Chapter 1

Accounting in Business

QUESTIONS

1. **The purpose of accounting is to provide decision makers with relevant and reliable information to help them make better decisions. Examples include information for people making investments, loans, and business plans.**
2. **Technology reduces the time, effort, and cost of recordkeeping. There is still a demand for people who can design accounting systems, supervise their operation, analyze complex transactions, and interpret reports. Demand also exists for people who can effectively use computers to prepare and analyze accounting reports. Technology will never substitute for qualified people with abilities to prepare, use, analyze, and interpret accounting information.**
3. **External users and their uses of accounting information include: (a) lenders, to measure the risk and return of loans; (b) shareholders, to assess whether to buy, sell, or hold their shares; (c) directors, to oversee their interests in the organization; (d) employees and labor unions, to judge the fairness of wages and assess future employment opportunities; and (e) regulators, to determine whether the organization is complying with regulations. Other users are voters, legislators, government officials, contributors to nonprofits, suppliers and customers.**
4. **Business owners and managers use accounting information to help answer questions such as: What resources does an organization own? What debts are owed? How much income is earned? Are expenses reasonable for the level of sales? Are customers' accounts being promptly collected?**
5. **Service businesses include: Standard and Poor's, Dun & Bradstreet, Merrill Lynch, Southwest Airlines, CitiCorp, Humana, Charles Schwab, and Prudential. Businesses offering products include Nike, Reebok, Gap, Apple Computer, Ford Motor Co., Philip Morris, Coca-Cola, Best Buy, and Circuit City.**
6. **The internal role of accounting is to serve the organization's internal operating functions. It does this by providing useful information for internal users in completing their tasks more effectively and efficiently. By providing this information, accounting helps the organization reach its overall goals.**
7. **Accounting professionals offer many services including auditing, management advice, tax planning, business valuation, and money management.**
8. **Marketing managers are likely interested in information such as sales volume, advertising costs, promotion costs, salaries of sales personnel, and sales commissions.**

9. **Accounting is described as a service activity because it serves decision makers by providing information to help them make better business decisions.**

10. **Some accounting-related professions include consultant, financial analyst, underwriter, financial planner, appraiser, FBI investigator, market researcher, and system designer.**

11. **Ethics rules require that auditors avoid auditing clients in which they have a direct investment, or if the auditor's fee is dependent on the figures in the client's reports. This will help prevent others from doubting the quality of the auditor's report.**

12. **In addition to preparing tax returns, tax accountants help companies and individuals plan future transactions to minimize the amount of tax to be paid. They are also actively involved in estate planning and in helping set up organizations. Some tax accountants work for regulatory agencies such as the IRS or the various state departments of revenue. These tax accountants help to enforce tax laws.**

13. **The objectivity concept means that financial statement information is supported by independent, unbiased evidence other than someone's opinion or imagination. This concept increases the reliability and verifiability of financial statement information.**

14. **This treatment is justified by both the cost principle and the going-concern assumption.**

15. **The revenue recognition principle provides guidance for managers and auditors so they know when to recognize revenue. If revenue is recognized too early, the business looks more profitable than it is. On the other hand, if revenue is recognized too late the business looks less profitable than it is. This principle demands that revenue be recognized when it is both earned (when service or product provided) and can be measured reliably. The amount of revenue should equal the value of the assets received or expected to be received from the business's operating activities covering a specific time period.**

16. **Business organizations can be organized in one of three basic forms: sole proprietorship, partnership, or corporation. These forms have implications for legal liability, taxation, continuity, number of owners, and legal status as follows:**

	Proprietorship	*Partnership*	*Corporation*
Business entity	**yes**	**yes**	**yes**
Legal entity	**no**	**no**	**yes**
Limited liability	**no***	**no***	**yes**
Unlimited life	**no**	**no**	**yes**
Business taxed	**no**	**no**	**yes**
One owner allowed	**yes**	**no**	**yes**

***Proprietorships and partnerships that are set up as LLCs provide limited liability.**

17. **(a) Assets are resources owned or controlled by a company that are expected to yield future benefits. (b) Liabilities are creditors' claims on assets that reflect obligations to provide assets, products or services to others. (c) Equity is the owner's claim on assets and is equal to assets minus liabilities. (d) Net assets refer to equity.**

18. **Equity is increased by investments from the owner and by net income (which is the excess of revenues over expenses). It is decreased by withdrawals by the owner and by a net loss (which is the excess of expenses over revenues).**

19. Accounting principles consist of (a) *general* and (b) *specific* principles. General principles are the basic assumptions, concepts, and guidelines for preparing financial statements. They stem from long-used accounting practices. Specific principles are detailed rules used in reporting on business transactions and events. They usually arise from the rulings of authoritative and regulatory groups such as the Financial Accounting Standards Board or the Securities and Exchange Commission.

20. Revenue (or sales) is the amount received from selling products and services.

21. Net income (also called income, profit or earnings) equals revenues minus expenses (if revenues exceed expenses). Net income increases equity. If expenses exceed revenues, the company has a net loss. Net loss decreases equity.

22. The four basic financial statements are: income statement, statement of owner's equity, balance sheet, and statement of cash flows.

23. An income statement reports a company's revenues and expenses along with the resulting net income or loss over a period of time.

24. Rent expense, utilities expense, administrative expenses, advertising and promotion expenses, maintenance expense, and salaries and wages expenses are some examples of business expenses.

25. The statement of owner's equity explains the changes in equity from net income or loss, and from any owner contributions and withdrawals over a period of time.

26. The balance sheet describes a company's financial position (types and amounts of assets, liabilities, and equity) at a point in time.

27. The statement of cash flows reports on the cash inflows and outflows from a company's operating, investing, and financing activities.

28. Return on assets, also called return on investment, is a profitability measure that is useful in evaluating management, analyzing and forecasting profits, and planning activities. It is computed as net income divided by the average total assets. For example, if we have an average annual balance of $100 in a bank account and it earns interest of $5 for the year, then our return on assets is $5 / $100 or 5%. The return on assets is a popular measure for analysis because it allows us to compare companies of different sizes and in different industries.

29[A]. Return refers to income, and risk is the uncertainty about the return we expect to make. The lower the risk of an investment, the lower the expected return. For example, savings accounts pay a low return because of the low risk of a bank not returning the principal with interest. Higher risk implies higher, but riskier, expected returns.

30[B]. Organizations carry out three major activities: financing, investing, and operating. Financing provides the means used to pay for resources. Investing refers to the acquisition and disposing of resources necessary to carry out the organization's plans. Operating activities are the actual carrying out of these plans. *(Planning is the glue that connects these activities, including the organization's ideas, goals and strategies.)*

31[B]. An organization's financing activities (liabilities and equity) pay for investing activities (assets). An organization cannot have more or less assets than its liabilities and equity combined and, similarly, it cannot have more or less liabilities and equity than its total assets. This means: assets = liabilities + equity. This relation is called the accounting equation (also called the *balance sheet equation*), and it applies to organizations at all times.

32. The dollar amounts in Research In Motion's financial statements are rounded to the nearest thousand ($1,000). Research In Motion's consolidated statement of earnings (or income statement) covers the fiscal year (consisting of 52 weeks) ended February 27, 2010. Research In Motion also reports comparative income statements for the previous two years (consisting of 52 weeks).

33. At September 26, 2009, Apple had ($ in millions) assets of $47,501, liabilities of $15,861, and equity of $31,640.

34. Confirmation of Nokia's accounting equation follows (numbers in EUR millions):

Assets	=	Liabilities	+	Equity
35,738	=	20,989	+	14,749

35. The independent auditor for Palm, Inc., is Deloitte and Touché LLP. The auditor expressly states that "our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits." The auditor also states that "these consolidated financial statements and financial statement schedule are the responsibility of the Company's management."

QUICK STUDIES

Quick Study 1-1

(a) and (b)

GAAP:	**Generally Accepted Accounting Principles**
Importance:	**GAAP are the rules that specify acceptable accounting practices.**
SEC:	**Securities and Exchange Commission**
Importance:	**The SEC is charged by Congress to set reporting rules for organizations that sell ownership shares to the public. The SEC delegates part of this responsibility to the FASB.**
FASB:	**Financial Accounting Standards Board**
Importance:	**FASB is an independent group of full-time members who are responsible for setting accounting rules.**
IASB:	**International Accounting Standards Board.**
Importance:	**Its purpose is to issue standards that identify preferred practices in the desire of harmonizing accounting practices across different countries. The vast majority of countries and financial exchanges support its activities and objectives.**
IFRS:	**International Financial Reporting Standards.**
Importance:	**A global set of accounting standards issued by the IASB. Many countries require or permit companies to comply with IFRS in preparing their financial statements. The FASB is undergoing a process with the IASB to converge GAAP and IFRS and to create a single set of accounting standards for global use.**

Quick Study 1-2

Internal controls serve several purposes:

- **They involve monitoring an organization's activities to promote efficiency and to prevent wrongful use of its resources.**
- **They help ensure the validity and credibility of accounting reports.**
- **They are often crucial to effective operations and reliable reporting.**

More generally, the absence of internal controls can adversely affect the effectiveness of domestic and global financial markets.

Examples of internal controls include cash registers with internal tapes or drives, scanners at doorways to identify tagged products, overhead video cameras, security guards, and many others.

Quick Study 1-3

a.	E	g.	E
b.	I	h.	E
c.	E	i.	E
d.	I	j.	I
e.	E	k.	E
f.	E	l.	E

Quick Study 1-4

Accounting professionals practice in at least four main areas. These four areas, along with a listing of some work opportunities in each, are:

1. Financial accounting
   - Preparation
   - Analysis
   - Auditing (external)
   - Consulting
   - Investigation
2. Managerial accounting
   - Cost accounting
   - Budgeting
   - Auditing (internal)
   - Consulting
3. Tax accounting
   - Preparation
   - Planning
   - Regulatory
   - Consulting
   - Investigation
4. Accounting-related
   - Lending
   - Consulting
   - Analyst
   - Investigator
   - Appraiser

Quick Study 1-5

The choice of an accounting method when more than one alternative method is acceptable often has ethical implications. This is because accounting information can have major impacts on individuals' (and firms') well-being.

To illustrate, many companies base compensation of managers on the amount of reported income. When the choice of an accounting method affects the amount of reported income, the amount of compensation is also affected. Similarly, if workers in a division receive bonuses based on the division's income, its computation has direct financial implications for these individuals.

Quick Study 1-6

a. Cost principle (also called historical cost)
b. Business entity assumption
c. Revenue recognition principle

Quick Study 1-7

Assets	=	Liabilities	+	Equity
$40,000		(a) $30,000		$10,000
$55,000		(b) $27,500		(b) $27,500

Quick Study 1-8

Assets	=	Liabilities	+	Equity
$30,000		(a) $10,000		$20,000
(b) $80,000		$ 50,000		$30,000
$90,000		$ 10,000		(c) $80,000

Quick Study 1-9

(a) Examples of business transactions that are measurable include:
- **Selling products and services.**
- **Collecting funds from dues, taxes, contributions, or investments.**
- **Borrowing money.**
- **Purchasing products and services.**

(b) Examples of business events that are measurable include:
- **Decreases in the value of securities (assets).**
- **Bankruptcy of a customer owing money.**
- **Technological advances rendering patents (or other assets) worthless.**
- **An "act of God" (casualty) that destroys assets.**

Quick Study 1-10

a. For September 26, 2009, the account and its dollar amount (in millions) for Apple are:

(1)	Assets	=	$47,501
(2)	Liabilities	=	$ 15,861
(3)	Equity	=	$ 31,640

b. Using Apple's amounts from (a) we verify that (in millions):

Assets	=	Liabilities	+	Equity
$47,501	=	$ 15,861	+	$ 31,640

Quick Study 1-11

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Average total assets}} = \frac{\$2{,}260}{\$42{,}744} = \underline{\underline{5.3\%}}$$

Interpretation: Its return of 5.3% is slightly above the 5% of its competitors. Home Depot's performance can be rated as above average.

Quick Study 1-12

[Code: Income statement (I), Balance sheet (B), Statement of owner's equity (OE), or Statement of cash flows (CF).]

a.	B	d.	B	g.	B
b.	I	e.	OE (and CF*)	h.	CF
c.	B	f.	I	i.	CF

*The more advanced student might know that this item would also appear in CF.

Quick Study 1-13 (10 minutes)

a. International Financial Reporting Standards (IFRS)

b. Convergence desires to achieve a single set of accounting standards for global use.

c. The SEC roadmap proposes that large U.S. companies adopt IFRS by 2014.

EXERCISES

Exercise 1-1 (10 minutes)

I	1.	Determining employee tasks behind a service
I	2.	Establishing revenues generated from a product
R	3.	Maintaining a log of service costs
R	4.	Measuring the costs of a product
C	5.	Preparing financial statements
C	6.	Analyzing and interpreting reports
C	7.	Presenting financial information

Exercise 1-2 (20 minutes)

Part A.

1.	**E**	**5.**	**I**
2.	**E**	**6.**	**I**
3.	**E**	**7.**	**I**
4.	**I**	**8.**	**I**

Part B.

1.	**I**	**5.**	**I**
2.	**E**	**6.**	**E**
3.	**I**	**7.**	**I**
4.	**E**		

Exercise 1-3 (10 minutes)

1.	**B**	**5.**	**A**
2.	**C**	**6.**	**A**
3.	**C**	**7.**	**B**
4.	**B**	**8.**	**A**

Exercise 1-4 (20 minutes)

a. Situations involving ethical decision making in coursework include performing independent work on examinations and individually completing assignments/projects. It can also extend to promptly returning reference materials so others can enjoy them, and to properly preparing for class to efficiently use the time and question period to not detract from others' instructional benefits.

b. Auditing professionals with competing audit clients are likely to learn valuable information about each client that the other clients would benefit from knowing. In this situation the auditor must take care to maintain the confidential nature of information about each client.

c. Accounting professionals who prepare tax returns can face situations where clients wish to claim deductions they cannot substantiate. Also, clients sometimes exert pressure to use methods not allowed or questionable under the law. Issues of confidentiality also arise when these professionals have access to clients' personal records.

d. Managers face several situations demanding ethical decision making in their dealings with employees. Examples include fairness in performance evaluations, salary adjustments, and promotion recommendations. They can also include avoiding any perceived or real harassment of employees by the manager or any other employees. It can also include issues of confidentiality regarding personal information known to managers.

Exercise 1-5 (10 minutes)

1.	G	4.	F
2.	A	5.	D
3.	C		

Exercise 1-6 (10 minutes)

Code		Description	Principle or Assumption
G	1.	Revenue is recorded only when the earnings process is complete.	Revenue recognition principle
A	2.	Information is based on actual costs incurred in transactions.	Cost principle
C	3.	Usually created by a pronouncement from an authoritative body.	Specific accounting principle
H	4.	Financial statements reflect the assumption that the business continues operating.	Going-concern assumption
D	5.	A company reports details behind financial statements that would impact users' decisions.	Full disclosure principle
B	6.	A company records the expenses incurred to generate the revenues reported.	Matching (expense recognition) principle
E	7.	Derived from long-used and generally accepted accounting practices.	General accounting principle
F	8.	Every business is accounted for separately from its owner or owners.	Business entity assumption`

Exercise 1-7 (10 minutes)

a. Corporation

b. Corporation

c. Sole proprietorship

d. Corporation

e. Partnership

f. Sole proprietorship

g. Sole proprietorship

Exercise 1-8 (20 minutes)

a. Using the accounting equation:

Assets	=	Liabilities	+	Equity
$123,000	=	$53,000	+	?

Thus, equity = $70,000

b. Using the accounting equation at the *beginning* of the year:

Assets	=	Liabilities	+	Equity
$200,000	=	?	+	$150,000

Thus, *beginning* liabilities = $50,000

Using the accounting equation at the *end* of the year:

Assets	=	Liabilities	+	Equity
$200,000 + $70,000	=	$50,000 + $30,000	+	?
$270,000	=	$80,000	+	?

Thus, *ending* equity = $190,000

Alternative approach to solving part (b):
ΔAssets($70,000) = ΔLiabilities($30,000) + ΔEquity(?)
where "Δ" refers to "change in."
***Thus: Ending* Equity = $150,000 + $40,000 = $190,000**

c. Using the accounting equation at the *end* of the year:

Assets	=	Liabilities	+	Equity
$180,000	=	$60,000 - $10,000	+	?
$180,000	=	$50,000	+	$130,000

Using the accounting equation at the *beginning* of the year:

Assets	=	Liabilities	+	Equity
$180,000 - $80,000	=	$60,000	+	?
$100,000	=	$60,000	+	?

Thus: *Beginning* Equity = $40,000

Exercise 1-9 (10 minutes)

Assets	=	Liabilities	+	Equity
(a) $95,000	=	$30,000	+	$65,000
$89,000	=	$22,000	+	(b) 67,000
$132,000	=	(c) $112,000	+	$20,000

Exercise 1-10 (15 minutes)

Examples of transactions that fit each case include:

a. **Business acquires office supplies (or some other asset) for cash (or some other asset). Another example is collection of cash from a receivable.**

b. **Business pays an account payable (or some other liability) with cash (or some other asset).**

c. **Business signs a note payable to extend the due date on an account payable.**

d. **Business purchases equipment (or some other asset) on credit.**

e. **Cash withdrawals (or some other asset) paid to the owner(s) of the business; OR, the business incurs an expense paid in cash.**

f. **Business incurs an expense that is not yet paid (for example, when employees earn wages that are not yet paid).**

g. **Owner(s) invest cash (or some other asset) in the business; OR, the business earns revenue and accepts cash (or another asset).**

Exercise 1-11 (30 minutes)

	Cash	+	Accounts Receivable	+	Equip-ment	=	Accounts Payable	+	L. Gold, Capital	–	L. Gold, Withdrawals	+	Revenues	–	Expenses
a.	+$50,000			+	$10,000	=		+	$60,000						
b.	– 1,600													–	$1,600
Bal.	48,400	+		+	10,000	=		+	60,000					–	1,600
c.				+	12,000		+$12,000								
Bal.	48,400	+		+	22,000	=	12,000	+	60,000					–	1,600
d.	+ 2,000											+	$2,000		
Bal.	50,400	+		+	22,000	=	12,000	+	60,000			+	2,000	–	1,600
e.		+	$7,000									+	7,000		
Bal.	50,400	+	7,000	+	22,000	=	12,000	+	60,000			+	9,000	–	1,600
f.	– 8,000			+	8,000										
Bal.	42,400	+	7,000	+	30,000	=	12,000	+	60,000			+	9,000	–	1,600
g.	– 2,400													–	2,400
Bal.	40,000	+	7,000	+	30,000	=	12,000	+	60,000			+	9,000	–	4,000
h.	+ 5,000	-	5,000												
Bal.	45,000	+	2,000	+	30,000	=	12,000	+	60,000			+	9,000	–	4,000
i.	– 12,000						– 12,000								
Bal.	33,000	+	2,000	+	30,000	=	0	+	60,000			+	9,000	–	4,000
j.	– 500									–	$500				
Bal.	$32,500	+	$2,000	+	$30,000	=	$ 0	+	$60,000	–	$500	+	$9,000	–	$4,000

Exercise 1-12 (20 minutes)

a. Started the business with the owner investing $20,000 cash.

b. Purchased office supplies for $1,500 by paying $1,000 cash and putting the remaining $500 balance on credit.

c. Purchased office furniture by paying $8,000 cash.

d. Billed a customer $3,000 for services earned.

e. Provided services for $500 cash.

Exercise 1-13 (15 minutes)

a. **Purchased land for $2,000 cash.**

b. **Purchased $500 of office supplies on credit.**

c. **Billed a client $950 for services provided.**

d. **Paid the $500 account payable created by the credit purchase of office supplies in transaction *b*.**

e. **Collected $950 cash for the billing in transaction *c*.**

Exercise 1-14 (15 minutes)

REAL SOLUTIONS
Income Statement
For Month Ended October 31

Revenues:		
Consulting fees earned		$15,000
Expenses:		
Salaries expense	$6,000	
Rent expense	2,550	
Miscellaneous expenses	680	
Telephone expense	660	
Total expenses		9,890
Net income		$ 5,110

Exercise 1-15 (15 minutes)

REAL SOLUTIONS
Statement of Owner's Equity
For Month Ended October 31

N. King, Capital, Oct. 1	$ 0
Add: Investments by owner	74,000
Net income (from Exercise 1-14)	5,110
	79,110
Less: Withdrawals by owner	3,360
N. King , Capital, Oct. 31	$75,750

Exercise 1-16 (15 minutes)

REAL SOLUTIONS
Balance Sheet
October 31

Assets		*Liabilities*	
Cash	$ 2,000	Accounts payable	$ 7,500
Accounts receivable	13,000		
Office supplies	4,250	*Equity*	
Office equipment	28,000	N. King, Capital*	75,750
Land	36,000		
Total assets	$83,250	Total liabilities and equity	$83,250

* Computation of amount from Exercise 1-15.

Exercise 1-17 (15 minutes)

REAL SOLUTIONS
Statement of Cash Flows
For Month Ended October 31

Cash flows from operating activities	
Cash received from customers	$ 2,000
Cash paid to employees	(2,750)
Cash paid for rent	(2,550)
Cash paid for telephone expenses	(660)
Cash paid for miscellaneous expenses	(680)
Net cash used by operating activities	(4,640)
Cash flows from investing activities	
Purchase of office equipment	(28,000)
Net cash used by investing activities	(28,000)
Cash flows from financing activities	
Owner's cash investments	38,000
Owner's cash withdrawals	(3,360)
Net cash provided by financing activities	34,640
Net increase in cash	$ 2,000
Cash balance, October 1	0
Cash balance, October 31	$ 2,000

Exercise 1-18 (10 minutes)

Return on assets	**=**	**Net income / Average total assets**
	=	**\$20,000 / [(\$100,000 + \$150,000)/2]**
	=	**<u>16%</u>**

Interpretation: Geneva Group's return on assets of 16% is markedly above the 10% return of its competitors. Accordingly, its performance is assessed as superior to its competitors.

Exercise 1-19 (10 minutes)

<u>A</u>	**1. Cash paid for wages**	**<u>A</u>**	**5. Cash paid on an account payable**
<u>C</u>	**2. Cash withdrawal by owner**	**<u>C</u>**	**6. Cash investment by owner**
<u>B</u>	**3. Cash purchase of equipment**	**<u>A</u>**	**7. Cash received from clients**
<u>A</u>	**4. Cash paid for advertising**	**<u>A</u>**	**8. Cash paid for rent**

Exercise 1-20[B] (10 minutes)

1.	**F**	**Financing***
2.	**I**	**Investing**
3.	**O**	**Operating**
4.	**F**	**Financing**
5.	**I**	**Investing**

***Would also be listed as "investing" if resources contributed by owner were in the form of non-financial resources.**

Exercise 1-21 (20 minutes)

NINTENDO
Income Statement
For Year Ended March 31, 2009

Net sales		¥ 1,838,622
Expenses		
Cost of sales	¥1,044,981	
Selling, general and administrative expenses	238,378	
Other expenses	276,174	
Total expenses		1,559,533
Net income		¥ 279,089

PROBLEM SET A

Problem 1-1A (25 minutes)

	Transaction	Balance Sheet			Income Statement	Statement of Cash Flows		
		Total Assets	Total Liab.	Total Equity	Net Income	Operating Activities	Financing Activities	Investing Activities
1	Owner invests cash in business	+		+			+	
2	Incurs legal costs on credit		+	–	–			
3	Pays cash for employee wages	–		–	–	–		
4	Borrows cash by signing L-T note payable	+	+				+	
5	Receives cash for services provided	+		+	+	+		
6	Buys land by signing note payable	+	+					
7	Buys office equipment for cash	+/–						–
8	Provides services on credit	+		+	+			
9	Collects cash on receivable from (8)	+/–				+		
10	Owner withdraws cash	–		–			–	

Problem 1-2A (40 minutes)

Part 1

Company A:

(a) Equity on December 31, 2010:

Assets	$45,000
Liabilities	(23,500)
Equity	$21,500

(b) Equity on December 31, 2011:

Equity, December 31, 2010	$21,500
Plus owner investments	5,000
Plus net income	7,500
Less owner's withdrawals	(2,500)
Equity, December 31, 2011	$31,500

(c) Amount of liabilities on December 31, 2011:

Assets	$48,000
Equity	(31,500)
Liabilities	$16,500

Part 2

Company B:

(a) and (b)

Equity:	***12/31/2010***	***12/31/2011***
Assets	**$35,000**	**$41,000**
Liabilities	**(22,500)**	**(27,500)**
Equity	**$12,500**	**$13,500**

(c) Net income for 2011:

Equity, December 31, 2010	**$12,500**
Plus owner investments	**1,500**
Plus net income	**?**
Less owner's withdrawals	**(3,000)**
Equity, December 31, 2011	**$13,500**

Therefore, net income must have been $ 2,500.

Problem 1-2A (continued)

Part 3

Company C:

First, calculate the beginning balance of equity:

	Dec. 31, 2010
Assets	$29,000
Liabilities	(14,000)
Equity	$15,000

Next, find the ending balance of equity by completing this table:

Equity, December 31, 2010	$15,000
Plus owner investments	7,750
Plus net income	9,000
Less owner's withdrawals	(3,875)
Equity, December 31, 2011	$27,875

Finally, find the ending amount of assets by adding the ending balance of equity to the ending balance of liabilities:

	Dec. 31, 2011
Liabilities	$19,000
Equity	27,875
Assets	$46,875

Part 4

Company D:

First, calculate the beginning and ending owner's equity balances:

	12/31/2010	12/31/2011
Assets	$80,000	$ 125,000
Liabilities	(38,000)	(64,000)
Owner's Equity	$42,000	$ 61,000

Then, find the amount of owner investments during 2011:

Equity, December 31, 2010	$42,000
Plus owner investments	?
Plus net income	12,000
Less owner withdrawals	0
Equity, December 31, 2011	$61,000

Thus, owner investments must have been: $ 7,000

Problem 1-2A (*Concluded*)

Part 5
Company E:

First, compute the balance of equity as of December 31, 2011:

Assets	$112,500
Liabilities	(75,000)
Equity	$ 37,500

Next, find the beginning balance of equity as follows:

Equity, December 31, 2010	$?
Plus owner investments	4,500
Plus net income	18,000
Less owner's withdrawals	(9,000)
Equity, December 31, 2011	$37,500

Thus, the beginning balance of equity was $24,000.

Finally, find the beginning amount of liabilities by subtracting the beginning balance of equity from the beginning balance of assets:

	Dec. 31, 2010
Assets	$123,000
Equity	(24,000)
Liabilities	$ 99,000

Problem 1-3A (15 minutes)

Affiliated Company
Balance Sheet
December 31, 2011

Assets	$ 90,000	Liabilities	$ 34,000
		Equity	56,000
Total assets	$ 90,000	Total liabilities and equity	$ 90,000

Problem 1-4A (15 minutes)

Sun Energy Company
Income Statement
For Year Ended December 31, 2011

Revenues	$65,000
Expenses	50,000
Net income	$15,000

Problem 1-5A (15 minutes)

Boardwalk
Statement of Owner's Equity
For Year Ended December 31, 2011

B. Walk, Capital, Dec. 31, 2010	$ 8,000
Add: Net income	9,000
	17,000
Less: Owner withdrawals	(2,000)
B. Walk, Capital, Dec. 31, 2011	$15,000

Problem 1-6A (15 minutes)

Trimark
Statement of Cash Flows
For Year Ended December 31, 2011

Cash from operating activities	$ 7,000
Cash used by investing activities	(3,000)
Cash used by financing activities	(3,800)
Net increase in cash	200
Cash, December 31, 2010	3,300
Cash, December 31, 2011	$ 3,500

Problem 1-7A (60 minutes) Parts 1 and 2

	Assets					= Liabilities		+ Equity			
	Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Building	= Accounts Payable	+ Notes Payable	+ M.Right, Capital	- M.Right, Withdrawals	+ Revenues	- Expenses
a.	+$60,000			+ $30,000				+ $90,000			
b.	- 50,000				+ $300,000		+ $250,000				
Bal.	10,000			+ 30,000	+ 300,000	=	+ 250,000	+ 90,000			
c.	- 6,000			+ 6,000							
Bal.	4,000			+ 36,000	+ 300,000	=	+ 250,000	+ 90,000			
d.			+ $4,000	+ 1,000		+ $5,000					
Bal.	4,000		+ 4,000	+ 37,000	+ 300,000	= 5,000	+ 250,000	+ 90,000			
e.	- 1,000										- $1,000
Bal.	3,000		+ 4,000	+ 37,000	+ 300,000	= 5,000	+ 250,000	+ 90,000			- 1,000
f.		+ $4,000								+ $4,000	
Bal.	3,000	+ 4,000	+ 4,000	+ 37,000	+ 300,000	= 5,000	+ 250,000	+ 90,000		+ 4,000	- 1,000
g.	+ 8,000									+ 8,000	
Bal.	11,000	+ 4,000	+ 4,000	+ 37,000	+ 300,000	= 5,000	+ 250,000	+ 90,000		+ 12,000	- 1000
h.	- 1,800								- $1,800		
Bal.	9,200	+ 4,000	+ 4,000	+ 37,000	+ 300,000	= 5,000	+ 250,000	+ 90,000	- 1,800	+ 12,000	- 1,000
i.	+ 3,000	- 3,000									
Bal.	12,200	+ 1,000	+ 4,000	+ 37,000	+ 300,000	= 5,000	+ 250,000	+ 90,000	- 1,800	+ 12,000	- 1,000
j.	- 500					- 500					
Bal.	11,700	+ 1,000	+ 4,000	+ 37,000	+ 300,000	= 4,500	+ 250,000	+ 90,000	- 1,800	+ 12,000	- 1,000
k.	- 2,500										- 2,500
Bal.	$9,200	+ $1,000	+ $4,000	+ $37,000	+ $300,000	= $4,500	+ $250,000	+ $90,000	- $1,800	+ $12,000	- $3,500

Part 3

Right Consulting's net income = $12,000 - $3,500 = $8,500

Problem 1-8A (60 minutes) *Parts 1 and 2*

	Assets			=	Liabilities	+	Equity			
Date	Cash	+ Accounts Receivable	+ Office Equipment	=	Accounts Payable	+	J.D. Simpson, Capital	− J.D. Simpson, Withdrawals	+ Revenues	− Expenses
May 1	+$60,000			=		+	$60,000			
1	- 3,200			=						– $3,200
3			+ $1,680	=	+ $1,680					
5	- 800			=						– 800
8	+ 4,600			=					+ $4,600	
12		+ $3,000		=					+ 3,000	
15	- 850			=						– 850
20	+ 3,000	– 3,000		=						
22		+ 2,800		=					+ 2,800	
25	+ 2,800	– 2,800		=						
26	- 1,680			=	– 1,680					
27				=	+ 60					– 60
28	- 850			=						– 850
30	- 200			=						– 200
30	- 480			=						– 480
31	- 1,200			=				– $1,200		
	$61,140	+ $ 0	+ $1,680	=	$ 60	+	$60,000	– $1,200	+ $10,400	– $6,440

Problem 1-8A *(Continued)*

Part 3

THE SIMPSON CO.
Income Statement
For Month Ended May 31

Revenues:		
Consulting services revenue		$10,400
Expenses:		
Rent expense....................................	$3,200	
Salaries expense................................	1,700	
Advertising expense..........................	60	
Cleaning expense	800	
Telephone expense............................	200	
Utilities expense................................	480	
Total expenses		6,440
Net income		$ 3,960

THE SIMPSON CO.
Statement of Owner's Equity
For Month Ended May 31

J.D. Simpson, Capital, May 1..................................	$ 0
Plus: Investments by owner....................................	60,000
Net income	3,960
	63,960
Less: Withdrawals by owner	1,200
J.D. Simpson, Capital, May 31.................................	$62,760

THE SIMPSON CO.
Balance Sheet
May 31

Assets		*Liabilities*	
Cash..............................	$61,140	Accounts payable................	$ 60
Office equipment..........	1,680		
		Equity	
		J.D. Simpson, Capital..........	62,760
Total assets...................	$62,820	Total liabilities and equity ..	$62,820

Problem 1-8A (*Concluded)*

Part 3—continued

THE SIMPSON CO.
Statement of Cash Flows
For Month Ended May 31

Cash flows from operating activities		
Cash received from customers	$10,400	
Cash paid for rent	(3,200)	
Cash paid for cleaning	(800)	
Cash paid for telephone	(200)	
Cash paid for utilities	(480)	
Cash paid to employees	(1,700)	
Net cash provided by operating activities		$ 4,020
Cash flows from investing activities		
Purchase of equipment	(1,680)	
Net cash used by investing activities		(1,680)
Cash flows from financing activities		
Investments by owner	60,000	
Withdrawals by owner	(1,200)	
Net cash provided by financing activities		58,800
Net increase in cash		$61,140
Cash balance, May 1		0
Cash balance, May 31		$61,140

Problem 1-9A (60 minutes) Parts 1 and 2

		Assets					= Liabilities	+ Equity			
Date		Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Electrical Equipment	= Accounts Payable	+ C.Hamilton, Capital	- C.Hamilton, Withdrawals	+ Revenues	- Expenses
Dec.	1	+$56,000					=	+ $56,000			
	2	- 800									- $800
Bal.		55,200					=	56,000			- 800
	3	- 3,200				+ $14,000	+ $10,800				
Bal.		52,000				+ 14,000	= 10,800	+ 56,000			- 800
	5	- 900		+ $ 900							
Bal.		51,100		+ 900		+ 14,000	= 10,800	+ 56,000			- 800
	6	+ 1,000								+ $1,000	
Bal.		52,100		+ 900		+ 14,000	= 10,800	+ 56,000		+ 1,000	- 800
	8				+ $3,800		+ 3,800				
Bal.		52,100		+ 900	+ 3,800	+ 14,000	= 14,600	+ 56,000		+ 1,000	- 800
	15		+ $4,000							+ 4,000	
Bal.		52,100	+ 4,000	+ 900	+ 3,800	+ 14,000	= 14,600	+ 56,000		+ 5,000	- 800
	18			+ 500			+ 500				
Bal.		52,100	+ 4,000	+ 1,400	+ 3,800	+ 14,000	= 15,100	+ 56,000		+ 5,000	- 800
	20	- 3,800					- 3,800				
Bal.		48,300	+ 4,000	+ 1,400	+ 3,800	+ 14,000	= 11,300	+ 56,000		+ 5,000	- 800
	24		+ 600							+ 600	
Bal.		48,300	+ 4,600	+ 1,400	+ 3,800	+ 14,000	= 11,300	+ 56,000		+ 5,600	- 800
	28	+ 4,000	- 4,000								
Bal.		52,300	+ 600	+ 1,400	+ 3,800	+ 14,000	= 11,300	+ 56,000		+ 5,600	- 800
	29	- 1,200									- 1,200
Bal.		51,100	+ 600	+ 1,400	+ 3,800	+ 14,000	= 11,300	+ 56,000		+ 5,600	- 2,000
	30	- 440									- 440
Bal.		50,660	+ 600	+ 1,400	+ 3,800	+ 14,000	= 11,300	+ 56,000		+ 5,600	- 2,440
	31	- 700							- $700		
Bal.		$49,960	+ $ 600	+ $1,400	+ $3,800	+ $14,000	= $11,300	+ $56,000	- $700	+ $5,600	- $2,440

Problem 1-9A *(Continued)*
Part 3

HAMILTON ELECTRIC Income Statement For Month Ended December 31		
Revenues:		
Electrical fees earned		$5,600
Expenses:		
Rent expense	$ 800	
Salaries expense	1,200	
Utilities expense	440	
Total expenses		2,440
Net income		$3,160

HAMILTON ELECTRIC Statement of Owner's Equity For Month Ended December 31	
C. Hamilton, Capital, December 1	$ 0
Plus: Owner investments	56,000
Net income	3,160
	59,160
Less: Owner withdrawals	700
C. Hamilton, Capital, December 31	$58,460

HAMILTON ELECTRIC Balance Sheet December 31			
Assets		***Liabilities***	
Cash	$49,960	Accounts payable	$11,300
Accounts receivable	600		
Office supplies	1,400	***Equity***	
Office equipment	3,800		
Electrical equipment	14,000	C. Hamilton, Capital	58,460
Total assets	$69,760	Total liabilities and equity	$69,760

Problem 1-9A *(Concluded)*

Part 3—continued

HAMILTON ELECTRIC Statement of Cash Flows For Month Ended December 31		
Cash flows from operating activities		
Cash received from customers	$ 5,000	
Cash paid for rent	(800)	
Cash paid for supplies	(900)	
Cash paid for utilities	(440)	
Cash paid to employees	(1,200)	
Net cash provided by operating activities		$ 1,660
Cash flows from investing activities		
Purchase of electrical equipment	(3,200)	
Purchase of office equipment	(3,800)	
Net cash used by investing activities		(7,000)
Cash flows from financing activities		
Cash invested by owner	56,000	
Cash withdrawals by owner	(700)	
Net cash provided by financing activities		55,300
Net increase in cash		$49,960
Cash balance, Dec. 1		0
Cash balance, Dec. 31		$49,960

Part 4

If the December 1 owner investment had been $40,000 cash instead of $56,000 and the $16,000 difference was borrowed by the company from a bank, then:

(a) ending equity would be $16,000 less,

(b) total liabilities would be $16,000 greater, and

(c) total assets would remain the same.

Problem 1-10A (15 minutes)

1. **Return on assets is net income divided by the average total assets.**

   Nolan's return: $55,000 / $250,000 = 0.22 or 22%.

2. **Return on assets seems satisfactory for the risk involved in the manufacturing, marketing, and selling of cellular telephones. Moreover, Nolan's 22% return is nearly double that of its competitors' 12% return.**

3. **We know that sales less expenses equal net income. Taking the sales and net income numbers for Nolan we obtain:**

   $455,000 - Expenses = $55,000 → Expenses must equal $400,000.

4. **We know from the accounting equation that total financing (liabilities plus equity) must equal the total for assets (investing). Since average total assets are $250,000, we know the average total of liabilities plus equity (financing) must equal $250,000.**

Problem 1-11A (20 minutes)

1. **Return on assets equals net income divided by average total assets.**
   - a. **Coca-Cola return:** **$6,906 / $44,595 = 0.155 or 15.5%.**
   - b. **PepsiCo return:** **$5,979 / $37,921 = 0.158 or 15.8%.**

2. **Strictly on the amount of sales to consumers, Coke's sales of $30,990 are less than PepsiCo's $43,232.**

3. **Success in returning net income from the average amount invested is revealed by the return on assets. Part 1 showed that PepsiCo's 15.8% return is slightly better than Coca-Cola's 15.5% return.**

4. **Current performance figures suggest that PepsiCo yields a marginally higher return on assets than Coca-Cola. Based on this information alone, we would be better advised to invest in PepsiCo than Coca-Cola.**

   Nevertheless, and particularly since the returns are only marginally different, we would look for additional information in financial statements and other sources for further guidance. For example, if Coca-Cola could dispose of some assets without curtailing its sales level, it would look more attractive. We would also look for consumer trends, market expansion, competition, product development, and promotion plans.

Problem 1-12A[A] (20 minutes)

Case 1	***Return*:**	**4% interest or $40/year.**
	***Risk*:**	**Very low; it is the risk of the financial institution not paying interest and principal.**
Case 2	***Return*:**	**Expected winnings from your bet.**
	***Risk*:**	**Depends on the probability of your team covering the "spread."**
Case 3	***Return*:**	**Expected return on your stock investment (both dividends and stock price changes).**
	***Risk*:**	**Depends on the current and future performance of Yahoo's stock price (and dividends).**
Case 4	***Return*:**	**Expected increase in career earnings and other rewards from an accounting degree (less all costs).**
	***Risk*:**	**Depends on your ability to successfully learn and apply accounting knowledge.**

Problem 1-13A[B] (15 minutes)

An organization pursues three major business activities: financing, investing, and operating.

(1) *Financing* is the means used to pay for resources.

(2) *Investing* refers to the buying and selling of resources (assets) necessary to carry out the organization's plans.

(3) *Operating* activities are the carrying out of an organization's plans.

If financial statements are to be informative about an organization's activities, then they will need to report on these three major activities. Also note that planning is the glue that links and coordinates these three major activities—it includes the ideas, goals, and strategies of an organization.

Problem 1-14A[B] (15 minutes)

1.	**F**	**5.**	**I**
2.	**I**	**6.**	**O**
3.	**I**	**7.**	**O**
4.	**F**	**8.**	**O**

PROBLEM SET B

Problem 1-1B (25 minutes)

		Balance Sheet			Income Statement	Statement of Cash Flows		
	Transaction	Total Assets	Total Liab.	Owner Equity	Net Income	Operating Activities	Financing Activities	Investing Activities
1	Owner invests cash	+		+			+	
2	Buys building by signing note payable	+	+					
3	Pays cash for salaries incurred	–		–	–	–		
4	Provides services for cash	+		+	+	+		
5	Pays cash for rent incurred	–		–	–	–		
6	Incurs utilities costs on credit		+	–	–			
7	Buys store equipment for cash	+/–						–
8	Owner withdraws cash	–		–			–	
9	Provides services on credit	+		+	+			
10	Collects cash on receivable from (9)	+/–				+		

Problem 1-2B (40 minutes)

Part 1

<u>Company V:</u>

(a) and (b)

Calculation of equity:	*12/31/2010*	*12/31/2011*
Assets	$45,000	$49,000
Liabilities	(30,000)	(26,000)
Equity	$15,000	$23,000

(c) Calculation of net income for 2010:

Equity, December 31, 2010	$15,000
Plus owner investments	6,000
Plus net income	?
Less owner withdrawals	(4,500)
Equity, December 31, 2011	$23,000
Therefore, net income must have been	$ 6,500

Part 2

<u>Company W:</u>

(a) Calculation of Equity at December 31, 2010:

Assets	$70,000
Liabilities	(50,000)
Equity	$20,000

(b) Calculation of Equity at December 31, 2011:

Equity, December 31, 2010	$20,000
Plus owner investments	10,000
Plus net income	30,000
Less owner withdrawals	(2,000)
Equity, December 31, 2011	$58,000

(c) Calculation of the amount of liabilities at December 31, 2011:

Assets	$90,000
Equity	(58,000)
Liabilities	$32,000

Problem 1-2B *(Continued)*

Part 3

Company X:

First, calculate the beginning and ending equity balances:

	12/31/2010	*12/31/2011*
Assets	$121,500	$136,500
Liabilities	(58,500)	(55,500)
Equity..............................	$ 63,000	$ 81,000

Then, find the amount of owner investments during 2011 as follows:

Equity, December 31, 2010	$ 63,000
Plus owner investments	?
Plus net income..	16,500
Less owner withdrawals..................................	0
Equity, December 31, 2011	$81,000
Thus, the owner investments must have been	$ 1,500

Part 4

Company Y:

First, calculate the beginning balance of equity:

	Dec. 31, 2010
Assets..	$82,500
Liabilities..	61,500
Equity	$21,000

Next, find the ending balance of equity as follows:

Equity, December 31, 2010	$21,000
Plus owner investments	38,100
Plus net income...	24,000
Less owner withdrawals............................	(18,000)
Equity, December 31, 2011	$65,100

Finally, find the ending amount of assets by adding the ending balance of equity to the ending balance of liabilities:

	Dec. 31, 2011
Liabilities..	$ 72,000
Equity	65,100
Assets..	$137,100

Problem 1-2B *(Concluded)*

Part 5
Company Z:

First, calculate the balance of equity as of December 31, 2011:

Assets	$160,000
Liabilities	(52,000)
Equity	$108,000

Next, find the beginning balance of equity as follows:

Equity, December 31, 2010	$?
Plus owner investments	40,000
Plus net income	32,000
Less owner withdrawals	(6,000)
Equity, December 31, 2011	$108,000

Thus, the beginning balance of equity is $42,000.

Finally, find the beginning amount of liabilities by subtracting the beginning balance of equity from the beginning balance of assets:

	Dec. 31, 2010
Assets	$124,000
Equity	(42,000)
Liabilities	$ 82,000

Problem 1-3B (15 minutes)

RWB Company
Balance Sheet
December 31, 2011

Assets	$114,000	Liabilities	$ 74,000
		Equity	40,000
Total assets	$114,000	Total liabilities and equity	$114,000

Problem 1-4B (15 minutes)

Online Co.
Income Statement
For Year Ended December 31, 2011

Revenues	$58,000
Expenses	30,000
Net income	$28,000

Problem 1-5B (15 minutes)

ComEx
Statement of Owner's Equity
For Year Ended December 31, 2011

C. Tex, Capital, Dec. 31, 2010	$ 49,000
Add: Investments by owner	0
Net income	6,000
	55,000
Less: Withdrawals by owner	(8,000)
C. Tex, Capital, Dec. 31, 2011	$47,000

Problem 1-6B (15 minutes)

BuyRight Co.
Statement of Cash Flows
For Year Ended December 31, 2011

Cash used by operating activities	$(4,000)
Cash from investing activities	2,600
Cash from financing activities	2,800
Net increase in cash	$ 1,400
Cash, December 31, 2010	1,300
Cash, December 31, 2011	$ 2,700

Problem 1-7B (60 minutes) Parts 1 and 2

	Assets					=	Liabilities		+	Equity		
	Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Building	=	Accounts Payable	+ Notes Payable	+	T.Moore, Capital	- T.Moore, Withdrawals	+ Reve-nues	- Expen-ses
a.	+ $95,000			+ $20,000						+ $115,000			
b.	- 20,000				+ $120,000			+ $100,000					
Bal.	75,000			+ 20,000	+ 120,000	=		100,000	+	115,000			
c.	- 20,000			+ 20,000									
Bal.	55,000			+ 40,000	+ 120,000	=		100,000	+	115,000			
d.			+ $1,400	+ 3,000			+ $4,400						
Bal.	55,000		1,400	+ 43,000	+ 120,000	=	4,400	+ 100,000	+	115,000			
e.	- 400												- $ 400
Bal.	54,600		+ 1,400	+ 43,000	+ 120,000	=	4,400	+ 100,000	+	115,000			- 400
f.		+ $1,800										+ $1,800	
Bal.	54,600	+ 1,800	+ 1,400	+ 43,000	+ 120,000	=	4,400	+ 100,000	+	115,000		+ 1,800	- 400
g.	+ 2,000											+ 2,000	
Bal.	56,600	+ 1,800	+ 1,400	+ 43,000	+ 120,000	=	4,400	+ 100,000	+	115,000		+ 3,800	- 400
h	- 5,000										- $5,000		
Bal.	51,600	+ 1,800	+ 1,400	+ 43,000	+ 120,000	=	4,400	+ 100,000	+	115,000	- 5,000	+ 3,800	- 400
i	+ 1,800	- 1,800											
Bal.	53,400	+ 0	+ 1,400	+ 43,000	+ 120,000	=	4,400	+ 100,000	+	115,000	- 5,000	+ 3,800	- 400
j	- 2,000						- 2,000						
Bal.	51,400	+ 0	+ 1,400	+ 43,000	+ 120,000	=	2,400	+ 100,000	+	115,000	- 5,000	+ 3,800	- 400
k	- 2,000												- 2,000
Bal.	$49,400	+ $ 0	+ $1,400	+ $43,000	+ $120,000	=	$2,400	+ $100,000	+	$115,000	- $5,000	+ $3,800	- $2,400

3. Tiana's Solutions' net income = $3,800 - $2,400 = $1,400

Problem 1-8B (60 minutes) *Parts 1 and 2*

	Assets					=	Liabilities	+	Equity						
Date	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	K. Stone, Capital	–	K. Stone, Withdrawals	+	Revenues	–	Expenses
June 1	+$120,000					=			+ $120,000						
2	– 4,500					=									– $4,500
4					+ $2,400	=	+ $2,400								
6	– 1,125					=									– 1,125
8	+ 750					=							+ $ 750		
14			+ $6,300			=							+ 6,300		
16	– 900					=									– 900
20	+ 6,300		– 6,300			=									
21			+ 3,500			=							+ 3,500		
24			+ 825			=							+ 825		
25	+ 3,500		– 3,500			=									
26	– 2,400					=	- 2,400								
28	– 900					=									– 900
29	– 2,000					=					- $2,000				
30	– 120					=									– 120
30	– 525					=									– 525
	$118,080	+	$ 825	+	$2,400	=	$ 0	+	$120,000	-	$2,000	+	$11,375	–	$8,070

Problem 1-8B *(Continued)*

Part 3

KEN'S MAINTENANCE CO.
Income Statement
For Month Ended June 30

Revenues:		
Maintenance services revenue		$11,375
Expenses:		
Rent expense	$4,500	
Salaries expense	1,800	
Advertising expense	1,125	
Utilities expense	525	
Telephone expense	120	
Total expenses		8,070
Net income		$ 3,305

KEN'S MAINTENANCE CO.
Statement of Owner's Equity
For Month Ended June 30

K. Stone, Capital, June 1	$ 0
Plus: Investment by owner	120,000
Net income	3,305
	123,305
Less: Owner withdrawals	(2,000)
K. Stone, Capital, June 30	$121,305

Problem 1-8B *(Concluded)*

KEN'S MAINTENANCE CO.
Balance Sheet
June 30

Assets		*Liabilities*	
Cash	$118,080	Accounts payable	$ 0
Accounts receivable	825	*Equity*	
Equipment	2,400	K. Stone, Capital	121,305
Total assets	$121,305	Total liabilities and equity	$121,305

KEN'S MAINTENANCE CO.
Statement of Cash Flows
For Month Ended June 30

Cash flows from operating activities:		
Cash received from customers	$ 10,550	
Cash paid for rent	(4,500)	
Cash paid for advertising	(1,125)	
Cash paid for telephone	(120)	
Cash paid for utilities	(525)	
Cash paid to employees	(1,800)	
Net cash provided by operating activities		$ 2,480
Cash flows from investing activities:		
Purchase of equipment	(2,400)	
Net cash used by investing activities		(2,400)
Cash flows from financing activities:		
Cash investment by owner	120,000	
Cash withdrawal by owner	(2,000)	
Net cash provided by financing activities		118,000
Net increase in cash		$118,080
Cash balance, June 1		0
Cash balance, June 30		$118,080

Problem 1-9B (60 minutes) Parts 1 and 2

		Assets									=	Liabilities	+	Equity						
Date		Cash	+	Accounts Receivable	+	Office Supplies	+	Office Equipment	+	Excavating Equipment	=	Accounts Payable	+	P.Swender, Capital	-	P.Swender, Withdrawals	+	Reve-nues	-	Expen-ses
July	1	+ $60,000									=		+	$60,000						
	2	- 500																	-	$500
Bal.		59,500									=			60,000					-	500
	3	- 800							+	$4,000		+ $3,200								
Bal.		58,700							+	4,000	=	3,200	+	60,000					-	500
	6	- 500			+	$ 500														
Bal.		58,200			+	500			+	4,000	=	3,200	+	60,000					-	500
	8	+ 2,200															+	$2,200		
Bal.		60,400			+	500			+	4,000	=	3,200	+	60,000			+	2,200	-	500
	10						+	$3,800				+ 3,800								
Bal.		60,400			+	500	+	3,800	+	4,000	=	7,000	+	60,000			+	2,200	-	500
	15		+	$2,400													+	2,400		
Bal.		60,400	+	2,400	+	500	+	3,800	+	4,000	=	7,000	+	60,000			+	4,600	-	500
	17				+	1,920						+ 1,920								
Bal.		60,400	+	2,400	+	2,420	+	3,800	+	4,000	=	8,920	+	60,000			+	4,600	-	500
	23	- 3,800										- 3,800								
Bal.		56,600	+	2,400	+	2,420	+	3,800	+	4,000	=	5,120	+	60,000			+	4,600	-	500
	25			5,000													+	5,000		
Bal.		56,600	+	7,400	+	2,420	+	3,800	+	4,000	=	5,120	+	60,000			+	9,600	-	500
	28	+ 2,400	-	2,400																
Bal.		59,000	+	5,000	+	2,420	+	3,800	+	4,000	=	5,120	+	60,000			+	9,600	-	500
	30	- 1,260																	-	1,260
Bal.		57,740	+	5,000	+	2,420	+	3,800	+	4,000	=	5,120	+	60,000			+	9,600	-	1,760
	31	- 260																	-	260
Bal.		57,480	+	5,000	+	2,420	+	3,800	+	4,000	=	5,120	+	60,000			+	9,600	-	2,020
	31	- 1,200													-	$1,200				
Bal.		$56,280	+	$ 5,000	+	$2,420	+	$3,800	+	$4,000	=	$5,120	+	$60,000	-	$1,200	+	$9,600	-	$2,020

Problem 1-9B- *continued*
Part 3

SWENDER EXCAVATING CO.
Income Statement
For Month Ended July 31

Revenues:		
Excavating fees earned		$9,600
Expenses:		
Rent expense	$ 500	
Salaries expense	1,260	
Utilities expense	260	
Total expenses		2,020
Net income		$7,580

SWENDER EXCAVATING CO.
Statement of Owner's Equity
For Month Ended July 31

P. Swender, Capital, July 1	$ 0
Plus: Investment by owner	60,000
Net income	7,580
	67,580
Less: Owner withdrawals	1,200
P. Swender, Capital, July 31	$66,380

SWENDER EXCAVATING CO.
Balance Sheet
July 31

Assets		*Liabilities*	
Cash	$56,280	Accounts payable	$ 5,120
Accounts receivable	5,000		
Office supplies	2,420	*Equity*	
Office equipment	3,800		
Excavating equipment	4,000	P. Swender, Capital	66,380
Total assets	$71,500	Total liabilities & equity	$71,500

Problem 1-9B *(Concluded)*
Part 3—continued

SWENDER EXCAVATING CO. Statement of Cash Flows For Month Ended July 31		
Cash flows from operating activities:		
Cash received from customers	$4,600	
Cash paid for rent	(500)	
Cash paid for supplies	(500)	
Cash paid for utilities	(260)	
Cash paid to employees	(1,260)	
Net cash provided by operating activities		$2,080
Cash flows from investing activities:		
Purchase of excavating equipment	(800)	
Purchase of office equipment	(3,800)	
Net cash used by investing activities		(4,600)
Cash flows from financing activities:		
Cash invested by owner	60,000	
Cash withdrawal by owner	(1,200)	
Net cash provided by financing activities		58,800
Net increase in cash		$56,280
Cash balance, July 1		0
Cash balance, July 31		$56,280

Part 4

If the $4,000 purchase on July 1 had been acquired through an additional owner investment of cash, then:

(a) total assets would be larger by $800,

(b) total liabilities would be $3,200 smaller, and

(c) equity would be $4,000 larger.

Problem 1-10B (20 minutes)

1. **Return on assets is net income divided by average total assets (the average amount invested). For Aspen Company this return is computed as:**

   $100,000 / $2,000,000 = 0.05 or 5%.

2. **Return on assets does not seem satisfactory for the risk involved in the manufacturing, marketing, and selling of snowmobile equipment. Aspen Company's 5% return is about one-half of the 9.5% return earned by its competitors.**

3. **We know that sales less expenses equal net income. Taking the sales and net income numbers for Aspen Company we obtain:**

   $1,200,000 - Expenses = $100,000 → Expenses must equal $1,100,000.

4. **We know from the accounting equation that the total of liabilities plus equity (financing) must equal the total for assets (investing). Since average total assets are $2,000,000, we know the average total of liabilities plus equity (financing) must equal $2,000,000.**

Problem 1-11B (15 minutes)

1. **Return on assets equals net income divided by average total assets.**

   a. **AT&T return: $12,535/ $266,999 = 0.047 or 4.7%**

   b. **Verizon return: $10,358/ $214,937 = 0.048 or 4.8%**

2. **On strictly amount of sales to consumers, AT&T's sales of $123,018 are greater than Verizon's sales of $107,808.**

3. **Success in returning net income from the amount invested is revealed by the return on assets ratio. Part 1 showed that AT&T has a marginally lower return on assets of 4.7% versus Verizon with a 4.8% return on assets.**

Problem 1-11B (concluded)

4. **Current performance figures suggest both are almost equally successful in generating income based on assets. Based on this information alone, it would be difficult to differentiate between the two companies.**

   Nevertheless, we would look for additional information in financial statements and other sources for further guidance. For example, if AT&T could reduce its expenses, or reduce its assets without reducing income, it could potentially be a more appealing investment given its greater market share. We would also look for consumer trends, market expansion, competition, and product development and promotion plans.

Problem 1-12B[A] (20 minutes)

Case 1.	***Return*:**	**No return is generated.**
	***Risk*:**	**Moderate Risk. By hiding money at home a person risks loss by theft or fire. Also such a strategy might result in a loss of purchasing power in the event of inflation.**
Case 2.	***Return*:**	**Expected winnings from your bet.**
	***Risk*:**	**Depends on the probability of your horse finishing the race in a position consistent with the odds assigned the horse for the race.**
Case 3.	***Return*:**	**Expected return on your stock investment (both dividends and stock price changes).**
	***Risk*:**	**Depends on the current and future performance of Nike’s stock price (and dividends).**
Case 4.	***Return*:**	**Expected return on the bond is a function of the interest rate paid on the bond.**
	***Risk*:**	**Very low because the full faith and credit of the U.S. government back savings bonds.**

Problem 1-13B[B] (15 minutes)

I. Financing Activities

- **A. Owner financing—investing resources in the company**
- **B. Non-owner (creditor) financing—borrowing money from a bank**

II. Investing Activities

- **A. Buying resources (assets)**
- **B. Selling resources (assets)**

III. Operating Activities

- **A. Use of assets to carry out plans**
- **B. Management of internal functions—R&D, marketing, and so forth**

[Note: Planning activities are the ideas, goals, and tactics for implementing financing, investing, and operating activities.]

Problem 1-14B[B] (15 minutes)

1.	**C**	**5.**	**C**
2.	**A**	**6.**	**A**
3.	**B**	**7.**	**C**
4.	**C**	**8.**	**C**

Serial Problem — SP 1 *Business Solutions*

		Assets					= Liabilities	+	Equity		
Date		Cash	+ Accounts Receivable	+ Computer Supplies	+ Computer System	+ Office Equipment	= Accounts Payable	+ S. Rey, Capital	- S. Rey, Withdrawals	+ Revenues	- Expenses
Oct.	1	+$45,000			$20,000	+ $8,000		+ $73,000			
	3			+ $1,420			+ $1,420				
Bal.		45,000		+ 1,420	+ 20,000	+ 8,000	= 1,420	+ 73,000			
	6		+ $4,800							+ $ 4,800	
Bal.		45,000	+ 4,800	+ 1,420	+ 20,000	+ 8,000	= 1,420	+ 73,000		+ 4,800	
	8	- 1,420					- 1,420				
Bal.		43,580	+ 4,800	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 4,800	
	12		+ 1,400							+ 1,400	
Bal.		43,580	+ 6,200	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	
	15	+ 4,800	- 4,800								
Bal.		48,380	+ 1,400	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	
	17	- 805									- $ 805
Bal.		47,575	+ 1,400	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	- 805
	20	- 1,728									- 1,728
Bal.		45,847	+ 1,400	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	- 2,533
	22	+ 1,400	- 1,400								
Bal.		47,247	+ 0	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	- 2,533
	28		+ 5,208							+ 5,208	
Bal.		47,247	+ 5,208	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 11,408	- 2,533
	31	- 875									- 875
Bal.		46,372	+ 5,208	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 11,408	- 3,408
	31	- 3,600							- $3,600		
Bal.		$42,772	+ $5,208	+ $1,420	+ $20,000	+ $8,000	= $ 0	+ $73,000	- $3,600	+ $11,408	- $3,408

Reporting in Action — BTN 1-1

1. An organization's total assets are equal to its total liabilities plus total equity. Because Research In Motion's liabilities and equity total $10,204 (in millions), this implies its amount of assets invested is the same $10,204 (in millions).
2. Return on assets is net income divided by the average total assets invested. For Research In Motion this return is ($ millions): $2,457 / [($8,101 + $10,204)/2] = 0.268 or 26.8%.
3. We know that net income equals total revenues less total expenses. For Research In Motion, we are told net income is $2,457 and revenues are $14,953. Thus, Research In Motion's total expenses are computed as: $14,953 - Expenses = $2,457. Total expenses must equal $12,496 (in millions).
4. Research In Motion's return on assets of 26.8% is good given the 2009-2010 recessionary period. Further, its return markedly exceeds its competitors' return on assets of approximately 18% for this period.
5. Answer depends on the current annual report information obtained.

Comparative Analysis — BTN 1-2

($ millions)	Research In Motion	Apple
1. Total assets = Liabilities + Equity	$10,204	$47,501
2. Return on assets	$2,457 / [($8,101 + $10,204)/2]	$8,235 / [($36,171 + $47,501)/2]
	26.8%	19.7%
3. Revenues-Expenses	$14,953-Expenses=$2,457	$42,905-Expenses=$8,235
= Net income	Expenses = $12,496	Expenses = $34,670

4. Analysis of return on assets: Research In Motion's 26.8% return is good given the moderate risk Research In Motion confronts and the recessionary period for these returns (and vis-à-vis the 18% return of its competitors). Apple's 19.7% return is still better than competitors but is not as strong as Research In Motion's.

5. Analysis conclusions: Apple's return is acceptable (good when compared to the industry norm); Research In Motion's return is arguably very good. Both companies' expenses are a large percentage of their revenues.

Ethics Challenge — BTN 1-3

1. **There are several parties affected. They include the users of financial statements such as shareholders, lenders, investors, analysts, suppliers, directors, unions, regulators and others. They also include the accounting firm, which can be sued if deemed a party to misleading statements.**
2. **A major factor in the value of an auditor's report is the auditor's independence. If an auditor accepted a fee that increases when the client's reported profit increases, the auditor is (or at least is perceived to be) interested in higher profits for the client. This compromises the auditor's independence.**
3. **Thorne should <u>not</u> accept this fee arrangement. To avoid compromising the auditor's independence, Thorne should reject it. (Further, the AICPA Code of Professional Conduct forbids auditors from accepting contingent fees that depend on amounts reported in a client's financial statements. This AICPA Code has been codified into law in most states and, therefore, this action would also be an illegal act for a CPA.)**
4. **Ethical considerations guiding this decision include the potential harm to affected parties by allowing such a fee arrangement to exist. The unacceptable nature of such a fee arrangement guards the profession against unethical actions that could undermine its real and perceived value to society.**

Communicating in Practice — BTN 1-4

1. **Deciding whether Facebook is a good loan risk can be difficult because the planned expansion is risky if customer demand does not meet expectations. As a loan officer in this situation you would want information on the company's (1) projections of expected cash receipts and cash payments (best provided on a monthly basis); (2) assessment of the market, the company's plans, and a strategy to achieve success; (3) cash contributions that Mark Zuckerberg will make to the business; and (4) a listing of tangible assets (including their price and useful life) necessary to carry out the company's plans.**
2. **How the company is organized is important to a loan officer. If it is a proprietorship (and not LLC), the personal assets of Mark Zuckerberg are available to repay the loan. In this case, a loan officer will want information about Mark's financial status. If it is a corporation, the amounts invested in the business by each shareholder are especially important. The loan officer can also require owners or shareholders to personally guarantee the loan for additional protection for the bank. Careful execution of these steps should minimize the bank's risk of taking on a bad loan.**

Taking It to the Net — BTN 1-5

(in thousands)	2009	2008	2007	2006	2005
Revenues........	$28,539	$31,878	$31,573	$28,074	$24,524
Net income......	3,719	4,961	4,745	4,065	3,317

1. **Rocky Mountain Chocolate Factory's (RMCF) revenues grew considerably from 2005 through 2007, but they flattened and even declined in the recessionary period of 2008 and 2009. Each year saw solid revenue growth prior to 2008. Management must work to recover those lost revenues.**

2. **Net income performance for RMCF was impressive over the time period 2005 through 2008. Its net income grew nearly 50%. However, 2009 net income declines 25% from its 2008 level. Although 2008 and 2009 were recessionary times, management must work to recover lost revenues and reestablish profitability levels.**

Teamwork in Action — BTN 1-6

Suggestions for forming support/learning teams are in the Instructor's Resource Manual (IRM). The IRM provides the master of a Student Data Form that can be duplicated and used to gather information as a basis for forming these teams. The IRM also includes other administrative materials helpful in creating an active learning environment for studying accounting.

[*Note: Instructors often have students use the copy function in e-mail to keep them advised of meeting times and other important team activities. This also encourages students to use and explore additional features of e-mail.*]

Entrepreneurial Decision — BTN 1-7

1. (a) AccountBook's total amount of liabilities and equity consists of the bank loan and the owner investments. Specifically:

Total assets	=	Bank Loan	+	Owner investment
	=	Liabilities	+	Equity
$750,000	=	$500,000	+	$250,000

(b) AccountBook's total amount of assets equals its total amount of liabilities plus equity, which is $750,000.

2. Return on assets = $80,000 / $750,000 = 0.107 = 10.7%

AccountBook's 10.7% return slightly exceeds its competitors' average return of 10%. Assuming AccountBook can continue to earn 10.7% or more, Mark Zuckerberg should consider further investment in the new company.

Hitting the Road — BTN 1-8

Check each student's report for the following content:

1. (a) Identification of the form of business organization for the business interviewed.

(b) Identification of the main business activities for the business interviewed.

2. Identification of the reasons why the owner(s) chose this particular form of business organization.

3. Identification of advantages or disadvantages of the form of business organization chosen.

[Note: Many instructors have students complete this assignment in teams.]

Global Decision — BTN 1-9

1. **Nokia's net income and revenues figures are computed using Euros, which is the currency of Europe. In contrast, Research In Motion and Apple compute their financial figures in U.S. dollars. Accordingly, one must convert these figures into comparable monetary units for business decisions that depend on direct comparisons of these numbers.**

   Moreover, Nokia's figures are computed according to International Financial Reporting Standards (IFRS) following pronouncements of the IASB, while Research In Motion and Apple use U.S. GAAP per the FASB. One should adjust these figures for any significant differences in accounting measurements to yield an 'apples-to-apples' comparison.

2. **Nokia's return on assets ratio eliminates differences in monetary units (between Euros and dollars). Consequently, we need not focus on differences in Euros and dollars for ratio comparisons provided we are comfortable with measurement techniques underlying the financial figures.**

   However, any comparisons using the return on assets ratio are still impacted by potential differences in IFRS GAAP as applied by Nokia compared to U.S. GAAP applied by Research In Motion and Apple.