# 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 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 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. 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 Best Buy's financial statements are rounded to the nearest $1,000,000. Best Buy's consolidated statement of earnings (or income statement) covers the fiscal year (consisting of 53 weeks) ended March 3, 2007. Best Buy also reports comparative income statements for the previous two years (consisting of 52 weeks).**

**33. In thousands, Circuit City's accounting equation is:**

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $4,007,283 | = | $2,216,039 | + | $1,791,244 |

**34. At December 31, 2006, RadioShack had (in millions) assets of $2,070.0, liabilities of $1,416.2, and equity of $653.8.**

**35. The independent auditor for Apple, Inc., is KPMG LLP. The auditor expressly states that "our responsibility is to express an opinion on these consolidated financial statements based on our audits." The auditor also states that "these consolidated financial statements are the responsibility of the Company's management."**

# QUICK STUDIES

**Quick Study 1-1**

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

**Quick Study 1-2**

**(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.

**Quick Study 1-3**

**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 1-4**

**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 1-5**

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

**Quick Study 1-6**

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 1-7**

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $375,000 | | (a) $125,000 | | $250,000 |
| (b) $250,000 | | $ 90,000 | | $160,000 |
| $185,000 | | $ 60,000 | | (c) $125,000 |

**Quick Study 1-8**

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $500,000 | | (a) $180,000 | | $320,000 |
| $900,000 | | (b) $450,000 | | (b) $450,000 |

**Quick Study 1-9**

a. For September 30, 2006, the account and its dollar amount (in millions) for Apple are:

| | | | |
|---|---|---|---|
| (1) | Assets | = | $17,205 |
| (2) | Liabilities | = | $ 7,221 |
| (3) | Equity | = | $ 9,984 |

**Quick Study 1-9—continued**

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

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $17,205 | = | $ 7,221 | + | $ 9,984 |

**Quick Study 1-10**

(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 1-11**

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

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

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

**Quick Study 1-12**

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Average total assets}} = \frac{\$5,761}{\$48,334} = \underline{\underline{11.9\%}}$$

Interpretation: Its return of 11.9% is slightly below the 12% of its competitors. Home Depot's performance can be rated as average.

# EXERCISES

**Exercise 1-1 (20 minutes)**

**External users and some questions they seek to answer with accounting information include:**

1. **Shareholders (investors), who seek answers to questions such as:**
   a. **Are resources owned by a business adequate to carry out plans?**
   b. **Are the debts owed excessive in amount?**
   c. **What is the current level of income (and its components)?**
2. **Creditors, who seek answers for questions such as:**
   a. **Does the business have the ability to repay its debts?**
   b. **Can the business take on additional debt?**
   c. **Are resources sufficient to cover current amounts owed?**
3. **Employees, who seek answers to questions such as:**
   a. **Is the business financially stable?**
   b. **Can the business afford to pay higher salaries?**
   c. **What are growth prospects for the organization?**

**Internal users and some ways they use accounting information on their jobs include:**

1. **Research and development managers, who need information on projected costs and revenues of any proposed changes in products or services.**
2. **Purchasing managers, who need to know what, when, and how much to purchase.**
3. **Human resource managers, who need information about employees' payroll, benefits, performance, and compensation.**
4. **Production managers, who depend on information to monitor costs and ensure quality.**
5. **Distribution managers, who need reports for timely, accurate, and efficient delivery of products and services.**

**Exercise 1-2 (10 minutes)**

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

**Exercise 1-3 (20 minutes)**

a. 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.

b. 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.

c. 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.

d. 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.

## Exercise 1-4 (10 minutes)

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

## Exercise 1-5 (10 minutes)

a. Sole proprietorship
b. Corporation
c. Sole proprietorship
d. Corporation
e. Corporation
f. Partnership
g. Sole proprietorship

## Exercise 1-6 (10 minutes)

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| (a) $180,000 | = | $164,000 | + | $16,000 |
| $ 90,000 | = | $ 39,000 | + | (b) $51,000 |
| $201,000 | = | (c) $139,000 | + | $62,000 |

**Exercise 1-7 (10 minutes)**

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

**Exercise 1-8 (20 minutes)**

**a. Using the accounting equation:**

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $137,000 | = | $110,000 | + | ? |

**Thus, equity = $27,000**

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

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $259,000 | = | ? | + | $194,250 |

**Thus, *beginning* liabilities = $64,750**

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

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $259,000 + $80,000 | = | $64,750 + $52,643 | + | ? |
| $339,000 | = | $117,393 | + | ? |

**Thus, *ending* equity = $221,607**

***Alternative approach to solving part (b):***
**ΔAssets($80,000) = ΔLiabilities($52,643) + ΔEquity(?)**
**where "Δ" refers to "change in."**
***Thus: Ending* Equity = $194,250 + $27,357 = $221,607**

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

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $190,000 | = | $57,000 - $16,000 | + | ? |
| $190,000 | = | $41,000 | + | $149,000 |

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

| Assets | = | Liabilities | + | Equity |
|---|---|---|---|---|
| $190,000 - $60,000 | = | $57,000 | + | ? |
| $130,000 | = | $57,000 | + | ? |

**Thus: *Beginning* Equity = $73,000**

**Exercise 1-9 (15 minutes)**

***Examples of transactions that fit each case include:***

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

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

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

d. **Business purchases office supplies (or some other asset) for cash (or some other asset).**

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

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

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

**Exercise 1-10 (20 minutes)**

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

b. **Purchased office supplies for $3,000 by paying $2,000 cash and putting the remaining $1,000 balance on credit.**

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

d. **Billed a customer $6,000 for services earned.**

e. **Provided services for $1,000 cash.**

**Exercise 1-11 (15 minutes)**

a. Purchased land for $4,000 cash.

b. Purchased $1,000 of office supplies on credit.

c. Billed a client $1,900 for services provided.

d. Paid the $1,000 account payable created by the credit purchase of office supplies in transaction *b*.

e. Collected $1,900 cash for the billing in transaction *c*.

**Exercise 1-12 (30 minutes)**

| | Cash | + | Accounts Receivable | + | Equip-ment | = | Accounts Payable | + | L. Diamond, Capital | – | L. Diamond, Withdrawals | + | Revenue | – | Expenses |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| a. | +$70,000 | | | + | $20,000 | = | | + | $90,000 | | | | | | |
| b. | – 2,000 | | | | | | | | | | | | | – | $2,000 |
| Bal. | 68,000 | + | | + | 20,000 | = | | + | 90,000 | | | | | – | 2,000 |
| c. | | | | + | 25,000 | | +$25,000 | | | | | | | | |
| Bal. | 68,000 | + | | + | 45,000 | = | 25,000 | + | 90,000 | | | | | – | 2,000 |
| d. | + 3,000 | | | | | | | | | | | + | $3,000 | | |
| Bal. | 71,000 | + | | + | 45,000 | = | 25,000 | + | 90,000 | | | + | 3,000 | – | 2,000 |
| e. | | + | $9,500 | | | | | | | | | + | 9,500 | | |
| Bal. | 71,000 | + | 9,500 | + | 45,000 | = | 25,000 | + | 90,000 | | | + | 12,500 | – | 2,000 |
| f. | – 5,000 | | | + | 5,000 | | | | | | | | | | |
| Bal. | 66,000 | + | 9,500 | + | 50,000 | = | 25,000 | + | 90,000 | | | + | 12,500 | – | 2,000 |
| g. | – 3,500 | | | | | | | | | | | | | – | 3,500 |
| Bal. | 62,500 | + | 9,500 | + | 50,000 | = | 25,000 | + | 90,000 | | | + | 12,500 | – | 5,500 |
| h. | + 6,500 | - | 6,500 | | | | | | | | | | | | |
| Bal. | 69,000 | + | 3,000 | + | 50,000 | = | 25,000 | + | 90,000 | | | + | 12,500 | – | 5,500 |
| i. | – 25,000 | | | | | | – 25,000 | | | | | | | | |
| Bal. | 44,000 | + | 3,000 | + | 50,000 | = | 0 | + | 90,000 | | | + | 12,500 | – | 5,500 |
| j. | – 1,500 | | | | | | | | | – | $1,500 | | | | |
| Bal. | $42,500 | + | $3,000 | + | $50,000 | = | $ 0 | + | $90,000 | – | $1,500 | + | $12,500 | – | $5,500 |

**Exercise 1-13 (15 minutes)**

**REAL ANSWERS**
**Income Statement**
**For Month Ended October 31**

| | | |
|---|---|---|
| Revenues | | |
| Consulting fees earned | | $14,000 |
| Expenses | | |
| Salaries expense | $5,600 | |
| Rent expense | 2,520 | |
| Telephone expense | 760 | |
| Miscellaneous expenses | 580 | |
| Total expenses | | 9,460 |
| Net income | | $ 4,540 |

**Exercise 1-14 (15 minutes)**

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

| | |
|---|---|
| K. King, Capital, October 1 | $ 0 |
| Add: Investments by owner | 84,360 |
| Net income (from Exercise 1-13) | 4,540 |
| | 88,900 |
| Less: Withdrawals by owner | 2,000 |
| K. King, Capital, October 31 | $86,900 |

**Exercise 1-15 (15 minutes)**

**REAL ANSWERS**
**Balance Sheet**
**October 31**

| *Assets* | | *Liabilities* | |
|---|---|---|---|
| Cash | $ 11,500 | Accounts payable | $ 25,037 |
| Accounts receivable | 12,000 | | |
| Office supplies | 24,437 | *Equity* | |
| Office equipment | 18,000 | | |
| Land | 46,000 | K. King, Capital* | 86,900 |
| Total assets | $111,937 | Total liabilities and equity | $111,937 |

* For the computation of this amount see Exercise 1-14.

**Exercise 1-16 (15 minutes)**

| REAL ANSWERS<br>Statement of Cash Flows<br>For Month Ended October 31 | |
|---|---|
| **Cash flows from operating activities** | |
| Cash received from customers[1] | $ 2,000 |
| Cash paid to employees[2] | (5,000) |
| Cash paid for rent | (2,520) |
| Cash paid for telephone expenses | (760) |
| Cash paid for miscellaneous expenses | (580) |
| Net cash used by operating activities | (6,860) |
| **Cash flows from investing activities** | |
| Purchase of office equipment | (18,000) |
| Net cash used by investing activities | (18,000) |
| **Cash flows from financing activities** | |
| Investments by owner | 38,360 |
| Withdrawals by owner | (2,000) |
| Net cash provided by financing activities | 36,360 |
| Net increase in cash | $11,500 |
| Cash balance, October 1 | 0 |
| Cash balance, October 31 | $11,500 |

[1]$14,000 Consulting Fees Earned - $12,000 Accounts Receivable

[2]$5,600 Salaries Expense - $600 still owed = $5,000 paid to employees.

**Exercise 1-17 (10 minutes)**

| | |
|---|---|
| <u>O</u> 1. Cash paid for rent | <u>O</u> 5. Cash paid for advertising |
| <u>O</u> 2. Cash paid on an account payable | <u>O</u> 6. Cash paid for wages |
| <u>F</u> 3. Cash investments by owner | <u>F</u> 7. Cash withdrawal by owner |
| <u>O</u> 4. Cash received from clients | <u>I</u> 8. Cash purchase of equipment |

**Exercise 1-18 (10 minutes)**

| | | |
|---|---|---|
| Return on assets | = | Net income / Average total assets |
| | = | $36,000 / [($135,000 + $185,000)/2] |
| | = | <u>22.5%</u> |

**Interpretation: Iowa Group's return on assets of 22.5% is markedly above the 10% return of its competitors. Accordingly, its performance is assessed as superior to its competitors.**

**Exercise 1-19[B] (10 minutes)**

a. Investing

b. Operating

c. Financing

d. Financing*

e. Investing

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

# PROBLEM SET A

**Problem 1-1A (40 minutes)**

***Part 1***
**Company A**

**(a) Equity on December 31, 2008:**

| | |
|---|---|
| Assets | $33,000 |
| Liabilities | (27,060) |
| Equity | $ 5,940 |

**(b) Equity on December 31, 2009:**

| | |
|---|---|
| Equity, December 31, 2008 | $ 5,940 |
| Plus owner investments | 6,000 |
| Plus net income | 7,760 |
| Less cash withdrawals | (3,500) |
| Equity, December 31, 2009 | $16,200 |

**(c) Liabilities on December 31, 2009:**

| | |
|---|---|
| Assets | $36,000 |
| Equity | (16,200) |
| Liabilities | $19,800 |

***Part 2***
**Company B**

**(a) and (b)**

| Equity: | *12/31/2008* | *12/31/2009* |
|---|---|---|
| Assets | $25,740 | $25,920 |
| Liabilities | (18,018) | (17,625) |
| Equity | $ 7,722 | $ 8,295 |

**(c) Net income for 2009:**

| | |
|---|---|
| Equity, December 31, 2008 | $ 7,722 |
| Plus owner investments | 1,400 |
| Plus net income | ? |
| Less cash withdrawals | (2,000) |
| Equity, December 31, 2009 | $ 8,295 |

**Therefore, net income must have been $ 1,173**

**Problem 1-1A *(Continued)***

***Part 3***

**Company C**

**First, calculate the beginning balance of equity:**

| | ***Dec. 31, 2008*** |
|---|---|
| Assets | $21,120 |
| Liabilities | (11,404) |
| Equity | $ 9,716 |

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

| | |
|---|---|
| Equity, December 31, 2008 | $ 9,716 |
| Plus owner investments | 9,750 |
| Less net loss | (1,289) |
| Less cash withdrawals | (5,875) |
| Equity, December 31, 2009 | $12,302 |

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

| | ***Dec. 31, 2009*** |
|---|---|
| Liabilities | $11,818 |
| Equity | 12,302 |
| Assets | $24,120 |

***Part 4***

**Company D**

**First, calculate the beginning and ending equity balances:**

| | ***12/31/2008*** | ***12/31/2009*** |
|---|---|---|
| Assets | $58,740 | $65,520 |
| Liabilities | (40,530) | (31,449) |
| Equity | $18,210 | $34,071 |

**Then, find the amount of owner investments during 2009:**

| | |
|---|---|
| Equity, December 31, 2008 | $18,210 |
| Plus owner investments | ? |
| Plus net income | 8,861 |
| Less cash withdrawals | 0 |
| Equity, December 31, 2009 | $34,071 |

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

**Problem 1-1A (*Concluded*)**

***Part 5***

**Company E**

**First, compute the balance of equity as of December 31, 2009:**

| | |
|---|---|
| Assets | $ 99,360 |
| Liabilities | (78,494) |
| Equity | $ 20,866 |

**Next, find the beginning balance of equity as follows:**

| | |
|---|---|
| Equity, December 31, 2008 | $ ? |
| Plus owner investments | 6,500 |
| Plus net income | 7,348 |
| Less cash withdrawals | (11,000) |
| Equity, December 31, 2009 | $20,866 |

**Thus, the beginning balance of equity is: $18,018**

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

| | *Dec. 31, 2008* |
|---|---|
| Assets | $90,090 |
| Equity | (18,018) |
| Liabilities | $72,072 |

## Problem 1-2A (25 minutes)

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

## Problem 1-3A (15 minutes)

**Elko Energy Company**
**Income Statement**
**For Year Ended December 31, 2009**

| | |
|---|---|
| Revenues ............................................... | $66,000 |
| Expenses ............................................... | 51,348 |
| Net income............................................... | $14,652 |

## Problem 1-4A (15 minutes)

**Amity Company**
**Balance Sheet**
**December 31, 2009**

| | | | |
|---|---|---|---|
| Assets | $142,000 | Liabilities | $ 54,244 |
| | | Equity | 87,756 |
| Total assets | $142,000 | Total liabilities and equity | $142,000 |

## Problem 1-5A (15 minutes)

**Fortune Company**
**Statement of Cash Flows**
**For Year Ended December 31, 2009**

| | |
|---|---|
| Cash from operating activities | $ 8,050 |
| Cash used by investing activities | (3,250) |
| Cash used by financing activities | (4,050) |
| Net increase in cash | $ 750 |
| Cash, December 31, 2008 | 4,100 |
| Cash, December 31, 2009 | $ 4,850 |

## Problem 1-6A (15 minutes)

**Atlee Company**
**Statement of Owner's Equity**
**For Year Ended December 31, 2009**

| | |
|---|---|
| A. Atlee, Capital, Dec. 31, 2008 | $11,000 |
| Add: Investments by owner | 0 |
| Net income | 7,750 |
| | 18,750 |
| Less: Withdrawals by owner | (2,000) |
| A. Atlee, Capital, Dec. 31, 2009 | $16,750 |

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

| | Assets | | | | | = | Liabilities | + | Equity | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | Cash | + | Accounts Receivable | + | Office Equipment | = | Accounts Payable | + | H. Graham, Capital | - | H. Graham, Withdrawals | + | Revenues | - | Expenses |
| May 1 | +$43,000 | | | | | = | | + | $43,000 | | | | | | |
| 1 | - 2,200 | | | | | = | | | | | | | | - | $2,200 |
| 3 | | | | + | $1,940 | = | + $1,940 | | | | | | | | |
| 5 | - 750 | ` | | | | = | | | | | | | | - | 750 |
| 8 | + 5,800 | | | | | = | | | | | | + | $5,800 | | |
| 12 | | + | $2,800 | | | = | | | | | | + | 2,800 | | |
| 15 | - 850 | | | | | = | | | | | | | | - | 850 |
| 20 | + 2,800 | - | 2,800 | | | = | | | | | | | | | |
| 22 | | + | 4,000 | | | = | | | | | | + | 4,000 | | |
| 25 | + 4,000 | - | 4,000 | | | = | | | | | | | | | |
| 26 | - 1,940 | | | | | = | - 1,940 | | | | | | | | |
| 27 | | | | | | = | + 85 | | | | | | | - | 85 |
| 28 | - 850 | | | | | = | | | | | | | | - | 850 |
| 30 | - 400 | | | | | = | | | | | | | | - | 400 |
| 30 | - 260 | | | | | = | | | | | | | | - | 260 |
| 31 | - 2,000 | | | | | = | | | | - | $2,000 | | | | |
| | $46,350 | + | $ 0 | + | $1,940 | = | $ 85 | + | $43,000 | - | $2,000 | + | $12,600 | - | $5,395 |

**Problem 1-7A *(Continued)***
***Part 3***

| Graham Company<br>Income Statement<br>For Month Ended May 31 | | |
|---|---|---|
| Revenues | | |
| Consulting services revenue | | $12,600 |
| Expenses | | |
| Rent expense | $2,200 | |
| Salaries expense | 1,700 | |
| Advertising expense | 85 | |
| Cleaning expense | 750 | |
| Telephone expense | 400 | |
| Utilities expense | 260 | |
| Total expenses | | 5,395 |
| Net income | | $ 7,205 |

| Graham Company<br>Statement of Owner's Equity<br>For Month Ended May 31 | |
|---|---|
| H. Graham, Capital, May 1 | $ 0 |
| Plus: Investments by owner | 43,000 |
| Net income | 7,205 |
| | 50,205 |
| Less: Withdrawals by owner | 2,000 |
| H. Graham, Capital, May 31 | $48,205 |

| Graham Company<br>Balance Sheet<br>May 31 | | | |
|---|---|---|---|
| ***Assets*** | | ***Liabilities*** | |
| Cash | $46,350 | Accounts payable | $ 85 |
| Office equipment | 1,940 | ***Equity*** | |
| | | H. Graham, Capital | 48,205 |
| Total assets | $48,290 | Total liabilities and equity | $48,290 |

**Problem 1-7A (*Concluded)***

**Part 3—continued**

| Graham Company<br>Statement of Cash Flows<br>For Month Ended May 31 | | |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash received from customers | $12,600 | |
| Cash paid for rent | (2,200) | |
| Cash paid for cleaning | (750) | |
| Cash paid for telephone | (400) | |
| Cash paid for utilities | (260) | |
| Cash paid to employees | (1,700) | |
| Net cash provided by operating activities | | $ 7,290 |
| **Cash flows from investing activities** | | |
| Purchase of equipment | (1,940) | |
| Net cash used by investing activities | | (1,940) |
| **Cash flows from financing activities** | | |
| Investments by owner | 43,000 | |
| Withdrawals by owner | (2,000) | |
| Net cash provided by financing activities | | 41,000 |
| Net increase in cash | | $46,350 |
| Cash balance, May 1 | | 0 |
| Cash balance, May 31 | | $46,350 |

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

| | | Assets | | | | | = Liabilities | + Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | | Cash | + Accounts Receivable | + Office Supplies | + Office Equipment | + Electrical Equipment | = Accounts Payable | + H. Anderson, Capital | - H. Anderson, Withdrawals | + Revenues | - Expenses |
| Dec. | 1 | +$68,800 | | | | | = | + $68,800 | | | |
| | 2 | - 1,800 | | | | | | | | | - $1,800 |
| Bal. | | 67,000 | | | | | = | 68,800 | | | - 1,800 |
| | 3 | - 4,800 | | | | + $13,000 | + $8,200 | | | | |
| Bal. | | 62,200 | | | | + 13,000 | = 8,200 | + 68,800 | | | - 1,800 |
| | 5 | - 1,000 | | + $ 1,000 | | | | | | | |
| Bal. | | 61,200 | | + 1,000 | | + 13,000 | = 8,200 | + 68,800 | | | - 1,800 |
| | 6 | + 1,600 | | | | | | | | + $1,600 | |
| Bal. | | 62,800 | | + 1,000 | | + 13,000 | = 8,200 | + 68,800 | | + 1,600 | - 1,800 |
| | 8 | | | | + $2,680 | | + 2,680 | | | | |
| Bal. | | 62,800 | | + 1,000 | + 2,680 | + 13,000 | = 10,880 | + 68,800 | | + 1,600 | - 1,800 |
| | 15 | | + $6,000 | | | | | | | + 6,000 | |
| Bal. | | 62,800 | + 6,000 | + 1,000 | + 2,680 | + 13,000 | = 10,880 | + 68,800 | | + 7,600 | - 1,800 |
| | 18 | | | + 360 | | | + 360 | | | | |
| Bal. | | 62,800 | + 6,000 | + 1,360 | + 2,680 | + 13,000 | = 11,240 | + 68,800 | | + 7,600 | - 1,800 |
| | 20 | - 2,680 | | | | | - 2,680 | | | | |
| Bal. | | 60,120 | + 6,000 | + 1,360 | + 2,680 | + 13,000 | = 8,560 | + 68,800 | | + 7,600 | - 1,800 |
| | 24 | | + 1,000 | | | | | | | + 1,000 | |
| Bal. | | 60,120 | + 7,000 | + 1,360 | + 2,680 | + 13,000 | = 8,560 | + 68,800 | | + 8,600 | - 1,800 |
| | 28 | + 6,000 | - 6,000 | | | | | | | | |
| Bal. | | 66,120 | + 1,000 | + 1,360 | + 2,680 | + 13,000 | = 8,560 | + 68,800 | | + 8,600 | - 1,800 |
| | 29 | - 1,500 | | | | | | | | | - 1,500 |
| Bal. | | 64,620 | + 1,000 | + 1,360 | + 2,680 | + 13,000 | = 8,560 | + 68,800 | | + 8,600 | - 3,300 |
| | 30 | - 570 | | | | | | | | | - 570 |
| Bal. | | 64,050 | + 1,000 | + 1,360 | + 2,680 | + 13,000 | = 8,560 | + 68,800 | | + 8,600 | - 3,870 |
| | 31 | - 900 | | | | | | | - $900 | | |
| Bal. | | $63,150 | + $ 1,000 | + $1,360 | + $2,680 | + $13,000 | = $8,560 | + $68,800 | - $900 | + $8,600 | - $3,870 |

**Problem 1-8A *(Continued*)**
***Part 3***

| Anderson Electric<br>Income Statement<br>For Month Ended December 31 | | |
|---|---|---|
| **Revenues** | | |
| Electrical fees earned | | $8,600 |
| **Expenses** | | |
| Rent expense | $1,800 | |
| Salaries expense | 1,500 | |
| Utilities expense | 570 | |
| Total expenses | | 3,870 |
| **Net income** | | $4,730 |

| Anderson Electric<br>Statement of Owner's Equity<br>For Month Ended December 31 | |
|---|---|
| H. Anderson, Capital, December 1 | $ 0 |
| Plus: Investments by owner | 68,800 |
| Net income | 4,730 |
| | 73,530 |
| Less: Withdrawals by owner | 900 |
| H. Anderson, Capital, December 31 | $72,630 |

| Anderson Electric<br>Balance Sheet<br>December 31 | | | |
|---|---|---|---|
| ***Assets*** | | ***Liabilities*** | |
| Cash | $63,150 | Accounts payable | $ 8,560 |
| Accounts receivable | 1,000 | | |
| Office supplies | 1,360 | ***Equity*** | |
| Office equipment | 2,680 | H. Anderson, Capital | 72,630 |
| Electrical equipment | 13,000 | | |
| Total assets | $81,190 | Total liabilities and equity | $81,190 |

**Problem 1-8A *(Concluded)***

***Part 3—continued***

| **Anderson Electric**<br>**Statement of Cash Flows**<br>**For Month Ended December 31** | | |
|---|---|---|
| **Cash flows from operating activities** | | |
| **Cash received from customers[1]** | **$ 7,600** | |
| **Cash paid for rent** | **(1,800)** | |
| **Cash paid for supplies** | **(1,000)** | |
| **Cash paid for utilities** | **(570)** | |
| **Cash paid to employees** | **(1,500)** | |
| **Net cash provided by operating activities** | | **$ 2,730** |
| **Cash flows from investing activities** | | |
| **Purchase of office equipment** | **(2,680)** | |
| **Purchase of electrical equipment** | **(4,800)** | |
| **Net cash used by investing activities** | | **(7,480)** |
| **Cash flows from financing activities** | | |
| **Investments by owner** | **68,800** | |
| **Withdrawals by owner** | **(900)** | |
| **Net cash provided by financing activities** | | **67,900** |
| **Net increase in cash** | | **$63,150** |
| **Cash balance, Dec. 1** | | **0** |
| **Cash balance, Dec. 31** | | **$63,150** |

**[1]$1,600 + $6,000 = $7,600**

***Part 4***

**If the December 1 investment had been $49,000 cash instead of $68,800 and the $19,800 difference was borrowed by the company from a bank, then:**

**(a) total beginning and ending equity would be $19,800 less,**

**(b) total liabilities would be $19,800 greater, and**

**(c) total assets would remain the same.**

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

| | Assets | | | | | Liabilities | | Equity | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | Accounts Receivable | Office Supplies | Office Equipment | Building | Accounts Payable | Notes Payable | I. Lopez, Capital | I. Lopez, Withdrawals | Revenues | Expenses |
| a. | +$67,000 | | | + $11,000 | | | | + $78,000 | | | |
| b. | - 15,000 | | | | + $144,000 | | + $129,000 | | | | |
| Bal. | 52,000 | | | 11,000 | 144,000 | | 129,000 | 78,000 | | | |
| c. | - 12,000 | | | + 12,000 | | | | | | | |
| Bal. | 40,000 | | | 23,000 | 144,000 | | 129,000 | 78,000 | | | |
| d. | | | + $1,000 | + 1,700 | | + $2,700 | | | | | |
| Bal. | 40,000 | | 1,000 | 24,700 | 144,000 | 2,700 | 129,000 | 78,000 | | | |
| e. | - 460 | | | | | | | | | | - $ 460 |
| Bal. | 39,540 | | 1,000 | 24,700 | 144,000 | 2,700 | 129,000 | 78,000 | | | 460 |
| f. | | + $2,400 | | | | | | | | + $2,400 | |
| Bal. | 39,540 | 2,400 | 1,000 | 24,700 | 144,000 | 2,700 | 129,000 | 78,000 | | 2,400 | 460 |
| g. | + 4,000 | | | | | | | | | + 4,000 | |
| Bal. | 43,540 | 2,400 | 1,000 | 24,700 | 144,000 | 2,700 | 129,000 | 78,000 | | 6,400 | 460 |
| h. | - 3,025 | | | | | | | | - $3,025 | | |
| Bal. | 40,515 | 2,400 | 1,000 | 24,700 | 144,000 | 2,700 | 129,000 | 78,000 | 3,025 | 6,400 | 460 |
| i. | + 1,800 | - 1,800 | | | | | | | | | |
| Bal. | 42,315 | 600 | 1,000 | 24,700 | 144,000 | 2,700 | 129,000 | 78,000 | 3,025 | 6,400 | 460 |
| j. | - 500 | | | | | - 500 | | | | | |
| Bal. | 41,815 | 600 | 1,000 | 24,700 | 144,000 | 2,200 | 129,000 | 78,000 | 3,025 | 6,400 | 460 |
| k. | - 1,800 | | | | | | | | | | - 1,800 |
| Bal. | $40,015 | $ 600 | $1,000 | $24,700 | $144,000 | $2,200 | $129,000 | $78,000 | $3,025 | $6,400 | $2,260 |

**Problem 1-9A *(Concluded)***

***Part 3***

**Wiz Consulting's net income = $6,400 - $2,260 = $4,140**

**Problem 1-10A (20 minutes)**

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

   a. **Coca-Cola return: $5,080 / $29,695 = 0.171 or 17.1%.**

   b. **PepsiCo return: $5,642 / $30,829 = 0.183 or 18.3%.**

2. **Strictly on the amount of sales to consumers, Coke's sales of $24,088 are less than PepsiCo's $35,187.**

3. **Success in returning net income from the average amount invested is revealed by the return on assets. Part 1 showed that PepsiCo's 18.3% return is better than Coca-Cola's 17.1% return.**

4. **Current performance figures suggest that PepsiCo yields a 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, 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 1-11A (15 minutes)**

1. **Return on assets is net income divided by the average total assets (average amount invested).**

   **Notaro's return: $64,000 / $250,000 = 0.256 or 25.6%.**

2. **Return on assets seems satisfactory for the risk involved in the manufacturing, marketing, and selling of cellular telephones. Moreover, Notaro's 25.6% return is more than twice as high as that of its competitors' 9.5% return.**

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

   **$468,000 - Expenses = $64,000 → Expenses must equal $404,000.**

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

| | | |
|---|---|---|
| **Case 1** | ***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 2** | ***Return*:** | **Expected winnings from your bet.** |
| | ***Risk*:** | **Depends on the probability of your team covering the "spread."** |
| **Case 3** | ***Return*:** | **5% interest or $100/year.** |
| | ***Risk*:** | **Very low; it is the risk of the financial institution not paying interest and principal.** |
| **Case 4** | ***Return*:** | **Expected increase in career earnings and other rewards from an accounting degree.** |
| | ***Risk*:** | **Depends on your ability to successfully learn and apply accounting knowledge.** |

**Problem 1-13A$^B$ (15 minutes)**

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

**Problem 1-14A$^B$ (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 SET B

**Problem 1-1B (40 minutes)**

***Part 1***
**Company V**

**(a) and (b)**

| Calculation of equity at | *12/31/2008* | *12/31/2009* |
|---|---|---|
| Assets .......................... | $36,000 | $39,000 |
| Liabilities ...................... | (29,520) | (21,450) |
| Equity ........................... | $ 6,480 | $17,550 |

**(c) Calculation of income or loss for the year 2009:**

| | |
|---|---|
| Equity, December 31, 2008 ...................... | $ 6,480 |
| Plus investments by owner ...................... | 6,000 |
| Plus net income ...................................... | ? |
| Less withdrawals by owner ...................... | (3,500) |
| Equity, December 31, 2009 ...................... | $17,550 |

**Therefore the income must be $8,570.**

***Part 2***
**Company W**

**(a) Calculation of Equity at December 31, 2008:**

| | |
|---|---|
| Assets ..................................................... | $28,080 |
| Liabilities ................................................ | (19,656) |
| Equity ..................................................... | $ 8,424 |

**(b) Calculation of Equity at December 31, 2009:**

| | |
|---|---|
| Equity, December 31, 2008 ...................... | $ 8,424 |
| Plus investments by owner ...................... | 1,400 |
| Plus net income ...................................... | 1,162 |
| Less withdrawals by owner ...................... | (2,000) |
| Equity, December 31, 2009 ...................... | $ 8,986 |

**(c) Calculation of the amount of liabilities at December 31, 2009:**

| | |
|---|---|
| Assets ..................................................... | $28,080 |
| Equity ..................................................... | (8,986) |
| Liabilities ................................................ | $19,094 |

**Problem 1-1B *(Continued)***

***Part 3***
**Company X**

**First, calculate the beginning and ending equity balances:**

| | ***12/31/2008*** | ***12/31/2009*** |
|---|---|---|
| **Assets** | **$23,040** | **$26,130** |
| **Liabilities** | **(12,441)** | **(12,803)** |
| **Equity** | **$10,599** | **$13,327** |

**Then, find the amount of owner investments during 2009 as follows:**

| | |
|---|---|
| **Equity, December 31, 2008** | **$10,599** |
| **Plus investments by owner** | **?** |
| **Less net loss** | **(1,147)** |
| **Less withdrawals by owner** | **(5,875)** |
| **Equity, December 31, 2009** | **$13,327** |
| **Thus, the owner investments must have been** | **$ 9,750** |

***Part 4***
**Company Y**

**First, calculate the beginning balance of equity:**

| | ***Dec. 31, 2008*** |
|---|---|
| **Assets** | **$64,080** |
| **Liabilities** | **44,215** |
| **Equity** | **$19,865** |

**Next, find the ending balance of equity as follows:**

| | |
|---|---|
| **Equity, December 31, 2008** | **$19,865** |
| **Plus investments by owner** | **7,000** |
| **Plus net income** | **10,045** |
| **Less withdrawals by owner** | **0** |
| **Equity, December 31, 2009** | **$36,910** |

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

| | ***Dec. 31, 2009*** |
|---|---|
| **Liabilities** | **$34,070** |
| **Equity** | **36,910** |
| **Assets** | **$70,980** |

**Problem 1-1B *(Concluded)***

***Part 5***
**Company Z**

**First, calculate the balance of equity as of December 31, 2009:**

| | |
|---|---|
| **Assets** | **$107,640** |
| **Liabilities** | **(85,035)** |
| **Equity** | **$ 22,605** |

**Next, find the beginning balance of equity as follows:**

| | |
|---|---|
| **Equity, December 31, 2008** | **$ ?** |
| **Plus investments by owner** | **6,500** |
| **Plus net income** | **7,449** |
| **Less withdrawals by owner** | **(11,000)** |
| **Equity, December 31, 2009** | **$ 22,605** |

**Thus, the beginning balance of equity is $19,656.**

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

| | ***Dec. 31, 2008*** |
|---|---|
| **Assets** | **$98,280** |
| **Equity** | **(19,656)** |
| **Liabilities** | **$78,624** |

## Problem 1-2B (25 minutes)

| | Transaction | Balance Sheet: Total Assets | Balance Sheet: Total Liab. | Balance Sheet: Total Equity | Income Statement: Net Income | Statement of Cash Flows: Operating Activities | Statement of Cash Flows: Financing Activities | Statement of Cash Flows: Investing Activities |
|---|---|---|---|---|---|---|---|---|
| 1 | Owner invests cash in business | + | | + | | | + | |
| 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 | Provides services on credit | + | | + | + | | | |
| 9 | Collects cash on receivable from (8) | +/– | | | | + | | |
| 10 | Owner withdraws cash | – | | – | | | – | |

## Problem 1-3B (15 minutes)

**Onshore Co.**
**Income Statement**
**For Year Ended December 31, 2009**

| | |
|---|---|
| Revenues ............................................... | $69,000 |
| Expenses ............................................... | 53,682 |
| Net income............................................... | $15,318 |

**Problem 1-4B (15 minutes)**

| NuTech Company<br>Balance Sheet<br>December 31, 2009 | | | |
|---|---|---|---|
| Assets | $121,000 | Liabilities | $ 46,222 |
| | | Equity | 74,778 |
| Total assets | $121,000 | Total liabilities and equity | $121,000 |

**Problem 1-5B (15 minutes)**

| HalfLife Company<br>Statement of Cash Flows<br>For Year Ended December 31, 2009 | |
|---|---|
| Cash from operating activities | $ 8,550 |
| Cash used by investing activities | (3,750) |
| Cash used by financing activities | (4,550) |
| Net increase in cash | $ 250 |
| Cash, December 31, 2008 | 3,700 |
| Cash, December 31, 2009 | $ 3,950 |

**Problem 1-6B (15 minutes)**

| Act First<br>Statement of Owner's Equity<br>For Year Ended December 31, 2009 | |
|---|---|
| I. Firstact, Capital, Dec. 31, 2008 | $ 5,500 |
| Add: Investments by owner | 0 |
| Net income | 7,000 |
| | 12,500 |
| Less: Withdrawals by owner | (2,000) |
| I. Firstact, Capital, Dec. 31, 2009 | $10,500 |

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

| | Assets | | | = | Liabilities | + | Equity | | |
|---|---|---|---|---|---|---|---|---|---|
| Date | Cash | + Accounts Receivable | + Equipment | = | Accounts Payable | + N. Benton, Capital | - N. Benton, Withdrawals | + Revenues | - Expenses |
| June 1 | + $41,000 | | | = | | + $41,000 | | | |
| 2 | - 2,200 | | | = | | | | | - $2,200 |
| 4 | | | + $1,860 | = | + $1,860 | | | | |
| 6 | - 780 | | | = | | | | | - 780 |
| 8 | + 5,700 | | | = | | | | + $ 5,700 | |
| 14 | | + $2,400 | | = | | | | + 2,400 | |
| 16 | - 810 | | | = | | | | | - 810 |
| 20 | + 2,400 | - 2,400 | | = | | | | | |
| 24 | | + 3,300 | | = | | | | + 3,300 | |
| 25 | + 3,300 | - 3,300 | | = | | | | | |
| 26 | - 1,860 | | | = | - 1,860 | | | | |
| 27 | | | | | + 80 | | | | - 80 |
| 28 | - 810 | | | = | | | | | - 810 |
| 29 | - 1,600 | | | = | | | - $1,600 | | |
| 30 | - 250 | | | = | | | | | - 250 |
| 30 | - 300 | | | = | | | | | - 300 |
| | $43,790 | + $ 0 | + $1,860 | = | $ 80 | + $41,000 | - $1,600 | + $11,400 | - $5,230 |

**Problem 1-7B** ***(Continued)***
***Part 3***

| Benton's Maintenance Co.<br>Income Statement<br>For Month Ended June 30 | | |
|---|---|---|
| Revenues | | |
| Maintenance services revenue .......... | | $11,400 |
| Expenses | | |
| Rent expense ...................................... | $2,200 | |
| Salaries expense ................................ | 1,620 | |
| Advertising expense .......................... | 860 | |
| Telephone expense ............................ | 250 | |
| Utilities expense ................................ | 300 | |
| Total expenses .................................. | | 5,230 |
| Net income ............................................. | | $ 6,170 |

| Benton's Maintenance Co.<br>Statement of Owner's Equity<br>For Month Ended June 30 | |
|---|---|
| N. Benton, Capital, June 1 .............................. | $ 0 |
| Plus: Investments by owner .......................... | 41,000 |
| Net income ........................................... | 6,170 |
| | 47,170 |
| Less: Withdrawals by owner .......................... | 1,600 |
| N. Benton, Capital, June 30 ............................ | $45,570 |

| Benton's Maintenance Co.<br>Balance Sheet<br>June 30 | | | |
|---|---|---|---|
| ***Assets*** | | ***Liabilities*** | |
| Cash ................................ | $43,790 | Accounts payable .................. | $ 80 |
| Equipment ...................... | 1,860 | ***Equity*** | |
| | | N. Benton, Capital .................. | 45,570 |
| Total assets .................... | $45,650 | Total liabilities and equity ...... | $45,650 |

**Problem 1-7B *(Concluded)***

***Part 3—continued***

**Benton's Maintenance Co.**
**Statement of Cash Flows**
**For Month Ended June 30**

| | | |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash received from customers[1] | $ 11,400 | |
| Cash paid for rent | (2,200) | |
| Cash paid for advertising | (780) | |
| Cash paid for telephone | (250) | |
| Cash paid for utilities | (300) | |
| Cash paid to employees | (1,620) | |
| Net cash provided by operating activities | | $ 6,250 |
| **Cash flows from investing activities** | | |
| Purchase of equipment | (1,860) | |
| Net cash used by investing activities | | (1,860) |
| **Cash flows from financing activities** | | |
| Investments by owner | 41,000 | |
| Withdrawals by owner | (1,600) | |
| Net cash provided by financing activities | | 39,400 |
| Net increase in cash | | $ 43,790 |
| Cash balance, June 1 | | 0 |
| Cash balance, June 30 | | $ 43,790 |

[1]$5,700 + $2,400 + $3,300 = $11,400

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

| Date | | Assets | | | | | = | Liabilities | + | Equity | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | | Cash | + Accounts Receivable | + Office Supplies | + Office Equipment | + Excavating Equipment | = | Accounts Payable | + | R. Truro, Capital | - R. Truro, Withdrawals | + Revenues | - Expenses |
| July | 1 | + $68,600 | | | | | = | | + | $68,600 | | | |
| | 2 | - 1,300 | | | | | | | | | | | - $1,300 |
| Bal. | | 67,300 | | | | | = | | | 68,600 | | | - 1,300 |
| | 3 | - 6,400 | | | | + $14,600 | | + $8,200 | | | | | |
| Bal. | | 60,900 | | | | + 14,600 | = | 8,200 | + | 68,600 | | | - 1,300 |
| | 6 | - 900 | | + $ 900 | | | | | | | | | |
| Bal. | | 60,000 | | + 900 | | + 14,600 | = | 8,200 | + | 68,600 | | | - 1,300 |
| | 8 | + 2,000 | | | | | | | | | | + $2,000 | |
| Bal. | | 62,000 | | + 900 | | + 14,600 | = | 8,200 | + | 68,600 | | + 2,000 | - 1,300 |
| | 10 | | | | + $2,720 | | | + 2,720 | | | | | |
| Bal. | | 62,000 | | + 900 | + 2,720 | + 14,600 | = | 10,920 | + | 68,600 | | + 2,000 | - 1,300 |
| | 15 | | + $ 4,300 | | | | | | | | | + 4,300 | |
| Bal. | | 62,000 | + 4,300 | + 900 | + 2,720 | + 14,600 | = | 10,920 | + | 68,600 | | + 6,300 | - 1,300 |
| | 17 | | | + 350 | | | | + 350 | | | | | |
| Bal. | | 62,000 | + 4,300 | + 1,250 | + 2,720 | + 14,600 | = | 11,270 | + | 68,600 | | + 6,300 | - 1,300 |
| | 23 | - 2,720 | | | | | | - 2,720 | | | | | |
| Bal. | | 59,280 | + 4,300 | + 1,250 | + 2,720 | + 14,600 | = | 8,550 | + | 68,600 | | + 6,300 | - 1,300 |
| | 25 | | + 1,000 | | | | | | | | | + 1,000 | |
| Bal. | | 59,280 | + 5,300 | + 1,250 | + 2,720 | + 14,600 | = | 8,550 | + | 68,600 | | + 7,300 | - 1,300 |
| | 28 | + 4,300 | - 4,300 | | | | | | | | | | |
| Bal. | | 63,580 | + 1,000 | + 1,250 | + 2,720 | + 14,600 | = | 8,550 | + | 68,600 | | + 7,300 | - 1,300 |
| | 30 | - 1,900 | | | | | | | | | | | - 1,900 |
| Bal. | | 61,680 | + 1,000 | + 1,250 | + 2,720 | + 14,600 | = | 8,550 | + | 68,600 | | + 7,300 | - 3,200 |
| | 31 | - 590 | | | | | | | | | | | - 590 |
| Bal. | | 61,090 | + 1,000 | + 1,250 | + 2,720 | + 14,600 | = | 8,550 | + | 68,600 | | + 7,300 | - 3,790 |
| | 31 | - 900 | | | | | | | | | - $900 | | |
| Bal. | | $60,190 | + $ 1,000 | + $1,250 | + $2,720 | + $14,600 | = | $8,550 | + | $68,600 | - $900 | + $7,300 | - $3,790 |

**Problem 1-8B *(Continued*)**
***Part 3***

| Truro Excavating Co.<br>Income Statement<br>For Month Ended July 31 | | |
|---|---|---|
| **Revenues** | | |
| Excavating fees earned | | $7,300 |
| **Expenses** | | |
| Rent expense | $1,300 | |
| Salaries expense | 1,900 | |
| Utilities expense | 590 | |
| Total expenses | | 3,790 |
| **Net income** | | $3,510 |

| Truro Excavating Co.<br>Statement of Owner's Equity<br>For Month Ended July 31 | |
|---|---|
| R. Truro, Capital, July 1 | $ 0 |
| Plus: Investments by owner | 68,600 |
| Net income | 3,510 |
| | 72,110 |
| Less: Withdrawals by owner | 900 |
| R. Truro, Capital, July 31 | $71,210 |

| Truro Excavating Co.<br>Balance Sheet<br>July 31 | | | |
|---|---|---|---|
| ***Assets*** | | ***Liabilities*** | |
| Cash | $ 60,190 | Accounts payable | $ 8,550 |
| Accounts receivable | 1,000 | | |
| Office supplies | 1,250 | ***Equity*** | |
| Office equipment | 2,720 | R. Truro, Capital | 71,210 |
| Excavating equipment | 14,600 | | |
| Total assets | $ 79,760 | Total liabilities & equity | $ 79,760 |

**Problem 1-8B *(Concluded)***
***Part 3—continued***

| Truro Excavating Co.<br>Statement of Cash Flows<br>For Month Ended July 31 | | |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash received from customers[1] | $ 6,300 | |
| Cash paid for rent | (1,300) | |
| Cash paid for supplies | (900) | |
| Cash paid for utilities | (590) | |
| Cash paid to employees | (1,900) | |
| Net cash provided by operating activities | | $ 1,610 |
| **Cash flows from investing activities** | | |
| Purchase of excavating equipment | (6,400) | |
| Purchase of office equipment | (2,720) | |
| Net cash used by investing activities | | (9,120) |
| **Cash flows from financing activities** | | |
| Investments by owner | 68,600 | |
| Withdrawals by owner | (900) | |
| Net cash provided by financing activities | | 67,700 |
| Net increase in cash | | $60,190 |
| Cash balance, July 1 | | 0 |
| Cash balance, July 31 | | $60,190 |

[1]$2,000 + $4,300 = $6,300

***Part 4***

If the $14,600 purchase on July 3 had been acquired through an additional owner investment of cash, then:

(a) total assets would be larger by $6,400,

(b) total liabilities would be $8,200 smaller, and

(c) total equity would be $14,600 larger.

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

| | Assets | | | | | | | | | = | Liabilities | | | + | Equity | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Accounts Receivable | + | Office Supplies | + | Office Equipment | + | Building | = | Accounts Payable | + | Notes Payable | + | N. Mitchell, Capital | - | N. Mitchell, Withdrawals | + | Revenues | - | Expenses |
| a. | + $70,000 | | | | | + | $12,000 | | | | | | | + | $82,000 | | | | | | |
| b. | - 15,000 | | | | | | | + | $141,000 | | | + | $126,000 | | | | | | | | |
| Bal. | 55,000 | | | | | + | 12,000 | + | 141,000 | = | | | 126,000 | + | 82,000 | | | | | | |
| c. | - 11,000 | | | | | + | 11,000 | | | | | | | | | | | | | | |
| Bal. | 44,000 | | | | | + | 23,000 | + | 141,000 | = | | | 126,000 | + | 82,000 | | | | | | |
| d. | | | | + | $600 | + | 1,300 | | | | + $1,900 | | | | | | | | | | |
| Bal. | 44,000 | | | | 600 | + | 24,300 | + | 141,000 | = | 1,900 | + | 126,000 | + | 82,000 | | | | | | |
| e. | - 500 | | | | | | | | | | | | | | | | | | | - | $ 500 |
| Bal. | 43,500 | | | + | 600 | + | 24,300 | + | 141,000 | = | 1,900 | + | 126,000 | + | 82,000 | | | | | - | 500 |
| f. | | + | $2,400 | | | | | | | | | | | | | | | + | $2,400 | | |
| Bal. | 43,500 | + | 2,400 | + | 600 | + | 24,300 | + | 141,000 | = | 1,900 | + | 126,000 | + | 82,000 | | | + | 2,400 | - | 500 |
| g. | + 4,000 | | | | | | | | | | | | | | | | | + | 4,000 | | |
| Bal. | 47,500 | + | 2,400 | + | 600 | + | 24,300 | + | 141,000 | = | 1,900 | + | 126,000 | + | 82,000 | | | + | 6,400 | - | 500 |
| h. | - 3,325 | | | | | | | | | | | | | | | - | $3,325 | | | | |
| Bal. | 44,175 | + | 2,400 | + | 600 | + | 24,300 | + | 141,000 | = | 1,900 | + | 126,000 | + | 82,000 | - | 3,325 | + | 6,400 | - | 500 |
| i. | + 1,750 | - | 1,750 | | | | | | | | | | | | | | | | | | |
| Bal. | 45,925 | + | 650 | + | 600 | + | 24,300 | + | 141,000 | = | 1,900 | + | 126,000 | + | 82,000 | - | 3,325 | + | 6,400 | - | 500 |
| j. | - 700 | | | | | | | | | | - 700 | | | | | | | | | | |
| Bal. | 45,225 | + | 650 | + | 600 | + | 24,300 | + | 141,000 | = | 1,200 | + | 126,000 | + | 82,000 | - | 3,325 | + | 6,400 | - | 500 |
| k. | - 1,750 | | | | | | | | | | | | | | | | | | | - | 1,750 |
| Bal. | $43,475 | + | $650 | + | $600 | + | $24,300 | + | $141,000 | = | $1,200 | + | $126,000 | + | $82,000 | - | $3,325 | + | $6,400 | - | $2,250 |

**Problem 1-9B *(Concluded)***

***Part 3***

**Financial Management's net income = $6,400 - $2,250 = $4,150**

**Problem 1-10B (20 minutes)**

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

   a. **AT&T return: $7,356/ $208,133 = 0.035 or 3.5%**

   b. **Verizon return: $6,197/ $178,467 = 0.035 or 3.5%**

2. **On strictly amount of sales to consumers, AT&T's sales of $63,055 are less than Verizon's sales of $84,144.**

3. **Success in returning net income from the amount invested is revealed by the return on assets ratio. Part 1 showed that AT&T and Verizon have an approximately equivalent 3.5% return on assets.**

4. **Current performance figures suggest both are 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 Verizon 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 1-11B (15 minutes)

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

   $62,500 / $243,000 = 0.257 or 25.7%.

2. Return on assets seems more than satisfactory for the risk involved in the manufacturing, marketing, and selling of ATV and snowmobile equipment. Carbondale Company's 25.7% return is over 2 ½ times greater than the 10% return earned by its competitors.

3. We know that revenues less expenses equal net income. Taking the revenues and net income numbers for Carbondale Company we obtain:

   $473,000 - Expenses = $62,500 → Expenses must equal $410,500.

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 $243,000, we know the average total of liabilities plus equity (financing) must equal $243,000.

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

| | | |
|---|---|---|
| Case 1. | *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 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*: | 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 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)**

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

**Problem 1-14B[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.]**

## *Serial Problem — SP 1* *Success Systems*

| Date | | Cash | | Accounts Receivable | | Computer Supplies | | Computer System | | Office Equipment | | Accounts Payable | | A. Lopez, Capital | | A. Lopez, Withdrawals | | Revenues | | Expenses |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Assets | + | | + | | + | | + | | = | Liabilities | + | Equity | | | | | | |
| | | Cash | + | Accounts Receivable | + | Computer Supplies | + | Computer System | + | Office Equipment | = | Accounts Payable | + | A. Lopez, Capital | - | A. Lopez, Withdrawals | + | Revenues | - | Expenses |
| Oct. | 1 | +$55,000 | | | | | | $20,000 | + | $8,000 | | | + | $83,000 | | | | | | |
| | 3 | | | | + | $1,420 | | | | | | + $1,420 | | | | | | | | |
| Bal. | | 55,000 | | | + | 1,420 | + | 20,000 | + | 8,000 | = | 1,420 | + | 83,000 | | | | | | |
| | 6 | | + | $4,800 | | | | | | | | | | | | | + | $ 4,800 | | |
| Bal. | | 55,000 | + | 4,800 | + | 1,420 | + | 20,000 | + | 8,000 | = | 1,420 | + | 83,000 | | | + | 4,800 | | |
| | 8 | - 1,420 | | | | | | | | | | - 1,420 | | | | | | | | |
| Bal. | | 53,580 | + | 4,800 | + | 1,420 | + | 20,000 | + | 8,000 | = | 0 | + | 83,000 | | | + | 4,800 | | |
| | 12 | | + | 1,400 | | | | | | | | | | | | | + | 1,400 | | |
| Bal. | | 53,580 | + | 6,200 | + | 1,420 | + | 20,000 | + | 8,000 | = | 0 | + | 83,000 | | | + | 6,200 | | |
| | 15 | + 4,800 | - | 4,800 | | | | | | | | | | | | | | | | |
| Bal. | | 58,380 | + | 1,400 | + | 1,420 | + | 20,000 | + | 8,000 | = | 0 | + | 83,000 | | | + | 6,200 | | |
| | 17 | - 805 | | | | | | | | | | | | | | | | | - | $ 805 |
| Bal. | | 57,575 | + | 1,400 | + | 1,420 | + | 20,000 | + | 8,000 | = | 0 | + | 83,000 | | | + | 6,200 | - | 805 |
| | 20 | - 1,940 | | | | | | | | | | | | | | | | | - | 1,940 |
| Bal. | | 55,635 | + | 1,400 | + | 1,420 | + | 20,000 | + | 8,000 | = | 0 | + | 83,000 | | | + | 6,200 | - | 2,745 |
| | 22 | + 1,400 | - | 1,400 | | | | | | | | | | | | | | | | |
| Bal. | | 57,035 | + | 0 | + | 1,420 | + | 20,000 | + | 8,000 | = | 0 | + | 83,000 | | | + | 6,200 | - | 2,745 |
| | 28 | | + | 5,208 | | | | | | | | | | | | | + | 5,208 | | |
| Bal. | | 57,035 | + | 5,208 | + | 1,420 | + | 20,000 | + | 8,000 | = | 0 | + | 83,000 | | | + | 11,408 | - | 2,745 |
| | 31 | - 875 | | | | | | | | | | | | | | | | | - | 875 |
| Bal. | | 56,160 | + | 5,208 | + | 1,420 | + | 20,000 | + | 8,000 | = | 0 | + | 83,000 | | | + | 11,408 | - | 3,620 |
| | 31 | - 3,600 | | | | | | | | | | | | | - | $3,600 | | | | |
| Bal. | | $52,560 | + | $5,208 | + | $1,420 | + | $20,000 | + | $8,000 | = | $ 0 | + | $83,000 | - | $3,600 | + | $11,408 | - | $3,620 |

## Reporting in Action — BTN 1-1

1. An organization's total assets are equal to its total liabilities plus total equity. Since Best Buy's liabilities and equity total $13,570 (in millions), then its amount of assets invested is the same $13,570 (in millions).
2. Return on assets is net income divided by the average total assets invested. For Best Buy this return is ($ millions):
   $1,377 / [($11,864 + $13,570)/2] = 0.108 or 10.8%.
3. We know that net income equals total revenues less total expenses. For Best Buy, we are told net income is $1,377 and revenues are $35,934. Thus, Best Buy's expenses are computed as: $35,934 - Expenses = $1,377. Expenses must equal $34,557 (in millions).
4. Best Buy's return on assets of 10.8% is good. Further, its return markedly exceeds its competitors' return on assets of 8.1%.
5. Answer depends on the current annual report information obtained.

## Comparative Analysis — BTN 1-2

| *($ millions)* | Best Buy | RadioShack |
|---|---|---|
| 1. Total assets = Liabilities + Equity | $13,570 | $2,070 |
| 2. Return on assets | $1,377 / [($11,864 + $13,570)/2]<br>10.8% | $73 / [($2,205 + $2,070)/2]<br>3.4% |
| 3. Revenues-Expenses = Net income | $35,934-Expenses=$1,377<br>Expenses = $34,557 | $4,778-Expenses=$73<br>Expenses = $4,705 |

4. Analysis of return on assets: Best Buy's 10.8% return is good given the moderate risk Best Buy confronts (and vis-à-vis the 8.1% return of its competitors). However, RadioShack's 3.4% return is not acceptable.

5. Analysis conclusions: Best Buy's return is acceptable (very good when compared to the industry norm); RadioShack's return is not acceptable. 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 'Life is good' 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 niche, and a strategy to achieve success; (3) cash contributions that Bert and John Jacobs 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 an important issue to a loan officer. If it is a proprietorship (and not LLC), the personal assets of Bert and John Jacobs are available to repay the loan. In this case, the loan officer will want information about their 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 the new manufacturing facilities 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) | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|
| Revenues ........... | $31,573 | $28,074 | $24,524 | $21,133 |
| Net income......... | 4,745 | 4,065 | 3,317 | 2,319 |

1. Rocky Mountain Chocolate Factory's (RMCF) revenues grew considerably from 2004 through 2007. Each year saw solid growth in its revenues.

2. Net income performance for RMCF was impressive over this time period. Its net income actually doubled from 2004 to 2007.

## 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) **LifeScreen Manufacturing Co.'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) **LifeScreen Manufacturing Co.'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%**

   **LifeScreen's 10.7% return slightly exceeds its competitors' average return of 10%. Assuming LifeScreen Manufacturing can continue to earn 10.7% or more, the Jacobs should further invest 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. **DSG's net income and revenues figures are computed using British pounds. In contrast, Best Buy and RadioShack 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, DSG's figures are computed according to Generally Accepted Accounting Principles in Britain, while Best Buy and RadioShack use U.S. GAAP. One should adjust these figures for any significant differences in accounting measurements to yield an 'apples-to-apples' comparison.**

2. **DSG's return on assets ratio eliminates differences in monetary units (between pounds and dollars). Consequently, one need not focus on differences in pounds and dollars.**

   **However, any comparisons using the return on assets ratio are still impacted by potential differences in British GAAP as applied by DSG compared to the U.S. GAAP applied by Best Buy and RadioShack.**