**ANSWERS TO QUESTIONS - CHAPTER 2**

**1. Accrual accounting attempts to record the effects of accounting events in the period when such events occur, regardless of when cash is received or paid. The goal is to match expenses with the revenues that they produce.**

**2. Recognition is the act of recording an event in the financial statements. When accruals are used, events are recognized before the associated cash is paid or collected.**

**3. If cash is collected in advance for services, the revenue is recognized when the services are rendered.**

**4. The issue of common stock, which is capital acquired from owners, increases business assets (usually cash) and equity (common stock).**

**5. The recognition of revenue on account increases the corresponding revenue account on the income statement, but does not affect the statement of cash flows. The cash flow statement is affected when the account is collected.**

**6. Revenue is recognized under accrual accounting when a revenue-producing event occurs, i.e., when the revenue is *earned*, even if no cash is collected at the time of the transaction.**

**7. The recognition of expenses affects the accounting equation by either decreasing assets or increasing liabilities (payables) and by decreasing stockholders’ equity (retained earnings).**

**8. A claims exchange transaction is one where the claims of creditors (liabilities) increase and the claims of stockholders (retained earnings) decrease, or vice versa. The total amount of claims is unchanged.**

**9. Expenses are recognized under accrual accounting at the time the expense is incurred or resources are consumed, regardless of when cash payment is made.**

**10. Net cash flows from operations on the cash flow statement may be different from net income because of the application of accrual accounting. Revenues and expenses reported on the income statement may be recognized before or after the actual collection or payment of cash that is reported on the cash flow statement.**

**11. Net income increases stockholders' claims on business assets by increasing retained earnings.**

**12. An expense is a decrease in assets or an increase in liabilities that occurs in the process of generating revenue.**

**13. The purpose of the statement of changes in stockholders’ equity is to display the effects of business operations and stock issued to owners and dividends paid to stockholders. It identifies the ways that an entity's equity increased and decreased as a result of its operations and transactions with its stockholders.**

**14. The purpose of the balance sheet is to provide information about an entity's assets, liabilities, and stockholders’ equity and their relationships to each other at a particular point in time. It provides a list of the economic resources that the enterprise has available for its operating activities and the claims to those resources.**

**15. The balance sheet is dated as of a specific date because it shows information about an entity's assets, liabilities, and stockholders’ equity as of that date, not measured over a time period. The statement of changes in stockholders’ equity, the income statement, and the statement of cash flows reflect transactions that occur over a period of time.**

**16. The statement of cash flows explains the change in cash from one accounting period to the next. It is prepared by analyzing the cash account and summarizing where cash came from and how it was used.**

**17. Period costs are costs that are recognized in an accounting period. Examples of period costs include rent expense, utilities expense, and salaries expense.**

**18. Salary of the tax return preparer could be directly matched with the revenue that it produces.**

SOLUTIONS TO EXERCISES – SERIES A – CHAPTER 2

EXERCISE 2-1A

a.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **The Ramires, Incorporated**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **56,000** | **+** | **NA** | **=** | **NA** | | **+** | **56,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **56,000 FA** |
| **2** |  | **52,000** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **52,000** |  | **52,000** | **−** | **NA** | **=** | **52,000** |  | **52,000 OA** |
| **3** |  | **(27,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(27,000)** |  | **NA** | **−** | **27,000** | **=** | **(27,000)** |  | **(27,000) OA** |
| **4** |  | **15,000** | **+** | **NA** | **=** | **15,000** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **15,000 FA** |
| **5** |  | **(40,000)** | **+** | **40,000** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(40,000) IA** |
| **6** |  | **(1,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(1,000)** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(1,000) FA** |
|  |  | **55,000** | **+** | **40,000** | **=** | **15,000** | | **+** | **56,000** | **+** | **24,000** |  | **52,000** | **−** | **27,000** | **=** | **25,000** |  | **55,000 NC** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

EXERCISE 2-1A (cont.)

b.

|  |  |  |  |
| --- | --- | --- | --- |
| **The Ramires, Incorporated**  **Income Statement**  **For the Period Ended December 31, Year 1** | | | |
|  |  |  |  |
|  | **Revenue** | **$52,000** |  |
|  | **Expenses** | **(27,000)** |  |
|  | **Net Income** | **$25,000** |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **The Ramires, Incorporated**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** |  |  |
|  | **Plus: Common Stock Issued** | **56,000** |  |  |
|  | **Ending Common Stock** |  | **$56,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$-0-** |  |  |
|  | **Plus: Net Income** | **25,000** |  |  |
|  | **Less: Dividends** | **(1,000)** |  |  |
|  | **Ending Retained Earnings** |  | **24,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$80,000** |  |
|  |  |  |  |  |

EXERCISE 2-1A b. (cont.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **The Ramires, Incorporated**  **Balance Sheet**  **As of December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$55,000** |  |  |
|  | **Land** | **40,000** |  |  |
|  | **Total Assets** |  | **$95,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** |  | **$15,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$56,000** |  |  |
|  | **Retained Earnings** | **24,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **$80,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$95,000** |  |
|  |  |  |  |  |

EXERCISE 2-1A b. (cont.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **The Ramires, Incorporated**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$52,000** |  |  |
|  | **Cash Payments for Expenses** | **(27,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$25,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Payment for Land** | **$(40,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **$(40,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$56,000** |  |  |
|  | **Cash Receipts from Borrowed Funds** | **15,000** |  |  |
|  | **Cash Dividends** | **(1,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **$70,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **55,000** |  |
|  | **Plus: Beginning Cash Balance** |  | **-0-** |  |
|  | **Ending Cash Balance** |  | **$55,000** |  |
|  |  |  |  |  |

EXERCISE 2-2A

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **The Candle Shop**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **I** | **+** | **NA** | **=** | **NA** | | **+** | **I** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **I FA** |
| **2** |  | **D** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **D** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **D FA** |
| **3** |  | **D** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **D** |  | **NA** | **−** | **I** | **=** | **D** |  | **D OA** |
| **4** |  | **I** | **+** | **NA** | **=** | **I** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **I FA** |
| **5** |  | **I** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **I** |  | **I** | **−** | **NA** | **=** | **I** |  | **I OA** |
| **6** |  | **D** | **+** | **I** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **D IA** |
| **7** |  | **NA** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **NA** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

EXERICSE 2-3A

**a. Missing items are determined as follow:**

**(a) $200,000; Since the cash flow column shows that this event was financing activity, we can infer that the company either borrowed money or issued stock. Since the model shows that liabilities were not affected, we conclude that the common stock account increased by $200,000.**

**(b) NA; Since issuing common stock (see answer to (a) above), does not affect the revenue account, the answer is not affected (NA).**

**(c) NA; Since issuing common stock (see answer to (a) above), does not affect net income, the answer is not affected (NA).**

**(d) NA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money does not affect net income.**

**(e) FA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money is a financing activity (FA).**

**(f) 500,000; Since cash decreased and no other balance sheet account other than the land account was affected, the company must have purchased land which would cause the land account to increase by 500,000.**

**(g) IA; Purchasing land (see answer to (f) above) is an investing activity (IA).**

**(h) 95,000; The income statement shows $95,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.**

**(i) 95,000; The income statement shows $95,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.**

**EXERCISE 2-3A a. (cont).**

**(j) (65,000); The statement of cash flows shows that the $65,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to reduce the amount of retained earnings shown in the balance sheet.**

**(k) 65,000; The statement of cash flows shows that the $65,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to increase the amount of expenses shown in the income statement.**

**(l) FA; Since the event decreases cash and retained earnings on the balance sheet; and does not affect the income statement, we conclude that this was a dividend payment which is a financing activity (FA)**

**(m) 68,000; This amount is determined by totaling the vertical column.**

**(n) 95,000; This amount is determined by totaling the vertical column.**

**EXERCISE 2-3A a. (cont.)**

**Completed Horizontal Financial Statements Model**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **The Frame Shop (TFS)**  **Horizontal Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
|  |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **Beg.** |  | **0** | **+** | **0** | **=** | **0** | | **+** | **0** | **+** | **0** |  | **0** | **−** | **0** | **=** | **0** |  | **NA** |
| **1** |  | **200,000** | **+** | **NA** | **=** | **NA** | | **+** | **200,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **200,000 FA** |
| **2** |  | **350,000** | **+** | **NA** | **=** | **350,000** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **350,000 FA** |
| **3** |  | **(500,000)** | **+** | **500,000** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(500,000) IA** |
| **4** |  | **95,000** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **95,000** |  | **95,000** | **−** | **NA** | **=** | **95,000** |  | **95,000 OA** |
| **5** |  | **(65,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(65,000)** |  | **NA** | **−** | **65,000** | **=** | **(65,000)** |  | **(65,000) OA** |
| **6** |  | **(12,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(12,000)** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(12,000) FA** |
|  |  | **68,000** | **+** | **500,000** | **=** | **350,000** | | **+** | **200,000** | **+** | **18,000** |  | **95,000** | **−** | **65,000** | **=** | **30,000** |  | **68,000 NC** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

**b. $568,000 Total Assets (Cash $68,000 + Land $500,000)**

**c. $30,000 Net Income (Revenue $95,000 – Expenses $65,000)**

**d. $538,000 Net Cash Flow from Financing Activities ($200,000 + $350,000 - $12,000)**

EXERCISE 2-4A

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Holloway Company**  **Effect of Events on the Year 1 Financial Statements** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  | **Assets** | | | **=** | **Liabilities** | | **+** | | **Stockholders’ Equity** | | |
| **Event** | **Cash** | **+** | **Accounts Rec.** | **=** |  | **+** | | **Common**  **Stock** | | **+** | **Retained**  **Earnings** |
| **Earned Revenue** | **NA** | **+** | **18,000** | **=** | **NA** | **+** | | **NA** | | **+** | **18,000** |
| **Coll. Acct. Rec.** | **14,000** | **+** | **(14,000)** | **=** | **NA** | **+** | | **NA** | | **+** | **NA** |
| **Ending Balance** | **14,000** | **+** | **4,000** | **=** | **-0-** | **+** | | **-0-** | | **+** | **18,000** |
|  |  |  |  |  |  |  | |  | |  |  |

**a. Accounts Receivable: $18,000 – $14,000 = $4,000**

**b. $18,000 Net Income**

**c. $14,000 cash collected from accounts receivable.**

**d. $18,000**

e. $18,000 of revenue was earned but only $14,000 of it was collected.

EXERCISE 2-5A

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **The Containers Inc.**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Accts. Rec** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **42,000** | **+** | **NA** | **=** | **NA** | | **+** | **42,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **42,000 FA** |
| **2** |  | **NA** | **+** | **25,000** | **=** | **NA** | | **+** | **NA** | **+** | **25,000** |  | **25,000** | **−** | **NA** | **=** | **25,000** |  | **NA** |
| **3** |  | **(18,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(18,000)** |  | **NA** | **−** | **18,000** | **=** | **(18,000)** |  | **(18,000) OA** |
| **4** |  | **10,000** | **+** | **NA** | **=** | **10,000** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **10,000 FA** |
| **5** |  | **22,000** | **+** | **(22,000)** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **22,000 OA** |
| **6** |  | **(1,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(1,000)** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(1,000) FA** |
|  |  | **55,000** | **+** | **3,000** | **=** | **10,000** | | **+** | **42,000** | **+** | **6,000** |  | **25,000** | **−** | **18,000** | **=** | **7,000** |  | **55,000 NC** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

a. Accounts receivable will appear as an “asset” on the December 31, Year 1 balance sheet.

b. $3,000. Total from the accounts receivable column in the Horizontal Financial Statements Model.

c. $7,000. Total from the net income column in the Horizontal Financial Statements Model.

d. $4,000. Net cash flow from operating activities ($22,000 - $18,000).

e. Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but will not be reflected on the cash flow statement until the cash is collected.

EXERCISE 2-6A

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Troy Company**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Accts. Rec** | **=** | **Accts.**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **15,000** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **15,000** |  | **15,000** | **−** | **NA** | **=** | **15,000** |  | **15,000 OA** |
| **2** |  | **NA** | **+** | **NA** | **=** | **12,000** | | **+** | **NA** | **+** | **(12,000)** |  | **NA** | **−** | **12,000** | **=** | **(12,000)** |  | **NA** |
| **3** |  | **(8,000)** | **+** | **NA** | **=** | **(8,000)** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(8,000) OA** |
|  |  | **7,000** | **+** | **0** | **=** | **4,000** | | **+** | **0** | **+** | **3,000** |  | **15,000** | **−** | **12,000** | **=** | **3,000** |  | **7,000 NC** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

a. $4,000. Total from the accounts payable column in the Horizontal Financial Statements Model.

b. $12,000. Total from the expenses column in the Horizontal Financial Statements Model.

c. $7,000. Total cash flow from operating activities.

d. $3,000. Total from the retained earnings column in the Horizontal Financial Statements Model.

e. Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. This also occurs when revenue is earned at a different time than cash is collected. When a company incurs an revenue or expense transaction, this amount is reflected in revenues or expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-7A

a.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Chung Corporation Accounting Equation – Year 1 | | | | | | | |
| Event | Assets | = | Liabilities | + | Stockholders’ Equity | | |
|  | Cash | = | Salaries Payable | + | Common Stock | + | Retained Earnings |
| Earned Rev. | 8,000 |  | NA |  | NA |  | 8,000 |
| Accrued Sal. | NA |  | 5,000 |  | NA |  | (5,000) |
| Ending Bal. | 8,000 | = | 5,000 | + | -0- | + | 3,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Chung Corporation  Balance Sheet  As of December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Assets |  |  |  |
|  | Cash | $8,000 |  |  |
|  | Total Assets |  | $8,000 |  |
|  |  |  |  |  |
|  | Liabilities |  |  |  |
|  | Salaries Payable | $5,000 |  |  |
|  | Total Liabilities |  | $5,000 |  |
|  |  |  |  |  |
|  | Stockholders’ Equity |  |  |  |
|  | Retained Earnings | $3,000 |  |  |
|  | Total Stockholders’ Equity |  | 3,000 |  |
|  |  |  |  |  |
|  | Total Liab. and Stockholders’ Equity |  | $8,000 |  |
|  |  |  |  |  |

b.

|  |  |
| --- | --- |
| Computation of Net Income |  |
|  |  |
| Revenue | $8,000 |
| Less: Expenses | (5,000) |
| Net Income | $3,000 |
|  |  |

EXERCISE 2-7A (cont.)

c.

|  |  |
| --- | --- |
| Cash Flow from Operating Activities |  |
|  |  |
| Cash from Revenue | $8,000 |
| Net Cash Flow from Operating Act. | $8,000 |
|  |  |

1. **The salary expense is deducted from revenue in computing net income, but it has not been paid. This creates a difference of $5,000 between net income and cash flow from operating activities. The revenue is the same because it has been earned and collected.**

**EXERCISE 2-8A**

a.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Milea Inc.  Accounting Equation  For the Year Ended December 31, Year 1 | | | | | | | | |
|  | | | | | | | | |
|  | Assets | | = | Liabilities | + | Stockholders’ Equity | |  |
| Event | Cash | Acct.  Rec. | = | Salaries Pay. | + | Common Stock | Retained Earn. | Acct. Title for RE |
| 1. | 20,000 |  | = |  | + | 20,000 |  |  |
| 2. |  | 56,000 | = |  | + |  | 56,000 | Revenue |
| 3. | (2,500) |  | = |  | + |  | (2,500) | Util. Exp. |
| 4. | 48,000 | (48,000) | = |  | + |  |  |  |
| 5. |  |  | = | 10,000 | + |  | (10,000) | Sal. Exp. |
| 6. | (2,000) |  | = |  | + |  | (2,000) | Dividends |
| Totals | 63,500 | 8,000 | = | 10,000 | + | 20,000 | 41,500 |  |
|  |  |  |  |  |  |  |  |  |

b.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Milea Inc.  Income Statement  For the Year Ended December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Revenue |  | $56,000 |  |
|  |  |  |  |  |
|  | Expenses |  |  |  |
|  | Utility Expense | $ 2,500 |  |  |
|  | Salaries Expense | 10,000 |  |  |
|  | Total Expenses |  | (12,500) |  |
|  |  |  |  |  |
|  | Net Income |  | $43,500 |  |
|  |  |  |  |  |

EXERCISE 2-8A b. (cont.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Milea Inc.  Statement of Changes in Stockholders’ Equity  For the Year Ended December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Beginning Common Stock | $ -0- |  |  |
|  | Plus: Common Stock Issued | 20,000 |  |  |
|  | Ending Common Stock |  | $20,000 |  |
|  |  |  |  |  |
|  | Beginning Retained Earnings | -0- |  |  |
|  | Plus: Net Income | $43,500 |  |  |
|  | Less: Dividends | (2,000) |  |  |
|  | Ending Retained Earnings |  | 41,500 |  |
|  |  |  |  |  |
|  | Total Stockholders’ Equity |  | $61,500 |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Milea Inc.  Balance Sheet  As of December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Assets |  |  |  |
|  | Cash | $63,500 |  |  |
|  | Accounts Receivable | 8,000 |  |  |
|  | Total Assets |  | $71,500 |  |
|  |  |  |  |  |
|  | Liabilities |  |  |  |
|  | Salaries Payable | $10,000 |  |  |
|  | Total Liabilities |  | $10,000 |  |
|  |  |  |  |  |
|  | Stockholders’ Equity |  |  |  |
|  | Common Stock | $20,000 |  |  |
|  | Retained Earnings | 41,500 |  |  |
|  | Total Stockholders’ Equity |  | 61,500 |  |
|  |  |  |  |  |
|  | Total Liab. and Stockholders’ Equity |  | $71,500 |  |
|  |  |  |  |  |

EXERCISE 2-8A b. (cont.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Milea Inc.  Statement of Cash Flows  For the Year Ended December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Cash Flow From Operating Activities |  |  |  |
|  | Cash Received from Customers | $48,000 |  |  |
|  | Cash Paid for Expenses | (2,500) |  |  |
|  | Net Cash Flow from Operating Act. |  | $45,500 |  |
|  |  |  |  |  |
|  | Cash Flow From Investing Activities |  | -0- |  |
|  |  |  |  |  |
|  | Cash Flow From Financing Activities |  |  |  |
|  | Issue of Stock | $20,000 |  |  |
|  | Paid Dividends | (2,000) |  |  |
|  | Net Cash Flow from Financing Act. |  | 18,000 |  |
|  |  |  |  |  |
|  | Net Change in Cash |  | 63,500 |  |
|  | Plus: Beginning Cash Balance |  | -0- |  |
|  | Ending Cash Balance |  | $63,500 |  |
|  |  |  |  |  |

1. Net income is the difference between services performed and expenses incurred, regardless of the cash collected or paid. Cash flow from operating activities is the difference between cash collected and paid for operating activities. There was $56,000 of income earned, but only $48,000 collected and $12,500 of expenses incurred, but there was only $2,500 paid.

# EXERCISE 2-9A

a.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Lewis and Harper  Horizontal Statements Model Year 1 | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | |
|  |  | Balance Sheet | | | | | | | | |  | Income Statement | | | | |  | Statement of |
|  |  | Assets | | | = | Liabilities | | | + | S. Equity |  | Rev. | – | Exp. | = | Net Inc. |  | Cash Flows |
| Event |  | Cash | + | Accts.  Rec. | = | Acct.  Payable | + | Sal. Pay. | + | Retained Earn. |  |  |  |  |  |  |  |  |
| 1. |  | NA | + | 70,000 | = | NA | + | NA | + | 70,000 |  | 70,000 | – | NA | = | 70,000 |  | NA |
| 2. |  | 40,000 | + | NA | = | NA | + | NA | + | 40,000 |  | 40,000 | – | NA | = | 40,000 |  | 40,000 OA |
| 3. |  | NA | + | NA | = | 36,000 | + | NA | + | (36,000) |  | NA | – | 36,000 | = | (36,000) |  | NA |
| 4. |  | (10,000) | + | NA | = | NA | + | NA | + | (10,000) |  | NA | – | 10,000 | = | (10,000) |  | (10,000) OA |
| 5. |  | 47,000 | + | (47,000) | = | NA | + | NA | + | NA |  | NA | – | NA | = | NA |  | 47,000 OA |
| 6. |  | (16,000) | + | NA | = | (16,000) | + | NA | + | NA |  | NA | – | NA | = | NA |  | (16,000) OA |
| 7. |  | (8,000) | + | NA | = | NA | + | NA | + | (8,000) |  | NA | – | NA | = | NA |  | (8,000) FA |
| 8. |  | NA | + | NA | = | NA | + | 2,000 | + | (2,000) |  | NA | – | 2,000 | = | (2,000) |  | NA |
| Totals |  | 53,000 | + | 23,000 | = | 20,000 | + | 2,000 | + | 54,000 |  | 110,000 | – | 48,000 | = | 62,000 |  | 53,000 NC |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

b. Total assets: $76,000 ($53,000 + $23,000)

c. $23,000

d. $20,000

e. Accounts Receivable (an asset) is an amount owed to Lewis and Harper: $23,000;

Accounts Payable (a liability) is an amount that Lewis and Harper owe: $20,000

f. $62,000

g. $61,000 ($40,000 – $10,000 + $47,000 – $16,000)

**EXERCISE 2-10A**

**a. & c.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Event** | **Revenue** | **Expense** | **Statement of Cash Flows** |
| **1.** | **NA** | **NA** | **$40,000 FA** |
| **2.** | **$82,000** | **NA** | **NA** |
| **3.** | **NA** | **NA** | **(6,000) FA** |
| **4.** | **NA** | **NA** | **76,000 OA** |
| **5.** | **NA** | **$53,000** | **(53,000) OA** |
| **6.** | **19,000** | **NA** | **19,000 OA** |
| **7.** | **NA** | **3,500** | **NA** |
|  |  |  |  |

b.

|  |  |
| --- | --- |
| Computation of Net Income |  |
|  |  |
| Revenue | $101,000 |
| Less: Expenses | (56,500) |
| Net Income | $44,500 |
|  |  |

d.

|  |  |
| --- | --- |
| Cash Flow from Operating Activities |  |
|  |  |
| Cash from Revenue | $95,000 |
| Cash paid for expenses | (53,000) |
| Net Cash Flow from Operating Act. | $42,000 |
|  |  |

e. The balance of Retained Earnings on the Year 1 Balance Sheet will be the amount of Net Income, $44,500 minus $6,000 of dividends that were paid during the year = $38,500. There was no beginning balance in Retained Earnings.

**EXERCISE 2-11A**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Lee Inc.**  **Effect of Events on the Accounts under Accounting Equation** | | | | | | | | | |
|  | | | | | | | | | |
|  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
| **Event** | **Cash** | **Accounts**  **Receivable** | **Land** | **=** | **Accounts**  **Payable** | **+** | **Com. Stock** | **+** | **Retained**  **Earnings** |
| **1. Sales on Account** |  | **62,000** |  |  |  |  |  |  | **62,000** |
| **2. Coll. Accts. Rec.** | **51,000** | **(51,000)** |  |  |  |  |  |  |  |
| **3. Incurred Expense** |  |  |  |  | **39,000** |  |  |  | **(39,000)** |
| **4. Pd. Acc. Pay.** | **(31,000)** |  |  |  | **(31,000)** |  |  |  |  |
| **5. Issue of Stock** | **40,000** |  |  |  |  |  | **40,000** |  |  |
| **6. Purchase Land** | **(21,000)** |  | **21,000** |  |  |  |  |  |  |
| **Totals** | **39,000** | **11,000** | **21,000** | **=** | **8,000** | **+** | **40,000** | **+** | **23,000** |
|  |  |  |  |  |  |  |  |  |  |

**a. Revenue recognized, $62,000.**

**b. Cash flow from revenue, $51,000.**

**c. Revenue, $62,000, less operating expenses, $39,000 = $23,000 net income.**

**d. Accounts receivable collected, $51,000, less cash paid for expenses, $31,000 = $20,000 cash flow from operating activities.**

**e. Income of $62,000 was earned, but only $51,000 was collected (a difference of $11,000); operating expenses incurred were $39,000 but only $31,000 was paid during the period (a difference of $8,000). Consequently, net income is $3,000 more than cash flow from operating activities.**

**f. $21,000 cash outflow for the purchase of land.**

**g. $40,000 cash inflow from the issue of common stock.**

**h. Total assets = $71,000 ($39,000 + $11,000 + $21,000)**

**Total liabilities = $8,000**

**Total equity = $63,000 ($40,000 + $23,000)EXERCISE 2-12A**

1. Examples of expenses that would be matched directly with revenue:

Sales commissions

Salaries expense

1. An example of a period cost that is difficult to match with revenue:

Advertising expense - A company cannot be certain when dollars spent for advertising will produce benefits.

EXERCISE 2-13A

**a. $8,000 x 6% = $480; $480 x 5/12 = $200**

**b. $-0-, no interest was paid in Year 1; $480 of interest will be paid in Year 2.**

c.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Bradley Company  Statements Model for Year 1 | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | |
|  |  | Balance Sheet | | | | | | | | |  | Income Statement | | | | |  | Statement of  Cash Flows |
| Event |  | Assets | = | Liabilities | | | + | Stockholders’ Equity | | |  | Rev. | - | Exp. | = | Net Inc. |  |  |
| No. |  | Cash | = | Notes  Payable | + | Int.  Payable | + | Common  Stock | + | Ret. Earn. |  |  |  |  |  |  |  |  |
| 1. |  | I | = | NA | + | NA | + | NA | + | I |  | I | - | NA | = | I |  | I OA |
| 2. |  | I | = | I | + | NA | + | NA | + | NA |  | NA | - | NA | = | NA |  | I FA |
| 3. |  | NA | = | NA | + | I | + | NA | + | D |  | NA | - | I | = | D |  | NA |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

EXERCISE 2-14A

a. Interest expense recognized for Year 1: $80,000 x 8% = $6,400;

$6,400 x 7/12 = $3,733 (rounded)

b.



See the adjusting entry in the accounting equation above (liabilities increase, equity decreases).

c. $-0-. All interest will be paid at maturity, June 1, Year 2, for this note payable.

d. $3,733

e. $6,400 ($80,000 x 8%). All interest will be paid when the note payable matures.

f. $2,667 ($80,000 x 8% x 5/12) or ($6,400 − $3,733 = $2,667)

**g. $-0-EXERCISE 2-15A**

**Solve for “X” in the following scenarios:**

**a.**

|  |  |  |  |
| --- | --- | --- | --- |
| **X Co.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$4,500** |  |
|  | **Increase in AR from Sales** | **69,400** |  |
|  | **Reduction in AR from Collections** | **(68,200)** |  |
|  | **Endings Accounts Receivable Balance** | **$5,700** | **(X)** |
|  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **X Co.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$4,300** | **(X)** |
|  | **Increase in AR from Sales** | **62,200** |  |
|  | **Reduction in AR from Collections** | **(63,100)** |  |
|  | **Endings Accounts Receivable Balance** | **$3,400** |  |
|  |  |  |  |

**c.**

|  |  |  |  |
| --- | --- | --- | --- |
| **X Co.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$9,700** |  |
|  | **Increase in AR from Sales** | **99,700** |  |
|  | **Reduction in AR from Collections** | **(99,100)** | **(X)** |
|  | **Endings Accounts Receivable Balance** | **$10,300** |  |
|  |  |  |  |

**EXERCISE 2-15A a. (cont.)**

**d.**

|  |  |  |  |
| --- | --- | --- | --- |
| **X Co.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$22,000** |  |
|  | **Increase in AR from Sales** | **108,300** | **(X)** |
|  | **Reduction in AR from Collections** | **(109,000)** |  |
|  | **Endings Accounts Receivable Balance** | **$21,300** |  |
|  |  |  |  |

EXERCISE 2-16A

**Solve for “X” in the following scenarios:**

**a.**

|  |  |  |  |
| --- | --- | --- | --- |
| **X Co.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$4,700** |  |
|  | **Plus: Expenses incurred on account** | **67,600** |  |
|  | **Minus: Payment of accounts payable** | **(68,900)** |  |
|  | **Ending accounts payable balance** | **$3,400** | **(X)** |
|  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **X Co.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$3,000** | **(X)** |
|  | **Plus: Expenses incurred on account** | **66,400** |  |
|  | **Minus: Payment of accounts payable** | **(64,100)** |  |
|  | **Ending accounts payable balance** | **$5,300** |  |
|  |  |  |  |

**c.**

|  |  |  |  |
| --- | --- | --- | --- |
| **X Co.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$4,100** |  |
|  | **Plus: Expenses incurred on account** | **67,600** |  |
|  | **Minus: Payment of accounts payable** | **(66,900)** | **(X)** |
|  | **Ending accounts payable balance** | **$4,800** |  |
|  |  |  |  |

**EXERCISE 2-16A a. (cont.)**

**d.**

|  |  |  |  |
| --- | --- | --- | --- |
| **X Co.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$7,700** |  |
|  | **Plus: Expenses incurred on account** | **79,400** | **(X)** |
|  | **Minus: Payment of accounts payable** | **(77,300)** |  |
|  | **Ending accounts payable balance** | **$9,800** |  |
|  |  |  |  |

EXERCISE 2-17A

a. Solve for “X”

|  |  |  |  |
| --- | --- | --- | --- |
| **Harbert, Inc.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$12,000** |  |
|  | **Increase in AR from Sales** | **70,500** | **(X)** |
|  | **Reduction in AR from Collections** | **(72,000)** |  |
|  | **Endings Accounts Receivable Balance** | **$10,500** |  |
|  |  |  |  |

b. $7,500. Revenue ($70,500) minus expenses ($63,000).

c. $9,000. Cash inflow from AR collections ($72,000) minus cash expenses ($63,000).

d. Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but will not be reflected on the cash flow statement until the cash is collected.

EXERCISE 2-18A

a. Solve for “X”

|  |  |  |  |
| --- | --- | --- | --- |
| **Kincaid, Inc.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$2,000** |  |
|  | **Plus: Expenses incurred on account** | **63,000** | **(X)** |
|  | **Minus: Payment of accounts payable** | **(40,000)** |  |
|  | **Ending accounts payable balance** | **$25,000** |  |
|  |  |  |  |

b. $22,000. Revenue ($85,000) minus expenses ($63,000).

c. $45,000. Cash inflow from sales ($85,000) minus cash outflow for expenses ($40,000).

d. Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. When a company incurs an expense, this amount is reflected in expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-19A

The six principles of the AICPA Code of Professional Conduct and a brief explanation is as follows:

**Responsibilities Principle**

**In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.**

**The Public Interest Principle**

**Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.**

**Integrity Principle**

**To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.**

**Objectivity and Independence Principle**

**A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.**

**Due Care Principle**

**A member should observe the profession’s technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member’s ability.**

**Scope and Nature of Services Principle**

A member in public practice should observe the principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

SOLUTIONS TO PROBLEMS – SERIES A – CHAPTER 2

**PROBLEM 2-20A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Maben Company**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Common Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **30,000** | **+** | **NA** | **=** | **NA** | **+** | **30,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **30,000 FA** |
| **2** |  | **40,000** | **+** | **NA** | **=** | **40,000** | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **40,000 FA** |
| **3** |  | **48,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **48,000** |  | **48,000** | **−** | **NA** | **=** | **48,000** |  | **48,000 OA** |
| **4** |  | **(25,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(25,000)** |  | **NA** | **−** | **25,000** | **=** | **(25,000)** |  | **(25,000) OA** |
| **5.** |  | **(1,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(1,000)** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(1,000) FA** |
| **6.** |  | **20,000** | **+** | **NA** | **=** | **NA** | **+** | **20,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **20,000 FA** |
| **7.** |  | **(10,000)** | **+** | **NA** | **=** | **(10,000)** | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(10,000) FA** |
| **8.** |  | **(53,000)** | **+** | **53,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(53,000) IA** |
| **9.** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **NA** |
| **Total** |  | **49,000** | **+** | **53,000** | **=** | **30,000** | **+** | **50,000** | **+** | **22,000** |  | **48,000** | **−** | **25,000** | **=** | **23,000** |  | **49,000 NC** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. **Total Assets = $49,000 + $53,000 = $102,000**

**c.**

|  |  |
| --- | --- |
| **Sources of Assets** | |
| **1. Issue of stock** | **$ 30,000** |
| **2. Cash from loan** | **40,000** |
| **3. Cash from revenue** | **48,000** |
| **6. Issue of stock** | **20,000** |
| **Total Sources of Assets** | **$138,000** |

**PROBLEM 2-20A (cont.)**

1. **Net income amounts to $23,000 (see part a.) Dividends are not expenses and do not appear on the income statement.**

**e.**

|  |  |
| --- | --- |
| **Operating Activities:** | |
| **Cash from revenue** | **$48,000** |
| **Cash paid for expenses** | **(25,000)** |
| **Net Cash Flow from Operating Activities** | **$23,000** |
|  |  |

|  |  |
| --- | --- |
| **Investing Activities:** | |
| **Cash paid to purchase land** | **$(53,000)** |
| **Net Cash Flow from Investing Activities** | **$(53,000)** |
|  |  |

|  |  |
| --- | --- |
| **Financing Activities:** | |
| **Cash from stock issue ($30,000 + $20,000)** | **$50,000** |
| **Cash from loan** | **40,000** |
| **Paid cash dividend** | **(1,000)** |
| **Cash paid on loan principal** | **(10,000)** |
| **Net Cash Flow from Financing Activities** | **$79,000** |
|  |  |

**f. Percentage of assets is provided as follows:**

**Investors ($50,000 ÷ $102,000) 49.0%**

**Creditors ($30,000 ÷ $102,000) 29.4%**

**Earnings ($22,000 ÷ $102,000) 21.6%**

g. Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.

PROBLEM 2-21A

|  |  |
| --- | --- |
| **Event No.** | **Description** |
| **6** | **Incurred cash expenses.** |
| **2** | **Earned revenue on account.** |
| **4** | **Earned cash revenue.** |
| **1** | **Issued common stock for cash.** |
| **8** | **Paid a cash dividend.** |
| **5** | **Collected cash from customer accounts receivable.** |
| **7** | **Used cash to pay off accounts payable.** |
| **3** | **Incurred expenses on account.** |

PROBLEM 2-22A

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | Wadell Company  Statements Model for Year 2 | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | | | |
|  |  | | Balance Sheet | | | | | | | | | |  | Income Statement | | | | |  | Statement of |
|  |  | | Assets | | | | | = | Liab. | + | S. Equity | |  | Rev. | – | Exp. | = | Net Inc. |  | Cash Flows |
| Date |  | | Cash | + | Accts.  Rec. | + | Land | = | Accts. Pay. | + | Common Stock | Retained Earn. |  |  |  |  |  |  |  |  |
| Beg. |  | | 35,000 | + | 9,000 | + | 51,000 | = | 7,500 | + | 40,000 | 47,500 |  | NA | – | NA | = | NA |  | 35,000 |
| 1/1 |  | | 20,000 | + | NA | + | NA | = | NA | + | 20,000 | NA |  | NA | – | NA | = | NA |  | 20,000 FA |
| 3/1 |  | | (2,000) | + | NA | + | NA | = | NA | + | NA | (2,000) |  | NA | – | NA | = | NA |  | (2,000) FA |
| 4/1 |  | | (15,000) | + | NA | + | 15,000 | = | NA | + | NA | NA |  | NA | – | NA | = | NA |  | (15,000) IA |
| 5/1 |  | | (5,500) | + | NA | + | NA | = | (5,500) | + | NA | NA |  | NA | – | NA | = | NA |  | (5,500) OA |
| 9/1 |  | | 30,000 | + | NA | + | (30,000) | = | NA | + | NA | NA |  | NA | – | NA | = | NA |  | 30,000 IA |
| 12/31 |  | | NA | + | 58,000 | + | NA | = | NA | + | NA | 58,000 |  | 58,000 | – | NA | = | 58,000 |  | NA |
| 12/31 |  | | 46,000 | + | (46,000) | + | NA | = | NA | + | NA | NA |  | NA | – | NA | = | NA |  | 46,000 OA |
| 12/31 |  | | NA | + | NA | + | NA | = | 28,000 | + | NA | (28,000) |  | NA | – | 28,000 | = | (28,000) |  | NA |
| 12/31 |  | | NA | + | NA | + | NA | = | NA | + | NA | NA |  | NA | – | NA | = | NA |  | NA |
| Totals |  | | 108,500 | + | 21,000 | + | 36,000 | = | 30,000 | + | 60,000 | 75,500 |  | 58,000 | - | 28,000 | = | 30,000 |  | 108,500 |
|  |  | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

a. $36,000. Total of the land column in the Horizontal Financial Statements Model.

b. $40,500. Cash inflows of $46,000 minus cash outflows of $5,500.

c. $30,000. Total of the liabilities column in the Horizontal Financial Statements Model.

d. $15,000. Cash inflow from the sale of land ($30,000) minus cash outflow from the purchase of land ($15,000).

PROBLEM 2-22A (cont.)

e. $28,000. Total of the expenses column in the Horizontal Financial Statements Model.

f. $58,000. Total of the revenue column in the Horizontal Financial Statements Model.

g. $18,000. Cash inflow from issuance of common stock ($20,000) minus cash outflow from dividend ($2,000).

h. $30,000. Revenues ($58,000) minus expenses ($28,000).

i. $75,500. Total of the retained earnings column in the Horizontal Financial Statements Model.

PROBLEM 2-23A

a.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Sentry, Inc.**  **Accounting Equation for Year 1** | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | | | | | **+** | | **Stockholders’ Equity** | | | | |
| **Event** |  | **Cash** | **+** | **Accts. Rec.** | **=** | **Accts Pay.** | **+** | **Notes Pay.** | **+** | **Int. Pay.** | **+** | | **Com.**  **Stock** | | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg.** |  | **$0** | **+** | **$0** | **=** | **$0** | **+** | **NA** | **+** | **NA** | **+** | | **$0** | | **+** | **$0** |  |
| **1. Issued stk.** |  | **20,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **+** | | **20,000** | | **+** | **NA** |  |
| **2. Rev. on acct.** |  | **NA** | **+** | **62,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **62,000** | **Rev.** |
| **3. Loan** |  | **12,000** | **+** | **NA** | **=** | **NA** | **+** | **12,000** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **4. Exp. On acct.** |  | **NA** | **+** | **NA** | **=** | **3,700** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **(3,700)** | **Exp.** |
| **5. AR collect.** |  | **5,000** | **+** | **(5,000)** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **6. AP payment** |  | **(2,900)** | **+** | **NA** | **=** | **(2,900)** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **7. Interest exp.\*** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **240** | **+** | | **NA** | | **+** | **(240)** | **Int. exp.** |
| **Totals** |  | **34,100** | **+** | **57,000** | **=** | **800** | **+** | **12,000** | **+** | **240** | **+** | | **20,000** | | **+** | **58,060** |  |
|  |  |  |  |  |  |  |  |  |  |  |  | |  | |  |  |  |

\*240 = (12,000 x .08) x 3/12

PROBLEM 2-23A a. (cont.)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Sentry, Inc.**  **Accounting Equation for Year 2** | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | | | | | **+** | | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Accts. Rec.** | **=** | **Accts Pay.** | **+** | **Notes Pay.** | **+** | **Int. Pay.** | **+** | | **Com.**  **Stock** | | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg.** |  | **$34,100** | **+** | **57,000** | **=** | **$800** | **+** | **12,000** | **+** | **240** | **+** | | **20,000** | | **+** | **58,060** |  |
| **1. AR collect.** |  | **57,000** | **+** | **(57,000)** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **2. AP payment** |  | **(800)** | **+** | **NA** | **=** | **(800)** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **3. Int. exp.\*** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **720** | **+** | | **NA** | | **+** | **(720)** | **Int. exp.** |
| **4. Int. pay.\*\*** |  | **(960)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(960)** | **+** | | **NA** | | **+** | **NA** |  |
| **5. Note pay.** |  | **(12,000)** | **+** | **NA** | **=** | **NA** | **+** | **(12,000)** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **Totals** |  | **77,340** | **+** | **0** | **=** | **0** | **+** | **0** | **+** | **0** | **+** | | **20,000** | | **+** | **57,340** |  |
|  |  |  |  |  |  |  |  |  |  |  |  | |  | |  |  |  |

\*720 = (12,000 \*.08) x 9/12

\*\*960 = 240 + 720

PROBLEM 2-23A (cont.)

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Sentry, Inc.**  **Income Statement**  **For the Period Ended December 31, Year 1 & Year2** | | | |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Revenue** | **$62,000** | **$0** |  |
|  | **Expenses** | **(3,940)** | **(720)** |  |
|  | **Net Income** | **$58,060** | **$(720)** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Sentry, Inc.**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1 & Year2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** | **$20,000** |  |
|  | **Plus: Common Stock Issued** | **20,000** | **0** |  |
|  | **Ending Common Stock** | **$20,000** | **$20,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** | **$58,060** |  |
|  | **Plus: Net Income** | **58,060** | **(720)** |  |
|  | **Ending Retained Earnings** | **$58,060** | **$57,340** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** | **$78,060** | **$77,340** |  |
|  |  |  |  |  |

**PROBLEM 2-23A b. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Sentry, Inc.**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$34,100** | **$77,340** |  |
|  | **Accounts Receivable** | **$57,000** | **$0** |  |
|  | **Total Assets** | **$91,100** | **$77,340** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Accounts Payable** | **$800** | **$0** |  |
|  | **Interest Payable** | **240** | **0** |  |
|  | **Notes Payable** | **12,000** | **0** |  |
|  | **Total Liabilities** | **$13,040** | **$0** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$20,000** | **$20,000** |  |
|  | **Retained Earnings** | **$58,060** | **$57,340** |  |
|  | **Total Stockholders’ Equity** | **$78,060** | **$77,340** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$91,100** | **$77,340** |  |
|  |  |  |  |  |

**PROBLEM 2-23A b. (cont.)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Sentry, Inc.**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1 & Year 2** | | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$5,000** | **$57,000** |  |
|  | **Cash Payments for Expenses** | **(2,900)** | **(1,760)\*** |  |
|  | **Net Cash Flow from Operating Activities** | **$2,100** | **$55,240** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities** |  |  |  |
|  | **Net Cash Flow from Investing Activities** | **$0** | **$0** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Transactions from Borrowed Funds** | **$12,000** | **($12,000)** |  |
|  | **Cash Receipts from Stock Issue** | **20,000** | **0** |  |
|  | **Net Cash Flow from Financing Activities** | **$32,000** | **($12,000)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** | **$34,100** | **$43,240** |  |
|  | **Plus: Beginning Cash Balance** | **-0-** | **$34,100** |  |
|  | **Ending Cash Balance** | **$34,100** | **$77,340** |  |
|  |  |  |  |  |

\*$1,760 = $800 + $960

c. Sentry Inc. has $77,340 worth of assets to distribute in the event of liquidation at the end of Year 2. During liquidation, creditors have first rights to the assets and any remaining assets are distributed to owners. As the company has no debts, creditors would receive $0 and total amount of assets of $77,340 would be distributed to owners.

**PROBLEM 2-24A**

**a.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Bennett Company**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Revenue** |  |  |  |
|  | **Service Revenue** | **$42,000** |  |  |
|  | **Total Revenue** |  | **$42,000** |  |
|  |  |  |  |  |
|  | **Expenses** |  |  |  |
|  | **Other Operating Expenses** | **$20,000** |  |  |
|  | **Salary Expense** | **10,000** |  |  |
|  | **Interest Expense** | **4,000** |  |  |
|  | **Total Expenses** |  | **(34,000)** |  |
|  |  |  |  |  |
|  | **Net Income** |  | **$8,000** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Bennett Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$40,000** |  |  |
|  | **Plus: Stock Issued** | **5,000** |  |  |
|  | **Ending Common Stock** |  | **$45,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 15,000** |  |  |
|  | **Plus: Net Income** | **8,000** |  |  |
|  | **Less: Dividends** | **(3,000)** |  |  |
|  | **Ending Retained Earnings** |  | **20,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$65,000** |  |
|  |  |  |  |  |

**PROBLEM 2-24A a. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Bennett Company**  **Balance Sheet**  **As of December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$23,000** |  |  |
|  | **Accounts Receivable** | **18,000** |  |  |
|  | **Land** | **59,000** |  |  |
|  | **Total Assets** |  | **$100,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Accounts Payable** | **$17,000** |  |  |
|  | **Interest Payable** | **3,000** |  |  |
|  | **Accrued Salaries Payable** | **5,000** |  |  |
|  | **Notes Payable** | **10,000** |  |  |
|  | **Total Liabilities** |  | **$ 35,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$45,000** |  |  |
|  | **Retained Earnings** | **20,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **$ 65,000** |  |
|  |  |  |  |  |
|  | **Total Liab. and Stockholders’ Equity** |  | **$100,000** |  |
|  |  |  |  |  |

**PROBLEM 2-24A a. (cont.)**

|  |  |  |  |
| --- | --- | --- | --- |
| **Bennett Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Cash Flow From Operating Activities** | **$33,000** |  |
|  |  |  |  |
|  | **Cash Flow From Investing Activities** | **(32,000)** |  |
|  |  |  |  |
|  | **Cash Flow From Financing Activities** | **2,000** |  |
|  |  |  |  |
|  | **Net Change in Cash** | **3,000** |  |
|  | **Plus: Beginning Cash Balance** | **20,000** |  |
|  | **Ending Cash Balance** | **$23,000** |  |
|  |  |  |  |

b.

|  |  |  |  |
| --- | --- | --- | --- |
| **Bennett Company**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$41,000** | **(X)** |
|  | **Increase in AR from Service Revenue** | **42,000** |  |
|  | **Reduction in AR from Collections** | **(65,000)** |  |
|  | **Endings Accounts Receivable Balance** | **$18,000** |  |
|  |  |  |  |

c.

|  |  |  |  |
| --- | --- | --- | --- |
| **Bennet Company**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$15,000** | **(X)** |
|  | **Plus: Expenses incurred on account** | **20,000** |  |
|  | **Minus: Payment of accounts payable** | **(18,000)** |  |
|  | **Ending accounts payable balance** | **$17,000** |  |
|  |  |  |  |

PROBLEM 2-25A

a.

|  |  |
| --- | --- |
| Computation of Net Income | |
| Revenue recognized on account | $68,000 |
| Less accrued salary expense | (46,000) |
| Net Income | $22,000 |
|  |  |

b.

|  |  |
| --- | --- |
| Computation of Cash Collected from Accounts Receivable | |
| Beginning balance of Accounts Receivable | $ 4,000 |
| Add revenue recognized on account | 68,000 |
| Less ending balance of Accounts Receivable | (4,500) |
| Cash collected from accounts receivable | $67,500 |
|  |  |

|  |  |
| --- | --- |
| Computation of Cash Paid for Salaries Expense | |
| Beginning balance of Salaries Payable | $ 2,600 |
| Add accrued salary expense recognized | 46,000 |
| Less ending balance of Salaries Payable | (1,500) |
| Cash paid for Salary Expense | $47,100 |
|  |  |

|  |  |
| --- | --- |
| Cash Flow from Operating Activities |  |
|  |  |
| Cash from Accounts Receivable | $67,500 |
| Cash paid for Salary Expense | (47,100) |
| Net Cash Flow from Operating Act. | $20,400 |
|  |  |

c. Net income is the difference between services performed and expenses incurred, regardless of the cash collected or paid. Cash flow from operating activities is the difference between cash collected and paid for operating activities. The time gap between these two activities often causes a difference between the net income and cash flow from operating activities.

PROBLEM 2-26A

The three common features of ethical misconduct are:

1. The availability of an opportunity
2. The existence of some sort of pressure
3. The capacity for rationalization
4. Even though Pete has exceeded his authority, no one has complained because he is bringing in more revenue. Oversight by a partner would eliminate this type of problem.
5. Pete is in a financial bind and does not want to discuss his problem with others for fear of ruining his image. Therefore, he is willing to take risks to keep his secret.
6. He rationalizes that his actions do not hurt anyone because the client is getting the service and the firm is getting a reasonable fee.

SOLUTIONS TO EXERCISES – SERIES B - CHAPTER 2

EXERCISE 2-1B

a.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **The Bruce Spruce Co.**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **75,000** | **+** | **NA** | **=** | **NA** | | **+** | **75,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **75,000 FA** |
| **2** |  | **48,000** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **48,000** |  | **48,000** | **−** | **NA** | **=** | **48,000** |  | **48,000 OA** |
| **3** |  | **(34,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(34,000)** |  | **NA** | **−** | **34,000** | **=** | **(34,000)** |  | **(34,000) OA** |
| **4** |  | **20,000** | **+** | **NA** | **=** | **20,000** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **20,000 FA** |
| **5** |  | **(38,000)** | **+** | **38,000** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(38,000) IA** |
| **6** |  | **(2,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(2,000)** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(2,000) FA** |
|  |  | **69,000** | **+** | **38,000** | **=** | **20,000** | | **+** | **75,000** | **+** | **12,000** |  | **48,000** | **−** | **34,000** | **=** | **14,000** |  | **69,000 NC** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

EXERCISE 2-1B (cont.)

b.

|  |  |  |  |
| --- | --- | --- | --- |
| **The Bruce Spruce Co.**  **Income Statement**  **For the Period Ended December 31, Year 1** | | | |
|  |  |  |  |
|  | **Revenue** | **$48,000** |  |
|  | **Expenses** | **(34,000)** |  |
|  | **Net Income** | **$14,000** |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **The Bruce Spruce Co.**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** |  |  |
|  | **Plus: Common Stock Issued** | **75,000** |  |  |
|  | **Ending Common Stock** |  | **$75,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$-0-** |  |  |
|  | **Plus: Net Income** | **14,000** |  |  |
|  | **Less: Dividends** | **(2,000)** |  |  |
|  | **Ending Retained Earnings** |  | **12,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$87,000** |  |
|  |  |  |  |  |

EXERCISE 2-1B b. (cont.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **The Bruce Spruce Co.**  **Balance Sheet**  **As of December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$69,000** |  |  |
|  | **Land** | **38,000** |  |  |
|  | **Total Assets** |  | **$107,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** |  | **$20,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$75,000** |  |  |
|  | **Retained Earnings** | **12,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **$87,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$107,000** |  |
|  |  |  |  |  |

EXERCISE 2-1B b. (cont.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **The Bruce Spruce Co.**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$48,000** |  |  |
|  | **Cash Payments for Expenses** | **(34,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$14,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Payment for Land** | **$(38,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **$(38,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$75,000** |  |  |
|  | **Cash Receipts from Borrowed Funds** | **20,000** |  |  |
|  | **Cash Dividends** | **(2,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **$93,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **69,000** |  |
|  | **Plus: Beginning Cash Balance** |  | **-0-** |  |
|  | **Ending Cash Balance** |  | **$69,000** |  |
|  |  |  |  |  |

EXERCISE 2-2B

**a.**

|  |  |
| --- | --- |
| **1.** | **Asset source** |
| **2.** | **Asset source** |
| **3.** | **NA** |
| **4.** | **Asset exchange** |
| **5.** | **Asset use** |
| **6.** | **Asset use** |
| **7.** | **NA** |

**b.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Pet Partners**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **I** | **+** | **NA** | **=** | **NA** | | **+** | **I** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **I FA** |
| **2** |  | **I** | **+** | **NA** | **=** | **I** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **I FA** |
| **3** |  | **NA** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **NA** |
| **4** |  | **D** | **+** | **I** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **D IA** |
| **5** |  | **D** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **D** |  | **NA** | **−** | **I** | **=** | **D** |  | **D OA** |
| **6** |  | **D** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **D** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **D FA** |
| **7** |  | **NA** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **NA** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

EXERCISE 2-3B

**a. Missing items are determined as follow:**

**(a) $500,000; Since the cash flow column shows that this event was financing activity, we can infer that the company either borrowed money or issued stock. Since the model shows that liabilities were not affected, we conclude that the common stock account increased by $500,000.**

**(b) NA; Since issuing common stock (see answer to (a) above), does not affect the revenue account, the answer is not affected (NA).**

**(c) NA; Since issuing common stock (see answer to (a) above), does not affect net income, the answer is not affected (NA).**

**(d) NA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money does not affect net income.**

**(e) FA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money is a financing activity (FA).**

**(f) 475,000; Since cash decreased and no other balance sheet account other than the land account was affected, the company must have purchased land which would cause the land account to increase by 475,000.**

**(g) IA; Purchasing land (see answer to (f) above) is an investing activity (IA).**

**(h) 105,000; The income statement shows $105,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.**

**(i) 105,000; The income statement shows $105,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.**

**EXERCISE 2-3B a. (cont).**

**(j) (80,000); The statement of cash flows shows that the $80,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to reduce the amount of retained earnings shown in the balance sheet.**

**(k) 80,000; The statement of cash flows shows that the $80,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to increase amount of expenses shown in the income statement.**

**(l) FA; Since the event decreases cash and retained earnings on the balance sheet; and does not affect the income statement, we conclude that this was a dividend payment which is a financing activity (FA).**

**(m) 435,000; This amount is determined by totaling the vertical column.**

**(n) 105,000; This amount is determined by totaling the vertical column.**

**EXERCISE 2-3B a. (cont.)**

**Completed Horizontal Financial Statements Model**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Surf’s Up Industries**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
|  |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **Beg.** |  | **0** | **+** | **0** | **=** | **0** | | **+** | **0** | **+** | **0** |  | **0** | **−** | **0** | **=** | **0** |  | **NA** |
| **1** |  | **500,000** | **+** | **NA** | **=** | **NA** | | **+** | **500,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **500,000 FA** |
| **2** |  | **400,000** | **+** | **NA** | **=** | **400,000** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **400,000 FA** |
| **3** |  | **(475,000)** | **+** | **475,000** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(475,000) IA** |
| **4** |  | **105,000** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **105,000** |  | **105,000** | **−** | **NA** | **=** | **105,000** |  | **105,000 OA** |
| **5** |  | **(80,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(80,000)** |  | **NA** | **−** | **80,000** | **=** | **(80,000)** |  | **(80,000) OA** |
| **6** |  | **(15,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(15,000)** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(15,000) FA** |
|  |  | **435,000** | **+** | **475,000** | **=** | **400,000** | | **+** | **500,000** | **+** | **10,000** |  | **105,000** | **−** | **80,000** | **=** | **25,000** |  | **435,000 NC** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

**b. $910,000 Total Assets (Cash $435,000 + Land $475,000)**

**c. $25,000 Net Income (Revenue $105,000 – Expenses $80,000)**

**d. $(475,000) Net Cash Flow from Investing Activities**

EXERCISE 2-4B

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Smith Company**  **Effect of Events on the Year 1 Financial Statements** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  | **Assets** | | | **=** | **Liabilities** | | **+** | | **Stockholders’ Equity** | | |
| **Event** | **Cash** | **+** | **Accounts Rec.** | **=** |  | **+** | | **Common**  **Stock** | | **+** | **Retained**  **Earnings** |
| **Earned Revenue** | **NA** | **+** | **12,000** | **=** | **NA** | **+** | | **NA** | | **+** | **12,000** |
| **Coll. Acct. Rec.** | **9,800** | **+** | **(9,800)** | **=** | **NA** | **+** | | **NA** | | **+** | **NA** |
| **Ending Balance** | **9,800** | **+** | **2,200** | **=** | **-0-** | **+** | | **-0-** | | **+** | **12,000** |
|  |  |  |  |  |  |  | |  | |  |  |

**a. Accounts Receivable: $12,000 – $9,800 = $2,200**

**b. $12,000**

**c. $9,800 cash collected from accounts receivable.**

**d. $12,000**

e. $12,000 of revenue was earned but only $9,800 of it was collected.

EXERCISE 2-5B

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **The Woodstock Shop**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Accts. Rec** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **38,000** | **+** | **NA** | **=** | **NA** | | **+** | **38,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **38,000 FA** |
| **2** |  | **NA** | **+** | **30,000** | **=** | **NA** | | **+** | **NA** | **+** | **30,000** |  | **30,000** | **−** | **NA** | **=** | **30,000** |  | **NA** |
| **3** |  | **(25,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(25,000)** |  | **NA** | **−** | **25,000** | **=** | **(25,000)** |  | **(25,000) OA** |
| **4** |  | **15,000** | **+** | **NA** | **=** | **15,000** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **15,000 FA** |
| **5** |  | **25,000** | **+** | **(25,000)** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **25,000 OA** |
| **6** |  | **(2,000)** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **(2,000)** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(2,000) FA** |
|  |  | **51,000** | **+** | **5,000** | **=** | **15,000** | | **+** | **38,000** | **+** | **3,000** |  | **30,000** | **−** | **25,000** | **=** | **5,000** |  | **51,000 NC** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

b. Accounts receivable will appear as an “asset” on the December 31, Year 1 balance sheet.

c. $5,000. Total from the accounts receivable column in the Horizontal Financial Statements Model.

d. $5,000. Total from the net income column in the Horizontal Financial Statements Model.

e. $0. Net cash flow from operating activities ($25,000 - $25,000).

f. Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but not cash flow from operating activities until the cash is collected.

EXERCISE 2-6B

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Kendall Company**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event** |  | **Cash** | **+** | **Accts. Rec** | **=** | **Accts.**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **20,000** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **20,000** |  | **20,000** | **−** | **NA** | **=** | **20,000** |  | **20,000 OA** |
| **2** |  | **NA** | **+** | **NA** | **=** | **10,000** | | **+** | **NA** | **+** | **(10,000)** |  | **NA** | **−** | **(10,000)** | **=** | **(10,000)** |  | **NA** |
| **3** |  | **(5,000)** | **+** | **NA** | **=** | **(5,000)** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(5,000) OA** |
|  |  | **15,000** | **+** | **0** | **=** | **5,000** | | **+** | **0** | **+** | **10,000** |  | **20,000** | **−** | **(10,000)** | **=** | **10,000** |  | **15,000 NC** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

a. $5,000. Total from the accounts payable column in the Horizontal Financial Statements Model.

b. $10,000. Total from the expenses column in the Horizontal Financial Statements Model.

c. $15,000. Total cash flow from operating activities.

d. $10,000. Total from the retained earnings column in the Horizontal Financial Statements Model.

e. Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. When a company incurs an expense, this amount is reflected in expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-7B

a.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Star Corporation Accounting Equation - Year 1 | | | | | | | |
| Event | Assets | = | Liabilities | + | Stockholders’ Equity | | |
|  | Cash | = | Salaries Payable | + | Common Stock | + | Retained Earnings |
| Earned Rev. | 5,000 |  | NA |  | NA |  | 5,000 |
| Accrued Sal. | NA |  | 3,000 |  | NA |  | (3,000) |
| Ending Bal. | 5,000 | = | 3,000 | + | -0- | + | 2,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Star Corporation  Balance Sheet  As of December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Assets |  |  |  |
|  | Cash | $5,000 |  |  |
|  | Total Assets |  | $5,000 |  |
|  |  |  |  |  |
|  | Liabilities |  |  |  |
|  | Salaries Payable | $3,000 |  |  |
|  | Total Liabilities |  | $3,000 |  |
|  |  |  |  |  |
|  | Stockholders’ Equity |  |  |  |
|  | Retained Earnings | $2,000 |  |  |
|  | Total Stockholders’ Equity |  | 2,000 |  |
|  |  |  |  |  |
|  | Total Liab. and Stockholders’ Equity |  | $5,000 |  |
|  |  |  |  |  |

b.

|  |  |
| --- | --- |
| Computation of Net Income |  |
|  |  |
| Revenue | $5,000 |
| Less: Expenses | (3,000) |
| Net Income | $2,000 |
|  |  |

EXERCISE 2-7B (cont.)

c.

|  |  |
| --- | --- |
| Cash Flow from Operating Activities |  |
|  |  |
| Cash from Revenue | $5,000 |
| Net Cash Flow from Operating Act. | $5,000 |
|  |  |

1. **The salary expense is deducted from revenue in computing net income, but it has not been paid. This creates a difference of $3,000. The revenue is the same because it has been earned and collected.**

**EXERCISE 2-8B**

a.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Talley, Inc.  Accounting Equation for the Year Ended December 31, Year 1 | | | | | | | | |
|  | | | | | | | | |
|  | Assets | | = | Liabilities | + | Stockholders’ Equity | |  |
| Event | Cash | Accts. Rec. | = | Salaries Pay. | + | Common Stock | Retained Earnings | Acct. Title for RE |
| 1. | 20,000 |  |  |  |  | 20,000 |  |  |
| 2. |  | 38,000 |  |  |  |  | 38,000 | Revenue |
| 3. | (2,500) |  |  |  |  |  | (2,500) | Util. Exp. |
| 4. | 21,000 | (21,000) |  |  |  |  |  |  |
| 5. |  |  |  | 15,000 |  |  | (15,000) | Sal. Exp. |
| 6. | (2,000) |  |  |  |  |  | (2,000) | Dividends |
| Totals | 36,500 | 17,000 | = | 15,000 | + | 20,000 | 18,500 |  |
|  |  |  |  |  |  |  |  |  |

b.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Talley, Inc.  Income Statement  For the Year Ended December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Revenue |  | $38,000 |  |
|  |  |  |  |  |
|  | Expenses |  |  |  |
|  | Utilities Expense | $ 2,500 |  |  |
|  | Salaries Expense | 15,000 |  |  |
|  | Total Expenses |  | (17,500) |  |
|  |  |  |  |  |
|  | Net Income |  | $20,500 |  |
|  |  |  |  |  |

EXERCISE 2-8B b. (cont.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Talley, Inc.  Statement of Changes in Stockholders’ Equity  For the Year Ended December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Beginning Common Stock | $ -0- |  |  |
|  | Plus: Common Stock Issued | 20,000 |  |  |
|  | Ending Common Stock |  | $20,000 |  |
|  |  |  |  |  |
|  | Beginning Retained Earnings | $ -0- |  |  |
|  | Plus: Net Income | 20,500 |  |  |
|  | Less: Dividends | (2,000) |  |  |
|  | Ending Retained Earnings |  | 18,500 |  |
|  |  |  |  |  |
|  | Total Stockholders’ Equity |  | $38,500 |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Talley, Inc.  Balance Sheet  As of December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Assets |  |  |  |
|  | Cash | $36,500 |  |  |
|  | Accounts Receivable | 17,000 |  |  |
|  | Total Assets |  | $53,500 |  |
|  |  |  |  |  |
|  | Liabilities |  |  |  |
|  | Salaries Payable | $15,000 |  |  |
|  | Total Liabilities |  | $15,000 |  |
|  |  |  |  |  |
|  | Stockholders’ Equity |  |  |  |
|  | Common Stock | $20,000 |  |  |
|  | Retained Earnings | 18,500 |  |  |
|  | Total Stockholders’ Equity |  | 38,500 |  |
|  |  |  |  |  |
|  | Total Liab. and Stockholders’ Equity |  | $53,500 |  |
|  |  |  |  |  |

EXERCISE 2-8B b. (cont.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Talley, Inc.  Statement of Cash Flows  For the Year Ended December 31, Year 1 | | | | |
|  |  |  |  |  |
|  | Cash Flow From Operating Activities |  |  |  |
|  | Cash Receipts from Customers | $21,000 |  |  |
|  | Cash Paid for Expenses | (2,500) |  |  |
|  | Net Cash Flow from Operating Act. |  | $18,500 |  |
|  |  |  |  |  |
|  | Cash Flow From Investing Activities |  | -0- |  |
|  |  |  |  |  |
|  | Cash Flow From Financing Activities |  |  |  |
|  | Issue of Stock | $20,000 |  |  |
|  | Paid Dividends | (2,000) |  |  |
|  | Net Cash Flow from Financing Act. |  | 18,000 |  |
|  |  |  |  |  |
|  | Net Change in Cash |  | 36,500 |  |
|  | Plus: Beginning Cash Balance |  | -0- |  |
|  | Ending Cash Balance |  | $36,500 |  |
|  |  |  |  |  |

1. Net income is based on income earned of $38,000 and expenses incurred of $17,500 for a net income of $20,500. Net cash flow from operating activities is based on cash collected from revenue, $21,000 and expenses paid, $2,500, for a net cash flow from operating activities of $18,500. The difference of $2,000 is reflected in the Accounts Receivable account ($17,000), revenues accrued but not yet collected, and the Salaries Payable account ($15,000), expenses incurred but not paid.

# EXERCISE 2-9B

a.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Parker and Moates  Statements Model  Year 1 | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | |
|  |  | Balance Sheet | | | | | | | | |  | Income Statement | | | | |  | Statement of |
|  |  | Assets | | | = | Liabilities | | | + | Stk. Equity |  | Rev. | – | Exp. | = | Net Inc. |  | Cash Flows |
| Event |  | Cash | + | Accts.  Rec. | = | Acct.  Payable | + | Sal. Pay. | + | Retained Earnings |  |  |  |  |  |  |  |  |
| 1. |  | NA | + | 96,000 | = | NA | + | NA | + | 96,000 |  | 96,000 | – | NA | = | 96,000 |  | NA |
| 2. |  | 65,000 | + | NA | = | NA | + | NA | + | 65,000 |  | 65,000 | – | NA | = | 65,000 |  | 65,000 OA |
| 3. |  | NA | + | NA | = | 45,000 | + | NA | + | (45,000) |  | NA | – | 45,000 | = | (45,000) |  | NA |
| 4. |  | (26,000) | + | NA | = | NA | + | NA | + | (26,000) |  | NA | – | 26,000 | = | (26,000) |  | (26,000) OA |
| 5. |  | 70,000 | + | (70,000) | = | NA | + | NA | + | NA |  | NA | – | NA | = | NA |  | 70,000 OA |
| 6. |  | (38,000) | + | NA | = | (38,000) | + | NA | + | NA |  | NA | – | NA | = | NA |  | (38,000) OA |
| 7. |  | (10,000) | + | NA | = | NA | + | NA | + | (10,000) |  | NA | – | NA | = | NA |  | (10,000) FA |
| 8. |  | NA | + | NA | = | NA | + | 3,000 | + | (3,000) |  | NA | – | 3,000 | = | (3,000) |  | NA |
| Totals |  | 61,000 | + | 26,000 | = | 7,000 | + | 3,000 | + | 77,000 |  | 161,000 | – | 74,000 | = | 87,000 |  | 61,000 NC |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

b. Total assets: $87,000 ($61,000 + $26,000)

c. $26,000

d. $7,000

e. Accounts Receivable (an asset) is an amount owed to Parker and Moates: $26,000;

Accounts Payable (a liability) is an amount that Parker and Moates owes: $7,000.

f. $87,000

g. $71,000 ($65,000 – $26,000 + $70,000 – $38,000)

**EXERCISE 2-10B**

**a. & c.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Event** | **Revenue** | **Expense** | **Statement of Cash Flows** |
| **1.** | **NA** | **NA** | **$50,000 FA** |
| **2.** | **$67,000** | **NA** | **NA** |
| **3.** | **NA** | **NA** | **(5,000) FA** |
| **4.** | **NA** | **NA** | **45,000 OA** |
| **5.** | **NA** | **$49,000** | **(49,000) OA** |
| **6.** | **10,000** | **NA** | **10,000 OA** |
| **7.** | **NA** | **2,000** | **NA** |
|  |  |  |  |

b.

|  |  |
| --- | --- |
| Computation of Net Income |  |
|  |  |
| Revenue | $77,000 |
| Less: Expenses | (51,000) |
| Net Income | $26,000 |
|  |  |

d.

|  |  |
| --- | --- |
| Cash Flow from Operating Activities |  |
|  |  |
| Cash from Revenue | $55,000 |
| Cash paid for expenses | (49,000) |
| Net Cash Flow from Operating Act. | $ 6,000 |
|  |  |

e. The balance of Retained Earnings on the Year 1 Balance Sheet will be the amount of Net Income: $26,000, less $5,000 of dividends paid since there is no beginning balance in Retained Earnings.

**EXERCISE 2-11B**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Hall, Inc.**  **Effect of Events on the Accounting Equation** | | | | | | | | | | |
|  | | | | | | | | | | |
|  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
| **Event** | **Cash** | **Accounts**  **Receivable** | **Land** | **=** | **Accounts**  **Payable** | **+** | **Com. Stock** | **+** | **Retained**  **Earnings** |
| **1. Sales on Account** |  | **62,000** |  |  |  |  |  |  | **62,000** |
| **2. Coll. Accts. Rec.** | **51,000** | **(51,000)** |  |  |  |  |  |  |  |
| **3. Incurred Expense** |  |  |  |  | **39,000** |  |  |  | **(39,000)** |
| **4. Pd. Acc. Pay.** | **(31,000)** |  |  |  | **(31,000)** |  |  |  |  |
| **5. Issue of Stock** | **40,000** |  |  |  |  |  | **40,000** |  |  |
| **6. Purchase Land** | **(21,000)** |  | **21,000** |  |  |  |  |  |  |
| **Totals** | **39,000** | **11,000** | **21,000** | **=** | **8,000** | **+** | **40,000** | **+** | **23,000** |
|  |  |  |  |  |  |  |  |  |  |

**a. Revenue recognized, $62,000.**

**b. Cash flow from revenue, $51,000.**

**c. Revenue, $62,000, less operating expenses, $39,000 = $23,000 net income.**

**d. Accounts receivable collected, $51,000, less cash paid for expenses, $31,000 = $20,000 cash flow from operating activities.**

**e. Income of $62,000 was earned, but only $51,000 was collected (a difference of $11,000); operating expenses incurred were $39,000 but only $31,000 was paid during the period (a difference of $8,000). Consequently, net income is $3,000 more than cash flow from operating activities.**

**f. $21,000 cash outflow for the purchase of land.**

**g. $40,000 cash inflow from the issue of common stock.**

**h. Total assets = $71,000 ($39,000 + $11,000 + $21,000)**

**Total liabilities = $8,000**

Total equity = $63,000 ($40,000 + $23,000)EXERCISE 2-12B

1. Directly matched
2. Period expense
3. Period expense

d. Directly matched

EXERCISE 2-13B

**a. $10,000 x 9% = $900; $900 x 4/12 = $300**

**b. $300**

**c. $-0-, No interest was paid in Year 1; $900 of interest will be paid in Year 2 when the note matures.**

d.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Connelly Company  Statements Model for Year 1 | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | |
|  |  | Balance Sheet | | | | | | | | |  | Income Statement | | | | |  | Statement of  Cash Flows |
| Event |  | Assets | = | Liabilities | | | + | Stockholders’ Equity | | |  | Rev. | - | Exp. | = | Net Inc. |  |  |
| No. |  | Cash | = | Notes  Payable | + | Int.  Payable | + | Common  Stock | + | Ret. Earn. |  |  |  |  |  |  |  |  |
| 1. |  | I |  | NA |  | NA |  | NA |  | I |  | I |  | NA |  | I |  | I OA |
| 2. |  | I |  | I |  | NA |  | NA |  | NA |  | NA |  | NA |  | NA |  | I FA |
| 3. |  | NA |  | NA |  | I |  | NA |  | D |  | NA |  | I |  | D |  | NA |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

EXERCISE 2-14B

a. Interest expense recognized for Year 1: $120,000 x 7% = $8,400;

$8,400 x 5/12 = $3,500

b.



See the adjusting entry in the accounting equation above (liabilities increase, equity decreases).

c. $-0-. All interest will be paid at maturity, August 1, Year 2, for this note payable.

d. $3,500

e. $8,400 ($120,000 x 7%). All interest will be paid when the note payable matures.

f. $4,900 ($120,000 x 7% x 7/12)

**g. $-0-**

**EXERCISE 2-15B**

**Solve for “X” in the following scenarios:**

**a.**

|  |  |  |  |
| --- | --- | --- | --- |
| **W Co.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$5,000** |  |
|  | **Increase in AR from Sales** | **72,500** |  |
|  | **Reduction in AR from Collections** | **(70,000)** |  |
|  | **Endings Accounts Receivable Balance** | **$7,500** | **(X)** |
|  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **W Co.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$3,800** | **(X)** |
|  | **Increase in AR from Sales** | **60,600** |  |
|  | **Reduction in AR from Collections** | **(61,200)** |  |
|  | **Endings Accounts Receivable Balance** | **$3,200** |  |
|  |  |  |  |

**c.**

|  |  |  |  |
| --- | --- | --- | --- |
| **W Co.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$11,300** |  |
|  | **Increase in AR from Sales** | **102,400** |  |
|  | **Reduction in AR from Collections** | **(97,900)** | **(X)** |
|  | **Endings Accounts Receivable Balance** | **$15,800** |  |
|  |  |  |  |

**EXERCISE 2-15B a. (cont.)**

**d.**

|  |  |  |  |
| --- | --- | --- | --- |
| **W Co.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$18,000** |  |
|  | **Increase in AR from Sales** | **135,500** | **(X)** |
|  | **Reduction in AR from Collections** | **(125,000)** |  |
|  | **Endings Accounts Receivable Balance** | **$28,500** |  |
|  |  |  |  |

EXERCISE 2-16B

**Solve for “X” in the following scenarios:**

**a.**

|  |  |  |  |
| --- | --- | --- | --- |
| **W Co.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$5,500** |  |
|  | **Plus: Expenses incurred on account** | **45,200** |  |
|  | **Minus: Payment of accounts payable** | **(43,100)** |  |
|  | **Ending accounts payable balance** | **$7,600** | **(X)** |
|  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **W Co.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$4,700** | **(X)** |
|  | **Plus: Expenses incurred on account** | **55,200** |  |
|  | **Minus: Payment of accounts payable** | **(54,600)** |  |
|  | **Ending accounts payable balance** | **$5,300** |  |
|  |  |  |  |

**c.**

|  |  |  |  |
| --- | --- | --- | --- |
| **W Co.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$3,000** |  |
|  | **Plus: Expenses incurred on account** | **73,000** |  |
|  | **Minus: Payment of accounts payable** | **(67,500)** | **(X)** |
|  | **Ending accounts payable balance** | **$8,500** |  |
|  |  |  |  |

**EXERCISE 2-16B a. (cont.)**

**d.**

|  |  |  |  |
| --- | --- | --- | --- |
| **W Co.**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$6,750** |  |
|  | **Plus: Expenses incurred on account** | **86,050** | **(X)** |
|  | **Minus: Payment of accounts payable** | **(82,000)** |  |
|  | **Ending accounts payable balance** | **$10,800** |  |
|  |  |  |  |

EXERCISE 2-17B

a. Solve for “X”

|  |  |  |  |
| --- | --- | --- | --- |
| **London Falls Inc.**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$15,000** |  |
|  | **Increase in AR from Sales** | **58,500** | **(X)** |
|  | **Reduction in AR from Collections** | **(65,000)** |  |
|  | **Endings Accounts Receivable Balance** | **$8,500** |  |
|  |  |  |  |

b. $5,500. Revenue ($58,500) minus expenses ($53,000).

c. $12,000. Cash inflow from AR collections ($65,000) minus cash expenses ($53,000).

d. Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but will not be reflected on the cash flow statement until the cash is collected.

EXERCISE 2-18B

a. Solve for “X”

|  |  |  |  |
| --- | --- | --- | --- |
| **Shelby Enterprises**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$25,000** |  |
|  | **Plus: Expenses incurred on account** | **78,000** | **(X)** |
|  | **Minus: Payment of accounts payable** | **(85,000)** |  |
|  | **Ending accounts payable balance** | **$18,000** |  |
|  |  |  |  |

b. $37,000. Revenue ($115,000) minus expenses ($78,000).

c. $30,000. Cash inflow from sales ($115,000) minus cash outflow for expenses ($85,000).

d. Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. When a company incurs an expense, this amount is reflected in expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-19B

One provision of the Sarbanes-Oxley Act of 2002 clarifies the legal responsibility of company management, including the CFO and controller. This provision states that the company chief executive officer (CEO) and the chief financial officer (CFO) must certify in writing that they have reviewed the financial reports being issued, and that the reports present fairly the company’s financial status. This provision would apply to the CEO and CFO of Hewlett-Packard Company. CEOs and CFOs who make intentional misrepresentations are subject to a fine of up to $5 million and imprisonment of up to 20 years.

**SOLUTIONS TO PROBLEMS – SERIES B – CHAPTER 2**

**PROBLEM 2-20B**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Daley Company**  **Horizontal Financial Statements Model for Year 1** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | |  | **Income Statement** | | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event**  **No.** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Common Stock** | **+** | **Retained**  **Earnings** |  |  | |  |  |  |  |  |  |
| **1** |  | **52,000** | **+** | **NA** | **=** | **NA** | **+** | **52,000** | **+** | **NA** |  | **NA** | | **−** | **NA** | **=** | **NA** |  | **52,000 FA** |
| **2** |  | **20,000** | **+** | **NA** | **=** | **20,000** | **+** | **NA** | **+** | **NA** |  | **NA** | | **−** | **NA** | **=** | **NA** |  | **20,000 FA** |
| **3** |  | **42,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **42,000** |  | **42,000** | | **−** | **NA** | **=** | **42,000** |  | **42,000 OA** |
| **4** |  | **(23,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(23,000)** |  | **NA** | | **−** | **23,000** | **=** | **(23,000)** |  | **(23,000) OA** |
| **5** |  | **(6,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(6,000)** |  | **NA** | | **−** | **NA** | **=** | **NA** |  | **(6,000) FA** |
| **6** |  | **10,000** | **+** | **NA** | **=** | **NA** | **+** | **10,000** | **+** | **NA** |  | **NA** | | **−** | **NA** | **=** | **NA** |  | **10,000 FA** |
| **7** |  | **(10,000)** | **+** | **NA** | **=** | **(10,000)** | **+** | **NA** | **+** | **NA** |  | **NA** | | **−** | **NA** | **=** | **NA** |  | **(10,000) FA** |
| **8** |  | **(45,000)** | **+** | **45,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  | **NA** | | **−** | **NA** | **=** | **NA** |  | **(45,000) IA** |
| **9** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  | **NA** | | **−** | **NA** | **=** | **NA** |  | **NA** |
| **Total** |  | **40,000** | **+** | **45,000** | **=** | **10,000** | **+** | **62,000** | **+** | **13,000** |  | **42,000** | | **−** | **23,000** | **=** | **19,000** |  | **40,000 NC** |
|  |  |  |  |  |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |

**b. Total Assets = $40,000 + $45,000 = $85,000**

**c.**

|  |  |
| --- | --- |
| **Sources of Assets** | |
| **Event** |  |
| **1. Issue of stock** | **$ 52,000** |
| **2. Cash from loan** | **20,000** |
| **3. Cash from revenue** | **42,000** |
| **6. Issue of stock** | **10,000** |
| **Total Sources of Assets** | **$124,000** |

**PROBLEM 2-20B (cont.)**

**d. Net income is $19,000 (see part a.) Dividends are not expenses so they do not appear on the income statement.**

**e.**

|  |  |
| --- | --- |
| **Operating Activities:** | |
| **Cash from customers** | **$42,000** |
| **Cash paid for expenses** | **(23,000)** |
| **Net Cash Flow from Operating Activities** | **$19,000** |
|  |  |

|  |  |
| --- | --- |
| **Investing Activities:** | |
| **Cash paid to purchase land** | **$(45,000)** |
| **Net Cash Flow from Investing Activities** | **$(45,000)** |
|  |  |

|  |  |
| --- | --- |
| **Financing Activities:** | |
| **Cash from stock issues ($52,000 + $10,000)** | **$62,000** |
| **Cash from loan** | **20,000** |
| **Paid cash dividend** | **(6,000)** |
| **Cash paid on loan principal** | **(10,000)** |
| **Net Cash Flow from Financing Activities** | **$66,000** |
|  |  |

**f. Percentage of assets provided by:**

**Creditors $10,000 ÷ $85,000 = 11.76%**

**Investors $62,000 ÷ $85,000 = 72.94%**

**Earnings $13,000 ÷ $85,000 = 15.29%**

g. Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.

PROBLEM 2-21B

|  |  |
| --- | --- |
| **Event No.** | **Description** |
| **4** | **Earned cash revenue.** |
| **3** | **Incurred expenses on account.** |
| **6** | **Incurred cash expenses.** |
| **7** | **Used cash to pay off accounts payable.** |
| **5** | **Collected cash from customer accounts receivable.** |
| **8** | **Paid a cash dividend.** |
| **1** | **Issued common stock for cash.** |
| **2** | **Earned revenue on account.** |

PROBLEM 2-22B

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | Waddell Company  Statements Model for Year 2 | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | | |
|  |  | | Balance Sheet | | | | | | | | | |  | Income Statement | | | | |  | Statement of |
|  |  | | Assets | | | | | = | Liab. | + | S. Equity | |  | Rev. | – | Exp. | = | Net Inc. |  | Cash Flows |
| Date |  | | Cash | + | Accts.  Rec. | + | Land | = | Accts. Pay. | + | Common Stock | Retained Earn. |  |  |  |  |  |  |  |  |
| Beg. |  | | 52,000 | + | 23,000 | + | 45,000 | = | 12,500 | + | 35,000 | 72,500 |  | NA | – | NA | = | NA |  | 52,000 |
| 1/1 |  | | 35,000 | + | NA | + | NA | = | NA | + | 35,000 | NA |  | NA | – | NA | = | NA |  | 35,000 FA |
| 3/1 |  | | (4,000) | + | NA | + | NA | = | NA | + | NA | (4,000) |  | NA | – | NA | = | NA |  | (4,000) FA |
| 4/1 |  | | (20,000) | + | NA | + | 20,000 | = | NA | + | NA | NA |  | NA | – | NA | = | NA |  | (20,000) IA |
| 5/1 |  | | (7,000) | + | NA | + | NA | = | (7,000) | + | NA | NA |  | NA | – | NA | = | NA |  | (7,000) OA |
| 9/1 |  | | 25,000 | + | NA | + | (25,000) | = | NA | + | NA | NA |  | NA | – | NA | = | NA |  | 25,000 IA |
| 12/31 |  | | NA | + | 65,000 | + | NA | = | NA | + | NA | 65,000 |  | 65,000 | – | NA | = | 65,000 |  | NA |
| 12/31 |  | | 55,000 | + | (55,000) | + | NA | = | NA | + | NA | NA |  | NA | – | NA | = | NA |  | 55,000 OA |
| 12/31 |  | | NA | + | NA | + | NA | = | 34,000 | + | NA | (34,000) |  | NA | – | 34,000 | = | (34,000) |  | NA |
| 12/31 |  | | NA | + | NA | + | NA | = | NA | + | NA | NA |  | NA | – | NA | = | NA |  | NA |
| Totals |  | | 136,000 | + | 33,000 | + | 40,000 | = | 39,500 | + | 70,000 | 99,500 |  | 65,000 | - | 34,000 | = | 31,000 |  | 136,000 NC |
|  |  | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

a. $40,000. Total of the land column in the Horizontal Financial Statements Model.

b. $48,000. Cash inflows of $55,000 minus cash outflows of $7,000.

1. $39,500. Total of the liabilities column in the Horizontal Financial Statements Model.

d. $5,000. Cash inflow from the sale of land ($25,000) minus cash outflow from the purchase of land ($20,000).

PROBLEM 2-22B (cont.)

e. $34,000. Total of the expenses column in the Horizontal Financial Statements Model.

f. $65,000. Total of the revenue column in the Horizontal Financial Statements Model.

g. $31,000. Cash inflow from issuance of common stock ($35,000) minus cash outflow from dividend ($4,000).

h. $31,000. Revenues ($65,000) minus expenses ($34,000).

i. $99,500. Total of the retained earnings column in the Horizontal Financial Statements Model.

PROBLEM 2-23B

a.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Matchstix**  **Accounting Equation for Year 1** | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | | | | | **+** | | **Stockholders’ Equity** | | | | |
| **Event** |  | **Cash** | **+** | **Accts. Rec.** | **=** | **Accts Pay.** | **+** | **Notes Pay.** | **+** | **Int. Pay.** | **+** | | **Com.**  **Stock** | | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg.** |  | **$0** | **+** | **$0** | **=** | **$0** | **+** | **NA** | **+** | **NA** | **+** | | **$0** | | **+** | **$0** |  |
| **1. Issued stk.** |  | **50,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **+** | | **50,000** | | **+** | **NA** |  |
| **2. Rev. on acct.** |  | **NA** | **+** | **24,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **24,000** | **Rev.** |
| **3. Loan** |  | **22,000** | **+** | **NA** | **=** | **NA** | **+** | **22,000** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **4. Exp. On acct.** |  | **NA** | **+** | **NA** | **=** | **10,500** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **(10,500)** | **Exp.** |
| **5. AR collect.** |  | **7,000** | **+** | **(7,000)** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **6. AP payment** |  | **(3,500)** | **+** | **NA** | **=** | **(3,500)** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **7. Interest exp.\*** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **330** | **+** | | **NA** | | **+** | **(330)** | **Int. exp.** |
| **Totals** |  | **75,500** | **+** | **17,000** | **=** | **7,000** | **+** | **22,000** | **+** | **330** | **+** | | **50,000** | | **+** | **13,170** |  |
|  |  |  |  |  |  |  |  |  |  |  |  | |  | |  |  |  |

\*330 = (22,000 x .06) x 3/12

PROBLEM 2-23B a. (cont.)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Matchstix**  **Accounting Equation for Year 2** | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | | | | | **+** | | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Accts. Rec.** | **=** | **Accts Pay.** | **+** | **Notes Pay.** | **+** | **Int. Pay.** | **+** | | **Com.**  **Stock** | | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg.** |  | **$75,500** | **+** | **17,000** | **=** | **7,000** | **+** | **22,000** | **+** | **330** | **+** | | **50,000** | | **+** | **13,170** |  |
| **1. AR collect.** |  | **17,000** | **+** | **(17,000)** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **2. AP payment** |  | **(7,000)** | **+** | **NA** | **=** | **(7,000)** | **+** | **NA** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **3. Int. exp.\*** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **990** | **+** | | **NA** | | **+** | **(990)** | **Int. exp.** |
| **4. Int. pay.\*\*** |  | **(1,320)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(1,320)** | **+** | | **NA** | | **+** | **NA** |  |
| **5. Note pay.** |  | **(22,000)** | **+** | **NA** | **=** | **NA** | **+** | **(22,000)** | **+** | **NA** | **+** | | **NA** | | **+** | **NA** |  |
| **Totals** |  | **62,180** | **+** | **0** | **=** | **0** | **+** | **0** | **+** | **0** | **+** | | **50,000** | | **+** | **12,180** |  |
|  |  |  |  |  |  |  |  |  |  |  |  | |  | |  |  |  |

\*990 = (22,000 \*.06) x 9/12

\*\*1,320 = 330 + 990

PROBLEM 2-23B (cont.)

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Matchstix**  **Income Statement**  **For the Period Ended December 31, Year 1 & Year2** | | | |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Revenue** | **$24,000** | **$0** |  |
|  | **Expenses** | **(10,830)** | **(990)** |  |
|  | **Net Income** | **$13,170** | **$(990)** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Matchstix**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1 & Year2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** | **$50,000** |  |
|  | **Plus: Common Stock Issued** | **50,000** | **0** |  |
|  | **Ending Common Stock** | **$50,000** | **$50,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** | **$13,170** |  |
|  | **Plus: Net Income** | **13,170** | **(990)** |  |
|  | **Ending Retained Earnings** | **$13,170** | **$12,180** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** | **$63,170** | **$62,180** |  |
|  |  |  |  |  |

**PROBLEM 2-23B b. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Matchstix**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$75,500** | **$62,180** |  |
|  | **Accounts Receivable** | **$17,000** | **$0** |  |
|  | **Total Assets** | **$92,500** | **$62,180** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Accounts Payable** | **$7,000** | **$0** |  |
|  | **Interest Payable** | **330** | **0** |  |
|  | **Notes Payable** | **22,000** | **0** |  |
|  | **Total Liabilities** | **$29,330** | **$0** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$50,000** | **$50,000** |  |
|  | **Retained Earnings** | **$13,170** | **$12,180** |  |
|  | **Total Stockholders’ Equity** | **$63,170** | **$62,180** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$92,500** | **$62,180** |  |
|  |  |  |  |  |

**PROBLEM 2-23B b. (cont.)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Matchstix**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1 & Year 2** | | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$7,000** | **$17,000** |  |
|  | **Cash Payments for Expenses** | **(3,500)** | **(8,320)\*** |  |
|  | **Net Cash Flow from Operating Activities** | **$3,500** | **$8,680** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities** |  |  |  |
|  | **Net Cash Flow from Investing Activities** | **$0** | **$0** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Transactions from Borrowed Funds** | **$22,000** | **$(22,000)** |  |
|  | **Cash Receipts from Stock Issue** | **50,000** | **0** |  |
|  | **Net Cash Flow from Financing Activities** | **$72,000** | **$(22,000)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** | **$75,500** | **$(13,320)** |  |
|  | **Plus: Beginning Cash Balance** | **-0-** | **75,500** |  |
|  | **Ending Cash Balance** | **$75,500** | **$62,180** |  |
|  |  |  |  |  |

\*$8,320 = $7,000 + $1,320

c. Matchstix has $62,180 worth of assets to distribute in the event of liquidation at the end of Year 2. During liquidation, creditors have first rights to the assets and any remaining assets are distributed to owners. As the company has no debts, creditors would receive $0 and total amount of assets of $62,180 would be distributed to owners.

**PROBLEM 2-24B**

**a.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Tristan Company**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Revenue** |  |  |  |
|  | **Service Revenue** | **$65,000** |  |  |
|  | **Total Revenue** |  | **$65,000** |  |
|  |  |  |  |  |
|  | **Expenses** |  |  |  |
|  | **Other Operating Expenses** | **$18,000** |  |  |
|  | **Salary Expense** | **12,000** |  |  |
|  | **Interest Expense** | **5,000** |  |  |
|  | **Total Expenses** |  | **(35,000)** |  |
|  |  |  |  |  |
|  | **Net Income** |  | **$30,000** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Tristan Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$55,000** |  |  |
|  | **Plus: Stock Issued** | **10,000** |  |  |
|  | **Ending Common Stock** |  | **$65,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 10,000** |  |  |
|  | **Plus: Net Income** | **30,000** |  |  |
|  | **Less: Dividends** | **(2,000)** |  |  |
|  | **Ending Retained Earnings** |  | **38,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$103,000** |  |
|  |  |  |  |  |

**PROBLEM 2-24B a. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Tristan Company**  **Balance Sheet**  **As of December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$ 35,000** |  |  |
|  | **Accounts Receivable** | **32,000** |  |  |
|  | **Land** | **75,000** |  |  |
|  | **Total Assets** |  | **$142,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Accounts Payable** | **$12,000** |  |  |
|  | **Interest Payable** | **5,000** |  |  |
|  | **Accrued Salaries Payable** | **9,000** |  |  |
|  | **Notes Payable** | **13,000** |  |  |
|  | **Total Liabilities** |  | **$39,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$65,000** |  |  |
|  | **Retained Earnings** | **38,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **$103,000** |  |
|  |  |  |  |  |
|  | **Total Liab. and Stockholders’ Equity** |  | **$142,000** |  |
|  |  |  |  |  |

**PROBLEM 2-24B a. (cont.)**

|  |  |  |  |
| --- | --- | --- | --- |
| **Tristan Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Cash Flow From Operating Activities** | **$45,000** |  |
|  |  |  |  |
|  | **Cash Flow From Investing Activities** | **(36,000)** |  |
|  |  |  |  |
|  | **Cash Flow From Financing Activities** | **8,000** |  |
|  |  |  |  |
|  | **Net Change in Cash** | **17,000** |  |
|  | **Plus: Beginning Cash Balance** | **18,000** |  |
|  | **Ending Cash Balance** | **$35,000** |  |
|  |  |  |  |

b.

|  |  |  |  |
| --- | --- | --- | --- |
| **Tristan Company**  **Accounts Receivable Summary** | | | |
|  |  |  |  |
|  | **Beginning AR Balance** | **$13,000** | **(X)** |
|  | **Increase in AR from Sales** | **65,000** |  |
|  | **Reduction in AR from Collections** | **(46,000)** |  |
|  | **Endings Accounts Receivable Balance** | **$32,000** |  |
|  |  |  |  |

c.

|  |  |  |  |
| --- | --- | --- | --- |
| **Tristan Company**  **Accounts Payable Summary** | | | |
|  |  |  |  |
|  | **Beginning accounts payable balance** | **$17,000** | **(X)** |
|  | **Plus: Expenses incurred on account** | **18,000** |  |
|  | **Minus: Payment of accounts payable** | **(23,000)** |  |
|  | **Ending accounts payable balance** | **$12,000** |  |
|  |  |  |  |

PROBLEM 2-25B

a.

|  |  |
| --- | --- |
| Computation of Net Income | |
| Revenue recognized on account | $40,000 |
| Less accrued salary expense | (35,000) |
| Net Income | $ 5,000 |
|  |  |

b.

|  |  |
| --- | --- |
| Computation of Cash Collected from Accounts Receivable | |
| Beginning balance of Accounts Receivable | $ 2,000 |
| Add revenue recognized on account | 40,000 |
| Less ending balance of Accounts Receivable | (2,400) |
| Cash collected from accounts receivable | $39,600 |
|  |  |

|  |  |
| --- | --- |
| Computation of Cash Paid for Salaries Expense | |
| Beginning balance of Salaries Payable | $ 1,300 |
| Add accrued salary expense recognized | 35,000 |
| Less ending balance of Salaries Payable | (900) |
| Cash paid for salary expense | $35,400 |
|  |  |

|  |  |
| --- | --- |
| Cash Flow from Operating Activities |  |
|  |  |
| Cash from accounts receivable | $39,600 |
| Cash paid for salary expense | (35,400) |
| Net Cash Flow from Operating Act. | $ 4,200 |
|  |  |

c. Net income is the difference between services performed and expenses incurred, regardless of the cash collected or paid. Cash flow from operating activities is the difference between cash collected and paid for operating activities. The time gap between these two activities often causes a difference between the net income and cash flow from operating activities.

PROBLEM 2-26B

a.

Several of the principles should be mentioned in the memo.

Responsibilities Principle

As a professional, Kato should exercise professional and moral judgment in his position.

*Integrity Principle*

Kato should perform his duties with the highest sense of integrity.

Due Care Principle

Members are required be competent in their areas of responsibility and to perform professional duties to the best of his/her ability.

b. Pleading ignorance would not relieve Kato of responsibility. The due care principle requires that members of the profession be competent and provide quality services

SOLUTIONS TO ANALYZE, THINK, COMMUNICATE – CHAPTER 2

ATC 2-1 (All dollar amounts are in millions.)

**a. Target’s accrual accounts are: Accounts payable, Accrued and other current liabilities. The “Other current assets” accounts includes two accrual accounts: “Vendor income receivables” and “Income tax and other receivables.” See Note 10. As Note 14 shows, all of the individual accounts included in “Accrued and other current liabilities” are accrual accounts.**

**The “Deferred income taxes” account shown under Liabilities is probably best classified as an accrual account, but students will probably think it is a deferral account.**

**b. Net income for 2018 was $2,937**

**Cash provided by operating activities for 2018 was $5,973**

**Thus, cash flow from operating activities exceeded net income by $3,036.**

**c.** **Net income increased by $23 from 2017 to 2018 ($2,937 - $2,914). Cash provided by operating activities decreased by $962 from 2017 to 2018 ($5,973- $6,935). Therefore, the change in cash flow from operations was the greatest.**

**ATC 2-2**

|  |  |  |
| --- | --- | --- |
| **Income Statments** | **Year 1** | **Year 2** |
| **Revenue** | **$50,000** | **$40,000** |
| **Expense** | **(30,000)** | **(25,000)** |
| **Net Income** | **$(20,000)** | **$(15,000)** |

|  |  |  |
| --- | --- | --- |
| **Accounts Receivable** | **Year 1** | **Year 2** |
| **Beginning accounts receivable balance** | **$0** | **$10,000** |
| **Plus: Increases due to sales on account** | **50,000** | **40,000** |
| **Minus: Decreases due to receivables collections** | **(40,000)** | **(50,000)** |
| **Yields: Ending accounts receivable balance** | **$10,000** | **$0** |

|  |  |  |
| --- | --- | --- |
| **Operating Activities Section of Statement of Cash Flows** | **Year 1** | **Year 2** |
| **Cash collections from customers** | **$40,000** | **$50,000** |
| **Cash payments for expense** | **(25,000)** | **(30,000)** |
| **Net cash flow from operating activities** | **$15,000** | **$20,000** |

|  |  |  |
| --- | --- | --- |
| **Accounts Payable** | **Year 1** | **Year 2** |
| **Beginning accounts payable balance** | **$0** | **$5,000** |
| **Plus: Increases due to expenses incurred on account** | **30,000** | **25,000** |
| **Minus: Decreases due to payments to reduce accounts payable** | **(25,000)** | **(30,000)** |
| **Yields: Ending accounts payable balance** | **$5,000** | **$0** |

**Class Discussion**

**The discussion should focus on how accrual accounting facilitates the matching of revenues with expenses.**

**ATC 2-3**

**Dollar amounts are in thousands.**

**a.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **2017** | **2018** |  |  |
| **Revenues** | **$2,926,289** | **$3,030,445** |  |  |
| **- Expenses** | **2,724,390** | **2,782,825** |  |  |
| **Net income** | **$ 201,899** | **$ 247,620** |  |  |
|  |  |  |  |  |
| **Beg. retained earnings** | **$ 488,481** | **$ 492,836** |  |  |
| **+ Net income** | **201,899** | **247,620** |  |  |
| **- Dividends** | **197,544** | **207,649** |  |  |
| **End. Retained earnings** | **$ 492,836** | **$ 532,807** |  |  |

**b. Revenue increased by 3.6%**

**($3,030,445 - $2,926,289) ÷ $2,926,289 = 3.6%**

**Net income increased by 22.6%**

**($247,620 - $201,899) ÷ $201,899 = 22.6%**

**c. 2017: $201,899 ÷ $2,926,289 = 6.9%**

**2018: $247,620 ÷ $3,030,445 = 8.2%**

**d. Both revenues and net income increased in 2018, and net income as a percentage of revenues was also higher in 2018, thus, 2018 appears to have been a better year than 2017.**

**ATC 2-4**

**Dollar amounts in millions.**

**a. and b.**

|  |  |  |
| --- | --- | --- |
|  | **2016** | **2017** |
| **Cash from operating activities** | **$1,030** | **$1,248** |
| **Cash from investing activities** | **1,472** | **(4)** |
| **Cash from financing activities** | **(1,734)** | **(778)** |
| **Net change in cash** | **768** | **466** |
| **+ Beg. cash balance** | **831** | **365** |
| **= End. Cash balance** | **$1,599** | **$ 831** |
|  |  |  |

**c. Negative cash flow from financing activities could result from the company either paying off long-term debt, paying significant amounts of dividends, repurchasing its stock, or some combination of these. None of these are negative events. Of course students will probably not think of repurchasing stock as a reason. The real reason for Yum! was paying off debt and repurchasing stock.**

ATC 2-5

**The memo provided by students should convey knowledge of the following relationships.**

**The amount of revenue recognized on account was greater than the amount of cash collected from customers. Accordingly, the amount of revenue recognized will be higher than the amount of cash collected thereby making net income higher than net cash flow from operating activities. At the end of the period, there will be a $9,000 balance in the accounts receivable account. This balance represents the amount of cash Corola expects to collect from customers in the next accounting period.**

ATC 2-6

**a.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Income Statement** | |  | **Balance Sheet** | | | | |  |
|  |  |  |  | |  |  |  |  | |
|  | **Service Revenue** | **$120,000** |  | | **Assets:** |  | $167,000 |  | |
|  | **Operating Exp.** | **(40,000)** |  | |  |  |  |  | |
|  | **Net Income** | **$ 80,000** |  | | **Liabilities:** |  | **$ 5,000** |  | |
|  |  |  |  | | **Stockholders’ Equity:** |  |  |  | |
|  |  |  |  | | **Common Stock** |  | 82,000 |  | |
|  |  |  |  | | **Retained Earnings** |  | 80,000 |  | |
|  |  |  |  | | **Total Stk Eqty.** |  | **162,000** |  | |
|  |  |  |  | | **Total Liab. and**  **Stk. Equity** |  | $167,000 |  | |
|  |  |  |  | |  |  |  |  | |

**Computations for Income Statement Items:**

**Revenue: $38,000 + $82,000 = $120,000**

**Operating Expense: $70,000 − $30,000 = $40,000**

**Computations for Balance Sheet Items:**

**Assets: $85,000 + $82,000 = $167,000**

**Liabilities: $35,000 − $30,000 = $5,000**

**Retained Earnings: $(32,000) + $82,000 + $30,000 = $80,000**

**b. Willful deception is an act of fraud and punishable under the law. Good intentions are not sufficient justification for breaking the law. Students should learn to avoid operating under an ends justifies the means philosophy. Suppose the unexpected happens in this case. Glenn fails to obtain the contract and is forced to declare bankruptcy after having manipulated the statements. He would not only stand to lose the friend that he deceived, but also may be convicted of a felony on charges of fraudulent reporting.**

**ACT 2-6 (cont.)**

c. The auditing profession has identified three elements that are typically present when fraud occurs. They are: (1) the availability of an opportunity, (2) the existence of some form of pressure leading to an incentive, and (3) the capacity for rationalization. Glenn had the opportunity to record the questionable adjustments because he was the owner and could make whatever adjustments he deemed appropriate. Glenn’s existence of pressure is the fact that he needs the financial statements to look good in order to obtain the loan. Because Glenn was confident that the contracts would be approved, he was able to rationalize making the adjustments. All three of the factors of ethical misconduct are present in this case.

ATC 2-7

**This solution is based on Netflix’s 2018 financial report.**

**a. Netflix’s accrual accounts are:**

**Current content liabilities (though students will probably not list this account)**

**Accounts payable**

**Accrued expenses**

**b. Netflix’s net income for 2018 was $1,211,242**

c. Netflix’s retained earnings increased by $1,211,242 from 2017 to 2018. [$2,942,359 - $1,731,117