Chapter 1

Accounting and the Business Environment

Questions

1. Accounting is a system for measuring, processing, and communicating financial information. Bookkeeping is a procedural element of accounting.
2. a. The general public uses accounting information to manage bank accounts, loan payments, etc.

b. Managers and owners of businesses use accounting to monitor expenses and revenue recorded.

c. Investors and creditors use accounting information to evaluate investments and loan applications.

d. Government agencies (including taxation authorities) use accounting data to create reports and collect payments.

e. Not-for-profit organizations such as churches and hospitals use accounting information in much the same way as managers of businesses do—to manage their organizations.

1. Financial accounting communicates financial information about a company to interested users who are external to the company (creditors and regulators, for example). Management accounting provides information that is used within a company to help make better future-oriented decisions.
2. Accounting students can pursue either the ACAF certification or the CPA designation. The advanced *certificate* in accounting and finance prepares them for intermediate positions. The Certified Professional Accountant *designatio*n allows members to use the letter “CPA” on their business cards.
3. The Accounting Standards Board formulates generally accepted accounting principles. It is not a government agency.
4. **Proprietorship** A proprietorship has a single owner, called the proprietor, who often manages the business. The business remains a business for the life of the owner. For accounting pruposes, each proprietorship is distinct from its owner. Thus, the accounting records of the proprietorship do not include the proprietor’s personal accounting records. However, from a legal perspective, the business is the proprietor, so if the business cannot pay its debts, lenders can take the proprietor’s personal assets (cash and belongings) to pay the proprietorship’s debt.

**Partnership** A partnership joins two or more individuals together as co-owners. Accounting treats the partnership as a separate organization distinct from the personal affairs of each partner. The partnership’s life is limited by the lives of the owners or the interest of the owners in remaining a partner. From a legal perspective, a partnership is the partners in a manner similar to a proprietorship. If the partnership cannot pay its debts, lenders can take each partner’s personal assets to pay the partnership’s debts.

**Corporation** A corporation is a business owned by shareholders. These are the people or other corporations who own shares of ownership in the business. A corporation is a separate legal entity that has an unlimited lifespan. Unlike a proprietorship or a partnership, once a corporation is formed, it is a legal entity separate and distinct from its owners. Since corporations are entities separate from their owners, they will prepare financial reports separate from their owners. If a corporation goes bankrupt, lenders cannot take the personal assets of the shareholders.

7. The owner of a proprietorship is called the proprietor, the owners of a partnership are called partners, and the owners of a corporation are called shareholders.

8. One advantage of the corporate form of ownership compared to the proprietorship form is, in most instances, it is easier for a shareholder to sell the shares (the investment) in a corporation than it is to sell the investment in a partnership or proprietorship. A second advantage is the shareholders of a corporation have limited legal liability, while the legal liability of a proprietorship extends to the owner.

9. The economic entity assumption draws clear boundaries around each entity. It is important because it allows decision makers to evaluate each entity as a separate economic unit.

10. The going concern assumption says that the entity will remain in operation for the foreseeable future. This means that there is no need to consider what assets might be worth if they were liquidated, but rather one should continue to use the historic cost of assets.

11. The cost principle dictates that assets and services purchased be recorded at the actual cost.

12. Liabilities = Assets – Owner’s Equity.

13. An account receivable is an asset because it is an economic resource that provides a future benefit—the right to collect cash from another party. An account payable is a liability because it is another party’s claim against the business’s cash—an economic obligation.

14. The result of operations is a net loss of $4,400, because expenses exceed revenues.

15. A more descriptive title for the balance sheet is the “statement of financial position.”

16. The balance between assets on the left side and liabilities and owner’s equity on the right side of the balance sheet gives this financial statement its name. The balance appears in the accounting equation, Assets = Liabilities + Owner’s Equity, which is essentially a summary of the balance sheet in equation form.

17. Another title of the income statement is the “statement of operations” or the “statement of earnings.”

18. The balance sheet is like a snapshot of the entity at a specific time. The income statement is like a moving picture/video of the entity’s operations during a period of time.

19. The statement of owner’s equity presents a summary of the changes that occurred in owner’s equity during the period due to additional investments by the owner, withdrawals by the owner, and net income or net loss.

20. Net income (or net loss) flows from the income statement to the statement of owner’s equity. The ending balance of the Owner, Capital account then flows to the balance sheet. The change in cash during the period on the balance sheet is explained by the cash flow statement, and the ending balance of cash on the cash flow statement matches the cash amount on the balance sheet.

21. Publicly accountable enterprises, which includes companies whose shares trade on stock exchanges, *must* report their financial results under IFRS. They are not allowed to report under accounting standards for private enterprises (ASPE). It makes sense that Canadian publicly traded companies should report under IFRS since technology and improved communications are allowing more businesses to either purchase or sell in markets outside Canada and to have shareholders that reside anywhere in the world. Investors in Canadian companies reside all over the world. It is important that these investors be able to compare the financial results from companies in similar industries that are located in different countries. Having one set of accounting principles for all countries allows investors to do this.

Starters

(5 min.) **S1-1**

a. FA b. FA c. FA d. FA (and also MA if the owner is also a manager e. MA

*(5 min.)* **S1-2**

1. The banker is an external user.

2. The balance sheet would be the best financial statement for the bank to use, as it lists all the assets, liabilities, and equities for the company.

(5 min.) **S1-3**

1. Marketing manager I = Internal
2. Canada Revenue Agency E = External
3. Investor E = External
4. Controller I = Internal
5. Supplier E = External

*(5-10 min.)* **S1-4**

Louise will want to consider the factors discussed in Exhibit 1–4. This shows that a corporation is the only type of business organization that has an unlimited life. Also, the corporation, not its shareholders, is responsible for business debts. In other words, Louise’s liability will be limited.

*(10–15 min.)* **S1-5**

|  |  |  |
| --- | --- | --- |
| a. Cost principle of measurement | e | Benefits of the information produced by an accounting system must be greater than the costs |
| b. Going concern assumption | f | Amounts may be ignored if the effect on a decision maker’s decision is not significant |
| c. Stable monetary unit assumption | a | Transactions are recorded based on the cash amount received or paid |
| d. Economic entity assumption | c | Ignore the effects of inflation in the accounting records |
| e. Cost–benefit constraint | b | Assumes that a business is going to continue operations indefinitely |
| f. Materiality constraint | d | Business must keep its accounting records separate from its owner’s accounting records |

*(5–10 min.)* **S1-6**

No, an intention to rent is not a transaction because an event has not yet occurred that affects the financial position of the company and can be measured reliably. When the rental is completed or when cash changes hands, then a transaction will have taken place.

*(5 min.)* **S1-7**

Revenues are the amounts earned by Shu in return for her providing goods and services to customers. Expenses are the decreases in equity that arise from the utilization of assets or the increase in liabilities to cover the costs needed to deliver goods and services to customers.

*(5–10 min.)* **S1-8**

1. a) Economic entity assumption

1. Cost principle of measurement
2. Stable monetary unit assumption
3. Cost-benefit constraint (although some students may identify the materiality constraint if they assume that the coffee is not material for the business)

2. Assets = Liabilities + Owner’s Equity

72,000 + 24,000 = 20,000 + Owner’s Equity

96,000 = 20,000 + Owner’s Equity

Thus, Owner’s Equity = 76,000

*(5–10 min.)* **S1-9**

a. L f. OE

b. A g. A

c. OE h. OE

d. A i. A

e. OE j. OE

*(5–10 min.)* **S1-10**

Owner’s equity is $50,000, calculated as:

Assets = Liabilities + Owner’s Equity

Assets – Liabilities = Owner’s Equity

$200,000 – $150,000 = $50,000

*(5–10 min.)* **S1-11**

|  |  |
| --- | --- |
| Accounts Receivable | B |
| Computer Equipment | B |
| S. Scott, Capital | B, OE |
| Rent Expense | I |
| Supplies | B |
| S. Scott, Withdrawals | OE |
| Salaries Expense | I |
| Consulting Service Revenue | I |
| Cash | B, CF |
| Note Payable | B |
| Supplies Expense | I |
| Accounts Payable | B |

*(10 min.)* **S1-12**

Revenue – Expenses = Net Income Solve for missing expenses.

Revenue – Net Income = Expenses

$42,000 – 10,000 = 32,000

*(10 min.)* **S1-13**

|  |  |  |  |
| --- | --- | --- | --- |
| **PICTURE PERFECT PET PHOTOGRAPHY** | | | |
| Balance Sheet | | | |
| January 31, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  5,000 | Accounts payable | $   6,000 |
| Accounts receivable | 2,000 |  |  |
| Supplies | 1,200 | **Owner’s Equity** |  |
| Camera equipment | 15,000 | C. Loranger, capital | $ 17,200 |
| Total assets | $23,200 | Total liabilities and owner’s equity | $ 23,200 |

*(10 min.)* **S1-14**

|  |  |  |
| --- | --- | --- |
| **BLACK CANARY SOUND STUDIO** | | |
| Income Statement | | |
| For the Year Ended December 31, 2019 | | |
| **Revenue** |  |  |
| Service revenue |  | $150,000 |
| **Expenses** |  |  |
| Insurance expense | $ 3,000 |  |
| Rent expense | 18,000 |  |
| Salaries expense | 50,000 |  |
| Supplies expense | 1,000 |  |
| Total expenses |  | 72,000 |
| Net income |  | $ 78,000 |

*(10 min.)* **S1-15**

1. Start with the accounting equation to solve for the total Owner’s Equity:

A = L + E

$45,800 = $15,230 + E

E = $30,570

Then look at how we calculate equity and break it down to solve for the Expenses:

(Hint: see Exhibit 1–10 for the following “formula.”)

Ending Equity (Capital) = Investment (Capital) – Withdrawals + Revenues – Expenses

$30,570 = $28,700 – $7,000 + $10,890 – Expenses

Expenses = $2,020

2. If Revenues are $10,890 and Expenses are $2,080, then there is a net income of $8,870. This would mean it was “a good year” for the business because they earned a profit and did not incur a loss.Exercises

(5-10 min.) **E1-1**

The *income statement* reports the revenues and expenses of a particular entity for a period such as a month or a year. Total *revenues* minus total *expenses* equals *net income*, or profit. A lender would require this information in order to predict whether the borrower can generate enough income to repay the loan.

The *balance sheet* reports the assets, liabilities, and owner’s equity of the entity at a particular point in time. The *assets* show the resources that the business has to work with. A lender wants to identify assets to know what can be taken if the borrower does not repay the loan. *Liabilities*—debts—represent creditors’ claims to the business’s assets. If the borrower already owes lots of money, he or she may be unable to repay the loan. *Owner’s equity* is the portion of the business assets owned outright by the owners of the business. The higher the owner’s equity, the stronger the borrower’s financial position and the greater the probability of loan repayment.

*Instructional Note:* Student responses may vary considerably.

(5-10 min.) **E1-2**

1. Sole proprietorship
2. Partnership
3. Sole proprietorship
4. Corporation
5. Partnership
6. Corporation

(5-10 min.) **E1-3**

1. f

2. a

3. d

4. b

5. c

6. e

(5-10 min.) **E1-4**

a) $750 increase

b) $5,000 decrease

c) $1,600 increase

d) $0

e) $150 increase

f) $800 increase

g) $3,000 increase

(5-15 min.) **E1-5**

Owner’s

Assets Liabilities Equity

Economy Cuts $160,000 $120,000 $ 40,000

Marpole Dry Cleaners 100,000 50,000 50,000

Dauphin Gift and Cards 145,000 115,000 30,000

(5-10 min.) **E1-6**

1. Assets = Liabilities + Owner’s

Equity

Cash + Furniture = Accounts + Note + J. Thorpe,

Payable Payable Capital

$18,000 + $40,000 = $7,000 + $30,000 + $21,000

2. Based on the accounting equation, the owner has $21,000 equity in the business.

(10-20 min.) **E1-7**

a. Increase asset (Cash)

Increase owner’s equity (Owner, Capital)

b. Decrease asset (Cash)

Decrease owner’s equity (Rent Expense)

c. Increase asset (Office Supplies)

Decrease asset (Cash)

d. Increase asset (Accounts Receivable)

Increase owner’s equity (Service Revenue)

e. Increase asset (Office Furniture)

Increase liability (Accounts Payable)

f. Increase asset (Cash)

Decrease asset (Accounts Receivable)

g. Decrease asset (Cash)

Decrease liability (Accounts Payable)

h. Increase asset (Cash)

Decrease asset (Land)

i. Increase asset (Cash)

Increase owner’s equity (Service Revenue)

(10-20 min.) **E 1-8**

Hayashi Medical Clinic

Analysis of Transactions

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | **Assets** | | | | | | **=** | **Liabilities** | **+** | **Owner’s Equity** | | | | | | | | |
| **Date** | | **Cash** | **+** | | **Medical Supplies** | **+** | **Land** | **=** | **Accounts Payable** | **+** | **G. Hayashi Capital** | **+** | **Service Revenue** | **-** | **Rent Expense** | **-** | **Salaries Expense** | **-** | **Utilities Expense** |
| Jan. | 6 | 250,000 | |  | |  | |  | | 250,000 | |  | |  | |  | |  | |
| Bal. |  | 250,000 | |  | |  | |  | | 250,000 | |  | |  | |  | |  | |
|  | 9 | (150,000) | |  | | 150,000 | |  | |  | |  | |  | |  | |  | |
| Bal. |  | 100,000 | |  | | 150,000 | |  | | 250,000 | |  | |  | |  | |  | |
|  | 12 |  | | 10,000 | |  | | 10,000 | |  | |  | |  | |  | |  | |
| Bal. |  | 100,000 | | 10,000 | | 150,000 | | 10,000 | | 250,000 | |  | |  | |  | |  | |
|  | 15 | Not a business transaction | | | | | | | | | | | | | | | | | |
|  | 15-31 | 20,000 | |  | |  | |  | |  | | 20,000 | |  | |  | |  | |
| Bal. |  | 120,000 | | 10,000 | | 150,000 | | 10,000 | | 250,000 | | 20,000 | |  | |  | |  | |
|  | 15-31 | (5,000) | |  | |  | |  | |  | |  | |  | | 5,000 | |  | |
|  |  | (4,000) | |  | |  | |  | |  | |  | | 4,000 | |  | |  | |
|  |  | (500) | |  | |  | |  | |  | |  | |  | |  | | 500 | |
| Bal. |  | 110,500 | | 10,000 | | 150,000 | | 10,000 | | 250,000 | | 20,000 | | 4,000 | | 5,000 | | 500 | |
|  | 28 | 1,000 | | (1,000) | |  | |  | |  | |  | |  | |  | |  | |
| Bal. |  | 111,500 | | 9,000 | | 150,000 | | 10,000 | | 250,000 | | 20,000 | | 4,000 | | 5,000 | | 500 | |
|  | 31 | (4,000) | |  | |  | | (4,000) | |  | |  | |  | |  | |  | |
| Bal. |  | 107,500 | | 9,000 | | 150,000 | | 6,000 | | 250,000 | | 20,000 | | 4,000 | | 5,000 | | 500 | |

266,500 266,500

(5-10 min.) **E1-9**

|  |  |  |
| --- | --- | --- |
| 1. Accounting equation | e | The basic tool of accounting, stated as Assets = Liabilities + Owner’s Equity |
| 2. Asset | a | An economic resource that is expected to be of benefit in the future |
| 3. Balance sheet | i | Report that shows an entity’s assets, liabilities, and owner’s equity as of a specific date |
| 4. Expense | f | The decrease in equity that occurs from using assets or increasing liabilities in the course of delivering goods or services to customers |
| 5. Income statement | j | Report of an entity’s revenues, expenses, and net income or net loss for a period of time |
| 6. Liability | b | An economic obligation (a debt) payable to an individual or an organization outside the business |
| 7. Net income | d | Excess of total revenues over total expenses |
| 8. Net loss | c | Excess of total expenses over total revenues |
| 9. Revenue | g | Amounts earned by delivering goods or services to customers |
| 10. Cash flow statement | h | Report that shows cash receipts and cash payments during a period |
| 11. Statement of owner’s equity | k | Report that shows the changes in owner’s equity for a period of time |

*(10–15 min.)* **E1–10**

|  |  |  |
| --- | --- | --- |
|  | 1. Type of Account | 1. Statement(s) |
| Supplies Expense | E | I |
| Accounts Receivable | A | B |
| J. Chiang, Capital | OE | SOE, B |
| Computer Equipment | A | B |
| Consulting Service Revenue | R | I |
| Accounts Payable | L | B |
| Rent Expense | E | I |
| Cash | A | B, CF |
| J. Chiang, Withdrawals | OE | SOE |
| Supplies | A | B |
| Note Payable | L | B |

(10-20 min.) **E1-11**

Req. 1

a. Investment by owner, Gary Oake

b. Purchase of rental equipment on account

c. Rental revenue for cash

d. Rental revenue on account

e. Payment of gas expense

f. Rental revenue for cash

g. Collection of account receivable

h. Payment of account payable

Req. 2

Revenues ($1,000 + $1,000 + $4,500) $6,500

Less: Expenses 2,000

Net income $4,500

(10-20 min.) **E1-12**

*Req. 1*

Bonicalzi Sales Training is a proprietorship, as shown by the owner’s capital account.

Req. 2

|  |  |  |  |
| --- | --- | --- | --- |
| **BONICALZI SALES TRAINING** | | | |
| Balance Sheet | | | |
| September 30, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  15,000 | Accounts payable | $  26,000 |
| Accounts receivable | 25,000 | Note payable | 50,000 |
| Supplies | 5,000 | Total liabilities | 76,000 |
| Computer equipment | 80,000 |  |  |
|  |  | **Owner’s Equity** |  |
|  |  | M. Bonicalzi, capital | $  49,000\* |
| Total assets | $125,000 | Total liabilities and owner’s equity | $125,000 |

\* Computation: Total assets ($125,000) – Total liabilities ($76,000) = Owner’s equity (x)

Owner’s equity: (x) = $125,000 – 76,000

Owner’s equity: (x) = $49,000

Req. 3

The balance sheet reports *financial position*. The income statement reports *operating results*.

Req. 1

(15-20 min.) **E1-13**

|  |  |  |
| --- | --- | --- |
| **PHILPOTT COMPANY** | | |
| Income Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Revenue** |  |  |
| Service revenue |  | $610,000 |
| **Expenses** |  |  |
| Rent expense | $ 48,000 |  |
| Research expense | 27,000 |  |
| Salaries expense | 430,000 |  |
| Supplies expense | 30,000 |  |
| Utilities expense | 18,000 |  |
| Total expenses |  | 553,000 |
| Net income |  | $ 57,000 |

Results of operations for 2020: Net income of $ 57,000

*(10-15 min.)* **E1-14**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **WILSON TOWING SERVICE** | | |
| Income Statement | | |
| For the Month Ended June 30, 2020 | | |
| **Revenue** |  |  |
| Service revenue |  | $15,000 |
| **Expenses** |  |  |
| Salaries expense | $2,400 |  |
| Rent expense | 900 |  |
| Total expenses |  | 3,300 |
| Net income |  | $11,700 |

*Req. 2*

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

*(10-15 min.)* **E1-15**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **WILSON TOWING SERVICE** | | |
| Statement of Owner’s Equity | | |
| For the Month Ended June 30, 2020 | | |
| J. Wilson, capital, June 1, 2020 | $ 3,250 |
| Add: Investment by owner | 11,000 |
| Net income for the month | 11,700 |
|  | 25,950 |
| Less: Withdrawals by owner | 3,500 |
| J. Wilson, capital, June 30, 2020 | $22,450 |

*Req. 2*

The statement of owner’s equity reports the changes in owner’s capital during a time period.

*(10-15 min.)* **E1-16**

*Req. 1*

|  |  |  |  |
| --- | --- | --- | --- |
| **WILSON TOWING SERVICE** | | | |
| Balance Sheet | | | |
| June 30, 2020 | | | |
| **Assets** | | **Liabilities** | |
| Cash | $ 1,400 | Accounts payable | $ 8,000 |
| Accounts receivable | 9,000 | Note payable | 6,800 |
| Office supplies | 1,000 | Total liabilities | 14,800 |
| Equipment | 25,850 | **Owner’s Equity** | |
|  |  | J. Wilson, capital | 22,450 |
| Total assets | $37,250 | Total liabilities and owner’s equity | $37,250 |

*Req. 2*

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

**Using Excel**

(60-75 min.) **E1-17**

The student templates for *Using Excel* are available online in MyLab in the Multimedia Library. The solution to *Using Excel* is located in the Instructor Resource Centre.

**Serial Exercise**

(35-40 min.) **E1-18**

*Req. 1*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Assets** | | | | | | | | | **=** | **Liabilities** | **+** | **Owner’s Equity** | | | | | | | | | | | | |
|  |  | **Cash** | **+** | **Accts Rec.** | **+** | **Office Supplies** | **+** | **Canoes** | **=** | **Accounts Payable** | **+** | **Amber**  **Wilson, Capital** | **-** | **Amber**  **Wilson, Withdrawals** | **+** | **Canoe Rental Revenue** | **-** | **Rent Expense** | **-** | **Salaries Expense** | **-** | **Utilities Expense** | **-** | **Telephone**  **Expense** |
|  | 1 | +16,000 |  |  |  |  |  |  |  |  |  | +16,000 |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 2 | –1,200 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | -1,200 |  |  |  |  |  |  |
| Bal. |  | $14,800 |  |  |  |  |  |  | = |  | + | $16,000 |  |  |  |  | - | 1,200 |  |  |  |  |  |  |
|  | 3 |  |  |  |  |  |  | +4,800 |  | +4,800 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Bal. |  | $14,800 |  |  |  |  | + | $4,800 | = | $4,800 | + | $16,000 |  |  |  |  | - | 1,200 |  |  |  |  |  |  |
|  | 4 |  |  |  |  | +750 |  |  |  | +750 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Bal. |  | $14,800 |  |  |  | $750 | + | $4,800 | = | $5,550 | + | $16,000 |  |  |  |  | - | 1,200 |  |  |  |  |  |  |
|  | 7 | +1,400 |  |  |  |  |  |  |  |  |  |  |  |  |  | +1,400 |  |  |  |  |  |  |  |  |
| Bal. |  | $16,200 |  |  | + | $750 | + | $4,800 | = | $5,550 | + | $16,000 |  |  | + | 1,400 | - | 1,200 |  |  |  |  |  |  |
|  | 13 | –1,500 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | -1,500 |  |  |  |  |
| Bal. |  | $14,700 |  |  | + | $750 | + | $4,800 | = | $5,550 | + | $16,000 |  |  | + | 1,400 | - | 1,200 | - | 1,500 |  |  |  |  |
|  | 15 | –50 |  |  |  |  |  |  |  |  |  |  |  | -50 |  |  |  |  |  |  |  |  |  |  |
| Bal. |  | $14,650 |  |  | + | $750 | + | $4,800 | = | $5,550 | + | $16,000 | - | 50 | + | 1,400 | - | 1,200 | - | 1,500 |  |  |  |  |
|  | 16 |  |  |  |  |  |  |  |  | +150 |  |  |  |  |  |  |  |  |  |  |  | -150 |  |  |
| Bal. |  | $14,650 |  |  | + | $750 | + | $4,800 | = | $5,700 | + | $16,000 | - | 50 | + | 1,400 | - | 1,200 | - | 1,500 | - | 150 |  |  |
|  | 20 |  |  |  |  |  |  |  |  | +175 |  |  |  |  |  |  |  |  |  |  |  |  |  | -175 |
| Bal. |  | $14,650 |  |  | + | $750 | + | $4,800 | = | $5,875 | + | $16,000 | - | 50 | + | 1,400 | - | 1,200 | - | 1,500 | - | 150 | - | 175 |
|  | 22 |  |  | +3,000 |  |  |  |  |  |  |  |  |  |  |  | +3,000 |  |  |  |  |  |  |  |  |
| Bal. |  | $14,650 | + | $3,000 | + | $750 | + | $4,800 | = | $5,875 | + | $16,000 | - | 50 | + | 4,400 | - | 1,200 | - | 1,500 | - | 150 | - | 175 |
|  | 26 | –1,000 |  |  |  |  |  |  |  | –1,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Bal. |  | $13,650 | + | $3,000 | + | $750 | + | $4,800 | = | $4,875 | + | $16,000 | - | 50 | + | 4,400 | - | 1,200 | - | 1,500 | - | 150 | - | 175 |
|  | 28 | +750 |  | –750 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Bal. |  | $14,400 | + | $2,250 | + | $750 | + | $4,800 | = | $4,875 | + | $16,000 | - | 50 | + | 4,400 | - | 1,200 | - | 1,500 | - | 150 | - | 175 |
|  | 30 | –100 |  |  |  |  |  |  |  |  |  |  |  | -100 |  |  |  |  |  |  |  |  |  |  |
| Bal. |  | $14,300 | + | $2,250 | + | $750 | + | $4,800 | = | $4,875 | + | $16,000 | - | 150 | + | 4,400 | - | 1,200 | - | 1,500 | - | 150 | - | 175 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

(continued) **E1-18**

*Req. 2*

|  |  |  |
| --- | --- | --- |
| **CANYON CANOE COMPANY** | | |
| Income Statement | | |
| For the Month Ended November 30, 2020 | | |
| **Revenue** |  |  |
| Canoe rental revenue |  | $4,400 |
| **Expenses** |  |  |
| Rent expense | $1,200 |  |
| Salaries expense | 1,500 |  |
| Utilities expense | 150 |  |
| Telephone expense | 175 |  |
| Total expenses |  | 3,025 |
| Net income |  | $1,375 |

*Req. 3*

|  |  |
| --- | --- |
| **CANYON CANOE COMPANY** | |
| Statement of Owner’s Equity | |
| For the Month Ended November 30, 2020 | |
| Amber Wilson, capital, November 1, 2020 | $ 0 |
| Add: Investment by owner | 16,000 |
| Net income for the month | 1,375 |
|  | 17,375 |
| Less: Withdrawals by owner | 150 |
| Amber Wilson, capital, November 30, 2020 | $17,225 |
|  |  |

*Req. 4*

|  |  |  |  |
| --- | --- | --- | --- |
| **CANYON CANOE COMPANY** | | | |
| Balance Sheet | | | |
| November 30, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $14,300 | Accounts payable | $ 4,875 |
| Accounts receivable | 2,250 |  |  |
| Office supplies | 750 | **Owner’s Equity** |  |
| Canoes | 4,800 | Amber Wilson, capital | 17,225 |
| Total assets | $22,100 | Total liabilities and owner’s equity | $22,100 |

Challenge Exercises

Computed amounts are shown in boxes. (30-40 min.) **E1-19**

Fraser Co. Delta Co. Pine Co.

**Beginning**

Assets $350,000 $300,000 $540,000

– Liabilities (200,000)  (120,000) (360,000)

= Owner’s equity $150,000 $180,000 $180,000

**Ending**

Assets $500,000 $360,000 $715,0005

– Liabilities (250,000)  (160,000) (480,000)

= Owner’s equity $250,000 $200,000 $235,000

**Income Statement**

Revenues $660,000 $350,000 $900,000

– Expenses   460,000   180,0003   675,000

= Net income $200,000 $170,000 $225,000

**Statement of Owner’s Equity**

Beginning owner’s equity $150,000 $180,000 $180,000

+ Investments by owner 150,0001 0 50,000

+ Net income 200,000 170,0002 225,000

– Withdrawals by owner (250,000)  (150,000) (220,000)

= Ending owner’s equity $250,000 $200,000 $235,0004

1 $150,000 + Investments (Y) + $200,000 – $250,000= $250,000

Investments = $150,000

2 Net income (X) = $170,000 (180,000 + 0 + NI – 150,000 = 200,000)

3 Revenues – Expenses = Net Income

$350,000 – Expenses = $170,000

Expenses = $180,000

4 Owner’s Equity = Beginning Equity + Investments + Net Income – Withdrawals

Owner’s Equity = $180,000 + $50,000 + $225,000 – $220,000

Owner’s Equity = $235,000

5 Assets – Liabilities = OE

Assets – $480,000 = $235,000

Assets = $715,000

*(15–20 min.)* **E1-20**

*Req. 1*

**January 1, 2020** **December 31, 2020**

# Total assets $300,000 $410,000

Total liabilities 260,000 340,000

Total owner’s equity $ 40,000 $ 70,000

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Beginning owner’s equity | **+** | Investment | **+** | Net Income or  Net Loss | – | Withdrawals | = | Ending  owner’s equity |
| – |
| $40,000 | **+** | $50,000 | **+** | X | – | $30,000 | = | $70,000 |

X = $10,000

*Req. 2*

|  |  |
| --- | --- |
| **STAR ESPORTS** | |
| Statement of Owner’s Equity | |
| For the Year Ended December 31, 2020 | |
| Duncan Shields, capital, January 1, 2020 | $ 40,000 |
| Add: Investment by owner | 50,000 |
| Net income | 10,000 |
|  | 100,000 |
| Less: Withdrawal by owner | (30,000) |
| Duncan Shields, capital, December 31, 2020 | $ 70,000 |

Beyond the Numbers

(15-30 min.) **BN1-1**

TO: Bank loan committee

SUBJECT: Vernon Engineering Co. loan recommendation

I recommend NOT lending $150,000 to Vernon Engineering Co. because

1. Net income has decreased slightly for the past two years.

2. Total assets have increased from $375,000 to $450,000; however, total liabilities have increased as well.

3. Withdrawals have exceeded net income for two of the past three years. As a result, owner’s equity has decreased from $230,000 to $205,000 in the past year.

4. A $150,000 loan to Vernon Engineering Co. would result in liabilities far exceeding owner’s equity.

It would be unlikely that Vernon Engineering Co. could repay the loan.

*Instructional Note:* Student responses may vary. Faculty may wish to discuss some ethical concerns: Unless these financial statements have been audited, which is unlikely, there’s no guarantee that the numbers presented to us are correct and not inflated. Note that the owner would have some incentive to inflate the numbers to make it appear as though the business was in better financial position than they are in reality in order to help secure our loan.

Ethical Issue EI1-1

1. The fundamental ethical issue in this situation is letting the financial statements tell the truth about the company’s performance for the past year. Performance was bad, and the financial statements should present the poor performance of the company.

2. The proposal to transfer personal assets *temporarily* to the company violates the spirit, if not the letter, of the *economic* *entity assumption*. The president implies that these assets can be transferred back to her at will, and the “investment” appears designed to make the company’s financial position appear better than it is. This is dishonest and unethical.

The request to “shave expenses” violates the *reliability characteristic*. The president wants the accountant to understate expenses in order to convert a loss into a reported income. This will make the financial statements inaccurate. This is dishonest and unethical.

Problems

Group A

(20-30 min.) **P1-1A**

Tanner Kerekes, Lawyer

**May 1:** Economic entity assumption: Tanner Kerekes is transferring personal funds of $30,000 into his law practice.

**May 3:** Reliability characteristic: The work should be recorded at $5,000, not at the “normal” amount, as the amount actually charged is the only objective evidence of what the work was worth.

**May 5:** Going concern assumption: The business expects to remain in operation long enough to use existing resources. The company must record this transaction as an asset, since it will provide future benefits, not as an expense, which is what Melrose wants to do.

**May 10:** Cost principle of measurement: This event should not be recorded as a transaction since no “cost” was paid or received with the signing of the lease. This event does not meet the definition of a transaction.

**May 18:** Economic entity assumption: The loan should not be recorded by the company as it is a personal liability of Kerekes. However, the transfer of the money from Kerekes to the company must be recorded by the company.

**May 25:** Economic entity assumption: This transaction should not be recorded by the company, as it is a personal transaction.

**May 28:** Economic entity assumption: This withdrawal relates to the business and should be treated as a reduction in Owner’s Equity. The payment of a portion of the loan is related to a personal liability of Kerekes and therefore should not be recorded by the company.

**May 31:** Reliability characteristic: The computer equipment should be recorded at $10,000 since the only objective evidence of its value is the $10,000 of legal work completed.

Req. 1 (10-15 min.) **P1-2A**

Classification of Transactions

Jul. 4 c 11 c

5 a 12 b

5 a 29 a

6 a 31 a

7 a

10 c

Req. 2 (continued) **P1-2A**

Jon Conlin, CPA

Analysis of Transactions

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Assets = Liabilities + Owner’s Equity** | | | | | | | | | | | |
|  | |  | **Accounts Office Accounts J. Conlin, J. Conlin, Service Rent**  **Cash + Receivable + Supplies + Furniture = Payable + Capital - Withdrawal + Revenue - Expense** | | | | | | | | |
| **Date** | | |
| Jul. | 4\* | |  |  |  |  |  |  |  |  |  |
|  | 5 | | 50,000 |  |  |  |  | 50,000 |  |  |  |
|  | 5 | | (3,000) |  |  |  |  |  |  |  | 3,000 |
| Bal. |  | | 47,000 |  |  |  |  | 50,000 |  |  | 3,000 |
|  | 6 | | (1,000) |  | 1,000 |  |  |  |  |  |  |
| Bal. |  | | 46,000 |  | 1,000 |  |  | 50,000 |  |  | 3,000 |
|  | 7 | |  |  |  | 7,000 | 7,000 |  |  |  |  |
| Bal. |  | | 46,000 |  | 1,000 | 7,000 | 7,000 | 50,000 |  |  | 3.000 |
|  | 10\* | |  |  |  |  |  |  |  |  |  |
|  | 11\* | |  |  |  |  |  |  |  |  |  |
|  | 12\* | |  |  |  |  |  |  |  |  |  |
|  | 29 | |  | 10,000 |  |  |  |  |  | 10,000 |  |
| Bal. |  | | 46,000 | 10,000 | 1,000 | 7,000 | 7,000 | 50,000 |  | 10,000 | 3,000 |
|  | 31 | | (3,000) |  |  |  |  |  | 3,000 |  |  |
| Bal. |  | | 43,000 | 10,000 | 1,000 | 7,000 | 7,000 | 50,000 | 3,000 | 10,000 | 3,000 |

61,000 61,000

\*Not a transaction of the business.

Req. 1 (25-35 min.) **P1-3A**

Jamate Company

Date Type of Transaction

Jun. 22 Investment of $7,000 by owner

Increase Cash, $7,000

Increase Owner’s Equity, $7,000

23 Cash purchase of equipment, $10,000

Decrease Cash, $10,000

Increase Equipment, $10,000

24 Purchase of supplies on account, $4,000

Increase Office Supplies, $4,000

Increase Accounts Payable, $4,000

25 Payment of $4,000 cash on accounts payable

Decrease Accounts Payable, $4,000

Decrease Cash, $4,000

26 Collection of $3,000 cash from customer on accounts receivable

Increase Cash, $3,000

Decrease Accounts Receivable, $3,000

27 Investment of $7,000 cash by owner

Increase Cash, $7,000

Increase Owner’s Equity, $7,000

28 Payment of $5,000 cash on accounts payable

Decrease Accounts Payable, $5,000

Decrease Cash, $5,000

29 Cash purchase of office supplies, $3,000

Decrease Cash, $3,000

Increase Office Supplies, $3,000

30 Owner withdrawal of $10,000

Decrease Cash, $10,000

Decrease Owner’s Equity, $10,000

Req. 1 (20-25 min.) **P1-4A**

Shawn Steele, Realtor

As a proprietorship is considered to be an extension of the individual, it offers no protection from liability exposure. To limit liability, Shawn Steele will have to incorporate his company.

Req. 2

Personal items not reported on the balance sheet of the business:

c. Personal residence ($500,000) and mortgage payable ($250,000)

d. Personal cash ($25,000)

e. Personal account payable ($1,000)

*Req. 3*

|  |  |  |  |
| --- | --- | --- | --- |
| **SHAWN STEELE, REALTOR** | | | |
| Balance Sheet | | | |
| November 30, 2019 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  19,000 | Accounts payable | $ 3,000 |
| Office supplies | 500 | Note payable | 30,000 |
| Furniture | 9,000 | Total liabilities | 33,000 |
| Land | 70,000 |  |  |
| Franchise | 15,000 | **Owner’s Equity** |  |
|  |  | S. Steele, capital | $ 80,500\* |
| Total assets | $113,500 | Total liabilities and owner’s equity | $113,500 |

\* Total assets 113,550

– Total liabilities   (33,000)

= Owner’s equity (capital) $80,500

(45-60 min.) **P1-5A**

Req. 1

|  |  |  |
| --- | --- | --- |
| **CANADIAN GARDENING CONSULTANTS** | | |
| Income Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Revenue** |  |  |
| Service revenue |  | $450,000 |
| **Expenses** |  |  |
| Salaries expense | $240,000 |  |
| Advertising expense | 48,500 |  |
| Interest expense | 15,000 |  |
| Courier expense | 7,000 |  |
| Insurance expense | 4,500 |  |
| Total expenses |  | 315,000 |
| Net income |  | $135,000 |

Req. 2

|  |  |
| --- | --- |
| **CANADIAN GARDENING CONSULTANTS** | |
| Statement of Owner’s Equity | |
| For the Year Ended December 31, 2020 | |
| J. Wu, capital, January 1, 2020 | $300,000 |
| Add: Net income for the year | 135,000 |
|  | 435,000 |
| Less: Owner withdrawals | 103,500 |
| J. Wu, capital, December 31, 2020 | $331,500 |

(continued) **P1-5A**

Req. 3

|  |  |  |  |
| --- | --- | --- | --- |
| **CANADIAN GARDENING CONSULTANTS** | | | |
| Balance Sheet | | | |
| December 31, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  15,000 | Accounts payable | $  57,000 |
| Accounts receivable | 36,000 | Note payable | 195,000 |
| Supplies | 7,500 | Salaries payable | 22,500 |
| Furniture | 45,000 | Total liabilities | 274,500 |
| Building | 300,000 |  |  |
| Computer Equipment | 165,000 | **Owner’s Equity** |  |
| Land | 37,500 | J. Wu, capital | $331,500 |
| Total assets | $606,000 | Total liabilities and owner’s equity | $606,000 |

Req. 4

a. Result of operations: Net income (a profit) of $135,000

b. Owner’s equity increased during the year. This would make it easier to borrow money from a bank in the future.

c. At December 31, 2020:

Total economic resources—total assets $606,000

– Total amount owed—total liabilities (274,500)

= Owner’s equity $331,500

Req. 1 (20-25 min.) **P1-6A**

|  |  |  |  |
| --- | --- | --- | --- |
| **OLIVER SERVICES CO.** | | | |
| Balance Sheet | | | |
| July 31, 2019 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  70,000 | Accounts payable | $ 45,000 |
| Accounts receivable | 75,000 | Note payable | 55,000 |
| Office supplies | 5,000 | Total liabilities | $100,000 |
| Furniture | 50,000 |  |  |
| Land | 130,000 | **Owner’s Equity** |  |
|  |  | J. Oliver, capital | $230,000 |
| Total assets | $330,000 | Total liabilities and owner’s equity | $330,000 |

\* Total assets $ 330,000

– Total liabilities   (100,000)

= Owner’s equity (capital) $ 230,000

Req. 2

The total assets presented in the corrected balance sheet are *less* than those of the original balance sheet. The accounts that are not presented on the corrected balance sheet because they are revenues or expenses, but that are presented on the income statement, are:

Advertising expense

Rent expense

Service revenue

These accounts affect the owner’s equity account balance and not the assets.

Note also that the date line in the balance sheet was changed from a period of time to a point in time.

Req. 1 (45-60 min.) **P1-7A**

Reaney Personnel Services

Analysis of Transactions

22382

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | **Assets** | | | | | | | **=** | **Liabilities** | **+** | **Owner’s equity** | | | | | | | | | |
| **Date** | | **Cash** | **+** | **Accounts Receivable** | **+** | **Office Supplies** | **+** | **Furniture** | **=** | **Accounts Payable** | **+** | **M. Reaney Capital** | **-** | **M. Reaney Withdrawals** | **-** | **Service Revenue** | **-** | **Advert. Expense** | **-** | **Salaries Expense** |
| Bal. |  | 40,000 | 35,000 | |  | | 95,000 | | 55,000 | | 115,000 | |  | |  | |  | |  | |
| Sep. | 3 | 80,000 |  | |  | |  | |  | | 80,000 | |  | |  | |  | |  | |
| Bal. |  | 120,000 | 35,000 | |  | | 95,000 | | 55,000 | | 195,000 | |  | |  | |  | |  | |
| Sep. | 4 | 5,000 |  | |  | |  | |  | |  | |  | | 5,000 | |  | |  | |
| Bal. |  | 125,000 | 35,000 | |  | | 95,000 | | 55,000 | | 195,000 | |  | | 5,000 | |  | |  | |
| Sep. | 9 | (55,000) |  | |  | |  | | (55,000) | |  | |  | |  | |  | |  | |
| Bal. |  | 70,000 | 35,000 | |  | | 95,000 | | 0 | | 195,000 | |  | | 5,000 | |  | |  | |
| Sep. | 15 |  |  | | 6,000 | |  | | 6,000 | |  | |  | |  | |  | |  | |
| Bal. |  | 70,000 | 35,000 | | 6,000 | | 95,000 | | 6,000 | | 195,000 | |  | | 5,000 | |  | |  | |
| Sep. | 18 | 7,500 | (7,500) | |  | |  | |  | |  | |  | |  | |  | |  | |
| Bal. |  | 77,500 | 27,500 | | 6,000 | | 95,000 | | 6,000 | | 195,000 | |  | | 5,000 | |  | |  | |
| Sep. | 19 |  | 48,000 | |  | |  | |  | |  | |  | | 48,000 | |  | |  | |
| Bal. |  | 77,500 | 75,500 | | 6,000 | | 95,000 | | 6,000 | | 195,000 | |  | | 53,000 | |  | |  | |
| Sep. | 22 | (5,000) |  | |  | |  | |  | |  | |  | |  | |  | | 5,000 | |
| Sep. | 22 | (4,000) |  | |  | |  | |  | |  | |  | |  | | 4,000 | |  | |
| Bal. |  | 68,500 | 75,500 | | 6,000 | | 95,000 | | 6,000 | | 195,000 | |  | | 53,000 | | 4,000 | | 5,000 | |
| Sep. | 24 | (1,000) |  | | 1,000 | |  | |  | |  | |  | |  | |  | |  | |
| Bal. |  | 67,500 | 75,500 | | 7,000 | | 95,000 | | 6,000 | | 195,000 | |  | | 53,000 | | 4,000 | | 5,000 | |
| Sep. | 29 | (8,000) |  | |  | |  | |  | |  | | 8,000 | |  | |  | |  | |
| Bal. |  | 59,500 | 75,500 | | 7,000 | | 95,000 | | 6,000 | | 195,000 | | 8,000 | | 53,000 | | 4,000 | | 5,000 | |

237,000 237,000

(continued) **P1-7A**

Req. 2

|  |  |  |
| --- | --- | --- |
| **REANEY PERSONNEL SERVICES** | | |
| Income Statement | | |
| For the Month Ended September 30, 2020 | | |
| **Revenue** |  |  |
| Service revenue\* |  | $53,000 |
| **Expenses** |  |  |
| Salaries expense | $5,000 |  |
| Advertising expense | 4,000 |  |
| Total expenses |  | 9,000 |
| Net income |  | $44,000 |

\* ($5,000 + $48,000)

Req. 3

|  |  |
| --- | --- |
| **REANEY PERSONNEL** **SERVICES** | |
| Statement of Owner’s Equity | |
| For the Month Ended September 30, 2020 | |
| M. Reaney, capital, September 1, 2020 | $115,000 |
| Add: Investment by owner | 80,000 |
| Net income | 44,000 |
|  | 239,000 |
| Less: Owner withdrawal | 8,000 |
| M. Reaney, capital, September 30, 2020 | $231,000 |

Req. 4

|  |  |  |  |
| --- | --- | --- | --- |
| **REANEY PERSONNEL SERVICES** | | | |
| Balance Sheet | | | |
| September 30, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  59,500 | Accounts payable | $    6,000 |
| Accounts receivable | 75,500 |  |  |
| Office supplies | 7,000 | **Owner’s Equity** |  |
| Furniture | 95,000 | M. Reaney, capital | 231,000 |
| Total assets | $237,000 | Total liabilities and owner’s equity | $237,000 |

(40-60 min.) **P1-8A**

Terrace Board Rentals

Req. 1

Total profits for the period of January 1, 2019, to November 30, 2019, is equal to the balance of the owner’s equity on November 30, 2019, minus total investments by Terrace (investments = $50,000 + $20,000). Calculate by subtracting liabilities and investments by Terrace from the total assets:

= $170,000\* – ($12,000 + $40,000 + $70,000)

= $48,000

\* 170,000 = 45,000 + 15,000 + 32,000 + 48,000 + 30,000

Req. 2

See the page following Req. 4.

Req. 3

|  |  |  |
| --- | --- | --- |
| **TERRACE BOARD RENTALS** | | |
| Income Statement | | |
| For the Month Ended December 31, 2019 | | |
| **Revenue** |  |  |
| Rental revenue\* |  | $73,000 |
| **Expenses** |  |  |
| Salaries expense | $10,000 |  |
| Rent expense | 5,000 |  |
| Utilities expense | 4,000 |  |
| Total expenses |  | 19,000 |
| Net income |  | $54,000 |

\* $73,000 = 14,000+21,000+22,000+16,000

Req. 4

|  |  |
| --- | --- |
| **TERRACE BOARD RENTALS** | |
| Statement of Owner’s Equity | |
| For the Month Ended December 31, 2019 | |
| R. Terrace, capital, December 1, 2019 | $118,000 |
| Add: Net income | 54,000 |
|  | 172,000 |
| Less: Withdrawals | 7,000 |
| R. Terrace, capital, December 31, 2019 | $165,000 |

Req. 2 (continued) **P1-8A**

Terrace Board Rentals

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | **Assets** | | | | | | | | | **=** | **Liabilities** | **+** | **Owner’s Equity** | | | | | | | | | | | | | |
| **Date** | | **Cash** | **+** | **Accounts Receivable** | **+** | **Rental Gear** | **+** | **Rental Snowbds** | **+** | **Store Equip.** | **=** | **Accounts Payable** | **+** | | **Note Payable** | **+** | **R. Terrace Capital** | **-** | **R. Terrace Withdraw** | **+** | **Rental Revenue** | **-** | **Rental Expense** | **-** | **Salaries Expense** | **-** | **Utilities Expense** |
|  |  | 45,000 | 15,000 | | 32,000 | | 48,000 | | 30,000 | | 12,000 | | 40,000 | | | 118,000 | |  | |  | |  | |  | |  | |
|  |  |  |  | |  | |  | |  | |  | |  | | |  | |  | |  | |  | |  | |  | |
| Dec | 1 | (5,000) |  | |  | |  | |  | |  | |  | | |  | |  | |  | | 5,000 | |  | |  | |
|  | 4 |  | No transaction recorded | | | | | |  | |  | |  | | |  | |  | |  | |  | |  | |  | |
|  | 6 | 10,500 | 3,500 | |  | |  | |  | |  | |  | | |  | |  | | 14,000 | |  | |  | |  | |
|  | 10 | (12,000) |  | |  | |  | |  | | (12,000) | |  | | |  | |  | |  | |  | |  | |  | |
|  | 12 |  |  | | 20,000 | | 40,000 | |  | | 60,000 | |  | | |  | |  | |  | |  | |  | |  | |
|  | 13 | 21,000 |  | |  | |  | |  | |  | |  | | |  | |  | | 21,000 | |  | |  | |  | |
|  | 15 | 15,000 | (15,000) | |  | |  | |  | |  | |  | | |  | |  | |  | |  | |  | |  | |
|  | 18 | (3,000) |  | |  | |  | | 10,000 | | 7,000 | |  | | |  | |  | |  | |  | |  | |  | |
|  | 20 | 11,000 | 11,000 | |  | |  | |  | |  | |  | | |  | |  | | 22,000 | |  | |  | |  | |
|  | 21 | (7,000) |  | |  | |  | |  | |  | |  | | |  | | -7,000 | |  | |  | |  | |  | |
|  | 24 | (60,000) |  | |  | |  | |  | | (60,000) | |  | | |  | |  | |  | |  | |  | |  | |
|  | 27 | 16,000 |  | |  | |  | |  | |  | |  | | |  | |  | | 16,000 | |  | |  | |  | |
|  | 27 | 3,500 | (3,500) | |  | |  | |  | |  | |  | | |  | |  | |  | |  | |  | |  | |
|  | 31 | (10,000) |  | |  | |  | |  | |  | |  | | |  | |  | |  | |  | | 10,000 | |  | |
|  | 31 | (4,000) |  | |  | |  | |  | |  | |  | | |  | |  | |  | |  | |  | | 4,000 | |
| Bal. |  | $21,000 | 11,000 | | 52,000 | | 88,000 | | 40,000 | | 7,000 | | 40,000 | | | 118,000 | | 7,000 | | 73,000 | | 5,000 | | 10,000 | | 4,000 | |

**TOTAL ASSETS = $212,000 TOTAL LIABILITIES AND OWNER’S EQUITY = $212,000**

(continued) **P1-8A**

Req. 5

|  |  |  |  |
| --- | --- | --- | --- |
| **TERRACE BOARD RENTALS** | | | |
| Balance Sheet | | | |
| December 31, 2019 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  21,000 | Accounts payable | $    7,000 |
| Accounts receivable | 11,000 | Note payable | 40,000 |
| Rental gear | 52,000 |  |  |
| Rental snowboards | 88,000 | **Owner’s Equity** |  |
| Store equipment | 40,000 | R. Terrace, capital | 165,000 |
| Total assets | $212,000 | Total liabilities and owner’s equity | $212,000 |

Req. 6

Ryan is correct in feeling that the business is profitable (profits of $54,000 in December 2019, on top of profits of $48,000 in the first 11 months of the year). The reason he has to keep investing more money and is unable to make withdrawals at this time is due to the growth of the business; the assets have grown by $42,000 since November 30, 2019 ($219,000 – $170,000) with a decrease in liabilities of only $5,000. Ryan will have to continue to invest (and may be unable to make withdrawals) as long as the business continues to grow by an amount in excess of profitability, unless he finances some of the growth through increasing the liabilities.

*Instructional Note:* Student responses may vary.

Problems

Group B

(20-30 min.) **P1-1B**

John Chang Plumbing

**June 1:**

Cost principle of measurement: The equipment should be recorded at its purchase price to John, not at its original cost to his brother or at its replacement cost.

**June 3:**

Reliability characteristic: The work should be recorded at $1,000, not at the “normal” amount, as the amount actually charged is the only objective evidence of what the work was worth.

**June 10:**

Cost principle of measurement: This event should not be recorded as a transaction since no “cost” was paid or received with the signing of the lease. This event does not meet the definition of a transaction.

**June 18:**

Economic entity assumption: The loan should not be recorded by the company as it is a personal liability of John.

**June 28:**

Economic entity assumption: The $7,000 that John paid on the loan is irrelevant to the records of John Chang Plumbing as it is a personal transaction and therefore should not be recorded by the company. The $12,000 withdrawal does relate to the business and should be treated as a reduction of Owner’s Equity.

**June 30:**

Stable monetary unit assumption: John must leave the value of the shop equipment at $30,000. Accountants assume that the dollar’s purchasing power is relatively stable and the stable monetary unit assumption is the basis for ignoring the effects of inflation in the accounting records.

Req. 1 (15-20 min.) **P1-2B**

Classification of Transactions

Jul. 1 c 7 a

2 c 9 a

3 c 23 a

5 a 31 a

5 a

6 b

Req. 2 (continued) **P1-2B**

Horowitz Design

Analysis of Transactions

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | **Assets** | | | | | | | **=** | | **Liabilities** | **+** | **Owner’s Equity** | | | | | | | |
|  |  | **Cash** | **+** | **Accounts Receivable** | **+** | **Supplies** | **+** | **Office Furniture** | | **=** | **Accounts Payable** | **+** | **L. Horowitz Capital** | **-** | **L. Horowitz Withdrawal** | **+** | **Service Revenue** | **-** | **Rent Expense** |
| **Date** | |
| July | 1\* |  |  | |  | |  | | |  | |  | |  | |  | |  | |
|  | 2\* |  |  | |  | |  | | |  | |  | |  | |  | |  | |
|  | 3\* |  |  | |  | |  | | |  | |  | |  | |  | |  | |
|  | 5 | 80,000 |  | |  | |  | | |  | | 80,000 | |  | |  | |  | |
|  | 5 | (4,000) |  | |  | |  | | |  | |  | |  | |  | | 4,000 | |
| Bal. |  | 76,000 |  | |  | |  | | |  | | 80,000 | |  | |  | | 4,000 | |
|  | 6\* |  |  | |  | |  | | |  | |  | |  | |  | |  | |
| Bal. |  | 76,000 |  | |  | |  | | |  | | 80,000 | |  | |  | | 4,000 | |
|  | 7 | (3,000) |  | | 3,000 | |  | | |  | |  | |  | |  | |  | |
| Bal. |  | 73,000 |  | | 3,000 | |  | | |  | | 80,000 | |  | |  | | 4,000 | |
|  | 9 |  |  | |  | | 10,000 | | | 10,000 | |  | |  | |  | |  | |
| Bal. |  | 73,000 |  | | 3,000 | | 10,000 | | | 10,000 | | 80,000 | |  | |  | | 4,000 | |
|  | 23 |  | 12,000 | |  | |  | | |  | |  | |  | | 12,000 | |  | |
| Bal. |  | 73,000 | 12,000 | | 3,000 | | 10,000 | | | 10,000 | | 80,000 | |  | | 12,000 | | 4,000 | |
|  | 31 | (5,000) |  | |  | |  | | |  | |  | | 5,000 | |  | |  | |
|  |  | 68,000 | 12,000 | | 3,000 | | 10,000 | | | 10,000 | | 80,000 | | 5,000 | | 12,000 | | 4,000 | |

93,000 93,000

\*Not a business transaction

Req. 1 (25-35 min.) **P1-3B**

Home 4 Yu

Date Type of Transaction

Nov. 17 Collection of $1,000 cash from customer on account receivable

Increase Cash, $1,000

Decrease Accounts Receivable, $1,000

18 Payment of $1,000 cash on accounts payable

Decrease Cash, $1,000

Decrease Accounts Payable, $1,000

19 Purchase of office supplies on account, $500

Increase Office Supplies, $500

Increase Accounts Payable, $500

20 Investment of $2,000 by owner

Increase Cash, $2,000

Increase Owner’s Equity (Capital), $2,000

23 Payment of $1,000 cash on accounts payable

Decrease Cash, $1,000

Decrease Accounts Payable, $1,000

24 Cash sale of furniture, $2,000

Increase Cash, $2,000

Decrease Furniture, $2,000

25 Cash purchase of office supplies, $500

Decrease Cash, $500

Increase Office Supplies, $500

26 Withdrawal of cash by owner, $1,000

Decrease Cash, $1,000

Decrease Owner’s Equity (Capital), $1,000

Req. 1 (20-25 min.) **P1-4B**

As a proprietorship is considered to be an extension of the individual, it offers no protection from liability exposure. To limit her liability, Lupita will have to incorporate her company.

Req. 2

Personal items not reported on the balance sheet of the business:

a. Personal cash ($10,000)

e. Personal residence ($320,000) and mortgage payable ($185,000)

f. Personal account payable ($2,500)

*Req. 3*

|  |  |  |  |
| --- | --- | --- | --- |
| **LUPITA GOODWIN REALTY** | | | |
| Balance Sheet | | | |
| March 31, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  90,000 | Accounts payable | $  14,000 |
| Office supplies | 6,000 | Note payable | 160,000 |
| Furniture | 18,000 | Total liabilities | 174,000 |
| Building | 195,000 |  |  |
| Franchise | 25,000 | **Owner’s Equity** |  |
|  |  | L. Goodwin, capital | $160,000\* |
| Total assets | $334,000 | Total liabilities and owner’s equity | $334,000 |

\* Total assets $334,000

– Total liabilities  (174,000)

= Owner’s equity (capital) $160,000

(40-60 min.) **P1-5B**

Req. 1

|  |  |  |
| --- | --- | --- |
| **HARADA OFFICE CLEANING** | | |
| Income Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Revenue** |  |  |
| Service revenue |  | $650,000 |
| **Expenses** |  |  |
| Salaries expense | $280,000 |  |
| Repairs expense | 30,000 |  |
| Utilities expense | 25,000 |  |
| Interest expense | 14,000 |  |
| Property tax expense | 10,000 |  |
| Total expenses |  | 359,000 |
| Net income |  | $291,000 |

Req. 2

|  |  |
| --- | --- |
| **HARADA OFFICE CLEANING** | |
| Statement of Owner’s Equity | |
| For the Year Ended December 31, 2020 | |
| Y. Harada, capital, January 1, 2020 | $200,000 |
| Add: Net income | 291,000 |
|  | 491,000 |
| Less: Withdrawals by owner | 71,000 |
| Y. Harada, capital, December 31, 2020 | $420,000 |

(continued) **P1-5B**

Req. 3

|  |  |  |  |
| --- | --- | --- | --- |
| **HARADA OFFICE CLEANING** | | | |
| Balance Sheet | | | |
| December 31, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  25,000 | Accounts payable | $  40,000 |
| Accounts receivable | 50,000 | Interest payable | 3,000 |
| Supplies | 10,000 | Note payable | 200,000 |
| Furniture | 18,000 | Total liabilities | 243,000 |
| Equipment | 110,000 |  |  |
| Building | 350,000 | **Owner’s Equity** |  |
| Land | 100,000 | Y. Harada, capital | $420,000 |
| Total assets | $663,000 | Total liabilities and owner’s equity | $663,000 |

Req. 4

a. Result of operations: Net income of $291,000, which is a profit.

b. Owner’s equity increased during the year. This would make it easier to borrow money from a bank in the future.

c. At December 31:

Total economic resources—total assets $ 663,000

– Total amount owed—total liabilities   (243,000)

= Owner’s equity $ 420,000

Req. 1 (20-25 min.) **P1-6B**

|  |  |  |  |
| --- | --- | --- | --- |
| **McBRIDE INSURANCE AGENCY** | | | |
| Balance Sheet | | | |
| October 31, 2019 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $24,000 | Accounts payable | $23,000 |
| Accounts receivable | 22,000 | Note payable | 40,000 |
| Prepaid rent | 24,000 | Total liabilities | 63,000 |
| Furniture | 20,000 |  |  |
|  |  | **Owner’s Equity** |  |
|  |  | C. McBride, capital | $27,000\* |
| Total assets | $90,000 | Total liabilities and owner’s equity | $90,000 |

\* Total assets $90,000

– Total liabilities  (63,000)

= Owner’s equity (capital) $27,000

Req. 2

The accounts that are not presented on the balance sheet because they are revenue and expenses, but that are presented on the income statement, are

Insurance expense

Rent expense

Salaries expense

Utilities expense

Premium revenue

These amounts affect the owner’s equity balance and not the total assets.

Note also that the date line in the balance sheet was changed from a period of time to a point in time.

Req. 1 (45-60 min.) **P1-7B**

Sykes Design Studio

Analysis of Transactions

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | **Assets** | | | | | | | **=** | **Liabilities** | **+** | **Owner’s Equity** | | | | | | | | |
| **Date** | | **Cash** | **+** | **Accounts Receivable** | **+** | **Supplies** | **+** | **Land** | **=** | **Accounts Payable** | **+** | **M. Sykes Capital** | **-** | **M. Sykes Withdr.** | **+** | **Service Revenue** | **-** | **Advert. Expense** | **-** | **Salaries Expense** |
| Bal. |  | 27,000 | 26,000 | |  | | 102,000 | | 33,000 | | 122,000 | |  | |  | |  | |  | |
| May. | 4 | 20,000 |  | |  | |  | |  | | 20,000 | |  | |  | |  | |  | |
| Bal. |  | 47,000 | 26,000 | |  | | 102,000 | | 33,000 | | 142,000 | |  | |  | |  | |  | |
| May | 6 | (33,000) |  | |  | |  | | (33,000) | |  | |  | |  | |  | |  | |
| Bal. |  | 14,000 | 26,000 | |  | | 102,000 | | 0 | | 142,000 | |  | |  | |  | |  | |
| May | 9 | 5,000 |  | |  | |  | |  | |  | |  | | 5,000 | |  | |  | |
| Bal. |  | 19,000 | 26,000 | |  | | 102,000 | | 0 | | 142,000 | |  | | 5,000 | |  | |  | |
| May | 10 | 4,000 | (4,000) | |  | |  | |  | |  | |  | |  | |  | |  | |
| Bal. |  | 23,000 | 22,000 | |  | | 102,000 | | 0 | | 142,000 | | 149,1490 | | 5,000 | |  | |  | |
| May | 12 |  |  | | 3,000 | |  | | 3,000 | |  | |  | |  | |  | |  | |
| Bal. |  | 23,000 | 22,000 | | 3,000 | | 102,000 | | 3,000 | | 142,000 | |  | | 5,000 | |  | |  | |
| May | 13 |  | 16,000 | |  | |  | |  | |  | |  | | 16,000 | |  | |  | |
| Bal. |  | 23,000 | 38,000 | | 3,000 | | 102,000 | | 3,000 | | 142,000 | |  | | 21,000 | |  | |  | |
| May | 19 | (6,000) |  | |  | |  | |  | |  | |  | |  | |  | | 6,000 | |
| May | 19 | (4,000) |  | |  | |  | |  | |  | |  | |  | | 4,000 | |  | |
| Bal. |  | 13,000 | 38,000 | | 3,000 | | 102,000 | | 3,000 | | 142,000 | |  | | 21,000 | | 4,000 | | 6,000 | |
| May | 24 | 1,000 |  | | (1,000) | |  | |  | |  | |  | |  | |  | |  | |
| Bal. |  | 14,000 | 38,000 | | 2,000 | | 102,000 | | 3,000 | | 142,000 | |  | | 21,000 | | 4,000 | | 6,000 | |
| May | 26 | (7,000) |  | |  | |  | |  | |  | | 7,000 | |  | |  | |  | |
| Bal. |  | 7,000 | 38,000 | | 2,000 | | 102,000 | | 3,000 | | 142,000 | | 7,000 | | 21,000 | | 4,000 | | 6,000 | |

149,000 149,000

(continued) **P1-7B**

Req. 2

|  |  |  |
| --- | --- | --- |
| **SYKES DESIGN STUDIO** | | |
| Income Statement | | |
| For the Month Ended May 31, 2020 | | |
| **Revenue** |  |  |
| Service revenue\* |  | $21,000 |
| **Expenses** |  |  |
| Salaries expense | $6,000 |  |
| Advertising expense | 4,000 |  |
| Total expenses |  | 10,000 |
| Net income |  | $11,000 |

\* ($5,000 + $16,000)

Req. 3

|  |  |
| --- | --- |
| **SYKES DESIGN STUDIO** | |
| Statement of Owner’s Equity | |
| For the Month Ended May 31, 2020 | |
| M. Sykes, capital, May 1, 2020 | $122,000 |
| Add: Investment by owner | 20,000 |
| Net income | 11,000 |
|  | 153,000 |
| Less: Owner withdrawal | 7,000 |
| M. Sykes, capital, May 31, 2020 | $146,000 |

Req. 4

|  |  |  |  |
| --- | --- | --- | --- |
| **SYKES DESIGN STUDIO** | | | |
| Balance Sheet | | | |
| May 31, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $ 7,000 | Accounts payable | $   3,000 |
| Accounts receivable | 38,000 |  |  |
| Supplies | 2,000 | **Owner’s Equity** |  |
| Land | 102,000 | M. Sykes, capital | 146,000 |
|  |  | Total liabilities and owner’s equity | $149,000 |
| Total assets | $149,000 |

(40-60 min.) **P1-8B**

Wilson Marketing Consulting

Req. 1

Total net income for the period of January 1, 2019, to December 31, 2019, is equal to the balance of the owner’s equity minus investments by Wilson ($50,000 + $30,000). This is calculated by subtracting the liabilities and investments by Wilson from the total assets:

= $123,000\* – ($18,000 + $80,000)

= $25,000

\* 123,000 = 25,000 + 30,000 + 21,000 + 15,000 + 32,000

This could also be calculated by subtracting the investments by Wilson from the owner’s equity:

= $105,000 – $80,000\*

= $25,000

\* 80,000 = 50,000 + 30,000

Req. 2

See the page following Req. 3.

Req. 3

|  |  |  |
| --- | --- | --- |
| **WILSON MARKETING CONSULTING** | | |
| Income Statement | | |
| For the Month Ended January 31, 2020 | | |
| **Revenue** |  |  |
| Service revenue\* |  | $43,000 |
| **Expenses** |  |  |
| Salaries expense | $10,000 |  |
| Rent expense | 4,000 |  |
| Delivery expense | 1,000 |  |
| Utility expense | 1,000 |  |
| Total expenses |  | 16,000 |
| Net income |  | $27,000 |

\* ($31,000 + $12,000)

Rest of statements shown after the next page.

(continued) **P1-8B**

*Req. 2*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Wilson Marketing Consulting | | | | | | | | | | | | | | | | | | | | | | | | | | |
|  | | **Assets** | | | | | | | | | **=** | **Liabilities** | **+** | **Owner’s Equity** | | | | | | | | | | | | |
| **Date** | | **Cash** | **+** | **Accounts Receivable** | **+** | **Office Software** | **+** | **Furniture** | **+** | **Computer Equip.** | **=** | **Accounts Payable** | **+** | **Lin Wilson Capital** | **-** | **Lin Wilson Withdraw.** | **+** | **Service Revenue** | **-** | **Delivery Expense** | **-** | **Rent Expense** | **-** | **Salaries Expense** | **-** | **Utilities Expense** |
|  |  | 25,000 | 30,000 | | 21,000 | | 15,000 | | 32,000 | | 18,000 | | 105,000 | |  | |  | |  | |  | |  | |  | |
| Jan. | 2 | 20,000 |  | |  | |  | |  | |  | | + 20,000 | |  | |  | |  | |  | |  | |  | |
|  | 2 | (4,000) |  | |  | |  | |  | |  | |  | |  | |  | |  | | 4,000 | |  | |  | |
|  | 4 | No transaction recorded yet. | | | | | | | | | | | | | | | | | | | | | | | | |
|  | 6 | 10,000 | 21,000 | |  | |  | |  | |  | |  | |  | | 31,000 | |  | |  | |  | |  | |
|  | 10 | (1,000) |  | |  | |  | |  | |  | |  | |  | |  | | 1,000 | |  | |  | |  | |
|  | 12 | No transaction recorded | | | | | | | | | | | | | | | | | | | | | | | | |
|  | 14 | (3,000) |  | | 5,000 | |  | |  | | 2,000 | |  | |  | |  | |  | |  | |  | |  | |
|  | 15 | 7,000 | (7,000) | |  | |  | |  | |  | |  | |  | |  | |  | |  | |  | |  | |
|  | 18 | (4,000) |  | |  | |  | | 10,000 | | 6,000 | |  | |  | |  | |  | |  | |  | |  | |
|  | 23 |  | 12,000 | |  | |  | |  | |  | |  | |  | | 12,000 | |  | |  | |  | |  | |
|  | 29 | (2,000) |  | |  | |  | |  | | (2,000) | |  | |  | |  | |  | |  | |  | |  | |
|  | 31 | (10,000) |  | |  | |  | |  | |  | |  | |  | |  | |  | |  | | 10,000 | |  | |
|  | 31 | (1,000) |  | |  | |  | |  | |  | |  | |  | |  | |  | |  | |  | | 1,000 | |
|  | 31 | (5,000) |  | |  | |  | |  | |  | |  | | 5,000 | |  | |  | |  | |  | |  | |
| Bal. |  | $32,000 | $56,000 | | $26,000 | | $15,000 | | $42,000 | | $24,000 | | $147,000 | | 5,000 | | 43,000 | | 1,000 | | 4,000 | | 10,000 | | 1,000 | |

**TOTAL ASSETS = $171,000 TOTAL LIABILITIES AND OWNER’S EQUITY = $171,000**

(continued) **P1-8B**

Req. 4

|  |  |
| --- | --- |
| **WILSON MARKETING CONSULTING** | |
| Statement of Owner’s Equity | |
| For the Month Ended January 31, 2020 | |
| L. Wilson, capital, January 1, 2020 | $105,000 |
| Add: Investment by owner | 20,000 |
| Net income | 27,000 |
|  | 152,000 |
| Less: Withdrawals | 5,000 |
| L. Wilson, capital, January 31, 2020 | $147,000 |

Req. 5

|  |  |  |  |
| --- | --- | --- | --- |
| **WILSON MARKETING CONSULTING** | | | |
| Balance Sheet | | | |
| January 31, 2020 | | | |
| **Assets** |  | **Liabilities** |  |
| Cash | $  32,000 | Accounts payable | $  24,000 |
| Accounts receivable | 56,000 |  |  |
| Software | 26,000 |  |  |
| Office furniture | 15,000 | **Owner’s Equity** |  |
| Computer equipment | 42,000 | L. Wilson, capital | 147,000 |
| Total assets | $171,000 | Total liabilities and owner’s equity | $171,000 |

Req. 6

Wilson is correct in feeling that the business is profitable (profits of $27,000 in January 2020 and profits of $25,000 in 2019). The reason she has to keep investing more money and is unable to make large withdrawals at this time is due to the growth of the business; the assets grew by $48,000 in January ($171,000 – $123,000) with an increase in liabilities of only $6,000. Wilson will have to continue to invest (and will be unable to make withdrawals) as long as the business continues to grow by an amount in excess of profitability unless she finances some of the growth through increasing the liabilities.

*Instructional Note:* Student responses may vary.

Challenge Problems

(15-20 min.) **P1-1C**

The student should explain that assets are valued on a going concern basis in the financial statements because the company expects to remain in operation into the foreseeable future. The company, therefore, expects to realize more than the cost value of its inventory (since selling price is set higher than the original cost of the inventory). It also expects it will collect the value of its receivables because customers will want to do future business with the company. Once the company goes out of business, the inventory becomes worth what it can be sold for under distress conditions and customers are not in a hurry to pay the company because the company is about to not exist, which leads to the receivables being sold to a collection agency for less than their face value.

(15-20 min.) **P1-2C**

A commitment (signed contract) is not a transaction. The group does have commitments from 200 families to pay them for the work they will do in the future. No transactions have occurred, so they cannot recognize the commitments as assets. A transaction must have occurred for an asset to be recorded.

The group should make a list of the commitments for the bank to show the bank that they have carefully planned and that they have prospective revenues.

The group should consider asking customers to pay in advance for the lawn-care work. This cash would have improved the balance sheet and reduced the need for a loan. The offsetting entry for this would be unearned revenue, which will be discussed in further detail in Chapter 3.

Decision Problem

(30-40 min.) **DP1-1**

Req. 1

Based solely on these balance sheets, Ryan’s Catering appears to be the better credit risk because Ryan’s has only $213,000 of liabilities compared to $390,000 for Tyler’s Bicycle Centre. Ryan’s owner’s equity is far greater than that of Tyler’s ($510,000 compared to $230,000). Tyler’s is already heavily in debt. You would be better off granting the loan to Ryan’s Catering. You should consider what would happen if the borrower could not pay you back as planned. The two companies have about the same amount of assets to sell for cash if they need to come up with the money to pay you, but Ryan’s has far less debt to pay to others before paying you.

Req. 2

Information required in addition to the balance sheet:

* Income statements for several recent periods to see the two companies’ profitability. Income statement data (especially the amount of net income or net loss) provide an important measure of business success or failure.
* Forecasted income for the future.
* Valuations of the assets of each company. For Tyler’s Bicycle Centre, a report from an assessor should give the current market value of the land and building.
* Statement of what they plan to do with the borrowed money and how they expect to pay it back.
* Credit ratings from an independent credit agency.
* Financial ratios, which will be examined in the coming chapters.

Financial Statement Cases

*(30-40 min.)* **FSC1-1**

All amounts in thousands of Canadian dollars.

*Req. 1*

Accounts receivable at April 1, 2017, was $7,448.

*Req. 2*

April 1, 2017 April 2, 2016

Total assets $608,602 $583,990

*Req. 3*

Assets = Liabilities + Equity

$608,602 = $236,758 + $371,844

*Req. 4*

52-week period ended 53-week period ended

April 1, 2017 April 2, 2016

Revenue $1,019,845 $994,181

There was an increase in revenues (sales).

*Req. 5*

Net earnings $20,918

There was a decrease. For the 53-week period ended April 2, 2016, there was a higher net earnings in the amount of $28,581.

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*(30-40 min.)* **FSC1-2**

All amounts in millions of Canadian dollars.

*Req. 1*

Accounts receivable, $1,471

*Req. 2*

December 31, 2016 December 31, 2015

Total assets $27,729 $26,406

*Req. 3*

Assets = Liabilities + Owners’ Equity

$27,729 = $19,793 + $7,936

*Req. 4*

December 31, 2016 December 31, 2015

Total revenue $12,799 $12,502

There was an increase in revenue during 2016.

*Req. 5*

December 31, 2016 December 31, 2015

Net income $1,236 $ 1,382

There was a decrease of $146 million during 2016. It was a worse year than 2015.