Solutions for Corporate Financial Accounting 16th Edition by Warren

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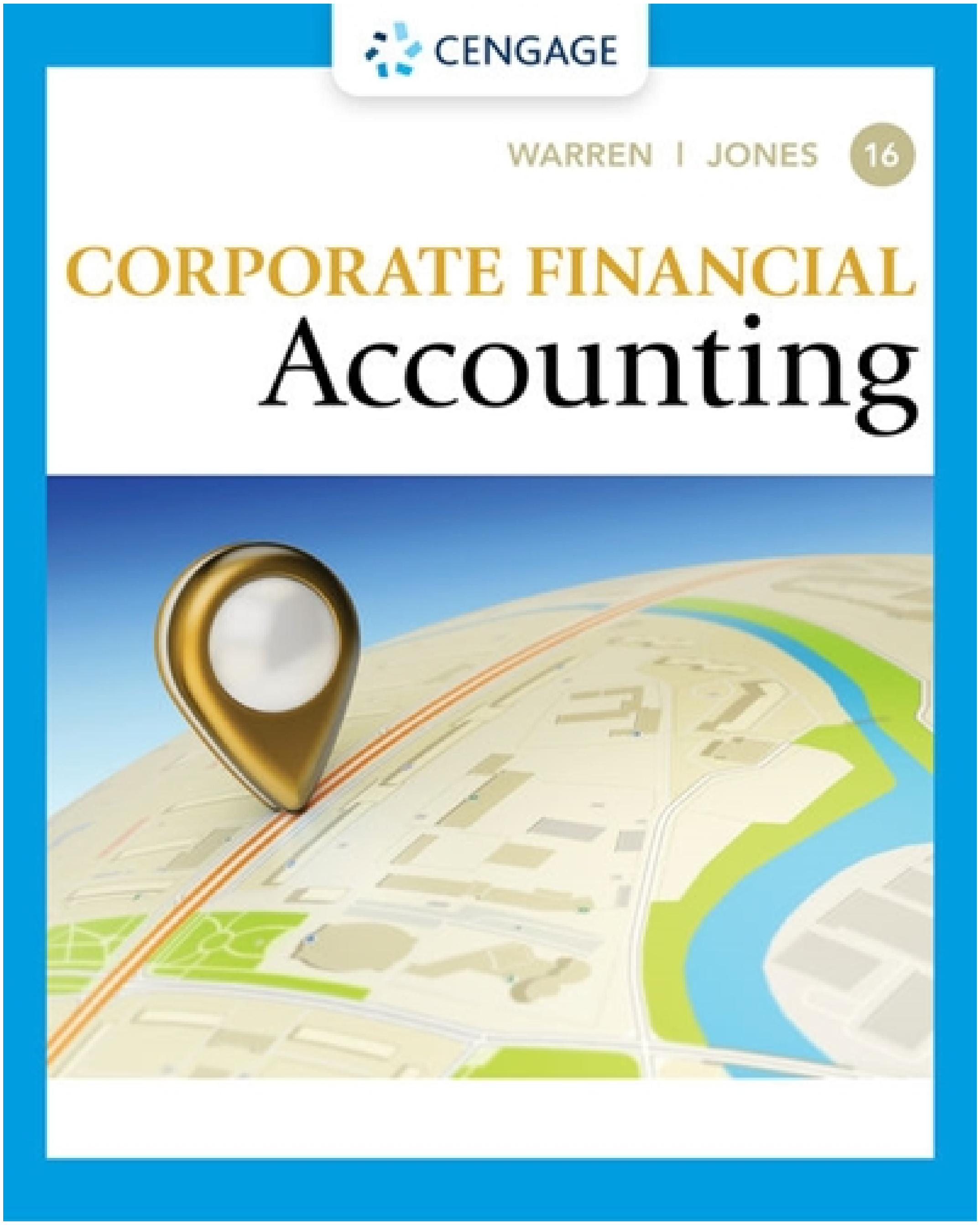

Solutions

Instructor Manual

Warren, Corporate Financial Accounting, 16e, 2022, 9780357510384, Chapter 1: Introduction to Accounting and Business

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Purpose and Perspective of the Chapter

The purpose of this chapter is to introduce students to business and accounting. For many students, Chapter 1 of *Corporate Financial Accounting* is their first taste of the business or accounting disciplines. The teaching challenge is to get students to understand and accept the importance of learning business and accounting concepts. This will make the course more than just another requirement that students must complete to graduate. Because this chapter will set the tone for the entire course and the students' business careers, avoid the temptation to rush through the material.

Chapter 1 begins with a discussion of the nature of business and accounting and the different types of businesses (service, retail, and manufacturing). Next, the chapter describes the role of accounting in business. The chapter then moves on to business ethics and discusses how individual character, firm culture, and laws and enforcement affect ethics as well as examples of accounting/business fraud. Opportunities in accounting professions/careers are discussed. Following this introductory information, the text explains generally accepted accounting principles (GAAP), the characteristics of financial information, and the assumptions that form the basis of GAAP. The forms of business entities (proprietorships, partnerships, corporations, and limited liability companies) are described. The four principles of financial accounting (measurement, historical cost, revenue recognition, and expense recognition) are defined. The accounting equation is introduced, and then the discussion of how business transactions affect accounts in the accounting equation begins. When transactions are analyzed, changes in assets, liabilities, and stockholders' equity are stated as "increases" or "decreases"; the terms *debit* and *credit* are not introduced until Chapter 2. The components of the accounting equation are discussed using several transactions for a business called NetSolutions. Next are examples of how to prepare the four primary financial statements using the accounting equation information and explanations of how the four financial statements are interrelated. The chapter ends with an explanation of the ratio of liabilities to stockholders' equity and how it is particularly important to creditors.

Cengage Supplements

The following product-level supplements provide additional information that may help you in preparing your course. They are available in the Instructor Resource Center.

- Educator's Guide
- PowerPoint® slides
- Test bank powered by Cognero®

Chapter Objectives

The following objectives are addressed in this chapter:

Obj. 1 Describe the nature of business and the role of accounting and ethics in business.
Obj. 2 Describe generally accepted accounting principles, including the underlying assumptions and principles.
Obj. 3 State the accounting equation and define each element of the equation.

Obj. 4 Describe and illustrate how business transactions can be recorded in terms of the resulting change in the elements of the accounting equation.
Obj. 5 Describe the financial statements of a corporation and explain how they interrelate.
Obj. 6 Describe and illustrate the use of the ratio of liabilities to stockholders' equity in evaluating a company's financial condition.

Complete List of Chapter Activities and Assessments

For additional guidance, refer to the Teaching Online Guide.

Chapter Objective	PPT Slide	Activity/Assessment
Obj. 1	2	Icebreaker
Obj. 1	6–7	Knowledge Check Activity 1
Obj. 2	25–26	Discussion Activity 1
Obj. 3	28–29	Discussion Activity 2
Obj. 4	44–45	Knowledge Check Activity 2
Obj. 5	57–58	Knowledge Check Activity 3

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Key Terms

Account payable: The liability created by a purchase on account.

Account receivable: An asset, which is a claim against the customer created by selling merchandise or services on credit.

Accounting: An information system that provides reports to stakeholders about the economic activities and condition of a business.

Accounting assumptions: Assumptions that provide the framework upon which accounting standards are constructed.

Accounting equation: The equation that shows the relationship among assets, liabilities, and equity; expressed as Assets = Liabilities + Equity.

Accounting principles: Principles that provide the framework upon which accounting standards are constructed.

Accounting standards: The rules that determine the accounting for individual business transactions.

Accounting Standards Codification: An electronic database maintained by the Financial Accounting Standards Board (FASB) that contains all of the accounting standards that make up the generally accepted accounting principles (GAAP).

Accounting Standards Updates: Published changes to accounting standards that are the source of updates to the Accounting Standards Codification.

Arm's-length transactions: Transactions between two independent parties.

Assets: The resources owned by a business.

Balance sheet: A list of the assets, liabilities, and stockholders' equity as of a specific date, usually at the close of the last day of a month or a year.

Business: An organization in which basic resources (inputs), such as materials and labor, are assembled and processed to provide goods or services (outputs) to customers.

Business entity assumption: A concept of accounting that limits the economic data in the accounting system to data related directly to the activities of the business.

Business transaction: An economic event or condition that directly changes an entity's financial condition or directly affects its results of operations.

Certified Public Accountant (CPA): Public accountants who have met a state's education, experience, and examination requirements.

Common stock: Certificates issued by a corporation to investors as proof of their ownership rights; an account representing the ownership rights of investors in a corporation; a class of stock issued by a corporation that bears no preference rights.

Comparability: A secondary characteristic of financial information; comparability includes consistent reporting, that allows users to identify similarities and differences among reported items.

Corporation: A business organized under state or federal statutes as a separate legal entity.

Cost principle: A concept of accounting that states that an asset should be recorded and maintained in the accounting records at its initial transaction price.

Data analytics: The science of analyzing raw data to discover patterns, identify anomalies, or gain other useful insights.

Dividends: Distributions of earnings to stockholders; an account representing the distribution of a corporation's earnings to stockholders.

Earnings: The amount by which revenues exceed expenses.

Equity: The rights of the owners of a business.

Ethics: Moral principles that guide the conduct of individuals.

Expense recognition principle: A principle, sometimes called the matching principle, that requires expenses to be recorded in the same period as the related revenue; a concept of accounting in which expenses are matched with the revenue generated during a period by those expenses.

Expenses: Amounts used to generate revenue; assets used up or services consumed in the process of generating revenues.

Faithful representation: A characteristic of financial reports that pertains to information accurately reflecting an entity's economic activity or condition.

Fees earned: Revenue from providing services.

Financial accounting: The branch of accounting that is concerned with recording transactions using generally accepted accounting principles (GAAP) for a business or other economic unit and with a periodic preparation of various statements from such records.

Financial Accounting Standards Board (FASB): The authoritative body that has the primary responsibility for developing accounting principles.

Financial statements: Financial reports that summarize the effects of events on a business.

Financing activities: Activities by which a company obtains funds to start and operate the company.

Fiscal year: The annual accounting period adopted by a business.

Generally accepted accounting principles (GAAP): Generally accepted guidelines for the preparation of financial statements.

General-purpose financial statements: A type of financial accounting report that is distributed to external users. The term "general purpose" refers to the wide range of decision-making needs that the reports are designed to serve.

Going concern assumption: An assumption that requires that financial reports be prepared assuming that the entity will continue operating in the future.

Historical cost principle: A concept of accounting that states that an asset should be recorded and maintained in the accounting records at its initial transaction price.

Income statement: A summary of the revenue and expenses for a specific period of time, such as a month or a year.

Interest revenue: Earnings received for interest.

International Accounting Standards Board (IASB): An organization that issues International Financial Reporting Standards for many countries outside the United States.

Investing activities: Activities by which a company acquires long-term assets for use in the operating activities of the company.

Liabilities: The rights of creditors that represent debts of the business.

Limited liability company (LLC): A business form consisting of one or more persons or entities filing an operating agreement with a state to conduct business with limited liability to the owners, yet treated as a partnership for tax purposes.

Managerial (or management) accounting: The branch of accounting that uses both historical and estimated data in providing internal users (management) with information relevant to decision making.

Manufacturing business: A type of business that changes basic inputs into products that are sold to individual customers.

Measurement principle: A principle that requires that amounts be objective and verifiable.

Monetary unit assumption: An accounting assumption that requires that financial reports be expressed in a single monetary unit, or currency.

Natural business year: A fiscal year that ends when business activities have reached the lowest point in an annual operating cycle.

Net income (or net profit): The amount by which revenues exceed expenses.

Net loss: The amount by which expenses exceed revenues.

Operating activities: Activities by which a company generates revenues from customers.

Owner's equity: The equity for a proprietorship, partnership, or a limited liability company.

Partnership: An unincorporated business form consisting of two or more persons conducting business as co-owners for profit.

Prepaid expenses: Assets created by making advanced payments for expense items, such as insurance premiums or supplies, that will be used in the business in the future.

Private accounting: The field of accounting whereby accountants are employed by a business firm or a not-for-profit organization.

Profit: The difference between the amounts received from customers for goods or services provided and the amounts paid for the inputs used to provide the goods or services.

Proprietorship: A business owned by one individual.

Public accounting: The field of accounting where accountants and their staff provide services on a fee basis.

Public Company Accounting Oversight Board (PCAOB): A new oversight body for the accounting profession that was established by the Sarbanes-Oxley Act.

Ratio of liabilities to stockholders' equity: A comprehensive leverage ratio that measures the relationship of the claims of creditors to stockholders' equity; a solvency ratio that measures how much of the company is financed by debt and equity, computed as total liabilities divided by total stockholders' equity.

Relevant: A characteristic of financial reports that pertains to information having the potential to impact decision making.

Rent revenue: Earnings from property that is leased to others for use.

Report form: A form of balance sheet with the "Liabilities" and "Stockholders' Equity" sections presented below the "Assets" section.

Retail business: A type of business that purchases products from other businesses and sells them to customers.

Retained earnings: The stockholders' equity created from business operations through revenue and expense transactions; an account representing the net income retained in a corporation.

Retained earnings statement: A summary of the changes in the retained earnings in a corporation that have occurred during a specific period of time, such as a month or a year.

Revenue: Increases in owner's equity as a result of providing services or selling goods to customers.

Revenue recognition principle: A concept of accounting that states that revenues are recorded when earned, which is when the services have been performed or products have been delivered to customers.

Sales: How revenue from the sale of merchandise is recorded; the total amount charged customers for merchandise sold, including cash sales and sales on account.

Sarbanes-Oxley Act (SOX): An act passed by Congress to restore public confidence and trust in the financial statements of companies.

Securities and Exchange Commission (SEC): An agency of the U.S. government that has authority over the accounting and financial disclosures for companies whose shares of ownership (stock) are traded and sold to the public.

Service business: A business providing services rather than products to customers.

Statement of cash flows: A summary of the cash receipts and cash payments for a specific period of time, such as a month or a year.

Statement of stockholders' equity: A summary of the changes in the stockholders' equity in a corporation that have occurred during a specific period of time, such as a month or a year.

Stockholders' equity: The ownership rights of stockholders in a corporation; the stockholders' rights to the assets in a corporation.

Timeliness: A secondary characteristic of financial information that requires distribution of financial reports in time to influence a user's decision.

Time period assumption: An accounting assumption that allows a company to report its economic activities on a regular basis for a specific period of time.

Understandability: A secondary characteristic of financial information that requires clear and concise financial reports that facilitate user interpretation and analysis.

Verifiability: A secondary characteristic of financial information that allows users to agree on the meaning of reported items.

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What's New in This Chapter

The following elements are improvements in this chapter from the previous edition:

- Why It Matters boxes from the previous edition have been relabeled as Business Insight boxes.
- New section on Business Activities has been added including a related exhibit.
- Exhibit 3 has been updated with new and more current examples of accounting and business frauds.
- New Business Insight box on "Business Strategies" has been added.
- Exhibit 11 is new and illustrates the interrelationships of the financial statements with the balance sheet as the connecting link.
- A new *Using Data Analytics* feature has been added. This feature box describes an application of data analytics to the chapter's content.

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Chapter Outline

In the outline below, each element includes references (in parentheses) to related content. "CH.##" refers to the chapter objective; "PPT Slide #" refers to the slide number in the PowerPoint deck for this chapter (provided in the PowerPoints section of the Instructor Resource Center); and, as applicable for each discipline, accreditation or certification standards ("BL 1.3.3"). Introduce the chapter and use the Ice Breaker in the PPT if desired, and if one is provided for this chapter. Review learning objectives for Chapter 1. (PPT Slide 3).

I. Nature of Business and Accounting (1-1, PPT Slides 4–15, BUSPROG: Analytic, AICPA: FN-Research)

   a. **Icebreaker:** *How does a business use accounting information?* (Slide 2)
   The class will be broken up into small groups (2-5 depending on the number of students in total). Each group will select a large, well-known business that most of them regularly patronize.

- Within each group, students will discuss how this business may use accounting information to make strategic decisions. For example, how can tracking their sales help them determine what products or services to sell? Use specific examples related to demographics or regions.
- Each group will select a spokesperson to introduce the group members to the class and share their findings.

b. The first objective starts with a list of the three types of businesses: service, retail, and manufacturing. It defines each type of business and gives examples.

c. **Knowledge Check Activity 1:** *Which of the following businesses would be considered a service business?* (Slides 6–7)
- Southwest Airlines would be considered a service business.
- Walmart and Starbucks would be considered retail businesses, and Ford Motor Company would be a manufacturer.

d. The role of accounting in business is discussed along with the two types of users: internal and external. Exhibit 1 (PPT Slide 8) shows the various users and the data they require.

e. Accounting can be defined as an information system that provides reports to users about the economic activities and condition of a business as shown in Exhibit 2 (PPT Slide 10).

f. Internal users require information from managerial accounting, while external users require information from financial accounting. To be useful, accounting information must be relevant, timely, and trustworthy.

g. The failure of individual character and a culture of corporate greed and ethical indifference led to the accounting and business frauds as shown in Exhibit 3 (PPT Slides 12 and 13). The Sarbanes-Oxley Act (SOX) was enacted in 2002 as a countermeasure to the fraud that was being committed. One of the many regulations that SOX established was a new oversight body for the accounting profession called the Public Company Accounting Oversight Board (PCAOB).

h. Opportunities for accountants are increasing as regulations increase, and people are beginning to realize the importance and value of accounting information. Exhibit 4 (PPT Slides 14 and 15) provides a list of accounting career paths and salaries.

II. Generally Accepted Accounting Principles (GAAP) (1-2, PPT Slides 16–26, BUSPROG: Analytic, AICPA: FN-Measurement)

a. Generally accepted accounting principles (GAAP) are used to prepare financial reports. This allows users to compare one company to another. In the United States, these principles are the responsibility of the Financial Accounting Standards Board (FASB). Companies that are publicly traded are also guided by the Securities and Exchanges Commission (SEC).

b. The FASB works with the International Accounting Standards Board (IASB) to reduce differences between international and U.S. standards. This helps make global investment and business easier. Financial accounting and GAAP are based on assumptions regarding the monetary unit, time period, business entity, and going concern.

c. This chapter also introduces the four forms of business entities: sole proprietorship, partnership, corporation, and limited liability company (LLC). Exhibit 5 (PPT Slides 21 and 22) lists the types of business entities and the characteristics and advantages of each.

d. Financial accounting relies on principles regarding measurement, historical cost, revenue recognition, and expense recognition.

e. **Discussion Activity 1:** *In the following scenarios, which form of business entity do you think would be the best choice? Explain your reasons.* (Slides 25–26)
   - A group of three dentists opening a full-service dental office
   - A graphic design artist specializing in digital marketing
   - Five entrepreneurs opening a chain of hair salons
     - There are advantages and disadvantages for each type of business formation. Small businesses often select a sole proprietorship, although it does expose them to liability issues, including potential lawsuits.
     - For each of these scenarios, the answers may vary. Legal and medical professionals often select a form of partnership or LLC. An individual, such as the graphic artist, may choose to be a sole proprietor. When there are more people involved and the potential exists for shares to be issued, a corporation would be the best choice (likely for the hair salons).
     - What did you choose for each, and why? If you opened a business, which would you choose?

f. More companies are relying on data analytics, which is the science of analyzing raw data to discover patterns and identify anomalies, in their operations. Because of accounting's role in providing useful information, accountants are increasingly using data analytics to help businesses make better decisions or gain other useful insights.

III. The Accounting Equation (1-3, PPT Slides 27–29, BUSPROG: Analytic, AICPA: FN-Measurement)

a. This objective defines assets, liabilities, and stockholders' equity and uses the accounting equation (Assets = Liabilities + Equity) to explain their relationship.

b. **Discussion Activity 2:** *Give an example of what a company might have as an asset and a liability. Then consider what an individual might have as an asset and a liability.* (Slides 28–29)
   - How would a business asset differ from an individual asset?
   - How would a business liability differ from an individual liability?
   - Can an individual calculate their net worth using the same accounting equation as a business?

IV. Business Transactions and the Accounting Equation (1-4, PPT Slides 30–45, BUSPROG: Analytic, AICPA: FN-Measurement)

a. Using a sample company called NetSolutions, this objective demonstrates how business transactions affect a company's financial condition.
b. Transactions, such as depositing cash, purchasing assets, selling services, and paying bills, affect the accounting equation. This shows students that through each transaction the two sides of the accounting equation must always be equal.
c. **Knowledge Check Activity 2:** *Hampshire Havens buys an adjoining piece of land to expand their golf course. They pay $89,000 in cash to acquire this land. Based on the accounting equation, what would be the effect of this transaction?* (Slides 44–45)
    - Cash would decrease by $89,000, and Land would increase by $89,000

V. Financial Statements (1-5, PPT Slides 46–58, BUSPROG: Analytic, AICPA: FN-Reporting)

a. This objective shows the income statement, statement of stockholders' equity, balance sheet, and statement of cash flows. Exhibit 8 (PPT Slide 47) shows the order in which the financial statements are prepared.
b. Using the same NetSolutions example as the previous objective, the order, preparation, and relationship among the four financial statements is demonstrated. Each statement is prepared for a specific period of time, except the balance sheet; it is prepared for a point in time.
c. The income statement is the first one prepared: revenue minus expenses is known as net income; if expenses are greater than revenue, the excess is a net loss. The statement of stockholders' equity reports the changes in common stock and retained earnings; the balance sheet reports the amount of assets, liabilities, and stockholders' equity and must follow the accounting equation. The statement of cash flows has three sections: operating, investing, and financing activities. Exhibit 9 (PPT Slides 48 and 49) shows the four financial statements for NetSolutions. Exhibit 10 (PPT Slides 54 and 55) explains the interrelationships between the financial statements. The balance sheet is the connecting link between the financial statements, and this is shown in Exhibit 11 (PPT Slide 56).
d. **Knowledge Check Activity 3:** *Which financial statement would a stockholder want to review if they are interested in the company's sales and expenses?* (Slides 57–58)
    - The income statement would list a company's sales, expenses, and net loss.

VI. Ratio of Liabilities to Stockholders' Equity (1-6, PPT Slides 59–61, BUSPROG: Analytic, AICPA: FN-Measurement)

a. Using the financial statements prepared in the previous objective, the use of the ratio of liabilities to stockholders' equity is examined. The total liabilities amount is divided by the total stockholders' equity amount to calculate this ratio.

b. Because creditors have rights to a business's assets before the owner, this ratio is important to both owners and creditors. This ratio can affect how a business pays its creditors and foretells how well a business will do in poor economic conditions. As this ratio increases, the creditors and the business become more at risk. Examples of the ratio for Twitter and Alphabet are shown on PPT Slides 60 and 61.

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Discussion Questions

You can assign these questions several ways: in a discussion forum in your LMS; as whole-class discussions in person; or as a partner or group activity in class.

1. Discussion: Importance of Accounting (Nature of Business and Role of Accounting, 1-1, PPT Slide 9) Duration 10 minutes.
    a. The role of accounting is to provide information to businesses about their activities, including operating, investing, and financing. Why is "accounting" so important?
        i. Answer: Accounting is the language of business. Without an organized system that provides information to users about the economic activities and condition of a business, there would no guarantee of a company being profitable or continuing in existence.
    b. Why do I need to know about accounting if I am not going to be an accountant?
        i. Answer: Any business professional needs to be aware of the functions and information provided by an accounting system. Without these vital data, such as information on sales, expenses, assets, liabilities, and equity, a business cannot survive, nor can its owners be assured of its profitability. Basic financial statements, such as the income statement and balance sheet, provide useful information for all users, internal and external, regarding a business. For example, if you are a marketing manager, it is important to know the expenses of the company's product or service to ensure the items are sold at a price that will provide a profit. Every employee of a business has a responsibility to uphold the company's mission to attain and sustain profitability.
2. Discussion: Recording Financial Transactions (Business Transactions and the Accounting Equation, 1-4) Duration 10 minutes.
    a. Why can't I just use a computer program to do all my accounting? Isn't that what technology is for?

i. Answer: Technology and software are extremely useful tools in all areas of business. Today's accounting software allows companies to record and process transactions very quickly and has lots of safeguards to protect against errors such as incorrect account numbers, math mistakes, unbalanced journal entries, and confusion in creating financial statements. However, financial and accounting systems are maintained by humans who need to provide directions and "rules" within the software programs. Accounting rules can change, and in certain areas, such as payroll processing, they vary from year to year or even more often—think of tax rate changes and employment laws. So while technology and accounting software are superb tools, it is important for trained employees to monitor the input and output carefully and to know how accounting works to use their judgment in processing data.

3. Discussion: Items Listed on Financial Statements (Financial Statements, 1-5, PPT Slides 50 and 52) Duration 15 minutes.
    a. The accounting system classifies different items into categories to help group similar items together for reporting and analysis. What is the difference between revenues and assets? Give examples of these items.
        i. Answer: Revenues are income derived from the sales of a company's products or services. These will change over time as the company grows or has seasonal activity. For example, a company such as Hershey's Food Corporation has increased sales prior to major holidays. A company's assets are resources that a company owns to provide the ability to earn revenues. For example, FedEx owns many delivery trucks and planes to earn revenues from delivering packages. Examples of assets include property, plant, and equipment, as well as cash, accounts receivable, and inventory.
    b. What is the difference between expenses and liabilities? Give examples of these items.
        i. Answer: Expenses are costs incurred by a company to make a product or provide a service. Examples of expenses include rent, payroll costs, raw materials, shipping, travel, and many others. Liabilities are amounts owed by the company to another entity. Examples of liabilities include mortgages, accounts payable to vendors, bond interest payable to bondholders, etc.

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Additional Activities and Assignments

1. **Class Discussion Activity:** *Types of Businesses* (Reflective Thinking, Critical Thinking, 1-1, PPT Slide 5) Duration 15 minutes.
   a. Have the class provide the names of businesses they have patronized in the past week. Include places they have shopped, eating establishments, products they use every day, and services they have used. When listing products, name the manufacturer; for iPod, for example, the manufacturer would be Apple. List these on the board or overhead.
      i. Answer: Student answers will vary.
   b. Have the students identify each listed business as service, retail, or manufacturing. Some will cross over categories. Nike, for example, manufactures products and owns retail outlets.
      i. Answer: Student answers will vary.
2. **Class Discussion Activity:** *Role of Ethics in Accounting and Business* (Reflective Thinking, Critical Thinking, 1-1, PPT Slide 11) Duration 20 minutes.
   a. Lauren Smith is the controller for Sports Central, a chain of sporting goods stores. She has been asked to recommend a site for a new store. Lauren has an uncle who owns a shopping plaza in the area of town where the new store is to be located, so she decides to contact her uncle about leasing space in his plaza. Lauren also contacted several other shopping plazas and malls, but her uncle's store turned out to be the most economical place to lease. Therefore, Lauren recommended locating the new store in her uncle's shopping plaza. In making her recommendation to management, she did not disclose that her uncle owns the shopping plaza. Discuss whether or not the accountant acted ethically.
      i. Answer: Lauren has a conflict of interest in recommending her uncle's shopping plaza as a site for the new store. After reviewing the data, management at Sports Central may agree with Lauren that her uncle's plaza is the most economical place to lease; however, Lauren should not make that recommendation without disclosing the family relationship. By hiding the conflict of interest, Lauren appears to lack integrity.
   b. John Jones is the chief accountant for the southwest district office of Security Life Insurance Company. While preparing the fourth-quarter sales report, John overheard the company president say that he would close Security's Phoenix office if it did not meet its fourth-quarter sales quota. John's best friend from college works at the Phoenix office. Anxious to find out whether the office was in jeopardy, John immediately finished the Phoenix office's report, only to find that it showed sales 25% below the quota. Later that afternoon, the company president called John for Phoenix's sales results. John told the president that he had not finished preparing the sales report for the Phoenix office. John wanted time to compile data that might convince

the president to continue operations in Phoenix, despite lagging sales. Discuss whether or not the accountant acted ethically.

i. Answer: Management accountants must communicate all information, both good and bad, fairly and objectively. It is not ethical to mislead management by withholding available information.

3. **Writing Exercises Activity:** *Business Entity and Cost Concept* (Reflective Thinking, Measurement, 1-2, PPT Slides 21 and 23) Duration 20 minutes.
    a. Sally Vertrees purchased a personal computer for use at home. Sally owns a dental practice. She occasionally uses the computer for a task related to her dental practice; however, the computer is used primarily by Sally's children. Can the computer be recorded as an asset in the accounting records of Sally's dental office? Why or why not?
        i. Answer: This is not the proper use of the business entity assumption. Purchasing items for personal use from business funds will affect the reporting of how successful or unsuccessful a business purports to be for a financial period.
    b. Jason Thompson purchased an office building 10 years ago for $780,000. The building was just appraised at $1.25 million. What value should be used for the building in Jason's accounting records? Support your answer.
        i. Answer: This is a clear example of the cost principle. Assets are recorded at cost and remain on the business books at cost until they are disposed of. Future economic conditions may change this appraised value; therefore, no adjustment is made until the asset is sold.
4. **Class Discussion and Online Activity:** *Types of Business Organizations* (Reflective Thinking, Critical Thinking, 1-2, PPT Slides 21 and 22) Duration 20 minutes.
    a. Ask students to name examples of businesses in the business entity categories of proprietorship, partnership, corporation, and limited liability corporation. Explain that they will be learning about accounting concepts related to businesses organized as corporations. Have them look online to find examples of each type.
        i. Answer: Student answers will vary. It may be a challenge to find businesses that fall under the category of limited liability corporation. Ask students what the advantages would be for each category.

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Additional Resources

Cengage Video Resources

A new, assignable Video Library is available in CNOWv2 for this title. To access the video library, login to CNOWv2, navigate to the Assignment Creation Wizard, and select Homework. The video library is shown within the expanded list of available homework items for each chapter. This chapter includes the following videos:

- 2 Quick Lessons videos
- 6 Tell Me More videos (1 for each learning objective)
- 25 Show Me How videos

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CHAPTER 1
INTRODUCTION TO ACCOUNTING AND BUSINESS

DISCUSSION QUESTIONS

1. Some users of accounting information include managers, employees, investors, creditors, customers, and the government.

2. The role of accounting is to provide information for managers to use in operating the business. In addition, accounting provides information to others to use in assessing the economic performance and condition of the business.

3. The corporate form allows the company to obtain large amounts of resources by issuing stock. For this reason, most companies that require large investments in property, plant, and equipment are organized as corporations.

4. No. The business entity assumption limits the recording of economic data to transactions directly affecting the activities of the business. The payment of the interest of $4,500 is a personal transaction of Josh Reilly and should not be recorded by Dispatch Delivery Service.

5. The land should be recorded at its cost of $167,500 to Reliable Repair Service. This is consistent with the cost principle.

6. **a.** No. The offer of $2,000,000 and the increase in the assessed value should not be recognized in the accounting records.

b. Cash would increase by $2,125,000, land would decrease by $900,000, and stockholders' equity would increase by $1,225,000.

7. An account receivable is a claim against a customer for goods or services sold. An account payable is an amount owed to a creditor for goods or services purchased. Therefore, an account receivable in the records of the seller is an account payable in the records of the purchaser.

8. **(b)** The business realized net income of $91,000 ($679,000 – $588,000).

9. **(a)** The business incurred a net loss of $75,000 ($640,000 – $715,000).

10. **(a)** Net income or net loss
(b) Common stock and retained earnings at the end of the period
(c) Cash at the end of the period

BASIC EXERCISES

BE 1–1

$320,000. Under the cost principle, the land should be recorded at the cost to Tin Roofing.

BE 1–2

a.

A	**=**	**L + SE**
$690,000	**=**	**$375,000 + SE**
SE	**=**	**$315,000**

b.

A	**=**	**L + SE**
$690,000 + $80,000	**=**	**$375,000 + $51,500 + SE**
$770,000	**=**	**$426,500 + SE**
SE	**=**	**$343,500**

BE 1–3

(2) Expense (Advertising Expense) increases by $3,500;
Asset (Cash) decreases by $3,500.

(3) Asset (Supplies) increases by $2,500;
Liability (Accounts Payable) increases by $2,500.

(4) Asset (Accounts Receivable) increases by $18,750;
Revenue (Delivery Service Fees) increases by $18,750.

(5) Asset (Cash) increases by $14,150;
Asset (Accounts Receivable) decreases by $14,150.

BE 1–4

A-One Travel Service Income Statement For the Year Ended August 31, 20Y6		
Fees earned		$1,150,000
Expenses:		
Wages expense	$640,000	
Office expense	150,000	
Miscellaneous expense	45,000	
Total expenses		(835,000)
Net income		$ 315,000

BE 1–5

A-One Travel Service Statement of Stockholders' Equity For the Year Ended August 31, 20Y6			
	Common Stock	Retained Earnings	Total
Balances, September 1, 20Y5	$60,000	$ 775,000	$ 835,000
Issued common stock	15,000		15,000
Net income		315,000	315,000
Dividends		(50,000)	(50,000)
Balances, August 31, 20Y6	$75,000	$1,040,000	$1,115,000

BE 1–6

A-One Travel Service Balance Sheet August 31, 20Y6		
Assets		
Cash		$ 184,500
Accounts receivable		68,000
Supplies		17,500
Land		880,000
Total assets		$1,150,000
Liabilities		
Accounts payable		$ 35,000
Stockholders' Equity		
Common stock	$ 75,000	
Retained earnings	1,040,000	
Total stockholders' equity		1,115,000
Total liabilities and stockholders' equity		$1,150,000

BE 1–7

A-One Travel Service Statement of Cash Flows For the Year Ended August 31, 20Y6		
Cash flows from (used for) operating activities:		
Cash received from customers	$1,125,000	
Cash paid for operating expenses	(815,000)	
Net cash flows from operating activities		$ 310,000
Cash flows from (used for) investing activities:		
Cash paid for purchase of land		(150,000)
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 15,000	
Cash paid for dividends	(50,000)	
Net cash flows used for financing activities		(35,000)
Net increase in cash		$ 125,000
Cash balance, September 1, 20Y5		59,500
Cash balance, August 31, 20Y6		$ 184,500

BE 1–8

a.

	Dec. 31, 20Y4	Dec. 31, 20Y3
Total liabilities	$4,085,000	$2,880,000
Total stockholders' equity	$4,300,000	$3,600,000
Ratio of liabilities to stockholders' equity	0.95*	0.80**

* $4,085,000 ÷ $4,300,000
** $2,880,000 ÷ $3,600,000

b. Increased

EXERCISES

Ex. 1–1

a.

1.	manufacturing	6.	manufacturing	11.	service
2.	manufacturing	7.	service	12.	service
3.	manufacturing	8.	service	13.	manufacturing
4.	service	9.	manufacturing	14.	service
5.	retail	10.	retail	15.	retail

b. The accounting equation is relevant to all companies. It serves as the basis of the accounting information system.

Ex. 1–2

As in many ethics issues, there is no one right answer. Oftentimes, disclosing only what is legally required may not be enough. In this case, it would be best for the company's chief executive officer to disclose both reports to the county representatives. In doing so, the chief executive officer could point out any flaws or deficiencies in the fired researcher's report.

Ex. 1–3

a.

1.	M	5.	O	9.	X
2.	L	6.	O	10.	O
3.	O	7.	X		
4.	M	8.	L		

b. A business transaction is an economic event or condition that directly changes an entity's financial condition or results of operations.

Ex. 1–4

Kroger's stockholders' equity: $38,118 – $30,283 = $7,835
Procter & Gamble's stockholders' equity: $115,095 – $67,516 = $47,579

Ex. 1–5

Dollar Tree's stockholders' equity: $13,501 – $7,858 = $5,643
Target's stockholders' equity: $41,290 – $29,993 = $11,297

Ex. 1–6

a. $2,075,000 ($1,200,000 + $875,000)
b. $2,960,000 ($3,860,000 – $900,000)
c. $12,750,000 ($71,850,000 – $59,100,000)

Ex. 1–7

a. $1,270,000 ($2,450,000 – $1,180,000)
b. $1,580,000 ($1,270,000 + $825,000 – $515,000)
c. $835,000 ($1,270,000 – $375,000 – $60,000)
d. $2,115,000 ($1,270,000 + $725,000 + $120,000)
e. Net income: $630,000 ($3,300,000 – $1,400,000 – $1,270,000)

Ex. 1–8

a. (2) liability
b. (1) asset
c. (3) stockholders' equity (revenue)
d. (1) asset
e. (3) stockholders' equity (expense)
f. (3) stockholders' equity (expense)

Ex. 1–9

a. Increases assets and increases stockholders' equity.
b. Decreases assets and decreases stockholders' equity.
c. Decreases assets and decreases stockholders' equity.
d. Increases assets and increases liabilities.
e. Increases assets and increases stockholders' equity.

Ex. 1–10

a. (1) Total assets increased $183,000 ($298,000 – $115,000).
   (2) No change in liabilities.
   (3) Stockholders' equity increased $183,000.

b. (1) Total assets decreased $80,000.
   (2) Total liabilities decreased $80,000.
   (3) No change in stockholders' equity.

c. No, it is false that a transaction always affects at least two elements (Assets, Liabilities, or Stockholders' Equity) of the accounting equation. Some transactions affect only one element of the accounting equation. For example, purchasing supplies for cash only affects assets.

Ex. 1–11

1. (a) increase
2. (a) increase
3. (b) decrease
4. (b) decrease

Ex. 1–12

1.	c	6.	c
2.	a	7.	d
3.	e	8.	a
4.	e	9.	e
5.	c	10.	e

Ex. 1–13

a. (1) Provided catering services for cash, $71,800.
   (2) Purchase of land for cash, $15,000.
   (3) Payment of cash for expenses, $47,500.
   (4) Purchase of supplies on account, $1,100.
   (5) Paid cash dividends, $5,000.
   (6) Payment of cash to creditors, $4,000.
   (7) Recognition of cost of supplies used, $1,500.

b. $300 ($40,300 – $40,000)

c. $17,800 (–$5,000 + $71,800 – $49,000)

d. $22,800 ($71,800 – $49,000)

e. $17,800 ($22,800 – $5,000)

Ex. 1–14

No. It would be incorrect to say that the business had incurred a net loss of $8,000. The excess of the dividends over the net income for the period is a decrease in the amount of stockholders' equity (retained earnings) in the business.

Ex. 1–15

Amber

Stockholders' equity at end of year ($1,730,000 – $1,150,000)	$ 580,000
Deduct stockholders' equity at beginning of year ($1,220,000 – $990,000)	(230,000)
Net income (increase in stockholders' equity)	$ 350,000

Blue

Increase in stockholders' equity (as determined for Amber)	$ 350,000
Add dividends	60,000
Net income	$ 410,000

Coral

Increase in stockholders' equity (as determined for Amber)	$ 350,000
Deduct additional issuance of common stock	(140,000)
Net income	$ 210,000

Daffodil

Increase in stockholders' equity (as determined for Amber)	$ 350,000
Deduct additional issuance of common stock	(140,000)
	$ 210,000
Add dividends	60,000
Net income	$ 270,000

Ex. 1–16

Balance sheet items: 1, 2, 3, 5, 7, 8, 10

Ex. 1–17

Income statement items: 4, 6, 9

Ex. 1–18

a.

Organic Products Company Statement of Stockholders' Equity For the Month Ended June 30, 20Y9			
	Common Stock	**Retained Earnings**	**Total**
Balances, June 1, 20Y9	$180,000	$1,630,000	$1,810,000
Issued common stock	50,000		50,000
Net income		115,000	115,000
Dividends		(25,000)	(25,000)
Balances, June 30, 20Y9	$230,000	$1,720,000	$1,950,000

b. **The statement of stockholders' equity is prepared before the June 30, 20Y9, balance sheet because common stock and retained earnings as of June 30, 20Y9, are needed for the June 30, 20Y9, balance sheet.**

Ex. 1–19

Imaging Services Income Statement For the Month Ended March 31, 20Y5		
Fees earned		$ 482,000
Expenses:		
Wages expense	$300,000	
Rent expense	41,500	
Supplies expense	3,600	
Miscellaneous expense	1,900	
Total expenses		(347,000)
Net income		$ 135,000

Ex. 1–20

In each case, solve for a single unknown, using the following equation:

Stockholders' Equity (beginning) + Additional Common Stock Issued – Dividends + Revenues – Expenses = Stockholders' Equity (ending)

Freeman

Stockholders' equity at end of year ($1,260,000 – $330,000).........		$ 930,000
Stockholders' equity at beginning of year ($900,000 – $360,000)...		(540,000)
Increase in stockholders' equity...		$ 390,000
Deduct increase due to net income ($570,000 – $240,000)...........		(330,000)
		$ 60,000
Add dividends..		75,000
Additional common stock issued...	(a)	$ 135,000

Heyward

Stockholders' equity at end of year ($675,000 – $220,000)...........		$ 455,000
Stockholders' equity at beginning of year ($490,000 – $260,000)...		(230,000)
Increase in stockholders' equity...		$ 225,000
Add dividends..		32,000
		$ 257,000
Deduct additional common stock issued..................................		(150,000)
Increase due to net income...		$ 107,000
Add expenses..		128,000
Revenue..	(b)	$ 235,000

Jones

Stockholders' equity at end of year ($100,000 – $80,000).............		$ 20,000
Stockholders' equity at beginning of year ($115,000 – $81,000).....		(34,000)
Decrease in stockholders' equity...		$(14,000)
Decrease in stockholders' equity due to net loss ($115,000 – $122,500)...		7,500
		$ (6,500)
Deduct common stock issued..		(10,000)
Dividends...	(c)	$(16,500)

Ramirez

Stockholders' equity at end of year ($270,000 – $136,000)...........		$134,000
Add decrease due to net loss ($115,000 – $128,000)....................		13,000
		$147,000
Add dividends..		39,000
Stockholders' equity at beginning of year.................................		$186,000
Deduct additional investment..		(55,000)
		$131,000
Add liabilities at beginning of year...		120,000
Assets at beginning of year...	(d)	$251,000

Ex. 1–21

a.

Ebony Interiors Balance Sheet February 28, 20Y3		
Assets		
Cash		$ 320,000
Accounts receivable		800,000
Supplies		30,000
Total assets		$1,150,000
Liabilities		
Accounts payable		$ 310,000
Stockholders' Equity		
Common stock	$200,000	
Retained earnings	640,000*	
Total stockholders' equity		840,000
Total liabilities and stockholders' equity		$1,150,000

* $640,000 = $320,000 + $800,000 + $30,000 – $310,000 – $200,000

Ebony Interiors Balance Sheet March 31, 20Y3		
Assets		
Cash		$ 380,000
Accounts receivable		960,000
Supplies		35,000
Total assets		$1,375,000
Liabilities		
Accounts payable		$ 400,000
Stockholders' Equity		
Common stock	$200,000	
Retained earnings	775,000*	
Total stockholders' equity		975,000
Total liabilities and stockholders' equity		$1,375,000

* $775,000 = $380,000 + $960,000 + $35,000 – $400,000 – $200,000

b.

Stockholders' equity, March 31	$ 975,000
Stockholders' equity, February 28	(840,000)
Net income	$ 135,000

Ex. 1–21 (Concluded)

c. Stockholders' equity, March 31	$ 975,000
Stockholders' equity, February 28	(840,000)
Increase in stockholders' equity	$ 135,000
Add dividends	50,000
Net income	$ 185,000

Ex. 1–22

a. Balance sheet: 1, 2, 3, 4, 6, 7, 8, 9, 10, 11, 13
Income statement: 5, 12, 14, 15

b. Yes, an item can appear on more than one financial statement. For example, cash appears on both the balance sheet and statement of cash flows. However, the same item cannot appear on both the income statement and balance sheet.

c. Yes, the accounting equation is relevant to all companies, including Exxon Mobil Corporation. The accounting equation is the basis for all accounting systems.

Ex. 1–23

1. (c) financing activity
2. (a) operating activity
3. (b) investing activity
4. (c) financing activity

Ex. 1–24

Parker Consulting Group Statement of Cash Flows For the Year Ended January 31, 20Y4		
Cash flows from (used for) operating activities:		
Cash received from customers	$1,200,000	
Cash paid for expenses	(800,000)	
Net cash flows from operating activities		$ 400,000
Cash flows from (used for) investing activities:		
Cash paid for purchase of land		(300,000)
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 90,000	
Cash paid for dividends	(36,000)	
Net cash flows from financing activities		54,000
Net increase in cash		$ 154,000
Cash balance, February 1, 20Y3		66,000
Cash balance, January 31, 20Y4		$ 220,000

Ex. 1–25

a. 1. All financial statements should contain the name of the business in their heading. The statement of stockholders' equity is incorrectly headed as "Omar Farah" rather than We-Sell Realty. The heading of the balance sheet needs to be the name of the business.

2. The income statement covers a period of time and should be labeled "For the Month Ended August 31, 20Y7."

3. The year in the heading for the statement of stockholders' equity should be 20Y7 rather than 20Y6.

4. The balance sheet should be labeled "August 31, 20Y7," rather than "For the Month Ended August 31, 20Y7."

5. On the income statement, the miscellaneous expense amount should be listed as the last expense.

6. On the income statement, the total expenses are subtracted from the sales commissions, resulting in an incorrect net income amount of $25,000. The correct net income should be $24,150. This also affects the statement of stockholders' equity and the amount of retained earnings that appears on the balance sheet.

7. On the statement of stockholders' equity, there is no column for common stock. Also, the statement is for the "month" rather than for the "year" ended August 31, 20Y7.

8. Accounts payable should be listed as a liability on the balance sheet.

9. Accounts receivable and supplies should be listed as assets on the balance sheet.

10. The balance sheet assets should equal the sum of the liabilities and stockholders' equity.

Ex. 1–25 (Concluded)

b. Corrected financial statements appear as follows:

We-Sell Realty Income Statement For the Month Ended August 31, 20Y7		
Sales commissions		$ 140,000
Expenses:		
Office salaries expense	$87,000	
Rent expense	18,000	
Automobile expense	7,500	
Supplies expense	1,150	
Miscellaneous expense	2,200	
Total expenses		(115,850)
Net income		$ 24,150

We-Sell Realty Statement of Stockholders' Equity For the Month Ended August 31, 20Y7			
	Common Stock	Retained Earnings	Total
Balances, August 1, 20Y7	$ 0	$ 0	$ 0
Issued common stock	15,000		15,000
Net income		24,150	24,150
Dividends		(10,000)	(10,000)
Balances, August 31, 20Y7	$15,000	$ 14,150	$ 29,150

We-Sell Realty Balance Sheet August 31, 20Y7		
Assets		
Cash		$ 8,900
Accounts receivable		38,600
Supplies		4,000
Total assets		$51,500
Liabilities		
Accounts payable		$22,350
Stockholders' Equity		
Common stock	$15,000	
Retained earnings	14,150	
Total stockholders' equity		29,150
Total liabilities and stockholders' equity		$51,500

PROBLEMS

Prob. 1–1A

1.

	Assets			= Liabilities +	Stockholders' Equity							
	Cash +	Accts. Rec. +	Supplies =	Accts. Payable +	Common Stock	– Dividends +	Fees Earned –	Rent Expense –	Salaries Expense –	Supplies Expense –	Auto Exp. –	Misc. Exp.
a.	+ 75,000				+ 75,000							
b.			+ 2,200	+ 2,200								
Bal.	75,000		2,200	2,200	75,000							
c.	+ 19,500						+ 19,500					
Bal.	94,500		2,200	2,200	75,000		19,500					
d.	– 8,000							– 8,000				
Bal.	86,500		2,200	2,200	75,000		19,500	– 8,000				
e.	– 1,850			– 1,850								
Bal.	84,650		2,200	350	75,000		19,500	– 8,000				
f.		+ 6,000					+ 6,000					
Bal.	84,650	6,000	2,200	350	75,000		25,500	– 8,000				
g.	– 2,300										– 1,500	– 800
Bal.	82,350	6,000	2,200	350	75,000		25,500	– 8,000			– 1,500	– 800
h.	– 5,500								– 5,500			
Bal.	76,850	6,000	2,200	350	75,000		25,500	– 8,000	– 5,500		– 1,500	– 800
i.			– 1,650							– 1,650		
Bal.	76,850	6,000	550	350	75,000		25,500	– 8,000	– 5,500	– 1,650	– 1,500	– 800
j.	– 4,000					– 4,000						
Bal.	72,850	6,000	550	350	75,000	– 4,000	25,500	– 8,000	– 5,500	– 1,650	– 1,500	– 800

2. Stockholders' equity is the right of stockholders (owners) to the assets of the business. These rights are increased by issuing common stock and revenues and decreased by dividends and expenses.

3. $8,050 ($25,500 – $8,000 – $5,500 – $1,650 – $1,500 – $800)

4. June's transactions increased stockholders' equity by $79,050, which is the common stock of $75,000 that was issued plus June's net income of $8,050 less dividends of $4,000.

Prob. 1–2A

1.

Adventure Travel Agency Income Statement For the Year Ended December 31, 20Y5		
Fees earned		$ 1,400,000
Expenses:		
Wages expense	$870,000	
Rent expense	75,000	
Utilities expense	40,000	
Supplies expense	15,300	
Miscellaneous expense	22,100	
Total expenses		(1,022,400)
Net income		$ 377,600

2.

Adventure Travel Agency Statement of Stockholders' Equity For the Year Ended December 31, 20Y5	Common Stock	Retained Earnings	Total
Balances, January 1, 20Y5	$250,000	$1,160,400	$1,410,400
Issued common stock	75,000		75,000
Net income		377,600	377,600
Dividends		(50,000)	(50,000)
Balances, December 31, 20Y5	$325,000	$1,488,000	$1,813,000

3.

Adventure Travel Agency Balance Sheet December 31, 20Y5		
Assets		
Cash		$ 198,600
Accounts receivable		310,400
Supplies		6,000
Land		1,350,000
Total assets		$1,865,000
Liabilities		
Accounts payable		$ 52,000
Stockholders' Equity		
Common stock	$ 325,000	
Retained earnings	1,488,000	
Total stockholders' equity		1,813,000
Total liabilities and stockholders' equity		$1,865,000

Prob. 1–2A (Concluded)

4. **Ending common stock and retained earnings appear on both the statement of stockholders' equity and the balance sheet. For Adventure Travel Agency, the December 31, 20Y5, common stock of $325,000 and retained earnings of $1,488,000 appear on the statement of stockholders' equity and balance sheet.**

Prob. 1–3A

1.

Reliance Financial Services Income Statement For the Month Ended July 31, 20Y2		
Fees earned		$ 144,500
Expenses:		
Salaries expense	$55,000	
Rent expense	33,000	
Auto expense	16,000	
Supplies expense	4,500	
Miscellaneous expense	4,800	
Total expenses		(113,300)
Net income		$ 31,200

2.

Reliance Financial Services Statement of Stockholders' Equity For the Month Ended July 31, 20Y2			
	Common Stock	Retained Earnings	Total
Balances, July 1, 20Y2	$ 0	$ 0	$ 0
Issued common stock	50,000		50,000
Net income		31,200	31,200
Dividends		(15,000)	(15,000)
Balances, July 31, 20Y2	$50,000	$ 16,200	$ 66,200

Prob. 1–3A (Concluded)

3.

Reliance Financial Services Balance Sheet July 31, 20Y2		
Assets		
Cash		$32,600
Accounts receivable		34,500
Supplies		2,500
Total assets		$69,600
Liabilities		
Accounts payable		$ 3,400
Stockholders' Equity		
Common stock	$50,000	
Retained earnings	16,200	
Total stockholders' equity		66,200
Total liabilities and stockholders' equity		$69,600

4. Optional

Reliance Financial Services Statement of Cash Flows For the Month Ended July 31, 20Y2		
Cash flows from (used for) operating activities:		
Cash received from customers	$ 110,000	
Cash paid for expenses and to creditors*	(112,400)	
Net cash flows used for operating activities		$ (2,400)
Cash flows from (used for) investing activities		0
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 50,000	
Cash paid for dividends	(15,000)	
Net cash flows from financing activities		35,000
Net increase in cash		$32,600
Cash balance, July 1, 20Y2		0
Cash balance, July 31, 20Y2		$32,600

* $3,600 + $33,000 + $20,800 + $55,000; these amounts are taken from the Cash column shown in the problem.

Prob. 1–4A

1.

	Assets		= Liabilities +	Stockholders' Equity							
	Cash	+ Supplies =	Accts. Payable +	Common Stock –	Dividends +	Sales Comm. –	Salaries Exp. –	Rent Exp. –	Auto Exp. –	Supplies Exp. –	Misc. Exp.
a.	+ 35,000			+ 35,000							
b.		+ 2,750	+ 2,750								
Bal.	35,000	2,750	2,750	35,000							
c.	– 1,800		– 1,800								
Bal.	33,200	2,750	950	35,000							
d.	+ 52,800					+ 52,800					
Bal.	86,000	2,750	950	35,000		52,800					
e.	– 4,500							– 4,500			
Bal.	81,500	2,750	950	35,000		52,800		– 4,500			
f.	– 3,000				– 3,000						
Bal.	78,500	2,750	950	35,000	– 3,000	52,800		– 4,500			
g.	– 2,300								– 1,100		– 1,200
Bal.	76,200	2,750	950	35,000	– 3,000	52,800		– 4,500	– 1,100		– 1,200
h.	– 5,250						– 5,250				
Bal.	70,950	2,750	950	35,000	– 3,000	52,800	– 5,250	– 4,500	– 1,100		– 1,200
i.		– 1,000								– 1,000	
Bal.	70,950	1,750	950	35,000	– 3,000	52,800	– 5,250	– 4,500	– 1,100	– 1,000	– 1,200

Prob. 1–4A (Concluded)

2.

Western Realty Income Statement For the Month Ended August 31, 20Y9		
Sales commissions		$ 52,800
Expenses:		
Salaries expense	$5,250	
Rent expense	4,500	
Automobile expense	1,100	
Supplies expense	1,000	
Miscellaneous expense	1,200	
Total expenses		(13,050)
Net income		$ 39,750

Western Realty Statement of Stockholders' Equity For the Month Ended August 31, 20Y9			
	Common Stock	Retained Earnings	Total
Balances, August 1, 20Y9	$ 0	$ 0	$ 0
Issued common stock	35,000		35,000
Net income		39,750	39,750
Dividends		(3,000)	(3,000)
Balances, August 31, 20Y9	$35,000	$36,750	$71,750

Western Realty Balance Sheet August 31, 20Y9		
Assets		
Cash		$70,950
Supplies		1,750
Total assets		$72,700
Liabilities		
Accounts payable		$ 950
Stockholders' Equity		
Common stock	$35,000	
Retained earnings	36,750	
Total stockholders' equity		71,750
Total liabilities and stockholders' equity		$72,700

Prob. 1–5A

1.

Assets							=	Liabilities	+	Stockholders' Equity		
Cash	+	Accounts Receivable	+	Supplies	+	Land	=	Accounts Payable	+	Common Stock	+	Retained Earnings
$45,000	+	$93,000	+	$7,000	+	$75,000	=	$40,000	+	$60,000	+	Retained Earnings
						$220,000	=	$100,000	+	Retained Earnings		
						$120,000	=	Retained Earnings				

Prob. 1–5A (Continued)

2.

	Assets				= Liabilities +	Stockholders' Equity		
	Cash +	Accts. Rec. +	Supplies +	Land =	Accts. Payable +	Common Stock +	Retained Earnings –	Dividends
Bal.	45,000	93,000	7,000	75,000	40,000	60,000	120,000	
a.	+ 35,000					+ 35,000		
Bal.	80,000	93,000	7,000	75,000	40,000	95,000	120,000	
b.	– 50,000			+ 50,000				
Bal.	30,000	93,000	7,000	125,000	40,000	95,000	120,000	
c.	+ 32,125							
Bal.	62,125	93,000	7,000	125,000	40,000	95,000	120,000	
d.	– 6,000							
Bal.	56,125	93,000	7,000	125,000	40,000	95,000	120,000	
e.			+ 2,500		+ 2,500			
Bal.	56,125	93,000	9,500	125,000	42,500	95,000	120,000	
f.	– 22,800				– 22,800			
Bal.	33,325	93,000	9,500	125,000	19,700	95,000	120,000	
g.		+ 84,750						
Bal.	33,325	177,750	9,500	125,000	19,700	95,000	120,000	
h.					+ 29,500			
Bal.	33,325	177,750	9,500	125,000	49,200	95,000	120,000	
i.	– 14,000							
Bal.	19,325	177,750	9,500	125,000	49,200	95,000	120,000	
j.	+ 88,000	– 88,000						
Bal.	107,325	89,750	9,500	125,000	49,200	95,000	120,000	
k.			– 3,600					
Bal.	107,325	89,750	5,900	125,000	49,200	95,000	120,000	
l.	– 12,000							– 12,000
Bal.	95,325	89,750	5,900	125,000	49,200	95,000	120,000	– 12,000

Prob. 1–5A (Continued)

	Stockholders' Equity (Continued)							
	+ Dry Cleaning Revenue	– Dry Cleaning Exp.	– Wages Exp.	– Rent Exp.	– Supplies Exp.	– Truck Exp.	– Utilities Exp.	– Misc. Exp.
Bal.								
a.								
Bal.								
b.								
Bal.								
c.	+ 32,125							
Bal.	32,125							
d.				– 6,000				
Bal.	32,125			– 6,000				
e.								
Bal.	32,125			– 6,000				
f.								
Bal.	32,125			– 6,000				
g.	+ 84,750							
Bal.	116,875			– 6,000				
h.		– 29,500						
Bal.	116,875	– 29,500		– 6,000				
i.			– 7,500			– 2,500	– 1,300	– 2,700
Bal.	116,875	– 29,500	– 7,500	– 6,000		– 2,500	– 1,300	– 2,700
j.								
Bal.	116,875	– 29,500	– 7,500	– 6,000		– 2,500	– 1,300	– 2,700
k.					– 3,600			
Bal.	116,875	– 29,500	– 7,500	– 6,000	– 3,600	– 2,500	– 1,300	– 2,700
l.								
Bal.	116,875	– 29,500	– 7,500	– 6,000	– 3,600	– 2,500	– 1,300	– 2,700

Prob. 1–5A (Continued)

3.

D'Lite Dry Cleaners Income Statement For the Month Ended July 31, 20Y4		
Dry cleaning revenue		$116,875
Expenses:		
Dry cleaning expense	$29,500	
Wages expense	7,500	
Rent expense	6,000	
Supplies expense	3,600	
Truck expense	2,500	
Utilities expense	1,300	
Miscellaneous expense	2,700	
Total expenses		(53,100)
Net income		$ 63,775

D'Lite Dry Cleaners Statement of Stockholders' Equity For the Month Ended July 31, 20Y4	Common Stock	Retained Earnings	Total
Balances, July 1, 20Y4	$60,000	$120,000	$180,000
Issued common stock	35,000		35,000
Net income		63,775	63,775
Dividends		(12,000)	(12,000)
Balances, July 31, 20Y4	$95,000	$171,775	$266,775

D'Lite Dry Cleaners Balance Sheet July 31, 20Y4		
Assets		
Cash		$ 95,325
Accounts receivable		89,750
Supplies		5,900
Land		125,000
Total assets		$315,975
Liabilities		
Accounts payable		$ 49,200
Stockholders' Equity		
Common stock	$ 95,000	
Retained earnings	171,775	
Total stockholders' equity		266,775
Total liabilities and stockholders' equity		$315,975

Prob. 1–5A (Concluded)

4. Optional

D'Lite Dry Cleaners Statement of Cash Flows For the Month Ended July 31, 20Y4		
Cash flows from (used for) operating activities:		
Cash received from customers*	$120,125	
Cash paid for expenses and to creditors**	(42,800)	
Net cash flows from operating activities		$ 77,325
Cash flows from (used for) investing activities:		
Cash paid for acquisition of land		(50,000)
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 35,000	
Cash paid for dividends	(12,000)	
Net cash flows from financing activities		23,000
Net increase in cash		$ 50,325
Cash balance, July 1, 20Y4		45,000
Cash balance, July 31, 20Y4		$ 95,325

* $32,125 + $88,000; these amounts are taken from the Cash column of the spreadsheet in Part 2.

** $6,000 + $22,800 + $14,000; these amounts are taken from the Cash column of the spreadsheet in Part 2.

Prob. 1–6A

a. **Fees earned, $750,000 ($275,000 + $475,000)**

b. **Supplies expense, $30,000 ($475,000 – $300,000 – $100,000 – $20,000 – $25,000)**

c. **The common stock, $375,000; the amount shown on the balance sheet**

d. **Net income for April, $275,000 from the income statement**

e. **$150,000 ($275,000 – $125,000)**

f. **Total stockholders' equity, $525,000 ($375,000 + $150,000)**

g. **Total assets, $625,000 ($462,500 + $12,500 + $150,000)**

h. **Retained earnings, $150,000; same as (e)**

i. **Total stockholders' equity, $525,000 ($375,000 + $150,000); same as (f)**

j. **Total liabilities and stockholders' equity, $625,000 ($100,000 + $525,000)**

k. **Cash received from customers, $750,000 ($387,500 + $362,500); this is the same as fees earned (a) since there are no accounts receivable.**

l. **Net cash flows from operating activities, $362,500 ($750,000 – $387,500)**

m. **Cash paid for land, ($150,000)**

n. **Cash received from issuing common stock, $375,000**

o. **Cash dividends, ($125,000)**

p. **Net cash flows from financing activities, $250,000 ($375,000 – $125,000)**

q. **Net increase in cash, $462,500 ($362,500 – $150,000 + $250,000)**

r. **Cash as of April 30, 20Y0, $462,500; same as (q) since Wolverine Realty was organized on April 1, 20Y0; also cash balance on the balance sheet.**

Prob. 1–1B

1.

	Assets			= Liabilities +	Stockholders' Equity								
	Cash +	Accts. Rec. +	Supplies =	Accts. Payable +	Common Stock	– Dividends +	Fees Earned	– Rent Expense	– Salaries Expense	– Supplies Expense	– Auto Exp.	– Misc. Exp.
a.	+ 50,000				+ 50,000							
b.			+ 4,000	+ 4,000								
Bal.	50,000		4,000	4,000	50,000							
c.	– 2,300			– 2,300								
Bal.	47,700		4,000	1,700	50,000							
d.	+ 13,800						+ 13,800					
Bal.	61,500		4,000	1,700	50,000		13,800					
e.	– 5,000							– 5,000				
Bal.	56,500		4,000	1,700	50,000		13,800	– 5,000				
f.	– 1,450										– 1,150	– 300
Bal.	55,050		4,000	1,700	50,000		13,800	– 5,000			– 1,150	– 300
g.	– 2,500								– 2,500			
Bal.	52,550		4,000	1,700	50,000		13,800	– 5,000	– 2,500		– 1,150	– 300
h.			– 1,300							– 1,300		
Bal.	52,550		2,700	1,700	50,000		13,800	– 5,000	– 2,500	– 1,300	– 1,150	– 300
i.		+ 12,500					+ 12,500					
Bal.	52,550	12,500	2,700	1,700	50,000		26,300	– 5,000	– 2,500	– 1,300	– 1,150	– 300
j.	– 3,900					– 3,900						
Bal.	48,650	12,500	2,700	1,700	50,000	– 3,900	26,300	– 5,000	– 2,500	– 1,300	– 1,150	– 300

2. Stockholders' equity is the right of stockholders (owners) to the assets of the business. These rights are increased by issuing common stock and revenues and decreased by dividends and expenses.

3. $16,050 ($26,300 – $5,000 – $2,500 – $1,300 – $1,150 – $300)

4. March's transactions increased stockholders' equity by $62,150, which is the common stock that was issued of $50,000 plus the excess of March's net income of $16,050 over dividends of $3,900.

Prob. 1–2B

1.

Wilderness Travel Service Income Statement For the Year Ended April 30, 20Y7		
Fees earned		$ 875,000
Expenses:		
Wages expense	$525,000	
Rent expense	75,000	
Utilities expense	38,000	
Supplies expense	12,000	
Taxes expense	10,000	
Miscellaneous expense	15,000	
Total expenses		(675,000)
Net income		$ 200,000

2.

Wilderness Travel Service Statement of Stockholders' Equity For the Year Ended April 30, 20Y7			
	Common Stock	Retained Earnings	Total
Balances, May 1, 20Y6	$25,000	$155,000	$180,000
Issued common stock	10,000		10,000
Net income		200,000	200,000
Dividends		(40,000)	(40,000)
Balances, April 30, 20Y7	$35,000	$315,000	$350,000

3.

Wilderness Travel Service Balance Sheet April 30, 20Y7		
Assets		
Cash		$156,000
Accounts receivable		210,000
Supplies		9,000
Total assets		$375,000
Liabilities		
Accounts payable		$ 25,000
Stockholders' Equity		
Common stock	$ 35,000	
Retained earnings	315,000	
Total stockholders' equity		350,000
Total liabilities and stockholders' equity		$375,000

4. Net income (or net loss) appears on both the income statement and the statement of stockholders' equity. For Wilderness Travel Service, net income for the year of $200,000 appears on the income statement and statement of stockholders' equity.

Prob. 1–3B

1.

Bronco Consulting Income Statement For the Month Ended August 31, 20Y1		
Fees earned		$ 125,000
Expenses:		
Salaries expense	$58,000	
Rent expense	27,000	
Auto expense	15,500	
Supplies expense	6,100	
Miscellaneous expense	7,500	
Total expenses		(114,100)
Net income		$ 10,900

2.

Bronco Consulting Statement of Stockholders' Equity For the Month Ended August 31, 20Y1			
	Common Stock	Retained Earnings	Total
Balances, August 1, 20Y1	$ 0	$ 0	$ 0
Issued common stock	75,000		75,000
Net income		10,900	10,900
Dividends		(5,000)	(5,000)
Balances, August 31, 20Y1	$75,000	$ 5,900	$80,900

3.

Bronco Consulting Balance Sheet August 31, 20Y1		
Assets		
Cash		$48,000
Accounts receivable		33,000
Supplies		2,900
Total assets		$83,900
Liabilities		
Accounts payable		$ 3,000
Stockholders' Equity		
Common stock	$75,000	
Retained earnings	5,900	
Total stockholders' equity		80,900
Total liabilities and stockholders' equity		$83,900

Prob. 1–3B (Concluded)

4. Optional

Bronco Consulting Statement of Cash Flows For the Month Ended August 31, 20Y1		
Cash flows from (used for) operating activities:		
Cash received from customers	$ 92,000	
Cash paid for expenses and to creditors*	(114,000)	
Net cash flows used for operating activities		$(22,000)
Cash flows from (used for) investing activities		0
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 75,000	
Cash paid for dividends	(5,000)	
Net cash flows from financing activities		70,000
Net increase in cash		$ 48,000
Cash balance, August 1, 20Y1		0
Cash balance, August 31, 20Y1		$ 48,000

* $27,000 + $6,000 + $23,000 + $58,000; these amounts are taken from the Cash column shown in the problem.

Prob. 1–4B

1.

	Assets		= Liabilities +	Stockholders' Equity							
	Cash	+ Supplies	= Accts. Payable	+ Common Stock	− Dividends	+ Sales Comm.	− Rent Exp.	− Salaries Exp.	− Auto Exp.	− Supplies Exp.	− Misc. Exp.
a.	+ 24,000			+ 24,000							
b.	– 3,600						– 3,600				
Bal.	20,400			24,000			– 3,600				
c.	– 1,950								– 1,350		– 600
Bal.	18,450			24,000			– 3,600		– 1,350		– 600
d.		+ 1,200	+ 1,200								
Bal.	18,450	1,200	1,200	24,000			– 3,600		– 1,350		– 600
e.	+ 19,800					+ 19,800					
Bal.	38,250	1,200	1,200	24,000		19,800	– 3,600		– 1,350		– 600
f.	– 750		– 750								
Bal.	37,500	1,200	450	24,000		19,800	– 3,600		– 1,350		– 600
g.	– 2,500							– 2,500			
Bal.	35,000	1,200	450	24,000		19,800	– 3,600	– 2,500	– 1,350		– 600
h.	– 3,500				– 3,500						
Bal.	31,500	1,200	450	24,000	– 3,500	19,800	– 3,600	– 2,500	– 1,350		– 600
i.		– 900								– 900	
Bal.	31,500	300	450	24,000	– 3,500	19,800	– 3,600	– 2,500	– 1,350	– 900	– 600

Prob. 1–4B (Concluded)

2.

Custom Realty Income Statement For the Month Ended April 30, 20Y8		
Sales commissions		$19,800
Expenses:		
Rent expense	$3,600	
Salaries expense	2,500	
Automobile expense	1,350	
Supplies expense	900	
Miscellaneous expense	600	
Total expenses		(8,950)
Net income		$10,850

Custom Realty Statement of Stockholders' Equity For the Month Ended April 30, 20Y8			
	Common Stock	Retained Earnings	Total
Balances, April 1, 20Y8	$ 0	$ 0	$ 0
Issued common stock	24,000		24,000
Net income		10,850	10,850
Dividends		(3,500)	(3,500)
Balances, April 30, 20Y8	$24,000	$ 7,350	$31,350

Custom Realty Balance Sheet April 30, 20Y8		
Assets		
Cash		$31,500
Supplies		300
Total assets		$31,800
Liabilities		
Accounts payable		$ 450
Stockholders' Equity		
Common stock	$24,000	
Retained earnings	7,350	
Total stockholders' equity		31,350
Total liabilities and stockholders' equity		$31,800

Prob. 1–5B

1.

Assets								=	Liabilities	+	Stockholders' Equity		
Cash	+	Accounts Receivable	+	Supplies	+	Land		=	Accounts Payable	+	Common Stock	+	Retained Earnings
$39,000	+	$80,000	+	$11,000	+	$50,000		=	$31,500	+	$50,000	+	Retained Earnings
						$180,000		=	$81,500	+	Retained Earnings		
						$98,500		=	Retained Earnings				

Prob. 1–5B (Continued)

2.

	Assets				= Liabilities +	Stockholders' Equity		
	Cash	+ Accts. Rec.	+ Supplies	+ Land	= Accts. Payable	+ Common Stock	+ Retained Earnings	– Dividends
Bal.	39,000	80,000	11,000	50,000	31,500	50,000	98,500	
a.	+ 21,000					+ 21,000		
Bal.	60,000	80,000	11,000	50,000	31,500	71,000	98,500	
b.	– 35,000			+ 35,000				
Bal.	25,000	80,000	11,000	85,000	31,500	71,000	98,500	
c.	– 4,000							
Bal.	21,000	80,000	11,000	85,000	31,500	71,000	98,500	
d.		+ 72,000						
Bal.	21,000	152,000	11,000	85,000	31,500	71,000	98,500	
e.	– 20,000				– 20,000			
Bal.	1,000	152,000	11,000	85,000	11,500	71,000	98,500	
f.			+ 8,000		+ 8,000			
Bal.	1,000	152,000	19,000	85,000	19,500	71,000	98,500	
g.	+ 38,000							
Bal.	39,000	152,000	19,000	85,000	19,500	71,000	98,500	
h.	+ 77,000	– 77,000						
Bal.	116,000	75,000	19,000	85,000	19,500	71,000	98,500	
i.					+ 29,450			
Bal.	116,000	75,000	19,000	85,000	48,950	71,000	98,500	
j.	– 29,200							
Bal.	86,800	75,000	19,000	85,000	48,950	71,000	98,500	
k.			– 7,200					
Bal.	86,800	75,000	11,800	85,000	48,950	71,000	98,500	
l.	– 5,000							– 5,000
Bal.	81,800	75,000	11,800	85,000	48,950	71,000	98,500	– 5,000

Prob. 1–5B (Continued)

Stockholders' Equity (Continued)

	+ Dry Cleaning Revenue	– Dry Cleaning Exp.	– Wages Exp.	– Supplies Exp.	– Rent Exp.	– Truck Exp.	– Utilities Exp.	– Misc. Exp.
Bal.								
a.								
Bal.								
b.								
Bal.								
c.					– 4,000			
Bal.					– 4,000			
d.	+ 72,000							
Bal.	72,000				– 4,000			
e.								
Bal.	72,000				– 4,000			
f.								
Bal.	72,000				– 4,000			
g.	+ 38,000							
Bal.	110,000				– 4,000			
h.								
Bal.	110,000				– 4,000			
i.		– 29,450						
Bal.	110,000	– 29,450			– 4,000			
j.			– 24,000			– 2,100	– 1,800	– 1,300
Bal.	110,000	– 29,450	– 24,000		– 4,000	– 2,100	– 1,800	– 1,300
k.				– 7,200				
Bal.	110,000	– 29,450	– 24,000	– 7,200	– 4,000	– 2,100	– 1,800	– 1,300
l.								
Bal.	110,000	– 29,450	– 24,000	– 7,200	– 4,000	– 2,100	– 1,800	– 1,300

Prob. 1–5B (Continued)

3.

Bev's Dry Cleaners Income Statement For the Month Ended November 30, 20Y3		
Dry cleaning revenue		$110,000
Expenses:		
Dry cleaning expense	$29,450	
Wages expense	24,000	
Supplies expense	7,200	
Rent expense	4,000	
Truck expense	2,100	
Utilities expense	1,800	
Miscellaneous expense	1,300	
Total expenses		(69,850)
Net income		$ 40,150

Bev's Dry Cleaners Statement of Stockholders' Equity For the Month Ended November 30, 20Y3			
	Common Stock	Retained Earnings	Total
Balances, November 1, 20Y3	$50,000	$ 98,500	$148,500
Issued common stock	21,000		21,000
Net income		40,150	40,150
Dividends		(5,000)	(5,000)
Balances, November 30, 20Y3	$71,000	$133,650	$204,650

Bev's Dry Cleaners Balance Sheet November 30, 20Y3		
Assets		
Cash		$ 81,800
Accounts receivable		75,000
Supplies		11,800
Land		85,000
Total assets		$253,600
Liabilities		
Accounts payable		$ 48,950
Stockholders' Equity		
Common stock	$ 71,000	
Retained earnings	133,650	
Total stockholders' equity		204,650
Total liabilities and stockholders' equity		$253,600

Prob. 1–5B (Concluded)

4. Optional

Bev's Dry Cleaners Statement of Cash Flows For the Month Ended November 30, 20Y3		
Cash flows from (used for) operating activities:		
Cash received from customers*	$115,000	
Cash paid for expenses and to creditors**	(53,200)	
Net cash flows from operating activities		$ 61,800
Cash flows from (used for) investing activities:		
Cash paid for acquisition of land		(35,000)
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 21,000	
Cash paid for dividends	(5,000)	
Net cash flows from financing activities		16,000
Net increase in cash		$ 42,800
Cash balance, November 1, 20Y3		39,000
Cash balance, November 30, 20Y3		$ 81,800

* $38,000 + $77,000; these amounts are taken from the Cash column of the spreadsheet in Part 2.

** $4,000 + $20,000 + $29,200; these amounts are taken from the Cash column of the spreadsheet in Part 2.

Prob. 1–6B

a. Wages expense, $203,200 ($288,000 – $48,000 – $17,600 – $14,400 – $4,800)

b. Net income, $112,000 ($400,000 – $288,000)

c. Common stock, $160,000; from statement of cash flows.

d. Net income for May, $112,000; from (b)

e. Dividends, $64,000; from statement of cash flows

f. Increase in retained earnings, $48,000 ($112,000 – $64,000)

g. Total stockholders' equity, $208,000 ($160,000 + $48,000)

h. Land, $120,000; from statement of cash flows.

i. Total assets, $256,000 ($123,200 + $12,800 + $120,000)

j. Common stock, $160,000; from statement of cash flows.

k. Retained earnings, $48,000; same as (f)

l. Total stockholders' equity, $208,000; same as (g)

m. Total liabilities and stockholders' equity, $256,000 ($48,000 + $208,000)

n. Cash received from customers, $400,000; this is the same as fees earned since there are no accounts receivable.

o. Net cash flows from operating activities, $147,200 ($400,000 – $252,800)

p. Net cash flows from financing activities, $96,000 ($160,000 – $64,000)

q. Net increase in cash, $123,200 ($147,200 – $120,000 + $96,000)

r. Cash as of May 31, 20Y6, $123,200; same as (q) since Atlas Realty was organized on May 1, 20Y6; also the cash balance on the balance sheet.

CONTINUING PROBLEM

1.

	Assets			= Liabilities +	Stockholders' Equity		
	Cash +	Accts. Rec. +	Supplies =	Accts. Payable +	Common Stock −	Dividends +	Fees Earned
June 1	+ 4,000				+ 4,000		
June 2	+ 3,500						+ 3,500
Bal.	7,500				4,000		3,500
June 2	− 800						
Bal.	6,700				4,000		3,500
June 4			+ 350	+ 350			
Bal.	6,700		350	350	4,000		3,500
June 6	− 500						
Bal.	6,200		350	350	4,000		3,500
June 8	− 675						
Bal.	5,525		350	350	4,000		3,500
June 12	− 350						
Bal.	5,175		350	350	4,000		3,500
June 13	− 100			− 100			
Bal.	5,075		350	250	4,000		3,500
June 16	+ 300						+ 300
Bal.	5,375		350	250	4,000		3,800
June 22		+ 1,000					+ 1,000
Bal.	5,375	1,000	350	250	4,000		4,800
June 25	+ 500						+ 500
Bal.	5,875	1,000	350	250	4,000		5,300
June 29	− 240						
Bal.	5,635	1,000	350	250	4,000		5,300
June 30	+ 900						+ 900
Bal.	6,535	1,000	350	250	4,000		6,200
June 30	− 400						
Bal.	6,135	1,000	350	250	4,000		6,200
June 30	− 300						
Bal.	5,835	1,000	350	250	4,000		6,200
June 30			− 180				
Bal.	5,835	1,000	170	250	4,000		6,200
June 30	− 415						
Bal.	5,420	1,000	170	250	4,000		6,200
June 30	− 1,000						
Bal.	4,420	1,000	170	250	4,000		6,200
June 30	− 500					− 500	
Bal.	3,920	1,000	170	250	4,000	− 500	6,200

Continuing Problem (Continued)

Stockholders' Equity (Continued)

		Music Exp.	Office Rent Exp.	Equip. Rent Exp.	Advertising Exp.	Wages Exp.	Utilities Exp.	Supplies Exp.	Misc. Exp.
June	1								
June	2								
Bal.									
June	2		800						
Bal.			800						
June	4								
Bal.			800						
June	6				500				
Bal.			800		500				
June	8			675					
Bal.			800	675	500				
June	12	350							
Bal.		350	800	675	500				
June	13								
Bal.		350	800	675	500				
June	16								
Bal.		350	800	675	500				
June	22								
Bal.		350	800	675	500				
June	25								
Bal.		350	800	675	500				
June	29	240							
Bal.		590	800	675	500				
June	30								
Bal.		590	800	675	500				
June	30					400			
Bal.		590	800	675	500	400			
June	30						300		
Bal.		590	800	675	500	400	300		
June	30							180	
Bal.		590	800	675	500	400	300	180	
June	30								415
Bal.		590	800	675	500	400	300	180	415
June	30	1,000							
Bal.		1,590	800	675	500	400	300	180	415
June	30								
Bal.		1,590	800	675	500	400	300	180	415

Continuing Problem (Concluded)

2.

PS Music Income Statement For the Month Ended June 30, 20Y5		
Fees earned:		$ 6,200
Expenses:		
Music expense	$1,590	
Office rent expense	800	
Equipment rent expense	675	
Advertising expense	500	
Wages expense	400	
Utilities expense	300	
Supplies expense	180	
Miscellaneous expense	415	
Total expenses		(4,860)
Net income		$ 1,340

3.

PS Music Statement of Stockholders' Equity For the Month Ended June 30, 20Y5			
	Common Stock	Retained Earnings	Total
Balances, June 1, 20Y5	$ 0	$ 0	$ 0
Issued common stock	4,000		4,000
Net income		1,340	1,340
Dividends		(500)	(500)
Balances, June 30, 20Y5	$4,000	$ 840	$4,840

4.

PS Music Balance Sheet June 30, 20Y5		
Assets		
Cash		$3,920
Accounts receivable		1,000
Supplies		170
Total assets		$5,090
Liabilities		
Accounts payable		$ 250
Stockholders' Equity		
Common stock	$4,000	
Retained earnings	840	
Total stockholders' equity		4,840
Total liabilities and stockholders' equity		$5,090

MAKE A DECISION

MAD 1–1

a. **Ratio of Liabilities to Stockholders' Equity** $= \dfrac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$

Amazon: $\dfrac{\$119{,}099}{\$43{,}549} = 2.73$

Best Buy: $\dfrac{\$9{,}595}{\$3{,}306} = 2.90$

b. **Amazon's ratio is 2.73, which means the total liabilities are over 2 1/2 times as great as the stockholders' equity. For Best Buy, the ratio is higher at 2.90, which is almost three times greater than stockholders' equity. Thus, the margin of protection is slightly more for Amazon's creditors than it is for Best Buy's creditors.**

MAD 1–2

a. **Ratio of Liabilities to Stockholders' Equity** $= \dfrac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$

Year 1: $\dfrac{\$26{,}478}{\$10{,}953} = 2.42$

Year 2: $\dfrac{\$28{,}652}{\$11{,}651} = 2.46$

Year 3: $\dfrac{\$29{,}993}{\$11{,}297} = 2.65$

b. **The ratio of liabilities to stockholders' equity for Target increased from 2.42 in Year 1 to 2.65 in Year 3, causing the margin of protection to creditors to decrease.**

MAD 1–3

a. **Ratio of Liabilities to Stockholders' Equity** $= \dfrac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$

Year 1: $\dfrac{\$118{,}290}{\$80{,}535} = 1.47$

Year 2: $\dfrac{\$123{,}700}{\$80{,}822} = 1.53$

Year 3: $\dfrac{\$139{,}661}{\$79{,}634} = 1.75$

b. **The ratio of liabilities to stockholders' equity for Walmart increased from 1.47 in Year 1 to 1.75 in Year 3, causing the margin of protection to creditors to decrease.**

Note to Instructor: **This increase occurred because the company used debt to finance the repurchase of its common stock. This caused liabilities to increase and stockholders' equity to decrease over the three-year period. The increased use of debt financing was probably due to the low interest rates during this three-year period.**

MAD 1–4

The ratios of liabilities to stockholders' equity are summarized below for Target (MAD 1–2) and Walmart (MAD 1–3).

	Year 3	Year 2	Year 1
Target	2.65	2.46	2.42
Walmart	1.75	1.53	1.47

Target's ratio of liabilities to stockholders' equity is more than that of Walmart for all three years. Thus, the risk to Target's creditors is more than that of Walmart's creditors. The three-year trend for both companies shows that the size of this ratio is increasing. However, Target appears to be more aggressive than Walmart in its use of debt.

MAD 1–5

a. **Ratio of Liabilities to Stockholders' Equity** $= \dfrac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$

Wendy's: $\dfrac{\$3,644}{\$648} = 5.6$

Chipotle: $\dfrac{\$824}{\$1,441} = 0.6$

b. **The ratio of liabilities to stockholders' equity is 5.6 for Wendy's. This ratio is relatively high and suggests that creditors have risk with their investments. Specifically, the small level of stockholders' equity provides a low margin of protection for creditors.**

c. **Chipotle's ratio of liabilities to stockholders' equity of 0.6 is extremely low and suggests that Chipotle is not using much debt to finance its operations. Given the low interest rates that are currently available in the market, Chipotle may be able to improve its profitability by increasing its use of debt.**

TAKE IT FURTHER

TIF 1–1

1. **The car repair is a personal expense and is Marco's personal responsibility. By using partnership funds to pay for the repair, Marco is behaving unethically because he is violating the business entity assumption. The business entity assumption treats the business as a separate entity from its owners. By taking money from the partnership for a personal expense, Marco is effectively stealing from his partners.**
2. **The partnership's net income will be reduced by the $2,000 Marco has taken. This will reduce the amount of net income available to Marco's partners.**
3. **Marco could ask his partners for a loan from the partnership. The loan could be repaid out of his salary or from his share of the partnership income.**

TIF 1–2

1. **Acceptable professional conduct requires that Colleen Fernandez supply First Federal Bank with all the relevant financial statements necessary for the bank to make an informed decision. Therefore, Colleen should provide the complete set of financial statements. These can be supplemented with a discussion of the net loss in the past year or other data explaining why granting the loan is a good investment for the bank.**

2. a. **Owners are generally willing to provide bankers with information about the operating and financial condition of the business, such as the following:**

   - **Operating Information:**
     - **Description of business operations**
     - **Results of past operations**
     - **Preliminary results of current operations**
     - **Plans for future operations**
   - **Financial Condition:**
     - **List of assets and liabilities (balance sheet)**
     - **Estimated current values of assets**
     - **Owner's personal investment in the business**
     - **Owner's commitment to invest additional funds in the business**

   Owners are normally reluctant to provide the following types of information to bankers:

   - ***Proprietary Operating Information.*** **Such information, which might hurt the business if it becomes known by competitors, might include special processes used by the business or future plans to expand operations into areas that are not currently served by a competitor.**
   - ***Personal Financial Information.*** **Owners may have little choice here because banks often require owners of small businesses to pledge their personal assets as security for a business loan. Personal financial information requested by bankers often includes the owner's net worth, salary, and other income. In addition, bankers usually request information about factors that might affect the personal financial condition of the owner. For example, a pending divorce by the owner might significantly affect the owner's personal wealth.**

   b. **Bankers typically want as much information as possible about the ability of the business and the owner to repay the loan with interest. Examples of such information are described above.**

   c. **Both bankers and business owners share the common interest of the business doing well and being successful. If the business is successful, the bankers will receive their loan payments on time with interest, and the owners will increase their personal wealth.**

TIF 1–3

A sample solution based on Twitter's Form 10-K for the fiscal year ended December 31, 2021, follows:

1. **Twitter, Inc.**
2. **San Francisco, CA**
3. **Parag Agrawal**
4. **Service**
5. **Our primary product, Twitter, is a global platform for public self-expression and conversation in real time. We have democratized content creation and distribution so people can consume, create, distribute and discover content about the topics and events they care about most. Through Topics, Interests, and Trends, we help people discover what's happening through text, images, on demand and live video, and audio from people, content partners, media organizations, advertisers and others. Media outlets, websites, and other partners extend the reach of Twitter content by distributing Tweets beyond our app and website**
6. **Balance sheet, statement of operations (income statement), statement of comprehensive income (loss) (discussed in advanced accounting courses), statement of stockholders' equity, statement of cash flows.**

TIF 1–4

Example Memo
To: **Teacher**
From: **Student**
Date: **Current Date**

Subject: **Causes of Accounting Fraud**

Business and accounting fraud typically result from either a failure of individual character or a culture of greed within an organization. Managers and accountants often face pressure to meet or exceed a company's financial goals. At times, supervisors can place pressure on individuals to violate accounting standards to improve a company's reported financial results. Individuals who give in to these pressures exhibit a failure of individual character. In other situations, a company may indirectly encourage employees to violate accounting rules as part of their job. This occurs in organizations that do not value ethical decision making or fair financial reporting and exhibit a culture of ethical indifference.

TIF 1–5

he difference in the two bank balances, $55,000 ($80,000 – $25,000), may not be pure profit from an accounting perspective. To determine the accounting profit for the six-month period, the revenues for the period would need to be matched with the related expenses. The revenues minus the expenses would indicate whether the business generated net income (profit) or a net loss for the period. Using only the difference between the two bank account balances ignores such factors as amounts due from customers (receivables), liabilities (accounts payable) that need to be paid for wages or other operating expenses, additional investments that Dr. Cousins may have made in the business during the period, or dividends paid during the period that Dr. Cousins might have taken for personal reasons unrelated to the business. Some businesses that have few, if any, receivables or payables may use a "cash" basis of accounting. The cash basis of accounting ignores receivables and payables because they are assumed to be insignificant in amount. However, even with the cash basis of accounting, additional investments during the period and any dividends paid during the period have to be considered in determining the net income (profit) or net loss for the period.