CHAPTER 1
INTRODUCTION TO ACCOUNTING AND BUSINESS

DISCUSSION QUESTIONS

1. Some users of accounting information include managers, employees, investors, creditors, customers, 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 assumption limits the recording of economic data to transactions directly affecting the activities of the business. The payment of the interest of $4,500 is a personal transaction of Josh Reilly and should not be recorded by Dispatch Delivery Service.

5. The land should be recorded at its cost of $167,500 to Reliable Repair Service. This is consistent with the cost principle.

6. **A.** No. The offer of $2,000,000 and the increase in the assessed value should not be recognized in the accounting records.

B. Cash would increase by $2,125,000, land would decrease by $900,000, and stockholders' equity would increase by $1,225,000.

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. **(B)** The business realized net income of $91,000 ($679,000 – $588,000).

9. **(A)** The business incurred a net loss of $75,000 ($640,000 – $715,000).

10. **(A)** Net income or net loss
(B) Retained earnings at the end of the period
(C) Cash at the end of the period

BASIC EXERCISES

BE 1–1

$275,000. Under the cost principle, the land should be recorded at the cost to Ritts Roofing.

BE 1–2

A.

A	=	L + SE	
$395,000	=	$97,000	+ SE
SE	=	$298,000	

B.

A	=	L + SE	
–$65,000	=	+$36,000	+ SE
SE	=	–$101,000	
SE on December 31, 2018	=	$298,000	– $101,000
SE on December 31, 2018	=	$197,000	

BE 1–3

(2) Expense (Advertising Expense) increases by $4,850;
Asset (Cash) decreases by $4,850.

(3) Asset (Supplies) increases by $2,100;
Liability (Accounts Payable) increases by $2,100.

(4) Asset (Accounts Receivable) increases by $14,700;
Revenue (Delivery Service Fees) increases by $14,700.

(5) Asset (Cash) increases by $8,200;
Asset (Accounts Receivable) decreases by $8,200.

BE 1–4

Paradise Travel Service
Income Statement
For the Year Ended May 31, 2018

Fees earned		$900,000
Expenses:		
Wages expense	$450,000	
Office expense	300,000	
Miscellaneous expense	15,000	
Total expenses		765,000
Net income		$135,000

BE 1–5

Paradise Travel Service Retained Earnings Statement For the Year Ended May 31, 2018		
Retained earnings, June 1, 2017		$300,000
Net income	$135,000	
Dividends	(10,000)	
Change in retained earnings		125,000
Retained earnings, May 31, 2018		$425,000

BE 1–6

Paradise Travel Service Balance Sheet May 31, 2018		
Assets		
Cash		$ 52,000
Accounts receivable		38,000
Supplies		3,000
Land		450,000
Total assets		$543,000
Liabilities		
Accounts payable		$ 18,000
Stockholders' Equity		
Common stock	$100,000	
Retained earnings	425,000	
Total stockholders' equity		525,000
Total liabilities and stockholders' equity		$543,000

BE 1–7

Paradise Travel Service Statement of Cash Flows For the Year Ended May 31, 2018		
Cash flows from operating activities:		
Cash received from customers	$ 880,000	
Cash payments for operating expenses	(758,000)	
Net cash flows from operating activities		$ 122,000
Cash flows used for investing activities:		
Cash payments for purchase of land		(150,000)
Cash flows from financing activities:		
Cash received from issuing common stock	$ 40,000	
Cash dividends	(10,000)	
Net cash flows from financing activities		30,000
Net increase in cash		$ 2,000
Cash as of June 1, 2017		50,000
Cash as of May 31, 2018		$ 52,000

EXERCISES

Ex. 1–1

A.

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

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. Oftentimes, 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.	**M**	**5.**	**O**	**9.**	**X**
2.	**L**	**6.**	**O**	**10.**	**O**
3.	**O**	**7.**	**X**		
4.	**M**	**8.**	**L**		

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

Keurig's stockholders' equity: $4,797 – $1,338 = $3,459
Starbucks' stockholders' equity: $10,753 – $5,481 = $5,272

Ex. 1–5

Dollar Tree's stockholders' equity: $2,772 – $1,601 = $1,171
Target's stockholders' equity: $44,553 – $28,322 = $16,231

Ex. 1–6

A. $1,895,000 ($550,000 + $1,345,000)
B. $187,700 ($776,500 – $588,800)
C. $10,295,000 ($14,750,000 – $4,455,000)

Ex. 1–7

A. $3,650,000 ($5,250,000 – $1,600,000)
B. $4,120,000 ($3,650,000 + $800,000 – $330,000)
C. $2,910,000 ($3,650,000 – $600,000 – $140,000)
D. $4,180,000 ($3,650,000 + $440,000 + $90,000)
E. Net income: $540,000 ($6,140,000 – $1,950,000 – $3,650,000)

Ex. 1–8

A. (2) liability
B. (1) asset
C. (3) stockholders' equity (revenue)
D. (1) asset
E. (1) asset
F. (3) stockholders' equity (expense)

Ex. 1–9

A. Increases assets and increases stockholders' equity.
B. Decreases assets and decreases stockholders' equity.
C. Increases assets and decreases assets.
D. Increases assets and increases liabilities.
E. Increases assets and increases stockholders' equity.

Ex. 1–10

A. (1) Total assets increased $183,000 ($298,000 – $115,000).
(2) No change in liabilities.
(3) Stockholders' equity increased $183,000.

B. (1) Total assets decreased $80,000.
(2) Total liabilities decreased $80,000.
(3) No change in stockholders' equity.

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. (B) decrease
2. (A) increase
3. (B) decrease
4. (A) increase

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, $71,800.
(2) Purchase of land for cash, $15,000.
(3) Payment of cash for expenses, $47,500.
(4) Purchase of supplies on account, $1,100.
(5) Paid cash dividends, $5,000.
(6) Payment of cash to creditors, $4,000.
(7) Recognition of cost of supplies used, $1,500.

B. $300 ($40,300 – $40,000)

C. $17,800 (–$5,000 + $71,800 – $49,000)

D. $22,800 ($71,800 – $49,000)

E. $17,800 ($22,800 – $5,000)

Ex. 1–14

No. It would be incorrect to say that the business had incurred a net loss of $8,000. 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

Amber

Stockholders' equity at end of year ($1,730,000 – $1,150,000)…………………	$580,000
Deduct stockholders' equity at beginning of year ($1,220,000 – $990,000)….	230,000
Net income (increase in stockholders' equity)………………………………	$350,000

Blue

Increase in stockholders' equity (as determined for Amber)……………………	$350,000
Add dividends………………………………………………………………………	60,000
Net income……………………………………………………………………	$410,000

Coral

Increase in stockholders' equity (as determined for Amber)……………………	$350,000
Deduct additional issuance of common stock……………………………………	140,000
Net income……………………………………………………………………	$210,000

Daffodil

Increase in stockholders' equity (as determined for Amber)……………………	$350,000
Deduct additional issuance of common stock……………………………………	140,000
	$210,000
Add dividends………………………………………………………………………	60,000
Net income……………………………………………………………………	$270,000

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.

Healthy Products Company Retained Earnings Statement For the Month Ended November 30, 2018		
Retained earnings, November 1, 2018		$2,940,000
Net income	$93,500	
Dividends	(7,000)	
Change in retained earnings		86,500
Retained earnings, November 30, 2018		$3,026,500

B. **The retained earnings statement is prepared before the November 30, 2018, balance sheet because retained earnings as of November 30, 2018, is needed for the balance sheet.**

Ex. 1–19

Imaging Services Income Statement For the Month Ended March 31, 2018		
Fees earned		$482,000
Expenses:		
Wages expense	$300,000	
Rent expense	41,500	
Supplies expense	3,600	
Miscellaneous expense	1,900	
Total expenses		347,000
Net income		$135,000

Ex. 1–20

In each case, solve for a single unknown, using the following equation:

Stockholders' Equity (beginning) + Additional Common Stock Issued – Dividends + Revenues – Expenses = Stockholders' Equity (ending)

Freeman

Stockholders' equity at end of year ($1,260,000 – $330,000)		$930,000
Stockholders' equity at beginning of year ($900,000 – $360,000)		540,000
Increase in stockholders' equity		$390,000
Deduct increase due to net income ($570,000 – $240,000)		330,000
		$ 60,000
Add dividends		75,000
Additional common stock issued	(A)	$135,000

Heyward

Stockholders' equity at end of year ($675,000 – $220,000)		$455,000
Stockholders' equity at beginning of year ($490,000 – $260,000)		230,000
Increase in stockholders' equity		$225,000
Add dividends		32,000
		$257,000
Deduct additional common stock issued		150,000
Increase due to net income		$107,000
Add expenses		128,000
Revenue	(B)	$235,000

Jones

Stockholders' equity at end of year ($100,000 – $80,000)		$ 20,000
Stockholders' equity at beginning of year ($115,000 – $81,000)		34,000
Decrease in stockholders' equity		$(14,000)
Decrease in stockholders' equity due to net loss ($115,000 – $122,500)		7,500
		$ (6,500)
Deduct common stock issued		(10,000)
Dividends	(C)	$(16,500)

Ramirez

Stockholders' equity at end of year ($270,000 – $136,000)		$134,000
Add decrease due to net loss ($115,000 – $128,000)		13,000
		$147,000
Add dividends		39,000
Stockholders' equity at beginning of year		$186,000
Deduct additional investment		55,000
		$131,000
Add liabilities at beginning of year		120,000
Assets at beginning of year	(D)	$251,000

Ex. 1–21

A.

Ebony Interiors Balance Sheet February 28, 2018		
Assets		
Cash		$ 320,000
Accounts receivable		800,000
Supplies		30,000
Total assets		$1,150,000
Liabilities		
Accounts payable		$ 310,000
Stockholders' Equity		
Common stock	$200,000	
Retained earnings	640,000*	
Total stockholders' equity		840,000
Total liabilities and stockholders' equity		$1,150,000

*$640,000 = $320,000 + $800,000 + $30,000 – $310,000 – $200,000

Ebony Interiors Balance Sheet March 31, 2018		
Assets		
Cash		$ 380,000
Accounts receivable		960,000
Supplies		35,000
Total assets		$1,375,000
Liabilities		
Accounts payable		$ 400,000
Stockholders' Equity		
Common stock	$200,000	
Retained earnings	775,000*	
Total stockholders' equity		975,000
Total liabilities and stockholders' equity		$1,375,000

*$775,000 = $380,000 + $960,000 + $35,000 – $400,000 – $200,000

B.

Stockholders' equity, March 31	$975,000
Stockholders' equity, February 28	840,000
Net income	$135,000

Ex. 1–21 (Concluded)

C.	Stockholders' equity, March 31	$975,000
	Stockholders' equity, February 28	840,000
	Increase in stockholders' equity	$135,000
	Add dividends	50,000
	Net income	$185,000

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 Exxon Mobil Corporation. The accounting equation is the basis for all accounting systems.

Ex. 1–23

1. (A) operating activity
2. (A) operating activity
3. (B) investing activity
4. (C) financing activity

Ex. 1–24

Ethos Consulting Group Statement of Cash Flows For the Year Ended May 31, 2018		
Cash flows from operating activities:		
Cash received from customers	$ 637,500	
Cash payments for operating expenses	(475,000)	
Net cash flows from operating activities		$162,500
Cash flows used for investing activities:		
Cash payments for purchase of land		(90,000)
Cash flows from financing activities:		
Cash received from issuing common stock	$ 62,500	
Cash dividends	(17,500)	
Net cash flows from financing activities		45,000
Net decrease in cash		$117,500
Cash as of June 1, 2017		58,000
Cash as of May 31, 2018		$175,500

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 "Omar Farah" rather than We-Sell 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 August 31, 2018."**
3. **The year in the heading for the retained earnings statement should be 2018 rather than 2017.**
4. **The balance sheet should be labeled "August 31, 2018," rather than "For the Month Ended August 31, 2018."**
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 $24,150. This also affects the retained earnings statement and the amount of retained earnings that appears on the balance sheet.**
7. **The additional issuance of common stock of $15,000 should not be included in the retained earnings statement.**
8. **In the retained earnings statement, the net income should be presented first. Dividends should then be subtracted from net income to yield a net increase in retained earnings.**
9. **Accounts payable should be listed as a liability on the balance sheet.**
10. **Accounts receivable and supplies should be listed as assets on the balance sheet.**
11. **The balance sheet assets should equal the sum of the liabilities and stockholders' equity.**

Ex. 1–25 (Concluded)

Corrected financial statements appear as follows:

We-Sell Realty
Income Statement
For the Month Ended August 31, 2018

Sales commissions		$140,000
Expenses:		
Office salaries expense	$87,000	
Rent expense	18,000	
Automobile expense	7,500	
Supplies expense	1,150	
Miscellaneous expense	2,200	
Total expenses		115,850
Net income		$ 24,150

We-Sell Realty
Retained Earnings Statement
For the Month Ended August 31, 2018

Retained earnings, August 1, 2018		$ 0
Net income	$ 24,150	
Dividends	(10,000)	
Change in retained earnings		14,150
Retained earnings, August 31, 2018		$14,150

We-Sell Realty
Balance Sheet
August 31, 2018

Assets		
Cash		$ 8,900
Accounts receivable		38,600
Supplies		4,000
Total assets		$51,500
Liabilities		
Accounts payable		$22,350
Stockholders' Equity		
Common stock	$15,000	
Retained earnings	14,150	
Total stockholders' equity		29,150
Total liabilities and stockholders' equity		$51,500

PROBLEMS

Prob. 1–1A

1.

	Assets			= Liabilities +	Stockholders' Equity							
	Cash	+ Accts. Rec.	+ Supplies	= Accts. Payable	+ Common Stock	– Dividends	+ Fees Earned	– Rent Expense	– Salaries Expense	– Supplies Expense	– Auto Exp.	– Misc. Exp.
(A)	+ 36,000				+ 36,000							
(B)			+ 1,800	+ 1,800								
Bal.	36,000		1,800	1,800	36,000							
(C)	+ 6,750						+ 6,750					
Bal.	42,750		1,800	1,800	36,000		6,750					
(D)	– 5,000							– 5,000				
Bal.	37,750		1,800	1,800	36,000		6,750	– 5,000				
(E)	– 1,375			– 1,375								
Bal.	36,375		1,800	425	36,000		6,750	– 5,000				
(F)		+ 9,500					+ 9,500					
Bal.	36,375	9,500	1,800	425	36,000		16,250	– 5,000				
(G)	– 1,800										– 840	– 960
Bal.	34,575	9,500	1,800	425	36,000		16,250	– 5,000			– 840	– 960
(H)	– 3,600								– 3,600			
Bal.	30,975	9,500	1,800	425	36,000		16,250	– 5,000	– 3,600		– 840	– 960
(I)			– 1,450							– 1,450		
Bal.	30,975	9,500	350	425	36,000		16,250	– 5,000	– 3,600	– 1,450	– 840	– 960
(J)	– 3,000					– 3,000						
Bal.	27,975	9,500	350	425	36,000	– 3,000	16,250	– 5,000	– 3,600	– 1,450	– 840	– 960

2. **Stockholders' equity is the right of stockholders (owners) to the assets of the business. These rights are increased by issuing common stock and revenues and decreased by dividends and expenses.**

3. **$4,400 ($16,250 – $5,000 – $3,600 – $1,450 – $840 – $960)**

4. **September's transactions increased retained earnings by $1,400 ($4,400 – $3,000), which is September's net income of $4,400 less dividends of $3,000.**

Prob. 1–2A

1.

Journey Travel Agency Income Statement For the Year Ended December 31, 2018		
Fees earned		$383,500
Expenses:		
Wages expense	$170,000	
Rent expense	22,500	
Utilities expense	16,700	
Supplies expense	11,300	
Miscellaneous expense	14,500	
Total expenses		235,000
Net income		$148,500

2.

Journey Travel Agency Retained Earnings Statement For the Year Ended December 31, 2018		
Retained earnings, January 1, 2018		$1,341,000
Net income	$148,500	
Dividends	(75,000)	
Change in retained earnings		73,500
Retained earnings, December 31, 2018		$1,414,500

3.

Journey Travel Agency Balance Sheet December 31, 2018		
Assets		
Cash		$ 190,500
Accounts receivable		236,500
Supplies		7,000
Land		1,500,000
Total assets		$1,934,000
Liabilities		
Accounts payable		$ 69,500
Stockholders' Equity		
Common stock	$ 450,000	
Retained earnings	1,414,500	
Total stockholders' equity		1,864,500
Total liabilities and stockholders' equity		$1,934,000

4. Ending retained earnings appears on both the retained earnings statement and the balance sheet. For Journey Travel Agency, the December 31, 2018, retained earnings of $1,414,500 appears on the retained earnings statement and balance sheet.

Prob. 1–3A

1.

Reliance Financial Services Income Statement For the Month Ended July 31, 2018		
Fees earned		$144,500
Expenses:		
Salaries expense	$55,000	
Rent expense	33,000	
Auto expense	16,000	
Supplies expense	4,500	
Miscellaneous expense	4,800	
Total expenses		113,300
Net income		$ 31,200

2.

Reliance Financial Services Retained Earnings Statement For the Month Ended July 31, 2018		
Retained earnings, July 1, 2018		$ 0
Net income	$ 31,200	
Dividends	(15,000)	
Change in retained earnings		16,200
Retained earnings, July 31, 2018		$16,200

3.

Reliance Financial Services Balance Sheet July 31, 2018		
Assets		
Cash		$32,600
Accounts receivable		34,500
Supplies		2,500
Total assets		$69,600
Liabilities		
Accounts payable		$ 3,400
Stockholders' Equity		
Common stock	$50,000	
Retained earnings	16,200	
Total stockholders' equity		66,200
Total liabilities and stockholders' equity		$69,600

Prob. 1–3A (Concluded)

4. (Optional)

Reliance Financial Services Statement of Cash Flows For the Month Ended July 31, 2018		
Cash flows from operating activities:		
Cash received from customers	$ 110,000	
Cash payments for expenses		
and payments to creditors*	(112,400)	
Net cash flows used for operating activities		$ (2,400)
Cash flows from investing activities		0
Cash flows from financing activities:		
Cash received from issuing common stock	$ 50,000	
Cash dividends	(15,000)	
Net cash flows from financing activities		35,000
Net increase in cash and July 31, 2018, cash balance		$32,600

* $3,600 + $33,000 + $20,800 + $55,000; these amounts are taken from the cash column shown in the problem.

Prob. 1–4A

1.

	Assets		= Liabilities +	Stockholders' Equity							
	Cash	+ Supplies	= Accts. Payable	+ Common Stock	– Dividends	+ Sales Comm.	– Salaries Exp.	– Rent Exp.	– Auto Exp.	– Supplies Exp.	– Misc. Exp.
(A)	+ 35,000			+ 35,000							
(B)		+ 2,750	+ 2,750								
Bal.	35,000	2,750	2,750	35,000							
(C)	– 1,800		– 1,800								
Bal.	33,200	2,750	950	35,000							
(D)	+ 52,800					+ 52,800					
Bal.	86,000	2,750	950	35,000		52,800					
(E)	– 4,500							– 4,500			
Bal.	81,500	2,750	950	35,000		52,800		– 4,500			
(F)	– 3,000				– 3,000						
Bal.	78,500	2,750	950	35,000	– 3,000	52,800		– 4,500			
(G)	– 2,300								– 1,100		– 1,200
Bal.	76,200	2,750	950	35,000	– 3,000	52,800		– 4,500	– 1,100		– 1,200
(H)	– 5,250						– 5,250				
Bal.	70,950	2,750	950	35,000	– 3,000	52,800	– 5,250	– 4,500	– 1,100		– 1,200
(I)		– 1,000								– 1,000	
Bal.	70,950	1,750	950	35,000	– 3,000	52,800	– 5,250	– 4,500	– 1,100	– 1,000	– 1,200

Prob. 1–4A (Concluded)

2.

Western Realty Income Statement For the Month Ended August 31, 2018		
Sales commissions		$52,800
Expenses:		
Salaries expense	$5,250	
Rent expense	4,500	
Automobile expense	1,100	
Supplies expense	1,000	
Miscellaneous expense	1,200	
Total expenses		13,050
Net income		$39,750

Western Realty Retained Earnings Statement For the Month Ended August 31, 2018		
Retained earnings, August 1, 2018		$ 0
Net income	$39,750	
Dividends	(3,000)	
Change in retained earnings		36,750
Retained earnings, August 31, 2018		$36,750

Western Realty Balance Sheet August 31, 2018		
Assets		
Cash		$70,950
Supplies		1,750
Total assets		$72,700
Liabilities		
Accounts payable		$ 950
Stockholders' Equity		
Common stock	$35,000	
Retained earnings	36,750	
Total stockholders' equity		71,750
Total liabilities and stockholders' equity		$72,700

Prob. 1–5A

1.

Assets							=	Liabilities	+	Stockholders' Equity		
Cash	+	Accounts Receivable	+	Supplies	+	Land	=	Accounts Payable	+	Common Stock	+	Retained Earnings
$45,000	+	$93,000	+	$7,000	+	$75,000	=	$40,000	+	60,000	+	Retained Earnings
						$220,000	=	$100,000	+	Retained Earnings		
						$120,000	=	Retained Earnings				

Prob. 1–5A (Continued)

2.

	Assets				= Liabilities +	Stockholders' Equity		
	Cash	+ Accts. Rec.	+ Supplies	+ Land	= Accts. Payable	+ Common Stock	+ Retained Earnings	– Dividends
Bal.	45,000	93,000	7,000	75,000	40,000	60,000	120,000	
(A)	+ 35,000					+ 35,000		
Bal.	80,000	93,000	7,000	75,000	40,000	95,000	120,000	
(B)	– 50,000			+ 50,000				
Bal.	30,000	93,000	7,000	125,000	40,000	95,000	120,000	
(C)	+ 32,125							
Bal.	62,125	93,000	7,000	125,000	40,000	95,000	120,000	
(D)	– 6,000							
Bal.	56,125	93,000	7,000	125,000	40,000	95,000	120,000	
(E)			+ 2,500		+ 2,500			
Bal.	56,125	93,000	9,500	125,000	42,500	95,000	120,000	
(F)	– 22,800				– 22,800			
Bal.	33,325	93,000	9,500	125,000	19,700	95,000	120,000	
(G)		+ 84,750						
Bal.	33,325	177,750	9,500	125,000	19,700	95,000	120,000	
(H)					+ 29,500			
Bal.	33,325	177,750	9,500	125,000	49,200	95,000	120,000	
(I)	– 14,000							
Bal.	19,325	177,750	9,500	125,000	49,200	95,000	120,000	
(J)	+ 88,000	– 88,000						
Bal.	107,325	89,750	9,500	125,000	49,200	95,000	120,000	
(K)			– 3,600					
Bal.	107,325	89,750	5,900	125,000	49,200	95,000	120,000	
(L)	– 12,000							– 12,000
Bal.	95,325	89,750	5,900	125,000	49,200	95,000	120,000	– 12,000

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)	+ 32,125							
Bal.	32,125							
(D)				– 6,000				
Bal.	32,125			– 6,000				
(E)								
Bal.	32,125			– 6,000				
(F)								
Bal.	32,125			– 6,000				
(G)	+ 84,750							
Bal.	116,875			– 6,000				
(H)		– 29,500						
Bal.	116,875	– 29,500		– 6,000				
(I)			– 7,500			– 2,500	– 1,300	– 2,700
Bal.	116,875	– 29,500	– 7,500	– 6,000		– 2,500	– 1,300	– 2,700
(J)								
Bal.	116,875	– 29,500	– 7,500	– 6,000		– 2,500	– 1,300	– 2,700
(K)					– 3,600			
Bal.	116,875	– 29,500	– 7,500	– 6,000	– 3,600	– 2,500	– 1,300	– 2,700
(L)								
Bal.	116,875	– 29,500	– 7,500	– 6,000	– 3,600	– 2,500	– 1,300	– 2,700

Prob. 1–5A (Continued)

3.

D'Lite Dry Cleaners
Income Statement
For the Month Ended July 31, 2018

Dry cleaning revenue		$116,875
Expenses:		
Dry cleaning expense	$29,500	
Wages expense	7,500	
Rent expense	6,000	
Supplies expense	3,600	
Truck expense	2,500	
Utilities expense	1,300	
Miscellaneous expense	2,700	
Total expenses		53,100
Net income		$ 63,775

D'Lite Dry Cleaners
Retained Earnings Statement
For the Month Ended July 31, 2018

Retained earnings, July 1, 2018		$120,000
Net income	$ 63,775	
Dividends	(12,000)	
Change in retained earnings		51,775
Retained earnings, July 31, 2018		$171,775

D'Lite Dry Cleaners
Balance Sheet
July 31, 2018

Assets		
Cash		$ 95,325
Accounts receivable		89,750
Supplies		5,900
Land		125,000
Total assets		$315,975
Liabilities		
Accounts payable		$ 49,200
Stockholders' Equity		
Common stock	$ 95,000	
Retained earnings	171,775	
Total stockholders' equity		266,775
Total liabilities and stockholders' equity		$315,975

Prob. 1–5A (Concluded)

4. (Optional)

D'Lite Dry Cleaners Statement of Cash Flows For the Month Ended July 31, 2018		
Cash flows from operating activities:		
Cash received from customers*	$120,125	
Cash payments for expenses		
and payments to creditors**	(42,800)	
Net cash flows from operating activities		$ 77,325
Cash flows used for investing activities:		
Purchase of land		(50,000)
Cash flows from financing activities:		
Cash received from issuing common stock	$ 35,000	
Cash dividends	(12,000)	
Net cash flows from financing activities		23,000
Net Increase in cash		$ 50,325
Cash balance, July 1, 2018		45,000
Cash balance, July 31, 2018		$ 95,325

* $32,125 + $88,000; these amounts are taken from the cash column of the spreadsheet in Part 2.

** $6,000 + $22,800 + $14,000; these amounts are taken from the cash column of the spreadsheet in Part 2.

Prob. 1–6A

A. **Fees earned, $750,000 ($275,000 + $475,000)**

B. **Supplies expense, $30,000 ($475,000 – $300,000 – $100,000 – $20,000 – $25,000)**

C. **Retained earnings, April 1, 2018, $0; Wolverine Realty was organized on April 1, 2018.**

D. **Net income for April, $275,000 from income statement**

E. **$150,000 ($275,000 – $125,000)**

F. **Retained earnings, April 30, 2018, $150,000**

G. **Total assets, $625,000 ($462,500 + $12,500 + $150,000)**

H. **Retained earnings, $150,000; same as (F)**

I. **Total stockholders' equity, $525,000 ($375,000 + $150,000)**

J. **Total liabilities and stockholders' equity, $625,000 ($100,000 + $525,000)**

K. **Cash received from customers, $750,000 ($387,500 + $362,500); this is the same as fees earned (A) since there are no accounts receivable.**

L. **Net cash flows from operating activities, $362,500 ($750,000 – $387,500)**

M. **Cash payments for acquisition of land, ($150,000)**

N. **Cash received from issuing common stock, $375,000**

O. **Cash dividends, ($125,000)**

P. **Net cash flows from financing activities, $250,000 ($375,000 – $125,000)**

Q. **Net cash flow and April 30, 2018, cash balance, $462,500 ($362,500 – $150,000 + $250,000); also the cash balance on the balance sheet.**

Prob. 1–1B

1.

	Assets			= Liabilities +	Stockholders' Equity							
	Cash	+ Accts. Rec.	+ Supplies	= Accts. Payable	+ Common Stock	– Dividends	+ Fees Earned	– Rent Expense	– Salaries Expense	– Supplies Expense	– Auto Exp.	– Misc. Exp.
(A)	+ 50,000				+ 50,000							
(B)			+ 4,000	+ 4,000								
Bal.	50,000		4,000	4,000	50,000							
(C)	– 2,300			– 2,300								
Bal.	47,700		4,000	1,700	50,000							
(D)	+ 13,800						+ 13,800					
Bal.	61,500		4,000	1,700	50,000		13,800					
(E)	– 5,000							– 5,000				
Bal.	56,500		4,000	1,700	50,000		13,800	– 5,000				
(F)	– 1,450										– 1,150	– 300
Bal.	55,050		4,000	1,700	50,000		13,800	– 5,000			– 1,150	– 300
(G)	– 2,500								– 2,500			
Bal.	52,550		4,000	1,700	50,000		13,800	– 5,000	– 2,500		– 1,150	– 300
(H)			– 1,300							– 1,300		
Bal.	52,550		2,700	1,700	50,000		13,800	– 5,000	– 2,500	– 1,300	– 1,150	– 300
(I)		+ 12,500					+ 12,500					
Bal.	52,550	12,500	2,700	1,700	50,000		26,300	– 5,000	– 2,500	– 1,300	– 1,150	– 300
(J)	– 3,900					– 3,900						
Bal.	48,650	12,500	2,700	1,700	50,000	– 3,900	26,300	– 5,000	– 2,500	– 1,300	– 1,150	– 300

2. **Stockholders' equity is the right of stockholders (owners) to the assets of the business. These rights are increased by issuing common stock and revenues and decreased by dividends and expenses.**

3. **$16,050 ($26,300 – $5,000 – $2,500 – $1,300 – $1,150 – $300)**

4. **March's transactions increased retained earnings by $12,150 ($16,050 – $3,900), which is the excess of March's net income of $16,050 over dividends of $3,900.**

Prob. 1–2B

1.

Wilderness Travel Service Income Statement For the Year Ended April 30, 2018		
Fees earned		$875,000
Expenses:		
Wages expense	$525,000	
Rent expense	75,000	
Utilities expense	38,000	
Supplies expense	12,000	
Taxes expense	10,000	
Miscellaneous expense	15,000	
Total expenses		675,000
Net income		$200,000

2.

Wilderness Travel Service Retained Earnings Statement For the Year Ended April 30, 2018		
Retained earnings, May 1, 2017		$145,000
Net income	$200,000	
Dividends	(40,000)	
Change in retained earnings		160,000
Retained earnings, April 30, 2018		$305,000

3.

Wilderness Travel Service Balance Sheet April 30, 2018		
Assets		
Cash		$146,000
Accounts receivable		210,000
Supplies		9,000
Total assets		$365,000
Liabilities		
Accounts payable		$ 25,000
Stockholders' Equity		
Common stock	$ 35,000	
Retained earnings	305,000	
Total stockholders' equity		340,000
Total liabilities and stockholders' equity		$365,000

4. Net income (or net loss) appears on both the income statement and the retained earnings statement. For Wilderness Travel Service, net income for the year of $200,000 appears on the income statement and retained earnings statement.

Prob. 1–3B

1.

Bronco Consulting Income Statement For the Month Ended August 31, 2018		
Fees earned		$125,000
Expenses:		
Salaries expense	$58,000	
Rent expense	27,000	
Auto expense	15,500	
Supplies expense	6,100	
Miscellaneous expense	7,500	
Total expenses		114,100
Net income		$ 10,900

2.

Bronco Consulting Retained Earnings Statement For the Month Ended August 31, 2018		
Retained earnings, August 1, 2018		$ 0
Net income	$10,900	
Dividends	(5,000)	
Change in retained earnings		5,900
Retained earnings, August 31, 2018		$5,900

3.

Bronco Consulting Balance Sheet August 31, 2018		
Assets		
Cash		$48,000
Accounts receivable		33,000
Supplies		2,900
Total assets		$83,900
Liabilities		
Accounts payable		$ 3,000
Stockholders' Equity		
Common stock	$75,000	
Retained earnings	5,900	
Total stockholders' equity		80,900
Total liabilities and stockholders' equity		$83,900

Prob. 1–3B (Concluded)

4. (Optional)

Bronco Consulting Statement of Cash Flows For the Month Ended August 31, 2018		
Cash flows from operating activities:		
Cash received from customers	$ 92,000	
Cash payments for expenses		
and payments to creditors*	(114,000)	
Net cash flows used for operating activities		$(22,000)
Cash flows from investing activities		0
Cash flows from financing activities:		
Cash received from issuing common stock	$ 75,000	
Cash dividends	(5,000)	
Net cash flows from financing activities		70,000
Net increase in cash and August 31, 2018, cash balance		$ 48,000

* $27,000 + $6,000 + $23,000 + $58,000; these amounts are taken from the cash column shown in the problem.

Prob. 1–4B

1.

	Assets		= Liabilities +	Stockholders' Equity							
	Cash	+ Supplies	= Accts. Payable	+ Common Stock	– Dividends	+ Sales Comm.	– Rent Exp.	– Salaries Exp.	– Auto Exp.	– Supplies Exp.	– Misc. Exp.
(A)	+ 24,000			+ 24,000							
(B)	– 3,600						– 3,600				
Bal.	20,400			24,000			– 3,600				
(C)	– 1,950								– 1,350		– 600
Bal.	18,450			24,000			– 3,600		– 1,350		– 600
(D)		+ 1,200	+ 1,200								
Bal.	18,450	1,200	1,200	24,000			– 3,600		– 1,350		– 600
(E)	+ 19,800					+ 19,800					
Bal.	38,250	1,200	1,200	24,000		19,800	– 3,600		– 1,350		– 600
(F)	– 750		– 750								
Bal.	37,500	1,200	450	24,000		19,800	– 3,600		– 1,350		– 600
(G)	– 2,500							– 2,500			
Bal.	35,000	1,200	450	24,000		19,800	– 3,600	– 2,500	– 1,350		– 600
(H)	– 3,500				– 3,500						
Bal.	31,500	1,200	450	24,000	– 3,500	19,800	– 3,600	– 2,500	– 1,350		– 600
(I)		– 900								– 900	
Bal.	31,500	300	450	24,000	– 3,500	19,800	– 3,600	– 2,500	– 1,350	– 900	– 600

Prob. 1–4B (Concluded)

2.

Custom Realty Income Statement For the Month Ended April 30, 2018		
Sales commissions		$19,800
Expenses:		
Rent expense	$3,600	
Salaries expense	2,500	
Automobile expense	1,350	
Supplies expense	900	
Miscellaneous expense	600	
Total expenses		8,950
Net income		$10,850

Custom Realty Retained Earnings Statement For the Month Ended April 30, 2018		
Retained earnings, April 1, 2018		$ 0
Net income	$10,850	
Dividends	(3,500)	
Change in retained earnings		7,350
Retained earnings, April 30, 2018		$7,350

Custom Realty Balance Sheet April 30, 2018		
Assets		
Cash		$31,500
Supplies		300
Total assets		$31,800
Liabilities		
Accounts payable		$ 450
Stockholders' Equity		
Common stock	$24,000	
Retained earnings	7,350	
Total stockholders' equity		31,350
Total liabilities and stockholders' equity		$31,800

Prob. 1–5B

1.

Assets							=	Liabilities	+	Stockholders' Equity		
Cash	+	Accounts Receivable	+	Supplies	+	Land	=	Accounts Payable	+	Common Stock	+	Retained Earnings
$39,000	+	$80,000	+	$11,000	+	$50,000	=	$31,500	+	50,000	+	Retained Earnings
						$180,000	=	$81,500	+	Retained Earnings		
						$98,500	=	Retained Earnings				

Prob. 1–5B (Continued)

2.

	Assets				= Liabilities +	Stockholders' Equity		
	Cash	+ Accts. Rec.	+ Supplies	+ Land	= Accts. Payable	+ Common Stock	+ Retained Earnings	– Dividends
Bal.	39,000	80,000	11,000	50,000	31,500	50,000	98,500	
(A)	+ 21,000					+ 21,000		
Bal.	60,000	80,000	11,000	50,000	31,500	71,000	98,500	
(B)	– 35,000			+ 35,000				
Bal.	25,000	80,000	11,000	85,000	31,500	71,000	98,500	
(C)	– 4,000							
Bal.	21,000	80,000	11,000	85,000	31,500	71,000	98,500	
(D)		+ 72,000						
Bal.	21,000	152,000	11,000	85,000	31,500	71,000	98,500	
(E)	– 20,000				– 20,000			
Bal.	1,000	152,000	11,000	85,000	11,500	71,000	98,500	
(F)			+ 8,000		+ 8,000			
Bal.	1,000	152,000	19,000	85,000	19,500	71,000	98,500	
(G)	+ 38,000							
Bal.	39,000	152,000	19,000	85,000	19,500	71,000	98,500	
(H)	+ 77,000	– 77,000						
Bal.	116,000	75,000	19,000	85,000	19,500	71,000	98,500	
(I)					+ 29,450			
Bal.	116,000	75,000	19,000	85,000	48,950	71,000	98,500	
(J)	– 29,200							
Bal.	86,800	75,000	19,000	85,000	48,950	71,000	98,500	
(K)			– 7,200					
Bal.	86,800	75,000	11,800	85,000	48,950	71,000	98,500	
(L)	– 5,000							– 5,000
Bal.	81,800	75,000	11,800	85,000	48,950	71,000	98,500	– 5,000

Prob. 1–5B (Continued)

	Stockholders' Equity (Continued)							
	+ Dry Cleaning Revenue	– Dry Cleaning Exp.	– Wages Exp.	– Supplies Exp.	– Rent Exp.	– Truck Exp.	– Utilities Exp.	– Misc. Exp.
Bal.								
(A)								
Bal.								
(B)								
Bal.								
(C)					– 4,000			
Bal.					– 4,000			
(D)	+ 72,000							
Bal.	72,000				– 4,000			
(E)								
Bal.	72,000				– 4,000			
(F)								
Bal.	72,000				– 4,000			
(G)	+ 38,000							
Bal.	110,000				– 4,000			
(H)								
Bal.	110,000				– 4,000			
(I)		– 29,450						
Bal.	110,000	– 29,450			– 4,000			
(J)			– 24,000			– 2,100	– 1,800	– 1,300
Bal.	110,000	– 29,450	– 24,000		– 4,000	– 2,100	– 1,800	– 1,300
(K)				– 7,200				
Bal.	110,000	– 29,450	– 24,000	– 7,200	– 4,000	– 2,100	– 1,800	– 1,300
(L)								
Bal.	110,000	– 29,450	– 24,000	– 7,200	– 4,000	– 2,100	– 1,800	– 1,300

Prob. 1–5B (Continued)

3.

Bev's Dry Cleaners Income Statement For the Month Ended November 30, 2018		
Dry cleaning revenue		$110,000
Expenses:		
Dry cleaning expense	$29,450	
Wages expense	24,000	
Supplies expense	7,200	
Rent expense	4,000	
Truck expense	2,100	
Utilities expense	1,800	
Miscellaneous expense	1,300	
Total expenses		69,850
Net income		$ 40,150

Bev's Dry Cleaners Retained Earnings Statement For the Month Ended November 30, 2018		
Retained earnings, November 1, 2018		$ 98,500
Net income	$40,150	
Dividends	(5,000)	
Change in retained earnings		35,150
Retained earnings, November 30, 2018		$133,650

Bev's Dry Cleaners Balance Sheet November 30, 2018		
Assets		
Cash		$ 81,800
Accounts receivable		75,000
Supplies		11,800
Land		85,000
Total assets		$253,600
Liabilities		
Accounts payable		$ 48,950
Stockholders' Equity		
Common stock	$ 71,000	
Retained earnings	133,650	
Total stockholders' equity		204,650
Total liabilities and stockholders' equity		$253,600

Prob. 1–5B (Concluded)

4. (Optional)

Bev's Dry Cleaners Statement of Cash Flows For the Month Ended Novemer 30, 2018		
Cash flows from operating activities:		
Cash received from customers*	$115,000	
Cash payments for expenses		
and payments to creditors**	(53,200)	
Net cash flows from operating activities		$ 61,800
Cash flows used for investing activities:		
Purchase of land		(35,000)
Cash flows from financing activities:		
Cash received from issuing common stock	$ 21,000	
Cash dividends	(5,000)	
Net cash flows from financing activities		16,000
Net increase in cash		$ 42,800
Cash balance, November 1, 2018		39,000
Cash balance, November 30, 2018		$ 81,800

* $38,000 + $77,000; these amounts are taken from the cash column of the spreadsheet in Part 2.

** $4,000 + $20,000 + $29,200; these amounts are taken from the cash column of the spreadsheet in Part 2.

Prob. 1–6B

A. Wages expense, $203,200 ($288,000 – $48,000 – $17,600 – $14,400 – $4,800)

B. Net income, $112,000 ($400,000 – $288,000)

C. Retained Earnings, May 1, 2018, $0; Atlas Realty was organized on May 1, 2018.

D. Net income for May, $112,000; from (B)

E. Dividends, $64,000; from statement of cash flows.

F. Increase in retained earnings, $48,000 ($112,000 – $64,000)

G. Retained earnings, May 31, 2018, $48,000 (same as F)

H. Land, $120,000; from statement of cash flows.

I. Total assets, $256,000 ($123,200 + $12,800 + $120,000)

J. Common stock, $160,000; from statement of cash flows.

K. Retained earnings, $48,000; from retained earnings statement.

L. Total stockholders' equity, $208,000 ($160,000 + $48,000)

M. Total liabilities and stockholders' equity, $256,000 ($48,000 + $208,000)

N. Cash received from customers, $400,000; this is the same as fees earned since there are no accounts receivable.

O. Net cash flows from operating activities, $147,200 ($400,000 – $252,800)

P. Net cash flows from financing activities, $96,000 ($160,000 – $64,000)

Q. Net cash flows and May 31, 2018, cash balance, $123,200 ($147,200 – $120,000 + $96,000); also, the cash balance on the balance sheet.

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CONTINUING PROBLEM

1.

	Assets			= Liabilities +	Stockholders' Equity		
	Cash	+ Accts. Rec.	+ Supplies	= Accts. Payable	+ Common Stock	– Dividends	+ Fees Earned
June 1	+ 4,000				+ 4,000		
June 2	+ 3,500						+ 3,500
Bal.	7,500				4,000		3,500
June 2	– 800						
Bal.	6,700				4,000		3,500
June 4			+ 350	+ 350			
Bal.	6,700		350	350	4,000		3,500
June 6	– 500						
Bal.	6,200		350	350	4,000		3,500
June 8	– 675						
Bal.	5,525		350	350	4,000		3,500
June 12	– 350						
Bal.	5,175		350	350	4,000		3,500
June 13	– 100			– 100			
Bal.	5,075		350	250	4,000		3,500
June 16	+ 300						+ 300
Bal.	5,375		350	250	4,000		3,800
June 22		+ 1,000					+ 1,000
Bal.	5,375	1,000	350	250	4,000		4,800
June 25	+ 500						+ 500
Bal.	5,875	1,000	350	250	4,000		5,300
June 29	– 240						
Bal.	5,635	1,000	350	250	4,000		5,300
June 30	+ 900						+ 900
Bal.	6,535	1,000	350	250	4,000		6,200
June 30	– 400						
Bal.	6,135	1,000	350	250	4,000		6,200
June 30	– 300						
Bal.	5,835	1,000	350	250	4,000		6,200
June 30			– 180				
Bal.	5,835	1,000	170	250	4,000		6,200
June 30	– 415						
Bal.	5,420	1,000	170	250	4,000		6,200
June 30	– 1,000						
Bal.	4,420	1,000	170	250	4,000		6,200
June 30	– 500					– 500	
Bal.	3,920	1,000	170	250	4,000	– 500	6,200

Continuing Problem (Continued)

		Stockholders' Equity (Continued)							
		Music Exp.	Office Rent Exp.	Equip. Rent Exp.	Adver-tising Exp.	Wages Exp.	Utilities Exp.	Supplies Exp.	Misc. Exp.
June	1								
June	2								
Bal.									
June	2		– 800						
Bal.			– 800						
June	4								
Bal.			– 800						
June	6				– 500				
Bal.			– 800		– 500				
June	8			– 675					
Bal.			– 800	– 675	– 500				
June	12	– 350							
Bal.		– 350	– 800	– 675	– 500				
June	13								
Bal.		– 350	– 800	– 675	– 500				
June	16								
Bal.		– 350	– 800	– 675	– 500				
June	22								
Bal.		– 350	– 800	– 675	– 500				
June	25								
Bal.		– 350	– 800	– 675	– 500				
June	29	– 240							
Bal.		– 590	– 800	– 675	– 500				
June	30								
Bal.		– 590	– 800	– 675	– 500				
June	30					– 400			
Bal.		– 590	– 800	– 675	– 500	– 400			
June	30						– 300		
Bal.		– 590	– 800	– 675	– 500	– 400	– 300		
June	30							– 180	
Bal.		– 590	– 800	– 675	– 500	– 400	– 300	– 180	
June	30								– 415
Bal.		– 590	– 800	– 675	– 500	– 400	– 300	– 180	– 415
June	30	– 1,000							
Bal.		– 1,590	– 800	– 675	– 500	– 400	– 300	– 180	– 415
June	30								
Bal.		– 1,590	– 800	– 675	– 500	– 400	– 300	– 180	– 415

Continuing Problem (Concluded)

2.

PS Music Income Statement For the Month Ended June 30, 2018		
Fees earned:		$6,200
Expenses:		
Music expense	$1,590	
Office rent expense	800	
Equipment rent expense	675	
Advertising expense	500	
Wages expense	400	
Utilities expense	300	
Supplies expense	180	
Miscellaneous expense	415	
Total expenses		4,860
Net income		$1,340

3.

PS Music Retained Earnings Statement For the Month Ended June 30, 2018		
Retained earnings, June 1, 2018		$ 0
Net income	$1,340	
Dividends	(500)	
Change in retained earnings		840
Retained earnings, June 30, 2018		$840

4.

PS Music Balance Sheet June 30, 2018		
Assets		
Cash		$3,920
Accounts receivable		1,000
Supplies		170
Total assets		$5,090
Liabilities		
Accounts payable		$ 250
Stockholders' Equity		
Common stock	$4,000	
Retained earnings	840	
Total stockholders' equity		4,840
Total liabilities and stockholders' equity		$5,090

ANALYSIS FOR DECISION MAKING

ADM–1

A. Ratio of Liabilities to Stockholders' Equity $= \dfrac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$

Amazon: $\dfrac{\$43{,}764}{\$10{,}741} = 4.07$

Best Buy: $\dfrac{\$10{,}024}{\$3{,}989} = 2.51$

B. Amazon's ratio exceeds 4.0, which means the total liabilities are four times as great as the stockholders' equity. For Best Buy, the ratio is only 2.51, which means total liabilities are 2.5 times as great as the stockholders' equity. Thus, the margin of protection is less for Amazon's creditors than it is for Best Buy's creditors.

ADM–2

A. Assets = Liabilities + Stockholders' Equity
Liabilities = Assets – Stockholders' Equity

Liabilities, Year 1: $40,518 – $17,898 = $22,620
Liabilities, Year 2: $41,804 – $17,777 = $24,027
Liabilities, Year 3: $40,518 – $12,522 = $27,996

Note: **The equality of total assets in Year 1 and Year 3 is an unusual coincidence.**

B. Ratio of Liabilities to Stockholders' Equity $= \dfrac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$

Ratio of Liabilities to Stockholders' Equity, Year 1: $\dfrac{\$22{,}620}{\$17{,}898} = 1.26$

Ratio of Liabilities to Stockholders' Equity, Year 2: $\dfrac{\$24{,}027}{\$17{,}777} = 1.35$

Ratio of Liabilities to Stockholders' Equity, Year 3: $\dfrac{\$27{,}996}{\$12{,}522} = 2.24$

C. The ratio of liabilities to stockholders' equity for Home Depot increased from 1.26 in Year 1 to 2.24 in Year 3, causing the margin of protection to creditors to decrease. This is a significant increase in this ratio for a three-year time period. The majority of the increase occurred between Year 2 and Year 3.

Note to Instructor: **This increase is due to the company using debt to finance the repurchase of its common stock. This intentional transaction caused liabilities to increase and stockholders' equity to decrease in Year 3.**

ADM–3

A. Assets = Liabilities + Stockholders' Equity
Stockholders' Equity = Assets – Liabilities

Stockholders' Equity, Year 1: $33,559 – $17,026 = $16,533
Stockholders' Equity, Year 2: $32,666 – $18,809 = $13,857
Stockholders' Equity, Year 3: $32,732 – $20,879 = $11,853

B. Ratio of Liabilities to Stockholders' Equity $= \dfrac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$

Ratio of Liabilities to Stockholders' Equity, Year 1: $\dfrac{\$17{,}026}{\$16{,}533} = 1.03$

Ratio of Liabilities to Stockholders' Equity, Year 2: $\dfrac{\$18{,}809}{\$13{,}857} = 1.36$

Ratio of Liabilities to Stockholders' Equity, Year 3: $\dfrac{\$20{,}879}{\$11{,}853} = 1.76$

C. The ratio of liabilities to stockholders' equity for Lowe's increased from 1.03 in Year 1 to 1.76 in Year 3, causing the margin of protection to creditors to decrease. This is a noticeable increase in this ratio for a three-year time period.

Note to Instructor: **This increase occurred because the company used debt to finance the repurchase of its common stock. This intentional transaction caused liabilities to increase and stockholders' equity to decrease over the three-year period.**

D. Lowe's ratio of liabilities to stockholders' equity is less than that of Home Depot for two out of the three years, including the most recent year. Thus, the risk to Lowe's creditors is slightly less than the risk to Home Depot's creditors. The trend for both companies shows that the size of this ratio is increasing over time.

ADM–4

A. **Ratio of Liabilities to Stockholders' Equity** $= \dfrac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$

Ratio of Liabilities to Stockholders' Equity, Papa John's: $\dfrac{\$405}{\$99} = 4.1$

Ratio of Liabilities to Stockholders' Equity, Yum! Brands: $\dfrac{\$6,732}{\$1,604} = 4.2$

B. **The ratio of liabilities to stockholders' equity is greater than 4.0 for both companies. This means the total liabilities are more than four times as great as the stockholders' equity. These are both very high ratios and suggest that creditors have risk with their investments in these two companies. The small level of stockholders' equity provides only a narrow margin of protection to creditors.**

C. **The ratio of liabilities to stockholders' equity is slightly higher for Yum! Brands at 4.2, compared to a 4.1 ratio for Papa John's. Both are risky, but this 0.1 difference does not represent a material difference in risk.**

TAKE IT FURTHER

TIF 1–1

1. **The car repair is a personal expense and is Marco's personal responsibility. By using partnership funds to pay for the repair, Marco is behaving unethically because he is violating the business entity assumption. The business entity assumption treats the business as a separate entity from its owners. By taking money from the partnership for a personal expense, Marco is effectively stealing from his partners.**
2. **The partnership's net income will be reduced by the $2,000 Marco has taken. This will reduce the amount of net income available to Marco's partners.**
3. **Marco could ask his partners for a loan from the partnership. The loan could be repaid out of his salary or from his share of the partnership income.**

TIF 1–2

A sample solution based on Nike Inc.'s Form 10-K for the fiscal year ended May 31, 2015, follows:

1. **Nike, Inc.**
2. **Beaverton, Oregon**
3. **Mark G. Parker**
4. **Manufacturing**
5. **Our principal business activity is the design, development, and worldwide marketing and selling of athletic footwear, apparel, equipment, accessories, and services.**
6. **Income statement, statement of comprehensive income, balance sheet, statement of stockholders' equity, statement of cash flows**

TIF 1–3

Example Memo

To: My Teacher
From: Ima Student
Date: January 1, 20XX
Re: Causes of Accounting Fraud

Business and accounting fraud typically result from either a failure of individual character or a culture of greed within an organization. Managers and accountants often face pressure to meet or exceed a company's financial goals. At times, supervisors can place pressure on individuals to violate accounting standards to improve a company's reported financial results. Individuals who give in to these pressures exhibit a failure of individual character. In other situations, the organization may expect employees to violate accounting rules as part of their job. This occurs in organizations that do not value ethical decision making or fair financial reporting and exhibit a culture of ethical indifference.