# Solutions Manual for Fundamental Financial Accounting Concepts 11th Edmonds

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## ANSWERS TO QUESTIONS - CHAPTER 1

1. **Stakeholders are the parties that use accounting information.**

   **Stakeholders with a direct interest include owners, managers, creditors, suppliers, and employees. These individuals are directly affected by what happens to the business.**

   **Stakeholders with an indirect interest include financial analysts, brokers, attorneys, government regulators, and news reporters. These individuals use information in the financial reports to advise and influence their clients.**

   **Students may give many different answers under the above categories depending on their level of experience in business.**

   **All students are direct users of accounting information related to tuition and fees, financial aid, and account balances.**

2. **Accounting provides information that is useful in making decisions by all participants in the market for resource goods and services, both profit-oriented and nonprofit oriented. Because accounting's role is so important, it is often called the language of business.**

3. **The primary mechanism used to allocate resources in the U.S. is competition for resources in the open market.**

4. **A market is a group of people or organizations that come together for the purpose of exchanging items of value.**

5. **The market for business resources involves three distinct participants: consumers, businesses, and resource owners. See Exhibit 1-1 that illustrates how market trilogy is involved in resource allocation.**

**6.** **Financial Resource: money**

**Physical Resource: natural resources (i.e. land, forests, mine ore, petroleum, etc.), buildings, machinery and equipment, furniture and fixtures**
**Labor Resource: includes both intellectual and physical labor; i.e. employees**

**7.** **Investors expect a distribution of the business's profits as a return on their financial investment (capital allocation).**

**Creditors lend financial resources to businesses and receive interest as a return or profit on the loan.**

**8.** **Financial accounting provides information that is useful to external resource providers.**

**Managerial accounting provides information that is useful to managers in operating an organization (i.e., internal users).**

**9.** **Not-for-profit or nonprofit entities provide goods or services to consumers for humanitarian or special reasons rather than to earn a profit for owners. For example, certain not-for-profit entities allocate resources to provide for research of diseases or social/environmental welfare; others allocate resources to promote the arts and provide education.**

**10.** **The U.S. rules of accounting information measurement are called generally accepted accounting principles (GAAP).**

**11.** **Careers in public accounting consist of providing services to the general public from a public accounting firm. These services include auditing, tax, and consulting services. Careers in private accounting usually consist of working for a specific company (which would be a client of the public accounting firm) providing a wide variety of services to the company including recording transactions, preparing financial statements, internal auditing, and others.**

12. Items reported on the financial statements are organized into classes or categories called elements. The ten elements of financial statements are:
    1. Assets
    2. Liabilities
    3. Equity (Stockholders' Equity)
    4. Investments by Owners (Contributed Capital)
    5. Revenue
    6. Expenses
    7. Distributions (Dividends)
    8. Net Income
    9. Gains
    10. Losses

    Accounts are specific items or subclassifications of the elements. Examples of accounts include cash, land, and common stock.

13. Assets, the economic resources of a business, are used to produce earnings.

14. The assets of a business belong to that business entity and there may be claims on the assets. Claims on the assets belong to resource providers.

15. Creditors are individuals and/or institutions that have provided goods or services to the business which are not yet paid for, or loaned money to the business. These parties have first claim to the assets of the business, and the investors have a residual interest in the assets.

16. The term "liabilities" is used to describe creditors' claims on the assets of a business.

**17. The accounting equation is:**

**ASSETS – LIABILITIES = STOCKHOLDERS' EQUITY**
**or**
**ASSETS = LIABILITIES + STOCKHOLDERS' EQUITY**

**Assets are the economic resources used by a business for the production of revenue. Liabilities are obligations of a business to relinquish assets, provide services, or accept other obligations. Equity, also called "residual interest" or "net assets", is the portion of the assets remaining after the creditors' claims have been satisfied (i.e., Assets – Liabilities).**

**18. The owners ultimately bear the risk and collect the rewards associated with operating a business.**

**19. A double-entry bookkeeping system is one in which every transaction affects at least two accounts. A transaction can affect both assets and claims (liabilities and equity) or only assets or only claims. In order to "balance" the accounting equation, every transaction requires a "double entry."**

**20. The right side of the accounting equation can be viewed as either sources of assets or as obligations and commitments of the business. Assets originating from liabilities can be viewed as sources or obligations of the business. Assets originating from issuing stock or retaining earnings can be viewed as sources of assets and commitments of the business.**

**21. The business could make a distribution of $1,000, but only $800 of it would be classified as a dividend. A distribution can only be a dividend to the extent of retained earnings.**

**22. Capital is acquired from owners by issuing stock to them. When stock is issued, the assets of the business increase and the stockholders' equity increases.**

**23. Assets that are acquired by issuing common stock are the result of investments by owners. Assets that are acquired by using retained earnings are assets the business acquires through its earnings activities.**

**24. <u>Revenue</u> increases the asset side of the accounting equation and also increases the retained earnings account in the stockholders' equity section of the equation.**

**25. The three primary sources of assets are (1) investments by owners (issue of stock), (2) borrowing from creditors, and (3) earnings activities.**

**26. Retained earnings are a result of a business retaining its earned assets, rather than distributing those earnings to its owners.**

**27. Distributions to owners, called dividends, decrease the asset side of the accounting equation and also decrease the retained earnings account in the stockholders' equity section of the equation.**

**28. Dividends and expenses are similar in that they both decrease assets and affect the accounting equation in the same way (i.e. reduction of retained earnings). However, dividends differ from expenses because of the nature of the decline in assets. Expenses reduce assets as the result of a firm's efforts to earn revenue. Dividends reduce assets because of a transfer of wealth to the owners.**

**29. (1) Income Statement - measures the difference between the asset increases and the asset decreases that were associated with operating a business during a particular accounting period.**
**(2) Statement of Changes in Stockholders' Equity - explains the effects of transactions on stockholders' equity during the accounting period.**
**(3) Balance Sheet - lists the assets and the corresponding claims against the entity as of a particular date.**
**(4) Statement of Cash Flows - explains how a company obtained and used cash during the accounting period.**

**30. The Balance sheet provides information about the enterprise at a particular point in time.**

**31. A net loss occurs when expenses exceed revenues in a given accounting period.**

**32. A business liquidation is when a business ceases to operate, its remaining assets are sold and the sale proceeds are returned to creditors and owners.**

**33. The going concern doctrine assumes that a business is able to continue its operations into the foreseeable future.**

**34. The matching concept is the practice of pairing revenues and expenses on the income statement.**

**35. (1) Operating activities - explain the cash generated from revenue and the cash paid for expenses.**
**(2) Investing activities - include cash received or spent by the business on productive assets used in the business, and investments in debt or equity of other companies.**
**(3) Financing activities - include cash inflows and outflows from the company's transactions with its owners and inflows and outflows from its borrowing activities.**

36. **Asset accounts are arranged on the balance sheet in accordance with their level of liquidity (those that can be most quickly converted to cash are listed first).**

37. **Articulation refers to the interrelationships among the various elements of the financial statements.**

38. **Temporary accounts are used to capture information for a single accounting period. The balances in temporary accounts are transferred out of the accounts at the end of the accounting period. Temporary accounts have zero balances at the beginning of an accounting period. Temporary accounts include revenue accounts, expense accounts, and dividends. Permanent accounts carry over from one accounting period to the next. Retained Earnings is a permanent account.**

39. **The information in the temporary accounts is transferred to Retained Earnings at the end of the accounting period so that the temporary accounts have a zero balance at the beginning of the next accounting period. This allows the income statement and statement of cash flow information to be presented for a certain period of time. Since information from last period has been transferred, only the information that pertains to the current accounting period is contained in the accounts.**

40. **The historical cost concept requires that most assets be reported at the amount paid for them regardless of their increase or decrease in value. It is related to the qualitative characteristic of verifiability in that information can be independently verified. The historical cost is verified, while a change in value is subjective.**

**41.** **An asset source transaction results in an increase in an asset account and an increase in one of the claims accounts; i.e., investments by owners (equity), borrowing funds from creditors (liabilities), or earnings activities (revenue).**

**An asset use transaction results in a decrease in an asset account and a decrease in either liabilities or equity; i.e., the payment of a liability, the payment of an expense, or a dividend.**

**An asset exchange transaction is a transaction in which one asset is exchanged for another; i.e., purchase of land with cash.**

**A claims exchange transaction will be covered in a later chapter.**

**42.** **While the contents of annual reports vary from company to company, all annual reports contain:**
**Management's discussion and analysis (MD&A)**
**Financial statements**
**Notes to the financial statements**
**Auditor's report**

**43.** **U.S. GAAP, generally accepted accounting principles in the United States, are the measurement rules established by the (FASB) Financial Accounting Standards Board. The FASB is a privately funded organization with the primary authority for establishing accounting standards in the United States. International Financial Reporting Standards (IFRS) are issued by the International Accounting Standards Board and are an attempt to set a common standard to be used in different countries. IFRS is used by global companies and there is a move underway to merge GAAP and IFRS or to lessen the differences between them.**

## SOLUTIONS TO EXERCISES - SERIES A - CHAPTER 1

## EXERCISE 1-1A

The three participants in the free business market are:

1. Resource owners
2. Businesses
3. Consumers

Note to instructor:

The memo should discuss the fact that the resource owners are those who own resources that are desired by others, either in the original form or in a converted form. The businesses are the parties that acquire the resource and supply it to consumers either in the original form or in a converted form with value added by the conversion. The consumers are the ultimate users of the resources.

It should also include a discussion of the public accountant and the allocation of resources. For example, public accountants audit the annual reports that businesses use to communicate information to investors and creditors (financial resource providers). Based on their findings they may certify or deny that the reports fairly represent the financial condition of the business. In other words, public accountants provide assurance that the information provided by the business is trustworthy. Public accountants usually gain the professional designation of Certified Public Accountant (CPA).

## EXERCISE 1-2A

**a. The most common designation held by a public accountant is the CPA license. CPA stands for certified public accountant. CPAs are licensed by the state government (or other jurisdiction). Although the requirements vary from state to state (jurisdiction), CPA candidates normally must have a college degree, pass a demanding technical examination and obtain relevant work experience.**

**b. Designations that private accountants may hold include the CMA, Certified Management Accountant, and the CIA, Certified Internal Auditor. Both require meeting educational requirements, passing a technical examination and obtaining relevant work experience. These designations are not professional licenses and are not government regulated.**

## EXERCISE 1-3A

| Entities mentioned: | Effect on cash: |
|---|---|
| Vicky Hill Recovery Fund | Increase for cash contributions, $21,000<br>Decrease for payment of advertising, $1,000<br>Decrease payment for hospital bills, $12,000<br>Decrease for donation to National Cyclist Fund, $8,000 |
| | |
| Karen White | Decrease by contribution, $1,000 |
| | |
| WKUX | Increase for advertising revenue, $1,000 |
| | |
| Public | Decrease for contributions, $20,000 |
| | |
| Mercy Hospital | Increase for medical care, $12,000 |
| | |
| National Cyclist Fund | Increase for donation, $8,000 |

## EXERCISE 1-4A

**a.**

| Term | Definition |
|---|---|
| a | 7 |
| b | 3 |
| c | 6 |
| d | 5 |
| e | 4 |
| f | 1 |
| g | 2 |

**b.**

**Accounting Equation**

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | | | | | Common | | Retained |
| Company | Assets | = | Liabilities | + | Stock | + | Earnings |
| A | *123,000* | = | 25,000 | + | 48,000 | + | 50,000 |
| B | 40,000 | = | *3,000* | + | 7,000 | + | 30,000 |
| C | 75,000 | = | 15,000 | + | *18,000* | + | 42,000 |
| D | 125,000 | = | 45,000 | + | 60,000 | + | *20,000* |

## EXERCISE 1-5A

**Olive Enterprises**
**Accounting Equation**

| | | | | | Stockholders' Equity | |
|---|---|---|---|---|---|---|
| Event Number | Assets | = | Liabilities | + | Common Stock | Retained Earnings |
| 1. | I | = | NA | + | I | NA |
| 2. | D | = | D | + | NA | NA |
| 3. | I/D | = | NA | + | NA | NA |
| 4. | I | = | NA | + | NA | I |
| 5. | D | = | NA | + | NA | D |
| 6. | D | = | NA | + | NA | D |

## EXERCISE 1-6A

**a.**

**Better Corporation**
**Accounting Equation for Year 2**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/Y2 | 10,000 | + | 20,000 | = | 12,000 | + | 7,000 | + | 11,000 | |
| 1. Pur. Land | (5,000) | + | 5,000 | = | NA | + | NA | + | NA | NA |
| 2. Issued stk. | 25,000 | + | NA | = | NA | + | 25,000 | + | NA | NA |
| 3. Provide Svc. | 75,000 | + | NA | = | NA | + | NA | + | 75,000 | Revenue |
| 4. Paid Exp. | (42,000) | + | NA | = | NA | + | NA | + | (42,000) | Oper. Exp. |
| 5. Loan | 10,000 | + | NA | = | 10,000 | + | NA | + | NA | NA |
| 6. Paid Div. | (5,000) | + | NA | = | NA | + | NA | + | (5,000) | Dividend |
| 7. Land Value | NA | + | NA | = | NA | + | NA | + | NA | NA |
| Totals | 68,000 | + | 25,000 | = | 22,000 | + | 32,000 | + | 39,000 | |

**b.**

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| $93,000 | = | $22,000 | + | $71,000 |

**c.** The balances of total assets, liabilities, and stockholders' equity will be the same on January 1, Year 3 as the balances on December 31, Year 2. (See b. above)

## EXERCISE 1-7A

**a.**

| Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|
| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
| 195,000 | = | 90,500 | + | 84,500 | + | ? |

**Retained Earnings = $195,000 – $90,500 – $84,500 = $20,000**

**b. & c.**

**Moss Company**
**Effect of Year 2 Transactions on the Accounting Equation**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| Beginning Balances | 195,000 | = | 90,500 | + | 84,500 | + | 20,000 |
| 1. Earned Revenue | 42,000 | = | NA | + | NA | + | 42,000 |
| 2. Paid expenses | (24,000) | = | NA | + | NA | + | (24,000) |
| 3. Paid dividend | (3,000) | = | NA | + | NA | + | (3,000) |
| Ending Balance | 210,000 | = | 90,500 | + | 84,500 | + | 35,000 |

**d.**

| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| 210,000 | = | 90,500 | + | 84,500 | + | 35,000 |

**Liabilities + Stockholders' Equity = $90,500 + $84,500 + $35,000 = $210,000**

**Assets = Liabilities + Stockholders' Equity**
**$210,000 = $210,000**

## EXERCISE 1-7A (cont.)

**e. The beginning and ending balances in the cash account were $195,000 and $210,000 respectively. The beginning balance in the common stock account was $84,500. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because the accounting events that Moss experienced during the Year 2 accounting period affected the cash account but not the common stock account.**

## EXERCISE 1-8A

a.

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| Computers | | Notes Payable | | Operating Expenses |
| Building | | Utilities Payable | | Utilities Expense |
| Cash | | Accounts Payable | | Gasoline Expense |
| Land | | | | Rent Revenue |
| Trucks | | | | Retained Earnings |
| Supplies | | | | Salaries Expense |
| Office Furniture | | | | Common Stock |
| | | | | Service Revenue |
| | | | | Interest Expense |
| | | | | Dividends |
| | | | | Supplies Expense |

b. No. The type of accounts will vary depending on the type of business. Some businesses will have only one revenue account; other businesses may have more than one type of revenue account. For instance, a business may have both service revenue and interest revenue. Also, the expense accounts that a business has are somewhat dependent on the type and complexity of the business. For instance, if a business owns its own building, it will not have rent expense. If a business does not have employees, it will not have salaries expense. The level of detail desired by the business will also affect the type of revenue and expense accounts that a business will have.

## EXERCISE 1-9A

a.

| | Assets | | | | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Common Stock |
| | 16,000 | + | 0 | = | 6,000 | + | 10,000 |
| | (12,000) | + | 12,000 | = | | + | |
| Bal. | 4,000 | + | 12,000 | = | 6,000 | + | 10,000 |

b. Creditor's Claim ÷ Total Assets = Percent of Total
$6,000 ÷ $16,000 = 37.5%

c. Investor's Claim ÷ Total Assets = Percent of Total
$10,000 ÷ $16,000 = 62.5%

d. The company cannot repay the debt. The company owes the creditors $6,000 but has only $4,000 cash. Note there is no actual money in the stockholders' equity account. Indeed, there is no cash in any account that appears on the right side of the accounting equation. The right side of the accounting equation represents obligations and commitments of a company to its creditors and stockholders. Indeed, the accounting equation could be written as:

| | Assets | | | | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Stockholders' Equity |
| Bal. | 4,000 | + | 12,000 | = | 37.5% | + | 62.5% |

All assets including any cash balances are shown on the left side of the equation.

## EXERCISE 1-10A

**a.** **While the exact amount of any available dividend cannot be determined, the maximum dividend that could be paid based on the information would be $1,800, the amount of retained earnings. In order to determine the amount that could be paid, the balance of the cash account is required.**

**b.**

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| **Company** | **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **Allen** | **100%** | **=** | **75%** | **+** | **20%** | **+** | **5%** |
| **White** | **100%** | **=** | **25%** | **+** | **60%** | **+** | **15%** |

**From the information given above, White is the more financially stable because it has only 25% debt. In contrast, Allen has 75% debt. Companies with a higher percentage of debt will have more problem paying that debt if there is a downturn in the economy or if they lose a major customer.**

**c.** **If Allen has a $3,500 loss, this would cause a deficit of $3,000 in retained earnings. Assets would be reduced to $6,500. Since $7,500 is owed to the creditors all of the cash would be paid to them. The investors would not receive anything.**

**d.** **If White has a $3,500 loss, this would cause a deficit of $1,700 in retained earnings. Assets will be reduced to $8,500. The creditors will be paid off ($3,000) and the remainder of cash, $5,500 ($8,500 – $3,000), will be paid to the shareholders. The shareholders (investors) will not get all of their $7,200 investment back but they do not lose everything.**

## EXERCISE 1-11A

a. The answers are shown in the order in which they were calculated. In other words, item (d) was calculated first, (g) second and so on. There are other possible patterns that would produce correct answers.

Begin by filling in all possible blanks on the horizontal rows.

(d) Since common stock increased by $68,000, cash had to increase by $68,000.

(g) Since cash decreased by $14,000, dividends must have caused retained earnings to decrease by $14,000.

(h) Since cash decreased by $50,000, land must have increased by $50,000.

Now shift to an analysis of the vertical columns.

(i) Given that land had a beginning balance of $90,000 and $50,000 of land was purchased, the ending balance in the land account has to be $140,000.

(b) The beginning balance in the notes payable account had to be $50,000 because this amount minus the $10,000 partial pay off of notes payable would result in ending balance in the notes payable account of $40,000.

(c) The $123,000 ending balance in the common stock account minus the $68,000 issued during the period yields $55,000 beginning balance.

Now shift back to a horizontal analysis of the rows.

(a) Cash (x) + Land = Notes Pay. + Common Stk. + Beg. Ret. Ear.
X = $40,000

(j) Cash + Land = Notes Pay. + Common Stk. + End. Ret. Ear. (X)
X = Cash + Land – Notes Pay – Common Stk.
X = $77,000 + $140,000 - $40,000 - $123,000
X = $54,000

## EXERCISE 1-11A (cont.)

**a.**

**(f)**

| | |
|---|---|
| Beginning Retained Earnings | $25,000 |
| + Revenue | X |
| - Expenses | (57,000) |
| - Dividends | (14,000) |
| Ending Retained Earnings | $54,000 |

$25,000 + x – $57,000 – $14,000 = $54,000
X = $100,000

(e) Given that revenue increase by $100,000 cash must have increased by $100,000.

The solution shown in table format is as follows:

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | (a)40,000 | + | 90,000 | = | (b)50,000 | + | (c)55,000 | + | 25,000 | |
| Event 1 | (d)68,000 | + | NA | = | NA | + | 68,000 | + | NA | NA |
| 2. | (e)100,000 | + | NA | = | NA | + | NA | + | (f)100,000 | Revenue |
| 3. | (57,000) | + | NA | = | NA | + | NA | + | (57,000) | Expenses |
| 4. | (14,000) | + | NA | = | NA | + | NA | + | (g)(14,000) | Dividend |
| 5. | (50,000) | + | (h)50,000 | = | NA | + | NA | + | NA | NA |
| 6. | (10,000) | + | NA | = | (10,000) | + | NA | + | NA | NA |
| End. Bal. | 77,000 | + | (i)140,000 | = | 40,000 | + | 123,000 | + | (j)54,000 | |

b. There is sufficient cash available to pay off the debt on January 1, Year 8. At that time, the company has cash of $77,000 which is more than enough funds to repay the $40,000 notes payable.

## EXERCISE 1-11A (cont.)

c. **The maximum cash dividend payable is limited by the lower of the balance in the cash account versus the balance in the retained earnings account. In this case $54,000 is the maximum cash dividend JGGW can pay.**

## EXERCISE 1-12A

a. Investors put assets into the company with the expectation of sharing profits. Creditors lend assets to the company with the expectation of repayment of the principal plus interest on the loan.

b.

**Harris Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | 7,800 | = | 3,600 | + | 4,200 |
| Earned income | 2,000 | = | | + | 2,000 |
| Balance | 9,800 | = | 3,600 | + | 6,200 |

Since creditors are owed $3,600 and there are sufficient funds to pay them; the creditors will receive the $3,600 that they are owed. Since the investors own the business, they are entitled to the profits earned by the business. The investors will receive $6,200 (their original $4,200 investment plus the $2,000 of profit).

c.

**Harris Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | 7,800 | = | 3,600 | + | 4,200 |
| Incurred loss | (2,000) | = | | + | (2,000) |
| Balance | 5,800 | = | 3,600 | + | 2,200 |

Since creditors are owed $3,600 and there are sufficient funds to pay them; the creditors will receive the $3,600 that they are owed. Since the investors own the business, they suffer the losses earned by the business. The investors will receive $2,200 (their original $4,200 investment minus the $2,000 loss).

## EXERCISE 1-12A (cont.)

**d.**

**Harris Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | 7,800 | = | 3,600 | + | 4,200 |
| Incurred loss | (4,900) | = | (700) | + | (4,200) |
| Balance | 2,900 | = | 2,900 | + | 0 |

**While creditors get first priority to receive assets in a business liquidation, this does not mean they cannot lose all or a portion of the assets they loan a business. In this case, creditors are owed $3,600 but the business has only $2,900 of assets. Since the creditors have first priority, the entire $2,900 would be distributed to them. In this case, the creditors lose $700 ($3,600 original loan - $2,900 returned). Since the investors own the business, they suffer the losses incurred by the business. The investors will lose the entire $4,200 they contributed to the business.**

## EXERCISE 1-13A

| Event | Classification |
|---|---|
| 1. | Asset Source |
| 2. | Asset Use |
| 3. | Asset Use |
| 4. | Asset Source |
| 5. | Asset Exchange |
| 6. | NA |
| 7. | Asset Source |
| 8. | Asset Use |
| 9. | Asset Source |
| 10. | Asset Exchange |
| 11. | Asset Source |
| | |

## EXERCISE 1-14A

**Steps:**

**1.**

**Common Stock Issued = Change in Common Stock**
**$20,000 (given) = *$20,000***

**2.**

**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**
**$65,000 (given) = $20,000 (1) + *$45,000***

**3.**

**Increase in Ret. Earn. = Net Income – Dividends**
**$45,000 (2) = *$50,000* – $5,000 (given)**

**Alternate Solution:**

**From the Statement of Changes in Stockholders' Equity we know (with minor modifications):**

| | | |
|---|---|---|
| Beginning Total Stk. Equity, 1/1/Year 2 | | $156,000 |
| (Common Stock + Retained Earnings) | | |
| | | |
| Plus: Common Stock Issued | $20,000 | |
| Plus: Net Income | ? | |
| Less: Dividends | (5,000) | |
| Change in Stockholders' Equity | | 65,000 |
| | | |
| Ending Total Stk. Equity, 12/31/Year 2 | | $221,000 |

## EXERCISE 1-14A (cont.)

**Working backwards from the change in equity we can solve for net income:**

| | |
|---|---|
| **Change in Stockholders' Equity, Year 2** | **$65,000** |
| **Plus: Dividends** | **5,000** |
| **Less: Common Stock Issued** | **(20,000)** |
| **Net Income, Year 2** | ***$50,000*** |

## EXERCISE 1-15A

**a.**

**Majka Company**
**Accounting Equation for Year 1**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | | | | | Common | | Retained |
| Event | Cash | = | | + | Stock | + | Earnings |
| 1. Issued stock | 50,000 | | NA | | 50,000 | | NA |
| 2. Cash revenues | 33,700 | = | NA | + | NA | + | 33,700 |
| 3. Paid expenses | (14,900) | = | NA | + | NA | + | (14,900) |
| 4. Paid dividend | (3,200) | = | NA | + | NA | + | (3,200) |
| Ending Balance | 65,600 | = | -0- | + | 50,000 | + | 15,600 |

**b.**

**Majka Company**
**Income Statement**
**For the Year Ended December 31, Year 1**

| | |
|---|---|
| Revenue | $33,700 |
| Expense | (14,900) |
| Net Income | $18,800 |

**Majka Company**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 1**

| | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 50,000 | |
| Ending Common Stock | | $ 50,000 |
| | | |
| Beginning Retained Earnings | $ -0- | |
| Plus: Net Income | 18,800 | |
| Less: Dividends | (3,200) | |
| Ending Retained Earnings | | 15,600 |

| | | | |
|---|---|---|---|
| | **Total Stockholders' Equity** | | **$65,600** |
| | | | |

## EXERCISE 1-15A (cont.)

b.

**Majka Company**
**Balance Sheet**
**As of December 31, Year 1**

| | | |
|---|---|---|
| **Assets** | | |
| Cash | | $65,600 |
| | | |
| **Liabilities** | | $ -0- |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $ 50,000 | |
| Retained Earnings | 15,600 | |
| Total Stockholders' Equity | | 15,600 |
| | | |
| Total Liabilities and Stockholders' Equity | | $65,600 |

c. The income statement is dated with the term "for the year ended" because it covers a one year span of time. The balance sheet is dated with the term "as of" because it describes information at a specific point in time.

## EXERCISE 1-16A

**Note: The memo should contain a reference to the fact that the value of the land is difficult to determine. It would have to be appraised each time the financial statements are prepared. However, the value of marketable securities are easily verified by obtaining the closing prices of the securities at the end of trading on the day the financial statements are prepared.**

## EXERCISE 1-17A

a.

| Moore Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Net Cash Inflow from Operating Activities | | $ 24,800 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Net Cash Outflow from Investing Activities | | (16,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Net Cash Outflow from Financing Activities | | (6,800) |
| | | |
| Net Increase in Cash | | 2,000 |
| Plus: Beginning Cash Balance | | 45,800 |
| Ending Cash Balance | | $47,800 |

b. Cash inflow from selling fast food to customers was greater than cash outflow for expenses.

c. The company paid cash to purchase long-term assets.

d. The company paid cash dividends or paid off a loan to a bank.

## EXERCISE 1-18A

**a.**

| Event | Statement of Cash Flow Classification |
|---|---|
| 1. | OA |
| 2. | IA |
| 3. | NA |
| 4. | FA |
| 5. | FA |
| 6. | OA |
| 7. | IA |
| 8. | FA |
| 9. | OA |
| 10. | FA |

## EXERCISE 1-18A (cont.)

**b.**

### All Star Automotive Company
### Statement of Cash Flows
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Revenue | $ 25,000 | |
| Cash Payment for Salaries Expense | (14,000) | |
| Cash Payments for Utilities Expense | (2,800) | |
| **Net Cash Flow from Operating Activities** | | $8,200 |
| | | |
| **Cash Flows From Investing Activities** | | |
| Cash from the Sale of Land | $ 9,000 | |
| Cash Paid to Purchase Land | (6,000) | |
| **Net Cash Flow from Investing Activities** | | 3,000 |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $ 50,000 | |
| Cash Receipts from Loan | 5,000 | |
| Cash Payment on Loan | (2,000) | |
| Cash Payments for Dividends | (5,000) | |
| **Net Cash Flow from Financing Activities** | | 48,000 |
| | | |
| **Net Increase in Cash** | | 59,200 |
| **Plus: Beginning Cash Balance** | | 9,000 |
| **Ending Cash Balance** | | $68,200 |

## EXERCISE 1-19A

a.

### Dakota Company
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/Y1 | 2,000 | + | 12,000 | = | -0- | + | 6,000 | + | 8,000 | |
| 1. Issued stk. | 30,000 | + | NA | = | NA | + | 30,000 | + | NA | NA |
| 2. Pur. Land | (12,000) | + | 12,000 | = | NA | + | NA | + | NA | NA |
| 3. Loan | 10,000 | + | NA | = | 10,000 | + | NA | + | NA | NA |
| 4. Provide Svc. | 20,000 | + | NA | = | NA | + | NA | + | 20,000 | Svc. Rev. |
| 5. Paid Utilities | (1,000) | + | NA | = | NA | + | NA | + | (1,000) | Util. Exp. |
| 6. Pd. Op. Exp. | (15,000) | + | NA | = | NA | + | NA | + | (15,000) | Op. Exp. |
| 7. Paid Div. | (2,000) | + | NA | = | NA | + | NA | + | (2,000) | Dividends |
| 8. Land Value | NA | + | NA | = | NA | + | NA | + | NA | |
| Totals | 32,000 | + | 24,000 | = | 10,000 | + | 36,000 | + | 10,000 | |

b.

### Dakota Company
### Income Statement
### For the Year Ended December 31, Year 2

| | |
|---|---|
| Service Revenue | $20,000 |
| Utilities Expense | (1,000) |
| Operating Expense | (15,000) |
| Net Income | $ 4,000 |

## EXERCISE 1-19A (cont.)

**b.**

**Dakota Company**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Beginning Common Stock | $ 6,000 | |
| Plus: Common Stock Issued | 30,000 | |
| Ending Common Stock | | $36,000 |
| | | |
| Beginning Retained Earnings | $ 8,000 | |
| Plus: Net Income | 4,000 | |
| Less: Dividends | (2,000) | |
| Ending Retained Earnings | | 10,000 |
| | | |
| Total Stockholders' Equity | | $46,000 |

## EXERCISE 1-19A (cont.)

**b.**

### Dakota Company
### Balance Sheet
### As of December 31, Year 2

| | | |
|---|---|---|
| **Assets** | | |
| Cash | $32,000 | |
| Land | 24,000 | |
| **Total Assets** | | $56,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | $10,000 | |
| **Total Liabilities** | | $10,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $36,000 | |
| Retained Earnings | 10,000 | |
| **Total Stockholders' Equity** | | 46,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $56,000 |

## EXERCISE 1-19A (cont.)

b.

| Dakota Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $20,000 | |
| Cash Payment for Utilities Expense | (1,000) | |
| Cash Payments for Other Operating Exp. | (15,000) | |
| **Net Cash Flow from Operating Activities** | | $ 4,000 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(12,000) | |
| **Net Cash Flow from Investing Activities** | | (12,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $30,000 | |
| Cash Receipts from Loan | 10,000 | |
| Cash Payments for Dividends | (2,000) | |
| **Net Cash Flow from Financing Activities** | | 38,000 |
| | | |
| Net Increase in Cash | | 30,000 |
| Plus: Beginning Cash Balance | | 2,000 |
| Ending Cash Balance | | $32,000 |

c. Percentage of assets provided by retained earnings:
$10,000 ÷ $56,000 = 17.9%

Cash cannot be directly traced to retained earnings. Retained earnings represent the amount earned less dividends since the company began.

## EXERCISE 1-20A

| | | |
|---|---|---|
| **a.** | **Riley Company:** | **Asset Exchange** |
| **b.** | **Smally Company:** | **Asset Exchange** |
| **c.** | **Riley Company:** | **Investing Activity** |
| **d.** | **Smally Company:** | **Investing Activity** |

## EXERCISE 1-21A

a.

| Carter Company<br>Accounting Equation as of January 1, Year 2 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| 800 | | 3,500 | | 600 | | 1,000 | | ? |

**Retained Earnings = $800 + $3,500 - $600 - $1,000 = $2,700**

b. **The company cannot pay a $1,000 dividend because it only has $800 of cash. The Retained Earnings account contains zero cash. The balance in this account represents a stockholders' equity claim on assets.**

c. **Total Assets = $800 + $3,500 = $4,300**

**Creditor's Loans ÷ Total Assets**
**$600 ÷ $4,300 = 14.0%**

d. **Investor's Contributions ÷ Total Assets**
**$1,000 ÷ $4,300 = 23.3%**

e. **Retained Earnings ÷ Total Assets**
**$2,700 ÷ $4,300 = 62.8%**

## EXERCISE 1-21A (cont.)

**f.**

**Carter Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| 800 | | 3,500 | | 13.9% | | 23.3% | | 62.8% |

**g.**

**Carter Company**
**Accounting Equation as of December 31, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained | |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings | |
| 800 | | 3,500 | | 600 | | 1,000 | | 2,700 | |
| 1,800 | | NA | | NA | | NA | | 1,800 | Rev. |
| (1,200) | | NA | | NA | | NA | | (1,200) | Exp. |
| (500) | | NA | | NA | | NA | | (500) | Div |
| 900 | | 3,500 | | 600 | | 1,000 | | 2,800 | |

**Carter Company**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | |
|---|---|
| Revenue | $1,800 |
| Expenses | (1,200) |
| Net Income | $600 |

## EXERCISE 1-21A (cont.)

g.

### Carter Company
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $1,000 | |
| Plus: Common Stock Issued | -0- | |
| Ending Common Stock | | $1,000 |
| | | |
| Beginning Retained Earnings | $2,700 | |
| Plus: Net Income | 600 | |
| Less: Dividends | (500) | |
| Ending Retained Earnings | | 2,800 |
| | | |
| Total Stockholders' Equity | | $3,800 |

### Carter Company
### Balance Sheet
### As of December 31, Year 2

| | | |
|---|---|---|
| Assets | | |
| Cash | $ 900 | |
| Land | 3,500 | |
| Total Assets | | $4,400 |
| | | |
| Liabilities | | |
| Notes Payable | $600 | |
| Total Liabilities | | $600 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $1,000 | |
| Retained Earnings | 2,800 | |
| Total Stockholders' Equity | | 3,800 |
| | | |
| Total Liabilities and Stockholders' Equity | | $4,400 |

## EXERCISE 1-21A (cont.)

g.

**Carter Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| **Cash Receipts from Customers** | **$1,800** | |
| **Cash Payments for Expenses** | **(1,200)** | |
| **Net Cash Flow from Operating Activities** | | **$ 600** |
| | | |
| **Cash Flows From Investing Activities:** | | **0** |
| | | |
| **Cash Flows From Financing Activities:** | | |
| **Cash Payments for Dividends** | **(500)** | |
| **Net Cash Flow from Financing Activities** | | **(500)** |
| | | |
| **Net Increase in Cash** | | **100** |
| **Plus: Beginning Cash Balance** | | **800** |
| **Ending Cash Balance** | | **$ 900** |

h. **The income statement, statement of changes in stockholders' equity, and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology "*For the Year Ended* December 31, Year 2". In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In the case the point in time is December 31, Year 2. Therefore, this statement uses the terminology "*As of* December 31, Year 2".**

## EXERCISE 1-21A (cont.)

**i. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company's books.**

**j. The balance in the revenue account is zero on January 1, Year 3, because the balance in this account is transferred to retained earnings in the December 31, Year 2 closing process.**

## EXERCISE 1-22A

a. Since the amount in the Notes Payable account increased from zero to $9,000, Room Designs, Inc. must have received a cash inflow of $9,000 from the issue of the note payable. Similarly, since the balance in the common stock account increased from $3,500 to $7,500, Room Designs must have received a cash inflow $4,000 ($7,500 - $3,500) from the issue of common stock. Finally, $2,000 dividend payment would have caused a net cash outflow. Therefore, the net cash inflow from financing activities can be explained as follows:

| | |
|---|---|
| Cash Flows From Financing Activities: | |
| Cash Receipts from Loan | $9,000 |
| Cash Receipts from Stock Issue | 4,000 |
| Cash Payments for Dividends | (2,000) |
| Net Cash Flow from Financing Activities | $11,000 |

b. Since the balance in the land account increases from zero to $16,500, Room Designs must have had a net cash outflow of $16,500 for the purchase of Land.

c.

Room Designs, Inc.
Income Statement
For the Year Ended December 31, Year 2

| | |
|---|---|
| Revenue | $18,100 |
| Expenses | (8,300) |
| Net Income | $9,800 |

## EXERCISE 1-22A (cont.)

c.

### Room Designs, Inc.
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $ 3,500 | |
| Plus: Common Stock Issued | 4,000 | |
| Ending Common Stock | | $7,500 |
| | | |
| Beginning Retained Earnings | $ 6,400 | |
| Plus: Net Income | 9,800 | |
| Less: Dividends | (2,000) | |
| Ending Retained Earnings | | 14,200 |
| | | |
| Total Stockholders' Equity | | $21,700 |

### Room Designs, Inc.
### Balance Sheet
### As of December 31, Year 2

| | | |
|---|---|---|
| Assets | | |
| Cash | $14,200 | |
| Land | 16,500 | |
| Total Assets | | $30,700 |
| | | |
| Liabilities | | |
| Notes Payable | $9,000 | |
| Total Liabilities | | $ 9,000 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $7,500 | |
| Retained Earnings | 14,200 | |
| Total Stockholders' Equity | | 21,700 |
| | | |
| Total Liabilities and Stockholders' Equity | | $30,700 |

## EXERCISE 1-22A (cont.)

c.

| Room Designs, Inc.<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $ 18,100 | |
| Cash Payments for Expenses | (8,300) | |
| Net Cash Flow from Operating Activities | | $ 9,800 |
| | | |
| Cash Flows From Investing Activities: | | |
| Cash Paid to Purchase Land | $(16,500) | |
| Net Cash Flow from Investing Activities | | (16,500) |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Loan | $ 9,000 | |
| Cash Receipts from Stock Issue | 4,000 | |
| Cash Payments for Dividends | (2,000) | |
| Net Cash Flow from Financing Activities | | 11,000 |
| | | |
| Net Increase in Cash | | 4,300 |
| Plus: Beginning Cash Balance | | 9,900 |
| Ending Cash Balance | | $14,200 |

## EXERCISE 1-23A

a.

**Flowers Company**
**Accounting Equation as of December 31, Year 1**

| Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| 130,000 | | 50,000 | | 70,000 | | ? |
| | | | | | | |

Retained Earnings = $130,000 - $70,000 - $50,000 = $10,000

| | |
|---|---|
| Retained Earnings after closing: | $10,000 |
| Less, Revenue | (30,000) |
| Add, Expenses | 18,000 |
| Add, Dividends | 3,000 |
| Retained Earnings before closing | $ 1,000 |

b. Retained Earnings after closing is $10,000 (see the equation above).

c. The balances in revenue, expense, and dividends before closing are:

| | |
|---|---|
| Revenue | 30,000 |
| Expenses | 18,000 |
| Dividends | 3,000 |

d. After closing revenue, expense and dividends, all of the balances will be zero.

e. Both Common Stock and Retained Earnings represent obligations the business has to stockholders. The Common Stock represents the assets a business has acquired from owners. Retained earnings represent assets a business has acquired by conducting its operations.

## EXERCISE 1-23A (cont.)

**f. The owners are no better off immediately after they contributed capital to the business. While equity increased $30,000, the amount invested by owners also increased $30,000. The owners are only in a better financial position if their equity exceeds the amount they have invested in the company. At this point, the owners have simply exchanged cash for an additional ownership interest in the business. The owners will not benefit until the business uses the assets to produce profits. Note that it is possible that the owners could be worse off if the business incurs losses. In summary, the owners share in the benefits and sacrifices that the business experiences. They do not benefit when the business raises additional equity.**

## EXERCISE 1-24A

a.

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| Year 1 | $20,000 | $11,000 | 9,000 | 9,000 |
| Year 2 | 30,000 | 14,000 | 16,000 | 25,000 |
| Year 3 | 40,000 | 22,000 | 18,000 | 43,000 |
| | | | | |

b. Net income is a measure of the benefits minus the sacrifices a company experiences during a single accounting period. Retained earnings is the amount of net income a company has earned minus the dividends it has paid out since its inception.

c.

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| Year 1 | $20,000 | $11,000 | 9,000 | 9,000 |
| Year 2 | 30,000 | 14,000 | 16,000 | 20,000* |
| Year 3 | 40,000 | 22,000 | 18,000 | 38,000** |
| | | | | |

*$9,000 Beginning Balance + $16,000 Net Income - $5,000 Dividends
**$20,000 Beginning Balance + $18,000 Net Income

## EXERCISE 1-25A

a. **The balance in the Retained Earnings account as of January 31, Year 1 is zero.**
*Explanation: The revenue is recorded in the Revenue account and is not transferred into retained earnings until the year-end closing process is accomplished.*

b. **The balance in the Revenue account as of January 31, Year 1 is $7,500. The balance in the Expense account as of January 31, Year 1 is $4,800.**
*Explanation: The amounts in the revenue and expense accounts are not transferred to the Retained Earnings account until the year-end closing process is accomplished.*

c. **The *before closing* balance in the Retained Earnings account as of December 31, Year 1 is zero.**
*Explanation: The revenue and expenses are recorded in the Revenue and Expense accounts throughout the year and the balances in these accounts are not transferred into retained earnings until the year-end closing process is accomplished.*

d. **The December 31, Year 1 *before closing* balance in the Revenue account is $93,500 ($7,500 + $86,000). The December 31, Year 1 *before closing* balance in the Expense account is $55,800 ($4,800 + $51,000).**
*Explanation: The revenue and expense amounts accumulate in the Revenue and Expense accounts throughout the year.*

## EXERCISE 1-25A (cont.)

e. **The January 1, Year 2 balance in the Retained Earnings account is $37,700.**

*Explanation: The December 31, Year 1 year-end closing process transfers the $93,500 balance in the Revenue account and $55,800 expense account into the Retained Earnings account. Since revenue increases retained earnings and expenses decrease retained earnings, the December 31, Year 1 retained earnings account balance* **after closing** *is $37,700 ($93,500 - $55,800). Since last year's ending balances become next year's beginning balances, the balance in the Retained Earnings account as of January 1, Year 2 is $37,700.*

f. **The January 1, Year 2 balance in the Revenue and Expense accounts is zero.**

*Explanation: The balances in the revenue and expense accounts* **after closing** *are zero because the balances accumulated during the year were transferred to the retained earnings account during the closing process. The January 1, Year 2 balances in the revenue and expense accounts are zero.*

## EXERCISE 1-26A

**a.**

| Event | |
|---|---|
| 1. | Asset Source |
| 2. | Asset Use |
| 3. | Asset Use |
| 4. | Asset Source |
| 5. | Asset Source |
| 6. | Asset Exchange |
| 7. | NA |

**b.**

**The Candle Shop**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | – | Expense | = | Net Inc. | | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | | |
| 1 | I | + | NA | = | NA | + | I | + | NA | NA | – | NA | = | NA | I | FA |
| 2 | D | + | NA | = | NA | + | NA | + | D | NA | – | NA | = | NA | D | FA |
| 3 | D | + | NA | = | NA | + | NA | + | D | NA | – | I | = | D | D | OA |
| 4 | I | + | NA | = | I | + | NA | + | NA | NA | – | NA | = | NA | I | FA |
| 5 | I | + | NA | = | NA | + | NA | + | I | I | – | NA | = | I | I | OA |
| 6 | D | + | I | = | NA | + | NA | + | NA | NA | – | NA | = | NA | D | IA |
| 7 | NA | + | NA | = | NA | + | NA | + | NA | NA | – | NA | = | NA | NA | |

## EXERCISE 1-27A

a. **The assets would be worth the same but would be shown at different amounts on the balance sheet depending on whether U.S. GAAP or IFRS is used.**

b. **US GAAP requires the asset be stated at its historical cost, which may be very different from the current value. IFRS allow companies to value assets at their current market values.**

## SOLUTIONS TO PROBLEMS - SERIES A - CHAPTER 1

## PROBLEM 1-28A

a. The memo should explain that all entities must account for the use of assets, even though they may not be for-profit entities. The stakeholders are interested in the use of assets as well as the financial health of the entity.

b. Financial accounting is designed to meet the needs of external users. External users such as creditors and investors are interested in an objective, overall picture. For instance, both investors and creditors would be interested in the assets and liabilities of a business as well as in the net income. Both groups are interested in the growth factor as well as the risk factor.

Managerial accounting is designed to meet the needs of internal users. While there is overlap between the needs of both groups, i.e. net income, managers need more specific and detailed information. Managers may be concerned with the profitability of a particular department or product line while an investor is more concerned with the overall profitability of the company.

c. Stakeholders of a not-for-profit entity that may want financial accounting reports would include taxpayers, contributors, lenders, suppliers, employees, managers, financial analysts, attorneys, and beneficiaries.

d. Stakeholders that may want managerial accounting reports would include suppliers, managers, and employees.

## PROBLEM 1-29A

| a. Entities mentioned: | b. Effect on the cash account: |
|---|---|
| 1. Bob Wilder | Decrease |
| Wilder Co. | Increase |
| | |
| 2. Sam Pace Business | Increase |
| Customers | Decrease |
| | |
| 3. Jim Sneed | Increase/Decrease |
| National Bank | Decrease |
| Iuka Ford | Increase |
| | |
| 4. OZ Company | Decrease |
| Employees | Increase |
| | |
| 5. Gil Roberts | Decrease |
| Jim | Increase |
| | |
| 6. Gane, Inc. | Decrease |
| Atlanta Land Co. | Increase |
| | |
| 7. Rob Moore | Decrease |
| Gil Thomas | Decrease |
| MT Partnership | Increase |
| | |
| 8. Stephen Woo | Decrease |
| Izzard, Inc. | Increase |
| | |
| 9. Natural Stone | Decrease |
| Shareholders | Increase |
| | |
| 10. Billows, Inc. | Increase |
| National Bank | Decrease |

## PROBLEM 1-30A

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| | | |
| 1. | Asset Source | Increase |
| 2. | Asset Use | Decrease |
| 3. | NA | NA |
| 4. | Asset Source | Increase |
| 5. | Asset Use | Decrease |
| 6. | Asset Use | Decrease |
| 7. | Asset Use | Decrease |
| 8. | Asset Exchange | Increase/Decrease |
| 9. | Asset Exchange | Increase/Decrease |
| 10. | Asset Use | Decrease |
| 11. | NA | NA |
| 12. | Asset Source | Increase |
| 13. | Asset Use | Decrease |
| 14. | NA | NA |
| 15. | Asset Exchange | Increase/Decrease |
| | | |

## PROBLEM 1-31A

| Item | Income Statement | Statement of Changes in Stk. Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| Financing activities | | | | ✓ |
| Ending common stock | | ✓ | ✓ | |
| Interest expense | ✓ | | | |
| As of (date) | | | ✓ | |
| Land | | | ✓ | |
| Beginning cash balance | | | | ✓ |
| Notes payable | | | ✓ | |
| Beginning common stock | | ✓ | | |
| Service revenue | ✓ | | | |
| Utility expense | ✓ | | | |
| Stock issue | | ✓ | | ✓ |
| Operating activities | | | | ✓ |
| For the Period Ended (Date) | ✓ | ✓ | | ✓ |
| Net income | ✓ | ✓ | | |
| Investing activities | | | | ✓ |
| Net loss | ✓ | ✓ | | |
| Ending cash balance | | | ✓ | ✓ |
| Salary expense | ✓ | | | |
| Consulting revenue | ✓ | | | |
| Dividends | | ✓ | | ✓ |

## PROBLEM 1-32A

**a.**

### Mark's Consulting Services
### Accounting Equation for Year 1

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| 1. Issued stk | 20,000 | + | NA | = | NA | + | 20,000 | + | NA | NA |
| 2. Revenue | 35,000 | + | NA | = | NA | + | NA | + | 35,000 | Revenue |
| 3. Loan | 25,000 | + | NA | = | 25,000 | + | NA | + | NA | NA |
| 4. Paid Exp. | (22,000) | + | NA | = | NA | + | NA | + | (22,000) | Expenses |
| 5. Pur. Land | (30,000) | + | 30,000 | = | NA | + | NA | + | NA | NA |
| Totals | 28,000 | + | 30,000 | = | 25,000 | + | 20,000 | + | 13,000 | |

### Mark's Consulting Services
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | 28,000 | + | 30,000 | = | 25,000 | + | 20,000 | + | 13,000 | |
| 1. Issued stk | 24,000 | + | NA | = | NA | + | 24,000 | + | NA | NA |
| 2. Revenue | 95,000 | + | NA | = | NA | + | NA | + | 95,000 | Revenue |
| 3. Paid Loan | (15,000) | + | NA | = | (15,000) | + | NA | + | NA | NA |
| 4. Paid Exp. | (71,500) | + | NA | = | NA | + | NA | + | (71,500) | Expenses |
| 5. Paid Div. | (3,000) | + | NA | = | NA | + | NA | + | (3,000) | Dividends |
| 6. Land Val. | NA | + | NA | = | NA | + | NA | + | NA | |
| Totals | 57,500 | + | 30,000 | = | 10,000 | + | 44,000 | + | 33,500 | |

## PROBLEM 1-32A (cont.)

**b.**

**Mark's Consulting Services**
**Income Statement**
**For the Period Ended December 31, Year 1**

| | |
|---|---|
| Revenue | $35,000 |
| Expenses | (22,000) |
| Net Income | $13,000 |

**Mark's Consulting Services**
**Statement of Changes in Stockholders' Equity**
**For the Period Ended December 31, Year 1**

| | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 20,000 | |
| Ending Common Stock | | $20,000 |
| | | |
| Beginning Retained Earnings | -0- | |
| Plus: Net Income | $13,000 | |
| Ending Retained Earnings | | 13,000 |
| | | |
| Total Stockholders' Equity | | $33,000 |

## PROBLEM 1-32A (cont.)

**b.**

| Mark's Consulting Services<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| **Assets** | | |
| Cash | $28,000 | |
| Land | 30,000 | |
| **Total Assets** | | $58,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | | $25,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $20,000 | |
| Retained Earnings | 13,000 | |
| **Total Stockholders' Equity** | | 33,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $58,000 |

## PROBLEM 1-32A (cont.)

**b.**

### Mark's Consulting Services
### Statement of Cash Flows
### For the Year Ended December 31, Year 1

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $35,000 | |
| Cash Payments for Expenses | (22,000) | |
| **Net Cash Flow from Operating Activities** | | $13,000 |
| **Cash Flows From Investing Activities:** | | |
| Cash Payment for Land | $(30,000) | |
| **Net Cash Flow from Investing Activities** | | (30,000) |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Borrowed Funds | $25,000 | |
| Cash Receipts from Stock Issue | 20,000 | |
| **Net Cash Flow from Financing Activities** | | 45,000 |
| **Net Increase in Cash** | | 28,000 |
| **Plus: Beginning Cash Balance** | | -0- |
| **Ending Cash Balance** | | $28,000 |

## PROBLEM 1-32A (cont.)

**b.**

### Mark's Consulting Services
### Income Statement
### For the Period Ended December 31, Year 2

| | |
|---|---|
| Revenue | $95,000 |
| Expenses | (71,500) |
| Net Income | $23,500 |

### Mark's Consulting Services
### Statement of Changes in Stockholders' Equity
### For the Period Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $20,000 | |
| Plus: Common Stock Issued | 24,000 | |
| Ending Common Stock | | $44,000 |
| | | |
| Beginning Retained Earnings | 13,000 | |
| Plus: Net Income | 23,500 | |
| Less: Dividends | (3,000) | |
| Ending Retained Earnings | | 33,500 |
| | | |
| Total Stockholders' Equity | | $77,500 |

## PROBLEM 1-32A (cont.)

**b.**

**Mark's Consulting Services**
**Balance Sheet**
**As of December 31, Year 2**

| | | |
|---|---|---|
| **Assets** | | |
| Cash | $57,500 | |
| Land | 30,000 | |
| **Total Assets** | | $87,500 |
| | | |
| **Liabilities** | | |
| Notes Payable | | $10,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $44,000 | |
| Retained Earnings | 33,500 | |
| **Total Stockholders' Equity** | | 77,500 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $87,500 |

## PROBLEM 1-32A (cont.)

b.

| Mark's Consulting Services<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $95,000 | |
| Cash Payments for Expenses | (71,500) | |
| Net Cash Flow from Operating Activities | | $23,500 |
| | | |
| Cash Flows From Investing Activities | | -0- |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Stock Issue | $24,000 | |
| Cash Payment on Debt | (15,000) | |
| Cash Payment for Dividends | (3,000) | |
| Net Cash Flow from Financing Activities | | 6,000 |
| | | |
| Net Increase in Cash | | 29,500 |
| Plus: Beginning Cash Balance | | 28,000 |
| Ending Cash Balance | | $57,500 |

c. Retained Earnings does not contain cash.

d. In Year 1 and Year 2 net income and cash flows from operating activities are the same because all revenues and expenses are cash. Ordinarily, net income will be different from cash flows from operating activities due to non-cash revenue and expense transactions (discussed in Chapter 2). The net change in cash is different from net income because investing and financing activities do not directly affect revenue and expenses.

## PROBLEM 1-32A (cont.)

**e. Immediately after Event 2 in Year 1 is recorded the balance in the Retained Earnings account is zero. The revenue is recorded in a Revenue account, not in the Retained Earnings account. The revenue, expense, and dividend accounts are closed to the Retained Earnings account at the end of each accounting period. After closing the accounts at the end of Year 1, the Retained Earnings accounts will have a balance of $13,000 ($35,000 revenue - $22,000 expenses).**

**The Year 1 ending balance becomes the Year 2 beginning balance. So, the balance in the Retained Earnings account on January 1, Year 2 is $13,000. This balance will not change until the closing process is completed in December Year 2. As a result, the balance in the Retained Earnings account immediately after Event 2 in Year 2 is recorded is $13,000.**

## PROBLEM 1-33A

**a.**

| Pratt Corp.<br>Income Statement<br>For the Year Ended December 31, Year 2 | |
|---|---|
| Revenue | $35,550[1] |
| Expense | (26,000) |
| Net Income | $ 9,550 |

[1]To calculate revenue, you must first determine the ending balance in the retained earnings account at the end of Year 2:

| | |
|---|---|
| Beginning Retained Earnings | $ 5,000 |
| Plus increase in Retained Earnings | 7,550 |
| Ending Retained earnings | $12,550 |

Next, you can use this information to determine the amount of net income:

| | |
|---|---|
| Beginning Retained Earnings | $ 5,000 |
| Plus Net Income | "X" |
| Minus Dividends | (2,000) |
| Ending Retained earnings | $12,550 |

X = $12,550 - $5,000 + $2,000; X = $9,550

Finally, using the amount of net income, you can derive revenue:

| | |
|---|---|
| Revenue | $ "X" |
| Expenses | (26,000) |
| Net Income | $ 9,550 |

X = $9,550 + $26,000; X = $35,550

## PROBLEM 1-33A (cont.)

**b.**

| Pratt Corp.<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Beginning Common Stock | $13,000[2] | |
| Plus: Common Stock Issued | 4,000 | |
| Ending Common Stock | | $17,000 |
| | | |
| Beginning Retained Earnings | $5,000 | |
| Plus: Net Income | 9,550 | |
| Less: Dividends | (2,000) | |
| Ending Retained Earnings | | 12,550 |
| | | |
| Total Stockholders' Equity | | $29,550 |

[2] To calculate the amount of beginning common stock; rearrange the accounting equation and solve for the missing variable common stock as follows:

| Assets | – | Liabilities | – | Retained Earnings | = | Common Stock: |
|---|---|---|---|---|---|---|
| $30,000 | – | $12,000 | – | $5,000 | = | *$13,000* |

## PROBLEM 1-33A (cont.)

**c.**

| Pratt Corp.<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| Assets | | $38,550[3] |
| Liabilities | | $ 9,000[4] |
| Stockholders' Equity | | |
| Common Stock | $17,000 | |
| Retained Earnings | 12,550 | |
| Total Stockholders' Equity | | 29,550 |
| Total Liabilities and Stockholders' Equity | | $38,550 |

[3] Based on the accounting equation total assets are equal to total liabilities ($9,000) plus stockholders' equity ($29,550).

[4] Total liabilities is calculated as follows:

Total Liabilities = $12,000 Beg. Bal. - $3,000 Partial Payoff = $9,000 ending balance.

## PROBLEM 1-33A (cont.)

d.

**Pratt Corp.**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipt from Revenue | $35,550 | |
| Cash Payment for Expense | (26,000) | |
| Net Cash Flow from Operating Activities | | $ 9,550 |
| Cash Flows From Investing Activities | | -0- |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Stock Issue | $ 4,000 | |
| Cash Payment to Creditors | (3,000) | |
| Cash Dividend Paid to Stockholders | (2,000) | |
| Net Cash Flow from Financing Activities | | (1,000) |
| Net Increase in Cash | | 8,550 |
| Plus: Beginning Cash Balance | | 30,000 |
| Ending Cash Balance | | $38,550 |

e. Percentage of assets provided by:

| | | |
|---|---|---|
| Creditors | $ 9,000 ÷ $38,550 | = 23.35% |
| Investors | $17,000 ÷ $38,550 | = 44.10% |
| Earnings | $12,550 ÷ $38,550 | = 32.56% |

f. Pratt Corp. has $38,550 worth of assets to distribute in the event of liquidation at the end of Year 2. During liquidation, creditors have first rights to the assets and any remaining assets are distributed to owners. Therefore, creditors would receive $9,000 and the remaining $29,550 would be distributed to owners.

## PROBLEM 1-34A

**a.**

**Maben Company**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | − | Expense | = | Net Inc. | Cash Flows | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | | |
| 1 | 30,000 | + | NA | = | NA | + | 30,000 | + | NA | NA | − | NA | = | NA | 30,000 | FA |
| 2 | 40,000 | + | NA | = | 40,000 | + | NA | + | NA | NA | − | NA | = | NA | 40,000 | FA |
| 3 | 48,000 | + | NA | = | NA | + | NA | + | 48,000 | 48,000 | − | NA | = | 48,000 | 48,000 | OA |
| 4 | (25,000) | + | NA | = | NA | + | NA | + | (25,000) | NA | − | 25,000 | = | (25,000) | (25,000) | OA |
| 5. | (1,000) | + | NA | = | NA | + | NA | + | (1,000) | NA | − | NA | = | NA | (1,000) | FA |
| 6. | 20,000 | + | NA | = | NA | + | 20,000 | + | NA | NA | − | NA | = | NA | 20,000 | FA |
| 7. | (10,000) | + | NA | = | (10,000) | + | NA | + | NA | NA | − | NA | = | NA | (10,000) | FA |
| 8. | (53,000) | + | 53,000 | = | NA | + | NA | + | NA | NA | − | NA | = | NA | (53,000) | IA |
| 9. | NA | + | NA | = | NA | + | NA | + | NA | NA | − | NA | = | NA | | NA |
| Total | 49,000 | + | 53,000 | = | 30,000 | + | 50,000 | + | 22,000 | 48,000 | − | 25,000 | | 23,000 | 49,000 | |

**b. Total Assets = $49,000 + $53,000 = $102,000**

**c.**

| Sources of Assets | |
|---|---|
| 1. Issue of stock | $ 30,000 |
| 2. Cash from loan | 40,000 |
| 3. Cash from revenue | 48,000 |
| 6. Issue of stock | 20,000 |
| Total Sources of Assets | $138,000 |

## PROBLEM 1-34A (cont.)

**d. Net income amounts to $23,000 (see part a.) Dividends are not expenses and do not appear on the income statement.**

**e.**

| **Operating Activities:** | |
|---|---|
| **Cash from revenue** | **$48,000** |
| **Cash paid for expenses** | **(25,000)** |
| **Net Cash Flow from Operating Activities** | **$23,000** |

| **Investing Activities:** | |
|---|---|
| **Cash paid to purchase land** | **$(53,000)** |
| **Net Cash Flow from Investing Activities** | **$(53,000)** |

| **Financing Activities:** | |
|---|---|
| **Cash from stock issue ($30,000 + $20,000)** | **$50,000** |
| **Cash from loan** | **40,000** |
| **Paid cash dividend** | **(1,000)** |
| **Cash paid on loan principal** | **(10,000)** |
| **Net Cash Flow from Financing Activities** | **$79,000** |

**f. Percentage of assets is provided as follows:**

| | | |
|---|---|---|
| **Investors** | **($50,000 ÷ $102,000)** | **49.0%** |
| **Creditors** | **($30,000 ÷ $102,000)** | **29.4%** |
| **Earnings** | **($22,000 ÷ $102,000)** | **21.6%** |

**g. Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.**

## SOLUTIONS TO EXERCISES - SERIES B - CHAPTER 1

### EXERCISE 1-1B

The three types of resources available to businesses are:

4. Financial resources
5. Physical resources
6. Labor resources

Note to instructor:

The memo should discuss the fact that the resource owners are those who own resources that are desired by others, either in the original form or in a converted form. The businesses are the parties that acquire the resource and supply it to consumers either in the original form or in a converted form with value added by the conversion. The consumers are the ultimate users of the resources.

It should also include a discussion of the role of the private accountant and the allocation of resources. For example, private accountants prepare the annual reports that businesses use to communicate information to investors and creditors (financial resource providers). In other words, they are the information providers. The most appropriate designation for private accountants is the attainment of a Certified Management Accountant (CMA). However, many private accountants get their start in public accounting and are therefore CPAs as well as CMAs.

## EXERCISE 1-2B

**a. The three areas of service provided by public accountants are auditing, tax, and consulting.**

**b. The private accountant generally works for a specific company. Some of the functions performed include classifying and recording transactions, billing customers, collecting amounts due, ordering merchandise, paying suppliers, preparing and analyzing financial statements, developing budgets, assessing performance, and making decisions.**

## EXERCISE 1-3B

| Entities | Distribution of Cash |
|---|---|
| Ray Steen (personal account) | Personal account was decreased by the $100,000 cash deposited in the Steen Enterprises' business account. |
| Steen Enterprises | Cash account increased by the $100,000 cash deposited by Mr. Steen.<br>Cash account increased by $60,000 cash borrowed from First Bank.<br>Cash account increased by $75,000 cash invested by Stan Rhoades.<br>Cash account decreased by $150,000 cash used to purchase building.<br>Cash account increased by $56,000 cash revenue earned.<br>Cash account decreased by $31,000 cash payment to employees for salaries. |
| First Bank | Cash account decreased by $60,000 cash loaned to Steen Enterprises. |
| Stan Rhoades, father-in-law, personal account | Cash decreased by $75,000 cash invested in Steen Enterprises. |
| Zoro Realty Company | Cash increased by $150,000 received from Steen Enterprises to purchase building. |
| Steen Enterprises' customers | Cash decreased by $56,000 when customers paid for services performed. |
| Steen Enterprises' employees | Cash increased by $31,000 when employees received payment for salaries. |

## EXERCISE 1-4B

**a.**

| Term | Definition |
|---|---|
| a | 2 |
| b | 5 |
| c | 1 |
| d | 3 |
| e | 4 |
| f | 6 |
| g | 7 |

**b.**

| Accounting Equation | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | | Stockholders' Equity | | |
| | | | | | Common | | Retained |
| Company | Assets | = | Liabilities | + | Stock | + | Earnings |
| A | *142,000* | = | 30,000 | + | 50,000 | + | 62,000 |
| B | 50,000 | = | *15,000* | + | 10,000 | + | 25,000 |
| C | 85,000 | = | 20,000 | + | *25,000* | + | 40,000 |
| D | 215,000 | = | 60,000 | + | 100,000 | + | *55,000* |

## EXERCISE 1-5B

**Morrison Co.**
**Accounting Equation**

| | | | | | Stockholders' Equity | |
|---|---|---|---|---|---|---|
| Event Number | Assets | = | Liabilities | + | Common Stock | Retained Earnings |
| 1. | I | = | NA | + | I | NA |
| 2. | I | = | I | + | NA | NA |
| 3. | I | = | NA | + | NA | I |
| 4. | I/D | = | NA | + | NA | NA |
| 5. | D | = | NA | + | NA | D |
| 6. | D | = | NA | + | NA | D |

## EXERCISE 1-6B

a.

### Master Corp.
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Event** | **Cash** | **+** | **Land** | **=** | **Notes Payable** | **+** | **Com. Stock** | **+** | **Retained Earnings** | **Acct. Title/RE** |
| Bal. 1/1/Y2 | 20,000 | + | 50,000 | = | 35,000 | + | 25,000 | + | 10,000 | |
| 1. Pur. Land | (12,000) | + | 12,000 | = | NA | + | NA | + | NA | NA |
| 2. Issued stk. | 20,000 | + | NA | = | NA | + | 20,000 | + | NA | NA |
| 3. Service | 50,000 | + | NA | = | NA | + | NA | + | 50,000 | Revenue |
| 4. Paid Exp. | (42,000) | + | NA | = | NA | + | NA | + | (42,000) | Oper. Exp. |
| 5. Loan | 20,000 | + | NA | = | 20,000 | + | NA | + | NA | NA |
| 6. Paid Div. | (2,000) | + | NA | = | NA | + | NA | + | (2,000) | Dividend |
| 7. Land Value | NA | + | NA | = | NA | + | NA | + | NA | NA |
| **Totals** | 54,000 | + | 62,000 | = | 55,000 | + | 45,000 | + | 16,000 | |

b.

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| $116,000 | = | $55,000 | + | $61,000 |

c. The balances of total assets, liabilities, and stockholders' equity will be the same on January 1, Year 3 as the balances on December 31, Year 2. (See b. above)

## EXERCISE 1-7B

**a.**

| Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|
| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
| 156,000 | = | 85,600 | + | 52,400 | + | ? |

**Retained Earnings = $156,000 – $85,600 – $52,400 = $18,000**

**b. & c.**

**Dunn Company**
**Effect of Year 2 Transactions on the Accounting Equation**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| Beginning Balances | 156,000 | = | 85,600 | + | 52,400 | + | 18,000 |
| 1. Earned Revenue | 36,000 | = | NA | + | NA | + | 36,000 |
| 2. Paid expenses | (20,000) | = | NA | + | NA | + | (20,000) |
| 3. Paid dividend | (3,000) | = | NA | + | NA | + | (3,000) |
| Ending Balance | 169,000 | = | 85,600 | + | 52,400 | + | 31,000 |

**d.**

| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| 169,000 | = | 85,600 | + | 52,400 | + | 31,000 |

**Liabilities + Stockholders' Equity = $85,600 + $52,400 + $31,000 = $169,000**

**Assets = Liabilities + Stockholders' Equity**
**$169,000 = $169,000**

## EXERCISE 1-7B (cont.)

**e. The beginning and ending balances in the cash account were $156,000 and $169,000, respectively. The beginning balance in the common stock account was $52,400. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because the accounting events that Dunn experienced during the Year 2 accounting period affected the cash account but not the common stock account.**

## EXERCISE 1-8B

**a.**

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| Cash | | Notes Payable | | Salaries Expense |
| Land | | Accounts Payable | | Common Stock |
| Office Furniture | | Utilities Payable | | Service Revenue |
| Trucks | | | | Interest Expense |
| Supplies | | | | Utilities Expense |
| Computers | | | | Operating Expenses |
| Building | | | | Rent Revenue |
| | | | | Supplies Expense |
| | | | | Gasoline Expense |
| | | | | Retained Earnings |
| | | | | Dividends |

## EXERCISE 1-8B (cont.)

b. No. The number of accounts will vary depending on the level of detail the reporting entity chooses to provide, as well as the type of company and industry in which it operates. More accounts provide financial statement users with more information about the reporting entity. However, the cost of keeping records on many accounts often outweighs the benefit of providing more information. For example, in this problem the company kept all of the trucks in one account (i.e. Trucks). If the company wanted to provide more detail the company could have created a separate account for each truck. If the company wanted even more detail the company could break the truck into different components and provide an account for each component of the truck (i.e. engine, frame, wheels, tires, etc.). Providing accounts for each truck component would be very difficult and time consuming and would not necessarily change any decision made by a financial statement user. Therefore, it makes more sense to aggregate all trucks and truck components into one account. Deciding the number of accounts to report is a subjective cost/benefit analysis. The goal is to provide financial statement users with detail (i.e. more accounts) when the benefit of the additional information outweighs the cost of providing the information. Remember, it is the stockholders who are paying for the production of accounting information. They do not want to pay to produce information that costs more than it is worth.

## EXERCISE 1-9B

a.

| | Assets | | | | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Stockholders' Equity |
| | $10,000 | | $ -0- | | $4,000 | | $6,000 |
| | (9,000) | | 9,000 | | NA | | NA |
| Bal. | $ 1,000 | + | $9,000 | = | $4,000 | + | $6,000 |

**b. Creditor's Claim ÷ Total Assets = Percent of Total**
**$4,000 ÷ $10,000 = 40%**

**c. Stockholder's Claim ÷ Total Assets = Percent of Total**
**$6,000 ÷ $10,000 = 60%**

**d. The company cannot repay the debt. The company owes the creditors $4,000 but has only $1,000 cash. Note there is no actual money in the stockholders' equity account. Indeed, there is no cash in any account that appears on the right side of the accounting equation. The right side of the accounting equation represents obligations and commitments of a company to its creditors and stockholders. Indeed, the accounting equation could be written as:**

| | Assets | | | | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Stockholders' Equity |
| Bal. | $ 1,000 | + | $9,000 | = | 40% | + | 60% |

**All assets including any cash balances are shown on the left side of the equation.**

## EXERCISE 1-10B

a. Dividends are paid to investors. The investor has an ownership interest in the business that allows the investor (owner) to share in the profits of the business. This pay out of a share of profits of a business to the owners is called a dividend.

b. There is no cash in the Retained Earnings account. Retained Earnings represents the business's commitments to its stockholders. It is the amount of past earnings that have not been paid out to owners.

c. The amount of dividends that can be paid are limited to retained earnings. In addition, a company must have enough cash to pay the dividend. White has $1,000 of retained earnings but only $800 of cash. The maximum amount of dividend that could be paid at this time would be $800.

d. If the total amount of the liability of $7,000 is due, White will not be able to satisfy the obligation. White has only $800 of cash; the balance of the assets are contained in the Land account. If payment must be made to creditors, White will have to liquidate the company in order to pay the debt.

e. If the land becomes worthless, the only asset remaining is the cash of $800. Since creditors have first claim on the assets, all of the $800 will be paid to the creditors. The investors will not be paid anything.

## EXERCISE 1-11B

a. The answers are shown in the order in which they were calculated. In other words, item (d) was calculated first, (g) second and so on. There are other possible patterns that would produce correct answers.

Begin by filling in all possible blanks on the horizontal rows.

(d) Since common stock increased by $50,000, cash had to increase by $50,000.

(g) Since cash decreased by $18,000, dividends must have caused retained earnings to decrease by $18,000.

(h) Since cash decreased by $65,000, land must have increased by $65,000.

Now shift to an analysis of the vertical columns.

(i) Given that land had a beginning balance of $70,000 and $65,000 of land was purchased, the ending balance in the land account has to be $135,000.

(b) The beginning balance in the notes payable account had to be $40,000 because this amount minus the $5,000 partial pay off of notes payable would result in ending balance in the notes payable account of $35,000.

(c) The $130,000 ending balance in the common stock account minus the $50,000 issued during the period yields $80,000 beginning balance.

Now shift back to a horizontal analysis of the rows.

(a) Cash (x) + Land = Notes Pay. + Common Stk. + Beg. Ret. Ear.
X = -$70,000 + $40,000 + $80,000 + $20,000
X = $70,000

(j) Cash + Land = Notes Pay. + Common Stk. + End. Ret. Ear. (X)
X = Cash + Land – Notes Pay – Common Stk.
X = $90,000 + $135,000 - $35,000 - $130,000
X = $60,000

## EXERCISE 1-11B (cont.)

(f)

| | |
|---|---|
| Beginning Retained Earnings | $20,000 |
| + Revenue | X |
| - Expenses | (30,000) |
| - Dividends | (18,000) |
| Ending Retained Earnings | $60,000 |

$20,000 + x – $30,000 – $18,000 = $60,000
X = $88,000

(e) Given that revenue increase by $88,000 cash must have increased by $88,000.

The solution shown in table format is as follows:

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | (a)70,000 | + | 70,000 | = | (b)40,000 | + | (c)80,000 | + | 20,000 | |
| Event 1 | (d)50,000 | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2. | (e)88,000 | + | NA | = | NA | + | NA | + | (f)88,000 | Revenue |
| 3. | (30,000) | + | NA | = | NA | + | NA | + | (30,000) | Expenses |
| 4. | (18,000) | + | NA | = | NA | + | NA | + | (g)(18,000) | Dividend |
| 5. | (65,000) | + | (h)65,000 | = | NA | + | NA | + | NA | NA |
| 6. | (5,000) | + | NA | = | (5,000) | + | NA | + | NA | NA |
| End. Bal. | 90,000 | + | (i)135,000 | = | 35,000 | + | 130,000 | + | (j)60,000 | |

b. There is sufficient cash available to pay off the debt on January 1, Year 8. At that time the company has cash of $70,000 which is more than enough funds to repay the $40,000 notes payable.

## EXERCISE 1-11B (cont.)

**c. The maximum cash dividend payable is limited by the lessor of the balance in the cash account versus the balance in the retained earnings account. In this case $60,000 is the maximum cash dividend Walter can pay.**

## EXERCISE 1-12B

a. **Investors put assets into the company with the expectation of sharing profits. Creditors lend assets to the company with the expectation of repayment of the principal plus interest on the loan.**

**b.**

**Clayton Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | 2,900 | = | 1,200 | + | 1,700 |
| Earned income | 800 | = | NA | + | 800 |
| Balance | 3,700 | = | 1,200 | + | 2,500 |

**Since creditors are owed $1,200 and there are sufficient funds to pay them; the creditors will receive the $1,200 that they are owed. Since the investors own the business, they are entitled to the profits earned by the business. The investors will receive $2,500 (their original $1,700 investment plus the $800 of profit).**

**c.**

**Clayton Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | 2,900 | = | 1,200 | + | 1,700 |
| Incurred loss | (800) | = | NA | + | (800) |
| Balance | 2,100 | = | 1,200 | + | 900 |

**Since creditors are owed $1,200 and there are sufficient funds to pay them; the creditors will receive the $1,200 that they are owed. Since the investors own the business, they suffer the losses earned by the business. The investors will receive $900 (their original $1,700 investment minus the $800 loss).**

## EXERCISE 1-12B (cont.)

**d.**

**Clayton Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | 2,900 | = | 1,200 | + | 1,700 |
| Incurred loss | (1,900) | = | (200) | + | (1,700) |
| Balance | 1,000 | = | 1,000 | + | 0 |

While creditors get first priority to receive assets in a business liquidation, this does not mean they cannot lose all or a portion of the assets they loan a business. In this case creditors are owed $1,200 but the business has only $1,000 of assets. Since the creditors have first priority, the entire $1,000 would be distributed to them. In this case the creditors lose $200 ($1,200 original loan - $1,000 returned). Since the investors own the business, they suffer the losses incurred by the business. The investors will lose the entire $1,700 they contributed to the business.

## EXERCISE 1-13B

| Event | Classification |
|---|---|
| 1. | Asset Source |
| 2. | Asset Source |
| 3. | Asset Exchange |
| 4. | Asset Source |
| 5. | Asset Source |
| 6. | Asset Exchange |
| 7. | Asset Use |
| 8. | NA |
| 9. | Asset Use |
| 10. | Asset Use |
| 11. | NA |
| | |

## EXERCISE 1-14B

**Steps:**

**1.**

**Common Stock Issued = Change in Common Stock**
**$30,000 (given) = *$30,000***

**2.**

**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**
**$80,000 (given) = $30,000 (1) + *$50,000***

**3.**

**Increase in Ret. Earn. = Net Income – Dividends**
**$50,000 (2) = *$52,000* – $2,000 (given)**

**Alternate Solution:**

**From the Statement of Changes in Stockholders' Equity we know (with minor modifications):**

| | | |
|---|---|---|
| Beginning Total Stk. Equity, 1/1/Year 2 | | $200,000 |
| (Common Stock + Retained Earnings) | | |
| | | |
| Plus: Common Stock Issued | $30,000 | |
| Plus: Net Income | ? | |
| Less: Dividends | (2,000) | |
| Change in Stockholders' Equity | | 80,000 |
| | | |
| Ending Total Stk. Equity, 12/31/Year 2 | | $280,000 |

**Working backwards from the change in equity we can solve for net income:**

## EXERCISE 1-14B (cont.)

| | |
|---|---|
| Change in Stockholders’ Equity, Year 1 | $80,000 |
| Plus: Dividends | 2,000 |
| Less: Common Stock Issued | (30,000) |
| Net Income, Year 1 | *$52,000* |

## EXERCISE 1-15B

a.

**Petre Company**
**Accounting Equation for Year 1**

|  | Assets | = | Liabilities | + | Stockholders' Equity |  |  |
|---|---|---|---|---|---|---|---|
|  |  |  |  |  | Common |  | Retained |
| Event | Cash | = |  | + | Stock | + | Earnings |
| 1. Issue stock | 25,000 |  | NA |  | 25,000 |  | NA |
| 2. Cash revenues | 14,500 | = | NA | + | NA | + | 14,500 |
| 3. Paid expenses | (9,200) | = | NA | + | NA | + | (9,200) |
| 4. Paid dividend | (500) | = | NA | + | NA | + | (500) |
| Ending Balance | 29,800 | = | -0- | + | 25,000 | + | 4,800 |

b.

**Petre Company**
**Income Statement**
**For the Year Ended December 31, Year 1**

|  |  |
|---|---|
| Revenue | $14,500 |
| Expense | (9,200) |
| Net Income | $ 5,300 |

**Petre Company**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 1**

|  |  |  |
|---|---|---|
| Beginning Common Stock | $ -0- |  |
| Plus: Common Stock Issued | 25,000 |  |
| Ending Common Stock |  | $ 25,000 |
|  |  |  |
| Beginning Retained Earnings | $ -0- |  |
| Plus: Net Income | 5,300 |  |
| Less: Dividends | (500) |  |
| Ending Retained Earnings |  | 4,800 |

| | | | | |
|---|---|---|---|---|
| | **Total Stockholders' Equity** | | **$29,800** | |
| | | | | |

## EXERCISE 1-15B (cont.)

**b.**

**Petre Company**
**Balance Sheet**
**As of December 31, Year 1**

| | | |
|---|---|---|
| **Assets** | | |
| **Cash** | | **$ 4,800** |
| **Liabilities** | | **$ -0-** |
| **Stockholders' Equity** | | |
| **Common Stock** | **$ 25,000** | |
| **Retained Earnings** | **4,800** | |
| **Total Stockholders' Equity** | | **4,800** |
| **Total Liabilities and Stockholders' Equity** | | **$ 29,800** |

**c. The income statement is dated with the term "for the year ended" because it covers a one year span of time. The balance sheet is dated with the term "as of" because it describes information at a specific point in time.**

## EXERCISE 1-16B

a. Land will be shown on the Year 8 balance sheet.

b. Land will be listed at its historical cost of $250,000.

c. The key concept used in listing land at its cost is the historical cost concept.

## EXERCISE 1-17B

**a.**

### Palmer Company
### Statement of Cash Flows
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| **Net Cash Inflow from Operating Activities** | | **$ 15,600** |
| **Cash Flows From Investing Activities:** | | |
| **Net Cash Outflow from Investing Activities** | | **(23,000)** |
| **Cash Flows From Financing Activities:** | | |
| **Net Cash Outflow from Financing Activities** | | **(4,500)** |
| **Net Decrease in Cash** | | **(11,900)** |
| **Plus: Beginning Cash Balance** | | **32,000** |
| **Ending Cash Balance** | | **$20,100** |

**b. Cash inflow from selling fast food to customers was greater than cash outflow for expenses.**

**c. The company paid cash to purchase long-term assets.**

**d. The company paid cash dividends or paid off a bank loan.**

## EXERCISE 1-18B

**a.**

| Event | Statement of Cash Flow Classification |
|---|---|
| 1. | OA |
| 2. | FA |
| 3. | FA |
| 4. | IA |
| 5. | OA |
| 6. | OA |
| 7. | IA |
| 8. | FA |
| 9. | NA |
| 10. | FA |

## EXERCISE 1-18B (cont.)

**b.**

**National Service Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $14,000 | |
| Cash Payments for Salaries | (4,000) | |
| Cash Payments for Utilities | (4,200) | |
| Net Cash Inflow from Operating Activities | | $ 5,800 |
| Cash Flows From Investing Activities: | | |
| Cash Paid to Purchase Land | $(8,000) | |
| Cash Collected from the Sale of Land | 7,000 | |
| Net Cash Outflow from Investing Activities | | (1,000) |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Loan | $ 8,000 | |
| Cash Paid to Loan Obligation | (3,000) | |
| Cash Receipts from Stock Issue | 30,000 | |
| Cash Payments for Dividends | (1,000) | |
| Net Cash Inflow from Financing Activities | | 34,000 |
| Net Increase in Cash | | 38,800 |
| Plus: Beginning Cash Balance | | 9,000 |
| Ending Cash Balance | | $47,800 |

## EXERCISE 1-19B

**a.**

### Tennessee Company
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/Y2 | 15,000 | + | 10,000 | = | -0- | + | 20,000 | + | 5,000 | |
| 1. Issued stk. | 50,000 | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2. Pur. Land | (15,000) | + | 15,000 | = | NA | + | NA | + | NA | NA |
| 3. Loan | 25,000 | + | NA | = | 25,000 | + | NA | + | NA | NA |
| 4. Provide Svc. | 60,000 | + | NA | = | NA | + | NA | + | 60,000 | Svc. Rev. |
| 5. Paid Rent | (12,000) | + | NA | = | NA | + | NA | + | (12,000) | Rent Exp. |
| 6. Pd. Op. Exp. | (22,000) | + | NA | = | NA | + | NA | + | (22,000) | Op. Exp. |
| 7. Paid Div. | (5,000) | + | NA | = | NA | + | NA | + | (5,000) | Dividends |
| 8. Land Value | NA | + | NA | = | NA | + | NA | + | NA | |
| Totals | 96,000 | + | 25,000 | = | 25,000 | + | 70,000 | + | 26,000 | |

**b.**

### Tennessee Company
### Income Statement
### For the Year Ended December 31, Year 2

| | |
|---|---|
| Service Revenue | $60,000 |
| Rent Expense | (12,000) |
| Operating Expense | (22,000) |
| Net Income | $26,000 |

## EXERCISE 1-19B (cont.)

**b.**

### Tennessee Company
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $20,000 | |
| Plus: Common Stock Issued | 50,000 | |
| Ending Common Stock | | $70,000 |
| | | |
| Beginning Retained Earnings | $ 5,000 | |
| Plus: Net Income | 26,000 | |
| Less: Dividends | (5,000) | |
| Ending Retained Earnings | | 26,000 |
| | | |
| Total Stockholders' Equity | | $96,000 |

## EXERCISE 1-19B (cont.)

**b.**

**Tennessee Company**
**Balance Sheet**
**As of December 31, Year 2**

| | | |
|---|---|---|
| **Assets** | | |
| Cash | $96,000 | |
| Land | 25,000 | |
| **Total Assets** | | $121,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | $25,000 | |
| **Total Liabilities** | | $25,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $70,000 | |
| Retained Earnings | 26,000 | |
| **Total Stockholders' Equity** | | 96,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $121,000 |

## EXERCISE 1-19B (cont.)

**b.**

| Tennessee Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $60,000 | |
| Cash Payment for Rent Expense | (12,000) | |
| Cash Payments for Other Operating Exp. | (22,000) | |
| **Net Cash Flow from Operating Activities** | | $26,000 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(15,000) | |
| **Net Cash Flow from Investing Activities** | | (15,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $50,000 | |
| Cash Receipts from Loan | 25,000 | |
| Cash Payments for Dividends | (5,000) | |
| **Net Cash Flow from Financing Activities** | | 70,000 |
| | | |
| **Net Increase in Cash** | | 81,000 |
| **Plus: Beginning Cash Balance** | | 15,000 |
| **Ending Cash Balance** | | $96,000 |

**c.** Percentage of assets provided by retained earnings:
$26,000 ÷ $121,000 = 21.5%

Cash cannot be directly traced to retained earnings. Retained earnings represent the amount earned less dividends since the company began.

## EXERCISE 1-20B

| | | |
|---|---|---|
| a. | Arnett Company: | Asset Source |
| b. | Dan Arnett: | Asset Exchange |
| c. | Arnett Company: | Financing Activity |
| d. | Dan Arnett: | Investing Activity |

## EXERCISE 1-21B

a.

**Zeke Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| 200 | | 1,800 | | 600 | | 1,000 | | ? |

**Retained Earnings = $200 + $1,800 - $600 - $1,000 = $400**

b. **The company cannot pay a $300 dividend because it only has $200 of cash. The Retained Earnings account contains zero cash. While a company may distribute dividends if it has a retained earnings balance, the company must also have the cash to enable it to pay the dividends.**

c. **Total Assets = $200 + $1,800 = $2,000**

**Creditor's Loans ÷ Total Assets**
**$600 ÷ $2,000 = 30%**

d. **Investor's Contributions ÷ Total Assets**
**$1,000 ÷ $2,000 = 50%**

e. **Retained Earnings ÷ Total Assets**
**$400 ÷ $2,000 = 20%**

f.

**Zeke Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| 200 | | 1,800 | | 30% | | 50% | | 20% |

## EXERCISE 1-21B (cont.)

**g.**

**Zeke Company**
**Accounting Equation as of December 31, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|
| Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | |
| 200 | + | 1,800 | = | 600 | + | 1,000 | + | 400 | |
| 500 | + | NA | = | NA | + | NA | + | 500 | Rev. |
| (300) | + | NA | = | NA | + | NA | + | (300) | Exp. |
| (50) | + | NA | = | NA | + | NA | + | (50) | Div. |
| 350 | + | 1,800 | = | 600 | + | 1,000 | + | 550 | |

**Zeke Company**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | |
|---|---|
| Revenue | $500 |
| Expenses | (300) |
| Net Income | $200 |

## EXERCISE 1-21B (cont.)

g.

**Zeke Company**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Beginning Common Stock | $1,000 | |
| Plus: Common Stock Issued | -0- | |
| Ending Common Stock | | $1,000 |
| | | |
| Beginning Retained Earnings | $ 400 | |
| Plus: Net Income | 200 | |
| Less: Dividends | (50) | |
| Ending Retained Earnings | | 550 |
| | | |
| Total Stockholders' Equity | | $1,550 |

**Zeke Company**
**Balance Sheet**
**As of December 31, Year 2**

| | | |
|---|---|---|
| Assets | | |
| Cash | $ 350 | |
| Land | 1,800 | |
| Total Assets | | $2,150 |
| | | |
| Liabilities | | |
| Notes Payable | $600 | |
| Total Liabilities | | $ 600 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $1,000 | |
| Retained Earnings | 550 | |
| Total Stockholders' Equity | | 1,550 |
| | | |
| Total Liabilities and Stockholders' Equity | | $2,150 |

## EXERCISE 1-21B (cont.)

g.

### Zeke Company
### Statement of Cash Flows
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $500 | |
| Cash Payments for Expenses | (300) | |
| **Net Cash Flow from Operating Activities** | | $ 200 |
| | | |
| **Cash Flows From Investing Activities:** | | 0 |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Payments for Dividends | (50) | |
| **Net Cash Flow from Financing Activities** | | (50) |
| | | |
| **Net Increase in Cash** | | 150 |
| **Plus: Beginning Cash Balance** | | 200 |
| **Ending Cash Balance** | | $ 350 |

h. The income statement, statement of changes in stockholders' equity, and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology "*For the Year Ended* December 31, Year 2". In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In this case, the point in time is December 31, Year 2. Therefore, this statement uses the terminology "*As of* December 31, Year 2".

## EXERCISE 1-21B (cont.)

**i. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company's books.**

**j. The balance in the revenue account is zero on January 1, Year 3, because the balance in this account is transferred to retained earnings in the December 31, Year 2 closing process.**

## EXERCISE 1-22B

a. Since the amount in the Notes Payable account increased from zero to $3,000, Shundra, Inc. must have received a cash inflow of $3,000 from the issue of the note payable. Similarly, since the balance in the common stock account increased from $2,500 to $8,000, Shundra, Inc. must have received a cash inflow $5,500 ($8,000 - $2,500) from the issue of common stock. Finally, the $900 dividend payment would have caused a net cash outflow. Therefore, the net cash inflow from financing activities can be explained as follows:

| Cash Flows From Financing Activities: | |
|---|---|
| Cash Receipts from Loan | $3,000 |
| Cash Receipts from Stock Issue | 5,500 |
| Cash Payments for Dividends | (900) |
| Net Cash Flow from Financing Activities | $7,600 |

b. Since the balance in the land account increases from zero to $13,000, Shundra, Inc. must have had a net cash outflow $13,000 for the purchase of Land.

c.

**Shundra, Inc.**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | |
|---|---|
| Revenue | $9,900 |
| Expenses | (4,800) |
| Net Income | $5,100 |

## EXERCISE 1-22B (cont.)

c.

### Shundra, Inc.
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $ 2,500 | |
| Plus: Common Stock Issued | 5,500 | |
| Ending Common Stock | | $8,000 |
| | | |
| Beginning Retained Earnings | $ 2,000 | |
| Plus: Net Income | 5,100 | |
| Less: Dividends | (900) | |
| Ending Retained Earnings | | 6,200 |
| | | |
| Total Stockholders' Equity | | $14,200 |

### Shundra, Inc.
### Balance Sheet
### As of December 31, Year 2

| | | |
|---|---|---|
| Assets | | |
| Cash | $ 4,200 | |
| Land | 13,000 | |
| Total Assets | | $17,200 |
| | | |
| Liabilities | | |
| Notes Payable | $3,000 | |
| Total Liabilities | | $ 3,000 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $8,000 | |
| Retained Earnings | 6,200 | |
| Total Stockholders' Equity | | 14,200 |
| | | |
| Total Liabilities and Stockholders' Equity | | $17,200 |

## EXERCISE 1-22B (cont.)

c.

**Shundra, Inc.**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $ 9,900 | |
| Cash Payments for Expenses | (4,800) | |
| Net Cash Flow from Operating Activities | | $ 5,100 |
| | | |
| Cash Flows From Investing Activities: | | |
| Cash Paid to Purchase Land | $(13,000) | |
| Net Cash Flow from Investing Activities | | (13,000) |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Loan | $ 3,000 | |
| Cash Receipts from Stock Issue | 5,500 | |
| Cash Payments for Dividends | (900) | |
| Net Cash Flow from Financing Activities | | 7,600 |
| | | |
| Net Decrease in Cash | | (300) |
| Plus: Beginning Cash Balance | | 4,500 |
| Ending Cash Balance | | $ 4,200 |

## EXERCISE 1-23B

a.

**Big Horn Company**
**Accounting Equation as of December 31, Year 1**

| Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| 100,000 | | $30,000 | | 50,000 | | ? |

**Retained Earnings = $100,000 - $30,000 - $50,000 = $20,000**

| | |
|---|---|
| Retained Earnings after closing: | $20,000 |
| Less, Revenue | (16,000) |
| Add, Expenses | 11,000 |
| Add, Dividends | 2,000 |
| Retained Earnings before closing | $17,000 |

b. Retained Earnings after closing is $20,000 (see the equation above).

c. The balances in revenue, expense and dividends before closing are:

| | |
|---|---|
| Revenue | 16,000 |
| Expenses | 11,000 |
| Dividends | 2,000 |

d. After closing revenue, expenses, and dividends, all of the balances will be zero.

e. Both Common Stock and Retained Earnings represent obligations the business has to stockholders. The Common Stock represents the assets a business has acquired from owners. Retained earnings represent assets a business has acquired by conducting its operations.

## EXERCISE 1-23B (cont.)

**f. The owners are no better off immediately after they contributed capital to the business. While equity increased $40,000, the amount invested by owners also increased $40,000. The owners are only in a better financial position if their equity exceeds the amount they have invested in the company. At this point, the owners have simply exchanged cash for an additional ownership interest in the business. The owners will not benefit until the business uses the assets to produce profits. Note that it is possible that the owners could be worse off if the business incurs losses. In summary, the owners share in the benefits and sacrifices that the business experiences. They do not benefit when the business raises additional equity.**

## EXERCISE 1-24B

**a.**

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| Year 1 | $40,000 | $21,000 | 19,000 | 19,000 |
| Year 2 | 50,000 | 32,000 | 18,000 | 37,000 |
| Year 3 | 70,000 | 48,000 | 22,000 | 59,000 |
| | | | | |

**b.** **Net income is a measure of the benefits minus the sacrifices a company experiences during a single accounting period. Retained earnings is the amount of net income a company has earned minus the dividends it has paid out since its inception.**

**c.**

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| Year 1 | $40,000 | $21,000 | 19,000 | 19,000 |
| Year 2 | 50,000 | 32,000 | 18,000 | 31,000* |
| Year 3 | 70,000 | 48,000 | 22,000 | 53,000** |
| | | | | |

***$19,000 Beginning Balance + $18,000 Net Income - $6,000 Dividends**
****$31,000 Beginning Balance + $22,000 Net Income**

## EXERCISE 1-25B

a. **The balance in the Retained Earnings account as of January 31, Year 1 is zero.**
*Explanation: The revenue is recorded in the Revenue account and is not transferred into retained earnings until the year-end closing process is accomplished.*

b. **The balance in the Revenue account as of January 31, Year 1 is $4,600. The balance in the Expense account as of January 31, Year 1 is $3,000.**
*Explanation: The amounts in the revenue and expense accounts are not transferred to the Retained Earnings account until the year-end closing process is accomplished.*

c. **The *before closing* balance in the Retained Earnings account as of December 31, Year 1 is zero.**
*Explanation: The revenue and expenses are recorded in the Revenue and Expense accounts throughout the year and the balances in these accounts are not transferred into retained earnings until the year-end closing process is accomplished.*

d. **The December 31, Year 1 *before closing* balance in the Revenue account is $56,600 ($4,600 + $52,000). The December 31, Year 1 *before closing* balance in the Expense account is $45,000 ($3,000 + $42,000).**
*Explanation: The revenue and expense amounts accumulate in the Revenue and Expense accounts throughout the year.*

e. **The January 1, Year 2 balance in the Retained Earnings account is $11,600.**
*Explanation: The December 31, Year 1 year-end closing process transfers the $56,600 balance in the Revenue account and $45,000 Expense account into the Retained Earnings account. Since revenue increases retained earnings and expenses decrease retained earnings, the December 31, Year 1 retained earnings account balance* **after closing** *is $11,600 ($56,600 - $45,000). Since last year's ending balances become next year's beginning balances, the balance in the Retained Earnings account as of January 1, Year 2 is $11,600.*

## EXERCISE 1-25B (cont.)

**f. The January 1, Year 2 balance in the Revenue and Expense accounts is zero.**

*Explanation: The balances in the revenue and expense accounts* **after closing** *are zero because the balances accumulated during the year were transferred to the retained earnings account during the closing process. The January 1, Year 2 balances in the revenue and expense accounts are zero.*

## EXERCISE 1-26B

a.

| Event | |
|---|---|
| 1. | Asset Source |
| 2. | Asset Source |
| 3. | NA |
| 4. | Asset Exchange |
| 5. | Asset Use |
| 6. | Asset Use |
| 7. | NA |

b.

**Pet Partners**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | – | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | I | + | NA | = | NA | + | I | + | NA | NA | – | NA | = | NA | I FA |
| 2 | I | + | NA | = | I | + | NA | + | NA | NA | – | NA | = | NA | I FA |
| 3 | NA | + | NA | = | NA | + | NA | + | NA | NA | – | NA | = | NA | NA |
| 4 | D | + | I | = | NA | + | NA | + | NA | NA | – | NA | = | NA | D IA |
| 5 | D | + | NA | = | NA | + | NA | + | D | NA | – | I | = | D | D OA |
| 6 | D | + | NA | = | NA | + | NA | + | D | NA | – | NA | = | NA | D FA |
| 7 | NA | + | NA | = | NA | + | NA | + | NA | NA | – | NA | = | NA | NA |

## EXERCISE 1-27B

a. **An asset's worth is based on its fair market value, not the amount recorded in the financial statements, regardless of which set of accounting principles are being utilized.**

b. **GAAP lists assets on the balance sheet at historical cost while IFRS uses current value. This can cause significant differences in the monetary amount of assets listed on the balance sheet.**

## SOLUTIONS TO PROBLEMS - SERIES B - CHAPTER 1

## PROBLEM 1-28B

a. GAAP Generally Accepted Accounting Principles

b. Revenue may be recognized in either of the years depending on the entity's determination of the point in time for revenue recognition. For example, if Jan's earning process is deemed complete when she delivers her report then she would recognize revenue in December Year 1. But if Jan's earning process is deemed complete upon client satisfaction, then she would recognize revenue in February Year 2.

c. Management accounting reporting is not bound by GAAP. GAAP is required for external reporting. It helps insure consistent reporting from period to period as well as from company to company. Some differences will exist, but the methods used should be disclosed. Internal reporting is more concerned with supplying managers with the information they need to make the best decisions.

## PROBLEM 1-29B

| a. Entities mentioned: | b. Effect on the cash account: |
|---|---|
| 1. Chris Hann | Decrease |
| Classic Auto Sales | Increase |
| | |
| 2. Sal Pearl | Decrease |
| Business | Increase |
| | |
| 3. First State Bank | Decrease |
| Strong Co. | Increase |
| | |
| 4. Cindy's Restaurant | Decrease |
| Midwest Utilities | Increase |
| | |
| 5. Sun Corp. | Increase/Decrease |
| City National Bank | Decrease |
| Carriage Realty | Increase |
| | |
| 6. Sue Wang | Decrease |
| International Sales Corporation | Increase |
| | |
| 7. Chris Gordon | Decrease |
| Daughter | Increase |
| | |
| 8. Motor Service Co. | Increase |
| Customers | Decrease |
| | |
| 9. Poy Imports | Decrease |
| Employees | Increase |
| | |
| 10. Borg Inc. | Decrease |
| Mark Borg | Increase |

## PROBLEM 1-30B

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1. | Asset Use | Decrease |
| 2. | Asset Use | Decrease |
| 3. | Asset Source | Increase |
| 4. | Asset Use | Decrease |
| 5. | Asset Source | Increase |
| 6. | Asset Exchange | Increase/Decrease |
| 7. | NA | NA |
| 8. | Asset Use | Decrease |
| 9. | Asset Source | Increase |
| 10. | Asset Exchange | Increase/Decrease |
| 11. | Asset Exchange | Increase/Decrease |
| 12. | Asset Use | Decrease |
| 13. | NA | NA |
| 14. | Asset Source | Increase |
| 15. | Asset Use | Decrease |
| | | |

## PROBLEM 1-31B

| Item | Income Statement | Statement of Changes in Stk. Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| For the Period Ended (date) | ✓ | ✓ | | ✓ |
| Net income | ✓ | ✓ | | |
| Investing activities | | | | ✓ |
| Net loss | ✓ | ✓ | | |
| Ending cash balance | | | ✓ | ✓ |
| Salary expense | ✓ | | | |
| Consulting revenue | ✓ | | | |
| Dividends | | ✓ | | ✓ |
| Financing activities | | | | ✓ |
| Ending common stock | | ✓ | ✓ | |
| Interest expense | ✓ | | | |
| As of (date) | | | ✓ | |
| Land | | | ✓ | |
| Beginning cash balance | | | | ✓ |
| Notes payable | | | ✓ | |
| Beginning common stock | | ✓ | | |
| Service revenue | ✓ | | | |
| Utility expense | ✓ | | | |
| Stock issue | | ✓ | | ✓ |
| Operating activities | | | | ✓ |

## PROBLEM 1-32B

a.

### Marco's Consulting
### Accounting Equation for Year 1

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| 1. Issued stk | 50,000 | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2. Revenue | 100,000 | + | NA | = | NA | + | NA | + | 100,000 | Svc. Rev. |
| 3. Loan | 15,000 | + | NA | = | 15,000 | + | NA | + | NA | NA |
| 4. Paid Exp. | (60,000) | + | NA | = | NA | + | NA | + | (60,000) | Expense |
| 5. Pur. Land | (40,000) | + | 40,000 | = | NA | + | NA | + | NA | NA |
| **Totals** | 65,000 | + | 40,000 | = | 15,000 | + | 50,000 | + | 40,000 | |

### Marco's Consulting
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | 65,000 | + | 40,000 | = | 15,000 | + | 50,000 | + | 40,000 | |
| 1. Issued stk | 20,000 | + | NA | = | NA | + | 20,000 | + | NA | NA |
| 2. Revenue | 130,000 | + | NA | = | NA | + | NA | + | 130,000 | Svc. Rev. |
| 3. Paid Loan | (10,000) | + | NA | = | (10,000) | + | NA | + | NA | NA |
| 4. Paid Exp. | (75,000) | + | NA | = | NA | + | NA | + | (75,000) | Expense |
| 5. Paid Div. | (15,000) | + | NA | = | NA | + | NA | + | (15,000) | Dividends |
| 6. Land Val. | NA | + | NA | = | NA | + | NA | + | NA | NA |
| **Totals** | 115,000 | + | 40,000 | = | 5,000 | + | 70,000 | + | 80,000 | |

## PROBLEM 1-32B (cont.)

**b.**

| Marco's Consulting<br>Income Statement<br>For the Period Ended December 31, Year 1 | |
|---|---|
| Service Revenue | $100,000 |
| Expenses | (60,000) |
| Net Income | $40,000 |

| Marco's Consulting<br>Statement of Changes in Stockholders' Equity<br>For the Period Ended December 31, Year 1 | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 50,000 | |
| Ending Common Stock | | $50,000 |
| | | |
| Beginning Retained Earnings | $ -0- | |
| Plus: Net Income | 40,000 | |
| Ending Retained Earnings | | 40,000 |
| | | |
| Total Stockholders' Equity | | $90,000 |

## PROBLEM 1-32B (cont.)

**b.**

| Marco's Consulting<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| **Assets** | | |
| Cash | $65,000 | |
| Land | 40,000 | |
| **Total Assets** | | $105,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | | $ 15,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $50,000 | |
| Retained Earnings | 40,000 | |
| **Total Stockholders' Equity** | | 90,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $105,000 |

## PROBLEM 1-32B (cont.)

**b.**

| Marco's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 1 | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $100,000 | |
| Cash Payments for Expenses | (60,000) | |
| Net Cash Flow from Operating Activities | | $40,000 |
| | | |
| Cash Flows From Investing Activities: | | |
| Cash Payment for Land | $(40,000) | |
| Net Cash Flow from Investing Activities | | (40,000) |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Borrowing | $15,000 | |
| Cash Receipts from Stock Issue | 50,000 | |
| Net Cash Flow from Financing Activities | | 65,000 |
| | | |
| Net Increase in Cash | | 65,000 |
| Plus: Beginning Cash Balance | | -0- |
| Ending Cash Balance | | $65,000 |

## PROBLEM 1-32B (cont.)

**b.**

| Marco's Consulting<br>Income Statement<br>For the Period Ended December 31, Year 2 | |
|---|---|
| Service Revenue | $130,000 |
| Expenses | (75,000) |
| Net Income | $55,000 |

| Marco's Consulting<br>Statement of Changes in Stockholders' Equity<br>For the Period Ended December 31, Year 2 | | |
|---|---|---|
| Beginning Common Stock | $50,000 | |
| Plus: Common Stock Issued | 20,000 | |
| Ending Common Stock | | $ 70,000 |
| | | |
| Beginning Retained Earnings | $40,000 | |
| Plus: Net Income | 55,000 | |
| Less: Dividends | (15,000) | |
| Ending Retained Earnings | | 80,000 |
| | | |
| Total Stockholders' Equity | | $150,000 |

## PROBLEM 1-32B (cont.)

**b.**

### Marco's Consulting
### Balance Sheet
### As of December 31, Year 2

| | | |
|---|---|---|
| **Assets** | | |
| Cash | $115,000 | |
| Land | 40,000 | |
| **Total Assets** | | $155,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | | $ 5,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $70,000 | |
| Retained Earnings | 80,000 | |
| **Total Stockholders' Equity** | | 150,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $155,000 |

## PROBLEM 1-32B (cont.)

b.

| Marco's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $130,000 | |
| Cash Payments for Expenses | (75,000) | |
| Net Cash Flow from Operating Activities | | $55,000 |
| | | |
| Cash Flows From Investing Activities | | -0- |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Stock Issue | $20,000 | |
| Cash Payment on Debt | (10,000) | |
| Cash Payment for Dividends | (15,000) | |
| Net Cash Flow from Financing Activities | | (5,000) |
| | | |
| Net Increase in Cash | | 50,000 |
| Plus: Beginning Cash Balance | | 65,000 |
| Ending Cash Balance | | $115,000 |

c. Retained Earnings does not contain cash.

d. Assets increased from $105,000 at December 31, Year 1 to $155,000 at December 31, Year 2. This increase of $50,000 is solely due to the increase in cash.

## PROBLEM 1-32B (cont.)

**e. Immediately after Event 2 in Year 1 is recorded the balance in the Retained Earnings account is zero. The revenue is recorded in a Revenue account, not in the Retained Earnings account. The revenue, expense, and dividend accounts are closed to the Retained Earnings account at the end of each accounting period. After closing the accounts at the end of Year 1 the Retained Earnings account will have a balance of $40,000 ($100,000 revenue - $60,000 expenses).**

**The Year 1 ending balance in Retained Earnings becomes next year's beginning balance. Thus, the balance in the Retained Earnings account on January 1, Year 2 is $40,000. This balance will not change until the closing process is completed in December Year 2. As a result, the balance in the Retained Earnings account immediately after Event 2 in Year 2 is $40,000.**

## PROBLEM 1-33B

**a.**

**Blix Corp.**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | |
|---|---|
| Revenue | $27,500[1] |
| Expense | (15,000) |
| Net Income | $12,500 |

[1] To calculate revenue, you must first determine the ending balance in the retained earnings account at the end of Year 2:

| | |
|---|---|
| Beginning Retained Earnings | $ 20,000 |
| Plus increase in Retained Earnings | 8,500 |
| Ending Retained earnings | $28,500 |

Next, you can use this information to determine the amount of net income:

| | |
|---|---|
| Beginning Retained Earnings | $ 20,000 |
| Plus Net Income | "X" |
| Minus Dividends | (4,000) |
| Ending Retained earnings | $28,500 |

X = $28,500 - $20,000 + $4,000; X = $12,500

Finally, using the amount of net income, you can derive revenue:

| | |
|---|---|
| Revenue | $ "X" |
| Expenses | (15,000) |
| Net Income | $12,500 |

X = $12,500 + $15,000; X = $27,500

## PROBLEM 1-33B (cont.)

**b.**

| Blix Corp.<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Beginning Common Stock | $10,000[2] | |
| Plus: Common Stock Issued | 8,000 | |
| Ending Common Stock | | $18,000 |
| | | |
| Beginning Retained Earnings | $20,000 | |
| Plus: Net Income | 12,500 | |
| Less: Dividends | (4,000) | |
| Ending Retained Earnings | | 28,500 |
| | | |
| Total Stockholders' Equity | | $46,500 |

[2] To calculate the amount of common stock issued; rearrange the accounting equation and solve for the missing variable common stock as follows:

| Assets | – | Liabilities | – | Retained Earnings | = | Common Stock: |
|---|---|---|---|---|---|---|
| $50,000 | – | $20,000 | – | $20,000 | = | *$10,000* |

## PROBLEM 1-33B (cont.)

c.

### Blix Corp.
### Balance Sheet
### As of December 31, Year 2

| | | |
|---|---|---|
| Assets | | $64,500[3] |
| | | |
| Liabilities | | $18,000[4] |
| | | |
| Stockholders' Equity | | |
| Common Stock | $18,000 | |
| Retained Earnings | 28,500 | |
| Total Stockholders' Equity | | 46,500 |
| | | |
| Total Liabilities and Stockholders' Equity | | $64,500 |

[3] Based on the accounting equation total assets are equal to total liabilities ($18,000) plus stockholders' equity ($46,500).

[4] Total liabilities is calculated as follows:

Total Liabilities = $20,000 Beg. Bal. - $2,000 Partial Payoff = $18,000 ending balance.

## PROBLEM 1-33B (cont.)

d.

| Blix Corp.<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipt from Revenue | $27,500 | |
| Cash Payment for Expense | (15,000) | |
| **Net Cash Flow from Operating Activities** | | $12,500 |
| | | |
| **Cash Flows From Investing Activities** | | -0- |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $ 8,000 | |
| Cash Payment to Creditors | (2,000) | |
| Cash Dividend Paid to Stockholders | (4,000) | |
| **Net Cash Flow from Financing Activities** | | $2,000 |
| | | |
| Net Increase in Cash | | 14,500 |
| Plus: Beginning Cash Balance | | 50,000 |
| Ending Cash Balance | | $64,500 |

e. Percentage of assets provided by:

Creditors $18,000 ÷ $64,500 = 27.90%
Investors $18,000 ÷ $64,500 = 27.90%
Earnings $28,500 ÷ $64,500 = 44.18%

f. Blix Corp. has $64,500 worth of assets to distribute in the event of liquidation at the end of Year 2. During liquidation, creditors have first rights to the assets and any remaining assets are distributed to owners. Therefore, creditors would receive $18,000 and the remaining $46,500 would be distributed to owners.

## PROBLEM 1-34B

**a.**

**Daley Company**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | – | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | 52,000 | + | NA | = | NA | + | 52,000 | + | NA | NA | – | NA | = | NA | 52,000 FA |
| 2 | 20,000 | + | NA | = | 20,000 | + | NA | + | NA | NA | – | NA | = | NA | 20,000 FA |
| 3 | 42,000 | + | NA | = | NA | + | NA | + | 42,000 | 42,000 | – | NA | = | 42,000 | 42,000 OA |
| 4 | (23,000) | + | NA | = | NA | + | NA | + | (23,000) | NA | – | 23,000 | = | (23,000) | (23,000) OA |
| 5 | (6,000) | + | NA | = | NA | + | NA | + | (6,000) | NA | – | NA | = | NA | (6,000) FA |
| 6 | 10,000 | + | NA | = | NA | + | 10,000 | + | NA | NA | – | NA | = | NA | 10,000 FA |
| 7 | (10,000) | + | NA | = | (10,000) | + | NA | + | NA | NA | – | NA | = | NA | (10,000) FA |
| 8 | (45,000) | + | 45,000 | = | NA | + | NA | + | NA | NA | – | NA | = | NA | (45,000) IA |
| 9 | NA | + | NA | = | NA | + | NA | + | NA | NA | – | NA | = | NA | NA |
| Total | 40,000 | + | 45,000 | = | 10,000 | + | 62,000 | + | 13,000 | 42,000 | – | 23,000 | = | 19,000 | 40,000 NC |

## PROBLEM 1-34B (cont.)

b. Total Assets = $40,000 + $45,000 = $85,000

c.

| Sources of Assets | |
|---|---|
| Event | |
| 1. Issue of stock | $ 52,000 |
| 2. Cash from loan | 20,000 |
| 3. Cash from revenue | 42,000 |
| 6. Issue of stock | 10,000 |
| Total Sources of Assets | $124,000 |

d. Net income is $19,000 (see part a.) Dividends are not expenses so they do not appear on the income statement.

e.

| Operating Activities: | |
|---|---|
| Cash from customers | $42,000 |
| Cash paid for expenses | (23,000) |
| Net Cash Flow from Operating Activities | $19,000 |

| Investing Activities: | |
|---|---|
| Cash paid to purchase land | $(45,000) |
| Net Cash Flow from Investing Activities | $(45,000) |

| Financing Activities: | |
|---|---|
| Cash from stock issues ($52,000 + $10,000) | $62,000 |
| Cash from loan | 20,000 |
| Paid cash dividend | (6,000) |
| Cash paid on loan principal | (10,000) |
| Net Cash Flow from Financing Activities | $66,000 |

## PROBLEM 1-34B (cont.)

**f. Percentage of assets provided by:**

| | |
|---|---|
| **Creditors** | **$10,000 ÷ $85,000 = 11.77%** |
| **Investors** | **$62,000 ÷ $85,000 = 72.94%** |
| **Earnings** | **$13,000 ÷ $85,000 = 15.29%** |

**g. Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.**

## SOLUTIONS TO ANALYZE, THINK, COMMUNICATE - CHAPTER 1

### ATC 1 – 1 (All dollar amounts are in millions.)

a. $ 3,281

b. Net income increased by $344

c.

| | | | | STOCKHOLDERS’ |
|---|---|---|---|---|
| ASSETS | = | LIABILITIES | + | EQUITY |
| $42,779 | = | $30,946* | + | $11,833 |

* Liabilities must be computed by subtracting equity from assets.

d. Sales increased by 3.6% from 2018 to 2019.
($77,130– $74,433) ÷ $74,433 = 3.6%

Cost of sales increased by 2.9% from 2018 to 2019.
($54,864 – $53,299) ÷ $53,299 = 2.9%

Selling, general and administrative expenses increased by 3.2% from 2018 to 2019. ($16,233– $ 15,723) ÷ $ 15,723 = 3.2%

The largest percentage increase was for sales.

## ATC 1-2

**a.**

**Income Statements (amounts given are in millions)**

| **Income Statements** | **Year 1** | **Year 2** | **Year 3** | **Year 4** |
|---|---|---|---|---|
| Revenue | $ 860 | $1,695 | (a) $2,575 | $2,900 |
| Expenses | (b) (840) | (1,070) | (2,400) | (2,600) |
| Net Income | $ 20 | (c) $ 625 | $ 175 | (d) $ 300 |
| **Balance Sheets** | **Year 1** | **Year 2** | **Year 3** | **Year 4** |
| Cash | (e) $ 350 | $2,520 | (f) $ 820 | $ 1,860 |
| Other Assets | 1,900 | (g) 1,180 | 2,500 | (h) 2,560 |
| Total Assets | $2,250 | $3,700 | (i) $3,320 | $4,420 |
| Liabilities | (j) $ 730 | (k) $1,555 | $1,000 | (l) $1,300 |
| Stockholders' Equity | | | | |
| Common Stock | $1,500 | $ 1,500 | (m) $1,500 | $ 2,000 |
| Retained Earnings | (n) 20 | 645 | 820 | (o) 1,120 |
| Total Stockholders' Equity | 1,520 | (p) 2,145 | 2,320 | 3,120 |
| Total Liab. and Stk. Equity | $2,250 | $3,700 | $3,320 | $4,420 |

## ATC 1-3

1. **Snap's borrowing of cash should be classified as a cash inflow in the financing activities section of the statement of cash flows.**

2. **Occidental's cash purchase of Anadarko should be classified as a cash outflow in the *investing* activities section of the statement of cash flows.**

3. **Comcast's cash payments for expenses sold should be classified as a cash outflow in the operating activities section of the statement of cash flows**

4. **Newells' sale of some of its businesses should be classified as a cash inflow in the investing activities section of the statement of cash flows.**

5. **Kroger's payment of dividends should be classified as a cash outflow in the financing activities section of the statement of cash flows.**

6. **MasterCard's cash revenues should be classified as a cash inflow in the operating activities section of the statement of cash flows.**

## ATC 1-4

a. The percentage growth from Year 1 to Year 2 was 65% [($264,000 – $160,000) ÷ $160,000]. However, this rate of growth will probably not continue from Year 2 to Year 3 because 69% ($72,000 ÷ $104,000) of the growth was from the lottery win. If the company continues to grow at the current rate, shareholders should expect an increase in net income of approximately 20%. This is the increase in net income from continuing operations [($192,000 – $160,000) ÷ $160,000 = 20%].

b. One could assume that the $264,000 was used to pay off liabilities since the total liabilities were reduced by $264,000. Also, assets and common stock did not change.

c. The percentage increase in net income from continuing operations was 20% (see a. above). Therefore, owners could expect net income to be $230,400 ($192,000 x 120%) in Year 3.

d.

Symphony Harp Builders
Income Statement
For Year Ended December 31, Year 3

| | |
|---|---|
| Revenue ($960,000 x 120%) | $1,152,000 |
| Operating Expenses ($768,000 x 120%) | (921,600) |
| Infrequent item – loss from storm | (60,000) |
| Net Income | $ 170,400 |

## ATC 1-4 (cont.)

**d.**

### Symphony Harp Builders
### Balance Sheet
### As of December 31, Year 3

| | | |
|---|---|---|
| **Assets** | | **$1,331,400** |
| | | |
| **Liabilities** | | **$ -0-** |
| | | |
| **Stockholders' Equity** | | |
| **Common Stock** | **$501,000** | |
| **Retained Earnings ($660,000 + $170,400)** | **830,400** | |
| **Total Stockholders' Equity** | | **1,331,400** |
| | | |
| **Total Liabilities and Stockholders' Equity** | | **$1,331,400** |

## ATC 1-5

**This problem is designed to test written communication skills. The memo should describe the balance sheet and the income statement. It should explain that the balance sheet is a statement of assets, liabilities, and stockholders' equity at the date of the financial statement. The income statement gives the amount of revenues and expenses for the designated period. The memo should also define each of the following terms:**

**Assets**
**Liabilities**
**Stockholders' Equity**
**Revenue**
**Expense**
**Net Income**

# ATC 1-6 a.

| Financial Statements | |
|---|---|
| **Income Statement** | |
| Revenue | $57,000 |
| Expense | (40,000) |
| Net Income | $17,000 |
| | |
| **Statement of Changes in Stockholders' Equity** | |
| Beginning Common Stock | $20,000 |
| Plus: Stock Issued | 5,000 |
| Ending Common Stock | 25,000 |
| | |
| Beginning Retained Earnings | 50,000 |
| Plus: Net Income | 17,000 |
| Less: Dividends | (2,000) |
| Ending Retained Earnings | 65,000 |
| | |
| Total Stockholders' Equity | $90,000 |
| | |
| **Balance Sheet** | |
| Assets | |
| Cash | $90,000 |
| Total Assets | $90,000 |
| | |
| Stockholders' Equity | |
| Common Stock | $25,000 |
| Retained Earnings | 65,000 |
| Total Stockholders' Equity | $90,000 |
| | |
| **Statement of Cash Flows** | |
| Net Cash Flow From Operating Activities: | |
| Inflow from Customers | $57,000 |
| Outflow for Expenses | (40,000) |
| Net Cash Flow from Operating Activities | 17,000 |
| | |
| Net Cash Flow From Investing Activities | -0- |
| | |
| Net Cash Flow From Financing Activities: | |
| Inflow from Stock Issue | 5,000 |
| Outflow for Dividends | (2,000) |
| Net Cash Flow from Financing Activities | 3,000 |
| | |
| Net Change in Cash | $20,000 |
| Plus: Beginning Cash Balance | 70,000 |
| Ending Cash Balance | $90,000 |

## ATC 1-6 (cont.)

**b. In the short-run replacing Kevin would save $5,000 in cash expenses. Accordingly, net income, assets, stockholders' equity, and cash flow from operating activities would increase. These effects can be confirmed by comparing the statements above (i.e., after effect of replacement) with those shown in the textbook (i.e., before effect of replacement). However, the long-run impact may be different depending on how other employees react to Kevin's replacement. If the replacement creates resentment and low morale among the remaining employees, then productivity and profitability may decline. In this case, the company may experience a negative impact rather than the expected positive effect. The best solution to this dilemma is avoidance. Kevin's salary should never have been permitted to rise above his value to the company. As future business managers, students should take heed of the perils of excessive generosity. Employees should be paid on a basis that is consistent with their contribution to the company's profitability. The pain of corporate downsizing can be avoided if businesses do not oversize in the first place.**

## ATC 1-7

**This solution is based on McDonald's December 31, 2018 annual report. Dollar amounts are in millions.**

**a. McDonald's net income for 2018 and 2017 were as follows:**

| | |
|---|---|
| **2018:** | **$5,924.3** |
| **2017:** | **5,192.3** |

**b. The company had $32,811.2 of assets at the end of 2018.**

**c. The company had deficit in total shareholders' equity of $6,258.4 at the end of 2018. NOTE: McDonald's negative shareholders' equity was due to the large balance in its Treasury Stock account at the end of 2018.**

**d. For 2018, the company's:**

**Net cash flow from *operating* activities were $6,966.7.**
**Net cash flow from *investing* activities were ($2,455.1).**
**Net cash flow from *financing* activities were ($5,949.6).**

## SOLUTION TO COMPREHENSIVE PROBLEM - CHAPTER 1

a.

**Pacilio Security Services, Inc.**
**Accounting Equation for Year 1**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| 1. Issued stock | 6,000 | + | | = | | + | 6,000 | + | | |
| 2. Loan | 5,000 | + | | = | 5,000 | + | | + | | |
| 3. Provided Svc. | 9,000 | + | | = | | + | | + | 9,000 | Service Rev. |
| 4. Paid salaries | (3,000) | + | | = | | + | | + | (3,000) | Sal. Expense |
| 5. Pur. land | (4,000) | + | 4,000 | = | | + | | + | | |
| 6. Paid expense | (2,000) | + | | = | | + | | + | (2,000) | Other Op. Ex. |
| 7. Paid dividend | (2,500) | + | | = | | + | | + | (2,500) | Dividends |
| 8. No entry | | + | | = | | + | | + | | |
| Totals | 8,500 | + | 4,000 | = | 5,000 | + | 6,000 | + | 1,500 | |

b.

**Pacilio Security Services, Inc.**
**Income Statement**
**For the Year Ended December 31, Year 1**

| | |
|---|---|
| Service Revenue | $9,000 |
| Salaries Expense | (3,000) |
| Other Operating Expense | (2,000) |
| Net Income | $4,000 |

## COMPREHENSIVE PROBLEM b. (cont.)

### Pacilio Security Services, Inc.
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 1

| | | |
|---|---|---|
| Beginning Common Stock | $ | |
| Plus: Common Stock Issued | 6,000 | |
| Ending Common Stock | | $6,000 |
| | | |
| Beginning Retained Earnings | -0- | |
| Plus: Net Income | $ 4,000 | |
| Less: Dividends | (2,500) | |
| Ending Retained Earnings | | 1,500 |
| | | |
| Total Stockholders' Equity | | $7,500 |

### Pacilio Security Services, Inc.
### Balance Sheet
### As of December 31, Year 1

| | | |
|---|---|---|
| Assets | | |
| Cash | $8,500 | |
| Land | 4,000 | |
| Total Assets | | $12,500 |
| | | |
| Liabilities | | |
| Notes Payable | $5,000 | |
| Total Liabilities | | $ 5,000 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $6,000 | |
| Retained Earnings | 1,500 | |
| Total Stockholders' Equity | | 7,500 |
| | | |
| Total Liabilities and Stockholders' Equity | | $12,500 |

## COMPREHENSIVE PROBLEM b. (cont.)

### Pacilio Security Services, Inc.
### Statement of Cash Flows
### For the Year Ended December 31, Year 1

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $9,000 | |
| Cash Payment for Salaries Expense | (3,000) | |
| Cash Payments for Other Operating Exp. | (2,000) | |
| **Net Cash Flow from Operating Activities** | | $4,000 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(4,000) | |
| **Net Cash Flow from Investing Activities** | | (4,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $6,000 | |
| Cash Receipts from Loan | 5,000 | |
| Cash Payments for Dividends | (2,500) | |
| **Net Cash Flow from Financing Activities** | | 8,500 |
| | | |
| **Net Increase in Cash** | | 8,500 |
| **Plus: Beginning Cash Balance** | | -0- |
| **Ending Cash Balance** | | $8,500 |

# Chapter 1
# An Introduction to Accounting

## General Comments for Chapter 1

The primary objective of the text is to teach students to understand how business events affect financial statements. The first step is for students to learn the elements of financial statements. Chapter 1 introduces the following elements: assets, liabilities, stockholders' equity, common stock, retained earnings, revenue, expenses, and distributions. Next, students must learn how the elements are interrelated, and finally, how those interrelationships are expressed in financial statements.

Chapter 1 establishes the foundation upon which the rest of the course sits. The range of content is more extensive than that covered in most introductory books. As a result, we have divided the chapter into two sections. To assure adequate exposure, we suggest treating each section as a separate chapter. ***Do not rush through this material***. It is more important to establish a strong foundation than it is to cover every topic in the text. I once had an intermediate accounting student who said. "I see what we are doing. In introductory we built the building. In intermediate we are moving in the furniture." I have never heard a better analogy.

# Problem-Base Learning

***Spoiler Alert!*** Have you ever been waiting to watch the season finale of a TV series only to have a friend tell you how it ends before you have a chance to watch it? Have you ever recorded a sports event so you could watch it later and then heard the final score before you start your show? Knowing the end result before the show begins makes for a boring experience. Even so, introductory accounting instructors almost always tell their students how to solve a problem before they give the students time to think about the problem.

It doesn't have to be this way. Instead, you can engage your students by using a teaching strategy called ***problem-based learning (PBL)***. PBL begins with the presentation of a problem with no mention of a solution. Learning occurs as students use reasoning and critical thinking skills to understand and/or solve the problem. Knowledge development is often facilitated by having students work in groups.

This manual provides a PBL case for each chapter of the text. The case should be used before any discussion or reading assignment of the underlying topic has occurred. Indeed, prior exposure to the subject can diminish the learning experience. Another name for PBL is ***discovery learning*** which is descriptive of the process. Students learn through discovery rather than memorization. If you do not want your students to memorize, provide opportunities for discovery. The first case along with instructions are presented in the following section of this manual.

# Problem-Based Learning Case:
# The Role of Accounting in Society

## Instructions:

The case appears on page 1-4 of this manual. We recommend that you read the case before you continue with the instructions.

**Distribute copies** of the case to the class before providing any explanation of accounting. Ask students to read the case and individually develop questions as directed in the case.

**Create a collaborative experience where students share their questions.** After allowing students time to develop their individual responses, put them into groups to compare the questions they have developed individually. Form groups of three or four students with an assignment of reaching consensus on three questions to ask the accountant. Allow groups time to develop answers. Also have each group select a spokesperson.

**Open a discussion regarding the purpose of accounting by having group spokespersons report on the questions developed by their group.** Guide the discussion to provide a conclusion that accountants communicate and analyze financial information. Discuss the difference in financial, managerial, and tax accounting. Discuss the purpose of financial accounting. This is a good time to say a few words about the different types of accounting information. Explain how outsiders (e.g., investors and creditors) need different kinds of information than insiders (e.g., managers). For example, a person deciding whether to invest in Kmart versus Wal-Mart is interested in knowing which company generated more earnings or profits. In contrast, a Wal-Mart vice-president needs information about specific stores and specific items within each store. Different branches of accounting have been established to satisfy the informational needs of different users. Emphasize that financial accounting focuses on the information needs of investors and creditors. Make the discussion light and breezy. Students quickly get bored with this kind of general discussion.

Instructors need to be flexible and creative in handling the student input. Problem-based learning is designed to provide an opportunity for student discovery. The exercise is designed to stimulate student interest and critical thinking. Expect a variety of questions. Also, be prepared to raise questions if the students do not ask about some of the things you want to discuss. The instructor should be prepared to address predetermined learning objectives. The primary learning objective, however, is for students to leave class able to describe the role accountants play in society. Specific topics include identifying the stakeholders of accounting information; distinguishing between financial and managerial accounting; distinguishing between various careers in accounting; and identifying the different professional designations. The instructor should guide the discussion toward the accomplishment of these objectives.

# Chapter 1 Problem-Based Learning Case:

# Ask Me Anything

*Assume that you are considering going into business with Linda Wilson. Assume that I am Linda's accountant and that you can ask me three questions. Write down the three questions that you would ask.*

# Detailed Lesson Plan for Chapter 1 – Section 1

I. **Introduce the entity concept.** Explain that in a business transaction there are multiple entities involved and that as an accountant you must take the perspective of the business entity. It is important that students understand that the owner and the business are separate entities. From the very beginning they need to learn to account for transactions from the perspective of the business. Exercise 1-3A&B provide good examples to get this point across.

***Note that there are two sets of exercises and problems (Set A and Set B) at the end of each chapter. As a general rule, we use Set B exercises and problems in the classroom and reserve the Set A equivalent exercises and problems as homework. We reserve Set A exercises and problems for homework because they are included in McGraw-Hill's*** Connect***, electronic homework management system.***

II. **Define assets**. Use the simplest definition possible. It is extremely important to use words that students can understand. They will read the technical terminology in the text. For example:

***Assets are things of value to a business. The value is the capacity of the asset to be used in the production of greater quantities of other assets.***

Use the classroom to provide specific examples. For example, the chairs, desks, and building the students are using are assets of the university because they are used to produce tuition dollars (other assets). Emphasize the point further by distinguishing between personal assets and business assets. Tom uses an old key chain his brother gave him over twenty years ago. While it has great value to Tom, it would have little value to a business because it could not be sold or otherwise used to produce other assets. You may not have an old key chain, but we're sure you can think of something meaningful to you that has little usefulness as a business asset. It is important that you personalize your comments. We highly encourage you to adapt our examples to reflect your personality. Students respond favorably to personalized examples. Often students have often heard the statement that 'people are our most valuable assets'. This is a great time to distinguish between the accounting concept of an asset and the intangible value of key employees.

III. **Introduce the accounting equation.** You can make a smooth transition from defining assets to introducing the accounting equation by noting that ***assets*** belong to some person or organization. The individual or institutional interests in the assets are called ***claims***. The ***accounting equation*** expresses the relationship between assets and claims as follows:

***Assets = Claims***

IV. **Distribute copies of Demonstration Problem 1-1 and work papers (optional)**. Distributing the work paper allows students to reduce note taking and thereby focus their attention on your explanations.

V. **Use the demonstration problem to introduce new terms and to elaborate on the interrelationships represented by the accounting equation.** Individuals or institutions acquire claims by providing assets to a business. ***There are three primary sources of assets***. The first three events of the demonstration problem illustrate the three sources. Discuss each event separately. Define the appropriate terms and explain how the event affects the accounting equation.

A. **Event No. 1:** Use Event No. 1 to introduce and define ***common stock***. Explain that when a business acquires assets from the owners, the assets of the business increase and the business establishes a corresponding ***claims account*** called ***common stock***. Introduce the accounting equation and the term ***stockholders' equity***. Show students how to record the event under the accounting equation. Record common stock under the term stockholders' equity. Leave room for retained earnings which will be illustrated in Event No. 3. Note that stockholders' equity represents ownership interest in the business. As you lead in to Event No. 2, tell the students that creditors also have claims on the assets of a business.

B. **Event No. 2:** Use this event to introduce ***liabilities***. Define liabilities as ***obligations of a business***. Note that Video Services Company (VSC) is obligated to return $5,000 of assets to creditors. Therefore, the creditors have a $5,000 claim on assets. Expand the accounting equation to include creditor claims.

C. **Event No. 3:** This event introduces the concept of ***revenue***. Define revenue as an ***increase in assets*** resulting from operating activities.[1] This definition defines revenue in terms of its relationship with assets. It is extremely important that students understand how the elements of financial statements articulate. You can achieve this goal by defining various elements in terms of their relationship to other elements. Expand the accounting equation to include retained earnings and record Event No. 3 under the equation.

Emphasize that the first three events represent the three sources of assets. Identify these events as ***asset source transactions***. Make an issue of the fact that thousands of different transactions can be classified into one of these three types of transactions. For example, businesses may increase their assets by providing consulting services, cleaning services, music lessons, investment advice, legal services, med-

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[1] You may be thinking that revenues can also result from activities that decrease liabilities. While this is true, revenue recognition within this context requires an understanding of deferrals. Deferrals are introduced in Chapter 2. Within the context of cash basis accounting, which is the underlying assumption for Chapter 1, revenue can be defined simply as an increase in assets and expenses as decreases in assets. These definitions will be expanded as accrual accounting topics are gradually introduced.

ical assistance, mechanical work, painting, and so on. Although these services represent distinctly different transactions, they can all be classified as asset source transactions. Emphasize that *it is easier to understand the three types of transactions* than *to memorize* the infinite number of specific transactions in which businesses engage. The next two events represent ***asset use transactions***.

D. **Event No. 4:** This event introduces the concept of ***expenses***. Define expenses as ***decreases in assets*** that occur in the process of attempting to earn revenue. This is the best place to introduce the term net income. Point out that (revenue – expenses) is the amount of ***net income*** or profit the company earned during the year. Explain that net income is an increase in wealth. In this case, the net income represents a net increase in assets resulting from operating the business during Year 1.

E. **Event No. 5:** This event introduces ***dividends***. Clearly distinguish dividends from expenses. While both are asset use transactions, dividends represent ***a transfer of wealth*** rather than a sacrifice made to obtain revenue.

VI. **Have students record the events for the second accounting cycle in an accounting equation.** Explain that the Year 1 ending balances become the Year 2 beginning balances. Illustrate the Year 2 accounting equation with beginning balances before the students attempt to record the Year 2 events. Circulate through the room while your students attempt to record the Year 2 events. Help those who are having trouble getting started. Event No. 2 represents debt repayment. While some students will immediately recognize this event as the reverse of a borrowing event, many will view it as an independent transaction that is totally foreign to them. If you notice that many students are having trouble with the event, interrupt the students to provide a brief explanation to the class.

Invariably, you will find that some students work faster than others. Instruct the faster students to record the Year 3 events while you continue to help those who are having trouble with Year 2. Stop the class after most students have recorded the Year 2 transactions. Assign the Year 3 events as homework for those students who are unable to finish them in class.

VII. **Time considerations.** Introducing the accounting equation, including student participation with Year 2 data, requires approximately one hour.

VIII. **Homework assignment.** Exercises 1-6A&B contain transactions that are consistent with the demonstration problem.

IX. **Interpreting Information shown in an accounting equation.** Beyond knowing how to record transactions in an accounting equation, you should spend class time assuring that students are able to interpret the information shown in the equation. Specific points of interest include:

**A.** Distinguish between the right and left side of the accounting equation. Specifically, note that **asset exchanges** affect only the left side of the equation. For example, paying cash to purchase land affects only assets. Indeed, this is a great time to highlight the fact that there is no cash on the right side of the accounting equation. Students often get the idea that there is a pot of cash in the retained earnings account. Dispel this notion quickly. Make clear that the right side of the accounting equation represents sources of or claims on assets. It is helpful to show students that the right side of the equation can be expressed as percentages as well as dollar amounts.

**B.** Explain that dividend payments are limited not only by the amount of retained earnings but also by the amount of cash. Again, this reinforces the fact that there is no cash in retained earnings.

**C.** Show how assets are distributed in business liquidations. Explain that owners accept greater risk than creditors because creditors are first in line to receive assets in a business liquidation.

Exercises 1-9A&B and 1-10A&B are designed to teach students to interpret the information contained in an accounting equation. We highly recommend that you cover these exercises before proceeding with Section 2 of Chapter 1.

# Detailed Lesson Plan for Chapter 1 – Section 2

X. **Introduce financial statements.** Return to Demonstration Problem 1-1 and show students how the information recorded in the accounting equation is summarized in financial statements. Emphasize that financial statements are designed to provide information useful in decision-making. This is a good time to say a few words about the different types of accounting information. Explain how outsiders (e.g., investors and creditors) need different kinds of information than insiders (e.g., managers). For example, a person deciding whether to invest in Kmart versus Walmart is interested in knowing which company generated more earnings. In contrast, a Walmart vice-president needs information about specific stores and specific items in each store. Different branches of accounting have been established to satisfy the information needs of different users. Emphasize that financial accounting focuses on the information needs of investors and creditors. Make the discussion light and breezy. Students quickly get bored with this kind of general discussion.

Present the statements in this order: (1) income statement, (2) statement of changes in stockholders' equity, (3) balance sheet, and (4) statement of cash flows. As you explain, point out the importance of this sequence. You need the amount of net income to prepare the statement of changes in stockholders' equity. You need the amount of stockholders' equity to prepare the balance sheet. Comments relevant to each statement follow:

A. **Income statement.** Emphasize how the elements of the income statement are related to the elements of the balance sheet. Reiterate that revenue is an increase in assets that results for operating the business. In this case, assets (cash) increased when the business provides services to customers. Expenses are decreases in assets that are incurred in the process of producing revenue. In this case, assets (cash) decreased when the business pays for operating expenses (i.e., paid employees, paid utility bills, etc.). Teach students more than the formula for computing net income (Revenue – Expenses = Net Income). Help them understand that net income represents the change in wealth (net assets) resulting from business operations during the accounting period. Sharing in this increase in wealth (net income) is the driving force that motivates investment in the business. If you want your students to understand interrelationships, you must emphasize those relationships in your classroom discussions and your examinations. Note: The definitions of revenue and expense will be expanded as new topics are introduced. Since Chapter 1 includes only cash transactions, revenues are always increases in assets (cash) and expenses are always decreases in assets (cash). Once accruals and deferrals are introduced the definition of revenue expands to increases in assets or decreases in liabilities. The definition of expenses expands to decreases in assets or increases in liabilities.

B. **Statement of changes in stockholders' equity.** This statement provides the opportunity to reemphasize the difference between expenses and dividends. Expenses affect the measurement of net income, after which a decision is made regarding how much of the income to distribute versus how much to retain in the business. Emphasize that net income is a periodic measurement, while retained earnings is a cumulative amount.

C. **Balance sheet.** Explain that the balance sheet is little more than a summary of the accounting equation. The statement lists assets and the corresponding claims on those assets. In this chapter, too few assets are illustrated to introduce the idea of presenting assets in accordance with liquidity. This subject is introduced later in the text. Explain that the statement represents a company's financial condition at a specific point in time.

D. **Statement of cash flows.** Introduce the categories of the statement of cash flows in a sequence consistent with forming a business. First, a business must obtain ***financing***. Once a business has cash, it ***invests*** the cash. Finally, the business uses and generates cash through its ***operating activities***. Use the direct method. Prepare the statement by analyzing the cash account. Students must merely learn to identify cash transactions as operating, investing, or financing. Many students find this task to be a real challenge. Do not be discouraged if your students have difficulty at first. While mastery requires a significant level of reinforcement, be assured that your students will grasp this critically important topic after working through several of the multicycle problems. Since the first chapter covers only cash transactions, the amount of cash flow from operating activities will equal the amount of net income. Therefore, we do not contrast these two amounts until Chapter 2. Instead, we emphasize that the statement of cash flows is more inclusive than the income statement. We point out that it reports investing and financing activities as well as operating activities.

**XI. Introduce the horizontal financial statements model.** While the horizontal financial statements model is introduced in Chapter 1, some instructors choose to introduce it in Chapter 2 after students have had the opportunity to gain a stronger grasp of the financial statements. Should you decide to delay coverage you can return to this section at whatever point you choose to cover the topic.

Use Requirement d of Demonstration Problem 1-1 to introduce the horizontal financial statements model. Engage your class by telling your students that the primary objective of the model is to teach them to think like business professionals. Business professionals tend to think about bottom-line consequences: If I do this or that, how will it affect my company's net income, total assets, cash flow, and so on. This type of thinking occurs whether you work in accounting, management, marketing, finance, insurance, real estate, or virtually any other area of business. Accordingly, learning to mimic this thinking approach benefits all business students regardless of whether they are accounting majors.

XII. **Fill in the gaps.** You will find additional terms and concepts covered in the text but not in the teaching notes. Although we do not expect our students to read the text prior to coming to class, we do expect them to read it after we have introduced the material. In other words, we expect our students to read behind us. They are responsible for filling in the gaps. There is not enough time to cover every single point in class. Class is a place to get started. Try to cover the more important and conceptually complex points in class. Hold your students responsible for a reasonable level of homework. Remind them accounting is a "learn by doing" subject. Regardless of how skillfully you explain the material, students need to work problems in order to fully grasp the concepts.

XIII. **Enrichment.** Appendix B contains excerpts from the Target 10-K report. It helps students to see a 'real world' example of what is being covered in class. While they are not yet ready to fully analyze financial statements as complex as those presented in this Appendix, you can point out the fact that the 4 financial statements are included in the report and discuss how they relate to the examples that have been covered in class.

# Demonstration Problem for Chapter 1

## Demonstration Problem 1-1 – The Accounting Cycle

The events below apply to Computer Services Company (CSC). Assume that all transactions involve receiving or paying cash.

Transactions for Year 1:
1. CSC was started when it acquired $9,000 cash by issuing common stock.
2. The company borrowed $5,000 from a bank.
3. The company provided services to customers and received $4,000.
4. The company paid operating expenses of $2,900.
5. The company paid $500 in dividends to its stockholders.

Transactions for the Year 2:
1. The company issued additional common stock for $4,500.
2. The company paid $2,000 to reduce its liabilities.
3. The company provided services to customers and received $6,700.
4. The company paid operating expenses of $4,300.
5. The company paid $700 in dividends to its stockholders.

Transactions for the Year 3:
1. The company issued additional common stock for $2,500.
2. The company borrowed an additional $1,000 from creditors.
3. The company provided services to customers and received $7,400.
4. The company paid operating expenses of $7,900.
5. The company paid $300 in dividends to its stockholders.
6. The company paid $9,000 to purchase land.
7. At the end of the accounting period the market value of the land was estimated to be $9,500.

**Required**

a. Record the events in an accounting equation.
b. Prepare an income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows for each year.
c. Given that the company experienced an operating loss in Year 3, explain how the company was able to pay dividends.
d. Record the events in a horizontal financial statements model.

# Solution for Chapter 1 Demonstration Problem

## Demonstration Problem 1-1: Requirement a

| Year 1 | Assets | | | = | Liab. | + | Stk. Equity | | | Acct. Title |
|---|---|---|---|---|---|---|---|---|---|---|
| *No.* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Earn.* | |
| Beg. Bal. | 0 | + | 0 | = | 0 | + | 0 | + | 0 | |
| 1 | 9,000 | + | NA | = | NA | + | 9,000 | + | NA | |
| 2 | 5,000 | + | NA | = | 5,000 | + | NA | + | NA | |
| 3 | 4,000 | + | NA | = | NA | + | NA | + | 4,000 | Revenue |
| 4 | (2,900) | + | NA | = | NA | + | NA | + | (2,900) | Expense |
| 5 | (500) | + | NA | = | NA | + | NA | + | (500) | Dividend |
| End Bal. | 14,600 | + | NA | = | 5,000 | + | 9,000 | + | 600 | |
| Year 2 | Assets | | | = | Liab. | + | Stk. Equity | | | |
| *No.* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Ear.* | |
| Beg. Bal. | 14,600 | + | NA | = | 5,000 | + | 9,000 | + | 600 | |
| 1 | 4,500 | + | NA | = | NA | + | 4,500 | + | NA | |
| 2 | (2,000) | + | NA | = | (2,000) | + | NA | + | NA | |
| 3 | 6,700 | + | NA | = | NA | + | NA | + | 6,700 | Revenue |
| 4 | (4,300) | + | NA | = | NA | + | NA | + | (4,300) | Expense |
| 5 | (700) | + | NA | = | NA | + | NA | + | (700) | Dividend |
| End Bal. | 18,800 | + | | = | 3,000 | + | 13,500 | + | 2,300 | |
| Year 3 | Assets | | | = | Liab. | + | Stk. Equity | | | |
| *No.* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Ear.* | |
| Beg. Bal. | 18,800 | + | NA | = | 3,000 | + | 13,500 | + | 2,300 | |
| 1 | 2,500 | + | NA | = | NA | + | 2,500 | + | NA | |
| 2 | 1,000 | + | NA | = | 1,000 | + | NA | + | NA | |
| 3 | 7,400 | + | NA | + | NA | + | NA | + | 7,400 | Revenue |
| 4 | (7,900) | + | NA | + | NA | + | NA | + | (7,900) | Expense |
| 5 | (300) | + | NA | + | NA | + | NA | + | (300) | Dividend |
| 6 | (9,000) | + | 9,000 | + | NA | + | NA | + | NA | |
| 7* | NA | + | NA | + | NA | + | NA | + | NA | |
| End Bal. | 12,500 | + | 9,000 | + | 4,000 | + | 16,000 | + | 1,500 | |

**Assets are maintained at their cost. As per the historical cost concept, increases and decreases in market value are not recognized. Exceptions to this general rule will be covered in later chapters.*

# Demonstration Problem 6-1: Requirement b

**Computer Services Company**
**Income Statements**

| For the Years Ended December 31, | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Services revenue | $4,000 | $6,700 | $7,400 |
| Operating expenses | (2,900) | (4,300) | (7,900) |
| Net income (loss) | $1,100 | $2,400 | $( 500) |
| **Statements of Changes in Stockholders' Equity** | | | |
| Beginning common stock | $ 0 | $ 9,000 | $13,500 |
| Plus: Common stock issued | 9,000 | 4,500 | 2,500 |
| Ending common stock | 9,000 | 13,500 | 16,000 |
| Beginning retained earnings | 0 | 600 | 2,300 |
| Plus: Net income (loss) | 1,100 | 2,400 | (500) |
| Less: Dividends | (500) | (700) | (300) |
| Ending retained earnings | 600 | 2,300 | 1,500 |
| Total stockholders' equity | $9,600 | $15,800 | $17,500 |
| **Balance Sheets at December 31** | | | |
| Assets | | | |
| Cash | $14,600 | $18,800 | $12,500 |
| Land | 0 | 0 | 9,000 |
| Total assets | $14,600 | $18,800 | $21,500 |
| Liabilities | $ 5,000 | $ 3,000 | $ 4,000 |
| Stockholders' equity | | | |
| Common stock | 9,000 | 13,500 | 16,000 |
| Retained earnings | 600 | 2,300 | 1,500 |
| Total stockholders' equity | 9,600 | 15,800 | 17,500 |
| Total liabilities and stockholders' equity | $14,600 | $18,800 | $21,500 |
| **Statements of Cash Flows** | | | |
| Cash flows from operating activities | | | |
| Cash inflows from revenue | $ 4,000 | $ 6,700 | $ 7,400 |
| Cash outflows for operating expenses | (2,900) | (4,300) | (7,900) |
| Net cash flow from operating activities | 1,100 | 2,400 | (500) |
| Cash flow from investing activities | | | |
| Cash outflow for land | | | (9,000) |
| Cash flows from financing activities | | | |
| Cash inflows from borrowing | 5,000 | | 1,000 |
| Cash outflows to reduce debt | | (2,000) | |
| Cash inflows from stock issues | 9,000 | 4,500 | 2,500 |
| Cash outflows for dividends | (500) | (700) | (300) |
| Net cash flows from financing activities | 13,500 | 1,800 | 3,200 |
| Net change in cash | 14,600 | 4,200 | (6,300) |
| Beginning cash balance | 0 | 14,600 | 18,800 |
| Ending cash balance | $14,600 | $18,800 | $12,500 |

## Demonstration Problem 1-1: Requirement c

Even though the company experienced a $500 ($7,900 revenue - $7,4000 expenses) operating loss in Year 3, the retained earnings account had a beginning balance of $2,300. As a result, the balance in the retained earnings account was $1,800 ($2,300 beginning balance - $500 loss) at the time the dividend was paid. This balance is significantly more than necessary to cover the $300 dividend. Further, the company had plenty of cash available for the dividend payment. So long as a company has sufficient retained earnings and cash, it can pay dividends. The fact that the earnings and cash were generated in previous accounting periods does not matter.

## Demonstration Problem 1-1: Requirement d

| **Year 1** | **Assets** | | | **=** | **Liab.** | **+** | **Stk. Equity** | | | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** | **Cash Flow** | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Events*** | ***Cash*** | **+** | ***Land*** | **=** | ***Liab.*** | **+** | ***C. Stk.*** | **+** | ***Ret. Earn.*** | | | | | | | |
| **Beg. Bal.** | NA | + | NA | = | NA | + | NA | + | NA | NA | – | NA | = | NA | NA | |
| 1 | 9,000 | + | NA | = | NA | + | 9,000 | + | NA | NA | – | NA | = | NA | 9,000 | FA |
| 2 | 5,000 | + | NA | = | 5,000 | + | NA | + | NA | NA | – | NA | = | NA | 5,000 | FA |
| 3 | 4,000 | + | NA | = | NA | + | NA | + | 4,000 | 4,000 | – | NA | = | 4,000 | 4,000 | OA |
| 4 | (2,900) | + | NA | = | NA | + | NA | + | (2,900) | NA | – | 2,900 | = | (2,900) | (2,900) | OA |
| 5 | (500) | + | NA | = | NA | + | NA | + | (500) | NA | – | NA | = | NA | (500) | FA |
| **End Bal.** | 14,600 | + | NA | = | 5,000 | + | 9,000 | + | 600 | 4,000 | – | 2,900 | = | 1,100 | 14,600 | NC |
| **Year 2** | **Assets** | | | **=** | **Liab.** | **+** | **Stk. Equity** | | | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** | **Cash Flow** | |
| ***Events*** | ***Cash*** | **+** | ***Land*** | **=** | ***Liab.*** | **+** | ***C. Stk.*** | **+** | ***Ret. Ear.*** | | | | | | | |
| **Beg. Bal.** | 14,600 | + | NA | = | 5,000 | + | 9,000 | + | 600 | NA | – | NA | = | NA | NA | |
| 1 | 4,500 | + | NA | = | NA | + | 4,500 | + | NA | NA | – | NA | = | NA | 4,500 | FA |
| 2 | (2,000) | + | NA | = | (2,000) | + | NA | + | NA | NA | – | NA | = | NA | (2,000) | FA |
| 3 | 6,700 | + | NA | = | NA | + | NA | + | 6,700 | 6,700 | – | NA | = | 6,700 | 6,700 | OA |
| 4 | (4,300) | + | NA | = | NA | + | NA | + | (4,300) | NA | – | 4,300 | = | (4,300) | (4,300) | OA |
| 5 | (700) | + | NA | = | NA | + | NA | + | (700) | NA | – | NA | = | NA | (700) | FA |
| **End Bal.** | 18,800 | + | NA | = | 3,000 | + | 13,500 | + | 2,300 | 6,700 | – | 4,300 | = | 2,400 | 4,200 | NC |
| **Year 3** | **Assets** | | | **=** | **Liab.** | **+** | **Stk. Equity** | | | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** | **Cash Flow** | |
| ***Events*** | ***Cash*** | **+** | ***Land*** | **=** | ***Liab.*** | **+** | ***C. Stk.*** | **+** | ***Ret. Ear.*** | | | | | | | |
| **Beg. Bal.** | 18,800 | + | NA | = | 3,000 | + | 13,500 | + | 2,300 | NA | – | NA | = | NA | NA | |
| 1 | 2,500 | + | NA | = | NA | + | 2,500 | + | NA | NA | – | NA | = | NA | 2,500 | FA |
| 2 | 1,000 | + | NA | = | 1,000 | + | NA | + | NA | NA | – | NA | = | NA | 1,000 | FA |
| 3 | 7,400 | + | NA | + | NA | + | NA | + | 7,400 | 7,400 | – | NA | = | 7,400 | 7,400 | OA |
| 4 | (7,900) | + | NA | + | NA | + | NA | + | (7,900) | NA | – | 7,900 | = | (7,900) | (7,900) | OA |
| 5 | (300) | + | NA | + | NA | + | NA | + | (300) | NA | – | NA | = | NA | (300) | FA |
| 6 | (9,000) | + | 9,000 | + | NA | + | NA | + | NA | NA | – | NA | = | NA | (9,000) | IA |
| 7 | NA | + | NA | + | NA | + | NA | + | NA | NA | – | NA | = | NA | (9,000) | IA |
| **End Bal.** | 12,500 | + | 9,000 | + | 4,000 | + | 16,000 | + | 1,500 | 7,400 | – | 7,900 | = | (500) | NA | |

# Workpapers for Chapter 1 Demonstration Problem

## Demonstration Problem 1-1: Requirement a

| Year 1 | Assets | | | = | Liab. | + | Stk. Equity | | | Acct. Title |
|---|---|---|---|---|---|---|---|---|---|---|
| *No.* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Earn.* | |
| Beg. Bal. | 0 | + | 0 | = | 0 | + | 0 | + | 0 | |
| 1 | 9,000 | + | NA | = | NA | + | 9,000 | + | NA | |
| 2 | | | | | | | | | | |
| 3 | | | | | | | | | | |
| 4 | | | | | | | | | | |
| 5 | | | | | | | | | | |
| End Bal. | 14,600 | + | NA | = | 5,000 | + | 9,000 | + | 600 | |
| Year 2 | Assets | | | = | Liab. | + | Stk. Equity | | | |
| *No.* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Ear.* | |
| Beg. Bal. | | | | | | | | | | |
| 1 | | | | | | | | | | |
| 2 | | | | | | | | | | |
| 3 | | | | | | | | | | |
| 4 | | | | | | | | | | |
| 5 | | | | | | | | | | |
| End Bal. | 18,800 | + | | = | 3,000 | + | 13,500 | + | 2,300 | |
| Year 3 | Assets | | | = | Liab. | + | Stk. Equity | | | |
| *No.* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Ear.* | |
| Beg. Bal. | | | | | | | | | | |
| 1 | | | | | | | | | | |
| 2 | | | | | | | | | | |
| 3 | | | | | | | | | | |
| 4 | | | | | | | | | | |
| 5 | | | | | | | | | | |
| 6 | | | | | | | | | | |
| 7* | | | | | | | | | | |
| End Bal. | 12,500 | + | 9,000 | + | 4,000 | + | 16,000 | + | 1,500 | |

**Assets are maintained at their cost. As per the historical cost concepts increases and decreases in market value are not recognized. Exceptions to this general rule will be covered in later chapters.*

# Demonstration Problem 6-1: Requirement b

**Computer Services Company**

**Income Statements**

| For the Years Ended December 31, | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Services revenue | | | |
| Operating expenses | | | |
| Net income (loss) | $1,100 | $2,400 | $( 500) |
| | | | |
| **Statements of Changes in Stockholders' Equity** | | | |
| Beginning common stock | $ 0 | $ 9,000 | $13,500 |
| Plus: Common stock issued | | | |
| Ending common stock | | | |
| Beginning retained earnings | | | |
| Plus: Net income (loss) | | | |
| Less: Dividends | | | |
| Ending retained earnings | | | |
| Total stockholders' equity | $9,600 | $15,800 | $17,500 |
| | | | |
| **Balance Sheets at December 31** | | | |
| Assets | | | |
| Cash | | | |
| Land | | | |
| Total assets | $14,600 | $18,800 | $21,500 |
| | | | |
| Liabilities | | | |
| | | | |
| Stockholders' equity | | | |
| Common stock | | | |
| Retained earnings | | | |
| Total stockholders' equity | | | |
| Total liabilities and stockholders' equity | $14,600 | $18,800 | $21,500 |
| **Statements of Cash Flows** | | | |
| Cash flows from operating activities | | | |
| Cash inflows from revenue | | | |
| Cash outflows for operating expenses | | | |
| Net cash flow from operating activities | 1,100 | 2,400 | (500) |
| | | | |
| Cash flow from investing activities | | | |
| Cash outflow for land | | | |
| | | | |
| Cash flows from financing activities | | | |
| Cash inflows from borrowing | | | |
| Cash outflows to reduce debt | | | |
| Cash inflows from stock issues | | | |
| Cash outflows for dividends | | | |
| Net cash flows from financing activities | 13,500 | 1,800 | 3,200 |
| | | | |
| Net change in cash | | | |
| Beginning cash balance | | | |
| Ending cash balance | $14,600 | $18,800 | $12,500 |

## Demonstration Problem 1-1:  Requirement c

## Demonstration Problem 1-1: Requirement d

| Year 1 | Assets | | | = | Liab. | + | Stk. Equity | | | Rev. | − | Exp. | = | Net Inc. | Cash Flow | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Events* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Earn.* | | | | | | | |
| Beg. bal. | NA | + | NA | = | NA | + | NA | + | NA | NA | – | NA | = | NA | NA | |
| 1 | 9,000 | + | NA | = | NA | + | 9,000 | + | NA | NA | – | NA | = | NA | 9,000 | FA |
| 2 | | | | | | | | | | | | | | | | |
| 3 | | | | | | | | | | | | | | | | |
| 4 | | | | | | | | | | | | | | | | |
| 5 | | | | | | | | | | | | | | | | |
| Totals | 14,600 | + | NA | = | 5,000 | + | 9,000 | + | 600 | 4,000 | – | 2,900 | = | 1,100 | 14,600 | NC |
| Year 2 | Assets | | | = | Liab. | + | Stk. Equity | | | Rev. | − | Exp. | = | Net Inc. | Cash Flow | |
| *Events* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Ear.* | | | | | | | |
| Beg. Bal. | | | | | | | | | | | | | | | | |
| 1 | | | | | | | | | | | | | | | | |
| 2 | | | | | | | | | | | | | | | | |
| 3 | | | | | | | | | | | | | | | | |
| 4 | | | | | | | | | | | | | | | | |
| 5 | | | | | | | | | | | | | | | | |
| End Bal. | 18,800 | + | NA | = | 3,000 | + | 13,500 | + | 2,300 | 6,700 | – | 4,300 | = | 2,400 | 4,200 | NC |
| Year 3 | Assets | | | = | Liab. | + | Stk. Equity | | | Rev. | − | Exp. | = | Net Inc. | Cash Flow | |
| *Events* | *Cash* | + | *Land* | = | *Liab.* | + | *C. Stk.* | + | *Ret. Ear.* | | | | | | | |
| Beg. Bal. | | | | | | | | | | | | | | | | |
| 1 | | | | | | | | | | | | | | | | |
| 2 | | | | | | | | | | | | | | | | |
| 3 | | | | | | | | | | | | | | | | |
| 4 | | | | | | | | | | | | | | | | |
| 5 | | | | | | | | | | | | | | | | |
| 6 | | | | | | | | | | | | | | | | |
| 7 | | | | | | | | | | | | | | | | |
| End Bal. | 12,500 | + | 9,000 | + | 4,000 | + | 16,000 | + | 1,500 | 7,400 | – | 7,900 | = | (500) | (6,300) | NC |

## Quiz Questions for Chapter 1

**The following information pertains to the next three questions**. At the beginning of the current year, X Company had assets of $600, liabilities of $300, and common stock of $100. During the current year, the company earned revenue of $750, incurred expenses of $500, and paid dividends of $100. All transactions were cash transactions.

1. The amount of net income reported on the income statement for the current year would be
   a. $250.
   b. $300.
   c. $150.
   d. none of the above.

2. The amount of retained earnings reported on the December 31 balance sheet for the current year would be
   a. $150.
   b. $250.
   c. $200.
   d. none of the above.

3. The amount of total assets reported on the December 31 balance sheet for the current year would be
   a. $750.
   b. $600.
   c. $850.
   d. $100.

4. P Company borrowed $400 cash from Citizens Bank. As a result of this transaction, P Company's
   a. assets would decrease by $400.
   b. liabilities would increase by $400.
   c. stockholders' equity would increase by $400.
   d. expenses would increase by $400.

**The following information pertains to the next two questions.** ABC Company borrowed $600 from Sun Bank and used $500 of this money to purchase land.

5. XYZ's total assets would increase by
   a. $1,100.
   b. $ 500.
   c. $ 600.
   d. $ 100.

6. The statement of cash flows for ABC Company would report
   a. an inflow of $600 from operating activities.
   b. an outflow of $500 for investing activities.
   c. an inflow of $500 from financing activities.
   d. an outflow of $500 for operating activities.

7. Select the correct statement from the choices listed below.
   a. Revenue is a decrease in assets resulting from operating activities.
   b. Dividends are decreases in assets incurred for the purpose of producing revenue.
   c. A company incurs expenses when it borrows money.
   d. Net income is an increase in stockholders' equity resulting primarily from operating activities.

8. If revenue exceeds expenses, there are no dividends, and total liabilities remain unchanged, then
    a. Stockholders' equity will decrease.
    b. Net assets will increase.
    c. Total assets will decrease.
    d. a and c.

**The following information pertains to the next two questions.** Company A paid $20,000 cash to buy land from Company B.

9. Select the statement that is true.
    a. Total liabilities of Company B would increase.
    b. Total assets of Company A would be unaffected.
    c. Company A's stockholders' equity would increase.
    d. None of the above.

10. Select the statement that is true.
    a. Company A would have a cash outflow from investing activities.
    b. Company B would have a cash inflow from investing activities.
    c. The balance in the cash account on Company A's books would decrease, while the balance in the cash account on Company B's books would increase.
    d. All of the above statements are true.

11. Revenue is less than expenses. If liabilities and common stock were unchanged, then
    a. cash flows from operating activities were greater than cash flows from investing activities.
    b. retained earnings were less than net income during the period.
    c. total assets decreased.
    d. the company must have purchased assets with cash.

12. The balance sheet of XYZ Company reports liabilities of $40,000, common stock of $10,000, and retained earnings of $50,000. Based on this information alone, you would know that
    a. XYZ Company has enough cash to pay off its liabilities.
    b. since the company's inception, the total amount of net income exceeded total dividends by at least $60,000.
    c. net assets of the company amounted to $20,000.
    d. total assets amounted to $100,000.

13. The Southern Company began the accounting period with assets of $600, common stock of $200, and retained earnings of $250. During the period, revenue was $300, expenses were $200, and dividends were $50. Common stock was unchanged during the accounting period. Liabilities decreased by $100. Based on this information,
    a. net income amounted to $50.
    b. total assets at the end of the period were $550.
    c. retained earnings at the end of the period amounted to $350.
    d. liabilities at the end of the period amounted to $100.

14. Which of the following illustrates how a cash dividend affects a company’s financial statements?

| | Balance Sheet | | | | | Income Statement | | | | | Statement of Cash Flow |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | = | Liab. | + | Stk. Equity | Rev. | − | Exp. | = | Net Inc. | |
| a. | + | | NA | | + | NA | | NA | | NA | + FA |
| b. | + | | NA | | + | + | | NA | | + | + OA |
| c. | − | | NA | | − | NA | | + | | − | − OA |
| d. | − | | NA | | − | NA | | NA | | NA | − FA |

15. Which of the following accounts is **not** closed at the end of the accounting period?

a. Retained Earnings
b. Operating Expenses
c. Dividends
d. Service Revenue

## Quiz Answers

| Question | Answer | Explanation |
|---|---|---|
| 1 | A | Earned revenue $750 – incurred expenses $500 = **$250 net income**. |
| 2 | D | Beginning retained earnings = $200 (assets $600 – liabilities $300 – dividends $100). Beginning retained earnings $200 + net income $250 – paid dividends $100 = **ending retained earnings $350**. |
| 3 | A | At year end: liabilities $300 + common stock $100 + retained earnings $350 = **assets $750**. |
| 4 | B | P Company's assets increase $400 and its **liabilities increase $400** from borrowing cash. |
| 5 | C | Borrowing cash and then paying cash for land overall increases total assets by the amount of cash borrowed. The first transaction borrowing $600 is an asset source **increasing assets $600**. The second transaction buying land is an asset exchange increasing land $500 while decreasing cash $500 resulting in no change to total assets. |
| 6 | B | Land purchased is recorded as an **outflow of $500 for investing activities**. |
| 7 | D | Net income increases retained earnings thus **stockholders' equity is increased**. |
| 8 | B | Retained earnings increases causing total stockholders' equity to increase. To keep the accounting equation in balance, **net assets will increase** the same amount as total stockholders' equity. |
| 9 | B | Company A paying cash to buy land from Company B is an asset exchange to Company A. Company A's decreases cash $20,000 and increases land $20,000. **Company A's total assets would be unaffected.** |
| 10 | D | **All of the above statements are true**. Paying cash for the land is an investing cash outflow for Company A. Receiving cash from the sale of land is an investing cash inflow for Company B. Company A's cash decreases from buying land. Company B's cash increases from selling land. |
| 11 | C | A net loss results from revenues being less than expenses. This causes retained earnings to decrease and total stockholders' equity to decrease. To keep the accounting equation in balance, **total assets decreased** the same amount as total stockholders' equity. |
| 12 | D | Liabilities $40,000 + common stock $10,000 + retained earnings $50,000 = **total assets $100,000**. |
| 13 | B | Beginning of the period: assets $600 – common stock $200 – retained earnings $250 = liabilities $150. During the period liabilities decreased $100 from $150 to $50. Beginning retained earnings $250 + revenues $300 – expenses $200 – dividends $50 = ending retained earnings $300. End of the period: liabilities $50 + common stock $200 + retained earnings $300 = **assets $550**. |

| Question | Answer | Explanation |
|---|---|---|
| 14 | D | On the balance sheet, a cash dividend **decreases assets** (cash) and **decreases stockholders' equity** (retained earnings). The income statement is not affected by a cash dividend. Paying a cash dividend is a **financing activity cash outflow**. |
| 15 | A | **Retained earnings** is not closed at the end of an accounting period. Retained earnings is a balance sheet account. Balance sheet account balances carry forward from one accounting period to the next. Income statement accounts and dividends are closed to retained earnings at the end of an accounting period. |

# Summary Outline of a Lesson Plan for

# Chapter 1 - Section 1

I. **Introduce the entity concept.** Explain that in a business transaction there are multiple entities involved and that as an accountant you must take the perspective of the business entity. It is important that students understand that the owner and the business are separate entities. From the very beginning they need to learn to account for transactions from the perspective of the business. Exercise 1-3A&B provide good examples to get this point across.

II. **Define assets**. Use the simplest definition possible. It is extremely important to use words that students can understand. They will read the technical terminology in the text. For example:

***Assets are things of value to a business. The value is the capacity of the asset to be used in the production of greater quantities of other assets.***

III. **Introduce the accounting equation.** You can make a smooth transition from defining assets to introducing the accounting equation by noting that ***assets*** belong to some person or organization. The individual or institutional interests in the assets are called ***claims***. The ***accounting equation*** expresses the relationship between assets and claims as follows:

**Assets = Claims**

IV. **Distribute copies of Demonstration Problem 1-1 and work papers (optional)**. Distributing the work paper allows students to reduce note taking and thereby focus their attention on your explanations.

V. **Use the demonstration problem to introduce new terms and to elaborate on the interrelationships represented by the accounting equation.** Record the Year 1 events under an accounting equation. Discuss each event separately. Define new terms as they are introduced with each succeeding event.

VI. **Have students record the events for the second accounting cycle in an accounting equation.** Explain that the Year 1 ending balances become the Year 2 beginning balances. Illustrate the Year 2 accounting equation with beginning balances before the students attempt to record the Year 2 events. Circulate through the room while your students attempt to record the Year 2 events. Since some students work faster than others, instruct the faster students to record the Year 3 events while you continue to help those who are having trouble with Year 3. Stop the class after most students have recorded the Year 2 transactions. Assign the Year 3 events as homework for those students who are unable to finish them in class.

VII. **Time considerations.** Introducing the accounting equation, including student participation with Year 2 data, requires approximately one hour.

VIII. **Homework assignment.** Exercises 1-6A&B contain transactions that are consistent with the demonstration problem.

IX. **Interpreting Information shown in an accounting equation.** Beyond knowing how to record transactions in an accounting equation, you should spend class time assuring that students are able to interpret the information shown in the equation. Exercises 1-9A&B and 1-10A&B are designed to teach students to interpret the information contained in an accounting equation. We highly recommend that you cover these exercises before proceeding with Section 2 of Chapter 1.

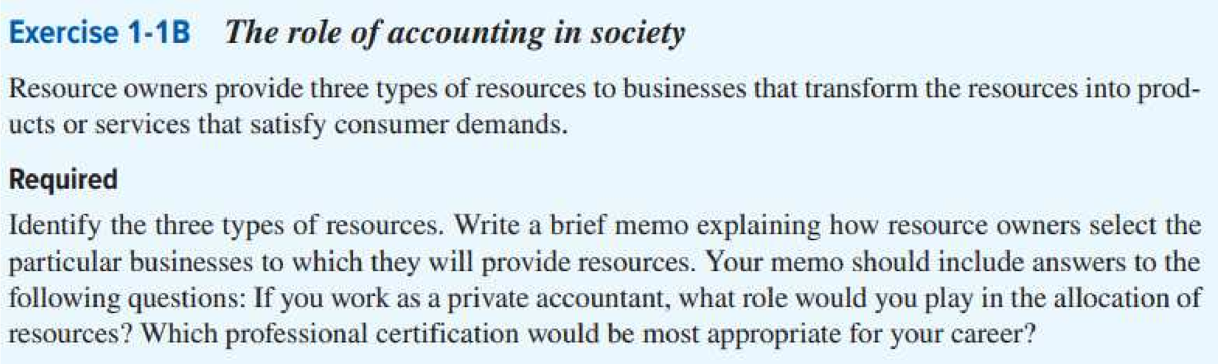
# Chapter 1 – Section 2

X. **Introduce financial statements.** Return to Demonstration Problem 1-1 and show students how the information recorded in the accounting equation is summarized in financial statements.

   A. **Income statement**
   B. **Statement of changes in stockholders' equity.**
   C. **Balance sheet.**
   D. **Statement of cash flows.**

XI. **Enrichment.** Appendix B contains excerpts from the Target 10-K report. It helps students to see a 'real world' example of what is being covered in class. While they are not yet ready to fully analyze financial statements as complex as those presented in this Appendix, you can point out the fact that the 4 financial statements are included here and discuss how they relate to the example that has been covered in class.

# CHAPTER 1



**Exercise 1-1B** ***The role of accounting in society***

Resource owners provide three types of resources to businesses that transform the resources into products or services that satisfy consumer demands.

**Required**

Identify the three types of resources. Write a brief memo explaining how resource owners select the particular businesses to which they will provide resources. Your memo should include answers to the following questions: If you work as a private accountant, what role would you play in the allocation of resources? Which professional certification would be most appropriate for your career?

## EXERCISE 1-1B

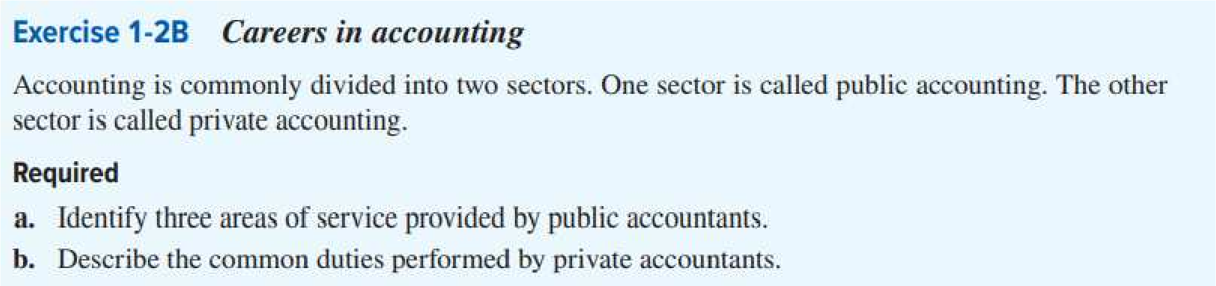
**The three types of resources available to businesses are:**

1. **Financial resources**
2. **Physical resources**
3. **Labor resources**

**Note to instructor:**

**The memo should discuss the fact that the resource owners are those who own resources that are desired by others, either in the original form or in a converted form. Businesses are the parties that acquire the resource and supply it to consumers either in the original form or in a converted form with value added by the conversion. The consumers are the ultimate users of the resources.**

**It should also include a discussion of the role of the private accountant and the allocation of resources. For example, private accountants prepare the annual reports that businesses use to communicate information to investors and creditors (financial resource providers). In other words, they are the information providers. The most appropriate designation for private accountants is the attainment of a Certified Management Accountant (CMA). However, many private accountants get their start in public accounting and are therefore CPAs as well as CMAs.**



**Exercise 1-2B** *Careers in accounting*

Accounting is commonly divided into two sectors. One sector is called public accounting. The other sector is called private accounting.

**Required**

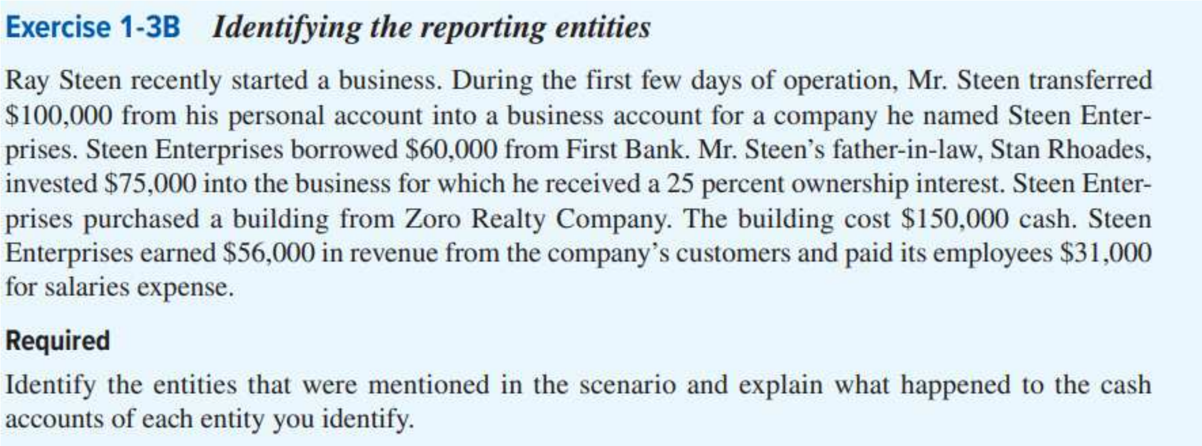
**a.** Identify three areas of service provided by public accountants.

**b.** Describe the common duties performed by private accountants.

## EXERCISE 1-2B

a. The three areas of service provided by public accountants are auditing, tax, and consulting.

b. The private accountant generally works for a specific company. Some of the functions performed include classifying and recording transactions, billing customers, collecting amounts due, ordering merchandise, paying suppliers, preparing and analyzing financial statements, developing budgets, assessing performance, and making decisions.



### Exercise 1-3B *Identifying the reporting entities*

Ray Steen recently started a business. During the first few days of operation, Mr. Steen transferred $100,000 from his personal account into a business account for a company he named Steen Enterprises. Steen Enterprises borrowed $60,000 from First Bank. Mr. Steen's father-in-law, Stan Rhoades, invested $75,000 into the business for which he received a 25 percent ownership interest. Steen Enterprises purchased a building from Zoro Realty Company. The building cost $150,000 cash. Steen Enterprises earned $56,000 in revenue from the company's customers and paid its employees $31,000 for salaries expense.

**Required**

Identify the entities that were mentioned in the scenario and explain what happened to the cash accounts of each entity you identify.

## EXERCISE 1-3B

| Entities | Distribution of Cash |
|---|---|
| Ray Steen (personal account) | Personal account was decreased by the $100,000 cash deposited in the Steen Enterprises' business account. |
| Steen Enterprises | Cash account increased by the $100,000 cash deposited by Mr. Steen.<br>Cash account increased by $60,000 cash borrowed from First Bank.<br>Cash account increased by $75,000 cash invested by Stan Rhoades.<br>Cash account decreased by $150,000 cash used to purchase building.<br>Cash account increased by $56,000 cash revenue earned.<br>Cash account decreased by $31,000 cash payment to employees for salaries. |
| First Bank | Cash account decreased by $60,000 cash loaned to Steen Enterprises. |
| Stan Rhoades, father-in-law, personal account | Cash decreased by $75,000 cash invested in Steen Enterprises. |
| Zoro Realty Company | Cash increased by $150,000 received from Steen Enterprises to purchase building. |
| Steen Enterprises' customers | Cash decreased by $56,000 when customers paid for services performed. |
| Steen Enterprises' employees | Cash increased by $31,000 when employees received payment for salaries. |

## **Exercise 1-4B** *Defining terms and identifying missing information in the accounting equation*

### Required

**a.** Match the terms, identified as (a) through (g), with the definitions and phrases (marked 1 through 7). For example, the term "a. Stockholders' Equity" matches with definition 2. Common Stock + Retained Earnings.

| | |
|---|---|
| a. Stockholders' Equity | 1. Individuals or institutions that have contributed assets or services to a business in exchange for an ownership interest in the business. |
| b. Liability | 2. Common Stock + Retained Earnings. |
| c. Stockholders | 3. Certificates that evidence ownership in a company. |
| d. Common Stock | 4. Assets − Liabilities − Common Stock. |
| e. Retained Earnings | 5. An obligation to pay cash in the future. |
| f. Creditors | 6. Individuals or institutions that have loaned goods or services to a business. |
| g. Assets | 7. Economic resources that will be used by a business to produce revenue. |

**b.** Calculate the missing amounts in the following table:

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Company | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| A | ? | | $30,000 | | $ 50,000 | | $62,000 |
| B | 50,000 | | ? | | 10,000 | | 25,000 |
| C | 85,000 | | 20,000 | | ? | | 40,000 |
| D | 215,000 | | 60,000 | | 100,000 | | ? |

## EXERCISE 1-4B

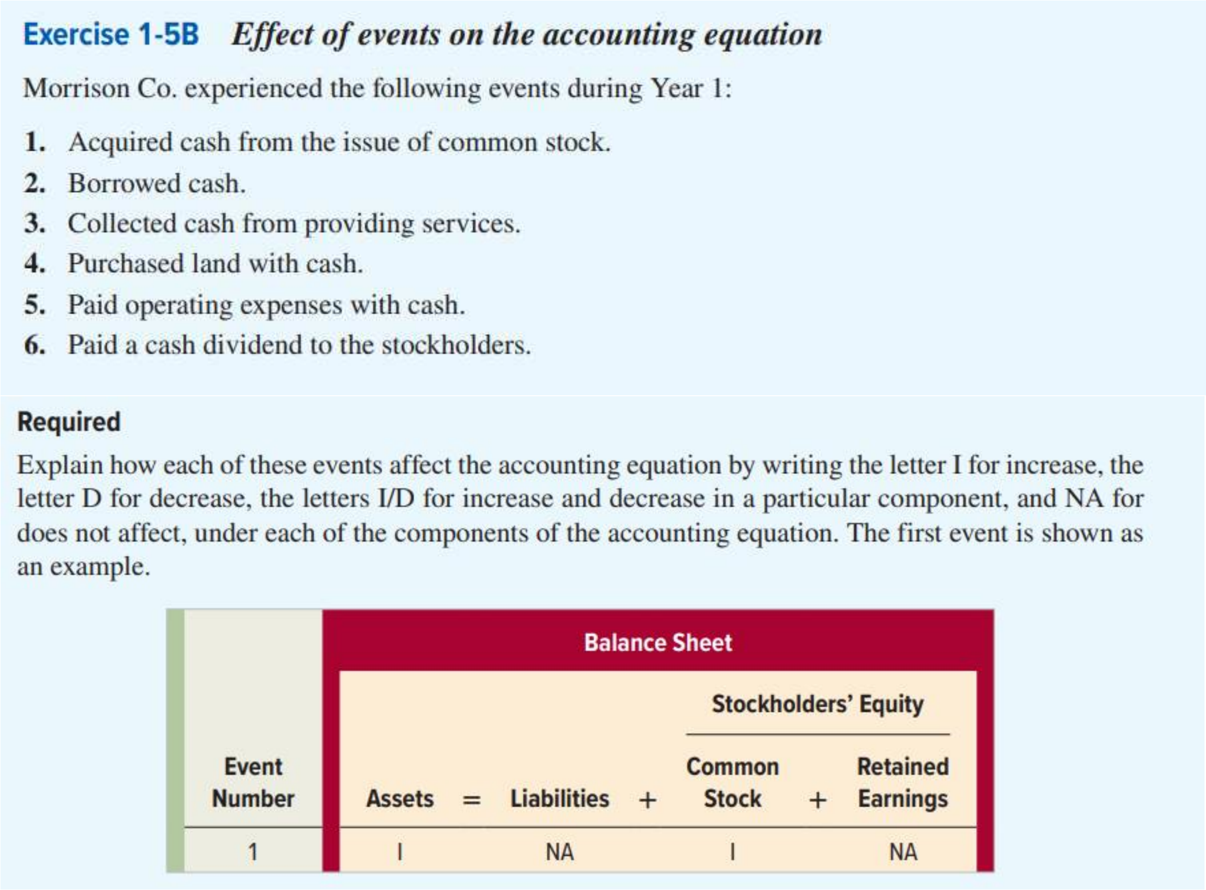
a.

| Term | Definition |
|---|---|
| a | 2 |
| b | 5 |
| c | 1 |
| d | 3 |
| e | 4 |
| f | 6 |
| g | 7 |

b.

**Accounting Equation**

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | | | | | Common | | Retained |
| Company | Assets | = | Liabilities | + | Stock | + | Earnings |
| A | *142,000* | = | 30,000 | + | 50,000 | + | 62,000 |
| B | 50,000 | = | *15,000* | + | 10,000 | + | 25,000 |
| C | 85,000 | = | 20,000 | + | *25,000* | + | 40,000 |
| D | 215,000 | = | 60,000 | + | 100,000 | + | *55,000* |



## **Exercise 1-5B** *Effect of events on the accounting equation*

Morrison Co. experienced the following events during Year 1:

1. Acquired cash from the issue of common stock.
2. Borrowed cash.
3. Collected cash from providing services.
4. Purchased land with cash.
5. Paid operating expenses with cash.
6. Paid a cash dividend to the stockholders.

**Required**

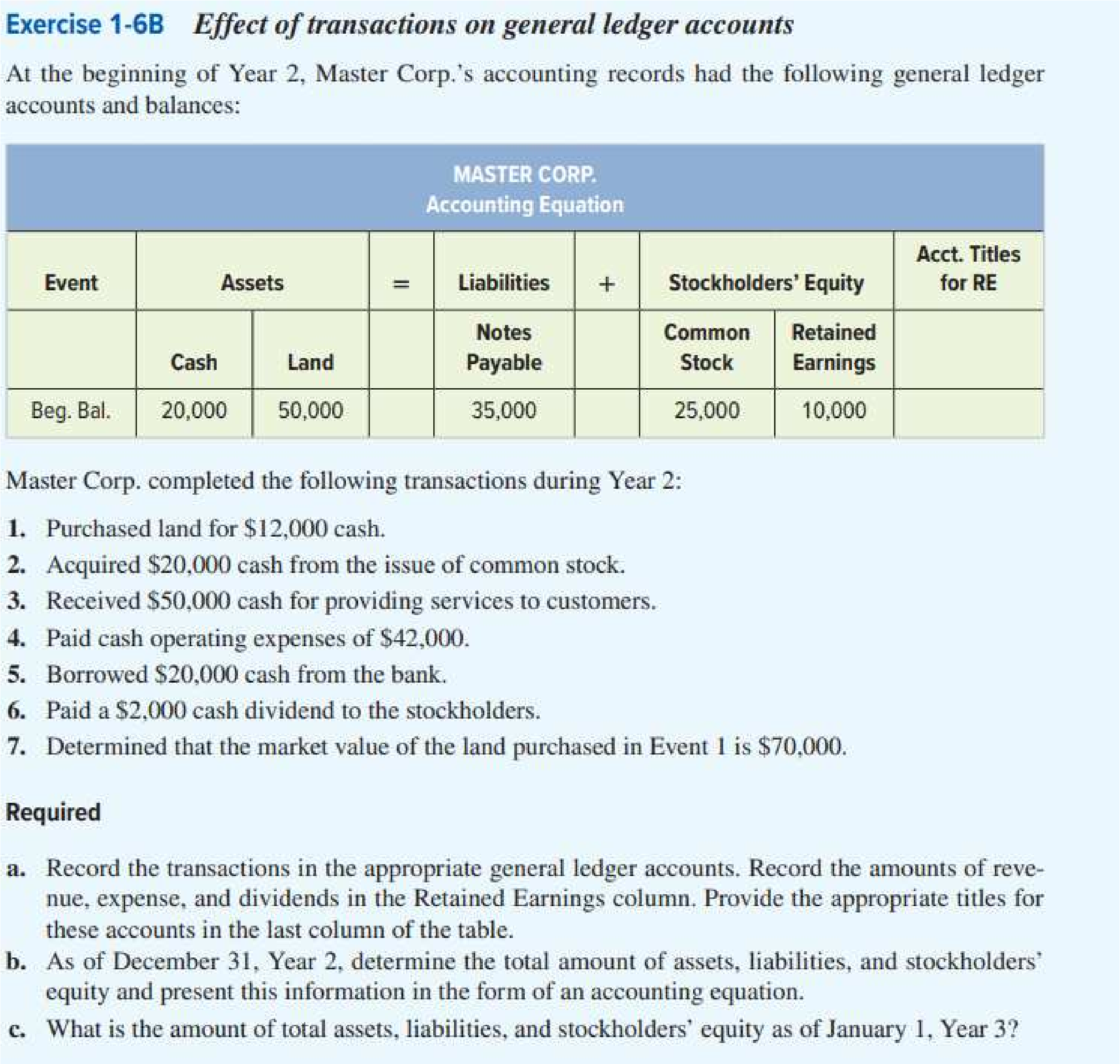
Explain how each of these events affect the accounting equation by writing the letter I for increase, the letter D for decrease, the letters I/D for increase and decrease in a particular component, and NA for does not affect, under each of the components of the accounting equation. The first event is shown as an example.

| | Balance Sheet | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | | Stockholders' Equity | | |
| Event Number | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| 1 | I | | NA | | I | | NA |

## EXERCISE 1-5B

### Morrison Co.
### Accounting Equation

| | | | | | Stockholders' Equity | |
|---|---|---|---|---|---|---|
| Event Number | Assets | = | Liabilities | + | Common Stock | Retained Earnings |
| 1. | I | = | NA | + | I | NA |
| 2. | I | = | I | + | NA | NA |
| 3. | I | = | NA | + | NA | I |
| 4. | I/D | = | NA | + | NA | NA |
| 5. | D | = | NA | + | NA | D |
| 6. | D | = | NA | + | NA | D |



### **Exercise 1-6B** *Effect of transactions on general ledger accounts*

At the beginning of Year 2, Master Corp.'s accounting records had the following general ledger accounts and balances:

**MASTER CORP.**
**Accounting Equation**

| **Event** | **Assets** | | **=** | **Liabilities** | **+** | **Stockholders' Equity** | | **Acct. Titles for RE** |
|---|---|---|---|---|---|---|---|---|
| | **Cash** | **Land** | | **Notes Payable** | | **Common Stock** | **Retained Earnings** | |
| Beg. Bal. | 20,000 | 50,000 | | 35,000 | | 25,000 | 10,000 | |

Master Corp. completed the following transactions during Year 2:

1. Purchased land for $12,000 cash.
2. Acquired $20,000 cash from the issue of common stock.
3. Received $50,000 cash for providing services to customers.
4. Paid cash operating expenses of $42,000.
5. Borrowed $20,000 cash from the bank.
6. Paid a $2,000 cash dividend to the stockholders.
7. Determined that the market value of the land purchased in Event 1 is $70,000.

**Required**

**a.** Record the transactions in the appropriate general ledger accounts. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide the appropriate titles for these accounts in the last column of the table.

**b.** As of December 31, Year 2, determine the total amount of assets, liabilities, and stockholders' equity and present this information in the form of an accounting equation.

**c.** What is the amount of total assets, liabilities, and stockholders' equity as of January 1, Year 3?

## EXERCISE 1-6B

a.

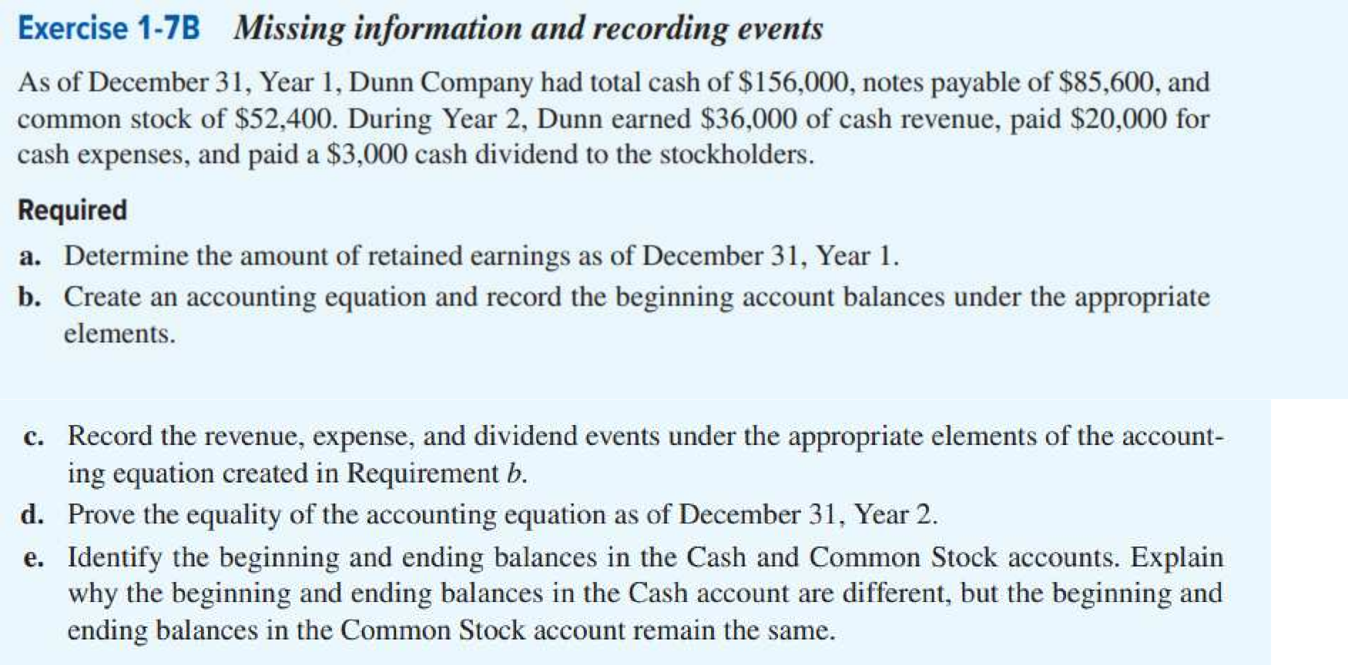
### Master Corp.
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/16 | 20,000 | + | 50,000 | = | 35,000 | + | 25,000 | + | 10,000 | |
| 1. Pur. Land | (12,000) | + | 12,000 | = | NA | + | NA | + | NA | NA |
| 2. Issued stk. | 20,000 | + | NA | = | NA | + | 20,000 | + | NA | NA |
| 3. Service | 50,000 | + | NA | = | NA | + | NA | + | 50,000 | Revenue |
| 4. Paid Exp. | (42,000) | + | NA | = | NA | + | NA | + | (42,000) | Oper. Exp. |
| 5. Loan | 20,000 | + | NA | = | 20,000 | + | NA | + | NA | NA |
| 6. Paid Div. | (2,000) | + | NA | = | NA | + | NA | + | (2,000) | Dividend |
| 7. Land Value | NA | + | NA | = | NA | + | NA | + | NA | NA |
| **Totals** | 54,000 | + | 62,000 | = | 55,000 | + | 45,000 | + | 16,000 | |

b.

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| $116,000 | = | $55,000 | + | $61,000 |

c. The balances of total assets, liabilities, and stockholders' equity will be the same on January 1, Year 3 as the balances on December 31, Year 2. (See b. above)



### **Exercise 1-7B** *Missing information and recording events*

As of December 31, Year 1, Dunn Company had total cash of $156,000, notes payable of $85,600, and common stock of $52,400. During Year 2, Dunn earned $36,000 of cash revenue, paid $20,000 for cash expenses, and paid a $3,000 cash dividend to the stockholders.

**Required**

**a.** Determine the amount of retained earnings as of December 31, Year 1.

**b.** Create an accounting equation and record the beginning account balances under the appropriate elements.

**c.** Record the revenue, expense, and dividend events under the appropriate elements of the accounting equation created in Requirement *b*.

**d.** Prove the equality of the accounting equation as of December 31, Year 2.

**e.** Identify the beginning and ending balances in the Cash and Common Stock accounts. Explain why the beginning and ending balances in the Cash account are different, but the beginning and ending balances in the Common Stock account remain the same.

## EXERCISE 1-7B

a.

| Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|
| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
| 156,000 | = | 85,600 | + | 52,400 | + | ? |

**Retained Earnings = $156,000 – $85,600 – $52,400 = $18,000**

b. & c.

**Dunn Company**
**Effect of Year 2 Transactions on the Accounting Equation**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| Beginning Balances | 156,000 | = | 85,600 | + | 52,400 | + | 18,000 |
| 1. Earned Revenue | 36,000 | = | NA | + | NA | + | 36,000 |
| 2. Paid expenses | (20,000) | = | NA | + | NA | + | (20,000) |
| 3. Paid dividend | (3,000) | = | NA | + | NA | + | (3,000) |
| Ending Balance | 169,000 | = | 85,600 | + | 52,400 | + | 31,000 |

d.

| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| 169,000 | = | 85,600 | + | 52,400 | + | 31,000 |

**Liabilities + Stockholders' Equity = $85,600 + $52,400 + $31,000 = $169,000**

Assets = Liabilities + Stockholders' Equity
$169,000 = $169,000

e. The beginning and ending balances in the cash account were $156,000 and $169,000, respectively. The beginning balance in the common stock account was $52,400. This balance did not change during the accounting period. The reason the cash balance changed but the

e. common stock balance did not was because the accounting events that Dunn experienced during the Year 2 accounting period affected the cash account but not the common stock account.

## **Exercise 1-8B** *Account titles and the accounting equation*

The following account titles were drawn from the general ledger of Pest Control, Incorporated (PCI): Cash, Notes Payable, Land, Accounts Payable, Office Furniture, Salaries Expense, Common Stock, Service Revenue, Interest Expense, Utilities Payable, Utilities Expense, Trucks, Supplies, Operating Expenses, Rent Revenue, Computers, Building, Supplies Expense, Gasoline Expense, Retained Earnings, Dividends.

### Required

**a.** Create an accounting equation using the elements assets, liabilities, and stockholders' equity. List each account title under the element of the accounting equation to which it belongs.

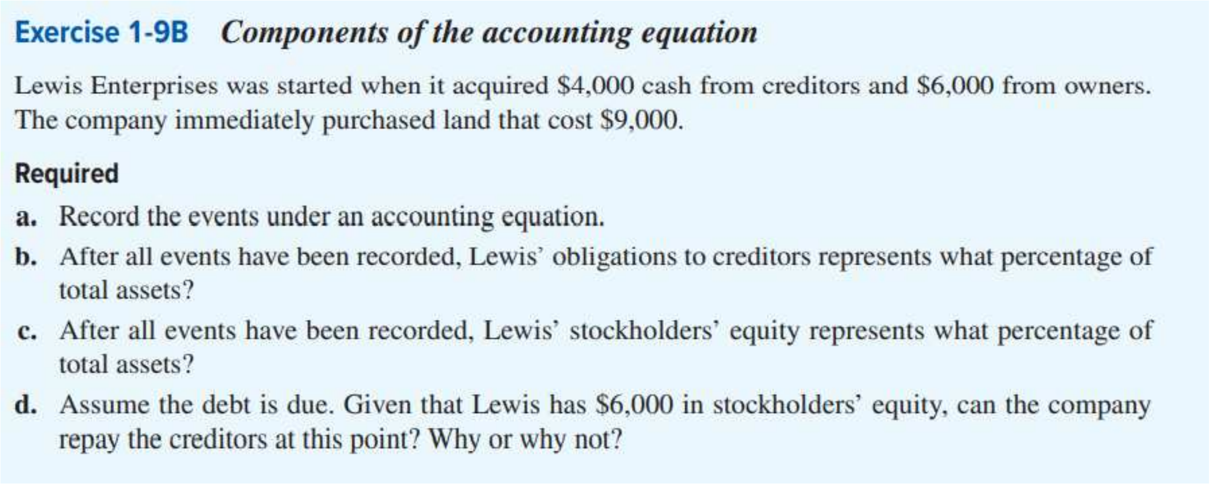
**b.** Will all businesses have the same number of accounts? Explain your answer.

## EXERCISE 1-8B

a.

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| Cash | | Notes Payable | | Salaries Expense |
| Land | | Accounts Payable | | Common Stock |
| Office Furniture | | Utilities Payable | | Service Revenue |
| Trucks | | | | Interest Expense |
| Supplies | | | | Utilities Expense |
| Computers | | | | Operating Expenses |
| Building | | | | Rent Revenue |
| | | | | Dividends |
| | | | | Supplies Expense |
| | | | | Gasoline Expense |
| | | | | Retained Earnings |
| | | | | Dividends |
| | | | | |

b. No. The number of accounts will vary depending on the level of detail the reporting entity chooses to provide, as well as the type of company and industry in which it operates. More accounts provide financial statement users with more information about the reporting entity. However, the cost of keeping records on many accounts often outweighs the benefit of providing more information. For example, in this problem the company kept all of the trucks in one account (i.e. Trucks). If the company wanted to provide more detail the company could have created a separate account for each truck. If the company wanted even more detail the company could break the truck into different components and provide an account for each component of the truck (i.e. engine, frame, wheels, tires, etc.). Providing accounts for each truck component would be very difficult and time consuming and would not necessarily change any decision made by a financial statement user. Therefore, it makes more sense to aggregate all trucks and truck components into one account. Deciding the number of accounts to report is a subjective cost/benefit analysis. The goal is to provide financial statement users with detail (i.e. more accounts) when the benefit of the additional information outweighs the cost of providing the information. Remember, it is the stockholders who are paying for the production of accounting information. They do not want to pay to produce information that cost more than it is worth.



**Exercise 1-9B** ***Components of the accounting equation***

Lewis Enterprises was started when it acquired $4,000 cash from creditors and $6,000 from owners. The company immediately purchased land that cost $9,000.

**Required**

**a.** Record the events under an accounting equation.

**b.** After all events have been recorded, Lewis' obligations to creditors represents what percentage of total assets?

**c.** After all events have been recorded, Lewis' stockholders' equity represents what percentage of total assets?

**d.** Assume the debt is due. Given that Lewis has $6,000 in stockholders' equity, can the company repay the creditors at this point? Why or why not?

## EXERCISE 1-9B

a.

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| | $10,000 | | $ -0- | | $4,000 | | $6,000 | | $ -0- |
| | (9,000) | | 9,000 | | NA | | NA | | NA |
| Bal. | $ 1,000 | + | $9,000 | = | $4,000 | + | $6,000 | + | $ 0 |

**b. Creditor's Claim ÷ Total Assets = Percent of Total**

**$4,000 ÷ $10,000 = 40%**

**c. Stockholder's Claim ÷ Total Assets = Percent of Total**

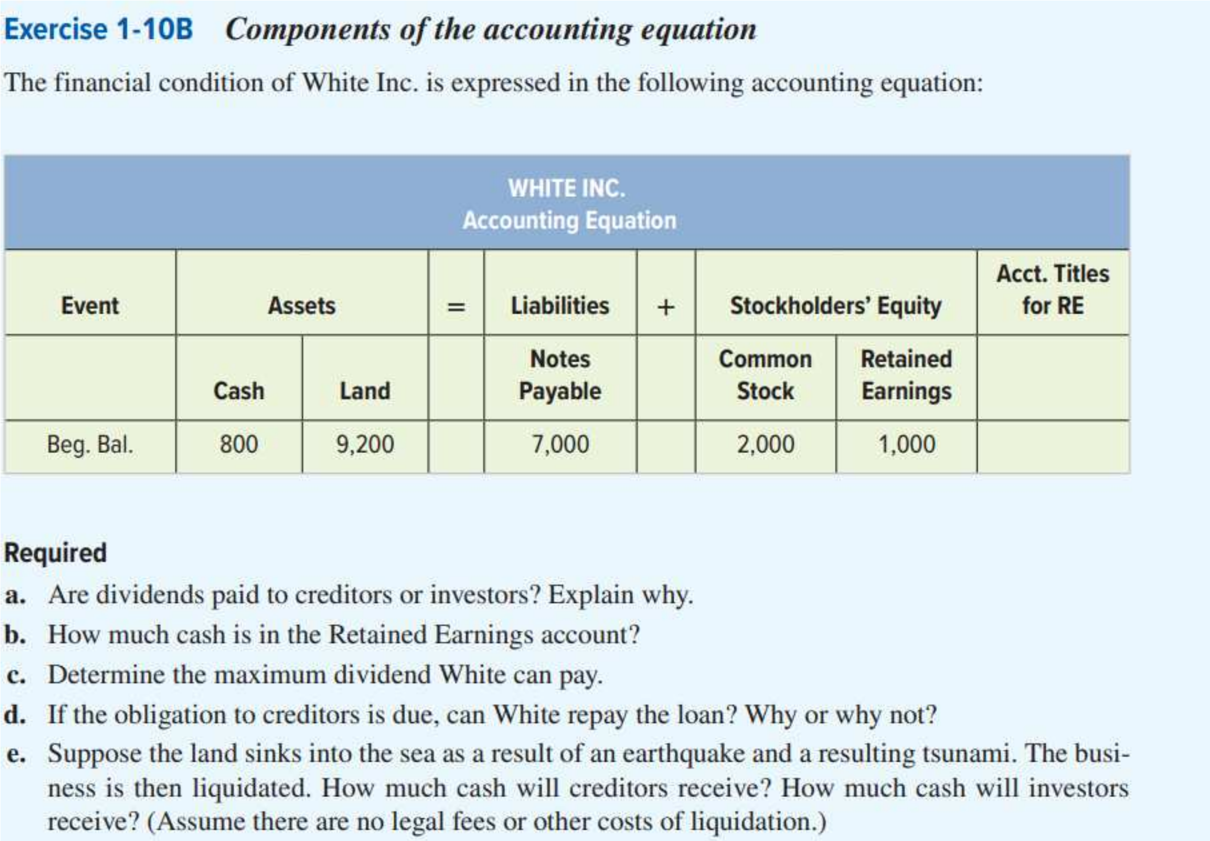
**$6,000 ÷ $10,000 = 60%**

## EXERCISE 1-9B (cont.)

d. The company cannot repay the debt. The company owes the creditors $4,000 but has only $1,000 cash. Note there is no actual money in the stockholders’ equity account. Indeed, there is no cash in any account that appears on the right side of the accounting equation. The right side of the accounting equation represents obligations and commitments of a company to its creditors and stockholders. Indeed, the accounting equation could be written as:

| Assets | | | | = | Liabilities | + | Stk. Equity | |
|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Common Stock | |
| Bal. | $ 1,000 | + | $9,000 | = | 40% | + | 60% | |

All assets including any cash balances are shown on the left side of the equation.



### Exercise 1-10B *Components of the accounting equation*

The financial condition of White Inc. is expressed in the following accounting equation:

**WHITE INC.**
**Accounting Equation**

| Event | Assets | | = | Liabilities | + | Stockholders' Equity | | Acct. Titles for RE |
|---|---|---|---|---|---|---|---|---|
| | Cash | Land | | Notes Payable | | Common Stock | Retained Earnings | |
| Beg. Bal. | 800 | 9,200 | | 7,000 | | 2,000 | 1,000 | |

**Required**

- **a.** Are dividends paid to creditors or investors? Explain why.
- **b.** How much cash is in the Retained Earnings account?
- **c.** Determine the maximum dividend White can pay.
- **d.** If the obligation to creditors is due, can White repay the loan? Why or why not?
- **e.** Suppose the land sinks into the sea as a result of an earthquake and a resulting tsunami. The business is then liquidated. How much cash will creditors receive? How much cash will investors receive? (Assume there are no legal fees or other costs of liquidation.)

## EXERCISE 1-10B

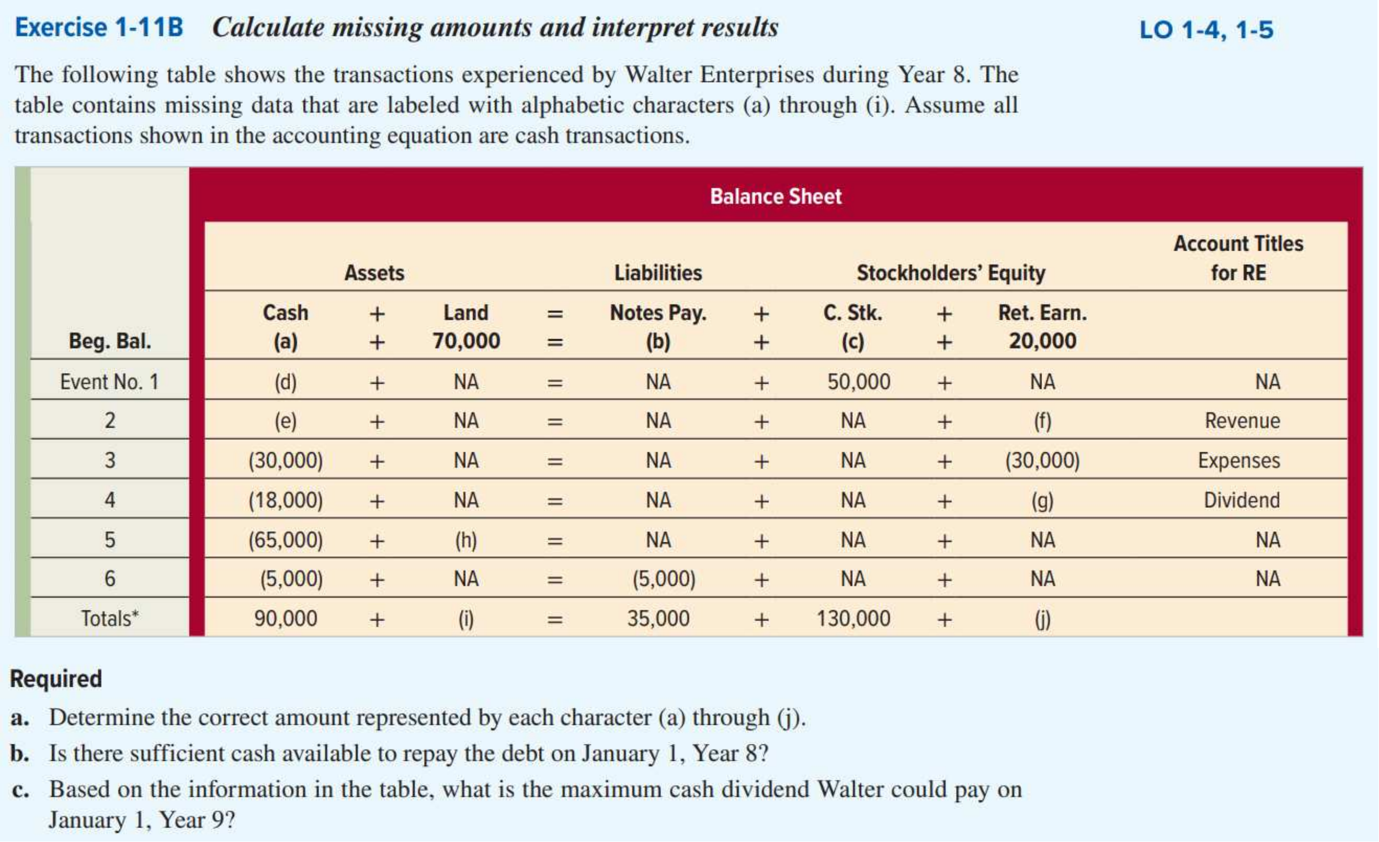
a. Dividends are paid to investors. The investor has an ownership interest in the business that allows the investor (owner) to share in the profits of the business. This pay out of a share of profits of a business to the owners is called a dividend.

b. There is no cash in the Retained Earnings account. Retained Earnings represents the business's commitments to its stockholders. It is the amount of past earnings that have not been paid out to owners.

c. The amount of dividends that can be paid are limited to retained earnings. In addition, a company must have enough cash to pay the dividend. White has $1,000 of retained earnings but only $800 of cash. The maximum amount of dividend that could be paid at this time would be $800.

d. If the total amount of the liability of $7,000 is due, White will not be able to satisfy the obligation. White has only $800 of cash; the balance of the assets are contained in the Land account. If payment must be made to creditors, White will have to liquidate the company in order to pay the debt.

e. If the land becomes worthless, the only asset remaining is the cash of $800. Since creditors have first claim on the assets, all of the $800 will be paid to the creditors. The investors will not be paid anything.



### **Exercise 1-11B** *Calculate missing amounts and interpret results* **LO 1-4, 1-5**

The following table shows the transactions experienced by Walter Enterprises during Year 8. The table contains missing data that are labeled with alphabetic characters (a) through (i). Assume all transactions shown in the accounting equation are cash transactions.

| | Balance Sheet | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | | Liabilities | | Stockholders' Equity | | | Account Titles for RE |
| | Cash | + | Land | = | Notes Pay. | + | C. Stk. | + | Ret. Earn. | |
| **Beg. Bal.** | **(a)** | + | **70,000** | = | **(b)** | + | **(c)** | + | **20,000** | |
| Event No. 1 | (d) | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2 | (e) | + | NA | = | NA | + | NA | + | (f) | Revenue |
| 3 | (30,000) | + | NA | = | NA | + | NA | + | (30,000) | Expenses |
| 4 | (18,000) | + | NA | = | NA | + | NA | + | (g) | Dividend |
| 5 | (65,000) | + | (h) | = | NA | + | NA | + | NA | NA |
| 6 | (5,000) | + | NA | = | (5,000) | + | NA | + | NA | NA |
| Totals* | 90,000 | + | (i) | = | 35,000 | + | 130,000 | + | (j) | |

**Required**

**a.** Determine the correct amount represented by each character (a) through (j).

**b.** Is there sufficient cash available to repay the debt on January 1, Year 8?

**c.** Based on the information in the table, what is the maximum cash dividend Walter could pay on January 1, Year 9?

## EXERCISE 1-11B

a. The answers are shown in the order in which they were calculated. In other words, item (d) was calculated first, (g) second and so on. There are other possible patterns that would produce correct answers.

Begin by filling in all possible blanks on the horizontal rows.

(d) Since common stock increased by $50,000, cash had to increase by $50,000.

(g) Since cash decreased by $18,000, dividends must have caused retained earnings to decrease by $18,000.

(h) Since cash decreased by $65,000, land must have increased by $65,000.

Now shift to an analysis of the vertical columns.

(i) Given that land had a beginning balance of $70,000 and $65,000 of land was sold, the ending balance in the land account has to be $135,000.

(b) The beginning balance in the notes payable account had to be $40,000 because this amount minus the $5,000 partial pay off of notes payable would result in ending balance in the notes payable account of $40,000.

(c) The $130,000 ending balance in the common stock account minus the $50,000 issued during the period yields $80,000 beginning balance.

Now shift back to a horizontal analysis of the rows.

(a) Cash (x) + Land = Notes Pay. + Common Stk. + Beg. Ret. Ear.
X = -$70,000 + $40,000 + $80,000 + $20,000
X = $70,000

(j) Cash + Land = Notes Pay. + Common Stk. + End. Ret. Ear. (X)
X = Cash + Land – Notes Pay – Common Stk.
X = $90,000 + $135,000 - $35,000 - $130,000
X = $60,000

## EXERCISE 1-11B (cont.)

(f)

| | |
|---|---|
| Beginning Retained Earnings | $20,000 |
| + Revenue | X |
| - Expenses | (30,000) |
| - Dividends | (18,000) |
| Ending Retained Earnings | $60,000 |

($20,000 + X – $30,000 – $18,000 = $60,000
X = $88,000)

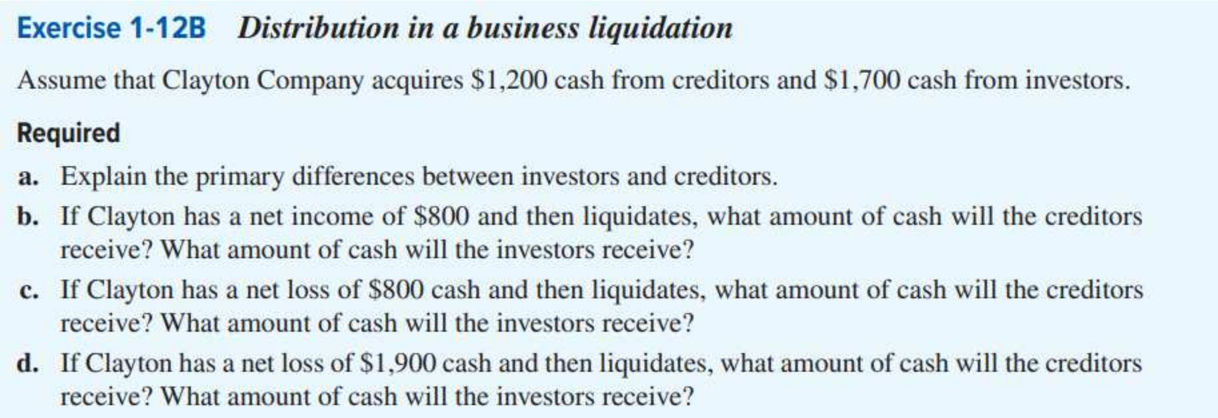
(e) Given that revenue increased by $88,000 cash must have increased by $88,000.

The solution shown in table format is as follows:

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | (a)70,000 | + | 70,000 | = | (b)40,000 | + | (c)80,000 | + | 20,000 | |
| Event 1 | (d)50,000 | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2. | (e)88,000 | + | NA | = | NA | + | NA | + | (f)88,000 | Revenue |
| 3. | (30,000) | + | NA | = | NA | + | NA | + | (30,000) | Expenses |
| 4. | (18,000) | + | NA | = | NA | + | NA | + | (g)(18,000) | Dividend |
| 5. | (65,000) | + | (h)65,000 | = | NA | + | NA | + | NA | NA |
| 6. | (5,000) | + | NA | = | (5,000) | + | NA | + | NA | NA |
| End. Bal. | 90,000 | + | (i)135,000 | = | 35,000 | + | 130,000 | + | (j)60,000 | |

b. There is sufficient cash available to pay off the debt on January 1, Year 8. At that time the company has cash of $70,000 which is more than enough funds to repay the $40,000 notes payable.

c. The maximum cash dividend payable is limited by the lessor of the balance in the cash account versus the balance in the retained earnings account. In this case $60,000 is the maximum cash dividend Walter can pay.



## Exercise 1-12B *Distribution in a business liquidation*

Assume that Clayton Company acquires $1,200 cash from creditors and $1,700 cash from investors.

**Required**

**a.** Explain the primary differences between investors and creditors.

**b.** If Clayton has a net income of $800 and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

**c.** If Clayton has a net loss of $800 cash and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

**d.** If Clayton has a net loss of $1,900 cash and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

## EXERCISE 1-12B

a. Investors put assets into the company with the expectation of sharing profits. Creditors lend assets to the company with the expectation of repayment of the principal plus interest on the loan.

b.

**Clayton Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | $2,900 | = | $1,200 | + | $1,700 |
| Earned income | 800 | = | NA | + | 800 |
| Balance | $3,700 | = | $1,200 | + | $2,500 |

Since creditors are owed $1,200 and there are sufficient funds to pay them; the creditors will receive the $1,200 that they are owed. Since the investors own the business, they are entitled to the profits earned by the business. The investors will receive $2,500 (their original $1,700 investment plus the $800 of profit).

c.

**Clayton Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | $2,900 | = | $1,200 | + | $1,700 |
| Incurred loss | (800) | = | NA | + | (800) |
| Balance | $2,100 | = | $1,200 | + | $ 900 |

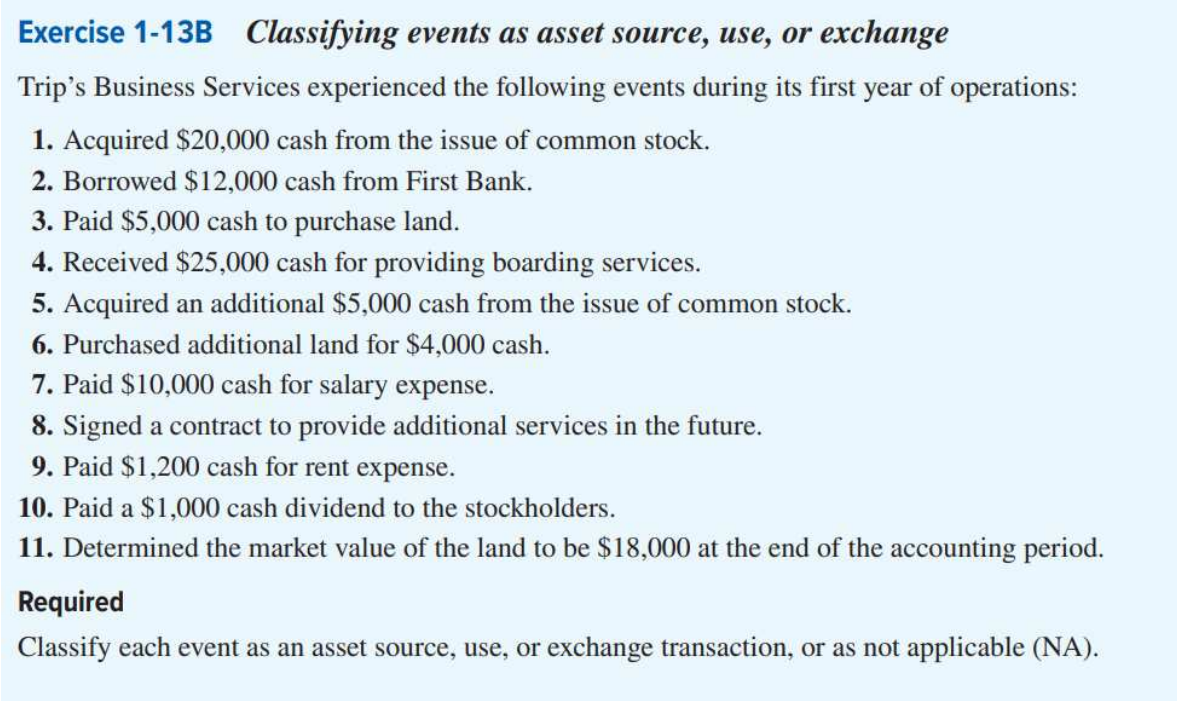
Since creditors are owed $1,200 and there are sufficient funds to pay them; the creditors will receive the $1,200 that they are owed. Since the investors own the business, they suffer the losses earned by the business. The investors will receive $900 (their original $1,700 investment minus the $800 loss).

## EXERCISE 1-12B (cont.)

d.

| Clayton Company<br>Accounting Equation | | | | | |
|---|---|---|---|---|---|
| Event | Assets | = | Liabilities | + | Stockholders' Equity |
| Acquired assets | $2,900 | = | $1,200 | + | $1,700 |
| Incurred loss | (1,900) | = | (200) | + | (1,700) |
| Balance | $1,000 | = | $1,000 | + | ($ 0) |

While creditors get first priority to receive assets in a business liquidation, this does not mean they cannot lose all or a portion of the assets they loan a business. In this case creditors are owed $1,200 but the business has only $1,000 of assets. Since the creditors have first priority, the entire $1,000 would be distributed to them. In this case the creditors lose $200 ($1,200 original loan - $1,000 returned). Since the investors own the business, they suffer the losses earned by the business. The investors will lose the entire $1,700 they contributed to the business.



**Exercise 1-13B** ***Classifying events as asset source, use, or exchange***

Trip’s Business Services experienced the following events during its first year of operations:

1. Acquired $20,000 cash from the issue of common stock.
2. Borrowed $12,000 cash from First Bank.
3. Paid $5,000 cash to purchase land.
4. Received $25,000 cash for providing boarding services.
5. Acquired an additional $5,000 cash from the issue of common stock.
6. Purchased additional land for $4,000 cash.
7. Paid $10,000 cash for salary expense.
8. Signed a contract to provide additional services in the future.
9. Paid $1,200 cash for rent expense.
10. Paid a $1,000 cash dividend to the stockholders.
11. Determined the market value of the land to be $18,000 at the end of the accounting period.

**Required**

Classify each event as an asset source, use, or exchange transaction, or as not applicable (NA).

## EXERCISE 1-13B

| Event | Classification |
|---|---|
| 1. | Asset Source |
| 2. | Asset Source |
| 3. | Asset Exchange |
| 4. | Asset Source |
| 5. | Asset Source |
| 6. | Asset Exchange |
| 7. | Asset Use |
| 8. | NA |
| 9. | Asset Use |
| 10. | Asset Use |
| 11. | NA |
| | |

### Exercise 1-14B *Missing information for determining net income*

The December 31, Year 1, balance sheet for James Company showed total stockholders' equity of $200,000. Total stockholders' equity increased by $80,000 between December 31, Year 1, and December 31, Year 2. During Year 2, James Company acquired $30,000 cash from the issue of common stock. James Company paid a $2,000 cash dividend to the stockholders during Year 2.

**Required**

Determine the amount of net income or loss James Company reported on its Year 2 income statement. (*Hint:* Remember that stock issues, net income, and dividends all change total stockholders' equity.)

## EXERCISE 1-14B

**Steps:**

**1.**

**Common Stock Issued = Change in Common Stock**
**$30,000 (given) = *$30,000***

**2.**

**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**
**$80,000 (given) = $30,000 (1) + *$50,000***

**3.**

**Increase in Ret. Earn. = Net Income – Dividends**
**$50,000 (2) = *$52,000* – $2,000 (given)**

**Alternate Solution:**

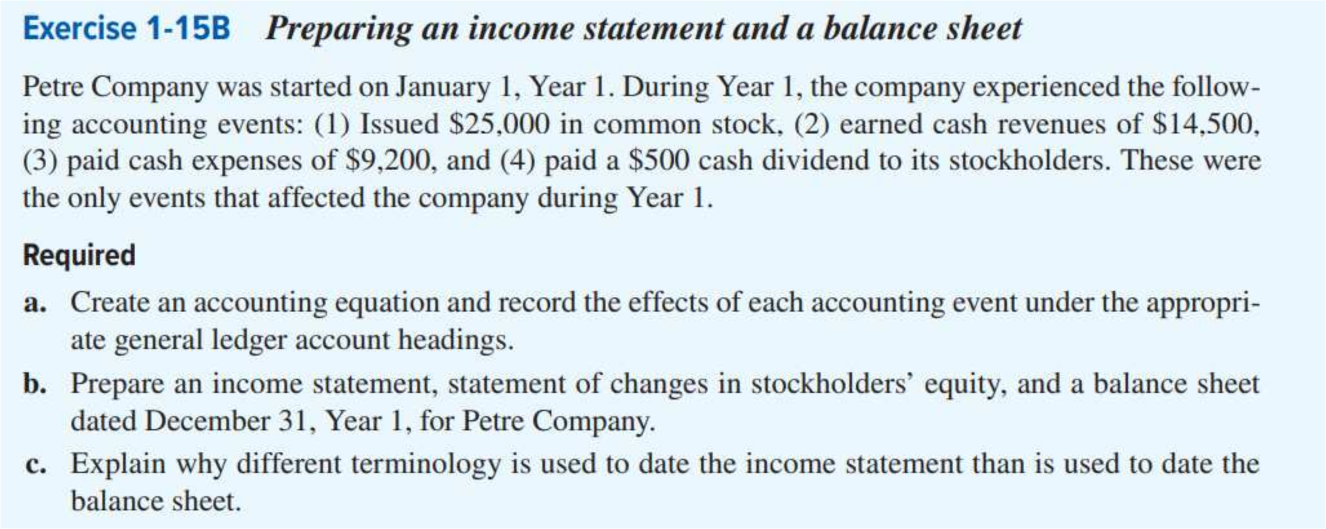
**From the Statement of Changes in Stockholders' Equity we know (with minor modifications):**

| | | |
|---|---|---|
| | | |
| Beginning Total Stk. Equity, 1/1/Year 2 | | $200,000 |
| (Common Stock + Retained Earnings) | | |
| | | |
| Plus: Common Stock Issued | $30,000 | |
| Plus: Net Income | ? | |
| Less: Dividends | (2,000) | |
| Change in Stockholders' Equity | | 80,000 |
| | | |
| Ending Total Stk. Equity, 12/31/Year 2 | | $280,000 |
| | | |

**Working backwards from the change in equity we can solve for net income:**

## EXERCISE 1-14B (cont.)

| | |
|---|---|
| Change in Stockholders’ Equity, Year 2 | $80,000 |
| Plus: Dividends | 2,000 |
| Less: Common Stock Issued | (30,000) |
| Net Income, Year 2 | *$52,000* |



### Exercise 1-15B *Preparing an income statement and a balance sheet*

Petre Company was started on January 1, Year 1. During Year 1, the company experienced the following accounting events: (1) Issued $25,000 in common stock, (2) earned cash revenues of $14,500, (3) paid cash expenses of $9,200, and (4) paid a $500 cash dividend to its stockholders. These were the only events that affected the company during Year 1.

**Required**

- **a.** Create an accounting equation and record the effects of each accounting event under the appropriate general ledger account headings.
- **b.** Prepare an income statement, statement of changes in stockholders' equity, and a balance sheet dated December 31, Year 1, for Petre Company.
- **c.** Explain why different terminology is used to date the income statement than is used to date the balance sheet.

## EXERCISE 1-15B

a.

### Petre Company
### Accounting Equation for Year 1

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | | + | Common Stock | + | Retained Earnings |
| 1. Issue stock | 25,000 | | | | 25,000 | | |
| 2. Cash revenues | 14,500 | | NA | | NA | | 14,500 |
| 3. Paid expenses | (9,200) | | NA | | NA | | (9,200) |
| 4. Paid dividend | (500) | | NA | | NA | | (500) |
| Ending Balance | 29,800 | = | -0- | + | 25,000 | + | 4,800 |

b.

### Petre Company
### Income Statement
### For the Year Ended December 31, Year 1

| | |
|---|---|
| Revenue | $14,500 |
| Expense | (9,200) |
| Net Income | $ 5,300 |

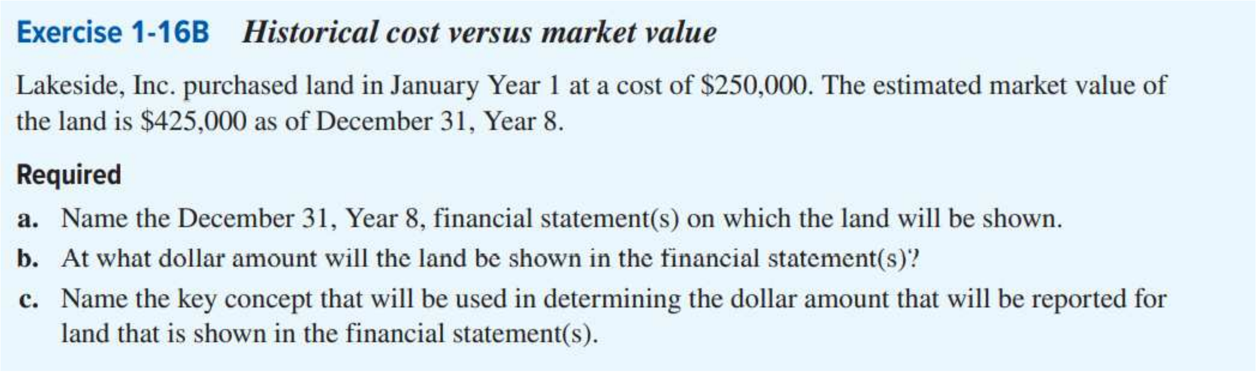
### Petre Company
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 1

| | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 25,000 | |
| Ending Common Stock | | $ 25,000 |
| | | |
| Beginning Retained Earnings | $ -0- | |
| Plus: Net Income | 5,300 | |
| Less: Dividends | (500) | |
| Ending Retained Earnings | | 4,800 |
| | | |
| Total Stockholders' Equity | | $29,800 |

## EXERCISE 1-15B (cont.)

| Petre Company<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| **Assets** | | |
| Cash | | $ 29,800 |
| | | |
| **Liabilities** | | $ -0- |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $ 25,000 | |
| Retained Earnings | 4,800 | |
| Total Stockholders' Equity | | 29,800 |
| | | |
| Total Liabilities and Stockholders' Equity | | $ 29,800 |

c. The income statement is dated with the term "for the year ended" because it covers a one year span of time. The balance sheet is dated with the term "as of" because it describes information at a specific point in time.



**Exercise 1-16B** ***Historical cost versus market value***

Lakeside, Inc. purchased land in January Year 1 at a cost of $250,000. The estimated market value of the land is $425,000 as of December 31, Year 8.

**Required**

**a.** Name the December 31, Year 8, financial statement(s) on which the land will be shown.

**b.** At what dollar amount will the land be shown in the financial statement(s)?

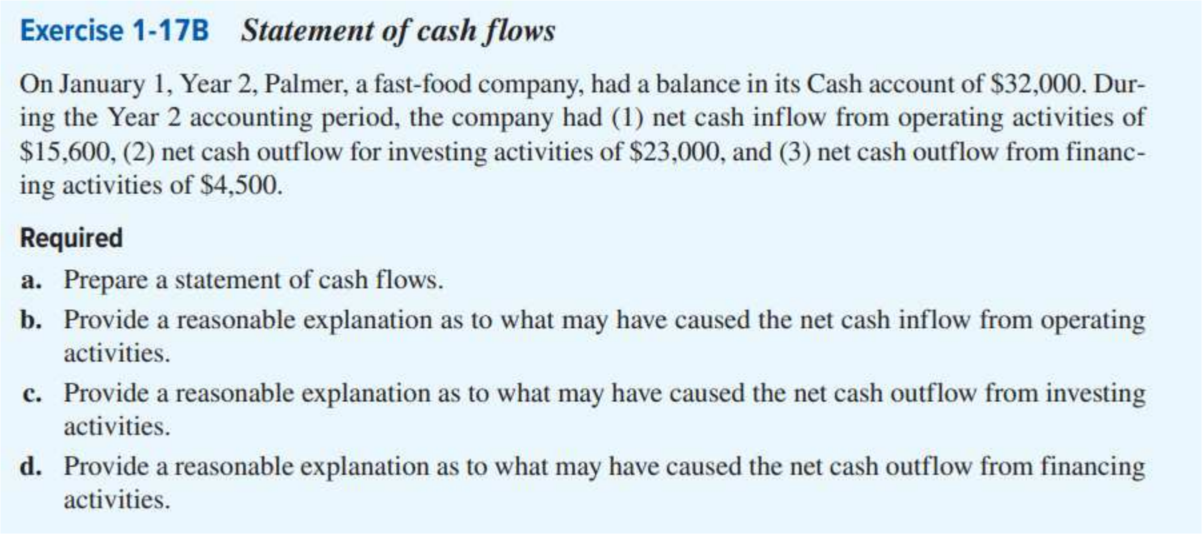
**c.** Name the key concept that will be used in determining the dollar amount that will be reported for land that is shown in the financial statement(s).

## EXERCISE 1-16B

**a.** **Land will be shown on the Year 8 balance sheet.**

**b.** **Land will be listed at its historical cost of $250,000.**

**c.** **The key concept used in listing land at its cost is the historical cost concept.**



**Exercise 1-17B** ***Statement of cash flows***

On January 1, Year 2, Palmer, a fast-food company, had a balance in its Cash account of $32,000. During the Year 2 accounting period, the company had (1) net cash inflow from operating activities of $15,600, (2) net cash outflow for investing activities of $23,000, and (3) net cash outflow from financing activities of $4,500.

**Required**

- **a.** Prepare a statement of cash flows.
- **b.** Provide a reasonable explanation as to what may have caused the net cash inflow from operating activities.
- **c.** Provide a reasonable explanation as to what may have caused the net cash outflow from investing activities.
- **d.** Provide a reasonable explanation as to what may have caused the net cash outflow from financing activities.

## EXERCISE 1-17B

a.

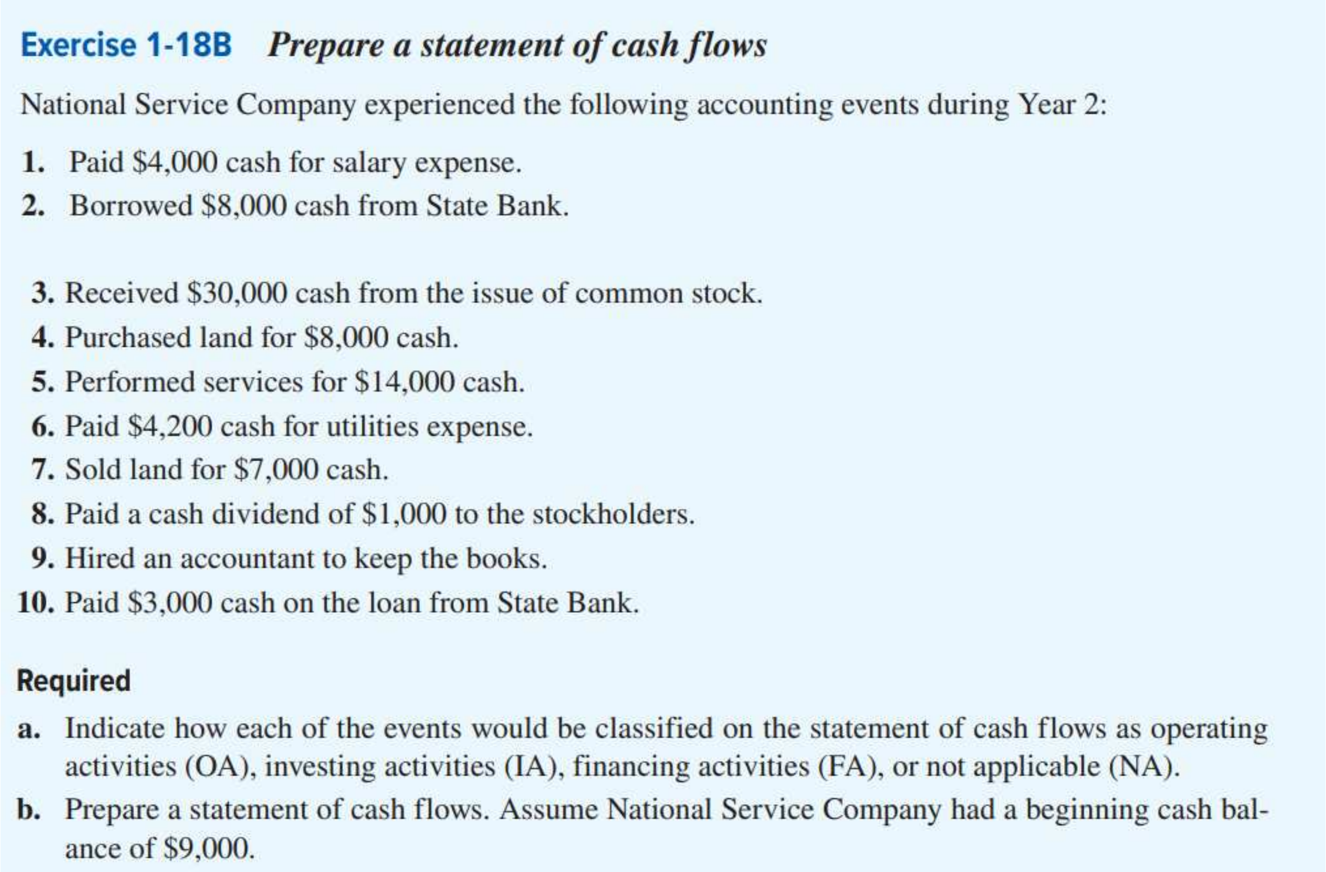
**Palmer Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| **Net Cash Inflow from Operating Activities** | | **$ 15,600** |
| **Cash Flows From Investing Activities:** | | |
| **Net Cash Outflow from Investing Activities** | | **(23,000)** |
| **Cash Flows From Financing Activities:** | | |
| **Net Cash Outflow from Financing Activities** | | **(4,500)** |
| **Net Decrease in Cash** | | **(11,900)** |
| **Plus: Beginning Cash Balance** | | **32,000** |
| **Ending Cash Balance** | | **$20,100** |

**b. Cash inflow from selling fast food to customers was greater than cash outflow for expenses.**

**c. The company paid cash to purchase long-term assets.**

**d. The company paid cash dividends or paid off a bank loan.**



## Exercise 1-18B *Prepare a statement of cash flows*

National Service Company experienced the following accounting events during Year 2:

1. Paid $4,000 cash for salary expense.
2. Borrowed $8,000 cash from State Bank.

3. Received $30,000 cash from the issue of common stock.
4. Purchased land for $8,000 cash.
5. Performed services for $14,000 cash.
6. Paid $4,200 cash for utilities expense.
7. Sold land for $7,000 cash.
8. Paid a cash dividend of $1,000 to the stockholders.
9. Hired an accountant to keep the books.
10. Paid $3,000 cash on the loan from State Bank.

**Required**

**a.** Indicate how each of the events would be classified on the statement of cash flows as operating activities (OA), investing activities (IA), financing activities (FA), or not applicable (NA).

**b.** Prepare a statement of cash flows. Assume National Service Company had a beginning cash balance of $9,000.

## EXERCISE 1-18B

a.

| Event | Statement of Cash Flow Classification |
|---|---|
| 1. | OA |
| 2. | FA |
| 3. | FA |
| 4. | IA |
| 5. | OA |
| 6. | OA |
| 7. | IA |
| 8. | FA |
| 9. | NA |
| 10. | FA |

b.

### National Service Company
### Statement of Cash Flows
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $14,000 | |
| Cash Payments for Salaries | (4,000) | |
| Cash Payments for Utilities | (4,200) | |
| **Net Cash Inflow from Operating Activities** | | $ 5,800 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(8,000) | |
| Cash Collected from the Sale of Land | 7,000 | |
| **Net Cash Outflow from Investing Activities** | | (1,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Loan | $ 8,000 | |
| Cash Paid to Loan Obligation | (3,000) | |
| Cash Receipts from Stock Issue | 30,000 | |
| Cash Payments for Dividends | (1,000) | |
| **Net Cash Inflow from Financing Activities** | | 34,000 |
| | | |
| **Net Increase in Cash** | | 38,800 |
| **Plus: Beginning Cash Balance** | | 9,000 |
| **Ending Cash Balance** | | $47,800 |

## **Exercise 1-19B** *Preparing financial statements*

Tennessee Company experienced the following events during Year 2:

1. Acquired $50,000 cash from the issue of common stock.
2. Paid $15,000 cash to purchase land.
3. Borrowed $25,000 cash.
4. Provided services for $60,000 cash.
5. Paid $12,000 cash for rent expense.
6. Paid $22,000 cash for other operating expenses.
7. Paid a $5,000 cash dividend to the stockholders.
8. Determined that the market value of the land purchased in Event 2 is now $16,500.

### Required

**a.** The January 1, Year 2, general ledger account balances are shown in the following accounting equation. Record the eight events in the appropriate general ledger accounts. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide the appropriate titles for these accounts in the last column of the table. The first event is shown as an example.

**TENNESSEE COMPANY**
**Accounting Equation**

| Event | Assets | | = | Liabilities | + | Stockholders' Equity | | Acct. Titles for RE |
|---|---|---|---|---|---|---|---|---|
| | Cash | Land | | Notes Payable | | Common Stock | Retained Earnings | |
| 1. Beg. Bal. | 15,000<br>50,000 | 10,000 | | 0 | | 20,000<br>50,000 | 5,000 | |

**b.** Prepare an income statement, statement of changes in stockholders' equity, year-end balance sheet, and statement of cash flows for the Year 2 accounting period.

**c.** Determine the percentage of assets that were provided by retained earnings. How much cash is in the retained earnings account?

## EXERCISE 1-19B

a.

### Tennessee Company
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/Y2 | 15,000 | + | 10,000 | = | -0- | + | 20,000 | + | 5,000 | |
| 1. Issued stk. | 50,000 | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2. Pur. Land | (15,000) | + | 15,000 | = | NA | + | NA | + | NA | NA |
| 3. Loan | 25,000 | + | NA | = | 25,000 | + | NA | + | NA | NA |
| 4. Provide Svc. | 60,000 | + | NA | = | NA | + | NA | + | 60,000 | Svc. Rev. |
| 5. Paid Rent | (12,000) | + | NA | = | NA | + | NA | + | (12,000) | Rent Exp. |
| 6. Pd. Op. Exp. | (22,000) | + | NA | = | NA | + | NA | + | (22,000) | Op. Exp. |
| 7. Paid Div. | (5,000) | + | NA | = | NA | + | NA | + | (5,000) | Dividends |
| 8. Land Value | NA | + | NA | = | NA | + | NA | + | NA | |
| Totals | 96,000 | + | 25,000 | = | 25,000 | + | 70,000 | + | 26,000 | |

b.

### Tennessee Company
### Income Statement
### For the Year Ended December 31, Year 2

| | |
|---|---|
| Service Revenue | $60,000 |
| Rent Expense | (12,000) |
| Operating Expense | (22,000) |
| Net Income | $26,000 |

## EXERCISE 1-19B (cont.)

b.

### Tennessee Company
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $20,000 | |
| Plus: Common Stock Issued | 50,000 | |
| Ending Common Stock | | $70,000 |
| | | |
| Beginning Retained Earnings | $ 5,000 | |
| Plus: Net Income | 26,000 | |
| Less: Dividends | (5,000) | |
| Ending Retained Earnings | | 26,000 |
| | | |
| Total Stockholders' Equity | | $96,000 |

## EXERCISE 1-19B (cont.)

b.

| Tennessee Company<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| **Assets** | | |
| Cash | $96,000 | |
| Land | 25,000 | |
| **Total Assets** | | $121,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | $25,000 | |
| **Total Liabilities** | | $25,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $70,000 | |
| Retained Earnings | 26,000 | |
| **Total Stockholders' Equity** | | 96,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $121,000 |

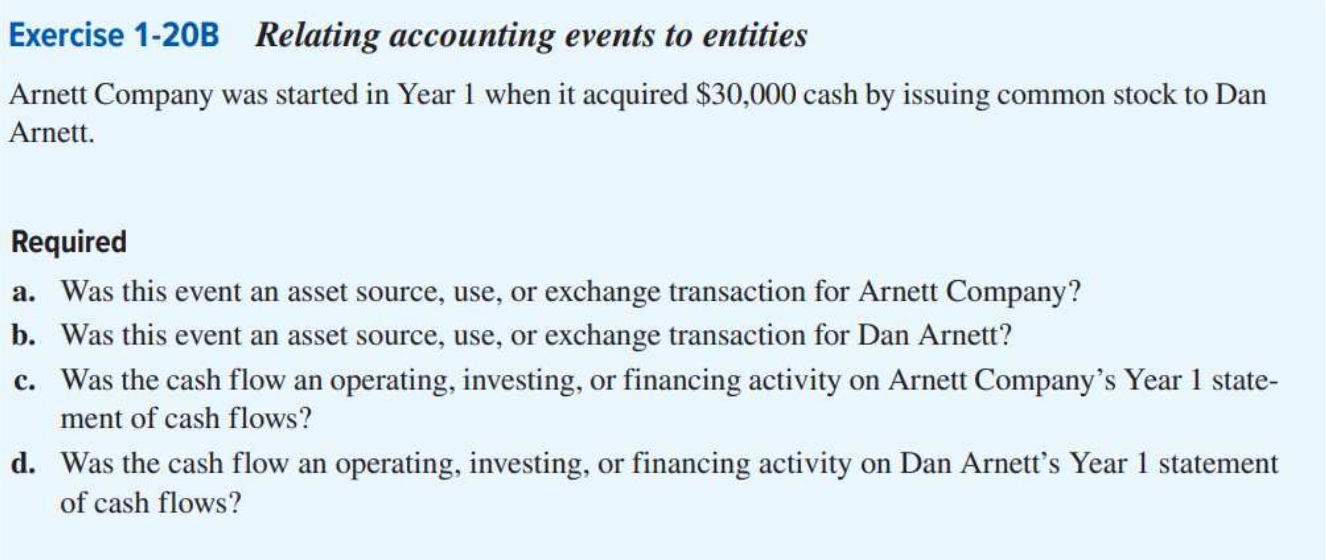
## EXERCISE 1-19B (cont.)

b.

| Tennessee Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $60,000 | |
| Cash Payment for Rent Expense | (12,000) | |
| Cash Payments for Other Operating Exp. | (22,000) | |
| Net Cash Flow from Operating Activities | | $26,000 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(15,000) | |
| Net Cash Flow from Investing Activities | | (15,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $50,000 | |
| Cash Receipts from Loan | 25,000 | |
| Cash Payments for Dividends | (5,000) | |
| Net Cash Flow from Financing Activities | | 70,000 |
| | | |
| Net Increase in Cash | | 81,000 |
| Plus: Beginning Cash Balance | | 15,000 |
| Ending Cash Balance | | $96,000 |

c. Percentage of assets provided by retained earnings:
$26,000 ÷ $121,000 = 21.5%

Cash cannot be directly traced to retained earnings. Retained earnings are used to acquire assets or pay liabilities or pay dividends.



### Exercise 1-20B *Relating accounting events to entities*

Arnett Company was started in Year 1 when it acquired $30,000 cash by issuing common stock to Dan Arnett.

**Required**

**a.** Was this event an asset source, use, or exchange transaction for Arnett Company?
**b.** Was this event an asset source, use, or exchange transaction for Dan Arnett?
**c.** Was the cash flow an operating, investing, or financing activity on Arnett Company's Year 1 statement of cash flows?
**d.** Was the cash flow an operating, investing, or financing activity on Dan Arnett's Year 1 statement of cash flows?

## EXERCISE 1-20B

| | | |
|---|---|---|
| **a.** | **Arnett Company:** | **Asset Source** |
| **b.** | **Dan Arnett:** | **Asset Exchange** |
| **c.** | **Arnett Company:** | **Financing Activity** |
| **d.** | **Dan Arnett:** | **Investing Activity** |

## Exercise 1-21B *Preparing financial statements—retained earnings emphasis*

On January 1, Year 2, the following information was drawn from the accounting records of Zeke Company: cash of $200; land of $1,800; notes payable of $600; and common stock of $1,000.

### Required

**a.** Determine the amount of retained earnings as of January 1, Year 2.

**b.** After looking at the amount of retained earnings, the chief executive officer (CEO) wants to pay a $300 cash dividend to the stockholders. Can the company pay this dividend? Why or why not?

**c.** As of January 1, Year 2, what percentage of the assets were acquired from creditors?

**d.** As of January 1, Year 2, what percentage of the assets were acquired from investors?

**e.** As of January 1, Year 2, what percentage of the assets were acquired from retained earnings?

**f.** Create an accounting equation using percentages instead of dollar amounts on the right side of the equation.

**g.** During Year 2, Zeke Company earned cash revenue of $500, paid cash expenses of $300, and paid a cash dividend of $50. Prepare an income statement, statement of changes in stockholders' equity, a balance sheet, and a statement of cash flows dated December 31, Year 2. (*Hint:* It is helpful to record these events under an accounting equation before preparing the statements.)

**h.** Comment on the terminology used to date each statement.

**i.** An appraiser determines that as of December 31, Year 2, the market value of the land is $2,000. How will this fact change the financial statements?

**j.** What is the balance in the Revenue account on January 1, Year 3?

## EXERCISE 1-21B

a.

**Zeke Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders’ Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| $200 | | $1,800 | | $600 | | $1,000 | | ? |

Retained Earnings = $200 + $1,800 - $600 - $1,000 = $400

b. The company cannot pay a $300 dividend because it only has $200 of cash. The Retained Earnings account contains zero cash. While a company may distribute dividends if it has a retained earnings balance, the company must also have the cash to enable it to pay the dividends.

c. Total Assets = $200 + $1,800 = $2,000

Creditor’s Loans ÷ Total Assets
$600 ÷ $2,000 = 30%

d. Investor’s Contributions ÷ Total Assets
$1,000 ÷ $2,000 = 50%

e. Retained Earnings ÷ Total Assets
$400 ÷ $2,000 = 20%

f.

**Zeke Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders’ Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| $200 | | $1,800 | | 30% | | $50% | | 20% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | |

## EXERCISE 1-21B (cont.)

g.

### Zeke Company
### Accounting Equation as of December 31, Year 2

| Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained | |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings | |
| 200 | + | 1,800 | = | 600 | + | 1,000 | + | 400 | |
| 500 | + | NA | = | NA | + | NA | + | 500 | Rev. |
| (300) | + | NA | = | NA | + | NA | + | (300) | Exp. |
| (50) | + | NA | = | NA | + | NA | + | (50) | Div |
| 350 | + | 1,800 | = | 600 | + | 1,000 | + | 550 | |

### Zeke Company
### Income Statement
### For the Year Ended December 31, Year 2

| | |
|---|---|
| Revenue | $500 |
| Expenses | (300) |
| Net Income | $200 |

## EXERCISE 1-21B (cont.)

g.

**Zeke Company**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Beginning Common Stock | $1,000 | |
| Plus: Common Stock Issued | -0- | |
| Ending Common Stock | | $1,000 |
| | | |
| Beginning Retained Earnings | $ 400 | |
| Plus: Net Income | 200 | |
| Less: Dividends | (50) | |
| Ending Retained Earnings | | 550 |
| | | |
| Total Stockholders' Equity | | $1,550 |

**Zeke Company**
**Balance Sheet**
**As of December 31, Year 2**

| | | |
|---|---|---|
| Assets | | |
| Cash | $ 350 | |
| Land | 1,800 | |
| Total Assets | | $2,150 |
| | | |
| Liabilities | | |
| Notes Payable | $600 | |
| Total Liabilities | | $ 600 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $1,000 | |
| Retained Earnings | 550 | |
| Total Stockholders' Equity | | 1,550 |
| | | |
| Total Liabilities and Stockholders' Equity | | $2,150 |

## EXERCISE 1-21B (cont.)

g.

**Zeke Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $500 | |
| Cash Payments for Expenses | (300) | |
| Net Cash Flow from Operating Activities | | $ 200 |
| | | |
| Cash Flows From Investing Activities: | | 0 |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Payments for Dividends | (50) | |
| Net Cash Flow from Financing Activities | | (50) |
| | | |
| Net Increase in Cash | | 150 |
| Plus: Beginning Cash Balance | | 200 |
| Ending Cash Balance | | $ 350 |

h. The income statement, statement of changes in stockholders' equity, and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology "*For the Year Ended* December 31, Year 2". In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In this case, the point in time is December 31, Year 2. Therefore, this statement uses the terminology "*As of* December 31, Year 2".

i. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company's books.

j. The balance in the revenue account is zero on January 1, Year 3, because the balance in this account is transferred to retained earnings in the December 31, Year 2 closing process.

### Exercise 1-22B *Preparing financial statements—cash flow emphasis*

As of January 1, Year 2, Shundra Inc. had a balance of $4,500 in Cash, $2,500 in Common Stock, and $2,000 in Retained Earnings. These were the only accounts with balances in the ledger on January 1, Year 2. Further analysis of the company's cash account indicated that during the Year 2 accounting period, the company had (1) net cash inflow from operating activities of $5,100, (2) net cash outflow for investing activities of $13,000, and (3) net cash inflow from financing activities of $7,600. All revenue and expense events were cash events. The following accounts and balances represent the general ledger of Shundra Inc. as of December 31, Year 2, before closing.

**SHUNDRA INC.**
**General Ledger**

| Assets | = | Liabilities | + | Stockholders' Equity | |
|---|---|---|---|---|---|
| **Cash** | | **Notes Payable** | | **Common Stock** | **Revenue** |
| Bal. 4,200 | | Bal. 3,000 | | Bal. 8,000 | Bal. 9,900 |
| **Land** | | | | **Retained Earnings** | **Expenses** |
| Bal. 13,000 | | | | Bal. 2,000 | Bal. 4,800 |
| | | | | | **Dividends** |
| | | | | | Bal. 900 |

**Required**

**a.** Assume that the net cash inflow from financing activities of $7,600 was caused by three events. Based on the information above, identify these events and determine the cash flow associated with each event.

**b.** What did the company purchase that resulted in the cash outflow from investing activities?

**c.** Prepare an income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows.

## EXERCISE 1-22B

a. Since the amount in the Notes Payable account increased from zero to $3,000, Shundra, Inc. must have received a cash inflow of $3,000 from the issue of the note payable. Similarly, since the balance in the common stock account increased from $2,500 to $8,000, Shundra, Inc. must have received a cash inflow $5,500 ($8,000 - $2,500) from the issue of common stock. Finally, the $900 dividend payment would have caused a net cash outflow. Therefore, the net cash inflow from financing activities can be explained as follows:

| Cash Flows From Financing Activities: | |
|---|---|
| Cash Receipts from Loan | $3,000 |
| Cash Receipts from Stock Issue | 5,500 |
| Cash Payments for Dividends | (900) |
| Net Cash Flow from Financing Activities | $7,600 |

b. Since the balance in the land account increases from zero to $13,000, Shundra, Inc. must have had a net cash outflow $13,000 for the purchase of Land.

c.

| Shundra, Inc.<br>Income Statement<br>For the Year Ended December 31, Year 2 | |
|---|---|
| Revenue | $9,900 |
| Expenses | (4,800) |
| Net Income | $5,100 |

## EXERCISE 1-22B (cont.)

c.

### Shundra, Inc.
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $ 2,500 | |
| Plus: Common Stock Issued | 5,500 | |
| Ending Common Stock | | $8,000 |
| | | |
| Beginning Retained Earnings | $ 2,000 | |
| Plus: Net Income | 5,100 | |
| Less: Dividends | (900) | |
| Ending Retained Earnings | | 6,200 |
| | | |
| Total Stockholders' Equity | | $14,200 |

### Shundra, Inc.
### Balance Sheet
### As of December 31, Year 2

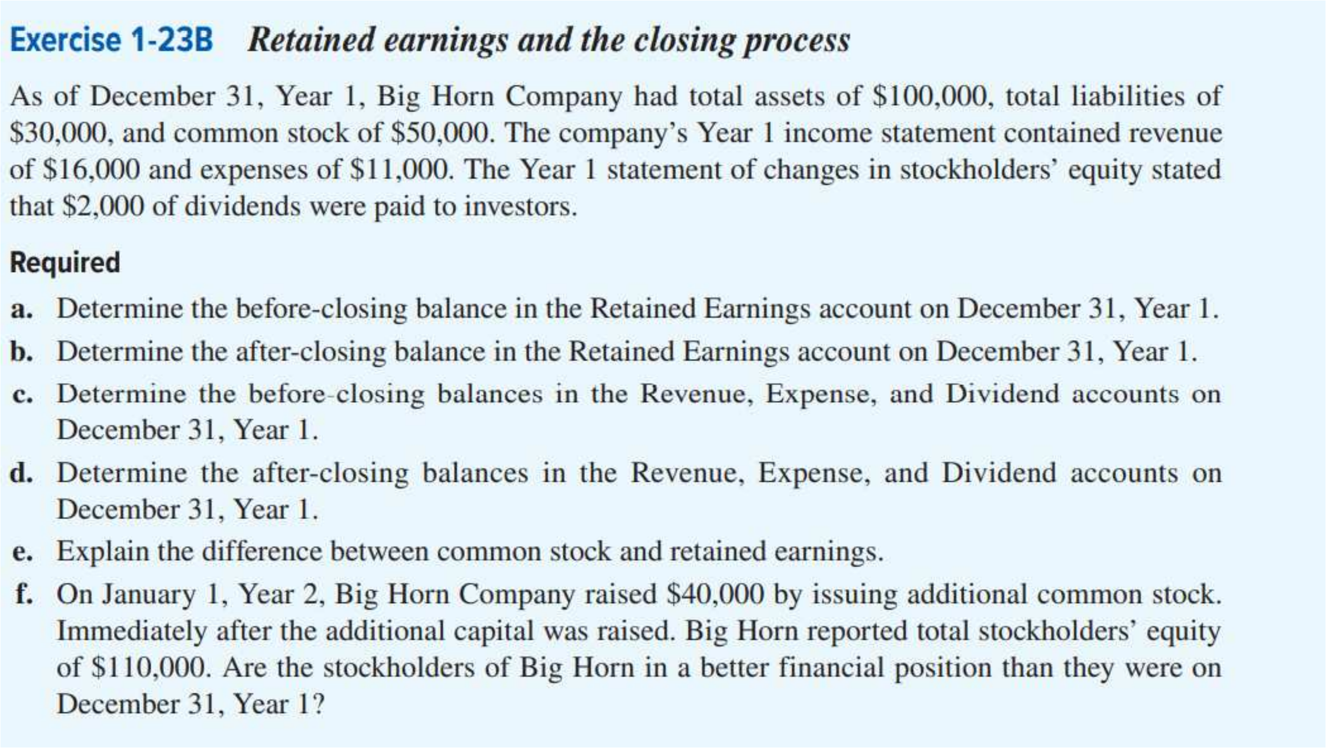
| | | |
|---|---|---|
| Assets | | |
| Cash | $ 4,200 | |
| Land | 13,000 | |
| Total Assets | | $17,200 |
| | | |
| Liabilities | | |
| Notes Payable | $3,000 | |
| Total Liabilities | | $ 3,000 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $8,000 | |
| Retained Earnings | 6,200 | |
| Total Stockholders' Equity | | 14,200 |
| | | |
| Total Liabilities and Stockholders' Equity | | $17,200 |

## EXERCISE 1-22B (cont.)

c.

### Shundra, Inc.
### Statement of Cash Flows
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $ 9,900 | |
| Cash Payments for Expenses | (4,800) | |
| **Net Cash Flow from Operating Activities** | | $ 5,100 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(13,000) | |
| **Net Cash Flow from Investing Activities** | | (13,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Loan | $ 3,000 | |
| Cash Receipts from Stock Issue | 5,500 | |
| Cash Payments for Dividends | (900) | |
| **Net Cash Flow from Financing Activities** | | 7,600 |
| | | |
| **Net Decrease in Cash** | | (300) |
| **Plus: Beginning Cash Balance** | | 4,500 |
| **Ending Cash Balance** | | $ 4,200 |



## Exercise 1-23B *Retained earnings and the closing process*

As of December 31, Year 1, Big Horn Company had total assets of $100,000, total liabilities of $30,000, and common stock of $50,000. The company's Year 1 income statement contained revenue of $16,000 and expenses of $11,000. The Year 1 statement of changes in stockholders' equity stated that $2,000 of dividends were paid to investors.

**Required**

**a.** Determine the before-closing balance in the Retained Earnings account on December 31, Year 1.

**b.** Determine the after-closing balance in the Retained Earnings account on December 31, Year 1.

**c.** Determine the before-closing balances in the Revenue, Expense, and Dividend accounts on December 31, Year 1.

**d.** Determine the after-closing balances in the Revenue, Expense, and Dividend accounts on December 31, Year 1.

**e.** Explain the difference between common stock and retained earnings.

**f.** On January 1, Year 2, Big Horn Company raised $40,000 by issuing additional common stock. Immediately after the additional capital was raised. Big Horn reported total stockholders' equity of $110,000. Are the stockholders of Big Horn in a better financial position than they were on December 31, Year 1?

## EXERCISE 1-23B

a.

**Big Horn Company**
**Accounting Equation as of December 31, Year 1**

| Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| $100,000 | | $30,000 | | $50,000 | | ? |

Retained Earnings = $100,000 - $30,000 - $50,000 = $20,000

| | |
|---|---|
| Retained Earnings after closing: | $20,000 |
| Less, Revenue | (16,000) |
| Add, Expenses | 11,000 |
| Add, Dividends | 2,000 |
| Retained Earnings before closing | $17,000 |

b. Retained Earnings after closing is $20,000 (see the equation above).

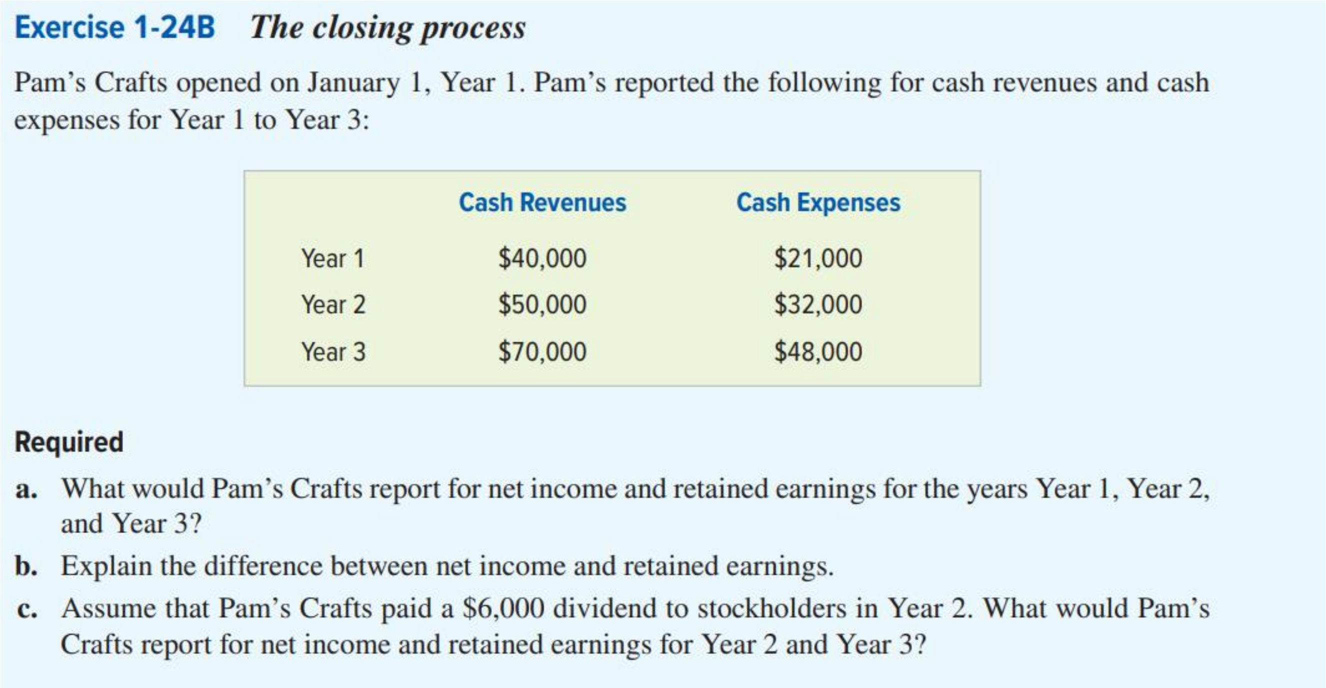
c. The balances in revenue, expense and dividends before closing are:

| | |
|---|---|
| Revenue | 16,000 |
| Expenses | 11,000 |
| Dividends | 2,000 |

d. After closing revenue, expenses, and dividends, all of the balances will be zero.

e. Both Common Stock and Retained Earnings represent obligations the business has to stockholders. The Common Stock represents the assets a business has acquired from owners. Retained earnings represent assets a business has acquired by conducting its operations.

f. The owners are no better off immediately after they contributed capital to the business. While equity increased $40,000, the amount invested by owners also increased $40,000. The owners are only in a better financial position if their equity exceeds the amount they have invested in the company. At this point, the owners have simply exchanged cash for an additional ownership interest in the business. The owners will not benefit until the business uses the assets to produce profits. Note that it is possible that the owners could be worse off if the business incurs losses. In summary, the owners share in the benefits and sacrifices that the business experiences. They do not benefit when the business raises additional equity.



**Exercise 1-24B** ***The closing process***

Pam's Crafts opened on January 1, Year 1. Pam's reported the following for cash revenues and cash expenses for Year 1 to Year 3:

| | Cash Revenues | Cash Expenses |
|---|---|---|
| Year 1 | $40,000 | $21,000 |
| Year 2 | $50,000 | $32,000 |
| Year 3 | $70,000 | $48,000 |

**Required**

**a.** What would Pam's Crafts report for net income and retained earnings for the years Year 1, Year 2, and Year 3?

**b.** Explain the difference between net income and retained earnings.

**c.** Assume that Pam's Crafts paid a $6,000 dividend to stockholders in Year 2. What would Pam's Crafts report for net income and retained earnings for Year 2 and Year 3?

## EXERCISE 1-24B

**a.**

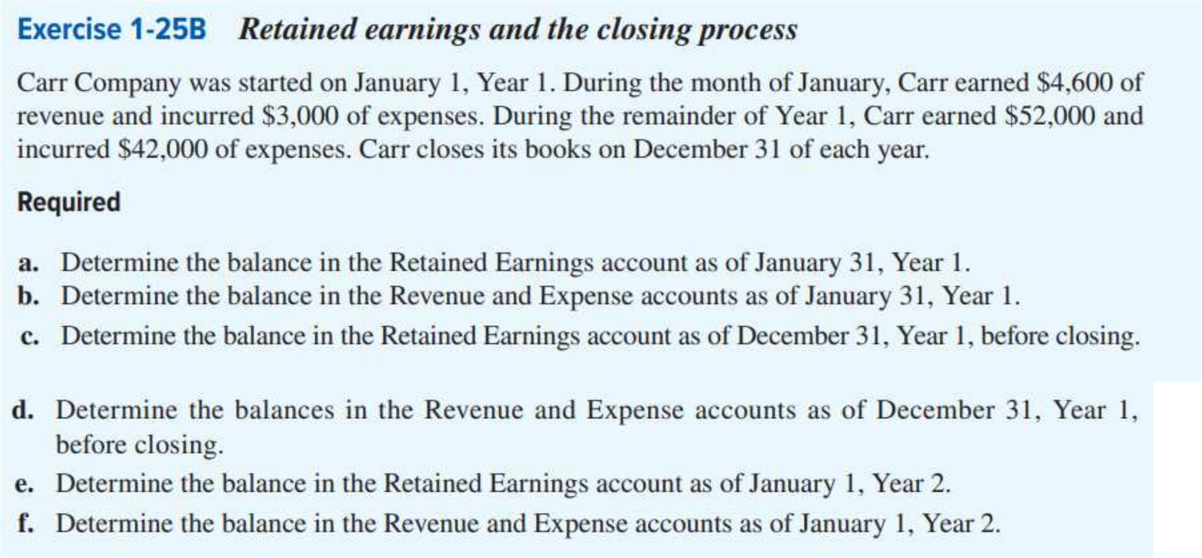
| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| Year 1 | $40,000 | $21,000 | 19,000 | 19,000 |
| Year 2 | 50,000 | 32,000 | 18,000 | 37,000 |
| Year 3 | 70,000 | 48,000 | 22,000 | 59,000 |
| | | | | |

**b. Net income is a measure of the benefits minus the sacrifices a company experiences during a single accounting period. Retained earnings is the amount of net income a company has earned minus the dividends it has paid out since its inception.**

**c.**

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| Year 1 | $40,000 | $21,000 | 19,000 | 19,000 |
| Year 2 | 50,000 | 32,000 | 18,000 | 31,000* |
| Year 3 | 70,000 | 48,000 | 22,000 | 53,000** |
| | | | | |

***$19,000 Beginning Balance + $18,000 Net Income - $6,000 Dividends**
****$31,000 Beginning Balance + $22,000 Net Income**



### Exercise 1-25B *Retained earnings and the closing process*

Carr Company was started on January 1, Year 1. During the month of January, Carr earned $4,600 of revenue and incurred $3,000 of expenses. During the remainder of Year 1, Carr earned $52,000 and incurred $42,000 of expenses. Carr closes its books on December 31 of each year.

**Required**

**a.** Determine the balance in the Retained Earnings account as of January 31, Year 1.
**b.** Determine the balance in the Revenue and Expense accounts as of January 31, Year 1.
**c.** Determine the balance in the Retained Earnings account as of December 31, Year 1, before closing.
**d.** Determine the balances in the Revenue and Expense accounts as of December 31, Year 1, before closing.
**e.** Determine the balance in the Retained Earnings account as of January 1, Year 2.
**f.** Determine the balance in the Revenue and Expense accounts as of January 1, Year 2.

## EXERCISE 1-25B

a. **The balance in the Retained Earnings account as of January 31, Year 1 is zero.**
*Explanation: The revenue is recorded in the Revenue account and is not transferred into retained earnings until the year-end closing process is accomplished.*

b. **The balance in the Revenue account as of January 31, Year 1 is $4,600. The balance in the Expense account as of January 31, Year 1 is $3,000.**
*Explanation: The amounts in the revenue and expense accounts are not transferred to the Retained Earnings account until the year-end closing process is accomplished.*

c. **The *before closing* balance in the Retained Earnings account as of December 31, Year 1 is zero.**
*Explanation: The revenue and expenses are recorded in the Revenue and Expense accounts throughout the year and the balances in these accounts are not transferred into retained earnings until the year-end closing process is accomplished.*

d. **The December 31, Year 1 *before closing* balance in the Revenue account is $56,600 ($4,600 + $52,000). The December 31, Year 1 *before closing* balance in the Expense account is $45,000 ($3,000 + $42,000).**
*Explanation: The revenue and expense amounts accumulate in the Revenue and Expense accounts throughout the year.*

e. **The January 1, Year 2 balance in the Retained Earnings account is $11,600.**
*Explanation: The December 31, Year 1 year-end closing process transfers the $56,600 balance in the Revenue account and $45,000 Expense account into the Retained Earnings account. Since revenue increases retained earnings and expenses decrease retained earnings, the December 31, Year 1 retained earnings account balance* **after closing** *is $11,600 ($56,600 - $45,000). Since last year's ending balances become next year's beginning balances, the balance in the Retained Earnings account as of January 1, Year 2 is $11,600.*

f. **The January 1, Year 2 balance in the Revenue and Expense accounts is zero.**
*Explanation: The balances in the revenue and expense accounts* **after closing** *are zero because the balances accumulated during the year were transferred to the retained earnings account during the closing process. The January 1, Year 2 balances in the revenue and expense accounts are zero.*

**LO 1-4, 1-6, 1-10**

### Exercise 1-26B *Types of transactions and the horizontal statements model*

Pet Partners experienced the following events during its first year of operations, Year 1:

1. Acquired cash by issuing common stock.
2. Borrowed cash from a bank.
3. Signed a contract to provide services in the future.
4. Purchased land with cash.
5. Paid cash for operating expenses.
6. Paid a cash dividend to the stockholders.
7. Determined that the market value of the land is higher than the historical cost.

**Required**

a. Indicate whether each event is an asset source, use, or exchange transaction.

b. Use a horizontal statements model to show how each event affects the balance sheet, income statement, and statement of cash flows. Indicate whether the event increases (I), decreases (D), or does not affect (NA) each element of the financial statements. Also, in the Statement of Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first transaction is shown as an example.

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab | + | Stk. Equity | | | | | | | | | |
| Event No. | Cash | + | Land | = | N. Pay. | + | C. Stk. | + | Ret. Ear. | Rev. | − | Exp. | = | Net Inc. | | |
| 1 | I | + | NA | = | NA | + | I | + | NA | NA | − | NA | = | NA | I | FA |

## EXERCISE 1-26B

a.

| Event | |
|---|---|
| 1. | Asset Source |
| 2. | Asset Source |
| 3. | NA |
| 4. | Asset Exchange |
| 5. | Asset Use |
| 6. | Asset Use |
| 7. | NA |

b.

**Pet Partners**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | − | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | I | + | NA | = | NA | + | I | + | NA | NA | − | NA | = | NA | I FA |
| 2 | I | + | NA | = | I | + | NA | + | NA | NA | − | NA | = | NA | I FA |
| 3 | NA | + | NA | = | NA | + | NA | + | NA | NA | − | NA | = | NA | NA |
| 4 | D | + | I | = | NA | + | NA | + | NA | NA | − | NA | = | NA | D IA |
| 5 | D | + | NA | = | NA | + | NA | + | D | NA | − | I | = | D | D OA |
| 6 | D | + | NA | = | NA | + | NA | + | D | NA | − | NA | = | NA | D FA |
| 7 | NA | + | NA | = | NA | + | NA | + | NA | NA | − | NA | = | NA | NA |

### **Exercise 1-27B** *International Financial Reporting Standards*

Corrugated Boxes Inc. is a U.S.-based company that develops its financial statements under GAAP. The total amount of the company's assets shown on its balance sheet for the current year was approximately $305 million. The president of Corrugated is considering the possibility of relocating the company to a country that practices accounting under IFRS. The president has hired an international accounting firm to determine what the company's statements would look like if they were prepared under IFRS. One striking difference is that under IFRS the assets shown on the balance sheet would be valued at approximately $345 million.

**Required**

**a.** Would Corrugated Boxes' assets really be worth $40 million more if it moves its headquarters?

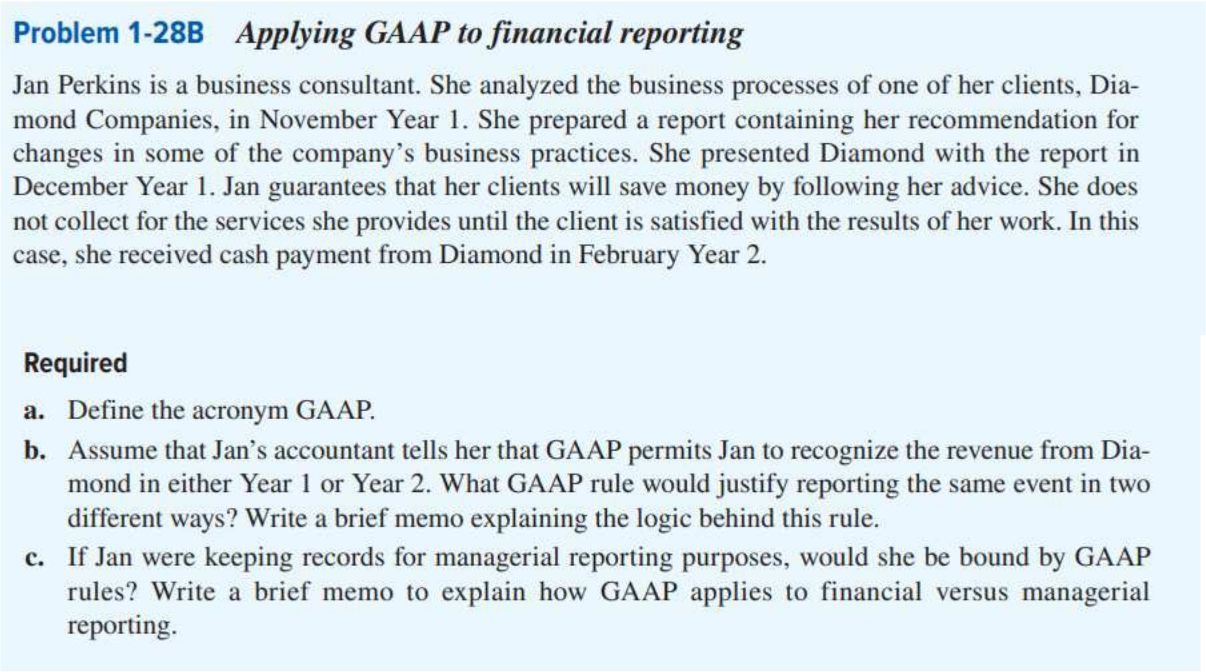
**b.** Discuss the underlying conceptual differences between U.S. GAAP and IFRS that cause the difference in the reported asset values.

## EXERCISE 1-27B

a. Historically, each country developed its own unique set of GAAP. However, this causes global companies to prepare multiple sets of financial statements in order to satisfy each country's GAAP. To address the need for a common set of financial statements, the International Accounting Standards Committee was formed in 1973. In 2001, the committee was reorganized into the International Accounting Standards Board (IASB). This Board issues International Financial Reporting Standards (IFRS), which are gaining support worldwide. While at this time, there is no requirement to use IFRS in the United States, there is a movement in that direction.

b. Similarities between the IASC and FASB include members from a variety of backgrounds, members generally work full-time for their respective boards, members cannot be compensated by other organizations, members generally serve a five-year term, funding is obtained from a variety of sources and in order to maintain independence, each has set of trustees to oversee fundraising. Some differences include the number of members on the board. The FASB has seven members while the IASC has sixteen members. In addition, the IASC must have a specific number of members from certain geographical regions. In addition, some of the principles differ significantly.

Differences are not limited to structure. One good example of difference in reporting requirements is the use of the historical cost concept for GAAP and the use of current values for IFRS. This can cause significant differences in the monetary amount of assets listed on the balance sheet.



**Problem 1-28B** ***Applying GAAP to financial reporting***

Jan Perkins is a business consultant. She analyzed the business processes of one of her clients, Diamond Companies, in November Year 1. She prepared a report containing her recommendation for changes in some of the company's business practices. She presented Diamond with the report in December Year 1. Jan guarantees that her clients will save money by following her advice. She does not collect for the services she provides until the client is satisfied with the results of her work. In this case, she received cash payment from Diamond in February Year 2.

**Required**

**a.** Define the acronym GAAP.

**b.** Assume that Jan's accountant tells her that GAAP permits Jan to recognize the revenue from Diamond in either Year 1 or Year 2. What GAAP rule would justify reporting the same event in two different ways? Write a brief memo explaining the logic behind this rule.

**c.** If Jan were keeping records for managerial reporting purposes, would she be bound by GAAP rules? Write a brief memo to explain how GAAP applies to financial versus managerial reporting.

## PROBLEM 1-28B

**a. GAAP Generally Accepted Accounting Principles**

**b. Revenue may be recognized in either of the years depending on the entity's determination of the point in time for revenue recognition. For example, if Jan's earning process is deemed complete when she delivers her report then she would recognize revenue in December Year 1. But if Jan's earning process is deemed complete upon client satisfaction, then she would recognize revenue in February Year 2.**

**c. Management accounting reporting is not bound by GAAP. GAAP is required for external reporting. It helps insure consistent reporting from period to period as well as from company to company. Some differences will exist, but the methods used should be disclosed. Internal reporting is more concerned with supplying managers with the information they need to make the best decisions.**

### Problem 1-29B *Accounting entities*

The following business scenarios are independent from one another:

1. Chris Hann purchased an automobile from Classic Auto Sales for $10,000.
2. Sal Pearl loaned $15,000 to the business in which he is a stockholder.
3. First State Bank paid interest to Strong Co. on a certificate of deposit that Strong Co. has invested at First State Bank.
4. Cindy's Restaurant paid the current utility bill of $135 to Midwest Utilities.
5. Sun Corp. borrowed $50,000 from City National Bank and used the funds to purchase land from Carriage Realty.
6. Sue Wang purchased $10,000 of common stock of International Sales Corporation from the corporation.
7. Chris Gordon loaned $6,000 cash to his daughter.
8. Motor Service Co. earned $20,000 in cash revenue.
9. Poy Imports paid $4,000 for salaries to each of its four employees.
10. Borg Inc. paid a cash dividend of $4,000 to its sole shareholder, Mark Borg.

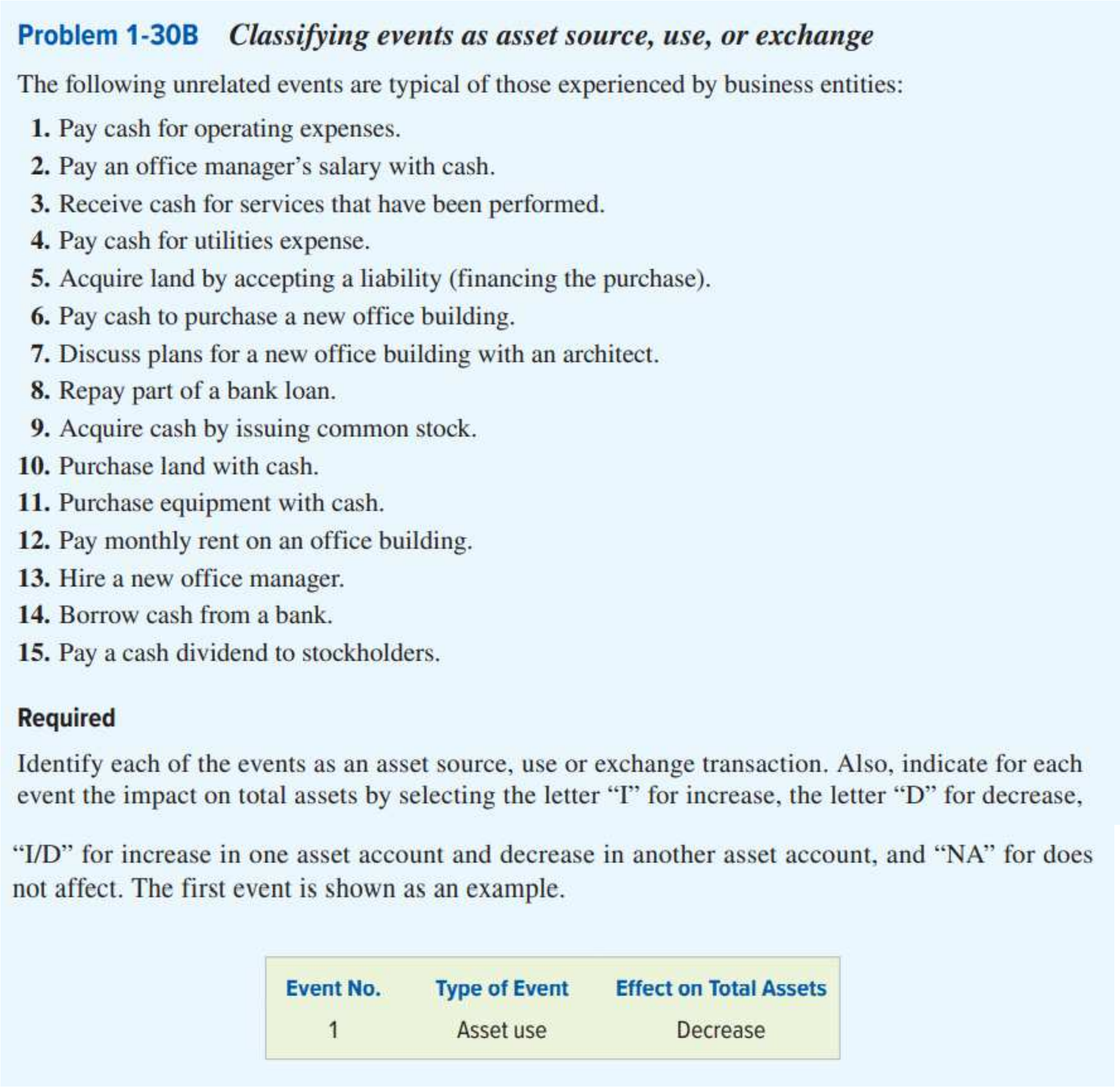
**Required**

**a.** For each scenario, create a list of all the entities mentioned in the description.

**b.** Describe what happens to the cash account of each entity you identified in Requirement *a*.

## PROBLEM 1-29B

| a. | Entities mentioned: | b. Effect on the cash account: |
|---|---|---|
| 1. | Chris Hann | Decrease |
| | Classic Auto Sales | Increase |
| | | |
| 2. | Sal Pearl | Decrease |
| | Business | Increase |
| | | |
| 3. | First State Bank | Decrease |
| | Strong Co. | Increase |
| | | |
| 4. | Cindy's Restaurant | Decrease |
| | Midwest Utilities | Increase |
| | | |
| 5. | Sun Corp. | Increase/Decrease |
| | City National Bank | Decrease |
| | Carriage Realty | Increase |
| | | |
| 6. | Sue Wang | Decrease |
| | International Sales Corporation | Increase |
| | | |
| 7. | Chris Gordon | Decrease |
| | Daughter | Increase |
| | | |
| 8. | Motor Service Co. | Increase |
| | Customers | Decrease |
| | | |
| 9. | Poy Imports | Decrease |
| | Employees | Increase |
| | | |
| 10. | Borg Inc. | Decrease |
| | Mark Borg | Increase |



### **Problem 1-30B** *Classifying events as asset source, use, or exchange*

The following unrelated events are typical of those experienced by business entities:

1. Pay cash for operating expenses.
2. Pay an office manager's salary with cash.
3. Receive cash for services that have been performed.
4. Pay cash for utilities expense.
5. Acquire land by accepting a liability (financing the purchase).
6. Pay cash to purchase a new office building.
7. Discuss plans for a new office building with an architect.
8. Repay part of a bank loan.
9. Acquire cash by issuing common stock.
10. Purchase land with cash.
11. Purchase equipment with cash.
12. Pay monthly rent on an office building.
13. Hire a new office manager.
14. Borrow cash from a bank.
15. Pay a cash dividend to stockholders.

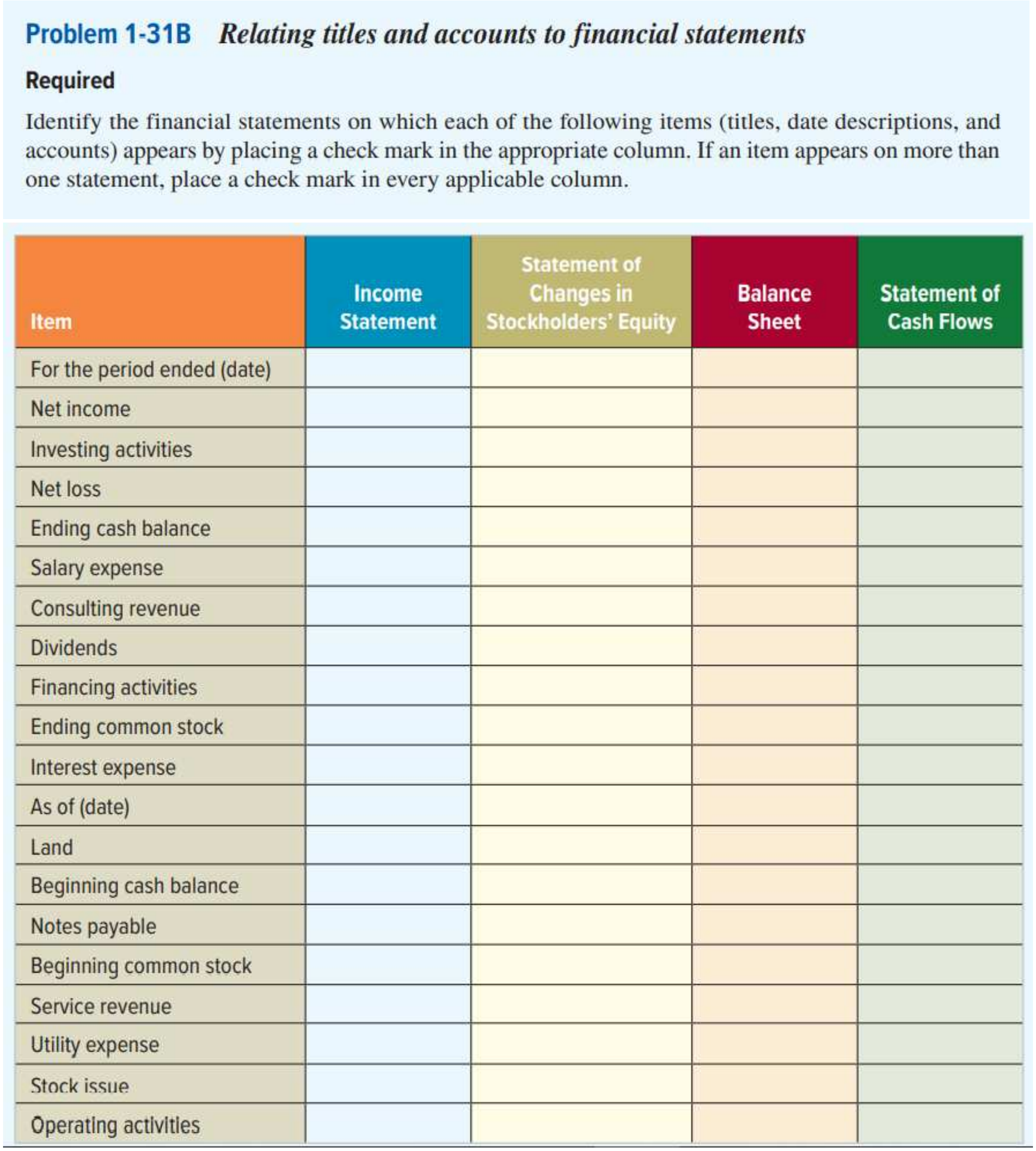
**Required**

Identify each of the events as an asset source, use or exchange transaction. Also, indicate for each event the impact on total assets by selecting the letter "I" for increase, the letter "D" for decrease, "I/D" for increase in one asset account and decrease in another asset account, and "NA" for does not affect. The first event is shown as an example.

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1 | Asset use | Decrease |

## PROBLEM 1-30B

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1. | Asset Use | Decrease |
| 2. | Asset Use | Decrease |
| 3. | Asset Source | Increase |
| 4. | Asset Use | Decrease |
| 5. | Asset Source | Increase |
| 6. | Asset Exchange | Increase/Decrease |
| 7. | NA | NA |
| 8. | Asset Use | Decrease |
| 9. | Asset Source | Increase |
| 10. | Asset Exchange | Increase/Decrease |
| 11. | Asset Exchange | Increase/Decrease |
| 12. | Asset Use | Decrease |
| 13. | NA | NA |
| 14. | Asset Source | Increase |
| 15. | Asset Use | Decrease |
| | | |



## **Problem 1-31B** *Relating titles and accounts to financial statements*

**Required**

Identify the financial statements on which each of the following items (titles, date descriptions, and accounts) appears by placing a check mark in the appropriate column. If an item appears on more than one statement, place a check mark in every applicable column.

| Item | Income Statement | Statement of Changes in Stockholders' Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| For the period ended (date) | | | | |
| Net income | | | | |
| Investing activities | | | | |
| Net loss | | | | |
| Ending cash balance | | | | |
| Salary expense | | | | |
| Consulting revenue | | | | |
| Dividends | | | | |
| Financing activities | | | | |
| Ending common stock | | | | |
| Interest expense | | | | |
| As of (date) | | | | |
| Land | | | | |
| Beginning cash balance | | | | |
| Notes payable | | | | |
| Beginning common stock | | | | |
| Service revenue | | | | |
| Utility expense | | | | |
| Stock issue | | | | |
| Operating activities | | | | |

## PROBLEM 1-31B

| Item | Income Statement | Statement of Changes in Stk. Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| For the Period Ended (date) | ✓ | ✓ | | ✓ |
| Net income | ✓ | ✓ | | |
| Investing activities | | | | ✓ |
| Net loss | ✓ | ✓ | | |
| Ending cash balance | | | ✓ | ✓ |
| Salary expense | ✓ | | | |
| Consulting revenue | ✓ | | | |
| Dividends | | ✓ | | ✓ |
| Financing activities | | | | ✓ |
| Ending common stock | | ✓ | ✓ | |
| Interest expense | ✓ | | | |
| As of (date) | | | ✓ | |
| Land | | | ✓ | |
| Beginning cash balance | | | | ✓ |
| Notes payable | | | ✓ | |
| Beginning common stock | | ✓ | | |
| Service revenue | ✓ | | | |
| Utility expense | ✓ | | | |
| Stock issue | | ✓ | | ✓ |
| Operating activities | | | | ✓ |

## Problem 1-32B *Preparing financial statements for two complete accounting cycles*

Marco's Consulting experienced the following transactions for Year 1, its first year of operations, and Year 2. *Assume that all transactions involve the receipt or payment of cash.*

### Transactions for Year 1

1. Acquired $50,000 by issuing common stock.
2. Received $100,000 cash for providing services to customers.
3. Borrowed $15,000 cash from creditors.
4. Paid expenses amounting to $60,000.
5. Purchased land for $40,000 cash.

### Transactions for Year 2

Beginning account balances for Year 2 are:

| | |
|---|---|
| Cash | $65,000 |
| Land | 40,000 |
| Notes payable | 15,000 |
| Common stock | 50,000 |
| Retained earnings | 40,000 |

1. Acquired an additional $20,000 from the issue of common stock.
2. Received $130,000 for providing services.
3. Paid $10,000 to creditors to reduce loan.
4. Paid expenses amounting to $75,000.
5. Paid a $15,000 dividend to the stockholders.
6. Determined that the market value of the land is $50,000.

### Required

a. Write an accounting equation, and record the effects of each accounting event under the appropriate headings for each year. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide appropriate titles for these accounts in the last column of the table.

b. Prepare an income statement, statement of changes in stockholders' equity, year-end balance sheet, and statement of cash flows for each year.

c. Determine the amount of cash that is in the Retained Earnings account at the end of Year 1 and Year 2.

d. Examine the balance sheets for the two years. How did assets change from Year 1 to Year 2?

e. Determine the balance in the Retained Earnings account immediately after Event 2 in Year 1 and in Year 2 are recorded.

## PROBLEM 1-32B

a.

**Marco’s Consulting**
**Accounting Equation for Year 1**

| | Assets | | | = | Liabilities | + | Stockholders’ Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| 1. Issued stk | 50,000 | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2. Revenue | 100,000 | + | NA | = | NA | + | NA | + | 100,000 | Svc. Rev. |
| 3. Loan | 15,000 | + | NA | = | 15,000 | + | NA | + | NA | NA |
| 4. Paid Exp. | (60,000) | + | NA | = | NA | + | NA | + | (60,000) | Expense |
| 5. Pur. Land | (40,000) | + | 40,000 | = | NA | + | NA | + | NA | NA |
| **Totals** | 65,000 | + | 40,000 | = | 15,000 | + | 50,000 | + | 40,000 | |

**Marco’s Consulting**
**Accounting Equation for Year 2**

| | Assets | | | = | Liabilities | + | Stockholders’ Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | 65,000 | + | 40,000 | = | 15,000 | + | 50,000 | + | 40,000 | |
| 1. Issued stk | 20,000 | + | NA | = | NA | + | 20,000 | + | NA | NA |
| 2. Revenue | 130,000 | + | NA | = | NA | + | NA | + | 130,000 | Svc. Rev. |
| 3. Paid Loan | (10,000) | + | NA | = | (10,000) | + | NA | + | NA | NA |
| 4. Paid Exp. | (75,000) | + | NA | = | NA | + | NA | + | (75,000) | Expense |
| 5. Paid Div. | (15,000) | + | NA | = | NA | + | NA | + | (15,000) | Dividends |
| 6. Land Val. | NA | + | NA | = | NA | + | NA | + | NA | NA |
| **Totals** | 115,000 | + | 40,000 | = | 5,000 | + | 70,000 | + | 80,000 | |

## PROBLEM 1-32B (cont.)

b.

### Marco's Consulting
### Income Statement
### For the Period Ended December 31, Year 1

| | |
|---|---|
| Service Revenue | $100,000 |
| Expenses | (60,000) |
| Net Income | $40,000 |

### Marco's Consulting
### Statement of Changes in Stockholders' Equity
### For the Period Ended December 31, Year 1

| | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 50,000 | |
| Ending Common Stock | | $50,000 |
| Beginning Retained Earnings | $ -0- | |
| Plus: Net Income | 40,000 | |
| Ending Retained Earnings | | 40,000 |
| Total Stockholders' Equity | | $90,000 |

b.

### Marco's Consulting
### Balance Sheet
### As of December 31, Year 1

| | | |
|---|---|---|
| **Assets** | | |
| Cash | $65,000 | |
| Land | 40,000 | |
| **Total Assets** | | $105,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | | $ 15,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $50,000 | |
| Retained Earnings | 40,000 | |
| **Total Stockholders' Equity** | | 90,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $105,000 |

b.

### Marco’s Consulting
### Statement of Cash Flows
### For the Year Ended December 31, Year 1

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $100,000 | |
| Cash Payments for Expenses | (60,000) | |
| Net Cash Flow from Operating Activities | | $40,000 |
| | | |
| Cash Flows From Investing Activities: | | |
| Cash Payment for Land | $(40,000) | |
| Net Cash Flow from Investing Activities | | (40,000) |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Borrowing | $15,000 | |
| Cash Receipts from Stock Issue | 50,000 | |
| Net Cash Flow from Financing Activities | | 65,000 |
| | | |
| Net Increase in Cash | | 65,000 |
| Plus: Beginning Cash Balance | | -0- |
| Ending Cash Balance | | $65,000 |

## PROBLEM 1-32B (cont.)

b.

### Marco's Consulting
### Income Statement
### For the Period Ended December 31, Year 2

| | |
|---|---|
| Service Revenue | $130,000 |
| Expenses | (75,000) |
| Net Income | $55,000 |

### Marco's Consulting
### Statement of Changes in Stockholders' Equity
### For the Period Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $50,000 | |
| Plus: Common Stock Issued | 20,000 | |
| Ending Common Stock | | $ 70,000 |
| | | |
| Beginning Retained Earnings | $40,000 | |
| Plus: Net Income | 55,000 | |
| Less: Dividends | (15,000) | |
| Ending Retained Earnings | | 80,000 |
| | | |
| Total Stockholders' Equity | | $150,000 |

**PROBLEM 1-32B (cont.)**

b.

**Marco’s Consulting**
**Balance Sheet**
**As of December 31, Year 2**

| | | |
|---|---|---|
| **Assets** | | |
| Cash | $115,000 | |
| Land | 40,000 | |
| **Total Assets** | | $155,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | | $ 5,000 |
| | | |
| **Stockholders’ Equity** | | |
| Common Stock | $70,000 | |
| Retained Earnings | 80,000 | |
| **Total Stockholders’ Equity** | | 150,000 |
| | | |
| **Total Liabilities and Stockholders’ Equity** | | $155,000 |

b.

| Marco's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $130,000 | |
| Cash Payments for Expenses | (75,000) | |
| **Net Cash Flow from Operating Activities** | | $55,000 |
| | | |
| **Cash Flows From Investing Activities** | | -0- |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $20,000 | |
| Cash Payment on Debt | (10,000) | |
| Cash Payment for Dividends | (15,000) | |
| **Net Cash Flow from Financing Activities** | | (5,000) |
| | | |
| Net Increase in Cash | | 50,000 |
| Plus: Beginning Cash Balance | | 65,000 |
| Ending Cash Balance | | $115,000 |

c. Retained Earnings does not contain cash.

d. Assets increased from $105,000 at December 31, Year 1 to $155,000 at December 31, Year 2. This increase of $50,000 is solely due to the increase in cash.

e. Immediately after Event 2 in Year 1 is recorded the balance in the Retained Earnings account is zero. The revenue is recorded in a Revenue account, not in the Retained Earnings account. The revenue, expense, and dividend accounts are closed to the Retained Earnings account at the end of each accounting period. After closing the accounts at the end of Year 1 the Retained Earnings account will have a balance of $40,000 ($100,000 revenue - $60,000 expenses).

**PROBLEM 1-32B (cont.)**

**e. The Year 1 ending balance in Retained Earnings becomes next year's beginning balance. Thus, the balance in the Retained Earnings account on January 1, Year 2 is $40,000. This balance will not change until the closing process is completed in December Year 2. As a result, the balance in the Retained Earnings account immediately after Event 2 in Year 2 is $40,000.**

## **Problem 1-33B** *Interrelationships among financial statements*

Blix Corp. started the Year 2 accounting period with total assets of $50,000 cash, $20,000 of liabilities, and $20,000 of retained earnings. During the Year 2 accounting period, the Retained Earnings account increased by $8,500. The bookkeeper reported that Blix Corp. paid cash expenses of $15,000 and paid a $4,000 cash dividend to stockholders, but she could not find a record of the amount of cash revenue that Blix Corp. received for performing services. Blix Corp. also paid $2,000 cash to reduce the liability owed to a bank, and the business acquired $8,000 of additional cash from the issue of common stock. Assume all transactions are cash transactions.

### Required

**a.** Prepare the Year 2 income statement.
**b.** Prepare the Year 2 statement of changes in stockholders' equity.
**c.** Prepare the Year 2 balance sheet.
**d.** Prepare the Year 2 statement of cash flows.
**e.** Determine the percentage of total assets that were provided by creditors, investors, and earnings.
**f.** If the company were liquidated on December 31, Year 2, how much cash would be distributed to the creditors? How much cash would be distributed to the owners?

## PROBLEM 1-33B

a.

| Blix Corp.<br>Income Statement<br>For the Year Ended December 31, Year 2 | |
|---|---|
| Revenue | $27,500[1] |
| Expense | (15,000) |
| Net Income | $12,500 |

[1] To calculate revenue, you must first determine the ending balance in the retained earnings account at the end of Year 2:

| | |
|---|---|
| Beginning Retained Earnings | $ 20,000 |
| Plus increase in Retained Earnings | 8,500 |
| Ending Retained earnings | $28,500 |

Next, you can use this information to determine the amount of net income:

| | |
|---|---|
| Beginning Retained Earnings | $ 20,000 |
| Plus Net Income | "X" |
| Minus Dividends | (4,000) |
| Ending Retained earnings | $28,500 |

X = $28,500 - $20,000 + $4,000; X = $12,500

Finally, using the amount of net income, you can derive revenue:

| | |
|---|---|
| Revenue | $ "X" |
| Expenses | (15,000) |
| Net Income | $12,500 |

X = $12,500 + $15,000; X = $27,500

## PROBLEM 1-33B (cont.)

b.

### Blix Corp.
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | $10,000[2] | |
| Plus: Common Stock Issued | 8,000 | |
| Ending Common Stock | | $18,000 |
| | | |
| Beginning Retained Earnings | $20,000 | |
| Plus: Net Income | 12,500 | |
| Less: Dividends | (4,000) | |
| Ending Retained Earnings | | 28,500 |
| | | |
| Total Stockholders' Equity | | $46,500 |

[2] To calculate the amount of common stock issued; rearrange the accounting equation and solve for the missing variable common stock as follows:

Assets – Liabilities – Retained Earnings = Common Stock:
$50,000 – $20,000 – $20,000 = *$10,000*

## EXERCISE 1-33B (cont.)

c.

### Blix Corp.
### Balance Sheet
### As of December 31, Year 2

| | | |
|---|---|---|
| Assets | | $64,500[3] |
| Liabilities | | $18,000[4] |
| Stockholders' Equity | | |
| Common Stock | $18,000 | |
| Retained Earnings | 28,500 | |
| Total Stockholders' Equity | | 46,500 |
| Total Liabilities and Stockholders' Equity | | $64,500 |

[3] Based on the accounting equation total assets are equal to total liabilities ($18,000) plus stockholders' equity ($46,500).

[4] Total liabilities is calculated as follows:

Total Liabilities = $20,000 Beg. Bal. - $2,000 Partial Payoff = $18,000 ending balance.

## PROBLEM 1-33B (cont.)

d.

### Blix Corp.
### Statement of Cash Flows
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipt from Revenue | $27,500 | |
| Cash Payment for Expense | (15,000) | |
| **Net Cash Flow from Operating Activities** | | $12,500 |
| | | |
| **Cash Flows From Investing Activities** | | -0- |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $ 8,000 | |
| Cash Payment to Creditors | (2,000) | |
| Cash Dividend Paid to Stockholders | (4,000) | |
| **Net Cash Flow from Financing Activities** | | $2,000 |
| | | |
| Net Increase in Cash | | 14,500 |
| Plus: Beginning Cash Balance | | 50,000 |
| Ending Cash Balance | | $64,500 |

e. Percentage of assets provided by:

| | | |
|---|---|---|
| Creditors | $18,000 ÷ $64,500 | = 27.90% |
| Investors | $18,000 ÷ $64,500 | = 27.90% |
| Earnings | $28,500 ÷ $64,500 | = 44.18% |

f. Blix Corp. has $64,500 worth of assets to distribute in the event of liquidation at the end of Year 2. During liquidation, creditors have first rights to the assets and any remaining assets are distributed to owners. Therefore, creditors would receive $18,000 and the remaining $46,500 would be distributed to owners.

## **Problem 1-34B** *Show how the events affect the horizontal statements model*

Daley Company was started on January 1, Year 1, and experienced the following events during its first year of operation:

1. Acquired $52,000 cash from the issue of common stock.
2. Borrowed $20,000 cash from National Bank.
3. Earned cash revenues of $42,000 for performing services.
4. Paid cash expenses of $23,000.
5. Paid a $6,000 cash dividend to the stockholders.
6. Acquired an additional $10,000 cash from the issue of common stock.
7. Paid $10,000 cash to reduce the principal balance of the bank note.
8. Paid $45,000 cash to purchase land.
9. Determined that the market value of the land is $55,000.

### Required

**a.** Use a horizontal statements model to show how each event affects the balance sheet, income statement, and statement of cash flows. Also, in the Statement of Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first event is shown as an example.

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab | + | Stk. Equity | | | | | | | | |
| Event No. | Cash | + | Land | = | N. Pay. | + | C. Stk. | + | Ret. Ear. | Rev. | − | Exp. | = | Net Inc. | |
| 1 | 52,000 | + | NA | = | NA | + | 52,000 | + | NA | NA | − | NA | = | NA | 52,000 FA |

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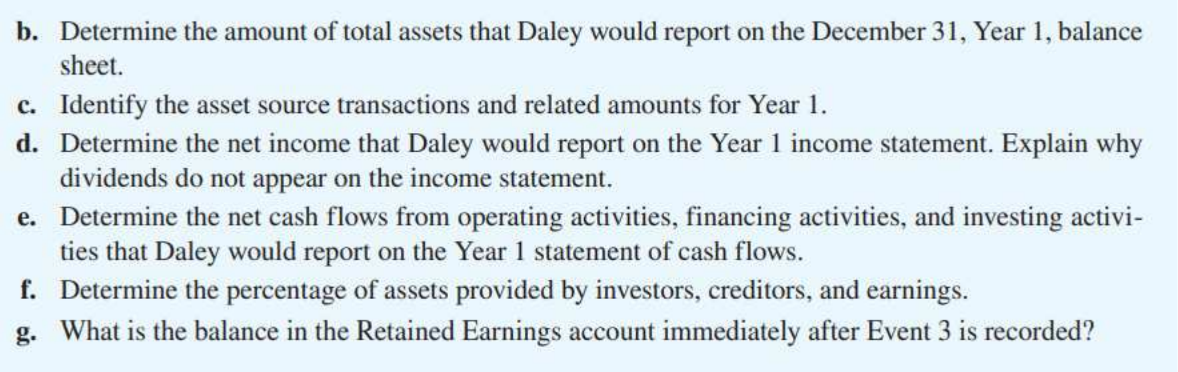


**b.** Determine the amount of total assets that Daley would report on the December 31, Year 1, balance sheet.

**c.** Identify the asset source transactions and related amounts for Year 1.

**d.** Determine the net income that Daley would report on the Year 1 income statement. Explain why dividends do not appear on the income statement.

**e.** Determine the net cash flows from operating activities, financing activities, and investing activities that Daley would report on the Year 1 statement of cash flows.

**f.** Determine the percentage of assets provided by investors, creditors, and earnings.

**g.** What is the balance in the Retained Earnings account immediately after Event 3 is recorded?

## PROBLEM 1-34B

a.

### Daley Company
### Horizontal Statements Model for Year 1

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | – | Expense | = | Net Inc. | Cash Flows |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | 52,000 | + | NA | = | NA | + | 52,000 | + | NA | NA | – | NA | = | NA | 52,000 FA |
| 2 | 20,000 | + | NA | = | 20,000 | + | NA | + | NA | NA | – | NA | = | NA | 20,000 FA |
| 3 | 42,000 | + | NA | = | NA | + | NA | + | 42,000 | 42,000 | – | NA | = | 42,000 | 42,000 OA |
| 4 | (23,000) | + | NA | = | NA | + | NA | + | (23,000) | NA | – | 23,000 | = | (23,000) | (23,000) OA |
| 5 | (6,000) | + | NA | = | NA | + | NA | + | (6,000) | NA | – | NA | = | NA | (6,000) FA |
| 6 | 10,000 | + | NA | = | NA | + | 10,000 | + | NA | NA | – | NA | = | NA | 10,000 FA |
| 7 | (10,000) | + | NA | = | (10,000) | + | NA | + | NA | NA | – | NA | = | NA | (10,000) FA |
| 8 | (45,000) | + | 45,000 | = | NA | + | NA | + | NA | NA | – | NA | = | NA | (45,000) IA |
| 9 | NA | + | NA | = | NA | + | NA | + | NA | NA | – | NA | = | NA | NA |
| Total | 40,000 | + | 45,000 | = | 10,000 | + | 62,000 | + | 13,000 | 42,000 | – | 23,000 | = | 19,000 | 40,000 NC |

## PROBLEM 1-34B (cont.)

b. Total Assets = $40,000 + $45,000 = $85,000

c.

| Sources of Assets | |
|---|---|
| Event | |
| 1. Issue of stock | $ 52,000 |
| 2. Cash from loan | 20,000 |
| 3. Cash from revenue | 42,000 |
| 6. Issue of stock | 10,000 |
| Total Sources of Assets | $124,000 |

d. Net income is $19,000 (see part a.) Dividends are not expenses so they do not appear on the income statement.

e.

| Operating Activities: | |
|---|---|
| Cash from customers | $42,000 |
| Cash paid for expenses | (23,000) |
| Net Cash Flow from Operating Activities | $19,000 |

| Investing Activities: | |
|---|---|
| Cash paid to purchase land | $(45,000) |
| Net Cash Flow from Investing Activities | $(45,000) |

| Financing Activities: | |
|---|---|
| Cash from stock issues ($52,000 + $10,000) | $62,000 |
| Cash from loan | 20,000 |
| Paid cash dividend | (6,000) |
| Cash paid on loan principal | (10,000) |
| Net Cash Flow from Financing Activities | $66,000 |

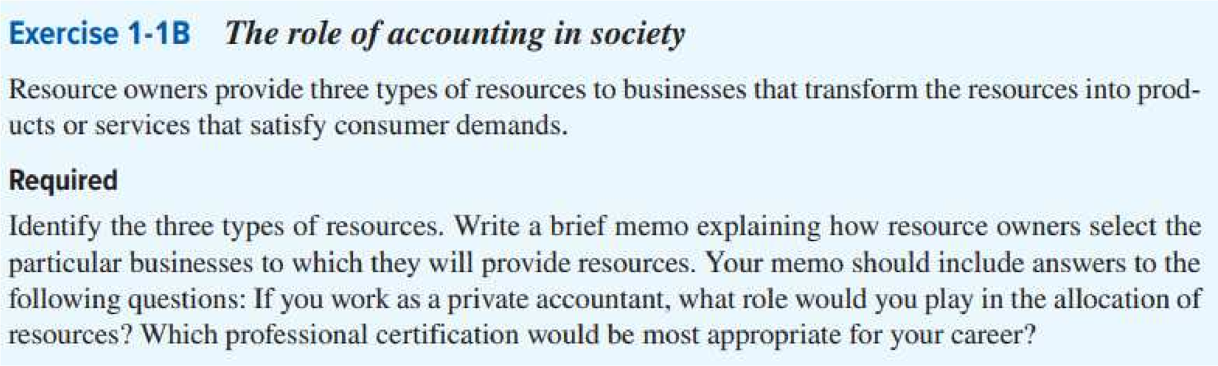
## PROBLEM 1-34B (cont.)

f. Percentage of assets provided by:

| | |
|---|---|
| Creditors | $10,000 ÷ $85,000 = 11.77% |
| Investors | $62,000 ÷ $85,000 = 72.94% |
| Earnings | $13,000 ÷ $85,000 = 15.29% |

g. Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.

# CHAPTER 1



**Exercise 1-1B** *The role of accounting in society*

Resource owners provide three types of resources to businesses that transform the resources into products or services that satisfy consumer demands.

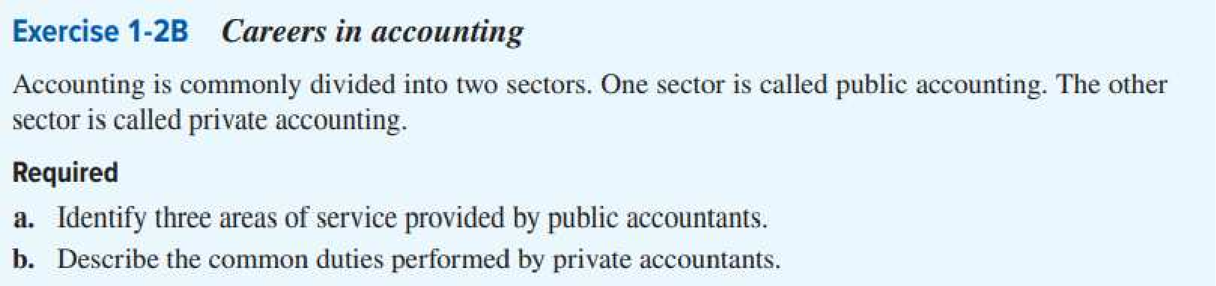
**Required**

Identify the three types of resources. Write a brief memo explaining how resource owners select the particular businesses to which they will provide resources. Your memo should include answers to the following questions: If you work as a private accountant, what role would you play in the allocation of resources? Which professional certification would be most appropriate for your career?

## EXERCISE 1-1B

**The three types of resources available to businesses are:**

1.
2.
3.



**Exercise 1-2B** *Careers in accounting*

Accounting is commonly divided into two sectors. One sector is called public accounting. The other sector is called private accounting.

**Required**

**a.** Identify three areas of service provided by public accountants.

**b.** Describe the common duties performed by private accountants.

## EXERCISE 1-2B

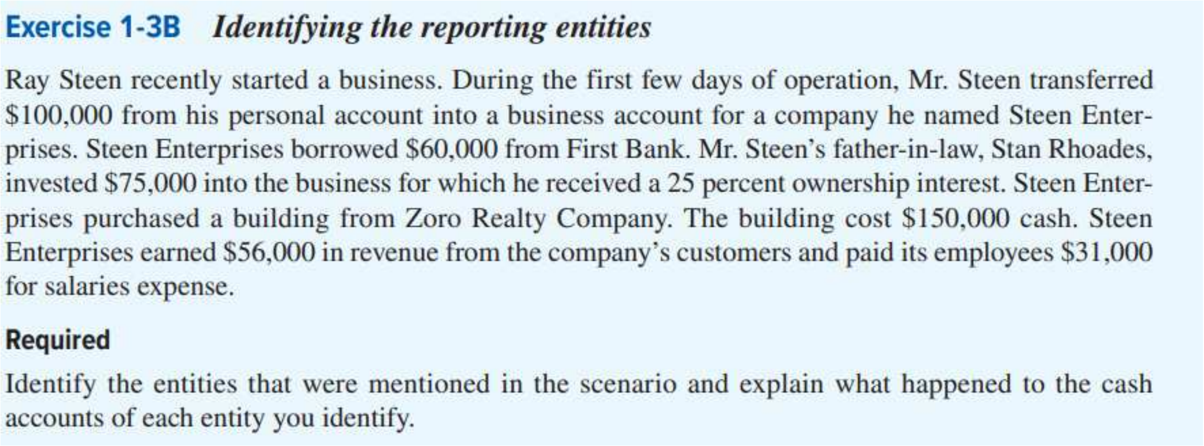
**a. The three areas of service provided by public accountants are:**

**1.**

**2.**

**3.**

**b. The private accountant generally works for a specific company. Some of the functions performed include:**



### **Exercise 1-3B** *Identifying the reporting entities*

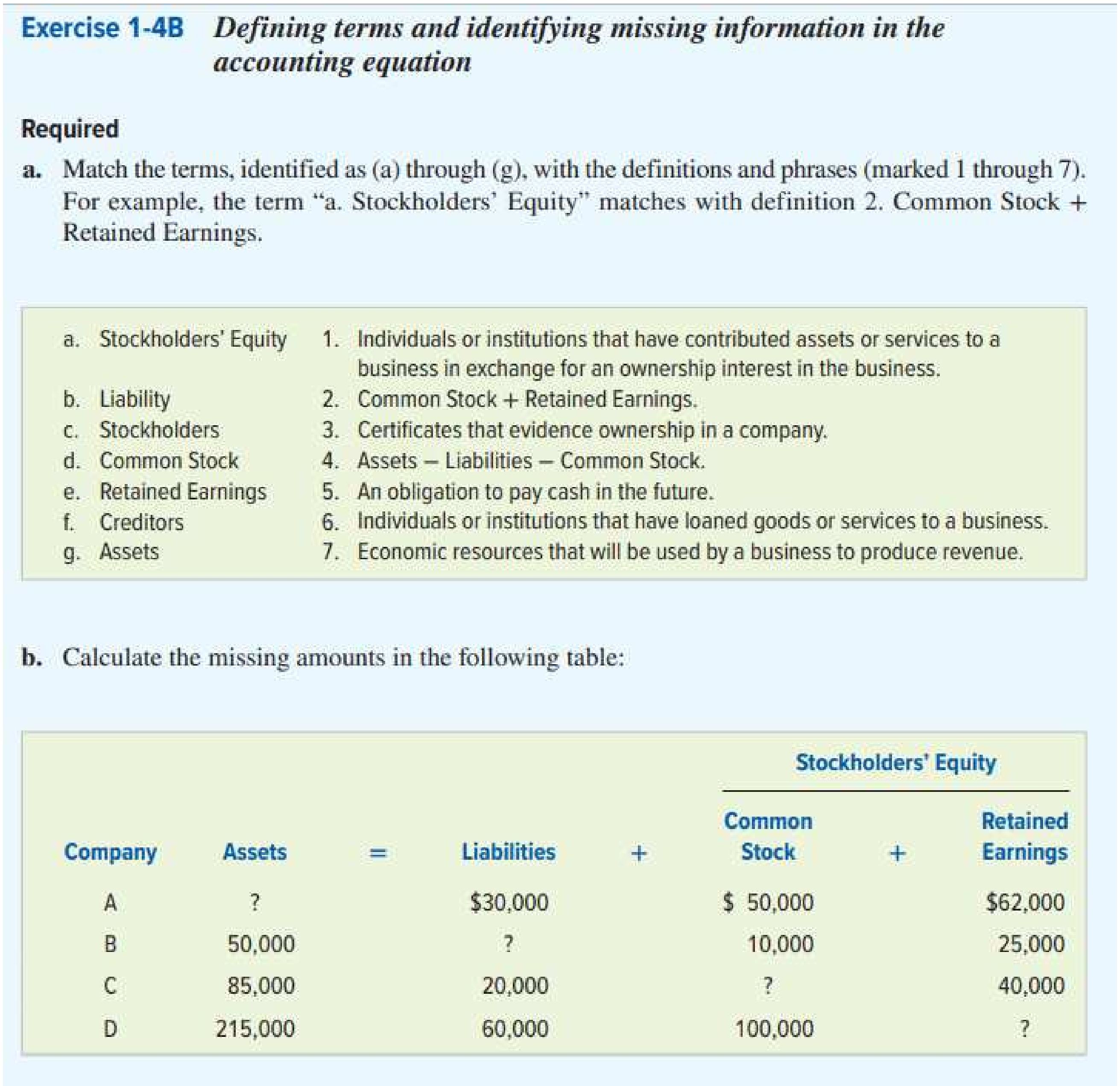
Ray Steen recently started a business. During the first few days of operation, Mr. Steen transferred $100,000 from his personal account into a business account for a company he named Steen Enterprises. Steen Enterprises borrowed $60,000 from First Bank. Mr. Steen's father-in-law, Stan Rhoades, invested $75,000 into the business for which he received a 25 percent ownership interest. Steen Enterprises purchased a building from Zoro Realty Company. The building cost $150,000 cash. Steen Enterprises earned $56,000 in revenue from the company's customers and paid its employees $31,000 for salaries expense.

**Required**

Identify the entities that were mentioned in the scenario and explain what happened to the cash accounts of each entity you identify.

## EXERCISE 1-3B

| Entities | Distribution of Cash |
|---|---|
| Ray Steen (personal account) | Personal account was decreased by the $100,000 cash deposited in the Steen Enterprises' business account. |
| | Cash<br>Cash<br>Cash<br>Cash<br>Cash |
| | Cash |
| | Cash |
| | Cash |
| Steen Enterprises' | Cash |
| Steen Enterprises' employees | Cash increased by $31,000 when salaries received |



## Exercise 1-4B *Defining terms and identifying missing information in the accounting equation*

**Required**

**a.** Match the terms, identified as (a) through (g), with the definitions and phrases (marked 1 through 7). For example, the term "a. Stockholders' Equity" matches with definition 2. Common Stock + Retained Earnings.

a. Stockholders' Equity
b. Liability
c. Stockholders
d. Common Stock
e. Retained Earnings
f. Creditors
g. Assets

1. Individuals or institutions that have contributed assets or services to a business in exchange for an ownership interest in the business.
2. Common Stock + Retained Earnings.
3. Certificates that evidence ownership in a company.
4. Assets − Liabilities − Common Stock.
5. An obligation to pay cash in the future.
6. Individuals or institutions that have loaned goods or services to a business.
7. Economic resources that will be used by a business to produce revenue.

**b.** Calculate the missing amounts in the following table:

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Company | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| A | ? | | $30,000 | | $ 50,000 | | $62,000 |
| B | 50,000 | | ? | | 10,000 | | 25,000 |
| C | 85,000 | | 20,000 | | ? | | 40,000 |
| D | 215,000 | | 60,000 | | 100,000 | | ? |

## EXERCISE 1-4B

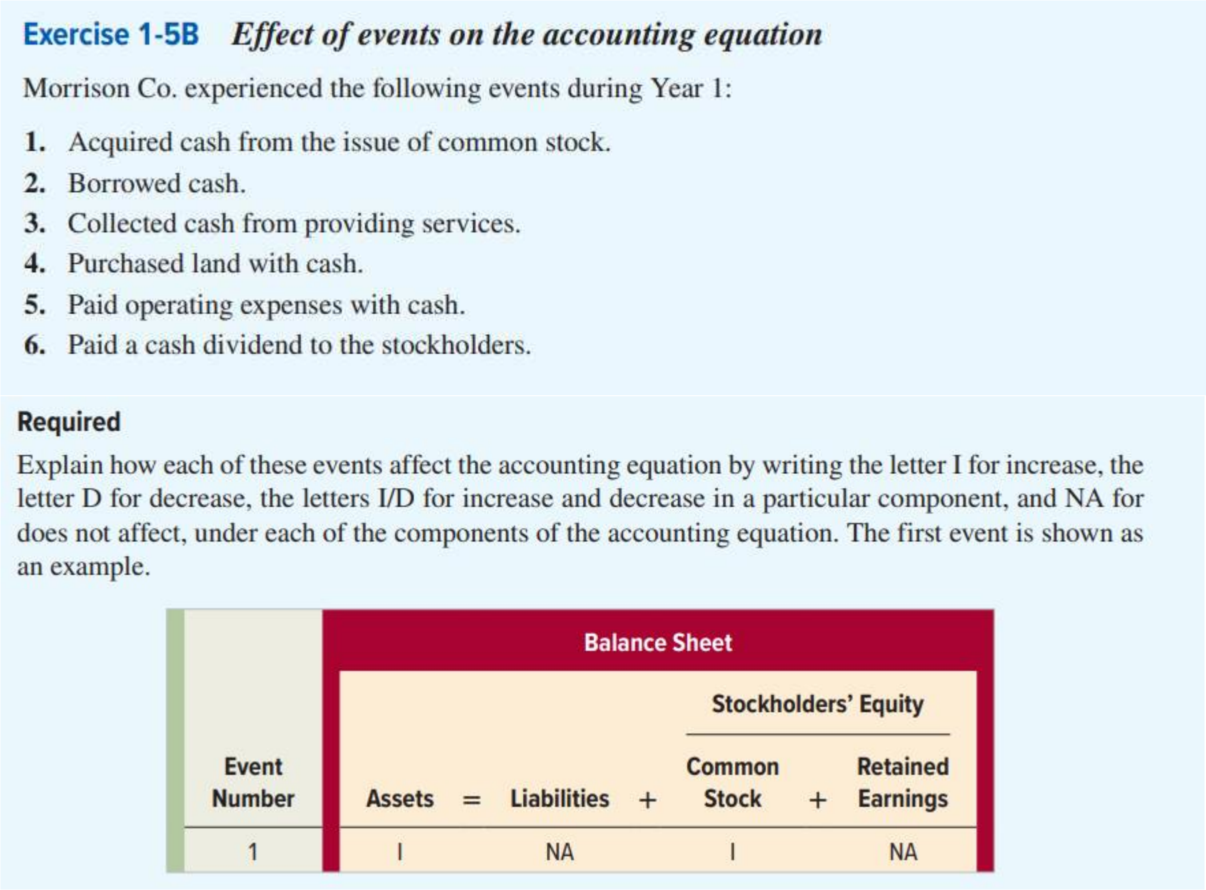
a.

| Term | Definition |
|---|---|
| a | 2 |
| b | |
| c | |
| d | |
| e | |
| f | |
| g | |

b.

**Accounting Equation**

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | | | | | Common | | Retained |
| Company | Assets | = | Liabilities | + | Stock | + | Earnings |
| A | [redacted] | = | 30,000 | + | 50,000 | + | 62,000 |
| B | 50,000 | = | [redacted] | + | 10,000 | + | 25,000 |
| C | 85,000 | = | 20,000 | + | [redacted] | + | 40,000 |
| D | 215,000 | = | 60,000 | + | 100,000 | + | [redacted] |



## Exercise 1-5B *Effect of events on the accounting equation*

Morrison Co. experienced the following events during Year 1:

1. Acquired cash from the issue of common stock.
2. Borrowed cash.
3. Collected cash from providing services.
4. Purchased land with cash.
5. Paid operating expenses with cash.
6. Paid a cash dividend to the stockholders.

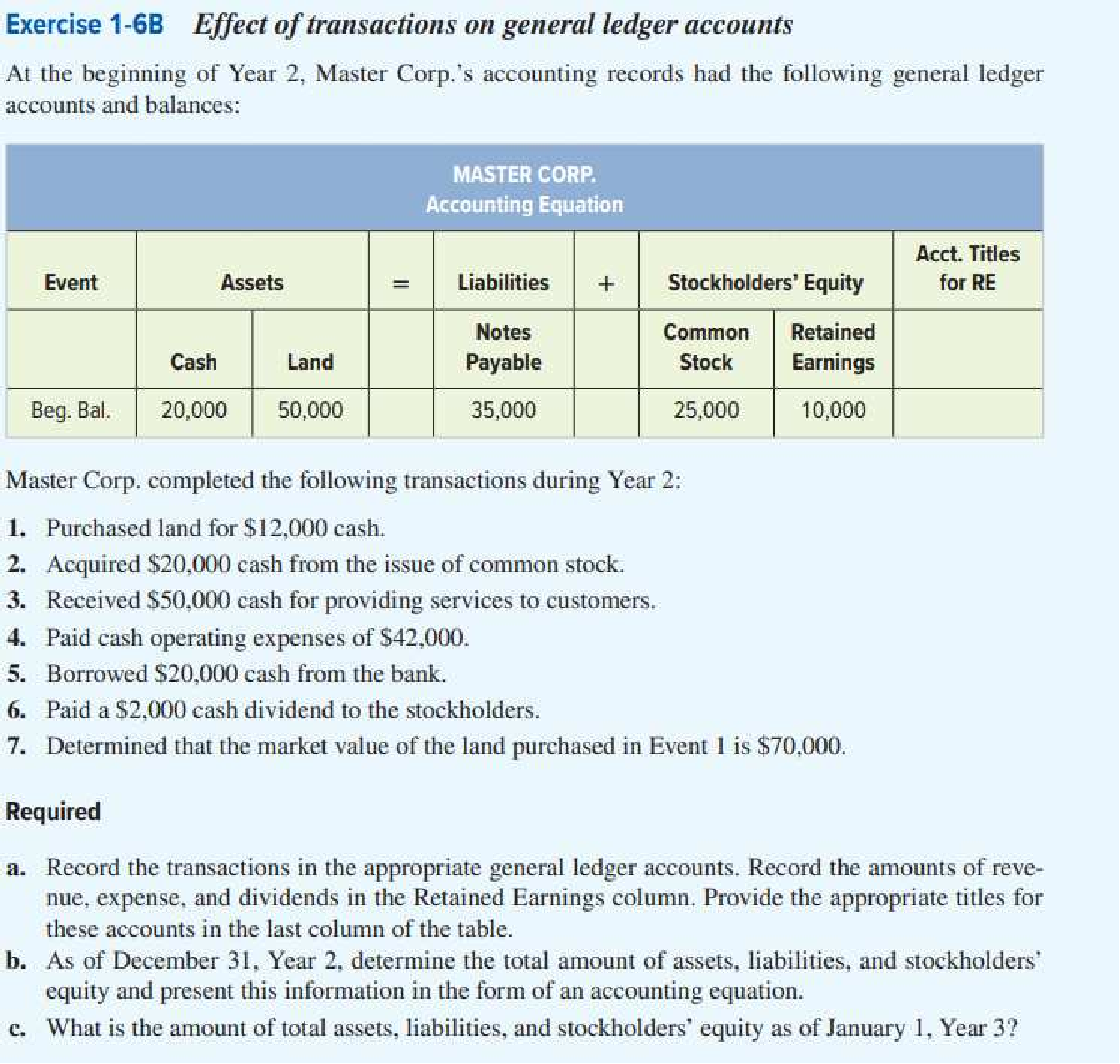
**Required**

Explain how each of these events affect the accounting equation by writing the letter I for increase, the letter D for decrease, the letters I/D for increase and decrease in a particular component, and NA for does not affect, under each of the components of the accounting equation. The first event is shown as an example.

| | Balance Sheet | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | | Stockholders' Equity | | |
| Event Number | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| 1 | I | | NA | | I | | NA |

## EXERCISE 1-5B

| Morrison Co.<br>Accounting Equation | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | Stockholders' Equity | |
| Event Number | Assets | = | Liabilities | + | Common Stock | Retained Earnings |
| 1. | I | = | NA | + | I | NA |
| 2. | | | | | | |
| 3. | | | | | | |
| 4. | | | | | | |
| 5. | | | | | | |
| 6. | | | | | | |
| | | | | | | |



### **Exercise 1-6B** *Effect of transactions on general ledger accounts*

At the beginning of Year 2, Master Corp.'s accounting records had the following general ledger accounts and balances:

**MASTER CORP.**
**Accounting Equation**

| Event | Assets | | = | Liabilities | + | Stockholders' Equity | | Acct. Titles for RE |
|---|---|---|---|---|---|---|---|---|
| | Cash | Land | | Notes Payable | | Common Stock | Retained Earnings | |
| Beg. Bal. | 20,000 | 50,000 | | 35,000 | | 25,000 | 10,000 | |

Master Corp. completed the following transactions during Year 2:

1. Purchased land for $12,000 cash.
2. Acquired $20,000 cash from the issue of common stock.
3. Received $50,000 cash for providing services to customers.
4. Paid cash operating expenses of $42,000.
5. Borrowed $20,000 cash from the bank.
6. Paid a $2,000 cash dividend to the stockholders.
7. Determined that the market value of the land purchased in Event 1 is $70,000.

**Required**

**a.** Record the transactions in the appropriate general ledger accounts. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide the appropriate titles for these accounts in the last column of the table.

**b.** As of December 31, Year 2, determine the total amount of assets, liabilities, and stockholders' equity and present this information in the form of an accounting equation.

**c.** What is the amount of total assets, liabilities, and stockholders' equity as of January 1, Year 3?

## EXERCISE 1-6B

a.

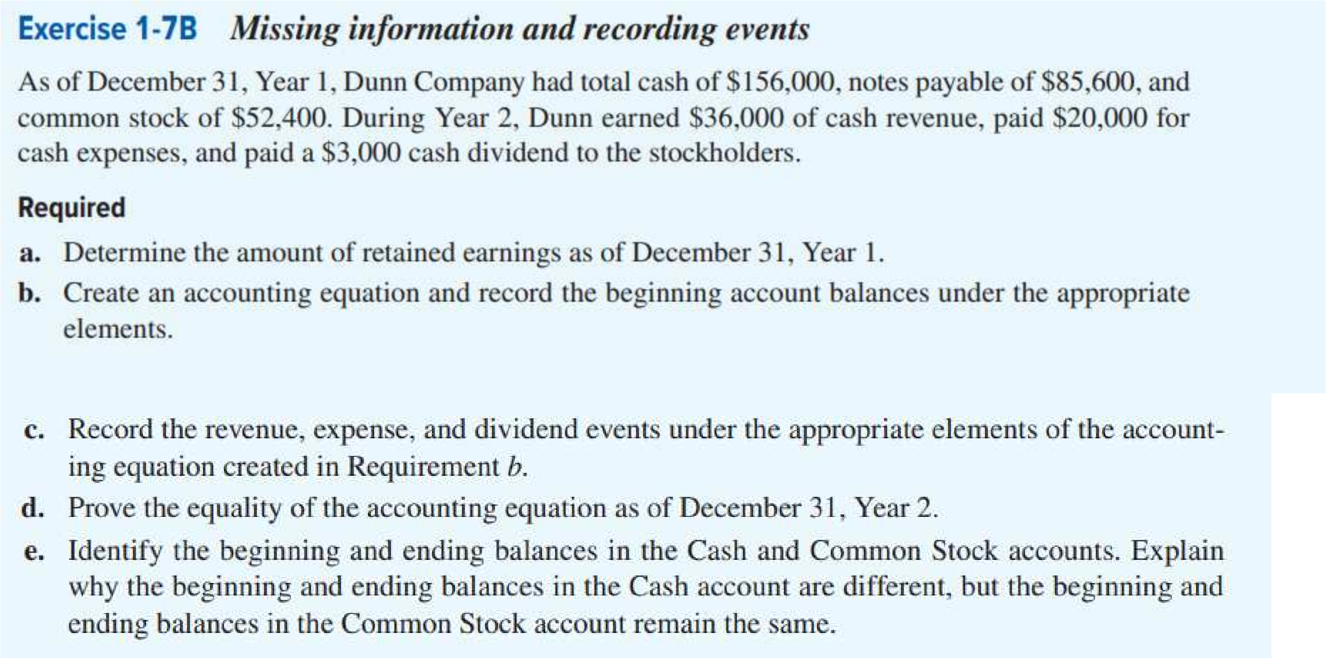
**Master Corp.**
**Accounting Equation for Year 2**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/16 | 20,000 | + | 50,000 | = | 35,000 | + | 25,000 | + | 10,000 | |
| 1. Pur. Land | (12,000) | + | 12,000 | = | NA | + | NA | + | NA | NA |
| 2. Issued stk. | | | | | | | | | | |
| 3. Service | | | | | | | | | | |
| 4. Paid Exp. | | | | | | | | | | |
| 5. Loan | | | | | | | | | | |
| 6. Paid Div. | | | | | | | | | | |
| 7. Land Value | | | | | | | | | | |
| Totals | 54,000 | + | | | | | | + | 16,000 | |

b. Year 2

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| | | | | |

c. Year 3 balances :



## Exercise 1-7B *Missing information and recording events*

As of December 31, Year 1, Dunn Company had total cash of $156,000, notes payable of $85,600, and common stock of $52,400. During Year 2, Dunn earned $36,000 of cash revenue, paid $20,000 for cash expenses, and paid a $3,000 cash dividend to the stockholders.

**Required**

**a.** Determine the amount of retained earnings as of December 31, Year 1.

**b.** Create an accounting equation and record the beginning account balances under the appropriate elements.

**c.** Record the revenue, expense, and dividend events under the appropriate elements of the accounting equation created in Requirement *b*.

**d.** Prove the equality of the accounting equation as of December 31, Year 2.

**e.** Identify the beginning and ending balances in the Cash and Common Stock accounts. Explain why the beginning and ending balances in the Cash account are different, but the beginning and ending balances in the Common Stock account remain the same.

## EXERCISE 1-7B

a.

| Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|
| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
| | | | | | + | ? |

b. & c.

### Dunn Company
### Effect of Year 2 Transactions on the Accounting Equation

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| Beginning Balances | 156,000 | = | 85,600 | + | 52,400 | + | 18,000 |
| 1. Earned Revenue | | | | | | | |
| 2. Paid expenses | | | | | | | |
| 3. Paid dividend | | | | | | | |
| Ending Balance | 169,000 | = | | | | | |

d.

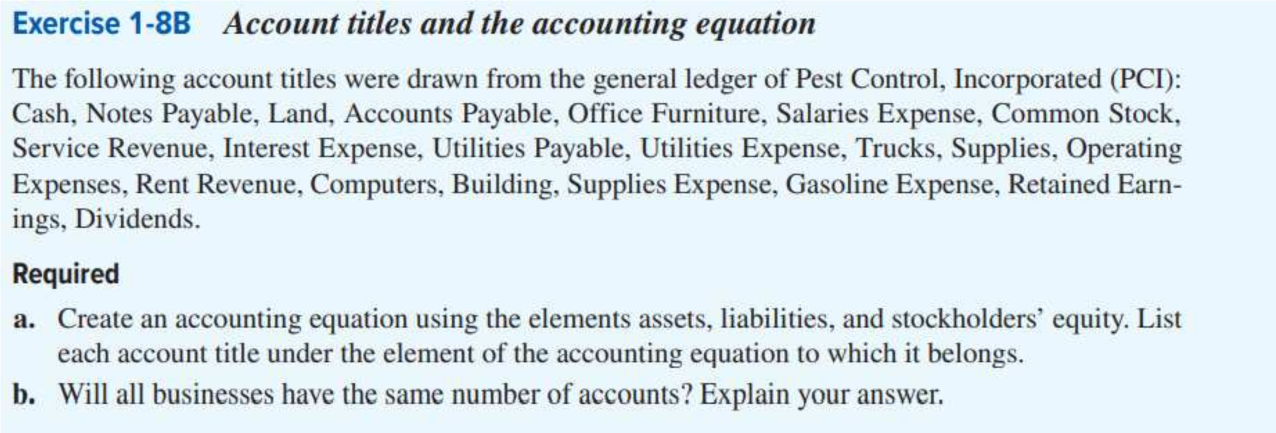
| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| | = | | | | | |

Liabilities + Stockholders' Equity =__________

## EXERCISE 1-7B e. (cont.)

**e. The beg. and ending balances for the cash account were $__________and $___________, respectively and for the common stock account $_______________ and $______________, respectively.**

**Explain the reason the cash balance changed but the common stock balance did not:**



### **Exercise 1-8B** *Account titles and the accounting equation*

The following account titles were drawn from the general ledger of Pest Control, Incorporated (PCI): Cash, Notes Payable, Land, Accounts Payable, Office Furniture, Salaries Expense, Common Stock, Service Revenue, Interest Expense, Utilities Payable, Utilities Expense, Trucks, Supplies, Operating Expenses, Rent Revenue, Computers, Building, Supplies Expense, Gasoline Expense, Retained Earnings, Dividends.

**Required**

**a.** Create an accounting equation using the elements assets, liabilities, and stockholders' equity. List each account title under the element of the accounting equation to which it belongs.

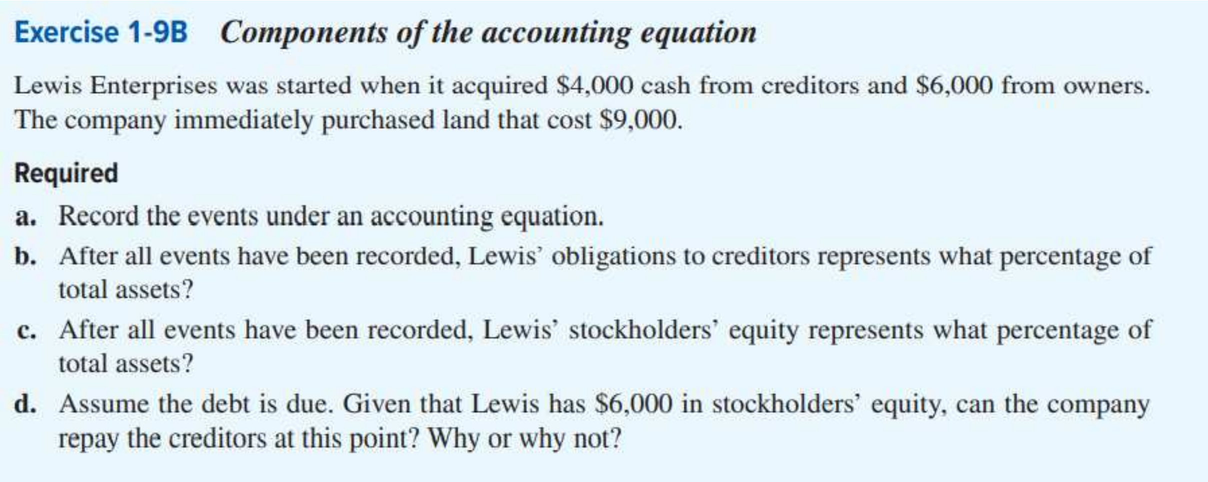
**b.** Will all businesses have the same number of accounts? Explain your answer.

## EXERCISE 1-8B

a.

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| Cash | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

**b. The number of accounts ______________(will/will not) vary. Explain:**



**Exercise 1-9B** ***Components of the accounting equation***

Lewis Enterprises was started when it acquired $4,000 cash from creditors and $6,000 from owners. The company immediately purchased land that cost $9,000.

**Required**

**a.** Record the events under an accounting equation.

**b.** After all events have been recorded, Lewis' obligations to creditors represents what percentage of total assets?

**c.** After all events have been recorded, Lewis' stockholders' equity represents what percentage of total assets?

**d.** Assume the debt is due. Given that Lewis has $6,000 in stockholders' equity, can the company repay the creditors at this point? Why or why not?

## EXERCISE 1-9B

a.

|  | Cash | + | Land | = | Creditors | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Bal. |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

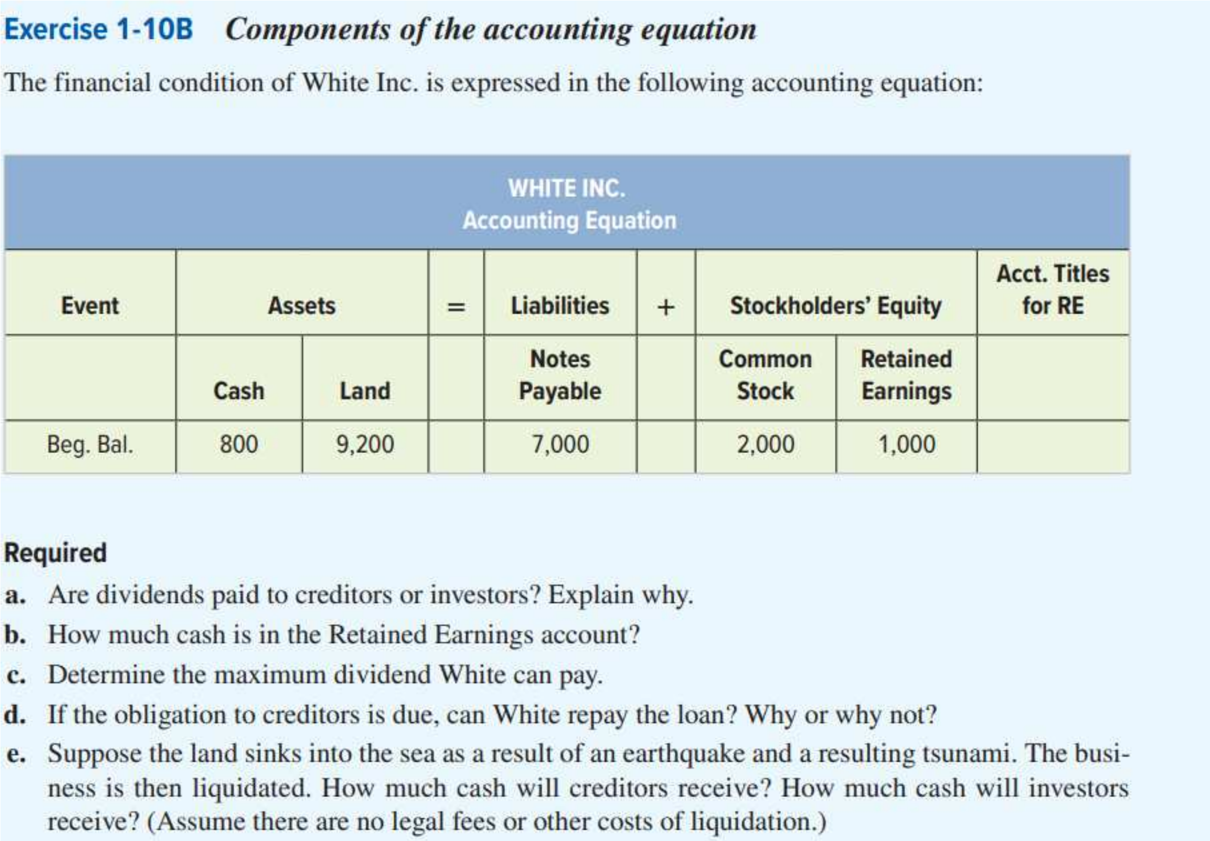
b.__________________ ÷ Total Assets = ______________%

c. __________________÷ _______________ = ____________%

## EXERCISE 1-7B (cont.)

**d. The company ____________________(can/can not) repay the debt.**

**Why?**



### Exercise 1-10B *Components of the accounting equation*

The financial condition of White Inc. is expressed in the following accounting equation:

**WHITE INC.**
**Accounting Equation**

| Event | Assets | | = | Liabilities | + | Stockholders' Equity | | Acct. Titles for RE |
|---|---|---|---|---|---|---|---|---|
| | Cash | Land | | Notes Payable | | Common Stock | Retained Earnings | |
| Beg. Bal. | 800 | 9,200 | | 7,000 | | 2,000 | 1,000 | |

**Required**

**a.** Are dividends paid to creditors or investors? Explain why.

**b.** How much cash is in the Retained Earnings account?

**c.** Determine the maximum dividend White can pay.

**d.** If the obligation to creditors is due, can White repay the loan? Why or why not?

**e.** Suppose the land sinks into the sea as a result of an earthquake and a resulting tsunami. The business is then liquidated. How much cash will creditors receive? How much cash will investors receive? (Assume there are no legal fees or other costs of liquidation.)

## EXERCISE 1-10B

a. Dividends are paid to _________________.

Explain why:

b. There is____________ cash in the Retained Earnings account.

c. The maximum amount of dividends that can be paid:

d. White ________________(can/cannot) repay the loan.

Explain your answer:

e. The amount of cash the creditors will receive is______________.
The amount of cash the investors will receive is______________.

### **Exercise 1-11B** *Calculate missing amounts and interpret results*

**LO 1-4, 1-5**

The following table shows the transactions experienced by Walter Enterprises during Year 8. The table contains missing data that are labeled with alphabetic characters (a) through (i). Assume all transactions shown in the accounting equation are cash transactions.

| | Balance Sheet | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | | Liabilities | | Stockholders' Equity | | | Account Titles for RE |
| | Cash | + | Land | = | Notes Pay. | + | C. Stk. | + | Ret. Earn. | |
| Beg. Bal. | (a) | + | 70,000 | = | (b) | + | (c) | + | 20,000 | |
| Event No. 1 | (d) | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2 | (e) | + | NA | = | NA | + | NA | + | (f) | Revenue |
| 3 | (30,000) | + | NA | = | NA | + | NA | + | (30,000) | Expenses |
| 4 | (18,000) | + | NA | = | NA | + | NA | + | (g) | Dividend |
| 5 | (65,000) | + | (h) | = | NA | + | NA | + | NA | NA |
| 6 | (5,000) | + | NA | = | (5,000) | + | NA | + | NA | NA |
| Totals* | 90,000 | + | (i) | = | 35,000 | + | 130,000 | + | (j) | |

**Required**

**a.** Determine the correct amount represented by each character (a) through (j).

**b.** Is there sufficient cash available to repay the debt on January 1, Year 8?

**c.** Based on the information in the table, what is the maximum cash dividend Walter could pay on January 1, Year 9?

## EXERCISE 1-11B

a.

Begin by filling in all possible blanks on the horizontal rows.

(d)

(g)

(h)

Now shift to an analysis of the vertical columns.

(i)

(b)

(c)

Now shift back to a horizontal analysis of the rows.

(a)

(j)

**Exercise 1-11B (cont.)**

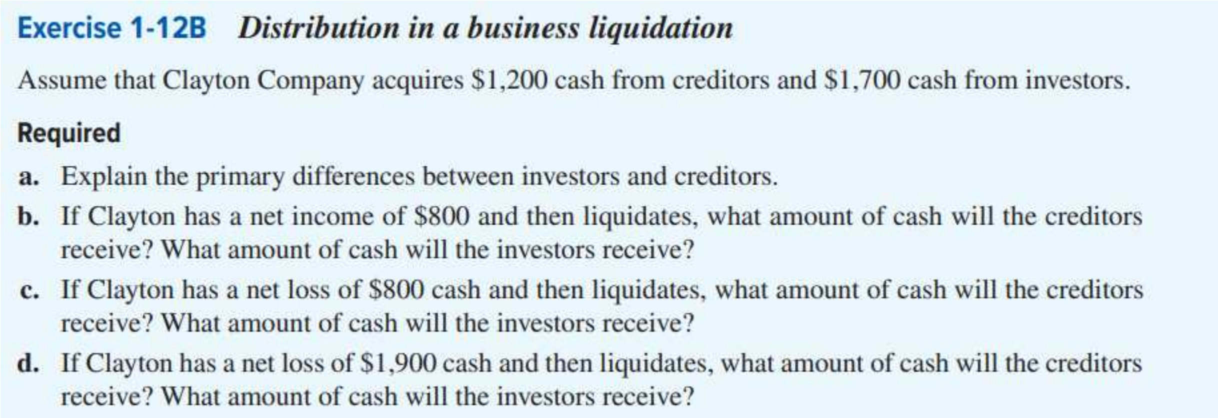
**(f)**

**$___________+ x – $_________ – $__________ = $60,000**
**X = $_____________**

**(e)**

**b. There_________(is/is not) sufficient cash available to pay off the debt on January 1, Year 8.**

**c. $_____________ is the maximum cash dividend Walter can pay.**



**Exercise 1-12B** ***Distribution in a business liquidation***

Assume that Clayton Company acquires $1,200 cash from creditors and $1,700 cash from investors.

**Required**

**a.** Explain the primary differences between investors and creditors.

**b.** If Clayton has a net income of $800 and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

**c.** If Clayton has a net loss of $800 cash and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

**d.** If Clayton has a net loss of $1,900 cash and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

## EXERCISE 1-12B

a. The primary differences between investors and creditors:

b.

**Clayton Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | $ | = | $1,200 | + | $1,700 |
| Earned income | | | | | |
| Balance | | | | | |

The creditors will receive the $_______________. The investors will receive $___________.

c.

**Clayton Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | | | | | |
| Incurred loss | | | | | |
| Balance | | | | | |

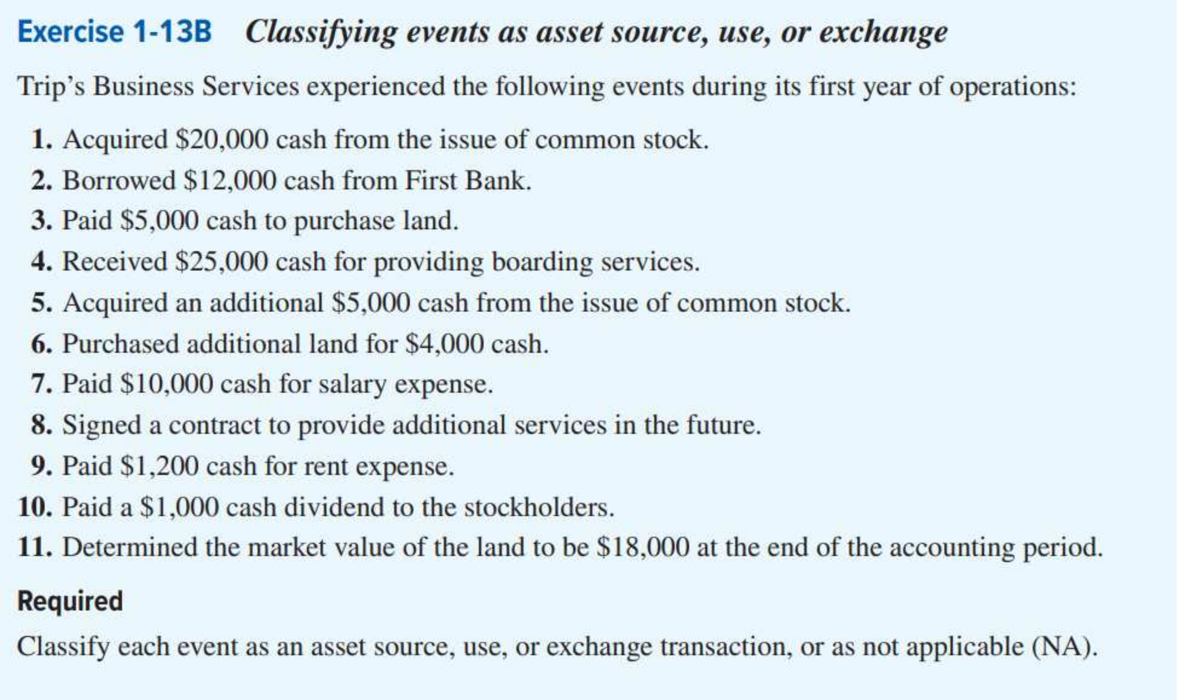
The creditors will receive the $_________. The investors will receive $___________.

**EXERCISE 1-12B (cont.)**

**d.**

| Clayton Company<br>Accounting Equation | | | | | |
|---|---|---|---|---|---|
| **Event** | | | | | |
| **Acquired assets** | | | | | |
| **Incurred loss** | | | | | |
| **Balance** | | | | | |

**The creditors will receive the $__________. The investors will receive $____________.**



**Exercise 1-13B** ***Classifying events as asset source, use, or exchange***

Trip's Business Services experienced the following events during its first year of operations:

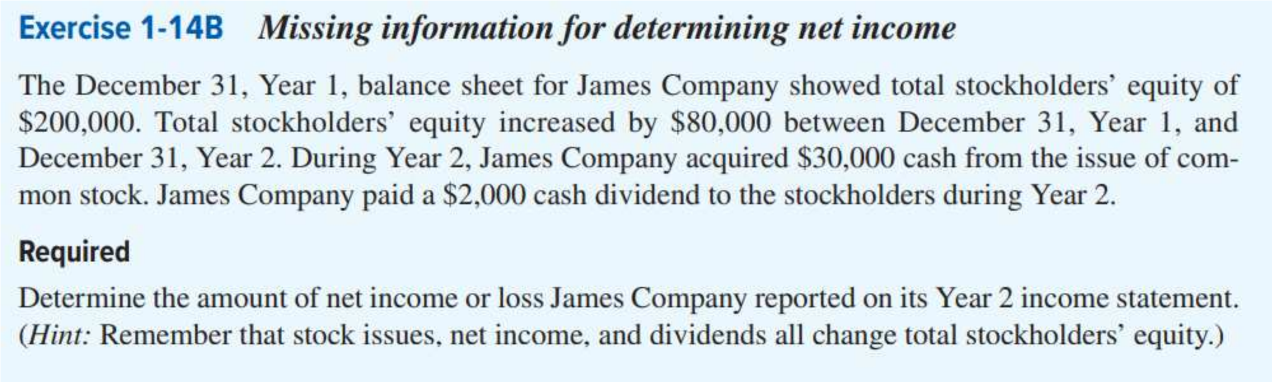
1. Acquired $20,000 cash from the issue of common stock.
2. Borrowed $12,000 cash from First Bank.
3. Paid $5,000 cash to purchase land.
4. Received $25,000 cash for providing boarding services.
5. Acquired an additional $5,000 cash from the issue of common stock.
6. Purchased additional land for $4,000 cash.
7. Paid $10,000 cash for salary expense.
8. Signed a contract to provide additional services in the future.
9. Paid $1,200 cash for rent expense.
10. Paid a $1,000 cash dividend to the stockholders.
11. Determined the market value of the land to be $18,000 at the end of the accounting period.

**Required**

Classify each event as an asset source, use, or exchange transaction, or as not applicable (NA).

## EXERCISE 1-13B

| Event | Classification |
|---|---|
| 1. | Asset Source |
| 2. | |
| 3. | |
| 4. | |
| 5. | |
| 6. | |
| 7. | |
| 8. | |
| 9. | |
| 10. | |
| 11. | |
| | |



### Exercise 1-14B *Missing information for determining net income*

The December 31, Year 1, balance sheet for James Company showed total stockholders' equity of $200,000. Total stockholders' equity increased by $80,000 between December 31, Year 1, and December 31, Year 2. During Year 2, James Company acquired $30,000 cash from the issue of common stock. James Company paid a $2,000 cash dividend to the stockholders during Year 2.

**Required**

Determine the amount of net income or loss James Company reported on its Year 2 income statement. (*Hint:* Remember that stock issues, net income, and dividends all change total stockholders' equity.)

## EXERCISE 1-14B

**From the Statement of Changes in Stockholders' Equity we know**

| | | |
|---|---|---|
| | | |
| From the Stat. of Changes in Stk. Equity | | |
| | | |
| Beginning Tot. Stk. Equity 1/1/Yr2 | | $ |
| Plus: Common Stock Issued | | |
| Plus:  Net Income | ? | |
| Less: | | |
| Change in Stockholders' Equity | | |
| | | |
| Ending Total Stk. Equity, 12/31/Year 2 | | |
| | | |

**Exercise 11-14B (cont.)**

**Working backwards from the change in equity solve for net income:**

| | |
|---|---|
| | |
| **Change in Stockholders' Equity, Year 2** | **$** |
| **Plus:** | |
| **Less:** | |
| **Net Income, Year 2** | |
| | |

### Exercise 1-15B *Preparing an income statement and a balance sheet*

Petre Company was started on January 1, Year 1. During Year 1, the company experienced the following accounting events: (1) Issued $25,000 in common stock, (2) earned cash revenues of $14,500, (3) paid cash expenses of $9,200, and (4) paid a $500 cash dividend to its stockholders. These were the only events that affected the company during Year 1.

**Required**

**a.** Create an accounting equation and record the effects of each accounting event under the appropriate general ledger account headings.

**b.** Prepare an income statement, statement of changes in stockholders' equity, and a balance sheet dated December 31, Year 1, for Petre Company.

**c.** Explain why different terminology is used to date the income statement than is used to date the balance sheet.

## EXERCISE 1-15B

a.

### Petre Company
### Accounting Equation for Year 1

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | | + | Common Stock | + | Retained Earnings |
| 1. Issue stock<br>2. Cash revenues | | | | | | | |
| 3. Paid expenses | | | | | | | |
| 4. Paid dividend | | | | | | | |
| Ending Balance | 29,800 | = | -0- | + | 25,000 | + | 4,800 |

b.

### Petre Company
### Income Statement
### For the Year Ended December 31, Year 1

| | |
|---|---|
| Revenue | |
| Expense | |
| Net Income | |

### Petre Company
### Statement of Changes in Stockholders' Equity
### For the Year Ended December 31, Year 1

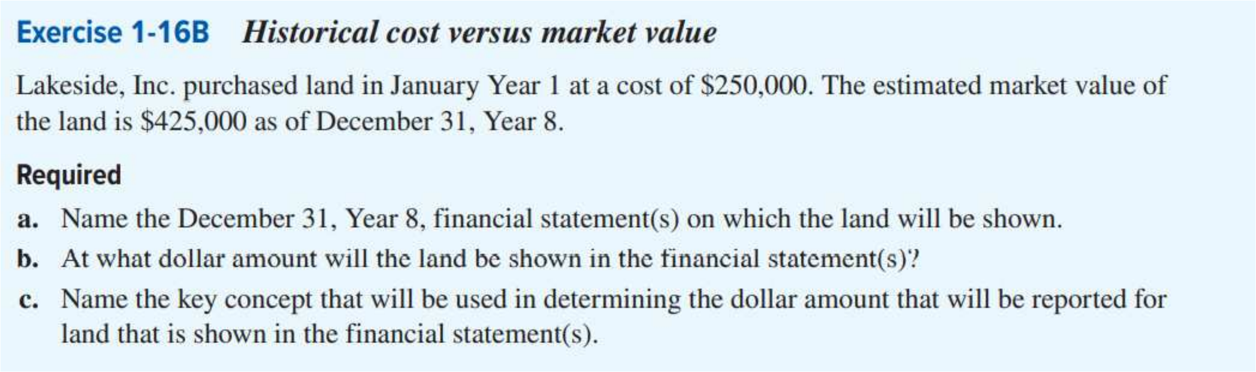
| | | |
|---|---|---|
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| Plus: Net Income | | |
| Less: Dividends | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | |

## EXERCISE 1-15B (cont.)

**Petre Company**
**Balance Sheet**
**As of December 31, Year 1**

| | | |
|---|---|---|
| | | |
| **Assets** | | |
| | | |
| | | |
| **Liabilities** | | |
| | | |
| **Stockholders' Equity** | | |
| **Common Stock** | | |
| **Retained Earnings** | | |
| **Total Stockholders' Equity** | | |
| | | |
| **Total Liabilities and Stockholders' Equity** | | |
| | | |

c. The income statement is dated with the term ____________________because____________________________________.
The balance sheet is dated with the term _______________________
because_______________________________________________________.



**Exercise 1-16B** ***Historical cost versus market value***

Lakeside, Inc. purchased land in January Year 1 at a cost of $250,000. The estimated market value of the land is $425,000 as of December 31, Year 8.

**Required**

**a.** Name the December 31, Year 8, financial statement(s) on which the land will be shown.

**b.** At what dollar amount will the land be shown in the financial statement(s)?

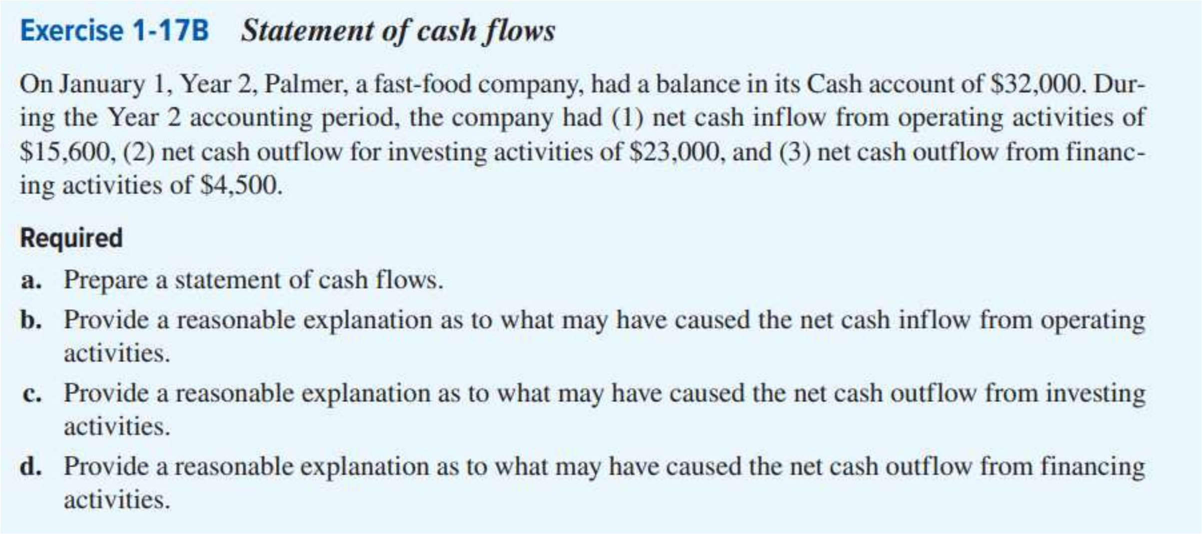
**c.** Name the key concept that will be used in determining the dollar amount that will be reported for land that is shown in the financial statement(s).

## EXERCISE 1-16B

**a. Land will be shown on the Year 8__________________________.**

**b. Land will be listed at________________________________.**

**c. The key concept used in listing land at its cost is the ____________________________concept.**



**Exercise 1-17B** ***Statement of cash flows***

On January 1, Year 2, Palmer, a fast-food company, had a balance in its Cash account of $32,000. During the Year 2 accounting period, the company had (1) net cash inflow from operating activities of $15,600, (2) net cash outflow for investing activities of $23,000, and (3) net cash outflow from financing activities of $4,500.

**Required**

- **a.** Prepare a statement of cash flows.
- **b.** Provide a reasonable explanation as to what may have caused the net cash inflow from operating activities.
- **c.** Provide a reasonable explanation as to what may have caused the net cash outflow from investing activities.
- **d.** Provide a reasonable explanation as to what may have caused the net cash outflow from financing activities.

## EXERCISE 1-17B

a.

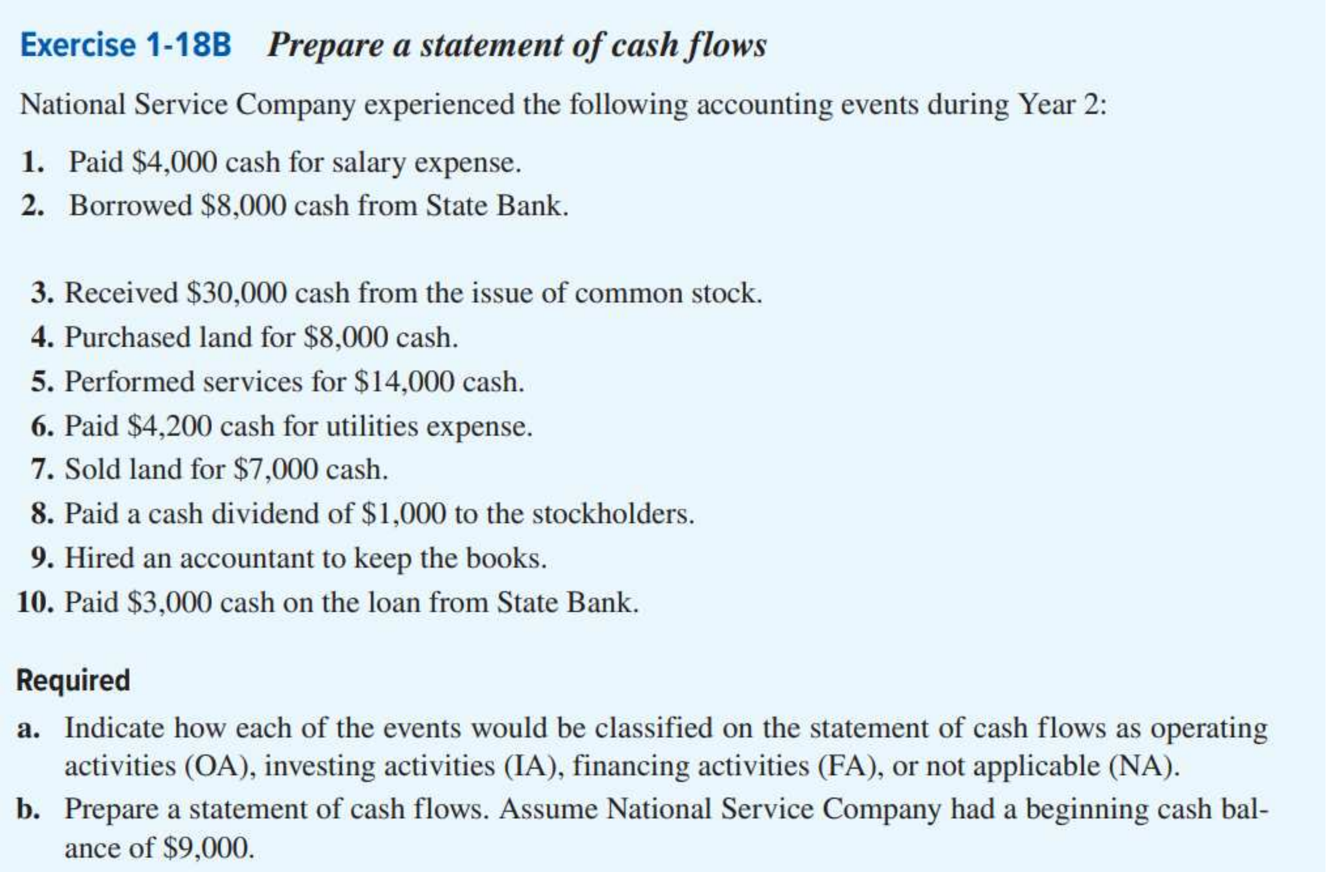
**Palmer Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net Cash Inflow from Operating Activities | | |
| | | |
| Cash Flows From Investing Activities: | | |
| Net Cash Outflow from Investing Activities | | |
| | | |
| Cash Flows From Financing Activities: | | |
| Net Cash Outflow from Financing Activities | | |
| | | |
| Net Decrease in Cash | | |
| Plus: Beginning Cash Balance | | |
| Ending Cash Balance | | |

b. Cash inflow from operating activities resulted as a result of:

c. The company paid cash to_______________________________.

d. The company paid cash____________ and ____________________.



### Exercise 1-18B *Prepare a statement of cash flows*

National Service Company experienced the following accounting events during Year 2:

1. Paid $4,000 cash for salary expense.
2. Borrowed $8,000 cash from State Bank.
3. Received $30,000 cash from the issue of common stock.
4. Purchased land for $8,000 cash.
5. Performed services for $14,000 cash.
6. Paid $4,200 cash for utilities expense.
7. Sold land for $7,000 cash.
8. Paid a cash dividend of $1,000 to the stockholders.
9. Hired an accountant to keep the books.
10. Paid $3,000 cash on the loan from State Bank.

**Required**

**a.** Indicate how each of the events would be classified on the statement of cash flows as operating activities (OA), investing activities (IA), financing activities (FA), or not applicable (NA).

**b.** Prepare a statement of cash flows. Assume National Service Company had a beginning cash balance of $9,000.

## EXERCISE 1-18B

a.

| Event | Statement of Cash Flow Classification |
|---|---|
| 1. | |
| 2. | |
| 3. | |
| 4. | |
| 5. | |
| 6. | |
| 7. | |
| 8. | |
| 9. | |
| 10. | |

## EXERCISE 1-18B (cont.)

b.

| National Service Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | | |
| Cash Payments for Salaries | | |
| Cash Payments for Utilities | | |
| **Net Cash Inflow from Operating Activities** | | |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | | |
| Cash Collected from the Sale of Land | | |
| **Net Cash Outflow from Investing Activities** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Loan | | |
| Cash Paid to Loan Obligation | | |
| Cash Receipts from Stock Issue | | |
| Cash Payments for Dividends | | |
| **Net Cash Inflow from Financing Activities** | | |
| | | |
| **Net Increase in Cash** | | |
| **Plus: Beginning Cash Balance** | | 9,000 |
| **Ending Cash Balance** | | |

## **Exercise 1-19B** *Preparing financial statements*

Tennessee Company experienced the following events during Year 2:

1. Acquired $50,000 cash from the issue of common stock.
2. Paid $15,000 cash to purchase land.
3. Borrowed $25,000 cash.
4. Provided services for $60,000 cash.
5. Paid $12,000 cash for rent expense.
6. Paid $22,000 cash for other operating expenses.
7. Paid a $5,000 cash dividend to the stockholders.
8. Determined that the market value of the land purchased in Event 2 is now $16,500.

### Required

**a.** The January 1, Year 2, general ledger account balances are shown in the following accounting equation. Record the eight events in the appropriate general ledger accounts. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide the appropriate titles for these accounts in the last column of the table. The first event is shown as an example.

**TENNESSEE COMPANY**
**Accounting Equation**

| Event | Assets | | = | Liabilities | + | Stockholders' Equity | | Acct. Titles for RE |
|---|---|---|---|---|---|---|---|---|
| | Cash | Land | | Notes Payable | | Common Stock | Retained Earnings | |
| 1. Beg. Bal. | 15,000<br>50,000 | 10,000 | | 0 | | 20,000<br>50,000 | 5,000 | |

**b.** Prepare an income statement, statement of changes in stockholders' equity, year-end balance sheet, and statement of cash flows for the Year 2 accounting period.

**c.** Determine the percentage of assets that were provided by retained earnings. How much cash is in the retained earnings account?

## EXERCISE 1-19B

a.

### Tennessee Company
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/Y2 | 15,000 | + | 10,000 | = | -0- | + | 20,000 | + | 5,000 | |
| 1. Issued stk. | 50,000 | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2. Pur. Land | | | | | | | | | | |
| 3. Loan | | | | | | | | | | |
| 4. Provide Svc. | | | | | | | | | | |
| 5. Paid Rent | | | | | | | | | | |
| 6. Pd. Op. Exp. | | | | | | | | | | |
| 7. Paid Div. | | | | | | | | | | |
| 8. Land Value | | | | | | | | | | |
| Totals | 96,000 | + | 25,000 | = | 25,000 | + | 70,000 | + | 26,000 | |

b.

### Tennessee Company
### Income Statement
### For the Year Ended December 31, Year 2

| | |
|---|---|
| Service Revenue | |
| Rent Expense | |
| Operating Expense | |
| Net Income | |

## EXERCISE 1-19B (cont.)

b.

| Tennessee Company<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| Plus: Net Income | | |
| Less: Dividends | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | $96,000 |

| Tennessee Company<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| **Assets** | | |
| Cash | | |
| Land | | |
| **Total Assets** | | $121,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | | |
| **Total Liabilities** | | |
| | | |
| **Stockholders’ Equity** | | |
| Common Stock | | |
| Retained Earnings | | |
| **Total Stockholders’ Equity** | | |
| | | |
| **Total Liabilities and Stockholders’ Equity** | | |

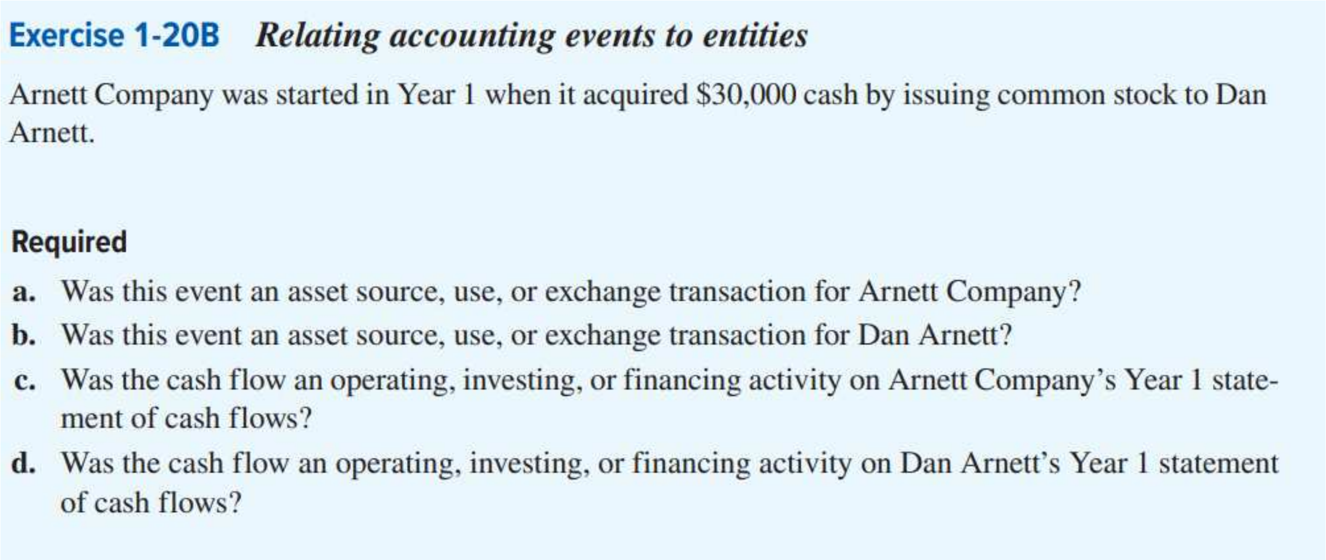
b.

| Tennessee Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| | | |
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | | |
| Cash Payment for Rent Expense | | |
| Cash Payments for Other Operating Exp. | | |
| **Net Cash Flow from Operating Activities** | | |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | | |
| **Net Cash Flow from Investing Activities** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from | | |
| Cash Receipts from | | |
| Cash Payments for | | |
| **Net Cash Flow from Financing Activities** | | |
| | | |
| **Net Increase in Cash** | | |
| **Plus: Beginning Cash Balance** | | 81,000 |
| **Ending Cash Balance** | | |
| | | |

c. **Percentage of assets provided by retained earnings:**

**$___________ ÷ $_________ = _____%**

**The amount of cash in retained earnings________________:**



### Exercise 1-20B *Relating accounting events to entities*

Arnett Company was started in Year 1 when it acquired $30,000 cash by issuing common stock to Dan Arnett.

**Required**

**a.** Was this event an asset source, use, or exchange transaction for Arnett Company?

**b.** Was this event an asset source, use, or exchange transaction for Dan Arnett?

**c.** Was the cash flow an operating, investing, or financing activity on Arnett Company's Year 1 statement of cash flows?

**d.** Was the cash flow an operating, investing, or financing activity on Dan Arnett's Year 1 statement of cash flows?

## EXERCISE 1-20B

| | |
|---|---|
| **a.** | **Arnett Company:** |
| **b.** | **Dan Arnett:** |
| **c.** | **Arnett Company:** |
| **d.** | **Dan Arnett:** |

## Exercise 1-21B *Preparing financial statements—retained earnings emphasis*

On January 1, Year 2, the following information was drawn from the accounting records of Zeke Company: cash of $200; land of $1,800; notes payable of $600; and common stock of $1,000.

### Required

**a.** Determine the amount of retained earnings as of January 1, Year 2.

**b.** After looking at the amount of retained earnings, the chief executive officer (CEO) wants to pay a $300 cash dividend to the stockholders. Can the company pay this dividend? Why or why not?

**c.** As of January 1, Year 2, what percentage of the assets were acquired from creditors?

**d.** As of January 1, Year 2, what percentage of the assets were acquired from investors?

**e.** As of January 1, Year 2, what percentage of the assets were acquired from retained earnings?

**f.** Create an accounting equation using percentages instead of dollar amounts on the right side of the equation.

**g.** During Year 2, Zeke Company earned cash revenue of $500, paid cash expenses of $300, and paid a cash dividend of $50. Prepare an income statement, statement of changes in stockholders' equity, a balance sheet, and a statement of cash flows dated December 31, Year 2. (*Hint:* It is helpful to record these events under an accounting equation before preparing the statements.)

**h.** Comment on the terminology used to date each statement.

**i.** An appraiser determines that as of December 31, Year 2, the market value of the land is $2,000. How will this fact change the financial statements?

**j.** What is the balance in the Revenue account on January 1, Year 3?

## EXERCISE 1-21B

a.

**Zeke Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| $200 | | $1,800 | | $600 | | $1,000 | | ? |
| | | | | | | | | |

**Retained Earnings =**

b. **The company ____________________(can/cannot) pay a $300 dividend of cash. Why?**

c. **Total Assets = _______________**

**$___________ ÷ $____________ = ___%**

d.

**$__________ ÷ $____________ = ___%**

e.

**$__________ ÷ $_________ = ___%**

f.

**Zeke Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| $200 | | $1,800 | | % | | % | | % |
| | | | | | | | | |

## EXERCISE 1-21B (cont.)

g.

### Zeke Company
### Accounting Equation as of December 31, Year 2

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |

### Zeke Company
### Income Statement
### For the Year Ended December 31, Year 2

| | |
|---|---|
| Revenue | |
| Expenses | |
| Net Income | |

## EXERCISE 1-21B (cont.)

g.

### Zeke Company
### Statement of Changes in Stockholders’ Equity
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| Plus: Net Income | | |
| Less: Dividends | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders’ Equity | | |

### Zeke Company
### Balance Sheet
### As of December 31, Year 2

| | | |
|---|---|---|
| Assets | | |
| Cash | | |
| Land | | |
| Total Assets | | |
| | | |
| Liabilities | | |
| Notes Payable | | |
| Total Liabilities | | |
| | | |
| Stockholders’ Equity | | |
| Common Stock | | |
| Retained Earnings | | |
| Total Stockholders’ Equity | | |
| | | |
| Total Liabilities and Stockholders’ Equity | | |

## EXERCISE 1-21B (cont.)

g.

**Zeke Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | | |
| Cash Payments for Expenses | | |
| **Net Cash Flow from Operating Activities** | | |
| | | |
| **Cash Flows From Investing Activities:** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Payments for Dividends | | |
| **Net Cash Flow from Financing Activities** | | |
| | | |
| **Net Increase in Cash** | | |
| **Plus: Beginning Cash Balance** | | |
| **Ending Cash Balance** | | |

h. Explain the terminology for the statements: The income statement, statement of________________________________________________,
and the statement of cash flows explain
________________________________________________.
Therefore, these statements use the terminology
"______________________________". In contrast, the
______________________explains the financial condition of the
terminology "______________________________".

i. The _____________ value is not shown in the financial statements.
The historical cost concept requires:

j. The balance in the revenue account is ________ on January 1, Year 3,
because :

### Exercise 1-22B *Preparing financial statements—cash flow emphasis*

As of January 1, Year 2, Shundra Inc. had a balance of $4,500 in Cash, $2,500 in Common Stock, and $2,000 in Retained Earnings. These were the only accounts with balances in the ledger on January 1, Year 2. Further analysis of the company's cash account indicated that during the Year 2 accounting period, the company had (1) net cash inflow from operating activities of $5,100, (2) net cash outflow for investing activities of $13,000, and (3) net cash inflow from financing activities of $7,600. All revenue and expense events were cash events. The following accounts and balances represent the general ledger of Shundra Inc. as of December 31, Year 2, before closing.

**SHUNDRA INC.**
**General Ledger**

| Assets | = | Liabilities | + | Stockholders' Equity | |
|---|---|---|---|---|---|
| **Cash** | | **Notes Payable** | | **Common Stock** | **Revenue** |
| Bal. 4,200 | | Bal. 3,000 | | Bal. 8,000 | Bal. 9,900 |
| **Land** | | | | **Retained Earnings** | **Expenses** |
| Bal. 13,000 | | | | Bal. 2,000 | Bal. 4,800 |
| | | | | | **Dividends** |
| | | | | | Bal. 900 |

**Required**

**a.** Assume that the net cash inflow from financing activities of $7,600 was caused by three events. Based on the information above, identify these events and determine the cash flow associated with each event.

**b.** What did the company purchase that resulted in the cash outflow from investing activities?

**c.** Prepare an income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows.

## EXERCISE 1-22B

a. The net cash inflow from financing activities can be explained as follows:

| Cash Flows From Financing Activities: | |
|---|---|
| Cash Receipts from___________________ | |
| Cash Receipts from___________________ | |
| Cash Payments for ___________________ | |
| Net Cash Flow from Financing Activities | $7,600 |

b. Net cash outflow from investing activities resulted from:

c.

**Shundra, Inc.**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Revenue | | |
| Expenses | | |
| Net Income | | |

## EXERCISE 1-22B (cont.)

c.

| Shundra, Inc.<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| Plus: Net Income | | |
| Less: Dividends | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | |

| Shundra, Inc.<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| Assets | | |
| Cash | | |
| Land | | |
| Total Assets | | |
| | | |
| Liabilities | | |
| Notes Payable | | |
| Total Liabilities | | |
| | | |
| Stockholders' Equity | | |
| Common Stock | | |
| Retained Earnings | | |
| Total Stockholders' Equity | | |
| | | |
| Total Liabilities and Stockholders' Equity | | |

## EXERCISE 1-22B (cont.)

c.

### Shundra, Inc.
### Statement of Cash Flows
### For the Year Ended December 31, Year 2

| | | |
|---|---|---|
| | | |
| **Cash Flows From Operating Activities:** | | |
| **Cash Receipts from Customers** | | |
| **Cash Payments for Expenses** | | |
| **Net Cash Flow from Operating Activities** | | |
| | | |
| **Cash Flows From Investing Activities:** | | |
| **Cash Paid to ____________________** | | |
| **Net Cash Flow from Investing Activities** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| | | |
| | | |
| | | |
| **Net Cash Flow from Financing Activities** | | |
| | | |
| **Net Decrease in Cash** | | |
| **Plus: Beginning Cash Balance** | | |
| **Ending Cash Balance** | | **$ 4,200** |
| | | |

## Exercise 1-23B *Retained earnings and the closing process*

As of December 31, Year 1, Big Horn Company had total assets of $100,000, total liabilities of $30,000, and common stock of $50,000. The company's Year 1 income statement contained revenue of $16,000 and expenses of $11,000. The Year 1 statement of changes in stockholders' equity stated that $2,000 of dividends were paid to investors.

### Required

**a.** Determine the before-closing balance in the Retained Earnings account on December 31, Year 1.

**b.** Determine the after-closing balance in the Retained Earnings account on December 31, Year 1.

**c.** Determine the before-closing balances in the Revenue, Expense, and Dividend accounts on December 31, Year 1.

**d.** Determine the after-closing balances in the Revenue, Expense, and Dividend accounts on December 31, Year 1.

**e.** Explain the difference between common stock and retained earnings.

**f.** On January 1, Year 2, Big Horn Company raised $40,000 by issuing additional common stock. Immediately after the additional capital was raised. Big Horn reported total stockholders' equity of $110,000. Are the stockholders of Big Horn in a better financial position than they were on December 31, Year 1?

## EXERCISE 1-23B

a.

**Big Horn Company**
**Accounting Equation as of December 31, Year 1**

| Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| $_________ | | $_________ | | $___________ | | ? |
| | | | | | | |

Retained Earnings = $__________

| | |
|---|---|
| Retained Earnings after closing: | |
| Less, | |
| Add, | |
| Add, | |
| Retained Earnings before closing | |

b. Retained Earnings after closing is $___________. (see the equation above).

c. The balances in revenue, expense and dividends before closing are:

| | |
|---|---|
| Revenue | |
| Expenses | |
| Dividends | |

d. After closing revenue, expenses, and dividends, all of the balances will be _______________.

e. Both Common Stock and Retained Earnings represent obligations the business has to stockholders. They differ in that the Common Stock represents__________________________________and retained earnings represents____________________________________________.

## Exercise 1-23B (cont.)

f. The additional stock issue resulted in the stockholders:

## Exercise 1-24B *The closing process*

Pam's Crafts opened on January 1, Year 1. Pam's reported the following for cash revenues and cash expenses for Year 1 to Year 3:

| | Cash Revenues | Cash Expenses |
|---|---|---|
| Year 1 | $40,000 | $21,000 |
| Year 2 | $50,000 | $32,000 |
| Year 3 | $70,000 | $48,000 |

**Required**

**a.** What would Pam's Crafts report for net income and retained earnings for the years Year 1, Year 2, and Year 3?

**b.** Explain the difference between net income and retained earnings.

**c.** Assume that Pam's Crafts paid a $6,000 dividend to stockholders in Year 2. What would Pam's Crafts report for net income and retained earnings for Year 2 and Year 3?

## EXERCISE 1-24B

**a.**

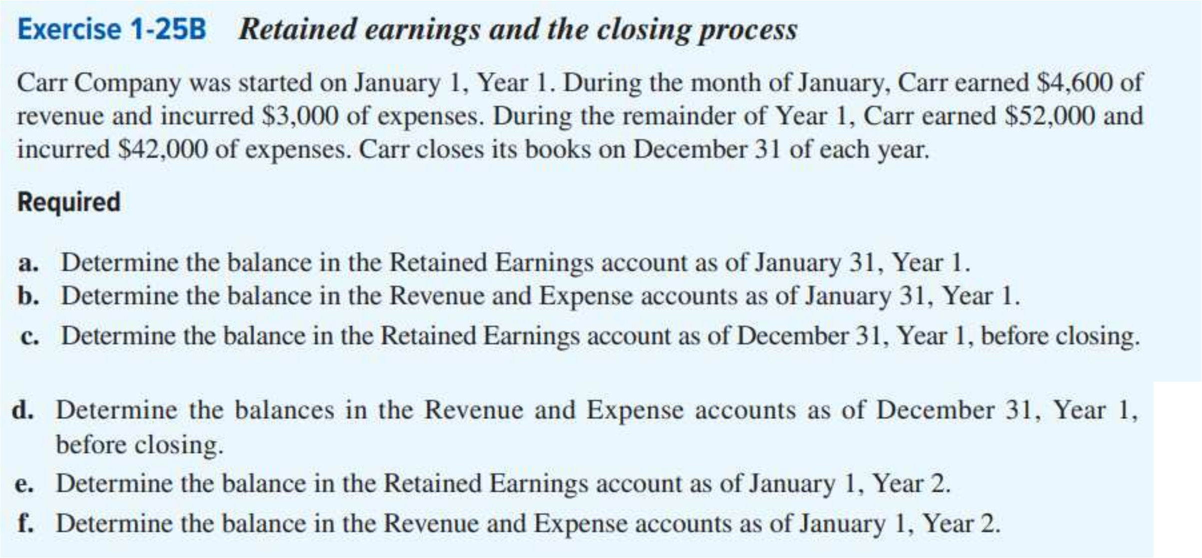
| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| Year 1 | $40,000 | $21,000 | | |
| Year 2 | 50,000 | 32,000 | | |
| Year 3 | 70,000 | 48,000 | | |
| | | | | |

**b. Net income is:**

**Whereas, retained earnings is:**

**c.**

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| Year 1 | $40,000 | $21,000 | | |
| Year 2 | 50,000 | 32,000 | | |
| Year 3 | 70,000 | 48,000 | | |
| | | | | |



## Exercise 1-25B *Retained earnings and the closing process*

Carr Company was started on January 1, Year 1. During the month of January, Carr earned $4,600 of revenue and incurred $3,000 of expenses. During the remainder of Year 1, Carr earned $52,000 and incurred $42,000 of expenses. Carr closes its books on December 31 of each year.

**Required**

**a.** Determine the balance in the Retained Earnings account as of January 31, Year 1.
**b.** Determine the balance in the Revenue and Expense accounts as of January 31, Year 1.
**c.** Determine the balance in the Retained Earnings account as of December 31, Year 1, before closing.
**d.** Determine the balances in the Revenue and Expense accounts as of December 31, Year 1, before closing.
**e.** Determine the balance in the Retained Earnings account as of January 1, Year 2.
**f.** Determine the balance in the Revenue and Expense accounts as of January 1, Year 2.

## EXERCISE 1-25B

a. **The balance in the Retained Earnings account as of January 31, Year 1 is_____________**

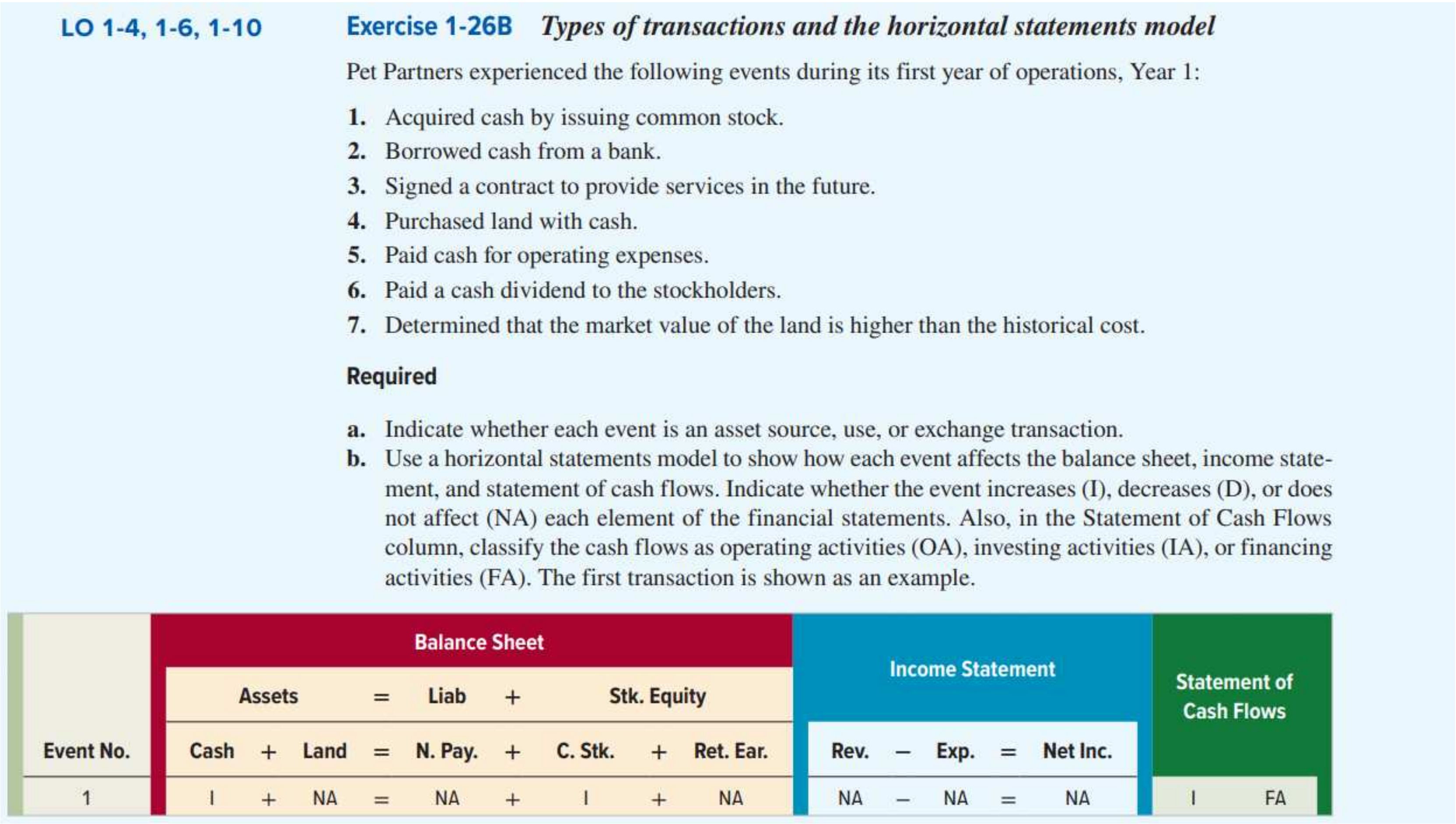
b. **The balance in the Revenue account as of January 31, Year 1 is $________. The balance in the Expense account as of January 31, Year 1 is $_________.**

c. **The *before closing* balance in the Retained Earnings account as of December 31, Year 1 is $_________.**

d. **The December 31, Year 1 *before closing* balance in the Revenue account is $__________. The December 31, Year 1 *before closing* balance in the Expense account is $___________.**

e. **The January 1, Year 2 balance in the Retained Earnings account is $___________.**

f. **The January 1, Year 2 balance in the Revenue and Expense accounts is $___________.**



LO 1-4, 1-6, 1-10

### Exercise 1-26B *Types of transactions and the horizontal statements model*

Pet Partners experienced the following events during its first year of operations, Year 1:

1. Acquired cash by issuing common stock.
2. Borrowed cash from a bank.
3. Signed a contract to provide services in the future.
4. Purchased land with cash.
5. Paid cash for operating expenses.
6. Paid a cash dividend to the stockholders.
7. Determined that the market value of the land is higher than the historical cost.

**Required**

**a.** Indicate whether each event is an asset source, use, or exchange transaction.

**b.** Use a horizontal statements model to show how each event affects the balance sheet, income statement, and statement of cash flows. Indicate whether the event increases (I), decreases (D), or does not affect (NA) each element of the financial statements. Also, in the Statement of Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first transaction is shown as an example.

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab | + | Stk. Equity | | | | | | | | | |
| Event No. | Cash | + | Land | = | N. Pay. | + | C. Stk. | + | Ret. Ear. | Rev. | − | Exp. | = | Net Inc. | | |
| 1 | I | + | NA | = | NA | + | I | + | NA | NA | − | NA | = | NA | I | FA |

## EXERCISE 1-26B

a.

| Event | |
|---|---|
| 1. | |
| 2. | |
| 3. | |
| 4. | |
| 5. | |
| 6. | |
| 7. | |

b.

**Pet Partners**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | − | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | I | + | NA | = | NA | + | I | + | NA | NA | – | NA | = | NA | I FA |
| 2 | | | | | | | | | | | | | | | |
| 3 | | | | | | | | | | | | | | | |
| 4 | | | | | | | | | | | | | | | |
| 5 | | | | | | | | | | | | | | | |
| 6 | | | | | | | | | | | | | | | |
| 7 | | | | | | | | | | | | | | | |

## **Exercise 1-27B** *International Financial Reporting Standards*

Corrugated Boxes Inc. is a U.S.-based company that develops its financial statements under GAAP. The total amount of the company's assets shown on its balance sheet for the current year was approximately $305 million. The president of Corrugated is considering the possibility of relocating the company to a country that practices accounting under IFRS. The president has hired an international accounting firm to determine what the company's statements would look like if they were prepared under IFRS. One striking difference is that under IFRS the assets shown on the balance sheet would be valued at approximately $345 million.

**Required**

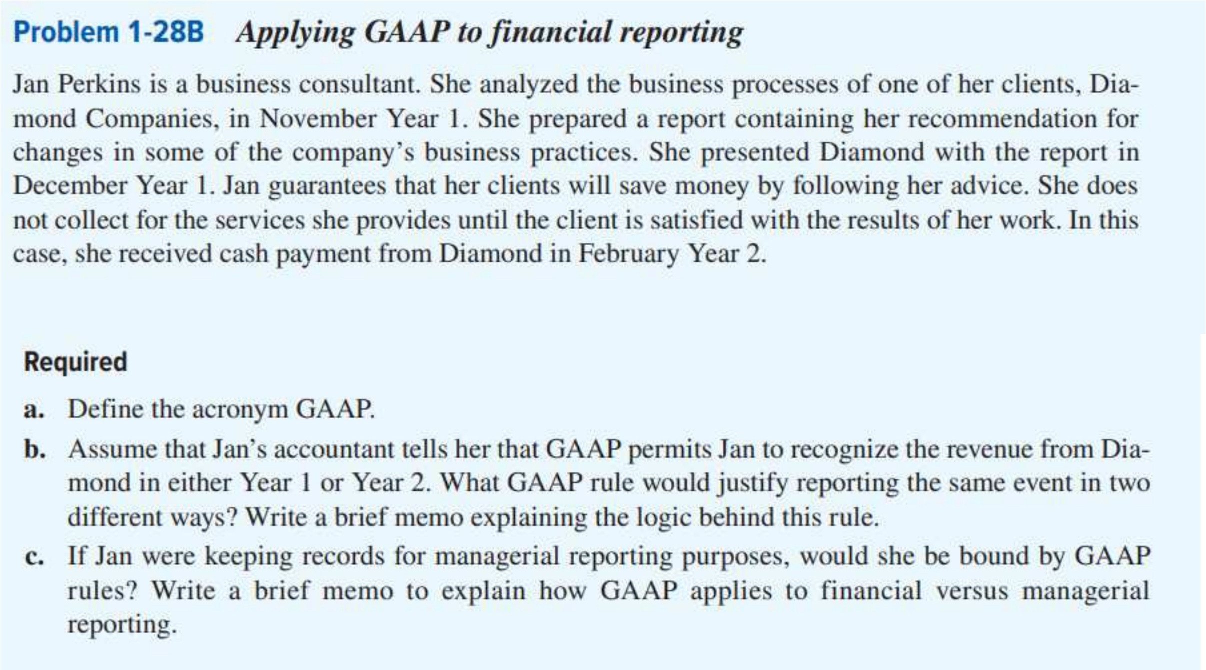
**a.** Would Corrugated Boxes' assets really be worth $40 million more if it moves its headquarters?

**b.** Discuss the underlying conceptual differences between U.S. GAAP and IFRS that cause the difference in the reported asset values.

## EXERCISE 1-27B

a. Corrugated Boxes _________________(would/would not) be worth $40 million more. Explain:

b. Conceptual differences between IASC and FASB that cause reported asset value differences include :



**Problem 1-28B** ***Applying GAAP to financial reporting***

Jan Perkins is a business consultant. She analyzed the business processes of one of her clients, Diamond Companies, in November Year 1. She prepared a report containing her recommendation for changes in some of the company's business practices. She presented Diamond with the report in December Year 1. Jan guarantees that her clients will save money by following her advice. She does not collect for the services she provides until the client is satisfied with the results of her work. In this case, she received cash payment from Diamond in February Year 2.

**Required**

**a.** Define the acronym GAAP.

**b.** Assume that Jan's accountant tells her that GAAP permits Jan to recognize the revenue from Diamond in either Year 1 or Year 2. What GAAP rule would justify reporting the same event in two different ways? Write a brief memo explaining the logic behind this rule.

**c.** If Jan were keeping records for managerial reporting purposes, would she be bound by GAAP rules? Write a brief memo to explain how GAAP applies to financial versus managerial reporting.

## PROBLEM 1-28B

**a. GAAP stand for____________________________________.**

**b. GAAP rule:**

**Memo Re: Logic behind the GAAP rule**

**c. Memo Re: How GAAP applies to financial versus managerial**

## **Problem 1-29B** *Accounting entities*

The following business scenarios are independent from one another:

1. Chris Hann purchased an automobile from Classic Auto Sales for $10,000.
2. Sal Pearl loaned $15,000 to the business in which he is a stockholder.
3. First State Bank paid interest to Strong Co. on a certificate of deposit that Strong Co. has invested at First State Bank.
4. Cindy's Restaurant paid the current utility bill of $135 to Midwest Utilities.
5. Sun Corp. borrowed $50,000 from City National Bank and used the funds to purchase land from Carriage Realty.
6. Sue Wang purchased $10,000 of common stock of International Sales Corporation from the corporation.
7. Chris Gordon loaned $6,000 cash to his daughter.
8. Motor Service Co. earned $20,000 in cash revenue.
9. Poy Imports paid $4,000 for salaries to each of its four employees.
10. Borg Inc. paid a cash dividend of $4,000 to its sole shareholder, Mark Borg.

### Required

**a.** For each scenario, create a list of all the entities mentioned in the description.

**b.** Describe what happens to the cash account of each entity you identified in Requirement *a*.

## PROBLEM 1-29B

| a. Entities mentioned: | b. Effect on the cash account: |
|---|---|
| 1. Chris Hann | Decrease |
| Classic Auto Sales | Increase |
| | |
| 2. | |
| | |
| | |
| 3. | |
| | |
| | |
| 4. | |
| | |
| | |
| 5. | |
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| 6. | |
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| 7. | |
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| 8. | |
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| 9. | |
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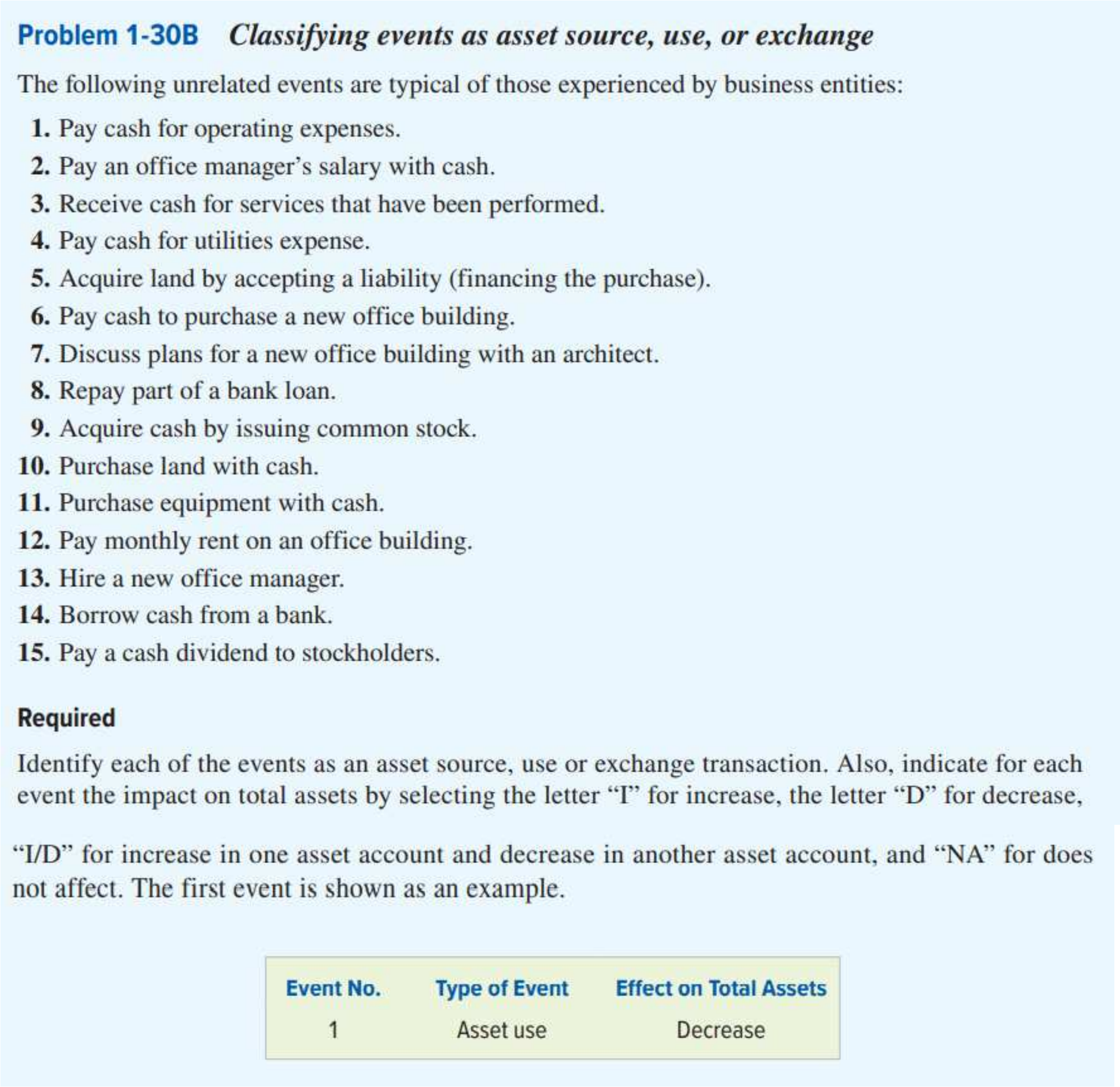
| | |
| 10. | |
| | |



## **Problem 1-30B** *Classifying events as asset source, use, or exchange*

The following unrelated events are typical of those experienced by business entities:

1. Pay cash for operating expenses.
2. Pay an office manager's salary with cash.
3. Receive cash for services that have been performed.
4. Pay cash for utilities expense.
5. Acquire land by accepting a liability (financing the purchase).
6. Pay cash to purchase a new office building.
7. Discuss plans for a new office building with an architect.
8. Repay part of a bank loan.
9. Acquire cash by issuing common stock.
10. Purchase land with cash.
11. Purchase equipment with cash.
12. Pay monthly rent on an office building.
13. Hire a new office manager.
14. Borrow cash from a bank.
15. Pay a cash dividend to stockholders.

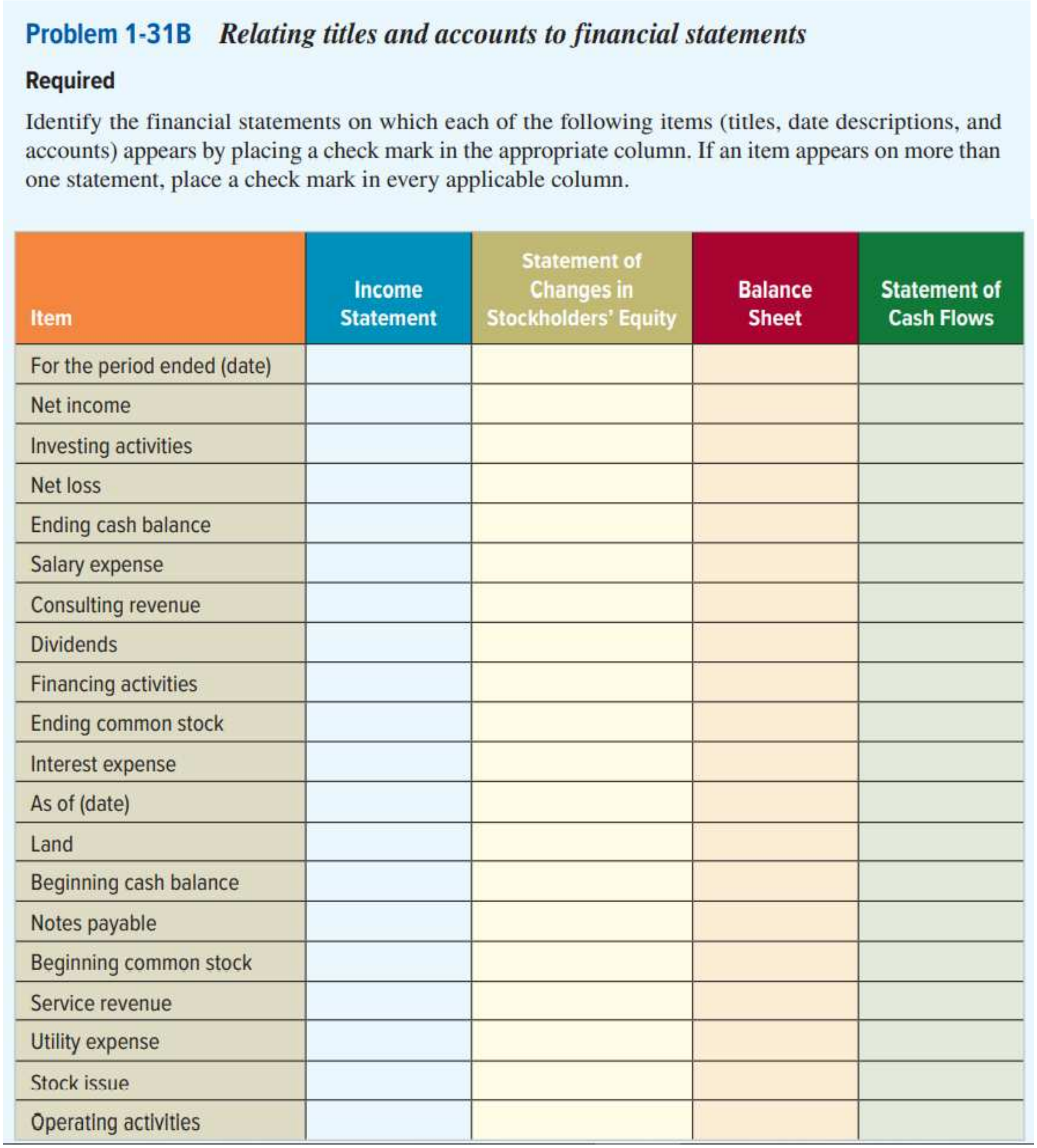
### Required

Identify each of the events as an asset source, use or exchange transaction. Also, indicate for each event the impact on total assets by selecting the letter "I" for increase, the letter "D" for decrease, "I/D" for increase in one asset account and decrease in another asset account, and "NA" for does not affect. The first event is shown as an example.

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1 | Asset use | Decrease |

## PROBLEM 1-30B

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1. | Asset Use | Decrease |
| 2. | | |
| 3. | | |
| 4. | | |
| 5. | | |
| 6. | | |
| 7. | | |
| 8. | | |
| 9. | | |
| 10. | | |
| 11. | | |
| 12. | | |
| 13. | | |
| 14. | | |
| 15. | | |
| | | |



## Problem 1-31B *Relating titles and accounts to financial statements*

**Required**

Identify the financial statements on which each of the following items (titles, date descriptions, and accounts) appears by placing a check mark in the appropriate column. If an item appears on more than one statement, place a check mark in every applicable column.

| Item | Income Statement | Statement of Changes in Stockholders' Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| For the period ended (date) | | | | |
| Net income | | | | |
| Investing activities | | | | |
| Net loss | | | | |
| Ending cash balance | | | | |
| Salary expense | | | | |
| Consulting revenue | | | | |
| Dividends | | | | |
| Financing activities | | | | |
| Ending common stock | | | | |
| Interest expense | | | | |
| As of (date) | | | | |
| Land | | | | |
| Beginning cash balance | | | | |
| Notes payable | | | | |
| Beginning common stock | | | | |
| Service revenue | | | | |
| Utility expense | | | | |
| Stock issue | | | | |
| Operating activities | | | | |

## PROBLEM 1-31B

| Item | Income Statement | Statement of Changes in Stk. Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| For the Period Ended (date) | ✓ | ✓ |  | ✓ |
| Net income |  |  |  |  |
| Investing activities |  |  |  |  |
| Net loss |  |  |  |  |
| Ending cash balance |  |  |  |  |
| Salary expense |  |  |  |  |
| Consulting revenue |  |  |  |  |
| Dividends |  |  |  |  |
| Financing activities |  |  |  |  |
| Ending common stock |  |  |  |  |
| Interest expense |  |  |  |  |
| As of (date) |  |  |  |  |
| Land |  |  |  |  |
| Beginning cash balance |  |  |  |  |
| Notes payable |  |  |  |  |
| Beginning common stock |  |  |  |  |
| Service revenue |  |  |  |  |
| Utility expense |  |  |  |  |
| Stock issue |  |  |  |  |
| Operating activities |  |  |  |  |

## **Problem 1-32B** *Preparing financial statements for two complete accounting cycles*

Marco's Consulting experienced the following transactions for Year 1, its first year of operations, and Year 2. *Assume that all transactions involve the receipt or payment of cash.*

### Transactions for Year 1

1. Acquired $50,000 by issuing common stock.
2. Received $100,000 cash for providing services to customers.
3. Borrowed $15,000 cash from creditors.
4. Paid expenses amounting to $60,000.
5. Purchased land for $40,000 cash.

### Transactions for Year 2

Beginning account balances for Year 2 are:

| | |
|---|---|
| Cash | $65,000 |
| Land | 40,000 |
| Notes payable | 15,000 |
| Common stock | 50,000 |
| Retained earnings | 40,000 |

1. Acquired an additional $20,000 from the issue of common stock.
2. Received $130,000 for providing services.
3. Paid $10,000 to creditors to reduce loan.
4. Paid expenses amounting to $75,000.
5. Paid a $15,000 dividend to the stockholders.
6. Determined that the market value of the land is $50,000.

### Required

**a.** Write an accounting equation, and record the effects of each accounting event under the appropriate headings for each year. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide appropriate titles for these accounts in the last column of the table.

**b.** Prepare an income statement, statement of changes in stockholders' equity, year-end balance sheet, and statement of cash flows for each year.

**c.** Determine the amount of cash that is in the Retained Earnings account at the end of Year 1 and Year 2.

**d.** Examine the balance sheets for the two years. How did assets change from Year 1 to Year 2?

**e.** Determine the balance in the Retained Earnings account immediately after Event 2 in Year 1 and in Year 2 are recorded.

## PROBLEM 1-32B

a.

### Marco’s Consulting
### Accounting Equation for Year 1

| | Assets | | | = | Liabilities | + | Stockholders’ Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| 1. Issued stk | 50,000 | + | NA | = | NA | + | 50,000 | + | NA | NA |
| 2. Revenue | | | | | | | | | | |
| 3. Loan | | | | | | | | | | |
| 4. Paid Exp. | | | | | | | | | | |
| 5. Pur. Land | | | | | | | | | | |
| Totals | 65,000 | + | | | | | | + | 40,000 | |

### Marco’s Consulting
### Accounting Equation for Year 2

| | Assets | | | = | Liabilities | + | Stockholders’ Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | 65,000 | + | 40,000 | = | 15,000 | + | 50,000 | + | 40,000 | |
| 1. Issued stk | | | | | | | | | | |
| 2. Revenue | | | | | | | | | | |
| 3. Paid Loan | | | | | | | | | | |
| 4. Paid Exp. | | | | | | | | | | |
| 5. Paid Div. | | | | | | | | | | |
| 6. Land Val. | | | | | | | | | | |
| Totals | 115,000 | + | | | | | | + | 80,000 | |

## PROBLEM 1-32B (cont.)

b.

### Marco's Consulting
### Income Statement
### For the Period Ended December 31, Year 1

| | |
|---|---|
| Service Revenue | |
| Expenses | |
| Net Income | |

### Marco's Consulting
### Statement of Changes in Stockholders' Equity
### For the Period Ended December 31, Year 1

| | | |
|---|---|---|
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| Plus: Net Income | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | |

## PROBLEM 1-32B (cont.)

b.

**Marco's Consulting**
**Balance Sheet**
**As of December 31, Year 1**

| | | |
|---|---|---|
| Assets | | |
| Cash | | |
| Land | | |
| Total Assets | | |
| | | |
| Liabilities | | |
| Notes Payable | | |
| | | |
| Stockholders' Equity | | |
| Common Stock | | |
| Retained Earnings | | |
| Total Stockholders' Equity | | |
| | | |
| Total Liabilities and Stockholders' Equity | | |

**PROBLEM 1-32B (cont.)**

**b.**

| Marco's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 1 | | |
|---|---|---|
| | | |
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | | |
| Cash Payments for Expenses | | |
| Net Cash Flow from Operating Activities | | |
| | | |
| Cash Flows From Investing Activities: | | |
| | | |
| Net Cash Flow from Investing Activities | | |
| | | |
| Cash Flows From Financing Activities: | | |
| | | |
| | | |
| Net Cash Flow from Financing Activities | | |
| | | |
| Net Increase in Cash | | |
| Plus: Beginning Cash Balance | | |
| Ending Cash Balance | | |
| | | |

## PROBLEM 1-32B (cont.)

b.

### Marco's Consulting
### Income Statement
### For the Period Ended December 31, Year 2

| | |
|---|---|
| Service Revenue | |
| Expenses | |
| Net Income | |

### Marco's Consulting
### Statement of Changes in Stockholders' Equity
### For the Period Ended December 31, Year 2

| | | |
|---|---|---|
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| Plus: Net Income | | |
| Less: Dividends | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | |

**PROBLEM 1-32B (cont.)**

**b.**

| Marco's Consulting<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| | | |
| **Assets** | | |
| Cash | | |
| Land | | |
| **Total Assets** | | |
| | | |
| **Liabilities** | | |
| Notes Payable | | |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | | |
| Retained Earnings | | |
| **Total Stockholders' Equity** | | |
| | | |
| **Total Liabilities and Stockholders' Equity** | | |
| | | |

**PROBLEM 1-32B (cont.)**

b.

**Marco's Consulting**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| | | |
| **Cash Flows From Operating Activities:** | | |
| **Cash Receipts from Customers** | | |
| **Cash Payments for Expenses** | | |
| **Net Cash Flow from Operating Activities** | | |
| | | |
| **Cash Flows From Investing Activities** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| | | |
| | | |
| | | |
| **Net Cash Flow from Financing Activities** | | |
| | | |
| **Net Increase in Cash** | | |
| **Plus: Beginning Cash Balance** | | |
| **Ending Cash Balance** | | |
| | | |

c. **Retained Earnings ________________(does/does not) contain cash.**

d. **Assets increased from $_____________at December 31, Year 1 to $_____________ at December 31, Year 2. This increase of $________ is solely due to the increase in cash.**

e. **Immediately after Event 2 in Year 1 is recorded the balance in the Retained Earnings account is $____________.**

# PROBLEM 1-32B (cont.)

e. The balance in the Retained Earnings account immediately after Event 2 in Year 2 is $__________________.

## **Problem 1-33B** *Interrelationships among financial statements*

Blix Corp. started the Year 2 accounting period with total assets of $50,000 cash, $20,000 of liabilities, and $20,000 of retained earnings. During the Year 2 accounting period, the Retained Earnings account increased by $8,500. The bookkeeper reported that Blix Corp. paid cash expenses of $15,000 and paid a $4,000 cash dividend to stockholders, but she could not find a record of the amount of cash revenue that Blix Corp. received for performing services. Blix Corp. also paid $2,000 cash to reduce the liability owed to a bank, and the business acquired $8,000 of additional cash from the issue of common stock. Assume all transactions are cash transactions.

### Required

- **a.** Prepare the Year 2 income statement.
- **b.** Prepare the Year 2 statement of changes in stockholders' equity.
- **c.** Prepare the Year 2 balance sheet.
- **d.** Prepare the Year 2 statement of cash flows.
- **e.** Determine the percentage of total assets that were provided by creditors, investors, and earnings.
- **f.** If the company were liquidated on December 31, Year 2, how much cash would be distributed to the creditors? How much cash would be distributed to the owners?

## PROBLEM 1-33B

a.

| Blix Corp.<br>Income Statement<br>For the Year Ended December 31, Year 2 | |
|---|---|
| | |
| Revenue | |
| Expense | |
| Net Income | |
| | |

[1] To calculate revenue, you must first determine the ending balance in the retained earnings account at the end of Year 2:

Next, you can use this information to determine the amount of net income:

| | |
|---|---|
| Beginning Retained Earnings | $ 20,000 |
| Plus Net Income | "X" |
| Minus Dividends | (4,000) |
| Ending Retained earnings | $ |

X = $_________ - $_________ + $4,000;

X = $_____________

Finally, using the amount of net income, you can derive revenue:

| | |
|---|---|
| Revenue | $ "X" |
| Expenses | (15,000) |
| Net Income | $ |

X = $__________ + $_________; X = $_________

**PROBLEM 1-33B (cont.)**

**b.**

**Blix Corp.**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 2**

| | | |
|---|---|---|
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| Plus: Net Income | | |
| Less: Dividends | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | |

[2] To calculate the amount of common stock issued; rearrange the accounting equation and solve for the missing variable common stock as follows:

## EXERCISE 1-33B (cont.)

c.

| Blix Corp.<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| | | |
| **Assets** | | |
| | | |
| **Liabilities** | | |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | | |
| Retained Earnings | | |
| **Total Stockholders' Equity** | | |
| | | |
| **Total Liabilities and Stockholders' Equity** | | |
| | | |

## PROBLEM 1-33B (cont.)

d.

| Blix Corp.<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| | | |
| **Cash Flows From Operating Activities:** | | |
| Cash Receipt from Revenue | | |
| Cash Payment for Expense | | |
| **Net Cash Flow from Operating Activities** | | |
| | | |
| **Cash Flows From Investing Activities** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | | |
| Cash Payment to Creditors | | |
| Cash Dividend Paid to Stockholders | | |
| **Net Cash Flow from Financing Activities** | | |
| | | |
| **Net Increase in Cash** | | |
| **Plus: Beginning Cash Balance** | | |
| **Ending Cash Balance** | | |
| | | |

e. Percentage of assets provided by:

Creditors $________ ÷ _______ =_______%

Investors $________ ÷ _______ = _______%

Earnings $________ ÷ ________ = _______%

f. Creditors would receive $____________ and $__________ would be distributed to owners.

## **Problem 1-34B** *Show how the events affect the horizontal statements model*

Daley Company was started on January 1, Year 1, and experienced the following events during its first year of operation:

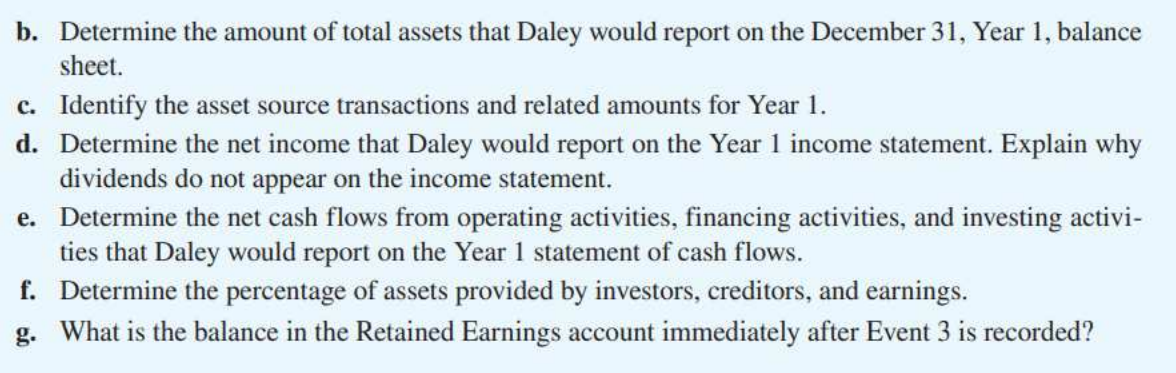
1. Acquired $52,000 cash from the issue of common stock.
2. Borrowed $20,000 cash from National Bank.
3. Earned cash revenues of $42,000 for performing services.
4. Paid cash expenses of $23,000.
5. Paid a $6,000 cash dividend to the stockholders.
6. Acquired an additional $10,000 cash from the issue of common stock.
7. Paid $10,000 cash to reduce the principal balance of the bank note.
8. Paid $45,000 cash to purchase land.
9. Determined that the market value of the land is $55,000.

### Required

**a.** Use a horizontal statements model to show how each event affects the balance sheet, income statement, and statement of cash flows. Also, in the Statement of Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first event is shown as an example.

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab | + | Stk. Equity | | | | | | | | | |
| Event No. | Cash | + | Land | = | N. Pay. | + | C. Stk. | + | Ret. Ear. | Rev. | − | Exp. | = | Net Inc. | | |
| 1 | 52,000 | + | NA | = | NA | + | 52,000 | + | NA | NA | − | NA | = | NA | 52,000 | FA |

**Continued on next page.**



**b.** Determine the amount of total assets that Daley would report on the December 31, Year 1, balance sheet.

**c.** Identify the asset source transactions and related amounts for Year 1.

**d.** Determine the net income that Daley would report on the Year 1 income statement. Explain why dividends do not appear on the income statement.

**e.** Determine the net cash flows from operating activities, financing activities, and investing activities that Daley would report on the Year 1 statement of cash flows.

**f.** Determine the percentage of assets provided by investors, creditors, and earnings.

**g.** What is the balance in the Retained Earnings account immediately after Event 3 is recorded?

## PROBLEM 1-34B

a.

**Daley Company**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | – | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | 52,000 | + | NA | = | NA | + | 52,000 | + | NA | NA | – | NA | = | NA | 52,000 FA |
| 2 | | | | | | | | | | | | | | | |
| 3 | | | | | | | | | | | | | | | |
| 4 | | | | | | | | | | | | | | | |
| 5 | | | | | | | | | | | | | | | |
| 6 | | | | | | | | | | | | | | | |
| 7 | | | | | | | | | | | | | | | |
| 8 | | | | | | | | | | | | | | | |
| 9 | | | | | | | | | | | | | | | |
| Total | 40,000 | + | | | | | | | | | | | | | |

## PROBLEM 1-34B (cont.)

b. Total Assets =

c.

| Sources of Assets | |
|---|---|
| Event | |
| 1. Issue of stock | $ 52,000 |
| 2. | |
| 3. | |
| 6. | |
| Total Sources of Assets | $124,000 |

d. Net income is $___________. Dividends are not _____________so they do not appear on the income statement.

e.

| Operating Activities: | |
|---|---|
| Cash from customers | |
| Cash paid for expenses | |
| Net Cash Flow from Operating Activities | |
| | |

| Investing Activities: | |
|---|---|
| | |
| Net Cash Flow from Investing Activities | |
| | |

| Financing Activities: | |
|---|---|
| Cash from stock issues | |
| | |
| | |
| | |
| Net Cash Flow from Financing Activities | |
| | |

f. **Percentage of assets provided by:**

**Creditors $_________ ÷ $_________ = _________%**
**Investors $_________ ÷ $_________ = _________%**
**Earnings $_________ ÷ $_________ = _________%**

g.