ANSWERS TO QUESTIONS - CHAPTER 2

1. **Accrual accounting attempts to record the effects of accounting events in the period when such events occur, regardless of when cash is received or paid. The goal is to match expenses with the revenues that they produce.**

2. **Recognition is the act of recording an event in the financial statements. When accruals are used, events are recognized before the associated cash is paid or collected.**

3. **If cash is collected in advance for services, the revenue is recognized when the services are rendered.**

4. **The issue of common stock, which is capital acquired from owners, increases business assets (usually cash) and equity (common stock).**

5. **The recognition of revenue on account increases the corresponding revenue account on the income statement, but does not affect the statement of cash flows. The cash flow statement is affected when the account is collected.**

6. **Revenue is recognized under accrual accounting when a revenue-producing event occurs, i.e., when the revenue is *earned*, even if no cash is collected at the time of the transaction.**

7. **The recognition of expenses affects the accounting equation by either decreasing assets or increasing liabilities (payables) and by decreasing stockholders' equity (retained earnings).**

8. **A claims exchange transaction is one where the claims of creditors (liabilities) increase and the claims of stockholders (retained earnings) decrease, or vice versa. The total amount of claims is unchanged.**

9. **Expenses are recognized under accrual accounting at the time the expense is incurred or resources are consumed, regardless of when cash payment is made.**

10. Net cash flows from operations on the cash flow statement may be different from net income because of the application of accrual accounting. Revenues and expenses reported on the income statement may be recognized before or after the actual collection or payment of cash that is reported on the cash flow statement.

11. Net income increases stockholders' claims on business assets by increasing retained earnings.

12. An expense is a decrease in assets or an increase in liabilities that occurs in the process of generating revenue.

13. The purpose of the statement of changes in stockholders' equity is to display the effects of business operations and stock issued to owners and dividends paid to stockholders. It identifies the ways that an entity's equity increased and decreased as a result of its operations and transactions with its stockholders.

14. The purpose of the balance sheet is to provide information about an entity's assets, liabilities, and stockholders' equity and their relationships to each other at a particular point in time. It provides a list of the economic resources that the enterprise has available for its operating activities and the claims to those resources.

15. The balance sheet is dated as of a specific date because it shows information about an entity's assets, liabilities, and stockholders' equity as of that date, not measured over a time period. The statement of changes in stockholders' equity, the income statement, and the statement of cash flows reflect transactions that occur over a period of time.

16. The statement of cash flows explains the change in cash from one accounting period to the next. It is prepared by analyzing the cash account and summarizing where cash came from and how it was used.

17. Period costs are costs that are recognized in an accounting period. Examples of period costs include rent expense, utilities expense, and salaries expense.

18. Salary of the tax return preparer could be directly matched with the revenue that it produces.

SOLUTIONS TO EXERCISES – SERIES A – CHAPTER 2

EXERCISE 2-1A

a.

The Ramires, Incorporated
Horizontal Financial Statements Model for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	–	Expense	=	Net Inc.	
Event	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings						
1	56,000	+	NA	=	NA	+	56,000	+	NA	NA	–	NA	=	NA	56,000 FA
2	52,000	+	NA	=	NA	+	NA	+	52,000	52,000	–	NA	=	52,000	52,000 OA
3	(27,000)	+	NA	=	NA	+	NA	+	(27,000)	NA	–	27,000	=	(27,000)	(27,000) OA
4	15,000	+	NA	=	15,000	+	NA	+	NA	NA	–	NA	=	NA	15,000 FA
5	(40,000)	+	40,000	=	NA	+	NA	+	NA	NA	–	NA	=	NA	(40,000) IA
6	(1,000)	+	NA	=	NA	+	NA	+	(1,000)	NA	–	NA	=	NA	(1,000) FA
	55,000	+	40,000	=	15,000	+	56,000	+	24,000	52,000	–	27,000	=	25,000	55,000 NC

EXERCISE 2-1A (cont.)

b.

The Ramires, Incorporated
Income Statement
For the Period Ended December 31, Year 1

Revenue	$52,000
Expenses	(27,000)
Net Income	$25,000

The Ramires, Incorporated
Statement of Changes in Stockholders' Equity
For the Period Ended December 31, Year 1

Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	56,000	
Ending Common Stock		$56,000
Beginning Retained Earnings	$-0-	
Plus: Net Income	25,000	
Less: Dividends	(1,000)	
Ending Retained Earnings		24,000
Total Stockholders' Equity		$80,000

EXERCISE 2-1A b. (cont.)

The Ramires, Incorporated Balance Sheet As of December 31, Year 1		
Assets		
Cash	$55,000	
Land	40,000	
Total Assets		$95,000
Liabilities		
Notes Payable		$15,000
Stockholders' Equity		
Common Stock	$56,000	
Retained Earnings	24,000	
Total Stockholders' Equity		$80,000
Total Liabilities and Stockholders' Equity		$95,000

EXERCISE 2-1A b. (cont.)

The Ramires, Incorporated Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$52,000	
Cash Payments for Expenses	(27,000)	
Net Cash Flow from Operating Activities		$25,000
Cash Flows From Investing Activities:		
Cash Payment for Land	$(40,000)	
Net Cash Flow from Investing Activities		$(40,000)
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	$56,000	
Cash Receipts from Borrowed Funds	15,000	
Cash Dividends	(1,000)	
Net Cash Flow from Financing Activities		$70,000
Net Increase in Cash		55,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$55,000

EXERCISE 2-2A

The Candle Shop
Horizontal Financial Statements Model for Year 1

	Balance Sheet										Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stockholders' Equity				Revenue	–	Expense	=	Net Inc.		
Event	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings								
1	I	+	NA	=	NA	+	I	+	NA		NA	–	NA	=	NA	I	FA
2	D	+	NA	=	NA	+	NA	+	D		NA	–	NA	=	NA	D	FA
3	D	+	NA	=	NA	+	NA	+	D		NA	–	I	=	D	D	OA
4	I	+	NA	=	I	+	NA	+	NA		NA	–	NA	=	NA	I	FA
5	I	+	NA	=	NA	+	NA	+	I		I	–	NA	=	I	I	OA
6	D	+	I	=	NA	+	NA	+	NA		NA	–	NA	=	NA	D	IA
7	NA	+	NA	=	NA	+	NA	+	NA		NA	–	NA	=	NA	NA	

EXERICSE 2-3A

a. Missing items are determined as follow:

(a) $200,000; Since the cash flow column shows that this event was financing activity, we can infer that the company either borrowed money or issued stock. Since the model shows that liabilities were not affected, we conclude that the common stock account increased by $200,000.

(b) NA; Since issuing common stock (see answer to (a) above), does not affect the revenue account, the answer is not affected (NA).

(c) NA; Since issuing common stock (see answer to (a) above), does not affect net income, the answer is not affected (NA).

(d) NA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money does not affect net income.

(e) FA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money is a financing activity (FA).

(f) 500,000; Since cash decreased and no other balance sheet account other than the land account was affected, the company must have purchased land which would cause the land account to increase by 500,000.

(g) IA; Purchasing land (see answer to (f) above) is an investing activity (IA).

(h) 95,000; The income statement shows $95,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.

(i) 95,000; The income statement shows $95,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.

EXERCISE 2-3A a. (cont).

(j) (65,000); The statement of cash flows shows that the $65,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to reduce the amount of retained earnings shown in the balance sheet.

(k) 65,000; The statement of cash flows shows that the $65,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to increase the amount of expenses shown in the income statement.

(l) FA; Since the event decreases cash and retained earnings on the balance sheet; and does not affect the income statement, we conclude that this was a dividend payment which is a financing activity (FA)

(m) 68,000; This amount is determined by totaling the vertical column.

(n) 95,000; This amount is determined by totaling the vertical column.

EXERCISE 2-3A a. (cont.)

Completed Horizontal Financial Statements Model

The Frame Shop (TFS) Horizontal Statements Model for Year 1															
	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	–	Expense	=	Net Inc.	
	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings						
Beg.	0	+	0	=	0	+	0	+	0	0	–	0	=	0	NA
1	200,000	+	NA	=	NA	+	200,000	+	NA	NA	–	NA	=	NA	200,000 FA
2	350,000	+	NA	=	350,000	+	NA	+	NA	NA	–	NA	=	NA	350,000 FA
3	(500,000)	+	500,000	=	NA	+	NA	+	NA	NA	–	NA	=	NA	(500,000) IA
4	95,000	+	NA	=	NA	+	NA	+	95,000	95,000	–	NA	=	95,000	95,000 OA
5	(65,000)	+	NA	=	NA	+	NA	+	(65,000)	NA	–	65,000	=	(65,000)	(65,000) OA
6	(12,000)	+	NA	=	NA	+	NA	+	(12,000)	NA	–	NA	=	NA	(12,000) FA
	68,000	+	500,000	=	350,000	+	200,000	+	18,000	95,000	–	65,000	=	30,000	68,000 NC

b. $568,000 Total Assets (Cash $68,000 + Land $500,000)

c. $30,000 Net Income (Revenue $95,000 – Expenses $65,000)

d. $538,000 Net Cash Flow from Financing Activities ($200,000 + $350,000 - $12,000)

EXERCISE 2-4A

Holloway Company
Effect of Events on the Year 1 Financial Statements

Event	Assets			=	Liabilities	+	Stockholders' Equity		
	Cash	+	Accounts Rec.	=		+	Common Stock	+	Retained Earnings
Earned Revenue	NA	+	18,000	=	NA	+	NA	+	18,000
Coll. Acct. Rec.	14,000	+	(14,000)	=	NA	+	NA	+	NA
Ending Balance	14,000	+	4,000	=	-0-	+	-0-	+	18,000

a. **Accounts Receivable: $18,000 – $14,000 = $4,000**

b. **$18,000 Net Income**

c. **$14,000 cash collected from accounts receivable.**

d. **$18,000**

e. **$18,000 of revenue was earned but only $14,000 of it was collected.**

EXERCISE 2-5A

The Containers Inc.
Horizontal Financial Statements Model for Year 1

	Balance Sheet									Income Statement					Statement of
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	–	Expense	=	Net Inc.	Cash Flows
Event	Cash	+	Accts. Rec	=	Notes Payable	+	Common Stock	+	Retained Earnings						
1	42,000	+	NA	=	NA	+	42,000	+	NA	NA	–	NA	=	NA	42,000 FA
2	NA	+	25,000	=	NA	+	NA	+	25,000	25,000	–	NA	=	25,000	NA
3	(18,000)	+	NA	=	NA	+	NA	+	(18,000)	NA	–	18,000	=	(18,000)	(18,000) OA
4	10,000	+	NA	=	10,000	+	NA	+	NA	NA	–	NA	=	NA	10,000 FA
5	22,000	+	(22,000)	=	NA	+	NA	+	NA	NA	–	NA	=	NA	22,000 OA
6	(1,000)	+	NA	=	NA	+	NA	+	(1,000)	NA	–	NA	=	NA	(1,000) FA
	55,000	+	3,000	=	10,000	+	42,000	+	6,000	25,000	–	18,000	=	7,000	55,000 NC

a. **Accounts receivable will appear as an "asset" on the December 31, Year 1 balance sheet.**

b. **$3,000. Total from the accounts receivable column in the Horizontal Financial Statements Model.**

c. **$7,000. Total from the net income column in the Horizontal Financial Statements Model.**

d. **$4,000. Net cash flow from operating activities ($22,000 - $18,000).**

e. **Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but will not be reflected on the cash flow statement until the cash is collected.**

EXERCISE 2-6A

Troy Company
Horizontal Financial Statements Model for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	–	Expense	=	Net Inc.	
Event	Cash	+	Accts. Rec	=	Accts. Payable	+	Common Stock	+	Retained Earnings						
1	15,000	+	NA	=	NA	+	NA	+	15,000	15,000	–	NA	=	15,000	15,000 OA
2	NA	+	NA	=	12,000	+	NA	+	(12,000)	NA	–	12,000	=	(12,000)	NA
3	(8,000)	+	NA	=	(8,000)	+	NA	+	NA	NA	–	NA	=	NA	(8,000) OA
	7,000	+	0	=	4,000	+	0	+	3,000	15,000	–	12,000	=	3,000	7,000 NC

a. **$4,000. Total from the accounts payable column in the Horizontal Financial Statements Model.**

b. **$12,000. Total from the expenses column in the Horizontal Financial Statements Model.**

c. **$7,000. Total cash flow from operating activities.**

d. **$3,000. Total from the retained earnings column in the Horizontal Financial Statements Model.**

e. **Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. This also occurs when revenue is earned at a different time than cash is collected. When a company incurs an revenue or expense transaction, this amount is reflected in revenues or expenses on the income statement but will not impact the cash flow statement until the cash is paid.**

EXERCISE 2-7A

a.

Chung Corporation Accounting Equation – Year 1								
Event	Assets	=	Liabilities	+	Stockholders' Equity			
	Cash	=	Salaries Payable	+	Common Stock	+	Retained Earnings
Earned Rev.	8,000		NA		NA		8,000
Accrued Sal.	NA		5,000		NA		(5,000)
Ending Bal.	8,000	=	5,000	+	-0-	+	3,000

Chung Corporation Balance Sheet As of December 31, Year 1		
Assets		
Cash	$8,000	
Total Assets		$8,000
Liabilities		
Salaries Payable	$5,000	
Total Liabilities		$5,000
Stockholders' Equity		
Retained Earnings	$3,000	
Total Stockholders' Equity		3,000
Total Liab. and Stockholders' Equity		$8,000

b.

Computation of Net Income	
Revenue	$8,000
Less: Expenses	(5,000)
Net Income	$3,000

EXERCISE 2-7A (cont.)

c.

Cash Flow from Operating Activities	
Cash from Revenue	**$8,000**
Net Cash Flow from Operating Act.	**$8,000**

d. **The salary expense is deducted from revenue in computing net income, but it has not been paid. This creates a difference of $5,000 between net income and cash flow from operating activities. The revenue is the same because it has been earned and collected.**

EXERCISE 2-8A

a.

Milea Inc.
Accounting Equation
For the Year Ended December 31, Year 1

	Assets		=	Liabilities	+	Stockholders' Equity		
Event	Cash	Acct. Rec.	=	Salaries Pay.	+	Common Stock	Retained Earn.	Acct. Title for RE
1.	20,000		=		+	20,000		
2.		56,000	=		+		56,000	Revenue
3.	(2,500)		=		+		(2,500)	Util. Exp.
4.	48,000	(48,000)	=		+			
5.			=	10,000	+		(10,000)	Sal. Exp.
6.	(2,000)		=		+		(2,000)	Dividends
Totals	63,500	8,000	=	10,000	+	20,000	41,500	

b.

Milea Inc.
Income Statement
For the Year Ended December 31, Year 1

Revenue		$56,000
Expenses		
Utility Expense	$ 2,500	
Salaries Expense	10,000	
Total Expenses		(12,500)
Net Income		$43,500

EXERCISE 2-8A b. (cont.)

Milea Inc.
Statement of Changes in Stockholders' Equity
For the Year Ended December 31, Year 1

Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	20,000	
Ending Common Stock		$20,000
Beginning Retained Earnings	-0-	
Plus: Net Income	$43,500	
Less: Dividends	(2,000)	
Ending Retained Earnings		41,500
Total Stockholders' Equity		$61,500

Milea Inc.
Balance Sheet
As of December 31, Year 1

Assets		
Cash	$63,500	
Accounts Receivable	8,000	
Total Assets		$71,500
Liabilities		
Salaries Payable	$10,000	
Total Liabilities		$10,000
Stockholders' Equity		
Common Stock	$20,000	
Retained Earnings	41,500	
Total Stockholders' Equity		61,500
Total Liab. and Stockholders' Equity		$71,500

EXERCISE 2-8A b. (cont.)

Milea Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flow From Operating Activities		
Cash Received from Customers	$48,000	
Cash Paid for Expenses	(2,500)	
Net Cash Flow from Operating Act.		$45,500
Cash Flow From Investing Activities		-0-
Cash Flow From Financing Activities		
Issue of Stock	$20,000	
Paid Dividends	(2,000)	
Net Cash Flow from Financing Act.		18,000
Net Change in Cash		63,500
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$63,500

c. Net income is the difference between services performed and expenses incurred, regardless of the cash collected or paid. Cash flow from operating activities is the difference between cash collected and paid for operating activities. There was $56,000 of income earned, but only $48,000 collected and $12,500 of expenses incurred, but there was only $2,500 paid.

EXERCISE 2-9A

a.

Lewis and Harper
Horizontal Statements Model Year 1

	Balance Sheet									Income Statement					Statement of
	Assets			=	Liabilities			+	S. Equity	Rev.	–	Exp.	=	Net Inc.	Cash Flows
Event	Cash	+	Accts. Rec.	=	Acct. Payable	+	Sal. Pay.	+	Retained Earn.						
1.	NA	+	70,000	=	NA	+	NA	+	70,000	70,000	–	NA	=	70,000	NA
2.	40,000	+	NA	=	NA	+	NA	+	40,000	40,000	–	NA	=	40,000	40,000 OA
3.	NA	+	NA	=	36,000	+	NA	+	(36,000)	NA	–	36,000	=	(36,000)	NA
4.	(10,000)	+	NA	=	NA	+	NA	+	(10,000)	NA	–	10,000	=	(10,000)	(10,000) OA
5.	47,000	+	(47,000)	=	NA	+	NA	+	NA	NA	–	NA	=	NA	47,000 OA
6.	(16,000)	+	NA	=	(16,000)	+	NA	+	NA	NA	–	NA	=	NA	(16,000) OA
7.	(8,000)	+	NA	=	NA	+	NA	+	(8,000)	NA	–	NA	=	NA	(8,000) FA
8.	NA	+	NA	=	NA	+	2,000	+	(2,000)	NA	–	2,000	=	(2,000)	NA
Totals	53,000	+	23,000	=	20,000	+	2,000	+	54,000	110,000	–	48,000	=	62,000	53,000 NC

b. Total assets: $76,000 ($53,000 + $23,000)

c. $23,000

d. $20,000

e. Accounts Receivable (an asset) is an amount owed to Lewis and Harper: $23,000;
Accounts Payable (a liability) is an amount that Lewis and Harper owe: $20,000

f. $62,000

g. $61,000 ($40,000 – $10,000 + $47,000 – $16,000)

EXERCISE 2-10A

a. & c.

Event	Revenue	Expense	Statement of Cash Flows
1.	NA	NA	$40,000 FA
2.	$82,000	NA	NA
3.	NA	NA	(6,000) FA
4.	NA	NA	76,000 OA
5.	NA	$53,000	(53,000) OA
6.	19,000	NA	19,000 OA
7.	NA	3,500	NA

b.

Computation of Net Income	
Revenue	$101,000
Less: Expenses	(56,500)
Net Income	$44,500

d.

Cash Flow from Operating Activities	
Cash from Revenue	$95,000
Cash paid for expenses	(53,000)
Net Cash Flow from Operating Act.	$42,000

e. The balance of Retained Earnings on the Year 1 Balance Sheet will be the amount of Net Income, $44,500 minus $6,000 of dividends that were paid during the year = $38,500. There was no beginning balance in Retained Earnings.

EXERCISE 2-11A

Lee Inc.
Effect of Events on the Accounts under Accounting Equation

	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	Accounts Receivable	Land	=	Accounts Payable	+	Com. Stock	+	Retained Earnings
1. Sales on Account		62,000							62,000
2. Coll. Accts. Rec.	51,000	(51,000)							
3. Incurred Expense					39,000				(39,000)
4. Pd. Acc. Pay.	(31,000)				(31,000)				
5. Issue of Stock	40,000						40,000		
6. Purchase Land	(21,000)		21,000						
Totals	39,000	11,000	21,000	=	8,000	+	40,000	+	23,000

a. Revenue recognized, $62,000.

b. Cash flow from revenue, $51,000.

c. Revenue, $62,000, less operating expenses, $39,000 = $23,000 net income.

d. Accounts receivable collected, $51,000, less cash paid for expenses, $31,000 = $20,000 cash flow from operating activities.

e. Income of $62,000 was earned, but only $51,000 was collected (a difference of $11,000); operating expenses incurred were $39,000 but only $31,000 was paid during the period (a difference of $8,000). Consequently, net income is $3,000 more than cash flow from operating activities.

f. $21,000 cash outflow for the purchase of land.

g. $40,000 cash inflow from the issue of common stock.

h. Total assets = $71,000 ($39,000 + $11,000 + $21,000)
Total liabilities = $8,000
Total equity = $63,000 ($40,000 + $23,000)

EXERCISE 2-12A

a. **Examples of expenses that would be matched directly with revenue:**
   Sales commissions
   Salaries expense

b. **An example of a period cost that is difficult to match with revenue:**
   Advertising expense - A company cannot be certain when dollars spent for advertising will produce benefits.

EXERCISE 2-13A

a. $8,000 x 6% = $480; $480 x 5/12 = $200

b. $-0-, no interest was paid in Year 1; $480 of interest will be paid in Year 2.

c.

Bradley Company
Statements Model for Year 1

Event	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets	=	Liabilities			+	Stockholders' Equity			Rev.	−	Exp.	=	Net Inc.	
No.	Cash	=	Notes Payable	+	Int. Payable	+	Common Stock	+	Ret. Earn.						
1.	I	=	NA	+	NA	+	NA	+	I	I	−	NA	=	I	I OA
2.	I	=	I	+	NA	+	NA	+	NA	NA	−	NA	=	NA	I FA
3.	NA	=	NA	+	I	+	NA	+	D	NA	−	I	=	D	NA

EXERCISE 2-14A

a. **Interest expense recognized for Year 1: $80,000 x 8% = $6,400; $6,400 x 7/12 = $3,733 (rounded)**

b.

Leach Company Accounting Equation for Year 1									
	Assets	=	Liabilities			+	Equity		
Event	Cash		Note Payable	+	Interest Payable		Common Stock	+	Retained Earnings
Note	80,000	=	80,000	+	NA	+	NA		NA
Adj.	NA		NA		3,733		NA		(3,733)

See the adjusting entry in the accounting equation above (liabilities increase, equity decreases).

c. **$-0-. All interest will be paid at maturity, June 1, Year 2, for this note payable.**

d. **$3,733**

e. **$6,400 ($80,000 x 8%). All interest will be paid when the note payable matures.**

f. **$2,667 ($80,000 x 8% x 5/12) or ($6,400 – $3,733 = $2,667)**

g. **$-0-**

EXERCISE 2-15A

Solve for "X" in the following scenarios:

a.

X Co. Accounts Receivable Summary		
Beginning AR Balance	$4,500	
Increase in AR from Sales	69,400	
Reduction in AR from Collections	(68,200)	
Endings Accounts Receivable Balance	$5,700	(X)

b.

X Co. Accounts Receivable Summary		
Beginning AR Balance	$4,300	(X)
Increase in AR from Sales	62,200	
Reduction in AR from Collections	(63,100)	
Endings Accounts Receivable Balance	$3,400	

c.

X Co. Accounts Receivable Summary		
Beginning AR Balance	$9,700	
Increase in AR from Sales	99,700	
Reduction in AR from Collections	(99,100)	(X)
Endings Accounts Receivable Balance	$10,300	

EXERCISE 2-15A a. (cont.)

d.

X Co. Accounts Receivable Summary		
Beginning AR Balance	$22,000	
Increase in AR from Sales	108,300	(X)
Reduction in AR from Collections	(109,000)	
Endings Accounts Receivable Balance	$21,300	

EXERCISE 2-16A

Solve for "X" in the following scenarios:

a.

X Co. Accounts Payable Summary		
Beginning accounts payable balance	$4,700	
Plus: Expenses incurred on account	67,600	
Minus: Payment of accounts payable	(68,900)	
Ending accounts payable balance	$3,400	(X)

b.

X Co. Accounts Payable Summary		
Beginning accounts payable balance	$3,000	(X)
Plus: Expenses incurred on account	66,400	
Minus: Payment of accounts payable	(64,100)	
Ending accounts payable balance	$5,300	

c.

X Co. Accounts Payable Summary		
Beginning accounts payable balance	$4,100	
Plus: Expenses incurred on account	67,600	
Minus: Payment of accounts payable	(66,900)	(X)
Ending accounts payable balance	$4,800	

EXERCISE 2-16A a. (cont.)

d.

X Co.
Accounts Payable Summary

Beginning accounts payable balance	$7,700	
Plus: Expenses incurred on account	79,400	(X)
Minus: Payment of accounts payable	(77,300)	
Ending accounts payable balance	$9,800	

EXERCISE 2-17A

a. Solve for "X"

Harbert, Inc. Accounts Receivable Summary		
Beginning AR Balance	$12,000	
Increase in AR from Sales	70,500	(X)
Reduction in AR from Collections	(72,000)	
Endings Accounts Receivable Balance	$10,500	

b. $7,500. Revenue ($70,500) minus expenses ($63,000).

c. $9,000. Cash inflow from AR collections ($72,000) minus cash expenses ($63,000).

d. Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but will not be reflected on the cash flow statement until the cash is collected.

EXERCISE 2-18A

a. Solve for "X"

Kincaid, Inc. Accounts Payable Summary		
Beginning accounts payable balance	$2,000	
Plus: Expenses incurred on account	63,000	(X)
Minus: Payment of accounts payable	(40,000)	
Ending accounts payable balance	$25,000	

b. $22,000. Revenue ($85,000) minus expenses ($63,000).

c. $45,000. Cash inflow from sales ($85,000) minus cash outflow for expenses ($40,000).

d. Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. When a company incurs an expense, this amount is reflected in expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-19A

The six principles of the AICPA Code of Professional Conduct and a brief explanation is as follows:

Responsibilities Principle

In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.

The Public Interest Principle

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

Integrity Principle

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

Objectivity and Independence Principle

A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

Due Care Principle

A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.

Scope and Nature of Services Principle

A member in public practice should observe the principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

SOLUTIONS TO PROBLEMS – SERIES A – CHAPTER 2

PROBLEM 2-20A

a.

Maben Company
Horizontal Financial Statements Model for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	–	Expense	=	Net Inc.		
Event	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings							
1	30,000	+	NA	=	NA	+	30,000	+	NA	NA	–	NA	=	NA	30,000	FA
2	40,000	+	NA	=	40,000	+	NA	+	NA	NA	–	NA	=	NA	40,000	FA
3	48,000	+	NA	=	NA	+	NA	+	48,000	48,000	–	NA	=	48,000	48,000	OA
4	(25,000)	+	NA	=	NA	+	NA	+	(25,000)	NA	–	25,000	=	(25,000)	(25,000)	OA
5.	(1,000)	+	NA	=	NA	+	NA	+	(1,000)	NA	–	NA	=	NA	(1,000)	FA
6.	20,000	+	NA	=	NA	+	20,000	+	NA	NA	–	NA	=	NA	20,000	FA
7.	(10,000)	+	NA	=	(10,000)	+	NA	+	NA	NA	–	NA	=	NA	(10,000)	FA
8.	(53,000)	+	53,000	=	NA	+	NA	+	NA	NA	–	NA	=	NA	(53,000)	IA
9.	NA	+	NA	=	NA	+	NA	+	NA	NA	–	NA	=	NA		NA
Total	49,000	+	53,000	=	30,000	+	50,000	+	22,000	48,000	–	25,000	=	23,000	49,000	NC

b. Total Assets = $49,000 + $53,000 = $102,000

c.

Sources of Assets		
1.	Issue of stock	$ 30,000
2.	Cash from loan	40,000
3.	Cash from revenue	48,000
6.	Issue of stock	20,000
Total Sources of Assets		$138,000

PROBLEM 2-20A (cont.)

d. Net income amounts to $23,000 (see part a.) Dividends are not expenses and do not appear on the income statement.

e.

Operating Activities:	
Cash from revenue	$48,000
Cash paid for expenses	(25,000)
Net Cash Flow from Operating Activities	$23,000

Investing Activities:	
Cash paid to purchase land	$(53,000)
Net Cash Flow from Investing Activities	$(53,000)

Financing Activities:	
Cash from stock issue ($30,000 + $20,000)	$50,000
Cash from loan	40,000
Paid cash dividend	(1,000)
Cash paid on loan principal	(10,000)
Net Cash Flow from Financing Activities	$79,000

f. Percentage of assets is provided as follows:

Investors	($50,000 ÷ $102,000)	49.0%
Creditors	($30,000 ÷ $102,000)	29.4%
Earnings	($22,000 ÷ $102,000)	21.6%

g. Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.

PROBLEM 2-21A

Event No.	Description
6	Incurred cash expenses.
2	Earned revenue on account.
4	Earned cash revenue.
1	Issued common stock for cash.
8	Paid a cash dividend.
5	Collected cash from customer accounts receivable.
7	Used cash to pay off accounts payable.
3	Incurred expenses on account.

PROBLEM 2-22A

Wadell Company
Statements Model for Year 2

	Balance Sheet											Income Statement					Statement of
	Assets					=	Liab.	+	S. Equity			Rev.	–	Exp.	=	Net Inc.	Cash Flows
Date	Cash	+	Accts. Rec.	+	Land	=	Accts. Pay.	+	Common Stock	Retained Earn.							
Beg.	35,000	+	9,000	+	51,000	=	7,500	+	40,000	47,500		NA	–	NA	=	NA	NA
1/1	20,000	+	NA	+	NA	=	NA	+	20,000	NA		NA	–	NA	=	NA	20,000 FA
3/1	(2,000)	+	NA	+	NA	=	NA	+	NA	(2,000)		NA	–	NA	=	NA	(2,000) FA
4/1	(15,000)	+	NA	+	15,000	=	NA	+	NA	NA		NA	–	NA	=	NA	(15,000) IA
5/1	(5,500)	+	NA	+	NA	=	(5,500)	+	NA	NA		NA	–	NA	=	NA	(5,500) OA
9/1	30,000	+	NA	+	(30,000)	=	NA	+	NA	NA		NA	–	NA	=	NA	30,000 IA
12/31	NA	+	58,000	+	NA	=	NA	+	NA	58,000		58,000	–	NA	=	58,000	NA
12/31	46,000	+	(46,000)	+	NA	=	NA	+	NA	NA		NA	–	NA	=	NA	46,000 OA
12/31	NA	+	NA	+	NA	=	28,000	+	NA	(28,000)		NA	–	28,000	=	(28,000)	NA
12/31	NA	+	NA	+	NA	=	NA	+	NA	NA		NA	–	NA	=	NA	NA
Totals	108,500	+	21,000	+	36,000	=	30,000	+	60,000	75,500		58,000	–	28,000	=	30,000	73,500 NC

a. **$36,000. Total of the land column in the Horizontal Financial Statements Model.**

b. **$40,500. Cash inflows of $46,000 minus cash outflows of $5,500.**

c. **$30,000. Total of the liabilities column in the Horizontal Financial Statements Model.**

d. **$15,000. Cash inflow from the sale of land ($30,000) minus cash outflow from the purchase of land ($15,000).**

PROBLEM 2-22A (cont.)

e. $28,000. Total of the expenses column in the Horizontal Financial Statements Model.

f. $58,000. Total of the revenue column in the Horizontal Financial Statements Model.

g. $18,000. Cash inflow from issuance of common stock ($20,000) minus cash outflow from dividend ($2,000).

h. $30,000. Revenues ($58,000) minus expenses ($28,000).

i. $75,500. Total of the retained earnings column in the Horizontal Financial Statements Model.

PROBLEM 2-23A

a.

Sentry, Inc.
Accounting Equation for Year 1

	Assets			=	Liabilities					+	Stockholders' Equity			
Event	Cash	+	Accts. Rec.	=	Accts Pay.	+	Notes Pay.	+	Int. Pay.	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
Beg.	$0	+	$0	=	$0	+	NA	+	NA	+	$0	+	$0	
1. Issued stk.	20,000	+	NA	=	NA	+	NA	+	NA	+	20,000	+	NA	
2. Rev. on acct.	NA	+	62,000	=	NA	+	NA	+	NA	+	NA	+	62,000	Rev.
3. Loan	12,000	+	NA	=	NA	+	12,000	+	NA	+	NA	+	NA	
4. Exp. On acct.	NA	+	NA	=	3,700	+	NA	+	NA	+	NA	+	(3,700)	Exp.
5. AR collect.	5,000	+	(5,000)	=	NA	+	NA	+	NA	+	NA	+	NA	
6. AP payment	(2,900)	+	NA	=	(2,900)	+	NA	+	NA	+	NA	+	NA	
7. Interest exp.*	NA	+	NA	=	NA	+	NA	+	240	+	NA	+	(240)	Int. exp.
Totals	34,100	+	57,000	=	800	+	12,000	+	240	+	20,000	+	58,060	

*240 = (12,000 x .08) x 3/12

PROBLEM 2-23A a. (cont.)

Sentry, Inc.
Accounting Equation for Year 2

	Assets			=	Liabilities					+	Stockholders' Equity			
Event	Cash	+	Accts. Rec.	=	Accts Pay.	+	Notes Pay.	+	Int. Pay.	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
Beg.	$34,100	+	57,000	=	$800	+	12,000	+	240	+	20,000	+	58,060	
1. AR collect.	57,000	+	(57,000)	=	NA	+	NA	+	NA	+	NA	+	NA	
2. AP payment	(800)	+	NA	=	(800)	+	NA	+	NA	+	NA	+	NA	
3. Int. exp.*	NA	+	NA	=	NA	+	NA	+	720	+	NA	+	(720)	Int. exp.
4. Int. pay.**	(960)	+	NA	=	NA	+	NA	+	(960)	+	NA	+	NA	
5. Note pay.	(12,000)	+	NA	=	NA	+	(12,000)	+	NA	+	NA	+	NA	
Totals	77,340	+	0	=	0	+	0	+	0	+	20,000	+	57,340	

*720 = (12,000 *.08) x 9/12

**960 = 240 + 720

PROBLEM 2-23A (cont.)

b.

Sentry, Inc.
Income Statement
For the Period Ended December 31, Year 1 & Year2

	Year 1	Year 2
Revenue	$62,000	$0
Expenses	(3,940)	(720)
Net Income	$58,060	$(720)

Sentry, Inc.
Statement of Changes in Stockholders' Equity
For the Period Ended December 31, Year 1 & Year2

	Year 1	Year 2
Beginning Common Stock	$ -0-	$20,000
Plus: Common Stock Issued	20,000	0
Ending Common Stock	$20,000	$20,000
Beginning Retained Earnings	$ -0-	$58,060
Plus: Net Income	58,060	(720)
Ending Retained Earnings	$58,060	$57,340
Total Stockholders' Equity	$78,060	$77,340

PROBLEM 2-23A b. (cont.)

Sentry, Inc.
Balance Sheet
December 31, Year 1 & Year 2

	Year 1	Year 2
Assets		
Cash	$34,100	$77,340
Accounts Receivable	$57,000	$0
Total Assets	$91,100	$77,340
Liabilities		
Accounts Payable	$800	$0
Interest Payable	240	0
Notes Payable	12,000	0
Total Liabilities	$13,040	$0
Stockholders' Equity		
Common Stock	$20,000	$20,000
Retained Earnings	$58,060	$57,340
Total Stockholders' Equity	$78,060	$77,340
Total Liabilities and Stockholders' Equity	$91,100	$77,340

PROBLEM 2-23A b. (cont.)

Sentry, Inc. Statement of Cash Flows For the Year Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$5,000	$57,000
Cash Payments for Expenses	(2,900)	(1,760)*
Net Cash Flow from Operating Activities	$2,100	$55,240
Cash Flows From Investing Activities		
Net Cash Flow from Investing Activities	$0	$0
Cash Flows From Financing Activities:		
Cash Transactions from Borrowed Funds	$12,000	($12,000)
Cash Receipts from Stock Issue	20,000	0
Net Cash Flow from Financing Activities	$32,000	($12,000)
Net Increase in Cash	$34,100	$43,240
Plus: Beginning Cash Balance	-0-	$34,100
Ending Cash Balance	$34,100	$77,340

*$1,760 = $800 + $960

c. Sentry Inc. has $77,340 worth of assets to distribute in the event of liquidation at the end of Year 2. During liquidation, creditors have first rights to the assets and any remaining assets are distributed to owners. As the company has no debts, creditors would receive $0 and total amount of assets of $77,340 would be distributed to owners.

PROBLEM 2-24A

a.

Bennett Company Income Statement For the Year Ended December 31, Year 2		
Revenue		
Service Revenue	$42,000	
Total Revenue		$42,000
Expenses		
Other Operating Expenses	$20,000	
Salary Expense	10,000	
Interest Expense	4,000	
Total Expenses		(34,000)
Net Income		$8,000

Bennett Company Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 2		
Beginning Common Stock	$40,000	
Plus: Stock Issued	5,000	
Ending Common Stock		$45,000
Beginning Retained Earnings	$ 15,000	
Plus: Net Income	8,000	
Less: Dividends	(3,000)	
Ending Retained Earnings		20,000
Total Stockholders' Equity		$65,000

PROBLEM 2-24A a. (cont.)

Bennett Company Balance Sheet As of December 31, Year 2		
Assets		
Cash	$23,000	
Accounts Receivable	18,000	
Land	59,000	
Total Assets		$100,000
Liabilities		
Accounts Payable	$17,000	
Interest Payable	3,000	
Accrued Salaries Payable	5,000	
Notes Payable	10,000	
Total Liabilities		$ 35,000
Stockholders' Equity		
Common Stock	$45,000	
Retained Earnings	20,000	
Total Stockholders' Equity		$ 65,000
Total Liab. and Stockholders' Equity		$100,000

PROBLEM 2-24A a. (cont.)

Bennett Company Statement of Cash Flows For the Year Ended December 31, Year 2	
Cash Flow From Operating Activities	$33,000
Cash Flow From Investing Activities	(32,000)
Cash Flow From Financing Activities	2,000
Net Change in Cash	3,000
Plus: Beginning Cash Balance	20,000
Ending Cash Balance	$23,000

b.

Bennett Company Accounts Receivable Summary		
Beginning AR Balance	$41,000	(X)
Increase in AR from Service Revenue	42,000	
Reduction in AR from Collections	(65,000)	
Endings Accounts Receivable Balance	$18,000	

c.

Bennet Company Accounts Payable Summary		
Beginning accounts payable balance	$15,000	(X)
Plus: Expenses incurred on account	20,000	
Minus: Payment of accounts payable	(18,000)	
Ending accounts payable balance	$17,000	

PROBLEM 2-25A

a.

Computation of Net Income	
Revenue recognized on account	$68,000
Less accrued salary expense	(46,000)
Net Income	$22,000

b.

Computation of Cash Collected from Accounts Receivable	
Beginning balance of Accounts Receivable	$ 4,000
Add revenue recognized on account	68,000
Less ending balance of Accounts Receivable	(4,500)
Cash collected from accounts receivable	$67,500

Computation of Cash Paid for Salaries Expense	
Beginning balance of Salaries Payable	$ 2,600
Add accrued salary expense recognized	46,000
Less ending balance of Salaries Payable	(1,500)
Cash paid for Salary Expense	$47,100

Cash Flow from Operating Activities	
Cash from Accounts Receivable	$67,500
Cash paid for Salary Expense	(47,100)
Net Cash Flow from Operating Act.	$20,400

c. Net income is the difference between services performed and expenses incurred, regardless of the cash collected or paid. Cash flow from operating activities is the difference between cash collected and paid for operating activities. The time gap between these two activities often causes a difference between the net income and cash flow from operating activities.

PROBLEM 2-26A

The three common features of ethical misconduct are:

1. **The availability of an opportunity**
2. **The existence of some sort of pressure**
3. **The capacity for rationalization**

1. **Even though Pete has exceeded his authority, no one has complained because he is bringing in more revenue. Oversight by a partner would eliminate this type of problem.**

2. **Pete is in a financial bind and does not want to discuss his problem with others for fear of ruining his image. Therefore, he is willing to take risks to keep his secret.**

3. **He rationalizes that his actions do not hurt anyone because the client is getting the service and the firm is getting a reasonable fee.**

SOLUTIONS TO EXERCISES – SERIES B - CHAPTER 2

EXERCISE 2-1B

a.

The Bruce Spruce Co.
Horizontal Financial Statements Model for Year 1

	Balance Sheet										Income Statement					Statement of
	Assets			=	Liab.	+	Stockholders' Equity				Revenue	–	Expense	=	Net Inc.	Cash Flows
Event	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings							
1	75,000	+	NA	=	NA	+	75,000	+	NA		NA	–	NA	=	NA	75,000 FA
2	48,000	+	NA	=	NA	+	NA	+	48,000		48,000	–	NA	=	48,000	48,000 OA
3	(34,000)	+	NA	=	NA	+	NA	+	(34,000)		NA	–	34,000	=	(34,000)	(34,000) OA
4	20,000	+	NA	=	20,000	+	NA	+	NA		NA	–	NA	=	NA	20,000 FA
5	(38,000)	+	38,000	=	NA	+	NA	+	NA		NA	–	NA	=	NA	(38,000) IA
6	(2,000)	+	NA	=	NA	+	NA	+	(2,000)		NA	–	NA	=	NA	(2,000) FA
	69,000	+	38,000	=	20,000	+	75,000	+	12,000		48,000	–	34,000	=	14,000	69,000 NC

EXERCISE 2-1B (cont.)

b.

The Bruce Spruce Co. Income Statement For the Period Ended December 31, Year 1	
Revenue	$48,000
Expenses	(34,000)
Net Income	$14,000

The Bruce Spruce Co. Statement of Changes in Stockholders' Equity For the Period Ended December 31, Year 1		
Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	75,000	
Ending Common Stock		$75,000
Beginning Retained Earnings	$-0-	
Plus: Net Income	14,000	
Less: Dividends	(2,000)	
Ending Retained Earnings		12,000
Total Stockholders' Equity		$87,000

EXERCISE 2-1B b. (cont.)

The Bruce Spruce Co. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$69,000	
Land	38,000	
Total Assets		$107,000
Liabilities		
Notes Payable		$20,000
Stockholders' Equity		
Common Stock	$75,000	
Retained Earnings	12,000	
Total Stockholders' Equity		$87,000
Total Liabilities and Stockholders' Equity		$107,000

EXERCISE 2-1B b. (cont.)

The Bruce Spruce Co.
Statement of Cash Flows
For the Year Ended December 31, Year 1

Cash Flows From Operating Activities:		
Cash Receipts from Customers	$48,000	
Cash Payments for Expenses	(34,000)	
Net Cash Flow from Operating Activities		$14,000
Cash Flows From Investing Activities:		
Cash Payment for Land	$(38,000)	
Net Cash Flow from Investing Activities		$(38,000)
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	$75,000	
Cash Receipts from Borrowed Funds	20,000	
Cash Dividends	(2,000)	
Net Cash Flow from Financing Activities		$93,000
Net Increase in Cash		69,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$69,000

EXERCISE 2-2B

a.

1.	Asset source
2.	Asset source
3.	NA
4.	Asset exchange
5.	Asset use
6.	Asset use
7.	NA

b.

Pet Partners
Horizontal Financial Statements Model for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	–	Expense	=	Net Inc.		
Event	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings							
1	I	+	NA	=	NA	+	I	+	NA	NA	–	NA	=	NA	I	FA
2	I	+	NA	=	I	+	NA	+	NA	NA	–	NA	=	NA	I	FA
3	NA	+	NA	=	NA	+	NA	+	NA	NA	–	NA	=	NA	NA	
4	D	+	I	=	NA	+	NA	+	NA	NA	–	NA	=	NA	D	IA
5	D	+	NA	=	NA	+	NA	+	D	NA	–	I	=	D	D	OA
6	D	+	NA	=	NA	+	NA	+	D	NA	–	NA	=	NA	D	FA
7	NA	+	NA	=	NA	+	NA	+	NA	NA	–	NA	=	NA	NA	

EXERCISE 2-3B

a. Missing items are determined as follow:

(a) $500,000; Since the cash flow column shows that this event was financing activity, we can infer that the company either borrowed money or issued stock. Since the model shows that liabilities were not affected, we conclude that the common stock account increased by $500,000.

(b) NA; Since issuing common stock (see answer to (a) above), does not affect the revenue account, the answer is not affected (NA).

(c) NA; Since issuing common stock (see answer to (a) above), does not affect net income, the answer is not affected (NA).

(d) NA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money does not affect net income.

(e) FA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money is a financing activity (FA).

(f) 475,000; Since cash decreased and no other balance sheet account other than the land account was affected, the company must have purchased land which would cause the land account to increase by 475,000.

(g) IA; Purchasing land (see answer to (f) above) is an investing activity (IA).

(h) 105,000; The income statement shows $105,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.

(i) 105,000; The income statement shows $105,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.

EXERCISE 2-3B a. (cont).

(j) (80,000); The statement of cash flows shows that the $80,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to reduce the amount of retained earnings shown in the balance sheet.

(k) 80,000; The statement of cash flows shows that the $80,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to increase amount of expenses shown in the income statement.

(l) FA; Since the event decreases cash and retained earnings on the balance sheet; and does not affect the income statement, we conclude that this was a dividend payment which is a financing activity (FA).

(m) 435,000; This amount is determined by totaling the vertical column.

(n) 105,000; This amount is determined by totaling the vertical column.

EXERCISE 2-3B a. (cont.)

Completed Horizontal Financial Statements Model

Surf's Up Industries
Horizontal Financial Statements Model for Year 1

	Balance Sheet										Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stockholders' Equity				Revenue	–	Expense	=	Net Inc.	
	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings							
Beg.	0	+	0	=	0	+	0	+	0		0	–	0	=	0	NA
1	500,000	+	NA	=	NA	+	500,000	+	NA		NA	–	NA	=	NA	500,000 FA
2	400,000	+	NA	=	400,000	+	NA	+	NA		NA	–	NA	=	NA	400,000 FA
3	(475,000)	+	475,000	=	NA	+	NA	+	NA		NA	–	NA	=	NA	(475,000) IA
4	105,000	+	NA	=	NA	+	NA	+	105,000		105,000	–	NA	=	105,000	105,000 OA
5	(80,000)	+	NA	=	NA	+	NA	+	(80,000)		NA	–	80,000	=	(80,000)	(80,000) OA
6	(15,000)	+	NA	=	NA	+	NA	+	(15,000)		NA	–	NA	=	NA	(15,000) FA
	435,000	+	475,000	=	400,000	+	500,000	+	10,000		105,000	–	80,000	=	25,000	435,000 NC

b. $910,000 Total Assets (Cash $435,000 + Land $475,000)

c. $25,000 Net Income (Revenue $105,000 – Expenses $80,000)

d. $(475,000) Net Cash Flow from Investing Activities

EXERCISE 2-4B

Smith Company Effect of Events on the Year 1 Financial Statements										
	Assets			=	Liabilities	+	Stockholders' Equity			
Event	Cash	+	Accounts Rec.	=		+	Common Stock	+	Retained Earnings
Earned Revenue	NA	+	12,000	=	NA	+	NA	+	12,000
Coll. Acct. Rec.	9,800	+	(9,800)	=	NA	+	NA	+	NA
Ending Balance	9,800	+	2,200	=	-0-	+	-0-	+	12,000

a. **Accounts Receivable: $12,000 – $9,800 = $2,200**

b. **$12,000**

c. **$9,800 cash collected from accounts receivable.**

d. **$12,000**

e. **$12,000 of revenue was earned but only $9,800 of it was collected.**

EXERCISE 2-5B

The Woodstock Shop
Horizontal Financial Statements Model for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	–	Expense	=	Net Inc.	
Event	Cash	+	Accts. Rec	=	Notes Payable	+	Common Stock	+	Retained Earnings						
1	38,000	+	NA	=	NA	+	38,000	+	NA	NA	–	NA	=	NA	38,000 FA
2	NA	+	30,000	=	NA	+	NA	+	30,000	30,000	–	NA	=	30,000	NA
3	(25,000)	+	NA	=	NA	+	NA	+	(25,000)	NA	–	25,000	=	(25,000)	(25,000) OA
4	15,000	+	NA	=	15,000	+	NA	+	NA	NA	–	NA	=	NA	15,000 FA
5	25,000	+	(25,000)	=	NA	+	NA	+	NA	NA	–	NA	=	NA	25,000 OA
6	(2,000)	+	NA	=	NA	+	NA	+	(2,000)	NA	–	NA	=	NA	(2,000) FA
	51,000	+	5,000	=	15,000	+	38,000	+	3,000	30,000	–	25,000	=	5,000	51,000 NC

b. Accounts receivable will appear as an "asset" on the December 31, Year 1 balance sheet.

c. $5,000. Total from the accounts receivable column in the Horizontal Financial Statements Model.

d. $5,000. Total from the net income column in the Horizontal Financial Statements Model.

e. $0. Net cash flow from operating activities ($25,000 - $25,000).

f. Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but not cash flow from operating activities until the cash is collected.

EXERCISE 2-6B

Kendall Company Horizontal Financial Statements Model for Year 1																
	Balance Sheet										Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stockholders' Equity				Revenue	–	Expense	=	Net Inc.	
Event	Cash	+	Accts. Rec	=	Accts. Payable	+	Common Stock	+	Retained Earnings							
1	20,000	+	NA	=	NA	+	NA	+	20,000		20,000	–	NA	=	20,000	20,000 OA
2	NA	+	NA	=	10,000	+	NA	+	(10,000)		NA	–	(10,000)	=	(10,000)	NA
3	(5,000)	+	NA	=	(5,000)	+	NA	+	NA		NA	–	NA	=	NA	(5,000) OA
	15,000	+	0	=	5,000	+	0	+	10,000		20,000	–	(10,000)	=	10,000	15,000 NC

a. $5,000. Total from the accounts payable column in the Horizontal Financial Statements Model.

b. $10,000. Total from the expenses column in the Horizontal Financial Statements Model.

c. $15,000. Total cash flow from operating activities.

d. $10,000. Total from the retained earnings column in the Horizontal Financial Statements Model.

e. Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. When a company incurs an expense, this amount is reflected in expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-7B

a.

Star Corporation Accounting Equation - Year 1								
Event	Assets	=	Liabilities	+	Stockholders' Equity			
	Cash	=	Salaries Payable	+	Common Stock	+	Retained Earnings
Earned Rev.	5,000		NA		NA		5,000
Accrued Sal.	NA		3,000		NA		(3,000)
Ending Bal.	5,000	=	3,000	+	-0-	+	2,000

Star Corporation Balance Sheet As of December 31, Year 1		
Assets		
Cash	$5,000	
Total Assets		$5,000
Liabilities		
Salaries Payable	$3,000	
Total Liabilities		$3,000
Stockholders' Equity		
Retained Earnings	$2,000	
Total Stockholders' Equity		2,000
Total Liab. and Stockholders' Equity		$5,000

b.

Computation of Net Income	
Revenue	$5,000
Less: Expenses	(3,000)
Net Income	$2,000

EXERCISE 2-7B (cont.)

c.

Cash Flow from Operating Activities	
Cash from Revenue	$5,000
Net Cash Flow from Operating Act.	$5,000

e. **The salary expense is deducted from revenue in computing net income, but it has not been paid. This creates a difference of $3,000. The revenue is the same because it has been earned and collected.**

EXERCISE 2-8B

a.

Talley, Inc.
Accounting Equation for the Year Ended December 31, Year 1

	Assets		=	Liabilities	+	Stockholders' Equity		
Event	Cash	Accts. Rec.	=	Salaries Pay.	+	Common Stock	Retained Earnings	Acct. Title for RE
1.	20,000					20,000		
2.		38,000					38,000	Revenue
3.	(2,500)						(2,500)	Util. Exp.
4.	21,000	(21,000)						
5.				15,000			(15,000)	Sal. Exp.
6.	(2,000)						(2,000)	Dividends
Totals	36,500	17,000	=	15,000	+	20,000	18,500	

b.

Talley, Inc.
Income Statement
For the Year Ended December 31, Year 1

Revenue		$38,000
Expenses		
Utilities Expense	$ 2,500	
Salaries Expense	15,000	
Total Expenses		(17,500)
Net Income		$20,500

EXERCISE 2-8B b. (cont.)

Talley, Inc. Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 1		
Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	20,000	
Ending Common Stock		$20,000
Beginning Retained Earnings	$ -0-	
Plus: Net Income	20,500	
Less: Dividends	(2,000)	
Ending Retained Earnings		18,500
Total Stockholders' Equity		$38,500

Talley, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$36,500	
Accounts Receivable	17,000	
Total Assets		$53,500
Liabilities		
Salaries Payable	$15,000	
Total Liabilities		$15,000
Stockholders' Equity		
Common Stock	$20,000	
Retained Earnings	18,500	
Total Stockholders' Equity		38,500
Total Liab. and Stockholders' Equity		$53,500

EXERCISE 2-8B b. (cont.)

Talley, Inc.
Statement of Cash Flows
For the Year Ended December 31, Year 1

Cash Flow From Operating Activities		
Cash Receipts from Customers	$21,000	
Cash Paid for Expenses	(2,500)	
Net Cash Flow from Operating Act.		$18,500
Cash Flow From Investing Activities		-0-
Cash Flow From Financing Activities		
Issue of Stock	$20,000	
Paid Dividends	(2,000)	
Net Cash Flow from Financing Act.		18,000
Net Change in Cash		36,500
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$36,500

c. Net income is based on income earned of $38,000 and expenses incurred of $17,500 for a net income of $20,500. Net cash flow from operating activities is based on cash collected from revenue, $21,000 and expenses paid, $2,500, for a net cash flow from operating activities of $18,500. The difference of $2,000 is reflected in the Accounts Receivable account ($17,000), revenues accrued but not yet collected, and the Salaries Payable account ($15,000), expenses incurred but not paid.

EXERCISE 2-9B

a.

Parker and Moates
Statements Model
Year 1

	Balance Sheet									Income Statement					Statement of
	Assets			=	Liabilities			+	Stk. Equity	Rev.	–	Exp.	=	Net Inc.	Cash Flows
Event	Cash	+	Accts. Rec.	=	Acct. Payable	+	Sal. Pay.	+	Retained Earnings						
1.	NA	+	96,000	=	NA	+	NA	+	96,000	96,000	–	NA	=	96,000	NA
2.	65,000	+	NA	=	NA	+	NA	+	65,000	65,000	–	NA	=	65,000	65,000 OA
3.	NA	+	NA	=	45,000	+	NA	+	(45,000)	NA	–	45,000	=	(45,000)	NA
4.	(26,000)	+	NA	=	NA	+	NA	+	(26,000)	NA	–	26,000	=	(26,000)	(26,000) OA
5.	70,000	+	(70,000)	=	NA	+	NA	+	NA	NA	–	NA	=	NA	70,000 OA
6.	(38,000)	+	NA	=	(38,000)	+	NA	+	NA	NA	–	NA	=	NA	(38,000) OA
7.	(10,000)	+	NA	=	NA	+	NA	+	(10,000)	NA	–	NA	=	NA	(10,000) FA
8.	NA	+	NA	=	NA	+	3,000	+	(3,000)	NA	–	3,000	=	(3,000)	NA
Totals	61,000	+	26,000	=	7,000	+	3,000	+	77,000	161,000	–	74,000	=	87,000	61,000 NC

b. Total assets: $87,000 ($61,000 + $26,000)

c. $26,000

d. $7,000

e. Accounts Receivable (an asset) is an amount owed to Parker and Moates: $26,000; Accounts Payable (a liability) is an amount that Parker and Moates owes: $7,000.

f. $87,000

g. $71,000 ($65,000 – $26,000 + $70,000 – $38,000)

EXERCISE 2-10B

a. & c.

Event	Revenue	Expense	Statement of Cash Flows
1.	NA	NA	$50,000 FA
2.	$67,000	NA	NA
3.	NA	NA	(5,000) FA
4.	NA	NA	45,000 OA
5.	NA	$49,000	(49,000) OA
6.	10,000	NA	10,000 OA
7.	NA	2,000	NA

b.

Computation of Net Income	
Revenue	$77,000
Less: Expenses	(51,000)
Net Income	$26,000

d.

Cash Flow from Operating Activities	
Cash from Revenue	$55,000
Cash paid for expenses	(49,000)
Net Cash Flow from Operating Act.	$ 6,000

e. **The balance of Retained Earnings on the Year 1 Balance Sheet will be the amount of Net Income: $26,000, less $5,000 of dividends paid since there is no beginning balance in Retained Earnings.**

EXERCISE 2-11B

Hall, Inc.
Effect of Events on the Accounting Equation

	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	Accounts Receivable	Land	=	Accounts Payable	+	Com. Stock	+	Retained Earnings
1. Sales on Account		62,000							62,000
2. Coll. Accts. Rec.	51,000	(51,000)							
3. Incurred Expense					39,000				(39,000)
4. Pd. Acc. Pay.	(31,000)				(31,000)				
5. Issue of Stock	40,000						40,000		
6. Purchase Land	(21,000)		21,000						
Totals	39,000	11,000	21,000	=	8,000	+	40,000	+	23,000

a. Revenue recognized, $62,000.

b. Cash flow from revenue, $51,000.

c. Revenue, $62,000, less operating expenses, $39,000 = $23,000 net income.

d. Accounts receivable collected, $51,000, less cash paid for expenses, $31,000 = $20,000 cash flow from operating activities.

e. Income of $62,000 was earned, but only $51,000 was collected (a difference of $11,000); operating expenses incurred were $39,000 but only $31,000 was paid during the period (a difference of $8,000). Consequently, net income is $3,000 more than cash flow from operating activities.

f. $21,000 cash outflow for the purchase of land.

g. $40,000 cash inflow from the issue of common stock.

h. Total assets = $71,000 ($39,000 + $11,000 + $21,000)
Total liabilities = $8,000
Total equity = $63,000 ($40,000 + $23,000)

EXERCISE 2-12B

a. **Directly matched**

b. **Period expense**

c. **Period expense**

d. **Directly matched**

EXERCISE 2-13B

a. **$10,000 x 9% = $900; $900 x 4/12 = $300**

b. **$300**

c. **$-0-, No interest was paid in Year 1; $900 of interest will be paid in Year 2 when the note matures.**

d.

Connelly Company
Statements Model for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows
Event	Assets	=	Liabilities			+	Stockholders' Equity			Rev.	−	Exp.	=	Net Inc.	
No.	Cash	=	Notes Payable	+	Int. Payable	+	Common Stock	+	Ret. Earn.						
1.	I		NA		NA		NA		I	I		NA		I	I OA
2.	I		I		NA		NA		NA	NA		NA		NA	I FA
3.	NA		NA		I		NA		D	NA		I		D	NA

EXERCISE 2-14B

a. **Interest expense recognized for Year 1: $120,000 x 7% = $8,400; $8,400 x 5/12 = $3,500**

b.

California Company
Accounting Equation for Year 1

	Assets	=	Liabilities			+	Stockholders' Equity		
Event	Cash	=	Note Payable	+	Interest Payable	+	Common Stock	+	Retained Earnings
Note	120,000	=	120,000	+	NA	+	NA	+	NA
Adj.	NA	=	NA	+	3,500	+	NA	+	(3,500)

See the adjusting entry in the accounting equation above (liabilities increase, equity decreases).

c. **$-0-. All interest will be paid at maturity, August 1, Year 2, for this note payable.**

d. **$3,500**

e. **$8,400 ($120,000 x 7%). All interest will be paid when the note payable matures.**

f. **$4,900 ($120,000 x 7% x 7/12)**

g. **$-0-**

EXERCISE 2-15B

Solve for "X" in the following scenarios:

a.

W Co. Accounts Receivable Summary		
Beginning AR Balance	$5,000	
Increase in AR from Sales	72,500	
Reduction in AR from Collections	(70,000)	
Endings Accounts Receivable Balance	$7,500	(X)

b.

W Co. Accounts Receivable Summary		
Beginning AR Balance	$3,800	(X)
Increase in AR from Sales	60,600	
Reduction in AR from Collections	(61,200)	
Endings Accounts Receivable Balance	$3,200	

c.

W Co. Accounts Receivable Summary		
Beginning AR Balance	$11,300	
Increase in AR from Sales	102,400	
Reduction in AR from Collections	(97,900)	(X)
Endings Accounts Receivable Balance	$15,800	

EXERCISE 2-15B a. (cont.)

d.

W Co. Accounts Receivable Summary		
Beginning AR Balance	$18,000	
Increase in AR from Sales	135,500	(X)
Reduction in AR from Collections	(125,000)	
Endings Accounts Receivable Balance	$28,500	

EXERCISE 2-16B

Solve for "X" in the following scenarios:

a.

W Co. Accounts Payable Summary		
Beginning accounts payable balance	$5,500	
Plus: Expenses incurred on account	45,200	
Minus: Payment of accounts payable	(43,100)	
Ending accounts payable balance	$7,600	(X)

b.

W Co. Accounts Payable Summary		
Beginning accounts payable balance	$4,700	(X)
Plus: Expenses incurred on account	55,200	
Minus: Payment of accounts payable	(54,600)	
Ending accounts payable balance	$5,300	

c.

W Co. Accounts Payable Summary		
Beginning accounts payable balance	$3,000	
Plus: Expenses incurred on account	73,000	
Minus: Payment of accounts payable	(67,500)	(X)
Ending accounts payable balance	$8,500	

EXERCISE 2-16B a. (cont.)

d.

W Co. Accounts Payable Summary		
Beginning accounts payable balance	$6,750	
Plus: Expenses incurred on account	86,050	(X)
Minus: Payment of accounts payable	(82,000)	
Ending accounts payable balance	$10,800	

EXERCISE 2-17B

a. **Solve for "X"**

London Falls Inc. Accounts Receivable Summary		
Beginning AR Balance	$15,000	
Increase in AR from Sales	58,500	(X)
Reduction in AR from Collections	(65,000)	
Endings Accounts Receivable Balance	$8,500	

b. **$5,500. Revenue ($58,500) minus expenses ($53,000).**

c. **$12,000. Cash inflow from AR collections ($65,000) minus cash expenses ($53,000).**

d. **Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but will not be reflected on the cash flow statement until the cash is collected.**

EXERCISE 2-18B

a. Solve for "X"

Shelby Enterprises Accounts Payable Summary		
Beginning accounts payable balance	$25,000	
Plus: Expenses incurred on account	78,000	(X)
Minus: Payment of accounts payable	(85,000)	
Ending accounts payable balance	$18,000	

b. $37,000. Revenue ($115,000) minus expenses ($78,000).

c. $30,000. Cash inflow from sales ($115,000) minus cash outflow for expenses ($85,000).

d. Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. When a company incurs an expense, this amount is reflected in expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-19B

One provision of the Sarbanes-Oxley Act of 2002 clarifies the legal responsibility of company management, including the CFO and controller. This provision states that the company chief executive officer (CEO) and the chief financial officer (CFO) must certify in writing that they have reviewed the financial reports being issued, and that the reports present fairly the company's financial status. This provision would apply to the CEO and CFO of Hewlett-Packard Company. CEOs and CFOs who make intentional misrepresentations are subject to a fine of up to $5 million and imprisonment of up to 20 years.

SOLUTIONS TO PROBLEMS – SERIES B – CHAPTER 2
PROBLEM 2-20B

a.

Daley Company
Horizontal Financial Statements Model for Year 1

	Balance Sheet										Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stockholders' Equity				Revenue	–	Expense	=	Net Inc.	
Event No.	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings							
1	52,000	+	NA	=	NA	+	52,000	+	NA		NA	–	NA	=	NA	52,000 FA
2	20,000	+	NA	=	20,000	+	NA	+	NA		NA	–	NA	=	NA	20,000 FA
3	42,000	+	NA	=	NA	+	NA	+	42,000		42,000	–	NA	=	42,000	42,000 OA
4	(23,000)	+	NA	=	NA	+	NA	+	(23,000)		NA	–	23,000	=	(23,000)	(23,000) OA
5	(6,000)	+	NA	=	NA	+	NA	+	(6,000)		NA	–	NA	=	NA	(6,000) FA
6	10,000	+	NA	=	NA	+	10,000	+	NA		NA	–	NA	=	NA	10,000 FA
7	(10,000)	+	NA	=	(10,000)	+	NA	+	NA		NA	–	NA	=	NA	(10,000) FA
8	(45,000)	+	45,000	=	NA	+	NA	+	NA		NA	–	NA	=	NA	(45,000) IA
9	NA	+	NA	=	NA	+	NA	+	NA		NA	–	NA	=	NA	NA
Total	40,000	+	45,000	=	10,000	+	62,000	+	13,000		42,000	–	23,000	=	19,000	40,000 NC

b. **Total Assets = $40,000 + $45,000 = $85,000**

c.

Sources of Assets	
Event	
1. Issue of stock	$ 52,000
2. Cash from loan	20,000
3. Cash from revenue	42,000
6. Issue of stock	10,000
Total Sources of Assets	$124,000

PROBLEM 2-20B (cont.)

d. **Net income is $19,000 (see part a.) Dividends are not expenses so they do not appear on the income statement.**

e.

Operating Activities:	
Cash from customers	$42,000
Cash paid for expenses	(23,000)
Net Cash Flow from Operating Activities	$19,000

Investing Activities:	
Cash paid to purchase land	$(45,000)
Net Cash Flow from Investing Activities	$(45,000)

Financing Activities:	
Cash from stock issues ($52,000 + $10,000)	$62,000
Cash from loan	20,000
Paid cash dividend	(6,000)
Cash paid on loan principal	(10,000)
Net Cash Flow from Financing Activities	$66,000

f. **Percentage of assets provided by:**

Creditors	$10,000 ÷ $85,000 = 11.76%
Investors	$62,000 ÷ $85,000 = 72.94%
Earnings	$13,000 ÷ $85,000 = 15.29%

g. **Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.**

PROBLEM 2-21B

Event No.	Description
4	Earned cash revenue.
3	Incurred expenses on account.
6	Incurred cash expenses.
7	Used cash to pay off accounts payable.
5	Collected cash from customer accounts receivable.
8	Paid a cash dividend.
1	Issued common stock for cash.
2	Earned revenue on account.

PROBLEM 2-22B

Waddell Company
Statements Model for Year 2

	Balance Sheet										Income Statement					Statement of
	Assets					=	Liab.	+	S. Equity		Rev.	–	Exp.	=	Net Inc.	Cash Flows
Date	Cash	+	Accts. Rec.	+	Land	=	Accts. Pay.	+	Common Stock	Retained Earn.						
Beg.	52,000	+	23,000	+	45,000	=	12,500	+	35,000	72,500	NA	–	NA	=	NA	NA
1/1	35,000	+	NA	+	NA	=	NA	+	35,000	NA	NA	–	NA	=	NA	35,000 FA
3/1	(4,000)	+	NA	+	NA	=	NA	+	NA	(4,000)	NA	–	NA	=	NA	(4,000) FA
4/1	(20,000)	+	NA	+	20,000	=	NA	+	NA	NA	NA	–	NA	=	NA	(20,000) IA
5/1	(7,000)	+	NA	+	NA	=	(7,000)	+	NA	NA	NA	–	NA	=	NA	(7,000) OA
9/1	25,000	+	NA	+	(25,000)	=	NA	+	NA	NA	NA	–	NA	=	NA	25,000 IA
12/31	NA	+	65,000	+	NA	=	NA	+	NA	65,000	65,000	–	NA	=	65,000	NA
12/31	55,000	+	(55,000)	+	NA	=	NA	+	NA	NA	NA	–	NA	=	NA	55,000 OA
12/31	NA	+	NA	+	NA	=	34,000	+	NA	(34,000)	NA	–	34,000	=	(34,000)	NA
12/31	NA	+	NA	+	NA	=	NA	+	NA	NA	NA	–	NA	=	NA	NA
Totals	136,000	+	33,000	+	40,000	=	39,500	+	70,000	99,500	65,000	–	34,000	=	31,000	84,000 NC

a. **$40,000. Total of the land column in the Horizontal Financial Statements Model.**

b. **$48,000. Cash inflows of $55,000 minus cash outflows of $7,000.**

c. **$39,500. Total of the liabilities column in the Horizontal Financial Statements Model.**

d. **$5,000. Cash inflow from the sale of land ($25,000) minus cash outflow from the purchase of land ($20,000).**

PROBLEM 2-22B (cont.)

e. **$34,000. Total of the expenses column in the Horizontal Financial Statements Model.**

f. **$65,000. Total of the revenue column in the Horizontal Financial Statements Model.**

g. **$31,000. Cash inflow from issuance of common stock ($35,000) minus cash outflow from dividend ($4,000).**

h. **$31,000. Revenues ($65,000) minus expenses ($34,000).**

i. **$99,500. Total of the retained earnings column in the Horizontal Financial Statements Model.**

PROBLEM 2-23B

a.

Matchstix
Accounting Equation for Year 1

	Assets			=	Liabilities					+	Stockholders' Equity			
Event	Cash	+	Accts. Rec.	=	Accts Pay.	+	Notes Pay.	+	Int. Pay.	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
Beg.	$0	+	$0	=	$0	+	NA	+	NA	+	$0	+	$0	
1. Issued stk.	50,000	+	NA	=	NA	+	NA	+	NA	+	50,000	+	NA	
2. Rev. on acct.	NA	+	24,000	=	NA	+	NA	+	NA	+	NA	+	24,000	Rev.
3. Loan	22,000	+	NA	=	NA	+	22,000	+	NA	+	NA	+	NA	
4. Exp. On acct.	NA	+	NA	=	10,500	+	NA	+	NA	+	NA	+	(10,500)	Exp.
5. AR collect.	7,000	+	(7,000)	=	NA	+	NA	+	NA	+	NA	+	NA	
6. AP payment	(3,500)	+	NA	=	(3,500)	+	NA	+	NA	+	NA	+	NA	
7. Interest exp.*	NA	+	NA	=	NA	+	NA	+	330	+	NA	+	(330)	Int. exp.
Totals	75,500	+	17,000	=	7,000	+	22,000	+	330	+	50,000	+	13,170	

*330 = (22,000 x .06) x 3/12

PROBLEM 2-23B a. (cont.)

Matchstix
Accounting Equation for Year 2

	Assets			=	Liabilities					+	Stockholders' Equity			
Event	Cash	+	Accts. Rec.	=	Accts Pay.	+	Notes Pay.	+	Int. Pay.	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
Beg.	$75,500	+	17,000	=	7,000	+	22,000	+	330	+	50,000	+	13,170	
1. AR collect.	17,000	+	(17,000)	=	NA	+	NA	+	NA	+	NA	+	NA	
2. AP payment	(7,000)	+	NA	=	(7,000)	+	NA	+	NA	+	NA	+	NA	
3. Int. exp.*	NA	+	NA	=	NA	+	NA	+	990	+	NA	+	(990)	Int. exp.
4. Int. pay.**	(1,320)	+	NA	=	NA	+	NA	+	(1,320)	+	NA	+	NA	
5. Note pay.	(22,000)	+	NA	=	NA	+	(22,000)	+	NA	+	NA	+	NA	
Totals	62,180	+	0	=	0	+	0	+	0	+	50,000	+	12,180	

*990 = (22,000 *.06) x 9/12

**1,320 = 330 + 990

PROBLEM 2-23B (cont.)

b.

Matchstix
Income Statement
For the Period Ended December 31, Year 1 & Year2

	Year 1	Year 2
Revenue	$24,000	$0
Expenses	(10,830)	(990)
Net Income	$13,170	$(990)

Matchstix
Statement of Changes in Stockholders' Equity
For the Period Ended December 31, Year 1 & Year2

	Year 1	Year 2
Beginning Common Stock	$ -0-	$50,000
Plus: Common Stock Issued	50,000	0
Ending Common Stock	$50,000	$50,000
Beginning Retained Earnings	$ -0-	$13,170
Plus: Net Income	13,170	(990)
Ending Retained Earnings	$13,170	$12,180
Total Stockholders' Equity	$63,170	$62,180

PROBLEM 2-23B b. (cont.)

Matchstix
Balance Sheet
December 31, Year 1 & Year 2

	Year 1	Year 2
Assets		
Cash	$75,500	$62,180
Accounts Receivable	$17,000	$0
Total Assets	$92,500	$62,180
Liabilities		
Accounts Payable	$7,000	$0
Interest Payable	330	0
Notes Payable	22,000	0
Total Liabilities	$29,330	$0
Stockholders' Equity		
Common Stock	$50,000	$50,000
Retained Earnings	$13,170	$12,180
Total Stockholders' Equity	$63,170	$62,180
Total Liabilities and Stockholders' Equity	$92,500	$62,180

PROBLEM 2-23B b. (cont.)

Matchstix Statement of Cash Flows For the Year Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$7,000	$17,000
Cash Payments for Expenses	(3,500)	(8,320)*
Net Cash Flow from Operating Activities	$3,500	$8,680
Cash Flows From Investing Activities		
Net Cash Flow from Investing Activities	$0	$0
Cash Flows From Financing Activities:		
Cash Transactions from Borrowed Funds	$22,000	$(22,000)
Cash Receipts from Stock Issue	50,000	0
Net Cash Flow from Financing Activities	$72,000	$(22,000)
Net Increase in Cash	$75,500	$(13,320)
Plus: Beginning Cash Balance	-0-	75,500
Ending Cash Balance	$75,500	$62,180

*$8,320 = $7,000 + $1,320

c. Matchstix has $62,180 worth of assets to distribute in the event of liquidation at the end of Year 2. During liquidation, creditors have first rights to the assets and any remaining assets are distributed to owners. As the company has no debts, creditors would receive $0 and total amount of assets of $62,180 would be distributed to owners.

PROBLEM 2-24B

a.

Tristan Company Income Statement For the Year Ended December 31, Year 2		
Revenue		
Service Revenue	$65,000	
Total Revenue		$65,000
Expenses		
Other Operating Expenses	$18,000	
Salary Expense	12,000	
Interest Expense	5,000	
Total Expenses		(35,000)
Net Income		$30,000

Tristan Company Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 2		
Beginning Common Stock	$55,000	
Plus: Stock Issued	10,000	
Ending Common Stock		$65,000
Beginning Retained Earnings	$ 10,000	
Plus: Net Income	30,000	
Less: Dividends	(2,000)	
Ending Retained Earnings		38,000
Total Stockholders' Equity		$103,000

PROBLEM 2-24B a. (cont.)

Tristan Company Balance Sheet As of December 31, Year 2		
Assets		
Cash	$ 35,000	
Accounts Receivable	32,000	
Land	75,000	
Total Assets		$142,000
Liabilities		
Accounts Payable	$12,000	
Interest Payable	5,000	
Accrued Salaries Payable	9,000	
Notes Payable	13,000	
Total Liabilities		$39,000
Stockholders' Equity		
Common Stock	$65,000	
Retained Earnings	38,000	
Total Stockholders' Equity		$103,000
Total Liab. and Stockholders' Equity		$142,000

PROBLEM 2-24B a. (cont.)

Tristan Company Statement of Cash Flows For the Year Ended December 31, Year 2	
Cash Flow From Operating Activities	$45,000
Cash Flow From Investing Activities	(36,000)
Cash Flow From Financing Activities	8,000
Net Change in Cash	17,000
Plus: Beginning Cash Balance	18,000
Ending Cash Balance	$35,000

b.

Tristan Company Accounts Receivable Summary		
Beginning AR Balance	$13,000	(X)
Increase in AR from Sales	65,000	
Reduction in AR from Collections	(46,000)	
Endings Accounts Receivable Balance	$32,000	

c.

Tristan Company Accounts Payable Summary		
Beginning accounts payable balance	$17,000	(X)
Plus: Expenses incurred on account	18,000	
Minus: Payment of accounts payable	(23,000)	
Ending accounts payable balance	$12,000	

PROBLEM 2-25B

a.

Computation of Net Income	
Revenue recognized on account	$40,000
Less accrued salary expense	(35,000)
Net Income	$ 5,000

b.

Computation of Cash Collected from Accounts Receivable	
Beginning balance of Accounts Receivable	$ 2,000
Add revenue recognized on account	40,000
Less ending balance of Accounts Receivable	(2,400)
Cash collected from accounts receivable	$39,600

Computation of Cash Paid for Salaries Expense	
Beginning balance of Salaries Payable	$ 1,300
Add accrued salary expense recognized	35,000
Less ending balance of Salaries Payable	(900)
Cash paid for salary expense	$35,400

Cash Flow from Operating Activities	
Cash from accounts receivable	$39,600
Cash paid for salary expense	(35,400)
Net Cash Flow from Operating Act.	$ 4,200

c. Net income is the difference between services performed and expenses incurred, regardless of the cash collected or paid. Cash flow from operating activities is the difference between cash collected and paid for operating activities. The time gap between these two activities often causes a difference between the net income and cash flow from operating activities.

PROBLEM 2-26B

a.

Several of the principles should be mentioned in the memo.

Responsibilities Principle
As a professional, Kato should exercise professional and moral judgment in his position.

Integrity Principle
Kato should perform his duties with the highest sense of integrity.

Due Care Principle
Members are required be competent in their areas of responsibility and to perform professional duties to the best of his/her ability.

b. Pleading ignorance would not relieve Kato of responsibility. The due care principle requires that members of the profession be competent and provide quality services

SOLUTIONS TO ANALYZE, THINK, COMMUNICATE – CHAPTER 2

ATC 2-1 (All dollar amounts are in millions.)

a. Target's accrual accounts are: Accounts payable, Accrued and other current liabilities. The "Other current assets" accounts includes two accrual accounts: "Vendor income receivables" and "Income tax and other receivables." See Note 10. As Note 14 shows, all of the individual accounts included in "Accrued and other current liabilities" are accrual accounts.

The "Deferred income taxes" account shown under Liabilities is probably best classified as an accrual account, but students will probably think it is a deferral account.

b.

Net income for 2018 was	$2,937
Cash provided by operating activities for 2018 was	$5,973

Thus, cash flow from operating activities exceeded net income by $3,036.

c. Net income increased by $23 from 2017 to 2018 ($2,937 - $2,914). Cash provided by operating activities decreased by $962 from 2017 to 2018 ($5,973- $6,935). Therefore, the change in cash flow from operations was the greatest.

ATC 2-2

Income Statments	Year 1	Year 2
Revenue	$50,000	$40,000
Expense	(30,000)	(25,000)
Net Income	$(20,000)	$(15,000)

Accounts Receivable	Year 1	Year 2
Beginning accounts receivable balance	$0	$10,000
Plus: Increases due to sales on account	50,000	40,000
Minus: Decreases due to receivables collections	(40,000)	(50,000)
Yields: Ending accounts receivable balance	$10,000	$0

Operating Activities Section of Statement of Cash Flows	Year 1	Year 2
Cash collections from customers	$40,000	$50,000
Cash payments for expense	(25,000)	(30,000)
Net cash flow from operating activities	$15,000	$20,000

Accounts Payable	Year 1	Year 2
Beginning accounts payable balance	$0	$5,000
Plus: Increases due to expenses incurred on account	30,000	25,000
Minus: Decreases due to payments to reduce accounts payable	(25,000)	(30,000)
Yields: Ending accounts payable balance	$5,000	$0

Class Discussion

The discussion should focus on how accrual accounting facilitates the matching of revenues with expenses.

ATC 2-3

Dollar amounts are in thousands.

a.

	2017	2018
Revenues	$2,926,289	$3,030,445
- Expenses	2,724,390	2,782,825
Net income	$ 201,899	$ 247,620
Beg. retained earnings	$ 488,481	$ 492,836
+ Net income	201,899	247,620
- Dividends	197,544	207,649
End. Retained earnings	$ 492,836	$ 532,807

b. **Revenue increased by 3.6%**
($3,030,445 - $2,926,289) ÷ $2,926,289 = 3.6%

Net income increased by 22.6%
($247,620 - $201,899) ÷ $201,899 = 22.6%

c. **2017: $201,899 ÷ $2,926,289 = 6.9%**
2018: $247,620 ÷ $3,030,445 = 8.2%

d. **Both revenues and net income increased in 2018, and net income as a percentage of revenues was also higher in 2018, thus, 2018 appears to have been a better year than 2017.**

ATC 2-4

Dollar amounts in millions.

a. and b.

	2016	2017
Cash from operating activities	$1,030	$1,248
Cash from investing activities	1,472	(4)
Cash from financing activities	(1,734)	(778)
Net change in cash	768	466
+ Beg. cash balance	831	365
= End. Cash balance	$1,599	$ 831

c. **Negative cash flow from financing activities could result from the company either paying off long-term debt, paying significant amounts of dividends, repurchasing its stock, or some combination of these. None of these are negative events. Of course students will probably not think of repurchasing stock as a reason. The real reason for Yum! was paying off debt and repurchasing stock.**

ATC 2-5

The memo provided by students should convey knowledge of the following relationships.

> **The amount of revenue recognized on account was greater than the amount of cash collected from customers. Accordingly, the amount of revenue recognized will be higher than the amount of cash collected thereby making net income higher than net cash flow from operating activities. At the end of the period, there will be a $9,000 balance in the accounts receivable account. This balance represents the amount of cash Corola expects to collect from customers in the next accounting period.**

ATC 2-6

a.

Income Statement		Balance Sheet	
Service Revenue	$120,000	Assets:	$167,000
Operating Exp.	(40,000)		
Net Income	$ 80,000	Liabilities:	$ 5,000
		Stockholders' Equity:	
		Common Stock	82,000
		Retained Earnings	80,000
		Total Stk Eqty.	162,000
		Total Liab. and Stk. Equity	$167,000

Computations for Income Statement Items:

Revenue: $38,000 + $82,000 = $120,000
Operating Expense: $70,000 – $30,000 = $40,000

Computations for Balance Sheet Items:

Assets: $85,000 + $82,000 = $167,000
Liabilities: $35,000 – $30,000 = $5,000
Retained Earnings: $(32,000) + $82,000 + $30,000 = $80,000

b. **Willful deception is an act of fraud and punishable under the law. Good intentions are not sufficient justification for breaking the law. Students should learn to avoid operating under an ends justifies the means philosophy. Suppose the unexpected happens in this case. Glenn fails to obtain the contract and is forced to declare bankruptcy after having manipulated the statements. He would not only stand to lose the friend that he deceived, but also may be convicted of a felony on charges of fraudulent reporting.**

ACT 2-6 (cont.)

c. The auditing profession has identified three elements that are typically present when fraud occurs. They are: (1) the availability of an opportunity, (2) the existence of some form of pressure leading to an incentive, and (3) the capacity for rationalization. Glenn had the opportunity to record the questionable adjustments because he was the owner and could make whatever adjustments he deemed appropriate. Glenn's existence of pressure is the fact that he needs the financial statements to look good in order to obtain the loan. Because Glenn was confident that the contracts would be approved, he was able to rationalize making the adjustments. All three of the factors of ethical misconduct are present in this case.

ATC 2-7

This solution is based on Netflix's 2018 financial report.

a. Netflix's accrual accounts are:

Current content liabilities (though students will probably not list this account)
Accounts payable
Accrued expenses

b. Netflix's net income for 2018 was $1,211,242

c. Netflix's retained earnings increased by $1,211,242 from 2017 to 2018. [$2,942,359 - $1,731,117