

# Chapter 1

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## The Financial Statements

### Short Exercises

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(5 min.) S 1-1

Computed amounts in boxes

	<u>Total Assets</u>	=	<u>Total Liabilities</u>	+	<u>Stockholders' Equity</u>
a.	<span style="border: 1px solid black; padding: 2px;">\$300,000</span>	=	\$150,000	+	\$150,000
b.	280,000	=	110,000	+	<span style="border: 1px solid black; padding: 2px;">170,000</span>
c.	210,000	=	<span style="border: 1px solid black; padding: 2px;">50,000</span>	+	160,000

(5 min.) S 1-2

Ethics is a factor that should be included in every business and accounting decision, beyond the potential economic and legal consequences. Ideally, for each decision, honesty and truthfulness should prevail, considering the rights of others. The decision guidelines at the end of the chapter spell out the considerations we should take when making decisions. Simply, we might ask ourselves three questions: (1) is the action legal? (2) Who will be affected by the decision? (3) How will the decision make me feel afterward?

(10 min.) S 1-3

- a. ***Corporation, Limited-liability partnership (LLP) and Limited-liability company (LLC).*** If any of these businesses fails and cannot pay its liabilities, creditors cannot force the owners to pay the business's debts from the owners' personal assets.
- b. ***Proprietorship.*** There is a single owner of the business, so the owner is answerable to no other owner.
- c. ***Partnership.*** If the partnership fails and cannot pay its liabilities, creditors can force the partners to pay the business's debts from their personal assets. A partnership affords more protection for creditors than a proprietorship because there are two or more owners to share this liability.

(5 min.) S 1-4

- 1. The ***entity assumption*** applies.
- 2. Application of the entity assumption will separate Newberry's personal assets from the assets of Healthy Food Brands. This will help Newberry, investors, and lenders know how much assets, liabilities and equity the business has, and this knowledge will help all parties evaluate the business realistically.

(5-10 min.) S 1-5

- a. **Historical cost principle**
- b. **Stable-monetary-unit assumption**
- c. **Entity assumption**
- d. **Historical cost principle**

(5 min.) S 1-6

**1. Owners' Equity = Assets – Liabilities**

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

**2. Liabilities = Assets – Owners' Equity**

(5 min.) S 1-7

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

*Owners' equity* represents the *insider claims* of a business, the owners' interest in its assets.

Assets and owners' equity *differ* in that assets are *resources* and owners' equity is a *claim to assets*. Assets must be at least as large as owners' equity, so equity can be smaller than assets.

**2. Both liabilities and owners' equity are *claims to assets*.**

Liabilities are the *outsider* claims to the assets of a business; they are obligations to pay creditors.

Owners' equity represents the *insider* claims to the assets of the business; they are the owners' interest in its assets.

(5-10 min.) S 1-8

a. Accounts payable   L  

b. Common stock   S  

c. Supplies   A  

d. Retained earnings   S  

e. Land   A  

f. Prepaid expenses   A  

g. Accounts receivable   A  

h. Long-term debt   L  

i. Merchandise inventory   A  

j. Notes payable   L  

k. Accrued expenses payable   L  

l. Equipment   A

(5 min.) S 1-9

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

(5 min.) S 1-10

**Split Second Wireless, Inc.**  
**Income Statement**  
**Year Ended December 31, 2012**

	<i>(millions)</i>
Revenues.....	\$ 97
Expenses.....	<u>26</u>
Net income.....	<u>\$ 71</u>

(5 min.) S 1-11

**CellPhone Corp.**  
**Statement of Retained Earnings**  
**Year Ended December 31, 2012**

	<i>(millions)</i>
Retained earnings, December 31, 2011.....	\$290
Add: Net income (\$360 – \$250).....	110
Less: Dividends.....	<u>(44)</u>
Retained earnings, December 31, 2012.....	<u>\$356</u>

(10 min.) S 1-12

**Landy Products  
Balance Sheet  
December 31, 2012**

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**ASSETS****Current assets:**

Cash .....	\$ 12,000
Receivables .....	8,000
Inventory .....	<u>44,000</u>
Total current assets .....	64,000

Equipment .....	<u>88,000</u>
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Total assets .....	<u><u>\$152,000</u></u>
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**LIABILITIES****Current liabilities:**

Accounts payable .....	<u>\$ 13,000</u>
Total current liabilities .....	13,000

**Long-term liabilities:**

Long-term notes payable .....	<u>80,000</u>
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Total liabilities .....	<u>93,000</u>
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**STOCKHOLDERS' EQUITY**

Common stock .....	15,300
Retained earnings .....	<u>43,700*</u>
Total stockholders' equity .....	<u>59,000</u>
Total liabilities and stockholders' equity .....	<u><u>\$152,000</u></u>

**\*Computation of retained earnings:**

Total assets (\$152,000) – current liabilities (\$13,000) – long-term notes payable (\$80,000) – common stock (\$15,300) = \$43,700

(10-15 min.) S 1-13

**Yidas Medical, Inc.**  
**Statement of Cash Flows**  
**Year Ended December 31, 2012**

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**Cash flows from operating activities:**

Net income.....	\$ 80,000
Adjustments to reconcile net income to net cash provided by operating activities.....	<u>(11,000)</u>
Net cash provided by operating activities	69,000

**Cash flows from investing activities:**

Purchases of equipment.....	<u>\$(32,000)</u>
Net cash used for investing activities ....	(32,000)

**Cash flows from financing activities:**

Payment of dividends.....	<u>\$(25,000)</u>
Net cash used for financing activities.....	<u>(25,000)</u>
Net increase in cash.....	12,000
Cash balance, December 31, 2011.....	<u>30,000</u>
Cash balance, December 31, 2012.....	<u><u>\$ 42,000</u></u>

(10 min.) S 1-14

- a. Dividends SRE, SCF
- b. Salary expense IS
- c. Inventory BS
- d. Sales revenue IS
- e. Retained earnings SRE, BS
- f. Net cash provided by operating activities SCF
- g. Net income IS, SRE, SCF
- h. Cash BS, SCF
- i. Net cash used for financing activities SCF
- j. Accounts payable BS
- k. Common stock BS
- l. Interest revenue IS
- m. Long-term debt BS
- n. Increase or decrease in cash SCF

(15-20 min.) S 1-15

- a. *Paying large dividends* will cause retained earnings to be low.
- b. Heavy *investing activity* and *paying off debts* can result in a cash shortage even if net income has been high.
- c. The single best source of cash for a business is collections from customers. This source of cash is best because it results from the core operations of the business.
- d. Borrowing, issuing stock, and selling land, buildings, and equipment can bring in cash even when the company has experienced losses. Reducing accounts receivable and inventory can also increase cash flow.

**Exercises**

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

*Amounts in billions; (computed amounts in boxes)*

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owners' Equity</u>
Perfect Cleaners	<span style="border: 1px solid black;">\$33</span>		\$ 15		\$18
Ernie's Bank	35		<span style="border: 1px solid black;">13</span>		22
Hudson Gift and Cards	27		17		<span style="border: 1px solid black;">10</span>

Ernie's Bank appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ( $\$13/\$35 = .37$ ). Stated differently, Ernie's Bank's equity is the highest percentage of company assets ( $\$22/\$35 = .63$ ).

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

**Req. 1***(Amounts in millions)*

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
	\$280		\$170		
	430		300		
	170				
<b>Total</b>	<u>\$880</u>	=	<u>\$470</u>	+	\$410

**Req. 2** Resources to work with**Req. 3** Amount owed to creditors**Req. 4** Actually owned by company stockholders



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

	Situation		
	1	2	3
	<i>Millions</i>		
<b>Total stockholders' equity,</b>			
January 31, 2012 (\$28 – \$5).....	\$23	\$23	\$23
<b>Add: Issuances of stock.....</b>	<b>1</b>	<b>-0-</b>	<b>33</b>
Net income.....	7	12*	-0-
<b>Less: Dividends.....</b>	<b>-0-</b>	<b>(4)</b>	<b>(8)</b>
Net loss.....	-0-*	-0-	(17)*
<b>Total stockholders' equity,</b>			
January 31, 2013 (\$48 – \$17).....	\$31	\$31	\$31

\*Must solve for these amounts.

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

## 1. Diamond, Inc.

	Assets	=	Liabilities	+	Stockholders' Equity
Beginning amount	\$130,000	=	\$95,000	+	\$35,000
Multiplier for increase	<u>× 1.05</u>				
Ending amount	<u>\$136,500</u>				

## 2. NorthWest Airlines, Ltd.

	Assets	–	Liabilities	=	Stockholders' Equity
Beginning amount	\$100,000	–	\$52,000	=	\$48,000
Net income					<u>27,000</u>
Ending amount					<u>\$75,000</u>

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

- a. **Balance sheet**
- b. **Balance sheet**
- c. **Statement of retained earnings, Statement of cash flows**
- d. **Income statement**
- e. **Balance sheet, Statement of retained earnings**
- f. **Balance sheet**
- g. **Balance sheet**
- h. **Income statement**
- i. **Statement of cash flows**
- j. **Income statement**
- k. **Statement of cash flows**
- l. **Balance sheet, Statement of cash flows**
- m. **Balance sheet**
- n. **Income statement, Statement of retained earnings, Statement of cash flows**

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

**Mary Burke Banking Company**  
**Balance Sheet (*Amounts in millions*)**  
**August 31, 2012**

<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$ 2.8	Current liabilities	\$155.4
Receivables	0.3	Long-term liabilities	<u>2.6</u>
Investment assets	169.3	Total liabilities	158.0
Property and equipment, net	1.6	<b>STOCKHOLDERS'</b>	
Other assets	14.2	<b>EQUITY</b>	
		Common stock	14.2
		Retained earnings	<u>16.0*</u>
		Total stockholders' equity	30.2
		Total liabilities and	
Total assets	<u>\$188.2</u>	stockholders' equity	<u>\$188.2</u>

**\*Computation of retained earnings:**

Total assets (\$188.2) – Total liabilities (\$158.0) – Common stock (\$14.2) = \$16.0

(15-25 min.) E 1-22A

**Req. 1**

**Mary Burke Banking Company**  
**Income Statement (*Amounts in millions*)**  
**Year Ended August 31, 2012**

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Total revenue.....		<b>\$31.4</b>
Expenses:		
Salary and other employee expenses.....	\$ 17.4	
Other expenses.....	6.6	
Interest expense.....	<u>0.1</u>	
Total expenses.....		<u><b>24.1</b></u>
Net income.....		<u><b>\$ 7.3</b></u>

**Req. 2**

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

**Mary Burke Banking Company**  
**Statement of Retained Earnings**  
**Year Ended August 3, 2012**

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**(*Amounts in millions*)**

Retained earnings, beginning of year.....	<b>\$9.3</b>
Add: Net income for the year ( <i>Req. 1</i> ).....	<u><b>7.3</b></u>
	<b>16.6</b>
Less: Dividends.....	<u><b>0.6</b></u>
Retained earnings, end of year (from Exercise 1-21A)....	<u><b>\$16.0</b></u>

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

**Glass, Inc.**  
**Statement of Cash Flows**  
**Year Ended December 31, 2012**

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**Cash flows from operating activities:**

Net income.....	<b>\$430,000</b>
Adjustments to reconcile net income to net cash provided by operating activities.....	<b><u>75,000</u></b>
Net cash provided by operating activities.....	<b>\$505,000</b>

**Cash flows from investing activities:**

Net cash used for investing activities.....	<b>(420,000)</b>
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**Cash flows from financing activities:**

Net cash provided by financing activities.....	<b><u>11,000</u></b>
Net increase in cash.....	<b>96,000</b>
Beginning cash balance.....	<b><u>83,000</u></b>
Ending cash balance.....	<b><u>\$179,000</u></b>

**Items given that do not appear on the statement of cash flows:**

- Total assets      – Balance sheet
- Total liabilities – Balance sheet

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

**Dogan Copy Center, Inc.**  
**Income Statement**  
**For the Month Ended July 31, 2012**

**Revenue:**

Service revenue.....	\$540,200
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**Expenses:**

Salary expense.....	\$160,000
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Utilities expense.....	10,500
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Rent expense.....	<u>2,700</u>
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Total expenses.....	<u>173,200</u>
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Net income.....	<u><u>\$ 367,000</u></u>
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**Dogan Copy Center, Inc.**  
**Statement of Retained Earnings**  
**For the Month Ended July 31, 2012**

Retained earnings, July 1, 2012.....	\$ -0-
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Add: Net income .....	<u>367,000</u>
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	367,000
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Less: Dividends.....	<u>(4,700)</u>
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Retained earnings, July 31, 2012.....	<u><u>\$362,300</u></u>
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(15-20 min.) E 1-25A

**Dogan Copy Center, Inc.**  
**Balance Sheet**  
**July 31, 2012**

<b>Assets</b>		<b>Liabilities</b>	
Cash.....	\$ 10,300	Accounts payable.....	\$ 17,400
Office supplies...	14,700		
Equipment.....	460,000	<b>Stockholders' Equity</b>	
		Common stock.....	105,300
		Retained earnings.....	<u>362,300</u>
		Total stockholders' equity....	467,600
		Total liabilities and	
Total assets.....	<u>\$485,000</u>	stockholders' equity.....	<u>\$485,000</u>

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

**Dogan Copy Center, Inc.**  
**Statement of Cash Flows**  
**For the Month Ended July 31, 2012**

<b>Cash flows from operating activities:</b>		
Net income.....		\$ 367,000
Adjustments to reconcile net income to net cash provided by operations.....		<u>2,700</u>
Net cash provided by operating activities		369,700
<b>Cash flows from investing activities:</b>		
Acquisition of equipment .....	\$(460,000)	
Net cash used for investing activities .....		(460,000)
<b>Cash flows from financing activities:</b>		
Issuance (sale) of stock to owners.....	\$ 105,300	
Payment of dividends.....	<u>(4,700)</u>	
Net cash provided by financing activities		<u>100,600</u>
Net increase in cash.....		10,300
Cash balance, July 1, 2012.....		<u>0</u>
→ Cash balance, July 31, 2012.....		<u><u>\$ 10,300</u></u>



(10-15 min.) E 1-27A

**TO:** Owner of Dogan Copy Center, Inc.  
**FROM:** Student Name  
**SUBJECT:** Opinion of net income, dividends, financial position, and cash flows

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Your first month of operations was successful. Revenues totaled \$540,200 and net income was \$367,000. These operating results look very strong.

The company was able to pay a \$4,700 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of \$485,000 and liabilities of only \$17,400. Your stockholders' equity is \$467,600.

Operating activities generated cash of \$369,700, which is respectable. You ended the month with cash of \$10,300. Based on the above facts, I believe you should stay in business.

Student responses may vary.

(10-15 min.) E 1-28B

*Amounts in billions; (computed amounts in boxes)*

	<b>Assets</b>	<b>=</b>	<b>Liabilities</b>	<b>+</b>	<b>Owners' Equity</b>
Fresh Produce	\$37		\$ 20		\$17
Margie's Bank	30		\$18		12
Flowers and Gifts	21		6		\$15

Flowers and Gifts appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ( $\$6/\$21 = .29$ ). Stated differently, Flowers and Gifts' equity is the highest percentage of company assets ( $\$15/\$21 = .71$ ).

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

**Req. 1***(Amounts in millions)*

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
	\$270		\$160		
	400		340		
	<u>160</u>				
<b>Total</b>	<b>\$830</b>	<b>=</b>	<b>\$500</b>	<b>+</b>	<b>\$330</b>

**Req. 2** Resources to work with**Req. 3** Amount owed to creditors**Req. 4** Actually owned by company stockholders

10-20 min.) E 1-30B

	<u>Situation</u>		
	<u>1</u>	<u>2</u>	<u>3</u>
	<i>Millions</i>		
<b>Total stockholders' equity,</b>			
January 31, 2012 (\$31 – \$7).....	\$24	\$24	\$24
<b>Add: Issuances of stock.....</b>	<b>4</b>	<b>-0-</b>	<b>10</b>
Net income.....	0	3*	39
<b>Less: Dividends.....</b>	<b>-0-</b>	<b>(4)</b>	<b>(50)</b>
Net loss.....	(5)*	-0-	-0*
<b>Total stockholders' equity,</b>			
January 31, 2013 (\$35 – \$12).....	\$23	\$23	\$23

\*Must solve for these amounts.

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

## 1. Emerald, Inc.

	<b>Assets</b>	<b>=</b>	<b>Liabilities</b>	<b>+</b>	<b>Stockholders' Equity</b>
Beginning amount	\$160,000	=	\$80,000	+	\$80,000
Multiplier for increase	<u>× 1.25</u>				
Ending amount	<u>\$200,000</u>				

## 2. JetWest Airlines, Ltd.

	<b>Assets</b>	<b>-</b>	<b>Liabilities</b>	<b>=</b>	<b>Stockholders' Equity</b>
Beginning amount	\$130,000	-	\$37,000	=	\$93,000
Net income					<u>28,000</u>
Ending amount					<u>\$121,000</u>

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

- a. Income statement
- b. Income statement, Statement of retained earnings, Statement of cash flows
- c. Balance sheet
- d. Balance sheet
- e. Balance sheet
- f. Balance sheet, Statement of retained earnings
- g. Income statement
- h. Balance sheet, Statement of cash flows
- i. Statement of retained earnings, Statement of cash flows
- j. Balance sheet
- k. Balance sheet
- l. Income statement
- m. Statement of cash flows
- n. Statement of cash flows

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

**Jill Carlson Banking Company**  
**Balance Sheet (*Amounts in millions*)**  
**May 31, 2012**

<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$ 2.3	Current liabilities	\$152.6
Receivables	0.8	Long-term liabilities	<u>2.7</u>
Investment assets	169.5	Total liabilities	155.3
Property and equipment, net	1.2	<b>STOCKHOLDERS' EQUITY</b>	
Other assets	14.6	Common stock	14.8
		Retained earnings	<u>18.3*</u>
		Total stockholders' equity	33.1
		Total liabilities and stockholders' equity	<u>188.4</u>
Total assets	<u>\$188.4</u>		

**\*Computation of retained earnings:**

**Total assets (\$188.4) – Total liabilities (\$155.3) – Common stock (\$14.8) = \$18.3**

(15-25 min.) E 1-34B

**Req. 1**

**Jill Carlson Banking Company**  
**Income Statement (*Amounts in millions*)**  
**Year Ended May 31, 2012**

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Total revenue.....	<b>\$34.7</b>
Expenses:	
Salary and other employee expenses .....	<b>\$ 17.3</b>
Other expenses .....	<b>6.6</b>
Interest expense .....	<b><u>0.7</u></b>
Total expenses .....	<b><u>24.6</u></b>
Net income.....	<b><u>\$ 10.1</u></b>

**Req. 2**

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

**Jill Carlson Banking Company**  
**Statement of Retained Earnings (*Amounts in millions*)**  
**Year Ended May 31, 2012**

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Retained earnings, beginning of year.....	<b>\$ 8.7</b>
Add: Net income for the year (Req. 1).....	<b><u>10.1</u></b>
	<b>18.8</b>
Less: Dividends .....	<b><u>0.5</u></b>
Retained earnings, end of year (from Exercise 1-33B).....	<b><u>\$18.3</u></b>

(15-20 min.) E 1-35B

**Groovy, Inc.**  
**Statement of Cash Flows**  
**Year Ended December 31, 2012**

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**Cash flows from operating activities:**

Net income.....	\$360,000
Adjustments to reconcile net income to net cash provided by operating activities .....	<u>60,000</u>
Net cash provided by operating activities.....	\$420,000

**Cash flows from investing activities:**

Net cash used for investing activities.....	(410,000)
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**Cash flows from financing activities:**

Net cash provided by financing activities .....	<u>5,000</u>
Net increase in cash.....	15,000
Beginning cash balance .....	<u>95,000</u>
Ending cash balance.....	<u><u>\$110,000</u></u>

**Items given that do not appear on the statement of cash flows:**

- Total assets      – Balance sheet
- Total liabilities – Balance sheet

(15-20 min.) E 1-36B

**Croyden Copy Center  
Income Statement  
For the Month Ended July 31, 2013**

**Revenue:**

Service revenue.....	\$544,600
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**Expenses:**

Salary expense.....	\$157,000	
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Utilities expense.....	10,500	
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Rent expense.....	<u>2,500</u>	
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Total expenses.....	<u>170,000</u>	
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Net income.....	<u>\$ 374,600</u>	
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**Croyden Copy Center  
Statement of Retained Earnings  
For the Month Ended July 31, 2013**

Retained earnings, July 1, 2013.....	\$ -0-
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Add: Net income for the month .....	<u>374,600</u>
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	374,600
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Less: Dividends .....	<u>(4,800)</u>
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Retained earnings, July 31, 2013 .....	<u>\$369,800</u>
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(15-20 min.) E 1-37B

**Croyden Copy Center  
Balance Sheet  
July 31, 2013**

Assets		Liabilities	
Cash.....	\$ 11,100	Accounts payable.....	\$ 17,300
Office supplies.....	14,800		
Equipment.....	410,000	Stockholders' Equity	
		Common stock.....	48,800
		Retained earnings.....	<u>369,800</u>
		Total stockholders' equity	418,600
		Total liabilities and	
Total assets.....	<u>\$435,900</u>	stockholders' equity.....	<u>\$435,900</u>

15-20 min.) E 1-38B

**Croyden Copy Center  
Statement of Cash Flows  
For the Month Ended July 31, 2013**

**Cash flows from operating activities:**

Net income .....	\$ 374,600
Adjustments to reconcile net income to net cash provided by operations .....	<u>2,500</u>
Net cash provided by operating activities...	377,100

**Cash flows from investing activities:**

Acquisition of equipment.....	<u>\$(410,000)</u>
Net cash used for investing activities.....	(410,000)

**Cash flows from financing activities:**

Issuance (sale) of stock to owners.....	\$ 48,800
Payment of dividends.....	<u>(4,800)</u>
Net cash provided by financing activities...	<u>44,000</u>

Net increase in cash .....	\$ 11,100
Cash balance, July 1, 2013.....	<u>0</u>
Cash balance, July 31, 2013.....	<u>\$ 11,100</u>



(10-15 min.) E 1-39B

**TO:** Owner of CROYDEN Copy Center, Inc.

**FROM:** Student Name

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

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Your first month of operations was successful. Revenues totaled \$544,600 and net income was \$374,600. These operating results look very strong.

The company was able to pay a \$4,800 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of \$435,900 and liabilities of only \$17,300. Your stockholders' equity is \$418,600.

Operating activities generated cash of \$377,100, which is respectable. You ended the month with cash of \$11,100. Based on the above facts, I believe you should stay in business.

Student responses may vary.

## Quiz

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Q1-40 c

Q1-41 c

Q1-42 c

Q1-43 b

	<b>Assets =</b>	<b>Liabilities</b>	<b>+</b>	<b>Stockholders' Equity</b>
	<b>+ \$28,000 =</b>	<b>+ \$9,000</b>	<b>+</b>	<b>+ \$19,000</b>

Q1-44 d

Q1-45 d

Q1-46 a

Q1-47 a

Q1-48 a

Q1-49 a  $[\$55,000 - \$58,000 - \$21,000 - \$6,000 = \$(30,000)]$ Q1-50 d  $(\$200,000 + \$105,000 - \$45,000 = \$260,000)$ 

Q1-51 d

Q1-52 b

Q1-53 d

	<b>Assets</b>	<b>=</b>	<b>Liabilities</b>	<b>+</b>	<b>Stockholders' Equity</b>
<b>Beg.</b>	<b>\$25,000</b>	<b>=</b>	<b>\$ 4,000*</b>	<b>+</b>	<b>\$21,000</b>
<b>Changes</b>			<b>+ 12,000</b>		
<b>End.</b>	<b>\$39,000*</b>	<b>=</b>	<b>\$16,000*</b>	<b>+</b>	<b>\$23,000</b>

\*Must solve for these amounts.

Q1-54 a

	<b>Assets</b>	<b>-</b>	<b>Liabilities</b>	<b>=</b>	<b>Stockholders' equity</b>
<b>Beg. bal.</b>	<b>\$530,000</b>	<b>-</b>	<b>\$24,000</b>	<b>=</b>	<b>\$506,000</b>
<b>+ Net income</b>					<b>+ X</b>
<b>- Dividends</b>					<b>- 80,000</b>
<b>End. bal.</b>	<b>\$750,000</b>	<b>-</b>	<b>\$33,000</b>	<b>=</b>	<b>\$717,000</b>

**Problems**

(15-30 min.) P 1-55A

**Req. 1**

**A Division of Harrold Corporation**  
**Income Statement**  
**Year Ended December 31, 2013**

<b>Revenue:</b>		
Service revenue .....	<b>\$250,000</b>	
Other revenue .....	<u><b>57,000</b></u>	
Total revenue .....		<b>\$307,000</b>
<b>Expenses:</b>		
Salary expense .....	<b>\$ 29,000</b>	
Other expenses .....	<u><b>242,000</b></u>	
Total operating expenses .....		<u><b>271,000</b></u>
Income before income tax .....		<b>36,000</b>
Income tax expense (\$36,000 × .34) .....		<u><b>12,240</b></u>
Net income .....		<u><u><b>\$ 23,760</b></u></u>

**Req. 2**

- a. Faithful representation. Report revenues at their actual sale value because that amount represents more faithfully what actually happened than what management believes the services are worth.
- b. Historical cost principle. Account for expenses at their actual cost, not a hypothetical amount that the company might have incurred under other conditions.
- c. Historical cost principle. Account for expenses at their actual cost.

**(continued) P 1-55A**

- d. Entity assumption. Each subdivision of the company is a separate entity, and the company as a whole constitutes an entity for accounting purposes.**
- e. Stable-monetary-unit assumption. Accounting in the United States ignores the effect of inflation.**
- f. Continuity (going-concern) assumption. There is no evidence that A Division of Harrold Corporation is going out of business, so it seems safe to assume that the division is a going concern.**

(30 min.) P 1-56A

**Req. 1**

Computed amounts in boxes

	Ruby	Lars	Barb
	Millions		
Balance sheets:			
Beginning:			
Assets.....	\$ 78	\$ 40	\$ 14
Liabilities.....	45	14	1
Common stock.....	4	3	6
Retained earnings.....	29	23	7
Ending:			
Assets.....	\$ 84	\$ 59	\$ 17
Liabilities.....	47	26	2
Common stock.....	4	3	6
Retained earnings.....	33	30	9
Income statement:			
Revenues.....	\$220	\$170	\$21
Expenses.....	214	160	18
Net income.....	\$ 6	\$ 10	3
Statement of retained earnings:			
Beginning RE.....	\$ 29	\$ 23	\$ 7
+ Net income.....	6	10	3
- Dividends.....	(2)	(3)	(1)
= Ending RE.....	\$ 33	\$ 30	\$ 9

(continued) P 1-56A

**Req. 2**

	<b>Ruby</b>	<b>Lars</b>	<b>Barb</b>
		<i>Millions</i>	
<b>Net income.....</b>	<b>\$6</b>	<b>\$10</b> <i>Highest</i>	<b>\$3</b>
<b>% of net income to revenues.....</b>	$\frac{\$6}{\$220} = 2.7\%$	$\frac{\$10}{\$170} = 5.9\%$	$\frac{\$3}{\$21} = 14.3\%$ <i>Highest</i>

(20-25 min.) P 1-57A

**Req. 1**

**Image Maker, Inc.  
Balance Sheet  
March 31, 2012**

<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$ 10,500	Accounts payable	\$ 4,500
Accounts receivable	2,400	Note payable	<u>53,000</u>
Notes receivable	16,000	Total liabilities	57,500
Office supplies	600	<b>STOCKHOLDERS'</b>	
Equipment	35,000	<b>EQUITY</b>	
Land	83,000	Stockholders' equity	90,000*
		Total liabilities and	
Total assets	<u>\$147,500</u>	stockholders' equity	<u>\$147,500</u>

\*Total assets (\$147,500) – Total liabilities (\$57,500) = Stockholders' equity (\$90,000).

**Req. 2**

Image Maker, Inc. is in *better* financial position than the erroneous balance sheet reports. Liabilities are \$16,600 less than originally reported, and assets and equity are greater than reported originally.

**Req. 3**

The following accounts are not reported on the balance sheet because they are expenses. Expenses are reported on the *income statement*.

Utilities expense  
Advertising expense  
Salary expense  
Interest expense

(20-25 min.) P 1-58A

**Req. 1**

**Carla Hilton, Realtor, Inc.  
Balance Sheet  
December 31, 2013**

<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$ 66,000	Accounts payable	\$ 32,000
Office supplies	7,000	Note payable	<u>45,000</u>
Furniture	45,000	Total liabilities	77,000
Land	118,000	<b>STOCKHOLDERS'</b>	
Franchise	21,000	<b>EQUITY</b>	
		Common stock	55,000
		Retained earnings	<u>125,000*</u>
		Total stockholders' equity	<u>180,000</u>
Total assets	<u>\$257,000</u>	Total liabilities and stockholders' equity	<u>\$257,000</u>

\*Total assets (\$257,000) – Total liabilities (\$77,000) – Common stock (\$55,000) = Retained earnings (\$125,000).

**Req. 2**

It appears that Carla Hilton's business can pay its debts. Total assets far exceed total liabilities.

**Req. 3**

Personal items not reported on the *balance sheet* of the business:

- a. Personal cash (\$16,000)
- b. Personal account payable (\$6,000)
- g. Personal residence (\$400,000) and personal mortgage (\$100,000)



(30-45 min.) P 1-59A

**Req. 1**

**Post Oak, Inc.**  
**Income Statement**  
**Year Ended December 31, 2012**

---

<b>Revenue:</b>	
Service revenue .....	<b>\$147,000</b>
<b>Expenses:</b>	
Salary expense.....	<b>\$30,000</b>
Rent expense.....	<b>11,000</b>
Interest expense.....	<b>5,100</b>
Utilities expense.....	<b>3,700</b>
Property tax expense .....	<u><b>2,100</b></u>
Total expenses .....	<u><b>51,900</b></u>
Net income .....	<u><u><b>\$ 95,100</b></u></u>

**Req. 2**

**Post Oak, Inc.**  
**Statement of Retained Earnings**  
**Year Ended December 31, 2012**

---

Retained earnings, December 31, 2011 .....	<b>\$114,000</b>
Add: Net income.....	<u><b>95,100</b></u>
	<b>209,100</b>
Less: Dividends.....	<u><b>(37,000)</b></u>
Retained earnings, December 31, 2012 .....	<u><u><b>\$172,100</b></u></u>

(continued) P 1-59A

**Req. 3**

**Post Oak, Inc.  
Balance Sheet  
December 31, 2012**

<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$ 20,000	Accounts payable	\$ 8,000
Accounts receivable	30,000	Interest payable	1,200
Supplies	2,300	Note payable	<u>34,000</u>
Equipment	36,000	Total liabilities	43,200
Building	123,000	<b>STOCKHOLDERS'</b>	
Land	9,000	<b>EQUITY</b>	
		Common stock	5,000
		Retained earnings	<u>172,100</u>
		Total stockholders' equity	177,100
		Total liabilities and	
Total assets	<u>\$220,300</u>	stockholders' equity	<u>\$220,300</u>

**Req. 4**

- a. Post Oak was profitable; net income was \$95,100.
- b. Retained earnings increased by \$58,100 — from \$114,000 to \$172,100.
- c. Total equity (\$177,100) exceeds total liabilities (\$43,200).

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

(20 min.) P 1-60A

**Req. 1**

**The Big Wave Company  
Statement of Cash Flows  
Year Ended May 31, 2013**

	<i>Millions</i>
<b>Cash flows from operating activities:</b>	
Net income .....	\$ 3,040
Adjustments to reconcile net income to cash provided by operations .....	<u>2,350</u>
Net cash provided by operating activities .....	5,390
 <b>Cash flows from investing activities:</b>	
Purchases of property, plant, and equipment .....	\$(3,505)
Sales of property, plant, and equipment .....	65
Other investing cash payments .....	<u>(155)</u>
Net cash used for investing activities .....	(3,595)
 <b>Cash flows from financing activities:</b>	
Issuance of common stock .....	\$ 180
Payment of dividends .....	<u>(290)</u>
Net cash used for financing activities .....	<u>(110)</u>
 Net increase in cash .....	1,685
Cash, beginning .....	<u>230</u>
Cash, ending .....	<u><u>\$ 1,915</u></u>

**Req. 2**

Operating activities provided the bulk of The Big Wave Company's cash. This is a sign of strength because operations should be the main source of cash.

(40-50 min.) P 1-61A

(Thousands)

**INCOME STATEMENT**

		2012	2011	
Revenues	13,890 =	\$ k	\$15,500	
Cost of goods sold		(11,070)	a	= (12,510)
Other expenses		<u>(1,230)</u>	<u>(1,180)</u>	
Income before income taxes		1,590	1,810	
Income taxes (35% tax rate)	557 =	<u>l</u>	<u>634</u>	
Net income	1,033 =	<u>\$ m</u>	<u>\$ b</u>	= 1,176

**STATEMENT OF RETAINED EARNINGS**

Beginning balance	3,796 =	\$ n	\$ 2,690	
Net income	1,033 =	o	c	= 1,176
Dividends		<u>(96)</u>	<u>(70)</u>	
Ending balance	4,733 =	<u>\$ p</u>	<u>\$ d</u>	= 3,796

**BALANCE SHEET****Assets:**

Cash	1,040 =	\$ q	\$ e	= 1,120
Property, plant and equipment		1,500	1,750	
Other assets	11,808 =	<u>r</u>	<u>10,381</u>	
Total assets	14,348 =	<u>\$ s</u>	<u>\$13,251</u>	

**Liabilities:**

Current liabilities	4,710 =	\$ t	\$ 5,640	
Notes payable and long-term debt		4,400	3,370	
Other liabilities		<u>90</u>	<u>110</u>	
Total liabilities		9,200	f	= 9,120

**Stockholders' Equity:**

Common stock		\$ 225	\$ 225	
Retained earnings	4,733 =	u	g	= 3,796
Other stockholders' equity		<u>190</u>	<u>110</u>	
Total stockholders' equity	5,148 =	<u>v</u>	<u>4,131</u>	
Total liabilities and stockholders' equity	14,348 =	<u>\$ w</u>	<u>\$ h</u>	= 13,251

**STATEMENT OF CASH FLOWS**

Net cash provided by operating activities	720 =	\$ x	\$ 850	
Net cash used for investing activities		(240)	(450)	
Net cash used for financing activities		<u>(560)</u>	<u>(550)</u>	
Increase (decrease) in cash		( 80)	i	= (150)
Cash at beginning of year	1,120 =	<u>y</u>	<u>1,270</u>	
Cash at end of year	1,040 =	<u>\$ z</u>	<u>\$ j</u>	= 1,120

(15-20 min.) P 1-62B

**Req. 1**

**Truett Corporation**  
**Income Statement**  
**Year Ended December 31, 2013**

**Revenue:**

Sales revenue.....	\$ 260,000	
Other revenue.....	<u>51,000</u>	
Total revenue.....		\$ 311,000

**Expenses:**

Salary expense.....	\$ 28,000	
Other expenses.....	<u>249,000</u>	
Total expenses.....		<u>277,000</u>
Income before income tax.....		34,000
Income tax expense (\$34,000 × .40)....		<u>13,600</u>
Net income.....		<u>\$ 20,400</u>

**Req. 2**

- a. Faithful representation. Report revenues at their actual sale value because that represents more faithfully what happened than what management believes the goods are worth.
- b. Historical cost principle. Account for expenses at their actual cost, not a hypothetical amount that the company might have incurred if the products were purchased outside.

(continued) P 1-62B

- c. Historical cost principle. Account for expenses at their actual cost.**
- d. Entity assumption. Each division of the company is a separate entity, and the company as a whole constitutes an entity for accounting purposes.**
- e. Stable-monetary-unit assumption. Accounting in the United States ignores the effect of inflation.**
- f. Continuity (going-concern) assumption. There is no evidence that A Division of Truett Corporation is going out of business, so it seems safe to assume that the company is a going concern.**

(30 min.) P 1-63B

**Req. 1**

Computed amounts in boxes.

	Topaz	Loiselle	Berger
	<i>Millions</i>		
<b>BALANCE SHEET</b>			
<i>Beginning:</i>			
Assets.....	\$84	\$ 45	\$ <span style="border: 1px solid black;">10</span>
Liabilities.....	48	21	3
Common stock.....	6	5	4
Retained earnings.....	<span style="border: 1px solid black;">30</span>	19	3
<i>Ending:</i>			
Assets.....	<span style="border: 1px solid black;">\$88</span>	\$ 65	\$ 11
Liabilities.....	50	32	<span style="border: 1px solid black;">4</span>
Common stock.....	6	<span style="border: 1px solid black;">5</span>	4
Retained earnings.....	32	<span style="border: 1px solid black;">28</span>	<span style="border: 1px solid black;">3</span>
<b>INCOME STATEMENT</b>			
Revenues.....	\$223	\$ <span style="border: 1px solid black;">167</span>	\$ 27
Expenses.....	<u>216</u>	<u>156</u>	<span style="border: 1px solid black;">25</span>
Net income.....	<u><span style="border: 1px solid black;">\$ 7</span></u>	<u><span style="border: 1px solid black;">\$ 11</span></u>	<u><span style="border: 1px solid black;">2</span></u>
<b>STATEMENT OF RETAINED EARNINGS</b>			
Beginning RE.....	\$ 30	\$ 19	\$ 3
+ Net income.....	<span style="border: 1px solid black;">7</span>	11	2
- Dividends.....	<u>(5)</u>	<u>(2)</u>	<span style="border: 1px solid black;">(2)</span>
= Ending RE.....	<u><span style="border: 1px solid black;">\$32</span></u>	<u><span style="border: 1px solid black;">\$ 28</span></u>	<u><span style="border: 1px solid black;">\$ 3</span></u>

**Req. 2**

	Topaz	Loiselle	Berger
	<i>Millions</i>		
Net income.....	\$7	\$11 <i>Highest</i>	\$2
% of net income to revenues.....	$\frac{\$7}{\$223} = 3.1\%$	$\frac{\$11}{\$167} = 6.6\%$	$\frac{\$2}{\$27} = 7.4\%$ <i>Highest</i>

(20-25 min.) P 1-64B

**Req. 1**

**Salem News, Inc.  
Balance Sheet  
April 30, 2012**

<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$11,000	Accounts payable	\$ 4,000
Accounts receivable	2,600	Note payable	<u>55,500</u>
Notes receivable	15,200	Total liabilities	59,500
Office supplies	800	<b>STOCKHOLDERS'</b>	
Equipment	35,600	<b>EQUITY</b>	
Land	84,000	Stockholders' equity	89,700*
		Total liabilities and	
Total assets	<u>\$149,200</u>	stockholders' equity	<u>\$149,200</u>

\*Total assets (\$149,200) – Total liabilities (\$59,500) = Stockholders' equity (\$89,700).

**Req. 2**

Salem News, Inc. is in *better* financial position than the erroneous balance sheet reports. Assets are \$9,500 higher than originally reported, but liabilities are somewhat lower, and owners' equity is higher than reported originally. Overall, Salem News has less debt and more equity than first reported.

**Req. 3**

The following accounts are not reported on the balance sheet because they are expenses. These accounts are reported on the *income statement*.

Advertising expense  
Utilities expense  
Salary expense  
Interest expense



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

**Req. 1**

**Reva Hamlet, Realtor, Inc.**  
**Balance Sheet**  
**September 30, 2013**

<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$ 71,000	Accounts payable	\$ 37,000
Office supplies	5,000	Note payable	<u>41,000</u>
Furniture	50,000	Total liabilities	78,000
Land	112,000	<b>STOCKHOLDERS'</b>	
Franchise	26,000	<b>EQUITY</b>	
		Common stock	90,000
		Retained earnings	<u>96,000*</u>
		Total stockholders' equity	186,000
		Total liabilities and	
Total assets	<u>\$264,000</u>	stockholders' equity	<u>\$264,000</u>

\*Total assets (\$264,000) – Total liabilities (\$78,000) – Common stock (\$90,000) = Retained earnings (\$96,000).

**Req. 2**

It appears that the business can pay its debts. Total assets far exceed total liabilities.

**Req. 3**

Personal items not reported on the *balance sheet* of the business:

- a. Personal cash (\$20,000)
- b. Personal account payable (\$9,000)
- g. Personal residence (\$380,000) and mortgage payable (\$120,000)

(30-45 min.) P 1-66B

**Req. 1**

**Post Fir Inc.**  
**Income Statement**  
**Year Ended December 31, 2012**

<b>Revenue</b>		
Service revenue .....		<b>\$143,000</b>
<b>Expenses</b>		
Salary expense.....	<b>\$34,000</b>	
Rent expense .....	<b>13,000</b>	
Interest expense .....	<b>4,650</b>	
Utilities expense .....	<b>2,700</b>	
Property tax expense .....	<b><u>2,400</u></b>	
Total expenses.....		<b><u>56,750</u></b>
Net income .....		<b><u>\$ 86,250</u></b>

**Req. 2**

**Post Fir Inc.**  
**Statement of Retained Earnings**  
**Year Ended December 31, 2012**

Retained earnings, December 31, 2011 .....	<b>\$ 114,000</b>
Add: Net income .....	<b><u>86,250</u></b>
	<b>200,250</b>
Less: Dividends.....	<b><u>(36,000)</u></b>
Retained earnings, December 31, 2012.....	<b><u>\$ 164,250</u></b>

(continued) P 1-66B

**Req. 3**

<b>Post Fir Inc.</b> <b>Balance Sheet</b> <b>December 31, 2012</b>			
<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$ 14,000	Accounts payable	\$ 9,000
Accounts receivable	26,500	Note payable	31,000
Supplies	1,900	Interest payable	<u>1,000</u>
Equipment	35,000	Total liabilities	41,000
Building	125,000	<b>STOCKHOLDERS'</b>	
Land	8,200	<b>EQUITY</b>	
		Common stock	5,350
		Retained earnings	<u>164,250</u>
		Total stockholders' equity	169,600
		Total liabilities and	
Total assets	<u>\$210,600</u>	stockholders' equity	<u>\$210,600</u>

**Req. 4**

- Post Fir was profitable; net income was \$86,250.
- Retained earnings increased by \$50,250 — from \$114,000 to \$164,250.
- Stockholders' equity (\$169,600) exceeds liabilities (\$48,100).

The stockholders own more of Post Fir's assets than do the company's creditors.

(20 min.) P 1-67B

**Req. 1**

**Water Fun Company  
Statement of Cash Flows  
Year Ended May 31, 2013**

*Millions***Cash flows from operating activities:**

Net income.....	\$ 3,050
Adjustments to reconcile net income to cash provided by operations .....	<u>2,370</u>
Net cash provided by operating activities .....	5,420

**Cash flows from investing activities:**

Purchases of property, plant, and equipment .....	\$(3,520)
Sales of property, plant, and equipment .....	35
Other investing cash payments .....	<u>(160)</u>
Net cash used for investing activities .....	(3,645)

**Cash flows from financing activities:**

Issuance of common stock .....	\$ 205
Payment of dividends.....	<u>(265)</u>
Net cash used for financing activities.....	<u>(60)</u>

Net increase in cash.....	1,715
Cash, beginning.....	<u>270</u>
Cash, ending .....	<u><u>\$ 1,985</u></u>

**Req. 2**

Operating activities provided the largest amount of cash. This signals financial strength because operations should be the main source of cash.

(40-50 min.) P 1-68B

**INCOME STATEMENT**

		2013	2012	
Revenues	13,880 =	\$ k	\$15,000	
Cost of goods sold		(11,090)	a =	(11,980)
Other expenses		<u>(1,210)</u>	<u>(1,160)</u>	
Income before income taxes		1,580	1,860	
Income taxes (35% tax rate)	553 =	<u>l</u>	<u>(651)</u>	
Net income	1,027 =	<u>\$ m</u>	<u>\$ b</u> =	1,209

**STATEMENT OF RETAINED EARNINGS**

Beginning balance	3,719 =	\$ n	\$ 2,650	
Net income	1,027 =	o	c =	1,209
Dividends		<u>(94)</u>	<u>(140)</u>	
Ending balance	4,652 =	<u>\$ p</u>	<u>\$ d</u> =	3,719

**BALANCE SHEET****Assets:**

Cash	1,340 =	\$ q	\$ e =	1,430
Property, plant and equipment		1,900	1,925	
Other assets	11,022 =	<u>r</u>	<u>9,854</u>	
Total assets	14,262 =	<u>\$ s</u>	<u>\$13,209</u>	

**Liabilities:**

Current liabilities	4,640 =	\$ t	\$ 5,620	
Notes payable and long-term debt		4,500	3,360	
Other liabilities		<u>110</u>	<u>130</u>	
Total liabilities		9,250	f =	9,110

**Stockholders' Equity:**

Common stock		\$ 200	\$ 200	
Retained earnings	4,652 =	u	g =	3,719
Other stockholders' equity		<u>160</u>	<u>180</u>	
Total stockholders' equity	5,012 =	<u>v</u>	<u>4,099</u>	
Total liabilities and stockholders' equity	14,262 =	<u>\$ w</u>	<u>\$ h</u> =	13,209

**STATEMENT OF CASH FLOWS**

Net cash provided by operating activities	670 =	\$ x	\$ 975	
Net cash used for investing activities		(200)	(325)	
Net cash used for financing activities		<u>(560)</u>	<u>(500)</u>	
Increase (decrease) in cash		( 90)	i =	150
Cash at beginning of year	1,430 =	<u>y</u>	<u>1,280</u>	
Cash at end of year	1,340 =	<u>\$ z</u>	<u>\$ j</u> =	1,430

## Decision Cases

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

**Based solely on these balance sheets, Open Road appears to be the better credit risk because:**

- 1. Blue Skies has more assets (\$150,000) than Open Road (\$65,000), but Blue Skies owes much more in liabilities (\$130,000 versus \$15,000 for Open Road). Open Road's stockholders' equity is far greater than that of Blue Sky (\$50,000 compared to \$20,000). Open Road is not heavily in debt, but Blue Skies is.**
- 2. You would be better off granting the loan to Open Road. You should consider what will happen if the borrower cannot pay you back as planned. Blue Skies has far more liabilities to pay, and it may be hard for Blue Skies to come up with the money to pay you. On the other hand, Open Road has little debt to pay to others before paying you.**

**(20-30 min.) Decision Case 2****Req. 1**

GrandPrize Unlimited, Inc. Income Statement Year Ended Dec. 31, 2012		GrandPrize Unlimited, Inc. Balance Sheet Dec. 31, 2012	
Revenue.....	\$140,000 <sup>1</sup>	Cash.....	\$ 6,000
Expenses.....	<u>130,000</u> <sup>2</sup>	Other assets....	<u>90,000</u> <sup>3</sup>
Net income.....	<u>\$ 10,000</u>	Total assets.....	<u>\$96,000</u>
		Liabilities.....	\$70,000 <sup>4</sup>
		Equity.....	<u>26,000</u> <sup>5</sup>
		Total liabilities and equity.....	<u>\$96,000</u>

$$^1\$100,000 + \$40,000 = \$140,000$$

$$^2\$80,000 + \$50,000 = \$130,000$$

$$^3\$100,000 - \$50,000 + \$40,000 = \$90,000$$

$$^4\$60,000 + \$10,000 = \$70,000$$

$$^5\$96,000 - \$70,000 = \$26,000$$

**Req. 3**

The company's *financial position* is much *weaker* than originally reported. Assets and equity are lower and liabilities are higher. *Results of operations* are *worse* than reported. The company did not earn as much profit as reported.

**Req. 4**

Based on the actual figures, I would *not* invest in GrandPrize Unlimited for reasons given in *Req. 2*.

## **Ethical Issue**

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**Note to instructor:** student responses will vary on this problem. Keep the discussion pointed toward use of the multiple-criteria model for making good ethical decisions, pointing out elements of students' reasoning that may be faulty or incomplete. It might be useful to have a debate or role play, assigning students to different sides of the issue (for or against accepting a copy of the exam).

### ***Req. 1***

The fundamental ethical issue in this situation is whether you should accept a copy of the old exam from your friend.

### ***Req. 2***

The stakeholders are:

- a. You
- b. Your friend
- c. The remainder of the students in the class
- d. The professor
- e. The University
- f. Your family

(This may not be a complete list; you may think of more.)

Consequences are discussed in requirement 3.

### ***Req. 3***

Analysis of the problem:

- a. **Economic perspective:** If use of the old exam turns out to help you (it may not) you might improve your grade and allow you to retain your scholarship. This might help you and your family



**(continued) Ethical Issue**

**financially. If you use the exam to your unfair advantage, and you are reported, you and possibly your friend might receive grades of F in the class although you might otherwise have passed. This could cause adverse economic consequences to you, your friend and your families.**

- b. Legal perspective: Although it may not violate local or federal law, giving or accepting copies of old exams may violate the university's honor code, which serves the same purpose of a legal code in this case. If you use the old exam and it turns out that you violated the University's honor code, both you and your friend could be in trouble. Your family and your friend's family could also be impacted by any adverse consequences to you or her.**

**Academic institutions establish policies against academic dishonesty because cheating hurts everyone—the student who commits the act, the other students in the class whose rights to fair treatment are violated by cheating, the professor, who must endure hours of investigating, reporting, and perhaps testifying.**

- c. Ethical perspective. Receiving questionable help from others in the face of policies that prohibit it is, at best, risky, and at worst, downright wrong. Cheating is similar to stealing, since it is stealing the work of another without their permission. It is usually accompanied by lying to cover it up, or at least, not concealing the truth. Cheating violates other students' rights to fair and equal treatment. It violates the instructor's rights to run a course as a**

**(continued) Ethical Issue**

**“fair game” for all participants. Because the students and faculty are hurt by cheating, the university is hurt too. If cheating goes unpunished, grades are inflated, ultimately damaging the academic reputation of the institution and eroding the value of its degrees. Parents of students who are caught cheating have to endure the agony of working through the problem with their son or daughter, and perhaps the social stigma that comes from adverse publicity.**

**These are just some of the arguments against cheating. Of course, there is a question in this case as to whether taking the test actually violates the professor’s or the university’s policies.**

***Req. 4***

**It would be helpful to find out what the professor’s policies are with respect to use of fraternity and sorority test files. The university might have a blanket policy on this. (Some students might spend a little time researching this by reading the university’s honor code on their web site; just reading the honor code will be an eye-opening experience for most students). Advise your students to research the use of fraternity and sorority test files on the university web site, or to discuss the issue with the head of the department or the chair of the university honor council.**

**Unfortunately, in this case, there is not much time. Researching the issue in the university’s honor code takes valuable time away from**

**(continued) Ethical Issue**

**studying for the exam, which, if you do, could help you raise your grade and solve the whole problem!**

**Probably the best solution to this problem is “when in doubt, don’t.” You may not do well on the test, but at least you won’t have to live with the terrible consequences of being accused as a cheater. It should make you feel better in the long run that, although you may not make the highest grades in the class, at least you are not a cheater.**

***Req. 5***

**Cheating is very closely related to stealing, which is a form of fraud. When employees steal from their companies, they steal property that belongs to others. There are economic, legal, and ethical consequences to the company, the employee and their families, and customers (who ultimately have to pay for fraud through higher prices). We will study fraud in depth in Chapter 4.**

## **Focus on Financials: Amazon.com, Inc.**

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(20-30 min.)

- 1. Students can emphasize a variety of points regarding Amazon.com, Inc., and its industry. For example, a discussion on the growth and recent changes in e-commerce would be appropriate. Additionally, discussing recent news articles related to Amazon, its competitors, or e-commerce/physical retailing would also be appropriate. Student answers will vary.**
- 2. Some important information in this portion of the financials is the description of their competitors (physical-world retailers, other e-commerce sites, etc). Additionally, the seasonality of Amazon's business is important to note given that they have higher sales in the fourth quarter relative to the first three. Lastly, it may come as a surprise that Amazon employs approximately 33,700 full-time employees. Student answers will vary.**
- 3. Ebay and Overstock.com are competitors of Amazon.com, Inc., because all three derive their revenue online from a variety of products. It is important to identify competitors because competitors tend to have similar business dynamics to one another, meaning that their financials can be compared to and benchmarked against each other. Student answers will vary.**
- 4. *Net income*, because it shows the overall result of all the revenues minus all the expenses for a period. In effect, net income gives the results of operations in a single figure.**

(continued) Amazon.com, Inc.

During 2010, net income rose to \$1,152 million from \$902 million in 2009. This is good news because the company's profit increased during the year.

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

6. Total resources (total assets) at the end of  
2010..... \$18,797 million
- Amount owed (total liabilities) at the end of  
the year (\$8,051 + \$2,321 + \$1,561)..... \$11,933 million
- Portion of the company's assets owned by  
the company's stockholders (this is  
shareholders' equity)..... \$6,864 million

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

Assets	=	Liabilities	+	Stockholders' equity
\$18,797	=	\$11,933	+	\$6,864

7. At the beginning of 2010, Amazon.com, Inc., had \$3,444 million of cash. At the end of the year, Amazon.com, Inc. had \$3,777 million of cash.

## **Focus on Analysis: RadioShack Corp.**

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**(30 min.)**

- 1. RadioShack Corporation sells consumer electronics goods and services. Students can emphasize a variety of points regarding RadioShack, Corp. and its industry. For example, a discussion on the growth and recent changes in consumer electronics would be appropriate. Additionally, discussing recent news articles related to RadioShack, its competitors, or consumer electronics would also be appropriate. Student answers will vary.**
  
- 2. Note 1 describes RadioShack's business and how RadioShack delivers its product to its customers. RadioShack sells its products through 1,267 kiosks, 1,207 dealer outlets, and RadioShack.com. Most of the operations are located in the United States, but are located in Mexico. This note also describes the different product lines (or platforms) of RadioShack and its support operations. It is important to understand RadioShack and its operations in order to make investing or lending decisions concerning the company.**
  
- 3. Best Buy and Wal-Mart are two competitors of RadioShack Corp. because all three (Best Buy, Wal-Mart, and RadioShack) are retailers of consumer electronics. It is important to identify competitors because competitors tend to have similar business dynamics to one another, meaning that their financials can be compared to and benchmarked against each other. Student answers will vary.**

(continued) RadioShack Corp.

4. *(Amounts in millions)*

<b>Assets</b>	<b>=</b>	<b>Liabilities</b>	<b>+</b>	<b>Shareholders' equity</b>
<b>\$2,175.4</b>	<b>=</b>	<b>\$1,332.9</b>	<b>+</b>	<b>\$842.5</b>

RadioShack Corp. appears to be in relatively strong financial condition. Total assets are almost double the amount of total liabilities. This suggests that the company will have no difficulty paying its debts and will have money to expand.

5. The result of operations for 2010 was a net income of \$206.1 million. This is good news for RadioShack. Revenue exceeded expenses for fiscal 2010, and there is a positive trend in earnings over the past two years (\$189.4 million, \$205.0 million, and \$206.1 million in fiscal 2008, 2009, and 2010, respectively).
6. In RadioShack Corp.'s Consolidated Balance Sheets, Retained Earnings *decreased* \$821.4 from \$2,323.9 million as of the beginning of 2010 (end of 2009). The Consolidated Statements of Stockholders' Equity and Comprehensive Income explain *why* retained earnings decreased during the year. Retained earnings increased \$206.1 (net income) but decreased \$26.1 (dividends) and \$1,001.0 (retirement of treasury stock).
7. The Consolidated Balance Sheets report cash as part of financial position. The Consolidated Statements of Cash Flows tell why cash increased or decreased. Cash decreased \$338.8 million during the year largely due to cash used by financing activities \$(413.8 million).

## **Group Projects**

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**Student responses will vary.**