**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 would increase by $1,225,000.

1. 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.
2. **(b)** The business realized net income of $91,000 ($679,000 – $588,000).
3. **(a)** The business incurred a net loss of $75,000 ($640,000 – $715,000).
4. **(a)** Net income or net loss
   1. Retained earnings at the end of the period
   2. Cash at the end of the period

# PRACTICE EXERCISES

PE 1–1A

$230,000. Under the cost concept, the land should be recorded at the cost to Kountry 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.** | **A** | **=** | **L** **+** **SE** |  |
|  | **$780,000** | **=** | **$150,000** | **+** **SE** |
|  | **SE** | **=** | **$630,000** |  |
| **b.** | **A** | **=** | **L** **+** **SE** |  |
|  | **+$90,000** | **=** | **+$25,000** | **+** **SE** |
|  | **SE** | **=** | **+$65,000** |  |
|  | **SE** **on** **December** **31,** **2016** | **=** | **$630,000** | **+** **$65,000** |
|  | **SE** **on** **December** **31,** **2016** | **=** | **$695,000** |  |
| **PE** **1–2B**  **a.** | **A** | **=** | **L** **+** **SE** |  |
|  | **$395,000** | **=** | **$97,000** | **+** **SE** |
|  | **SE** | **=** | **$298,000** |  |
| **b.** | **A** | **=** | **L** **+** **SE** |  |
|  | **–$65,000** | **=** | **+$36,000** | **+** **SE** |
|  | **SE** | **=** | **–$101,000** |  |
|  | **SE** **on** **December** **31,** **2016** | **=** | **$298,000** | **–** **$101,000** |
|  | **SE** **on** **December** **31,** **2016** | **=** | **$197,000** |  |

PE 1–3A

1. Asset (Cash) decreases by $3,750;

Liability (Accounts Payable) decreases by $3,750.

1. Asset (Accounts Receivable) increases by $22,400; Revenue (Delivery Service Fees) increases by $22,400.
2. Asset (Cash) increases by $11,300;

Asset (Accounts Receivable) decreases by $11,300.

1. Asset (Cash) decreases by $6,000; Dividends increases by $6,000.

PE 1–3B

* 1. Expense (Advertising Expense) increases by $4,850; Asset (Cash) decreases by $4,850.
  2. Asset (Supplies) increases by $2,100;

Liability (Accounts Payable) increases by $2,100.

* 1. Asset (Accounts Receivable) increases by $14,700; Revenue (Delivery Service Fees) increases by $14,700.
  2. Asset (Cash) increases by $8,200;

Asset (Accounts Receivable) decreases by $8,200.

PE 1–4A

|  |  |  |
| --- | --- | --- |
| **OUSEL TRAVEL SERVICE**  **Income Statement**  **For the Year Ended November 30, 2016** | | |
| **Fees earned** |  | **$1,475,000** |
| **Expenses:** |  |  |
| **Wages expense** | **$885,000** |  |
| **Office expense** | **320,000** |  |
| **Miscellaneous expense** | **28,000** |  |
| **Total expenses** |  | **1,233,000** |
| **Net income** |  | **$ 242,000** |
|  |  |  |

PE 1–4B

|  |  |  |
| --- | --- | --- |
| **SENTINEL TRAVEL SERVICE**  **Income Statement**  **For the Year Ended August 31, 2016** | | |
| **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

|  |  |  |
| --- | --- | --- |
| **OUSEL TRAVEL SERVICE**  **Retained Earnings Statement**  **For the Year Ended November 30, 2016** | | |
| **Retained earnings, December 1, 2015** |  | **$566,000** |
| **Net income for the year** | **$242,000** |  |
| **Less dividends** | **30,000** |  |
| **Increase in retained earnings** |  | **212,000** |
| **Retained earnings, November 30, 2016** |  | **$778,000** |
|  |  |  |

PE 1–5B

|  |  |  |
| --- | --- | --- |
| **SENTINEL TRAVEL SERVICE**  **Retained Earnings Statement For the Year Ended August 31, 2016** | | |
| **Retained earnings, September 1, 2015** |  | **$250,000** |
| **Net loss for the year** | **$ 7,000** |  |
| **Plus dividends** | **18,000** |  |
| **Decrease in retained earnings** |  | **25,000** |
| **Retained earnings, August 31, 2016** |  | **$275,000** |
|  |  |  |

PE 1–6A

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **OUSEL TRAVEL SERVICE**  **Balance Sheet November 30, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$308,000** | **Accounts payable** |  | **$ 62,500** |
| **Accounts receivable** | **186,000** |  |  |  |
| **Supplies** | **16,500** | **Stockholders’ Equity** | | |
| **Land** | **480,000** | **Common stock** | **$150,000** |  |
|  |  | **Retained earnings** | **778,000** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **928,000** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$990,500** | **stockholders’ equity** |  | **$990,500** |
|  |  |  |  |  |

PE 1–6B

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **SENTINEL TRAVEL SERVICE**  **Balance Sheet August 31, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$ 45,400** | **Accounts payable** |  | **$ 44,600** |
| **Accounts receivable** | **75,500** |  | |  |
| **Supplies** | **4,700** | **Stockholders’ Equity** | | |
| **Land** | **310,000** | **Common stock** | **$116,000** |  |
|  |  | **Retained earnings** | **275,000** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **391,000** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$435,600** | **stockholders’ equity** |  | **$435,600** |
|  |  |  |  |  |

PE 1–7A

|  |  |  |
| --- | --- | --- |
| **OUSEL TRAVEL SERVICE**  **Statement of Cash Flows**  **For the Year Ended November 30, 2016** | | |
| **Cash flows from operating activities:** |  |  |
| **Cash received from customers** | **$ 1,465,000** |  |
| **Deduct cash payments for operating expenses** | **(1,230,000)** |  |
| **Net cash flows from operating activities** |  | **$ 235,000** |
| **Cash flows used for investing activities:** |  |  |
| **Cash payments for purchase of land** |  | **(150,000)** |
| **Cash flows from financing activities:** |  |  |
| **Cash received from issuing common stock** | **$ 50,000** |  |
| **Deduct cash dividends** | **(30,000)** |  |
| **Net cash flows from financing activities** |  | **20,000** |
| **Net increase in cash during year** |  | **$ 105,000** |
| **Cash as of December 1, 2015** |  | **203,000** |
| **Cash as of November 30, 2016** |  | **$ 308,000** |
|  |  |  |

PE 1–7B

|  |  |  |
| --- | --- | --- |
| **SENTINEL TRAVEL SERVICE**  **Statement of Cash Flows**  **For the Year Ended August 31, 2016** | | |
| **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** |  | **$(11,600)** |
| **Cash flows used for investing activities:** |  |  |
| **Cash payments for purchase of land** |  | **(50,000)** |
| **Cash flows from financing activities:** |  |  |
| **Cash received from issuing common stock** | **$ 36,000** |  |
| **Deduct cash dividends** | **(18,000)** |  |
| **Net cash flows from financing activities** |  | **18,000** |
| **Net decrease in cash during year** |  | **$(43,600)** |
| **Cash as of September 1, 2015** |  | **89,000** |
| **Cash as of August 31, 2016** |  | **$ 45,400** |
|  |  |  |

PE 1–8A

1. Dec. 31, Dec. 31,

2016 2015

Total liabilities……………………………………………… $547,800 $518,000 Total stockholders’ equity………………………………… $415,000 $370,000

Ratio of liabilities to stockholders’ equity…………… 1.32 \*

**\* $547,800 ÷ $415,000**

**\*\* $518,000 ÷ $370,000**

1. Decreased

1.40\*\*

PE 1–8B

1. Dec. 31, Dec. 31,

2016 2015

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\*

**\* $4,085,000 ÷ $4,300,000**

**\*\* $2,880,000 ÷ $3,600,000**

1. Increased

0.80\*\*

# 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

Green Mountain Coffee Roasters’ stockholders’ equity: $3,616 – $1,345 = $2,271 Starbucks’ stockholders’ equity: $8,219 – $3,110 = $5,109

Ex. 1–5

Dollar Tree’s stockholders’ equity: $2,329 – $984 = $1,345 Target’s stockholders’ equity: $46,630 – $30,809 = $15,821

Ex. 1–6

a. $1,271,000 ($376,000 + $895,000)

|  |  |  |
| --- | --- | --- |
| **b.** | **$520,000** | **($1,375,000 – $855,000)** |
| **c.** | **$652,500** | **($863,500 – $211,000)** |

Ex. 1–7

|  |  |  |
| --- | --- | --- |
| **a.** | **$540,000** | **($720,000 – $180,000)** |
| **b.** | **$606,500** | **($540,000 + $96,500 – $30,000)** |
| **c.** | **$357,000** | **($540,000 – $168,000 – $15,000)** |
| **d.** | **$733,000** | **($540,000 + $175,000 + $18,000)** |

e. Net income: $120,000 ($880,000 – $220,000 – $540,000)

Ex. 1–8

1. (2) liability
2. (1) asset
3. (3) stockholders’ equity (revenue)
4. (1) asset
5. (1) asset
6. (3) stockholders’ equity (expense)

Ex. 1–9

1. Increases assets and increases stockholders’ equity.
2. Decreases assets and decreases stockholders’ equity.
3. Increases assets and decreases assets.
4. Increases assets and increases liabilities.
5. Increases assets and increases stockholders’ equity.

Ex. 1–10

a. (1) Total assets increased $183,000 ($298,000 – $115,000).

* + 1. No change in liabilities.
    2. Stockholders’ equity increased $183,000.

1. (1) Total assets decreased $80,000.
2. Total liabilities decreased $80,000.
3. No change in stockholders’ equity.
4. 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

* + 1. (1) Provided catering services for cash, $71,800.
  1. Purchase of land for cash, $15,000.
  2. Payment of cash for expenses, $47,500.
  3. Purchase of supplies on account, $1,100.
  4. Paid cash dividends, $5,000.
  5. Payment of cash to creditors, $4,000.
  6. Recognition of cost of supplies used, $1,500. b. $300 ($40,300 – $40,000)

|  |  |  |
| --- | --- | --- |
| **c.** | **$17,800** | **(–$5,000 + $71,800 – $49,000)** |
| **d.** | **$22,800** | **($71,800 – $49,000)** |
| **e.** | **$17,800** | **($22,800 – $5,000)** |

Ex. 1–14

No. It would be incorrect to say that the business had incurred a net loss of

$8,000. The excess of the dividends over the net income for the period is a decrease in the amount of stockholders’ equity (retained earnings) in the business.

Ex. 1–15

Jupiter

|  |  |
| --- | --- |
| **Stockholders’ equity at end of year ($844,000 – $320,000)……………………** | **$524,000** |
| **Deduct stockholders’ equity at beginning of year ($550,000 – $215,000)…** | **335,000** |
| **Net income (increase in stockholders’ equity)………………………………** | **$189,000** |
| **Mars** |  |
| **Increase in stockholders’ equity (as determined for Jupiter)…………………** | **$189,000** |
| **Add dividends…………………………………………………………………………** | **36,000** |
| **Net income…………………………………………………………………………** | **$225,000** |
| **Saturn** |  |
| **Increase in stockholders’ equity (as determined for Jupiter)…………………** | **$189,000** |
| **Deduct additional issuance of common stock…………………………………** | **60,000** |
| **Net income…………………………………………………………………………** | **$129,000** |
| **Venus** |  |
| **Increase in stockholders’ equity (as determined for Jupiter)…………………** | **$189,000** |
| **Deduct additional issuance of common stock…………………………………** | **60,000** |
|  | **$129,000** |
| **Add dividends…………………………………………………………………………** | **36,000** |
| **Net income…………………………………………………………………………** | **$165,000** |

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.

|  |  |  |
| --- | --- | --- |
| **UDDER PRODUCTS COMPANY**  **Retained Earnings Statement For the Month Ended April 30, 2016** | | |
| **Retained earnings, April 1, 2016** |  | **$384,500** |
| **Net income for April** | **$166,000** |  |
| **Less dividends** | **25,000** |  |
| **Increase in retained earnings** |  | **141,000** |
| **Retained earnings, April 30, 2016** |  | **$525,500** |
|  |  |  |

* + 1. The retained earnings statement is prepared before the April 30, 2016, balance sheet because retained earnings as of April 30, 2016, is needed for the balance sheet.

Ex. 1–19

|  |  |  |
| --- | --- | --- |
| **DAIRY SERVICES**  **Income Statement**  **For the Month Ended August 31, 2016** | | |
| **Fees earned** |  | **$783,000** |
| **Expenses:** |  |  |
| **Wages expense** | **$550,000** |  |
| **Rent expense** | **35,000** |  |
| **Supplies expense** | **8,500** |  |
| **Miscellaneous expense** | **11,400** |  |
| **Total expenses** |  | **604,900** |
| **Net income** |  | **$178,100** |
|  |  |  |

Ex. 1–20

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

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

Freeman

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

Heyward

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

Jones

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

Ramirez

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

Ex. 1–21

a.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **EBONY INTERIORS**  **Balance Sheet February 29, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$ 320,000** | **Accounts payable** |  | **$ 310,000** |
| **Accounts receivable** | **800,000** |  |  |  |
| **Supplies** | **30,000** | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$200,000** |  |
|  |  | **Retained earnings** | **640,000**\* |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **840,000** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$1,150,000** | **stockholders’ equity** |  | **$1,150,000** |
|  |  |  |  |  |

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

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **EBONY INTERIORS**  **Balance Sheet March 31, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$ 380,000** | **Accounts payable** |  | **$ 400,000** |
| **Accounts receivable** | **960,000** |  |  |  |
| **Supplies** | **35,000** | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$200,000** |  |
|  |  | **Retained earnings** | **775,000**\* |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **975,000** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$1,375,000** | **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 29…………………….………………………** | **840,000** |
|  | **Net income……………………………………………………………………** | **$135,000** |
| **c.** | **Stockholders’ equity, March 31…………………………………………………** | **$975,000** |
|  | **Stockholders’ equity, February 29…………………….………………………** | **840,000** |
|  | **Increase in stockholders’ equity……………………………………………** | **$135,000** |
|  | **Add dividends……………………………………………………………………** | **50,000** |
|  | **Net income……………………………………………………………………** | **$185,000** |

Ex. 1–22

a. Balance sheet: 1, 2, 3, 4, 6, 7, 8, 9, 10, 11, 13

Income statement: 5, 12, 14, 15

1. 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.
2. 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, 2016** | | |
| **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** |  | **$162,500** |
| **Cash flows used for investing activities:** |  |  |
| **Cash payments for purchase of land** |  | **(90,000)** |
| **Cash flows from financing activities:** |  |  |
| **Cash received from issuing common stock** | **$ 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, 2015** |  | **58,000** |
| **Cash as of May 31, 2016** |  | **$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, 2016.”
    3. The year in the heading for the retained earnings statement should be 2016 rather than 2015.
    4. The balance sheet should be labeled “August 31, 2016,” rather than “For the Month Ended August 31, 2016.”
    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 common stock of $15,000 should not be included in the retained earnings statement.
    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, 2016** | | |
| **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, 2016** | | |
| **Retained earnings, August 1, 2016** |  | **$ 0** |
| **Net income for August** | **$24,150** |  |
| **Less withdrawals during August** | **10,000** |  |
| **Increase in retained earnings** |  | **14,150** |
| **Retained earnings, August 31, 2016** |  | **$14,150** |
|  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **WE-SELL REALTY**  **Balance Sheet August 31, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$ 8,900** | **Accounts payable** |  | **$22,350** |
| **Accounts receivable** | **38,600** |  |  |  |
| **Supplies** | **4,000** | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$15,000** |  |
|  |  | **Retained earnings** | **14,150** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **29,150** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$51,500** | **stockholders’ equity** |  | **$51,500** |
|  |  |  |  |  |

Ex. 1–26

a. Year 2: $17,898 ($40,518 – $22,620) Year 1: $18,889 ($40,125 – $21,236)

b. Year 2: 0.79 ($17,898 ÷ $22,620) Year 1: 0.89 ($18,889 ÷ $21,236)

c. The ratio of liabilities to stockholders’ equity decreased from 0.89 to 0.79 indicating a slight decrease in risk for creditors from Year 1 to Year 2.

Ex. 1–27

a. Year 2: $16,533 ($33,559 – $17,026) Year 1: $18,112 ($33,699 – $15,587)

b. Year 2: 1.03 ($17,026 ÷ $16,533) Year 1: 0.86 ($15,587 ÷ $18,112)

1. The risk for creditors has increased from 0.86 in Year 1 to 1.03 in Year 2.
2. Lowe’s ratio of liabilities to stockholders’ equity is more than 1 in Year 2 (1.03) and less than 1 in Year 1 (0.86). In comparison, The Home Depot’s ratio of liabilities to stockholders’ equity is less than 1 for both years. Thus, the risk to creditors of Lowe's is slightly more than The Home Depot.

**Prob. 1–1A**

**1. Assets = Liabilities +**

PROBLEMS

**Stockholders’ Equity**

**Cash**

**Accts.**

**+ Rec.**

**+ Supplies =**

**Accts. Payable +**

**Common Stock**

**– Dividends +**

**Fees Earned**

**Rent**

**– Expense –**

**Salaries Expense –**

**Supplies Expense –**

**Auto Exp.**

**Misc.**

**– Exp.**

**(a) + 45,000 + 45,000**

**(b) + 2,000 + 2,000**

**Bal. 45,000 2,000 2,000 45,000**

**(c) + 8,500 + 8,500**

**Bal. 53,500 2,000 2,000 45,000 8,500**

**(d) – 5,000 – 5,000**

**Bal. 48,500 2,000 2,000 45,000 8,500 – 5,000**

**(e) – 1,375 – 1,375**

**Bal. 47,125 2,000 625 45,000 8,500 – 5,000**

**(f) + 11,250 + 11,250**

**Bal. 47,125 11,250 2,000 625 45,000 19,750 – 5,000**

**(g) – 1,740 – 840 – 900**

**Bal. 45,385 11,250 2,000 625 45,000 19,750 – 5,000 – 840 – 900**

**(h) – 3,600 – 3,600**

**Bal. 41,785 11,250 2,000 625 45,000 19,750 – 5,000 – 3,600 – 840 – 900**

**(i) – 1,450 – 1,450**

**Bal. 41,785 11,250 550 625 45,000 19,750 – 5,000 – 3,600 – 1,450 – 840 – 900**

**(j) – 2,000 – 2,000**

**Bal. 39,785 11,250 550 625 45,000 – 2,000 19,750 – 5,000 – 3,600 – 1,450 – 840 – 900**

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

**3. $7,960 ($19,750 – $5,000 – $3,600 – $1,450 – $840 – $900)**

**4. April’s transactions increased retained earnings by $5,960 ($7,960 – $2,000), which is April's net income of $7,960 less dividends of $2,000.**

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Prob. 1–2A 1.

|  |  |  |
| --- | --- | --- |
| **NORDIC TRAVEL AGENCY**  **Income Statement**  **For the Year Ended December 31, 2016** | | |
| **Fees earned** |  | **$912,500** |
| **Expenses:** |  |  |
| **Wages expense** | **$510,000** |  |
| **Rent expense** | **36,000** |  |
| **Utilities expense** | **28,500** |  |
| **Supplies expense** | **4,100** |  |
| **Miscellaneous expense** | **6,400** |  |
| **Total expenses** |  | **585,000** |
| **Net income** |  | **$327,500** |
|  |  |  |

2.

|  |  |  |
| --- | --- | --- |
| **NORDIC TRAVEL AGENCY**  **Retained Earnings Statement**  **For the Year Ended December 31, 2016** | | |
| **Retained earnings, January 1, 2016** |  | **$600,000** |
| **Net income for the year** | **$327,500** |  |
| **Less dividends** | **42,000** |  |
| **Increase in retained earnings** |  | **285,500** |
| **Retained earnings, December 31, 2016** |  | **$885,500** |
|  |  |  |

3.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **NORDIC TRAVEL AGENCY**  **Balance Sheet December 31, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$ 190,500** | **Accounts payable** |  | **$ 69,500** |
| **Accounts receivable** | **285,000** |  |  |  |
| **Supplies** | **5,500** |  |  | |
| **Land** | **544,000** | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$ 70,000** |  |
|  |  | **Retained earnings** | **885,500** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **955,500** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$1,025,000** | **stockholders’ equity** |  | **$1,025,000** |
|  |  |  |  |  |

4. Retained earnings of $885,500

Prob. 1–3A 1.

|  |  |  |
| --- | --- | --- |
| **RELIANCE FINANCIAL SERVICES**  **Income Statement**  **For the Month Ended July 31, 2016** | | |
| **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, 2016** | | |
| **Retained earnings, July 1, 2016** |  | **$ 0** |
| **Net income for July** | **$31,200** |  |
| **Less dividends** | **15,000** |  |
| **Increase in retained earnings** |  | **16,200** |
| **Retained earnings, July 31, 2016** |  | **$16,200** |
|  |  |  |

3.

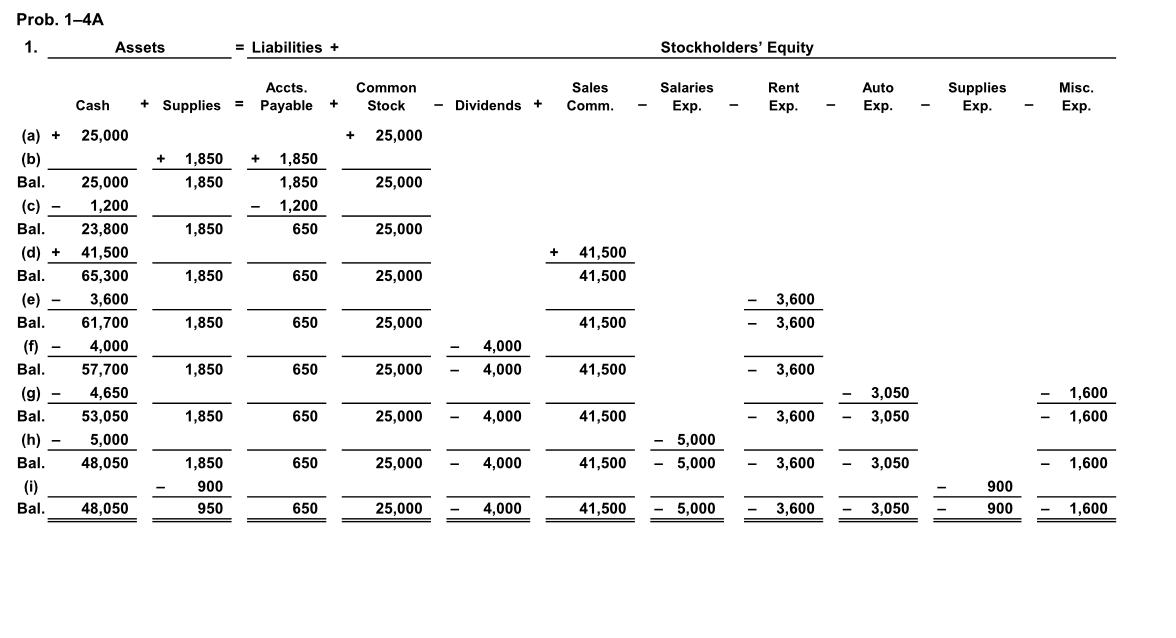
|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **RELIANCE FINANCIAL SERVICES**  **Balance Sheet July 31, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$32,600** | **Accounts payable** |  | **$ 3,400** |
| **Accounts receivable** | **34,500** |  |  |  |
| **Supplies** | **2,500** | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$50,000** |  |
|  |  | **Retained earnings** | **16,200** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **66,200** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$69,600** | **stockholders’ equity** |  | **$69,600** |
|  |  |  |  |  |

Prob. 1–3A (Concluded)

4. (Optional)

|  |  |  |
| --- | --- | --- |
| **RELIANCE FINANCIAL SERVICES**  **Statement of Cash Flows**  **For the Month Ended July 31, 2016** | | |
| **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 common stock** | **$ 50,000** |  |
| **Deduct cash dividends** | **(15,000)** |  |
| **Net cash flows from financing activities** |  | **35,000** |
| **Net increase in cash and July 31, 2016, cash balance** |  | **$32,600** |
|  |  |  |

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

**.**

**= Liabilities +**

**Stockholders’ Equity**

**Cash**

**+ Supplies =**

**Accts. Payable +**

**Common Stock**

* **Dividends +**

**Sales Comm.**

**Salaries**

* + **Exp. –**

**Rent Exp.**

**Auto**

* + **Exp.**

**Supplies**

* + **Exp. –**

**Misc. Exp.**

**(a) + 25,000 + 25,000**

**(b) + 1,850 + 1,850**

**Bal. 25,000 1,850 1,850 25,000**

**(c) – 1,200 – 1,200**

**Bal. 23,800 1,850 650 25,000**

**(d) + 41,500 + 41,500**

**Bal. 65,300 1,850 650 25,000 41,500**

**(e) – 3,600 – 3,600**

**Bal. 61,700 1,850 650 25,000 41,500 – 3,600**

**(f) – 4,000 – 4,000**

**Bal. 57,700 1,850 650 25,000 – 4,000 41,500 – 3,600**

**(g) – 4,650 – 3,050 – 1,600**

**Bal. 53,050 1,850 650 25,000 – 4,000 41,500 – 3,600 – 3,050 – 1,600**

**(h) – 5,000 – 5,000**

**Bal. 48,050 1,850 650 25,000 – 4,000 41,500 – 5,000 – 3,600 – 3,050 – 1,600**

**(i) – 900 – 900**

**Bal. 48,050 950 650 25,000 – 4,000 41,500 – 5,000 – 3,600 – 3,050 – 900 – 1,600**

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Prob. 1–4A (Concluded) 2.

|  |  |  |
| --- | --- | --- |
| **HALF MOON REALTY**  **Income Statement**  **For the Month Ended July 31, 2016** | | |
| **Sales commissions** |  | **$41,500** |
| **Expenses:** |  |  |
| **Salaries expense** | **$5,000** |  |
| **Rent expense** | **3,600** |  |
| **Automobile expense** | **3,050** |  |
| **Supplies expense** | **900** |  |
| **Miscellaneous expense** | **1,600** |  |
| **Total expenses** |  | **14,150** |
| **Net income** |  | **$27,350** |
|  |  |  |

|  |  |  |
| --- | --- | --- |
| **HALF MOON REALTY**  **Retained Earnings Statement For the Month Ended July 31, 2016** | | |
| **Retained earnings, July 1, 2016** |  | **$ 0** |
| **Net income for July** | **$27,350** |  |
| **Less dividends** | **4,000** |  |
| **Increase in retained earnings** |  | **23,350** |
| **Retained earnings, July 31, 2016** |  | **$23,350** |
|  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **HALF MOON REALTY**  **Balance Sheet July 31, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$48,050** | **Accounts payable** |  | **$ 650** |
| **Supplies** | **950** |  |  |  |
|  |  | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$25,000** |  |
|  |  | **Retained earnings** | **23,350** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **48,350** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$49,000** | **stockholders’ equity** |  | **$49,000** |
|  |  |  |  |  |

Prob. 1–5A 1.

**Assets**

**= Liabilities**

**+ Stockholders’ Equity**

**Cash +**

**Accounts Receivable**

**+ Supplies +**

**Land**

**Accounts**

**= Payable**

**Common**

**+ Stock +**

**Retained Earnings**

**$45,000 +**

**$93,000**

**+ $7,000**

**+ $75,000**

**= $40,000**

**+ 60,000 +**

**Retained Earnings**

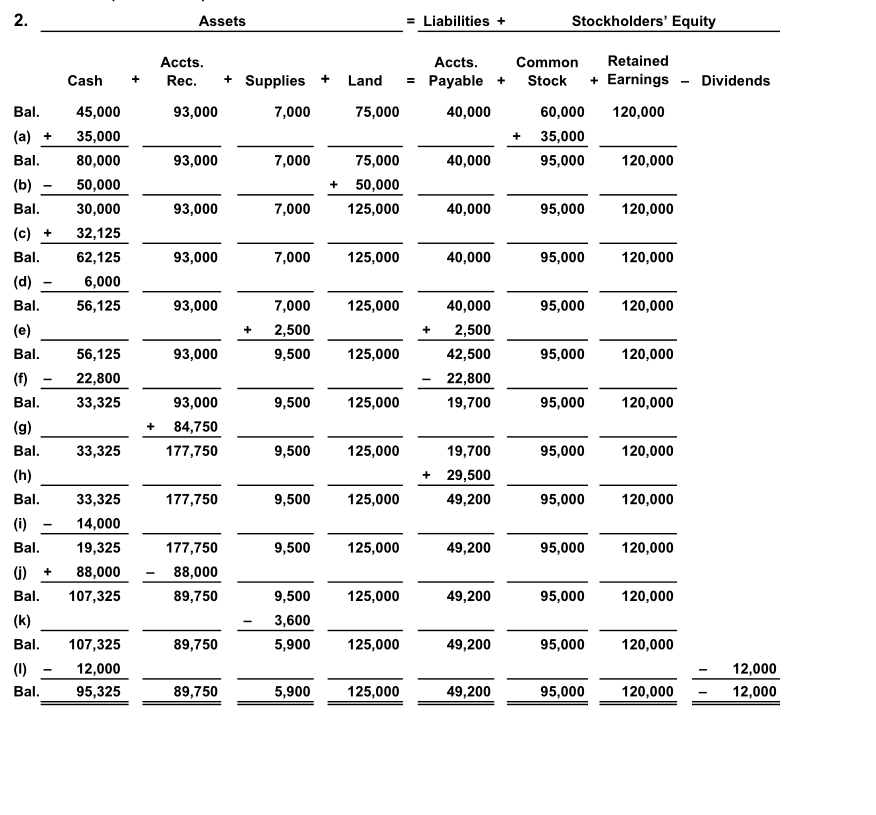
**$220,000**

**= $100,000**

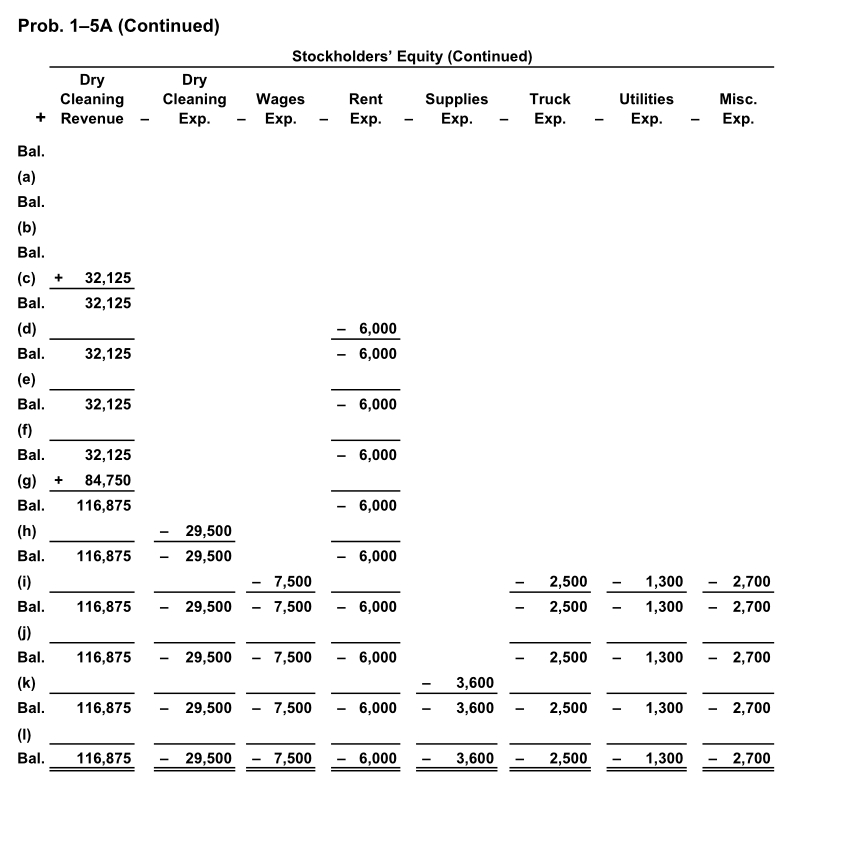
**+ Retained Earnings**

**$120,000**

**= Retained Earnings**

**Prob. 1–5A (Continued)**

Prob. 1–5A (Continued)



**Stockholders’ Equity (Continued)**

Prob. 1–5A (Continued) 3.

|  |  |  |
| --- | --- | --- |
| **D'LITE DRY CLEANERS**  **Income Statement**  **For the Month Ended July 31, 2016** | | |
| **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, 2016** | | |
| **Retained earnings, July 1, 2016** |  | **$120,000** |
| **Net income for July** | **$63,775** |  |
| **Less dividends** | **12,000** |  |
| **Increase in retained earnings** |  | **51,775** |
| **Retained earnings, July 31, 2016** |  | **$171,775** |
|  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **D'LITE DRY CLEANERS**  **Balance Sheet July 31, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$ 95,325** | **Accounts payable** |  | **$ 49,200** |
| **Accounts receivable** | **89,750** |  |  |  |
| **Supplies** | **5,900** | **Stockholders’ Equity** | | |
| **Land** | **125,000** | **Common stock** | **$ 95,000** |  |
|  |  | **Retained earnings** | **171,775** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **266,775** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$315,975** | **stockholders’ equity** |  | **$315,975** |
|  |  |  |  |  |

Prob. 1–5A (Concluded)

4. (Optional)

|  |  |  |
| --- | --- | --- |
| **D'LITE DRY CLEANERS**  **Statement of Cash Flows**  **For the Month Ended July 31, 2016** | | |
| **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 common 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, 2016** |  | **45,000** |
| **Cash balance, July 31, 2016** |  | **$ 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)

1. Retained earnings, April 1, 2016, $0; Wolverine Realty was organized on April 1, 2016.
2. Net income for April, $275,000 from income statement e. $150,000 ($275,000 – $125,000)

f. Retained earnings, April 30, 2016, $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)

1. Total liabilities and stockholders’ equity, $625,000 ($100,000 + $525,000)
2. Cash received from customers, $750,000 ($387,500 + $362,500); this is the same as fees earned (a) since there are no accounts receivable.
3. Net cash flows from operating activities, $362,500 ($750,000 – $387,500)
4. Cash payments for acquisition of land, ($150,000)
5. Cash received from issuing common stock, $375,000
6. Cash dividends, ($125,000)
7. Net cash flows from financing activities, $250,000 ($375,000 – $125,000)

q. Net cash flow and April 30, 2016, 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 +**

**Common Stock**

* **Dividends +**

**Fees Earned**

**Rent**

* + **Expense –**

**Salaries Expense**

**Supplies**

* **Expense –**

**Auto Exp.**

**Misc.**

* + **Exp.**

**(a) + 50,000 + 50,000**

**(b) + 4,000 + 4,000**

**Bal. 50,000 4,000 4,000 50,000**

**(c) – 2,300 – 2,300**

**Bal. 47,700 4,000 1,700 50,000**

**(d) + 13,800 + 13,800**

**Bal. 61,500 4,000 1,700 50,000 13,800**

**(e) – 5,000 – 5,000**

**Bal. 56,500 4,000 1,700 50,000 13,800 – 5,000**

**(f) – 1,450 – 1,150 – 300**

**Bal. 55,050 4,000 1,700 50,000 13,800 – 5,000 – 1,150 – 300**

**(g) – 2,500 – 2,500**

**Bal. 52,550 4,000 1,700 50,000 13,800 – 5,000 – 2,500 – 1,150 – 300**

**(h) – 1,300 – 1,300**

**Bal. 52,550 2,700 1,700 50,000 13,800 – 5,000 – 2,500 – 1,300 – 1,150 – 300**

**(i) + 12,500 + 12,500**

**Bal. 52,550 12,500 2,700 1,700 50,000 26,300 – 5,000 – 2,500 – 1,300 – 1,150 – 300**

**(j) – 3,900 – 3,900**

**Bal. 48,650 12,500 2,700 1,700 50,000 – 3,900 26,300 – 5,000 – 2,500 – 1,300 – 1,150 – 300**

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

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

**4. March’s transactions increased 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.**

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Prob. 1–2B 1.

|  |  |  |
| --- | --- | --- |
| **WILDERNESS TRAVEL SERVICE**  **Income Statement**  **For the Year Ended April 30, 2016** | | |
| **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** |
|  |  |  |

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| **WILDERNESS TRAVEL SERVICE**  **Retained Earnings Statement For the Year Ended April 30, 2016** | | |
| **Retained earnings, May 1, 2015** |  | **$145,000** |
| **Net income for the year** | **$200,000** |  |
| **Less dividends** | **40,000** |  |
| **Increase in retained earnings** |  | **160,000** |
| **Retained earnings, April 30, 2016** |  | **$305,000** |
|  |  |  |

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| **WILDERNESS TRAVEL SERVICE**  **Balance Sheet April 30, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$146,000** | **Accounts payable** |  | **$ 25,000** |
| **Accounts receivable** | **210,000** |  |  |  |
| **Supplies** | **9,000** | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$ 35,000** |  |
|  |  | **Retained earnings** | **305,000** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **340,000** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$365,000** | **stockholders’ equity** |  | **$365,000** |
|  |  |  |  |  |

4. Net income of $200,000

Prob. 1–3B

|  |  |  |
| --- | --- | --- |
| **BRONCO CONSULTING**  **Income Statement**  **For the Month Ended August 31, 2016** | | |
| **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** |
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| **BRONCO CONSULTING**  **Retained Earnings Statement**  **For the Month Ended August 31, 2016** | | |
| **Retained earnings, August 1, 2016** |  | **$ 0** |
| **Net income for August** | **$10,900** |  |
| **Less dividends** | **5,000** |  |
| **Increase in retained earnings** |  | **5,900** |
| **Retained earnings, August 31, 2016** |  | **$5,900** |
|  |  |  |

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| --- | --- | --- | --- | --- |
| **BRONCO CONSULTING**  **Balance Sheet August 31, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$48,000** | **Accounts payable** |  | **$ 3,000** |
| **Accounts receivable** | **33,000** |  |  |  |
| **Supplies** | **2,900** | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$75,000** |  |
|  |  | **Retained earnings** | **5,900** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **80,900** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$83,900** | **stockholders’ equity** |  | **$83,900** |
|  |  |  |  |  |

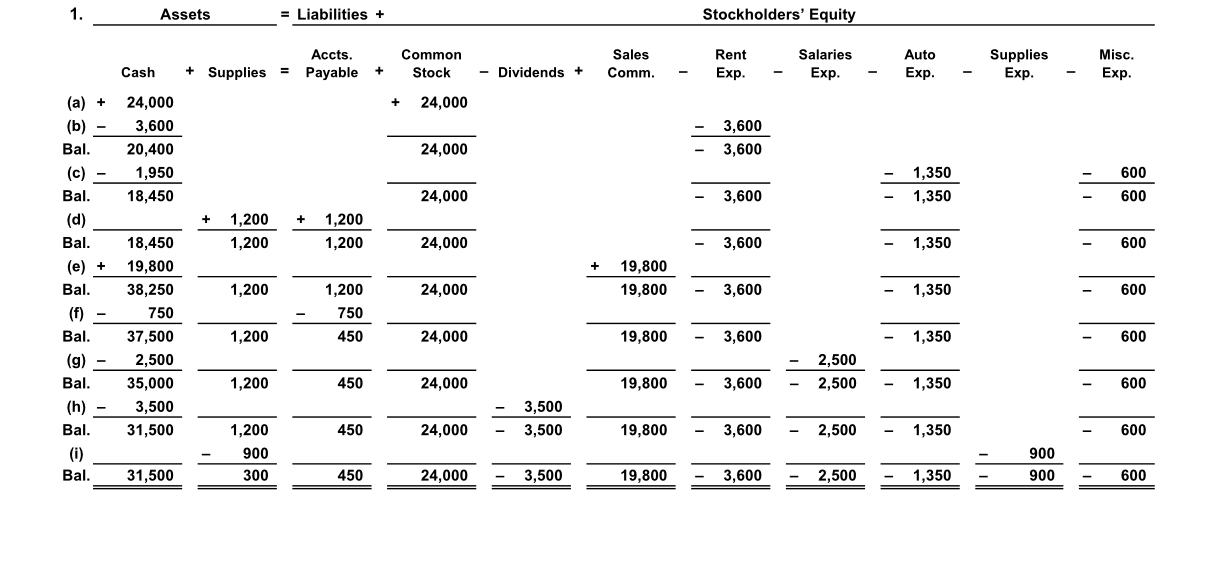
Prob. 1–3B (Concluded)

4. (Optional)

|  |  |  |
| --- | --- | --- |
| **BRONCO CONSULTING**  **Statement of Cash Flows**  **For the Month Ended August 31, 2016** | | |
| **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** |  | **$(22,000)** |
| **Cash flows from investing activities** |  | **0** |
| **Cash flows from financing activities:** |  |  |
| **Cash received from issuing common stock** | **$ 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**

****

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Prob. 1–4B (Concluded) 2.

|  |  |  |
| --- | --- | --- |
| **CUSTOM REALTY**  **Income Statement**  **For the Month Ended April 30, 2016** | | |
| **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** |  | **$10,850** |
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| --- | --- | --- |
| **CUSTOM REALTY**  **Retained Earnings Statement For the Month Ended April 30, 2016** | | |
| **Retained earnings, April 1, 2016** |  | **$ 0** |
| **Net income for April** | **$10,850** |  |
| **Less dividends** | **3,500** |  |
| **Increase in retained earnings** |  | **7,350** |
| **Retained earnings, April 30, 2016** |  | **$7,350** |
|  |  |  |

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| --- | --- | --- | --- | --- |
| **CUSTOM REALTY**  **Balance Sheet April 30, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$31,500** | **Accounts payable** |  | **$ 450** |
| **Supplies** | **300** |  |  |  |
|  |  | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$24,000** |  |
|  |  | **Retained earnings** | **7,350** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **31,350** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$31,800** | **stockholders’ equity** |  | **$31,800** |
|  |  |  |  |  |

Prob. 1–5B 1.

**Assets**

**= Liabilities +**

**Stockholders’ Equity**

**Cash**

**Accounts**

**+ Receivable**

**+ Supplies +**

**Land**

**Accounts**

**= Payable +**

**Common Stock +**

**Retained Earnings**

**50,000 +**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **$39,000 +** | **$80,000** | **+ $11,000** | **+ $50,000** | **=** | **$31,500** | **+** |
|  |  |  | **$180,000** | **=** | **$81,500** | **+** |

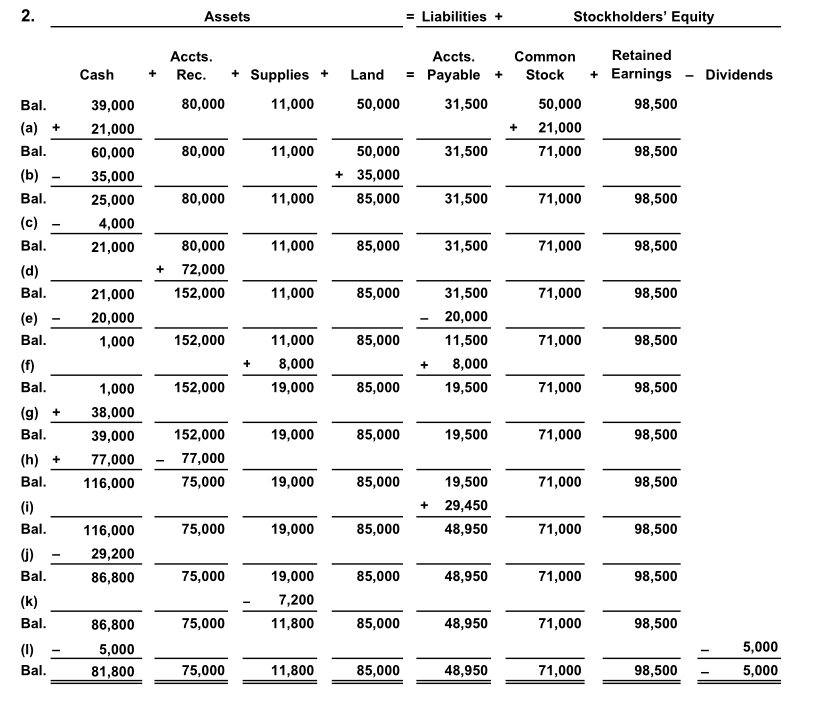
**Retained Earnings**

**$98,500**

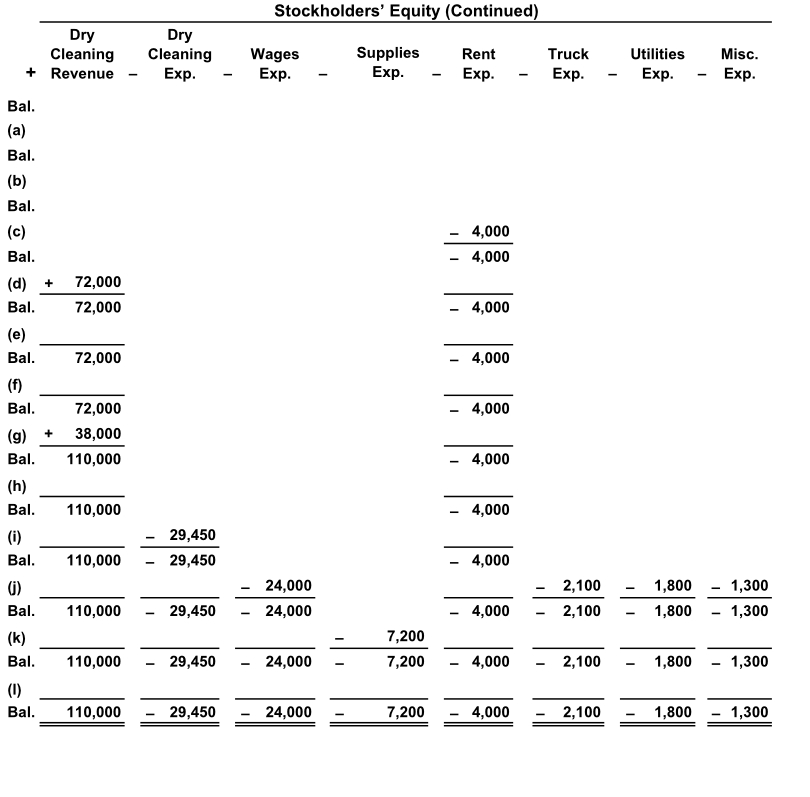
**Retained Earnings**

**= Retained Earnings**

**Prob. 1–5B (Continued)**



Prob. 1–5B (Continued)



Prob. 1–5B (Continued) 3.

|  |  |  |
| --- | --- | --- |
| **BEV'S DRY CLEANERS**  **Income Statement**  **For the Month Ended November 30, 2016** | | |
| **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, 2016** | | |
| **Retained earnings, November 1, 2016** |  | **$ 98,500** |
| **Net income for November** | **$40,150** |  |
| **Less dividends** | **5,000** |  |
| **Increase in retained earnings** |  | **35,150** |
| **Retained earnings, November 30, 2016** |  | **$133,650** |
|  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **BEV'S DRY CLEANERS**  **Balance Sheet November 30, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$ 81,800** | **Accounts payable** |  | **$ 48,950** |
| **Accounts receivable** | **75,000** |  |  |  |
| **Supplies** | **11,800** | **Stockholders’ Equity** | | |
| **Land** | **85,000** | **Common stock** | **$ 71,000** |  |
|  |  | **Retained earnings** | **133,650** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **204,650** |
|  | **Total liabilities and** |  |  |
| **Total assets** | **$253,600** | **stockholders’ equity** |  | **$253,600** |
|  |  |  |  |  |

Prob. 1–5B (Concluded)

4. (Optional)

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| --- | --- | --- |
| **BEV'S DRY CLEANERS**  **Statement of Cash Flows**  **For the Month Ended Novemer 30, 2016** | | |
| **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 common 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, 2016** |  | **39,000** |
| **Cash balance, November 30, 2016** |  | **$ 81,800** |
|  |  |  |

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

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

**spreadsheet in Part 2.**

Prob. 1–6B

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

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

1. Retained Earnings, May 1, 2016, $0; Atlas Realty was organized on May 1, 2016.
2. Net income for May, $112,000; from (b)
3. Dividends, $64,000; from statement of cash flows.
4. Increase in retained earnings, $48,000 ($112,000 – $64,000)
5. Retained earnings, May 31, 2016, $48,000 (same as f)
6. Land, $120,000; from statement of cash flows.

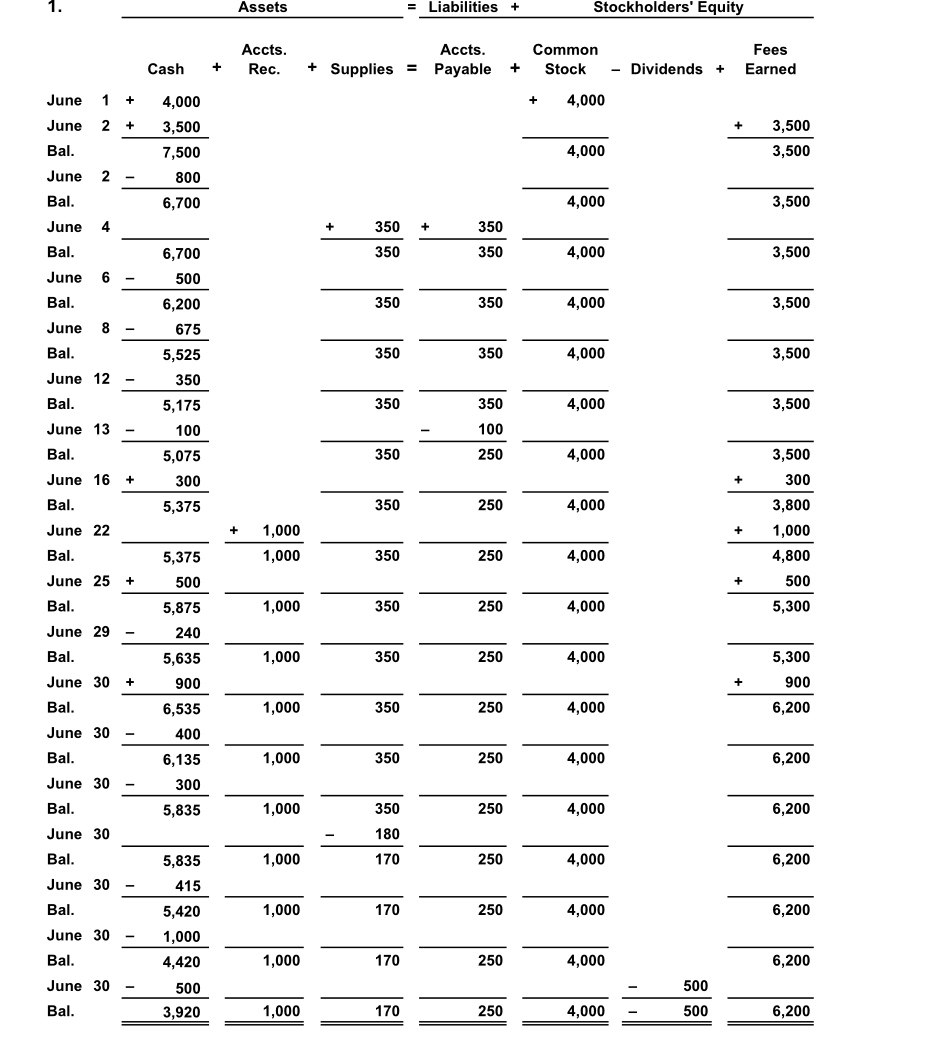
i. Total assets, $256,000 ($123,200 + $12,800 + $120,000)

1. Common stock, $160,000; from statement of cash flows.
2. Retained earnings, $48,000; from retained earnings statement. l. Total stockholders' equity, $208,000 ($160,000 + $48,000)
3. Total liabilities and stockholders’ equity, $256,000 ($48,000 + $208,000)
4. Cash received from customers, $400,000; this is the same as fees earned since there are no accounts receivable.
5. Net cash flows from operating activities, $147,200 ($400,000 – $252,800)
6. Net cash flows from financing activities, $96,000 ($160,000 – $64,000)

q. Net cash flows and May 31, 2016, cash balance, $123,200 ($147,200 – $120,000

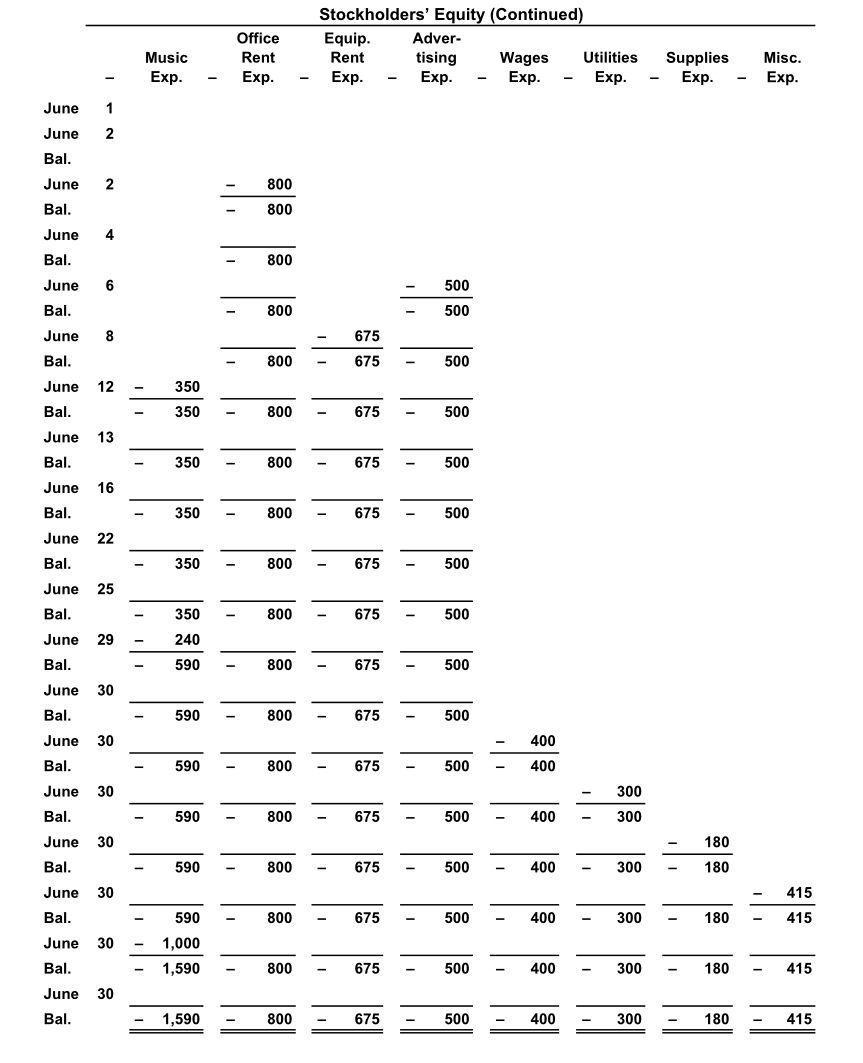
+ $96,000); also, the cash balance on the balance sheet.

# CONTINUING PROBLEM



Continuing Problem (Continued)

**Stockholders’ Equity (Continued)**



Continuing Problem (Concluded) 2.

|  |  |  |
| --- | --- | --- |
| **PS MUSIC**  **Income Statement**  **For the Month Ended June 30, 2016** | | |
| **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** |
|  |  |  |

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| **PS MUSIC**  **Retained Earnings Statement For the Month Ended June 30, 2016** | | |
| **Retained earnings, June 1, 2016** |  | **$ 0** |
| **Net income for June** | **$1,340** |  |
| **Less dividends** | **500** |  |
| **Increase in retained earnings** |  | **840** |
| **Retained earnings, June 30, 2016** |  | **$840** |
|  |  |  |

4.

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| --- | --- | --- | --- | --- |
| **PS MUSIC**  **Balance Sheet June 30, 2016** | | | | |
| **Assets** | | **Liabilities** | | |
| **Cash** | **$3,920** | **Accounts payable** | | **$ 250** |
| **Accounts receivable** | **1,000** |  | |  |
| **Supplies** | **170** | **Stockholders’ Equity** | | |
|  |  | **Common stock** | **$4,000** |  |
|  |  | **Retained earnings** | **840** |  |
|  |  | **Total stockholders’** |  |  |
|  |  | **equity** |  | **4,840** |
|  |  | **Total liabilities and** |  |  |
| **Total assets** | **$5,090** | **stockholders’ equity** |  | **$5,090** |
|  |  |  |  |  |

CP 1–1

# CASES & PROJECTS

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

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

* + *Proprietary Operating Information.* Such information, which might hurt the business if it becomes known by competitors, might include special processes used by the business or future plans to expand operations into areas that are not currently served by a competitor.
  + *Personal Financial Information.* Owners may have little choice here because banks often require owners of small businesses to pledge their personal assets as security for a business loan. Personal financial information requested by bankers often includes the owner’s net worth, salary, and other income. In addition, bankers usually request information about factors that might affect the personal financial condition of the owner. For example, a pending divorce by the owner might significantly affect the owner’s personal wealth.
  1. 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.
  2. 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

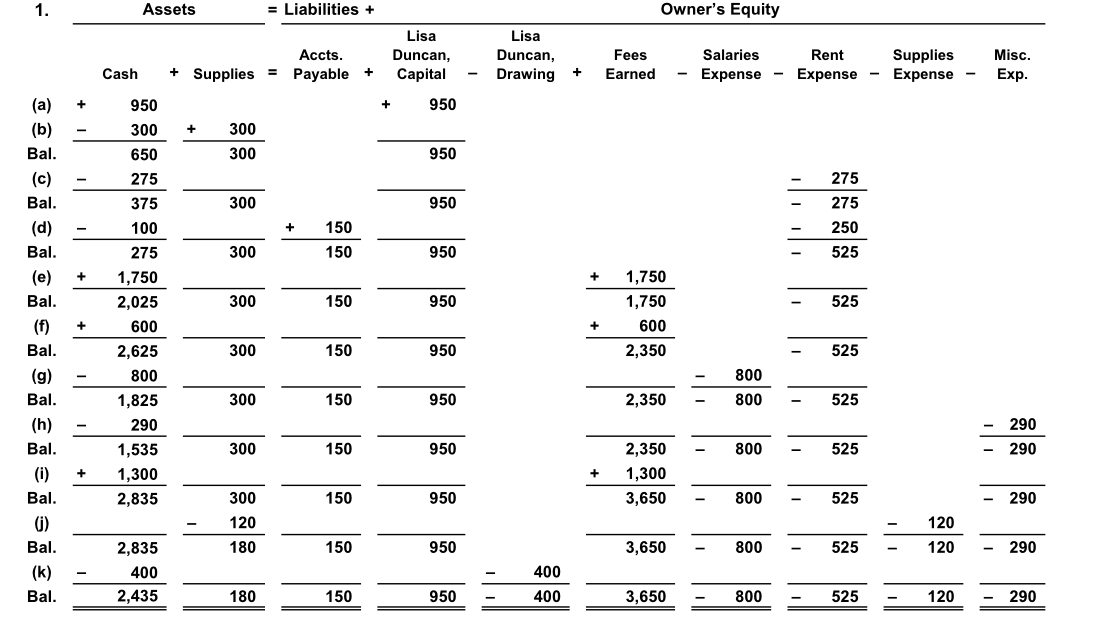
The difference in the two bank balances, $55,000 ($80,000 – $25,000), may not be pure profit from an accounting perspective. To determine the accounting profit for the six-month period, the revenues for the period would need to be matched with the related expenses. The revenues minus the expenses would 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 that Dr.

Cousins may have made in the business during the period, or dividends paid during the period that Dr. Cousins might have taken for personal reasons unrelated to the business.

Some businesses that have few, if any, receivables or payables may use a “cash” basis of accounting. The cash basis of accounting ignores receivables and payables because they are assumed to be insignificant in amount. However, even with the

cash basis of accounting, additional investments during the period and any dividends paid during the period have to be considered in determining the net income (profit)

or net loss for the period.

**CP 1–3**

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CP 1–3 (Continued)

2.

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| **SERVE-N-VOLLEY**  **Income Statement**  **For the Month Ended September 30, 2016** | | |
| **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** |
|  |  |  |

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| **SERVE-N-VOLLEY**  **Statement of Owner’s Equity**  **For the Month Ended September 30, 2016** | | |
| **Lisa Duncan, capital, September 1, 2016** |  | **$ 0** |
| **Investment on September 1, 2016** | **$ 950** |  |
| **Net income for September** | **1,915** |  |
|  | **$2,865** |  |
| **Less withdrawals** | **400** |  |
| **Increase in owner’s equity** |  | **2,465** |
| **Lisa Duncan, capital, September 30, 2016** |  | **$2,465** |
|  |  |  |

4.

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| --- | --- | --- | --- |
| **SERVE-N-VOLLEY**  **Balance Sheet September 30, 2016** | | | |
| **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** | **owner’s 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………………………… 1,200

Difference……………………………………………………………………… $ 715

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, rather, 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 students with useful information (such as starting salaries, etc.) on careers in accounting:

American Institute of Certified Public Accountants (AICPA) [www.aicpa.org/becomeacpa/faqs/pages/faqs.aspx](http://www.aicpa.org/becomeacpa/faqs/pages/faqs.aspx)

Institute of Certified Management Accountants (IMA) imanet.org/ima\_home.aspx

Institute of Internal Auditors (IIA)

[www.theiia.org/theiia/about-the-profession/about-the-internal-audit-profession/](http://www.theiia.org/theiia/about-the-profession/about-the-internal-audit-profession/)

CP 1–5

First Second Third

Year Year 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 is also the case for Amazon.com.

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 ÷ $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.