

CHAPTER 1 - An Introduction to Accounting

ANSWERS TO QUESTIONS

1. **Stakeholders** are the parties that use accounting information.

Stakeholders with a **direct interest** include owners, managers, creditors, suppliers, and employees. These individuals are directly affected by what happens to the business.

Stakeholders with an **indirect interest** include financial analysts, brokers, attorneys, government regulators, and news reporters. These individuals use information in the financial reports to advise and influence their clients.

Students may give many different answers under the above categories depending on their level of experience in business.

All students are direct users of accounting information related to tuition and fees, financial aid, and account balances.

2. Accounting provides important information to the stakeholders of both profit oriented and nonprofit oriented organizations. Such information is useful in making decisions by all participants in the market for resource goods and services. Because of this communicative role of accounting, it is often called the language of business.
3. The primary mechanism used to allocate resources in the U.S. is competition for resources in the open market.
4. A market is a group of people or organizations that come together for the purpose of exchanging items of value.
5. See Exhibit 1-1
6. **Financial Resource**: money

Physical Resource: natural resources (i.e. land, forests, mine ore, petroleum, etc.), buildings, machinery and equipment, furniture and fixtures

Labor Resource: includes both intellectual and physical labor; i.e. employees

7. Investors expect a distribution of the business's profits as a return on their financial investment (capital allocation).

Creditors lend financial resources to businesses and receive interest as a return or profit on their investment.

8. **Financial accounting** provides information that is useful to external resource providers.

Managerial accounting provides information that is useful to managers in operating an organization (i.e., internal users).

9. Not-for-profit or nonprofit entities provide goods or services to consumers for humanitarian or special reasons rather than to earn a profit for owners. For example, certain not-for-profit entities allocate resources to provide for research on diseases or social/environmental welfare; others allocate resources to promote the arts and provide education.
10. The U.S. rules of accounting information measurement are called generally accepted accounting principles (GAAP).
11. Careers in public accounting consist of providing services to the general public from a public accounting firm. These services include auditing, tax and consulting services. Careers in private accounting usually consist of working for a specific company (which would be a client of the public accounting firm) providing a wide variety of services to the company including recording transactions, preparing financial statements, internal auditing and others.
12. Items reported on the financial statements are organized into classes or categories called elements. The ten elements of financial statements are:

- 1. Assets**
- 2. Liabilities**
- 3. Equity (Stockholders' Equity)**
- 4. Investments by Owners (Contributed Capital)**
- 5. Revenue**
- 6. Expenses**
- 7. Distributions (Dividends)**
- 8. Net Income**
- 9. Gains**
- 10. Losses**

Accounts are specific items or subclassifications of the elements. Examples of accounts include cash, land and common stock.

- 13. Assets, the economic resources of a business, are used to produce earnings.**
- 14. The assets of a business belong to that business entity and there may be claims on the assets. Claims on the assets belong to resource providers.**
- 15. Creditors are individuals and/or institutions that have provided goods or services to the business which are not yet paid for, or loaned money to the business. These parties have first claim to the assets of the business, and the owners have a residual interest in the assets.**
- 16. The term "liabilities" is used to describe creditors' claims on the assets of a business.**
- 17. The accounting equation is:**
ASSETS – LIABILITIES = STOCKHOLDERS' EQUITY
or
ASSETS = LIABILITIES + STOCKHOLDERS' EQUITY

Assets are the economic resources used by a business for the production of revenue. **Liabilities** are obligations of a business that can be settled by relinquishing assets, providing goods or services, or accepting other obligations. **Equity**, also called “residual interest” or “net assets”, is the portion of the assets remaining after the creditors' claims have been satisfied (i.e., Assets – Liabilities).

18. The **owners** ultimately bear the risk and collect the rewards associated with operating a business.
19. A double-entry bookkeeping system is one in which every transaction affects at least two accounts. A transaction can affect both assets and claims (liabilities and equity) or only assets or only claims. In order to “balance” the accounting equation, every transaction requires a “double entry.”
20. Capital is acquired from owners by issuing stock to them. When stock is issued, the assets of the business increase and the stockholders' equity increases.
21. Assets that are acquired by issuing common stock are the result of investments by owners. Assets that are acquired by using retained earnings are assets the business acquires through its earnings activities.
22. **Revenue** increases the asset side of the accounting equation and also increases the retained earnings account in the stockholders' equity section of the equation.
23. The three primary sources of assets are (1) investments by owners (issue of stock), (2) borrowing from creditors, and (3) earnings activities.
24. Retained earnings are a result of a business retaining its earned assets, rather than distributing those earnings to its owners.
25. Distributions to owners, called dividends, decrease the asset side of the accounting equation and also decrease the retained earnings account in the stockholders' equity section of the equation.

- 26. Dividends and expenses are similar in the sense that they both decrease assets and affect the accounting equation in the same way (i.e. reduction of retained earnings). However, dividends differ from expenses because of the nature of the decline in assets. Expenses reduce assets as the result of a firm's efforts to earn revenue. Dividends reduce assets because of a transfer of wealth to the owners.**
- 27. (1) Income Statement - measures the difference between the asset increases and the asset decreases that were associated with operating a business during a particular accounting period.**
- (2) Statement of Changes in Stockholders' Equity - explains the effects of transactions on stockholders' equity during the accounting period.**
- (3) Balance Sheet - lists the assets and the corresponding claims on those assets as of a particular date.**
- (4) Statement of Cash Flows - explains how a company obtained and used cash during the accounting period.**
- 28. The balance sheet provides information about the enterprise at a particular point in time.**
- 29. A net loss occurs when expenses exceed revenues in a given accounting period.**
- 30. (1) Operating activities - explain the cash generated from revenue and the cash paid for expenses.**
- (2) Investing activities - include cash received or spent by the business on productive assets used in the business, and investments in debt or equity of other companies.**
- (3) Financing activities - include cash inflows and outflows from the company's transactions with its owners and inflows and outflows from its borrowing activities.**

31. **Asset accounts are arranged on the balance sheet in accordance with their level of liquidity (those that can be most quickly converted to cash are listed first).**
32. **Articulation refers to the interrelationships among the various elements of the financial statements.**
33. **Temporary accounts are used to capture information for a single accounting period. The balances in temporary accounts are transferred out of the accounts at the end of the accounting period. Temporary accounts have zero balances at the beginning of an accounting period. Permanent accounts carry over from one accounting period to the next. Retained Earnings is a permanent account.**
34. **The historical cost concept requires that most assets be reported at the amount paid for them regardless of their increase or decrease in value. It is related to the reliability concept that says information can be independently verified. The historical cost is verifiable, while a change in value is subjective.**
35. **An asset source transaction results in an increase in an asset account and an increase in one of the claims accounts; i.e., investments by owners (equity), borrowing funds from creditors (liabilities), or earnings activities (revenue).**

An asset use transaction results in a decrease in an asset account and a decrease in either liabilities or equity; i.e., the payment of a liability, the payment of an expense, or a dividend.

An asset exchange transaction is a transaction in which one asset is exchanged for another; i.e., purchase of land with cash.

A claims exchange transaction will be covered in a later chapter.

36. **While the contents of annual reports vary from company to company, all annual reports contain:
Management's discussion and analysis (MD&A)
Financial statements
Footnotes to the financial statements
Auditor's report**

- 37. U.S. GAAP, generally accepted accounting principles in the United States, are the measurement rules established by the (FASB) Financial Accounting Standards Board. The FASB is a privately funded organization with the primary authority for establishing accounting standards in the United States. International Financial Reporting Standards (IFRS) are issued by the International Accounting Standards Board and are an attempt to set a common standard to be used in different countries. IFRS is used by global companies and there is a move underway to merge GAAP and IFRS.**

SOLUTIONS TO EXERCISES - SERIES A - CHAPTER 1

EXERCISE 1-1

The three participants in the free business market are:

- 1. Resource owners**
- 2. Conversion agents**
- 3. Consumers**

Note to instructor:

The memo should discuss the fact that the resource owners are those who own resources that are desired by others, either in the original form or in a converted form. The conversion agents are the parties that acquire the resource and supply it to consumers either in the original form or in a converted form with value added by the conversion. The consumers are the ultimate users of the resources.

It should also include a discussion of the public accountant and the allocation of resources. For example, public accountants audit the accounting records that businesses (conversion agents) use to communicate information to investors and creditors (financial resource providers). Based on their findings they may certify or deny that the reports fairly represent the financial condition of the business. In other words, public accountants provide assurance that the information provided by the business is trustworthy. Public accountants usually gain the professional designation of Certified Public Accountant (CPA).

EXERCISE 1-2

- a. Investors put assets into the company with the expectation of sharing profits. Creditors lend assets to the company with the expectation of repayment of the principal plus interest on the loan.

b.

Kennedy Company Accounting Equation						
Event	Assets	=	Liabilities	+	Stockholders' Equity	
	Cash		Notes Payable		Common Stock	Retained Earnings
Acquired assets	\$3,400		\$1,600		\$1,800	
Incurred loss	(1,600)					(1,600)
Balance	\$1,800	=	\$1,600	+	\$1,800	\$(1,600)

The cash balance of \$1,800 will be distributed first to the creditors. Since the company owed \$1,600 to creditors and there are sufficient funds to pay them, the creditors will receive \$1,600. The investors will receive the balance of \$200.

c.

Kennedy Company Accounting Equation						
Event	Assets	=	Liabilities	+	Stockholders' Equity	
	Cash		Notes Payable		Common Stock	Retained Earnings
Acquired assets	\$3,400		\$1,600		\$1,800	
earned profit	1,600					1,600
Balance	\$5,000	=	\$1,600	+	\$1,800	\$1,600

The creditor will receive the \$1,600 that is owed to them. The stockholders will receive their initial investment of \$1,800 plus an additional \$1,600 of profit for a total of \$3,400.

EXERCISE 1-3

- a. The three areas of service provided by public accounting are auditing, tax and consulting.
- b. The private accountant generally works for a specific company. Some of the functions performed include classifying and recording transactions, billing customers, collecting amounts due, ordering merchandise, paying suppliers, preparing and analyzing financial statements, developing budgets, assessing performance and making decisions.

EXERCISE 1-4

Entities	Distribution of Cash
Mr. Chang (personal account)	Personal account was decreased by the \$30,000 cash deposited in the Chang Enterprises' business account.
Chang Enterprises	Cash account increased by the \$30,000 cash deposited by Mr. Chang. Cash account increased by \$40,000 cash borrowed from First Bank. Cash account increased by \$64,000 cash invested by Jim Harwood. Cash account decreased by \$120,000 cash used to purchase building. Cash account increased by \$28,000 cash revenue earned. Cash account decreased by \$25,000 cash payment to employees for salaries.
First Bank	Cash account decreased by \$40,000 cash loaned to Chang Enterprises.
Jim Harwood, father-in-law, personal account	Cash decreased by \$64,000 cash invested in Chang Enterprises.
Morton Realty Company	Cash increased by \$120,000 received from Chang Enterprises from the sale of the building.
Chang Enterprises' customers	Cash decreased by \$28,000 when customers paid for services performed.
Chang Enterprises' employees	Cash increased by \$25,000 when employees received payment for salaries.

EXERCISE 1-5

	Title or Account	Financial Statement(s)
a.	Common Stock	Balance Sheet; Statement of Changes in Stockholders' Equity
b.	Land	Balance Sheet
c.	Ending Cash Balance	Balance Sheet; Statement of Cash Flows
d.	Beginning Cash Balance	Statement of Cash Flows
e.	Notes Payable	Balance Sheet
f.	Retained Earnings	Balance Sheet; Statement of Changes in Stockholders' Equity
g.	Revenue	Income Statement
h.	Dividends	Statement of Changes in Stockholders' Equity
i.	Financing Activities	Statement of Cash Flows
j.	Salaries Expense	Income Statement

EXERCISE 1-6

a.

Craig's Cars Accounting Equation					
				Claims	
	Assets	=	Liabilities	+	Stockholders' Equity
	\$4,550	=	\$1,350	+	\$3,200

Liabilities $\$4,550 - \$3,200 = \$1,350$

Claims $\$1,350 + \$3,200 = \$4,550$

b.

Heavenly Bakery Accounting Equation					
				Claims	
	Assets	=	Liabilities	+	Stockholders' Equity
	\$10,200	=	\$4,800	+	\$5,400

Assets $\$4,800 + \$5,400 = \$10,200$

Net Assets = Assets – Liabilities;
or Net Assets = Total Stockholders' Equity
 $\$10,200 - \$4,800 = \$5,400$

c.

Bell's Candy Company Accounting Equation					
			Claims		
	Assets	=	Liabilities	+	Stockholders' Equity
	\$49,200	=	\$28,200	+	\$21,000

Stockholders' Equity $\$49,200 - \$28,200 = \$21,000$

Net Assets are equal to Stockholders' Equity: \$21,000

EXERCISE 1-7

Accounting Equation							
					Stockholders' Equity		
					Common		Retained
Company	Assets	=	Liabilities	+	Stock	+	Earnings
A	123,000	=	25,000	+	48,000	+	50,000
B	40,000	=	3,000	+	7,000	+	30,000
C	75,000	=	15,000	+	18,000	+	42,000
D	125,000	=	45,000	+	60,000	+	20,000

EXERCISE 1-8

a. 2012

Assets = Liabilities + Common Stock + Retained Earnings
 $\$156,000 = \$85,600 + \$52,400 + \underline{\underline{\$18,000}}$

Or: $\$156,000 - \$85,600 - \$52,400 = \$18,000.$

b. 2013

$$\begin{array}{rclcl} \text{Revenue} & - & \text{Expenses} & = & \text{Net Income} \\ \$36,000 & - & \$20,000 & = & \underline{\underline{\$16,000}} \end{array}$$

c. Retained Earnings, January 1, 2013	\$18,000
Plus: 2013 Net Income	16,000
Less: 2013 Dividends	<u>(2,000)</u>
Retained Earnings, December 31, 2013	<u><u>\$32,000</u></u>

- d. Cash cannot be directly traced to retained earnings. Cash can result from an asset exchange, an increase in liability as well as from earnings of the business.**

EXERCISE 1-9

Steps:

1.

$$\begin{array}{rcl} \text{Common Stock Issued} & = & \text{Change in Common Stock} \\ \$13,000 \text{ (given)} & = & \$13,000 \end{array}$$

2.

$$\begin{array}{rclcl} \text{Change in Stk. Equity} & = & \text{Change in Com. Stock} & + & \text{Change in Ret. Earn.} \\ \$53,400 \text{ (given)} & = & \$13,000 \text{ (1)} & + & \$40,400 \end{array}$$

3.

$$\begin{array}{rclcl} \text{Increase in Ret. Earn.} & = & \text{Net Income} & - & \text{Dividends} \\ \$40,400 \text{ (2)} & = & \$48,400 & - & \$8,000 \text{ (given)} \end{array}$$

Alternate Solution:

From the Statement of Changes in Stockholders' Equity we know (with minor modifications):

Beginning Total Stk. Equity, 1/1/2013		\$ 82,500
(Common Stock + Retained Earnings)		
Plus: Common Stock Issued	\$13,000	

Plus: Net Income	?	
Less: Dividends	(8,000)	
Change in Stockholders' Equity		53,400
Ending Total Stk. Equity, 12/31/2013		\$135,900

Working backwards from the change in equity we can solve for net income:

Change in Stockholders' Equity, 2013	\$53,400
Plus: Dividends	8,000
Less: Common Stock Issued	(13,000)
Net Income, 2013	\$48,400

EXERCISE 1-10

Olive Enterprises Accounting Equation						
					Stockholders' Equity	
Event Number	Assets	=	Liabilities	+	Common Stock	Retained Earnings
1.	I		NA		I	NA
2.	D		D		NA	NA
3.	I/D		NA		NA	NA
4.	I		NA		NA	I
5.	D		NA		NA	D
6.	D		NA		NA	D

EXERCISE 1-11

Shiloh Company Accounting Equation for 2012						
	Assets	=	Liabilities	+	Stockholders' Equity	
Event	Cash	=	Notes Payable	+	Common Stock	+ Retained Earnings
Issued stock	15,000	=	NA	+	15,000	+ NA

EXERCISE 1-12

Marcum Company Accounting Equation for 2012						
	Assets	=	Liabilities	+	Stockholders' Equity	
Event	Cash	=	Notes Payable	+	Common Stock	+ Retained Earnings
Issued note	6,200	=	6,200	+	NA	+ NA

EXERCISE 1-13

a.

Rhodes Company Accounting Equation for 2012						
	Assets	=	Liabilities	+	Stockholders' Equity	
Event	Cash	=		+	Common Stock	Retained Earnings
1. Cash revenues	13,500		NA		NA	13,500
2. Paid expenses	(9,200)		NA		NA	(9,200)
3. Paid dividend	(500)		NA		NA	(500)
Ending Balance	3,800	=	-0-	+	-0-	3,800

b.

Rhodes Company Income Statement For the Year Ended December 31, 2012		
Revenue	\$13,500	
Expense	(9,200)	
Net Income	\$ 4,300	

Rhodes Company Balance Sheet As of December 31, 2012		
Assets		
Cash		\$ 3,800
Liabilities		\$ -0-
Stockholders' Equity		
Common Stock	\$ -0-	
Retained Earnings	3,800	
Total Stockholders' Equity		3,800
Total Liabilities and Stockholders' Equity		\$ 3,800

EXERCISE 1-13 (cont.)

- c. **Zero.** Revenue is recorded in the Revenue account at the time it is recognized. It is transferred to Retained Earnings at the end of the accounting period through the closing process.
- d. The balance in the Retained Earnings account after closing is \$3,800. In the closing process, revenue increased retained earnings while expenses and dividends decrease retained earnings. $\$13,500 - \$9,200 - \$500 = \$3,800$

EXERCISE 1-14

a.

J & J Corporation Accounting Equation for 2012							
	Assets			=	Liabilitie s	+	Stockholders' Equity
Event	Cash	+	Land	=	Notes Payable	+	Com. Stock + Retained Earnings + Acct. Title/RE
Bal. 1/1/11	10,000		20,000	=	12,000		7,000 + 11,000
1. Pur. Land	(5,000)		5,000	=	NA		NA + NA
2. Issued stk.	25,000		NA	=	NA		25,000 + NA
3. Provide Svc.	75,000		NA	=	NA		NA + 75,000 Revenue
4. Paid Exp.	(42,000)		NA	=	NA		NA + (42,000) Oper. Exp.
5. Loan	10,000		NA	=	10,000		NA + NA
6. Paid Div.	(5,000)		NA	=	NA		NA + (5,000) Dividend
7. Land Value	NA		NA	=	NA		NA + NA
Totals	68,000	+	25,000	=	22,000	+	32,000 + 39,000

b. Net Cash Flow from Financing Activities:

Issue of Stock	\$25,000
Borrowed Cash	10,000
Paid Dividend	(5,000)
Net Cash Flow from Financing Activities	\$30,000

- c. The balance in the Retained Earnings account will be \$39,000.

EXERCISE 1-15

Event	Classification
1.	Asset Source
2.	Asset Source
3.	Asset Exchange
4.	Asset Source
5.	Asset Source
6.	Asset Exchange
7.	Asset Use
8.	NA
9.	Asset Use
10.	Asset Use
11.	NA

EXERCISE 1-16

Event	Statement of Cash Flow Classification
a.	OA
b.	FA
c.	FA
d.	IA
e.	OA
f.	OA
g.	IA
h.	FA
i.	NA
j.	FA

EXERCISE 1-17**a.**

Montana Company Accounting Equation for 2012						
	Assets		=	Liabilities	+	Stockholders' Equity
Event	Cash	+ Land	=	Notes Payable	+	Com. Stock + Retained Earnings + Acct. Title/RE
Bal. 1/1/11	2,000	12,000	=	-0-	+	6,000 + 8,000
1. Issued stk.	30,000	NA	=	NA	+	30,000 + NA + NA
2. Pur. Land	(12,000)	12,000	=	NA	+	NA + NA + NA
3. Loan	10,000	NA	=	10,000	+	NA + NA + NA
4. Provide Svc.	20,000	NA	=	NA	+	NA + 20,000 + Svc. Rev.
5. Paid Rent	(1,000)	NA	=	NA	+	NA + (1,000) + Rent Exp.
6. Pd. Op. Exp.	(15,000)	NA	=	NA	+	NA + (15,000) + Op. Exp.
7. Paid Div.	(2,000)	NA	=	NA	+	NA + (2,000) + Dividends
8. Land Value	NA	NA	=	NA	+	NA + NA
Totals	32,000	+ 24,000	=	10,000	+	36,000 + 10,000

b.

Montana Company Income Statement For the Year Ended December 31, 2012		
Service Revenue	\$20,000	
Rent Expense	(1,000)	
Operating Expense	(15,000)	
Net Income	\$ 4,000	

EXERCISE 1-17 b. (cont.)

Montana Company Statement of Changes in Stockholders' Equity For the Year Ended December 31, 2012		
Beginning Common Stock	\$ 6,000	
Plus: Common Stock Issued	30,000	
Ending Common Stock		\$36,000

Beginning Retained Earnings	\$ 8,000	
Plus: Net Income	4,000	
Less: Dividends	(2,000)	
Ending Retained Earnings		10,000
Total Stockholders' Equity		\$46,000

Montana Company Balance Sheet As of December 31, 2012		
Assets		
Cash	\$32,000	
Land	24,000	
Total Assets		\$56,000
Liabilities		
Notes Payable	\$10,000	
Total Liabilities		\$10,000
Stockholders' Equity		
Common Stock	\$36,000	
Retained Earnings	10,000	
Total Stockholders' Equity		46,000
Total Liabilities and Stockholders' Equity		\$56,000

EXERCISE 1-17 b. (cont.)

Montana Company Statement of Cash Flows For the Year Ended December 31, 2012		
Cash Flows From Operating Activities:		
Cash Receipts from Customers	\$20,000	
Cash Payment for Rent Expense	(1,000)	
Cash Payments for Other Operating Exp.	(15,000)	
Net Cash Flow from Operating Activities		\$ 4,000

Cash Flows From Investing Activities:		
Cash Paid to Purchase Land	<u>\$(12,000)</u>	
Net Cash Flow from Investing Activities		<u>(12,000)</u>
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	\$30,000	
Cash Receipts from Loan	10,000	
Cash Payments for Dividends	<u>(2,000)</u>	
Net Cash Flow from Financing Activities		<u>38,000</u>
Net Increase in Cash		30,000
Plus: Beginning Cash Balance		2,000
Ending Cash Balance		<u>\$32,000</u>

- c. **Percentage of assets provided by retained earnings:**
 $\$10,000 \div \$56,000 = 17.9\%$

Cash cannot be directly traced to retained earnings. Retained earnings are used to acquire assets or pay liabilities.

EXERCISE 1-18

- a. **Zero. Revenue and expenses are not recorded directly into the Retained Earnings account. Balances in the Revenue and Expense accounts are transferred to Retained Earnings at the end of the accounting period through the closing process.**
- b. **Retained earnings is an account and is part of an element titled “equity” or “net assets”. Accounts are records containing more detailed information about the element. An element of financial statements is a group of items which has various subparts, i.e. accounts, in which specific information is accumulated. Equity is an element representing claims by owners of the entity. Retained Earnings is the account which represents accumulated undistributed earning of the entity to which owners would be entitled.**
- c. **The Retained Earnings account is not affected at the time expenses are recognized. The Retained Earnings account is affected at the end of the accounting period during the closing process.**

EXERCISE 1-19

- a Before the accounts are closed the balance in retained earnings is zero. Revenue, expenses, and dividends are recorded in temporary accounts at the time they are recognized. The accounts are transferred to Retained Earnings at the end of the accounting period through the closing process. After the closing process the balance in the Retained Earnings account is \$100. In the closing process, revenue increases retained earnings while expenses and dividends decrease retained earnings. $\$800 - \$500 - \$200 = \100 .

Washington Company Accounting Equation					
	Assets	=	Liabilities	+	Stockholders' Equity
					Common Retained
Event	Cash	=		+	Stock + Earnings
1. Issued Stock	2,000				2,000
2. Cash revenue	800		NA		NA 800
3. Paid expenses	(500)		NA		NA (500)
4. Paid dividend	(200)		NA		NA (200)
Ending Balance	2,100	=	-0-	+	2,000 + 100

Retained earnings is \$100. Normally retained earnings cannot be traced to a specific account. But since cash is the only asset and there were no liabilities incurred or paid, the \$100 remaining in retained earnings is reflected in the cash account.

- b. Percentage of assets provided by retained earnings:

$$\$100 \div \$2,100 = 4.76\%$$

EXERCISE 1-20

- a. Land will be shown on the 2012 balance sheet.**
- b. Land will be listed at its historical cost of \$270,000.**
- c. The key concept used in listing land at its cost is the historical cost concept.**

EXERCISE 1-21

a.	Wright Company:	Asset Source
b.	Cal Wright:	Asset Exchange
c.	Wright Company:	Financing Activity
d.	Cal Wright:	Investing Activity

EXERCISE 1-22

City Consulting Services Horizontal Statements Model for 2012																
Event No.	Balance Sheet									Income Statement				Statement of Cash Flows		
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	-	Expense	=			Net Inc.
	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings							
1	I	+	NA	=	NA	+	I	+	NA	NA	-	NA	=	NA	I	FA
2	I	+	NA	=	NA	+	NA	+	I	I	-	NA	=	I	I	OA
3	I	+	NA	=	I	+	NA	+	NA	NA	-	NA	=	NA	I	FA
4	D	+	I	=	NA	+	NA	+	NA	NA	-	NA	=	NA	D	IA
5	D	+	NA	=	NA	+	NA	+	D	NA	-	I	=	D	D	OA
6	D	+	NA	=	NA	+	NA	+	D	NA	-	NA	=	NA	D	FA
7	NA	+	NA	=	NA	+	NA	+	NA	NA	-	NA	=	NA	NA	

EXERCISE 1-23

a.

Expo Company Horizontal Statements Model for 2012														
	Balance Sheet							Income Statement					Statement of Cash Flows	
	Assets	=	Liabilitie s	+	Stockholders' Equity		Revenue	–	Expense	=	Net Inc.			
Event No.	Cash	=	Notes Payable	+	Common Stock	+	Retained Earnings							
1	11,000	=	NA	+	11,000	+	NA	NA	–	NA	=	NA	11,000 FA	

2	18,000	=	NA	+	NA	+	18,000	18,000	-	NA	=	18,000	18,000	OA
3	(10,500)	=	NA	+	NA	+	(10,500)	NA	-	10,500	=	(10,500)	(10,500)	OA
4	(1,000)	=	NA	+	NA	+	(1,000)	NA	-	NA	=	NA	(1,000)	FA
Tot.	17,500	=	-0-	+	11,000	+	6,500	18,000	-	10,500	=	7,500	17,500	NC

b. Net income of \$7,500 contributed \$7,500 to the increase in assets.

EXERCISE 1-24

a.

Solito, Inc. Horizontal Statements Model for 2012																	
Event No.	Balance Sheet						Income Statement			Statement of Cash Flows							
	Assets		=	Liab.	+	Stockholders' Equity	Revenue	-	Expense	=	Net Inc.						
	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings								
1	50,000		NA		NA		50,000		NA		NA	50,000	FA				
2	(12,000)		12,000		NA		NA		NA		NA	(12,000)	IA				
3	50,000		NA		NA		NA		50,000		50,000	50,000	OA				
4	(9,500)		NA		NA		NA		(9,500)		(9,500)	(9,500)	OA				
5	5,000		NA		NA		5,000		NA		NA	5,000	FA				
6	10,000		NA		10,000		NA		NA		NA	10,000	FA				
7	(10,000)		10,000		NA		NA		NA		NA	(10,000)	IA				
8	(8,000)		NA		NA		NA		(8,000)		(8,000)	(8,000)	OA				
9	(2,800)		NA		NA		NA		(2,800)		NA	(2,800)	FA				
10	NA		NA		NA		NA		NA		NA	NA					
Total	72,700	+	22,000	=	10,000	+	55,000	+	29,700		50,000	-	17,500	=	32,500	72,700	NC

- b. Net Income for 2012: \$32,500**
- c. Total Assets at the end of 2012: \$72,700 + \$22,000= \$94,700**
- d. Net Cash Flow from Operating Activities for 2012: \$50,000 – \$9,500 – \$8,000 = \$32,500**
- e. Net Cash Flow from Investing Activities for 2012: – \$12,000 + – \$10,000 = – \$22,000**
- f. Net Cash Flow from Financing Activities for 2012: \$50,000 + \$5,000 + \$10,000 – \$2,800 = 62,200**
- g. Cash balance at December 31, 2012: \$72,700**

EXERCISE 1-24 (cont.)

- h. Percentage of assets provided by:**

Creditors	\$10,000	÷	\$94,700	= 10.56%
Investors	\$55,000	÷	\$94,700	= 58.08%
Retained Earnings	\$29,700	÷	\$94,700	= 31.36%

- i. Zero. Revenue and expenses are not recorded directly into the Retained Earnings account. Balances in the Revenue and Expense accounts are transferred to Retained Earnings at the end of the accounting period through the closing process.**

EXERCISE 1-25

a.

Event	
1.	Asset Source
2.	Asset Exchange
3.	Asset Source
4.	NA
5.	Asset Use
6.	Asset Use
7.	NA

b.

Partner's Pet Store Horizontal Statements Model for 2012															
Event No.	Balance Sheet								Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stockholders' Equity		Revenue	-	Expense	=	Net Inc.		
	Cash	+	Land	=	Notes Payable	+	Common Stock	+ Retained Earnings							
1	I	+	NA	=	NA	+	I	+ NA	NA	—	NA	=	NA	I FA	
2	D	+	I	=	NA	+	NA	+ NA	NA	—	NA	=	NA	D IA	
3	I	+	NA	=	I	+	NA	+ NA	NA	—	NA	=	NA	I FA	
4	NA	+	NA	=	NA	+	NA	+ NA	NA	—	NA	=	NA	NA	
5	D	+	NA	=	NA	+	NA	+ D	NA	—	NA	=	NA	D FA	
6	D	+	NA	=	NA	+	NA	+ D	NA	—	I	=	D	D OA	
7	NA	+	NA	=	NA	+	NA	+ NA	NA	—	NA	=	NA	NA	

EXERCISE 1-26

- a. The assets would be worth the same, but would be shown at different amounts on the balance depending on whether U.S. GAAP or IFRS is used.
- b. US GAAP requires the asset be stated at its historical cost, which may be very different from the current value. IFRS allow companies to value asset at their current market values.

SOLUTIONS TO PROBLEMS -SERIES A - CHAPTER 1

PROBLEM 1-27

- a. The memo should explain that all entities must account for the use of assets, even though they may not be for-profit entities. The stakeholders are interested in the use of assets as well as the financial health of the entity.
- b. Financial accounting is designed to meet the needs of external users. External users such as creditors and investors are interested in an objective, overall picture. For instance, both investors and creditors would be interested in the assets and liabilities of a business as well as in the net income. Both groups are interested in the growth factor as well as the risk factor.

Managerial accounting is designed to meet the needs of internal users. While there is overlap between the needs of both groups, i.e. net income, managers need more specific and detailed information. Managers may be concerned with the profitability of a particular department or product line while an investor is more concerned with the overall profitability of the company.

- c. Stakeholders of a not-for-profit entity that may want financial accounting reports would include taxpayers, contributors, lenders, suppliers, employees, managers, financial analysts, attorneys, and beneficiaries.
- d. Stakeholders that may want managerial accounting reports would include suppliers, managers, and employees.

PROBLEM 1-28

a. Entities mentioned:	b. Effect on the cash account:
1. Beth Mays Mills Bros.	Decrease Increase
2. Bill Becham Business	Decrease Increase
3. First State Bank Levi Co.	Decrease Increase
4. Southside Restaurant Midwest Utilities	Decrease Increase
5. Filmore, Inc. City National Bank Tuchols Realty	Increase/Decrease Decrease Increase
6. Jing Chu International Sales Corporation	Decrease Increase
7. Bill Mann Daughter	Decrease Increase
8. Research Service Co. Customers	Increase Decrease
9. Yang Imports Employees	Decrease Increase
10. Meyers, Inc. Mark Meyers	Decrease Increase

PROBLEM 1-29

Item	Income Statement	Statement of Changes in Stk. Equity	Balance Sheet	Statement of Cash Flows
Notes Payable			✓	
Beginning Common Stock		✓		
Service Revenue	✓			
Utility Expense	✓			
Cash from Stock Issue		✓		✓
Operating Activities				✓
For the Period Ended (Date)	✓	✓		✓
Net Income	✓	✓		
Investing Activities				✓
Net Loss	✓	✓		
Ending Cash Balance			✓	✓
Salary Expense	✓			
Consulting Revenue	✓			
Dividends		✓		✓
Financing Activities				✓
Ending Common Stock		✓	✓	
Interest Expense	✓			
As of (Date)			✓	
Land			✓	
Beginning Cash Balance				✓

PROBLEM 1-30

a.

Webster Consulting Accounting Equation for 2012									
	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	+	Land	=	Notes Payable	+	Common Stock	+ Retained Earnings	Acct. Title/RE
1. Issued stk	20,000		NA		NA		20,000	NA	NA
2. Revenue	35,000		NA		NA		NA	35,000	Svc. Rev.
3. Loan	25,000		NA		25,000		NA	NA	NA
4. Paid Exp.	(22,000)		NA		NA		NA	(22,000)	Expense
5. Pur. Land	(30,000)		30,000		NA		NA	NA	NA
Totals	28,000	+	30,000	=	25,000	+	20,000	+ 13,000	

Webster Consulting Accounting Equation for 2013								
	Assets		=	Liabilities	+	Stockholders' Equity		
Event	Cash	+ Land	=	Notes Payable	+	Common Stock	+ Retained Earnings	Acct. Title/RE
Beg. Bal.	28,000	30,000		25,000		20,000	13,000	
1. Issued stk	24,000	NA		NA		24,000	NA	NA
2. Revenue	95,000	NA		NA		NA	95,000	Svc. Rev.
3. Paid Loan	(15,000)	NA		(15,000)		NA	NA	NA
4. Paid Exp.	(71,500)	NA		NA		NA	(71,500)	Expense
5. Paid Div.	(3,000)	NA		NA		NA	(3,000)	Dividends
6. Land Val.	NA	NA		NA		NA	NA	NA
Totals	57,500	+ 30,000	=	10,000	+	44,000	+ 33,500	

PROBLEM 1-30 (cont.)

b.

Webster Consulting Income Statement For the Period Ended December 31, 2012		
Service Revenue		\$35,000
Expenses		(22,000)
Net Income		<u>\$13,000</u>

Webster Consulting Statement of Changes in Stockholders' Equity For the Period Ended December 31, 2012		
Beginning Common Stock	\$ -0-	
Plus: Common Stock Issued	<u>20,000</u>	
Ending Common Stock		\$20,000
Beginning Retained Earnings	\$ -0-	
Plus: Net Income	<u>13,000</u>	
Ending Retained Earnings		<u>13,000</u>
Total Stockholders' Equity		<u>\$33,000</u>

PROBLEM 1-30 b. (cont.)

Webster Consulting Balance Sheet As of December 31, 2012		
Assets		
Cash	\$28,000	
Land	30,000	
Total Assets		\$58,000
Liabilities		
Notes Payable		\$25,000
Stockholders' Equity		
Common Stock	\$20,000	
Retained Earnings	13,000	
Total Stockholders' Equity		33,000
Total Liabilities and Stockholders' Equity		\$58,000

PROBLEM 1-30 b. (cont.)

Webster Consulting Statement of Cash Flows For the Year Ended December 31, 2012			
Cash Flows From Operating Activities:			
Cash Receipts from Customers	\$35,000		
Cash Payments for Expenses	(22,000)		
Net Cash Flow from Operating Activities		\$13,000	
Cash Flows From Investing Activities:			
Cash Payment for Land	\$(30,000)		
Net Cash Flow from Investing Activities		(30,000)	
Cash Flows From Financing Activities:			
Cash Receipts from Borrowing	\$25,000		
Cash Receipts from Stock Issue	20,000		
Net Cash Flow from Financing Activities		45,000	
Net Increase in Cash		28,000	
Plus: Beginning Cash Balance		-0-	
Ending Cash Balance		\$28,000	

PROBLEM 1-30 b. (cont.)

Webster Consulting Income Statement For the Period Ended December 31, 2013		
Service Revenue	\$95,000	
Expenses	(71,500)	
Net Income	\$23,500	

Webster Consulting Statement of Changes in Stockholders' Equity For the Period Ended December 31, 2013			
Beginning Common Stock	\$20,000		
Plus: Common Stock Issued	24,000		
Ending Common Stock		\$44,000	
Beginning Retained Earnings	\$13,000		
Plus: Net Income	23,500		
Less: Dividends	(3,000)		
Ending Retained Earnings		33,500	
Total Stockholders' Equity		\$77,500	

PROBLEM 1-30 b. (cont.)

Webster Consulting Balance Sheet As of December 31, 2013			
Assets			
Cash	\$57,500		
Land	30,000		
Total Assets		\$87,500	
Liabilities			
Notes Payable		\$10,000	
Stockholders' Equity			
Common Stock	\$44,000		
Retained Earnings	33,500		
Total Stockholders' Equity		77,500	
Total Liabilities and Stockholders' Equity		\$87,500	

PROBLEM 1-30 b. (cont.)

Webster Consulting Statement of Cash Flows For the Year Ended December 31, 2013			
Cash Flows From Operating Activities:			
Cash Receipts from Customers	\$95,000		
Cash Payments for Expenses	(71,500)		
Net Cash Flow from Operating Activities		\$23,500	
Cash Flows From Investing Activities		-0-	
Cash Flows From Financing Activities:			
Cash Receipts from Stock Issue	\$24,000		
Cash Payment on Debt	(15,000)		
Cash Payment for Dividends	(3,000)		
Net Cash Flow from Financing Activities		6,000	
Net Increase in Cash		29,500	
Plus: Beginning Cash Balance		28,000	
Ending Cash Balance		\$57,500	

- c. Retained earnings cannot be traced to cash.
- d. Assets increased from \$58,000 at December 31, 2012 to \$87,500 at December 31, 2013. This increase of \$29,500 is solely due to the increase in cash.
- e. Immediately after Event 2 in 2012 is recorded the balance in the Retained Earnings account is zero. The revenue is recorded in a Revenue account, not in the Retained Earnings account. The revenue, expense, and dividend accounts are closed to the Retained Earnings account at the end of each accounting period. After closing the accounts at the end of 2012 the Retained Earnings account will have a balance of \$13,000 (\$35,000 revenue - \$22,000 expenses).

PROBLEM 1-30 (cont.)

This year's ending balance becomes next year's beginning balance. Thus, the balance in the Retained Earnings account on January 1, 2013 is \$13,000. This balance will not change until the closing process is completed in December 2013. As a result, the balance in the Retained Earnings account immediately after Event 2 in 2013 is recorded is \$13,000.

PROBLEM 1-31

Not required:

Gofish Enterprises Accounting Equation						
	Assets	=	Liabilities	+	Stockholders' Equity	
	Cash	=	Liabilities	+	Common Stock	Retained Earnings
Beg. Balances	50,000		18,000		4,000	28,000
Earned Revenue	38,000					38,000
Paid Expenses	(32,000)					(32,000)
Paid Dividends	(2,000)					(2,000)
Issued Stock	15,000				15,000	
Paid Liability	(10,000)		(10,000)			
	59,000	=	8,000	+	19,000	32,000

a.

Gofish Enterprises Income Statement For the Period Ended December 31, 2012		
Revenue		\$38,000
Expenses		(32,000)
Net Income		\$ 6,000

PROBLEM 1-31 a. (cont.)

Gofish Enterprises Statement of Changes in Stockholders' Equity For the Period Ended December 31, 2012		
Beginning Common Stock	\$ 4,000	
Plus: Common Stock Issued	15,000	
Ending Common Stock		\$19,000
Beginning Retained Earnings	28,000	
Plus: Net Income	6,000	
Less: Dividends	(2,000)	
Ending Retained Earnings		32,000
Total Stockholders' Equity		\$51,000

Gofish Enterprises Balance Sheet As of December 31, 2012			
Assets			
Cash	\$59,000		
Total Assets		\$59,000	
Liabilities		\$ 8,000	
Stockholders' Equity			
Common Stock	\$19,000		
Retained Earnings	32,000		
Total Stockholders' Equity		51,000	
Total Liabilities and Stockholders' Equity		\$59,000	

PROBLEM 1-31 a. (cont.)

Gofish Enterprises Statement of Cash Flows For the Year Ended December 31, 2012		
Cash Flows From Operating Activities:		
Cash Receipts from Customers	\$38,000	
Cash Payments for Expenses	(32,000)	
Net Cash Flow from Operating Activities		\$ 6,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	15,000	
Cash Payments to Creditors	(10,000)	
Cash Dividend to Stockholders	(2,000)	
Net Cash Flow from Financing Activities		3,000
Net Increase in Cash		9,000
Plus: Beginning Cash Balance		50,000
Ending Cash Balance		\$59,000

b. Percentage of assets provided by:

Creditors	\$ 8,000 ÷ \$59,000 = 13.55%
Investors	\$19,000 ÷ \$59,000 = 32.20%
Retained Earnings	\$32,000 ÷ \$59,000 = 54.24%

PROBLEM 1-32

Event No.	Type of Event	Effect on Total Assets
1.	Asset Source	Increase
2.	Asset Exchange	No Effect
3.	Asset Exchange	No Effect

4.	Asset Use	Decrease
5.	NA	NA
6.	Asset Source	Increase
7.	Asset Use	Decrease
8.	Asset Use	Decrease
9.	Asset Use	Decrease
10.	Asset Source	Increase
11.	Asset Use	Decrease
12.	Asset Source	Increase
13.	Asset Exchange	No Effect
14.	NA	NA
15.	Asset Use	Decrease

PROBLEM 1-33

Texas Corporation Horizontal Statements Model for 2012																
Event No.	Balance Sheet									Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	-	Expense	=	Net Inc.		
	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings							
1	D	+	NA	=	NA	+	NA	+	D	NA	-	NA	=	NA	D	FA
2	I	+	NA	=	NA	+	I	+	NA	NA	-	NA	=	NA	I	FA
3	NA	+	NA	=	NA	+	NA	+	NA	NA	-	NA	=	NA	NA	
4	I	+	NA	=	NA	+	NA	+	I	I	-	NA	=	I	I	OA
5	D	+	NA	=	NA	+	NA	+	D	NA	-	I	=	D	D	OA
6	I	+	D	=	NA	+	NA	+	NA	NA	-	NA	=	NA	I	IA
7	I	+	NA	=	I	+	NA	+	NA	NA	-	NA	=	NA	I	FA
8	NA	+	NA	=	NA	+	NA	+	NA	NA	-	NA	=	NA	NA	

PROBLEM 1-34

a.

Cooley Company															
Horizontal Statements Model for 2012															
Event No.	Balance Sheet							Income Statement				Statement of Cash Flows			
	Assets			=	Liab.	+	Stockholders' Equity	Revenue	-	Expense	=			Net Inc.	
	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings						
1	30,000		NA		NA		30,000		NA		NA		NA	30,000	FA
2	40,000		NA		40,000		NA		NA		NA		NA	40,000	FA

3	48,000	NA	NA	NA	48,000	48,000	NA	48,000	48,000 OA							
4	(45,000)	NA	NA	NA	(45,000)	NA	45,000	(45,000)	(45,000) OA							
5	(1,000)	NA	NA	NA	(1,000)	NA	NA	NA	(1,000) FA							
6	20,000	NA	NA	20,000	NA	NA	NA	NA	20,000 FA							
7	(10,000)	NA	(10,000)	NA	NA	NA	NA	NA	(10,000) FA							
8	(53,000)	53,000	NA	NA	NA	NA	NA	NA	(53,000) IA							
9	NA	NA	NA	NA	NA	NA	NA	NA	NA							
Total	29,000	+	53,000	=	30,000	+	50,000	+	2,000	48,000	-	45,000	=	3,000	29,000	NC

b. Total Assets = \$29,000 + \$53,000 = \$82,000

c.

Sources of Assets	
Event	
1. Issue of stock	\$ 30,000
2. Cash from loan	40,000
3. Cash from revenue	48,000
6. Issue of stock	20,000
Total Sources of Assets	\$138,000

PROBLEM 1-34 (cont.)

- d. Net income is \$3,000 (see part a.) Dividends are not expenses so they do not appear on the income statement.

e.

Operating Activities:	
Cash from customers	\$48,000
Cash paid for expenses	(45,000)
Net Cash Flow from Operating Activities	\$ 3,000

Investing Activities:	
Cash paid to purchase land	\$(53,000)
Net Cash Flow from Investing Activities	\$(53,000)

Financing Activities:	
Cash from stock issues (\$30,000 + \$20,000)	\$50,000
Cash from loan	40,000
Paid cash dividend	(1,000)
Cash paid on loan principal	(10,000)
Net Cash Flow from Financing Activities	\$79,000

- f. Percentage of assets provided by:

Creditors	$\$30,000 \div \$82,000 = 36.59\%$
Investors	$\$50,000 \div \$82,000 = 60.98\%$
Retained Earnings	$\$ 2,000 \div \$82,000 = 2.44\%$

- g. Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.

SOLUTIONS TO ANALYZE, THINK, COMMUNICATE – CHAPTER 1**ATC 1-1 (All dollar amounts are in millions.)**a. **\$2,488**b. **Net income increased by \$274**

									STOCKHOLDERS'
c. ASSETS	=	LIABILITIES	+		EQUITY				
\$44,533	=	\$29,186*	+		\$15,347				

* Liabilities must be computed by subtracting equity from assets.

d. **Net sales increased by 0.9% from 2008 to 2009.**

$$(\$63,435 - \$62,884) \div \$62,884 = 0.9\%$$

Cost of sales decreased by 0.2% from 2008 to 2009.

$$(\$44,062 - \$44,157) \div \$44,157 = -0.2\%$$

Selling, general and administrative expenses increased by 1.0% from 2008 to 2009. $(\$13,078 - \$12,954) \div \$12,954 = 1.0\%$ **The largest percentage increase was for selling and administrative expenses.****ATC 1-2**

a.

Income Statements (amounts given are in millions)

	2014	2013	2012	2011
Revenue	\$ 860	\$1,520	(a) \$2,720	\$1,200
Cost and Expenses	(a) (840)	(a) (1,070)	(2,400)	(860)
Income from Cont. Op.	(b) 20	450	320	(a) 340

Unusual Items	-0-	175	(b)	(145)	(b)	(40)
Net Income	\$ 20	(b) \$ 625		\$ 175		\$ 300
Balance Sheets						
Cash and Marketable Sec.	\$ 350	\$1,720	(c)	\$ 750		\$ 940
Other Assets	1,900	(c) 1,180		2,500	(c)	2,560
Total Assets	\$2,250	\$2,900	(d)	\$3,250		\$3,500
Liabilities	(c) \$ 730	(d) \$1,555		\$1,001	(d)	\$1,300
Stockholders' Equity						
Common Stock	880	720	(e)	1,449		800
Retained Earnings	(d) 640	(e) 625		800	(e)	1,400
Total Stockholders' Equity	1,520	1,345	(f)	2,249		2,200
Total Liab. and Stk. Equity	\$2,250	(f) \$2,900		\$3,250		\$3,500

ATC 1-3

This solution is based on McDonald's 2009 financial report.

- a. McDonald's net income for 2009, 2008, and 2007 were as follows:

2009: \$4,551.0 million
 2008: 4,313.2
 2007: 2,395.1

- b. The company had \$30,224.9 million of assets at the end of 2009.
- c. The company had \$31,270.8 million of retained earnings at the end of 2009.
- d. For 2009, the company's:

net cash flow from *operating* activities were \$5,751.0 million
 net cash flow from *investing* activities were (\$1,655.3) million.

net cash flow from *financing* activities were (\$4,421.0) million.

ATC 1-4

This problem is designed to test written communication skills. The memo should describe the balance sheet and the income statement. It should explain that the balance sheet is a statement of assets, liabilities, and stockholders' equity at the date of the financial statement. The income statement gives the amount of revenues and expenses for the designated period. The memo should also define each of the following terms:

Assets

Liabilities

Stockholders' Equity

Revenue

Expense

Net Income