

CHAPTER 1

INTRODUCTION TO ACCOUNTING AND BUSINESS

DISCUSSION QUESTIONS

1. Some users of accounting information include managers, employees, investors, creditors, customers, and the government.
2. The role of accounting is to provide information for managers to use in operating the business. In addition, accounting provides information to others to use in assessing the economic performance and condition of the business.
3. The corporate form allows the company to obtain large amounts of resources by issuing stock. For this reason, most companies that require large investments in property, plant, and equipment are organized as corporations.
4. No. The business entity concept limits the recording of economic data to transactions directly affecting the activities of the business. The payment of the interest of \$4,500 is a personal transaction of Josh Reilly and should not be recorded by Dispatch Delivery Service.
5. The land should be recorded at its cost of \$167,500 to Reliable Repair Service. This is consistent with the cost concept.
6.
 - a. No. The offer of \$2,000,000 and the increase in the assessed value should not be recognized in the accounting records.
 - b. Cash would increase by \$2,125,000, land would decrease by \$900,000, and stockholders' equity (retained earnings) would increase by \$1,225,000.
7. An account receivable is a claim against a customer for goods or services sold. An account payable is an amount owed to a creditor for goods or services purchased. Therefore, an account receivable in the records of the seller is an account payable in the records of the purchaser.
8. (b) The business realized net income of \$91,000 (\$679,000 – \$588,000).
9. (a) The business incurred a net loss of \$75,000 (\$640,000 – \$715,000).
10.
 - (a) Net income or net loss
 - (b) Retained earnings at the end of the period
 - (c) Cash at the end of the period

PRACTICE EXERCISES**PE 1–1A**

\$345,000. Under the cost concept, the land should be recorded at the cost to Integrity Repair Service.

PE 1–1B

\$437,500. Under the cost concept, the land should be recorded at the cost to Higgins Repair Service.

PE 1–2A

a.

$$\begin{array}{rclcl} & A & = & L + SE & \\ \$942,000 & = & \$584,000 & + SE & \\ SE & = & \$358,000 & & \end{array}$$

b.

$$\begin{array}{rclcl} & A & = & L + SE & \\ +\$113,000 & = & +\$44,000 & + SE & \\ SE & = & +\$69,000 & & \\ SE \text{ on December 31, 2014} & = & \$358,000 & + \$69,000 & \\ SE \text{ on December 31, 2014} & = & \$427,000 & & \end{array}$$

PE 1–2B

a.

$$\begin{array}{rclcl} & A & = & L + SE & \\ \$395,000 & = & \$97,000 & + SE & \\ SE & = & \$298,000 & & \end{array}$$

b.

$$\begin{array}{rclcl} & A & = & L + SE & \\ -\$65,000 & = & +\$36,000 & + SE & \\ SE & = & -\$101,000 & & \\ SE \text{ on December 31, 2014} & = & \$298,000 & - \$101,000 & \\ SE \text{ on December 31, 2014} & = & \$197,000 & & \end{array}$$

PE 1–3A

- (2) Asset (Cash) decreases by \$3,750;
Liability (Accounts Payable) decreases by \$3,750.
- (3) Asset (Accounts Receivable) increases by \$22,400;
Revenue (Delivery Service Fees) increases by \$22,400.
- (4) Asset (Cash) increases by \$11,300;
Asset (Accounts Receivable) decreases by \$11,300.
- (5) Asset (Cash) decreases by \$6,000;
Stockholders' Equity (Dividends) increases by \$6,000.

PE 1–3B

- (2) Expense (Advertising Expense) increases by \$4,850;
Asset (Cash) decreases by \$4,850.
- (3) Asset (Supplies) increases by \$2,100;
Liability (Accounts Payable) increases by \$2,100.
- (4) Asset (Accounts Receivable) increases by \$14,700;
Revenue (Delivery Service Fees) increases by \$14,700.
- (5) Asset (Cash) increases by \$8,200;
Asset (Accounts Receivable) decreases by \$8,200.

PE 1–4A

SUNSET TRAVEL SERVICE Income Statement For the Year Ended April 30, 2014		
Fees earned		\$1,673,000
Expenses:		
Wages expense	\$660,000	
Office expense	488,000	
Miscellaneous expense	34,000	
Total expenses		1,182,000
Net income		\$ 491,000

PE 1–4B

SENTINEL TRAVEL SERVICE Income Statement For the Year Ended August 31, 2014		
Fees earned		\$750,000
Expenses:		
Wages expense	\$450,000	
Office expense	295,000	
Miscellaneous expense	12,000	
Total expenses		757,000
Net loss		\$ (7,000)

PE 1–5A

SUNSET TRAVEL SERVICE Retained Earnings Statement For the Year Ended April 30, 2014		
Retained earnings, May 1, 2013		\$250,000
Net income for the year	\$491,000	
Less dividends	66,000	
Increase in retained earnings		425,000
Retained earnings, April 30, 2014		\$675,000

PE 1–5B

SENTINEL TRAVEL SERVICE Retained Earnings Statement For the Year Ended August 31, 2014		
Retained earnings, September 1, 2013		\$300,000
Net loss for the year	\$ 7,000	
Plus dividends	18,000	
Decrease in retained earnings		25,000
Retained earnings, August 31, 2014		\$275,000

PE 1–6A

SUNSET TRAVEL SERVICE Balance Sheet April 30, 2014				
Assets		Liabilities		
Cash	\$274,000	Accounts payable	\$ 61,000	
Accounts receivable	124,000			
Supplies	13,000	Stockholders' Equity		
Land	450,000	Capital stock	\$125,000	
		Retained earnings	675,000	
		Total stockholders' equity		800,000
		Total liabilities and stockholders' equity		\$861,000
Total assets	\$861,000			

PE 1–6B

SENTINEL TRAVEL SERVICE Balance Sheet August 31, 2014				
Assets		Liabilities		
Cash	\$ 45,400	Accounts payable		\$ 44,600
Accounts receivable	75,500			
Supplies	4,700	Stockholders' Equity		
Land	310,000	Capital stock	\$116,000	
		Retained earnings	275,000	
		Total stockholders' equity		391,000
		Total liabilities and stockholders' equity		\$435,600
Total assets	\$435,600			

PE 1–7A

SUNSET TRAVEL SERVICE Statement of Cash Flows For the Year Ended April 30, 2014		
Cash flows from operating activities:		
Cash received from customers	\$ 1,500,000	
Deduct cash payments for operating expenses	(1,215,000)	
Net cash flows from operating activities		\$ 285,000
Cash flows used for investing activities:		
Cash payments for purchase of land		(240,000)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 75,000	
Deduct cash dividends	(66,000)	
Net cash flows from financing activities		9,000
Net increase in cash during year		\$ 54,000
Cash as of May 1, 2013		220,000
Cash as of April 30, 2014		\$ 274,000

PE 1-7B

SENTINEL TRAVEL SERVICE Statement of Cash Flows For the Year Ended August 31, 2014		
Cash flows from operating activities:		
Cash received from customers	\$ 734,000	
Deduct cash payments for operating expenses	(745,600)	
Net cash flows used for operating activities		\$(11,600)
Cash flows used for investing activities:		
Cash payments for purchase of land		(50,000)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 36,000	
Deduct cash dividends	(18,000)	
Net cash flows from financing activities		18,000
Net decrease in cash during year		\$(43,600)
Cash as of September 1, 2013		89,000
Cash as of August 31, 2014		\$ 45,400

PE 1-8A

a.	Dec. 31, 2014	Dec. 31, 2013
Total liabilities.....	\$547,800	\$518,000
Total stockholders' equity.....	\$415,000	\$370,000
Ratio of liabilities to stockholders' equity.....	1.32 *	1.40 **
* \$547,800 ÷ \$415,000		
** \$518,000 ÷ \$370,000		

b. Decreased

PE 1-8B

a.	Dec. 31, 2014	Dec. 31, 2013
Total liabilities.....	\$4,085,000	\$2,880,000
Total stockholders' equity.....	\$4,300,000	\$3,600,000
Ratio of liabilities to stockholders' equity.....	0.95 *	0.80 **
* \$4,085,000 ÷ \$4,300,000		
** \$2,880,000 ÷ \$3,600,000		

b. Increased

EXERCISES**Ex. 1–1**

- a.
- | | | |
|------------------|------------------|-------------------|
| 1. manufacturing | 6. manufacturing | 11. service |
| 2. manufacturing | 7. service | 12. service |
| 3. manufacturing | 8. service | 13. manufacturing |
| 4. service | 9. manufacturing | 14. service |
| 5. merchandise | 10. merchandise | 15. merchandise |
- b. The accounting equation is relevant to all companies. It serves as the basis of the accounting information system.

Ex. 1–2

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

Ex. 1–3

- a.
- | | | |
|------|------|-------|
| 1. M | 5. O | 9. X |
| 2. L | 6. O | 10. O |
| 3. O | 7. X | |
| 4. M | 8. L | |
- b. A business transaction is an economic event or condition that directly changes an entity's financial condition or results of operations.

Ex. 1–4

Peet's Coffee & Tea's stockholders' equity: $\$209 - \$36 = \$173$

Starbucks' stockholders' equity: $\$6,386 - \$2,711 = \$3,675$

Ex. 1–5

Dollar Tree's stockholders' equity: $\$2,381 - \$922 = \$1,459$

Target's stockholders' equity: $\$43,705 - \$28,218 = \$15,487$

Ex. 1–6

- a. **\$456,100 (\$118,000 + \$338,100)**
- b. **\$355,010 (\$766,750 – \$411,740)**
- c. **\$2,072,200 (\$3,250,300 – \$1,178,100)**

Ex. 1–7

- a. **\$775,000 (\$1,250,000 – \$475,000)**
- b. **\$890,000 (\$775,000 + \$225,000 – \$110,000)**
- c. **\$385,000 (\$775,000 – \$300,000 – \$90,000)**
- d. **\$1,460,000 (\$775,000 + \$550,000 + \$135,000)**
- e. **Net income: \$350,000 (\$1,500,000 – \$375,000 – \$775,000)**

Ex. 1–8

- a. **(2) liability**
- b. **(1) asset**
- c. **(3) stockholders' equity (retained earnings; revenue)**
- d. **(1) asset**
- e. **(1) asset**
- f. **(3) stockholders' equity (retained earnings; expense)**

Ex. 1–9

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

Ex. 1–10

- a. **(1) Total assets increased \$260,000 (\$440,000 – \$180,000).**
(2) No change in liabilities.
(3) Stockholders' equity increased \$260,000.
- b. **(1) Total assets decreased \$69,000.**
(2) Total liabilities decreased \$69,000.
(3) No change in stockholders' equity.
- c. **No, it is false that a transaction always affects at least two elements (Assets, Liabilities, or Stockholders' Equity) of the accounting equation. Some transactions affect only one element of the accounting equation. For example, purchasing supplies for cash only affects assets.**

Ex. 1–11

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

Ex. 1–12

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

Ex. 1–13

- a. (1) Provided catering services for cash, \$33,000.
 (2) Purchase of land for cash, \$20,000.
 (3) Payment of cash for expenses, \$24,000.
 (4) Purchase of supplies on account, \$1,000.
 (5) Paid cash dividends, \$3,000.
 (6) Payment of cash to creditors, \$6,000.
 (7) Recognition of cost of supplies used, \$1,800.
- b. – \$20,000 (\$10,000 – \$30,000)
- c. \$4,200 (–\$3,000 + \$33,000 – \$25,800)
- d. \$7,200 (\$33,000 – \$25,800)
- e. \$4,200 (\$7,200 – \$3,000)

Ex. 1–14

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

Ex. 1–15

Juliet	
Stockholders' equity at end of year (\$1,125,000 – \$500,000).....	\$625,000
Deduct stockholders' equity at beginning of year (\$600,000 – \$150,000).....	<u>450,000</u>
Net income (increase in stockholders' equity).....	<u>\$175,000</u>
Kilo	
Increase in stockholders' equity (as determined for Juliet).....	\$175,000
Add dividends.....	<u>55,000</u>
Net income.....	<u>\$230,000</u>
Lima	
Increase in stockholders' equity (as determined for Juliet).....	\$175,000
Deduct additional issuance of capital stock.....	<u>100,000</u>
Net income.....	<u>\$ 75,000</u>
Mike	
Increase in stockholders' equity (as determined for Juliet).....	\$175,000
Deduct additional issuance of capital stock.....	<u>100,000</u>
	\$ 75,000
Add dividends.....	<u>55,000</u>
Net income.....	<u>\$130,000</u>

Ex. 1–16

Balance sheet items: 1, 2, 3, 5, 6, 10

Ex. 1–17

Income statement items: 4, 7, 8, 9

Ex. 1–18**a.**

INFRA-SYSTEMS COMPANY Retained Earnings Statement For the Month Ended November 30, 2014		
Retained earnings, November 1, 2014		\$400,000
Net income for November	\$275,000	
Less dividends	40,000	
Increase in retained earnings		235,000
Retained earnings, November 30, 2014		\$635,000

- b.** The retained earnings statement is prepared before the November 30, 2014, balance sheet because retained earnings as of November 30, 2014, is needed for the balance sheet.

Ex. 1–19

EXPLORATION SERVICES Income Statement For the Month Ended March 31, 2014		
Fees earned		\$1,100,000
Expenses:		
Wages expense	\$715,000	
Rent expense	80,000	
Supplies expense	9,000	
Miscellaneous expense	12,000	
Total expenses		816,000
Net income		\$ 284,000

Ex. 1–20

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

$$\text{Stockholders' Equity (beginning)} + \text{Additional Issuance of Capital Stock} - \text{Dividends} + \text{Revenues} - \text{Expenses} = \text{Stockholders' Equity (ending)}$$

Freeman

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

Heyward

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

Jones

Stockholders' equity at end of year (\$100,000 – \$80,000).....	\$ 20,000
Stockholders' equity at beginning of year (\$115,000 – \$81,000).....	<u>34,000</u>
Decrease in stockholders' equity.....	\$ (14,000)
Deduct decrease due to net loss (\$115,000 – \$122,500).....	<u>7,500</u>
	\$ (6,500)
Deduct additional issuance of capital stock.....	<u>10,000</u>
Dividends from the business..... (c)	<u><u>\$ (16,500)</u></u>

Ramirez

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

Ex. 1-21

a.

EBONY INTERIORS Balance Sheet February 28, 2014				
Assets		Liabilities		
Cash	\$ 320,000	Accounts payable		\$ 310,000
Accounts receivable	800,000			
Supplies	30,000	Stockholders' Equity		
		Capital stock	\$200,000	
		Retained earnings*	640,000	
		Total stockholders' equity		840,000
Total assets	\$1,150,000	Total liabilities and stockholders' equity		\$1,150,000

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

EBONY INTERIORS Balance Sheet March 31, 2014				
Assets		Liabilities		
Cash	\$ 380,000	Accounts payable		\$ 400,000
Accounts receivable	960,000			
Supplies	35,000	Stockholders' Equity		
		Capital stock	\$200,000	
		Retained earnings**	775,000	
		Total stockholders' equity		975,000
Total assets	\$1,375,000	Total liabilities and stockholders' equity		\$1,375,000

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

b. Stockholders' equity, March 31.....	\$975,000
Stockholders' equity, February 28***	<u>840,000</u>
Net income.....	<u>\$135,000</u>

$$***\$840,000 = \$320,000 + \$800,000 + \$30,000 - \$310,000$$

c. Stockholders' equity, March 31.....	\$975,000
Stockholders' equity, February 28.....	<u>840,000</u>
Increase in stockholders' equity.....	\$135,000
Add dividends.....	<u>50,000</u>
Net income.....	<u>\$185,000</u>

Ex. 1–22

- a. Balance sheet: 1, 2, 3, 4, 6, 7, 8, 9, 10, 11, 13
Income statement: 5, 12, 14, 15
- b. Yes, an item can appear on more than one financial statement. For example, cash appears on both the balance sheet and statement of cash flows. However, the same item cannot appear on both the income statement and balance sheet.
- c. Yes, the accounting equation is relevant to all companies, including Exxon Mobil Corporation.

Ex. 1–23

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

Ex. 1–24

ETHOS CONSULTING GROUP Statement of Cash Flows For the Year Ended May 31, 2014		
Cash flows from operating activities:		
Cash received from customers	\$637,500	
Deduct cash payments for operating expenses	(475,000)	
Net cash flows from operating activities		\$162,500
Cash flows used for investing activities:		
Cash payments for purchase of land		(90,000)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 62,500	
Deduct cash dividends	(17,500)	
Net cash flows from financing activities		45,000
Net decrease in cash during year		\$117,500
Cash as of June 1, 2013		58,000
Cash as of May 31, 2014		\$175,500

Ex. 1–25

1. All financial statements should contain the name of the business in their heading. The retained earnings statement is incorrectly headed as “Omar Farah” rather than We-Sell Realty. The heading of the balance sheet needs the name of the business.
2. The income statement and retained earnings statement cover a period of time and should be labeled “For the Month Ended August 31, 2014.”
3. The year in the heading for the retained earnings statement should be 2014 rather than 2013.
4. The balance sheet should be labeled “August 31, 2014,” rather than “For the Month Ended August 31, 2014.”
5. In the income statement, the miscellaneous expense amount should be listed as the last expense.
6. In the income statement, the total expenses are incorrectly subtracted from the sales commissions, resulting in an incorrect net income amount. The correct net income should be \$24,150. This also affects the retained earnings statement and the amount of retained earnings that appears on the balance sheet.
7. The additional issuance of capital stock of \$15,000 should not be included in the retained earnings statement. Capital stock should be listed in the balance sheet as part of Stockholders' Equity.
8. In the retained earnings statement, the net income should be presented first. Dividends should then be subtracted from net income to yield a net increase in retained earnings.
9. Accounts payable should be listed as a liability on the balance sheet.
10. Accounts receivable and supplies should be listed as assets on the balance sheet.
11. The balance sheet assets should equal the sum of the liabilities and stockholders' equity.

Ex. 1–25 (Concluded)

Corrected financial statements appear as follows:

WE-SELL REALTY Income Statement For the Month Ended August 31, 2014		
Sales commissions		\$140,000
Expenses:		
Office salaries expense	\$87,000	
Rent expense	18,000	
Automobile expense	7,500	
Supplies expense	1,150	
Miscellaneous expense	2,200	
Total expenses		115,850
Net income		\$ 24,150

WE-SELL REALTY Retained Earnings Statement For the Month Ended August 31, 2014		
Retained earnings, August 1, 2014		\$ 0
Net income for August	\$24,150	
Less dividends during August	10,000	
Increase in retained earnings		14,150
Retained earnings, August 31, 2014		\$14,150

WE-SELL REALTY Balance Sheet August 31, 2014			
Assets		Liabilities	
Cash	\$ 8,900	Accounts payable	\$22,350
Accounts receivable	38,600		
Supplies	4,000	Stockholders' Equity	
		Capital stock	\$15,000
		Retained earnings	14,150
		Total stockholders' equity	29,150
		Total liabilities and stockholders' equity	\$51,500
Total assets	\$51,500		

Ex. 1–26

- a. Year 2: \$21,236 ($\$40,125 - \$18,889$)
Year 1: \$21,484 ($\$40,877 - \$19,393$)
- b. Year 2: 1.12 ($\$21,236 \div \$18,889$)
Year 1: 1.11 ($\$21,484 \div \$19,393$)
- c. The ratio of liabilities to stockholders' equity increased from 1.11 to 1.12 indicating a slight increase in risk for creditors from Year 1 to Year 2.

Ex. 1–27

- a. Year 2: \$18,112 ($\$33,699 - \$15,587$)
Year 1: \$19,069 ($\$33,005 - \$13,936$)
- b. Year 2: 0.86 ($\$15,587 \div \$18,112$)
Year 1: 0.73 ($\$13,936 \div \$19,069$)
- c. The risk for creditors has increased from 0.73 in Year 1 to 0.86 in Year 2. In both years, creditors have less at stake in Lowe's than do stockholders, since the ratio is less than 1.
- d. Lowe's ratio of liabilities to stockholders' equity is less than 1. In comparison, The Home Depot's ratio of liabilities to stockholders' equity is greater than 1 for Year 2 and Year 1. Thus, the creditors of The Home Depot are more at risk than are the creditors of Lowe's.

PROBLEMS

Prob. 1–1A

1.	Assets				=	Liabilities +		Stockholders' Equity																	
	Cash	+	Accts. Rec.	+	Supplies	=	Accts. Payable	+	Capital Stock	–	Dividends	+	Fees Earned	–	Rent Expense	–	Salaries Expense	–	Supplies Expense	–	Auto Exp.	–	Misc. Exp.		
(a)	+	30,000							+	30,000															
(b)					+	1,200	+	1,200																	
Bal.	30,000				1,200		1,200		30,000																
(c)	+	7,200											+	7,200											
Bal.	37,200				1,200		1,200		30,000				7,200												
(d)	–	3,000													–	3,000									
Bal.	34,200				1,200		1,200		30,000				7,200		–	3,000									
(e)	–	750					–	750																	
Bal.	33,450				1,200		450		30,000				7,200		–	3,000									
(f)			+	5,000									+	5,000											
Bal.	33,450		5,000		1,200		450		30,000				12,200		–	3,000									
(g)	–	900																			–	600	–	300	
Bal.	32,550		5,000		1,200		450		30,000				12,200		–	3,000					–	600	–	300	
(h)	–	1,800															–	1,800							
Bal.	30,750		5,000		1,200		450		30,000				12,200		–	3,000	–	1,800			–	600	–	300	
(i)					–	500													–	500					
Bal.	30,750		5,000		700		450		30,000				12,200		–	3,000	–	1,800	–	500	–	600	–	300	
(j)	–	1,500									–	1,500													
Bal.	29,250		5,000		700		450		30,000		–	1,500		12,200		–	3,000	–	1,800	–	500	–	600	–	300

- Stockholders' equity is the right of stockholders (owners) to the assets of the business. These rights are increased by issuances of capital stock and revenues and decreased by dividends and expenses.
- \$6,000 (\$12,200 – \$3,000 – \$1,800 – \$500 – \$600 – \$300)
- June's transactions increased retained earnings by \$4,500 (\$6,000 – \$1,500), which is June's net income of \$6,000 less dividends of \$1,500.

Prob. 1–2A

1.

ORIENTAL TRAVEL AGENCY Income Statement For the Year Ended December 31, 2014		
Fees earned		\$1,100,000
Expenses:		
Wages expense	\$490,000	
Rent expense	150,000	
Utilities expense	79,000	
Supplies expense	14,000	
Miscellaneous expense	7,000	
Total expenses		740,000
Net income		\$ 360,000

2.

ORIENTAL TRAVEL AGENCY Retained Earnings Statement For the Year Ended December 31, 2014		
Retained earnings, January 1, 2014		\$400,000
Net income for the year	\$360,000	
Less dividends	25,000	
Increase in retained earnings		335,000
Retained earnings, December 31, 2014		\$735,000

3.

ORIENTAL TRAVEL AGENCY Balance Sheet December 31, 2014			
Assets		Liabilities	
Cash	\$210,000	Accounts payable	\$115,000
Accounts receivable	370,000		
Supplies	20,000		
Land	300,000	Stockholders' Equity	
		Capital stock	\$ 50,000
		Retained earnings	735,000
		Total stockholders' equity	785,000
		Total liabilities and stockholders' equity	\$900,000
Total assets	\$900,000		

4. Retained earnings of \$735,000

Prob. 1–3A

1.

RELIANCE FINANCIAL SERVICES Income Statement For the Month Ended July 31, 2014		
Fees earned		\$144,500
Expenses:		
Salaries expense	\$55,000	
Rent expense	33,000	
Auto expense	16,000	
Supplies expense	4,500	
Miscellaneous expense	4,800	
Total expenses		113,300
Net income		\$ 31,200

2.

RELIANCE FINANCIAL SERVICES Retained Earnings Statement For the Month Ended July 31, 2014		
Retained earnings, July 1, 2014		\$ 0
Net income for July	\$31,200	
Less dividends	15,000	
Increase in retained earnings		16,200
Retained earnings, July 31, 2014		\$16,200

3.

RELIANCE FINANCIAL SERVICES Balance Sheet July 31, 2014				
Assets		Liabilities		
Cash	\$32,600	Accounts payable	\$ 3,400	
Accounts receivable	34,500			
Supplies	2,500	Stockholders' Equity		
		Capital stock	\$50,000	
		Retained earnings	16,200	
		Total stockholders' equity		66,200
		Total liabilities and stockholders' equity		\$69,600
Total assets	\$69,600			

Prob. 1–3A (Concluded)

4. (Optional)

RELIANCE FINANCIAL SERVICES Statement of Cash Flows For the Month Ended July 31, 2014		
Cash flows from operating activities:		
Cash received from customers	\$110,000	
Deduct cash payments for expenses		
and payments to creditors*	(112,400)	
Net cash flows used for operating activities		\$ (2,400)
Cash flows from investing activities		0
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 50,000	
Deduct cash dividends	(15,000)	
Net cash flows from financing activities		35,000
Net increase in cash and July 31, 2014, cash balance		\$ 32,600

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

Prob. 1–4A

1.	Assets		=	Liabilities		+	Stockholders' Equity							
	Cash	+ Supplies	=	Accts. Payable	+	Capital Stock	– Dividends	+	Sales Comm.	– Rent Exp.	– Salaries Exp.	– Auto Exp.	– Supplies Exp.	– Misc. Exp.
(a)	+ 18,000					+ 18,000								
(b)		+ 3,200		+ 3,200										
Bal.	18,000	3,200		3,200		18,000								
(c)	– 1,800			– 1,800										
Bal.	16,200	3,200		1,400		18,000								
(d)	+ 36,750							+ 36,750						
Bal.	52,950	3,200		1,400		18,000		36,750						
(e)	– 4,000								– 4,000					
Bal.	48,950	3,200		1,400		18,000		36,750	– 4,000					
(f)	– 3,000						– 3,000							
Bal.	45,950	3,200		1,400		18,000	– 3,000	36,750	– 4,000					
(g)	– 3,700											– 2,500		– 1,200
Bal.	42,250	3,200		1,400		18,000	– 3,000	36,750	– 4,000			– 2,500		– 1,200
(h)	– 3,750									– 3,750				
Bal.	38,500	3,200		1,400		18,000	– 3,000	36,750	– 4,000	– 3,750	– 2,500			– 1,200
(i)		– 1,650											– 1,650	
Bal.	38,500	1,550		1,400		18,000	– 3,000	36,750	– 4,000	– 3,750	– 2,500	– 1,650		– 1,200

Prob. 1–4A (Concluded)

2.

SUNRISE REALTY Income Statement For the Month Ended October 31, 2014		
Sales commissions		\$36,750
Expenses:		
Rent expense	\$4,000	
Salaries expense	3,750	
Automobile expense	2,500	
Supplies expense	1,650	
Miscellaneous expense	1,200	
Total expenses		13,100
Net income		\$23,650

SUNRISE REALTY Retained Earnings Statement For the Month Ended October 31, 2014		
Retained earnings, October 1, 2014		\$ 0
Net income for October	\$23,650	
Less dividends	3,000	
Increase in retained earnings		20,650
Retained earnings, October 31, 2014		\$20,650

SUNRISE REALTY Balance Sheet October 31, 2014				
Assets		Liabilities		
Cash	\$38,500	Accounts payable		\$ 1,400
Supplies	1,550			
		Stockholders' Equity		
		Capital stock	\$18,000	
		Retained earnings	20,650	
		Total stockholders' equity		38,650
		Total liabilities and stockholders' equity		\$40,050
Total assets	\$40,050			

Prob. 1–5A

1.	<u>Assets</u>				=	Liabilities	+	<u>Stockholders' Equity</u>					
	Cash	+	Accounts Receivable	+	Supplies	+	Land	=	Accounts Payable	+	Capital Stock	+	Retained Earnings
	\$45,000	+	\$93,000	+	\$7,000	+	\$75,000	=	\$40,000	+	\$60,000	+	Retained Earnings
							\$220,000	=	\$100,000	+	Retained Earnings		
							\$120,000	=	Retained Earnings				

Prob. 1–5A (Continued)

2.	Assets						=	Liabilities + Stockholders' Equity							
	Cash	+	Accts. Rec.	+	Supplies	+	Land	=	Accts. Payable	+	Capital Stock	+	Retained Earnings	–	Dividends
Bal.	45,000		93,000		7,000		75,000		40,000		60,000		120,000		0
(a)	+	35,000								+	35,000				
Bal.	80,000		93,000		7,000		75,000		40,000		95,000		120,000		0
(b)	–	50,000					+ 50,000								
Bal.	30,000		93,000		7,000		125,000		40,000		95,000		120,000		0
(c)	+	32,125													
Bal.	62,125		93,000		7,000		125,000		40,000		95,000		120,000		0
(d)	–	6,000													
Bal.	56,125		93,000		7,000		125,000		40,000		95,000		120,000		0
(e)					+	2,500			+	2,500					
Bal.	56,125		93,000		9,500		125,000		42,500		95,000		120,000		0
(f)	–	22,800							–	22,800					
Bal.	33,325		93,000		9,500		125,000		19,700		95,000		120,000		0
(g)			+		84,750										
Bal.	33,325		177,750		9,500		125,000		19,700		95,000		120,000		0
(h)									+	29,500					
Bal.	33,325		177,750		9,500		125,000		49,200		95,000		120,000		0
(i)	–	14,000													
Bal.	19,325		177,750		9,500		125,000		49,200		95,000		120,000		0
(j)	+	88,000	–		88,000										
Bal.	107,325		89,750		9,500		125,000		49,200		95,000		120,000		0
(k)					–		3,600								
Bal.	107,325		89,750		5,900		125,000		49,200		95,000		120,000		0
(l)	–	12,000												–	12,000
Bal.	95,325		89,750		5,900		125,000		49,200		95,000		120,000	–	12,000

Prob. 1–5A (Continued)

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

Prob. 1–5A (Continued)

3.

D'LITE DRY CLEANERS Income Statement For the Month Ended July 31, 2014		
Dry cleaning revenue		\$116,875
Expenses:		
Dry cleaning expense	\$29,500	
Wages expense	7,500	
Rent expense	6,000	
Supplies expense	3,600	
Truck expense	2,500	
Utilities expense	1,300	
Miscellaneous expense	2,700	
Total expenses		53,100
Net income		\$ 63,775

D'LITE DRY CLEANERS Retained Earnings Statement For the Month Ended July 31, 2014		
Retained earnings, July 1, 2014		\$120,000
Net income for July	\$63,775	
Less dividends	12,000	
Increase in retained earnings		51,775
Retained earnings, July 31, 2014		\$171,775

D'LITE DRY CLEANERS Balance Sheet July 31, 2014				
Assets		Liabilities		
Cash	\$ 95,325	Accounts payable		\$ 49,200
Accounts receivable	89,750			
Supplies	5,900	Stockholders' Equity		
Land	125,000	Capital stock	\$ 95,000	
		Retained earnings	171,775	
		Total stockholders' equity		266,775
		Total liabilities and stockholders' equity		\$315,975
Total assets	\$315,975			

Prob. 1–5A (Concluded)**4. (Optional)**

D'LITE DRY CLEANERS Statement of Cash Flows For the Month Ended July 31, 2014		
Cash flows from operating activities:		
Cash received from customers*	\$120,125	
Deduct cash payments for expenses		
and payments to creditors**	(42,800)	
Net cash flows from operating activities		\$ 77,325
Cash flows used for investing activities:		
Purchase of land		(50,000)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 35,000	
Deduct cash dividends	(12,000)	
Net cash flows from financing activities		23,000
Net Increase in cash during July		\$ 50,325
Cash balance, July 1, 2014		45,000
Cash balance, July 31, 2014		\$ 95,325

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

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

Prob. 1–6A

- a. Fees earned, \$750,000 ($\$275,000 + \$475,000$)
- b. Supplies expense, \$30,000 ($\$475,000 - \$300,000 - \$100,000 - \$20,000 - \$25,000$)
- c. Retained earnings, April 1, 2014, \$0; Wolverine Realty was organized on April 1, 2014.
- d. Net income for April, \$275,000 from income statement
- e. \$150,000 ($\$275,000 - \$125,000$)
- f. Retained earnings, April 30, 2014, \$150,000
- g. Total assets, \$625,000 ($\$462,500 + \$12,500 + \$150,000$)
- h. Retained earnings, \$150,000; same as (f)
- i. Total stockholders' equity, \$525,000 ($\$375,000 + \$150,000$)
- j. Total liabilities and stockholders' equity, \$625,000 ($\$100,000 + \$525,000$)
- k. Cash received from customers, \$750,000; this is the same as fees earned (a) since there are no accounts receivable.
- l. Net cash flows from operating activities, \$362,500 ($\$750,000 - \$387,500$)
- m. Cash payments for acquisition of land, (\$150,000)
- n. Cash received from issuing capital stock, \$375,000
- o. Cash dividends, (\$125,000)
- p. Net cash flows from financing activities, \$250,000 ($\$375,000 - \$125,000$)
- q. Net cash flow and April 30, 2014, cash balance, \$462,500 ($\$362,500 - \$150,000 + \$250,000$); also the cash balance on the balance sheet.

Prob. 1–1B

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

- Stockholders' equity is the right of stockholders (owners) to the assets of the business. These rights are increased by issuing capital stock and decreased by dividends and expenses.
- \$16,050 (\$26,300 – \$5,000 – \$2,500 – \$1,300 – \$1,150 – \$300)
- March's transactions increased retained earnings by \$12,150 (\$16,050 – \$3,900) which is the excess of March's net income of \$16,050 over dividends of \$3,900.

Prob. 1–2B

WILDERNESS TRAVEL SERVICE Income Statement For the Year Ended April 30, 2014		
Fees earned		\$875,000
Expenses:		
Wages expense	\$525,000	
Rent expense	75,000	
Utilities expense	38,000	
Supplies expense	12,000	
Taxes expense	10,000	
Miscellaneous expense	15,000	
Total expenses		675,000
Net income		\$200,000

WILDERNESS TRAVEL SERVICE Retained Earnings Statement For the Year Ended April 30, 2014		
Retained earnings, May 1, 2013		\$145,000
Net income for the year	\$200,000	
Less dividends	40,000	
Increase in retained earnings		160,000
Retained earnings, April 30, 2014		\$305,000

WILDERNESS TRAVEL SERVICE Balance Sheet April 30, 2014				
Assets		Liabilities		
Cash	\$146,000	Accounts payable	\$ 25,000	
Accounts receivable	210,000			
Supplies	9,000	Stockholders' Equity		
		Capital stock	\$ 35,000	
		Retained earnings	305,000	
		Total stockholders' equity		340,000
		Total liabilities and stockholders' equity		\$365,000
Total assets	\$365,000			

4. Net income of \$200,000

Prob. 1–3B

1.

BRONCO CONSULTING Income Statement For the Month Ended August 31, 2014		
Fees earned		\$125,000
Expenses:		
Salaries expense	\$58,000	
Rent expense	27,000	
Auto expense	15,500	
Supplies expense	6,100	
Miscellaneous expense	7,500	
Total expenses		114,100
Net income		\$ 10,900

2.

BRONCO CONSULTING Retained Earnings Statement For the Month Ended August 31, 2014		
Retained earnings, August 1, 2014		\$ 0
Net income for August	\$10,900	
Less dividends	5,000	
Increase in retained earnings		5,900
Retained earnings, August 31, 2014		\$5,900

3.

BRONCO CONSULTING Balance Sheet August 31, 2014				
Assets		Liabilities		
Cash	\$48,000	Accounts payable		\$ 3,000
Accounts receivable	33,000			
Supplies	2,900	Stockholders' Equity		
		Capital stock	\$75,000	
		Retained earnings	5,900	
		Total stockholders' equity		80,900
		Total liabilities and stockholders' equity		\$83,900
Total assets	\$83,900			

Prob. 1–3B (Concluded)**4. (Optional)**

BRONCO CONSULTING Statement of Cash Flows For the Month Ended August 31, 2014		
Cash flows from operating activities:		
Cash received from customers	\$ 92,000	
Deduct cash payments for expenses		
and payments to creditors*	(114,000)	
Net cash flows used for operating activities		\$(22,000)
Cash flows from investing activities		0
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 75,000	
Deduct cash dividends	(5,000)	
Net cash flows from financing activities		70,000
Net increase in cash and August 31, 2014, cash balance		\$ 48,000

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

Prob. 1-4B

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

Prob. 1–4B (Concluded)

2.

CUSTOM REALTY Income Statement For the Month Ended April 30, 2014		
Sales commissions		\$19,800
Expenses:		
Rent expense	\$3,600	
Salaries expense	2,500	
Automobile expense	1,350	
Supplies expense	900	
Miscellaneous expense	600	
Total expenses		8,950
Net income		\$10,850

CUSTOM REALTY Retained Earnings Statement For the Month Ended April 30, 2014		
Retained earnings, April 1, 2014		\$ 0
Net income for April	\$10,850	
Less dividends	3,500	
Increase in retained earnings		7,350
Retained earnings, April 30, 2014		\$7,350

CUSTOM REALTY Balance Sheet April 30, 2014				
Assets		Liabilities		
Cash	\$31,500	Accounts payable		\$ 450
Supplies	300			
		Stockholders' Equity		
		Capital stock	\$24,000	
		Retained earnings	7,350	
		Total stockholders' equity		31,350
		Total liabilities and stockholders' equity		\$31,800
Total assets	\$31,800			

Prob. 1–5B

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

Prob. 1–5B (Continued)

2.	Assets					=	Liabilities	+	Stockholders' Equity		
	Cash	+	Accts. Rec.	+ Supplies	+ Land	=	Accts. Payable	+	Capital Stock	+ Retained Earnings	– Dividends
Bal.	39,000		80,000	11,000	50,000		31,500		50,000	98,500	0
(a)	+ 21,000							+ 21,000			
Bal.	60,000		80,000	11,000	50,000		31,500		71,000	98,500	0
(b)	– 35,000				+ 35,000						
Bal.	25,000		80,000	11,000	85,000		31,500		71,000	98,500	0
(c)	– 4,000										
Bal.	21,000		80,000	11,000	85,000		31,500		71,000	98,500	0
(d)		+ 72,000									
Bal.	21,000		152,000	11,000	85,000		31,500		71,000	98,500	0
(e)	– 20,000						– 20,000				
Bal.	1,000		152,000	11,000	85,000		11,500		71,000	98,500	0
(f)				+ 8,000			+ 8,000				
Bal.	1,000		152,000	19,000	85,000		19,500		71,000	98,500	0
(g)	+ 38,000										
Bal.	39,000		152,000	19,000	85,000		19,500		71,000	98,500	0
(h)	+ 77,000	– 77,000									
Bal.	116,000		75,000	19,000	85,000		19,500		71,000	98,500	0
(i)							+ 29,450				
Bal.	116,000		75,000	19,000	85,000		48,950		71,000	98,500	0
(j)	– 29,200										
Bal.	86,800		75,000	19,000	85,000		48,950		71,000	98,500	0
(k)				– 7,200							
Bal.	86,800		75,000	11,800	85,000		48,950		71,000	98,500	0
(l)	– 5,000										– 5,000
Bal.	81,800		75,000	11,800	85,000		48,950		71,000	98,500	– 5,000

Prob. 1–5B (Continued)

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

Prob. 1–5B (Continued)

3.

BEV'S DRY CLEANERS Income Statement For the Month Ended November 30, 2014		
Dry cleaning revenue		\$110,000
Expenses:		
Dry cleaning expense	\$29,450	
Wages expense	24,000	
Supplies expense	7,200	
Rent expense	4,000	
Truck expense	2,100	
Utilities expense	1,800	
Miscellaneous expense	1,300	
Total expenses		69,850
Net income		\$ 40,150

BEV'S DRY CLEANERS Retained Earnings Statement For the Month Ended November 30, 2014		
Retained earnings, November 1, 2014		\$ 98,500
Net income for November	\$40,150	
Less dividends	5,000	
Increase in retained earnings		35,150
Retained earnings, November 30, 2014		\$133,650

BEV'S DRY CLEANERS Balance Sheet November 30, 2014				
Assets		Liabilities		
Cash	\$ 81,800	Accounts payable		\$ 48,950
Accounts receivable	75,000			
Supplies	11,800	Stockholders' Equity		
Land	85,000	Capital stock	\$ 71,000	
		Retained earnings	133,650	
		Total stockholders' equity		204,650
		Total liabilities and stockholders' equity		\$253,600
Total assets	\$253,600			

Prob. 1–5B (Concluded)**4. (Optional)**

BEV'S DRY CLEANERS Statement of Cash Flows For the Month Ended November 30, 2014		
Cash flows from operating activities:		
Cash received from customers*	\$115,000	
Deduct cash payments for expenses		
and payments to creditors**	(53,200)	
Net cash flows from operating activities		\$61,800
Cash flows used for investing activities:		
Purchase of land		(35,000)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 21,000	
Deduct cash dividends	(5,000)	
Net cash flows from financing activities		16,000
Net increase in cash during November		\$42,800
Cash balance, November 1, 2014		39,000
Cash balance, November 30, 2014		\$81,800

* $\$38,000 + \$77,000 = \$115,000$; these amounts are taken from the cash column of the spreadsheet in Part 2.

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

Prob. 1–6B

- a. Wages expense, \$203,200 ($\$288,000 - \$48,000 - \$17,600 - \$14,400 - \$4,800$)
- b. Net income, \$112,000 ($\$400,000 - \$288,000$)
- c. Retained earnings, May 1, 2014, \$0; Atlas Realty was organized on May 1, 2014.
- d. Net income for May, \$112,000; from (b)
- e. Dividends, \$64,000; from statement of cash flows.
- f. Increase in retained earnings, \$48,000 ($\$112,000 - \$64,000$)
- g. Retained earnings, May 31, 2014, \$48,000
- h. Land, \$120,000; from statement of cash flows.
- i. Total assets, \$256,000 ($\$123,200 + \$12,800 + \$120,000$)
- j. Capital stock, \$160,000; from statement of cash flows
- k. Retained earnings, \$48,000; from retained earnings statement
- l. Total stockholders' equity, \$208,000 ($\$160,000 + \$48,000$)
- m. Total liabilities and stockholders' equity, \$256,000 ($\$48,000 + \$208,000$)
- n. Cash received from customers, \$400,000; this is the same as fees earned since there are no accounts receivable.
- o. Net cash flows from operating activities, \$147,200 ($\$400,000 - \$252,800$)
- p. Net cash flows from financing activities, \$96,000 ($\$160,000 - \$64,000$)
- q. Net cash flows and May 31, 2014, cash balance, \$123,200 ($\$147,200 - \$120,000 + \$96,000$); also, the cash balance on the balance sheet.

CONTINUING PROBLEM

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

Continuing Problem (Continued)

Stockholders' Equity (Continued)									
	Music	Office	Equip.	Adver-	Wages	Utilities	Supplies	Misc.	
	Exp.	Rent	Rent	tising	Exp.	Exp.	Exp.	Exp.	Exp.
	-	-	-	-	-	-	-	-	-
June 1									
June 2									
Bal.									
June 2		- 800							
Bal.		- 800							
June 4									
Bal.		- 800							
June 6				- 500					
Bal.		- 800		- 500					
June 8			- 675						
Bal.		- 800	- 675	- 500					
June 12	- 350								
Bal.	- 350	- 800	- 675	- 500					
June 13									
Bal.	- 350	- 800	- 675	- 500					
June 16									
Bal.	- 350	- 800	- 675	- 500					
June 22									
Bal.	- 350	- 800	- 675	- 500					
June 25									
Bal.	- 350	- 800	- 675	- 500					
June 29	- 240								
Bal.	- 590	- 800	- 675	- 500					
June 30									
Bal.	- 590	- 800	- 675	- 500					
June 30					- 400				
Bal.	- 590	- 800	- 675	- 500	- 400				
June 30						- 300			
Bal.	- 590	- 800	- 675	- 500	- 400	- 300			
June 30							- 180		
Bal.	- 590	- 800	- 675	- 500	- 400	- 300	- 180		
June 30								- 415	
Bal.	- 590	- 800	- 675	- 500	- 400	- 300	- 180	- 415	
June 30	- 1,000								
Bal.	- 1,590	- 800	- 675	- 500	- 400	- 300	- 180	- 415	
June 30									
Bal.	- 1,590	- 800	- 675	- 500	- 400	- 300	- 180	- 415	

Continuing Problem (Concluded)

2.

PS MUSIC Income Statement For the Month Ended June 30, 2014		
Fees earned:		\$6,200
Expenses:		
Music expense	\$1,590	
Office rent expense	800	
Equipment rent expense	675	
Advertising expense	500	
Wages expense	400	
Utilities expense	300	
Supplies expense	180	
Miscellaneous expense	415	
Total expenses		4,860
Net income		\$1,340

3.

PS MUSIC Retained Earnings Statement For the Month Ended June 30, 2014		
Retained earnings, June 1, 2014		\$ 0
Net income for June	\$1,340	
Less dividends	500	
Increase in retained earnings		840
Retained earnings, June 30, 2014		\$840

4.

PS MUSIC Balance Sheet June 30, 2014				
Assets		Liabilities		
Cash	\$3,920	Accounts payable		\$ 250
Accounts receivable	1,000			
Supplies	170	Stockholders' Equity		
		Capital stock	\$4,000	
		Retained earnings	840	
		Total stockholders' equity		4,840
		Total liabilities and stockholders' equity		\$5,090
Total assets	\$5,090			

CASES & PROJECTS**CP 1–1**

1. Acceptable professional conduct requires that Colleen Fernandez supply First Federal Bank with all the relevant financial statements necessary for the bank to make an informed decision. Therefore, Colleen should provide the complete set of financial statements. These can be supplemented with a discussion of the net loss in the past year or other data explaining why granting the loan is a good investment by the bank.
2. a. Owners are generally willing to provide bankers with information about the operating and financial condition of the business, such as the following:
 - **Operating Information:**
 - Description of business operations
 - Results of past operations
 - Preliminary results of current operations
 - Plans for future operations
 - **Financial Condition:**
 - List of assets and liabilities (balance sheet)
 - Estimated current values of assets
 - Owner's personal investment in the business
 - Owner's commitment to invest additional funds in the business

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

- ***Proprietary Operating Information.*** Such information, which might hurt the business if it becomes known by competitors, might include special processes used by the business or future plans to expand operations into areas that are not currently served by a competitor.
 - ***Personal Financial Information.*** Owners may have little choice here because banks often require owners of small businesses to pledge their personal assets as security for a business loan. Personal financial information requested by bankers often includes the owner's net worth, salary, and other income. In addition, bankers usually request information about factors that might affect the personal financial condition of the owner. For example, a pending divorce by the owner might significantly affect the owner's personal wealth.
- b. Bankers typically want as much information as possible about the ability of the business and the owner to repay the loan with interest. Examples of such information are described above.
 - c. Both bankers and business owners share the common interest of the business doing well and being successful. If the business is successful, the bankers will receive their loan payments on time with interest, and the owners will increase their personal wealth.

CP 1–2

The difference in the two bank balances, \$55,000 (\$80,000 – \$25,000), may not be pure profit from an accounting perspective. To determine the accounting profit for the six-month period, the revenues for the period would need to be matched with the related expenses. The revenues minus the expenses would indicate whether the business generated net income (profit) or a net loss for the period. Using only the difference between the two bank account balances ignores such factors as amounts due from customers (receivables), liabilities (accounts payable) that need to be paid for wages or other operating expenses, additional investments made by Dr. Cousins in the business, and dividends that may have been paid during the period.

Some businesses that have few, if any, receivables or payables may use a “cash” basis of accounting. The cash basis of accounting ignores receivables and payables because they are assumed to be insignificant in amount. However, even with the cash basis of accounting, additional investments during the period and any dividends paid during the period have to be considered in determining the net income (profit) or net loss for the period.

CP 1–3

1.	Assets			=	Liabilities +		Owner's Equity												
	Cash	+	Supplies	=	Accts. Payable	+	Lisa Duncan, Capital	-	Lisa Duncan, Drawing	+	Fees Earned	-	Salaries Expense	-	Rent Expense	-	Supplies Expense	-	Misc. Exp.
(a)	+	950					+	950											
(b)	-	300	+	300															
Bal.		650		300				950											
(c)	-	275													-	275			
Bal.		375		300				950							-	275			
(d)	-	100			+	150									-	250			
Bal.		275		300		150		950							-	525			
(e)	+	1,750								+	1,750								
Bal.		2,025		300		150		950			1,750				-	525			
(f)	+	600								+	600								
Bal.		2,625		300		150		950			2,350				-	525			
(g)	-	800										-	800						
Bal.		1,825		300		150		950			2,350	-	800		-	525			
(h)	-	290																	- 290
Bal.		1,535		300		150		950			2,350	-	800		-	525			- 290
(i)	+	1,300								+	1,300								
Bal.		2,835		300		150		950			3,650	-	800		-	525			- 290
(j)			-	120													-	120	
Bal.		2,835		180		150		950			3,650	-	800		-	525	-	120	- 290
(k)	-	400							-	400									
Bal.		2,435		180		150		950	-	400	3,650	-	800		-	525	-	120	- 290

CP 1–3 (Continued)

2.

SERVE-N-VOLLEY Income Statement For the Month Ended September 30, 2014		
Fees earned:		\$3,650
Expenses:		
Salaries expense	\$800	
Rent expense	525	
Supplies expense	120	
Miscellaneous expense	290	
Total expenses		1,735
Net income		\$1,915

3.

SERVE-N-VOLLEY Statement of Owner's Equity For the Month Ended September 30, 2014		
Lisa Duncan, capital, September 1, 2014		\$ 0
Investment on September 1, 2014	\$ 950	
Net income for September	1,915	
	\$2,865	
Less withdrawals	400	
Increase in owner's equity		2,465
Lisa Duncan, capital, September 30, 2014		\$2,465

4.

SERVE-N-VOLLEY Balance Sheet September 30, 2014			
Assets		Liabilities	
Cash	\$2,435	Accounts payable	\$ 150
Supplies	180		
		Owner's Equity	
		Lisa Duncan, capital	2,465
		Total liabilities and	
Total assets	\$2,615	stockholders' equity	\$2,615

CP 1–3 (Concluded)

5. a. **Serve-N-Volley would provide Lisa with \$715 more income per month than working as a waitress. This amount is computed as follows:**

Net income of Serve-N-Volley, per month.....	\$1,915
Earnings as waitress, per month:	
30 hours per week × \$10 per hour × 4 weeks.....	<u>1,200</u>
Difference.....	<u>\$ 715</u>

- b. **Other factors that Lisa should consider before discussing a long-term arrangement with the Phoenix Tennis Club include the following:**

Lisa should consider whether the results of operations for September are indicative of what to expect each month. For example, Lisa should consider whether club members will continue to request lessons or use the ball machine during the fall months when interest in tennis may slacken. Lisa should evaluate whether the additional income of \$715 per month from Serve-N-Volley is worth the risk being taken and the effort being expended.

Lisa should also consider how much her investment in Serve-N-Volley could have earned if invested elsewhere. For example, if the initial investment of \$950 had been invested to earn a rate of return of 6% per year, it would have earned \$4.75 in September, or \$57 for the year.

Note to Instructors: Numerous other considerations could be mentioned by students, such as the ability of Lisa to withdraw cash from Serve-N-Volley for personal use. For example, some of her investment in Serve-N-Volley will be in the form of supplies (tennis balls, etc.), which are readily convertible to cash. The objective of this case is not to mention all possible considerations but to encourage students to begin thinking about the use of accounting information in making business decisions.

CP 1–4

Note to Instructors: The purpose of this activity is to familiarize students with the certification requirements and their online availability. You might use this as an opportunity to discuss the advantages and disadvantages of careers in public accounting (CPA), management accounting (CMA), and internal auditing (CIA).

The following Web sites provide useful information (such as starting salaries, etc.) for students on careers in accounting:

American Institute of Certified Public Accountants (AICPA)

<http://www.aicpa.org/becomeacpa/faqs/pages/faqs.aspx>

Institute of Certified Management Accountants (IMA)

http://imanet.org/ima_home.aspx

Institute of Internal Auditors (IIA)

<http://www.theiia.org/theiia/about-the-profession/about-the-internal-audit-profession/>

CP 1–5

	First Year	Second Year	Third Year
Net cash flows from operating activities	negative	positive	positive
Net cash flows from investing activities	negative	negative	negative
Net cash flows from financing activities	positive	positive	positive

Start-up companies normally experience negative net cash flows from operating activities; however, Amazon.com was able to generate positive net cash flows from operations by its second year. Start-up companies normally have negative net cash flows from investing activities as they build up their infrastructure through purchases of property, plant, and equipment. This was the case with Amazon.com for each of its first three years. Likewise, start-up companies normally have positive net cash flows from financing activities from raising capital. This was also the case for Amazon.com. Also, start-up companies normally have positive cash flows from financing activities—activities from raising capital.

CP 1–6

As can be seen from the balance sheet data in the case, Enron was financed largely by debt as compared to equity. Specifically, Enron's stockholders' equity represented only 17.5% ($\$11,470 \div \$65,503$) of Enron's total assets. The remainder of Enron's total assets, 82.5%, was financed by debt. When a company is financed largely by debt, it is said to be highly leveraged.

In late 2001 and early 2002, allegations arose as to possible misstatements of Enron's financial statements. These allegations revolved around the use of "special purpose entities" (partnerships) and related party transactions. The use of special purpose entities allowed Enron to hide a significant amount of additional debt off its balance sheet. The result was that Enron's total assets were even more financed by debt than the balance sheet indicated.

After the allegations of misstatements became public, Enron's stock rapidly declined and the company filed for bankruptcy. Subsequently, numerous lawsuits were filed against the company and its management. In addition, the Securities and Exchange Commission, the Justice Department, and Congress launched investigations into Enron. As a result, several of Enron's top executives faced criminal prosecution and were sentenced to prison.

Note to Instructors: The role of the auditors and board of directors of Enron also might be discussed. Note, however, that these topics are not covered in Chapter 1 but in later chapters.

