Chapter 1

Accounting and the Business Environment

√ Quick Check

Answers:

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

Explanations:

4. c. Liabilities ($117) = Assets ($381) – Owner's Equity ($264)

8. a. Net income ($15,000) = Revenues ($50,000) – Expenses ($35,000)

√ Short Exercises

(5 min.) S 1-1

***Revenues* increase owner's equity by delivering goods or services to customers.**

***Expenses* decrease owner's equity by using up assets or increasing liabilities in order to deliver goods or services to customers.**

(5 min.) S 1-2

***Assets* are the economic resources of a business that are expected to benefit the business in the future.**

***Liabilities* are debts payable to outsiders called creditors.**

***Owner's equity* is the owner's claim to the assets of the business.**

The relationship among assets, liabilities, and owner's equity is given by the accounting equation:

ASSETS = LIABILITIES + OWNER'S EQUITY

(5 min.) **S 1-3**

1. **Keep your business's accounting records *separate* from your personal records so that you can evaluate the success or failure of the business. If your personal records get mixed up with your business's accounting records, it may become difficult to tell how well the business is performing (entity concept).**

2. **Record assets and liabilities at actual historical cost (cost principle).**

(5 min.) **S 1-4**

Hunter is violating the *going-concern concept*.

Hunter should account for assets at their actual *cost*, as determined by the *cost principle*.

(5 min.) S 1-5

Assets	=	Liabilities	+	Owner's Equity
Cash		Note Payable		Owner, Capital
$\underbrace{\$2{,}000 + \$1{,}000}_{\$3{,}000}$	=	$1,000	+	$2,000

(5-10 min.) S 1-6

Assets	=	Liabilities	+	Owner's Equity
Cash + Furniture	=	Accounts Payable	+	Craven, Capital
$2,000 + $8,000	=	$6,000	+	$4,000

Based on the accounting equation, Craven has $4,000 equity in the business.

(5 min.) S 1-7

Jackson recorded no liability for the purchase of land because he paid for the land with cash. Jackson has no debt—no liability—to make a future payment for the land.

(5 min.) S 1-8

Cash:	**$ -0-**
Total assets (accounts receivable):	**$3,000**

(5 min.) S 1-9

Polson recorded no revenue when he collected cash on account because he recorded the revenue one month earlier, when he earned it.

(5 min.) S 1-10

	Assets	=	Liabilities + Owner's Equity	
	Cash		**Owner, Capital**	
(a)	**$300**	**=**	**$300**	**Revenue**
(b)	**− $200**	**=**	**− $200**	**Expense**

(10 min.) S 1-11

Cookie Lapp Travel Design			
Balance Sheet			
April 21, 2008			
ASSETS		LIABILITIES	
Cash	$11,900	Accounts payable	$ 200
Accounts receivable	3,000		
Office supplies	500	OWNER'S EQUITY	
Land	20,000	Cookie Lapp, capital	35,200
		Total liabilities and	
Total assets	$35,400	owner's equity	$35,400

(5 min.) S 1-12

Total revenues – Total expenses = Net income (or Net loss)

(5-10 min.) S 1-13

Advanced Automotive		
Income Statement		
Year Ended December 31, 2008		
Revenue:		
Service revenue		$90,000
Expenses:		
Salary expense	$42,000	
Rent expense	13,000	
Insurance expense	4,000	
Supplies expense	1,000	
Total expenses		60,000
Net income		$30,000

√ Exercises

(10 min.) E 1-14

To decide on an investment, you should use ebay's *financial statements*. You will use ebay's *net income* (or *net loss*) information. And you hope ebay's accountants follow the *reliability principle* because you must rely on the company's data to make your investment decision.

Student responses may vary.

(15-20 min.) E 1-15

The *balance sheet* reports the assets, liabilities, and owner's equity of the entity at a particular date. The *assets* are the resources the business has to work with. *Liabilities* are debts owed to creditors. *Owner's equity* is the portion of the business assets owned outright by the owner.

The *income statement* reports the revenues and the expenses of a particular entity for a period such as a month or a year. Total *revenues* minus total *expenses* equals *net income* (or *net loss*).

Student responses may vary.

(5-10 min.) E 1-16

a. Purchase of asset for cash
   Sale of asset for cash
   Collection of account receivable
b. Withdrawal by owner
   Pay an expense
c. Pay a liability
d. Investment by owner
   Revenue transaction
e. Purchase of asset on account
   Borrow money

Wording may vary.

(10-15 min.) E 1-17

a. Increased assets (cash)
b. No effect on total assets. Increase in land offsets the decrease in cash.
c. Decreased assets (cash)
d. Increased assets (equipment)
e. Increased assets (accounts receivable)
f. Decreased assets (cash)
g. No effect on total assets. Increase in cash offsets the decrease in accounts receivable.
h. Increased assets (cash)

(5-10 min.) E 1-18

	Assets	=	Liabilities	+	Owner's Equity
Pep Boys	*$ 81,000*		$60,000		$21,000
Eddie Bauer	72,000		*32,000*		40,000
Benbrook Exxon	100,000		79,000		*21,000*

(10 min.) E 1-19

	Total Assets	–	Total Liabilities	=	Owner's Equity
Beginning…..	$22,000	–	$10,000	=	$12,000
Req. 1					
Increase during the year…..					4,000
Ending…..	$30,000	–	$14,000	=	$16,000

Req. 2

Possible reasons for the increase in owner's equity:

1. Net income.
2. The owner made an additional investment in the company.

(10-20 min.) **E 1-20**

We find the solution by preparing the statement of owner's equity, plugging in the known amounts, and determining the net income or net loss (X). For situation 1:

$$
\begin{aligned}
\$50{,}000 + \$2{,}000 + X &= \$65{,}000 \\
X &= \$65{,}000 - \$50{,}000 - \$2{,}000 \\
X &= \$13{,}000
\end{aligned}
$$

A-1 Rentals Statement of Owner's Equity Month Ended June 30, 2009			
	1	2	3
Capital, May 31, 2009			
($150,000 – $100,000)	$50,000	$50,000	$50,000
Add: Investments by owner	2,000	-0-	6,000
Net income for the month	13,000	20,000	19,000
	65,000	70,000	75,000
Less: Withdrawals by owner	(-0-)	(5,000)	(10,000)
Capital, June 30, 2009			
($195,000 – $130,000)	$65,000	$65,000	$65,000

2: $50,000 + 0 + X – $5,000 = $65,000; X = $20,000

3: $50,000 + $6,000 + X – $10,000 = $65,000; X = $19,000

(10-20 min.) E 1-21

a. Increase asset (Cash)
   Increase owner's equity (Capital)

b. Increase asset (Accounts Receivable)
   Increase owner's equity (Rent Revenue)

c. Increase asset (Office Furniture)
   Increase liability (Accounts Payable)

d. Increase asset (Cash)
   Decrease asset (Accounts Receivable)

e. Decrease asset (Cash)
   Decrease liability (Accounts Payable)

f. Increase asset (Cash)
   Decrease asset (Land)

g. Increase asset (Cash)
   Increase owner's equity (Rent Revenue)

h. Decrease asset (Cash)
   Decrease owner's equity (Rent Expense)

i. Increase asset (Supplies)
   Decrease asset (Cash)

(10-20 min.) E 1-22

Analysis of Transactions

	ASSETS			= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH +	MEDICAL SUPPLIES +	LAND =	ACCOUNTS PAYABLE +	M. LANGE, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
July 6	45,000				45,000	Owner investment
Bal.	45,000				45,000	
9	(35,000)		35,000			
Bal.	10,000		35,000		45,000	
12		2,000		2,000		
Bal.	10,000	2,000	35,000	2,000	45,000	
15	Not a transaction of the business					
15-31	7,000				7,000	Service revenue
Bal.	17,000	2,000	35,000	2,000	52,000	
15-31	(1,700)				(1,700)	Salary expense
	(1,000)				(1,000)	Rent expense
	(300)				(300)	Utilities expense
Bal.	14,000	2,000	35,000	2,000	49,000	
28	500	(500)				
Bal.	14,500	1,500	35,000	2,000	49,000	
31	(1,500)			(1,500)		
Bal.	13,000	1,500	35,000	500	49,000	

$\underbrace{\text{Assets}}_{49,500}$ $\underbrace{\text{Liabilities + Owner's Equity}}_{49,500}$

(10-15 min.) E 1-23

Req. 1

1. Investment by owner
2. Earned revenue on account
3. Purchased equipment on account
4. Collected cash on account
5. Cash purchase of equipment
6. Paid on account
7. Earned revenue and received cash
8. Paid cash for expenses

Req. 2

Revenues ($2,400 + $900)……………………..	$3,300
Less: Expenses…………………………………	(2,000)
Net income……………………………………..	$1,300

(10-20 min.) E 1-24

Req. 1

Allen Samuel Road Service			
Balance Sheet			
November 30, 2009			
ASSETS		LIABILITIES	
Cash	$ 2,000	Accounts payable	$ 3,500
Accounts receivable	6,000	Note payable	5,000
Supplies	500	Total liabilities	8,500
Equipment	15,500	OWNER'S EQUITY	
		Allen Samuel, capital	15,500*
		Total liabilities and	
Total assets	$24,000	owner's equity	$24,000

* Total assets	–	Total liabilities	=	Capital
$24,000	–	$8,500	=	$15,500

Req. 2

The balance sheet reports *financial position*.

The income statement reports *operating results*.

(15-25 min.) E 1-25

Req. 1

Ciliotta Design Studio Income Statement Year Ended December 31, 2006		
Revenue:		
Service revenue		**$158,100**
Expenses:		
Salary expense	**$60,000**	
Rent expense	**24,000**	
Utilities expense	**6,800**	
Supplies expense	**4,000**	
Property tax expense	**1,200**	
Total expenses		**96,000**
Net income		**$ 62,100**

Results of operations for 2006: Net income of $62,100

Req. 2

First we prepare the statement of owner's equity for the year ended December 31, 2006, as follows:

Ciliotta Design Studio	
Statement of Owner's Equity	
Year Ended December 31, 2006	
Capital, beginning of year	$ -0-
Add: Investment by owner	15,000
Net income for the year (*Req. 1*)	62,100
	77,100
Less: Withdrawals by owner	(50,000)
Capital, end of year	$ 27,100

To solve for proprietor withdrawal (X), we can put the data in equation form:

$$
\begin{aligned}
\$0 + \$15{,}000 + \$62{,}100 - X &= \$27{,}100 \\
X &= \$62{,}100 + \$15{,}000 - \$27{,}100 \\
X &= \$50{,}000
\end{aligned}
$$

(10-15 min.) E 1-26

		(Billions) 20X4
1.	Revenues	$32
	Expenses	29
	Net income	$ 3

(Billions)

2.	Total assets	–	Total liabilities	=	Owner's equity
Year end 20X3	$30	–	$17	=	$13
Increase during 20X4				→	3
Year end 20X4	$33	–	$17	=	$16

Performance evaluation for 20X4: Good, because 20X4 was a profitable year. As a result, owners' equity increased.

(30-40 min.) E 1-27

Computed amounts are shown in $\boxed{\text{boxes}}$.

	Jupiter
Beginning:	
Assets	$ 50,000
– Liabilities	(20,000)
= Owner's equity	$ 30,000
Ending:	
Assets	$ 70,000
– Liabilities	(30,000)
= Owner's equity	$ 40,000
Statement of Owner's Equity:	
Beginning owner's equity	$ 30,000
+ Investments by owner	0
+ Net income	Y[1] $\boxed{= \$55,000}$
– Withdrawals by owner	(45,000)
= Ending owner's equity	$ 40,000
Income Statement	
Revenues	$ 230,000
– Expenses	($\boxed{175,000}$)[2]
= Net income	$ $\boxed{55,000}$

[1]Net income (Y) = $55,000

[2]Revenues – expenses
= net income
$230,000 – expenses
= $55,000
Expenses = $175,000

Jupiter earned net income of $55,000 for the year.

√ Problems

Group A

The solutions to these problems begin on the next page.

(20-30 min.) P 1-28A

Req. 1

Abraham Woody, CPA

Analysis of Transactions

DATE	ASSETS: CASH +	ACCOUNTS RECEIVABLE	+ SUPPLIES +	OFFICE FURNITURE	= LIABILITIES + OWNER'S EQUITY: ACCOUNTS PAYABLE +	ABRAHAM WOODY, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Feb. 4*							
5	60,000					60,000	Owner investment
Bal.	60,000					60,000	
6	(300)		300				
Bal.	59,700		300			60,000	
7				7,000	7,000		
Bal.	59,700		300	7,000	7,000	60,000	
10*							
11*							
12*							
18		5,000				5,000	Service revenue
Bal.	59,700	5,000	300	7,000	7,000	65,000	
25	(1,000)					(1,000)	Rent expense
Bal.	58,700	5,000	300	7,000	7,000	64,000	
28	(3,000)					(3,000)	Withdrawal
Bal.	55,700	5,000	300	7,000	7,000	61,000	

$\underbrace{\text{Assets}}_{68,000}$ $\underbrace{\text{Liabilities + Owner's Equity}}_{68,000}$

*Not a transaction of the business

Req. 2

a.	**Total assets**	**=**	**$68,000**
b.	**Total liabilities**	**=**	**$ 7,000**
c.	**Total owner's equity**	**=**	**$61,000**
d.	**Net income for February**	**=**	**$ 4,000 ($5,000 – $1,000)**

(60-75 min.) P 1-29A

Req. 1

Best Foot Forward

Analysis of Transactions

ASSETS					= LIABILITIES	+ OWNER'S EQUITY	
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	LAND =	ACCOUNTS PAYABLE +	MARILYN CRONE, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Bal.	2,200	1,500		12,000	8,000	7,700	
a)	20,000					20,000	Owner investment
Bal.	22,200	1,500		12,000	8,000	27,700	
b)	700					700	Service revenue
Bal.	22,900	1,500		12,000	8,000	28,400	
c)	(8,000)				(8,000)		
Bal.	14,900	1,500		12,000	-0-	28,400	
d)			1,000		1,000		
Bal.	14,900	1,500	1,000	12,000	1,000	28,400	
e)	1,000	(1,000)					
Bal.	15,900	500	1,000	12,000	1,000	28,400	
f)	1,000					1,000	Owner investment
Bal.	16,900	500	1,000	12,000	1,000	29,400	
g)		3,000				3,000	Service revenue
Bal.	16,900	3,500	1,000	12,000	1,000	32,400	
h)	(900)					(900)	Rent expense
	(100)					(100)	Advertising expense
Bal.	15,900	3,500	1,000	12,000	1,000	31,400	
i)	100		(100)				
Bal.	16,000	3,500	900	12,000	1,000	31,400	
j)	(1,500)					(1,500)	Owner withdrawal
Balance	14,500	3,500	900	12,000	1,000	29,900	

30,900 30,900

Req. 2

Best Foot Forward		
Income Statement		
Month Ended September 30, 2007		
Revenues:		
Service revenue ($700 + $3,000)		$3,700
Expenses:		
Rent expense	$900	
Advertising expense	100	
Total expenses		1,000
Net income		$2,700

Req. 3

Best Foot Forward	
Statement of Owner's Equity	
Month Ended September 30, 2007	
Marilyn Crone, capital, August 31, 2007	$ 7,700
Add: Investments by owner ($20,000 + $1,000)	21,000
Net income for the month	2,700
	31,400
Less: Withdrawals by owner	(1,500)
Marilyn Crone, capital, September 30, 2007	$29,900

Req. 4

Best Foot Forward			
Balance Sheet			
September 30, 2007			
ASSETS		**LIABILITIES**	
Cash	$14,500	Accounts payable	$ 1,000
Accounts receivable	3,500		
Supplies	900	**OWNER'S EQUITY**	
Land	12,000	Marilyn Crone, capital	29,900
		Total liabilities and	
Total assets	$30,900	owner's equity	$30,900

(20-25 min.) **P 1-30A**

Carolina Sports Consulting

Date		***Type of Transaction***
June	**4**	**Investment of $9,000 by owner**
		Increase Cash, $9,000
		Increase Owner's Equity (Capital), $9,000
	9	**Cash purchase of land, $7,000**
		Decrease Cash, $7,000
		Increase Land, $7,000
	13	**Purchase of supplies on account, $2,000**
		Increase Supplies, $2,000
		Increase Accounts Payable, $2,000
	16	**Payment of $1,000 cash on account payable**
		Decrease Accounts Payable, $1,000
		Decrease Cash, $1,000
	19	**Collection of $2,000 cash from customer on account receivable**
		Increase Cash, $2,000
		Decrease Accounts Receivable, $2,000
	22	**Investment of $8,000 cash by owner**
		Increase Cash, $8,000
		Increase Owner's Equity (Capital), $8,000
	25	**Payment of $3,000 cash on account payable**
		Decrease Accounts Payable, $3,000
		Decrease Cash, $3,000
	27	**Cash purchase of supplies, $1,000**
		Decrease Cash, $1,000
		Increase Supplies, $1,000
	30	**Withdrawal of $8,000 cash by owner**
		Decrease Cash, $8,000
		Decrease Owner's Equity (Capital), $8,000

(20-30 min.) P 1-31A

a.

Accent Photography		
Income Statement		
Year Ended December 31, 2007		
Service revenue		$71,000
Salary expense	$14,000	
Advertising expense	4,000	
Insurance expense	2,000	
Total expenses		20,000
Net income		$51,000

b.

Accent Photography	
Statement of Owner's Equity	
Year Ended December 31, 2007	
M.A. Thomas, capital, December 31, 2006	$ 56,000
Add: Net income	51,000
	107,000
Less: Withdrawals	(46,000)
M.A. Thomas, capital, December 31, 2007	$ 61,000

c.

Accent Photography			
Balance Sheet			
December 31, 2007			
ASSETS		LIABILITIES	
Cash	$14,000	Accounts payable	$ 1,000
Accounts receivable	3,000	Note payable	35,000
Equipment	80,000	Total liabilities	36,000
		OWNER'S EQUITY	
		M.A. Thomas, capital	61,000
		Total liabilities and	
Total assets	$97,000	owner's equity	$97,000

(45-60 min.) P 1-32A

Req. 1

Gotcha Covered Security Systems		
Income Statement		
Year Ended December 31, 2007		
Revenues:		
Service revenue		$189,000
Expenses:		
Salary expense	$63,000	
Rent expense	23,000	
Advertising expense	13,000	
Interest expense	9,000	
Property tax expense	4,000	
Insurance expense	2,000	
Total expenses		114,000
Net income		$ 75,000

Req. 2

Gotcha Covered Security Systems	
Statement of Owner's Equity	
Year Ended December 31, 2007	
Andrew Stryker, capital, December 31, 2006	$150,000
Add: Net income for the year	75,000
	225,000
Less: Withdrawals by owner	(40,000)
Andrew Stryker, capital, December 31, 2007	$185,000

Req. 3

Gotcha Covered Security Systems			
Balance Sheet			
December 31, 2007			
ASSETS		LIABILITIES	
Cash	$ 14,000	Accounts payable	$ 19,000
Accounts receivable	12,000	Salary payable	1,000
Supplies	3,000	Note payable	35,000
Equipment	20,000	Total liabilities	55,000
Building	131,000	OWNER'S EQUITY	
Land	60,000	Andrew Stryker, capital	185,000*
		Total liabilities and	
Total assets	$240,000	owner's equity	$240,000

____

* Total assets – Total liabilities = Capital
$240,000 – $55,000 = $185,000

Req. 4

a. Result of operations: Net income of $75,000

b. Total economic resources (total assets)………… $240,000
– Total amount owed (total liabilities)………………. (55,000)
= Owner's equity…………………………………….... $185,000

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

Req. 1

Jan Featherston, Realtor			
Balance Sheet			
November 30, 2006			
ASSETS		**LIABILITIES**	
Cash	$ 7,000	Accounts payable	$ 5,000
Office supplies	1,000	Note payable	55,000
Franchise	20,000	Total liabilities	60,000
Furniture	14,000	**OWNER'S EQUITY**	
Land	80,000	Jan Featherston, capital	62,000*
		Total liabilities and	
Total assets	$122,000	owner's equity	$122,000

* Total assets	–	Total liabilities	=	Capital
$122,000	–	$60,000	=	$62,000

Req. 2

Personal items not reported on the balance sheet of the business:

c. Personal residence ($150,000) and mortgage payable ($60,000)
d. Personal cash ($4,000)
e. Personal account payable ($3,000)

(20-25 min.) P 1-34A

Lone Star Landscaping			
Balance Sheet			
July 31, 2008			
ASSETS		**LIABILITIES**	
Cash	$ 4,000	Accounts payable	$ 8,000
Accounts receivable	23,000	Note payable	36,000
Office supplies	1,000	Total liabilities	44,000
Office furniture	16,000	**OWNER'S EQUITY**	
Land	50,000	Lynn Woodward, Capital	50,000*
		Total liabilities and	
Total assets	$94,000	owner's equity	$94,000

____

* Total assets……………………….. $94,000

– Total liabilities…………………… (44,000)

= Owner's equity (capital)……….. $50,000

√ Problems

Group B

The solutions to these problems begin on the next page.

(20-30 min.) P 1-35B

Req. 1

Amy Fisk, Attorney

Analysis of Transactions

	ASSETS				= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH +	ACCOUNTS RECEIVABE +	SUPPLIES +	OFFICE FURNITURE =	ACCOUNTS PAYABLE +	AMY FISK, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
July 1*							
2*							
3*							
5	100,000					100,000	Owner investment
Bal.	100,000					100,000	
6*							
7	(500)		500				
Bal.	99,500		500			100,000	
9				9,500	9,500		
Bal.	99,500		500	9,500	9,500	100,000	
23		3,000				3,000	Service revenue
Bal.	99,500	3,000	500	9,500	9,500	103,000	
30	(1,500)					(1,500)	Rent expense
Bal.	98,000	3,000	500	9,500	9,500	101,500	
31	(5,000)					(5,000)	Withdrawal
Bal.	93,000	3,000	500	9,500	9,500	96,500	

106,000 106,000

*Not a transaction of the business.

Req. 2

a.	**Total assets**	**=**	**$106,000**
b.	**Total liabilities**	**=**	**$ 9,500**
c.	**Total owner's equity**	**=**	**$ 96,500**
d.	**Net income for July**	**=**	**$ 1,500 ($3,000 – $1,500)**

(60-75 min.) P 1-36B

Req. 1

Analysis of Transactions — Grayson Architecture

	ASSETS				= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	LAND =	ACCOUNTS PAYABLE +	BOB GRAYSON, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Bal.	1,720	3,240		24,100	5,400	23,660	
a)	12,000					12,000	Owner investment
Bal.	13,720	3,240		24,100	5,400	35,660	
b)	(5,400)				(5,400)		
Bal.	8,320	3,240		24,100	-0-	35,660	
c)	1,100					1,100	Service revenue
Bal.	9,420	3,240		24,100		36,760	
d)	750	(750)					
Bal.	10,170	2,490		24,100		36,760	
e)			720		720		
Bal.	10,170	2,490	720	24,100	720	36,760	
f)		5,000				5,000	Service revenue
Bal.	10,170	7,490	720	24,100	720	41,760	
g)	1,700					1,700	Owner investment
Bal.	11,870	7,490	720	24,100	720	43,460	
h)	(1,200)					(1,200)	Rent expense
	(600)					(600)	Advertising expense
Bal.	10,070	7,490	720	24,100	720	41,660	
i)	80		(80)				
Bal.	10,150	7,490	640	24,100	720	41,660	
j)	(2,400)					(2,400)	Owner withdrawal
Bal.	7,750	7,490	640	24,100	720	39,260	

$\underbrace{\text{Assets}}_{39{,}980}$ $\qquad$ $\underbrace{\text{Liabilities + Owner's Equity}}_{39{,}980}$

Req. 2

Grayson Architecture		
Income Statement		
Month Ended May 31, 2007		
Revenues:		
Service revenue ($1,100 + $5,000)		$6,100
Expenses:		
Rent expense	$1,200	
Advertising expense	600	
Total expenses		1,800
Net income		$4,300

Req. 3

Grayson Architecture	
Statement of Owner's Equity	
Month Ended May 31, 2007	
Bob Grayson, capital, April 30, 2007	$23,660
Add: Investments by owner ($12,000 + $1,700)	13,700
Net income for the month	4,300
	41,660
Less: Withdrawals by owner	(2,400)
Bob Grayson, capital, May 31, 2007	$39,260

Req. 4

Grayson Architecture			
Balance Sheet			
May 31, 2007			
ASSETS		**LIABILITIES**	
Cash	$ 7,750	Accounts payable	$ 720
Accounts receivable	7,490		
Supplies	640	**OWNER'S EQUITY**	
Land	24,100	Bob Grayson, capital	39,260
		Total liabilities and	
Total assets	$39,980	owner's equity	$39,980

(20-25 min.) P 1-37B

Pellegrini Electronics

Date		*Type of Transaction*
May	7	Collection of $4,000 cash from customer on account receivable Increase Cash, $4,000 Decrease Accounts Receivable, $4,000
	12	Payment of $2,000 cash on account payable Decrease Cash, $2,000 Decrease Accounts Payable, $2,000
	17	Purchase of supplies on account, $300 Increase Supplies, $300 Increase Accounts Payable, $300
	19	Investment of $1,000 by owner Increase Cash, $1,000 Increase Owner's Equity (Capital), $1,000
	20	Payment of $1,100 cash on account payable Decrease Cash, $1,100 Decrease Accounts Payable, $1,100
	22	Cash sale of land, $6,000 Increase Cash, $6,000 Decrease Land, $6,000
	25	Sale of $700 supplies on account receivable Increase Accounts Receivable, $700 Decrease Supplies, $700
	26	Cash purchase of supplies, $600 Decrease Cash, $600 Increase Supplies, $600
	30	Withdrawal of cash by owner, $5,100 Decrease Cash, $5,100 Decrease Owner's Equity (Capital), $5,100

(20-30 min.) P 1-38B

a.

Studio Gallery		
Income Statement		
Year Ended December 31, 2009		
Service revenue		$74,000
Salary expense	$22,000	
Rent expense	7,000	
Advertising expense	4,000	
Total expenses		33,000
Net income		$41,000

b.

Studio Gallery	
Statement of Owner's Equity	
Year Ended December 31, 2009	
Mike Magid, capital, December 31, 2008	$50,000
Add: Net income	41,000
	91,000
Less: Withdrawals	(16,000)
Mike Magid, capital, December 31, 2009	$75,000

c.

Studio Gallery			
Balance Sheet			
December 31, 2009			
ASSETS		**LIABILITIES**	
Cash	$20,000	Accounts payable	$ 6,000
Accounts receivable	8,000	Note payable	12,000
Equipment	65,000	Total liabilities	18,000
		OWNER'S EQUITY	
		Mike Magid, capital	75,000
		Total liabilities and	
Total assets	$93,000	owner's equity	$93,000

(45-60 min.) P 1-39B

Req. 1

Town & Country Realty		
Income Statement		
Year Ended December 31, 2007		
Revenue:		
Service revenue		$100,000
Expenses:		
Salary expense	$38,000	
Rent expense	14,000	
Interest expense	4,000	
Utilities expense	3,000	
Property tax expense	2,000	
Total expenses		61,000
Net income		$ 39,000

Req. 2

Town & Country Realty	
Statement of Owner's Equity	
Year Ended December 31, 2007	
Kevin Kobelsky, capital, December 31, 2006	$43,000
Add: Net income for the year	39,000
	82,000
Less: Withdrawals by owner	(32,000)
Kevin Kobelsky, capital, December 31, 2007	$50,000

Req. 3

Town & Country Realty			
Balance Sheet			
December 31, 2007			
ASSETS		LIABILITIES	
Cash	$ 7,000	Accounts payable	$12,000
Accounts receivable	3,000	Interest payable	1,000
Supplies	7,000	Note payable	31,000
Equipment	13,000	Total liabilities	44,000
Building	56,000	OWNER'S EQUITY	
Land	8,000	Kevin Kobelsky, capital	50,000*
		Total liabilities and	
Total assets	$94,000	owner's equity	$94,000

* Total assets − Total liabilities = Capital
$94,000 − $44,000 = $50,000

Req. 4

a. Result of operations: Net income of $39,000

b. The owner increased the company's capital as net income ($39,000) exceeded withdrawals by the owner ($32,000).
This would make it easier to borrow because the business's equity is growing.

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

Req. 1

Kinko's of Santa Rosa			
Balance Sheet			
March 31, 2006			
ASSETS		LIABILITIES	
Cash	$ 17,000	Accounts payable	$ 15,000
Office supplies	1,000	Note payable	34,000
Franchise	15,000	Total liabilities	49,000
Furniture	22,000	OWNER'S EQUITY	
Land	60,000	Martha Agee, capital	66,000*
		Total liabilities and	
Total assets	$115,000	owner's equity	$115,000

* Total assets	−	Total liabilities	=	Capital
$115,000	−	$49,000	=	$66,000

Req. 2

Personal items not reported on the balance sheet of the business:

a. Personal cash ($3,000)
e. Personal residence ($105,000) and mortgage payable ($60,000)
f. Personal account payable ($950)

(20-25 min.) P 1-41B

Dave Lundy Tax Service			
Balance Sheet			
October 31, 2007			
ASSETS		**LIABILITIES**	
Cash	$ 5,400	Accounts payable	$ 2,300
Accounts receivable	2,600	Note payable	21,000
Notes receivable	3,000	Total liabilities	23,300
Office supplies	800		
Office furniture	6,000	**OWNER'S EQUITY**	
Land	31,500	Dave Lundy, capital	26,000*
		Total liabilities and	
Total assets	$49,300	owner's equity	$49,300

*	Total assets……………………….	$49,300
−	Total liabilities……………………	(23,300)
=	Owner's equity (capital)………..	$26,000

√ # Continuing Problem

(60-75 min.) P 1-42

Req. 1

Redmon Consulting

Analysis of Transactions

	ASSETS					= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	EQUIP-MENT +	FURNI-TURE	= ACCOUNTS PAYABLE +	CARL REDMON, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Dec 2	**10,000**						**10,000**	**Owner investment**
Bal.	**10,000**						**10,000**	
2	**−500**						**–500**	**Rent expense**
Bal.	**9,500**						**9,500**	
3	**−2,000**			**+2,000**				
Bal.	**7,500**			**2,000**			**9,500**	
4					**+3,600**	**+3,600**		
Bal.	**7,500**			**2,000**	**3,600**	**3,600**	**9,500**	
5			**+300**			**+300**		
Bal.	**7,500**		**300**	**2,000**	**3,600**	**3,900**	**9,500**	
9		**+1,700**					**+1,700**	**Service revenue**
Bal.	**7,500**	**1,700**	**300**	**2,000**	**3,600**	**3,900**	**11,200**	
12	**–200**						**–200**	**Utilities expense**
Bal.	**7,300**	**1,700**	**300**	**2,000**	**3,600**	**3,900**	**11,000**	
18	**+800**						**+800**	**Service revenue**
Bal.	**8,100**	**1,700**	**300**	**2,000**	**3,600**	**3,900**	**11,800**	

$$\underbrace{\qquad\qquad\qquad\qquad}_{15,700} \qquad \underbrace{\qquad\qquad}_{15,700}$$

Req. 2

Redmon Consulting		
Income Statement		
Month Ended December 31, 2007		
Revenues:		
Service revenue ($1,700 + $800)		$2,500
Expenses:		
Rent expense	$500	
Utilities expense	200	
Total expenses		700
Net income		$1,800

Req. 3

Redmon Consulting	
Statement of Owner's Equity	
Month Ended December 31, 2007	
Carl Redmon, capital, December 1, 2007	$ -0-
Add: Investment by owner	10,000
Net income for the month	1,800
	11,800
Less: Withdrawals by owner	(-0-)
Carl Redmon, capital, December 31, 2007	$11,800

Req. 4

Redmon Consulting			
Balance Sheet			
December 31, 2007			
ASSETS		LIABILITIES	
Cash	$ 8,100	Accounts payable	$ 3,900
Accounts receivable	1,700		
Supplies	300		
Equipment	2,000	OWNER'S EQUITY	
Furniture	3,600	Carl Redmon, capital	11,800
		Total liabilities and	
Total assets	$15,700	owner's equity	$15,700

√ Decision Cases

(15-20 min.) Decision Case 1

Larger amount denoted by check mark (√)

Req. 1

	Sherman	DeFilippo
Total assets……	**$12,000**	**$13,000 √** **($7000 + $6,000)**

Req. 2

Total liabilities…	**$ 4,000** **($12,000 – $8,000)**	**$ 7,000 √**

Req. 3

Owner capital….	**$ 8,000 √**	**$ 6,000**

Req. 4

Total revenue….	**$35,000**	**$53,000 √** **($44,000 + $9,000)**

Req. 5

Net income……..	**$13,000 √** **($35,000 – $22,000)**	**$9,000**

Req. 6

There's no single correct answer to this question. Possible answers include the following:

a. Which business is more profitable? A business must be profitable to survive.

b. Which business owes more to creditors? Big debts make a business risky.

c. Which business has more owner investment? More owner's equity makes a business less risky.

Req. 7

Sherman Lawn Service looks better financially because:

a. Sherman earned more net income on less total revenue.

b. Sherman owes less and has more owner capital. Sherman has less risk.

(20-30 min.) Decision Case 2

Req. 1

The banker would *not* congratulate the Guerreras for their net income because they have not measured net income properly. In fact, they have *no net income* at all. Their accounting errors include the following:

1. **The amount of cash in the bank does *not* measure net income. The cash balance only shows how much cash is available for use in the business.**

2. **Neither an investment by an owner nor a bank loan creates a revenue. A business earns revenue by providing goods or services to customers. The Tres Amigos B & B hasn't even opened, so there is no revenue yet. And a bank loan increases liabilities, not revenue.**

3. **None of the items they list as expenses is really an expense. The house and its renovation, furniture, kitchen equipment, and computer are all assets because these items provide future benefit to the business. Expenses result from using assets or creating liabilities in order to earn revenue. The Tres Amigos B & B hasn't had any expenses yet.**

4. **The business will earn service revenue after it opens—from renting rooms. Expenses will result from using up assets and creating liabilities in the process of earning the revenue.**

Req. 2

Tres Amigos Bed & Breakfast			
Balance Sheet			
June 30, 2007			
ASSETS		**LIABILITIES**	
Cash	$ 38,000	Bank loan payable	$100,000
Computer	2,000		
Kitchen equipment	10,000	**OWNER'S EQUITY**	
Furniture	20,000	Owner, capital	100,000
Building ($80,000 + $50,000)	130,000	Total liabilities and	
Total assets	$200,000	owner's equity	$200,000

√ Ethical Issues

Ethical Issue 1

Req. 1

The fundamental ethical issue in this situation is letting the financial statements tell the truth about the company's performance. Performance was bad, and the financial statements should present a bad picture of the company.

Req. 2

The proposal to transfer personal assets *temporarily* to the company violates the *entity concept*. The president implies that these assets can be transferred back to him, and the "investment" appears designed to make the company's financial position appear better than it is. This is dishonest and unethical.

The request to "shave expenses" violates the *reliability principle*. The president wants the accountant to understate expenses in order to convert a loss into a reported income. This is dishonest and unethical.

Ethical Issue 2

1. **The chief financial officer (CFO) of Philip Morris would be torn between telling the truth about the reason for the payments versus trying to downplay the negative effects in the company's annual report. The ethical course of action for the CFO is to tell the truth.**

2. **Negative consequences of *not* telling the truth include Philip Morris's losing its reputation for honesty in its financial reports. Investors might stop investing in Philip Morris if they suspect that the company's financial statements do not tell the truth.**

   Negative consequences of telling the truth include painting so bleak a picture of the effects of smoking that investors will view Philip Morris as too risky and stop buying the company's stock.

   It would be worse to lose a reputation for honesty.

√ Financial Statement Case

(30-40 min.)

(All amounts in millions of dollars)

Req. 1

Cash (and cash equivalents)............................... $1,013

Req. 2

	December 31, 2005	December 31, 2004
Total assets………....	$3,696	$3,248

Req. 3

Assets	=	Liabilities	+	Stockholders' Equity (same as Owners' Equity)
$3,696	=	$3,450	−	$246

Req. 4

	2005	2004
Net sales…………….	$8,490	$6,921

Increase of $1,569

Req. 5

Net income………….	$359	$588

2005 was worse than 2004. Net income was down in 2005.

√ Team Projects

Project 1

Suggested Answers

***Req. 1* - Factors to consider in establishing the business:**

1. **How to organize the business—as a proprietorship, a partnership, or a corporation (you have decided to organize as a proprietorship)**

2. **Where to locate the business**

3. **How much of your own time and money to commit to the business**

4. **How to finance the business—with your own personal money or through borrowing**

5. **How many people to employ for the business**

6. **How to measure the business's success or failure; how to account for the assets, liabilities, and operations of the business**

7. **What type of animals to board (dogs only, dogs and cats, birds, reptiles, and so on)**

8. **Whether to sell pet foods, toys, and other supplies**

9. **Whether to offer obedience lessons and other pet training**

10. **How to advertise the business (newspapers, radio, posters)**

Student answers may vary.

Req. 2 **(Transactions)**

1. **Invest money to start the business**
2. **Purchase land and a building**
3. **Renovate the building to make it suitable for a kennel**
4. **Purchase pet food and other supplies that will be needed to operate a kennel**
5. **Advertise the business**
6. **Earn service revenue by keeping pets**
7. **Pay utility bills**
8. **Use pet food and other supplies to take care of the pets**
9. **Pay the wages of an employee**
10. **Borrow money if necessary**
11. **Withdraw cash for personal living costs**

Student answers may vary.

Suggested Answers

Req. 3

Quail Creek Pet Kennel		
Income Statement		
Month Ended January 31, 20XX		
Revenue:		
Service revenue		$10,000
Expenses:*		
Wage expense	$2,000	
Supplies expense	400	
Advertising expense	300	
Utilities expense	100	2,800
Net income		$ 7,200

*Students may also include depreciation expense on the building.

Quail Creek Pet Kennel	
Statement of Owner's Equity	
Month Ended January 31, 20XX	
Your name, capital, January 1, 20XX	$ 0
Add: Investment by owner	30,000
Net income for the month	7,200
	37,200
Less: Withdrawal by owner	(2,000)
Your name, capital, January 31, 20XX	$35,200

Suggested Answers

***Req. 3* – continued**

Quail Creek Pet Kennel			
Balance Sheet			
January 31, 20XX			
ASSETS		**LIABILITIES**	
Cash	**$ 1,500**	**Accounts payable**	**$ 1,000**
Supplies	**200**		
Land	**9,500**	**OWNER'S EQUITY**	
Building	**25,000**	**Your name, capital**	**35,200**
		Total liabilities and	
Total assets	**$36,200**	**owner's equity**	**$36,200**

Req. 4

Evaluate the success of the business by its

- **Net income or net loss for the period, as reported on the income statement**

- **Financial position at the end of the period, as reported on the balance sheet**

Specifically, you hope to earn a *net income*, and you hope to end the period with *assets* far in excess of your *liabilities*. Finally, you also need plenty of cash to continue in business.

Project 2

Suggested Answers

Req. 1 **– Factors to consider in establishing the business:**

1. **How to organize the business—as a proprietorship, a partnership, or a corporation (assume you have decided to organize as a proprietorship)**

2. **Where to locate the headquarters of the business**

3. **How much of your own time and money to commit to the business**

4. **How to finance the business—with your own personal money or through borrowing**

5. **How many people to employ for the business**

6. **How to measure the business's success or failure; how to account for the assets, liabilities, and operations of the business**

7. **What type of music to feature. What age group or interest group to appeal to**

8. **Whether to sell concessions (food, drinks, T-shirts, and so on) yourself or to arrange for outsiders to sell concessions at the concert**

9. **How to advertise the business (newspapers, radio, posters)**

Req. 1 **– continued**

10. Whether to sponsor the concerts yourself or to arrange for corporate or charitable organizations to sponsor the concerts

Student answers may vary.

Suggested Answers

***Req. 2* – Items to arrange in order to promote and stage a rock concert:**

1. **Which band (or bands) to feature at the concerts**
2. **How much and when to pay the performers (flat rate or a percentage of gate receipts)**
3. **Where to stage the concerts and how to pay for the site rental**
4. **Need for city or county permits to stage a concert**
5. **How to ensure security at the concert**
6. **How to get people to come to the concert. How to advertise the concerts (newspapers, radio, posters, or other) and how much to pay for advertising**
7. **How to offer concessions (buy and sell them yourself or arrange for outside concessionaires). If outsiders, how will they be compensated—keep their own revenues or share them with you?**
8. **Need for traffic control if the crowd disrupts city traffic**
9. **Weather considerations if the concert is staged outdoors**
10. **Timing of the concert in relation to other events in the area at the time.**

Student answers may vary.

Suggested Answers

Req. 3

Concert Enterprises		
Income Statement		
Three Months Ended June 30, 20XX		
Revenues:		
Ticket sales revenue		$300,000
Concession revenue		50,000
Total revenue		350,000
Expenses:		
Band expense	$100,000	
Advertising expense	50,000	
Concession expense	20,000	
Rent expense	15,000	
Security expense	10,000	
Utilities expense	3,000	
Permits expense	2,000	
Total expenses		200,000
Net income		$150,000

Concert Enterprises	
Statement of Owner's Equity	
Three Months Ended June 30, 20XX	
Your name, capital, March 31, 20XX	$ 0
Add: Investments by owner	1,000
Net income for the period	150,000
	151,000
Less: Withdrawals by owner	(10,000)
Your name, capital, June 30, 20XX	$141,000

Suggested Answers

Req. 3 - continued

Concert Enterprises			
Balance Sheet			
June 30, 20XX			
ASSETS		**LIABILITIES**	
Cash	$136,000	Accounts payable	$ 7,000
Receivables	8,000		
Supplies	4,000	**OWNER'S EQUITY**	
		Your name, capital	141,000
	________	Total liabilities and	________
Total assets	$148,000	owner's equity	$148,000

Student answers may vary.

Req. 4

Evaluate the success of the business by its

- **Net income or net loss for the period, as reported on the income statement**

- **Financial position at the end of the period, as reported on the balance sheet**

Specifically, you hope to earn a *net income*, and you hope to end the period with *assets* far in excess of your *liabilities*. Finally, you also need plenty of cash to continue in business.

BLANK PAGE