

Principles of Accounting, Volume 1: Financial Accounting
Chapter 2: Introduction to Financial Statements

Multiple Choice

1. **LO 2.1** Which of these statements is *not* one of the financial statements?

- A. income statement
- B. balance sheet
- C. statement of cash flows
- D. statement of owner investments

Solution

D

2. **LO 2.1** Stakeholders are less likely to include which of the following groups?

- A. owners
- B. employees
- C. community leaders
- D. competitors

Solution

D

3. **LO 2.1** Identify the correct components of the income statement.

- A. revenues, losses, expenses, and gains
- B. assets, liabilities, and owner's equity
- C. revenues, expenses, investments by owners, distributions to owners
- D. assets, liabilities, and dividends

Solution

A

4. **LO 2.1** The balance sheet lists which of the following?

- A. assets, liabilities, and owners' equity
- B. revenues, expenses, gains, and losses
- C. assets, liabilities, and investments by owners
- D. revenues, expenses, gains, and distributions to owners

Solution

A

5. **LO 2.1** Assume a company has a \$350 credit (not cash) sale. How would the transaction appear if the business uses *accrual* accounting?

- A. \$350 would show up on the balance sheet as a sale.
- B. \$350 would show up on the income statement as a sale.
- C. \$350 would show up on the statement of cash flows as a cash outflow.
- D. The transaction would not be reported because the cash was not exchanged.

Solution

B

6. **LO 2.2** Which of the following statements is true?

- A. Tangible assets lack physical substance.
- B. Tangible assets will be consumed in a year or less.
- C. Tangible assets have physical substance.
- D. Tangible assets will be consumed in over a year.

Solution

C

7. **LO 2.2** Owners have no personal liability under which legal business structure?

- A. a corporation
- B. a partnership
- C. a sole proprietorship
- D. There is liability in every legal business structure.

Solution

A

8. **LO 2.2** The accounting equation is expressed as _____.

- A. $\text{Assets} + \text{Liabilities} = \text{Owner's Equity}$
- B. $\text{Assets} - \text{Noncurrent Assets} = \text{Liabilities}$
- C. $\text{Assets} = \text{Liabilities} + \text{Investments by Owners}$
- D. $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$

Solution

D

9. **LO 2.2** Which of the following decreases owner's equity?

- A. investments by owners
- B. losses
- C. gains
- D. short-term loans

Solution

B

10. **LO 2.2** Exchanges of assets for assets have what effect on equity?

- A. increase equity
- B. may have no impact on equity
- C. decrease equity
- D. There is no relationship between assets and equity.

Solution

B

11. **LO 2.2** All of the following increase owner's equity *except* for which one?

- A. gains
- B. investments by owners
- C. revenues
- D. acquisitions of assets by incurring liabilities

Solution

D

12. **LO 2.3** Which of the following is not an element of the financial statements?

- A. future potential sales price of inventory
- B. assets
- C. liabilities
- D. equity

Solution

A. The future sales price of an asset is not an element of a financial statement until it is actually sold.

13. **LO 2.3** Which of the following is the correct order of preparing the financial statements?

- A. income statement, statement of cash flows, balance sheet, statement of owner's equity
- B. income statement, statement of owner's equity, balance sheet, statement of cash flows
- C. income statement, balance sheet, statement of owner's equity, statement of cash flows
- D. income statement, balance sheet, statement of cash flows, statement of owner's equity

Solution

B

14. **LO 2.3** The three heading lines of financial statements typically include which of the following?

- A. company, statement title, time period of report
- B. company headquarters, statement title, name of preparer
- C. statement title, time period of report, name of preparer
- D. name of auditor, statement title, fiscal year end

Solution

A

15. **LO 2.3** Which financial statement shows the financial *performance* of the company on a cash basis?

- A. balance sheet
- B. statement of owner's equity
- C. statement of cash flows
- D. income statement

Solution

C. While all four statements can be used to reflect financial performance, all but the cash flow statement use accrual accounting. The cash flow statement is the only financial statement that uses the cash basis.

16. **LO 2.3** Which financial statement shows the financial *position* of the company?

- A. balance sheet
- B. statement of owner's equity
- C. statement of cash flows
- D. income statement

Solution

A

17. **LO 2.3** Working capital is an indication of the firm's _____.

- A. asset utilization
- B. amount of noncurrent liabilities
- C. liquidity
- D. amount of noncurrent assets

Solution

C

Questions

1. **LO 2.1** Identify the four financial statements and describe the purpose of each.

Solution

Income statement shows the financial performance of a business for a period of time; statement of owner's equity shows the change in net worth of a business for a period of time; balance sheet

shows the financial position of a business on a specific date; statement of cash flows shows the cash inflows and outflows of the business for a period of time.

2. **LO 2.1** Define the term *stakeholders*. Identify two stakeholder groups, and explain how each group might use the information contained in the financial statements.

Solution

Stakeholders are those with an interest in the activities of an organization. Stakeholders include employees (including managers and directors), creditors, lenders, owners (potential and current), and the community. Each group would use the financial information to make decisions.

Employees would use the information to determine future changes, if any, to make in the organization. Creditors and lenders would use the information to assess granting financing to the organization. Owners would decide whether to invest or maintain ownership. The community would use the financial and nonfinancial information to assess the relationship between the organization and the community.

3. **LO 2.1** Identify one similarity and one difference between revenues and gains. Why is this distinction important to stakeholders?

Solution

Both revenues and gains represent inflows to the business, making it more valuable. Revenues relate to the primary purpose of the business, while gains represent incidental or peripheral activities. This is important to stakeholders because revenues represent ongoing or permanent activities, while gains represent infrequent or transient activities. Stakeholders should focus on permanent earnings and put peripheral or incidental earnings into the proper context.

4. **LO 2.1** Identify one similarity and one difference between expenses and losses. Why is this distinction important to stakeholders?

Solution

Both expenses and losses represent outflows from the business, making it less valuable. Expenses are related to the primary purpose of the business, while losses represent incidental or peripheral activities. This is important to stakeholders because expenses represent ongoing or permanent activities, while losses represent infrequent or transient activities. Stakeholders should focus on permanent earnings and put transient earnings into the proper context.

5. **LO 2.1** Explain the concept of equity, and identify some activities that affect equity of a business.

Solution

Equity is the net worth of the business. It can also be thought of as the net assets (assets minus liabilities) of the business. Activities that affect equity include revenues, expenses, gains, losses, and investment by and distributions to owners.

6. **LO 2.2** Explain the difference between current and noncurrent assets and liabilities. Why is this distinction important to stakeholders?

Solution

Current assets and liabilities will be settled (generally) in one year or less; noncurrent assets and liabilities will be settled (generally) in more than one year. This is important to stakeholders as it helps them assess the liquidity and solvency of the business.

7. **LO 2.2** Identify/discuss one similarity and one difference between tangible and intangible assets.

Solution

Both tangible and intangible assets have value to the company and can be bought, sold, or impaired; tangible assets have physical substance, while intangible assets do not.

8. **LO 2.2** Name the three types of legal business structure. Describe one advantage and one disadvantage of each.

Solution

Sole proprietorship—advantages include ease of formation, favorable tax treatment, and a high level of control; disadvantages may include unlimited personal liability, inseparability between the owner and the business, fairly limited ability to raise capital, and limited expertise.

Partnership—advantages include favorable tax treatment, the longevity of the business, and better access to capital and expertise; disadvantages may include unlimited personal liability and increased complexity to form.

Corporation—advantages include owners do not have personal liability, owners have relatively easy access to large amounts of capital, and the business operates beyond the life of the shareholders; the primary disadvantage is double taxation.

9. **LO 2.2** What is the “accounting equation”? List two examples of business transactions, and explain how the accounting equation would be impacted by these transactions.

Solution

Assets = Liabilities + Owner’s Equity. Answers will vary and should include a combination of revenues/gains (increases), expenses/losses (decreases), investments (increases), and distributions (decreases). It is important to understand the following transactions/exchanges will not change equity: an asset for an asset, liability for liability, asset acquisitions by incurring liabilities, and asset reductions to reduce liabilities.

10. **LO 2.3** Identify the order in which the four financial statements are prepared, and explain how the first three statements are interrelated.

Solution

The four financial statements are prepared in this order: income statement, statement of owner’s equity, balance sheet, and statement of cash flows. The net income from the income statement is carried forward to the statement of owner's equity and is added to the beginning owner's equity balance, as one step in arriving at the ending balance in owner's equity. (The other steps are to add in owner's investments and subtract owner's withdrawals.) Once computed, the ending balance in owner's equity is carried forward to the balance sheet as the balance for the owner's equity section of the balance sheet.

11. **LO 2.3** Explain how the following items affect equity: revenue, expenses, investments by owners, and distributions to owners.

Solution

Revenues and investments increase equity, while expenses and distributions decrease equity.

12. **LO 2.3** Explain the purpose of the statement of cash flows and why this statement is needed.

Solution

The statement of cash flows provides details regarding the changes in the cash balance throughout the period. It is needed because the other statements are prepared using accrual accounting.

Exercise Set A

EA1. **LO 2.1** For each independent situation below, calculate the missing values.

OpenStax *Principles of Accounting, Volume 1: Financial Accounting*
Chapter 2: Introduction to Financial Statements

Revenues	-	Expenses	+	Gains	-	Losses	=	Net Income/(Loss)
\$ 1,250		\$ 1,100		\$ 125		\$ 75		?
?		100,755		0		1,550		\$ (485)
75,560		68,600		?		1,675		6,485
26,390		?		320		600		(990)
872,300		856,995		11,000		?		26,305

Solution

Revenues	-	Expenses	+	Gains	-	Losses	=	Net Income/(Loss)
\$1,250		\$1,100		\$125		\$75		\$200
\$101,820		\$100,755		\$0		\$1,550		(\$485)
\$75,560		\$68,600		\$1,200		\$1,675		\$6,485
\$26,390		\$27,100		\$320		\$600		(\$990)
\$872,300		\$856,995		\$11,000		\$0		\$26,305

EA2. **LO 2.1** For each independent situation below, calculate the missing values for owner's equity

Beginning Balance + Investments - Distributions = Ending Balance				
\$ 0	\$ 22,750	\$ 12,000		?
17,630	?	7,500		\$ 66,330
?	75,300	163,200		138,900
0	175,300	?		159,530
85,800	62,750	43,900		?

Solution

Beginning Balance	+	Investments	-	Distributions	=	Ending Balance
\$0		\$22,750		\$12,000		\$10,750
\$17,630		\$56,200		\$7,500		\$66,330
\$226,800		\$75,300		\$163,200		\$138,900
\$0		\$175,300		\$15,770		\$159,530
\$85,800		\$62,750		\$43,900		\$104,650

EA3. **LO 2.1** For each independent situation below, calculate the missing values.

Assets	-	Liabilities	=	Owner's Equity
\$ 32,000		\$ 17,000		?
168,700		?		\$146,300
17,500		16,830		?
?		232,000		330,700
382,170		?		125,270

Solution

Assets	-	Liabilities	=	Owner's Equity
\$32,000		\$17,000		\$15,000
\$168,700		\$22,400		\$146,300
\$17,500		\$16,830		\$670
\$562,700		\$232,000		\$330,700
\$382,170		\$256,900		\$125,270

EA4. **LO 2.1** For each independent situation below, place an (X) by the transactions that would be included in the statement of cash flows.

Transaction	Included
Sold items on account	
Wrote check to pay utilities	
Received cash investment by owner	
Recorded wages owed to employees	
Received bill for advertising	

Table 2.3

Solution

Transaction	Included
Sold items on account	
Wrote check to pay utilities	X
Received cash investment by owner	X
Recorded wages owed to employees	
Received bill for advertising	

EA5. **LO 2.2** For each of the following items, identify whether the item is considered current or noncurrent, and explain why.

Item	Current or Noncurrent?
Cash	
Inventory	
Machines	
Trademarks	
Accounts Payable	
Wages Payable	
Owner, Capital	
Accounts Receivable	

Table 2.4

Solution

Item	Current or Noncurrent?
Cash	Current
Inventory	Current
Machines	Noncurrent
Trademarks	Noncurrent
Accounts Payable	Current
Wages Payable	Current
Owner, Capital	Noncurrent
Accounts Receivable	Current

Current items will be settled in cash in a year or less; noncurrent items in greater than one year.

EA6. **LO 2.2** For the items listed below, indicate how the item affects equity (increase, decrease, or no impact).

Item	Increase? Decrease? or No Impact?
Expenses	
Assets	
Gains	
Liabilities	
Dividends	

Table 2.5

Solution

Item	Increase? Decrease? No Impact?
Expenses	Decrease
Assets	No Impact
Gains	Increase
Liabilities	No Impact
Dividends	Decrease

EA7. **LO 2.2** Forest Company had the following transactions during the month of December. What is the December 31 cash balance?

Cash sales	\$3,250
Payments for inventory	1,760
Investments by owners	3,000
Supplies used	175
Cash withdrawals	260
Inventory received	2,500
Wages paid	2,390
Cash balance Dec. 1	4,250

Solution

The December 31 balance is \$6,090 ($\$4,250 + \$3,250 - \$1,760 + \$3,000 - \$260 - \$2,390$).

EA8. **LO 2.2** Here are facts for the Hudson Roofing Company for December.

Hudson Alexander, Capital Dec. 1	\$175,300
Dec. revenue	56,400
Dec. expenses	59,800

Assuming no investments or withdrawals, what is the ending balance in the owners' capital account?

Solution

The December 31 balance is \$171,900 ($\$175,300 + \$56,400 - \$59,800$).

EA9. **LO 2.3** Prepare an income statement using the following information for DL Enterprises for the month of July 2018.

OpenStax *Principles of Accounting, Volume 1: Financial Accounting*
 Chapter 2: Introduction to Financial Statements

Sales revenue	\$62,500
Rental revenue	15,300
Product expense	52,200
Wages expense	18,900
Owner investment	12,000
Equipment purchases	56,000
Utilities expense	1,800
Taxes expense	400

Solution

DL Enterprises Income Statement For the Month Ended July 31, 2018	
Sales Revenue	\$62,500
Rental Revenue	<u>\$15,300</u>
Total Revenue	\$77,800
Expenses	
Product Expense	\$52,200
Wages Expense	\$18,900
Utilities Expense	\$1,800
Taxes Expense	<u>\$400</u>
Total Expenses	<u>\$73,300</u>
Net Income	<u>\$4,500</u>

EA10. **LO 2.3** Prepare a statement of owner's equity using the information provided for Pirate Landing for the month of October 2018.

Cash	\$14,500
Pirate Pete, Capital Oct. 1	56,000
Net loss Oct. 2017	7,800
Owner investments	1,500
Wages payable	3,250
Supplies expense	750
Owner withdrawals	100

Solution

Pirate Landing Statement of Owner's Equity For the Month Ended Oct. 31, 2018	
Pirate Pete, Capital Oct. 1	\$56,000
Increases:	
Owner Investments	<u>\$1,500</u>
Total Increases	\$1,500
Decreases:	
Net Loss October 2018	\$7,800

Owner Withdrawals	<u>\$100</u>
Total Decreases	<u>\$7,900</u>
Pirate Pete, Capital October 31	<u>\$49,600</u>

EA11. **LO 2.3** Prepare a balance sheet using the following information for the Ginger Company as of March 31, 2019.

Accounts payable	\$ 1,730
Cash	11,050
Ginger Ale, Capital Mar. 1	17,300
Inventory	8,230
Wages payable	2,150
Sales	13,600
Product expenses	8,200
Ginger Ale, Capital Mar. 31	22,700
Equipment	7,300

Solution

Ginger Company Balance Sheet Mar. 31, 2019			
Assets:		Liabilities:	
Cash	\$11,050	Accounts Payable	\$1,730
			0
Inventory	\$8,230	Wages Payable	<u>\$2,150</u>
			0
Equipment	\$7,300	Total Liabilities	\$3,880
		Owner's Equity	
		Ginger Ale, Capital March 31	
		<u>\$22,700</u>	
Total Assets	<u>\$26,580</u>	Total Liabilities and Owner's Equity	<u>\$26,580</u>

Exercise Set B

EB1. **LO 2.1** For each independent situation below, calculate the missing values.

Revenues	-	Expenses	+	Gains	-	Losses	=	Net Income/(Loss)
\$ 1,813		\$ 1,595		\$ 181		\$ 109		?
?		146,095		\$ 0		2,248		\$ (703)
109,562		99,470		?		2,429		9,403
38,266		?		464		870		(1,436)
1,264,835		1,242,643		15,950		?		38,142

Solution

Revenues	-	Expenses	+	Gains	-	Losses	=	Net Income/(Loss)
-----------------	----------	-----------------	----------	--------------	----------	---------------	----------	--------------------------

\$1,813	\$1,595	\$181	\$109	\$290
\$147,640	\$146,095	\$0	\$2,248	(\$703)
\$109,562	\$99,470	\$1,740	\$2,429	\$9,403
\$38,266	\$39,296	\$464	\$870	(\$1,436)
\$1,264,835	\$1,242,643	\$15,950	\$0	\$38,142

EB2. **LO 2.1** For each independent situation below, calculate the missing values for Owner's Equity.

Beginning Balance + Investments - Distributions = Ending Balance				
\$ 0	\$ 14,333	\$ 7,560		?
11,107	?	4,725		\$ 41,788
?	47,439	102,816		87,507
0	110,439	?		100,504
54,054	39,533	27,657		?

Solution

Beginning Balance	+	Investments	-	Distributions	=	Ending Balance
\$0		\$14,333		\$7,560		\$6,773
\$11,107		\$35,406		\$4,725		\$41,788
\$142,884		\$47,439		\$102,816		\$87,507
\$0		\$110,439		\$9,935		\$100,504
\$54,054		\$39,533		\$27,657		\$65,930

EB3. **LO 2.1** For each independent situation below, calculate the missing values.

Assets	-	Liabilities	=	Owner's Equity
\$ 81,600		\$ 17,000		?
430,185		?		\$373,065
44,625		42,917		?
?		591,600		843,285
974,534		?		319,439

Solution

Assets	-	Liabilities	=	Owner's Equity
\$81,600		\$17,000		\$64,600
\$430,185		\$57,120		\$373,065
\$44,625		\$42,917		\$1,708
\$1,434,885		\$591,600		\$843,285
\$974,534		\$655,095		\$319,439

EB4. **LO 2.1** For each of the following independent situations, place an (X) by the transactions that would be included in the statement of cash flows.

Transaction	Included
Purchased supplies with check	
Received inventory (a bill was included)	
Paid cash to owner for withdrawal	

OpenStax *Principles of Accounting, Volume 1: Financial Accounting*
 Chapter 2: Introduction to Financial Statements

Gave cash donation to local charity	
Received bill for utilities	

Table 2.6

Solution

Transaction	Included
Purchased supplies with check	X
Received inventory (a bill was included)	
Paid cash to owner for withdrawal	X
Gave cash donation to local charity	X
Received bill for utilities	

EB5. **LO 2.2** For each of the following items, identify whether the item is considered current or noncurrent, and explain why.

Item	Current or Noncurrent?
Inventory	
Buildings	
Accounts Receivable	
Cash	
Trademarks	
Accounts Payable	
Wages Payable	
Common Stock	

Table 2.7

Solution

Item	Current or Noncurrent?
Inventory	Current
Buildings	Noncurrent
Accounts Receivable	Current
Cash	Current
Trademarks	Noncurrent
Accounts Payable	Current
Wages Payable	Current
Common Stock	Noncurrent

Current items will be settled in a year or less; noncurrent items in greater than one year.

EB6. **LO 2.2** For the items listed below, indicate how the item affects equity (increase, decrease, or no impact).

Item	Increase? Decrease? or No Impact?
Revenues	
Gains	
Losses	
Drawings	
Investment	

s	
---	--

Table 2.8

Solution

Item	Increase? Decrease? No Impact?
Revenues	Increase
Gains	Increase
Losses	Decrease
Drawings	Decrease
Investments	Increase

EB7. **LO 2.2** Gumbo Company had the following transactions during the month of December. What was the December 1 cash balance?

Dividends paid	\$ 221
Credit sales	149
Payments for equipment	1,496
Taxes paid	2,032
Common stock sold	2,550
Inventory received	2,125
Cash sales	2,763
Cash balance Dec. 31	9,869

Solution

The December 1 balance is \$8,305 ($\$9,869 - \$2,550 - \$2,763 + \$221 + \$1,496 + \$2,032$).

EB8. **LO 2.2** Here are facts for Hailey's Collision Service for January.

Hailey Shusher, Capital Jan. 1	\$61,355
Jan. revenue	23,240
Jan. expenses	20,930

Assuming no investments or withdrawals, what is the ending balance in the owners' capital account?

Solution

The January 31 balance is \$63,665 ($\$61,355 + \$23,240 - \$20,930$).

EB9. **LO 2.3** Prepare an income statement using the following information for CK Company for the month of February 2019.

Sales revenue	\$26,250
Rental revenue	6,426
Product expense	21,924
Wages expense	7,938
Owner investment	5,040
Equipment purchases	23,520
Utilities expense	756
Taxes expense	168

Solution

CK Company Income Statement For the Month Ended Feb. 28, 2019	
Sales Revenue	\$26,250
Rental Revenue	<u>\$6,426</u>

Total Revenue	\$32,676
Expenses	
Product Expense	\$21,924
Wages Expense	\$7,938
Utilities Expense	\$756
Taxes Expense	<u>\$168</u>
Total Expenses	<u>\$30,786</u>
Net Income	<u>\$1,890</u>

EB10. **LO 2.3** Prepare a statement of owner's equity using the following information for the Can Due Shop for the month of September 2018.

Cash	\$ 51,040
Steve due, Capital Sep.1	197,120
Net income Sep. 2018	27,456
Owner investments	5,280
Wages payable	11,440
Supplies expense	2,640
Owner withdraws	352

Solution

Can Due Shop Statement of Owner's Equity For the Month Ended Sep. 30, 2018	
Steve Due, Capital September 1	\$197,120
Increases:	
Net Income September 2018	\$27,456
Owner Investments	<u>\$5,280</u>
Total Increases	\$32,736
Decreases:	
Owner Withdrawals	<u>\$352</u>
Total Decreases	<u>\$352</u>
Steve Due, Capital September 30	<u>\$229,504</u>

EB11. **LO 2.3** Prepare a balance sheet using the following information for Mike's Consulting as of January 31, 2019.

OpenStax *Principles of Accounting, Volume 1: Financial Accounting*
 Chapter 2: Introduction to Financial Statements

Accounts payable	\$ 570
Cash	3,646
Mike Michael, Capital Jan. 1	5,709
Inventory	2,716
Wages payable	710
Sales	4,488
Product expenses	2,706
Mike Michael, Capital Jan. 31	7,491
Equipment	2,409

Solution

Mike's Consulting Balance Sheet January 31, 2019			
Assets:		Liabilities:	
Cash	\$3,646	Accounts Payable	\$570
Inventory	\$2,716	Wages Payable	<u>\$710</u>
Equipment	\$2,409	Total Liabilities	\$1,280
		Owner's Equity	
		Mike Michael, Capital January 31	<u>\$7,491</u>
Total Assets	<u>\$8,771</u>	Total Liabilities and Owner's Equity	<u>\$8,771</u>

Problem Set A

PA1. **LO 2.1** The following information is taken from the records of Baklava Bakery for the year 2019.

Revenues: Jan.	\$22,500
Gains: Feb.	1,200
Losses: Mar.	3,700
Expenses: Feb.	21,620
Gains: Jan.	0
Revenues: Mar.	42,800
Losses: Feb.	1,600
Expenses: Mar.	45,100
Losses: Jan.	0
Revenues: Feb.	37,550
Expenses: Jan.	20,760
Gains: Mar.	5,600

- Calculate net income or net loss for January.
- Calculate net income or net loss for February.
- Calculate net income or net loss for March.
- For each situation, comment on how a stakeholder might view the firm's performance. (Hint: Think about the source of the income or loss.)

Solution

Revenues/ Expenses	Gains/ Losses	Net Income (Loss)	D. Comments
-----------------------	------------------	-------------------------	-------------

A. January	\$1,740	\$0	\$1,740	Earnings from ongoing (core) portion of business
B. February	\$15,930	(\$400)	\$15,530	Strong earnings from ongoing (core) portion of business; minor loss from peripheral activities
C. March	(\$2,300)	\$1,900	(\$400)	Poor earnings from core business; masked by gain, which is peripheral

Note: Responses may also observe the strong month of February (Valentine's Day).

PA2. **LO 2.1** Each situation below relates to an independent company's owners' equity.

	Beginning Balance	+ Net Income	- Net Loss	+ Investments	- Distributions	= Ending Balance
Co.1	?	\$16,500	\$ 0	\$22,300	\$ 1,750	\$ 37,050
Co.2	\$ 63,180	0	12,000	0	?	44,880
Co.3	275,300	?	0	0	24,100	299,400

A. Calculate the missing values.

B. Based on your calculations, make observations about each company.

Solution

A.

Beginning Balance	+ Net Income	- Net Loss	+ Investments	- Distributions	= Ending Balance
\$0	\$16,500	\$0	\$22,300	\$1,750	\$37,050
\$63,180	\$0	\$12,000	\$0	\$6,300	\$44,880
\$275,300	\$48,200	\$0	\$0	\$24,100	\$299,400

B. Observations: Company 1: brand new company with net income during the first period, strong investment with little taken out of the business; Company 2: established company that is trending unfavorably—net loss and owner withdraws; Company 3: mature company with a strong financial performance that allows for owner withdrawals without the need for investment.

PA3. **LO 2.1** The following information is from a new business. Comment on the year-to-year changes in the accounts and possible sources and uses of funds (how were the funds obtained and used).

	Assets	- Liabilities	= Owner's Equity
End of Year 1	\$245,000	\$120,000	\$125,000
End of Year 2	286,000	150,000	136,000
End of Year 3	212,000	80,000	132,000

Solution

End of Year 1: Asset increase of \$245,000 financed by increase of liabilities of \$120,000 and combination of net income and net owner investments of \$125,000.

End of Year 2: Asset increase of \$41,000 financed by increase of liabilities of \$30,000 and combination of net income and net owner investments of \$11,000.

End of Year 3: Assets of \$74,000 used to reduce \$70,000 of liabilities. Company also had combination of net loss and net withdrawals of \$4,000 (or small net income offset by large withdrawals).

PA4. **LO 2.1** Each of the following situations relates to a different company.

	Company A	Company B	Company C	Company D
1 Revenues	\$16,500	\$167,320	?	\$235,000
2 Expenses	12,400	?	\$72,300	241,000
3 Gains	750	1,350	0	?
4 Losses	900	6,240	5,200	0
5 Net Income or (Loss)	?	(9,250)	5,100	6,300

A. For each of these independent situations, find the missing amounts.

B. How would stakeholders view the financial performance of each company? Explain.

Solution

A.

	Company A	Company B	Company C	Company D
1 Revenues	\$16,500	\$167,320	\$82,600	\$235,000
2 Expenses	\$12,400	\$171,680	\$72,300	\$241,000
3 Gains	\$750	\$1,350	\$0	\$12,300
4 Losses	<u>\$900</u>	<u>\$6,240</u>	<u>\$5,200</u>	<u>\$0</u>
5 Net Income or (Loss)	<u>\$3,950</u>	<u>(\$9,250)</u>	<u>\$5,100</u>	<u>\$6,300</u>
	24%	-6%	6%	3%

B. Stakeholders' views:

Company A has strong core business and minor impact from gains/losses.

Company B has poor core business and unfavorable gains/losses.

Company C has solid core business negatively impacted by large loss.

Company D has poor core business results that were hidden by large gain.

Note: Answers will vary but may include observations about each company's performance for ongoing operations (revenues-expenses) versus incidental activities (gains and losses).

Instructors may also consider introducing the concept of profit margin to highlight differences between dollar value and percentages.

PA5. **LO 2.2** For each of the following independent transactions, indicate whether there was an increase, a decrease, or no impact for each financial statement element.

Transaction	Assets	Liabilities	Owners' Equity
Paid cash for expenses			
Sold common stock for cash			
Owe vendor for purchase of asset			
Paid owners for dividends			
Paid vendor for amount previously owed			

Table 2.9

Solution

Transaction	Assets	Liabilities	Owners' Equity
Paid cash for expenses	Decrease	No Impact	Decrease
Sold common stock for cash	Increase	No Impact	Increase
Owe vendor for purchase of asset	Increase	Increase	No Impact
Paid owners for dividends	Decrease	No Impact	Decrease

Paid vendor for amount previously owed	Decrease	Decrease	No Impact
--	----------	----------	-----------

PA6. **LO 2.2** Olivia's Apple Orchard had the following transactions during the month of September, the first month in business.

Transaction	Amount	Asset	-	Liability	=	Owner's Equity
Amount owed for land purchase	\$50,000	\$50,000		\$50,000		\$0
Apple sales: cash	3,000	?		?		?
Apple sales: credit	6,000	?		?		?
Collections of credit sales	4,000	?		?		?
Cash purchase of equipment	10,000	?		?		?
Owner investments	25,000	?		?		?
Wages expenses paid	6,000	?		?		?
Fuel expenses paid	400	?		?		?
Amount owed for utility expense	1,000	?		?		?
Current totals		\$50,000		\$50,000		\$0

Complete the chart to determine the ending balances. As an example, the first transaction has been completed. Note: Negative amounts should be indicated with minus signs (–) and unaffected should be noted as \$0.

(Hints: 1. each transaction will involve two financial statement elements; 2. the net impact of the transaction may be \$0.)

Solution

Transaction	Amount	Asset	Liability	Owner's Equity
Amount owed for land purchase	\$50,000	\$50,000	\$50,000	\$0
Apple sales: cash	\$3,000	\$3,000	\$0	\$3,000
Apple sales: credit	\$6,000	\$6,000	\$0	\$6,000
Collections of credit sales	\$4,000	\$0	\$0	\$0
Cash purchase of equipment	\$10,000	\$0	\$0	\$0
Owner investments	\$25,000	\$25,000	\$0	\$25,000
Wages expenses paid	\$6,000	(\$6,000)	\$0	(\$6,000)
Fuel expenses paid	\$400	(\$400)	\$0	(\$400)
Amount owed for utility expense	\$1,000	<u>\$0</u>	<u>\$1,000</u>	<u>(\$1,000)</u>
		\$77,600	\$51,000	\$26,600

PA7. **LO 2.2** Using the information in Exercise PA6, determine the amount of revenue and expenses for Olivia's Apple Orchard for the month of September.

Solution

Revenue is \$9,000 (\$3,000 + \$6,000); expenses are \$7,400 (\$6,000 + 400 + \$1,000).

PA8. **LO 2.3** The following ten transactions occurred during the July grand opening of the Pancake Palace. Assume all Retained Earnings transactions relate to the primary purpose of the business.

OpenStax *Principles of Accounting, Volume 1: Financial Accounting*
Chapter 2: Introduction to Financial Statements

	Assets			Liabilities		Owner's Equity	
	Cash	Inventory	Equipment	Accounts Payable	Wages Payable	Common Stock	Retained Earnings
1	\$50,000					\$50,000	
2	(6,000)	\$6,000					
3			\$22,000	\$22,000			
4	1,250						\$ 1,250
5	(750)						(750)
6				600			(600)
7					\$3,000		(3,000)
8	3,200						3,200
9				175			(175)
10	(1,000)		1,000				
Ending Balance							

- Calculate the ending balance for each account.
- Create the income statement.
- Create the statement of owner's equity.
- Create the balance sheet.

Solution

(Condensed):

A.

	Assets			Liabilities		Owner's Equity	
	Cash	Inventory	Equipment	Accounts Payable	Wages Payable	Common Stock	Retained Earnings
1	\$50,000					\$50,000	
2	(\$6,000)	\$6,000					
3			\$22,000	\$22,000			
4	\$1,250						\$1,250
5	(\$750)						(\$750)
6				\$600			(\$600)
7					\$3,000		(\$3,000)
8	\$3,200						\$3,200
9				\$175			(\$175)
10	(\$1,000)		\$1,000				
A. Ending Balance	<u>\$46,700</u>	<u>\$6,000</u>	<u>\$23,000</u>	<u>\$22,775</u>	<u>\$3,000</u>	<u>\$50,000</u>	<u>(\$75)</u>
		\$75,700		\$75,700			

B.

Income Statement	
Revenues	\$4,450
Expenses	<u>(\$4,525)</u>
Net Loss	<u>(\$75)</u>

C.

Beginning Balance	\$0
-------------------	-----

Sale of Common Stock	\$50,000
Retained Earnings	<u>(\$75)</u>
Ending Balance	<u>\$49,925</u>

D.

Balance Sheet			
Cash	\$46,700	Accounts Payable	\$22,775
Inventory	\$6,000	Wages Payable	<u>\$3,000</u>
Equipment	\$23,000	Total Liabilities	\$25,775
		Common Stock	\$50,000
		Retained Earnings	<u>(\$75)</u>
		Total Equity	\$49,925
Total Assets	<u>\$75,700</u>	Total Liability and Owner's Equity	<u>\$75,700</u>

Problem Set B

PB1. **LO 2.1** The following information is taken from the records of Rosebloom Flowers for the year 2019.

Revenues: Jan.	\$36,425
Gains: Feb.	2,820
Losses: Mar.	8,695
Expenses: Feb.	50,807
Gains: Jan.	0
Revenues: Mar.	53,580
Losses: Feb.	3,760
Expenses: Mar.	58,985
Losses: Jan.	0
Revenues: Feb.	88,243
Expenses: Jan.	48,786
Gains: Mar.	13,160

- Calculate net income or net loss for January.
- Calculate net income or net loss for February.
- Calculate net income or net loss for March.
- For each situation, comment on how a stakeholder might view the firm's performance. (Hint: think about the source of the income or loss.)

Solution

	Revenues/ Expenses	Gains/ Losses	Net Income (Loss)	D. Comments
A. January	(\$12,361)	\$0	(\$12,361)	Earnings from ongoing (core) portion of business
B. February	\$37,436	(\$940)	\$36,496	Strong earnings from ongoing (core) portion of business; minor loss from peripheral activities
C. March	(\$5,405)	\$4,465	(\$940)	Poor earnings from core business;

masked by gain, which is peripheral

Note: Responses may also observe the strong month of February (Valentine's Day).

PB2. **LO 2.1** Each situation below relates to an independent company's Owners' Equity.

	Beginning Balance	+	Net Income	-	Net Loss	+	Investments	-	Distributions	=	Ending Balance
Co.1	\$163,800		\$16,500		\$ 0		?		\$ 1,750		\$254,150
Co.2	63,180		0		12,000		\$ 0		51,180		?
Co.3	0		0		?		150,000		0		101,400

A. Calculate the missing values.

B. Based on your calculations, make observations about each company.

Solution

A.

	Beginning Balance	Net Income	Net Loss	Investment s	Distribution s	Ending Balance
Co. 1	\$163,800	\$16,500	\$0	\$75,600	\$1,750	\$254,150
Co. 2	\$63,180	\$0	\$12,000	\$0	\$51,180	\$0
Co. 3	\$0	\$0	\$48,600	\$150,000	\$0	\$101,400

B. Observations: Company 1: strong performing company that is still attracting new investment with owners leaving all but a small portion in business; Company 2: business that has ended; Company 3: new business with poor financial performance—a sense of urgency due to rapidly declining equity.

PB3. **LO 2.1** The following information is from a new business. Comment on the year-to-year changes in the accounts and possible sources and uses funds (how were the funds obtained and used).

	Assets	-	Liabilities	=	Owner's Equity
End of Year 1	\$137,000		\$62,000		\$75,000
End of Year 2	148,000		57,000		91,000
End of Year 3	168,000		80,000		88,000

Solution

End of Year 1: Asset increase of \$137,000 financed by increase of liabilities of \$62,000 and combination of net income and net owner investments of \$75,000.

End of Year 2: Combination of net income and net owner investments of \$16,000 financed asset increase of \$11,000 and decrease of liabilities of \$5,000.

End of Year 3: Assets increase of \$20,000 financed by \$23,000 increase in liabilities, which also covered a combination of net loss and net withdrawals of \$3,000.

PB4. **LO 2.1** Each of the following situations relates to a different company.

	Company A	Company B	Company C	Company D
1 Revenues	?	\$1,480,500	\$103,950	\$1,054,116
2 Expenses	\$455,490	1,518,300	78,120	?
3 Gains	0	?	4,725	8,505
4 Losses	32,760	0	5,670	39,312
5 Net Income or (Loss)	<u>32,130</u>	<u>39,690</u>	<u>?</u>	<u>(58,275)</u>

A. For each of these independent situations, find the missing amounts.

B. How would stakeholders view the financial performance of each company? Explain.

Solution

A.

	Company A	Company B	Company C	Company D
1 Revenues	\$520,380	\$1,480,500	\$103,950	\$1,054,116
2 Expenses	\$455,490	\$1,518,300	\$78,120	\$1,081,584
3 Gains	\$0	\$77,490	\$4,725	\$8,505
4 Losses	<u>\$32,760</u>	<u>\$0</u>	<u>\$5,670</u>	<u>\$39,312</u>
5 Net Income or (Loss)	<u>\$32,130</u>	<u>\$39,690</u>	<u>\$24,885</u>	<u>(\$58,275)</u>
	6%	3%	24%	-6%

B. Stakeholders' views:

Company A has solid core business negatively impacted by large loss.

Company B has poor core business results that were hidden by large gain.

Company C has strong core business and minor impact from gains/losses.

Company D has poor core business and unfavorable gains/losses.

Note: Answers will vary but may include observations about each company's performance for ongoing operations (revenues-expenses) versus incidental activities (gains and losses).

Instructors may also consider introducing the concept of profit margin to highlight differences between dollar value and percentages.

PB5. **LO 2.2** For each of the following independent transactions, indicate whether there was an increase, decrease, or no impact on each financial statement element.

Transaction	Assets	Liabilities	Owners' Equity
Received cash for sale of asset (no gain or loss)			
Cash distribution to owner			
Cash sales			
Investment by owners			
Owe vendor for inventory purchase			

Table 2.10

Solution

Transaction	Assets	Liabilities	Owners' Equity
Received cash for sale of asset (no gain or loss)	No Impact	No Impact	No Impact
Cash distribution to owner	Decrease	No Impact	Decrease
Cash sales	Increase	No Impact	Increase
Investment by owners	Increase	No Impact	Increase
Owe vendor for inventory purchase	Increase	Increase	No Impact

PB6. **LO 2.2** Mateo's Maple Syrup had the following transactions during the month of February, its first month in business.

Transaction	Amount	Asset	-	Liability	=	Owner's Equity
Common stock sold	\$ 3,000	\$3,000		\$0		\$3,000
Amount owed for tax expense	1,950	?		?		?
Amount owed for insurance expense	750	?		?		?
Syrup sales: cash	13,000	?		?		?
Syrup sales: credit	6,000	?		?		?
Dividends paid	40	?		?		?
Collections of credit sales	1,700	?		?		?
Cash purchase for supplies expenses	250	?		?		?
Cash paid for amounts owed	1,600	?		?		?
Utility expenses paid	400	?		?		?
Taxes paid	600	?		?		?
		<u>\$3,000</u>		<u>\$0</u>		<u>\$3,000</u>

Complete the chart to determine the ending balances. As an example, the first transaction has been completed. Note: negative amounts should be indicated with minus signs (-).

(Hints: 1. each transaction will involve two financial statement elements; 2. the net impact of the transaction may be \$0.)

Solution

Transaction	Amount	Asset	-	Liability	=	Owner's Equity
Common stock sold	\$3,000	\$3,000		\$0		\$3,000
Amount owed for tax expense	\$1,950	\$0		\$1,950		(\$1,950)
Amount owed for insurance expense	\$750	\$0		\$750		(\$750)
Syrup sales-cash	\$13,000	\$13,000		\$0		\$13,000
Syrup sales-credit	\$6,000	\$6,000		\$0		\$6,000
Dividends paid	\$40	(\$40)		\$0		(\$40)
Collections of credit sales	\$1,700	\$0		\$0		\$0
Cash purchase for supplies expenses	\$250	(\$250)		\$0		(\$250)
Cash paid for amounts owed	\$1,600	(\$1,600)		(\$1,600)		\$0
Utility expenses paid	\$400	(\$400)		\$0		(\$400)
Taxes paid for amount owed	\$600	<u>(\$600)</u>		<u>(\$600)</u>		<u>\$0</u>
		\$19,110		\$500		\$18,610

PB7. **LO 2.2** Using the information in Exercise PB6, determine the amount of revenue and expenses for Mateo's Maple Syrup for the month of February.

Solution

Revenue is \$19,000 (\$13,000 + \$6,000); expenses are \$3,350 (\$1,950 + \$750 + \$250 + \$400).

Thought Provokers

TP1. **LO 2.1** Choose three stakeholders (or stakeholder groups) for **Walmart** and prepare a written response for each stakeholder. In your written response, consider the factors about the business the particular stakeholder would be interested in. Consider the financial and any nonfinancial factors that would be relevant to the stakeholder (or stakeholder group). Explain why these factors are important. Do some research and see if you can find support for your points.

Solution

Answers will vary. Responses should include investors, creditors, employees, and communities.

TP2. **LO 2.1** Assume you purchased ten shares of **Roku** during the company's IPO. Comment on why this might be a good investment. Consider factors such as what you expect to get from your investment, why you think **Roku** would become a publicly traded company, and what you think is the landscape of the industry **Roku** is in. What other factors might be relevant to your decision to invest in **Roku**?

Solution

Answers will vary. Responses should include the desire to get dividends and increase in stock value, Roku's growth goals, competitors, and future of the streaming market.

TP3. **LO 2.2** A trademark is an intangible asset that has value to a business. Assume that you are an accountant with the responsibility of valuing the trademark of a well-known company such as **Nike** or **McDonald's**. What makes each of these companies unique and adds value? While the value of a trademark may not necessarily be recorded on the company's balance sheet, discuss what factors you think would affect (increase or decrease) the value of the company's trademark? Consider your answer through the perspective of various stakeholders.

Solution

Nike has a distinctive advantage of product development and high performance. McDonald's has historically been an innovator in the fast-food industry. Considerations of a company's trademark would include trademark recognition, investments in trademark development (legal, branding), market structure/competitors, financial performance of the firm, opportunity for growth in sectors, and products.

TP4. **LO 2.3** For each of the following ten independent transactions, provide a written description of what occurred in each transaction. Figure 2.4 might help you.

	Assets			Liabilities		Owner's Equity	
	Cash	Inventory	Equipment	Accounts Payable	Wages Payable	Common Stock	Retained Earnings
1	\$57,500					\$57,500	
2	(6,900)	\$6,900					
3			\$25,300	\$25,300			
4	1,438						\$ 1,438
5	(863)						(863)
6				460			(460)
7					\$3,450		(3,450)
8	3,680						3,680
9				102			(102)
10	(1,150)		1,150				

Solution

1 Sold common stock for cash

2	Purchased inventory for cash
3	Purchased equipment on account
4	Cash sales
5	Paid cash for expenses (or dividends)
6	Purchased expense items on account
7	Wages to be paid
8	Cash sales
9	Purchased expense items on account
1	
0	Purchased equipment for cash

TP5. **LO 2.3** The following historical information is from Assisi Community Markets.

	Current Assets			Current Liabilities	
	Cash	Accounts Receivable	Inventory	Accounts Payable	Wages Payable
Year 1	\$42,000	\$12,500	\$ 6,200	\$12,500	\$3,200
Year 2	37,500	16,800	7,600	14,600	3,700
Year 3	26,800	22,900	10,300	19,800	4,500
Year 4	22,100	28,000	15,400	20,600	6,000
Year 5	15,700	29,500	16,700	22,900	8,200

Calculate the working capital and current ratio for each year. What observations do you make, and what actions might the owner consider taking?

Solution

Working Capital	Current Ratio
\$45,000	3.87
\$43,600	3.38
\$35,700	2.47
\$38,900	2.46
\$30,800	1.99

Answers will vary. Sample answer: The trend is that working capital generally trends down.

- The current ratio trends downward every year.
- The owner could look at improving accounts receivable collections and moving to lowering inventory levels (just-in-time).
- The owner could look at terms with vendors—perhaps the terms are out of line with industry norms.

Instructors may also use this as an opportunity to calculate (and graph) rates of change within each category.

Feature Boxes

Your Turn: Business Owners as Decision Makers

Solution

Business owners will use financial information for many decisions, such as comparing sales from one period to another, determining trends in costs and other expenses, and identifying areas in

which to reduce or reallocate expenses. This information will be used to determine, for example, staffing and inventory levels, streamlining of operations, and advertising or other investment decisions.

Your Turn: Coffee Shop Products

Solution

Many coffee shops earn revenue through multiple revenue streams, including coffee and other specialty drinks, food items, gift cards, and merchandise.

Your Turn: Coffee Shop Expenses

Solution

Costs of the coffee shop that might be readily observed would include rent; wages for the employees; and the cost of the coffee, pastries, and other items/merchandise that may be sold. In addition, costs such as utilities, equipment, and cleaning or other supplies might also be readily observable. More obscure costs of the coffee shop would include insurance, regulatory costs such as health department licensing, point-of-sale/credit card costs, advertising, donations, and payroll costs such as workers' compensation, unemployment, and so on.

Think It Through: Borrowing

Solution

Based on their research, students will likely find that payments for student loans do not typically begin until after the student graduates. Based on this, the student will not be delinquent on a student loan payment because there is no expectation for repayment while the student is pursuing his degree. It is typically expected, however, that the student will not miss a car payment (without incurring interest or penalties).

Your Turn: The Accounting Equation

Solution

Answers will vary but may include vehicles, clothing, electronics (include cell phones and computer/gaming systems, and sports equipment). They may also include money owed on these assets, most likely vehicles and perhaps cell phones. In the case of a student loan, there may be a liability with no corresponding asset (yet). Responses should be able to evaluate the benefit of investing in college is the wage differential between earnings with and without a college degree.

This resource file is copyright 2019, Rice University. All Rights Reserved.