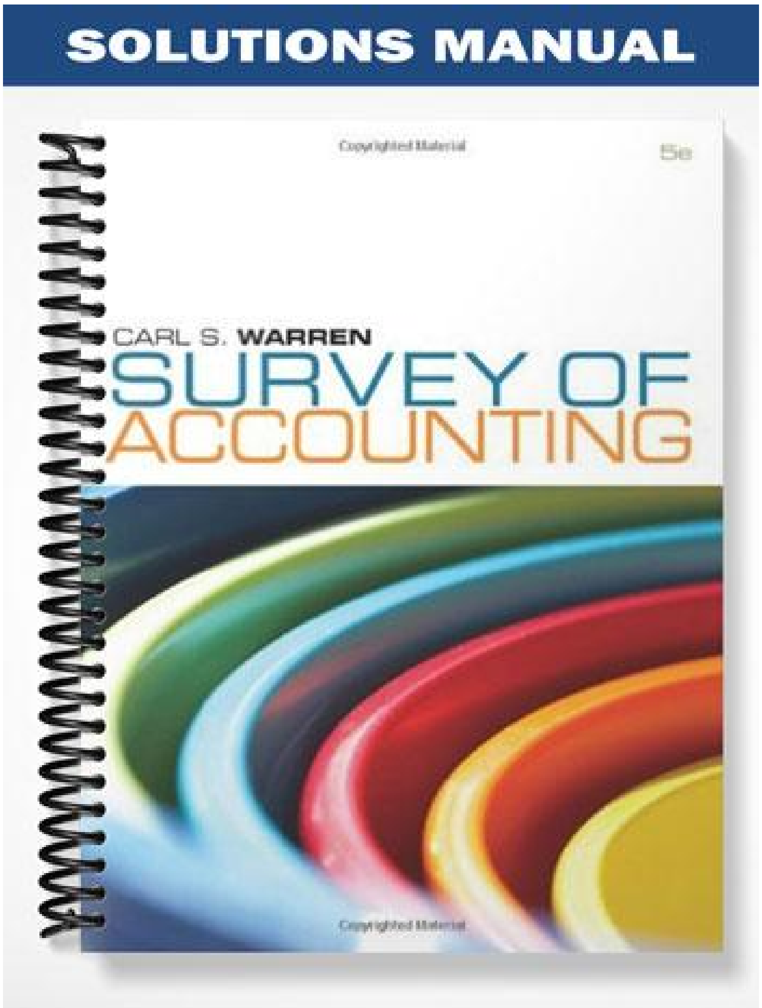
SOLUTIONS MANUAL
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CARL S. WARREN
SURVEY OF
ACCOUNTING
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CHAPTER 2
BASIC ACCOUNTING CONCEPTS

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; (2) a framework for preparing financial statements; and (3) one or more controls to determine whether errors may have occurred in the recording process. These elements apply to all businesses, from a local restaurant to Apple Inc. 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) $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) $40,000. The expense is salary expense or bonus expense.

3. Out of balance. Assets are correct, but retained earnings (utilities expense) should have been decreased by $3,700 rather than $7,300. Thus, retained earnings is understated by $3,600, and total liabilities plus stockholders' equity would be less than total assets by $3,600.

4. **a.** Out of balance. Assets are overstated by $33,975 ($37,750 – $3,775), and, thus, total assets would exceed total liabilities plus stockholders' equity by $33,975.

b. In balance. Even though liabilities and stockholders' equity are incorrect, the accounting equation balances. For this error, liabilities are overstated by $4,000, and retained earnings (fees earned) are understated by $4,000; thus, the over- and understatements offset each other, and the accounting equation balances.

5. A primary control for determining the accuracy of record keeping is the equality of the accounting equation. The accounting equation must balance.

6. Total assets are increased by $275,000: an increase in cash of $375,000 and a decrease in land of $100,000. Stockholders' equity (retained earnings) is increased by $275,000, the gain on the sale of the land.

7. **a.** The payment of $40,000 of dividends decreases total assets (decrease in cash) and decreases stockholders' equity (decrease in retained earnings).

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 $25,000, and net income would be understated by $25,000. On the retained earnings statement, the beginning and ending retained earnings would be correct. However, net income and dividends would be understated by $25,000. 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 $90,000, and net income would be overstated by $90,000. On the retained earnings statement, the beginning retained earnings would be correct. However, net income and ending retained earnings would be overstated by $90,000. The balance sheet total assets is correct. However, liabilities (notes payable) is understated by $90,000, and stockholders' equity (retained earnings) is overstated by $90,000. The understatement of liabilities is offset by the overstatement of stockholders' equity, and, thus, total liabilities and stockholders' 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.** $500,000 ($800,000 – $300,000), the same as the stockholders' equity as of January 1, 2011.

b.

Stockholders' equity as of December 31, 2011	$690,000
Less stockholders' equity as of January 1, 2011	500,000
Net income	$190,000

11.

Change in stockholders' equity (see Question 10)	$190,000
Plus dividends	45,000
Net income	$235,000

EXERCISES

E2–1

a. $1,030,000 ($250,000 + $780,000)

b. $85,500 ($125,000 – $39,500)

c. $52,500 ($60,000 – $7,500)

E2–2

a. $30,753 ($60,928 – $30,675)

b. $1 decrease ($1,569 – $1,570)

c. Total assets = $62,497 ($60,928 + $1,569)
Total liabilities = $30,174 ($30,175 – $1)
Total stockholders' equity = $32,323 ($30,753 + $1,570)

d. Yes. [$62,497 (total assets) = $30,174 (total liabilities) + $32,323 (total stockholders' equity)]

E2–3

a. $1,295 ($6,445 – $5,150)

b. $23 increase ($29 – $6)

c. Total assets = $6,474 ($6,445 + $29)
Total liabilities = $5,156 ($5,150 + $6)
Total stockholders' equity = $1,318 ($1,295 + $23)

d. Yes. [$6,474 (total assets) = $5,156 (total liabilities) + $1,318 (total stockholders' equity)]

E2–4

(a) \$2,646 (\$3,529 – \$883)

(b) \$22,690 (\$25,336 – \$2,646)

(c) \$31,768 (\$25,336 + \$6,432)

(d) \$28,239 (\$31,768 – \$3,529) or (\$22,690 + \$5,549)

(e) \$186,959 (\$202,352 – \$15,393) or (\$136,378 + \$50,581)

(f) \$136,378 (\$160,646 – \$24,268) or (\$186,959 – \$50,581)

(g) \$15,393 (\$24,268 – \$8,875)

(h) –\$8,875 (\$41,706 – \$50,581)

(i) \$160,646 (\$202,352 – \$41,706)

E2–5

a. \$520,000 (\$760,000 – \$240,000)

b. \$568,000 (\$520,000 + \$120,000 – \$72,000)

c. \$438,400 (\$520,000 – \$60,000 – \$21,600)

d. \$658,400 (\$520,000 + \$100,000 + \$38,400)

e. Net income: \$284,000 (\$960,000 – \$156,000 – \$520,000)

E2–6

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

E2–7

a. Increases assets and increases stockholders' equity.

b. Decreases assets and decreases stockholders' equity.

c. Increases assets and increases liabilities.

d. Increases assets and increases stockholders' equity.

e. Increases assets and decreases assets.

E2–8

(1) Total assets increased $60,000.
(2) Total liabilities decreased $80,000.
(3) Stockholders' equity increased $140,000.

E2–9

1. (a) increase
2. (a) increase
3. (b) decrease
4. (b) decrease
5. (b) decrease

E2–10

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

E2–11

a. (1) Sale of catering services for cash, $25,000.
   (2) Purchase of land for cash, $20,000.
   (3) Payment of expenses, $18,000.
   (4) Payment of cash dividends, $3,000.

b. $16,000 ($30,000 – $14,000)

c. $4,000 ($94,000 – $90,000)

d. $7,000 ($25,000 – $18,000)

e. $4,000 ($7,000 – $3,000)

f. $7,000 ($25,000 – $18,000)

g. $20,000 used for purchase of land

h. $3,000 used for payment of dividends

E2–12

It would be incorrect to say that the business had incurred a net loss of $25,000. The excess of the dividends over the net income for the period is a decrease in the amount of retained earnings in the corporation.

E2–13

Company A

Stockholders' equity at end of year ($1,296,000 – $540,000)	$756,000
Stockholders' equity at beginning of year ($810,000 – $324,000)	486,000
Net income (increase in stockholders' equity)	$270,000

Company B

Increase in stockholders' equity (as determined for A)	$270,000
Add dividends	72,000
Net income	$342,000

Company C

Increase in stockholders' equity (as determined for A)	$270,000
Deduct issuance of additional capital stock	162,000
Net income	$108,000

Company D

Increase in stockholders' equity (as determined for A)	$270,000
Deduct issuance of additional capital stock	162,000
	$108,000
Add dividends	72,000
Net income	$180,000

E2–14

In each case, solve for a single unknown, using the following equation:

Stockholders' equity (beginning) + Issuance of Capital Stock – Dividends + Revenues – Expenses = Stockholders' equity (ending)

Earth	Stockholders' equity at end of year ($268,200 – $117,000)...		$151,200
	Stockholders' equity at beginning of year ($216,000 – $129,600) .		86,400
	Increase in Stockholders' equity..		$ 64,800
	Deduct increase due to net income ($71,190 – $38,880)		32,310
			$ 32,490
	Add dividends..		14,400
	Additional issuance of capital stock.................................	(a)	$ 46,890
Mars	Stockholders' equity at end of year ($350,000 – $110,000)...		$240,000
	Stockholders' equity at beginning of year ($250,000 – $130,000) .		120,000
	Increase in Stockholders' equity..		$120,000
	Add dividends..		16,000
			$136,000
	Deduct additional issuance of capital stock		50,000
	Increase due to net income		$ 86,000
	Add expenses		64,000
	Revenue	(b)	$150,000
Neptune	Stockholders' equity at end of year ($90,000 – $80,000).......		$ 10,000
	Stockholders' equity at beginning of year ($100,000 – $76,000) .		24,000
	Decrease in Stockholders' equity		$ (14,000)
	Deduct decrease due to net loss ($115,000 – $122,500)		(7,500)
			$ (6,500)
	Deduct additional issuance of capital stock		10,000
	Dividends	(c)	$ (16,500)
Pluto	Stockholders' equity at end of year ($248,000 – $136,000)...		$112,000
	Add decrease due to net loss ($112,000 – $128,000).............		16,000
			$128,000
	Add dividends..		60,000
	Stockholders' equity at beginning of year		$188,000
	Deduct additional issuance of capital stock		40,000
			$148,000
	Add liabilities at beginning of year		120,000
	Assets at beginning of year..	(d)	$268,000

E2–15

a. **$96,457 ($696,861 – $600,404)**

b. **The net cash flows used for investing activities is determined by solving the following equation:**

Net increase in cash = Net cash flows from operating activities + Net cash flows used for investing activities + Net cash flows used for financing activities

$12,280 = $434,680 + Net cash flows used for investing activities – $241,837
Net cash flows used for investing activities = $12,280 + $241,837 – $434,680
Net cash flows used for investing activities = –$180,563

E2–16

a.

KATE'S INTERIORS
Balance Sheet
May 31, 2011

Assets		
Cash		$100,000
Land		500,000
Total assets		$600,000
Liabilities		
Notes payable		$200,000
Stockholders' Equity		
Capital stock	$ 75,000	
Retained earnings	325,000	
Total stockholders' equity		400,000
Total liabilities and stockholders' equity		$600,000

E2–16, Concluded

KATE'S INTERIORS
Balance Sheet
June 30, 2011

Assets		
Cash		$175,000
Land		575,000
Total assets		$750,000
Liabilities		
Notes payable		$250,000
Stockholders' Equity		
Capital stock	$ 90,000	
Retained earnings	410,000	
Total stockholders' equity		500,000
Total liabilities and stockholders' equity		$750,000

b.

Retained earnings, June 30, 2011	$410,000
Retained earnings, May 31, 2011	325,000
Increase in retained earnings	$ 85,000
Add dividends	35,000
Net income	$120,000

c. Net cash flows from operating activities = $120,000 = $75,000 + $75,000 – $30,000

d. –$75,000, used for the increase in the land

e. $30,000, the increase in capital stock of $15,000 plus the increase in notes payable of $50,000 less the dividends of $35,000

f. $75,000 ($175,000 – $100,000)

E2–17

POLARIS REALTY INC.
Income Statement
For the Month Ending November 30, 2011

Revenues:		
Sales commissions		$120,100
Expenses:		
Salaries expense	$65,000	
Utilities expense	15,000	
Rent expense	5,000	
Interest expense	2,000	
Miscellaneous expense	3,000	
Total expenses		90,000
Net income		$ 30,000

E2–18

POLARIS REALTY INC.
Retained Earnings Statement
For the Month Ending November 30, 2011

Net income	$30,000
Less dividends	10,000
Retained earnings, November 30, 2011	$20,000

E2–19

POLARIS REALTY INC.
Balance Sheet
November 30, 2011

Assets		
Cash		$38,000
Land		42,000
Total assets		$80,000
Liabilities		
Notes payable		$35,000
Stockholders' Equity		
Capital stock	$25,000	
Retained earnings	20,000	
Total stockholders' equity		45,000
Total liabilities and stockholders' equity		$80,000

E2–20

POLARIS REALTY INC.
Statement of Cash Flows
For the Month Ending November 30, 2011

Cash flows from operating activities:		
Cash receipts from operating activities	$120,000	
Cash payments for operating activities	90,000	
Net cash flows from operating activities		$ 30,000
Cash flows from investing activities:		
Cash payments for land		(42,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock	$ 25,000	
Cash receipts from notes payable	35,000	
Cash payments for dividends	(10,000)	
Net cash flows from financing activities		50,000
Net increase in cash during June		$ 38,000
Cash as of November 1, 2011		0
Cash as of November 30, 2011		$ 38,000

E2–21

a. Decrease in assets and decrease in stockholders' equity.

b. Increase in assets and decrease in assets.

c. Increase in assets and increase in stockholders' equity.

d. Increase in assets and increase in liabilities.

e. Increase in assets and increase in stockholders' equity.

f. Decrease in assets and decrease in stockholders' equity.

g. Decrease in assets and decrease in stockholders' equity.

h. Increase in assets, decrease in assets, and increase in stockholders' equity.

i. Decrease in assets and decrease in stockholders' equity.

j. Decrease in assets and decrease in stockholders' equity.

k. Decrease in assets and decrease in liabilities.

l. Decrease in assets and decrease in stockholders' equity.

E2–22

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

PROBLEMS

P2–1

1.

Statement of Cash Flows	Cash	+	Land	=	Notes Payable	+	Capital Stock	+	Retained Earnings	Income Statement
	Assets			=	Liabilities	+	Stockholders' Equity			
a. Investment	40,000						40,000			
b. Issued note payable	30,000				30,000					
Balances	70,000				30,000		40,000			
c. Fees earned	28,000								28,000	c.
Balances	98,000				30,000		40,000		28,000	
d. Rent expense	–3,000								–3,000	d.
Balances	95,000				30,000		40,000		25,000	
e. Paid expenses	–2,700								–2,700	e.
Balances	92,300				30,000		40,000		22,300	
f. Paid salary expense	–4,200								–4,200	f.
Balances	88,100				30,000		40,000		18,100	
g. Paid interest expense	–100								–100	g.
Balances	88,000				30,000		40,000		18,000	
h. Purchased land	–55,000		55,000							
Balances	33,000		55,000		30,000		40,000		18,000	
i. Paid dividends	–2,000								–2,000	
Balances, January 31	31,000		55,000		30,000		40,000		16,000	

Statement of Cash Flows

a.	Financing	40,000
b.	Financing	30,000
c.	Operating	28,000
d.	Operating	–3,000
e.	Operating	–2,700
f.	Operating	–4,200
g.	Operating	–100
h.	Investing	–55,000
i.	Financing	–2,000
	Increase in cash	31,000

Income Statement

c. Fees earned	28,000
d. Rent expense	–3,000
e. Auto expense	–1,800
e. Misc. expense	–900
f. Salary expense	–4,200
g. Interest expense	–100
Net income	18,000

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.

P2–1, Continued

3.

WOODS INSURANCE INC.
Income Statement
For the Month Ending July 31, 2011

Revenues:		
Fees earned		$28,000
Expenses:		
Salary expense	$4,200	
Rent expense	3,000	
Auto expense	1,800	
Interest expense	100	
Miscellaneous expense	900	
Total expenses		10,000
Net income		$18,000

WOODS INSURANCE INC.
Retained Earnings Statement
For the Month Ending July 31, 2011

Net income	$18,000
Less dividends	2,000
Retained earnings, July 31, 2011	$16,000

4.

WOODS INSURANCE INC.
Balance Sheet
July 31, 2011

Assets		
Cash		$31,000
Land		55,000
Total assets		$86,000
Liabilities		
Notes payable		$30,000
Stockholders' Equity		
Capital stock	$40,000	
Retained earnings	16,000	
Total stockholders' equity		56,000
Total liabilities and stockholders' equity		$86,000

P2–1, Concluded

5.

WOODS INSURANCE INC.
Statement of Cash Flows
For the Month Ending July 31, 2011

Cash flows from operating activities:		
Cash receipts from operating activities	$28,000	
Cash payments for operating activities	10,000	
Net cash flows from operating activities		$18,000
Cash flows from investing activities:		
Cash payment for land		55,000
Cash flows from financing activities:		
Cash receipts from issuing capital stock	$40,000	
Cash receipts from note payable	30,000	
Cash payments for dividends	(2,000)	
Net cash flows from financing activities		68,000
Net increase in cash during July		$31,000
Cash as of July 1, 2011		0
Cash as of July 31, 2011		$31,000

P2–2

1. **OUTLAW COMPUTER SERVICES**
Income Statement
For the Month Ended January 31, 2011

Fees earned		$22,000
Operating expenses:		
Salaries expense	$3,600	
Rent expense	2,500	
Automobile expense	1,200	
Miscellaneous expense	700	
Total operating expenses		8,000
Net income		$14,000

2. **OUTLAW COMPUTER SERVICES**
Retained Earnings Statement
For the Month Ended January 31, 2011

Net income for January	$14,000
Less dividends	2,000
Retained earnings, January 31, 2011	$12,000

3. **OUTLAW COMPUTER SERVICES**
Balance Sheet
January 31, 2011

Assets		
Cash		$12,000
Land		40,000
Total assets		$52,000
Liabilities		
Notes payable		$10,000
Stockholders' Equity		
Capital stock	$30,000	
Retained earnings	12,000	
Total stockholders' equity		42,000
Total liabilities and stockholders' equity		$52,000

P2–2, Concluded

4.

OUTLAW COMPUTER SERVICES
Statement of Cash Flows
For the Month Ended January 31, 2011

Cash flows from operating activities:		
Cash receipts from operating activities	$22,000	
Cash payments for operating activities	8,000	
Net cash flows from operating activities		$14,000
Cash flows from investing activities:		
Cash payments for land		(40,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock	$30,000	
Cash receipts from notes payable	10,000	
Cash payments for dividends	(2,000)	
Net cash flows from financing activities		38,000
Net increase in cash during January		$12,000
Cash as of January 1, 2011		0
Cash as of January 31, 2011		$12,000

P2–3

1. **BONTANCIA SERVICES, INC.**
Income Statement
For the Year Ending August 31, 2011

Revenues:		
Fees earned		$300,000
Expenses:		
Salaries expense	$90,000	
Utilities expense	40,000	
Rent expense	28,000	
Taxes expense	22,000	
Interest expense	2,500	
Miscellaneous expense	7,500	
Total expenses		190,000
Net income		$110,000

2. **BONTANCIA SERVICES, INC.**
Retained Earnings Statement
For the Year Ending August 31, 2011

Net income	$110,000
Less dividends	13,000
Retained earnings, August 31, 2011	$97,000

P2–3, Concluded

3. **BONTANCIA SERVICES, INC.**
Balance Sheet
August 31, 2011

Assets		
Cash		$ 50,000
Land		100,000
Total assets		$150,000
Liabilities		
Notes payable		$ 30,000
Stockholders' Equity		
Capital stock	$23,000	
Retained earnings	97,000	
Total stockholders' equity		120,000
Total liabilities and stockholders' equity		$150,000

4. **BONTANCIA SERVICES, INC.**
Statement of Cash Flows
For the Year Ending August 31, 2011

Cash flows from operating activities:		
Cash receipts from operating activities	$300,000	
Cash payments for operating activities	190,000	
Net cash flows from operating activities		$ 110,000
Cash flows from investing activities:		
Cash payments for land		(100,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock	$ 23,000	
Cash receipts from notes payable	30,000	
Cash payments for dividends	(13,000)	
Net cash flows from financing activities		40,000
Net increase in cash during the year		$ 50,000
Cash as of September 1, 2010		0
Cash as of August 31, 2011		$ 50,000

P2–4

1.

BONTANCIA SERVICES, INC.
Income Statement
For the Year Ending August 31, 2012

Revenues:		
Fees earned		$400,000
Expenses:		
Salaries expense	$110,000	
Utilities expense	52,000	
Rent expense	36,000	
Taxes expense	28,000	
Interest expense	3,000	
Miscellaneous expense	11,000	
Total expenses		240,000
Net income		$160,000

2.

BONTANCIA SERVICES, INC.
Retained Earnings Statement
For the Year Ending August 31, 2012

Retained earnings, September 1, 2011		$ 97,000
Net income	$160,000	
Less dividends	25,000	
Increase in retained earnings		135,000
Retained earnings, August 31, 2012		$232,000

P2–4, Concluded

3.

BONTANCIA SERVICES, INC.
Balance Sheet
August 31, 2012

Assets		
Cash		$ 85,000
Land		240,000
Total assets		$325,000
Liabilities		
Notes payable		$ 38,000
Stockholders' Equity		
Capital stock	$ 55,000	
Retained earnings	232,000	
Total stockholders' equity		287,000
Total liabilities and stockholders' equity		$325,000

4.

BONTANCIA SERVICES, INC.
Statement of Cash Flows
For the Year Ending August 31, 2012

Cash flows from operating activities:		
Cash receipts from operating activities	$400,000	
Cash payments for operating activities	240,000	
Net cash flows from operating activities		$ 160,000
Cash flows from investing activities:		
Cash payment for land		(140,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock	$ 32,000	
Cash receipts from notes payable	8,000	
Cash payments for dividends	(25,000)	
Net cash flows from financing activities		15,000
Net increase in cash during the year		$ 35,000
Cash as of September 1, 2010		50,000
Cash as of August 31, 2011		$ 85,000

P2–5

a. $117,000 (net income for July, $49,500, plus total operating expenses; also, the amount of cash received from customers on the statement of cash flows.)

b. $10,620 ($67,500 – $33,120 – $18,000 – $1,800 – $3,960)

c. $49,500 ($117,000 – $67,500); 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. $9,000 (See the cash dividends on the statement of cash flows.)

f. $40,500 ($49,500 – $9,000)

g. $40,500 ($0 + $40,500)

h. $58,500 ($238,500 – $180,000)

i. $90,000 (See the cash received from capital stock on the statement of cash flows.)

j. $40,500 [the same as (g)].

k. $130,500 ($90,000 + $40,500) or (i + j)

l. $238,500 ($108,000 + $130,500); also the same as total assets.

m. $49,500 ($117,000 – $67,500)

n. $108,000 (See notes payable on the balance sheet.)

o. $198,000 ($90,000 + $108,000)

p. $189,000 ($198,000 – $9,000)

q. $58,500 ($49,500 – $180,000 + $189,000)

r. $0 (July was the first month of operation.)

s. $58,500 [the same as (h)].

P2–6

1. All financial statements should contain the name of the business in their heading. The retained earnings statement is incorrectly headed as "Dale Flynn" rather than Bitterroot 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, 2011."

3. The year in the heading for the retained earnings statement should be 2011 rather than 2010.

4. The balance sheet should be labeled as of "October 31, 2011," rather than "For the Month Ended October 31, 2010."

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, 2011.

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.

P2–6, Continued

13. **Since this is Bitterroot Realty's first month of operation, the increase in cash for October should equal $60,850, the cash balance as of October 31, 2011.**

    Corrected financial statements appear as follows:

BITTERROOT REALTY, INC.
Income Statement
For the Month October 31, 2011

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

BITTERROOT REALTY, INC.
Retained Earnings Statement
For the Month Ended October 31, 2011

Net income for October	$63,250
Less dividends during October	2,000
Retained earnings, October 31, 2011	$61,250

P2–6, Concluded

BITTERROOT REALTY, INC.
Balance Sheet
October 31, 2011

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

BITTERROOT REALTY, INC.
Statement of Cash Flows
For the Month Ended October 31, 2011

Cash flows from operating activities:		
Cash receipts from sales commissions	$92,200	
Cash payments for operating expenses	28,950	
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	(2,000)	
Net cash from financing activities		38,000
Net increase in cash during May		$ 60,850
Cash as of October 1, 2011		0
Cash as of October 31, 2011		$ 60,850

ACTIVITIES

A2–1

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: SteinMart, Wal-Mart, Kmart, Costco
   premium-price emphasis: GAP, Limited, Sub-Zero, Talbots

3. **The answers will vary among the student groups. Normally, venture capital firms demand a large percentage of ownership, which may be the majority (over 50%) ownership.**

A2–2

Dr. Hendley's comment is not correct. The difference in the cash balance of $45,000 ($75,000 – $30,000) represents the net result of operating, investing, and financing cash activities. To determine the profit, the effects of Dr. Hendley's investing and financing activities would also need to be considered. For example, Dr. Hendley might have invested in buildings, land, computer equipment, or software programs that would be classified as investing activities. Also, Dr. Hendley may have borrowed cash from a bank or withdrawn cash from Med as dividends.

A2–3

	Year 1	Year 2	Year 3
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.

A2–4

***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 Apple Inc. data as of September 2, 2009, from Yahoo.com's finance Web site.**

1. **$165.30 (See opening page for AAPL)**

2. **$78.20 to $173.50 (See opening page for AAPL)**

3. **September 2, 2008, at a price of $173.50 (See Key Statistics)**

4. **516,114 shares (net) were sold and purchased in the last 6 months ending September 2, 2009. (See Insider Transactions)**

5. **Steven P. Jobs; he is 53 years old. (See Profile)**

6. **$0 (See Profile)**

7. **$0 (See Key Statistics)**

8. **Strong Buy = 14**
   Buy = 18
   Hold = 6
   Sell = 1
   Strong Sell = 1

   Average broker recommendation is 1.9 (See Analyst Opinion)

9. **$9,596,000,000 (See Financials: Cash Flows)**

10. **19.98% (See Key Statistics)**

A2–5

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 unfavorable concerning Apple's prospects for the future.**

2. **No. It would be unwise to sell Apple Inc. stock based only upon this article. Other information would include analysts' recommendations and Apple Inc.'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.**