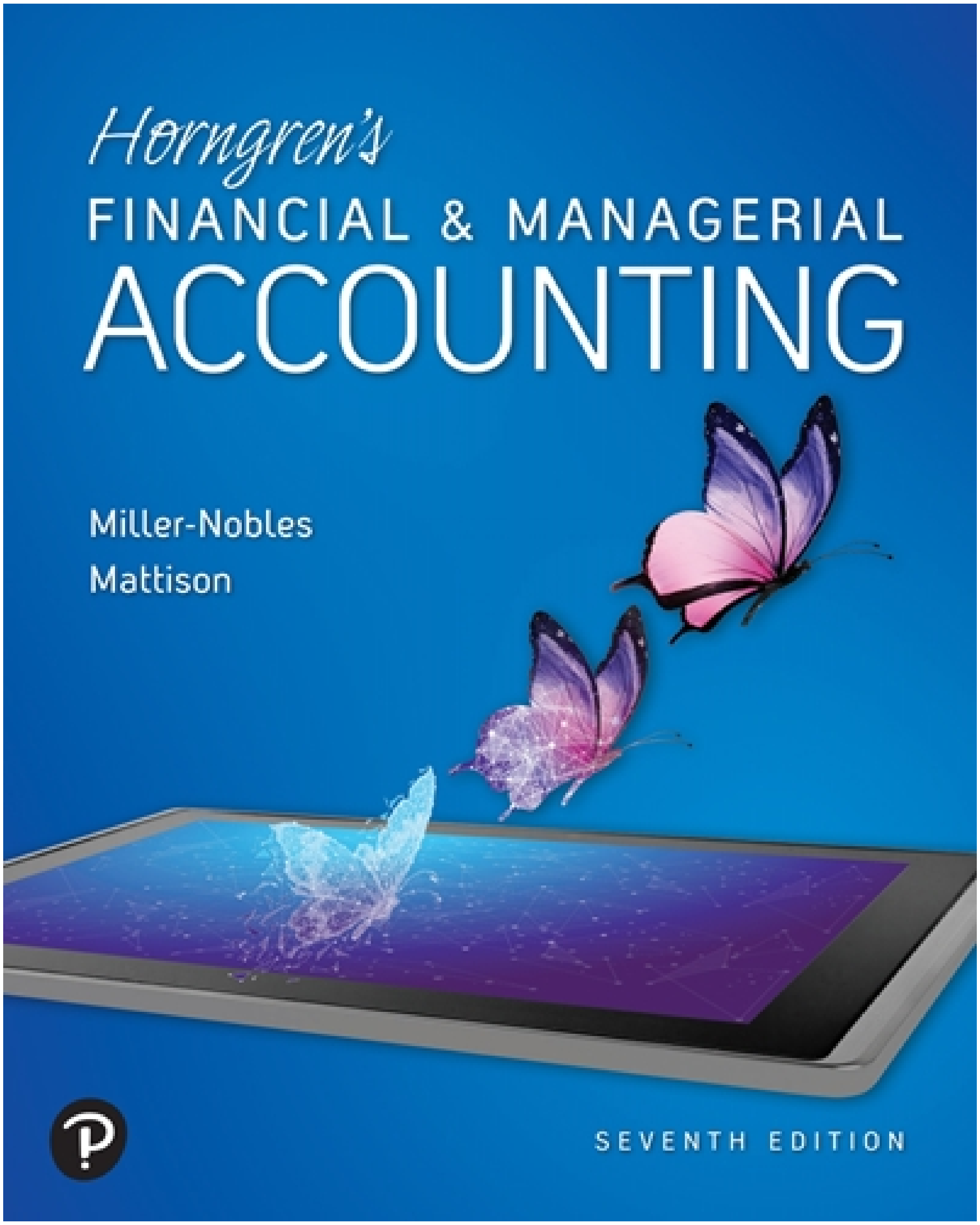
Solutions for Horngrens Financial and Managerial Accounting 7th Edition by Nobles



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
b. FA
c. FA
d. MA
e. MA
f. FA
g. 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
b. A
c. E
d. A
e. E
f. E
g. A
h. E
i. A
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

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

Introduction to Managerial Accounting

Directed Reading Guide

LO1. Why is managerial accounting important?

a) Identify as a focus of Managerial (M) or Financial (F) accounting:

i) Primarily for internal users __**M**__

ii) Primarily for external users ___**F**___

iii) Follows GAAP rules ___**F**___

iv) Summary reports of the entire company ___**F**___

v) Concerned about how reports will affect employee behavior ___**M**___

b) Managers need information for?

i) **Planning**

ii) **Strategic Planning**

iii) **Operational Planning**

iv) **Directing**

v) **Controlling**

In MyLab Accounting, complete Try It! and S-M:1-1 and S-M:1-2.

LO2. How are costs classified?

a) Manufacturing (product) costs categories are:

i) **Direct Materials**

ii) Direct Labor

iii) **Manufacturing Overhead**

b) ___**Prime costs**____ combines direct materials and direct labor.

c) ____**Conversion Costs**___ combines direct labor and manufacturing overhead.

d) Selling and administrative expenses are referred to as ___**Period Costs____.**

In MyLab Accounting, complete Try It! and S-M:1-3 through S-M:1-5.

LO3. How do manufacturing companies prepare financial statement?

a) Identify if the item is part of the Cost of Goods Manufactured (COGM) or the Cost of Goods Sold (COGS):

i) Beginning Finished Goods Inventory ___**COGS**___

ii) Direct Materials Used ___**COGM**___

iii) Direct Labor ___**COGM**___

iv) Beginning Work-in-Process Inventory ___**COGM**___

b) If beginning Finished Good Inventory is $2,000, ending Finished Goods Inventory is $3,000, and Cost of Goods Manufactured is $10,000, what is Cost of Gods Sold?

$2,000 + $10,000 - $3,000 = $9,000

In MyLab Accounting, complete Try It! and S-M:1-6 through S-M:1-10.

LO4. What are business trends that are affecting managerial accounting?

a) Which business trend to you think is affecting managerial accounting the most in today's business's and why? **Student answers will vary.**

b) Pick an activity in the value chain and describe how it can add value to a product (you may pick a product to use as part of your example). **Student answers will vary.**

In MyLab Accounting, complete Try It! and S-M:1-11.

LO5. How is managerial accounting used in service and merchandising companies?

a) ABC Company has incurred costs of $4,000 and provided service to 1,000 customers, what is the cost per service?

$4,000 / 1,000 = $4 per service

b) ABC Company sold 300 bottles of water that costs $150 to purchase, what is the cost per water bottle?

$150 / 300 bottles = .50 per bottle

In MyLab Accounting, complete Try It! and S-M:1-12.

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:

During the Year	Δ Assets =	Δ Liabilities	+ Contributed Capital
			+ Revenues
			– Expenses
			– Dividends

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).

Chapter 2

Recording Business Transactions

Chapter 2: Overview

The chapter introduces the account and then briefly describes specific asset, liability, and stockholders' equity accounts. The chart of accounts is presented as a way to organize accounts, and a Data Analytics in Accounting feature highlights the chart of accounts as a tool for analyzing a company's accounting data. The ledger is introduced as a tool for maintaining the accounts. The concept of double-entry accounting and the rules of debit and credit for increasing or decreasing assets, liabilities, and equity are described. The rules of debit and credit are then expanded to include specific types of equity accounts. The normal balances of accounts are explained. The T-account is illustrated. The accounting equation is tied to the rules of debit and credit.

The flow of accounting data is illustrated from the occurrence of a transaction through recording of the transaction. The process of recording transactions (journalizing) is presented. A series of entries are analyzed, journalized, and posted to T-accounts in the ledger. The four-column account is introduced. The trial balance is defined and illustrated. Some typical accounting errors revealed by a trial balance are described. How the debt ratio is used to evaluate business performance is discussed.

An Ethics feature helps give real-world perspective on the importance of source documents. The Tying It All Together feature focusses on Fry's Electronics, Inc. A Decisions feature helps students see how the debt ratio can be used to make a real-world decision. The Review section includes Things You Should Know which highlights the information students should have acquired from the chapter. A Check Your Understanding reviews opening accounts, journalizing, posting, and preparing a trial balance. A list of Key Terms is provided. A Quick Check gives students a chance to assess their knowledge of the chapter learning objectives.

Chapter 2: Learning Objectives

LO 1. Explain accounts as they relate to the accounting equation and describe common accounts

LO 2. Define debits, credits, and normal account balances using double-entry accounting and T-accounts

LO 3. Record transactions in a journal and post journal entries to the ledger

LO 4. Prepare the trial balance and illustrate how to use the trial balance to prepare financial statements

LO 5. Use the debt ratio to evaluate business performance

Chapter 2: Teaching Outline with Lecture Notes

LO 1. Explain accounts as they relate to the accounting equation and describe common accounts

a) Review the accounting equation

i) Account

b) Assets (Exhibit 2-1: Asset Accounts)

c) Liabilities (Exhibit 2-2: Liability Accounts)

d) Equity (Exhibit 2-3: Equity Accounts)

e) Chart of accounts (Exhibit 2-4: Chart of Accounts—Smart Touch Learning)

i) Ledger

Lecture Notes: An understanding of Chapter 2 is essential for student success in the remaining financial accounting chapters. Spend adequate time in the beginning with accounting terminology. Accounting is a "foreign" language to many students, and, as is the case with a real foreign language, you must start with the basics.

Students seem to understand assets and liabilities more easily than they understand equity. An asset can be touched, and a liability can be confirmed by looking at an invoice, but equity is conceptual. Equity is the residual stockholders' claims to the business assets—what is left over after liabilities are subtracted from assets. Students may own a car or home that has an outstanding loan or mortgage, so it may be helpful to ask them to think about their personal equity for their car or home.

Suggested In-Class Exercise: E2-11

LO 2. Define debits, credits, and normal account balances using double-entry accounting and T-accounts

a) Double-entry system

b) The T-account

c) The accounting equation and the rules of debit and credit

d) Increases and decreases in the accounts

e) Expanding the rules of debit and credit

f) The normal balance of an account

g) Exhibit 2-5: Rules of Debit and Credit and Normal Balances for Each Account Type

h) Determining the balance of a T-account

Lecture Notes: Define double entry accounting. Emphasize that *every* basic accounting transaction affects at least two accounts, with at least one account to be debited and at least one account to be credited. Every journal entry must balance (debits = credits) in order for the accounting system to accurately generate correct and useful information. An incorrect journal entry that is posted to the correct accounts will still produce incorrect information.

When discussing T-accounts, explain how they represent accounts in the general ledger. Emphasize the various account types and the specific accounts within them. In the rules of debit and credit, *debit* means left side, and *credit* means right side—nothing more. Point out that students may have heard the terms used in other contexts, such as credit reports and debit cards, but these are different meanings of the words *debit* and *credit*. Furthermore, *debit* does not mean increase, and *credit* does not mean decrease. Increases and decreases depend on the account type.

An account can have only one balance. Debits and credits within the same account are subtracted to determine the account balance, just like positives and negatives from a mathematical standpoint. The normal balance is the side used to record increases in the account.

Suggested In-Class Exercise: E2-13

LO 3. Record transactions in a journal and post journal entries to the ledger

a) Source documents—the origin of the transactions

b) Exhibit 2-6: Flow of Accounting Data

c) Journalizing and posting transactions

d) Introduce the five steps of journalizing and posting

e) Journalize and post with 17 specific Smart Touch Learning examples

f) The ledger accounts after posting

g) Exhibit 2-7: Smart Touch Learning's Accounts After Posting Journal Entries in November and December

h) The four-column account: An alternative to the T-account

i) Exhibit 2-8: T-Account Versus Four-Column Account

j) Exhibit 2-9: Posting References

Lecture Notes: Define source documents, journalizing, and posting. Walk through the five steps of journalizing and posting transactions. When discussing the posting process, emphasize the need to be very careful when transferring amounts to the ledger. It is common for students to reverse a posting and record a debit as a credit or vice versa. A debit is placed on the left side, and a credit is placed on the right side. Also, relate to them that transposing digits during the posting process is a common mistake. For example, a transaction might be for $630 and recorded in the journal as $630 but posted to the ledger as $360. If the trial balance doesn't balance, it is common for students to have reversed a posting or transposed digits. For this reason, it is important to include dates and/or transaction numbers linking the journal entry to the ledger account to more easily trace those errors.

Suggested In-Class Exercises: E2-16, E2-17

LO 4. Prepare the trial balance and illustrate how to use the trial balance to prepare financial statements

a) Trial balance

b) Exhibit 2-10: Trial Balance

c) Preparing financial statements from the trial balance

d) Exhibit 2-11: Smart Touch Learning's Financial Statements

e) Correcting trial balance errors

Lecture Notes: Define a trial balance and explain its importance in the accounting cycle. It may be helpful for students to view the accounting system from both ends. The natural process is to journalize transactions, post entries, and prepare a trial balance. However, once the chapter content is discussed, you can also begin with the trial balance and have students trace back to the ledger and journal to find a specific transaction. They may also get experience doing this when correcting a trial balance that does not balance.

Suggested In-Class Exercise: E2-22

LO 5. Use the debt ratio to evaluate business performance

a) Define the debt ratio and explain how it is calculated

Lecture Notes: Remind student about the accounting equation: Assets = Liabilities + Equity. This makes it clear that the debt ratio represents the proportion of the total assets that are financed with debt, and therefore "belong" to the creditors of the business. Conversely, 1 – Debt ratio% is the proportion of the assets that belong to the owners (stockholders) of the business.

Suggested In-Class Exercise: E2-28

Chapter 2: Handout for Student Notes

LO 1. What is an account?

- Assets
- Liabilities
- Equity
- Chart of accounts
- Ledger

LO 2. What is double-entry accounting?

- The T-account
- Increases and decreases in the accounts
- Expanding the rules of debit and credit
- The normal balance of an account
- Determining the balance of a T-account

LO 3. How do you record transactions?

- Source documents—The origin of the transactions

- Journalizing and posting transactions:

    - 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

    - Transaction 10—Prepaid expenses

        - Transaction 11—Payment of expense with cash
        - Transaction 12—Purchase of building with notes payable
        - Transaction 13—Stockholder contribution
        - Transaction 14—Accrued liability
        - Transaction 15—Payment of expense with cash
        - Transaction 16—Unearned revenue
        - Transaction 17—Earning of service revenue for cash
    - The ledger accounts after posting
    - The four-column account: An alternative to the T-account

LO 4. What is the trial balance?

    - Preparing financial statements from the trial balance
    - Correcting trial balance errors

LO 5. How do you use the debt ratio to evaluate business performance?

Chapter 2: Student Chapter Summary

LO 1. Explain accounts as they relate to the accounting equation and describe common accounts

An account is a detailed record of all increases and decreases that have occurred in an individual asset, liability, or equity during a specific period. Common asset accounts include Cash, Accounts Receivable, Notes Receivable, Prepaid Expense, Land, Building, and Furniture. Common liability accounts include Accounts Payable, Notes Payable, Accrued Liability, and Unearned Revenue. Common equity accounts include Common Stock, Dividends, Revenues, and Expenses. A chart of accounts lists a company's accounts along with account numbers. A ledger shows the increases and decreases in each account along with their balances.

LO 2. Define debits, credits, and normal account balances using double-entry accounting and T-accounts

Double-entry accounting requires transactions to be recorded into at least two accounts. The T-account is shaped like a capital *T*, with debits posted to the left side of the vertical line and credits posted to the right side of the vertical line. T-accounts represent ledger accounts. In accounting, *debit* means left side of the account, and *credit* means right side of the account. Assets, Expenses, and Dividends are increased with a debit and decreased with a credit. Liabilities, Common Stock, and Revenues are increased with a credit and decreased with a debit. The normal balance of an account is the increase side of that account.

LO 3. Record transactions in a journal and post journal entries to the ledger

Source documents provide the evidence and data for transactions. Transactions are recorded in a journal, and then the journal entries are posted (transferred) to the ledger. Transactions are journalized and posted using five steps:

Step 1. Identify the accounts and the account type (asset, liability, and equity).
Step 2. Decide whether each account increases or decreases, then apply the rules of debits and credits.
Step 3. Record the transaction in the journal.
Step 4. Post the journal entry to the ledger.
Step 5. Determine whether the accounting equation is in balance.

LO 4. Prepare the trial balance and use the trial balance to prepare financial statements

The trial balance summarizes the ledger by listing all the accounts with their balances. Assets are listed first, followed by liabilities, and then equity. The trial balance ensures that debits equal credits and is used to prepare the financial statements.

LO 5. Use the debt ratio to evaluate business performance

The debt ratio, calculated as Total liabilities / Total assets, is used to evaluate a business's ability to pay its debts.

Chapter 2: Assignment Grid and Other Materials

	LO 1	LO 2	LO 3	LO 4	LO 5
S2-1	X				
S2-2		X			
S2-3		X			
S2-4		X			
S2-5			X		
S2-6			X		
S2-7			X		
S2-8				X	
S2-9					X
E2-10	X	X	X	X	
E2-11	X				
E2-12	X	X			
E2-13		X			
E2-14			X		
E2-15			X		
E2-16			X		
E2-17			X		
E2-18			X		
E2-19			X		
E2-20			X		
E2-21			X		
E2-22				X	
E2-23				X	
E2-24			X	X	
E2-25				X	
E2-26				X	
E2-27				X	
E2-28					X
P2-29A, P2-35B			X	X	
P2-30A, P2-36B			X	X	
P2-31A, P2-37B			X	X	
P2-32A, P2-38B			X	X	
P2-33A, P2-39B				X	
P2-34A, P2-40B				X	X

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

Other End-of-Chapter Materials:

Using Excel P2-41
Continuing Problem P2-42
Practice Set P2-43
Tying It All Together Case 2-1
Decision Case 2-1
Ethical Issue 2-1
Fraud Case 2-1
Financial Statement Case 2-1
Communication Activity 2-1

CHAPTER 2
TEN-MINUTE QUIZ

Circle the letter of the best response.

1. What is the detailed record of all increases and decreases that have occurred in a specific individual asset, liability, or equity during a specific period?
   A. Ledger
   B. Trial balance
   C. Account
   D. Journal

2. Which of the following is a collection of all the accounts, the changes in those accounts, and their balances?
   A. Balance sheet
   B. Ledger
   C. Journal
   D. Trial balance

3. Which of the following statements is correct?
   A. Service Revenue is increased with a debit.
   B. Accounts Receivable is decreased with a debit.
   C. Unearned Revenue is increased with a credit.
   D. Retained Earnings is decreased with a credit.

4. Suppose Akter Corporation has Furniture totaling $316,000, Cash of $36,000, and a $128,000 Note Payable. In addition, the business has Accounts Payable of $104,000 and Accounts Receivable of $86,000. How much is Akter's stockholders' equity?
   A. $462,000
   B. $290,000
   C. $242,000
   D. $206,000

5. Cohen Company billed a customer for $7,600 of services provided on account. This transaction appears in T-accounts as follows:

A.

Service Revenue	
7,600	

Accounts Payable	
	7,600

B.

Service Revenue	
	7,600

Accounts Payable	
7,600	

C.

Service Revenue	
	7,600

Accounts Receivable	
7,600	

D.

Service Revenue	
7,600	

Accounts Receivable	
	7,600

6. Littleton, Inc., began the year with total assets of $354,000 and liabilities of $224,000. During the year, the business earned revenue of $206,000 and incurred expenses of $96,000. The stockholders received cash dividends of $48,000 and no additional stock has been issued. How much is stockholders' equity at year-end?
   A. $240,000
   B. $192,000
   C. $158,000
   D. $62,000

7. Takagi Printing, Inc., erroneously recorded a purchase of equipment on account by debiting Equipment and crediting Cash. What will be an effect of this error on the trial balance?
   A. Liabilities understated
   B. Cash overstated
   C. Equipment overstated
   D. Equipment understated

8. Jerry Lopez is a stockholder of Genesis Corporation. In exchange for additional shares of common stock, Lopez provided Genesis Corporation with $150,000 of computer equipment. The journal entry to record this transaction is as follows:

	Accounts and Explanations	**Debit**	**Credit**
A.	Common Stock	150,000	
	Equipment Expense		150,000
B.	Equipment Expense	150,000	
	Common Stock		150,000
C.	Equipment	150,000	
	Common Stock		150,000
D.	Common Stock	150,000	
	Equipment		150,000

9. The Bravo Company performed services for a customer, earning $12,000 of service revenue on account. Which journal entry records the collection of the $12,000 cash received when the customer subsequently pays the invoice?

	Accounts and Explanations	Debit	Credit
A.	Cash	12,000	
	Accounts Receivable		12,000
B.	Cash	12,000	
	Service Revenue		12,000
C.	Accounts Receivable	12,000	
	Cash		12,000
D.	Service Revenue	12,000	
	Cash		12,000

10. A company has $144,000 in liabilities and $196,000 in equity. What is the debt ratio?
    A. 26.5%
    B. 42.4%
    C. 73.5%
    D. 136.1%

Answer Key to Ten-Minute Quiz:

1. C

2. B

3. C

4. D

Assets		=	Liabilities		+	Stockholders' Equity
Accounts Receivable	$ 86,000		Accounts Payable	$ 104,000		
Cash	36,000		Note Payable	128,000		
Furniture	316,000					
Total	$ 438,000		Total	$ 232,000	Total	?

Assets = Liabilities + Stockholders' equity; therefore, Stockholders' equity = Assets –Liabilities

Stockholders' equity = $438,000 – $232,000 = $206,000

5. C

6. B

Assets = Liabilities + Stockholders' equity; therefore, Stockholders' equity = Assets –Liabilities

Stockholders' equity at the beginning of the year = $354,000 – $224,000 = $130,000

As no common stock has been issued, Stockholder's equity is made up of the balance in Retained earnings:

Retained earnings, beginning of year	$ 130,000
Net income earned during the year (revenue − expenses)	110,000
	240,000
Dividends	(48,000)
Retained earnings, end of year	$ 192,000

7. A

8. C

9. A

10. B
Debt ratio = Total liabilities / Total assets* = $144,000 / $340,000 = 42.4%
*Total assets = Liabilities + Equity = $144,000 + 196,000 = $340,000

Extra Critical Thinking Questions

Decision Case 2-2

Answer the following questions. Consider each question separately.

Requirements

1. Explain the advantages of double-entry bookkeeping instead of recording transactions in terms of the accounting equation to a friend who is opening a used book store.
2. When you deposit money in your bank account, the bank credits your account. Is the bank misusing the word *credit* in this context? Why does the bank use the term *credit* instead of *debit* to refer to your deposit?

Decision Case 2-2: Solution

Requirement 1

The advantage of double-entry bookkeeping it that it provides an arithmetic check on the accounting transactions; the total debits and total credits have to equal, and something is wrong if they don't. Double-entry bookkeeping can also handle a higher number of transactions than using the accounting equation.

Requirement 2

The bank uses the term *credit your account* when you deposit money because it is crediting a liability on its books. It owes you the funds that you just deposited.

Team Project 2-1

Contact a local business and arrange with the owner to learn what accounts the business uses.

Requirements

1. Obtain a copy of the business's chart of accounts.
2. Prepare the company's financial statements for the most recent month, quarter, or year. (You may omit the statement of cash flows.) You may use either made-up account balances or balances supplied by the owner.

If the business has a large number of accounts within a category, combine related accounts and report a single amount on the financial statements. For example, the company may have several Cash accounts. Combine all Cash amounts and report a single Cash amount on the balance sheet. You will probably encounter numerous accounts that you have not yet learned about. Deal with them as best you can. Keep in mind that the financial statements report the balances of the accounts listed in the company's chart of accounts, either by individual account or in summarized categories. Therefore, the financial statements must be consistent with the chart of accounts.

Team Project 2-1: Solution

Requirements 1 and 2

Student answers will vary widely, as the various groups use the charts of accounts of different businesses. The financial statements that the students prepare should be consistent with the business's chart of accounts.

