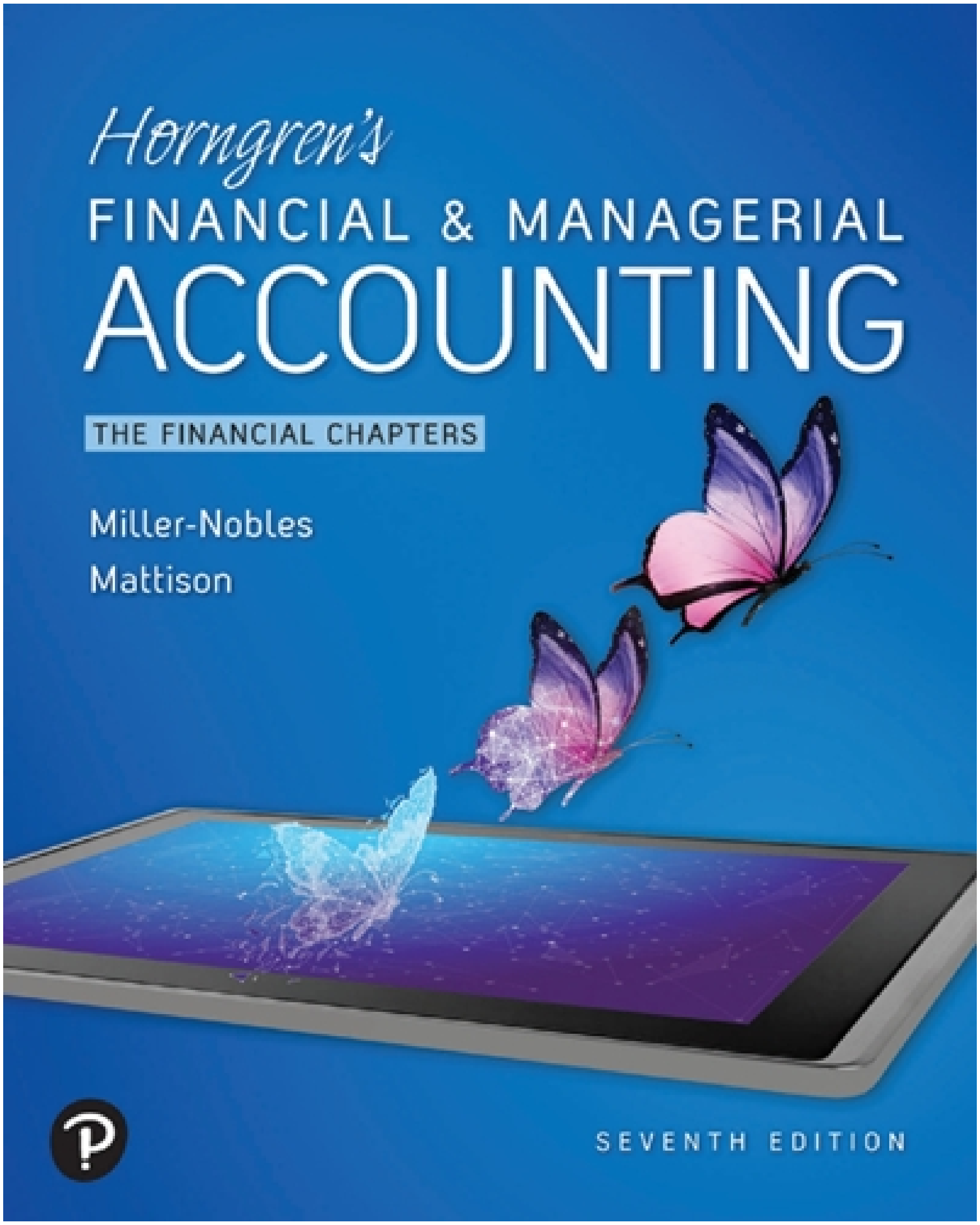
Solutions for Horngrens Financial and Managerial Accounting The Financial Chapters 7th Edition by Nobles



Solutions

Chapter 1
Accounting and the Business Environment

Review Questions

1. Accounting is the information system that measures business activities, processes the information into reports, and communicates the results to decision makers. Accounting is the language of business.

2. Financial accounting provides information for external decision makers, such as outside investors, lenders, customers, and the federal government. Managerial accounting focuses on information for internal decision makers, such as the company's managers and employees.

3. Individuals use accounting information to help them manage their money, evaluate a new job, and better decide whether they can afford to make a new purchase. Business owners use accounting information to set goals, measure progress toward those goals, and make adjustments when needed. Investors use accounting information to help them decide whether or not a company is a good investment and once they have invested, they use a company's financial statements to analyze how their investment is performing. Creditors use accounting information to decide whether to lend money to a business and to evaluate a company's ability to make the loan payments. Taxing authorities use accounting information to calculate the amount of income tax that a company has to pay.

4. Certified Public Accountants (CPAs) are licensed professional accountants who serve the general public. They work for public accounting firms, businesses, government, or educational institutions. A Chartered Global Management Accountant (CGMA) is an accountant who has advanced knowledge in finance, operations, strategy, and management. Certified Management Accountants (CMAs) specialize in accounting and financial management knowledge. They work for a single company. Certified Financial Planners (CFPs) work with individuals to help them budget, plan for retirement, save for education, and manage their finances.

5. The FASB oversees the creation and governance of accounting standards. They work with governmental regulatory agencies, congressionally created groups, and private groups.

6. The guidelines for accounting information are called GAAP. It is the main U.S. accounting rule book and is currently created and governed by the FASB. Investors and lenders must have information that is relevant and has faithful representation in order to make decisions and GAAP provides the framework for this financial reporting.

7. A sole proprietorship has a single owner, terminates upon the owner's death or choice, the owner has personal liability for the business's debts, and it is not a separate tax entity. A partnership has two or more owners, terminates at partner's choice or death, the partners have personal liability, and it is not a separate tax entity. A corporation is a separate legal entity, has one or more owners, has indefinite life, the stockholders are not personally liable for the business's debts, and it is a separate tax entity. A limited-liability company has one or more members and each is only liable for his or her own actions, has an indefinite life, and is not a separate tax entity.

8. The land should be recorded at $5,000. The cost principle states that assets should be recorded at their historical cost.

9. The going concern assumption assumes that the entity will remain in business for the foreseeable future and long enough to use existing resources for their intended purpose.

10. The faithful representation concept states that accounting information should be complete, neutral, and free from material error.

11. The monetary unit assumption states that items on the financial statements should be measured in terms of a monetary unit.

12. The IASB is the organization that develops and creates IFRS which are a set of global accounting standards that would be used around the world.

13. Assets = Liabilities + Equity. Assets are economic resources that are expected to benefit the business in the future. They are things of value that a business owns or has control of. Liabilities are debts that are owed to creditors. They are one source of claims against assets. Equity is the other source of claims against assets. Equity is the stockholders' claims against assets and is the amount of assets that is left over after the company has paid its liabilities. It represents the net worth of the corporation.

14. Retained earnings increases with revenues. Retained earnings decreases with expenses and dividends.

15. Revenues – Expenses = Net Income. Revenues are earnings resulting from delivering goods or services to customers. Expenses are the cost of selling goods or service.

16. Step 1: Identify the accounts and the account type. Step 2: Decide if each account increases or decreases. Step 3: Determine if the accounting equation is in balance.

17. Income Statement – Shows the difference between an entity's revenues and expenses and reports the net income or net loss for a specific period.
Statement of Retained Earnings – Shows the changes in retained earnings for a specific period including net income (loss) and dividends.
Balance Sheet – Shows the assets, liabilities, and stockholders' equity of the business as of a specific date.
Statement of Cash Flows – Shows a business's cash receipts and cash payments for a specific period.

18. Return on Assets = Net income / Average total assets. ROA measures how profitably a company uses its assets.

Short Exercises

S-F:1-1

a. FA	e. MA
b. FA	f. FA
c. FA	g. MA
d. MA	h. FA

S-F:1-2

The Financial Accounting Standards Board governs the majority of guidelines, called Generally Accepted Accounting Principles (GAAP), that the CPA will use to prepare financial statements for Wholly Shirts.

S-F:1-3

Chloe's needs will best be met by organizing a corporation since a corporation has an unlimited life and is a separate tax entity. In addition, the owners (stockholders) have limited liability. Chloe could also consider a limited liability company (LLC) as an option. A LLC meets two of the three criteria. It has an unlimited life and limited liability for the owner. However, a LLC is not a separate tax entity.

S-F:1-4

Advantages:
1. Easy to organize.
2. Unification of ownership and management.
3. Less government regulation.
4. Owner has more control over business.

Disadvantages:
1. The owner pays taxes on the entity's earnings since it is not a separate tax entity.
2. No continuous life or transferability of ownership.
3. Unlimited liability of owner for business's debts.

S-F:1-5

a. The economic entity assumption
b. The cost principle.
c. The monetary unit assumption.
d. The going concern assumption.

S-F:1-6
Requirement 1

Thompson Handyman Services has equity of $9,350.

Assets	=	Liabilities	+	Equity
$18,400	=	$9,050	+	?
$18,400	=	$9,050	+	**$9,350**

Requirement 2

Thompson Handyman Services has liabilities of $17,200.

Assets	=	Liabilities	+	Equity
$18,400 + $4,300	=	?	+	$9,350 – $3,850
$22,700	=	**$17,200**	+	$5,500

S-F:1-7
Requirement 1

ASSETS	=	LIABILITIES	+	EQUITY						
				Contributed Capital	+	Retained Earnings				
			+	Common Stock	–	Dividends	+	Revenues	–	Expenses
$45,800	=	$17,220	+	$27,460	–	$6,500	+	$8,850	–	**?**
$45,800	=	$17,220	+	$27,460	–	$6,500	+	$8,850	–	**$1,230**

Requirement 2

Roland's Overhead Doors reported net income of $7,620. Net Income = Revenues ($8,850) – Expenses ($1,230)

S-F:1-8

a. L	f. E
b. A	g. A
c. E	h. E
d. A	i. A
e. E	j. E

S-F:1-9

a. Increase asset (Cash); Increase equity (Service Revenue)
b. Decrease asset (Cash); Decrease equity (Salaries Expense)
c. Increase asset (Cash); Increase Equity (Common Stock)
d. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
e. Increase liability (Accounts Payable); Decrease equity (Utility Expense)
f. Decrease asset (Cash); Decrease equity (Dividends)

S-F:1-10

a. Increase asset (Cash); Increase equity (Common Stock)
b. Increase asset (Equipment); Increase liability (Accounts Payable)
c. Increase asset (Office Supplies); Decrease asset (Cash)
d. Increase asset (Cash); Increase equity (Service Revenue)
e. Decrease asset (Cash); Decrease equity (Wages Expense)
f. Decrease asset (Cash); Decrease equity (Dividends)
g. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
h. Decrease asset (Cash); Decrease equity (Rent Expense)
i. Increase liability (Accounts Payable); Decrease equity (Utilities Expense)

S-F:1-11

a. B	f. I
b. B, C	g. B
c. B	h. RE
d. B	i. B
e. I	j. I

S-F:1-12

CENTERPIECE ARRANGEMENTS
Income Statement
Year Ended December 31, 2024

Revenue:		
Service Revenue		$ 70,000
Expenses:		
Salaries Expense	$ 46,000	
Rent Expense	16,000	
Insurance Expense	4,500	
Utilities Expense	1,400	
Total Expenses		67,900
Net Income		$ 2,100

S-F:1-13

CENTERPIECE ARRANGEMENTS
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, January 1, 2024	$ 5,100
Net income for the year	2,100
	7,200
Dividends	(4,800)
Retained Earnings, December 31, 2024	$ 2,400

S-F:1-14

CENTERPIECE ARRANGEMENTS
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 7,200	Accounts Payable	$ 17,600
Accounts Receivable	8,000		
Office Supplies	1,700	Stockholders' Equity	
Equipment	12,100	Common Stock	9,000
		Retained Earnings	2,400
		Total Stockholders' Equity	11,400
Total Assets	$ 29,000	Total Liabilities and Stockholders' Equity	$ 29,000

S-F:1-15

POLK STREET HOMES
Statement of Cash Flows
Month Ended July 31, 2024

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 25,000
Payments:		
To employees	$ (1,500)	
To suppliers	(2,500)	(4,000)
Net cash provided by operating activities		21,000
Cash flows from investing activities:		
Purchase of equipment	(25,000)	
Net cash used by investing activities		(25,000)
Cash flows from financing activities:		
Issued common stock	13,000	
Payment of cash dividend	(4,000)	
Net cash provided by financing activities		9,000
Net increase in cash		5,000
Cash balance, July 1, 2024		14,000
Cash balance, July 31, 2024		$ 19,000

S-F:1-16

Return on assets	=	Net income / Average total assets
	=	$50,880 / (($362,000 + $486,000) / 2)
	=	$50,880 / $424,000
	=	12%

Exercises

E-F:1-17

a.	E	e.	E
b.	I	f.	I
c.	E	g.	I
d.	E	h.	E

E-F:1-18

1.	d	6.	f
2.	e	7.	b
3.	g	8.	c
4.	a	9.	j
5.	i	10.	h

E-F:1-19

1.	e	7.	d
2.	a	8.	c
3.	i	9.	g
4.	f	10.	h
5.	j	11.	k
6.	b		

E-F:1-20

	Assets	Liabilities	Equity
Hair Styles	**$ 72,000**	$ 36,000	$ 36,000
Style Cuts	90,000	**42,000**	48,000
Your Basket	101,000	68,000	**33,000**

E-F:1-21

	a.	b.	c.
Stockholders' equity, May 31, 2024 ($122,000 – $66,000)	$ 56,000	$ 56,000	$ 56,000
Issuance of common stock	10,000	0	12,500
Net income for the month	**77,000**	**90,000**	**104,500**
	143,000	146,000	173,000
Dividends	0	(3,000)	(30,000)
Stockholders' equity, June 30, 2024 ($287,000 – $144,000)	$ 143,000	$ 143,000	$ 143,000

E-F:1-22
Requirement 1

	Assets	=	Liabilities	+	Equity
Beginning of 2024	$19,000	=	$14,000	+	?
	$19,000	=	$14,000	+	**$5,000**
End of 2024	$12,000	=	$9,000	+	?
	$12,000	=	$9,000	+	**$3,000**

Stockholders' equity decreased in 2024 by $2,000 ($5,000 – $3,000).

Requirement 2

a. Increase through issuance of common stock.
b. Increase through net income.
c. Decrease through dividend payment.
d. Decrease through net loss.

E-F:1-23
Requirement 1

Revenues	–	Expenses	=	Net Income
$30,000	–	$15,000	=	**$15,000**

Requirement 2

Flowing Rivers Spa's equity increased by $15,000 ($29,000 - $14,000) or the amount of the net income.

	Assets	=	Liabilities	+	Equity
Beginning of 2024	$28,000	=	$14,000	+	?
	$28,000	=	$14,000	+	$14,000
Ending of 2024	$43,000	=	$14,000	+	?
	$43,000	=	$14,000	+	$29,000

E-F:1-24
Requirement 1

	Assets	−	Liabilities	=	Equity
Beginning of 2024	$67,000	−	$11,000	=	$56,000
Ending of 2024	$46,000	−	$34,000	=	$12,000

Retained Earnings:

Retained Earnings, Jan. 1, 2024	$ 45,000
Plus: Revenues	205,000
Less: Expenses	**(241,000)**
Less: Dividends	(8,000)
Retained Earnings, Dec. 31, 2024	$ 1,000

Stockholders' Equity:

Common Stock	$ 11,000
Retained Earnings	1,000
Total Stockholders' Equity	$ 12,000

Requirement 2

Felix Company suffered (or reported) a net loss of ($36,000).

Revenue	−	Expenses	=	Net Income (Loss)
$205,000	−	$241,000	=	($36,000)

E-F:1-25

Student responses will vary. Examples include:
a. Cash purchase of office supplies.
b. Cash dividends paid to stockholders.
c. Paid cash on accounts payable.
d. Received cash for services provided.
e. Borrowed cash from the bank.

E-F:1-26

a. Increase asset (Cash); Increase equity (Common Stock)
b. Increase asset (Accounts Receivable); Increase equity (Rental Revenue)
c. Increase asset (Office Furniture); Increase liability (Accounts Payable)
d. Increase asset (Cash); Decrease asset (Accounts Receivable)
e. Decrease asset (Cash); Decrease liability (Accounts Payable)
f. Increase asset (Cash); Increase equity (Rental Revenue)
g. Decrease asset (Cash); Decrease equity (Rent Expense)
h. Decrease asset (Cash); Increase asset (Office Supplies).

E-F:1-27

a. Increase asset (Cash); Increase equity (Common Stock)
b. Increase asset (Land); Decrease asset (Cash)
c. Decrease asset (Cash); Decrease liability (Accounts Payable)
d. Increase asset (Equipment); Increase liability (Notes Payable)
e. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
f. Increase liability (Salaries Payable); Decrease equity (Salaries Expense)
g. Increase asset (Cash); Decrease asset (Accounts Receivable)
h. Increase asset (Cash); Increase liability (Notes Payable)
i. Decrease asset (Cash); Decrease equity (Dividends)
j. Increase liability (Accounts Payable); Decrease equity (Utility Expense)

E-F:1-28

Transaction Descriptions:

1. Issuance of common stock to stockholders
2. Earned revenue on account
3. Purchased equipment on account
4. Collected cash on account
5. Cash purchase of equipment
6. Paid cash on account
7. Earned revenue and received cash
8. Paid cash for salaries

E-F:1-29

	ASSETS					=	LIABILITIES	+	EQUITY										
									Contributed Capital	+	Retained Earnings								
Date	Cash	+	Medical Supplies	+	Land	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Salaries Expense	–	Rent Expense	–	Utilities Expense
July 6	+68,000								+68,000										
Bal.	$68,000					=		+	$68,000										
9	–56,000				+56,000	=													
Bal.	$12,000			+	$56,000	=		+	$68,000										
12		+	+1,500			=	+1,500												
Bal.	$12,000	+	$1,500	+	$56,000	=	$1,500	+	$68,000										
15																			
Bal.	$12,000	+	$1,500	+	$56,000	=	$1,500	+	$68,000										
20	–2,900					=									–1,300		–1,500		–100
Bal.	$ 9,100	+	$1,500	+	$56,000	=	$1,500	+	$68,000					–	$1,300	–	$1,500	–	$100
31	+13,000					=							+13,000						
Bal.	$22,100	+	$1,500	+	$56,000	=	$1,500	+	$68,000			+	$13,000	–	$1,300	–	$1,500	–	$100
31	–1,050					=	–1,050												
Bal.	$21,050	+	$1,500	+	$56,000	=	$ 450	+	$68,000			+	$13,000	–	$1,300	–	$1,500	–	$100

E-F:1-30

Requirement 1

a. Income statement
b. Statement of retained earnings
c. Balance sheet
d. Statement of cash flows

Requirement 2

Yes, the financial statements should be prepared in the order listed above in Requirement 1.

Requirement 3

Income Statement:

a. The header includes the name of the business, the title of the statement, and the time period. An income statement always represents a period of time, for example, a month or a year.
b. The revenue accounts are always listed first and then subtotaled if necessary.
c. Each expense account is listed separately from largest to smallest and then subtotaled if necessary.
d. Net income is calculated as total revenues minus total expenses.

Statement of Retained Earnings:

a. The header includes the name of the business, the title of the statement, and the time period. A statement of retained earnings always represents a period of time, for example, a month or a year.
b. The beginning retained earnings is listed first and will always be the ending retained earnings from the previous time period.
c. The net income is added to the beginning retained earnings.
d. The dividends are subtracted from retained earnings. If there had been a net loss, this would also be subtracted.

Balance Sheet:

a. The header includes the name of the business and the title of the statement but the date is different. The balance sheet shows the date as a specific date and not a period of time.
b. Each asset account is listed separately and then totaled. Cash is always listed first.
c. Liabilities are listed separately and then totaled. Liabilities that are to be paid first are listed first.
d. The stockholders' equity section includes common stock and ending retained earnings from the statement of retained earnings.
e. The balance sheet must always balance: Assets = Liabilities + Equity.

Statement of Cash Flows:

a. The header includes the name of the business, the title of the statement, and the time period. A statement of cash flows always represents a period of time, for example, a month or a year.
b. Each dollar amount is calculated by evaluating the cash column on the transaction detail.
c. Operating activities involve cash receipts for services provided and cash payments for expenses paid.
d. Investing activities include the purchase and sale of land and equipment for cash.
e. Financing activities include cash from the issuance of common stock and payment of cash dividends.
f. The ending cash balance must match the cash balance on the balance sheet.

E-F:1-31
Requirement 1

WILSON TOWING SERVICE Income Statement Month Ended June 30, 2024		
Revenue:		
Service Revenue		$ 15,000
Expenses:		
Salaries Expense	$ 2,400	
Rent Expense	900	
Total Expenses		3,300
Net Income		$ 11,700

Requirement 2

The income statement reports revenues and expenses for a period of time.

E-F:1-32
Requirement 1

WILSON TOWING SERVICE Statement of Retained Earnings Month Ended June 30, 2024	
Retained Earnings, June 1, 2024	$ 3,250
Net income for the month	11,700
	14,950
Dividends	(3,500)
Retained Earnings, June 30, 2024	$ 11,450

Requirement 2

The statement of retained earnings reports the changes in retained earnings for a corporation during a time period. The statement of retained earnings reports a corporation's net income or net loss and dividends declared.

E-F:1-33
Requirement 1

WILSON TOWING SERVICE
Balance Sheet
June 30, 2024

Assets		Liabilities	
Cash	$ 1,400	Accounts Payable	$ 8,000
Accounts Receivable	9,000	Notes Payable	6,800
Office Supplies	1,000	Total Liabilities	14,800
Equipment	25,850	Stockholders' Equity	
		Common Stock	11,000
		Retained Earnings	11,450
		Total Stockholders' Equity	22,450
Total Assets	$ 37,250	Total Liabilities and Stockholders' Equity	$ 37,250

Requirement 2

The balance sheet reports an entity's assets, liabilities, and stockholders' equity as of a specific date.

E-F:1-34

DAMON DESIGN STUDIO
Income Statement
Year Ended December 31, 2024

Revenue:		
Service Revenue		$ 154,600
Expenses:		
Salaries Expense	$ 65,000	
Rent Expense	23,000	
Utilities Expense	7,200	
Miscellaneous Expense	3,800	
Property Tax Expense	2,200	
Total Expenses		101,200
Net Income		$ 53,400

E-F:1-35

DAMON DESIGN STUDIO
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, January 1, 2024	$ 39,000
Net income for the year	53,400
	92,400
Dividends	(57,000)
Retained Earnings, December 31, 2024	$ 35,400

E-F:1-36

DAMON DESIGN STUDIO
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 3,200	Accounts Payable	$ 3,600
Accounts Receivable	9,300	Notes Payable	14,000
Office Supplies	5,100	Total Liabilities	17,600
Office Furniture	48,400	Stockholders' Equity	
		Common Stock	13,000
		Retained Earnings	35,400
		Total Stockholders' Equity	48,400
Total Assets	$ 66,000	Total Liabilities and Stockholders' Equity	$ 66,000

E-F:1-37

a. F +	f. I –
b. O –	g. O –
c. X	h. X
d. F –	i. O –
e. O +	j. X

E-F:1-38

MORNING BEAN FOOD EQUIPMENT COMPANY
Statement of Cash Flows
Month Ended January 31, 2024

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 8,500
Payments:		
To employees	$ (1,300)	
To suppliers	(2,050)	(3,350)
Net cash provided by operating activities		5,150
Cash flows from investing activities:		
Purchase of land	(19,000)	
Net cash used by investing activities		(19,000)
Cash flows from financing activities:		
Issuance of common stock	5,000	
Payment of cash dividends	(500)	
Net cash provided by financing activities		4,500
Net decrease in cash		(9,350)
Cash balance, January 1, 2024		11,800
Cash balance, January 31, 2024		$ 2,450

E-F:1-39

Average total assets = (Beginning total assets + ending total assets) / 2
Beginning total assets = $34,000 + $23,000 + $160,000 + $2,200 + $24,000 + $4,800 = $248,000
Ending total assets = $134,200 + $44,000 + $160,000 + $19,800 + $42,000 + $2,000 = $402,000
Average total assets = ($248,000 + $402,000) / 2 = $325,000

ROA = Net income / Average total assets
ROA = $58,500 / $325,000 = 0.18 = 18%

E-F:1-40

a. Decreases. The increase in assets (office furniture) increases the denominator in the equation and therefore decreases the ratio.
b. Increases. The increase in rental revenue increases net income in the numerator of the equation, therefore increases the ratio.
c. Does not change. The decrease in assets (cash) and increase in assets (office supplies) in the denominator of the equation causes no change.
d. Decreases. The increase in assets (cash) increases the denominator in the equation and therefore decreases the ratio.
e. Increases. The decrease in assets (cash) decreases the denominator in the equation and therefore increases the ratio.
f. Does not change. The increase in assets (cash) and decrease in assets (accounts receivable) in the denominator of the equation causes no change.

Problems (Group A)

P-F:1-41A

			ASSETS					=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Advertising Expense
Bal.	$1,900	+	$3,200			+	$15,000	=	$5,000	+	$11,900				+ $3,200				
(a)	+17,000										+17,000								
Bal.	$18,900	+	$3,200			+	$15,000	=	$5,000	+	$28,900				$3,200				
(b)	+800														+800				
Bal.	$19,700	+	$3,200			+	$15,000	=	$5,000	+	$28,900				$4,000				
(c)	–5,000								–5,000										
Bal.	$14,700	+	$3,200			+	$15,000	=	$0	+	$28,900			+	$4,000				
(d)					+1,200				+1,200										
Bal.	$14,700	+	$3,200	+	$1,200	+	$15,000	=	$1,200	+	$28,900			+	$4,000				
(e)	+2,000		–2,000																
Bal.	$16,700	+	$1,200	+	$1,200	+	$15,000	=	$1,200	+	$28,900			+	$4,000				
(f)	–1,600												–1,600						
Bal.	$15,100	+	$1,200	+	$1,200	+	$15,000	=	$1,200	+	$28,900	–	$1,600	+	$4,000				
(g)			+4,500												+4,500				
Bal.	$15,100	+	$5,700	+	$1,200	+	$15,000	=	$1,200	+	$28,900	–	$1,600	+	$8,500				
(h)	–1,500																–1,000		–500
Bal.	$13,600	+	$5,700	+	$1,200	+	$15,000	=	$1,200	+	$28,900	–	$1,600	+	$8,500	–	$1,000	–	$500

P-F:1-42A

	ASSETS					=	LIABILITIES	+	EQUITY												
									Contributed Capital	+	Retained Earnings										
	Cash	+	Accounts Receivable	+	Office Supplies	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense	–	Wages Expense	–	Advertising Expense
1	+19,000								+19,000												
2	+3,800												+3,800								
Bal.	$22,800					=		+	$19,000			+	$3,800								
5	–200				+200																
Bal.	$22,600			+	$200	=		+	$19,000			+	$3,800								
9			+4,500										+4,500								
Bal.	$22,600	+	$4,500	+	$200	=		+	$19,000			+	$8,300								
10							+200										–200				
Bal.	$22,600	+	$4,500	+	$200	=	$200	+	$19,000			+	$8,300			–	$200				
15	–250																				–250
Bal.	$22,350	+	$4,500	+	$200	=	$200	+	$19,000			+	$8,300			–	$200			–	$250
20	–200						–200														
Bal.	$22,150	+	$4,500	+	$200	=	$ 0	+	$19,000			+	$8,300			–	$200			–	$250
25	+4,500		–4,500																		
Bal.	$26,650	+	$ 0	+	$200	=		+	$19,000			+	$8,300			–	$200			–	$250
28	–1,600														–1,600						
Bal.	$25,050			+	$200	=		+	$19,000			+	$8,300	–	$1,600	–	$200			–	$250
28	–1,450																		–1,450		
Bal.	$23,600			+	$200	=		+	$19,000			+	$8,300	–	$1,600	–	$200	–	$1,450	–	$250
30	+1,400												+1,400								
Bal.	$25,000			+	$200	=		+	$19,000			+	$9,700	–	$1,600	–	$200	–	$1,450	–	$250
31	–3,500										–3,500										
Bal.	$21,500	+	$ 0	+	$200	=	$ 0	+	$19,000	–	$3,500	+	$9,700	–	$1,600	–	$200	–	$1,450	–	$250

P-F:1-43A

Requirement 1

HOMETOWN DÉCOR COMPANY
Income Statement
Year Ended December 31, 2024

Revenue:		
Service Revenue		$ 225,000
Expenses:		
Salaries Expense	$ 67,000	
Advertising Expense	17,000	
Rent Expense	14,000	
Interest Expense	6,800	
Property Tax Expense	2,800	
Insurance Expense	1,700	
Total Expenses		109,300
Net Income		$ 115,700

Requirement 2

HOMETOWN DÉCOR COMPANY
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, December 31, 2023	$ 56,000
Net income for the year	115,700
	171,700
Dividends	(36,000)
Retained Earnings, December 31, 2024	$ 135,700

P-F:1-43A, cont.
Requirement 3

HOMETOWN DÉCOR COMPANY
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 2,800	Accounts Payable	$ 14,000
Accounts Receivable	800	Notes Payable	33,000
Office Supplies	8,000	Salaries Payable	1,300
Land	13,000	Total Liabilities	48,300
Building	170,400		
Equipment	17,000	Stockholders' Equity	
		Common Stock	28,000
		Retained Earnings	135,700
		Total Stockholders' Equity	163,700
Total Assets	$ 212,000	Total Liabilities and Stockholders' Equity	$ 212,000

P-F:1-44A
Part a.

PICTURE PERFECT PHOTOGRAPHY
Income Statement
Year Ended December 31, 2024

Revenue:		
Service Revenue		$ 75,000
Expenses:		
Salaries Expense	$ 25,000	
Insurance Expense	6,000	
Advertising Expense	4,000	
Total Expenses		35,000
Net Income		$ 40,000

Part b.

PICTURE PERFECT PHOTOGRAPHY
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, December 31, 2023	$ 16,000
Net income for the year	40,000
	56,000
Dividends	(8,000)
Retained Earnings, December 31, 2024	$ 48,000

Part c.

PICTURE PERFECT PHOTOGRAPHY
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 42,000	Accounts Payable	$ 11,000
Accounts Receivable	13,000	Notes Payable	14,000
Equipment	46,000	Total Liabilities	25,000
		Stockholders' Equity	
		Common Stock	28,000
		Retained Earnings	48,000
		Total Stockholders' Equity	76,000
Total Assets	$101,000	Total Liabilities and Stockholders' Equity	$101,000

P-F:1-45A

OUTDOOR LIFE LANDSCAPING
Balance Sheet
November 30, 2024

Assets		Liabilities	
Cash	$ 4,600	Accounts Payable	$ 2,700
Accounts Receivable	2,000	Notes Payable	24,600
Office Supplies	600	Total Liabilities	27,300
Land	34,100	Stockholders' Equity	
Office Furniture	5,800	Common Stock	8,000
		Retained Earnings	11,800
		Total Stockholders' Equity	19,800
Total assets	$ 47,100	Total Liabilities and Stockholders' Equity	$ 47,100

P-F:1-46A
Requirement 1

	ASSETS							=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Furniture	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense
5	+75,000										+75,000								
6	–300				+300														
Bal.	$74,700			+	$300			=		+	$75,000								
7							+9,500		+9,500										
Bal.	$74,700			+	$300	+	$9,500	=	$9,500	+	$75,000								
10	+4,000														+4,000				
Bal.	$78,700			+	$300	+	$9,500	=	$9,500	+	$75,000			+	$4,000				
11	–190																		–190
Bal.	$78,510			+	$300	+	$9,500	=	$9,500	+	$75,000			+	$4,000			–	$190
12			+20,000												+20,000				
Bal.	$78,510	+	$20,000	+	$300	+	$9,500	=	$9,500	+	$75,000			+	$24,000			–	$190
18	–750																–750		
Bal.	$77,760	+	$20,000	+	$300	+	$9,500	=	$9,500	+	$75,000			+	$24,000	–	$750	–	$190
25	+20,000		–20,000																
Bal.	$97,760		$ 0	+	$300	+	$9,500	=	$9,500	+	$75,000			+	$24,000	–	$750	–	$190
27	–9,500								–9,500										
Bal.	$88,260			+	$300	+	$9,500	=	$ 0	+	$75,000			+	$24,000	–	$750	–	$190
30	–3,500												–3,500						
Bal.	$84,760	+	$ 0	+	$300	+	$9,500	=	$ 0	+	$75,000	–	$3,500	+	$24,000	–	$750	–	$190

P-F:1-46A, cont.
Requirement 2a

ALLEN SHONTON, CPA
Income Statement
Month Ended April 30, 2024

Revenue:		
Service Revenue		$ 24,000
Expenses:		
Rent Expense	$ 750	
Utilities Expense	190	
Total Expenses		940
Net Income		$ 23,060

Requirement 2b

ALLEN SHONTON, CPA
Statement of Retained Earnings
Month Ended April 30, 2024

Retained Earnings, April 1, 2024	$ 0
Net income for the month	23,060
	23,060
Dividends	(3,500)
Retained Earnings, April 30, 2024	$ 19,560

Requirement 2c

ALLEN SHONTON, CPA
Balance Sheet
April 30, 2024

Assets		Liabilities	
Cash	$ 84,760		
Office Supplies	300		
Furniture	9,500	Stockholders' Equity	
		Common Stock	$ 75,000
		Retained Earnings	19,560
		Total Stockholders' Equity	94,560
Total Assets	$ 94,560	Total Liabilities and Stockholders' Equity	$ 94,560

P-F:1-47A
Requirement 1

	ASSETS							=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Computer	=	Accounts Payable	+	Common Stock	−	Dividends	+	Service Revenue	−	Utilities Expense	−	Miscellaneous Expense
3	+73,000										+73,000								
5	–700				+700														
Bal.	$72,300			+	$700			=		+	$73,000								
7							+5,000		+5,000										
Bal.	$72,300			+	$700	+	$5,000	=	$5,000	+	$73,000								
9	+2,800														+2,800				
Bal.	$75,100			+	$700	+	$5,000	=	$5,000	+	$73,000			+	$2,800				
15									+400										–400
Bal.	$75,100			+	$700	+	$5,000	=	$5,400	+	$73,000			+	$2,800	–		–	$400
23			+10,000												+10,000				
Bal.	$75,100	+	$10,000	+	$700	+	$5,000	=	$5,400	+	$73,000			+	$12,800	–		–	$400
28	–400								–400										
Bal.	$74,700	+	$10,000	+	$700	+	$5,000	=	$5,000	+	$73,000			+	$12,800	–		–	$400
30	–1,200																–1,200		
Bal.	$73,500	+	$10,000	+	$700	+	$5,000	=	$5,000	+	$73,000			+	$12,800	–	$1,200	–	$400
31	+3,300		–3,300																
Bal.	$76,800	+	$6,700	+	$700	+	$5,000	=	$5,000	+	$73,000			+	$12,800	–	$1,200	–	$400
31	–5,500												–5,500						
Bal.	$71,300	+	$6,700	+	$700	+	$5,000	=	$5,000	+	$73,000	–	$5,500	+	$12,800	–	$1,200	–	$400

P-F:1-47A, cont.
Requirement 2a

ANNETTE PACHELO, ATTORNEY
Income Statement
Month Ended March 31, 2024

Revenue:		
Service Revenue		$ 12,800
Expenses:		
Utilities Expense	$ 1,200	
Miscellaneous Expense	400	
Total Expenses		1,600
Net Income		$ 11,200

Requirement 2b

ANNETTE PACHELO, ATTORNEY
Statement of Retained Earnings
Month Ended March 31, 2024

Retained Earnings, March 1, 2024	$ 0
Net income for the month	11,200
	11,200
Dividends	(5,500)
Retained Earnings, March 31, 2024	$ 5,700

Requirement 2c

ANNETTE PACHELO, ATTORNEY
Balance Sheet
March 31, 2024

Assets		Liabilities	
Cash	$ 71,300	Accounts Payable	$ 5,000
Accounts Receivable	6,700		
Office Supplies	700	Stockholders' Equity	
Computer	5,000	Common Stock	73,000
		Retained Earnings	5,700
		Total Stockholders' Equity	78,700
Total Assets	$ 83,700	Total Liabilities and Stockholders' Equity	$ 83,700

P-F:1-47A, cont.
Requirement 2d

ANNETTE PACHELO, ATTORNEY
Statement of Cash Flows
Month Ended March 31, 2024

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 6,100
Payments:		
To suppliers		(2,300)
Net cash provided by operating activities		3,800
Cash flows from investing activities:		0
Cash flows from financing activities		
Issued common stock	$ 73,000	
Payment of cash dividends	(5,500)	
Net cash provided by financing activities		67,500
Net increase in cash		71,300
Cash balance, March 1, 2024		0
Cash balance, March 31, 2024		$ 71,300

Requirement 3

Average total assets = (Beginning total assets + ending total assets) / 2
Average total assets = ($0 + $83,700 / 2 = $41,850

ROA = Net income / Average total assets
ROA = $11,200 / $41,850 = 0.27 = 27% (rounded)

Problems Group B

P-F:1-48B

	ASSETS							=	LIABILITIES	+	EQUITY									
											Contributed Capital	+	Retained Earnings							
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Advertising Expense	
Bal.	$2,600	+	$2,500	+		+	$16,000	=	$5,000	+	$13,600			+	2,500					
(a)	+14,000										+14,000									
Bal.	$16,600	+	$2,500			+	$16,000	=	$5,000	+	$27,600			+	2,500					
(b)	+1,600														+1,600					
Bal.	$18,200	+	$2,500			+	$16,000	=	$5,000	+	$27,600			+	$4,100					
(c)	–5,000								–5,000											
Bal.	$13,200	+	$2,500			+	$16,000	=	$0	+	$27,600			+	$4,100					
(d)					+1,200				+1,200											
Bal.	$13,200	+	$2,500	+	$1,200	+	$16,000	=	$1,200	+	$27,600			+	$4,100					
(e)	+2,300		–2,300																	
Bal.	$15,500	+	$200	+	$1,200	+	$16,000	=	$1,200	+	$27,600			+	$4,100					
(f)	–1,500												–1,500							
Bal.	$14,000	+	$200	+	$1,200	+	$16,000	=	$1,200	+	$27,600	–	$1,500	+	$4,100					
(g)			+4,000												+4,000					
Bal.	$14,000	+	$4,200	+	$1,200	+	$16,000	=	$1,200	+	$27,600	–	$1,500	+	$8,100					
(h)	–1,350																–900		–450	
Bal.	$12,650	+	$4,200	+	$1,200	+	$16,000	=	$1,200	+	$27,600	–	$1,500	+	$8,100	–	$900	–	$450	

P-F:1-49B

			ASSETS			=	LIABILITIES	+	EQUITY												
									Contributed Capital	+	Retained Earnings										
	Cash	+	Accounts Receivable	+	Office Supplies	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense	–	Wages Expense	–	Advertising Expense
1	+19,000								+19,000												
2	+3,800												+3,800								
Bal.	$22,800					=		+	$19,000			+	$3,800								
5	–300				+300																
Bal.	$22,500			+	$300	=		+	$19,000			+	$3,800								
9			+4,500										+4,500								
Bal.	$22,500	+	$4,500	+	$300	=		+	$19,000			+	$8,300								
10							+150										–150				
Bal.	$22,500	+	$4,500	+	$300	=	$150	+	$19,000			+	$8,300			–	$150				
15	–350																				–350
Bal.	$22,150	+	$4,500	+	$300	=	$150	+	$19,000			+	$8,300			–	$150			–	$350
20	–150						–150														
Bal.	$22,000	+	$4,500	+	$300	=	$ 0	+	$19,000			+	$8,300			–	$150			–	$350
25	+4,500		–4,500																		
Bal.	$26,500	+	$ 0	+	$300	=		+	$19,000			+	$8,300			–	$150			–	$350
28	–2,600														–2,600						
Bal.	$23,900			+	$300	=		+	$19,000			+	$8,300	–	$2,600	–	$150			–	$350
28	–1,200																		–1,200		
Bal.	$22,700			+	$300	=		+	$19,000			+	$8,300	–	$2,600	–	$150	–	$1,200	–	$350
30	+1,600												+1,600								
Bal.	$24,300			+	$300	=		+	$19,000			+	$9,900	–	$2,600	–	$150	–	$1,200	–	$350
31	–3,000										–3,000										
Bal.	$21,300	+	$ 0	+	$300	=	$ 0	+	$19,000	–	$3,000	+	$9,900	–	$2,600	–	$150	–	$1,200	–	$350

P-F:1-50B

Requirement 1

PEMBROKE BOOKKEEPING COMPANY
Income Statement
Year Ended December 31, 2024

Revenues:		
Service Revenue		$ 192,000
Expenses:		
Salaries Expense	$ 64,000	
Advertising Expense	12,000	
Rent Expense	7,000	
Interest Expense	6,600	
Property Tax Expense	3,100	
Insurance Expense	1,700	
Total Expenses		94,400
Net Income		$ 97,600

Requirement 2

PEMBROKE BOOKKEEPING COMPANY
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, December 31, 2023	$ 51,000
Net income for the year	97,600
	148,600
Dividends	(28,000)
Retained Earnings, December 31, 2024	$ 120,600

Requirement 3

PEMBROKE BOOKKEEPING COMPANY
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 2,800	Accounts Payable	$ 7,000
Accounts Receivable	1,200	Notes Payable	31,000
Office Supplies	12,000	Salaries Payable	800
Land	10,000	Total Liabilities	38,800
Building	147,400	Stockholders' Equity	
Equipment	15,000	Common Stock	29,000
		Retained Earnings	120,600
		Total Stockholders' Equity	149,600
Total Assets	$ 188,400	Total Liabilities and Stockholders' Equity	$ 188,400

P-F:1-51B
Requirement a

PRETTY PICTURES
Income Statement
Year Ended December 31, 2024

Revenues:		
Service Revenue		$ 115,000
Expenses:		
Salaries Expense	$ 30,000	
Insurance Expense	6,000	
Advertising Expense	4,500	
Total Expenses		40,500
Net Income		$ 74,500

Requirement b

PRETTY PICTURES
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, December 31, 2023	$ 20,000
Net income for the year	74,500
	94,500
Dividends	(13,000)
Retained Earnings, December 31, 2024	$ 81,500

Requirement c

PRETTY PICTURES
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 42,000	Accounts Payable	$ 13,000
Accounts Receivable	5,000	Notes Payable	10,000
Equipment	85,500	Total Liabilities	23,000
		Stockholders' Equity	
		Common Stock	28,000
		Retained Earnings	81,500
		Total Stockholders' Equity	109,500
Total Assets	$ 132,500	Total Liabilities And Stockholders' Equity	$ 132,500

P-F:1-52B

JUNIPER LANDSCAPING
Balance Sheet
July 31, 2024

Assets		Liabilities	
Cash	$ 5,300	Accounts Payable	$ 2,700
Accounts Receivable	1,800	Notes Payable	24,700
Office Supplies	800	Total Liabilities	27,400
Land	34,500		
Office Furniture	6,300	Stockholders' Equity	
		Common Stock	10,000
		Retained Earnings	11,300
		Total Stockholders' Equity	21,300
Total Assets	$ 48,700	Total Liabilities and Stockholders' Equity	$ 48,700

P-F:1-53B

Requirement 1

	ASSETS				= LIABILITIES +	EQUITY				
						Contributed Capital +	Retained Earnings			
	Cash +	Accounts Receivable +	Office Supplies +	Office Furniture =	Accounts Payable +	Common Stock −	Dividends +	Service Revenue −	Rent Expense −	Utilities Expense
5	+45,000					+45,000				
Bal.	$45,000					$45,000				
6	–300		+300							
Bal.	$44,700		$300			$45,000				
7				+6,500	+6,500					
Bal.	$44,700		$300	$6,500	$6,500	$45,000				
10	+3,300							+3,300		
Bal.	$48,000		$300	$6,500	$6,500	$45,000		$3,300		
11	–340									–340
Bal.	$47,660		$300	$6,500	$6,500	$45,000		$3,300		$340
12		+16,000						+16,000		
Bal.	$47,660	$16,000	$300	$6,500	$6,500	$45,000		$19,300		$340
18	–1,800								–1,800	
Bal.	$45,860	$16,000	$300	$6,500	$6,500	$45,000		$19,300	$1,800	$340
25	+16,000	–16,000								
Bal.	$61,860	$ 0	$300	$6,500	$6,500	$45,000		$19,300	$1,800	$340
27	–6,500				–6,500					
Bal.	$55,360	$ 0	$300	$6,500	$ 0	$45,000		$19,300	$1,800	$340
31	–3,800						–3,800			
Bal.	$51,560	$ 0	$300	$6,500	$ 0	$45,000	$3,800	$19,300	$1,800	$340

P-F:1-53B, cont.
Requirement 2a

AMOS SHARP, CPA
Income Statement
Month Ended October 31, 2024

Revenues:		
Service Revenue		$ 19,300
Expenses:		
Rent Expense	$ 1,800	
Utilities Expense	340	
Total Expenses		2,140
Net Income		$ 17,160

Requirement 2b

AMOS SHARP, CPA
Statement of Retained Earnings
Month Ended October 31, 2024

Retained Earnings, October 1, 2024	$ 0
Net income for the month	17,160
	17,160
Dividends	(3,800)
Retained Earnings, October 31, 2024	$ 13,360

Requirement 2c

AMOS SHARP, CPA
Balance Sheet
October 31, 2024

Assets		Liabilities	
Cash	$ 51,560		
Office Supplies	300		
Office Furniture	6,500	Stockholders' Equity	
		Common Stock	$ 45,000
		Retained Earnings	13,360
		Total Stockholders' Equity	58,360
Total Assets	$ 58,360	Total Liabilities and Stockholders' Equity	$ 58,360

P-F:1-54B
Requirement 1

	ASSETS							=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Computer	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Utility Expense	–	Misc. Expense
3	+89,000										+89,000								
5	–600				+600														
Bal.	$88,400				$600	+		=		+	$89,000								
7							+8,000		+8,000										
Bal.	$88,400			+	$600	+	$8,000	=	$8,000	+	$89,000								
9	+2,900														+2,900				
Bal.	$91,300			+	$600	+	$8,000	=	$8,000	+	$89,000			+	$2,900				
15									+300										–300
Bal.	$91,300			+	$600	+	$8,000	=	$8,300	+	$89,000			+	$2,900	–		–	$300
23			+8,000												+8,000				
Bal.	$91,300	+	$8,000	+	$600	+	$8,000	=	$8,300	+	$89,000			+	$10,900	–		–	$300
28	–300								–300										
Bal.	$91,000	+	$8,000	+	$600	+	$8,000	=	$8,000	+	$89,000			+	$10,900	–		–	$300
30	–900																–900		
Bal.	$90,100	+	$8,000	+	$600	+	$8,000	=	$8,000	+	$89,000			+	$10,900	–	$900	–	$300
31	+2,800		–2,800																
Bal.	$92,900	+	$5,200	+	$600	+	$8,000	=	$8,000	+	$89,000			+	$10,900	–	$900	–	$300
31	–3,000												–3,000						
Bal.	$89,900	+	$5,200	+	$600	+	$8,000	=	$8,000	+	$89,000	–	$3,000	+	$10,900	–	$900	–	$300

P-F:1-54B, cont.
Requirement 2a

ABBY PERRY, ATTORNEY
Income Statement
Month Ended December 31, 2024

Revenues:		
Service Revenue		$ 10,900
Expenses:		
Utility Expense	$ 900	
Miscellaneous Expense	300	
Total Expenses		1,200
Net Income		$ 9,700

Requirement 2b

ABBY PERRY, ATTORNEY
Statement of Retained Earnings
Month Ended December 31, 2024

Retained Earnings, December 1, 2024	$ 0
Net income for the month	9,700
	9,700
Dividends	(3,000)
Retained Earnings, December 31, 2024	$ 6,700

Requirement 2c

ABBY PERRY, ATTORNEY
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 89,900	Accounts Payable	$ 8,000
Accounts Receivable	5,200		
Office Supplies	600	Stockholders' Equity	
Computer	8,000	Common Stock	89,000
		Retained Earnings	6,700
		Total Stockholders' Equity	95,700
Total Assets	$ 103,700	Total Liabilities and Stockholders' Equity	$ 103,700

P-F:1-54B, cont.
Requirement 2d

ABBY PERRY, ATTORNEY Statement of Cash Flows Month Ended December 31, 2024		
Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 5,700
Payments:		
To suppliers		(1,800)
Net cash provided by operating activities		3,900
Cash flows from investing activities:		0
Cash flows from financing activities		
Issued common stock	$ 89,000	
Payment of cash dividends	(3,000)	
Net cash provided by financing activities		86,000
Net increase in cash		89,900
Cash balance, December 1, 2024		0
Cash balance, December 31, 2024		$ 89,900

Requirement 3

Average total assets = (Beginning total assets + ending total assets) / 2
Average total assets = ($0 + $103,700) / 2 = $51,850

ROA = Net income / Average total assets
ROA = $9,700 / $51,850 = 0.19 = 19% (rounded)

Using Excel

The student templates for *Using Excel* are available online in MyLab Accounting in the Multimedia Library or at http://www.pearsonhighered.com/Horngren. The solution to *Using Excel* is located in MyLab Accounting in the Instructor Resource Center or at http://www.pearsonhighered.com/Horngren.

Continuing Problem

P-F:1-55, Requirement 1

	ASSETS				= LIABILITIES			+ EQUITY						
								Contributed Capital	+ Retained Earnings					
	Cash	+ Accounts Receivable	+ Office Supplies	+ Canoes	= Accounts Payable	+ Utilities Payable	+ Telephone Payable	+ Common Stock	– Dividends	+ Canoe Rental Revenue	– Rent Expense	– Utilities Expense	– Wages Expense	– Telephone Expense
1	+16,000							+16,000						
2	–1,200										–1,200			
Bal.	$14,800							$16,000			$1,200			
3				+4,800	+4,800									
Bal.	$14,800			$4,800	$4,800			$16,000			$1,200			
4			+750		+750									
Bal.	$14,800		$750	$4,800	$5,550			$16,000			$1,200			
7	+1,400									+1,400				
Bal.	$16,200		$750	$4,800	$5,550			$16,000		$1,400	$1,200			
13	–1,500												–1,500	
Bal.	$14,700		$750	$4,800	$5,550			$16,000		$1,400	$1,200		$1,500	
15	–50								–50					
Bal.	$14,650		$750	$4,800	$5,550			$16,000	$50	$1,400	$1,200		$1,500	
16						+150						–150		
Bal.	$14,650		$750	$4,800	$5,550	$150		$16,000	$50	$1,400	$1,200	$150	$1,500	
20							+175							–175
Bal.	$14,650		$750	$4,800	$5,550	$150	$175	$16,000	$50	$1,400	$1,200	$150	$1,500	$175
22		+3,000								+3,000				
Bal.	$14,650	$3,000	$750	$4,800	$5,550	$150	$175	$16,000	$50	$4,400	$1,200	$150	$1,500	$175
26	–1,000				–1,000									
Bal.	$13,650	$3,000	$750	$4,800	$4,550	$150	$175	$16,000	$50	$4,400	$1,200	$150	$1,500	$175
28	+750	–750												
Bal.	$14,400	$2,250	$750	$4,800	$4,550	$150	$175	$16,000	$50	$4,400	$1,200	$150	$1,500	$175
30	–100								–100					
Bal.	$14,300	$2,250	$750	$4,800	$4,550	$150	$175	$16,000	$150	$4,400	$1,200	$150	$1,500	$175

P-F:1-55, cont.
Requirement 2

CANYON CANOE COMPANY
Income Statement
Month Ended November 30, 2024

Revenue:		
Canoe Rental Revenue		$ 4,400
Expenses:		
Wages Expense	$ 1,500	
Rent Expense	1,200	
Telephone Expense	175	
Utilities Expense	150	
Total Expense		3,025
Net Income		$ 1,375

Requirement 3

CANYON CANOE COMPANY
Statement of Retained Earrings
Month Ended November 30, 2024

Retained Earnings, November 1, 2024	$ 0
Net income for the month	1,375
	1,375
Dividends	(150)
Retained Earnings, November 30, 2024	$ 1,225

Requirement 4

CANYON CANOE COMPANY
Balance Sheet
November 30, 2024

Assets		Liabilities	
Cash	$ 14,300	Accounts Payable	$ 4,550
Accounts Receivable	2,250	Utilities Payable	150
Office Supplies	750	Telephone Payable	175
Canoes	4,800	Total Liabilities	4,875
		Stockholders' Equity	
		Common Stock	16,000
		Retained Earnings	1,225
		Total Stockholder's Equity	17,225
Total Assets	$ 22,100	Total Liabilities and Stockholders' Equity	$ 22,100

P-F:1-55, cont.
Requirement 5
Average total assets = ($0 + $22,100) / 2 = $11,050
Return on assets = Net income / Average total assets = $1,375 / $11,050 = 0.124 = 12.4%

Critical Thinking

Tying It All Together Case F:1-1
Requirement 1

Starbucks Corporation would report the cost of internet service as an expense on its income statement. Most likely, the expense would be included in Store Operating Expenses.

Requirement 2

When Starbucks receives a bill from its internet service provider, Starbucks would record the following:
Increase Accounts Payable
Increase Store Operating Expenses
This would cause liabilities to increase and equity to decrease.

Requirement 3

When Starbucks pays the bill, Starbucks would record the following:
Decrease Cash
Decrease Accounts Payable
This would cause assets to decrease and liabilities to decrease.

Requirement 4

An increase in the cost of internet service in the coming year would cause expenses to increase. If revenue did not change, this would cause net income to decrease. Starbucks might overcome this impact by charging customers for using the internet service, thereby offsetting the increase in expenses with additional revenue. This change, though, might discourage customers from visiting Starbucks when other competitors might offer free internet service. Another alternative would be to increase the prices of the products sold to cover the increased cost of internet service.

Decision Case F:1-1
Requirement 1

Greg's Tunes has more assets.
Sal’s $23,000, Greg’s $25,000 ($10,000 + $6,000 + $9,000)

Requirement 2

Greg's Tunes owes more to creditors.
Sal’s $2,000 ($23,000 – ($8,000 + $35,000 – $22,000)), Greg’s $10,000

Requirement 3

Sal’s Silly Songs has more stockholders’ equity.
Sal’s $21,000 ($8,000 + $35,000 – $22,000) Greg’s $15,000 ($6,000 + $9,000)

Requirement 4

Greg’s Tunes earned more revenue.
Sal’s $35,000, Greg’s $53,000 ($9,000 + $44,000)

Requirement 5

Sal’s Silly Songs is more profitable.
Sal’s $13,000 ($35,000 – $22,000), Greg’s $9,000

Requirement 6

This question is opinion based. More profit is good, which means Sal’s has the advantage. Greg’s also owes more to creditors which is risky. Sal’s has much more equity, which minimizes risk.

Requirement 7

Sal’s looks financially better, because Sal earned more net income on less total revenue. Sal also owes less to creditors and has more equity.

Ethical Issues F:1-1
Requirement 1

The chief financial officer (CFO) of Philip Morris would be torn between addressing the fact that the payments are related to illnesses caused by the company's products, or alternatively, omitting or concealing this fact. The ethical course of action for the CFO is to be open, honest and forthcoming about the reasons for the payments.

Requirement 2

Negative consequences of not telling the truth are as follows: If users of the financial statements feel they are only getting part of the truth, or that the reports are distorting the information, this will damage the credibility of the company, and damage the company's reputation.

Negative consequences of telling the truth include painting so bleak a picture of the effects of smoking that investors will view Philip Morris as too risky and stop buying the company's stock. Another negative consequence would be to create the impression that the company is engaged in unethical behavior by selling a product that damages people's health.

Fraud Case F:1-1
Requirement 1

The proposed action would increase net income by increasing revenues. It would distort the balance sheet by understating liabilities and overstating equity.

Requirement 2

By making the company's financial situation look better than it actually was, the company's creditors would likely be more willing to extend credit to the company, and offer the credit at a lower interest rate.

Financial Statement Case F1-1
Requirement 1

$1,556 (in millions)

Requirement 2

$41,290 (in millions) at February 2, 2019; $40,303 (in millions) at February 3, 2018

Requirement 3

Target Corporation adopted Accounting Standards Update (ASU) No. 2014-09—*Revenue from Contracts with Customers (Topic 606)* and ASU No. 2016-02—*Leases (Topic 842)*. This required the company to adjust its financial statements for year ending on February 3, 2018.

Requirement 4

Assets	=	Liabilities	+	Equity
$41,290	=	($15,014 + $14,979)	+	$11,297
$41,290	=	$29,993	+	$11,297

(shown in millions)

Requirement 5

$75,356 (in millions) for year ended February 2, 2019. This is an increase of $2,642 (in millions) over fiscal year 2017. ($75,356 − $72,714)

Requirement 6

$2,937 (in millions) in 2018
$2,914 (in millions) in 2017
Target's net income increased by $23 (million) from fiscal 2017 to fiscal 2018 ($2,937 − $2,914).

Financial Statement Case F:1-1, cont.
Requirement 7

All amounts in millions.
Average total assets = ($40,303 + $41,290) / 2 = $40,797 (rounded)
Return on assets = $2,937 / $40,797 = 0.0719 = 7.2% (rounded)

Requirement 8

Target Corporation's return on assets (7.2%) was one (1) percentage point higher than Kohl's Corporation (6.2%).

Chapter 1
Accounting and the Business Environment

Review Questions

1. What is accounting?

Accounting is the information system that measures business activities, processes the information into reports, and communicates the results to decision makers. Accounting is the language of business.

2. Briefly describe the two major fields of accounting.

Financial accounting provides information for external decision makers, such as outside investors, lenders, customers, and the federal government. Managerial accounting focuses on information for internal decision makers, such as the company's managers and employees.

3. Describe the various types of individuals who use accounting information and how they use that information to make important decisions.

Individuals use accounting information to help them manage their money, evaluate a new job, and better decide whether they can afford to make a new purchase. Business owners use accounting information to set goals, measure progress toward those goals, and make adjustments when needed. Investors use accounting information to help them decide whether or not a company is a good investment and once they have invested, they use a company's financial statements to analyze how their investment is performing. Creditors use accounting information to decide whether to lend money to a business and to evaluate a company's ability to make the loan payments. Taxing authorities use accounting information to calculate the amount of income tax that a company has to pay.

4. What are the various certifications available for accountants? Breifly explain each certification.

Certified Public Accountants (CPAs) are licensed professional accountants who serve the general public. They work for public accounting firms, businesses, government, or educational institutions. A Chartered Global Management Accountant (CGMA) is an accountant who has advanced knowledge in finance, operations, strategy, and management. Certified Management Accountants (CMAs) specialize in accounting and financial management knowledge. They work for a single company. Certified Financial Planners (CFPs) work with individuals to help them budget, plan for retirement, save for education, and manage their finances.

5. What is the role of the Financial Accounting Standards Board (FASB)?

The FASB oversees the creation and governance of accounting standards. They work with governmental regulatory agencies, congressionally created groups, and private groups.

6. Explain the purpose of Generally Accepted Accounting Principles (GAAP), including the organization currently responsible for the creation and governance fo these standards.

The guidelines for accounting information are called GAAP. It is the main U.S. accounting rule book and is currently created and governed by the FASB. Investors and lenders must have information that is relevant and has faithful representation in order to make decisions and GAAP provides the framework for this financial reporting.

7. Describe the similarities and differences among the four different types of business entities discussed in the chapter.

A sole proprietorship has a single owner, terminates upon the owner's death or choice, the owner has personal liability for the business's debts, and it is not a separate tax entity. A partnership has two or more owners, terminates at partner's choice or death, the partners have personal liability, and it is not a separate tax entity. A corporation is a separate legal entity, has one or more owners, has indefinite life, the stockholders are not personally liable for the business's debts, and it is a separate tax entity. A limited-liability company has one or more members and each is only liable for his or her own actions, has an indefinite life, and is not a separate tax entity.

8. A business purchases an acre of land for $5,000. The current market value is $5,500, and the land was assessed for property tax purposes at $5,250. What value should the land be recorded at, and which accounting principle supports your answer?

The land should be recorded at $5,000. The cost principle states that assets should be recorded at their historical cost.

9. What does the going concern assumption mean for a business?

The going concern assumption assumes that the entity will remain in business for the foreseeable future and long enough to use existing resources for their intended purpose.

10. Which concept states that accounting information should be complete, neutral, and free from material error?

The faithful representation concept states that accounting information should be complete, neutral, and free from material error.

11. Financial statements in the United States are reported in U.S. dollars. What assumption supports this statement?

The monetary unit assumption states that items on the financial statements should be measured in terms of a monetary unit.

12. Explain the role of the International Accounting Standards Board (IASB) in relation to International Financial Reporting Standards (IFRS).

The IASB is the organization that develops and creates IFRS which are a set of global accounting standards that would be used around the world.

13. What is the accounting equation? Briefly explain each of the three parts.

Assets = Liabilities + Equity. Assets are economic resources that are expected to benefit the business in the future. They are things of value that a business owns or has control of. Liabilities are debts that are owed to creditors. They are one source of claims against assets. Equity is the other source of claims against assets. Equity is the stockholders' claims against assets and is the amount of assets that is left over after the company has paid its liabilities. It represents the net worth of the corporation.

14. How does retained earnings increase? What are the two ways that retained earnings decreases?

Retained earnings increases with revenues. Retained earnings decreases with expenses and dividends.

15. How is net income calculated? Define *revenues* and *expenses*.

Revenues – Expenses = Net Income. Revenues are earnings resulting from delivering goods or services to customers. Expenses are the cost of selling goods or service.

16. What are the steps used when analyzing a business transaction?

What Step 1: Identify the accounts and the account type. Step 2: Decide if each account increases or decreases. Step 3: Determine if the accounting equation is in balance.

17. List the four financial statements. Briefly describe each statement.

Income Statement – Shows the difference between an entity's revenues and expenses and reports the net income or net loss for a specific period.
Statement of Retained Earnings – Shows the changes in retained earnings for a specific period including net income (loss) and dividends.
Balance Sheet – Shows the assets, liabilities, and stockholders' equity of the business as of a specific date.
Statement of Cash Flows – Shows a business's cash receipts and cash payments for a specific period.

18. What is the calculation for ROA? Explain what ROA measures.

Return on Assets = Net income / Average total assets. ROA measures how profitably a company uses its assets.

Short Exercises

S-F:1-1 Identifying users of accounting information
Learning Objective 1

For each user of accounting information, identify if the user would use financial accounting or managerial accounting

a. investor
b. banker
c. IRS
d. manager of the business
e. controller
f. stockholder
g. human resources director
h. creditor

SOLUTION

a. FA	e. MA
b. FA	f. FA
c. FA	g. MA
d. MA	h. FA

S-F:1-2 Determining organizations that govern accounting
Learning Objective 2

Suppose you are starting a business, Wholly Shirts, to imprint logos on T-shirts. In organizing the business and setting up its accounting records, you take your information to a CPA to prepare financial statements for the bank. Name the organization that governs the majority of the guidelines that the CPA will use to prepare financial statements for Wholly Shirts. What are those guidelines called?

SOLUTION

The Financial Accounting Standards Board governs the majority of guidelines, called Generally Accepted Accounting Principles (GAAP), that the CPA will use to prepare financial statements for Wholly Shirts.

S-F:1-3 Identifying types of business organizations
Learning Objective 2

Chloe Michaels plans on opening Chloe Michaels Floral Designs. She is considering the various types of business organizations and wishes to organize her business with unlimited life and wants owners of the business to not be held personally liable for the business's debts. Additionally, Chloe wants the business to be a separate taxable entity. Which type of business organization will meet Chloe's needs best?

SOLUTION

Chloe's needs will best be met by organizing a corporation since a corporation has an unlimited life and is a separate tax entity. In addition, the owners (stockholders) have limited liability. Chloe could also consider a limited liability company (LLC) as an option. A LLC meets two of the three criteria. It has an unlimited life and limited liability for the owner. However, a LLC is not a separate tax entity.

S-F:1-4 Identigyinf trypes of business organizations
Learning Objective 2

You would like to start a cellular telephone equipment service business. You are considering organizing the business as a sole proprietorship. Identify the advantages and disadvantages of owning a sole proprietorship.

SOLUTION

Advantages:
1. Easy to organize.
2. Unification of ownership and management.
3. Less government regulation.
4. Owner has more control over business.

Disadvantages:
1. The owner pays taxes on the entity’s earnings since it is not a separate tax entity.
2. No continuous life or transferability of ownership.
3. Unlimited liability of owner for business’s debts.

S-F:1-5 Applying accounting assumptions and principles
Learning Objective 2

Michael McNamee is the proprietor of a property management company, Apartment Exchange, near the campus of Pensacola State College. The business has cash of $8,000 and furniture that cost $9,000 and has a market value of $13,000. The business debts include accounts payable of $6,000. Michael’s personal home is valued at $400,000, and his personal bank account has a balance of $1,200. Consider the accounting principles and assumptions discussed in the chapter, and identify the principle or assumption that best matches the situation:

a. Michael’s personal assets are not recorded on the Apartment Exchange’s balance sheet.

b. The Apartment Exchange records furniture at its cost of $9,000, not its market value of $13,000.

c. The Apartment Exchange reports its financial statements in U.S. dollars.

d. Michael expects the Apartment Exchange to remain in operation for the foreseeable future.

SOLUTION

a**.** The economic entity assumption
b. The cost principle.
c. The monetary unit assumption.
d. The going concern assumption.

S-F:1-6 Using the accounting equation

Learning Objective 3

Thompson Handyman Services has total assets for the year of $18,400 and total liabilities of $9,050.

Requirements

1. Use the accounting equation to solve for equity.
2. If next year assets increased by $4,300 and equity decreased by $3,850, what would be the amount of total liabilities for Thompson Handyman Services?

SOLUTION

Requirement 1

Thompson Handyman Services has equity of $9,350.

Assets	=	Liabilities	+	Equity
$18,400	=	$9,050	+	?
$18,400	=	$9,050	+	**$9,350**

Requirement 2

Thompson Handyman Services has liabilities of $17,200.

Assets	=	Liabilities	+	Equity
$18,400 + $4,300	=	?	+	$9,350 – $3,850
$22,700	=	**$17,200**	+	$5,500

S-F:1-7 Using the accounting equation

Learning Objective 3

Roland's Overhead Doors reports the following financial information:

Assets	$ 45,800
Liabilities	17,220
Common Stock	27,460
Dividends	6,500
Revenues	8,850
Expenses	?

Requirements

1. Use the accounting equation to solve for the missing information.

2. Did Roland's Overhead Doors report net income or net loss?

SOLUTION

Requirement 1

ASSETS	=	LIABILITIES	+	EQUITY						
				Contributed Capital	+	Retained Earnings				
			+	Common Stock	–	Dividends	+	Revenues	–	Expenses
$45,800	=	$17,220	+	$27,460	–	$6,500	+	$8,850	–	**?**
$45,800	=	$17,220	+	$27,460	–	$6,500	+	$8,850	–	**$1,230**

Requirement 2

Roland's Overhead Doors reported net income of $7,620. Net Income = Revenues ($8,850) – Expenses ($1,230)

S-F:1-8 Identifying Accounts
Learning Objective 3

Consider the following accounts:

a. Accounts Payable

b. Cash

c. Common Stock

d. Accounts Receivable

e. Rent Expense

f. Service Revenue

g. Office Supplies

h. Dividends

i. Land

j. Salaries Expense

Identify each account as Asset, Liability, or Equity.

SOLUTION

a. L	f. E
b. A	g. A
c. E	h. E
d. A	i. A
e. E	j. E

S-F:1-9 Using the accounting equation to analyze transactions
Learning Objective 4

Tiny Town Kennel earns service revenue by caring for the pets of customers. Tiny Town Kennel is organized as a corporation. During the past month, Tiny Town Kennel has the following transactions:

a. Received $520 cash for service revenue earned.

b. Paid $325 cash for salaries expense.

c. Received a $1,000 contribution in exchange for common stock.

d. Earned $640 for service revenue, but the customer has not paid Tiny Town Kennel yet.

e. Received utility bill of $85, which will be paid next month.

f. Cash dividends of $100 were paid to stockholders.

Indicate the effects of the business transactions on the accounting equation for Tiny Town Kennel. Transaction (a) is answered as a guide. Use the following accounts: Cash, Accounts receivable, Accounts Payable, Common Stock, Dividends, Service Revenue, Salaries Expense, and Utitlities Expense.

a. Increase asset (Cash); Increase equity (Service Revenue)

SOLUTION

a. Increase asset (Cash); Increase equity (Service Revenue)
b. Decrease asset (Cash); Decrease equity (Salaries Expense)
c. Increase asset (Cash); Increase Equity (Common Stock)
d. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
e. Increase liability (Accounts Payable); Decrease equity (Utility Expense)
f. Decrease asset (Cash); Decrease equity (Dividends)

S-F:1-10 Using the accounting equation to analyze transactions

Learning Objective 4

Elaine's Inflatables earns service revenue by providing party planning services and inflatable playscapes. Elaine's Inflatables is organized as a corporation. During the past month, Elaine's Inflatables had the following transactions:

a. Received contributions of $10,000 in exchange for common stock.

b. Purchased equipment for $5,000 on account.

c. Paid $400 for office supplies.

d. Earned and received $2,500 cash for service revenue.

e. Paid $400 for wages to employees.

f. Cash dividends of $1,000 were paid to stockholders.

g. Earned $1,000 for services provided. Customer has not yet paid.

h. Paid $1,000 for rent.

i. Received a bill for $250 for the monthly utilities. The bill has not yet been paid.

Indicate the effects of the business transactions on the accounting equation for Elaine's Inflatables. Transaction (a) is answered as a guide. Use the following accounts: Cash, Accounts Receivable, Supplies, Equipment, Accounts Payable, Common Stock, Dividends, Service Revenue, Wages Expense, Rent Expense, and Utilities Expense.

a. Increase asset (Cash); Increase equity (Common Stock)

SOLUTION

a. Increase asset (Cash); Increase equity (Common Stock)
b. Increase asset (Equipment); Increase liability (Accounts Payable)
c. Increase asset (Office Supplies); Decrease asset (Cash)
d. Increase asset (Cash); Increase equity (Service Revenue)
e. Decrease asset (Cash); Decrease equity (Wages Expense)
f. Decrease asset (Cash); Decrease equity (Dividends)
g. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
h. Decrease asset (Cash); Decrease equity (Rent Expense)
i. Increase liability (Accounts Payable); Decrease equity (Utilities Expense)

S-F:1-11 Identifying accounts on the financial statements
Learning Objective 5

Consider the following accounts:

a. Accounts Payable

b. Cash

c. Common Stock

d. Accounts Receivable

e. Rent Expense

f. Service Revenue

g. Office Supplies

h. Dividends

i. Land

j. Salaries Expense

Identify the financial statement (or statements) that each account would appear on. Use I for Income Statement, RE for Statement of Retained Earnings, B for Balance Sheet, and C for Statement of Cash Flows.

SOLUTION

a. B	f. I
b. B, C	g. B
c. B	h. RE
d. B	i. B
e. I	j. I

Use the following information to answer Short Exercises S-F:1-12 through S-F:1-14.

Centerpiece Arrangements has just completed operations for the year ended December 31, 2024. This is the third year of operations for the company. The following data have been assembled for the business:

Insurance Expense	$ 4,500	Salaries Expense	$ 46,000
Service Revenue	70,000	Accounts Payable	17,600
Utilities Expense	1,400	Office Supplies	1,700
Rent Expense	16,000	Dividends	4,800
Common Stock	9,000	Accounts Receivable	8,000
Cash	7,200	Equipment	12,100
Retained Earnings, January 1, 2024	5,100		

S-F:1-12 Preparing the income statement
Learning Objective 5

Prepare the income statement of Centerpiece Arrangements for the year ended December 31, 2024.

SOLUTION

CENTERPIECE ARRANGEMENTS Income Statement Year Ended December 31, 2024		
Revenue:		
Service Revenue		$ 70,000
Expenses:		
Salaries Expense	$ 46,000	
Rent Expense	16,000	
Insurance Expense	4,500	
Utilities Expense	1,400	
Total Expenses		67,900
Net Income		$ 2,100

S-F:1-13 Preparing the statement of retained earnings
Learning Objective 5

Prepare the statement of retained earnings of Centerpiece Arrangements for the year ended December 31, 2024.

SOLUTION

CENTERPIECE ARRANGEMENTS Statement of Retained Earnings Year Ended December 31, 2024	
Retained Earnings, January 1, 2024	$ 5,100
Net income for the year	2,100
	7,200
Dividends	(4,800)
Retained Earnings, December 31, 2024	$ 2,400

S-F:1-14 S1-14 Preparing the balance sheet
Learning Objective 5

Prepare the balance sheet of Centerpiece Arrangements as of December 31, 2024.

SOLUTION

CENTERPIECE ARRANGEMENTS
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 7,200	Accounts Payable	$ 17,600
Accounts Receivable	8,000		
Office Supplies	1,700	Stockholders' Equity	
Equipment	12,100	Common Stock	9,000
		Retained Earnings	2,400
		Total Stockholders' Equity	11,400
Total Assets	$ 29,000	Total Liabilities and Stockholders' Equity	$ 29,000

S-F:1-15 Preparing the statement of cash flows
Learning Objective 5

Polk Street Homes had the following cash transactions for the month ended July 31, 2024.

Cash receipts:	
Collections from customers	$ 25,000
Issued common stock	13,000
Cash payments:	
Rent	500
Utilities	2,000
Salaries	1,500
Purchase of equipment	25,000
Payment of cash dividends	4,000
Cash balance, July 1, 2024	14,000
Cash balance, July 31, 2024	19,000

Prepare the statement of cash flows for Polk Street Homes for the month ended July 31, 2024.

SOLUTION

POLK STREET HOMES
Statement of Cash Flows
Month Ended July 31, 2024

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 25,000
Payments:		
To employees	$ (1,500)	
To suppliers	(2,500)	(4,000)
Net cash provided by operating activities		21,000
Cash flows from investing activities:		
Purchase of equipment	(25,000)	
Net cash used by investing activities		(25,000)
Cash flows from financing activities:		
Issued common stock	13,000	
Payment of cash dividend	(4,000)	
Net cash provided by financing activities		9,000
Net increase in cash		5,000
Cash balance, July 1, 2024		14,000
Cash balance, July 31, 2024		$ 19,000

S-F:1-16 Calculating ROA
Learning Objective 6

Matured Water Services had net income for the month of October of $50,880. Assets as of the beginning and end of the month totaled $362,000, and $486,000, respectively. Calculate Matured Water Services' ROA for the month of October.

SOLUTION

Return on assets	=	Net income / Average total assets
	=	$50,880 / (($362,000 + $486,000) / 2)
	=	$50,880 / $424,000
	=	12%

Exercises

E-F:1-17 Identifying users of accounting information
Learning Objective 1

For each of the users of accounting information, identify whether the user is an external decision maker (E) or an internal decision maker (I):

a. customer

b. company manager

c. Internal Revenue Service

d. lender

e. investor

f. controller

g. cost accountant

h. SEC

SOLUTION

a.	E	e.	E
b.	I	f.	I
c.	E	g.	I
d.	E	h.	E

E-F:1-18 Using accounting vocabulary
Learning Objective 2

Consider the following accounting terms and definitions, and match each term to the definition:

1. Sole proprietorship	**a.** Set of global accounting guidelines, formulated by the IASB
2. Faithful representation	**b.** Holds that fair market value should not be used over actual costs
3. Partnership	**c.** Stands for Financial Accounting Standards Board
4. IFRS	**d.** Owner is referred to as a proprietor
5. Corporation	**e.** Asserts that accounting information should be complete, neutral, and free from material error
6. Audit	
7. Cost principle	**f.** An examination of a company's financial statements and records
8. FASB	**g.** Has two or more owners (called partners)
9. Creditors	**h.** U.S. governmental agency that oversees the U.S. financial markets
10. SEC	**i.** Type of entity that is designed to limit personal liability exposure of owners to the entity's debts
	j. Person or business lending money

SOLUTION

1. d	6. f
2. e	7. b
3. g	8. c
4. a	9. j
5. i	10. h

E-F:1-19 Using accounting vocabulary

Learning Objective 3, 5

Consider the following accounting terms and definitions, and match each term to the definition:

1.	Accounting equation	**a.**	An economic resource that is expected to be of benefit in the future
2.	Asset	**b.**	Debts that are owed to creditors
3.	Balance sheet	**c.**	Excess of total expenses over total revenues
4.	Expense	**d.**	Excess of total revenues over total expenses
5.	Income statement	**e.**	The basic tool of accounting, stated as $\text{Assets} = \text{Liabilities} + \text{Equity}$
6.	Liability	**f.**	Decreases in equity that occur in the course of selling goods or services
7.	Net income	**g.**	Increases in equity that occur in the course of selling goods or services
8.	Net loss	**h.**	Reports on a business's cash receipts and cash payments during a period
9.	Revenue	**i.**	Reports on an entity's assets, liabilities, and stockholders' equity as of a specific date
10.	Statement of cash flows	**j.**	Reports on an entity's revenues, expenses, and net income or loss for the period
11.	Statement of retained earnings	**k.**	Reports how the company's retained earnings balance changed from the beginning to the end of the period

SOLUTION

1. e	7. d
2. a	8. c
3. i	9. g
4. f	10. h
5. j	11. k
6. b	

E-F:1-20 Using the accounting equation
Learning Objective 3

Compute the missing amount in the accounting equation for each entity from the financial information presented:

	Assets	**Liabilities**	**Equity**
Hair Styles	$?	$ 36,000	$ 36,000
Style Cuts	90,000	?	48,000
Your Basket	101,000	68,000	?

SOLUTION

	Assets	Liabilities	Equity
Hair Styles	**$ 72,000**	$ 36,000	$ 36,000
Style Cuts	90,000	**42,000**	48,000
Your Basket	101,000	68,000	**33,000**

E-F:1-21 Using the accounting equation
Learning Objective 3

Wizco Advertising's balance sheet data at May 31, 2024, and June 30, 2024, follow:

	May 31, 2024	**June 30, 2024**
Total Assets	$ 122,000	$ 287,000
Total Liabilities	66,000	144,000

For each of the following situations that occurred in June, 2024 with regard to common stock and dividends of a corporation, compute the amount of net income or net loss during June 2024.

a. The company issued $10,000 of common stock and paid no dividends.

b. The company issued no common stock. It paid cash dividends of $3,000.

c. The company issued $12,500 of common stock and paid cash dividends of $30,000.

SOLUTION

	a.	b.	c.
Stockholders' equity, May 31, 2024 ($122,000 – $66,000)	$ 56,000	$ 56,000	$ 56,000
Issuance of common stock	10,000	0	12,500
Net income for the month	**77,000**	**90,000**	**104,500**
	143,000	146,000	173,000
Dividends	0	(3,000)	(30,000)
Stockholders' equity, June 30, 2024 ($287,000 – $144,000)	$ 143,000	$ 143,000	$ 143,000

E-F:1-22 Using the accounting equation
Learning Objective 3

Mountain Drycleaners started 2024 with total assets of $19,000 and total liabilities of $14,000. At the end of 2024, Mountain's total assets stood at $12,000 and total liabilities were $9,000.

Requirements

1. Did the stockholders' equity of Mountain Drycleaners increase or decrease during 2024? By how much?
2. Identify the four possible reasons that stockholders' equity can change.

SOLUTION

Requirement 1

	Assets	=	Liabilities	+	Equity
Beginning of 2024	$19,000	=	$14,000	+	?
	$19,000	=	$14,000	+	**$5,000**
End of 2024	$12,000	=	$9,000	+	?
	$12,000	=	$9,000	+	**$3,000**

Stockholders' equity decreased in 2024 by $2,000 ($5,000 – $3,000).

Requirement 2

a. Increase through issuance of common stock.
b. Increase through net income.
c. Decrease through dividend payment.
d. Decrease through net loss.

E-F:1-23 Using the accounting equation
Learning Objective 3

During 2024, Flowing Rivers Spa reported revenue of $30,000. Total expenses for the year were $15,000. Flowing Rivers Spa ended the year with total assets of $43,000, and it owed debts totaling $14,000. At year-end 2023, the business reported total assets of $28,000 and total liabilities of $14,000.

Requirements

1. Compute Flowing Rivers Spa's net income for 2024.
2. Did Flowing Rivers Spa's stockholders' equity increase or decrease during 2024? By how much?

SOLUTION

Requirement 1

Revenues	–	Expenses	=	Net Income
$30,000	–	$15,000	=	**$15,000**

Requirement 2

Flowing Rivers Spa's equity increased by $15,000 ($29,000 - $14,000) or the amount of the net income.

	Assets	=	Liabilities	+	Equity
Beginning of 2024	$28,000	=	$14,000	+	?
	$28,000	=	$14,000	+	$14,000
Ending of 2024	$43,000	=	$14,000	+	?
	$43,000	=	$14,000	+	$29,000

E-F:1-24 Using the accounting equation
Learning Objective 3

The records of Felix Company show the following at December 31, 2024:

Assets & Liabilities:		**Equity:**	
Beginning:		Common Stock	$ 11,000
Assets	$ 67,000	Dividends	8,000
Liabilities	11,000	Revenues	205,000
Ending:		Expenses	?
Assets	$ 46,000	Retained Earnings, January 1, 2024	45,000
Liabilities	34,000		

Requirements

1. Compute the missing amount for Felix Company. You will need to determine Retained Earnings, December 31, 2024, and total stockholders' equity, December 31, 2024.
2. Did Felix earn a net income or suffer a net loss for the year? Compute the amount.

SOLUTION

Requirement 1

	Assets	−	Liabilities	=	Equity
Beginning of 2024	$67,000	−	$11,000	=	$56,000
Ending of 2024	$46,000	−	$34,000	=	$12,000

Retained Earnings:

Retained Earnings, Jan. 1, 2024	$ 45,000
Plus: Revenues	205,000
Less: Expenses	**(241,000)**
Less: Dividends	(8,000)
Retained Earnings, Dec. 31, 2024	$ 1,000

Stockholders' Equity:

Common Stock	$ 11,000
Retained Earnings	1,000
Total Stockholders' Equity	$ 12,000

Requirement 2

Felix Company suffered (or reported) a net loss of ($36,000).

Revenue	−	Expenses	=	Net Income (Loss)
$205,000	−	$241,000	=	($36,000)

E-F:1-25 Using the accounting equation to analyze transactions
Learning Objective 4

As the manager of a Papa Sean's restaurant, you must deal with a variety of business transactions. Give an example of a transaction that has each of the following effects on the accounting equation:

a. Increase one asset and decrease another asset.

b. Decrease an asset and decrease equity.

c. Decrease an asset and decrease a liability.

d. Increase an asset and increase equity.

e. Increase an asset and increase a liability.

SOLUTION

Student responses will vary. Examples include:
a. Cash purchase of office supplies.
b. Cash dividends paid to stockholders.
c. Paid cash on accounts payable.
d. Received cash for services provided.
e. Borrowed cash from the bank.

E-F:1-26 Using the accounting equation to analyze business transactions
Learning Objective 4

Indicate the effects of the following business transactions on the accounting equation of Vivian's Online Video store. Transaction (a) is answered as a guide.

a. Received cash of $10,000 from issuance of common stock.

Answer: Increase asset (Cash); Increase equity (Common Stock)

b. Earned video rental revenue on account, $2,800.

c. Purchased office furniture on account, $300.

d. Received cash on account, $400.

e. Paid cash on account, $100.

f. Rented videos and received cash of $200.

g. Paid monthly office rent of $1,000.

h. Paid $100 cash to purchase office supplies.

SOLUTION

a. Increase asset (Cash); Increase equity (Common Stock)
b. Increase asset (Accounts Receivable); Increase equity (Rental Revenue)
c. Increase asset (Office Furniture); Increase liability (Accounts Payable)
d. Increase asset (Cash); Decrease asset (Accounts Receivable)
e. Decrease asset (Cash); Decrease liability (Accounts Payable)
f. Increase asset (Cash); Increase equity (Rental Revenue)
g. Decrease asset (Cash); Decrease equity (Rent Expense)
h. Decrease asset (Cash); Increase asset (Office Supplies).

E-F:1-27 Using the accounting equation to analyze business transactions
Learning Objective 4

Indicate the effects of the following business transactions on the accounting equation for Sam's Snack Foods, a supplier of snack foods. Transaction (a) is answered as a guide.

a. Sam's Snack Foods received cash from issuance of common stock to stockholders.

Answer: Increase asset (Cash); Increase equity (Common Stock)

b. Cash purchase of land for a building site.

c. Paid cash on accounts payable.

d. Purchased equipment; signed a note payable.

e. Performed service for a customer on account.

f. Employees worked for the week but will be paid next Tuesday.

g. Received cash from a customer on accounts receivable.

h. Borrowed money from the bank.

i. Cash dividends paid to stockholders.

j. Incurred utilities expense on account.

SOLUTION

a. Increase asset (Cash); Increase equity (Common Stock)
b. Increase asset (Land); Decrease asset (Cash)
c. Decrease asset (Cash); Decrease liability (Accounts Payable)
d. Increase asset (Equipment); Increase liability (Notes Payable)
e. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
f. Increase liability (Salaries Payable); Decrease equity (Salaries Expense)
g. Increase asset (Cash); Decrease asset (Accounts Receivable)
h. Increase asset (Cash); Increase liability (Notes Payable)
i. Decrease asset (Cash); Decrease equity (Dividends)
j. Increase liability (Accounts Payable); Decrease equity (Utility Expense)

E-F:1-28 Using the accounting equation to analyze business transactions
Learning Objective 4

The analysis of the first eight transactions of Advanced Accounting Service follows. Describe each transaction.

	ASSETS			=	LIABILITIES +	EQUITY			
						Contributed Capital +	Retained Earnings		
	Cash +	Accounts Receivable +	Equipment		Accounts Payable +	Common Stock −	Dividends +	Service Revenue −	Salaries Expense
1	+31,000					+31,000			
2		+3,800						+3,800	
Bal.	$31,000 +	$3,800				$31,000		+ $3,800	
3			+13,400		+13,400				
Bal.	$31,000 +	$3,800 +	$13,400		$13,400 +	$31,000		+ $3,800	
4	+190	−190							
Bal.	$31,190 +	$3,610 +	$13,400		$13,400 +	$31,000		+ $3,800	
5	−410		+410						
Bal.	$30,780 +	$3,610 +	$13,810		$13,400 +	$31,000		+ $3,800	
6	−8,000				−8,000				
Bal.	$22,780 +	$3,610 +	$13,810		$5,400 +	$31,000		+ $3,800	
7	+790							+790	
Bal.	$23,570 +	$3,610 +	$13,810		$5,400 +	$31,000		+ $4,590	
8	−1,500								−1,500
Bal.	$22,070 +	$3,610 +	$13,810		$5,400 +	$31,000		+ $4,590 −	$1,500

SOLUTION

Transaction Descriptions:
1. Issuance of common stock to stockholders
2. Earned revenue on account
3. Purchased equipment on account
4. Collected cash on account
5. Cash purchase of equipment
6. Paid cash on account
7. Earned revenue and received cash
8. Paid cash for salaries

E-F:1-29 Using the accounting equation to analyze business transactions
Learning Objective 4

Ashley Stamper opened a medical practice. During July, the first month of operation, the business, titled Ashley Stamper, MD, experienced the following events:

Jul. 6	Received a contribution of $68,000 from Stamper and opened a bank account in the name of A. Stamper, MD. The corporation issued common stock to Stamper.
9	Paid $56,000 cash for land.
12	Purchased medical supplies for $1,500 on account.
15	Officially opened for business.
20	Paid cash expenses: employees' salaries, $1,300; office rent, $1,500; utilities, $100.
31	Earned service revenue for the month, $13,000, receiving cash.
31	Paid $1,050 on account.

Analyze the effects of these events on the accounting equation of the medical practice of Ashley Stamper, MD, using the following format:

ASSETS				LIABILITIES +	EQUITY					
					Contributed Capital +	Retained Earnings				
Cash	+ Medical Supplies	+ Land	=	Accounts Payable	+ Common Stock	− Dividends	+ Service Revenue	− Salaries Expense	− Rent Expense	− Utilities Expense

SOLUTION

			ASSETS			=	LIABILITIES	+	EQUITY										
									Contributed Capital	+	Retained Earnings								
Date	Cash	+	Medical Supplies	+	Land	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Salaries Expense	–	Rent Expense	–	Utilities Expense
July 6	+68,000								+68,000										
Bal.	$68,000					=		+	$68,000										
9	–56,000				+56,000	=													
Bal.	$12,000			+	$56,000	=		+	$68,000										
12		+	+1,500			=	+1,500												
Bal.	$12,000	+	$1,500	+	$56,000	=	$1,500	+	$68,000										
15																			
Bal.	$12,000	+	$1,500	+	$56,000	=	$1,500	+	$68,000										
20	–2,900					=									–1,300		–1,500		–100
Bal.	$ 9,100	+	$1,500	+	$56,000	=	$1,500	+	$68,000					–	$1,300	–	$1,500	–	$100
31	+13,000					=							+13,000						
Bal.	$22,100	+	$1,500	+	$56,000	=	$1,500	+	$68,000			+	$13,000	–	$1,300	–	$1,500	–	$100
31	–1,050					=	–1,050												
Bal.	$21,050	+	$1,500	+	$56,000	=	$ 450	+	$68,000			+	$13,000	–	$1,300	–	$1,500	–	$100

E-F:1-30 Preparing the financial statements
Learning Objective 5

Estella Osage publishes an online travel magazine. In need of cash, the business applies for a loan with National Bank. The bank requires borrowers to submit financial statements. With little knowledge of accounting, Estella Osage, a stockholder, does not know how to proceed.

Requirements

1. What are the four financial statements that the business will need to prepare?

2. Is there a specific order in which the financial statements must be prepared?

3. Explain how to prepare each statement.

Use the following information to answer Exercises E1-31 through E1-33.

The account balances of Wilson Towing Service at June 30, 2024, follow:

Equipment	$ 25,850	Service Revenue	$ 15,000
Office Supplies	1,000	Accounts Receivable	9,000
Notes Payable	6,800	Accounts Payable	8,000
Rent Expense	900	Retained Earnings, June 1, 2024	3,250
Cash	1,400	Salaries Expense	2,400
Dividends	3,500	Common Stock	11,000

SOLUTION

Requirement 1
a. Income statement
b. Statement of retained earnings
c. Balance sheet
d. Statement of cash flows

Requirement 2
Yes, the financial statements should be prepared in the order listed above in Requirement 1.

Requirement 3
Income Statement:

a. The header includes the name of the business, the title of the statement, and the time period. An income statement always represents a period of time, for example, a month or a year.
b. The revenue accounts are always listed first and then subtotaled if necessary.
c. Each expense account is listed separately from largest to smallest and then subtotaled if necessary.
d. Net income is calculated as total revenues minus total expenses.

Statement of Retained Earnings:

a. The header includes the name of the business, the title of the statement, and the time period. A statement of retained earnings always represents a period of time, for example, a month or a year.
b. The beginning retained earnings is listed first and will always be the ending retained earnings from the previous time period.

c. The net income is added to the beginning retained earnings.
d. The dividends are subtracted from retained earnings. If there had been a net loss, this would also be subtracted.

Balance Sheet:

a. The header includes the name of the business and the title of the statement but the date is different. The balance sheet shows the date as a specific date and not a period of time.
b. Each asset account is listed separately and then totaled. Cash is always listed first.
c. Liabilities are listed separately and then totaled. Liabilities that are to be paid first are listed first.
d. The stockholders' equity section includes common stock and ending retained earnings from the statement of retained earnings.
e. The balance sheet must always balance: Assets = Liabilities + Equity.

Statement of Cash Flows:

a. The header includes the name of the business, the title of the statement, and the time period. A statement of cash flows always represents a period of time, for example, a month or a year.
b. Each dollar amount is calculated by evaluating the cash column on the transaction detail.
c. Operating activities involve cash receipts for services provided and cash payments for expenses paid.
d. Investing activities include the purchase and sale of land and equipment for cash.
e. Financing activities include cash from the issuance of common stock and payment of cash dividends.
f. The ending cash balance must match the cash balance on the balance sheet.

E-F:1-31 Preparing the income statement
Learning Objective 5

Net Income $11,700

Requirements

1. Prepare the income statement for Wilson Towing Service for the month ending June 30, 2024.

2. What does the income statement report?

SOLUTION

Requirement 1

WILSON TOWING SERVICE Income Statement Month Ended June 30, 2024		
Revenue:		
Service Revenue		$ 15,000
Expenses:		
Salaries Expense	$ 2,400	
Rent Expense	900	
Total Expenses		3,300
Net Income		$ 11,700

Requirement 2

The income statement reports revenues and expenses for a period of time.

E-F:1-32 Preparing the statement of retained earnings
Learning Objective 5

Ending Retained Earnings $11,450

Requirements

1. Prepare the statement of retained earnings for Wilson Towing Service for the month ending June 30, 2024.

2. What does the statement of retained earnings report?

SOLUTION

Requirement 1

WILSON TOWING SERVICE
Statement of Retained Earnings
Month Ended June 30, 2024

Retained Earnings, June 1, 2024	$ 3,250
Net income for the month	11,700
	14,950
Dividends	(3,500)
Retained Earnings, June 30, 2024	$ 11,450

Requirement 2

The statement of retained earnings reports the changes in retained earnings for a corporation during a time period. The statement of retained earnings reports a corporation's net income or net loss and dividends declared.

E-F:1-33 Preparing the balance sheet
Learning Objective 5

Total Assets $37,250

Requirements

1. Prepare the balance sheet for Wilson Towing Service as of June 30, 2024.
2. What does the balance sheet report?

SOLUTION

Requirement 1

WILSON TOWING SERVICE
Balance Sheet
June 30, 2024

Assets		Liabilities	
Cash	$ 1,400	Accounts Payable	$ 8,000
Accounts Receivable	9,000	Notes Payable	6,800
Office Supplies	1,000	Total Liabilities	14,800
Equipment	25,850	Stockholders' Equity	
		Common Stock	11,000
		Retained Earnings	11,450
		Total Stockholders' Equity	22,450
Total Assets	$ 37,250	Total Liabilities and Stockholders' Equity	$ 37,250

Requirement 2

The balance sheet reports an entity's assets, liabilities, and stockholders' equity as of a specific date.

Use the following information to answer Exercises E1-34 through E1-36.

The assets, liabilities, and equities of Damon Design Studio have the following balances at December 31, 2024. The retained earnings was $39,000 at the beginning of the year. At year end, common stock was $13,000 and dividends were $57,000.

Notes Payable	$ 14,000	Office Furniture	$ 48,400
Rent Expense	23,000	Utilities Expense	7,200
Cash	3,200	Accounts Payable	3,600
Office Supplies	5,100	Service Revenue	154,600
Salaries Expense	65,000	Accounts Receivable	9,300
Property Tax Expense	2,200	Miscellaneous Expense	3,800

E-F:1-34 Preparing the income statement

Learning Objective 5

Net Income $53,400

Prepare the income statement for Damon Design Studio for the year ending December 31, 2024.

SOLUTION

DAMON DESIGN STUDIO
Income Statement
Year Ended December 31, 2024

Revenue:		
Service Revenue		$ 154,600
Expenses:		
Salaries Expense	$ 65,000	
Rent Expense	23,000	
Utilities Expense	7,200	
Miscellaneous Expense	3,800	
Property Tax Expense	2,200	
Total Expenses		101,200
Net Income		$ 53,400

E-F:1-35 Preparing the statement of retained earnings
Learning Objective 5

Ending Retained Earnings $35,400

Prepare the statement of retained earnings for Damon Design Studio for the year ending December 31, 2024.

SOLUTION

DAMON DESIGN STUDIO
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, January 1, 2024	$ 39,000
Net income for the year	53,400
	92,400
Dividends	(57,000)
Retained Earnings, December 31, 2024	$ 35,400

E-F:1-36 Preparing the balance sheet
Learning Objective 5

Total Assets $66,000

Prepare the balance sheet for Damon Design Studio as of December 31, 2024.

SOLUTION

DAMON DESIGN STUDIO
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 3,200	Accounts Payable	$ 3,600
Accounts Receivable	9,300	Notes Payable	14,000
Office Supplies	5,100	Total Liabilities	17,600
Office Furniture	48,400	Stockholders' Equity	
		Common Stock	13,000
		Retained Earnings	35,400
		Total Stockholders' Equity	48,400
Total Assets	$ 66,000	Total Liabilities and Stockholders' Equity	$ 66,000

E-F:1-37 Preparing the statement of cash flows

Learning Objective 5

For each transaction, identify the appropriate section on the statement of cash flows to report the transaction. Choose from: Cash flows from operating activities (O), Cash flows from investing activities (I), Cash flows from financing activities (F), or Is not reported on the statement of cash flows (X). If reported on the statement, decide whether the transaction should be shown as a positive cash flow (+) or a negative cash flow (–):

a. The business received cash from the issuance of common stock.

b. Paid cash on accounts payable for office supplies purchased.

c. Performed services for a customer on account.

d. Cash dividends were paid to stockholders.

e. Received cash from a customer for services performed.

f. Purchased equipment with cash.

g. Paid rent for the month.

h. Purchased land; signed a note payable.

i. Paid employees wages for the week.

j. Incurred utility expense on account.

SOLUTION

a. F +	f. I –
b. O –	g. O –
c. X	h. X
d. F –	i. O –
e. O +	j. X

E-F:1-38 Preparing the statement of cash flows

Learning Objective 5

Decrease in cash $9,350

Morning Bean Food Equipment Company had the following transactions for the month ending January 31, 2024. Morning Bean's cash balance on January 1, 2024, was $11,800.

Jan. 1	Common stock was issued to stockholders for $5,000 cash.
7	Purchased equipment for $2,400 on account.
14	Paid $19,000 cash for land.
17	Paid cash expenses: employees' salaries, $1,300; office rent, $1,600; utilities, $450.
23	Paid cash dividends of $500.
26	Earned service revenue for the month, $8,500, receiving cash.

Prepare the statement of cash flows of Morning Bean Food Equipment Company for the month ended January 31, 2024.

SOLUTION

MORNING BEAN FOOD EQUIPMENT COMPANY
Statement of Cash Flows
Month Ended January 31, 2024

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 8,500
Payments:		
To employees	$ (1,300)	
To suppliers	(2,050)	(3,350)
Net cash provided by operating activities		5,150
Cash flows from investing activities:		
Purchase of land	(19,000)	
Net cash used by investing activities		(19,000)
Cash flows from financing activities:		
Issuance of common stock	5,000	
Payment of cash dividends	(500)	
Net cash provided by financing activities		4,500
Net decrease in cash		(9,350)
Cash balance, January 1, 2024		11,800
Cash balance, January 31, 2024		$ 2,450

E-F:1-39 Calculating Return on Assets
Learning Objective 6

Alice Appliance Service had net income for the year of $58,500. In addition, the balance sheet reports the following balances:

	Jan 1, 2024	Dec 31, 2024
Notes Payable	$ 32,000	$ 58,000
Cash	34,000	134,200
Office Furniture	23,000	44,000
Building	160,000	160,000
Accounts Payable	11,500	11,000
Total Stockholders' Equity	204,500	333,000
Accounts Receivable	2,200	19,800
Equipment	24,000	42,000
Office Supplies	4,800	2,000

Calculate the return on assets for Alice Appliance Service for the year ending December 31, 2024.

SOLUTION

Average total assets = (Beginning total assets + ending total assets) / 2
Beginning total assets = $34,000 + $23,000 + $160,000 + $2,200 + $24,000 + $4,800 = $248,000
Ending total assets = $134,200 + $44,000 + $160,000 + $19,800 + $42,000 + $2,000 = $402,000
Average total assets = ($248,000 + $402,000) / 2 = $325,000

ROA = Net income / Average total assets
ROA = $58,500 / $325,000 = 0.18 = 18%

E-F:1-40 Using the accounting equation for transaction analysis and calculating return on assets. Learning Objective 4, 6

Vivian's Online Video currently has a return on assets of 10%. Indicate the effects of the following business transactions on the Vivian's Online Video return on assets. Consider each transaction independently of the others. Identify if the return on assets increases, decreases, or does not change. Explain you answer. Transaction (a) is answered as a guide.

a. Purchased office furntiture on account, $300

Answer: Decreases. The increase in assets (office furniture) increases the denominator in the equation and therefore decreases the ratio.

b. Earned video rental revenue on account, $2,800.
c. Paid $100 cash to purchase office supplies.
d. Received cash of $10,000 from issuance of common stock.
e. Paid cash on account, $100
f. Received cash on account, $400

SOLUTION

a. Decreases. The increase in assets (office furniture) increases the denominator in the equation and therefore decreases the ratio.
b. Increases. The increase in rental revenue increases net income in the numerator of the equation, therefore increases the ratio.
c. Does not change. The decrease in assets (cash) and increase in assets (office supplies) in the denominator of the equation causes no change.
d. Decreases. The increase in assets (cash) increases the denominator in the equation and therefore decreases the ratio.
e. Increases. The decrease in assets (cash) decreases the denominator in the equation and therefore increases the ratio.
f. Does not change. The increase in assets (cash) and decrease in assets (accounts receivable) in the denominator of the equation causes no change.

Problems (Group A)

P-F:1-41A Using the accounting equation for transaction analysis
Learning Objective 4

Cash $13,600

Meg McKinney opened a public relations firm called Solid Gold on August 1, 2024. The following amounts summarize her business on August 31, 2024:

	ASSETS					LIABILITIES +	EQUITY				
							Contributed Capital +	Retained Earnings			
	Cash	+ Accounts Receivable	+ Office Supplies	+ Land	=	Accounts Payable	+ Common Stock	− Dividends	+ Service Revenue	− Rent Expense	− Advertising Expense
Bal.	$1,900	+ $3,200	+ $0	+ $15,000		$5,000	+ $11,900		+ $3,200		

During September 2024, the business completed the following transactions:

a. Received contribution of $17,000 cash from Meg McKinney in exchange for common stock.

b. Performed service for a client and received cash of $800.

c. Paid off the beginning balance of accounts payable.

d. Purchased office supplies from OfficeMax on account, $1,200.

e. Collected cash from a customer on account, $2,000.

f. Cash dividends of $1,600 were paid to stockholders.

g. Consulted for a new band and billed the client for services rendered, $4,500.

h. Recorded the following business expenses for the month:

Paid office rent: $1,000.

Paid advertising: $500.

Analyze the effects of the transactions on the accounting equation of Solid Gold using the format presented in Exhibit F:1-6.

SOLUTION

	ASSETS							=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Advertising Expense
Bal.	$1,900	+	$3,200			+	$15,000	=	$5,000	+	$11,900				+ $3,200				
(a)	+17,000										+17,000								
Bal.	$18,900	+	$3,200			+	$15,000	=	$5,000	+	$28,900				$3,200				
(b)	+800														+800				
Bal.	$19,700	+	$3,200			+	$15,000	=	$5,000	+	$28,900				$4,000				
(c)	–5,000								–5,000										
Bal.	$14,700	+	$3,200			+	$15,000	=	$0	+	$28,900			+	$4,000				
(d)					+1,200				+1,200										
Bal.	$14,700	+	$3,200	+	$1,200	+	$15,000	=	$1,200	+	$28,900			+	$4,000				
(e)	+2,000		–2,000																
Bal.	$16,700	+	$1,200	+	$1,200	+	$15,000	=	$1,200	+	$28,900			+	$4,000				
(f)	–1,600												–1,600						
Bal.	$15,100	+	$1,200	+	$1,200	+	$15,000	=	$1,200	+	$28,900	–	$1,600	+	$4,000				
(g)			+4,500												+4,500				
Bal.	$15,100	+	$5,700	+	$1,200	+	$15,000	=	$1,200	+	$28,900	–	$1,600	+	$8,500				
(h)	–1,500																–1,000		–500
Bal.	$13,600	+	$5,700	+	$1,200	+	$15,000	=	$1,200	+	$28,900	–	$1,600	+	$8,500	–	$1,000	–	$500

P-F:1-42A Using the accounting equation for transaction analysis
Learning Objective 4

Cash $21,500

Conner Thomas started a new business, Thomas Gymnastics, and completed the following transactions during December:

Dec. 1	Received $19,000 cash from Conner in exchange for common stock.
2	Received $3,800 cash from customers for services performed.
5	Paid $200 cash for office supplies.
9	Performed services for a customer and billed the customer for services rendered, $4,500.
10	Received $200 invoice for utilities due in two weeks.
15	Paid for advertising in the local paper, $250.
20	Paid utility invoice received on December 10.
25	Collected cash in full from customer billed on December 9.
28	Paid rent for the month, $1,600.
28	Paid $1,450 to assistant for wages.
30	Received $1,400 cash from customers for services performed.
31	Cash dividends of $3,500 were paid to stockholders.

Analyze the effects of the transactions on the accounting equation of Thomas Gymnastics using a format similar to Exhibit F:1-6. Use the following accounts: Cash Accounts Receivable, Office Supplies, Accounts Payable, common Stock, Dividends, Service Revenue, Rent Expense, Utitlities Expense, Wages Expense, and Advertising Expense.

SOLUTION

	ASSETS					=	LIABILITIES	+	EQUITY												
									Contributed Capital	+	Retained Earnings										
	Cash	+	Accounts Receivable	+	Office Supplies	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense	–	Wages Expense	–	Advertising Expense
1	+19,000								+19,000												
2	+3,800												+3,800								
Bal.	$22,800					=		+	$19,000			+	$3,800								
5	–200				+200																
Bal.	$22,600			+	$200	=		+	$19,000			+	$3,800								
9			+4,500										+4,500								
Bal.	$22,600	+	$4,500	+	$200	=		+	$19,000			+	$8,300								
10							+200										–200				
Bal.	$22,600	+	$4,500	+	$200	=	$200	+	$19,000			+	$8,300			–	$200				
15	–250																				–250
Bal.	$22,350	+	$4,500	+	$200	=	$200	+	$19,000			+	$8,300			–	$200			–	$250
20	–200						–200														
Bal.	$22,150	+	$4,500	+	$200	=	$ 0	+	$19,000			+	$8,300			–	$200			–	$250
25	+4,500		–4,500																		
Bal.	$26,650	+	$ 0	+	$200	=		+	$19,000			+	$8,300			–	$200			–	$250
28	–1,600														–1,600						
Bal.	$25,050			+	$200	=		+	$19,000			+	$8,300	–	$1,600	–	$200			–	$250
28	–1,450																		–1,450		
Bal.	$23,600			+	$200	=		+	$19,000			+	$8,300	–	$1,600	–	$200	–	$1,450	–	$250
30	+1,400												+1,400								
Bal.	$25,000			+	$200	=		+	$19,000			+	$9,700	–	$1,600	–	$200	–	$1,450	–	$250
31	–3,500										–3,500										
Bal.	$21,500	+	$ 0	+	$200	=	$ 0	+	$19,000	–	$3,500	+	$9,700	–	$1,600	–	$200	–	$1,450	–	$250

P-F:1-43A Preparing financial statements
Learning Objective 5

1. Net Income $115,700

Presented here are the accounts of Hometown Décor Company for the year ended December 31, 2024.

Land	$ 13,000	Common Stock	$ 28,000
Notes Payable	33,000	Accounts Payable	14,000
Property Tax Expense	2,800	Accounts Receivable	800
Dividends	36,000	Advertising Expense	17,000
Rent Expense	14,000	Building	170,400
Salaries Expense	67,000	Cash	2,800
Salaries Payable	1,300	Equipment	17,000
Service Revenue	225,000	Insurance Expense	1,700
Office Supplies	8,000	Interest Expense	6,800
Retained Earnings, Dec. 31, 2017	56,000		

Requirements

1. Prepare Hometown Décor Company's income statement for the year ended December 31, 2024.

2. Prepare the statement of retained earnings for the year ended December 31, 2024.

3. Prepare the balance sheet as of December 31, 2024.

SOLUTION

Requirement 1

HOMETOWN DÉCOR COMPANY
Income Statement
Year Ended December 31, 2024

Revenue:		
Service Revenue		$ 225,000
Expenses:		
Salaries Expense	$ 67,000	
Advertising Expense	17,000	
Rent Expense	14,000	
Interest Expense	6,800	
Property Tax Expense	2,800	
Insurance Expense	1,700	
Total Expenses		109,300
Net Income		$ 115,700

Requirement 2

HOMETOWN DÉCOR COMPANY
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, December 31, 2023	$ 56,000
Net income for the year	115,700
	171,700
Dividends	(36,000)
Retained Earnings, December 31, 2024	$ 135,700

Requirement 3

HOMETOWN DÉCOR COMPANY
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 2,800	Accounts Payable	$ 14,000
Accounts Receivable	800	Notes Payable	33,000
Office Supplies	8,000	Salaries Payable	1,300
Land	13,000	Total Liabilities	48,300
Building	170,400		
Equipment	17,000	Stockholders' Equity	
		Common Stock	28,000
		Retained Earnings	135,700
		Total Stockholders' Equity	163,700
Total Assets	$ 212,000	Total Liabilities and Stockholders' Equity	$ 212,000

P-F:1-44A Preparing financial statements
Learning Objective 5

b. Ending Retained Earnings $48,000

Picture Perfect Photography works weddings and prom-type parties. The balance of retained earnings was $16,000 at December 31, 2023. At December 31, 2024, the business's accounting records show these balances:

Insurance Expense	$ 6,000	Accounts Receivable	$ 13,000
Cash	42,000	Notes Payable	14,000
Accounts Payable	11,000	Retained Earnings, Dec. 31, 2024	?
Advertising Expense	4,000	Salaries Expense	25,000
Service Revenue	75,000	Equipment	46,000
Dividends	8,000	Common Stock	28,000

Prepare the following financial statements for Picture Perfect Photography for the year ended December 31, 2024:

a. Income statement for the year ended December 31, 2024.

b. Statement of retained earnings for the year ended December 31, 2024.

c. Balance sheet as of December 31, 2024.

SOLUTION

Part a.

PICTURE PERFECT PHOTOGRAPHY
Income Statement
Year Ended December 31, 2024

Revenue:		
Service Revenue		$ 75,000
Expenses:		
Salaries Expense	$ 25,000	
Insurance Expense	6,000	
Advertising Expense	4,000	
Total Expenses		35,000
Net Income		$ 40,000

P-F:1-44A (cont.)
Part b.

PICTURE PERFECT PHOTOGRAPHY
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, December 31, 2023	$ 16,000
Net income for the year	40,000
	56,000
Dividends	(8,000)
Retained Earnings, December 31, 2024	$ 48,000

Part c.

PICTURE PERFECT PHOTOGRAPHY
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 42,000	Accounts Payable	$ 11,000
Accounts Receivable	13,000	Notes Payable	14,000
Equipment	46,000	Total Liabilities	25,000
		Stockholders' Equity	
		Common Stock	28,000
		Retained Earnings	48,000
		Total Stockholders' Equity	76,000
Total Assets	$101,000	Total Liabilities and Stockholders' Equity	$101,000

P-F:1-45A Preparing financial statements
Learning Objective 5

Total Assets $47,100

The bookkeeper of Outdoor Life Landscaping prepared the company's balance sheet while the accountant was ill. The balance sheet, shown on the next page, contains numerous errors. In particular, the bookkeeper knew that the balance sheet should balance, so he plugged in the retained earnings amount needed to achieve this balance. The retained earnings is incorrect. All other amounts are correct, but some are out of place or should not be included in this statement. Prepare a corrected balance sheet.

OUTDOOR LIFE LANDSCAPING
Balance Sheet
Month Ended November 30, 2024

Assets		Liabilities	
Cash	$ 4,600	Accounts Receivable	$ 2,000
Office Supplies	600	Dividends	11,000
Land	34,100	Service Revenue	35,000
Salaries Expense	2,700	Property Tax Expense	3,000
Office Furniture	5,800	Accounts Payable	2,700
Notes Payable	24,600	Retained Earnings	11,150
Rent Expense	450	**Stockholders' Equity**	
		Common Stock	8,000
Total Assets	$ 72,850	Total Liabilities	$ 72,850

SOLUTION

OUTDOOR LIFE LANDSCAPING
Balance Sheet
November 30, 2024

Assets		Liabilities	
Cash	$ 4,600	Accounts Payable	$ 2,700
Accounts Receivable	2,000	Notes Payable	24,600
Office Supplies	600	Total Liabilities	27,300
Land	34,100	Stockholders' Equity	
Office Furniture	5,800	Common Stock	8,000
		Retained Earnings	11,800
		Total Stockholders' Equity	19,800
Total assets	$ 47,100	Total Liabilities and Stockholders' Equity	$ 47,100

P-F:1-46A Using the accounting equation for transaction analysis and preparing financial statements
Learning Objective 4, 5

2b. Ending Retained Earnings $19,560

Allen Shonton recently opened his own accounting firm on April 1, which he operates as a corporation. The name of the new entity is Allen Shonton, CPA. Shonton experienced the following events during the organizing phase of the new business and its first month of operations in 2024:

Apr. 5	Shonton deposited $75,000 in a new business bank account titled Allen Shonton, CPA. The business issued common stock to Shonton.
6	Paid $300 cash for letterhead stationery for new office.
7	Purchased office furniture for the office on account, $9,500.
10	Consulted with tax client and received $4,000 for services rendered.
11	Paid utilities, $190.
12	Finished tax hearings on behalf of a client and submitted a bill for accounting services, $20,000.
18	Paid office rent, $750.
25	Received amount due from client that was billed on April 12.
27	Paid full amount of accounts payable created on April 7.
30	Cash dividends of $3,500 were paid to stockholders.

Requirements

1. Analyze the effects of the events on the accounting equation of Allen Shonton, CPA. Use a format similar to Exhibit F:1-6. Use the following accounts: Cash, Accounts Receivable, Office Supplies, Furniture, Accounts Payable, Common Stock, Dividends, Service Revenue, Rent Expense, and Utilities Expense.

2. Prepare the following financial statements:

   a. Income statement forth emonth ended April 30, 2024.

   b. Statement of retained earnings for the month ended April 30, 2024.

   c. Balance sheet as of April 30, 2024.

SOLUTION

Requirement 1

			ASSETS					=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Furniture	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense
5	+75,000										+75,000								
6	–300				+300														
Bal.	$74,700			+	$300			=		+	$75,000								
7							+9,500		+9,500										
Bal.	$74,700			+	$300	+	$9,500	=	$9,500	+	$75,000								
10	+4,000														+4,000				
Bal.	$78,700			+	$300	+	$9,500	=	$9,500	+	$75,000			+	$4,000				
11	–190																		–190
Bal.	$78,510			+	$300	+	$9,500	=	$9,500	+	$75,000			+	$4,000			–	$190
12			+20,000												+20,000				
Bal.	$78,510	+	$20,000	+	$300	+	$9,500	=	$9,500	+	$75,000			+	$24,000			–	$190
18	–750																–750		
Bal.	$77,760	+	$20,000	+	$300	+	$9,500	=	$9,500	+	$75,000			+	$24,000	–	$750	–	$190
25	+20,000		–20,000																
Bal.	$97,760		$ 0	+	$300	+	$9,500	=	$9,500	+	$75,000			+	$24,000	–	$750	–	$190
27	–9,500								–9,500										
Bal.	$88,260			+	$300	+	$9,500	=	$ 0	+	$75,000			+	$24,000	–	$750	–	$190
30	–3,500												–3,500						
Bal.	$84,760	+	$ 0	+	$300	+	$9,500	=	$ 0	+	$75,000	–	$3,500	+	$24,000	–	$750	–	$190

P-F:1-46A, cont.
Requirement 2a

ALLEN SHONTON, CPA
Income Statement
Month Ended April 30, 2024

Revenue:		
Service Revenue		$ 24,000
Expenses:		
Rent Expense	$ 750	
Utilities Expense	190	
Total Expenses		940
Net Income		$ 23,060

Requirement 2b

ALLEN SHONTON, CPA
Statement of Retained Earnings
Month Ended April 30, 2024

Retained Earnings, April 1, 2024	$ 0
Net income for the month	23,060
	23,060
Dividends	(3,500)
Retained Earnings, April 30, 2024	$ 19,560

Requirement 2c

ALLEN SHONTON, CPA
Balance Sheet
April 30, 2024

Assets		Liabilities	
Cash	$ 84,760		
Office Supplies	300		
Furniture	9,500	Stockholders' Equity	
		Common Stock	$ 75,000
		Retained Earnings	19,560
		Total Stockholders' Equity	94,560
Total Assets	$ 94,560	Total Liabilities and Stockholders' Equity	$ 94,560

P-F:1-47A Using the accounting equation for transaction analysis and preparing financial statements
Learning Objective 4, 5, 6

2c. Total Assets $83,700

Annette Pachelo recently opened her own law office on March 1, which she operates as a corporation. The name of the new entity is Annette Pachelo, Attorney. Pachelo experienced the following events during the organizing phase of the new business and its first month of operation, March 2024. Some of the events were personal and did not affect the law practice. Others were business transactions and should be accounted for by the business.

Mar. 1	Sold personal investment in Amazon stock, which she had owned for several years, receiving $35,000 cash.
2	Deposited the $35,000 cash from the sale of the Amazon stock in her personal bank account.
3	Deposited $73,000 cash in a new business bank account titled Annette Pachelo, Attorney. The business issued common stock to Pachelo.
5	Paid $700 cash for ink cartridges for the printer.
7	Purchased computer for the law office, agreeing to pay the account, $5,000, within three months.
9	Received $2,800 cash from customers for services rendered.
15	Received bill from *The Lawyer* for magazine subscription, $400. (Use Miscellaneous Expense account.)
23	Finished court hearings on behalf of a client and submitted a bill for legal services, $10,000, on account.
28	Paid bill from *The Lawyer*.
30	Paid utilities, $1,200.
31	Received $3,300 cash from clients billed on March 23.
31	Cash dividends of $5,500 were paid to stockholders.

Requirements

1. Analyze the effects of the preceding events on the accounting equation of Annette Pachelo, Attorney. Use a format similar to Exhibit F:1-6.

2. Prepare the following financial statements:

a. Income statement for the month ended March 31, 2024.

b. Statement of retained earnings for the month ended March 31, 2024.

c. Balance sheet as of March 31, 2024.

d. Statement of cash flows for the month ended March 31, 2024.

3. Calculate Annette Pachelo, Attorney's return on assets. Round to the nearest whole percent.

SOLUTION

Requirement 1

	ASSETS							=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Computer	=	Accounts Payable	+	Common Stock	−	Dividends	+	Service Revenue	–	Utilities Expense	–	Miscellaneous Expense
3	+73,000										+73,000								
5	–700				+700														
Bal.	$72,300			+	$700			=		+	$73,000								
7							+5,000		+5,000										
Bal.	$72,300			+	$700	+	$5,000	=	$5,000	+	$73,000								
9	+2,800														+2,800				
Bal.	$75,100			+	$700	+	$5,000	=	$5,000	+	$73,000			+	$2,800				
15									+400										–400
Bal.	$75,100			+	$700	+	$5,000	=	$5,400	+	$73,000			+	$2,800	–		–	$400
23			+10,000												+10,000				
Bal.	$75,100	+	$10,000	+	$700	+	$5,000	=	$5,400	+	$73,000			+	$12,800	–		–	$400
28	–400								–400										
Bal.	$74,700	+	$10,000	+	$700	+	$5,000	=	$5,000	+	$73,000			+	$12,800	–		–	$400
30	–1,200																–1,200		
Bal.	$73,500	+	$10,000	+	$700	+	$5,000	=	$5,000	+	$73,000			+	$12,800	–	$1,200	–	$400
31	+3,300		–3,300																
Bal.	$76,800	+	$6,700	+	$700	+	$5,000	=	$5,000	+	$73,000			+	$12,800	–	$1,200	–	$400
31	–5,500												–5,500						
Bal.	$71,300	+	$6,700	+	$700	+	$5,000	=	$5,000	+	$73,000	–	$5,500	+	$12,800	–	$1,200	–	$400

P-F:1-47A, cont.
Requirement 2a

ANNETTE PACHELO, ATTORNEY
Income Statement
Month Ended March 31, 2024

Revenue:		
Service Revenue		$ 12,800
Expenses:		
Utilities Expense	$ 1,200	
Miscellaneous Expense	400	
Total Expenses		1,600
Net Income		$ 11,200

Requirement 2b

ANNETTE PACHELO, ATTORNEY
Statement of Retained Earnings
Month Ended March 31, 2024

Retained Earnings, March 1, 2024	$ 0
Net income for the month	11,200
	11,200
Dividends	(5,500)
Retained Earnings, March 31, 2024	$ 5,700

Requirement 2c

ANNETTE PACHELO, ATTORNEY
Balance Sheet
March 31, 2024

Assets		Liabilities	
Cash	$ 71,300	Accounts Payable	$ 5,000
Accounts Receivable	6,700		
Office Supplies	700	Stockholders' Equity	
Computer	5,000	Common Stock	73,000
		Retained Earnings	5,700
		Total Stockholders' Equity	78,700
Total Assets	$ 83,700	Total Liabilities and Stockholders' Equity	$ 83,700

P-F:1-47A, cont.
Requirement 2d

ANNETTE PACHELO, ATTORNEY
Statement of Cash Flows
Month Ended March 31, 2024

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 6,100
Payments:		
To suppliers		(2,300)
Net cash provided by operating activities		3,800
Cash flows from investing activities:		0
Cash flows from financing activities		
Issued common stock	$ 73,000	
Payment of cash dividends	(5,500)	
Net cash provided by financing activities		67,500
Net increase in cash		71,300
Cash balance, March 1, 2024		0
Cash balance, March 31, 2024		$ 71,300

Requirement 3

Average total assets = (Beginning total assets + ending total assets) / 2
Average total assets = ($0 + $83,700 / 2 = $41,850

ROA = Net income / Average total assets
ROA = $11,200 / $41,850 = 0.27 = 27% (rounded)

Problems Group B

P-F:1-48B Using the accounting equation for transaction analysis
Learning Objective 4

Cash $12,650

Meg McIntyre opened a public relations firm called Pop Chart on August 1, 2024. The following amounts summarize her business on August 31, 2024:

	ASSETS					LIABILITIES +	EQUITY				
							Contributed Capital +	Retained Earnings			
	Cash	+ Accounts Receivable	+ Office Supplies	+ Land	=	Accounts Payable	+ Common Stock	− Dividends	+ Service Revenue	− Rent Expense	− Advertising Expense
Bal.	$2,600	+ $2,500	+ $0	+ $16,000		$5,000	+ $13,600		+ $2,500		

During September 2024, the business completed the following transactions:

a. Received contribution of $14,000 cash from Meg McIntyre in exchange for common stock.

b. Performed service for a client and received cash of $1,600.

c. Paid off the beginning balance of accounts payable.

d. Purchased office supplies from OfficeMax on account, $1,200.

e. Collected cash from a customer on account, $2,300.

f. Cash dividends of $1,500 were paid to stockholders.

g. Consulted for a new band and billed the client for services rendered, $4,000.

h. Recorded the following business expenses for the month:

Paid office rent: $900.

Paid advertising: $450.

Analyze the effects of the transactions on the accounting equation of Pop Chart using the format presented above.

SOLUTION

	ASSETS							=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Advertising Expense
Bal.	$2,600	+	$2,500	+		+	$16,000	=	$5,000	+	$13,600			+	2,500				
(a)	+14,000										+14,000								
Bal.	$16,600	+	$2,500			+	$16,000	=	$5,000	+	$27,600			+	2,500				
(b)	+1,600														+1,600				
Bal.	$18,200	+	$2,500			+	$16,000	=	$5,000	+	$27,600			+	$4,100				
(c)	–5,000								–5,000										
Bal.	$13,200	+	$2,500			+	$16,000	=	$0	+	$27,600			+	$4,100				
(d)					+1,200				+1,200										
Bal.	$13,200	+	$2,500	+	$1,200	+	$16,000	=	$1,200	+	$27,600			+	$4,100				
(e)	+2,300		–2,300																
Bal.	$15,500	+	$200	+	$1,200	+	$16,000	=	$1,200	+	$27,600			+	$4,100				
(f)	–1,500												–1,500						
Bal.	$14,000	+	$200	+	$1,200	+	$16,000	=	$1,200	+	$27,600	–	$1,500	+	$4,100				
(g)			+4,000												+4,000				
Bal.	$14,000	+	$4,200	+	$1,200	+	$16,000	=	$1,200	+	$27,600	–	$1,500	+	$8,100				
(h)	–1,350																–900		–450
Bal.	$12,650	+	$4,200	+	$1,200	+	$16,000	=	$1,200	+	$27,600	–	$1,500	+	$8,100	–	$900	–	$450

P-F:1-49B Using the accounting equation for transaction analysis
Learning Objective 4

Cash $21,300

Cosmo Thomas started a new business, Thomas Gymnastics, and completed the following transactions during December:

Dec. 1	Received $19,000 cash from Thomas in exchange for common stock.
2	Received $3,800 cash from customers for services performed.
5	Paid $300 cash for office supplies.
9	Performed services for a customer and billed the customer for services rendered, $4,500.
10	Received $150 invoice for utilities due in two weeks.
15	Paid for advertising in the local paper, $350.
20	Paid utility invoice received on Dec. 10.
25	Collected cash in full from customer billed on Dec. 9.
28	Paid rent for the month, $2,600.
28	Paid $1,200 to assistant for wages.
30	Received $1,600 cash from customers for services performed.
31	Cash dividends of $3,000 were paid to stockholders.

Analyze the effects of the transactions on the accounting equation of Thomas Gymnastics using a format similar to Exhibit F:1-6. Use the following accounts: Cash, Accounts Receivable, Office Supplies, Accounts Payable, Common Stock, Dividents, Service Revenue, Rent Expense, Utilities Expense, Salaries Expense, and Advertising Expense.

SOLUTION

	ASSETS					=	LIABILITIES	+	EQUITY												
									Contributed Capital	+	Retained Earnings										
	Cash	+	Accounts Receivable	+	Office Supplies	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense	–	Wages Expense	–	Advertising Expense
1	+19,000								+19,000												
2	+3,800												+3,800								
Bal.	$22,800					=		+	$19,000			+	$3,800								
5	–300				+300																
Bal.	$22,500			+	$300	=		+	$19,000			+	$3,800								
9			+4,500										+4,500								
Bal.	$22,500	+	$4,500	+	$300	=		+	$19,000			+	$8,300								
10							+150										–150				
Bal.	$22,500	+	$4,500	+	$300	=	$150	+	$19,000			+	$8,300			–	$150				
15	–350																				–350
Bal.	$22,150	+	$4,500	+	$300	=	$150	+	$19,000			+	$8,300			–	$150			–	$350
20	–150						–150														
Bal.	$22,000	+	$4,500	+	$300	=	$ 0	+	$19,000			+	$8,300			–	$150			–	$350
25	+4,500		–4,500																		
Bal.	$26,500	+	$ 0	+	$300	=		+	$19,000			+	$8,300			–	$150			–	$350
28	–2,600														–2,600						
Bal.	$23,900			+	$300	=		+	$19,000			+	$8,300	–	$2,600	–	$150			–	$350
28	–1,200																		–1,200		
Bal.	$22,700			+	$300	=		+	$19,000			+	$8,300	–	$2,600	–	$150	–	$1,200	–	$350
30	+1,600												+1,600								
Bal.	$24,300			+	$300	=		+	$19,000			+	$9,900	–	$2,600	–	$150	–	$1,200	–	$350
31	–3,000										–3,000										
Bal.	$21,300	+	$ 0	+	$300	=	$ 0	+	$19,000	–	$3,000	+	$9,900	–	$2,600	–	$150	–	$1,200	–	$350

P-F:1-50B Preparing financial statements
Learning Objective 5

1. Net Income $97,600

Presented here are the accounts of Pembroke Bookkeeping Company for the year ended December 31, 2024:

Land	$ 10,000	Common Stock	$ 29,000
Notes Payable	31,000	Accounts Payable	7,000
Property Tax Expense	3,100	Accounts Receivable	1,200
Dividends	28,000	Advertising Expense	12,000
Rent Expense	7,000	Building	147,400
Salaries Expense	64,000	Cash	2,800
Salaries Payable	800	Equipment	15,000
Service Revenue	192,000	Insurance Expense	1,700
Office Supplies	12,000	Interest Expense	6,600
Retained Earnings, Dec. 31, 2023	51,000		

Requirements

1. Prepare Pembroke Bookkeeping Company's income statement for the year ended December 31, 2024.

2. Prepare the statement of retained earnings for the year ended December 31, 2024.

3. Prepare the balance sheet as of December 31, 2024.

SOLUTION

Requirement 1

PEMBROKE BOOKKEEPING COMPANY
Income Statement
Year Ended December 31, 2024

Revenues:		
Service Revenue		$ 192,000
Expenses:		
Salaries Expense	$ 64,000	
Advertising Expense	12,000	
Rent Expense	7,000	
Interest Expense	6,600	
Property Tax Expense	3,100	
Insurance Expense	1,700	
Total Expenses		94,400
Net Income		$ 97,600

Requirement 2

PEMBROKE BOOKKEEPING COMPANY
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, December 31, 2023	$ 51,000
Net income for the year	97,600
	148,600
Dividends	(28,000)
Retained Earnings, December 31, 2024	$ 120,600

Requirement 3

PEMBROKE BOOKKEEPING COMPANY
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 2,800	Accounts Payable	$ 7,000
Accounts Receivable	1,200	Notes Payable	31,000
Office Supplies	12,000	Salaries Payable	800
Land	10,000	Total Liabilities	38,800
Building	147,400	Stockholders' Equity	
Equipment	15,000	Common Stock	29,000
		Retained Earnings	120,600
		Total Stockholders' Equity	149,600
Total Assets	$ 188,400	Total Liabilities and Stockholders' Equity	$ 188,400

P-F:1-51B Preparing financial statements
Learning Objective 5

b. Ending Retained Earnings $81,500

Pretty Pictures works weddings and prom-type parties. The balance of Retained Earnings was $20,000 at December 31, 2023. At December 31, 2024, the business's accounting records show these balances:

Insurance Expense	$ 6,000	Accounts Receivable	$ 5,000
Cash	42,000	Notes Payable	10,000
Accounts Payable	13,000	Retained Earnings, Dec. 31, 2024	?
Advertising Expense	4,500	Salaries Expense	30,000
Service Revenue	115,000	Equipment	85,500
Dividends	13,000	Common Stock	28,000

Prepare the following financial statements for Pretty Pictures for the year ended December 31, 2024:

a. Income statement.

b. Statement of retained earnings.

c. Balance sheet.

SOLUTION

Requirement a

PRETTY PICTURES
Income Statement
Year Ended December 31, 2024

Revenues:		
Service Revenue		$ 115,000
Expenses:		
Salaries Expense	$ 30,000	
Insurance Expense	6,000	
Advertising Expense	4,500	
Total Expenses		40,500
Net Income		$ 74,500

P-F:1-51B (cont.)
Requirement b

PRETTY PICTURES
Statement of Retained Earnings
Year Ended December 31, 2024

Retained Earnings, December 31, 2023	$ 20,000
Net income for the year	74,500
	94,500
Dividends	(13,000)
Retained Earnings, December 31, 2024	$ 81,500

Requirement c

PRETTY PICTURES
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 42,000	Accounts Payable	$ 13,000
Accounts Receivable	5,000	Notes Payable	10,000
Equipment	85,500	Total Liabilities	23,000
		Stockholders' Equity	
		Common Stock	28,000
		Retained Earnings	81,500
		Total Stockholders' Equity	109,500
Total Assets	$ 132,500	Total Liabilities And Stockholders' Equity	$ 132,500

P-F:1-52BPreparing financial statements

Learning Objective 5

Total Assets $48,700

The bookkeeper of Juniper Landscaping prepared the company's balance sheet while the accountant was ill. The balance sheet, shown on the next page, contains numerous errors. In particular, the bookkeeper knew that the balance sheet should balance, so he plugged in the retained earnings amount needed to achieve this balance. The retained earnings is incorrect. All other amounts are correct, but some are out of place or should not be included on this statement. Prepare a corrected balance sheet.

JUNIPER LANDSCAPING Balance Sheet Month Ended July 31, 2024			
Assets		**Liabilities**	
Cash	$ 5,300	Accounts Receivable	$ 1,800
Office Supplies	800	Dividends	14,000
Land	34,500	Service Revenue	38,000
Salaries Expense	3,200	Property Tax Expense	3,300
Office Furniture	6,300	Accounts Payable	2,700
Notes Payable	24,700	Retained Earnings	5,300
Rent Expense	300	**Stockholders' Equity**	
		Common Stock	10,000
Total Assets	$ 75,100	Total Liabilities	$ 75,100

SOLUTION

JUNIPER LANDSCAPING Balance Sheet July 31, 2024			
Assets		Liabilities	
Cash	$ 5,300	Accounts Payable	$ 2,700
Accounts Receivable	1,800	Notes Payable	24,700
Office Supplies	800	Total Liabilities	27,400
Land	34,500		
Office Furniture	6,300	Stockholders' Equity	
		Common Stock	10,000
		Retained Earnings	11,300
		Total Stockholders' Equity	21,300
Total Assets	$ 48,700	Total Liabilities and Stockholders' Equity	$ 48,700

P-F:1-53B Using the accounting equation for transaction analysis and preparing financial statements
Learning Objective 5

2c. Total Assets $58,360

Amos Sharp recently opened his own accounting firm on October 1, which he operates as a corporation. The name of the new entity is Amos Sharp, CPA. Sharp experienced the following events during the organizing phase of the new business and its first month of operations in 2024.

Oct. 5	Sharp deposited $45,000 in a new business bank account titled Amos Sharp, CPA. The business issued common stock to Sharp.
6	Paid $300 cash for letterhead stationery for new office.
7	Purchased office furniture for the office on account, $6,500.
10	Consulted with tax client and received $3,300 for services rendered.
11	Paid utilities, $340.
12	Finished tax hearings on behalf of a client and submitted a bill for accounting services, $16,000.
18	Paid office rent, $1,800.
25	Received amount due from client that was billed on October 12.
27	Paid full amount of Accounts Payable created on October 7.
31	Cash dividends of $3,800 were paid to stockholders.

Requirements

1. Analyze the effects of the events on the accounting equation of Amos Sharp, CPA. Use a format similar to Exhibit F:1-6. Use the following accounts: Cash, Accounts Receivable, Office Supplies, Furniture, Accounts Payable, Common Stock, Dividends, Service Revenue, Rent Expense, and Utilities Expense.

2. Prepare the following financial statements:

a. Income statement for the month ended October 31, 2024.

b. Statement of retained earnings for the month ended October 31, 2024.

c. Balance sheet as of October 31, 2024.

SOLUTION

Requirement 1

	ASSETS							=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Office Furniture	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense
5	+45,000										+45,000								
Bal.	$45,000							=		+	$45,000								
6	–300				+300														
Bal.	$44,700			+	$300			=		+	$45,000								
7							+6,500		+6,500										
Bal.	$44,700			+	$300	+	$6,500	=	$6,500	+	$45,000								
10	+3,300														+3,300				
Bal.	$48,000			+	$300	+	$6,500	=	$6,500	+	$45,000			+	$3,300				
11	–340																		–340
Bal.	$47,660			+	$300	+	$6,500	=	$6,500	+	$45,000			+	$3,300			–	$340
12			+16,000												+16,000				
Bal.	$47,660	+	$16,000	+	$300	+	$6,500	=	$6,500	+	$45,000			+	$19,300			–	$340
18	–1,800																–1,800		
Bal.	$45,860	+	$16,000	+	$300	+	$6,500	=	$6,500	+	$45,000			+	$19,300	–	$1,800	–	$340
25	+16,000		–16,000																
Bal.	$61,860		$ 0	+	$300	+	$6,500	=	$6,500	+	$45,000			+	$19,300	–	$1,800	–	$340
27	–6,500								–6,500										
Bal.	$55,360		$ 0	+	$300	+	$6,500	=	$ 0	+	$45,000			+	$19,300	–	$1,800	–	$340
31	–3,800												–3,800						
Bal.	$51,560	+	$ 0	+	$300	+	$6,500	=	$ 0	+	$45,000	–	$3,800	+	$19,300	–	$1,800	–	$340

P-F:1-53B, cont.
Requirement 2a

AMOS SHARP, CPA
Income Statement
Month Ended October 31, 2024

Revenues:		
Service Revenue		$ 19,300
Expenses:		
Rent Expense	$ 1,800	
Utilities Expense	340	
Total Expenses		2,140
Net Income		$ 17,160

Requirement 2b

AMOS SHARP, CPA
Statement of Retained Earnings
Month Ended October 31, 2024

Retained Earnings, October 1, 2024	$ 0
Net income for the month	17,160
	17,160
Dividends	(3,800)
Retained Earnings, October 31, 2024	$ 13,360

Requirement 2c

AMOS SHARP, CPA
Balance Sheet
October 31, 2024

Assets		Liabilities	
Cash	$ 51,560		
Office Supplies	300		
Office Furniture	6,500	Stockholders' Equity	
		Common Stock	$ 45,000
		Retained Earnings	13,360
		Total Stockholders' Equity	58,360
Total Assets	$ 58,360	Total Liabilities and Stockholders' Equity	$ 58,360

P-F:1-54B Using the accounting equation for transaction analysis and preparing financial statements
Learning Objectives 4, 5, 6

2c. Total Assets $103,700

Abby Perry recently opened her own law office on December 1, which she operates as a corporation. The name of the new entity is Abby Perry, Attorney. Perry experienced the following events during the organizing phase of the new business and its first month of operation, December 2024. Some of the events were personal and did not affect the law practice. Others were business transactions and should be accounted for by the business.

Dec. 1	Sold personal investment in Nike stock, which she had owned for several years, receiving $30,000 cash.
2	Deposited the $30,000 cash from the sale of the Nike stock in her personal bank account.
3	Deposited $89,000 cash in a new business bank account titled Abby Perry, Attorney. The business issued common stock to Perry.
5	Paid $600 cash for ink cartridges for the printer.
7	Purchased computer for the law office, agreeing to pay the account, $8,000, within three months.
9	Received $2,900 cash from customers for services rendered.
15	Received bill from *The Lawyer* for magazine subscription, $300. (Use Miscellaneous Expense account.)
23	Finished court hearings on behalf of a client and submitted a bill for legal services, $8,000, on account.
28	Paid bill from *The Lawyer*.
30	Paid utilities, $900.
31	Received $2,800 cash from clients billed on Dec. 23.
31	Cash dividends of $3,000 were paid to stockholders.

Requirements

1. Analyze the effects of the preceding events on the accounting equation of Abby Perry, Attorney. Use a format similar to Exhibit 1-6.

2. Prepare the following financial statements:

- **a.** Income statement for the month ended December 31, 2024.
- **b.** Statement of retained earnings for the month ended December 31, 2024.
- **c.** Balance sheet as of December 31, 2024.

d. Statement of cash flows for the month ended December 31, 2024.

3. Calculate Abby Perry, Attorney's return on assets. Round to the nearest whole percent.

SOLUTION

Requirement 1

	ASSETS							=	LIABILITIES	+	EQUITY								
											Contributed Capital	+	Retained Earnings						
	Cash	+	Accounts Receivable	+	Office Supplies	+	Computer	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Utility Expense	–	Misc. Expense
3	+89,000										+89,000								
5	–600				+600														
Bal.	$88,400				$600	+		=		+	$89,000								
7							+8,000		+8,000										
Bal.	$88,400			+	$600	+	$8,000	=	$8,000	+	$89,000								
9	+2,900														+2,900				
Bal.	$91,300			+	$600	+	$8,000	=	$8,000	+	$89,000			+	$2,900				
15									+300										–300
Bal.	$91,300			+	$600	+	$8,000	=	$8,300	+	$89,000			+	$2,900	–		–	$300
23			+8,000												+8,000				
Bal.	$91,300	+	$8,000	+	$600	+	$8,000	=	$8,300	+	$89,000			+	$10,900	–		–	$300
28	–300								–300										
Bal.	$91,000	+	$8,000	+	$600	+	$8,000	=	$8,000	+	$89,000			+	$10,900	–		–	$300
30	–900																–900		
Bal.	$90,100	+	$8,000	+	$600	+	$8,000	=	$8,000	+	$89,000			+	$10,900	–	$900	–	$300
31	+2,800		–2,800																
Bal.	$92,900	+	$5,200	+	$600	+	$8,000	=	$8,000	+	$89,000			+	$10,900	–	$900	–	$300
31	–3,000												–3,000						
Bal.	$89,900	+	$5,200	+	$600	+	$8,000	=	$8,000	+	$89,000	–	$3,000	+	$10,900	–	$900	–	$300

P-F:1-54B, cont.
Requirement 2a

ABBY PERRY, ATTORNEY
Income Statement
Month Ended December 31, 2024

Revenues:		
Service Revenue		$ 10,900
Expenses:		
Utility Expense	$ 900	
Miscellaneous Expense	300	
Total Expenses		1,200
Net Income		$ 9,700

Requirement 2b

ABBY PERRY, ATTORNEY
Statement of Retained Earnings
Month Ended December 31, 2024

Retained Earnings, December 1, 2024	$ 0
Net income for the month	9,700
	9,700
Dividends	(3,000)
Retained Earnings, December 31, 2024	$ 6,700

Requirement 2c

ABBY PERRY, ATTORNEY
Balance Sheet
December 31, 2024

Assets		Liabilities	
Cash	$ 89,900	Accounts Payable	$ 8,000
Accounts Receivable	5,200		
Office Supplies	600	Stockholders' Equity	
Computer	8,000	Common Stock	89,000
		Retained Earnings	6,700
		Total Stockholders' Equity	95,700
Total Assets	$ 103,700	Total Liabilities and Stockholders' Equity	$ 103,700

P-F:1-54B, cont.
Requirement 2d

ABBY PERRY, ATTORNEY
Statement of Cash Flows
Month Ended December 31, 2024

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 5,700
Payments:		
To suppliers		(1,800)
Net cash provided by operating activities		3,900
Cash flows from investing activities:		0
Cash flows from financing activities		
Issued common stock	$ 89,000	
Payment of cash dividends	(3,000)	
Net cash provided by financing activities		86,000
Net increase in cash		89,900
Cash balance, December 1, 2024		0
Cash balance, December 31, 2024		$ 89,900

Requirement 3

Average total assets = (Beginning total assets + ending total assets) / 2
Average total assets = ($0 + $103,700) / 2 = $51,850

ROA = Net income / Average total assets
ROA = $9,700 / $51,850 = 0.19 = 19% (rounded)

Using Excel

The student templates for *Using Excel* are available online in MyLab Accounting in the Multimedia Library or at http://www.pearsonhighered.com/Horngren. The solution to *Using Excel* is located in MyLab Accounting in the Instructor Resource Center or at http://www.pearsonhighered.com/Horngren.

Continuing Problem

P1-55 is the first problem in a continuing problem that will be used throughout the chapters to reinforce the concepts learned.

P1-55 Using the accounting equation for transaction analysis, preparing financial statements, and calculating return on assets (ROA)

Canyon Canoe Company is a service-based company that rents canoes for use on local lakes and rivers. Amber and Zack Wilson graduated from college about 10 years ago. They both worked for one of the “Big Four” accounting firms and became CPAs. Because they both love the outdoors, they decided to begin a new business that will combine their love of outdoor activities with their business knowledge. Amber and Zack decide that they will create a new corporation, Canyon Canoe Company, or CCC for short. The business began operations on November 1, 2024.

Nov. 1	Received $16,000 cash to begin the company and issued common stock to Amber and Zack.
2	Signed a lease for a building and paid $1,200 for the first month’s rent.
3	Purchased canoes for $4,800 on account.
4	Purchased office supplies on account, $750.
7	Earned $1,400 cash for rental of canoes.
13	Paid $1,500 cash for wages.
15	Paid $50 dividends to stockholders.
16	Received a bill for $150 for utilities. (Use separate payable account.)
20	Received a bill for $175 for cell phone expenses. (Use separate payable account.)
22	Rented canoes to Early Start Daycare on account, $3,000.
26	Paid $1,000 on account related to the November 3, 2024, purchase.
28	Received $750 from Early Start Daycare for canoe rental on November 22, 2024.
30	Paid $100 dividends to stockholders.

Requirements

1. Analyze the effects of Canyon Canoe Company’s transactions on the accounting equation. Use the format of Exhibit 1-6, and include these headings: Cash; Accounts Receivable; Office Supplies; Canoes; Accounts Payable; Utilities Payable; Telephone Payable; Common Stock; Dividends; Canoe Rental Revenue; Rent Expense; Utilities Expense; Wages Expense; and Telephone Expense.
2. Prepare the income statement of Canyon Canoe Company for the month ended November 30, 2024.
3. Prepare the statement of retained earnings for the month ended November 30, 2024.

4. Prepare the balance sheet as of November 30, 2024.

5. Calculate the return on assets for Canyon Canoe Company for November 2024.

SOLUTION

Requirement 1

	ASSETS							=	LIABILITIES					+	EQUITY												
															Contributed Capital	+	Retained Earnings										
	Cash	+	Accounts Receivable	+	Office Supplies	+	Canoes	=	Accounts Payable	+	Utilities Payable	+	Telephone Payable	+	Common Stock	–	Dividends	+	Canoe Rental Revenue	–	Rent Expense	–	Utilities Expense	–	Wages Expense	–	Telephone Expense
1	+16,000														+16,000												
2	–1,200																				–1,200						
Bal.	$14,800							=						+	$16,000					–	$1,200						
3							+4,800		+4,800																		
Bal.	$14,800					+	$4,800	=	$4,800					+	$16,000					–	$1,200						
4					+750				+750																		
Bal.	$14,800				$750	+	$4,800	=	$5,550					+	$16,000					–	$1,200						
7	+1,400																		+1,400								
Bal.	$16,200			+	$750	+	$4,800	=	$5,550					+	$16,000			+	$1,400	–	$1,200						
13	–1,500																								–1,500		
Bal.	$14,700			+	$750	+	$4,800	=	$5,550					+	$16,000			+	$1,400	–	$1,200			–	$1,500		
15	–50																–50										
Bal.	$14,650			+	$750	+	$4,800	=	$5,550					+	$16,000	–	$50	+	$1,400	–	$1,200			–	$1,500		
16											+150												–150				
Bal.	$14,650			+	$750	+	$4,800	=	$5,550	+	$150			+	$16,000	–	$50	+	$1,400	–	$1,200	–	$150	–	$1,500		
20													+175														–175
Bal.	$14,650			+	$750	+	$4,800	=	$5,550	+	$150	+	$175	+	$16,000	–	$50	+	$1,400	–	$1,200	–	$150	–	$1,500	–	$175
22			+3,000																+3,000								
Bal.	$14,650	+	$3,000	+	$750	+	$4,800	=	$5,550	+	$150	+	$175	+	$16,000	–	$50	+	$4,400	–	$1,200	–	$150	–	$1,500	–	$175
26	–1,000								–1,000																		
Bal.	$13,650	+	$3,000	+	$750	+	$4,800	=	$4,550	+	$150	+	$175	+	$16,000	–	$50	+	$4,400	–	$1,200	–	$150	–	$1,500	–	$175
28	+750		–750																								
Bal.	$14,400	+	$2,250	+	$750	+	$4,800	=	$4,550	+	$150	+	$175	+	$16,000	–	$50	+	$4,400	–	$1,200	–	$150	–	$1,500	–	$175
30	–100																–100										
Bal.	$14,300	+	$2,250	+	$750	+	$4,800	=	$4,550	+	$150	+	$175	+	$16,000	–	$150	+	$4,400	–	$1,200	–	$150	–	$1,500	–	$175

P-F:1-55, cont.
Requirement 2

CANYON CANOE COMPANY
Income Statement
Month Ended November 30, 2024

Revenue:		
Canoe Rental Revenue		$ 4,400
Expenses:		
Wages Expense	$ 1,500	
Rent Expense	1,200	
Telephone Expense	175	
Utilities Expense	150	
Total Expense		3,025
Net Income		$ 1,375

Requirement 3

CANYON CANOE COMPANY
Statement of Retained Earrings
Month Ended November 30, 2024

Retained Earnings, November 1, 2024	$ 0
Net income for the month	1,375
	1,375
Dividends	(150)
Retained Earnings, November 30, 2024	$ 1,225

Requirement 4

CANYON CANOE COMPANY
Balance Sheet
November 30, 2024

Assets		Liabilities	
Cash	$ 14,300	Accounts Payable	$ 4,550
Accounts Receivable	2,250	Utilities Payable	150
Office Supplies	750	Telephone Payable	175
Canoes	4,800	Total Liabilities	4,875
		Stockholders' Equity	
		Common Stock	16,000
		Retained Earnings	1,225
		Total Stockholder's Equity	17,225
Total Assets	$ 22,100	Total Liabilities and Stockholders' Equity	$ 22,100

P-F:1-55, cont.

Requirement 5

Average total assets = ($0 + $22,100) / 2 = $11,050

Return on assets = Net income / Average total assets = $1,375 / $11,050 = 0.124 = 12.4%

Critical Thinking

Tying It All Together Case F:1-1
Before you begin this assignment, review the Tying It All Together feature in the chapter.

Starbucks Corporation is the premier roaster, marketer, and retailer of specialty coffee in the world, operating in 68 countries. Starbucks generates revenues through company-operated stores, licensed stores, and consumer packaged goods. In fiscal 2018, revenues from company-operated stores accounted for 52% of total revenues, while the other 48% of total revenues was earned from the company's licensed stores. Starbucks states that its retail objective is to be the leading retailer and brand of coffee and tea by selling the finest quality coffee, tea, and related products. In addition, the company strives to provide the *Starbucks Experience* by exemplifying superior customer service and providing clean and well-maintained stores. Part of this experience involves providing free internet service to customers while they are enjoying their food and beverages.

Requirements

1. How would the cost of internet service be reported by Starbucks and on which financial statement?
2. Suppose Starbucks receives a bill from its internet service provider but has not yet paid the bill. What would be the effect on assets, liabilities, and equity when Starbucks receives this bill?
3. What would be the effect on assets, liabilities, and equity when Starbucks pays its internet service bill?
4. Suppose Starbucks expects that the cost of internet service will increase by 4% in the coming year. What would be the impact on Starbucks' net income? How might Starbucks overcome this impact?

SOLUTION

Requirement 1

Starbucks Corporation would report the cost of internet service as an expense on its income statement. Most likely, the expense would be included in Store Operating Expenses.

Requirement 2

When Starbucks receives a bill from its internet service provider, Starbucks would record the following:
Increase Accounts Payable
Increase Store Operating Expenses
This would cause liabilities to increase and equity to decrease.

Requirement 3

When Starbucks pays the bill, Starbucks would record the following:
Decrease Cash
Decrease Accounts Payable
This would cause assets to decrease and liabilities to decrease.

Requirement 4

An increase in the cost of internet service in the coming year would cause expenses to increase. If revenue did not change, this would cause net income to decrease. Starbucks might overcome this impact by charging customers for using the internet service, thereby offsetting the increase in expenses with additional revenue. This change, though, might discourage customers from visiting Starbucks when other competitors might offer free internet service. Another alternative would be to increase the prices of the products sold to cover the increased cost of internet service.

Decision Case F:1-1

Let's examine a case using Greg's Tunes and Sal's Silly Songs. It is now the end of the first year of operations, and the stockholders want to know how well each business came out at the end of the year. Neither business kept complete accounting records, and no dividends were paid. The businesses throw together the data shown on the next page at year-end:

Sal's Silly Songs:	
Total Assets	$ 23,000
Common Stock	8,000
Total Revenues	35,000
Total Expenses	22,000
Greg's Tunes:	
Total Liabilities	$ 10,000
Common Stock	6,000
Total Expenses	44,000
Net Income	9,000

To gain information for evaluating the businesses, the stockholders ask you several questions. For each answer, you must show your work to convince the stockholders that you know what you are talking about.

Requirements

1. Which business has more assets?
2. Which business owes more to creditors?
3. Which business has more stockholders' equity at the end of the year?
4. Which business brought in more revenue?
5. Which business is more profitable?
6. Which of the foregoing questions do you think is most important for evaluating these two businesses? Why?
7. Which business looks better from a financial standpoint?

SOLUTION
Requirement 1

Greg's Tunes has more assets.
Sal's $23,000, Greg's $25,000 ($10,000 + $6,000 + $9,000)

Requirement 2

Greg's Tunes owes more to creditors.
Sal's $2,000 ($23,000 – ($8,000 + $35,000 – $22,000)), Greg's $10,000

Requirement 3

Sal's Silly Songs has more stockholders' equity.
Sal's $21,000 ($8,000 + $35,000 – $22,000)   Greg's $15,000 ($6,000 + $9,000)

Requirement 4

Greg's Tunes earned more revenue.
Sal's $35,000, Greg's $53,000 ($9,000 + $44,000)

Requirement 5

Sal's Silly Songs is more profitable.
Sal's $13,000 ($35,000 – $22,000), Greg's $9,000

Requirement 6

This question is opinion based. More profit is good, which means Sal's has the advantage. Greg's also owes more to creditors which is risky. Sal's has much more equity, which minimizes risk.

Requirement 7

Sal's looks financially better, because Sal earned more net income on less total revenue. Sal also owes less to creditors and has more equity.

Ethical Issues F:1-1

The tobacco companies have paid billions because of smoking-related illnesses. In particular, Philip Morris, a leading cigarette manufacturer, paid more than $3,000,000,000 in settlement payments in one year.

Requirements

1. Suppose you are the chief financial officer (CFO) responsible for the financial statements of Philip Morris. What ethical issue would you face as you consider what to report in your company's annual report about the cash payments? What is the ethical course of action for you to take in this situation?
2. What are some of the negative consequences to Philip Morris for not telling the truth? What are some of the negative consequences to Philip Morris for telling the truth?

SOLUTION

Requirement 1

The chief financial officer (CFO) of Philip Morris would be torn between addressing the fact that the payments are related to illnesses caused by the company's products, or alternatively, omitting or concealing this fact. The ethical course of action for the CFO is to be open, honest and forthcoming about the reasons for the payments.

Requirement 2

Negative consequences of not telling the truth are as follows: If users of the financial statements feel they are only getting part of the truth, or that the reports are distorting the information, this will damage the credibility of the company, and damage the company's reputation.

Negative consequences of telling the truth include painting so bleak a picture of the effects of smoking that investors will view Philip Morris as too risky and stop buying the company's stock. Another negative consequence would be to create the impression that the company is engaged in unethical behavior by selling a product that damages people's health.

Fraud Case F:1-1

Exeter is a building contractor on the Gulf Coast. After losing a number of big lawsuits, it was facing its first annual net loss as the end of the year approached. The owner, Hank Snow, was under intense pressure from the company's creditors to report positive net income for the year. However, he knew that the controller, Alice Li, had arranged a short-term bank loan of $10,000 to cover a temporary shortfall of cash. He told Li to record the incoming cash as "construction revenue" instead of a loan. That would nudge the company's income into positive territory for the year, and then, he said, the entry could be corrected in January when the loan was repaid.

Requirements

1. How would this action affect the year-end income statement? How would it affect the year-end balance sheet?

2. If you were one of the company's creditors, how would this fraudulent action affect you?

SOLUTION

Requirement 1

The proposed action would increase net income by increasing revenues. It would distort the balance sheet by understating liabilities and overstating equity.

Requirement 2

By making the company's financial situation look better than it actually was, the company's creditors would likely be more willing to extend credit to the company, and offer the credit at a lower interest rate.

Financial Statement Case F1-1

This and similar cases in later chapters focus on the financial statements of a real company—**Target Corporation**, a discount merchandiser that sells a wide assortment of general merchandise and food. Target sells both national and private and exclusive brands, with approximately one-third of its 2018 sales related to private and exclusive brands. As you work each case, you will gain confidence in your ability to use the financial statements of real companies.

Visit **http://www.pearsonhighered.com/Horngren** to view a link to Target Corporation's Fiscal 2018 Annual Report.

Requirements

1. How much in cash (including cash equivalents) did Target Corporation have on February 2, 2019?

2. What were the company's total assets at February 2, 2019? At February 3, 2018?

3. Why were the financial sttements for year ending on February 3, 2018 adjusted? Review Note 2 of the accompanying Notes to Consolidated Financial Statements.

3. Write the company's accounting equation at February 2, 2019, by filling in the dollar amounts:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

4. Identify total sales (revenues) for the year ended February 2, 2019. How much did total revenue increase or decrease from fiscal year 2017 to fiscal year 2018? (Because Target's fiscal year end of

February 2, 2019 ends at the beginning of 2019, the majority of Target's financial results were obtained in the calendar year of 2018. As a result, Target calls the fiscal year 2018 even though the year reported on the annual report ends on February 2, 2019.)

5. How much net income (net earnings) or net loss did Target earn for 2018 and for 2017? Based on net income, was 2018 better or worse than 2017?

6. Calculate Target Corporation's return on assets for the year ending February 2, 2019. Round to one decimal place.

7. How did Target Corporation's return on assets compare to Kohl's Corporation return on assets?

SOLUTION
Requirement 1

$1,556 (in millions)

Requirement 2

$41,290 (in millions) at February 2, 2019; $40,303 (in millions) at February 3, 2018

Requirement 3

Target Corporation adopted Accounting Standards Update (ASU) No. 2014-09—*Revenue from Contracts with Customers (Topic 606)* and ASU No. 2016-02—*Leases (Topic 842)*. This required the company to adjust its financial statements for year ending on February 3, 2018.

Requirement 4

Assets	=	Liabilities	+	Equity
$41,290	=	($15,014 + $14,979)	+	$11,297
$41,290	=	$29,993	+	$11,297

(shown in millions)

Requirement 5

$75,356 (in millions) for year ended February 2, 2019. This is an increase of $2,642 (in millions) over fiscal year 2017. ($75,356 − $72,714)

Requirement 6

$2,937 (in millions) in 2018
$2,914 (in millions) in 2017
Target's net income increased by $23 (million) from fiscal 2017 to fiscal 2018 ($2,937 − $2,914).

Financial Statement Case F:1-1, cont.
Requirement 7

All amounts in millions.
Average total assets = ($40,303 + $41,290) / 2 = $40,797 (rounded)
Return on assets = $2,937 / $40,797 = 0.0719 = 7.2% (rounded)

Requirement 8

Target Corporation's return on assets (7.2%) was one (1) percentage point higher than Kohl's Corporation (6.2%).

Chapter 1

Accounting and the Business Environment

Directed Reading Guide

LO1. Why is Accounting important?

a) In your own words, what is *Accounting*? **Accounting is the information system that measures business activities, processes the information into reports, and communicates the results to decision makers.**

  i) Who are the typical users of *Financial Accounting* information? **Financial accounting provides information for external decision makers such as investors, lenders, customers, and the federal government.**

  ii) Who are the typical users of *Managerial Accounting* information? **Managerial accounting focuses on information for internal decision makers, such as the company's managers and employees.**

b) What are the specialties of a Certified Financial Planner?
CFP are certified professionals who specialized in budgeting, planning for retirement, and managing finances.

In MyLab Accounting, complete Try It! and S-F:1-1.

LO2. What are the organizations and rules that govern accounting?

a) Briefly describe the purpose of each of the following:
  i) *Financial Accounting Standards Board (FASB)* – **A privately funded organization that oversees the creation and governance of accounting standards.**
  ii) *Securities and Exchange Commission (SEC)* – **A U.S. governmental agency that oversees the U.S. financial markets.**
  iii) *Generally Accepted Accounting Principles (GAAP)* – **Is the main U.S. accounting rule book that is currently created and governed by the FASB. It identifies the framework of financial statements and creates the acceptable accounting practices.**

b) Describe each of the following types of business organizations:
  i) *Sole Proprietorship* - **A business with a single owner, but students may include other characteristics.**

ii) *Partnership* – **A business with two or more owners but is not organized as a corporation, but students may include other characteristics.**

iii) *Corporation* – **A business organized under state law that is a separate legal entity, but students may include other characteristics.**

iv) Limited-Liability Company (LLC) – **A company in which each member is only liable for his or her own actions, but students may include other characteristics.**

c) What is the *Sarbanes-Oxley Act?* **This act requires management to review internal control and take responsibility of the accuracy and completeness of their financial reports.**

In MyLab Accounting, complete Try It! and S-F:1-2 through S-F:1-5.

LO3. What is the accounting equation?

a) Please write the basic accounting equation: **Assets = Liabilities + Equity**

a. List 3 examples of *Assets* **- Examples may include Cash, Merchandise Inventory, Furniture, and Land.**

b. List 3 examples of *Liabilities* – **Examples may include Accounts Payable, Notes Payable, and Salaries Payable.**

c. In your own words, what is *Equity* **– The owner's claims to the assets of the business.**

In MyLab Accounting, complete Try It! and S-F:1-6 through S-F:1-8.

LO4. How do you analyze a transaction?

a) In your own words, what is *transaction*? **A transaction is any event that affects the financial position of the business and can be measured with faithful representation.**

b) Which accounts would be affected by each of the following transactions and identify if the account would increase or decrease.

i) The company received cash in exchange for the issuance of common stock

Example: Cash (Increase) and Common Stock (Increase)

ii) The company paid cash for land - **Cash (Decrease) and Land (Increase)**

iii) Performed services for clients on account – **Accounts Receivable (Increase) and Service Revenue (Increase)**

iv) Purchased Office Supplies on account – **Supplies (Increase) and Accounts Payable (Increase)**

In MyLab Accounting, complete Try It! and S-F:1-9 to S-F:1-10.

LO5. How do you prepare financial statements?

a) What two types of accounts appear on the income statement? **Revenues and Expenses**

b) Included on the statement of retained earnings is the net income and which accounts? **Retained Earnings and Dividends**

c) What does the balance sheet tell an investor? **It is a snapshot of the entity's overall health of a business.**

d) What are the three sections of the statement of cash flows? **Operating, Investing, and Financing**

In MyLab Accounting, complete Try It! and S-F:1-11 through S-F:1-15.

L06. How do you use financial statements to evaluate business performance?

a) What is the formula for return on assets? **Net income / Average total assets**

b) Net income is $10,000 and total assets are $150,000 for the current year. Total assets for the previous year was $100,000. What is the ROA?

$10,000 / ($150,000 + $100,000) / 2) = .08 = 8%

In MyLab Accounting, complete Try It! and S-F:1-16.

Chapter 1

Accounting and the Business Environment

Chapter 1: Overview

The chapter begins with an introduction to accounting and a brief discussion of why accounting is important. The differences between financial and managerial accounting are delineated. The text discusses how accounting information is needed by various users—individuals, businesses, investors, creditors, and taxing authorities. Reasons accounting is important to students not majoring in accounting and career paths available to accounting majors are briefly described, including a comparison of various accounting positions. The role of governing organizations such as the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC) as well as the FASB's relationships with both congressionally created and private accounting groups are explained. Generally Accepted Accounting Principles (GAAP) are introduced. The sole proprietorship, partnership, corporation, and limited liability company (LLC) forms of business are briefly described in the context of the economic entity assumption. In addition, the cost principle, going concern assumption, and monetary unit assumption are explained. The nature of International Financial Reporting Standards (IFRS) and the role of the International Accounting Standards Board (IASB) in their development are explained. The role of ethics in accounting and business is described. The U.S. government's passing of the Sarbanes-Oxley Act (SOX) and the creation of the Public Company Accounting Oversight Board (PCAOB) are presented. A Data Analytics in Accounting feature highlights the importance of data analytics skills for accountants.

The next section of the chapter introduces the accounting equation: Assets = Liabilities + Equity. Each element of the accounting equation is defined. Nine basic business transactions are analyzed, and their impact on the accounting equation is discussed. The financial statements—income statement, statement of retained earnings, balance sheet, and statement of cash flows—are illustrated. The interrelationship of the financial statements is emphasized.

A Tying It All Together feature poses four questions regarding a company's asset, liability, revenue, and expense accounts and the proper financial statement reporting for each. Financial statements and return on assets (ROA) are used to evaluate business performance. A Decisions feature helps students see how financial statements and ROA can be used to make real-world decisions. The Review section includes Things You Should Know which highlights the information students should have acquired from the chapter. A Check Your Understanding feature allows students to record the effects of transactions on the accounting equation, prepare financial statements, and calculate ROA. A list of Key Terms is provided. A Quick Check gives students a chance to assess their knowledge of the chapter learning objectives.

Chapter 1: Learning Objectives

LO 1. Explain why accounting is important and list the users of accounting information

LO 2. Describe the organizations and rules that govern accounting

LO 3. Describe the accounting equation and define assets, liabilities, and equity

LO 4. Use the accounting equation to analyze transactions

LO 5. Prepare financial statements

LO 6. Use financial statements and return on assets (ROA) to evaluate business performance

Chapter 1: Teaching Outline with Lecture Notes

LO 1. Explain why accounting is important and list the users of accounting information

a) Define the term accounting and explain what accountants do

b) Exhibit 1-1: Pathways Vision Model

Lecture Notes: The model emphasizes that good decisions have an impact on accounting judgments and economic activity, thus creating a circular flow of cause and effect. Accounting is defined as the information system that measures business activities, processes the information into reports, and communicates the results to decision makers. However, accountants do not simply prepare various types of accounting reports and tax returns. They also review and interpret business information using critical thinking and judgment to partner with clients and managers to help them make better business decisions.

c) Differentiate between financial accounting and managerial accounting

d) Exhibit 1-2: Decision Making: Financial Versus Managerial Accounting

Lecture Notes: Financial accounting provides historical information—the company reports on events that have already occurred—to external decision makers, including investors and creditors. Managerial accounting provides more future-oriented information—many companies prepare budgets, forecasts, and projections based on future events—for internal decision makers (company managers and executives).

e) Identify the users of accounting information:

i. Individuals

ii. Businesses

iii. Investors

iv. Creditors

v. Taxing authorities

Lecture Notes: The officers of a company may be (and probably are) stockholders as well. Not all investors are “outside” the company. The financial statements are the primary tools for providing information to outside investors; but officers may also use the statements, along with other financial information, to manage the company on a day-to-day basis.

f) Describe career options and certifications available in the accounting profession

Lecture Notes: Certified Public Accountants, or CPAs, are licensed professional accountants who serve the general public. Certified Management Accountants, or CMAs, are certified professionals who specialize in accounting and financial management knowledge. Not all accountants are licensed, and those who are may not necessarily be members of the AICPA and IMA, the professional associations described in the textbook. There are many other types of accounting-related associations and certifications in the United States and elsewhere around the world, including Certified Internal Auditor (CIA), Certified Government Financial Manager (CGFM), Certified Fraud Examiner (CFE), Certified Financial Manager (CFM), Enrolled Agent (EA), Certified Global Management Accountant (CGMA), Chartered Accountant (CA), Certified Financial Planner (CFP), and many more.

Accountants also need data analytics skills to be successful. An understanding of how technology is used to process financial information is critical in today's job market.

g) Exhibit 1-3: Comparison of Accounting Positions

Suggested In-Class Exercise: E1-17

LO 2. Describe the organizations and rules that govern accounting

a) Identify accounting governing organizations, including the Financial Accounting Standards Board (FASB), the Security Exchange Commission (SEC), and the International Accounting Standards Board (IASB)

b) Describe Generally Accepted Accounting Principles (GAAP) and introduce the primary objective of financial reporting

c) Explain the economic entity assumption

i. Identify the different types of business organizations:

- Sole proprietorship
- Partnership
- Corporation
- Limited-liability company (LLC)

ii. Exhibit 1-4: Business Organizations

iii. Describe the distinguishing characteristics and organization of a corporation:

- Separate legal entity
- Continuous life and transferability of ownership
- No mutual agency

- Limited liability of stockholders
- Separation of ownership and management
- Corporate taxation
- Government regulation
- Organization of a corporation

iv. Exhibit 1-5: Structure of a Corporation

Lecture Notes: Corporate status is not based on the size of the company. Not all large companies are corporations, and not all small companies are sole proprietorships or partnerships. A corporation could have only one stockholder. Why would a one-shareholder business incorporate the business in this case? One reason is limited liability protection. Regardless of the number of stockholders, all corporations follow the same general corporate procedures.

d) Explain the cost principle

e) Explain the going concern assumption

Lecture Note: Point out to students that if it is known that a company should not be considered a going concern, different accounting rules from those covered in this course apply to that company.

f) Explain the monetary unit assumption

Lecture Note: Point out to students that an implication of the monetary unit assumption is that business activities that cannot be expressed in monetary units are not represented within the financial statements. For example, a company with a well-trained workforce, talented managers, a good reputation with customers, and innovative research and development has important assets that are not represented on the balance sheet.

g) Describe International Financial Reporting Standards (IFRS)

h) Ethics in accounting and business

i. Sarbanes-Oxley Act (SOX)

ii. Public Company Accounting Oversight Board (PCAOB)

Lecture Notes: Not all accounting information and financial statements are publicly available; such information is disclosed by public companies only. Company size is not a determinant of public ownership; some large companies are still privately held. All companies, public and private, can follow GAAP. However, this may not be a requirement for private companies. Private companies can use other bases of accounting, such as the cash basis, unless GAAP is required due to an audit. There is also a difference between record keeping and financial statement preparation. Companies can keep their accounting records on another basis and convert the financial statements to GAAP. For example, small private companies may use the cash basis for record keeping and convert to the accrual basis for financial statement preparation.

The Sarbanes-Oxley Act and the PCAOB relate to public companies. As a rule, public companies are more regulated (in terms of accounting information) than private companies. Some companies are now going private; one reason for doing so may be to reduce the compliance cost associated with these additional regulations.

Although much has been written and discussed about the possibility of convergence of U.S. GAAP and IFRS, complete convergence appears to be increasingly unlikely. The SEC previously announced a policy dedicated to investigating endorsement of IFRS, but political winds now seem to be shifting. Furthermore, standard-setting paths of FASB and IASB sometimes converge, as in recent development of unified revenue recognition standards, but sometimes fail to converge, as in recent issuance of very different guidance on leases. For now, U.S. GAAP continue to be different in many respects from IFRS, a condition which seems likely to continue for the foreseeable future, although efforts to increase similarities also continue to meet with some degree of success.

Suggested In-Class Exercise: E1-18

LO 3. Describe the accounting equation and define assets, liabilities, and equity

a) The accounting equation: Assets = Liabilities + Equity

b) Define assets

c) Define liabilities

d) Define equity

Lecture Notes: The accounting equation must always balance. Demonstrate that the accounting equation always balances, not just at the beginning of the year (or any accounting period). During the year, the change in assets equals the change in liabilities plus the change in equity. At the end of the year, the new values of the accounting equation will balance.

Beginning of Year	Assets =	Liabilities +	Equity
During the Year	Δ Assets =	Δ Liabilities +	Δ Equity
End of Year	New Assets =	New Liabilities +	New Equity

Discuss with students that while most textbook examples show companies that are profitable from the very beginning and always have positive equity balances, stockholders' equity can be negative if liabilities exceed assets, but the accounting equation would still balance. If a company records net losses in the very beginning, Retained Earnings will be negative, and the company will record Accumulated Deficit instead of Retained Earnings. For example, a company could have $100 of assets, $150 of liabilities, and $(50) of equity, and the accounting equation would equal $100 on each side. While this position is usually not desirable, it is not unusual in the business world, especially for new businesses.

Suggested In-Class Exercise: E1-21

LO 4. Use the accounting equation to analyze transactions

a) Transaction analysis for Smart Touch Learning

i. Transaction 1—Stockholder contribution

ii. Transaction 2—Purchase of land for cash

iii. Transaction 3—Purchase of office supplies on account

iv. Transaction 4—Earning of service revenue for cash

v. Transaction 5—Earning of service revenue on account

vi. Transaction 6—Payment of expenses with cash

vii. Transaction 7—Payment on account (Accounts Payable)

viii. Transaction 8—Collection on account (Accounts Receivable)

ix. Transaction 9—Payment of cash dividend

b) Exhibit 1-6: Analysis of Transactions, Smart Touch Learning

Lecture Notes: Every basic transaction always affects at least two accounts. Becoming familiar with each of the nine basic transactions and the two accounts affected by each will promote development of students' transaction analysis skills. Demonstrate the following transaction analysis process for each transaction:

1. Identify the accounts and the account type.
2. Decide if each account increases or decreases.
3. Determine if the accounting equation is in balance.

When this process is applied correctly, the accounting equation will always balance. Thus, for all transactions that occur during the year:

During the Year	Δ Assets =	Δ Liabilities +	Δ Equity

Note that every transaction affects the balance sheet in some way—increasing or decreasing an asset, liability, or equity account—but may or may not affect another financial statement. Remind students that there are two main components of equity: contributed capital and retained earnings. Retained earnings is affected by three types of events: revenues, expenses, and dividends. Thus, there are four ways that equity can change during the year:

<table>
<tr><td rowspan="4">During the Year</td><td rowspan="4">Δ Assets =</td><td rowspan="4">Δ Liabilities</td><td>+ Contributed Capital</td></tr>
<tr><td>+ Revenues</td></tr>
<tr><td>– Expenses</td></tr>
<tr><td>– Dividends</td></tr>
</table>

Some students may be confused by how the issuance of stock increases a company's equity. "If the company sells the stock and receives cash in return, how is the stock account increasing?" Explain that when a company issues stock, it increases the amount of common stock outstanding (or in the hands of stockholders). This results in an increase in Assets (Cash) and an increase in Common Stock (Equity).

Also, it may be helpful to point out that some transactions affect only one side of the accounting equation (left or right), yet the accounting equation still balances. For example, when a company purchases supplies with cash, one asset increases and another asset decreases—with no effect on liabilities and equity. Thus, the accounting equation balances.

Suggested In-Class Exercise: E1-27

LO 5. Prepare financial statements

a) Exhibit 1-7: Financial Statements

  i. Exhibit 1-8: Income Statement

  ii. Exhibit 1-9: Statement of Retained Earnings

  iii. Exhibit 1-10: Balance Sheet

  iv. Exhibit 1-11: Statement of Cash Flows

Lecture Notes: Each of the financial statements required by GAAP focuses on a different aspect of the company's financial position or financial activity. All four statements should be completed and analyzed in order to get a complete picture of a company. Emphasize the links between the statements.

The income statement shows the change in equity that results from the operation of the business during the year and is prepared first. The retained earnings statement shows the change in equity from profits earned less dividends paid to the stockholders during the year and is prepared second. Balance sheets show the financial position of the company at specific points in time and is prepared third. The statement of cash flows explains the change in Cash in relation to everything else that changed during the year and is the final statement to be prepared.

Each financial statement should have a company name, a statement title, and some form of date. The income statement tracks profitability—revenues minus expenses. Remember that "profit" doesn't necessarily mean "money"; the profit may not have been collected in cash yet. The statement of retained earnings shows the changes in the portion of equity arising from the results of operations (but not the changes in contributed capital) less dividends paid to stockholders. As profits increase, stockholders' equity will increase; as dividends are paid, profits remaining in the business will decrease. The balance sheet shows the financial position of the company at a specific point in time, such as at the end of the year. The balance sheet will probably change the day after it is prepared. All the other financial statements describe what happened to the company *during* the year. The statement of cash flows describes how the balance of the Cash account changed in relation to changes in other assets, liabilities, and all the components of equity.

Financial position (the balance sheet) is different from profitability (the income statement). A company could be very profitable and do a terrible job of managing its profits or vice versa. Students probably know a person who is like this. Some people have high income levels and end up with very little net worth because they do not manage their finances effectively. On the other hand, some people have modest income levels and do a very good job of managing their finances.

The statement of cash flows shows how the company is generating and using its cash. Students may have heard the phrase “cash is king.” A company must have cash to pay its outstanding bills. Some recent accounting fraud cases involved companies that reported great profits but no corresponding cash flow—a possible red flag!

Net income and cash flow are separate concepts; neither is always positive. A company could have net income and negative cash flow in one year, and then the company could have a net loss and positive cash flow in another year. Many creditors will focus on cash flow in order to determine whether a company can generate cash in order to pay back any outstanding liabilities.

The stockholders’ equity balance does not represent the balance in the Cash account. Students sometimes think the corporation can simply declare dividends from profits earned at any given time. However, the income included in stockholders’ equity is based on accrual accounting and may not yet have been collected in cash. In addition, some items that have been paid in cash may not be included in net income until some future period.

Suggested In-Class Exercises: E1-31, E1-32, E1-33

LO 6. Use financial statements and return on assets (ROA) to evaluate business performance

a) Review financial statements of Kohl’s Corporation. (see http://www.pearsonhighered.com/Horngren)

b) Explain return on assets (ROA)

Lecture Notes: Information presented in the financial statements is largely based on historical cost—the cost principle. The balance sheet values of major assets such as land, buildings, and equipment are based on the historical cost of those assets and may not represent their fair market value. For example, land purchased 10 years ago is likely to be worth more than the original cost, but it would still be valued on the balance sheet at original cost. This difference between the fair market value and the balance sheet value is sometimes called “hidden assets.” How are the “true” values of a company’s assets determined? One could have them appraised, but even then, the current fair market value of assets does not represent the value of the company as a whole. Don’t forget about subtracting liabilities! But, of course, even then the resulting value of stockholders’ equity (fair market value of all the assets minus liabilities) does not necessarily represent the true market value of the company as a whole.

Return on assets measures how well a company uses its assets to generate profits. It is calculated by dividing net income by average total assets. Average total assets is calculated by adding the beginning and ending total assets for the time period and then dividing by two.

Suggested In-Class Exercise: E1-27

Chapter 1: Handout for Student Notes

LO 1. Why is accounting important?

- Decision makers: The users of accounting information
  - Individuals
  - Businesses
  - Investors
  - Creditors
  - Taxing authorities
- Accounting matters

LO 2. What are the organizations and rules that govern accounting?

- Governing organizations
- Generally Accepted Accounting Principles (GAAP)
- The economic entity assumption
  - Distinguishing characteristics and organization of a corporation

- The cost principle
- The going concern assumption
- The monetary unit assumption
- International Financial Reporting Standards
- Ethics in accounting and business

LO 3. What is the accounting equation?

- Assets
- Liabilities
- Equity

LO 4. How do you analyze a transaction?

- Transaction analysis for Smart Touch Learning
  - Transaction 1—Stockholder contribution
  - Transaction 2—Purchase of land for cash

- Transaction 3—Purchase of office supplies on account
- Transaction 4—Earning of service revenue for cash
- Transaction 5—Earning of service revenue on account
- Transaction 6—Payment of expenses with cash
- Transaction 7—Payment on account (Accounts Payable)
- Transaction 8—Collection on account (Accounts Receivable)
- Transaction 9—Payment of cash dividend

LO 5. How do you prepare financial statements?

- Income statement
- Statement of retained earnings
- Balance sheet
- Statement of cash flows

LO 6. How do you use financial statements to evaluate business performance?

- Kohl's Corporation
  (see http://www.pearsonhighered.com/Horngren)

- Return on assets (ROA)

Chapter 1: Student Chapter Summary

LO 1. Explain why accounting is important and list the users of accounting information

Accounting is the language of business. Financial accounting is used by a variety of decision makers outside the company, including individuals, businesses, investors, creditors, and taxing authorities, while managerial accounting is directed to decision makers inside the company. All businesses need accountants. Accountants work in public accounting, private accounting, and governmental accounting jobs. Accountants can be licensed as a Certified Public Accountant (CPA), Certified Global Management Accountant (CGMA), or Certified Management Accountant (CMA), or Certified Financial Planner (CFP). Further, non-accountant business professionals require accounting knowledge as well, as they regularly utilize accounting information to make business decisions.

LO 2. Describe the organizations and rules that govern accounting

The rules that govern accounting are called Generally Accepted Accounting Principles (GAAP). The Financial Accounting Standards Board (FASB) is responsible for the creation and governance of U.S. GAAP. The Securities and Exchange Commission (SEC) oversees the U.S. financial markets and other standard setters, such as the FASB.

A thorough understanding of GAAP is essential to the use and preparation of financial statements. The primary objective of financial reporting is to provide information useful for making investment and credit decisions. Financial statement information must be relevant and have faithful representation to be considered useful. Relevant information is timely and is capable of making a difference in the user's decision. Information is faithfully representative when it is complete, neutral, and free from material error.

Four accounting principles are introduced. The economic entity assumption requires that the subject of a set of accounting financial statements is a single economic unit separate and distinct from its owners and from other economic units. The cost principle requires that transactions record acquisition of assets and services at their actual cost. The going concern assumption specifies that financial reporting should presume the entity will remain in operation for the foreseeable future. The monetary unit assumption requires that only economic events that can be measured in monetary units are represented in the financial statements.

LO 3. Describe the accounting equation and define assets, liabilities, and equity

The fundamental relationship on which all accounting is based is represented by the accounting equation: Assets = Liabilities + Equity. Assets are economic resources with future benefits. Liabilities are obligations owed to others. Equity represents the residual value of the assets left over after obligations represented by the liabilities are fulfilled.

LO 4. Use the accounting equation to analyze transactions

Transactions are economic events that affect the financial position of the company and can be measured reliably. Basic transactions affect at least two accounts. Transactions are analyzed in three steps:

Step 1. Identify the accounts and the account type (Asset, Liability, or Equity).
Step 2. Decide whether each account increases or decreases.
Step 3. Determine whether the accounting equation is in balance.

LO 5. Prepare financial statements

Four financial statements are prepared for each accounting period. The income statement reports net income or net loss, calculated as revenues earned minus expenses incurred, for a specific period of time. The statement of retained earnings reports the change in retained earnings from net income (or net loss) minus dividends for a specific period of time. The balance sheet reports the financial position (assets, liabilities, and equity) of the company at a specific point in time. The statement of cash flows reports the cash receipts and cash payments categorized by operating, investing, and financing activities. The financial statements are prepared in the following order: (1) income statement, (2) statement of retained earnings, (3) balance sheet, and (4) statement of cash flows.

LO 6. Use financial statements and return on assets (ROA) to evaluate business performance

The income statement evaluates profitability. The statement of retained earnings shows the amount of earnings kept and reinvested in the company. The balance sheet lists the economic resources owned, the debts and obligations owed, and the residual interest that remains for the stockholders. The statement of cash flows shows the change in cash resulting from operating, investing, and financing activities. Return on assets measures how profitably the company uses its assets.

Chapter 1: Assignment Grid and Other Materials

	LO 1	LO 2	LO 3	LO 4	LO 5	LO 6
S1-1	X					
S1-2		X				
S1-3		X				
S1-4		X				
S1-5		X				
S1-6			X			
S1-7			X			
S1-8			X			
S1-9				X		
S1-10				X		
S1-11					X	
S1-12					X	
S1-13					X	
S1-14					X	
S1-15					X	
S1-16						X
E1-17	X					
E1-18		X				
E1-19			X		X	
E1-20			X			
E1-21			X			
E1-22			X			
E1-23			X			
E1-24			X			
E1-25				X		
E1-26				X		
E1-27				X		
E1-28				X		
E1-29				X		
E1-30					X	
E1-31					X	
E1-32					X	
E1-33					X	
E1-34					X	
E1-35					X	
E1-36					X	
E1-37					X	
E1-38					X	
E1-39						X

	LO 1	LO 2	LO 3	LO 4	LO 5	LO 6
P 1-40A				X		X
P 1-41A				X		
P 1-42A				X		
P 1-43A					X	
P 1-44A					X	
P 1-45A					X	
P 1-46A				X	X	
P 1-47A				X	X	X
P 1-48B				X		
P 1-49B				X		
P 1-50B					X	
P 1-51B					X	
P 1-52B					X	
P 1-53B					X	
P 1-54B				X	X	X

S – Short Exercises (*Easy)*
E – Exercises (*Moderate)*
P – Problems (*Difficult)*

Other End-of-Chapter Materials:

Continuing Problem P1-55
Tying It All Together Case 1-1
Decision Case 1-1
Ethical Issue 1-1
Fraud Case 1-1
Financial Statement Case 1-1

CHAPTER 1
TEN-MINUTE QUIZ

Circle the letter of the best response.

1. Which of the following organizations oversees the creation and governance of accounting standards in the United States?
   A. American Institute of Certified Public Accountants (AICPA)
   B. Financial Accounting Standards Board (FASB)
   C. International Accounting Standards Board (IASB)
   D. Securities and Exchange Commission (SEC)

2. The ultimate control of the corporation rests with the ______________?
   A. President
   B. Chairperson of the Board of Directors
   C. Board of Directors
   D. Stockholders

3. Which accounting principle or assumption states that acquired assets and services should be recorded at the actual amount paid?
   A. Economic entity assumption
   B. Cost principle
   C. Monetary unit assumption
   D. Going concern assumption

4. Blue Dog Boutique is famous for fashion collars and other high-end pet supplies. At the end of a recent year, Blue Dog's total assets added up to $48,000,000, and liabilities were $32,000,000. How much was Blue Dog's equity?
   A. $16,000,000
   B. $32,000,000
   C. $48,000,000
   D. $80,000,000

5. Assume Blue Dog Boutique purchased office supplies on account for $85,000. How would this transaction affect Blue Dog's accounting equation?
   A. Increase assets and liabilities by $85,000
   B. Decrease assets and liabilities by $85,000
   C. Increase assets and equity by $85,000
   D. None of the above

6. Which of the following best describes the role of the Public Company Accounting Oversight Board (PCAOB)?
   A. Oversees the creation and governance of accounting standards in the United States
   B. Oversees U.S. financial markets
   C. Monitors the work of independent accountants who audit public companies
   D. Creates International Financial Reporting Standards

7. Last year, Accounting Service Company (ASC) sold services on account for $150,000 and incurred expenses totaling $96,000. At the end of the year, the balance for Accounts Receivable was $20,000, and the balance for Accounts Payable was $16,000. What was ASC's net income or net loss for the year?
   A. Net income of $54,000
   B. Net income of $76,000
   C. Net income of $170,000
   D. Net income of $246,000

8. The income statement reports the
   A. Financial position for a specific period.
   B. Results of operations for a specific period.
   C. Financial position on a specific date.
   D. Results of operations on a specific date.

9. Blue Dog Boutique reported net income of $1,800,000 on the 20XX income statement. The company reported beginning total assets of $16,000,000 and ending total assets of $20,000,000 on the 20XX balance sheet. What is Blue Dog's return on assets for 20XX?
   A. 9.00%
   B. 10.00%
   C. 11.25%
   D. 25.00%

10. Which of the following is a characteristic of a limited-liability company?
   A. Indefinite life
   B. Separate taxable entity
   C. Personal liability
   D. All of the above

Answer Key to Ten-Minute Quiz:

1. B

2. D

3. B

4. A
Assets = Liabilities + Equity
\$48,000,000 = \$32,000,000 + Equity
Equity = \$48,000,000 −\$32,000,000 = \$16,000,000

5. A

6. C

7. A
Net Income (Loss) = Revenues −Expenses = \$150,000 −\$96,000 = \$54,000

8. B

9. B
Return on assets = Net Income / Average total assets = \$1,800,000 / [(\$16,000,000 + \$20,000,000) / 2] = \$1,800,000 / \$18,000,000 = 10.00%

10. A

Extra Critical Thinking Questions

Decision Case 1-2

Sofia and Luisa Ruiz are sisters and have had a lifelong dream to open a bed and breakfast together named Dos Hermanas. They invested $200,000 of their own money, and the company issued common stock to them. The business then got a $200,000 bank loan for the total of $400,000 needed to get started. The company bought a Spanish mission style home in Santa Fe for $160,000. It was in need of renovations which cost another $100,000. They found most of the furniture at antique shops and flea markets—for a total cost of $40,000. Kitchen equipment cost $20,000, and a computer system cost $4,000.

Prior to the grand opening, the banker requests a report on their activities thus far. The bank statement of Dos Hermanas shows a cash balance of $76,000. Sofia and Luisa believe that the $76,000 represents net income for the period, and they feel pretty good about the results of their business. To better understand how well they are doing, they prepare the following income statement for presentation to the bank:

DOS HERMANAS BED AND BREAKFAST
Income Statement
Six Months Ended June 30, 20XX

Revenues:		
Common stock	$ 200,000	
Bank loan	200,000	
Total revenues		$ 400,000
Expenses:		
Cost of the house	160,000	
Renovation to the house	100,000	
Furniture expense	40,000	
Kitchen equipment expense	20,000	
Computer expense	4,000	
Total expenses		324,000
Net Income		**$ 76,000**

Requirements

1. Suppose you are the Ruiz sisters' banker, and they have given you this income statement. Would you congratulate them on their net income? If so, explain why. If not, how would you advise them to measure the net income of the business? Does the amount of cash in the bank measure net income? Explain.
2. Prepare the balance sheet for Dos Hermanas based on these data.

Decision Case 1-2: Solution

Requirement 1

The banker would not congratulate the Ruiz sisters for their net income because they have not measured net income properly. In fact, they have no net income at all. Net income is revenues minus expenses, and the Sofia and Luisa have neither revenues nor expenses. The amount of cash in the bank does not measure net income, as it is the result of a loan from the bank.

Requirement 2

DOS HERMANAS BED AND BREAKFAST
Balance Sheet
June 30, 20XX

Assets		Liabilities	
Cash	$ 76,000	Bank Loan Payable	$ 200,000
Computer	4,000		
Kitchen Equipment	20,000		
Furniture	40,000	Stockholders' Equity	
Building ($160,000 + $100,000)	260,000	Common Stock	200,000
Total Assets	$ 400,000	Total Liabilities and Stockholders' Equity	$ 400,000

Team Project 1-1

You are opening Pigeon Run Animal Clinic. Your purpose is to earn a profit, and you organize as a corporation.

Requirements

1. Make a detailed list of 10 factors you must consider to establish the business.
2. Identify 10 or more transactions that your business will undertake to open and operate the kennel.
3. Prepare the Pigeon Run Animal Clinic income statement, statement of retained earnings, and balance sheet at the end of the first month of operations. Use made-up figures and include a complete heading for each financial statement. Date the balance sheet as of January 31, 20XX.
4. Discuss how you will evaluate the success of your business and how you will decide whether to continue its operation.

Team Project 1-1: Solution (Suggested answers. Student answers may vary.)

Requirement 1

1. How to organize the business—as a proprietorship, a partnership, an LLC, or a corporation (You have decided to organize as a corporation.)
2. Where to locate the business
3. How much of your own time and money to commit to the business
4. How to finance the business—with your own personal money, with equity contributions from others, or through borrowing
5. How many people to employ for the business
6. How to measure the business's success or failure; how to account for the assets, liabilities, and operations of the business
7. What type of animals to serve (all types, dogs only, dogs and cats, birds, reptiles, and so on)
8. Whether to sell pet foods, toys, and other supplies
9. Whether to offer day play, obedience lessons, or other grooming services
10. How to advertise the business (newspapers, radio, posters, online)

Requirement 2

1. Obtain equity financing to start the business
2. Purchase land and building
3. Renovate the building to make it suitable for an animal clinic
4. Purchase veterinary supplies that will be needed to operate the animal clinic
5. Advertising
6. Earn service revenue
7. Pay utility bills
8. Pay employee wages
9. Borrow money
10. Pay dividends

Team Project 1-1: Solution (cont'd)

Requirement 3

PIGEON RUN ANIMAL CLINIC
Income Statement
Month Ended January 31, 20XX

Revenue:		
Service Revenue		$ 10,000
Expenses:*		
Wages Expense	$ 2,000	
Supplies Expense	400	
Advertising Expense	300	
Utilities Expense	100	
Total Expense		2,800
Net Income		$ 7,200

*Students may also include depreciation expense on the building.

PIGEON RUN ANIMAL CLINIC
Statement of Retained Earnings
Month Ended January 31, 20XX

Retained Earnings, January 1, 20XX	$ 0
Net income for the month	7,200
	7,200
Dividends	(2,000)
Retained Earnings, January 31, 20XX	$ 5,200

PIGEON RUN ANIMAL CLINIC
Balance Sheet
January 31, 20XX

Assets		Liabilities	
Cash	$ 1,500	Accounts Payable	$ 1,000
Supplies	200		
Building	25,000	Stockholders' Equity	
Land	9,500	Common Stock	30,000
		Retained Earnings	5,200
		Total Stockholders' Equity	35,200
Total Assets	$ 36,200	Total Liabilities And Stockholders' Equity	$ 36,200

Team Project 1-1: Solution (cont'd)

Requirement 4

We evaluate the success of the business by considering its:

- Net income or net loss for the period, as reported on the income statement
- Financial position at the end of the period, as reported on the balance sheet

A profitable business that should continue is one that shows net income for the period, assets exceeding liabilities, and positive cash flow.

Team Project 1-2

You are promoting a music festival in your area. Your purpose is to earn a profit, and you organize Electric Sounds Enterprises as a corporation.

Requirements

1. Make a detailed list of 10 factors you must consider to establish the business.
2. Describe 10 of the items your business must arrange in order to promote and stage the music festival.
3. Prepare your business's income statement, statement of retained earnings, and balance sheet on June 30, 20XX, immediately after the music festival. Use made-up amounts and include a complete heading for each financial statement. For the income statement and the statement of retained earnings, assume the period is the three months ended June 30, 20XX.
4. Assume that you will continue to promote music festivals if the venture is successful. If it is unsuccessful, you will terminate the business within three months after the music festival. Discuss how you will evaluate the success of your venture and how you will decide whether to continue in business.

Team Project 1-2: Solution (Suggested answers. Student answers may vary.)

Requirement 1

1. How to organize the business—as a proprietorship, a partnership, an LLC, or a corporation (Assume you have decided to organize as a corporation.)
2. Where to locate the headquarters of the business
3. How much of your own time and money to commit to the business
4. How to finance the business—with your own personal money, with equity contributions from others, or through borrowing
5. How many people to employ for the business
6. How to measure the business's success or failure; how to account for the assets, liabilities, and operations of the business
7. What type of music to feature; what age group or interest group to appeal to
8. Whether to sell concessions (food, drinks, T-shirts, and so on) yourself or to arrange for outsiders to sell concessions at the music festival
9. How to advertise the business (newspapers, radio, posters, online)
10. Whether to sponsor the music festivals yourself or to arrange for corporate or charitable organizations to sponsor the music festivals

Requirement 2

1. Which band (or bands) to feature at the music festivals
2. How much and when to pay the performers (flat rate or a percentage of gate receipts)
3. Where to stage the music festivals and how to pay for the site rental
4. Need for city or county permits to stage a music festival
5. How to ensure security at the music festival
6. How to get people to come to the music festival—how to advertise the music festivals (newspapers, radio, posters, or other) and how much to pay for advertising

7. How to offer concessions (buy and sell them yourself or arrange for outside concessionaires). If outsiders, how will they be compensated—keep their own revenues or share them with you?
8. Need for traffic control if the crowd disrupts city traffic
9. Weather considerations if the music festival is staged outdoors
10. Timing of the music festival in relation to other events in the area at the time.

Team Project 1-2: Solution (cont'd)

Requirement 3

ELECTRIC SOUND ENTERPRISES
Income Statement
Three Months Ended June 30, 20XX

Revenue:		
Ticket Sales Revenue		$ 300,000
Concession Revenue		50,000
Total Revenue		350,000
Expenses:		
Band Expense	$ 100,000	
Advertising Expense	50,000	
Concession Expense	20,000	
Rent Expense	15,000	
Security Expense	10,000	
Utilities Expense	3,000	
Permits Expense	2,000	
Total Expenses		200,000
Net Income		$ 150,000

Team Project 1-2: Solution (cont'd)

ELECTRIC SOUND ENTERPRISES
Statement of Retained Earnings
Three Months Ended June 30, 20XX

Retained Earnings, April 1, 20XX	$ 0
Net income for quarter	150,000
	150,000
Dividends	(10,000)
Retained Earnings, June 30, 20XX	$ 140,000

ELECTRIC SOUND ENTERPRISES
Balance Sheet
June 30, 20XX

Assets		Liabilities	
Cash	$ 136,000	Accounts Payable	$ 7,000
Accounts Receivable	8,000		
Supplies	4,000	Stockholders' Equity	
		Common Stock	1,000
		Retained Earnings	140,000
		Total Stockholders' Equity	141,000
Total Assets	$ 148,000	Total Liabilities And Stockholders' Equity	$ 148,000

Requirement 4

We evaluate the success of the business by considering its:

- Net income or net loss for the period, as reported on the income statement
- Financial position at the end of the period, as reported on the balance sheet

A profitable business that should continue is one that shows net income for the period, assets exceeding liabilities, and positive cash flow.

Communication Activity 1-1

Using 25 words or fewer, illustrate the accounting equation and explain each part of the accounting equation.

Communication Activity 1-1: Solution

Assets = Liabilities + Equity simply shows the resources that a business owns (assets) and the claims that others have against those resources (liabilities and equity).