Financial Accounting for Undergraduates 4th edition Wallace Solutions Manual

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Chapter 1

Financial Accounting andBusiness Decisions

QUESTIONS

1. Accounting is the process of measuring the economic activity of an enterprise in monetary terms and communicating the results to interested parties. The basic purpose of accounting is to provide financial information that is useful in making economic decisions.

2. The major goal of Financial Accounting is the preparation of a balance sheet, a statement of stockholders' equity, a statement of cash flows, and an income statement. These statements must be prepared in accordance with a well-defined set of conventions and rules called *generally-accepted accounting principles.* Managerial Accounting provides the data necessary for management to plan and control the operations of a business and to make decisions. No rigid conventions or rules govern managerial accounting; any analytical approach or mode of accounting may be employed in this area.

3. In addition to stockholders and creditors, the following outside groups may be interested in a company's financial data: prospective investors and creditors, financial analysts, taxing agencies, regulatory agencies, labor unions, and economic planners. Prospective investors and financial analysts desire to evaluate the relative attractiveness of various investments, while creditors are primarily interested in a firm's financial strength. Taxing and regulatory agencies are concerned with whether a firm has met its reporting or other legal requirements. Labor unions are interested in the firm's relations with employees, especially with regard to wages. Economic planners use reliable financial data in their planning and forecasting activities.

4. Generally-accepted accounting principles (GAAP) are standards that accountants have developed to guide the accumulation of financial accounting data and the preparation of financial statements. Many principles have evolved over time and have become entrenched through general acceptance. Although the SEC has the power to set the accounting principles, the agency has largely delegated that principle-setting responsibility. The primary non-governmental body whose pronouncements are authoritative concerning such principles is the Financial Accounting Standards Board (FASB).

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5. The main advantages of the corporate form of organization are limited liability for stockholders and the ease of transferring ownership interests. The main disadvantage is the possibility of double taxation of the corporation's net income at the company and individual levels.

6. Financial accounting provides financial information to investors and creditors who need to make decisions about where to allocate their resources. Financial statements express the economic activity of business entities in monetary terms and report on the entities' profitability, financial strength, and cash flow. Financial statements that present the results of economic activity fairly and completely should contribute significantly to the best possible allocation decisions by investors and creditors.

7. The accounting equation is Assets = Liabilities + Stockholders' Equity. Assets are the economic resources of an enterprise that can be expressed in monetary terms. Liabilities are the obligations, or debts, that an enterprise must pay in cash or services at some time in the future because of past transactions or events. Stockholders' equity is the interest of the owners in the assets of the enterprise and is represented as the difference between the enterprise's assets and liabilities.

8. The three types of business activities are operating activities, investing activities, and financing activities. Operating activities are the day-to-day business transactions of an enterprise. Investing activities are those events in which the firm acquires the needed infrastructure to support the day-to-day operations. Financing activities are those debt or equity transactions that generate the needed funds to acquire the needed infrastructure of an enterprise.

9. Corporate social responsibility is a value system that believes that enterprises should focus on more than just a business' financial bottom line. Instead, the enterprise should also act socially responsible and also focus on its environmental bottom line.

10. GAAP are the accounting guidelines promulgated by the FASB to assist companies in the U.S. to prepare their financial data fairly. IFRS are the accounting guidelines promugated by the IASB to guide non-U.S. firms in the preparation of their financial statements.

11. Revenues are an increase in stockholders' equity that a firm earns when it provides goods or services to its customers. Sales revenue is measured by the value of the assets received in exchange for the goods or services. Expenses are the decreases in stockholders' equity that a firm incurs in the process of earning revenues. Expenses are measured by the value of the assets that are used up as a result of a firm's operating activities.

12. The purpose of an income statement is to report the results of operations for a period. It does this by listing a firm's revenues and expenses for the period. The purpose of a statement of stockholders' equity is to report the events causing a change in stockholders' equity for a period. These events include owner investments and dividends and the earning of net income or net loss. The purpose of a balance sheet is to present a firm's assets, liabilities, and stockholders' equity on a given date. The purpose of a statement of cash flows is to report information about cash inflows and cash outflows during a period of time. The cash flows are grouped into three categories: operating activities, investing activities, and financing activities.

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13. A period-of-time statement presents financial information covering a specific period of time. Examples are the income statement, the statement of stockholders' equity, and the statement of cash flows.

14. A point-in-time statement presents financial information as of a specific date. An example is a balance sheet.

15. $800,000 Assets - $230,000 Liabilities =

$570,000	Stockholders' equity
(400,000)	Common stock
$170,000	Retained earnings

16. The following three aspects of the accounting environment may create ethical pressure on the accountant.

(1) The output produced by accountants may have significant financial implications for one or more persons. Examples include calculation of a bonus amount or of income taxes owed.

(2) Accountants have access to confidential, sensitive information, such as salary data, income tax returns, and details of various financial arrangements.

(3) U.S. businesses tend to emphasize short-term profits, which may create pressure on accountants if management engages in unethical procedures to influence profits in the short run.

17. The Management's Discussion and Analysis (MD&A) section contain's management's interpretation of a company's past performance and may also contain forward-looking statements about a company's future activities.

18. An auditor's report provides assurance to financial statement users that the data in the statements is fairly presented, and therefore is likely to be useful for economic decision-making purposes.

19. a. False. The accounting process involves both measuring and communicating economic activities.

b. False. There are many potentail users of financial accounting information including internal management, taxing agencies, regulatory agencies, investors, creditors, among others.

c. True. Financial accounting is primarily used to communicate to outside users and managerial accounting is primarily used for internal communication.

d. False. Because auditors are independent of the companies that they audit, their opinion helps to provide assurance to financial statement users that the information is fairly presented. However, they cannot guarantee that the financial statements are without error.

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20. The FASB developed the conceptual accounting framework to guide the formulation of specific U.S. accounting principles.

21. The two primary qualities of accounting information that contribute to its decision usefulness are relevance and faithful representation.

22. *Accounting entity.* An economic unit that has identifiable boundaries and that is the focus for the accumulation and reporting of financial information.

Accounting period. The time period for which periodic accounting reports are prepared.

Monetary unit. A monetary unit is used to measure and record an entity's economic activity.

Cost-benefit. An accounting restraint requiring that the benefit derived from the information outweighs the cost of providing it.

Going concern. An accounting concept that assumes that in the absence of contrary evidence, a business enterprise will have an indefinite life.

Consistency. An accounting characteristic that states that unless otherwise disclosed, a company's accounting reports should be prepared on a basis consistent with the preceding period.

Revenue recognition. An accounting principle requiring that with few exceptions, revenue should be recognized when services are performed or when goods are sold.

Expense recognition (matching). An accounting principle that states that net income is determined by linking any expenses incurred with the related earned sales revenue.

Materiality. An accounting constraint that states that transactions so insignificant that they would not affect a user's actions may be recorded in the most expedient manner.

Full disclosure. An accounting principle stipulating the disclosure of all facts necessary to make financial statements useful to readers.

23. d. Relevance, faithful representation, and comparability are all important characteristics of accounting information. The fourth characteristic is understandability.

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SHORT EXERCISES

SE1-1. Forms of Business Organization
(LO1)

a. Partnership
b. Corporation
c. Sole proprietorship

SE1-2. Accounting Processes
(LO4)

a. Communicating
b. Measuring
c. Measuring
d. Communicating
e. Measuring

SE1-3. Types of Statements
(LO3)

a. Investor
b. Taxation authority
c. Management
d. Regulatory agency

SE1-4. Accounting Organizations
(LO4)

a. FASB
b. IASB

SE1-5. Business Activities
(LO2)

a. Operating
b. Investing
c. Operating
d. Financing
e. Financing
f. Investing
g. Operating
h. Investing

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SE1-6. Financial Statement Items
(LO5)

a. BS
b. IS
c. SCF
d. BS, SSE
e. IS
f. SCF
g. IS, SSE
h. BS

SE1-7. Annual Report Components
(LO6)

c. Details about potential new products to be introduced during the next year

SE1-8. Sarbanes-Oxley Act
(LO3)

c. A new statement of social responsibility

SE1-9. Financial Accounting and Generally Accepted Accounting Principles
(LO4)

1. *a.* Provide comedy material for late-night talk shows.

2. *b.* A set of standards and procedures that form guidelines for international financial accounting.

3. *c.* Is a set of guidelines for preparing financial reports in the United States.

SE1-10. Cash Flow Activity Classification
(LO2)

1. Financing
2. Operating
3. Investing
4. Operating
5. Financing
6. Operating

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SE1-11.Using the Basic Accounting Equation
(LO5)

a. $40,000
b. $275,000
c. $55,000 increase

SE1-12. Using the Basic Accounting Equation
(LO5)

a. $115,000
b. $205,000
c. $395,000

SE1-13. Financial Statements
(LO5)

a. IS
b. BS, SCF
c. SCF
d. SSE, SCF

SE1-14. Financial Statements
(LO5)

a. IS
b. BS, SCF
c. SCF
d. SSE, SCF

SE1-15.International Accounting Principles
(LO4)

a. International Accounting Standards Board (IASB)

b. Improve the operation of the international capital markets or reduce the information-generating costs of multinational companies.

SE1-16. Principles of Accounting
(LO8, Appendix 1A)

d. The cash basis of accounting is used when preparing the statement of cash flows.

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SE1-17. Generally Accepted Accounting Principles
(LO8, Appendix 1A)

1. *b.* Useful information
2. *c.* Ratio analysis guidelines for analysts
3. *b.* Liabilities

SE1-18. Basic Accounting Principles
(LO8, Appendix 1A)

1. Comparability
2. Going concern concept
3. Materiality constraint
4. Accounting period concept
5. Cost principle
6. Consistency
7. Full disclosure principle

SE1-19.FASB Codification
(L04)

b. Ease the convergence between U.S. GAAP and IFRS

SE1-20. Basic Accounting Principles
(LO8, Appendix 1A)

c. While this is the basic accounting equation, it is not a qualitative characteristic of accounting information.

SE1-21. Basic Accounting Principles
(LO8, Appendix 1A)

1. True
2. True
3. True

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EXERCISES—SET A

E1-1A. Forms of Business Organization
(LO1)

1. Sole proprietorship and partnership (*a* & *b*)
2. Sole proprietorship (*a*)
3. Sole proprietorship and partnership (*a* & *b*)
4. Corporation (*c*)
5. Corporation (*c*)

E1-2A. Accounting Process
(LO4)

b. Identify
c. Quantify
a. Record

E1-3A. Types of Accounting
(LO3)

a. Managerial
b. Tax
c. Financial
d. Combination as needed

E1-4A. Corporate Social Responsibility
(LO5)

c. Competitive bottom line

E1-5A. Generally Accepted Accounting Principles
(LO4)

a. False
b. False
c. False
d. True

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E1-6A. Business Activities
(LO2)

a. O
b. F
c. F
d. I
e. O
f. I

E1-7A. The Accounting Equation
(LO5)

Assets = $84,000
Liabilities = $54,000
Stockholders' Equity = $128,000

E1-8A. Determining Net Income
(LO5)

c. $15,000 net income

E1-9A. Determining Retained Earnings and Net Income
(LO5)

a. $65,000
b. $40,000

E1-10A. Determining Stockholders' Equity
(LO5)

a. $294,000
b. $460,000

E1-11A. Financial Statements
(LO5)

a. BS
b. SCF
c. IS, SSE
d. SCF
e. BS
f. IS
g. BS
h. BS

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E1-12A. Omitted Financial Statement Data
(LO5)

A. Sales revenue = $29,000
B. Liabilities = $8,000
C. Dividends = $2,000
D. Assets = $47,000

E1-13A. Other Components of the Annual Report
(LO6)

a. Auditor's report
b. MD&A
c. Notes to financial statements
d. Not disclosed

E1-14A. Ethics
(LO3)

1. (a) Pressure to achieve a favorable outcome
   (b) The accountant should refuse to do it.

2. (a) Pressure to disclose confidential/ sensitive information
   (b) The accountant should not discuss the contract.

3. (a) Pressure to report good short-term profits
   (b) The accountant should not do it.

E1-15A. International Accounting Principles
(LO4)

1. False. Globilization is increasing.

2. False. IFRS is accepted in over 100 countries of the world but it is not accepted in all countries (eg. the U.S.).

3. True. However the push to converge has decreased in recent years.

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E1-16A. The Conceptual Accounting Framework
(LO8, Appendix 1A)

a. The purpose of the FASB's conceptual accounting framework is to guide the formulation of specific U.S. accounting principles.

b. The financial reporting objectives are:

1. Provide information that is useful in making investment, credit, and similar decisions.

2. Provide information helpful in assessing the ability of enterprises to generate future cash flows.

3. Provide information about a firm's economic resources, the claims on those resources, and the effects of events that change those resources and claims.

E1-17A. Recognition and Measurement Criteria
(LO8, Appendix 1A)

a. Accounting entity concept
b. Materiality constraint
c. Expense recognition (matching) principle
d. Full disclosure principle

E1-18A. Revenue Recognition Principle
(LO8, Appendix 1A)

a. No. The equipment has not yet been manufactured or delivered to the customer.

b. No. No customer has yet been found to purchase the TVs.

c. Assuming the receipt of $1,800 on Jan. 2 is assured, it would be possible to recognize $900 on Dec. 31 since one month of the four month contract has expired.

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E1-19A. Accrual Basis of Accounting versus Cash Basis of Accounting (L05, LO8, Appendix 1A)

a. Accrual basis

GREG JONES Income Statement For Year Ended December 31	
Fees billed to clients for services rendered	$131,000
Less:	
Supplies used	6,100
Rent expense	12,000
Utility expense	4,500
Salary expense	39,400
Net income	$69,000

b. Cash basis

GREG JONES Income Statement For Year Ended December 31	
Cash received from clients	$119,000
Less:	
Supplies purchased for cash	7,100
Cash paid for rent	15,000
Utility bills paid	3,300
Salary paid to assistant	35,100
Net income	$58,500

c. The accrual basis of accounting (Net income = $69,000) is computed on a basis consistent with generally accepted accounting principles.

E1-20A. Recognition and Measurement Criteria (LO8, Appendix 1A)

1. Materiality constraint. The cost of the snow shovel is immaterial and consequently should be immediately expensed.

2. Full disclosure principle. Since the lawsuit represents a potential material loss to the firm, it should be disclosed in the footnotes.

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EXERCISES—SET B

E1-1B. Forms of Business Organization
(LO1)

1. *c.* Corporation
2. *b.* Partnership
3. *c.* Corporation
4. *a.* Sole proprietorship
5. c. Corporation

E1-2B. The Accounting Process
(LO4)

b. Identify
a. Quantify
c. Record

E1-3B. Types of Accounting
(LO3)

a. Managerial
b. Tax
c. Financial
d. Combination as needed

E1-4B. Corporate Social Responsibility
(LO5)

d. Efficiency bottom line

E1-5B.Generally Accepted Accounting Principles
(LO4)

a. True
b. True
c. True
d. False

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E1-6B. Business Activities
(LO2)

a. O
b. F
c. F
d. I
e. O
f. I

E1-7B. The Accounting Equation
(LO5)

Assets = $99,000
Liabilities = $125,000
Stockholders' Equity = $60,000

E1-8B. Determining Net Income
(LO5)

b. $27,000 net income

E1-9B. Determining Retained Earnings and Net Income
(LO5)

a. Retained earnings = $35,000
b. Net income = $20,000

E1-10B. Determining Stockholders' Equity
(LO5)

a. Stockholders' equity = $660,000
b. Assets = $365,000

E1-11B. Financial Statements
(LO5)

a. BS
b. SCF
c. IS, SSE
d. SCF
e. BS
f. IS
g. BS
h. BS

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E1-12B. Omitted Financial Statement Data
(LO5)

A. Sales revenue = $16,000
B. Liabilities = $30,500
C. Dividends = $11,000
D. Assets = $56,000

E1-13B. Other Components of the Annual Report
(LO6)

a. Auditor's report
b. MD&A
c. Notes to the financial statements
d. Not disclosed

E1-14B. Ethics
(LO3)

1. (a) Pressure to achieve a favorable outcome
   (b) Do not comply with the request.

2. (a) Pressure to reveal sensitive, confidential information
   (b) Do not comply with the request.

3. (a) Pressure to achieve short-run profits
   (b) Do not comply with the request.

E1-15B. International Accounting Principles
(LO4)

Three benefits to the worldwide acceptance of a global set of international accounting principles include:

1. Makes it easier for companies that raise capital in more than one country by allowing investors to compare companies from different countries.

2. Reduces the cost of complying with different accounting standards since a company will be able to follow just one set of standards in multiple countries.

3. Increases the mobility of accounting professionals since they would not need to learn entirely new accounting standards in order to practice in different countries.

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E1-16B. The Conceptual Framework
(LO8, Appendix 1A)

a. The financial statement elements include assets, liabilities, stockholders' equity, investments by owners, distributions to owners, revenues, expenses, gains, losses, and comprehensive income.

b. The element (see a) under consideration must meet the definition of the element and be measurable, and information about the element must achieve the primary qualitative characteristics of accounting information to be recognized.

E1-17B. Recognition and Measurement Criteria
(LO8, Appendix 1A)

a. Revenue recognition principle
b. Accounting entity concept
c. Cost principle
d. Full disclosure principle

E1-18B. Revenue Recognition Principle
(LO8, Appendix 1A)

a. No. The equipment has not yet been manufactured or delivered to the customer.

b. No. No customer has yet been found to purchase the appliances.

c. The yard maintenance service may recognize $1,500 on Dec. 31 since two months of the eight month contract has been fulfilled.

E1-19B. Accrual Basis of Accounting versus Cash Basis of Accounting
(L05, LO8, Appendix 1A)

a. Accrual basis

JOHN BUSH Income Statement For Year Ended December 31	
Fees billed to clients for services rendered	$137,000
Less:	
Supplies used	6,800
Rent expense	12,000
Utility expense	3,100
Salary expense	39,000
Net income	$76,100

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b. Cash basis

JOHN BUSH Income Statement For Year Ended December 31	
Cash received from clients	$115,000
Less:	
Supplies purchased for cash	9,000
Cash paid for rent	14,000
Utility bills paid	3,200
Salary paid to assistant	35,000
Net income	$53,800

c. The accrual basis of accounting (Net income = $76,100) is computed on a basis consistent with generally accepted accounting principles.

E1-20B. Recognition and Measurement Criteria (LO8, Appendix 1A)

1. Expense recognition (matching) principle. Even though the rent and utilities expense are unpaid in December, the expenses should be recognized and matched with December's revenues.

2. Accounting entity concept. Only those expenses related to the business should be charged to the business' accounts.

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PROBLEMS—SET A

P1-1A. Forms of Business Organization
(LO1)

a. Sole proprietorship. The business doesn't require any capital (corporation) nor does it require any partners with particular skills or expertise (partnership).

b. Partnership. There is more than one owner but the business doesn't require any new capital (corporation).

c. Corporation. Capital formation will be important to bring the product to market plus limited liability will be needed to protect the personal assets of the three chemists.

d. Corporation. New capital will be required to finance the expansion plus there will be liability exposure.

P1-2A. Financial Statements
(LO5)

a. Income statement. Stock prices are a function of future earnings.

b. Balance sheet. This statement reveals any collateralizable assets.

c. Statement of stockholders' equity. This statement shows the net income and dividends paid.

d. Statement of cash flows. This statement shows the cash flows from operations, from investing, and from financing.

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P1-3A. Balance Sheet
(LO5)

BRINTANY COASTAL CATERING SERVICE Balance Sheet May 31, 2019	
Assets	
Cash	$ 16,300
Accounts receivable	27,300
Supplies	15,400
Equipment, net	61,000
Total Assets	$120,000
Liabilities	
Accounts payable	$ 10,200
Notes payable	29,000
Total Liabilities	$ 39,200
Stockholders' Equity	
Common stock	$ 41,500
Retained earnings	39,300
Total Stockholders' Equity	$ 80,800
Total Liabilities and Stockholders' Equity	$120,000

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P1-4A. Statement of Stockholders' Equity and Balance Sheet (LO5)

a.

TUTTLE JANITORIAL SERVICE, INC.
Balance Sheets
December 31, 2019 and December 31, 2018

	December 31, 2019	2018
Assets		
Cash	$ 25,000	$ 22,000
Accounts receivable	39,000	31,000
Supplies	18,000	16,000
Land	56,000	46,000
Building, net	250,000	260,000
Equipment, net	44,000	46,000
Total Assets	$432,000	$421,000
Liabilities		
Accounts payable	$ 6,000	$ 9,000
Mortgage payable	93,000	88,000
Total Liabilities	$ 99,000	$97,000
Stockholders' Equity		
Common stock	$225,000	$225,000
Retained earnings	108,000	99,000
Total Stockholders' Equity	$333,000	$324,000
Total Liabilities and Stockholders' Equity	$432,000	$421,000

b.

TUTTLE JANITORIAL SERVICE INC.
Statement of Stockholders' Equity
For Year Ended December 31, 2019

	Common Stock	Retained Earnings	Total
Balance, December 31, 2018	$225,000	$ 99,000	$324,000
Add: Net income for 2019		21,000	21,000
Less: Dividends for 2019		(12,000)	(12,000)
Balance, December 31, 2019	$225,000	$108,000	$333,000

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P1-5A. Statement of Stockholders' Equity and Balance Sheet (LO5)

a.

FLUSH JANITORIAL SERVICE, INC.
Balance Sheets
December 31, 2019 and December 31, 2018

	December 31, 2019	2018
Assets		
Cash	$ 50,000	$ 44,000
Accounts receivable	78,000	62,000
Supplies	27,000	22,000
Land	92,000	92,000
Building, net	500,000	520,000
Equipment, net	75,000	77,000
Total Assets	$822,000	$817,000
Liabilities		
Accounts payable	$ 17,000	$ 18,000
Mortgage payable	175,000	205,000
Total Liabilities	192,000	223,000
Stockholders' Equity		
Common stock	$420,000	$420,000
Retained earnings	210,000	174,000
Total Stockholders' Equity	630,000	594,000
Total Liabilities and Stockholders' Equity	$822,000	$817,000

b.

FLUSH JANITORIAL SERVICE INC.
Statement of Stockholders' Equity
For Year Ended December 31, 2019

	Common Stock	Retained Earnings	Total
Balance, December 31, 2018	$420,000	$174,000	$594,000
Add: Net income for 2019		56,000	56,000
Less: Dividends for 2019		(20,000)	(20,000)
Balance, December 31, 2019	$420,000	$210,000	$630,000

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P1-6A. Income Statement and Balance Sheet (LO5)

a.

DODGE DELIVERY SERVICE
Income Statement
For Month Ended March 31, 2019

Revenue		
Delivery fees earned		$ 23,300
Expenses		
Rent expense	$2,500	
Advertising expense	1,100	
Supplies expense	2,500	
Salaries expense	6,200	
Insurance expense	900	
Miscellaneous expense	1,300	
Total Expenses		14,500
Net income		$ 8,800

b.

DODGE DELIVERY SERVICE
Balance Sheet
March 31, 2019

Assets		Liabilities		
Cash	$12,700	Accounts payable	$1,400	
Accounts receivable	10,700	Notes payable	8,000	
Supplies	14,800	Total Liabilities		$9,400
		Stockholders' Equity		
		Common stock	20,000	
		Retained earnings	8,800	
		Total Stockholders' Equity		$28,800
Total Assets	$38,200	Total Liabilities and Stockholders' Equity		$38,200

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P1-7A. Statement of Cash Flows
(LO5)

a.

MERRIS CORPORATION Statement of Cash Flows For Year Ended Dec. 31, 2019		
Operating activities		
Cash collected from customers	$ 350,000	
Cash paid for operating expenses	(225,000)	
Cash flow from operating activities		125,000
Investing activities		
Cash purchase of equipment	(29,000)	
Cash flow for investing activities		(29,000)
Financing activities		
Principal payments on notes payable	(41,000)	
Cash dividends paid	(38,000)	
Cash flow for financing activities		(79,000)
Increase in cash		$ 17,000

b. Merris Corporation's operations provided $125,000 of cash flow. This provided *sufficient* cash *for* Merris to purchase equipment, make note payments, and pay a cash dividend.

P1-8A. Ethics
(LO3)

1. (a) Pressure to achieve a favorable outcome
   (b) The accountant should correct the inappropriate charges.

2. (a) Pressure to achieve a favorable outcome
   (b) The accountant should report the sales revenue in the year earned.

3. (a) Pressure to discuss confidential, sensitive information
   (b) The accountant should not discuss the contract.

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P1-9A. Financial Statements and Other Components (LO5,LO6)

1. *b.* Balance Sheet
2. *c.* Statement of Cash Flows
3. *g.* Auditor's Report
4. *d.* Statement of Stockholders' Equity
5. *f.* Management's Discussion and Analysis (MD&A)
6. *e.* Notes to the Financial Statements
7. *a.* Income Statement

P1-10A. Income Statement, Statement of Stockholders' Equity, and Balance Sheet (LO5)

a.

PETTY CORPORATION Income Statement For Year Ended December 31, 2019	
Sales revenue	$32,000
Expenses	20,000
Net income	$12,000

PETTY CORPORATION Statement of Stockholders' Equity For Year Ended December 31, 2019			
	Common Stock	Retained Earnings	Total
Balance, January 1, 2019	$0	$0	$0
Add: Net income for 2019		12,000	12,000
Less: Dividends for 2019		(8,000)	(8,000)
Add: Issuance of common stock	33,000		33,000
Balance, December 31, 2019	$33,000	$4,000	$37,000

continued

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a. continued

PETTY CORPORATION Balance Sheet December 31, 2019		
Assets		
Cash		$ 3,250
Accounts receivable		2,750
Inventory		4,500
Building, net		59,000
Equipment, net		25,000
Total assets		$94,500
Liabilities and Stockholders' Equity		
Liabilities		
Accounts payable	$ 7,000	
Notes payable	50,500	
Total liabilities		57,500
Stockholders' Equity		
Common stock	33,000	
Retained earnings	4,000	
Total stockholders' equity		37,000
Total liabilities and stockholders' equity		$94,500

b. The dividend amount of $8,000 appears very large relative to the corporation's earnings of $12,000 and remaining cash balance of $3,250. For young corporations such as Petty, it may be wiser to retain this cash so that they have a cushion for unexpected events, or for additional opportunities.

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P1-11A. Recognition and Measurement Criteria
(LO8, Appendix 1A)

1. The John Company appears to be invoking the materiality constraint by expensing the entire amount in advertising. Since the company is prepaying the expense for the entire year, a better treatment would be to increase the asset account "Prepaid Advertising" and to write-off the asset on a monthly basis (i.e. 1/12 would be written-off at the end of December). The Expense recognition (matching) principle should be considered here.

2. The measurement or cost principle is being correctly applied in this situation. Even though the asset was acquired at a discount, it should be recorded at the price paid to purchase it.

3. The issue here is the accounting entity concept. If Tony uses cash from his business to buy his wife shares in a company, the cash should be withdrawn from the business (decrease Cash, decrease Equity). The entry as recorded implies that the investments were purchased by the business, not by Tony for his personal use.

4. This entry is incorrectly recorded in that it violates the cost principle that assets are initially recorded at cost, and that this value is maintained unless the asset depreciates in value or suffers a value impairment.

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PROBLEMS—SET B

P1-1B. Forms of Business Organization
(LO1)

a. Sole proprietorship. No new capital is required (corporation) and no additional skills or expertise are needed (partnership).
b. Partnership. No new capital is required (corporation) but there is more than one owner.
c. Partnership. No new capital is required but there is more than one owner. Legal exposure will be managed by purchasing insurance.
d. Corporation. New capital will be required to finance the expansion and there will be significant liability exposure to be avoided.

P1-2B. Financial Statements
(LO5)

a. Income statement. This statement reveals revenue growth over time.
b. Balance sheet. Reveals the relative use of debt versus equity financing.
c. Statement of stockholders' equity. Permits a comparison of dividends paid to net income.
d. Statement of cash flow. Reveals the principal sources and uses of cash.

P1-3B. Balance Sheet
(LO5)

BETTER PLUMBING CONTRACTORS, INC. Balance Sheet May 31, 2019	
Assets	
Cash	$ 15,700
Accounts receivable	9,200
Supplies	28,500
Land	31,000
Equipment	100,000
Total Assets	$184,400
Liabilities	
Accounts payable	$ 9,900
Notes payable	31,000
Total Liabilities	$ 40,900
Stockholders' Equity	
Common stock	$101,000
Retained earnings	42,500
Total Stockholders' Equity	$143,500
Total Liabilities and Stockholders' Equity	$184,400

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P1-4B. Statement of Stockholders' Equity and Balance Sheet (LO5)

a.

BRYANT PACKAGING SERVICE
Balance Sheets
December 31, 2019 and December 31, 2018

	December 31, 2019	December 31, 2018
Assets		
Cash	$11,000	$ 12,000
Accounts receivable	23,800	19,500
Supplies	5,700	5,200
Equipment, net	33,000	31,000
Total Assets	$73,500	$67,700
Liabilities		
Accounts payable	$2,800	$2,600
Notes payable	21,000	21,000
Total Liabilities	23,800	23,600
Stockholders' Equity		
Common stock	6,000	6,000
Retained earnings	43,700	38,100
Total Stockholders' Equity	49,700	44,100
Total Liabilities & Stockholders' Equity	$73,500	$67,700

b.

BRYANT PACKAGING SERVICE
Statement of Stockholders' Equity
For Year Ended December 31, 2019

	Common Stock	Retained Earnings	Total
Balance, December 31, 2018	$6,000	$38,100	$44,100
Add: Net income for 2019		18,600	18,600
Less: Dividends for 2019		(13,000)	(13,000)
Balance, December 31, 2019	$6,000	$43,700	$49,700

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P1-5B. Statement of Stockholders' Equity and Balance Sheet (LO5)

a.

PHILIP PACKAGING SERVICE Balance Sheets December 31, 2019 and December 31, 2018		
	December 31, 2019	2018
Assets		
Cash	$53,000	$ 49,000
Accounts receivable	80,000	64,000
Supplies	29,000	31,000
Equipment, net	76,000	78,000
Total Assets	$238,000	$222,000
Liabilities		
Accounts payable	$16,000	$14,000
Notes payable	175,000	175,000
Total Liabilities	191,000	189,000
Stockholders' Equity		
Common stock	30,000	30,000
Retained earnings	17,000	3,000
Total Stockholders' Equity	47,000	33,000
Total Liabilities and Stockholders' Equity	$238,000	$222,000

b.

PHILIP PACKING INC. Statement of Stockholders' Equity For Year Ended December 31, 2019			
	Common Stock	Retained Earnings	Total
Balance, December 31, 2018	$30,000	$3,000	$33,000
Add: Net income for 2019		29,000	29,000
Less: Dividends for 2019		(15,000)	(15,000)
Balance, December 31, 2019	$30,000	$17,000	$47,000

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P1-6B. Income Statement and Balance Sheet
(LO5)

a.

R. LEVITT, INTERIOR DECORATOR Income Statement For Year Ended December 31, 2019		
Revenue		
Decorating fees earned		$57,600
Expenses		
Supplies expense	$ 8,100	
Insurance expense	1,600	
Advertising expense	700	
Salaries expense	36,000	
Rent expense	4,500	
Miscellaneous expense	1,200	
Total Expenses		52,100
Net income		$ 5,500

b.

R. LEVITT, INTERIOR DECORATOR Balance Sheet December 31, 2019				
Assets		Liabilities		
Cash	$ 6,200	Accounts payable	$ 2,800	
Accounts receivable	8,600	Notes payable	6,000	
Supplies	6,500	Total Liabilities		$ 8,800
		Stockholders' Equity		
		Common stock	7,000	
		Retained earnings	5,500	
		Total Stockholders' Equity		12,500
Total Assets	$21,300	Total Liabilities and Stockholders Equity		$21,300

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P1-7B. Statement of Cash Flows
(LO5)

a.

WILLY CORPORATION Statement of Cash Flows For Year Ended Dec. 31, 2019		
Operating activities		
Cash collected from customers	$ 670,000	
Cash paid for operating activities	(425,000)	
Cash flow from operating activities		$245,000
Investing activities		
Cash purchase of equipment	(129,000)	
Cash flow for investing activities		(129,000)
Financing activities		
Principal payments on note payable	(128,000)	
Cash dividends paid	(90,000)	
Cash flow for financing		(218,000)
Decrease in cash		$ (102,000)

b. Willy Corporation's operations generated $245,000 of cash, however this was not adequate to provide for both the $129,000 cash used for investing activities and the $218,000 cash used for financing activities.

P1-8B. Ethics
(LO3)

1. (a) Pressure to achieve a favorable outcome
   (b) The accountant should correct the expense deduction.

2. (a) Pressure to achieve a favorable outcome
   (b) The accountant should properly report the revenue when earned.

3. (a) Pressure to divulge sensitive, confidential information
   (b) The accountant should not discuss employee salary data.

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P1-9B. Financial Statements and Other Components (LO5,LO6)

1. *c.* Balance Sheet
2. *g.* Auditor's report
3. *f.* Notes to the Financial Statements
4. *d.* Statement of Cash Flows
5. *a.* Income Statement
6. *e.* Management's Discussion and Analysis (MD&A)
7. *b.* Statement of Stockholders' Equity

P1-10B. Income Statement, Statement of Stockholders' Equity, and Balance Sheet (LO5)

a.

PICK CORPORATION Income Statement For Year Ended December 31, 2019	
Sales revenue	$52,000
Expenses	41,000
Net income	$11,000

PICK CORPORATION Statement of Stockholders' Equity For Year Ended December 31, 2019			
	Common Stock	Retained Earnings	Total
Balance, January 1, 2019	$0	$0	$0
Add: Net income for 2019		11,000	11,000
Less: Dividends for 2019		(4,000)	(4,000)
Add: Issuance of common stock	33,000		33,000
Balance, December 31, 2019	$33,000	$7,000	$40,000

continued

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PICK CORPORATION Balance Sheet December 31, 2019		
Assets		
Cash		$ 5,250
Accounts receivable		6,750
Inventory		5,500
Building, net		49,000
Equipment, net		31,000
Total assets		$97,500
Liabilities and Stockholders' Equity		
Liabilities		
Accounts payable	$ 8,000	
Notes payable	49,500	
Total liabilities		57,500
Stockholders' Equity		
Common stock	33,000	
Retained earnings	7,000	
Total stockholders' equity		40,000
Total liabilities and stockholders' equity		$97,500

b. The dividend amount of $4,000 appears very large relative to the corporation's earnings of $11,000 and remaining cash balance of $5,250. For young corporations such as Pick, it may be wiser to retain this cash so that they have a cushion for unexpected events, or for additional opportunities.

P1-11B. Recognition and Measurement Criteria
(LO8, Appendix 1A)

1. The Buchanan Company appears to be invoking the materiality constraint by expensing the entire amount in advertising. Since the company is prepaying the expense for the entire year, a better treatment would be to increase the asset account "Prepaid Advertising" and to write-off the asset on a monthly basis (i.e. 1/12 would be written-off at the end of December). The expense recognition (matching) principle should be considered here.

2. The measurement or cost principle is being correctly applied in this situation. Even though the asset was acquired at a discount, it should be recorded at the price paid to purchase it.

3. The issue here is the accounting entity concept. If J.R. Brown uses cash from his business to buy his wife shares in a company, the cash should be withdrawn from the business (decrease Cash, decrease Equity). The entry as recorded implies that the investments were purchased by the business, not by J.R. Brown.

4. This entry is incorrectly recorded in that it violates the cost principle that assets are initially recorded at cost, and that this value is maintained unless the asset depreciates in value or suffers a value impairment.

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SERIAL PROBLEM: KATE'S CARDS

SP1. *a.* Sole proprietorship. Kate does not require much capital formation (corporation) nor does she need any additional expertise (partnership).

b. Since Kate has few assets, the key information for her will be revenues and expenses on the income statement and carefully managing her cash flows via her statement of cash flow.

c. Kate's asset accounts will involve cash, accounts receivable (assuming that she extends trade credit to her customers), inventory, and her iMac as her equipment. Her revenues will be from card sales and any fees that she charges for card design classes, while her expenses will be principally materials used to create cards, depreciation on her iMac, rent, utilities, insurance, and income taxes.

d. Kate should set up a separate bank/checking account for her business to facilitate her cash management of her personal expenses versus expenses for her business.

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EXTENDING YOUR KNOWLEDGE

REPORTING AND ANALYSIS

EYK1-1.Financial Reporting Problem: Columbia Sportswear Company

a Columbia's total assets increased by $199.008 million from 2016 to 2017.

b. Columbia's cash and cash equivalents account increased by $121.777 million from 2016 to 2017. The company ended fiscal-year 2017 with a cash and cash equivalents balance of $673.166 million.

c. Accounts receivable at year-end 2017 totalled $364.862 million, whereas accounts payable ended the year at $252.301 million.

d. Sales revenue increased by $89.060 million from 2016 to 2017.

e. Net income for 2017 was $112.315 million, down $86.124 million from 2016.

EYK1-2.Comparative Analysis Problem: Columbia Sportswear Company vs. Under Armour, Inc.

			Columbia	Under Armour
1.	*a.*	Total assets	$2,212.9 million	$ 4,006.4 million
	b.	Sales	2,466.1 million	4,976.6 million
	c.	Net income (loss)	105.1 million	(48.3) million
	d.	Cash flow from operations	341.1 million	234.1 million

2. Based on 2017 comparable financial data, Under Armour is larger than Columbia when measured in terms of total assets and in terms of sales revenue. Given its larger size, it makes sense that Under Armour will also report higher net income and cash flow from operations. However, that is not the case. Columbia reports a profit of $105.1 million, whereas Under Armour reported a loss of $48.3 mllion. Columbia also reported a larger cash flow from operations, both in total dollars and as a percentage of sales (13.8%) compared to (4.7%) suggesting that its operating cash flow performance is stronger.

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EYK1-3. Business Decision Problem

a. $360,000 Assets - $60,000 Liabilities = $300,000 Stockholders' Equity. $75,000 Average Annual Income / $300,000 = 25 percent return. Seger's return would be 20 percent ($75,000 Average Annual Income / $375,000 Investment), assuming no adjustment is made for salary. (See part b.)

b. No. Withdrawals do not affect net income, since they are not part of the firm's operating activities. However, in calculating Krum's return in part a, Seale might wish to "impute" an amount for Krum's half-time work in computing Krum's return on investment. Thus, if Seger believes that Krum's services are worth $15,000 (half of the $30,000 salary he expects to pay a full-time manager), annual income should be calculated at $60,000 instead of $75,000. If Seger hires a full-time manager at $30,000, his return will be only 12 percent [($75,000 - $30,000)/$375,000].

c. Yes, the difference between net income shown in the financial statements and net income shown on the tax return can be legitimate, since income tax rules for determining revenues and deductions from revenues may differ from generally-accepted accounting principles. Seale may obtain additional assurance about the propriety of the financial statements by engaging a licensed professional accountant to audit the financial statements and render a report on them. Tax preparers usually prepare a statement reflecting how the taxable income was arrived at as compared to the financial statements. This document would also provide assurances.

EYK1-4. Financial Analysis Problem

a. Columbia's financial statements were audited by Deloitte & Touche LLP.

b. 2017 net income totaled $105.1 million versus $191.9 million in 2016.

c. The cash flow from investing in 2017 was $147.8 million cash outflow. The principal source of cash for investing was the sale of short-term investments ($36.3 million). The principle use of cash for investing was the purchse of short-term investments ($131 million).

d. Accrued liabilities totaled $182.2 million in 2017. The balance sheet indicates that accrued liabilities are discussed in more detail in Note 9 to the Consolidated Financial Statements, which shows that this total is composed of accrued salaries ($79.5 million), accrued import duties ($12.4 million), accrued product warranty ($12.3 million), and other accrued liabilities ($78.0 million).

e. At the end of the Management's Discussion & Analysis (beginning on page 37) Columbia indicates that its critical accounting estimates involve revenue recognition, the allowance for uncollectable accounts receivable, inventory, product warranty, long-lived and intangible assets, incomes taxes, and stock-based compensation.

f. Columbia rounds its financial data to the nearest thousand dollars.

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CRITICAL THINKING

EYK1-5. Accounting Research Problem

a. 1. General Mills uses the corporate form of business organization. The balance sheets for General Mills present a stockholders' equity section with common stock and retained earnings categories. These are the label and categories that characterize the balance sheet of a corporation. Also, the title of the company is "General Mills, Inc." with Inc. referring to being incorporated.

2. The date of the most recent balance sheet presented is May 28, 2017.

3. Goodwill, at $8,747.2 million, represents the largest asset reported on the May 28, 2017, balance sheet. The largest liability reported is long-term debt at $7,642.9 million.

b. 1. The time period covered by the fiscal year 2017 statement of earnings is the fiscal year ended May 28, 2017.

2. General Mills reported sales revenue of $15,619.8 million for the fiscal year ended May 28, 2017. Sales revenue decreased $943.3 million for the fiscal year.

3. Net earnings of $1,701.1 million are reported for the fiscal year ended May 28, 2017. This represents an decrease of $35.7 million from the net earnings for the preceding fiscal year.

c. 1. For the fiscal year ended May 28, 2017, the net cash provided by operating activities was $2,313.3 million, and this figure was a smaller inflow than in 2016.

2. For the fiscal year ended May 28, 2017, the net cash used by investment activities was $646.9 million, and this figure was a larger outflow than in 2016, which showed cash provided of $93.4 million.

3. For the fiscal year ended May 28, 2017, the net cash used by financing activities was $1,645.5 million, and this figure was a smaller outflow than in 2016.

EYK1-6. Accounting Communication Activity

a.

START COMPANY
Balance Sheet
December 31, 2019

Assets		Liabilities and Stockholders' Equity	
Cash	$15,000	Accounts payable	$22,000
Accounts receivable	30,000	Notes payable	34,000
Inventory	20,000	Common stock	10,000
Equipment	28,000	Retained earnings	27,000
Total	$93,000	Total	$93,000

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b. Memo to Bruce

Your balance sheet included the following errors:

1. Accounts payable is a liability, not an asset.
2. Inventory is an asset, not a liability.
3. Retained earnings is calculated as follows:

Retained earnings, Jan. 1, 2019	$10,000
Add: Net income	28,000
Less: Dividends paid	(11,000)
Retained earnings, Dec. 31, 2019	$27,000

c. *(Would be included in the memo)* The purpose of a balance sheet is to report a company's assets, liabilities, and stockholders' equity as of a given date.

EYK1-7.Accounting Ethics Case

It is important for a CPA to be independent when performing audit services because third parties will be relying on the audited financial statements in making decisions. The financial statements are the representations of the corporation's management. The audit by a CPA adds credibility to the financial statements. Only if third parties believe that the CPA is independent will a CPA be able to add credibility to financial statements.

Jack is not independent for three reasons: (1) His brother is president and chair of the board of directors of the company to be audited. (2) Jack is on the board of directors of the company to be audited. (3) Jack does consulting work for the company. Under the Sarbanes-Oxley Act, CPAs can no longer remain independent if they engage in consulting work, however Jack's other activity for the company—tax work—does not impair a CPA's independence. This last point may generate some discussion, particularly in this case when the potential auditor is the same person (Jack) who is doing the tax work. Usually, when the same CPA firm does both auditing and tax work, different persons do the audit than do the tax work.

EYK1-8. Ethics

Your supervisor is asking you to participate in the preparation of fraudulent financial reports. This is not only unethical, but it is also illegal and could subject you to criminal prosecution. You are being asked to smooth the company's earnings between the two years. While it does report a more conservative profit number this year, it will inflate next year's earnings. By reporting the expenses in the current year, the financial reports will mislead financial statement users. This in turn may lead them to make erroneous investment decisions. You should not follow your supervisor's request. Instead you should explain to your supervisor why reporting revenues and expenses in an improper period is wrong. If your supervisor continues to pressure you, you should report your supervisor to a higher level of management in the company.

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EYK1-9. Corporate Social Responsibility Problem

a. "At Columbia Sportswear, we are committed to building a company of which we can all be proud – not only of the innovative products we create and the financial results we achieve, but the manner in which we achieve them. Whether it's responsible sourcing, giving back to our communities, or reducing our environmental impact, we believe corporate responsibility is a companywide effort."

b. The Higg Index is an industry-wide tool that enables companies to evaluate material types, products, facilities and processes based on a set of environmental indicators. Columbia is "committed to measuring, tracking and improving our supply chain environmental performance and are using the Higg Index framework to do so."

c. Columbia is participating in the HERproject, which provides health education for female factory workers in developing countries and links women's health to business value.

d. It's the corporate culture of individuals who founded the company, but it is also good business.

EYK1-10. Forensic Accounting Problem

a. Forensic acountant combine their accounting aknowledge with investigative skills in various litigation support and investigative accounting setting. Typical job responsibilities include performing forensic research to trace funds and identify assets for recovery, conducting forensic analysis of financial data, preparing forensic accounting reports from financial findings, and preparing analytical data for litigation and testifying when needed.

b. Some of the many useful skills and abilities include: research skills, analytical, objective, computer application skills, legal knowledge, verbal and written communication.

c. The accounting knowledge gained from this textbook would be extremely beneficial for becoming a forensic accountant.

EYK1-11. Analyzing IFRS Financial Statements

a. Brands and other intangible fixed assets in the amount of 13,714 million euros represent 20 percent (13,714/68,550) of the company's total assets.

b. LVMH is principally debt financed. Almost 56 percent of the company's assets are financed with debt [(23,287+15,003)/68,550].

c. LVMH's net income, group share was 5,129 million euros . Net income as a percent of net sales was 12 percent (5,129/42,636).

d. Cash flow from operating activities = 7,030 million euros. LVMH's operating cash flow as a percentage of net income was 137.1 percent (7,030/5,129).

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EYK1-12. Working with the Takeaways

a. You should request an annual report from Columbia Sportswear containing the income statement, the statement of stockholders' equity, the balance sheet, and a statement of cash flows. Alternatively, you can download this data directly from the company's Website or from the SEC site.

b. It is important that these statements be audited by an independent auditor such as Deloitte and Touche, the auditors of Columbia's financial statements. The auditor is able to provide a level of assurance that the financial statements are presented fairly and can be relied upon for investment decision-making purposes.

c. Each of the four financial statements provides different information that, taken together, provides a more complete view of the financial condition and operating performance of the company. The income statement reports revenues and expenses—that is, information regarding the company's profitability. The statement of stockholders' equity provides information regarding the company's decision as to how much net income will be distributed to its stockholders and how much will be retained in the company to fund future growth. The balance sheet reports Columbia's assets, liabilities, and stockholders' equity to help you evaluate the company's financial position. Finally, the statement of cash flows reports the company's sources and uses of cash to help you determine the company's ability to generate future cash flow and details how those cash flows are likely to be used.

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