Chapter 1

Accounting and the Business Environment

Short Exercises

(5 min.) **S 1-1**

Req. 1

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

Expenses **are decreases in equity from using assets or increasing liabilities in the course of delivering goods or services to customers.**

Req. 2

If revenues increase, equity would *increase*.

(5 min.) **S 1-2**

Req. 1

The banker is an *external* user of financial information.

Req. 2

The financial statement that would provide the best information to answer the banker's questions is the *balance sheet.*

(5 – 10 min.) S 1-3

Req. 1

This organization is the *Financial Accounting Standards Board.*

(5 – 10 min.) S 1-4

Req. 1

Chloe's* needs will best be met by organizing a *corporation.

(5 – 10 min.) S 1-5

Req. 1

Advantages:

1. **Easy to organize.**
2. **Neither stockholders to notify nor are there articles of incorporation to file.**
3. **Unification of ownership and management.**

Disadvantages:

1. **No continuous life or transferability of ownership.**
2. **Unlimited liability of owner.**

(5 - 10 min.) **S 1-6**

Req. 1

a. ***the entity concept***

b. ***the cost principle***

c. ***the stable monetary unit concept***

d. ***the faithful representation principle***

Req. 2

Michael McNamee has $11,000 equity in the business.

Assets	=	Liabilities	+	Owner's equity
		Accounts		
Cash + Furniture	=	Payable	+	Owner's equity
$8,000 + $9,000	=	$6,000	+	$11,000

(5 min.) S 1-7

Req. 1

	Assets	=	Liabilities	+	Owner's equity	Type of Transaction
(a)	Cash $320	=	(not affected) $ 0	+	Capital $320	Revenues
(b)	Cash $(125)	=	(not affected) 0	+	Capital $(125)	Expenses
(c)	Accts receivable $440	=	(not affected) 0	+	Capital $440	Revenues
(d)	(not affected) 0	=	Accts payable $65	+	Capital $(65)	Expenses

(5 min.) S 1-8

Req. 1

Account	**Amount**
Cash	**$ (26,000)**
Land	**$ 26,000**

(5 min.) S 1-9

Req. 1

After this transaction (the first and only for the business), cash equals *$ 0* and the total assets equal *$2,800*.

Req. 2

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

(5 min.) S 1-10

Req. 1

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

Req. 2

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

(10 min.) S 1-11

Req. 1

Smart Touch Learning			
Balance Sheet			
April 21, 2013			
ASSETS		**LIABILITIES**	
Cash	**$11,900**	**Accounts payable**	**$ 200**
Accounts receivable	**3,000**		
Office supplies	**500**	**OWNER'S EQUITY**	
Land	**20,000**	**Bright, capital**	**35,200**
		Total liabilities and	
Total assets	**$35,400**	**owner's equity**	**$35,400**

(10 min.) S 1-12

Req. 1

Elegant Arrangements		
Income Statement		
Year Ended December 31, 2012		
Revenue:		
Service revenue		$74,000
Expenses:		
Salary expense	$42,000	
Rent expense	13,000	
Insurance expense	4,000	
Supplies expense	1,100	
Total expenses		60,100
Net income		$13,900

(10 min.) S 1-13

Req.1 **The operations of Elegant Arrangements in 2012 resulted in a *good* year.**
This can be measured by the *net income of $13,900.*

Req. 2 **Net income would be *lower by $14,800*.**

Req. 3 **Net income would be *lower by $8,400*.**

Exercises

(10 – 15 min.) E 1-14

Req. 1

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

(15 - 20 min.) E 1-15

Req. 1

The *balance sheet* is prepared by summarizing the assets, liabilities, and owner's equity of the entity at a particular date. The *assets* are the resources the business has to work with. *Liabilities* are debts owed to creditors. *Owner's equity* is the portion of the business assets owned outright by the proprietor.

The *income statement* is prepared by summarizing the revenues and the expenses of a particular entity for a period such as a month or a year. Total *revenues* minus total *expenses* equals *net income* (or *net loss*).

Req. 2

The *Financial Accounting Standards Board* is the self-regulating body of accountants that defines pronouncements that guide how the financial statements will be prepared.

Req. 3

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

Req. 4

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

Req. 5

A *corporation* would be the best option.

(5 - 10 min.) E 1-16

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

Req. 1

New Rock Gas	Assets	= $24,000 + $50,000 = $74,000
DJ Video Rentals	Liabilities	= $75,000 – $32,000 = $43,000
Corner Grocery	Owner's equity	= $100,000 – $53,000 = $47,000

Req. 2

The main characteristics of a proprietorship are:

1. **Separate legal entity**
2. **No continuous life and transferability of ownership**
3. **Unlimited liability of owner**
4. **Unification of ownership and management**
5. **No corporate taxation**
6. **No government regulation**

Req. 3

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

(5 - 10 min.) E 1-17

Req. 1

Under the US GAAP, the land would be reported on the balance sheet at January 3, 2012 at $50,000. On the December 31, 2012 balance sheet, the land would be reported at $50,000.

Req. 2

Under IFRS, the land would be reported on the balance sheet at January 3, 2012 at $50,000. On the December 31, 2012 balance sheet, the land would be recorded at $55,000.

(5 - 10 min.) E 1-18

Req. 1

	a.	b.	c.
Owner's equity, May 31, 2012			
($177,000 – $122,000)	$55,000	$55,000	$55,000
Owner's investment	6,000	0	18,000
Net income for the month	*8,000*	*24,000*	*16,000*
	69,000	79,000	89,000
Drawings	0	(10,000)	(20,000)
Owner's equity, June 30, 2012			
($213,000 – $144,000)	$69,000	$69,000	$69,000

(5 - 10 min.) E 1-19

Req. 1

a. Purchase of asset for cash
Sale of asset for cash
Collection of accounts receivable
b. Pay an expense
Drawings
c. Pay an account payable
d. Investment by owner
Revenue transaction
e. Purchase of asset on account
Borrow money

Wording may vary.

(10 – 20 min.) E 1-20

Req. 1

a. Increase asset (Cash)
Increase capital (Viviani, capital)

b. Increase asset (Accounts receivable)
Increase capital (Viviani, capital)

c. Increase asset (Office furniture)
Increase liability (Accounts Payable)

Req. 1

d. Increase asset (Cash)
Decrease asset (Accounts receivable)

e. Decrease asset (Cash)
Decrease liability (Accounts payable)

f. Increase asset (Cash)
Decrease asset (Land)

g. Increase asset (Cash)
Increase capital (Viviani, capital)

h. Decrease asset (Cash)
Decrease capital (Viviani, capital)

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

(10 - 20 min.) **E 1-21**

Req. 1

Analysis of Transactions — Caren Smith, M.D.

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

$60,400 = **$60,400**

Total assets = Total liabilities and owner's equity

(10 - 15 min.) E 1-22

Req. 1

Transaction Description

1. **Investment by the owner**
2. **Earned revenue on account**
3. **Purchased equipment on account**
4. **Collected cash on account**
5. **Cash purchase of equipment**
6. **Paid on account**
7. **Earned revenue and received cash**
8. **Paid cash for expenses**

Req. 2

All-in-one Accounting Service's net income = <u>$3,090</u>.

(10 min.) E 1-23

Req. 1

The owner's equity *increased* during the year by <u>$4,000</u>.

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

Req. 2

Owner's equity can change three ways:

- **Owner's equity can *increase* through: Owner contributions and/or Net income**
- **Owner's equity can *decrease* through: Owner drawings**

(10 - 15 min.) E 1-24

Req. 1

Net income for American Express Services (AES) is <u>$7,000,000,000.</u>

Revenues – Expenses = Net Income
$21,000,000,000 - $14,000,000,000 = $7,000,000,000

Req. 2

The owner's equity *increased* during the year by <u>$7,000,000,000.</u>

Req.3

The AES's performance for 2012 is *good,* because 2012 was a *profitable* year.

(30-40 min.) **E 1-25**

Req. 1

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

<u>Owner's equity</u>	
Beginning balance:	$ 16,000
Investment by the owner	0
Net income	20,000
	$36,000
Drawings	(19,000)
Ending balance	<u>$17,000</u>

Felix *earned net income of <u>$20,000</u>.*

Revenue	-	Net income	=	Expenses
$ 242,000	-	$20,000	=	$222,000

Req. 2

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

(10-15 min.) E 1-26

Req. 1

	Effects on total assets	Asset account(s) affected
a.	Increased total assets	Cash
b.	No effect on total assets	Cash and land
c.	Decreased total assets	Cash
d.	Increased total assets	Equipment
e.	Increased total assets	Accounts receivable
f.	No effect on total assets	No asset account(s) affected
g.	No effect on total assets	Cash and Accounts receivable
h.	Increased total assets	Cash
i.	Decreased total assets	Cash
j.	No effect on total assets	No asset account(s) affected

(10 - 20 min.) E 1-27

Req. 1

Wilson Towing Service			
Balance Sheet			
June 30, 2012			
ASSETS		**LIABILITIES**	
Cash	$ 2,900	Accounts payable	$ 3,000
Accounts receivable	6,200	Note payable	6,900
Supplies	900	Total liabilities	9,900
Equipment	13,600	**OWNER'S EQUITY**	
		Wilson, capital	13,700*
		Total liabilities and	
Total assets	$23,600	owner's equity	$23,600

* Total assets	–	Total liabilities	=	Owner's equity
$23,600	–	$9,900	=	$13,700

Req. 2 The balance sheet reports *financial position*.

Req. 3 The *income statement.*

(10 - 15 min.) E 1-28

Req. 1

Davis Design Studio		
Income Statement		
Year Ended December 31, 2012		
Revenue:		
Service revenue		$158,300
Expenses:		
Salary expense	$65,000	
Rent expense	23,000	
Utilities expense	6,900	
Supplies expense	4,200	
Property tax expense	1,500	
Total expenses		100,600
Net income		$ 57,700

The result of operations is net income of $57,700

Req. 2

The amount of owner drawings during the year was $54,400.

Problems

Group A

(15 - 20 min.) P 1-29A

Req. 1

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

(20 - 25 min.) P 1-30A

Req. 1

The proprietorship feature that limits Andrea's business taxes is called *business taxation*.

Req. 2

Andrea Scarlett, Realtor			
Balance Sheet			
September 30, 2012			
ASSETS		LIABILITIES	
Cash	$ 9,000	Accounts payable	$ 2,000
Office supplies	1,300	Note payable	61,000
Franchise	23,000	Total liabilities	63,000
Furniture	15,000	OWNER'S EQUITY	
Land	83,000	Scarlett, capital	68,300*
		Total liabilities and	
Total assets	$131,300	owner's equity	$131,300

*	Total assets	–	Total liabilities	=	Total owner's equity
	$131,300	–	$63,000	=	$68,300

Req. 3

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

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

(20 - 30 min.) P 1-31A

Req. 1

Analysis of Transactions — Alex Shore, CPA

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

$\underbrace{\hspace{6em}}_{\$74{,}200}$ = $\underbrace{\hspace{4em}}_{\$74{,}200}$

*Not a transaction of the business.

(continued) P 1-31A

Req. 2

a.	Total assets	=	$74,200
b.	Total liabilities	=	$ 9,700
c.	Total owner's' equity	=	$64,500
d.	Net income for February	=	$15,500

(20 - 30 min.) P 1-32A

Req. 1

Analysis of Transactions **Angela Peters, Attorney**

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

$108,600 = $108,600

*Not a transaction of the business.

Req. 2

a.	**Total assets**	**=**	**$108,600**
b.	**Total liabilities**	**=**	**$ 9,300**
c.	**Total owner's equity**	**=**	**$ 99,300**
d.	**Net income for March**	**=**	**$ 12,300**

Req. 3

Angela Peter's first month of operations was *good* because the business *earned net income of $12,300.*

(20-25 min.) **P 1-33A**

Req. 1

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

(15 - 25 min.) **P 1-34A**

Req. 1

Analysis of Transactions — Dance Fever

DATE	ASSETS: CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	LAND =	LIABILITIES: ACCOUNTS PAYABLE +	OWNER'S EQUITY: CRONE, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Bal.	2,300	1,800	0	14,000	8,000	10,100	
a)	13,000					13,000	Owner's investment
Bal.	15,300	1,800	0	14,000	8,000	23,100	
b)	900					900	Service revenue
Bal.	16,200	1,800	0	14,000	8,000	24,000	
c)	(8,000)				(8,000)		
Bal.	8,200	1,800	0	14,000	0	24,000	
d)			600		600		
Bal.	8,200	1,800	600	14,000	600	24,000	
e)	700	(700)					
Bal.	8,900	1,100	600	14,000	600	24,000	
f)	1,600					1,600	Owner's investment
Bal.	10,500	1,100	600	14,000	600	25,600	
g)		5,500				5,500	Service revenue
Bal.	10,500	6,600	600	14,000	600	31,100	
h)-1	(1,200)					(1,200)	Rent expense
h)-2	(600)					(600)	Advertising expense
Bal.	8,700	6,600	600	14,000	600	29,300	
i)			(110)		(110)		
Bal.	8,700	6,600	490	14,000	490	29,300	
j)	(2,000)					(2,000)	Owner's drawings
Bal.	6,700	6,600	490	14,000	490	27,300	

$27,790 $27,790

(20 - 30 min.) P 1-35A

Req. 1

Gate City Answering Service		
Income Statement		
Year Ended December 31, 2012		
Revenue:		
Service revenue		$192,000
Expenses:		
Salary expense	$65,000	
Advertising expense	15,000	
Rent expense	13,000	
Interest expense	7,000	
Property tax expense	2,600	
Insurance expense	2,500	
Total expenses		105,100
Net income		$ 86,900

Req. 2

Gate City Answering Service	
Statement of Owner's Equity	
Year Ended December 31, 2012	
Wayne, capital, December 31, 2011	$54,000
Owner investment	28,000
Net income	86,900
	168,900
Drawings	(30,000)
Wayne, capital, December 31, 2012	$138,900

Req. 3

Gate City Answering Service			
Balance Sheet			
December 31, 2012			
ASSETS		LIABILITIES	
Cash	$ 3,000	Accounts payable	$11,000
Accounts receivable	1,000	Salary payable	1,300
Supplies	10,000	Note payable	32,000
Equipment	16,000	Total liabilities	$44,300
Building	145,200	OWNER'S EQUITY	
Land	8,000	Wayne, capital	138,900
		Total liabilities and	
Total assets	$183,200	owner's equity	$183,200

Req. 4

a. Result of operations: Profit of $86,900

b. The total economic resources were $183,200

c. The total amount owed was $44,300

d. The amount of owner's equity at the end of the year was $138,900

(20 – 30 min.) P1-36A

Req. 1

a.

Studio Photography		
Income Statement		
Year Ended December 31, 2012		
Revenue:		
Service revenue		$80,000
Expenses:		
Salary expense	$25,000	
Insurance expense	8,000	
Advertising expense	3,000	
Total expenses		36,000
Net income		$44,000

b.

Studio Photography	
Statement of Owner's Equity	
Year Ended December 31, 2012	
Ansel, capital, December 31, 2011	$16,000
Owner investment	29,000
Net income	44,000
	89,000
Drawings	(13,000)
Ansel, capital, December 31, 2012	$76,000

c.

Studio Photography			
Balance Sheet			
December 31, 2012			
ASSETS		LIABILITIES	
Cash	$37,000	Accounts payable	$ 7,000
Accounts receivable	8,000	Note payable	12,000
Equipment	50,000	Total liabilities	19,000
		OWNER'S EQUITY	
		Ansel, capital	76,000
		Total liabilities and	
Total assets	$95,000	owner's equity	$95,000

(20 - 30 min.) P 1-37A

Req. 1

Greener Landscaping			
Balance Sheet			
November 30, 2012			
ASSETS		**LIABILITIES**	
Cash	$ 4,900	Accounts payable	$ 2,700
Accounts receivable	2,200	Note payable	24,200
Office supplies	600	Total liabilities	26,900
Office furniture	6,100		
Land	34,200	OWNER'S EQUITY	
		Tum, capital	21,100*
		Total liabilities and	
Total assets	$48,000	owner's equity	$ 48,000

***$48,000 – $26,900 = $21,100**

Req. 2

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

Problems

Group B

(15 - 20 min.) **P 1-38B**

Req. 1

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

(20 – 25 min.) **P 1-39B**

Req. 1

The proprietorship feature that limits Sandy's business taxes is called *business taxation*.

Req.2

Sandy White, Realtor			
Balance Sheet			
May 31, 2012			
ASSETS		LIABILITIES	
Cash	$ 13,000	Accounts payable	$ 5,000
Office supplies	1,100	Note payable	62,000
Franchise	26,000	Total liabilities	67,000
Furniture	20,000	OWNER'S EQUITY	
Land	80,000	White, capital	73,100*
		Total liabilities and	
Total assets	$140,100	owner's equity	$140,100

*	Total assets	–	Total liabilities	=	Total owner's equity
	$140,100	–	$67,000	=	$73,100

Req. 3

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

Personal cash	$4,000
Personal accounts payable	$3,000
Mortgage payable	$70,000
Residence	$130,000

(20 - 30 min.) P 1- 40B

Req. 1

Analysis of Transactions **Arron Woody, CPA**

	ASSETS				= LIABILITIES +	OWNER'S EQUTY	
DATE	CASH +	ACCOUNTS RECEIVABE +	SUPPLIES +	OFFICE FURNITURE =	ACCOUNTS PAYABLE +	WOODY, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Feb 4*							
5	40,000					40,000	Owner's investment
Bal.	40,000	0	0	0	0	40,000	
6	(200)		200				
Bal.	39,800	0	200	0	0	40,000	
7				9,500	9,500		
Bal.	39,800	0	200	9,500	9,500	40,000	
10*							
11*							
12							
18		14,000				14,000	Service revenue
Bal.	39,800	14,000	200	9,500	9,500	54,000	
25	(1,900)					(1,900)	Rent expense
Bal.	37,900	14,000	200	9,500	9,500	52,100	
28	(8,000)					(8,000)	Owner's drawings
Bal.	29,900	14,000	200	9,500	9,500	44,100	

$$\underbrace{\text{Assets}}_{\$53,600} \qquad \underbrace{\text{Liabilities + Owner's Equity}}_{\$53,600}$$

*Not a transaction of the business.

Req.2

a.	**Total assets**	=	**$53,600**
b.	**Total liabilities**	=	**$ 9,500**
c.	**Total owner’s equity**	=	**$44,100**
d.	**Net income for February**	=	**$12,100**

(20 - 30 min.) P 1- 41B

Req. 1

Analysis of Transactions — **Aimee Griffin, Attorney**

DATE	ASSETS: CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	COMPUTER	= LIABILITIES: ACCOUNTS PAYABLE +	OWNER'S EQUITY: GRIFFIN, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Dec 1*							
2*							
3*							
5	109,000					109,000	Owner's investment
Bal.	109,000	0	0	0	0	109,000	
7	(900)		900				
Bal.	108,100	0	900	0	0	109,000	
9				9,200	9,200		
Bal.	108,100	0	900	9,200	9,200	109,000	
23		17,000				17,000	Service revenue
Bal.	108,100	17,000	900	9,200	9,200	126,000	
30	(1,900)					(1,900)	Utilities expense
Bal.	106,200	17,000	900	9,200	9,200	124,100	
31	(5,000)					(5,000)	Owner's drawings
Bal.	101,200	17,000	900	9,200	9,200	119,100	

$128,300 (Assets) — $128,300 (Liabilities + Owner's Equity)

*Not a transaction of the business.

Req. 2

a.	**Total assets**	**=**	**$128,300**
b.	**Total liabilities**	**=**	**$9,200**
c.	**Total owner's equity**	**=**	**$119,100**
d.	**Net income for December**	**=**	**$15,100**

Req. 3

Aimee Griffin's first month of operations was *good* because the business *earned net income of $15,100.*

(20 - 25 min.) **P 1-42B**

Req. 1

Alterri Mechanical

Date		*Transaction Type*	*Account*	*Increase / Decrease*	*Amount*
Nov.	4	Owner's investment	Cash Alterri, capital	Increase Increase	$3,000
	9	Cash purchase	Land Cash	Increase Decrease	$3,000
	13	Purchase on account	Supplies Accounts payable	Increase Increase	$200
	16	Payment on account	Accounts payable Cash	Decrease Decrease	$1,700
	19	Collection on account	Cash Accounts receivable	Increase Decrease	$900
	22	Owner's investment	Cash Alterri, capital	Increase Increase	$8,000
	25	Payment on account	Accounts payable Cash	Decrease Decrease	$500
	27	Cash purchase	Supplies Cash	Increase Decrease	$600
	30	Owner's drawings	Alterri, capital Cash	Decrease Decrease	$5,500

(60 - 75 min.) P 1- 43B

Req. 1

Analysis of Transactions — Top 40

	ASSETS					LIABILITIES + OWNER'S EQUITY		
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	LAND =	ACCOUNTS PAYABLE +	CRONE, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Bal.	2,100	2,000	0	10,000	6,000	8,100	
a)	10,000					10,000	Owner's investment
Bal.	12,100	2,000	0	10,000	6,000	18,100	
b)	1,000					1,000	Service revenue
Bal.	13,100	2,000	0	10,000	6,000	19,100	
c)	(6,000)				(6000)		
Bal.	7,100	2,000	0	10,000	0	19,100	
d)			700		700		
Bal.	7,100	2,000	700	10,000	700	19,100	
e)	500	(500)					
Bal.	7,600	1,500	700	10,000	700	19,100	
f)	1,900					1,900	Owner's investment
Bal.	9,500	1,500	700	10,000	700	21,000	
g)		5,800				5,800	Service revenue
Bal.	9,500	7,300	700	10,000	700	26,800	
h)-1	(900)					(900)	Rent expense
h)-2	(400)					(400)	Advertising expense
Bal.	8,200	7,300	700	10,000	700	25,500	
i)			(80)		(80)		
Bal.	8,200	7,300	620	10,000	620	25,500	
j)	(2,700)					(2,700)	Owner's drawings
Bal.	5,500	7,300	620	10,000	620	22,800	

$\underbrace{\text{Assets}}_{\$23,420}$ $\qquad$ $\underbrace{\text{Liabilities + Owner's Equity}}_{\$23,420}$

(20 - 30 min.) P 1- 44B

Req. 1

Quick and EZ Delivery		
Income Statement		
Year Ended December 31, 2012		
Revenue:		
Service revenue		$192,000
Expenses:		
Salary expense	$69,000	
Advertising expense	17,000	
Rent expense	13,000	
Interest expense	6,000	
Property tax expense	2,900	
Insurance expense	2,000	
Total expenses		109,900
Net income		$ 82,100

Req. 2

Quick and EZ Delivery	
Statement of Owner's Equity	
Year Ended December 31, 2012	
Trott, capital, December 31, 2011	$51,000
Owner investment	32,000
Net income	82,100
	165,100
Drawings	(32,000)
Trott, capital, December 31, 2012	$133,100

Req. 3

Quick and EZ Delivery			
Balance Sheet			
December 31, 2012			
ASSETS		LIABILITIES	
Cash	$ 6,000	Accounts payable	$14,000
Accounts receivable	1,700	Salary payable	500
Supplies	8,000	Note payable	30,000
Equipment	17,000	Total liabilities	44,500
Building	137,900		
Land	7,000	OWNER'S EQUITY	
		Trott, capital	133,100
		Total liabilities and	
Total assets	$177,600	owner's equity	$177,600

Req. 4

b. Result of operations: Net income of $82,100

b. The total economic resources were $177,600

c. The total amount owed was $44,500

d. The amount of owner's equity at the end of the year was $133,100

(20 – 30 min.) **P1- 45B**

Req. 1

a.

Photo Gallery		
Income Statement		
Year Ended December 31, 2012		
Revenue:		
Service revenue		$78,000
Expenses:		
Salary expense	$21,000	
Insurance expense	9,000	
Advertising expense	2,000	
Total expenses		32,000
Net income		$46,000

b.

Photo Gallery	
Statement of Owner's Equity	
Year Ended December 31, 2012	
Leibovitz, capital, December 31, 2011	$17,000
Owner investment	35,000
Net income	46,000
	98,000
Drawings	(14,000)
Leibovitz, capital, December 31, 2012	$84,000

c.

Photo Gallery			
Balance Sheet			
December 31, 2012			
ASSETS		LIABILITIES	
Cash	$26,000	Accounts payable	$ 4,000
Accounts receivable	6,000	Note payable	14,000
Equipment	70,000	Total liabilities	18,000
		OWNER'S EQUITY	
		Leibovitz, capital,	84,000
		Total liabilities and	
Total assets	$102,000	owner's equity	$102,000

(20 - 30 min.) **P 1- 46B**

Req. 1

Outdoor Life Landscaping			
Balance Sheet			
July 31, 2012			
ASSETS		**LIABILITIES**	
Cash	**$ 5,000**	**Accounts payable**	**$ 2,800**
Accounts receivable	**2,300**	**Note payable**	**26,400**
Office supplies	**800**	**Total liabilities**	**29,200**
Office furniture	**5,200**	**OWNER'S EQUITY**	
Land	**28,400**	**Kamp, capital**	**12,500***
		Total liabilities and	
Total assets	**$41,700**	**owner's equity**	**$ 41,700**

***$41,700 – $29,200 = $12,500**

Req. 2

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

Continuing Exercise

(10 - 15 min.) **E 1- 47**

Req. 1

Analysis of Transactions — **Lawlor Lawn Service**

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

$$\underbrace{\text{Assets}}_{\$4{,}060} \qquad \underbrace{\text{Liabilities + Owner's Equity}}_{\$4{,}060}$$

Continuing Problem

(20 - 25 min.) P 1- 48

Req. 1

Analysis of Transactions — **Draper Consulting**

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

$\underbrace{\text{Assets}}_{\$24,900}$ = $\underbrace{\text{Liabilities + Owner's Equity}}_{\$24,900}$

Req. 2

Draper Consulting		
Income Statement		
Month Ended December 31, 2012		
Revenue:		
Service revenue ($1,500 + $1,100)		$2,600
Expenses:		
Rent expense	$550	
Utilities expense	250	
Total expenses		800
Net income		$1,800

Req. 3

Draper Consulting	
Statement of Owner's Equity	
Month Ended December 31, 2012	
Draper, capital, December 1, 2012	$ 0
Owner investment	18,000
Net income	1,800
	19,800
Drawing	0
Retained earnings, December 31, 2012	$19,800

Req. 4

Draper Consulting			
Balance Sheet			
December 31, 2012			
ASSETS		LIABILITIES	
Cash	$ 16,500	Accounts payable	$ 5,100
Accounts receivable	1,500	Total liabilities	5,100
Supplies	900		
Equipment	1,800	OWNER'S EQUITY	
Furniture	4,200	Draper, capital	19,800
		Total liabilities and	
Total assets	$24,900	owner's equity	$24,900

Practice Set: Chapter 1 (10 – 15 min.)

Req. 1 Analysis of Transactions Shine King Cleaning

	ASSETS							= LIABILITIES + OWNER'S EQUITY			
DATE	CASH +	AR +	SUPP +	PREPAID RENT +	PREPAID INS +	TRUCK +	EQUIP +	AP +	USR +	N/P +	HUDSON, CAPITAL
Nov. 1	35,000					8,000					43,000
Bal.	35,000	0	0	0	0	8,000	0	0	0	0	43,000
2	(2,000)			2,000							
Bal.	33,000	0	0	2,000	0	8,000	0	0	0	0	43,000
3	(2,400)				2,400						
Bal.	30,600	0	0	2,000	2,400	8,000	0	0	0	0	43,000
4			270					270			
Bal.	30,600	0	270	2,000	2,400	8,000	0	270	0	0	43,000
5							1,000	1,000			
Bal.	30,600	0	270	2,000	2,400	8,000	1,000	1,270	0	0	43,000
7	(1,200)						1,200				
Bal.	29,400	0	270	2,000	2,400	8,000	2,200	1,270	0	0	43,000
9		3,000									3,000
Bal.	29,400	3,000	270	2,000	2,400	8,000	2,200	1,270	0	0	46,000
10	100	(100)									
Bal.	29,500	2,900	270	2,000	2,400	8,000	2,200	1,270	0	0	46,000
15	(500)										(500)
Bal.	29,000	2,900	270	2,000	2,400	8,000	2,200	1,270	0	0	45,500
16	3,600								3,600		
Bal.	32,600	2,900	270	2,000	2,400	8,000	2,200	1,270	3,600	0	45,500
17	800										800
Bal.	33,400	2,900	270	2,000	2,400	8,000	2,200	1,270	3,600	0	46,300
18								175			(175)
Bal.	33,400	2,900	270	2,000	2,400	8,000	2,200	1,445	3,600	0	46,125
20	40,000									40,000	
Bal.	73,400	2,900	270	2,000	2,400	8,000	2,200	1,445	3,600	40,000	46,125
21	900	(900)									
Bal.	74,300	2,000	270	2,000	2,400	8,000	2,200	1,445	3,600	40,000	46,125
25	(500)							(500)			
Bal.	73,800	2,000	270	2,000	2,400	8,000	2,200	945	3,600	40,000	46,125
29	(100)										(100)
Bal.	73,700	2,000	270	2,000	2,400	8,000	2,200	945	3,600	40,000	46,025
30	(600)										(600)
Bal.	73,100	2,000	270	2,000	2,400	8,000	2,200	945	3,600	40,000	45,425

Total assets	**=**	**Total liabilities + Owner's equity**
$89,970		**$89,970**

Ch 1: Apply Your Knowledge

Decision Cases

Decision Case 1-1

Req. 1 **Assets**

Sal's $23,000, Greg's $25,000

Req. 2 **Liabilities**

Sal's $2,000,   Greg's $10,000

Req. 3 **Owner's equity**

Sal's $21,000,   Greg's $15,000

Req. 4 **Revenue**

Sal's $35,000, Greg's $53,000

Req. 5 **Profitable (net income)**

Sal's $13,000, Greg's $9,000

Req. 6

There's no single correct answer to this question. Possible answers include the following:

a. Which business is more profitable? A business must be profitable to survive.

b. Which business owes more to creditors? Big debts make a business risky.

c. Which business has more owner equity? More owner equity makes a business less risky.

Req. 7

Sal's Silly Songs looks better financially because:

a. Sal's earned more net income on less total revenue.

b. Sal's owes less and has more owner equity. Sal's has less risk.

Decision Case 1-2

Req. 1

The banker would *not* congratulate the Guerreras for their net income because they have not measured net income properly. In fact, they have *no net income* at all. Their accounting errors include the following:

1. **The amount of cash in the bank does *not* measure net income. The cash balance only shows how much cash is available for use in the business.**

2. **Neither an investment by an owner nor a bank loan creates a revenue. A business earns revenue by providing goods or services to customers. The Tres Amigos B&B hasn't even opened, so there is no revenue yet. And a bank loan increases liabilities, not revenue.**

3. **None of the items they list as expenses is really an expense. The house and its renovation, furniture, kitchen equipment, and computer are all assets because these items provide future benefit to the business. Expenses are costs of doing business that have no lasting, or future value. The Tres Amigos B&B hasn't had any expenses yet.**

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

Req. 2

Tres Amigos Bed & Breakfast			
Balance Sheet			
June 30, 2013			
ASSETS		LIABILITIES	
Cash	$ 38,000	Bank loan payable	$100,000
Computer	2,000		
Kitchen equipment	10,000	OWNER'S EQUITY	
Furniture	20,000	Guerrera, capital	100,000
Building ($80,000 + $50,000)	130,000	Total liabilities and	
Total assets	$200,000	owner's equity	$200,000

Ethical Issues

Ethical Issue 1-1

Req. 1

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

Req. 2

The proposal to transfer assets to the company in the prior year would be a sham, and thus it would be dishonest and unethical. The proposal to "shave expenses", meaning reclassifying expenses, would violate the rules of GAAP, thus it would be dishonest and unethical.

Ethical Issue 1-2

Req. 1

The chief financial officer (CFO) of Philip Morris would be torn between addressing the fact that the payments are related to illnesses caused by the company's products, or alternatively, omitting or concealing this fact. The ethical course of action for the CFO is to be open, honest and forthcoming about the reasons for the payments.

Req. 2

Negative consequences are as follows: If users of the financial statements feel they are only getting part of the truth, or that the reports are distorting the information, that will damage the credibility of the company, and damage the company's reputation.

Negative consequences of telling the truth include painting so bleak a picture of the effects of smoking that investors will view Philip Morris as too risky and stop buying the company's stock. Another negative consequence would be to create the impression that the company is engaged in unethical behavior by selling a product that damages people's health.

Fraud Case 1-1

Req. 1

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

Req. 2

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

Financial Statement Case 1-1

Req. 1

Cash balance at December 31, 2009: $3,444M

Req. 2

Total assets at December 31, 2009: $13,813M
December 31, 2008: $8,314M

Req. 3

Accounting Equation: $13,813M = $8,556M + $5,257M

Req. 4

Revenue (net sales) earned in 2008: $19,166M
Increase from 2008 to 2009: $5,343M

***Req.* 5**

Net income in 2009: $902M
2008: $645M

2009 was better than 2008

Team Projects

Team Project 1-1

Suggested Answers

***Req. 1* - Factors to consider in establishing the business:**

1. **How to organize the business—as a proprietorship, a partnership, an LLC, or a corporation (you have decided to organize as a proprietorship)**
2. **Where to locate the business**
3. **How much of your own time and money to commit to the business**
4. **How to finance the business—with your own personal money, with equity investments from others, or through borrowing**
5. **How many people to employ for the business**
6. **How to measure the business's success or failure; how to account for the assets, liabilities, and operations of the business**
7. **What type of animals to board (dogs only, dogs and cats, birds, reptiles, and so on)**
8. **Whether to sell pet foods, toys, and other supplies**
9. **Whether to offer obedience lessons and other pet training**
10. **How to advertise the business (newspapers, radio, posters)**

Student answers may vary.

Req. 2 **(Transactions)**

1. **Obtain equity financing to start the business**
2. **Purchase land and a building**
3. **Renovate the building to make it suitable for a kennel**
4. **Purchase pet food and other supplies that will be needed to operate a kennel**
5. **Advertise the business**
6. **Earn service revenue by keeping pets**
7. **Pay utility bills**
8. **Pay for veterinarian services needed for the animals**
9. **Pay the wages of an employee**
10. **Borrow money**
11. **Drawings by owner**

Student answers may vary.

Req. 3

Quail Creek Pet Kennel		
Income Statement		
Month Ended January 31, 20XX		
Revenue:		
Service revenue		$10,000
Expenses:*		
Wage expense	$2,000	
Supplies expense	400	
Advertising expense	300	
Utilities expense	100	2,800
Net income		$ 7,200

***Students may also include depreciation expense on the building.**

***Req. 3* – continued**

Suggested Answers

Quail Creek Pet Kennel	
Statement of Owner's Equity	
Month Ended January 31, 20XX	
Last name, capital, January 1, 20XX	$ 0
Owner investment	30,000
Net income	7,200
	37,200
Drawing	(2,000)
Last name, capital, January 31, 20XX	$ 35,200

Quail Creek Pet Kennel			
Balance Sheet			
January 31, 20XX			
ASSETS		LIABILITIES	
Cash	$ 1,500	Accounts payable	$ 1,000
Supplies	200		
Land	9,500	OWNER'S EQUITY	
Building	25,000		
		Last name, capital	35,200
Total assets	$36,200	Total liabilities and owner's equity	$36,200

Req. 4

Evaluate the success of the business by its

- **Net income or net loss for the period, as reported on the income statement**
- **Financial position at the end of the period, as reported on the balance sheet**

Specifically, you hope to earn a *net income*, and you hope to end the period with *assets* far in excess of your *liabilities*. Finally, you also need plenty of cash to continue in business.

Team Project 1-2

Suggested Answers

Req. 1 **– Factors to consider in establishing the business:**

1. **How to organize the business—as a proprietorship, a partnership, an LLC, or a corporation (assume you have decided to organize as a proprietorship)**
2. **Where to locate the headquarters of the business**
3. **How much of your own time and money to commit to the business**
4. **How to finance the business—with your own personal money, with equity investment from others, or through borrowing**
5. **How many people to employ for the business**
6. **How to measure the business's success or failure; how to account for the assets, liabilities, and operations of the business**
7. **What type of music to feature. What age group or interest group to appeal to**
8. **Whether to sell concessions (food, drinks, T-shirts, and so on) yourself or to arrange for outsiders to sell concessions at the concert**
9. **How to advertise the business (newspapers, radio, posters)**
10. **Whether to sponsor the concerts yourself or to arrange for corporate or charitable organizations to sponsor the concerts**

Student answers may vary.

Suggested Answers

Req. 2 **– Items to arrange in order to promote and stage a rock concert:**

1. **Which band (or bands) to feature at the concerts**
2. **How much and when to pay the performers (flat rate or a percentage of gate receipts)**
3. **Where to stage the concerts and how to pay for the site rental**
4. **Need for city or county permits to stage a concert**
5. **How to ensure security at the concert**
6. **How to get people to come to the concert. How to advertise the concerts (newspapers, radio, posters, or other) and how much to pay for advertising**
7. **How to offer concessions (buy and sell them yourself or arrange for outside concessionaires). If outsiders, how will they be compensated—keep their own revenues or share them with you**
8. **Need for traffic control if the crowd disrupts city traffic**
9. **Weather considerations if the concert is staged outdoors**
10. **Timing of the concert in relation to other events in the area at the time**

Student answers may vary.

Suggested Answers

Req. 3

Concert Enterprises		
Income Statement		
Three Months Ended June 30, 20XX		
Revenues:		
Ticket sales revenue		$300,000
Concession revenue		50,000
Total revenue		350,000
Expenses:		
Band expense	$100,000	
Advertising expense	50,000	
Concession expense	20,000	
Rent expense	15,000	
Security expense	10,000	
Utilities expense	3,000	
Permits expense	2,000	
Total expenses		200,000
Net income		$150,000

Concert Enterprises	
Statement of Owner's Equity	
Three Months Ended June 30, 20XX	
Last name, capital, March 31, 20XX	$ 0
Owner investment	1,000
Net income	150,000
	151,000
Drawings	(10,000)
Last name, capital, June 30, 20XX	$141,000

Suggested Answers

Req. 3 **- continued**

Concert Enterprises			
Balance Sheet			
June 30, 20XX			
ASSETS		**LIABILITIES**	
Cash	$136,000	Accounts payable	$ 7,000
Accounts receivable	8,000		
Supplies	4,000	**OWNER'S EQUITY**	
		Last name, capital	141,000
Total assets	$148,000	Total liabilities and owner's equity	$148,000

Student answers may vary.

Req. 4

Evaluate the success of the business by its

- **Net income or net loss for the period, as reported on the income statement**
- **Financial position at the end of the period, as reported on the balance sheet**

Specifically, you hope to earn a *net income*, and you hope to end the period with *assets* far in excess of your *liabilities*. Finally, you also need plenty of cash to continue in business

Communication Activity 1-1

Assets = Liabilities + Equity simply shows the resources that a business owns and the claims that others have against those resources (assets).