CHAPTER

2 Financial Statements and Accounting Concepts/Principles

M2.1.

	A	=	L	+	SE	
Beginning:	$96,000	=	$54,000	+	?	
Changes:		=			+16,000	net income (increase to retained earnings)
					-4,000	dividends (decrease to retained earnings)
Ending:		=		+	?	

Solution approach:
Beginning stockholders' equity = $96,000 - $54,000 = **$42,000**. Net income increases retained earnings and dividends decrease retained earnings. Retained earnings are part of stockholders' equity, so assuming no other changes occurred during the year, ending stockholders' equity = $42,000 + $16,000 - $4,000 = **$54,000**.

E2.7.

	Category	*Financial Statement(s)*
Cash……	**A**	**BS**
Accounts payable…….……..	**L**	**BS**
Common stock……	**SE**	**BS**
Depreciation expense……..	**E**	**IS**
Net sales……..	**R**	**IS**
Income tax expense…….	**E**	**IS**
Short-term investments……...	**A**	**BS**
Gain on sale of land…….	**G**	**IS**
Retained earnings……	**SE**	**BS**
Dividends payable……..	**L**	**BS**
Accounts receivable……	**A**	**BS**
Short-term debt……	**L**	**BS**

E2.10.

Use the accounting equation to solve for the missing information:

Firm A:

A	=	L	+	PIC	+	(Beg. RE	+	NI	-	DIV	=	End. RE)
$?	=	$160,000	+	$110,000	+	($100,000	+	136,000	-	$24,000	=	?)

In this case, the ending balance of retained earnings must be determined first:
$100,000 + $136,000 - $24,000 = End. RE
Retained earnings, 12/31/19 = **$212,000**

Once the ending balance of retained earnings is known, total assets can be determined:
A = $160,000 + $110,000 + $212,000
Total assets, 12/31/19 = **$482,000**

Firm B:

A	=	L	+	PIC	+	(Beg. RE	+	NI	-	DIV	=	End. RE)
$870,000	=	?	+	$118,000	+	($248,000	+	$220,000	-	?	=	$372,000)

$870,000 = L + $118,000 + $372,000
Total liabilities, 12/31/19 = **$380,000**

$248,000 + $220,000 - DIV = $372,000
Dividends declared and paid during 2019 = **$96,000**

Firm C:

A	=	L	+	PIC	+	(Beg. RE	+	NI	-	DIV	=	End. RE)
$310,000	=	$150,000	+	$90,000	+	(?	+	$50,000	-	$32,000	=	?)

In this case, the ending balance of retained earnings must be determined first:
$310,000 = $150,000 + $90,000 + End. RE
Retained earnings, 12/31/19 = **$70,000**

Once the ending balance of retained earnings is known, the beginning balance of retained earnings can be determined:
Beg. RE + $50,000 - $32,000 = $70,000
Retained earnings, 1/1/19 = **$52,000**

P2.17.

Cash	$ 27,000
Accounts receivable	99,000
Supplies	18,000
Merchandise inventory	93,000
Total current assets	**$237,000**
Accounts payable	$ 69,000
Long-term debt	120,000
Common stock	30,000
Retained earnings	177,000
Total liabilities and stockholders' equity	**$396,000**
Net Sales	$420,000
Cost of goods sold	(270,000)
Gross profit	$150,000
Service revenue	60,000
Depreciation expense	(36,000)
Supplies expense	(42,000)
Earnings from operations (operating income)	**$132,000**
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Interest expense	(12,000)
Earnings before taxes	$120,000
Income tax expense	(36,000)
Net income	**$ 84,000**

$36,000 income tax expense / $120,000 earnings before taxes = **30% average tax rate**

Retained earnings, January 1, 2019	?
Net income for the year	$ 84,000
Dividends declared and paid during the year	(48,000)
Retained earnings, December 31, 2019	$177,000

Solving the model, the beginning retained earnings balance must have been **$141,000**, because the account balance increased by $36,000 during the year to an ending balance of $177,000.