CHAPTER 1
INTRODUCTION TO ACCOUNTING AND BUSINESS

DISCUSSION QUESTIONS

1. Some users of accounting information include managers, employees, investors, creditors, customers, and the government.

2. The role of accounting is to provide information for managers to use in operating the business. In addition, accounting provides information to others to use in assessing the economic performance and condition of the business.

3. The corporate form allows the company to obtain large amounts of resources by issuing stock. For this reason, most companies that require large investments in property, plant, and equipment are organized as corporations.

4. No. The business entity assumption limits the recording of economic data to transactions directly affecting the activities of the business. The payment of the interest of $4,500 is a personal transaction of Josh Reilly and should not be recorded by Dispatch Delivery Service.

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

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

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

7. An account receivable is a claim against a customer for goods or services sold. An account payable is an amount owed to a creditor for goods or services purchased. Therefore, an account receivable in the records of the seller is an account payable in the records of the purchaser.

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

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

10. **(a)** Net income or net loss

(b) Common stock and retained earnings at the end of the period

(c) Cash at the end of the period

BASIC EXERCISES

BE 1–1

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

BE 1–2

a.

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

b.

A	=	L + SE
–$65,000	=	$36,000
SE	=	–$101,000
SE on December 31, 20Y2	=	$298,000
SE on December 31, 20Y3	=	$197,000

BE 1–3

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

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

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

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

BE 1–4

Paradise Travel Service Income Statement For the Year Ended May 31, 20Y6		
Fees earned		$ 900,000
Expenses:		
Wages expense	$450,000	
Office expense	300,000	
Miscellaneous expense	15,000	
Total expenses		(765,000)
Net income		$ 135,000

BE 1–5

Paradise Travel Service Statement of Stockholders' Equity For the Year Ended May 31, 20Y6			
	Common Stock	Retained Earnings	Total
Balances, June 1, 20Y5	$ 60,000	$300,000	$360,000
Issued common stock	40,000		40,000
Net income		135,000	135,000
Dividends		(10,000)	(10,000)
Balances, May 31, 20Y6	$100,000	$425,000	$525,000

BE 1–6

Paradise Travel Service Balance Sheet May 31, 20Y6		
Assets		
Cash		$ 52,000
Accounts receivable		38,000
Supplies		3,000
Land		450,000
Total assets		$ 543,000
Liabilities		
Accounts payable		$ 18,000
Stockholders' Equity		
Common stock	$100,000	
Retained earnings	425,000	
Total stockholders' equity		525,000
Total liabilities and stockholders' equity		$ 543,000

BE 1–7

Paradise Travel Service Statement of Cash Flows For the Year Ended May 31, 20Y6		
Cash flows from (used for) operating activities:		
Cash received from customers	$ 880,000	
Cash paid for operating expenses	(758,000)	
Net cash flows from operating activities		$ 122,000
Cash flows from (used for) investing activities:		
Cash paid for purchase of land		(150,000)
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 40,000	
Cash paid for dividends	(10,000)	
Net cash flows from financing activities		30,000
Net increase in cash		$ 2,000
Cash balance, June 1, 20Y5		50,000
Cash balance, May 31, 20Y6		$ 52,000

BE 1–8

a.

	Dec. 31, 20Y4	Dec. 31, 20Y3
Total liabilities	$4,085,000	$2,880,000
Total stockholders' equity	$4,300,000	$3,600,000
Ratio of liabilities to stockholders' equity	0.95*	0.80**

* $4,085,000 ÷ $4,300,000

** $2,880,000 ÷ $3,600,000

b. Increased

EXERCISES

Ex. 1–1

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

b. The accounting equation is relevant to all companies. It serves as the basis of the accounting information system.

Ex. 1–2

As in many ethics issues, there is no one right answer. Oftentimes, disclosing only what is legally required may not be enough. In this case, it would be best for the company's chief executive officer to disclose both reports to the county representatives. In doing so, the chief executive officer could point out any flaws or deficiencies in the fired researcher's report.

Ex. 1–3

a.
1. M
2. L
3. O
4. M
5. O
6. O
7. X
8. L
9. X
10. O

b. A business transaction is an economic event or condition that directly changes an entity's financial condition or results of operations.

Ex. 1–4

McDonald's stockholders' equity: $37,939 – $30,851 = $7,088
Starbucks' stockholders' equity: $14,330 – $8,446 = $5,884

Ex. 1–5

Dollar Tree's stockholders' equity: $15,901 – $11,494 = $4,407
Target's stockholders' equity: $40,262 – $27,305 = $12,957

Ex. 1–6

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

Ex. 1–7

a. $3,650,000 ($5,250,000 – $1,600,000)
b. $4,120,000 ($3,650,000 + $800,000 – $330,000)
c. $2,910,000 ($3,650,000 – $600,000 – $140,000)
d. $4,180,000 ($3,650,000 + $440,000 + $90,000)
e. Net income: $540,000 ($6,140,000 – $1,950,000 – $3,650,000)

Ex. 1–8

a. (2) liability
b. (1) asset
c. (3) stockholders’ equity (revenue)
d. (1) asset
e. (3) stockholders’ equity (expense)
f. (3) stockholders’ equity (expense)

Ex. 1–9

a. Increases assets and increases stockholders’ equity.
b. Decreases assets and decreases stockholders’ equity.
c. Decreases assets and decreases stockholders’ equity.
d. Increases assets and increases liabilities.
e. Increases assets and increases stockholders’ equity.

Ex. 1–10

a. (1) Total assets increased $183,000 ($298,000 – $115,000).
   (2) No change in liabilities.
   (3) Stockholders’ equity increased $183,000.
b. (1) Total assets decreased $80,000.
   (2) Total liabilities decreased $80,000.
   (3) No change in stockholders’ equity.
c. No, it is false that a transaction always affects at least two elements (Assets, Liabilities, or Stockholders’ Equity) of the accounting equation. Some transactions affect only one element of the accounting equation. For example, purchasing supplies for cash only affects assets.

Ex. 1–11

1. (a) increase
2. (a) increase
3. (b) decrease
4. (b) decrease

Ex. 1–12

1.	**c**	**6.**	**c**
2.	**a**	**7.**	**d**
3.	**e**	**8.**	**a**
4.	**e**	**9.**	**e**
5.	**c**	**10.**	**e**

Ex. 1–13

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

b. $300 ($40,300 – $40,000)
c. $17,800 (–$5,000 + $71,800 – $49,000)
d. $22,800 ($71,800 – $49,000)
e. $17,800 ($22,800 – $5,000)

Ex. 1–14

No. It would be incorrect to say that the business had incurred a net loss of $8,000. The excess of the dividends over the net income for the period is a decrease in the amount of stockholders’ equity (retained earnings) in the business.

Ex. 1–15

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

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

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

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

Ex. 1–16

Balance sheet items: 1, 2, 3, 5, 7, 8, 10

Ex. 1–17

Income statement items: 4, 6, 9

Ex. 1–18

a.

Organic Products Company
Statement of Stockholders' Equity
For the Month Ended June 30, 20Y9

	Common Stock	Retained Earnings	Total
Balances, June 1, 20Y9	$180,000	$1,630,000	$1,810,000
Issued common stock	50,000		50,000
Net income		115,000	115,000
Dividends		(25,000)	(25,000)
Balances, June 30, 20Y9	$230,000	$1,720,000	$1,950,000

b. **The statement of stockholders' equity is prepared before the June 30, 20Y9, balance sheet because common stock and retained earnings as of June 30, 20Y9, are needed for the June 30, 20Y9, balance sheet.**

Ex. 1–19

Imaging Services
Income Statement
For the Month Ended March 31, 20Y5

Fees earned		$ 482,000
Expenses:		
Wages expense	$300,000	
Rent expense	41,500	
Supplies expense	3,600	
Miscellaneous expense	1,900	
Total expenses		(347,000)
Net income		$ 135,000

Ex. 1–20

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

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

Freeman

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

Heyward

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

Jones

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

Ramirez

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

Ex. 1–21

a.

Ebony Interiors Balance Sheet February 28, 20Y3		
Assets		
Cash		$ 320,000
Accounts receivable		800,000
Supplies		30,000
Total assets		$1,150,000
Liabilities		
Accounts payable		$ 310,000
Stockholders' Equity		
Common stock	$200,000	
Retained earnings	640,000*	
Total stockholders' equity		840,000
Total liabilities and stockholders' equity		$1,150,000

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

Ebony Interiors Balance Sheet March 31, 20Y3		
Assets		
Cash		$ 380,000
Accounts receivable		960,000
Supplies		35,000
Total assets		$1,375,000
Liabilities		
Accounts payable		$ 400,000
Stockholders' Equity		
Common stock	$200,000	
Retained earnings	775,000*	
Total stockholders' equity		975,000
Total liabilities and stockholders' equity		$1,375,000

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

b. Stockholders' equity, March 31 .... $ 975,000
Stockholders' equity, February 28 .... (840,000)
Net income.......... $ 135,000

Ex. 1–21 (Concluded)

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

Ex. 1–22

a. Balance sheet: 1, 2, 3, 4, 6, 7, 8, 9, 10, 11, 13
Income statement: 5, 12, 14, 15

b. Yes, an item can appear on more than one financial statement. For example, cash appears on both the balance sheet and statement of cash flows. However, the same item cannot appear on both the income statement and balance sheet.

c. Yes, the accounting equation is relevant to all companies, including Exxon Mobil Corporation. The accounting equation is the basis for all accounting systems.

Ex. 1–23

1. (c) financing activity
2. (a) operating activity
3. (b) investing activity
4. (c) financing activity

Ex. 1–24

Parker Consulting Group
Statement of Cash Flows
For the Year Ended January 31, 20Y4

Cash flows from (used for) operating activities:		
Cash received from customers	$1,200,000	
Cash paid for expenses	(800,000)	
Net cash flows from operating activities		$ 400,000
Cash flows from (used for) investing activities:		
Cash paid for purchase of land		(300,000)
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 90,000	
Cash paid for dividends	(36,000)	
Net cash flows from financing activities		54,000
Net increase in cash		$ 154,000
Cash balance, February 1, 20Y3		66,000
Cash balance, January 31, 20Y4		$ 220,000

Ex. 1–25

a. 1. All financial statements should contain the name of the business in their heading. The statement of stockholders' equity is incorrectly headed as "Omar Farah" rather than We-Sell Realty. The heading of the balance sheet needs to be the name of the business.

2. The income statement covers a period of time and should be labeled "For the Month Ended August 31, 20Y7."

3. The year in the heading for the statement of stockholders' equity should be 20Y7 rather than 20Y6.

4. The balance sheet should be labeled "August 31, 20Y7," rather than "For the Month Ended August 31, 20Y7."

5. On the income statement, the miscellaneous expense amount should be listed as the last expense.

6. On the income statement, the total expenses are subtracted from the sales commissions, resulting in an incorrect net income amount of $25,000. The correct net income should be $24,150. This also affects the statement of stockholders' equity and the amount of retained earnings that appears on the balance sheet.

7. On the statement of stockholders' equity, there is no column for common stock. Also, the statement is for the "month" rather than for the "year" ended August 31, 20Y7.

8. Accounts payable should be listed as a liability on the balance sheet.

9. Accounts receivable and supplies should be listed as assets on the balance sheet.

10. The balance sheet assets should equal the sum of the liabilities and stockholders' equity.

Ex. 1–25 (Concluded)

b. Corrected financial statements appear as follows:

We-Sell Realty
Income Statement
For the Month Ended August 31, 20Y7

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

We-Sell Realty
Statement of Stockholders' Equity
For the Month Ended August 31, 20Y7

	Common Stock	Retained Earnings	Total
Balances, August 1, 20Y7	$ 0	$ 0	$ 0
Issued common stock	15,000		15,000
Net income		24,150	24,150
Dividends		(10,000)	(10,000)
Balances, August 31, 20Y7	$15,000	$14,150	$ 29,150

We-Sell Realty
Balance Sheet
August 31, 20Y7

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

PROBLEMS

Prob. 1–1A

1.

	Assets			= Liabilities +	Stockholders' Equity							
	Cash	+ Accts. Rec.	+ Supplies	= Accts. Payable	+ Common Stock	– Dividends	+ Fees Earned	– Rent Expense	– Salaries Expense	– Supplies Expense	– Auto Exp.	– Misc. Exp.
a.	+ 60,000				+ 60,000							
b.			+ 1,800	+ 1,800								
Bal.	60,000		1,800	1,800	60,000							
c.	+ 22,300						+ 22,300					
Bal.	82,300		1,800	1,800	60,000		22,300					
d.	– 7,000							– 7,000				
Bal.	75,300		1,800	1,800	60,000		22,300	– 7,000				
e.	– 1,100			– 1,100								
Bal.	74,200		1,800	700	60,000		22,300	– 7,000				
f.		+ 3,600					+ 3,600					
Bal.	74,200	3,600	1,800	700	60,000		25,900	– 7,000				
g.	– 1,750										– 750	– 1,000
Bal.	72,450	3,600	1,800	700	60,000		25,900	– 7,000			– 750	– 1,000
h.	– 4,000								– 4,000			
Bal.	68,450	3,600	1,800	700	60,000		25,900	– 7,000	– 4,000		– 750	– 1,000
i.			– 1,550							– 1,550		
Bal.	68,450	3,600	250	700	60,000		25,900	– 7,000	– 4,000	– 1,550	– 750	– 1,000
j.	– 5,000					– 5,000						
Bal.	63,450	3,600	250	700	60,000	– 5,000	25,900	– 7,000	– 4,000	– 1,550	– 750	– 1,000

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

3. **$11,600 ($25,900 – $7,000 – $4,000 – $1,550 – $750 – $1,000)**

4. **April's transactions increased stockholders' equity by $66,600, which is the common stock of $60,000 that was issued plus April's net income of $11,600 less dividends of $5,000.**

Prob. 1–2A

1.

Global Travel Agency Income Statement For the Year Ended December 31, 20Y5		
Fees earned		$ 940,000
Expenses:		
Wages expense	$415,000	
Rent expense	56,000	
Utilities expense	34,800	
Supplies expense	12,700	
Miscellaneous expense	19,500	
Total expenses		(538,000)
Net income		$ 402,000

2.

Global Travel Agency Statement of Stockholders' Equity For the Year Ended December 31, 20Y5			
	Common Stock	Retained Earnings	Total
Balances, January 1, 20Y5	$525,000	$1,250,000	$1,775,000
Issued common stock	50,000		50,000
Net income		402,000	402,000
Dividends		(90,000)	(90,000)
Balances, December 31, 20Y5	$575,000	$1,562,000	$2,137,000

3.

Global Travel Agency Balance Sheet December 31, 20Y5		
Assets		
Cash		$ 200,000
Accounts receivable		539,000
Supplies		6,000
Land		1,500,000
Total assets		$2,245,000
Liabilities		
Accounts payable		$ 108,000
Stockholders' Equity		
Common stock	$ 575,000	
Retained earnings	1,562,000	
Total stockholders' equity		2,137,000
Total liabilities and stockholders' equity		$2,245,000

Prob. 1–2A (Concluded)

4. Ending common stock and retained earnings appear on both the statement of stockholders' equity and the balance sheet. For Global Travel Agency, the December 31, 20Y5, common stock of $575,000 and retained earnings of $1,562,000 appear on the statement of stockholders' equity and balance sheet.

Prob. 1–3A

1.

Reliance Financial Services
Income Statement
For the Month Ended July 31, 20Y2

Fees earned		$144,500
Expenses:		
Salaries expense	$55,000	
Rent expense	33,000	
Auto expense	16,000	
Supplies expense	4,500	
Miscellaneous expense	4,800	
Total expenses		(113,300)
Net income		$ 31,200

2.

Reliance Financial Services
Statement of Stockholders' Equity
For the Month Ended July 31, 20Y2

	Common Stock	Retained Earnings	Total
Balances, July 1, 20Y2	$ 0	$ 0	$ 0
Issued common stock	50,000		50,000
Net income		31,200	31,200
Dividends		(15,000)	(15,000)
Balances, July 31, 20Y2	$50,000	$ 16,200	$ 66,200

Prob. 1–3A (Concluded)

3.

Reliance Financial Services Balance Sheet July 31, 20Y2		
Assets		
Cash		$32,600
Accounts receivable		34,500
Supplies		2,500
Total assets		$69,600
Liabilities		
Accounts payable		$ 3,400
Stockholders' Equity		
Common stock	$50,000	
Retained earnings	16,200	
Total stockholders' equity		66,200
Total liabilities and stockholders' equity		$69,600

4. (Optional)

Reliance Financial Services Statement of Cash Flows For the Month Ended July 31, 20Y2		
Cash flows from (used for) operating activities:		
Cash received from customers	$ 110,000	
Cash paid for expenses and to creditors*	(112,400)	
Net cash flows used for operating activities		$ (2,400)
Cash flows from (used for) investing activities		0
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 50,000	
Cash paid for dividends	(15,000)	
Net cash flows from financing activities		35,000
Net increase in cash		$32,600
Cash balance, July 1, 20Y2		0
Cash balance, July 31, 20Y2		$32,600

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

Prob. 1–4A

1.

	Assets		=	Liabilities +		Stockholders' Equity							
	Cash	+ Supplies	=	Accts. Payable	+	Common Stock	– Dividends	+ Sales Comm.	– Salaries Exp.	– Rent Exp.	– Auto Exp.	– Supplies Exp.	– Misc. Exp.
a.	+ 35,000					+ 35,000							
b.		+ 2,750		+ 2,750									
Bal.	35,000	2,750		2,750		35,000							
c.	– 1,800			– 1,800									
Bal.	33,200	2,750		950		35,000							
d.	+ 52,800							+ 52,800					
Bal.	86,000	2,750		950		35,000		52,800					
e.	– 4,500									– 4,500			
Bal.	81,500	2,750		950		35,000		52,800		– 4,500			
f.	– 3,000						– 3,000						
Bal.	78,500	2,750		950		35,000	– 3,000	52,800		– 4,500			
g.	– 2,300										– 1,100		– 1,200
Bal.	76,200	2,750		950		35,000	– 3,000	52,800		– 4,500	– 1,100		– 1,200
h.	– 5,250								– 5,250				
Bal.	70,950	2,750		950		35,000	– 3,000	52,800	– 5,250	– 4,500	– 1,100		– 1,200
i.		– 1,000										– 1,000	
Bal.	70,950	1,750		950		35,000	– 3,000	52,800	– 5,250	– 4,500	– 1,100	– 1,000	– 1,200

Prob. 1–4A (Concluded)

2.

Western Realty
Income Statement
For the Month Ended August 31, 20Y9

Sales commissions		$ 52,800
Expenses:		
Salaries expense	$5,250	
Rent expense	4,500	
Automobile expense	1,100	
Supplies expense	1,000	
Miscellaneous expense	1,200	
Total expenses		(13,050)
Net income		$ 39,750

Western Realty
Statement of Stockholders' Equity
For the Month Ended August 31, 20Y9

	Common Stock	Retained Earnings	Total
Balances, August 1, 20Y9	$ 0	$ 0	$ 0
Issued common stock	35,000		35,000
Net income		39,750	39,750
Dividends		(3,000)	(3,000)
Balances, August 31, 20Y9	$35,000	$36,750	$71,750

Western Realty
Balance Sheet
August 31, 20Y9

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

Prob. 1–5A

1.

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

Prob. 1–5A (Continued)

2.

	Assets				=	Liabilities	+	Stockholders' Equity		
	Cash	+ Accts. Rec.	+ Supplies	+ Land	=	Accts. Payable	+	Common Stock	+ Retained Earnings	– Dividends
Bal.	45,000	93,000	7,000	75,000		40,000		60,000	120,000	
a.	+ 35,000							+ 35,000		
Bal.	80,000	93,000	7,000	75,000		40,000		95,000	120,000	
b.	– 50,000			+ 50,000						
Bal.	30,000	93,000	7,000	125,000		40,000		95,000	120,000	
c.	+ 32,125									
Bal.	62,125	93,000	7,000	125,000		40,000		95,000	120,000	
d.	– 6,000									
Bal.	56,125	93,000	7,000	125,000		40,000		95,000	120,000	
e.			+ 2,500			+ 2,500				
Bal.	56,125	93,000	9,500	125,000		42,500		95,000	120,000	
f.	– 22,800					– 22,800				
Bal.	33,325	93,000	9,500	125,000		19,700		95,000	120,000	
g.		+ 84,750								
Bal.	33,325	177,750	9,500	125,000		19,700		95,000	120,000	
h.						+ 29,500				
Bal.	33,325	177,750	9,500	125,000		49,200		95,000	120,000	
i.	– 14,000									
Bal.	19,325	177,750	9,500	125,000		49,200		95,000	120,000	
j.	+ 88,000	– 88,000								
Bal.	107,325	89,750	9,500	125,000		49,200		95,000	120,000	
k.			– 3,600							
Bal.	107,325	89,750	5,900	125,000		49,200		95,000	120,000	
l.	– 12,000									– 12,000
Bal.	95,325	89,750	5,900	125,000		49,200		95,000	120,000	– 12,000

Prob. 1–5A (Continued)

	Stockholders' Equity (Continued)							
	+ Dry Cleaning Revenue	– Dry Cleaning Exp.	– Wages Exp.	– Rent Exp.	– Supplies Exp.	– Truck Exp.	– Utilities Exp.	– Misc. Exp.
Bal.								
a.								
Bal.								
b.								
Bal.								
c.	+ 32,125							
Bal.	32,125							
d.				– 6,000				
Bal.	32,125			– 6,000				
e.								
Bal.	32,125			– 6,000				
f.								
Bal.	32,125			– 6,000				
g.	+ 84,750							
Bal.	116,875			– 6,000				
h.		– 29,500						
Bal.	116,875	– 29,500		– 6,000				
i.			– 7,500			– 2,500	– 1,300	– 2,700
Bal.	116,875	– 29,500	– 7,500	– 6,000		– 2,500	– 1,300	– 2,700
j.								
Bal.	116,875	– 29,500	– 7,500	– 6,000		– 2,500	– 1,300	– 2,700
k.					– 3,600			
Bal.	116,875	– 29,500	– 7,500	– 6,000	– 3,600	– 2,500	– 1,300	– 2,700
l.								
Bal.	116,875	– 29,500	– 7,500	– 6,000	– 3,600	– 2,500	– 1,300	– 2,700

Prob. 1–5A (Continued)

3.

D'Lite Dry Cleaners Income Statement For the Month Ended July 31, 20Y4		
Dry cleaning revenue		$116,875
Expenses:		
Dry cleaning expense	$29,500	
Wages expense	7,500	
Rent expense	6,000	
Supplies expense	3,600	
Truck expense	2,500	
Utilities expense	1,300	
Miscellaneous expense	2,700	
Total expenses		(53,100)
Net income		$ 63,775

D'Lite Dry Cleaners Statement of Stockholders' Equity For the Month Ended July 31, 20Y4			
	Common Stock	Retained Earnings	Total
Balances, July 1, 20Y4	$60,000	$120,000	$180,000
Issued common stock	35,000		35,000
Net income		63,775	63,775
Dividends		(12,000)	(12,000)
Balances, July 31, 20Y4	$95,000	$171,775	$266,775

D'Lite Dry Cleaners Balance Sheet July 31, 20Y4		
Assets		
Cash		$ 95,325
Accounts receivable		89,750
Supplies		5,900
Land		125,000
Total assets		$315,975
Liabilities		
Accounts payable		$ 49,200
Stockholders' Equity		
Common stock	$ 95,000	
Retained earnings	171,775	
Total stockholders' equity		266,775
Total liabilities and stockholders' equity		$315,975

Prob. 1–5A (Concluded)

4. (Optional)

D'Lite Dry Cleaners Statement of Cash Flows For the Month Ended July 31, 20Y4		
Cash flows from (used for) operating activities:		
Cash received from customers*	$120,125	
Cash paid for expenses		
and to creditors**	(42,800)	
Net cash flows from operating activities		$ 77,325
Cash flows from (used for) investing activities:		
Cash paid for acquisition of land		(50,000)
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 35,000	
Cash paid for dividends	(12,000)	
Net cash flows from financing activities		23,000
Net increase in cash		$ 50,325
Cash balance, July 1, 20Y4		45,000
Cash balance, July 31, 20Y4		$ 95,325

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

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

Prob. 1–6A

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

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

c. **The common stock, $375,000; the amount shown on the balance sheet**

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

e. **$150,000 ($275,000 – $125,000)**

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

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

h. **Retained earnings, $150,000; same as (e)**

i. **Total stockholders' equity, $525,000 ($375,000 + $150,000); same as (f)**

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

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

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

m. **Cash paid for land, ($150,000)**

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

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

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

q. **Net increase in cash, $462,500 ($362,500 – $150,000 + $250,000)**

r. **Cash as of April 30, 20Y0, $462,500; same as (q) since Wolverine Realty was organized on April 1, 20Y0; also cash balance on the balance sheet.**

Prob. 1–1B

1.

	Assets			= Liabilities +	Stockholders' Equity							
	Cash	+ Accts. Rec.	+ Supplies	= Accts. Payable	+ Common Stock	– Dividends	+ Fees Earned	– Rent Expense	– Salaries Expense	– Supplies Expense	– Auto Exp.	– Misc. Exp.
a.	+ 50,000				+ 50,000							
b.			+ 4,000	+ 4,000								
Bal.	50,000			4,000	50,000							
c.	– 2,300		4,000	– 2,300								
Bal.	47,700			1,700	50,000							
d.	+ 13,800		4,000				+ 13,800					
Bal.	61,500			1,700	50,000		13,800					
e.	– 5,000		4,000					– 5,000				
Bal.	56,500			1,700	50,000		13,800	– 5,000				
f.	– 1,450		4,000								– 1,150	– 300
Bal.	55,050			1,700	50,000		13,800	– 5,000			– 1,150	– 300
g.	– 2,500		4,000						– 2,500			
Bal.	52,550		4,000	1,700	50,000		13,800	– 5,000	– 2,500		– 1,150	– 300
h.			– 1,300							– 1,300		
Bal.	52,550		2,700	1,700	50,000		13,800	– 5,000	– 2,500	– 1,300	– 1,150	– 300
i.		+ 12,500					+ 12,500					
Bal.	52,550	12,500	2,700	1,700	50,000		26,300	– 5,000	– 2,500	– 1,300	– 1,150	– 300
j	– 3,900					– 3,900						
Bal.	48,650	12,500	2,700	1,700	50,000	– 3,900	26,300	– 5,000	– 2,500	– 1,300	– 1,150	– 300

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

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

4. March's transactions increased stockholders' equity by $62,150, which is the common stock that was issued of $50,000 plus the excess of March's net income of $16,050 over dividends of $3,900.

Prob. 1–2B

1.

Wilderness Travel Service Income Statement For the Year Ended April 30, 20Y7		
Fees earned		$ 875,000
Expenses:		
Wages expense	$525,000	
Rent expense	75,000	
Utilities expense	38,000	
Supplies expense	12,000	
Taxes expense	10,000	
Miscellaneous expense	15,000	
Total expenses		(675,000)
Net income		$ 200,000

2.

Wilderness Travel Service Statement of Stockholders' Equity For the Year Ended April 30, 20Y7			
	Common Stock	Retained Earnings	Total
Balances, May 1, 20Y6	$25,000	$155,000	$180,000
Issued common stock	10,000		10,000
Net income		200,000	200,000
Dividends		(40,000)	(40,000)
Balances, April 30, 20Y7	$35,000	$315,000	$350,000

3.

Wilderness Travel Service Balance Sheet April 30, 20Y7		
Assets		
Cash		$156,000
Accounts receivable		210,000
Supplies		9,000
Total assets		$375,000
Liabilities		
Accounts payable		$ 25,000
Stockholders' Equity		
Common stock	$ 35,000	
Retained earnings	315,000	
Total stockholders' equity		350,000
Total liabilities and stockholders' equity		$375,000

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

Prob. 1–3B

1.

Bronco Consulting Income Statement For the Month Ended August 31, 20Y1		
Fees earned		$ 125,000
Expenses:		
Salaries expense	$58,000	
Rent expense	27,000	
Auto expense	15,500	
Supplies expense	6,100	
Miscellaneous expense	7,500	
Total expenses		(114,100)
Net income		$ 10,900

2.

Bronco Consulting Statement of Stockholders' Equity For the Month Ended August 31, 20Y1			
	Common Stock	Retained Earnings	Total
Balances, August 1, 20Y1	$ 0	$ 0	$ 0
Issued common stock	75,000		75,000
Net income		10,900	10,900
Dividends		(5,000)	(5,000)
Balances, August 31, 20Y1	$ 75,000	$ 5,900	$80,900

3.

Bronco Consulting Balance Sheet August 31, 20Y1		
Assets		
Cash		$48,000
Accounts receivable		33,000
Supplies		2,900
Total assets		$83,900
Liabilities		
Accounts payable		$ 3,000
Stockholders' Equity		
Common stock	$75,000	
Retained earnings	5,900	
Total stockholders' equity		80,900
Total liabilities and stockholders' equity		$83,900

Prob. 1–3B (Concluded)

4. (Optional)

Bronco Consulting Statement of Cash Flows For the Month Ended August 31, 20Y1		
Cash flows from (used for) operating activities:		
Cash received from customers	$ 92,000	
Cash paid for expenses		
and to creditors*	(114,000)	
Net cash flows used for operating activities		$(22,000)
Cash flows from (used for) investing activities		0
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 75,000	
Cash paid for dividends	(5,000)	
Net cash flows from financing activities		70,000
Net increase in cash		$ 48,000
Cash balance, August 1, 20Y1		0
Cash balance, August 31, 20Y1		$ 48,000

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

Prob. 1–4B

1.

	Assets		= Liabilities +	Stockholders' Equity							
	Cash	+ Supplies =	Accts. Payable +	Common Stock –	Dividends +	Sales Comm. –	Rent Exp. –	Salaries Exp. –	Auto Exp. –	Supplies Exp. –	Misc. Exp.
a.	+ 24,000			+ 24,000							
b.	– 3,600						– 3,600				
Bal.	20,400			24,000			– 3,600				
c.	– 1,950								– 1,350		– 600
Bal.	18,450			24,000			– 3,600		– 1,350		– 600
d.		+ 1,200	+ 1,200								
Bal.	18,450	1,200	1,200	24,000			– 3,600		– 1,350		– 600
e.	+ 19,800					+ 19,800					
Bal.	38,250	1,200	1,200	24,000		19,800	– 3,600		– 1,350		– 600
f.	– 750		– 750								
Bal.	37,500	1,200	450	24,000		19,800	– 3,600		– 1,350		– 600
g.	– 2,500							– 2,500			
Bal.	35,500	1,200	450	24,000		19,800	– 3,600	– 2,500	– 1,350		– 600
h.	– 3,500				– 3,500						
Bal.	31,500	1,200	450	24,000	– 3,500	19,800	– 3,600	– 2,500	– 1,350		– 600
i.		– 900								– 900	
Bal.	31,500	300	450	24,000	– 3,500	19,800	– 3,600	– 2,500	– 1,350	– 900	– 600

Prob. 1–4B (Concluded)

2.

Custom Realty
Income Statement
For the Month Ended April 30, 20Y8

Sales commissions		$19,800
Expenses:		
Rent expense	$3,600	
Salaries expense	2,500	
Automobile expense	1,350	
Supplies expense	900	
Miscellaneous expense	600	
Total expenses		(8,950)
Net income		$10,850

Custom Realty
Statement of Stockholders' Equity
For the Month Ended April 30, 20Y8

	Common Stock	Retained Earnings	Total
Balances, April 1, 20Y8	$ 0	$ 0	$ 0
Issued common stock	24,000		24,000
Net income		10,850	10,850
Dividends		(3,500)	(3,500)
Balances, April 30, 20Y8	$24,000	$ 7,350	$31,350

Custom Realty
Balance Sheet
April 30, 20Y8

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

Prob. 1–5B

1.

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

Prob. 1–5B (Continued)

2.

	Assets				= Liabilities +	Stockholders' Equity		
	Cash +	Accts. Rec. +	Supplies +	Land =	Accts. Payable +	Common Stock +	Retained Earnings –	Dividends
	39,000	80,000	11,000	50,000	31,500	50,000	98,500	
Bal. a.	+ 21,000					+ 21,000		
Bal.	60,000	80,000	11,000	50,000	31,500	71,000	98,500	
b.	– 35,000			+ 35,000				
Bal.	25,000	80,000	11,000	85,000	31,500	71,000	98,500	
c.	– 4,000							
Bal.	21,000	80,000	11,000	85,000	31,500	71,000	98,500	
d.		+ 72,000						
Bal.	21,000	152,000	11,000	85,000	31,500	71,000	98,500	
e.	– 20,000				– 20,000			
Bal.	1,000	152,000	11,000	85,000	11,500	71,000	98,500	
f.			+ 8,000		+ 8,000			
Bal.	1,000	152,000	19,000	85,000	19,500	71,000	98,500	
g.	+ 38,000							
Bal.	39,000	152,000	19,000	85,000	19,500	71,000	98,500	
h.	+ 77,000	– 77,000						
Bal.	116,000	75,000	19,000	85,000	19,500	71,000	98,500	
i.					+ 29,450			
Bal.	116,000	75,000	19,000	85,000	48,950	71,000	98,500	
j.	– 29,200							
Bal.	86,800	75,000	19,000	85,000	48,950	71,000	98,500	
k.			– 7,200					
Bal.	86,800	75,000	11,800	85,000	48,950	71,000	98,500	
l.	– 5,000							– 5,000
Bal.	81,800	75,000	11,800	85,000	48,950	71,000	98,500	– 5,000

Prob. 1–5B (Continued)

	Stockholders' Equity (Continued)							
+	Dry Cleaning Revenue	– Dry Cleaning Exp.	– Wages Exp.	– Supplies Exp.	– Rent Exp.	– Truck Exp.	– Utilities Exp.	– Misc. Exp.
Bal.								
a.								
Bal.								
b.								
Bal.								
c.					– 4,000			
Bal.					– 4,000			
d.	+ 72,000							
Bal.	72,000				– 4,000			
e.								
Bal.	72,000				– 4,000			
f.								
Bal.	72,000				– 4,000			
g.	+ 38,000							
Bal.	+ 110,000				– 4,000			
h.								
Bal.	110,000				– 4,000			
i.		– 29,450						
Bal.	110,000	– 29,450			– 4,000			
j.			– 24,000			– 2,100	– 1,800	– 1,300
Bal.	110,000	– 29,450	– 24,000		– 4,000	– 2,100	– 1,800	– 1,300
k.				– 7,200				
Bal.	110,000	– 29,450	– 24,000	– 7,200	– 4,000	– 2,100	– 1,800	– 1,300
l.								
Bal.	110,000	– 29,450	– 24,000	– 7,200	– 4,000	– 2,100	– 1,800	– 1,300

Prob. 1–5B (Continued)

3.

Bev's Dry Cleaners
Income Statement
For the Month Ended November 30, 20Y3

Dry cleaning revenue		$110,000
Expenses:		
Dry cleaning expense	$ 29,450	
Wages expense	24,000	
Supplies expense	7,200	
Rent expense	4,000	
Truck expense	2,100	
Utilities expense	1,800	
Miscellaneous expense	1,300	
Total expenses		(69,850)
Net income		$ 40,150

Bev's Dry Cleaners
Statement of Stockholders' Equity
For the Month Ended November 30, 20Y3

	Common Stock	Retained Earnings	Total
Balances, November 1, 20Y3	$ 50,000	$ 98,500	$ 148,500
Issued common stock	21,000		21,000
Net income		40,150	40,150
Dividends		(5,000)	(5,000)
Balances, November 30, 20Y3	$ 71,000	$133,650	$ 204,650

Bev's Dry Cleaners
Balance Sheet
November 30, 20Y3

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

Prob. 1–5B (Concluded)

4. (Optional)

Bev's Dry Cleaners Statement of Cash Flows For the Month Ended November 30, 20Y3		
Cash flows from (used for) operating activities:		
Cash received from customers*	$ 115,000	
Cash paid for expenses and to creditors**	(53,200)	
Net cash flows from operating activities		$ 61,800
Cash flows from (used for) investing activities:		
Cash paid for acquisition of land		(35,000)
Cash flows from (used for) financing activities:		
Cash received from issuing common stock	$ 21,000	
Cash paid for dividends	(5,000)	
Net cash flows from financing activities		16,000
Net increase in cash		$ 42,800
Cash balance, November 1, 20Y3		39,000
Cash balance, November 30, 20Y3		$ 81,800

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

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

Prob. 1–6B

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

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

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

d. Net income for May, $112,000; from (b)

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

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

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

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

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

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

k. Retained earnings, $48,000; same as (f)

l. Total stockholders' equity, $208,000; same as (g)

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

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

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

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

q. Net increase in cash, $123,200 ($147,200 – $120,000 + $96,000)

r. Cash as of May 31, 20Y6, $123,200; same as (q) since Atlas Realty was organized on May 1, 20Y6; also the cash balance on the balance sheet.

CONTINUING PROBLEM

1.

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

Continuing Problem (Continued)

Stockholders' Equity (Continued)

	Music Exp.	Office Rent Exp.	Equip. Rent Exp.	Advertising Exp.	Wages Exp.	Utilities Exp.	Supplies Exp.	Misc. Exp.
June 1								
June 2								
Bal.								
June 2		– 800						
Bal.		– 800						
June 4								
Bal.		– 800						
June 6				– 500				
Bal.		– 800		– 500				
June 8			– 675					
Bal.		– 800	– 675	– 500				
June 12	– 350							
Bal.	– 350	– 800	– 675	– 500				
June 13								
Bal.	– 350	– 800	– 675	– 500				
June 16								
Bal.	– 350	– 800	– 675	– 500				
June 22								
Bal.	– 350	– 800	– 675	– 500				
June 25								
Bal.	– 350	– 800	– 675	– 500				
June 29	– 240							
Bal.	– 590	– 800	– 675	– 500				
June 30								
Bal.	– 590	– 800	– 675	– 500				
June 30					– 400			
Bal.	– 590	– 800	– 675	– 500	– 400			
June 30						– 300		
Bal.	– 590	– 800	– 675	– 500	– 400	– 300		
June 30							– 180	
Bal.	– 590	– 800	– 675	– 500	– 400	– 300	– 180	
June 30								– 415
Bal.	– 590	– 800	– 675	– 500	– 400	– 300	– 180	– 415
June 30	– 1,000							
Bal.	– 1,590	– 800	– 675	– 500	– 400	– 300	– 180	– 415
June 30								
Bal.	– 1,590	– 800	– 675	– 500	– 400	– 300	– 180	– 415

Continuing Problem (Concluded)

2.

PS Music Income Statement For the Month Ended June 30, 20Y5		
Fees earned:		$ 6,200
Expenses:		
Music expense	$1,590	
Office rent expense	800	
Equipment rent expense	675	
Advertising expense	500	
Wages expense	400	
Utilities expense	300	
Supplies expense	180	
Miscellaneous expense	415	
Total expenses		(4,860)
Net income		$ 1,340

3.

PS Music Statement of Stockholders' Equity For the Month Ended June 30, 20Y5			
	Common Stock	Retained Earnings	Total
Balances, June 1, 20Y5	$ 0	$ 0	$ 0
Issued common stock	4,000		4,000
Net income		1,340	1,340
Dividends		(500)	(500)
Balances, June 30, 20Y5	$4,000	$ 840	$ 4,840

4.

PS Music Balance Sheet June 30, 20Y5		
Assets		
Cash		$ 3,920
Accounts receivable		1,000
Supplies		170
Total assets		$ 5,090
Liabilities		
Accounts payable		$ 250
Stockholders' Equity		
Common stock	$ 4,000	
Retained earnings	840	
Total stockholders' equity		4,840
Total liabilities and stockholders' equity		$ 5,090

MAKE A DECISION

MAD 1–1

a. $$\textbf{Ratio of Liabilities to Stockholders' Equity} = \frac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$$

$$\textbf{Amazon:} \quad \frac{\$51{,}363}{\$13{,}384} = 3.84$$

$$\textbf{Best Buy:} \quad \frac{\$9{,}141}{\$4{,}378} = 2.09$$

b. Amazon's ratio is 3.84, which means the total liabilities are almost four times as great as the stockholders' equity. For Best Buy, the ratio is only 2.09, which means total liabilities are over two times as great as the stockholders' equity. Thus, the margin of protection is less for Amazon's creditors than it is for Best Buy's creditors.

MAD 1–2

a. $$\textbf{Ratio of Liabilities to Stockholders' Equity} = \frac{\textbf{Total Liabilities}}{\textbf{Total Stockholders' Equity}}$$

$$\textbf{Year 1:} \quad \frac{\$27{,}996}{\$12{,}522} = 2.24$$

$$\textbf{Year 2:} \quad \frac{\$30{,}624}{\$9{,}322} = 3.29$$

$$\textbf{Year 3:} \quad \frac{\$36{,}233}{\$6{,}316} = 5.74$$

b. The ratio of liabilities to stockholders' equity for Home Depot increased from 2.24 in Year 1 to 5.74 in Year 3, causing the margin of protection to creditors to decrease. This is a significant increase in this ratio for the three-year period.

Note to Instructor: **This increase is due to the company using debt to finance the repurchase of its common stock. This caused liabilities to increase and stockholders' equity to decrease. The increased use of debt financing was probably due to the low interest rates during this three-year period.**

MAD 1–3

a. $$\text{Ratio of Liabilities to Stockholders' Equity} = \frac{\text{Total Liabilities}}{\text{Total Stockholders' Equity}}$$

$$\text{Year 1:} \quad \frac{\$20,879}{\$11,853} = 1.76$$

$$\text{Year 2:} \quad \frac{\$21,753}{\$9,968} = 2.18$$

$$\text{Year 3:} \quad \frac{\$23,612}{\$7,654} = 3.08$$

b. **The ratio of liabilities to stockholders' equity for Lowe's increased from 1.76 in Year 1 to 3.08 in Year 3, causing the margin of protection to creditors to decrease. This is a significant increase in this ratio for the three-year period.**

Note to Instructor: **This increase occurred because the company used debt to finance the repurchase of its common stock. This caused liabilities to increase and stockholders' equity to decrease over the three-year period. The increased use of debt financing was probably due to the low interest rates during this three-year period.**

MAD 1–4

The ratios of liabilities to stockholders' equity are summarized below for Home Depot (MAD 1–2) and Lowe's (MAD 1–3).

	Year 3	Year 2	Year 1
Home Depot	5.74	3.29	2.24
Lowe's	3.08	2.18	1.76

Lowe's ratio of liabilities to stockholders' equity is less than that of Home Depot for all three years. Thus, the risk to Lowe's creditors is less than that of Home Depot's creditors. The three-year trend for both companies shows that the size of this ratio is increasing. However, Home Depot appears to be more aggressive than Lowe's in its use of debt.

MAD 1–5

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

Papa John's: $\dfrac{\$444}{\$51} = 8.7$

Yum! Brands: $\dfrac{\$7{,}164}{\$911} = 7.9$

b. The ratio of liabilities to stockholders' equity is 8.7 for Papa John's and 7.9 for Yum! Brands. These are both very high ratios and suggest that creditors have risk with their investments in these two companies. The small level of stockholders' equity provides only a narrow margin of protection to creditors.

c. Papa John's ratio of liabilities to stockholders' equity of 8.7 is higher than that of Yum! Brands. This implies that the creditors of Papa John's have more risk than the creditors of Yum! Brands.

TAKE IT FURTHER

TIF 1–1

1. **The car repair is a personal expense and is Marco's personal responsibility. By using partnership funds to pay for the repair, Marco is behaving unethically because he is violating the business entity assumption. The business entity assumption treats the business as a separate entity from its owners. By taking money from the partnership for a personal expense, Marco is effectively stealing from his partners.**

2. **The partnership's net income will be reduced by the $2,000 Marco has taken. This will reduce the amount of net income available to Marco's partners.**

3. **Marco could ask his partners for a loan from the partnership. The loan could be repaid out of his salary or from his share of the partnership income.**

TIF 1–2

1. **Acceptable professional conduct requires that Colleen Fernandez supply First Federal Bank with all the relevant financial statements necessary for the bank to make an informed decision. Therefore, Colleen should provide the complete set of financial statements. These can be supplemented with a discussion of the net loss in the past year or other data explaining why granting the loan is a good investment for the bank.**

2. a. **Owners are generally willing to provide bankers with information about the operating and financial condition of the business, such as the following:**

    - **Operating Information:**
        - **Description of business operations**
        - **Results of past operations**
        - **Preliminary results of current operations**
        - **Plans for future operations**
    - **Financial Condition:**
        - **List of assets and liabilities (balance sheet)**
        - **Estimated current values of assets**
        - **Owner's personal investment in the business**
        - **Owner's commitment to invest additional funds in the business**

    Owners are normally reluctant to provide the following types of information to bankers:

    - ***Proprietary Operating Information.* Such information, which might hurt the business if it becomes known by competitors, might include special processes used by the business or future plans to expand operations into areas that are not currently served by a competitor.**
    - ***Personal Financial Information.* Owners may have little choice here because banks often require owners of small businesses to pledge their personal assets as security for a business loan. Personal financial information requested by bankers often includes the owner's net worth, salary, and other income. In addition, bankers usually request information about factors that might affect the personal financial condition of the owner. For example, a pending divorce by the owner might significantly affect the owner's personal wealth.**

    b. **Bankers typically want as much information as possible about the ability of the business and the owner to repay the loan with interest. Examples of such information are described above.**

    c. **Both bankers and business owners share the common interest of the business doing well and being successful. If the business is successful, the bankers will receive their loan payments on time with interest, and the owners will increase their personal wealth.**

TIF 1–3

A sample solution based on Twitter's Form 10-K for the fiscal year ended December 31, 2016, follows:

1. **Twitter, Inc.**
2. **San Francisco, CA**
3. **Jack Dorsey**
4. **Service**
5. **Twitter is a global platform for public self-expression and conversation in real time. Twitter allows people to consume, create, distribute and discover content and has democratized content creation and distribution.**
6. **Balance sheet, statement of operations (income statement), statement of comprehensive loss (discussed in Appendix 2 of Chapter 14), statement of stockholders' equity, statement of cash flows.**

TIF 1–4

Example Memo

To:	**Teacher**
From:	**Student**
Date:	**Current Date**
Subject:	**Causes of Accounting Fraud**

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

TIF 1–5

The difference in the two bank balances, $55,000 ($80,000 – $25,000), may not be pure profit from an accounting perspective. To determine the accounting profit for the six-month period, the revenues for the period would need to be matched with the related expenses. The revenues minus the expenses would indicate whether the business generated net income (profit) or a net loss for the period. Using only the difference between the two bank account balances ignores such factors as amounts due from customers (receivables), liabilities (accounts payable) that need to be paid for wages or other operating expenses, additional investments that Dr. Cousins may have made in the business during the period, or dividends paid during the period that Dr. Cousins might have taken for personal reasons unrelated to the business.

Some businesses that have few, if any, receivables or payables may use a "cash" basis of accounting. The cash basis of accounting ignores receivables and payables because they are assumed to be insignificant in amount. However, even with the cash basis of accounting, additional investments during the period and any dividends paid during the period have to be considered in determining the net income (profit) or net loss for the period.

TIF 1–6

1.

	Assets		= Liabilities +	Owner's Equity							
	Cash	+ Supplies	= Accts. Payable	+ Lisa Duncan, Capital	– Lisa Duncan, Drawing	+ Fees Earned	– Salaries Expense	– Rent Expense	– Supplies Expense	– Misc. Exp.
a.	+ 950			+ 950						
b.	– 300	+ 300								
Bal.	650	300		950						
c.	– 275							– 275		
Bal.	375	300		950				– 275		
d.	– 100		+ 150					– 250		
Bal.	275	300	150	950				– 525		
e.	+ 1,750					+ 1,750				
Bal.	2,025	300	150	950		1,750		– 525		
f.	+ 600					+ 600				
Bal.	2,625	300	150	950		2,350		– 525		
g.	– 800						– 800			
Bal.	1,825	300	150	950		2,350	– 800	– 525		
h.	– 290									– 290
Bal.	1,535	300	150	950		2,350	– 800	– 525		– 290
i.	+ 1,300					+ 1,300				
Bal.	2,835	300	150	950		3,650	– 800	– 525		– 290
j.		– 120							– 120	
Bal.	2,835	180	150	950		3,650	– 800	– 525	– 120	– 290
k.	– 400				– 400					
Bal.	2,435	180	150	950	– 400	3,650	– 800	– 525	– 120	– 290

TIF 1–6 (Continued)

2.

Serve–N–Volley Income Statement For the Month Ended September 30, 20Y2		
Fees earned:		$ 3,650
Expenses:		
Salaries expense	$800	
Rent expense	525	
Supplies expense	120	
Miscellaneous expense	290	
Total expenses		(1,735)
Net income		$ 1,915

3.

Serve–N–Volley Statement of Owner's Equity For the Month Ended September 30, 20Y2		
Lisa Duncan, capital, September 1, 20Y2		$ 0
Investment on September 1, 20Y2	$ 950	
Net income for September	1,915	
Owner's withdrawals	(400)	
Increase in owner's equity		2,465
Lisa Duncan, capital, September 30, 20Y2		$2,465

4.

Serve–N–Volley Balance Sheet September 30, 20Y2		
Assets		
Cash		$2,435
Supplies		180
Total assets		$2,615
Liabilities		
Accounts payable		$ 150
Owner's Equity		
Lisa Duncan, capital		2,465
Total liabilities and owner's equity		$2,615

TIF 1–6 (Concluded)

5. a. Serve-N-Volley would provide Lisa with $715 more income per month than working as a waitress. This amount is computed as follows:

Net income of Serve-N-Volley, per month	**$1,915**
Earnings as waitress, per month:	
30 hours per week × $10 per hour × 4 weeks	**1,200**
Difference	**$ 715**

b. Other factors that Lisa should consider before discussing a long-term arrangement with the Phoenix Tennis Club include the following:

Lisa should consider whether the results of operations for September are indicative of what to expect each month. For example, Lisa should consider whether club members will continue to request lessons or use the ball machine during the fall months when interest in tennis may slacken. Lisa should evaluate whether the additional income of $715 per month from Serve-N-Volley is worth the risk being taken and the effort being expended.

Lisa should also consider how much her investment in Serve-N-Volley could have earned if invested elsewhere. For example, if the initial investment of $950 had been invested to earn a rate of return of 6% per year, it would have earned $4.75 in September, or $57 for the year.

***Note to Instructor:* Numerous other considerations could be mentioned by students, such as the ability of Lisa to withdraw cash from Serve-N-Volley for personal use. For example, some of her investment in Serve-N-Volley will be in the form of supplies (tennis balls, etc.), which are not readily convertible to cash. The objective of this case is not to mention all possible considerations but, rather, to encourage students to begin thinking about the use of accounting information in making business decisions.**