

Problems: Set B

P1-1B Presented below are five independent situations.

- Randy Gentry, a college student looking for summer employment, opened a produce stand along a busy local highway. Each morning he buys produce from local farmers, then sells it in the afternoon as people return home from work.
- Dave Boyce and Davey Lopez each owned separate swing-set manufacturing businesses. They have decided to combine their businesses and try to expand their reach beyond their local market. They expect that within the coming year they will need significant funds to expand their operations.
- Three chemistry professors at LU have formed a business to employ enzymes to clean up toxic waste sites. Each has contributed an equal amount of cash and knowledge to the venture. The use of enzymes in this situation is experimental, and legal obligations could result.
- Marty Wells has run a successful, but small cooperative vitamin store for over 20 years. The increased sales of her store have made her believe that the time is right to open a national chain of vitamin stores across the country. Of course, this will require a substantial investment in stores, inventory, and employees in each store. Marty has no savings or personal assets. She wants to maintain control over the business.
- Charles Kuehl and Peg Lambing recently graduated with masters degrees in business. They have decided to start a consulting business focused on teaching the basics of exporting to small business owners interested in exporting.

Determine forms of business organization.

(LO 1), C

Instructions

In each case, explain what form of organization the business is likely to take—sole proprietorship, partnership, or corporation. Give reasons for your choice.

P1-2B Financial decisions often place heavier emphasis on one type of financial statement over the others. Consider each of the following hypothetical situations independently.

- An investor is considering purchasing common stock of the **24/7 Fitness** company. The investor plans to hold the investment for at least 3 years.
- Xerox** is considering extending credit to a new customer. The terms of the credit would require the customer to pay within 60 days of receipt of goods.
- The president of **American Airlines** is trying to determine whether the company is generating enough cash to increase the amount of dividends paid to investors in this and future years, and still have enough cash to buy new flight equipment as it is needed.
- PNC Bank** is considering extending a loan to a small company. The company would be required to make interest payments at the end of each year for 5 years, and to repay the loan at the end of the fifth year.

Identify users and uses of financial statements.

(LO 2, 4, 5), K

Instructions

In each of the situations above, state whether the decision-maker would be most likely to place primary emphasis on information provided by the income statement, balance sheet, or statement of cash flows. In each case, provide a brief justification for your choice. Choose only one financial statement in each case.

P1-3B Shaw's Garden was started on May 1 with an investment of \$45,000 cash. Following are the assets, liabilities, and common stock of the company on May 31, 2014, and the revenues and expenses for the month of May, its first month of operations.

Accounts receivable	\$ 8,400	Notes payable	\$26,000
Service revenue	10,400	Salaries and wages expense	1,900
Advertising expense	1,800	Equipment	58,800
Accounts payable	4,400	Maintenance and repairs expense	2,100
Cash	10,800	Insurance expense	400
Common stock	45,000		

Prepare an income statement, retained earnings statement, and balance sheet; discuss results.

(LO 4, 5), AP

No additional common stock was issued in May, but a dividend of \$1,600 in cash was paid.

2 chapter 1 Introduction to Financial Statements

(a) Net income	\$ 4,200
Ret. earnings	\$ 2,600
Tot. assets	\$78,000

Determine items included in a statement of cash flows, prepare the statement, and comment.

(LO 5), AP



(a) Net increase \$26,000

Comment on proper accounting treatment and prepare a corrected income statement.

(LO 4, 5), AP

(b) Net income \$30,000

Instructions

- (a) Prepare an income statement and a retained earnings statement for the month of May and a balance sheet at May 31, 2014.
- (b) Briefly discuss whether the company's first month of operations was a success.
- (c) Discuss the company's decision to distribute a dividend.

P1-4B Presented below are selected financial statement items for Preacher Corporation for December 31, 2014.

Inventory	\$ 55,000	Cash paid to purchase equipment	\$ 20,000
Cash paid to suppliers	154,000	Equipment	40,000
Buildings	400,000	Service revenue	200,000
Common stock	20,000	Cash received from customers	162,000
Cash dividends paid	2,000	Cash received from issuing	
Cash at beginning of period	11,000	bonds payable	40,000

Instructions

- (a) Determine which items should be included in a statement of cash flows, and then prepare the statement for Preacher Corporation.
- (b) Comment on the adequacy of net cash provided by operating activities to fund the company's investing activities and dividend payments.

P1-5B Walters Corporation was formed during 2013 by John Walters. John is the president and sole stockholder. At December 31, 2014, John prepared an income statement for Walters Corporation. John is not an accountant, but he thinks he did a reasonable job preparing the income statement by looking at the financial statements of other companies. He has asked you for advice. John's income statement appears as follows.

WALTERS CORPORATION
Income Statement
For the Year Ended December 31, 2014

Accounts receivable	\$17,000
Service revenue	40,000
Rent expense	10,000
Insurance expense	7,000
Vacation expense	6,000
Net income	<u>\$34,000</u>

John has also provided you with these facts.

1. Included in the service revenue account is \$3,000 of revenue that the company provided service for and received payment for in 2013. He forgot to include it in the 2013 income statement, so he put it in this year's statement.
2. John operates his business out of the basement of his parents' home. They do not charge him anything, but he thinks that if he paid rent it would cost him about \$10,000 per year. He, therefore, included \$10,000 of rent expense in the income statement.
3. To reward himself for a year of hard work, John went to Turkey. He did not use company funds to pay for the trip, but he reported it as an expense on the income statement since it was his job that made him need the vacation.

Instructions

- (a) Comment on the proper accounting treatment of the three items above.
- (b) Prepare a corrected income statement for Walters Corporation.