Financial Accounting 6th edition Spiceland Solutions Manual

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Chapter 1
A Framework for Financial Accounting

REVIEW QUESTIONS

Question 1-1 (LO 1-1)

Accounting is the language of business. Whereas a basic math class might involve adding, subtracting, and solving for unknown variables, accounting involves learning to measure business transactions and communicating those measurements in a format that is generally understood by decision makers.

Question 1-2 (LO 1-1)

Those interested in making decisions about a company include investors, creditors, customers, suppliers, managers, employees, competitors, regulators, tax authorities, and local communities.

Question 1-3 (LO 1-1)

Financial accounting seeks to measure business activities of a company and to communicate those measurements to *external* parties for decision-making purposes. The two primary external, or outside the firm, users of financial accounting information are investors and creditors. Managerial accounting deals with the methods accountants use to provide information to an organization's *internal* users, that is, its own managers.

Question 1-4 (LO 1-1)

The two primary functions of financial accounting are to measure business activities of a company and to communicate information about those activities to investors and creditors for decision-making purposes.

Question 1-5 (LO 1-2)

The three basic business activities are financing, investing, and operating activities. Financing activities are transactions that raise cash needed to operate the business, such as issuing stock and borrowing money from a bank. Investing activities typically include the purchase or disposal of long-term resources that are expected to benefit the company for several years, such as land, buildings, equipment, and machinery. Operating activities include the primary operations of the company, providing products and services to customers and the associated costs of doing so, like utilities, taxes, advertising, wages, rent, and maintenance.

Question 1-6 (LO 1-2)

Typical financing activities for UPS would include selling stock and paying dividends to investors, as well as borrowing and repaying debt to creditors.

Question 1-7 (LO 1-2)

Typical investing activities for Caesars Entertainment would include the purchase or disposal of land, casino buildings, hotels, gaming tables, chairs, cleaning equipment, and food preparation machines.

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Answers to Review Questions (continued)

Question 1-8 (LO 1-2)

Typical operating activities for Oracle would include the sale of software and consulting services, as well as costs related to salaries, research, utilities, advertising, rent, and taxes.

Question 1-9 (LO 1-2)

The three major legal forms of business organizations include sole proprietorship, partnership, and corporation? A corporation is chosen by most of the largest companies in the United States.

Question 1-10 (LO 1-2)

Assets: Resources owned.
Liabilities: Amounts owed.
Stockholders' equity: Owners' claims to resources.
Dividends: Distributions to stockholders.
Revenues: Sales of products or services to customers.
Expenses: Costs of selling products or services.

Question 1-11 (LO 1-2)

The major advantage of a corporation is limited liability. Stockholders of a corporation are not held personally responsible for the financial obligations of the corporation. Owners of sole proprietorships or partnerships remain personally liable for activities of the business. Corporations have the disadvantages of double taxation compared to sole proprietorships and partnerships. Sole proprietorship and partnership forms of business have the advantage that income is taxed only once. However, there could be other tax advantages for certain types of corporations, such as a lower overall tax rate compared to partnerships and sole proprietorships. Sole proprietorships and partnerships are often limited in the amount of funds they can raise to start a business.

Question 1-12 (LO 1-3)

1. **Income statement**: Reports the company's revenues and expenses during an interval of time. If revenues exceed expenses, then the company reports net income. If expenses exceed revenues, then the company reports a net loss.
2. **Statement of stockholders' equity**: Summarizes the changes in stockholders' equity from net income, dividends, and stock issuances during an interval of time.
3. **Balance sheet**: Presents the financial position of the company on a particular date. It shows that assets equal liabilities plus stockholders' equity.
4. **Statement of cash flows**: Reports cash inflows and outflows related to operating, investing, and financing activities during an interval of time.

Question 1-13 (LO 1-3)

Balances of accounts reported in the income statement, statement of stockholders' equity, and statement of cash flows reflect activity from the beginning of the period through the end of the period. Balances of accounts reported in the balance sheet reflect the financial position of the company as of a single date, the end of the period. The income statement, statement of stockholders' equity and statement of cash flows is like a video (shows events over time), whereas the balance sheet is like a photograph (shows events at a point in time).

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Answers to Review Questions (continued)

Question 1-14 (LO 1-3)

Basic revenues would include sale of products (such as toys, dolls, and games) and services (such as theme park tickets). Expenses include cost of merchandise sold, employee salaries, utilities, advertising, taxes, interest, and legal fees.

Question 1-15 (LO 1-3)

The accounting equation is: Assets = Liabilities + Stockholders' Equity. The format of the balance sheet follows the accounting equation.

Question 1-16 (LO 1-3)

Assets would include items such as merchandise inventory, office supplies, buildings, land, trucks, and equipment. Liabilities would include items such as amounts owed to employees, suppliers, taxing authorities, and lenders.

Question 1-17 (LO 1-3)

Retained earnings represent the cumulative amount of net income earned over the life of the company that has *not* been distributed to stockholders as dividends. Net income is shown in the income statement and retained earnings are reported in the balance sheet. Thus, retained earnings represent a balance sheet account which reflects the cumulative result of income statements over the life of the company (less any dividends).

Question 1-18 (LO 1-3)

The statement of cash flows reports operating, investing, and financing activities involving cash receipts and cash payments over an interval of time. Examples of each include:

Operating – selling merchandise, paying employee salaries, and paying for advertisement.

Investing – purchasing land and buildings to open new factories and selling equipment for cash.

Financing – Borrowing from lenders or issuing stock to owners to obtain funds necessary to expand operations.

Question 1-19 (LO 1-3)

Two other important sources of information are the (1) management discussion and analysis (MD&A) of the company's activities and (2) note disclosures to the financial statements.

Question 1-20 (LO 1-4)

Successful companies use their resources efficiently to sell products and services for a profit. Unsuccessful companies either offer lower-quality products and services or do not efficiently keep their costs low. When a company is unprofitable, investors will neither invest in nor lend to the firm. Without these sources of financing, eventually the company will fail. When a company is able to make a profit, investors and creditors are willing to transfer their resources to it, and the company will expand its profitable operations even further. Investors and creditors rely heavily on financial accounting information in making investment and lending decisions.

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Answers to Review Questions (continued)

Question 1-21 (LO 1-5)

GAAP refers to Generally Accepted Accounting Principles, or the rules of financial accounting. The fact that all companies use the same rules is critical to financial statement users, because it allows them to accurately *compare* financial information among companies when they are making decisions about where to lend or invest their resources. The U.S. Securities and Exchange Commission requires that all public companies listed on stock exchanges follow GAAP. Private companies must follow GAAP in many contractual relationships with lenders and investors.

Question 1-22 (LO 1-5)

The Financial Accounting Standards Board (FASB) is primarily responsible for the establishment of GAAP in the United States. The International Accounting Standards Board (IASB) serves this function on an international basis.

Question 1-23 (LO 1-5)

U.S. GAAP refers to the set of accounting standards being developed in the United States by the Financial Accounting Standards Board (FASB). IFRS (International Financial Reporting Standards) refers to the set of accounting standards being developed by the International Accounting Standards Board (IASB). The IASB promotes the use of IFRS around the world. Today, the IASB and FASB work closely in an effort to converge the two sets of accounting standards.

Question 1-24 (LO 1-5)

The 1933 Securities Act and the 1934 Securities Exchange Act were designed to restore investor confidence in financial accounting following the stock market crash in 1929 and the ensuing Great Depression. The SEC has the power to require companies with publicly traded securities to prepare periodic financial statements for distribution to investors and creditors.

Question 1-25 (LO 1-5)

The role of auditors is to help ensure that management has in fact appropriately applied GAAP in preparing the company's financial statements. They are hired by a company as an independent party to express a professional opinion of the conformity of that company's financial statements with GAAP. Auditors play a major role in investors' and creditors' decisions by adding credibility to the financial statements.

Question 1-26 (LO 1-5)

According to FASB, the three objectives of financial reporting are providing information that:

1. is useful to investors and creditors in making decisions.
2. helps to predict cash flows.
3. tells about economic resources, claims to resources, and changes in resources and claims.

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Answers to Review Questions (continued)

Question 1-27 (LO 1-6)

The benefits to obtaining a degree in accounting include a wide variety of job opportunities, high demand, and high salaries. Public accounting firms are professional service firms that traditionally have focused on three areas: auditing, tax preparation/planning, and business consulting. Private accounting means providing accounting services to the company that employs you. Traditional careers include auditor, tax preparer, consultant, and basic accounting services. Accountants are now expanding to work as financial analysts, forensic accountants, tax lawyers, FBI agents, and many others.

Question 1-28 (LO 1-7)

Relevance and *faithful representation* are the two fundamental qualitative characteristics. Relevance implies that information is useful to the decision at hand. Faithful representation indicates that information accurately represents the underlying activity.

Question 1-29 (LO 1-7)

The three components/aspects of relevance include:

1. Predictive value – Information is useful in helping to forecast future outcomes.
2. Confirmatory value – Information provides feedback on past activities.
3. Materiality – The nature or amount of an item has the ability to affect decisions.

The three components/aspects of faithful representation include:

1. Completeness – All information necessary to describe an item is reported.
2. Neutrality – Measurements that independent parties would agree upon.
3. Free from error – Reported amounts reflect the best available information.

Question 1-30 (LO 1-7)

Cost effectiveness refers to practical boundaries (constraints) to achieving desired qualitative characteristics. Cost effectiveness suggests that financial accounting information is provided only when the benefits of doing so exceed the costs.

Question 1-31 (LO 1-7)

The four basic assumptions underlying GAAP include:

1. Economic entity assumption – All economic events can be identified with a particular economic entity.
2. Monetary unit assumption - A common denominator is needed to measure all elements. The dollar in the United States is the most appropriate common denominator to express information about financial statement elements and changes in those elements.
3. Periodicity assumption – The economic life of an enterprise (presumed to be indefinite) can be divided into artificial time periods for financial reporting.
4. Going concern assumption – In the absence of information to the contrary, it is anticipated that a business entity will continue to operate indefinitely.

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BRIEF EXERCISES

Brief Exercise 1-1 (LO 1-1)

1. True
2. True
3. False

Brief Exercise 1-2 (LO 1-2)

1. b.
2. c.
3. a.

Brief Exercise 1-3 (LO 1-2)

1. c.
2. a.
3. b.

Brief Exercise 1-4 (LO 1-2)

1. e.
2. f.
3. b.
4. c.
5. a.
6. d.

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Brief Exercise 1-5 (LO 1-2)

1. e.
2. d.
3. f.
4. a.
5. b.

Brief Exercise 1-6 (LO 1-2)

1. b.
2. a.
3. e.
4. c.
5. d.

Brief Exercise 1-7 (LO 1-3)

1. b.
2. a.
3. d.
4. c.

Brief Exercise 1-8 (LO 1-3)

1. c.
2. a.
3. d.
4. b.

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Brief Exercise 1-9 (LO 1-5)

1. b.
2. d.
3. a.
4. c.

Brief Exercise 1-10 (LO 1-5)

1. Yes.
2. No.
3. Yes.
4. No.
5. Yes.
6. No.

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Brief Exercise 1-11 (LO 1-6)

1. **True**
2. **True**
3. **True**
4. **True**
5. **True**
6. **True**
7. **True**
8. **True**
9. **True**
10. **True**
11. **True**
12. **True**

Brief Exercise 1-12 (LO 1-7)

1. b.
2. a.
3. c.

Brief Exercise 1-13 (LO 1-7)

1. c.
2. b.
3. a.

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EXERCISES

Exercise 1-1 (LO 1-2)

1. a.
2. c.
3. a.
4. b.
5. c.
6. a.
7. b.

Exercise 1-2 (LO 1-2)

Transaction	Financial Statement	Account	Activity
1. Falcon purchases common stock of Wildcat.	Balance sheet	Asset	Investing
2. Falcon borrows from Wildcat by signing a note.	Balance sheet	Liability	Financing
3. Falcon provides services to Wildcat.	Income statement	Revenue	Operating
4. Falcon pays interest to Wildcat on borrowing.	Income statement	Expense	Operating

Exercise 1-3 (LO 1-2)

Transaction	Financial Statement	Account	Activity
1. Wildcat issues common stock to Falcon.	Balance sheet	Equity	Financing
2. Wildcat lends to Falcon by accepting a note.	Balance sheet	Asset	Investing
3. Wildcat receives services from Falcon.	Income statement	Expense	Operating
4. Wildcat receives interest from Falcon on lending.	Income statement	Revenue	Operating

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Exercise 1-4 (LO 1-2)

Requirement 1

Revenues	−	Expenses	=	Net Income
$14,000	−	$9,000	=	**$5,000**

Requirement 2

Assets	=	Liabilities	+	Stockholders' equity
$50,000	=	$27,000	+	$X
$50,000	−	$27,000	=	**$23,000**

Exercise 1-5 (LO 1-2)

Requirement 1

Revenues	−	Expenses	=	Net Loss
$28,000	−	$33,000	=	**($5,000)**

Requirement 2

Assets	=	Liabilities	+	Stockholders' equity
$19,000	=	$15,000	+	$X
$19,000	−	$15,000	=	**$4,000**

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Exercise 1-6 (LO 1-3)

Cowboy Law Firm
Income Statement
For the period ended December 31

Service revenue	$9,300
Expenses:	
Salaries	2,200
Utilities	1,200
Total expenses	3,400
Net income	$5,900

Exercise 1-7 (LO 1-3)

Buffalo Drilling
Statement of Stockholders' Equity
For the year ended December 31

	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance, Jan. 1	$11,000	$ 8,200	$19,200
Issuance of common stock	8,000		8,000
Add: Net income		8,500	8,500
Less: Dividends		(3,200)	(3,200)
Ending balance, Dec. 31	$19,000	$13,500	$32,500

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Exercise 1-8 (LO 1-3)

Wolfpack Construction
Balance Sheet
December 31

Assets		Liabilities		
Cash	$ 6,000	Accounts payable	$ 3,000	
Land	18,000	Notes payable	20,000	
Equipment	26,000	Total liabilities	23,000	
		Stockholders' Equity		
		Common stock	11,000	
		Retained earnings	16,000	*
		Total stockholders' equity	27,000	
Total assets	$50,000	Total liabilities and stockholders' equity	$50,000	

*

Assets	=	Liabilities	+	Stockholders' equity
$50,000	=	$23,000	+	($11,000 + Retained earnings)
$50,000	−	$23,000	−	$11,000 = Retained earnings
				$16,000 = Retained earnings

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Exercise 1-9 (LO 1-3)

Requirement 1

Beginning balance	$ 5,000
Cash received from sale of products to customers	40,000
Cash received from the bank for long-term loan	45,000
Cash paid to purchase factory equipment	(50,000)
Cash paid to merchandise suppliers	(12,000)
Cash received from the sale of an unused warehouse	13,000
Cash paid to workers	(24,000)
Cash paid for advertisement	(4,000)
Cash received for sale of services to customers	30,000
Cash paid for dividends to stockholders	(6,000)
Ending balance	**$37,000**

Requirement 2

Tiger Trade
Statement of Cash Flows

Cash Flows from Operating Activities		
Cash inflows:		
From sale of products to customers	$40,000	
From sale of services to customers	30,000	
Cash outflows:		
For merchandise suppliers	(12,000)	
For workers	(24,000)	
For advertisement	(4,000)	
Net cash flows from operating activities		$30,000
Cash Flows from Investing Activities		
Purchase factory equipment	(50,000)	
Sale of warehouse	13,000	
Net cash flows used in investing activities		(37,000)
Cash Flows from Financing Activities		
Borrow from bank	45,000	
Pay dividends	(6,000)	
Net cash flows from financing activities		39,000
Net increase in cash		32,000
Cash at the beginning of the year		5,000
Cash at the end of the year		$37,000

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Exercise 1-10 (LO 1-3)

Requirement 1

Fighting Okra Cooking Services
Income Statement
For the year ended December 31, 2024

Service revenue	$75,000
Expenses:	
Salaries	24,000
Supplies	14,500
Rent	10,600
Legal fees	2,400
Postage	1,500
Total expenses	53,000
Net income	**$22,000**

Requirement 2

Fighting Okra Cooking Services
Statement of Stockholders' Equity
For the year ended December 31, 2024

	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance	$200,000	$32,000	$232,000
Issuance of common stock	25,000		25,000
Add: Net income		**22,000**	22,000
Less: Dividends		(10,000)	(10,000)
Ending balance	$225,000	$44,000	$269,000

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Exercise 1-11 (LO 1-3)

Requirement 1

Artichoke Academy
Statement of Stockholders' Equity
For the year ended December 31, 2024

	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance	$150,000	$50,000	$200,000
Issuance of common stock	40,000		40,000
Add: Net income		30,000	30,000
Less: Dividends		(10,000)	(10,000)
Ending balance	**$190,000**	**$70,000**	$260,000

Requirement 2

Artichoke Academy
Balance Sheet
December 31, 2024

Assets		**Liabilities**	
Cash	$ 52,600	Accounts payable	$ 9,100
Supplies	13,400	Utilities payable	2,400
Prepaid rent	24,000	Salaries payable	3,500
Land	200,000	Notes payable	15,000
		Total liabilities	30,000
		Stockholders' Equity	
		Common stock	**190,000**
		Retained earnings	**70,000**
		Total stockholders' equity	260,000
Total assets	$290,000	Total liabilities and stockholders' equity	$290,000

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Exercise 1-12 (LO 1-3)

Requirement 1

Squirrel Tree Services
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 7,700	Accounts payable	$ 9,700
Supplies	1,800	Salaries payable	3,500
Prepaid insurance	3,500	Notes payable	20,000
Building	72,000	Total liabilities	33,200
		Stockholders' Equity	
		Common stock	40,000
		Retained earnings	11,800
		Total stockholders' equity	51,800
Total assets	$85,000	Total liabilities and stockholders' equity	$85,000

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Requirement 2

Squirrel Tree Services
Statement of Cash Flows
For the year ended December 31, 2024

Cash Flows from Operating Activities		
Cash inflows from customers	$ 60,000	
Cash outflows for salaries	(22,000)	
Cash outflows for supplies	(4,000)	
Net cash flows from operating activities		$34,000
Cash Flows from Investing Activities		
Sale of investments	10,000	
Purchase building	(62,000)	
Net cash flows used in investing activities		(52,000)
Cash Flows from Financing Activities		
Borrow from bank	20,000	
Pay dividends	(6,500)	
Net cash flows from financing activities		13,500
Net decrease in cash		(4,500)
Cash at the beginning of the year*		12,200
Cash at the end of the year		$ **7,700**

* Plug number in order to calculate correct ending balance

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Exercise 1-13 (LO 1-3)

1.	Revenues	−	Expenses	=	Net Income
	$27,000	−	$18,000	=	**$9,000**

2.	Change in stockholders' equity	=	Issue common stock	+	Net Income	−	Dividends
	$17,000	=	$11,000	+	$12,000	−	$X
	$17,000	−	$11,000	−	$12,000	=	**$6,000**

3.	Assets	=	Liabilities	+	Stockholders' equity
	$24,000	=	$X	+	$15,000
	$24,000	=	**$9,000**	+	$15,000

4.	Total change in cash	=	Operating cash flows	+	Investing cash flows	+	Financing cash flows
	$26,000	=	$34,000	+	($17,000)	+	$X
	$26,000	−	$34,000	−	($17,000)	=	**$9,000**

Exercise 1-14 (LO 1-3)

Year	Net Income	Dividends	Retained Earnings*
1	$1,700	$ 600	**$ 1,100**
2	2,200	600	**2,700**
3	3,100	1,500	**4,300**
4	4,200	1,500	**7,000**
5	5,400	1,500	**10,900**

* Retained earnings = Beginning retained earnings + Net income − Dividends

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Exercise 1-15 (LO 1-3)

($ in billions)

	Change in retained earnings	=	Net income	−	Dividends

1.	Change in retained earnings	=	Net income	−	Dividends
	$3.2	=	$6.9	−	**$X**
	$3.2	=	$6.9	−	**$3.7**
2.	Change in retained earnings	=	Net income	−	Dividends
	$3.4	=	**$X**	−	$2.6
	$3.4	=	**$6.0**	−	$2.6
3.	Change in retained earnings	=	Net income	−	Dividends
	$1.6	=	$1.6	−	**$X**
	$1.6	=	$1.6	−	**$0**
4.	Change in retained earnings	=	Net income	−	Dividends
	[**$X** − (−$1.6)]	=	($1.0)	−	$0
	$X = **($2.6)**				
5.	Change in retained earnings	=	Net income	−	Dividends
	[$1.56 − **$X**]	=	$0.43	−	$0.06
	$X = **$1.19**				

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Exercise 1-16 (LO 1-3)

($ in billions)

	Assets	=	Liabilities	+	Stockholders' equity

1.	Assets	=	Liabilities	+	Stockholders' equity
	$228	=	$107	+	**$X**
	$228	=	$107	+	**$121**
2.	Assets	=	Liabilities	+	Stockholders' equity
	$X	=	$1,500	+	$110
	$1,610	=	$1,500	+	$110
3.	Assets	=	Liabilities	+	Stockholders' equity
	$4.7	=	**$X**	+	$0.3
	$4.7	=	**$4.4**	+	$0.3
4.	Change in assets	=	Change in liabilities	+	Change in stockholders' equity
	$1.2	=	$0.3	+	**$X**
	$1.2	=	$0.3	+	**$0.9**
5.	Change in assets	=	Change in liabilities	+	Change in stockholders' equity
	$X	=	($0.34)	+	$0.02
	($0.32)	=	($0.34)	+	$0.02

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Exercise 1-17 (LO 1-3)

($ in billions)

	Total change in cash	=	Operating cash flows	+	Investing cash flows	+	Financing cash flows
1.	**$0**	=	$3.6	+	$0.6	+	($4.2)
2.	($X − $0.7) **$X = $0.4**	=	$1.4	+	($0.3)	+	($1.4)
3.	$0.04	=	$0.07	+	$0.63	+	**($0.66)**
4.	$0.02	=	$0.60	+	**($1.00)**	+	$0.42
5.	$0.02	=	**$0.41**	+	($1.42)	+	$1.03

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Exercise 1-18 (LO 1-5)

1. d.
2. e.
3. a.
4. c.
5. f.
6. b.
7. g.

Exercise 1-19 (LO 1-7)

1. **g.** Comparability
2. **f.** Free from error
3. **b.** Predictive value
4. **i.** Timeliness
5. **a.** Confirmatory value
6. **e.** Neutrality
7. **d.** Completeness
8. **h.** Verifiability
9. **j.** Understandability
10. **c.** Materiality

Exercise 1-20 (LO 1-7)

1. b.
2. c.
3. d.
4. a.

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PROBLEMS: SET A

Problem 1-1A (LO 1-2)

	Type of business activity	Transactions
1.	**Financing**	Pay amount owed to the bank for previous borrowing.
2.	**Operating**	Pay utility costs.
3.	**Investing**	Purchase equipment to be used in operations.
4.	**Operating**	Provide services to customers.
5.	**Operating**	Purchase office supplies.
6.	**Investing**	Purchase a building.
7.	**Operating**	Pay workers' salaries.
8.	**Operating**	Pay for research and development costs.
9.	**Operating**	Pay taxes to the IRS.
10.	**Financing**	Sell common stock to investors.

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Problem 1-2A (LO 1-2)

	Account classifications	Account Names
1.	**Stockholders' equity**	Common stock
2.	**Asset**	Equipment
3.	**Liability**	Salaries payable
4.	**Revenue**	Service revenue
5.	**Expense**	Utilities expense
6.	**Asset**	Supplies
7.	**Expense**	Research and development expense
8.	**Asset**	Land
9.	**Liability**	Income tax payable
10.	**Liability**	Interest payable

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Problem 1-3A (LO 1-3)

Longhorn Corporation
Income Statement
For the year ended Dec. 31, 2024

Service revenue	$67,700
Expenses:	
Salaries	53,400
Rent	5,500
Delivery	2,600
Total expenses	61,500
Net income	$ 6,200

Longhorn Corporation
Statement of Stockholders' Equity
For the year ended Dec. 31, 2024

	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance	$40,000	$18,200	$58,200
Issuance of common stock	4,000		4,000
Add: Net income		6,200	6,200
Less: Dividends		(0)	(0)
Ending balance	$44,000	$24,400	$68,400

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Problem 1-3A (concluded)

Longhorn Corporation
Balance Sheet
Dec. 31, 2024

Assets		**Liabilities**	
Cash	$ 1,200	Accounts payable	$ 4,400
Supplies	3,400	Salaries payable	800
Equipment	29,000	Total liabilities	5,200
Buildings	40,000		
		Stockholders' Equity	
		Common stock	44,000
		Retained earnings	24,400
		Total stockholders' equity	68,400
Total assets	$73,600	Total liabilities and stockholders' equity	$73,600

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Problem 1-4A (LO 1-3)

(Suggested order of calculation)

On the statement of stockholders' equity,
$7,000 + (c) − $3,000 = $10,000
(c) = **$6,000**

From (c),
(b) = **$6,000**

From (b),
$39,000 − (a) − $6,000 − $4,000 = $6,000 (b)
(a) = **$23,000**

From the statement of stockholders' equity,
(e) = **$11,100**
(f) = **$10,000**

From total assets,
(g) = **$26,000**

From (e), (f), and (g),
(d) + $11,100 (e) + $10,000 (f) = $26,000 (g)
(d) = **$4,900**

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Problem 1-5A (LO 1-3)

Cornhusker Company
Income Statement
For the year ended December 31, 2024

Service revenues	$37,000
Expenses:	
Rent	7,000
Utilities	4,900
Salaries	13,300
Insurance	3,500
Total expenses	28,700
Net income	$ 8,300

Cornhusker Company
Statement of Stockholders' Equity
For the year ended December 31, 2024

	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance (Jan. 1)	$16,000	$ 7,300	$23,300
Issuance of common stock	0		0
Add: Net income		8,300	8,300
Less: Dividends		(3,200)	(3,200)
Ending balance (Dec. 31)	$16,000	$12,400	$28,400

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Problem 1-5A (concluded)

Cornhusker Company
Balance Sheet
December 31, 2024

Assets		**Liabilities**	
Cash	$ 4,800	Accounts payable	$ 2,200
Accounts receivable	7,200	Salaries payable	2,400
Land	21,000	Total liabilities	4,600
		Stockholders' Equity	
		Common stock	16,000
		Retained earnings	12,400
		Total stockholders' equity	28,400
Total assets	$33,000	Total liabilities and stockholders' equity	$33,000

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Problem 1-6A (LO 1-7)

	Assumption violated
1.	**Going concern**
2.	**Economic entity**
3.	**Monetary unit**
4.	**Periodicity**

Problem 1-7A (LO 1-7)

1. d.
2. b.
3. i.
4. c.
5. a.
6. g.
7. h.
8. f.
9. e.

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PROBLEMS: SET B

Problem 1-1B (LO 1-2)

	Type of business activity	Transactions
1.	Operating	Pay for advertising.
2.	Financing	Pay dividends to stockholders.
3.	Operating	Collect cash from customer for previous sale.
4.	Investing	Purchase a building to be used for operations.
5.	Investing	Purchase equipment.
6.	Investing	Sell land.
7.	Financing	Receive a loan from the bank by signing a note.
8.	Operating	Pay suppliers for purchase of supplies.
9.	Operating	Provide services to customers.
10.	Investing	Invest in securities of another company.

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Problem 1-2B (LO 1-2)

	Account classifications	Account Names
1.	**Asset**	Cash
2.	**Revenue**	Service Revenue
3.	**Asset**	Supplies
4.	**Asset**	Buildings
5.	**Expense**	Advertising Expense
6.	**Asset**	Equipment
7.	**Expense**	Interest Expense
8.	**Liability**	Accounts Payable
9.	**Dividends**	Dividends
10.	**Liability**	Notes Payable

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Problem 1-3B (LO 1-3)

Gator Investments
Income Statement
For the year ended Dec. 31, 2024

Service revenue	$127,600
Expenses:	
Advertising	33,500
Salaries	65,100
Utilities	15,500
Interest	3,500
Total expenses	117,600
Net income	$ 10,000

Gator Investments
Statement of Stockholders' Equity
For the year ended Dec. 31, 2024

	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance	$100,000	$30,300	$130,300
Issuance of common stock	11,000		11,000
Add: Net income		10,000	10,000
Less: Dividends		(5,200)	(5,200)
Ending balance	$111,000	$35,100	$146,100

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Problem 1-3B (concluded)

Gator Investments
Balance Sheet
Dec. 31, 2024

Assets		**Liabilities**	
Cash	$ 5,500	Accounts payable	$ 6,400
Equipment	27,000	Notes payable	30,000
Buildings	150,000	Total liabilities	36,400
		Stockholders' Equity	
		Common stock	111,000
		Retained earnings	35,100
		Total stockholders' equity	146,100
Total assets	$182,500	Total liabilities and stockholders' equity	$182,500

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Problem 1-4B (LO 1-3)

(Suggested order of calculation)

On the statement of stockholders' equity,
$14,000 + (c) = $17,000
(c) = **$3,000**

$7,000 + $5,000 − (d) = $8,000
(d) = **$4,000**

(b) = **$5,000**

From (b),
(a) − $13,000 − $7,000 − $5,000 = $5,000 (b)
(a) = **$30,000**

From the statement of stockholders' equity,
(g) = **$17,000**
(h) = **$8,000**

From (g) and (h),
$4,000 + $17,000 (g) + $8,000 (h) = (i)
(i) = **$29,000**

From total liabilities and stockholders' equity,
(f) = **$29,000**

From (f),
$1,100 + (e) + $6,000 + $16,000 = $29,000 (f)
(e) = **$5,900**

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Problem 1-5B (LO 1-3)

Tar Heel Corporation
Income Statement
For the year ended December 31, 2024

Service revenues	$69,400
Expenses:	
Advertising	10,400
Utilities	6,000
Salaries	26,700
Interest	2,100
Total expenses	45,200
Net income	$24,200

Tar Heel Corporation
Statement of Stockholders' Equity
For the year ended December 31, 2024

	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance	$21,000	$26,800	$47,800
Issuance of common stock	6,000		6,000
Add: Net income		24,200	24,200
Less: Dividends		**(11,000)** *	(11,000)
Ending balance	$27,000	$40,000	$67,000

* Beginning retained earnings	$26,800
+ Net income	24,200
− Dividends	?
= Ending retained earnings	$40,000

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Problem 1-5B (concluded)

Tar Heel Corporation
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 5,200	Accounts payable	$ 7,700
Accounts receivable	13,200	Salaries payable	3,300
Supplies	4,600	Note payable	25,000
Building	80,000	Total liabilities	36,000
		Stockholders' Equity	
		Common stock	27,000
		Retained earnings	40,000
		Total stockholders' equity	67,000
Total assets	$103,000	Total liabilities and stockholders' equity	$103,000

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Problem 1-6B (LO 1-7)

	Assumption violated
1.	**Periodicity**
2.	**Monetary unit**
3.	**Going concern**
4.	**Economic entity**

Problem 1-7B (LO 1-7)

1. h.
2. g.
3. f.
4. a.
5. d.
6. e.
7. i.
8. b.
9. c.

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REAL-WORLD PERSPECTIVES

Real-World Perspective 1-1

GREAT ADVENTURES

Requirement 1

The three primary forms of business organizations include sole proprietorship, partnership, and corporation. The major advantage of a corporation is limited liability. Stockholders of a corporation are not held personally responsible for the financial obligations of the corporation. Owners of sole proprietorships or partnerships remain personally liable for activities of the business. Because of the higher risk of personal injury due to outdoor adventure activities, it is recommended that Great Adventures be organized as a **corporation**.

Requirement 2

Account Name	Financial Statement	Account
Cash	Balance sheet	Asset
Common Stock	Balance sheet	Equity
Service Revenue	Income statement	Revenue
Salaries Expense	Income statement	Expense
Accounts Payable	Balance sheet	Liability
Equipment	Balance sheet	Asset
Advertising Expense	Income statement	Expense
Supplies	Balance sheet	Asset
Salaries Payable	Balance sheet	Liability
Insurance Expense	Income statement	Expense

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Real-World Perspective 1-2

AMERICAN EAGLE OUTFITTERS, INC.

($ in thousands)

Requirement 1

Total assets	= $3,328,679
Total liabilities	= $2,080,826
Stockholders' equity	= $1,247,853

Assets	=	Liabilities	+	Stockholders' Equity
$3,328,679	=	$2,080,826	+	$1,247,853

Requirement 2

Consolidated Statements of Operations

Requirement 3

Net sales	= $4,308,212
Net income	= $191,257

Requirement 4

	Inflows	Outflows
Investing activities	Sale of available-for-sale investments	Capital expenditures for property and equipment
Financing activities	Net proceeds from stock options exercised	Repurchase of common stock

Requirement 5

The company's auditor is Ernst & Young LLP.

The auditor states, "We have audited the accompanying consolidated balance sheets of American Eagle Outfitters, Inc. (the Company) as of February 1, 2020 and February 2, 2019, the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended February 1, 2020, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at February 1, 2020 and

February 2, 2019, and the results of its operations and its cash flows for each of the three years in the period ended February 1, 2020, in conformity with U.S. generally accepted accounting principles."

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Real-World Perspective 1-3

THE BUCKLE, INC.

($ in thousands)

Requirement 1

Total assets	= $867,890
Total liabilities	= $478,742
Stockholders' equity	= $389,148

Assets	=	Liabilities	+	Stockholders' Equity
$867,890	=	$478,742	+	$389,148

Requirement 2

Consolidated Statements of Income

Requirement 3

Net sales	= $900,254
Net income	= $104,429

Requirement 4

	Inflows	Outflows
Investing activities	Proceeds from sales/maturities of investments	Purchases of investments
Financing activities	There are none	Payment of dividends

Requirement 5

The company's auditor is Deloitte & Touche LLP.

The auditor states, "

We have audited the accompanying consolidated balance sheets of The Buckle, Inc. and subsidiary (the "Company") as of February 1, 2020 and February 2, 2019, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows, for each of the three fiscal years in the period ended February 1, 2020, and the related notes and the schedule listed in the Index at Item 15 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of February 1, 2020 and February 2, 2019, and the results of its operations and its cash flows for each of the three fiscal years in the period ended February 1, 2020, in conformity with accounting principles generally accepted in the United States of America."

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Real-World Perspective 1-4

AMERICAN EAGLE VS. THE BUCKLE

Requirement 1

The total assets of **American Eagle** are higher than the total assets of The Buckle.

Requirement 2

The total liabilities of **American Eagle** are higher than the total liabilities of The Buckle.

A higher amount of liabilities **does not** necessarily mean a higher chance of bankruptcy. The probability of bankruptcy relates to the ability of a company to repay its liabilities as they become due. If sufficient resources are available, then high levels of debt can be paid.

Requirement 3

Ability to repay debt.

The ratio of total liabilities to total assets can be used as one measure of a company's ability to repay its liabilities. The higher the ratio, the more difficult it will be for a company to pay its liabilities.

Requirement 4

The net income of **American Eagle** is higher than the net income of The Buckle. When one company has a higher net income than another company does, this **does not** always mean the company's operations are more successful. One company may be larger than another company so it has higher net income in absolute dollar amounts because operations are larger, but it may be making less profit per dollar of invested assets.

Requirement 5

Ability to generate profits.

Net income provides a measure of a company's ability to generate profit for its owners. In the case of American Eagle and The Buckle, the owners are the stockholders of the company. An increase in net income is a desirable characteristic of a company that, along with other factors, increases the value (or stock price) of the company to its owners.

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Real-World Perspective 1-5

EDGAR RESEARCH – FACEBOOK
(In millions)
1. $70,697
2. $13,600
3. Decrease by $3,626
4. $133,376
5. $32,322
6. Yes

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Real-World Perspective 1-6

1. **Yes.**
The role of an auditor is to express an independent, professional opinion of the extent to which financial statements are prepared in compliance with Generally Accepted Accounting Principles. An auditor's ethics might be challenged because of the need to retain the client as a source of revenue. In this case, the auditor might fear losing the audit fee if it upsets its largest client by requiring a correction to the financial statements because of questionable accounting practices. The company may fire the auditor and retain the services of someone else. This problem is further worsened by the company offering an additional $200,000 in audit fees this year and the promise of continued services for the next five years. Management may be using these monetary incentives as a way to entice the auditor to allow certain reporting practices. If the auditor upsets the client, the auditor faces the possibility of losing revenue each year from audit services.

2. **No.**
Auditors are not employees of the company. They are hired by a company as an independent party. To the extent they feel management's reporting practices violate Generally Accepted Accounting Principles, they can issue an opinion stating so.

3. **Yes.**
Although ultimate responsibility for fair presentation of financial statements lies with management, the auditor's opinion lends additional credibility to those financial statements. These statements are useful to investors, creditors and others for making decisions. In addition, if the auditor detects that financial statements are misstated and does not disclose this opinion, then the auditor likely faces monetary penalties and other sanctions that could limit its ability to perform any audits in the future.

4. **No.**
Even though the auditor faces this ethical dilemma, they serve an important role in the reporting of financial information to help investors and creditors make decisions. Auditors follow a strict set of guidelines in providing auditing services. In addition, they typically face severe legal and monetary penalties in the case of negligence or willful allowance of materially misstated financial statements by management. The auditor should issue an opinion stating its belief that financial statements are materially misstated.

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Real-World Perspective 1-7

The functions of financial accounting are to measure business activities of a company and to communicate information about those activities to investors and creditors and other outside users for decision-making purposes.

The four financial statements include:
1. Income statement, which shows revenues and expenses during the reporting period.
2. Statement of stockholders' equity, which shows the change in stockholders' equity during the reporting period.
3. Balance sheet, which shows a company's resources (assets), creditors' claims to those assets (liabilities), and the remaining claims of stockholders to those assets (stockholders' equity) at the end of the period.
4. Statement of cash flows, which shows a company's inflows and outflows of cash arising from operating, investing, and financing activities during the reporting period.

The role of auditors is to help ensure that management has in fact appropriately applied Generally Accepted Accounting Principles in preparing the company's financial statements. Auditors are trained individuals hired by a company as an independent party to express a professional opinion of that company's financial statements.

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