Solution Manual for Fundamentals of Financial Accounting Canadian 4th Edition by Phillips Libby Mackintosh ISBN 1259103293 9781259103292

Chapter 1: Business Decisions and Financial Accounting

ANSWERS TO QUESTIONS

1. Accounting is a system of analyzing, recording, and summarizing the results of a business's activities and then reporting them to decision makers.
2. An advantage of operating as a sole proprietorship, rather than a corporation, is that it is easy to establish. Another advantage is that income from a sole proprietorship is taxed only once in the hands of the individual proprietor (income from a corporation is taxed in the corporation and then again in the hands of the individual proprietor). A disadvantage of operating as a sole proprietorship, rather than a corporation, is that the individual proprietor can be held responsible for the debts of the business.
3. Financial accounting focuses on preparing and using the financial statements that are made available to owners and external users such as customers, creditors, and potential investors who are interested in reading them. Managerial accounting focuses on other accounting reports that are not released to the general public, but instead are prepared and used by employees, supervisors, and managers who run the company.
4. Financial reports are used by both internal and external groups and individuals. The internal groups are comprised of the various managers of the business. The external groups include investors, creditors, governmental agencies, other interested parties, and the public at large.
5. The business itself, not the individual shareholders who own the business, is viewed as owning the assets and owing the liabilities on its balance sheet. A business's balance sheet includes the assets, liabilities, and shareholders' equity of only that business and not the personal assets, liabilities, and equity of the shareholders. The financial statements of a company show the results of the business activities of only that company.
6. (a) Operating – These activities are directly related to earning profits. They include buying supplies, making products, serving customers, cleaning the premises, advertising, renting a building, repairing equipment, and obtaining insurance coverage.
   (b) Investing – These activities involve buying and selling productive resources with long lives (such as buildings, land, equipment, and tools), purchasing investments, and lending to others.
   (c) Financing – Any borrowing from banks, repaying bank loans, receiving contributions from shareholders, or paying dividends to shareholders are considered financing activities.

7. The heading of each of the four primary financial statements should include the following:
   (a) Name of the business
   (b) Name of the statement
   (c) Date of the statement, or the period of time

8. (a) The purpose of the balance sheet is to report the financial position (assets, liabilities and shareholders' equity) of a business at a point in time.
   (b) The purpose of the income statement is to present information about the revenues, expenses, and net income of a business for a specified period of time.
   (c) The statement of retained earnings reports the way that net income and the distribution of dividends affected the financial position of the company during the period.
   (d) The purpose of the statement of cash flows is to summarize how a business's operating, investing, and financing activities caused its cash balance to change over a particular period of time.

9. The income statement, statement of retained earnings, and statement of cash flows would be dated "For the Year Ended December 31, 2014," because they report the inflows and outflows of resources during a period of time. In contrast, the balance sheet would be dated "At December 31, 2014," because it represents the assets, liabilities and shareholders' equity at a specific date.

10. Net income is the excess of total revenues over total expenses. A net loss occurs if total expenses exceed total revenues.

11. The accounting equation for the balance sheet is: Assets = Liabilities + Shareholders' Equity. Assets are the economic resources controlled by the company. Liabilities are amounts owed by the business. Shareholders' equity is the owners' claims to the business. It includes amounts contributed to the business (by investors through purchasing the company's shares) and the amounts earned and accumulated through profitable business operations.

12. The equation for the income statement is Revenues – Expenses = Net Income. Revenues are increases in a company's resources, arising primarily from its operating activities. Expenses are decreases in a company's resources, arising primarily from its operating activities. Net Income is equal to revenues minus expenses. (If expenses are greater than revenues, the company has a Net Loss.)

13. The equation for the statement of retained earnings is: Beginning Retained Earnings + Net Income - Dividends = Ending Retained Earnings. It begins with beginning-of-the-year retained earnings which is the prior year's ending retained earnings reported on the prior year's balance sheet. The current year's net income reported on the income statement is added and the current year's dividends are subtracted from this amount. The ending retained earnings amount is reported on the end-of-year balance sheet.

14. The equation for the statement of cash flows is: Cash flows from operating activities + Cash flows from investing activities + Cash flows from financing activities = Change in cash for the period. Change in cash for the period + Beginning cash balance = Ending cash balance. The net cash flows for the period represent the increase or decrease in cash that occurred during the period. Cash flows from operating activities are cash flows directly related to earning income (normal business activity). Cash flows from investing activities include cash flows that are related to the acquisition or sale of the company's long-term assets. Cash flows from financing activities are directly related to the financing of the company.

15. Currently, the Chartered Professional Accountants of Canada (CPA) is given the primary responsibility for setting the detailed rules that become Generally Accepted Accounting Principles (GAAP) in Canada. (Internationally, the International Accounting Standards Board (IASB) has the responsibility for setting accounting rules known as International Financial Reporting Standards (IFRS).)

16. The main goal of accounting rules is to ensure that companies produce useful financial information for present and potential investors, lenders, and other creditors in making decisions in their capacity as capital providers. Financial information must show relevance and faithful representation, as well as be comparable, verifiable, timely, and understandable.

17. An ethical dilemma is a situation where following one moral principle would result in violating another. Three steps that should be considered when evaluating ethical dilemmas are:
    (a) Identify who will benefit from the situation (often, the manager or employee) and how others will be harmed (other employees, the company's reputation, owners, creditors, and the public in general).
    (b) Identify the alternative courses of action.
    (c) Choose the alternative that is the most ethical – that which you would be proud to have reported in the news media. Often, there is no one right answer and hard choices will need to be made. Following strong ethical practices is a key part of ensuring good financial reporting by businesses of all sizes.

18. Accounting frauds and cases involving academic dishonesty are similar in many respects. Both involve deceiving others in an attempt to influence their actions or decisions, often resulting in temporary personal gain for the deceiver. For example, when an accounting fraud is committed, financial statement users may be misled into making decisions they wouldn't have made had the fraud not occurred (e.g., creditors might loan money to the company, investors might invest in the company, or shareholders might reward top managers with big bonuses). When academic dishonesty is committed, instructors might assign a higher grade than is warranted by the student's individual contribution. Another similarity is that, as a consequence of the deception, innocent bystanders may be adversely affected by fraud and academic dishonesty. Fraud may require the company to charge higher prices to customers to cover costs incurred as a result of the fraud. Academic dishonesty may lead to stricter grading standards, with significant deductions taken for inadequate documentation of sources referenced. A final similarity is that if fraud and academic dishonesty are ultimately uncovered, both are likely to lead to adverse long-term consequences for the perpetrator. Fraudsters may be fined, imprisoned, and encounter an abrupt end to their careers. Students who cheat may be penalized through lower course grades or expulsion, and might find it impossible to obtain academic references for employment applications.

Authors' Recommended Solution Time
(Time in minutes)

Mini-exercises		*Exercises*		*Problems*		*Skills Development Cases**		*Continuing Case*	
No.	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*
1	3	1	10	CP1-1	45	1	20	1	45
2	11	2	10	CP1-2	10	2	20		
3	12	3	15	CP1-3	60	3	30		
4	6	4	25	PA1-1	45	4	30		
5	6	5	25	PA1-2	10	5	20		
6	6	6	10	PA1-3	50	6	30		
7	6	7	15	PB1-4	45	7	45		
8	4	8	10	PA1-5	50				
9	4	9	20	PB1-1	45				
10	3	10	10	PB1-2	10				
11	3	11	3	PB1-3	45				
12	6	12	3	PB1-4	10				
13	6			PB1-5	50				
14	6								
15	6								
16	12								

* Due to the nature of cases, it is very difficult to estimate the amount of time students will need to complete them. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear, and by offering suggestions (about how to research topics or what companies to select). The skills developed by these cases are indicated below.

Case	Financial Analysis	Research	Ethical Reasoning	Critical Thinking	Technology	Writing	Teamwork
1	x						
2	x						
3	x	x			x	x	x
4	x		x	x			
5	x			x		x	
6	x			x		x	
7	x				x		

ANSWERS TO MINI-EXERCISES

M1-1

Abbreviation	Full Designation
1. CPA	Chartered Professional Accountant
2. GAAP	Generally Accepted Accounting Principles
3. IASB	International Accounting Standards Board
4. CSA	Canadian Securities Administrators
5. IFRS	International Financial Reporting Standards
6. ASPE	Accounting Standards for Private Enterprises

M1-2

	Term or Abbreviation
F	(1) Investing activities
D	(2) Private company
E	(3) Corporation
A	(4) Accounting
C	(5) Partnership
I	(6) AcSB
G	(7) Financing activities
B	(8) Unit of measure
K	(9) GAAP
J	(10) Public company
H	(11) Operating activities

Definition

A. A system that collects and processes financial information about an organization and reports that information to decision makers.
B. Measurement of information about a business in the monetary unit (dollars or other national currency).
C. An unincorporated business owned by two or more persons.
D. A company that sells shares privately and is not required to release its financial statements to the public.
E. An incorporated business that issues shares as evidence of ownership.
F. Buying and selling productive resources with long lives.
G. Transactions with lenders (borrowing and repaying cash) and shareholders (selling company shares and paying dividends).
H. Activities directly related to running the business to earn profit.
I. Accounting Standards Board.
J. A company that has its shares bought and sold by investors on established stock exchanges.
K. Generally accepted accounting principles.

M1-3

		Term		Definition
F	(1)	Relevance	A.	The financial reports of a business are assumed to include the results of only that business's activities.
I	(2)	Faithful Representation	B.	The resources owned by a business.
C	(3)	Comparability	C.	Financial information that can be compared across businesses because similar accounting methods have been applied.
A	(4)	Separate Entity	D.	The total amounts invested and reinvested in the business by its owners.
B	(5)	Assets	E.	The costs of business necessary to earn revenues.
H	(6)	Liabilities	F.	A feature of financial information that allows it to influence a decision.
D	(7)	Shareholders' Equity	G.	Earned by selling goods or services to customers.
G	(8)	Revenues	H.	The amounts owed by the business.
E	(9)	Expenses	I.	Financial information that depicts the economic substance of business activities.
J	(10)	Unit of Measure	J.	The assumption that states that results of business activities should be reported in an appropriate monetary unit.

M1-4

L (B/S) (1) Accounts Payable
A (B/S) (2) Accounts Receivable
A (B/S) (3) Cash
E (I/S) (4) Income Tax Expense
E (I/S) (5) Selling and Administrative Expenses
R (I/S) (6) Sales Revenue
L (B/S) (7) Notes Payable
SE(B/S) (8) Retained Earnings

M1-5

A (B/S) (1) Accounts Receivable
R (I/S) (2) Sales Revenue
A (B/S) (3) Equipment
E (I/S) (4) Supplies Expense
A (B/S) (5) Cash
E (I/S) (6) Advertising Expense
L (B/S) (7) Accounts Payable
SE(B/S) (8) Retained Earnings

M1-6

A (B/S)	(1) Accounts Receivable
E (I/S)	(2) Selling and Administrative Expenses
A (B/S)	(3) Cash
A (B/S)	(4) Equipment
E (I/S)	(5) Advertising Expenses
R (I/S)	(6) Sales Revenue
L (B/S)	(7) Notes Payable
SE(B/S)	(8) Retained Earnings
L (B/S)	(9) Accounts Payable

M1-7

L (B/S)	(1) Accounts Payable
SE(B/S)	(2) Contributed Capital
A (B/S)	(3) Equipment
A (B/S)	(4) Accounts Receivable
L (B/S)	(5) Notes Payable
A (B/S)	(6) Cash
SE(B/S)	(7) Retained Earnings
E (I/S)	(8) Selling and Administrative Expenses
R (I/S)	(9) Sales Revenue
A (B/S)	(10) Supplies

M1-8

SRE*	(1) Dividends
B/S	(2) Total Shareholders' Equity
I/S	(3) Sales Revenue
B/S	(4) Total Assets
SCF	(5) Cash Flows from Operating Activities
B/S	(6) Total Liabilities
I/S, SRE	(7) Net Income
SCF	(8) Cash Flows from Financing Activities

* An argument could be made for also including SCF as a plausible answer because the SCF reports “Dividends paid in cash.” The answer SCF has been excluded here because (technically) the caption would have to read “Dividends paid in cash” if it were to be reported on the SCF.

M1-9

		Element		Financial Statement
D	(1)	Cash Flows from Financing Activities	A.	Balance Sheet
B	(2)	Expenses	B.	Income Statement
D	(3)	Cash Flows from Investing Activities	C.	Statement of Retained Earnings
A	(4)	Assets	D.	Statement of Cash Flows
C	(5)	Dividends		
B	(6)	Revenues		
D	(7)	Cash Flows from Operating Activities		
A	(8)	Liabilities		

M1-10

(F) (1) Cash paid for dividends
O (2) Cash collected from customers
F (3) Cash received when signing a note
(O) (4) Cash paid to employees
(I) (5) Cash paid to purchase equipment
F (6) Cash received from issuing shares

M1-11

(I) (1) Cash paid to purchase equipment
O (2) Cash collected from clients
I (3) Cash received from selling equipment
(F) (4) Cash paid for dividends
(O) (5) Cash paid to suppliers
F (6) Cash received from issuing shares

M1-12

STONE CULTURE CORPORATION
Statement of Retained Earnings
For the Year Ended December 31, 2013

Retained Earnings, January 1, 2013	$ 0
Add: Net Income	36,000
Subtract: Dividends	(15,000)
Retained Earnings, December 31, 2013	$ 21,000

M1-12 (continued)

STONE CULTURE CORPORTATION
Statement of Retained Earnings
For the Year Ended December 31, 2014

Retained Earnings, January 1, 2014	$ 21,000
Add: Net Income	45,000
Subtract: Dividends	(20,000)
Retained Earnings, December 31, 2014	$ 46,000

M1-13

	Apple, Inc.	Google, Inc.	Intel Corp.
Contributed Capital	$11	$18	$17
Dividends	0	0	4
Net Income	(a) 14	(d) 9	(g) 11
Retained Earnings, Beginning of Year	23	20	26
Retained Earnings, End of Year	(b) 37	(e) 29	(h) 33
Total Assets	(c) 75	(f) 59	(i) 63
Total Expenses	51	20	33
Total Liabilities	27	12	13
Total Revenues	65	29	44

Net income = Revenues – Expenses

Retained Earnings, End of Year = Retained Earnings Beginning of Year + Net Income – Dividends

Total Assets = Total Liabilities and Shareholders' Equity

M1-14

	Amazin' Corp.	**Best Tech, Inc.**	**Colossal Corp.**
Contributed Capital	$5	$15	$100
Dividends	10	5	50
Net Income	(a) 25	(d) 20	(g) 100
Retained Earnings, Beginning of Year	30	0	200
Retained Earnings, End of Year	(b) 45	(e) 15	(h) 250
Total Assets	(c) 80	(f) 60	(i) 700
Total Expenses	75	30	200
Total Liabilities	30	30	350
Total Revenues	100	50	300

M1-14 (continued)

Net income = Revenues – Expenses
Retained Earnings, End of Year = Retained Earnings Beginning of Year + Net Income – Dividends

Total Assets = Total Liabilities and Shareholders' Equity

M1-15

(a) (300) (b) 70 (c) 3,900. Electronic Arts was not profitable because its expenses ($3,900) were greater than its revenues ($3,600), resulting in the net loss of $300 reported on the income statement.

The above amounts are determined using the various relationships that exist in the financial statements. Because this exercise excludes two pieces of information from both the income statement and statement of retained earnings, students must first work backwards from the balance sheet to the statement of retained earnings to the income statement. Although not required, the following statements show the given and missing information. The ?s in the balance sheet are determined from A = L + SE.

Electronic Arts, Inc.
Income Statement
For the Year Ended xxxx

Revenues	$3,600
Expenses	<u>(c)</u>
Net Income (Loss)	(a)

Electronic Arts, Inc. Statement of Retained Earnings For the Year Ended xxxx

RE, beginning	$370
Net income (loss)	(a)
Dividends	<u>(0)</u>
RE, ending	(b)

Electronic Arts, Inc.
Balance Sheet
At xxxx

Total Assets	<u>$4,900</u>
Liabilities and Shareholders' Equity	
Total Liabilities	<u>$2,400</u>
Shareholders' Equity	
Contributed capital	$2,430
Retained earnings	(b)
Total SE	?
Total Liabilities & SE	?

M1-16

Req. 1

WESTJET AIRLINES, LTD.
Income Statement
For the Year Ended December 31, 2014
(Amounts in millions)

Revenues	
Ticket Revenues	$ 9,861
Other Revenue	336
Total Revenue	10,197
Expenses	
Salaries Expense	3,213
Aircraft Fuel Expense	2,536
Other Operating Expenses	2,145
Repairs and Maintenance Expense	616
Landing Fees Expense	560
Interest Expense	69
Income Tax Expense	413
Total Expenses	9,552
Net Income	$ 645

Req. 2

WESTJET AIRLINES, LTD.
Statement of Retained Earnings
For the Year Ended December 31, 2014
(Amounts in millions)

Retained Earnings, January 1, 2014	$ 4,157
Add: Net Income	645
Subtract: Dividends	(14)
Retained Earnings, December 31, 2014	$ 4,788

M1-16 (continued)

Req. 3

WESTJET AIRLINES, LTD.
Balance Sheet
At December 31, 2014
(Amounts in millions)

Assets		
Cash	$	2,213
Accounts Receivable		845
Supplies		259
Property and Equipment		10,874
Other Assets		2,581
Total Assets	$	16,772
Liabilities		
Accounts Payable	$	1,731
Notes Payable		4,993
Other Liabilities		3,107
Total Liabilities		9,831
Shareholders' Equity		
Contributed Capital		2,153
Retained Earnings		4,788
Total Shareholders' Equity		6,941
Total Liabilities and Shareholders' Equity	$	16,772

Req. 4

Westjet Airlines financed its assets primarily with liabilities ($9,831) as opposed to shareholders' equity ($6,941).

ANSWERS TO EXERCISES

E1-1

a) Assets = Liabilities + Shareholders' Equity
= \$13,750 + \$4,450
= \$18,200
= Assets reported on the balance sheet

b) Net Income = Revenue – Expenses
= \$10,500 - \$9,200
= \$1,300
= Net income reported on the income statement

c) Beginning Retained Earnings (R/E) + Net Income – Dividends = Ending R/E
\$3,500 + \$1,300 - \$500 = \$4,300

d) Beginning Cash + Cash Flows from Operating Activities + Cash Flows from Investing Activities + Cash Flows from Financing Activities = Ending Cash
\$1,000 + \$1,600 + (\$1,000) + (\$900) = \$700

E1-2

a) Assets = Liabilities + Shareholders' Equity
= \$18,500 + \$61,000
= \$79,500
= Assets reported on the balance sheet

b) Net Income = Revenue – Expenses
= \$32,100 – \$18,950
= \$13,150
= Net income reported on the income statement

c) Beginning Retained Earnings (R/E) + Net Income – Dividends = Ending R/E
\$20,500 + \$13,150 – \$4,900 = \$28,750

d) Beginning Cash + Cash Flows from Operating Activities + Cash Flows from Investing Activities + Cash Flows from Financing Activities = Ending Cash
\$3,200 + \$15,700 + (\$7,200) + (\$5,300) = \$6,400

E1-3

Req. 1

Designer Footwear Inc.
Balance Sheet
At November 1, 2014
(in thousands)

Assets	
Cash	$ 45,570
Accounts Receivable	11,888
Property, Plant, and Equipment	233,631
Other Assets	494,294
Total Assets	$785,383
Liabilities	
Accounts Payable	$136,405
Notes Payable	99,044
Other Liabilities	79,148
Total Liabilities	314,597
Shareholders' Equity	
Contributed Capital	291,248
Retained Earnings	179,538
Total Shareholders' Equity	470,786
Total Liabilities and Shareholders' Equity	$785,383

Req. 2

Most of the financing as of November 1 came from shareholders. The shareholders have financed $470,786 of the total assets and creditors have financed only $314,597 of the total assets of the company.

E1-4

Req. 1

READER DIRECT
Balance Sheet
At December 31, 2014

Assets		Liabilities	
Cash	$ 47,500	Accounts Payable	$ 8,000
Accounts Receivable	26,900	Note Payable	2,850
Property and Equipment	48,000		
		Total Liabilities	10,850
		Shareholders' Equity	
		Contributed Capital	98,000
		Retained Earnings	13,550
		Total Shareholders' Equity	111,550
		Total Liabilities and	
Total Assets	$122,400	Shareholders' Equity	$122,400

Req. 2

Beginning Retained Earnings (R/E) + Net Income – Dividends = Ending R/E, so
Net Income= Ending R/E + Dividends - Beginning R/E
= $13,550 + 0 – 0
= $13,550
Net income for the year was $13,550. This is the first year of operations and no dividends were declared or paid to shareholders; therefore, retained earnings is $13,550 (which represents income for one year).

Req. 3

Most of the financing as of December 31, 2014 came from shareholders. The shareholders have financed $111,550 of the total assets and creditors have financed only $10,850 of the total assets of the company.

Req.4

Beginning Retained Earnings (R/E) + Net Income – Dividends = Ending R/E, so
Ending R/E = $13,550 + 3,000 – 2,000
= $14,550
Retained Earnings at December 31, 2015 would be $14,550.

E1-5

		Req. 1 Label	Req. 2 Type
a.	Coins, bullion, and currency	Inventory	A
b.	Amounts Collectibles Canada owes to suppliers of coins, bullion and currency	Accounts Payable	L
c.	Amounts Collectibles Canada can collect from customers	Accounts Receivable	A
d.	Amounts owed to bank for loan to buy building	Notes Payable	L
e.	Property on which buildings will be built	Land	A
f.	Amounts distributed from profits to shareholders	Dividends	SE
g.	Earned by Collectibles Canada by selling coin collecting supplies	Revenue	R
h.	Unused paper in Collectibles Canada head office	Supplies	A
i.	Cost of paper used up during month	Supplies Expense	E
j.	Amounts contributed to Collectibles Canada by shareholders	Contributed Capital	SE

E1-6

Req. 1

CINEPLEX ENTERTAINMENT
Income Statement
For the Quarter Ended June 26, 2014
(in thousands)

Revenues	
Admissions Revenues	$455,700
Concessions Revenues	188,900
Other Revenues	31,200
Total Revenues	675,800
Expenses	
Film Rental Expenses	247,000
Rent Expense	90,000
General, Selling and Administrative Expenses	65,700
Concessions Expenses	25,500
Other Expenses	233,800
Total Expenses	662,000
Net Income	$ 13,800

E1-6 (continued)

The question marks in the exercise correspond to Total Expenses of $662,000 and Net Income of $13,800, as determined above.

Req. 2

Cineplex's main source of revenue is admissions and its biggest expense is its film rental expense and other expenses.

E1-7

HOME REALTY, INCORPORATED
Income Statement
For the Year Ended December 31, 2014

Revenue:	
Sales Revenue	$166,000
Expenses:	
Selling Expenses	97,000
Promotion and Advertising Expenses	9,025
Interest Expense	6,300
Income Tax Expense	18,500
Total Expenses	130,825
Net Income	$ 35,175

Note that dividends declared are not an expense. As a distribution of the company's prior profits, they will be deducted from Retained Earnings.

E1-8

A Net Income = $100,000 - $82,000 = $18,000
Shareholders' Equity = $150,000 - $70,000 = $80,000

B Total Revenues = $80,000 + $12,000 = $92,000
Total Liabilities = $112,000 - $60,000 = $52,000

C Net Income (Loss) = $80,000 - $86,000 = $(6,000)
Shareholders' Equity = $104,000 - $26,000 = $78,000

D Total Expenses = $50,000 - $13,000 = $37,000
Total Assets = $22,000 + $77,000 = $99,000

E Total Revenues = $81,000 - $6,000 = $75,000
Total Assets = $73,000 + $28,000 = $101,000

E1-9

Req. 1

MONCTON CLAY CORPORATION
Income Statement
For the Month Ended January 31, 2014

Total Revenues	$131,000
Operating Expenses	90,500
Net Income	$ 40,500

MONCTON CLAY CORPORATION
Balance Sheet
At January 31, 2014

Assets:	
Cash	$30,800
Accounts Receivable	25,300
Supplies	40,700
Total Assets	$96,800
Liabilities:	
Accounts Payable	$25,700
Total Liabilities	25,700
Shareholders' Equity:	
Contributed Capital (2,600 shares)	30,600
Retained Earnings ***(from the income statement above)***	40,500
Total Shareholders' Equity	71,100
Total Liabilities and Shareholders' Equity	$96,800

Req. 2

Moncton Clay Corporation should have no problem paying its liabilities since it has more total assets than total liabilities. In fact, it has over three times as many total assets as liabilities ($96,800/$25,700 = 3.77 times). This means that Moncton Clay Corporation could pay its liabilities more than three times over if all assets on hand at January 31, 2014, were converted to cash. Of course, not all assets will be converted into cash right away. Even so, looking only at the amount of cash at the end of January, we see that Moncton Clay has enough cash to cover all its liabilities. This is a very strong financial position.

E1-10

Req. 1

Average monthly revenue, $216,000 ÷ 12 = $18,000

Req. 2

Average monthly salaries and wages expense, $33,000 ÷ 12 = $2,750

Req. 3

Advertising is an expense because it represents the cost of ads that were run during the period to generate revenue.

Req. 4

The dividends are not reported as an expense because they represent a distribution of prior profits to shareholders. Consequently, they appear only on the statement of retained earnings, not the income statement.

Req. 5

Standing alone, the income statement does not report, or make it possible to determine, the ending cash balance. Some revenues might not have been collected, and some expenses might not have been paid by the end of the year. The amount of cash on December 31, 2014, would be reported on the balance sheet under assets and on the cash flow statement as the final amount shown.

E1-11

(O) 1. Cash paid to suppliers and employees
O 2. Cash received from customers
F 3. Cash received from borrowing long-term debt
F 4. Cash received from issuing shares
(I) 5. Cash paid to purchase equipment

E1-12

(I) 1. Purchases of equipment
O 2. Cash received from customers
F 3. Cash received from issuing shares
(O) 4. Cash paid to suppliers and employees
(F) 5. Cash paid on notes payable
I 6. Cash received from selling equipment

ANSWERS TO COACHED PROBLEMS

CP1-1

Req. 1

NUCLEAR COMPANY
Income Statement
For the Year Ended December 31, 2014

Sales Revenue	$ 88,000
Expenses	
Operating Expenses	57,200
Other Expenses	8,850
Total Expenses	66,050
Net Income	$ 21,950

Req.2

NUCLEAR COMPANY
Statement of Retained Earnings
For the Year Ended December 31, 2014

Retained Earnings, January 1, 2014	$ 0
Add: Net Income	21,950
Subtract: Dividends	(200)
Retained Earnings, December 31, 2014	$ 21,750

Req. 3

NUCLEAR COMPANY
Balance Sheet
At December 31, 2014

Assets	
Cash	$ 12,000
Accounts Receivable	59,500
Supplies	8,000
Equipment	36,000
Total Assets	$115,500
Liabilities	
Accounts Payable	$ 30,297
Notes Payable	1,470
Total Liabilities	31,767
Shareholders' Equity	
Contributed Capital	61,983
Retained Earnings	21,750
Total Shareholders' Equity	83,733
Total Liabilities and Shareholders' Equity	$115,500

CP1-2

Req. 1

Nuclear Company's income statement reported net income of $21,950, suggesting that the company was profitable because revenues exceeded expenses.

Req. 2

Nuclear Company's statement of retained earnings reported a retained earnings balance of $21,750, after dividends of $200 had been subtracted. This suggests the company could have sustained additional dividends of $21,750, if sufficient cash were available to pay them. As it turns out, the company's balance sheet reports cash of $12,000, suggesting that only $12,000 in additional dividends could be paid (without borrowing additional cash).

Req. 3

Nuclear Company's balance sheet reports total liabilities of $31,767 and shareholders' equity of $83,733, indicating that the company is financed mainly by shareholders.

Req. 4

Nuclear Company was founded at the beginning of the year, so it began with no cash. The balance sheet reports a cash balance of $12,000 at the end of the year. The reasons for this increase of $12,000 would be shown in the statement of cash flows.

CP1-3

Req. 1

FITNESS AND FUN, INC.
Income Statement
For the Nine Months Ended September 30, 2014
(in thousands)

Gym Revenues	$575,667
Expenses	
Gym Operating Expenses	350,835
General, Selling and Administrative Expense	83,207
Advertising and Marketing Expense	23,608
Interest and Other Expenses	20,316
Income Tax Expense	38,895
Total Expenses	516,861
Net Income	$ 58,806

CP1-3 (continued)

Req. 2

FITNESS AND FUN, INC.
Statement of Retained Earnings
For the Nine Months Ended September 30, 2014
(in thousands)

Retained Earnings, January 1, 2014	$199,890
Add: Net Income	58,806
Subtract: Dividends	0
Retained Earnings, September 30, 2014	$258,696

Req. 3

FITNESS AND FUN, INC.
Balance Sheet
At September 30, 2014
(in thousands)

Assets	
Cash	$ 7,119
Accounts Receivable	5,318
Supplies	14,739
Property and Equipment	1,451,641
Other Assets	117,108
Total Assets	$1,595,925
Liabilities	
Accounts Payable	$ 102,665
Accrued Liabilities	119,482
Notes Payable	647,120
Other Liabilities	86,234
Total Liabilities	955,501
Shareholders' Equity	
Contributed Capital	381,728
Retained Earnings	258,696
Total Shareholders' Equity	640,424
Total Liabilities and Shareholders' Equity	$1,595,925

CP1-3 (continued)

Req. 4

FITNESS AND FUN, INC.
Statement of Cash Flows
For the Nine Months Ended September 30, 2014
(in thousands)

Cash Flows from Operating Activities:	
Cash received from customers	$574,824
Cash paid to suppliers and employees	(472,265)
Cash Provided by Operating Activities	102,559
Cash Flows from Investing Activities:	
Cash paid to purchase equipment	(354,255)
Cash received from sale of long-term assets	161,885
Cash Used in Investing Activities	(192,370)
Cash Flows from Financing Activities:	
Cash received from issuing common shares	9,061
Repayments of borrowings	(13,043)
Cash received from borrowings	95,558
Cash Provided by Financing Activities	91,576
Change in Cash	1,765
Beginning Cash Balance, January 1, 2014	5,354
Ending Cash Balance, September 30, 2014	$ 7,119

ANSWERS TO GROUP A PROBLEMS

PA1-1

Req. 1

HIGH POWER CORPORATION
Income Statement
For the Year Ended December 31, 2014

Sales Revenue	$91,000
Expenses	
Operating Expenses	58,700
Other Expenses	8,850
Total Expenses	67,550
Net Income	$23,450

Req.2

HIGH POWER CORPORATION
Statement of Retained Earnings
For the Year Ended December 31, 2014

Retained Earnings, January 1, 2014	$ 0
Add: Net Income	23,450
Subtract: Dividends	(1,950)
Retained Earnings, December 31, 2014	$ 21,500

Req. 3

HIGH POWER CORPORATION
Balance Sheet
At December 31, 2014

Assets	
Cash	$ 13,300
Accounts Receivable	9,550
Supplies	5,000
Equipment	86,000
Total Assets	$113,850
Liabilities	
Accounts Payable	$ 32,087
Notes Payable	1,160
Total Liabilities	33,247
Shareholders' Equity	
Contributed Capital	59,103
Retained Earnings	21,500
Total Shareholders' Equity	80,603
Total Liabilities and Shareholders' Equity	$113,850

PA1-2

Req. 1

High Power Corporation's income statement reported net income of $23,450, suggesting that the company was profitable because revenues exceeded expenses.

Req. 2

High Power Corporation's statement of retained earnings reported a retained earnings balance of $21,500, after dividends of $1,950 had been subtracted. This suggests the company could have sustained additional dividends of $21,500, if sufficient cash were available to pay them. As it turns out, the company's balance sheet reports cash of $13,300, suggesting that only $13,300 in additional dividends could be paid (without borrowing additional cash).

Req. 3

High Power Corporation's balance sheet reports total liabilities of $33,247 and shareholders' equity of $80,603, indicating that the company is financed mainly by shareholders.

Req. 4

High Power Corporation was founded at the beginning of the year, so it began with no cash. The balance sheet reports a cash balance of $13,300 at the end of the year. The reasons for this increase of $13,300 would be shown in the statement of cash flows.

PA1-3

Req. 1

COLLEGE PARK VETERINARY CLINIC
Income Statement
For the Year Ended June 30, 2014

Sales Revenue	$250,000
Expenses	
Operating Expenses	185,700
General, Selling and Administrative Expenses	53,400
Advertising and Marketing Expenses	27,800
Interest Expense	5,000
Total Expenses	271,900
Net Loss	($21,900)

PA1-3 (continued)

Req.2

COLLEGE PARK VETERINARY CLINIC
Statement of Retained Earnings
For the Year Ended June 30, 2014

Retained Earnings, July 1, 2013	$ 50,000
Add: Net Loss	(21,900)
Subtract: Dividends	(27,500)
Retained Earnings, June 30, 2014	$ 600

Req. 3

COLLEGE PARK VETERINARY CLINIC
Balance Sheet
At June 30, 2014

Assets	
Cash	$ 5,000
Accounts Receivable	125,600
Supplies	25,000
Property and Equipment	242,500
Other Assets	13,500
Total Assets	$411,600
Liabilities	
Accounts Payable	$ 87,000
Notes Payable	150,000
Other Liabilities	37,000
Total Liabilities	274,000
Shareholders' Equity	
Contributed Capital	137,000
Retained Earnings	600
Total Shareholders' Equity	137,600
Total Liabilities and Shareholder's Equity	$411,600

PA1-4

Req. 1

College Park Veterinary Clinic's income statement reported net loss of $21,900, suggesting that the company was not profitable because expenses exceeded revenues.

Req. 2

College Park Veterinary Clinic's statement of retained earnings reported a retained earnings balance of $600, after dividends of $27,500 had been subtracted. This suggests the company could have sustained additional dividends of $600, if sufficient cash were available to pay them. As it turns out, the company's balance sheet reports cash of $5,000, suggesting that additional dividends could be paid (without borrowing additional cash).

Req. 3

College Park Veterinary Clinic's balance sheet reports total liabilities of $274,000 and shareholders' equity of $137,600, indicating that the company is financed mainly by debt/creditors.

Req. 4

It is not possible to determine the amount of cash increase or decrease that would be shown in the statement of cash flows from the information presented. To determine this change, we would either require the opening cash balance at July 1, 2014, or would require the necessary information to calculate the cash from or cash used in the operating, investing and financing activities for the current year. None of this information is available in the information currently provided.

PA1-5

Req. 1

OSI RESTAURANT PARTNERS, INC.
Income Statement
For the Year Ended December 31, 2014
(in millions)

Revenues:	
Restaurant Sales Revenue	$ 3,920
Other Revenues	21
Total Revenues	3,941
Expenses:	
Food and Supplies Expenses	1,415
Utilities and Other Expenses	1,104
Wages Expense	1,087
General, Selling and Administrative Expenses	235
Total Expenses	3,841
Net Income	$ 100

PA1-5 (continued)

Req. 2

OSI RESTAURANT PARTNERS, INC.
Statement of Retained Earnings
For the Year Ended December 31, 2014
(in millions)

Retained Earnings, January 1, 2014	$1,074
Add: Net Income	100
Less: Dividends	(39)
Retained Earnings, December 31, 2014	$ 1,135

Req. 3

OSI RESTAURANT PARTNERS, INC.
Balance Sheet
At December 31, 2014
(in millions)

Assets	
Cash	$ 94
Food and Supply Inventories	87
Property, Fixtures, and Equipment	1,549
Other Assets	529
Total Assets	$ 2,259
Liabilities and Owners' Equity	
Liabilities	
Accounts Payable	$ 166
Notes Payable	235
Wages and Taxes Payable	120
Other Liabilities	517
Total Liabilities	1,038
Shareholders' Equity	
Contributed Capital	86
Retained Earnings	1,135
Total Shareholders' Equity	1,221
Total Liabilities and Shareholders' Equity	$ 2,259

PA1-5 (continued)

Req. 4

OSI RESTAURANT PARTNERS, INC.
Statement of Cash Flows
For the Year Ended December 31, 2014
(in millions)

Cash Flows from Operating Activities	
Cash received from customers	$ 2,946
Cash paid to suppliers and employees	(2,578)
Cash Provided by Operating Activities	368
Cash Flows from Investing Activities	
Cash paid to purchase equipment	(384)
Cash received from sale of fixtures and equipment	32
Other cash outflows used for investing activities	(2)
Cash Used in Investing Activities	(354)
Cash Flows from Financing Activities	
Cash received from bank borrowings	375
Common shares issued to owners	16
Repayments of bank borrowings	(294)
Dividends paid in cash	(39)
Other cash outflows used for financing activities	(62)
Cash Used in Financing Activities	(4)
Change in Cash	10
Cash at January 1, 2014	84
Cash at December 31, 2014	$ 94

ANSWERS TO GROUP B PROBLEMS

PB1-1

Req. 1

AEROSPACE EXPLORATIONS
Income Statement
For the Year Ended December 31, 2014

Sales Revenue	$ 94,000
Expenses	
Operating Expenses	60,000
Other Expenses	8,850
Total Expenses	68,850
Net Income	$ 25,150

Req. 2

AEROSPACE EXPLORATIONS
Statement of Retained Earnings
For the Year Ended December 31, 2014

Retained Earnings, January 1, 2014	$ 0
Add: Net Income	25,150
Subtract: Dividends	(1,100)
Retained Earnings, December 31, 2014	$ 24,050

Req. 3

AEROSPACE EXPLORATIONS
Balance Sheet
At December 31, 2014

Assets	
Cash	$ 13,900
Accounts Receivable	9,500
Supplies	9,000
Equipment	86,000
Total Assets	$118,400
Liabilities	
Accounts Payable	$ 30,277
Notes Payable	1,220
Total Liabilities	31,497
Shareholders' Equity	
Contributed Capital	62,853
Retained Earnings	24,050
Total Shareholders' Equity	86,903
Total Liabilities and Shareholders' Equity	$118,400

PB1-2

Req. 1

Aerospace Corporation’s income statement reported net income of $25,150, suggesting that the company was profitable because revenues exceeded expenses.

Req. 2

Aerospace Corporation’s statement of retained earnings reported a retained earnings balance of $24,050, after dividends of $1,100 had been subtracted. This suggests the company could have sustained additional dividends of $24,050, if sufficient cash were available to pay them. As it turns out, the company’s balance sheet reports cash of $13,900, suggesting that only $13,900 in additional dividends could be paid (without borrowing additional cash).

Req. 3

Aerospace Corporation’s balance sheet reports total liabilities of $31,497 and shareholders’ equity of $86,903, indicating that the company is financed mainly by shareholders.

Req. 4

Aerospace Corporation was founded at the beginning of the year, so it began with no cash. The balance sheet reports a cash balance of $13,900 at the end of the year. The reasons for this increase of $13,900 would be shown in the statement of cash flows.

PB1-3

Req. 1

ROCK POINT ADVENTURES INC.
Income Statement
For the Year Ended June 30, 2014

Revenue	
Sales Revenue	$ 143,098
Rental Revenue	34,986
Concessions Revenue	25,873
Total Revenue	203,957
Expenses	
Operating Expenses	74,390
Rent Expense	25,198
Concessions Expense	21,985
Other Expenses	4,278
Total Expenses	125,851
Net Income	$ 78,106

PB1-3 (continued)

Req. 2

ROCK POINT ADVENTURES INC.
Statement of Retained Earnings
For the Year Ended June 30, 2014

Retained Earnings, July 1, 2013	$ 53,456
Add: Net Income	78,106
Subtract: Dividends	(50,000)
Retained Earnings, June 30, 2014	$ 81,562

Req. 3

ROCK POINT ADVENTURES INC.
Balance Sheet
At June 30, 2014

Assets	
Accounts Receivable	$ 124,579
Supplies	14,356
Property and Equipment	136,897
Other Assets	3,857
Total Assets	$279,689
Liabilities	
Bank Overdraft	$ 2,058
Accounts Payable	58,973
Notes Payable	74,985
Other Liabilities	3,765
Total Liabilities	139,781
Shareholders’ Equity	
Contributed Capital	58,346
Retained Earnings	81,562
Total Shareholders’ Equity	139,908
Total Liabilities and Shareholders’ Equity	$279,689

PB1-4

Req. 1

Rock Point Adventures Inc.'s income statement reported net income of $78,106, suggesting that the company was profitable because revenues exceeded expenses.

Req. 2

Rock Point Adventures Inc.'s statement of retained earnings reported a retained earnings balance of $81,562, after dividends of $50,000 had been subtracted. This suggests the company could have sustained additional dividends of $81,562, if sufficient cash were available to pay them. As it turns out, the company's balance sheet reports bank overdraft of $2,058, suggesting that no additional dividends could be paid (without borrowing additional cash).

Req. 3

Rock Point Adventures Inc.'s balance sheet reports total liabilities of $139,781 and shareholders' equity of $139,908, indicating that the company is financed equally by shareholders and debt/creditors.

Req. 4

It is not possible to determine the amount of cash increase or decrease that would be shown in the statement of cash flows from the information presented. To determine this change, we would either require the opening cash balance at July 1, 2013, or would require the necessary information to calculate the cash from or cash used in the operating, investing and financing activities for the current year. None of this information is available in the information currently provided.

PB1-4

Req. 1

THE CHEESECAKE FACTORY
Income Statement
For the Year Ended January 2, 2014
(in thousands)

Revenues:	
Restaurant Sales Revenue	$1,315,325
Other Revenues	8,171
Total Revenues	1,323,496
Expenses:	
Wages Expenses	420,957
Utilities and Other Expenses	414,978
Food and Supplies Expense	333,528
Selling and Administrative Expenses	72,751
Total Expenses	1,242,214
Net Income	$ 81,282

Req. 2

THE CHEESECAKE FACTORY
Statement of Retained Earnings
For the Year Ended January 2, 2014
(in thousands)

Retained Earnings, Beginning	$ 440,510
Add: Net Income	81,282
Less: Dividends	(49,994)
Retained Earnings, Ending	$ 471,798

PB1-5 (continued)

Req. 3

THE CHEESECAKE FACTORY
Balance Sheet
At January 2, 2014
(in thousands)

Assets:	
Cash	$ 44,790
Accounts Receivable	11,639
Food and Supply Inventories	20,775
Prepaid Rent	43,870
Property and Equipment	732,204
Other Assets	186,453
Total Assets	$1,039,731
Liabilities and Shareholders' Equity:	
Liabilities:	
Accounts Payable	$ 45,570
Notes Payable	39,381
Wages Payable	117,226
Other Liabilities	126,012
Total Liabilities	328,189
Shareholders' Equity:	
Contributed Capital	239,744
Retained Earnings	471,798
Total Shareholders' Equity	711,542
Total Liabilities and Shareholders' Equity	$1,039,731

PB1-5 (continued)

Req. 4

THE CHEESECAKE FACTORY
Statement of Cash Flows
For the Year Ended January 2, 2014
(in thousands)

Cash Flows from Operating Activities	
Cash received from customers	$ 1,276,008
Cash paid to suppliers and employees	(1,123,353)
Cash Provided by Operating Activities	152,655
Cash Flows from Investing Activities	
Cash paid to purchase equipment	(243,211)
Cash received from sale of long-term assets	115,975
Cash Used in Investing Activities	(127,236)
Cash Flows from Financing Activities	
Additional investments by shareholders	33,555
Cash received from borrowings	175,000
Repayments of borrowings	(170,242)
Dividends paid to shareholders	(49,994)
Cash Used in Financing Activities	(11,681)
Change in Cash	13,738
Cash at January 3, 2013	31,052
Cash at January 2, 2014	$ 44,790

ANSWERS TO SKILLS DEVELOPMENT CASES

S1-1

Req. 1
Rona's income statement shows a net loss of $153,014 (thousand), which is labeled net (loss) income. Note that the amounts on the financial statements are rounded to the nearest thousand, so this is actually $153,014,000.

Req. 2

The income statement shows that the amount of sales was $4,192,192 (thousand) for the year ended December 29, 2013.

Req. 3

The Statement of Financial Position shows that inventory costing $738,752 (thousand) was on hand at December 29, 2013.

Req. 4

The balance sheet and statement of cash flows show Cash totaling $8,245 (thousand) at December 29, 2013.

Req. 5

Because Rona's shares are traded on the Toronto Stock Exchange, Rona Inc. must be a public company.

S1-2

Req. 1

The Home Depot's net earnings for the year ended February 2, 2014 was $5,385 (million). Note that the amounts on these financial statements are rounded to the nearest million, so this is actually $5,385,000,000. This is much higher than the net loss of $153,014, (thousand) earned by Rona Inc. for the year ended December 29, 2013.

Req. 2

The Home Depot's reported sales revenue of $78,812 (million) for the year ended February 2, 2014. This is again higher than the $4,192,192 (thousand) reported by Rona for the year ended December 29, 2013.

Req. 3

The Home Depot's inventory (merchandise inventories) as of February 2, 2014 was $11,057 (million). This is higher than the $738,752 (thousand) reported by Rona Inc. as of December 29, 2013.

Req. 4

The Home Depot's Cash (and Cash Equivalents) on February 2, 2014 was $1,929 (million). This is again higher than the $8,245 (thousand) reported by Rona Inc. at December 29, 2013.

Req. 5

Like Rona Inc., The Home Depot is a public company. Its shares trades on the New York Stock Exchange under the symbol HD.

Req. 6

Two measures of financial success are the company's Net Income and Sales Revenues. As noted for requirements 1 and 2, Home Depot reported much greater amounts for both of these measures, suggesting that the company was more successful during the 2013 fiscal year. It is important to note, though, that Home Depot is a much bigger company than Rona, with more locations, more inventory (see requirement 3), and more total assets. Given these differences, it is reasonable to expect that Home Depot would produce more sales and net income than Rona. Rona had a net loss in 2013 unlike the prior year in 2012. To truly determine whether Home Depot is run more successfully than Rona, a complete analysis is required. Such an analysis would take into account size differences between the two companies. (You'll learn about this kind of analysis in later chapters).

S1-3

The solutions to this case will depend on the company and/or accounting period selected for analysis.

S1-4

Req. 1

The accounting concept that the Rigas family is accused of violating is the separate entity assumption.

Req. 2

Based on the limited information available, it is difficult to categorize particular dealings as appropriate or inappropriate. Dealings would clearly be inappropriate if they involved Adelphia paying for items for the owners' personal use or to unfairly transfer some of the resources of Adelphia (and its shareholders) to the Rigas family. However, we cannot determine the propriety of the payments from the limited information available.

Req. 3

Shareholders should take at least two actions to ensure this kind of behavior does not occur or does not occur without their knowledge. First, shareholders should ensure that the managers of the business are accountable for their actions. The most common way of doing this is to appoint a board of directors who are independent of top management. These directors should review and challenge the actions taken by management and require that the financial statements disclose significant transactions with related parties. Second, shareholders should read the financial statements, including any notes describing related party transactions. Any questionable dealings should be raised with top management at the company's annual meeting. If shareholders don't receive satisfactory answers to their concerns, they should sell their investment in the company's shares.

Req. 4

Other parties that might be harmed by the actions committed by the Rigas family are creditors (such as suppliers and banks), the company's auditors, governmental agencies (such as the IRS and SEC), and the public at large.

S1-5

Req. 1

You should take the position that an *independent* annual audit of the financial statements is an absolute must. This is the best way to ensure that the financial statements are complete, are free from bias, and conform with GAAP. You should be prepared to reject the partner's uncle as the auditor because there is no evidence about his competence as an accountant or auditor. Also, he does not appear independent because he is related to the partner who prepares the financial statements, resulting in a potential conflict of interest.

Req. 2
You should strongly recommend the selection of an independent CPA in public practice because the financial statements should be audited by a competent and independent professional who must follow prescribed accounting and auditing standards on a strictly independent basis. An audit by an uncle would not meet these requirements.

S1-6

Req. 1

A balance sheet lists items owned (assets) and owed (liabilities) at a particular point in time, producing a "net worth" that represents the excess of assets over liabilities. Two balance sheets are presented below, one based on historical costs (similar to GAAP) and one based on market values (similar to a personal financial planning approach). Notes for these balance sheets also are presented, along with a conclusion about which individual is better off.

Based on historical cost:

Ashley		**Jason**	
Assets		Assets	
Cash	$ 1,000	Cash	$ 6,000
Vintage Car	800	PlayStation Console	350
Total Assets	1,800	Total Assets	6,350
Liabilities		Liabilities	
Car Loan	250	Tuition Payable	800
Total Liabilities	250	Student Loan	4,800
		Total Liabilities	5,600
Net Worth	$ 1,550	Net Worth	$ 750

S1-6 (continued):

Req. 1 (continued)

Based on market value:

Ashley		**Jason**	
Assets		Assets	
Cash	$ 1,000	Cash	$ 6,000
Vintage Car	1,400	PlayStation Console	280
Total Assets	2,400	Total Assets	6,280
Liabilities		Liabilities	
Car Loan	250	Tuition Payable	800
Total Liabilities	250	Student Loan	4,800
		Total Liabilities	5,600
Net Worth	$ 2,150	Net Worth	$ 680

The notes are an important part of these balance sheets.

Notes:

1) The goal in preparing these balance sheets is to estimate each individual's net worth, represented as the excess of assets over liabilities.
2) Use of historical cost is consistent with generally accepted accounting principles. Note that these asset values have not been adjusted for "value" consumed through use, which is not consistent with generally accepted accounting principles. The market value balance sheets are based on the estimated current values of assets, some of which are greater and others less than their cost.
3) Some potential assets (e.g., Porsche) are not recorded because their likelihood of occurrence is not certain.

Req. 2

Based on the calculations of net worth and underlying assumptions indicated above, Ashley is "better off" because her net worth ($1,550 or $2,150) is greater than Jason's ($750 or $680). As a creditor, it would be better to lend money to Ashley because she has a greater net worth and earnings potential seeing she has a job. Note that choosing between historical cost and market values inevitably requires trading off the reliability of accounting information (cost is not as subjective as market) and the potential relevance of that information (market values may be more relevant when determining an individual's net worth).

S1-6 (continued):

Req. 3

An income statement lists the amounts earned (revenues) and costs incurred (expenses) during a particular period of time, producing "net income" that represents the excess of revenues over expenses. An income statement is presented below for both Ashley and Jason. Notes for these income statements are presented below, along with a conclusion about which individual is more successful.

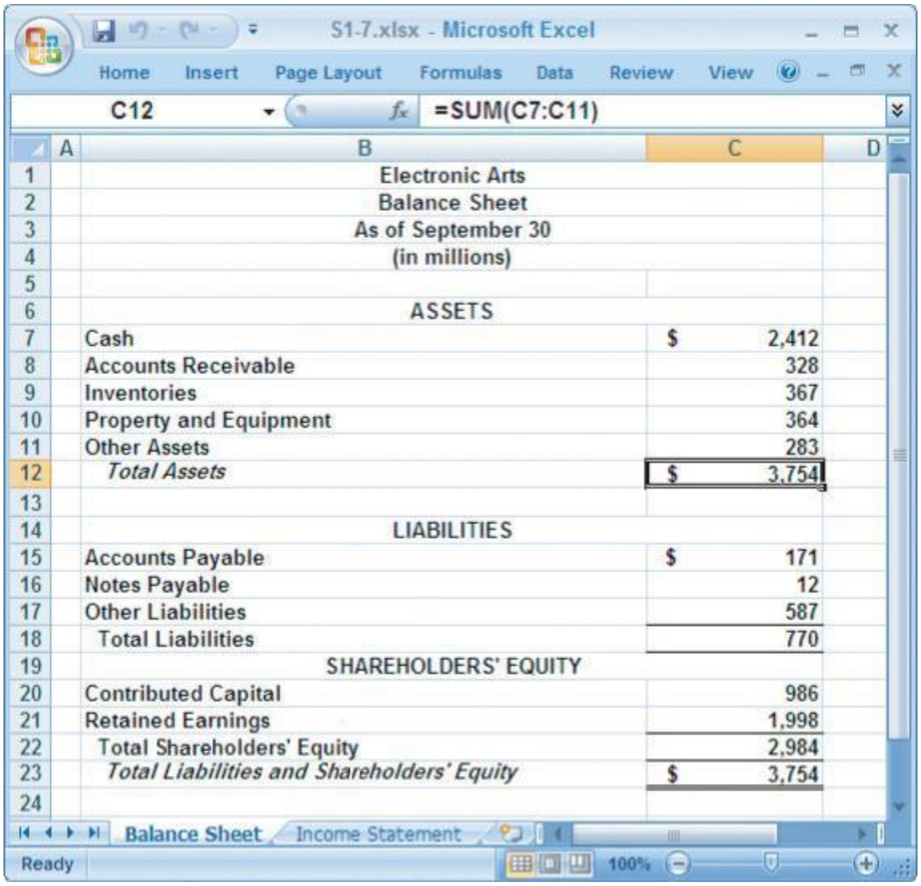
Ashley		**Jason**	
Revenue		Revenue	
Part Time Job (for October)	$ 1,500	Lottery Ticket Winnings	$ 1,950
Expenses		Expenses	
Rent Expense (for October)	470	Rent Expense (for Oct)	800
Living Expenses (for October)	950	Living Expenses (for Oct)	950
Total Expenses	1, 420	Total Expenses	1,750
Net Income	$ 80	Net Income	$ 200

Notes:
1) Jason's lottery ticket winnings are not likely to recur in the future.
2) Income taxes are not reported (although they may apply to Ashley but not Jason as lottery winnings are not taxed in Canada).

Req.4

Conclusion:
Based on the net income numbers alone, Jason was more successful in the current period. However, his revenues are likely to be non-recurring, whereas Ashley's appear more stable and likely to recur in the future. For this reason, one might conclude that Ashley actually was more successful, but that the current period's net income does not yet reflect this greater success. As a long-term creditor, it would be better to lend money to Ashley as she has a more stable source of income to meet future expenses. Notice that you should not reach a conclusion based only on the numbers.

S1-7



	A	B	C
1		Electronic Arts	
2		Balance Sheet	
3		As of September 30	
4		(in millions)	
5			
6		ASSETS	
7		Cash	$ 2,412
8		Accounts Receivable	328
9		Inventories	367
10		Property and Equipment	364
11		Other Assets	283
12		*Total Assets*	$ 3,754
13			
14		LIABILITIES	
15		Accounts Payable	$ 171
16		Notes Payable	12
17		Other Liabilities	587
18		Total Liabilities	770
19		SHAREHOLDERS' EQUITY	
20		Contributed Capital	986
21		Retained Earnings	1,998
22		Total Shareholders' Equity	2,984
23		*Total Liabilities and Shareholders' Equity*	$ 3,754
24			

S1-7 (continued)

Electronic Arts
Income Statement
For the Period Ending September 30
(in millions)

Revenue	
Sales	$ 675
Expenses	
Cost of Goods Sold Expense	284
Selling Expense	223
Promotion Expense	107
Income Tax Expense	9
Other Expenses	1
Total Expenses	624
Net Income	$ 51

ANSWERS TO CONTINUING CASE

CC1-1

Req. 1

NICOLE'S GETAWAY SPA
Income Statement (forecasted)
For the Year Ended December 31, 2014

Sales Revenue	$ 40,000
Expenses:	
Wages Expense	24,000
Supplies Expense	7,000
Selling and Administrative Expenses	5,000
Income Tax Expense	1,600
Total Expenses	37,600
Net Income	$ 2,400

CC1-1 (continued)

Req. 2

NICOLE'S GETAWAY SPA Statement of
Retained Earnings (forecasted) For the Year
Ended December 31, 2014

Retained Earnings, January 1, 2014	$ 0
Add: Net Income	2,400
Subtract: Dividends	(2,000)
Retained Earnings, December 31, 2014	$ 400

Req. 3

NICOLE'S GETAWAY SPA
Balance Sheet (forecasted)
At December 31, 2014

Assets:	
Cash	$ 2,150
Accounts Receivable	1,780
Property, Plant and Equipment	70,000
Total Assets	$73,930
Liabilities:	
Accounts Payable	$ 4,660
Notes Payable	38,870
Total Liabilities	43,530
Shareholders' Equity:	
Contributed Capital	30,000
Retained Earnings	400
Total Shareholders' Equity	30,400
Total Liabilities and Shareholders' Equity	$73,930

Req. 4

As of December 31, 2014, more financing is expected to come from creditors ($43,530) than from shareholders ($30,400).