

CHAPTER 1

INTRODUCTION TO ACCOUNTING AND BUSINESS

DISCUSSION QUESTIONS

1. Some users of accounting information include managers, employees, creditors, customers, investors, and the government.
2. The role of accounting is to provide information for managers to use in operating the business. In addition, accounting provides information to others to use in assessing the economic performance and condition of the business.
3. The corporate form allows the company to obtain large amounts of resources by issuing stock. For this reason, most companies that require large investments in property, plant, and equipment are organized as corporations.
4. No. The business entity concept limits the recording of economic data to transactions directly affecting the activities of the business. The payment of the interest of \$3,200 is a personal transaction of Murray Stoltz and should not be recorded by Ontime Delivery Service.
5. The land should be recorded at its cost of \$82,000 to A2Z Repair Service. This is consistent with the cost concept.
6.
 - a. No. The offer of \$1,000,000 and the increase in the assessed value should not be recognized in the accounting records.
 - b. Cash would increase by \$1,000,000, land would decrease by \$525,000, and owner's equity would increase by \$475,000.
7. An account receivable is a claim against a customer for goods or services sold. An account payable is an amount owed to a creditor for goods or services purchased. Therefore, an account receivable in the records of the seller is an account payable in the records of the purchaser.
8. (a) The business incurred a net loss of \$185,000 (\$615,000 – \$430,000).
9. (b) The business realized net income of \$117,000 (\$825,000 – \$708,000).
10. Net income or net loss
Retained earnings at the end of the period
Cash at the end of the period

PRACTICE EXERCISES

PE 1–1A

\$105,000. Under the cost concept, the land should be recorded at the cost to Easy Repair Service.

PE 1–1B

\$57,500. Under the cost concept, the land should be recorded at the cost to AAA Repair Service.

PE 1–2A

a.

$$\begin{aligned} A &= L + OE \\ \$800,000 &= \$450,000 + OE \\ OE &= \$350,000 \end{aligned}$$

b.

$$\begin{aligned} A &= L + OE \\ + \$175,000 &= - \$60,000 + OE \\ OE &= + \$235,000 \\ \text{OE on December 31, 2012} &= \\ \$585,000 &= \$350,000 + \$235,000 \end{aligned}$$

PE 1–2B

a.

$$\begin{aligned} A &= L + OE \\ \$575,000 &= \$125,000 + OE \\ OE &= \$450,000 \end{aligned}$$

b.

$$\begin{aligned} A &= L + OE \\ + \$85,000 &= + \$30,000 + OE \\ OE &= + \$55,000 \\ \text{OE on December 31, 2012} &= \\ \$505,000 &= \$450,000 + \$55,000 \end{aligned}$$

PE 1–3A

- (2) Asset (Cash) decreases by \$1,800; Liability (Accounts Payable) decreases by \$1,800.
- (3) Asset (Accounts Receivable) increases by \$12,500; Revenue (Delivery Service Fees) increases by \$12,500.
- (4) Asset (Cash) increases by \$6,900; Asset (Accounts Receivable) decreases by \$6,900.
- (5) Asset (Cash) decreases by \$4,000; Dividends increases by \$4,000.

PE 1–3B

- (2) Expense (Advertising Expense) increases by \$1,200; Asset (Cash) decreases by \$1,200.
- (3) Asset (Supplies) increases by \$450; Liability (Accounts Payable) increases by \$450.
- (4) Asset (Accounts Receivable) increases by \$7,500; Revenue (Delivery Service Fees) increases by \$7,500.
- (5) Asset (Cash) increases by \$4,900; Asset (Accounts Receivable) decreases by \$4,900.

PE 1–4A

DYNASTY TRAVEL SERVICE
Income Statement
For the Year Ended June 30, 2012

Fees earned		\$950,000
Expenses:		
Wages expense	\$478,000	
Office expense	222,000	
Miscellaneous expense	<u>16,000</u>	
Total expenses		<u>716,000</u>
Net income		<u>\$234,000</u>

PE 1–4B

ESCAPE TRAVEL SERVICE
Income Statement
For the Year Ended November 30, 2012

Fees earned		\$942,500
Expenses:		
Wages expense	\$562,500	
Office expense	391,625	
Miscellaneous expense	<u>15,875</u>	
Total expenses		<u>970,000</u>
Net loss		<u>\$ 27,500</u>

PE 1–5A

DYNASTY TRAVEL SERVICE
Retained Earnings Statement
For the Year Ended June 30, 2012

Retained earnings, July 1, 2011		\$175,000
Net income for the year	\$234,000	
Less dividends	<u>36,000</u>	
Increase in retained earnings		<u>198,000</u>
Retained earnings, June 30, 2012.....		<u><u>\$373,000</u></u>

PE 1–5B

ESCAPE TRAVEL SERVICE
Retained Earnings Statement
For the Year Ended November 30, 2012

Retained earnings, December 1, 2011		\$375,000
Net loss for the year	\$27,500	
Plus dividends	<u>25,000</u>	
Decrease in retained earnings		<u>52,500</u>
Retained earnings, November 30, 2012.....		<u><u>\$322,500</u></u>

PE 1–6A

DYNASTY TRAVEL SERVICE
Balance Sheet
June 30, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$156,000	Accounts payable	\$ 24,000
Accounts receivable	64,000		
Supplies	12,000		
Land.....	<u>300,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$135,000
		Retained earnings	<u>373,000</u>
		Total stockholders' equity	<u>508,000</u>
		Total liabilities and stockholders' equity	<u><u>\$532,000</u></u>
Total assets	<u><u>\$532,000</u></u>		

PE 1–6B

ESCAPE TRAVEL SERVICE
Balance Sheet
November 30, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$ 56,750	Accounts payable	\$ 52,500
Accounts receivable	94,375		
Supplies	6,375		
Land.....	<u>362,500</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$145,000
		Retained earnings	<u>322,500</u>
		Total stockholders'	
		equity	<u>467,500</u>
		Total liabilities and	
Total assets	<u>\$520,000</u>	stockholders' equity	<u>\$520,000</u>

PE 1–7A

DYNASTY TRAVEL SERVICE
Statement of Cash Flows
For the Year Ended June 30, 2012

Cash flows from operating activities:		
Cash received from customers	\$920,000	
Deduct cash payments for operating expenses	<u>710,000</u>	
Net cash flows from operating activities		\$ 210,000
Cash flows from investing activities:		
Cash payments for purchase of land		(208,000)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 60,000	
Deduct cash dividends.....	<u>36,000</u>	
Net cash flows from financing activities		<u>24,000</u>
Net increase in cash during year		\$ 26,000
Cash as of July 1, 2011		<u>130,000</u>
Cash as of June 30, 2012.....		<u>\$156,000</u>

PE 1–7B

ESCAPE TRAVEL SERVICE
Statement of Cash Flows
For the Year Ended November 30, 2012

Cash flows from operating activities:		
Cash received from customers	\$875,000	
Deduct cash payments for operating expenses	<u>912,500</u>	
Net cash flows from operating activities		\$ (37,500)
Cash flows from investing activities:		
Cash payments for purchase of land		(67,500)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$ 45,000	
Deduct cash dividends	<u>25,000</u>	
Net cash flows from financing activities		<u>20,000</u>
Net decrease in cash during year		\$ (85,000)
Cash as of December 1, 2011		<u>141,750</u>
Cash as of November 30, 2012		<u>\$ 56,750</u>

PE 1–8A

a.	Dec. 31, 2012	Dec. 31, 2011
Total liabilities	\$375,000	\$287,500
Total stockholders' equity	300,000	250,000
Ratio of liabilities to stockholders' equity	1.25	1.15
	(\$375,000/\$300,000)	(\$287,500/\$250,000)

b. Increased

PE 1–8B

a.	Dec. 31, 2012	Dec. 31, 2011
Total liabilities	\$340,000	\$300,000
Total stockholders' equity	500,000	400,000
Ratio of liabilities to stockholders' equity	0.68	0.75
	(\$340,000/\$500,000)	(\$300,000/\$400,000)

b. Decreased

EXERCISES

Ex. 1–1

a.

- | | | |
|------------------|------------------|-------------------|
| 1. service | 6. manufacturing | 11. merchandise |
| 2. service | 7. service | 12. service |
| 3. merchandise | 8. manufacturing | 13. merchandise |
| 4. manufacturing | 9. manufacturing | 14. manufacturing |
| 5. service | 10. service | 15. manufacturing |

- b. The accounting equation is relevant to all companies. It serves as the basis of the accounting information system.

Ex. 1–2

As in many ethics issues, there is no one right answer. Often times, disclosing only what is legally required may not be enough. In this case, it would be best for the company's chief executive officer to disclose both reports to the county representatives. In doing so, the chief executive officer could point out any flaws or deficiencies in the fired researcher's report.

Ex. 1–3

a.

- | | | |
|------|------|-------|
| 1. B | 5. R | 9. X |
| 2. M | 6. R | 10. R |
| 3. R | 7. X | |
| 4. B | 8. M | |

- b. A business transaction is an economic event or condition that directly changes an entity's financial condition or results of operations.

Ex. 1–4

Peet's Coffee & Tea's stockholders' (owners') equity: $\$176 - \$32 = \$144$
Starbucks' stockholders' (owners') equity: $\$5,577 - \$2,531 = \$3,046$

Ex. 1–5

Dollar Tree's stockholders' (owners') equity: $\$2,036 - \$783 = \$1,253$
Target's stockholders' (owners') equity: $\$44,106 - \$30,394 = \$13,712$

Ex. 1–6

- a. $\$600,000 (\$150,000 + \$450,000)$
- b. $\$225,000 (\$275,000 - \$50,000)$
- c. $\$425,000 (\$615,000 - \$190,000)$

Ex. 1–7

- a. $\$450,000 (\$800,000 - \$350,000)$
- b. $\$530,000 (\$450,000 + \$150,000 - \$70,000)$
- c. $\$370,000 (\$450,000 - \$60,000 - \$20,000)$
- d. $\$590,000 (\$450,000 + \$100,000 + \$40,000)$
- e. Net income: $\$125,000 (\$975,000 - \$400,000 - \$450,000)$

Ex. 1–8

- a. (1) asset
- b. (3) stockholders' equity (retained earnings)
- c. (2) liability
- d. (3) stockholders' equity (retained earnings)
- e. (1) asset
- f. (1) asset

Ex. 1–9

- a. Increases assets and increases stockholders' equity (capital stock).
- b. Increases assets and decreases assets.
- c. Increases assets and increases liabilities.
- d. Increases assets and increases stockholders' equity (retained earnings).
- e. Decreases assets and decreases stockholders' equity (retained earnings).

Ex. 1–10

- a. (1) Total assets increased \$250,000 (\$350,000 – \$100,000).
(2) No change in liabilities.
(3) Stockholders' equity (retained earnings) increased \$250,000.
- b. (1) Total assets decreased \$75,000.
(2) Total liabilities decreased \$75,000.
(3) No change in stockholders' equity (retained earnings).
- c. No, it is false that a transaction always affects at least two elements (Assets, Liabilities, or Stockholders' Equity) of the accounting equation. Some transactions affect only one element of the accounting equation. For example, purchasing supplies for cash only affects assets.

Ex. 1–11

- 1. (a) increase
- 2. (a) increase
- 3. (b) decrease
- 4. (b) decrease

Ex. 1–12

- | | |
|------|-------|
| 1. c | 6. c |
| 2. a | 7. d |
| 3. e | 8. a |
| 4. e | 9. e |
| 5. c | 10. e |

Ex. 1–13

- a. (1) Provided catering services for cash, \$29,000.
(2) Purchase of land for cash, \$20,000.
(3) Payment of expenses, \$14,000.
(4) Purchase of supplies on account, \$1,000.
(5) Paid cash dividends, \$2,000.
(6) Payment of cash to creditors, \$7,000.
(7) Recognition of cost of supplies used, \$1,800.
- b. \$14,000 (\$25,000 – \$11,000)
- c. \$11,200 (–\$2,000 + \$29,000 – \$15,800)
- d. \$13,200 (\$29,000 – \$15,800)
- e. \$11,200 (\$13,200 – \$2,000)

Ex. 1–14

No. It would be incorrect to say that the business had incurred a net loss of \$10,000. The excess of the dividends over the net income for the period is a decrease in the amount of stockholders' equity (retained earnings) in the business.

Ex. 1–15**Aries**

Stockholders' equity at end of year (\$750,000 – \$300,000)	\$450,000
Deduct stockholders' equity at beginning of year (\$400,000 – \$100,000)	<u>300,000</u>
Net income (increase in stockholders' equity)	<u>\$150,000</u>

Gemini

Increase in stockholders' equity (as determined for Aries)	\$150,000
Add dividends	<u>40,000</u>
Net income	<u>\$190,000</u>

Leo

Increase in stockholders' equity (as determined for Aries)	\$150,000
Deduct additional issuance of capital stock	<u>90,000</u>
Net income	<u>\$ 60,000</u>

Pisces

Increase in stockholders' equity (as determined for Aries)	\$150,000
Deduct additional issuance of capital stock	<u>90,000</u>
	\$ 60,000
Add dividends	<u>40,000</u>
Net income	<u>\$100,000</u>

Ex. 1–16

Balance sheet items: 1, 2, 3, 5, 6, 10

Ex. 1–17

Income statement items: 4, 7, 8, 9

Ex. 1–18**a.**

LOST TRAIL COMPANY
Retained Earnings Statement
For the Month Ended June 30, 2012

Retained earnings, June 1, 2012		\$375,000
Net income for June	\$125,000	
Less dividends.....	<u>18,000</u>	
Increase in retained earnings equity		<u>107,000</u>
Retained earnings, June 30, 2012		<u>\$482,000</u>

- b. The retained earnings statement is prepared before the June 30, 2012, balance sheet because retained earnings as of June 30, 2012, is needed for the balance sheet.

Ex. 1–19

UNIVERSAL SERVICES
Income Statement
For the Month Ended October 31, 2012

Fees earned		\$800,000
Expenses:		
Wages expense	\$270,000	
Rent expense.....	60,000	
Supplies expense.....	9,000	
Miscellaneous expense	<u>12,000</u>	
Total expenses		<u>351,000</u>
Net income.....		<u>\$449,000</u>

Ex. 1–20

In each case, solve for a single unknown, using the following equation:
**Stockholders' equity (beginning) + Additional issuance of Capital Stock – Divi-
dends + Revenues – Expenses = Stockholders' equity (ending)**

Aquarius	Stockholders' equity at end of year (\$420,000 – \$110,000)	\$310,000
	Stockholders' equity at beginning of year (\$300,000 – \$120,000) ..	<u>180,000</u>
	Increase in stockholders' equity	\$130,000
	Deduct increase due to net income (\$190,000 – \$80,000)	<u>110,000</u>
		\$ 20,000
	Add dividends	<u>25,000</u>
	Additional issuance of capital stock	(a) <u>\$ 45,000</u>
Libra	Stockholders' equity at end of year (\$700,000 – \$220,000)	\$480,000
	Stockholders' equity at beginning of year (\$500,000 – \$260,000) ..	<u>240,000</u>
	Increase in stockholders' equity	\$240,000
	Add dividends	<u>32,000</u>
		\$272,000
	Deduct additional issuance of capital stock	<u>100,000</u>
	Increase due to net income	\$172,000
	Add expenses	<u>128,000</u>
	Revenue	(b) <u>\$300,000</u>
Scorpio	Stockholders' equity at end of year (\$90,000 – \$80,000)	\$ 10,000
	Stockholders' equity at beginning of year (\$100,000 – \$76,000)	<u>24,000</u>
	Decrease in stockholders' equity	\$(14,000)
	Deduct decrease due to net loss (\$115,000 – \$122,500)	<u>(7,500)</u>
		\$ (6,500)
	Deduct additional issuance of capital stock	<u>10,000</u>
	Dividends	(c) <u>\$(16,500)</u>
Taurus	Stockholders' equity at end of year (\$248,000 – \$136,000)	\$112,000
	Add decrease due to net loss (\$112,000 – \$128,000)	<u>16,000</u>
		\$128,000
	Add dividends	<u>60,000</u>
	Stockholders' equity at beginning of year	\$188,000
	Deduct additional issuance of capital stock	<u>40,000</u>
		\$148,000
	Add liabilities at beginning of year	<u>120,000</u>
	Assets at beginning of year	(d) <u>\$268,000</u>

Ex. 1–21

a.

LADY INTERIORS
Balance Sheet
July 31, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$ 80,000	Accounts payable	\$ 90,000
Accounts receivable	200,000		
Supplies	<u>20,000</u>	<u>Stockholders' Equity</u>	
		Capital stock	\$ 80,000
		Retained earnings..	<u>130,000</u>
		Total stockholders'	
		equity	<u>210,000</u>
		Total liabilities and	
Total assets	<u>\$300,000</u>	stockholders' equity	<u>\$300,000</u>

LADY INTERIORS
Balance Sheet
August 31, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$ 95,000	Accounts payable	\$100,000
Accounts receivable	240,000		
Supplies	<u>15,000</u>	<u>Stockholders' Equity</u>	
		Capital stock	\$ 80,000
		Retained earnings..	<u>170,000</u>
		Total stockholders'	
		equity	<u>250,000</u>
		Total liabilities and	
Total assets	<u>\$350,000</u>	stockholders' equity	<u>\$350,000</u>

b. Stockholders' equity, August 31	\$250,000
Stockholders' equity, July 31	<u>210,000</u>
Net income	<u>\$ 40,000</u>

c. Stockholders' equity, August 31	\$250,000
Stockholders' equity, July 31	<u>210,000</u>
Increase in stockholders' equity	\$ 40,000
Add dividends.....	<u>35,000</u>
Net income	<u>\$ 75,000</u>

Ex. 1–22

- a. Balance sheet: 1, 2, 3, 4, 6, 7, 8, 9, 10, 11, 13
Income statement: 5, 12, 14, 15
- b. Yes, an item can appear on more than one financial statement. For example, cash appears on both the balance sheet and statement of cash flows. However, the same item cannot appear on both the income statement and balance sheet.
- c. Yes, the accounting equation is relevant to all companies including ExxonMobil Corporation.

Ex. 1–23

1. (a) operating activity
2. (a) operating activity
3. (b) investing activity
4. (c) financing activity

Ex. 1–24

ABSOLUTE CONSULTING GROUP
Statement of Cash Flows
For the Year Ended July 31, 2012

Cash flows from operating activities:		
Cash received from customers	\$187,500	
Deduct cash payments for operating expenses	<u>127,350</u>	
Net cash flows from operating activities		\$60,150
Cash flows from investing activities:		
Cash payments for purchase of land		(30,000)
Cash flows from financing activities:		
Cash received from issuing additional capital stock ..	\$ 40,000	
Deduct cash dividends	<u>5,000</u>	
Net cash flows from financing activities		<u>35,000</u>
Net increase in cash during year		\$65,150
Cash as of August 1, 2011		<u>27,100</u>
Cash as of July 31, 2012		<u><u>\$92,250</u></u>

Ex. 1–25

- 1. All financial statements should contain the name of the business in their heading. The retained earnings statement is incorrectly headed as “Bertram Mitchell” rather than Empire Realty. The heading of the balance sheet needs the name of the business.**
- 2. The income statement and retained earnings statement cover a period of time and should be labeled “For the Month Ended May 31, 2012.”**
- 3. The year in the heading for the retained earnings statement should be 2012 rather than 2011.**
- 4. The balance sheet should be labeled “May 31, 2012,” rather than “For the Month Ended May 31, 2012.”**
- 5. In the income statement, the miscellaneous expense amount should be listed as the last expense.**
- 6. In the income statement, the total expenses are incorrectly subtracted from the sales commissions, resulting in an incorrect net income amount. The correct net income should be \$22,050. This also affects the retained earnings statement and the amount of retained earnings that appears on the balance sheet.**
- 7. In the retained earnings statement, the additional issuance of capital stock should not be added to retained earnings, as of May 1, 2012. The net income should be presented after the beginning retained earnings as of May 1, 2012, followed by the amount of dividends, which is subtracted from the net income to yield a net increase in retained earnings.**
- 8. Accounts payable should be listed as a liability on the balance sheet.**
- 9. Accounts receivable and supplies should be listed as assets on the balance sheet.**
- 10. The balance sheet assets should equal the sum of the liabilities and stockholders’ equity.**

Ex. 1–25 (Concluded)

Corrected financial statements appear as follows:

EMPIRE REALTY
Income Statement
For the Month Ended May 31, 2012

Sales commissions		\$233,550
Expenses:		
Office salaries expense	\$145,800	
Rent expense	49,500	
Automobile expense	11,250	
Supplies expense	1,350	
Miscellaneous expense	<u>3,600</u>	
Total expenses		<u>211,500</u>
Net income		<u>\$ 22,050</u>

EMPIRE REALTY
Retained Earnings Statement
For the Month Ended May 31, 2012

Retained earnings, May 1, 2012		\$36,800
Net income for May	\$22,050	
Less dividends	<u>9,000</u>	
Increase in retained earnings		<u>13,050</u>
Retained earnings, May 31, 2012		<u>\$49,850</u>

EMPIRE REALTY
Balance Sheet
May 31, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$14,850	Accounts payable	\$17,100
Accounts receivable	64,350		
Supplies	<u>9,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$21,250
		Retained earnings..	<u>49,850</u>
		Total stockholders'	
		equity	<u>71,100</u>
		Total liabilities and	
Total assets	<u>\$88,200</u>	stockholders' equity	<u>\$88,200</u>

Ex. 1–26

- a. 2009: \$23,387 ($\$41,164 - \$17,777$)
2008: \$26,610 ($\$44,324 - \$17,714$)
- b. 2009: 1.32 ($\$23,387 \div \$17,777$)
2008: 1.50 ($\$26,610 \div \$17,714$)
- c. The ratio of liabilities to stockholders' equity decreased from 2008 to 2009, indicating a decrease in risk for creditors.

Ex. 1–27

- a. 2009: \$18,055 ($\$32,686 - \$14,631$)
2008: \$16,098 ($\$30,869 - \$14,771$)
- b. 2009: 0.81 ($\$14,631 \div \$18,055$)
2008: 0.92 ($\$14,771 \div \$16,098$)
- c. The margin of safety for creditors has increased slightly from 2008 to 2009. In both years, creditors have less at stake in Lowe's than do stockholders, since the ratio is less than 1.
- d. Lowe's ratio of liabilities to stockholders' equity is less than 1. In comparison, The Home Depot's ratio of liabilities to stockholders' equity is greater than 1 for 2009 and 2008. Thus, the creditors of The Home Depot are more at risk than are the creditors of Lowe's.

PROBLEMS

Prob. 1–1A

1.	Assets				=	Liabilities		+	Stockholders' Equity														
	Cash	+	Accts. Rec.	+	Supplies	=	Accts. Payable	+	Capital Stock	–	Dividends	+	Fees Earned	–	Rent Exp.	–	Salaries Exp.	–	Supplies Exp.	–	Auto Exp.	–	Misc. Exp.
a.	+ 40,000								+ 40,000														
b.					+ 2,200		+ 2,200																
Bal.	40,000				2,200		2,200		40,000														
c.	+ 6,000												+ 6,000										
Bal.	46,000				2,200		2,200		40,000				6,000										
d.	– 2,700														– 2,700								
Bal.	43,300				2,200		2,200		40,000				6,000		– 2,700								
e.	– 1,000						– 1,000																
Bal.	42,300				2,200		1,200		40,000				6,000		– 2,700								
f.			+ 5,000										+ 5,000										
Bal.	42,300		5,000		2,200		1,200		40,000				11,000		– 2,700								
g.	– 900																				– 600		– 300
Bal.	41,400		5,000		2,200		1,200		40,000				11,000		– 2,700						– 600		– 300
h.	– 1,900																– 1,900						
Bal.	39,500		5,000		2,200		1,200		40,000				11,000		– 2,700		– 1,900				– 600		– 300
i.					– 900															– 900			
Bal.	39,500		5,000		1,300		1,200		40,000				11,000		– 2,700		– 1,900		– 900		– 600		– 300
j.	– 1,800										– 1,800												
Bal.	37,700		5,000		1,300		1,200		40,000		– 1,800		11,000		– 2,700		– 1,900		– 900		– 600		– 300

- Stockholders' equity is the right of stockholders (owners) to the assets of the business. These rights are increased by stockholders' investments and revenues and decreased by dividends and expenses.
- \$4,600 (\$11,000 – \$2,700 – \$1,900 – \$900 – \$600 – \$300)
- September's transactions increased retained earnings by \$2,800 (\$4,600 – \$1,800), which is the excess of September's net income of \$4,600 over dividends of \$1,800.

Prob. 1–2A

1.

NEW WORLD TRAVEL AGENCY
Income Statement
For the Year Ended December 31, 2012

Fees earned		\$200,000
Expenses:		
Wages expense	\$90,000	
Rent expense	45,000	
Utilities expense	18,000	
Supplies expense	3,000	
Miscellaneous expense.....	<u>4,000</u>	
Total expenses		<u>160,000</u>
Net income		<u>\$ 40,000</u>

2.

NEW WORLD TRAVEL AGENCY
Retained Earnings Statement
For the Year Ended December 31, 2012

Retained earnings, January 1, 2012.....		\$105,000
Net income for the year.....	\$40,000	
Less dividends.....	<u>10,000</u>	
Increase in retained earnings.....		<u>30,000</u>
Retained earnings, December 31, 2012		<u>\$135,000</u>

3.

NEW WORLD TRAVEL AGENCY
Balance Sheet
December 31, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$110,000	Accounts payable	\$ 25,000
Accounts receivable	60,000		
Supplies	<u>5,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$ 15,000
		Retained earnings..	<u>135,000</u>
		Total stockholders'	
		equity	<u>150,000</u>
		Total liabilities and	
Total assets	<u>\$175,000</u>	stockholders' equity	<u>\$175,000</u>

4. Retained earnings, \$135,000

Prob. 1–3A

1.

FREEDOM FINANCIAL SERVICES
Income Statement
For the Month Ended March 31, 2012

Fees earned		\$118,500
Expenses:		
Salaries expense	\$48,000	
Rent expense	22,500	
Auto expense	13,500	
Supplies expense	4,500	
Miscellaneous expense.....	<u>3,600</u>	
Total expenses		<u>92,100</u>
Net income.....		<u>\$ 26,400</u>

2.

FREEDOM FINANCIAL SERVICES
Retained Earnings Statement
For the Month Ended March 31, 2012

Retained earnings, March 1, 2012.....		\$ 0
Net income for March.....	\$26,400	
Less dividends.....	<u>15,000</u>	
Increase in retained earnings.....		<u>11,400</u>
Retained earnings, March 31, 2012.....		<u>\$11,400</u>

3.

FREEDOM FINANCIAL SERVICES
Balance Sheet
March 31, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$24,600	Accounts payable	\$ 4,740
Accounts receivable	34,500		
Supplies	<u>2,040</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$45,000
		Retained earnings..	<u>11,400</u>
		Total stockholders' equity	<u>56,400</u>
		Total liabilities and stockholders' equity	<u>\$61,140</u>
Total assets	<u>\$61,140</u>		

Prob. 1–3A (Concluded)

4. (Optional)

FREEDOM FINANCIAL SERVICES
Statement of Cash Flows
For the Month Ended March 31, 2012

Cash flows from operating activities:		
Cash received from customers	\$84,000	
Deduct cash payments for expenses and payments to creditors.....	<u>89,400*</u>	
Net cash flow used for operating activities.....		\$ (5,400)
Cash flows from investing activities		0
Cash flows from financing activities:		
Cash received from issuing additional capital stock	\$45,000	
Deduct cash dividends	<u>15,000</u>	
Net cash flow from financing activities		<u>30,000</u>
Net cash flow and March 31, 2012, cash balance		<u><u>\$24,600</u></u>

***\$1,800 + \$22,500 + \$17,100 + \$48,000**

Prob. 1–4A

1.

Assets		=	Liabilities +		Stockholders' Equity						
			Accts.	Capital							
			Payable	Stock	Dividends	Sales	Rent	Office	Auto	Supplies.	Misc.
						Comm.	Exp.	Salaries	Exp.	Exp.	Exp.
								Exp.			
a.	+ 25,000			+25,000							
b.		+ 2,500	+ 2,500								
Bal.	25,000	+ 2,500	2,500	25,000							
c.	- 1,600		- 1,600								
Bal.	23,400	2,500	900	25,000							
d.	+ 25,500					+ 25,500					
Bal.	48,900	2,500	900	25,000		25,500					
e.	- 5,000						- 5,000				
Bal.	43,900	2,500	900	25,000		25,500	- 5,000				
f.	- 8,000				- 8,000						
Bal.	35,900	2,500	900	25,000	- 8,000	25,500	- 5,000				
g.	- 3,700								- 2,500		- 1,200
Bal.	32,200	2,500	900	25,000	- 8,000	25,500	- 5,000		- 2,500		- 1,200
h.	- 3,000							- 3,000			
Bal.	29,200	2,500	900	25,000	- 8,000	25,500	- 5,000	- 3,000	- 2,500		- 1,200
i.		- 1,650								- 1,650	
Bal.	<u>29,200</u>	<u>850</u>	<u>900</u>	<u>25,000</u>	<u>- 8,000</u>	<u>25,500</u>	<u>- 5,000</u>	<u>- 3,000</u>	<u>- 2,500</u>	<u>- 1,650</u>	<u>- 1,200</u>

Prob. 1–4A (Concluded)

2.

VISTA REALTY
Income Statement
For the Month Ended January 31, 2012

Sales commissions		\$25,500
Expenses:		
Rent expense	\$5,000	
Office salaries expense	3,000	
Automobile expense	2,500	
Supplies expense	1,650	
Miscellaneous expense.....	<u>1,200</u>	
Total expenses		<u>13,350</u>
Net income.....		<u>\$12,150</u>

VISTA REALTY
Retained Earnings Statement
For the Month Ended January 31, 2012

Retained earnings, January 1, 2012.....		\$ 0
Net income for January.....	\$12,150	
Less dividends.....	<u>8,000</u>	
Increase in retained earnings.....		<u>4,150</u>
Retained earnings, January 31, 2012.....		<u>\$4,150</u>

VISTA REALTY
Balance Sheet
January 31, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$29,200	Accounts payable	\$ 900
Supplies	<u>850</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$25,000
		Retained earnings..	<u>4,150</u>
		Total stockholders'	
		equity	<u>29,150</u>
		Total liabilities and	
Total assets	<u>\$30,050</u>	stockholders' equity	<u>\$30,050</u>

Prob. 1–5A

1.

Assets				=	Liabilities	+ Stockholders' Equity	
Accounts				=	Accounts		
Cash	+ Receivable	+ Supplies	+ Land	=	Payable	+ Capital Stock	+ Retained Earnings
\$15,000	+ \$31,000	+ \$3,000	+ \$36,000	=	\$13,000	+ Capital Stock	+ Retained Earnings
			\$85,000	=	\$13,000	+ \$25,000	+ Retained Earnings
			\$47,000	=	Retained earnings		

Prob. 1–5A (Continued)

2.

	Assets				=	Liabilities	+	Stockholders' Equity	
	Cash	Accounts Receivable	Supplies	Land	=	Accounts Payable	Capital Stock	Dividends	Retained Earnings
Bal.	15,000	31,000	3,000	36,000		13,000	25,000		47,000
a.	+ 28,000						+ 28,000		
Bal.	43,000	31,000	3,000	36,000		13,000	53,000		47,000
b.	- 14,000			+ 14,000					
Bal.	29,000	31,000	3,000	50,000		13,000	53,000		47,000
c.	+ 17,000								
Bal.	46,000	31,000	3,000	50,000		13,000	53,000		47,000
d.	- 5,000								
Bal.	41,000	31,000	3,000	50,000		13,000	53,000		47,000
e.			+ 2,500			+ 2,500			
Bal.	41,000	31,000	5,500	50,000		15,500	53,000		47,000
f.	- 12,800					- 12,800			
Bal.	28,200	31,000	5,500	50,000		2,700	53,000		47,000
g.		+ 34,000							
Bal.	28,200	65,000	5,500	50,000		2,700	53,000		47,000
h.						+ 13,500			
Bal.	28,200	65,000	5,500	50,000		16,200	53,000		47,000
i.	- 14,000								
Bal.	14,200	65,000	5,500	50,000		16,200	53,000		47,000
j.	+ 28,000	- 28,000							
Bal.	42,200	37,000	5,500	50,000		16,200	53,000		47,000
k.			- 3,600						
Bal.	42,200	37,000	1,900	50,000		16,200	53,000		47,000
l.	- 8,000							- 8,000	
Bal.	34,200	37,000	1,900	50,000		16,200	53,000	- 8,000	47,000

Prob. 1–5A (Continued)

Stockholders' Equity (Continued)											
	Dry Cleaning + Revenue –	Dry Cleaning Exp. –	Wages Exp. –	Rent Exp. –	Supplies Exp. –	Truck Exp. –	Utilities Exp. –	Misc. Exp.			
Bal.											
a.											
Bal.											
b.											
Bal.											
c.	<u>+ 17,000</u>										
Bal.	17,000										
d.				<u>– 5,000</u>							
Bal.	17,000			– 5,000							
e.											
Bal.	17,000			– 5,000							
f.											
Bal.	17,000			– 5,000							
g.	<u>+ 34,000</u>										
Bal.	51,000			– 5,000							
h.		<u>– 13,500</u>									
Bal.	51,000	– 13,500		– 5,000							
i.			<u>– 7,500</u>			<u>– 2,500</u>	<u>– 1,300</u>	<u>– 2,700</u>			
Bal.	51,000	– 13,500	– 7,500	– 5,000		– 2,500	– 1,300	– 2,700			
j.											
Bal.	51,000	– 13,500	– 7,500	– 5,000		– 2,500	– 1,300	– 2,700			
k.					<u>– 3,600</u>						
Bal.	51,000	– 13,500	– 7,500	– 5,000	– 3,600	– 2,500	– 1,300	– 2,700			
l.											
Bal.	<u>51,000</u>	<u>– 13,500</u>	<u>– 7,500</u>	<u>– 5,000</u>	<u>– 3,600</u>	<u>– 2,500</u>	<u>– 1,300</u>	<u>– 2,700</u>			

Prob. 1–5A (Continued)

3.

KEAN DRY CLEANERS
Income Statement
For the Month Ended March 31, 2012

Dry cleaning revenue		\$51,000
Expenses:		
Dry cleaning expense.....	\$13,500	
Wages expense	7,500	
Rent expense	5,000	
Supplies expense	3,600	
Truck expense	2,500	
Utilities expense	1,300	
Miscellaneous expense.....	<u>2,700</u>	
Total expenses		<u>36,100</u>
Net income		<u>\$14,900</u>

KEAN DRY CLEANERS
Retained Earnings Statement
For the Month Ended March 31, 2012

Retained earnings, March 1, 2012.....		\$47,000
Net income for March.....	\$14,900	
Less dividends.....	<u>8,000</u>	
Increase in retained earnings.....		<u>6,900</u>
Retained earnings, March 31, 2012.....		<u>\$53,900</u>

KEAN DRY CLEANERS
Balance Sheet
March 31, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$ 34,200	Accounts payable	\$ 16,200
Accounts receivable	37,000		
Supplies	1,900	<u>Stockholders' Equity</u>	
Land.....	<u>50,000</u>	Capital stock	\$53,000
		Retained earnings..	<u>53,900</u>
		Total stockholders'	
		equity	<u>106,900</u>
		Total liabilities and	
Total assets.....	<u>\$123,100</u>	stockholders' equity	<u>\$123,100</u>

Prob. 1–5A (Concluded)

4. (Optional)

KEAN DRY CLEANERS
Statement of Cash Flows
For the Month Ended March 31, 2012

Cash flows from operating activities:		
Cash received from customers	\$45,000*	
Deduct cash payments for expenses and payments to creditors.....	<u>31,800**</u>	
Net cash flow from operating activities.....		\$ 13,200
Cash flows from investing activities:		
Purchase of land.....		(14,000)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$28,000	
Deduct cash dividends	<u>8,000</u>	
Net cash flow from financing activities		<u>20,000</u>
Increase in cash		\$ 19,200
Cash balance, March 1, 2012.....		<u>15,000</u>
Cash balance, March 31, 2012.....		<u><u>\$ 34,200</u></u>

*\$17,000 + \$28,000

**\$5,000 + \$12,800 + \$14,000

Prob. 1–6A

- a. Fees earned, \$300,000 ($\$110,000 + \$190,000$)
- b. Supplies expense, \$12,000 ($\$190,000 - \$120,000 - \$40,000 - \$8,000 - \$10,000$)
- c. Retained earnings, June 1, 2012, \$0
- d. Net income for June, \$110,000
- e. Increase in retained earnings, \$60,000 ($\$110,000 - \$50,000$)
- f. Retained earnings, June 30, 2012, \$60,000
- g. Total assets, \$250,000 ($\$185,000 + \$5,000 + \$60,000$)
- h. Retained earnings, \$60,000; same as (f)
- i. Total stockholders' equity, \$210,000 ($\$150,000 + \$60,000$)
- j. Total liabilities and stockholders' equity, \$250,000
- k. Cash received from customers, \$300,000 ($\$155,000 + \$145,000$); this is the same as fees earned (a) since there are no accounts receivable.
- l. Net cash flow from operating activities, \$145,000 ($\$300,000 - \$155,000$)
- m. Cash payments for acquisition of land, (\$60,000)
- n. Cash received from issuing capital stock, \$150,000
- o. Cash dividends, (\$50,000)
- p. Net cash flow from financing activities, \$100,000 ($\$150,000 - \$50,000$)
- q. Net cash flow and June 30, 2012, cash balance, \$185,000 ($\$145,000 - \$60,000 + \$100,000$); also the cash balance on the balance sheet.

Prob. 1–1B

1.	Assets				=	Liabilities		+	Stockholders' Equity												
	Accts.				Accts.	Capital		Fees	Rent	Salaries	Supplies	Auto	Misc.								
	Cash	+	Rec.	+	Supplies	=	Payable	+	Stock	–	Dividends	+	Earned	–	Exp.	–	Exp.	–	Exp.	–	Exp.
a.	+ 75,000							+ 75,000													
b.						+ 3,000		+ 3,000													
Bal.	75,000					3,000		3,000	75,000												
c.	– 1,000							– 1,000													
Bal.	74,000					3,000		2,000	75,000												
d.	+ 11,800													+ 11,800							
Bal.	85,800					3,000		2,000	75,000					11,800							
e.	– 4,000														– 4,000						
Bal.	81,800					3,000		2,000	75,000					11,800	– 4,000						
f.	– 800																		– 600		– 200
Bal.	81,000					3,000		2,000	75,000					11,800	– 4,000				– 600		– 200
g.	– 2,500															– 2,500					
Bal.	78,500					3,000		2,000	75,000					11,800	– 4,000	– 2,500			– 600		– 200
h.						– 1,100												– 1,100			
Bal.	78,500					1,900		2,000	75,000					11,800	– 4,000	– 2,500	– 1,100		– 600		– 200
i.					+ 12,500									+ 12,500							
Bal.	78,500				12,500	1,900		2,000	75,000					24,300	– 4,000	– 2,500	– 1,100		– 600		– 200
j.	– 5,000												– 5,000								
Bal.	73,500				12,500	1,900		2,000	75,000				– 5,000	24,300	– 4,000	– 2,500	– 1,100		– 600		– 200

- Stockholders' equity is the right of stockholders (owners) to the assets of the business. These rights are increased by stockholders' investments and revenues and decreased by dividends and expenses.
- \$15,900 (\$24,300 – \$4,000 – \$2,500 – \$1,100 – \$600 – \$200)
- January's transactions increased retained earnings by \$10,900 (\$15,900 – \$5,000), which is the excess of January's net income of \$15,900 over dividends of \$5,000.

Prob. 1–2B

1.

ST. SIMON TRAVEL SERVICE
Income Statement
For the Year Ended June 30, 2012

Fees earned		\$500,000
Expenses:		
Wages expense	\$280,000	
Rent expense	75,000	
Utilities expense	36,000	
Supplies expense	10,000	
Taxes expense	8,000	
Miscellaneous expense.....	<u>11,000</u>	
Total expenses		<u>420,000</u>
Net income		<u>\$ 80,000</u>

2.

ST. SIMON TRAVEL SERVICE
Retained Earnings Statement
For the Year Ended June 30, 2012

Retained earnings, July 1, 2011		\$90,000
Net income for the year.....	\$80,000	
Less dividends.....	<u>30,000</u>	
Increase in retained earnings.....		<u>50,000</u>
Retained earnings, June 30, 2012		<u>\$140,000</u>

3.

ST. SIMON TRAVEL SERVICE
Balance Sheet
June 30, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash.....	\$123,000	Accounts payable	\$ 25,000
Accounts receivable.....	90,000		
Supplies	<u>12,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$ 60,000
		Retained earnings..	<u>140,000</u>
		Total stockholders'	
		equity	<u>200,000</u>
		Total liabilities and	
Total assets.....	<u>\$225,000</u>	stockholders' equity	<u>\$225,000</u>

4. Net income of \$80,000

Prob. 1–3B

1.

COMPUTERS 4 LESS
Income Statement
For the Month Ended February 29, 2012

Fees earned		\$201,000
Expenses:		
Salaries expense	\$48,000	
Rent expense	32,000	
Auto expense	15,500	
Supplies expense	6,100	
Miscellaneous expense.....	<u>7,500</u>	
Total expenses		<u>109,100</u>
Net income		<u>\$ 91,900</u>

2.

COMPUTERS 4 LESS
Retained Earnings Statement
For the Month Ended February 29, 2012

Retained earnings, February 29, 2012		\$ 0
Net income for February	\$91,900	
Less dividends.....	<u>30,000</u>	
Total stockholders' equity		<u>61,900</u>
Retained earnings, February 29, 2012		<u>\$61,900</u>

3.

COMPUTERS 4 LESS
Balance Sheet
February 29, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash.....	\$100,000	Accounts payable	\$ 5,400
Accounts receivable.....	83,000		
Supplies	<u>4,300</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$120,000
		Retained earnings	<u>61,900</u>
		Total stockholders' equity	<u>181,900</u>
		Total liabilities and stockholders' equity	<u>\$187,300</u>
Total assets.....	<u>\$187,300</u>		

Prob. 1–3B (Concluded)

4. (Optional)

COMPUTERS 4 LESS
Statement of Cash Flows
For the Month Ended February 29, 2012

Cash flows from operating activities:		
Cash received from customers	\$118,000	
Deduct cash payments for expenses and payments to creditors.....	<u>108,000*</u>	
Net cash flow from operating activities.....		\$ 10,000
Cash flows from investing activities:		0
Cash flows from financing activities:		
Cash received from issuing capital stock.....	\$120,000	
Deduct cash dividends	<u>30,000</u>	
Net cash flow from financing activities		<u>90,000</u>
Net cash flow and February 29, 2012, cash balance ..		<u><u>\$100,000</u></u>

*\$32,000 + \$5,000 + \$23,000 + \$48,000

Prob. 1–4B

1.

Assets		=	Liabilities +		Stockholders' Equity						
Cash	+ Supplies	=	Accts. Payable	+ Capital Stock	- Dividends	+ Sales Comm.	- Rent Exp.	- Office Salaries Exp.	- Auto Exp.	- Supplies Exp.	- Misc. Exp.
a. + 15,000				+ 15,000							
b. <u>- 4,000</u>							<u>- 4,000</u>				
Bal. 11,000				15,000			- 4,000				
c. <u>- 2,000</u>									<u>- 1,200</u>		<u>- 800</u>
Bal. 9,000				15,000			- 4,000		- 1,200		- 800
d. <u>+ 1,000</u>	<u>+ 1,000</u>		<u>+ 1,000</u>								
Bal. 9,000	1,000		1,000	15,000			- 4,000		- 1,200		- 800
e. <u>+ 18,500</u>						<u>+ 18,500</u>					
Bal. 27,500	1,000		1,000	15,000		18,500	- 4,000		- 1,200		- 800
f. <u>- 600</u>			<u>- 600</u>								
Bal. 26,900	1,000		400	15,000		18,500	- 4,000		- 1,200		- 800
g. <u>- 2,500</u>								<u>- 2,500</u>			
Bal. 24,400	1,000		400	15,000		18,500	- 4,000	- 2,500	1,200		- 800
h. <u>- 5,000</u>					<u>- 5,000</u>						
Bal. 19,400	1,000		400	15,000	- 5,000	18,500	- 4,000	- 2,500	- 1,200		- 800
i. <u>- 700</u>	<u>- 700</u>									<u>- 700</u>	
Bal. <u>19,400</u>	<u>300</u>		<u>400</u>	<u>15,000</u>	<u>- 5,000</u>	<u>18,500</u>	<u>- 4,000</u>	<u>- 2,500</u>	<u>- 1,200</u>	<u>- 700</u>	<u>- 800</u>

Prob. 1–4B (Concluded)

2.

EQUITY REALTY
Income Statement
For the Month Ended June 30, 2012

Sales commissions		\$18,500
Expenses:		
Rent expense	\$4,000	
Office salaries expense	2,500	
Automobile expense	1,200	
Supplies expense	700	
Miscellaneous expense.....	<u>800</u>	
Total expenses		<u>9,200</u>
Net income		<u>\$ 9,300</u>

EQUITY REALTY
Retained Earnings Statement
For the Month Ended June 30, 2012

Retained earnings, June 1, 2012		\$ 0
Net income for June	\$9,300	
Less dividends.....	<u>5,000</u>	
Increase in retained earnings.....		<u>4,300</u>
Retained earnings, June 30, 2012		<u>\$4,300</u>

EQUITY REALTY
Balance Sheet
June 30, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash.....	\$19,400	Accounts payable	\$ 400
Supplies	<u>300</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$15,000
		Retained earnings..	<u>4,300</u>
		Total stockholders'	
		equity	<u>19,300</u>
		Total liabilities and	
Total assets.....	<u>\$19,700</u>	stockholders' equity	<u>\$19,700</u>

Prob. 1–5B

1.

Assets				=	Liabilities + Stockholders' Equity		
Accounts					Accounts		
Cash	+	Receivable	+	Supplies	+	Land	= Payable + Capital + Retained
							Stock Earnings
\$25,000	+	\$30,000	+	\$5,000	+	\$50,000	= \$18,000 + Capital + Retained
							Stock Earnings
							\$110,000 = \$18,000 + \$35,000 + Retained
							Earnings
							\$57,000 = Retained Earnings

Prob. 1–5B (Continued)

2.

	Assets				=	Liabilities	+	Stockholders' Equity	
	Cash	+ Accounts Receivable	+ Supplies	+ Land	=	Accounts Payable	+ Capital Stock	– Dividends	+ Retained Earnings
Bal.	25,000	30,000	5,000	50,000		18,000	35,000		57,000
a.	+ 15,000						+ 15,000		
Bal.	40,000	30,000	5,000	50,000		18,000	50,000		57,000
b.	– 20,000			+ 20,000					
Bal.	20,000	30,000	5,000	70,000		18,000	50,000		57,000
c.	– 3,000								
Bal.	17,000	30,000	5,000	70,000		18,000	50,000		57,000
d.		+ 22,000							
Bal.	17,000	52,000	5,000	70,000		18,000	50,000		57,000
e.	– 13,000					– 13,000			
Bal.	4,000	52,000	5,000	70,000		5,000	50,000		57,000
f.			+ 1,000			+ 1,000			
Bal.	4,000	52,000	6,000	70,000		6,000	50,000		57,000
g.	+ 28,000								
Bal.	32,000	52,000	6,000	70,000		6,000	50,000		57,000
h.	+ 27,000	– 27,000							
Bal.	59,000	25,000	6,000	70,000		6,000	50,000		57,000
i.						+ 21,500			
Bal.	59,000	25,000	6,000	70,000		27,500	50,000		57,000
j.	– 19,200								
Bal.	39,800	25,000	6,000	70,000		27,500	50,000		57,000
k.			– 2,600						
Bal.	39,800	25,000	3,400	70,000		27,500	50,000		57,000
l.	– 1,000							– 1,000	
Bal.	<u>38,800</u>	<u>25,000</u>	<u>3,400</u>	<u>70,000</u>		<u>27,500</u>	<u>50,000</u>	<u>– 1,000</u>	<u>57,000</u>

Prob. 1–5B (Continued)

Stockholders' Equity (Continued)											
	Dry Cleaning + Revenue –	Dry Cleaning Exp. –	Wages Exp. –	Rent Exp. –	Supplies Exp. –	Truck Exp. –	Utilities Exp. –	Misc. Exp.			
Bal.											
a.											
Bal.											
b.											
Bal.											
c.				– 3,000							
Bal.				– 3,000							
d.	+ 22,000										
Bal.	22,000			– 3,000							
e.											
Bal.	22,000			– 3,000							
f.											
Bal.	22,000			– 3,000							
g.	+ 28,000										
Bal.	50,000			– 3,000							
h.											
Bal.	50,000			– 3,000							
i.		– 21,500									
Bal.	50,000	– 21,500		– 3,000							
j.			– 14,000			– 2,100	– 1,800	– 1,300			
Bal.	50,000	– 21,500	– 14,000	– 3,000		– 2,100	– 1,800	– 1,300			
k.					– 2,600						
Bal.	50,000	– 21,500	– 14,000	– 3,000	– 2,600	– 2,100	– 1,800	– 1,300			
l.											
Bal.	<u>50,000</u>	<u>– 21,500</u>	<u>– 14,000</u>	<u>– 3,000</u>	<u>– 2,600</u>	<u>– 2,100</u>	<u>– 1,800</u>	<u>– 1,300</u>			

Prob. 1–5B (Continued)

3.

ANNY'S DRY CLEANERS
Income Statement
For the Month Ended June 30, 2012

Dry cleaning revenue		\$50,000
Expenses:		
Dry cleaning expense.....	\$21,500	
Wages expense	14,000	
Rent expense	3,000	
Supplies expense	2,600	
Truck expense	2,100	
Utilities expense	1,800	
Miscellaneous expense.....	<u>1,300</u>	
Total expenses		<u>46,300</u>
Net income		<u>\$ 3,700</u>

ANNY'S DRY CLEANERS
Retained Earnings Statement
For the Month Ended June 30, 2012

Retained earnings, June 1, 2012		\$57,000
Net income for June	\$3,700	
Less dividends.....	<u>1,000</u>	
Increase in retained earnings.....		<u>2,700</u>
Retained earnings, June 30, 2012		<u>\$59,700</u>

ANNY'S DRY CLEANERS
Balance Sheet
June 30, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash.....	\$ 38,800	Accounts payable	\$ 27,500
Accounts receivable...	25,000		
Supplies	3,400		
Land.....	<u>70,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$50,000
		Retained earnings	<u>59,700</u>
		Total stockholders'	
		equity	<u>109,700</u>
		Total liabilities and	
Total assets.....	<u>\$137,200</u>	stockholders' equity	<u>\$137,200</u>

Prob. 1–5B (Concluded)

4. (Optional)

ANNY'S DRY CLEANERS
Statement of Cash Flows
For the Month Ended June 30, 2012

Cash flows from operating activities:		
Cash received from customers	\$55,000*	
Deduct cash payments for expenses and payments to creditors.....	<u>35,200**</u>	
Net cash flow from operating activities.....		\$ 19,800
Cash flows from investing activities:		
Purchase of land.....		(20,000)
Cash flows from financing activities:		
Cash received from issuing capital stock	\$15,000	
Deduct cash dividends	<u>1,000</u>	
Net cash flow from financing activities		<u>14,000</u>
Increase in cash		\$ 13,800
Cash balance, June 1, 2012		<u>25,000</u>
Cash balance, June 30, 2012		<u><u>\$38,800</u></u>

*\$28,000 + \$27,000

**\$3,000 + \$13,000 + \$19,200

Prob. 1–6B

- a. Wages expense, \$127,000 ($\$180,000 - \$30,000 - \$11,000 - \$9,000 - \$3,000$)
- b. Net income, \$70,000 ($\$250,000 - \$180,000$)
- c. Retained earnings, October 1, 2012, \$0
- d. Net income for October, \$70,000
- e. Dividends, \$40,000; from statement of cash flows.
- f. Increase in retained earnings, \$30,000 ($\$70,000 - \$40,000$)
- g. Retained earnings, October 31, 2012, \$30,000
- h. Land, \$75,000; from statement of cash flows.
- i. Total assets, \$160,000 ($\$77,000 + \$8,000 + \$75,000$)
- j. Capital stock, \$100,000; from statement of cash flows
- k. Retained earnings, \$30,000; from retained earnings statement (g)
- l. Total stockholders' equity, \$130,000 ($\$100,000 + \$30,000$)
- m. Total liabilities and stockholders' equity, \$160,000 ($\$30,000 + \$130,000$)
- n. Cash received from customers, \$250,000; this is the same as fees earned since there are no accounts receivable.
- o. Net cash flow from operating activities, \$92,000 ($\$250,000 - \$158,000$)
- p. Net cash flow from financing activities, \$60,000 ($\$100,000 - \$40,000$)
- q. Net cash flow and October 31, 2012, cash balance, \$77,000 ($\$92,000 - \$75,000 + \$60,000$); also, the cash balance on the balance sheet.

CONTINUING PROBLEM

1.

	Assets			=	Liabilities	+	Stockholders' Equity		
	Cash	+ Accounts Receivable	+ Supplies	=	Accounts Payable	+	Capital Stock	- Dividends	+ Fees Earned
June 1	5,000						5,000		
2	<u>+ 3,600</u>								<u>+ 3,600</u>
Bal.	8,600						5,000		3,600
June 2	<u>- 750</u>								
Bal.	7,850						5,000		3,600
June 4			<u>+ 350</u>		<u>+ 350</u>				
Bal.	7,850		350		350		5,000		3,600
June 6	<u>- 450</u>								
Bal.	7,400		350		350		5,000		3,600
June 8	<u>- 700</u>								
Bal.	6,700		350		350		5,000		3,600
June 12	<u>- 350</u>								
Bal.	6,350		350		350		5,000		3,600
June 13	<u>- 100</u>				<u>- 100</u>				
Bal.	6,250		350		250		5,000		3,600
June 16	<u>+ 500</u>								<u>+ 500</u>
Bal.	6,750		350		250		5,000		4,100
June 22		<u>+ 1,250</u>							<u>+ 1,250</u>
Bal.	6,750	1,250	350		250		5,000		5,350
June 25	<u>+ 400</u>								<u>+ 400</u>
Bal.	7,150	1,250	350		250		5,000		5,750
June 29	<u>- 240</u>								
Bal.	6,910	1,250	350		250		5,000		5,750
June 30	<u>+ 900</u>								<u>+ 900</u>
Bal.	7,810	1,250	350		250		5,000		6,650
June 30	<u>- 400</u>								
Bal.	7,410	1,250	350		250		5,000		6,650
June 30	<u>- 300</u>								
Bal.	7,110	1,250	350		250		5,000		6,650
June 30			<u>- 180</u>						
Bal.	7,110	1,250	170		250		5,000		6,650
June 30	<u>- 300</u>								
Bal.	6,810	1,250	170		250		5,000		6,650
June 30	<u>- 1,000</u>								
Bal.	5,810	1,250	170		250		5,000		6,650
June 30	<u>- 500</u>							<u>- 500</u>	
Bal.	<u>5,310</u>	<u>1,250</u>	<u>170</u>		<u>250</u>		<u>5,000</u>	<u>- 500</u>	<u>6,650</u>

Continuing Problem (Continued)

Stockholders' Equity (Continued)																
	Music		Office		Equip.		Adver-		Wages		Utilities		Supplies		Misc.	
	Exp.	-	Rent	-	Rent	-	Exp.	-	Exp.	-	Exp.	-	Exp.	-	Exp.	
June 1																
2																
Bal.																
June 2			-	750												
Bal.			-	750												
June 4																
Bal.			-	750												
June 6							-	450								
Bal.			-	750			-	450								
June 8					-	700										
Bal.			-	750	-	700	-	450								
June 12	-	350														
Bal.	-	350	-	750	-	700	-	450								
June 13																
Bal.	-	350	-	750	-	700	-	450								
June 16																
Bal.	-	350	-	750	-	700	-	450								
June 22																
Bal.	-	350	-	750	-	700	-	450								
June 25																
Bal.	-	350	-	750	-	700	-	450								
June 29	-	240														
Bal.	-	590	-	750	-	700	-	450								
June 30																
Bal.	-	590	-	750	-	700	-	450								
June 30									-	400						
Bal.	-	590	-	750	-	700	-	450	-	400						
June 30											-	300				
Bal.	-	590	-	750	-	700	-	450	-	400	-	300				
June 30													-	180		
Bal.	-	590	-	750	-	700	-	450	-	400	-	300	-	180		
June 30															-	300
Bal.	-	590	-	750	-	700	-	450	-	400	-	300	-	180	-	300
June 30	-	1,000														
Bal.	-	1,590	-	750	-	700	-	450	-	400	-	300	-	180	-	300
June 30																
Bal.	-	1,590	-	750	-	700	-	450	-	400	-	300	-	180	-	300

Continuing Problem (Concluded)

2.

PS MUSIC Income Statement For the Month Ended June 30, 2012

Fees earned		\$6,650
Expenses:		
Music expense	\$1,590	
Office rent expense	750	
Equipment rent expense	700	
Advertising expense	450	
Wages expense	400	
Utilities expense	300	
Supplies expense	180	
Miscellaneous expense	<u>300</u>	
Total expenses		<u>4,670</u>
Net income		<u>\$1,980</u>

3.

PS MUSIC Retained Earnings Statement For the Month Ended June 30, 2012

Retained earnings, June 1, 2012		\$ 0
Net income for June	\$1,980	
Less dividends	<u>500</u>	
Increase in retained earnings		<u>1,480</u>
Retained earnings, June 30, 2012		<u>\$1,480</u>

4.

PS MUSIC Balance Sheet June 30, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$5,310	Accounts payable	\$ 250
Accounts receivable	1,250		
Supplies	<u>170</u>		
		<u>Stockholders' Equity</u>	
		Capital stock	\$5,000
		Retained earnings ..	<u>1,480</u>
		Total stockholders' equity	<u>6,480</u>
		Total liabilities and stockholders' equity	<u>\$6,730</u>
Total assets	<u>\$6,730</u>		

CASES & PROJECTS

CP 1–1

- 1. Acceptable professional conduct requires that Vince Hunt supply First National Bank with all the relevant financial statements necessary for the bank to make an informed decision. Therefore, Vince should provide the complete set of financial statements. These can be supplemented with a discussion of the net loss in the past year or other data explaining why granting the loan is a good investment by the bank.**
- 2. a. Owners are generally willing to provide bankers with information about the operating and financial condition of the business, such as the following:**
 - Operating Information:**
 - Description of business operations**
 - Results of past operations**
 - Preliminary results of current operations**
 - Plans for future operations**
 - Financial Condition:**
 - List of assets and liabilities (balance sheet)**
 - Estimated current values of assets**
 - Owner's personal investment in the business**
 - Owner's commitment to invest additional funds in the business**

Owners are normally reluctant to provide the following types of information to bankers:

- Proprietary Operating Information.** Such information, which might hurt the business if it becomes known by competitors, might include special processes used by the business or future plans to expand operations into areas that are not currently served by a competitor.
- Personal Financial Information.** Owners may have little choice here because banks often require owners of small businesses to pledge their personal assets as security for a business loan. Personal financial information requested by bankers often includes the owner's net worth, salary, and other income. In addition, bankers usually request information about factors that might affect the personal financial condition of the owner. For example, a pending divorce by the owner might significantly affect the owner's personal wealth.

CP 1–1 (Concluded)

- b. Bankers typically want as much information as possible about the ability of the business and the owner to repay the loan with interest. Examples of such information are described above.**
- c. Both bankers and business owners share the common interest of the business doing well and being successful. If the business is successful, the bankers will receive their loan payments on time with interest, and the owners will increase their personal wealth.**

CP 1–2

The difference in the two bank balances, \$50,000 (\$90,000 – \$40,000), may not be pure profit from an accounting perspective. To determine the accounting profit for the six-month period, the revenues for the period would need to be matched with the related expenses. The revenues minus the expenses would indicate whether the business generated net income (profit) or a net loss for the period. Using only the difference between the two bank account balances ignores such factors as amounts due from customers (receivables), liabilities (accounts payable) that need to be paid for wages or other operating expenses, additional investments that Dr. Dewitt may have made in the business during the period, or dividends paid during the period.

Some businesses that have few, if any, receivables or payables may use a “cash” basis of accounting. The cash basis of accounting ignores receivables and payables because they are assumed to be insignificant in amount. However, even with the cash basis of accounting, additional investments during the period and dividends paid during the period have to be considered in determining the net income (profit) or net loss for the period.

CP 1–3

1.

Assets		=	Liabilities	+	Owner's Equity					
				Jan	Jan					
			Accts.	Martinelli,	Martinelli,	Service	Salary	Rent	Supplies	Misc.
			Payable	Capital	Drawing	Revenue	Expense	Expense	Expense	Expense
Cash	+ Supplies	=								
a. + 1,000				+ 1,000						
b. - 300	+ 300									
Bal. 700	300			1,000						
c. - 200								- 200		
Bal. 500	300			1,000				- 200		
d. - 100			+ 150					- 250		
Bal. 400	300		150	1,000				- 450		
e. + 1,600						+ 1,600				
Bal. 2,000	300		150	1,000		1,600		- 450		
f. + 500						+ 500				
Bal. 2,500	300		150	1,000		2,100		- 450		
g. - 800							- 800			
Bal. 1,700	300		150	1,000		2,100	- 800	- 450		
h. - 225										- 225
Bal. 1,475	300		150	1,000		2,100	- 800	- 450		- 225
i. + 1,200						+ 1,200				
Bal. 2,675	300		150	1,000		3,300	- 800	- 450		- 225
j. - 120									- 120	
Bal. 2,675	180		150	1,000		3,300	- 800	- 450	- 120	- 225
k. - 250					- 250					
Bal. 2,425	180		150	1,000	- 250	3,300	- 800	- 450	- 120	- 225

CP 1–3 (Continued)

2.

TOPSPIN
Income Statement
For the Month Ended April 30, 2012

Service revenue		\$3,300
Expenses:		
Salary expense	\$800	
Rent expense	450	
Supplies expense	120	
Miscellaneous expense.....	<u>225</u>	
Total expenses		<u>1,595</u>
Net income		<u><u>\$1,705</u></u>

3.

TOPSPIN
Statement of Owner's Equity
For the Month Ended April 30, 2012

Jan Martinelli, capital, April 1, 2012		\$ 0
Investment on April 1, 2009	\$1,000	
Net income for April	<u>1,705</u>	
	\$2,705	
Less withdrawals.....	<u>250</u>	
Increase in owner's equity.....		<u>2,455</u>
Jan Martinelli, capital, April 30, 2012		<u><u>\$2,455</u></u>

4.

TOPSPIN
Balance Sheet
April 30, 2012

<u>Assets</u>		<u>Liabilities</u>	
Cash.....	\$2,425	Accounts payable	\$ 150
Supplies	<u>180</u>		
		<u>Owner's Equity</u>	
		Jan Martinelli, capital	<u>2,455</u>
		Total liabilities and	
Total assets.....	<u><u>\$2,605</u></u>	owner's equity.....	<u><u>\$2,605</u></u>

CP 1–3 (Concluded)

5. a. Topspin would provide Jan with \$625 more income per month than working as a waitress. This amount is computed as follows:

Net income of Topspin, per month	\$1,705
Earnings as waitress, per month:	
30 hours per week × \$9 per hour × 4 weeks	<u>1,080</u>
Difference.....	<u>\$ 625</u>

- b. Other factors that Jan should consider before discussing a long-term arrangement with the Naples Tennis Club include the following:

Jan should consider whether the results of operations for April are indicative of what to expect each month. For example, Jan should consider whether club members will continue to request lessons or use the ball machine during the fall months when interest in tennis may slacken. Jan should evaluate whether the additional income of \$625 per month from Topspin is worth the risk being taken and the effort being expended.

Jan should also consider how much her investment in Topspin could have earned if invested elsewhere. For example, if the initial investment of \$1,000 had been deposited in a money market account at 4% interest, it would have earned \$3.33 interest in April, or \$40 for the year.

Note to Instructors: Numerous other considerations could be mentioned by students, such as the ability of Jan to withdraw cash from Topspin for personal use. Unlike a money market account or savings account, some of her investment in Topspin will be in the form of supplies (tennis balls, etc.), which may not be readily convertible to cash. The objective of this case is not to mention all possible considerations, but rather to encourage students to begin thinking about the use of accounting information in making business decisions.

CP 1–4

Note to Instructors: The purpose of this activity is to familiarize students with the certification requirements and their online availability. You might use this as an opportunity to discuss the advantages and disadvantages of careers in public accounting (CPA), management accounting (CMA), and internal auditing (CIA).

The following Web sites provide useful information (such as starting salaries, etc.) for students on careers in accounting:

American Institute of Certified Public Accountants (AICPA)

<https://www.aicpa.org/Becoming+a+CPA/CPA+Candidates+and+Students/>

Institute of Certified Management Accountants (IMA)

http://imanet.org/about_management.asp

Institute of Internal Auditors (IIA)

<http://www.theiia.org/theiia/about-the-profession/about-the-internal-audit-profession/>

CP 1–5

	First Year	Second Year	Third Year
Net cash flows from operating activities	negative	positive	positive
Net cash flows from investing activities	negative	negative	negative
Net cash flows from financing activities	positive	positive	positive

Start-up companies normally experience negative cash flows from operating and investing activities. Also, start-up companies normally have positive cash flows from financing activities—activities from raising capital.

CP 1–6

As can be seen from the balance sheet data in the case, Enron was financed largely by debt as compared to equity. Specifically, Enron's stockholders' equity represented only 17.5% (\$11,470 divided by \$65,503) of Enron's total assets. The remainder of Enron's total assets, 82.5%, was financed by debt. When a company is financed largely by debt, it is said to be highly leveraged.

In late 2001 and early 2002, allegations arose as to possible misstatements of Enron's financial statements. These allegations revolved around the use of "special purpose entities" (partnerships) and related party transactions. The use of special purpose entities allowed Enron to hide a significant amount of additional debt off its balance sheet. The result was that Enron's total assets were even more financed by debt than the balance sheet indicated.

After the allegations of misstatements became public, Enron's stock rapidly declined and the company filed for bankruptcy. Subsequently, numerous lawsuits were filed against the company and its management. In addition, the Securities and Exchange Commission, the Justice Department, and Congress launched investigations into Enron. As a result, several of Enron's top executives faced criminal prosecution and were sentenced to prison.

Note to Instructors: The role of the auditors and board of directors of Enron might also be discussed. Note, however, that these topics are not covered in Chapter 1 but in later chapters.