# ***Survey of Accounting 6th edition Edmonds Solutions Manual***

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**Exercise 1-1B** *The role of accounting in society*

Resource owners provide three types of resources to conversion agents that transform the resources into products or services that satisfy consumer demands.

**Required**

Identify the three types of resources. Write a brief memo explaining how resource owners select the particular conversion agents to which they will provide resources. Your memo should include answers to the following questions: If you work as a private accountant, what role would you play in the allocation of resources? Which professional certification would be most appropriate to your career?

## EXERCISE 1-1B SOLUTION

**The three types of resources available to conversion agents are:**

1. **Financial resources**
2. **Physical resources**
3. **Labor resources**

**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 role of the private accountant and the allocation of resources. For example, private accountants prepare the annual reports that businesses (conversion agents) use to communicate information to investors and creditors (financial resource providers). In other words, they are the information providers. The most appropriate designation for private accountants is the attainment of a Certified Management Accountant (CMA). However, many private accountants get their start in public accounting and are therefore CPAs as well as CMAs.**

**Exercise 1-2B** *Careers in accounting*

Accounting is commonly divided into two sectors. One sector is called public accounting. The other sector is called private accounting.

**Required**

a. Identify three areas of service provided by public accountants.

b. Describe the common duties performed by private accountants.

## EXERCISE 1-2B SOLUTION

**a.** **The three areas of service provided by public accountants 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 1-3B *Identifying the reporting entities*

Ray Steen recently started a business. During the first few days of operation, Mr. Steen transferred $100,000 from his personal account into a business account for a company he named Steen Enterprises. Steen Enterprises borrowed $60,000 from First Bank. Mr. Steen's father-in-law, Stan Rhoades, invested $75,000 into the business for which he received a 25 percent ownership interest. Steen Enterprises purchased a building from Zoro Realty Company. The building cost $150,000 cash. Steen Enterprises earned $56,000 in revenue from the company's customers and paid its employees $31,000 for salaries expense.

**Required**

Identify the entities that were mentioned in the scenario and explain what happened to the cash accounts of each entity that you identify.

## EXERCISE 1-3B SOLUTION

| Entities | Distribution of Cash |
|---|---|
| Ray Steen (personal account) | Personal account was decreased by the $100,000 cash deposited in the Steen Enterprises' business account. |
| Steen Enterprises | Cash account increased by the $100,000 cash deposited by Mr. Steen.<br>Cash account increased by $60,000 cash borrowed from First Bank.<br>Cash account increased by $75,000 cash invested by Stan Rhoades.<br>Cash account decreased by $150,000 cash used to purchase building.<br>Cash account increased by $56,000 cash revenue earned.<br>Cash account decreased by $31,000 cash payment to employees for salaries. |
| First Bank | Cash account decreased by $60,000 cash loaned to Steen Enterprises. |
| Stan Rhoades, father-in-law, personal account | Cash decreased by $75,000 cash invested in Steen Enterprises. |
| Zoro Realty Company | Cash increased by $150,000 received from Steen Enterprises to purchase building. (CONT. NEXT PAGE) |

| | |
|---|---|
| Steen Enterprises' customers | Cash decreased by $56,000 when customers paid for services performed. |
| Steen Enterprises' employees | Cash increased by $31,000 when employees received payment for salaries. |
| | |

## Exercise 1-4B *Key definitions and missing information in the accounting equation*

**Required**

a. Match the terms (identified as a through g) with the definitions and phrases (marked 1 through 7). For example, the term "a. Investors" matches with definition "4. Company or individual who gives assets or services in exchange for security certificates representing ownership interest."

| | |
|---|---|
| a. Investors | 1. Value added by transforming resources into products or services desired by customers. |
| b. Managerial Accounting | 2. Individuals or institutions that have loaned goods or services to a business. |
| c. Profit | 3. Basic class of corporate stock that carries no preferences as to claims on assets or dividends; certificates that evidence ownership in a company. |
| d. Expenses | 4. Company or individual who gives assets or services in exchange for security certificates representing ownership interests. |
| e. Common Stock | 5. Statement that lists the assets of a business and the corresponding claims (liabilities and equity) on those assets. |
| f. Creditors | 6. Branch of accounting that provides information useful to internal decision makers and managers in operating an organization. |
| g. Balance Sheet | 7. Economic sacrifices (decreases in assets or increases in liabilities) that are incurred in the process of generating revenues. |

b. Calculate the missing amounts in the following table.

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Company | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| A | $ ? | | $30,000 | | $ 50,000 | | $62,000 |
| B | 50,000 | | ? | | 10,000 | | 25,000 |
| C | 85,000 | | 20,000 | | ? | | 40,000 |
| D | 215,000 | | 60,000 | | 100,000 | | ? |

## EXERCISE 1-4B SOLUTION

**a.**

| | | | |
|---|---|---|---|
| a. | Investors | 4. | Company or individual who gives assets or services in exchange for security certificate's representing ownership interests. |
| | | | |
| b. | Managerial Accounting | 6. | Branch of accounting that provides information useful to internal decision makers and managers in operating an organization. |
| c. | Profit | 1. | Value added by transforming resources into products or services desired by customers. |
| d. | Expenses | 7. | Economic sacrifices (decreases in assets or increases in liabilities) that are incurred in the process of generating revenues. |
| e. | Common Stock | 3. | Basic class of corporate stock that carries no preferences as to claims on assets or dividends; certificates that evidence ownership in a company. |
| f. | Asset Use Transaction | 2. | Individuals or institutions that have loaned goods or services to a business. |
| g. | Balance Sheet | 5. | Statement that lists the assets of a business and the corresponding claims (liabilities and equity) on those assets. |

**EXERCISE 1-4b (cont. on next page)**

## EXERCISE 1-4B SOLUTION

| Accounting Equation | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | | Stockholders' Equity | | |
| | | | | | Common | | Retained |
| Company | Assets | = | Liabilities | + | Stock | + | Earnings |
| A | *142,000* | = | 30,000 | + | 50,000 | + | 62,000 |
| B | 50,000 | = | *15,000* | + | 10,000 | + | 25,000 |
| C | 85,000 | = | 20,000 | + | *25,000* | + | 40,000 |
| D | 215,000 | = | 60,000 | + | 100,000 | + | *55,000* |

## Exercise 1-5B *Effect of events on the accounting equation*

Hansen Enterprises experienced the following events during Year 2:

1. Acquired cash from the issue of common stock.
2. Provided services to clients for cash.
3. Paid utilities expenses with cash.
4. Paid cash to reduce the principal on a bank note.
5. Sold land for cash at an amount equal to its cost.
6. Paid a cash dividend to the stockholders.

### Required

Explain how each of the events would affect the accounting equation by writing the letter I for increase, the letter D for decrease, and NA for does not affect under each of the components of the accounting equation. If an event increases one account and decreases another account equally within the same element, record I/D. The first event is shown as an example.

| | HANSEN ENTERPRISES Accounting Equation | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | | Stockholders' Equity | | |
| Event Number | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| 1 | I | | NA | | I | | NA |

## EXERCISE 1-5B

**Hansen Enterprises**
**Accounting Equation**

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

## Exercise 1-6B *Effect of transactions on the accounting equation*

At the beginning of Year 4, Foster Corp.'s accounting equation showed the following accounts and balances.

| | FOSTER CORP. Accounting Equation | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Assets | | = | Liabilities | + | Stockholders' Equity | | | Acct. Titles for RE |
| Event | Cash | Land | | Notes Payable | | Common Stock | | Retained Earnings | |
| Balance 1/1/Year 4 | 30,000 | 16,000 | | 10,000 | | 20,000 | | 16,000 | |

Foster Corp. completed the following transactions during Year 4:

1. Purchased land for $20,000 cash.
2. Acquired $10,000 cash from the issue of common stock.
3. Received $90,000 cash for providing services to customers.
4. Paid cash operating expenses of $65,000.
5. Borrowed $20,000 cash from the bank.
6. Paid a $5,000 cash dividend to the stockholders.
7. Determined that the market value of the land purchased in event 1 is $30,000.

**Required**

a. Record the transactions in the accounting equation for Year 4. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide the appropriate titles for these accounts in the last column of the table.

b. As of December 31, Year 4, determine the total amount of assets, liabilities, and stockholder's equity and present this information in the form of an accounting equation.

c. What is the amount of total assets, liabilities, and stockholders' equity as of January 1, Year 5?

## EXERCISE 1-6B SOLUTION

a.

**Foster Corp.**
**Accounting Equation for Year 4**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/Y4 | 30,000 | | 16,000 | | 10,000 | | 20,000 | | 16,000 | |
| 1. Pur. Land | (20,000) | | 20,000 | | NA | | NA | | NA | NA |
| 2. Issued stk. | 10,000 | | NA | | NA | | 10,000 | | NA | NA |
| 3. Provide Svc. | 90,000 | | NA | | NA | | NA | | 90,000 | Revenue |
| 4. Paid Exp. | (65,000) | | NA | | NA | | NA | | (65,000) | Oper. Exp. |
| 5. Loan | 20,000 | | NA | | 20,000 | | NA | | NA | NA |
| 6. Paid Div. | (5,000) | | NA | | NA | | NA | | (5,000) | Dividend |
| 7. Land Value | NA | | NA | | NA | | NA | | NA | NA |
| Totals | 60,000 | + | 36,000 | = | 30,000 | + | 30,000 | + | 36,000 | |

b.

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| $96,000 | = | $30,000 | + | $66,000 |

c. The balances of total assets, liabilities and stockholders' equity will be the same on January 1, Year 5 as the balances on December 31, Year 4. (See b. above)

**Exercise 1-7B** *Missing information and recording events*

As of December 31, Year 3, Post Company had total cash of $156,000, notes payable of $85,600, and common stock of $52,400. During Year 4, Post earned $36,000 of cash revenue, paid $20,000 for cash expenses, and paid a $3,000 cash dividend to the stockholders.

**Required**

a. Determine the amount of retained earnings as of December 31, Year 3.

b. Create an accounting equation and record the beginning account balances under the appropriate headings.

c. Record the revenue, expense, and dividend events under the appropriate headings of the accounting equation created in Requirement *b*.

d. Prove the equality of the accounting equation as of December 31, Year 4.

e. Identify the beginning and ending balances in the Cash and Common Stock accounts. Explain why the beginning and ending balances in the Cash account are different, but the beginning and ending balances in the Common Stock account remain the same.

## EXERCISE 1-7B SOLUTION

**a.**

| Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|
| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
| 156,000 | = | 85,600 | + | 52,400 | + | ? |

**Retained Earnings = $156,000 – $85,600 – $52,400 = $18,000**

**b. & c.**

**Post Company**
**Effect of Year 4 Transactions on the Accounting Equation**

| | Assets | = | Liabilities | + | Stockholders' Equity | |
|---|---|---|---|---|---|---|
| Event | Cash | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| Beginning Balances | 156,000 | | 85,600 | | 52,400 | | 18,000 |
| 1. Earned Revenue | 36,000 | | NA | | NA | | 36,000 |
| 2. Paid expenses | (20,000) | | NA | | NA | | (20,000) |
| 3. Paid dividend | (3,000) | | NA | | NA | | (3,000) |
| Ending Balance | 169,000 | = | 85,600 | + | 52,400 | + | 31,000 |

EXERCISE 1-7B (cont. on next page)

**EXERCISE 1-7B (cont.).**

**d.**

| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| 169,000 | = | 85,600 | + | 52,400 | + | 31,000 |

**Liabilities + Stockholders' Equity = $85,600 + $52,400 + $31,000 = $169,000**

**Assets = Liabilities + Stockholders' Equity**
**$169,000 = $169,000**

**e. The beginning and ending balances in the cash account were $156,000 and $169,000 respectively. The beginning balance in the common stock account was $52,400. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because the accounting events that Post experienced during the Year 4 accounting period affected the cash account but not the common stock account.**

**Exercise 1-8B** *Account titles and the accounting equation*

The following account titles were drawn from the general ledger of Gutter Control, Incorporated (GCI): Cash, Notes Payable, Land, Accounts Payable, Office Furniture, Salaries Expense, Common Stock, Service Revenue, Interest Expense, Utilities Payable, Utilities Expense, Trucks, Supplies, Operating Expenses, Rent Revenue, Dividends, Computers, Building, Supplies Expense, Gasoline Expense, Retained Earnings, Dividends.

**Required**

a. Create an accounting equation using the headings assets, liabilities, and stockholders' equity. List each account title under the element of the accounting equation to which it belongs.

b. Will all businesses have the same number of accounts? Explain your answer.

## EXERCISE 1-8B SOLUTION

**a.**

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| Cash | | Notes Payable | | Salaries Expense |
| Land | | Accounts Payable | | Common Stock |
| Office Furniture | | Utilities Payable | | Service Revenue |
| Trucks | | | | Interest Expense |
| Supplies | | | | Utilities Expense |
| Computers | | | | Operating Expenses |
| Building | | | | Rent Revenue |
| | | | | Dividends |
| | | | | Supplies Expense |
| | | | | Gasoline Expense |
| | | | | Retained Earnings |
| | | | | Dividends |
| | | | | |

**EXERCISE 1-8b (cont. on next page**

## EXERCISE 1-8B (cont.)

**b. No. The number of accounts will vary depending on the level of detail the reporting entity chooses to provide, as well as the type of company and industry in which it operates. More accounts provide financial statement users with more information about the reporting entity. However, the cost of keeping records on many accounts often outweighs the benefit of providing more information. For example, in this problem the company kept all of the trucks in one account (i.e. Trucks). If the company wanted to provide more detail the company could have created a separate account for each truck. If the company wanted even more detail the company could break the truck into different components and provide an account for each component of the truck (i.e. engine, frame, wheels, tires, etc.). Providing accounts for each truck component would be very difficult and time consuming and would not necessarily change any decision made by a financial statement user. Therefore, it makes more sense to aggregate all trucks and truck components into one account. Deciding the number of accounts to report is a subjective cost/benefit analysis. The goal is to provide financial statement users with detail (i.e. more accounts) when the benefit of the additional information outweighs the cost of providing the information. Remember, it is the stockholders who are paying for the production of accounting information. They do not want to pay to produce information that cost more than it is worth.**

**Exercise 1-9B** ***Interpreting the accounting equation***

Lang Enterprises was started when it acquired $4,000 cash from creditors and $6,000 from owners. The company immediately purchased land that cost $9,000.

**Required**

a. Record the events under an accounting equation.

b. After all events have been recorded, Lang's obligations to creditors represent what percent of total assets?

c. After all events have been recorded, Lang's stockholder's equity represents what percent of total assets?

d. Assume the debt is due. Given that Lang has $6,000 in stockholders' equity, can the company repay the creditors at this point? Why or why not?

## EXERCISE 1-9B SOLUTION

**a.**

| | Cash | + | Land | = | Creditors | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | $10,000 | | $ -0- | | $4,000 | | $6,000 |
| | (9,000) | | 9,000 | | NA | | NA |
| Bal. | $ 1,000 | + | $9,000 | = | $4,000 | + | $6,000 |

**b. Creditor's Claim ÷ Total Assets = Percent of Total**
**$4,000 ÷ $10,000 = 40%**

**c. Stakeholder's Claim ÷ Total Assets = Percent of Total**
**$6,000 ÷ $10,000 = 60%**

**d. The company cannot repay the debt. The company owes the creditors $4,000 but has only $1,000 cash. Note there is no actual money in the stockholders' equity account. Indeed, there is no cash in any account that appears on the right side of the accounting equation. The right side of the accounting equation represents obligations and commitments of a company to its creditors and stockholders. Indeed, the accounting equation could be written as:**

| | Cash | + | Land | = | Creditors | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| Bal. | $ 1,000 | + | $9,000 | = | 40% | + | 60% |

**All assets including any cash balances are shown on the left side of the equation.**

**Exercise 1-10B** *Interpreting the accounting equation*

The financial condition of GreyCo Inc. is expressed in the following accounting equation:

| Accounting Equation | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Assets | | | = | Liabilities | + | Common stock | + | Retained earnings |
| Cash | | Land | | | | | | |
| $800 | + | $9,200 | = | $7,000 | + | $2,000 | + | $1,000 |

**Required**

a. Are dividends paid to creditors or investors? Explain why.

b. How much cash is in the Retained Earnings account?

c. Determine the maximum dividend GreyCo can pay.

d. If the obligation to creditors is due, can GreyCo repay the loan? Why or why not?

e. Suppose the land sinks into the sea as a result of an earthquake and a resulting tsunami. The business is then liquidated. How much cash will creditors receive? How much cash will investors receive? (Assume there are no legal fees or other costs of liquidation.)

## EXERCISE 1-10B SOLUTION

**a. Dividends are paid to investors. The investor has an ownership interest in the business that allows the investor (owner) to share in the profits of the business. This pay out of a share of profits of a business to the owners is called a dividend.**

**b. There is no cash in the Retained Earnings account. Retained Earnings represents the business's commitments to its stockholders. It is the amount of past earnings that have not been paid out to owners.**

**c. The amount of dividends that can be paid are limited to retained earnings. In addition, a company must have enough cash to pay the dividend. GreyCo. Has $1,000 of retained earnings but only $800 of cash. The maximum amount of dividend that could be paid at this time would be $800.**

**EXERCISE 1-10 (cont. on next page)**

## EXERCISE 1-10 (cont.)

**d. If the total amount of the liability of $7,000 is due, GreyCo. will not be able to satisfy the obligation. GreyCo. has only $800 of cash; the balance of the assets are contained in the Land account. If payment must be made to creditors, GreyCo. will have to liquidate the company in order to pay the debt.**

**e. If the land becomes worthless, the only asset remaining is the cash of $800. Since creditors have first claim on the assets, all of the $800 will be paid to the creditors. The investors will not be paid anything.**

## Exercise 1-11B *Differences between interest and dividends*

The following account balances were drawn from the financial records of Crystal Company (CC) as of January 1, Year 3. Assets, $14,000; Liabilities, $4,000; Common Stock, $7,000; and Retained Earnings, $3,000. CC has agreed to pay the creditors $400 of interest per year. Further, CC agrees that for the Year 3 fiscal year any annual earnings remaining after the interest charges will be paid out as dividends to the owners.

**Required**

a. Assuming CC earns a before interest expense recognition profit of $900 during Year 3, determine the amount of interest and dividends paid.

b. Assuming CC earns a before interest expense recognition profit of $500 during Year 3, determine the amount of interest and dividends paid.

c. Assuming CC earns a before interest expense recognition profit of $100 during Year 3, determine the amount of interest and dividends paid.

## EXERCISE 1-11B SOLUTION

**a. Creditors receive their $400 interest payment, leaving $500 ($900 - $400) to be paid as dividends to the investors.**

**b. Creditors receive their $400 interest payment, leaving $100 ($500 – $400) to be paid as dividends to the investors. Note that the creditors receive the same fixed interest payment while dividends paid to investors fluctuate with profitability.**

**c. Creditors receive their $400 interest payment. No dividend is paid to investors. In this case the recognition of the interest expense will cause the company to have an after interest expense net loss of $300 ($100 before interest profit - $400 interest expense). Note that interest is a contractual obligation that must be paid even if annual earnings are insufficient to support the interest payment. Indeed, bankruptcy is frequently caused by the inability to pay interest. In contrast, corporations are not required to pay dividends. Dividends are dependent on earnings. If there are no current or retained earnings, companies cannot pay dividends.**

**Note that these answers are based on the customary characteristics of interest and dividends. In practice, interest and dividends are based on the contractual terms of unique debt or equity agreements which may differ from ordinary circumstances. There are exceptions to the general treatment for interest and dividends that is described above.**

**Exercise 1-12B** *Distribution in a business liquidation*

Assume that Clinton Company acquires $1,200 cash from creditors and $1,700 cash from investors.

**Required**

a. Explain the primary differences between investors and creditors.

b. If Clinton has net income of $800 and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

c. If Clinton has a net loss of $800 cash and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

d. If Clinton has a net loss of $1,900 cash and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

## EXERCISE 1-12B SOLUTION

**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.**

**Clinton Company**
**Accounting Equation**

| Event | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | $2,900 | | $1,200 | | $1,700 |
| Earned income | 800 | | | | 800 |
| Balance | $3,700 | | $1,200 | | $2,500 |

**Since creditors are owed $1,200 and there are sufficient funds to pay them; the creditors will receive the $1,200 that they are owed. Since the investors own the business, they are entitled to the profits earned by the business. The investors will receive $2,500 (their original $1,700 investment plus the $800 of profit).**

**EXERCISE 1-12 (cont. on next page)**

## EXERCISE 1-12 (cont.)

c.

| Clinton Company<br>Accounting Equation | | | | | |
|---|---|---|---|---|---|
| Event | Assets | = | Liabilities | + | Stockholders' Equity |
| Acquired assets | $2,900 | | $1,200 | | $1,700 |
| Incurred loss | (800) | | | | (800) |
| Balance | $2,100 | | $1,200 | | $ 900 |

Since creditors are owed $1,200 and there are sufficient funds to pay them; the creditors will receive the $1,200 that they are owed. Since the investors own the business, they suffer the losses earned by the business. The investors will receive $900 (their original $1,700 investment minus the $800 loss).

d.

| Clinton Company<br>Accounting Equation | | | | | |
|---|---|---|---|---|---|
| Event | Assets | = | Liabilities | + | Stockholders' Equity |
| Acquired assets | $2,900 | | $1,200 | | $1,700 |
| Incurred loss | (1,900) | | (200) | | (1,700) |
| Balance | $1,000 | | $1,000 | | ($ 0) |

While creditors get first priority to receive assets in a business liquidation, this does not mean they cannot lose all or a portion of the assets they loan a business. In this case creditors are owed $1,200 but the business has only $1,000 of assets. Since the creditors have first priority, the entire $1,000 would be distributed to them. In this case the creditors lose $200 ($1,200 original loan - $1,000 returned). Since the investors own the business, they suffer the losses earned by the business. The investors will lose the entire $1,700 they contributed to the business.

## Exercise 1-13B *Classifying events as asset source, use, or exchange*

Dale's Business Services experienced the following events during its first year of operations:

1. Acquired $20,000 cash from the issue of common stock.
2. Borrowed $12,000 cash from First Bank.
3. Paid $5,000 cash to purchase land.
4. Received $25,000 cash for providing boarding services.
5. Acquired an additional $5,000 cash from the issue of common stock.
6. Purchased additional land for $4,000 cash.
7. Paid $10,000 cash for salary expense.
8. Signed a contract to provide additional services in the future.
9. Paid $1,200 cash for rent expense.
10. Paid a $1,000 cash dividend to the stockholders.
11. Determined the market value of the land to be $18,000 at the end of the accounting period.

**Required**

Classify each event as an asset source, use, or exchange transaction or as not applicable (NA).

## EXERCISE 1-13B SOLUTION

| 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 1-14B *Missing information for determining net income*

The December 31, Year 2, balance sheet for Thomas Company showed total stockholders' equity of $156,000. Total stockholders' equity increased by $65,000 between December 31, Year 2, and December 31, Year 3. During Year 3 Thomas Company acquired $20,000 cash from the issue of common stock. Thomas Company paid a $5,000 cash dividend to the stockholders during Year 3.

**Required**

Determine the amount of net income or loss Thomas reported on its Year 3 income statement. (*Hint:* Remember that stock issues, net income, and dividends all change total stockholders' equity.)

## EXERCISE 1-14B SOLUTION

**Steps:**

**1.**

**Common Stock Issued = Change in Common Stock**
**$20,000 (given) = *$20,000***

**2.**

**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**
**$65,000 (given) = $20,000 (1) + *$45,000***

**3.**

**Increase in Ret. Earn. = Net Income – Dividends**
**$45,000 (2) = *$50,000* – $5,000 (given)**

**Alternate Solution:**

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

| | | |
|---|---|---|
| Beginning Total Stk. Equity, 1/1/Year 3 | | $156,000 |
| (Common Stock + Retained Earnings) | | |
| | | |
| Plus: Common Stock Issued | $20,000 | |
| Plus: Net Income | ? | |
| Less: Dividends | (5,000) | |
| Change in Stockholders' Equity | | 65,000 |
| | | |
| Ending Total Stk. Equity, 12/31/Year 3 | | $221,000 |

EXERCISE 1-14B (CONT. ON NEXT PAGE)

## EXERCISE 1-14B (cont.)

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

| | |
|---|---|
| Change in Stockholders' Equity, Year 3 | $65,000 |
| Plus: Dividends | 5,000 |
| Less: Common Stock Issued | (20,000) |
| Net Income, Year 3 | *$50,000* |

## Exercise 1-15B *Preparing an income statement and a balance sheet*

Topez Company was started on January 1, Year 1. During Year 1, the company experienced the following three accounting events: (1) earned cash revenues of $14,500, (2) paid cash expenses of $9,200, and (3) paid a $500 cash dividend to its stockholders. These were the only events that affected the company during Year 1.

**Required**

a. Create an accounting equation and record the effects of each accounting event under the appropriate general ledger account headings.

b. Prepare an income statement, statement of changes in stockholder's equity, and a balance sheet dated December 31, Year 1, for Topez Company.

c. Explain why the income statement uses different terminology to date the income statement than is used to date the balance sheet.

# EXERCISE 1-15B SOLUTION

**a.**

**Topez Company**
**Accounting Equation for Year 1**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | | + | Common Stock | + | Retained Earnings |
| 1. Cash revenues | 14,500 | | NA | | NA | | 14,500 |
| 2. Paid expenses | (9,200) | | NA | | NA | | (9,200) |
| 3. Paid dividend | (500) | | NA | | NA | | (500) |
| Ending Balance | 4,800 | = | -0- | + | -0- | + | 4,800 |

**b.**

**Topez Company**
**Income Statement**
**For the Year Ended December 31, Year 1**

| | |
|---|---|
| Revenue | $14,500 |
| Expense | (9,200) |
| Net Income | $ 5,300 |

**EXERCISE 1-15B b. (CONT. ON NEXT PAGE)**

## EXERCISE 1-15B b. (cont.)

| Topez Company<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 1 | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 0 | |
| Ending Common Stock | | $ -0- |
| | | |
| Beginning Retained Earnings | $ -0- | |
| Plus: Net Income | 5,300 | |
| Less: Dividends | (500) | |
| Ending Retained Earnings | | 4,800 |
| | | |
| Total Stockholders' Equity | | $4,800 |

| Topez Company<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| Assets | | |
| Cash | | $ 4,800 |
| | | |
| Liabilities | | $ -0- |
| | | |
| Stockholders' Equity | | |
| Common Stock | $ -0- | |
| Retained Earnings | 4,800 | |
| Total Stockholders' Equity | | 4,800 |
| | | |
| Total Liabilities and Stockholders' Equity | | $ 4,800 |

c. The income statement is dated with the term "for the year ended" because it covers a one year span of time. The balance sheet is dated with the term "as of" because it describes information at a specific point in time.

**Exercise 1-16B** ***Historical cost versus market value***

Mountain View, Inc., purchased land in January Year 2 at a cost of $400,000. The estimated market value of the land is $650,000 as of December 31, Year 7.

**Required**

a. Name the December 31, Year 7, financial statement(s) on which the land will be shown.

b. At what dollar amount will the land be shown in the financial statement(s)?

c. Name the key concept that will be used in determining the dollar amount that will be reported for land that is shown in the financial statement(s).

## EXERCISE 1-16B SOLUTION

a. **Land will be shown on the Year 7 Balance Sheet.**

b. **Land will be listed at its historical cost of $400,000.**

c. **The key concept used in listing land at its cost is the historical cost concept.**

## Exercise 1-17B *Statement of cash flows*

On January 1, Year 3, Palmetto, a fast-food company, had a balance in its Cash account of $32,000. During the Year 3 accounting period, the company had (1) net cash inflow from operating activities of $15,600, (2) net cash outflow for investing activities of $23,000, and (3) net cash outflow from financing activities of $4,500.

**Required**

a. Prepare a statement of cash flows.
b. Provide a reasonable explanation as to what may have caused the net cash inflow from operating activities.
c. Provide a reasonable explanation as to what may have caused the net cash outflow from investing activities.
d. Provide a reasonable explanation as to what may have caused the net cash outflow from financing activities.

## EXERCISE 1-17B SOLUTION

**a.**

**Palmetto Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 3**

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| **Net Cash Inflow from Operating Activities** | | **$ 15,600** |
| **Cash Flows From Investing Activities:** | | |
| **Net Cash Outflow from Investing Activities** | | **(23,000)** |
| **Cash Flows From Financing Activities:** | | |
| **Net Cash Outflow from Financing Activities** | | **(4,500)** |
| **Net Decrease in Cash** | | **(11,900)** |
| **Plus: Beginning Cash Balance** | | **32,000** |
| **Ending Cash Balance** | | **$20,100** |

**b. Cash inflow from selling fast food to customers was greater than cash outflow for expenses.**

**c. The company paid cash to purchase long-term assets.**

**d. The company paid cash dividends or paid off a bank loan.**

## Exercise 1-18B *Prepare a statement of cash flows*

American General Company experienced the following accounting events during Year 2:

1. Paid $4,000 cash for salary expense.
2. Borrowed $8,000 cash from State Bank.
3. Received $30,000 cash from the issue of common stock.
4. Purchased land for $8,000 cash.
5. Performed services for $14,000 cash.
6. Paid $4,200 cash for utilities expense.
7. Sold land for $7,000 cash.
8. Paid a cash dividend of $1,000 to the stockholders.
9. Hired an accountant to keep the books.
10. Paid $3,000 cash on the loan from State Bank.

**Required**

a. Indicate how each of the events would be classified on the statement of cash flows as operating activities (OA), investing activities (IA), financing activities (FA), or not applicable (NA).

b. Prepare a statement of cash flows for Year 2. Assume American General had a beginning cash balance of $9,000 on January 1, Year 2.

## EXERCISE 1-18B SOLUTION

**a.**

| Event | Statement of Cash Flow Classification |
|---|---|
| 1. | OA |
| 2. | FA |
| 3. | FA |
| 4. | IA |
| 5. | OA |
| 6. | OA |
| 7. | IA |
| 8. | FA |
| 9. | NA |
| 10. | FA |

**EXERCISE 1-18B (cont. on next page)**

## EXERCISE 1-18B (cont.)

**b.**

| American General Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $14,000 | |
| Cash Payments for Salaries | (4,000) | |
| Cash Payments for Utilities | (4,200) | |
| **Net Cash Inflow from Operating Activities** | | $ 5,800 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(8,000) | |
| Cash Collected from the Sale of Land | 7,000 | |
| **Net Cash Outflow from Investing Activities** | | (1,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Loan | $ 8,000 | |
| Cash Paid to Loan Obligation | (3,000) | |
| Cash Receipts from Stock Issue | 30,000 | |
| Cash Payments for Dividends | (1,000) | |
| **Net Cash Inflow from Financing Activities** | | 34,000 |
| | | |
| Net Increase in Cash | | 38,800 |
| Plus: Beginning Cash Balance | | 9,000 |
| Ending Cash Balance | | $47,800 |

## Exercise 1-19B *Preparing financial statements*

Carolina Company experienced the following events during Year 3.

1. Acquired $50,000 cash from the issue of common stock.
2. Paid $15,000 cash to purchase land.
3. Borrowed $25,000 cash.
4. Provided services for $60,000 cash.
5. Paid $12,000 cash for rent expense.
6. Paid $22,000 cash for other operating expenses.
7. Paid a $5,000 cash dividend to the stockholders.
8. Determined that the market value of the land purchased in Event 2 is now $16,500.

### Required

a. The January 1, Year 3, general ledger account balances are shown in the following accounting equation. Record the eight events in the appropriate general ledger accounts. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide the appropriate titles for these accounts in the last column of the table. The first event is shown as an example.

**CAROLINA COMPANY**
**Accounting Equation**

| | Assets | | = | Liabilities | + | Stockholders' Equity | | Acct. Titles for RE |
|---|---|---|---|---|---|---|---|---|
| Event | Cash | Land | | Notes Payable | | Common Stock | Retained Earnings | |
| Balance 1/1/Year 3 | 15,000 | 10,000 | | 0 | | 20,000 | 5,000 | |
| 1. | 50,000 | | | | | 50,000 | | |

b. Prepare an income statement, statement of changes in equity, year-end balance sheet, and statement of cash flows for the Year 3 accounting period.

c. Determine the percentage of assets that were provided by retained earnings (round to 3 decimal places). How much cash is in the retained earnings account?

## EXERCISE 1-19B SOLUTION

a.

**Carolina Company**
**Accounting Equation for Year 3**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/14 | 15,000 | | 10,000 | | -0- | | 20,000 | | 5,000 | |
| 1. Issued stk. | 50,000 | | NA | | NA | | 50,000 | | NA | NA |
| 2. Pur. Land | (15,000) | | 15,000 | | NA | | NA | | NA | NA |
| 3. Loan | 25,000 | | NA | | 25,000 | | NA | | NA | NA |
| 4. Provide Svc. | 60,000 | | NA | | NA | | NA | | 60,000 | Svc. Rev. |
| 5. Paid Rent | (12,000) | | NA | | NA | | NA | | (12,000) | Rent Exp. |
| 6. Pd. Op. Exp. | (22,000) | | NA | | NA | | NA | | (22,000) | Op. Exp. |
| 7. Paid Div. | (5,000) | | NA | | NA | | NA | | (5,000) | Dividends |
| 8. Land Value | NA | | NA | | NA | | NA | | NA | |
| Totals | 96,000 | + | 25,000 | = | 25,000 | + | 70,000 | + | 26,000 | |

b.

**Carolina Company**
**Income Statement**
**For the Year Ended December 31, Year 3**

| | |
|---|---|
| Service Revenue | $60,000 |
| Rent Expense | (12,000) |
| Operating Expense | (22,000) |
| Net Income | $26,000 |

EXERCISE 1-19B b. (cont. on next page)

## EXERCISE 1-19B b. (cont.)

**Carolina Company**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 3**

| | | |
|---|---|---|
| Beginning Common Stock | $20,000 | |
| Plus: Common Stock Issued | 50,000 | |
| Ending Common Stock | | $70,000 |
| | | |
| Beginning Retained Earnings | $ 5,000 | |
| Plus: Net Income | 26,000 | |
| Less: Dividends | (5,000) | |
| Ending Retained Earnings | | 26,000 |
| | | |
| Total Stockholders' Equity | | $96,000 |

**Carolina Company**
**Balance Sheet**
**As of December 31, Year 3**

| | | |
|---|---|---|
| Assets | | |
| Cash | $96,000 | |
| Land | 25,000 | |
| Total Assets | | $121,000 |
| | | |
| Liabilities | | |
| Notes Payable | $25,000 | |
| Total Liabilities | | $25,000 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $70,000 | |
| Retained Earnings | 26,000 | |
| Total Stockholders' Equity | | 96,000 |
| | | |
| Total Liabilities and Stockholders' Equity | | $121,000 |

EXERCISE 1-19B b. (cont. on next page)

## EXERCISE 1-19B b. (cont.)

| Carolina Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 3 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $60,000 | |
| Cash Payment for Rent Expense | (12,000) | |
| Cash Payments for Other Operating Exp. | (22,000) | |
| **Net Cash Flow from Operating Activities** | | $26,000 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(15,000) | |
| **Net Cash Flow from Investing Activities** | | (15,000) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $50,000 | |
| Cash Receipts from Loan | 25,000 | |
| Cash Payments for Dividends | (5,000) | |
| **Net Cash Flow from Financing Activities** | | 70,000 |
| | | |
| Net Increase in Cash | | 81,000 |
| Plus: Beginning Cash Balance | | 15,000 |
| Ending Cash Balance | | $96,000 |

c. **Percentage of assets provided by retained earnings:**
**$26,000 ÷ $121,000 = 21.5%**

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

## Exercise 1-20B *Relating accounting events to entities*

Pandora Company paid $40,000 cash to purchase land from Donnelley Company in Year 2. Donnelley originally paid $40,000 for the land.

**Required**

a. Was this event an asset source, use, or exchange transaction for Pandora Company?

b. Was this event an asset source, use, or exchange transaction for Donnelley Company?

c. Was the cash flow an operating, investing, or financing activity on Pandora Company's Year 2 statement of cash flows?

d. Was the cash flow an operating, investing, or financing activity on Donnelley Company's Year 2 statement of cash flows?

## EXERCISE 1-20B SOLUTION

| | | |
|---|---|---|
| **a.** | **Pandora Company:** | **Asset Exchange** |
| **b.** | **Donnelley Company:** | **Asset Exchange** |
| **c.** | **Pandora Company:** | **Investing Activity** |
| **d.** | **Donnelley Company:** | **Investing Activity** |

## Exercise 1-21B *Preparing financial statements—retained earnings emphasis*

On January 1, Year 2, the following information was drawn from the accounting records of Wilson Company: cash of $200; land of $1,800; notes payable of $600; and common stock of $1,000.

**Required**

a. Determine the amount of retained earnings as of January 1, Year 2.

b. After looking at the amount of retained earnings, the chief executive officer (CEO) wants to pay a $300 cash dividend to the stockholders. Can the company pay this dividend? Why or why not?

c. As of January 1, Year 2, what percent of the assets were acquired from creditors? (round to three decimal places.)

d. As of January 1, Year 2, what percent of the assets were acquired from investors? (round to three decimal places.)

e. As of January 1, Year 2, what percent of the assets were acquired from retained earnings? (round to three decimal places.)

f. Create an accounting equation using percentages instead of dollar amounts on the right side of the equation.

g. During Year 2, Wilson Company earned cash revenue of $500, paid cash expenses of $300, and paid a cash dividend of $50. Prepare an income statement, statement of changes in stockholders' equity, a balance sheet, and a statement of cash flows dated December 31, Year 2. (*Hint:* It is helpful to record these events under an accounting equation before preparing the statements.)

h. Comment on the terminology used to date each statement.

i. An appraiser determines that as of December 31, Year 2, the market value of the land is $2,000. How will this fact change the financial statements?

j. What is the balance in the Revenue account on January 1, Year 3?

## EXERCISE 1-21B SOLUTION

**a.**

**Wilson Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| $200 | | $1,800 | | $600 | | $1,000 | | ? |

**Retained Earnings = $200 + $1,800 - $600 - $1,000 = $400**

**EXERCISE 1-21B (cont. on next page)**

**EXERCISE 1-21B (cont.)**

b. The company cannot pay a $300 dividend because it only has $200 of cash. The Retained Earnings account contains zero cash. While a company may distribute dividends if it has a retained earnings balance, the company must also have the cash to enable it to pay the dividends.

c. Total Assets = $200 + $1,800 = $2,000

Creditor's Loans ÷ Total Assets
$600 ÷ $2,000 = 30%

d. Investor's Contributions ÷ Total Assets
$1,000 ÷ $2,000 = 50%

e. Retained Earnings ÷ Total Assets
$400 ÷ $2,000 = 20%

f.

| Wilson Company<br>Accounting Equation as of January 1, Year 2 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| $200 | | $1,800 | | 30% | | $50% | | 20% |

EXERCISE 1-21B (cont. on next page)

## EXERCISE 1-21B (cont.)

**g.**

**Wilson Company**
**Accounting Equation as of December 31, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained | |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings | |
| $200 | | $1,800 | | $600 | | $1,000 | | 400 | |
| 500 | | NA | | NA | | NA | | 500 | Rev. |
| (300) | | NA | | NA | | NA | | (300) | Exp. |
| (50) | | NA | | NA | | NA | | (50) | Div |
| 350 | | $1,800 | | $600 | | $1,000 | | $550 | |

**Wilson Company**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | |
|---|---|
| Revenue | $500 |
| Expenses | (300) |
| Net Income | $200 |

EXERCISE 1-21B g. (cont. on next page)

## EXERCISE 1-21B g. (cont.)

| Wilson Company<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Beginning Common Stock | $1,000 | |
| Plus: Common Stock Issued | 0 | |
| Ending Common Stock | | $1,000 |
| | | |
| Beginning Retained Earnings | $ 400 | |
| Plus: Net Income | 200 | |
| Less: Dividends | (50) | |
| Ending Retained Earnings | | 550 |
| | | |
| Total Stockholders' Equity | | $1,550 |

| Wilson Company<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| Assets | | |
| Cash | $ 350 | |
| Land | 1,800 | |
| Total Assets | | $2,150 |
| | | |
| Liabilities | | |
| Notes Payable | $600 | |
| Total Liabilities | | $ 600 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $1,000 | |
| Retained Earnings | 550 | |
| Total Stockholders' Equity | | 1,550 |
| | | |
| Total Liabilities and Stockholders' Equity | | $2,150 |

EXERCISE 1-21B g. (cont. on next page)

## EXERCISE 1-21B g. (cont.)

| Wilson Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $500 | |
| Cash Payments for Expenses | (300) | |
| **Net Cash Flow from Operating Activities** | | $ 200 |
| | | |
| **Cash Flows From Investing Activities:** | | 0 |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Payments for Dividends | (50) | |
| **Net Cash Flow from Financing Activities** | | (50) |
| | | |
| Net Increase in Cash | | 150 |
| Plus: Beginning Cash Balance | | 200 |
| Ending Cash Balance | | $ 350 |

h. The income statement, statement of changes in stockholders' equity and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology "*For the Year Ended* December 31, Year 2". In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In the case, the point in time is December 31, Year 2. Therefore, this statement uses the terminology "*As of* December 31, Year 2".

i. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company's books.

j. The balance in the revenue account is zero on January 1, Year 3, because the balance in this account is transferred to retained earnings in the December 31, Year 2 closing process.

## Exercise 1-22B *Preparing financial statements—cash flow emphasis*

As of January 1, Year 3, Concepts Inc. had a balance of $4,500 in Cash, $2,500 in Common Stock, and $2,000 in Retained Earnings. These were the only accounts with balances in the ledger on January 1, Year 3. Further analysis of the company's cash account indicated that during the Year 3 accounting period, the company had (1) net cash inflow from operating activities of $5,100, (2) net cash outflow for investing activities of $13,000, and (3) net cash inflow from financing activities of $7,600. All revenue and expense events were cash events. The following accounts and balances represent the general ledger of Concepts Inc. as of December 31, Year 3, before closing.

**CONCEPTS INC.**
Accounting Equation

| Assets | | = | Liabilities | | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Cash** | | | **Notes Payable** | | | **Common Stock** | | **Revenue** | |
| Bal. | 4,200 | | Bal. | 3,000 | | Bal. | 8,000 | Bal. | 9,900 |
| **Land** | | | | | | **Retained Earnings** | | **Expenses** | |
| Bal. | 13,000 | | | | | Bal. | 2,000 | Bal. | 4,800 |
| | | | | | | | | **Dividends** | |
| | | | | | | | | Bal. | 900 |

**Required**

a. Assume that the net cash inflow from financing activities of $7,600 was caused by three events. Based on the information given, identify these events and determine the cash flow associated with each event.

b. What did the company purchase that resulted in the cash outflow from investing activities?

c. Prepare an income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows.

## EXERCISE 1-22B SOLUTION

a. Since the amount in the Notes Payable account increased from zero to $3,000, Concepts, Inc. must have received a cash inflow of $3,000 from the issue of the note payable. Similarly, since the balance in the common stock account increased from $2,500 to $8,000, Concepts, Inc. must have received a cash inflow $5,500 ($8,000 - $2,500) from the issue of common stock. Finally, $900 dividend payment would have caused a net cash outflow. Therefore, the net cash inflow from financing activities can be explained as follows:

| | |
|---|---|
| Cash Flows From Financing Activities: | |
| Cash Receipts from Loan | $3,000 |
| Cash Receipts from Stock Issue | 5,500 |
| Cash Payments for Dividends | (900) |
| Net Cash Flow from Financing Activities | $7,600 |

b. Since the balance in the land account increases from zero to $13,000, Concepts, Inc. must have had a net cash outflow $13,000 for the purchase of Land.

c.

| Concepts, Inc.<br>Income Statement<br>For the Year Ended December 31, Year 3 | |
|---|---|
| Revenue | $9,900 |
| Expenses | (4,800) |
| Net Income | $5,100 |

EXERCISE 1-22B c. (cont.)

## EXERCISE 1-22B c. (cont.)

| Concepts, Inc.<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 3 | | |
|---|---|---|
| Beginning Common Stock | $ 2,500 | |
| Plus: Common Stock Issued | 5,500 | |
| Ending Common Stock | | $8,000 |
| | | |
| Beginning Retained Earnings | $ 2,000 | |
| Plus: Net Income | 5,100 | |
| Less: Dividends | (900) | |
| Ending Retained Earnings | | 6,200 |
| | | |
| Total Stockholders' Equity | | $14,200 |

| Concepts, Inc.<br>Balance Sheet<br>As of December 31, Year 3 | | |
|---|---|---|
| Assets | | |
| Cash | $ 4,200 | |
| Land | 13,000 | |
| Total Assets | | $17,200 |
| | | |
| Liabilities | | |
| Notes Payable | $3,000 | |
| Total Liabilities | | $ 3,000 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $8,000 | |
| Retained Earnings | 6,200 | |
| Total Stockholders' Equity | | 14,200 |
| | | |
| Total Liabilities and Stockholders' Equity | | $17,200 |

EXERCISE 1-22B c. (cont.)

## EXERCISE 1-22B c. (cont.)

**Concepts, Inc.**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 3**

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $ 9,900 | |
| Cash Payments for Expenses | (4,800) | |
| Net Cash Flow from Operating Activities | | $ 5,100 |
| | | |
| Cash Flows From Investing Activities: | | |
| Cash Paid to Purchase Land | $(13,000) | |
| Net Cash Flow from Investing Activities | | (13,000) |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Loan | $ 3,000 | |
| Cash Receipts from Stock Issue | 5,500 | |
| Cash Payments for Dividends | (900) | |
| Net Cash Flow from Financing Activities | | 7,600 |
| | | |
| Net Decrease in Cash | | (300) |
| Plus: Beginning Cash Balance | | 4,500 |
| Ending Cash Balance | | $ 4,200 |

**Exercise 1-23B** *Retained earnings and the closing process*

As of December 31, Year 4, Blue Haven Company had total assets of $100,000, total liabilities of $30,000, and common stock of $50,000. The company's Year 4 income statement contained revenue of $16,000 and expenses of $11,000. The Year 4 statement of changes in stockholder's equity stated that $2,000 of dividends were paid to investors.

**Required**

a. Determine the before-closing balance in the Retained Earnings account on December 31, Year 4.
b. Determine the after-closing balance in the Retained Earnings account on December 31, Year 4.
c. Determine the before-closing balances in the Revenue, Expense, and Dividend accounts on December 31, Year 4.
d. Determine the after-closing balances in the Revenue, Expense, and Dividend accounts on December 31, Year 4.
e. Explain the difference between common stock and retained earnings.
f. On January 1, Year 5, Blue Haven Company raised $40,000 by issuing additional common stock. Immediately after the additional capital was raised. Blue Haven reported total equity of $110,000. Are the stockholders of Blue Haven in a better financial position than they were on December 31, Year 4?

## EXERCISE 1-23B SOLUTION

**a.**

| Blue Haven Company<br>Accounting Equation as of December 31, Year 4 | | | | | | |
|---|---|---|---|---|---|---|
| **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **$100,000** | | **$30,000** | | **$50,000** | | **?** |

**Retained Earnings = $100,000 - $30,000 - $50,000 = $20,000**

| | |
|---|---|
| **Retained Earnings after closing:** | **$20,000** |
| **Less, Revenue** | **(16,000)** |
| **Add, Expenses** | **11,000** |
| **Add, Dividends** | **2,000** |
| **Retained Earnings before closing** | **$17,000** |

**b. Retained Earnings after closing is $20,000 (see the equation above).**

**EXERCISE 1-23B (cont. on next page)**

## EXERCISE 1-23B (cont.)

**c. The balances in revenue, expense and dividends before closing are:**

| | |
|---|---|
| Revenue | 16,000 |
| Expenses | 11,000 |
| Dividends | 2,000 |

**d. After closing revenue, expense and dividends, the all of the balances will be zero.**

**e. Both Common Stock and Retained Earnings represent obligations the business has to stockholders. The Common Stock represents the assets a business has acquired from owners. Retained earnings represent assets a business has acquired by conducting its operations.**

EXERCISE 1-23B (cont. on next page)

## EXERCISE 1-23B (cont.)

f. The owners are no better off immediately after they contributed capital to the business. While equity increased $40,000, the amount invested by owners also increased $40,000. The owners are only in a better financial position if their equity exceeds the amount they have invested in the company. At this point, the owners have simply exchanged cash for an additional ownership interest in the business. The owners will not benefit until the business uses the assets to produce profits. Note that it is possible that the owners could be worse off if the business incurs losses. In summary, the owners share in the benefits and sacrifices that the business experiences. They do not benefit when the business raises additional equity.

## Exercise 1-24B *The closing process*

Sammy's Pizza opened on January 1, Year 1. Sammy's reported the following for cash revenues and cash expenses for the Years 1 to 3:

| | Cash Revenues | Cash Expenses |
|---|---|---|
| 1 | 40,000 | 21,000 |
| 2 | 50,000 | 24,000 |
| 3 | 60,000 | 32,000 |

**Required**

a. What would Sammy's Pizza report for net income and retained earnings for the Years 1, 2, and 3?
b. Explain the difference between net income and retained earnings.
c. Assume that Sammy's Pizza paid a $5,000 dividend to stockholders in Year 2. What would Sammy's Pizza report for net income and retained earnings for Years 2 and 3?

## EXERCISE 1-24B

**a.**

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| 1 | $40,000 | $21,000 | 19,000 | 19,000 |
| 2 | 50,000 | 24,000 | 26,000 | 45,000 |
| 3 | 60,000 | 32,000 | 28,000 | 73,000 |
| | | | | |

**b. Net income is a measure of the benefits minus the sacrifices a company experiences during a single accounting period. Retained earnings is the amount of net income a company has earned minus the dividends it has paid out since its inception.**

**EXERCISE 1-24B (cont. on next page)**

## EXERCISE 1-24B (cont.)

**c.**

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| 1 | $40,000 | $21,000 | 19,000 | 19,000 |
| 2 | 50,000 | 24,000 | 26,000 | 40,000* |
| 3 | 60,000 | 32,000 | 28,000 | 68,000** |
| | | | | |

*$19,000 Beginning Balance + $26,000 Net Income - $5,000 Dividends
**$40,000 Beginning Balance + $28,000 Net Income

**Exercise 1-25B** ***Retained earnings and the closing process***

Davis Company was started on January 1, Year 1. During the month of January, Davis earned $4,600 of revenue and incurred $3,000 of expenses. During the remainder of Year 1, Davis earned $52,000 and incurred $42,000 of expenses. Davis closes its books on December 31 of each year.

**Required**

a. Determine the balance in the Retained Earnings account as of January 31, Year 1.
b. Determine the balance in the Revenue and Expense accounts as of January 31, Year 1.
c. Determine the balance in the Retained Earnings account as of December 31, Year 1, before closing.
d. Determine the balances in the Revenue and Expense accounts as of December 31, Year 1, before closing.
e. Determine the balance in the Retained Earnings account as of January 1, Year 2.
f. Determine the balance in the Revenue and Expense accounts as of January 1, Year 2.

## EXERCISE 1-25B SOLUTION

a. **The balance in the Retained Earnings account as of January 31, Year 1 is zero.**
*Explanation: The revenue is recorded in the Revenue account and is not transferred into retained until the year end closing process is accomplished.*

b. **The balance in the Revenue account as of January 31, Year 1 is $4,600. The balance in the Expense account as of January 31, Year 1 is $3,000.**
*Explanation: The amounts in the revenue and expense accounts are not transferred to the Retained Earnings account until the year end closing process is accomplished.*

c. **The *before closing* balance in the Retained Earnings account as of December 31, Year 1 is zero.**
*Explanation: The revenue and expenses are recorded in the Revenue and Expense accounts throughout the year and the balances in these accounts are not transferred into retained earnings until the year end closing process is accomplished.*

d. **The December 31, Year 1 *before closing* balance in the Revenue account is $56,600 ($4,600 + $52,000). The December 31, Year 1 *before closing* balance in the Expense account is $45,000 ($3,000 + $42,000).**
*Explanation: The revenue and expense amounts accumulate in the Revenue and Expense accounts throughout the year.*

**EXERCISE 1-25B (cont. on next page)**

## EXERCISE 1-25B (cont.)

**e. The January 1, Year 2 balance in the Retained Earnings account is $11,600.**

*Explanation: The December 31. Year 1 year-end closing process transfers the $56,600 balance in the Revenue account and $45,000 expense account into the Retained Earnings account. Since revenue increases retained earnings and expenses decrease retained earnings, the December 31, Year 1 retained earnings account balance* **after closing** *is $11,600 ($56,600 - $45,000). Since last year's ending balances become next year's beginning balances, the balance in the Retained Earnings account as of January 1, Year 2 is $11,600.*

**f. The January 1, Year 2 balance in the Revenue and Expense accounts is zero.**

*Explanation: The balances in the revenue and expense accounts* **after closing** *are zero because the balances accumulated during the year were transferred to the retained earnings account during the closing process. The January 1, Year 2 balances in the revenue and expense accounts are zero*

## Exercise 1-26B *Types of transactions and the horizontal statements model*

Happy Pet Store experienced the following events during its first year of operations:

1. Acquired cash by issuing common stock.
2. Borrowed cash from a bank.
3. Provided services and collected cash.
4. Purchased land with cash.
5. Paid cash for operating expenses.
6. Paid a cash dividend to the stockholders.
7. Determined that the market value of the land is higher than the historical cost.

### Required

a. Indicate whether each event is an asset source, use, or exchange transaction.

b. Use a horizontal statements model to show how each event affects the balance sheet, income statement, and statement of cash flows. Indicate whether the event increases (I), decreases (D), or does not affect (NA) each element of the financial statements. Also, in the Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first transaction is shown as an example.

| Event No. | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | N. Pay | + | C. Stock. | + | Ret. Ear. | Rev. | − | Exp. | = | Net Inc. | |
| 1. | I | + | NA | = | NA | + | I | + | NA | NA | − | NA | = | NA | I FA |

## EXERCISE 1-26B SOLUTION

a.

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

b.

**Happy Pet Store**
**Horizontal Statements Model**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | − | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Commo n Stock | + | Retained Earnings | | | | | | |
| 1 | I | + | NA | = | NA | + | I | + | NA | NA | – | NA | = | NA | I FA |
| 2 | I | + | NA | = | I | + | NA | + | NA | NA | – | NA | = | NA | I FA |
| 3 | NA | + | NA | = | NA | + | NA | + | NA | NA | – | NA | = | NA | NA |
| 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 1-27** *International Financial Reporting Standards*

Corrugated Boxes Inc. is a U.S.-based company that develops its financial statements under GAAP. The total amount of the company's assets shown on the balance sheet was approximately $305 million. The president of Corrugated is considering the possibility of relocating the company to a country that practices accounting under IFRS. The president has hired an international accounting firm to determine what the company's statements would look like if they were prepared under IFRS. One striking difference is that under IFRS the assets shown on the balance sheet would be valued at approximately $345 million.

**Required**

a. Would Corrugated Boxes' assets really be worth $40 million more if it moves its headquarters?

b. Discuss the underlying conceptual differences between U.S. GAAP and IFRS that cause the difference in the reported asset values.

## EXERCISE 1-27B SOLUTION

**a.** **The assets would be worth the same, but would be shown at different amounts on the balance sheet 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 allows companies to value assets at their current market values.**

**Problem 1-28B** *Accounting's role in not-for-profits*

Karen White is struggling to pass her introductory accounting course. Karen is intelligent but she likes to party. Studying is a low priority for Karen. When one of her friends tells her that she is going to have trouble in business if she doesn't learn accounting, Karen responds that she doesn't plan to go into business. She says that she is arts oriented and plans someday to be a director of a museum. She is in the school of business to develop her social skills, not her quantitative skills. Karen says she won't have to worry about accounting, since museums are not intended to make a profit.

**Required**

a. Write a brief memo explaining whether you agree or disagree with Karen's position regarding accounting and not-for-profit organizations.
b. Distinguish between financial accounting and managerial accounting.
c. Identify some of the stakeholders of not-for-profit institutions that would expect to receive financial accounting reports.
d. Identify some of the stakeholders of not-for-profit institutions that would expect to receive managerial accounting reports.

## PROBLEM 1-28B SOLUTION

**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.**

**PROBLEM 1-28B (cont. on next page)**

## PROBLEM 1-28B (cont.)

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 1-29B *Accounting entities*

The following business scenarios are independent from one another:

1. Chris Hann purchased an automobile from Classic Auto Sales for $10,000.
2. Sal Pearl loaned $15,000 to the business in which he is a stockholder.
3. First State Bank paid interest to Strong Co. on a certificate of deposit that Strong Co. has invested at First State Bank.
4. Cindy's Restaurant paid the current utility bill of $135 to Midwest Utilities.
5. Sun Corp. borrowed $50,000 from City National Bank and used the funds to purchase land from Carriage Realty.
6. Sue Wang purchased $10,000 of common stock of International Sales Corporation from the corporation.
7. Chris Gordon loaned $6,000 cash to his daughter.
8. Motor Service Co. earned $20,000 in cash revenue.
9. Poy Imports paid $4,000 for salaries to each of its four employees.
10. Borg Inc. paid a cash dividend of $4,000 to its sole shareholder, Mark Borg.

**Required**

a. For each scenario, create a list of all of the entities that are mentioned in the description.
b. Describe what happens to the cash account of each entity that you identified in Requirement *a.*

## PROBLEM 1-29B

| a. | Entities mentioned: | b. Effect on the cash account: |
|---|---|---|
| 1. | Chris Hann | Decrease |
| | Classic Auto Sales | Increase |
| | | |
| 2. | Sal Pearl | Decrease |
| | Business | Increase |
| | | |
| 3. | First State Bank | Decrease |
| | Strong Co. | Increase |
| | | |
| 4. | Cindy's Restaurant | Decrease |
| | Midwest Utilities | Increase |
| | | |
| 5. | Sun Corp. | Increase/Decrease |
| | City National Bank | Decrease |
| | Carriage Realty | Increase |
| Problem 1-29 a.b. (cont. on next page) | | |

| | | |
|---|---|---|
| 6. | Sue Wang | Decrease |
| | International Sales Corporation | Increase |
| | | |
| 7. | Chris Gordon | Decrease |
| | Daughter | Increase |
| | | |
| 8. | Motor Service Co. | Increase |
| | Customers | Decrease |
| | | |
| 9. | Poy Imports | Decrease |
| | Employees | Increase |
| | | |
| 10. | Borg, Inc. | Decrease |
| | Mark Borg | Increase |

LO 1-3

**Problem 1-30B** *Matching key terms with definitions*

**Required**

Match the terms (identified as a. through o.) with the definitions and phrases (marked 1 through 15). For example, the term "a. Matching concept" matches with definition "10. Process of matching expenses with the revenues they produce . . ."

| | |
|---|---|
| **a. Matching concept** | **1.** Actual price paid for an asset when it was purchased. |
| **b. Users** | **2.** Particular businesses or other organizations for which financial statements are prepared. |
| **c. Going concern** | **3.** Individuals or organizations that use financial information for decision making. Also called stakeholders. |
| **d. Dividend** | **4.** Accounts that contain information transferred from one accounting period to the next. |
| **e. Historical cost concept** | **5.** Document in which an organization provides information to stockholders, usually on an annual basis. |
| **f. Manufacturing business** | **6.** Natural resources that businesses transform to create more valuable resources. |
| **g. Permanent accounts** | **7.** Fee paid for the use of borrowed funds; also refers to revenue from debt securities. |
| **h. Annual report** | **8.** Group of people or entities organized to buy and sell resources. |
| **i. Physical resources** | **9.** Rules and regulations that accountants agree to follow when preparing financial reports for public distribution. |
| **j. Stewardship** | **10.** Process of matching expenses with the revenues they produce; three ways to match expenses with revenues include matching expenses directly to revenues, matching expenses to the period in which they are incurred, and matching expenses systematically with revenues. |
| **k. Interest** | **11.** Companies that make the goods they sell to customers. |
| **l. Market** | **12.** Ability to convert assets to cash quickly and meet short-term obligations. |
| **m. Generally Accepted Accounting Principles (GAAP)** | **13.** Accounting presumption that a company will continue to operate indefinitely, benefiting from its assets and paying its obligations in full; justifies reporting assets and liabilities in the financial statements. |
| **n. Liquidity** | **14.** Transfer of wealth from a business to its owners. |
| **o. Reporting entities** | **15.** A duty to protect and use the assets of a business for the benefit of the owners. |

## PROBLEM 1-30B SOLUTION

| | | | |
|---|---|---|---|
| **a.** | **Matching concept** | **10.** | Process of matching expenses with the revenues they produce; three ways to match expenses with revenues include matching expenses directly to revenues, matching expenses to the period in which they are incurred, and matching expenses systematically with revenues. |
| **b.** | **Users** | **3.** | Individuals or organizations that use financial information for decision making. Also called stakeholders. |
| **c.** | **Going concern** | **13.** | Accounting presumption that a company will continue to operate indefinitely, benefiting from its assets and paying its obligations in full; justifies reporting assets and liabilities in the financial statements. |
| **d.** | **Dividend** | **14.** | Transfer of wealth from a business to its owners. |
| **e.** | **Historical cost concept** | **1.** | Actual price paid for an asset when it was purchased. |

| | | | |
|---|---|---|---|
| **f.** | **Manufacturing business** | **11.** | Companies that make the goods they sell to customers. **(Solution cont. on next page)** |
| **g.** | **Permanent accounts** | **4.** | Accounts that contain information transferred from one accounting period to the next. |
| **h.** | **Annual report** | **5.** | Document in which an organization provides information to stockholders, usually on an annual basis. |
| **i.** | **Physical resources** | **6.** | Natural resources that businesses transform to create more valuable resources. |
| **j.** | **Stewardship** | **15.** | A duty to protect and use the assets of a business for the benefit of the owners. |
| **k.** | **Interest** | **7.** | Fee paid for the use of borrowed funds; also refers to revenue from debt securities. |
| **l.** | **Market** | **8.** | Group of people or entities organized to buy and sell resources. |
| **m.** | **Generally Accepted Accounting Principles (GAAP)** | **9.** | Rules and regulations that accountants agree to follow when preparing financial reports for public distribution. |
| **n.** | **Liquidity** | **12.** | Ability to convert assets to cash quickly and meet short-term obligations. |
| **o.** | **Reporting entities** | **2.** | Particular businesses or other organizations for which financial statements are prepared. |

## Problem 1-31B *Classifying events as asset source, use, or exchange*

The following unrelated events are typical of those experienced by business entities:

1. Pay cash for operating expenses.
2. Pay an office manager's salary with cash.
3. Receive cash for services that have been performed.
4. Pay cash for utilities expense.
5. Acquire land by accepting a liability (financing the purchase).
6. Pay cash to purchase a new office building.
7. Discuss plans for a new office building with an architect.
8. Repay part of a bank loan.
9. Acquire cash by issuing common stock.
10. Purchase land with cash.
11. Purchase equipment with cash.
12. Pay monthly rent on an office building.
13. Hire a new office manager.
14. Borrow cash from a bank.
15. Pay a cash dividend to stockholders.

### Required

Identify each of the events as an asset source, use, or exchange transaction. If an event would not be recorded under generally accepted accounting principles, identify it as not applicable (NA). Also indicate for each event whether total assets would increase, decrease, or remain unchanged. Organize your answer according to the following table. The first event is shown in the table as an example.

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1 | Asset use | Decrease |

## PROBLEM 1-31B SOLUTION

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1. | Asset Use | Decrease |
| 2. | Asset Use | Decrease |
| 3. | Asset Source | Increase |
| 4. | Asset Use | Decrease |
| 5. | Asset Source | Increase |
| 6. | Asset Exchange | No Effect |
| 7. | NA | NA |
| 8. | Asset Use | Decrease |
| 9. | Asset Source | Increase |
| 10. | Asset Exchange | No Effect |
| 11. | Asset Exchange | No Effect |
| 12. | Asset Use | Decrease |
| 13. | NA | NA |
| 14. | Asset Source | Increase |
| 15. | Asset Use | Decrease |

## Problem 1-32B *Relating titles and accounts to financial statements*

**Required**

Identify the financial statements on which each of the following items (titles, date descriptions, and accounts) appears by placing a check mark in the appropriate column. If an item appears on more than one statement, place a check mark in every applicable column.

| Item | Income Statement | Statement of Changes in Stockholders' Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| 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 | | | | |
| Notes payable | | | | |
| Beginning common stock | | | | |
| Service revenue | | | | |
| Utility expense | | | | |
| Stock issue | | | | |
| Operating activities | | | | |

## PROBLEM 1-32B SOLUTION

| Item | Income Statement | Statement of Changes in Stk. Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| 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 | | | | ✔ |
| Notes payable | | | ✔ | |
| Beginning common stock | | ✔ | | |
| Service revenue | ✔ | | | |
| Utility expense | ✔ | | | |
| Stock issue | | ✔ | | ✔ |
| Operating activities | | | | ✔ |

## Problem 1-33B *Preparing financial statements for two complete accounting cycles*

Susan's Consulting experienced the following transactions for Year 1, its first year of operations, and Year 2. *Assume that all transactions involve the receipt or payment of cash.*

### Transactions for Year 1

1. Acquired $50,000 by issuing common stock.
2. Received $100,000 cash for providing services to customers.
3. Borrowed $15,000 cash from creditors.
4. Paid expenses amounting to $60,000.
5. Purchased land for $40,000 cash.

### Transactions for Year 2

Beginning account balances for Year 2 are:

| | |
|---|---|
| Cash | $65,000 |
| Land | 40,000 |
| Notes payable | 15,000 |
| Common stock | 50,000 |
| Retained earnings | 40,000 |

1. Acquired an additional $20,000 from the issue of common stock.
2. Received $130,000 for providing services.
3. Paid $10,000 to creditors to reduce loan.
4. Paid expenses amounting to $75,000.
5. Paid a $15,000 dividend to the stockholders.
6. Determined that the market value of the land is $50,000.

### Required

a. Write an accounting equation, and record the effects of each accounting event under the appropriate headings for each year. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide appropriate titles for these accounts in the last column of the table.

b. Prepare an income statement, statement of changes in stockholders' equity, year-end balance sheet, and statement of cash flows for each year.

c. Determine the amount of cash that is in the Retained Earnings account at the end of Year 1 and Year 2.

d. Examine the balance sheets for the two years. How did assets change from Year 1 to Year 2?

e. Determine the balance in the Retained Earnings account immediately after Event 2 in Year 1 and in Year 2 are recorded.

## PROBLEM 1-33B SOLUTION

a.

**Susan's Consulting**
**Accounting Equation for Year 1**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| 1. Issued stk | 50,000 | | NA | | NA | | 50,000 | | NA | NA |
| 2. Revenue | 100,000 | | NA | | NA | | NA | | 100,000 | Svc. Rev. |
| 3. Loan | 15,000 | | NA | | 15,000 | | NA | | NA | NA |
| 4. Paid Exp. | (60,000) | | NA | | NA | | NA | | (60,000) | Expense |
| 5. Pur. Land | (40,000) | | 40,000 | | NA | | NA | | NA | NA |
| Totals | 65,000 | + | 40,000 | = | 15,000 | + | 50,000 | + | 40,000 | |

**Susan's Consulting**
**Accounting Equation for Year 2**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | 65,000 | | 40,000 | | 15,000 | | 50,000 | | 40,000 | |
| 1. Issued stk | 20,000 | | NA | | NA | | 20,000 | | NA | NA |
| 2. Revenue | 130,000 | | NA | | NA | | NA | | 130,000 | Svc. Rev. |
| 3. Paid Loan | (10,000) | | NA | | (10,000) | | NA | | NA | NA |
| 4. Paid Exp. | (75,000) | | NA | | NA | | NA | | (75,000) | Expense |
| 5. Paid Div. | (15,000) | | NA | | NA | | NA | | (15,000) | Dividends |
| 6. Land Val. | NA | | NA | | NA | | NA | | NA | NA |
| Totals | 115,000 | + | 40,000 | = | 5,000 | + | 70,000 | + | 80,000 | |

PROBLEM 1-33B (cont. on next page)

**PROBLEM 1-33B (cont.)**

**b.**

| Susan's Consulting<br>Income Statement<br>For the Period Ended December 31, Year 1 | |
|---|---|
| Service Revenue | $100,000 |
| Expenses | (60,000) |
| Net Income | $40,000 |

| Susan's Consulting<br>Statement of Changes in Stockholders' Equity<br>For the Period Ended December 31, Year 1 | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 50,000 | |
| Ending Common Stock | | $50,000 |
| | | |
| Beginning Retained Earnings | $ -0- | |
| Plus: Net Income | 40,000 | |
| Ending Retained Earnings | | 40,000 |
| | | |
| Total Stockholders' Equity | | $90,000 |

PROBLEM 1-33B b. (cont. on next page)

## PROBLEM 1-33B b. (cont.)

| Susan's Consulting<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| | | |
| **Assets** | | |
| Cash | $65,000 | |
| Land | 40,000 | |
| **Total Assets** | | $105,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | | $ 15,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $50,000 | |
| Retained Earnings | 40,000 | |
| **Total Stockholders' Equity** | | 90,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $105,000 |
| | | |

PROBLEM 1-33B b. (cont. on next page)

## PROBLEM 1-33B b. (cont.)

**Susan's Consulting**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 1**

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $100,000 | |
| Cash Payments for Expenses | (60,000) | |
| Net Cash Flow from Operating Activities | | $40,000 |
| | | |
| Cash Flows From Investing Activities: | | |
| Cash Payment for Land | $(40,000) | |
| Net Cash Flow from Investing Activities | | (40,000) |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Borrowing | $15,000 | |
| Cash Receipts from Stock Issue | 50,000 | |
| Net Cash Flow from Financing Activities | | 65,000 |
| | | |
| Net Increase in Cash | | 65,000 |
| Plus: Beginning Cash Balance | | -0- |
| Ending Cash Balance | | $65,000 |

PROBLEM 1-33B b. (cont. on next page)

## PROBLEM 1-33B b. (cont.)

**Susan's Consulting**
**Income Statement**
**For the Period Ended December 31, Year 2**

| | |
|---|---|
| Service Revenue | $130,000 |
| Expenses | (75,000) |
| Net Income | $55,000 |

**Susan's Consulting**
**Statement of Changes in Stockholders' Equity**
**For the Period Ended December 31, Year 2**

| | | |
|---|---|---|
| Beginning Common Stock | $50,000 | |
| Plus: Common Stock Issued | 20,000 | |
| Ending Common Stock | | $ 70,000 |
| | | |
| Beginning Retained Earnings | $40,000 | |
| Plus: Net Income | 55,000 | |
| Less: Dividends | (15,000) | |
| Ending Retained Earnings | | 80,000 |
| | | |
| Total Stockholders' Equity | | $150,000 |

PROBLEM 1-33B b. (cont. on next page)

## PROBLEM 1-33B b. (cont.)

**Susan's Consulting**
**Balance Sheet**
**As of December 31, Year 2**

| | | |
|---|---|---|
| **Assets** | | |
| Cash | $115,000 | |
| Land | 40,000 | |
| **Total Assets** | | $155,000 |
| | | |
| **Liabilities** | | |
| Notes Payable | | $ 5,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $70,000 | |
| Retained Earnings | 80,000 | |
| **Total Stockholders' Equity** | | 150,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $155,000 |

PROBLEM 1-33B b. (cont. on next page)

**PROBLEM 1-33B b. (cont.)**

| Susan's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $130,000 | |
| Cash Payments for Expenses | (75,000) | |
| **Net Cash Flow from Operating Activities** | | $55,000 |
| | | |
| **Cash Flows From Investing Activities** | | -0- |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $20,000 | |
| Cash Payment on Debt | (10,000) | |
| Cash Payment for Dividends | (15,000) | |
| **Net Cash Flow from Financing Activities** | | (5,000) |
| | | |
| **Net Increase in Cash** | | 50,000 |
| **Plus: Beginning Cash Balance** | | 65,000 |
| **Ending Cash Balance** | | $115,000 |

c. Retained earnings does not contain cash.

d. Assets increased from $105,000 at December 31, Year 1 to $155,000 at December 31, Year 2. This increase of $50,000 is solely due to the increase in cash.

PROBLEM 1-33B (cont. on next page)

**PROBLEM 1-33B (cont.)**

**e. Immediately after Event 2 in Year 1 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 Year 1 the Retained Earnings account will have a balance of $40,000 ($100,000 revenue - $60,000 expenses).**

**The Year 1 ending balance in Retained Earnings becomes next year's beginning balance. Thus, the balance in the Retained Earnings account on January 1, Year 2 is $40,000. This balance will not change until the closing process is completed in December Year 2. As a result, the balance in the Retained Earnings account immediately after Event 2 in Year 2 is $40,000.**

**Problem 1-34B** *Interrelationships among financial statements*

Crawford Enterprises started the Year 3 accounting period with $75,000 of assets (all cash), $15,000 of liabilities, and $25,000 of common stock. During the year, Crawford earned cash revenues of $46,000, paid cash expenses of $26,000, and paid a cash dividend to stockholders of $5,000. Crawford also acquired $15,000 of additional cash from the sale of common stock and paid $10,000 cash to reduce the liability owed to a bank.

**Required**

a. Prepare an income statement, statement of changes in stockholders' equity, period-end balance sheet, and statement of cash flows for the Year 3 accounting period. (*Hint:* Determine the amount of beginning retained earnings before considering the effects of the current period events. It also might help to record all events under an accounting equation before preparing the statements.)

b. Determine the percentage of total assets that were provided by creditors, investors, and earnings (round to 3 decimal places).

c. Determine the balance in the Revenue, Expense, and Dividends accounts as of January 1, Year 4.

## PROBLEM 1-34B SOLUTION

**Not required:**

**Crawford Enterprises**
**Accounting Equation**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | Cash | = | Liabilities | + | Common Stock | + | Retained Earnings |
| Beg. Balances | 75,000 | | 15,000 | | 25,000 | | *35,000* |
| Earned Revenue | 46,000 | | | | | | 46,000 |
| Paid Expenses | (26,000) | | | | | | (26,000) |
| Paid Dividends | (5,000) | | | | | | (5,000) |
| Issued Stock | 15,000 | | | | 15,000 | | |
| Paid Liability | (10,000) | | (10,000) | | | | |
| | 95,000 | = | 5,000 | + | 40,000 | + | 50,000 |

PROBLEM 1-34B (cont. on next page)

## PROBLEM 1-34B (cont.)

**a.**

**Crawford Enterprises**
**Income Statement**
**For the Period Ended December 31, Year 3**

| | |
|---|---|
| Revenue | $46,000 |
| Expenses | (26,000) |
| Net Income | $20,000 |

**Crawford Enterprises**
**Statement of Changes in Stockholders' Equity**
**For the Period Ended December 31, Year 3**

| | | |
|---|---|---|
| Beginning Common Stock | $25,000 | |
| Plus: Common Stock Issued | 15,000 | |
| Ending Common Stock | | $40,000 |
| | | |
| Beginning Retained Earnings | 35,000 | |
| Plus: Net Income | 20,000 | |
| Less: Dividends | (5,000) | |
| Ending Retained Earnings | | 50,000 |
| | | |
| Total Stockholders' Equity | | $90,000 |

PROBLEM 1-34B a. (cont. on next page)

## PROBLEM 1-34B a. (cont.)

**Crawford Enterprises**
**Balance Sheet**
**As of December 31, Year 3**

| | | |
|---|---|---|
| **Assets** | | |
| Cash | $95,000 | |
| **Total Assets** | | $95,000 |
| | | |
| **Liabilities** | | $ 5,000 |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | $40,000 | |
| Retained Earnings | 50,000 | |
| **Total Stockholders' Equity** | | 90,000 |
| | | |
| **Total Liabilities and Stockholders' Equity** | | $95,000 |

PROBLEM 1-34B a. (cont. on next page)

## PROBLEM 1-34B a. (cont.)

| Crawford Enterprises<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 3 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $46,000 | |
| Cash Payments for Expenses | (26,000) | |
| Net Cash Flow from Operating Activities | | $20,000 |
| | | |
| 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 | (5,000) | |
| Net Cash Flow from Financing Activities | | -0- |
| | | |
| Net Increase in Cash | | 20,000 |
| Plus: Beginning Cash Balance | | 75,000 |
| Ending Cash Balance | | $95,000 |

b. Percentage of assets provided by:

Creditors $ 5,000 ÷ $95,000 = 5.26%
Investors $40,000 ÷ $95,000 = 42.11%
Earnings $50,000 ÷ $95,000 = 52.63%

c. The balance in the temporary accounts, revenue, expenses and dividends will be zero on January 1, Year 4, because they were closed to Retained Earnings at December 31, Year 3.

## Problem 1-35B *Recording events in a horizontal statements model*

Davidson Company was started on January 1, Year 1, and experienced the following events during its first year of operation:

1. Acquired $52,000 cash from the issue of common stock.
2. Borrowed $20,000 cash from National Bank.
3. Earned cash revenues of $42,000 for performing services.
4. Paid cash expenses of $23,000.
5. Paid a $6,000 cash dividend to the stockholders.
6. Acquired an additional $10,000 cash from the issue of common stock.
7. Paid $10,000 cash to reduce the principal balance of the bank note.
8. Paid $45,000 cash to purchase land.
9. Determined that the market value of the land is $55,000.

### Required

a. Record the preceding transactions in the horizontal statements model. Also, in the Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first event is shown as an example.

**PROBLEM 1-35B (cont. on next page**

## PROBLEM 1-35B (cont.)

| Event No. | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | N. Pay | + | C. Stock. | + | Ret. Ear. | Rev. | − | Exp. | = | Net Inc. | |
| 1. | 52,000 | + | NA | = | NA | + | 52,000 | + | NA | NA | − | NA | = | NA | 52,000 FA |

b. Determine the amount of total assets that Davidson would report on the December 31, Year 1, balance sheet.

c. Identify the asset source transactions and related amounts for Year 1.

d. Determine the net income that Davidson would report on the Year 1 income statement. Explain why dividends do not appear on the income statement.

e. Determine the net cash flows from operating activities, financing activities, and investing activities that Davidson would report on the Year 1 statement of cash flows.

f. Determine the percentage of assets that were provided by investors, creditors, and earnings (round to 3 decimal places).

g. What is the balance in the Retained Earnings account immediately after Event 3 is recorded?

# PROBLEM 1-35B SOLUTION

**a.**

| Davidson Company<br>Horizontal Statements Model for Year 1 | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | – | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | 52,000 | | NA | | NA | | 52,000 | | NA | NA | | NA | | NA | 52,000 FA |
| 2 | 20,000 | | NA | | 20,000 | | NA | | NA | NA | | NA | | NA | 20,000 FA |
| 3 | 42,000 | | NA | | NA | | NA | | 42,000 | 42,000 | | NA | | 42,000 | 42,000 OA |
| 4 | (23,000) | | NA | | NA | | NA | | (23,000) | NA | | 23,000 | | (23,000) | (23,000) OA |
| 5 | (6,000) | | NA | | NA | | NA | | (6,000) | NA | | NA | | NA | (6,000) FA |
| 6 | 10,000 | | NA | | NA | | 10,000 | | NA | NA | | NA | | NA | 10,000 FA |
| 7 | (10,000) | | NA | | (10,000) | | NA | | NA | NA | | NA | | NA | (10,000) FA |
| 8 | (45,000) | | 45,000 | | NA | | NA | | NA | NA | | NA | | NA | (45,000) IA |
| 9 | NA | | NA | | NA | | NA | | NA | NA | | NA | | NA | NA |
| Total | 40,000 | + | 45,000 | = | 10,000 | + | 62,000 | + | 13,000 | 42,000 | – | 23,000 | = | 19,000 | 40,000 NC |

**b. Total Assets = $40,000 + $45,000 = $85,000**

**PROBLEM 1-35B (cont.)**

**c.**

| Sources of Assets | |
|---|---|
| Event | |
| 1. Issue of stock | $ 52,000 |
| 2. Cash from loan | 20,000 |
| 3. Cash from revenue | 42,000 |
| 6. Issue of stock | 10,000 |
| Total Sources of Assets | $124,000 |

**d.** **Net income is $19,000 (see part a.) Dividends are not expenses so they do not appear on the income statement.**

**PROBLEM 1-35B (cont. on next page)**

**PROBLEM 1-35B (cont.)**

**e.**

| Operating Activities: | |
|---|---|
| Cash from customers | $42,000 |
| Cash paid for expenses | (23,000) |
| Net Cash Flow from Operating Activities | $19,000 |
| | |

| Investing Activities: | |
|---|---|
| Cash paid to purchase land | $(45,000) |
| Net Cash Flow from Investing Activities | $(45,000) |
| | |

| Financing Activities: | |
|---|---|
| Cash from stock issues ($52,000 + $10,000) | $62,000 |
| Cash from loan | 20,000 |
| Paid cash dividend | (6,000) |
| Cash paid on loan principal | (10,000) |
| Net Cash Flow from Financing Activities | $66,000 |
| | |

**f.** Percentage of assets provided by:

Creditors $10,000 ÷ $85,000 = 11.76%
Investors $62,000 ÷ $85,000 = 72.94%
Earnings $13,000 ÷ $85,000 = 15.29%

**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.

**Exercise 1-1B** *The role of accounting in society*

Resource owners provide three types of resources to conversion agents that transform the resources into products or services that satisfy consumer demands.

**Required**

Identify the three types of resources. Write a brief memo explaining how resource owners select the particular conversion agents to which they will provide resources. Your memo should include answers to the following questions: If you work as a private accountant, what role would you play in the allocation of resources? Which professional certification would be most appropriate to your career?

## EXERCISE 1-1B SOLUTION

### The three types of resources available to conversion agents are:

1.
2.
3.

### Memo:

**Exercise 1-2B** *Careers in accounting*

Accounting is commonly divided into two sectors. One sector is called public accounting. The other sector is called private accounting.

**Required**

a. Identify three areas of service provided by public accountants.
b. Describe the common duties performed by private accountants.

## EXERCISE 1-2B SOLUTION

**a. The three areas of service provided by public accountants are:**

**b. The private accountant generally works for a specific company. Some of the functions performed include:**

**Exercise 1-3B** ***Identifying the reporting entities***

Ray Steen recently started a business. During the first few days of operation, Mr. Steen transferred $100,000 from his personal account into a business account for a company he named Steen Enterprises. Steen Enterprises borrowed $60,000 from First Bank. Mr. Steen's father-in-law, Stan Rhoades, invested $75,000 into the business for which he received a 25 percent ownership interest. Steen Enterprises purchased a building from Zoro Realty Company. The building cost $150,000 cash. Steen Enterprises earned $56,000 in revenue from the company's customers and paid its employees $31,000 for salaries expense.

**Required**

Identify the entities that were mentioned in the scenario and explain what happened to the cash accounts of each entity that you identify.

## EXERCISE 1-3B SOLUTION

| Entities | Distribution of Cash |
|---|---|
| Ray Steen (personal account) | Personal account was decreased by the $100,000 cash deposited in the Steen business account. |
| | Cash account |
| | Cash |
| | Cash |
| | Cash |

EXERCISE 1-3b (cont. on next page)

| | |
|---|---|
| | **Cash** |
| | **Cash** |
| | |

## Exercise 1-4B *Key definitions and missing information in the accounting equation*

**Required**

a. Match the terms (identified as a through g) with the definitions and phrases (marked 1 through 7). For example, the term "a. Investors" matches with definition "4. Company or individual who gives assets or services in exchange for security certificates representing ownership interest."

| | |
|---|---|
| a. Investors | 1. Value added by transforming resources into products or services desired by customers. |
| b. Managerial Accounting | 2. Individuals or institutions that have loaned goods or services to a business. |
| c. Profit | 3. Basic class of corporate stock that carries no preferences as to claims on assets or dividends; certificates that evidence ownership in a company. |
| d. Expenses | 4. Company or individual who gives assets or services in exchange for security certificates representing ownership interests. |
| e. Common Stock | 5. Statement that lists the assets of a business and the corresponding claims (liabilities and equity) on those assets. |
| f. Creditors | 6. Branch of accounting that provides information useful to internal decision makers and managers in operating an organization. |
| g. Balance Sheet | 7. Economic sacrifices (decreases in assets or increases in liabilities) that are incurred in the process of generating revenues. |

b. Calculate the missing amounts in the following table.

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Company | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| A | $ ? | | $30,000 | | $ 50,000 | | $62,000 |
| B | 50,000 | | ? | | 10,000 | | 25,000 |
| C | 85,000 | | 20,000 | | ? | | 40,000 |
| D | 215,000 | | 60,000 | | 100,000 | | ? |

## EXERCISE 1-4B SOLUTION

**a.**

| | | | |
|---|---|---|---|
| **a.** | **Investors** | **4.** | **Company or individual who gives assets or services in exchange for security certificate's representing ownership interests.** |
| | | | |
| **b.** | **Managerial Accounting** | | |
| **c.** | **Profit** | | |
| **d.** | **Expenses** | | |
| **e.** | **Common Stock** | | |
| **f.** | **Asset Use Transaction** | | |
| **g.** | **Balance Sheet** | | |

**EXERCISE 1-4b (cont. on next page)**

## EXERCISE 1-4B SOLUTION

**Accounting Equation**

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | | | | | Common | | Retained |
| Company | Assets | = | Liabilities | + | Stock | + | Earnings |
| A | *142,000* | = | 30,000 | + | 50,000 | + | 62,000 |
| B | | | | | | | |
| C | | | | | | | |
| D | | | | | | | |

## Exercise 1-5B *Effect of events on the accounting equation*

Hansen Enterprises experienced the following events during Year 2:

1. Acquired cash from the issue of common stock.
2. Provided services to clients for cash.
3. Paid utilities expenses with cash.
4. Paid cash to reduce the principal on a bank note.
5. Sold land for cash at an amount equal to its cost.
6. Paid a cash dividend to the stockholders.

### Required

Explain how each of the events would affect the accounting equation by writing the letter I for increase, the letter D for decrease, and NA for does not affect under each of the components of the accounting equation. If an event increases one account and decreases another account equally within the same element, record I/D. The first event is shown as an example.

**HANSEN ENTERPRISES**
**Accounting Equation**

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event Number | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| 1 | I | | NA | | I | | NA |

## EXERCISE 1-5B

| Hansen Enterprises<br>Accounting Equation | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | Stockholders' Equity | |
| Event Number | Assets | = | Liabilities | + | Common Stock | Retained Earnings |
| 1. | I | | NA | | I | NA |
| 2. | | | | | | |
| 3. | | | | | | |
| 4. | | | | | | |
| 5. | | | | | | |
| 6. | | | | | | |

## Exercise 1-6B *Effect of transactions on the accounting equation*

At the beginning of Year 4, Foster Corp.'s accounting equation showed the following accounts and balances.

| | FOSTER CORP. Accounting Equation | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Assets | | = | Liabilities | + | Stockholders' Equity | | Acct. Titles for RE |
| Event | Cash | Land | | Notes Payable | | Common Stock | Retained Earnings | |
| Balance 1/1/Year 4 | 30,000 | 16,000 | | 10,000 | | 20,000 | 16,000 | |

Foster Corp. completed the following transactions during Year 4:

1. Purchased land for $20,000 cash.
2. Acquired $10,000 cash from the issue of common stock.
3. Received $90,000 cash for providing services to customers.
4. Paid cash operating expenses of $65,000.
5. Borrowed $20,000 cash from the bank.
6. Paid a $5,000 cash dividend to the stockholders.
7. Determined that the market value of the land purchased in event 1 is $30,000.

**Required**

a. Record the transactions in the accounting equation for Year 4. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide the appropriate titles for these accounts in the last column of the table.

b. As of December 31, Year 4, determine the total amount of assets, liabilities, and stockholder's equity and present this information in the form of an accounting equation.

c. What is the amount of total assets, liabilities, and stockholders' equity as of January 1, Year 5?

## EXERCISE 1-6B SOLUTION

a.

**Foster Corp.**
**Accounting Equation for Year 4**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/Y4 | 30,000 | | 16,000 | | 10,000 | | 20,000 | | 16,000 | |
| 1. Pur. Land | | | | | | | | | | |
| 2. Issued stk. | | | | | | | | | | |
| 3. Provide Svc. | | | | | | | | | | |
| 4. Paid Exp. | | | | | | | | | | |
| 5. Loan | | | | | | | | | | |
| 6. Paid Div. | | | | | | | | | | |
| 7. Land Value | | | | | | | | | | |
| Totals | 60,000 | + | | | | | | | | |

b.

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| | = | | + | |

c. **The balances of total assets, liabilities and stockholders' equity:**

**Exercise 1-7B** *Missing information and recording events*

As of December 31, Year 3, Post Company had total cash of $156,000, notes payable of $85,600, and common stock of $52,400. During Year 4, Post earned $36,000 of cash revenue, paid $20,000 for cash expenses, and paid a $3,000 cash dividend to the stockholders.

**Required**

a. Determine the amount of retained earnings as of December 31, Year 3.

b. Create an accounting equation and record the beginning account balances under the appropriate headings.

c. Record the revenue, expense, and dividend events under the appropriate headings of the accounting equation created in Requirement *b*.

d. Prove the equality of the accounting equation as of December 31, Year 4.

e. Identify the beginning and ending balances in the Cash and Common Stock accounts. Explain why the beginning and ending balances in the Cash account are different, but the beginning and ending balances in the Common Stock account remain the same.

## EXERCISE 1-7B SOLUTION

**a.**

| Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|
| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
| 156,000 | = | 85,600 | + | 52,400 | + | ? |

**Retained Earnings = $156,000 –**

**b. & c.**

**Post Company**
**Effect of Year 4 Transactions on the Accounting Equation**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| Beginning Balances | 156,000 | | 85,600 | | 52,400 | | 18,000 |
| 1. Earned Revenue | | | | | | | |
| 2. Paid expenses | | | | | | | |
| 3. Paid dividend | | | | | | | |
| Ending Balance | | | | | | | |

EXERCISE 1-7B (cont. on next page)

## EXERCISE 1-7B (cont.).

**d.**

| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| | = | | | | | |

**Liabilities + Stockholders' Equity =**

**Assets = Liabilities + Stockholders' Equity**
**= +**

**d.** The beginning and ending balances in the cash account were $__________ and $__________, respectively. The beginning balance in the common stock account was $__________. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because:

**Exercise 1-8B** ***Account titles and the accounting equation***

The following account titles were drawn from the general ledger of Gutter Control, Incorporated (GCI): Cash, Notes Payable, Land, Accounts Payable, Office Furniture, Salaries Expense, Common Stock, Service Revenue, Interest Expense, Utilities Payable, Utilities Expense, Trucks, Supplies, Operating Expenses, Rent Revenue, Dividends, Computers, Building, Supplies Expense, Gasoline Expense, Retained Earnings, Dividends.

**Required**

**a.** Create an accounting equation using the headings assets, liabilities, and stockholders' equity. List each account title under the element of the accounting equation to which it belongs.

**b.** Will all businesses have the same number of accounts? Explain your answer.

## EXERCISE 1-8B SOLUTION

**a.**

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| Cash | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | Dividends |
| | | | | |

**EXERCISE 1-8b (cont. on next page**

## EXERCISE 1-8B (cont.)

**b. ______________(Yes/No)**

**Explain:**

**Exercise 1-9B** *Interpreting the accounting equation*

Lang Enterprises was started when it acquired $4,000 cash from creditors and $6,000 from owners. The company immediately purchased land that cost $9,000.

**Required**

a. Record the events under an accounting equation.

b. After all events have been recorded, Lang's obligations to creditors represent what percent of total assets?

c. After all events have been recorded, Lang's stockholder's equity represents what percent of total assets?

d. Assume the debt is due. Given that Lang has $6,000 in stockholders' equity, can the company repay the creditors at this point? Why or why not?

## EXERCISE 1-9B SOLUTION

**a.**

| | Cash | + | Land | = | Creditors | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| | | | | | | | |
| **Bal.** | | | | | | | |
| | | | | | | | |

**b. Creditor's Claim ÷ ____________ = Percent of Total**

**$________ ÷ $________ = ____%**

**c. ________________ ÷ ________________ = Percent of Total**

**$____________ ÷ $___________ = ____%**

**d. The company __________(can/cannot) repay the debt. Explain:**

**Exercise 1-10B** *Interpreting the accounting equation*

The financial condition of GreyCo Inc. is expressed in the following accounting equation:

| Accounting Equation | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Assets | | | = | Liabilities | + | Common stock | + | Retained earnings |
| Cash | | Land | | | | | | |
| $800 | + | $9,200 | = | $7,000 | + | $2,000 | + | $1,000 |

**Required**

a. Are dividends paid to creditors or investors? Explain why.
b. How much cash is in the Retained Earnings account?
c. Determine the maximum dividend GreyCo can pay.
d. If the obligation to creditors is due, can GreyCo repay the loan? Why or why not?
e. Suppose the land sinks into the sea as a result of an earthquake and a resulting tsunami. The business is then liquidated. How much cash will creditors receive? How much cash will investors receive? (Assume there are no legal fees or other costs of liquidation.)

## EXERCISE 1-10B SOLUTION

**a. Dividends are paid to ____________. Explain why:**

**b. There is _____________ cash in the Retained Earnings account. Retained Earnings represents:**

**c. The amount of dividends that can be paid are limited to __________________. In addition, a company must have enough _______ to pay the dividend. Grey Co. can pay a maximum amount of dividend of______________.**

**EXERCISE 1-10 (cont. on next page)**

## EXERCISE 1-10 (cont.)

**d. If the total amount of the liability of $7,000 is due, GreyCo. ______________(will/ will not) Explain:**

**e. If the land becomes worthless, the creditors will be paid $_____________. The investors will receive $____________. Explain:**

## Exercise 1-11B *Differences between interest and dividends*

The following account balances were drawn from the financial records of Crystal Company (CC) as of January 1, Year 3. Assets, $14,000; Liabilities, $4,000; Common Stock, $7,000; and Retained Earnings, $3,000. CC has agreed to pay the creditors $400 of interest per year. Further, CC agrees that for the Year 3 fiscal year any annual earnings remaining after the interest charges will be paid out as dividends to the owners.

**Required**

a. Assuming CC earns a before interest expense recognition profit of $900 during Year 3, determine the amount of interest and dividends paid.

b. Assuming CC earns a before interest expense recognition profit of $500 during Year 3, determine the amount of interest and dividends paid.

c. Assuming CC earns a before interest expense recognition profit of $100 during Year 3, determine the amount of interest and dividends paid.

## EXERCISE 1-11B SOLUTION

**a. Creditors receive their $__________ interest payment, leaving $_______ to be paid to the investors as____________.**

**b. Creditors receive their $_________ interest payment, leaving $________ to be paid to investors as dividends.**

**c. Creditors receive $______ interest payment. $_________ dividend is paid to investors.**

**Note: Your answers are based on the customary characteristics of interest and dividends. In practice, interest and dividends are based on the contractual terms of unique debt or equity agreements which may differ from ordinary circumstances. There are exceptions to the general treatment for interest and dividends that is described above.**

**Exercise 1-12B** *Distribution in a business liquidation*

Assume that Clinton Company acquires $1,200 cash from creditors and $1,700 cash from investors.

**Required**

a. Explain the primary differences between investors and creditors.

b. If Clinton has net income of $800 and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

c. If Clinton has a net loss of $800 cash and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

d. If Clinton has a net loss of $1,900 cash and then liquidates, what amount of cash will the creditors receive? What amount of cash will the investors receive?

## EXERCISE 1-12B SOLUTION

**a. Investors:**

**Creditors:**

**b.**

**Clinton Company**
**Accounting Equation**

| Events | Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|---|
| Acquired assets | | | | | |
| | | | | | |
| Balance | | | | | |

**The creditors will receive $________________. Since the investors own the business, they are entitled to the profits earned by the business. The investors will receive $________________**

**EXERCISE 1-12 (cont. on next page)**

## EXERCISE 1-12 (cont.)

c.

| Clinton Company<br>Accounting Equation | | | | | |
|---|---|---|---|---|---|
| Event | Assets | = | Liabilities | + | Stockholders' Equity |
| Acquired assets | | | | | |
| | | | | | |
| | | | | | |

The creditors will receive $_____________.The investors will receive $____________.

d.

| Clinton Company<br>Accounting Equation | | | | | |
|---|---|---|---|---|---|
| Event | Assets | = | Liabilities | + | Stockholders' Equity |
| | | | | | |
| | | | | | |
| | | | | | |

The creditors will receive $_________.
The investors will receive$_________..

## Exercise 1-13B *Classifying events as asset source, use, or exchange*

Dale's Business Services experienced the following events during its first year of operations:

1. Acquired $20,000 cash from the issue of common stock.
2. Borrowed $12,000 cash from First Bank.
3. Paid $5,000 cash to purchase land.
4. Received $25,000 cash for providing boarding services.
5. Acquired an additional $5,000 cash from the issue of common stock.
6. Purchased additional land for $4,000 cash.
7. Paid $10,000 cash for salary expense.
8. Signed a contract to provide additional services in the future.
9. Paid $1,200 cash for rent expense.
10. Paid a $1,000 cash dividend to the stockholders.
11. Determined the market value of the land to be $18,000 at the end of the accounting period.

**Required**

Classify each event as an asset source, use, or exchange transaction or as not applicable (NA).

## EXERCISE 1-13B SOLUTION

| Event | Classification |
|---|---|
| 1. | Asset Source |
| 2. | |
| 3. | |
| 4. | |
| 5. | |
| 6. | |
| 7. | |
| 8. | |
| 9. | |
| 10. | |
| 11. | |
| | |

**Exercise 1-14B** *Missing information for determining net income*

The December 31, Year 2, balance sheet for Thomas Company showed total stockholders' equity of $156,000. Total stockholders' equity increased by $65,000 between December 31, Year 2, and December 31, Year 3. During Year 3 Thomas Company acquired $20,000 cash from the issue of common stock. Thomas Company paid a $5,000 cash dividend to the stockholders during Year 3.

**Required**

Determine the amount of net income or loss Thomas reported on its Year 3 income statement. (*Hint:* Remember that stock issues, net income, and dividends all change total stockholders' equity.)

**EXERCISE 1-14B SOLUTION**
**Steps:**
**1.**
**Common Stock Issued = Change in Common Stock**

**2.**
**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**

**3.**
**Increase in Ret. Earn. = Net Income – Dividends**

**Alternate Solution:**
**From the Statement of Changes in Stockholders' Equity**

| | | |
|---|---|---|
| **Beginning Total Stk. Equity, 1/1/Year 3** | | |
| **(Common Stock + Retained Earnings)** | | |
| | | |
| **Plus: Common Stock Issued** | | |
| **Plus: Net Income** | | |
| **Less: Dividends** | | |
| **Change in Stockholders' Equity** | | |
| | | |
| **Ending Total Stk. Equity, 12/31/Year 3** | | |
| | | |

EXERCISE 1-14B (CONT. ON NEXT PAGE)

## EXERCISE 1-14B (cont.)

### Working backwards from the change in equity.

| | |
|---|---|
| | |
| Change in Stockholders' Equity, Year 3 | |
| Plus: Dividends | |
| Less: Common Stock Issued | |
| Net Income, Year 3 | |
| | |

**Exercise 1-15B** *Preparing an income statement and a balance sheet*

Topez Company was started on January 1, Year 1. During Year 1, the company experienced the following three accounting events: (1) earned cash revenues of $14,500, (2) paid cash expenses of $9,200, and (3) paid a $500 cash dividend to its stockholders. These were the only events that affected the company during Year 1.

**Required**

a. Create an accounting equation and record the effects of each accounting event under the appropriate general ledger account headings.

b. Prepare an income statement, statement of changes in stockholder's equity, and a balance sheet dated December 31, Year 1, for Topez Company.

c. Explain why the income statement uses different terminology to date the income statement than is used to date the balance sheet.

## EXERCISE 1-15B SOLUTION

**a.**

**Topez Company**
**Accounting Equation for Year 1**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| Event | Cash | = | | + | Common Stock | + | Retained Earnings |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| Ending Balance | 4,800 | = | -0- | + | -0- | + | 4,800 |

**b.**

**Topez Company**
**Income Statement**
**For the Year Ended December 31, Year 1**

| | |
|---|---|
| Revenue | |
| Expense | |
| Net Income | |

**EXERCISE 1-15B b. (CONT. ON NEXT PAGE)**

## EXERCISE 1-15B b. (cont.)

| Topez Company<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 1 | | |
|---|---|---|
| Beginning Common Stock | | |
| | | |
| Ending Common Stock | | |
| Beginning Retained Earnings | | |
| | | |
| | | |
| Ending Retained Earnings | | |
| Total Stockholders' Equity | | |

| Topez Company<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| Assets | | |
| Cash | | |
| Liabilities | | |
| Stockholders' Equity | | |
| | | |
| | | |
| Total Stockholders' Equity | | |
| Total Liabilities and Stockholders' Equity | | |

c. The income statement is dated with the term "for the year ended" because….
The balance sheet is dated______________________________because…

d. it covers a one year span of time. The balance sheet is dated with the term "as of" because it describes information at a specific point in time.

**Exercise 1-16B** ***Historical cost versus market value***

Mountain View, Inc., purchased land in January Year 2 at a cost of $400,000. The estimated market value of the land is $650,000 as of December 31, Year 7.

**Required**

a. Name the December 31, Year 7, financial statement(s) on which the land will be shown.

b. At what dollar amount will the land be shown in the financial statement(s)?

c. Name the key concept that will be used in determining the dollar amount that will be reported for land that is shown in the financial statement(s).

## EXERCISE 1-16B SOLUTION

**a. Land will be shown on the ….**

**b. Land will be listed at ….**

**c. The key concept used in listing land at its cost is the ______________________________ concept.**

## Exercise 1-17B *Statement of cash flows*

On January 1, Year 3, Palmetto, a fast-food company, had a balance in its Cash account of $32,000. During the Year 3 accounting period, the company had (1) net cash inflow from operating activities of $15,600, (2) net cash outflow for investing activities of $23,000, and (3) net cash outflow from financing activities of $4,500.

**Required**

a. Prepare a statement of cash flows.

b. Provide a reasonable explanation as to what may have caused the net cash inflow from operating activities.

c. Provide a reasonable explanation as to what may have caused the net cash outflow from investing activities.

d. Provide a reasonable explanation as to what may have caused the net cash outflow from financing activities.

## EXERCISE 1-17B SOLUTION

**a.Palmetto Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 3**

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| | | |
| **Cash Flows From Investing Activities:** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| | | |
| **Net Decrease in Cash** | | |
| **Plus: Beginning Cash Balance** | | |
| **Ending Cash Balance** | | **$20,100** |

**b.**

**c.**

**d.**

## Exercise 1-18B *Prepare a statement of cash flows*

American General Company experienced the following accounting events during Year 2:

1. Paid $4,000 cash for salary expense.
2. Borrowed $8,000 cash from State Bank.
3. Received $30,000 cash from the issue of common stock.
4. Purchased land for $8,000 cash.
5. Performed services for $14,000 cash.
6. Paid $4,200 cash for utilities expense.
7. Sold land for $7,000 cash.
8. Paid a cash dividend of $1,000 to the stockholders.
9. Hired an accountant to keep the books.
10. Paid $3,000 cash on the loan from State Bank.

**Required**

a. Indicate how each of the events would be classified on the statement of cash flows as operating activities (OA), investing activities (IA), financing activities (FA), or not applicable (NA).

b. Prepare a statement of cash flows for Year 2. Assume American General had a beginning cash balance of $9,000 on January 1, Year 2.

## EXERCISE 1-18B SOLUTION

**a.**

| Event | Statement of Cash Flow Classification |
|---|---|
| 1. | |
| 2. | |
| 3. | |
| 4. | |
| 5. | |
| 6. | |
| 7. | |
| 8. | |
| 9. | |
| 10. | |

**EXERCISE 1-18B (cont. on next page)**

## EXERCISE 1-18B (cont.)

**b.**

| American General Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| | | |
| **Cash Flows From Operating Activities:** | | |
| | | |
| | | |
| | | |
| **Net Cash Inflow from Operating Activities** | | |
| | | |
| **Cash Flows From Investing Activities:** | | |
| | | |
| | | |
| **Net Cash Outflow from Investing Activities** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Loan | | |
| Cash Paid to Loan Obligation | | |
| Cash Receipts from Stock Issue | | |
| Cash Payments for Dividends | | |
| **Net Cash Inflow from Financing Activities** | | |
| | | |
| **Net Increase in Cash** | | 38,800 |
| **Plus: Beginning Cash Balance** | | |
| **Ending Cash Balance** | | |
| | | |

## Exercise 1-19B *Preparing financial statements*

Carolina Company experienced the following events during Year 3.

1. Acquired $50,000 cash from the issue of common stock.
2. Paid $15,000 cash to purchase land.
3. Borrowed $25,000 cash.
4. Provided services for $60,000 cash.
5. Paid $12,000 cash for rent expense.
6. Paid $22,000 cash for other operating expenses.
7. Paid a $5,000 cash dividend to the stockholders.
8. Determined that the market value of the land purchased in Event 2 is now $16,500.

### Required

a. The January 1, Year 3, general ledger account balances are shown in the following accounting equation. Record the eight events in the appropriate general ledger accounts. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide the appropriate titles for these accounts in the last column of the table. The first event is shown as an example.

**CAROLINA COMPANY**
**Accounting Equation**

| | Assets | | = | Liabilities | + | Stockholders' Equity | | Acct. Titles for RE |
|---|---|---|---|---|---|---|---|---|
| Event | Cash | Land | | Notes Payable | | Common Stock | Retained Earnings | |
| Balance 1/1/Year 3 | 15,000 | 10,000 | | 0 | | 20,000 | 5,000 | |
| 1. | 50,000 | | | | | 50,000 | | |

b. Prepare an income statement, statement of changes in equity, year-end balance sheet, and statement of cash flows for the Year 3 accounting period.

c. Determine the percentage of assets that were provided by retained earnings (round to 3 decimal places). How much cash is in the retained earnings account?

## EXERCISE 1-19B SOLUTION

a.

**Carolina Company**
**Accounting Equation for Year 3**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/14 | 15,000 | | 10,000 | | -0- | | 20,000 | | 5,000 | |
| 1. Issued stk. | | | | | | | | | | |
| 2. Pur. Land | | | | | | | | | | |
| 3. Loan | | | | | | | | | | |
| 4. Provide Svc. | | | | | | | | | | |
| 5. Paid Rent | | | | | | | | | | |
| 6. Pd. Op. Exp. | | | | | | | | | | |
| 7. Paid Div. | | | | | | | | | | |
| 8. Land Value | | | | | | | | | | |
| Totals | 96,000 | + | 25,000 | = | 25,000 | + | 70,000 | + | | |

b.

**Carolina Company**
**Income Statement**
**For the Year Ended December 31, Year 3**

| | |
|---|---|
| Service Revenue | |
| Rent Expense | |
| Operating Expense | |
| Net Income | |

EXERCISE 1-19B b. (cont. on next page)

## EXERCISE 1-19B b. (cont.)

**Carolina Company**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 3**

| | | |
|---|---|---|
| Beginning Common Stock | $20,000 | |
| | | |
| Ending Common Stock | | |
| Beginning Retained Earnings | $ 5,000 | |
| | | |
| | | |
| Ending Retained Earnings | | |
| Total Stockholders' Equity | | |

**Carolina Company**
**Balance Sheet**
**As of December 31, Year 3**

| | | |
|---|---|---|
| Assets | | |
| | | |
| | | |
| Total Assets | | |
| Liabilities | | |
| Notes Payable | $25,000 | |
| Total Liabilities | | |
| Stockholders' Equity | | |
| | | |
| | | |
| Total Stockholders' Equity | | |
| Total Liabilities and Stockholders' Equity | | $121,000 |

EXERCISE 1-19B b. (cont. on next page)

## EXERCISE 1-19B b. (cont.)

**Carolina Company**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 3**

| | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| | | |
| | | |
| | | |
| **Net Cash Flow from Operating Activities** | | **$26,000** |
| | | |
| **Cash Flows From Investing Activities:** | | |
| | | |
| **Net Cash Flow from Investing Activities** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| | | |
| | | |
| | | |
| **Net Cash Flow from Financing Activities** | | |
| | | |
| **Net Increase in Cash** | | |
| **Plus: Beginning Cash Balance** | | |
| **Ending Cash Balance** | | |

**c.** **Percentage of assets provided by retained earnings:**

**____________ ÷ ___________ = _______%**

**Cash ________________(can/cannot) be directly traced to retained earnings. Retained earnings ______________(are/are not) used to acquire assets or pay liabilities or pay dividends.**

## Exercise 1-20B *Relating accounting events to entities*

Pandora Company paid $40,000 cash to purchase land from Donnelley Company in Year 2. Donnelley originally paid $40,000 for the land.

**Required**

a. Was this event an asset source, use, or exchange transaction for Pandora Company?

b. Was this event an asset source, use, or exchange transaction for Donnelley Company?

c. Was the cash flow an operating, investing, or financing activity on Pandora Company's Year 2 statement of cash flows?

d. Was the cash flow an operating, investing, or financing activity on Donnelley Company's Year 2 statement of cash flows?

# EXERCISE 1-20B SOLUTION

| | | |
|---|---|---|
| **a.** | **Pandora Company:** | **Asset Exchange** |
| **b.** | **Donnelley Company:** | |
| **c.** | **Pandora Company:** | |
| **d.** | **Donnelley Company:** | |

## Exercise 1-21B *Preparing financial statements—retained earnings emphasis*

On January 1, Year 2, the following information was drawn from the accounting records of Wilson Company: cash of $200; land of $1,800; notes payable of $600; and common stock of $1,000.

**Required**

a. Determine the amount of retained earnings as of January 1, Year 2.

b. After looking at the amount of retained earnings, the chief executive officer (CEO) wants to pay a $300 cash dividend to the stockholders. Can the company pay this dividend? Why or why not?

c. As of January 1, Year 2, what percent of the assets were acquired from creditors? (round to three decimal places.)

d. As of January 1, Year 2, what percent of the assets were acquired from investors? (round to three decimal places.)

e. As of January 1, Year 2, what percent of the assets were acquired from retained earnings? (round to three decimal places.)

f. Create an accounting equation using percentages instead of dollar amounts on the right side of the equation.

g. During Year 2, Wilson Company earned cash revenue of $500, paid cash expenses of $300, and paid a cash dividend of $50. Prepare an income statement, statement of changes in stockholders' equity, a balance sheet, and a statement of cash flows dated December 31, Year 2. (*Hint:* It is helpful to record these events under an accounting equation before preparing the statements.)

h. Comment on the terminology used to date each statement.

i. An appraiser determines that as of December 31, Year 2, the market value of the land is $2,000. How will this fact change the financial statements?

j. What is the balance in the Revenue account on January 1, Year 3?

# EXERCISE 1-21B SOLUTION

**a.**

**Wilson Company**
**Accounting Equation as of January 1, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| $200 | | $1,800 | | $600 | | $1,000 | | ? |
| | | | | | | | | |

**EXERCISE 1-21B (cont. on next page)**

## EXERCISE 1-21B (cont.)

b. The company __________(can/cannot) pay a $300 dividend. The Retained Earnings account contains __________ cash. The company ___________(may not/may) distribute dividends if it has a retained earnings balance. But, the company must also have the _________.

c. Total Assets = $___________
Creditor's Loans___(/,÷) Total Assets
$600 ___(/,÷) $_________ = _____%

d.

e.

f.

**Wilson Company**
**Accounting Equation as of January 1, Year 2**

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| $ | | $ | | % | | % | | % |
| | | | | | | | | |

EXERCISE 1-21B (cont. on next page)

## EXERCISE 1-21B (cont.)

**g.**

**Wilson Company**
**Accounting Equation as of December 31, Year 2**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |
| 350 | | | | | | | | |

**Wilson Company**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | |
|---|---|
| Revenue | |
| Expenses | |
| Net Income | |

EXERCISE 1-21B g. (cont. on next page)

## EXERCISE 1-21B g. (cont.)

| Wilson Company<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| | | |
| Beginning Common Stock | | |
| Plus: | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| | | |
| | | |
| | | |
| | | |
| Total Stockholders' Equity | | |
| | | |

| Wilson Company<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| | | |
| Assets | | |
| | | |
| | | |
| Total Assets | | |
| | | |
| Liabilities | | |
| | | |
| Total Liabilities | | |
| | | |
| Stockholders' Equity | | |
| | | |
| | | |
| Total Stockholders' Equity | | |
| | | |
| Total Liabilities and Stockholders' Equity | | |
| | | |

EXERCISE 1-21B g. (cont. on next page)

## EXERCISE 1-21B g. (cont.)

| Wilson Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| | | |
| Cash Flows From Operating Activities: | | |
| | | |
| | | |
| Net Cash Flow from Operating Activities | | |
| | | |
| Cash Flows From Investing Activities: | | |
| | | |
| Cash Flows From Financing Activities: | | |
| | | |
| Net Cash Flow from Financing Activities | | |
| | | |
| Net Increase in Cash | | |
| Plus: | | |
| Ending Cash Balance | | $ 350 |
| | | |

h. The income statement, statement of changes in stockholders' equity and the statement of cash flows explain what happens over______________________________. Therefore, these statements use terminology "______________________December 31, Year 2". In contrast, the balance sheet explains the financial condition of the company_______________. Therefore, this statement uses the terminology "__________ December 31, Year 2".

i. The market value ___________(is/is not) shown in the financial statements. The historical cost concept requires that……

j. The balance in the revenue account is ______ on January 1, Year 3, because….

## Exercise 1-22B *Preparing financial statements—cash flow emphasis*

As of January 1, Year 3, Concepts Inc. had a balance of $4,500 in Cash, $2,500 in Common Stock, and $2,000 in Retained Earnings. These were the only accounts with balances in the ledger on January 1, Year 3. Further analysis of the company's cash account indicated that during the Year 3 accounting period, the company had (1) net cash inflow from operating activities of $5,100, (2) net cash outflow for investing activities of $13,000, and (3) net cash inflow from financing activities of $7,600. All revenue and expense events were cash events. The following accounts and balances represent the general ledger of Concepts Inc. as of December 31, Year 3, before closing.

**CONCEPTS INC.**
**Accounting Equation**

| Assets | | = | Liabilities | | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|
| Cash | | | Notes Payable | | | Common Stock | | Revenue | |
| Bal. | 4,200 | | Bal. | 3,000 | | Bal. | 8,000 | Bal. | 9,900 |
| Land | | | | | | Retained Earnings | | Expenses | |
| Bal. | 13,000 | | | | | Bal. | 2,000 | Bal. | 4,800 |
| | | | | | | | | Dividends | |
| | | | | | | | | Bal. | 900 |

**Required**

a. Assume that the net cash inflow from financing activities of $7,600 was caused by three events. Based on the information given, identify these events and determine the cash flow associated with each event.

b. What did the company purchase that resulted in the cash outflow from investing activities?

c. Prepare an income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows.

# EXERCISE 1-22B SOLUTION

## a. Events

1.

2.

3.

**b.**

| Cash Flows From Financing Activities: | |
|---|---|
| | |
| | |
| | |
| **Net Cash Flow from Financing Activities** | |

**c.**

| Concepts, Inc.<br>Income Statement<br>For the Year Ended December 31, Year 3 | |
|---|---|
| | |
| **Revenue** | |
| **Expenses** | |
| **Net Income** | |
| | |

**EXERCISE 1-22B c. (cont.)**

## EXERCISE 1-22B c. (cont.)

**Concepts, Inc.**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 3**

| | | |
|---|---|---|
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | $8,000 |
| | | |
| Beginning Retained Earnings | $ 2,000 | |
| Plus: Net Income | | |
| Less: Dividends | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | |

**Concepts, Inc.**
**Balance Sheet**
**As of December 31, Year 3**

| | | |
|---|---|---|
| Assets | | |
| | | |
| | | |
| Total Assets | | |
| | | |
| Liabilities | | |
| | | |
| Total Liabilities | | |
| | | |
| Stockholders' Equity | | |
| | | |
| | | |
| Total Stockholders' Equity | | |
| | | |
| Total Liabilities and Stockholders' Equity | | |

EXERCISE 1-22B c. (cont.)

## EXERCISE 1-22B c. (cont.)

**Concepts, Inc.**
**Statement of Cash Flows**
**For the Year Ended December 31, Year 3**

| | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | | |
| Cash Payments for Expenses | | |
| Net Cash Flow from Operating Activities | | $ 5,100 |
| | | |
| Cash Flows From Investing Activities: | | |
| Cash Paid to Purchase Land | | |
| Net Cash Flow from Investing Activities | | |
| | | |
| Cash Flows From Financing Activities: | | |
| | | |
| | | |
| | | |
| Net Cash Flow from Financing Activities | | 7,600 |
| | | |
| Net Decrease in Cash | | |
| Plus: Beginning Cash Balance | | |
| Ending Cash Balance | | |

## Exercise 1-23B *Retained earnings and the closing process*

As of December 31, Year 4, Blue Haven Company had total assets of $100,000, total liabilities of $30,000, and common stock of $50,000. The company's Year 4 income statement contained revenue of $16,000 and expenses of $11,000. The Year 4 statement of changes in stockholder's equity stated that $2,000 of dividends were paid to investors.

**Required**

a. Determine the before-closing balance in the Retained Earnings account on December 31, Year 4.

b. Determine the after-closing balance in the Retained Earnings account on December 31, Year 4.

c. Determine the before-closing balances in the Revenue, Expense, and Dividend accounts on December 31, Year 4.

d. Determine the after-closing balances in the Revenue, Expense, and Dividend accounts on December 31, Year 4.

e. Explain the difference between common stock and retained earnings.

f. On January 1, Year 5, Blue Haven Company raised $40,000 by issuing additional common stock. Immediately after the additional capital was raised. Blue Haven reported total equity of $110,000. Are the stockholders of Blue Haven in a better financial position than they were on December 31, Year 4?

## EXERCISE 1-23B SOLUTION

**a.**

**Blue Haven Company**
**Accounting Equation as of December 31, Year 4**

| Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| $100,000 | | $30,000 | | $50,000 | | ? |
| | | | | | | |

**b.**

| | |
|---|---|
| Retained Earnings after closing: | |
| | |
| | |
| Add, Dividends | 2,000 |
| Retained Earnings before closing | |

**Retained Earnings after closing is $________ (see the equation above).**

EXERCISE 1-23B (cont. on next page)

## EXERCISE 1-23B (cont.)

**c. The balances in Revenue, Expense and Dividends before closing are:**

| | |
|---|---|
| Revenue | |
| Expenses | |
| Dividends | |

**d. After closing Revenue, Expense and Dividends would be….**

**e. Both Common Stock and Retained Earnings represent…**

**The Common Stock represents…**

**Retained Earnings represent…**

**EXERCISE 1-23B (cont. on next page)**

## EXERCISE 1-23B (cont.)

**f. The owners are ___________(better/no better) off immediately after they contributed capital to the business. Explain**

## Exercise 1-24B *The closing process*

Sammy's Pizza opened on January 1, Year 1. Sammy's reported the following for cash revenues and cash expenses for the Years 1 to 3:

| | Cash Revenues | Cash Expenses |
|---|---|---|
| 1 | 40,000 | 21,000 |
| 2 | 50,000 | 24,000 |
| 3 | 60,000 | 32,000 |

**Required**

a. What would Sammy's Pizza report for net income and retained earnings for the Years 1, 2, and 3?

b. Explain the difference between net income and retained earnings.

c. Assume that Sammy's Pizza paid a $5,000 dividend to stockholders in Year 2. What would Sammy's Pizza report for net income and retained earnings for Years 2 and 3?

## EXERCISE 1-24B

**a.**

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| 1 | $40,000 | $21,000 | | |
| 2 | 50,000 | 24,000 | | |
| 3 | 60,000 | 32,000 | | |
| | | | | |

**b. Net income is…**

**Retained earnings is…**

**EXERCISE 1-24B (cont. on next page)**

## EXERCISE 1-24B (cont.)

**c.**

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| 1 | $40,000 | $21,000 | | |
| 2 | 50,000 | 24,000 | | |
| 3 | 60,000 | 32,000 | | |
| | | | | |

## Exercise 1-25B *Retained earnings and the closing process*

Davis Company was started on January 1, Year 1. During the month of January, Davis earned $4,600 of revenue and incurred $3,000 of expenses. During the remainder of Year 1, Davis earned $52,000 and incurred $42,000 of expenses. Davis closes its books on December 31 of each year.

**Required**

a. Determine the balance in the Retained Earnings account as of January 31, Year 1.
b. Determine the balance in the Revenue and Expense accounts as of January 31, Year 1.
c. Determine the balance in the Retained Earnings account as of December 31, Year 1, before closing.
d. Determine the balances in the Revenue and Expense accounts as of December 31, Year 1, before closing.
e. Determine the balance in the Retained Earnings account as of January 1, Year 2.
f. Determine the balance in the Revenue and Expense accounts as of January 1, Year 2.

## EXERCISE 1-25B SOLUTION

**a. The balance in the Retained Earnings account as of January 31, Year 1 is $__________.**
*Explanation:*
.

**b. The balance in the Revenue account as of January 31, Year 1 is $________. The balance in the Expense account as of January 31, Year 1 is $________.**
*Explanation:*

**c. The *before closing* balance in the Retained Earnings account as of December 31, Year 1 is $_______.**
*Explanation:*

**d. The December 31, Year 1 *before closing* balance in the Revenue account is $__________. The December 31, Year 1 *before closing* balance in the Expense account is $________.**
*Explanation:*

**EXERCISE 1-25B (cont. on next page)**

## EXERCISE 1-25B (cont.)

**f. The January 1, Year 2 balance in the Retained Earnings account is $__________.**

*Explanation:*

**f. The January 1, Year 2 balance in the Revenue and Expense accounts is $_________.**

*Explanation:*

## Exercise 1-26B *Types of transactions and the horizontal statements model*

Happy Pet Store experienced the following events during its first year of operations:

1. Acquired cash by issuing common stock.
2. Borrowed cash from a bank.
3. Provided services and collected cash.
4. Purchased land with cash.
5. Paid cash for operating expenses.
6. Paid a cash dividend to the stockholders.
7. Determined that the market value of the land is higher than the historical cost.

### Required

a. Indicate whether each event is an asset source, use, or exchange transaction.

b. Use a horizontal statements model to show how each event affects the balance sheet, income statement, and statement of cash flows. Indicate whether the event increases (I), decreases (D), or does not affect (NA) each element of the financial statements. Also, in the Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first transaction is shown as an example.

| Event No. | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | N. Pay | + | C. Stock. | + | Ret. Ear. | Rev. | − | Exp. | = | Net Inc. | |
| 1. | I | + | NA | = | NA | + | I | + | NA | NA | − | NA | = | NA | I FA |

## EXERCISE 1-26B SOLUTION

**a.**

| Event | |
|---|---|
| 1. | Asset Source |
| 2. | |
| 3. | |
| 4. | |
| 5. | |
| 6. | |
| 7. | |

**b.**

**Happy Pet Store**
**Horizontal Statements Model**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | − | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | I | + | NA | = | NA | + | I | + | NA | NA | – | NA | = | NA | I FA |
| 2 | | | | | | | | | | | | | | | |
| 3 | | | | | | | | | | | | | | | |
| 4 | | | | | | | | | | | | | | | |
| 5 | | | | | | | | | | | | | | | |
| 6 | | | | | | | | | | | | | | | |
| 7 | | | | | | | | | | | | | | | |

## Exercise 1-27 *International Financial Reporting Standards*

Corrugated Boxes Inc. is a U.S.-based company that develops its financial statements under GAAP. The total amount of the company's assets shown on the balance sheet was approximately $305 million. The president of Corrugated is considering the possibility of relocating the company to a country that practices accounting under IFRS. The president has hired an international accounting firm to determine what the company's statements would look like if they were prepared under IFRS. One striking difference is that under IFRS the assets shown on the balance sheet would be valued at approximately $345 million.

**Required**

a. Would Corrugated Boxes' assets really be worth $40 million more if it moves its headquarters?

b. Discuss the underlying conceptual differences between U.S. GAAP and IFRS that cause the difference in the reported asset values.

## EXERCISE 1-27B SOLUTION

**a. The assets would be worth…..**

**b. US GAAP requires….**

**IFRS allows companies to value assets ….**

**Problem 1-28B** *Accounting's role in not-for-profits*

Karen White is struggling to pass her introductory accounting course. Karen is intelligent but she likes to party. Studying is a low priority for Karen. When one of her friends tells her that she is going to have trouble in business if she doesn't learn accounting, Karen responds that she doesn't plan to go into business. She says that she is arts oriented and plans someday to be a director of a museum. She is in the school of business to develop her social skills, not her quantitative skills. Karen says she won't have to worry about accounting, since museums are not intended to make a profit.

**Required**

a. Write a brief memo explaining whether you agree or disagree with Karen's position regarding accounting and not-for-profit organizations.

b. Distinguish between financial accounting and managerial accounting.

c. Identify some of the stakeholders of not-for-profit institutions that would expect to receive financial accounting reports.

d. Identify some of the stakeholders of not-for-profit institutions that would expect to receive managerial accounting reports.

## PROBLEM 1-28B SOLUTION

**a. Memo:**

**b. Financial accounting is designed to meet the needs of ……**

**Managerial accounting is designed to meet the needs of ….**

**PROBLEM 1-28B (cont. on next page)**

## PROBLEM 1-28B (cont.)

**c. Stakeholders of a not-for-profit entity that may want financial accounting reports would include ….**

**d. Stakeholders that may want managerial accounting reports would include…**

**Problem 1-29B** ***Accounting entities***

The following business scenarios are independent from one another:

1. Chris Hann purchased an automobile from Classic Auto Sales for $10,000.
2. Sal Pearl loaned $15,000 to the business in which he is a stockholder.
3. First State Bank paid interest to Strong Co. on a certificate of deposit that Strong Co. has invested at First State Bank.
4. Cindy's Restaurant paid the current utility bill of $135 to Midwest Utilities.
5. Sun Corp. borrowed $50,000 from City National Bank and used the funds to purchase land from Carriage Realty.
6. Sue Wang purchased $10,000 of common stock of International Sales Corporation from the corporation.
7. Chris Gordon loaned $6,000 cash to his daughter.
8. Motor Service Co. earned $20,000 in cash revenue.
9. Poy Imports paid $4,000 for salaries to each of its four employees.
10. Borg Inc. paid a cash dividend of $4,000 to its sole shareholder, Mark Borg.

**Required**

a. For each scenario, create a list of all of the entities that are mentioned in the description.
b. Describe what happens to the cash account of each entity that you identified in Requirement *a.*

## PROBLEM 1-29B

| a. Entities mentioned: | b. Effect on the cash account: |
|---|---|
| 1. Chris Hann | |
| Classic Auto Sales | |
| | |
| 2. | |
| | |
| | |
| 3. | |
| . | |
| | |
| 4. | |
| | |
| | |
| 5. | |
| | |
| | |

| Problem 1-29 a.b. (cont. on next page) | |
|---|---|
| 6. | |
| | |
| | |
| 7. | |
| r | |
| | |
| 8. | |
| | |
| | |
| 9. | |
| | |
| | |
| 10. | |
| | |

LO 1-3 **Problem 1-30B** *Matching key terms with definitions*

**Required**

Match the terms (identified as a. through o.) with the definitions and phrases (marked 1 through 15). For example, the term "a. Matching concept" matches with definition "10. Process of matching expenses with the revenues they produce . . ."

| | |
|---|---|
| a. Matching concept | 1. Actual price paid for an asset when it was purchased. |
| b. Users | 2. Particular businesses or other organizations for which financial statements are prepared. |
| c. Going concern | 3. Individuals or organizations that use financial information for decision making. Also called stakeholders. |
| d. Dividend | 4. Accounts that contain information transferred from one accounting period to the next. |
| e. Historical cost concept | 5. Document in which an organization provides information to stockholders, usually on an annual basis. |
| f. Manufacturing business | 6. Natural resources that businesses transform to create more valuable resources. |
| g. Permanent accounts | 7. Fee paid for the use of borrowed funds; also refers to revenue from debt securities. |
| h. Annual report | 8. Group of people or entities organized to buy and sell resources. |
| i. Physical resources | 9. Rules and regulations that accountants agree to follow when preparing financial reports for public distribution. |
| j. Stewardship | 10. Process of matching expenses with the revenues they produce; three ways to match expenses with revenues include matching expenses directly to revenues, matching expenses to the period in which they are incurred, and matching expenses systematically with revenues. |
| k. Interest | 11. Companies that make the goods they sell to customers. |
| l. Market | 12. Ability to convert assets to cash quickly and meet short-term obligations. |
| m. Generally Accepted Accounting Principles (GAAP) | 13. Accounting presumption that a company will continue to operate indefinitely, benefiting from its assets and paying its obligations in full; justifies reporting assets and liabilities in the financial statements. |
| n. Liquidity | 14. Transfer of wealth from a business to its owners. |
| o. Reporting entities | 15. A duty to protect and use the assets of a business for the benefit of the owners. |

## PROBLEM 1-30B SOLUTION

| | | | |
|---|---|---|---|
| **a.** | **Matching concept** | **10.** | Process of matching expenses with the revenues they produce; three ways to match expenses with revenues include matching expenses directly to revenues, matching expenses to the period in which they are incurred, and matching expenses systematically with revenues. |
| **b.** | **Users** | | |
| **c.** | **Going concern** | | |
| **d.** | **Dividend** | | |
| **e.** | **Historical cost concept** | | |
| **f.** | **Manufacturing business** | | **(Solution cont. on next page)** |

| | | | |
|---|---|---|---|
| g. | **Permanent accounts** | | |
| h. | **Annual report** | | . |
| i. | **Physical resources** | | |
| j. | **Stewardship** | | . |
| k. | **Interest** | | |
| l. | **Market** | | |
| m. | **Generally Accepted Accounting Principles (GAAP)** | | |
| n. | **Liquidity** | | |
| o. | **Reporting entities** | | |

## Problem 1-31B *Classifying events as asset source, use, or exchange*

The following unrelated events are typical of those experienced by business entities:

1. Pay cash for operating expenses.
2. Pay an office manager's salary with cash.
3. Receive cash for services that have been performed.
4. Pay cash for utilities expense.
5. Acquire land by accepting a liability (financing the purchase).
6. Pay cash to purchase a new office building.
7. Discuss plans for a new office building with an architect.
8. Repay part of a bank loan.
9. Acquire cash by issuing common stock.
10. Purchase land with cash.
11. Purchase equipment with cash.
12. Pay monthly rent on an office building.
13. Hire a new office manager.
14. Borrow cash from a bank.
15. Pay a cash dividend to stockholders.

### Required

Identify each of the events as an asset source, use, or exchange transaction. If an event would not be recorded under generally accepted accounting principles, identify it as not applicable (NA). Also indicate for each event whether total assets would increase, decrease, or remain unchanged. Organize your answer according to the following table. The first event is shown in the table as an example.

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1 | Asset use | Decrease |

## PROBLEM 1-31B SOLUTION

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| 1. | Asset Use | Decrease |
| 2. | | |
| 3. | | |
| 4. | | |
| 5. | | |
| 6. | | |
| 7. | | |
| 8. | | |
| 9. | | |
| 10. | | |
| 11. | | |
| 12. | | |
| 13. | | |
| 14. | | |
| 15. | | |
| | | |

## Problem 1-32B *Relating titles and accounts to financial statements*

**Required**

Identify the financial statements on which each of the following items (titles, date descriptions, and accounts) appears by placing a check mark in the appropriate column. If an item appears on more than one statement, place a check mark in every applicable column.

| Item | Income Statement | Statement of Changes in Stockholders' Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| 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 | | | | |
| Notes payable | | | | |
| Beginning common stock | | | | |
| Service revenue | | | | |
| Utility expense | | | | |
| Stock issue | | | | |
| Operating activities | | | | |

## PROBLEM 1-32B SOLUTION

| Item | Income Statement | Statement of Changes in Stk. Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| 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 | | | | |
| Notes payable | | | | |
| Beginning common stock | | | | |
| Service revenue | | | | |
| Utility expense | | | | |
| Stock issue | | | | |
| Operating activities | | | | |

## Problem 1-33B *Preparing financial statements for two complete accounting cycles*

Susan's Consulting experienced the following transactions for Year 1, its first year of operations, and Year 2. *Assume that all transactions involve the receipt or payment of cash.*

### Transactions for Year 1

1. Acquired $50,000 by issuing common stock.
2. Received $100,000 cash for providing services to customers.
3. Borrowed $15,000 cash from creditors.
4. Paid expenses amounting to $60,000.
5. Purchased land for $40,000 cash.

### Transactions for Year 2

Beginning account balances for Year 2 are:

| | |
|---|---|
| Cash | $65,000 |
| Land | 40,000 |
| Notes payable | 15,000 |
| Common stock | 50,000 |
| Retained earnings | 40,000 |

1. Acquired an additional $20,000 from the issue of common stock.
2. Received $130,000 for providing services.
3. Paid $10,000 to creditors to reduce loan.
4. Paid expenses amounting to $75,000.
5. Paid a $15,000 dividend to the stockholders.
6. Determined that the market value of the land is $50,000.

### Required

a. Write an accounting equation, and record the effects of each accounting event under the appropriate headings for each year. Record the amounts of revenue, expense, and dividends in the Retained Earnings column. Provide appropriate titles for these accounts in the last column of the table.

b. Prepare an income statement, statement of changes in stockholders' equity, year-end balance sheet, and statement of cash flows for each year.

c. Determine the amount of cash that is in the Retained Earnings account at the end of Year 1 and Year 2.

d. Examine the balance sheets for the two years. How did assets change from Year 1 to Year 2?

e. Determine the balance in the Retained Earnings account immediately after Event 2 in Year 1 and in Year 2 are recorded.

## PROBLEM 1-33B SOLUTION

**a.**

**Susan's Consulting**
**Accounting Equation for Year 1**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| 1. Issued stk | 50,000 | | NA | | NA | | 50,000 | | NA | NA |
| 2. Revenue | | | | | | | | | | |
| 3. Loan | | | | | | | | | | |
| 4. Paid Exp. | | | | | | | | | | |
| 5. Pur. Land | | | | | | | | | | |
| Totals | 65,000 | + | 40,000 | = | 15,000 | + | 50,000 | + | 40,000 | |

**Susan's Consulting**
**Accounting Equation for Year 2**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | Acct. Title/RE |
| Beg. Bal. | 65,000 | | 40,000 | | 15,000 | | 50,000 | | 40,000 | |
| 1. Issued stk | | | | | | | | | | |
| 2. Revenue | | | | | | | | | | |
| 3. Paid Loan | | | | | | | | | | |
| 4. Paid Exp. | | | | | | | | | | |
| 5. Paid Div. | | | | | | | | | | |
| 6. Land Val. | | | | | | | | | | |
| Totals | 115,000 | + | | | | | | | | |

**PROBLEM 1-33B (cont. on next page)**

## PROBLEM 1-33B (cont.)

**b.**

**Susan's Consulting**
**Income Statement**
**For the Period Ended December 31, Year 1**

| | |
|---|---|
| Service Revenue | |
| Expenses | |
| Net Income | |

**Susan's Consulting**
**Statement of Changes in Stockholders' Equity**
**For the Period Ended December 31, Year 1**

| | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| | | |
| | | |
| Beginning Retained Earnings | $ -0- | |
| | | |
| | | |
| Total Stockholders' Equity | | $90,000 |

PROBLEM 1-33B b. (cont. on next page)

## PROBLEM 1-33B b. (cont.)

| Susan's Consulting<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| **Assets** | | |
| | | |
| | | |
| **Total Assets** | | **$105,000** |
| | | |
| **Liabilities** | | |
| | | |
| | | |
| **Stockholders' Equity** | | |
| | | |
| | | |
| **Total Stockholders' Equity** | | **90,000** |
| | | |
| **Total Liabilities and Stockholders' Equity** | | **$105,000** |

**PROBLEM 1-33B b. (cont. on next page)**

## PROBLEM 1-33B b. (cont.)

| Susan's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 1 | | |
|---|---|---|
| | | |
| **Cash Flows From Operating Activities:** | | |
| | | |
| | | |
| **Net Cash Flow from Oper. Activities** | | |
| | | |
| **Cash Flows From Investing Activities:** | | |
| | | |
| **Net Cash Flow from Investing Activities** | | |
| | | |
| **Cash Flows From Financing Activities:** | | |
| | | |
| | | |
| **Net Cash Flow from Financing Activities** | | |
| | | |
| **Net Increase in Cash** | | **65,000** |
| **Plus: Beginning Cash Balance** | | |
| **Ending Cash Balance** | | |
| | | |

**PROBLEM 1-33B b. (cont. on next page)**

## PROBLEM 1-33B b. (cont.)

| Susan's Consulting<br>Income Statement<br>For the Period Ended December 31, Year 2 | |
|---|---|
| | |
| Service Revenue | |
| Expenses | |
| Net Income | |
| | |

| Susan's Consulting<br>Statement of Changes in Stockholders' Equity<br>For the Period Ended December 31, Year 2 | | |
|---|---|---|
| | | |
| | | |
| Plus: | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | | |
| | | |
| | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | |
| | | |

PROBLEM 1-33B b. (cont. on next page)

## PROBLEM 1-33B b. (cont.)

| Susan's Consulting<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| **Assets** | | |
| | | |
| | | |
| **Total Assets** | | |
| **Liabilities** | | |
| | | |
| **Stockholders' Equity** | | |
| | | |
| | | |
| **Total Stockholders' Equity** | | |
| **Total Liabs. and Stockholders' Equity** | | **$155,000** |

**PROBLEM 1-33B b. (cont. on next page)**

## PROBLEM 1-33B b. (cont.)

| Susan's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| | | |
| **Cash Flows From Operating Activities:** | | |
| | | |
| | | |
| **Net Cash Flow from Oper. Activities** | | **$55,000** |
| | | |
| **Cash Flows From Investing Activities** | | **-0-** |
| | | |
| **Cash Flows From Financing Activities:** | | |
| | | |
| | | |
| | | |
| **Net Cash Flow from Financing Activities** | | **(5,000)** |
| | | |
| **Net Increase in Cash** | | |
| **Plus:** | | |
| **Ending Cash Balance** | | |
| | | |

**c.** **Retained earnings ___________(does/does not) contain cash.**

**d.** **Assets____________(increased/decreased) from $________ at December 31, Year 1 to $_______ at December 31, Year 2. This is solely due to….**

PROBLEM 1-33B (cont. on next page)

## PROBLEM 1-33B (cont.)

**e.** **Immediately after Event 2 in Year 1 is recorded the balance in the Retained Earnings account is________.  Explain:**

**The balance in the Retained Earnings account on January 1, Year 2 is $_________.  Explain:**

**Problem 1-34B** *Interrelationships among financial statements*

Crawford Enterprises started the Year 3 accounting period with $75,000 of assets (all cash), $15,000 of liabilities, and $25,000 of common stock. During the year, Crawford earned cash revenues of $46,000, paid cash expenses of $26,000, and paid a cash dividend to stockholders of $5,000. Crawford also acquired $15,000 of additional cash from the sale of common stock and paid $10,000 cash to reduce the liability owed to a bank.

**Required**

a. Prepare an income statement, statement of changes in stockholders' equity, period-end balance sheet, and statement of cash flows for the Year 3 accounting period. (*Hint:* Determine the amount of beginning retained earnings before considering the effects of the current period events. It also might help to record all events under an accounting equation before preparing the statements.)

b. Determine the percentage of total assets that were provided by creditors, investors, and earnings (round to 3 decimal places).

c. Determine the balance in the Revenue, Expense, and Dividends accounts as of January 1, Year 4.

## PROBLEM 1-34B SOLUTION

**Not required:**

**Crawford Enterprises**
**Accounting Equation**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | Cash | = | Liabilities | + | Common Stock | + | Retained Earnings |
| Beg. Balances | 75,000 | | 15,000 | | 25,000 | | *35,000* |
| Earned Revenue | 46,000 | | | | | | 46,000 |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |

PROBLEM 1-34B (cont. on next page)

## PROBLEM 1-34B (cont.)

**a.**

| Crawford Enterprises<br>Income Statement<br>For the Period Ended December 31, Year 3 | |
|---|---|
| | |
| Revenue | |
| Expenses | |
| Net Income | |
| | |

| Crawford Enterprises<br>Statement of Changes in Stockholders' Equity<br>For the Period Ended December 31, Year 3 | | |
|---|---|---|
| | | |
| Beginning Common Stock | | |
| Plus: Common Stock Issued | | |
| Ending Common Stock | | |
| | | |
| Beginning Retained Earnings | 35,000 | |
| | | |
| | | |
| Ending Retained Earnings | | |
| | | |
| Total Stockholders' Equity | | |
| | | |

PROBLEM 1-34B a. (cont. on next page)

## PROBLEM 1-34B a. (cont.)

| Crawford Enterprises<br>Balance Sheet<br>As of December 31, Year 3 | | |
|---|---|---|
| | | |
| **Assets** | | |
| Cash | | |
| **Total Assets** | | |
| | | |
| **Liabilities** | | |
| | | |
| **Stockholders' Equity** | | |
| Common Stock | | |
| Retained Earnings | | |
| **Total Stockholders' Equity** | | |
| | | |
| **Total Liabilities and Stockholders' Equity** | | |
| | | |

PROBLEM 1-34B a. (cont. on next page)

## PROBLEM 1-34B a. (cont.)

| Crawford Enterprises<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 3 | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| | | |
| | | |
| Net Cash Flow from Operating Activities | | $20,000 |
| | | |
| Cash Flows From Investing Activities | | |
| | | |
| Cash Flows From Financing Activities: | | |
| | | |
| | | |
| | | |
| Net Cash Flow from Financing Activities | | |
| | | |
| Net Increase in Cash | | |
| Plus: Beginning Cash Balance | | |
| Ending Cash Balance | | |

b. Percentage of assets provided by:

Creditors = %

Investors = %

Earnings = %

c. The balance in the temporary accounts, revenue, expenses and dividends will be _________ on January 1, Year 4, because…

## Problem 1-35B *Recording events in a horizontal statements model*

Davidson Company was started on January 1, Year 1, and experienced the following events during its first year of operation:

1. Acquired $52,000 cash from the issue of common stock.
2. Borrowed $20,000 cash from National Bank.
3. Earned cash revenues of $42,000 for performing services.
4. Paid cash expenses of $23,000.
5. Paid a $6,000 cash dividend to the stockholders.
6. Acquired an additional $10,000 cash from the issue of common stock.
7. Paid $10,000 cash to reduce the principal balance of the bank note.
8. Paid $45,000 cash to purchase land.
9. Determined that the market value of the land is $55,000.

### Required

a. Record the preceding transactions in the horizontal statements model. Also, in the Cash Flows column, classify the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first event is shown as an example.

**PROBLEM 1-35B (cont. on next page**

## PROBLEM 1-35B (cont.)

| Event No. | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Land | = | N. Pay | + | C. Stock. | + | Ret. Ear. | Rev. | − | Exp. | = | Net Inc. | |
| 1. | 52,000 | + | NA | = | NA | + | 52,000 | + | NA | NA | − | NA | = | NA | 52,000 FA |

b. Determine the amount of total assets that Davidson would report on the December 31, Year 1, balance sheet.

c. Identify the asset source transactions and related amounts for Year 1.

d. Determine the net income that Davidson would report on the Year 1 income statement. Explain why dividends do not appear on the income statement.

e. Determine the net cash flows from operating activities, financing activities, and investing activities that Davidson would report on the Year 1 statement of cash flows.

f. Determine the percentage of assets that were provided by investors, creditors, and earnings (round to 3 decimal places).

g. What is the balance in the Retained Earnings account immediately after Event 3 is recorded?

## PROBLEM 1-35B SOLUTION

**a.**

**Davidson Company**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | − | Expense | = | Net Inc. | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | |
| 1 | 52,000 | | NA | | NA | | 52,000 | | NA | NA | | NA | | NA | 52,000 FA |
| 2 | | | | | | | | | | | | | | | |
| 3 | | | | | | | | | | | | | | | |
| 4 | | | | | | | | | | | | | | | |
| 5 | | | | | | | | | | | | | | | |
| 6 | | | | | | | | | | | | | | | |
| 7 | | | | | | | | | | | | | | | |
| 8 | | | | | | | | | | | | | | | |
| 9 | | | | | | | | | | | | | | | |
| Total | 40,000 | + | | | | | | | | | | | | | 40,000 NC |

**b. Total Assets =**

PROBLEM 1-35B (cont. on next page)

## PROBLEM 1-35B (cont.)

c.

| Sources of Assets | |
|---|---|
| Event | |
| 1. Issue of stock | $ 52,000 |
| 2. | |
| 3. | |
| 6. | |
| Total Sources of Assets | |

d. Net income is $__________. Dividends ____________(d0/do not) appear on the incomestatement. Explain:

PROBLEM 1-35B (cont. on next page)

## PROBLEM 1-35B (cont.)

**e.**

| Operating Activities: | |
|---|---|
| Cash from customers | $42,000 |
| | |
| Net Cash Flow from Operating Activities | |
| | |

| Investing Activities: | |
|---|---|
| | |
| | |
| | |

| Financing Activities: | |
|---|---|
| | |
| | |
| | |
| | |
| Net Cash Flow from Financing Activities | $66,000 |
| | |

**f.** **Percentage of assets provided by:**

**Creditors** = ___________%

**Investors** = ___________%

**Earnings** = ___________%

**g.** ___________ **Explain:**

# General Comments for Chapter 1

## An Introduction to Accounting

The primary objective of this chapter is to teach students how business events affect financial statements. First, students learn the elements of financial statements: assets, liabilities, equity, common stock, retained earnings, revenue, expenses, and distributions. Next, students learn how the elements are interrelated, and finally, how those interrelationships are expressed in financial statements.

There are two distinct ways to introduce financial accounting using this text. One alternative (equation approach) is to show students how to record transaction data using the accounting equation and then to develop financial statements from the data organized in equation form. The second alternative (statements model approach) is first to introduce financial statements and then show students how to record events in a financial statements model. The text material for Chapter 1 uses the equation approach. Even so, many instructors using the text successfully employ the second approach. Indeed, we provide detailed lesson plans for both approaches.

# Detailed Outline of a Lesson Plan for Chapter 1

## (Equation Approach)

**I. Distribute copies of Demonstration Problem 1-1.**

**II. Define assets.** Use the simplest definition possible, words that students can understand. They will read the technical terminology in the text. For example:

***Assets are things of value to a business. An asset's value is its capacity to be used to earn other assets (money). For example, a lawyer uses supplies (assets) to obtain money (other assets) from clients.***

Use the classroom to provide other specific examples. For example, the chairs, desks, and building the students are using are assets of the university because they are used to produce tuition dollars (other assets). Emphasize the point further by distinguishing between personal assets and business assets. Tom (one of the authors of the textbook) uses an old key chain his brother gave him over twenty years ago. While it has great value to Tom, it would have little value to a business because it could not be sold or otherwise used to produce other assets. If you saw this key chain you would truly understand its limitations as a business asset. You may not have an old key chain, but we're sure you can think of something meaningful to you that has little usefulness as a business asset. You might use a framed photograph of a family member. Select examples that reflect your personality and interests. Students respond favorably to personalized examples.

**III. Introduce the accounting equation.** You can make a smooth transition from defining assets to introducing the accounting equation by noting that ***assets*** belong to some person or organization. The individual or institutional interests in the assets are called ***claims***. The ***accounting equation*** expresses the relationship between assets and claims as follows:

**Assets = Claims**

**IV. Use the demonstration problem to introduce new terms and to elaborate on the interrelationships represented by the accounting equation.** Individuals or institutions acquire claims by providing assets to a business. *There are three primary sources of assets*. The first three events of the demonstration problem illustrate the three sources. Discuss each event separately. Define the appropriate terms, and explain how the event affects the accounting equation.

**A. Event No. 1:** Use Event No. 1 to introduce and define ***common stock***. Explain that when a business acquires assets from owners, the assets of the business increase and the business establishes a corresponding ***claims account*** called ***common stock***. Introduce the accounting equation and the term ***equity***. Show students how to record the event under the accounting equation. Record common stock under the term equity. Leave room for retained earnings which will be illustrated in Event No. 3. Note that equity represents ownership interest in the business. As you lead in to Event No. 2, tell the students that creditors also have an interest in the assets of a business.

**B. Event No. 2:** Use this event to introduce ***liabilities***. Define liabilities as ***obligations of a business***. Note that Rustic Camp Sites (RCS) is obligated to return $5,000 of assets to creditors. Therefore, the creditors have a $5,000 claim on assets. Expand the accounting equation to include creditor interests.

C. **Event No. 3:** This event introduces the concept of ***revenue***. Define revenue as an ***increase in assets*** resulting from the operating activities of providing services or goods to customers.[1] This definition defines revenue in terms of its relationship with assets. It is extremely important that students understand how the elements of financial statements articulate. You can achieve this goal by defining various elements in terms of their relationship to other elements. Expand the accounting equation to include retained earnings and record Event No. 3 under the equation.

Emphasize that the first three events represent the three sources of assets. Identify these events as ***asset source transactions*** and explain the basic nature of asset source transactions. Emphasize that thousands of different events can be classified into one of these three types of transactions. For example, businesses may increase their assets by providing consulting services, cleaning services, music lessons, investment advice, legal services, medical assistance, mechanical work, painting, and so on. Although these services represent distinctly different events, they can all be classified as asset source transactions. Emphasize that *it is easier to understand the three types of transactions* than *to memorize* the infinite number of specific transactions in which businesses engage.

The next two events represent ***asset use transactions***.

D. **Event No. 4:** This event introduces the concept of ***expenses***. Define expenses as ***decreases in*** **assets that occur in the process of attempting to earn revenue.**

E. **Event No. 5:** This event introduces ***dividends***. Clearly distinguish dividends from expenses. While both are asset use transactions, dividends represent ***a transfer of wealth*** rather than a sacrifice made to obtain revenue.

V. **Have students record the events for the second accounting cycle in an accounting equation.** Explain that the Year 1 ending balances become the Year 2 beginning balances. Illustrate the Year 2 accounting equation with beginning balances before the students attempt to record the year 2 events. Circulate through the room while your students attempt to record the Year 2 events. Help those who are having trouble getting started. Event No. 2 represents debt repayment. While some students will immediately recognize this event as the reverse of a borrowing event, many will view it as an independent transaction that is totally foreign to them. If you notice that many students are having trouble with the event, interrupt the students to provide a brief explanation to the class as a whole.

Invariably, you will find that some students work faster than others. Instruct the faster students to record the Year 3 events while you continue to help those who are having trouble with Year 2. Stop the class after the majority of students have recorded the Year 2 transactions. Assign the Year 3 events as homework for those students who are unable to finish them in class.

VI. **Time considerations.** Introducing the accounting equation, including student participation with Year 2 data, requires approximately one hour.

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[1]Revenues can also result from activities that decrease liabilities. Revenue recognition within this context requires an understanding of deferrals. Deferrals are introduced in Chapter 2. Within the context of cash basis accounting, which is the underlying assumption for Chapter 1, revenue can be defined simply as an increase in assets from providing services and expenses as decreases in assets from revenue-producing activities. These definitions will be expanded as accrual accounting topics are gradually introduced.

**VII. Homework assignment.** Problem 1-33 is similar to the demonstration problem. At this point, students should be able to complete *part a* of the requirements for this problem. *Parts b-e* require preparing and analyzing financial statements, which is discussed in the next section.

**VIII. Introduce financial statements.** Return to the Year 1 data for Demonstration Problem 1-1 and show students how the information recorded in the accounting equation is summarized in financial statements. Emphasize that financial statements are designed to provide information useful in decision-making. This is a good time to say a few words about the different types of accounting information. Explain how outsiders (e.g., investors and creditors) need different kinds of information than insiders (e.g., managers). For example, a person deciding whether to invest in Target versus Wal-Mart is interested in knowing which company generated more earnings. In contrast, a Wal-Mart vice-president needs information about specific stores and specific items in each store. Different branches of accounting have been established to satisfy the information needs of different users. Emphasize that financial accounting focuses on the information needs of investors and creditors. Make the discussion light and breezy. Students quickly get bored with this kind of general discussion.

Present the statements in this order: (1) income statement, (2) statement of changes in stockholders' equity, (3) balance sheet, and (4) statement of cash flows. As you explain, point out the importance of this sequence. You need the amount of net income to prepare the statement of changes in stockholders' equity. You need the amount of stockholders' equity to prepare the balance sheet. Comments relevant to each statement follow:

**A. Income Statement.** Emphasize how the elements of the income statement are related to the elements of the balance sheet. Reiterate that revenue increases assets from providing services and expenses decrease assets in efforts to earn revenue. Teach students more than the formula for computing net income (Revenue - Expenses = Net Income). Help them understand that net income represents the change in wealth resulting from business operations during the accounting period. If you want your students to understand interrelationships, you must emphasize those relationships in your classroom discussions and your examinations.

**B. Statement of Changes in Stockholders' Equity.** This statement provides the opportunity to emphasize the difference between expenses and dividends. Expenses affect the measurement of net income, after which a decision is made regarding how much of the income to distribute versus how much to retain in the business. Emphasize that net income is a **periodic measurement**, while retained earnings is a **cumulative amount**.

**C. Balance Sheet.** Explain that the balance sheet is a summary of the accounting equation. The statement lists assets and the corresponding claims on those assets. In this chapter, too few assets are illustrated to introduce the idea of presenting assets in accordance with liquidity. This subject is introduced later in the text. Explain that the statement represents a company's financial condition at a **specific point in time**.

**D. Statement of Cash Flows.** Introduce the categories of the statement of cash flows in a sequence consistent with forming a business. First, a business must obtain ***financing***. Once a business has cash, it ***invests*** the cash. Finally, the business uses and generates cash through its ***operations***. Use the direct method. Prepare the statement by analyzing the cash account. Students should learn to identify cash transactions as operating, investing, or financing. Even so, many students find this task to be a real challenge. While mastery requires a significant level of reinforcement, be assured that your students will grasp this topic after working through several of the multicycle problems. Because the first chapter covers only cash transactions, the amount of cash flow from operating activities will equal the amount of net income. Therefore, we do not contrast these two amounts until Chapter 2. Instead, we emphasize that the statement of cash flows is more inclusive than the income statement. We point out that it reports investing and financing activities as well as operating activities.

**IX. Have students prepare financial statements for the Year 2 transactions.** Again, spend your time walking around the room, observing, assisting, and encouraging. If you discover a general misunderstanding, stop the class and clarify the matter. Encourage your students with positive feedback as well as correction. If they are doing well, tell them so. A few words of encouragement go further than a flurry of criticism.

**X. Introduce the horizontal financial statements model** to show your students how to record the effects (increase, decrease, no effect) of transactions on the statements. The effects of the Year 1 transactions from Demonstration Problem 1 are recorded below as an example.

| Event No. | Balance Sheet | | | Income Statement | | | Statement of Cash Flow |
|---|---|---|---|---|---|---|---|
| | Assets = | Liab. + | Equity | Rev. − | Exp. = | Net Inc. | |
| 1 | + | NA | + | NA | NA | NA | + FA |
| 2 | + | + | NA | NA | NA | NA | + FA |
| 3 | + | NA | + | + | NA | + | + OA |
| 4 | − | NA | − | NA | + | − | − OA |
| 5 | − | NA | − | NA | NA | NA | − FA |

**XI. Filling in the gaps.** You will find additional terms and concepts covered in the text but not in the teaching notes. While we do not expect our students to read the text prior to coming to class, we do expect them to read it after we have introduced the material. In other words, we expect our students to read behind us. They are responsible for filling in the gaps. There is simply not enough time to cover every single point in class. Class is a place to get started. Try to cover the more important and conceptually complex points there. Hold your students responsible for a reasonable level of homework.

**XII. Enrichment.** There is a section of materials at the end of each chapter (after exercises and problems) entitled “Analyze, Think, Communicate.” These materials include real-world cases, ethics cases, group exercises, internet assignments, communication exercises and Excel problems. Use some of these materials to facilitate skill development among your students. You will not have time to include all these materials. In Chapter 1, we urge you to consider including ATC Case 1-1. It is important for students to see some real-world statements early in the course. Students seem to be motivated by the fact that what they are learning has real-world relevance. The Target Corporation’s annual report, which is included in an Appendix in the back of the textbook, offers excellent opportunities to introduce real-world reporting practices.

# Detailed Outline of a Lesson Plan for Chapter 1

## (Statements Model Approach)

**I. Use the problem-based learning case, "Ask Me Anything," to introduce financial statements to students.** (We describe problem-based learning in the introduction to this manual.)

Instructions: The case appears below. You can cut and paste the case into a separate Word Document or into PowerPoint. Display and/or distribute copies of the case to the class before providing any explanation of accounting. Ask students to read the case and individually develop answers.

### Chapter 1 Problem-Based Learning Case: Accounting Questions

### Ask Me Anything

***Assume that you are considering going in business with Linda Wilson. Assume that I am Linda's accountant and that you can ask me three questions. Write down the three questions that you would ask.***

**II. Create a collaborative experience where students share their questions.** After allowing students time to develop their individual responses, put them into groups to reach consensus on their questions. For example, have students pair off with one another, share their questions, and reach consensus on three questions that represent the combined interest of the two people. Combine pairs of students into groups of four people and have each group of four choose the three questions that they would ask the accountant. Allow groups time to develop answers. Also have each group select a spokesperson.

**III. Briefly introduce the basic financial statements.** Explain that accountants communicate financial information to the public through a set of reports called financial statements. At this point introduce three of these statements: 1) the balance sheet, 2) the income statement, and 3) the statement of cash flows. Use a business cycle approach to introduce the statement of cash flows. Specifically, starting a business requires some cash (financing activities); the cash is used to buy operating assets (investing activities); and finally, the business runs on a day to day basis (operating activities).

**IV. Use student input to demonstrate the usefulness of financial statement information.** Ask the group spokespersons to share the questions their group would like to have the accountant answer. Identify information that would appear in financial statements. For example, "How much money does Linda make?" would appear as revenue on the income statement. Draw a skeleton of an income statement on the board and show the students where revenue appears on that statement. You could use this question to expand the discussion into other areas. Ask, for example, "Is the amount of Linda's salary equal to the amount of her take-home pay?" This question creates an opportunity to demonstrate the difference between the income statement and the statement of cash flows. A question like "Does she pay her bills on time?" affords the opportunity to explain that some information is not provided directly in the statements but is available through financial statement analysis. Some questions provide the opportunity to demonstrate the limitations of financial statement data. For example, answers to questions like "Is Linda an honest person?" cannot be found in the financial statements. However, this question invites you to point out the importance of ethical conduct by accountants.

We hope these examples demonstrate the need for the instructor to be flexible and creative in handling the student input. Expect a variety of questions. Also, be prepared to raise questions if the students do not ask about some of the things you want to discuss. Problem-based learning is designed to provide an opportunity for student discovery, not discovery on the part of the professor. The instructor should be prepared to address predetermined learning objectives. In this case, one objective is to introduce financial statements in a way that engages students. The case is designed to stimulate student interest and critical thinking. The primary learning objective, however, is for students to leave class able to name three financial statements and to describe the specific elements that appear in each statement. The instructor should guide the discussion toward the accomplishment of these objectives.

V. **Distribute copies of Demonstration Problem 1-1.** After establishing an understanding of financial statements, you can use this problem to show students how to record business events directly into a set of financial statements (*part b* of Demonstration Problem 1-1).

VI. **Create a financial statements model for Demonstration Problem 1-1** *(part a)*. Either draw on the board or use an e-transparency to display a financial statements model for the students. Explain to the students that the statements model is a learning tool that doesn't include many details (titles, dates, headings, etc.) that normally appear in formal financial statements. In lecture mode, analyze and record the transactions. Each transaction introduces a new financial statement element. Provide a clear explanation of each element, including the interrelationships between elements and their statements effects. For example, describe revenue as an economic benefit a company obtains by providing customers with goods and services. Revenue causes an increase in equity and a corresponding increase in assets. At this early point, you can limit the explanation of revenue to an increase in equity with a corresponding increase in assets. How does revenue differ from issuing stock which also results in an increase in assets? Obviously, revenue results from work performed by the company, while a successful stock issue results from convincing stockholders that the company can produce revenue. Point out the revenue appears on the income statement while a stock issue does not. Similarly, describe each element and show the students how the business events affect the financial statements.

VII. **Actively involve the students in learning.** After explaining the Year 1 accounting transactions, show how this year's ending balances become next year's beginning balances. Record the ending balances in a statements model that applies to the Year 2 accounting cycle. Observe that the balance sheet accounts are carried forward from year to year while the income statement accounts are closed, resulting in zero beginning balances for all revenue and expense accounts. This is an excellent time to mention the closing process without getting into procedural detail. After students record the beginning balances in the statements model, require them to record the transactions for the Year 2 accounting cycle in the model. Walk around the room and provide assistance as needed. If you notice that a particular transaction is confusing a lot of students, stop the class and provide a brief explanation to the class as a whole. Instruct the faster students to move on to the Year 3 accounting cycle. Have those students who do not finish the third cycle in class complete *part a* of the problem as a homework assignment.

VIII. **Introduce the accounting equation.** You can now define assets by noting that they belong to some person or organization. The individual or institutional interests in those assets are called claims. Explain that the accounting equation can be represented, Assets = Claims, and that it is the logic underlying the balance sheet.

**IX. Assign homework.** Problem 1-35 will give students practice in recording transactions in horizontal financial statements models and is an excellent review of Demonstration Problem 1-1.

**X. Filling in the gaps.** You will find additional terms and concepts covered in the text but not in the teaching notes. While we do not expect our students to read the text prior to coming to class, we do expect them to read it after we have introduced the material. In other words, we expect our students to read behind us. They are responsible for filling in the gaps. There is simply not enough time to cover every single point in class. Class is a place to get started. Try to cover the more important and conceptually complex points there. Hold your students responsible for a reasonable level of homework.

**XI. Enrichment.** There is a section of materials at the end of each chapter (after exercises and problems) entitled "Analyze, Think, Communicate." These materials include real-world cases, ethics cases, group exercises, internet assignments, communication exercises and Excel problems. Use some of these materials to facilitate skill development among your students. You will not have time to include all these materials. In Chapter 1, we urge you to consider including ATC Case 1-1. It is important for students to see some real-world statements early in the course. Students seem to be motivated by the fact that what they are learning has real-world relevance. The Target Corporation's annual report, which is included in an Appendix in the back of the textbook, offers excellent opportunities to introduce real-world reporting practices.

# Demonstration Problem for Chapter 1

## Demonstration Problem 1-1: The Accounting Cycle

The events below apply to the Video Services Company (VSC). Assume that all transactions involve receiving or paying cash.

Transactions for the year Year 1:

1. The company was started when it acquired $9,000 cash by issuing common stock.
2. The company borrowed $5,000 from creditors.
3. The company provided services to customers and received $4,000.
4. The company paid expenses of $2,900.
5. The company paid $500 in dividends to its stockholders.

Transactions for the year Year 2:

1. The company issued additional common stock for $4,500.
2. The company paid $2,000 to reduce its liabilities to creditors.
3. The company provided services to customers and received $6,700.
4. The company paid expenses of $4,300.
5. The company paid $700 in dividends to its stockholders.

Transactions for the year Year 3:

1. The company issued additional common stock for $2,500.
2. The company borrowed $1,000 from creditors.
3. The company provided services to customers and received $7,400.
4. The company paid expenses of $7,900.
5. The company paid $300 in dividends to its stockholders.
6. The company paid $9,000 to purchase land.

**Required:** For each year,

a. Record the events under an accounting equation.
b. Prepare an income statement, statement of changes in stockholders' equity, balance sheet and statement of cash flows.

# SOLUTIONS TO DEMONSTRATION PROBLEM

The solutions for the equation approach are shown first, followed by the solutions for the statements model approach.

We HIGHLY recommend that you try to display the solutions to the class using the e-transparency option described in the introduction to this manual. The electronic Word files are available in Connect®. You may want to cut and paste the solution to a separate Word document to facilitate ease of display. Because these are Word files, you can add or delete material as you desire. Remember to put additional material in Word tables. Note that text material can be placed in a single cell table with the cell stretching from margin to margin. You can then hide or display data in each cell of the table using the key strokes described in the introduction to this manual.

# Demonstration Problem 1-1: Solution, part a. Equation Approach

## Effect of Events on the Accounting Equation

| For Year Year 1 | | | | | Equity | | |
|---|---|---|---|---|---|---|---|
| Events | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| Beginning Balances | $ 0 | = | $ 0 | + | $ 0 | + | $ 0 |
| 1. Effect of Stock Issue | 9,000 | | | | 9,000 | | |
| 2. Effect of Borrowing | 5,000 | | 5,000 | | | | |
| 3. Effect of Revenue | 4,000 | | | | | | 4,000 |
| 4. Effect of Expense | (2,900) | | | | | | (2,900) |
| 5. Effect of Dividends | (500) | | | | | | (500) |
| | —— | | —— | | —— | | —— |
| Ending Balances | $14,600 | = | $5,000 | + | $9,000 | + | $ 600 |
| | ===== | | ===== | | ===== | | ===== |

| For Year Year 2 | | | | | Equity | | |
|---|---|---|---|---|---|---|---|
| Events | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| Beginning Balances | $14,600 | = | $5,000 | + | $ 9,000 | + | $ 600 |
| 1. Effect of Stock Issue | 4,500 | | | | 4,500 | | |
| 2. Effect of Debt Repay. | (2,000) | | (2,000) | | | | |
| 3. Effect of Revenue | 6,700 | | | | | | 6,700 |
| 4. Effect of Expense | (4,300) | | | | | | (4,300) |
| 5. Effect of Dividends | (700) | | | | | | (700) |
| | —— | | —— | | —— | | —— |
| Ending Balances | $18,800 | = | $3,000 | + | $13,500 | + | $ 2,300 |
| | ===== | | ===== | | ===== | | ===== |

| For Year Year 3 | Assets | | | = | Liab. | + | Equity | | |
|---|---|---|---|---|---|---|---|---|---|
| Events | Cash | + | Land | = | Liab. | + | Common Stock | + | Retained Earnings |
| Beginning Balances | $18,800 | | | | $3,000 | + | $13,500 | + | $ 2,300 |
| 1. Effect of Stock Issue | 2,500 | | | | | | 2,500 | | |
| 2. Effect of Borrowing | 1,000 | | | | 1,000 | | | | |
| 3. Effect of Revenue | 7,400 | | | | | | | | 7,400 |
| 4. Effect of Expense | (7,900) | | | | | | | | (7,900) |
| 5. Effect of Dividends | (300) | | | | | | | | (300) |
| 6. Effect of Land Purch. | (9,000) | | $9,000 | | | | | | |
| | —— | | —— | | —— | | —— | | —— |
| Ending Balances | $12,500 | + | $9,000 | = | $4,000 | + | $16,000 | + | $1,500 |
| | ===== | | ===== | | ===== | | ===== | | ===== |

# Demonstration Problem 1-1: Solution, part b. Financial Statements

| Video Services Company | | | |
|---|---|---|---|
| **Income Statements** | | | |
| **For the Years Ended December 31,** | **Year 1** | **Year 2** | **Year 3** |
| Services Revenue | $4,000 | $6,700 | $7,400 |
| Expenses | (2,900) | (4,300) | (7,900) |
| Net Income (Loss) | $1,100 | $2,400 | $( 500) |
| **Statements of Changes in Stockholders' Equity** | | | |
| Beginning Common Stock | $ 0 | $ 9,000 | $13,500 |
| Plus: Common Stock Issued | 9,000 | 4,500 | 2,500 |
| Ending Common Stock | $9,000 | $13,500 | $16,000 |
| Beginning Retained Earnings | $ 0 | $ 600 | $ 2,300 |
| Net Income (Loss) | 1,100 | 2,400 | (500) |
| Dividends | (500) | (700) | (300) |
| Ending Retained Earnings | $ 600 | $ 2,300 | $ 1,500 |
| Total Stockholders' Equity | $9,600 | $15,800 | $17,500 |
| **Balance Sheets at December 31** | | | |
| Assets | | | |
| Cash | $14,600 | $18,800 | $12,500 |
| Land | | | 9,000 |
| Total Assets | $14,600 | $18,800 | $21,500 |
| Liabilities | $ 5,000 | $ 3,000 | $ 4,000 |
| Stockholders' Equity | | | |
| Common Stock | $ 9,000 | $13,500 | $16,000 |
| Retained Earnings | 600 | 2,300 | 1,500 |
| Total Stockholders' Equity | $ 9,600 | $15,800 | $17,500 |
| Total Liabilities and Stockholders' Equity | $14,600 | $18,800 | $21,500 |
| **Statements of Cash Flows** | | | |
| Cash Flows from Operating Activities | | | |
| Cash Inflows from Revenue | $ 4,000 | $ 6,700 | $ 7,400 |
| Cash Outflows for Expenses | (2,900) | (4,300) | (7,900) |
| Net Cash Flow from Operating Activities | $ 1,100 | $ 2,400 | $ (500) |
| Cash Flow from Investing Activities | | | |
| Cash Outflow for Land | | | $(9,000) |
| Cash Flows from Financing Activities | | | |
| Cash Inflows from Borrowed Funds | $ 5,000 | | $ 1,000 |
| Cash Outflows to Reduce Debt | | $(2,000) | |
| Cash Inflows from Stock Issues | 9,000 | 4,500 | 2,500 |
| Cash Outflows for Dividends | (500) | (700) | (300) |
| Net Cash Flows from Financing Activities | $13,500 | $ 1,800 | $ 3,200 |
| Net Change in Cash | $14,600 | $ 4,200 | $ (6,300) |

| | | | |
|---|---|---|---|
| **Beginning Cash Balance** | **0** | **14,600** | **18,800** |
| **Ending Cash Balance** | **$14,600** | **$18,800** | **$12,500** |

# Demonstration Problem 1-1: Solution, part a.

## Statements Model Approach

| Year 1 | Assets | | = Liab. | + | Equity | | Rev. | − Exp. | = Net Inc. | Cash Flow | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *No.* | *Cash* | + *Land* | = *Liab.* | + | *C. Stk.* | + *Ret. Ear.* | | | | | |
| Beg. Bal. | | + | = | + | | + | | − | = | | |
| 1 | 9,000 | + | = | + | 9,000 | + | | − | = | 9,000 | FA |
| 2 | 5,000 | + | =5,000 | + | | + | | − | = | 5,000 | FA |
| 3 | 4,000 | + | = | + | | + 4,000 | 4,000 | − | = 4,000 | 4,000 | OA |
| 4 | (2,900) | + | = | + | | + (2,900) | | − 2,900 | = (2,900) | (2,900) | OA |
| 5 | (500) | + | = | + | | + (500) | | − | = | (500) | FA |
| Totals | 14,600 | + | =5,000 | + | 9,000 | + 600 | 4,000 | − 2,900 | = 1,100 | 14,600 | NC |

| Year 2 | Assets | | = Liab. | + | Equity | | Rev. | − Exp. | = Net Inc. | Cash Flow | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *No.* | *Cash* | + *Land* | = *Liab.* | + | *C. Stk.* | + *Ret. Ear.* | | | | | |
| Beg. Bal. | 14,600 | + | =5,000 | + | 9,000 | + 600 | | − | = | | |
| 1 | 4,500 | + | = | + | 4,500 | + | | − | = | 4,500 | FA |
| 2 | (2,000) | + | =(2,000) | + | | + | | − | = | (2,000) | FA |
| 3 | 6,700 | + | = | + | | + 6,700 | 6,700 | − | = 6,700 | 6,700 | OA |
| 4 | (4,300) | + | = | + | | + (4,300) | | − 4,300 | = (4,300) | (4,300) | OA |
| 5 | (700) | + | = | + | | + (700) | | − | = | (700) | FA |
| Totals | 18,800 | + | =3,000 | + | 13,500 | + 2,300 | 6,700 | − 4,300 | = 2,400 | 4,200 | NC |

| Year 3 | Assets | | = Liab. | + | Equity | | Rev. | − Exp. | = Net Inc. | Cash Flow | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *No.* | *Cash* | + *Land* | = *Liab.* | + | *C. Stk.* | + *Ret. Ear.* | | | | | |
| Beg. Bal. | 18,800 | + | =3,000 | + | 13,500 | + 2,300 | | − | = | | |
| 1 | 2,500 | + | = | + | 2,500 | + | | − | = | 2,500 | FA |
| 2 | 1,000 | + | =1,000 | + | | + | | − | = | 1,000 | FA |
| 3 | 7,400 | + | + | + | | + 7,400 | 7,400 | − | = 7,400 | 7,400 | OA |
| 4 | (7,900) | + | + | + | | + (7,900) | | −(7,900) | = (7,900) | (7,900) | OA |
| 5 | (300) | + | + | + | | + (300) | | − | = | (300) | FA |
| 6 | (9,000) | + 9,000 | + | + | | + | | − | = | (9,000) | IA |
| Totals | 12,500 | + 9,000 | +4,000 | + | 16,000 | + 1,500 | 7,400 | − 7,900 | = (500) | (6,300) | NC |

# WORK PAPERS FOR

# DEMONSTRATION PROBLEM

The work papers are designed for student use. You may copy them and distribute the hard copies to your students. However, a more efficient way to distribute them is to cut and paste them into a separate

Word document and then make that document available to students on your university website. The students can download the files and print out the contents. Again, the original Word files are available in Connect®.

# Demonstration Problem 1-1: Work Paper, part a. Equation Approach

## Effect of Events on the Accounting Equation

| For Year 1 | | | | | | Equity | | |
|---|---|---|---|---|---|---|---|---|
| Events | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| Beginning Balances | $ 0 | = | $ 0 | + | $ 0 | + | $ 0 |
| 1. Effect of Stock Issue | | | | | | | |
| 2. Effect of Borrowing | | | | | | | |
| 3. Effect of Revenue | | | | | | | |
| 4. Effect of Expense | | | | | | | |
| 5. Effect of Dividends | | | | | | | |
| | ______ | | ______ | | ______ | | ______ |
| Ending Balances | $14,600 | = | $5,000 | + | $9,000 | + | $ 600 |
| | ====== | | ====== | | ====== | | ====== |

| For Year 2 | | | | | | Equity | | |
|---|---|---|---|---|---|---|---|---|
| Events | Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| Beginning Balances | | = | | + | | + | |
| 1. Effect of Stock Issue | | | | | | | |
| 2. Effect of Debt Repay. | | | | | | | |
| 3. Effect of Revenue | | | | | | | |
| 4. Effect of Expense | | | | | | | |
| 5. Effect of Dividends | | | | | | | |
| | ______ | | ______ | | ______ | | ______ |
| Ending Balances | $18,800 | = | $3,000 | + | $13,500 | + | $ 2,300 |
| | ====== | | ====== | | ====== | | ====== |

| For Year 3 | Assets | | | = | Liab. | + | Equity | | |
|---|---|---|---|---|---|---|---|---|---|
| Events | Cash | + | Land | = | Liab. | + | Common Stock | + | Retained Earnings |
| Beginning Balances | | | | | | + | | + | |
| 1. Effect of Stock Issue | | | | | | | | | |
| 2. Effect of Borrowing | | | | | | | | | |
| 3. Effect of Revenue | | | | | | | | | |
| 4. Effect of Expense | | | | | | | | | |
| 5. Effect of Dividends | | | | | | | | | |
| 6. Effect of Land Purch. | | | | | | | | | |
| | ______ | | _____ | | _____ | | ______ | | ______ |
| Ending Balances | $12,500 | + | $9,000 | = | $4,000 | + | $16,000 | + | $1,500 |
| | ====== | | ====== | | ====== | | ====== | | ====== |

# Demonstration Problem 1-1: Work Paper, part b. Financial Statements

| Video Services Company | | | |
|---|---|---|---|
| **Income Statements** | | | |
| **For the Years Ended December 31,** | **Year 1** | **Year 2** | **Year 3** |
| Services Revenue | | | |
| Expenses | | | |
| Net Income (Loss) | $1,100 | $2,400 | $( 500) |
| **Statements of Changes in Stockholders' Equity** | | | |
| Beginning Common Stock | $ 0 | $ 9,000 | $13,500 |
| Plus: Common Stock Issued | | | |
| Ending Common Stock | | | |
| Beginning Retained Earnings | | | |
| Net Income (Loss) | | | |
| Dividends | | | |
| Ending Retained Earnings | | | |
| Total Stockholders' Equity | $9,600 | $15,800 | $17,500 |
| **Balance Sheets at December 31** | | | |
| Assets | | | |
| Cash | | | |
| Land | | | |
| Total Assets | $14,600 | $18,800 | $21,500 |
| Liabilities | | | |
| Stockholders' Equity | | | |
| Common Stock | | | |
| Retained Earnings | | | |
| Total Stockholders' Equity | | | |
| Total Liabilities and Stockholders' Equity | $14,600 | $18,800 | $21,500 |
| **Statements of Cash Flows** | | | |
| Cash Flows from Operating Activities | | | |
| Cash Inflows from Revenue | $ 4,000 | $ 6,700 | $ 7,400 |
| Cash Outflows for Expenses | | | |
| Net Cash Flow from Operating Activities | | | |
| Cash Flow from Investing Activities | | | |
| Cash Outflows for Land | | | |
| Cash Flows from Financing Activities | | | |
| Cash Inflows from Borrowed Funds | | | |
| Cash Outflows to Reduce Debt | | | |
| Cash Inflows from Stock Issues | | | |
| Cash Outflows for Dividends | | | |
| Net Cash Flows from Financing Activities | | | |
| Net Change in Cash | $14,600 | $ 4,200 | $(6,300) |
| Beginning Cash Balance | | | |
| Ending Cash Balance | | | |

# Demonstration Problem 1-1: Work Paper, part a.

## Statements Model Approach

| Year 1 | Assets | | = Liab. | + Equity | | Rev. | − Exp. | = Net Inc. | Cash Flow |
|---|---|---|---|---|---|---|---|---|---|
| *No.* | *Cash* | *+ Land* | *= Liab.* | *+ C. Stk.* | *+ Ret. Ear.* | | | | |
| Beg. Bal. | | | | | | | | | |
| 1 | | | | | | | | | |
| 2 | | | | | | | | | |
| 3 | | | | | | | | | |
| 4 | | | | | | | | | |
| 5 | | | | | | | | | |
| Totals | 14,600 | | 5,000 | 9,000 | 600 | 4,000 | 2,900 | 1,100 | 14,600NC |

| Year2 | Assets | | = Liab. | + Equity | | Rev. | − Exp. | = Net Inc. | Cash Flow |
|---|---|---|---|---|---|---|---|---|---|
| *No.* | *Cash* | *+ Land* | *= Liab.* | *+ C. Stk.* | *+ Ret. Ear.* | | | | |
| Beg. Bal. | | | | | | | | | |
| 1 | | | | | | | | | |
| 2 | | | | | | | | | |
| 3 | | | | | | | | | |
| 4 | | | | | | | | | |
| 5 | | | | | | | | | |
| Totals | 18,800 | | 3,000 | 13,500 | 2,300 | 6,700 | 4,300 | 2,400 | 4,200NC |

| Year 3 | Assets | | = Liab. | + Equity | | Rev. | − Exp. | = Net Inc. | Cash Flow |
|---|---|---|---|---|---|---|---|---|---|
| *No.* | *Cash* | *+ Land* | *= Liab.* | *+ C. Stk.* | *+ Ret. Ear.* | | | | |
| Beg. Bal. | | | | | | | | | |
| 1 | | | | | | | | | |
| 2 | | | | | | | | | |
| 3 | | | | | | | | | |
| 4 | | | | | | | | | |
| 5 | | | | | | | | | |
| 6 | | | | | | | | | |
| Totals | 12,500 | 9,000 | 4,000 | 16,000 | 1,500 | 7,400 | 7,900 | (500) | (6,300) NC |

# Quiz Questions for Chapter 1

**The following information pertains to the next four questions**. At the beginning of Year 2, X Company had assets of $300, liabilities of $150, and common stock of $50. During Year 2 the company earned revenue of $400, incurred expenses of $250, and paid dividends of $100. All transactions were cash transactions.

1. What is the amount of retained earnings at the beginning of Year 2?
   a. $ 50.
   b. $100.
   c. $150.
   d. none of the above.

2. The amount of net income reported on the Year 2 income statement would be
   a. $400.
   b. $150.
   c. $ 50.
   d. none of the above.

3. The amount of retained earnings reported on the December 31, Year 2 balance sheet would be
   a. $100.
   b. $250.
   c. $650.
   d. none of the above.

4. The amount of total assets reported on the December 31, Year 2 balance sheet would be
   a. $350.
   b. $300.
   c. $450.
   d. $ 50.

5. Z Company borrowed $500 cash from the National Bank. As a result of this transaction, Z Company's
   a. assets would increase by $500.
   b. liabilities would decrease by $500.
   c. equity would increase by $500.
   d. revenue would decrease by $500.

**The following information pertains to the next two questions.** XYZ Company borrowed $800 from the State Bank and used $500 of this money to purchase land.

6. As a result of these transactions, XYZ's total assets would increase by
   a. $1,300.
   b. $ 800.
   c. $ 500.
   d. $ 300.

7. The statement of cash flows for XYZ Company would report
   a. an inflow of $500 from financing activities.
   b. an outflow of $800 for investing activities.
   c. an inflow of $800 from financing activities.
   d. an outflow of $500 for operating activities.

8. Select the correct statement from the choices listed below.
   a. Revenue is a decrease in assets resulting from operating activities.
   b. Dividends are decreases in assets incurred for the purpose of producing revenue.
   c. A company incurs expenses when it borrows money.

d. Net income is an increase in equity resulting primarily from operating activities.

9. If revenue exceeds expenses, there are no dividends, and total liabilities remain unchanged, then
   a. Equity will increase.
   b. Retained earnings will decrease.
   c. Total assets will increase.
   d. Both a and c.

**The following information pertains to the next two questions.** Person A paid $10,000 cash to buy land from Person B.

10. Select the statement that is true.
    a. Total liabilities of Person B would increase.
    b. Total assets of Person A would be unaffected.
    c. Person A's equity would increase.
    d. None of the above.

11. Select the statement that is true.
    a. Person A would have a cash outflow from investing activities.
    b. Person B would have a cash inflow from investing activities.
    c. The balance in the cash account on Person A's books would decrease, while the balance in the cash account on Person B's books would increase.
    d. All of the above statements are true.

12. Revenue is less than expenses. If liabilities and common stock were unchanged, then
    a. a. cash flows from operating activities were greater than cash flows from investing activities.
    b. b. total assets decreased.
    c. c. retained earnings were less than net income during the period.
    d. d. the company must have purchased assets with cash.

13. Among other items, the balance sheet of XYZ Company reports retained earnings of $50,000 and total liabilities of $40,000. Based on this information alone, you would know that
    a. since the company's inception, the total amount of net income exceeded total dividends by at least $50,000.
    b. XYZ Company has enough cash to pay off its liabilities.
    c. stockholders' equity of the company amounted to $10,000.
    d. total assets amounted to $90,000.

14. The Southern Company began the accounting period with assets of $600, common stock of $200, and retained earnings of $250. During the period, revenue was $300, expenses were $200, and dividends were $50. Common stock was unchanged during the accounting period. Liabilities decreased by $100. Based on this information,
    a. net income amounted to $50.
    b. total assets at the end of the period were $550.
    c. retained earnings at the end of the period amounted to $350.
    d. liabilities at the end of the period amounted to $100.

15. Which of the following illustrates how a cash dividend affects a company's financial statements?

| | Balance Sheet | | | Income Statement | | | Statement of |
|---|---|---|---|---|---|---|---|
| | Assets = | Liab. + | Equity | Rev. − | Exp. = | Net Inc. | Cash Flow |
| a. | + | n/a | + | n/a | n/a | n/a | + FA |
| b. | + | n/a | + | + | n/a | + | + OA |
| c. | − | n/a | − | n/a | + | − | − OA |
| d. | − | n/a | − | n/a | n/a | n/a | − FA |

# Solutions to Quiz Questions

| Question | Answer |
|---|---|
| 1 | B |
| 2 | B |
| 3 | D |
| 4 | A |
| 5 | A |
| 6 | B |
| 7 | C |
| 8 | D |
| 9 | D |
| 10 | B |
| 11 | D |
| 12 | B |
| 13 | A |
| 14 | B |
| 15 | D |

# Summary Outline of a Lesson Plan for Chapter 1

## (Equation Approach)

I. **Distribute copies of Demonstration Problem 1-1.**

II. **Define assets.** *Assets* are things of value to a business. The value is the capacity of the asset to be used in the production of greater quantities of other assets.

III. **Introduce the accounting equation.**

IV. **Use the demonstration problem to introduce new terms and to elaborate on the interrelationships represented by the accounting equation.** *There are three primary sources of assets*.

- A. **Event No. 1** introduces common stock (owner interest).
- B. **Event No. 2** introduces liabilities (creditor interest).
- C. **Event No. 3** introduces revenue (increase in assets from earnings activities).

***There are two asset use transactions.***

- D. **Event No. 4** introduces expenses (decreases in assets from earnings activities).
- E. **Event No. 5** introduces dividends (wealth transfer).

V. **Have students record the events for the second accounting cycle in an accounting equation.**

VI. **Time considerations.** Introducing the accounting equation, including student participation with Year 2 data, requires approximately one hour.

VII. **Homework assignments.** Problem 1-33A is similar to the demonstration problem.

VIII. **Introduce financial statements.**

- A. **Income Statement**. Because revenues increase and expenses decrease assets, net income represents the ***change in wealth*** resulting from business operations ***during the accounting period***.
- B. **Statement of Changes in Stockholders' Equity.** Distinguish between expenses and dividends.
- C. **Balance Sheet.** This statement summarizes the accounting equation.
- D. **Statement of Cash Flows. Use** the direct method; analyze the cash account.

IX. **Have students prepare financial statements for the Year 2 transactions.**

X. **Introduce the horizontal financial statements model.**

XI. **Filling in the gaps.** Remind students they must read the text to fill in the gaps.

XII. **Enrichment.** If time permits, have students complete ATC Case 1-1 (financial statement analysis).

# Summary Outline of a Lesson Plan for Chapter 1

## (Statements Model Approach)

I. **Use the problem-based learning case, "Ask Me Anything," to introduce financial statements to students.**

II. **Create a collaborative experience where students reach consensus on their questions.** Have each group select a spokesperson.

III. **Briefly introduce the basic financial statements.** Introduce: 1) the balance sheet, 2) the income statement, and 3) the statement of cash flows.

IV. **Use student input to demonstrate the usefulness of financial statement information.** Ask the group spokespersons to share the questions their group would like to have the accountant answer. Identify information that would or would not appear in financial statements. Students should learn to name three financial statements and to describe the specific elements that appear in each statement.

V. **Distribute copies of Demonstration Problem 1-1.** Show students how to record business events directly into a set of financial statements (*part b*).

VI. **Create a financial statements model for Demonstration Problem 1-1** *(part a)*. Present and explain a financial statements model for the students. Analyze and record the transactions.

VII. **Actively involve the students in learning.** After explaining the Year 1 accounting transactions, show how this year's ending balances become next year's beginning balances. Require the students to record the transactions for the Year 2 accounting cycle in the model. Assist as needed. Instruct the faster students to record Year 3 transactions. Have those students who do not finish the third cycle in class complete *part a* of the problem as a homework assignment.

VIII. **Introduce the accounting equation**. Explain that the accounting equation can be represented, Assets = Claims, and that it is the logic underlying the balance sheet.

IX. **Assign homework.** Problem 1-35A will give students practice in recording transactions in horizontal financial statements models.

X. **Filling in the gaps.** Remind students that they are responsible for reading the textbook to fill in the gaps because not all information can be presented in class.

XI. **Enrichment.** If time permits, have students complete ATC Case 1-1 (financial statements in the real world - Target Corporation).

## SOLUTIONS TO ANALYZE, THINK, COMMUNICATE – CHAPTER 1

**ATC 1 – 1 (All dollar amounts are in millions.)**

a. $ 2,937

b. Net income increased by $23

c.

| | | | | STOCKHOLDERS' |
|---|---|---|---|---|
| ASSETS | = | LIABILITIES | + | EQUITY |
| $41,290 | = | $29,993* | + | $11,297 |

* Liabilities must be computed by subtracting equity from assets.

d. Sales increased by 3.7% from 2017 to 2018.
($74,443– $71,786) ÷ $71,786 = 3.7%

Cost of sales increased by 4.3% from 2017 to 2018.
($53,299– $51,125) ÷ $51,125 = 4.3%

Selling, general and administrative expenses increased by 3.9% from 2017 to 2018. ($15,723– $ 15,140) ÷ $ 15,140 = 3.9%

The largest percentage increase was for cost of sales expenses.

**ATC 1-2**

**a.**

**Income Statements (amounts given are in millions)**

| | Year 6 | Year 5 | Year 4 | Year 3 |
|---|---|---|---|---|
| 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 2017 financial report.**

**a.** **McDonald's net income for 2017, 2016, and 2015 were as follows:**

| | |
|---|---|
| **2017:** | **$5,192.3 million** |
| **2016:** | **4,686.5** |
| **2015:** | **4,529.3** |

**b.** **The company had $33,803.7 million of assets at the end of 2017.**

**c.** **The company had $48,325.8 million of retained earnings at the end of 2017.**

**d.** **For 2017, the company's:**
**net cash flow from *operating* activities were $5,551.2 million**
**net cash flow from *investing* activities were $562.0 million.**
**net cash flow from *financing* activities were ($5,310.8) 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**

## ANSWERS TO QUESTIONS - CHAPTER 1

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 information that is useful in making decisions by all participants in the market for resource goods and services, both profit-oriented and nonprofit oriented. Because accounting's role is so important, 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. The market for business resources involves three distinct participants: consumers, conversion agents, and resource owners. See Exhibit 1-1 that illustrates how market trilogy is involved in resource allocation.

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 the loan.**

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 of 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**

**<u>Assets</u> are the economic resources used by a business for the production of revenue. <u>Liabilities</u> are obligations of a business to relinquish assets, provide services, or accept other obligations. <u>Equity</u>, 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 <u>owners</u> 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. <u>Revenue</u> 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 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 against the entity 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. Temporary accounts include revenue accounts, expense accounts and dividends. 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 qualitative characteristic of verifiability in that information can be independently verified. The historical cost is verified, 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**
**Notes 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 1-1A

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 annual reports 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 1-2A

a. The most common designation held by a public accountant is the CPA license. CPA stands for certified public accountant. CPAs are licensed by the state government (or other jurisdiction). Although the requirements vary from state to state (jurisdiction), CPA candidates normally must have a college degree, pass a demanding technical examination and obtain relevant work experience.

b. Designations that private accountants may hold include the CMA, Certified Management Accountant, and the CIA, Certified Internal Auditor. Both require meeting educational requirements, passing a technical examination, and obtaining relevant work experience. These designations are not professional licenses and are not government regulated.

**EXERCISE 1-3A**

| Entities mentioned: | Effect on cash: |
|---|---|
| Vicky Hill Recovery Fund | Increase for cash contributions, $21,000<br>Decrease for payment of advertising, $1,000<br>Decrease payment for hospital bills, $12,000<br>Decrease for donation to National Cyclist Fund, $8,000 |
| | |
| Karen White | Decrease by contribution, $1,000 |
| | |
| WKUX | Increase for advertising revenue, $1,000 |
| | |
| Public | Decrease for contributions, $20,000 |
| | |
| Mercy Hospital | Increase for medical care, $12,000 |
| | |
| National Cyclist Fund | Increase for donation, $8,000 |

## EXERCISE 1-4A

a.

| | Term | | Definition |
|---|---|---|---|
| a. | Assets | 7. | Economic resources that will be used by a business to produce revenue. |
| b. | Common Stock | 3. | Certificates that evidence ownership in a company. |
| c. | Creditors | 6. | Individuals or institutions that have loaned goods or services to a business. |
| d. | Liability | 5. | An obligation to pay cash in the future. |
| e. | Retained Earnings | 4. | Assets – Liabilities – Common Stock. |
| f. | Stockholders | 1. | Individuals or institutions that have contributed assets or services to a business in exchange for an ownership interest in the business. |
| g. | Stockholders' Equity | 2. | Common Stock + Retained Earnings. |

b.

**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 1-5A

| Olive Enterprises<br>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 1-6A**

**a.**

| Better Corporation<br>Accounting Equation for Year 2 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | | | |
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | | Acct. Title/RE | |
| Bal. 1/1/Y2 | 10,000 | | 20,000 | | 12,000 | | 7,000 | | 11,000 | | | |
| 1. Pur. Land | (5,000) | | 5,000 | | NA | | NA | | NA | | NA | |
| 2. Issued stk. | 25,000 | | NA | | NA | | 25,000 | | NA | | 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 | | NA | |
| 6. Paid Div. | (5,000) | | NA | | NA | | NA | | (5,000) | | Dividend | |
| 7. Land Value | NA | | NA | | NA | | NA | | NA | | NA | |
| Totals | 68,000 | + | 25,000 | = | 22,000 | + | 32,000 | + | 39,000 | | | |

**b.**

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| $93,000 | = | $22,000 | + | $71,000 |

**c.** The balances of total assets, liabilities and stockholders' equity will be the same on January 1, Year 3 as the balances on December 31, Year 2. (See b. above)

## EXERCISE 1-7A

a.

| Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|
| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
| 195,000 | = | 90,500 | + | 84,500 | + | ? |

**Retained Earnings = $195,000 – $90,500 – $84,500 = $20,000**

b. & c.

| Moss Company<br>Effect of Year 3 Transactions on the Accounting Equation | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Assets | = | Liabilities | + | Stockholders' Equity | | |
| Event | Cash | = | Notes Payable | + | Common Stock | + | Retained Earnings |
| Beginning Balances | 195,000 | | 90,500 | | 84,500 | | 20,000 |
| 1. Earned Revenue | 42,000 | | NA | | NA | | 42,000 |
| 2. Paid expenses | (24,000) | | NA | | NA | | (24,000) |
| 3. Paid dividend | (3,000) | | NA | | NA | | (3,000) |
| Ending Balance | 210,000 | = | 90,500 | + | 84,500 | + | 35,000 |

d.

| Cash | = | Note Payable | + | Common Stock | + | Retained Earnings |
|---|---|---|---|---|---|---|
| 210,000 | = | 90,500 | + | 84,500 | + | 35,000 |

**Liabilities + Stockholders' Equity = $90,500 + $84,500 + $35,000 = $210,000**

| Assets | = | Liabilities + Stockholders' Equity |
|---|---|---|
| $210,000 | = | $210,000 |

e. The beginning and ending balances in the cash account were $195,000 and $210,000 respectively. The beginning balance in the common stock account was $84,500. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because the accounting events that Moss experienced during the Year 3 accounting period affected the cash account but not the common stock account.

## EXERCISE 1-8A

a.

| Assets | = | Liabilities | + | Stockholders' Equity |
|---|---|---|---|---|
| Computers | | Notes Payable | | Operating Expenses |
| Building | | Utilities Payable | | Rent Revenue |
| Cash | | Accounts Payable | | Utilities Expense |
| Land | | | | Gasoline Expense |
| Trucks | | | | Retained Earnings |
| Supplies | | | | Salaries Expense |
| Office Furniture | | | | Common Stock |
| | | | | Service Revenue |
| | | | | Interest Expense |
| | | | | Dividends |
| | | | | Supplies Expense |

b. No. The type of accounts will vary depending on the type of business. Some businesses will have only one revenue account; other businesses may have more than one type of revenue account. For instance, a business may have both service revenue and interest revenue. Also, the expense accounts that a business has are somewhat dependent on the type and complexity of the business. For instance, if a business owns its own building, it will not have rent expense. If a business does not have employees, it will not have salaries expense. The level of detail desired by the business will also affect the type of revenue and expense accounts that a business will have.

## EXERCISE 1-9A

a.

| | Cash | + | Land | = | Creditors | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | $16,000 | | $ 0 | | $6,000 | | $10,000 |
| | (12,000) | | 12,000 | | NA | | NA |
| Bal. | $ 4,000 | + | $12,000 | = | $6,000 | + | $10,000 |

b. Creditor's Claim ÷ Total Assets = Percent of Total
$6,000 ÷ $16,000 = 37.5%

c. Investor's Claim ÷ Total Assets = Percent of Total
$10,000 ÷ $16,000 = 62.5%

d. The company cannot repay the debt. The company owes the creditors $6,000 but has only $4,000 cash. Note there is no actual money in the stockholders' equity account. Indeed, there is no cash in any account that appears on the right side of the accounting equation. The right side of the accounting equation represents obligations and commitments of a company to its creditors and stockholders. Indeed, the accounting equation could be written as:

| | Cash | + | Land | = | Creditors | + | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| Bal. | $ 4,000 | + | $12,000 | = | 37.5% | + | 62.5% |

All assets including any cash balances are shown on the left side of the equation.

## EXERCISE 1-10A

a. Dividends are paid to investors. The investor has an ownership interest in the business that allows the investor (owner) to share in the profits of the business. This pay out of a share of profits of a business to the owners is called a dividend.

b. There is no cash in the Retained Earnings account. Retained Earnings represents the business's commitments to its stockholders. It is the amount of past earnings that have not been paid out to owners.

c. The amount of dividends that can be paid are limited to retained earnings. In addition, a company must have enough cash to pay the dividend. White Co. H has $2,800 of retained earnings but only $1,800 of cash. The maximum amount of dividend that could be paid at this time would be $1,800.

d. If the total amount of the liability of $6,000 is due, White Co Inc. will not be able to satisfy the obligation. White Co., Inc. has only $1,800 of cash; the balance of the assets are contained in the Land account. If payment must be made to creditors, White Co., Inc. will have to liquidate the company (or sell the land) in order to pay the debt.

e. If the land becomes worthless, the only asset remaining is the cash of $1,800. Since creditors have first claim on the assets, all of the $1,800 will be paid to the creditors. The investors will not be paid anything.

## EXERCISE 1-11A

a. Creditors receive their $400 interest payment, leaving $1,200 ($1,600 - $400) to be paid as dividends to the investors.

b. Creditors receive their $400 interest payment, leaving $500 ($900 – $400) to be paid as dividends to the investors. Note that the creditors receive the same fixed interest payment while dividends paid to investors fluctuate with profitability.

c. Creditors receive their $400 interest payment. No dividend is paid to investors. In this case the recognition of the interest expense will cause the company to have a net loss of $100 after interest expense ($300 before-interest profit - $400 interest expense). Note that interest is a contractual obligation that must be paid even if annual earnings are insufficient to support the interest payment. Indeed, bankruptcy is frequently caused by the inability to pay interest. In contrast, corporations are not required to pay dividends. Dividends are dependent on earnings. If there are no retained earnings, companies cannot pay dividends.

Note that these answers are based on the customary characteristics of interest and dividends. In practice, interest and dividends are based on the contractual terms of unique debt or equity agreements which may differ from ordinary circumstances. In other words, there are exceptions to the general treatment for interest and dividends that is described above.

**EXERCISE 1-12A**

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.

| Harris Company Accounting Equation | | | | | |
|---|---|---|---|---|---|
| Event | Assets | = | Liabilities | + | Stockholders' Equity |
| Acquired assets | $7,800 | | $3,600 | | $4,200 |
| Earned income | 2,000 | | | | 2,000 |
| Balance | $9,800 | | $3,600 | | $6,200 |

Since creditors are owed $3,600 and there are sufficient funds to pay them; the creditors will receive the $3,600 that they are owed. Since the investors own the business, they are entitled to the profits earned by the business. The investors will receive $6,200 (their original $4,200 investment plus the $2,000 of profit).

c.

| Harris Company Accounting Equation | | | | | |
|---|---|---|---|---|---|
| Event | Assets | = | Liabilities | + | Stockholders' Equity |
| Acquired assets | $7,800 | | $3,600 | | $4,200 |
| Incurred loss | (2,000) | | | | (2,000) |
| Balance | $5,800 | | $3,600 | | $2,200 |

Since creditors are owed $3,600 and there are sufficient funds to pay them; the creditors will receive the $3,600 that they are owed. Since the investors own the business, they suffer the losses earned by the business. The investors will receive $2,200 (their original $4,200 investment minus the $2,000 loss).

**EXERCISE 1-12A (cont.)**

**d.**

| Harris Company<br>Accounting Equation | | | | | |
|---|---|---|---|---|---|
| **Event** | **Assets** | **=** | **Liabilities** | **+** | **Stockholders' Equity** |
| Acquired assets | $7,800 | | $3,600 | | $4,200 |
| Incurred loss | (4,900) | | (700) | | (4,200) |
| Balance | $2,900 | | $2,900 | | $ 0 |

**While creditors get first priority to receive assets in a business liquidation, this does not mean they cannot lose all or a portion of the assets they loan a business. In this case, creditors are owed $3,600 but the business has only $2,900 of assets. Since the creditors have first priority, the entire $2,900 would be distributed to them. In this case, the creditors lose $700 ($3,600 original loan - $2,900 returned). Since the investors own the business, they suffer the losses earned by the business. The investors will lose the entire $4,200 they contributed to the business.**

## EXERCISE 1-13A

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

## EXERCISE 1-14A

**Steps:**

**1.**

**Common Stock Issued = Change in Common Stock**

**$20,000 (given) = *$20,000***

**2.**

**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**

**$65,000 (given) = $20,000 (1) + *$45,000***

**3.**

**Increase in Ret. Earn. = Net Income – Dividends**

**$45,000 (2) = *$50,000* – $5,000 (given)**

**Alternate Solution:**

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

| | | |
|---|---|---|
| Beginning Total Stk. Equity, 1/1/Year 5 | | $156,000 |
| (Common Stock + Retained Earnings) | | |
| | | |
| Plus: Common Stock Issued | $20,000 | |
| Plus: Net Income | ? | |
| Less: Dividends | (5,000) | |
| Change in Stockholders' Equity | | 65,000 |
| | | |
| Ending Total Stk. Equity, 12/31/Year 5 | | $221,000 |

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

| | |
|---|---|
| Change in Stockholders' Equity, Year 5 | $65,000 |
| Plus: Dividends | 5,000 |
| Less: Common Stock Issued | (20,000) |
| Net Income, Year 5 | *$50,000* |

## EXERCISE 1-15A

a.

**Mijka Company**
**Accounting Equation for Year 1**

| | Assets | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | | | | | Common | | Retained |
| Event | Cash | = | | + | Stock | + | Earnings |
| 1. Cash revenues | 28,600 | | NA | | NA | | 28,600 |
| 2. Paid expenses | (13,200) | | NA | | NA | | (13,200) |
| 3. Paid dividend | (1,500) | | NA | | NA | | (1,500) |
| Ending Balance | 13,900 | = | -0- | + | -0- | + | 13,900 |

b.

**Mijka Company**
**Income Statement**
**For the Year Ended December 31, Year 1**

| | |
|---|---|
| Revenue | $28,600 |
| Expense | (13,200) |
| Net Income | $ 15,400 |

**Mijka Company**
**Statement of Changes in Stockholders' Equity**
**For the Year Ended December 31, Year 1**

| | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 0 | |
| Ending Common Stock | | $ -0- |
| | | |
| Beginning Retained Earnings | $ -0- | |
| Plus: Net Income | 15,400 | |
| Less: Dividends | (1,500) | |
| Ending Retained Earnings | | 13,900 |
| | | |
| Total Stockholders' Equity | | $13,900 |

**EXERCISE 1-15A (cont.)**

| Mijka Company<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| **Assets** | | |
| Cash | | $13,900 |
| **Liabilities** | | $ -0- |
| **Stockholders' Equity** | | |
| Common Stock | $ -0- | |
| Retained Earnings | 13,900 | |
| Total Stockholders' Equity | | 13,900 |
| Total Liabilities and Stockholders' Equity | | $13,900 |

c. The income statement is dated with the term "for the year ended" because it covers a one year span of time. The balance sheet is dated with the term "as of" because it describes information at a specific point in time.

**EXERCISE 1-16A**

a. Land will be shown on the Year 8 balance sheet.

b. Land will be listed at its historical cost of $250,000.

c. The key concept used in listing land at its cost is the historical cost concept.

## EXERCISE 1-17A

a.

| Moore Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net Cash Inflow from Operating Activities | | $ 24,800 |
| Cash Flows From Investing Activities: | | |
| Net Cash Outflow from Investing Activities | | (16,000) |
| Cash Flows From Financing Activities: | | |
| Net Cash Outflow from Financing Activities | | (6,800) |
| Net Increase in Cash | | 2,000 |
| Plus: Beginning Cash Balance | | 45,800 |
| Ending Cash Balance | | $47,800 |

b. Cash inflow from selling fast food to customers was greater than cash outflow for expenses.

c. The company paid cash to purchase long-term assets.

d. The company paid cash dividends or paid off a loan to a bank.

## EXERCISE 1-18A

**a.**

| Event | Statement of Cash Flow Classification |
|---|---|
| 1. | OA |
| 2. | IA |
| 3. | NA |
| 4. | FA |
| 5. | FA |
| 6. | OA |
| 7. | IA |
| 8. | FA |
| 9. | OA |
| 10. | FA |

## EXERCISE 1-18A (cont.)

b.

| All-Star Automotive Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 3 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Revenue | $ 25,000 | |
| Cash Payment for Salary Expense | (14,000) | |
| Cash Payments for Utilities Expense | (2,800) | |
| **Net Cash Flow from Operating Activities** | | $8,200 |
| **Cash Flows From Investing Activities** | | |
| Cash from the Sale of Land | $ 9,000 | |
| Cash Paid to Purchase Land | (6,000) | |
| **Net Cash Flow from Investing Activities** | | 3,000 |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Stock Issue | $ 50,000 | |
| Cash Receipts from Loan | 5,000 | |
| Cash Payment on Loan | (10,000) | |
| Cash Payments for Dividends | (5,000) | |
| **Net Cash Flow from Financing Activities** | | 40,000 |
| **Net Increase in Cash** | | 51,200 |
| **Plus: Beginning Cash Balance** | | 9,000 |
| **Ending Cash Balance** | | $60,200 |

## EXERCISE 1-19A

a.

**Dakota Company**
**Accounting Equation for Year 2**

| | Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Event | Cash | + | Land | = | Notes Payable | + | Com. Stock | + | Retained Earnings | Acct. Title/RE |
| Bal. 1/1/Y2 | 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 Utilities | (1,000) | | NA | | NA | | NA | | (1,000) | Util. 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.

**Dakota Company**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | |
|---|---|
| Service Revenue | $20,000 |
| Utilities Expense | (1,000) |
| Operating Expense | (15,000) |
| Net Income | $ 4,000 |

**EXERCISE 1-19A b. (cont.)**

| Dakota Company<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| 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 |

| Dakota Company<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| 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 1-19A b. (cont.)

| Dakota Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipts from Customers | $20,000 | |
| Cash Payment for Utilities 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 | $(12,000) | |
| Net Cash Flow from Investing Activities | | (12,000) |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Stock Issue | $30,000 | |
| Cash Receipts from Loan | 10,000 | |
| Cash Payments for Dividends | (2,000) | |
| Net Cash Flow from Financing Activities | | 38,000 |
| | | |
| Net Increase in Cash | | 30,000 |
| Plus: Beginning Cash Balance | | 2,000 |
| Ending Cash Balance | | $32,000 |

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

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

## EXERCISE 1-20A

| | | |
|---|---|---|
| a. | Riley Company: | Asset Exchange |
| b. | Smally Company: | Asset Exchange |
| c. | Riley Company: | Investing Activity |
| d. | Smally Company: | Investing Activity |

## EXERCISE 1-21A

a.

| Carter Company<br>Accounting Equation as of January 1, Year 3 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| $800 | | $3,500 | | $600 | | $1,000 | | ? |

Retained Earnings = $800 + $3,500 - $600 - $1,000 = $2,700

b. The company cannot pay a $1,000 dividend because it only has $800 of cash. The Retained Earnings account contains zero cash. The balance in this account represents a stockholders' equity claim on assets.

c. Total Assets = $800 + $3,500 = $4,300

Creditor's Loans ÷ Total Assets
$600 ÷ $4,300 = 13.9%

d. Investor's Contributions ÷ Total Assets
$1,000 ÷ $4,300 = 23.3%

e. Retained Earnings ÷ Total Assets
$2,700 ÷ $4,300 = 62.8%

f.

| Carter Company<br>Accounting Equation as of January 1, Year 3 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Assets | | | = | Liabilities | + | Stockholders' Equity | | |
| | | | | Notes | | Common | | Retained |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings |
| $800 | | $3,500 | | 13.9% | | 23.3% | | 62.8% |

## EXERCISE 1-21A (cont.)

g.

**Carter Company**
**Accounting Equation as of December 31, Year 3**

| Assets | | | = | Liabilities | + | Stockholders' Equity | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Notes | | Common | | Retained | |
| Cash | + | Land | = | Payable | + | Stock | + | Earnings | |
| $800 | | $3,500 | | $600 | | $1,000 | | 2,700 | |
| 1,800 | | NA | | NA | | NA | | 1,800 | Rev. |
| (1,200) | | NA | | NA | | NA | | (1,200) | Exp. |
| (500) | | NA | | NA | | NA | | (500) | Div |
| 900 | | $3,500 | | $600 | | $1,000 | | $2,800 | |

**Carter Company**
**Income Statement**
**For the Year Ended December 31, Year 3**

| | |
|---|---|
| Revenue | $1,800 |
| Expenses | (1,200) |
| Net Income | $ 600 |

EXERCISE 1-21A g. (cont,)

| Carter Company<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 3 | | |
|---|---|---|
| Beginning Common Stock | $1,000 | |
| Plus: Common Stock Issued | -0- | |
| Ending Common Stock | | $1,000 |
| | | |
| Beginning Retained Earnings | $2,700 | |
| Plus: Net Income | 600 | |
| Less: Dividends | (500) | |
| Ending Retained Earnings | | 2,800 |
| | | |
| Total Stockholders' Equity | | $3,800 |

| Carter Company<br>Balance Sheet<br>As of December 31, Year 3 | | |
|---|---|---|
| Assets | | |
| Cash | $ 900 | |
| Land | 3,500 | |
| Total Assets | | $4,400 |
| | | |
| Liabilities | | |
| Notes Payable | $600 | |
| Total Liabilities | | $ 600 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $1,000 | |
| Retained Earnings | 2,800 | |
| Total Stockholders' Equity | | 3,800 |
| | | |
| Total Liabilities and Stockholders' Equity | | $4,400 |

**EXERCISE 1-21A g.(cont.)**

| Carter Company<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 3 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $1,800 | |
| Cash Payments for Expenses | (1,200) | |
| **Net Cash Flow from Operating Activities** | | $ 600 |
| | | |
| **Cash Flows From Investing Activities:** | | 0 |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Payments for Dividends | (500) | |
| **Net Cash Flow from Financing Activities** | | (500) |
| | | |
| **Net Increase in Cash** | | 100 |
| **Plus: Beginning Cash Balance** | | 800 |
| **Ending Cash Balance** | | $ 900 |

h. The income statement, statement of changes in stockholders' equity and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology "*For the Year Ended* December 31, Year 3". In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In the case the point in time is December 31, Year 3. Therefore, this statement uses the terminology "*As of* December 31, Year 3".

i. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company's books.

j. The balance in the revenue account is zero on January 1, Year 4, because the balance in this account is transferred to retained earnings in the December 31, Year 3 closing process.

## EXERCISE 1-22A

a. Since the amount in the Notes Payable account increased from zero to $9,000, Room Designs, Inc. must have received a cash inflow of $9,000 from the issue of the note payable. Similarly, since the balance in the common stock account increased from $3,500 to $7,500, Room Design must have received a cash inflow $4,000 ($7,500 - $3,500) from the issue of common stock. Finally, $2,000 dividend payment would have caused a net cash outflow. Therefore, the net cash inflow from financing activities can be explained as follows:

| | |
|---|---|
| Cash Flows From Financing Activities: | |
| Cash Receipts from Loan | $9,000 |
| Cash Receipts from Stock Issue | 4,000 |
| Cash Payments for Dividends | (2,000) |
| Net Cash Flow from Financing Activities | $11,000 |

b. Since the balance in the land account increases from zero to $16,500, Room Designs must have had a net cash outflow $16,500 for the purchase of Land.

c.

| Room Designs, Inc.<br>Income Statement<br>For the Year Ended December 31, Year 2 | |
|---|---|
| Revenue | $18,100 |
| Expenses | (8,300) |
| Net Income | $9,800 |

**EXERCISE 1-22A c. (cont.)**

| Room Designs, Inc.<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Beginning Common Stock | $ 3,500 | |
| Plus: Common Stock Issued | 4,000 | |
| Ending Common Stock | | $7,500 |
| | | |
| Beginning Retained Earnings | $ 6,400 | |
| Plus: Net Income | 9,800 | |
| Less: Dividends | (2,000) | |
| Ending Retained Earnings | | 14,200 |
| | | |
| Total Stockholders' Equity | | $21,700 |

| Room Designs, Inc.<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| Assets | | |
| Cash | $14,200 | |
| Land | 16,500 | |
| Total Assets | | $30,700 |
| | | |
| Liabilities | | |
| Notes Payable | $9,000 | |
| Total Liabilities | | $ 9,000 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $7,500 | |
| Retained Earnings | 14,200 | |
| Total Stockholders' Equity | | 21,700 |
| | | |
| Total Liabilities and Stockholders' Equity | | $30,700 |

## EXERCISE 1-22A c. (cont.)

| Room, Designs, Inc.<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Cash Receipts from Customers | $ 18,100 | |
| Cash Payments for Expenses | (8,300) | |
| **Net Cash Flow from Operating Activities** | | $ 9,800 |
| | | |
| **Cash Flows From Investing Activities:** | | |
| Cash Paid to Purchase Land | $(16,500) | |
| **Net Cash Flow from Investing Activities** | | (16,500) |
| | | |
| **Cash Flows From Financing Activities:** | | |
| Cash Receipts from Loan | $ 9,000 | |
| Cash Receipts from Stock Issue | 4,000 | |
| Cash Payments for Dividends | (2,000) | |
| **Net Cash Flow from Financing Activities** | | 11,000 |
| | | |
| Net Increase in Cash | | 4,300 |
| Plus: Beginning Cash Balance | | 9,900 |
| Ending Cash Balance | | $14,200 |

## EXERCISE 1-23A

a.

| Flowers Company<br>Accounting Equation as of December 31, Year 3 | | | | | | |
|---|---|---|---|---|---|---|
| Assets | = | Liabilities | + | Common Stock | + | Retained Earnings |
| $130,000 | | $50,000 | | $70,000 | | ? |

**Retained Earnings = $130,000 - $70,000 - $50,000 = $10,000**

| | |
|---|---|
| Retained Earnings after closing: | $10,000 |
| Less, Revenue | (30,000) |
| Add, Expenses | 18,000 |
| Add, Dividends | 3,000 |
| Retained Earnings before closing | $ 1,000 |

b. Retained Earnings after closing is $10,000 (see the equation above).

c. The balances in revenue, expenses, and dividends before closing are:

| | |
|---|---|
| Revenue | 30,000 |
| Expenses | 18,000 |
| Dividends | 3,000 |

d. After closing revenue, expenses, and dividends, all of the balances will be zero.

e. Both Common Stock and Retained Earnings represent obligations the business has to stockholders. The Common Stock represents the assets a business has acquired from owners. Retained earnings represent assets a business has acquired by conducting its operations.

## EXERCISE 1-23A (cont.)

f. The owners are no better off immediately after they contributed capital to the business. While equity increased $30,000, the amount invested by owners also increased $30,000. The owners are only in a better financial position if their equity exceeds the amount they have invested in the company. At this point, the owners have simply exchanged cash for an additional ownership interest in the business. The owners will not benefit until the business uses the assets to produce profits. Note that it is possible that the owners could be worse off if the business incurs losses. In summary, the owners share in the benefits and sacrifices that the business experiences. They do not benefit when the business raises additional equity.

## EXERCISE 1-24A

a.

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| 1 | $20,000 | $11,000 | 9,000 | 9,000 |
| 2 | 30,000 | 14,000 | 16,000 | 25,000 |
| 3 | 40,000 | 22,000 | 18,000 | 43,000 |
| | | | | |

b. Net income is a measure of the benefits minus the sacrifices a company experiences during a single accounting period. Retained earnings is the amount of net income a company has earned minus the dividends it has paid out since its inception.

c.

| Year | Cash Revenues | Cash Expenses | Net Income | Retained Earnings |
|---|---|---|---|---|
| 1 | $20,000 | $11,000 | 9,000 | 9,000 |
| 2 | 30,000 | 14,000 | 16,000 | 20,000* |
| 3 | 40,000 | 22,000 | 18,000 | 38,000** |
| | | | | |

*$9,000 Beginning Balance + $16,000 Net Income - $5,000 Dividends
**$20,000 Beginning Balance + $18,000 Net Income

## EXERCISE 1-25A

a. **The balance in the Retained Earnings account as of January 31, Year 1 is zero.**
*Explanation: The revenue is recorded in the Revenue account and is not transferred into retained earnings until the year-end closing process is accomplished.*

b. **The balance in the Revenue account as of January 31, Year 1 is $7,500. The balance in the Expense accounts as of January 31, Year 1 is $4,800.**
*Explanation: The amounts in the revenue and expense accounts are not transferred to the Retained Earnings account until the year-end closing process is accomplished.*

c. **The *before closing* balance in the Retained Earnings account as of December 31, Year 1 is zero.**
*Explanation: The revenue and expenses are recorded in the Revenue and Expense accounts throughout the year and the balances in these accounts are not transferred into retained earnings until the year-end closing process is accomplished.*

d. **The December 31, Year 1 *before closing* balance in the Revenue account is $93,500 ($7,500 + $86,000). The December 31, Year 1 *before closing* balance in the Expense accounts is $55,800 ($4,800 + $51,000).**
*Explanation: The revenue and expense amounts accumulate in the Revenue and Expense accounts throughout the year.*

e. **The January 1, Year 2 balance in the Retained Earnings account is $37,700.**
*Explanation: The December 31. Year 1 year-end closing process transfers the $93,500 balance in the Revenue account and $55,800 expense accounts into the Retained Earnings account. Since revenue increases retained earnings and expenses decrease retained earnings, the December 31, Year 1 retained earnings account balance* **after closing** *is $37,700 ($93,500 - $55,800). Since last year's ending balances become next year's beginning balances, the balance in the Retained Earnings account as of January 1, Year 2 is $37,700.*

f. **The January 1, Year 2 balance in the Revenue and Expense accounts is zero.**
*Explanation: The balances in the revenue and expense accounts* **after closing** *are zero because the balances accumulated during the year were transferred to the retained earnings account during the closing process. The January 1, Year 2 balances in the revenue and expense accounts are zero.*

## EXERCISE 1-26A

a.

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

b.

**The Candle Shop**
**Horizontal Statements Model**

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

.

**EXERCISE 1-27A**

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. U.S. GAAP requires the asset be stated at its historical cost, which may be very different from the current value. IFRS allow companies to value assets at their current market values.

## SOLUTIONS TO PROBLEMS - CHAPTER 1

## PROBLEM 1-28A

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 1-29A**

| a. | Entities mentioned: | b. Effect on the cash account: |
|---|---|---|
| 1. | Bob Wilder | Decrease |
| | Wilder Co. | Increase |
| | | |
| 2. | Sam Pace Business | Increase |
| | Customers | Decrease |
| | | |
| 3. | Jim Sneed | Increase/Decrease |
| | National Bank | Decrease |
| | Iuka Ford | Increase |
| | | |
| 4. | OZ Company | Decrease |
| | Employees | Increase |
| | | |
| 5. | Gil Roberts | Decrease |
| | Jim | Increase |
| | | |
| 6. | Game, Inc. | Decrease |
| | Atlanta Land Co. | Increase |
| | | |
| 7. | Rob Moore | Decrease |
| | Gil Thomas | Decrease |
| | MT Partnership | Increase |
| | | |
| 8. | Stephen Woo | Decrease |
| | Izzard, Inc. | Increase |
| | | |
| 9. | Natural Stone | Decrease |
| | Shareholders | Increase |
| | | |
| 10. | Billows, Inc. | Increase |
| | National Bank | Decrease |

## PROBLEM 1-30A

| Term | | Definition/Phrase | |
|---|---|---|---|
| a. | Assets | 15. | Equal to liabilities plus stockholders' equity. |
| b. | Common Stock | 5. | Assets minus liabilities and retained earnings. |
| c. | Creditors | 7. | Individuals or institutions that have loaned goods or services to a business. |
| d. | Dividend | 14. | The item shown on the statement of changes in stockholders' equity that represents a transfer of wealth from a business to its owners. |
| e. | General Ledger | 8. | Complete set of accounts used in accounting systems. |
| f. | Expense | 3. | The economic sacrifice (decrease in assets) incurred in the process of providing goods or services to customers. |
| g. | Financing Activity | 12. | The section of the statement of cash flows that reflects cash collected from the issue of stock. |
| h. | Investing Activity | 13. | The section of the statement of cash flows that reflects cash paid to purchase land. |
| i. | Liability | 4. | Created when a company borrows money from a bank. |
| j. | Net Income | 9. | Occurs when revenue exceed expenses during the year. |
| k. | Net Loss | 6. | Occurs when expenses exceed revenues during the year. |
| l. | Operating Activity | 11. | The section of the statement of cash flows that reflects cash paid for expenses. |
| m. | Retained Earnings | 16. | A stockholders' equity account that contains the amount of net income earned minus dividends paid since the inception of the business. |
| n. | Revenue | 1. | The economic benefit (increase in assets) gained by providing goods or services to customers. |
| o. | Stockholders | 2. | Investors who purchase common stock. |
| p. | Stockholders' Equity | 10. | Assets minus liabilities. |

## PROBLEM 1-31A

| Event No. | Type of Event | Effect on Total Assets |
|---|---|---|
| | | |
| 1. | Asset Source | Increase |
| 2. | Asset Use | Decrease |
| 3. | NA | NA |
| 4. | Asset Source | Increase |
| 5. | Asset Use | Decrease |
| 6. | Asset Use | Decrease |
| 7. | Asset Use | Decrease |
| 8. | Asset Exchange | No Effect |
| 9. | Asset Exchange | No Effect |
| 10. | Asset Use | Decrease |
| 11. | NA | NA |
| 12. | Asset Source | Increase |
| 13. | Asset Use | Decrease |
| 14. | NA | NA |
| 15. | Asset Exchange | No Effect |

## PROBLEM 1-32A

| Item | Income Statement | Statement of Changes in Stk. Equity | Balance Sheet | Statement of Cash Flows |
|---|---|---|---|---|
| Financing activities | | | | ✔ |
| Ending common stock | | ✔ | ✔ | |
| Interest expense | ✔ | | | |
| As of (date) | | | ✔ | |
| Land | | | ✔ | |
| Beginning cash balance | | | | ✔ |
| Notes payable | | | ✔ | |
| Beginning common stock | | ✔ | | |
| Service revenue | ✔ | | | |
| Utility expense | ✔ | | | |
| Stock issued | | ✔ | | ✔ |
| Operating activities | | | | ✔ |
| For the Period Ended (Date) | ✔ | ✔ | | ✔ |
| Net income | ✔ | ✔ | | |
| Investing activities | | | | ✔ |
| Net loss | ✔ | ✔ | | |
| Ending cash balance | | | ✔ | ✔ |
| Salary expense | ✔ | | | |
| Consulting revenue | ✔ | | | |
| Dividends | | ✔ | | ✔ |

## PROBLEM 1-33A

a.

**Mark's Consulting**
**Accounting Equation for Year 1**

| | Assets | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| **Event** | **Cash** | **+ Land** | **=** | **Notes Payable** | **+** | **Com. 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 | Revenue |
| 3. Loan | 25,000 | NA | | 25,000 | | NA | NA | NA |
| 4. Paid Exp. | (22,000) | NA | | NA | | NA | (22,000) | Oper. Exp. |
| 5. Pur. Land | (30,000) | 30,000 | | NA | | NA | NA | NA |
| **Totals** | 28,000 | + 30,000 | = | 25,000 | + | 20,000 | + 13,000 | |

**Mark's Consulting**
**Accounting Equation for Year 2**

| | Assets | | = | Liabilities | + | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|---|
| **Event** | **Cash** | **+ Land** | **=** | **Notes Payable** | **+** | **Com. 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 | Revenue |
| 3. Paid Loan | (15,000) | NA | | (15,000) | | NA | NA | NA |
| 4. Paid Exp. | (71,500) | NA | | NA | | NA | (71,500) | Oper. Exp. |
| 5. Paid Div. | (3,000) | NA | | NA | | NA | (3,000) | Dividends |
| 6. Land Val. | NA | NA | | NA | | NA | NA | |
| **Totals** | 57,500 | + 30,000 | = | 10,000 | + | 44,000 | + 33,500 | |

**PROBLEM 1-33A (cont.)**

**b.**

**Mark's Consulting**
**Income Statement**
**For the Period Ended December 31, Year 1**

| | |
|---|---|
| Service Revenue | $35,000 |
| Expenses | (22,000) |
| Net Income | $13,000 |

**Mark's Consulting**
**Statement of Changes in Stockholders' Equity**
**For the Period Ended December 31, Year 1**

| | | |
|---|---|---|
| Beginning Common Stock | $ -0- | |
| Plus: Common Stock Issued | 20,000 | |
| Ending Common Stock | | $20,000 |
| | | |
| Beginning Retained Earnings | -0- | |
| Plus: Net Income | $13,000 | |
| Ending Retained Earnings | | 13,000 |
| | | |
| Total Stockholders' Equity | | $33,000 |

**PROBLEM 1-33A b. (cont.)**

| Mark's Consulting<br>Balance Sheet<br>As of December 31, Year 1 | | |
|---|---|---|
| **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 1-33A b. (cont.)

| Mark's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 1 | | |
|---|---|---|
| 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 Borrowed Funds | $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 1-33A b. (cont.)**

| Mark's Consulting<br>Income Statement<br>For the Period Ended December 31, Year 2 | |
|---|---|
| Service Revenue | $95,000 |
| Expenses | (71,500) |
| Net Income | $23,500 |

| Mark's Consulting<br>Statement of Changes in Stockholders' Equity<br>For the Period Ended December 31, Year 2 | | |
|---|---|---|
| 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 1-33A b. (cont.)

| Mark's Consulting<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| **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 1-33A b. (cont.)**

| Mark's Consulting<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| 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 does not contain cash.

d. In Year 1 and Year 2 net income and cash flows from operating activities are the same because all revenues and expenses are cash. Ordinarily, net income will be different from cash flows from operating activities due to non-cash revenue and expense transactions (discussed in Chapter 2). The net change in cash is different from net income because investing and financing activities do not directly affect revenue and expenses.

**PROBLEM 1-33A (cont.)**

e. Immediately after Event 2 in Year 1 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 Year 1, the Retained Earnings account will have a balance of $13,000 ($35,000 revenue - $22,000 expenses). The Year 1 ending balance becomes the Year 2 beginning balance. So, the balance in the Retained Earnings account on January 1, Year 2 is $13,000. This balance will not change until the closing process is completed in December Year 2. As a result, the balance in the Retained Earnings account immediately after Event 2 in Year 2 is recorded is $13,000.

**PROBLEM 1-34A**

**a.**

**Prat Corp.**
**Accounting Equation**

| | | | | | Stockholders' Equity | | |
|---|---|---|---|---|---|---|---|
| | | | | | Common | | Retained |
| Event | Assets | = | Liabilities | + | Stock | + | Earnings |
| Beginning Balances | 30,000 | = | 12,000 | + | 13,000 | + | *5,000*[1] |
| 1. Paid Expense | (26,000) | | | | | | (26,000) |
| 3. Paid Dividend | (2,000) | | | | | | (2,000) |
| 4. Paid Liability | (3,000) | | (3,000) | | | | |
| 5. Issued Stock | 4,000 | | | | 4,000 | | |
| 6. Revenue* | 35,550 | | | | | | 35,550[2] |
| Ending Balance | 38,550 | = | 9,000 | + | 17,000 | + | 12,550 |

[1]Assets – Liabilities – Common Stock =:Retained Earnings
$30,000 – $12,000 – $13,000 = *$5,000*

| | |
|---|---|
| [2]Increase in Retained Earnings: | $ 7,550 |
| Add: Expenses | 26,000 |
| Add: Dividends | 2,000 |
| Revenue | $35,550 |

**Prat Corp.**
**Income Statement**
**For the Year Ended December 31, Year 2**

| | |
|---|---|
| Revenue | $35,550 |
| Expense | (26,000) |
| Net Income | $ 9,550 |

## PROBLEM 1-34A (cont.)

| Prat Corp.<br>Statement of Changes in Stockholders' Equity<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Beginning Common Stock | $13,000 | |
| Plus: Common Stock Issued | 4,000 | |
| Ending Common Stock | | $17,000 |
| | | |
| Beginning Retained Earnings | $5,000 | |
| Plus: Net Income | 9,550 | |
| Less: Dividends | (2,000) | |
| Ending Retained Earnings | | 12,550 |
| | | |
| Total Stockholders' Equity | | $29,550 |

| Prat Corp.<br>Balance Sheet<br>As of December 31, Year 2 | | |
|---|---|---|
| Assets | | $38,550 |
| | | |
| Liabilities | | $ 9,000 |
| | | |
| Stockholders' Equity | | |
| Common Stock | $17,000 | |
| Retained Earnings | 12,550 | |
| Total Stockholders' Equity | | 29,550 |
| | | |
| Total Liabilities and Stockholders' Equity | | $38,550 |

PROBLEM 1-34A (cont.)

| Prat Corp.<br>Statement of Cash Flows<br>For the Year Ended December 31, Year 2 | | |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Cash Receipt from Revenue | $35,550 | |
| Cash Payment for Expense | (26,000) | |
| Net Cash Flow from Operating Activities | | $ 9,550 |
| | | |
| Cash Flows From Investing Activities | | -0- |
| | | |
| Cash Flows From Financing Activities: | | |
| Cash Receipts from Stock Issue | $ 4,000 | |
| Cash Payment to Creditors | (3,000) | |
| Cash Dividend Paid to Stockholders | (2,000) | |
| Net Cash Flow from Financing Activities | | (1,000) |
| | | |
| Net Increase in Cash | | 8,550 |
| Plus: Beginning Cash Balance* | | 30,000 |
| Ending Cash Balance | | $38,550 |

*Assumes all assets are cash.

b. Percentage of assets provided by:

| | | | |
|---|---|---|---|
| Creditors | $ 9,000 ÷ $38,550 | = | 23.35% |
| Investors | $17,000 ÷ $38,550 | = | 44.10% |
| Earnings | $12,550 ÷ $38,550 | = | 32.56% |

c. The balance in the temporary accounts, revenue, expenses and dividends will be zero on January 1, Year 3, because they were closed to Retained Earnings at December 31, Year 2.

## PROBLEM 1-35A

**a.**

**Maben Company**
**Horizontal Statements Model for Year 1**

| | Balance Sheet | | | | | | | | | Income Statement | | | | | Statement of Cash Flows | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | | = | Liab. | + | Stockholders' Equity | | | Revenue | − | Expense | = | Net Inc. | | |
| Event No. | Cash | + | Land | = | Notes Payable | + | Common Stock | + | Retained Earnings | | | | | | | |
| 1 | 30,000 | + | NA | = | NA | + | 30,000 | + | NA | NA | − | NA | = | NA | 30,000 | FA |
| 2 | 40,000 | + | NA | = | 40,000 | + | NA | + | NA | NA | − | NA | = | NA | 40,000 | FA |
| 3 | 48,000 | + | NA | = | NA | + | NA | + | 48,000 | 48,000 | − | NA | = | 48,000 | 48,000 | OA |
| 4 | (25,000) | + | NA | = | NA | + | NA | + | (25,000) | NA | − | 25,000 | = | (25,000) | (25,000) | 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 | 49,000 | + | 53,000 | = | 30,000 | + | 50,000 | + | 22,000 | 48,000 | − | 25,000 | | 23,000 | 49,000 | NC |

**b.** **Total Assets = $49,000 + $53,000 = $102,000**

**c.**

| Sources of Assets | | |
|---|---|---|
| 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 1-35A (cont.)

d. Net income amounts to $23,000 (see part a.) Dividends are not expenses and do not appear on the income statement.

e.

| Operating Activities: | |
|---|---|
| Cash from revenue | $48,000 |
| Cash paid for expenses | (25,000) |
| Net Cash Flow from Operating Activities | $23,000 |
| | |

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

| Financing Activities: | |
|---|---|
| Cash from stock issue ($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 is provided as follows:

| | | |
|---|---|---|
| Investors | ($50,000 ÷ $102,000) | 49.0% |
| Creditors | ($30,000 ÷ $102,000) | 29.4% |
| Earnings | ($22,000 ÷ $102,000) | 21.6% |

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.