

Chapter 1

Introducing Financial Statements

QUESTIONS

1. The purpose of accounting is to provide decision makers with relevant and reliable information to help them make better decisions. Examples include information for people making investments, loans, and business plans.
2. Technology reduces the time, effort, and cost of recordkeeping. There is still a demand for people who can design accounting systems, supervise their operation, analyze complex transactions, and interpret reports. Demand also exists for people who can effectively use computers to prepare and analyze accounting reports. Technology will never substitute for qualified people with abilities to prepare, use, analyze, and interpret accounting information.
3. External users and their uses of accounting information include: (a) lenders, to measure the risk and return of loans; (b) shareholders, to assess whether to buy, sell, or hold their shares; (c) directors, to oversee their interests in the organization; (d) employees and labor unions, to judge the fairness of wages and assess future employment opportunities; and (e) regulators, to determine whether the organization is complying with regulations. Other users are voters, legislators, government officials, contributors to nonprofits, suppliers and customers.
4. Business owners and managers use accounting information to help answer questions such as: What resources does an organization own? What debts are owed? How much income is earned? Are expenses reasonable for the level of sales? Are customers' accounts being promptly collected?
5. Service businesses include: Standard and Poor's, Dun & Bradstreet, Merrill Lynch, Southwest Airlines, CitiCorp, Humana, Charles Schwab, and Prudential. Businesses offering products include Nike, Reebok, Gap, Apple, Ford Motor Co., Philip Morris, Coca-Cola, Best Buy, and WalMart.
6. The internal role of accounting is to serve the organization's internal operating functions. It does this by providing useful information for internal users in completing their tasks more effectively and efficiently. By providing this information, accounting helps the organization reach its overall goals.
7. Accounting professionals offer many services including auditing, management advice, tax planning, business valuation, and money management.
8. Marketing managers are likely interested in information such as sales volume, advertising costs, promotion costs, salaries of sales personnel, and sales commissions.

9. Accounting is described as a service activity because it serves decision makers by providing information to help them make better business decisions.
10. Some accounting-related professions include consultant, financial analyst, underwriter, financial planner, appraiser, FBI investigator, market researcher, and system designer.
11. Ethics rules require that auditors avoid auditing clients in which they have a direct investment, or if the auditor's fee is dependent on the figures in the client's reports. This will help prevent others from doubting the quality of the auditor's report.
12. In addition to preparing tax returns, tax accountants help companies and individuals plan future transactions to minimize the amount of tax to be paid. They are also actively involved in estate planning and in helping set up organizations. Some tax accountants work for regulatory agencies such as the IRS or the various state departments of revenue. These tax accountants help to enforce tax laws.
13. The objectivity concept means that financial statement information is supported by independent, unbiased evidence other than someone's opinion or imagination. This concept increases the reliability and verifiability of financial statement information.
14. This treatment is justified by both the cost principle and the going-concern assumption.
15. The revenue recognition principle provides guidance for managers and auditors so they know when to recognize revenue. If revenue is recognized too early, the business looks more profitable than it is. On the other hand, if revenue is recognized too late the business looks less profitable than it is. This principle demands that revenue be recognized when it is both earned (when service or product provided) and can be measured reliably. The amount of revenue should equal the value of the assets received or expected to be received from the business's operating activities covering a specific time period.
16. Business organizations can be organized in one of three basic forms: sole proprietorship, partnership, or corporation. These forms have implications for legal liability, taxation, continuity, number of owners, and legal status as follows:

	<i>Proprietorship</i>	<i>Partnership</i>	<i>Corporation</i>
Business entity	yes	yes	yes
Legal entity	no	no	yes
Limited liability	no*	no*	yes
Unlimited life	no	no	yes
Business taxed	no	no	yes
One owner allowed	yes	no	yes

*Proprietorships and partnerships that are set up as LLCs provide limited liability.

17. (a) Assets are resources owned or controlled by a company that are expected to yield future benefits. (b) Liabilities are creditors' claims on assets that reflect obligations to provide assets, products or services to others. (c) Equity is the owner's claim on assets and is equal to assets minus liabilities. (d) Net assets refer to equity.
18. Equity is increased by investments from the owner and by net income (which is the excess of revenues over expenses). It is decreased by dividends to the owner and by a net loss (which is the excess of expenses over revenues).

19. Accounting principles consist of (a) *general* and (b) *specific* principles. General principles are the basic assumptions, concepts, and guidelines for preparing financial statements. They stem from long-used accounting practices. Specific principles are detailed rules used in reporting on business transactions and events. They usually arise from the rulings of authoritative and regulatory groups such as the Financial Accounting Standards Board or the Securities and Exchange Commission.
20. Revenue (or sales) is the amount received from selling products and services.
21. Net income (also called income, profit or earnings) equals revenues minus expenses (if revenues exceed expenses). Net income increases equity. If expenses exceed revenues, the company has a net loss. Net loss decreases equity.
22. The four basic financial statements are: income statement, statement of retained earnings, balance sheet, and statement of cash flows.
23. An income statement reports a company's revenues and expenses along with the resulting net income or loss over a period of time.
24. Rent expense, utilities expense, administrative expenses, advertising and promotion expenses, maintenance expense, and salaries and wages expenses are some examples of business expenses.
25. The statement of retained earnings explains the changes in equity from net income or loss, and from any dividends over a period of time.
26. The balance sheet describes a company's financial position (types and amounts of assets, liabilities, and equity) at a point in time.
27. The statement of cash flows reports on the cash inflows and outflows from a company's operating, investing, and financing activities.
28. Return on assets, also called return on investment, is a profitability measure that is useful in evaluating management, analyzing and forecasting profits, and planning activities. It is computed as net income divided by the average total assets. For example, if we have an average annual balance of \$100 in a bank account and it earns interest of \$5 for the year, then our return on assets is $\$5 / \100 or 5%. The return on assets is a popular measure for analysis because it allows us to compare companies of different sizes and in different industries.
- 29^A. Return refers to income, and risk is the uncertainty about the return we expect to make. The lower the risk of an investment, the lower the expected return. For example, savings accounts pay a low return because of the low risk of a bank not returning the principal with interest. Higher risk implies higher, but riskier, expected returns.
- 30^B. Organizations carry out three major activities: financing, investing, and operating. Financing provides the means used to pay for resources. Investing refers to the acquisition and disposing of resources necessary to carry out the organization's plans. Operating activities are the actual carrying out of these plans. (*Planning is the glue that connects these activities, including the organization's ideas, goals and strategies.*)

- 31^B. An organization's financing activities (liabilities and equity) pay for investing activities (assets). An organization cannot have more or less assets than its liabilities and equity combined and, similarly, it cannot have more or less liabilities and equity than its total assets. This means: $\text{assets} = \text{liabilities} + \text{equity}$. This relation is called the accounting equation (also called the *balance sheet equation*), and it applies to organizations at all times.
32. The dollar amounts in Apple's financial statements are rounded to the nearest million (\$1,000,000). Apple's consolidated statement of income (or income statement) covers the fiscal year ended September 27, 2014. Apple also reports comparative income statements for the previous two years.
33. At December 31, 2014, Google had (\$ in millions) assets of \$131,133, liabilities of \$26,633, and equity of \$104,500.
34. Confirmation of Samsung's accounting equation follows (numbers in KRW millions):
- | | | | | |
|---------------|----------|--------------------|----------|---------------|
| Assets | = | Liabilities | + | Equity |
| 230,422,958 | = | 62,334,770 | + | 168,088,188 |
35. The independent auditor for Apple, is Ernst & Young, LLP. The auditor expressly states that "our responsibility is to express an opinion on these financial statements based on our audits." The auditor also states that "these financial statements are the responsibility of the Company's management."

QUICK STUDIES

Quick Study 1-1 (10 minutes)

1. f. Technology
2. c. Recording
3. h. Recordkeeping (bookkeeping)

Quick Study 1-2 (10 minutes)

- | | | | |
|----|---|----|---|
| a. | E | g. | E |
| b. | E | h. | E |
| c. | E | i. | I |
| d. | E | j. | E |
| e. | I | k. | E |
| f. | E | l. | E |

Quick Study 1-3 (10 minutes)

- a. The choice of an accounting method when more than one alternative method is acceptable often has ethical implications. This is because accounting information can have major impacts on individuals' (and firms') well-being.

To illustrate, many companies base compensation of managers on the amount of reported income. When the choice of an accounting method affects the amount of reported income, the amount of compensation is also affected. Similarly, if workers in a division receive bonuses based on the division's income, its computation has direct financial implications for these individuals.

- b. Internal controls serve several purposes:

- They involve monitoring an organization's activities to promote efficiency and to prevent wrongful use of its resources.
- They help ensure the validity and credibility of accounting reports.
- They are often crucial to effective operations and reliable reporting.

More generally, the absence of internal controls can adversely affect the effectiveness of domestic and global financial markets.

Examples of internal controls include cash registers with internal tapes or drives, scanners at doorways to identify tagged products, overhead video cameras, security guards, and many others.

Quick Study 1-4 (5 minutes)

1. c. constraint
2. b. assumption
3. c. constraint
4. a. principle

Quick Study 1-5 (10 minutes)

	Attribute Present	Proprietorship	Partnership	Corporation
1. Business taxed		no	no	yes
2. Business entity		yes	yes	yes
3. Legal entity		no	no	yes

Quick Study 1-6 (10 minutes)

- a. Revenue recognition principle
- b. Cost principle (also called historical cost)
- c. Business entity assumption

Quick Study 1-7 (5 minutes)

Assets	=	Liabilities	+	Equity
\$700,000		(a) <u>\$280,000</u>		\$420,000
\$500,000		(b) <u>\$250,000</u>		(b) <u>\$250,000</u>

Quick Study 1-8 (10 minutes)

1.

Assets	=	Liabilities	+	Equity
\$75,000		(a) <u>\$35,000</u>		\$40,000
(b) <u>\$95,000</u>		\$25,000		\$70,000
\$85,000		\$20,000		(c) <u>\$65,000</u>

2.

Assets	=	Liabilities	+ Common Stock	- Dividends	+ Revenues	- Expenses
\$40,000		\$16,000	\$20,000	\$ 0	(a) <u>\$12,000</u>	\$ 8,000
\$80,000		\$32,000	\$44,000	(b) <u>\$2,000</u>	\$24,000	\$18,000

Quick Study 1-9 (10 minutes)

- a. For December 31, 2014, the account and its dollar amount (in KRW millions) for Samsung are:

(1) Assets	=	<u>230,422,958</u>
(2) Liabilities	=	<u>62,334,770</u>
(3) Equity	=	<u>168,088,188</u>

- b. Using Samsung's amounts from (a) we verify that (in KRW millions):

Assets	=	Liabilities	+	Equity
230,422,958	=	62,334,770	+	168,088,188

Quick Study 1-10 (15 minutes)

Assets				=	Liabilities		+	Equity					
Cash		+	Accounts Recble.	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses
(a)	\$5,500			=							\$5,500 Consulting		
(b)		+	\$4,000	=						+	4,000 Commission		
Bal.	5,500	+	4,000	=						+	9,500		
(c)	-1,400			=								-	1,400 Wages
Bal.	4,100	+	4,000	=						+	9,500	-	1,400
(d)	+1,000	+	- 1,000	=								-	
Bal.	5,100	+	3,000	=						+	9,500	-	1,400
(e)	-700	+		=								-	700 Cleaning
Bal.	4,400	+	3,000	=						+	9,500	-	2,100

Quick Study 1-11 (15 minutes)

	Assets					=	Liabilities		+	Equity				
	Cash	+ Supplies	+ Equip.	+ Land	=	Accts. Pay.	+ Notes Pay.	+ Common Stock	- Divi- dends	+ Rev.	- Exp.			
(a)	\$15,000				=			\$15,000						
(b)	-500	+	\$500		=									
Bal.	14,500	+	500		=			+	15,000					
(c)			+	\$10,000	=		+	\$10,000						
Bal.	14,500	+	500	+	10,000	=		+	10,000	+	15,000			
(d)		+	200		=	+\$200								
Bal.	14,500	+	700	+	10,000	=	200	+	10,000	+	15,000			
(e)	-9,000			+	9,000	=								
Bal.	5,500	+	700	+	10,000	+	9,000	=	200	+	10,000	+	15,000	

Quick Study 1-12 (10 minutes)

[Code: *Income statement (I), Balance sheet (B), Statement of retained earnings (E), or Statement of cash flows (CF).*]

- | | | |
|---------------|------|-------|
| a. B | d. B | g. CF |
| b. CF | e. I | h. I |
| c. E (or CF*) | f. B | i. B |

*An advanced student might know that this item would also appear on CF, which is an acceptable answer.

Quick Study 1-13 (5 minutes)

1. EX
2. R
3. EX
4. D

Quick Study 1-14 (5 minutes)

1. A
2. EQ
3. A
4. L
5. A

Quick Study 1-15 (10 minutes)

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Average total assets}} = \frac{\$6}{\$40} = \underline{\underline{15.0\%}}$$

Interpretation: Its return of 15.0% exceeds the 11% of its competitors. Home Depot's performance can be judged as above average.

Quick Study 1-16 (10 minutes)

- a. International Financial Reporting Standards (IFRS)
- b. Convergence desires to achieve a single set of accounting standards for global use.

Quick Study 1-17 (10 minutes)

1. D
2. E
3. A
4. C

EXERCISES

Exercise 1-1 (10 minutes)

- | | | |
|----------|----|---|
| <u>C</u> | 1. | Analyzing and interpreting reports |
| <u>C</u> | 2. | Presenting financial information |
| <u>R</u> | 3. | Keeping a log of service costs |
| <u>R</u> | 4. | Measuring the costs of a product |
| <u>C</u> | 5. | Preparing financial statements |
| <u>I</u> | 6. | Seeing revenues generated from a service |
| <u>I</u> | 7. | Observing employee tasks behind a product |
| <u>R</u> | 8. | Registering cash sales of products sold |

Exercise 1-2 (20 minutes)

Part A.

- | | | | |
|----|---|----|---|
| 1. | I | 5. | I |
| 2. | E | 6. | E |
| 3. | I | 7. | I |
| 4. | E | | |

Part B.

- | | | | |
|----|---|----|---|
| 1. | I | 5. | I |
| 2. | I | 6. | E |
| 3. | E | 7. | I |
| 4. | E | 8. | I |

Exercise 1-3 (10 minutes)

- | | | | |
|----|---|----|---|
| 1. | B | 5. | C |
| 2. | A | 6. | C |
| 3. | B | 7. | A |
| 4. | B | 8. | A |

Exercise 1-4 (10 minutes)

- | | |
|-------------|-------------|
| 1. A | 4. F |
| 2. G | 5. C |
| 3. D | |

Exercise 1-5 (20 minutes)

- a. **Auditing professionals with competing audit clients are likely to learn valuable information about each client that the other clients would benefit from knowing. In this situation the auditor must take care to maintain the confidential nature of information about each client.**
- b. **Accounting professionals who prepare tax returns can face situations where clients wish to claim deductions they cannot substantiate. Also, clients sometimes exert pressure to use methods not allowed or questionable under the law. Issues of confidentiality also arise when these professionals have access to clients' personal records.**
- c. **Managers face several situations demanding ethical decision making in their dealings with employees. Examples include fairness in performance evaluations, salary adjustments, and promotion recommendations. They can also include avoiding any perceived or real harassment of employees by the manager or any other employees. It can also include issues of confidentiality regarding personal information known to managers.**
- d. **Situations involving ethical decision making in coursework include performing independent work on examinations and individually completing assignments/projects. It can also extend to promptly returning reference materials so others can enjoy them, and to properly preparing for class to efficiently use the time and question period to not detract from others' instructional benefits.**

Exercise 1-6 (10 minutes)

- | | |
|------------------------------------|------------------------------------|
| a. (C) Corporation | e. (C) Corporation |
| b. (P) Partnership | f. (SP) Sole proprietorship |
| c. (SP) Sole proprietorship | g. (C) Corporation |
| d. (SP) Sole proprietorship | |

Exercise 1-7 (10 minutes)

<u>Code</u>	<u>Description</u>	<u>Principle/Assumption</u>
<u>H.</u>	1. A company reports details behind financial statements that would impact users' decisions.	Full disclosure principle
<u>G</u>	2. Financial statements reflect the assumption that the business continues operating.	Going-concern assumption
<u>F</u>	3. A company records the expenses incurred to generate the revenues reported.	Matching (expense recognition) principle
<u>A</u>	4. Derived from long-used and generally accepted accounting practices.	General accounting principle
<u>C</u>	5. Every business is accounted for separately from its owner or owners.	Business entity assumption
<u>D</u>	6. Revenue is recorded only when the earnings process is complete.	Revenue recognition principle
<u>E</u>	7. Usually created by a pronouncement from an authoritative body.	Specific accounting principle
<u>B</u>	8. Information is based on actual costs incurred in transactions.	Cost principle

Exercise 1-8 (10 minutes)

<u>Assets</u>	<u>=</u>	<u>Liabilities</u>	<u>+</u>	<u>Equity</u>
(a) <u>\$ 65,000</u>	=	\$ 20,000	+	\$45,000
\$100,000	=	\$ 34,000	+	(b) <u>\$66,000</u>
\$154,000	=	(c) <u>\$114,000</u>	+	\$40,000

Exercise 1-9 (20 minutes)

- a. Using the accounting equation at the *beginning* of the year:

Assets	=	Liabilities	+	Equity
\$300,000	=	?	+	\$100,000

Thus, *beginning* liabilities = \$200,000

Using the accounting equation at the *end* of the year:

Assets	=	Liabilities	+	Equity
\$300,000 + \$80,000	=	\$200,000 + \$50,000	+	?
\$380,000	=	\$250,000	+	?

Thus, *ending* equity = \$130,000

Alternative approach to solving part (b):

$\Delta \text{Assets}(\$80,000) = \Delta \text{Liabilities}(\$50,000) + \Delta \text{Equity}(?)$

where “ Δ ” refers to “change in.”

Thus: *Ending* Equity = \$100,000 + \$30,000 = \$130,000

- b. Using the accounting equation:

Assets	=	Liabilities	+	Equity
\$123,000	=	\$47,000	+	?

Thus, equity = \$76,000

- c. Using the accounting equation at the *end* of the year:

Assets	=	Liabilities	+	Equity
\$190,000	=	\$70,000 - \$5,000	+	?
\$190,000	=	\$65,000	+	\$125,000

Using the accounting equation at the *beginning* of the year:

Assets	=	Liabilities	+	Equity
\$190,000 - \$60,000	=	\$70,000	+	?
\$130,000	=	\$70,000	+	?

Thus: *Beginning* Equity = \$60,000

Exercise 1-10 (20 minutes)

- a. Started the business with the owner investing \$40,000 cash in the business in exchange for common stock.
- b. Purchased office supplies for \$3,000 by paying \$2,000 cash and putting the remaining \$1,000 balance on credit.
- c. Purchased office furniture by paying \$8,000 cash.
- d. Billed a customer \$6,000 for services earned.
- e. Provided services for \$1,000 cash.

Exercise 1-11 (20 minutes)

- a. Purchased land for \$4,000 cash.
- b. Purchased \$1,000 of office supplies on credit.
- c. Billed a client \$1,900 for services provided.
- d. Paid the \$1,000 account payable created by the credit purchase of office supplies in transaction *b*.
- e. Collected \$1,900 cash for the billing in transaction *c*.

Exercise 1-12 (15 minutes)

Examples of transactions that fit each case include:

- a. Cash dividends (or some other asset) paid to the owner of the business; OR, the business incurs an expense paid in cash.
- b. Business purchases equipment (or some other asset) on credit.
- c. Business signs a note payable to extend the due date on an account payable; OR, the business renegotiates a liability (perhaps to obtain a lower interest rate.)
- d. Business pays an account payable (or some other liability) with cash (or some other asset).
- e. Business purchases office supplies (or some other asset) for cash (or some other asset).
- f. Business incurs an expense that is not yet paid (for example, when employees earn wages that are not yet paid).
- g. Owner invests cash (or some other asset) in the business; OR, the business earns revenue and accepts cash (or another asset).

Exercise 1-13 (30 minutes)

	Assets			=	Liabilities	+	Equity		
	Cash	+ Accounts Receivable	+ Equip-ment	=	Accounts Payable	+	Common Stock	- Dividends	+ Revenues - Expenses
a.	+\$60,000		+ \$15,000	=		+	\$75,000		
b.	- 1,500								- \$1,500
Bal.	58,500	+	15,000	=		+	75,000		- 1,500
c.			+ 10,000		+\$10,000				
Bal.	58,500	+	25,000	=	10,000	+	75,000		- 1,500
d.	+ 2,500							+ \$2,500	
Bal.	61,000	+	25,000	=	10,000	+	75,000	+ 2,500	- 1,500
e.		+ \$8,000						+ 8,000	
Bal.	61,000	+ 8,000	+ 25,000	=	10,000	+	75,000	+ 10,500	- 1,500
f.	- 6,000		+ 6,000						
Bal.	55,000	+ 8,000	+ 31,000	=	10,000	+	75,000	+ 10,500	- 1,500
g.	- 3,000								- 3,000
Bal.	52,000	+ 8,000	+ 31,000	=	10,000	+	75,000	+ 10,500	- 4,500
h.	+ 5,000	- 5,000							
Bal.	57,000	+ 3,000	+ 31,000	=	10,000	+	75,000	+ 10,500	- 4,500
i.	- 10,000				- 10,000				
Bal.	47,000	+ 3,000	+ 31,000	=	0	+	75,000	+ 10,500	- 4,500
j.	- 1,000							- \$1,000	
Bal.	<u>\$46,000</u>	+ <u>\$3,000</u>	+ <u>\$31,000</u>	=	<u>\$ 0</u>	+	<u>\$75,000</u>	- <u>\$1,000</u>	+ <u>\$10,500</u> - <u>\$4,500</u>

Exercise 1-14 (10 minutes)

$$\begin{aligned}
 \text{Return on assets} &= \text{Net income} / \text{Average total assets} \\
 &= \$40,000 / [(\$200,000 + \$300,000)/2] \\
 &= \underline{16\%}
 \end{aligned}$$

Interpretation: Swiss Group's return on assets of 16% is markedly above the 11% return of its competitors. Accordingly, its performance is assessed as superior to its competitors.

Exercise 1-15 (15 minutes)

ERNST CONSULTING Income Statement For Month Ended October 31		
Revenues		
Consulting revenues.....		\$14,000
Expenses		
Salaries expense.....	\$7,000	
Rent expense.....	3,550	
Telephone expense.....	760	
Miscellaneous expenses.....	<u>580</u>	
Total expenses.....		<u>11,890</u>
Net income.....		<u>\$ 2,110</u>

Exercise 1-16 (15 minutes)

ERNST CONSULTING Statement of Retained Earnings For Month Ended October 31		
Retained earnings, October 1.....	\$	0
Add: Net income (from Exercise 1-15).....		<u>2,110</u>
		2,110
Less: Dividends.....		<u>2,000</u>
Retained earnings, October 31.....	\$	<u>110</u>

Exercise 1-17 (15 minutes)

ERNST CONSULTING Balance Sheet October 31			
<i>Assets</i>		<i>Liabilities</i>	
Cash.....	\$11,360	Accounts payable.....	\$ 8,500
Accounts receivable....	14,000		
Office supplies.....	3,250		
Office equipment.....	18,000		
Land.....	<u>46,000</u>		
Total assets.....	<u>\$92,610</u>		
		<i>Equity</i>	
		Common stock.....	84,000
		Retained earnings*.....	<u>110</u>
		Total liabilities and equity....	<u>\$92,610</u>

* For the computation of this amount see Exercise 1-16.

Exercise 1-18 (15 minutes)

ERNST CONSULTING Statement of Cash Flows For Month Ended October 31	
Cash flows from operating activities	
Cash received from customers.....	\$ 0
Cash paid to employees ¹	(1,750)
Cash paid for rent.....	(3,550)
Cash paid for telephone expenses.....	(760)
Cash paid for miscellaneous expenses.....	<u>(580)</u>
Net cash used by operating activities.....	(6,640)
Cash flows from investing activities	
Purchase of office equipment.....	<u>(18,000)</u>
Net cash used by investing activities.....	(18,000)
Cash flows from financing activities	
Cash investment from stockholders.....	38,000
Cash dividends.....	<u>(2,000)</u>
Net cash provided by financing activities.....	<u>36,000</u>
Net increase in cash.....	\$11,360
Cash balance, October 1.....	<u>0</u>
Cash balance, October 31.....	<u>\$11,360</u>

¹\$7,000 Salaries Expense - \$5,250 still owed = \$1,750 paid to employees.

Exercise 1-19 (10 minutes)

- | | |
|--|---|
| <u>I</u> 1. Cash purchase of equipment | <u>Q</u> 5. Cash paid on an account payable |
| <u>F</u> 2. Cash paid for dividends | <u>Q</u> 6. Cash received from clients |
| <u>Q</u> 3. Cash paid for advertising | <u>F</u> 7. Cash investment from stockholders |
| <u>Q</u> 4. Cash paid for wages | <u>Q</u> 8. Cash paid for rent |

Exercise 1-20 (20 minutes)

BMW GROUP		
Income Statement		
For Year Ended December 31, 2014		
(Euros in millions)		
Revenues		€ 80,401
Expenses		
Cost of sales.....	€63,396	
Sales and administrative costs.....	7,892	
Other expenses.....	<u>3,296</u>	
Total expenses.....		<u>74,584</u>
Net income.....		<u>€ 5,817</u>

Exercise 1-21^B (10 minutes)

- a. Financing*
- b. Financing
- c. Operating
- d. Investing
- e. Investing

* Would also be listed as “investing” if resources contributed by owner were in the form of nonfinancial resources.

PROBLEM SET A

Problem 1-1A (25 minutes)

Transaction	Balance Sheet			Income Statement	Statement of Cash Flows		
	Total Assets	Total Liab.	Total Equity	Net Income	Operating Activities	Investing Activities	Financing Activities
1 Owner invests cash for its stock	+		+				+
2 Receives cash for services provided	+		+	+	+		
3 Pays cash for employee wages	-		-	-	-		
4 Incurs legal costs on credit		+	-	-			
5 Borrows cash by signing L-T note payable	+	+					+
6 Buys office equipment for cash	+/-					-	
7 Buys land by signing note payable	+	+					
8 Provides services on credit	+		+	+			
9 Pays cash dividend	-		-				-
10 Collects cash on receivable from (8)	+/-				+		

Problem 1-2A (40 minutes)

Part 1

Company A

(a) Equity on December 31, 2015:

Assets.....	\$55,000
Liabilities.....	<u>(24,500)</u>
Equity.....	<u>\$30,500</u>

(b) Equity on December 31, 2016:

Equity, December 31, 2015.....	\$30,500
Plus stock issuances.....	6,000
Plus net income.....	8,500
Less dividends.....	<u>(3,500)</u>
Equity, December 31, 2016.....	<u>\$41,500</u>

(c) Liabilities on December 31, 2016:

Assets.....	\$58,000
Equity.....	<u>(41,500)</u>
Liabilities.....	<u>\$16,500</u>

Part 2

Company B

(a) and (b)

Equity:	<u>12/31/2015</u>	<u>12/31/2016</u>
Assets.....	\$34,000	\$40,000
Liabilities.....	<u>(21,500)</u>	<u>(26,500)</u>
Equity.....	<u>\$12,500</u>	<u>\$13,500</u>

(c) Net income for 2016:

Equity, December 31, 2015.....	\$12,500
Plus stock issuances.....	1,400
Plus net income.....	?
Less dividends.....	<u>(2,000)</u>
Equity, December 31, 2016.....	<u>\$13,500</u>
Therefore, net income must have been	<u>\$ 1,600</u>

Problem 1-2A (Continued)

Part 3

Company C

First, calculate the beginning balance of equity:

	<u>Dec. 31, 2015</u>
Assets.....	\$24,000
Liabilities.....	(9,000)
Equity.....	<u>\$15,000</u>

Next, find the ending balance of equity by completing this table:

Equity, December 31, 2015.....	\$15,000
Plus stock issuances.....	9,750
Plus net income.....	8,000
Less dividends.....	<u>(5,875)</u>
Equity, December 31, 2016.....	<u>\$26,875</u>

Finally, find the ending amount of assets by adding the ending balance of equity to the ending balance of liabilities:

	<u>Dec. 31, 2016</u>
Liabilities.....	\$29,000
Equity.....	<u>26,875</u>
Assets.....	<u>\$55,875</u>

Part 4

Company D

First, calculate the beginning and ending equity balances:

	<u>12/31/2015</u>	<u>12/31/2016</u>
Assets.....	\$60,000	\$85,000
Liabilities.....	<u>(40,000)</u>	<u>(24,000)</u>
Equity.....	<u>\$20,000</u>	<u>\$61,000</u>

Then, find the amount of investment (stock issuances) during 2016:

Equity, December 31, 2015.....	\$20,000
Plus stock issuances.....	?
Plus net income.....	14,000
Less dividends.....	<u>0</u>
Equity, December 31, 2016.....	<u>\$61,000</u>

Thus, investment (stock issuances) must have been \$27,000

Problem 1-2A (Concluded)

Part 5

Company E

First, compute the balance of equity as of December 31, 2016:

Assets.....	\$113,000
Liabilities.....	<u>(70,000)</u>
Equity.....	<u>\$ 43,000</u>

Next, find the beginning balance of equity as follows:

Equity, December 31, 2015.....	\$?
Plus stock issuances.....	6,500
Plus net income.....	20,000
Less dividends.....	<u>(11,000)</u>
Equity, December 31, 2016.....	<u>\$43,000</u>

Thus, the beginning balance of equity is: \$27,500

Finally, find the beginning amount of liabilities by subtracting the beginning balance of equity from the beginning balance of assets:

	<u>Dec. 31, 2015</u>
Assets.....	\$119,000
Equity.....	<u>(27,500)</u>
Liabilities.....	<u>\$ 91,500</u>

Problem 1-3A (15 minutes)

Armani Company			
Balance Sheet			
December 31, 2016			
Assets.....	\$90,000	Liabilities.....	\$44,000
		Equity.....	<u>46,000</u>
Total assets.....	<u>\$90,000</u>	Total liabilities and equity.....	<u>\$90,000</u>

Problem 1-4A (15 minutes)

Edison Energy Company	
Income Statement	
For Year Ended December 31, 2016	
Revenues	\$55,000
Expenses.....	<u>40,000</u>
Net income.....	<u>\$15,000</u>

Problem 1-5A (15 minutes)

Kojo Company	
Statement of Retained Earnings	
For Year Ended December 31, 2016	
Retained earnings, Dec. 31, 2015	\$ 7,000
Add: Net income.....	<u>8,000</u>
	15,000
Less: Dividends.....	<u>(1,000)</u>
Retained earnings, Dec. 31, 2016.....	<u>\$14,000</u>

Problem 1-6A (15 minutes)

Kia Company Statement of Cash Flows For Year Ended December 31, 2016
--

Cash from operating activities	\$ 6,000
Cash used by investing activities.....	(2,000)
Cash used by financing activities.....	<u>(2,800)</u>
Net increase in cash.....	\$ 1,200
Cash, December 31, 2015.....	<u>2,300</u>
Cash, December 31, 2016.....	<u>\$ 3,500</u>

Problem 1-7A (60 minutes) *Parts 1 and 2*

Assets = Liabilities + Equity																						
Date	Cash	+	Accounts Receivable	+	Office Equipment	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses							
May 1	+\$40,000					=	+ \$40,000															
1	- 2,200					=						- \$2,200										
3						=	+ \$1,890															
5	- 750					=						- 750										
8	+ 5,400					=						+ \$5,400										
12						=						+ 2,500										
15	- 750					=						- 750										
20	+ 2,500		- 2,500			=																
22						=						+ 3,200										
25	+ 3,200		- 3,200			=																
26	- 1,890					=	- 1,890															
27						=	+ 80					- 80										
28	- 750					=						- 750										
30	- 300					=						- 300										
30	- 280					=						- 280										
31	- 1,400					=						- \$1,400										
	\$42,780		+		\$ 0	+		\$1,890	=	\$ 80	+		\$40,000	-		\$1,400	+		\$11,100	-		\$5,110

Problem 1-7A (Continued)

Part 3

The Gram Co. Income Statement For Month Ended May 31		
Revenues		
Consulting services revenue		\$11,100
Expenses		
Rent expense.....	\$2,200	
Salaries expense.....	1,500	
Cleaning expense.....	750	
Telephone expense.....	300	
Utilities expense.....	280	
Advertising expense.....	<u>80</u>	
Total expenses.....		<u>5,110</u>
Net income.....		<u>\$ 5,990</u>

The Gram Co. Statement of Retained Earnings For Month Ended May 31	
Retained earnings, May 1.....	\$ 0
Add: Net income.....	<u>5,990</u>
	5,990
Less: Dividends.....	<u>1,400</u>
Retained earnings, May 31.....	<u>\$ 4,590</u>

The Gram Co. Balance Sheet May 31			
Assets		Liabilities	
Cash.....	\$42,780	Accounts payable.....	\$ 80
Office equipment.....	1,890	Equity	
		Common stock.....	40,000
		Retained earnings.....	<u>4,590</u>
Total assets.....	<u>\$44,670</u>	Total liabilities and equity.....	<u>\$44,670</u>

Problem 1-7A (Concluded)

Part 3—continued

The Gram Co. Statement of Cash Flows For Month Ended May 31		
Cash flows from operating activities		
Cash received from customers	\$11,100	
Cash paid for rent	(2,200)	
Cash paid for cleaning	(750)	
Cash paid for telephone	(300)	
Cash paid for utilities	(280)	
Cash paid to employees	<u>(1,500)</u>	
Net cash provided by operating activities		\$ 6,070
Cash flows from investing activities		
Purchase of equipment	<u>(1,890)</u>	
Net cash used by investing activities		(1,890)
Cash flows from financing activities		
Investment from stockholders	40,000	
Cash dividends	<u>(1,400)</u>	
Net cash provided by financing activities		<u>38,600</u>
Net increase in cash		\$42,780
Cash balance, May 1		<u>0</u>
Cash balance, May 31		<u><u>\$42,780</u></u>

Problem 1-8A (60 minutes) Parts 1 and 2

Assets					=	Liabilities		+	Equity			
Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Building	=	Accounts Payable	+ Notes Payable	+ Common Stock	- Dividends	+ Revenues	- Expenses	
a. +\$70,000			+ \$10,000					+ \$80,000				
b. - 20,000				+ \$150,000			+ \$130,000					
Bal. 50,000			+ 10,000	+ 150,000	=		+ 130,000	+ 80,000				
c. - 15,000			+ 15,000									
Bal. 35,000			+ 25,000	+ 150,000	=		+ 130,000	+ 80,000				
d.		+ \$1,200	+ 1,700			+ \$2,900						
Bal. 35,000		+ 1,200	+ 26,700	+ 150,000	=	2,900	+ 130,000	+ 80,000				
e. - 500												- \$ 500
Bal. 34,500		+ 1,200	+ 26,700	+ 150,000	=	2,900	+ 130,000	+ 80,000				- 500
f.	+ \$2,800									+ \$2,800		
Bal. 34,500	+ 2,800	+ 1,200	+ 26,700	+ 150,000	=	2,900	+ 130,000	+ 80,000		+ 2,800	- 500	
g. + 4,000										+ 4,000		
Bal. 38,500	+ 2,800	+ 1,200	+ 26,700	+ 150,000	=	2,900	+ 130,000	+ 80,000		+ 6,800	- 500	
h. - 3,275									- \$3,275			
Bal. 35,225	+ 2,800	+ 1,200	+ 26,700	+ 150,000	=	2,900	+ 130,000	+ 80,000	- 3,275	+ 6,800	- 500	
i. + 1,800	- 1,800											
Bal. 37,025	+ 1,000	+ 1,200	+ 26,700	+ 150,000	=	2,900	+ 130,000	+ 80,000	- 3,275	+ 6,800	- 500	
j. - 700						- 700						
Bal. 36,325	+ 1,000	+ 1,200	+ 26,700	+ 150,000	=	2,200	+ 130,000	+ 80,000	- 3,275	+ 6,800	- 500	
k. - 1,800												- 1,800
Bal. \$34,525	+ \$1,000	+ \$1,200	+ \$26,700	+ \$150,000	=	\$2,200	+ \$130,000	+ \$80,000	- \$3,275	+ \$6,800	- \$2,300	

Problem 1-8A (Concluded)

Part 3

Biz Consulting's net income = \$6,800 - \$2,300 = \$4,500

Problem 1-9A (60 minutes) Parts 1 and 2

		Assets					=	Liabilities	+	Equity										
Date		Cash	+	Accounts Receivable	+	Office Supplies	+	Office Equipment	+	Electrical Equipment	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses
Dec. 1		+\$65,000									=			+	\$65,000					
	2	- 1,000																	-	\$1,000
Bal.		64,000									=				65,000				-	1,000
	3	- 4,800								+\$13,000		+	\$8,200							
Bal.		59,200								13,000	=	8,200	+	65,000					-	1,000
	5	- 800				+	\$ 800													
Bal.		58,400				+	800			13,000	=	8,200	+	65,000					-	1,000
	6	+ 1,200															+	\$1,200		
Bal.		59,600				+	800			13,000	=	8,200	+	65,000			+	1,200	-	1,000
	8							+	\$2,530			+	2,530							
Bal.		59,600				+	800	+	2,530	13,000	=	10,730	+	65,000			+	1,200	-	1,000
	15		+	\$5,000													+	5,000		
Bal.		59,600	+	5,000	+	800	+	2,530	+	13,000	=	10,730	+	65,000			+	6,200	-	1,000
	18					+	350					+	350							
Bal.		59,600	+	5,000	+	1,150	+	2,530	+	13,000	=	11,080	+	65,000			+	6,200	-	1,000
	20	- 2,530										-	2,530							
Bal.		57,070	+	5,000	+	1,150	+	2,530	+	13,000	=	8,550	+	65,000			+	6,200	-	1,000
	24		+	900													+	900		
Bal.		57,070	+	5,900	+	1,150	+	2,530	+	13,000	=	8,550	+	65,000			+	7,100	-	1,000
	28	+ 5,000	-	5,000																
Bal.		62,070	+	900	+	1,150	+	2,530	+	13,000	=	8,550	+	65,000			+	7,100	-	1,000
	29	- 1,400																	-	1,400
Bal.		60,670	+	900	+	1,150	+	2,530	+	13,000	=	8,550	+	65,000			+	7,100	-	2,400
	30	- 540																	-	540
Bal.		60,130	+	900	+	1,150	+	2,530	+	13,000	=	8,550	+	65,000			+	7,100	-	2,940
	31	- 950															-	\$950		
Bal.		\$59,180	+	\$ 900	+	\$1,150	+	\$2,530	+	\$13,000	=	\$8,550	+	\$65,000	-	\$950	+	\$7,100	-	\$2,940

Problem 1-9A (Continued)
Part 3

Sony Electric Income Statement For Month Ended December 31		
Revenues		
Electrical fees earned.....		\$7,100
Expenses		
Rent expense.....	\$1,000	
Salaries expense.....	1,400	
Utilities expense	<u>540</u>	
Total expenses.....		<u>2,940</u>
Net income.....		<u>\$4,160</u>

Sony Electric Statement of Retained Earnings For Month Ended December 31		
Retained earnings, December 1.....	\$	0
Add: Net income.....		<u>4,160</u>
		4,160
Less: Dividends.....		<u>950</u>
Retained earnings, December 31.....	\$	<u>3,210</u>

Sony Electric Balance Sheet December 31			
Assets		Liabilities	
Cash.....	\$59,180	Accounts payable.....	\$ 8,550
Accounts receivable.....	900		
Office supplies.....	1,150	Equity	
Office equipment.....	2,530	Common stock.....	65,000
Electrical equipment.....	13,000	Retained earnings.....	3,210
Total assets.....	\$76,760	Total liabilities and equity.....	\$76,760

Problem 1-9A (Concluded)

Part 3—continued

Sony Electric Statement of Cash Flows For Month Ended December 31		
Cash flows from operating activities		
Cash received from customers ¹	\$ 6,200	
Cash paid for rent	(1,000)	
Cash paid for supplies	(800)	
Cash paid for utilities	(540)	
Cash paid to employees	<u>(1,400)</u>	
Net cash provided by operating activities		\$ 2,460
Cash flows from investing activities		
Purchase of office equipment	(2,530)	
Purchase of electrical equipment	<u>(4,800)</u>	
Net cash used by investing activities		(7,330)
Cash flows from financing activities		
Investments from stockholders	65,000	
Cash dividends	<u>(950)</u>	
Net cash provided by financing activities		<u>64,050</u>
Net increase in cash		\$59,180
Cash balance, Dec. 1		<u>0</u>
Cash balance, Dec. 31		<u><u>\$59,180</u></u>

¹\$1,200 + \$5,000 = \$6,200

Part 4

If the December 1 investment had been \$49,000 cash instead of \$65,000 and the \$16,000 difference was borrowed by the company from a bank, then:

- (a) total owner investments during this period, as well as the ending equity, would be \$16,000 lower,
- (b) total liabilities would be \$16,000 greater, and
- (c) total assets would remain the same.

Problem 1-10A (15 minutes)

1. Return on assets is net income divided by the average total assets.
Kyzera's return: $\$65,000 / \$250,000 = 0.26$ or 26%.
2. Return on assets seems satisfactory for the risk involved in the manufacturing, marketing, and selling of cellular telephones. Moreover, Kyzera's 26% return is more than twice as high as that of its competitors' 12% return.
3. We know that revenues less expenses equal net income. Taking the revenues and net income numbers for Kyzera we obtain:
 $\$475,000 - \text{Expenses} = \$65,000 \rightarrow \text{Expenses must equal } \underline{\$410,000}$.
4. We know from the accounting equation that total financing (liabilities plus equity) must equal the total for assets (investing). Since average total assets are \$250,000, we know the average total of liabilities plus equity (financing) must equal \$250,000.

Problem 1-11A (20 minutes)

1. Return on assets equals net income divided by average total assets.
 - a. Coca-Cola return: $\$8,634 / \$76,448 = 0.113$ or 11.3%.
 - b. PepsiCo return: $\$6,462 / \$70,518 = 0.092$ or 9.2%.
2. Strictly on the amount of sales to consumers, Coca-Cola's sales of \$46,542 are less than PepsiCo's \$66,504.
3. Success in returning net income from the average amount invested is revealed by the return on assets. Part 1 showed that Coca-Cola's 11.3% return is better than PepsiCo's 9.2% return.
4. The reported figures suggest that Coca-Cola yields a marginally higher return on assets than PepsiCo. Based on this information alone, we would be better advised to invest in Coca-Cola than PepsiCo.

Nevertheless, and because the returns are not dramatically different, we would look for additional information in financial statements and other sources for further guidance. For example, if Coca-Cola could dispose of some assets without curtailing its sales level, it would look even more attractive; or, PepsiCo could do likewise, and close the gap. We would also look for consumer trends, market expansion, competition, product development, and promotion plans.

Problem 1-12A^A (20 minutes)

- | | |
|---------------|---|
| Case 1 | Return: 5% interest or \$100/year.
Risk: Very low; it is the risk of the financial institution not paying interest and principal. |
| Case 2 | Return: Expected winnings from your bet.
Risk: Depends on the probability of your team covering the “spread.” |
| Case 3 | Return: Expected return on your stock investment (both dividends and stock price changes).
Risk: Depends on the current and future performance of Yahoo’s stock price (and dividends). |
| Case 4 | Return: Expected increase in career earnings and other rewards from an accounting degree (less all costs).
Risk: Depends on your ability to successfully learn and apply accounting knowledge. |

Problem 1-13A^B (15 minutes)

- | | |
|------|------|
| 1. F | 5. I |
| 2. I | 6. O |
| 3. I | 7. O |
| 4. F | 8. O |

Problem 1-14A^B (15 minutes)

An organization pursues three major business activities: financing, investing, and operating.

- (1) *Financing* is the means used to pay for resources.
- (2) *Investing* refers to the buying and selling of resources (assets) necessary to carry out the organization’s plans.
- (3) *Operating* activities are the carrying out of an organization’s plans.

If financial statements are to be informative about an organization’s activities, then they will need to report on these three major activities. Also note that planning is the glue that links and coordinates these three major activities—it includes the ideas, goals, and strategies of an organization.

PROBLEM SET B

Problem 1-1B (25 minutes)

Transaction	Balance Sheet			Income Statement	Statement of Cash Flows		
	Total Assets	Total Liab.	Total Equity	Net Income	Operating Activities	Investing Activities	Financing Activities
1 Owner invests cash for its stock	+		+				+
2 Buys building by signing note payable	+	+					
3 Buys store equipment for cash	+/-					-	
4 Provides services for cash	+		+	+	+		
5 Pays cash for rent incurred	-		-	-	-		
6 Incurs utilities costs on credit		+	-	-			
7 Pays cash for salaries incurred	-		-	-	-		
8 Pays cash dividend	-		-				-
9 Provides services on credit	+		+	+			
10 Collects cash on receivable from (9)	+/-				+		

Problem 1-2B (40 minutes)

Part 1

Company V

(a) and (b)

Calculation of equity:	<u>12/31/2015</u>	<u>12/31/2016</u>
Assets	\$54,000	\$59,000
Liabilities	<u>(25,000)</u>	<u>(36,000)</u>
Equity	<u>\$29,000</u>	<u>\$23,000</u>

(c) Calculation of net income for 2016:

Equity, December 31, 2015.....	\$29,000
Plus stock issuances.....	5,000
Plus net income.....	?
Less dividends.....	<u>(5,500)</u>
Equity, December 31, 2016.....	<u>\$23,000</u>

Therefore, the net loss must have been \$(5,500).

Part 2

Company W

(a) Calculation of equity at December 31, 2015:

Assets.....	\$80,000
Liabilities.....	<u>(60,000)</u>
Equity.....	<u>\$20,000</u>

(b) Calculation of equity at December 31, 2016:

Equity, December 31, 2015.....	\$20,000
Plus stock issuances.....	20,000
Plus net income.....	40,000
Less dividends.....	<u>(2,000)</u>
Equity, December 31, 2016.....	<u>\$78,000</u>

(c) Calculation of the amount of liabilities at December 31, 2016:

Assets.....	\$100,000
Equity.....	<u>(78,000)</u>
Liabilities.....	<u>\$ 22,000</u>

Problem 1-2B (Continued)

Part 3

Company X

First, calculate the beginning and ending equity balances:

	<u>12/31/2015</u>	<u>12/31/2016</u>
Assets	\$141,500	\$186,500
Liabilities	(68,500)	(65,800)
Equity	<u>\$ 73,000</u>	<u>\$120,700</u>

Then, find the amount of investment (stock issuances) during 2016:

Equity, December 31, 2015.....	\$ 73,000
Plus stock issuances.....	?
Plus net income.....	18,500
Less dividends.....	<u>0</u>
Equity, December 31, 2016.....	<u>\$120,700</u>

Thus, the investment (stock issuances) must have been..... \$29,200

Part 4

Company Y

First, calculate the beginning balance of equity:

	<u>Dec. 31, 2015</u>
Assets.....	\$92,500
Liabilities.....	<u>51,500</u>
Equity.....	<u>\$41,000</u>

Next, find the ending balance of equity as follows:

Equity, December 31, 2015.....	\$41,000
Plus stock issuances.....	48,100
Plus net income.....	24,000
Less dividends.....	<u>(20,000)</u>
Equity, December 31, 2016.....	<u>\$93,100</u>

Finally, find the ending amount of assets by adding the ending balance of equity to the ending balance of liabilities:

	<u>Dec. 31, 2016</u>
Liabilities.....	\$ 42,000
Equity.....	<u>93,100</u>
Assets.....	<u>\$135,100</u>

Problem 1-2B (Concluded)

Part 5

Company Z

First, calculate the balance of equity as of December 31, 2016:

Assets.....	\$170,000
Liabilities.....	<u>(42,000)</u>
Equity.....	<u>\$128,000</u>

Next, find the beginning balance of equity as follows:

Equity, December 31, 2015.....	\$?
Plus stock issuances.....	60,000
Plus net income.....	32,000
Less dividends.....	<u>(8,000)</u>
Equity, December 31, 2016.....	<u>\$128,000</u>

Thus, the beginning balance of equity is \$44,000.

Finally, find the beginning amount of liabilities by subtracting the beginning balance of equity from the beginning balance of assets:

	<u>Dec. 31, 2015</u>
Assets.....	\$144,000
Equity.....	<u>(44,000)</u>
Liabilities.....	<u>\$100,000</u>

Problem 1-3B (15 minutes)

Safari Company Balance Sheet December 31, 2016			
Assets.....	\$114,000	Liabilities.....	\$ 64,000
		Equity.....	<u>50,000</u>
Total assets.....	<u>\$114,000</u>	Total liabilities and equity....	<u>\$114,000</u>

Problem 1-4B (15 minutes)

Solar Company	
Income Statement	
For Year Ended December 31, 2016	
Revenues	\$68,000
Expenses.....	<u>40,000</u>
Net income.....	<u>\$28,000</u>

Problem 1-5B (15 minutes)

Audi Company	
Statement of Retained Earnings	
For Year Ended December 31, 2016	
Retained earnings, Dec. 31, 2015	\$49,000
Add: Net income.....	<u>5,000</u>
	54,000
Less: Dividends.....	<u>(7,000)</u>
Retained earnings, Dec. 31, 2016.....	<u>\$47,000</u>

Problem 1-6B (15 minutes)

Banji Company	
Statement of Cash Flows	
For Year Ended December 31, 2016	
Cash used by operating activities	\$(3,000)
Cash from investing activities.....	1,600
Cash from financing activities.....	<u>1,800</u>
Net increase in cash.....	\$ 400
Cash, December 31, 2015.....	<u>1,300</u>
Cash, December 31, 2016.....	<u>\$ 1,700</u>

Problem 1-7B (60 minutes) *Parts 1 and 2*

Assets					=	Liabilities	+	Equity							
Date	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses
June 1	+\$130,000				=		+	\$130,000							
2	- 6,000				=									-	\$6,000
4				+	\$2,400	=	+	\$2,400							
6	- 1,150				=									-	1,150
8	+ 850				=							+	\$ 850		
14		+	\$7,500		=							+	7,500		
16	- 800				=									-	800
20	+ 7,500		- 7,500		=										
21		+	7,900		=							+	7,900		
24		+	675		=							+	675		
25	+ 7,900		- 7,900		=										
26	- 2,400				=	- 2,400									
28	- 800				=									-	800
29	- 4,000				=					-	\$4,000				
30	- 150				=									-	150
30	- 890				=									-	890
	\$130,060	+	\$ 675	+	\$2,400	=	\$ 0	+	\$130,000	-	\$4,000	+	\$16,925	-	\$9,790

Problem 1-7B (Continued)
Part 3

Niko's Maintenance Co. Income Statement For Month Ended June 30		
Revenues		
Maintenance services revenue.....		\$16,925
Expenses		
Rent expense.....	\$6,000	
Salaries expense.....	1,600	
Advertising expense.....	1,150	
Utilities expense.....	890	
Telephone expense.....	<u>150</u>	
Total expenses.....		<u>9,790</u>
Net income.....		<u>\$ 7,135</u>

Niko's Maintenance Co. Statement of Retained Earnings For Month Ended June 30		
Retained earnings, June 1.....	\$	0
Add: Net income.....		<u>7,135</u>
		7,135
Less: Dividends.....		<u>4,000</u>
Retained earnings, June 30.....	\$	<u>3,135</u>

Niko's Maintenance Co. Balance Sheet June 30			
Assets		Liabilities	
Cash	\$130,060	Accounts payable	\$ 0
Accounts receivable	675	Equity	
Equipment	2,400	Common stock	130,000
		Retained earnings	<u>3,135</u>
Total assets	<u>\$133,135</u>	Total liabilities and equity	<u>\$133,135</u>

Problem 1-7B (Concluded)

Part 3—continued

Niko's Maintenance Co. Statement of Cash Flows For Month Ended June 30		
Cash flows from operating activities		
Cash received from customers ¹	\$ 16,250	
Cash paid for rent	(6,000)	
Cash paid for advertising	(1,150)	
Cash paid for telephone	(150)	
Cash paid for utilities	(890)	
Cash paid to employees	<u>(1,600)</u>	
Net cash provided by operating activities		\$ 6,460
Cash flows from investing activities		
Purchase of equipment	<u>(2,400)</u>	
Net cash used by investing activities		(2,400)
Cash flows from financing activities		
Investments from stockholders	130,000	
Dividends	<u>(4,000)</u>	
Net cash provided by financing activities		<u>126,000</u>
Net increase in cash		\$130,060
Cash balance, June 1		<u>0</u>
Cash balance, June 30		<u><u>\$130,060</u></u>

¹\$850 + \$7,500 + \$7,900 = \$16,250

Problem 1-8B (60 minutes) Parts 1 and 2

Assets					=	Liabilities		+	Equity			
Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Building	=	Accounts Payable	+ Notes Payable	+ Common Stock	- Dividends	+ Revenues	- Expenses	
a. + \$90,000			+ \$10,000					+ \$100,000				
b. - 40,000				+ \$150,000			+ \$110,000					
Bal. 50,000			+ 10,000	+ 150,000	=		110,000	+ 100,000				
c. - 25,000			+ 25,000									
Bal. 25,000			+ 35,000	+ 150,000	=		110,000	+ 100,000				
d.		+ \$1,200	+ 1,700			+ \$2,900						
Bal. 25,000		1,200	+ 36,700	+ 150,000	=	2,900	+ 110,000	+ 100,000				
e. - 750												- \$ 750
Bal. 24,250		+ 1,200	+ 36,700	+ 150,000	=	2,900	+ 110,000	+ 100,000				- 750
f.	+ \$2,800									+ \$2,800		
Bal. 24,250	+ 2,800	+ 1,200	+ 36,700	+ 150,000	=	2,900	+ 110,000	+ 100,000		+ 2,800	- 750	
g. + 4,000										+ 4,000		
Bal. 28,250	+ 2,800	+ 1,200	+ 36,700	+ 150,000	=	2,900	+ 110,000	+ 100,000		+ 6,800	- 750	
h. - 11,500									- \$11,500			
Bal. 16,750	+ 2,800	+ 1,200	+ 36,700	+ 150,000	=	2,900	+ 110,000	+ 100,000	- 11,500	+ 6,800	- 750	
i. + 1,800	- 1,800											
Bal. 18,550	+ 1,000	+ 1,200	+ 36,700	+ 150,000	=	2,900	+ 110,000	+ 100,000	- 11,500	+ 6,800	- 750	
j. - 700						- 700						
Bal. 17,850	+ 1,000	+ 1,200	+ 36,700	+ 150,000	=	2,200	+ 110,000	+ 100,000	- 11,500	+ 6,800	- 750	
k. - 2,500												- 2,500
Bal. \$15,350	+ \$1,000	+ \$1,200	+ \$36,700	+ \$150,000	=	\$2,200	+ \$110,000	+ \$100,000	- \$11,500	+ \$6,800	- \$3,250	

Problem 1-8B (Concluded)

Part 3

The company's net income = \$6,800 - \$3,250 = \$3,550

Problem 1-9B (60 minutes) Parts 1 and 2

		Assets					=	Liabilities	+	Equity														
Date		Cash	+	Accounts Receivable	+	Office Supplies	+	Office Equipment	+	Roofing Equipment	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses				
July	1	+ \$80,000					=		+	\$80,000														
	2	- 700																		-	\$700			
Bal.		79,300					=							80,000					-	700				
	3	- 1,000								+	\$5,000	=	+ \$4,000											
Bal.		78,300								+	5,000	=	4,000	+	80,000				-	700				
	6	- 600																+	\$ 600					
Bal.		77,700								+	600	=	4,000	+	80,000				+	600				
	8	+ 7,600																						
Bal.		85,300								+	600	=	4,000	+	80,000				+	\$7,600				
	10									+	\$2,300	=	+ 2,300						+	7,600	-	700		
Bal.		85,300								+	600	=	6,300	+	80,000				+	7,600	-	700		
	15									+	2,300	=							+	8,200				
Bal.		85,300								+	8,200	=	6,300	+	80,000				+	15,800	-	700		
	17									+	3,100	=	+ 3,100											
Bal.		85,300								+	8,200	=	9,400	+	80,000				+	15,800	-	700		
	23	- 2,300																						
Bal.		83,000								+	8,200	=	7,100	+	80,000				+	15,800	-	700		
	25									+	5,000	=							+	5,000				
Bal.		83,000								+	13,200	=	7,100	+	80,000				+	20,800	-	700		
	28	+ 8,200								-	8,200	=												
Bal.		91,200								+	5,000	=	7,100	+	80,000				+	20,800	-	700		
	30	- 1,560																			-	1,560		
Bal.		89,640								+	5,000	=	7,100	+	80,000				+	20,800	-	2,260		
	31	- 295																			-	295		
Bal.		89,345								+	5,000	=	7,100	+	80,000				+	20,800	-	2,555		
	31	- 1,800																		-	\$1,800			
Bal.		\$87,545								+	\$ 5,000	=	\$7,100	+	\$80,000				-	\$1,800	+	\$20,800	-	\$2,555

Problem 1-9B (Continued)
Part 3

Rivera Roofing Company Income Statement For Month Ended July 31		
Revenues		
Roofing fees earned		\$20,800
Expenses		
Rent expense.....	\$ 700	
Salaries expense.....	1,560	
Utilities expense	295	
Total expenses.....		<u>2,555</u>
Net income.....		<u>\$18,245</u>

Rivera Roofing Company Statement of Retained Earnings For Month Ended July 31		
Retained earnings, July 1.....	\$ 0	
Add: Net income.....	<u>18,245</u>	
	18,245	
Less: Dividends.....	<u>1,800</u>	
Retained earnings, July 31.....	<u>\$16,445</u>	

Rivera Roofing Company Balance Sheet July 31			
Assets		Liabilities	
Cash.....	\$ 87,545	Accounts payable.....	\$ 7,100
Accounts receivable.....	5,000		
Office supplies.....	3,700	Equity	
Office equipment.....	2,300	Common stock.....	80,000
Roofing equipment.....	<u>5,000</u>	Retained earnings.....	<u>16,445</u>
Total assets.....	<u>\$103,545</u>	Total liabilities & equity.....	<u>\$103,545</u>

Problem 1-9B (Concluded)
Part 3—continued

Rivera Roofing Company Statement of Cash Flows For Month Ended July 31		
Cash flows from operating activities		
Cash received from customers ¹	\$15,800	
Cash paid for rent	(700)	
Cash paid for supplies	(600)	
Cash paid for utilities	(295)	
Cash paid to employees	<u>(1,560)</u>	
Net cash provided by operating activities		\$12,645
Cash flows from investing activities		
Purchase of roofing equipment	(1,000)	
Purchase of office equipment	<u>(2,300)</u>	
Net cash used by investing activities		(3,300)
Cash flows from financing activities		
Investments from stockholders	80,000	
Cash dividends	<u>(1,800)</u>	
Net cash provided by financing activities		<u>78,200</u>
Net increase in cash		\$87,545
Cash balance, July 1		<u>0</u>
Cash balance, July 31		<u><u>\$87,545</u></u>

¹\$7,600 + \$8,200 = \$15,800

Part 4

If the \$5,000 purchase on July 3 had been acquired through an additional owner investment of cash, then:

- (a) total assets would be larger by \$1,000,
- (b) total liabilities would be \$4,000 smaller, and
- (c) total equity would be \$5,000 larger.

Problem 1-10B (15 minutes)

1. Return on assets is net income divided by average total assets (the average amount invested). For Ski-Doo Company this return is computed as:

$$\text{\$201,000} / \text{\$3,000,000} = 0.067 \text{ or } \underline{\underline{6.7\%}}.$$

2. Return on assets does not seem satisfactory for the risk involved in the manufacturing, marketing, and selling of snowmobile equipment. Ski-Doo Company's 6.7% return is less than the 9.5% return earned by its competitors.
3. We know that revenues less expenses equal net income. Taking the revenues and net income numbers for Ski-Doo Company we obtain:
 $\text{\$1,400,000} - \text{Expenses} = \text{\$201,000} \rightarrow \text{Expenses must equal } \underline{\underline{\text{\$1,199,000}}}.$
4. We know from the accounting equation that the total of liabilities plus equity (financing) must equal the total for assets (investing). Since average total assets are $\text{\$3,000,000}$, we know the average total of liabilities plus equity (financing) must equal $\underline{\underline{\text{\$3,000,000}}}.$

Problem 1-11B (15 minutes)

1. Return on assets equals net income divided by average total assets.
 - a. AT&T return: $\$4,184 / \$269,868 = 0.016$ or 1.6%
 - b. Verizon return: $\$10,198 / \$225,233 = 0.045$ or 4.5%
2. On strictly the amount of sales to consumers, AT&T's sales of \$126,723 are greater than Verizon's sales of \$110,875.
3. Success in returning net income from the amount invested is revealed by the return on assets ratio. Part 1 showed that AT&T has a much lower return on assets of 1.6% versus Verizon with a 4.5% return on assets.
4. The reported figures suggest Verizon is more successful in generating income based on assets. Based on this information alone, we would be better advised to invest in Verizon than AT&T.

Nevertheless, we would look for additional information in financial statements and other sources for further guidance. For example, if AT&T could reduce its expenses, or reduce its assets without reducing income, it could potentially be a more appealing investment given its greater market share; or, Verizon could do the same and make it appear more appealing as an investment. We would also look for consumer trends, market expansion, competition, and product development and promotion plans.

Problem 1-12B^A (20 minutes)

- | | | |
|----------------|----------------|---|
| Case 1. | Return: | No return is generated. |
| | Risk: | Moderate Risk. By hiding money at home a person risks loss by theft or fire. Also such a strategy might result in a loss of purchasing power in the event of inflation. |
| Case 2. | Return: | Expected winnings from your bet. |
| | Risk: | Depends on the probability of your horse finishing the race in a position consistent with the odds assigned the horse for the race. |
| Case 3. | Return: | Expected return on your stock investment (both dividends and stock price changes). |
| | Risk: | Depends on the current and future performance of Nike's stock price (and dividends). |
| Case 4. | Return: | Expected return on the bond is a function of the interest rate paid on the bond. |
| | Risk: | Very low because the full faith and credit of the U.S. government back savings bonds. |

Problem 1-13B^B (15 minutes)

- | | | | |
|----|---|----|---|
| 1. | O | 5. | O |
| 2. | F | 6. | F |
| 3. | I | 7. | O |
| 4. | O | 8. | O |

Problem 1-14B^B (15 minutes)

I. Financing Activities

- A. Owner financing—owner invests in the company**
- B. Non-owner (creditor) financing—borrowing money from a bank**

II. Investing Activities

- A. Buying resources (assets)**
- B. Selling resources (assets)**

III. Operating Activities

- A. Use of assets to carry out plans**
- B. Management of internal functions—R&D, marketing, and so forth**

[Note: Planning activities are the ideas, goals, and tactics for implementing financing, investing, and operating activities.]

Serial Problem — SP 1 (30 minutes)

Date		Assets					=	Liabilities	+	Equity										
		Cash	+	Accounts Receivable	+	Computer Supplies	+	Computer System	+	Office Equipment	=	Accounts Payable	+	Common Stock	-	Dividends	+	Revenues	-	Expenses
Oct.	1	\$45,000						\$20,000	+	\$8,000			+	\$73,000						
	3					+	\$1,420					+	\$1,420							
Bal.		45,000			+	1,420		20,000	+	8,000	=	1,420	+	73,000						
	6		+	\$4,800														+	\$ 4,800	
Bal.		45,000	+	4,800	+	1,420	+	20,000	+	8,000	=	1,420	+	73,000			+	4,800		
	8	- 1,420										- 1,420								
Bal.		43,580	+	4,800	+	1,420	+	20,000	+	8,000	=	0	+	73,000			+	4,800		
	12		+	1,400													+	1,400		
Bal.		43,580	+	6,200	+	1,420	+	20,000	+	8,000	=	0	+	73,000			+	6,200		
	15	+ 4,800	-	4,800																
Bal.		48,380	+	1,400	+	1,420	+	20,000	+	8,000	=	0	+	73,000			+	6,200		
	17	- 805																	\$ 805	
Bal.		47,575	+	1,400	+	1,420	+	20,000	+	8,000	=	0	+	73,000			+	6,200	- 805	
	20	- 1,728																	1,728	
Bal.		45,847	+	1,400	+	1,420	+	20,000	+	8,000	=	0	+	73,000			+	6,200	- 2,533	
	22	+ 1,400	-	1,400																
Bal.		47,247	+	0	+	1,420	+	20,000	+	8,000	=	0	+	73,000			+	6,200	- 2,533	
	28		+	5,208													+	5,208		
Bal.		47,247	+	5,208	+	1,420	+	20,000	+	8,000	=	0	+	73,000			+	11,408	- 2,533	
	31	- 875																	875	
Bal.		46,372	+	5,208	+	1,420	+	20,000	+	8,000	=	0	+	73,000			+	11,408	- 3,408	
	31	- 3,600														-	\$3,600			
Bal.		\$42,772	+	\$5,208	+	\$1,420	+	\$20,000	+	\$8,000	=	\$ 0	+	\$73,000	-	\$3,600	+	\$11,408	-	\$3,408

Reporting in Action — BTN 1-1

1. An organization's total assets are equal to its total liabilities plus total equity. Because Apple's liabilities and equity total \$231,839 (in millions), this implies its amount of assets invested is the same \$231,839 (in millions).
2. Return on assets is net income divided by the average total assets invested. For Apple this return is (\$ millions):
 $\$39,510 / [(\$207,000 + 231,839)/2] = 0.1801$ or 18.0%.
3. We know that net income equals total revenues less total expenses. For Apple, we are told net income is \$39,510 and revenues are \$182,795. Thus, Apple's total expenses are computed as: \$182,795 - Expenses = \$39,510. Total expenses must equal \$143,285 (all \$ in millions).
4. Apple's return on assets of 18.0% is good given that it exceeds its competitors' return on assets of roughly 11% for this period.
5. Answer depends on the current annual report information obtained.

Comparative Analysis — BTN 1-2

(\$ millions)	Apple	Google
1. Total assets = Liabilities + Equity	<u>\$231,839</u>	<u>\$131,133</u>
2. Return on assets	$\frac{\$39,510}{[(\$207,000 + \$231,839)/2]} = \underline{18.0\%}$	$\frac{\$14,444}{[(\$110,920 + \$131,133)/2]} = \underline{11.9\%}$
3. Revenues-Expenses = Net income → Expenses =	$\begin{aligned} &\$182,795 - \text{Expenses} \\ &= \$39,510 \\ &\text{Expenses} = \underline{\$143,285} \end{aligned}$	$\begin{aligned} &\$66,001 - \text{Expenses} \\ &= \$14,444 \\ &\text{Expenses} = \underline{\$51,557} \end{aligned}$
4. Analysis of return on assets:	Apple's 18.0% return is good given the moderate risk Apple confronts and vis-à-vis the 11% return of its competitors. Google's 11.9% return is slightly better than competitors and is not as high as Apple's.	
5. Analysis conclusions:	Google's return is adequate (better when compared to the industry norm); Apple's return is arguably very good. Both companies' expenses are a large percentage of their revenues.	

Ethics Challenge — BTN 1-3

1. There are several parties affected. They include the users of financial statements such as shareholders, lenders, investors, analysts, suppliers, directors, unions, regulators and others. They also include the accounting firm, which can be sued if deemed a party to misleading statements.
2. A major factor in the value of an auditor's report is the auditor's independence. If an auditor accepted a fee that increases when the client's reported profit increases, the auditor is (or at least is perceived to be) interested in higher profits for the client. This compromises the auditor's independence.
3. Thorne should not accept this fee arrangement. To avoid compromising the auditor's independence, Thorne should reject it. (Further, the AICPA Code of Professional Conduct forbids auditors from accepting contingent fees that depend on amounts reported in a client's financial statements. This AICPA Code has been codified into law in most states and, therefore, this action would also be an illegal act for a CPA.)
4. Ethical considerations guiding this decision include the potential harm to affected parties by allowing such a fee arrangement to exist. The unacceptable nature of such a fee arrangement guards the profession against unethical actions that could undermine its real and perceived value to society.

Communicating in Practice — BTN 1-4

1. Deciding whether Apple is a good loan risk can be difficult because the planned expansion is risky if customer demand does not meet expectations. As a loan officer in this situation you would want information on the company's (1) projections of expected cash receipts and cash payments (best provided on a monthly basis); (2) assessment of the market, the company's plans, and a strategy to achieve success; (3) cash contributions that the owners will make to the business; and (4) a listing of tangible assets (including their price and useful life) necessary to carry out the company's plans.
2. How the company is organized is important to a loan officer. If it is a standard partnership (which it was, and not a LLC), the personal assets of the owners are available to repay the loan. In this case, a loan officer will want information about the owners' financial condition. If it is a corporation, the amounts invested in the business by each shareholder are especially important. The loan officer can also require owners or shareholders to personally guarantee the loan for additional protection for the bank. Careful execution of these steps should minimize the bank's risk of taking on a bad loan.

Taking It to the Net — BTN 1-5

\$ thousands	2015	2014	2013	2012	2011
Revenues	\$41,508	\$39,185	\$36,315	\$34,627	\$31,128
Net income	3,938	4,392	1,478	3,876	3,911

1. Rocky Mountain Chocolate Factory's (RMCF) revenues exhibit a consistent, positive trend. Specifically, its revenues consistently grew during the 5-year period of 2011 through 2015. Management must work to continue to pursue policies that grow revenues.
2. Net income performance for RMCF decreased from 2011 through 2013, but substantially rebounded in 2014. Its 2015 were similar, but slightly lower, than 2014 income. Management must work to increase and sustain higher profitability levels for long-run success.

Teamwork in Action — BTN 1-6

Suggestions for forming support/learning teams are in the Instructor's Resource Manual (IRM). The IRM provides the master of a Student Data Form that can be duplicated and used to gather information as a basis for forming these teams. The IRM also includes other administrative materials helpful in creating an active learning environment for studying accounting.

[Note: Instructors often have students use the copy function in e-mail to keep them advised of meeting times and other important team activities. This also encourages students to use and explore additional features of e-mail.]

Entrepreneurial Decision — BTN 1-7

1. (a) AccountApp's total amount of liabilities and equity consists of the bank loan and the owner investments. Specifically:

Total assets	=	Bank Loan	+	Owner investment
	=	Liabilities	+	Equity
\$750,000	=	\$500,000	+	\$250,000

- (b) AccountApp's total amount of assets equals its total amount of liabilities plus equity, which is \$750,000.

2. Return on assets = $\$80,250 / \$750,000 = 0.107 = \underline{10.7\%}$

AccountApp's 10.7% return slightly exceeds its competitors' average return of 10%. Assuming the company can continue to earn 10.7% or more, the owners should consider further investment in the new company.

Hitting the Road — BTN 1-8

Check each student's report for the following content:

1. (a) Identification of the form of business organization for the business interviewed.
(b) Identification of the main business activities for the business interviewed.
2. Identification of the reasons why the owner(s) chose this particular form of business organization.
3. Identification of advantages or disadvantages of the form of business organization chosen.

[Note: Many instructors have students complete this assignment in teams.]

1. Samsung's net income and revenues figures are computed using Korean Won (KRW), which is the currency of Korea. In contrast, Apple and Google compute their financial figures in U.S. dollars. Accordingly, one must convert these figures into comparable monetary units for business decisions that depend on direct comparisons of these numbers.

Moreover, Samsung's figures are computed according to International Financial Reporting Standards (IFRS) following pronouncements of the IASB, while Apple and Google use U.S. GAAP per the FASB. One should adjust these figures for any significant differences in accounting measurements to yield an 'apples-to-apples' comparison.

2. Samsung's return on assets ratio eliminates differences in monetary units (between KRW and dollars). Consequently, we need not focus on differences in KRW and dollars for ratio comparisons provided we are comfortable with measurement techniques underlying the financial figures.

However, any comparisons using the return on assets ratio are still impacted by potential differences in IFRS GAAP as applied by Samsung compared to U.S. GAAP applied by Apple and Google.

