# **Chapter 1**

**Conceptual Framework and Financial Statements**

**Short Exercises**

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

**a. *Corporation and Limited-liability partnership (LLP).* 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 1-2**

**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’ residual interest in its assets after claims from its creditors.**

**(5-10 min.) S 1-3**

|  |  |  |  |
| --- | --- | --- | --- |
| **a.** | **Cash and cash equivalents A** | **g.** | **Accounts payable L**  |
|  |  |  |  |
| **b.** | **Long-Term investment A**  | **h.** | **Share capital E** |
|  |  |  |  |
| **c.** | **Income tax payables L**  | **i.** | **Short term bank borrowings L**  |
|  |  |  |  |
| **d.** | **Notes payable L**  | **j.** | **Retained earnings E** |
|  |  |  |  |
| **e.** | **Wages payable L**  | **k.** | **Buildings A**  |
|  |  |  |  |
| **f.** | **Trademarks A**  | **l.** | **Prepaid expenses A** |

**(5 min.) S 1-4**

**1. Assets and liabilities**

**2. Equity**

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

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

**2. Application of the entity assumption will separate Newman’s personal assets from the assets of Quality Food Brands. This will help Newman, investors, and lenders know how much in assets the business controls, and this knowledge will help all parties evaluate the business realistically.**

**(5-10 min.) S 1-6**

**a. Going concern assumption**

**b. Accrual accounting assumption, relevance characteristic**

**c. Comparability characteristic**

**d. Accrual accounting assumption**

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

|  |
| --- |
| **Computed amounts in boxes** |
|  |  |  |  |  |  |
|  | **Total Assets** | **=** | **Total Liabilities** | **+** | **Shareholders’ Equity** |
|  |  |  |  |  |  |
| **a.** | **$211,000** | **=** | **$50,200** | **+** | **$160,800** |
|  |  |  |  |  |  |
| **b.** |  **270,000** | **=** |  **50,290** | **+** | **219,710** |
|  |  |  |  |  |  |
| **c.** | **172,800** | **=** |  **96,000** | **+** |  **76,800** |

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

**1. Owners’ Equity = Assets − Liabilities**

 **This way of determining the amount of owners’ equity applies to any company, your household, or a single Burger King outlet.**

**2. Liabilities = Assets − Owners’ Equity**

**(5 min.) S 1-9**

|  |  |
| --- | --- |
| **Maxis Play** |  |
| **Income Statement** |  |
| **Year Ended December 31, 20X6** |  |
|  | ***Millions*** |
| **Revenues……………………………………..** | **$ 262** |
| **Expenses……………………………………..** |  **108** |
| **Net income…………………………………...** | **$ 154** |

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

|  |  |
| --- | --- |
| **Idea Corp.** |  |
| **Statement of Changes in Equity** |  |
| **Year Ended December 31, 20X6** |  |
|  | ***Millions*** |
|  |  |
| **Total Equity, January 1, 20X6 ($900 + $375)………**  | **$1,275** |
| **Add: Net income ($1,530 − $975)………** | **555****1,830** |
| **Less: Dividends………………………...** |  **(45)** |
| **Total Equity, December 31, 20X6……** | **$1,785** |

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

|  |
| --- |
| **Atlantia Products** |
| **Balance Sheet** |
| **As at December 31, 20X6** |
| **ASSETS** |  |
| **Current assets:** |  |
|  **Cash……………………………………………………** | **$ 7,500** |
|  **Receivables…………………………………………...** | **11,000** |
|  **Inventory………………………………………………** |  **10,000** |
|  **Total current assets…………………………………** | **28,500** |
| **Equipment……………………………………………….** |  **24,500** |
| **Total assets……………………………………………...** | **$53,000** |
|  |  |
| **LIABILITIES** |  |
| **Current liabilities:** |  |
|  **Accounts payable……………………………………** | **$ 10,500** |
|  **Total current liabilities……………………………...** | **10,500** |
| **Long-term liabilities:** |  |
|  **Long-term notes payable…………………………..** | **25,000** |
| **Total liabilities………………………………………...** | **$35,500** |
|  |  |
| **SHAREHOLDERS’ EQUITY** |  |
| **Share Capital…………………………………………….** | **17,500** |
| **Retained earnings………………………………………** |  **0\*** |
|  **Total shareholders’ equity…………………………** | **17,500** |
| **Total liabilities and shareholders’ equity…………..** | **$53,000** |

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**\*Computation of retained earnings:**

 **Total assets ($53,000) − current liabilities ($10,500) − long-term notes payable ($25,000) − share capital ($17,500) = $0**

 **(10-15 min.) S 1-12**

|  |
| --- |
| **Apollo Medical Inc.** |
| **Statement of Cash Flows** |
| **Year Ended December 31, 20X6** |
| **Cash flows from operating activities:** |  |
|  **Net income………………………………………...** | **$ 216,300** |
|  **Adjustments to reconcile net income to net**  |  |
|  **cash provided by operating activities….** |  **(66,000)** |
|  **Net cash provided by operating activities…** | **150,300** |
|  |  |
| **Cash flows from investing activities:** |  |
|  **Purchases of equipment…………** |  **$ (135,000)** |  |
|  **Net cash used for investing activities……..** | **(135,000)** |
|  |  |
| **Cash flows from financing activities:** |  |
|  **Payment of dividends…………….** |  **$ (32,100)** |  |
|  **Net cash used for financing activities…….** |  **(32,100)** |
| **Net decrease in cash………………………………..** | **(16,800)** |
| **Cash balance, December 31, 20X5………………** |  **90,000** |
| **Cash balance, December 31, 20X6………………** | **$ 73,200** |

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

1. **Bank balance BS, SCF**
2. **Net cash used for investing activities SCF**
3. **Accounts receivable BS**
4. **Share capital BS**
5. **Interest expense   IS**
6. **Long-term investment BS**
7. **Dividend paid SCE, SCF**
8. **Reserves SCE, BS**
9. **Rent expense IS**
10. **Property, plant and equipment BS**
11. **Notes payable BS**
12. **Retained earnings SCE, BS**
13. **Rental income IS**
14. **Net income IS, SCE, SCF**

**(15-20 min.) S1-14**

**a. *Paying large dividends* will cause retained earnings to be low.**

**b. Heavy *investing activity* and *paying off debts* can result in a cash shortage even if net income has been high.**

**c. The single best source of cash for a business is operating activities — *net income* and the *related cash receipts.* This source of cash is best because it is a result of the core operations of the business.**

1. ***Borrowing, issuing shares,* and *selling* plant, property and equipment (PPE) can bring in cash even when the company has experienced losses. Reducing accounts receivable and inventory can also increase cash flow.**

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

**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 chapter 1 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?**

**Exercises**

**Group A**

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

|  |
| --- |
| ***Amounts in thousands; computed amounts in boxes)*** |
|  |  |  |  |  |  |
|  | Assets | **=** | Liabilities | **+** | Owners’ Equity |
| Alpha  | **$32** |  | **$12** |  | **$20** |
| **Bravo**  | **21** |  | **16** |  | **5** |
| **Charlie**  | **44** |  | **21** |  | **23** |

Alpha appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ($12 / $32 = 0.375); Alpha’s equity is the highest percentage of company assets ($20 / $32 = 0.625).

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

### Req. 1

|  |
| --- |
| ***(Amounts in millions)*** |
|  | **Assets** | **=** | **Liabilities** | **+** | **Shareholders’****Equity** |
|  |  **$500** |  | **$240** |  |  |
|  |  **880** |  |  **600** |  |  |
|  |  **200** |  |  |  |  |
| **Total** | **$1,580** | **=** | **$840** | **+** | **$740** |
|  |  |  |  |  |  |
| ***Req. 2*** | **Resources****to work with** | ***Req. 3* Amount** **owed to**  **creditors** | ***Req. 4* Actually** **owned by company**  **shareholders** |

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

|  |  |
| --- | --- |
|  | **Situation** |
|  | **1** | **2** | **3** |
|  | ***Millions*** |
| **Total shareholders’ equity,** |  |  |  |
|  **January 31, 20X6 ($60 − $12)………...** |  **$48** | **$48** | **$48** |
| **Add: Issuances of shares.……………...** |  **16** |  **-0-** |  **4** |
|  **Net income………………………..** |  |  **26\*** |  **18\*** |
| **Less: Dividends…………………………...** |  **-0-** | **(16)** | **(12)** |
|  **Net loss…………………………….** | **(6)\*** |  |  |
| **Total shareholders’ equity,** |  |  |  |
|  **January 31, 20X7 ($74 − $16)…………** |  **$58** |  **$58** | **$58** |

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

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

|  |  |  |
| --- | --- | --- |
| **1.** | **Galaxy Hotels, Inc.** |  |
|  |  | **Assets** | **=** | **Liabilities** | **+** | **Shareholders’****Equity** |
|  | **Beginning amount** | **$150,000** | **=** | **$80,000** | **+** | **$70,000** |
|  | **Multiplier for increase** |  **× 0.80** |  |  |  |  |
|  | **Ending amount** | **$120,000** |  |  |  |  |

|  |  |
| --- | --- |
| **2.** | **Sky Airlines, Ltd.** |
|  |  | **Assets** | **−**  | **Liabilities**  | **=** | **Shareholders’****Equity** |
|  | **Beginning amount** | **$110,000** | **−** | **$25,000** | **=** | **$85,000** |
|  | **Net income** |  |  |  |  |  **18,000** |
|  | **Dividends** |  |  |  |  | **(3,000)** |
|  | **Ending amount** |  |  |  |  | **$100,000** |

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

**a. Statement of cash flows**

**b. Income statement**

**c. Statement of cash flows**

**d. Balance sheet, Statement of cash flows**

**e. Balance sheet**

**f. Income statement, Statement of changes in equity, Statement of cash flows**

**g. Balance sheet**

**h. Balance sheet**

**i. Statement of changes in equity, Statement of cash flows**

**j. Income statement**

**k. Balance sheet**

**l. Balance sheet**

**m. Balance sheet**

**n. Income statement**

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

|  |
| --- |
| **Allianz Inc.** |
| **Balance Sheet (*Amounts in millions*)** |
| ***As at January 31, 20X6*** |
| ***ASSETS*** | **LIABILITIES** |
| **Cash and cash equivalent**  | **$5.0** | **Current liabilities** | **$4.0** |
| **Receivables** | **1.6** | **Long-term liabilities** |  **6.0** |
| **Inventories** | **10.0** | **Total liabilities** | **10.0** |
| **Investment assets** | **30.0** | **SHAREHOLDERS’****EQUITY** |
| **Property and**  **equipment, net** | **33.2** |
|  |  | **Share capital** |  **28.6** |
|  | **Retained earnings** |  **41.2\*** |
|  | **Total shareholders’ equity** |  **69.8** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$79.8** |  **shareholders’ equity** |  **$79.8** |

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\*Computation of retained earnings:

**Total assets ($79.8) − Total liabilities ($10.0) − Share capital ($28.6) = $41.2**

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

***Req. 1***

|  |
| --- |
| **Allianz Inc.** |
| **Income Statement (*Amounts in millions*)** |
| **Year Ended January 31, 20X6** |
|  |  |
| **Total revenue……………………………………….** |  | **$77.6** |
| **Expenses:** |  |  |
|  **Interest expense………………………………..** | **$ 1.4** |  |
|  **Salary and other employee expenses………** | **35.0** |  |
|  **Other expenses…………………………………** |  **13.4** |  |
|  **Total expenses………………………………….** |  |  **49.8** |
| **Net income………………………………………….** |  | **$27.8** |

***Req. 2***

**Looking at retained earnings movements, we can calculate dividend paid.**

|  |
| --- |
| **Retained Earnings (*Amounts in millions*)** |
|  |  |
| **Retained earnings, beginning of year………………** |  **$16.4** |
| **Add: Net income for the year (*Req. 1*)…………………** |  **27.8** |
|  |  **44.2** |
| **Less: Dividends\*…………………………………………...** |  **3.0** |
| **Retained earnings, end of year (from Exercise 1-21A)….** |  **$41.2** |

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**\* Solve for dividends**

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

|  |
| --- |
| **Neptune Ltd.** |
| **Statement of Cash Flows** |
| **Year Ended December 31, 20X6** |
|  |  |
| **Cash flows from operating activities:** |  |
|  **Net income…………………………………….** | **$(210,000)** |  |
|  **Adjustments to reconcile net income to** |  |  |
|  **net cash provided by operating activities.** |  **120,000** |  |
|  **Net cash used by operating activities……..** | **$(90,000)** |
|  |  |
| **Cash flows from investing activities:** |  |
|  **Net cash used provided by investing activities…** | **250,000** |
|  |  |
| **Cash flows from financing activities:** |  |
|  **Net cash provided by financing activities……..** |  **(136,000)** |
| **Net increase in cash………………………………………...** | **24,000** |
| **Beginning cash balance……………………………………** |  **176,000** |
| **Ending cash balance………………………………………..** | **$200,000** |

**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**

|  |
| --- |
| **Fast Copy Center, Inc.** |
| **Income Statement** |
| **Month Ended July 31, 20X6** |
| **Revenue:** |  |  |
|  **Service revenue……………** |  | **$604,500** |
| **Expenses:** |  |  |
|  **Salary expense………………** |  **$168,000** |  |
|  **Rent expense…………………** | **2,300** |  |
|  **Utilities expense…………….** | **12,000** |  |
|  **Total expenses………………** |  |  **182,300**  |
| **Net income………………………** |  | **$ 422,200** |

|  |
| --- |
| **Fast Copy Center, Inc.** |
| **Statement Of Changes In Equity** |
| **Month Ended July 31, 20X6** |
| **Total Equity, July 1, 20X6………………** | **$ 69,500** |
| **Add: Net income for the month……….** |  **422,200** |
|  |  **491,700** |
| **Less: Dividends………………………….** |  **(4,200)** |
| **Total Equity, July 31, 20X6………..** |  **$487,500** |

 **(15-20 min.) E 1-25A**

|  |
| --- |
| **Fast Copy Center, Inc.** |
| **Balance Sheet** |
| **As at July 31, 20X6** |
| Assets | Liabilities |
| **Cash…………** |  **$ 9,800** | **Accounts payable………** | **$ 16,000** |
| **Office supplies** | **13,700** |  |  |
| **Equipment……** | **480,000** | **Shareholders’ Equity** |
|  |  | **Share capital.……………** | **69,500** |
|  |  | **Retained earnings………** |  **418,000** |
|  |  | **Total shareholders’ equity** | **487,500** |
|  |  | **Total liabilities and** |  |
| **Total assets….** | **$503,500** | **shareholders’ equity……** | **$503,500** |

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

|  |
| --- |
| **Fast Copy Center, Inc.** |
| **Statement Of Cash Flows** |
| **Month Ended July 31, 20X6** |
| **Cash flows from operating activities:** |  |  |
|  **Net income………………………………………** |  | **$ 422,200** |
|  **Adjustments to reconcile net income** |  |  |
|  **to net cash provided by operations…………** |  |  **2,300** |
|  **Net cash provided by operating activities** |  |  **424,500** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
|  **Acquisition of equipment……………………** |  **$(480,000)** |  |
|  **Net cash used for investing activities…** |  |  **(480,000)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
|  **Issuance (sale) of shares to owners…………** |  **$ 69,500** |  |
|  **Payment of dividends…………………………..** |  **(4,200)** |  |
|  **Net cash provided by financing activities.** |  |  **65,300** |
| **Net increase in cash………………………………** |  |  **$ 9,800** |
| **Cash balance, July 1, 20X6…………………….** |  |  **0** |
| **Cash balance, July 31, 20X6…………………….** |  |  **$ 9,800** |
| **The ending cash balance on statement of cash flow corresponds with the balance sheet. Total income increases total equity on the statement of changes in equity, which tallies with the ending equity on the balance sheet.** |

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

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

**FROM: Student Name**

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

 **Your first month of operations was successful. Revenues totaled $604,500 and net income was $422,200. These operating results look very strong.**

 **The company was able to pay a $4,200 dividend, and this should make you happy with so quick a return on your capital investment of $69,500.**

 **Your financial position looks secure, with assets of $503,500 and liabilities of only $16,000. Your shareholders’ equity is $487,500.**

 **Operating activities generated cash of $424,500, which is respectable. You ended the month with cash of $9,800. Based on the above facts, I believe you should continue to well in your business.**

***Student responses may vary*.**

**Exercises**

**Group B**

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

|  |
| --- |
| ***Amounts in thousands; computed amounts in boxes)*** |
|  |  |  |  |  |  |
|  | Assets | **=** | Liabilities | **+** | Owners’ Equity |
| Delta video rentals | **$28** |  | **$ 9** |  | **$19** |
| **Echo entertainment** | **35** |  | **30** |  | **5** |
| **Portal gift & cards** | **33** |  | **16** |  | **17** |

Delta appears to have the strongest financial position because its liabilities make up the smallest percentage of company assets ($9 / $28 = 0.32). Stated differently, Delta’s equity is the highest percentage of company assets ($19 / $28 = 0.68).

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

### Req. 1

|  |
| --- |
| ***(Amounts in millions)*** |
|  | **Assets** | **=** | **Liabilities** | **+** | **Shareholders’****Equity** |
|  | **€300** |  | **€200** |  |  |
|  |  **420** |  |  **340** |  |  |
|  |  **110** |  |  |  |  |
| **Total** | **€830** | **=** | **€540** | **+** | **$290** |
|  |  |  |  |  |  |
| ***Req. 2*** | **Resources****to work with** | ***Req. 3* Amount** **owed to**  **creditors** | ***Req. 4* Actually** **owned by company**  **shareholders** |

 **(10-20 min.) E 1-30B**

|  |  |
| --- | --- |
|  | **Situation** |
|  | **1** | **2** | **3** |
|  | ***Millions*** |
| **Total shareholders’ equity,** |  |  |  |
|  **January 31, 20X6 (€40 − €6)…………..** |  **€34** | **€34** | **€34** |
| **Add: Issuances of shares.……………..** | **20** |  **-0-** |  **12** |
|  **Net income……………………..** |  **-0\*-** |  **40\*** |  **16\*** |
| **Less: Dividends…………………………...** |  **-0-** |  **(20)** |  **(8)** |
|  **Net Loss…………………………….** |  |  |  |
| **Total shareholders’ equity,** |  |  |  |
|  **January 31, 20X7 (€78 − €24)………….** | **€54** | **€54** | **€54** |

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

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

|  |  |  |
| --- | --- | --- |
| **1.** | **Sapphire Hotels, Inc.** |  |
|  |  | **Assets** | **=** | **Liabilities** | **+** | **Shareholders’****Equity** |
|  | **Beginning amount** | **€135,000** | **=** | **€100,000** | **+** | **€35,000** |
|  | **Multiplier for increase** | **× 0.80** |  |  |  |  |
|  | **Ending amount** | **€108,000** |  |  |  |  |

|  |  |
| --- | --- |
| **2.** | **Dolphin Travel Ltd.** |
|  |  | **Assets** | **−** | **Liabilities** | **=** | **Shareholders’****Equity** |
|  | **Beginning amount** | **€95,000** | **−** | **€30,000** | **=** | **€65,000** |
|  | **Net income** |  |  |  |  |  **24,000** |
|  | **Dividends** |  |  |  |  | **(4,000)** |
|  | **Ending amount** |  |  |  |  | **€85,000** |

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

**a. Statement of changes in equity, Statement of cash flows**

**b. Balance sheet**

**c. Balance sheet**

**d. Income statement**

**e. Statement of cash flows**

**f. Statement of cash flows**

**g. Balance sheet**

**h. Income statement, Statement of changes in equity, Statement of cash flows**

**i. Balance sheet**

**j. Balance sheet**

**k. Balance sheet**

**l. Balance sheet**

**m. Income statement**

**n. Balance sheet, Statement of cash flows**

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

|  |
| --- |
| **Jackson Company** |
| **Balance Sheet (*Amounts in millions*)** |
| ***As at May 31, 20X6*** |
| ***ASSETS*** | **LIABILITIES** |
| **Cash and Cash Equivalent**  | **€ 5.0**  | **Current liabilities** | **€12.0** |
| **Receivables** | **0.4** | **Long-term liabilities** |  **6.0** |
| **Inventories**  | **10.0** | **Total liabilities** |  **18.0** |
| **Investments** | **32.2** | **SHAREHOLDERS’****EQUITY** |
| **Property and**  **equipment, net** | **36.0** |
|  |  | **Share capital** |  **31.8** |
|  | **Retained earnings** | **33.8** |
|  | **Total shareholders’ equity** | **65.6** |
|  | **\_\_\_\_** | **Total liabilities and** | **\_**  |
| **Total assets** | **€83.6** |  **shareholders’ equity** | **€83.6** |

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

\*Computation of retained earnings:

**Total assets (€83.6) − Total liabilities (€18.0) − Share capital (€31.8) = €33.8**

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

***Req. 1***

|  |
| --- |
| **Jackson Company** |
| **Income Statement (*Amounts in millions*)** |
| **Year Ended May 31, 20X6** |
|  |  |
| **Total revenue……………………………………….** |  | **€68.0** |
| **Expenses:** |  |  |
|  **Interest expense………………………………..** | **€ 0.4** |  |
|  **Salary and other employee expenses………** | **31.0** |  |
|  **Other expenses…………………………………** |  **13.6** |  |
|  **Total expenses………………………………….** |  | **45.0** |
| **Net income………………………………………….** |  | **€23.0** |

***Req. 2***

**The statement of changes in equity helps to compute dividends, as follows:**

|  |
| --- |
| **Statement of Changes in Equity (*Amounts in millions*)** |
|  |  |
| **Total Equity, beginning of year…………………………** | **€50.4**  |
| **Add: Net income for the year (*Req. 1*)…………………** |  **23.0** |
|  | **73.4** |
| **Less: Dividends…………………………………………...** | **(7.8)**  |
| **Total Equity, end of year (from Exercise 1-33B)….** | **€65.6**  |

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

|  |
| --- |
| **Alpina Inc.,** |
| **Statement of Cash Flows** |
| **Year Ended December 31, 20X6** |
|  |  |
| **Cash flows from operating activities:** |  |
|  **Net income………………………………** | **€ (630,000** | **)** |
|  **Adjustments to reconcile net income to** |  |  |
|  **net cash provided by operating activities.** |  **360,000** |  |
|  **Net cash used by operating activities……..** | **€ (270,000)** |
|  |  |
| **Cash flows from investing activities:** |  |
|  **Net cash used provided by investing activities….** | **750,000** |
|  |  |
| **Cash flows from financing activities:** |  |
|  **Net cash provided by financing activities……..** | **(408,000)** |
| **Net increase in cash………………………………………...** | **72,000** |
| **Beginning cash balance……………………………………** | **528,000** |
| **Ending cash balance………………………………………..** | **€ 600,000** |

**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**

|  |
| --- |
| **EXPRESS COPY CENTER, INC.** |
| **INCOME STATEMENT** |
| **MONTH ENDED JULY 31, 20X7** |
| **Revenue:** |  |  |
|  **Service revenue……………** |  | **€544,450** |
| **Expenses:** |  |  |
|  **Salary expense………………** |  **€161,800** |  |
|  **Rent expense…………………** | **5,750** |  |
|  **Utilities expense…………….** | **11,000** |  |
|  **Total expenses………………** |  |  **178,550**  |
| **Net income………………………** |  | **€ 365,900** |

|  |
| --- |
| **EXPRESS COPY CENTER, INC.** |
| **STATEMENT OF CHANGES IN EQUITY** |
| **MONTH ENDED JULY 31, 20X7** |
| **Total equity, July 1, 20X7………………** | **€0**  |
| **Add: Issuance of shares** | **$54,000** |
| **Add: Net income for the month……….** |  **365,900** |
|  |  **419,900** |
| **Less: Dividends………………………….** |  **(3,100)** |
| **Total equity, July 31, 20X7……………..** |  **€416,800** |

**(15-20 min.) E 1-37B**

|  |
| --- |
| **EXPRESS COPY CENTER, INC.** |
| **BALANCE SHEET** |
| **As at JULY 31, 20X7** |
| Assets | Liabilities |
| **Cash…………** |  **€ 8,600** | **Accounts payable………** | **€ 17,000** |
| **Office supplies** | **14,200** |  |  |
| **Equipment……** | **411,000** | **Shareholders’ Equity** |
|  |  | **Share capital..……………** | **54,000** |
|  |  | **Retained earnings………** |  **362,800** |
|  |  | **Total shareholders’ equity** | **416,800** |
|  |  | **Total liabilities and** |  |
| **Total assets….** | **€433,800** | **shareholders’ equity……** | **€433,800** |

**(15-20 min.) E 1-38B**

|  |
| --- |
| **EXPRESS COPY CENTER, INC.** |
| **STATEMENT OF CASH FLOWS** |
| **MONTH ENDED JULY 31, 20X7** |
| **Cash flows from operating activities:** |  |  |
|  **Net income………………………………………** |  |  **365,900** |
|  **Adjustments to reconcile net income** |  |  |
|  **to net cash provided by operations…………** |  |  **2,800** |
|  **Net cash provided by operating activities** |  |  **368,700** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
|  **Acquisition of equipment……………………** |  **€(411,000)** |  |
|  **Net cash used for investing activities…** |  |  **(411,000)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
|  **Issuance of shares to owners…………** |  **€ 54,000** |  |
|  **Payment of dividends…………………………..** |  **(3,100)** |  |
|  **Net cash provided by financing activities.** |  |  **50,900** |
| **Net increase in cash………………………………** |  |  **€ 8,600** |
| **Cash balance, July 1, 20X7…………………….** |  |  **0** |
| **Cash balance, July 31, 20X7…………………….** |  |  **€ 8,600** |

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

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

**FROM: Student Name**

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

 **Your first month of operations was successful. Revenues totaled €544,450 and net income was €365,900. These operating results look very strong.**

 **The company was able to pay a €3,100 dividend, and this should make you happy with so quick a return on your investment.**

 **Your financial position looks secure, with assets of €433,800 and liabilities of only €17,000. Your shareholders’ equity is €416,800.**

 **Operating activities generated cash of €368,700, which is respectable. You ended the month with cash of €8,600. Based on the above facts, I believe you should stay in business.**

***Student responses may vary.***

**Quiz**

|  |  |
| --- | --- |
| **Q1-40** | **b** |
| **Q1-41** | **a** |
| **Q1-42** | **b** |
| **Q1-43** | **c** | **Shareholders’** |  |
|  |  |  **Assets = Liabilities + Equity** |  |
|  |  | **+ $18,000 = + $5,000 + $13,000** |  |
| **Q1-44** | **d** |
| **Q1-45** | **d** |
| **Q1-46** | **c** |
| **Q1-47** | **c** |
| **Q1-48** | **b** |
| **Q1-49** | **a ($133,000 − $56,000 − $10,000 − $5,000 = $62,000)** |
| **Q1-50** | **b ($150,000 + $120,000 − $20,000 = $250,000)** |
| **Q1-51** | **a** |
| **Q1-52** | **b** |
| **Q1-53** | **d**  |  |  |  |  |  | **Shareholders’** |  |
|  |  |  | **Assets** | **=** | **Liabilities** | **+** | **Equity** |  |
|  |  | **Begin.** |  **$25,000** | **=** | **$9,000\*** | **+** | **$16,000** |  |
|  |  | **Changes** |  |  | **+ 8,000** |  |  |  |
|  |  | **End.** |  **$38,000\*** | **=** | **$17,000\*** | **+** | **$21,000** |  |
|  |  | **\_\_\_\_\_** |  |  |  |  |  |  |
|  |  | **\*Must solve for these amounts.** |  |
|  |  |  |
| **Q1-54** | **b or c** | **Total shareholders’ equity** |
|  |  |  **Begin. bal.** | **$520,000 − $180,000 = $340,000** |  |  |
|  |  | **+ Net income** |  **X**  | **= $180,000** |  |
|  |  | **− Dividends** |  **− 50,000** |  |  |
|  |  |  **End. bal.** | **$750,000 − $280,000 = $470,000** |  |  |

**Problems**

**Group A**

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

***Req. 1***

|  |
| --- |
| **Division A of Smith Corporation** |
| **Income Statement** |
| **Year Ended December 31, 20X7** |
|  |  |  |
| **Service revenue…………………………..** | **$250,000** |  |
| **Sales revenue……………………………..** |  **55,000** |  |
| **Total revenue……………………………...** |  | **$305,000** |
|

|  |  |  |
| --- | --- | --- |
| **Cost of goods sold……………………….** | **30,000** |  |

 | **32,000** |  |
| **Depreciation expense** | **3,000** |  |
| **Other expenses……………………….…..** |  **245,000** | **$280,000** |
| **Net income………………………………...** |  | **$ 25,000** |

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

***Req. 2***

**a. Faithful representation characteristic. 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. Accrual accounting. While cash was only received later on, revenue is recognized because services have been performed.**

**c. Entity concept. If the reporting entity is Division A, then the revenue is recognized. If the reporting entity is Smith Corporation as a whole, then sales from one division to another alone is not recognized as revenue.**

**d. Faithful representation characteristics. New information is a more faithful representation rather than old information.**

**e. Accrual accounting. While cash was only paid later on, expenses are recognized because services have been consumed or goods have been used.**

**(30 min.) P 1-56A**

***Req. 1***

**Computed amounts in boxes**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Swift** | **Brezza** | **Ritz** |
|  | ***Millions*** |
| ***Balance sheets:*** |  |  |  |
| ***Beginning*:** |  |  |  |
|  **Assets………………………...** | **$ 160** | **$ 80** | **$ 16** |
|  **Liabilities……………………..** | **86** | **50** | **2** |
|  **Share capital………………...** | **18** | **6** | **4** |
|  **Retained earnings………….** | **56** | **24** | **10** |
|  |  |  |  |
| ***Ending*:** |  |  |  |
|  **Assets………………………...** | **$ 168** | **$ 84** | **$ 16** |
|  **Liabilities……………………..** | **96** | **48** | **0** |
|  **Share capital………………...** | **6** | **4** | **2** |
|  **Retained earnings………….** | **66** | **32** | **14** |
|  |  |  |  |
| ***Income statement*:** |  |  |  |
|  **Revenues…………………….** | **$436** | **$322** | **$24** |
|  **Expenses…………………….** |  **420** |  **304** |  **16** |
|  **Net income…………………..** | **$ 16** | **$ 18** | **$   8** |
|  |  |  |  |
| ***Statement of changes in equity:*** |  |  |  |
|  **Beginning RE………………..** | **$ 56** | **$ 24** | **$ 10** |
| **+ Net income…………………..** | **16** | **18** | **8** |
| **− Dividends…………………….** |  **(6)** |  **(10)** |  **(4)** |
| **= Ending RE……………………** | **$ 66** | **$ 32** | **$ 14** |

**(continued) P 1-56A**

***Req. 2***

|  |  |
| --- | --- |
|  |  **Swift Brezza Ritz** |
|  |  |  ***Millions*** |  |  |  |
|  |  |  |  |  |  |
| **Net income………….** | **$16** |  |  | **$18** |  |  | **$8** |  |
|  |  |  |  | ***Highest*** |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| **% of net income** | **$16** | **= 3.7%** |  | **$18** | **= 5.6%** |  | **$8** | **= 33%** |
| **to revenues………** | **$436** |  | **$322** |  | **$24** |
|  |  |  |  |  |  | ***Highest*** |  |

**The company that has the highest net income is Brezza Corp.**

**The company that has the highest percentage of net income to revenues is Ritz Corp.**

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

***Req. 1***

|  |
| --- |
| **Baselines, Inc.** |
| **Balance Sheet** |
| **As at June 30, 20X6** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 14,000** | **Accounts payable** |  **$ 15,000** |
| **Accounts receivable** | **5,500** | **Note payable** |  **110,000** |
| **Notes receivable** | **3,000** | **Total liabilities** |  **125,000** |
| **Office supplies** | **2,400** | **SHAREHOLDERS’** |
| **Equipment** | **80,000** | **EQUITY** |
| **Land** | **156,000** | **Shareholders’ equity** |  **135,900\*** |
|  |  | **Total liabilities and** |  **\_\_\_\_\_\_\_\_** |
| **Total assets** | **$260,900** |  **shareholders’ equity** |  **$260,900** |

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

**\*Total assets ($260,900) − Total liabilities ($125,000) =**

 **Shareholders’ equity ($135,900).**

***Req. 2***

**Baseline, Inc. is in *better* financial position than the erroneous balance sheet reports. Liabilities are less, 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***

|  |
| --- |
| **Sandy Healey Realtor** |
| **Balance Sheet** |
| **As at April 30, 20X7** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 70,000** | **Accounts payable** | **$ 32,000** |
| **Office supplies** | **13,000** | **Note payable** |  **36,000** |
| **Franchise** | **22,000** | **Total liabilities** |  **68,000** |
| **Furniture** | **38,000** | **SHAREHOLDERS’** |
| **Land** | **112,000** | **EQUITY** |
|  |  | **Share capital** | **85,000** |
|  |  | **Retained earnings** |  **102,000\*** |
|  |  | **Total shareholders’ equity** | **187,000** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$255,000** |  **shareholders’ equity** | **$255,000** |

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

**\*Total assets ($255,000) − Total liabilities ($68,000) − Share capital ($85,000) = Retained earnings ($102,000).**

***Req. 2***

**It appears that Sandy Healy’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 ($15,000)**

 **e. Personal residence ($360,000) and mortgage**

 **payable ($142,000)**

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

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

***Req. 1***

|  |
| --- |
| **Venus Rollers, Inc.** |
| **Income Statement** |
| **Year Ended December 31, 20X6** |
| **Revenue** |  |  |
|  **Service revenue……………….** |  | **$576,000** |
| **Expenses** |  |  |
|  **Salary expense………………...** | **$132,800** |  |
|  **Rent expense…………………..** | **52,000** |  |
|  **Interest expense………………** | **16,000** |  |
|  **Utilities expense………………** | **14,800** |  |
|  **Property tax expense…………** |  **6,400** |  |
|  **Total expenses…………………** |  |  **222,000** |
| **Net income………………………...** |  | **$ 354,000** |

***Req. 2***

|  |  |
| --- | --- |
| **Venus Rollers, Inc.** |  |
| **Statement of Changes in Equity** |  |
| **Year Ended December 31, 20X6** |  |
| **Total Equity, January 1, 20X6…………….** | **$468,800** |
| **Add: Net income for the year……….…..** |  **354,000** |
|  |  **822,800** |
| **Less: Dividends…………………………....** |  **(166,400)** |
| **Total Equity, December 31, 20X6………** | **$ 656,400** |

**(continued) P 1-59A**

***Req. 3***

|  |
| --- |
| **Venus Rollers, Inc.** |
| **Balance Sheet** |
| **As at December 31, 20X6** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **$ 56,000** | **Accounts payable** | **$ 40,000** |
| **Accounts receivable** | **88,000** | **Interest payable** |  **7,200** |
| **Supplies** | **9,200** | **Note payable** |  **110,000** |
| **Equipment** | **126,800** | **Total liabilities** |  **157,200** |
| **Building** | **501,600** | **SHAREHOLDERS’** |
| **Land** | **32,000** | **EQUITY** |
|  |  | **Share capital** | **4,800** |
|  |  | **Retained earnings** |  **651,900** |
|  |  | **Total shareholders’ equity** | **656,400** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$813,600** |  **shareholders’ equity** | **$813,600** |

***Req. 4***

**a. Venus Rollers was profitable; net income was $354,000.**

**b. Retained earnings increased by $187,600 — from $464,000 to $651,600.**

**c. Total equity ($656,400) exceeds total liabilities ($157,200).**

 **Therefore, the shareholders own more of the company’s assets than the creditors. (20 min.) P 1-60A**

***Req. 1***

|  |
| --- |
| **Water Fountain Company** |
| **Statement of Cash Flows** |
| **Year Ended May 31, 20X7** |
|  | ***Millions*** |
| **Cash flows from operating activities:** |  |  |
|  **Net income…………………………………………** |  | **$ 3,000** |
|  **Adjustments to reconcile net income** |  |  |
|  **to cash provided by operations…………….** |  |  **2,250** |
|  **Net cash provided by operating activities..** |  |  **5,250** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
|  **Purchases of property, plant, and equipment.** |  **$(3,500)** |  |
|  **Sales of property, plant, and equipment……..** |  **50** |  |
|  **Other investing cash payments………………..** |  **(320)** |  |
|  **Net cash used for investing activities……..** |  |  **(3,770)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
|  **Issuance of common shares..…………………..** |  **$ 200** |  |
|  **Payment of dividends……………………………** |  **(300)** |  |
|  **Net cash used for financing activities……..** |  |  **(100)** |
|  |  |  |
| **Net increase in cash…………………………………** |  |  **1,380** |
| **Cash, beginning……………………………………** |  |  **300** |
| **Cash, ending………………………………………….** |  | **$ 1,680** |

***Req. 2***

**Operating activities provided the bulk of Water Fountain Company's cash. This is a sign of strength because operations should be the main source of cash.**

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

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **20X7** | **20X6** |  |  |
|  |  |  | ***(Thousands)*** |  |  |
| **INCOME STATEMENT**  |  |  |  |  |  |  |
| **Income revenues** | **13,850** | **=** | **$ k** | **$16,020** |  |  |
| **Cost of goods sold** |  |  | **(11,000)** |  **(a)** | **=** | **(12,900)** |
| **Other expenses** |  |  |  **(1,250)** |  **(1,200)** |  |  |
| **Income before income taxes** |  |  | **1,600** |  **1,920** |  |  |
| **Income taxes (35% tax rate)** | **560** | **=** |  **(l)** |  **672** |  |  |
| **Net income** | **1,040** | **=** | **$ m** | **$ b** | **=** |  **1,248** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CHANGES IN EQUITY** |  |  |  |  |  |  |
| **Beginning balance****Shares bought back** | **3,874** | **=** | **$ n****(30)** |  **$ 2,826****0** |  |  |
| **Net income** | **1,040** | **=** |  **o** |  **C** | **=** |  **1,248** |
| **Dividends** |  |  |  **(96)** |  **(200)** |  |  |
| **Ending balance** | **4,788** | **=** | **$ p** |  **$ d** | **=** |  **3,874** |
|  |  |  |  |  |  |  |
| **BALANCE SHEET** |  |  |  |  |  |  |
| **Assets:** |  |  |  |  |  |  |
|  **Cash** | **1,080** | **=** | **$ q** | **$ e** | **=** |  **1,160** |
|  **Property, plant and equipment** |  |  |  **1,680** |  **1,725** |  |  |
|  **Other assets** | **11,628** | **=** |  **r** |  **10,184** |  |  |
|  **Total assets** | **14,388** | **=** | **$ s** |  **$13,069** |  |  |
|  |  |  |  |  |  |  |
| **Liabilities:** |  |  |  |  |  |  |
|  **Current liabilities** | **5,290** | **=** | **$ t** | **$ 5,725** |  |  |
|  **Notes payable and long-term debt** |  |  |  **4,250** |  **3,400** |  |  |
|  **Other liabilities** |  |  |  **60** |  **70** |  |  |
|  **Total liabilities** |  |  |  **9,600** |  **f** | **=** |  **9,195** |
|  |  |  |  |  |  |  |
| **Shareholders’ Equity:** |  |  |  |  |  |  |
|  **Share capital** |  |  |  **$ 400** | **$ 410** |  |  |
|  **Retained earnings** | **4,388** | **=** |  **u** |  **g** | **=** |  **3,464** |
|  **Total shareholders’ equity** | **4,788** | **=** |  **v** |  **3,874** |  |  |
|  **Total liabilities and shareholders’ equity** | **14,388** | **=** | **$ w** |  **$ h** | **=** |  **13,069** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CASH FLOWS** |  |  |  |  |  |  |
|  **Net cash provided by operating activities** | **715** | **=** | **$ x** | **$ 850** |  |  |
|  **Net cash provided by investing activities** |  |  |  **(220)** |  **(320)** |  |  |
|  **Net cash used for financing activities** |  |  |  **(575)** |  **(570)** |  |  |
|  **Increase (decrease) in cash** |  |  |  **( 80)** |  **(i)** | **=** |  **(40)** |
|  **Cash at beginning of year** | **1,160** | **=** |  **y** |  **1,200** |  |  |
|  **Cash at end of year** | **1,080** | **=** | **$ z** |  **$ j** | **=** |  **1,160** |

**Problems**

**Group B**

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

***Req. 1***

|  |
| --- |
| **Division X of Paris Corporation** |
| **Income Statement** |
| **Year Ended December 31, 20X7** |
|  | ***Thousands*** |
| **Service revenue…………………..** | **€ 262** |  |
| **Sales revenue………………………..** |  **20** |  |
| **Total revenue………………………...** |  | **€ 282** |
| **Cost of goods sold………………….** | **17** |  |
| **Depreciation expense……………..** | **7** |  |
| **Other expenses……………………...** |  **230** |  |
| **Total expenses………………………** |  |  **254** |
| **Net income……………………………** |  | **€ 28** |

**(continued) P 1-62B**

***Req. 2***

**a. Faithful representation characteristic. 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. Accrual accounting. While cash was only received later on, revenue is recognized because services have been performed.**

**c. Entity concept. If the reporting entity is Division X, then the revenue is recognized. If the reporting entity is Paris Corporation as a whole, then sales from one division to another alone is not recognized as revenue.**

**d. Faithful representation characteristics. New information is a more faithful representation rather than old information.**

**e. Accrual accounting. While cash was only paid later on, expenses are recognized because services have been consumed or goods have been used.**

**(30 min.) P 1-63B**

***Req. 1***

**Computed amounts in boxes.**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Dylan** | **Zachary** | **Eunice** |
|  | ***Millions*** |
| ***Balance sheets:*** |  |  |  |
| ***Beginning*:** |  |  |  |
|  **Assets………………………...** | **€ 320** | **€ 160** | **€ 32** |
|  **Liabilities……………………..** | **172** | **100** | **4** |
|  **Share capital ……………...** | **36** | **12** | **8** |
|  **Retained earnings………….** | **112** | **48** | **20** |
|  |  |  |  |
| ***Ending*:** |  |  |  |
|  **Assets………………………...** | **€ 336** | **€ 168** | **€ 32** |
|  **Liabilities……………………..** | **192** | **96** | **2** |
|  **Share capital ……………...** | **12** | **8** | **2** |
|  **Retained earnings………….** | **132** | **64** |  **28** |
|  |  |  |  |
| ***Income statement*:** |  |  |  |
|  **Revenues…………………….** | **€872** | **€644** | **€48** |
|  **Expenses…………………….** |  **840** |  **608** |  **32** |
|  **Net income…………………..** | **$ 32** | **$ 36** | **16** |
|  |  |  |  |
| ***Statement of changes in equity:*** |  |  |  |
|  **Beginning RE………………..** | **€ 112** | **€ 48** | **€ 20** |
| **+ Net income…………………..** | **32** | **36** | **16** |
| **− Dividends…………………….** |  **(12)** |  **(20)** |  **(8)** |
| **= Ending RE……………………** | **$ 132** | **$ 64** | **$ 28** |

***Req. 2***

|  |  |
| --- | --- |
|  | **Dylan Zachary Eunice** |
|  |  |  ***Millions*** |  |  |  |
|  |  |  |  |  |  |
| **Net income………….** | **€32** |  |  | **€36** |  |  | **€16** |  |
|  |  |  |  |  ***Highest*** |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| **% of net income** | **€32** | **= 3.7%** |  | **€36** | **= 5.6%** |  | **€16** | **= 33%** |
|  **to revenues………** | **€872** |  | **€644** |  | **€48** |
|  |  |  |  |  |  | ***Highest*** |  |

**The company that has the highest net income is Zachary Corp.**

**The company that has the highest percentage of net income to revenues is Eunice Corp.**

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

***Req. 1***

|  |
| --- |
| **Red Tape, Inc.** |
| **Balance Sheet** |
| **As at June 30, 20X6** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **€14,400** | **Accounts payable** |  **€ 10,000** |
| **Accounts receivable** | **6,400** | **Note payable** |  **112,000** |
| **Notes receivable** | **29,200** | **Total liabilities** |  **122,000** |
| **Office supplies** | **1,400** | **SHAREHOLDERS’** |
| **Equipment** | **76,400** | **EQUITY** |
| **Land** | **162,000** | **Shareholders’ equity** |  **167,800\*** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **€289,800** |  **shareholders’ equity** | **€289,800** |

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

**\*Total assets (€289,800) − Total liabilities (€122,000) =**

 **Shareholders’ equity (€167,800).**

***Req. 2***

**Red Tape, Inc. is in *better* financial position than the erroneous balance sheet reports. Liabilities are less, 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 1-65B**

***Req. 1***

|  |
| --- |
| **Jeana Hart, Inc.** |
| **Balance Sheet** |
| **As at September 30, 20X7** |
| **ASSETS** | **LIABILITIES** |
| **Cash** |  **€31,000** | **Accounts payable** |  **€ 30,000** |
| **Office supplies** | **5,000** | **Note payable** |  **35,000** |
| **Franchise** | **28,000** | **Total liabilities** |  **65,000** |
| **Furniture** | **40,000** | **SHAREHOLDERS’** |
| **Land** | **115,000** | **EQUITY** |
|  |  | **Share capital** |  **80,000** |
|  |  | **Retained earnings** |  **74,000\*** |
|  |  | **Total shareholders’ equity** |  **154,000** |
|  |  | **Total liabilities and** | **\_\_\_\_\_\_\_\_** |
| **Total assets** | **€219,000** |  **shareholders’ equity** | **€219,000** |

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

**\*Total assets (€219,000) − Total liabilities (€65,000) − Share capital (€80,000) = €74,000.**

***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 (€11,000)**

 **b. Personal account payable (€1,000)**

 **g. Personal residence (€375,000) and mortgage payable (€141,000)**

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

***Req. 1***

|  |
| --- |
| **Green Lotus**  |
| **Income Statement** |
| **Year Ended December 31, 20X6** |
| **Revenue** |  |  |
|  **Service revenue…………………** |  | **€429,000** |
| **Expenses** |  |  |
|  **Salary expense………………….** | **€111,000** |  |
|  **Rent expense……………………** | **39,600** |  |
|  **Utilities expense……………...** | **14,550** |  |
|  **Interest expense………………..** | **9,000** |  |
|  **Property tax expense…………..** |  **4,500** |  |
|  **Total expenses…………………..** |  |  **178,650** |
| **Net income………………………….** |  | **€ 250,350** |

***Req. 2***

|  |  |
| --- | --- |
| **Green Lotus** |  |
| **Statement of Changes in Equity** |  |
| **Year Ended December 31, 20X6** |  |
| **Total equity, January 1, 20X6……….........** |  **€ 398,250**  |
| **Add: Net income for the year……………** |  **250,350** |
|  |  **648,600** |
| **Less: Dividends…………………………….** |  **(138,000)** |
| **Total equity, December 31, 20X6……….…** |  **€ 510,600** |

**(continued) P 1-66B**

### Req. 3

|  |
| --- |
| **Green Lotus** |
| **Balance Sheet** |
| **As at December 31, 20X6** |
| **ASSETS** | **LIABILITIES** |
| **Cash** | **€ 45,000** | **Accounts payable** | **€ 40,500** |
| **Accounts receivable** | **81,000** | **Interest payable** |  **3,000** |
| **Supplies** | **5,100** | **Note payable** | **97,500** |
| **Equipment** | **108,900** | **Total liabilities** | **141,000** |
| **Building** | **387,600** | **SHAREHOLDERS’** |
| **Land** | **24,000** | **EQUITY** |
|  |  | **Share capital** | **48,750** |
|  |  | **Retained earnings** |  **461,850** |
|  |  | **Total shareholders’ equity** |  **510,600**  |
|  |  | **Total liabilities and** |  |
| **Total assets** | **€651,600** |  **shareholders’ equity** | **€651,600** |

***Req. 4***

**a. Green Lotus was profitable; net income was €250,350.**

**b. Retained earnings increased by €112,350 — from €349,500 to €461,850.**

**c. Total equity (€510,600) exceeds total liabilities (€141,000).**

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

**(20 min.) P 1-67B**

***Req. 1***

|  |
| --- |
| **The High Tide Company** |
| **Statement of Cash Flows** |
| **Year Ended May 31, 20X7** |
|  | ***Millions*** |
| **Cash flows from operating activities:** |  |  |
|  **Net income…………………………………………** |  | **€ 3,000** |
|  **Adjustments to reconcile net income** |  |  |
|  **to cash provided by operations…………….** |  |  **2,420** |
|  **Net cash provided by operating activities..** |  |  **5,420** |
|  |  |  |
| **Cash flows from investing activities:** |  |  |
|  **Purchases of property, plant, and equipment.** | **€(3,500)** |  |
|  **Sales of property, plant, and equipment……..** |  **50** |  |
|  **Other investing cash payments………………..** |  **(180)** |  |
|  **Net cash used for investing activities……..** |  | **(3,630)** |
|  |  |  |
| **Cash flows from financing activities:** |  |  |
|  **Issuance of common shares..…………………..** |  **€ 175** |  |
|  **Payment of dividends……………………………** |  **(290)** |  |
|  **Net cash provided by financing activities…** |  |  **(115)** |
|  |  |  |
| **Net increase in cash…………………………………** |  | **$ 1,675** |
| **Cash, beginning……………………………………** |  |  **150** |
| **Cash, ending………………………………………….** |  | **€ 1,825** |

***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**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **20X7** | **20X6** |  |  |
| **INCOME STATEMENT** |  |  |  |  |  |  |
| **Revenues** | **€13,910** | **=** | **$ k** | **€15,300** |  |  |
| **Cost of goods sold** |  |  | **(11,010)** |  **(a)** | **=** | **(12,300)** |
| **Other expenses** |  |  |  **(1,300)** | **(1,200)** |  |  |
| **Income before income taxes** |  |  |  **1,600** | **1,800** |  |  |
| **Income taxes (35% tax rate** | **560** | **=** |  **(l)** |  **(630)** |  |  |
| **Net income** | **1,040** | **=** | **€ m** | **€ b** | **=** | **1,170** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CHANGES IN EQUITY** |  |  |  |  |  |  |
| **Beginning balance****Shares bought back** | **4,400** | **=** | **€ n****(100)** | **$ 3,430****0** |  |  |
| **Net income** | **1,040** | **=** |  **o** |  **c** | **=** | **1,170** |
| **Dividends** |  |  |  **(121)** |  **(200)** |  |  |
| **Ending balance** | **5,219** | **=** | **€ p** | **€ d** | **=** | **4,400** |
|  |  |  |  |  |  |  |
| **BALANCE SHEET** |  |  |  |  |  |  |
| **Assets:** |  |  |  |  |  |  |
|  **Cash** | **1,155** | **=** | **€ q** | **€ e** | **=** | **1,235** |
|  **Property, plant and equipment** |  |  | **2,006** |  **1,830** |  |  |
|  **Other assets** | **11,044** | **=** |  **r** |  **10,500** |  |  |
|  **Total assets** | **14,205** | **=** | **€ s** | **€13,565** |  |  |
|  |  |  |  |  |  |  |
| **Liabilities:** |  |  |  |  |  |  |
|  **Current liabilities** | **4,326** | **=** | **€ t** | **€ 5,800** |  |  |
|  **Notes payale and long-term debt**  **Other liabilties** |  |  |  **4,600****60** |  **3,300****65** |  |  |
|  **Total liabilities** |  |  | **8,986** |  **f** | **=** | **9,165** |
|  |  |  |  |  |  |  |
| **Shareholders’ Equity:** |  |  |  |  |  |  |
|  **Share capital** |  |  | **€ 479** | **€ 556** |  |  |
|  **Retained earnings** | **4,740** | **=** |  **u** |  **g** | **=** | **3,844** |
|  **Total shareholders’ equity** | **5,219** | **=** |  **v** |  **4,400** |  |  |
|  **Total liabilities and shareholders’ equity** | **14,205** | **=** | **€ w** | **€ h** | **=** | **13,565** |
|  |  |  |  |  |  |  |
| **STATEMENT OF CASH FLOWS** |  |  |  |  |  |  |
|  **Net cash provided by operating activities** | **630** | **=** | **€ x** | **€ 840** |  |  |
|  **Net cash used for investing activities** |  |  | **(230)** | **(330)** |  |  |
|  **Net cash provided by financing activities** |  |  |  **(480)** |  **(475)** |  |  |
|  **Increase (decrease) in cash** |  |  |  **( 80)** |  **i** | **=** | **35** |
|  **Cash at beginning of year** | **1,235** | **=** |  **y** |  **1,200** |  |  |
|  **Cash at end of year** | **1,155** | **=** | **€ z** | **€ j** | **=** | **1,235** |

**Decision Cases**

**(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 shareholders’ equity is far greater than that of Blue Skies’ owners’ equity ($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.** |  | **GrandPrize Unlimited, Inc.** |
| **Income Statement** |  | **Balance Sheet** |
| **Year Ended Dec. 31, 20X6** |  | **Dec. 31, 20X6** |
| **Revenues………..** |  **$145,0001** |  | **Cash……………** | **$ 7,000** | **Liabilities………** | **$66,0004** |
| **Expenses………..** |  **120,0002** |  | **Other assets….** |  **79,0003** | **Equity…………..** |  **20,0005** |
|  |  |  |  |  | **Total liabilities** |  |
| **Net income………** |  **$ 25,000**  |  | **Total assets…...** | **$86,000** | **and equity……..** | **$86,000** |

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

**1$120,000 + $25,000 = $145,000**

**2$75,000 + $45,000 = $120,000**

**3$99,000 − $45,000 + $25,000 = $79,000**

**4$56,000 + $10,000 = $66,000**

**5$86,000 − $66,000 = $20,000**

***Req. 2***

**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. 3***

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

**Ethical Issue**

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

***Req. 1***

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

***Req. 2***

**The stakeholders are:**

1. **You**
2. **Your friend**
3. **The remainder of the students in the class**
4. **The professor**
5. **The University**
6. **Your family**

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

**Consequences are discussed in requirement 3.**

***Req. 3***

**Analysis of the problem:**

1. **Economic perspective: If use of the old exam turns out to help you (it may not) you might improve your grade and allow you to retain your scholarship. This might help you and your family financially. If you use the exam to your unfair advantage, and you are reported, you and possibly your friend might receive grades of F in the class although you might otherwise have passed. This could cause adverse economic consequences to you, your friend and your families.**
2. **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.**
3. **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 “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 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: Nestlé**

**(30 min.)**

**1. Suggested item- Net Profit (profit attributable to shareholders of the parent) – The net profit, or earnings, of Nestlé is derived by subtracting out expenses and losses from total revenues (sales and other revenues). This income determines (to a certain extent), the dividends that can be paid out. Although revenues are also extremely important to shareholders, profitability should be more important to Nestlé’s shareholders as its large market share inhibits high organic growth rates. The profitability of Nestlé should thus be afforded more consideration than their ability to grow their revenues. From 2020 to 2021, though the net profit of Nestlé increased by 39% indicating increased profitability, this is mainly due to significantly higher share of income from associates and joint ventures. In fact, the profit before taxes, associates and joint ventures was down by 22.38% due to comparatively higher rate of increase in expenses vis-à-vis the revenues. This is troubling news for investors.**

***2.* The largest expense item was cost of goods sold. This refers to all the direct costs that are incurred in manufacturing and selling a good.**

**3. Both sales and net income have increased over the 5-year period of 2017–2021. Note that in 2021, the sharp rise in net profit of CHF 16,905 million from CHF 12,232 million the past year was due mainly to higher share of income from the associates and joint ventures. As we analyse trends in financial statements, it is crucial that we seek to remove these non-recurring events that could cloud the observed trends.**

**4. At December 31, 2021:**

**a. Nestlé owned total assets worth CHF 139,142 million.**

**b. Of these, CHF 85,415 million was owed to external parties in the form of liabilities.**

**c. Shareholders owned a total of CHF 53,727 million in the form of shareholders’ equity.**

**Thus, the accounting equation can be simplified as follows:**

**Assets (CHF 139,142 m) = Liabilities (CHF 85,415 m) + Shareholders’ equity (CHF 53,727 m)**

**5. Retained earnings increased from CHF 76,812 million in 2020 to CHF 81,363 million in 2021. Although the company made CHF 16,905 million in net profits and paid out dividends of CHF 7,681 million to equity owners, other items like changes in the balance sheet do affect retained earnings.**

**6. Nestlé started out with CHF 5,235 million in cash in 2020 and ended that year with CHF 6,988 million. It is necessary for Nestlé to have a healthy cash balance to fund working capital needs (paying salaries, utilities bills, repayment of principal and interest on loans) and also, to act quickly on acquisition opportunities.**

**Group Projects**

***Student responses will vary*.**