

# Chapter 1

## Accounting and the Business Environment

### *Review Questions*

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**1. What is accounting?**

Accounting is the information system that measures business activities, processes the information into reports, and communicates the results to decision makers. Accounting is the language of business.

**2. Briefly describe the two major fields of accounting.**

Financial accounting provides information for external decision makers, such as outside investors, lenders, customers, and the federal government. Managerial accounting focuses on information for internal decision makers, such as the company's managers and employees.

**3. Describe the various types of individuals who use accounting information and how they use that information to make important decisions.**

Individuals use accounting information to help them manage their money, evaluate a new job, and better decide whether they can afford to make a new purchase. Business owners use accounting information to set goals, measure progress toward those goals, and make adjustments when needed. Investors use accounting information to help them decide whether or not a company is a good investment and once they have invested, they use a company's financial statements to analyze how their investment is performing. Creditors use accounting information to decide whether to lend money to a business and to evaluate a company's ability to make the loan payments. Taxing authorities use accounting information to calculate the amount of income tax that a company has to pay.

**4. What are two certifications available for accountants? Briefly explain each certification.**

Certified Public Accountants (CPAs) are licensed professional accountants who serve the general public. They work for public accounting firms, businesses, government, or educational institutions. To be certified they must meet educational and/or experience requirements and pass an exam. Certified Management Accountants (CMAs) specialize in accounting and financial management knowledge. They work for a single company.

**5. What is the role of the Financial Accounting Standards Board (FASB)?**

The FASB oversees the creation and governance of accounting standards. They work with governmental regulatory agencies, congressionally created groups, and private groups.

- 6.** Explain the purpose of Generally Accepted Accounting Principles (GAAP), including the organization currently responsible for the creation and governance of these standards.

The guidelines for accounting information are called GAAP. It is the main U.S. accounting rule book and is currently created and governed by the FASB. Investors and lenders must have information that is relevant and has faithful representation in order to make decisions and GAAP provides the framework for this financial reporting.

- 7.** Describe the similarities and differences among the four different types of business entities discussed in the chapter.

A sole proprietorship has a single owner, terminates upon the owner's death or choice, the owner has personal liability for the business's debts, and it is not a separate tax entity. A partnership has two or more owners, terminates at partner's choice or death, the partners have personal liability, and it is not a separate tax entity. A corporation is a separate legal entity, has one or more owners, has indefinite life, the stockholders are not personally liable for the business's debts, and it is a separate tax entity. A limited-liability company has one or more members and each is only liable for his or her own actions, has an indefinite life, and is not a separate tax entity.

- 8.** A business purchases an acre of land for \$5,000. The current market value is \$5,550, and the land was assessed for property tax purposes at \$5,250. What value should the land be recorded at, and which accounting principle supports your answer?

The land should be recorded at \$5,000. The cost principle states that assets should be recorded at their historical cost.

- 9.** What does the going concern assumption mean for a business?

The going concern assumption assumes that the entity will remain in business for the foreseeable future and long enough to use existing resources for their intended purpose.

- 10.** Which concept states that accounting information should be complete, neutral, and free from material error?

The faithful representation concept states that accounting information should be complete, neutral, and free from material error.

- 11.** Financial statements in the United States are reported in U.S. dollars. What assumption supports this statement?

The monetary unit assumption states that items on the financial statements should be measured in terms of a monetary unit.

- 12.** Explain the role of the International Accounting Standards Board (IASB) in relation to International Financial Reporting Standards (IFRS).

The IASB is the organization that develops and creates IFRS which are a set of global accounting standards that would be used around the world.

**13.** What is the accounting equation? Briefly explain each of the three parts.

Assets = Liabilities + Equity. Assets are economic resources that are expected to benefit the business in the future. They are things of value that a business owns or has control of. Liabilities are debts that are owed to creditors. They are one source of claims against assets. Equity is the other source of claims against assets. Equity is the stockholders' claims against assets and is the amount of assets that is left over after the company has paid its liabilities. It represents the net worth of the corporation.

**14.** How does retained earnings increase? What are the two ways that retained earnings decreases?

Retained earnings increases with revenues. Retained earnings decreases with expenses and dividends.

**15.** How is net income calculated? Define *revenues* and *expenses*.

Revenues – Expenses = Net Income. Revenues are earnings resulting from delivering goods or services to customers. Expenses are the cost of selling goods or service.

**16.** What are the steps used when analyzing a business transaction?

Step 1: Identify the accounts and the account type. Step 2: Decide if each account increases or decreases. Step 3: Determine if the accounting equation is in balance.

**17.** List the four financial statements. Briefly describe each statement.

Income Statement – Shows the difference between an entity's revenues and expenses and reports the net income or net loss for a specific period.

Statement of Retained Earnings – Shows the changes in retained earnings for a specific period including net income (loss) and dividends.

Balance Sheet – Shows the assets, liabilities, and stockholders' equity of the business as of a specific date.

Statement of Cash Flows – Shows a business's cash receipts and cash payments for a specific period.

**18.** What is the calculation for return on assets (ROA)? Explain what ROA measures.

Return on Assets = Net income / Average total assets. ROA measures how profitably a company uses its assets.

## ***Short Exercises***

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### **S1-1 Identifying users of accounting information**

#### Learning Objective 1

For each user of accounting information, identify if the user would use financial accounting (FA) or managerial accounting (MA).

- |                             |                             |
|-----------------------------|-----------------------------|
| a. investor                 | e. controller               |
| b. banker                   | f. stockholder              |
| c. Internal Revenue Service | g. human resources director |
| d. manager of the business  | h. creditor                 |

#### **SOLUTION**

- |       |       |
|-------|-------|
| a. FA | e. MA |
| b. FA | f. FA |
| c. FA | g. MA |
| d. MA | h. FA |

### **S1-2 Determining organizations that govern accounting**

#### Learning Objective 2

Suppose you are starting a business, Wholly Shirts, to imprint logos on T-shirts. In organizing the business and setting up its accounting records, you take your information to a CPA to prepare financial statements for the bank. Name the organization that governs the majority of the guidelines that the CPA will use to prepare financial statements for Wholly Shirts. What are those guidelines called?

#### **SOLUTION**

The Financial Accounting Standards Board governs the majority of guidelines, called Generally Accepted Accounting Principles (GAAP), that the CPA will use to prepare financial statements for Wholly Shirts.

### **S1-3 Identifying types of business organizations**

#### Learning Objective 2

Chloe Michaels plans on opening Chloe Michaels Floral Designs. She is considering the various types of business organizations and wishes to organize her business with unlimited life and wants owners of the business to not be held personally liable for the business's debts. Additionally, Chloe wants the business to be a separate taxable entity. Which type of business organization will meet Chloe's needs best?

## **SOLUTION**

Chloe's needs will best be met by organizing a corporation since a corporation has an unlimited life and is a separate tax entity. In addition, the owners (stockholders) have limited liability. Chloe could also consider a limited liability company (LLC) as an option. A LLC meets two of the three criteria. It has an unlimited life and limited liability for the owner. However, a LLC is not a separate tax entity.

### **S1-4 Identifying types of business organizations**

#### **Learning Objective 2**

You would like to start a cellular telephone equipment service business. You are considering organizing the business as a sole proprietorship. Identify the advantages and disadvantages of owning a sole proprietorship.

## **SOLUTION**

Advantages:

1. Easy to organize.
2. Unification of ownership and management.
3. Less government regulation.
4. Owner has more control over business.

Disadvantages:

1. The owner pays taxes since it is not a separate tax entity.
2. No continuous life or transferability of ownership.
3. Unlimited liability of owner for business's debts.

### **S1-5 Applying accounting assumptions and principles**

#### **Learning Objective 2**

Michael McNamee is the proprietor of a property management company, Apartment Exchange, near the campus of Pensacola State College. The business has cash of \$8,000 and furniture that cost \$9,000 and has a market value of \$13,000. The business debts include accounts payable of \$6,000. Michael's personal home is valued at \$400,000, and his personal bank account has a balance of \$1,200. Consider the accounting principles and assumptions discussed in the chapter, and identify the principle or assumption that best matches the situation:

- a. Michael's personal assets are not recorded on the Apartment Exchange's balance sheet.
- b. The Apartment Exchange records furniture at its cost of \$9,000, not its market value of \$13,000.
- c. The Apartment Exchange reports its financial statements in U.S. dollars.
- d. Michael expects the Apartment Exchange to remain in operation for the foreseeable future.

## **SOLUTION**

- a. The economic entity assumption
- b. The cost principle.
- c. The monetary unit assumption.
- d. The going concern assumption.

## S1-6 Using the accounting equation

### Learning Objective 3

Kenmore Handyman Services has total assets for the year of \$16,400 and total liabilities of \$8,680.

#### Requirements

1. Use the accounting equation to solve for equity.
2. If next year assets increased by \$3,500 and equity decreased by \$2,580, what would be the amount of total liabilities for Kenmore Handyman Services?

#### SOLUTION

##### Requirement 1

Kenmore Handyman Services has equity of \$7,720.

Assets	=	Liabilities	+	Equity
\$16,400	=	\$8,680	+	?
\$16,400	=	\$8,680	+	<b>\$7,720</b>

##### Requirement 2

Kenmore Handyman Services has liabilities of \$14,760.

Assets	=	Liabilities	+	Equity
\$16,400 + \$3,500	=	?	+	\$7,720 – \$2,580
\$19,900	=	<b>\$14,760</b>	+	\$5,140

## S1-7 Using the accounting equation

### Learning Objective 3

Josh's Overhead Doors reports the following financial information:

Assets	\$ 42,600
Liabilities	17,220
Common Stock	26,240
Dividends	8,500
Revenues	12,080
Expenses	?

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#### Requirements

1. Use the accounting equation to solve for the missing information.
2. Did Josh's Overhead Doors report net income or net loss?

## SOLUTION

### Requirement 1

Assets	=	Liabilities	+	Equity						
				Contributed Capital	+	Retained Earnings				
				Common Stock	−	Dividends	+	Revenues	−	Expenses
\$42,600	=	\$17,220	+	\$26,240	−	\$8,500	+	\$12,080	−	?
\$42,600	=	\$17,220	+	\$26,240	−	\$8,500	+	\$12,080	−	\$4,440

### Requirement 2

Josh's Overhead Doors reported net income of \$7,640. Net Income = Revenues (\$12,080) – Expenses (\$4,440)

### S1-8 Identifying accounts

Learning Objective 3

Consider the following accounts:

- |                        |                     |
|------------------------|---------------------|
| a. Accounts Payable    | f. Service Revenue  |
| b. Cash                | g. Office Supplies  |
| c. Common Stock        | h. Dividends        |
| d. Accounts Receivable | i. Land             |
| e. Rent Expense        | j. Salaries Expense |

Identify each account as Asset (A), Liability (L), or Equity (E).

## SOLUTION

- |      |      |
|------|------|
| a. L | f. E |
| b. A | g. A |
| c. E | h. E |
| d. A | i. A |
| e. E | j. E |

### **S1-9 Using the accounting equation to analyze transactions**

#### **Learning Objective 4**

Tiny Town Kennel earns service revenue by caring for the pets of customers. Tiny Town Kennel is organized as a corporation. During the past month, Tiny Town Kennel has the following transactions:

- a.** Received \$520 cash for service revenue earned.
- b.** Paid \$325 cash for salaries expense.
- c.** Investors contributed \$1,000 to the corporation in exchange for common stock.
- d.** Earned \$640 for service revenue, but the customer has not paid Tiny Town Kennel yet.
- e.** Received utility bill of \$85, which will be paid next month.
- f.** Cash dividends of \$100 were paid to stockholders.

Indicate the effects of the business transactions on the accounting equation for Tiny Town Kennel. Transaction (a) is answered as a guide.

- a. Increase asset (Cash); Increase equity (Service Revenue)*

#### **SOLUTION**

- a. Increase asset (Cash); Increase equity (Service Revenue)
- b. Decrease asset (Cash); Decrease equity (Salaries Expense)
- c. Increase asset (Cash); Increase Equity (Common Stock)
- d. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
- e. Increase liability (Accounts Payable); Decrease equity (Utility Expense)
- f. Decrease asset (Cash); Decrease equity (Dividends)

### **S1-10 Using the accounting equation to analyze transactions**

#### **Learning Objective 4**

Elaine's Inflatables earns service revenue by providing party planning services and inflatable playscapes. Elaine's Inflatables is organized as a corporation. During the past month, Elaine's Inflatables had the following transactions:

- a.** Investors contributed \$10,000 to the corporation in exchange for common stock.
- b.** Purchased equipment for \$5,000 on account.
- c.** Paid \$400 for office supplies.
- d.** Earned and received \$2,500 cash for service revenue.
- e.** Paid \$400 for wages to employees.
- f.** Cash dividends of \$1,000 were paid to stockholders.
- g.** Earned \$1,000 for services provided. Customer has not yet paid.
- h.** Paid \$1,000 for rent.
- i.** Received a bill for \$250 for the monthly utilities. The bill has not yet been paid.

Indicate the effects of the business transactions on the accounting equation for Elaine's Inflatables. Transaction (a) is answered as a guide.

- a. Increase asset (Cash); Increase equity (Common Stock)*



## SOLUTION

- a. Increase asset (Cash); Increase equity (Common Stock)
- b. Increase asset (Equipment); Increase liability (Accounts Payable)
- c. Increase asset (Office Supplies); Decrease asset (Cash)
- d. Increase asset (Cash); Increase equity (Service Revenue)
- e. Decrease asset (Cash); Decrease equity (Wages Expense)
- f. Decrease asset (Cash); Decrease equity (Dividends)
- g. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
- h. Decrease asset (Cash); Decrease equity (Rent Expense)
- i. Increase liability (Accounts Payable); Decrease equity (Utilities Expense)

### **S1-11 Identifying accounts on the financial statements**

#### Learning Objective 5

Consider the following accounts:

- |                        |                     |
|------------------------|---------------------|
| a. Accounts Payable    | f. Service Revenue  |
| b. Cash                | g. Office Supplies  |
| c. Common Stock        | h. Dividends        |
| d. Accounts Receivable | i. Land             |
| e. Rent Expense        | j. Salaries Expense |

Identify the financial statement (or statements) that each account would appear on. Use I for Income Statement, RE for Statement of Retained Earnings, and B for Balance Sheet.

## SOLUTION

- |      |       |
|------|-------|
| a. B | f. I  |
| b. B | g. B  |
| c. B | h. RE |
| d. B | i. B  |
| e. I | j. I  |

***Use the following information to answer Short Exercises S1-12 through S1-14.***

Decorating Arrangements has just completed operations for the year ended December 31, 2016. This is the third year of operations for the company. The following data have been assembled for the business:

Insurance Expense	\$ 2,000	Salaries Expense	\$ 37,000
Service Revenue	80,000	Accounts Payable	4,300
Utilities Expense	500	Office Supplies	1,500
Rent Expense	11,000	Dividends	4,500
Common Stock	8,500	Accounts Receivable	7,500
Cash	7,000	Equipment	26,600
Retained Earnings, Jan. 1, 2016	4,800		

### **S1-12 Preparing the income statement**

Learning Objective 5

Prepare the income statement of Decorating Arrangements for the year ended December 31, 2016.

#### **SOLUTION**

DECORATING ARRANGEMENTS		
Income Statement		
Year Ended December 31, 2016		
Revenue:		
Service Revenue		\$ 80,000
Expenses:		
Salaries Expense	\$ 37,000	
Rent Expense	11,000	
Insurance Expense	2,000	
Utilities Expense	500	
Total Expenses		<u>50,500</u>
Net Income		<u>\$ 29,500</u>

### **S1-13 Preparing the statement of retained earnings**

Learning Objective 5

Prepare the statement of retained earnings of Decorating Arrangements for the year ended December 31, 2016.

## SOLUTION

DECORATING ARRANGEMENTS	
Statement of Retained Earnings	
Year Ended December 31, 2016	
Retained Earnings, January 1, 2016	\$ 4,800
Net income for the year	29,500
	34,300
Dividends	(4,500)
Retained Earnings, December 31, 2016	\$ 29,800

### S1-14 Preparing the balance sheet

#### Learning Objective 5

Prepare the balance sheet of Decorating Arrangements as of December 31, 2016.

## SOLUTION

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### DECORATING ARRANGEMENTS

#### Balance Sheet December 31, 2016

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Assets		Liabilities	
Cash	\$ 7,000	Accounts Payable	\$ 4,300
Accounts Receivable	7,500		
Office Supplies	1,500	Stockholders' Equity	
Equipment	26,600	Common Stock	8,500
		Retained Earnings	29,800
		Total Stockholders' Equity	<u>38,300</u>
Total Assets	<u>\$ 42,600</u>	Total Liabilities and Stockholders' Equity	<u>\$ 42,600</u>

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### S1-15 Preparing the statement of cash flows

#### Learning Objective 5

Pushing Daisies Homes had the following cash transactions for the month ended July 31, 2016.

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<b>Cash receipts:</b>	
Collections from customers	\$ 24,000
Issued common stock	12,000
<b>Cash payments:</b>	
Rent	3,000
Utilities	900
Salaries	1,600
Purchase of equipment	18,000
Payment of cash dividends	3,500
Cash balance, July 1, 2016	11,000
Cash balance, July 31, 2016	20,000

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Prepare the statement of cash flows for Pushing Daisies Homes for the month ended July 31, 2016.

## SOLUTION

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PUSHING DAISIES HOMES  
Statement of Cash Flows  
Month Ended July 31, 2016

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Cash flows from operating activities:

Receipts:

Collections from customers \$ 24,000

Payments:

For rent \$ (3,000)

For salaries (1,600)

For utilities (900) (5,500)

Net cash provided by operating activities 18,500

Cash flows from investing activities:

Purchase of equipment (18,000)

Net cash used by investing activities (18,000)

Cash flows from financing activities:

Issued common stock 12,000

Payment of cash dividend (3,500)

Net cash provided by financing activities 8,500

Net increase in cash 9,000

Cash balance, July 1, 2016 11,000

Cash balance, July 31, 2016 \$ 20,000

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## S1-16 Calculating Return on Assets (ROA)

Learning Objective 6

Refined Water Services had net income for the month of October of \$74,000. Assets as of the beginning and end of the month totaled \$350,000, and \$390,000, respectively. Calculate Refined Water Services' return on assets (ROA) for the month of October.

## SOLUTION

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Return on assets	=	Net income / Average total assets
	=	\$74,000 / ((\$350,000 + \$390,000) / 2)
	=	\$74,000 / \$370,000
	=	20%

## Exercises

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### E1-17 Identifying users of accounting information

#### Learning Objective 1

For each of the users of accounting information, identify whether the user is an external decision maker (E) or an internal decision maker (I):

- |                             |                    |
|-----------------------------|--------------------|
| a. customer                 | e. investor        |
| b. company manager          | f. controller      |
| c. Internal Revenue Service | g. cost accountant |
| d. lender                   | h. SEC             |

#### SOLUTION

- |      |      |
|------|------|
| a. E | e. E |
| b. I | f. I |
| c. E | g. I |
| d. E | h. E |

### E1-18 Using accounting vocabulary

#### Learning Objective 2

Consider the following accounting terms and definitions, and match each term to the definition:

- |                            |   |
|----------------------------|---|
| 1. Sole proprietorship     | a. Set of global accounting guidelines, formulated by the IASB  |
| 2. Faithful representation | b. Holds that fair market value should not be used over actual costs                                    |
| 3. Partnership             | c. Stands for Financial Accounting Standards Board  |
| 4. IFRS                    | d. Owner is referred to as a proprietor   |
| 5. Corporation             | e. Asserts that accounting information should be complete, neutral, and free from material error        |
| 6. Audit                   | f. An examination of a company's financial statements and records                                       |
| 7. Cost principle          | g. Has two or more owners (called partners)   |
| 8. FASB                    | h. U.S. governmental agency that oversees the U.S. financial markets                                    |
| 9. Creditors               | i. Type of entity that is designed to limit personal liability exposure of owners to the entity's debts |
| 10. SEC                    | j. Person or business lending money   |

## SOLUTION

- |      |       |
|------|-------|
| 1. d | 6. f  |
| 2. e | 7. b  |
| 3. g | 8. c  |
| 4. a | 9. j  |
| 5. i | 10. h |

### E1-19 Using accounting vocabulary

Learning Objectives 3, 5

Consider the following accounting terms and definitions, and match each term to the definition:

1. Accounting equation	a. An economic resource that is expected to be of benefit in the future
2. Asset	b. Debts that are owed to creditors
3. Balance sheet	c. Excess of total expenses over total revenues
4. Expense	d. Excess of total revenues over total expenses
5. Income statement	e. The basic tool of accounting, stated as $\text{Assets} = \text{Liabilities} + \text{Equity}$
6. Liability	f. Decreases in equity that occur in the course of selling goods or services
7. Net income	g. Increases in equity that occur in the course of selling goods or services
8. Net loss	h. Reports on a business's cash receipts and cash payments during a period
9. Revenue	i. Reports on an entity's assets, liabilities, and stockholders' equity as of a specific date
10. Statement of cash flows	j. Reports on an entity's revenues, expenses, and net income or loss for the period
11. Statement of retained earnings	k. Reports how the company's retained earnings balance changed from the beginning to the end of the period

## SOLUTION

- |      |       |
|------|-------|
| 1. e | 7. d  |
| 2. a | 8. c  |
| 3. i | 9. g  |
| 4. f | 10. h |
| 5. j | 11. k |
| 6. b |       |

## E1-20 Using the accounting equation

### Learning Objective 3

Compute the missing amount in the accounting equation for each entity from the financial information presented:

	Assets	Liabilities	Equity
Newton Gas	\$ ?	\$ 64,000	\$ 80,000
Vegas Video Rentals	65,000	?	25,000
Cline's Grocery	200,000	43,000	?

### SOLUTION

	Assets	Liabilities	Equity
Newton Gas	<b>\$ 144,000</b>	\$ 64,000	\$ 80,000
Vegas Video Rentals	65,000	<b>40,000</b>	25,000
Cline's Grocery	200,000	43,000	<b>157,000</b>

## E1-21 Using the accounting equation

### Learning Objective 3

Green City Builders' balance sheet data at May 31, 2016, and June 30, 2016, follow:

	May 31, 2016	June 30, 2016
Total assets	\$ 188,000	\$ 244,000
Total liabilities	122,000	88,000

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For each of the following situations with regard to common stock and dividends of a corporation, compute the amount of net income or net loss during June 2016.

- The company issued \$7,500 of common stock and paid no dividends.
- The company issued no common stock. It paid cash dividends of \$13,000.
- The company issued \$20,000 of common stock and paid cash dividends of \$18,000.



## SOLUTION

	a.	b.	c.
Stockholders' equity, May 31, 2016 (\$188,000 – \$122,000)	\$ 66,000	\$ 66,000	\$ 66,000
Issuance of common stock	7,500	0	20,000
Net income for the month	<b>82,500</b>	<b>103,000</b>	<b>88,000</b>
	156,000	169,000	174,000
Dividends	0	(13,000)	(18,000)
Stockholders' equity, June 30, 2016 (\$244,000 – \$88,000)	\$ 156,000	\$ 156,000	\$ 156,000

### E1-22 Using the accounting equation

#### Learning Objective 3

Star Nursery started 2016 with total assets of \$24,000 and total liabilities of \$5,000. At the end of 2016, Star Nursery's total assets stood at \$18,000 and total liabilities were \$1,000.

#### Requirements

1. Did the stockholders' equity of Star Nursery increase or decrease during 2016? By how much?
2. Identify the four possible reasons that stockholders' equity can change.

## SOLUTION

### Requirement 1

	Assets	=	Liabilities	+	Equity
Beginning of 2016	\$24,000	=	\$5,000	+	?
	\$24,000	=	\$5,000	+	<b>\$19,000</b>
End of 2016	\$18,000	=	\$1,000	+	?
	\$18,000	=	\$1,000	+	<b>\$17,000</b>

Stockholders' equity decreased in 2016 by \$2,000 (\$17,000 – \$19,000).

### Requirement 2

- a. Increase through issuance of common stock.
- b. Increase through net income.
- c. Decrease through dividend payment.
- d. Decrease through net loss.

## E1-23 Using the accounting equation

### Learning Objective 3

During 2016, Peaceful River Spa reported revenue of \$40,000. Total expenses for the year were \$35,000. Peaceful River Spa ended the year with total assets of \$23,000, and it owed debts totaling \$9,000. At year-end 2015, the business reported total assets of \$18,000 and total liabilities of \$9,000.

### Requirements

1. Compute Peaceful River Spa's net income for 2016.
2. Did Peaceful River Spa's stockholders' equity increase or decrease during 2016? By how much?

### SOLUTION

#### Requirement 1

Revenues	–	Expenses	=	Net Income
\$40,000	–	\$35,000	=	<b>\$5,000</b>

#### Requirement 2

Peaceful River Spa's equity increased by \$5,000 (\$14,000 - \$9,000) or the amount of the net income.

	Assets	=	Liabilities	+	Equity
Beginning of 2016	\$18,000	=	\$9,000	+	?
	\$18,000	=	\$9,000	+	\$9,000
Ending of 2016	\$23,000	=	\$9,000	+	?
	\$23,000	=	\$9,000	+	\$14,000

## E1-24 Using the accounting equation

### Learning Objective 3

The records of Meehan Company show the following at December 31, 2016:

Beginning:		Equity:	
Assets	\$ 64,000	Common Stock	\$ 13,000
Liabilities	44,000	Dividends	4,000
Ending:		Revenues	257,000
Assets	\$ 54,000	Expenses	?
Liabilities	39,000	Retained Earnings, Jan. 1, 2016	7,000

### Requirements

1. Compute the missing amount for Meehan Company. You will need to determine Retained Earnings, December 31, 2016, and total stockholders' equity.
2. Did Meehan earn a net income or suffer a net loss for the year? Compute the amount.

### SOLUTION

#### Requirement 1

	Assets	–	Liabilities	=	Equity
Beginning of 2016	\$64,000	–	\$44,000	=	\$20,000
Ending of 2016	\$54,000	–	\$39,000	=	\$15,000

#### Retained Earnings:

Retained Earnings, Jan. 1, 2016	\$ 7,000
Plus: Revenues	257,000
Less: Expenses	(258,000)
Less: Dividends	(4,000)
Retained Earnings, Dec. 31, 2016	<u>\$ 2,000</u>

#### Stockholders' Equity:

Common Stock	\$ 13,000
Retained Earnings	2,000
Total Stockholders' Equity	<u>\$ 15,000</u>

#### Requirement 2

Meehan Company suffered (or reported) a net loss of (\$1,000).

Revenue	–	Expenses	=	Net Income (Loss)
\$257,000	–	\$258,000	=	(\$1,000)

## E1-25 Using the accounting equation to analyze transactions

## Learning Objective 4

As the manager of a Papa Sean's restaurant, you must deal with a variety of business transactions. Give an example of a transaction that has each of the following effects on the accounting equation:

- a. Increase one asset and decrease another asset.
- b. Decrease an asset and decrease equity.
- c. Decrease an asset and decrease a liability.
- d. Increase an asset and increase equity.
- e. Increase an asset and increase a liability.

### SOLUTION

Student responses will vary. Examples include:

- a. Cash purchase of office supplies.
- b. Cash dividends paid to stockholders.
- c. Paid cash on accounts payable.
- d. Received cash for services provided.
- e. Borrowed cash from the bank.

## E1-26 Using the accounting equation to analyze business transactions

### Learning Objective 4

Indicate the effects of the following business transactions on the accounting equation of Vivian's Online Video store. Transaction (a) is answered as a guide.

- a. Received cash of \$10,000 from issuance of common stock.  
*Answer: Increase asset (Cash); Increase equity (Common Stock)*
- b. Earned video rental revenue on account, \$2,800.
- c. Purchased office furniture on account, \$300.
- d. Received cash on account, \$400.
- e. Paid cash on account, \$100.
- f. Rented videos and received cash of \$200.
- g. Paid monthly office rent of \$1,000.
- h. Paid \$100 cash to purchase office supplies.

### SOLUTION

- a. Increase asset (Cash); Increase equity (Common Stock)
- b. Increase asset (Accounts Receivable); Increase equity (Rental Revenue)
- c. Increase asset (Office Furniture); Increase liability (Accounts Payable)
- d. Increase asset (Cash); Decrease asset (Accounts Receivable)
- e. Decrease asset (Cash); Decrease liability (Accounts Payable)
- f. Increase asset (Cash); Increase equity (Rental Revenue)
- g. Decrease asset (Cash); Decrease equity (Office Rent Expense)
- h. Decrease asset (Cash); Increase asset (Office Supplies).

## E1-27 Using the accounting equation to analyze business transactions

### Learning Objective 4

Indicate the effects of the following business transactions on the accounting equation for Sam's Snack Foods, a supplier of snack foods. Transaction (a) is answered as a guide.

- a. Sam's Snack Foods received cash from issuance of common stock to stockholders.

*Answer: Increase asset (Cash); Increase equity (Common Stock)*

- b. Cash purchase of land for a building site.
- c. Paid cash on accounts payable.
- d. Purchased equipment; signed a note payable.
- e. Performed service for a customer on account.
- f. Employees worked for the week but will be paid next Tuesday.
- g. Received cash from a customer on accounts receivable.
- h. Borrowed money from the bank.
- i. Cash dividends paid to stockholders.
- j. Incurred utilities expense on account.

### SOLUTION

- a. Increase asset (Cash); Increase equity (Common Stock)
- b. Increase asset (Land); Decrease asset (Cash)
- c. Decrease asset (Cash); Decrease liability (Accounts Payable)
- d. Increase asset (Equipment); Increase liability (Notes Payable)
- e. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
- f. Increase liability (Salaries Payable); Decrease equity (Salaries Expense)
- g. Increase asset (Cash); Decrease asset (Accounts Receivable)
- h. Increase asset (Cash); Increase liability (Notes Payable)
- i. Decrease asset (Cash); Decrease equity (Dividends)
- j. Increase liability (Accounts Payable); Decrease equity (Utility Expense)

## E1-28 Using the accounting equation to analyze business transactions

### Learning Objective 4

The analysis of the first eight transactions of Advanced Accounting Service follows. Describe each transaction.

ASSETS				=	LIABILITIES + EQUITY				
Cash	+	Accounts Receivable	Equipment		Accounts Payable	+	Contributed Capital	+	Retained Earnings
							Common Stock	–	Dividends + Service Revenue – Salaries Expense
1	+	31,000					+31,000		
2			+3,800						+3,800
Bal.	\$31,000	+	\$3,800				\$31,000		+ \$3,800
3			+13,400		+13,400				
Bal.	\$31,000	+	\$3,800		\$13,400	+	\$31,000		+ \$3,800
4	+190		–190						
Bal.	\$31,190	+	\$3,610		\$13,400	+	\$31,000		+ \$3,800
5	–410		+410						
Bal.	\$30,780	+	\$3,610		\$13,400	+	\$31,000		+ \$3,800
6	–8,000				–8,000				
Bal.	\$22,780	+	\$3,610		\$5,400	+	\$31,000		+ \$3,800
7	+790								+790
Bal.	\$23,570	+	\$3,610		\$5,400	+	\$31,000		+ \$4,590
8	–1,500								–1,500
Bal.	\$22,070	+	\$3,610		\$5,400	+	\$31,000		+ \$4,590 – \$1,500

## SOLUTION

### Transaction Descriptions:

1. Issuance of common stock to stockholders
2. Earned revenue on account
3. Purchased equipment on account
4. Collected cash on account
5. Cash purchase of equipment
6. Paid cash on account
7. Earned revenue and received cash
8. Paid cash for salaries expense

## E1-29 Using the accounting equation to analyze business transactions

### Learning Objective 4

Samantha Stamford opened a medical practice. During July, the first month of operation, the business, titled Samantha Stamford, M.D., experienced the following events:

July 6	Stamford contributed \$65,000 in the business by opening a bank account in the name of S. Stamford, M.D. The corporation issued common stock to Stamford.
9	Paid \$52,000 cash for land.
12	Purchased medical supplies for \$1,600 on account.
15	Officially opened for business.
20	Paid cash expenses: employees' salaries, \$1,500; office rent, \$1,300; utilities, \$350.
31	Earned service revenue for the month, \$8,000, receiving cash.
31	Paid \$800 on account.

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Analyze the effects of these events on the accounting equation of the medical practice of Samantha Stamford, M.D., using the following format:

ASSETS			}	=	{	LIABILITIES +		EQUITY						
Cash	Medical Supplies	Land				Accounts Payable	+ Common Stock	Contributed Capital + Retained Earnings						
								Dividends	+ Service Revenue	- Salaries Expense	- Rent Expense	- Utilities Expense		

## SOLUTION

Assets					=	Liabilities	+	Equity											
Date	Cash	+	Medical Supplies	+	Land	=	Accounts Payable	+	Contributed Capital		–	Dividends	+	Retained Earnings					
									Common Stock	+				Service Revenue	–	Salaries Expense	–	Rent Expense	–
July 6	+65,000								+65,000										
Bal.	\$65,000					=		+	\$65,000										
9	–52,000				+52,000	=													
Bal.	\$13,000			+	\$52,000	=		+	\$65,000										
12		+	+1,600			=	+1,600												
Bal.	\$13,000	+	\$1,600	+	\$52,000	=	\$1,600	+	\$65,000										
15																			
Bal.	\$13,000	+	\$1,600	+	\$52,000	=	\$1,600	+	\$65,000										
20	–3,150					=										–1,500		–1,300	–350
Bal.	\$ 9,850	+	\$1,600	+	\$52,000	=	\$1,600	+	\$65,000						–	\$1,500	–	\$1,300	–350
31	+8,000					=													
Bal.	\$17,850	+	\$1,600	+	\$52,000	=	\$1,600	+	\$65,000				+	+8,000	–	\$1,500	–	\$1,300	–350
31	–800					=	–800												
Bal.	\$17,050	+	\$1,600	+	\$52,000	=	\$ 800	+	\$65,000				+	\$8,000	–	\$1,500	–	\$1,300	–350



## **E1-30 Preparing the financial statements**

### **Learning Objective 5**

Estella Osage publishes an online travel magazine. In need of cash, the business applies for a loan with National Bank. The bank requires borrowers to submit financial statements. With little knowledge of accounting, Estella Osage, a stockholder, does not know how to proceed.

### **Requirements**

1. What are the four financial statements that the business will need to prepare?
2. Is there a specific order in which the financial statements must be prepared?
3. Explain how to prepare each statement.

### **SOLUTION**

#### **Requirement 1**

- a. Income statement
- b. Statement of retained earnings
- c. Balance sheet
- d. Statement of cash flows

#### **Requirement 2**

Yes, the financial statements should be prepared in the order listed above in Requirement 1.

#### **Requirement 3**

Income Statement:

- a. The header includes the name of the business, the title of the statement, and the time period. An income statement always represents a period of time, for example, a month or a year.
- b. The revenue accounts are always listed first and then subtotaled if necessary.
- c. Each expense account is listed separately from largest to smallest and then subtotaled if necessary.
- d. Net income is calculated as total revenues minus total expenses.

Statement of Retained Earnings:

- a. The header includes the name of the business, the title of the statement, and the time period. A statement of retained earnings always represents a period of time, for example, a month or a year.
- b. The beginning retained earnings is listed first and will always be the ending retained earnings from the previous time period.
- c. The net income is added to the beginning retained earnings.
- d. The dividends are subtracted from retained earnings. If there had been a net loss, this would also be subtracted.

Balance Sheet:

- a. The header includes the name of the business and the title of the statement but the date is different. The balance sheet shows the date as a specific date and not a period of time.
- b. Each asset account is listed separately and then totaled. Cash is always listed first.
- c. Liabilities are listed separately and then totaled. Liabilities that are to be paid first are listed first.
- d. The stockholders' equity section includes common stock and ending retained earnings from the statement of retained earnings.
- e. The balance sheet must always balance:  $\text{Assets} = \text{Liabilities} + \text{Equity}$ .

### Statement of Cash Flows:

- a. The header includes the name of the business, the title of the statement, and the time period. A statement of cash flows always represents a period of time, for example, a month or a year.
- b. Each dollar amount is calculated by evaluating the cash column on the transaction detail.
- c. Operating activities involve cash receipts for services provided and cash payments for expenses paid.
- d. Investing activities include the purchase and sale of land and equipment for cash.
- e. Financing activities include cash from the issuance of common stock and payment of cash dividends.
- f. The ending cash balance must match the cash balance on the balance sheet.

*Use the following information to answer Exercises E1-31 through E1-33.*

The account balances of Wilford Towing Service at June 30, 2016, follow:

Equipment	\$ 17,500	Service Revenue	\$ 13,000
Office Supplies	1,300	Accounts Receivable	8,200
Notes Payable	6,900	Accounts Payable	6,000
Rent Expense	800	Retained Earnings, June 1, 2016	3,700
Cash	1,900	Salaries Expense	1,900
Dividends	2,000	Common Stock	4,000

### **E1-31 Preparing the income statement**

Learning Objective 5

Net Income \$10,300

#### **Requirements**

1. Prepare the income statement for Wilford Towing Service for the month ending June 30, 2016.
2. What does the income statement report?

## SOLUTION

### Requirement 1

WILFORD TOWING SERVICE		
Income Statement		
Month Ended June 30, 2016		
Revenue:		
Service Revenue		\$ 13,000
Expenses:		
Salaries Expense	\$ 1,900	
Rent Expense	800	
Total Expenses		<u>2,700</u>
Net Income		<u>\$ 10,300</u>

### Requirement 2

The income statement reports revenues and expenses for a period of time.

### E1-32 Preparing the statement of retained earnings

Learning Objective 5

Ending Retained Earnings \$12,000

### Requirements

1. Prepare the statement of retained earnings for Wilford Towing Service for the month ending June 30, 2016.
2. What does the statement of retained earnings report?

## SOLUTION

### Requirement 1

WILFORD TOWING SERVICE	
Statement of Retained Earnings	
Month Ended June 30, 2016	
Retained Earnings, June 1, 2016	\$ 3,700
Net income for the month	<u>10,300</u>
	14,000
Dividends	<u>(2,000)</u>
Retained Earnings, June 30, 2016	<u>\$ 12,000</u>

## Requirement 2

The statement of retained earnings reports the changes in retained earnings for a corporation during a time period. The statement of retained earnings reports a corporation's net income or net loss and dividends declared.

### E1-33 Preparing the balance sheet

Learning Objective 5

Total Assets \$28,900

#### Requirements

1. Prepare the balance sheet for Wilford Towing Service as of June 30, 2016.
2. What does the balance sheet report?

#### SOLUTION

##### Requirement 1

WILFORD TOWING SERVICE				
Balance Sheet				
June 30, 2016				
Assets		Liabilities		
Cash	\$ 1,900	Accounts Payable	\$ 6,000	
Accounts Receivable	8,200	Notes Payable	<u>6,900</u>	
Office Supplies	1,300	Total Liabilities	12,900	
Equipment	17,500	Stockholders' Equity		
		Common Stock	4,000	
		Retained Earnings	<u>12,000</u>	
		Total Stockholders' Equity	<u>16,000</u>	
Total Assets	<u>\$ 28,900</u>	Total Liabilities and Stockholders' Equity	<u>\$ 28,900</u>	

## Requirement 2

The balance sheet reports an entity's assets, liabilities, and stockholders' equity as of a specific date.

*Use the following information to answer Exercises E1-34 through E1-36.*

The assets, liabilities, and equities of Drought Design Studio have the following balances at December 31, 2016. The retained earnings was \$31,000 at the beginning of the year with common stock of \$20,000 and dividends of \$55,000 at year end.

Notes Payable	\$ 9,800	Office Furniture	\$ 55,200
Rent Expense	22,000	Utilities Expense	6,500
Cash	3,100	Accounts Payable	3,700
Office Supplies	4,500	Service Revenue	159,200
Salaries Expense	62,000	Accounts Receivable	10,200
Property Tax Expense	1,200	Miscellaneous Expense	4,000

### E1-34 Preparing the income statement

Learning Objective 5

Net Income \$63,500

Prepare the income statement for Drought Design Studio for the year ending December 31, 2016.

### SOLUTION

DROUGHT DESIGN STUDIO			
Income Statement			
Year Ended December 31, 2016			
Revenue:			
Service Revenue			\$ 159,200
Expenses:			
Salaries Expense	\$ 62,000		
Rent Expense	22,000		
Utilities Expense	6,500		
Miscellaneous Expense	4,000		
Property Tax Expense	1,200		
Total Expenses			95,700
Net Income			\$ 63,500

**E1-35 Preparing the statement of retained earnings**

Learning Objective 5

Ending Retained Earnings \$39,500

Prepare the statement of retained earnings for Drought Design Studio for the year ending December 31, 2016.

**SOLUTION**

DROUGHT DESIGN STUDIO	
Statement of Retained Earnings	
Year Ended December 31, 2016	
Retained Earnings, January 1, 2016	\$ 31,000
Net income for the year	<u>63,500</u>
	94,500
Dividends	<u>(55,000)</u>
Retained Earnings, December 31, 2016	<u><u>\$ 39,500</u></u>

**E1-36 Preparing the balance sheet**

Learning Objective 5

Total Assets \$73,000

Prepare the balance sheet for Drought Design Studio as of December 31, 2016.

**SOLUTION**

DROUGHT DESIGN STUDIO			
Balance Sheet			
December 31, 2016			
Assets		Liabilities	
Cash	\$ 3,100	Accounts Payable	\$ 3,700
Accounts Receivable	10,200	Notes Payable	<u>9,800</u>
Office Supplies	4,500	Total Liabilities	13,500
Office Furniture	55,200	Stockholders' Equity	
		Common Stock	20,000
		Retained Earnings	<u>39,500</u>
		Total Stockholders' Equity	<u>59,500</u>
		Total Liabilities and Stockholders' Equity	<u><u>\$ 73,000</u></u>
Total Assets	<u>\$ 73,000</u>		

## E1-37 Preparing the statement of cash flows

### Learning Objective 5

For each transaction, identify the appropriate section on the statement of cash flows to report the transaction. Choose from: Cash flows from operating activities (O), Cash flows from investing activities (I), Cash flows from financing activities (F), or Is not reported on the statement of cash flows (X). If reported on the statement, decide whether the transaction should be shown as a positive cash flow (+) or a negative cash flow (–):

- a. The business received cash from the issuance of common stock.
- b. Paid cash on accounts payable for office supplies purchased.
- c. Performed services for a customer on account.
- d. Cash dividends were paid to stockholders.
- e. Received cash from a customer for services performed.
- f. Purchased equipment with cash.
- g. Paid rent for the month.
- h. Purchased land; signed a note payable.
- i. Paid employees wages for the week.
- j. Incurred utility expense on account.

### SOLUTION

- |        |        |
|--------|--------|
| a. F + | f. I – |
| b. O – | g. O – |
| c. X   | h. X   |
| d. F – | i. O – |
| e. O + | j. X   |

## E1-38 Preparing the statement of cash flows

### Learning Objective 5

Decrease in cash \$9,300

Bean Town Food Equipment Company had the following transactions for the month ending February 29, 2016. Bean Town's cash balance on February 1, 2016, was \$16,400.

---

Feb. 1	Common stock was issued to stockholders for \$7,500 cash.
7	Purchased equipment for \$2,500 on account.
14	Paid \$18,000 cash for land.
17	Paid cash expenses: employees' salaries, \$1,500; office rent, \$1,800; utilities, \$500.
23	Paid cash dividends of \$3,000.
26	Earned service revenue for the month, \$8,000, receiving cash.

---

Prepare the statement of cash flows of Bean Town Food Equipment Company for the month ended February 29, 2016.

## SOLUTION

---

### BEAN TOWN FOOD EQUIPMENT COMPANY

#### Statement of Cash Flows

Month Ended February 29, 2016

---

Cash flows from operating activities:

Receipts:

Collections from customers \$ 8,000

Payments:

For rent \$ (1,800)

For salaries (1,500)

For utilities (500) (3,800)

Net cash provided by operating activities 4,200

Cash flows from investing activities:

Purchase of land (18,000)

Net cash used by investing activities (18,000)

Cash flows from financing activities:

Issuance of common stock 7,500

Payment of cash dividends (3,000)

Net cash provided by financing activities 4,500

Net decrease in cash (9,300)

Cash balance, February 1, 2016 16,400

Cash balance, February 29, 2016 \$ 7,100

---

## E1-39 Calculating return on assets (ROA)

Learning Objective 6

Alec Appliance Service had net income for the year of \$18,200. In addition, the balance sheet reports the following balances:

	Jan. 1, 2016	Dec. 31, 2016
Notes Payable	\$ 34,000	\$ 54,000
Cash	39,000	20,200
Office Furniture	20,000	38,000
Building	155,000	155,000
Accounts Payable	9,500	10,000
Total Stockholders' Equity	198,300	214,200
Accounts Receivable	1,600	18,400
Equipment	22,000	46,000
Office Supplies	4,200	600

Calculate the return on assets (ROA) for Alec Appliance Service for the year ending December 31, 2016.



## SOLUTION

Average total assets = (Beginning total assets + ending total assets) / 2

Beginning total assets = \$39,000 + \$20,000 + \$155,000 + \$1,600 + \$22,000 + \$4,200 = \$241,800

Ending total assets = \$20,200 + \$38,000 + \$155,000 + \$18,400 + \$46,000 + \$600 = \$278,200

Average total assets = (\$241,800 + \$278,200) / 2 = \$260,000

ROA = Net income / Average total assets

ROA = \$18,200 / \$260,000 = 0.07 = 7%

## Problems (Group A)

---

### P1-40A Using the accounting equation for transaction analysis

Learning Objective 4

Cash \$7,350

Missy Mansion opened a public relations firm called Solid Gold on August 1, 2016. The following amounts summarize her business on August 31, 2016:

ASSETS					}	=	LIABILITIES +		EQUITY									
								Contributed Capital	+	Retained Earnings								
Cash	+	Accounts Receivable	+	Office Supplies			Land	Accounts Payable	+	Common Stock	-	Dividends	+	Service Revenue	-	Rent Expense	-	Advertising Expense
Bal.	\$2,400	+	\$2,600	+	\$0		+\$15,000	\$3,000	+	\$14,400			+	\$2,600				

## SOLUTION

Assets						=	Liabilities		+	Equity									
										Contributed Capital	+	Retained Earnings							
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Common Stock	−	Dividends	+	Service Revenue	−	Rent Expense	−	Advertising Expense
Bal.	\$2,400	+	\$2,600			+	\$15,000	=	\$3,000	+	\$14,400				+	\$2,600			
(a)	+8,000										+8,000								
Bal.	\$10,400	+	\$2,600			+	\$15,000	=	\$3,000	+	\$22,400					\$2,600			
(b)	+1,300															+1,300			
Bal.	\$11,700	+	\$2,600			+	\$15,000	=	\$3,000	+	\$22,400					\$3,900			
(c)	−3,000								−3,000										
Bal.	\$8,700	+	\$2,600			+	\$15,000	=	\$0	+	\$22,400			+	\$3,900				
(d)					+400				+400										
Bal.	\$8,700	+	\$2,600	+	\$400	+	\$15,000	=	\$400	+	\$22,400			+	\$3,900				
(e)	+2,200		−2,200																
Bal.	\$10,900	+	\$400	+	\$400	+	\$15,000	=	\$400	+	\$22,400			+	\$3,900				
(f)	−1,800												−1,800						
Bal.	\$9,100	+	\$400	+	\$400	+	\$15,000	=	\$400	+	\$22,400	−	\$1,800	+	\$3,900				
(g)			+6,500												+6,500				
Bal.	\$9,100	+	\$6,900	+	\$400	+	\$15,000	=	\$400	+	\$22,400	−	\$1,800	+	\$10,400				
(h)	−1,750																−1,400		−350
Bal.	\$7,350	+	\$6,900	+	\$400	+	\$15,000	=	\$400	+	\$22,400	−	\$1,800	+	\$10,400	−	\$1,400	−	\$350

## **P1-41A Using the accounting equation for transaction analysis**

Learning Objective 4

Cash \$18,550

Cameron Turnbull started a new business, Turnbull Gymnastics, and completed the following transactions during December:

---

Dec. 1	Cameron contributed \$21,000 cash in exchange for common stock.
2	Received \$2,400 cash from customers for services performed.
5	Paid \$350 cash for office supplies.
9	Performed services for a customer and billed the customer for services rendered, \$1,500.
10	Received \$100 invoice for utilities due in two weeks.
15	Paid for advertising in the local paper, \$300.
20	Paid utility invoice received on Dec. 10.
25	Collected cash in full from customer billed on Dec. 9.
28	Paid rent for the month, \$2,800.
28	Paid \$1,100 to assistant for wages.
30	Received \$2,800 cash from customers for services performed.
31	Cash dividends of \$4,500 were paid to stockholders.

---

Analyze the effects of the transactions on the accounting equation of Turnbull Gymnastics using a format similar to Exhibit 1-6.

## SOLUTION

Assets					=	Liabilities		+	Equity												
									Contributed Capital	+	Retained Earnings										
	Cash	+	Accounts Receivable	+	Office Supplies	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense	–	Salaries Expense	–	Advertising Expense
1	+21,000								+21,000												
2	+2,400												+2,400								
Bal.	\$23,400					=		+	\$21,000			+	\$2,400								
5	–350				+350																
Bal.	\$23,050			+	\$350	=		+	\$21,000			+	\$2,400								
9			+1,500										+1,500								
Bal.	\$23,050	+	\$1,500	+	\$350	=		+	\$21,000			+	\$3,900								
10							+100										–100				
Bal.	\$23,050	+	\$1,500	+	\$350	=	\$100	+	\$21,000			+	\$3,900				–	\$100			
15	–300																			–300	
Bal.	\$22,750	+	\$1,500	+	\$350	=	\$100	+	\$21,000			+	\$3,900				–	\$100			\$300
20	–100						–100														
Bal.	\$22,650	+	\$1,500	+	\$350	=	\$ 0	+	\$21,000			+	\$3,900				–	\$100			\$300
25	+1,500		–1,500																		
Bal.	\$24,150	+	\$ 0	+	\$350	=		+	\$21,000			+	\$3,900				–	\$100			\$300
28	–2,800														–2,800						
Bal.	\$21,350			+	\$350	=		+	\$21,000			+	\$3,900	–	\$2,800	–	\$100				\$300
28	–1,100																		–		
Bal.	\$20,250			+	\$350	=		+	\$21,000			+	\$3,900	–	\$2,800	–	\$100	–	\$1,100	–	\$300
30	+2,800												+2,800								
Bal.	\$23,050			+	\$350	=		+	\$21,000			+	\$6,700	–	\$2,800	–	\$100	–	\$1,100	–	\$300
31	–4,500										–4,500										
Bal.	\$18,550	+	\$ 0	+	\$350	=	\$ 0	+	\$21,000	–	\$4,500	+	\$6,700	–	\$2,800	–	\$100	–	\$1,100	–	\$300

## P1-42A Preparing financial statements

### Learning Objective 5

#### 1. Net Income \$97,800

Presented here are the accounts of Golden City Barbershop for the year ended December 31, 2016.

Land	\$ 5,000	Common Stock	\$ 25,000
Notes Payable	37,000	Accounts Payable	17,000
Property Tax Expense	2,700	Accounts Receivable	900
Dividends	32,000	Advertising Expense	13,000
Rent Expense	11,000	Building	157,000
Salaries Expense	61,000	Cash	3,800
Salaries Payable	900	Equipment	19,000
Service Revenue	195,000	Insurance Expense	2,500
Office Supplies	9,000	Interest Expense	7,000
Retained Earnings, 12/31/15	49,000		

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### Requirements

1. Prepare Golden City Barbershop's income statement.
2. Prepare the statement of retained earnings.
3. Prepare the balance sheet.

### SOLUTION

#### Requirement 1

---

**GOLDEN CITY BARBERSHOP**  
Income Statement  
Year Ended December 31, 2016

---

Revenue:		
Service Revenue		\$ 195,000
Expenses:		
Salaries Expense	\$ 61,000	
Advertising Expense	13,000	
Rent Expense	11,000	
Interest Expense	7,000	
Property Tax Expense	2,700	
Insurance Expense	2,500	
Total Expenses		<u>97,200</u>
Net Income		<u><u>\$ 97,800</u></u>

---

**Requirement 2**


---

GOLDEN CITY BARBERSHOP  
Statement of Retained Earnings  
Year Ended December 31, 2016

---

Retained Earnings, December 31, 2015	\$ 49,000
Net income for the year	97,800
	<hr/> 146,800
Dividends	(32,000)
Retained Earnings, December 31, 2016	<hr/> <u>\$ 114,800</u>

---

**Requirement 3**


---

GOLDEN CITY BARBERSHOP  
Balance Sheet  
December 31, 2016

---

Assets		Liabilities	
Cash	\$ 3,800	Accounts Payable	\$ 17,000
Accounts Receivable	900	Notes Payable	37,000
Office Supplies	9,000	Salaries Payable	900
Equipment	19,000	Total Liabilities	<hr/> 54,900
Building	157,000		
Land	5,000	Stockholders' Equity	
		Common Stock	25,000
		Retained Earnings	114,800
		Total Stockholders' Equity	<hr/> 139,800
		Total Liabilities and Stockholders' Equity	<hr/> <u>\$ 194,700</u>
Total Assets	<hr/> <u>\$ 194,700</u>		

---

## P1-43A Preparing financial statements

### Learning Objective 5

#### b. Ending Retained Earnings \$76,800

Click a Pix Photography works weddings and prom-type parties. The balance of retained earnings was \$26,000 at December 31, 2015. At December 31, 2016, the business's accounting records show these balances:

Insurance Expense	\$ 11,000	Accounts Receivable	\$ 12,000
Cash	40,000	Notes Payable	9,000
Accounts Payable	6,000	Retained Earnings, Dec. 31, 2016	?
Advertising Expense	3,200	Salaries Expense	20,000
Service Revenue	95,000	Equipment	73,800
Dividends	10,000	Common Stock	34,000

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Prepare the following financial statements for Click a Pix Photography for the year ended December 31, 2016:

- Income statement.
- Statement of retained earnings.
- Balance sheet.

## SOLUTION

### Part a.

---

CLICK A PIX PHOTOGRAPHY  
Income Statement  
Year Ended December 31, 2016

---

Revenue:		
Service Revenue		\$ 95,000
Expenses:		
Salaries Expense	\$ 20,000	
Insurance Expense	11,000	
Advertising Expense	3,200	
Total Expenses		<u>34,200</u>
Net Income		<u><u>\$ 60,800</u></u>

---

**Part b.**


---

CLICK A PIX PHOTOGRAPHY  
Statement of Retained Earnings  
Year Ended December 31, 2016

---

Retained Earnings, December 31, 2015	\$ 26,000
Net income for the year	60,800
	<u>86,800</u>
Dividends	(10,000)
Retained Earnings, December 31, 2016	<u>\$ 76,800</u>

---

**Part c.**


---

CLICK A PIX PHOTOGRAPHY  
Balance Sheet  
December 31, 2016

---

Assets		Liabilities	
Cash	\$ 40,000	Accounts Payable	\$ 6,000
Accounts Receivable	12,000	Notes Payable	9,000
Equipment	73,800	Total Liabilities	<u>15,000</u>
		Stockholders' Equity	
		Common Stock	34,000
		Retained Earnings	76,800
		Total Stockholders' Equity	<u>110,800</u>
		Total Liabilities and Stockholders' Equity	
Total Assets	<u>\$125,800</u>		<u>\$125,800</u>

---



## P1-44A Preparing financial statements

### Learning Objective 5

Total Assets \$47,100

The bookkeeper of Lone Star Landscaping prepared the company's balance sheet while the accountant was ill. The balance sheet contains numerous errors. In particular, the bookkeeper knew that the balance sheet should balance, so he plugged in the retained earnings amount needed to achieve this balance. The retained earnings is incorrect. All other amounts are correct, but some are out of place or should not be included in this statement. Prepare a corrected balance sheet.

LONE STAR LANDSCAPING Balance Sheet Month Ended November 30, 2016			
Assets		Liabilities	
Cash	\$ 4,900	Accounts Receivable	\$ 2,100
Office Supplies	300	Dividends	8,000
Land	33,800	Service Revenue	44,000
Salaries Expense	3,100	Property Tax Expense	2,700
Office Furniture	6,000	Accounts Payable	2,800
Notes Payable	24,200	Retained Earnings	1,150
Rent Expense	450	Stockholders' Equity	
		Common Stock	12,000
Total Assets	<b>\$ 72,750</b>	Total Liabilities	<b>\$ 72,750</b>

## SOLUTION

---

LONE STAR LANDSCAPING  
Balance Sheet  
November 30, 2016

---

Assets		Liabilities	
Cash	\$ 4,900	Accounts Payable	\$ 2,800
Accounts Receivable	2,100	Notes Payable	24,200
Office Supplies	300	Total Liabilities	<u>27,000</u>
Office Furniture	6,000	Stockholders' Equity	
Land	33,800	Common Stock	12,000
		Retained Earnings	8,100
		Total Stockholders' Equity	<u>20,100</u>
		Total Liabilities and Stockholders' Equity	<u>\$ 47,100</u>
Total assets	<u>\$ 47,100</u>		

---

## **P1-45A Using the accounting equation for transaction analysis and preparing financial statements**

Learning Objectives 4, 5

2b. Ending Retained Earnings \$6,900

Alfonso Sheen recently opened his own accounting firm, which he operates as a corporation. The name of the new entity is Alfonso Sheen, CPA. Sheen experienced the following events during the organizing phase of the new business and its first month of operations in 2016:

---

Feb. 5	Sheen deposited \$70,000 in a new business bank account titled Alfonso Sheen, CPA. The business issued common stock to Sheen.
6	Paid \$350 cash for letterhead stationery for new office.
7	Purchased office furniture for the office on account, \$7,000.
10	Consulted with tax client and received \$1,800 for services rendered.
11	Paid utilities, \$400.
12	Finished tax hearings on behalf of a client and submitted a bill for accounting services, \$11,000.
18	Paid office rent, \$1,000.
25	Received amount due from client that was billed on February 12.
27	Paid full amount of accounts payable created on February 7.
29	Cash dividends of \$4,500 were paid to stockholders.

---

### **Requirements**

1. Analyze the effects of the events on the accounting equation of Alfonso Sheen, CPA. Use a format similar to Exhibit 1-6.
2. Prepare the following financial statements:
  - a. Income statement.
  - b. Statement of retained earnings.
  - c. Balance sheet.

## SOLUTION

### Requirement 1

Assets					=	Liabilities	+	Equity											
								Contributed Capital	+	Retained Earnings									
	Cash	+	Accounts Receivable	+	Office Supplies	+	Furniture	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense
5	+70,000										+70,000								
6	<u>–350</u>				<u>+350</u>														
Bal.	\$69,650			+	\$350			=		+	\$70,000								
7							<u>+7,000</u>		<u>+7,000</u>										
Bal.	\$69,650			+	\$350	+	\$7,000	=	\$7,000	+	\$70,000								
10	<u>+1,800</u>														<u>+1,800</u>				
Bal.	\$71,450			+	\$350	+	\$7,000	=	\$7,000	+	\$70,000			+	\$1,800				
11	<u>–400</u>																		<u>–400</u>
Bal.	\$71,050			+	\$350	+	\$7,000	=	\$7,000	+	\$70,000			+	\$1,800			–	\$400
12			<u>+11,000</u>												<u>+11,000</u>				
Bal.	\$71,050	+	\$11,000	+	\$350	+	\$7,000	=	\$7,000	+	\$70,000			+	\$12,800			–	\$400
18	<u>–1,000</u>															<u>–1,000</u>			
Bal.	\$70,050	+	\$11,000	+	\$350	+	\$7,000	=	\$7,000	+	\$70,000			+	\$12,800	–	\$1,000	–	\$400
25	<u>+11,000</u>		<u>–11,000</u>																
Bal.	\$81,050		\$ 0	+	\$350	+	\$7,000	=	\$7,000	+	\$70,000			+	\$12,800	–	\$1,000	–	\$400
27	<u>–7,000</u>								<u>–7,000</u>										
Bal.	\$74,050			+	\$350	+	\$7,000	=	\$ 0	+	\$70,000			+	\$12,800	–	\$1,000	–	\$400
29	<u>–4,500</u>												<u>–4,500</u>						
Bal.	\$69,550	+	\$ 0	+	\$350	+	\$7,000	=	\$ 0	+	\$70,000	–	\$4,500	+	\$12,800	–	\$1,000	–	\$400

**P1-45A, cont.**  
**Requirement 2a**

---

ALFONSO SHEEN, CPA  
Income Statement  
Month Ended February 29, 2016

---

Revenue:		
Service Revenue		\$ 12,800
Expenses:		
Rent Expense	\$ 1,000	
Utilities Expense	400	
Total Expenses		<u>1,400</u>
Net Income		<u><u>\$ 11,400</u></u>

---

**Requirement 2b**

---

ALFONSO SHEEN, CPA  
Statement of Retained Earnings  
Month Ended February 29, 2016

---

Retained Earnings, February 1, 2016	\$ 0
Net income for the month	<u>11,400</u>
	11,400
Dividends	<u>(4,500)</u>
Retained Earnings, February 29, 2016	<u><u>\$ 6,900</u></u>

---

**Requirement 2c**

---

ALFONSO SHEEN, CPA  
Balance Sheet  
February 29, 2016

---

Assets		Liabilities	
Cash	\$ 69,550		
Office Supplies	350		
Furniture	7,000	Stockholders' Equity	
		Common Stock	\$ 70,000
		Retained Earnings	<u>6,900</u>
		Total Stockholders' Equity	<u>76,900</u>
		Total Liabilities and Stockholders'	
Total Assets	<u><u>\$ 76,900</u></u>	Equity	<u><u>\$ 76,900</u></u>

---

## P1-46A Using the accounting equation for transaction analysis and preparing financial statements

Learning Objectives 4, 5

2c. Total Assets \$94,360

Angela Petrillo recently opened her own law office, which she operates as a corporation. The name of the new entity is Angela Petrillo, Attorney. Petrillo experienced the following events during the organizing phase of the new business and its first month of operation, March 2016. Some of the events were personal and did not affect the law practice. Others were business transactions and should be accounted for by the business.

---

Mar. 1	Sold personal investment in Amazon stock, which she had owned for several years, receiving \$31,000 cash.
2	Deposited the \$31,000 cash from the sale of the Amazon stock in her personal bank account.
3	Deposited \$72,000 cash in a new business bank account titled Angela Petrillo, Attorney. The business issued common stock to Petrillo.
5	Paid \$350 cash for ink cartridges for the printer.
7	Purchased computer for the law office, agreeing to pay the account, \$5,500, within three months.
9	Received \$2,500 cash from customers for services rendered.
15	Received bill from <i>The Lawyer</i> for magazine subscription, \$340. (Use Miscellaneous Expense account.)
23	Finished court hearings on behalf of a client and submitted a bill for legal services, \$18,000, on account.
28	Paid bill from <i>The Lawyer</i> .
30	Paid utilities, \$1,300.
31	Received \$1,800 cash from clients billed on Mar. 23.
31	Cash dividends of \$2,000 were paid to stockholders.

---

### Requirements

1. Analyze the effects of the preceding events on the accounting equation of Angela Petrillo, Attorney. Use a format similar to Exhibit 1-6.
2. Prepare the following financial statements:
  - a. Income statement.
  - b. Statement of retained earnings.
  - c. Balance sheet.

## SOLUTION

### Requirement 1

Assets					=	Liabilities	+	Equity											
								Contributed Capital	+	Retained Earnings									
	Cash	+	Accounts Receivable	+	Office Supplies	+	Computer	=	Accounts Payable	+	Common Stock	-	Dividends	+	Service Revenue	-	Utilities Expense	-	Miscellaneous Expense
3	+72,000										+72,000								
5	-350				+350														
Bal.	\$71,650			+	\$350			=		+	\$72,000								
7							+5,500		+5,500										
Bal.	\$71,650			+	\$350	+	\$5,500	=	\$5,500	+	\$72,000								
9	+2,500														+2,500				
Bal.	\$74,150			+	\$350	+	\$5,500	=	\$5,500	+	\$72,000			+	\$2,500				
15									+340										-340
Bal.	\$74,150			+	\$350	+	\$5,500	=	\$5,840	+	\$72,000			+	\$2,500	-		-	\$340
23			+18,000												+18,000				
Bal.	\$74,150	+	\$18,000	+	\$350	+	\$5,500	=	\$5,840	+	\$72,000			+	\$20,500	-		-	\$340
28	-340								-340										
Bal.	\$73,810	+	\$18,000	+	\$350	+	\$5,500	=	\$5,500	+	\$72,000			+	\$20,500	-		-	\$340
30	-1,300																-1,300		
Bal.	\$72,510	+	\$18,000	+	\$350	+	\$5,500	=	\$5,500	+	\$72,000			+	\$20,500	-	\$1,300	-	\$340
31	+1,800		-1,800																
Bal.	\$74,310	+	\$16,200	+	\$350	+	\$5,500	=	\$5,500	+	\$72,000			+	\$20,500	-	\$1,300	-	\$340
31	-2,000												-2,000						
Bal.	\$72,310	+	\$16,200	+	\$350	+	\$5,500	=	\$5,500	+	\$72,000	-	\$2,000	+	\$20,500	-	\$1,300	-	\$340

**P1-46A, cont.**  
**Requirement 2a**

ANGELA PETRILLO, ATTORNEY			
Income Statement			
Month Ended March 31, 2016			
Revenue:			
Service Revenue			\$ 20,500
Expenses:			
Utilities Expense	\$ 1,300		
Miscellaneous Expense	340		
Total Expenses			<u>1,640</u>
Net Income			<u><u>\$ 18,860</u></u>

**Requirement 2b**

ANGELA PETRILLO, ATTORNEY	
Statement of Retained Earnings	
Month Ended March 31, 2016	
Retained Earnings, March 1, 2016	\$ 0
Net income for the month	<u>18,860</u>
	18,860
Dividends	<u>(2,000)</u>
Retained Earnings, March 31, 2016	<u><u>\$ 16,860</u></u>

**Requirement 2c**

ANGELA PETRILLO, ATTORNEY			
Balance Sheet			
March 31, 2016			
	Assets		Liabilities
Cash	\$ 72,310	Accounts Payable	\$ 5,500
Accounts Receivable	16,200		
Office Supplies	350	Stockholders' Equity	
Computer	5,500	Common Stock	72,000
		Retained Earnings	<u>16,860</u>
		Total Stockholders' Equity	<u>88,860</u>
		Total Liabilities and Stockholders'	
Total Assets	<u><u>\$ 94,360</u></u>	Equity	<u><u>\$ 94,360</u></u>





## SOLUTION

Assets							=	Liabilities		+	Equity								
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Contributed Capital	+	Retained Earnings						
											Common Stock	−	Dividends	+	Service Revenue	−	Rent Expense	−	Advertising Expense
Bal.	\$2,100	+	\$2,500	+		+	\$11,000	=	\$6,000	+	\$7,100			+	2,500				
(a)	+13,000										+13,000								
Bal.	\$15,100	+	\$2,500			+	\$11,000	=	\$6,000	+	\$20,100			+	2,500				
(b)	+1,200														+1,200				
Bal.	\$16,300	+	\$2,500			+	\$11,000	=	\$6,000	+	\$20,100			+	\$3,700				
(c)	−6,000								−6,000										
Bal.	\$10,300	+	\$2,500			+	\$11,000	=	\$0	+	\$20,100			+	\$3,700				
(d)					+1,000				+1,000										
Bal.	\$10,300	+	\$2,500	+	\$1,000	+	\$11,000	=	\$1,000	+	\$20,100			+	\$3,700				
(e)	+1,500		−1,500																
Bal.	\$11,800	+	\$1,000	+	\$1,000	+	\$11,000	=	\$1,000	+	\$20,100			+	\$3,700				
(f)	−1,900												−1,900						
Bal.	\$9,900	+	\$1,000	+	\$1,000	+	\$11,000	=	\$1,000	+	\$20,100	−	\$1,900	+	\$3,700				
(g)			+6,000												+6,000				
Bal.	\$9,900	+	\$7,000	+	\$1,000	+	\$11,000	=	\$1,000	+	\$20,100	−	\$1,900	+	\$9,700				
(h)	−1,750																−1,400		−350
Bal.	\$8,150	+	\$7,000	+	\$1,000	+	\$11,000	=	\$1,000	+	\$20,100	−	\$1,900	+	\$9,700	−	\$1,400	−	\$350

## **P1-48B Using the accounting equation for transaction analysis**

### **Learning Objective 4**

Cash \$19,775

Cosmo Timmins started a new business, Timmins Gymnastics, and completed the following transactions during December:

- 
- |        |   |
|--------|---|
| Dec. 1 | Cosmo contributed \$20,000 cash in exchange for common stock.                             |
| 2      | Received \$2,200 cash from customers for services performed.                              |
| 5      | Paid \$350 cash for office supplies.  |
| 9      | Performed services for a customer and billed the customer for services rendered, \$4,500. |
| 10     | Received \$100 invoice for utilities due in two weeks.                                    |
| 15     | Paid for advertising in the local paper, \$475.   |
| 20     | Paid utility invoice received on Dec. 10.   |
| 25     | Collected cash in full from customer billed on Dec. 9.                                    |
| 28     | Paid rent for the month, \$3,000.   |
| 28     | Paid \$1,500 to assistant for wages.  |
| 30     | Received \$2,000 cash from customers for services performed.                              |
| 31     | Cash dividends of \$3,500 were paid to stockholders.                                      |
- 

Analyze the effects of the transactions on the accounting equation of Timmins Gymnastics using a format similar to Exhibit 1-6.

## SOLUTION

Assets					=	Liabilities		+	Equity												
									Contributed Capital	+	Retained Earnings										
	Cash	+	Accounts Receivable	+	Office Supplies	=	Accounts Payable	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense	–	Salaries Expense	–	Advertising Expense
1	+20,000								+20,000												
2	+2,200												+2,200								
Bal.	\$22,200					=		+	\$20,000			+	\$2,200								
5	–350				+350																
Bal.	\$21,850			+	\$350	=		+	\$20,000			+	\$2,200								
9			+4,500										+4,500								
Bal.	\$21,850	+	\$4,500	+	\$350	=		+	\$20,000			+	\$6,700								
10							+100										–100				
Bal.	\$21,850	+	\$4,500	+	\$350	=	\$100	+	\$20,000			+	\$6,700			–	\$100				
15	–475																				–475
Bal.	\$21,375	+	\$4,500	+	\$350	=	\$100	+	\$20,000			+	\$6,700			–	\$100			–	\$475
20	–100						–100														
Bal.	\$21,275	+	\$4,500	+	\$350	=	\$ 0	+	\$20,000			+	\$6,700			–	\$100			–	\$475
25	+4,500		–4,500																		
Bal.	\$25,775	+	\$ 0	+	\$350	=		+	\$20,000			+	\$6,700			–	\$100			–	\$475
28	–3,000														–3,000						
Bal.	\$22,775			+	\$350	=		+	\$20,000			+	\$6,700	–	\$3,000	–	\$100			–	\$475
28	–1,500																		–1,500		
Bal.	\$21,275			+	\$350	=		+	\$20,000			+	\$6,700	–	\$3,000	–	\$100	–	\$1,500	–	\$475
30	+2,000												+2,000								
Bal.	\$23,275			+	\$350	=		+	\$20,000			+	\$8,700	–	\$3,000	–	\$100	–	\$1,500	–	\$475
31	–3,500										–3,500										
Bal.	\$19,775	+	\$ 0	+	\$350	=	\$ 0	+	\$20,000	–	\$3,500	+	\$8,700	–	\$3,000	–	\$100	–	\$1,500	–	\$475

## P1-49B Preparing financial statements

### Learning Objective 5

#### 1. Net Income \$74,900

Presented here are the accounts of Town and Country Realty for the year ended December 31, 2016:

Land	\$ 5,000	Common Stock	\$ 28,000
Notes Payable	36,000	Accounts Payable	14,000
Property Tax Expense	3,400	Accounts Receivable	1,000
Dividends	32,000	Advertising Expense	14,000
Rent Expense	10,000	Building	144,600
Salaries Expense	69,000	Cash	3,800
Salaries Payable	1,500	Equipment	13,000
Service Revenue	180,000	Insurance Expense	2,200
Office Supplies	12,000	Interest Expense	6,500
Retained Earnings, 12/31/15	57,000		

### Requirements

1. Prepare Town and Country Realty's income statement.
2. Prepare the statement of retained earnings.
3. Prepare the balance sheet.

### SOLUTION

#### Requirement 1

---

TOWN AND COUNTRY REALTY  
Income Statement  
Year Ended December 31, 2016

---

Revenues:		
Service Revenue		\$ 180,000
Expenses:		
Salaries Expense	\$ 69,000	
Advertising Expense	14,000	
Rent Expense	10,000	
Interest Expense	6,500	
Property Tax Expense	3,400	
Insurance Expense	2,200	
Total Expenses		<u>105,100</u>
Net Income		<u><u>\$ 74,900</u></u>

---

**Requirement 2**


---

TOWN AND COUNTRY REALTY  
Statement of Retained Earnings  
Year Ended December 31, 2016

---

Retained Earnings, December 31, 2015	\$ 57,000
Net income for the year	74,900
	<u>131,900</u>
Dividends	(32,000)
Retained Earnings, December 31, 2016	<u><u>\$ 99,900</u></u>

---

**Requirement 3**


---

TOWN AND COUNTRY REALTY  
Balance Sheet  
December 31, 2016

---

Assets		Liabilities	
Cash	\$ 3,800	Accounts Payable	\$ 14,000
Accounts Receivable	1,000	Notes Payable	36,000
Office Supplies	12,000	Salaries Payable	1,500
Equipment	13,000	Total Liabilities	<u>51,500</u>
Building	144,600	Stockholders' Equity	
Land	5,000	Common Stock	28,000
		Retained Earnings	99,900
		Total Stockholders' Equity	<u>127,900</u>
		Total Liabilities and Stockholders'	
Total Assets	<u>\$ 179,400</u>	Equity	<u>\$ 179,400</u>

---

## P1-50B Preparing financial statements

### Learning Objective 5

#### b. Ending Retained Earnings \$86,500

Precision Pics works weddings and prom-type parties. The balance of Retained Earnings was \$26,000 at December 31, 2015. At December 31, 2016, the business's accounting records show these balances:

Insurance Expense	\$ 14,000	Accounts Receivable	\$ 7,000
Cash	38,000	Notes Payable	9,000
Accounts Payable	13,000	Retained Earnings, Dec. 31, 2016	?
Advertising Expense	3,500	Salaries Expense	21,000
Service Revenue	110,000	Equipment	96,500
Dividends	11,000	Common Stock	33,000

Prepare the following financial statements for Precision Pics for the year ended December 31, 2016:

- Income statement.
- Statement of retained earnings.
- Balance sheet.

## SOLUTION

### Requirement a

PRECISION PICS			
Income Statement			
Year Ended December 31, 2016			
Revenues:			
Service Revenue			\$ 110,000
Expenses:			
Salaries Expense		\$ 21,000	
Insurance Expense		14,000	
Advertising Expense		3,500	
Total Expenses			<u>38,500</u>
Net Income			<u>\$ 71,500</u>

**Requirement b**

PRECISION PICS	
Statement of Retained Earnings	
Year Ended December 31, 2016	
Retained Earnings, December 31, 2015	\$ 26,000
Net income for the year	<u>71,500</u>
	97,500
Dividends	<u>(11,000)</u>
Retained Earnings, December 31, 2016	<u>\$ 86,500</u>

**Requirement c**

PRECISION PICS			
Balance Sheet			
December 31, 2016			
Assets		Liabilities	
Cash	\$ 38,000	Accounts Payable	\$ 13,000
Accounts Receivable	7,000	Notes Payable	<u>9,000</u>
Equipment	96,500	Total Liabilities	22,000
		Stockholders' Equity	
		Common Stock	33,000
		Retained Earnings	<u>86,500</u>
		Total Stockholders' Equity	<u>119,500</u>
		Total Liabilities And Stockholders' Equity	
Total Assets	<u>\$ 141,500</u>		<u>\$ 141,500</u>



## P1-51B Preparing financial statements

### Learning Objective 5

Total Assets \$47,400

The bookkeeper of Beautiful World Landscaping prepared the company's balance sheet while the accountant was ill. The balance sheet contains numerous errors. In particular, the bookkeeper knew that the balance sheet should balance, so he plugged in the retained earnings amount needed to achieve this balance. The retained earnings is incorrect. All other amounts are correct, but some are out of place or should not be included on this statement. Prepare a corrected balance sheet.

BEAUTIFUL WORLD LANDSCAPING Balance Sheet Month Ended July 31, 2016			
Assets		Liabilities	
Cash	\$ 5,500	Accounts Receivable	\$ 1,900
Office Supplies	300	Dividends	13,000
Land	34,100	Service Revenue	44,000
Salaries Expense	2,700	Property Tax Expense	2,600
Office Furniture	5,600	Accounts Payable	2,400
Notes Payable	24,600	Retained Earnings	3,300
Rent Expense	400	Stockholders' Equity	
		Common Stock	6,000
Total Assets	<u>\$ 73,200</u>	Total Liabilities	<u>\$ 73,200</u>

### SOLUTION

BEAUTIFUL WORLD LANDSCAPING Balance Sheet July 31, 2016			
Assets		Liabilities	
Cash	\$ 5,500	Accounts Payable	\$ 2,400
Accounts Receivable	1,900	Notes Payable	<u>24,600</u>
Office Supplies	300	Total Liabilities	27,000
Office Furniture	5,600		
Land	34,100	Stockholders' Equity	
		Common Stock	6,000
		Retained Earnings	<u>14,400</u>
		Total Stockholders' Equity	<u>20,400</u>
		Total Liabilities and Stockholders' Equity	<u>\$ 47,400</u>
Total Assets	<u>\$ 47,400</u>		

## **P1-52B Using the accounting equation for transaction analysis and preparing financial statements**

Learning Objectives 4, 5

2c. Total Assets \$76,700

Andre Simmon recently opened his own accounting firm, which he operates as a corporation. The name of the new entity is Andre Simmon, CPA. Simmon experienced the following events during the organizing phase of the new business and its first month of operations in 2016.

---

Feb. 5	Simmon deposited \$65,000 in a new business bank account titled Andre Simmon, CPA. The business issued common stock to Simmon.
6	Paid \$300 cash for letterhead stationery for new office.
7	Purchased office furniture for the office on account, \$6,800.
10	Consulted with tax client and received \$3,300 for services rendered.
11	Paid utilities, \$100.
12	Finished tax hearings on behalf of a client and submitted a bill for accounting services, \$12,500.
18	Paid office rent, \$1,000.
25	Received amount due from client that was billed on February 12.
27	Paid full amount of accounts payable created on February 7.
29	Cash dividends of \$3,000 were paid to stockholders.

---

### **Requirements**

1. Analyze the effects of the events on the accounting equation of Andre Simmon, CPA. Use a format similar to Exhibit 1-6.
2. Prepare the following financial statements:
  - a. Income statement.
  - b. Statement of retained earnings.
  - c. Balance sheet.

## SOLUTION

### Requirement 1

	Assets					=	Liabilities	+	Equity										
	Cash	+	Accounts Receivable	+	Office Supplies	+	Office Furniture	=	Accounts Payable	+	Contributed Capital	+	Retained Earnings						
											Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense
5	+65,000										+65,000								
Bal.	\$65,000							=		+	\$65,000								
6	–300				+300														
Bal.	\$64,700			+	\$300			=		+	\$65,000								
7							+6,800		+6,800										
Bal.	\$64,700			+	\$300	+	\$6,800	=	\$6,800	+	\$65,000								
10	+3,300														+3,300				
Bal.	\$68,000			+	\$300	+	\$6,800	=	\$6,800	+	\$65,000			+	\$3,300				
11	–100																		–100
Bal.	\$67,900			+	\$300	+	\$6,800	=	\$6,800	+	\$65,000			+	\$3,300			–	\$100
12			+12,500												+12,500				
Bal.	\$67,900	+	\$12,500	+	\$300	+	\$6,800	=	\$6,800	+	\$65,000			+	\$15,800			–	\$100
18	–1,000																–1,000		
Bal.	\$66,900	+	\$12,500	+	\$300	+	\$6,800	=	\$6,800	+	\$65,000			+	\$15,800	–	\$1,000	–	\$100
25	+12,500		–12,500																
Bal.	\$79,400		\$ 0	+	\$300	+	\$6,800	=	\$6,800	+	\$65,000			+	\$15,800	–	\$1,000	–	\$100
27	–6,800								–6,800										
Bal.	\$72,600		\$ 0	+	\$300	+	\$6,800	=	\$ 0	+	\$65,000			+	\$15,800	–	\$1,000	–	\$100
29	–3,000												–3,000						
Bal.	\$69,600	+	\$ 0	+	\$300	+	\$6,800	=	\$ 0	+	\$65,000	–	\$3,000	+	\$15,800	–	\$1,000	–	\$100

**P1-52B, cont.**  
**Requirement 2a**

---

ANDRE SIMMON, CPA  
Income Statement  
Month Ended February 29, 2016

---

Revenues:		
Service Revenue		\$ 15,800
Expenses:		
Rent Expense	\$ 1,000	
Utilities Expense	100	
Total Expenses		<u>1,100</u>
Net Income		<u>\$ 14,700</u>

---

**Requirement 2b**

---

ANDRE SIMMON, CPA  
Statement of Retained Earnings  
Month Ended February 29, 2016

---

Retained Earnings, February 1, 2016	\$ 0
Net income for the month	<u>14,700</u>
	14,700
Dividends	<u>(3,000)</u>
Retained Earnings, February 29, 2016	<u>\$ 11,700</u>

---

**Requirement 2c**

---

ANDRE SIMMON, CPA  
Balance Sheet  
February 29, 2016

---

Assets		Liabilities	
Cash	\$ 69,600		
Office Supplies	300		
Office Furniture	6,800	Stockholders' Equity	
		Common Stock	\$ 65,000
		Retained Earnings	<u>11,700</u>
		Total Stockholders' Equity	<u>76,700</u>
		Total Liabilities and Stockholders'	
Total Assets	<u>\$ 76,700</u>	Equity	<u>\$ 76,700</u>

---

## P1-53B Using the accounting equation for transaction analysis and preparing financial statements

Learning Objectives 4, 5

2c. Total Assets \$89,060

Ariana Peterson recently opened her own law office, which she operates as a corporation. The name of the new entity is Ariana Peterson, Attorney. Peterson experienced the following events during the organizing phase of the new business and its first month of operation, December 2016. Some of the events were personal and did not affect the law practice. Others were business transactions and should be accounted for by the business.

---

Dec. 1	Sold personal investment in Nike stock, which she had owned for several years, receiving \$25,000 cash.
2	Deposited the \$25,000 cash from the sale of the Nike stock in her personal bank account.
3	Deposited \$65,000 cash in a new business bank account titled Ariana Peterson, Attorney. The business issued common stock to Peterson.
5	Paid \$400 cash for ink cartridges for the printer.
7	Purchased computer for the law office, agreeing to pay the account, \$6,800, within three months.
9	Received \$2,900 cash from customers for services rendered.
15	Received bill from <i>The Lawyer</i> for magazine subscription, \$300. (Use Miscellaneous Expense account.)
23	Finished court hearings on behalf of a client and submitted a bill for legal services, \$18,000, on account.
28	Paid bill from <i>The Lawyer</i> .
30	Paid utilities, \$840.
31	Received \$2,800 cash from clients billed on Dec. 23.
31	Cash dividends of \$2,500 were paid to stockholders.

---

### Requirements

1. Analyze the effects of the preceding events on the accounting equation of Ariana Peterson, Attorney. Use a format similar to Exhibit 1-6.
2. Prepare the following financial statements:
  - a. Income statement.
  - b. Statement of retained earnings.
  - c. Balance sheet.

## SOLUTION

### Requirement 1

Assets							=	Liabilities		+	Equity								
	Cash	+	Accounts Receivable	+	Office Supplies	+	Computer	=	Accounts Payable	+	Contributed Capital	+	Retained Earnings						
											Common Stock	–	Dividends	+	Service Revenue	–	Utility Expense	–	Misc. Expense
3	+65,000										+65,000								
5	–400				+400														
Bal.	\$64,600				\$400	+		=		+	\$65,000								
7							+6,800		+6,800										
Bal.	\$64,600			+	\$400	+	\$6,800	=	\$6,800	+	\$65,000								
9	+2,900														+2,900				
Bal.	\$67,500			+	\$400	+	\$6,800	=	\$6,800	+	\$65,000			+	\$2,900				
15									+300										–300
Bal.	\$67,500			+	\$400	+	\$6,800	=	\$7,100	+	\$65,000			+	\$2,900	–		–	\$300
23			+18,000												+18,000				
Bal.	\$67,500	+	\$18,000	+	\$400	+	\$6,800	=	\$7,100	+	\$65,000			+	\$20,900	–		–	\$300
28	–300								–300										
Bal.	\$67,200	+	\$18,000	+	\$400	+	\$6,800	=	\$6,800	+	\$65,000			+	\$20,900	–		–	\$300
30	–840																–840		
Bal.	\$66,360	+	\$18,000	+	\$400	+	\$6,800	=	\$6,800	+	\$65,000			+	\$20,900	–	\$840	–	\$300
31	+2,800		–2,800																
Bal.	\$69,160	+	\$15,200	+	\$400	+	\$6,800	=	\$6,800	+	\$65,000			+	\$20,900	–	\$840	–	\$300
31	–2,500												–2,500						
Bal.	\$66,660	+	\$15,200	+	\$400	+	\$6,800	=	\$6,800	+	\$65,000	–	\$2,500	+	\$20,900	–	\$840	–	\$300

**P1-53B, cont.**  
**Requirement 2a**

<b>ARIANA PETERSON, ATTORNEY</b> <b>Income Statement</b> <b>Month Ended December 31, 2016</b>			
Revenues:			
Service Revenue			\$ 20,900
Expenses:			
Utility Expense		\$ 840	
Miscellaneous Expense		300	
Total Expenses			<u>1,140</u>
Net Income			<u><u>\$ 19,760</u></u>

**Requirement 2b**

<b>ARIANA PETERSON, ATTORNEY</b> <b>Statement of Retained Earnings</b> <b>Month Ended December 31, 2016</b>	
Retained Earnings, December 1, 2016	\$ 0
Net income for the month	<u>19,760</u>
	19,760
Dividends	<u>(2,500)</u>
Retained Earnings, December 31, 2016	<u><u>\$ 17,260</u></u>

**Requirement 2c**

<b>ARIANA PETERSON, ATTORNEY</b> <b>Balance Sheet</b> <b>December 31, 2016</b>			
<b>Assets</b>		<b>Liabilities</b>	
Cash	\$ 66,660	Accounts Payable	\$ 6,800
Accounts Receivable	15,200		
Office Supplies	400	Stockholders' Equity	
Computer	6,800	Common Stock	65,000
		Retained Earnings	<u>17,260</u>
		Total Stockholders' Equity	<u>82,260</u>
		Total Liabilities and Stockholders' Equity	
Total Assets	<u>\$ 89,060</u>		<u>\$ 89,060</u>

## ***Continuing Problem***

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Problem P1-54 is the first problem in a sequence that begins an accounting cycle. The cycle is continued in Chapter 2 and completed in Chapter 5.

### **P1-54 Using the accounting equation for transaction analysis, preparing financial statements, and calculating return on assets (ROA)**

Daniels Consulting began operations and completed the following transactions during December 2016:

---

Dec. 2	Stockholders contributed \$20,000 cash in exchange for common stock.
2	Paid monthly office rent, \$2,000.
3	Paid cash for a computer, \$3,600. This equipment is expected to remain in service for five years.
4	Purchased office furniture on account, \$3,000. The furniture should last for five years.
5	Purchased office supplies on account, \$800.
9	Performed consulting service for a client on account, \$2,500.
12	Paid utilities expenses, \$150.
18	Performed service for a client and received cash of \$2,100.
21	Received \$2,400 in advance for client service to be performed in the future. (This increases the Unearned Revenue account, which is a liability. This account will be explained in more detail in Chapter 2.)
21	Hired an administrative assistant to be paid \$2,055 on the 20th day of each month. The secretary begins work immediately.
26	Paid \$200 on account.
28	Collected \$400 on account.
30	Cash dividends of \$1,000 were paid to stockholders.

---

### **Requirements**

1. Analyze the effects of Daniels Consulting's transactions on the accounting equation. Use the format of Exhibit 1-6, and include these headings: Cash; Accounts Receivable; Office Supplies; Equipment; Furniture; Accounts Payable; Unearned Revenue; Common Stock; Dividends; Service Revenue; Rent Expense; and Utilities Expense.
2. Prepare the income statement of Daniels Consulting for the month ended December 31, 2016.
3. Prepare the statement of retained earnings for the month ended December 31, 2016.
4. Prepare the balance sheet as of December 31, 2016.
5. Calculate the return on assets for Daniels Consulting for December, 2016.



## SOLUTION

### Requirement 1

Assets										=	Liabilities			+	Equity								
														Contributed Capital	+	Retained Earnings							
	Cash	+	Accounts Receivable	+	Office Supplies	+	Equipment	+	Furniture	=	Accounts Payable	+	Unearned Revenue	+	Common Stock	–	Dividends	+	Service Revenue	–	Rent Expense	–	Utilities Expense
2	+20,000														+20,000								
2	<u>–2,000</u>																				<u>–2,000</u>		
Bal.	\$18,000									=				+	<u>\$20,000</u>					–	<u>\$2,000</u>		
3	<u>–3,600</u>						<u>+3,600</u>																
Bal.	\$14,400						<u>\$3,600</u>	+		=				+	<u>\$20,000</u>					–	<u>\$2,000</u>		
4									<u>+3,000</u>		<u>+3,000</u>												
Bal.	\$14,400						<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,000</u>			+	<u>\$20,000</u>					–	<u>\$2,000</u>		
5					<u>+800</u>						<u>+800</u>												
Bal.	\$14,400				<u>\$800</u>	+	<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,800</u>			+	<u>\$20,000</u>					–	<u>\$2,000</u>		
9			<u>+2,500</u>																<u>+2,500</u>				
Bal.	\$14,400	+	<u>\$2,500</u>	+	<u>\$800</u>	+	<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,800</u>			+	<u>\$20,000</u>			+	<u>\$2,500</u>	–	<u>\$2,000</u>		
12	<u>–150</u>																					<u>–150</u>	
Bal.	\$14,250	+	<u>\$2,500</u>	+	<u>\$800</u>	+	<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,800</u>			+	<u>\$20,000</u>			+	<u>\$2,500</u>	–	<u>\$2,000</u>	–	<u>\$150</u>
18	<u>+2,100</u>																		<u>+2,100</u>				
Bal.	\$16,350	+	<u>\$2,500</u>	+	<u>\$800</u>	+	<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,800</u>			+	<u>\$20,000</u>			+	<u>\$4,600</u>	–	<u>\$2,000</u>	–	<u>\$150</u>
21	<u>+2,400</u>												<u>+2,400</u>										
Bal.	\$18,750	+	<u>\$2,500</u>	+	<u>\$800</u>	+	<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,800</u>	+	<u>\$2,400</u>	+	<u>\$20,000</u>			+	<u>\$4,600</u>	–	<u>\$2,000</u>	–	<u>\$150</u>
26	<u>–200</u>												<u>–200</u>										
Bal.	\$18,550	+	<u>\$2,500</u>	+	<u>\$800</u>	+	<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,600</u>	+	<u>\$2,400</u>	+	<u>\$20,000</u>			+	<u>\$4,600</u>	–	<u>\$2,000</u>	–	<u>\$150</u>
28	<u>+400</u>		<u>–400</u>																				
Bal.	\$18,950	+	<u>\$2,100</u>	+	<u>\$800</u>	+	<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,600</u>	+	<u>\$2,400</u>	+	<u>\$20,000</u>			+	<u>\$4,600</u>	–	<u>\$2,000</u>	–	<u>\$150</u>
30	<u>–1,000</u>																						
Bal.	\$17,950	+	<u>\$2,100</u>	+	<u>\$800</u>	+	<u>\$3,600</u>	+	<u>\$3,000</u>	=	<u>\$3,600</u>	+	<u>\$2,400</u>	+	<u>\$20,000</u>	–	<u>–1,000</u>	+	<u>\$4,600</u>	–	<u>\$2,000</u>	–	<u>\$150</u>

**P1-54, cont.**  
**Requirement 2**

---

DANIELS CONSULTING  
Income Statement  
Month Ended December 31, 2016

---

Revenue:		
Service Revenue		\$ 4,600
Expenses:		
Rent Expense	\$ 2,000	
Utilities Expense	150	
Total Expense		2,150
Net Income		\$ 2,450

---

**Requirement 3**

---

DANIELS CONSULTING  
Statement of Retained Earnings  
Month Ended December 31, 2016

---

Retained Earnings, December 1, 2016	\$ 0
Net income for the month	2,450
	2,450
Dividends	(1,000)
Retained Earnings, December 31, 2016	\$ 1,450

---

**Requirement 4**

---

DANIELS CONSULTING  
Balance Sheet  
December 31, 2016

---

Assets		Liabilities	
Cash	\$ 17,950	Accounts Payable	\$ 3,600
Accounts Receivable	2,100	Unearned Revenue	2,400
Office Supplies	800	Total Liabilities	6,000
Equipment	3,600		
Furniture	3,000	Stockholders' Equity	
		Common Stock	20,000
		Retained Earnings	1,450
		Total Stockholder's Equity	21,450
		Total Liabilities and Stockholders'	
Total Assets	\$ 27,450	Equity	\$ 27,450

---

**Requirement 5**

Average total assets =  $(\$0 + \$27,450) / 2 = \$13,725$

Return on assets = Net income / Average total assets =  $\$2,450 / \$13,725 = 0.179 = 17.9\%$

## Critical Thinking

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### Decision Case 1-1

Let's examine a case using Greg's Tunes and Sal's Silly Songs. It is now the end of the first year of operations, and the stockholders want to know how well each business came out at the end of the year. Neither business kept complete accounting records, and no dividends were paid. The businesses throw together the following data at year-end:

<b>Sal's Silly Songs:</b>	
Total assets	\$ 23,000
Common Stock	8,000
Total revenues	35,000
Total expenses	22,000
<b>Greg's Tunes:</b>	
Total liabilities	\$ 10,000
Common Stock	6,000
Total expenses	44,000
Net income	9,000

To gain information for evaluating the businesses, the stockholders ask you several questions. For each answer, you must show your work to convince the stockholders that you know what you are talking about.

### Requirements

1. Which business has more assets?
2. Which business owes more to creditors?
3. Which business has more stockholders' equity at the end of the year?
4. Which business brought in more revenue?
5. Which business is more profitable?
6. Which of the foregoing questions do you think is most important for evaluating these two businesses? Why?
7. Which business looks better from a financial standpoint?

## **SOLUTION**

### **Requirement 1**

Greg's Tunes has more assets.

Sal's \$23,000, Greg's \$25,000 ( $\$10,000 + \$6,000 + \$9,000$ )

### **Requirement 2**

Greg's Tunes owes more to creditors.

Sal's \$2,000 ( $\$23,000 - (\$8,000 + \$35,000 - \$22,000)$ ), Greg's \$10,000

### **Requirement 3**

Sal's Silly Songs has more stockholders' equity.

Sal's \$21,000 ( $\$8,000 + \$35,000 - \$22,000$ ) Greg's \$15,000 ( $\$6,000 + \$9,000$ )

### **Requirement 4**

Greg's Tunes earned more revenue.

Sal's \$35,000, Greg's \$53,000 ( $\$9,000 + \$44,000$ )

### **Requirement 5**

Sal's Silly Songs is more profitable.

Sal's \$13,000 ( $\$35,000 - \$22,000$ ), Greg's \$9,000

### **Requirement 6**

This question is opinion based. More profit is good, which means Sal's has the advantage. Greg's also owes more to creditors which is risky. Sal's has much more equity, which minimizes risk.

### **Requirement 7**

Sal's looks financially better, because Sal earned more net income on less total revenue. Sal also owes less to creditors and has more equity.

## **Ethical Issues 1-1**

The tobacco companies have paid billions because of smoking-related illnesses. In particular, Philip Morris, a leading cigarette manufacturer, paid more than \$3,000,000,000 in settlement payments in one year.

### **Requirements**

1. Suppose you are the chief financial officer (CFO) responsible for the financial statements of Philip Morris. What ethical issue would you face as you consider what to report in your company's annual report about the cash payments? What is the ethical course of action for you to take in this situation?
2. What are some of the negative consequences to Philip Morris for not telling the truth? What are some of the negative consequences to Philip Morris for telling the truth?

## **SOLUTION**

### **Requirement 1**

The chief financial officer (CFO) of Philip Morris would be torn between addressing the fact that the payments are related to illnesses caused by the company's products, or alternatively, omitting or concealing this fact. The ethical course of action for the CFO is to be open, honest and forthcoming about the reasons for the payments.

### **Requirement 2**

Negative consequences of not telling the truth are as follows: If users of the financial statements feel they are only getting part of the truth, or that the reports are distorting the information, this will damage the credibility of the company, and damage the company's reputation.

Negative consequences of telling the truth include painting so bleak a picture of the effects of smoking that investors will view Philip Morris as too risky and stop buying the company's stock. Another negative consequence would be to create the impression that the company is engaged in unethical behavior by selling a product that damages people's health.

### **Fraud Case 1-1**

Exeter is a building contractor on the Gulf Coast. After losing a number of big lawsuits, it was facing its first annual net loss as the end of the year approached. The owner, Hank Snow, was under intense pressure from the company's creditors to report positive net income for the year. However, he knew that the controller, Alice Li, had arranged a short-term bank loan of \$10,000 to cover a temporary shortfall of cash. He told Alice to record the incoming cash as "construction revenue" instead of a loan. That would nudge the company's income into positive territory for the year, and then, he said, the entry could be corrected in January when the loan was repaid.

#### **Requirements**

1. How would this action affect the year-end income statement? How would it affect the year-end balance sheet?
2. If you were one of the company's creditors, how would this fraudulent action affect you?

### **SOLUTION**

#### **Requirement 1**

The proposed action would increase net income by increasing revenues. It would distort the balance sheet by understating liabilities and overstating equity.

#### **Requirement 2**

By making the company's financial situation look better than it actually was, the company's creditors would likely be more willing to extend credit to the company, and offer the credit at a lower interest rate.

### **Financial Statement Case 1-1**

This and similar cases in later chapters focus on the financial statements of a real company—**Starbucks Corporation**, a premier roaster and retailer of specialty coffee. As you work each case, you will gain confidence in your ability to use the financial statements of real companies.

Visit <http://www.pearsonhighered.com/Horngren> to view a link to the Starbucks Corporation Fiscal 2013 Annual Report.

#### **Requirements**

1. How much in cash (including cash equivalents) did Starbucks Corporation have on September 29, 2013?
2. What were the company's total assets at September 29, 2013? At September 30, 2012?
3. Write the company's accounting equation at September 29, 2013, by filling in the dollar amounts:  
$$\text{Assets} = \text{Liabilities} + \text{Equity}$$
4. Identify total net sales (revenues) for the year ended September 29, 2013. How much did total revenue increase or decrease from 2012 to 2013?
5. How much net income (net earnings) or net loss did Starbucks earn for 2013 and for 2012? Based on net income, was 2013 better or worse than 2012?
6. Calculate Starbucks Corporation's return on assets for the year ending September 29, 2013.
7. How did Starbucks Corporation's return on assets compare to Green Mountain Coffee Roasters, Inc.'s return on assets?

## **SOLUTION**

### **Requirement 1**

\$2,575.7 (in millions)

### **Requirement 2**

\$11,516.7 (in millions) at September 29, 2013;      \$8,219.2 (in millions) at September 30, 2012

### **Requirement 3**

Assets	=	Liabilities	+	Equity
\$11,516.7	=	\$7,034.4	+	\$4,482.3

(shown in millions)

### **Requirement 4**

\$14,892.2 (in millions) for year ended September 29, 2013

This is an increase of \$1,592.7 (in millions) over 2012. (\$14,892.2– \$13,299.5)

### **Requirement 5**

\$8.3 (in millions) in 2013

\$1,383.8 (in millions) in 2012

2012 was better than 2013.

### **Requirement 6**

Average total assets =  $(\$8,219.2 + \$11,516.7) / 2 = \$9,867.95$  (rounded)

Return on assets =  $\$8.3 / \$9,867.95 = 0.0008 = 0.08\%$

**Financial Statement Case, cont.**

### **Requirement 7**

Starbucks Corporation's return on assets (0.08%) was significantly lower than Green Mountain Coffee Roasters, Inc. (13.1%).