

SOLUTIONS TO EXERCISES – SERIES A – CHAPTER 2

EXERCISE 2-1A

a.

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

EXERCISE 2-1A (cont.)

b.

The Ramires, Incorporated Income Statement For the Period Ended December 31, Year 1			
Revenue		\$52,000	
Expenses		(27,000)	
Net Income		\$25,000	

The Ramires, Incorporated Statement of Changes in Stockholders' Equity For the Period Ended December 31, Year 1			
Beginning Common Stock	\$ -0-		
Plus: Common Stock Issued	56,000		
Ending Common Stock		\$56,000	
Beginning Retained Earnings	\$-0-		
Plus: Net Income	25,000		
Less: Dividends	(1,000)		
Ending Retained Earnings		24,000	
Total Stockholders' Equity		\$80,000	

EXERCISE 2-1A b. (cont.)

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

EXERCISE 2-1A b. (cont.)

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

EXERCISE 2-2A

a.

The Candle Shop Horizontal Statements Model for Year 1														
Event	Balance Sheet								Income Statement				Statement of Cash Flows	
	Assets			=	Liab.	+	Stockholders' Equity	Revenue	–	Expense	=	Net Inc.		
	Cash	+	Land	=	Notes Payable	+	Common Stock							
1	I	+	NA	=	NA	+	I	NA	–	NA	=	NA	I	FA
2	D	+	NA	=	NA	+	NA	NA	–	NA	=	NA	D	FA
3	D	+	NA	=	NA	+	NA	NA	–	I	=	D	D	OA
4	I	+	NA	=	I	+	NA	NA	–	NA	=	NA	I	FA
5	I	+	NA	=	NA	+	NA	I	–	NA	=	I	I	OA
6	D	+	I	=	NA	+	NA	NA	–	NA	=	NA	D	IA
7	NA	+	NA	=	NA	+	NA	NA	–	NA	=	NA	NA	

EXERICSE 2-3A

a. Missing items are determined as follow:

- (a) \$200,000; Since the cash flow column shows that this event was financing activity, we can infer that the company either borrowed money or issued stock. Since the model shows that liabilities were not affected, we conclude that the common stock account increased by \$200,000.**
- (b) NA; Since issuing common stock (see answer to (a) above), does not affect the revenue account, the answer is not affected (NA).**
- (c) NA; Since issuing common stock (see answer to (a) above), does not affect net income, the answer is not affected (NA).**
- (d) NA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money does not affect net income.**
- (e) FA; Since assets and liabilities increased, we infer that the company borrowed money. Borrowing money is a financing activity (FA).**
- (f) 500,000; Since cash decreased and no other balance sheet account other than the land account was affected, the company must have purchased land which would cause the land account to increase by 500,000.**
- (g) IA; Purchasing land (see answer to (f) above) is in investing activity (IA).**
- (h) 95,000; The income statement shows \$95,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.**
- (i) 95,000; The income statement shows \$95,000 of revenue. Recognizing revenue increases the cash and retained earning accounts on the balance sheet.**

EXERCISE 2-3A a. (cont).

- (j) (65,000); The statement of cash flows shows that the \$65,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to reduce the amount of retained earnings shown in the balance sheet.**
- (k) 65,000; The statement of cash flows shows that the \$65,000 cash outflow was an operating activity. Therefore, we conclude that this is an expense item that will act to increase amount of expenses shown in the income statement.**
- (l) FA; Since the event decreases cash and retained earnings on the balance sheet; and does not affect the income statement, we conclude that this was a dividend payment which is a financing activity (FA)**
- (m) 68,000; This amount is determined by totaling the vertical column.**
- (n) 95,000; This amount is determined by totaling the vertical column.**

EXERCISE 2-3A a. (cont.)

Completed Horizontal Statements Model

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

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

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

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

EXERCISE 2-4A

Holloway Company Effect of Events on the Year 1 Financial Statements									
	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	+	Accounts Rec.	=		+	Common Stock	+	Retained Earnings
Earned Revenue	NA	+	18,000	=	NA	+	NA	+	18,000
Coll. Acct. Rec.	14,000	+	(14,000)	=	NA	+	NA	+	NA
Ending Balance	14,000	+	4,000	=	-0-	+	-0-	+	18,000

- Accounts Receivable: $\$18,000 - \$14,000 = \$4,000$
- $\$18,000$ Net Income
- $\$14,000$ cash collected from accounts receivable.
- $\$18,000$
- $\$18,000$ of revenue was earned but only $\$14,000$ of it was collected.

EXERCISE 2-5A

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

- Accounts receivable will appear as an “asset” on the December 31, Year 1 balance sheet.
- \$3,000. Total from the accounts receivable column in the horizontal statements model.
- \$7,000. Total from the net income column in the horizontal statements model.
- \$4,000. Net cash flow from operating activities (\$22,000 - \$18,000).
- Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but will not be reflected on the cash flow statement until the cash is collected.

EXERCISE 2-6A

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

- \$4,000. Total from the accounts payable column in the horizontal statements model.
- \$12,000. Total from the expenses column in the horizontal statements model.
- \$7,000. Total cash flow from operating activities.
- \$3,000. Total from the retained earnings column in the horizontal statements model.
- Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. When a company incurs an expense, this amount is reflected in expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-7A

a.

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

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

b.

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

EXERCISE 2-7A (cont.)

c.

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

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

EXERCISE 2-8A

a.

Milea Inc. General Ledger Accounts For the Year Ended December 31, Year 1							
	Assets		=	Liabilities	+	Stockholders' Equity	
Event	Cash	Acct. Rec.	=	Salaries Pay.	+	Common Stock	Retained Earn.
1.	20,000		=		+	20,000	
2.		56,000	=		+		56,000
3.	(2,500)		=		+		(2,500)
4.	48,000	(48,000)	=		+		
5.			=	10,000	+		(10,000)
6.	(2,000)		=		+		(2,000)
Totals	63,500	8,000	=	10,000	+	20,000	41,500

b.

Milea Inc. Income Statement For the Year Ended December 31, Year 1			
Revenue			\$56,000
Expenses			
Utility Expense	\$ 2,500		
Salaries Expense	10,000		
Total Expenses			(12,500)
Net Income			\$43,500

EXERCISE 2-8A b. (cont.)

Milea Inc. Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 1			
Beginning Common Stock	\$ -0-		
Plus: Common Stock Issued	20,000		
Ending Common Stock		\$20,000	
Beginning Retained Earnings	-0-		
Plus: Net Income	\$43,500		
Less: Dividends	(2,000)		
Ending Retained Earnings		41,500	
Total Stockholders' Equity		\$61,500	

Milea Inc. Balance Sheet As of December 31, Year 1			
Assets			
Cash	\$63,500		
Accounts Receivable	8,000		
Total Assets		\$71,500	
Liabilities			
Salaries Payable	\$10,000		
Total Liabilities		\$10,000	
Stockholders' Equity			
Common Stock	\$20,000		
Retained Earnings	41,500		
Total Stockholders' Equity		61,500	
Total Liab. and Stockholders' Equity		\$71,500	

EXERCISE 2-8A b. (cont.)

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

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

EXERCISE 2-9A

a.

Lewis and Harper Statements Model for Year 1															
	Balance Sheet								Income Statement				Statement of		
	Assets			=	Liabilities			+	S. Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flows
Event	Cash	+	Accts. Rec.	=	Acct. Payable	+	Sal. Pay.	+	Retained Earn.						
1.	NA	+	70,00	=	NA	+	NA	+	70,000	70,000	-	NA	=	70,000	NA
2.	40,000	+	NA	=	NA	+	NA	+	40,000	40,000	-	NA	=	40,000	40,000 OA
3.	NA	+	NA	=	36,000	+	NA	+	(36,000)	NA	-	36,000	=	(36,000)	NA
4.	(10,000)	+	NA	=	NA	+	NA	+	(10,000)	NA	-	10,000	=	(10,000)	(10,000) OA
5.	47,000	+	(47,000)	=	NA	+	NA	+	NA	NA	-	NA	=	NA	47,000 OA
6.	(16,000)	+	NA	=	(16,000)	+	NA	+	NA	NA	-	NA	=	NA	(16,000) OA
7.	(8,000)	+	NA	=	NA	+	NA	+	(8,000)	NA	-	NA	=	NA	(8,000) FA
8.	NA	+	NA	=	NA	+	2,000	+	(2,000)	NA	-	2,000	=	(2,000)	NA
Totals	53,000	+	23,000	=	20,000	+	2,000	+	54,000	110,000	-	48,000	=	62,000	53,000 NC

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

c. \$23,000

d. \$20,000

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

f. \$62,000

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

EXERCISE 2-10A

a. & c.

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

b.

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

d.

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

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

EXERCISE 2-11A

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

- Revenue recognized, \$62,000.
- Cash flow from revenue, \$51,000.
- Revenue, \$62,000, less operating expenses, \$39,000 = \$23,000 net income.
- Accounts receivable collected, \$51,000, less cash paid for expenses, \$31,000 = \$20,000 cash flow from operating activities.
- Income of \$62,000 was earned, but only \$51,000 was collected (a difference of \$11,000); operating expenses incurred were \$39,000 but only \$31,000 was paid during the period (a difference of \$8,000). Consequently, net income is \$3,000 more than cash flow from operating activities.
- \$21,000 cash outflow for the purchase of land.
- \$40,000 cash inflow from the issue of common stock.
- Total assets**
Total liabilities
Total equity

= \$71,000 (\$39,000 + \$11,000 + \$21,000)
= \$8,000
= \$63,000 (\$40,000 + \$23,000)

EXERCISE 2-12A

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

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

EXERCISE 2-13A

- a. $\$8,000 \times 6\% = \480 ; $\$480 \times 5/12 = \200
- b. $\$0$ -, no interest was paid in Year 1; $\$480$ of interest will be paid in Year 2.
- c.

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

EXERCISE 2-14A

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

b.

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

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

- c. \$-0-. All interest will be paid at maturity, June 1, Year 2, for this note payable.
- d. \$3,733
- e. \$6,400 ($\$80,000 \times 8\%$). All interest will be paid when the note payable matures.
- f. \$2,667 ($\$80,000 \times 8\% \times 5/12$) or ($\$6,400 - \$3,733 = \$2,667$)
- g. \$-0-

EXERCISE 2-15A

Solve for “X” in the following scenarios:

a.

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

b.

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

c.

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

EXERCISE 2-15A a. (cont.)

d.

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

EXERCISE 2-16A

Solve for “X” in the following scenarios:

a.

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

b.

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

c.

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

EXERCISE 2-16A a. (cont.)

d.

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

EXERCISE 2-17A

- a. Solve for "X"

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

- b. \$7,500. Revenue (\$70,500) minus expenses (\$63,000).
- c. \$9,000. Cash inflow from AR collections (\$72,000) minus cash expenses (\$63,000).
- d. Cash flow from operating activities and net income are different in most cases, because there is a time gap between when revenue is earned and cash is collected. When a company earns revenue on account, this amount is reflected in net income but will not be reflected on the cash flow statement until the cash is collected.

EXERCISE 2-18A

- a. Solve for “X”

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

- b. \$22,000. Revenue (\$85,000) minus expenses (\$63,000).
- c. \$45,000. Cash inflow from sales (\$85,000) minus cash outflow for expenses (\$40,000).
- d. Cash flow from operating activities and expenses are different in most cases, because there is a time gap between when an expense is incurred and when cash is paid for that expense. When a company incurs an expense, this amount is reflected in expenses on the income statement but will not impact the cash flow statement until the cash is paid.

EXERCISE 2-19A

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

Responsibilities Principle

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

The Public Interest Principle

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

Integrity Principle

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

Objectivity and Independence Principle

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

Due Care Principle

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

Scope and Nature of Services Principle

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

SOLUTIONS TO PROBLEMS – SERIES A – CHAPTER 2

PROBLEM 2-20A

a.

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

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

c.

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

PROBLEM 2-20A (cont.)

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

e.

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

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

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

- f. Percentage of assets is provided as follows:

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

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

PROBLEM 2-21A

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

PROBLEM 2-22A

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

- \$36,000. Total of the land column in the horizontal statements model.
- \$40,500. Cash inflows of \$46,000 minus cash outflows of \$5,500.
- \$30,000. Total of the liabilities column in the horizontal statements model.
- \$15,000. Cash inflow from the sale of land (\$30,000) minus cash outflow from the purchase of land (\$15,000).

PROBLEM 2-22A (cont.)

- e. \$28,000. Total of the expenses column in the horizontal statements model.**
- f. \$58,000. Total of the revenue column in the horizontal statements model.**
- g. \$18,000. Cash inflow from issuance of common stock (\$20,000) minus cash outflow from dividend (\$2,000).**
- h. \$30,000. Revenues (\$58,000) minus expenses (\$28,000).**
- i. \$75,500. Total of the retained earnings column in the horizontal statements model.**

PROBLEM 2-23A

a.

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

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

PROBLEM 2-23A a. (cont.)

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

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

**960 = 240 + 720

PROBLEM 2-23A (cont.)

b.

Sentry Inc. Income Statement For the Period Ended December 31, Year 1 & Year2			
	Year 1	Year 2	
Revenue	\$62,000	\$0	
Expenses	(3,940)	(720)	
Net Income	\$58,060	\$(720)	

Sentry Inc. Statement of Changes in Stockholders' Equity For the Period Ended December 31, Year 1 & Year2			
	Year 1	Year 2	
Beginning Common Stock	\$ -0-	\$20,000	
Plus: Common Stock Issued	20,000	0	
Ending Common Stock	\$20,000	\$20,000	
Beginning Retained Earnings	\$ -0-	\$58,060	
Plus: Net Income	58,060	(720)	
Ending Retained Earnings	\$58,060	\$57,340	
Total Stockholders' Equity	\$78,060	\$77,340	

PROBLEM 2-23A b. (cont.)

Sentry Inc. Balance Sheet December 31, Year 1 & Year 2			
	Year 1	Year 2	
Assets			
Cash	\$34,100	\$77,340	
Accounts Receivable	\$57,000	\$0	
Total Assets	\$91,100	\$77,340	
Liabilities			
Accounts Payable	\$800	\$0	
Interest Payable	240	0	
Notes Payable	12,000	0	
Total Liabilities	\$13,040	\$0	
Stockholders' Equity			
Common Stock	\$20,000	\$20,000	
Retained Earnings	\$58,060	\$57,340	
Total Stockholders' Equity	\$78,060	\$77,340	
Total Liabilities and Stockholders' Equity	\$91,100	\$77,340	

PROBLEM 2-23A b. (cont.)

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

***\$1,760 = \$800 + \$960**

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

PROBLEM 2-24A

a.

Bennett Company Income Statement For the Year Ended December 31, Year 1			
Revenue			
Service Revenue	\$42,000		
Total Revenue		\$42,000	
Expenses			
Other Operating Expenses	\$20,000		
Salary Expense	10,000		
Interest Expense	4,000		
Total Expenses		(34,000)	
Net Income		\$8,000	

Bennett Company Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 1			
Beginning Common Stock	\$40,000		
Plus: Stock Issued	5,000		
Ending Common Stock		\$45,000	
Beginning Retained Earnings	\$ 15,000		
Plus: Net Income	8,000		
Less: Dividends	(3,000)		
Ending Retained Earnings		20,000	
Total Stockholders' Equity		\$65,000	

PROBLEM 2-24A a. (cont.)

Bennett Company Balance Sheet As of December 31, Year 1			
Assets			
Cash	\$23,000		
Accounts Receivable	18,000		
Land	59,000		
Total Assets		\$100,000	
Liabilities			
Accounts Payable	\$17,000		
Interest Payable	3,000		
Accrued Salaries Payable	5,000		
Notes Payable	10,000		
Total Liabilities		\$ 35,000	
Stockholders' Equity			
Common Stock	\$45,000		
Retained Earnings	20,000		
Total Stockholders' Equity		\$ 65,000	
Total Liab. and Stockholders' Equity		\$100,000	

PROBLEM 2-24A a. (cont.)

Bennett Company Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flow From Operating Activities	\$33,000	
Cash Flow From Investing Activities	(32,000)	
Cash Flow From Financing Activities	2,000	
Net Change in Cash	3,000	
Plus: Beginning Cash Balance	20,000	
Ending Cash Balance	\$23,000	

b.

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

c.

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

PROBLEM 2-25A

a.

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

b.

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

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

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

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

PROBLEM 2-26A

The three common features of ethical misconduct are:

- 1. The availability of an opportunity**
 - 2. The existence of some sort of pressure**
 - 3. The capacity for rationalization**
-
- 1. Even though Pete has exceeded his authority, no one has complained because he is bringing in more revenue. Oversight by a partner would eliminate this type of problem.**
 - 2. Pete is in a financial bind and does not want to discuss his problem with others for fear of ruining his image. Therefore, he is willing to take risks to keep his secret.**
 - 3. He rationalizes that his actions do not hurt anyone because the client is getting the service and the firm is getting a reasonable fee.**