’s cost of the products the company sells, such as books and Kindle readers. Another title of this expense is *cost of goods sold*.**

|  |  |  |
| --- | --- | --- |
| **6.** | **Total resources (total assets) at the end of** |  |
|  | **2012** | **$32,555 million** |
|  | **Amount owed (total liabilities) at the end of** |  |
|  | **the year ($19,002 + $3,084 + $2,277)** | **$24,363 million** |
|  | **Portion of the company’s assets owned by** |  |
|  | **the company’s stockholders (this is** |  |
|  | **shareholders’ equity)** | **$8,192 million** |

**Amazon.com, Inc.’s accounting equation *(in millions):***

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ equity** |
| **$32,555** | **=** | **$24,363** | **+** | **$8,192** |

**7. At the beginning of 2012, Amazon.com, Inc., had $5,269 million of cash and cash equivalents. At the end of the year, Amazon.com, Inc. had $8,084 million of cash and cash equivalents.**

**Focus on Analysis: Yum! Brands, Inc.**

**(30 min.)**

**1. Yum! Brands, Inc. is a quick service restaurant company. Students can emphasize a variety of points regarding Yum! Brands, Inc. and its industry. For example, a discussion on the growth and recent changes in fast food services would be appropriate. Additionally, discussing recent news articles related to Yum! Brands, its competitors, or fast food services would also be appropriate. Student answers will vary.**

**2. Note 1 describes Yum! Brands’ business and how Yum! Brands delivers its products to its customers. Yum! Brands sells its products through six operating segments worldwide. These segments are the China Division, International Division, three U.S. divisions, and the India Division. This note describes the different types of restaurants of Yum! Brands. It is important to understand Yum! Brands and its operations in order to make investing or lending decisions concerning the company. Finally, this note includes a brief description of the restaurant chains sold in 2011 and their impact on the financial statements.**

**3. McDonald’s and Chick-fil-A are two competitors of Yum! Brands, Inc. because all three (McDonald’s, Chick-fil-A, and Yum! Brands) are all quick service restaurants. It is important to identify competitors because competitors tend to have similar business**

**(continued) Yum! Brands, Inc.**

**dynamics to one another, meaning that their financial statements can be compared to and benchmarked against each other.**

**Student answers will vary.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **4.** | ***(Amounts in millions)*** | | | | | |
|  | **Assets** | **=** | **Liabilities** | **+** | **Shareholders’ equity** |
|  | **$9,011** | **=** | **$6,699** | **+** | **$59 + $2,253** |

**Yum! Brands, Inc. appears to be in relatively strong financial condition. Total assets are about 135% of 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 2012 was a net income of $1,597 million. This is good news for Yum! Brands. Revenue exceeded expenses for fiscal 2012, and there is a positive trend in earnings over the past two years ($1,158 million, $1,319 million, and $1,597 million in fiscal 2010, 2011, and 2012, respectively).**

**6. In Yum! Brands, Inc.’s Consolidated Balance Sheets, Retained Earnings *increased* $234 million from $2,052 million as of the beginning of 2012 (end of 2011). The Consolidated Statements of Stockholders’ Equity explain *why* retained earnings increased during the year. Retained earnings increased $1,597 million due to**

**(continued) Yum! Brands, Inc.**

**net income, but decreased $569 million due to dividends and $794 million due to repurchase of common stock.**

**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. Cash and cash equivalents changed during the year due to operating activities, investing activities and financing activities. The net cash provided by operating activities was $2,294 million, which is a net cash inflow. The net cash used by investing activities was $1,005 million, which is a net cash outflow. The net cash used by financing activities was $1,716 million, which is a net cash outflow.**

**Group Projects**

**Student responses will vary.**