

Chapter 1: Business, Accounting, and You

Discussion Questions: Key Points

1. The economic events that affect a business are communicated through the accounting function. Language helps us to make sense of the world around us. If we don't know the language, we will be limited in our ability to operate effectively in the business environment.
2. Valid arguments can be made on both sides of this question. Without technical knowledge an accountant will not be able to provide much value. Without ethics, however, an accountant can be dangerous. Accounting exists because of a need for an objective account of the economic events that affect an entity.
3. Financial statements seek to provide information about the events that have already occurred. For example, the cost principle is used to carry assets on the books. It is up to the user to make projections as to how past transactions are likely to affect future events.
4. Reasons why—reliability, objectivity. Disadvantages—relevance, decision-usefulness.
5. Financial statement uses discussed in the text: allow investors and creditors to make investment decisions, enable suppliers and customers to determine the financial condition of a business, and report to regulatory agencies.
6. It is a separate legal entity from its owners. Factors—liability of owners for business activities, taxation, distribution of income.
7. $A = L + SE$. Assets—things of value a company has. Liabilities—amount a business owes to third parties. Stockholder's equity—the amount of assets that is owned by the stockholders.
8. The transactions would have the following effects:
 - a. $A+$, $SE+$
 - b. $A+$, $L+$
 - c. $A+$, $SE+$
 - d. $A+$, $A-$
9. Income Statement, Statement of Retained Earnings, Balance Sheet, Statement of Cash Flows. The financial statements articulate (join together). The income statement needs to be prepared in order to produce the net income amount that is reported on the statement of retained earnings. The ending balance in retained earnings is needed in order to prepare the balance sheet. The ending balance in cash on the balance sheet and other information is needed for the statement of cash flows.
10. The financial statements are
 - a. Balance sheet
 - b. Statement of retained earnings
 - c. Statement of cash flows
 - d. Income statement

Short Exercises

(5-10 min.) S 1-1

1. d
2. a
3. c
4. b

(5-10 min.) S 1-2

Answer: d. Cost Principle

(10-15 min.) S 1-3

1. e
2. f
3. d
4. g
5. b
6. c
7. a

(5-10 min.) S 1-4

- a. \$82,000 ($\$106,000 - \$24,000$)
- b. \$91,000 ($\$63,000 + \$28,000$)
- c. \$49,000 ($\$94,000 - \$45,000$)

(5-10 min.) S 1-5

Assets	=	Liabilities	+	Stockholder's Equity
<u>Cash + Equipment</u>	=	<u>Accounts payable + Notes payable</u>	+	<u>Stockholder's equity</u>
\$13,000 + \$35,000	=	\$9,000 + \$5,000	+	\$34,000

Based on the accounting equation, Beach has \$34,000 of equity in the business. Assets of \$48,000 (\$13,000 + \$35,000) – Liabilities of \$14,000 (\$9,000 + \$5,000) = Stockholder's equity of \$34,000.

(5-10 min.) S 1-6

Assets	=	Liabilities	+	Stockholders' Equity
<u>Cash + Supplies</u>	=	<u></u>	+	<u>Stockholders' equity</u>
\$36,000 + \$1,500	=	\$9,500	+	\$28,000

Based on the accounting equation, Boehms has \$9,500 of liabilities. Assets of \$37,500 (\$36,000 + \$1,500) – Stockholders' equity of \$28,000 = Liabilities of \$9,500

(5-10 min.) S 1-7

	Assets	=	Liabilities	+	Stockholders' Equity
	<u>Cash</u>	=	<u>Notes Payable</u>	+	<u>Common Stock</u>
Investment	+ \$15,000	=			+ \$15,000
Borrowing	<u>+ 18,000</u>	=	<u>+ \$18,000</u>	+	
Bal.	\$33,000	=	\$18,000	+	\$15,000

(5-10 min.) S 1-8

	Assets		=	Liabilities	+	Stockholders' Equity		
	Cash	+ Accounts receivable		Accounts payable		Common stock	+	Retained Earnings
								Service revenue – Salary expense – Dividends
a.		+\$62,000						+ 62,000
b.	-\$33,000							+ \$33,000

(5-10 min.) S 1-9

1. e
2. a
3. c
4. a
5. e
6. e
7. a
8. e
9. d
10. b
11. a

(5-10 min.) S 1-10

1. BS
2. BS
3. IS
4. IS
5. BS, RE
6. BS

(5-10 min.) S 1-11

1. d
2. e
3. b
4. a
5. c

(5-10 min.) S 1-12

1. Increased total assets (Cash)
2. No effect on total assets. The increase in Land offset the decrease in Cash.
3. Decreased total assets (Cash)
4. Increased total assets (Machinery and equipment)
5. Increased total assets (Accounts receivable)
6. Decreased total assets (Cash)
7. No effect on total assets. The increase in Cash offset the decrease in Accounts receivable.
8. No effect on total assets. The increase in Cash offset the decrease in Land.
9. Increased total assets (Cash)

(5-10 min.) S 1-13

1. True
2. False (Increase Supplies; decrease Cash)
3. True
4. True
5. True
6. False (Decrease Cash; decrease Accounts payable)
7. True
8. True
9. False (Decrease Cash; increase Expense/decrease Stockholders' equity)

(5-10 min.) S 1-14

Req. 1

1. g. Sold stock to start the business.
2. e. Paid cash to purchase equipment.
3. h. Purchased equipment with a bank loan.
4. a. Earned revenue for services provided, but customer will pay later.
5. d. Paid cash for expenses incurred to operate the business.
6. c. Received cash for revenue earned by providing services.
7. b. Received cash from customers for services completed earlier in the month.
8. f. Received utility bill in the mail. Bill will be paid in 30 days.

Req. 2

Revenues (transactions “4” and “6”).....	\$2,950
Less: Expenses (transactions “5” and “8”).....	<u>1,585</u>
Net income.....	<u>\$1,365</u>

Exercises

(10-15 min.) E 1-15A

Hanson, Corp.	$\$44,900 + \$10,300 = \$55,200$
Tiny Tots Daycare, Inc.	$\$97,000 - \$39,000 = \$58,000$
Intermountain, Inc.	$\$107,400 - \$91,500 = \$15,900$

(10-15 min.) E 1-16A

Req. 1

	<u>Total Assets</u>	—	<u>Total Stockholders' Equity</u>	=	<u>Total Liabilities</u>
Beginning.....	\$95,000	—	\$62,000	=	\$33,000
Ending.....	\$151,000	—	\$105,000	=	\$46,000
Increase during the year				=	\$ 13,000

Req. 2

Possible reasons for the increase in Liabilities may include:

- Purchases were made on account
- Borrowed money on a note payable

(10-15 min.) E 1-17A

Req. 1

	<u>Total Assets</u>	—	<u>Total Liabilities</u>	=	<u>Total Stockholders' Equity</u>
Beginning.....	\$40,000	—	\$26,000	=	\$14,000
Ending.....	\$53,000	—	\$16,000	=	\$37,000
Increase during the year				=	\$23,000

Req. 2

Possible reasons for the increase in Stockholders' equity may include:

- Sold stock
- Earned net income

(15-20 min.) E 1-18A

	Aug. 31, 2016	Sept. 30, 2016
Total assets	\$105,000	\$180,000
- Total liabilities	<u>\$(75,000)</u>	<u>\$(129,000)</u>
= Stockholders' equity	\$30,000	\$51,000
- Common stock	<u>(10,000)</u>	<u>(10,000)</u>
= Retained earnings	<u>\$20,000</u>	<u>\$41,000</u>

Assumption A: No dividends were paid

$$\begin{array}{rcl}
 \$41,000 \text{ ending balance} & = & \$20,000 \text{ Beg bal} + \text{Net income} - \text{dividends} \\
 \$41,000 & = & \$20,000 + \text{Net income} - 0 \\
 \$21,000 & = & \text{Net income}
 \end{array}$$

Assumption B: \$10,000 of dividends were paid

$$\begin{array}{rcl}
 \$41,000 \text{ ending balance} & = & \$20,000 \text{ Beg bal} + \text{Net income} - \text{dividends} \\
 \$41,000 & = & \$20,000 + \text{Net income} - \$10,000 \\
 \$31,000 & = & \text{Net income}
 \end{array}$$

Assumption C: \$16,000 of dividends were paid

$$\begin{array}{rcl}
 \$41,000 \text{ ending balance} & = & \$20,000 \text{ Beg bal} + \text{Net income} - \text{dividends} \\
 \$41,000 & = & \$20,000 + \text{Net income} - \$16,000 \\
 \$37,000 & = & \text{Net income}
 \end{array}$$

(15-20 min.) E 1-19A

		Assets			=	Liabilities	+	Stockholders' Equity								
		Cash	+	Medical supplies	+	Land		Accounts payable		Common stock	+	Retained Earnings				
												Service revenue	–	Rent expense	–	Utilities expense
August																
2		+ 60,000								+ 60,000						
6		- 45,000				+45,000										
11				+ 700				+ 700								
15		No entry														
17		+ 10,000										+ 10,000				
19		- 1,400											+ 1,400			
22		+ 300		- 300												
25								+175							+175	
30		-100						-100								
Bal.		\$23,800	+	\$400	+	\$45,000	=	\$775	+	\$60,000	+	\$10,000	–	\$1,400	–	\$175

(10-15 min.) E 1-20A

Req. 1

The business is a corporation, as shown by the fact that it has a common stock account.

Req. 2

Fitness Fanatics, Inc.			
Balance Sheet			
March 31, 2016			
ASSETS		LIABILITIES	
Cash	\$ 15,000	Accounts payable	\$3,300
Accounts receivable	600	Note payable	<u>5,000</u>
Supplies	700	Total liabilities	8,300
Office equipment	10,300	STOCKHOLDERS' EQUITY	
		Common stock	6,000
		Retained earnings	<u>12,300</u>
		Total Stockholders' equity	<u>18,300</u>
		Total liabilities and	
Total assets	<u>\$26,600</u>	stockholders' equity	<u>\$26,600</u>

Req. 3

The balance sheet reports the financial position of a company at a given point in time and that
 Assets = Liabilities + Stockholders' Equity.

(15-20 min.) E 1-21A**Req. 1**

Account	Type of Account	Account	Type of Account
Office furniture	Asset	Rent expense	Expense
Utilities expense	Expense	Cash	Asset
Accounts payable	Liability	Office supplies	Asset
Notes payable	Liability	Salaries expense	Expense
Service revenue	Revenue	Salaries payable	Liability
Accounts receivable	Asset	Property tax expense	Expense
Supplies expense	Expense	Equipment	Asset

Req. 2

Annis Consulting, Inc.		
Income Statement		
For the Year Ended December 31, 2016		
Service Revenue		\$141,500
Expenses		
Salaries expense	\$41,000	
Rent expense	40,000	
Utilities expense	13,500	
Supplies expense	3,800	
Property tax expense	<u>2,000</u>	
Total expenses		<u>100,300</u>
Net income		<u>\$ 41,200</u>

Results of operations for 2016: Net income of \$41,200

(15-20 min.) E 1-21A Cont.

Req 3

Annis Consulting, Inc.	
Statement of Retained Earnings	
For the Year Ended December 31, 2016	
Retained earnings, Jan. 1, 2016	\$0
Add: Net income	<u>41,200</u>
Subtotal	41,200
Less: Dividends	<u>5,000</u>
Retained earnings, Dec. 31, 2016	<u>\$36,200</u>

The dividends for the year were \$5,000. ($\$0 + \$41,200 - \$36,200$)

(15-20 min.) E 1-22A

Req 1

	<u>Anderson Sign, Inc.</u>
Beginning:	
Assets	\$ 133,000
– Liabilities	<u>25,000</u>
= Stockholders' Equity	<u>\$ 108,000</u>

Req 2

Ending:	
Assets	\$ 154,000
– Liabilities	<u>70,000</u>
= Stockholders' Equity	<u>\$ 84,000</u>

Req 3

Ending Stockholders' equity	\$84,000
- Beginning Stockholders' equity	108,000
= Change in Stockholders' equity	(24,000)
- Sale of stock	19,000
= Change in retained earnings	(43,000)
+ Dividends	40,000
= Net loss	<u>(\$3,000)</u>

Note: The change in Retained earnings equals Net income minus Dividends. So, Dividends are added back to the change in Retained earnings to arrive at Net income.

(10-15 min.) E 1-23B

Lundy Plumbing Corp.	$\$50,500 + \$13,300 = \$63,800$
Sanchez Hardware, Inc.	$\$95,000 - \$34,000 = \$61,000$
Cutter & Son Cleaners, Inc.	$\$117,900 - \$88,200 = \$29,700$

(10-15 min.) E 1-24B**Req. 1**

	<u>Total Assets</u>	–	<u>Total Stockholders' Equity</u>	=	<u>Total Liabilities</u>
Beginning.....	\$94,000	–	\$10,000	=	\$84,000
Ending.....	\$151,000	–	\$112,000	=	\$39,000
Decrease during the year				=	\$ 45,000

Req. 2

Possible reasons for the decrease in Liabilities may include:

- Made payments on account
- Paid money on a note payable

(10-15 min.) E 1-25B**Req. 1**

	<u>Total Assets</u>	–	<u>Total Liabilities</u>	=	<u>Total Stockholders' Equity</u>
Beginning.....	\$50,000	–	\$18,000	=	\$32,000
Ending.....	\$39,000	–	\$10,000	=	\$29,000
Decrease during the year				=	\$ 3,000

(10-15 min.) E 1-25B (cont)

Req. 2

Possible reasons for the decrease in Stockholders' equity may include:

- Paid dividends
- Incurred a net loss

(15-20 min.) E 1-26B

	Aug. 31, 2016	Sep. 30, 2016
Total assets	\$125,000	\$175,000
- Total liabilities	<u>\$(69,000)</u>	<u>\$(125,000)</u>
= Stockholders' equity	\$56,000	\$50,000
- Common stock	<u>(45,000)</u>	<u>(45,000)</u>
= Retained earnings	<u>\$11,000</u>	<u>\$5,000</u>

Assumption A: No dividends were paid.

$$\begin{array}{rcl} \$5,000 \text{ ending balance} & = & \$11,000 \text{ Beg bal} + \text{Net income} - \text{Dividends} \\ \$5,000 & = & \$11,000 + \text{Net income} - 0 \\ (\$6,000) & = & \text{Net loss} \end{array}$$

Assumption B: \$8,000 of dividends were paid.

$$\begin{array}{rcl} \$5,000 \text{ ending balance} & = & \$11,000 \text{ Beg bal} + \text{Net income} - \text{Dividends} \\ \$5,000 & = & \$11,000 + \text{Net income} - \$8,000 \\ \$2,000 & = & \text{Net income} \end{array}$$

Assumption C: \$16,000 of dividends were paid.

$$\begin{array}{rcl} \$5,000 \text{ ending balance} & = & \$11,000 \text{ Beg bal} + \text{Net income} - \text{Dividends} \\ \$5,000 & = & \$11,000 + \text{Net income} - \$16,000 \\ \$10,000 & = & \text{Net income} \end{array}$$

(15-20 min.) E 1-27B

Assets					=	Liabilities	+	Stockholders' Equity							
	Cash	+	Medical supplies	+	Land		Accounts payable		Common stock	+	Retained Earnings				
July											Service revenue	–	Rent expense	–	Utilities expense
2	+ 80,000								+ 80,000						
6	- 65,000				+ 65,000										
11			+ 800				+ 800								
15	No entry required														
17	+ 12,000									+ 12,000					
19	- 2,400												+ 2,400		
22	+ 300		- 300												
25							+ 235								+ 235
30	-250						- 250								
Bal.	\$24,650	+	\$500	+	\$65,000	=	\$785	+	\$80,000	+	\$12,000	–	\$2,400	–	\$235

(10-15 min.) E 1-28B

Req. 1

The business is a corporation, as shown by the fact that it has a common stock account.

Req. 2

Jerome's Coffee Shop, Inc.			
Balance Sheet			
March 31, 2016			
ASSETS		LIABILITIES	
Cash	\$ 22,000	Accounts payable	\$1,800
Accounts receivable	2,100	Note payable	<u>5,000</u>
Supplies	500	Total liabilities	6,800
Office equipment	15,100	STOCKHOLDERS' EQUITY	
		Common stock	2,000
		Retained earnings	<u>30,900</u>
		Total Stockholders' equity	<u>32,900</u>
		Total liabilities and	
Total assets	<u>\$39,700</u>	stockholders' equity	<u>\$39,700</u>

Req. 3

The balance sheet reports the financial position of a company at a given point in time and that
 $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.

(15-20 min.) E 1-29B**Req. 1**

Account	Type of Account	Account	Type of Account
Office furniture	Asset	Rent expense	Expense
Utilities expense	Expense	Cash	Asset
Accounts payable	Liability	Office supplies	Asset
Notes payable	Liability	Salaries expense	Expense
Service revenue	Revenue	Salaries payable	Liability
Accounts receivable	Asset	Property tax expense	Expense
Supplies expense	Expense	Equipment	Asset

Req. 2

Andover Consulting, Inc.		
Income Statement		
For the Year Ended December 31, 2016		
Service Revenue		\$139,500
Expenses		
Salaries expense	\$50,000	
Rent expense	36,000	
Utilities expense	14,200	
Supplies expense	4,000	
Property tax expense	<u>2,200</u>	
Total expenses		<u>106,400</u>
Net income		<u>\$ 33,100</u>

Results of operations for 2016: Net income of \$33,100.

(15-20 min.) E 1-29B Cont.

Req 3

Andover Consulting, Inc.	
Statement of Retained Earnings	
For the Year Ended December 31, 2016	
Retained earnings, Jan. 1, 2016	\$0
Add: Net income	<u>33,100</u>
Subtotal	33,100
Less: Dividends	<u>15,000</u>
Retained earnings, Dec. 31, 2016	<u>\$18,100</u>

The dividends for the year were \$15,000 (\$0 + \$33,100 - \$18,100).

(15-20 min.) E 1-30B

Req 1

	<u>Eliason, Inc.</u>
Beginning:	
Assets	\$ 44,000
– Liabilities	<u>20,000</u>
= Stockholders' Equity	<u>\$ 24,000</u>

Req 2

Ending:	
Assets	\$ 104,000
– Liabilities	<u>25,000</u>
= Stockholders' Equity	<u>\$ 79,000</u>

Req 3

Ending Stockholders' equity	\$79,000
- Beginning Stockholders' equity	24,000
= Change in Stockholders' equity	55,000
- Sale of stock	12,000
= Change in retained earnings	43,000
+ Dividends	60,000
= Net income	<u>\$103,000</u>

Note: The change in Retained earnings equals Net income minus Dividends. So, Dividends are added back to the change in Retained earnings to arrive at Net income.

Problems

(20-25 min.) P 1-31A

Req. 1

Assets								=	Liabilities	+	Stockholders' Equity						
Cash		+	Accounts receivable	+	Supplies	+	Office furniture		Accounts payable		Common stock	+	Retained Earnings				
June													Service revenue	–	Rent expense	–	Dividends
3	*																
5	+ 95,000										+ 95,000						
Bal.	\$95,000	+	\$0	+	\$0	+	\$0	=	\$0	+	\$95,000	+	\$0	–	\$0	–	\$0
7	- 450				+ 450												
Bal.	\$94,550	+	\$0	+	\$450	+	\$0	=	\$0	+	\$95,000	+	\$0	–	\$0	–	\$0
9							+ 4,700		+ 4,700								
Bal.	\$94,550	+	\$0	+	\$450	+	\$4,700	=	\$4,700	+	\$95,000	+	\$0	–	\$0	–	\$0
10	*																
14	**																
20			+ 3,800										+ 3,800				
Bal.	\$94,550	+	\$3,800	+	\$450	+	\$4,700	=	\$4,700	+	\$95,000	+	\$3,800	–	\$0	–	\$0
27	- 1,500														+ 1,500		
Bal.	\$93,050	+	\$3,800	+	\$450	+	\$4,700	=	\$4,700	+	\$95,000	+	\$3,800	–	\$1,500	–	\$0
29	- 2,000								- 2,000								
Bal.	\$91,050	+	\$3,800	+	\$450	+	\$4,700	=	\$2,700	+	\$95,000	+	\$3,800	–	\$1,500	–	\$0
30	- 500																+ 500
Bal.	\$90,550	+	\$3,800	+	\$450	+	\$4,700	=	\$2,700	+	\$95,000	+	\$3,800	–	\$1,500	–	\$500

* Represents a personal, not a business transaction

** Not a transaction as there was no financial impact

Req. 2

- a. Total assets = \$99,500 ($\$90,550 + \$3,800 + \$450 + \$4,700$)
- b. Total liabilities = \$2,700
- c. Total stockholder's equity = \$96,800 ($\$95,000 + \$3,800 - \$1,500 - \500)
- d. Net income for June = \$2,300 ($\$3,800 - \$1,500$)

(25-30 min.) P 1-32A

Req. 1

Assets								=	Liabilities		+	Stockholders' Equity					
Cash	+	Accounts receivable	+	Supplies	+	Equipment			Accounts payable		Common stock	+	Retained Earnings				
													Service revenue	–	Salaries expense	–	Dividends
Apr. Beg. bal.	\$1,380	+	\$3,820	+	\$0	+	\$28,000	=	\$4,500	+	\$24,000	+	\$6,700	–	\$2,000	–	\$0
a.	+ 8,000										+ 8,000						
Bal. b.	\$9,380	+	\$3,820	+	\$0	+	\$28,000	=	\$4,500	+	\$32,000	+	\$6,700	–	\$2,000	–	\$0
	-4,500								-4,500								
Bal. c.	\$4,880	+	\$3,820	+	\$0	+	\$28,000	=	\$0	+	\$32,000	+	\$6,700	–	\$2,000	–	\$0
	+ 3,500												+ 3,500				
Bal. d.	\$8,380	+	\$3,820	+	\$0	+	\$28,000	=	\$0	+	\$32,000	+	\$10,200	–	\$2,000	–	\$0
	+ 400		- 400														
Bal. e.	\$8,780	+	\$3,420	+	\$0	+	\$28,000	=	\$0	+	\$32,000	+	\$10,200	–	\$2,000	–	\$0
				+ 1,300					+ 1,300								
Bal. f.	\$8,780	+	\$3,420	+	\$1,300	+	\$28,000	=	\$1,300	+	\$32,000	+	\$10,200	–	\$2,000	–	\$0
			+ 5,500										+ 5,500				
Bal. g.	\$8,780	+	\$8,920	+	\$1,300	+	\$28,000	=	\$1,300	+	\$32,000	+	\$15,700	–	\$2,000	–	\$0
	+10,000										+ 10,000						
Bal. h.	\$18,780	+	\$8,920	+	\$1,300	+	\$28,000	=	\$1,300	+	\$42,000	+	\$15,700	–	\$2,000	–	\$0
	- 2,500													+ 2,500			
Bal. i.	\$16,280	+	\$8,920	+	\$1,300	+	\$28,000	=	\$1,300	+	\$42,000	+	\$15,700	–	\$4,500	–	\$0
	+175			- 175													
Bal. j.	\$16,455	+	\$8,920	+	\$1,125	+	\$28,000	=	\$1,300	+	\$42,000	+	\$15,700	–	\$4,500	–	\$0
	-800																+800
Bal.	\$15,655	+	\$8,920	+	\$1,125	+	\$28,000	=	\$1,300	+	\$42,000	+	\$15,700	–	\$4,500	–	\$800

(25-30 min.) P 1-32A (cont.)

Req. 2

Interiors by Design Inc.		
Income Statement		
Month Ended April 30, 2016		
Revenues		
Service revenue		\$15,700
Expenses		
Salaries expense		<u>4,500</u>
Net income		<u>\$11,200</u>

Req. 3

Interiors by Design, Inc.	
Statement of Retained Earnings	
Month Ended April 30, 2016	
Retained earnings, April 1, 2016	\$0
Add: Net income	<u>11,200</u>
Subtotal	11,200
Less: Dividends	<u>800</u>
Retained earnings, April 30, 2016	<u>\$10,400</u>

Req. 4

Interiors by Design, Inc.			
Balance Sheet			
April 30, 2016			
ASSETS		LIABILITIES	
Cash	\$ 15,655	Accounts payable	\$ 1,300
Accounts receivable	8,920		
Supplies	1,125	STOCKHOLDERS' EQUITY	
Equipment	28,000	Common stock	42,000
		Retained earnings	<u>10,400</u>
		Total Stockholders' equity	<u>52,400</u>
		Total liabilities and	
Total assets	<u>\$53,700</u>	stockholder's equity	<u>\$53,700</u>

(20-25 min.) P 1-33A

Req. 1

Account	Type of Account	Account	Type of Account
Accounts Receivable	Asset	Cash	Asset
Note Payable	Liability	Accounts Payable	Liability
Retained Earnings	Stockholders' equity	Advertising Expense	Stockholders' equity
Salaries Expense	Stockholders' equity	Service Revenue	Stockholders' equity
Equipment	Asset	Common Stock	Stockholders' equity
Insurance Expense	Stockholders' equity	Rent Expense	Stockholders' equity
Utilities Expense	Stockholders' equity	Supplies	Asset

Req. 2

a.

Gear Heads, Inc.		
Income Statement		
Year Ended December 31, 2016		
Service revenue		\$92,800
Expenses		
Salaries expense	\$16,600	
Rent Expense	4,800	
Advertising expense	3,700	
Insurance expense	3,200	
Utilities expense	<u>2,300</u>	
Total expenses		<u>30,600</u>
Net Income		<u>\$62,200</u>

b.

Gear Heads, Inc.	
Statement of Retained Earnings	
Year Ended December 31, 2016	
Retained earnings, December 31, 2015	\$19,700
Add: Net income	<u>62,200</u>
Subtotal	81,900
Less: Dividends	<u>45,000</u>
Retained earnings, December 31, 2016	<u>\$36,900</u>

c.

Gear Heads, Inc.			
Balance Sheet			
December 31, 2016			
ASSETS		LIABILITIES	
Cash	\$14,700	Accounts payable	\$ 6,500
Accounts receivable	9,300	Notes payable	<u>17,000</u>
Supplies	1,400	Total liabilities	23,500
Equipment	68,000		
		STOCKHOLDERS' EQUITY	
		Common stock	33,000
		Retained earnings	<u>36,900</u>
		Total stockholders' equity	<u>69,900</u>
		Total liabilities and	
Total assets	<u>\$93,400</u>	stockholders' equity	<u>\$93,400</u>

(25-30 min.) P 1-34A

Req. 1

Account	Type of Account	Account	Type of Account
Accounts payable	Liability	Interest expense	Stockholders' equity
Accounts receivable	Asset	Land	Asset
Advertising expense	Stockholders' equity	Note payable	Liability
Building	Asset	Property tax expense	Stockholders' equity
Cash	Asset	Rent expense	Stockholders' equity
Common stock	Stockholders' equity	Salaries expense	Stockholders' equity
Dividends	Stockholders' equity	Salaries payable	Liability
Equipment	Asset	Service revenue	Stockholders' equity
Insurance expense	Stockholders' equity	Supplies	Asset

Req. 2

Extreme Sports, Inc.		
Income Statement		
Year Ended October 31, 2016		
Service revenue		\$190,000
Expenses		
Salaries expense	\$61,000	
Rent expense	22,000	
Advertising expense	19,000	
Interest expense	5,500	
Property tax expense	4,300	
Insurance expense	<u>2,800</u>	
Total expenses		<u>114,600</u>
Net Income		<u>\$ 75,400</u>

Extreme Sports, Inc.	
Statement of Retained Earnings	
Year Ended October 31, 2016	
Retained earnings, October 31, 2015	\$94,900
Add: Net income	<u>75,400</u>
Subtotal	170,300
Less: Dividends	<u>36,000</u>
Retained earnings, October 31, 2016	<u>\$134,300</u>

(continued) P 1-34A

Req. 3

Extreme Sports, Inc.			
Balance Sheet			
October 31, 2016			
ASSETS		LIABILITIES	
Cash	\$18,000	Accounts payable	\$ 18,000
Accounts receivable	14,000	Salaries payable	6,000
Supplies	1,300	Notes payable	<u>65,000</u>
Land	35,000	Total liabilities	89,000
Equipment	50,000		
Building	<u>125,000</u>	STOCKHOLDERS' EQUITY	
		Common stock	20,000
		Retained earnings	<u>134,300</u>
		Total stockholders' equity	<u>154,300</u>
		Total liabilities and	
Total assets	<u>\$243,300</u>	stockholders' equity	<u>\$243,300</u>

Req. 4

- \$75,400 (Net profit = net income).
- Increase of \$39,400 (\$75,400 Net income minus \$36,000 Dividends).
- \$243,300 (Total economic resources = total assets).
- \$ 89,000 (Total owed = total liabilities).

(20-25 min.) P 1-35A

Valley Realty, Inc.			
Balance Sheet			
November 30, 2016			
ASSETS		LIABILITIES	
Cash	\$9,400	Accounts payable	\$ 1,800
Accounts receivable	3,200	Salaries payable	2,150
Supplies	440	Notes payable	<u>5,300</u>
Equipment	<u>17,300</u>	Total liabilities	9,250
		STOCKHOLDERS' EQUITY	
		Common stock	9,000
		Retained earnings	<u>12,090</u>
		Total stockholders' equity	<u>21,090</u>
		Total liabilities and	
Total assets	<u>\$30,340</u>	stockholders' equity	<u>\$30,340</u>

(20-25 min.) P 1-36B

Req. 1

Assets								=	Liabilities	+	Stockholders' Equity							
Cash		+	Accounts receivable	+	Supplies	+	Office furniture		Accounts payable		Common stock	+	Retained Earnings					
Nov													Service revenue	–	Rent expense	–	Dividends	
	3	*																
	5	+ 55,000									+ 55,000							
	Bal.	\$55,000	+	\$0	+	\$0	+	\$0	=	\$0	+	\$55,000	+	\$0	–	\$0	–	\$0
	7	-450			+ 450													
	Bal.	\$54,550	+	\$0	+	\$450	+	\$0	=	\$0	+	\$55,000	+	\$0	–	\$0	–	\$0
	9							+3,800		+3,800								
	Bal.	\$54,550	+	\$0	+	\$450	+	\$3,800	=	\$3,800	+	\$55,000	+	\$0	–	\$0	–	\$0
	10	*																
	14	**																
	20			+4,000									+4,000					
	Bal.	\$54,550	+	\$4,000	+	\$450	+	\$3,800	=	\$3,800	+	\$55,000	+	\$4,000	–	\$0	–	\$0
	27	-1,400													+1,400			
	Bal.	\$53,150	+	\$4,000	+	\$450	+	\$3,800	=	\$3,800	+	\$55,000	+	\$4,000	–	\$1,400	–	\$0
	29	-2,500								- 2,500								
	Bal.	\$50,650	+	\$4,000	+	\$450	+	\$3,800	=	\$1,300	+	\$55,000	+	\$4,000	–	\$1,400	–	\$0
	30	-800															+ 800	
	Bal.	\$49,850	+	\$4,000	+	\$450	+	\$3,800	=	\$1,300	+	\$55,000	+	\$4,000	–	\$1,400	–	\$800

* Represents a personal, not a business transaction

** Not a transaction as there was no financial impact

Req. 2

- a. Total assets = \$58,100 (\$49,850 + \$4,000 + \$450 + \$3,800)
- b. Total liabilities = \$1,300
- c. Total stockholder's equity = \$56,800 (\$55,000 + \$4,000 - \$1,400 - \$800)
- d. Net income for November = \$2,600 (\$4,000 - \$1,400)

(25-30 min.) P 1-37B

Req. 1

Assets								=	Liabilities	+	Stockholders' Equity						
Cash	+	Accounts receivable	+	Supplies	+	Equipment		Accounts payable		Common stock	+	Retained Earnings					
												Service revenue	–	Salaries expense	–	Dividends	
June Beg. bal.	\$1,610	+	\$3,070	+	\$0	+	\$25,000	=	\$4,500	+	\$20,000	+	\$6,700	–	\$1,520	–	\$0
a.	+16,000										+ 16,000						
Bal. b.	\$17,610	+	\$3,070	+	\$0	+	\$25,000	=	\$4,500	+	\$36,000	+	\$6,700	–	\$1,520	–	\$0
	-4,500								-4,500								
Bal. c.	\$13,110	+	\$3,070	+	\$0	+	\$25,000	=	\$0	+	\$36,000	+	\$6,700	–	\$1,520	–	\$0
	+ 5,000											+ 5,000					
Bal. d.	\$18,110	+	\$3,070	+	\$0	+	\$25,000	=	\$0	+	\$36,000	+	\$11,700	–	\$1,520	–	\$0
	+1,150		- 1,150														
Bal. e.	\$19,260	+	\$1,920	+	\$0	+	\$25,000	=	\$0	+	\$36,000	+	\$11,700	–	\$1,520	–	\$0
				+800					+ 800								
Bal. f.	\$19,260	+	\$1,920	+	\$800	+	\$25,000	=	\$800	+	\$36,000	+	\$11,700	–	\$1,520	–	\$0
			4,500									+ 4,500					
Bal. g.	\$19,260	+	\$6,420	+	\$800	+	\$25,000	=	\$800	+	\$36,000	+	\$16,200	–	\$1,520	–	\$0
	+9,000										+9,000						
Bal. h.	\$28,260	+	\$6,420	+	\$800	+	\$25,000	=	\$800	+	\$45,000	+	\$16,200	–	\$1,520	–	\$0
	- 2,200													+ 2,200			
Bal. i.	\$26,060	+	\$6,420	+	\$800	+	\$25,000	=	\$800	+	\$45,000	+	\$16,200	–	\$3,720	–	\$0
	+250				- 250												
Bal. j.	\$26,310	+	\$6,420	+	\$550	+	\$25,000	=	\$800	+	\$45,000	+	\$16,200	–	\$3,720	–	\$0
	-1,000																+1,000
Bal.	\$25,310	+	\$6,420	+	\$550	+	\$25,000	=	\$800	+	\$45,000	+	\$16,200	–	\$3,720	–	\$1,000

(25-30 min.) P 1-37B (cont.)

Req. 2

Interiors on Demand, Inc.		
Income Statement		
Month Ended June 30, 2016		
Revenues		
Service revenue		\$16,200
Expenses		
Salaries expense		<u>3,720</u>
Net income		<u>\$12,480</u>

Req. 3

Interiors on Demand, Inc.	
Statement of Retained Earnings	
Month Ended June 30, 2016	
Retained earnings, June 1, 2016	\$0
Add: Net income	<u>12,480</u>
Subtotal	12,480
Less: Dividends	<u>1,000</u>
Retained earnings, June 30, 2016	<u>\$11,480</u>

Req. 4

Interiors on Demand, Inc.			
Balance Sheet			
June 30, 2016			
ASSETS		LIABILITIES	
Cash	\$ 25,310	Accounts payable	\$ 800
Accounts receivable	6,420		
Supplies	550	STOCKHOLDERS' EQUITY	
Equipment	25,000	Common stock	45,000
		Retained earnings	<u>11,480</u>
		Total Stockholders' equity	<u>56,480</u>
		Total liabilities and	
Total assets	<u>\$57,280</u>	stockholder's equity	<u>\$57,280</u>

(20-25 min.) P 1-38B

Req. 1

Account	Type of Account	Account	Type of Account
Accounts Receivable	Asset	Cash	Asset
Note Payable	Liability	Accounts Payable	Liability
Retained Earnings	Stockholders' equity	Advertising Expense	Stockholders' equity
Salaries Expense	Stockholders' equity	Service Revenue	Stockholders' equity
Equipment	Asset	Common Stock	Stockholders' equity
Insurance Expense	Stockholders' equity	Rent Expense	Stockholders' equity
Utilities Expense	Stockholders' equity	Supplies	Asset

Req. 2

a.

Classic Cars, Inc.		
Income Statement		
Year Ended December 31, 2016		
Service Revenue		\$68,900
Expenses		
Salaries Expense	\$22,600	
Rent Expense	7,700	
Advertising Expense	3,100	
Insurance Expense	2,800	
Utilities Expense	<u>1,400</u>	
Total expenses		<u>37,600</u>
Net Income		<u><u>\$31,300</u></u>

b.

Classic Cars, Inc.	
Statement of Retained Earnings	
Year Ended December 31, 2016	
Retained earnings, December 31, 2015	\$22,300
Add: Net income	<u>31,300</u>
Subtotal	53,600
Less: Dividends	<u>20,000</u>
Retained earnings, December 31, 2016	<u><u>\$33,600</u></u>

(25-30 min.) P 1-38B (cont.)

c.

Classic Cars, Inc.			
Balance Sheet			
December 31, 2016			
ASSETS		LIABILITIES	
Cash	\$12,300	Accounts payable	\$ 6,150
Accounts receivable	11,600	Note payable	<u>18,000</u>
Supplies	850	Total liabilities	24,150
Equipment	65,000		
		STOCKHOLDERS' EQUITY	
		Common stock	32,000
		Retained earnings	<u>33,600</u>
		Total stockholders' equity	<u>65,600</u>
		Total liabilities and	
Total assets	<u>\$89,750</u>	stockholders' equity	<u>\$89,750</u>

(25-30 min.) P 1-39B

Req. 1

Account	Type of Account	Account	Type of Account
Accounts payable	Liability	Interest expense	Stockholders' equity
Accounts receivable	Asset	Land	Asset
Advertising expense	Stockholders' equity	Note payable	Liability
Building	Asset	Property tax expense	Stockholders' equity
Cash	Asset	Rent expense	Stockholders' equity
Common stock	Stockholders' equity	Salaries expense	Stockholders' equity
Dividends	Stockholders' equity	Salaries payable	Liability
Equipment	Asset	Service revenue	Stockholders' equity
Insurance expense	Stockholders' equity	Supplies	Asset

Req. 2

The Fitness Guru, Inc.		
Income Statement		
Year Ended August 31, 2016		
Service revenue		\$166,000
Expenses		
Salaries expense	\$92,000	
Rent expense	22,000	
Advertising expense	15,000	
Interest expense	5,000	

Property tax expense	4,500	
Insurance expense	<u>2,200</u>	
Total expenses		<u>140,700</u>
Net Income		<u>\$ 25,300</u>

The Fitness Guru, Inc.
Statement of Retained Earnings
Year Ended August 31, 2016

Retained earnings, August 31, 2015	\$87,100
Add: Net income	<u>25,300</u>
Subtotal	112,400
Less: Dividends	<u>29,000</u>
Retained earnings, August 31, 2016	<u>\$83,400</u>

(continued) P 1-39B

Req. 3

The Fitness Guru, Inc.			
Balance Sheet			
August 31, 2016			
ASSETS		LIABILITIES	
Cash	\$16,000	Accounts payable	\$ 15,000
Accounts receivable	14,000	Salaries payable	5,000
Supplies	1,400	Note payable	<u>70,000</u>
Land	37,000	Total liabilities	90,000
Equipment	40,000		
Building	<u>135,000</u>	STOCKHOLDERS' EQUITY	
		Common stock	70,000
		Retained earnings	<u>83,400</u>
		Total stockholders' equity	<u>153,400</u>
		Total liabilities and	
Total assets	<u>\$243,400</u>	stockholders' equity	<u>\$243,400</u>

Req. 4

- a. \$25,300 (Net profit = net income).
- b. Decrease of \$3,700 (\$25,300 Net income minus \$29,000 Dividends).
- c. \$243,400 (Total economic resources = total assets).
- d. \$ 90,000 (Total owed = total liabilities).

(20-25 min.) P 1-40B

Highland Realty, Inc.			
Balance Sheet			
September 30, 2016			
ASSETS		LIABILITIES	
Cash	\$9,000	Accounts payable	\$ 2,000
Accounts receivable	1,400	Salaries payable	1,100
Supplies	600	Notes payable	<u>5,700</u>
Equipment	<u>8,300</u>	Total liabilities	8,800
		STOCKHOLDERS' EQUITY	
		Common stock	9,000
		Retained earnings	<u>1,500</u>
		Total stockholders' equity	<u>10,500</u>
		Total liabilities and	
Total assets	<u>\$19,300</u>	stockholders' equity	<u>\$19,300</u>

Continuing Exercise

ASSETS							=	LIABILITIES		+	STOCKHOLDERS' EQUITY				
	Cash	+	Accounts receivable	+	Supplies	+	Equipment	=	Accounts payable	+	Common stock	+	Retained Earnings		
May													Service revenue	–	Utilities expense
1	+1,500										+1,500				
3							+1,908		+1,908						
5	-125				+125										
6			+375										+375		
17	+275												+275		
28	-65														+65
30	+150		-150												
Bal	1,735	+	225	+	125	+	1,908	=	1,908	+	1,500	+	650	-	65

Continuing Problem

Req 1

	Assets					=	Liabilities		+	Stockholders' Equity														
	Cash	+	Accounts receivable	+	Supplies	+	Equipment	+	Vehicles		Accounts payable	+	Note payable		Common stock	+	Retained Earnings							
																		Service revenue	-	Salaries expense	-	Utilities expense	-	Dividend
3/1	+22,000								+13,000						+35,000									
3/3	-3,600						+3,600																	
3/7					+900						+900													
3/12	+850																	+850						
3/15	-620																			+620				
3/16	+13,000								-13,000															
3/18									+35,800				+35,800											
3/21			+3,200															+3,200						
3/27	-150										-150													
3/30	+1,900		-1,900																					
3/31											+250											+250		
3/31	-1,500																							+1,500
Bal	31,880	+	1,300	+	900	+	3,600	+	35,800	=	1,000	+	35,800	+	35,000	+	4,050	-	620	-	250	-	1,500	

Continuing Problem (cont.)

Req 2

Fitness Equipment Doctor, Inc.
Income Statement
Month Ended March 31, 2016

Service revenue		\$4,050
Expenses:		
Salaries expense	\$620	
Utilities expense	<u>250</u>	
Total expenses		<u>870</u>
Net Income		<u>\$3,180</u>

Req 3

Fitness Equipment Doctor, Inc.
Statement of Retained Earnings
For the Month Ended March 31, 2016

Retained Earnings, March 1, 2016	\$0
Add: Net Income for the Month	<u>3,180</u>
Subtotal	3,180
Less: Dividends	<u>1,500</u>
Retained Earnings, March 31, 2016	<u>\$1,680</u>

Req 4

Fitness Equipment Doctor, Inc.
Balance Sheet
March 31, 2016

ASSETS		LIABILITIES	
Cash	\$31,880	Accounts payable	\$1,000
Accounts receivable	1,300	Note Payable	<u>35,800</u>
Supplies	900	Total Liabilities	\$36,800
Equipment	3,600		
Vehicles	<u>35,800</u>		
		STOCKHOLDERS' EQUITY	
		Common Stock	\$35,000
		Retained Earnings	<u>1,680</u>
		Total Stockholders' Equity	<u>36,680</u>
Total Assets	<u>\$73,480</u>	Total Liabilities and Stockholders' Equity	<u>\$73,480</u>

Req 5

It is unknown how much Adam was earning at his previous job and, after only one month of operations, it is probably too early to tell. However, Fitness Equipment Doctor, Inc. made almost \$3,200 of profit for its very first month of operations. So, it appears that Adam probably made a good decision.

Continuing Financial Statement Analysis Problem

1.

“Our mission is to be recognized by our customers as the #1 sports and fitness specialty omni-channel retailer that serves and inspires athletes and outdoor enthusiasts to achieve their personal best through the relentless improvement of everything we do.

2.

Dick’s is an upscale, retail merchandiser of quality sporting and fitness products. Dicks operates four types of retail stores. The four types are:

- Dick’s Sporting Goods
- Gold Galaxy
- Field and Stream
- True Runner

3.

Dick’s sells a wide assortment of sporting and fitness merchandise. The products Dick’s sells are purchased from manufacturers. Many of these manufacturers produce national brand merchandise such as Nike, Under Armor, and others. However Dick’s also sells private brands that are exclusive to Dick’s. This private-brand merchandise is purchased from manufacturers under exclusive agreements.

4.

Dicks’ customers are sports and fitness enthusiasts of all ages.

5.

Answers will vary. Students will talk about what they like and dislike about Dick’s. The focus should be whether they are providing value to its stakeholders, including customers, employees, suppliers, society, lenders, and especially owners. Students should think about earning profits, but also acknowledge the importance of when the profits are earned (time) and the risk associated with profits. With this, the importance of accounting can be stressed (i.e., recognizing, measuring, recording, and reporting financial information).

Ethics in Action

Case #1

- What Lisa proposed is not unethical as long as the assets contributed can legitimately be used in the business and the stockholders' equity accounts properly reflect the contribution. The business entity principle recognizes the difference between the personal assets of the owners and the assets owned by the business. When assets are contributed to the business by the owners, proper accounting will reflect the transaction. Should a business need additional assets, there is nothing wrong or improper for an owner to contribute additional assets that can be used in the business.
- What Mike proposed is unethical. His plan would provide information that would not be reliable as the "sales" would be nothing more than disguised owner distributions. Inflating the income statement by including fictitious sales is unethical, misleading and not allowable. Mike should not provide false information that is unreliable.

There is nothing unethical about a business wanting to improve its Balance Sheet by properly adding more business assets. It would be unacceptable, however, for a business to temporarily add more assets just to improve the Balance Sheet in order to obtain a loan and remove those assets once the loan is granted.

Case #2

- The Balance Sheet should follow Generally Accepted Accounting Principles, and thus the assets should be listed at the total cost of \$2,100,000. This would also provide for more reliable data as well.
- Only one Balance Sheet can be provided, and it needs to comply with Generally Accepted Accounting Principles. Adding supplemental footnote disclosures would be acceptable. However, providing another Balance Sheet not following generally accepted accounting principles would be misleading and confusing and therefore unacceptable.

Financial Analysis

1. No solution.
2. The total assets were \$1,792,209,000 as of December 31, 2014. This was an increase from the \$1,605,588,000 as of December 31, 2013.
3. No solution.
5. Total revenues in 2014 were \$2,100,590,000. This is an increase from the \$1,684,996,000 in 2013 which was an increase from \$1,669,563,000 in 2012.

Industry Analysis

Columbia Sportswear's stockholders have a claim to 75.6% (\$1,355,234/\$1,792,209) of company assets compared to only 64.5% (\$1,350,300/\$2,095,083) for Under Armour's Stockholders. (Numbers in thousands.)

Small Business Analysis

The CPA tells you, "The income statement is not the only financial statement that will affect your cash balance. The income statement only gives you the results of your operations. If all you did during the year was to collect revenue and pay out expenses, then the net income would directly correspond to the increase in your cash balance. But there are other aspects of BCS Consultants as well. There's the financing aspect, borrowing money and paying money back, as well as the investment aspect, buying and disposing of fixed assets. These will also affect your cash balance. In addition, the payment of dividends decreases the cash balance.

"You purchased a piece of equipment during the year for \$12,000 and paid cash for it. That decreased your cash by \$12,000. You paid down your Note at the bank from \$75,000 to \$58,000 during the year. That used \$17,000 in cash. And you paid yourself a dividend of \$15,000. None of these three items will appear on the income statement because they are not revenues or expenses, but each of them affects cash."

So here's the recap of what happened to cash for the year:

Cash balance, Dec. 31, 2015	\$38,000
Increase for net income 2016	36,000
Decrease for equipment purchased	(12,000)
Decrease for Note payment	(17,000)
Decrease for Dividends paid 2016	<u>(15,000)</u>
Cash Balance, Dec. 31, 2016	\$30,000 - a decrease of \$8,000

Written Communication

In your e-mail back to this potential new client, you would want to list the four basic types of business organizations available to most small businesses today. These were outlined in your chapter, and they are sole proprietor, partnership, corporation and limited liability company. Of course, you would want to elaborate on the tax advantages and disadvantages of each of these types of organizations (that discussion is beyond the scope of our text) as well as talk briefly about the legal aspects of each of them. But remember, we are not attorneys. Leave the high-level discussions about legal liability to them.

However, because we are accountants, we can certainly tell this potential new client about the benefits of having an accountant as part of the team of professionals that is necessary to help achieve success in today's business climate. Accountants "keep score". They help ensure that the business is running profitably. They help to determine what the true cost is for one unit of the product that you are selling. They prepare financial statements for the stakeholders of the business. They speak the language of business.