

CHAPTER

4

The Balance Sheet and the Statement of Changes in Stockholders' Equity

OBJECTIVES

After careful study of this chapter, you will be able to:

1. Understand the purposes of the balance sheet.
2. Define the elements of a balance sheet.
3. Explain how to measure (value) the elements of a balance sheet.
4. Classify the assets of a balance sheet.
5. Classify the liabilities of a balance sheet.
6. Report the stockholders' equity of a balance sheet.
7. Prepare a statement of changes in stockholders' equity.
8. Understand the other disclosure issues for a balance sheet.
9. Describe the SEC integrated disclosures.
10. Explain the reporting techniques used in an annual report.

Synopsis

Purposes of the Balance Sheet

1. A balance sheet, or statement of financial position, summarizes the financial position of a company at a particular date by reporting the economic resources (assets), the economic obligations (liabilities), and equity. It reports a company's resource structure (major classes and amounts of assets) and its financial structure (major classes and amounts of liabilities and equity). It is a detailed explanation of the basic accounting equation: $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.
2. The balance sheet information helps external users (a) assess the company's liquidity, financial flexibility, and operating capability, and (b) evaluate its income-producing performance during the period. Liquidity is the speed with which assets can be converted into cash to pay bills. Information about liquidity helps users evaluate the timing of cash flows. This is important in evaluating the amount of future cash flows.
3. A company's capital, its assets less its liabilities, is also called its net assets or owners' equity. By comparing beginning owners' equity with ending owners' equity, the financial statement user can tell whether capital for the accounting period was increased or decreased.

Recognition in the Balance Sheet

4. Recognition is the process of formally recording and reporting an element in the financial statements. To be recognized, an item must (a) meet the definition of an element as specified in FASB Statement of Concepts No. 6, (b) be measurable, (c) be relevant, and (d) be reliable.

Elements of the Balance Sheet

5. The elements of the balance sheet are the broad classes of items comprising it. These items and their definitions are:
 - a) **Assets:** The probable future economic benefits obtained or controlled by a company as a result of past transactions or events.
 - b) **Liabilities:** The probable future sacrifices of economic benefits arising from the present obligations of a company to transfer assets or provide services in the future as a result of past transactions or events.
 - c) **Stockholders' equity:** The residual interest in the assets of a company after the liabilities have been deducted.

Measurement (Valuation) of the Elements of a Balance Sheet

6. Assets and liabilities must have a monetary value for balance sheet presentation. The FASB has identified five alternative valuation methods.
 - a) Historical cost is the exchange price of the asset at the time of the original transaction reduced by any recorded depreciation, amortization, or impairment to date. This is the most commonly used valuation.

- b) Fair Value is the price that a company would receive to sell an asset (or transfer a liability) in an orderly transaction between market participants on the date of measurement. Fair value may be used on a company's balance sheet to report the value of its "financial" assets (and liabilities), such as cash, accounts receivable, and notes receivable. To increase consistency and comparability in fair value measurements, the FASB established a hierarchy that prioritizes the inputs a company is to use in its valuation method.
- c) Present value is the net amount of the discounted future cash inflows less the discounted future cash outflows relating to the asset.

Reporting Classifications on the Balance Sheet

- 7. The balance sheet is arranged to be useful to a company's external users. The individual categories (assets, liabilities, and stockholders' equity) are further subdivided to provide useful information. These subdivisions are briefly explained below.
- 8. Current assets are cash and other assets that a company expects to convert into cash, sell, or consume within one year or the normal operating cycle, whichever is longer. An operating cycle, usually a year or less, is the average time taken by a company to spend cash for inventory, process and sell the inventory, and collect the cash from the sale. Current assets are presented in order of liquidity.
- 9. Current liabilities are obligations that a company expects to liquidate within one year or the operating cycle (if longer) through the use of current assets or the creation of other current liabilities.
- 10. Working capital is the difference between a company's current assets and its current liabilities. A company's working capital is a measure of the short-run liquidity of the company.
- 11. Long-term investments are investments that the company plans to hold for more than one year or its operating cycle, if longer.
- 12. The property, plant, and equipment section of a company's balance sheet includes all tangible assets (fixed assets) used in operations. Except for land, these assets are either depreciated, amortized (for leased assets), or depleted (for natural resource assets). In these cases, a contra-asset account is deducted from the original asset cost in order to display both the historical cost and the book value.
- 13. Intangible assets are noncurrent economic resources that are used in the operations but that have no physical existence. The value of this type of asset lies in the special right of the company to its use. Intangible assets with finite useful lives (e.g., patents) are amortized over their useful lives, and disclosed on the balance sheet at book value. Intangible assets with indefinite lives (e.g., goodwill) are not amortized but are reviewed for impairment at least annually. They are reported at their historical cost or, if impaired, at their lower fair value.
- 14. Long-term liabilities (noncurrent liabilities) are obligations that are not expected to require the use of current assets or not expected to create current liabilities within one year or the operating cycle, if longer. Bonds are usually sold for more than face value (premium) or less than face value (discount). On a balance sheet, bonds are reported at their book value. The book value is the face value of the bonds plus any unamortized premium or less any unamortized discount.
- 15. The stockholders' equity section of a corporation's balance sheet consists of three main categories: contributed capital, retained earnings, and accumulated other comprehensive income. Contributed capital represents amounts owners have invested in the business. Contributed capital is often separated into capital stock and additional paid-in capital. Corporations may issue two types of capital stock, common and preferred, each of which has distinguishing characteristics.

16. Retained earnings represent the cumulative amount of past net income kept in the business.
17. Accumulated other comprehensive income (loss) includes (a) unrealized gains or losses in the market value of investments in available-for-sale securities, (b) translation adjustments from converting the financial statements of a company's foreign operations into U.S. dollars, (c) certain gains and losses on "derivative" financial instruments, and (d) certain pension liability adjustments.

Statement of Changes in Stockholders' Equity

18. FASB Statement of Concepts No. 6 suggests that financial statements include information about (a) investments by owners, and (b) distributions to owners. To disclose this information as well as the retained earnings changes, a statement of changes in stockholders' equity is often presented as a financial statement. The statement of changes reconciles beginning balances of capital stock, additional paid-in capital, retained earnings, and accumulated other comprehensive income to their ending balances by showing the changes in each item.

Other Disclosure Issues

19. Because all of the relevant financial information pertaining to a company's activities cannot be disclosed directly in the body of the financial statements, a company will make additional disclosures in the notes to the financial statements.
20. APB Opinion No. 22 requires disclosure in a company's notes of information related to its accounting policies. This disclosure includes revenue recognition and asset allocation principles that involve: (a) a selection from existing alternatives, (b) principles peculiar to a specific industry, or (c) an innovative application of an accounting principle.
21. A company discloses contingent liabilities (loss contingencies) in the notes to the financial statements if there is only a reasonable possibility that the loss may have been incurred or if the amount of the loss cannot be reasonably estimated. If it is probable that the loss has been incurred and if the amount can be reasonably estimated, an estimated loss from a loss contingency is accrued and reported directly on the balance sheet as a liability or a reduction of an asset. Gain contingencies are not reported in the financial statements and should be judiciously explained if disclosed in the notes. Gain contingencies are not reported in a company's financial statements and, if disclosed in a note, should be carefully explained in order to avoid misleading implications as to the likelihood of future revenues or gains.
22. Another common note to the financial statements is a description of an important event that occurs between the balance sheet date and the date of issuance of the annual report. This is called a subsequent event. Subsequent events must be disclosed so that users may interpret the financial statements in light of the most recent company information. If a subsequent event provides information about conditions that existed on the balance sheet date and significantly affect the estimates used in the preparation of the financial statements, the company adjusts the statements themselves.
23. Most users of financial statements are interested in evaluating trends of the company over time. For this reason, financial statements are usually prepared on a comparative basis by presenting information for the current and preceding year side by side.

24. Through the SEC's "integrated disclosures" provision, companies regulated by the SEC now satisfy certain Form 10-K disclosure requirements by reference to information included in the annual report. Therefore, these companies include (a) comparative balance sheets for two years and comparative income statements and statements of cash flows for three years; (b) a five-year summary of critical accounting information; (c) management's discussion and analysis (MD&A) of the company's financial condition, changes in financial condition, and results of operations; and (d) disclosures on common stock market prices and dividends. Each company's chief executive officer and chief financial officer both must "certify" that the company's annual report in the Form 10-K (or interim report within the company's Form 10-Q) is both complete and accurate.
25. The IASB sets international accounting standards for published financial statements that are similar to those in the United States. Under the International Accounting Standards, a balance sheet, statement of changes in equity, income statement, and statement of cash flows are required as well as related notes and explanatory materials. In general, classification of items and disclosures are similar to that required under U.S. GAAP. However, on the balance sheet, the liabilities and owners' equity sections are usually ordered differently.

Reporting Techniques

26. Companies generally use one of two basic formats for balance sheet presentation: (a) the report form (the most common format) in which asset accounts are listed first and then liability and stockholders' equity accounts are listed in sequential order directly below assets, and (b) the account form that lists asset accounts on the left-hand side and liability and stockholders' equity accounts on the right-hand side of the statement.
27. Balance sheets often show a single amount for a company's inventory and/or its total property, plant, and equipment. In such cases, to comply with generally accepted disclosure rules, a detailed listing of inventory by major category (raw material, and so forth) and of property, plant, and equipment (land, and so forth) must be presented in notes to the financial statements.

International Balance Sheet

28. Example 4-3 in the text shows comparative balance sheets for an international company. These balance sheets were prepared using IRFS.

True-False Questions

Determine whether each of the following statements is true or false.

1. The stockholders' equity section of the balance sheet may be divided into categories of contributed capital, retained earnings, and accumulated other comprehensive income.

Answer: True

Stockholders' equity consists of three components: (1) contributed capital, (2) retained earnings, and (3) accumulated other comprehensive income.

2. A significant business event that affects the estimates used that occurs after the end of the accounting period but before the financial statements are actually issued will be reported in the financial statements for the year in which it occurred.

Answer: False

A company usually does not issue its annual report for several months after the end of the accounting period. During this time, it is possible for significant business events and transactions to occur that, if not disclosed in the company's annual report, would cause this report to be misleading. If a subsequent event occurs that (1) provides additional evidence about conditions that existed on the balance sheet date and (2) significantly affects the estimate(s) used in preparing the company's financial statements, the company must make an adjustment to the financial statements.

3. A reader may use balance sheet information to evaluate the company's liquidity but the balance sheet is not helpful in evaluating income-producing performance.

Answer: False

A company's balance sheet is intended to help external users do two things: (1) assess its liquidity, financial flexibility, and operating capability and (2) evaluate information about its income-producing performance during the period.

4. To be recognized as an element in the financial statements, an item need only be measurable and relevant.

Answer: False

To be recognized, an item (and information about it) must meet the definition of an element and be measurable, relevant, and reliable.

5. To be classified as an asset, a resource must first and foremost have service potential.

Answer: True

The primary attribute of all assets is service potential, the capacity to provide services or benefits to the company that uses them.

6. According to the FASB, an obligation is a liability only if the company is bound by a legal responsibility to transfer assets or provide services.

Answer: False

Although most liabilities involve legal rights and duties, some are the result of equitable (ethical or moral) obligations or constructive (inferred from the facts) obligations. Thus, while a liability is usually bound by a legal obligation, obligations that are bound by equitable or constructive responsibility to transfer assets or provide services would also be considered liabilities.

7. While present-day balance sheets report most assets at their historical cost, more disclosure of current values may result from increased emphasis on reporting about liquidity, financial flexibility, and operating capability.

Answer: True

As increased emphasis is placed on reporting information concerning a company's liquidity, financial flexibility, and operating capability, it is likely that the FASB will require more fair values to be reported on balance sheets (or related notes).

8. Most business entities have an operating cycle of less than one year.

Answer: True

An operating cycle is the average time taken by a company to go from cash to cash. From the cash spent on inventory, to process and sell the inventory, and collect the receivables, converting them back into cash. While a few companies in certain industries (paper, wine, construction, etc.) have operating cycles longer than one year, most companies have operating cycles of a year or less.

9. Marketable securities are classified as current assets only if company management intends to convert them back into cash within the longer of one year or the company's normal operating cycle.

Answer: True

The key to this question is the intent to convert the securities into cash within one year or the company's normal operating cycle, whichever is longer. Because management's intent meets the definition of current assets, these securities would be properly classified current assets.

10. Land that is being held to accommodate future expansion of the company's manufacturing plant in five years is classified as a part of the property, plant, and equipment section of the balance sheet.

Answer: False

If the land were to be used within the next year or one operating cycle, whichever is longer, then it would properly be classified as part of property, plant, and equipment. If the company expects to hold the item for more than one year or the operating cycle, whichever is longer, it is classified as a long-term (noncurrent) investment.

11. The legal capital of a corporation is the amount legally available for distribution to stockholders as dividends.

Answer: False

Legal capital is the minimum amount of stockholders' equity that the corporation may not distribute as dividends; it is one element of the total amount of contributed capital.

12. If a company has a million dollar balance in its Retained Earnings account, it could still have little or no cash in its bank account.

Answer: True

Retained earnings is the total amount of corporate net income that has not been distributed to stockholders as dividends. The balance in retained earnings has no relationship to the cash that is available for dividends.

13. Consistent with its emphasis on conservatism, the FASB requires the disclosure of only the historical cost associated with asset and liability financial instruments.

Answer: False

While some financial instruments are reported at cost, most financial instruments are reported at fair value (available-for-sale securities and trading securities) or present value (long-term liabilities).

14. Gain contingencies are not reported in the financial statements.

Answer: True

Gain contingencies are not reported in a company's financial statements. They are sometimes disclosed in a note, but they should be carefully explained to avoid misleading external users of the likelihood of future revenues or gains.

15. Both International Accounting Standards and GAAP require assets to be listed in order of liquidity and liabilities to be listed in order of expected due date.

Answer: False

While many foreign companies list their assets in order of liquidity, International Accounting Standards do not require a particular format.

16. No information may be included in the notes accompanying financial statements that is not presented in at least a condensed fashion in the body of the statements themselves.

Answer: False

There are numerous items that are only included in notes and not in the body of the financial statements. This is because much of the information in the notes usually contains narrative discussions, additional monetary amounts, and sometimes supplemental schedules that would be difficult to explain in the body of the financial statements.

17. The FASB-recommended format for the balance sheet is the account form.

Answer: False

Most companies do not use the account format but instead use the report format. The choice of which format to use is determined by the company based on industry practices, regulatory requirements, the size of the company, or tradition.

18. The balance sheet discloses economic information that has occurred over a period of time.

Answer: False

The balance sheet discloses economic information at one particular point in time, not over a period of time.

19. Liquidity refers to the ability of a company to use its financial resources to adapt to change.

Answer: False

Liquidity refers to how quickly a company can convert an asset into cash to pay its bills. Financial flexibility refers to the ability of a company to use its financial resources to adapt to change.

20. Historical cost is used extensively as a valuation method because it is based on transactions and provides information that has a high degree of relevance.

Answer: False

Historical cost is used extensively as a valuation method because it is based on transactions and provides information that has a high degree of reliability, not necessarily relevance.

Multiple Choice Questions

Select the one best answer for each of the following questions.

1. The purpose of the balance sheet is to help external users evaluate the company's:
- (a) liquidity, financial flexibility, operating capability, and financing activities.
 - (b) liquidity, financial flexibility, operating capability, financing activities, and investing activities.
 - (c) liquidity, financing activities, income-producing performance, and investing activities.
 - (d) liquidity, financial flexibility, operating capability, and income-producing performance.

Answer: (d) liquidity, financial flexibility, operating capability, and income-producing performance.

A company's balance sheet is intended to help external users (1) assess its liquidity, financial flexibility, and operating capability and (2) evaluate information about its income-producing performance during the period.

Answers (a), (b), and (c) are all incorrect because they list financing and/or investing activities. These activities, while important, are addressed in the statement of cash flows, not the balance sheet.

2. The ending balance sheet discloses:
- (a) the capital of the corporation at the beginning of the accounting period.
 - (b) the results of the corporation's financing and investing activities during the accounting period.
 - (c) the capital at the end of the accounting period.
 - (d) changes in working capital accounts during the accounting period.

Answer: (c) the capital at the end of the accounting period.

A corporation's ending balance sheet discloses the company's capital structure on a specific date; at the end of the accounting period.

Answer (a) is incorrect because the beginning balance sheet would disclose the capital at the beginning of the period. Answer (b) is incorrect because the balance sheet does not address the results of financing and investing activities. Answer (d) is incorrect because the balance sheet only discloses the capital structure at one moment of time, not the changes over a period of time.

3. The elements of the balance sheet as identified by FASB Statement of Concepts No. 6 are:

- (a) liquidity, financial flexibility, and operating capability.
- (b) assets, liabilities, and stockholders' equity.
- (c) financial capital, physical capital, and contributed capital.
- (d) current assets, property, plant, and equipment, current liabilities, long-term liabilities, and retained earnings.

Answer: (b) assets, liabilities, and stockholders' equity.

The elements of the balance sheet are the broad classes of items comprising it. Therefore, the broad classes of items included in a balance sheet are the assets, liabilities, and stockholders' equity.

Answer (a) is incorrect because liquidity, financial flexibility, and operating capability are characteristics of a company, not classes of items. Answer (c) is incorrect because financial capital, physical capital, and contributed capital are categories of capital and do not address the separate classes of items. Answer (d) is incorrect because current assets, property, plant, and equipment, current liabilities, long-term liabilities, and retained earnings are more specific classes of items, not broad classes of items.

4. A resource is classified as an asset when it is:

- (a) a probable future economic benefit obtained and controlled by a particular company as a result of purchase, production, or investment.
- (b) a probable future economic benefit obtained as a result of past purchase, production, or investment.
- (c) a probable future economic benefit obtained or controlled by a particular company as a result of a past transaction.
- (d) a probable future economic benefit obtained as a result of a past transaction that involves legal rights and duties.

Answer: (c) a probable future economic benefit obtained or controlled by a particular company as a result of a past transaction.

As defined in paragraph 25 of FASB Statement of Concepts No. 6, assets are the probable future economic benefits obtained or controlled by a company as a result of past transactions or events.

Answer (a) is incorrect because purchase, production, or investment is not broad enough to consider other transactions that might occur. Answer (b) is incorrect because it does not address the control of the economic benefit by the entity. Answer (d) is incorrect because it also does not address the control of an economic entity and it limits assets to legal rights and duties. While these legal rights and duties may or may not be present, they are not required to define an item as an asset.

5. Because stockholders' equity is a residual interest,
- (a) its value is determined independently of assets and liabilities.
 - (b) its value is determined by stockholders' investments of economic resources.
 - (c) its value is determined by the company's net assets.
 - (d) its value is determined by the value of the company's assets.

Answer: (c) its value is determined by the company's net assets.

Stockholders' equity is a residual interest, which means it is what is left over of the economic resources (assets) that have been used to satisfy obligations (liabilities). A company's net assets are defined as assets - liabilities, which is stockholders' equity.

Answer (a) is incorrect because assets, liabilities, and stockholders' equity are all interrelated. While assets and liabilities can be determine independent of each other, by definition stockholders' equity consists of the difference between the two. Answer (b) is incorrect because it does not address the use of the investments once they are committed to the company. Once the investments are committed to the company, stockholders' equity becomes dependent on assets and liabilities. Answer (d) is incorrect because it is only partially correct. Yes. Stockholders' equity is partially determined by the value of the company's assets, but answer (c) is a more complete answer because it also deals with the liability side of the equation.

6. Accounts receivable on the balance sheet are valued at the amount estimated to be collectible. This is an example of the valuation alternative known as:
- (a) net realizable value.
 - (b) current market value.
 - (c) present value.
 - (d) historical cost.

Answer: (a) net realizable value.

The net realizable value of an asset is the amount of cash (or equivalent) into which the asset is expected to be converted in the ordinary operations of the company, less any expected costs. Because accounts receivable are valued at what we expect to collect, it meets this requirement.

Answer (b) is incorrect because current market value implies that the value is what we could get if we sold the item today. This is not the same as what we expect to collect over time. Answer (c) is incorrect because the present value is the net amount of discounted future cash inflows less the discounted future cash outflows relating to the asset. Accounts receivable are generally not discounted for the time value of money. Answer (d) is incorrect because historical cost would recognize the amount at which the asset was acquired, ignoring the accounts that will become uncollectible.

7. For a manufacturer of air conditioning units, the operating cycle represents the period of time:
- (a) between selling the product on credit and collecting cash from the customer.
 - (b) between producing the product, selling it on credit, and collecting cash from the customer.
 - (c) required to purchase raw material, produce the product, sell it on credit, and collect cash from the customer.
 - (d) required to purchase raw material, produce the product, and sell it on credit.
8. Advance payment of two years of rent:
- (a) should not be classified as a current asset because the time period involved extends beyond one year.
 - (b) may be included in the current asset section if the amount does not materially distort the current asset presentation.
 - (c) meets all of the conceptual requirements for inclusion in the current asset section of the balance sheet.
 - (d) should be included in the long-term investments section of the balance sheet.

Answer: (c) required to purchase raw material, produce the product, sell it on credit, and collect cash from the customer.

An operating cycle is the average time it takes a company to go from cash, back to cash in its normal business operations. For a manufacturer of air conditioning units this would include purchasing the raw materials, producing the units, selling the units, and collecting the cash for the sales.

Answer (a) is incorrect because it does not take into consideration the period in which the raw materials and units are being processed. Answer (b) is incorrect because it does not take into consideration the time required to purchase the raw materials. Answer (d) is incorrect because it does not account for the time necessary to collect the cash from the credit sales.

Answer: (b) may be included in the current asset section if the amount does not materially distort the current asset presentation.

Conceptually, prepaid items should not be classified as current assets because they do not directly enter into the operating cycle. However, they are included as current assets because had they not been paid in advance, cash would have been paid out within the cycle. In this case, even though a two-year prepayment of rent would extend over more than an annual operating cycle, the payment is usually classified as a current asset as long as the amount in question is not material.

Answer (a) is incorrect because it is common practice to include prepaid items as long as the amount in question is immaterial. Answer (c) is incorrect because prepaid assets do not meet the conceptual definition of a current asset. Answer (d) is incorrect because prepaid assets will be consumed in the normal course of operations.

9. The working capital of a company:
- (a) is rarely disclosed on the face of the balance sheet as a separate balance.
 - (b) should be larger than the company's retained earnings balance.
 - (c) is a primary measure used to evaluate the company's profitability.
 - (d) is a legal measure related to the amount of stock the company has sold to those who have invested in the business.

Answer: (a) is rarely disclosed on the face of the balance sheet as a separate balance.

Working capital is the excess of a company's current assets over its current liabilities. Although a company rarely computes its working capital on the balance sheet, it is often used by creditors and others as an indicator of the short-run liquidity of the company.

Answer (b) is incorrect because working capital might be larger or smaller than retained earnings. In general, the two measures are not related. Answer (c) is incorrect because working capital is used to measure the liquidity of a company, not the profitability. Answer (d) is incorrect because working capital has nothing to do with the amount of stock in a company.

10. A statement of changes in stockholders' equity:
- (a) is not required to be included as a basic part of a company's financial statements so long as the change in the various equity accounts is disclosed in some manner.
 - (b) is required as an integral part of the statement of cash flows and usually appears on the face of the latter statement.
 - (c) is designed primarily to link the balance sheet information with information in the income statement of the company.
 - (d) is necessary only if the company has sold additional shares of stock since its last accounting period ended.

Answer: (a) is not required to be included as a basic part of a company's financial statements as long as the change in the various equity accounts is disclosed in some manner.

A corporation must disclose the changes in its stockholders' equity accounts. There is no mandated method required so it may be accomplished by a financial statement, a supporting schedule, or a note to the financial statements.

Answer (b) is incorrect because the statement of cash flows is a separate required financial statement. Answers (c) and (d) are incorrect because the statement of changes in stockholders' equity is designed to show investments by and distributions to the owners, not link the balance sheet to the income statement, regardless of the issuance of new stock during the accounting period.

11. If a company sells 1,000 shares of \$5 par value common stock for \$15 a share, the result of this sale will appear on the company's balance sheet as a:

- (a) \$15,000 increase in the Common Stock account.
- (b) \$5,000 increase in the Common Stock account and a \$10,000 increase in the Additional Paid-in Capital account.
- (c) \$5,000 increase in the Common Stock account and a \$10,000 increase in the Retained Earnings account.
- (d) \$5,000 increase in the Common Stock account and a \$10,000 increase in an item of other comprehensive income.

Answer: (b) \$5,000 increase in the Common Stock account and a \$10,000 increase in the Additional Paid-in Capital account.

The company is required to record the entire \$15,000 (1,000 shares × \$15 per share) invested by the investors as a part of stockholders' equity. The Common Stock account will only be increased by the par value of the stock issued, which is \$5,000 (1,000 share × \$5 par value per share). This leaves the remaining \$10,000 to be recorded as Additional-Paid-in Capital.

Answer (a) is incorrect because it does not accurately reflect the \$5 par value per share. Answer (c) is incorrect because retained earnings represent the total amount of corporate net income that has not been distributed to stockholders as dividends, not an investment by stockholders. Answer (d) is incorrect because other comprehensive income does not represent investments by the stockholders.

12. One of Tampa Bay Corporation's three manufacturing plants was totally destroyed by a fire on January 14, 2012. What effect should this event have on the corporation's 2011 financial statements that are to be released on March 1, 2012?

- (a) This event should have no effect on the financial statements or the accompanying notes, because the event occurred after December 31, 2011, which is the end of the company's accounting period.
- (b) The event should be included in the notes to the financial statements only if the event was not reported by the national news media.
- (c) The event should be included in the notes to the financial statements but the statements themselves should not be adjusted.
- (d) The event should be included in the notes to the financial statements and the statements should be adjusted.

Answer: (c) The event should be included in the notes to the financial statements but the statements should not be adjusted.

Because the conditions did not exist on the company's balance sheet date the company does not adjust its financial statements. Instead, the information is disclosed in a note, pro forma ("as if") statement, or an explanatory paragraph in the audit report, depending upon the materiality of the financial impact.

Answer (a) is incorrect because failure to report this information would be misleading to external users because it will almost certainly have an impact on future operations. Answer (b) is incorrect because reporting by the national news media has no effect on what is included in financial reporting. Answer (d) is incorrect because the financial statements should not be adjusted because they were accurate as of the date indicated.

13. The ability of a company to generate sufficient net cash inflows in order to adapt to change is the measure of its:
- (a) liquidity.
 - (b) financial flexibility.
 - (c) solvency.
 - (d) retained earnings.

Answer: (b) financial flexibility

Financial flexibility refers to the ability of a company to use its financial resources to adapt to change.

Answer (a) is incorrect because liquidity is how quickly a company can convert an asset into cash to pay its bills. Answer (c) is incorrect because solvency is the ability of a company to meet its long-term obligations as they become due. Answer (d) is incorrect because retained earnings are the total amount of corporate net income that has not been distributed to stockholders as dividends.

14. Stockholders' equity is defined as:
- (a) assets minus retained earnings.
 - (b) assets plus liabilities.
 - (c) liabilities minus assets.
 - (d) assets minus liabilities.

Answer: (d) assets minus liabilities

The basic accounting equation is: $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.

Algebraically this can be rewritten as $\text{Stockholders' Equity} = \text{Assets} - \text{Liabilities}$, which is the representation for a residual equity system.

Answer (a) is incorrect because retained earnings are a part of stockholders' equity. Answers (b) and (c) are incorrect because they are algebraically wrong.

15. Current assets could include:
- (a) accounts receivable, temporary investments, and land.
 - (b) cash, prepaid rent, and inventory.
 - (c) cash, accounts payable, and investments.
 - (d) accounts receivable, accumulated depreciation, and inventory.

Answer: (b) cash, prepaid rent, and inventory

Current assets are cash and other assets that a company expects to convert into cash, sell, or consume within one year or the normal operating cycle, whichever is longer. Cash is already converted and is a current asset. Prepaid rent will be consumed by the company and is included in current assets. Inventory will be sold and converted to cash during the year, or one operating cycle.

Answer (a) is incorrect because land is not a current asset. Answer (c) is incorrect because accounts payable is a liability, not an asset. Answer (d) is incorrect because accumulated depreciation, which is a contra-asset account, is not a current asset.

16. Current assets minus current liabilities is called:

- (a) liquidity.
- (b) solvency.
- (c) financial flexibility.
- (d) working capital.

Answer: (d) working capital

Working capital is the excess of a company's current assets over its current liabilities; or, stated another way; current assets minus current liabilities.

Answer (a) is incorrect because current assets minus current liabilities (working capital) is just one of many measures of liquidity. Answer (b) is incorrect because solvency is the ability of a company to meet its long-term obligations as they become due. Answer (d) is incorrect because financial flexibility refers to the ability of a company to use its financial resources to adapt to change.

17. Property, plant, and equipment could include which of the following accounts?

- (a) inventory
- (b) franchise
- (c) accumulated depreciation
- (d) bonds payable

Answer: (c) accumulated depreciation

Accumulated depreciation is a contra-asset account that is deducted from the corresponding operational asset account to determine the book value of the operational asset. Therefore, it is a part property, plant, and equipment.

Answer (a) is incorrect because inventory is a current asset. Answer (b) is incorrect because a franchise is an intangible asset. Answer (d) is incorrect because bonds payable are a liability.

18. Intangible assets could include which of the following accounts?

- (a) Patents
- (b) Copyrights
- (c) Trademarks
- (d) All of the above

Answer: (d) All of the above

Patents, copyrights, and trademarks are all intangible assets; therefore, answer (d) is the correct answer. An intangible asset is a noncurrent economic resource that a company uses in its operations but has no physical existence.

19. An estimated loss from a loss contingency should be accrued and reported directly on the balance sheet as a liability or a reduction of an asset in which of the following conditions? The loss is

	<u>Probable</u>	<u>Reasonably estimable</u>
(a) Yes	No	
(b) Yes	Yes	
(c) No	No	
(d) No	Yes	

Answer: (b) Loss is Probable (Yes); Loss is Reasonably Estimable (Yes)

A company accrues (reports a loss and a liability or a reduction of an asset) an estimated loss (or expense) from a loss contingency if (1) it is probable that a liability has been incurred (or an asset impaired) and (2) the amount of the loss can be reasonably estimated.

Answers (a), (c), and (d) are incorrect because each one does not include both elements (probability of the loss and the ability to reasonably estimate the amount of the probable loss) required for recognition of a loss contingency.

Matching

1. The balance sheet of the Longbow Company has the following major headings:

- | | |
|-----------------------------------|--|
| a. Current assets | g. Long-term liabilities |
| b. Long-term investments | h. Other liabilities |
| c. Property, plant, and equipment | i. Contributed capital |
| d. Intangible assets | j. Retained earnings |
| e. Other assets | k. Accumulated other comprehensive income (loss) |
| f. Current liabilities | |

Below is a list of accounts. Using the letters **a** through **k**, indicate the section of the balance sheet in which each account belongs. Put parentheses around the letter used if the account is a contra account. If the account does not belong on the balance sheet, place an **x** in the space provided.

- ___ 1. Trademarks
- ___ 2. United States income taxes payable
- ___ 3. Office supplies
- ___ 4. Dividends payable
- ___ 5. Goods in process
- ___ 6. Bond sinking fund
- ___ 7. Discount on bonds payable (bonds due in seven years)
- ___ 8. Preferred stock
- ___ 9. Depreciation expense: building
- ___ 10. Land on which factory is located
- ___ 11. Current portion of long-term bonds payable
- ___ 12. Unrealized increase in value of available-for-sale securities
- ___ 13. Improvements on leased warehouse
- ___ 14. Retained earnings restricted for plant expansion
- ___ 15. Investment in Zee Company stock (for control purposes)
- ___ 16. Mineral deposits
- ___ 17. Unearned service revenue (to be earned within next six months)
- ___ 18. Prepaid insurance

2. The balance sheet of the Junebug Company has the following sections:

- | | |
|-----------------------------------|--|
| a. Current assets | g. Long-term liabilities |
| b. Long-term investments | h. Other liabilities |
| c. Property, plant, and equipment | i. Contributed capital |
| d. Intangible assets | j. Retained earnings |
| e. Other assets | k. Accumulated other comprehensive income (loss) |
| f. Current liabilities | |

Several items or events are listed below. Using the letters **a** through **k**, indicate which section of the balance sheet the item or event would affect. If the item or event will appear only in a note to the financial statements, place the letter **n** in the space provided. If the item will not appear in any manner on the financial statements, place an **x** in the space. If the item will appear as a contra account balance, place parentheses around the letter.

- ___ 1. The company extends a one-year warranty on all products sold.
- ___ 2. Temporary investment of cash in marketable securities.
- ___ 3. Company obtained a patent on a new production process.
- ___ 4. Construction half completed on new manufacturing plant.
- ___ 5. The government has filed suit against the company alleging violations of antitrust laws. There is a reasonable probability a loss may have been incurred.
- ___ 6. A ten-year bond liability due in six months with no plan to refinance and no sinking fund on hand.
- ___ 7. Portion of underground mineral resources expected to be mined and sold during the next 12 months.
- ___ 8. Expected future value of services to be rendered to company by its chief management personnel.
- ___ 9. Lease of a warehouse that is regarded as a capital lease.
- ___ 10. Premium related to 30-year bond liability that is still five years from maturity date.
- ___ 11. Net income from prior years that was kept in the business to finance expansion.
- ___ 12. The company chooses to disclose the costs it incurred to issue certain bonds by carrying this amount under an asset classification of the balance sheet.
- ___ 13. Income taxes have been deferred by using faster depreciation methods in tax returns than are used for financial reporting purposes.
- ___ 14. Minimum pension liability adjustment.

- 15. An insurance policy held by the company to insure the life of its president has a large cash surrender value.
- 16. Preferred stock with a par value of \$100 a share had been issued for \$115 a share.
- 17. Contractual agreement requiring appropriation of prior earnings to be kept in the business.
- 18. Copyrights held on literary and musical works.
- 19. Mortgage related to new plant acquisition.

3. Financial information related to a company may appear in the following financial statements, or related notes, as discussed in this chapter:

- a. Balance sheet
- b. Statement of changes in stockholders' equity
- c. Notes accompanying the financial statements

Various elements of financial information are listed below. By placing the appropriate letter in the space provided, indicate whether the information would most likely appear in one of the two financial statements listed above or in the accompanying notes. If none of the answer choices given above is applicable, place an **x** in the space provided. Two answer choices apply to a few items.

- 1. The specific amount of income earned by the company during the current period.
- 2. The amount of accounts receivable expected to be uncollectible.
- 3. Accounting methods used to depreciate buildings and equipment.
- 4. Commissions paid to sales personnel during the current period.
- 5. Face value of bonds sold four years ago that mature in 16 years.
- 6. Loss contingency related to a lawsuit filed against the company. It is probable that the loss has been incurred and the amount can be reasonably estimated.
- 7. Depreciation expense recorded by the company during the current period.
- 8. Proceeds from a sale of common stock during the current period.
- 9. Destruction of a major plant facility one month after the current accounting period closed. Destruction resulted from explosions and related fire.
- 10. Changes in the current assets (other than cash) and current liabilities involved in the operating cycle that affected cash flows differently from net income.

Problem-Solving Strategies

Classified Balance Sheet

- Strategy:** The most important aspect of success with this chapter is learning in what section each account type belongs. In other words, you must be able to determine which accounts are assets, which are liabilities, and which are stockholders' equity.
- Strategy:** A classified balance sheet subdivides the major classifications into smaller categories to allow grouping of the individual items. This grouping allows for more meaningful interpretations of the accounting information.
- Strategy:** In a classified balance sheet, assets are grouped into one of two major categories: (1) current assets, (2) noncurrent assets. Noncurrent assets are further divided into four categories: (1) long-term investments; (2) property, plant and equipment; (3) intangible assets; and (4) other assets. Generally speaking, assets are displayed in order of liquidity, from the most liquid to the least liquid.
- Strategy:** In contrast, liabilities are generally just separated into two categories; (1) current liabilities and (2) noncurrent liabilities. There is also no generally accepted order in which current liabilities are entered in a classified balance sheet, although in many instances they are entered in order of magnitude (largest first, second largest, etc.).

On June 30, 2011, Casey Industries had the following balances in selected accounts. Using this information prepare a classified balance sheet in proper form.

	<u>Debit</u>	<u>Credit</u>
Accounts payable		12,000
Accounts receivable	65,000	
Accumulated depreciation - Buildings		125,000
Accumulated depreciation - Equipment		215,500
Accumulated depreciation - Furniture		9,500
Allowance for doubtful accounts		1,500
Building	275,000	
Cash	\$29,100	
Common Stock		200,000
Equipment	375,800	
Furniture	21,500	
Goodwill	25,000	
Inventory	205,000	
Short-term Investments	123,500	
Land	55,000	
Land (held for future office building)	45,000	
Note payable, due 12/31/2011		125,000
Note payable, due 12/31/2013		250,000
Prepaid insurance	12,000	
Prepaid Rent	6,600	
Retained earnings		275,000
Unearned revenue		25,000
	<u>\$1,238,500</u>	<u>\$1,238,500</u>

Strategy: The best way to approach a problem of this type is to separate the accounts by type. Once you have placed the assets, liabilities, and stockholders' equity into separate classifications, it will be easier to further separate the items into their appropriate categories within each classification.

Asset accounts are:

- Accounts receivable
- Accumulated depreciation - Buildings
- Accumulated depreciation - Equipment
- Accumulated depreciation - Furniture
- Allowance for doubtful accounts
- Building
- Cash
- Equipment
- Furniture
- Goodwill
- Inventory
- Short-term Investments
- Land
- Land (held for future office building)
- Prepaid insurance
- Prepaid Rent

Liability accounts are:

- Accounts payable
- Note payable, due 12/31/2011
- Note payable, due 12/31/2013
- Unearned revenue

Strategy: Note that despite the term "revenue" in the account title, unearned revenue is really a liability account.

Stockholders' Equity accounts are:

- Common Stock
- Retained earnings

Once the accounts have been separated by classification, they need further separation into categories within each classification.

Assets should be divided into (1) current assets, (2) long-term investments, (3) property, plant, and equipment, (4) intangible assets, and (5) other assets.

(1) Current assets:

- Accounts receivable
- Allowance for doubtful accounts
- Cash
- Inventory
- Short-term Investments
- Prepaid insurance
- Prepaid Rent

- (2) Long-term investments:
Land (held for future office building)

Strategy: The term "investment" is oftentimes confusing. We normally think of an investment as an asset that we buy in hopes that it will grow in value. After it has grown in value, we will then sell that asset. However, if a company purchases an asset with the intention to use it for a specific future purpose such as the acquisition of property, plant, and equipment for expansion, then it is considered an investment. Once the asset is being utilized for its intended purpose, and not held for future use, it would be considered property, plant, and equipment.

Strategy: Another common mistake is categorizing an asset based on the item and not the intended use of the asset. As an example, consider a parcel of land. If a company is using the land as the site of their warehouse, it would be considered property, plant, and equipment. The same parcel of land without the warehouse, but held for future use of the company, would be considered a long-term investment. The same parcel of land, this time being sold by a real estate development company would be considered inventory. One parcel of land with three different uses would be classified on the balance sheet in three different categories.

- (3) Property, plant, and equipment:
Accumulated depreciation - Buildings
Accumulated depreciation - Equipment
Accumulated depreciation - Furniture
Building
Equipment
Furniture
Land

- (4) Intangible Assets:
Goodwill

- (5) Other Assets - There are no other assets in this example.

The next step is to separate the liabilities into current liabilities and long-term liabilities.

- (1) Current liabilities:
Accounts payable
Note payable, due 12/31/2011
Unearned revenue

- (2) Long-term investments:
Note payable, due 12/31/2013

Strategy: In this instance, it is the time the liability is payable that determines in which category it belongs. The note payable that are due in six months (12/31/11) are considered short-term, or current. The note payable that is due in 30 months (12/31/13) is long-term. Accounts payable and the unearned revenue are current, unless otherwise stated.

Stockholders' Equity accounts do not require classification.

The final step is to place the accounts in the proper order within their categories and add the amounts.

Strategy: Make sure that you include a proper heading for this and all financial statements. A proper title would include three lines. The first line would contain the company's name. The second line would be the title of the statement (balance sheet, income statement, etc.). The third line would be for the date of the statement or the period the statement covers.

Casey Industries
Balance Sheet
At June 30, 2011 (For the period ended=income statement)

Assets

Current Assets

Cash		\$ 29,100
Short-term Investments		123,500
Accounts Receivable	\$ 65,000	
Less Allowance for Doubtful Accounts	<u>1,500</u>	63,500
Inventory		205,000
Prepaid Items		
Insurance	12,000	
Rent	<u>6,600</u>	<u>18,600</u>
Total Current Assets		439,700

Long-Term Investments

Land, held for future office building		45,000
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Property, Plant, and Equipment

Land		55,000
Building	275,000	
Less Accumulated Depreciation - Building	<u>125,000</u>	150,000
Equipment	375,800	
Less Accumulated Depreciation - Equipment	<u>215,500</u>	160,300
Furniture	21,500	
Less Accumulated Depreciation - Furniture	<u>9,500</u>	<u>12,000</u>
Total Property, Plant, and Equipment		377,300

Intangible Assets

Goodwill		<u>25,000</u>
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Total Assets

\$887,000

Casey Industries
Balance Sheet
At June 30, 2011
(Continued)

Liabilities and Stockholders' Equity

<u>Current Liabilities</u>	
Accounts Payable	\$ 12,000
Unearned Revenue	25,000
Note Payable, due 12/31/2011	<u>125,000</u>
Total Current Liabilities	162,000
 <u>Long-Term Liabilities</u>	
Note Payable, due 12/31/2013	<u>250,000</u>
 <u>Total Liabilities</u>	 <u>\$412,000</u>
 <u>Stockholders' Equity</u>	
Common Stock	200,000
Retained Earnings	<u>275,000</u>
Total Stockholders' Equity	<u>\$475,000</u>
 Total Liabilities and Stockholders' Equity	 <u>\$887,000</u>

Strategy: At this point, you should be ready to handle the proper formatting of a classified balance sheet. The biggest challenge will be to correctly separate the accounts into their appropriate classifications and categories. In addition, you must make sure that each account is accounted for properly. For instance, if land that is being held for a future use is accounted for as Property, Plant, and Equipment, it will not appear to be wrong at first glance because we are used to seeing it categorized in that manner. Approach problems of this type with a questioning manner.

Statement of Changes in Stockholders' Equity

On January 1, 2011, the Ragtag Company had the following stockholders' equity balances:

Additional paid-in capital on common stock	\$125,000
Common stock, \$10 par	100,000
Retained earnings	340,000
Accumulated other comprehensive income	18,000

During 2011, the following events occurred and were properly recorded:

- a. The company issued 1,000 shares of common stock for \$30 per share.
- b. The company earned net income of \$75,000.
- c. The company invested in available-for-sale securities. At year-end, the market value of the securities had decreased by \$8,500.
- d. The company paid a \$1.50 per share dividend on the common stock outstanding at year-end.

Prepare a statement of changes in stockholders' equity that includes retained earnings for 2011.

Strategy: Preparing the statement of changes in stockholders' equity is not very difficult if you set up the format properly. To set the form properly you need to ensure that you understand that we are looking for a total for each column and a total for each row. This will result in an overall balance of the amount to be included in stockholders' equity and it also shows where that balance changed during the period.

To start, address each event and determine what accounts the event will affect.

- a. The company issued 1,000 shares of common stock for \$30 per share.

Because the shares were issued for a price greater than the par value (\$10) of the stock, this event will increase both the common stock account ($1,000 \times \$10$ par value = \$10,000 increase), and the additional paid-in-capital account ($\$30$ sale price – \$10 par value = \$20 per share additional paid-in-capital; therefore additional paid-in-capital will increase by $1,000$ shares \times \$20 = \$20,000).

- b. The company earned net income of \$75,000.

Net income and losses affect retained earnings. Therefore, retained earnings will be increased by the \$75,000 of net income for 2011.

- c. The company invested in available-for-sale securities. At year-end, the market value of the securities had decreased by \$8,500.

An unrealized decrease in the fair market value of available-for-sale securities is one of the four items that are reported directly in other comprehensive income in the stockholders' equity section. (The other three, which will be discussed in more detail in later chapters, are translation adjustments from converting the financial statements of a company's foreign operations into U.S. dollars, certain gains and losses on "derivative" financial instruments, and certain pension liability adjustments.) This decrease in value of the available-for-sale securities will result in a decrease of \$8,500 in the accumulated other comprehensive income column.

- d. The company paid a \$1.50 per share dividend on the common stock outstanding at year-end.

Dividends are paid from retained earnings. Therefore, the amount of the dividend will be deducted from the retained earnings column. To determine the total amount of dividends paid we must multiply the per share amount (\$1.50) by the number of shares outstanding at the end of the year. The beginning balance of common stock was \$100,000 at \$10 par value per share, which means that there were 10,000 shares outstanding ($\$100,000 \div \$10 = 10,000$). We also must consider the fact that we added another 1,000 shares during the year. This means that at the end of the year there were 11,000 shares outstanding and we paid \$16,500 in dividends ($11,000 \times \$1.50 = \$16,500$).

Once you have determined which transactions have affected the accounts in the stockholders' equity section you are ready to prepare the statement. To do this you need to set up columns for each of the stockholders' equity balances (common stock, additional paid-in-capital (APIC), retained earnings, and accumulated other comprehensive income. You should also include an unlabeled column to list events on the left and a column for totals on the right.

	<u>Common Stock</u>	<u>Additional Paid- in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total</u>
--	-------------------------	--	------------------------------	---	--------------

Once you have completed this you would then add a row for each event or transaction and enter the amounts you have already calculated. Be sure to include a row for the beginning balance and the ending balance and total all the columns and rows.

	<u>Common Stock</u>	<u>Additional Paid- in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total</u>
Balance 1/1/11	\$100,000	\$125,000	\$340,000	\$18,000	\$583,000
Unrealized decrease in available-for-sale securities				(8,500)	(8,500)
Net Income			75,000		75,000
Cash dividends paid			(16,500)		(16,500)
Common stock issued	<u>10,000</u>	<u>20,000</u>			<u>30,000</u>
Balance 12/31/11	\$110,000	\$145,000	\$398,500	\$9,500	\$663,000

Test Your Knowledge

4-1. Rocky Corporation's trial balance reflected the following account balances (not all accounts are shown), shown in alphabetical order, on December 31, 2011:

Accounts receivable	\$ 75,000
Accumulated depreciation - Equipment	27,500
Allowance for doubtful accounts	3,250
Cash	89,500
Inventory	254,750
Equipment	135,250
Patent	35,000
Prepaid Advertising	2,750
Retained earnings	300,000
Sales revenue	635,000
Trading Securities	27,000
Unearned revenue	23,500

Prepare the asset section of a classified balance sheet for Rocky Corporation at December 31, 2011.

- 4-2.** Appalachian Corporation's trial balance reflected the following account balances (not all accounts are shown), shown in alphabetical order, on December 31, 2011. The bonds mature on 12/31/2015. A portion of the notes payable (\$50,000) plus the interest payable must be paid every June 30.

Accounts payable	\$ 15,000
Additional paid-in capital	85,000
Bonds payable	150,000
Common Stock	300,000
Interest payable	5,000
Note payable	200,000
Retained earnings	950,000
Service revenue	1,525,000
Unearned revenue	47,500

Prepare the liability section of a classified balance sheet for Appalachian Corporation at December 31, 2011.

- 4-3. Blue Ridge, Inc.'s trial balance reflected the following account balances (not all accounts are shown), shown in alphabetical order, on January 1, 2011:

Accounts payable	\$ 275,000
Additional paid-in capital	2,325,000
Bonds payable (mature in 2025)	4,500,000
Common Stock (\$10 par value)	750,000
Interest payable	135,250
Note payable (due 7/01/12)	725,000
Rent revenue	150,000
Revenue	6,835,000
Retained earnings	3,500,000
Unearned revenue	250,000

In addition, the following items affecting stockholders' equity occurred in 2011:

Net income for 2011 was \$2,500,000.

Dividends were declared and paid in the amount of \$500,000.

On October 1, 2011, 10,000 new shares of common stock were issued for \$30 per share.

Prepare the stockholders' equity section of a classified balance sheet for Blue Ridge, Inc. on December 31, 2011.

- 4-4.** In 2011, Teton Construction had the following transactions that affected stockholders' equity.
- a. There were 4,000,000 shares of common stock (\$0.01 value) issued and outstanding at the beginning of 2011.
 - b. Additional paid-in capital at the beginning of 2011 was \$90,000,000.
 - c. On June 1, 2011, Teton issued 1,000,000 new shares of common stock for \$25 per share.
 - d. Retained earnings at the beginning of 2011 were \$80,000,000.
 - e. Retained earnings at the end of 2011 were \$97,000,000.
 - f. On December 31, 2011, Teton declared and paid cash dividends of \$0.50 per share.
 - g. Stocks purchased on January 1, 2011, for \$1,000,000 and held as available-for-sale were worth \$1,180,000 on December 31, 2011. This is the only stock that Teton holds.
 - h. The beginning balance in the accumulated other comprehensive account was \$0 at the beginning of 2011.

Using this information, prepare a statement of changes in stockholders' equity for 2011.

Answers to Matching

- | | | | | | | |
|----|----|---|-----|-------|-----|---|
| 1. | 1. | d | 7. | g | 13. | c |
| | 2. | f | 8. | i | 14. | j |
| | 3. | a | 9. | x | 15. | b |
| | 4. | f | 10. | c | 16. | c |
| | 5. | a | 11. | f | 17. | f |
| | 6. | b | 12. | k | 18. | a |
| 2. | 1. | f | 7. | c | 13. | h |
| | 2. | a | 8. | x | 14. | k |
| | 3. | d | 9. | c & g | 15. | b |
| | 4. | c | 10. | g | 16. | i |
| | 5. | n | 11. | j | 17. | j |
| | 6. | f | 12. | e | 18. | d |
| | | | | 19. | g | |
| 3. | 1. | b | 6. | a | | |
| | 2. | a | 7. | x | | |
| | 3. | c | 8. | b | | |
| | 4. | x | 9. | c | | |
| | 5. | a | 10. | x | | |

Answers to Test Your Knowledge

4-1.

Rocky Corporation
Balance Sheet (Partial)
At December 31, 2011

Assets

Current Assets

Cash		\$ 89,500
Trading Securities		27,000
Accounts Receivable	\$ 75,000	
Less Allowance for Doubtful Accounts	<u>3,250</u>	71,750
Inventory		254,750
Prepaid Advertising		<u>2,750</u>
Total Current Assets		445,750
Equipment	135,250	
Less Accumulated Depreciation - Equipment	<u>27,500</u>	107,750
Patent		<u>35,000</u>
Total Assets		<u>\$588,500</u>

4-2.

Appalachian Corporation
Balance Sheet (Partial)
At December 31, 2011

Liabilities

Current Liabilities

Accounts Payable	\$ 15,000
Interest Payable	5,000
Unearned Revenue	47,500
Note Payable, (current portion)	<u>50,000</u>
Total Current Liabilities	117,500

Long-Term Liabilities

Note Payable, (noncurrent portion)	150,000
Bonds Payable	<u>150,000</u>
Total Long-Term Liabilities	300,000

Total Liabilities	<u>\$417,500</u>
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4-3.

Blue Ridge, Inc.
Balance Sheet (Partial)
At December 31, 2011

Stockholders' Equity

Common Stock	\$ 850,000
Additional Paid-in Capital	2,525,000
Retained Earnings	<u>5,500,000</u>
Total Stockholders' Equity	<u>\$8,875,000</u>

Common stock issue $10,000 \times \$30 = \$300,000$.

New common stock par value $10,000 \times \$10.00 = \$100,000$.

Common stock outstanding $\$750,000$ (original) + $\$100,000$ (issued 2011) = $850,000$

Additional paid-in capital for issuance: $\$300,000 - \$100,000 = \$200,000$

Additional paid-in capital outstanding $\$2,325,000$ (original) + $\$200,000$ (issued 2011) = $2,525,000$

Retained earnings (2011) = $\$3,500,000$ (original) + $\$2,500,000$ (net income) - $\$500,000$

(dividends) = $\$5,500,000$

4-4. Need to add a heading to this statement: Teton Construction Company, Statement of Changes in Stockholders' Equity, For the period ending December 31, 2011

	<u>Common Stock</u>	<u>Additional Paid- in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total</u>
Balance 1/1/11	\$40,000	\$ 90,000,000	\$80,000,000	\$ 0	\$170,040,000
Unrealized decrease in available-for-sale securities				180,000	180,000
Net Income			19,500,000		19,500,000
Cash dividends paid			(2,500,000)		(2,500,000)
Common stock issued	<u>10,000</u>	<u>24,990,000</u>			<u>25,000,000</u>
Balance 12/31/11	<u>\$50,000</u>	<u>\$114,990,000</u>	<u>\$97,000,000</u>	<u>\$180,000</u>	<u>\$212,200,000</u>

Common stock outstanding at beginning of 2011: $\$40,000 \div \$0.01 = 4,000,000$.

Common stock issue $1,000,000 \times \$25 = \$25,000,000$.

New common stock par value $1,000,000 \times \$0.01 = \$10,000$.

Additional paid-in capital for issuance: $\$25,000,000 - \$10,000 = \$24,990,000$

Dividends = $\$0.50 \times (4,000,000 + 1,000,000) = \$2,500,000$

Net Income = $\$97,000,000 + \$2,500,000 - \$80,000,000 = \$19,500,000$