Chapter 1

The role of accounting in decision making

Quick check

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

Starters

(5 min.) S1-1

Financial accounting. Financial accountants prepare information for *external* users.

(5 min.) S1-2

Profit is the increase in equity over a period of time.

Revenues are increases in equity from delivering goods or services to customers.

Expenses are decreases in equity from delivering goods or services to customers.

(5 min.) S1-3

Equity is the excess of the value of the assets of a business over its liabilities.

	Assets	=	Liabilities	+	Owners' equity	Type of transaction
(a)	Cash $320	=	(not affected)	+	Capital $320	Revenues
(b)	Cash $(125)	=	(not affected)	+	Capital $(125)	Expense
(c)	Accts receivable $440	=	(not affected)	+	Capital $440	Revenues
(d)	(not affected)	=	Accts payable $(65)	+	Capital $65	Expense

(5 min.) S1-3

Equity is the excess of the value of the assets of a business over its liabilities.

(5 min.) S1-4

Req. 1

After this transaction (the first and only for the business), cash equals $0 and the total assets equal $3 800.

Req. 2

The business's asset that was increased as a result of the transaction is accounts receivable.

(5 min.) S1-5

Req. 1

The business didn't record any revenue when it collected cash on account because the business recorded the revenue one month earlier, when it was *earned*.

Req. 2

	Assets			=	Liabilities	+	Owner's equity	Type of transaction
	Cash	+	Accounts receivable	=	(not affected)	+	Bob Martin Deliveries, capital	
(a)	$ 500	+	$ 0	=	$ 0	+	$ 500	Revenues
(b)	500	+	(500)	=	0	+	0	No effect on equity

(5 min.) S1-6

The balance sheet.

The income and cash flow statements contain additional information about changes relating to assets, liabilities and equity during the accounting period.

(10 min.) S1-7

Req. 1

SMART TOUCH LEARNING **Balance sheet** as at 21 May 2016			
Assets		**Liabilities**	
Cash	$11 900	Accounts payable	$200
Accounts receivable	3 000		
Office supplies	500	**Owners' Equity**	
Land	20 000	Sheena Bright, capital	35 200
		Total liabilities and	
Total assets	$35 400	owners' equity	$35 400

(10 min.) S1-8

Req. 1

ELEGANT ARRANGEMENTS **Income statement** for the year ended 31 December 2016		
Revenue		
Service revenue		$74 000
Expenses:		
Salary expense	$42 000	
Rent expense	13 000	
Insurance expense	4 000	
Supplies expense	1 100	
Total expenses		60 100
Profit		$13 900

(10 min.) S1-9

Req. 1

The operations of Elegant Arrangements in 2016 resulted in a *good year.* This can be measured by the *profit of $13 900.*

Req. 2

Profit would be *lower by $14 800.*

Req. 3

Profit would be lower by $8 400.

(5–10 min.) S1-10

Req. 1

This organisation is the Australian Accounting Standards Board.

(5–10 min.) S1-11

Req. 1

a. entity concept
b. accounting period concept
c. going concern assumption
d. accrual basis of accounting

Req. 2

Michael McNamee has $11 000 equity in the business.

Assets	=	Liabilities	+	Owner's equity
		Accounts		
Cash + furniture	=	payable	+	Owners' equity
$8 000 + $9 000	=	$6 000	+	$11 000

(5–10 min.) S1-12

Chloe's needs will best be met by establishing a company.

(5–10 min.) S1-13

Issues of environmental and economic sustainability are suggested. The environmental costs are imponderable but arguably at least as important as the economic ones. However, they are not independent, since, depending upon the seriousness with which the environmental effects are treated, the financial costs of a clean-up vary. The eventual financial costs of remedying waste pollution may be much higher than estimated, which raises the issue of intergenerational equity (the present generation passing costs on to future generations). Also, probabilities are involved. There may be no environmental pollution. If the chance of pollution is, say, 50%, do you weight the costs accordingly? Or is it best to be very conservative when considering outcomes that may have dire environmental consequences – for instance, by assuming worst financial outcome scenarios?

The obvious financial arithmetic is: The total profit for landfill project over 30 years is 30 X \$(2 – 1)m – \$5m = \$25m. If the landfill is successfully contained, this is the overall profit. If the chance of contamination is 50%, then, 'on average', the net financial benefit will be zero (\$25m – 50% X \$50m). However, unless contracts require Southern Waste to pay for any contamination, it will still realise a lifetime profit of \$25m, while the taxpayer or ratepayer will suffer a loss of the same amount. The financial situation will be worse and possibly more inequitable if the costs of the environmental clean-up turn out to be higher.

Exercises

(10–15 min.) E1-1

1	E
2	A
3	I
4	F
5	J
6	B
7	D
8	C
9	G
10	H
11	K

(15–20 min.) E1-2

Req. 1

The *balance sheet* is prepared by summarising the assets, liabilities and owners' 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. Owners' equity is the portion of the business assets owned outright by the proprietor.

The *income statement* is prepared by summarising 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 *profit* (or *net loss*).

Req. 2

The *Australian Accounting Standards Board* is the body that defines pronouncements that guide how the financial statements will be prepared.

Req. 3

Before lending money, the lender evaluates O'Brien's ability to make the loan payments. Lenders will use the reported profit and other information in the financial statements to predict future income of O'Brien's travel magazine. Therefore, the bank requires the financial statements of O'Brien's travel magazine in order to make a decision about l lending money to O'Brien.

(continued) E1-2

Req. 4

Evan O'Brien is organised as a *proprietorship*.

Req. 5

A *corporation* would be the best option.

(5–10 min.) E1-3

	Assets	=	Liabilities	+	Owner's equity
New Rock Gas	$ *?*		$24 000		$50 000
DJ Video Rentals	75 000		*?*		32 000
Corner Grocery	100 000		53 000		*?*

Req. 1.

New Rock Gas assets	=	$24 000 + $50 000 = $74 000
DJ Video Rentals liabilities	=	$75 000 – $32 000 = $43 000
Corner Grocery owners' equity	=	$100 000 – $53 000 = $47 000

Req. 2

The main characteristics of a proprietorship are:

1. The life of the organisation is limited by owner's choice or death.
2. There is a single owner.
3. The owner's liability is unlimited.

Req. 3

The accounting concept or principle that tells us that the above three proprietorships will continue to exist in the future is the *going concern concept*.

(5–10 min.) E1-4

a. Purchase of asset for cash
Sale of asset for cash
Collection of accounts receivable

b. Pay an account payable

c. Pay an expense

d. Investment by owner
Revenue transaction

e. Purchase of asset on account
Borrow money

Wording may vary.

(5–10 min.) E1-5

Req. 1

	1.	**2.**	**3.**
Owners' equity, 31 May 2016			
(\$177 000 – \$122 000)	\$55 000	\$55 000	\$55 000
Owners' investment	6 000	0	18 000
Profit for the month	8 000	24 000	16 000
	69 000	79 000	89 000
Drawings	0	(10 000)	(20 000)
Owners' equity, 30 June 2016			
(\$213 000 - \$144 000	\$69 000	\$69 000	\$69 000

(10–20 min.) E1-6

a. Increase asset (Cash)
Increase capital (Owners' equity, capital)

b. Increase asset (Accounts receivable)
Increase capital (Owners' equity, capital))

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 capital (Owners' equity, capital)

h. Decrease asset (Cash)
Decrease capital (Owners' equity, capital)

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

(10–20 min.) E1-7

Analysis of transactions

Caren Smith, GP

	ASSETS		=	LIABILITIES +	OWNERS' EQUITY	
DATE	CASH +	MEDICAL SUPPLIES =	LAND +	ACCOUNTS PAYABLE	SMITH, CAPITAL	TYPE OF OWNERS' EQUITY TRANSACTION
July 6	55 000				55 000	Owners' investment
Bal.	55 000	0	0	0	55 000	
9	(46 000)		46 000			No effect
Bal.	9 000	0	46 000	0	55 000	
12		1 800		1 800		No effect
Bal.	9 000	1 800	46 000	1 800	55 000	
15						No effect
Bal.	9 000	1 800	46 000	1 800	55 000	
15–31	8 000				8 000	Service revenue
Bal.	17 000	1 800	46 000	1 800	63 000	
29	(1 600)				(1 600)	Salary expense
	(900)				(900)	Rent expense
	(100)				(100)	Utilities expense
Bal.	14 400	1 800	46 000	1 800	60 400	
30		(700)		(700)		No effect
Bal.	14 400	1 100	46 000	1 100	60 400	
31	(1 100)			(1 100)		No effect
Bal.	13 300	1 100	46 000	0	60 400	

$$\underbrace{13\,300 + 1\,100 + 46\,000}_{\$60\,400\ \text{Total assets}} \qquad \underbrace{0 + 60\,400}_{\$60\,400\ \text{Total liabilities and owners' equity}}$$

(10–15 min.) E1-8

Transaction description

1. Investment by the owner
2. Earned revenue on credit
3. Purchased equipment on credit
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

(10 min.) E1-9

Req. 1

The owners' equity *increased* during the year by *$4 000.*

Beginning owners' equity:	$19 000 – $9 000 = $10 000
Ending owners' equity:	$27 000 – $13 000 = $14 000
Change in owners' equity:	$14 000 – $10 000 = $4 000

Req. 2

Owners' equity can change in these three ways:

Owners' equity can *increase* through:	Owner contributions
	Profit
Owners' equity can *decrease* through:	Owner drawings

(10–15 min.) E1-10

Req. 1

The profit for Australian Express Services (AES) is *$7 billion*.

Revenues	–	Expenses	=	Profit
$21bn	–	$14bn	=	$7bn

Req. 2

The owners' equity increased during the year by *$7 billion.*

Req. 3

AES's performance for 2016 is *good*, because 2016 was a *profitable* year.

(30–40 min.) E1-11

Req. 1

	Assets	-	Liabilities	=	Owner's equity
Beginning	$ 45 000	-	$29 000	=	$16 000
Ending	$ 55 000	-	$38 000	=	$17 000

Owners' equity	
Beginning balance:	$ 16 000
Investment by the owner	0
Profit	20 000
	$36 000
Drawings	(19 000)
Ending balance	$17 000

Felix earned a *profit of $20 000.*

Revenue	–	Profit	=	Expenses
$242 000	–	$20 000	=	$222 000

Req. 2

Felix's performance for the year was *good* because the business *earned positive income.*

(10–15 min.) E1-12

Effects on total assets	Asset account(s) affected
Increased total assets	Cash
No effect on total assets	Cash and land
Decreased total assets	Cash
Increased total assets	Equipment
Increased total assets	Accounts receivable
No effect on total assets	No asset account(s) affected
No effect on total assets	Cash and Accounts receivable
Increased total assets	Cash
i. Decreased total assets	Cash
j.No effect on total assets	No asset account(s) affected

(10–20 min.) E1-13

Req. 1

BLAKE INVESTIGATIVE SERVICE Balance sheet as at 30 June 2016			
Assets		**Liabilities**	
Cash	$ 2 900	Accounts payable	$ 3 000
Accounts receivable	6 200	Loan payable	6 900
Supplies	900	Total liabilities	9 900
Equipment	13 600	**Owners' Equity**	
		Blake, capital	13 700*
Total assets	$23 600	Total liabilities and owners' equity	$23 600

*	Total assets	–	Total liabilities	=	Owners' equity
	$23 600	–	$9 900	=	$13 700

Req. 2

The balance sheet reports *financial position.*

Req. 3

The *income statement.*

Income statement for the year to 30 June 2016 (reconciliation)		
Service revenue		11 400
Rent expense	650	
Salary expense	2 000	2 650
Profit		8 750
Blake, capital b/f		4 950
Blake, capital c/f		13 700

(10–15 min.) E1-14

Req. 1

DAVIS DESIGN STUDIOS		
Income statement		
for the year ended 30 June 2016		
Revenue:		
Service revenue		$158 300
Expenses:		
Salary expense	$65 000	
Rent expense	23 000	
Electricity and gas expense	6 900	
Supplies expense	4 200	
Rates expense	1 500	
Total expenses		100 600
Profit		$ 57 700

The result of operations is a profit of *$57 700.*

Req. 2

The amount of owner drawings during the year was *$39 400.*

Problems

(15–20 min.) P1-1

1. D
2. E
3. G
4. H
5. A
6. I
7. B
8. C
9. F
10. J

(20–25 min.) P1-2

Req. 1

There is no proprietorship feature that limits Andrea’s personal liability. She is personally liable for the debts of the business.

Req. 2

ANDREA SCARLETT BLUME RAY WHITE **Balance sheet** as at 30 September 2016			
Assets		**Liabilities**	
Cash	$ 9 000	Accounts payable	$ 2 000
Office supplies	1 000	Loan payable	61 000
Franchise	23 000	Total liabilities	63 000
Furniture	15 000	**Owners' Equity**	
Land	83 000		
		Andrea Scarlett, capital	68 000*
Total assets	$131 000	Total liabilities and owners' equity	$131 000

*	Total assets	–	Total liabilities	=	Owners’ equity
	$131 000	–	$63 000	=	$68 000

Req. 3

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

Personal cash	$5 000
Personal accounts payable	$4 000
Mortgage payable	$80 000
Residence	$160 000

(20–30 min.) P1-3

Req. 1

Analysis of transactions

Alex Shore Accounting

	ASSETS				= LIABILITIES + OWNERS' EQUITY		
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	OFFICE FURNITURE +	= ACCOUNTS PAYABLE	ALEX SHORE, CAPITAL	TYPE OF OWNERS' EQUITY TRANSACTION
Feb 4*							
5	50 000					50 000	Owners' investment
Bal.	50 000	0	0	0	0	50 000	
6	(100)		100				
	49 900	0	100	0	0	50 000	
7				9 700	9 700		
Bal.	49 900	0	100	9 700	9 700	50 000	
10*							
11*							
12							
Bal.	49 900	0	100	9 700	9 700	50 000	
18		17 000				17 000	Service revenue
Bal.	49 900	17 000	100	9 700	9 700	67 000	
25	(1 500)					(1 500	Rent expense
Bal.	48 400	17 000	100	9 700	9 700	65 500	
28	(1 000					(1 000)	Owners' drawings
Bal.	47 400	17 000	100	9 700	9 700	64 500	

$74 200 $74 200

*Not a transaction of the business.

(continued) P1-3

Req. 2

a.	Total assets	=	\$74 200
b.	Total liabilities	=	\$ 9 700
c.	Total owners' equity	=	\$64 500
d.	Profit for February	=	\$15 500

(20–30 min.) P1-4

Req. 1

Analysis of transactions

Angela Peters, Solicitor

ASSETS					= LIABILITIES + OWNERS' EQUITY		
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	COMPUTER +	= ACCOUNTS PAYABLE	ANGELA PETERS, CAPITAL	TYPE OF OWNERS' EQUITY TRANSACTION
Mar 1*							
2*							
3*							
5	89 000					89 000	Owners' investment
Bal.	89 000	0	0	0	0	89 000	
7	(400)		400				
Bal.	88 600	0	400	0	0	89 000	
9				9 300	9 300		
Bal.	88 600	0	400	9 300	9 300	89 000	
23		13 500				13 500	Service revenue
Bal.	88 600	13 500	400	9 300	9 300	102 500	
30	(1 200)					(1 200)	Electricity and gas expense
Bal.	87 400	13 500	400	9 300	9 300	101 300	
31	(2 000)					(2 000)	Owners' drawing
Bal.	85 400	13 500	400	9 300	9 300	99 300	

$108 600 $108 600

*Not a transaction of the business.

(continued) P1-4

Req. 2

a.	Total assets	=	$108 600
b.	Total liabilities	=	$ 9 300
c.	Total owners' equity	=	$ 99 300
d.	Profit for March	=	$ 12 300

Req. 3

Angela Peters' first month of operations was *good* because the business *earned a profit of $12 300.*

(20–25 min.) P1-5

Date	Transaction type	Account	Increase/ Decrease	Amount
Oct. 4	Owners' investment	Cash Zelinsky, capital	Increase Increase	$5 000
9	Cash purchase	Land Cash	Increase Decrease	$4 000
13	Purchase on account	Supplies Accounts payable	Increase Increase	$400
16	Payment on account	Accounts payable Cash	Decrease Decrease	$1 500
19	Collection on account	Cash Accounts receivable	Increase Decrease	$1 300
22	Owners' investment	Cash Zelinsky, capital	Increase Increase	$5 000
25	Payment on account	Accounts payable Cash	Decrease Decrease	$600
27	Cash purchase	Supplies Cash	Increase Decrease	$800
30	Owners' drawing	Zelinsky, capital Cash	Decrease Decrease	$5 700

(15–25 min.) P1-6

Analysis of transactions

Facelift

	ASSETS				= LIABILITIES + OWNERS' EQUITY		
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	LAND +	= ACCOUNTS PAYABLE	SHEILAH CRONJE, CAPITAL	TYPE OF OWNERS' EQUITY TRANSACTION
Bal.	2 200	1 900	0	14 000	8 000	10 100	
a	13 000					13 000	Owners' investment
Bal.	15 200	1 900	0	14 000	8 000	23 100	
b	900					900	Service revenue
Bal.	16 100	1 900	0	14 000	8 000	24 000	
c	(8 000)				(8 000)		
Bal.	8 100	1 900	0	14 000	0	24 000	
d			600		600		
Bal.	8 100	1 900	600	14 000	600	24 000	
e	700	(700)					
Bal.	8 800	1 200	600	14 000	600	24 000	
f	1 600					1 600	Owners' investment
Bal.	10 400	1 200	600	14 000	600	25 600	
g		5 500				5 500	Service revenue
Bal.	10 400	6 700	600	14 000	600	31 100	
h-1	(1 200)					(1 200)	Rent expense
h-2	(600)					(600)	Advertising expense
Bal.	8 600	6 700	600	14 000	600	29 300	
i			(110)		(110)		
Bal.	8 600	6 700	490	14 000	490	29 300	
j	(1 000)					(1 000	Owners' drawings
Bal.	7 600	6 700	490	14 000	490	28 300	

$$\underbrace{\text{Assets}}_{\$28\ 790} \qquad \underbrace{\text{Liabilities + Owners' equity}}_{\$28\ 790}$$

(20–30 min.) P1-7

Req. 1

GATE CITY ANSWERING SERVICE **Income statement** for the year ended 30 June 2016		
Revenue:		
Service revenue		$192 000
Expenses:		
Salary expense	$65 000	
Advertising expense	15 000	
Rent expense	13 000	
Interest expense	7 000	
Rates expense	2 600	
Insurance expense	2 500	
Total expenses		105 100
Profit		$ 86 900

Req. 2

GATE CITY ANSWERING SERVICE **Statement of changes in equity** for the year ended 30 June 2016	
Walters, capital, 30 June 2015	$54 000
Owner investment	28 000
Profit	86 900
	168 900
Less: Drawings	(30 000)
Walters, capital, 30 June 2016	$138 900

Req. 3

GATE CITY ANSWERING SERVICE Balance sheet as at 30 June 2016			
Assets		**Liabilities**	
Cash	$ 3 000	Accounts payable	$11 000
Accounts receivable	1 000	Salary payable	1 300
Supplies	10 000	Bill payable	32 000
Equipment	16 000	Total liabilities	$44 300
Building	145 200	**Owners' equity**	
Land	8 000	Walters, capital	138 900
		Total liabilities and	
Total assets	$183 200	owners' equity	$183 200

Req. 4

a. Result of operations: Profit of *$86 900.*
b. The total economic resources were *$183 200.*
c. The total amount owed was *$44 300.*
d. The amount of owners' equity at the end of the year was *$138 900.*

(20–30 min.) P1-8

a

STUDIO PHOTOGRAPHS Income statement for the year ended 30 June 2016		
Revenue:		
Service revenue		$80 000
Expenses:		
Salary expense	$25 000	
Insurance expense	8 000	
Advertising expense	3 000	36 000
Total expenses		$44 000
Profit		$80 000

(continued) P1-8

b

STUDIO PHOTOGRAPHS **Statement of changes in equity** for the year ended 30 June 2016	
Ansel, capital, 30 June 2015	$16 000
Owner investment	29 000
Profit	44 000
	89 000
Less: Drawings	(13 000)
Ansel, capital, 30 June 2016	$76 000

c

STUDIO PHOTOGRAPHS **Balance sheet** as at 30 June 2016			
Assets		**Liabilities**	
Cash	$37 000	Accounts payable	$ 7 000
Accounts receivable	8 000	Bill payable	12 000
Equipment	50 000	Total liabilities	19 000
		Owners' equity	
		Ansel, capital	76 000
		Total liabilities and	
Total assets	$95 000	owners' equity	$95 000

(20–30 min.) P1-9

Req. 1

GREENER LANDSCAPING Balance sheet as at 30 June 2016			
Assets		**Liabilities**	
Cash	$ 4 900	Accounts payable	$ 2 700
Accounts receivable	2 200	Loan payable	24 200
Office supplies	600	Total liabilities	26 900
Office furniture	6 100		
Land	34 200		
		Owners' equity	
		Tum, capital	21 100*
		Total liabilities and	
Total assets	$95 000	owners' equity	$48 000

*$48 000 – $26 900 = $21 100

Req. 2

Total assets as presented in the corrected balance sheet *decreased* from the original balance sheet because *expenses and liabilities were incorrectly classified as assets*.

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Continuing exercise

(10–15 min.) E1-15

Analysis of transactions

Lawlor Lawn Service

	ASSETS				= LIABILITIES + OWNERS' EQUITY		
DATE	CASH +	ACCOUNTS RECEIVABLE +	LAWN SUPPLIES +	EQUIPMENT +	= ACCOUNTS PAYABLE	LAWLOR, CAPITAL	TYPE OF OWNERS' EQUITY TRANSACTION
May 1	1 700					1 700	Owners' investment
Bal.	1 700	0	0	0	0	1 700	
3				1 440	1 440		
Bal.	1 700	0	0	1 440	1 440	1 700	
5	(30)					(30)	Fuel expense
Bal.	1 670	0	0	1 440	1 440	1 670	
6		150				150	Service revenue
Bal.	1 670	150	0	1 440	1 440	1 820	
8	(150)		150				
Bal.	1 520	150	150	1 440	1 440	1 820	
17	800					800	Service revenue
Bal.	2 320	150	150	1 440	1 440	2 620	
31	100	(100)					
Bal.	2 420	50	150	1 440	1 440	2 620	

$4 060 $4 060

Continuing problem

(20–25 min.) P1-10

Req. 1, 2

Analysis of transactions
Draper Consulting

ASSETS						= LIABILITIES + OWNERS' EQUITY		
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	EQUIPMENT +	FURNITURE	= ACCOUNTS PAYABLE	CARL DRAPER, CAPITAL	TYPE OF OWNERS' EQUITY TRANSACTION
Dec. 2	18 000						18 000	Owners' investment
Bal.	18 000	0	0	0	0	0	18 000	
2	(550)						(550)	Rent expense
Bal.	17 450	0	0	0	0	0	17 450	
3	(1 800)			1 800				
Bal.	15 650	0	0	1 800	0	0	17 450	
4					4 200	4 200		
Bal.	15 650	0		1 800	4 200	4 200	17 450	
5			900			900		
Bal.	15 650	0	900	1 800	4 200	5 100	17 450	
9		1 500					1 500	Service revenue
Bal.	15 650	1 500	900	1 800	4 200	5 100	18 950	
12	(250)						(250)	Rates expense
Bal.	15 400	1 500	900	1 800	4 200	5 100	18 700	
18	1 100						1 100	Service revenue
Bal.	16 500	1 500	900	1 800	4 200	5 100	19 800	

$24 900 $24 900

(continued) P1-10

Req. 3

DRAPER CONSULTING **Income statement** for the year ended 18 December 2016		
Revenue:		
Service revenue ($1 500 + $1 100)		$2 600
Expenses:		
Rent expense	$550	
Rates expense	250	
Total expenses		800
Profit		$1 800

Req. 4

DRAPER CONSULTING **Statement of owners' equity** for the year ended 31 December 2016	
Carl Draper, capital, 1 December 2016	$ 0
Owner investment	18 000
Profit	1 800
	19 800
Less: Drawings	0
Retained earnings, 18 December 2016	$19 800

Req. 5

DRAPER CONSULTING Balance sheet as at 18 December 2016			
Assets		**Liabilities**	
Cash	$ 16 500	Accounts payable	$ 5 100
Accounts receivable	1 500	Total liabilities	5 100
Supplies	900		
Equipment	1 800		
Furniture	4 200		
		Owners' equity	
Total assets	$24 900	Carl Draper, capital	19 800
Cash	$ 16 500	Total liabilities and	
Accounts receivable	1 500	owners' equity	$24 900

Decision cases

Case 1-1

Req. 1 Assets

Pancho's Pizza $46 000, Keith's Kebabs $50 000

Req. 2 Liabilities

Pancho's Pizza $4 000, Keith's Kebabs $20 000

Req. 3 Owners' equity

Pancho's Pizza $42 000, Keith's Kebabs $30 000

Req. 4 Revenue

Pancho's Pizza $70 000, Keith's Kebabs $106 000

Req. 5 Profitable (net income)

Pancho's Pizza $26 000, Keith's Kebabs $18 000

(continued) Case 1-1

Req. 6

There is 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 equity? More owner equity makes a business less risky.

Req. 7

Pancho's Pizza looks better financially because:

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

b. It owes less and has more owners' equity.

Case 1-2

Req. 1

The banker would *not* congratulate the Gulgongs on their profit because they haven't measured it properly. In fact, they have *no profit* at all. Their accounting errors include the following:

1. The amount of cash in the bank does *not* measure profit. 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 Tanilba Bay Didgeridoo Bed and Breakfast 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 are costs of doing business that have no lasting or future value. The Tanilba Bay Didgeridoo Bed and Breakfast hasn't had any expenses yet.

(continued) Case 1-2

4. The business will earn service revenue after it opens – from renting rooms. Expenses will result from incurring costs which have no lasting or future value.

Req. 2

TANILBA BAY DIDGERIDOO BED AND BREAKFAST **Balance sheet** as at 30 June 2015			
Assets		**Liabilities**	
Cash	$ 38 000	Bank loan payable	100 000
Computer	2 000		
Kitchen equipment	10 000	**Owners' equity**	
Furniture	20 000	Gulgongs, capital	100 000
Building ($80 000 + $50 000)	130 000	Total liabilities and	
Total assets	$200 000	owners' equity	$200 000

Focus on ethics

Req. 1

The fundamental ethical issue in this situation is letting the financial statements tell the truth about the company’s performance and financial position. There are two specific items to address. First, transferring the land violates Australian accounting standards and basic accounting principles because it is a sham transaction that is not at arm’s length. The second issue is that of ‘shaving expenses’. If ‘shaving’ simply means reducing expenses, this isn’t a problem. If it means reclassifying expenses in an effort to boost net income, it is false and dishonest.

Req. 2

The proposal to transfer assets to the company in the prior year disregards the accounting entity and period concepts, and the transaction would be a sham. It would be dishonest and unethical. The proposal to ‘shave expenses’, meaning reclassifying expenses, violates conservatism in treating expenses as assets. Many instances of accounting fraud involve this kind of mismeasurement.

Fraud case

Req. 1

The proposed action would increase profit by increasing revenues. It would distort the balance sheet by understating liabilities.

Req. 2

By making the company’s financial situation look better than it actually was, the company's creditors would likely be more willing to extend credit to the company at a lower interest rate.

Financial statement case

The answer to this question will depend upon the year of the financial statements used.