

Chapter 1

The role of accounting in decision making

Quick check

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

Starters

(5 min.) S1-1

Financial accounting. Financial accountants prepare information for *external* users.

(5 min.) S1-2

Profit is the increase in equity over a period of time.

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

Expenses are decreases in equity from delivering goods or services to customers.

(5 min.) S1-3

Equity is the excess of the value of the assets of a business over its liabilities.

| | Assets | = | Liabilities | + | Owners' equity | Type of transaction |
|-----|---------------------------|---|-------------------------|---|--------------------|---------------------|
| (a) | Cash \$320 | = | (not affected) | + | Capital \$320 | Revenues |
| (b) | Cash \$(125) | = | (not affected) | + | Capital \$(125) | Expense |
| (c) | Accts receivable \$440 | = | (not affected) | + | Capital \$440 | Revenues |
| (d) | (not affected) | = | Accts payable \$(65) | + | Capital \$65 | Expense |

(5 min.) S1-3

Equity is the excess of the value of the assets of a business over its liabilities.

(5 min.) S1-4

Req. 1

After this transaction (the first and only for the business), cash equals \$0 and the total assets equal \$3 800.

Req. 2

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

(5 min.) S1-5

Req. 1

The business didn't 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) | + | Bob Martin Deliveries, capital |
| (a) | \$ 500 | + | \$ 0 | = | \$ 0 | + | \$ 500 Revenues |
| (b) | 500 | + | (500) | = | 0 | + | 0 No effect on equity |

(5 min.) S1-6

The balance sheet.

The income and cash flow statements contain additional information about changes relating to assets, liabilities and equity during the accounting period.

(10 min.) S1-7**Req. 1**

| SMART TOUCH LEARNING | | | |
|-----------------------------|----------|---------------------------|----------|
| Balance sheet | | | |
| as at 21 May 2016 | | | |
| Assets | | Liabilities | |
| Cash | \$11 900 | Accounts payable | \$200 |
| Accounts receivable | 3 000 | | |
| Office supplies | 500 | Owners' Equity | |
| Land | 20 000 | Sheena Bright, capital | 35 200 |
| | | Total liabilities and | |
| Total assets | \$35 400 | owners' equity | \$35 400 |

(10 min.) S1-8**Req. 1**

| ELEGANT ARRANGEMENTS | |
|-------------------------------------|----------|
| Income statement | |
| for the year ended 31 December 2016 | |
| 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 |
| Profit | \$13 900 |

(10 min.) S1-9**Req. 1**

The operations of Elegant Arrangements in 2016 resulted in a *good year*. This can be measured by the *profit of \$13 900*.

Req. 2

Profit would be *lower by \$14 800*.

Req. 3

Profit would be lower by \$8 400.

(5–10 min.) S1-10

Req. 1

This organisation is the Australian Accounting Standards Board.

(5–10 min.) S1-11

Req. 1

- a. entity concept
- b. accounting period concept
- c. going concern assumption
- d. accrual basis of accounting

Req. 2

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

| | | | | |
|-------------------|---|-------------|---|----------------|
| Assets | = | Liabilities | + | Owner's equity |
| | | Accounts | | |
| Cash + furniture | = | payable | + | Owners' equity |
| \$8 000 + \$9 000 | = | \$6 000 | + | \$11 000 |

(5–10 min.) S1-12

Chloe's needs will best be met by establishing a company.

(5–10 min.) S1-13

Issues of environmental and economic sustainability are suggested. The environmental costs are imponderable but arguably at least as important as the economic ones. However, they are not independent, since, depending upon the seriousness with which the environmental effects are treated, the financial costs of a clean-up vary. The eventual financial costs of remedying waste pollution may be much higher than estimated, which raises the issue of intergenerational equity (the present generation passing costs on to future generations). Also, probabilities are involved. There may be no environmental pollution. If the chance of pollution is, say, 50%, do you weight the costs accordingly? Or is it best to be very conservative when considering outcomes that may have dire environmental consequences – for instance, by assuming worst financial outcome scenarios?

The obvious financial arithmetic is: The total profit for landfill project over 30 years is $30 \times \$2\text{m} - \$5\text{m} = \$25\text{m}$. If the landfill is successfully contained, this is the overall profit. If the chance of contamination is 50%, then, 'on average', the net financial benefit will be zero ($\$25\text{m} - 50\% \times \50m). However, unless contracts require Southern Waste to pay for any contamination, it will still realise a lifetime profit of \$25m, while the taxpayer or ratepayer will suffer a loss of the same amount. The financial situation will be worse and possibly more inequitable if the costs of the environmental clean-up turn out to be higher.

Exercises**(10–15 min.) E1-1**

- 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.) E1-2**Req. 1**

The *balance sheet* is prepared by summarising the assets, liabilities and owners' 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. Owners' equity is the portion of the business assets owned outright by the proprietor.

The *income statement* is prepared by summarising 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 *profit* (or *net loss*).

Req. 2

The *Australian Accounting Standards Board* is the body 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 profit and other information in the financial statements to predict future income of O'Brien's travel magazine. Therefore, the bank requires the financial statements of O'Brien's travel magazine in order to make a decision about lending money to O'Brien.

(continued) E1-2**Req. 4**

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

Req. 5

A *corporation* would be the best option.

(5–10 min.) E1-3

| | 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 owners' equity | = | $\$100\,000 - \$53\,000 = \$47\,000$ |

Req. 2

The main characteristics of a proprietorship are:

1. The life of the organisation is limited by owner's choice or death.
2. There is a single owner.
3. The owner's liability is unlimited.

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.) E1-4

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

Wording may vary.

(5–10 min.) E1-5

Req. 1

| | 1. | 2. | 3. |
|------------------------------|-----------|-----------|-----------|
| Owners' equity, 31 May 2016 | | | |
| (\$177 000 – \$122 000) | \$55 000 | \$55 000 | \$55 000 |
| Owners' investment | 6 000 | 0 | 18 000 |
| Profit for the month | 8 000 | 24 000 | 16 000 |
| | 69 000 | 79 000 | 89 000 |
| Drawings | 0 | (10 000) | (20 000) |
| Owners' equity, 30 June 2016 | | | |
| (\$213 000 – \$144 000) | \$69 000 | \$69 000 | \$69 000 |

(10–20 min.) E1-6

- a. Increase asset (Cash)
Increase capital (Owners' equity, capital)
- b. Increase asset (Accounts receivable)
Increase capital (Owners' equity, capital))
- c. Increase asset (Office furniture)
Increase liability (Accounts payable)
- 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 (Owners' equity, capital)
- h. Decrease asset (Cash)
Decrease capital (Owners' equity, capital)
- i. Increase asset (Supplies)
Decrease asset (Cash)

(10–20 min.) E1-7

Analysis of transactions

Caren Smith, GP

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

| | | | | | |
|--------------|--|--|--------------------------------------|--|--|
| \$60 400 | | | \$60 400 | | |
| Total assets | | | Total liabilities and owners' equity | | |

(10–15 min.) E1-8**Transaction description**

- Investment by the owner
- Earned revenue on credit
- Purchased equipment on credit
- Collected cash on account
- Cash purchase of equipment
- Paid on account
- Earned revenue and received cash
- Paid cash for expenses

(10 min.) E1-9**Req. 1**

The owners' equity *increased* during the year by \$4 000.

| | |
|---------------------------|--------------------------------|
| Beginning owners' equity: | \$19 000 – \$9 000 = \$10 000 |
| Ending owners' equity: | \$27 000 – \$13 000 = \$14 000 |
| Change in owners' equity: | \$14 000 – \$10 000 = \$4 000 |

Req. 2

Owners' equity can change in these three ways:

Owners' equity can *increase* through: Owner contributions
 Profit

Owners' equity can *decrease* through: Owner drawings

(10–15 min.) E1-10**Req. 1**

The profit for Australian Express Services (AES) is \$7 billion.

| | | | | |
|----------|---|----------|---|--------|
| Revenues | – | Expenses | = | Profit |
| \$21bn | – | \$14bn | = | \$7bn |

Req. 2

The owners' equity increased during the year by \$7 billion.

Req. 3

AES's performance for 2016 is *good*, because 2016 was a *profitable* year.

(30–40 min.) E1-11

Req. 1

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

| Owners' equity | |
|-------------------------|-----------------|
| Beginning balance: | \$ 16 000 |
| Investment by the owner | 0 |
| Profit | <u>20 000</u> |
| | \$36 000 |
| Drawings | <u>(19 000)</u> |
| Ending balance | <u>\$17 000</u> |

Felix earned a *profit of \$20 000*.

| Revenue | - | Profit | = | Expenses |
|-----------|---|----------|---|-----------|
| \$242 000 | - | \$20 000 | = | \$222 000 |

Req. 2

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

(10–15 min.) E1-12

| Effects on total assets | Asset account(s) affected |
|-----------------------------|------------------------------|
| Increased total assets | Cash |
| No effect on total assets | Cash and land |
| Decreased total assets | Cash |
| Increased total assets | Equipment |
| Increased total assets | Accounts receivable |
| No effect on total assets | No asset account(s) affected |
| No effect on total assets | Cash and Accounts receivable |
| Increased total assets | Cash |
| i. Decreased total assets | Cash |
| j.No effect on total assets | No asset account(s) affected |

(10–20 min.) E1-13**Req. 1**

| BLAKE INVESTIGATIVE SERVICE | | | |
|------------------------------------|----------|--------------------------------------|----------------|
| Balance sheet | | | |
| as at 30 June 2016 | | | |
| Assets | | Liabilities | |
| Cash | \$ 2 900 | Accounts payable | \$ 3 000 |
| Accounts receivable | 6 200 | Loan payable | <u>6 900</u> |
| Supplies | 900 | Total liabilities | 9 900 |
| Equipment | 13 600 | Owners' Equity | |
| | | Blake, capital | <u>13 700*</u> |
| Total assets | \$23 600 | Total liabilities and owners' equity | \$23 600 |

* Total assets – Total liabilities = Owners' equity
 \$23 600 – \$9 900 = \$13 700

Req. 2

The balance sheet reports *financial position*.

Req. 3

The *income statement*.

| Income statement for the year to 30 June 2016 (reconciliation) | | |
|---|-------|---------------|
| Service revenue | | 11 400 |
| Rent expense | 650 | |
| Salary expense | 2 000 | 2 650 |
| Profit | | 8 750 |
| Blake, capital b/f | | 4 950 |
| Blake, capital c/f | | <u>13 700</u> |

(10–15 min.) E1-14**Req. 1**

| DAVIS DESIGN STUDIOS | | |
|---------------------------------|--------------|------------------|
| Income statement | | |
| for the year ended 30 June 2016 | | |
| Revenue: | | |
| Service revenue | | \$158 300 |
| Expenses: | | |
| Salary expense | \$65 000 | |
| Rent expense | 23 000 | |
| Electricity and gas expense | 6 900 | |
| Supplies expense | 4 200 | |
| Rates expense | <u>1 500</u> | |
| Total expenses | | <u>100 600</u> |
| Profit | | <u>\$ 57 700</u> |

The result of operations is a profit of \$57 700.

Req. 2

The amount of owner drawings during the year was \$39 400.

Problems**(15–20 min.) P1-1**

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

(20–25 min.) P1-2**Req. 1**

There is no proprietorship feature that limits Andrea's personal liability. She is personally liable for the debts of the business.

Req. 2

| ANDREA SCARLETT BLUME RAY WHITE | | | |
|--|------------------|--------------------------------------|---------------|
| Balance sheet | | | |
| as at 30 September 2016 | | | |
| Assets | | Liabilities | |
| Cash | \$ 9 000 | Accounts payable | \$ 2 000 |
| Office supplies | 1 000 | Loan payable | <u>61 000</u> |
| Franchise | 23 000 | Total liabilities | 63 000 |
| Furniture | 15 000 | Owners' Equity | |
| Land | 83 000 | Andrea Scarlett, capital | 68 000* |
| Total assets | <u>\$131 000</u> | Total liabilities and owners' equity | \$131 000 |

| | | | | | |
|---|--------------|---|-------------------|---|----------------|
| * | Total assets | – | Total liabilities | = | Owners' equity |
| | \$131 000 | – | \$63 000 | = | \$68 000 |

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.) P1-3

Req. 1

Analysis of transactions

Alex Shore Accounting

| DATE | ASSETS | | | | = LIABILITIES + OWNERS' EQUITY | | |
|--------|----------------|-----------------------------|---------------|--------------------------|--------------------------------|------------------------|---------------------------------------|
| | CASH + | ACCOUNTS RECEIVABLE + | SUPPLIES + | OFFICE FURNITURE + | = ACCOUNTS PAYABLE | ALEX SHORE, CAPITAL | TYPE OF OWNERS' EQUITY TRANSACTION |
| Feb 4* | | | | | | | |
| 5 | <u>50 000</u> | | | | | <u>50 000</u> | Owners' investment |
| Bal. | 50 000 | 0 | 0 | 0 | 0 | 50 000 | |
| 6 | <u>(100)</u> | | <u>100</u> | | | | |
| | 49 900 | 0 | 100 | 0 | 0 | 50 000 | |
| 7 | | | | <u>9 700</u> | <u>9 700</u> | | |
| 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 | | <u>17 000</u> | | | | <u>17 000</u> | Service revenue |
| Bal. | 49 900 | 17 000 | 100 | 9 700 | 9 700 | 67 000 | |
| 25 | <u>(1 500)</u> | | | | | <u>(1 500)</u> | Rent expense |
| Bal. | 48 400 | 17 000 | 100 | 9 700 | 9 700 | 65 500 | |
| 28 | <u>(1 000)</u> | | | | | <u>(1 000)</u> | Owners' drawings |
| Bal. | <u>47 400</u> | <u>17 000</u> | <u>100</u> | <u>9 700</u> | <u>9 700</u> | <u>64 500</u> | |

\$74 200

\$74 200

*Not a transaction of the business.

(continued) P1-3**Req. 2**

- | | | | |
|----|----------------------|---|----------|
| a. | Total assets | = | \$74 200 |
| b. | Total liabilities | = | \$ 9 700 |
| c. | Total owners' equity | = | \$64 500 |
| d. | Profit for February | = | \$15 500 |

(20–30 min.) P1-4

Req. 1

Analysis of transactions

Angela Peters, Solicitor

| DATE | ASSETS | | | | = LIABILITIES + OWNERS' EQUITY | | |
|--------|----------------|-----------------------------|---------------|---------------|--------------------------------|------------------------------|---------------------------------------|
| | CASH + | ACCOUNTS RECEIVABLE + | SUPPLIES + | COMPUTER + | = ACCOUNTS PAYABLE | ANGELA PETERS, CAPITAL | TYPE OF OWNERS' EQUITY TRANSACTION |
| Mar 1* | | | | | | | |
| 2* | | | | | | | |
| 3* | | | | | | | |
| 5 | <u>89 000</u> | | | | | <u>89 000</u> | Owners' investment |
| Bal. | 89 000 | 0 | 0 | 0 | 0 | 89 000 | |
| 7 | <u>(400)</u> | | <u>400</u> | | | | |
| Bal. | 88 600 | 0 | 400 | 0 | 0 | 89 000 | |
| 9 | | | | <u>9 300</u> | <u>9 300</u> | | |
| Bal. | 88 600 | 0 | 400 | 9 300 | 9 300 | 89 000 | |
| 23 | | <u>13 500</u> | | | | <u>13 500</u> | Service revenue |
| Bal. | 88 600 | 13 500 | 400 | 9 300 | 9 300 | 102 500 | |
| 30 | <u>(1 200)</u> | | | | | <u>(1 200)</u> | Electricity and gas expense |
| Bal. | 87 400 | 13 500 | 400 | 9 300 | 9 300 | 101 300 | |
| 31 | <u>(2 000)</u> | | | | | <u>(2 000)</u> | Owners' drawing |
| Bal. | <u>85 400</u> | <u>13 500</u> | <u>400</u> | <u>9 300</u> | <u>9 300</u> | <u>99 300</u> | |
| | \$108 600 | | | | \$108 600 | | |

*Not a transaction of the business.

(continued) P1-4

Req. 2

| | | | |
|----|----------------------|---|-----------|
| a. | Total assets | = | \$108 600 |
| b. | Total liabilities | = | \$ 9 300 |
| c. | Total owners' equity | = | \$ 99 300 |
| d. | Profit for March | = | \$ 12 300 |

Req. 3

Angela Peters' first month of operations was *good* because the business *earned a profit of \$12 300*.

(20–25 min.) P1-5

| Date | Transaction type | Account | Increase/ Decrease | Amount |
|--------|-----------------------|------------------------------|-----------------------|---------|
| Oct. 4 | Owners' 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 | Owners' 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 | Owners' drawing | Zelinsky, capital Cash | Decrease Decrease | \$5 700 |

(15–25 min.) P1-6

Analysis of transactions

Facelift

| DATE | ASSETS | | | | = LIABILITIES + OWNERS' EQUITY | | |
|------|----------------|-----------------------------|---------------|---------------|--------------------------------|-------------------------------|---------------------------------------|
| | CASH + | ACCOUNTS RECEIVABLE + | SUPPLIES + | LAND + | = ACCOUNTS PAYABLE | SHEILAH CRONJE, CAPITAL | TYPE OF OWNERS' EQUITY TRANSACTION |
| Bal. | 2 200 | 1 900 | 0 | 14 000 | 8 000 | 10 100 | |
| a | <u>13 000</u> | | | | | <u>13 000</u> | Owners' investment |
| Bal. | 15 200 | 1 900 | 0 | 14 000 | 8 000 | 23 100 | |
| b | <u>900</u> | | | | | <u>900</u> | Service revenue |
| Bal. | 16 100 | 1 900 | 0 | 14 000 | 8 000 | 24 000 | |
| c | <u>(8 000)</u> | | | | <u>(8 000)</u> | | |
| Bal. | 8 100 | 1 900 | 0 | 14 000 | 0 | 24 000 | |
| d | | | <u>600</u> | | <u>600</u> | | |
| Bal. | 8 100 | 1 900 | 600 | 14 000 | 600 | 24 000 | |
| e | <u>700</u> | <u>(700)</u> | | | | | |
| Bal. | 8 800 | 1 200 | 600 | 14 000 | | 24 000 | |
| f | <u>1 600</u> | | | | 600 | <u>1 600</u> | Owners' investment |
| Bal. | 10 400 | 1 200 | 600 | 14 000 | 600 | 25 600 | |
| g | | <u>5 500</u> | | | | <u>5 500</u> | Service revenue |
| Bal. | 10 400 | 6 700 | 600 | 14 000 | 600 | 31 100 | |
| h-1 | <u>(1 200)</u> | | | | | <u>(1 200)</u> | Rent expense |
| h-2 | <u>(600)</u> | | | | | <u>(600)</u> | Advertising expense |
| Bal. | 8 600 | 6 700 | 600 | 14 000 | 600 | 29 300 | |
| i | | | <u>(110)</u> | | <u>(110)</u> | | |
| Bal. | 8 600 | 6 700 | 490 | 14 000 | 490 | 29 300 | |
| j | <u>(1 000)</u> | | | | | <u>(1 000)</u> | Owners' drawings |
| Bal. | <u>7 600</u> | <u>6 700</u> | <u>490</u> | <u>14 000</u> | <u>490</u> | <u>28 300</u> | |
| | \$28 790 | | | | \$28 790 | | |

(20–30 min.) P1-7**Req. 1**

| GATE CITY ANSWERING SERVICE | |
|------------------------------------|------------------|
| Income statement | |
| for the year ended 30 June 2016 | |
| Revenue: | |
| Service revenue | \$192 000 |
| Expenses: | |
| Salary expense | \$65 000 |
| Advertising expense | 15 000 |
| Rent expense | 13 000 |
| Interest expense | 7 000 |
| Rates expense | 2 600 |
| Insurance expense | <u>2 500</u> |
| Total expenses | <u>105 100</u> |
| Profit | <u>\$ 86 900</u> |

Req. 2

| GATE CITY ANSWERING SERVICE | |
|---------------------------------------|------------------|
| Statement of changes in equity | |
| for the year ended 30 June 2016 | |
| Walters, capital, 30 June 2015 | \$54 000 |
| Owner investment | 28 000 |
| Profit | <u>86 900</u> |
| | 168 900 |
| Less: Drawings | <u>(30 000)</u> |
| Walters, capital, 30 June 2016 | <u>\$138 900</u> |

Req. 3

| GATE CITY ANSWERING SERVICE | | | |
|------------------------------------|-------------------|-----------------------|------------------|
| Balance sheet | | | |
| as at 30 June 2016 | | | |
| Assets | | Liabilities | |
| Cash | \$ 3 000 | Accounts payable | \$11 000 |
| Accounts receivable | 1 000 | Salary payable | 1 300 |
| Supplies | 10 000 | Bill payable | <u>32 000</u> |
| Equipment | 16 000 | Total liabilities | \$44 300 |
| Building | 145 200 | Owners' equity | |
| Land | 8 000 | Walters, capital | <u>138 900</u> |
| | <u> </u> | Total liabilities and | |
| Total assets | <u>\$183 200</u> | owners' equity | <u>\$183 200</u> |

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 owners' equity at the end of the year was \$138 900.

(20–30 min.) P1-8**a**

| STUDIO PHOTOGRAPHS | | | |
|---------------------------------|--------------|--|-----------------|
| Income statement | | | |
| for the year ended 30 June 2016 | | | |
| Revenue: | | | |
| Service revenue | | | \$80 000 |
| Expenses: | | | |
| Salary expense | \$25 000 | | |
| Insurance expense | 8 000 | | |
| Advertising expense | <u>3 000</u> | | <u>36 000</u> |
| Total expenses | | | <u>\$44 000</u> |
| Profit | | | \$80 000 |

(continued) P1-8**b**

| STUDIO PHOTOGRAPHS | |
|---------------------------------------|-----------------|
| Statement of changes in equity | |
| for the year ended 30 June 2016 | |
| Ansel, capital, 30 June 2015 | \$16 000 |
| Owner investment | 29 000 |
| Profit | <u>44 000</u> |
| | 89 000 |
| Less: Drawings | <u>(13 000)</u> |
| Ansel, capital, 30 June 2016 | <u>\$76 000</u> |

c

| STUDIO PHOTOGRAPHS | | | |
|---------------------------|-----------------|-----------------------|-----------------|
| Balance sheet | | | |
| as at 30 June 2016 | | | |
| Assets | | Liabilities | |
| Cash | \$37 000 | Accounts payable | \$ 7 000 |
| Accounts receivable | 8 000 | Bill payable | <u>12 000</u> |
| Equipment | 50 000 | Total liabilities | 19 000 |
| | | Owners' equity | |
| | | Ansel, capital | <u>76 000</u> |
| | | Total liabilities and | |
| Total assets | <u>\$95 000</u> | owners' equity | <u>\$95 000</u> |

(20–30 min.) P1-9**Req. 1**

| GREENER LANDSCAPING | | | |
|----------------------------|-------------------|-----------------------|-----------------|
| Balance sheet | | | |
| as at 30 June 2016 | | | |
| Assets | | Liabilities | |
| Cash | \$ 4 900 | Accounts payable | \$ 2 700 |
| Accounts receivable | 2 200 | Loan payable | <u>24 200</u> |
| Office supplies | 600 | Total liabilities | 26 900 |
| Office furniture | 6 100 | | |
| Land | 34 200 | | |
| | | Owners' equity | |
| | <u> </u> | Tum, capital | <u>21 100*</u> |
| | | Total liabilities and | |
| Total assets | <u>\$95 000</u> | owners' equity | <u>\$48 000</u> |

*\$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*.

Continuing exercise

(10–15 min.) E1-15

Analysis of transactions

Lawlor Lawn Service

| DATE | ASSETS | | | | = LIABILITIES + OWNERS' EQUITY | | |
|-------|--------------|-----------------------------|-----------------------|----------------|--------------------------------|--------------------|---------------------------------------|
| | CASH + | ACCOUNTS RECEIVABLE + | LAWN SUPPLIES + | EQUIPMENT + | = ACCOUNTS PAYABLE | LAWLOR, CAPITAL | TYPE OF OWNERS' EQUITY TRANSACTION |
| May 1 | <u>1 700</u> | | | | | <u>1 700</u> | Owners' investment |
| Bal. | 1 700 | 0 | 0 | 0 | 0 | 1 700 | |
| 3 | | | | <u>1 440</u> | <u>1 440</u> | | |
| Bal. | 1 700 | 0 | 0 | 1 440 | 1 440 | 1 700 | |
| 5 | <u>(30)</u> | | | | | <u>(30)</u> | Fuel expense |
| Bal. | 1 670 | 0 | 0 | 1 440 | 1 440 | 1 670 | |
| 6 | | <u>150</u> | | | | <u>150</u> | Service revenue |
| Bal. | 1 670 | 150 | 0 | 1 440 | 1 440 | 1 820 | |
| 8 | <u>(150)</u> | | <u>150</u> | | | | |
| Bal. | 1 520 | 150 | 150 | 1 440 | 1 440 | 1 820 | |
| 17 | <u>800</u> | | | | | <u>800</u> | Service revenue |
| Bal. | 2 320 | 150 | 150 | 1 440 | 1 440 | 2 620 | |
| 31 | <u>100</u> | <u>(100)</u> | | | | | |
| Bal. | <u>2 420</u> | <u>50</u> | <u>150</u> | <u>1 440</u> | <u>1 440</u> | <u>2 620</u> | |
| | \$4 060 | | | \$4 060 | | | |

Continuing problem

(20–25 min.) P1-10

Req. 1, 2

**Analysis of transactions
Draper Consulting**

| DATE | ASSETS | | | | | = LIABILITIES + OWNERS' EQUITY | | | |
|--------|----------------|-----------------------------|---------------|----------------|--------------|--------------------------------|----------------------------|---------------------------------------|--|
| | CASH + | ACCOUNTS RECEIVABLE + | SUPPLIES + | EQUIPMENT + | FURNITURE | = ACCOUNTS PAYABLE | CARL DRAPER, CAPITAL | TYPE OF OWNERS' EQUITY TRANSACTION | |
| Dec. 2 | <u>18 000</u> | — | — | — | — | — | <u>18 000</u> | Owners' investment | |
| Bal. | 18 000 | 0 | 0 | 0 | 0 | 0 | 18 000 | | |
| 2 | <u>(550)</u> | — | — | — | — | — | <u>(550)</u> | Rent expense | |
| Bal. | 17 450 | 0 | 0 | 0 | 0 | 0 | 17 450 | | |
| 3 | <u>(1 800)</u> | — | — | <u>1 800</u> | — | — | — | | |
| Bal. | 15 650 | 0 | 0 | 1 800 | 0 | 0 | 17 450 | | |
| 4 | — | — | — | — | <u>4 200</u> | <u>4 200</u> | — | | |
| Bal. | 15 650 | 0 | 0 | 1 800 | <u>4 200</u> | <u>4 200</u> | 17 450 | | |
| 5 | — | — | <u>900</u> | — | — | <u>900</u> | — | | |
| Bal. | 15 650 | 0 | 900 | 1 800 | 4 200 | 5 100 | 17 450 | | |
| 9 | — | <u>1 500</u> | — | — | — | — | <u>1 500</u> | Service revenue | |
| Bal. | 15 650 | 1 500 | 900 | 1 800 | 4 200 | 5 100 | 18 950 | | |
| 12 | <u>(250)</u> | — | — | — | — | — | <u>(250)</u> | Rates expense | |
| Bal. | 15 400 | 1 500 | 900 | 1 800 | 4 200 | 5 100 | 18 700 | | |
| 18 | <u>1 100</u> | — | — | — | — | — | <u>1 100</u> | Service revenue | |
| Bal. | <u>16 500</u> | <u>1 500</u> | <u>900</u> | <u>1 800</u> | <u>4 200</u> | <u>5 100</u> | <u>19 800</u> | | |
| | \$24 900 | | | | | \$24 900 | | | |

(continued) P1-10**Req. 3**

| DRAPER CONSULTING | | |
|-------------------------------------|------------|----------------|
| Income statement | | |
| for the year ended 18 December 2016 | | |
| Revenue: | | |
| Service revenue (\$1 500 + \$1 100) | | \$2 600 |
| Expenses: | | |
| Rent expense | \$550 | |
| Rates expense | <u>250</u> | |
| Total expenses | | <u>800</u> |
| Profit | | <u>\$1 800</u> |

Req. 4

| DRAPER CONSULTING | |
|---------------------------------------|-----------------|
| Statement of owners' equity | |
| for the year ended 31 December 2016 | |
| Carl Draper, capital, 1 December 2016 | \$ 0 |
| Owner investment | 18 000 |
| Profit | <u>1 800</u> |
| | 19 800 |
| Less: Drawings | <u>0</u> |
| Retained earnings, 18 December 2016 | <u>\$19 800</u> |

Req. 5

| DRAPER CONSULTING | | | |
|--------------------------|-------------------|-----------------------|-----------------|
| Balance sheet | | | |
| as at 18 December 2016 | | | |
| Assets | | Liabilities | |
| Cash | \$ 16 500 | Accounts payable | <u>\$ 5 100</u> |
| Accounts receivable | 1 500 | Total liabilities | 5 100 |
| Supplies | 900 | | |
| Equipment | 1 800 | | |
| Furniture | 4 200 | | |
| | <u> </u> | Owners' equity | |
| Total assets | <u>\$24 900</u> | Carl Draper, capital | <u>19 800</u> |
| Cash | \$ 16 500 | Total liabilities and | |
| Accounts receivable | 1 500 | owners' equity | <u>\$24 900</u> |

Decision cases**Case 1-1****Req. 1 Assets**

Pancho's Pizza \$46 000, Keith's Kebabs \$50 000

Req. 2 Liabilities

Pancho's Pizza \$4 000, Keith's Kebabs \$20 000

Req. 3 Owners' equity

Pancho's Pizza \$42 000, Keith's Kebabs \$30 000

Req. 4 Revenue

Pancho's Pizza \$70 000, Keith's Kebabs \$106 000

Req. 5 Profitable (net income)

Pancho's Pizza \$26 000, Keith's Kebabs \$18 000

(continued) Case 1-1**Req. 6**

There is 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

Pancho's Pizza looks better financially because:

- a. It earned more net income on less total revenue.
- b. It owes less and has more owners' equity.

Case 1-2**Req. 1**

The banker would *not* congratulate the Gulgongs on their profit because they haven't measured it properly. In fact, they have *no profit* at all. Their accounting errors include the following:

1. The amount of cash in the bank does *not* measure profit. 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 Tanilba Bay Didgeridoo Bed and Breakfast 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 Tanilba Bay Didgeridoo Bed and Breakfast hasn't had any expenses yet.

(continued) Case 1-2

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

| TANILBA BAY DIDGERIDOO BED AND BREAKFAST | | | |
|---|------------------|-----------------------|-----------------------------|
| Balance sheet | | | |
| as at 30 June 2015 | | | |
| Assets | | Liabilities | |
| Cash | \$ 38 000 | Bank loan payable | 100 000 |
| Computer | 2 000 | | |
| Kitchen equipment | 10 000 | Owners' equity | |
| Furniture | 20 000 | Gulgongs, capital | 100 000 |
| Building (\$80 000 + \$50 000) | <u>130 000</u> | Total liabilities and | <u> </u> |
| Total assets | <u>\$200 000</u> | owners' equity | <u>\$200 000</u> |

Focus on ethics

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, transferring the land violates Australian accounting standards and basic accounting principles because it is a sham transaction that is not at arm's length. The second issue is that of 'shaving expenses'. If 'shaving' simply means reducing expenses, this isn't 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 disregards the accounting entity and period concepts, and the transaction would be a sham. It would be dishonest and unethical. The proposal to 'shave expenses', meaning reclassifying expenses, violates conservatism in treating expenses as assets. Many instances of accounting fraud involve this kind of mismeasurement.

Fraud case

Req. 1

The proposed action would increase profit 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

The answer to this question will depend upon the year of the financial statements used.