CHAPTER 1

SOLUTIONS TO EXERCISES – SET B

EXERCISE 1-1B

R Summarizing economic events.

I Selecting economic activities relevant to the company.

C Reporting information in a standard format.

C Preparing accounting reports.

R Measuring events in dollars and cents.

R Keeping a systematic chronological diary of events.

C Explaining uses, meaning, and limitations of data.

R Classifying economic events.

C Analyzing and interpreting information.

EXERCISE 1-2B

(a) *Internal users*

Marketing manager

Production supervisor

Store manager

Vice-president of finance

*External users*

Customers

Internal Revenue Service

Labor unions

Securities and Exchange Commission

Suppliers

(b) E Will the company be able to pay its short-term debts?

I Which product should we emphasize?

I What does it cost us to manufacture each unit produced?

E How does the company’s profitability compare to other companies?

I Do we need to borrow in the near future?

E Did the company earn a satisfactory income?

I Can we afford to give our employees a pay raise?

EXERCISE 1-3B

Bill Belachek, president of Belachek Company, instructed Tom Brady, the head of the accounting department, to report the company’s land in their accounting reports at its market value of $150,000 instead of its cost of $100,000, in an effort to make the company appear to be a better investment. Although we have an accounting system that permits various measurement approaches cost should be used whenever there are questions regarding the reliability of a market value. In this case, valuation of land is too subjective and therefore the cost principle should be used.

The stakeholders include stockholders and creditors of Belachek Company, potential stockholders and creditors, other users of Belacheck’s accounting reports, Bill Belachek, and Tom Brady. All users of Belachek’s accounting reports could be harmed by relying on information which violates accounting principles. Bill Belachek could benefit if the company is able to attract more investors, but would be harmed if the fraudulent reporting is discovered. Similarly, Tom Brady could benefit by pleasing his boss, but would be harmed if the fraudulent reporting is discovered.

Tom’s alternatives are to report the land at $100,000 or to report it at $150,000. Reporting the land at $150,000 is not appropriate since it would mislead many people who rely on Belachek’s accounting reports to make financial decisions. Tom should report the land at its cost of $100,000. He should try to convince Bill Belachek that this is the appropriate course of action, but be prepared to resign his position if Belachek insists.

EXERCISE 1-4B

1. Incorrect. The *cost principle* requires that most assets be recorded and reported at their cost due to reliability concerns about valuation. In this case, the cost principle should be applied.

2. Correct. The *monetary unit assumption* requires that companies include in the accounting records only transaction data that can be expressed in terms of money.

3. Incorrect. The *economic entity assumption* requires that the activities of the entity be kept separate and distinct from the activities of its owner and all other economic entities.

EXERCISE 1-5B

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Asset |  | Liability |  | Stockholders’ Equity |
| Cash |  | Salaries and wages |  | Common stock |
| Equipment | payable | Retained earnings |
| Supplies | Income taxes payable |
| Accounts receivable |  |  |  |  |

EXERCISE 1-6B

1. Increase in assets and increase in stockholders’ equity.

2. Decrease in assets and decrease in stockholders’ equity.

3. Increase in assets and increase in liabilities.

4. Increase in assets and increase in stockholders’ equity.

5. Decrease in assets and decrease in stockholders’ equity.

6. Increase in assets and decrease in assets.

7. Increase in liabilities and decrease in stockholders’ equity.

8. Increase in assets and decrease in assets.

9. Increase in assets and increase in stockholders’ equity.

EXERCISE 1-7B

1. (c) 5. (d)

2. (d) 6. (b)

3. (a) 7. (e)

4. (b) 8. (f)

EXERCISE 1-8B

(a) 1. Stockholders invested $25,000 cash in the business.

2. Purchased equipment for $6,000, paying $4,000 in cash and the balance of $2,000 on account.

3. Paid $650 cash for supplies.

4. Earned $7,500 in revenue, receiving $5,000 cash and $2,500 on account.

5. Paid $1,200 cash on accounts payable.

6. Paid $1,500 cash dividends to stockholders.

7. Paid $850 cash for rent.

8. Collected $750 cash from customers on account.

9. Paid salaries of $4,500.

10. Incurred $300 of utilities expense on account.

(b) Investment $25,000

Service revenue 7,500

Dividends (1,500 )

Rent expense (850 )

Salaries and wages expense (4,500 )

Utilities expense (300 )

Increase in stockholders’ equity $25,350

(c) Service revenue $7,500

Rent expense (850 )

Salaries and wages expense (4,500 )

Utilities expense (300 )

Net income $1,850

EXERCISE 1-9B

P. PATRON & CO.

Income Statement

For the Month Ended August 31, 2019

Revenues

Service revenue $7,500

Expenses

Salaries and wages expense $4,500

Rent expense 850

Utilities expense 300

Total expenses 5,650

Net income $1,850

P. PATRON & CO.

Retained Earnings Statement

For the Month Ended August 31, 2019

Retained earnings, August 1 $ 0

Add: Net income 1,850

1,850

Less: Dividends 1,500

Retained earnings, August 31 $ 350

P. PATRON & CO.

Balance Sheet

August 31, 2019

Assets

Cash $ 18,050

Accounts receivable 1,750

Supplies 650

Office equipment 6,000

Total assets $26,450

Liabilities and Stockholders’ Equity

Liabilities

Accounts payable $ 1,100

Stockholders’ equity

Common stock $25,000

Retained earnings        350   25,350

Total liabilities and stockholders’ equity $26,450

EXERCISE 1-10B

(a) Stockholders’ equity—12/31/18 ($400,000 – $220,000) $180,000

Stockholders’ equity—1/1/18 120,000

Increase in stockholders’ equity 60,000

Add: Dividends 13,000

Net income for 2018 $ 73,000

(b) Stockholders’ equity—12/31/19 ($510,000 – $300,000) $210,000

Stockholders’ equity—1/1/19—see (a) 180,000

Increase in stockholders’ equity 30,000

Less: Additional investment 60,000

Net loss for 2019 $ 30,000

(c) Stockholders’ equity—12/31/20 ($590,000 – $400,000) $190,000

Stockholders’ equity—1/1/20—see (b) 210,000

Decrease in stockholders’ equity (20,000)

Less: Additional investment 15,000

(35,000)

Add: Dividends 45,000

Net income for 2020 $ 10,000

EXERCISE 1-11B

(a) Total assets (beginning of year) $ 95,000

Total liabilities (beginning of year) 80,000

Total stockholders’ equity (beginning of year) $ 15,000

(b) Total stockholders’ equity (end of year) $ 40,000

Total stockholders’ equity (beginning of year) 15,000

Increase in stockholders’ equity $ 25,000

Total revenues $215,000

Total expenses 185,000

Net income $ 30,000

Increase in stockholders’ equity $ 25,000

Less: Net income $(30,000)

Add: Dividends 20,000) (10,000 )

Additional investment $ 15,000

(c) Total assets (beginning of year) $129,000

Total stockholders’ equity (beginning of year) 90,000

Total liabilities (beginning of year) $ 39,000

(d) Total stockholders’ equity (end of year) $130,000

Total stockholders’ equity (beginning of year) 90,000

Increase in stockholders’ equity $ 40,000

Total revenues $120,000

Total expenses 75,000

Net income $ 45,000

Increase in stockholders’ equity $ 40,000

Less: Net income $(45,000)

Additional investment (3,000) (48,000)

Dividends $ 8,000

EXERCISE 1-12B

IGNATENKO CO.

Income Statement

For the Year Ended December 31, 2019

Revenues

Service revenue $60,500

Expenses

Salaries and wages expense $28,000

Rent expense 10,200

Utilities expense 3,000

Advertising expense 1,300

Total expenses 42,500

Net income $18,000

IGNATENKO CO.

Retained Earnings Statement

For the Year Ended December 31, 2019

Retained earnings, January 1 $42,000

Add: Net income 18,000

60,000

Less: Dividends 4,000

Retained earnings, December 31 $56,000

EXERCISE 1-13B

PENEZ COMPANY

Balance Sheet

December 31, 2019

Assets

Cash $17,000

Accounts receivable 9,500

Supplies 7,000

Equipment 45,000

Total assets $78,500

Liabilities and Stockholders’ Equity

Liabilities

Accounts payable $19,000

Stockholders’ equity

Common stock $49,000

Retained earnings ($15,500 – $5,000)     10,500   59,500

Total liabilities and stockholders’ equity $78,500

EXERCISE 1-14B

(a) Camping fee revenues $160,000

General store revenues 50,000

Total revenue 210,000

Expenses 160,000

Net income $ 50,000

(b) DEER PARK

Balance Sheet

December 31, 2019

Assets

Cash $ 27,000

Supplies 3,500

Equipment 116,500

Total assets $147,000

December 31, 2019

Liabilities and Stockholders’ Equity

Liabilities

Notes payable $ 65,000

Accounts payable 12,000

Total liabilities 77,000

Stockholders’ equity

Common stock $20,000

Retained earnings   50,000 70,000

Total liabilities and stockholders’ equity $147,000

EXERCISE 1-15B

MIKE GREGORY COMPANY

Income Statement

For the Year Ended December 31, 2019

Revenues

Ticket revenue $340,000

Expenses

Salaries and wages expense $160,000

Maintenance and repairs expense 98,000

Utilities expense 7,000

Advertising expense 3,800

Total expenses 268,800

Net income $ 71,200

EXERCISE 1-16B

KING AND JAMES, ATTORNEYS AT LAW

Retained Earnings Statement

For the Year Ended December 31, 2019

Retained earnings, January 1 $ 26,000

Add: Net income 120,000\*

146,000

Less: Dividends 74,000

Retained earnings, December 31 $ 72,000

\*Service revenue $330,000

Total expenses 210,000

Net income $120,000

EXERCISE 1-17B

MIDVALE COMPANY

Statement of Cash Flows

For the Year Ended December 31, 2019

Cash flows from operating activities

Cash receipts from revenues $500,000

Cash payments for expenses (340,000)

Net cash provided by operating activities 160,000

Cash flows from investing activities

Purchase of equipment (90,000)

Cash flows from financing activities

Sale of common stock $250,000

Payment of cash dividends    (10,000) 240,000

Net increase in cash 310,000

Cash at the beginning of the period     40,000

Cash at the end of the period $350,000