**P2.4A** **(**[**LO 1**](https://jigsaw.vitalsource.com/books/9781119594543/epub/OPS/c02.xhtml?favre=brett#c02-feafxd-0022)**)** These items are taken from the financial statements of Mbong Corporation for the year ended December 31, 2021:

|  |  |
| --- | --- |
| Retained earnings, January 1 | $221,000 |
| Cash | 11,900 |
| Salaries payable | 3,000 |
| Utilities expense | 2,000 |
| Equipment | 66,000 |
| Accounts payable | 15,000 |
| Buildings | 72,000 |
| Common shares | 34,200 |
| Dividends declared | 5,000 |
| Service revenue | 213,900 |
| Prepaid insurance | 2,000 |
| Repair and maintenance expense | 2,800 |
| Land | 156,000 |
| Depreciation expense | 6,200 |
| Accounts receivable | 14,200 |
| Insurance expense | 2,200 |
| Salaries expense | 129,800 |
| Accumulated depreciation—equipment | 17,600 |
| Income tax expense | 6,000 |
| Supplies | 200 |
| Operating expense | 39,400 |
| Supplies expense | 1,000 |
| Bank loan payable, due 2024 | 15,000 |
| Trading investments | 20,000 |
| Accumulated depreciation—buildings | 18,000 |
| Interest expense | 1,500 |
| Interest income | 500 |

**Additional information:**

1. Mbong started the year with $30,000 of common shares and issued $4,200 more during the year.
2. Mbong must pay $1,500 of the bank loan payable next year in 2022.

**Instructions**

1. Prepare a statement of income, statement of changes in equity, and statement of financial position for the year.

|  |  |
| --- | --- |
| Mbong Corporation  Statement of Income  Year Ended December 31, 2021 | |
| Service Revenue | 213,900 |
| Interest income | 500 |
| Salaries expense | (129,800) |
| Operating Expense | (39,400) |
| Depreciation expense | (6,200) |
| Repair and maintenance expense | (2,800) |
| Insurance expense | (2,200) |
| Utilities expense | (2,000) |
| Interest expense | (1,500) |
| Supplies expense | (1,000) |
| Income Before Income Tax | 28,500 |
| Income tax expense | (6,000) |
| Net Income | $23,500 |

|  |  |  |  |
| --- | --- | --- | --- |
| Mbong Corporation  Statement of Changes in Equity  Year Ended December 31, 2021 | | | |
|  | Common Shares | Retained Earnings | Total Equity |
| Balance, January 1st, 2021 | 30,000 | 221,000 | 251,000 |
| Issued common shares | 4,200 |  | 4,200 |
| Net income |  | 23,500 | 23,500 |
| Dividends declared |  | (5,000) | (5,000) |
| Balance | $34,200 | $239,500 | $273,700 |

|  |  |  |  |
| --- | --- | --- | --- |
| **Mbong Corporation**  **Statement of Financial Position**  **Year Ended December 31, 2021** | | | |
| **Assets** | | **Liabilities and Shareholders’ Equity** | |
| Cash | 11,900 | Bank loan payable, due 2024 | 15,000 |
| Accounts receivable | 14,200 | Accounts payable | 15,000 |
| Trading investments | 20,000 | Salaries payable | 3,000 |
| Supplies | 200 | Total Liabilities | $33,000 |
| Equipment | 66,000 | **Shareholders’ Equity** | |
| Accumulated depreciation—equipment | (17,600) | Retained earnings, December 31st | 239,500 |
| Buildings | 72,000 | Common shares | 34,200 |
| Accumulated depreciation—buildings | (18,000) | Total Shareholders’ Equity | $273,700 |
| Prepaid insurance | 2,000 |  |  |
| Land | 156,000 |  |  |
|  |  |  |  |
| Current Assets | 48,300 | Current Liabilities | 19,500 |
| Non-Current Assets | 294,000 | Non-Current Liabilities | 13,500 |
| Total Assets | $306,700 | Total Liabilities and Shareholders’ Equity | $306,700 |

1. Explain how each financial statement relates to the others.

*Calculate ratios and comment on liquidity, solvency, and profitability*.

* The statement of Income first gives you your Net Income which you use to calculate your new Retained Earnings on your Statement of Changes in Equity which you then use in your Statement of Financial Position.
* Liquidity:
  + Current Ratio: [Current Assets] / [Current Liabilities]
    - [48,300] / [19,500] = 2.48
  + Working Capital: [Current Assets] – [Current Liabilities]
    - [48,300] – [19,500] = $28,800
* Solvency Ratio = [Total Debt] / [Total Assets]
  + - [33,000] / [306,700] = 0.108
* Profitability Ratio:
  + Gross Profit = [Revenue] – [Cost of Goods Sold]
    - [213,900] – [39,400] = $174,500
  + [Basic Earnings Per Share] = [Income Av. To Shareholders] / [Weighted Avg. Number of Shares]
    - [Income Av. To Shareholders] = [Revenue] – [Expenses] – [Dividends]
    - [18,500] / [34,200] = $0.54

From our figures we can see that Mbong is sufficiently liquid by having a ratio above 2:1, and that it likely to survive long-term to pay its debts based on having a modest solvency ratio of 10%. With a gross profit of $175,500 Mbong appears to be a small corporation. While it does appear to be profitable with a BEP of $0.54, it is difficult to determine if this is growth without previous years records.