Chapter 1

Business Decisions and Financial Accounting

ANSWERS TO QUESTIONS

1. Accounting is a system of analyzing, recording, and summarizing the results of a business’s activities and then reporting them to decision makers.

2. An advantage of operating as a sole proprietorship, rather than a corporation, is that it is easy to establish. Another advantage is that income from a sole proprietorship is taxed only once in the hands of the individual proprietor (income from a corporation is taxed in the corporation and then again in the hands of the individual proprietor). A disadvantage of operating as a sole proprietorship, rather than a corporation, is that the individual proprietor can be held responsible for the debts of the business.

3. Financial accounting focuses on preparing and using the financial statements that are made available to owners and external users such as customers, creditors, and potential investors who are interested in reading them. Managerial accounting focuses on other accounting reports that are not released to the general public, but instead are prepared and used by employees, supervisors, and managers who run the company.

4. Financial reports are used by both internal and external groups and individuals. The internal groups are comprised of the various managers of the business. The external groups include investors, creditors, governmental agencies, other interested parties, and the public at large.

5. The business itself, not the individual shareholders who own the business, is viewed as owning the assets and owing the liabilities on its balance sheet. A business’s balance sheet includes the assets, liabilities, and shareholders’ equity of only that business and not the personal assets, liabilities, and equity of the shareholders. The financial statements of a company show the results of the business activities of only that company.

6. (a) Operating – These activities are directly related to earning profits. They include buying supplies, making products, serving customers, cleaning the premises, advertising, renting a building, repairing equipment, and obtaining insurance coverage.

(b) Investing – These activities involve buying and selling productive resources with long lives (such as buildings, land, equipment, and tools), purchasing investments, and lending to others.

(c) Financing – Any borrowing from banks, repaying bank loans, receiving contributions from shareholders, or paying dividends to shareholders are considered financing activities.

7. The heading of each of the four primary financial statements should include the following:

(a) Name of the business

(b) Name of the statement

(c) Date of the statement, or the period of time

8. (a) The purpose of the balance sheet is to report the financial position (assets, liabilities and shareholders’ equity) of a business at a point in time.

(b) The purpose of the income statement is to present information about the revenues, expenses, and net income of a business for a specified period of time.

(c) The statement of retained earnings reports the way that net income and the distribution of dividends affected the financial position of the company during the period.

(d) The purpose of the statement of cash flows is to summarize how a business’s operating, investing, and financing activities caused its cash balance to change over a particular period of time.

9. The income statement, statement of retained earnings, and statement of cash flows would be dated “For the Year Ended December 31, 2014,” because they report the inflows and outflows of resources during a period of time. In contrast, the balance sheet would be dated “At December 31, 2014,” because it represents the assets, liabilities and shareholders’ equity at a specific date.

10. Net income is the excess of total revenues over total expenses. A net loss occurs if total expenses exceed total revenues.

11. The accounting equation for the balance sheet is: Assets = Liabilities + Shareholders’ Equity. Assets are the economic resources controlled by the company. Liabilities are amounts owed by the business. Shareholders’ equity is the owners’ claims to the business. It includes amounts contributed to the business (by investors through purchasing the company’s shares) and the amounts earned and accumulated through profitable business operations.

12. The equation for the income statement is Revenues – Expenses = Net Income. Revenues are increases in a company’s resources, arising primarily from its operating activities. Expenses are decreases in a company’s resources, arising primarily from its operating activities. Net Income is equal to revenues minus expenses. (If expenses are greater than revenues, the company has a Net Loss.)

13. The equation for the statement of retained earnings is: Beginning Retained Earnings + Net Income - Dividends = Ending Retained Earnings. It begins with beginning-of-the-year retained earnings which is the prior year’s ending retained earnings reported on the prior year’s balance sheet. The current year's net incomereported on the income statement is added and the current year's dividends are subtracted from this amount. The ending retained earnings amount is reported on the end-of-year balance sheet.

14. The equation for the statement of cash flows is: Cash flows from operating activities + Cash flows from investing activities + Cash flows from financing activities = Change in cash for the period. Change in cash for the period + Beginning cash balance = Ending cash balance. The net cash flows for the period represent the increase or decrease in cash that occurred during the period. Cash flows from operating activities are cash flows directly related to earning income (normal business activity). Cash flows from investing activities include cash flows that are related to the acquisition or sale of the company’s long-term assets. Cash flows from financing activities are directly related to the financing of the company.

15. Currently, the Chartered Professional Accountants of Canada (CPA) is given the primary responsibility for setting the detailed rules that become Generally Accepted Accounting Principles (GAAP) in Canada. (Internationally, the International Accounting Standards Board (IASB) has the responsibility for setting accounting rules known as International Financial Reporting Standards (IFRS).)

16. The main goal of accounting rules is to ensure that companies produce useful financial information for present and potential investors, lenders, and other creditors in making decisions in their capacity as capital providers. Financial information must show relevance and faithful representation, as well as be comparable, verifiable, timely, and understandable.

17. An ethical dilemma is a situation where following one moral principle would result in violating another. Three steps that should be considered when evaluating ethical dilemmas are:

(a) Identify who will benefit from the situation (often, the manager or employee) and how others will be harmed (other employees, the company’s reputation, owners, creditors, and the public in general).

(b) Identify the alternative courses of action.

(c) Choose the alternative that is the most ethical – that which you would be proud to have reported in the news media. Often, there is no one right answer and hard choices will need to be made. Following strong ethical practices is a key part of ensuring good financial reporting by businesses of all sizes.

18. Accounting frauds and cases involving academic dishonesty are similar in many respects. Both involve deceiving others in an attempt to influence their actions or decisions, often resulting in temporary personal gain for the deceiver. For example, when an accounting fraud is committed, financial statement users may be misled into making decisions they wouldn’t have made had the fraud not occurred (e.g., creditors might loan money to the company, investors might invest in the company, or shareholders might reward top managers with big bonuses). When academic dishonesty is committed, instructors might assign a higher grade than is warranted by the student’s individual contribution. Another similarity is that, as a consequence of the deception, innocent bystanders may be adversely affected by fraud and academic dishonesty. Fraud may require the company to charge higher prices to customers to cover costs incurred as a result of the fraud. Academic dishonesty may lead to stricter grading standards, with significant deductions taken for inadequate documentation of sources referenced. A final similarity is that if fraud and academic dishonesty are ultimately uncovered, both are likely to lead to adverse long-term consequences for the perpetrator. Fraudsters may be fined, imprisoned, and encounter an abrupt end to their careers. Students who cheat may be penalized through lower course grades or expulsion, and might find it impossible to obtain academic references for employment applications.

**Authors' Recommended Solution Time**

(Time in minutes)

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *Mini-exercises* | | *Exercises* | | *Problems* | | *Skills Development Cases\** | | *Continuing Case* | |
| *No.* | *Time* | *No.* | *Time* | *No.* | *Time* | *No.* | *Time* | *No.* | *Time* |
| 1 | 3 | 1 | 10 | CP1-1 | 45 | 1 | 20 | 1 | 45 |
| 2 | 11 | 2 | 10 | CP1-2 | 10 | 2 | 20 |  |  |
| 3 | 12 | 3 | 15 | CP1-3 | 60 | 3 | 30 |  |  |
| 4 | 6 | 4 | 25 | PA1-1 | 45 | 4 | 30 |  |  |
| 5 | 6 | 5 | 25 | PA1-2 | 10 | 5 | 20 |  |  |
| 6 | 6 | 6 | 10 | PA1-3 | 50 | 6 | 30 |  |  |
| 7 | 6 | 7 | 15 | PB1-4 | 45 | 7 | 45 |  |  |
| 8 | 4 | 8 | 10 | PA1-5 | 50 |  |  |  |  |
| 9 | 4 | 9 | 20 | PB1-1 | 45 |  |  |  |  |
| 10 | 3 | 10 | 10 | PB1-2 | 10 |  |  |  |  |
| 11 | 3 | 11 | 3 | PB1-3 | 45 |  |  |  |  |
| 12 | 6 | 12 | 3 | PB1-4 | 10 |  |  |  |  |
| 13 | 6 |  |  | PB1-5 | 50 |  |  |  |  |
| 14 | 6 |  |  |  |  |  |  |  |  |
| 15 | 6 |  |  |  |  |  |  |  |  |
| 16 | 12 |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

\* Due to the nature of cases, it is very difficult to estimate the amount of time students will need to complete them. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear, and by offering suggestions (about how to research topics or what companies to select). The skills developed by these cases are indicated below.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Case | Financial Analysis | Research | Ethical  Reasoning | Critical  Thinking | Technology | Writing | Teamwork |
| 1 | x |  |  |  |  |  |  |
| 2 | x |  |  |  |  |  |  |
| 3 | x | x |  |  | x | x | x |
| 4 | x |  | x | x |  |  |  |
| 5 | x |  |  | x |  | x |  |
| 6 | x |  |  | x |  | x |  |
| 7 | x |  |  |  | x |  |  |

ANSWERS TO MINI-EXERCISES

**M1-1**

**Abbreviation Full Designation**

1. CPA Chartered Professional Accountant

2. GAAP Generally Accepted Accounting Principles

3. IASB International Accounting Standards Board

4. CSA Canadian Securities Administrators

5. IFRS International Financial Reporting Standards

6. ASPE Accounting Standards for Private Enterprises

**M1-2**

**Term or Abbreviation Definition**

|  |  |  |  |
| --- | --- | --- | --- |
| F  D  E  A  C  I  G  B  K  J  H | (1)  (2)  (3)  (4)  (5)  (6)  (7)  (8)  (9)  (10)  (11) | Investing activities  Private company  Corporation  Accounting  Partnership  AcSB  Financing activities  Unit of measure  GAAP  Public company  Operating activities | 1. A system that collects and processes financial information about an organization and reports that information to decision makers. 2. Measurement of information about a business in the monetary unit (dollars or other national currency). 3. An unincorporated business owned by two or more persons. 4. A company that sells shares privately and is not required to release its financial statements to the public. 5. An incorporated business that issues shares as evidence of ownership. 6. Buying and selling productive resources with long lives. 7. Transactions with lenders (borrowing and repaying cash) and shareholders (selling company shares and paying dividends). 8. Activities directly related to running the business to earn profit. 9. Accounting Standards Board. 10. A company that has its shares bought and sold by investors on established stock exchanges. 11. Generally accepted accounting principles. |

**M1-3**

**Term Definition**

|  |  |  |  |
| --- | --- | --- | --- |
| F  I  C  A  B  H  D  G  E  J | (1)  (2)  (3)  (4)  (5)  (6)  (7)  (8)  (9)  (10) | Relevance  Faithful Representation  Comparability  Separate Entity  Assets  Liabilities  Shareholders’ Equity  Revenues  Expenses  Unit of Measure | 1. The financial reports of a business are assumed to include the results of only that business’s activities. 2. The resources owned by a business. 3. Financial information that can be compared across businesses because similar accounting methods have been applied. 4. The total amounts invested and reinvested in the business by its owners. 5. The costs of business necessary to earn revenues. 6. A feature of financial information that allows it to influence a decision. 7. Earned by selling goods or services to customers. 8. The amounts owed by the business. 9. Financial information that depicts the economic substance of business activities. 10. The assumption that states that results of business activities should be reported in an appropriate monetary unit. |

**M1-4**

|  |  |
| --- | --- |
| L (B/S) | (1) Accounts Payable |
| A (B/S) | (2) Accounts Receivable |
| A (B/S) | (3) Cash |
| E (I/S) | (4) Income Tax Expense |
| E (I/S) | (5) Selling and Administrative Expenses |
| R (I/S) | (6) Sales Revenue |
| L (B/S) | (7) Notes Payable |
| SE(B/S) | (8) Retained Earnings |

**M1-5**

|  |  |
| --- | --- |
| A (B/S) | (1) Accounts Receivable |
| R (I/S) | (2) Sales Revenue |
| A (B/S) | (3) Equipment |
| E (I/S) | (4) Supplies Expense |
| A (B/S) | (5) Cash |
| E (I/S) | (6) Advertising Expense |
| L (B/S) | (7) Accounts Payable |
| SE(B/S) | (8) Retained Earnings |

#### M1-6

|  |  |
| --- | --- |
| A (B/S) | (1) Accounts Receivable |
| E (I/S) | (2) Selling and Administrative Expenses |
| A (B/S) | (3) Cash |
| A (B/S) | (4) Equipment |
| E (I/S) | (5) Advertising Expenses |
| R (I/S) | (6) Sales Revenue |
| L (B/S) | (7) Notes Payable |
| SE(B/S) | (8) Retained Earnings |
| L (B/S) | (9) Accounts Payable |

**M1-7**

|  |  |
| --- | --- |
| L (B/S) | (1) Accounts Payable |
| SE(B/S) | (2) Contributed Capital |
| A (B/S) | (3) Equipment |
| A (B/S) | (4) Accounts Receivable |
| L (B/S) | (5) Notes Payable |
| A (B/S) | (6) Cash |
| SE(B/S) | (7) Retained Earnings |
| E (I/S) | (8) Selling and Administrative Expenses |
| R (I/S) | (9) Sales Revenue |
| A (B/S) | (10) Supplies |

#### M1-8

|  |  |
| --- | --- |
| SRE\* | (1) Dividends |
| B/S | (2) Total Shareholders’ Equity |
| I/S | (3) Sales Revenue |
| B/S | (4) Total Assets |
| SCF | (5) Cash Flows from Operating Activities |
| B/S | (6) Total Liabilities |
| I/S, SRE | (7) Net Income |
| SCF | (8) Cash Flows from Financing Activities |

\* An argument could be made for also including SCF as a plausible answer because the SCF reports “Dividends paid in cash.” The answer SCF has been excluded here because (technically) the caption would have to read “Dividends paid in cash” if it were to be reported on the SCF.

**M1-9**

|  |  |  |
| --- | --- | --- |
|  | **Element** | **Financial Statement** |
| D | (1) Cash Flows from Financing Activities | A. Balance Sheet |
| B | (2) Expenses | B. Income Statement |
| D | (3) Cash Flows from Investing Activities | C. Statement of Retained Earnings |
| A | (4) Assets | D. Statement of Cash Flows |
| C | (5) Dividends |  |
| B | (6) Revenues |  |
| D | (7) Cash Flows from Operating Activities |  |
| A | (8) Liabilities |  |

#### M1-10

|  |  |
| --- | --- |
| (F) | (1) Cash paid for dividends |
| O | (2) Cash collected from customers |
| F | (3) Cash received when signing a note |
| (O) | (4) Cash paid to employees |
| (I) | (5) Cash paid to purchase equipment |
| F | (6) Cash received from issuing shares |

#### M1-11

|  |  |
| --- | --- |
| (I) | (1) Cash paid to purchase equipment |
| O | (2) Cash collected from clients |
| I | (3) Cash received from selling equipment |
| (F) | (4) Cash paid for dividends |
| (O) | (5) Cash paid to suppliers |
| F | (6) Cash received from issuing shares |

**M1-12**

STONE CULTURE CORPORATION

Statement of Retained Earnings

For the Year Ended December 31, 2013

Retained Earnings, January 1, 2013 $ 0

Add: Net Income 36,000

Subtract: Dividends (15,000)

Retained Earnings, December 31, 2013 $ 21,000

**M1-12 (continued)**

STONE CULTURE CORPORTATION

Statement of Retained Earnings

For the Year Ended December 31, 2014

Retained Earnings, January 1, 2014 $ 21,000

Add: Net Income 45,000

Subtract: Dividends (20,000)

Retained Earnings, December 31, 2014 $ 46,000

**M1-13**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Apple, Inc. | Google, Inc. | Intel Corp. |
| Contributed Capital | $11 | $18 | $17 |
| Dividends | 0 | 0 | 4 |
| Net Income | (a) 14 | (d) 9 | (g) 11 |
| Retained Earnings, Beginning of Year | 23 | 20 | 26 |
| Retained Earnings, End of Year | (b) 37 | (e) 29 | (h) 33 |
| Total Assets | (c) 75 | (f) 59 | (i) 63 |
| Total Expenses | 51 | 20 | 33 |
| Total Liabilities | 27 | 12 | 13 |
| Total Revenues | 65 | 29 | 44 |

**Net income = Revenues – Expenses**

**Retained Earnings, End of Year = Retained Earnings Beginning of Year + Net Income – Dividends**

**Total Assets = Total Liabilities and Shareholders’ Equity**

**M1-14**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Amazin’ Corp.** | **Best Tech, Inc.** | **Colossal Corp.** |
| Contributed Capital | $5 | $15 | $100 |
| Dividends | 10 | 5 | 50 |
| Net Income | (a) 25 | (d) 20 | (g) 100 |
| Retained Earnings, Beginning of Year | 30 | 0 | 200 |
| Retained Earnings, End of Year | (b) 45 | (e) 15 | (h) 250 |
| Total Assets | (c) 80 | (f) 60 | (i) 700 |
| Total Expenses | 75 | 30 | 200 |
| Total Liabilities | 30 | 30 | 350 |
| Total Revenues | 100 | 50 | 300 |

**M1-14 (continued)**

**Net income = Revenues – Expenses**

**Retained Earnings, End of Year = Retained Earnings Beginning of Year + Net Income – Dividends**

**Total Assets = Total Liabilities and Shareholders’ Equity**

**M1-15**

(a) (300) (b) 70 (c) 3,900. Electronic Arts was not profitable because its expenses ($3,900) were greater than its revenues ($3,600), resulting in the net loss of $300 reported on the income statement.

The above amounts are determined using the various relationships that exist in the financial statements. Because this exercise excludes two pieces of information from both the income statement and statement of retained earnings, students must first work backwards from the balance sheet to the statement of retained earnings to the income statement. Although not required, the following statements show the given and missing information. The ?s in the balance sheet are determined from A = L + SE.

|  |  |
| --- | --- |
| **Electronic Arts, Inc.**  **Balance Sheet**  **At xxxx** | |
| Total Assets | $4,900 |
| Liabilities and Shareholders’ Equity | |
| Total Liabilities | $2,400 |
| Shareholders’ Equity | |
| Contributed capital | $2,430 |
| Retained earnings | (b) |
| Total SE | ? |
| Total Liabilities & SE | ? |

|  |  |
| --- | --- |
| **Electronic Arts, Inc.**  **Income Statement**  **For the Year Ended xxxx** | |
| Revenues | $3,600 |
| Expenses | (c) |
| Net Income (Loss) | (a) |
| **Electronic Arts, Inc.**  **Statement of Retained Earnings**  **For the Year Ended xxxx** | |
| RE, beginning | $370 |
| Net income (loss) | (a) |
| Dividends | (0) |
| RE, ending | (b) |

**M1-16**

Req. 1

WESTJET AIRLINES, LTD.

Income Statement

For the Year Ended December 31, 2014

*(Amounts in millions)*

|  |  |  |
| --- | --- | --- |
| Revenues  Ticket Revenues |  | $ 9,861 |
| Other Revenue |  | 336 |
| Total Revenue |  | 10,197 |
| Expenses |  |  |
| Salaries Expense |  | 3,213 |
| Aircraft Fuel Expense |  | 2,536 |
| Other Operating Expenses |  | 2,145 |
| Repairs and Maintenance Expense |  | 616 |
| Landing Fees Expense |  | 560 |
| Interest Expense |  | 69 |
| Income Tax Expense |  | 413 |
| Total Expenses |  | 9,552 |
|  |  |  |
| Net Income |  | $    645 |

Req. 2

WESTJET AIRLINES, LTD.

Statement of Retained Earnings

For the Year Ended December 31, 2014

*(Amounts in millions)*

Retained Earnings, January 1, 2014 $ 4,157

Add: Net Income 645

Subtract: Dividends (14)

Retained Earnings, December 31, 2014 $ 4,788

**M1-16 (continued)**

Req. 3

WESTJET AIRLINES, LTD.

Balance Sheet

At December 31, 2014

*(Amounts in millions)*

|  |  |
| --- | --- |
| Assets |  |
| Cash | $    2,213 |
| Accounts Receivable | 845 |
| Supplies | 259 |
| Property and Equipment | 10,874 |
| Other Assets | 2,581 |
| Total Assets | $ 16,772 |
|  |  |
| Liabilities |  |
| Accounts Payable | $   1,731 |
| Notes Payable | 4,993 |
| Other Liabilities | 3,107 |
| Total Liabilities | 9,831 |
| Shareholders’ Equity |  |
| Contributed Capital | 2,153 |
| Retained Earnings | 4,788 |
| Total Shareholders’ Equity | 6,941 |
| Total Liabilities and Shareholders’ Equity | $ 16,772 |

Req. 4

Westjet Airlines financed its assets primarily with liabilities ($9,831) as opposed to shareholders’ equity ($6,941).

**ANSWERS TO EXERCISES**

**E1-1**

1. Assets = Liabilities + Shareholders’ Equity

= $13,750 + $4,450

= $18,200

= Assets reported on the balance sheet

1. Net Income = Revenue – Expenses

= $10,500 - $9,200

= $1,300

= Net income reported on the income statement

1. Beginning Retained Earnings (R/E) + Net Income – Dividends = Ending R/E

$3,500 + $1,300 - $500 = $4,300

1. Beginning Cash + Cash Flows from Operating Activities + Cash Flows from Investing Activities + Cash Flows from Financing Activities = Ending Cash

$1,000 + $1,600 + ($1,000) + ($900) = $700

#### E1-2

1. Assets = Liabilities + Shareholders’ Equity

= $18,500 + $61,000

= $79,500

= Assets reported on the balance sheet

1. Net Income = Revenue – Expenses

= $32,100 – $18,950

= $13,150

= Net income reported on the income statement

1. Beginning Retained Earnings (R/E) + Net Income – Dividends = Ending R/E

$20,500 + $13,150 – $4,900 = $28,750

1. Beginning Cash + Cash Flows from Operating Activities + Cash Flows from Investing Activities + Cash Flows from Financing Activities = Ending Cash

$3,200 + $15,700 + ($7,200) + ($5,300) = $6,400

**E1-3**

Req. 1

Designer Footwear Inc.

Balance Sheet

At November 1, 2014

(in thousands)

|  |  |
| --- | --- |
| Assets |  |
| Cash | $ 45,570 |
| Accounts Receivable | 11,888 |
| Property, Plant, and Equipment | 233,631 |
| Other Assets | 494,294 |
| Total Assets | $785,383 |
|  |  |
| Liabilities |  |
| Accounts Payable | $136,405 |
| Notes Payable | 99,044 |
| Other Liabilities | 79,148 |
| Total Liabilities | 314,597 |
| Shareholders’ Equity |  |
| Contributed Capital | 291,248 |
| Retained Earnings | 179,538 |
| Total Shareholders’ Equity | 470,786 |
| Total Liabilities and Shareholders’ Equity | $785,383 |

Req. 2

Most of the financing as of November 1 came from shareholders. The shareholders have financed $470,786 of the total assets and creditors have financed only $314,597 of the total assets of the company.

**E1-4**

Req. 1

READER DIRECT

Balance Sheet

At December 31, 2014

|  |  |  |  |
| --- | --- | --- | --- |
| Assets |  | Liabilities |  |
| Cash | $  47,500 | Accounts Payable | $   8,000 |
| Accounts Receivable | 26,900 | Note Payable | 2,850 |
| Property and Equipment | 48,000 |  |  |
|  |  | Total Liabilities | 10,850 |
|  |  |  |  |
|  |  | Shareholders’ Equity |  |
|  |  | Contributed Capital | 98,000 |
|  |  | Retained Earnings | 13,550 |
|  |  | Total Shareholders’ Equity | 111,550 |
| Total Assets | $122,400 | Total Liabilities and  Shareholders’ Equity | $122,400 |

Req. 2

Beginning Retained Earnings (R/E) + Net Income – Dividends = Ending R/E, so

Net Income= Ending R/E + Dividends - Beginning R/E

= $13,550 + 0 – 0

= $13,550

Net income for the year was $13,550. This is the first year of operations and no dividends were declared or paid to shareholders; therefore, retained earnings is $13,550 (which represents income for one year).

Req. 3

Most of the financing as of December 31, 2014 came from shareholders. The shareholders have financed $111,550 of the total assets and creditors have financed only $10,850 of the total assets of the company.

Req.4

Beginning Retained Earnings (R/E) + Net Income – Dividends = Ending R/E, so

Ending R/E = $13,550 + 3,000 – 2,000

= $14,550

Retained Earnings at December 31, 2015 would be $14,550.

**E1-5**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **Req. 1**  Label | **Req. 2**  Type |
| a. | Coins, bullion, and currency | Inventory | A |
| b. | Amounts Collectibles Canada owes to suppliers of coins, bullion and currency | Accounts Payable | L |
| c. | Amounts Collectibles Canada can collect from customers | Accounts Receivable | A |
| d. | Amounts owed to bank for loan to buy building | Notes Payable | L |
| e. | Property on which buildings will be built | Land | A |
| f. | Amounts distributed from profits to shareholders | Dividends | SE |
| g. | Earned by Collectibles Canada by selling coin collecting supplies | Revenue | R |
| h. | Unused paper in Collectibles Canada head office | Supplies | A |
| i. | Cost of paper used up during month | Supplies Expense | E |
| j. | Amounts contributed to Collectibles Canada by shareholders | Contributed Capital | SE |

**E1-6**

Req. 1

CINEPLEX ENTERTAINMENT

Income Statement

For the Quarter Ended June 26, 2014

(in thousands)

|  |  |
| --- | --- |
| Revenues |  |
| Admissions Revenues | $455,700 |
| Concessions Revenues | 188,900 |
| Other Revenues | 31,200 |
| Total Revenues | 675,800 |
| Expenses |  |
| Film Rental Expenses | 247,000 |
| Rent Expense | 90,000 |
| General, Selling and Administrative Expenses | 65,700 |
| Concessions Expenses | 25,500 |
| Other Expenses | 233,800 |
| Total Expenses | 662,000 |
| Net Income | $ 13,800 |

**E1-6 (continued)**

The question marks in the exercise correspond to Total Expenses of $662,000 and Net Income of $13,800, as determined above.

Req. 2

Cineplex’s main source of revenue is admissions and its biggest expense is its film rental expense and other expenses.

**E1-7**

HOME REALTY, INCORPORATED

Income Statement

For the Year Ended December 31, 2014

Revenue:

Sales Revenue $166,000

Expenses:

Selling Expenses 97,000

Promotion and Advertising Expenses 9,025

Interest Expense 6,300

Income Tax Expense 18,500

Total Expenses 130,825

Net Income $ 35,175

Note that dividends declared are not an expense. As a distribution of the company’s prior profits, they will be deducted from Retained Earnings.

**E1-8**

A Net Income = $100,000 - $82,000 = $18,000

Shareholders’ Equity = $150,000 - $70,000 = $80,000

B Total Revenues = $80,000 + $12,000 = $92,000

Total Liabilities = $112,000 - $60,000 = $52,000

C Net Income (Loss) = $80,000 - $86,000 = $(6,000)

Shareholders’ Equity = $104,000 - $26,000 = $78,000

D Total Expenses = $50,000 - $13,000 = $37,000

Total Assets = $22,000 + $77,000 = $99,000

E Total Revenues = $81,000 - $6,000 = $75,000

Total Assets = $73,000 + $28,000 = $101,000

**E1-9**

Req. 1

MONCTON CLAY CORPORATION

Income Statement

For the Month Ended January 31, 2014

Total Revenues $131,000

Operating Expenses 90,500

Net Income $ 40,500

MONCTON CLAY CORPORATION

Balance Sheet

At January 31, 2014

Assets:

Cash $30,800

Accounts Receivable 25,300

Supplies 40,700

Total Assets $96,800

Liabilities:

Accounts Payable $25,700

Total Liabilities 25,700

Shareholders’ Equity:

Contributed Capital (2,600 shares) 30,600

Retained Earnings ***(from the income statement above)*** 40,500

Total Shareholders’ Equity 71,100

Total Liabilities and Shareholders’ Equity $96,800

Req. 2

Moncton Clay Corporation should have no problem paying its liabilities since it has more total assets than total liabilities. In fact, it has over three times as many total assets as liabilities ($96,800/$25,700 = 3.77 times). This means that Moncton Clay Corporation could pay its liabilities more than three times over if all assets on hand at January 31, 2014, were converted to cash. Of course, not all assets will be converted into cash right away. Even so, looking only at the amount of cash at the end of January, we see that Moncton Clay has enough cash to cover all its liabilities. This is a very strong financial position.

**E1-10**

Req. 1

Average monthly revenue, $216,000 12 = $18,000

Req. 2

Average monthly salaries and wages expense, $33,000 12 = $2,750

Req. 3

Advertising is an expense because it represents the cost of ads that were run during the period to generate revenue.

Req. 4

The dividends are not reported as an expense because they represent a distribution of prior profits to shareholders. Consequently, they appear only on the statement of retained earnings, not the income statement.

Req. 5

Standing alone, the income statement does not report, or make it possible to determine, the ending cash balance. Some revenues might not have been collected, and some expenses might not have been paid by the end of the year. The amount of cash on December 31, 2014, would be reported on the balance sheet under assets and on the cash flow statement as the final amount shown.

**E1-11**

|  |  |
| --- | --- |
| (O) | 1. Cash paid to suppliers and employees |
| O | 2. Cash received from customers |
| F | 3. Cash received from borrowing long-term debt |
| F | 4. Cash received from issuing shares |
| (I) | 5. Cash paid to purchase equipment |

**E1-12**

|  |  |
| --- | --- |
| (I) | 1. Purchases of equipment |
| O | 2. Cash received from customers |
| F | 3. Cash received from issuing shares |
| (O) | 4. Cash paid to suppliers and employees |
| (F) | 5. Cash paid on notes payable |
| I | 6. Cash received from selling equipment |

**ANSWERS TO COACHED PROBLEMS**

**CP1-1**

Req. 1

NUCLEAR COMPANY

Income Statement

For the Year Ended December 31, 2014

Sales Revenue $ 88,000

Expenses

Operating Expenses 57,200

Other Expenses 8,850

Total Expenses 66,050

Net Income $ 21,950

Req.2

NUCLEAR COMPANY

Statement of Retained Earnings

For the Year Ended December 31, 2014

Retained Earnings, January 1, 2014 $           0

Add: Net Income 21,950

Subtract: Dividends (200)

Retained Earnings, December 31, 2014 $ 21,750

Req. 3

NUCLEAR COMPANY

Balance Sheet

At December 31, 2014

Assets

Cash $  12,000

Accounts Receivable 59,500

Supplies 8,000

Equipment 36,000

Total Assets $115,500

Liabilities

Accounts Payable $ 30,297

Notes Payable 1,470

Total Liabilities    31,767

Shareholders’ Equity

Contributed Capital 61,983

Retained Earnings 21,750

Total Shareholders’ Equity 83,733

Total Liabilities and Shareholders’ Equity $115,500

**CP1-2**

Req. 1

Nuclear Company’s income statement reported net income of $21,950, suggesting that the company was profitable because revenues exceeded expenses.

Req. 2

Nuclear Company’s statement of retained earnings reported a retained earnings balance of $21,750, after dividends of $200 had been subtracted. This suggests the company could have sustained additional dividends of $21,750, if sufficient cash were available to pay them. As it turns out, the company’s balance sheet reports cash of $12,000, suggesting that only $12,000 in additional dividends could be paid (without borrowing additional cash).

Req. 3

Nuclear Company’s balance sheet reports total liabilities of $31,767 and shareholders’ equity of $83,733, indicating that the company is financed mainly by shareholders.

Req. 4

Nuclear Company was founded at the beginning of the year, so it began with no cash. The balance sheet reports a cash balance of $12,000 at the end of the year. The reasons for this increase of $12,000 would be shown in the statement of cash flows.

**CP1-3**

Req. 1

FITNESS AND FUN, INC.

Income Statement

For the Nine Months Ended September 30, 2014

(in thousands)

Gym Revenues $575,667

Expenses

Gym Operating Expenses 350,835

General, Selling and Administrative Expense 83,207

Advertising and Marketing Expense 23,608

Interest and Other Expenses 20,316

Income Tax Expense 38,895

Total Expenses 516,861

Net Income $ 58,806

**CP1-3 (continued)**

Req. 2

FITNESS AND FUN, INC.

Statement of Retained Earnings

For the Nine Months Ended September 30, 2014

(in thousands)

Retained Earnings, January 1, 2014 $199,890

Add: Net Income 58,806

Subtract: Dividends 0

Retained Earnings, September 30, 2014 $258,696

Req. 3

FITNESS AND FUN, INC.

Balance Sheet

At September 30, 2014

(in thousands)

Assets

Cash $  7,119

Accounts Receivable 5,318

Supplies 14,739

Property and Equipment 1,451,641

Other Assets 117,108

Total Assets $1,595,925

Liabilities

Accounts Payable $ 102,665

Accrued Liabilities 119,482

Notes Payable 647,120

Other Liabilities 86,234

Total Liabilities 955,501

Shareholders’ Equity

Contributed Capital 381,728

Retained Earnings 258,696

Total Shareholders’ Equity 640,424

Total Liabilities and Shareholders’ Equity $1,595,925

**CP1-3 (continued)**

Req. 4

FITNESS AND FUN, INC.

Statement of Cash Flows

For the Nine Months Ended September 30, 2014

(in thousands)

Cash Flows from Operating Activities:

Cash received from customers $574,824

Cash paid to suppliers and employees (472,265)

Cash Provided by Operating Activities  102,559

Cash Flows from Investing Activities:

Cash paid to purchase equipment (354,255)

Cash received from sale of long-term assets 161,885

Cash Used in Investing Activities (192,370)

Cash Flows from Financing Activities:

Cash received from issuing common shares 9,061

Repayments of borrowings (13,043)

Cash received from borrowings 95,558

Cash Provided by Financing Activities 91,576

Change in Cash 1,765

Beginning Cash Balance, January 1, 2014 5,354

Ending Cash Balance, September 30, 2014 $ 7,119

**ANSWERS TO GROUP A PROBLEMS**

**PA1-1**

Req. 1

HIGH POWER CORPORATION

Income Statement

For the Year Ended December 31, 2014

Sales Revenue $91,000

Expenses

Operating Expenses 58,700

Other Expenses 8,850

Total Expenses 67,550

Net Income $23,450

Req.2

HIGH POWER CORPORATION

Statement of Retained Earnings

For the Year Ended December 31, 2014

Retained Earnings, January 1, 2014 $ 0

Add: Net Income 23,450

Subtract: Dividends (1,950)

Retained Earnings, December 31, 2014 $ 21,500

Req. 3

HIGH POWER CORPORATION

Balance Sheet

At December 31, 2014

Assets

Cash $  13,300

Accounts Receivable 9,550

Supplies 5,000

Equipment 86,000

Total Assets $113,850

Liabilities

Accounts Payable $ 32,087

Notes Payable 1,160

Total Liabilities 33,247

Shareholders’ Equity

Contributed Capital 59,103

Retained Earnings 21,500

Total Shareholders’ Equity 80,603

Total Liabilities and Shareholders’ Equity $113,850

**PA1-2**

Req. 1

High Power Corporation’s income statement reported net income of $23,450, suggesting that the company was profitable because revenues exceeded expenses.

Req. 2

High Power Corporation’s statement of retained earnings reported a retained earnings balance of $21,500, after dividends of $1,950 had been subtracted. This suggests the company could have sustained additional dividends of $21,500, if sufficient cash were available to pay them. As it turns out, the company’s balance sheet reports cash of $13,300, suggesting that only $13,300 in additional dividends could be paid (without borrowing additional cash).

Req. 3

High Power Corporation’s balance sheet reports total liabilities of $33,247 and shareholders’ equity of $80,603, indicating that the company is financed mainly by shareholders.

Req. 4

High Power Corporation was founded at the beginning of the year, so it began with no cash. The balance sheet reports a cash balance of $13,300 at the end of the year. The reasons for this increase of $13,300 would be shown in the statement of cash flows.

**PA1-3**

Req. 1

COLLEGE PARK VETERINARY CLINIC

Income Statement

For the Year Ended June 30, 2014

Sales Revenue $250,000

Expenses

Operating Expenses 185,700

General, Selling and Administrative Expenses 53,400

Advertising and Marketing Expenses 27,800

Interest Expense 5,000

Total Expenses 271,900

Net Loss ($21,900)

**PA1-3 (continued)**

Req.2

COLLEGE PARK VETERINARY CLINIC

Statement of Retained Earnings

For the Year Ended June 30, 2014

Retained Earnings, July 1, 2013 $ 50,000

Add: Net Loss (21,900)

Subtract: Dividends (27,500)

Retained Earnings, June 30, 2014 $ 600

Req. 3

COLLEGE PARK VETERINARY CLINIC

Balance Sheet

At June 30, 2014

Assets

Cash $   5,000

Accounts Receivable 125,600

Supplies 25,000

Property and Equipment 242,500

Other Assets 13,500

Total Assets $411,600

Liabilities

Accounts Payable $ 87,000

Notes Payable 150,000

Other Liabilities 37,000

Total Liabilities 274,000

Shareholders’ Equity

Contributed Capital 137,000

Retained Earnings 600

Total Shareholders’ Equity 137,600

Total Liabilities and Shareholder’s Equity $411,600

**PA1-4**

Req. 1

College Park Veterinary Clinic’s income statement reported net loss of $21,900, suggesting that the company was not profitable because expenses exceeded revenues.

Req. 2

College Park Veterinary Clinic’s statement of retained earnings reported a retained earnings balance of $600, after dividends of $27,500 had been subtracted. This suggests the company could have sustained additional dividends of $600, if sufficient cash were available to pay them. As it turns out, the company’s balance sheet reports cash of $5,000, suggesting that additional dividends could be paid (without borrowing additional cash).

Req. 3

College Park Veterinary Clinic’s balance sheet reports total liabilities of $274,000 and shareholders’ equity of $137,600, indicating that the company is financed mainly by debt/creditors.

Req. 4

It is not possible to determine the amount of cash increase or decrease that would be shown in the statement of cash flows from the information presented. To determine this change, we would either require the opening cash balance at July 1, 2014, or would require the necessary information to calculate the cash from or cash used in the operating, investing and financing activities for the current year. None of this information is available in the information currently provided.

**PA1-5**

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| OSI RESTAURANT PARTNERS, INC. | | | |
| Income Statement | | | |
| For the Year Ended December 31, 2014 | | | |
| (in millions) | | | |
|  |  |  | |
| Revenues: | | |  |
| Restaurant Sales Revenue | | | $ 3,920 |
| Other Revenues |  | | 21 |
| Total Revenues |  | | 3,941 |
| Expenses: |  | |  |
| Food and Supplies Expenses |  | | 1,415 |
| Utilities and Other Expenses | | | 1,104 |
| Wages Expense |  | | 1,087 |
| General, Selling and Administrative Expenses | | | 235 |
| Total Expenses |  | | 3,841 |
| Net Income |  | | $ 100 |

**PA1-5 (continued)**

Req. 2

|  |  |  |
| --- | --- | --- |
| OSI RESTAURANT PARTNERS, INC. | | |
| Statement of Retained Earnings | | |
| For the Year Ended December 31, 2014 | | |
| (in millions) | | |
|  |  |  |
| Retained Earnings, January 1, 2014 | | $1,074 |
| Add: Net Income | | 100 |
| Less: Dividends | | (39) |
| Retained Earnings, December 31, 2014 | | $ 1,135 |

Req. 3

|  |  |  |  |
| --- | --- | --- | --- |
| OSI RESTAURANT PARTNERS, INC. | | | |
| Balance Sheet | | | |
| At December 31, 2014 | | | |
| (in millions) | | | |
|  |  |  |  |
| Assets | |  |  |
|  | Cash |  | $ 94 |
|  | Food and Supply Inventories |  | 87 |
|  | Property, Fixtures, and Equipment | | 1,549 |
|  | Other Assets |  | 529 |
| Total Assets | |  | $ 2,259 |
|  |  |  |  |
| Liabilities and Owners’ Equity | |  |  |
| Liabilities | |  |  |
|  | Accounts Payable |  | $ 166 |
|  | Notes Payable |  | 235 |
|  | Wages and Taxes Payable | | 120 |
|  | Other Liabilities |  | 517 |
|  | Total Liabilities |  | 1,038 |
| Shareholders’ Equity | |  |  |
| Contributed Capital | |  | 86 |
|  | Retained Earnings |  | 1,135 |
|  | Total Shareholders’ Equity |  | 1,221 |
| Total Liabilities and Shareholders’ Equity | | | $ 2,259 |

**PA1-5 (continued)**

Req. 4

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| OSI RESTAURANT PARTNERS, INC. | | | | | |
| Statement of Cash Flows | | | | | |
| For the Year Ended December 31, 2014 | | | | | |
| (in millions) | | | | | |
|  |  |  | |  | |
| Cash Flows from Operating Activities | | | | |  |
|  | Cash received from customers | | | | $ 2,946 |
|  | Cash paid to suppliers and employees | | | | (2,578) |
|  | Cash Provided by Operating Activities | | | | 368 |
|  | | | | |  |
| Cash Flows from Investing Activities | | | | |  |
|  | Cash paid to purchase equipment | | | | (384) |
|  | Cash received from sale of fixtures and equipment | | | | 32 |
|  | Other cash outflows used for investing activities | | | | (2) |
|  | Cash Used in Investing Activities | | | | (354) |
|  | | | | |  |
| Cash Flows from Financing Activities | | | | |  |
|  | Cash received from bank borrowings | | | | 375 |
|  | Common shares issued to owners | | | | 16 |
|  | Repayments of bank borrowings | | | | (294) |
|  | Dividends paid in cash |  | | | (39) |
|  | Other cash outflows used for financing activities | | | | (62) |
|  | Cash Used in Financing Activities | | | | (4) |
|  |  | |  | |  |
| Change in Cash | | |  | | 10 |
| Cash at January 1, 2014 | | | | | 84 |
| Cash at December 31, 2014 | | | | | $ 94 |

**ANSWERS TO GROUP B PROBLEMS**

**PB1-1**

Req. 1

AEROSPACE EXPLORATIONS

Income Statement

For the Year Ended December 31, 2014

Sales Revenue $ 94,000

Expenses

Operating Expenses 60,000

Other Expenses 8,850

Total Expenses 68,850

Net Income $ 25,150

Req. 2

AEROSPACE EXPLORATIONS

Statement of Retained Earnings

For the Year Ended December 31, 2014

Retained Earnings, January 1, 2014 $ 0

Add: Net Income 25,150

Subtract: Dividends (1,100)

Retained Earnings, December 31, 2014 $ 24,050

Req. 3

AEROSPACE EXPLORATIONS

Balance Sheet

At December 31, 2014

Assets

Cash $ 13,900

Accounts Receivable 9,500

Supplies 9,000

Equipment 86,000

Total Assets $118,400

Liabilities

Accounts Payable $ 30,277

Notes Payable 1,220

Total Liabilities 31,497

Shareholders’ Equity

Contributed Capital 62,853

Retained Earnings 24,050

Total Shareholders’ Equity 86,903

Total Liabilities and Shareholders’ Equity $118,400

**PB1-2**

Req. 1

Aerospace Corporation’s income statement reported net income of $25,150, suggesting that the company was profitable because revenues exceeded expenses.

Req. 2

Aerospace Corporation’s statement of retained earnings reported a retained earnings balance of $24,050, after dividends of $1,100 had been subtracted. This suggests the company could have sustained additional dividends of $24,050, if sufficient cash were available to pay them. As it turns out, the company’s balance sheet reports cash of $13,900, suggesting that only $13,900 in additional dividends could be paid (without borrowing additional cash).

Req. 3

Aerospace Corporation’s balance sheet reports total liabilities of $31,497 and shareholders’ equity of $86,903, indicating that the company is financed mainly by shareholders.

Req. 4

Aerospace Corporation was founded at the beginning of the year, so it began with no cash. The balance sheet reports a cash balance of $13,900 at the end of the year. The reasons for this increase of $13,900 would be shown in the statement of cash flows.

**PB1-3**

Req. 1

ROCK POINT ADVENTURES INC.

Income Statement

For the Year Ended June 30, 2014

Revenue

Sales Revenue $ 143,098

Rental Revenue 34,986

Concessions Revenue 25,873

Total Revenue 203,957

Expenses

Operating Expenses 74,390

Rent Expense 25,198

Concessions Expense 21,985

Other Expenses 4,278

Total Expenses 125,851

Net Income $  78,106

**PB1-3 (continued)**

Req. 2

ROCK POINT ADVENTURES INC.

Statement of Retained Earnings

For the Year Ended June 30, 2014

Retained Earnings, July 1, 2013 $ 53,456

Add: Net Income 78,106

Subtract: Dividends (50,000)

Retained Earnings, June 30, 2014 $ 81,562

Req. 3

ROCK POINT ADVENTURES INC.

Balance Sheet

At June 30, 2014

Assets

Accounts Receivable $ 124,579

Supplies 14,356

Property and Equipment 136,897

Other Assets 3,857

Total Assets $279,689

Liabilities

Bank Overdraft $ 2,058

Accounts Payable 58,973

Notes Payable 74,985

Other Liabilities 3,765

Total Liabilities 139,781

Shareholders’ Equity

Contributed Capital 58,346

Retained Earnings 81,562

Total Shareholders’ Equity 139,908

Total Liabilities and Shareholders’ Equity $279,689

**PB1-4**

Req. 1

Rock Point Adventures Inc.’s income statement reported net income of $78,106, suggesting that the company was profitable because revenues exceeded expenses.

Req. 2

Rock Point Adventures Inc.’s statement of retained earnings reported a retained earnings balance of $81,562, after dividends of $50,000 had been subtracted. This suggests the company could have sustained additional dividends of $81,562, if sufficient cash were available to pay them. As it turns out, the company’s balance sheet reports bank overdraft of $2,058, suggesting that no additional dividends could be paid (without borrowing additional cash).

Req. 3

Rock Point Adventures Inc.’s balance sheet reports total liabilities of $139,781 and shareholders’ equity of $139,908, indicating that the company is financed equally by shareholders and debt/creditors.

Req. 4

It is not possible to determine the amount of cash increase or decrease that would be shown in the statement of cash flows from the information presented. To determine this change, we would either require the opening cash balance at July 1, 2013, or would require the necessary information to calculate the cash from or cash used in the operating, investing and financing activities for the current year. None of this information is available in the information currently provided.

**PB1-5**

Req. 1

|  |  |  |
| --- | --- | --- |
| THE CHEESECAKE FACTORY | | |
| Income Statement | | |
| For the Year Ended January 2, 2014 | | |
| (in thousands) | | |
|  |  |  |
| Revenues: | |  |
| Restaurant Sales Revenue | | $1,315,325 |
| Other Revenues |  | 8,171 |
| Total Revenues |  | 1,323,496 |
| Expenses: |  |  |
| Wages Expenses |  | 420,957 |
| Utilities and Other Expenses | | 414,978 |
| Food and Supplies Expense | | 333,528 |
| Selling and Administrative Expenses | | 72,751 |
| Total Expenses |  | 1,242,214 |
| Net Income |  | $ 81,282 |

Req. 2

|  |  |  |
| --- | --- | --- |
| THE CHEESECAKE FACTORY | | |
| Statement of Retained Earnings | | |
| For the Year Ended January 2, 2014 | | |
| (in thousands) | | |
|  |  |  |
| Retained Earnings, Beginning | | $ 440,510 |
| Add: Net Income | | 81,282 |
| Less: Dividends | | (49,994)) |
| Retained Earnings, Ending | | $ 471,798 |

**PB1-5 (continued)**

Req. 3

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| THE CHEESECAKE FACTORY | | | | |
| Balance Sheet | | | | |
| At January 2, 2014 | | | | |
| (in thousands) | | | | |
|  |  |  |  | |
| Assets: | |  |  | |
|  | Cash |  | | $ 44,790 |
|  | Accounts Receivable | | | 11,639 |
|  | Food and Supply Inventories |  | | 20,775 |
|  | Prepaid Rent | | | 43,870 |
|  | Property and Equipment | | | 732,204 |
|  | Other Assets |  | | 186,453 |
| Total Assets | |  | | $1,039,731 |
|  |  |  | |  |
| Liabilities and Shareholders’ Equity: | |  | |  |
| Liabilities: | |  | |  |
|  | Accounts Payable |  | | $ 45,570 |
|  | Notes Payable |  | | 39,381 |
|  | Wages Payable | | | 117,226 |
|  | Other Liabilities |  | | 126,012 |
|  | Total Liabilities |  | | 328,189 |
| Shareholders’ Equity: | |  | |  |
|  | Contributed Capital |  | | 239,744 |
|  | Retained Earnings |  | | 471,798 |
|  | Total Shareholders’ Equity |  | | 711,542 |
| Total Liabilities and Shareholders’ Equity | | | | $1,039,731 |

**PB1-5 (continued)**

Req. 4

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| THE CHEESECAKE FACTORY | | | | |
| Statement of Cash Flows | | | | |
| For the Year Ended January 2, 2014 | | | | |
| (in thousands) | | | | |
|  |  |  |  | |
| Cash Flows from Operating Activities | | |  | |
|  | Cash received from customers | | $ 1,276,008 | |
|  | Cash paid to suppliers and employees | | (1,123,353) | |
|  | Cash Provided by Operating Activities | | 152,655 | |
|  | | |  | |
| Cash Flows from Investing Activities | | |  | |
|  | Cash paid to purchase equipment | | (243,211) | |
|  | Cash received from sale of long-term assets | | | 115,975 |
|  | Cash Used in Investing Activities | | (127,236) | |
|  | | |  | |
| Cash Flows from Financing Activities | | |  | |
|  | Additional investments by shareholders | | 33,555 | |
|  | Cash received from borrowings | | 175,000 | |
|  | Repayments of borrowings |  | (170,242) | |
|  | Dividends paid to shareholders |  | (49,994) | |
|  | Cash Used in Financing Activities | | (11,681) | |
|  |  |  |  | |
| Change in Cash | |  | 13,738 | |
| Cash at January 3, 2013 | | | 31,052 | |
| Cash at January 2, 2014 | | | $ 44,790 | |

**ANSWERS TO SKILLS DEVELOPMENT CASES**

**S1-1**

Req. 1

Rona’s income statement shows a net loss of $153,014 (thousand), which is labeled net (loss) income. Note that the amounts on the financial statements are rounded to the nearest thousand, so this is actually $153,014,000.

Req. 2

The income statement shows that the amount of sales was $4,192,192 (thousand) for the year ended December 29, 2013.

Req. 3

The Statement of Financial Position shows that inventory costing $738,752 (thousand) was on hand at December 29, 2013.

Req. 4

The balance sheet and statement of cash flows show Cash totaling $8,245 (thousand) at December 29, 2013.

Req. 5

Because Rona’s shares are traded on the Toronto Stock Exchange, Rona Inc. must be a public company.

**S1-2**

Req. 1

The Home Depot’s net earnings for the year ended February 2, 2014 was $5,385 (million). Note that the amounts on these financial statements are rounded to the nearest million, so this is actually $5,385,000,000. This is much higher than the net loss of $153,014, (thousand) earned by Rona Inc. for the year ended December 29, 2013.

Req. 2

The Home Depot’s reported sales revenue of $78,812 (million) for the year ended February 2, 2014. This is again higher than the $4,192,192 (thousand) reported by Rona for the year ended December 29, 2013.

Req. 3

The Home Depot’s inventory (merchandise inventories) as of February 2, 2014 was $11,057 (million). This is higher than the $738,752 (thousand) reported by Rona Inc. as of December 29, 2013.

Req. 4

The Home Depot’s Cash (and Cash Equivalents) on February 2, 2014 was $1,929 (million). This is again higher than the $8,245 (thousand) reported by Rona Inc. at December 29, 2013.

Req. 5

Like Rona Inc., The Home Depot is a public company. Its shares trades on the New York Stock Exchange under the symbol HD.

Req. 6

Two measures of financial success are the company’s Net Income and Sales Revenues. As noted for requirements 1 and 2, Home Depot reported much greater amounts for both of these measures, suggesting that the company was more successful during the 2013 fiscal year. It is important to note, though, that Home Depot is a much bigger company than Rona, with more locations, more inventory (see requirement 3), and more total assets. Given these differences, it is reasonable to expect that Home Depot would produce more sales and net income than Rona. Rona had a net loss in 2013 unlike the prior year in 2012. To truly determine whether Home Depot is run more successfully than Rona, a complete analysis is required. Such an analysis would take into account size differences between the two companies. (You’ll learn about this kind of analysis in later chapters).

**S1-3**

The solutions to this case will depend on the company and/or accounting period selected for analysis.

**S1-4**

Req. 1

The accounting concept that the Rigas family is accused of violating is the separate entity assumption.

Req. 2

Based on the limited information available, it is difficult to categorize particular dealings as appropriate or inappropriate. Dealings would clearly be inappropriate if they involved Adelphia paying for items for the owners’ personal use or to unfairly transfer some of the resources of Adelphia (and its shareholders) to the Rigas family. However, we cannot determine the propriety of the payments from the limited information available.

Req. 3

Shareholders should take at least two actions to ensure this kind of behavior does not occur or does not occur without their knowledge. First, shareholders should ensure that the managers of the business are accountable for their actions. The most common way of doing this is to appoint a board of directors who are independent of top management. These directors should review and challenge the actions taken by management and require that the financial statements disclose significant transactions with related parties. Second, shareholders should read the financial statements, including any notes describing related party transactions. Any questionable dealings should be raised with top management at the company’s annual meeting. If shareholders don’t receive satisfactory answers to their concerns, they should sell their investment in the company’s shares.

Req. 4

Other parties that might be harmed by the actions committed by the Rigas family are creditors (such as suppliers and banks), the company’s auditors, governmental agencies (such as the IRS and SEC), and the public at large.

**S1-5**

Req. 1

You should take the position that an *independent* annual audit of the financial statements is an absolute must. This is the best way to ensure that the financial statements are complete, are free from bias, and conform with GAAP. You should be prepared to reject the partner’s uncle as the auditor because there is no evidence about his competence as an accountant or auditor. Also, he does not appear independent because he is related to the partner who prepares the financial statements, resulting in a potential conflict of interest.

Req. 2

You should strongly recommend the selection of an independent CPA in public practice because the financial statements should be audited by a competent and independent professional who must follow prescribed accounting and auditing standards on a strictly independent basis. An audit by an uncle would not meet these requirements.

**S1-6**

Req. 1

A balance sheet lists items owned (assets) and owed (liabilities) at a particular point in time, producing a “net worth” that represents the excess of assets over liabilities. Two balance sheets are presented below, one based on historical costs (similar to GAAP) and one based on market values (similar to a personal financial planning approach). Notes for these balance sheets also are presented, along with a conclusion about which individual is better off.

Based on historical cost:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Ashley** | | | |  | **Jason** | |
| Assets | | |  |  | Assets |  |
| Cash | | $ 1,000 | |  | Cash | $ 6,000 |
| Vintage Car | | 800 | |  | PlayStation Console | 350 |
| Total Assets | | 1,800 | |  | Total Assets | 6,350 |
|  | |  | |  |  |  |
| Liabilities | |  | |  | Liabilities |  |
| Car Loan | | 250 | |  | Tuition Payable | 800 |
| Total Liabilities | | 250 | |  | Student Loan | 4,800 |
|  | |  | |  | Total Liabilities | 5,600 |
|  | |  | |  |  |  |
| Net Worth | | $ 1,550 | |  | Net Worth | $ 750 |
|  |  | | |  |  |  |

**S1-6 (continued):**

Req. 1 (continued)

Based on market value:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Ashley** | | | |  | **Jason** | |
| Assets | | |  |  | Assets |  |
| Cash | $ 1,000 | | |  | Cash | $ 6,000 |
| Vintage Car | 1,400 | | |  | PlayStation Console | 280 |
| Total Assets | 2,400 | | |  | Total Assets | 6,280 |
|  |  | | |  |  |  |
| Liabilities |  | | |  | Liabilities |  |
| Car Loan | 250 | | |  | Tuition Payable | 800 |
| Total Liabilities | 250 | | |  | Student Loan | 4,800 |
|  |  | | |  | Total Liabilities | 5,600 |
|  |  | | |  |  |  |
| Net Worth | $ 2,150 | | |  | Net Worth | $ 680 |
|  | |  | |  |  |  |

The notes are an important part of these balance sheets.

Notes:

1. The goal in preparing these balance sheets is to estimate each individual’s net worth, represented as the excess of assets over liabilities.
2. Use of historical cost is consistent with generally accepted accounting principles. Note that these asset values have not been adjusted for “value” consumed through use, which is not consistent with generally accepted accounting principles. The market value balance sheets are based on the estimated current values of assets, some of which are greater and others less than their cost.
3. Some potential assets (e.g., Porsche) are not recorded because their likelihood of occurrence is not certain.

Req. 2

Based on the calculations of net worth and underlying assumptions indicated above, Ashley is “better off” because her net worth ($1,550 or $2,150) is greater than Jason’s ($750 or $680). As a creditor, it would be better to lend money to Ashley because she has a greater net worth and earnings potential seeing she has a job. Note that choosing between historical cost and market values inevitably requires trading off the reliability of accounting information (cost is not as subjective as market) and the potential relevance of that information (market values may be more relevant when determining an individual’s net worth).

**S1-6 (continued):**

Req. 3

An income statement lists the amounts earned (revenues) and costs incurred (expenses) during a particular period of time, producing “net income” that represents the excess of revenues over expenses. An income statement is presented below for both Ashley and Jason. Notes for these income statements are presented below, along with a conclusion about which individual is more successful.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Ashley** | |  | **Jason** | |
| Revenue |  |  | Revenue |  |
| Part Time Job (for October) | $ 1,500 |  | Lottery Ticket Winnings | $ 1,950 |
| Expenses |  |  | Expenses |  |
| Rent Expense (for October) | 470 |  | Rent Expense (for Oct) | 800 |
| Living Expenses (for October) | 950 |  | Living Expenses (for Oct) | 950 |
| Total Expenses | 1, 420 |  | Total Expenses | 1,750 |
| Net Income | $ 80 |  | Net Income | $ 200 |

Notes:

1. Jason’s lottery ticket winnings are not likely to recur in the future.
2. Income taxes are not reported (although they may apply to Ashley but not Jason as lottery winnings are not taxed in Canada).

Req.4

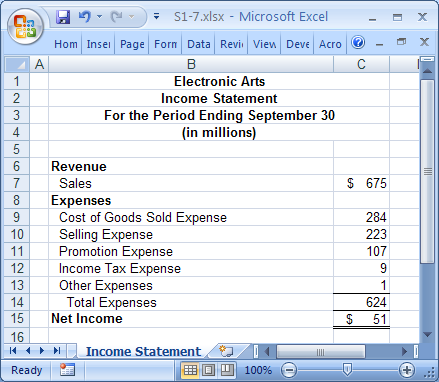
Conclusion:

Based on the net income numbers alone, Jason was more successful in the current period. However, his revenues are likely to be non-recurring, whereas Ashley’s appear more stable and likely to recur in the future. For this reason, one might conclude that Ashley actually was more successful, but that the current period’s net income does not yet reflect this greater success. As a long-term creditor, it would be better to lend money to Ashley as she has a more stable source of income to meet future expenses. Notice that you should not reach a conclusion based only on the numbers.

**S1-7**



**S1-7 (continued)**



**ANSWERS TO CONTINUING CASE**

**CC1-1**

Req. 1

|  |  |  |
| --- | --- | --- |
| NICOLE’S GETAWAY SPA  Income Statement (forecasted)  For the Year Ended December 31, 2014 | | |
| Sales Revenue |  | $ 40,000 |
| Expenses:  Wages Expense  Supplies Expense  Selling and Administrative Expenses  Income Tax Expense |  | 24,000  7,000  5,000  1,600 |
| Total Expenses |  | 37,600 |
| Net Income |  | $ 2,400 |

**CC1-1 (continued)**

Req. 2

|  |  |  |
| --- | --- | --- |
| NICOLE’S GETAWAY SPA  Statement of Retained Earnings (forecasted)  For the Year Ended December 31, 2014 | | |
| Retained Earnings, January 1, 2014 |  | $         0 |
| Add: Net Income  Subtract: Dividends |  | 2,400  (2,000) |
| Retained Earnings, December 31, 2014 |  | $   400 |

Req. 3

|  |  |  |  |
| --- | --- | --- | --- |
| NICOLE’S GETAWAY SPA  Balance Sheet (forecasted)  At December 31, 2014 | | | |
| Assets:  Cash  Accounts Receivable  Property, Plant and Equipment  Total Assets |  | | $ 2,150  1,780  70,000  $ 73,930 |
| Liabilities:  Accounts Payable  Notes Payable  Total Liabilities |  | | $ 4,660  38,870  43,530  30,000  400  30,400 |
| Shareholders’ Equity:  Contributed Capital  Retained Earnings  Total Shareholders’ Equity | |  |
| Total Liabilities and Shareholders’ Equity | |  | $ 73,930 |

Req. 4

As of December 31, 2014, more financing is expected to come from creditors ($43,530) than from shareholders ($30,400).