Solutions for Financial Accounting 7th Edition by Horngren

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Solutions

Chapter 1

The Financial Statements

Short Exercises

(5 min.) S 1-1

1. *Assets* are resources controlled by the company as a result of past events and from which the company expects to receive future economic benefits.

   Shareholders' equity represents the insider claims of a business, the claims to the assets held by the owners of the business.

   Assets and shareholders' equity differ in that shareholders' equity is a claim to assets.

   Assets must be at least as large as shareholders' equity. Equity can be smaller than assets.

2. Both liabilities and shareholders' equity are claims to assets.

   Liabilities are the *outsider* claims to the assets of a business. Shareholders' equity represents the *insider* claims to the assets of the business.

(5 min.) S 1-2

Total assets	=	Total liabilities	+	Shareholders' equity
$\boxed{\$300,000}$	=	$150,000	+	$150,000
290,000	=	90,000	+	$\boxed{200,000}$
220,000	=	$\boxed{100,000}$	+	120,000

(continued) S 1-2

A different presentation should be:

a) Total assets = Total liabilities + Shareholders' equity

= $150,000 + $150,000 = $300,000

b) Shareholders' equity = Total assets – Total liabilities

= $290,000 – $90,000 = $200,000

c) Total liabilities = Total assets – Shareholders' equity

= $220,000 – $120,000 = $100,000

(5 min.) S 1-3

1. Shareholders' Equity = Assets – Liabilities

   It would not change in analyzing a household or a neighbourhood restaurant's information.

2. Liabilities = Assets – Shareholders' Equity

(5-10 min.) S 1-4

a. Accounts payable L
b. Common shares E
c. Cash A
d. Retained earnings E
e. Land A
f. Prepaid expenses A
g. Accounts receivable A
h. Long-term debt L
i. Merchandise inventories A
j. Notes payable L
k. Accrued expenses payable L
l. Equipment A

(5 min.) S 1-5

1. *Income* and *expenses*

2. Net income, or net earnings (or net loss, if negative)

(10 min.) S 1-6

Split Second Wireless Inc.
Statement of Income
For the Year Ended December 31, 2020
(*In millions*)

Revenue	$ 90
Expenses	20
Net income	$ 70

(5 min.) S 1-7

Mondala Ltd.
Statement of Retained Earnings
For the Year Ended December 31, 2020
(*In millions*)

Balance, beginning of year	$200
Net income ($400 − $300)	100
Less: Dividends	(40)
Balance, end of year	$260

(10-15 min.) S 1-8

Skate Sharp Limited
Balance Sheet
December 31, 2020

ASSETS	
Current assets:	
Cash	$ 13,000
Receivables	2,000
Inventory	40,000
Total current assets	55,000
Equipment	75,000
Other assets	10,000
Total assets	$140,000
LIABILITIES	
Current liabilities:	
Accounts payable	$ 10,000
Short-term notes payable	5,000
Total current liabilities	15,000
Long-term liabilities:	
Long-term debt	70,000
Total liabilities	85,000
SHAREHOLDERS' EQUITY	
Share capital	15,000
Retained earnings	40,000*
Total shareholders' equity	55,000
Total liabilities and shareholders' equity	$140,000

*Computation:
Total assets ($140,000) – current liabilities ($15,000) – long-term debt ($70,000) – share capital ($15,000) = $40,000

(10-15 min.) S 1-9

Brazos Medical Inc.
Statement of Cash Flows
For the Year Ended December 31, 2020

Cash flows from operating activities:		
Net income		$120,000
Adjustments to reconcile net income to net cash provided by operating activities		(20,000)
Net cash inflow from operating activities		100,000
Cash flows from investing activities:		
Purchases of equipment	$(300,000)	
Sale of equipment	60,000	
Net cash outflow from investing activities		(240,000)
Cash flows from financing activities:		
Borrowing on long-term note payable	$150,000	
Payment of dividends	(15,000)	
Net cash inflow from financing activities		135,000
Net increase (decrease) in cash		(5,000)
Cash balance, December 31, 2019		24,000
Cash balance, December 31, 2020		$ 19,000

(5 min.) S 1-10

1. The *separate-entity assumption* applies.

2. Application of the separate-entity assumption will separate John's personal assets from the assets of the business. This information will show how much in assets the business owns and this knowledge will help him evaluate the business realistically.

(5 min.) S 1-11

Standards of professional conduct are designed to produce information that has predictive or confirming value and is completely free from bias and without material error. This is information that can be used for decision making.

If there were no standards, companies could be motivated to report information to make their company look good. This could provide external users with inappropriate information.

(10 min.) S 1-12

a. Dividends SRE, SCF

b. Salary expense IS

c. Inventory BS

d. Sales revenue IS

e. Retained earnings SRE, BS

f. Net cash provided by operating activities SCF

g. Net income IS, SRE, SCF (if prepared by the indirect method)

h. Cash BS, SCF

i. Net cash provided by financing activities SCF

j. Accounts payable BS

k. Common shares BS

l. Interest revenue IS

m. Long-term debt BS

n. Net increase or decrease in cash SCF

Exercises

(10 min.) E 1-13

a. *Corporation*. If the corporation fails and cannot pay its liabilities, creditors cannot force shareholders to pay the business's debts from their personal assets. Therefore, the most an investor can expect to lose on an investment in a corporation is the amount invested.

b. *Proprietorship*. There is a single owner of the business, so the owner has absolute control over the business.

c. *Proprietorship.* If the proprietorship fails and cannot pay its liabilities, creditors can force the proprietor to pay the business's debts from their personal assets.

d. The answer depends on your objective. If you want to maintain absolute control of the business, you may prefer to organize as a *proprietorship*. If your objective is to maintain a high degree of control but you need additional money or expertise, a *partnership* may work for you. If you want the business to grow large, or if you wish to avoid personal liability for business debts, you should organize as a *corporation*.

(10 min.) E 1-14

Req. 1

1. The *income statement* reports the revenues and expenses of a particular entity for a period such as a month or a year. Total *revenues* minus total *expenses* equals *net income*, or profit.

   The *balance sheet* reports the assets, liabilities, and owners' equity of the entity at a particular point in time. *Assets = Liabilities + Owner's Equity*.

2. A lender would use information from the income statement in order to predict whether the borrower can generate enough income to repay the loan.

3. On the balance sheet, the *assets* show the resources that the business has to work with. Because borrowers pay loans with assets, a lender wants to know the business's assets (especially cash). *Liabilities*—debts—represent creditors' claims to the business's *assets*. Knowing how much total liabilities a company has helps a lender assess whether the business has the ability to take on and eventually repay additional debt.

(continued) E 1-14

4. Because the bank will use the income statement to predict whether the business can generate enough income to repay the loan, Ed may be biased to report higher revenues and lower expenses than are realistic to expect, which would result in the income statement reporting higher income than the business will likely earn.

   Because the bank will use the balance sheet to assess whether the business will have sufficient assets to repay its liabilities, including any new loan from the bank, Ed may be biased to report more assets and fewer liabilities than the business actually has, which would result in a more favourable financial position than is warranted.

   It would not be ethical for Ed to report the business's financial information this way because he would be deliberately misrepresenting its performance and financial position, which could mislead the bank into approving a loan to him that they otherwise would not make. This constitutes fraud, which is illegal.

Note: Student responses may vary.

(5-10 min.) E 1-15

a. Historical-cost assumption – the amount received from the sale.

b. Going-concern assumption – Trammel Crow Realtors will stay in business long enough to use existing assets for their intended purposes.

c. Separate-entity assumption – each division records information as a separate economic unit.

d. Historical-cost assumption – assets should be recorded at actual cost of purchase.

(5-15 min.) E 1-16

(Amounts in millions)

	Assets	=	Liabilities	+	Owners' Equity
Telus	$\boxed{\$16,987}$		$10,061		$6,926
Scotiabank	411,510		$\boxed{392,706}$		18,804
Shoppers Drug Mart	5,644		2,434		$\boxed{3,210}$

(10-15 min.) E 1-17

Req. 1

(Amounts in millions)

	Assets	=	Liabilities	+	Shareholders' Equity
Current	$ 633.6		$ 591.2		
Capital	1,126.7				
Other	1,237.5		1,245.2		
Total	$2,997.8	=	$1,836.4	+	$1,161.4
	↑		↑		↑
Req. 2	Resources to work with	*Req. 3*	Amount owed to creditors	*Req. 4*	Actually owned by the shareholders

(10-20 min.) E 1-18

	Situation		
	1	2 (Millions)	3
Total shareholders' equity			
December 31, 2019 ($30 – $8)	$22	$22	$22
Add: Issuance of shares	2	0	11
Net income	$\boxed{6}$	$\boxed{11}$	
Less: Dividends	0	(3)	(2)
Net loss	0	0	$\boxed{(1)}$
Total shareholders' equity,			
December 31, 2020 ($40 – $10)	$30	$30	$30

(10-15 min.) E 1-19

1. Mortimer Limited

	Assets	=	Liabilities	+	Shareholders' Equity
Beginning	$700,000	=	$400,000	+	$300,000
Multiplier for increase	× 1.20				
Ending	$840,000				

2. Aztec Associates

	Assets	–	Liabilities	=	Shareholders' Equity
Beginning amount	$500,000	–	$200,000	=	$300,000
Net income					$100,000
Ending amount					$400,000

(10-15 min.) E 1-20

a. Balance sheet

b. Balance sheet

c. Statement of retained earnings, Statement of cash flows

d. Income statement

e. Balance sheet, Statement of retained earnings

f. Balance sheet

g. Balance sheet

h. Income statement

i. Statement of cash flows

j. Income statement

k. Statement of cash flows

l. Balance sheet, Statement of cash flows

m. Balance sheet

n. Income statement, Statement of retained earnings, Statement of cash flows

o. Income statement

(10-20 min.) E 1-21

Torrance Associates Inc.
Balance Sheet
As at December 31, 2020
(in millions)

ASSETS		LIABILITIES	
Cash	$28		
Investments	72	Current liabilities	$290
Receivables	253	Long-term liabilities	73
Other assets	43		
Property and equipment, net	4		
		Total liabilities	363
		SHAREHOLDERS' EQUITY	
		Common shares	12
		Retained earnings	25*
		Total shareholders' equity	37
Total assets	$400	Total liabilities and shareholders' equity	$400

*Computation:
Retained earnings = Total assets ($400) – Total liabilities ($363) – Common shares ($12) = $25

(15-25 min.) E 1-22

Torrance Associates Inc.
Income Statement
For the Year Ended December 31, 2020

	(*millions*)	
Total revenue		$35
Expenses:		
Salary and other employee expenses	$9	
Interest expense	3	
Other expenses	14	
Total expenses		26
Net income before tax		$ 9

(continued) E 1-22

Torrance Associates Inc.
Statement of Retained Earnings
For the Year Ending December 31, 2020

	(*millions*)
Balance, beginning of year	$19
Net income	9
Less: Dividends	(3)*
Balance, end of year	$25

*19 + 9 – 25 = $3
Dividends declared by Torrance Associates Inc. were $3 million

(15-20 min.) E 1-23

1. Items given that do not appear on the statement of cash flows:

Total assets	—	Balance sheet
Total liabilities	—	Balance sheet

2.

Groovy Limited
Statement of Cash Flows
For the Year Ended December 31, 2020

	(*Thousands*)
Cash flows from operating activities:	
Net income	$300
Adjustments to reconcile net income to net cash provided by operating activities	60
Net cash provided by operating activities	360
Net cash used in investing activities	(400)
Net cash provided by financing activities	70
Net increase in cash	30
Beginning cash balance	95
Ending cash balance	$125

3. Investing activities may have included building a new studio, renovating an existing studio, and buying recording equipment to use in the studios.

(continued) E 1-23

4. Financing activities may have included repaying loans, taking out new loans, paying dividends, or issuing new shares.

(15-20 min.) E 1-24

COBER PRINTING INC.
INCOME STATEMENT
FOR THE MONTH ENDED JULY 31, 2020

Revenue:		
Service revenue		$14,000
Expenses:		
Rent expense......	$ 700	
Office supplies expense......	1,200	
Utilities expense	200	
Salary expense	4,000	
Total expenses		6,100
Net income		$ 7,900

COBER PRINTING INC.
STATEMENT OF RETAINED EARNINGS
FOR THE MONTH ENDED JULY 31, 2020

Retained earnings, July 1, 2020	$ 0
Add: Net income for the month	7,900
	7,900
Less: Dividends......	(2,000)
Retained earnings, July 31, 2020	$5,900

(15-20 min.) E 1-25

COBER PRINTING INC. BALANCE SHEET JULY 31, 2020			
Assets		**Liabilities**	
Cash	$ 8,100	Accounts payable	$ 3,200
Equipment	36,000	**Shareholders' Equity**	
		Common shares	35,000
		Retained earnings	5,900
		Total shareholders' equity	40,900
		Total liabilities and	
Total assets	$44,100	shareholders' equity	$44,100

(15-20 min.) E 1-26

COBER PRINTING INC.
STATEMENT OF CASH FLOWS
FOR THE MONTH ENDED JULY 31, 2020

Cash flows from operating activities:		
Net income		$ 7,900
Adjustments to reconcile net income to cash provided by operations		3,200
Net cash provided by operating activities…		11,100
Cash flows from investing activities:		
Acquisition of equipment	$(36,000)	
Net cash used for investing activities		(36,000)
Cash flows from financing activities:		
Issuance (sale) of shares to owners	$ 35,000	
Payment of dividends	(2,000)	
Net cash provided by financing activities		33,000
Net increase in cash		$ 8,100
Cash balance, July 1, 2020		0
Cash balance, July 31, 2020		$ 8,100

(10-15 min.) E 1-27

TO: Owner of Cober Printing Inc.

FROM: Student Name

SUBJECT: Opinion of operating results, financial position, and cash flows

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Your first month of operations appears to have been successful. Revenues totalled $14,000 and net income was $7,900. These operating results look very strong.

The store was able to pay a $2,000 dividend, and this should make you happy with so quick a return on your investment.

Your financial position looks secure, with assets of $44,100 and liabilities of only $3,200. Your shareholders' equity is $40,900.

Operating activities generated cash of $11,100. You ended the month with cash of $8,100. Based on the above facts, I believe you should keep the company operating.

Note: Student responses may vary.

(15-20 min.) E 1-28

a. *Paying large dividends* will cause retained earnings to be low.

b. Heavy *investing activity* and *paying off debts* can result in a cash shortage even if net income has been high. High non-cash current assets such as accounts receivable and inventories will do the same.

c. The single best source of cash for a business is *collections from customers* based on delivery of goods and/or services. This source of cash is best because it results from the core operating activity of the business. Collections from customers do not create liabilities that must be paid back to anyone.

d. *Borrowing money, issuing (selling) shares to shareholders, and selling capital assets* such as land, buildings, and equipment can bring in cash even during a period when the company has experienced net losses.

Problems

Group A

(15-20 min.) P 1-29A

Req. 1

Staples's Special Contract Division
Income Statement
For the Year Ended December 31, 2020

Sales revenue	$250,000	
Other revenue	50,000	
Total revenue		$300,000
Salaries expense	$ 20,000	
Other expenses	240,000	
Total operating expenses		260,000
Income before income tax		40,000
Income tax expense ($40,000 × 0.30)		(12,000)
Net income		$ 28,000

Req. 2

a. Faithful representation characteristic. Report revenues at their actual sale value because that amount is supported by verifiable data and free from bias. What management believes the goods are worth is based on opinion and subject to dispute.

b. Faithful representation characteristic. Account for expenses at their actual cost, not a hypothetical amount that the company might have incurred.

c. Faithful representation characteristic. Account for expenses at their actual cost, not what they would have cost had the circumstances been different.

d. Separate-entity assumption. Each operating division of the company is a separate entity with its own financial statements. Staples as a whole constitutes an entity for accounting purposes.

e. Stable-monetary-unit assumption. Accounting in Canada ignores the effect of inflation as the dollar's purchasing power is relatively stable.

f. Going-concern assumption. There is no evidence that Staples is going out of business, so it seems safe to assume that the division is a going concern. Therefore, the potential sale value of Staples assets is not relevant, nor recorded.

(30-40 min.) P 1-30A

Req. 1

Computed amounts are shown in boxes.
Amounts in millions.

	Link Ltd.	Chain Inc.	Fence Corp.
Beginning			
Assets	$78	$ 30	$$\boxed{7}$
– Liabilities	–47	–19	–2
= Common shares	6	1	2
+ Retained earnings	$\boxed{\$25}$	$10	$3
Ending			
Assets	$\boxed{\$81}$	$48	$9
– Liabilities	–48	–30	$\boxed{-3}$
= Common shares	6	1	2
+ Retained earnings	$27	$\boxed{\$17}$	$\boxed{\$4}$
Owner's equity			
Dividends	$3	2	0
Income statement			
Revenues	$216	$\boxed{\$153}$	20
Expenses	–211	–144	–19
Net income	$ 5	$ 9	$ 1
Statement of retained earnings			
Beginning retained earnings	$25	$10	$3
+ Net income (Net loss)	5	9	1
− Dividends	–3	–2	0
= Ending retained earnings	$27	$17	$4

(continued) P 1-30A

Link	Chain	Fence
Retained earnings = Assets – Liabilities – Common shares $78 – $47 – $6 = $25	Retained earnings = Assets – Liabilities – Common shares $48 – $30 – $1 = $17	Assets = Liabilities + Common shares + Retained earnings $2 + $2 + $3 = $7
Assets = Liabilities + Owner's equity $48 + $6 + $27 = $81		Liabilities = Assets – Common shares – Retained earnings $9 – $2 – $4 = $3
Net income = Revenues – Expenses $216 – 211 = $5	Revenues = Net income + Expenses $9 – $144 = $153	

Req. 2

Assets and Revenues are the two lines items that are most relevant for determining the relative sizes of companies. A company's total assets are a measure of how much resources it has to deploy to earn revenues, so a company with more assets will generally have more resources to deploy in the form of inventory, buildings, equipment, and other tangible and intangible assets. Revenues report how much a company was able to sell in goods and services during the period, so a company with higher sales is likely much larger than one with lower sales.

Req. 3

		Link Ltd.	Chain Inc.	Fence Corp.
Highest net income		$5	$9	$1
Chain has the highest $ income				
Percentage of net income to revenues	=	$\frac{\$5}{\$216}$	$\frac{\$9}{\$153}$	$\frac{\$1}{\$20}$
	=	2.3%	= 5.9%	= 5.0%

Chain has the highest % of net income to revenues.

Net income as a percentage of revenues is the better measure for comparing operating performance because it takes into account the relative size of each company based on total revenues and factors in all the expenses each incurred to earn their revenues. Two companies may report similar net incomes, but the one that has a higher proportion of revenues leftover after deducting all expenses will have relatively more money to return to shareholders, acquire more assets for expansion, and pay down debts.

(20-25 min.) P 1-31A

Req. 1

The amounts that are not presented on the balance sheet because they are revenues or expenses, but that are presented on the income statement, are as follows:

Rent expense
Salaries expense
Advertising expense
Sales revenue
Interest expense

Req. 2

Strides Inc.
Balance Sheet
As at July 31, 2020

ASSETS		LIABILITIES	
Cash	$25,000	Accounts payable	$16,000
Accounts receivable	20,000	Note payable	9,000
Store fixtures	10,000	Total liabilities	25,000
Land	44,000	**SHAREHOLDERS' EQUITY**	
		Shareholders' equity	74,000*
		Total liabilities and	
Total assets	$99,000	shareholders' equity	$99,000

*Total assets ($99,000) – Total liabilities ($25,000) = Shareholders' equity ($74,000).

Req. 3

Strides is in a *better* financial position as shareholders' equity has increased by $66,800, and liabilities have decreased by $84,800.

(20-25 min.) P 1-32A

Req. 1

Items not reported on the balance sheet of the business were personal, and due to the separate-entity assumption, are not part of the business.

a. Personal cash ($5,000)
e. Personal residence ($350,000) and mortgage payable ($100,000)
f. Personal account payable ($1,800)

Req. 2

Alexa Markowitz Realtor Inc.
Balance Sheet
As at March 31, 2020

ASSETS		LIABILITIES	
Cash	$ 14,000	Accounts payable	$ 6,000
Office supplies	1,000	Note payable	60,000
Furniture	10,000	Total liabilities	66,000
Land	110,000	**SHAREHOLDERS' EQUITY**	
Franchise	25,000		
		Common shares	60,000
		Retained earnings	34,000*
		Total shareholders' equity	94,000
Total assets	$160,000	Total liabilities and shareholders' equity	$160,000

*Total assets ($160,000) – Total liabilities ($66,000) – Common shares ($60,000) = Retained earnings ($34,000).

Req. 3

Cash and Accounts Payable are the two accounts most relevant to assessing whether it can pay its short-term debts.

Req. 4

Yes, the company has $14,000 in cash at the end of the month and has to pay only $6,000 in Accounts Payable in the coming weeks, so it should be able to pay its short-term debts.

(30-45 min.) P 1-33A

Note: It is left to the student to realize they must prepare the financial statements below before being able to answer the questions asked.

Web Services Inc.
Income Statement
For the Year Ended December 31, 2020

Revenue		
Service revenue		$150,000
Expenses		
Salary expense	$40,000	
Rent expense	15,000	
Interest expense	4,000	
Utilities expense	3,000	
Property tax expense	2,000	
Total expenses		64,000
Net income		$ 86,000

Web Services Inc.
Statement of Retained Earnings
For the Year Ended December 31, 2020

Retained earnings, beginning of year		$ 60,000
Add:	Net income for the year	86,000
		146,000
Less:	Dividends	(30,000)
Retained earnings, end of year		$116,000

(continued) P 1-33A

Web Services Inc.
Balance Sheet
As at December 31, 2020

ASSETS		LIABILITIES	
Cash	$ 8,000	Accounts payable	$ 15,000
Accounts receivable	25,000	Interest payable	2,000
Supplies	2,000	Note payable	32,000
Equipment	11,000	Total liabilities	49,000
Building	126,000	**SHAREHOLDERS' EQUITY**	
Land	8,000		
		Common shares	15,000
		Retained earnings	116,000
		Total shareholders' equity	131,000
		Total liabilities and	
Total assets	$180,000	shareholders' equity	$180,000

*Total assets ($180,000) – Total liabilities ($49,000) – Common shares ($15,000) = Retained earnings ($116,000).

Req.

a. Web Services was profitable in 2020, earning a net income of $86,000.

b. Retained earnings increased by $56,000 after paying dividends to shareholders of $30,000.

c. Shareholders' equity exceeds liabilities by ($131,000 – $49,000) $82,000, so shareholders have a larger claim on Web Services' assets.

The CEO should be pleased with the results of Web Services Inc. because it earned a healthy net income for the year, paid $30,000 in dividends to its shareholders, and still had $56,000 in retained earnings to deploy in the future.

(20 min.) P 1-34A

Req. 1

Stuart Inc.
Statement of Cash Flows
For the Fiscal Year Ended March 1, 2020

		(Millions)
Cash flows from operating activities:		
Net income (loss)		$(251)
Adjustments to reconcile net income (loss) to cash provided by operations		397
Net cash provided by operating activities		146
Cash flows from investing activities:		
Purchases of capital assets and other assets	$(144)	
Sales of capital assets and other assets	1	
Net cash used for investing activities		(143)
Cash flows from financing activities:		
Issuance of long-term debt	164	
Repayment of long-term debt	(1)	
Issuance of common shares	1	
Repurchase of common shares	(177)	
Payment of dividends	(31)	
Net cash used for financing activities		(44)
Net decrease in cash		(41)
Cash, beginning		41
Cash, ending		$ 0

Req. 2

Operating activities provided the bulk of Stuart Inc.'s cash. This is normally a sign of financial strength. Cash available was used to invest in capital asset purchases and pay dividends. The result of investing and financing activities reduced cash available at fiscal year end to 0. This is a negative statement of cash flows.

(40-50 min.) P 1-35A

Req. 1

			2020	2019		
			(Thousands)			
STATEMENT OF INCOME						
Revenues	16,800	=	$ k	$16,000		
Cost of goods sold			11,500	a	=	11,100
Other expenses			1,300	1,200		
Earnings before income taxes			4,000	3,700		
Income taxes (35% tax rate)	1,400	=	l	1,300		
Net earnings	2,600	=	$ m	$ b	=	2,400
STATEMENT OF RETAINED EARNINGS						
Beginning balance	5,700	=	$ n	$ 3,500		
Net earnings	2,600	=	o	c	=	2,400
Dividends			(300)	(200)		
Ending balance	8,000	=	$ p	$ d	=	5,700
BALANCE SHEET						
Assets:						
Cash	2,400	=	$ q	$ e	=	2,000
Capital assets			3,000	1,800		
Other assets	12,000	=	r	11,200		
Total assets	17,400	=	$ s	$15,000		
Liabilities:						
Current liabilities	4,520	=	$ t	$ 5,600		
Notes payable and long-term debt			4,500	3,200		
Other liabilities			80	200		
Total liabilities			9,100	f	=	9,000
Shareholders' Equity:						
Common shares			$ 300	$ 300		
Retained earnings	8,000	=	u	g	=	5,700
Total shareholders' equity	8,300	=	v	6,000		
Total liabilities and shareholders' equity	17,400	=	$ w	$ h	=	15,000

(continued) P 1-35A

STATEMENT OF CASH FLOWS

Net cash provided by operating activities	2,100	=	$ x	$ 1,900		
Net cash provided by investing activities			(1,000)	(900)		
Net cash used for financing activities			(700)	(1,010)		
Increase (decrease) in cash			400	i	=	(10)
Cash at beginning of year	2,000	=	y	2,010		
Cash at end of year	2,400	=	$ z	$ j	=	2,000

Req. 2

a. The revenues are found in the statement of income. Operations improved during 2020. Revenues increased by $800 thousand and net earnings increased from $2,400 thousand to $2,600 thousand.

b. The amount of dividends are found in the statement of retained earnings. The company retained most of its net earnings for use in the business. Dividends were only $200 thousand in 2019 and $300 thousand in 2020, which are much less than net earnings.

c. The amount of dividends are found in the statement of retained earnings. Total assets at the end of 2020 were $17,400 thousand. This is the amount of total resources that the company has to work with as it moves into the year 2021.

d. The amount of dividends are found in the statement of retained earnings. At the end of 2019 the company owed total liabilities of $9,000 thousand. At the end of 2020 the company owed $9,100 thousand. Although total liabilities increased marginally, there was a larger increase in total assets, which means that total shareholders' equity is increasing.

e. The amount of dividends are found in the statement of retained earnings. The company's major source of cash is operating activities, and cash increased in 2020 by $400 thousand. Based on these two facts, it appears that the company's ability to generate cash is strong.

(10-15 min.) P 1-36A

Req. 1

(Amounts in millions)

	Assets	=	***Liabilities***	+	***Shareholders' Equity***
	$240		$150		
	350		360		
	170				
Total	$760	=	$510	+	$250

Req. 2	Resources to work with	*Req. 3* Amount owed to creditors	*Req. 4* Actually owned by company shareholders

Problems

Group B

(15-20 min.) P 1-37B

Req. 1

Snap Fasteners Inc.
Income Statement
For the Year Ended December 31, 2020

		(Millions)
Sales revenue		$56.2
Cost of goods sold	$40.0	
Other expenses	14.9	
Total expenses		54.9
Income before income tax		1.3
Income tax expense ($1.3 × 0.35)		0.5
Net income		$ 0.8

(continued) P 1-37B

Req. 2

a. Faithful representation characteristic. Account for expenses at their actual cost.

b. Separate-entity assumption. Each division of the company is a separate entity, and the company as a whole constitutes an entity for accounting purposes.

c. Stable-monetary-unit assumption. Accounting in Canada ignores the effect of inflation as the dollar's purchasing power is relatively stable.

d. Going-concern assumption. There is no evidence that Snap Fasteners Inc. is going out of business, so it seems safe to assume that the company is a going concern. Therefore, the potential sale value of Snap's assets is not relevant, nor recorded.

e. Faithful representation characteristic. Report revenues at their actual sale value because they can be verified by sales transactions and are free from bias.

f. Faithful representation characteristic. Account for expenses at their actual cost, not a hypothetical amount that the company might have incurred if the products were purchased outside.

(30-40 min.) P 1-38B

Req. 1 Computed amounts are shown in $\boxed{\text{boxes}}$. Amounts are in millions.

	Gas Limited	Electric Inc.	Water Corp.
Beginning:			
Assets	$11,200	$ 3,256	$ 909
– Liabilities	(4,075)	(1,756)	(564)
= Owners' equity	$ 7,125	$ 1,500	$ 345
Ending:			
Assets	$12,400	$ $\boxed{3,389^2}$	$1,025
– Liabilities	(4,400)	(1,699)	(565)
= Owners' Equity	$ 8,000	$ 1,690	$ 460
Owners' Equity:			
Issuance (repurchase) of shares	$ (36)	$ (0)	$ $\boxed{20^3}$
– Dividends	(341)	(30)	(0)
Income Statement:			
Revenues	$11,288	$11,099	$1,663
– Expenses	$\boxed{(10,036)^1}$	(10,879)	(1,568)
= Net income (Net loss)	$ 1,252	$ 220	$ 95
Statement of owners' equity			
Beginning owners' equity	$ 7,125	$ 1,500	$ 345
+ Issuance (repurchase) of shares	(36)	(0)	$\boxed{20^3}$
+ Net income (Net loss)	$\boxed{1,252^1}$	220	95
– Dividends	(341)	(30)	0
= Ending owners' equity	$ 8,000	$\boxed{\$\ 1,690}$	$ 460

[1]Net income = Ending owners' equity – beginning owners' equity + repurchase of shares + dividends
Net income = $8,000 – 7,125 + 36 + 341 = $1,252
Revenue – expenses = net income
$11,288 – expenses = $1,252
Expenses = $10,036

[2]Assets – liabilities = OE
Assets = $1,699 + $1,690
Assets = $3,389

[3]$345 + Issuances of shares + 95 – $0 = $460
Issuances of shares = $20

(continued) P 1-38B

Req. 2

Assets and Revenues are the two lines items that are most relevant for determining the relative sizes of companies. A company's total assets are a measure of how much resources it has to deploy to earn revenues, so a company with more assets will generally have more resources to deploy in the form of inventory, buildings, equipment, and other tangible and intangible assets. Revenues report how much a company was able to sell in goods and services during the period, so a company with higher sales is likely much larger than one with lower sales.

Req. 3

		Gas Limited	**Electric Inc.**	**Water Corp.**
Highest net income	=	\$1,252 highest	\$220	\$95
Percentage of net income to revenues	=	\$1,252 / \$11,288	\$220 / \$11,099	\$95 / \$1,663
		= 11.1% highest	= 2.0%	= 5.7%

Net income as a percentage of revenues is the better measure for comparing operating performance because it takes into account the relative size of each company based on total revenues and factors in all the expenses each incurred to earn their revenues. Two companies may report similar net incomes, but the one that has a higher proportion of revenues leftover after deducting all expenses will have relatively more money to return to shareholders, acquire more assets for expansion, and pay down debts.

(20-25 min.) P 1-39B

Req. 1

The accounts that are not presented on the balance sheet because they are revenues or expenses, but which are presented on the income statement, are as follows:

Sales revenue
Rent expense
Advertising expense
Salary expense

(continued) P 1-39B

Req. 2

Lunenberg Times Inc.
Balance Sheet
As at October 31, 2020

ASSETS		**LIABILITIES**	
Cash	$ 25,000	Accounts payable	$ 8,000
Accounts receivable	10,000	Note payable	16,000
Inventory	30,000	Total liabilities	24,000
Office furniture	15,000	**SHAREHOLDERS' EQUITY**	
Land	34,000		
		Shareholders' equity	90,000*
		Total liabilities and	
Total assets	$114,000	shareholders' equity	$114,000

*Total assets ($114,000) – Total liabilities ($24,000) = Shareholders' equity ($90,000).

Req. 3

Lunenberg Times Inc. is in a *better* financial position. Shareholders' equity has increased by $71,500, while liabilities have decreased by $84,000.

(20-25 min.) P 1-40B

Req. 1

Personal items not reported on the balance sheet of the business:

a. Personal accounts payable ($5,000)

c. Personal cash ($5,000)

f. Personal residence ($300,000) and mortgage payable ($125,000)

(continued) P 1-40B

Req. 2

Luis Fontano Realtor Inc.
Balance Sheet
As at July 31, 2020

ASSETS		**LIABILITIES**	
Cash	$ 10,000	Accounts payable	$ 10,000
Office supplies	1,000	Note payable	80,000
Furniture	18,000	Total liabilities	90,000
Land	135,000	**SHAREHOLDERS' EQUITY**	
Franchise	35,000		
		Common shares	75,000
		Retained earnings	34,000*
		Total shareholders' equity	109,000
Total assets	$199,000	Total liabilities and shareholders' equity	$199,000

*Total assets ($199,000) – Total liabilities ($90,000) – Common shares ($75,000) = $34,000.

Req. 3

Cash and Accounts Payable are the two accounts most relevant to assessing whether it can pay its short-term debts.

Req. 4

Yes, the company has $10,000 in cash at the end of the month and has to pay $10,000 in Accounts Payable in the coming weeks, so it should be able to pay its short-term debts.

(30-45 min.) P 1-41B

Note: It is left to the student to realize they must prepare the financial statements below before being able to answer the questions asked.

Beckwith Garden Supply, Inc.
Income Statement
For the Year Ended December 31, 2020

Revenue		
Service revenue		$457,600
Expenses		
Salary expense	$108,500	
Rent expense	40,600	
Interest expense	10,200	
Utilities expense	8,500	
Property tax expense	7,300	
Total expenses		175,100
Net income		$282,500

Beckwith Garden Supply, Inc.
Statement of Retained Earnings
For the Year Ended December 31, 2020

Retained earnings, December 31, 2019	$ 364,200
Add: Net income	282,500
Subtotal	646,700
Less: Dividends declared	(106,000)
Retained earnings, December 31, 2020	$ 540,700

(continued) P 1-41B

Beckwith Garden Supply, Inc.
Balance Sheet
As at December 31, 2020

ASSETS		LIABILITIES	
Cash	$ 41,000	Accounts payable	$ 24,000
Accounts receivable	84,600	Note payable	99,500
Supplies	6,800	Interest payable	2,500
Land	27,000	Total liabilities	126,000
Building	401,000	**SHAREHOLDERS' EQUITY**	
Equipment	119,000		
		Common shares	12,700
		Retained earnings	540,700
		Total shareholders' equity	553,400
Total assets	$679,400	Total liabilities and shareholders' equity	$679,400

Req. 1

a. Beckwith Garden Supply was profitable; net income was $282,500.

b. Retained earnings increased by $176,500 — from $364,200 to $540,700.

c. Shareholders' equity ($553,400) exceeds liabilities ($126,000).

The Shareholders have a greater claim against Beckwith Garden Supply's assets than do the company's creditors.

(20 min.) P 1-42B

Req. 1

Long Boat Ltd.
Statement of Cash Flows
For a Recent Year (*in thousands*)

Cash flows from operating activities:		
Net income		$ 180
Adjustments to reconcile net income to cash provided by operations		65
Net cash flow from operating activities		245
Cash flows from investing activities:		
Purchases of capital assets	$(123)	
Sales of capital assets	2	
Net cash outflow for investing activities		(121)
Cash flows from financing activities:		
Payment of dividends	(24)	
Issuance of common shares	4	
Change in bank loan	(44)	
Payment of long-term debt	(26)	
Net cash inflow from financing activities		(90)
Net increase in cash		$ 34
Cash, beginning		(11)
Cash, ending		$ 23

Req. 2

Operations were the main source of cash, which is a sign of strength. Funds from operations provided funds for investing and financing needs with a net increase in cash indicating financial strength.

(40-50 min.) P 1-43B

Req. 1

			2020	2019		
			(Thousands)			
STATEMENT OF INCOME						
Revenues			$94,500	a	=	88,250
Cost of goods sold	$73,195	=	k	65,400		
Other expenses			15,660	13,550		
Income before income taxes			5,645	9,300		
Income taxes			1,975	3,450		
Net income	3,670	=	$ l	$ b	=	5,850
STATEMENT OF RETAINED EARNINGS						
Beginning balance	15,400	=	$ m	$10,000		
Net income	3,670	=	n	c	=	5,850
Dividends			(480)	(450)		
Ending balance	18,590	=	$ o	$ d	=	15,400
BALANCE SHEET						
Assets:						
Cash	450	=	$ p	$ 400		
Capital assets			23,790	e	=	20,200
Other assets	19,250	=	q	17,900		
Total assets	43,490	=	$ r	$38,500		
Liabilities:						
Current liabilities			$11,100	$10,000		
Long-term debt and other liabilities	13,400	=	s	12,500		
Total liabilities			24,500	f	=	22,500
Shareholders' Equity:						
Common shares			$ 400	$ 600		
Retained earnings	18,590	=	t	g	=	15,400
Total shareholders' equity	18,990	=	u	16,000		
Total liabilities and shareholders' equity	43,490	=	$ v	$ h	=	38,500

(continued) P 1-43B

STATEMENT OF CASH FLOWS

Net cash provided by operating activities	2,500	=	$ w	$ 3,600		
Net cash used for investing activities			(2,700)	(4,150)		
Net cash provided by financing activities			250	900		
Increase (decrease) in cash			50	i	=	350
Cash at beginning of year	400	=	x	50		
Cash at end of year	450	=	$ y	$ j	=	400

Req. 2

a. Operations deteriorated during 2020. The income statement reports that revenues increased, but net income fell from $5,850 thousand to $3,670 thousand. Cost of goods sold increased as a percentage of revenue (77.4% vs. 74.1%).

b. The company retained most of its net income for use in the business. The statement of retained earnings reports that paid dividends were $480 thousand in 2020 and $450 thousand in 2019, which are much less than net income.

c. The balance sheet reports total assets at the end of 2020 were $43,490 thousand. This is the amount of total resources that the company has to work with as it moves into the year 2021. At the end of 2019 the balance sheet shows that the company had total assets of $38,500 thousand.

d. The balance sheet shows that at the end of 2019, the company owed total liabilities of $22,500 thousand and at the end of 2020, the company owed $24,500 thousand.

e. The statement of cash flows reports that the company's major source of cash is operating activities, and cash is increasing. Based on these two facts, it appears that the company's ability to generate cash is strong despite the dip in 2020 net income. The company is using most of its cash to invest. It is clear from the large amounts of cash used for investing activities that the company is growing.

(5-10 min.) P 1-44B

Req. 1

(Amounts in millions)

	Assets	=	*Liabilities*	+	*Shareholders' Equity*
	$320		$190		
	250		410		
	140				
Total	$710	=	$600	+	$110

Req. 2 Resources to work with	*Req. 3* Amount owed to creditors	*Req. 4* Actually owned by company shareholders

Decision Cases

(20-30 min.) Decision Case 1

Req. 1

Based solely on these balance sheets, PC Providers Inc. (PPI) appears to be the better credit risk than Web Services Corporation (WSC) because,

1. WSC has more assets ($430,000) than PPI ($223,000), but WSC owes much more in liabilities than PPI ($390,000 versus $40,000). PPI's shareholders' equity is far greater than WSC's ($183,000 compared to $40,000). PPI is not heavily in debt, but WSC is.

2. The student should consider the borrower's ability to pay the loan. WSC has large liabilities to pay, and has very little shareholders' equity. PPI has little debt to pay before undertaking a new loan. The income statement and statement of cash flows should also be considered.

Req. 2

1. The student should request that the borrower present the entity's *income statement* for a recent period, such as the most recent month, the most recent three months, and the last year. The income statement reports the revenues earned by the entity, the expenses it incurred, and the net income or net loss for the periods. Income statement data (especially the amount of net income or net loss) provide an important measure of business success or failure, in particular over recent fiscal periods.

(continued) Decision Case 1

2. The student should request that the borrower present the entity's statement of cash flows for the most recent period. In particular, he or she would want to know how the borrower generates cash—from operating, investing, or financing activities. If cash from operations is strong, WSC may be able to cover large debt obligations.

3. What the borrower plans to do with the loan will affect the decision — investment in assets to generate greater revenue would provide greater opportunity for a loan provision.

(15-20 min.) Decision Case 2

Note: It is left to the student to realize they must first prepare the corrected statements below before being able to answer the requirement.

My Dream Inc.
Income Statement
For the Year Ended December 31, 2020

Revenues ($80,000 + $10,000)	$90,000
Expenses ($60,000 + $20,000 + $10,000)	90,000
Net income	$ 0

My Dream Inc.
Balance Sheet
December 31, 2020

Cash	$13,000	Liabilities ($35,000 + $10,000)	$45,000
Accounts receivable	10,000	Equity ($45,000 – $20,000)	25,000
Other assets ($67,000 – $20,000)	47,000		
	$70,000		$70,000

(continued) Decision Case 2

Req. 1

The balance sheet indicates that My Dream has greater debt than shareholder's equity. The statement of cash flows would provide information as to how much of the debt relates to investment in assets to generate revenue in the future.

The income statement indicates the company broke even with neither a profit nor a loss in its first year.

I would buy shares in the company if my friend would invest more or find other investors, and if she would also commit to getting a competent accountant to keep her records and prepare her financial statements.

Note: Student responses may vary.

(20-30 min.) Decision Case 3

Island Coffee Roasters Corporation
Income Statement
For the Month Ended August 31, 2020

Revenue:		
Service revenue …………………………		$279,300
Expenses:		
Salary expense …………………………	$78,100	
Utilities expense ………………………	5,800	
Rent expense ……………………………	1,800	
Total expenses …………………………		85,700
Net income ……………………………………		$193,600

(continued) Decision Case 3

Island Coffee Roasters Corporation
Statement of Retained Earnings
For the Month Ended August 31, 2020

Retained earnings, August 1, 2020	$ -0-
Add: Net income	193,600
Subtotal	193,600
Less: Dividends declared	(2,700)
Retained earnings, August 31, 2020	$190,900

Island Coffee Roasters Corporation
Balance Sheet
As at August 31, 2020

Assets		**Liabilities**	
Cash	$ 6,000	Accounts payable	$ 8,900
Office supplies	7,500	Shareholders' Equity	
Equipment	200,000	Common shares	13,700
		Retained earnings	190,900
		Total shareholders' equity	204,600
		Total liabilities and	
Total assets	$213,500	shareholders' equity	$213,500

(continued) Decision Case 3

Island Coffee Roasters Corporation
Statement of Cash Flows
For the Month Ended August 31, 2020

Cash flows from operating activities:		
Net income		$193,600
Adjustments to reconcile net income to net cash provided by operations		1,400
Net cash provided by operating activities		195,000
Cash flows from investing activities:		
Acquisition of equipment	$(200,000)	
Net cash used for investing activities		(200,000)
Cash flows from financing activities:		
Issuance (sale) of shares to owners	$ 13,700	
Payment of dividends	(2,700)	
Net cash provided by financing activities..		11,000
Net increase in cash		$ 6,000
Cash balance, August 1, 2020		0
Cash balance, August 31, 2020		$ 6,000

(continued) Decision Case 3

Note: It is left to the student to realize they have to prepare the financial statements above before being able to write the report that follows.

TO: Owner of Island Coffee Roasters Corporation

FROM: Student Name

SUBJECT: Opinion of net income, dividends, financial position, and cash flows

Your first month of operations was successful. Revenues totalled $279,300 and net income was $193,600. These operating results look very strong.

The company was able to pay a $2,700 dividend, and this should make you happy with so quick a return on your investment. Your financial position looks secure, with assets of $213,500 and liabilities of only $8,900. Your shareholders' equity is $204,600.

Operating activities generated cash of $195,000, which is respectable. Operating activities are the main source of cash, which is expected for a thriving company. You ended the month with cash of $6,000. Based on the above facts, I believe you should stay in business.

Student responses may vary.

Ethical Decision 1

Note to instructor: student responses will vary on this problem. Keep the discussion pointed toward use of the multiple-criteria model for making good ethical decisions, pointing out elements of students' reasoning that may be faulty or incomplete. It might be useful to have a debate or role play, assigning students to different sides of the issue (for or against accepting a copy of the exam).

Req. 1

The fundamental ethical issue in this situation is whether you should accept a copy of the old exam from your friend.

(continued) Ethical Decision 1

Req. 2

The stakeholders are:

a. You
b. Your friend
c. The remainder of the students in the class
d. The professor
e. The University
f. Your family

(This may not be a complete list; you may think of more.)
Consequences are discussed in requirement 3.

Req. 3

Analysis of the problem:

a. Economic perspective: If use of the old exam turns out to help you (it may not) you might improve your grade and allow you to retain your scholarship. This might help you and your family financially. If you use the exam to your unfair advantage, and you are reported, you and possibly your friend might receive grades of F in the class although you might otherwise have passed. This could cause adverse economic consequences to you, your friend and your families.

b. Legal perspective: Although it may not violate local or federal law, giving or accepting copies of old exams may violate the university's honor code, which serves the same purpose of a legal code in this case. If you use the old exam and it turns out that you violated the University's honor code, both you and your friend could be in trouble. Your family and your friend's family could also be impacted by any adverse consequences to you or her. Academic institutions establish policies against academic dishonesty because cheating hurts everyone—the student who commits the act, the other students in the class whose rights to fair treatment are violated by cheating, the professor, who must endure hours of investigating, reporting, and perhaps testifying.

(continued) Ethical Decision 1

c. Ethical perspective. Receiving questionable help from others in the face of policies that prohibit it is, at best, risky, and at worst, downright wrong. Cheating is similar to stealing, since it is stealing the work of another without their permission. It is usually accompanied by lying to cover it up, or at least, not concealing the truth. Cheating violates other students' rights to fair and equal treatment. It violates the instructor's rights to run a course as a "fair game" for all participants. Because the students and faculty are hurt by cheating, the university is hurt too. If cheating goes unpunished, grades are inflated, ultimately damaging the academic reputation of the institution and eroding the value of its degrees. Parents of students who are caught cheating have to endure the agony of working through the problem with their son or daughter, and perhaps the social stigma that comes from adverse publicity.

These are just some of the arguments against cheating. Of course, there is a question in this case as to whether taking the test actually violates the professor's or the university's policies.

Req. 4

It would be helpful to find out what the professor's policies are with respect to use of fraternity and sorority test files. The university might have a blanket policy on this. (Some students might spend a little time researching this by reading the university's honor code on their web site; just reading the honor code will be an eye-opening experience for most students). Advise your students to research the use of fraternity and sorority test files on the university web site, or to discuss the issue with the head of the department or the chair of the university honor council.

Unfortunately, in this case, there is not much time. Researching the issue in the university's honour code takes valuable time away from studying for the exam, which, if you do, could help you raise your grade and solve the whole problem!

Probably the best solution to this problem is "when in doubt, don't." You may not do well on the test, but at least you won't have to live with the terrible consequences of being accused as a cheater. It should make you feel better in the long run that, although you may not make the highest grades in the class, at least you are not a cheater.

(continued) Ethical Decision 1

Req. 5

Cheating is very closely related to stealing, which is a form of fraud. When employees steal from their companies, they steal property that belongs to others. There are economic, legal, and ethical consequences to the company, the employee and their families, and customers (who ultimately have to pay for fraud through higher prices).

Ethical Decision 2

Hill should report the errors to Armour because Armour is Hill's supervisor, and Armour is responsible for the errors. If Armour fails to take action, then Hill should report the errors to the manager of the organization. In any event, outsiders who are relying on Stainton Hardware's financial statements must be made aware of the need to correct the reported net income figure.

Ethical Decision 3

a. Professional behaviour, integrity

b. Professional competence

c. Professional behaviour, integrity

d. Professional behaviour, integrity

Focus on Financial Statement Analysis

(30 min.) Dollarama Inc.

1. *Net earnings*, This item is important as it expresses the net result of all the income minus all the expenses for a period. Net earnings gives the results of operations in a single figure.

   In fiscal year 2018, net earnings increased from $445.6 million to $519.4 million. This increase of 16.6% is great news for Dollarama and its stakeholders.

2. Dollarama's largest expense is the cost of sales, which amounted to $1,965.2 million in 2018 and $1,801.9 million in 2017. These costs represented 60.2% and 60.8% of total sales in each year. Items that make up this expense would include the costs of the kitchenware, candy, toys, party supplies, and other goods sold in Dollarama's stores.

   This expense is less than sales revenue because Dollarama runs its business to earn a profit. If this expense exceeded sales revenue, the company would be in financial difficulty.

(continued) Dollarama Inc.

3. Total resources (total assets) .... $1,934.3 million

   Amount owed (total liabilities) .... $2,186.7 million

   Portion of the company's assets owned by the company's
   shareholders (shareholders' deficit) .... $(252.4) million

   Dollarama's accounting equation is (*in millions*):

Assets	=	Liabilities	+	Shareholders' equity
$1,934.3	=	$2,186.7	+	$(252.4)

4. At the beginning of fiscal year 2018 Dollarama had cash of $62 million, and at the end of the year Dollarama had cash of $54.8 million. Operating activities generated the most cash during 2018. Dollarama spent the most cash on financing activities during 2018

5. Dollarama's financial condition looks fairly strong because both its sales and net earnings increased significantly from 2017 and it generated significant cash flows from operating activities. One weak spot is its financial position, with its liabilities exceeding its assets, leaving Dollarama's shareholders in a deficit position at the end of the year.

