CHAPTER 1
INTRODUCTION TO ACCOUNTING AND BUSINESS

EYE OPENERS

1. The objective of most businesses is to earn a profit. Profit is the difference between the amounts received from customers for goods or services provided and the amounts paid for the inputs used to provide those goods or services.
2. A manufacturing business changes basic inputs into products that are then sold to customers. A service business provides services rather than products to customers. A restaurant such as Applebee's has characteristics of both a manufacturing and a service business in that Applebee's takes raw inputs such as cheese, fish, and beef and processes them into products for consumption by its customers. At the same time, Applebee's provides services of waiting on its customers as they dine.
3. Some users of accounting information include owners, managers, employees, customers, creditors, and the government.
4. Simply put, the role of accounting is to provide information for managers to use in operating the business. In addition, accounting provides information to others to use in assessing the economic performance and condition of the business.
5. The corporate form allows the company to obtain large amounts of resources by issuing stock. For this reason, most companies that require large investments in property, plant, and equipment are organized as corporations.
6. No. The business entity concept limits the recording of economic data to transactions directly affecting the activities of the business. The payment of the interest of $3,000 is a personal transaction of Barry Bergan and should not be recorded by Elephant Delivery Service.
7. The land should be recorded at its cost of $115,000 to Gremlin Repair Service. This is consistent with the cost concept.
8. **a.** No. The offer of $900,000 and the increase in the assessed value should not be recognized in the accounting records.
   b. Cash would increase by $900,000, land would decrease by $475,000, and owner's equity would increase by $425,000.
9. An account receivable is a claim against a customer for goods or services sold. An account payable is an amount owed to a creditor for goods or services purchased. Therefore, an account receivable in the records of the seller is an account payable in the records of the purchaser.
10. (a); the business incurred a net loss of $115,000 ($715,000 – $600,000).
11. (b); the business realized net income of $195,100 ($687,500 – $492,400).
12. Net income or net loss
    Owner's equity at the end of the period
    Cash at the end of the period

PRACTICE EXERCISES

PE 1–1A

$81,000. Under the cost concept, the land should be recorded at the cost to Snap Repair Service.

PE 1–1B

$44,000. Under the cost concept, the land should be recorded at the cost to Terrier Repair Service.

PE 1–2A

a.

$$A = L + OE$$
$$\$475,000 = \$115,000 + OE$$
$$OE = \$360,000$$

b.

$$A = L + OE$$
$$+\$90,000 = \$28,000 + OE$$
$$OE = +\$62,000$$

OE on December 31, 2010 =
$422,000 = $360,000 + $62,000

PE 1–2B

a.

$$A = L + OE$$
$$\$750,000 = \$293,000 + OE$$
$$OE = \$457,000$$

b.

$$A = L + OE$$
$$+\$75,000 = -\$30,000 + OE$$
$$OE = +\$105,000$$

OE on December 31, 2010 =
$562,000 = $457,000 + $105,000

PE 1–3A

(2) Expense (Advertising Expense) increases by $900; Asset (Cash) decreases by $900.

(3) Asset (Supplies) increases by $600; Liability (Accounts Payable) increases by $600.

(4) Asset (Accounts Receivable) increases by $9,000; Revenue (Delivery Service Fees) increases by $9,000.

(5) Asset (Cash) increases by $5,500; Asset (Accounts Receivable) decreases by $5,500.

PE 1–3B

(2) Asset (Cash) decreases by $1,500; Liability (Accounts Payable) decreases by $1,500.

(3) Asset (Accounts Receivable) increases by $11,500; Revenue (Delivery Service Fees) increases by $11,500.

(4) Asset (Cash) increases by $2,700; Asset (Accounts Receivable) decreases by $2,700.

(5) Asset (Cash) decreases by $2,000; Drawing (Betty Pasha, Drawing) increases by $2,000.

PE 1–4A

IMPECCABLE TRAVEL SERVICE
Income Statement
For the Year Ended November 30, 2010

Fees earned		$754,000
Expenses:		
Wages expense	$450,000	
Office expense	313,300	
Miscellaneous expense	12,700	
Total expenses		776,000
Net loss		$ 22,000

PE 1–4B

EXPRESS TRAVEL SERVICE
Income Statement
For the Year Ended June 30, 2010

Fees earned		$475,000
Expenses:		
Wages expense	$239,000	
Office expense	111,000	
Miscellaneous expense	8,000	
Total expenses		358,000
Net income		$117,000

PE 1–5A

IMPECCABLE TRAVEL SERVICE
Statement of Owner's Equity
For the Year Ended November 30, 2010

Charly Maves, capital, December 1, 2009		$380,000
Additional investment by owner during year	$ 36,000	
Net loss for the year	(22,000)	
Less withdrawals	(20,000)	
Decrease in owner's equity		(6,000)
Charly Maves, capital, November 30, 2010		$374,000

PE 1–5B

EXPRESS TRAVEL SERVICE
Statement of Owner's Equity
For the Year Ended June 30, 2010

Janis Paisley, capital, July 1, 2009		$125,000
Additional investment by owner during year	$ 30,000	
Net income for the year	117,000	
	$147,000	
Less withdrawals	18,000	
Increase in owner's equity		129,000
Janis Paisley, capital, June 30, 2010		$254,000

PE 1–6A

IMPECCABLE TRAVEL SERVICE
Balance Sheet
November 30, 2010

Assets		Liabilities	
Cash	$ 45,400	Accounts payable	$ 42,000
Accounts receivable	75,500		
Supplies	5,100	Owner's Equity	
Land	290,000	Charly Maves, capital	374,000
		Total liabilities and	
Total assets	$416,000	owner's equity	$416,000

PE 1–6B

EXPRESS TRAVEL SERVICE
Balance Sheet
June 30, 2010

Assets		Liabilities	
Cash	$ 78,000	Accounts payable	$ 12,000
Accounts receivable	32,000		
Supplies	6,000	Owner's Equity	
Land	150,000	Janis Paisley, capital	254,000
		Total liabilities and	
Total assets	$266,000	owner's equity	$266,000

PE 1–7A

IMPECCABLE TRAVEL SERVICE
Statement of Cash Flows
For the Year Ended November 30, 2010

Cash flows from operating activities:		
Cash received from customers	$ 700,000	
Deduct cash payments for operating expenses	730,000	
Net cash flows from operating activities		$ (30,000)
Cash flows from investing activities:		
Cash payments for purchase of land		(54,000)
Cash flows from financing activities:		
Cash received from owner as investment	$ 36,000	
Deduct cash withdrawals by owner	20,000	
Net cash flows from financing activities		16,000
Net decrease in cash during year		$ (68,000)
Cash as of December 1, 2009		113,400
Cash as of November 30, 2010		$ 45,400

PE 1–7B

EXPRESS TRAVEL SERVICE
Statement of Cash Flows
For the Year Ended June 30, 2010

Cash flows from operating activities:		
Cash received from customers	$460,000	
Deduct cash payments for operating expenses	355,000	
Net cash flows from operating activities		$105,000
Cash flows from investing activities:		
Cash payments for purchase of land		(104,000)
Cash flows from financing activities:		
Cash received from owner as investment	$ 30,000	
Deduct cash withdrawals by owner	18,000	
Net cash flows from financing activities		12,000
Net increase in cash during year		$ 13,000
Cash as of July 1, 2009		65,000
Cash as of June 30, 2010		$ 78,000

EXERCISES

Ex. 1–1

1. service
2. service
3. merchandise
4. manufacturing
5. service
6. manufacturing
7. service
8. manufacturing
9. manufacturing
10. service
11. merchandise
12. service
13. merchandise
14. manufacturing
15. manufacturing

Ex. 1–2

As in many ethics issues, there is no one right answer. A fired researcher at the company reported on this issue in these terms: “The company covered up the first report, and the local newspaper uncovered the company’s secret. The company was forced to not locate here (Collier County). It became patently clear that doing the least that is legally allowed is not enough.”

Ex. 1–3

1. C
2. C
3. X
4. C
5. B
6. C
7. B
8. J
9. X
10. J

Ex. 1–4

Coca-Cola owners’ equity: $29,963 – $13,043 = $16,920
PepsiCo owners’ equity: $29,930 – $14,483 = $15,447

Ex. 1–5

eBay	$13,494 – $2,589 = $10,905
Google	$18,473 – $1,433 = $17,040

Ex. 1–6

a. $1,030,000 ($250,000 + $780,000)
b. $85,500 ($125,000 – $39,500)
c. $52,500 ($60,000 – $7,500)

Ex. 1–7

a. $520,000 ($760,000 – $240,000)
b. $568,000 ($520,000 + $120,000 – $72,000)
c. $438,400 ($520,000 – $60,000 – $21,600)
d. $658,400 ($520,000 + $100,000 + $38,400)
e. Net income: $284,000 ($960,000 – $156,000 – $520,000)

Ex. 1–8

a. (2) liability
b. (1) asset
c. (3) owner's equity
d. (1) asset
e. (1) asset
f. (3) owner's equity

Ex. 1–9

a. Increases assets and increases owner's equity.
b. Increases assets and increases owner's equity.
c. Decreases assets and decreases owner's equity.
d. Increases assets and decreases assets.
e. Increases assets and increases liabilities.

Ex. 1–10

a. (1) Total assets increased $140,000.
   (2) No change in liabilities.
   (3) Owner's equity increased $140,000.

b. (1) Total assets decreased $80,000.
   (2) Total liabilities decreased $80,000.
   (3) No change in owner's equity.

Ex. 1–11

1. (b) decrease
2. (a) increase
3. (a) increase
4. (b) decrease

Ex. 1–12

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

Ex. 1–13

a. (1) Provided catering services for cash, $35,000.
   (2) Purchase of land for cash, $15,000.
   (3) Payment of expenses, $26,000.
   (4) Purchase of supplies on account, $1,500.
   (5) Withdrawal of cash by owner, $2,000.
   (6) Payment of cash to creditors, $7,200.
   (7) Recognition of cost of supplies used, $3,000.

b. $15,200 ($30,000 – $14,800)
c. $4,000 (–$2,000 + $35,000 – $29,000)
d. $6,000 ($35,000 – $29,000)
e. $4,000 ($6,000 – $2,000)

Ex. 1–14

No. It would be incorrect to say that the business had incurred a net loss of $25,000. The excess of the withdrawals over the net income for the period is a decrease in the amount of owner's equity in the business.

Ex. 1–15

Jupiter

Owner's equity at end of year	
($1,296,000 – $540,000)	$756,000
Deduct owner's equity at beginning of year	
($810,000 – $324,000)	486,000
Net income (increase in owner's equity)	$270,000

Mercury

Increase in owner's equity (as determined for Jupiter)	$270,000
Add withdrawals	72,000
Net income	$342,000

Saturn

Increase in owner's equity (as determined for Jupiter)	$270,000
Deduct additional investment	162,000
Net income	$108,000

Venus

Increase in owner's equity (as determined for Jupiter)	$270,000
Deduct additional investment	162,000
	$108,000
Add withdrawals	72,000
Net income	$180,000

Ex. 1–16

Balance sheet items: 1, 2, 4, 5, 6, 10

Ex. 1–17

Income statement items: 3, 7, 8, 9

Ex. 1–18

TEFLON COMPANY
Statement of Owner's Equity
For the Month Ended April 30, 2010

Hedi Fry, capital, April 1, 2010		$715,320
Net income for the month	$93,780	
Less withdrawals	10,000	
Increase in owner's equity		83,780
Hedi Fry, capital, April 30, 2010		$799,100

Ex. 1–19

RELAX SERVICES
Income Statement
For the Month Ended May 31, 2010

Fees earned		$363,200
Expenses:		
Wages expense	$187,000	
Rent expense	36,000	
Supplies expense	11,500	
Miscellaneous expense	12,100	
Total expenses		246,600
Net income		$116,600

Ex. 1–20

In each case, solve for a single unknown, using the following equation:
Owner's equity (beginning) + Investments – Withdrawals + Revenues – Expenses = Owner's equity (ending)

Earth	Owner's equity at end of year ($268,200 – $117,000)		$151,200
	Owner's equity at beginning of year ($216,000 – $129,600)		86,400
	Increase in owner's equity		$ 64,800
	Deduct increase due to net income ($71,190 – $38,880)		32,310
			$ 32,490
	Add withdrawals		14,400
	Additional investment in the business	(a)	$ 46,890
Mars	Owner's equity at end of year ($350,000 – $110,000)		$240,000
	Owner's equity at beginning of year ($250,000 – $130,000)		120,000
	Increase in owner's equity		$120,000
	Add withdrawals		16,000
			$136,000
	Deduct additional investment		50,000
	Increase due to net income		$ 86,000
	Add expenses		64,000
	Revenue	(b)	$150,000
Neptune	Owner's equity at end of year ($90,000 – $80,000)		$ 10,000
	Owner's equity at beginning of year ($100,000 – $76,000)		24,000
	Decrease in owner's equity		$ (14,000)
	Deduct decrease due to net loss ($115,000 – $122,500)		(7,500)
			$ (6,500)
	Deduct additional investment		10,000
	Withdrawals from the business	(c)	$ (16,500)
Pluto	Owner's equity at end of year ($248,000 – $136,000)		$112,000
	Add decrease due to net loss ($112,000 – $128,000)		16,000
			$128,000
	Add withdrawals		60,000
	Owner's equity at beginning of year		$188,000
	Deduct additional investment		40,000
			$148,000
	Add liabilities at beginning of year		120,000
	Assets at beginning of year	(d)	$268,000

Ex. 1–21

a.

PLEXIGLASS INTERIORS
Balance Sheet
October 31, 2010

Assets		Liabilities	
Cash	$180,000	Accounts payable	$ 46,200
Accounts receivable	102,000		
Supplies	9,000	Owner's Equity	
		Claudia Symonds, capital	244,800
		Total liabilities and	
Total assets	$291,000	owner's equity	$291,000

PLEXIGLASS INTERIORS
Balance Sheet
November 30, 2010

Assets		Liabilities	
Cash	$306,000	Accounts payable	$ 49,800
Accounts receivable	117,375		
Supplies	7,500	Owner's Equity	
		Claudia Symonds, capital	381,075
		Total liabilities and	
Total assets	$430,875	owner's equity	$430,875

b.

Owner's equity, November 30	$381,075
Owner's equity, October 31	244,800
Net income	$136,275

c.

Owner's equity, November 30	$381,075
Owner's equity, October 31	244,800
Increase in owner's equity	$136,275
Add withdrawal	37,500
Net income	$173,775

Ex. 1–22

Balance sheet: a, b, c, d, f, g, h, i, j, k, m
Income statement: e, l, n, o

Ex. 1–23

1. c–financing activity
2. b–investing activity
3. a–operating activity
4. a–operating activity

Ex. 1–24

PICKEREL CONSULTING GROUP
Statement of Cash Flows
For the Year Ended March 31, 2010

Cash flows from operating activities:		
Cash received from customers	$239,100	
Deduct cash payments for operating expenses	162,900	
Net cash flows from operating activities		$ 76,200
Cash flows from investing activities:		
Cash payments for purchase of land		(75,000)
Cash flows from financing activities:		
Cash received from owner as investment	$ 50,000	
Deduct cash withdrawals by owner	10,000	
Net cash flows from financing activities		40,000
Net increase in cash during year		$ 41,200
Cash as of April 1, 2009		30,800
Cash as of March 31, 2010		$ 72,000

Ex. 1–25

1. All financial statements should contain the name of the business in their heading. The statement of owner's equity is incorrectly headed as "Steffy Owen" rather than Driftwood Realty. The heading of the balance sheet needs the name of the business.
2. The income statement and statement of owner's equity cover a period of time and should be labeled "For the Month Ended August 31, 2010."
3. The year in the heading for the statement of owner's equity should be 2010 rather than 2009.
4. The balance sheet should be labeled as of "August 31, 2010," rather than "For the Month Ended August 31, 2010."
5. In the income statement, the miscellaneous expense amount should be listed as the last expense.
6. In the income statement, the total expenses are incorrectly subtracted from the sales commissions, resulting in an incorrect net income amount. The correct net income should be $44,100. This also affects the statement of owner's equity and the amount of Steffy Owen, capital, that appears on the balance sheet.
7. In the statement of owner's equity, the additional investment should be added first to Steffy Owen, capital, as of August 1, 2010. The net income should be presented next, followed by the amount of withdrawals, which is subtracted from the net income to yield a net increase in owner's equity.
8. Accounts payable should be listed as a liability on the balance sheet.
9. Accounts receivable and supplies should be listed as assets on the balance sheet.
10. The balance sheet assets should equal the sum of the liabilities and owner's equity.

Ex. 1–25 Concluded

Corrected financial statements appear as follows:

DRIFTWOOD REALTY
Income Statement
For the Month Ended August 31, 2010

Sales commissions		$467,100
Expenses:		
Office salaries expense	$291,600	
Rent expense	99,000	
Automobile expense	22,500	
Supplies expense	2,700	
Miscellaneous expense	7,200	
Total expenses		423,000
Net income		$ 44,100

DRIFTWOOD REALTY
Statement of Owner's Equity
For the Month Ended August 31, 2010

Steffy Owen, capital, August 1, 2010		$ 93,600
Additional investment during August	$22,500	
Net income for August	44,100	
	$66,600	
Less withdrawals during August	18,000	
Increase in owner's equity		48,600
Steffy Owen, capital, August 31, 2010		$142,200

DRIFTWOOD REALTY
Balance Sheet
August 31, 2010

Assets		Liabilities	
Cash	$ 29,700	Accounts payable	$ 34,200
Accounts receivable	128,700		
Supplies	18,000	Owner's Equity	
		Steffy Owen, capital	142,200
		Total liabilities and	
Total assets	$176,400	owner's equity	$176,400

Ex. 1–26

a. **2007: $27,233 ($52,263 – $25,030)**
2006: $17,496 ($44,405 – $26,909)

b. **2007: 1.09 ($27,233 ÷ $25,030)**
2006: 0.65 ($17,496 ÷ $26,909)

c. **The ratio of liabilities to stockholders' equity increased from 2006 to 2007, indicating an increase in risk for creditors. However, the assets of The Home Depot are more than sufficient to satisfy creditor claims.**

Ex. 1–27

a. **2007: $15,725 ($27,767 – $12,042)**
2006: $14,296 ($24,639 – $10,343)

b. **2007: 0.77 ($12,042 ÷ $15,725)**
2006: 0.72 ($10,343 ÷ $14,296)

c. **The margin of safety for creditors has remained approximately the same from 2006 to 2007. In both years, creditors have less at stake in Lowe's than do stockholders, since the ratio is less than 1.**

d. **Lowe's ratio of liabilities to stockholders' equity is less than 1. In comparison, Home Depot's ratio of liabilities to stockholders' equity has increased from 2006 and is greater than 1 for 2007. Thus, the creditors of Home Depot are more at risk than are the creditors of Lowe's.**

PROBLEMS

Prob. 1–1A

1.

	Assets			= Liabilities +	Owner's Equity							
	Cash +	Accts. Rec. +	Supplies =	Accts. Payable +	Jean Howard, Capital –	Jean Howard, Drawing +	Fees Earned –	Rent Exp. –	Sal. Exp. –	Supp. Exp. –	Auto Exp. –	Misc. Exp.
a.	+ 50,000				+ 50,000							
b.			+ 1,600	+ 1,600								
Bal.	50,000		1,600	1,600	50,000							
c.	– 500			– 500								
Bal.	49,500		1,600	1,100	50,000							
d.	+ 9,250						+ 9,250					
Bal.	58,750		1,600	1,100	50,000		9,250					
e.	– 2,500							– 2,500				
Bal.	56,250		1,600	1,100	50,000		9,250	– 2,500				
f.	– 1,200										– 900	– 300
Bal.	55,050		1,600	1,100	50,000		9,250	– 2,500			– 900	– 300
g.	– 1,900								– 1,900			
Bal.	53,150		1,600	1,100	50,000		9,250	– 2,500	– 1,900		– 900	– 300
h.			– 1,050							– 1,050		
Bal.	53,150		550	1,100	50,000		9,250	– 2,500	– 1,900	– 1,050	– 900	– 300
i.		+ 11,150					+ 11,150					
Bal.	53,150	11,150	550	1,100	50,000		20,400	– 2,500	– 1,900	– 1,050	– 900	– 300
j.	– 2,700					– 2,700						
Bal.	50,450	11,150	550	1,100	50,000	– 2,700	20,400	– 2,500	– 1,900	– 1,050	– 900	– 300

2. Owner's equity is the right of owners to the assets of the business. These rights are increased by owner's investments and revenues and decreased by owner's withdrawals and expenses.

Prob. 1–2A

1.

HEAVENLY TRAVEL SERVICE
Income Statement
For the Year Ended April 30, 2010

Fees earned		$600,000
Expenses:		
Wages expense	$232,640	
Rent expense	80,900	
Utilities expense	49,150	
Supplies expense	13,200	
Taxes expense	10,250	
Miscellaneous expense	5,000	
Total expenses		391,140
Net income		$208,860

2.

HEAVENLY TRAVEL SERVICE
Statement of Owner's Equity
For the Year Ended April 30, 2010

Jennifer Burch, capital, May 1, 2009		$ 45,540
Net income for the year	$208,860	
Less withdrawals	25,000	
Increase in owner's equity		183,860
Jennifer Burch, capital, April 30, 2010		$229,400

3.

HEAVENLY TRAVEL SERVICE
Balance Sheet
April 30, 2010

Assets		Liabilities	
Cash	$159,200	Accounts payable	$ 14,600
Accounts receivable	78,000		
Supplies	6,800	Owner's Equity	
		Jennifer Burch, capital	229,400
Total assets	$244,000	Total liabilities and owner's equity	$244,000

Prob. 1–3A

1.

OMH COMPUTER SERVICES
Income Statement
For the Month Ended July 31, 2010

Fees earned		$ 50,250
Expenses:		
Salaries expense	$ 12,000	
Rent expense	8,000	
Auto expense	3,875	
Supplies expense	1,525	
Miscellaneous expense	1,875	
Total expenses		27,275
Net income		$ 22,975

2.

OMH COMPUTER SERVICES
Statement of Owner's Equity
For the Month Ended July 31, 2010

Doug Van Buren, capital, July 1, 2010		$ 0
Investment on July 1, 2010	$30,000	
Net income for July	22,975	
	$52,975	
Less withdrawals	7,500	
Increase in owner's equity		45,475
Doug Van Buren, capital, July 31, 2010		$45,475

3.

OMH COMPUTER SERVICES
Balance Sheet
July 31, 2010

Assets		Liabilities	
Cash	$ 25,000	Accounts payable	$ 1,350
Accounts receivable	20,750		
Supplies	1,075	Owner's Equity	
		Doug Van Buren, capital	45,475
		Total liabilities and	
Total assets	$ 46,825	owner's equity	$ 46,825

Prob. 1–3A Concluded

4. (Optional)

OMH COMPUTER SERVICES
Statement of Cash Flows
For the Month Ended July 31, 2010

Cash flows from operating activities:		
Cash received from customers	$ 29,500	
Deduct cash payments for expenses and payments to creditors	27,000*	
Net cash flow from operating activities		$ 2,500
Cash flows from investing activities:		0
Cash flows from financing activities:		
Cash received as owner's investment	$ 30,000	
Deduct cash withdrawal by owner	7,500	
Net cash flow from financing activities		22,500
Net cash flow and July 31, 2010, cash balance		$ 25,000

*$8,000 + $1,250 + $5,750 + $12,000

Prob. 1–4A

1.

	Assets		= Liabilities +	Owner's Equity							
	Cash +	Supplies =	Accts. Payable +	Ryan Barnes, Capital –	Ryan Barnes, Drawing +	Sales Comm. –	Office Sal. Exp. –	Rent Exp. –	Auto Exp. –	Supp. Exp. –	Misc. Exp.
a.	+ 25,000			+25,000							
b.	– 3,200							– 3,200			
Bal.	21,800			25,000				– 3,200			
c.	– 2,000								– 1,200		– 800
Bal.	19,800			25,000				– 3,200	– 1,200		– 800
d.		+ 900	+ 900								
Bal.	19,800	900	900	25,000				– 3,200	– 1,200		– 800
e.	+ 24,000					+ 24,000					
Bal.	43,800	900	900	25,000		24,000		– 3,200	– 1,200		– 800
f.	– 400		– 400								
Bal.	43,400	900	500	25,000		24,000		– 3,200	– 1,200		– 800
g.	– 3,600						– 3,600				
Bal.	39,800	900	500	25,000		24,000	– 3,600	– 3,200	– 1,200		– 800
h.	– 3,000				– 3,000						
Bal.	36,800	900	500	25,000	– 3,000	24,000	– 3,600	– 3,200	– 1,200		– 800
i.		– 750								– 750	
Bal.	36,800	150	500	25,000	– 3,000	24,000	– 3,600	– 3,200	– 1,200	– 750	– 800

Prob. 1–4A Concluded

2.

COYOTE REALTY
Income Statement
For the Month Ended April 30, 2010

Sales commissions		$24,000
Expenses:		
Office salaries expense	$3,600	
Rent expense	3,200	
Automobile expense	1,200	
Supplies expense	750	
Miscellaneous expense	800	
Total expenses		9,550
Net income		$14,450

COYOTE REALTY
Statement of Owner's Equity
For the Month Ended April 30, 2010

Ryan Barnes, capital, April 1, 2010		$ 0
Investment on April 1, 2010	$25,000	
Net income for April	14,450	
	$39,450	
Less withdrawals	3,000	
Increase in owner's equity		36,450
Ryan Barnes, capital, April 30, 2010		$36,450

COYOTE REALTY
Balance Sheet
April 30, 2010

Assets		Liabilities	
Cash	$36,800	Accounts payable	$ 500
Supplies	150		
		Owner's Equity	
		Ryan Barnes, capital	36,450
		Total liabilities and	
Total assets	$36,950	owner's equity	$36,950

Prob. 1–5A

1.

Assets							=	Liabilities	+	Owner's Equity
Cash	+	Accounts Receivable	+	Supplies	+	Land	=	Accounts Payable	+	Maria Acosta, Capital
34,200	+	40,000	+	5,000	+	50,000	=	16,400	+	Maria Acosta, Capital
		129,200					=	16,400	+	Maria Acosta, Capital
		112,800					=			Maria Acosta, Capital

Prob. 1–5A Continued

2.

	Assets				= Liabilities +	Owner's Equity	
	Cash	+ Accounts Receivable	+ Supplies	+ Land	= Accounts Payable	+ Maria Acosta, Capital	– Maria Acosta, Drawing
Bal.	34,200	40,000	5,000	50,000	16,400	112,800	
a.	+ 35,000					+ 35,000	
Bal.	69,200	40,000	5,000	50,000	16,400	147,800	
b.	– 30,000			+ 30,000			
Bal.	39,200	40,000	5,000	80,000	16,400	147,800	
c.	– 4,500						
Bal.	34,700	40,000	5,000	80,000	16,400	147,800	
d.		+ 18,250					
Bal.	34,700	58,250	5,000	80,000	16,400	147,800	
e.	– 9,000				– 9,000		
Bal.	25,700	58,250	5,000	80,000	7,400	147,800	
f.			+ 2,800		+ 2,800		
Bal.	25,700	58,250	7,800	80,000	10,200	147,800	
g.	+ 31,750						
Bal.	57,450	58,250	7,800	80,000	10,200	147,800	
h.	+ 27,800	– 27,800					
Bal.	85,250	30,450	7,800	80,000	10,200	147,800	
i.					+ 14,800		
Bal.	85,250	30,450	7,800	80,000	25,000	147,800	
j.	– 12,500						
Bal.	72,750	30,450	7,800	80,000	25,000	147,800	
k.			– 4,250				
Bal.	72,750	30,450	3,550	80,000	25,000	147,800	
l.	– 10,000						– 10,000
Bal.	62,750	30,450	3,550	80,000	25,000	147,800	– 10,000

Prob. 1–5A Continued

Owner's Equity (Continued)

	+ Dry Cleaning Revenue	– Dry Cleaning Exp.	– Wages Exp.	– Rent Exp.	– Supplies Exp.	– Truck Exp.	– Utilities Exp.	– Misc. Exp.
Bal.								
a.								
Bal.								
b.								
Bal.								
c.				– 4,500				
Bal.				– 4,500				
d.	+ 18,250							
Bal.	18,250			– 4,500				
e.								
Bal.	18,250			– 4,500				
f.								
Bal.	18,250			– 4,500				
g.	+ 31,750							
Bal.	50,000			– 4,500				
h.								
Bal.	50,000			– 4,500				
i.		– 14,800						
Bal.	50,000	– 14,800		– 4,500				
j.			– 8,200			– 1,875	– 1,575	– 850
Bal.	50,000	– 14,800	– 8,200	– 4,500		– 1,875	– 1,575	– 850
k.					– 4,250			
Bal.	50,000	– 14,800	– 8,200	– 4,500	– 4,250	– 1,875	– 1,575	– 850
l.								
Bal.	50,000	– 14,800	– 8,200	– 4,500	– 4,250	– 1,875	– 1,575	– 850

Prob. 1–5A Continued

3.

COLFAX DRY CLEANERS
Income Statement
For the Month Ended November 30, 2010

Dry cleaning revenue		$50,000
Expenses:		
Dry cleaning expense	$ 14,800	
Wages expense	8,200	
Rent expense	4,500	
Supplies expense	4,250	
Truck expense	1,875	
Utilities expense	1,575	
Miscellaneous expense	850	
Total expenses		36,050
Net income		$13,950

COLFAX DRY CLEANERS
Statement of Owner's Equity
For the Month Ended November 30, 2010

Maria Acosta, capital, November 1, 2010			$112,800
Additional investment by Maria Acosta	$35,000		
Net income for November	13,950	$ 48,950	
Less withdrawals		10,000	
Increase in owner's equity			38,950
Maria Acosta, capital, November 30, 2010			$151,750

COLFAX DRY CLEANERS
Balance Sheet
November 30, 2010

Assets		Liabilities	
Cash	$ 62,750	Accounts payable	$ 25,000
Accounts receivable	30,450		
Supplies	3,550	Owner's Equity	
Land	80,000	Maria Acosta, capital	151,750
		Total liabilities and	
Total assets	$176,750	owner's equity	$176,750

Prob. 1–5A Concluded

4. (Optional)

COLFAX DRY CLEANERS
Statement of Cash Flows
For the Month Ended November 30, 2010

Cash flows from operating activities:		
Cash received from customers	$ 59,550*	
Deduct cash payments for expenses and payments to creditors	26,000**	
Net cash flow from operating activities		$ 33,550
Cash flows from investing activities:		
Purchase of land		(30,000)
Cash flows from financing activities:		
Cash received as owner's investment	$ 35,000	
Deduct cash withdrawal by owner	10,000	
Net cash flow from financing activities		25,000
Increase in cash		$ 28,550
Cash balance, November 1, 2010		34,200
Cash balance, November 30, 2010		$ 62,750

*$31,750 + $27,800
**$4,500 + $9,000 + $12,500

Prob. 1–6A

a. Wages expense, $54,825 ($121,890 – $24,480 – $20,400 – $13,770 – $8,415)

b. Net income, $117,810 ($239,700 – $121,890)

c. Jeremy Parks, capital, July 1, 2010, $0

d. Investment on July 1, 2010, $459,000; from statement of cash flows.

e. Net income for July, $117,810

f. $576,810 ($459,000 + $117,810)

g. Withdrawals, $61,200; from statement of cash flows.

h. Increase in owner's equity, $515,610 ($576,810 – $61,200)

i. Jeremy Parks, capital, July 31, 2010, $515,610

j. Land, $367,200; from statement of cash flows.

k. Total assets, $527,850

l. Jeremy Parks, capital, $515,610

m. Total liabilities and owner's equity, $527,850 ($12,240 + $515,610)

n. Cash received from customers, $239,700; this is the same as fees earned since there are no accounts receivable.

o. Net cash flow from operating activities, $119,850 ($239,700 – $119,850)

p. Net cash flow from financing activities, $397,800 ($459,000 – $61,200)

q. Net cash flow and July 31, 2010, cash balance, $150,450

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Prob. 1–1B

1.

	Assets					= Liabilities +		Owner's Equity															
	Cash	+	Accts. Rec.	+	Supplies	=	Accts. Payable	+	Rhea Quade, Capital	–	Rhea Quade, Drawing	+	Fees Earned	–	Rent Exp.	–	Sal. Exp.	–	Supp. Exp.	–	Auto Exp.	–	Misc. Exp.
a.	+ 30,000								+ 30,000														
b.					+ 1,750		+ 1,750																
Bal.	30,000				1,750		1,750		30,000														
c.	+ 3,600												+ 3,600										
Bal.	33,600				1,750		1,750		30,000				3,600										
d.	– 1,300														– 1,300								
Bal.	32,300				1,750		1,750		30,000				3,600		– 1,300								
e.	– 500						– 500																
Bal.	31,800				1,750		1,250		30,000				3,600		– 1,300								
f.			+ 4,800										+ 4,800										
Bal.	31,800		4,800		1,750		1,250		30,000				8,400		– 1,300								
g.	– 700																				– 500		– 200
Bal.	31,100		4,800		1,750		1,250		30,000				8,400		– 1,300						– 500		– 200
h.	– 1,000																– 1,000						
Bal.	30,100		4,800		1,750		1,250		30,000				8,400		– 1,300		– 1,000				– 500		– 200
i.					– 950														– 950				
Bal.	30,100		4,800		800		1,250		30,000				8,400		– 1,300		– 1,000		– 950		– 500		– 200
j.	– 2,000										– 2,000												
Bal.	28,100		4,800		800		1,250		30,000		– 2,000		8,400		– 1,300		– 1,000		– 950		– 500		– 200

2. Owner's equity is the right of owners to the assets of the business. These rights are increased by owner's investments and revenues and decreased by owner's withdrawals and expenses.

Prob. 1–2B

1\.

ST. KITTS TRAVEL AGENCY
Income Statement
For the Year Ended December 31, 2010

Fees earned		$125,000
Expenses:		
Wages expense	$32,500	
Rent expense	12,500	
Utilities expense	9,100	
Supplies expense	1,400	
Miscellaneous expense	750	
Total expenses		56,250
Net income		$ 68,750

2\.

ST. KITTS TRAVEL AGENCY
Statement of Owner's Equity
For the Year Ended December 31, 2010

Robin Egan, capital, January 1, 2010		$ 45,000
Net income for the year	$68,750	
Less withdrawals	7,500	
Increase in owner's equity		61,250
Robin Egan, capital, December 31, 2010		$106,250

3\.

ST. KITTS TRAVEL AGENCY
Balance Sheet
December 31, 2010

Assets		Liabilities	
Cash	$ 90,000	Accounts payable	$ 6,250
Accounts receivable	21,150		
Supplies	1,350	Owner's Equity	
		Robin Egan, capital	106,250
Total assets	$112,500	Total liabilities and owner's equity	$112,500

Prob. 1–3B

1.

FAIR PLAY FINANCIAL SERVICES
Income Statement
For the Month Ended January 31, 2010

Fees earned		$39,500
Expenses:		
Salaries expense	$ 16,000	
Rent expense	7,500	
Auto expense	4,500	
Supplies expense	1,500	
Miscellaneous expense	1,200	
Total expenses		30,700
Net income		$ 8,800

2.

FAIR PLAY FINANCIAL SERVICES
Statement of Owner's Equity
For the Month Ended January 31, 2010

Ashley Rhymer, January 1, 2010		$ 0
Investment on January 1, 2010	$15,000	
Net income for January	8,800	
	$23,800	
Less withdrawals	5,000	
Increase in owner's equity		18,800
Ashley Rhymer, capital, January 31, 2010		$18,800

3.

FAIR PLAY FINANCIAL SERVICES
Balance Sheet
January 31, 2010

Assets		Liabilities	
Cash	$ 8,200	Accounts payable	$ 1,580
Accounts receivable	11,500		
Supplies	680	**Owner's Equity**	
		Ashley Rhymer, capital	18,800
		Total liabilities and	
Total assets	$ 20,380	owner's equity	$ 20,380

Prob. 1–3B Concluded

4. (Optional)

FAIR PLAY FINANCIAL SERVICES
Statement of Cash Flows
For the Month Ended January 31, 2010

Cash flows from operating activities:		
Cash received from customers	$ 28,000	
Deduct cash payments for expenses and payments to creditors	29,800*	
Net cash flow used for operating activities		$ (1,800)
Cash flows from investing activities		0
Cash flows from financing activities:		
Cash received as owner's investment	$ 15,000	
Deduct cash withdrawal by owner	5,000	
Net cash flow from financing activities		10,000
Net cash flow and January 31, 2010, cash balance		$ 8,200

*$600 + $7,500 + $5,700 + $16,000

Prob. 1–4B

1.

	Assets		= Liabilities +	Owner's Equity							
	Cash	+ Supplies	= Accts. Payable	+ Tanja Zier, Capital	– Tanja Zier, Drawing	+ Sales Comm.	– Office Sal. Exp.	– Rent Exp.	– Auto Exp.	– Supp. Exp.	– Misc. Exp.
a.	+ 20,000			+20,000							
b.		+ 2,650	+ 2,650								
Bal.	20,000	+ 2,650	2,650	20,000							
c.	– 1,600		– 1,600								
Bal.	18,400	2,650	1,050	20,000							
d.	+ 28,750					+ 28,750					
Bal.	47,150	2,650	1,050	20,000		28,750					
e.	– 4,200							– 4,200			
Bal.	42,950	2,650	1,050	20,000		28,750		– 4,200			
f.	– 5,000				– 5,000						
Bal.	37,950	2,650	1,050	20,000	– 5,000	28,750		– 4,200			
g.	– 3,700								– 2,500		– 1,200
Bal.	34,250	2,650	1,050	20,000	– 5,000	28,750		– 4,200	– 2,500		– 1,200
h.	– 10,000						– 10,000				
Bal.	24,250	2,650	1,050	20,000	– 5,000	28,750	– 10,000	– 4,200	– 2,500		– 1,200
i.		– 1,650								– 1,650	
Bal.	24,250	1,000	1,050	20,000	– 5,000	28,750	– 10,000	– 4,200	– 2,500	– 1,650	– 1,200

Prob. 1–4B Concluded

2.

ROYAL REALTY
Income Statement
For the Month Ended August 31, 2010

Sales commissions		$28,750
Expenses:		
Office salaries expense	$10,000	
Rent expense	4,200	
Automobile expense	2,500	
Supplies expense	1,650	
Miscellaneous expense	1,200	
Total expenses		19,550
Net income		$ 9,200

ROYAL REALTY
Statement of Owner's Equity
For the Month Ended August 31, 2010

Tanja Zier, capital, August 1, 2010		$ 0
Investment on August 1, 2010	$20,000	
Net income for August	9,200	
	$29,200	
Less withdrawals	5,000	
Increase in owner's equity		24,200
Tanja Zier, capital, August 31, 2010		$24,200

ROYAL REALTY
Balance Sheet
August 31, 2010

Assets		Liabilities	
Cash	$24,250	Accounts payable	$ 1,050
Supplies	1,000		
		Owner's Equity	
		Tanja Zier, capital	24,200
Total assets	$25,250	Total liabilities and owner's equity	$25,250

Prob. 1–5B

1.

Assets								=	Liabilities	+	Owner's Equity
Cash	+	Accounts Receivable	+	Supplies	+	Land		=	Accounts Payable	+	Peyton Keyes, Capital
17,000	+	31,000	+	3,200	+	36,000		=	10,400	+	Peyton Keyes, Capital
				87,200				=	10,400	+	Peyton Keyes, Capital
				76,800				=			Peyton Keyes, Capital

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Prob. 1–5B Continued

2.

	Assets				=	Liabilities	+	Owner's Equity	
	Cash	+ Accounts Receivable	+ Supplies	+ Land	=	Accounts Payable	+	Peyton Keyes, Capital	– Peyton Keyes, Drawing
Bal.	17,000	31,000	3,200	36,000		10,400		76,800	
a.	+ 25,000							+ 25,000	
Bal.	42,000	31,000	3,200	36,000		10,400		101,800	
b.	– 24,000			+ 24,000					
Bal.	18,000	31,000	3,200	60,000		10,400		101,800	
c.	+ 19,500								
Bal.	37,500	31,000	3,200	60,000		10,400		101,800	
d.	– 3,000								
Bal.	34,500	31,000	3,200	60,000		10,400		101,800	
e.			+ 1,550			+ 1,550			
Bal.	34,500	31,000	4,750	60,000		11,950		101,800	
f.	– 5,100					– 5,100			
Bal.	29,400	31,000	4,750	60,000		6,850		101,800	
g.		+ 24,750							
Bal.	29,400	55,750	4,750	60,000		6,850		101,800	
h.						+ 8,200			
Bal.	29,400	55,750	4,750	60,000		15,050		101,800	
i.	– 8,050								
Bal.	21,350	55,750	4,750	60,000		15,050		101,800	
j.	+ 26,750	– 26,750							
Bal.	48,100	29,000	4,750	60,000		15,050		101,800	
k.			– 2,950						
Bal.	48,100	29,000	1,800	60,000		15,050		101,800	
l.	– 18,000								– 18,000
Bal.	30,100	29,000	1,800	60,000		15,050		101,800	– 18,000

Prob. 1–5B Continued

Owner's Equity (Continued)

	Dry Cleaning + Revenue –	Dry Cleaning Exp. –	Wages Exp. –	Rent Exp. –	Supplies Exp. –	Truck Exp. –	Utilities Exp. –	Misc. Exp.
Bal.								
a.								
Bal.								
b.								
Bal.								
c.	+ 19,500							
Bal.	19,500							
d.				– 3,000				
Bal.	19,500			– 3,000				
e.								
Bal.	19,500			– 3,000				
f.								
Bal.	19,500			– 3,000				
g.	+ 24,750							
Bal.	44,250			– 3,000				
h.		– 8,200						
Bal.	44,250	– 8,200		– 3,000				
i.			– 5,100			– 1,200	– 800	– 950
Bal.	44,250	– 8,200	– 5,100	– 3,000		– 1,200	– 800	– 950
j.								
Bal.	44,250	– 8,200	– 5,100	– 3,000		– 1,200	– 800	– 950
k.					– 2,950			
Bal.	44,250	– 8,200	– 5,100	– 3,000	– 2,950	– 1,200	– 800	– 950
l.								
Bal.	44,250	– 8,200	– 5,100	– 3,000	– 2,950	– 1,200	– 800	– 950

Prob. 1–5B Continued

3.

SWAN DRY CLEANERS
Income Statement
For the Month Ended July 31, 2010

Dry cleaning revenue		$44,250
Expenses:		
Dry cleaning expense	$8,200	
Wages expense	5,100	
Rent expense	3,000	
Supplies expense	2,950	
Truck expense	1,200	
Utilities expense	800	
Miscellaneous expense	950	
Total expenses		22,200
Net income		$22,050

SWAN DRY CLEANERS
Statement of Owner's Equity
For the Month Ended July 31, 2010

Peyton Keyes, capital, July 1, 2010			$ 76,800
Additional investment by Peyton Keyes	$25,000		
Net income for July	22,050	$47,050	
Less withdrawals		18,000	
Increase in owner's equity			29,050
Peyton Keyes, capital, July 31, 2010			$105,850

SWAN DRY CLEANERS
Balance Sheet
July 31, 2010

Assets		Liabilities	
Cash	$ 30,100	Accounts payable	$ 15,050
Accounts receivable	29,000		
Supplies	1,800	Owner's Equity	
Land	60,000	Peyton Keyes, capital	105,850
		Total liabilities and	
Total assets	$120,900	owner's equity	$120,900

Prob. 1–5B Concluded

4. (Optional)

SWAN DRY CLEANERS
Statement of Cash Flows
For the Month Ended July 31, 2010

Cash flows from operating activities:		
Cash received from customers	$46,250*	
Deduct cash payments for expenses and payments to creditors	16,150**	
Net cash flow from operating activities		$ 30,100
Cash flows from investing activities:		
Purchase of land		(24,000)
Cash flows from financing activities:		
Cash received as owner's investment	$25,000	
Deduct cash withdrawal by owner	18,000	
Net cash flow from financing activities		7,000
Increase in cash		$ 13,100
Cash balance, July 1, 2010		17,000
Cash balance, July 31, 2010		$ 30,100

*$19,500 + $26,750
**$3,000 + $5,100 + $8,050

Prob. 1–6B

a. Fees earned, $180,000 ($74,400 + $105,600)
b. Supplies expense, $18,000 ($105,600 – $51,000 – $19,200 – $10,800 – $6,600)
c. Laura Biddle, capital, November 1, 2010, $0
d. Net income for November, $74,400
e. $314,400 ($240,000 + $74,400)
f. Increase in owner's equity, $278,400 ($314,400 – $36,000)
g. Laura Biddle, capital, November 30, 2010, $278,400
h. Total assets, $288,000 ($26,700 + $21,300 + $240,000)
i. Laura Biddle, capital, $278,400 ($288,000 – $9,600)
j. Total liabilities and owner's equity, $288,000
k. Cash received from customers, $180,000; this is the same as fees earned (a) since there are no accounts receivable.
l. Net cash flow from operating activities, $62,700 ($180,000 – $117,300)
m. Cash payments for acquisition of land, ($240,000)
n. Cash received as owner's investment, $240,000
o. Cash withdrawal by owner, ($36,000)
p. Net cash flow from financing activities, $204,000 ($240,000 – $36,000)
q. Net cash flow and November 30, 2010, cash balance, $26,700

CONTINUING PROBLEM

1.

	Assets			= Liabilities +	Owner's Equity		
	Cash +	Accounts Receivable +	Supplies =	Accounts Payable +	Lee Chang, Capital	– Lee Chang, Drawing +	Fees Earned
June 1	8,000				8,000		
2	+ 2,400						+ 2,400
Bal.	10,400				8,000		2,400
June 2	– 750						
Bal.	9,650				8,000		2,400
June 4			+ 350	+ 350			
Bal.	9,650		350	350	8,000		2,400
June 6	– 600						
Bal.	9,050		350	350	8,000		2,400
June 8	– 500						
Bal.	8,550		350	350	8,000		2,400
June 12	– 250						
Bal.	8,300		350	350	8,000		2,400
June 13	– 100			– 100			
Bal.	8,200		350	250	8,000		2,400
June 16	+ 400						+ 400
Bal.	8,600		350	250	8,000		2,800
June 22		+ 1,350					+ 1,350
Bal.	8,600	1,350	350	250	8,000		4,150
June 25	+ 500						+ 500
Bal.	9,100	1,350	350	250	8,000		4,650
June 29	– 240						
Bal.	8,860	1,350	350	250	8,000		4,650
June 30	+ 1,000						+ 1,000
Bal.	9,860	1,350	350	250	8,000		5,650
June 30	– 400						
Bal.	9,460	1,350	350	250	8,000		5,650
June 30	– 300						
Bal.	9,160	1,350	350	250	8,000		5,650
June 30			– 180				
Bal.	9,160	1,350	170	250	8,000		5,650
June 30	– 150						
Bal.	9,010	1,350	170	250	8,000		5,650
June 30	– 800						
Bal.	8,210	1,350	170	250	8,000		5,650
June 30	– 200					– 200	
Bal.	8,010	1,350	170	250	8,000	– 200	5,650

Continuing Problem Continued

Owner's Equity (Continued)

	– Music Exp.	– Office Rent Exp.	– Equip. Rent Exp.	– Advertising Exp.	– Wages Exp.	– Utilities Exp.	– Supplies Exp.	– Misc. Exp.
June 1								
2								
Bal.								
June 2		– 750						
Bal.		– 750						
June 4								
Bal.		– 750						
June 6				– 600				
Bal.		– 750		– 600				
June 8			– 500					
Bal.		– 750	– 500	– 600				
June 12	– 250							
Bal.	– 250	– 750	– 500	– 600				
June 13								
Bal.	– 250	– 750	– 500	– 600				
June 16								
Bal.	– 250	– 750	– 500	– 600				
June 22								
Bal.	– 250	– 750	– 500	– 600				
June 25								
Bal.	– 250	– 750	– 500	– 600				
June 29	– 240							
Bal.	– 490	– 750	– 500	– 600				
June 30								
Bal.	– 490	– 750	– 500	– 600				
June 30					– 400			
Bal.	– 490	– 750	– 500	– 600	– 400			
June 30						– 300		
Bal.	– 490	– 750	– 500	– 600	– 400	– 300		
June 30							– 180	
Bal.	– 490	– 750	– 500	– 600	– 400	– 300	– 180	
June 30								– 150
Bal.	– 490	– 750	– 500	– 600	– 400	– 300	– 180	– 150
June 30	– 800							
Bal.	– 1,290	– 750	– 500	– 600	– 400	– 300	– 180	– 150
June 30								
Bal.	– 1,290	– 750	– 500	– 600	– 400	– 300	– 180	– 150

Continuing Problem Concluded

2.

MUSIC DEPOT
Income Statement
For the Month Ended June 30, 2010

Fees earned		$5,650
Expenses:		
Music expense	$1,290	
Office rent expense	750	
Advertising expense	600	
Equipment rent expense	500	
Wages expense	400	
Utilities expense	300	
Supplies expense	180	
Miscellaneous expense	150	
Total expenses		4,170
Net income		$1,480

3.

MUSIC DEPOT
Statement of Owner's Equity
For the Month Ended June 30, 2010

Lee Chang, capital, June 1, 2010		$ 0
Investment on June 1, 2010	$8,000	
Net income for June	1,480	
	$9,480	
Less withdrawals	200	
Increase in owner's equity		9,280
Lee Chang, capital, June 30, 2010		$9,280

4.

MUSIC DEPOT
Balance Sheet
June 30, 2010

Assets		Liabilities	
Cash	$8,010	Accounts payable	$ 250
Accounts receivable	1,350		
Supplies	170	Owner's Equity	
		Lee Chang, capital	9,280
Total assets	$9,530	Total liabilities and owner's equity	$9,530

SPECIAL ACTIVITIES

Activity 1–1

1. **Acceptable professional conduct requires that Blake Gillis supply American National Bank with all the relevant financial statements necessary for the bank to make an informed decision. Therefore, Blake should provide the complete set of financial statements. These can be supplemented with a discussion of the net loss in the past year or other data explaining why granting the loan is a good investment by the bank.**
2. **a. Owners are generally willing to provide bankers with information about the operating and financial condition of the business, such as the following:**
   - **Operating Information:**
     - **Description of business operations**
     - **Results of past operations**
     - **Preliminary results of current operations**
     - **Plans for future operations**
   - **Financial Condition:**
     - **List of assets and liabilities (balance sheet)**
     - **Estimated current values of assets**
     - **Owner's personal investment in the business**
     - **Owner's commitment to invest additional funds in the business**

   Owners are normally reluctant to provide the following types of information to bankers:

   - ***Proprietary Operating Information.* Such information, which might hurt the business if it becomes known by competitors, might include special processes used by the business or future plans to expand operations into areas that are not currently served by a competitor.**
   - ***Personal Financial Information*. Owners may have little choice here because banks often require owners of small businesses to pledge their personal assets as security for a business loan. Personal financial information requested by bankers often includes the owner's net worth, salary, and other income. In addition, bankers usually request information about factors that might affect the personal financial condition of the owner. For example, a pending divorce by the owner might significantly affect the owner's personal wealth.**

Activity 1–1 Concluded

b. **Bankers typically want as much information as possible about the ability of the business and the owner to repay the loan with interest. Examples of such information are described above.**

c. **Both bankers and business owners share the common interest of the business doing well and being successful. If the business is successful, the bankers will receive their loan payments on time with interest, and the owners will increase their personal wealth.**

Activity 1–2

The difference in the two bank balances, $45,000 ($75,000 – $30,000), may not be pure profit from an accounting perspective. To determine the accounting profit for the six-month period, the revenues for the period would need to be matched with the related expenses. The revenues minus the expenses would indicate whether the business generated net income (profit) or a net loss for the period. Using only the difference between the two bank account balances ignores such factors as amounts due from customers (receivables), liabilities (accounts payable) that need to be paid for wages or other operating expenses, additional investments that Dr. Hendley may have made in the business during the period, or withdrawals during the period that Dr. Hendley might have taken for personal reasons unrelated to the business.

Some businesses that have few, if any, receivables or payables may use a "cash" basis of accounting. The cash basis of accounting ignores receivables and payables because they are assumed to be insignificant in amount. However, even with the cash basis of accounting, additional investments during the period and any withdrawals during the period have to be considered in determining the net income (profit) or net loss for the period.

Activity 1–3

1.

	Assets		= Liabilities +	Owner's Equity						
	Cash +	Supplies =	Accts. Payable +	Amber Keck, Capital –	Amber Keck, Drawing +	Service Revenue –	Salary Expense –	Rent Expense –	Supplies Expense –	Misc. Expense
a.	+ 1,250			+ 1,250						
b.	– 250	+ 250								
Bal.	1,000	250		1,250						
c.	– 150							– 150		
Bal.	850	250		1,250				– 150		
d.	– 100		+ 100					– 200		
Bal.	750	250	100	1,250				– 350		
e.	+ 1,500					+ 1,500				
Bal.	2,250	250	100	1,250		1,500		– 350		
f.	+ 400					+ 400				
Bal.	2,650	250	100	1,250		1,900		– 350		
g.	– 600						– 600			
Bal.	2,050	250	100	1,250		1,900	– 600	– 350		
h.	– 120									– 120
Bal.	1,930	250	100	1,250		1,900	– 600	– 350		– 120
i.	+ 800					+ 800				
Bal.	2,730	250	100	1,250		2,700	– 600	– 350		– 120
j.		– 100							– 100	
Bal.	2,730	150	100	1,250		2,700	– 600	– 350	– 100	– 120
k.	– 270				– 270					
Bal.	2,460	150	100	1,250	– 270	2,700	– 600	– 350	– 100	– 120

Activity 1–3 Continued

2.

DEUCE
Income Statement
For the Month Ended June 30, 2009

Service revenue		$2,700
Expenses:		
Salary expense	$600	
Rent expense	350	
Supplies expense	100	
Miscellaneous expense	120	
Total expenses		1,170
Net income		$1,530

3.

DEUCE
Statement of Owner's Equity
For the Month Ended June 30, 2009

Amber Keck, capital, June 1, 2009		$ 0
Investment on June 1, 2009	$1,250	
Net income for June	1,530	
	$2,780	
Less withdrawals	270	
Increase in owner's equity		2,510
Amber Keck, capital, June 30, 2009		$2,510

4.

DEUCE
Balance Sheet
June 30, 2009

Assets		Liabilities	
Cash	$2,460	Accounts payable	$ 100
Supplies	150		
		Owner's Equity	
		Amber Keck, capital	2,510
Total assets	$2,610	Total liabilities and owner's equity	$2,610

Activity 1–3 Concluded

5. a. Deuce would provide Amber with $570 more income per month than working as a waitress. This amount is computed as follows:

Net income of Deuce, per month	$1,530
Earnings as waitress, per month:	
30 hours per week × $8 per hour × 4 weeks	960
Difference	$ 570

b. Other factors that Amber should consider before discussing a long-term arrangement with the North Fulton Tennis Club include the following:

Amber should consider whether the results of operations for June are indicative of what to expect each month. For example, Amber should consider whether club members will continue to request lessons or use the ball machine during the winter months when interest in tennis may slacken. Amber should evaluate whether the additional income of $570 per month from Deuce is worth the risk being taken and the effort being expended.

Amber should also consider how much her investment in Deuce could have earned if invested elsewhere. For example, if the initial investment of $1,250 had been deposited in a money market or savings account at 4% interest, it would have earned $4.17 interest in June, or $50 for the year.

Note to Instructors: Numerous other considerations could be mentioned by students, such as the ability of Amber to withdraw cash from Deuce for personal use. Unlike a money market account or savings account, some of her investment in Deuce will be in the form of supplies (tennis balls, etc.), which may not be readily convertible to cash. The objective of this case is not to mention all possible considerations, but rather to encourage students to begin thinking about the use of accounting information in making business decisions.

Activity 1–4

Note to Instructors: The purpose of this activity is to familiarize students with the certification requirements and their online availability.

Activity 1–5

	First Year	Second Year	Third Year
Net cash flows from operating activities	negative	positive	positive
Net cash flows from investing activities	negative	negative	negative
Net cash flows from financing activities	positive	positive	positive

Start-up companies normally experience negative cash flows from operating and investing activities. Also, start-up companies normally have positive cash flows from financing activities—activities from raising capital.

Activity 1–6

As can be seen from the balance sheet data in the case, Enron was financed largely by debt as compared to equity. Specifically, Enron's stockholders' equity represented only 17.5% ($11,470 divided by $65,503) of Enron's total assets. The remainder of Enron's total assets, 82.5%, was financed by debt. When a company is financed largely by debt, it is said to be highly leveraged.

In late 2001 and early 2002, allegations arose as to possible misstatements of Enron's financial statements. These allegations revolved around the use of "special purpose entities" (partnerships) and related party transactions. The use of special purpose entities allowed Enron to hide a significant amount of additional debt off its balance sheet. The result was that Enron's total assets were even more financed by debt than the balance sheet indicated.

After the allegations of misstatements became public, Enron's stock rapidly declined, and the company filed for bankruptcy. Subsequently, numerous lawsuits were filed against the company and its management. In addition, the Securities and Exchange Commission, the Justice Department, and Congress launched investigations into Enron. As a result, several of Enron's top executives faced criminal prosecution and were sentenced to prison.

Note to Instructors: The role of the auditors and board of directors of Enron might also be discussed. However, these topics are not covered in Chapter 1 but are covered in later chapters.