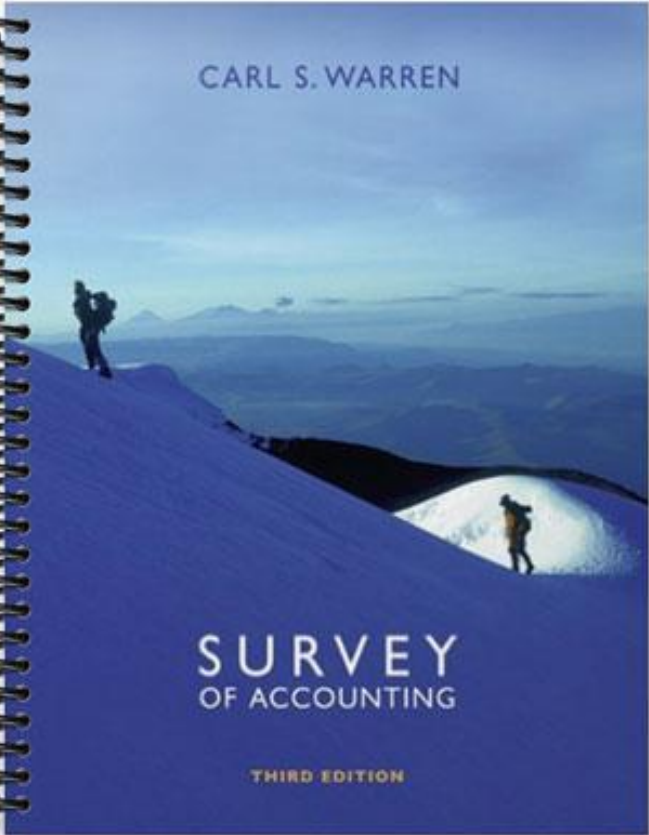


SOLUTIONS MANUAL



CARL S. WARREN



SURVEY
OF ACCOUNTING

THIRD EDITION

CHAPTER 2

BASIC ACCOUNTING CONCEPTS

CLASS DISCUSSION QUESTIONS

1. The basic elements of a financial accounting system include (1) a set of rules for determining what, when, and the amount that should be recorded for economic events, (2) a framework for facilitating preparation of financial statements, and (3) one or more controls to determine whether errors may have arisen in the recording process. These elements apply to all businesses from a local restaurant to General Motors. All businesses require a financial reporting system so that financial statements can be provided to stakeholders.
2.
 - a. Purchase of land for cash affects only assets.
 - b. Payment of a liability affects assets and liabilities; receipt of cash for fees earned affects assets and stockholders' equity.
 - c. Incurring an expense that is partially paid in cash decreases assets, increases liabilities, and decreases stockholders' equity (retained earnings). For example, assume that a business hires a lawyer for \$20,000 to draft and file the necessary documents to start and incorporate the business. The business pays the lawyer \$8,000 and agrees to pay the remaining \$12,000 over the next several months. This transaction would decrease assets (\$8,000), increase liabilities (\$12,000), and decrease stockholders' equity (retained earnings) by \$20,000. The expense is an organizational expense.
Likewise, a new business might hire a new chief operating officer by agreeing to pay a nonrefundable, noncancellable, signing bonus of \$40,000, with \$15,000 due at signing and the remainder due in four installments. This transaction would decrease assets (\$15,000), increase liabilities (\$25,000), and decrease stockholders' equity (retained earnings) by \$40,000. The expense is salary expense or bonus expense.
3. Out of balance. Assets are correct, but retained earnings (wages expense) should have been decreased by \$6,750 rather than \$6,570. Thus, retained earnings is overstated by \$180, and total liabilities plus stockholders' equity would exceed total assets by \$180.
4.
 - a. Out of balance. Assets are overstated by \$45,000 (\$50,000 – \$5,000), and, thus, total assets would exceed total liabilities plus stockholders' equity by \$45,000.
 - b. In balance. Even though liabilities and stockholders' equity are incorrect, the accounting equation balances. For this error, liabilities are overstated by \$7,500, and retained earnings (fees earned) are understated by \$7,500; thus, the over- and understatements offset each other, and the accounting equation balances.
5. A control for determining the accuracy of record keeping is the equality of the accounting equation.
6. Total assets are increased by \$55,000: an increase in cash of \$80,000 and a decrease in land of \$25,000. Stockholders' equity (retained earnings) is increased by \$55,000, the gain on the sale of the land.
7.
 - a. The payment of \$30,000 of dividends decreases total assets (decrease in cash) and decreases stockholders' equity (decrease in retained earnings). This transaction does not affect liabilities.
 - b. Net income is not affected by the payment of dividends. Dividends are a distribution of income to stockholders and are not an expense.
8.
 - a. The equality of the accounting equation would not be affected. That is, the accounting equation would still balance.
 - b. On the income statement, total operating expenses (salary expense) would be overstated by \$11,500, and net income would be understated by \$11,500. On the retained earnings statement, the beginning and ending retained earnings would be correct. However, net income and dividends would be understated by \$11,500. These understatements offset one another, and, thus, ending retained earnings is correct. The balance sheet is not affected by the error. On the statement of cash flows, net cash flows from

operating activities is understated, since cash paid for salary expense is overstated. In addition, net cash flows from financing activities is overstated, since cash paid for dividends is understated. The understatement of net cash flows from operating activities is offset by the overstatement of net cash flows from financing activities, and, thus, the net increase or decrease in cash for the period is correct, as is the ending cash balance.

9. a. The equality of the accounting equation would not be affected. That is, the accounting equation would still balance.
- b. On the income statement, revenues (fees earned) would be overstated by \$80,000, and net income would be overstated by \$80,000. On the retained earnings statement, the beginning retained earnings would be correct. However, net income and ending retained earnings would be overstated by \$80,000. The balance sheet total assets is correct. However, liabilities (notes payable) is understated by \$80,000, and stockholders' equity (retained earnings) is overstated by \$80,000. The understatement of liabilities is offset by the overstatement of stockholders' equity, and, thus, total liabilities and stockhold-

ers' equity is correct. On the statement of cash flows, net cash flows from operating activities is overstated, since cash received from fees earned is overstated. In addition, net cash flows from financing activities is understated, since cash received from borrowing (notes payable) is understated. The overstatement of net cash flows from operating activities is offset by the understatement of net cash flows from financing activities, and, thus, the net increase or decrease in cash for the period is correct, as is the ending cash balance.

10. a. \$212,500 (\$562,500 – \$350,000), the same as the stockholders' equity as of January 1, 2007.
- b. Stockholders' equity as of
- | | |
|---------------------------------|------------------|
| December 31, 2007 | \$281,250 |
| Less stockholders' equity as of | |
| January 1, 2007 | <u>212,500</u> |
| Net income..... | <u>\$ 68,750</u> |
11. Change in stockholders' equity
- | | |
|-------------------------|-----------------|
| (see Question 10) | \$68,750 |
| Plus dividends | <u>22,500</u> |
| Net income..... | <u>\$91,250</u> |

EXERCISES

Ex. 2-1

- a. \$193,000 ($\$50,000 + \$143,000$)
- b. \$135,500 ($\$165,500 - \$30,000$)
- c. \$39,000 ($\$74,000 - \$35,000$)

Ex. 2-2

- a. \$23,791 ($\$49,988 - \$26,197$)
- b. \$1,624 increase ($\$3,914 - \$2,290$)
- c. Total assets = \$53,902 ($\$49,988 + \$3,914$)
Total liabilities = \$27,821 ($\$26,197 + \$1,624$)
Total stockholders' equity = \$26,081 ($\$23,791 + \$2,290$)
- d. Yes. [$\$53,902$ (total assets) = $\$27,821$ (total liabilities) + $\$26,081$ (total stockholders' equity)]

Ex. 2-3

- a. \$387 ($\$6,205 - \$5,818$)
- b. \$487 increase ($\$470 + \17)
- c. Total assets = \$6,675 ($\$6,205 + \470)
Total liabilities = \$5,801 ($\$5,818 - \17)
Total stockholders' equity = \$874 ($\$387 + \487)
- d. Yes. [$\$6,675$ (total assets) = $\$5,801$ (total liabilities) + $\$874$ (total stockholders' equity)]

Ex. 2-4

- (a) \$423,239 (\$451,877 – \$28,638)**
- (b) \$25,268 (\$448,507 – \$423,239)**
- (c) \$479,603 (\$448,507 + \$31,096)**
- (d) \$27,726 (\$479,603 – \$451,877) or (\$25,268 + \$2,458)**
- (e) \$27,342 (\$31,327 – \$3,985)**
- (f) \$13,252 (\$15,392 – \$2,140) or (\$27,342 – \$14,090)**
- (g) \$3,985 (\$1,845 + \$2,140)**
- (h) \$1,845 (\$15,935 – \$14,090)**
- (i) \$15,392 (\$31,327 – \$15,935)**

Ex. 2-5

- a. \$275,000 (\$475,000 – \$200,000)**
- b. \$310,000 (\$275,000 + \$75,000 – \$40,000)**
- c. \$233,000 (\$275,000 – \$15,000 – \$27,000)**
- d. \$465,000 (\$275,000 + \$125,000 + \$65,000)**
- e. Net income: \$45,000 (\$425,000 – \$105,000 – \$275,000)**

Ex. 2-6

- | | |
|------------------|-----------------|
| a. (3) No effect | f. (1) Increase |
| b. (2) Decrease | g. (2) Decrease |
| c. (2) Decrease | h. (2) Decrease |
| d. (3) No effect | i. (1) Increase |
| e. (3) No effect | j. (2) Decrease |

Ex. 2-7

- a. Increases assets and increases stockholders' equity.
- b. Increases assets and increases liabilities.
- c. Decreases assets and decreases stockholders' equity.
- d. Increases assets and increases stockholders' equity.
- e. Increases assets and decreases assets.

Ex. 2-8

- (1) Total assets increased \$50,000.
- (2) Total liabilities decreased \$30,000.
- (3) Stockholders' equity increased \$80,000.

Ex. 2-9

- | | |
|--------|--------|
| 1. (b) | 4. (a) |
| 2. (b) | 5. (b) |
| 3. (a) | |

Ex. 2-10

- | | |
|--------|---------|
| 1. (c) | 6. (a) |
| 2. (c) | 7. (e) |
| 3. (d) | 8. (a) |
| 4. (c) | 9. (e) |
| 5. (e) | 10. (e) |

Ex. 2-11

- a. (1) Sale of catering services for cash, \$25,000.
(2) Purchase of land for cash, \$10,000.
(3) Payment of expenses, \$16,000.
(4) Payment of cash dividends, \$3,000.
- b. (\$4,000) (\$18,000 – \$14,000)
- c. \$6,000 (\$63,000 – \$57,000)
- d. \$9,000 (\$25,000 – \$16,000)
- e. \$6,000 (\$9,000 – \$3,000)
- f. \$9,000 (\$25,000 – \$16,000)
- g. – \$10,000 for purchase of land
- h. – \$3,000 for payment of dividends

Ex. 2-12

It would be incorrect to say that the business had incurred a net loss of \$21,750. The excess of the dividends over the net income for the period is a decrease in the amount of retained earnings in the corporation.

Ex. 2-13

Company E

Stockholders' equity at end of year (\$776,000 – \$340,000).....	\$436,000
Stockholders' equity at beginning of year (\$420,000 – \$176,000).....	<u>244,000</u>
Net income (increase in stockholders' equity).....	<u>\$192,000</u>

Company F

Increase in stockholders' equity (as determined for E)	\$192,000
Add dividends	<u>40,000</u>
Net income	<u>\$232,000</u>

Company G

Increase in stockholders' equity (as determined for E)	\$192,000
Deduct issuance of additional capital stock.....	<u>60,000</u>
Net income	<u>\$132,000</u>

Company H

Increase in stockholders' equity (as determined for E)	\$192,000
Deduct issuance of additional capital stock.....	<u>60,000</u>
	\$132,000
Add dividends	<u>40,000</u>
Net income	<u>\$172,000</u>

Ex. 2-14

O. Stockholders' equity at end of year (\$675,000 – \$375,000)	\$ 300,000
Stockholders' equity at beginning of year (\$300,000 – \$195,000)	105,000
Increase in stockholders' equity	\$ 195,000
Deduct increase due to net income (\$187,500 – \$135,000)	52,500
	\$ 142,500
Add dividends	30,000
Additional issue of capital stock.....	(a) \$ 172,500
P. Stockholders' equity at end of year (\$250,000 – \$70,000)	\$ 180,000
Stockholders' equity at beginning of year (\$190,000 – \$90,000).	100,000
Increase in stockholders' equity	\$ 80,000
Add dividends	16,000
	\$ 96,000
Deduct additional issue of capital stock.....	44,000
Increase due to net income.....	\$ 52,000
Add expenses.....	104,000
Revenue	(b) \$ 156,000
Q. Stockholders' equity at end of year (\$120,000 – \$105,000)	\$ 15,000
Stockholders' equity at beginning of year (\$100,000 – \$80,000).	20,000
Decrease in stockholders' equity	\$ (5,000)
Deduct decrease due to net loss (\$175,000 – \$177,000).....	(2,000)
	\$ (3,000)
Deduct additional issue of capital stock.....	10,000
Dividends	(c) \$ (13,000)
R. Stockholders' equity at end of year (\$930,000 – \$510,000)	\$ 420,000
Add decrease due to net loss (\$420,000 – \$480,000).....	60,000
	\$ 480,000
Add dividends	225,000
	\$ 705,000
Deduct additional issue of capital stock.....	150,000
	\$ 555,000
Add liabilities at beginning of year.....	450,000
Assets at beginning of year.....	(d) \$1,005,000

Ex. 2–15

a. \$388 increase (\$5,642 – \$5,254)

b. Net income of \$647 million is computed as follows:

Increase in retained earnings during 2004	\$388
Plus dividends	<u>259</u>
Net income for 2004	<u>\$647</u>

Ex. 2–16

a. **THORSTAD INTERIORS**
Balance Sheet
June 30, 2007

<u>Assets</u>		
Cash		\$ 54,000
Land		<u>51,000</u>
Total assets		<u>\$105,000</u>
<u>Liabilities</u>		
Notes payable.....		\$ 30,000
<u>Stockholders' Equity</u>		
Capital stock.....	\$18,000	
Retained earnings.....	<u>57,000</u>	<u>75,000</u>
Total liabilities and stockholders' equity.....		<u>\$105,000</u>

THORSTAD INTERIORS
Balance Sheet
July 31, 2007

<u>Assets</u>		
Cash		\$ 81,000
Land		<u>75,000</u>
Total assets		<u>\$156,000</u>
<u>Liabilities</u>		
Notes payable.....		\$ 45,000
<u>Stockholders' Equity</u>		
Capital stock.....	\$27,000	
Retained earnings.....	<u>84,000</u>	<u>111,000</u>
Total liabilities and stockholders' equity.....		<u>\$156,000</u>

Ex. 2–16, Concluded

b. Retained earnings, July 31	\$84,000
Retained earnings, June 30	<u>57,000</u>
Increase in retained earnings	\$27,000
Add dividends	<u>6,000</u>
Net income	<u>\$33,000</u>
c. \$33,000 [(f) \$27,000 – (e) \$18,000 + (d) \$24,000]	
d. – \$24,000, the increase in the land	
e. \$18,000, the increase in capital stock (\$9,000) plus the increase in notes payable (\$15,000) less the dividends (\$6,000)	
f. \$27,000 (\$81,000 – \$54,000)]	

Ex. 2–17

**THREE RIVERS REALTY, INC.
Income Statement
For the Month Ending November 30, 2007**

Revenues:	
Sales commissions.....	\$49,500
Expenses:	
Salaries expense.....	\$9,000
Utilities expense.....	7,500
Rent expense.....	6,000
Interest expense.....	2,000
Miscellaneous expense	<u>2,500</u>
Total expenses.....	<u>27,000</u>
Net income	<u>\$22,500</u>

Ex. 2-18

THREE RIVERS REALTY, INC.
Retained Earnings Statement
For the Month Ending November 30, 2007

Net income	\$22,500
Less dividends	<u>4,000</u>
Retained earnings, November 30, 2007	<u>\$18,500</u>

Ex. 2-19

THREE RIVERS REALTY, INC.
Balance Sheet
November 30, 2007

<u>Assets</u>		
Cash		\$21,500
Land.....		<u>37,000</u>
Total assets		<u>\$58,500</u>
<u>Liabilities</u>		
Notes payable		\$30,000
<u>Stockholders' Equity</u>		
Capital stock.....	\$10,000	
Retained earnings	<u>18,500</u>	
Total stockholders' equity		<u>28,500</u>
Total liabilities and stockholders' equity		<u>\$58,500</u>

Ex. 2-20

THREE RIVERS REALTY, INC.
Statement of Cash Flows
For the Month Ending November 30, 2007

Cash flows from operating activities:		
Cash receipts from operating activities.....	\$ 49,500	
Cash payments for operating activities	<u>27,000</u>	
Net cash flows from operating activities.....		\$ 22,500
Cash flows from investing activities:		
Cash payments for land		(37,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock	\$ 10,000	
Cash receipts from notes payable.....	30,000	
Cash payments for dividends	<u>(4,000)</u>	
Net cash flows from financing activities		<u>36,000</u>
Net increase in cash during November		\$ 21,500
Cash as of November 1, 2007.....		<u>0</u>
Cash as of November 30, 2007.....		<u><u>\$ 21,500</u></u>

Ex. 2–21

- a. Increase in assets and increase in stockholders' equity.
- b. Decrease in assets and decrease in liabilities.
- c. Increase in assets, decrease in assets, and increase in stockholders' equity.
- d. Decrease in assets and decrease in stockholders' equity.
- e. Increase in assets and increase in stockholders' equity.
- f. Increase in assets and increase in liabilities.
- g. Decrease in assets and decrease in stockholders' equity.
- h. Decrease in assets and decrease in stockholders' equity.
- i. Decrease in assets and decrease in stockholders' equity.
- j. Increase in assets and decrease in assets.
- k. Decrease in assets and decrease in stockholders' equity.
- l. Decrease in assets and decrease in stockholders' equity.

Ex. 2–22

- | | |
|----------------------|----------------------|
| a. financing section | g. operating section |
| b. financing section | h. operating section |
| c. investing section | i. operating section |
| d. financing section | j. investing section |
| e. operating section | k. operating section |
| f. financing section | l. operating section |

PROBLEMS

Prob. 2-1

1.

Statement of Cash Flows	Balance Sheet					Income Statement
	Assets		=	Liabilities + Stockholders' Equity		
	Cash	+ Land	=	Notes Payable	+ Capital Stock	
a. Investment	18,000				18,000	
b. Issued note payable	10,000			10,000		
Balances	28,000			10,000	18,000	
c. Fees earned	9,500					9,500
Balances	37,500			10,000	18,000	9,500
d. Rent expense	-2,000					-2,000
Balances	35,500			10,000	18,000	7,500
e. Paid expenses	-1,400					-1,400
Balances	34,100			10,000	18,000	6,100
f. Paid salary expense	-1,200					-1,200
Balances	32,900			10,000	18,000	4,900
g. Paid interest expense	-80					-80
Balances	32,820			10,000	18,000	4,820
h. Purchased land	-19,500	19,500				
Balances	13,320	19,500		10,000	18,000	4,820
i. Paid dividends	-2,500					-2,500
Balances, July 31	10,820	19,500		10,000	18,000	2,320

<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Statement of Cash Flows</th> </tr> </thead> <tbody> <tr> <td style="width: 60%;">Financing</td> <td style="text-align: right;">18,000</td> </tr> <tr> <td>Financing</td> <td style="text-align: right;">10,000</td> </tr> <tr> <td>Operating</td> <td style="text-align: right;">9,500</td> </tr> <tr> <td>Operating</td> <td style="text-align: right;">-2,000</td> </tr> <tr> <td>Operating</td> <td style="text-align: right;">-1,400</td> </tr> <tr> <td>Operating</td> <td style="text-align: right;">-1,200</td> </tr> <tr> <td>Operating</td> <td style="text-align: right;">-80</td> </tr> <tr> <td>Investing</td> <td style="text-align: right;">-19,500</td> </tr> <tr> <td>Financing</td> <td style="text-align: right;"><u>-2,500</u></td> </tr> <tr> <td>Increase in cash</td> <td style="text-align: right;"><u>10,820</u></td> </tr> </tbody> </table>	Statement of Cash Flows		Financing	18,000	Financing	10,000	Operating	9,500	Operating	-2,000	Operating	-1,400	Operating	-1,200	Operating	-80	Investing	-19,500	Financing	<u>-2,500</u>	Increase in cash	<u>10,820</u>		<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Income Statement</th> </tr> </thead> <tbody> <tr> <td style="width: 60%;">c. Fees earned</td> <td style="text-align: right;">9,500</td> </tr> <tr> <td>d. Rent expense</td> <td style="text-align: right;">-2,000</td> </tr> <tr> <td>e. Auto expense</td> <td style="text-align: right;">-1,000</td> </tr> <tr> <td>e. Misc. expense</td> <td style="text-align: right;">-400</td> </tr> <tr> <td>f. Salary expense</td> <td style="text-align: right;">-1,200</td> </tr> <tr> <td>g. Interest expense</td> <td style="text-align: right;"><u>-80</u></td> </tr> <tr> <td>Net income</td> <td style="text-align: right;"><u>4,820</u></td> </tr> </tbody> </table>	Income Statement		c. Fees earned	9,500	d. Rent expense	-2,000	e. Auto expense	-1,000	e. Misc. expense	-400	f. Salary expense	-1,200	g. Interest expense	<u>-80</u>	Net income	<u>4,820</u>
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g. Interest expense	<u>-80</u>																																							
Net income	<u>4,820</u>																																							

2. Stockholders' equity is the right of stockholders to the assets of the business. These rights are increased by stockholders' investments and revenues and decreased by dividends and expenses.

Prob. 2–1, Continued

3. **WOODALL INSURANCE, INC.**
Income Statement
For the Month Ending July 31, 2007

Revenues:		
Fees earned.....		\$9,500
Expenses:		
Rent expense	\$2,000	
Salaries expense	1,200	
Automotive expense	1,000	
Interest expense	80	
Miscellaneous expense.....	<u>400</u>	
Total expenses		<u>4,680</u>
Net income		<u>\$4,820</u>

WOODALL INSURANCE, INC.
Retained Earnings Statement
For the Month Ending July 31, 2007

Net income	\$4,820
Less dividends.....	<u>2,500</u>
Retained earnings, July 31, 2007.....	<u>\$2,320</u>

4. **WOODALL INSURANCE, INC.**
Balance Sheet
July 31, 2007

<u>Assets</u>		
Cash		\$10,820
Land		<u>19,500</u>
Total assets		<u>\$30,320</u>
<u>Liabilities</u>		
Notes payable.....		\$10,000
<u>Stockholders' Equity</u>		
Capital stock.....	\$18,000	
Retained earnings.....	<u>2,320</u>	
Total stockholders' equity		<u>20,320</u>
Total liabilities and stockholders' equity.....		<u>\$30,320</u>

Prob. 2–1, Concluded

5.

WOODALL INSURANCE, INC.
Statement of Cash Flows
For the Month Ending July 31, 2007

Cash flows from operating activities:		
Cash receipts from operating activities	\$ 9,500	
Cash payments for operating activities.....	<u>4,680</u>	
Net cash flows from operating activities		\$ 4,820
Cash flows from investing activities:		
Cash payment for land.....		(19,500)
Cash flows from financing activities:		
Cash receipts from issuing capital stock.....	\$18,000	
Cash receipts from note payable	10,000	
Cash payments for dividends.....	<u>(2,500)</u>	
Net cash flows from financing activities.....		<u>25,500</u>
Net increase in cash during July		\$ 10,820
Cash as of July 1, 2007.....		<u>0</u>
Cash as of July 31, 2007.....		<u><u>\$ 10,820</u></u>

Prob. 2-2

1. **TOP-GUN COMPUTER SERVICES**
Income Statement
For the Month Ended January 31, 2007

Fees earned		\$15,000
Operating expenses:		
Salaries expense	\$3,500	
Rent expense	2,500	
Automobile expense	950	
Miscellaneous expense.....	<u>700</u>	
Total operating expenses		<u>7,650</u>
Net income		<u>\$ 7,350</u>

2. **TOP-GUN COMPUTER SERVICES**
Retained Earnings Statement
For the Month Ended January 31, 2007

Net income for January	\$7,350
Less dividends	<u>1,500</u>
Retained earnings, January 31, 2007	<u>\$5,850</u>

3. **TOP-GUN COMPUTER SERVICES**
Balance Sheet
January 31, 2007

<u>Assets</u>		
Cash		\$10,850
Land		<u>30,000</u>
Total assets		<u>\$40,850</u>
<u>Liabilities</u>		
Notes payable.....		\$10,000
<u>Stockholders' Equity</u>		
Capital stock.....	\$25,000	
Retained earnings.....	<u>5,850</u>	
Total stockholders' equity		<u>30,850</u>
Total liabilities and stockholders' equity		<u>\$40,850</u>

Prob. 2–2, Concluded

4.

TOP-GUN COMPUTER SERVICES
Statement of Cash Flows
For the Month Ended January 31, 2007

Cash flows from operating activities:		
Cash receipts from operating activities	\$15,000	
Cash payments for operating activities.....	<u>7,650</u>	
Net cash flows from operating activities		\$ 7,350
Cash flows from investing activities:		
Cash payments for land		(30,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock	\$25,000	
Cash receipts from notes payable	10,000	
Cash payments for dividends.....	<u>(1,500)</u>	
Net cash flows from financing activities.....		<u>33,500</u>
Net increase in cash during January		\$ 10,850
Cash as of January 1, 2007		<u>0</u>
Cash as of January 31, 2007		<u>\$ 10,850</u>

Prob. 2–3

1.

LISKO SERVICES, INC.
Income Statement
For the Year Ending December 31, 2007

Revenues:	
Fees earned.....	\$321,300
Expenses:	
Salaries expense	\$91,000
Utilities expense	44,800
Rent expense	33,600
Taxes expense	25,200
Interest expense	1,680
Miscellaneous expense.....	<u>9,520</u>
Total expenses	<u>205,800</u>
Net income	<u>\$115,500</u>

2.

LISKO SERVICES, INC.
Retained Earnings Statement
For the Year Ending December 31, 2007

Net income	\$115,500
Less dividends	<u>7,000</u>
Retained earnings, December 31, 2007.....	<u>\$108,500</u>

Prob. 2–3, Concluded

3.

LISKO SERVICES, INC.
Balance Sheet
December 31, 2007

<u>Assets</u>		
Cash		\$ 38,500
Land		<u>105,000</u>
Total assets		<u>\$143,500</u>
 <u>Liabilities</u>		
Notes payable.....		\$ 21,000
 <u>Stockholders' Equity</u>		
Capital stock.....	\$ 14,000	
Retained earnings.....	<u>108,500</u>	
Total stockholders' equity		<u>122,500</u>
Total liabilities and stockholders' equity		<u>\$143,500</u>

4.

LISKO SERVICES, INC.
Statement of Cash Flows
For the Year Ending December 31, 2007

Cash flows from operating activities:		
Cash receipts from operating activities	\$321,300	
Cash payments for operating activities.....	<u>205,800</u>	
Net cash flows from operating activities		\$ 115,500
Cash flows from investing activities:		
Cash payments for land		(105,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock.....	\$ 14,000	
Cash receipts from notes payable	21,000	
Cash payments for dividends.....	<u>(7,000)</u>	
Net cash flows from financing activities.....		<u>28,000</u>
Net increase in cash during the year		\$ 38,500
Cash as of January 1, 2007		<u>0</u>
Cash as of December 31, 2007.....		<u>\$ 38,500</u>

Prob. 2-4

1. **LISKO SERVICES, INC.**
Income Statement
For the Year Ending December 31, 2008

Revenues:		
Fees earned.....		\$355,740
Expenses:		
Salaries expense	\$98,000	
Utilities expense	50,400	
Rent expense	39,200	
Taxes expense	28,000	
Interest expense	2,240	
Miscellaneous expense.....	<u>9,800</u>	
Total expenses		<u>227,640</u>
Net income		<u>\$128,100</u>

2. **LISKO SERVICES, INC.**
Retained Earnings Statement
For the Year Ending December 31, 2008

Retained earnings, January 1, 2008		\$108,500
Net income	\$128,100	
Less dividends	<u>21,000</u>	
Increase in retained earnings		<u>107,100</u>
Retained earnings, December 31, 2008.....		<u>\$215,600</u>

Prob. 2–4, Concluded

3.

LISKO SERVICES, INC.
Balance Sheet
December 31, 2008

<u>Assets</u>		
Cash		\$ 82,600
Land		<u>196,000</u>
Total assets		<u>\$278,600</u>
 <u>Liabilities</u>		
Notes payable.....		\$ 28,000
 <u>Stockholders' Equity</u>		
Capital stock.....	\$ 35,000	
Retained earnings.....	<u>215,600</u>	
Total stockholders' equity		<u>250,600</u>
Total liabilities and stockholders' equity		<u>\$278,600</u>

4.

LISKO SERVICES, INC.
Statement of Cash Flows
For the Year Ending December 31, 2008

Cash flows from operating activities:		
Cash receipts from operating activities	\$355,740	
Cash payments for operating activities.....	<u>227,640</u>	
Net cash flows from operating activities		\$128,100
Cash flows from investing activities:		
Cash payment for land.....		(91,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock.....	\$ 21,000	
Cash receipts from notes payable	7,000	
Cash payments for dividends.....	<u>(21,000)</u>	
Net cash flows from financing activities.....		<u>7,000</u>
Net increase in cash during the year		\$ 44,100
Cash as of January 1, 2008		<u>38,500</u>
Cash as of December 31, 2008.....		<u>\$ 82,600</u>

Prob. 2–5

- a. **\$19,500 (net income for July, \$8,250, plus total operating expenses; also, the amount of cash received from customers on the statement of cash flows.)**
- b. **\$1,770 ($\$11,250 - \$9,480$)**
- c. **\$8,250 ($\$19,500 - \$11,250$); also, see the net income for July on the retained earnings statement.**
- d. **\$0 (There is no beginning retained earnings, since July was the first month of operation.)**
- e. **\$1,500 (See the cash dividends on the statement of cash flows.)**
- f. **\$6,750 ($\$8,250 - \$1,500$)**
- g. **\$6,750 ($\$0 + \$6,750$)**
- h. **\$9,750 ($\$39,750 - \$30,000$)**
- i. **\$15,000 (See the cash received from capital stock on the statement of cash flows.)**
- j. **\$6,750 [the same as (g)].**
- k. **\$21,750 ($\$15,000 + \$6,750$)**
- l. **\$39,750 ($\$18,000 + \$21,750$); also the same as total assets.**
- m. **\$8,250 ($\$19,500 - \$11,250$)**
- n. **\$18,000 (See notes payable on the balance sheet.)**
- o. **\$33,000 ($\$15,000 + \$18,000$)**
- p. **\$31,500 ($\$33,000 - \$1,500$)**
- q. **\$9,750 ($\$8,250 - \$30,000 + \$31,500$)**
- r. **\$0 (July was the first month of operation.)**
- s. **\$9,750 [the same as (h)].**

Prob. 2–6

1. All financial statements should contain the name of the business in their heading. The retained earnings statement is incorrectly headed as “Jane Eckhart” rather than Crazy Creek Realty, Inc. The heading of the balance sheet needs the name of the business.
2. The income statement, retained earnings statement, and statement of cash flows cover a period of time and should be labeled “For the Month Ended October 31, 2007.”
3. The year in the heading for the retained earnings statement should be 2007 rather than 2006.
4. The balance sheet should be labeled as of “October 31, 2007,” rather than “For the Month Ended October 31, 2007.”
5. In the income statement, the dividends should not be listed as an operating expense, but should be included in the retained earnings statement.
6. In the income statement, the total operating expenses are incorrectly subtracted from the sales commissions, resulting in an incorrect net income amount. This also affects the retained earnings statement and the amount of retained earnings that appears on the balance sheet.
7. In the retained earnings statement, the net income should be presented, followed by the amount of dividends, which is subtracted from the net income to yield retained earnings as of October 31, 2007.
8. Notes payable should be listed as a liability on the balance sheet.
9. Land should be listed as an asset on the balance sheet.
10. The balance sheet assets should equal the sum of the liabilities and stockholders’ equity.
11. The cash payments for operating expenses have been omitted from the operating activities section of the statement of cash flows.
12. The cash flows from financing activities should not include retained earnings. In addition, the financing activities section should include cash received from issuance of capital stock and from notes payable. Also, the cash paid for dividends should be included as a deduction to arrive at net cash flows from financing activities.

Prob. 2–6, Continued

13. Since this is Crazy Creek Realty’s first month of operation, the increase in cash for October should equal \$60,850, the cash balance as of October 31, 2007.

Corrected financial statements appear as follows:

**CRAZY CREEK REALTY, INC.
Income Statement
For the Month Ended October 31, 2007**

Sales commissions.....		\$92,200
Expenses:		
Office salaries expense.....	\$16,300	
Rent expense	7,600	
Automobile expense	3,500	
Miscellaneous expense.....	<u>1,550</u>	
Total operating expenses		<u>28,950</u>
Net income		<u>\$63,250</u>

**CRAZY CREEK REALTY, INC.
Retained Earnings Statement
For the Month Ended October 31, 2007**

Net income for October		\$63,250
Less dividends during October		<u>2,000</u>
Retained earnings, October 31, 2007		<u>\$61,250</u>

Prob. 2–6, Concluded

CRAZY CREEK REALTY, INC.
Balance Sheet
October 31, 2007

<u>Assets</u>		
Cash		\$ 60,850
Land		<u>40,400</u>
Total assets		<u>\$101,250</u>
<u>Liabilities</u>		
Notes payable.....		\$ 20,000
<u>Stockholders' Equity</u>		
Capital stock.....	\$20,000	
Retained earnings.....	<u>61,250</u>	<u>81,250</u>
Total liabilities and stockholders' equity.....		<u>\$101,250</u>

CRAZY CREEK REALTY, INC.
Statement of Cash Flows
For the Month Ended October 31, 2007

Cash flows from operating activities:		
Cash receipts from sales commissions	\$92,200	
Cash payments for operating expenses.....	<u>28,950</u>	
Net cash from operating activities		\$ 63,250
Cash flows from investing activities:		
Cash payments for land		(40,400)
Cash flows from financing activities:		
Cash receipts from issuance of capital stock.....	\$20,000	
Cash receipts from notes payable	20,000	
Cash payments for dividends.....	<u>(2,000)</u>	
Net cash from financing activities		<u>38,000</u>
Net increase in cash during October		\$ 60,850
Cash as of October 1, 2007		<u>0</u>
Cash as of October 31, 2007		<u>\$ 60,850</u>

SPECIAL ACTIVITIES

Activity 2–1

1. From our discussions in Chapter 1, the two possible business emphases that could be used are as follows:

 low-cost emphasis
 premium-price emphasis

2. Real world examples of each emphasis are as follows:

 low-cost emphasis: Stein Mart, Wal-Mart, Kmart, Costco
 premium-price emphasis: GAP, Limited, Old Navy, Talbots

3. The answers will vary among the students groups. Normally, venture capital firms demand a large percentage of ownership, which many times is the majority (over 50%) ownership.

Activity 2–2

1. Kristin's comment is not correct. The difference in the cash balance of \$40,000 represents the net result of operating, investing, and financing cash activities. To determine the profit, the effects of Kristin's investing and financing activities would also need to be considered. For example, Kristin might have invested in buildings, land, computer equipment, or software programs that would be classified as investing activities. Also, Kristin may have borrowed cash from a bank or withdrawn cash from Stokes Consulting as dividends.

Activity 2–3

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>
Net cash flows from operating activities	negative	positive	positive
Net cash flows from investing activities	negative	negative	negative
Net cash flows from financing activities	positive	positive	positive

Start-up companies normally experience negative cash flows from operating and investing activities. Also, start-up companies normally have positive cash flows from financing activities—activities from raising capital.

Activity 2–4

Note to Instructors: The objective of this case is to familiarize students with financial reporting resources available on the Internet. The following solution is based upon the Wm. J. Wrigley Jr. Company data as of April 8, 2005, from Yahoo.com’s finance Web site.

1. \$65.81 (See opening page for WWY)
2. \$58.51 to \$71.50 (See opening page for WWY)
3. January 24, 2005, at a price of \$71.50 (See Key Statistics)
4. 82,000 shares were sold and purchased in the last six months ending April 8, 2005. (See Insider Transactions)
5. William Wrigley, Jr.; he is 40 years old. (See Profile)
6. \$1,200,000 (See Profile)
7. \$1.12 (See Key Statistics)
8. Strong Buy = 3
Buy = 4
Hold = 1
Sell = 1
Strong Sell = 0
Average broker recommendation is 2.0 (See Analyst Opinion)
9. \$724,510,000 (See Key Statistics)
10. 19.74% (See Key Statistics)

Activity 2–5

Note to Instructors: The purpose of this case is to make students aware of alternative sources of information useful for investment decisions.

1. Although some may disagree, most would characterize the article as favorable concerning Wrigley's prospects for the future.
2. No. It would be unwise to invest in Wrigley stock based only upon this article. Other information would include analysts' recommendations and Wrigley's published financial statements.
3. No. Other sources of information should also be obtained, such as analysts' recommendations, current newspaper articles concerning the company, and statements by the company's management.
4. Analysts use a variety of sources of information in making investment decisions and recommendations. In addition to published financial statements, analysts rely upon statements and interviews with management, economy-wide data, industry trends, consumer trends, newspaper articles, etc.

