

Solutions Manual for Financial Accounting for Managers 1st Thomas

Chapter 2

The Financial Statements

Instructors' Notes

Chapter 2 offers a deep dive into the five financial statements. For this chapter, we focus on a single company, **Lululemon**, that we introduce in the feature story. This introduction provides some information about the company's origin and subsequent growth story (the *narrative story*), but it primarily explains that the chapter is dedicated to helping students understand how to use financial statements to discover the *financial story* of company. We focus on a single company so that students can see how the various financial statements each help to tell its unique part of the story.

It is critical that students have a solid understanding of financial statements before diving into the details of the accounting cycle presented in Chapter 3 and 4. Having this solid foundation will make it less likely that students get "lost in the weeds" in these subsequent chapters because they will have a clear picture of the final destination – the financial statements.

PART A: The Balance Sheet

- LO2-1** Describe the various asset classifications and measurement methods.
- LO2-2** Describe the various liabilities and stockholders' equity classifications.
- LO2-3** Understand the limitations of the balance sheet.

Part A is dedicated to the balance sheet. We first drive home the idea that the balance sheet (or statement of financial position) presents the assets, liabilities, and equity accounts of a company at a given *point in time*. The balance sheet of Lululemon is presented and then we simply walk-down the balance sheet, providing a description of the various accounts and how they are organized. One key distinction to emphasize in the balance sheet is classification of current versus long-term. Decision makers want to compare the company's current resources to current obligations, as well as long-term resources to long-term obligations.

The discussion of the various current assets includes cash and cash equivalents, accounts receivable, inventories and prepaid expenses, and introduces the idea that these accounts are listed in order of liquidity. The discussion of the long-term assets includes descriptions of long-term investments, PPE, operating leases, and intangible assets. We then make a very important point that the various assets reported in the balance sheet are measured using different methods including historical cost, amortized cost, net realizable value, and fair value. In class, we like to present these different valuation methods and then ask students to try to identify an example account that uses each particular method.

Next, we walk down the current liabilities, which includes a discussion of accounts payable, deferred revenues, accrued liabilities, and the current portion of long-term debt. This is followed by a discussion of long-term liabilities that features notes, bonds, leases, and pension obligations. We complete the walk down of the balance sheet by discussing contributed capital (i.e., common stock and APIC), retained earnings, and AOCI.

In class, we like to present the balance sheet of a different company from another industry (e.g., Dropbox) and repeat this walk down talking through and answering questions about each of the major accounts on the balance sheet.

Part B concludes with the limitations of the balance sheet. We feel it is very important that students understand that the accounting system is not perfect and has its limitations. We emphasize the difference between book value and market value, which is an important contrast to make. In class, we like to emphasize the market-to-book ratio and drive home the point that both the accounting system (book value) and the market system (market value) are trying to measure the same economics, but these each do so imperfectly with noise. The book value is subject to limitations such as historical costs, unreported assets, and the use of estimates. The market value is subject to limitations such as market bubbles. Some students are surprised to see that market values nearly always tend to be far greater than book values (Illustration 2-7).

PART B: The Income Statement

- LO2-4** Describe revenues, expenses, gains, and losses.
- LO2-5** Calculate the different measures of income.
- LO2-6** Understand the limitations of the income statement.

Part B focuses entirely on the income statement. Here we follow a similar pattern to that used in Part A. That is, we present the income statement of Lululemon and then provide a description of each of the major components of net income including revenue, expense, gain, and loss accounts. We emphasize that the income statement measures activity *over a period of time*. This is followed by a discussion of the various measures of income including gross profit, operating income, nonoperating income, pretax income, and finally net income. We also discuss EPS in this section and introduce the idea that the income statement generally is presented in one of two formats – the single-step format or the multiple-step format.

Part B ends with a discussion of the limitations of the income statement, which includes challenges related to the how taxes relate to operating and nonoperating accounts and the extensive use of estimates and judgements to create the statement, which are susceptible to manipulation and bias.

In class, we find it very useful to also walk down the income statement of a different company (e.g., Dropbox) to reinforce the reading and answer questions.

PART C: The Statement of Cash Flow

- LO2-7** Identify operating, investing, and financing activities.

Part C focuses on the statement of cash flow. Chapter 11 is entirely dedicated to the construction of the statement of cash flows, so in Chapter 2, our objective is simply to help students get familiar with the three types of cash flow activities. We present an abbreviated version of Lululemon's statement of cash flows that collapses all of the adjustments to net income in the operating section into two groups: (1) adjustments of noncash items and (2) changes in operating assets and liabilities. The related discussion provides a very simple discussion of why such adjustments are needed to go from net income to operating cash flows. In this discussion, we talk about the difference between cash-basis and accrual-basis accounting, which provides an excellent foundation for the material in Chapters 3 and 4. We then walk down the investment and financing sections of the statement.

In class, we like to have the students work through a “sorting laundry” exercise where we give them a list of transactions and then ask them to categorize each into operating, investing, or financing activities. The transactions provided in Illustrations 2-10, 2-12, and 2-13 can be used to create this list.

PART D: Statements of Stockholders' Equity and Comprehensive Income

LO2-8 Understand the purpose of the statement of stockholders' equity.

LO2-9 Understand the distinguishing features of comprehensive income.

We conclude the chapter with brief discussions of the statement of stockholders' equity and the statement of comprehensive income. In Illustration 2-14, we present the statement of stockholders' equity for Lululemon. In class, we like to emphasize the Retained Earnings column as that place where the income statement and the balance sheet link (or articulate) with each another. We then discuss comprehensive income as “an even more bottom line”. Many students are surprised that another measure of income exists. In class, we like to present the list of items included in other comprehensive income and then ask the class to think about what these items all have in common. Here we make the point that they generally are outside the control of management and unrealized. In class, it is also fun to show an example where a company has a big difference between net income and comprehensive income. Even though this example is dated, Abercrombie and Fitch (period ending January 20, 2010) works well. Many of the companies with the largest positive amounts of accumulated other comprehensive income tend to be financial institutions. Many nonfinancial companies have large negative amounts of accumulated other comprehensive income from foreign currency translations and pension losses.

TBEXAM.COM

Chapter 2

The Financial Statements

REAL-WORLD PERSPECTIVES

RWP2-1 EDGAR Costco Wholesale Corp. (ticker: COST)

1. \$45,400 million
2. \$29,816 million
3. \$15,584 million
4. Yes, $\$45,400 - \$29,816 = \$15,584$
5. Total non-current assets = Total assets – Current assets = $\$45,400 - \$23,485 = \$21,915$
6. Costco's long-term debt increased over the previous year by \$246 million

	Current <u>year</u>	Previous <u>year</u>	Change
Current portion of LT debt	\$1,699	\$90	
Long-term debt (excluding current portion)	5,124	6,487	
Total debt	\$6,823	\$6,577	\$246

TBEXAM.COM

7. Costco's retained earnings increased over the previous year by \$2,371 ($\$10,258 - \$7,887$)

RWP2-2 EDGAR Amazon (ticker: AMZN)

1. \$280,522 million. Revenue increased over the previous year.
2. \$14,541 million. Operating income increased over the previous year.
3. \$11,588 million. Net income increased over the previous year.
4. Operating activities produced a positive net cash inflow of \$38,514 million in cash.
5. Investing activities produced a negative net cash outflow of \$24,281 million in cash.
6. Financing activities produced a negative net cash outflow of \$10,066 million in cash.

RWP2-3 EDGAR AMC Entertainment Holdings (ticker: AMC)

1. \$1,397.6 million
2. \$1,214.2 million
3. Net loss decreased the balance in total stockholder's equity by \$149.1 million.
4. Stock based compensation increased the balance by \$4.4 million.

RWP2-4 EDGAR Domino's Pizza Inc (ticker: DPZ)

1. Comprehensive income is greater than net income.
2. Foreign currency translation adjustment.

RWP2-5 Financial Analysis: American Eagle

(\$ in thousands)

1. Operating lease right-of-use assets are the largest asset.
2. Non-current operating lease liabilities are the largest liability.
3. Sales (or net revenue) Growth % = $(\$4,308,212 - \$4,035,720) \div \$4,035,720 = 6.8\%$
4. Cost of sales is the largest expense item.
5. American Eagle's operations produced cash flows of \$415,416.
6. American Eagle has capital expenditures of \$210,360.

RWP2-6 Financial Analysis: The Buckle, Inc.

(\$ in thousands)

1. Property and equipment is the largest asset.
2. Noncurrent operating lease liabilities are the largest liability.
3. Sales Growth % = $(\$900,254 - \$885,496) \div \$885,496 = 1.7\%$
4. Cost of sales is the largest expense item.
5. Buckle's operations produced cash flows of \$130,665.
6. Buckle has capital expenditures of \$7,322.

Account Name	Financial Statement	Account
Cash	Balance sheet	Asset
Common Stock	Balance sheet	Equity
Service Revenue	Income statement	Revenue
Salaries Expense	Income statement	Expense
Accounts Payable	Balance sheet	Liability
Equipment	Balance sheet	Asset
Advertising Expense	Income statement	Expense
Supplies	Balance sheet	Asset
Salaries Payable	Balance sheet	Liability
Insurance Expense	Income statement	Expense

©McGraw Hill LLC. All rights reserved. No reproduction or further distribution permitted without the prior written consent of McGraw Hill LLC

Brief Exercise 2-3

	<u>(Yes/No)</u>	<u>Balance Sheet Account?</u>
1.	<u>Yes</u>	Cash
2.	<u>No</u>	Service revenue
3.	<u>Yes</u>	Accounts payable
4.	<u>No</u>	Salaries expense
5.	<u>Yes</u>	Retained earnings
6.	<u>Yes</u>	Equipment
7.	<u>No</u>	Income tax expense
8.	<u>No</u>	Cost of goods sold
9.	<u>Yes</u>	Operating lease
10.	<u>No</u>	Sales revenue

Brief Exercise 2-4

KAT Productions
Balance Sheet
December 31, 2024

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$10,000	Accounts payable	\$ 9,000
Inventory	15,000	Notes payable	20,000
Equipment	38,000	Total liabilities	29,000
		<u>Stockholders' Equity</u>	
		Common stock	19,000
		Retained earnings	15,000
		Total stockholders' equity	34,000
Total assets	<u>\$63,000</u>	Total liabilities and stockholders' equity	<u>\$63,000</u>

Brief Exercise 2-5

AMT Tax Consulting Balance Sheet December 31, 2024

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$ 44,000	Accounts payable	\$ 61,000
Accounts receivable	80,000	Accrued liabilities	42,000
Equipment	90,000	Deferred revenues	18,000
Operating lease	10,000	Total liabilities	121,000
		<u>Stockholders' Equity</u>	
		Common stock	55,000
		Retained earnings	48,000
		Total stockholders' equity	103,000
Total assets	<u>\$224,000</u>	Total liabilities and stockholders' equity	<u>\$224,000</u>

TBEXAM.COM

Brief Exercise 2-6

Assets and Liabilities

1. a Prepaid rent
2. b Intangible assets
3. a Accounts payable
4. a Inventory
5. b Bond payable
6. b Equipment
7. a Accounts receivable
8. a Accrued liabilities
9. a Deferred revenues
10. a Cash

Classification

- a. Current
- b. Long-term

Brief Exercise 2-7

State whether the following limitation applies to the balance sheet (bs) or income statement (is), or both (b).

<u>Limitation</u>	<u>Financial Statement</u>
1. <u>b</u> Includes recurring and non-recurring items.	a. Balance sheet
2. <u>a</u> Book value does not necessarily capture market value.	b. Income statement
3. <u>c</u> Subject to the potential misuse of estimates and judgments.	c. Both

Brief Exercise 2-8

KAT Productions Income Statement For the year ended December 31, 2024	
Sales revenues	\$100,000
Expenses:	
Cost of goods sold	78,000
Marketing expenses	8,000
Depreciation expense	11,000
Loss on sale of equipment	1,000
Other expenses	5,000
Total expenses	<u>103,000</u>
Net loss	<u>\$ (3,000)</u>

Brief Exercise 2-9

AMT Tax Consulting Income Statement For the year ended December 31, 2024	
Service revenues	\$500,000
Gain on sale of investments	10,000
Expenses:	
Cost of services	200,000
Selling and administrative expenses	66,000
Maintenance expense	25,000
Advertising expense	35,000
Income tax expense	38,000
Total expenses	<u>364,000</u>
Net income	<u><u>\$146,000</u></u>

Brief Exercise 2-10

TBEXAM.COM

Seamons Capital Income Statement For the year ended December 31, 2024	
Service revenues	\$316,000
Cost of services	<u>150,000</u>
Gross profit	166,000
Selling and administrative expenses	12,000
Depreciation expense	<u>25,000</u>
Operating income	129,000
Interest expense	35,000
Loss on sale of investments	<u>4,000</u>
Pre-tax Income	90,000
Income tax expense	<u>30,000</u>
Net income	<u><u>\$60,000</u></u>

Brief Exercise 2-11

Measure of Income

1. d Gross profit
2. a Net income
3. c Operating income
4. b Pre-tax income

Description

- a. All revenues minus all expenses.
- b. Profits before accounting for income taxes.
- c. Profits related to the operating activities of the company.
- d. Profits directly related to the key costs needed to generate those revenues.

Brief Exercise 2-12

KAT Productions Income Statement

For the year ended December 31, 2024

Sales revenues	\$100,000
Cost of goods sold	78,000
Gross profit	22,000
Marketing expenses	8,000
Depreciation expense	11,000
Operating income	3,000
Loss on sale of equipment	1,000
Other expenses	5,000
Net income	\$ (3,000)

Brief Exercise 2-13

AMT Tax Consulting Income Statement For the year ended December 31, 2024	
Service revenues	\$500,000
Cost of services	200,000
Gross profit	300,000
Selling and administrative expenses	66,000
Maintenance expense	25,000
Advertising expense	35,000
Operating income	174,000
Gain on sale of investments	10,000
Pre-tax income	184,000
Income tax expense	38,000
Net income	\$146,000

Brief Exercise 2-14

TBEXAM.COM

Net cash flows from operating activities	\$ 6,500
Net cash flows from investing activities	(2,000)
Net cash flows from financing activities	500
Net change in cash for the period	\$ 5,000

Brief Exercise 2-15

Business Activities

Descriptions

- | | |
|-----------------------|---|
| 1. b Financing | a. Transactions related to revenues and expenses. |
| 2. c Investing | b. Transactions with lenders and owners. |
| 3. a Operating | c. Transactions involving the purchase and sale of productive assets. |

Brief Exercise 2-16

<u>Activity</u>	<u>Amount</u>
Cash from selling merchandise	\$ 688,000
Cash paid for income taxes	(135,000)
Cash paid to purchase merchandise.	(710,000)
Cash paid in salaries and wages.	(410,000)
Net cash flows from operating activities	<u>\$(567,000)</u>

Brief Exercise 2-17

<u>Activity</u>	<u>Amount</u>
Cash paid to purchase property	(400,000)
Cash received from sale of investments	40,000
Cash paid to purchase investment securities	(50,000)
Net cash flows from investing activities	<u>\$(410,000)</u>

Brief Exercise 2-18

TBEXAM.COM

<u>Activity</u>	<u>Amount</u>
Cash received from a long-term note	\$ 850,000
Cash paid to repurchase stock	(100,000)
Cash received from issuing equity shares	500,000
Net cash flows from financing activities	<u>\$1,250,000</u>

Brief Exercise 2-19

<u>Item</u>	<u>Effect</u>
1. <u>b</u> Dividends	a. Increases stockholders' equity
2. <u>b</u> Stock repurchases	b. Decreases stockholders' equity
3. <u>a</u> Stock issuance	
4. <u>a</u> Net income	

Brief Exercise 2-20

	Common stock	Additional Paid- in Capital	Retained Earnings	Total Stockholders' Equity
Beginning balance	\$5	\$995	\$600	\$1,600
Net income			100	100
Dividends			\$(40)	(40)
Stock repurchase		(15)		(15)
Ending balance	\$5	\$980	\$660	\$1,645

Brief Exercise 2-21

- | | |
|---|----------------------|
| 1. <u>a</u> Cost of goods sold | a. Income statement |
| 2. <u>a</u> Gains on sale of equipment | b. Statement of |
| 3. <u>a</u> Marketing expense | comprehensive income |
| 4. <u>b</u> Foreign currency adjustments | |
| 5. <u>a</u> Depreciation expense | |
| 6. <u>a</u> Interest expense | |
| 7. <u>b</u> Pension plan gains and losses | |
| 8. <u>a</u> Income from discontinued operations | |
| 9. <u>a</u> Other income/expenses | |
| 10. <u>b</u> Unrealized gains and losses on derivatives | |

EXERCISES

Exercise 2-1

Wolfpack Construction Balance Sheet December 31, 2024

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$ 6,000	Accounts payable	\$ 3,000
Land	18,000	Notes payable	20,000
Equipment	26,000	Total liabilities	23,000
		<u>Stockholders' Equity</u>	
		Common stock	11,000
		Retained earnings	16,000 *
		Total stockholders' equity	27,000
		Total liabilities and stockholders' equity	\$50,000
Total assets	<u>\$50,000</u>		

*	Assets	=	Liabilities	+	Stockholders' equity
	\$50,000	=	\$23,000	+	(\$11,000 + Retained earnings)
	\$50,000	=	\$23,000	+	\$11,000 + Retained earnings
					\$16,000 = Retained earnings

Exercise 2-2

Current assets – Cash and cash equivalents – Accounts receivable = Inventory

$$\$235,000 - \$40,000 - \$120,000 = \$75,000$$

Total assets – Current assets = Property, plant, and equipment (net)

$$\$400,000 - \$235,000 = \$165,000$$

Total assets – Accounts payable – Notes payable – Common stock = Retained earnings

$$\$400,000 - \$32,000 - \$50,000 - \$100,000 = \$218,000$$

Exercise 2-3

- (a) Current
- (b) Current
- (c) Long-term
- (d) Current
- (e) Long-term
- (f) Long-term

Exercise 2-4

- | | |
|---------------------------------------|---|
| 1. ___a___ Prepaid insurance | 9. ___a___ Inventory |
| 2. ___d___ Goodwill | 10. ___e___ Accrued liabilities |
| 3. ___c___ Equipment | 11. ___d___ Patent |
| 4. ___e___ Deferred revenues | 12. ___c___ Building |
| 5. ___g___ Common stock | 13. ___h___ Dividends |
| 6. ___g___ Additional paid-in capital | 14. ___e___ Notes payable (current portion) |
| 7. ___e___ Accounts payable | |
| 8. ___a___ Accounts receivable | |

Exercise 2-5

Current assets:

$$\$16,000 + \$11,000 + \$25,000 = \text{\textcolor{blue}{\$52,000}}$$

Current liabilities:

$$\$14,000 + \$9,000 + \$1,000 = \text{\textcolor{blue}{\$24,000}}$$

Exercise 2-6

Assets:	\$ 52,000	current assets
	75,000	equipment (net)
	<u>5,000</u>	equipment (net)(leased assets)
	\$132,000	total assets
<i>minus</i>		
Liabilities	\$ 24,000	current liabilities
	<u>30,000</u>	notes payable
	\$ 54,000	total liabilities
<i>equals</i>		
Stockholders' equity	\$78,000	(total assets \$132,000 – total liab. \$54,000)
	<u>(50,000)</u>	common stock
	\textcolor{blue}{\\$28,000}	retained earnings

Exercise 2-7

McK NURSERY, INC.

Balance Sheet

At December 31, 2024

Assets

Current assets:

Cash	\$ 16,000
Accounts receivable	11,000
Inventory	<u>25,000</u>
Total current assets	52,000

Long-term assets:

Equipment (net)	75,000
Operating leases	<u>5,000</u>
Total assets	<u><u>\$132,000</u></u>

Liabilities and Stockholders' Equity

Current liabilities:

Accounts payable	\$ 14,000
Salaries payable	9,000
Interest payable	<u>1,000</u>
Total current liabilities	24,000

Long-term liabilities:

Notes payable	<u>30,000</u>
Total liabilities	54,000

Stockholders' equity:

Common stock	\$50,000
Retained earnings*	<u>28,000</u>
Total stockholders' equity	<u>78,000</u>
Total liabilities and stockholders' equity	<u><u>\$132,000</u></u>

* see solution to E2-6.

Exercise 2-8

Cowboy Law Firm

Income Statement

For the period ended December 31, 2024

Service revenue	\$9,300
Expenses:	
Salaries	2,200
Utilities	1,200
Total expenses	<u>3,400</u>
Net income	<u>\$5,900</u>

TBEXAM.COM

Exercise 2-9

MMT CORPORATION

Income Statement

For the Year Ended December 31, 2024

(\$ in millions)

Revenues and gains:

Sales revenue	\$2,106
Gain on sale of investments	<u>45</u>
Total revenues and gains	2,151

Expenses and losses:

Cost of goods sold	\$1,240
Selling expense	126
General and administrative expense	105
Interest expense.....	<u>40</u>
Total expenses and losses	<u>1,511</u>
Income before income taxes	640
Income tax expense*	<u>160</u>
Net income	<u>\$ 480</u>

* $\$640 \times 25\% = \160

Exercise 2-10

(a)	Sales revenue	\$2,106
	Less: Cost of goods sold	<u>(1,240)</u>
	Gross profit	866
	Less: Selling expense	(126)
	General and administrative expense	<u>(105)</u>
	Operating income	\$ 635
(b)	Gain on sale of investments	45
	Interest expense	<u>(40)</u>
	Nonoperating income	\$5

TBEXAM.COM

Exercise 2-11

MMT CORPORATION		
Income Statement		
For the Year Ended December 31, 2024		
(\$ in millions)		
Sales revenue		\$2,106
Cost of goods sold		<u>1,240</u>
Gross profit		866
<i>Operating expenses:</i>		
Selling expense	\$126	
General and administrative expense	<u>105</u>	
Total operating expenses		<u>231</u>
Operating income		635
TBEXAM.COM		
<i>Other income (expense):</i>		
Gain on sale of investments	45	
Interest expense	<u>(40)</u>	
Total other income, net		<u>5</u>
Income before income taxes		640
Income tax expense*		<u>160</u>
Net income		<u>\$ 480</u>
*\$640 x 25% = \$160		

Exercise 2-12

Jedgy Corporation Income Statement

Service revenue	\$400,000
Cost of services	180,000
Gross Profit (a)	220,000
Selling and administrative expenses	45,000
Operating income (b)	175,000
Gain on sale of equipment	3,000
Interest expense	(24,000)
Pre-tax income (c)	154,000
Income tax expense	28,000
Net income (d)	\$126,000

Exercise 2-13

Uber Inc. Income Statement

Revenues	14,147
Cost of revenues	7,208
Gross Profit	6,939
Operating expenses	2,302
Marketing expenses	4,626
Research and development expense	4,836
General and administrative expense	3,299
Depreciation expense	472
Operating loss	(8,596)
Interest expense	(559)
Other income	694
Pre-tax income	(8,461)
Income tax expense	45
Net loss	(8,506)

Exercise 2-14

1. a.
2. c.
3. a.
4. b.
5. c.
6. a.
7. b.

Exercise 2-15

1. b Purchase of equipment for cash.
2. a Payment of employee salaries.
3. a Collection of cash from customers.
4. c Cash proceeds from notes payable.
5. b Purchase of common stock of another corporation for cash.
6. c Issuance of common stock for cash.
7. b Sale of equipment for cash.
8. a Payment of interest on notes payable.
9. c Payment of cash dividends to stockholders.
10. c Payment of principal on notes payable.

Exercise 2-16

<u>Activity</u>	<u>Amount</u>	<u>Inflow or Outflow?</u>
Cash received from providing consulting services	275,000	Inflow
Interest paid on debt	15,000	Outflow
Cash paid for income taxes	45,000	Outflow
Salaries paid	150,000	Outflow
Cash flows from operating activities	65,000	
Cash received from the sale of investments	7,000	Inflow
Cash paid for computing equipment	40,000	Outflow
Cash flows from investing activities	(33,000)	
Cash received from a loan	300,000	Inflow
Cash paid to repurchase stock	60,000	Outflow
Cash flows from financing activities	240,000	
Net change in cash flows	272,000	

TBEXAM.COM

Requirement 1

TBEXAM.COM

*E2-17 Cont.***Requirement 2**

Tiger Trade
Statement of Cash Flows
For the year ended December 31, 2024

Cash Flows from Operating Activities

From sale of products to customers	\$40,000	
From sale of services to customers	30,000	
For merchandise suppliers	(12,000)	
For workers	(24,000)	
For advertisement	(4,000)	
Net cash flows from operating activities		\$30,000

Cash Flows from Investing Activities

Purchase factory equipment	(50,000)	
Sale of warehouse	13,000	
Net cash flows from investing activities		(37,000)

Cash Flows from Financing Activities

Borrow from bank	45,000	
Pay dividends	(6,000)	
Net cash flows from financing activities		39,000

Net increase in cash		32,000
Cash at the beginning of the year		5,000
Cash at the end of the year		<u>\$37,000</u>

Buffalo Drilling
Statement of Stockholders' Equity
For the year ended December 31, 2024

	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance, Jan. 1	\$11,000	\$ 8,200	\$19,200
Issuance of common stock	8,000		8,000
Add: Net income		8,500	8,500
Less: Dividends		(3,200)	(3,200)
Ending balance, Dec. 31	<u>\$19,000</u>	<u>\$13,500</u>	<u>\$32,500</u>

TBEXAM.COM

Exercise 2-19

Net income	\$ 6,140
Foreign currency adjustments	(490)
Unrealized loss on derivatives	(60)
Gain related to pension plan	<u>160</u>
Comprehensive Income	\$ 5,750

Exercise 2-20

Requirement 1

Net unrealized gains/losses on investments	\$ 680
Net unrealized gains/losses on derivatives	(16)
Net gains/losses related to pension costs	<u>26</u>
Other comprehensive income	\$ 690

TBEXAM.COM

Requirement 2

Net income	\$ 4,807
Net unrealized gains/losses on investments	680
Net unrealized gains/losses on derivatives	(16)
Net gains/losses related to pension costs	<u>26</u>
Total comprehensive income	\$ 5,497

PROBLEMS

Problem 2-1

T B E X A M . C O M	
TIMPVVIEW, INC. Balance Sheet At December 31, 2024	
Assets	
<i>Current assets:</i>	
Cash	\$ 40,000
Investment in equity securities	10,000
Accounts receivable	34,000
Inventory	75,000
Prepaid rent	<u>16,000</u>
Total current assets	175,000
<i>Property, plant, and equipment:</i>	
Machinery (net)	134,000
<i>Intangible assets:</i>	
Patent (net)	<u>83,000</u>
Total assets	<u>\$392,000</u>
Liabilities and Stockholders' Equity	
<i>Current liabilities:</i>	
Accounts payable	\$ 8,000
Salaries payable	4,000
Income taxes payable	<u>32,000</u>
Total current liabilities	44,000
<i>Long-term liabilities:</i>	
Bonds payable	<u>200,000</u>
Total liabilities	244,000
<i>Stockholders' equity:</i>	
Common stock	\$100,000
Retained earnings	<u>48,000</u>
Total stockholders' equity	<u>148,000</u>
Total liabilities and stockholders' equity	<u>\$392,000</u>

Problem 2-2

	Account classifications	Account Names
1.	Asset	Cash
2.	Revenue	Service Revenue
3.	Asset	Supplies
4.	Asset	Buildings
5.	Expense	Advertising Expense
6.	Asset	Equipment
7.	Expense	Interest Expense
8.	Liability	Accounts Payable
9.	Dividend	Dividends
10.	Liability	Notes Payable

TBEXAM.COM

1.	<u>f</u>	Interest payable (due in 3 months)
2.	<u>d</u>	Franchise
3.	<u>c</u>	Accumulated depreciation
4.	<u>a</u>	Prepaid insurance (for 2025)
5.	<u>g</u>	Bonds payable (due in 10 years)
6.	<u>f</u>	Current maturities of long-term debt
7.	<u>f</u>	Notes payable (due in 3 months)
8.	<u>b</u>	Long-term receivables
9.	<u>e</u>	Restricted cash (will be used to retire bonds in 10 years)
10.	<u>a</u>	Supplies
11.	<u>c</u>	Machinery
12.	<u>c</u>	Land (used in operations)
13.	<u>f</u>	Deferred revenue (for 2025)
14.	<u>d</u>	Copyrights
15.	<u>h</u>	Common stock
16.	<u>b</u>	Land (held for speculation)
17.	<u>a</u>	Cash equivalents
18.	<u>f</u>	Salaries payable

©McGraw Hill LLC. All rights reserved. No reproduction or further distribution permitted without the prior written consent of McGraw Hill LLC
Solutions Manual, Chapter 2 *2-31*

Problem 2-4

Requirement 1

SUNDANCE INVESTMENTS		
Income Statement		
For the Year Ended December 31, 2024		
<i>Revenues and gains:</i>		
Sales revenue		\$1,300,000
Interest revenue		30,000
Gain on sale of investments		<u>50,000</u>
Total revenues and gains		1,380,000
<i>Expenses and losses:</i>		
Cost of goods sold	TBEXAM.COM	\$720,000
Selling expense		160,000
General and administrative expense		75,000
Interest expense.....		<u>40,000</u>
Total expenses and losses		<u>995,000</u>
Income before income taxes		385,000
Income tax expense		<u>130,000</u>
Net income		<u><u>\$ 255,000</u></u>

Requirement 2

SUNDANCE INVESTMENTS	
Income Statement	
For the Year Ended December 31, 2024	
Sales revenue	\$1,300,000
Cost of goods sold	<u>720,000</u>
Gross profit	580,000
<i>Operating expenses:</i>	
Selling expense	\$160,000
General and administrative expense	<u>75,000</u>
Total operating expenses	<u>235,000</u>
Operating income	345,000
<i>Other income (expense):</i>	
Interest revenue	30,000
Gain on sale of investments	50,000
Interest expense	<u>(40,000)</u>
Total other income, net	<u>40,000</u>
Income before income taxes	385,000
Income tax expense	<u>130,000</u>
Net income	<u>\$ 255,000</u>

Requirement 3

Earnings per share = $\$255,000 \div 100,000 \text{ shares}$ = **\$2.55**

Problem 2-5

Requirement 1

ACC PARTNERS		
Income Statement		
For the Year Ended December 31, 2024		
<i>Revenues and gains:</i>		
Sales revenue		\$2,350,000
Interest revenue		<u>80,000</u>
Total revenues and gains		2,430,000
<i>Expenses and losses:</i>		
Cost of sales	\$1,200,300	
Marketing expense	300,000	
General and administrative expense	150,000	
Interest expense.....	90,000	
Loss on sale of investments	22,500	
Loss on sale of property	<u>200,000</u>	
Total expenses and losses		<u>1,962,800</u>
Income before income taxes		467,200
Income tax expense *		<u>116,800</u>
Net income		<u>\$ 350,400</u>

* \$467,200 × 25%

Problem 2-6

Gator Investments	
Income Statement	
For the year ended Dec. 31, 2024	
Service revenue	\$127,600
Expenses:	
Advertising	33,500
Salaries	65,100
Utilities	15,500
Interest	3,500
Total expenses	117,600
Net income	\$ 10,000

Gator Investments			
Statement of Stockholders' Equity			
For the year ended Dec. 31, 2024			
	Common Stock	Retaine d Earning s	Total Stockholders' Equity
Beginning balance	\$100,000	\$30,300	\$130,300
Issuance of common stock	11,000		11,000
Add: Net income		10,000	10,000
Less: Dividends		(5,200)	(5,200)
Ending balance	\$111,000	\$35,100	\$146,100

Gator Investments
Balance Sheet
Dec. 31, 2024

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$ 5,500	Accounts payable	\$ 6,400
Equipment	27,000	Notes payable	<u>30,000</u>
Buildings	150,000	Total liabilities	36,400
		<u>Stockholders' Equity</u>	
		Common stock	111,000
		Retained earnings	<u>35,100</u>
		Total stockholders' equity	<u>146,100</u>
		Total liabilities and	
Total assets	<u>\$182,500</u>	stockholders' equity	<u>\$182,500</u>

TBEXAM.COM

Problem 2-7

(Suggested order of calculation)

On the statement of stockholders' equity,

$$\$14,000 + (c) = \$17,000$$

$$(c) = \text{\textcolor{blue}{\$3,000}}$$

$$\$7,000 + \$5,000 - (d) = \$8,000$$

$$(d) = \text{\textcolor{blue}{\$4,000}}$$

$$(b) = \text{\textcolor{blue}{\$5,000}}$$

From (b),

$$(a) - \$13,000 - \$7,000 - \$5,000 = \$5,000 \quad (b)$$

$$(a) = \text{\textcolor{blue}{\$30,000}}$$

From the statement of stockholders' equity,

$$(g) = \text{\textcolor{blue}{\$17,000}}$$

$$(h) = \text{\textcolor{blue}{\$8,000}}$$

TBEXAM.COM

From (g) and (h),

$$\$4,000 + \$17,000 (g) + \$8,000 (h) = (i)$$

$$(i) = \text{\textcolor{blue}{\$29,000}}$$

From total liabilities and stockholders' equity,

$$(f) = \text{\textcolor{blue}{\$29,000}}$$

From (f),

$$\$1,100 + (e) + \$6,000 + \$16,000 = \$29,000 \quad (f)$$

$$(e) = \text{\textcolor{blue}{\$5,900}}$$

Problem 2-8

	Type of Business Activity	Transactions
1.	Operating	Pay for advertising
2.	Financing	Pay dividends to stockholders
3.	Operating	Collect cash from customer for previous sale
4.	Investing	Purchase a building to be used for operations
5.	Investing	Purchase equipment
6.	Investing	Sell land
7.	Financing	Receive a loan from the bank by signing a note
8.	Operating	Pay suppliers for purchase of supplies
9.	Operating	Provide services to customers
10.	Investing	Invest in securities of another company

TBEXAM.COM

Problem 2-9

Shepa, Inc. Statement of Cash Flows For the year ended December 31, 2024

Sales to customers	\$ 475,000	
Interest on investment	6,000	
Purchase of inventory	(33,000)	
Interest on notes payable	(5,000)	
Salaries to employees	(140,000)	
Operating expenses	(25,000)	
Purchase of supplies	(3,000)	
Income and property taxes	(11,000)	
Net cash flows from operating activities		\$ 264,000
Collection of note receivable	50,000	
Sale of investments	30,000	
Sale of long-term asset	40,000	
Purchase of equipment	(18,000)	
Purchase of property	(400,000)	
Net cash flows from investing activities		(298,000)
Issuance of notes payable	202,000	
Issuance of equity	228,000	
Dividends to stockholders	(20,000)	
Repurchase of stock	(8,000)	
Net cash flows from financing activities		402,000
Net change in cash		368,000
Beginning cash		220,000
Ending cash		<u>\$ 588,000</u>

Sundance Investments
Statement of Stockholders' Equity
For the year ended December 31, 2024

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
Beginning balance	\$10,000	\$990,000	\$400,000	\$1,400,000
Net income			255,000	255,000
Dividends			(50,000)	(50,000)
Stock-based compensation		10,000		10,000
Ending balance	\$10,000	\$1,000,000	\$605,000	\$1,615,000

TBEXAM.COM

Problem 2-11

THE MASSOUD CONSULTING GROUP Statement of Comprehensive Income For the Year Ended December 31, 2024	
Net income	\$1,354,000
Other comprehensive income, net of tax:	
Foreign currency translation adjustment*	\$180,000
Unrealized loss on debt securities**	<u>(60,000)</u>
Total other comprehensive income	<u>120,000</u>
Comprehensive income	<u><u>\$1,474,000</u></u>

* $\$240,000 - (\$240,000 \times 25\%)$

** $\$80,000 - (\$80,000 \times 25\%)$

TBEXAM.COM