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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

<u>Assets</u> are the economic resources used by a business for the production of revenue. <u>Liabilities</u> are obligations of a business to relinquish assets, provide services, or accept other obligations. <u>Equity</u>, 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 <u>owners</u> ultimately bear the risk and collect the rewards associated with operating a business.

19. 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.

20. 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.

21. 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.

22. 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.

23. <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.

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

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

26. 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.

27. 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.

28. (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.

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

30. A net loss is caused when the company's expenses exceed the amount of revenues generated during a period.

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

32. (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.

33. 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).

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

35. 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.

36. 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.

37. 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

38. 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 BRIEF EXERCISES - CHAPTER 1

BRIEF EXERCISE 1-1

1. Investors
2. Creditors

BRIEF EXERCISE 1-2

Reporting entities

BRIEF EXERCISE 1-3

Accounting Equation						
				Stockholders' Equity		
Assets	=	**Liabilities**	+	**Common Stock**	+	**Retained Earnings**
$150,000	=	$20,000	+	$100,000	+	$30,000

BRIEF EXERCISE 1-4

1. Asset Source
2. Asset Exchange
3. Asset Source
4. Asset Use

BRIEF EXERCISE 1-5

Agave Moss Accounting Equation									
	Assets				Liabilities		Stockholders' Equity		
Event No.	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings
1	500,000	+	NA	=	NA	+	500,000	+	NA
2	(200,000)	+	200,000	=	NA	+	NA	+	NA
3	80,000	+	NA	=	80,000	+	NA	+	NA
4	150,000	+	NA	=	NA	+	NA	+	150,000

BRIEF EXERCISE 1-6

Rocket, Inc. Balance Sheet Year 1 & Year 2		
	Year 1	Year 2
Assets		
Cash	$1,200	$1,500[1]
Total Assets	$1,200	$1,500
Total Liabilities	$500	$500
Stockholders' Equity		
Common Stock	$700	$700
Retained Earnings	$0	$300[2]
Total Stockholders' Equity	$700	$1,000
Total Liabilities and Stockholders' Equity	$1,200	$1,500

[1]**Cash revenues of $1,800 minus cash expenses of $1,500 equals a $300 increase in the cash balance.**
[2]**Cash revenues of $1,800 minus cash expenses of $1,500 equals retained earnings of $300.**

BRIEF EXERCISE 1-7

Capital Consultants Co. Income Statement For the Year Ended December 31, Year 2	
Revenue	$580,000
Expense	(420,000)
Net Income	$160,000

BRIEF EXERCISE 1-8

Social Net
Statement of Changes in Stockholders' Equity
For the Year Ended December 31, Year 1

Common Stock	$ 0	
Plus: Common Stock Issued	120,000	
Ending Common Stock		120,000
Beginning Retained Earnings	$ -0-	
Plus: Net Income	34,000[1]	
Less: Dividends	(10,000)	
Ending Retained Earnings		24,000
Total Stockholders' Equity		$144,000

[1]Revenues of $86,000 minus expenses of $52,000 equals net income of $34,000.

BRIEF EXERCISE 1-9

Ride-With-Me Statement of Cash Flows For the Year Ended December 31, Year 2		
Cash Flows From Operating Activities:		
Net Cash Inflow from Operating Activities		$ 310,000
Cash Flows From Investing Activities:		
Net Cash Outflow from Investing Activities		(150,000)
Cash Flows From Financing Activities:		
Net Cash Outflow from Financing Activities		(85,000)
Net Increase in Cash		75,000
Plus: Beginning Cash Balance		280,000
Ending Cash Balance		$355,000

BRIEF EXERCISE 1-10

Balance Sheet

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 Decrease for payment of advertising, $1,000 Decrease payment for hospital bills, $12,000 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

EXERCISE 1-5A

a.

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 1-6A

a.

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

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 1-7A

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

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 1-9A

a. **Decrease**

b. **Increase**

c. **Increase**

d. **Decrease**

e. **Asset Exchange**

f. **Asset Exchange**

EXERCISE 1-10A

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 1-11A

a.

Better Corp.
Accounting Equation for Year 1

	Assets			=	Liabilities	+	Stockholders' Equity			
Event	Cash	+	Land	=	Notes Payable	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
1. Issued Stk.	7,000	+	NA	=	NA	+	7,000	+	NA	NA
2. Loan	12,000	+	NA	=	12,000	+	NA	+	NA	NA
3. Provide Svc.	47,000	+	NA	=	NA	+	NA	+	47,000	Svc. Rev.
4. Pd Op. Exp.	(30,000)	+	NA	=	NA	+	NA	+	(30,000)	Op. Exp.
5. Paid Div.	(8,000)	+	NA	=	NA	+	NA	+	(8,000)	Dividends
6. Land Purch.	(20,000)	+	20,000	=	NA	+	NA	+	NA	
End Bal.	8,000	+	20,000	=	12,000	+	7,000	+	9,000	

EXERCISE 1-11A (cont.)

b.

Assets	=	Liabilities	+	Stockholders' Equity
28,000	=	12,000	+	16,000

Better Corp. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$8,000	
Land	20,000	
Total Assets		$28,000
Liabilities		
Notes Payable	$12,000	
Total Liabilities		$12,000
Stockholders' Equity		
Common Stock	$7,000	
Retained Earnings	9,000	
Total Stockholders' Equity		$16,000
Total Liabilities and Stockholders' Equity		$28,000

c.

Assets	=	Liabilities	+	Stockholders' Equity
28,000	=	12,000	+	16,000

The ending balances for assets, liabilities, and stockholders' equity at end of Year 1 will become the beginning balances for these same accounts in Year 2.

d. **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.**

EXERCISE 1-12A

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/Year 2	8,000		20,000		12,000		7,000		9,000	
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	Svc. Rev.
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
End Bal.	66,000	+	25,000	=	22,000	+	32,000	+	37,000	

EXERCISE 1-12A (cont.)

b.

Assets	=	Liabilities	+	Stockholders' Equity
91,000	=	22,000	+	69,000

Better Corp. Balance Sheets December 31, Year 1 & Year 2		
	Year 1	**Year 2**
Assets		
Cash	$8,000	$66,000
Land	20,000	25,000
Total Assets	$28,000	$91,000
Liabilities		
Notes Payable	$12,000	$22,000
Total Liabilities	$12,000	$22,000
Stockholders' Equity		
Common Stock	$7,000	$32,000
Retained Earnings	9,000	37,000
Total Stockholders' Equity	$16,000	$69,000
Total Liabilities and Stockholders' Equity	$28,000	$91,000

EXERCISE 1-12A (cont.)

c. **There is no cash in the notes payable account. Cash is an asset that belongs on the left side of the accounting equation. Notes payable are liabilities that represents an obligation of the Company to distribute assets in the future.**

d. **There is no cash in the common stock account. Cash is an asset that belongs on the left side of the accounting equation. Common stock represents the portion of assets owned by the investors of the Company.**

e. **There is no cash in the retained earnings account. Retained earnings represent earnings that have already been reinvested into the business to support its core functions. There is no physical cash in the retained earnings account. At the end of Year 2, the cash account has a balance of $66,000 while the ending balance in the retained earnings account is $37,000. These balances differ because retained earnings represents the excess of earnings over expenses that were earned during Year 2 while the cash account represents the physical amount of cash on hand at the end of Year 2.**

f. **The balance in the land account at the end of Year 2 is $25,000. 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.**

EXERCISE 1-13A

a.

	Cash	+	Land	=	Creditors	+	Stockholders' Equity
	$10,000	+	$ 0	=	$ 0	+	$10,000
	6,000	+	0	=	6,000	+	0
	(12,000)	+	12,000	=	NA	+	NA
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. There were no transactions involving revenue or expense during Year 1. Accordingly, Jones has no net income or retained earnings at the end of Year 1. Jones is unable to pay a dividend due to not having any retained earnings at the end of Year 1. Since dividends are distributions of assets generated through earnings, the company cannot distribute an amount exceeding retained earnings regardless of whether it has enough cash on hand to pay the dividend.

e. 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:

	Cash	+	Land	=	Creditors	+	Stockholders' Equity
Bal.	4,000	+	12,000	=	37.5%	+	62.5%

EXERCISE 1-13A (cont.)

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

EXERCISE 1-14A

a. The maximum dividend that Allen Co. could pay based on the information would be $500, the amount of retained earnings. Since dividends are distributions of assets generated through earnings, the company cannot distribute an amount exceeding retained earnings regardless of whether it has enough cash on hand to pay the dividend.

b. White Co. is unable to pay a dividend due to having a $0 cash balance. Remember that retained earnings does not contain any cash. Without any cash on hand, the company is unable to pay a dividend.

c.

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

d. There are three alternative definitions of the right side of the accounting equation. First, the right side could be referred to as sources of assets. Second, it could be defined as claims on assets. Lastly, it could be defined as obligations to creditors and commitments to owners.

EXERCISE 1-15A

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 an 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 + $90,000 = $50,000 + $55,000 + $25,000
X = -$90,000 + $50,000 + $55,000 + $25,000
X = $40,000

(j) Cash + Land = Notes Pay. + Common Stk. + End. Ret. Ear. (X)
X = Cash + Land – Notes Pay – Common Stk.
X = $69,000 + $140,000 - $40,000 - $123,000
X = $46,000

EXERCISE 1-15A (cont.)

(f)

Beginning Retained Earnings	$25,000
+ Revenue	X
- Expenses	(57,000)
- Dividends	(14,000)
Ending Retained Earnings	$46,000

$25,000 + X – $57,000 – $14,000 = $46,000
X = $92,000

(e) Given that revenue increased by $92,000 cash must have increased by $92,000.

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)92,000	+	NA	=	NA	+	NA	+	(f)92,000	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.	69,000	+	(i)140,000	=	40,000	+	123,000	+	(j)46,000	

b. There is sufficient cash available to pay off the debt on January 1, Year 8. At that time, the company has cash of $69,000 which is more than enough funds to repay the $40,000 notes payable.

EXERCISE 1-15A (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, $46,000 is the maximum cash dividend JGGW can pay.

EXERCISE 1-16A

a. **Event #3 and #4 will affect the income statement.**

b.

Ollie Company Income Statement For the Year Ended December 31, Year 1	
Revenue	$59,000
Expense	(43,000)
Net Income	$16,000

EXERCISE 1-17A

Emma, Inc.
Balance Sheets
December 31, Year 1 & Year 2

	Year 1	Year 2
Assets		
Cash	$600	$260
Total Assets	$600	$260
Total Liabilities	$400	$400
Stockholders' Equity		
Common Stock	$200	$200
Retained Earnings	$0	$(340)
Total Stockholders' Equity	$200	$(140)
Total Liabilities and Stockholders' Equity	$600	$260

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

Revenue	$560
Expense	(900)
Net Loss	$(340)

EXERCISE 1-18A

Ollie Company Statement of Changes in Stockholders' Equity For the Period Ended December 31, Year 1		
Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	72,000	
Ending Common Stock		$72,000
Beginning Retained Earnings	-0-	
Plus: Net Income	$16,000	
Less: Dividends	(7,000)	
Ending Retained Earnings		9,000
Total Stockholders' Equity		$81,000

EXERCISE 1-19A

a.

Majka Company
Accounting Equation for Year 1

	Assets	=	Liabilities	+	Stockholders' Equity		
					Common		Retained
Event	Cash	=		+	Stock	+	Earnings
Common Stock	$50,000				$50,000		
1. Cash revenues	28,600		NA		NA		28,600
2. Paid expenses	(13,200)		NA		NA		(13,200)
3. Paid dividend	(1,500)		NA		NA		(1,500)
Ending Balance	63,900	=	-0-	+	50,000	+	13,900

b.

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

Revenue	$28,600
Expense	(13,200)
Net Income	$ 15,400

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

Common Stock	$ 0	
Plus: Common Stock Issued	50,000	
Ending Common Stock		50,000
Beginning Retained Earnings	$ -0-	
Plus: Net Income	15,400	
Less: Dividends	(1,500)	
Ending Retained Earnings		13,900

	Total Stockholders' Equity		**$63,900**	

EXERCISE 1-19A (cont.)

Majka Company Balance Sheet As of December 31, Year 1		
Assets		
Cash		$63,900
Liabilities		$ -0-
Stockholders' Equity		
Common Stock	50,000	
Retained Earnings	13,900	
Total Stockholders' Equity		63,900
Total Liabilities and Stockholders' Equity		$63,900

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 1-20A

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 1-20A (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 1-21A

a.

Moore Company Statement of Cash Flows For the Year Ended December 31, Year 1		
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 1-22A

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

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 Salary 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	10,000	
Cash Payment on Loan	(10,000)	
Cash Payments for Dividends	(5,000)	
Net Cash Flow from Financing Activities		45,000
Net Increase in Cash		56,200
Plus: Beginning Cash Balance		9,000
Ending Cash Balance		$65,200

EXERCISE 1-23A

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/Year 2	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	
End Bal.	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 1-23A (cont.)

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

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 1-23A (cont.)

Dakota Company
Statement of Cash Flows
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%

There is zero cash in the retained earnings account.

d. **The maximum dividend that Dakota could pay is the lessor of cash on hand or retained earnings. Therefore, the maximum dividend at December 31, Year 2 would be the total amount of retained earnings of $10,000.**

EXERCISE 1-24A

a.

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		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%

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%

EXERCISE 1-24A (cont.)

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 1-24A (cont.)

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 1-24A (cont.)

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 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 maximum dividend that Carter could pay is the lessor of cash on hand or retained earnings. Therefore, the maximum dividend at December 31, Year 2 would be the total amount of cash on hand of $900.

EXERCISE 1-25A

a. **The cash flow from operating activities is calculated by subtracting the cash outflow for expenses from the cash inflow from customers. ($18,100 - $8,300 = $9,800).**

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

c. **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 of $4,000 ($7,500 - $3,500) from the issue of common stock. Finally, the $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**

EXERCISE 1-25A (cont.)

d.

Room Designs Inc. Statement of Cash Flows 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 1-25A (cont.)

e.

Room Designs Inc. Income Statement For the Year Ended December 31, Year 2	
Revenue	$18,100
Expenses	(8,300)
Net Income	$9,800

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

EXERCISE 1-25A (cont.)

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 1-26A

a.

Ortho Company
Accounting Equation for Year 1

	Assets			=	Liabilities	+	Stockholders' Equity			
Event	Cash	+	Land	=	Notes Payable	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
Beg. Bal.	$0	+	$0	=	$0	+	$0	+	$0	
1. Issued stk.	68,000	+	NA	=	NA	+	68,000	+	NA	NA
2. Loan	36,000	+	NA	=	36,000	+	NA	+	NA	NA
3. Cash Rev.	59,000	+	NA	=	NA	+	NA	+	59,000	Rev.
4. Cash Exp.	(43,000)	+	NA	=	NA	+	NA	+	(43,000)	Exp.
5. Paid Div.	(7,000)	+	NA	=	NA	+	NA	+	(7,000)	Dividends
6. Land Purch.	(37,000)	+	37,000	=	NA	+	NA	+	NA	
End Bal.	76,000	+	37,000	=	36,000	+	68,000	+	9,000	

Ortho Company
Accounting Equation for Year 2

	Assets			=	Liabilities	+	Stockholders' Equity			
Event	Cash	+	Land	=	Notes Payable	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
Beg. Bal.	$76,000	+	$37,000	=	$36,000	+	$68,000	+	$9,000	
1. Issued stk.	50,000	+	NA	=	NA	+	50,000	+	NA	NA
2. Loan	20,000	+	NA	=	20,000	+	NA	+	NA	NA
3. Cash Rev.	85,000	+	NA	=	NA	+	NA	+	85,000	Rev.
4. Cash Exp.	(62,000)	+	NA	=	NA	+	NA	+	(62,000)	Exp.
5. Paid Div.	(2,000)	+	NA	=	NA	+	NA	+	(2,000)	Dividends
6. Land Purch.	(25,000)	+	25,000	=	NA	+	NA	+	NA	
End Bal.	142,000	+	62,000	=	56,000	+	118,000	+	30,000	

EXERCISE 1-26A (cont.)

b.

Ortho Company
Income Statements
For the Period Ended December 31, Year 1 & Year 2

	Year 1	Year 2
Revenue	$59,000	$85,000
Expenses	(43,000)	(62,000)
Net Income	$16,000	$23,000

Ortho Company
Statements of Changes in Stockholders' Equity
For the Period Ended December 31, Year 1 & Year 2

	Year 1	Year 2
Beginning Common Stock	$ -0-	$68,000
Plus: Common Stock Issued	68,000	50,000
Ending Common Stock	$68,000	$118,000
Beginning Retained Earnings	$ -0-	$9,000
Plus: Net Income	16,000	23,000
Less: Dividends	(7,000)	(2,000)
Ending Retained Earnings	$9,000	$30,000
Total Stockholders' Equity	$77,000	$148,000

EXERCISE 1-26A (cont.)

Ortho Company Balance Sheets December 31, Year 1 & Year 2		
	Year 1	**Year 2**
Assets		
Cash	$76,000	$142,000
Land	$37,000	$62,000
Total Assets	$113,000	$204,000
Total Liabilities	$36,000	$56,000
Stockholders' Equity		
Common Stock	$68,000	$118,000
Retained Earnings	$9,000	$30,000
Total Stockholders' Equity	$77,000	$148,000
Total Liabilities and Stockholders' Equity	$113,000	$204,000

EXERCISE 1-26A (cont.)

Ortho Company
Statements of Cash Flows
For the Year Ended December 31, Year 1 & Year 2

	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$59,000	$85,000
Cash Payments for Expenses	(43,000)	(62,000)
Net Cash Flow from Operating Activities	$16,000	$23,000
Cash Flows From Investing Activities:		
Cash Payment for Land	$(37,000)	$(25,000)
Net Cash Flow from Investing Activities	$(37,000)	$(25,000)
Cash Flows From Financing Activities:		
Cash Receipts from Borrowed Funds	$36,000	$20,000
Cash Receipts from Stock Issue	68,000	50,000
Cash Dividend	(7,000)	(2,000)
Net Cash Flow from Financing Activities	$97,000	$68,000
Net Increase in Cash	$76,000	$66,000
Plus: Beginning Cash Balance	-0-	$76,000
Ending Cash Balance	$76,000	$142,000

EXERCISE 1-27A

Financial Statements	Descriptions
Balance Sheet	C. Summarizes all the company's accounts under the accounting equation as of a point in time. All other financial statements can be created from activity included in this statement.
Income Statement	D. Summarizes the revenues and expenses recorded under the retained earnings column of the accounting equation. This statement focuses on company performance over a fixed period of time.
Statement of Cash Flows	A. Summarizes the activity under the cash account within the accounting equation. Explains the activities that caused the cash balance to change from the beginning of the year to the end of the year.
Statement of Stockholders' Equity	B. Summarizes all the activity under the equity section of the accounting equation. This statement generally shows how common stock and retained earnings changed from the beginning of the year to the end of the year.

EXERCISE 1-28A

a. **Composite Fabricators' 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 asset at their current market values.**

SOLUTIONS TO PROBLEMS – SERIES A - CHAPTER 1

PROBLEM 1-29A

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 1-30A

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
	Partnership	Increase
8.	Stephen Woo	Decrease
	Izzard, Inc.	Increase
9.	Natural Stone	Decrease
	Shareholders	Increase
10.	Billows, Inc.	Increase
	National Bank	Decrease

PROBLEM 1-31A

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	No Effect
9.	Asset Exchange	No Effect
10.	Asset Use	Decrease
11.	NA	NA
12.	Asset Source	Increase
13.	Asset Use	Decrease
14.	NA	NA
15.	Asset Exchange	No Effect

PROBLEM 1-32A

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 1-33A

a.

Pratt Corp. Income Statement For the Year Ended December 31, Year 2	
Revenue	$35,550[a]
Expense	(26,000)
Net Income	$ 9,550

[a]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. Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 2		
Beginning Common Stock	$13,000[b]	
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

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

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

EXERCISE 1-33A (cont.)

c.

Pratt Corp. Balance Sheet As of December 31, Year 2		
Assets		**$38,550[c]**
Liabilities		**$ 9,000[d]**
Stockholders' Equity		
Common Stock	**$17,000**	
Retained Earnings	**12,550**	
Total Stockholders' Equity		**29,550**
Total Liabilities and Stockholders' Equity		**$38,550**

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

[d] **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%

PROBLEM 1-34A

a.

Mark's Consulting
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. Svc. Rev.	35,000		NA		NA		NA		35,000	Svc. Rev.
3. Loan	25,000		NA		25,000		NA		NA	NA
4. Paid Exp.	(22,000)		NA		NA		NA		(22,000)	Oper. Exp.
5. Pur. Land	(30,000)		30,000		NA		NA		NA	NA
End Bal.	28,000	+	30,000	=	25,000	+	20,000	+	13,000	

Mark's Consulting
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. Svc. Rev.	95,000		NA		NA		NA		95,000	Svc. Rev.
3. Paid Loan	(15,000)		NA		(15,000)		NA		NA	NA
4. Paid Exp.	(71,500)		NA		NA		NA		(71,500)	Oper. Exp.
5. Paid Div.	(3,000)		NA		NA		NA		(3,000)	Dividends
6. Land Val.	NA		NA		NA		NA		NA	
End Bal.	57,500	+	30,000	=	10,000	+	44,000	+	33,500	

PROBLEM 1-34A (cont.)

b.

Mark's Consulting Income Statements For the Period Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Service Revenue	$35,000	$95,000
Operating Expenses	(22,000)	(71,500)
Net Income	$13,000	$23,500

Mark's Consulting Statements of Changes in Stockholders' Equity For the Period Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Beginning Common Stock	$ -0-	$20,000
Plus: Common Stock Issued	20,000	24,000
Ending Common Stock	$20,000	$44,000
Beginning Retained Earnings	$ -0-	$13,000
Plus: Net Income	13,000	23,500
Less: Dividends	-0-	(3,000)
Ending Retained Earnings	$13,000	$33,500
Total Stockholders' Equity	$33,000	$77,500

PROBLEM 1-34A (cont.)

Mark's Consulting Balance Sheets December 31, Year 1 & Year 2		
	Year 1	Year 2
Assets		
Cash	$28,000	$57,500
Land	$30,000	$30,000
Total Assets	$58,000	$87,500
Total Liabilities	$25,000	$10,000
Stockholders' Equity		
Common Stock	$20,000	$44,000
Retained Earnings	$13,000	$33,500
Total Stockholders' Equity	$33,000	$77,500
Total Liabilities and Stockholders' Equity	$58,000	$87,500

PROBLEM 1-34A (cont.)

Mark's Consulting Statements of Cash Flows For the Year Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$35,000	$95,000
Cash Payments for Expenses	(22,000)	(71,500)
Net Cash Flow from Operating Activities	$13,000	$23,500
Cash Flows From Investing Activities:		
Cash Payment for Land	$(30,000)	-0-
Net Cash Flow from Investing Activities	(30,000)	-0-
Cash Flows From Financing Activities:		
Cash Receipts from Borrowed Funds	$25,000	-0-
Cash Receipts from Stock Issue	20,000	24,000
Cash Payment on Debt		(15,000)
Cash Dividend	-0-	(3,000)
Net Cash Flow from Financing Activities	$45,000	$6,000
Net Increase in Cash	$28,000	$29,500
Plus: Beginning Cash Balance	-0-	$28,000
Ending Cash Balance	$28,000	$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 1-35A

FOR THE YEARS	Year 1	Year 2	Year 3
Income Statements			
Revenue (cash)	$ 900	$ 1,800	$ 2,500
Expense (cash)	(a) (600)	(600)	(1,200)
Net income	$ 300	(m)$ 1,200	$ 1,300
Statements of Changes in Stockholders' Equity			
Beginning common stock	$ -0-	(n) $6,000	$7,000
Plus: Common stock issued	6,000	1,000	3,000
Ending common stock	6,000	7,000	(t) 10,000
Beginning retained earnings	-0-	200	1,100
Plus: Net income	(b) 300	1,200	1,300
Less: Dividends	(c) (100)	(300)	(500)
Ending retained earnings	200	(p) 1,100	1,900
Total stockholders' equity	(d) $6,200	$8,100	$11,900
Balance Sheets			
Assets			
Cash	(e) $8,100	(q) $ 9,000	(u)$11,800
Land	-0-	(r) 5,000	5,000
Total assets	(f) $8,100	$14,000	$16,800
Liabilities	(g) $ 1,900	$ 5,900	$ 4,900
Stockholders' equity			
Common stock	(h) 6,000	(s) 7,000	10,000
Retained earnings	(i) 200	1,100	1,900
Total stockholders' equity	(j) 6,200	8,100	11,900
Total liabilities and stk. equity	$8,100	$14,000	$16,800

PROBLEM 1-35A (cont.)

FOR THE YEARS	Year 1	Year 2	Year 3
Statements of Cash Flows			
Cash flows from oper. activities:			
Cash receipts from revenue	(k)$ 900	$ 1,800	(v)$ 2,500
Cash payments for expenses	(l) (600)	(600)	(w) (1,200)
Net cash flows from oper. Act.	300	1,200	1,300
Cash flows from invest. activities:			
Cash payments for land	-0-	(5,000)	-0-
Net cash flows from invest. act.	-0-	$(5,000)	-0-
Cash flows from fin. activities:			
Cash rec. from borrowed funds	1,900	6,000	-0-
Cash payments to reduce debt	-0-	(2,000)	(x) (1,000)
Cash receipts from stock issue	6,000	1,000	(y) 3,000
Cash payments for dividends	(100)	(300)	(z) (500)
Net cash flows from fin. activities	$7,800	$4,700	$1,500
Net change in cash	8,100	900	2,800
Plus: beginning cash balance	-0-	8,100	9,000
Ending cash balance	$8,100	$ 9,000	$11,800

PROBLEM 1-35A (cont.)

Computations of amounts:

a. $600 Expenses = $900 Revenue – $300 Net Income.
b. $300 Net Income = $300 Net Income from Income Statement.
c. $100 Dividends = $100 Dividends in Cash Flow Statement
d. $6,200 Total Stockholders' Equity = $6,000 Ending CS + $200 Ending RE.
e. $8,100 Cash = Ending Cash Balance in Cash Flow Statement
f. $8,100 Total Assets = $8,100 Cash + $0 Land
g. $1,900 Liabilities = $1,900 Cash Receipts from Loan in Cash Flow Statement
h. $6,000 Common Stock = $6,000 Common Stock Issued from Changes in SH Equity
i. $200 RE = $200 Retained Earnings Issued from Changes in SH Equity
j. $6,200 Total SE = $6,000 Common Stock + $200 Retained Earnings
k. $900 Cash Receipts = $900 Revenue from Income Statement
l. $600 Cash Expenses = $600 Expenses from Income Statement
m. $1,200 Net Income = $1,800 Revenue – $600 Expense
n. $6,000 Beginning Common Stock = $6,000 Ending Common Stock from Year 1
p. $1,100 Ending RE = $200 Beg. RE + $1,200 Net Income – $300 Dividends
q. $9,000 Cash = $9,000 Ending Cash Balance in Cash Flow Statement
r. $5,000 Land = $5,000 Cash Payment for Land in Cash Flow Statement
s. $7,000 Common Stock = $7,000 Ending Common Stock in Change in SH Equity
t. $10,000 Ending Common Stock = $7,000 Beg. CS + $3,000 CS Issued
u. $11,800 Cash = $16,800 Total Assets – $5,000 Land
v. $2,500 Cash Receipts = $2,500 Revenue in Income Statement
w. $1,200 Cash Expenses = $1,200 Expense in Income Statement
x. $1,000 Cash Payment on Debt = $5,900 Year 2 Liabilities – $4,900 Year 3 Liabilities
y. $3,000 Cash Receipts from Stock Issue = $3,000 Issued Stock in SE Equity Stmt
z. $500 Dividends = $500 Dividends in Changes in SE Equity Statement

SOLUTIONS TO EXERCISES - SERIES B - CHAPTER 1

EXERCISE 1-1B

The three types of resources available to conversion agents 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. The conversion agents 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 (conversion agents) 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. Cash account increased by $60,000 cash borrowed from First Bank. Cash account increased by $75,000 cash invested by Stan Rhoades. Cash account decreased by $150,000 cash used to purchase building. Cash account increased by $56,000 cash revenue earned. 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

EXERCISE 1-5B

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 1-6B

a.

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

EXERCISE 1-6B (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 cost more than it is worth.

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

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

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 1-9B

a. **Decrease**

b. **Increase**

c. **Increase**

d. **Decrease**

e. **Asset Exchange**

f. **Asset Exchange**

EXERCISE 1-10B

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 1-11B

a.

Green Gardens, Inc.
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. Loan	8,000		NA		8,000		NA		NA	NA
3. Provide Svc.	38,000		NA		NA		NA		38,000	Svc. Rev.
4. Pd Op. Exp.	(15,000)		NA		NA		NA		(15,000)	Op. Exp.
5. Paid Div.	(5,000)		NA		NA		NA		(5,000)	Dividends
6. Land Purch.	(18,000)		18,000		NA		NA		NA	
End Bal.	28,000	+	18,000	=	8,000	+	20,000	+	18,000	

EXERCISE 1-11B (cont.)

b.

Assets	=	Liabilities	+	Stockholders' Equity
$46,000	=	$8,000	+	$38,000

Green Gardens, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$28,000	
Land	18,000	
Total Assets		$46,000
Liabilities		
Notes Payable	$8,000	
Total Liabilities		$8,000
Stockholders' Equity		
Common Stock	$20,000	
Retained Earnings	18,000	
Total Stockholders' Equity		$38,000
Total Liabilities and Stockholders' Equity		$46,000

c.

Assets	=	Liabilities	+	Stockholders' Equity
$46,000	=	$8,000	+	$38,000

The ending balances for assets, liabilities and stockholders' equity at the end of Year 1 will become the beginning balances for these same accounts in Year 2.

d. 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.

EXERCISE 1-12B

a.

Green Gardens, Inc.
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	28,000		18,000		8,000		20,000		18,000	
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
End Bal.	62,000	+	30,000	=	28,000	+	40,000	+	24,000	

EXERCISE 1-12B (cont.)

b. **Year 2**

Assets	=	Liabilities	+	Stockholders' Equity
$92,000	=	$28,000	+	$64,000

Green Gardens, Inc.
Balance Sheet
December 31, Year 1 & Year 2

	Year 1	Year 2
Assets		
Cash	$28,000	$62,000
Land	18,000	30,000
Total Assets	$46,000	$92,000
Liabilities		
Notes Payable	$8,000	$28,000
Total Liabilities	$8,000	$28,000
Stockholders' Equity		
Common Stock	$20,000	$40,000
Retained Earnings	18,000	24,000
Total Stockholders' Equity	$38,000	$64,000
Total Liabilities and Stockholders' Equity	$46,000	$92,000

c. There is no cash in the notes payable account. Cash is an asset that belongs on the left side of the accounting equation. Notes payable are liabilities that represents an obligation of the Company to distribute assets in the future.

d. There is no cash in the common stock account. Cash is an asset that belongs on the left side of the accounting equation. Common stock

represents the portion of assets owned by the investors of the Company.

EXERCISE 1-12B (cont.)

e. **There is no cash in the retained earnings account. Retained earnings represent earnings that have already been reinvested into the business to support its core functions. There is no physical cash in the retained earnings account. At the end of Year 2, the cash account has a balance of $62,000 while the ending balance in the retained earnings account is $24,000. These balances differ because retained earnings represents the excess of earnings over expenses that were earned during Year 2 while the cash account represents the physical amount of cash on hand at the end of Year 2.**

f. **The balance in the land account at the end of Year 2 is $30,000. 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.**

EXERCISE 1-13B

a.

	Cash	+	Land	=	Creditors	+	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. Investor's Claim ÷ Total Assets = Percent of Total

$6,000 ÷ $10,000 = 60%

d. There were no transactions involving revenue or expense during Year 1. Accordingly, Lewis has no net income or retained earnings at the end of Year 1. Lewis is unable to pay a dividend due to not having any retained earnings at the end of Year 1. Since dividends are distributions of assets generated through earnings, the company cannot distribute an amount exceeding retained earnings regardless of whether it has enough cash on hand to pay the dividend.

e. 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:

	Cash	+	Land	=	Creditors	+	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 1-14B

b. The maximum dividend that Smith Co. could pay based on the information would be $1,000, the amount of retained earnings. Since dividends are distributions of assets generated through earnings, the company cannot distribute an amount exceeding retained earnings regardless of whether it has enough cash on hand to pay the dividend.

b. James Co. is unable to pay a dividend due to having a $0 cash balance. Remember that retained earnings does not contain any cash. Without any cash on hand, the company is unable to pay a dividend.

c.

					Stockholders' Equity		
Company	**Assets**	**=**	**Liabilities**	**+**	**Common Stock**	**+**	**Retained Earnings**
Smith	**100%**		**66%**		**26%**		**8%**
James	**100%**		**30%**		**60%**		**10%**

d. There are three alternative definitions of the right side of the accounting equation. First, the right side could be referred to as sources of assets. Second, it could be defined as claims on assets. Lastly, it could be defined as obligations to creditors and commitments to owners.

EXERCISE 1-15B

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 an 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 the $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 1-15B (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 $90,000, which is more than enough funds to repay the $35,000 notes payable.

EXERCISE 1-15B (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 1-16B

a. Event #3 and #4 will affect the income statement.

b.

Leaf Company Income Statement For the Year Ended December 31, Year 1	
Revenue	$48,000
Expense	(34,000)
Net Income	$14,000

EXERCISE 1-17B

Jameson Co.
Balance Sheets
December 31, Year 1 & Year 2

	Year 1	Year 2
Assets		
Cash	$800	$500
Total Assets	$800	$500
Total Liabilities	$500	$500
Stockholders' Equity		
Common Stock	$300	$300
Retained Earnings	$0	$(300)
Total Stockholders' Equity	$300	($0)
Total Liabilities and Stockholders' Equity	$800	$500

Jameson Co.
Income Statement
For the Year Ended December 31, Year 2

Revenue	$650
Expense	(950)
Net Loss	$(300)

EXERCISE 1-18B

Forrest Inc.
Statement of Changes in Stockholders' Equity
For the Period Ended December 31, Year 1

Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	65,000	
Ending Common Stock		$65,000
Beginning Retained Earnings	-0-	
Plus: Net Income	$13,000	
Less: Dividends	(5,000)	
Ending Retained Earnings		8,000
Total Stockholders' Equity		$73,000

EXERCISE 1-19B

a.

Petre Company Accounting Equation for Year 1								
	Assets	=	Liabilities	+	Stockholders' Equity			
Event	Cash	=		+	Common Stock	+	Retained Earnings
Common Stock	30,000				30,000		
1. Cash revenues	14,500		NA		NA		14,500
2. Paid expenses	(9,200)		NA		NA		(9,200)
3. Paid dividend	(500)		NA		NA		(500)
Ending Balance	34,800	=	-0-	+	30,000	+	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	$ 30,000	
Ending Common Stock		$ 30,000
Beginning Retained Earnings	$ -0-	
Plus: Net Income	5,300	
Less: Dividends	(500)	
Ending Retained Earnings		4,800
Total Stockholders' Equity		$34,800

EXERCISE 1-19B b. (cont.)

Petre Company Balance Sheet As of December 31, Year 1		
Assets		
Cash		$ 34,800
Liabilities		$ -0-
Stockholders' Equity		
Common Stock	$ 30,000	
Retained Earnings	4,800	
Total Stockholders' Equity		34,800
Total Liabilities and Stockholders' Equity		$ 34,800

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 1-20B

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**

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 1-21B

a.

Palmer Company Statement of Cash Flows For the Year Ended December 31, Year 1		
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 1-22B

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 1-22B (cont.)

b.

National Service Company
Statement of Cash Flows
For the Year Ended December 31, Year 1

Cash Flows From Operating Activities:		
Cash Receipts from Revenue	$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 1-23B

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/Y	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		
End Bal.	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 1-23B (cont.)

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

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 1-23B (cont.)

Tennessee Company Statement of Cash Flows 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%

There is zero cash in the retained earnings account.

d. **The maximum dividend that Tennessee Co. could pay is the lessor of cash on hand or retained earnings. Therefore, the maximum dividend at December 31, Year 2 would be the total amount of retained earnings of $26,000.**

EXERCISE 1-24B

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 1-24B (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 1-24B (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 1-24B (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 maximum dividend that Zeke Co. could pay is the lessor of cash on hand or retained earnings. Therefore, the maximum dividend at December 31, Year 2 would be the total amount of cash of $350.

j. No adjustment is made to the book value for changes in market value as land is recorded as historical cost.

EXERCISE 1-25B

a. **The cash flow from operating activities is calculated by subtracting the cash outflow for expenses from the cash inflow from customers. ($9,900 - $4,800 = $5,100).**

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

c. **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 of $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

EXERCISE 1-25B (cont.)

d.

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

e.

Shundra Inc. Income Statement For the Year Ended December 31, Year 2	
Revenue	$9,900
Expenses	(4,800)
Net Income	$5,100

EXERCISE 1-25B (cont.)

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 1-26B

a.

Amelia Company
Accounting Equation for Year 1

	Assets			=	Liabilities	+	Stockholders' Equity			
Event	Cash	+	Land	=	Notes Payable	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
Beg. Bal.	$0	+	$0	=	$0	+	$0	+	$0	
1. Issued stk.	75,000	+	NA	=	NA	+	75,000	+	NA	NA
2. Loan	28,000	+	NA	=	28,000	+	NA	+	NA	NA
3. Cash Rev.	72,000	+	NA	=	NA	+	NA	+	72,000	Rev.
4. Cash Exp.	(55,000)	+	NA	=	NA	+	NA	+	(55,000)	Exp.
5. Paid Div.	(5,000)	+	NA	=	NA	+	NA	+	(5,000)	Dividends
6. Land Purch.	(34,000)	+	34,000	=	NA	+	NA	+	NA	
End Bal.	81,000	+	34,000	=	28,000	+	75,000	+	12,000	

Amelia Company
Accounting Equation for Year 2

	Assets			=	Liabilities	+	Stockholders' Equity			
Event	Cash	+	Land	=	Notes Payable	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
Beg. Bal.	$81,000	+	$34,000	=	$28,000	+	$75,000	+	$12,000	
1. Issued stk.	45,000	+	NA	=	NA	+	45,000	+	NA	NA
2. Loan	15,000	+	NA	=	15,000	+	NA	+	NA	NA
3. Cash Rev.	90,000	+	NA	=	NA	+	NA	+	90,000	Rev.
4. Cash Exp.	(55,000)	+	NA	=	NA	+	NA	+	(55,000)	Exp.
5. Paid Div.	(7,000)	+	NA	=	NA	+	NA	+	(7,000)	Dividends
6. Land Purch.	(22,000)	+	22,000	=	NA	+	NA	+	NA	
End Bal.	147,000	+	56,000	=	43,000	+	120,000	+	40,000	

EXERCISE 1-26B (cont.)

b.

Amelia Company Income Statements For the Period Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Revenue	$72,000	$90,000
Expenses	(55,000)	(55,000)
Net Income	$17,000	$35,000

Amelia Company Statements of Changes in Stockholders' Equity For the Period Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Beginning Common Stock	$ -0-	$75,000
Plus: Common Stock Issued	75,000	45,000
Ending Common Stock	$75,000	$120,000
Beginning Retained Earnings	$ -0-	$12,000
Plus: Net Income	17,000	35,000
Less: Dividends	(5,000)	(7,000)
Ending Retained Earnings	$12,000	$40,000
Total Stockholders' Equity	$87,000	$160,000

EXERCISE 1-26B (cont.)

Amelia Company
Balance Sheets
December 31, Year 1 & Year 2

	Year 1	Year 2
Assets		
Cash	$81,000	$147,000
Land	$34,000	$56,000
Total Assets	$115,000	$203,000
Total Liabilities	$28,000	$43,000
Stockholders' Equity		
Common Stock	$75,000	$120,000
Retained Earnings	$12,000	$40,000
Total Stockholders' Equity	$87,000	$160,000
Total Liabilities and Stockholders' Equity	$115,000	$203,000

EXERCISE 1-26B (cont.)

Amelia Company
Statements of Cash Flows
For the Year Ended December 31, Year 1 & Year 2

	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$72,000	$90,000
Cash Payments for Expenses	(55,000)	(55,000)
Net Cash Flow from Operating Activities	$17,000	$35,000
Cash Flows From Investing Activities:		
Cash Payment for Land	$(34,000)	$(22,000)
Net Cash Flow from Investing Activities	(34,000)	(22,000)
Cash Flows From Financing Activities:		
Cash Receipts from Borrowed Funds	$28,000	$15,000
Cash Receipts from Stock Issue	75,000	45,000
Cash Dividend	(5,000)	(7,000)
Net Cash Flow from Financing Activities	$98,000	$53,000
Net Increase in Cash	$81,000	$66,000
Plus: Beginning Cash Balance	-0-	$81,000
Ending Cash Balance	$81,000	$147,000

EXERCISE 1-27B

Financial Statements	Descriptions
Statement of Cash Flows	A. Summarizes the activity under the cash account within the accounting equation. Explains the activities that caused the cash balance to change from the beginning of the year to the end of the year.
Balance Sheet	C. Summarizes all the company's accounts under the accounting equation as of a point in time. All other financial statements can be created from activity included in this statement.
Statement of Stockholders' Equity	B. Summarizes all the activity under the equity section of the accounting equation. This statement generally shows how common stock and retained earnings changed from the beginning of the year to the end of the year.
Income Statement	D. Summarizes the revenues and expenses recorded under the retained earnings column of the accounting equation. This statement focuses on company performance over a fixed period of time.

EXERCISE 1-28B

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 a 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.

SOLUTIONS TO PROBLEMS – SERIES B - CHAPTER 1

PROBLEM 1-29B

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 1-30B

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 1-31B

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	No Effect
7.	NA	NA
8.	Asset Use	Decrease
9.	Asset Source	Increase
10.	Asset Exchange	No Effect
11.	Asset Exchange	No Effect
12.	Asset Use	Decrease
13.	NA	NA
14.	Asset Source	Increase
15.	Asset Use	Decrease

PROBLEM 1-32B

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 1-33B

a.

Blix Corp. Income Statement For the Year Ended December 31, Year 2	
Revenue	$27,500[a]
Expense	(15,000)
Net Income	$12,500

[a]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[b]	
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

[b] 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[c]
Liabilities		$18,000[d]
Stockholders' Equity		
Common Stock	$18,000	
Retained Earnings	28,500	
Total Stockholders' Equity		46,500
Total Liabilities and Stockholders' Equity		$64,500

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

[d] 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%

PROBLEM 1-34B

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
End Bal.	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
End Bal.	115,000	+	40,000	=	5,000	+	70,000	+	80,000	

PROBLEM 1-34B (cont.)

b.

Marco's Consulting Income Statements For the Period Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Service Revenue	$100,000	$130,000
Expenses	(60,000)	(75,000)
Net Income	$40,000	$55,000

Marco's Consulting Statements of Changes in Stockholders' Equity For the Period Ended December 31, Year 1 & Year 2		
	Year 1	Year 2
Beginning Common Stock	$ -0-	$50,000
Plus: Common Stock Issued	50,000	20,000
Ending Common Stock	$50,000	$70,000
Beginning Retained Earnings	$ -0-	$40,000
Plus: Net Income	40,000	55,000
Less: Dividends	-0-	(15,000)
Ending Retained Earnings	$40,000	$80,000
Total Stockholders' Equity	$90,000	$150,000

PROBLEM 1-34B (cont.)

Marco's Consulting Balance Sheets December 31, Year 1 & Year 2		
	Year 1	Year 2
Assets		
Cash	$65,000	$115,000
Land	40,000	$40,000
Total Assets	$105,000	$155,000
Total Liabilities	$15,000	$5,000
Stockholders' Equity		
Common Stock	$50,000	$70,000
Retained Earnings	40,000	$80,000
Total Stockholders' Equity	$90,000	$150,000
Total Liabilities and Stockholders' Equity	$105,000	$155,000

PROBLEM 1-34B (cont.)

Marco's Consulting
Statements of Cash Flows
For the Year Ended December 31, Year 1 & Year 2

	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$100,000	$130,000
Cash Payments for Expenses	(60,000)	(75,000)
Net Cash Flow from Operating Activities	$40,000	$55,000
Cash Flows From Investing Activities:		
Cash Payment for Land	(40,000)	-0-
Net Cash Flow from Investing Activities	(40,000)	-0-
Cash Flows From Financing Activities:		
Cash Receipts from Borrowed Funds	$15,000	-0-
Cash Receipts from Stock Issue	50,000	$20,000
Cash Payment on Debt		(10,000)
Cash Dividend	-0-	(15,000)
Net Cash Flow from Financing Activities	$65,000	$(5,000)
Net Increase in Cash	$65,000	$50,000
Plus: Beginning Cash Balance	-0-	$65,000
Ending Cash Balance	$65,000	$115,000

PROBLEM 1-34B (cont.)

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 1-35B

FOR THE YEARS	Year 1	Year 2	Year 3
Income Statements			
Revenue (cash)	$ 700	$ 1,300	$ 2,000
Expense (cash)	(a) (500)	(700)	(1,300)
Net income	$ 200	(m) $ 600	$ 700
Statements of Changes in Stockholders' Equity			
Beginning common stock	$ -0-	(n) $5,000	$6,000
Plus: Common stock issued	5,000	1,000	2,000
Ending common stock	5,000	6,000	(t) 8,000
Beginning retained earnings	-0-	100	200
Plus: Net income	(b) 200	(o) 600	700
Less: Dividends	(c) (100)	(500)	(300)
Ending retained earnings	100	(p) 200	600
Total stockholders' equity	(d) $5,100	$6,200	$8,600
Balance Sheets			
Assets			
Cash	(e) $8,100	(q) $ 3,200	(u) $ 2,600
Land	-0-	(r) 8,000	8,000
Total assets	(f) $8,100	$11,200	$10,600
Liabilities	(g) $ 3,000	$ 5,000	$ 2,000
Stockholders' equity			
Common stock	(h) 5,000	(s) 6,000	8,000
Retained earnings	(i) 100	200	600
Total stockholders' equity	(j) 5,100	6,200	8,600
Total liabilities and stk. equity	$8,100	$11,200	$10,600

PROBLEM 1-35B (cont.)

FOR THE YEARS	Year 1	Year 2	Year 3
Statements of Cash Flows			
Cash flows from oper. activities:			
Cash receipts from revenue	(k)$ 700	$ 1,300	(v) $ 2,000
Cash payments for expenses	(l) (500)	(700)	(w) (1,300)
Net cash flows from oper. Act.	200	600	700
Cash flows from invest. activities:			
Cash payments for land	-0-	(8,000)	-0-
Net cash flows from invest. act.	-0-	(8,000)	-0-
Cash flows from fin. activities:			
Cash rec. from loan	3,000	2,000	-0-
Cash payments to reduce debt	-0-	-0-	(x) (3,000)
Cash receipts from stock issue	5,000	1,000	(y) 2,000
Cash payments for dividends	(100)	(500)	(z) (300)
Net cash flows from fin. activities	7,900	2,500	(1,300)
Net change in cash	8,100	(4,900)	(600)
Plus: beginning cash balance	-0-	8,100	3,200
Ending cash balance	$8,100	$ 3,200	$ 2,600

PROBLEM 1-35B (cont.)

Computations of amounts:

a. $500 Expenses = $700 Revenue – $200 Net Income.
b. Net income equal to amount shown in income statement.
c. $100 Dividends = $200 Net Income – $100 Ending Retained Earnings
d. $5,100 Total Stockholders' Equity = $5,000 Ending Common Stock + $100 Ending Retained Earnings
e. $8,100 Cash = $8,100 Total Assets – $-0- Land.
f. $8,100 Total Assets = $8,100 Cash – $-0- Land.
g. $3,000 Liabilities = $8,100 Total Liabilities and Stockholders' Equity – $5,100 Total Stockholders' Equity.
h. $5,000 Common Stock = $5,000 Common Stock Issued – $0 Beginning Common Stock
i. $100 Retained Earnings = $100 Ending Retained Earnings
j. $5,100 Total Stockholders' Equity = $5,000 Ending Common Stock + $100 Ending Retained Earnings.
k. $700 Cash Receipts from Revenue = $700 Revenue from Income Statement.
l. $500 Cash Payments for Expenses = $500 Expenses from Income Statement.
m. $600 Net Income = $1,300 Revenue – $700 Expenses.
n. $5,000 Beginning Common Stock = $5,000 Ending Common Stock for Year 1.
o. $600 Net Income = $600 Net Income from Income Statement
p. $200 Ending Retained Earnings = $100 Beginning Retained Earnings + $600 Net Income – $500 Dividends.
q. $3,200 Cash = $3,200 Ending Cash Balance from the Statement of Cash Flows.
r. $8,000 Land = $11,200 Total Assets – $3,200 Cash.
s. $6,000 Common Stock = $6,000 Ending Common Stock from Statement of Changes in Stockholders' Equity
t. $8,000 Ending Common Stock = $6,000 Beginning Common Stock + $2,000 Stock issued.
u. $2,600 Cash = $10,600 Total Assets – $8,000 Land.
v. $2,000 Cash Receipts from Revenue = $2,000 Revenue from Income Statement.
w. $1,300 Cash Payments for Expenses = $1,300 Expenses from Income Statement.
x. $3,000 Cash Payments to Reduce Debt = $5,000 Liabilities Balance, Year 2 – $2,000 Liabilities Balance, Year 3.
y. $2,000 Cash Receipts from Stock Issue = $2,000 Common Stock Issued from Statement of Changes in Stockholders' Equity.
z. $300 Cash Payments for Dividends = $300 Dividends from Statement of Changes in Stockholders' Equity.

SOLUTIONS TO CRITICAL THINKING – CHAPTER 1

CT 1-1 (All dollar amounts are in millions.)

a. **$ 2,780**

b. **Net income decreased by $4,166 ($2,780 – $6,946)**

c.					STOCKHOLDERS'
	ASSETS	=	LIABILITIES	+	EQUITY
	$53,335	=	$42,103*	+	$11,232

*** Liabilities must be computed by subtracting equity from assets.**

d. **Sales increased by 2.8% from 2021 to 2022.**
($107,588 – $104,611) ÷ $104,611 = 2.8%

Cost of sales increased by 9.7% from 2021 to 2022.
($82,229 – $74,963) ÷ $74,963 = 9.7%

Selling, general and administrative expenses increased by 4.6% from 2021 to 2022. ($20,658 – $19,752) ÷ $19,752 = 4.6%

Net income decreased by 150% from 2021 to 2022.
($6,946 – $2,780) ÷ $2,780 = 150%

The largest percentage change was a decrease in net income.

CT 1-2

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

CT 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. **Microsoft's cash purchase of Activision Blizzard should be classified as a cash outflow in the investing activities section of the statement of cash flows.**

3. **Amazon'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. **Unilever's sale of its tea business 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. **Apple's cash revenues should be classified as a cash inflow in the operating activities section of the statement of cash flows.**

CT 1-4

a. **The percentage growth from Year 1 to Year 2 was 65% [($264,000 – $160,000) ÷ $160,000].**

b. **Pay off liabilities**

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. **$230,400**

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

CT 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**

e. An example of a student response is provided below:

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%].

CT 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

CT 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

CT 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.

CT 1-7

This solution is based on McDonald's December 31, 2022 annual report. Dollar amounts are in millions.

a. McDonald's net income for 2022 is $6,177.4 million.

b. The company had $50,435.6 million of assets at the end of 2022.

c. The company had deficit in total shareholders' equity of $6,003.4 million at the end of 2022. NOTE: McDonald's negative shareholders' equity was due to the large balance in its Treasury Stock account at the end of 2022.

d. For 2022, the company's (amounts in millions):

Net cash flow from *operating* activities were $7,386.7.
Net cash flow from *investing* activities were ($2,678.1).
Net cash flow from *financing* activities were ($6,580.2).

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. This chapter 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.

This first chapter introduces several terms and concepts that may be new to many, if not all, students. This chapter also lays an important foundation for the rest of the course. The chapter is divided into Sections 1 and 2. Given the importance of theses topic, we suggest allocating more class time to this material. In our classes, we treat each section as a Chapter in terms of allocating class time.

Problem-Based 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.

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, medical 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***.

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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 3. 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.

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.** Problems 1-34A&B contain transactions that are consistent with the demonstration problem. At this point, students should be able to complete *part a* of the requirements for these problems. *Parts b*, *c*, and *d* require preparing financial statements, which is discussed in the next class.

IX. **Introduce the balance sheet.** Return to the Year 1 data in the CSC demonstration problem. Show students how the ending balance in the accounting equation can be summarized more formally in a 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. Explain that the statement represents a company's financial condition at a specific point in time.

X. **Have the students prepare a balance sheet for Years 2 and 3.** Circulate through the room while your students attempt to record the events for Year 2 and 3.

XI. **Have a class discussion on balance sheet format and interpretation.** Go ahead and complete the Year 3 balance sheet as some students may not have finished. For the Year 3 balance sheet, introduce the idea of presenting assets in accordance with liquidity (i.e. Cash before Land).

Make sure students notice that while the amounts in liabilities, common stock, and retained earnings are measured in dollars, they do not represent cash. In other words, there is no cash in the liability, common stock, or retained earning accounts. Ask the class, what is the maximum dividend that CSC could pay its shareholders at the end of Year 3? A common answer will be $1,500 as that is the amount in Retained Earnings. The actual answer is $500, because that is all the cash the company has available. The point is students need to understand that retained earnings represents assets not cash.

Pose the same maximum dividend question for Year 2. Even though the retained earnings balance does not represent an amount of cash held by a company, it does limit the amount of cash that can be used to pay dividends. Given that CSC has $18,800 in cash at the end of Year 2, can the company pay a $18,800 dividend? The answer is no. Based on the information in the balance sheet, CSC has only $2,300 of retained earnings at the end of Year 2. Because dividends are a distribution of assets that were generated through earnings, the maximum dividend CSC can distribute now is $2,300. In summary, the payment of dividends is limited by both the amount of cash and the amount of retained earnings.

A good way to think about the liability and stockholders' equity sections of the balance sheet is to think of them as percentages of assets instead of dollars. As an additional exercise, you can have students scale the liabilities, common stock, and retained earnings by total assets so that they can be displayed as percentages of assets.

XII. **It is important to make sure your students are comfortable** with the accounting equation and balance sheet before moving onto the other financial statements. It is also important for students to understand that balance sheets are prepared at the end of every accounting cycle and the ending balances become next period's beginning balances. I recommend exercises 1-11A&B and 1-12A&B to drill these concepts. This concludes the first section of Chapter 1.

XIII. **Introduce the other financial statements.** Emphasize that financial statements are designed to provide information useful in decision-making. Emphasize that financial accounting focuses on the information needs of investors. Start by showing CSC's Year 2 and 3 balance sheets on a time line (see **Figure 1**). Discuss how users desire more information than the company's financial position at the end of the accounting period. Investors also want to know what happened during the accounting period. The other financial statements provide this information. Present the other financial statements in this order: (1) statement of changes in stockholders' equity, (2) income statement, and (3) statement of cash flows. This order of presentation is different than the traditional procedural approach to teaching introductory accounting. The focus is on understanding what each financial statement coveys about business.

XIV. **Statement of Changes in Stockholders' Equity.** Refer back to **Figure 1**, and discuss that while the balance sheet provides investors with the account balances in the stockholders' equity accounts at the end of each year it does not explain how those balances changed during the year. Comparing the Year 2 and 3 balance sheets in **Figure 1**, we can see that total stockholders' equity increased but retained earnings decreased during year 3. The decrease in retained earnings is concerning and investors would like more information on what caused these changes. This information is provided in the Statement of Changes in Stockholders' Equity.

To find out how stockholders' equity changed, refer students back to the Year 3 accounting equation in the CSC demonstration problem. Show students how Common Stock changed (i.e. Beg. Balance 13,500 + 2,500 stock issue = End Balance 16,000).

Then, using the same example, explain how Retained Earnings changed. Remind students that (revenue – expense) is the company's net income (loss). Show students how Retained Earnings changed (i.e. Beg. Balance 2,300 - Net Loss 500 – Dividend 300 = End Balance 1,500).

Show how these changes in the accounting equation can be presented formally on the Statement of Changes in Stockholders' Equity. Use **Figure 2** to show that this statement provided investors with information on how the stockholders' position in the company changed during the accounting period which in this cash is Year 3.

This is also a good time 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.

XV. **Income statement.** Using **Figure 2**, discuss that while the Statement of Changes in Stockholders' Equity provides investor with the amount of net income (loss) during the period it does not provide any information on how that net income (loss) was derived. Emphasize the importance of the net income as a performance measure for the business and how investors want more information about this number.

Refer back to the Year 3 accounting equation in the CSC Demonstration Problem. Identify the revenue (Event 3) and expense (Event 4) transactions. Reiterate that revenue increases assets from providing services and expenses decrease assets in efforts to earn revenue. Help them understand that net income represents the change in wealth (net assets) resulting from business operations during the accounting period. If you want your students to understand interrelationships, you must emphasize those relationships in your classroom discussions and your examinations.

Show students how these changes in the accounting equation are presented formally on the Income Statement. Use **Figure 3** to show that this statement provides investors with information on how net income was derived. Point out that the net loss would be view unfavorably by investors and it indicates that it is cost of providing services to its customers exceeds the revenue (or benefits) of providing those services.

XVI. **Statement of Cash Flows.** Using **Figure 3**, discuss how the two balance sheets tell us that cash decreased from $18,800 at the end of Year 2 to $500 at the end of Year 3. This is a significant decrease in cash and investors would like to know what happened. The Statement of Cash Flows provides this information.

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 ***operations***. 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.

Refer back to the Year 3 accounting equation in the CSC Demonstration Problem. Classify the Year 3 events as either an operating, investing, or financing activity. Use these classifications to prepare a formal Statement of Cash Flows for the Year 3 accounting period.

Use **Figure 4** to show that this statement provides investors with information on how cash changed during the accounting period or in this cash Year 3. Point out that while there was a significant decrease in the cash balance, most of cash was used to purchase a new asset than can be used to earn future revenues. Make note that cash outflows for investing activities is typically viewed as positive news as it indicates the company is investing more into assets to run its business. The only negative news on this statement is the net outflow of ($500) for operating activities. This indicates that the business in not able to generate positive cash flow from running its business. 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

XVII. **Tying it all together.** Spend a little time analyzing **Figure 4**. The purpose is for students to see that the balance sheet provides investors with end of period balances and the other statements explain how the balance sheet balances changed.

Students may wonder why some of the other changes in the two balance sheets are not explained by other financial statements. For example, why is there no *statement of changes in liabilities* to explain the changes in the notes payable account balances? Indeed, there could be different statements that would explain all of the differences in the Year 2 versus Year 3 balance sheet account balances. However, the demand for information that would be provided by additional statements has not been sufficient to merit the creation of such statements.

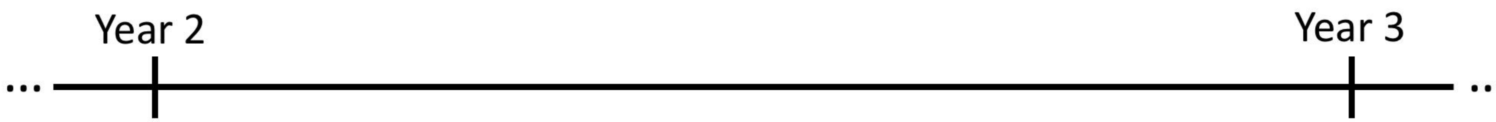
This is a good time to provide a little history. The four financial statements currently recognized by generally accepted accounting principles (GAAP) have evolved slowly. Indeed, the first mention of an income account appeared in a treatise written by Luca Pacioli in 1494. Even so, it was not until the early 1930s, with the establishment of the Securities and Exchange Commission, that contemporary forms of income statements and balance sheets were required in annual reports. Further, it was 1987 when the FASB mandated that a *statement of cash flows* be included in annual reports as the fourth financial statement. In summary, the current set of financial statements are designed to satisfy the most pressing needs of today's stakeholders. Other statements may be developed if the benefits of providing additional information justify the cost that would be incurred to produce and distribute that information.

XVIII. **Actively involve the students in learning**. Have students complete the CSC Demonstration Problem by preparing the financial statements for Years 1 and 2. Walk around the room and provide assistance as needed. If you notice that a particular transaction is confusing a lot of students, stop the class and provide a brief explanation to the class as a whole.

XIX. **Fill in the gaps.** You will find additional terms and concepts covered in the text but not in the teaching notes. While we do not recommend that you expect your students to cover everything in the text, we do expect our students to cover some material outside of class. 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 there. 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 concepts, students cannot learn to work accounting problems without actually working accounting problems.

XX. **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 tie to the example that has been covered in class.

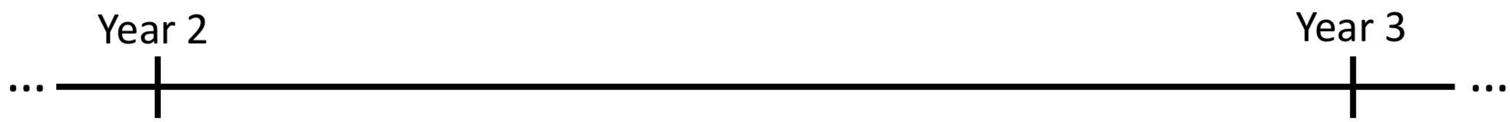
Figure 1



Computer Services Company	
Balance Sheet as of December 31, Year 2	
Assets	
Cash	$18,800
Land	0
Total assets	$18,800
Liabilities	$ 3,000
Stockholders' equity	
Common stock	13,500
Retained earnings	2,300
Total stockholders' equity	15,800
Total liabilities and stockholders' equity	$18,800

Computer Services Company	
Balance Sheet as of December 31, Year 3	
Assets	
Cash	$500
Land	21,000
Total assets	$21,500
Liabilities	$ 4,000
Stockholders' equity	
Common stock	16,000
Retained earnings	1,500
Total stockholders' equity	17,500
Total liabilities and stockholders' equity	$21,500

Figure 2



Computer Services Company	
Balance Sheet as of December 31, Year 2	
Assets	
Cash	$18,800
Land	0
Total assets	$18,800
Liabilities	$ 3,000
Stockholders' equity	
Common stock	13,500
Retained earnings	2,300
Total stockholders' equity	15,800
Total liabilities and stockholders' equity	$18,800

Computer Services Company	
Statement of Changes in Stockholders' Equity	
For the Year Ended December 31, Year 3	
Beginning common stock	$13,500
Plus: Common stock issued	2,500
Ending common stock	16,000
Beginning retained earnings	2,300
Plus: Net income (loss)	(500)
Less: Dividends	(300)
Ending retained earnings	1,500
Total stockholders' equity	$17,500

Computer Services Company	
Balance Sheet as of December 31, Year 3	
Assets	
Cash	$500
Land	21,000
Total assets	$21,500
Liabilities	$ 4,000
Stockholders' equity	
Common stock	16,000
Retained earnings	1,500
Total stockholders' equity	17,500
Total liabilities and stockholders' equity	$21,500

Figure 3

… Year 2 ———————————— Year 3 …

Computer Services Company Balance Sheet as of December 31, Year 2	
Assets	
Cash	$18,800
Land	0
Total assets	$18,800
Liabilities	$ 3,000
Stockholders' equity	
Common stock	13,500
Retained earnings	2,300
Total stockholders' equity	15,800
Total liabilities and stockholders' equity	$18,800

Computer Services Company Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 3	
Beginning common stock	$13,500
Plus: Common stock issued	2,500
Ending common stock	16,000
Beginning retained earnings	2,300
Plus: Net income (loss)	(500)
Less: Dividends	(300)
Ending retained earnings	1,500
Total stockholders' equity	$17,500

Computer Services Company Income Statement For the Year Ended December 31, Year 3	
Services revenue	$7,400
Operating expenses	(7,900)
Net income (loss)	$(500)

Computer Services Company Balance Sheet as of December 31, Year 3	
Assets	
Cash	$500
Land	21,000
Total assets	$21,500
Liabilities	$ 4,000
Stockholders' equity	
Common stock	16,000
Retained earnings	1,500
Total stockholders' equity	17,500
Total liabilities and stockholders' equity	$21,500

Figure 4

Year 2 … Year 3

Computer Services Company
Balance Sheet as of December 31, Year 2

Assets	
Cash	$18,800
Land	0
Total assets	$18,800
Liabilities	$ 3,000
Stockholders' equity	
Common stock	13,500
Retained earnings	2,300
Total stockholders' equity	15,800
Total liabilities and stockholders' equity	$18,800

Computer Services Company
Statement of Cash Flows
For the Year Ended December 31, Year 3

Net cash flow from operating activities	(500)
Cash flow from investing activities	(21,000)
Net cash flows from financing activities	3,200
Net change in cash	(18,300)
Beginning cash balance	18,800
Ending cash balance	$500

Computer Services Company
Statement of Changes in Stockholders' Equity
For the Year Ended December 31, Year 3

Beginning common stock	$13,500
Plus: Common stock issued	2,500
Ending common stock	16,000
Beginning retained earnings	2,300
Plus: Net income (loss)	(500)
Less: Dividends	(300)
Ending retained earnings	1,500
Total stockholders' equity	$17,500

Computer Services Company
Income Statement
For the Year Ended December 31, Year 3

Services revenue	$7,400
Operating expenses	(7,900)
Net income (loss)	$(500)

Computer Services Company
Balance Sheet as of December 31, Year 3

Assets	
Cash	$500
Land	21,000
Total assets	$21,500
Liabilities	$ 4,000
Stockholders' equity	
Common stock	16,000
Retained earnings	1,500
Total stockholders' equity	17,500
Total liabilities and stockholders' equity	$21,500

Demonstration Problems 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 the 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 acquired $4,500 cash by issuing common stock.
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 acquired $2,500 by issuing common stock.
2. The company borrowed $1,000 cash 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 $21,000 to purchase land.

Required

a. Record the events into the accounting equation. Classify events affecting Retained Earnings as either Revenue, Expenses, or Dividends.
b. Prepare a balance sheet for Year 1, 2, and 3.
c. Prepare an Income Statement for Years 1, 2, and 3.
d. Prepare a Statement of Changes in Stockholders' Equity for Years 1, 2, and 3.
e. Classify the events affecting Cash in the Accounting Equation as either Operating, Investing, or Financing activities.
f. Prepare a Statement of Cash Flows for Years 1, 2, and 3.

Solution for Chapter 1 Demonstration Problem

Demonstration Problem 1-1: Requirement a

Year 1	Assets			=	Liabilities	+	Stockholders' Equity			
No.	*Cash*	+	*Land*	=	*Liabilities*	+	*Com. Stk.*	+	*Ret. Earn.*	
Beg. bal.	NA	+	NA	=	NA	+	NA	+	NA	
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
Totals	14,600	+	NA	=	5,000	+	9,000	+	600	
Year 2	**Assets**			**=**	**Liabilities**	**+**	**Stockholders' Equity**			
No.	*Cash*	+	*Land*	=	*Liabilities.*	+	*Com. Stk.*	+	*Ret. Earn.*	
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
Totals	18,800	+	NA	=	3,000	+	13,500	+	2,300	
Year 3	**Assets**			**=**	**Liabilities**	**+**	**Stockholders' Equity**			
No.	*Cash*	+	*Land*	=	*Liabilities.*	+	*Com. Stk.*	+	*Ret. Earn.*	
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	(21,000)	+	21,000	+	NA	+	NA	+	NA	
Totals	500	+	21,000	+	4,000	+	16,000	+	1,500	

Demonstration Problem 1-1: Requirement b

Computer Services Company

Balance Sheets at December 31			
As of the Years Ended December 31,	Year 1	Year 2	Year 3
Assets			
Cash	$14,600	$18,800	$500
Land	0	0	21,000
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

Demonstration Problem 1-1: Requirement c

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)

Demonstration Problem 1-1: Requirement d

Computer Services Company Statements of Changes in Stockholders' Equity			
For the Years Ended December 31,	Year 1	Year 2	Year 3
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

Demonstration Problem 1-1: Requirement e

Year 1

Event	Cash Flow Classification
1	9,000 FA
2	5,000 FA
3	4,000 OA
4	(2,900) OA
5	(500) FA

Year 2

Event	Cash Flow Classification
1	4,500 FA
2	(2,000) FA
3	6,700 OA
4	(4,300) OA
5	(700) FA

Year 3

Event	Cash Flow Classification
1	2,500 FA
2	1,000 FA
3	7,400 OA
4	(7,900) OA
5	(300) FA
6	(21,000) IA

Demonstration Problem 1-1: Requirement f

Computer Services Company Statements of Cash Flows			
For the Years Ended December 31,	Year 1	Year 2	Year 3
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			(21,000)
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	(18,300)
Beginning cash balance	0	14,600	18,800
Ending cash balance	$14,600	$18,800	$500

Workpapers for Chapter 1 Demonstration Problem

Demonstration Problem 1-1: Requirement a

Year 1	Assets			=	Liabilities	+	Stockholders' Equity		
No.	*Cash*	+	*Land*	=	*Liabilities*	+	*Com. Stk.*	+	*Ret. Earn.*
Beg. bal.		+		=		+		+	
1		+		=		+		+	
2		+		=		+		+	
3		+		=		+		+	
4		+		=		+		+	
5		+		=		+		+	
Totals	14,600	+		=	5,000	+	9,000	+	600
Year 2	**Assets**			=	**Liabilities**	+	**Stockholders' Equity**		
No.	*Cash*	+	*Land*	=	*Liabilities.*	+	*Com. Stk.*	+	*Ret. Earn.*
Beg. bal.	14,600	+		=	5,000	+	9,000	+	600
1		+		=		+		+	
2		+		=		+		+	
3		+		=		+		+	
4		+		=		+		+	
5		+		=		+		+	
Totals	18,800	+		=	3,000+		13,500	+	2,300
Year 3	**Assets**			=	**Liabilities**	+	**Stockholders' Equity**		
No.	*Cash*	+	*Land*	=	*Liabilities.*	+	*Com. Stk.*	+	*Ret. Earn.*
Beg. bal.	18,800	+		=	3,000	+	13,500	+	2,300
1		+		=		+		+	
2		+		=		+		+	
3		+		+		+		+	
4		+		+		+		+	
5		+		+		+		+	
6		+		+		+		+	
Totals	500	+	21,000	+	4,000	+	16,000	+	1,500

Demonstration Problem 1-1: Requirement b

Computer Services Company			
Balance Sheets at December 31			
As of the Years Ended December 31,	Year 1	Year 2	Year 3
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

Demonstration Problem 1-1: Requirement c

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)

Demonstration Problem 1-1: Requirement d

Computer Services Company			
Statements of Changes in Stockholders' Equity			
For the Years Ended December 31,	Year 1	Year 2	Year 3
Beginning common stock	$ 0	$ 9,000	$13,500
Plus: Common stock issued			
Ending common stock			
Beginning retained earnings	0	600	2,300
Plus: Net income (loss)			
Less: Dividends			
Ending retained earnings			
Total stockholders' equity	$9,600	$15,800	$17,500

Demonstration Problem 1-1: Requirement e

Year 1

Event	Cash Flow Classification
1	
2	
3	
4	
5	

Year 2

Event	Cash Flow Classification
1	
2	
3	
4	
5	

Year 3

Event	Cash Flow Classification
1	
2	
3	
4	
5	
6	

Demonstration Problem 1-1: Requirement f

Computer Services Company Statements of Cash Flows			
For the Years Ended December 31,	Year 1	Year 2	Year 3
Cash flows from operating activities			
Cash inflows from revenue	$ 4,000	$ 6,700	$ 7,400
Cash outflows for operating expenses			
Net cash flow from operating activities			
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			
Net change in cash	14,600	4,200	
Beginning cash balance			18,800
Ending cash balance			$500

Quiz Questions for Chapter 1

The following information pertains to the next three questions. At the beginning of Year 2, X Company had assets of $600, liabilities of $300, and common stock of $100. During 2016 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 Year 2 income statement would be
   a. $250.
   b. $300.
   c. $150.
   d. none of the above are correct.

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

3. The amount of total assets reported on the December 31, Year 2 balance sheet 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. Stockholders' equity will increase.
   c. Liabilities will decrease.
   d. both answer b and answer c are correct.

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. Among other items, the balance sheet of XYZ Company reports retained earnings of $60,000 and total liabilities of $40,000. 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 (assets – liabilities) of the company amounted to $20,000.
    d. total assets amounted to at least $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. How does a cash dividend affect a company's financial statements?
    a. Decreases assets and stockholders' equity on the balance sheet.
    b. Decreases net income on the income statement.
    c. Both answer a and answer b are correct.
    d. None of the above answers are correct.

15. How does a cash expense affect a company's financial statements?
    a. Decreases assets and stockholders' equity on the balance sheet.
    b. Decreases net income on the income statement.
    c. Both answer a and answer b are correct.
    d. None of the above answers are correct.

Quiz Answers

Question	Answer	Explanation
1	A	Earned revenues $750 – incurred expenses $500 = $250 net income.
2	D	Beginning retained earnings year 2 $200 + net income $250 – dividends $100 = ending retained earnings year 2 $350.
3	A	Retained earnings increased $150 during year 2. Common stock and liabilities did not change during year 2. Total assets at the end of year 1 $600 + increase in claims to assets $150 = total assets at the end of year 2 = $750.
4	B	Liabilities increase as a result of borrowing cash.
5	C	Total assets increase by $600 from the asset source transaction borrowing $600 from the bank. Purchasing land with the cash borrowed from the bank is an asset exchange.
6	B	Cash flows related to assets needed to run a business are investing activities. The $500 cash paid for the land is an investing activity cash outflow.
7	D	Net income increases retained earnings which is a stockholders' equity account.
8	B	Stockholders' equity increases when revenue exceeds expenses, there are no dividends, and total liabilities remain unchanged.
9	B	Total assets of Company A would be unaffected. Using cash to purchase another assets is an asset exchange transaction.
10	D	Answers a, b, and c are all correct. Company A would have a cash outflow from investing activities. Company B would have a cash inflow from investing activities. 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.
11	C	Total assets decrease when revenue is less than expenses and liabilities and common stock were unchanged. For the accounting equation to balance if claims to assets decrease then assets also must decrease.
12	D	For the accounting equation to balance, total assets must be at least $100,000 when retained earnings are $60,000 and total liabilities $40,000.
13	B	Retained earnings increased $50 (revenues $300 - expenses $200 - dividends $50). Liabilities decreased $100. Thus, during the year claims to total assets decreased $50. Beginning total assets $600 - $50 decrease in claims to assets = ending total assets $550.
14	A	A cash dividend decreases assets and stockholders' equity on the balance sheet.
15	C	A cash expense decreases assets and stockholders' equity on the balance sheet and decreases net income on the income statement.

Summary Outline of a Lesson Plan for Chapter 1

I. **Distribute copies of the Demonstration Problem**.

II. **Define assets**.

III. **Introduce the accounting equation.**

Assets **=** ***Claims***

IV. **Use demonstration problem to introduce new terms and to elaborate on the interrelationships represented by the accounting equation.** Discuss how cash events affect the accounting equation

V. **Actively involve students in learning.** Have students complete Part *a* of the demonstration problem.

VI. **Introduce the balance sheet** (Figure 1)**.**

VII. **Introduce the other financial statements.** Statement of Changes in Stockholders' Equity (Figure 2), Income Statement (Figure 3), and the Statement of Cash Flows (Figure 4)

VIII. **Actively involve the students in learning**. Have students complete the financial statements for Years 1 and 2 in the demonstration problem.

IX. **Fill in the gaps.** You will find additional terms and concepts covered in the text but not in the teaching notes.

X. **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 tie to the example that has been covered in class.