Survey of Accounting 2nd edition Kimmel Solutions Manual

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CHAPTER 1

Introduction to Financial Statements

Learning Objectives

1. Identify the forms of business organization and the uses of accounting information.
2. Explain the three principal types of business activity.
3. Describe the four financial statements and how they are prepared.

ANSWERS TO QUESTIONS

1. The three basic forms of business organizations are (1) sole proprietorship, (2) partnership, and (3) corporation.

LO 1 BT: K Difficulty: E TOT: 1 min. AACSB: None AICPA BB: Governance Perspective

2. Advantages of a corporation are limited liability (stockholders not being personally liable for corporate debts), easy transferability of ownership, and ease of raising funds. Disadvantages of a corporation are increased taxation and government regulations.

LO 1 BT: K Difficulty: E TOT: 1 min. AACSB: None AICPA BB: Governance Perspective

3. Proprietorships and partnerships receive favorable tax treatment compared to corporations and are easier to form than corporations. They are also owner controlled. Disadvantages of proprietorships and partnerships are unlimited liability (proprietors/partners are personally liable for all debts) and difficulty in obtaining financing compared to corporations.

LO 1 BT: K Difficulty: E TOT: 1 min. AACSB: None AICPA BB: Governance Perspective

4. Yes. A person cannot earn a living, spend money, buy on credit, make an investment, or pay taxes without receiving, using, or dispensing financial information. Accounting provides financial information to interested users through the preparation and distribution of financial statements.

LO 1 BT: C Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

5. Internal users are managers who plan, organize, and run a business. To assist management, accounting provides timely internal reports. Examples include financial comparisons of operating alternatives, projections of income from new sales campaigns, forecasts of cash needs for the next year, and financial statements.

LO 1 BT: C Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

6. External users are those outside the business who have either a present or potential direct financial interest (investors and creditors) or an indirect financial interest (taxing authorities, regulatory agencies, labor unions, customers, and economic planners).

LO 1 BT: C Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

7. The three types of business activities are financing activities, investing activities, and operating activities. Financing activities include borrowing money and selling shares of stock. Investing activities include the purchase and sale of property, plant, and equipment. Operating activities include selling goods, performing services, and purchasing inventory.

LO 2 BT: C Difficulty: M TOT: 2 min. AACSB: None AICPA FC: Reporting

8.
(a) Income statement.
(b) Balance sheet.
(c) Income statement.
(d) Balance sheet.
(e) Balance sheet.
(f) Balance sheet.

LO 3 BT: K Difficulty: M TOT: 2 min. AACSB: None AICPA FC: Reporting

9. When a company pays dividends, it reduces the amount of assets available to pay creditors. Therefore, banks and other creditors monitor dividend payments to ensure they do not put a company's ability to make debt payments at risk.

LO 3 BT: C Difficulty: M TOT: 2 min. AACSB: None AICPA BB: Critical Thinking

10. Yes. Net income does appear on the income statement—it is the result of subtracting expenses from revenues. In addition, net income appears in the retained earnings statement—it is shown as an addition to the beginning-of-period retained earnings. Indirectly, the net income of a company is also included in the balance sheet. It is included in the retained earnings account which appears in the stockholders' equity section of the balance sheet.

LO 3 BT: C Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

11. The primary purpose of the statement of cash flows is to provide financial information about the cash receipts and cash payments of a business for a specific period of time.

LO 3 BT: K Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

12. The three categories of the statement of cash flows are operating activities, investing activities, and financing activities. The categories were chosen because they represent the three principal types of business activities.

LO 3 BT: C Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

13. Retained earnings is the net income retained in a corporation. Retained earnings is increased by net income and is decreased by dividends and a net loss.

LO 3 BT: C Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

14. The basic accounting equation is Assets = Liabilities + Stockholders' Equity.

LO 3 BT: K Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

15. (a) Assets are resources owned by a business. Liabilities are amounts owed to creditors. Put more simply, liabilities are existing debts and obligations. Stockholders' equity is the ownership claim on net assets.

(b) The items that affect stockholders' equity are issuance of common stock and the components of retained earnings (dividends, revenues, and expenses).

LO 3 BT: K Difficulty: E TOT: 2 min. AACSB: None AICPA FC: Reporting

16. The liabilities are (b) Accounts payable and (g) Salaries and wages payable.

LO 3 BT: C Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

17. (a) Net income from the income statement is reported as an increase to retained earnings on the retained earnings statement.

(b) The ending amount on the retained earnings statement is reported as the retained earnings amount on the balance sheet.

(c) The ending amount on the statement of cash flows is reported as the cash amount on the balance sheet.

LO 3 BT: C Difficulty: M TOT: 2 min. AACSB: None AICPA FC: Reporting

18. The purpose of the management discussion and analysis section is to provide management's views on its ability to pay short-term obligations, its ability to fund operations and expansion, and its results of operations. The MD&A section is a required part of the annual report.

LO 3 BT: K Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

19. An unqualified opinion shows that, in the opinion of an independent auditor, the financial statements have been presented fairly, in conformity with generally accepted accounting principles. This gives investors more confidence that they can rely on the figures reported in the financial statements.

LO 3 BT: C Difficulty: E TOT: 2 min. AACSB: None AICPA FC: Reporting

20. Information included in the notes to the financial statements clarifies information presented in the financial statements and includes descriptions of accounting policies, explanations of uncertainties and contingencies, and statistics and details too voluminous to be reported in the financial statements.

LO 3 BT: K Difficulty: E TOT: 1 min. AACSB: None AICPA FC: Reporting

21. Using dollar amounts, Apple's accounting equation (in millions) is:

Assets		Liabilities		Stockholders' Equity
$365,725	=	$258,578	+	$107,147

LO 3 BT: AP Difficulty: E TOT: 2 min. AACSB: Analytic AICPA FC: Reporting

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 1.1

(a) P Shared control, tax advantages, increased skills and resources.

(b) SP Simple to set up and maintains control with owner.

(c) C Easier to transfer ownership and raise funds, no personal liability.

LO 1 BT: K Difficulty: Easy TOT: 2.0 min. AACSB: None AICPA BB: Governance Perspective

BRIEF EXERCISE 1.2

(a) 4 Investors in common stock
(b) 3 Marketing managers
(c) 2 Creditors
(d) 5 Chief Financial Officer
(e) 1 Internal Revenue Service

LO 1 BT: K Difficulty: Easy TOT: 2.0 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

BRIEF EXERCISE 1.3

O (a) Cash received from customers.
F (b) Cash paid to stockholders (dividends).
F (c) Cash received from issuing new common stock.
O (d) Cash paid to suppliers.
I (e) Cash paid to purchase a new office building.

LO 2 BT: K Difficulty: Easy TOT: 2.0 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation & Reporting

BRIEF EXERCISE 1.4

E	(a)	Advertising expense
R	(b)	Service revenue
E	(c)	Insurance expense
E	(d)	Salaries and wages expense
D	(e)	Dividends
R	(f)	Rent revenue
E	(g)	Utilities expense
NSE	(h)	Cash purchase of equipment
C	(i)	Issued common stock for cash.

LO 3 BT: C Difficulty: Easy TOT: 3.0 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation & Reporting

BRIEF EXERCISE 1.5

KAROL COMPANY
Balance Sheet
December 31, 2022

Assets		
Cash		$22,000
Accounts receivable		71,000
Total assets		$93,000
Liabilities and Stockholders' Equity		
Liabilities		
Accounts payable		$65,000
Stockholders' equity		
Common stock	$18,000	
Retained earnings	10,000	
Total stockholders' equity		28,000
Total liabilities and stockholders' equity		$93,000

LO 3 BT: AP Difficulty: Medium TOT: 4.0 min. AACSB: Analytic AICPA FC: Reporting

BRIEF EXERCISE 1.6

IS	(a)	Income tax expense
BS	(b)	Inventory
BS	(c)	Accounts payable
BS	(d)	Retained earnings
BS	(e)	Equipment
IS	(f)	Sales revenue
IS	(g)	Cost of goods sold
BS	(h)	Common stock
BS	(i)	Accounts receivable
IS	(j)	Interest expense

LO 3 BT: K Difficulty: Easy TOT: 3.0 min. AACSB: None AICPA FC: Reporting

BRIEF EXERCISE 1.7

IS	(a)	Revenue during the period.
BS	(b)	Supplies on hand at the end of the year.
SCF	(c)	Cash received from issuing new bonds during the period.
BS	(d)	Total debts outstanding at the end of the period.

LO 3 BT: K Difficulty: Easy TOT: 2.0 min. AACSB: None AICPA FC: Reporting

BRIEF EXERCISE 1.8

(a) $90,000 + $230,000 = $320,000 (Total assets)

(Liabilities + Stockholder's equity = Assets)

($90,000 + $230,000 = $320,000)

(b) $170,000 – $80,000 = $90,000 (Total liabilities)

(Assets – Stockholder's equity = Liabilities)

($170,000 - $80,000 = $90,000)

(c) $800,000 – 0.25($800,000) = $600,000 (Stockholders' equity)

(Assets – (1/4 × Assets) = Stockholder's equity)

[$800,000 – (0.25 x $800,000) = $600,000]

LO 3 BT: AP Difficulty: Medium TOT: 4.0 min. AACSB: Analytic AICPA: FC: Measurement Analysis and Interpretation

BRIEF EXERCISE 1.9

(a) (\$800,000 + \$150,000) – (\$500,000 – \$80,000) = \$530,000 (Stockholders' equity)

[(Assets ± Change in assets) – (Liabilities ± Change in liabilities) = Stockholders' equity]

[(\$800,000 + \$150,000) – (\$500,000 - \$80,000) = \$530,000]

(b) (\$500,000 + \$100,000) + (\$800,000 – \$500,000 – \$70,000) = \$830,000 (Assets)

[(Liabilities ± Change in liabilities) + (Stockholders' equity ± Change in stockholders' equity) = Assets]

[(\$500,000 + \$100,000) + (\$800,000 - \$500,000 - \$70,000) = \$830,000]

(c) (\$800,000 – \$80,000) – (\$800,000 – \$500,000 + \$110,000) = \$310,000 (Liabilities)

[(Assets ± Change in assets) – (Stockholders' equity ± Change in stockholders' equity) = Liabilities]

[(\$800,000 - \$80,000) – (\$800,000 - \$500,000 + \$110,000) = \$310,000]

LO 3 BT: AP Difficulty: Hard TOT: 5.0 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation

BRIEF EXERCISE 1.10

A	(a)	Accounts receivable
L	(b)	Salaries and wages payable
A	(c)	Equipment
A	(d)	Supplies
SE	(e)	Common stock
L	(f)	Notes payable

LO 3 BT: K Difficulty: Easy TOT: 3.0 min. AACSB: None AICPA FC: Reporting

BRIEF EXERCISE 1.11

(d) All of these are required.

LO 3 BT: K Difficulty: Easy TOT: 2.0 min. AACSB: None AICPA FC: Reporting

SOLUTIONS TO DO IT! EXERCISES

DO IT! 1.1

(a) Easier to transfer ownership: corporation
(b) Easier to raise funds: corporation
(c) More owner control: sole proprietorship
(d) Tax advantages: sole proprietorship and partnership
(e) No personal legal liability: corporation

LO 1 BT: C Difficulty: Easy TOT: 2.0 min. AACSB: None AICPA BB: Governance Perspective

DO IT! 1.2

(a) Issuance of ownership shares is classified as common stock.
(b) Land purchased is classified as an asset.
(c) Amounts owed to suppliers are classified as liabilities.
(d) Bonds payable are classified as liabilities.
(e) Amount recorded from selling a product is classified as revenue.
(f) Cost of advertising is classified as expense.

LO 2 BT: K Difficulty: Easy TOT: 2.0 min. AACSB: None AICPA FC: Reporting

DO IT! 1.3a

GRAY CORPORATION
Income Statement
For the Year Ended December 31, 2022

Revenues		
Service revenue		$25,000
Expenses		
Rent expense	$10,000	
Advertising expense	4,000	
Supplies expense	1,700	
Total expenses		15,700
Net income		$ 9,300

[Serv. rev.– Tot. expenses = Net inc. or (loss)]
[$25,000 – ($10,000 + $4,000 + $1,700) = $9,300]

DO IT! 1.3a (Continued)

GRAY CORPORATION
Retained Earnings Statement
For the Year Ended December 31, 2022

Retained earnings, January 1	$ –0–
Add: Net income	9,300
	9,300
Less: Dividends	2,500
Retained earnings, December 31	$6,800

(Beg. ret. earn. ± Changes in ret. earn. = End. ret. earn.)

($0 + $9,300 - $2,500 = $6,800)

GRAY CORPORATION
Balance Sheet
December 31, 2022

Assets

Cash		$ 3,100
Accounts receivable		2,000
Supplies		1,900
Equipment		
26,800		
Total assets		$33,800

Liabilities and Stockholders' Equity

Liabilities		
Notes payable	$ 7,000	
Account payable	5,000	
Total liabilities		$12,000
Stockholder's equity		
Common stock	15,000	
Retained earnings	6,800	
Total stockholders' equity		21,800
Total liabilities and stockholder's equity		$33,800

(Assets = Liabl. + SE)

[($3,100 + $2,000 + $1,900 + $26,800) = (($7,000 + $5,000) + ($15,000 + $6,800))]

LO 3 BT: AP Difficulty: Hard TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

DO IT! 1.3b

(a) Description of ability to pay near-term obligations: MD&A
(b) Unqualified opinion: auditor's report
(c) Details concerning liabilities, too voluminous to be included in the statements: notes
(d) Description of favorable and unfavorable trends: MD&A
(e) Certified Public Accountant (CPA): auditor's report
(f) Descriptions of significant accounting policies: notes

LO 3 BT: K Difficulty: Easy TOT: 3.0 min. AACSB: None AICPA FC: Reporting

SOLUTIONS TO EXERCISES

EXERCISE 1.1

(a) 8. Auditor's opinion
(b) 1. Corporation
(c) 6. Common stock
(d) 7. Accounts payable
(e) 3. Accounts receivable
(f) 2. Creditor
(g) 5. Stockholder
(h) 4. Partnership

LO 1-3 BT: K Difficulty: Easy TOT: 2.0 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation & Reporting

EXERCISE 1.2

a. 8 Assets = Liabilities + Stockholders' Equity.
b. 1 An individual who has met certain criteria and is thus allowed to perform audits of corporations.
c. 4 Payments of cash from a corporation to its stockholders.
d. 9 The cost of assets consumed or services used in the process of generating revenues.
e. 10 Amounts owed to creditors in the form of debts and other obligations.
f. 2 A section of the annual report that presents management's views on the company's ability to pay near-term obligations, its ability to fund operations and expansion, and its results of operations.
g. 6 The amount by which expenses exceed revenues.
h. 3 The increase in assets or decrease in liabilities resulting from the sale of goods or the performance of services in the normal course of business.
i. 11 Regulations passed by Congress to reduce unethical corporate behavior.
j. 7 A business owned by one person.
k. 5 The owner's claim to assets.

LO 1-3 BT: K Difficulty: Easy TOT: 3 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation & Reporting

EXERCISE 1.3

(a) Answers will vary.

	Financing	Investing	Operating
Abitibi-Consolidated Inc.	Sale of stock	Purchase long-term investments	Sale of newsprint
Cal State University—Northridge Student Union	Borrow money from a bank	Purchase office equipment	Payment of wages and benefits
Oracle Corporation	Sale of bonds	Purchase other companies	Payment of research expenses
Aquilini Investment Group	Payment of dividends to stockholders	Purchase hockey equipment	Payment for ice rink rentals
Grant Thornton LLP	Distribute earnings to partners	Purchase computers	Bill clients for professional services
Southwest Airlines	Sale of stock	Purchase airplanes	Payment for jet fuel

(b) Financing

Sale of stock is common to all corporations. Borrowing from a bank is common to all businesses. Distribution of earnings to partners would only be common to partnerships. Payment of dividends is common to all corporations. Sale of bonds is common to large corporations.

Investing

Purchase and sale of property, plant, and equipment would be common to all businesses—the types of assets would vary according to the type of business and some types of businesses require a larger investment in long-lived assets. A new business or expanding business would be more apt to acquire property, plant, and equipment while a mature or declining business would be more apt to sell it. Purchase of long-term investments and other companies would be common to all businesses.

Operating

The general activities identified would be common to most businesses, although the service or product would differ.

LO 2 BT: C Difficulty: Easy TOT: 3.0 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation & Reporting

EXERCISE 1.4

Accounts payable	L
Accounts receivable	A
Equipment	A
Sales revenue	R
Service revenue	R
Inventory	A
Mortgage payable	L
Supplies expense	E
Rent expense	E
Salaries and wages expense	E

LO 2, 3 BT: C Difficulty: Easy TOT: 3.0 min AACSB: None AICPA FC: Measurement Analysis and Interpretation & Reporting

EXERCISE 1.5

BENSER CO.
Income Statement
For the Year Ended December 31, 2022

Revenues		
Service revenue		$58,000
Expenses		
Salaries and wages expense..............................	$30,000	
Rent expense	10,400	
Utilities expense	2,400	
Advertising expense	1,800	
Total expenses		44,600
Net income		$13,400

(Serv. rev. – Tot. exp. = Net inc.)

[$58,000 – ($30,000 + $10,400 + $2,400 + $1,800) = $13,400]

EXERCISE 1.5 (Continued)

BENSER CO.
Retained Earnings Statement
For the Year Ended December 31, 2022

Retained earnings, January 1	$67,000
Add: Net income	13,400
	80,400
Less: Dividends	6,000
Retained earnings, December 31	$74,400

(Beg. ret. earn. + Net inc. – Div. = End. ret. earn.)
($67,000 + $13,400 - $6,000 = $74,400)
LO 3 BT: AP Difficulty: Medium TOT: 6.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.6

(a)

MERCK AND CO.
Income Statement
For the Year Ended December 31, 2022
(in millions)

Revenues		
Sales revenue		$38,576.0
Expenses		
Cost of goods sold	$ 9,018.9	
Selling and administrative expenses	8,543.2	
Research and development expense	5,845.0	
Income tax expense	2,267.6	
Total expenses		25,674.7
Net income		$12,901.3

(Sales rev. – Tot. exp. = Net inc.)
[$38,576.0 – ($9,018.9 + $8,543.2 + $5,845.0 + $2,267.6) = $12,901.3]

EXERCISE 1.6 (Continued)

MERCK AND CO.
Retained Earnings Statement
For the Year Ended December 31, 2022
(in millions)

Retained earnings, January 1	$43,698.8
Add: Net income	12,901.3
	56,600.1
Less: Dividends	3,597.7
Retained earnings, December 31	$53,002.4

(Beg. ret. earn. + Net inc. – Div. = End. ret. earn.)
($43,698.8 + $12,901.3 - $3,597.7 = $53,002.4]

(b) The short-term implication would be a decrease in expenses of $2,922.5 ($5,845 X 50%) resulting in a corresponding increase in income (ignoring income taxes). If all other revenues and expenses remain unchanged, decreasing research and development expenses would produce 22.7% more net income ($2,922.5 ÷ $12,901.3).

The long-term implications would be more difficult to quantify but it is safe to predict that a reduction in research and development expenses would probably result in lower sales revenues in the future. Pharmaceutical companies are usually able to charge higher prices for newly developed products while lower cost generic versions usually replace older products. Decreasing research and development activities will probably mean fewer new products.

The stock market's initial reaction might be positive since Merck's net income would increase significantly. Such a reaction would probably be very short-lived as more knowledgeable investors reviewed Merck's financial statements and discovered the cause of the increase.

LO 3 BT: AP Difficulty: Hard TOT: 8.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.7

ZHENG INC.
Retained Earnings Statement
For the Year Ended December 31, 2022

Retained earnings, January 1		$130,000
Add: Net income		225,000*
		355,000
Less: Dividends		65,000
Retained earnings, December 31		$290,000
*Service revenue	$400,000	
Total expenses	175,000	
Net income	$225,000	

(Beg. ret. earn. + Net inc. – Div. = End. ret. earn.)
[$130,000 + ($400,000 - $175,000) - $65,000 = $290,000]
LO 3 BT: AP Difficulty: Medium TOT: 4.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.8

Randall Inc.
Balance Sheet
December 31, 2022

Assets

Cash	$ 6,250
Accounts receivable	2,400
Inventory	2,840
Supplies	3,760
Equipment (net)	108,200
Total assets	$123,450

EXERCISE 1.8 (Continued)

Liabilities and Stockholders' Equity

Liabilities		
Accounts payable	$ 3,700	
Notes payable	31,500	
Interest payable	580	
Salaries and wages payable	745	
Unearned service revenue	850	
Total liabilities		$37,375
Stock holders' equity		
Common stock..	50,700	
Retained earnings**.....................................	35,375	
Total stockholders' equity*............................		86,075
Total liabilities and stockholders' equity		$123,450

*Tot. assets – Total liabl. = Total SE

$123,450 – $37,375 = $86,075

**Tot. SE – Common stk. = Ret. earn.

$86,075 – $50,700 = $35,375

LO 3 BT: AP Difficulty: Medium TOT: 6 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.9

(a) Lee Corporation is distributing nearly all of this year's net income as dividends. This suggests that Lee is not pursuing rapid growth. Companies that have a lot of opportunities for growth pay low dividends.

(b) Steele Corporation is not generating sufficient cash provided by operating activities to fund its investing activities. Instead it generates additional cash through financing activities. This is common for companies in their early years of existence.

LO 3 BT: AN Difficulty: Medium TOT: 4.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.10

(a)

A	Cash
SE	Retained earnings
E	Cost of goods sold
E	Salaries and wages expense
A	Prepaid insurance
A	Inventory
A	Accounts receivable
R	Sales revenue
L	Notes payable
L	Accounts payable
R	Service revenue
E	Interest expense

(b)

LONYEAR INC.
Income Statement
For the Year Ended December 31, 2022

Revenues		
Sales revenue......................................	$584,951	
Service revenue	4,806	
Total revenues.................................		$589,757
Expenses		
Cost of goods sold	438,458	
Salaries and wages expense.............	115,131	
Interest expense	1,882	
Total expenses		555,471
Net income..		$ 34,286

[Tot. rev. – Tot. exp. = Net inc.]

[($584,951 + $4,806) – ($438,458 + $115,131 + $1,882) = $34,286]

LO 3 BT: AP Difficulty: Medium TOT: 5.0 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation & Reporting

EXERCISE 1.11

(a)

E	Interest expense	A	Equipment (net)
L	Interest payable	E	Depreciation expense
L	Notes payable	A	Supplies
R	Sales revenue	SE	Common stock
A	Cash	E	Supplies expense
E	Salaries and wages expense		

(b)

Familia Inc.
Income Statement
For the Year Ended December 31, 2022

Revenues		
Sales revenue		$44,300
Expenses		
Salaries and wages expense	$15,600	
Depreciation expense	3,200	
Interest expense	2,200	
Supplies expense	900	
Total expenses		21,900
Net income		$22,400

LO 3 BT: AP Difficulty: Medium TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.12

First note that the retained earnings statement shows that (b) equals $27,000.

Accounts payable + Common stock + Retained earnings = Total liabilities and stockholders' equity

$5,000 + a + $27,000 = $62,000
a + $32,000 = $62,000
a = <u>$30,000</u>

Beginning retained earnings + Net income – Dividends = Ending retained earnings

$12,000 + e – $5,000 = $27,000
$7,000 + e = $27,000
e = <u>$20,000</u>

From above, we know that net income (d) equals $20,000.

Revenue – Cost of goods sold – Salaries and wages expense = Net income

$85,000 – c – $10,000 = $20,000
$75,000 – c = $20,000
c = <u>$55,000</u>

LO 3 BT: AN Difficulty: Hard TOT: 7.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.13

(c) $37,000 (given)

(d) $97,000 ($22,000 + $38,000 + $37,000)

(b) $97,000 (See (d))

(a) $3,000 ($97,000 – $29,000 – $65,000)

(e) $17,000 [$53,000 – ($25,000 + $1,000 + $10,000)]

(g) $25,000 (given)

(f) $18,000 ($37,000 + $6,000 – $25,000)

LO 3 BT: AN Difficulty: Medium TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.14

(a)

Service revenue	$132,000	
Sales revenue	25,000	
Total revenue		$157,000
Expenses		126,000
Net income		$ 31,000

(Tot. rev. – Exp. = Net inc.)
[($132,000 + $25,000) - $126,000 = $31,000]

(b)

OTAY LAKES PARK
Retained Earnings Statement
For the Year Ended December 31, 2022

Retained earnings, January 1	$ 5,000
Add: Net income	31,000
	36,000
Less: Dividends	9,000
Retained earnings, December 31	$27,000

(Beg. ret. earn. + Net inc. – Div. = End. ret. earn.)
($5,000 + $31,000 - $9,000 = $27,000)

OTAY LAKES PARK
Balance Sheet
December 31, 2022

Assets		
Cash		$ 8,500
Supplies		5,500
Equipment		114,000
Total assets		$128,000
Liabilities and Stockholders' Equity		
Liabilities		
Notes payable	$50,000	
Accounts payable	11,000	
Total liabilities		$ 61,000
Stockholders' equity		
Common stock	40,000	
Retained earnings	27,000	
Total stockholders' equity		67,000
Total liabilities and stockholders' equity		$128,000

(Assets = Liabl. + SE)
[($8,500 + $5,500 + $114,000) = (($50,000 + $11,000) + ($40,000 + $27,000))]

(c) The income statement indicates that revenues from the general store were only about 16% ($25,000 ÷ $157,000) of total revenue which tends to support Walt's opinion. In order to decide if the store is "more trouble than it is worth," I would need to know the amount of expenses attributable to the general store. The income statement reports all expenses in a single category rather than separating them into camping and general store expenses to correspond with revenues. A break down into two categories would help me decide if the general store is generating a profit or loss.

Even if the general store is operating at a loss, I might recommend retaining it if campers indicated that the convenience of having a general store on site was an important amenity in selecting a campground.

LO 3 BT: AP Difficulty: Hard TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.15

(a)

SE	Retained earnings
E	Cost of goods sold
E	Selling and administrative expenses
A	Cash
L	Notes payable
E	Interest expense
L	Bonds payable
A	Inventory
R	Sales revenue
L	Accounts payable
SE	Common stock
E	Income tax expense

(b)

KELLOGG COMPANY
Income Statement
For the Year Ended December 31, 2022
(in millions)

Revenues		
Sales revenue		$12,575
Expenses		
Cost of goods sold	$7,184	
Selling and administrative expenses	3,390	
Income tax expense	498	
Interest expense	295	
Total expenses		11,367
Net income		$ 1,208

[Sales rev. – Tot. exp. = Net inc.]

[$12,575 – ($7,184 + $3,390 + $498 + $295) = $1,208]

LO 3 BT: AP Difficulty: Medium TOT: 6.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.16

(a)

WILLIAMS CORPORATION
Statement of Cash Flows
For the Year Ended December 31, 2022

Cash flows from operating activities		
Cash received from customers	$ 50,000	
Cash paid to suppliers	(16,000)	
Net cash provided by operating activities		$ 34,000
Cash flows from investing activities		
Cash paid for new equipment	(28,000)	
Net cash used by investing activities		(28,000)
Cash flows from financing activities		
Cash received from lenders	20,000	
Cash dividends paid	(8,000)	
Net cash provided by financing activities		12,000
Net increase in cash		18,000
Cash at beginning of period		12,000
Cash at end of period		$ 30,000

(Cash flows from oper., invest., and fin. act. = Net change in cash)

[($50,000 - $16,000) - $28,000 + ($20,000 - $8,000) = $18,000]

(b) As a creditor, I would feel reasonably confident that Williams has the ability to repay its lenders. During 2022, Williams generated $34,000 of cash from its operating activities. This amount more than covered its expenditures for new equipment but not both equipment purchases and dividends.

LO 3 BT: AP Difficulty: Medium TOT: 6.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.17

(a)

SOUTHWEST AIRLINES
Statement of Cash Flows
For the Year Ended December 31, 2022
(in millions)

Cash flows from operating activities		
Cash received from customers	$9,823	
Cash paid for goods and services	(6,978)	
Net cash provided by operating activities		$2,845
Cash flows from investing activities		
Cash paid for property and equipment	(1,529)	
Net cash used by investing activities		(1,529)
Cash flows from financing activities		
Cash received from issuance of long-term debt	500	
Cash received from issuance of common stock	144	
Cash paid for repurchase of common stock	(1,001)	
Cash paid for repayment of debt	(122)	
Cash paid for dividends	(14)	
Net cash used by financing activities		(493)
Net increase in cash		823
Cash at beginning of period		1,390
Cash at end of period		$2,213

(Cash flows from oper., invest., and fin. act. = Net change in cash)

[($9,823 - $6,978) - $1,529 + ($500 + $144 - $1,001 - $122 - $14) = $823]

(b) Southwest reported $2,845,000,000 cash from operating activities but spent $1,529,000,000 to invest in new property and equipment. Its cash from operating activities was sufficient to finance its investing activities. Southwest supplemented the cash from operating activities by issuing long-term debt and additional shares of common stock. It used excess cash to repurchase stock, pay down debt, and pay dividends. In total, it generated more cash from operating activities than it paid for investing and financing activities resulting in a net increase in cash for 2022.

LO 3 BT: AP Difficulty: Hard TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.18

BEESON COMPANY
Balance Sheet
December 31, 2022

Assets		
Cash		$18,000
Accounts receivable		12,000
Supplies		9,500
Equipment		40,000
Total assets		$79,500
Liabilities and Stockholders' Equity		
Liabilities		
Accounts payable		$16,000
Stockholders' equity		
Common stock	$40,000	
Retained earnings	23,500*	
Total stockholders' equity		63,500
Total liabilities and stockholders' equity		$79,500

*$31,500 – $8,000

(Assets = Liabl. + SE)
[($18,000 + $12,000 + $9,500 + $40,000) = ($16,000 + ($40,000 + ($31,500 - $8,000)))]

LO 3 BT: AP Difficulty: Medium TOT: 5 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.19

All dollars are in millions.

(a) **Assets**

Cash	$ 2,291.1
Accounts receivable	2,883.9
Inventory	2,357.0
Equipment	1,957.7
Buildings	3,759.9
Total assets	$13,249.6

Liabilities

Notes payable	$ 342.9
Accounts payable	2,815.8
Mortgage payable	1,311.5
Income taxes payable	86.3
Total liabilities	$ 4,556.5

Stockholders' Equity

Common stock	$ 2,874.2
Retained earnings	5,818.9
Total stockholders' equity	$ 8,693.1

(b)

Assets	=	Liabilities	+	Stockholders' Equity
$13,249.6		$4,556.5		$8,693.1

(c) Nike has relied more heavily on equity than debt to finance its assets. Debt (liabilities) financed 34% of its assets ($4,556.5 ÷ $13,249.6) compared to equity financing of 66% ($8,693.1 ÷ $13,249.6).

LO 3 BT: AP Difficulty: Medium TOT: 8.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.20

(a)	Assets	=	Liabilities	+	Stockholders' Equity
	$110,000	=	$70,000	+	(a)
	(a)	=	$40,000		

(b)	Assets	=	Liabilities	+	Stockholders' Equity
	(b)	=	$120,000	+	$60,000
	(b)	=	$180,000		

(c)	Beginning Stockholders' Equity	+	Revenues	–	Expenses	–	Dividends	=	Ending Stockholders' Equity
	$40,000(a)	+	$215,000	–	$165,000	–	(c)	=	$60,000
			$ 90,000	–	(c)			=	$60,000
					(c)			=	$30,000

(d)	Assets	=	Liabilities	+	Stockholders' Equity
	$150,000	=	(d)	+	$70,000
	(d)	=	$80,000		

(e)	Assets	=	Liabilities	+	Stockholders' Equity
	$180,000	=	$ 55,000	+	(e)
	(e)	=	$125,000		

(f)	Beginning Stockholders' Equity	+	Revenues	–	Expenses	–	Dividends	=	Ending Stockholders' Equity
	$70,000	+	(f)	–	$80,000	–	$5,000	=	$125,000(e)
	(f)	=	$140,000						

LO 3 BT: AN Difficulty: Hard TOT: 12.0 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 1.21

(a) Financial statements
(b) Auditor's opinion
(c) Notes to the financial statements
(d) Financial statements
(e) Management discussion and analysis
(f) Not disclosed

LO 3 BT: K Difficulty: Easy TOT: 3.0 min. AACSB: None AICPA FC: Reporting

SOLUTIONS TO PROBLEMS

PROBLEM 1.1

(a) The concern over legal liability would make the corporate form a better choice over a partnership. Also, the corporate form will allow the business to raise cash more easily, which may be of importance in a rapidly growing industry.

(b) Bob should run his business as a sole proprietor. He has no real need to raise funds, and he doesn't need the expertise provided by other partners. The sole proprietorship form would provide the easiest form. One should avoid a more complicated form of business unless the characteristics of that form are needed.

(c) The fact that the combined business expects that it will need to raise significant funds in the near future makes the corporate form more desirable in this case.

(d) It is likely that this business would form as a partnership. Its needs for additional funds would probably be minimal in the foreseeable future. Also, the three know each other well and would appear to be contributing equally to the firm. Service firms, like consulting businesses, are frequently formed as partnerships.

(e) One way to ensure control would be for Don to form a sole proprietorship. However, in order for this business to thrive it will need a substantial investment of funds early. This would suggest the corporate form of business. In order for Don to maintain control over the business he would need to own more than 50 percent of the voting shares of common stock. In order for the business to grow, he may have to be willing to give up some control.

LO 1 BT: C Difficulty: Medium TOT: 20 min. AACSB: None AICPA BB: Governance Perspective

PROBLEM 1.2

(a) In deciding whether to extend credit for 30 days, The North Face would be most interested in the balance sheet because the balance sheet shows the assets on hand that would be available for settlement of the debt in the near-term.

(b) In purchasing an investment that will be held for an extended period, the investor must try to predict the future performance of Amazon.com. The income statement provides the most useful information for predicting future performance.

(c) In extending a loan for a relatively long period of time, the lender is most interested in the probability that the company will generate sufficient income to meet its interest payments and repay its principal. The lender would therefore be interested in predicting future net income using the income statement. It should be noted, however, that the lender would also be very interested in both the balance sheet and statement of cash flows—the balance sheet because it would show the amount of debt the company had already incurred, as well as assets that could be liquidated to repay the loan. And the company would be interested in the statement of cash flows because it would provide useful information for predicting the company's ability to generate cash to repay its obligations.

(d) The president would probably be most interested in the statement of cash flows since it shows how much cash the company generates and how that cash is used. The statement of cash flows can be used to predict the company's future cash-generating ability.

LO 3 BT: C Difficulty: Medium TOT: 15 min AACSB: None AICPA FC: Reporting

PROBLEM 1.3

(a)

ELITE SERVICE CO.
Income Statement
For the Month Ended June 30, 2022

Revenues		
Service revenue		$7,500
Expenses		
Salaries and wages expense..........................	$1,400	
Supplies expense..	1,000	
Maintenance and repairs expense.................	600	
Advertising expense......................................	400	
Utilities expense..	300	
Total expenses		3,700
Net income		$3,800

(Serv. rev. – Tot. exp. = Net inc.)

[$7,500 – ($1,400 + $1,000 + $600 + $400 + $300) = $3,800]

ELITE SERVICE CO.
Retained Earnings Statement
For the Month Ended June 30, 2022

Retained earnings, June 1	$ 0
Add: Net income...	3,800
	3,800
Less: Dividends..	1,400
Retained earnings, June 30	$2,400

(Beg. ret. earn. - Net inc. – Div. = End. ret. earn.)

($0 + $3,800 - $1,400 = $2,400)

PROBLEM 1.3 (Continued)

ELITE SERVICE CO.
Balance Sheet
June 30, 2022

Assets		
Cash		$ 4,600
Accounts receivable		4,000
Supplies		2,400
Equipment		26,000
Total assets		$37,000
Liabilities and Stockholders' Equity		
Liabilities		
Notes payable	$12,000	
Accounts payable	500	
Total liabilities		$12,500
Stockholders' equity		
Common stock	22,100	
Retained earnings	2,400	
Total stockholders' equity		24,500
Total liabilities and stockholders' equity		$37,000

(Assets = Liabl. + SE)
[($4,600 + $4,000 + $2,400 + $26,000) = (($12,000 + $500) + ($22,100 + $2,400))]

(b) Elite had a very successful first month, earning $3,800 or 51% of service revenues ($3,800 ÷ $7,500). Its net income represents a 17% return on the initial investment ($3,800 ÷ $22,100).

(c) Distributing a dividend after only one month of operations is probably unusual. Most new businesses choose to build up a cash balance to provide for future operating and investing activities or pay down debt. Elite distributed 37% ($1,400 ÷ $3,800) of its first month's income but it had adequate cash to do so and still showed a significant increase in retained earnings.

LO 3 BT: AP Difficulty: Hard TOT: 50 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 1.4

REESE INC
Income Statement
For the Month Ended October 31, 2022

Revenues:		
Service revenue		$20,920
Expenses:		
Salaries and wages expense	$2,500	
Interest expense	410	
Supplies expense	380	
Depreciation expense	270	
Total expense		3,560
Net Income		$17,360

(Serv. rev. – Tot. exp. = Net inc.)
[$20,920 – ($2,500 + $410 + $380 + $270) = $17,360]

REESE INC
Retained Earnings Statement
For the Month Ended October 31, 2022

Retained earnings, October 1	$ 0
Add: Net income	17,360
Retained earnings, October 31	$17,360

(Beg. ret. earn. + Net inc. = End. ret. earn)
($0 + $17,360 = $17,360)

PROBLEM 1.4 (Continued)

REESE INC
Balance Sheet
October 31, 2022

Assets

Cash		$ 3,950
Accounts receivable		1,300
Supplies		2,460
Equipment (net)		48,200
Total assets		$55,910

Liabilities and Stockholders' Equity

Liabilities		
Bonds payable	$21,500	
Accounts payable	3,300	
Unearned service revenue	4,065	
Salaries and wages payable	445	
Interest payable	140	
Total liabilities		$29,450
Stockholders' Equity		
Common stock	9,100	
Retained earnings	17,360	
Total stockholders' equity		26,460
Total liabilities and stockholders' equity		$55,910

(Assets = Liabl. + SE)
[($3,950 + $1,300 + $2,460 + $48,200) = (($21,500 + $3,300 + $4,065 + $445 + $140) + ($9,100 + $17,360))]

LO 3 BT: AP Difficulty: Medium TOT: 30 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 1.5

(a)

ROJO CORPORATION
Statement of Cash Flows
For the Year Ended December 31, 2022

Cash flows from operating activities		
Cash received from customers	$132,000	
Cash paid to suppliers	(104,000)	
Net cash provided by operating activities		$28,000
Cash flows from investing activities		
Cash paid to purchase equipment	(12,000)	
Net cash used by investing activities		(12,000)
Cash flows from financing activities		
Cash received from issuing common stock	22,000	
Cash dividends paid..	(7,000)	
Net cash provided by financing activities		15,000
Net increase in cash		31,000
Cash at beginning of period....................................		9,000
Cash at end of period		$40,000

(Cash flows from oper., invest., and fin. act. = Net change in cash)
[($132,000 - $104,000) - $12,000 + ($22,000 - $7,000) = $31,000]

(b) Rojo Corporation's operating activities provided $28,000 cash which was adequate to fund its investing activities $12,000 and make $7,000 of dividend payments.

LO 3 BT: AP Difficulty: Medium TOT: 30 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 1.6

(a) 1. Since the boat actually belongs to Miko Liu—not to Micado Corporation—it should not be reported on the corporation's balance sheet. Likewise, the boat loan is a personal loan of Miko's—not a liability of Micado Corporation.

2. The inventory should be reported at $25,000, the amount paid when it was purchased. Micado Corporation will record $36,000 as revenues when the inventory is sold.

3. The $10,000 receivable is not an asset of Micado Corporation—it is a personal asset of Miko Liu.

(b)

MICADO CORPORATION
Balance Sheet
December 31, 2022

Assets		
Cash		$20,000
Accounts receivable		40,000*
Inventory		25,000
Total assets		$85,000
Liabilities and Stockholders' Equity		
Liabilities		
Notes payable	$15,000	
Accounts payable	30,000	
Total liabilities		$45,000
Stockholders' equity		40,000**
Total liabilities and stockholders' equity		$85,000

*$50,000 – $10,000
**$85,000 – $45,000 (Total assets minus total liabilities)

(Assets = Liabl. + SE)
[($20,000 + ($50,000 - $10,000) + $25,000) = (($15,000 + $30,000) + ($85,000 - $45,000))]
LO 3 BT: AN Difficulty: Medium TOT: 40 min. AACSB: Analytic AICPA FC: Reporting

CT 1.1 FINANCIAL REPORTING PROBLEM

(a) **Apple's total assets at September 28, 2018 were $365,725 and at September 30, 2017 were $375,319.**

(b) **Apple had $25,913 of cash and cash equivalents at September 28, 2018.**

(c) **Apple had accounts payable totaling $55,888 on September 28, 2018 and $44,242 on September 30, 2017.**

(d) **Apple reported net sales in 2018 of $265,595, in 2017 of $229,234, and in 2016 of $215,639.**

(e) **Apple's net income increased by $11,180 from 2017 to 2018, from $48,351 to $59,531.**

LO 3 BT: AN Difficulty: Medium TOT: 5.0 min. AACSB: Analytic AICPA FC: Reporting

CT 1.2 COMPARATIVE ANALYSIS PROBLEM

(a)

(amounts in thousands)	Columbia Sportswear Company	Under Armour, Inc.
1. Total liabilities	$678,408	$2,228,151
2. Net property, plant and equipment	$291,596	$ 826,868
3. Net cash provided (used) by investing activities.	$(232,231)	$(202,904)
4. Net income(loss)	$274,948	$(46,302)

(b) Columbia is profitable, while Under Armour is not. Under Armour's net property, pant, and equipment and total liabilities suggest that it is substantially bigger than Columbia. Under Armour's liabilities are more than three times as big as Columbia's.

LO 3 BT: AN Difficulty: Medium TOT: 8.0 min. AACSB: Analytic AICPA FC: Reporting

CT 1.3 INTERPRETING FINANCIAL STATEMENTS

(a) Creditors lend money to companies with the expectation that they will be repaid at a specified point in time in the future. If a company is generating cash from operations in excess of its investing needs, it is more likely that it will be able to repay its creditors. Not only did Xerox actually have negative cash from operations, but all of the cash it received in order to meet its cash deficiency was from issuing new debt. Both of these facts would be of concern to the company's creditors, since it would suggest it will be less likely to be able to repay its debts.

(b) As a stockholder, you are interested in the long-term performance of a company and how that translates into its stock price. Often during the early years of a company's life its cash provided by operations is not sufficient to meet its investment needs, so the company will have to get cash from outside sources. However, in the case of Xerox, the company has operated for many years and has a well-established name brand. The negative cash from operations might suggest operating deficiencies.

(c) The statement of cash flows reports information on a cash basis. An investor cannot get the complete story on the company's performance and financial position without looking at the income statement and balance sheet. Also, investors would want to look at more than one year's worth of data. The current year might not be representative of past or future years.

(d) Xerox is a well known company. It has a past record of paying dividends. Its management probably decided to continue to pay a dividend to demonstrate confidence in the company's future. They may have felt that by not paying the dividend for the year they would send a negative message to investors. However, by choosing to pay a cash dividend the company obviously weakened its cash position, and decreased its ability to repay its debts.

LO 3 BT: S Difficulty: Hard TOT: 15.0 min. AACSB: Analytic AICPA FC: Reporting AICPA PC: Decision Making

CT 1.4	REAL-WORLD FOCUS

Answers to this question will differ depending on the companies chosen by the student, and the year. We provide the following solution for Netflix for the year ended December 31, 2018.

(a) During the year ended December 31, 2018, Netflix reported net income of $1,211,242 thousand.

(b) During the year ended December 31, 2018. Netflix reported sales of $15,794,341 thousand.

(c) The "Industry" label on the left side of the Profile site tells us that Netflix is in the CATV systems.

(d) Companies also in this industry would include Directv, Hulu, Dish Network, and Comcast Corporation.

(e) We chose Dish Network. During the year ended December 31, 2018, Dish reported sales of $13,621,302 thousand and net income of $1,575,091 thousand.

LO 3 BT: AP Difficulty: Medium TOT: 15.0 min. AACSB: Technology AICPA FC: Reporting

CT 1.5 REAL-WORLD FOCUS

(a) The current auditor's report focuses primarily on whether or not a company's numbers are "fairly presented".

(b) It will also require auditors to tell investors about any "critical audit matters" – areas of their audit that were especially challenging or complex or forced them to make tough decisions in evaluating a company's books.

Examples include: assessing how a company sets aside loan-loss reserves when it introduces a new loan product; evaluation of a company's estimates; and, evaluation of the valuations used for acquired assets.

(c) The new requirement will bring the U. S. closer to the U. K. and other European countries where such disclosures in the audit report are already required.

(d) To be disclosed, an item must be material and significant enough to be reported to the company's audit committee.

LO 3 BT: S Difficulty: Medium TOT: 15.0 min. AACSB: Technology, Communication AICPA FC: Reporting AICPA PC: Communication

CT 1.6 DECISION-MAKING ACROSS THE ORGANIZATION

(a) The Report of Independent Registered Public Accounting Firm indicates that PricewaterhouseCoopers LLP performed the audit of Johnson & Johnson's financial statements.

(b) The Consolidated Statements of Operations states that its basic earnings per share were $5.70 in 2018.

(c) In the Selected Financial Data (Part II, Item 6 and Note to Financial Statements No. 18), shows that customer – international sales was $39,697 million in 2018.

(d) In the Consolidated Income Statement, sales to customers for 2017 was $76,450 million.

(e) The Shareholders' Equity section of the Consolidated Balance Sheets states that 4,320,000,000 shares were authorized.

(f) Per the Consolidated Statements of Cash Flows, $3,670 million was spent on additions to property, plant, and equipment.

(g) Note 1 states that building and building equipment depreciation is based on 20–30 years using straight-line depreciation.

(h) Per the Consolidated Statement of Financial Position, inventories were $8,599 million in 2018.

LO 3 BT: AN Difficulty: Hard TOT: 20 min. AACSB: Analytic AICPA FC: Reporting

CT 1.7 COMMUNICATION ACTIVITY

To: Marci Ling

From: Student

I have received the balance sheet of Samco Company, Inc. as of December 31, 2022. The purpose of a balance sheet is to report a company's financial position at a point in time. It reports what the company owns (assets) and what it owes (liabilities) and the net amount attributed to owners (equity). A number of items in this balance sheet are not properly reported. They are:

(1) The balance sheet should be dated as of a specific date, not for a period of time. Therefore, it should be stated "December 31, 2022."

(2) Equipment should be below Supplies on the balance sheet.

(3) Accounts receivable should be shown as an asset and reported between Cash and Supplies on the balance sheet.

(4) Accounts payable should be shown as a liability, not an asset. Therefore, it should be reported in the liability section, after notes payable.

(5) Liabilities and stockholders' equity should be shown separately on the balance sheet. Common Stock, Retained Earnings, and Dividends are not liabilities.

(6) Common Stock, Retained Earnings, and Dividends are part of stock-holders' equity. The Dividends account is not reported on the balance sheet but is subtracted from beginning Retained Earnings to arrive at the ending balance.

A correct balance sheet is as follows:

SAMCO COMPANY, INC.
Balance Sheet
December 31, 2022

Assets

Cash		$ 9,000
Accounts receivable		6,000
Supplies		1,000
Equipment		18,000
Total assets		$34,000

Liabilities and Stockholders' Equity

Liabilities		
Notes payable	$10,000	
Accounts payable	4,000	
Total liabilities		$14,000
Stockholders' equity		
Common stock	12,000	
Retained earnings	8,000*	
Total stockholders' equity		20,000
Total liabilities and stockholders' equity		$34,000

*Retained earnings	$10,000
Less: Dividends	2,000
Ending retained earnings	$ 8,000

(Assets = Liabl. + SE)
[($9,000 + $6,000 + $1,000 + $18,000) = (($10,000 + $4,000) + ($12,000 + ($10,000 - $2,000)))]

LO 3 BT: C Difficulty: Medium TOT: 15.0 min. AACSB: None AICPA FC: Reporting

CT 1.8	ETHICS CASE

(a) **Investors rely on auditors to perform an independent assessment of a company. If the auditor owns stock in that company, he or she might not be able to act in an independent and impartial manner.**

(b) **There are pros and cons to this argument. On the positive side, it could be argued that as long as a person has no direct relationship with a client company, that person will not influence the findings of the work. However, a counter argument is that an influential partner within a firm, who had an investment in a client that he or she didn't work on, might be tempted to try to influence the findings of the audit if he or she feared that the findings were going to negatively affect the value of his or her investment.**

(c) **The fact that four firms have become so big means that prohibiting employees of those accounting firms from buying stock in clients of the firm would bar those employees from investing in roughly 25% of publicly traded firms. Some have argued that such restrictive rules would create undue hardship, and unfairly restrict the investment options of these people. They also argue that in such a large organization it is increasingly unlikely that an individual who does not work on a particular audit will be able to influence the outcome of that audit. As a consequence, rules that focus on restricting investments by those employees actually involved in the audit of a client may be most reasonable and most effective.**

(d) **Answers to this question will vary. This is a particularly difficult issue since the rule effectively eliminates the individual's control over their investment portfolio. They did nothing wrong when they bought the shares, but now they are being forced to sell when it is not advantageous.**

(e) **The management of PricewaterhouseCoopers noted that auditor independence is vitally important to the audit function. If investors don't think the auditor is independent of the client they will lose faith in auditing, which would have dire consequences for securities markets. Therefore, it was important that the firm make a bold, unambiguous response to address this problem.**

LO 3 BT: E Difficulty: Hard TOT: 30.0 min. AACSB: Ethics AICPA FC: Reporting AICPA PC: Ethical Conduct

CT 1.9 ALL ABOUT YOU

(a) Answers to the following will vary depending on students' opinions.

1. **This does not represent the hiding of assets, but rather a choice as to the order of use of assets. This would seem to be ethical.**
2. **This does not represent the hiding of assets, but rather is a change in the nature of assets. Since the expenditure was necessary, although perhaps accelerated, it would seem to be ethical.**
3. **This represents an intentional attempt to deceive the financial aid office. It would therefore appear to be both unethical and potentially illegal.**
4. **This is a difficult issue. By taking the leave, actual net income would be reduced. The form asks the applicant to report actual net income. However, it is potentially deceptive since you do not intend on taking unpaid absences in the future, thus future income would be higher than reported income.**

(b) Companies might want to overstate net income in order to potentially increase the stock price by improving investors' perceptions of the company. Also, a higher net income would make it easier to receive debt financing. Finally, managers would want a higher net income to increase the size of their bonuses.

(c) Sometimes companies want to report a lower income if they are negotiating with employees. For example, professional sports teams frequently argue that they cannot increase salaries because they aren't making enough money. This also occurs in negotiations with unions. For tax accounting (as opposed to the financial accounting in this course) companies frequently try to minimize the amount of reported taxable income.

(d) Unfortunately many times people who are otherwise very ethical will make unethical decisions regarding financial reporting. They might be driven to do this because of greed. Frequently it is because their superiors have put pressure on them to take an unethical action, and they are afraid to not follow directions because they might lose their job. Also, in some instances top managers will tell subordinates that they should be a team player, and do the action because it would help the company, and therefore would help fellow employees.

LO3 BT: E Difficulty: Hard TOT: 30.0 min. AACSB: Reflective Thinking AICPA FC: Reporting AICPA PC: Decision Making