**ANSWERS TO QUESTIONS – CHAPTER 1**

**1. Stakeholders are the parties that use accounting information.**

**Stakeholders with a direct interest include owners, managers, creditors, suppliers, and employees. These individuals are directly affected by what happens to the business.**

**Stakeholders with an indirect interest include financial analysts, brokers, attorneys, government regulators, and news reporters. These individuals use information in the financial reports to advise and influence their clients.**

**Students may give many different answers under the above categories depending on their level of experience in business.**

**All students are direct users of accounting information related to tuition and fees, financial aid, and account balances.**

**2. Accounting provides information that is useful in making decisions by all participants in the market for resource goods and services, both profit-oriented and nonprofit oriented. Because accounting’s role is so important, it is often called the language of business.**

**3. The primary mechanism used to allocate resources in the U.S. is competition for resources in the open market.**

1. **A market is a group of people or organizations that come together for the purpose of exchanging items of value.**

**5. The market for business resources involves three distinct participants: consumers, businesses, and resource owners. See Exhibit 1.1 that illustrates how market trilogy is involved in resource allocation.**

**6. Financial Resource: money**

**Physical Resource: natural resources (i.e. land, forests, mine ore, petroleum, etc.), buildings, machinery and equipment, furniture and fixtures.**

**Labor Resource: includes both intellectual and physical labor; i.e. employees.**

**7. Investors expect a distribution of the business’s profits as a return on their financial investment (capital allocation).**

**Creditors lend financial resources to businesses and receive interest as a return or profit on the loan.**

**8. Financial accounting provides information that is useful to external resource providers.**

**Managerial accounting provides information that is useful to managers in operating an organization (i.e., internal users).**

**9. Not-for-profit or nonprofit entities provide goods or services to consumers for humanitarian or special reasons rather than to earn a profit for owners. For example, certain not-for-profit entities allocate resources to provide for research of diseases or social/environmental welfare; others allocate resources to promote the arts and provide education.**

**10. The U.S. rules of accounting information measurement are called generally accepted accounting principles (GAAP).**

**11. Careers in public accounting consist of providing services to the general public from a public accounting firm. These services include auditing, tax, and consulting services. Careers in private accounting usually consist of working for a specific company (which would be a client of the public accounting firm) providing a wide variety of services to the company including recording transactions, preparing financial statements, internal auditing, and others.**

**12. Items reported on the financial statements are organized into classes or categories called elements. The ten elements of financial statements are:**

**1. Assets**

**2. Liabilities**

**3. Equity (Stockholders’ Equity)**

**4. Investments by Owners (Contributed Capital)**

**5. Revenue**

**6. Expenses**

**7. Distributions (Dividends)**

**8. Net Income**

**9. Gains**

**10. Losses**

**Accounts are specific items or subclassifications of the elements. Examples of accounts include cash, land, and common stock.**

**13. Assets, the economic resources of a business, are used to produce earnings.**

**14. The assets of a business belong to that business entity and there may be claims on the assets. Claims on the assets belong to resource providers.**

**15. Creditors are individuals and/or institutions that have provided goods or services to the business which are not yet paid for, or loaned money to the business. These parties have first claim to the assets of the business, and the investors have a residual interest in the assets.**

**16. The term “liabilities” is used to describe creditors' claims on the assets of a business.**

**17. The accounting equation is:**

**ASSETS – LIABILITIES = STOCKHOLDERS’ EQUITY**

**or**

**ASSETS = LIABILITIES + STOCKHOLDERS’ EQUITY**

**Assets are the economic resources used by a business for the production of revenue. Liabilities are obligations of a business to relinquish assets, provide services, or accept other obligations. Equity, also called “residual interest” or “net assets,” is the portion of the assets remaining after the creditors' claims have been satisfied (i.e., Assets – Liabilities).**

1. **The owners ultimately bear the risk and collect the rewards associated with operating a business.**

**19. The right side of the accounting equation can be viewed as either sources of assets or as obligations and commitments of the business. Assets originating from liabilities can be viewed as sources or obligations of the business. Assets originating from issuing stock or retaining earnings can be viewed as sources of assets and commitments of the business.**

**20. The business could make a distribution of $1,000, but only $800 of it would be classified as a dividend. A distribution can only be a dividend to the extent of retained earnings.**

**21. Capital is acquired from owners by issuing stock to them. When stock is issued, the assets of the business increase and the stockholders’ equity increases.**

**22. Assets that are acquired by issuing common stock are the result of investments by owners. Assets that are acquired by using retained earnings are assets the business acquires through its earnings activities.**

**23. Revenue increases the asset side of the accounting equation and also increases the retained earnings account in the stockholders’ equity section of the equation.**

**24. The three primary sources of assets are (1) investments by owners (issue of stock), (2) borrowing from creditors, and (3) earnings activities.**

**25. Retained earnings are a result of a business retaining its earned assets, rather than distributing those earnings to its owners.**

**26. Distributions to owners, called dividends, decrease the asset side of the accounting equation and also decrease the retained earnings account in the stockholders’ equity section of the equation.**

**27. Dividends and expenses are similar in that they both decrease assets and affect the accounting equation in the same way (i.e. reduction of retained earnings). However, dividends differ from expenses because of the nature of the decline in assets. Expenses reduce assets as the result of a firm's efforts to earn revenue. Dividends reduce assets because of a transfer of wealth to the owners.**

**28. (1) Income Statement - measures the difference between the asset increases and the asset decreases that were associated with operating a business during a particular accounting period.**

1. **Statement of Changes in Stockholders’ Equity - explains the effects of transactions on stockholders’ equity during the accounting period.**

**(3) Balance Sheet - lists the assets and the corresponding claims against the entity as of a particular date.**

**(4) Statement of Cash Flows - explains how a company obtained and used cash during the accounting period.**

**29. The Balance sheet provides information about the enterprise at a particular point in time.**

**30. A net loss is caused when the company’s expenses exceed the amount of revenues generated during a period.**

**31. The matching concept is the practice of pairing revenues and expenses on the income statement.**

**32. (1) Operating activities - explain the cash generated from revenue and the cash paid for expenses.**

1. **Investing activities - include cash received or spent by the business on productive assets used in the business, and investments in debt or equity of other companies.**

**(3) Financing activities - include cash inflows and outflows from the company's transactions with its owners and inflows and outflows from its borrowing activities.**

**33. Asset accounts are arranged on the balance sheet in accordance with their level of liquidity (those that can be most quickly converted to cash are listed first).**

**34. Articulation refers to the interrelationships among the various elements of the financial statements.**

**35. The historical cost concept requires that most assets be reported at the amount paid for them regardless of their increase or decrease in value. It is related to the qualitative characteristic of verifiability in that information can be independently verified. The historical cost is verified, while a change in value is subjective.**

**36. An asset source transaction results in an increase in an asset account and an increase in one of the claims accounts; i.e., investments by owners (equity), borrowing funds from creditors (liabilities), or earnings activities (revenue).**

**An asset use transaction results in a decrease in an asset account and a decrease in either liabilities or equity; i.e., the payment of a liability, the payment of an expense, or a dividend.**

**An asset exchange transaction is a transaction in which one asset is exchanged for another; i.e., purchase of land with cash.**

**A claims exchange transaction will be covered in a later chapter.**

**37. While the contents of annual reports vary from company to company, all annual reports contain:**

**Management’s discussion and analysis (MD&A)**

**Financial statements**

**Notes to the financial statements**

**Auditor’s report**

**38. U.S. GAAP, generally accepted accounting principles in the United States, are the measurement rules established by the (FASB) Financial Accounting Standards Board. The FASB is a privately funded organization with the primary authority for establishing accounting standards in the United States. International Financial Reporting Standards (IFRS) are issued by the International Accounting Standards Board and are an attempt to set a common standard to be used in different countries. IFRS is used by global companies and there is a move underway to merge GAAP and IFRS or to lessen the differences between them.**

**SOLUTIONS TO EXERCISES - SERIES A - CHAPTER 1**

**EXERCISE 1-1A**

**The three participants in the free business market are:**

1. **Resource owners**
2. **Businesses**
3. **Consumers**

**Note to instructor:**

**The memo should discuss the fact that the resource owners are those who own resources that are desired by others, either in the original form or in a converted form. The businesses are the parties that acquire the resource and supply it to consumers either in the original form or in a converted form with value added by the conversion. The consumers are the ultimate users of the resources.**

**It should also include a discussion of the public accountant and the allocation of resources. For example, public accountants audit the annual reports that businesses use to communicate information to investors and creditors (financial resource providers). Based on their findings they may certify or deny that the reports fairly represent the financial condition of the business. In other words, public accountants provide assurance that the information provided by the business is trustworthy. Public accountants usually gain the professional designation of Certified Public Accountant (CPA).**

**EXERCISE 1-2A**

1. **The most common designation held by a public accountant is the CPA license. CPA stands for certified public accountant. CPAs are licensed by the state government (or other jurisdiction). Although the requirements vary from state to state (jurisdiction), CPA candidates normally must have a college degree, pass a demanding technical examination, and obtain relevant work experience.**

**b. Designations that private accountants may hold include the CMA, Certified Management Accountant, and the CIA, Certified Internal Auditor. Both require meeting educational requirements, passing a technical examination and obtaining relevant work experience. These designations are not professional licenses and are not government regulated.**

**EXERCISE 1-3A**

|  |  |
| --- | --- |
| **Entities mentioned:** | **Effect on cash:** |
| **Vicky Hill Recovery Fund** | **Increase for cash contributions, $21,000**  **Decrease for payment of advertising, $1,000 Decrease payment for hospital bills, $12,000 Decrease for donation to National Cyclist Fund, $8,000** |
|  |  |
| **Karen White** | **Decrease by contribution, $1,000** |
|  |  |
| **WKUX** | **Increase for advertising revenue, $1,000** |
|  |  |
| **Public** | **Decrease for contributions, $20,000** |
|  |  |
| **Mercy Hospital** | **Increase for medical care, $12,000** |
|  |  |
| **National Cyclist Fund** | **Increase for donation, $8,000** |

**EXERCISE 1-4A**

**a.**

|  |  |
| --- | --- |
| **Term** | **Definition** |
| **a** | **7** |
| **b** | **3** |
| **c** | **6** |
| **d** | **5** |
| **e** | **4** |
| **f** | **1** |
| **g** | **2** |

**EXERCISE 1-5A**

**a.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  |  |  |  |  | **Stockholders’ Equity** | | |
|  |  |  |  |  | **Common** |  | **Retained** |
| **Company** | **Assets** | **=** | **Liabilities** | **+** | **Stock** | **+** | **Earnings** |
| **A** | ***$123,000*** | **=** | **$25,000** | **+** | **$48,000** | **+** | **$50,000** |
| **B** | **40,000** | **=** | ***3,000*** | **+** | **7,000** | **+** | **30,000** |
| **C** | **75,000** | **=** | **15,000** | **+** | ***18,000*** | **+** | **42,000** |
| **D** | **125,000** | **=** | **45,000** | **+** | **60,000** | **+** | ***20,000*** |
|  |  |  |  |  |  |  |  |

**EXERCISE 1-6A**

**a.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |  |
|  | **Computers** |  | **Accounts Payable** |  | **Operating Expenses** |  |
|  | **Building** |  |  |  | **Gasoline Expense** |  |
|  | **Cash** |  |  |  | **Rent Revenue** |  |
|  | **Land** |  |  |  | **Retained Earnings** |  |
|  | **Trucks** |  |  |  | **Salaries Expense** |  |
|  | **Supplies** |  |  |  | **Common Stock** |  |
|  | **Office Furniture** |  |  |  | **Service Revenue** |  |
|  |  |  |  |  | **Dividends** |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |

**b. No. The type of accounts will vary depending on the type of business. Some businesses will have only one revenue account; other businesses may have more than one type of revenue account. For instance, a business may have both service revenue and interest revenue. Also, the expense accounts that a business has are somewhat dependent on the type and complexity of the business. For instance, if a business owns its own building, it will not have rent expense. If a business does not have employees, it will not have salaries expense. The level of detail desired by the business will also affect the type of revenue and expense accounts that a business will have.**

**EXERCISE 1-7A**

**a.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
| **Cash** | **=** | **Note Payable** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **195,000** | **=** | **90,500** | **+** | **84,500** | **+** | **?** |

**Retained Earnings = $195,000 – $90,500 – $84,500 = $20,000**

**b. & c.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Moss Company**  **Effect of Year 2 Transactions on the Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Event** | **Cash** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **Beginning Balances** | **195,000** |  | **90,500** |  | **84,500** |  | **20,000** |
| **1. Earned Revenue** | **42,000** |  | **NA** |  | **NA** |  | **42,000** |
| **2. Paid expenses** | **(24,000)** |  | **NA** |  | **NA** |  | **(24,000)** |
| **3. Paid dividend** | **(3,000)** |  | **NA** |  | **NA** |  | **(3,000)** |
| **Ending Balance** | **210,000** | **=** | **90,500** | **+** | **84,500** | **+** | **35,000** |
|  |  |  |  |  |  |  |  |

**d.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Cash** | **=** | **Note Payable** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **210,000** | **=** | **90,500** | **+** | **84,500** | **+** | **35,000** |

**Liabilities + Stockholders’ Equity = $90,500 + $84,500 + $35,000 = $210,000**

**Assets = Liabilities + Stockholders’ Equity**

**$210,000 = $210,000**

**EXERCISE 1-7A (cont.)**

**e. The beginning and ending balances in the cash account were $195,000 and $210,000 respectively. The beginning balance in the common stock account was $84,500. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because the accounting events that Moss experienced during the Year 2 accounting period affected the cash account but not the common stock account.EXERCISE 1-8A**

|  |  |
| --- | --- |
| **Event** | **Classification** |
| **1.** | **Asset Source** |
| **2.** | **Asset Use** |
| **3.** | **Asset Use** |
| **4.** | **Asset Source** |
| **5.** | **Asset Exchange** |
| **6.** | **NA** |
| **7.** | **Asset Source** |
| **8.** | **Asset Use** |
| **9.** | **Asset Source** |
| **10.** | **Asset Exchange** |
| **11.** | **Asset Source** |
|  |  |

**EXERCISE 1-9A**

**a. Decrease**

**b. Increase**

**c. Increase**

**d. Decrease**

**e. Asset Exchange**

**f. Asset Exchange**

**EXERCISE 1-10A**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Olive Enterprises**  **Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  |  |  | |  |  | **Stockholders’**  **Equity** | |
| **Event**  **Number** | **Assets** | **=** | **Liabilities** | | **+** | **Common Stock** | **Retained Earnings** |
| **1.** | **I** |  | **NA** | |  | **I** | **NA** |
| **2.** | **D** |  | **D** | |  | **NA** | **NA** |
| **3.** | **I/D** |  | **NA** | |  | **NA** | **NA** |
| **4.** | **I** |  | **NA** | |  | **NA** | **I** |
| **5.** | **D** |  | **NA** | |  | **NA** | **D** |
| **6.** | **D** |  | **NA** | |  | **NA** | **D** |
|  |  |  |  | |  |  |  |

**EXERCISE 1-11A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Better Corp.**  **Accounting Equation for Year 1** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **1. Issued Stk.** |  | **7,000** | **+** | **NA** | **=** | **NA** | **+** | **7,000** | **+** | **NA** | **NA** |
| **2. Loan** |  | **12,000** | **+** | **NA** | **=** | **12,000** | **+** | **NA** | **+** | **NA** | **NA** |
| **3. Provide Svc.** |  | **47,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **47,000** | **Svc. Rev.** |
| **4. Pd Op. Exp.** |  | **(30,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(30,000)** | **Op. Exp.** |
| **5. Paid Div.** |  | **(8,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(8,000)** | **Dividends** |
| **6. Land Purch.** |  | **(20,000)** | **+** | **20,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  |
| **End Bal.** |  | **8,000** | **+** | **20,000** | **=** | **12,000** | **+** | **7,000** | **+** | **9,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

**EXERCISE 1-11A (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **28,000** | **=** | **12,000** | **+** | **16,000** |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Better Corp.**  **Balance Sheet**  **As of December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$8,000** |  |  |
|  | **Land** | **20,000** |  |  |
|  | **Total Assets** |  | **$28,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$12,000** |  |  |
|  | **Total Liabilities** |  | **$12,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$7,000** |  |  |
|  | **Retained Earnings** | **9,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **$16,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$28,000** |  |
|  |  |  |  |  |

**c.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **28,000** | **=** | **12,000** | **+** | **16,000** |

**The ending balances for assets, liabilities, and stockholders’ equity at end of Year 1 will become the beginning balances for these same accounts in Year 2.**

**d. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company’s books.**

**EXERCISE 1-12A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Better Corporation**  **Accounting Equation for Year 2** | | | | | | | | | | | | |
|  | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Bal. 1/1/Year 2** |  | **8,000** |  | **20,000** |  | **12,000** |  | | **7,000** |  | **9,000** |  |
| **1. Pur. Land** |  | **(5,000)** |  | **5,000** |  | **NA** |  | | **NA** |  | **NA** | **NA** |
| **2. Issued stk.** |  | **25,000** |  | **NA** |  | **NA** |  | | **25,000** |  | **NA** | **NA** |
| **3. Provide Svc.** |  | **75,000** |  | **NA** |  | **NA** |  | | **NA** |  | **75,000** | **Svc. Rev.** |
| **4. Paid Exp.** |  | **(42,000)** |  | **NA** |  | **NA** |  | | **NA** |  | **(42,000)** | **Oper. Exp.** |
| **5. Loan** |  | **10,000** |  | **NA** |  | **10,000** |  | | **NA** |  | **NA** | **NA** |
| **6. Paid Div.** |  | **(5,000)** |  | **NA** |  | **NA** |  | | **NA** |  | **(5,000)** | **Dividend** |
| **7. Land Value** |  | **NA** |  | **NA** |  | **NA** |  | | **NA** |  | **NA** | **NA** |
| **End Bal.** |  | **66,000** | **+** | **25,000** | **=** | **22,000** | **+** | | **32,000** | **+** | **37,000** |  |
|  |  |  |  |  |  |  |  | |  |  |  |  |

**EXERCISE 1-12A (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **91,000** | **=** | **22,000** | **+** | **69,000** |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Better Corp.**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$8,000** | **$66,000** |  |
|  | **Land** | **20,000** | **25,000** |  |
|  | **Total Assets** | **$28,000** | **$91,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$12,000** | **$22,000** |  |
|  | **Total Liabilities** | **$12,000** | **$22,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$7,000** | **$32,000** |  |
|  | **Retained Earnings** | **9,000** | **37,000** |  |
|  | **Total Stockholders’ Equity** | **$16,000** | **$69,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$28,000** | **$91,000** |  |
|  |  |  |  |  |

**EXERCISE 1-12A (cont.)**

**c. There is no cash in the notes payable account. Cash is an asset that belongs on the left side of the accounting equation. Notes payable are liabilities that represents an obligation of the Company to distribute assets in the future.**

**d. There is no cash in the common stock account. Cash is an asset that belongs on the left side of the accounting equation. Common stock represents the portion of assets owned by the investors of the Company.**

**e. There is no cash in the retained earnings account. Retained earnings represent earnings that have already been reinvested into the business to support its core functions. There is no physical cash in the retained earnings account. At the end of Year 2, the cash account has a balance of $66,000 while the ending balance in the retained earnings account is $37,000. These balances differ because retained earnings represents the excess of earnings over expenses that were earned during Year 2 while the cash account represents the physical amount of cash on hand at the end of Year 2.**

**f. The balance in the land account at the end of Year 2 is $25,000. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company’s books.**

**EXERCISE 1-13A**

**a.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash** | **+** | **Land** | **=** | **Creditors** | **+** | **Stockholders’**  **Equity** |  |
|  | **$10,000** | **+** | **$ 0** | **=** | **$ 0** | **+** | **$10,000** |  |
|  | **6,000** | **+** | **0** | **=** | **6,000** | **+** | **0** |  |
|  | **(12,000)** | **+** | **12,000** | **=** | **NA** | **+** | **NA** |  |
| **Bal.** | **4,000** | **+** | **12,000** | **=** | **6,000** | **+** | **10,000** |  |
|  |  |  |  |  |  |  |  |  |

**b. Creditor’s Claim ÷ Total Assets = Percent of Total**

**$6,000 ÷ $16,000 = 37.5%**

**c. Investor’s Claim ÷ Total Assets = Percent of Total**

**$10,000 ÷ $16,000 = 62.5%**

**d. There were no transactions involving revenue or expense during Year 1. Accordingly, Jones has no net income or retained earnings at the end of Year 1. Jones is unable to pay a dividend due to not having any retained earnings at the end of Year 1. Since dividends are distributions of assets generated through earnings, the company cannot distribute an amount exceeding retained earnings regardless of whether it has enough cash on hand to pay the dividend.**

**e. The company cannot repay the debt. The company owes the creditors $6,000 but has only $4,000 cash. Note there is no actual money in the stockholders’ equity account. Indeed, there is no cash in any account that appears on the right side of the accounting equation. The right side of the accounting equation represents obligations and commitments of a company to its creditors and stockholders. Indeed, the accounting equation could be written as:**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash** | **+** | **Land** | **=** | **Creditors** | **+** | **Stockholders’**  **Equity** |  |
| **Bal.** | **4,000** | **+** | **12,000** | **=** | **37.5%** | **+** | **62.5%** |  |

**EXERCISE 1-13A (cont.)**

**All assets including any cash balances are shown on the left side of the equation.**

EXERCISE 1-14A

1. **The maximum dividend that Allen Co. could pay based on the information would be $500, the amount of retained earnings. Since dividends are distributions of assets generated through earnings, the company cannot distribute an amount exceeding retained earnings regardless of whether it has enough cash on hand to pay the dividend.**

**b. White Co. is unable to pay a dividend due to having a $0 cash balance. Remember that retained earnings does not contain any cash. Without any cash on hand, the company is unable to pay a dividend.**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **Stockholders’ Equity** | | |  |
|  | **Company** |  | **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  | **Allen** |  | **100%** | **=** | **75%** | **+** | **20%** | **+** | **5%** |  |
|  | **White** |  | **100%** | **=** | **25%** | **+** | **60%** | **+** | **15%** |  |
|  |  |  |  |  |  |  |  |  |  |  |

**c.**

**d. There are three alternative definitions of the right side of the accounting equation. First, the right side could be referred to as sources of assets. Second, it could be defined as claims on assets. Lastly, it could be defined as obligations to creditors and commitments to owners.**

**EXERCISE 1-15A**

**a. The answers are shown in the order in which they were calculated. In other words, item (d) was calculated first, (g) second and so on. There are other possible patterns that would produce correct answers.**

**Begin by filling in all possible blanks on the horizontal rows.**

**(d) Since common stock increased by $68,000, cash had to increase by $68,000.**

**(g) Since cash decreased by $14,000, dividends must have caused retained earnings to decrease by $14,000.**

**(h) Since cash decreased by $50,000, land must have increased by $50,000.**

**Now shift to an analysis of the vertical columns.**

**(i) Given that land had a beginning balance of $90,000 and $50,000 of land was purchased, the ending balance in the land account has to be $140,000.**

**(b) The beginning balance in the notes payable account had to be $50,000 because this amount minus the $10,000 partial pay off of notes payable would result in an ending balance in the notes payable account of $40,000.**

**(c) The $123,000 ending balance in the common stock account minus the $68,000 issued during the period yields $55,000 beginning balance.**

**Now shift back to a horizontal analysis of the rows.**

**(a) Cash (X) + Land = Notes Pay. + Common Stk. + Beg. Ret. Ear.**

**X + $90,000 = $50,000 + $55,000 + $25,000**

**X = -$90,000 + $50,000 + $55,000 + $25,000**

**X = $40,000**

**(j) Cash + Land = Notes Pay. + Common Stk. + End. Ret. Ear. (X)**

**X = Cash + Land – Notes Pay – Common Stk.**

**X = $69,000 + $140,000 - $40,000 - $123,000**

**X = $46,000**

**EXERCISE 1-15A (cont.)**

**(f)**

|  |  |
| --- | --- |
| **Beginning Retained Earnings** | **$25,000** |
| **+ Revenue** | **X** |
| **- Expenses** | **(57,000)** |
| **- Dividends** | **(14,000)** |
| **Ending Retained Earnings** | **$46,000** |

**$25,000 + X – $57,000 – $14,000 = $46,000**

**X = $92,000**

**(e) Given that revenue increased by $92,000 cash must have increased by $92,000.**

**The solution shown in table format is as follows:**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | | |
|  |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg. Bal.** |  | **(a)40,000** | **+** | **90,000** | **=** | **(b)50,000** | **+** | | **(c)55,000** | **+** | **25,000** |  |
| **Event 1** |  | **(d)68,000** | **+** | **NA** | **=** | **NA** | **+** | | **68,000** | **+** | **NA** | **NA** |
| **2.** |  | **(e)92,000** | **+** | **NA** | **=** | **NA** | **+** | | **NA** | **+** | **(f)92,000** | **Revenue** |
| **3.** |  | **(57,000)** | **+** | **NA** | **=** | **NA** | **+** | | **NA** | **+** | **(57,000)** | **Expenses** |
| **4.** |  | **(14,000)** | **+** | **NA** | **=** | **NA** | **+** | | **NA** | **+** | **(g)(14,000)** | **Dividend** |
| **5.** |  | **(50,000)** | **+** | **(h)50,000** | **=** | **NA** | **+** | | **NA** | **+** | **NA** | **NA** |
| **6.** |  | **(10,000)** | **+** | **NA** | **=** | **(10,000)** | **+** | | **NA** | **+** | **NA** | **NA** |
| **End. Bal.** |  | **69,000** | **+** | **(i)140,000** | **=** | **40,000** | **+** | | **123,000** | **+** | **(j)46,000** |  |
|  |  |  |  |  |  |  |  | |  |  |  |  |

**b. There is sufficient cash available to pay off the debt on January 1, Year 8. At that time, the company has cash of $69,000 which is more than enough funds to repay the $40,000 notes payable.**

**EXERCISE 1-15A (cont.)**

**c. The maximum cash dividend payable is limited by the lessor of the balance in the cash account versus the balance in the retained earnings account. In this case, $46,000 is the maximum cash dividend JGGW can pay.**

**EXERCISE 1-16A**

**a. Event #3 and #4 will affect the income statement.**

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Ollie Company**  **Income Statement**  **For the Year Ended December 31, Year 1** | | | |
|  |  |  |  |
|  | **Revenue** | **$59,000** |  |
|  | **Expense** | **(43,000)** |  |
|  | **Net Income** | **$16,000** |  |
|  |  |  |  |

**EXERCISE 1-17A**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Emma, Inc.**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$600** | **$260** |  |
|  | **Total Assets** | **$600** | **$260** |  |
|  |  |  |  |  |
|  | **Total Liabilities** | **$400** | **$400** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$200** | **$200** |  |
|  | **Retained Earnings** | **$0** | **$(340)** |  |
|  | **Total Stockholders’ Equity** | **$200** | **$(140)** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$600** | **$260** |  |
|  |  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **Emma, Inc.**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$560** |  |
|  | **Expense** | **(900)** |  |
|  | **Net Income** | **$(340)** |  |
|  |  |  |  |

**EXERCISE 1-18A**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Ollie Company**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** |  |  |
|  | **Plus: Common Stock Issued** | **72,000** |  |  |
|  | **Ending Common Stock** |  | **$72,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **-0-** |  |  |
|  | **Plus: Net Income** | **$16,000** |  |  |
|  | **Less: Dividends** | **(7,000)** |  |  |
|  | **Ending Retained Earnings** |  | **9,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$81,000** |  |
|  |  |  |  |  |

**EXERCISE 1-19A**

**a.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Majka Company**  **Accounting Equation for Year 1** | | | | | | | |
|  | | | | | | | |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  |  | **Common** |  | **Retained** |
| **Event** | **Cash** | **=** |  | **+** | **Stock** | **+** | **Earnings** |
| **Common Stock** | **$50,000** |  |  |  | **$50,000** |  |  |
| **1. Cash revenues** | **28,600** |  | **NA** |  | **NA** |  | **28,600** |
| **2. Paid expenses** | **(13,200)** |  | **NA** |  | **NA** |  | **(13,200)** |
| **3. Paid dividend** | **(1,500)** |  | **NA** |  | **NA** |  | **(1,500)** |
| **Ending Balance** | **63,900** | **=** | **-0-** | **+** | **50,000** | **+** | **13,900** |
|  |  |  |  |  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Majka Company**  **Income Statement**  **For the Year Ended December 31, Year 1** | | | |
|  |  |  |  |
|  | **Revenue** | **$28,600** |  |
|  | **Expense** | **(13,200)** |  |
|  | **Net Income** | **$ 15,400** |  |
|  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Majka Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 1** | | | | | |
|  |  |  |  |  |
|  | **Common Stock** | **$ 50,000** |  |  |
|  | **Plus: Common Stock Issued** | **0** |  |  |
|  | **Ending Common Stock** |  | **50,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** |  |  |
|  | **Plus: Net Income** | **15,400** |  |  |
|  | **Less: Dividends** | **(1,500)** |  |  |
|  | **Ending Retained Earnings** |  | **13,900** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$63,900** |  |
|  |  |  |  |  |

**EXERCISE 1-19A (cont.)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Majka Company**  **Balance Sheet**  **As of December 31, Year 1** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** |  | **$63,900** |  |
|  |  |  |  |  |
|  | **Liabilities** |  | **$ -0-** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **50,000** |  |  |
|  | **Retained Earnings** | **13,900** |  |  |
|  | **Total Stockholders’ Equity** |  | **63,900** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$63,900** |  |
|  |  |  |  |  |

**c. The income statement is dated with the term “for the year ended” because it covers a one-year span of time. The balance sheet is dated with the term “as of” because it describes information at a specific point in time.**

**EXERCISE 1-20A**

**Steps:**

**1.**

**Common Stock Issued = Change in Common Stock**

**$20,000 (given) = *$20,000***

**2.**

**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**

**$65,000 (given) = $20,000 (1) + *$45,000***

**3.**

**Increase in Ret. Earn. = Net Income − Dividends**

**$45,000 (2) = *$50,000* − $5,000 (given)**

**Alternate Solution:**

**From the Statement of Changes in Stockholders’ Equity we know (with minor modifications):**

|  |  |  |
| --- | --- | --- |
|  |  |  |
| **Beginning Total Stk. Equity, 1/1/Year 2** |  | **$156,000** |
| **(Common Stock + Retained Earnings)** |  |  |
|  |  |  |
| **Plus: Common Stock Issued** | **$20,000** |  |
| **Plus: Net Income** | **?** |  |
| **Less: Dividends** | **(5,000)** |  |
| **Change in Stockholders’ Equity** |  | **65,000** |
|  |  |  |
| **Ending Total Stk. Equity, 12/31/Year 2** |  | **$221,000** |
|  |  |  |

**EXERCISE 1-20A (cont.)**

**Working backwards from the change in equity we can solve for net income:**

|  |  |
| --- | --- |
|  |  |
| **Change in Stockholders’ Equity, Year 2** | **$65,000** |
| **Plus: Dividends** | **5,000** |
| **Less: Common Stock Issued** | **(20,000)** |
| **Net Income, Year 2** | ***$50,000*** |
|  |  |

**EXERCISE 1-21A**

**a.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Moore Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Net Cash Inflow from Operating Activities** |  | **$ 24,800** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Net Cash Outflow from Investing Activities** |  | **(16,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Net Cash Outflow from Financing Activities** |  | **(6,800)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **2,000** |  |
|  | **Plus: Beginning Cash Balance** |  | **45,800** |  |
|  | **Ending Cash Balance** |  | **$47,800** |  |
|  |  |  |  |  |

**b. Cash inflow from selling fast food to customers was greater than cash outflow for expenses.**

**c. The company paid cash to purchase long-term assets.**

**d. The company paid cash dividends or paid off a loan to a bank.EXERCISE 1-22A**

**a.**

|  |  |
| --- | --- |
| **Event** | **Statement of Cash Flow Classification** |
| **1.** | **OA** |
| **2.** | **IA** |
| **3.** | **NA** |
| **4.** | **FA** |
| **5.** | **FA** |
| **6.** | **OA** |
| **7.** | **IA** |
| **8.** | **FA** |
| **9.** | **OA** |
| **10.** | **FA** |

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **All-Star Automotive Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Revenue** | **$ 25,000** |  |  |
|  | **Cash Payment for Salary Expense** | **(14,000)** |  |  |
|  | **Cash Payments for Utilities Expense** | **(2,800)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$8,200** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities** |  |  |  |
|  | **Cash from the Sale of Land** | **$ 9,000** |  |  |
|  | **Cash Paid to Purchase Land** | **(6,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **3,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$ 50,000** |  |  |
|  | **Cash Receipts from Loan** | **5,000** |  |  |
|  | **Cash Payment on Loan** | **(2,000)** |  |  |
|  | **Cash Payments for Dividends** | **(5,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **48,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **59,200** |  |
|  | **Plus: Beginning Cash Balance** |  | **9,000** |  |
|  | **Ending Cash Balance** |  | **$68,200** |  |
|  |  |  |  |  |

**EXERCISE 1-23A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Dakota Company**  **Accounting Equation for Year 2** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Bal. 1/1/Year 2** |  | **2,000** |  | **12,000** |  | **-0-** |  | **6,000** |  | **8,000** |  |
| **1. Issued stk.** |  | **30,000** |  | **NA** |  | **NA** |  | **30,000** |  | **NA** | **NA** |
| **2. Pur. Land** |  | **(12,000)** |  | **12,000** |  | **NA** |  | **NA** |  | **NA** | **NA** |
| **3. Loan** |  | **10,000** |  | **NA** |  | **10,000** |  | **NA** |  | **NA** | **NA** |
| **4. Provide Svc.** |  | **20,000** |  | **NA** |  | **NA** |  | **NA** |  | **20,000** | **Svc. Rev.** |
| **5. Paid Utilities** |  | **(1,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(1,000)** | **Util. Exp.** |
| **6. Pd. Op. Exp.** |  | **(15,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(15,000)** | **Op. Exp.** |
| **7. Paid Div.** |  | **(2,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(2,000)** | **Dividends** |
| **8. Land Value** |  | **NA** |  | **NA** |  | **NA** |  | **NA** |  | **NA** |  |
| **End Bal.** |  | **32,000** | **+** | **24,000** | **=** | **10,000** | **+** | **36,000** | **+** | **10,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Dakota Company**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Service Revenue** | **$20,000** |  |
|  | **Utilities Expense** | **(1,000)** |  |
|  | **Operating Expense** | **(15,000)** |  |
|  | **Net Income** | **$ 4,000** |  |
|  |  |  |  |

**EXERCISE 1-23A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Dakota Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ 6,000** |  |  |
|  | **Plus: Common Stock Issued** | **30,000** |  |  |
|  | **Ending Common Stock** |  | **$36,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 8,000** |  |  |
|  | **Plus: Net Income** | **4,000** |  |  |
|  | **Less: Dividends** | **(2,000)** |  |  |
|  | **Ending Retained Earnings** |  | **10,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$46,000** |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Dakota Company**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$32,000** |  |  |
|  | **Land** | **24,000** |  |  |
|  | **Total Assets** |  | **$56,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$10,000** |  |  |
|  | **Total Liabilities** |  | **$10,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$36,000** |  |  |
|  | **Retained Earnings** | **10,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **46,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$56,000** |  |
|  |  |  |  |  |

**EXERCISE 1-23A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Dakota Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$20,000** |  |  |
|  | **Cash Payment for Utilities Expense** | **(1,000)** |  |  |
|  | **Cash Payments for Other Operating Exp.** | **(15,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 4,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Paid to Purchase Land** | **$(12,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **(12,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$30,000** |  |  |
|  | **Cash Receipts from Loan** | **10,000** |  |  |
|  | **Cash Payments for Dividends** | **(2,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **38,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **30,000** |  |
|  | **Plus: Beginning Cash Balance** |  | **2,000** |  |
|  | **Ending Cash Balance** |  | **$32,000** |  |
|  |  |  |  |  |

**c. Percentage of assets provided by retained earnings:**

**$10,000 ÷ $56,000 = 17.9%**

**There is zero cash in the retained earnings account.**

**d. The maximum dividend that Dakota could pay is the lessor of cash on hand or retained earnings. Therefore, the maximum dividend at December 31, Year 2 would be the total amount of retained earnings of $10,000.**

**EXERCISE 1-24A**

**a.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Carter Company**  **Accounting Equation as of January 1, Year 2** | | | | | | | | |
|  | | | | | | | | |
| **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Cash** | **+** | **Land** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **800** |  | **3,500** |  | **600** |  | **1,000** |  | **?** |
|  |  |  |  |  |  |  |  |  |

**Retained Earnings = $800 + $3,500 - $600 - $1,000 = $2,700**

**b. The company cannot pay a $1,000 dividend because it only has $800 of cash. The Retained Earnings account contains zero cash. The balance in this account represents a stockholders’ equity claim on assets.**

**c. Total Assets = $800 + $3,500 = $4,300**

**Creditor’s Loans ÷ Total Assets**

**$600 ÷ $4,300 = 14.0%**

**d. Investor’s Contributions ÷ Total Assets**

**$1,000 ÷ $4,300 = 23.3%**

**e. Retained Earnings ÷ Total Assets**

**$2,700 ÷ $4,300 = 62.8%**

**f.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Carter Company**  **Accounting Equation as of January 1, Year 2** | | | | | | | | |
|  | | | | | | | | |
| **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Cash** | **+** | **Land** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **800** |  | **3,500** |  | **13.9%** |  | **23.3%** |  | **62.8%** |
|  |  |  |  |  |  |  |  |  |

**EXERCISE 1-24A (cont.)**

**g.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Carter Company**  **Accounting Equation as of December 31, Year 2** | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | |
| **Assets** | | | | | **=** | | **Liabilities** | | **+** | | **Stockholders’ Equity** | | | | |
|  |  |  |  |  | | **Notes** | |  | | **Common** | |  | **Retained** |  |
|  | **Cash** | **+** | **Land** | **=** | | **Payable** | | **+** | | **Stock** | | **+** | **Earnings** |  |
|  | **$800** |  | **$3,500** |  | | **$600** | |  | | **$1,000** | |  | **2,700** |  |
|  | **1,800** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **1,800** | **Rev.** |
|  | **(1,200)** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **(1,200)** | **Exp.** |
|  | **(500)** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **(500)** | **Div.** |
|  | **900** |  | **3,500** |  | | **600** | |  | | **1,000** | |  | **2,800** |  |
|  |  |  |  |  | |  | |  | |  | |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **Carter Company**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$1,800** |  |
|  | **Expenses** | **(1,200)** |  |
|  | **Net Income** | **$ 600** |  |
|  |  |  |  |

**EXERCISE 1-24A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Carter Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$1,000** |  |  |
|  | **Plus: Common Stock Issued** | **-0-** |  |  |
|  | **Ending Common Stock** |  | **$1,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$2,700** |  |  |
|  | **Plus: Net Income** | **600** |  |  |
|  | **Less: Dividends** | **(500)** |  |  |
|  | **Ending Retained Earnings** |  | **2,800** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$3,800** |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Carter Company**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$ 900** |  |  |
|  | **Land** | **3,500** |  |  |
|  | **Total Assets** |  | **$4,400** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$600** |  |  |
|  | **Total Liabilities** |  | **$600** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$1,000** |  |  |
|  | **Retained Earnings** | **2,800** |  |  |
|  | **Total Stockholders’ Equity** |  | **3,800** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$4,400** |  |
|  |  |  |  |  |

**EXERCISE 1-24A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Carter Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$1,800** |  |  |
|  | **Cash Payments for Expenses** | **(1,200)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 600** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  | **0** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Payments for Dividends** | **(500)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **(500)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **100** |  |
|  | **Plus: Beginning Cash Balance** |  | **800** |  |
|  | **Ending Cash Balance** |  | **$ 900** |  |
|  |  |  |  |  |

**h. The income statement, statement of changes in stockholders’ equity and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology “***For the Year Ended* **December 31, Year 2.” In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In this case, the point in time is December 31, Year 2. Therefore, this statement uses the terminology “***As of* **December 31, Year 2.”**

**i. The maximum dividend that Carter could pay is the lessor of cash on hand or retained earnings. Therefore, the maximum dividend at December 31, Year 2 would be the total amount of cash on hand of $900.**

**EXERCISE 1-25A**

**a. The cash flow from operating activities is calculated by subtracting the cash outflow for expenses from the cash inflow from customers. ($18,100 - $8,300 = $9,800).**

**b. Since the balance in the land account increases from zero to $16,500, Room Designs must have had a net cash outflow $16,500 for the purchase of Land.**

**c. Since the amount in the Notes Payable account increased from zero to $9,000, Room Designs Inc. must have received a cash inflow of $9,000 from the issue of the note payable. Similarly, since the balance in the common stock account increased from $3,500 to $7,500, Room Design must have received a cash inflow of $4,000 ($7,500 - $3,500) from the issue of common stock. Finally, the $2,000 dividend payment would have caused a net cash outflow. Therefore, the net cash inflow from financing activities can be explained as follows:**

|  |  |
| --- | --- |
| **Cash Flows From Financing Activities:** |  |
| **Cash Receipts from Loan** | **$9,000** |
| **Cash Receipts from Stock Issue** | **4,000** |
| **Cash Payments for Dividends** | **(2,000)** |
| **Net Cash Flow from Financing Activities** | **$11,000** |

**EXERCISE 1-25A (cont.)**

**d.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Room Designs Inc.**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$ 18,100** |  |  |
|  | **Cash Payments for Expenses** | **(8,300)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 9,800** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Paid to Purchase Land** | **$(16,500)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **(16,500)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Loan** | **$ 9,000** |  |  |
|  | **Cash Receipts from Stock Issue** | **4,000** |  |  |
|  | **Cash Payments for Dividends** | **(2,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **11,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **4,300** |  |
|  | **Plus: Beginning Cash Balance** |  | **9,900** |  |
|  | **Ending Cash Balance** |  | **$14,200** |  |
|  |  |  |  |  |

**EXERCISE 1-25A (cont.)**

**e.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Room Designs Inc.**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$18,100** |  |
|  | **Expenses** | **(8,300)** |  |
|  | **Net Income** | **$9,800** |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Room Designs Inc.**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ 3,500** |  |  |
|  | **Plus: Common Stock Issued** | **4,000** |  |  |
|  | **Ending Common Stock** |  | **$7,500** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 6,400** |  |  |
|  | **Plus: Net Income** | **9,800** |  |  |
|  | **Less: Dividends** | **(2,000)** |  |  |
|  | **Ending Retained Earnings** |  | **14,200** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$21,700** |  |
|  |  |  |  |  |

**EXERCISE 1-25A (cont.)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Room Designs Inc.**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$14,200** |  |  |
|  | **Land** | **16,500** |  |  |
|  | **Total Assets** |  | **$30,700** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$9,000** |  |  |
|  | **Total Liabilities** |  | **$ 9,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$7,500** |  |  |
|  | **Retained Earnings** | **14,200** |  |  |
|  | **Total Stockholders’ Equity** |  | **21,700** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$30,700** |  |
|  |  |  |  |  |

**EXERCISE 1-26A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Ortho Company**  **Accounting Equation for Year 1** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg. Bal.** |  | **$0** | **+** | **$0** | **=** | **$0** | **+** | **$0** | **+** | **$0** |  |
| **1. Issued stk.** |  | **68,000** | **+** | **NA** | **=** | **NA** | **+** | **68,000** | **+** | **NA** | **NA** |
| **2. Loan** |  | **36,000** | **+** | **NA** | **=** | **36,000** | **+** | **NA** | **+** | **NA** | **NA** |
| **3. Cash Rev.** |  | **59,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **59,000** | **Rev.** |
| **4. Cash Exp.** |  | **(43,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(43,000)** | **Exp.** |
| **5. Paid Div.** |  | **(7,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(7,000)** | **Dividends** |
| **6. Land Purch.** |  | **(37,000)** | **+** | **37,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  |
| **End Bal.** |  | **76,000** | **+** | **37,000** | **=** | **36,000** | **+** | **68,000** | **+** | **9,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Ortho Company**  **Accounting Equation for Year 2** | | | | | | | | | | | | |
|  | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg. Bal.** |  | **$76,000** | **+** | **$37,000** | **=** | **$36,000** | **+** | **$68,000** | **+** | **$9,000** |  |
| **1. Issued stk.** |  | **50,000** | **+** | **NA** | **=** | **NA** | **+** | **50,000** | **+** | **NA** | **NA** |
| **2. Loan** |  | **20,000** | **+** | **NA** | **=** | **20,000** | **+** | **NA** | **+** | **NA** | **NA** |
| **3. Cash Rev.** |  | **85,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **85,000** | **Rev.** |
| **4. Cash Exp.** |  | **(62,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(62,000)** | **Exp.** |
| **5. Paid Div.** |  | **(2,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(2,000)** | **Dividends** |
| **6. Land Purch.** |  | **(25,000)** | **+** | **25,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  |
| **End Bal.** |  | **142,000** | **+** | **62,000** | **=** | **56,000** | **+** | **118,000** | **+** | **30,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

**EXERCISE 1-26A (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Ortho Company**  **Income Statement**  **For the Period Ended December 31, Year 1 & Year 2** | | | |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Revenue** | **$59,000** | **$85,000** |  |
|  | **Expenses** | **(43,000)** | **(62,000)** |  |
|  | **Net Income** | **$16,000** | **$23,000** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Ortho Company**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** | **$68,000** |  |
|  | **Plus: Common Stock Issued** | **68,000** | **50,000** |  |
|  | **Ending Common Stock** | **$68,000** | **$118,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** | **$9,000** |  |
|  | **Plus: Net Income** | **16,000** | **23,000** |  |
|  | **Less: Dividends** | **(7,000)** | **(2,000)** |  |
|  | **Ending Retained Earnings** | **$9,000** | **$30,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** | **$77,000** | **$148,000** |  |
|  |  |  |  |  |

**EXERCISE 1-26A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Ortho Company**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$76,000** | **$142,000** |  |
|  | **Land** | **$37,000** | **$62,000** |  |
|  | **Total Assets** | **$113,000** | **$204,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities** | **$36,000** | **$56,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$68,000** | **$118,000** |  |
|  | **Retained Earnings** | **$9,000** | **$30,000** |  |
|  | **Total Stockholders’ Equity** | **$77,000** | **$148,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$113,000** | **$204,000** |  |
|  |  |  |  |  |

**EXERCISE 1-26A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Ortho Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$59,000** | **$85,000** |  |
|  | **Cash Payments for Expenses** | **(43,000)** | **(62,000)** |  |
|  | **Net Cash Flow from Operating Activities** | **$16,000** | **$23,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Payment for Land** | **$(37,000)** | **$(25,000)** |  |
|  | **Net Cash Flow from Investing Activities** | **$(37,000)** | **$(25,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Borrowed Funds** | **$36,000** | **$20,000** |  |
|  | **Cash Receipts from Stock Issue** | **68,000** | **50,000** |  |
|  | **Cash Dividend** | **(7,000)** | **(2,000)** |  |
|  | **Net Cash Flow from Financing Activities** | **$97,000** | **$68,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** | **$76,000** | **$66,000** |  |
|  | **Plus: Beginning Cash Balance** | **-0-** | **$76,000** |  |
|  | **Ending Cash Balance** | **$76,000** | **$142,000** |  |
|  |  |  |  |  |

**EXERCISE 1-27A**

|  |  |
| --- | --- |
| **Financial Statements** | **Descriptions** |
| **Balance Sheet** | **C.  Summarizes all the company's accounts under the accounting equation as of a point in time.  All other financial statements can be created from activity included in this statement.** |
| **Income Statement** | **D.  Summarizes the revenues and expenses recorded under the retained earnings column of the accounting equation.  This statement focuses on company performance over a fixed period of time.** |
| **Statement of Cash Flows** | **A.  Summarizes the activity under the cash account within the accounting equation.  Explains the activities that caused the cash balance to change from the beginning of the year to the end of the year.** |
| **Statement of Stockholders Equity** | **B.  Summarizes all the activity under the equity section of the accounting equation.  This statement generally shows how common stock and retained earnings changed from the beginning of the year to the end of the year.** |

**EXERCISE 1-28A**

1. **Composite Fabricators’ assets would be worth the same, but would be shown at different amounts on the balance sheet depending on whether U.S. GAAP or IFRS is used.**
2. **US GAAP requires the asset be stated at its historical cost, which may be very different from the current value. IFRS allow companies to value asset at their current market values.**

**SOLUTIONS TO PROBLEMS – SERIES A - CHAPTER 1**

**PROBLEM 1-29A**

**a. The memo should explain that all entities must account for the use of assets, even though they may not be for-profit entities. The stakeholders are interested in the use of assets as well as the financial health of the entity.**

**b. Financial accounting is designed to meet the needs of external users. External users such as creditors and investors are interested in an objective, overall picture. For instance, both investors and creditors would be interested in the assets and liabilities of a business as well as in the net income. Both groups are interested in the growth factor as well as the risk factor.**

**Managerial accounting is designed to meet the needs of internal users. While there is overlap between the needs of both groups, i.e. net income, managers need more specific and detailed information. Managers may be concerned with the profitability of a particular department or product line while an investor is more concerned with the overall profitability of the company.**

**c. Stakeholders of a not-for-profit entity that may want financial accounting reports would include taxpayers, contributors, lenders, suppliers, employees, managers, financial analysts, attorneys, and beneficiaries.**

**d. Stakeholders that may want managerial accounting reports would include suppliers, managers, and employees.**

**PROBLEM 1-30A**

|  |  |
| --- | --- |
| **a. Entities mentioned:** | **b. Effect on the cash account:** |
| **1. Bob Wilder** | **Decrease** |
| **Wilder Co.** | **Increase** |
|  |  |
| **2. Sam Pace Business** | **Increase** |
| **Customers** | **Decrease** |
|  |  |
| **3. Jim Sneed** | **Increase/Decrease** |
| **National Bank** | **Decrease** |
| **Iuka Ford** | **Increase** |
|  |  |
| **4. OZ Company** | **Decrease** |
| **Employees** | **Increase** |
|  |  |
| **5. Gil Roberts** | **Decrease** |
| **Jim** | **Increase** |
|  |  |
| **6. Gane, Inc.** | **Decrease** |
| **Atlanta Land Co.** | **Increase** |
|  |  |
| **7. Rob Moore** | **Decrease** |
| **Gil Thomas** | **Decrease** |
| **Partnership** | **Increase** |
|  |  |
| **8. Stephen Woo** | **Decrease** |
| **Izzard, Inc.** | **Increase** |
|  |  |
| **9. Natural Stone** | **Decrease** |
| **Shareholders** | **Increase** |
|  |  |
| **10. Billows, Inc.** | **Increase** |
| **National Bank** | **Decrease** |

**PROBLEM 1-31A**

|  |  |  |
| --- | --- | --- |
| **Event No.** | **Type of Event** | **Effect on Total Assets** |
|  |  |  |
| **1.** | **Asset Source** | **Increase** |
| **2.** | **Asset Use** | **Decrease** |
| **3.** | **NA** | **NA** |
| **4.** | **Asset Source** | **Increase** |
| **5.** | **Asset Use** | **Decrease** |
| **6.** | **Asset Use** | **Decrease** |
| **7.** | **Asset Use** | **Decrease** |
| **8.** | **Asset Exchange** | **No Effect** |
| **9.** | **Asset Exchange** | **No Effect** |
| **10.** | **Asset Use** | **Decrease** |
| **11.** | **NA** | **NA** |
| **12.** | **Asset Source** | **Increase** |
| **13.** | **Asset Use** | **Decrease** |
| **14.** | **NA** | **NA** |
| **15.** | **Asset Exchange** | **No Effect** |
|  |  |  |

**PROBLEM 1-32A**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Item** | **Income Statement** | **Statement of Changes in Stk. Equity** | **Balance Sheet** | **Statement of Cash Flows** |
| **Financing activities** |  |  |  |  |
| **Ending common stock** |  |  |  |  |
| **Interest expense** |  |  |  |  |
| **As of (date)** |  |  |  |  |
| **Land** |  |  |  |  |
| **Beginning cash balance** |  |  |  |  |
| **Notes payable** |  |  |  |  |
| **Beginning common stock** |  |  |  |  |
| **Service revenue** |  |  |  |  |
| **Utility expense** |  |  |  |  |
| **Stock issue** |  |  |  |  |
| **Operating activities** |  |  |  |  |
| **For the period ended (date)** |  |  |  |  |
| **Net income** |  |  |  |  |
| **Investing activities** |  |  |  |  |
| **Net loss** |  |  |  |  |
| **Ending cash balance** |  |  |  |  |
| **Salary expense** |  |  |  |  |
| **Consulting revenue** |  |  |  |  |
| **Dividends** |  |  |  |  |

**PROBLEM 1-33A**

**a.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Pratt Corp.**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$35,550a** |  |
|  | **Expense** | **(26,000)** |  |
|  | **Net Income** | **$ 9,550** |  |
|  |  |  |  |

**aTo calculate revenue, you must first determine the ending balance in the retained earnings account at the end of Year 2:**

|  |  |  |
| --- | --- | --- |
| **Beginning Retained Earnings** |  | **$ 5,000** |
| **Plus increase in Retained Earnings** |  | **7,550** |
| **Ending Retained earnings** |  | **$12,550** |
|  |  |  |

**Next, you can use this information to determine the amount of net income:**

|  |  |  |
| --- | --- | --- |
| **Beginning Retained Earnings** |  | **$ 5,000** |
| **Plus Net Income** |  | **“X”** |
| **Minus Dividends** |  | **(2,000)** |
| **Ending Retained earnings** |  | **$12,550** |
| **X = $12,550 - $5,000 + $2,000; X = $9,550** |  |  |

**Finally, using the amount of net income, you can derive revenue:**

|  |  |  |  |
| --- | --- | --- | --- |
| **Revenue** |  | **$ “X”** | |
| **Expenses** |  | **(26,000)** |
| **Net Income** |  | **$ 9,550** |
|  |  |  |

**X = $9,550 + $26,000; X = $35,550**

**PROBLEM 1-33A (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Pratt Corp.**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$13,000b** |  |  |
|  | **Plus: Common Stock Issued** | **4,000** |  |  |
|  | **Ending Common Stock** |  | **$17,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$5,000** |  |  |
|  | **Plus: Net Income** | **9,550** |  |  |
|  | **Less: Dividends** | **(2,000)** |  |  |
|  | **Ending Retained Earnings** |  | **12,550** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$29,550** |  |
|  |  |  |  |  |

**b To calculate the amount of beginning common stock; rearrange the accounting equation and solve for the missing variable as follows:**

**Assets − Liabilities − Retained Earnings = Common Stock:**

**$30,000 − $12,000 − $5,000 = *?***

**$30,000 − $12,000 − $5,000 = *$13,000***

**EXERCISE 1-33A (cont.)**

**c.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Pratt Corp.**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  | **$38,550c** |  |
|  |  |  |  |  |
|  | **Liabilities** |  | **$ 9,000d** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$17,000** |  |  |
|  | **Retained Earnings** | **12,550** |  |  |
|  | **Total Stockholders’ Equity** |  | **29,550** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$38,550** |  |
|  |  |  |  |  |

**c Based on the accounting equation total assets are equal to total liabilities ($9,000) plus stockholders’ equity ($29,550).**

**d Total liabilities is calculated as follows:**

**Total Liabilities = $12,000 Beg. Bal. - $3,000 Partial Payoff = $9,000 ending balance.**

**PROBLEM 1-33A (cont.)**

**d.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Pratt Corp.**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipt from Revenue** | **$35,550** |  |  |
|  | **Cash Payment for Expense** | **(26,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 9,550** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities** |  | **-0-** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$ 4,000** |  |  |
|  | **Cash Payment to Creditors** | **(3,000)** |  |  |
|  | **Cash Dividend Paid to Stockholders** | **(2,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **(1,000)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **8,550** |  |
|  | **Plus: Beginning Cash Balance** |  | **30,000** |  |
|  | **Ending Cash Balance** |  | **$38,550** |  |
|  |  |  |  |  |

**e. Percentage of assets provided by:**

**Creditors $ 9,000 ÷ $38,550 = 23.35%**

**Investors $17,000 ÷ $38,550 = 44.10%**

**Earnings $12,550 ÷ $38,550 = 32.56%**

**PROBLEM 1-34A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Accounting Equation for Year 1** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com. Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **1. Issued stk** |  | **20,000** |  | **NA** |  | **NA** |  | **20,000** |  | **NA** | **NA** |
| **2. Svc. Rev.** |  | **35,000** |  | **NA** |  | **NA** |  | **NA** |  | **35,000** | **Svc. Rev.** |
| **3. Loan** |  | **25,000** |  | **NA** |  | **25,000** |  | **NA** |  | **NA** | **NA** |
| **4. Paid Exp.** |  | **(22,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(22,000)** | **Oper. Exp.** |
| **5. Pur. Land** |  | **(30,000)** |  | **30,000** |  | **NA** |  | **NA** |  | **NA** | **NA** |
| **End Bal.** |  | **28,000** | **+** | **30,000** | **=** | **25,000** | **+** | **20,000** | **+** | **13,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Accounting Equation for Year 2** | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | **+** | | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | | **Com.**  **Stock** | | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg. Bal.** |  | **28,000** |  | **30,000** |  | **25,000** |  | | **20,000** | |  | **13,000** |  |
| **1. Issued stk** |  | **24,000** |  | **NA** |  | **NA** |  | | **24,000** | |  | **NA** | **NA** |
| **2. Svc. Rev.** |  | **95,000** |  | **NA** |  | **NA** |  | | **NA** | |  | **95,000** | **Svc. Rev.** |
| **3. Paid Loan** |  | **(15,000)** |  | **NA** |  | **(15,000)** |  | | **NA** | |  | **NA** | **NA** |
| **4. Paid Exp.** |  | **(71,500)** |  | **NA** |  | **NA** |  | | **NA** | |  | **(71,500)** | **Oper. Exp.** |
| **5. Paid Div.** |  | **(3,000)** |  | **NA** |  | **NA** |  | | **NA** | |  | **(3,000)** | **Dividends** |
| **6. Land Val.** |  | **NA** |  | **NA** |  | **NA** |  | | **NA** | |  | **NA** |  |
| **End Bal.** |  | **57,500** | **+** | **30,000** | **=** | **10,000** | **+** | | **44,000** | | **+** | **33,500** |  |
|  |  |  |  |  |  |  |  | |  | |  |  |  |

**PROBLEM 1-34A (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Mark’s Consulting**  **Income Statement**  **For the Period Ended December 31, Year 1 & Year 2** | | | |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Service Revenue** | **$35,000** | **$95,000** |  |
|  | **Operating Expenses** | **(22,000)** | **(71,500)** |  |
|  | **Net Income** | **$13,000** | **$23,500** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** | **$20,000** |  |
|  | **Plus: Common Stock Issued** | **20,000** | **24,000** |  |
|  | **Ending Common Stock** | **$20,000** | **$44,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** | **$13,000** |  |
|  | **Plus: Net Income** | **13,000** | **23,500** |  |
|  | **Less: Dividends** | **-0-** | **(3,000)** |  |
|  | **Ending Retained Earnings** | **$13,000** | **$33,500** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** | **$33,000** | **$77,500** |  |
|  |  |  |  |  |

**PROBLEM 1-34A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$28,000** | **$57,500** |  |
|  | **Land** | **$30,000** | **$30,000** |  |
|  | **Total Assets** | **$58,000** | **$87,500** |  |
|  |  |  |  |  |
|  | **Total Liabilities** | **$25,000** | **$10,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$20,000** | **$44,000** |  |
|  | **Retained Earnings** | **$13,000** | **$33,500** |  |
|  | **Total Stockholders’ Equity** | **$33,000** | **$77,500** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$58,000** | **$87,500** |  |
|  |  |  |  |  |

**PROBLEM 1-34A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$35,000** | **$95,000** |  |
|  | **Cash Payments for Expenses** | **(22,000)** | **(71,500)** |  |
|  | **Net Cash Flow from Operating Activities** | **$13,000** | **$23,500** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Payment for Land** | **$(30,000)** | **-0-** |  |
|  | **Net Cash Flow from Investing Activities** | **(30,000)** | **-0-** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Borrowed Funds** | **$25,000** | **-0-** |  |
|  | **Cash Receipts from Stock Issue** | **20,000** | **24,000** |  |
|  | **Cash Payment on Debt** |  | **(15,000)** |  |
|  | **Cash Dividend** | **-0-** | **(3,000)** |  |
|  | **Net Cash Flow from Financing Activities** | **$45,000** | **$6,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** | **$28,000** | **$29,500** |  |
|  | **Plus: Beginning Cash Balance** | **-0-** | **$28,000** |  |
|  | **Ending Cash Balance** | **$28,000** | **$57,500** |  |
|  |  |  |  |  |

**c. Retained Earnings does not contain cash.**

**d. In Year 1 and Year 2 net income and cash flows from operating activities are the same because all revenues and expenses are cash. Ordinarily, net income will be different from cash flows from operating activities due to non-cash revenue and expense transactions (discussed in Chapter 2). The net change in cash is different from net income because investing and financing activities do not directly affect revenue and expenses.**

**PROBLEM 1-35A**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | | | | | | |
|  |  | | | | | | |  |
| **FOR THE YEARS** | | | **Year 1** |  | **Year 2** |  | **Year 3** |  |
|  | |  |  |  |  |  |  |  |
| **Income Statements** | | | | | | | | |
|  | | **Revenue (cash)** | **$ 900** |  | **$ 1,800** |  | **$ 2,500** |  |
|  | | **Expense (cash)** | **(a) (600)** |  | **(600)** |  | **(1,200)** |  |
|  | | **Net income** | **$ 300** |  | **(m)$ 1,200** |  | **$ 1,300** |  |
|  | |  |  |  |  |  |  |  |
| **Statements of Changes in Stockholders’ Equity** | | | | | | | | |
|  | | **Beginning common stock** | **$ -0-** |  | **(n) $6,000** |  | **$7,000** |  |
|  | | **Plus: Common stock issued** | **6,000** |  | **1,000** |  | **3,000** |  |
|  | | **Ending common stock** | **6,000** |  | **7,000** |  | **(t) 10,000** |  |
|  | |  |  |  |  |  |  |  |
|  | | **Beginning retained earnings** | **-0-** |  | **200** |  | **1,100** |  |
|  | | **Plus: Net income** | **(b) 300** |  | **1,200** |  | **1,300** |  |
|  | | **Less: Dividends** | **(c) (100)** |  | **(300)** |  | **(500)** |  |
|  | | **Ending retained earnings** | **200** |  | **(p) 1,100** |  | **1,900** |  |
|  | | **Total stockholders’ equity** | **(d) $6,200** |  | **$8,100** |  | **$11,900** |  |
|  | |  |  |  |  |  |  |  |
| **Balance Sheets** | | | | | | | | |
|  | | **Assets** |  |  |  |  |  |  |
|  | | **Cash** | **(e) $8,100** |  | **(q) $ 9,000** |  | **(u)$ 11,800** |  |
|  | | **Land** | **-0-** |  | **(r) 5,000** |  | **5,000** |  |
|  | | **Total assets** | **(f) $8,100** |  | **$14,000** |  | **$16,800** |  |
|  | |  |  |  |  |  |  |  |
|  | | **Liabilities** | **(g) $ 1,900** |  | **$ 5,900** |  | **$ 4,900** |  |
|  | |  |  |  |  |  |  |  |
|  | | **Stockholders’ equity** |  |  |  |  |  |  |
|  | | **Common stock** | **(h) 6,000** |  | **(s) 7,000** |  | **10,000** |  |
|  | | **Retained earnings** | **(i) 200** |  | **1,100** |  | **1,900** |  |
|  | | **Total stockholders’ equity** | **(j) 6,200** |  | **8,100** |  | **11,900** |  |
|  | | **Total liabilities and stk. equity** | **$8,100** |  | **$14,000** |  | **$16,800** |  |
|  | |  |  |  |  |  |  |  |

**PROBLEM 1-35A (cont.)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | | | | | | |
|  |  | | | | | | |  |
| **FOR THE YEARS** | | **Year 1** |  | **Year 2** |  | **Year 3** | |  |
|  |  |  |  |  |  |  | |  |
| **Statements of Cash Flows** | | | | | | | | |
|  |  |  |  |  |  |  | |  |
|  | **Cash flows from oper. activities:** |  |  |  |  |  | |  |
|  | **Cash receipts from revenue** | **(k)$ 900** |  | **$ 1,800** |  | **(v) $ 2,500** | |  |
|  | **Cash payments for expenses** | **(l) (600)** |  | **(600)** |  | | **(w) (1,200)** |  |
|  | **Net cash flows from oper. Act.** | **300** |  | **1,200** |  | **1,300** | |  |
|  |  |  |  |  |  |  | |  |
|  | **Cash flows from invest. activities:** |  |  |  |  |  | |  |
|  | **Cash payments for land** | **-0-** |  | **(5,000)** |  | **-0-** | |  |
|  | **Net cash flows from invest. act.** | **-0-** |  | **$(5,000)** |  | **-0-** | |  |
|  |  |  |  |  |  |  | |  |
|  | **Cash flows from fin. activities:** |  |  |  |  |  | |  |
|  | **Cash rec. from borrowed funds** | **1,900** |  | **6,000** |  | **-0-** | |  |
|  | **Cash payments to reduce debt** | **-0-** |  | **(2,000)** |  | **(x) (1,000)** | |  |
|  | **Cash receipts from stock issue** | **6,000** |  | **1,000** |  | **(y) 3,000** | |  |
|  | **Cash payments for dividends** | **(100)** |  | **(300)** |  | **(z) (500)** | |  |
|  | **Net cash flows from fin. activities** | **$7,800** |  | **$4,700** |  | **$1,500** | |  |
|  |  |  |  |  |  |  | |  |
|  | **Net change in cash** | **8,100** |  | **900** |  | **2,800** | |  |
|  | **Plus: beginning cash balance** | **-0-** |  | **8,100** |  | **9,000** | |  |
|  | **Ending cash balance** | **$8,100** |  | **$ 9,000** |  | **$11,800** | |  |
|  |  |  |  |  |  |  | |  |

**PROBLEM 1-35A (cont.)**

**Computations of amounts:**

**a. $600 Expenses = $900 Revenue − $300 Net Income.**

**b. $300 Net Income = $300 Net Income from Income Statement.**

**c. $100 Dividends = $100 Dividends in Cash Flow Statement**

**d. $6,200 Total Stockholders’ Equity = $6,000 Ending CS + $200 Ending RE.**

**e. $8,100 Cash = Ending Cash Balance in Cash Flow Statement**

**f. $8,100 Total Assets = $8,100 Cash + $0 Land**

**g. $1,900 Liabilities = $1,900 Cash Receipts from Loan in Cash Flow Statement**

**h. $6,000 Common Stock = $6,000 Common Stock Issued from Changes in SH Equity**

**i. $200 RE = $200 Retained Earnings Issued from Changes in SH Equity**

**j. $6,200 Total SE = $6,000 Common Stock + $200 Retained Earnings**

**k. $900 Cash Receipts = $900 Revenue from Income Statement**

**l. $600 Cash Expenses = $600 Expenses from Income Statement**

**m. $1,200 Net Income = $1,800 Revenue − $600 Expense**

**n. $6,000 Beginning Common Stock = $6,000 Ending Common Stock from Year 1**

**p. $1,100 Ending RE = $200 Beg. RE + $1,200 Net Income − $300 Dividends**

**q. $9,000 Cash = $9,000 Ending Cash Balance in Cash Flow Statement**

**r. $5,000 Land = $5,000 Cash Payment for Land in Cash Flow Statement**

**s. $7,000 Common Stock = $7,000 Ending Common Stock in Change in SH Equity**

**t. $10,000 Ending Common Stock = $7,000 Beg. CS + $3,000 CS Issued**

**u. $11,800 Cash = $16,800 Total Assets − $5,000 Land**

**v. $2,500 Cash Receipts = $2,500 Revenue in Income Statement**

**w. $1,200 Cash Expenses = $1,200 Expense in Income Statement**

**x. $1,000 Cash Payment on Debt = $5,900 Year 2 Liabilities − $4,900 Year 3 Liabilities**

**y. $3,000 Cash Receipts from Stock Issue = $3,000 Issued Stock in SE Equity Stmt**

**z. $500 Dividends = $500 Dividends in Changes in SE Equity Statement**

**SOLUTIONS TO EXERCISES - SERIES B - CHAPTER 1**

**EXERCISE 1-1B**

**The three types of resources available to conversion agents are:**

1. **Financial resources**
2. **Physical resources**
3. **Labor resources**

**Note to instructor:**

**The memo should discuss the fact that the resource owners are those who own resources that are desired by others, either in the original form or in a converted form. The conversion agents are the parties that acquire the resource and supply it to consumers either in the original form or in a converted form with value added by the conversion. The consumers are the ultimate users of the resources.**

**It should also include a discussion of the role of the private accountant and the allocation of resources. For example, private accountants prepare the annual reports that businesses (conversion agents) use to communicate information to investors and creditors (financial resource providers). In other words, they are the information providers. The most appropriate designation for private accountants is the attainment of a Certified Management Accountant (CMA). However, many private accountants get their start in public accounting and are therefore CPAs as well as CMAs.**

**EXERCISE 1-2B**

1. **The three areas of service provided by public accountants are auditing, tax, and consulting.**

**b. The private accountant generally works for a specific company. Some of the functions performed include classifying and recording transactions, billing customers, collecting amounts due, ordering merchandise, paying suppliers, preparing and analyzing financial statements, developing budgets, assessing performance, and making decisions.**

**EXERCISE 1-3B**

|  |  |
| --- | --- |
| **Entities** | **Distribution of Cash** |
| **Ray Steen (personal account)** | **Personal account was decreased by the $100,000 cash deposited in the Steen Enterprises’ business account.** |
| **Steen Enterprises** | **Cash account increased by the $100,000 cash deposited by Mr. Steen.**  **Cash account increased by $60,000 cash borrowed from First Bank.**  **Cash account increased by $75,000 cash invested by Stan Rhoades.**  **Cash account decreased by $150,000 cash used to purchase building.**  **Cash account increased by $56,000 cash revenue earned.**  **Cash account decreased by $31,000 cash payment to employees for salaries.** |
| **First Bank** | **Cash account decreased by $60,000 cash loaned to Steen Enterprises.** |
| **Stan Rhoades, father-in-law, personal account** | **Cash decreased by $75,000 cash invested in Steen Enterprises.** |
| **Zoro Realty Company** | **Cash increased by $150,000 received from Steen Enterprises to purchase building.** |
| **Steen Enterprises’ customers** | **Cash decreased by $56,000 when customers paid for services performed.** |
| **Steen Enterprises’ employees** | **Cash increased by $31,000 when employees received payment for salaries.** |

**EXERCISE 1-4B**

**a.**

|  |  |
| --- | --- |
| **Term** | **Definition** |
| **a** | **2** |
| **b** | **5** |
| **c** | **1** |
| **d** | **3** |
| **e** | **4** |
| **f** | **6** |
| **g** | **7** |

**EXERCISE 1-5B**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  |  |  |  |  | **Stockholders’ Equity** | | |
|  |  |  |  |  | **Common** |  | **Retained** |
| **Company** | **Assets** | **=** | **Liabilities** | **+** | **Stock** | **+** | **Earnings** |
| **A** | ***$142,000*** | **=** | **$30,000** | **+** | **$50,000** | **+** | **$62,000** |
| **B** | **50,000** | **=** | ***15,000*** | **+** | **10,000** | **+** | **25,000** |
| **C** | **85,000** | **=** | **20,000** | **+** | ***25,000*** | **+** | **40,000** |
| **D** | **215,000** | **=** | **60,000** | **+** | **100,000** | **+** | ***55,000*** |
|  |  |  |  |  |  |  |  |

**EXERCISE 1-6B**

**a.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |  |
|  | **Cash** |  | **Accounts Payable** |  | **Salaries Expense** |  |
|  | **Land** |  |  |  | **Common Stock** |  |
|  | **Office Furniture** |  |  |  | **Service Revenue** |  |
|  | **Trucks** |  |  |  | **Operating Expenses** |  |
|  | **Supplies** |  |  |  | **Rent Revenue** |  |
|  | **Computers** |  |  |  | **Dividends** |  |
|  | **Building** |  |  |  | **Gasoline Expense** |  |
|  |  |  |  |  | **Retained Earnings** |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |

**EXERCISE 1-6B (cont).**

**b. No. The number of accounts will vary depending on the level of detail the reporting entity chooses to provide, as well as the type of company and industry in which it operates. More accounts provide financial statement users with more information about the reporting entity. However, the cost of keeping records on many accounts often outweighs the benefit of providing more information. For example, in this problem the company kept all of the trucks in one account (i.e. Trucks). If the company wanted to provide more detail the company could have created a separate account for each truck. If the company wanted even more detail the company could break the truck into different components and provide an account for each component of the truck (i.e. engine, frame, wheels, tires, etc.). Providing accounts for each truck component would be very difficult and time consuming and would not necessarily change any decision made by a financial statement user. Therefore, it makes more sense to aggregate all trucks and truck components into one account. Deciding the number of accounts to report is a subjective cost/benefit analysis. The goal is to provide financial statement users with detail (i.e. more accounts) when the benefit of the additional information outweighs the cost of providing the information. Remember, it is the stockholders who are paying for the production of accounting information. They do not want to pay to produce information that cost more than it is worth.**

**EXERCISE 1-7B**

**a.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
| **Cash** | **=** | **Note Payable** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **156,000** | **=** | **85,600** | **+** | **52,400** | **+** | **?** |

**Retained Earnings = $156,000 – $85,600 – $52,400 = $18,000**

**b. & c.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Dunn Company**  **Effect of Year 2 Transactions on the Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Event** | **Cash** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **Beginning Balances** | **156,000** |  | **85,600** |  | **52,400** |  | **18,000** |
| **1. Earned Revenue** | **36,000** |  | **NA** |  | **NA** |  | **36,000** |
| **2. Paid expenses** | **(20,000)** |  | **NA** |  | **NA** |  | **(20,000)** |
| **3. Paid dividend** | **(3,000)** |  | **NA** |  | **NA** |  | **(3,000)** |
| **Ending Balance** | **169,000** | **=** | **85,600** | **+** | **52,400** | **+** | **31,000** |
|  |  |  |  |  |  |  |  |

**d.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Cash** | **=** | **Note Payable** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **169,000** | **=** | **85,600** | **+** | **52,400** | **+** | **31,000** |

**Liabilities + Stockholders’ Equity = $85,600 + $52,400 + $31,000 = $169,000**

**Assets = Liabilities + Stockholders’ Equity**

**$169,000 = $169,000**

**EXERCISE 1-7B**

**e. The beginning and ending balances in the cash account were $156,000 and $169,000 respectively. The beginning balance in the common stock account was $52,400. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because the accounting events that Dunn experienced during the Year 2 accounting period affected the cash account but not the common stock account.**

**EXERCISE 1-8B**

|  |  |
| --- | --- |
| **Event** | **Classification** |
| **1.** | **Asset Source** |
| **2.** | **Asset Source** |
| **3.** | **Asset Exchange** |
| **4.** | **Asset Source** |
| **5.** | **Asset Source** |
| **6.** | **Asset Exchange** |
| **7.** | **Asset Use** |
| **8.** | **NA** |
| **9.** | **Asset Use** |
| **10.** | **Asset Use** |
| **11.** | **NA** |
|  |  |

**EXERCISE 1-9B**

**a. Decrease**

**b. Increase**

**c. Increase**

**d. Decrease**

**e. Asset Exchange**

**f. Asset Exchange**

**EXERCISE 1-10B**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Morrison Co.**  **Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  |  |  | |  |  | **Stockholders’**  **Equity** | |
| **Event**  **Number** | **Assets** | **=** | **Liabilities** | | **+** | **Common Stock** | **Retained Earnings** |
| **1.** | **I** |  | **NA** | |  | **I** | **NA** |
| **2.** | **I** |  | **I** | |  | **NA** | **NA** |
| **3.** | **I** |  | **NA** | |  | **NA** | **I** |
| **4.** | **I/D** |  | **NA** | |  | **NA** | **NA** |
| **5.** | **D** |  | **NA** | |  | **NA** | **D** |
| **6.** | **D** |  | **NA** | |  | **NA** | **D** |
|  |  |  |  | |  |  |  |

**EXERCISE 1-11B**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Green Gardens, Inc.**  **Accounting Equation for Year 1** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **1. Issued stk.** |  | **20,000** |  | **NA** |  | **NA** |  | **20,000** |  | **NA** | **NA** |
| **2. Loan** |  | **8,000** |  | **NA** |  | **8,000** |  | **NA** |  | **NA** | **NA** |
| **3. Provide Svc.** |  | **38,000** |  | **NA** |  | **NA** |  | **NA** |  | **38,000** | **Svc. Rev.** |
| **4. Pd Op. Exp.** |  | **(15,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(15,000)** | **Op. Exp.** |
| **5. Paid Div.** |  | **(5,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(5,000)** | **Dividends** |
| **6. Land Purch.** |  | **(18,000)** |  | **18,000** |  | **NA** |  | **NA** |  | **NA** |  |
| **End Bal.** |  | **28,000** | **+** | **18,000** | **=** | **8,000** | **+** | **20,000** | **+** | **18,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

**EXERCISE 1-11B (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **$46,000** | **=** | **$8,000** | **+** | **$38,000** |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Green Gardens, Inc.**  **Balance Sheet**  **As of December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$28,000** |  |  |
|  | **Land** | **18,000** |  |  |
|  | **Total Assets** |  | **$46,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$8,000** |  |  |
|  | **Total Liabilities** |  | **$8,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$20,000** |  |  |
|  | **Retained Earnings** | **18,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **$38,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$46,000** |  |
|  |  |  |  |  |

**c.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **$46,000** | **=** | **$8,000** | **+** | **$38,000** |

**The ending balances for assets, liabilities and stockholders’ equity at the end of Year 1 will become the beginning balances for these same accounts in Year 2.**

**d. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company’s books.**

**EXERCISE 1-12B**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Green Gardens, Inc.**  **Accounting Equation for Year 2** | | | | | | | | | | | | |
|  | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Bal. 1/1/Y2** |  | **28,000** |  | **18,000** |  | **8,000** |  | | **20,000** |  | **18,000** |  |
| **1. Pur. Land** |  | **(12,000)** |  | **12,000** |  | **NA** |  | | **NA** |  | **NA** | **NA** |
| **2. Issued stk.** |  | **20,000** |  | **NA** |  | **NA** |  | | **20,000** |  | **NA** | **NA** |
| **3. Service** |  | **50,000** |  | **NA** |  | **NA** |  | | **NA** |  | **50,000** | **Revenue** |
| **4. Paid Exp.** |  | **(42,000)** |  | **NA** |  | **NA** |  | | **NA** |  | **(42,000)** | **Oper. Exp.** |
| **5. Loan** |  | **20,000** |  | **NA** |  | **20,000** |  | | **NA** |  | **NA** | **NA** |
| **6. Paid Div.** |  | **(2,000)** |  | **NA** |  | **NA** |  | | **NA** |  | **(2,000)** | **Dividend** |
| **7. Land Value** |  | **NA** |  | **NA** |  | **NA** |  | | **NA** |  | **NA** | **NA** |
| **End Bal.** |  | **62,000** | **+** | **30,000** | **=** | **28,000** | **+** | | **40,000** | **+** | **24,000** |  |
|  |  |  |  |  |  |  |  | |  |  |  |  |

**EXERCISE 1-12B (cont.)**

**b. Year 2**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **$92,000** | **=** | **$28,000** | **+** | **$64,000** |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Green Gardens, Inc.**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$28,000** | **$62,000** |  |
|  | **Land** | **18,000** | **30,000** |  |
|  | **Total Assets** | **$46,000** | **$92,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$8,000** | **$28,000** |  |
|  | **Total Liabilities** | **$8,000** | **$28,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$20,000** | **$40,000** |  |
|  | **Retained Earnings** | **18,000** | **24,000** |  |
|  | **Total Stockholders’ Equity** | **$38,000** | **$64,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$46,000** | **$92,000** |  |
|  |  |  |  |  |

**c. There is no cash in the notes payable account. Cash is an asset that belongs on the left side of the accounting equation. Notes payable are liabilities that represents an obligation of the Company to distribute assets in the future.**

**d. There is no cash in the common stock account. Cash is an asset that belongs on the left side of the accounting equation. Common stock represents the portion of assets owned by the investors of the Company.**

**EXERCISE 1-12B (cont.)**

**e. There is no cash in the retained earnings account. Retained earnings represent earnings that have already been reinvested into the business to support its core functions. There is no physical cash in the retained earnings account. At the end of Year 2, the cash account has a balance of $62,000 while the ending balance in the retained earnings account is $24,000. These balances differ because retained earnings represents the excess of earnings over expenses that were earned during Year 2 while the cash account represents the physical amount of cash on hand at the end of Year 2.**

**f. The balance in the land account at the end of Year 2 is $30,000. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company’s books.**

**EXERCISE 1-13B**

**a.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash** | **+** | **Land** | **=** | **Creditors** | **+** | **Stockholders’**  **Equity** |  |
|  | **$10,000** |  | **$ 0** |  | **$4,000** |  | **$6,000** |  |
|  | **(9,000)** |  | **9,000** |  | **NA** |  | **NA** |  |
| **Bal.** | **$ 1,000** | **+** | **$9,000** | **=** | **$4,000** | **+** | **$6,000** |  |
|  |  |  |  |  |  |  |  |  |

**b. Creditor’s Claim ÷ Total Assets = Percent of Total**

**$4,000 ÷ $10,000 = 40%**

**c. Investor’s Claim ÷ Total Assets = Percent of Total**

**$6,000 ÷ $10,000 = 60%**

**d. There were no transactions involving revenue or expense during Year 1. Accordingly, Lewis has no net income or retained earnings at the end of Year 1. Lewis is unable to pay a dividend due to not having any retained earnings at the end of Year 1. Since dividends are distributions of assets generated through earnings, the company cannot distribute an amount exceeding retained earnings regardless of whether it has enough cash on hand to pay the dividend.**

**e. The company cannot repay the debt. The company owes the creditors $4,000 but has only $1,000 cash. Note, there is no actual money in the stockholders’ equity account. Indeed, there is no cash in any account that appears on the right side of the accounting equation. The right side of the accounting equation represents obligations and commitments of a company to its creditors and stockholders. Indeed, the accounting equation could be written as:**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash** | **+** | **Land** | **=** | **Creditors** | **+** | **Stockholders’**  **Equity** |  |
| **Bal.** | **$ 1,000** | **+** | **$9,000** | **=** | **40%** | **+** | **60%** |  |

All assets including any cash balances are shown on the left side of the equation.

EXERCISE 1-14B

1. **The maximum dividend that Smith Co. could pay based on the information would be $1,000, the amount of retained earnings. Since dividends are distributions of assets generated through earnings, the company cannot distribute an amount exceeding retained earnings regardless of whether it has enough cash on hand to pay the dividend.**

**b. James Co. is unable to pay a dividend due to having a $0 cash balance. Remember that retained earnings does not contain any cash. Without any cash on hand, the company is unable to pay a dividend.**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **Stockholders’ Equity** | | |  |
|  | **Company** |  | **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  | **Smith** |  | **100%** |  | **66%** |  | **26%** |  | **8%** |  |
|  | **James** |  | **100%** |  | **30%** |  | **60%** |  | **10%** |  |
|  |  |  |  |  |  |  |  |  |  |  |

**c.**

**d. There are three alternative definitions of the right side of the accounting equation. First, the right side could be referred to as sources of assets. Second, it could be defined as claims on assets. Lastly, it could be defined as obligations to creditors and commitments to owners.**

**EXERCISE 1-15B**

**a. The answers are shown in the order in which they were calculated. In other words, item (d) was calculated first, (g) second, and so on. There are other possible patterns that would produce correct answers.**

**Begin by filling in all possible blanks on the horizontal rows.**

**(d) Since common stock increased by $50,000, cash had to increase by $50,000.**

**(g) Since cash decreased by $18,000, dividends must have caused retained earnings to decrease by $18,000.**

**(h) Since cash decreased by $65,000, land must have increased by $65,000.**

**Now shift to an analysis of the vertical columns.**

**(i) Given that land had a beginning balance of $70,000 and $65,000 of land was purchased, the ending balance in the land account has to be $135,000.**

**(b) The beginning balance in the notes payable account had to be $40,000 because this amount minus the $5,000 partial pay off of notes payable would result in an ending balance in the notes payable account of $35,000.**

**(c) The $130,000 ending balance in the common stock account minus the $50,000 issued during the period yields the $80,000 beginning balance.**

**Now shift back to a horizontal analysis of the rows.**

**(a) Cash (X) + Land = Notes Pay. + Common Stk. + Beg. Ret. Ear.**

**X = -$70,000 + $40,000 + $80,000 + $20,000**

**X = $70,000**

**(j) Cash + Land = Notes Pay. + Common Stk. + End. Ret. Ear. (X)**

**X = Cash + Land – Notes Pay – Common Stk.**

**X = $90,000 + $135,000 - $35,000 - $130,000**

**X = $60,000**

**EXERCISE 1-15B (cont.)**

**(f)**

|  |  |
| --- | --- |
| **Beginning Retained Earnings** | **$20,000** |
| **+ Revenue** | **X** |
| **- Expenses** | **(30,000)** |
| **- Dividends** | **(18,000)** |
| **Ending Retained Earnings** | **$60,000** |

**$20,000 + x – $30,000 – $18,000 = $60,000**

**X = $88,000**

**(e) Given that revenue increased by $88,000 cash must have increased by $88,000.**

**The solution shown in table format is as follows:**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | | |
|  |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg. Bal.** |  | **(a)70,000** |  | **70,000** |  | **(b)40,000** |  | | **(c)80,000** |  | **20,000** |  |
| **Event 1** |  | **(d)50,000** |  | **NA** |  | **NA** |  | | **50,000** |  | **NA** | **NA** |
| **2.** |  | **(e)88,000** |  | **NA** |  | **NA** |  | | **NA** |  | **(f)88,000** | **Revenue** |
| **3.** |  | **(30,000)** |  | **NA** |  | **NA** |  | | **NA** |  | **(30,000)** | **Expenses** |
| **4.** |  | **(18,000)** |  | **NA** |  | **NA** |  | | **NA** |  | **(g)(18,000)** | **Dividend** |
| **5.** |  | **(65,000)** |  | **(h)65,000** |  | **NA** |  | | **NA** |  | **NA** | **NA** |
| **6.** |  | **(5,000)** |  | **NA** |  | **(5,000)** |  | | **NA** |  | **NA** | **NA** |
| **End. Bal.** |  | **90,000** | **+** | **(i)135,000** | **=** | **35,000** | **+** | | **130,000** | **+** | **(j)60,000** |  |
|  |  |  |  |  |  |  |  | |  |  |  |  |

**b. There is sufficient cash available to pay off the debt on January 1, Year 8. At that time the company has cash of $90,000, which is more than enough funds to repay the $35,000 notes payable.**

**EXERCISE 1-15B (cont.)**

**c. The maximum cash dividend payable is limited by the lessor of the balance in the cash account versus the balance in the retained earnings account. In this case, $60,000 is the maximum cash dividend Walter can pay.**

**EXERCISE 1-16B**

**a. Event #3 and #4 will affect the income statement.**

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Leaf Company**  **Income Statement**  **For the Year Ended December 31, Year 1** | | | |
|  |  |  |  |
|  | **Revenue** | **$48,000** |  |
|  | **Expense** | **(34,000)** |  |
|  | **Net Income** | **$14,000** |  |
|  |  |  |  |

**EXERCISE 1-17B**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Jameson Co.**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$800** | **$500** |  |
|  | **Total Assets** | **$800** | **$500** |  |
|  |  |  |  |  |
|  | **Total Liabilities** | **$500** | **$500** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$300** | **$300** |  |
|  | **Retained Earnings** | **$0** | **$(300)** |  |
|  | **Total Stockholders’ Equity** | **$300** | **($0)** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$800** | **$500** |  |
|  |  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **Jameson Co.**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$650** |  |
|  | **Expense** | **(950)** |  |
|  | **Net Income** | **$(300)** |  |
|  |  |  |  |

**EXERCISE 1-18B**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Forrest Inc.**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** |  |  |
|  | **Plus: Common Stock Issued** | **65,000** |  |  |
|  | **Ending Common Stock** |  | **$65,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **-0-** |  |  |
|  | **Plus: Net Income** | **$13,000** |  |  |
|  | **Less: Dividends** | **(5,000)** |  |  |
|  | **Ending Retained Earnings** |  | **8,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$73,000** |  |
|  |  |  |  |  |

**EXERCISE 1-19B**

**a.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Petre Company**  **Accounting Equation for Year 1** | | | | | | | |
|  | | | | | | | |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  |  | **Common** |  | **Retained** |
| **Event** | **Cash** | **=** |  | **+** | **Stock** | **+** | **Earnings** |
| **Beg. Bal.** | **30,000** |  |  |  | **30,000** |  |  |
| **1. Cash revenues** | **14,500** |  | **NA** |  | **NA** |  | **14,500** |
| **2. Paid expenses** | **(9,200)** |  | **NA** |  | **NA** |  | **(9,200)** |
| **3. Paid dividend** | **(500)** |  | **NA** |  | **NA** |  | **(500)** |
| **Ending Balance** | **34,800** | **=** | **-0-** | **+** | **30,000** | **+** | **4,800** |
|  |  |  |  |  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Petre Company**  **Income Statement**  **For the Year Ended December 31, Year 1** | | | |
|  |  |  |  |
|  | **Revenue** | **$14,500** |  |
|  | **Expense** | **(9,200)** |  |
|  | **Net Income** | **$ 5,300** |  |
|  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Petre Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 1** | | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ 30,000** |  |  |
|  | **Plus: Common Stock Issued** | **0** |  |  |
|  | **Ending Common Stock** |  | **$ 30,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** |  |  |
|  | **Plus: Net Income** | **5,300** |  |  |
|  | **Less: Dividends** | **(500)** |  |  |
|  | **Ending Retained Earnings** |  | **4,800** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$34,800** |  |
|  |  |  |  |  |

**EXERCISE 1-19B b. (cont.)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Petre Company**  **Balance Sheet**  **As of December 31, Year 1** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** |  | **$ 34,800** |  |
|  |  |  |  |  |
|  | **Liabilities** |  | **$ -0-** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$ 30,000** |  |  |
|  | **Retained Earnings** | **4,800** |  |  |
|  | **Total Stockholders’ Equity** |  | **34,800** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$ 34,800** |  |
|  |  |  |  |  |

**c. The income statement is dated with the term “for the year ended” because it covers a one year span of time. The balance sheet is dated with the term “as of” because it describes information at a specific point in time.**

**EXERCISE 1-20B**

**Steps:**

**1.**

**Common Stock Issued = Change in Common Stock**

**$20,000 (given) = *$20,000***

**2.**

**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**

**$65,000 (given) = $20,000 (1) + *$45,000***

**3.**

**Increase in Ret. Earn. = Net Income − Dividends**

**$45,000 (2) = *$50,000* − $5,000 (given)**

**Alternate Solution:**

**From the Statement of Changes in Stockholders’ Equity we know (with minor modifications):**

|  |  |  |
| --- | --- | --- |
|  |  |  |
| **Beginning Total Stk. Equity, 1/1/Year 2** |  | **$156,000** |
| **(Common Stock + Retained Earnings)** |  |  |
|  |  |  |
| **Plus: Common Stock Issued** | **$20,000** |  |
| **Plus: Net Income** | **?** |  |
| **Less: Dividends** | **(5,000)** |  |
| **Change in Stockholders’ Equity** |  | **65,000** |
|  |  |  |
| **Ending Total Stk. Equity, 12/31/Year 2** |  | **$221,000** |
|  |  |  |

**Working backwards from the change in equity we can solve for net income:**

|  |  |
| --- | --- |
|  |  |
| **Change in Stockholders’ Equity, Year 2** | **$65,000** |
| **Plus: Dividends** | **5,000** |
| **Less: Common Stock Issued** | **(20,000)** |
| **Net Income, Year 2** | ***$50,000*** |
|  |  |

**EXERCISE 1-21B**

**a.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Palmer Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Net Cash Inflow from Operating Activities** |  | **$ 15,600** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Net Cash Outflow from Investing Activities** |  | **(23,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Net Cash Outflow from Financing Activities** |  | **(4,500)** |  |
|  |  |  |  |  |
|  | **Net Decrease in Cash** |  | **(11,900)** |  |
|  | **Plus: Beginning Cash Balance** |  | **32,000** |  |
|  | **Ending Cash Balance** |  | **$20,100** |  |
|  |  |  |  |  |

**b. Cash inflow from selling fast food to customers was greater than cash outflow for expenses.**

**c. The company paid cash to purchase long-term assets.**

**d. The company paid cash dividends or paid off a bank loan.EXERCISE 1-22B**

**a.**

|  |  |
| --- | --- |
| **Event** | **Statement of Cash Flow Classification** |
| **1.** | **OA** |
| **2.** | **FA** |
| **3.** | **FA** |
| **4.** | **IA** |
| **5.** | **OA** |
| **6.** | **OA** |
| **7.** | **IA** |
| **8.** | **FA** |
| **9.** | **NA** |
| **10.** | **FA** |

**EXERCISE 1-22B (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **National Service Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Revenue** | **$14,000** |  |  |
|  | **Cash Payments for Salaries** | **(4,000)** |  |  |
|  | **Cash Payments for Utilities** | **(4,200)** |  |  |
|  | **Net Cash Inflow from Operating Activities** |  | **$ 5,800** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Paid to Purchase Land** | **$(8,000)** |  |  |
|  | **Cash Collected from the Sale of Land** | **7,000** |  |  |
|  | **Net Cash Outflow from Investing Activities** |  | **(1,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Loan** | **$ 8,000** |  |  |
|  | **Cash Paid to Loan Obligation** | **(3,000)** |  |  |
|  | **Cash Receipts from Stock Issue** | **30,000** |  |  |
|  | **Cash Payments for Dividends** | **(1,000)** |  |  |
|  | **Net Cash Inflow from Financing Activities** |  | **34,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **38,800** |  |
|  | **Plus: Beginning Cash Balance** |  | **9,000** |  |
|  | **Ending Cash Balance** |  | **$47,800** |  |
|  |  |  |  |  |

**EXERCISE 1-23B**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Tennessee Company**  **Accounting Equation for Year 2** | | | | | | | | | | | | |
|  | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Bal. 1/1/Y** |  | **15,000** | **+** | **10,000** | **=** | **-0-** | **+** | **20,000** | **+** | **5,000** |  |
| **1. Issued stk.** |  | **50,000** | **+** | **NA** | **=** | **NA** | **+** | **50,000** | **+** | **NA** | **NA** |
| **2. Pur. Land** |  | **(15,000)** | **+** | **15,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **NA** |
| **3. Loan** |  | **25,000** | **+** | **NA** | **=** | **25,000** | **+** | **NA** | **+** | **NA** | **NA** |
| **4. Provide Svc.** |  | **60,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **60,000** | **Svc. Rev.** |
| **5. Paid Rent** |  | **(12,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(12,000)** | **Rent Exp.** |
| **6. Pd. Op. Exp.** |  | **(22,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(22,000)** | **Op. Exp.** |
| **7. Paid Div.** |  | **(5,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(5,000)** | **Dividends** |
| **8. Land Value** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  |
| **End Bal.** |  | **96,000** | **+** | **25,000** | **=** | **25,000** | **+** | **70,000** | **+** | **26,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Tennessee Company**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Service Revenue** | **$60,000** |  |
|  | **Rent Expense** | **(12,000)** |  |
|  | **Operating Expense** | **(22,000)** |  |
|  | **Net Income** | **$26,000** |  |
|  |  |  |  |

**EXERCISE 1-23B (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Tennessee Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$20,000** |  |  |
|  | **Plus: Common Stock Issued** | **50,000** |  |  |
|  | **Ending Common Stock** |  | **$70,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 5,000** |  |  |
|  | **Plus: Net Income** | **26,000** |  |  |
|  | **Less: Dividends** | **(5,000)** |  |  |
|  | **Ending Retained Earnings** |  | **26,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$96,000** |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Tennessee Company**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$96,000** |  |  |
|  | **Land** | **25,000** |  |  |
|  | **Total Assets** |  | **$121,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$25,000** |  |  |
|  | **Total Liabilities** |  | **$25,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$70,000** |  |  |
|  | **Retained Earnings** | **26,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **96,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$121,000** |  |
|  |  |  |  |  |

**EXERCISE 1-23B (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Tennessee Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$60,000** |  |  |
|  | **Cash Payment for Rent Expense** | **(12,000)** |  |  |
|  | **Cash Payments for Other Operating Exp.** | **(22,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$26,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Paid to Purchase Land** | **$(15,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **(15,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$50,000** |  |  |
|  | **Cash Receipts from Loan** | **25,000** |  |  |
|  | **Cash Payments for Dividends** | **(5,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **70,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **81,000** |  |
|  | **Plus: Beginning Cash Balance** |  | **15,000** |  |
|  | **Ending Cash Balance** |  | **$96,000** |  |
|  |  |  |  |  |

**c. Percentage of assets provided by retained earnings:**

**$26,000 ÷ $121,000 = 21.5%**

**There is zero cash in the retained earnings account.**

**d. The maximum dividend that Tennessee Co. could pay is the lessor of cash on hand or retained earnings. Therefore, the maximum dividend at December 31, Year 2 would be the total amount of retained earnings of $26,000.**

**EXERCISE 1-24B**

**a.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Zeke Company**  **Accounting Equation as of January 1, Year 2** | | | | | | | | |
|  | | | | | | | | |
| **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Cash** | **+** | **Land** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **$200** |  | **$1,800** |  | **$600** |  | **$1,000** |  | **?** |
|  |  |  |  |  |  |  |  |  |

**Retained Earnings = $200 + $1,800 - $600 - $1,000 = $400**

**b. The company cannot pay a $300 dividend because it only has $200 of cash. The Retained Earnings account contains zero cash. While a company may distribute dividends if it has a retained earnings balance, the company must also have the cash to enable it to pay the dividends.**

**c. Total Assets = $200 + $1,800 = $2,000**

**Creditor’s Loans ÷ Total Assets**

**$600 ÷ $2,000 = 30%**

**d. Investor’s Contributions ÷ Total Assets**

**$1,000 ÷ $2,000 = 50%**

**e. Retained Earnings ÷ Total Assets**

**$400 ÷ $2,000 = 20%**

**f.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Zeke Company**  **Accounting Equation as of January 1, Year 2** | | | | | | | | |
|  | | | | | | | | |
| **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Cash** | **+** | **Land** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **$200** |  | **$1,800** |  | **30%** |  | **50%** |  | **20%** |
|  |  |  |  |  |  |  |  |  |

**EXERCISE 1-24B (cont.)**

**g.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Zeke Company**  **Accounting Equation as of December 31, Year 2** | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | |
| **Assets** | | | | | **=** | | **Liabilities** | | **+** | | **Stockholders’ Equity** | | | | |
|  |  |  |  |  | | **Notes** | |  | | **Common** | |  | **Retained** |  |
|  | **Cash** | **+** | **Land** | **=** | | **Payable** | | **+** | | **Stock** | | **+** | **Earnings** |  |
|  | **$200** |  | **$1,800** |  | | **$600** | |  | | **$1,000** | |  | **400** |  |
|  | **500** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **500** | **Rev.** |
|  | **(300)** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **(300)** | **Exp.** |
|  | **(50)** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **(50)** | **Div** |
|  | **350** |  | **$1,800** |  | | **$600** | |  | | **$1,000** | |  | **$550** |  |
|  |  |  |  |  | |  | |  | |  | |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **Zeke Company**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$500** |  |
|  | **Expenses** | **(300)** |  |
|  | **Net Income** | **$200** |  |
|  |  |  |  |

**EXERCISE 1-24B (cont.)**

**g.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Zeke Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$1,000** |  |  |
|  | **Plus: Common Stock Issued** | **-0-** |  |  |
|  | **Ending Common Stock** |  | **$1,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 400** |  |  |
|  | **Plus: Net Income** | **200** |  |  |
|  | **Less: Dividends** | **(50)** |  |  |
|  | **Ending Retained Earnings** |  | **550** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$1,550** |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Zeke Company**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$ 350** |  |  |
|  | **Land** | **1,800** |  |  |
|  | **Total Assets** |  | **$2,150** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$600** |  |  |
|  | **Total Liabilities** |  | **$ 600** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$1,000** |  |  |
|  | **Retained Earnings** | **550** |  |  |
|  | **Total Stockholders’ Equity** |  | **1,550** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$2,150** |  |
|  |  |  |  |  |

**EXERCISE 1-24B (cont.)**

**g.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Zeke Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$500** |  |  |
|  | **Cash Payments for Expenses** | **(300)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 200** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  | **0** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Payments for Dividends** | **(50)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **(50)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **150** |  |
|  | **Plus: Beginning Cash Balance** |  | **200** |  |
|  | **Ending Cash Balance** |  | **$ 350** |  |
|  |  |  |  |  |

**h. The income statement, statement of changes in stockholders’ equity, and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology “*For the Year Ended* December 31, Year 2.” In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In this case, the point in time is December 31, Year 2. Therefore, this statement uses the terminology “*As of* December 31, Year 2.”**

**i. The maximum dividend that Zeke Co. could pay is the lessor of cash on hand or retained earnings. Therefore, the maximum dividend at December 31, Year 2 would be the total amount of cash of $350.**

**j. No adjustment is made to the book value for changes in market value as land is recorded as historical cost.**

**EXERCISE 1-25B**

**a. The cash flow from operating activities is calculated by subtracting the cash outflow for expenses from the cash inflow from customers. ($9,900 - $4,800 = $5,100).**

**b. Since the balance in the land account increases from zero to $13,000, Shundra, Inc. must have had a net cash outflow of $13,000 for the purchase of Land.**

**c. Since the amount in the Notes Payable account increased from zero to $3,000, Shundra Inc. must have received a cash inflow of $3,000 from the issue of the note payable. Similarly, since the balance in the common stock account increased from $2,500 to $8,000,**

**Shundra, Inc. must have received a cash inflow of $5,500 ($8,000 - $2,500) from the issue of common stock. Finally, the $900 dividend payment would have caused a net cash outflow. Therefore, the net cash inflow from financing activities can be explained as follows:**

|  |  |
| --- | --- |
| **Cash Flows From Financing Activities:** |  |
| **Cash Receipts from Loan** | **$3,000** |
| **Cash Receipts from Stock Issue** | **5,500** |
| **Cash Payments for Dividends** | **(900)** |
| **Net Cash Flow from Financing Activities** | **$7,600** |

**EXERCISE 1-25B (cont.)**

**d.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Shundra, Inc.**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$ 9,900** |  |  |
|  | **Cash Payments for Expenses** | **(4,800)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$5,100** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Paid to Purchase Land** | **$(13,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **$(13,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Loan** | **$3,000** |  |  |
|  | **Cash Receipts from Stock Issue** | **5,500** |  |  |
|  | **Cash Payments for Dividends** | **(900)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **$7,600** |  |
|  |  |  |  |  |
|  | **Net Decrease in Cash** |  | **($300)** |  |
|  | **Plus: Beginning Cash Balance** |  | **4,500** |  |
|  | **Ending Cash Balance** |  | **$4,200** |  |
|  |  |  |  |  |

**e.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Shundra Inc.**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$9,900** |  |
|  | **Expenses** | **(4,800)** |  |
|  | **Net Income** | **$5,100** |  |
|  |  |  |  |

**EXERCISE 1-25B (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Shundra, Inc.**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ 2,500** |  |  |
|  | **Plus: Common Stock Issued** | **5,500** |  |  |
|  | **Ending Common Stock** |  | **$8,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 2,000** |  |  |
|  | **Plus: Net Income** | **5,100** |  |  |
|  | **Less: Dividends** | **(900)** |  |  |
|  | **Ending Retained Earnings** |  | **6,200** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$14,200** |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Shundra Inc.**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$ 4,200** |  |  |
|  | **Land** | **13,000** |  |  |
|  | **Total Assets** |  | **$17,200** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$3,000** |  |  |
|  | **Total Liabilities** |  | **$ 3,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$8,000** |  |  |
|  | **Retained Earnings** | **6,200** |  |  |
|  | **Total Stockholders’ Equity** |  | **14,200** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$17,200** |  |
|  |  |  |  |  |

**EXERCISE 1-26B**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Amelia Company**  **Accounting Equation for Year 1** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg. Bal.** |  | **$0** | **+** | **$0** | **=** | **$0** | **+** | **$0** | **+** | **$0** |  |
| **1. Issued stk.** |  | **75,000** | **+** | **NA** | **=** | **NA** | **+** | **75,000** | **+** | **NA** | **NA** |
| **2. Loan** |  | **28,000** | **+** | **NA** | **=** | **28,000** | **+** | **NA** | **+** | **NA** | **NA** |
| **3. Cash Rev.** |  | **72,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **72,000** | **Rev.** |
| **4. Cash Exp.** |  | **(55,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(55,000)** | **Exp.** |
| **5. Paid Div.** |  | **(5,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(5,000)** | **Dividends** |
| **6. Land Purch.** |  | **(34,000)** | **+** | **34,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  |
| **End Bal.** |  | **81,000** | **+** | **34,000** | **=** | **28,000** | **+** | **75,000** | **+** | **12,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Amelia Company**  **Accounting Equation for Year 2** | | | | | | | | | | | | |
|  | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg. Bal.** |  | **$81,000** | **+** | **$34,000** | **=** | **$28,000** | **+** | **$75,000** | **+** | **$12,000** |  |
| **1. Issued stk.** |  | **45,000** | **+** | **NA** | **=** | **NA** | **+** | **45,000** | **+** | **NA** | **NA** |
| **2. Loan** |  | **15,000** | **+** | **NA** | **=** | **15,000** | **+** | **NA** | **+** | **NA** | **NA** |
| **3. Cash Rev.** |  | **90,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **90,000** | **Rev.** |
| **4. Cash Exp.** |  | **(55,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(55,000)** | **Exp.** |
| **5. Paid Div.** |  | **(7,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(7,000)** | **Dividends** |
| **6. Land Purch.** |  | **(22,000)** | **+** | **22,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  |
| **End Bal.** |  | **147,000** | **+** | **56,000** | **=** | **43,000** | **+** | **120,000** | **+** | **40,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

**EXERCISE 1-26B (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Amelia Company**  **Income Statement**  **For the Period Ended December 31, Year 1 & Year 2** | | | |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Revenue** | **$72,000** | **$90,000** |  |
|  | **Expenses** | **(55,000)** | **(55,000)** |  |
|  | **Net Income** | **$17,000** | **$35,000** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Amelia Company**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** | **$75,000** |  |
|  | **Plus: Common Stock Issued** | **75,000** | **45,000** |  |
|  | **Ending Common Stock** | **$75,000** | **$120,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** | **$12,000** |  |
|  | **Plus: Net Income** | **17,000** | **35,000** |  |
|  | **Less: Dividends** | **(5,000)** | **(7,000)** |  |
|  | **Ending Retained Earnings** | **$12,000** | **$40,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** | **$87,000** | **$160,000** |  |
|  |  |  |  |  |

**EXERCISE 1-26B (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Amelia Company**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$81,000** | **$147,000** |  |
|  | **Land** | **$34,000** | **$56,000** |  |
|  | **Total Assets** | **$115,000** | **$203,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities** | **$28,000** | **$43,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$75,000** | **$120,000** |  |
|  | **Retained Earnings** | **$12,000** | **$40,000** |  |
|  | **Total Stockholders’ Equity** | **$87,000** | **$160,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$115,000** | **$203,000** |  |
|  |  |  |  |  |

**EXERCISE 1-26B (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Amelia Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$72,000** | **$90,000** |  |
|  | **Cash Payments for Expenses** | **(55,000)** | **(55,000)** |  |
|  | **Net Cash Flow from Operating Activities** | **$17,000** | **$35,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Payment for Land** | **$(34,000)** | **$(22,000)** |  |
|  | **Net Cash Flow from Investing Activities** | **(34,000)** | **(22,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Borrowed Funds** | **$28,000** | **$15,000** |  |
|  | **Cash Receipts from Stock Issue** | **75,000** | **45,000** |  |
|  | **Cash Dividend** | **(5,000)** | **(7,000)** |  |
|  | **Net Cash Flow from Financing Activities** | **$98,000** | **$53,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** | **$81,000** | **$66,000** |  |
|  | **Plus: Beginning Cash Balance** | **-0-** | **$81,000** |  |
|  | **Ending Cash Balance** | **$81,000** | **$147,000** |  |
|  |  |  |  |  |

**EXERCISE 1-27B**

|  |  |
| --- | --- |
| **Financial Statements** | **Descriptions** |
| **Statement of Cash Flows** | **A.  Summarizes the activity under the cash account within the accounting equation.  Explains the activities that caused the cash balance to change from the beginning of the year to the end of the year.** |
| **Balance Sheet** | **C.  Summarizes all the company's accounts under the accounting equation as of a point in time.  All other financial statements can be created from activity included in this statement.** |
| **Statement of Stockholders Equity** | **B.  Summarizes all the activity under the equity section of the accounting equation.  This statement generally shows how common stock and retained earnings changed from the beginning of the year to the end of the year.** |
| **Income Statement** | **D.  Summarizes the revenues and expenses recorded under the retained earnings column of the accounting equation.  This statement focuses on company performance over a fixed period of time.** |

**EXERCISE 1-28B**

1. **Historically, each country developed its own unique set of GAAP. However, this causes global companies to prepare multiple sets of financial statements in order to satisfy each country’s GAAP. To address the need for a common set of financial statements, the International Accounting Standards Committee was formed in 1973. In 2001, the committee was reorganized into the International Accounting Standards Board (IASB). This Board issues International Financial Reporting Standards (IFRS), which are gaining support worldwide. While at this time, there is no requirement to use IFRS in the United States, there is a movement in that direction.**
2. **Similarities between the IASC and FASB include members from a variety of backgrounds, members generally work full-time for their respective boards, members cannot be compensated by other organizations, members generally serve a five-year term, funding is obtained from a variety of sources and in order to maintain independence, each has a set of trustees to oversee fundraising. Some differences include the number of members on the board. The FASB has seven members while the IASC has sixteen members. In addition, the IASC must have a specific number of members from certain geographical regions. In addition, some of the principles differ significantly.**

**Differences are not limited to structure. One good example of difference in reporting requirements is the use of the historical cost concept for GAAP and the use of current values for IFRS. This can cause significant differences in the monetary amount of assets listed on the balance sheet.**

**SOLUTIONS TO PROBLEMS – SERIES B - CHAPTER 1**

**PROBLEM 1-29B**

**a. GAAP Generally Accepted Accounting Principles**

**b. Revenue may be recognized in either of the years depending on the entity’s determination of the point in time for revenue recognition. For example, if Jan’s earning process is deemed complete when she delivers her report then she would recognize revenue in December Year 1. But if Jan’s earning process is deemed complete upon client satisfaction, then she would recognize revenue in February Year 2.**

**c. Management accounting reporting is not bound by GAAP. GAAP is required for external reporting. It helps insure consistent reporting from period to period as well as from company to company. Some differences will exist, but the methods used should be disclosed. Internal reporting is more concerned with supplying managers with the information they need to make the best decisions.**

**PROBLEM 1-30B**

|  |  |
| --- | --- |
| **a. Entities mentioned:** | **b. Effect on the cash account:** |
| **1. Chris Hann** | **Decrease** |
| **Classic Auto Sales** | **Increase** |
|  |  |
| **2. Sal Pearl** | **Decrease** |
| **Business** | **Increase** |
|  |  |
| **3. First State Bank** | **Decrease** |
| **Strong Co.** | **Increase** |
|  |  |
| **4. Cindy’s Restaurant** | **Decrease** |
| **Midwest Utilities** | **Increase** |
|  |  |
| **5. Sun Corp.** | **Increase/Decrease** |
| **City National Bank** | **Decrease** |
| **Carriage Realty** | **Increase** |
|  |  |
| **6. Sue Wang** | **Decrease** |
| **International Sales Corporation** | **Increase** |
|  |  |
| **7. Chris Gordon** | **Decrease** |
| **Daughter** | **Increase** |
|  |  |
| **8. Motor Service Co.** | **Increase** |
| **Customers** | **Decrease** |
|  |  |
| **9. Poy Imports** | **Decrease** |
| **Employees** | **Increase** |
|  |  |
| **10. Borg Inc.** | **Decrease** |
| **Mark Borg** | **Increase** |

**PROBLEM 1-31B**

|  |  |  |
| --- | --- | --- |
| **Event No.** | **Type of Event** | **Effect on Total Assets** |
| **1.** | **Asset Use** | **Decrease** |
| **2.** | **Asset Use** | **Decrease** |
| **3.** | **Asset Source** | **Increase** |
| **4.** | **Asset Use** | **Decrease** |
| **5.** | **Asset Source** | **Increase** |
| **6.** | **Asset Exchange** | **No Effect** |
| **7.** | **NA** | **NA** |
| **8.** | **Asset Use** | **Decrease** |
| **9.** | **Asset Source** | **Increase** |
| **10.** | **Asset Exchange** | **No Effect** |
| **11.** | **Asset Exchange** | **No Effect** |
| **12.** | **Asset Use** | **Decrease** |
| **13.** | **NA** | **NA** |
| **14.** | **Asset Source** | **Increase** |
| **15.** | **Asset Use** | **Decrease** |
|  |  |  |

**PROBLEM 1-32B**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Item** | **Income Statement** | **Statement of Changes in Stk. Equity** | **Balance Sheet** | **Statement of Cash Flows** |
| **For the Period Ended (Date)** |  |  |  |  |
| **Net income** |  |  |  |  |
| **Investing activities** |  |  |  |  |
| **Net loss** |  |  |  |  |
| **Ending cash balance** |  |  |  |  |
| **Salary expense** |  |  |  |  |
| **Consulting revenue** |  |  |  |  |
| **Dividends** |  |  |  |  |
| **Financing activities** |  |  |  |  |
| **Ending common stock** |  |  |  |  |
| **Interest expense** |  |  |  |  |
| **As of (date)** |  |  |  |  |
| **Land** |  |  |  |  |
| **Beginning cash balance** |  |  |  |  |
| **Notes payable** |  |  |  |  |
| **Beginning common stock** |  |  |  |  |
| **Service revenue** |  |  |  |  |
| **Utility expense** |  |  |  |  |
| **Stock issue** |  |  |  |  |
| **Operating activities** |  |  |  |  |

**PROBLEM 1-33B**

**a.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Blix Corp.**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$27,500a** |  |
|  | **Expense** | **(15,000)** |  |
|  | **Net Income** | **$12,500** |  |
|  |  |  |  |

**aTo calculate revenue, you must first determine the ending balance in the retained earnings account at the end of Year 2:**

|  |  |  |
| --- | --- | --- |
| **Beginning Retained Earnings** |  | **$ 20,000** |
| **Plus increase in Retained Earnings** |  | **8,500** |
| **Ending Retained earnings** |  | **$28,500** |
|  |  |  |

**Next, you can use this information to determine the amount of net income:**

|  |  |  |
| --- | --- | --- |
| **Beginning Retained Earnings** |  | **$ 20,000** |
| **Plus Net Income** |  | **“X”** |
| **Minus Dividends** |  | **(4,000)** |
| **Ending Retained earnings** |  | **$28,500** |
| **X = $28,500 - $20,000 + $4,000; X = $12,500** |  |  |

**Finally, using the amount of net income, you can derive revenue:**

|  |  |  |  |
| --- | --- | --- | --- |
| **Revenue** |  | **$ “X”** | |
| **Expenses** |  | **(15,000)** |
| **Net Income** |  | **$12,500** |
|  |  |  |

**X = $12,500 + $15,000; X = $27,500**

**PROBLEM 1-33B (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Blix Corp.**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$10,000b** |  |  |
|  | **Plus: Common Stock Issued** | **8,000** |  |  |
|  | **Ending Common Stock** |  | **$18,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$20,000** |  |  |
|  | **Plus: Net Income** | **12,500** |  |  |
|  | **Less: Dividends** | **(4,000)** |  |  |
|  | **Ending Retained Earnings** |  | **28,500** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$46,500** |  |
|  |  |  |  |  |

**b To calculate the amount of common stock issued; rearrange the accounting equation and solve for the missing variable common stock as follows:**

**Assets − Liabilities − Retained Earnings = Common Stock:**

**$50,000 − $20,000 − $20,000 = *$10,000***

**EXERCISE 1-33B (cont.)**

**c.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Blix Corp.**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  | **$64,500c** |  |
|  |  |  |  |  |
|  | **Liabilities** |  | **$18,000d** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$18,000** |  |  |
|  | **Retained Earnings** | **28,500** |  |  |
|  | **Total Stockholders’ Equity** |  | **46,500** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$64,500** |  |
|  |  |  |  |  |

**c Based on the accounting equation total assets are equal to total liabilities ($18,000) plus stockholders’ equity ($46,500).**

**d Total liabilities is calculated as follows:**

**Total Liabilities = $20,000 Beg. Bal. - $2,000 Partial Payoff = $18,000 Ending Balance.**

**PROBLEM 1-33B (cont.)**

**d.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Blix Corp.**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipt from Revenue** | **$27,500** |  |  |
|  | **Cash Payment for Expense** | **(15,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$12,500** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities** |  | **-0-** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$ 8,000** |  |  |
|  | **Cash Payment to Creditors** | **(2,000)** |  |  |
|  | **Cash Dividend Paid to Stockholders** | **(4,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **$2,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **14,500** |  |
|  | **Plus: Beginning Cash Balance** |  | **50,000** |  |
|  | **Ending Cash Balance** |  | **$64,500** |  |
|  |  |  |  |  |

**e. Percentage of assets provided by:**

**Creditors $18,000 ÷ $64,500 = 27.90%**

**Investors $18,000 ÷ $64,500 = 27.90%**

**Earnings $28,500 ÷ $64,500 = 44.18%**

**PROBLEM 1-34B**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Marco’s Consulting**  **Accounting Equation for Year 1** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |  |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Common**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **1. Issued stk** |  | **50,000** | **+** | **NA** | **=** | **NA** | **+** | **50,000** | **+** | **NA** | **NA** |
| **2. Revenue** |  | **100,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **100,000** | **Svc. Rev.** |
| **3. Loan** |  | **15,000** | **+** | **NA** | **=** | **15,000** | **+** | **NA** | **+** | **NA** | **NA** |
| **4. Paid Exp.** |  | **(60,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(60,000)** | **Expense** |
| **5. Pur. Land** |  | **(40,000)** | **+** | **40,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **NA** |
| **End Bal.** |  | **65,000** | **+** | **40,000** | **=** | **15,000** | **+** | **50,000** | **+** | **40,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Marco’s Consulting**  **Accounting Equation for Year 2** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |  |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Common**  **Stock** | **+** | **Retained Earnings** | **Acct. Title/RE** |
| **Beg. Bal.** |  | **65,000** | **+** | **40,000** | **=** | **15,000** | **+** | **50,000** | **+** | **40,000** |  |
| **1. Issued stk** |  | **20,000** | **+** | **NA** | **=** | **NA** | **+** | **20,000** | **+** | **NA** | **NA** |
| **2. Revenue** |  | **130,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **130,000** | **Svc. Rev.** |
| **3. Paid Loan** |  | **(10,000)** | **+** | **NA** | **=** | **(10,000)** | **+** | **NA** | **+** | **NA** | **NA** |
| **4. Paid Exp.** |  | **(75,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(75,000)** | **Expense** |
| **5. Paid Div.** |  | **(15,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(15,000)** | **Dividends** |
| **6. Land Val.** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **NA** | **NA** |
| **End Bal.** |  | **115,000** | **+** | **40,000** | **=** | **5,000** | **+** | **70,000** | **+** | **80,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

**PROBLEM 1-34B (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Marco’s Consulting**  **Income Statement**  **For the Period Ended December 31, Year 1 & Year 2** | | | |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Service Revenue** | **$100,000** | **$130,000** |  |
|  | **Expenses** | **(60,000)** | **(75,000)** |  |
|  | **Net Income** | **$40,000** | **$55,000** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Marco’s Consulting**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** | **$50,000** |  |
|  | **Plus: Common Stock Issued** | **50,000** | **20,000** |  |
|  | **Ending Common Stock** | **$50,000** | **$70,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** | **$40,000** |  |
|  | **Plus: Net Income** | **40,000** | **55,000** |  |
|  | **Less: Dividends** | **-0-** | **(15,000)** |  |
|  | **Ending Retained Earnings** | **$40,000** | **$80,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** | **$90,000** | **$150,000** |  |
|  |  |  |  |  |

**PROBLEM 1-34B (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Marco’s Consulting**  **Balance Sheet**  **December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$65,000** | **$115,000** |  |
|  | **Land** | **40,000** | **$40,000** |  |
|  | **Total Assets** | **$105,000** | **$155,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities** | **$15,000** | **$5,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$50,000** | **$70,000** |  |
|  | **Retained Earnings** | **40,000** | **$80,000** |  |
|  | **Total Stockholders’ Equity** | **$90,000** | **$150,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** | **$105,000** | **$155,000** |  |
|  |  |  |  |  |

**PROBLEM 1-34B (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Marco’s Consulting**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1 & Year 2** | | | | |
|  |  |  |  |  |
|  |  | **Year 1** | **Year 2** |  |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$100,000** | **$130,000** |  |
|  | **Cash Payments for Expenses** | **(60,000)** | **(75,000)** |  |
|  | **Net Cash Flow from Operating Activities** | **$40,000** | **$55,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Payment for Land** | **(40,000)** | **-0-** |  |
|  | **Net Cash Flow from Investing Activities** | **(40,000)** | **-0-** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Borrowed Funds** | **$15,000** | **-0-** |  |
|  | **Cash Receipts from Stock Issue** | **50,000** | **$20,000** |  |
|  | **Cash Payment on Debt** |  | **(10,000)** |  |
|  | **Cash Dividend** | **-0-** | **(15,000)** |  |
|  | **Net Cash Flow from Financing Activities** | **$65,000** | **$(5,000)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** | **$65,000** | **$50,000** |  |
|  | **Plus: Beginning Cash Balance** | **-0-** | **$65,000** |  |
|  | **Ending Cash Balance** | **$65,000** | **$115,000** |  |
|  |  |  |  |  |

**PROBLEM 1-34B (cont.)**

**c. Retained earnings does not contain cash.**

**d. In Year 1 and Year 2, net income and cash flows from operating activities are the same because all revenues and expenses are cash. Ordinarily, net income will be different from cash flows from operating activities due to non-cash revenue and expense transactions (discussed in Chapter 2). The net change in cash is different from net income because investing and financing activities do not directly affect revenue and expenses.**

**PROBLEM 1-35B**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | | | | | | |
|  |  | | | | | | |  |
| **FOR THE YEARS** | | | **Year 1** |  | **Year 2** |  | **Year 3** |  |
|  | |  |  |  |  |  |  |  |
| **Income Statements** | | | | | | | | |
|  | | **Revenue (cash)** | **$ 700** |  | **$ 1,300** |  | **$ 2,000** |  |
|  | | **Expense (cash)** | **(a) (500)** |  | **(700)** |  | **(1,300)** |  |
|  | | **Net income** | **$ 200** |  | **(m) $ 600** |  | **$ 700** |  |
|  | |  |  |  |  |  |  |  |
| **Statements of Changes in Stockholders’ Equity** | | | | | | | | |
|  | | **Beginning common stock** | **$ -0-** |  | **(n) $5,000** |  | **$6,000** |  |
|  | | **Plus: Common stock issued** | **5,000** |  | **1,000** |  | **2,000** |  |
|  | | **Ending common stock** | **5,000** |  | **6,000** |  | **(t) 8,000** |  |
|  | |  |  |  |  |  |  |  |
|  | | **Beginning retained earnings** | **-0-** |  | **100** |  | **200** |  |
|  | | **Plus: Net income** | **(b) 200** |  | **(o) 600** |  | **700** |  |
|  | | **Less: Dividends** | **(c) (100)** |  | **(500)** |  | **(300)** |  |
|  | | **Ending retained earnings** | **100** |  | **(p) 200** |  | **600** |  |
|  | | **Total stockholders’ equity** | **(d) $5,100** |  | **$6,200** |  | **$8,600** |  |
|  | |  |  |  |  |  |  |  |
| **Balance Sheets** | | | | | | | | |
|  | | **Assets** |  |  |  |  |  |  |
|  | | **Cash** | **(e) $8,100** |  | **(q) $ 3,200** |  | **(u) $ 2,600** |  |
|  | | **Land** | **-0-** |  | **(r) 8,000** |  | **8,000** |  |
|  | | **Total assets** | **(f) $8,100** |  | **$11,200** |  | **$10,600** |  |
|  | |  |  |  |  |  |  |  |
|  | | **Liabilities** | **(g) $ 3,000** |  | **$ 5,000** |  | **$ 2,000** |  |
|  | |  |  |  |  |  |  |  |
|  | | **Stockholders’ equity** |  |  |  |  |  |  |
|  | | **Common stock** | **(h) 5,000** |  | **(s) 6,000** |  | **8,000** |  |
|  | | **Retained earnings** | **(i) 100** |  | **200** |  | **600** |  |
|  | | **Total stockholders’ equity** | **(j) 5,100** |  | **6,200** |  | **8,600** |  |
|  | | **Total liabilities and stk. equity** | **$8,100** |  | **$11,200** |  | **$10,600** |  |
|  | |  |  |  |  |  |  |  |

**PROBLEM 1-35B (cont.)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | | | | | | |
|  |  | | | | | | |  |
| **FOR THE YEARS** | | **Year 1** |  | **Year 2** |  | **Year 3** | |  |
|  |  |  |  |  |  |  | |  |
| **Statements of Cash Flows** | | | | | | | | |
|  |  |  |  |  |  |  | |  |
|  | **Cash flows from oper. activities:** |  |  |  |  |  | |  |
|  | **Cash receipts from revenue** | **(k)$ 700** |  | **$ 1,300** |  | **(v) $ 2,000** | |  |
|  | **Cash payments for expenses** | **(l) (500)** |  | **(700)** |  | | **(w) (1,300)** |  |
|  | **Net cash flows from oper. Act.** | **200** |  | **600** |  | **700** | |  |
|  |  |  |  |  |  |  | |  |
|  | **Cash flows from invest. activities:** |  |  |  |  |  | |  |
|  | **Cash payments for land** | **-0-** |  | **(8,000)** |  | **-0-** | |  |
|  | **Net cash flows from invest. act.** | **-0-** |  | **(8,000)** |  | **-0-** | |  |
|  |  |  |  |  |  |  | |  |
|  | **Cash flows from fin. activities:** |  |  |  |  |  | |  |
|  | **Cash rec. from loan** | **3,000** |  | **2,000** |  | **-0-** | |  |
|  | **Cash payments to reduce debt** | **-0-** |  | **-0-** |  | **(x) (3,000)** | |  |
|  | **Cash receipts from stock issue** | **5,000** |  | **1,000** |  | **(y) 2,000** | |  |
|  | **Cash payments for dividends** | **(100)** |  | **(500)** |  | **(z) (300)** | |  |
|  | **Net cash flows from fin. activities** | **7,900** |  | **2,500** |  | **(1,300)** | |  |
|  |  |  |  |  |  |  | |  |
|  | **Net change in cash** | **8,100** |  | **(4,900)** |  | **(600)** | |  |
|  | **Plus: beginning cash balance** | **-0-** |  | **8,100** |  | **3,200** | |  |
|  | **Ending cash balance** | **$8,100** |  | **$ 3,200** |  | **$ 2,600** | |  |
|  |  |  |  |  |  |  | |  |

**PROBLEM 1-35B (cont.)**

**Computations of amounts:**

1. **$500 Expenses = $700 Revenue − $200 Net Income.**
2. **Net income equal to amount shown in income statement.**
3. **$100 Dividends = $200 Net Income − $100 Ending Retained Earnings**
4. **$5,100 Total Stockholders’ Equity = $5,000 Ending Common Stock + $100 Ending Retained Earnings**
5. **$8,100 Cash = $8,100 Total Assets − $-0- Land.**
6. **$8,100 Total Assets = $8,100 Cash − $-0- Land.**
7. **$3,000 Liabilities = $8,100 Total Liabilities and Stockholders’ Equity − $5,100 Total Stockholders’ Equity.**
8. **$5,000 Common Stock = $5,000 Common Stock Issued − $0 Beginning Common Stock**
9. **$100 Retained Earnings = $100 Ending Retained Earnings**
10. **$5,100 Total Stockholders’ Equity = $5,000 Ending Common Stock + $100 Ending Retained Earnings.**
11. **$700 Cash Receipts from Revenue = $700 Revenue from Income Statement.**
12. **$500 Cash Payments for Expenses = $500 Expenses from Income Statement.**
13. **$600 Net Income = $1,300 Revenue − $700 Expenses.**
14. **$5,000 Beginning Common Stock = $5,000 Ending Common Stock for Year 1.**
15. **$600 Net Income = $600 Net Income from Income Statement**
16. **$200 Ending Retained Earnings = $100 Beginning Retained Earnings + $600 Net Income − $500 Dividends.**
17. **$3,200 Cash = $3,200 Ending Cash Balance from the Statement of Cash Flows.**
18. **$8,000 Land = $11,200 Total Assets − $3,200 Cash.**
19. **$6,000 Common Stock = $6,000 Ending Common Stock from Statement of Changes in Stockholders’ Equity**
20. **$8,000 Ending Common Stock = $6,000 Beginning Common Stock + $2,000 Stock issued.**
21. **$2,600 Cash = $10,600 Total Assets − $8,000 Land.**
22. **$2,000 Cash Receipts from Revenue = $2,000 Revenue from Income Statement.**
23. **$1,300 Cash Payments for Expenses = $1,300 Expenses from Income Statement.**
24. **$3,000 Cash Payments to Reduce Debt = $5,000 Liabilities Balance, Year 2 − $2,000 Liabilities Balance, Year 3.**
25. **$2,000 Cash Receipts from Stock Issue = $2,000 Common Stock Issued from Statement of Changes in Stockholders’ Equity.**
26. **$300 Cash Payments for Dividends = $300 Dividends from Statement of Changes in Stockholders’ Equity.**

**SOLUTIONS TO ANALYZE, THINK, COMMUNICATE – CHAPTER 1**

**ATC 1–1 (All dollar amounts are in millions.)**

**a. $ 2,937**

**b. Net income increased by $23**

**STOCKHOLDERS’**

**c. ASSETS = LIABILITIES + EQUITY**

**$41,290 = $29,993\* + $11,297**

**\* Liabilities must be computed by subtracting equity from assets.**

**d. Sales increased by 3.7% from 2017 to 2018.**

**($74,443− $71,786) ÷ $71,786 = 3.7%**

**Cost of sales increased by 4.3% from 2017 to 2018.**

**($53,299− $51,125) ÷ $51,125 = 4.3%**

**Selling, general and administrative expenses increased by 3.9% from 2017 to 2018. ($15,723− $ 15,140) ÷ $ 15,140 = 3.9%**

**The largest percentage increase was for cost of sales expenses.**

**ATC 1-2**

**a.**

**Income Statements (amounts given are in millions)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
|  | **Year 1** | **Year 2** | **Year 3** | **Year 4** |
|  |  |  |  |  |
| **Revenue** | $ 860 | **$1,695** | (a) $2,575 | $2,900 |
| **Cost and Expenses** | **(a) (840)** | **(1,070)** | **(2,400)** | **(2,600)** |
| **Net Income** | **$ 20** | **(a) $ 625** | **$ 175** | (a) $ 300 |
|  |  |  |  |  |
| **Balance Sheets** |  |  |  |  |
| **Cash** | **(b) $ 350** | **$2,520** | (b) $820 | $ 1,860 |
| **Other Assets** | **1,900** | **(b) 1,180** | **2,500** | **(b) 2,560** |
| **Total Assets** | **$2,250** | **$3,700** | **(c) 3,320** | $4,420 |
|  |  |  |  |  |
| **Liabilities** | (c) $ 730 | **(c) $1,555** | $1,000 | **(c) $1,300** |
|  |  |  |  |  |
| **Stockholders’ Equity** |  |  |  |  |
| **Common Stock** | **$ 1,500** | $ 1,500 | (d) $1,500 | $ 2,000 |
| **Retained Earnings** | **(d) 20** | **645** | **820** | **(d) 1,120** |
| **Total Stockholders’ Equity** | **1,520** | **(d) 2,145** | **2,320** | 3,120 |
|  |  |  |  |  |
| **Total Liab. and Stk. Equity** | **$2,250** | **$3,700** | $3,320 | **$4,420** |
|  |  |  |  |  |

**ATC 1-3**

**1. Ford’s cash purchase of Autonomic and TransLoc should be classified as a cash outflow in the investing activities section of the statement of cash flows**

**2. Facebook’s cash expenses should be classified as a cash outflow in the operating activities section of the statement of cash flows.**

**3. General Electric’s sale of its Value-Based Care Division should be classified as a cash inflow in the investing activities section of the statement of cash flows.**

**4. General Motor’s borrowing of cash using long-term debt should be classified as a cash inflow in the financing activities section of the statement of cash flows.**

**5. IBM’s collection of cash from sales should be classified as a cash inflow in the operating activities section of the statement of cash flows.**

**6. McDonald’s payment of dividends should be classified as a cash outflow in the financing activities section of the statement of cash flows.**

**ATC 1-4**

1. **The percentage growth from Year 1 to Year 2 was 67% [($200,000 − $120,000) ÷ $120,000]. However, this rate of growth will probably not continue from Year 2 to Year 3 because 77.5% ($62,000 ÷ $80,000) of the growth was from the lottery win. If the company continues to grow at the current rate, shareholders should expect an increase in net income of approximately 15%. This is the increase in net income without the lottery win [($138,000 − $120,000) ÷ $120,000 = 15%].**
2. **One could assume that the $200,000 was used to pay off liabilities since the total liabilities were reduced by $200,000. Also, assets and common stock did not change.**
3. **The percentage increase in net income was 15% (see a. above). Therefore, owners could expect net income to be $158,700 ($138,000 x 115%) in Year 3.**

**d.**

|  |  |  |
| --- | --- | --- |
| **Machine Imports Company**  **Income Statement**  **For Year Ended December 31, Year 3** | | |
|  |  |  |
| **Revenue ($690,000 x 115%)** |  | **$793,500** |
| **Operating Expenses ($552,000 x 115%)** |  | **(634,800)** |
| **Infrequent item – loss from storm** |  | **(40,000)** |
|  |  |  |
| **Net Income** |  | **$118,700** |
|  |  |  |

**ATC 1-4 d. (cont.)**

|  |  |  |
| --- | --- | --- |
| **Machine Imports Company**  **Balance Sheet**  **As of December 31, Year 3** | | |
|  |  |  |
| **Assets** |  | **$998,700** |
|  |  |  |
| **Liabilities** |  | **$ -0-** |
|  |  |  |
| **Stockholders’ Equity** |  |  |
| **Common Stock** | **$380,000** |  |
| **Retained Earnings ($500,000 + $118,700)** | **618,700** |  |
| **Total Stockholders’ Equity** |  | **998,700** |
|  |  |  |
| **Total Liabilities and Stockholders’ Equity** |  | **$998,700** |
|  |  |  |

**ATC 1-5**

**This problem is designed to test written communication skills. The memo should describe the balance sheet and the income statement. It should explain that the balance sheet is a statement of assets, liabilities, and stockholders’ equity at the date of the financial statement. The income statement gives the amount of revenues and expenses for the designated period. The memo should also define each of the following terms:**

**Assets**

**Liabilities**

**Stockholders’ Equity**

**Revenue**

**Expense**

**Net Income**

**ATC 1-6   
a.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Financial Statements** | | | |
|  |  |  |  |
| **Income Statement** | | | |
|  | **Revenue** | **$57,000** |  |
|  | **Expense** | **(40,000)** |  |
|  | **Net Income** | **$17,000** |  |
|  |  |  |  |
| **Statement of Changes in Stockholders’ Equity** | | | |
|  | **Beginning Common Stock** | **$20,000** |  |
|  | **Plus: Stock Issued** | **5,000** |  |
|  | **Ending Common Stock** | **25,000** |  |
|  |  |  |  |
|  | **Beginning Retained Earnings** | **50,000** |  |
|  | **Plus: Net Income** | **17,000** |  |
|  | **Less: Dividends** | **(2,000)** |  |
|  | **Ending Retained Earnings** | **65,000** |  |
|  |  |  |  |
|  | **Total Stockholders’ Equity** | **$90,000** |  |
|  |  |  |  |
| **Balance Sheet** | | | |
|  | **Assets** |  |  |
|  | **Cash** | **$90,000** |  |
|  | **Total Assets** | **$90,000** |  |
|  |  |  |  |
|  | **Stockholders’ Equity** |  |  |
|  | **Common Stock** | **$25,000** |  |
|  | **Retained Earnings** | **65,000** |  |
|  | **Total Stockholders’ Equity** | **$90,000** |  |
|  |  |  |  |
| **Statement of Cash Flows** | | | |
|  | **Net Cash Flow From Operating Activities:** |  |  |
|  | **Inflow from Customers** | **$57,000** |  |
|  | **Outflow for Expenses** | **(40,000)** |  |
|  | **Net Cash Flow from Operating Activities** | **17,000** |  |
|  |  |  |  |
|  | **Net Cash Flow From Investing Activities** | **-0-** |  |
|  |  |  |  |
|  | **Net Cash Flow From Financing Activities:** |  |  |
|  | **Inflow from Stock Issue** | **5,000** |  |
|  | **Outflow for Dividends** | **(2,000)** |  |
|  | **Net Cash Flow from Financing Activities** | **3,000** |  |
|  |  |  |  |
|  | **Net Change in Cash** | **$20,000** |  |
|  | **Plus: Beginning Cash Balance** | **70,000** |  |
|  | **Ending Cash Balance** | **$90,000** |  |
|  |  |  |  |

**ATC 1-6 (cont.)**

**b. In the short-run replacing Kevin would save $5,000 in cash expenses. Accordingly, net income, assets, stockholders’ equity, and cash flow from operating activities would increase. These effects can be confirmed by comparing the statements above (i.e., after effect of replacement) with those shown in the textbook (i.e., before effect of replacement). However, the long-run impact may be different depending on how other employees react to Kevin’s replacement. If the replacement creates resentment and low morale among the remaining employees, then productivity and profitability may decline. In this case, the company may experience a negative impact rather than the expected positive effect. The best solution to this dilemma is avoidance. Kevin’s salary should never have been permitted to rise above his value to the company. As future business managers, students should take heed of the perils of excessive generosity. Employees should be paid on a basis that is consistent with their contribution to the company’s profitability. The pain of corporate downsizing can be avoided if businesses do not oversize in the first place.**

**ATC 1-7**

**This solution is based on McDonald’s December 31, 2018 annual report. Dollar amounts are in millions.**

**a. McDonald’s net income for 2018 and 2017 were as follows:**

**2018: $5,924.3**

**2017: 5,192.3**

**b. The company had $32,811.2 of assets at the end of 2018.**

**c. The company had a deficit in total shareholders’ equity of $6,258.4 at the end of 2018. NOTE: McDonald’s negative shareholders’ equity was due to the large balance in its Treasury Stock account at the end of 2018.**

**d. For 2018, the company’s:**

**Net cash flow from *operating* activities were $6,966.7.**

**Net cash flow from *investing* activities were ($2,455.1).**

**Net cash flow from *financing* activities were ($5,949.6).**