Chapter 1
Accounting and the Business Environment

Review Questions

1. The accounting equation measures the resources of a business (what the business owns or has control of) and the claims to those resources (what the business owes to creditors and to the owner). The accounting equation is made up of three parts—assets, liabilities, and equity—and shows how these three parts are related. Assets appear on the left side of the equation, and the liabilities and equity appear on the right side.

2. Financial accounting provides information for external decision makers, such as outside investors, lenders, customers, and the federal government. These external decision makers use the information provided to make decision like whether to invest in the business, and whether the business is profitable.

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

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

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

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

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

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

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

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

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

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

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

14. The statement of cash flows is divided into three distinct sections: operating, investing, and financing. Operating activities involve cash receipts for services provided and cash payments for expenses paid. Investing activities include the purchase and sale of land and equipment for cash. The third section, financing activities, includes cash contributions by the owner and withdrawals of cash by the owner.

15. The income statement summarizes an entity's revenues and expenses and reports the net income or net loss for a specific period. The balance sheet, on the other hand, reports on the assets, liabilities, and owner's equity of the business as of a specific date

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

17. The statement of owner's equity shows the changes in the owner's capital account for a specific period. The owner's capital account increases by owner's contributions and net income and decreases by owner's withdrawals and net losses.

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

Short Exercises

S1-1

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

S1-2

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

S1-3

There are 3 basic forms of businesses that they brothers can choose from : sole proprietorship, partnership, or corporation. Since there are 2 of them, a proprietorship would be out of the question. These forms have implications for legal liability, taxation, continuity, number of owners, and legal status as follows:

Proprietorship	Partnership	Corporation	
Business entity	yes	yes	yes
Legal entity	no	no	yes
Limited liability	no	no	yes
Unlimited life	no	no	yes
Business taxed	no	no	yes
One owner allowed	yes	no	yes

The advantages of a partnership :
Generally partnerships are easy to establish and since there is more than one owner, there is a bigger pool of resources (financial or otherwise) at the busjness' disposal.

Disadvantages of a partnership :
Both the brothers are vulnerable to unlimited liability for anything to do with the business, whether caused by one or the other and may even lose the business as well as their personal assets. The business shall automatically cease upon the death of either one of them, although partners are allowed to independently make commitments without the other's approval.

All this only applies if there is no partnership agreement stipulating otherwise. A limited partnership is also possible in cases where there is a need to limit the extent of liability to one party. It is recommended that they should consider starting a general partnership with a tailor-made Partnership Agreement spelling out each brother's responsibility, authority, commitment and liability as well as operational and strategic roles.

S1-4

This would simplify the burden of the brothers in owning and running their own business. There will be no direct liability, but there will also be no authority in the business. Ah Soh will simply be their boss and may be able to over-rule their decisions although she may not have any expertise in web design. Ah Lee and Ah Beng will be employees with a salary and any other formal benefits. They will have to live up to the procedures, policies and rules made by their sister. On the other hand, they would not have to cough up the capital or be directly responsible for the business' success.
The decision depends entirely on the brothers' priorities. Do they want to be entrepreneurs or do they want to hone their craft? If they aren't concerned about the money part of this, then they might want to be employed instead of striking out on their own

S1-5

a Cost Principle
b. Business Entity Principle
c. Going Concern Principle.
d. Monetary Unit Principle

S1-6
Requirement 1

Total Assets = Total Liabilities + Total Equity = \$74,000 + \$23,500 = \$ 97,500

Requirement 2

Total Equity = Beginning Capital + Profit(Loss) – Withdrawals

\$23,000 - \$10,000 = \$13,000 ----→ PROFIT

S1-7
Requirement 1

Total Assets = Total Liabilities + Total Equity

Total Equity = 76,000 – 33,800 =42,200

Requirement 2

Profit = Revenue – Expenses = 32,560 – 22,430 = 10,130

Additional investment or withdrawals = Total Equity – (beginning capital + profit)

= 42,200 – (28,000 + 10,130)

= 4,070 -----------→ Additional Investment

S1-8

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

S1-9

a. Increase asset (Cash); Increase equity (Service Revenue)
b. Decrease asset (Cash); Decrease equity (Salaries Expense)
c. Increase asset (Cash); Increase Equity (Martin, Capital)
d. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
e. Increase liability (Accounts Payable); Decrease equity (Utility Expense)
f. Decrease asset (Cash); Decrease equity (Martin, Withdrawals)

S1-10

a. Increase asset (Cash); Increase equity (Gonzalez, Capital)
b. Increase asset (Equipment); Increase liability (Accounts Payable)
c. Increase asset (Office Supplies); Decrease asset (Cash)
d. Increase asset (Cash); Increase equity (Service Revenue)
e. Decrease asset (Cash); Decrease equity (Wages Expense)
f. Decrease asset (Cash); Decrease equity (Gonzalez, Withdrawals)
g. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
h. Decrease asset (Cash); Decrease equity (Rent Expense)
i. Increase liability (Accounts Payable); Decrease equity (Utilities Expense)

S1-11

a. B	f. I
b. B	g. B
c. OE, B	h. OE
d. B	i. B
e. I	j. I

S1-12

ELEGANT ARRANGEMENTS
Income Statement
Year Ended December 31, 2014

Revenue:		
Service Revenue		$ 74,000
Expenses:		
Salaries Expense	$ 42,000	
Rent Expense	13,000	
Insurance Expense	4,000	
Utilities Expense	1,100	
Total Expenses		60,100
Net Income		$ 13,900

S1-13

ELEGANT ARRANGEMENTS
Statement of Owner's Equity
Year Ended December 31, 2014

Rose, Capital, January 1, 2014	$ 10,500
Owner contribution	0
Net income for the year	13,900
	24,400
Owner withdrawals	(3,900)
Rose, Capital, December 31, 2014	$ 20,500

S1-14

ELEGANT ARRANGEMENTS
Balance Sheet
December 31, 2014

Assets		Liabilities	
Cash	$ 4,700	Accounts Payable	$ 6,800
Accounts Receivable	5,500		
Office Supplies	2,100	Owner's Equity	
Equipment	15,000	Rose, Capital	20,500
Total Assets	$ 27,300	Total Liabilities and Owner's Equity	$ 27,300

S1-15

MAIN STREET HOMES
Statement of Cash Flows
Month Ended July 31, 2014

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 20,000
Payments:		
For rent	$ (3,000)	
For salaries	(2,100)	
For utilities	(1,500)	(6,600)
Net cash provided by operating activities		13,400
Cash flows from investing activities:		
Purchase of equipment	(10,750)	
Net cash used by investing activities		(10,750)
Cash flows from financing activities:		
Owner contribution	8,000	
Owner withdrawals	(5,250)	
Net cash provided by financing activities		2,750
Net increase in cash		5,400
Cash balance, July 1, 2014		12,500
Cash balance, July 31, 2014		$ 17,900

S1-16

Return on assets	=	Net income / Average total assets
	=	$30,000 / (($355,000 + $345,000) / 2)
	=	$30,000 / $350,000
	=	8.57%

Exercises

E1-17

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

E1-18

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

E1-19

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

E1-20

	Assets	Liabilities	Equity
New Rock Gas	**$ 74,000**	$ 24,000	$ 50,000
DJ Video Rentals	75,000	**43,000**	32,000
Corner Grocery	100,000	53,000	**47,000**

E1-21

	a.	b.	c.
Owner's equity, May 31, 2014 ($177,000 – $122,000)	$ 55,000	$ 55,000	$ 55,000
Owner contribution	6,000	0	18,000
Net income for the month	**8,000**	**24,000**	**16,000**
	69,000	79,000	89,000
Owner withdrawals	0	(10,000)	(20,000)
Owner's equity, June 30, 2014 ($213,000 – $144,000)	$ 69,000	$ 69,000	$ 69,000

E1-22
Requirement 1

	Assets	=	Liabilities	+	Equity
Beginning of 2014	$19,000	=	$9,000	+	?
	$19,000	=	$9,000	+	**$10,000**
End of 2014	$27,000	=	$13,000	+	?
	$27,000	=	$13,000	+	**$14,000**

Owner's equity increased in 2014 by $4,000 ($14,000 – $10,000).

Requirement 2

a. Increase through owner contributions.
b. Increase through net income.
c. Decrease through owner withdrawals.
d. Decrease through net loss.

E1-23
Requirement 1

Revenues	–	Expenses	=	Net Income
$21,000	–	$14,000	=	**$7,000**

Requirement 2

Serenity Creek Spa's equity increased by $7,000 ($16,000 - $9,000) or the amount of the net income.

	Assets	=	Liabilities	+	Equity
Beginning of 2014	$23,000	=	$14,000	+	?
	$23,000	=	$14,000	+	$9,000
Ending of 2014	$30,000	=	$14,000	+	?
	$30,000	=	$14,000	+	$16,000

E1-24
Requirement 1

	Assets	−	Liabilities	=	Equity
Beginning of 2014	$45,000	−	$29,000	=	$16,000
Ending of 2014	$55,000	−	$38,000	=	$17,000

Owner's equity:

Capital, Beginning balance	$ 16,000
Plus: Contribution by the owner	0
Plus: Revenues	242,000
Less: Expenses	**(222,000)**
Less: Owner withdrawals	(19,000)
Capital, Ending balance	$ 17,000

Requirement 2

Felix Company earned net income of $20,000.

Revenue	−	Expenses	=	Net Income
$242,000	−	$222,000	=	$20,000

E1-25

Student responses will vary. Examples include:
a. Cash purchase of office supplies.
b. Owner withdrew cash from the business.
c. Paid cash on accounts payable.
d. Received cash for services provided.
e. Borrowed cash from the bank.

E1-26

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

E1-27

a. Increase asset (Cash); Increase equity (Shane, Capital)
b. Increase asset (Land); Decrease asset (Cash)
c. Decrease asset (Cash); Decrease liability (Accounts Payable)
d. Increase asset (Equipment); Increase liability (Notes Payable)
e. Increase asset (Accounts Receivable); Increase equity (Service Revenue)
f. Increase liability (Salaries Payable); Decrease equity (Salaries Expense)
g. Increase asset (Cash); Decrease asset (Accounts Receivable)
h. Increase asset (Cash); Increase liability (Notes Payable)
i. Decrease asset (Cash); Decrease equity (Shane, Withdrawals)
j. Increase liability (Accounts Payable); Decrease equity (Utility Expense)

E1-28

Transaction Descriptions:
1. Contribution of cash by the owner
2. Earned revenue on account
3. Purchased equipment on account
4. Collected cash on account
5. Cash purchase of equipment
6. Paid cash on account
7. Earned revenue and received cash
8. Paid cash for salaries expense

E1-29

			Assets			=	Liabilities	+					Equity						
Date	Cash	+	Medical Supplies	+	Land	=	Accounts Payable	+	Smith, Capital	–	Smith, Withdrawal	+	Service Revenue	–	Salaries Expense	–	Rent Expense	–	Utilities Expense
July 6	+55,000								+55,000										
Bal.	$55,000					=		+	$55,000										
9	–46,000				+46,000	=													
Bal.	$ 9,000			+	$46,000	=		+	$55,000										
12		+	+1,800			=	+1,800												
Bal.	$ 9,000	+	$1,800	+	$46,000	=	$1,800	+	$55,000										
15																			
Bal.	$ 9,000	+	$1,800	+	$46,000	=	$1,800	+	$55,000										
20	–2,600					=									–1,600		–900		–100
Bal.	$ 6,400	+	$1,800	+	$46,000	=	$1,800	+	$55,000					–	$1,600	–	$900	–	$100
31	+8,000					=							+8,000						
Bal.	$14,400	+	$1,800	+	$46,000	=	$1,800	+	$55,000			+	$8,000	–	$1,600	–	$900	–	$100
31	–1,100					=	–1,100												
Bal.	$13,300	+	$1,800	+	$46,000	=	$ 700	+	$55,000			+	$8,000	–	$1,600	–	$900	–	$100

E1-30
Requirement 1

a. Income statement
b. Statement of owner's equity
c. Balance sheet
d. Statement of cash flows

Requirement 2
Yes, the financial statements should be prepared in the order listed above in Requirement 1.

Requirement 3

Income statement:

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

Statement of owner's equity:

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

Balance sheet:

a. The header includes the name of the business and the title of the statement but the date is different. The balance sheet shows the date as a specific date and not a period of time.
b. Each asset account is listed separately and then totaled. Cash is always listed first.
c. Liabilities are listed separately and then totaled. Liabilities that are to be paid first are listed first.
d. The owner's equity is taken directly from the statement of owner's equity.
e. The balance sheet must always balance: Assets = Liabilities + Equity.

Statement of cash flows:

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

E1-31
Requirement 1

WILSON TOWING SERVICE Income Statement Month Ended June 30, 2014		
Revenue:		
Service Revenue		$ 11,200
Expenses:		
Salaries Expense	$ 1,900	
Rent Expense	550	
Total Expenses		2,450
Net Income		$ 8,750

Requirement 2

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

E1-32
Requirement 1

WILSON TOWING SERVICE Statement of Owner's Equity Month Ended June 30, 2014	
Wilson, Capital, June 1, 2014	$ 2,950
Owner contribution	2,000
Net income for the month	8,750
	13,700
Owner withdrawals	(1,000)
Wilson, Capital, June 30, 2014	$ 12,700

Requirement 2

The statement of owner's equity reports the changes in capital for a business entity during a time period.

E1-33
Requirement 1

WILSON TOWING SERVICE
Balance Sheet
June 30, 2014

Assets		Liabilities	
Cash	$ 1,900	Accounts Payable	$ 3,000
Accounts Receivable	6,200	Notes Payable	6,900
Office Supplies	900	Total Liabilities	9,900
Equipment	13,600	Owner's Equity	
		Wilson, Capital	12,700
Total Assets	$ 22,600	Total Liabilities and Owner's Equity	$ 22,600

Requirement 2

The Balance Sheet reports on an entity's assets, liabilities, and owner's equity as of a specific date.

E1-34

DAVIS DESIGN STUDIO
Income Statement
Year Ended December 31, 2014

Revenue:		
Service Revenue		$ 158,300
Expenses:		
Salaries Expense	$ 65,000	
Rent Expense	23,000	
Utilities Expense	6,900	
Miscellaneous Expense	4,200	
Property Tax Expense	1,500	
Total Expenses		100,600
Net Income		$ 57,700

E1-35

DAVIS DESIGN STUDIO
Statement of Owner's Equity
Year Ended December 31, 2014

Davis, Capital, January 1, 2014	$ 33,300
Owner contribution	15,000
Net income for the year	57,700
	106,000
Owner withdrawals	(54,400)
Davis, Capital, December 31, 2014	$ 51,600

E1-36

DAVIS DESIGN STUDIO
Balance Sheet
December 31, 2014

Assets		Liabilities	
Cash	$ 3,600	Accounts Payable	$ 3,200
Accounts Receivable	8,600	Notes Payable	10,900
Office Supplies	4,500	Total Liabilities	14,100
Office Furniture	49,000	Owner's Equity	
		Davis, Capital	51,600
Total Assets	$ 65,700	Total Liabilities and Owner's Equity	$ 65,700

E1-37

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

E1-38

JAVA FOOD EQUIPMENT COMPANY
Statement of Cash Flows
Month Ended February 28, 2014

Cash flows from operating activities:		
Receipts:		
Collections from customers		$ 4,000
Payments:		
For rent	$ (1,000)	
For salaries	(800)	
For utilities	(250)	(2,050)
Net cash provided by operating activities		1,950
Cash flows from investing activities:		
Purchase of land	(15,000)	
Net cash used by investing activities		(15,000)
Cash flows from financing activities:		
Owner contributions	10,000	
Owner withdrawals	(2,000)	
Net cash provided by financing activities		8,000
Net decrease in cash		(5,050)
Cash balance, February 1, 2014		13,750
Cash balance, February 28, 2014		$ 8,700

E1-39

Average total assets = (Beginning total assets + ending total assets) / 2
Beginning total assets = $35,000 + $28,000 + $150,000 + $2,600 + $20,000 + $4,400 = $240,000
Ending total assets = $55,000 + $50,000 + $150,000 + $18,800 + $45,000 + $1,200 = $320,000
Average total assets = ($240,000 + $320,000) / 2 = $280,000

ROA = Net income / Average total assets
ROA = $35,000 / $280,000 = 0.125 = 12.5%

Problems (Group A)

P1-40A

	Assets							=	Liabilities	+	Equity									
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Crone, Capital	–	Crone, Withdrawals	+	Service Revenue	–	Rent Expense	–	Advertising Expense
Bal.	$2,300	+	$3,000			+	$14,000	=	$8,000	+	$11,300								
(a)	+13,000										+13,000								
Bal.	$15,300	+	$3,000			+	$14,000	=	$8,000	+	$24,300								
(b)	+900														+900				
Bal.	$16,200	+	$3,000			+	$14,000	=	$8,000	+	$24,300				$900				
(c)	–8,000								–8,000										
Bal.	$8,200	+	$3,000			+	$14,000	=	$0	+	$24,300			+	$900				
(d)					+600				+600										
Bal.	$8,200	+	$3,000	+	$600	+	$14,000	=	$600	+	$24,300			+	$900				
(e)	+2,300		–2,300																
Bal.	$10,500	+	$700	+	$600	+	$14,000	=	$600	+	$24,300			+	$900				
(f)	–1,600												–1,600						
Bal.	$8,900	+	$700	+	$600	+	$14,000	=	$600	+	$24,300	–	$1,600	+	$900				
(g)			+5,500												+5,500				
Bal.	$8,900	+	$6,200	+	$600	+	$14,000	=	$600	+	$24,300	–	$1,600	+	$6,400				
(h)	–1,800																–1,200		–600
Bal.	$7,100	+	$6,200	+	$600	+	$14,000	=	$600	+	$24,300	–	$1,600	+	$6,400	–	$1,200	–	$600

P1-41A

	Assets					=	Liabilities	+	Equity												
	Cash	+	Accounts Receivable	+	Office Supplies	=	Accounts Payable	+	Turner, Capital	–	Turner, Withdrawals	+	Service Revenue	–	Rent Expense	–	Utilities Expense	–	Salaries Expense	–	Advertising Expense
1	+21,000								+21,000												
2	+3,500												+3,500								
Bal.	$24,500					=		+	$21,000			+	$3,500								
5	–200				+200																
Bal.	$24,300			+	$200	=		+	$21,000			+	$3,500								
9			+2,000										+2,000								
Bal.	$24,300	+	$2,000	+	$200	=		+	$21,000			+	$5,500								
10							+300										–300				
Bal.	$24,300	+	$2,000	+	$200	=	$300	+	$21,000			+	$5,500			–	$300				
15	–325																				–325
Bal.	$23,975	+	$2,000	+	$200	=	$300	+	$21,000			+	$5,500			–	$300			–	$325
20	–300						–300														
Bal.	$23,675	+	$2,000	+	$200	=	$ 0	+	$21,000			+	$5,500			–	$300			–	$325
25	+2,000		–2,000																		
Bal.	$25,675	+	$ 0	+	$200	=		+	$21,000			+	$5,500			–	$300			–	$325
28	–2,000														–2,000						
Bal.	$23,675			+	$200	=		+	$21,000			+	$5,500	–	$2,000	–	$300			–	$325
28	–1,250																		–1,250		
Bal.	$22,425			+	$200	=		+	$21,000			+	$5,500	–	$2,000	–	$300	–	$1,250	–	$325
30	+1,800												+1,800								
Bal.	$24,225			+	$200	=		+	$21,000			+	$7,300	–	$2,000	–	$300	–	$1,250	–	$325
31	–5,000										–5,000										
Bal.	$19,225	+	$ 0	+	$200	=	$ 0	+	$21,000	–	$5,000	+	$7,300	–	$2,000	–	$300	–	$1,250	–	$325

P1-42A
Requirement 1

GATE CITY ANSWERING SERVICE Income Statement Year Ended December 31, 2014		
Revenue:		
Service Revenue		$ 192,000
Expenses:		
Salaries Expense	$ 65,000	
Advertising Expense	15,000	
Rent Expense	13,000	
Interest Expense	7,000	
Property Tax Expense	2,600	
Insurance Expense	2,500	
Total Expenses		105,100
Net Income		$ 86,900

Requirement 2

GATE CITY ANSWERING SERVICE Statement of Owner's Equity Year Ended December 31, 2014	
Wayne, Capital, January 1, 2014	$ 54,000
Owner contribution	28,000
Net income for the year	86,900
	168,900
Owner withdrawals	(30,000)
Wayne, Capital, December 31, 2014	$ 138,900

Requirement 3

GATE CITY ANSWERING SERVICE Balance Sheet December 31, 2014			
Assets		Liabilities	
Cash	$ 3,000	Accounts Payable	$ 11,000
Accounts Receivable	1,000	Notes Payable	32,000
Office Supplies	10,000	Salaries Payable	1,300
Equipment	16,000	Total Liabilities	44,300
Building	145,200		
Land	8,000	Owner's Equity	
		Wayne, Capital	138,900
Total Assets	$ 183,200	Total Liabilities and Owner's Equity	$ 183,200

P1-43A
Part a.

STUDIO PHOTOGRAPHY Income Statement Year Ended December 31, 2014		
Revenue:		
Service Revenue		$ 80,000
Expenses:		
Salaries Expense	$ 25,000	
Insurance Expense	8,000	
Advertising Expense	3,000	
Total Expenses		36,000
Net Income		$ 44,000

Part b.

STUDIO PHOTOGRAPHY Statement of Owner's Equity Year Ended December 31, 2014	
Ansel, Capital, January 1, 2014	$ 16,000
Owner contribution	29,000
Net income for the year	44,000
	89,000
Owner withdrawals	(13,000)
Ansel, Capital, December 31, 2014	$ 76,000

Part c.

STUDIO PHOTOGRAPHY
Balance Sheet
December 31, 2014

Assets		Liabilities	
Cash	$ 37,000	Accounts Payable	$ 7,000
Accounts Receivable	8,000	Notes Payable	12,000
Equipment	50,000	Total Liabilities	19,000
		Owner's Equity	
		Ansel, Capital	76,000
Total Assets	$ 95,000	Total Liabilities and Owner's Equity	$ 95,000

P1-44A

GREENER LANDSCAPING
Balance Sheet
November 30, 2014

Assets		Liabilities	
Cash	$ 4,900	Accounts Payable	$ 2,700
Accounts Receivable	2,200	Notes Payable	24,200
Office Supplies	600	Total Liabilities	26,900
Office Furniture	6,100	Owner's Equity	
Land	34,200	Tum, Capital	21,100
Total assets	$ 48,000	Total Liabilities and Owner's Equity	$ 48,000

P1-45A
Requirement 1

	Assets							=	Liabilities	+	Equity								
	Cash	+	Accounts Receivable	+	Office Supplies	+	Furniture	=	Accounts Payable	+	Shore, Capital	–	Shore, Withdrawals	+	Service Revenue	–	Rent Expense	–	Utilities Expense
5	+50,000										+50,000								
6	–100				+100														
Bal.	$49,900			+	$100			=		+	$50,000								
7							+9,700		+9,700										
Bal.	$49,900			+	$100	+	$9,700	=	$9,700	+	$50,000								
10	+2,000														+2,000				
Bal.	$51,900			+	$100	+	$9,700	=	$9,700	+	$50,000			+	$2,000				
11	–200																		–200
Bal.	$51,700			+	$100	+	$9,700	=	$9,700	+	$50,000			+	$2,000			–	$200
12			+17,000												+17,000				
Bal.	$51,700	+	$17,000	+	$100	+	$9,700	=	$9,700	+	$50,000			+	$19,000			–	$200
18	–1,500																–1,500		
Bal.	$50,200	+	$17,000	+	$100	+	$9,700	=	$9,700	+	$50,000			+	$19,000	–	$1,500	–	$200
25	+17,000		–17,000																
Bal.	$67,200		$ 0	+	$100	+	$9,700	=	$9,700	+	$50,000			+	$19,000	–	$1,500	–	$200
27	–9,700								–9,700										
Bal.	$57,500			+	$100	+	$9,700	=	$ 0	+	$50,000			+	$19,000	–	$1,500	–	$200
	–1,000												–1,000						
Bal.	$56,500	+	$ 0	+	$100	+	$9,700	=	$ 0	+	$50,000	–	$1,000	+	$19,000	–	$1,500	–	$200

P1-45A, cont.
Requirement 2a

ALEX SHORE, CPA Income Statement Month Ended February 28, 2014		
Revenue:		
Service Revenue		$ 19,000
Expenses:		
Rent Expense	$ 1,500	
Utilities Expense	200	
Total Expenses		1,700
Net Income		$ 17,300

Requirement 2b

ALEX SHORE, CPA Statement of Owner's Equity Month Ended February 28, 2014	
Shore, Capital, February 1, 2014	$ 0
Owner contribution	50,000
Net income for the month	17,300
	$ 67,300
Owner withdrawals	(1,000)
Shore, Capital, February 28, 2014	$ 66,300

Requirement 2c

ALEX SHORE. CPA
Balance Sheet
February 28, 2014

Assets		Liabilities	
Cash	$ 56,500		
Office Supplies	100		
Furniture	9,700	Owner's Equity	
		Shore, Capital	66,300
Total Assets	$66,300	Total Liabilities and Owner's Equity	$66,300

P1-46A
Requirement 1

	Assets				= Liabilities	+ Equity				
	Cash	+ Accounts Receivable	+ Office Supplies	+ Computer	= Accounts Payable	+ Peters, Capital	− Peters, Withdrawals	+ Service Revenue	− Utilities Expense	− Miscellaneous Expense
3	+89,000					+89,000				
5	–400		+400							
Bal.	$88,600		$400			$89,000				
7				+9,300	+9,300					
Bal.	$88,600		$400	$9,300	$9,300	$89,000				
9	+2,000							+2,000		
Bal.	$90,600		$400	$9,300	$9,300	$89,000		$2,000		
15					+120					–120
Bal.	$90,600		$400	$9,300	$9,420	$89,000		$2,000	$0	$120
23		+13,500						+13,500		
Bal.	$90,600	$13,500	$400	$9,300	$9,420	$89,000		$15,500	$0	$120
28	–120				–120					
Bal.	$90,480	$13,500	$400	$9,300	$9,300	$89,000		$15,500	$0	$120
30	–1,200								–1,200	
Bal.	$89,280	$13,500	$400	$9,300	$9,300	$89,000		$15,500	$1,200	$120
31	+3,000	–3,000								
Bal.	$92,280	$10,500	$400	$9,300	$9,300	$89,000		$15,500	$1,200	$120
31	–2,000						–2,000			
Bal.	$90,280	$10,500	$400	$9,300	$9,300	$89,000	$2,000	$15,500	$1,200	$120

P1-46A, cont.
Requirement 2a

ANGELA PETERS, ATTORNEY
Income Statement
Month Ended March 31, 2014

Revenue:		
Service Revenue		$ 15,500
Expenses:		
Utilities Expense	$ 1,200	
Miscellaneous Expense	120	
Total Expenses		1,320
Net Income		$ 14,180

Requirement 2b

ANGELA PETERS, ATTORNEY
Statement of Owner's Equity
Month Ended March 31, 2014

Peters, Capital, March 1, 2014	$ 0
Owner contribution	89,000
Net income for the month	14,180
	103,180
Owner withdrawals	(2,000)
Peters, Capital, March 31, 2014	$ 101,180

Requirement 2c

ANGELA PETERS, ATTORNEY
Balance Sheet
March 31, 2014

Assets		Liabilities	
Cash	$ 90,280	Accounts Payable	$ 9,300
Accounts Receivable	10,500		
Office Supplies	400	Owner's Equity	
Computer	9,300	Peters, Capital	101,180
Total Assets	$ 110,480	Total Liabilities and Owner's Equity	$ 110,480

Problems Group B

P1-47B

	Assets							=	Liabilities	+	Equity								
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Collins, Capital	–	Collins, Withdrawals	+	Service Revenue	–	Rent Expense	–	Advertising Expense
Bal.	$2,100	+	$2,000	+		+	$10,000	=	$6,000	+	$8,100								
(a)	+10,000										+10,000								
Bal.	$12,100	+	$2,000			+	$10,000	=	$6,000	+	$18,100								
(b)	+1,000														+1,000				
Bal.	$13,100	+	$2,000			+	$10,000	=	$6,000	+	$18,100			+	$1,000				
(c)	–6,000								–6,000										
Bal.	$7,100	+	$2,000			+	$10,000	=	$0	+	$18,100			+	$1,000				
(d)					+700				+700										
Bal.	$7,100	+	$2,000	+	$700	+	$10,000	=	$700	+	$18,100			+	$1,000				
(e)	+500		–500																
Bal.	$7,600	+	$1,500	+	$700	+	$10,000	=	$700	+	$18,100			+	$1,000				
(f)	–1,900												–1,900						
Bal.	$5,700	+	$1,500	+	$700	+	$10,000	=	$700	+	$18,100	–	$1,900	+	$1,000				
(g)			+5,800												+5,800				
Bal.	$5,700	+	$7,300	+	$700	+	$10,000	=	$700	+	$18,100	–	$1,900	+	$6,800				
(h)	–1,300																–900		–400
Bal.	$4,400	+	$7,300	+	$700	+	$10,000	=	$700	+	$18,100	–	$1,900	+	$6,800	–	$900	–	$400

P1-48B

	Assets					=	Liabilities	+	Equity												
	Cash	+	Accounts Receivable	+	Office Supplies	=	Accounts Payable	+	Taylor, Capital	–	Taylor, Withdrawals	+	Service Revenue	–	Rent Expense	–	Utilities Expense	–	Salaries Expense	–	Advertising Expense
1	+30,000								+30,000												
2	+4,000												+4,000								
Bal.	$34,000					=		+	$30,000			+	$4,000								
5	–100				+100																
Bal.	$33,900			+	$100	=		+	$30,000			+	$4,000								
9			+3,000										+3,000								
Bal.	$33,900	+	$3,000	+	$100	=		+	$30,000			+	$7,000								
10							+200										–200				
Bal.	$33,900	+	$3,000	+	$100	=	$200	+	$30,000			+	$7,000			–	$200				
15	–125																				–125
Bal.	$33,775	+	$3,000	+	$100	=	$200	+	$30,000			+	$7,000			–	$200			–	$125
20	–200						–200														
Bal.	$33,575	+	$3,000	+	$100	=	$ 0	+	$30,000			+	$7,000			–	$200			–	$125
25	+3,000		–3,000																		
Bal.	$36,575	+	$ 0	+	$100	=		+	$30,000			+	$7,000			–	$200			–	$125
28	–1,500														–1,500						
Bal.	$35,075			+	$100	=		+	$30,000			+	$7,000	–	$1,500	–	$200			–	$125
28	–1,050																		–1,050		
Bal.	$34,025			+	$100	=		+	$30,000			+	$7,000	–	$1,500	–	$200	–	$1,050	–	$125
30	+2,800												+2,800								
Bal.	$36,825			+	$100	=		+	$30,000			+	$9,800	–	$1,500	–	$200	–	$1,050	–	$125
31	–2,000										–2,000										
Bal.	$34,825	+	$ 0	+	$100	=	$ 0	+	$30,000	–	$2,000	+	$9,800	–	$1,500	–	$200	–	$1,050	–	$125

P1-49B, cont.
Part a.

QUICK AND EZ DELIVERY
Income Statement
Year Ended December 31, 2014

Revenues:		
Service Revenue		$ 192,000
Expenses:		
Salaries Expense	$ 69,000	
Advertising Expense	17,000	
Rent Expense	13,000	
Interest Expense	6,000	
Property Tax Expense	2,900	
Insurance Expense	2,000	
Total Expenses		109,900
Net Income		$ 82,100

Part b.

QUICK AND EZ DELIVERY
Statement of Owner's Equity
Year Ended December 31, 2014

Trott, Capital, January 1, 2014	$ 51,000
Owner contribution	32,000
Net income for the year	82,100
	$ 165,100
Owner withdrawals	(32,000)
Trott, Capital, December 31, 2014	$ 133,100

Part c.

QUICK AND EZ DELIVERY
Balance Sheet
December 31, 2014

Assets		Liabilities	
Cash	$ 6,000	Accounts Payable	$ 14,000
Accounts Receivable	1,700	Notes Payable	30,000
Office Supplies	8,000	Salaries Payable	500
Equipment	17,000	Total Liabilities	$ 44,500
Building	137,900	Owner's Equity	
Land	7,000	Trott, Capital	133,100
Total Assets	$ 177,600	Total Liabilities and Owner's Equity	$ 177,600

P1-50B
Requirement a

PHOTO GALLERY
Income Statement
Year Ended December 31, 2014

Revenues:		
Service Revenue		$ 78,000
Expenses:		
Salaries Expense	$ 21,000	
Insurance Expense	9,000	
Advertising Expense	2,000	
Total Expenses		32,000
Net Income		$ 46,000

Requirement b

PHOTO GALLERY
Statement of Owner's Equity
Year Ended December 31, 2014

Leibovitz, Capital, January 1, 2014	$ 17,000
Owner contribution	35,000
Net income for the year	46,000
	98,000
Owner withdrawals	(14,000)
Leibovitz, Capital, December 31,2014	$ 84,000

Requirement c

PHOTO GALLERY
Balance Sheet
December 31, 2014

Assets		Liabilities	
Cash	$ 26,000	Accounts Payable	$ 4,000
Accounts Receivable	6,000	Notes Payable	14,000
Equipment	70,000	Total Liabilities	18,000
		Owner's Equity	
		Leibovitz, Capital	84,000
Total Assets	$ 102,000	Total Liabilities And Owner's Equity	$ 102,000

P1-51B

OUTDOOR LIFE LANDSCAPING
Balance Sheet
July 31, 2014

Assets		Liabilities	
Cash	$ 5,000	Accounts Payable	$ 2,800
Accounts Receivable	2,300	Notes Payable	26,400
Office Supplies	800	Total Liabilities	29,200
Office Furniture	5,200		
Land	28,400	Owner's Equity	
		Kamp, Capital	12,500
Total Assets	$ 41,700	Total Liabilities and Owner's Equity	$ 41,700

P1-52B

	Assets							=	Liabilities	+	Equity								
	Cash	+	Accounts Receivable	+	Office Supplies	+	Office Furniture	=	Accounts Payable	+	Woody, Capital	−	Woody, Withdrawals	+	Service Revenue	−	Rent Expense	−	Utilities Expense
5	+31,000										+31,000								
Bal.	$31,000							=		+	$31,000								
6	−200				+200														
Bal.	$30,800			+	$200			=		+	$31,000								
7							+9,500		+9,500										
Bal.	$30,800			+	$200	+	$9,500	=	$9,500	+	$31,000								
10	+3,000														+3,000				
Bal.	$33,800			+	$200	+	$9,500	=	$9,500	+	$31,000			+	$3,000				
11	−150																		−150
Bal.	$33,650			+	$200	+	$9,500	=	$9,500	+	$31,000			+	$3,000			−	$150
12			+14,000												+14,000				
Bal.	$33,650	+	$14,000	+	$200	+	$9,500	=	$9,500	+	$31,000			+	$17,000			−	$150
18	−1,900																−1,900		
Bal.	$31,750	+	$14,000	+	$200	+	$9,500	=	$9,500	+	$31,000			+	$17,000	−	$1,900	−	$150
25	+14,000		−14,000																
Bal.	$45,750		$ 0	+	$200	+	$9,500	=	$9,500	+	$31,000			+	$17,000	−	$1,900	−	$150
27	−9,500								−9,500										
Bal.	$36,250			+	$200	+	$9,500	=	$ 0	+	$31,000			+	$17,000	−	$1,900	−	$150
28	−8,000												−8,000						
Bal.	$28,250	+	$ 0	+	$200	+	$9,500	=	$ 0	+	$31,000	−	$8,000	+	$17,000	−	$1,900	−	$150

P1-52B, cont.
Requirement 2a

AARON WOODY, CPA Income Statement Month Ended February 28, 2014		
Revenues:		
Service Revenue		$ 17,000
Expenses:		
Rent Expense	$ 1,900	
Utilities Expense	150	
Total Expenses		2,050
Net Income		$ 14,950

Requirement 2b

AARON WOODY, CPA Statement of Owner's Equity Month Ended February 28, 2014	
Woody, Capital, February 1, 2014	$ 0
Owner contribution	31,000
Net income for the month	14,950
	$ 45,950
Owner withdrawals	(8,000)
Woody, Capital, February 28, 2014	$ 37,950

Requirement 2c

AARON WOODY, CPA
Balance Sheet
February 28,2014

Assets		Liabilities	
Cash	$ 28,250		
Office Supplies	200		
Office Furniture	9,500	Owner's Equity	
		Woody, Capital	$ 37,950
Total Assets	$ 37,950	Total Liabilities and Owner's Equity	$ 37,950

P1-53B
Requirement 1

	Assets							=	Liabilities	+	Equity								
	Cash	+	Accounts Receivable	+	Office Supplies	+	Computer	=	Accounts Payable	+	Griffin, Capital	–	Griffin, Withdrawals	+	Service Revenue	–	Utility Expense	–	Misc. Expense
3	+109,000										+109,000								
5	–900				+900														
Bal.	$108,100				$900	+		=		+	$109,000								
7							+9,200		+9,200										
Bal.	$108,100			+	$900	+	$9,200	=	$9,200	+	$109,000								
9	+3,000														+3,000				
Bal.	$111,100			+	$900	+	$9,200	=	$9,200	+	$109,000			+	$3,000				
15									+80										–80
Bal.	$111,100			+	$900	+	$9,200	=	$9,280	+	$109,000			+	$3,000	–		–	$80
23			+17,000												+17,000				
Bal.	$111,100	+	$17,000	+	$900	+	$9,200	=	$9,280	+	$109,000			+	$20,000	–		–	$80
28	–80								–80										
Bal.	$111,020	+	$17,000	+	$900	+	$9,200	=	$9,200	+	$109,000			+	$20,000	–		–	$80
30	–1,900																–1,900		
Bal.	$109,120	+	$17,000	+	$900	+	$9,200	=	$9,200	+	$109,000			+	$20,000	–	$1,900	–	$80
31	+4,000		–4,000																
Bal.	$113,120	+	$13,000	+	$900	+	$9,200	=	$9,200	+	$109,000			+	$20,000	–	$1,900	–	$80
31	–5,000												–5,000						
Bal.	$108,120	+	$13,000	+	$900	+	$9,200	=	$9,200	+	$109,000	–	$5,000	+	$20,000	–	$1,900	–	$80

P1-53B, cont.
Requirement 2a

AIMEE GRIFFIN, ATTORNEY Income Statement Month Ended December 31, 2014		
Revenues:		
Service Revenue		$ 20,000
Expenses:		
Utility Expense	$ 1,900	
Miscellaneous Expense	80	
Total Expenses		1,980
Net Income		$ 18,020

Requirement 2b

AIMEE GRIFFIN, ATTORNEY Statement of Owner's Equity Month Ended December 31, 2014	
Griffin, Capital, December 1, 2014	$ 0
Owner contribution	109,000
Net income for the month	18,020
	$ 127,020
Owner withdrawals	(5,000)
Griffin, Capital, December 31, 2014	$ 122,020

Requirement 2c

AIMEE GRIFFIN, ATTORNEY
Balance Sheet
December 31, 2014

Assets		Liabilities	
Cash	$ 108,120	Accounts Payable	$ 9,200
Accounts Receivable	13,000		
Office Supplies	900	Owner's Equity	
Computer	9,200	Griffin, Capital	122,020
Total Assets	$ 131,220	Total Liabilities and Owner's Equity	$ 131,220

Continuing Problem

P1-54 Requirement 1

	Assets									=	Liabilities			+	Equity							
	Cash	+	Accounts Receivable	+	Office Supplies	+	Equipment	+	Furniture	=	Accounts Payable	+	Unearned Revenue	+	Davis, Capital	–	Davis, Withdrawals	+	Service Revenue	–	Rent Expense	–	Utilities Expense
(1)	+18,000														+18,000								
(2)	–550																				–550		
Bal.	$17,450									=				+	$18,000					–	$550		
(3)	–1,800						+1,800																
Bal.	$15,650					+	$1,800			=				+	$18,000					–	$550		
(4)									+4,200		+4,200												
Bal.	$15,650					+	$1,800	+	$4,200	=	$4,200			+	$18,000					–	$550		
(5)					+900						+900												
Bal.	$15,650			+	$900	+	$1,800	+	$4,200	=	$5,100			+	$18,000					–	$550		
(9)			+1,500																+1,500				
Bal.	$15,650	+	$1,500	+	$900	+	$1,800	+	$4,200	=	$5,100			+	$18,000			+	$1,500	–	$550		
(12)	–250																						–250
Bal.	$15,400	+	$1,500	+	$900	+	$1,800	+	$4,200	=	$5,100			+	$18,000			+	$1,500	–	$550	–	$250
(18)	+1,100																		+1,100				
Bal.	$16,500	+	$1,500	+	$900	+	$1,800	+	$4,200	=	$5,100			+	$18,000			+	$2,600	–	$550	–	$250
(21)	+ 1,400												+1,400										
Bal.	$17,900	+	$1,500	+	$900	+	$1,800	+	$4,200	=	$5,100	+	$1,400	+	$18,000			+	$2,600	–	$550	–	$250
(26)	– 400										– 400												
Bal.	$17,500	+	$1,500	+	$900	+	$1,800	+	$4,200	=	$4,700	+	$1,400	+	$18,000			+	$2,600	–	$550	–	$250
(28)	+ 300		–300																				
Bal.	$17,800	+	$1,200	+	$900	+	$1,800	+	$4,200	=	$4,700	+	$1,400	+	$18,000			+	$2,600	–	$550	–	$250
(30)	–1,400																–1,400						
Bal.	$16,400	+	$1,200	+	$900	+	$1,800	+	$4,200	=	$4,700	+	$1,400	+	$18,000	–	$1,400	+	$2,600	–	$550	–	$250

P1-54, cont.
Requirement 2

DAVIS CONSULTING
Income Statement
Month Ended December 31, 2014

Revenue:		
Service Revenue		$ 2,600
Expenses:		
Rent Expense	$ 550	
Utilities Expense	250	
Total Expense		800
Net Income		$ 1,800

Requirement 3

DAVIS CONSULTING
Statement of Owner's Equity
Month Ended December 31, 2014

Davis, Capital, December 1, 2014	$ 0
Owner contribution	18,000
Net income for the month	1,800
	$ 19,800
Owner withdrawals	(1,400)
Davis, Capital, December 31, 2014	$ 18,400

Requirement 4

DAVIS CONSULTING
Balance Sheet
December 31, 2014

Assets		Liabilities	
Cash	$ 16,400	Accounts Payable	$ 4,700
Accounts Receivable	1,200	Unearned Revenue	1,400
Office Supplies	900	Total Liabilities	$ 6,100
Equipment	1,800		
Furniture	4,200	Owner's Equity	
		Davis, Capital	18,400
Total Assets	$ 24,500	Total Liabilities and Owner's Equity	$ 24,500

Requirement 5
Average total assets = ($0 + $24,500) / 2 = $12,250
Return on assets = Net income / Average total assets = $1,800 / $12,250 = 0.147 = 14.7%

Critical Thinking

Decision Case 1-1
Requirement 1

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

Requirement 2

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

Requirement 3

Sal’s   Sal’s $21,000 ($8,000 + $35,000 – $22,000)   Greg’s $15,000 ($6,000 + $9,000)

Requirement 4

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

Requirement 5

Sal’s   Sal’s $13,000 ($35,000 – $22,000), Greg’s $9,000

Requirement 6

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

Requirement 7

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

Decision Case 1-2
Requirement 1

The banker would not congratulate the Guerreras for their net income because they have not measured net income properly. In fact, they have no net income at all. Net income is revenues minus expenses, and the Guerraras do not have any revenues or expenses. The amount of cash in the bank does not measure net income, as it is the result of a loan from the bank.

Requirement 2

TRES AMIGOS BED & BREAKFAST
Balance Sheet
June 30, 2015

Assets		Liabilities	
Cash	$ 38,000	Bank Loan Payable	$ 100,000
Computer	2,000		
Kitchen Equipment	10,000		
Furniture	20,000	Owner's Equity	
Building ($80,000 + $50,000)	130,000	Guerrera, Capital	100,000
Total Assets	$ 200,000	Total Liabilities and Owner's Equity	$ 200,000

Ethical Issues 1-1
Req. 1

If an auditor is in fact independent, but one or more factors suggest otherwise, this could potentially lead to the public concluding that the audit report does not represent a true and fair view. There is a clear ethical statement on conflict of interest which must be observed if an auditor wishes to continue practicing.

Req. 2

There are two main options. Firstly the accounts of one of the companies could be transferred to another partner within McIntosh & Co. and disclosing this to both companies. Auditing the accounts of the two firms is not of itself an ethical concern, it is the potential conflict of interest if one were to be taking on work from the other. The auditor should instruct Tartan Promotions to consult an independent advisor since he, as an auditor, is not the right person to answer that question, especially because the promotion firm is also an audit client.

Req. 3

The purpose of an audit is to enhance the credibility of financial statements by providing written reasonable assurance from an independent source that they present a true and fair view in accordance with an accounting standard. This objective will not be met if users of the audit report believe that the auditor may have been influenced by other parties, more specifically company managers/directors or by conflicting interests.

Fraud Case 1-1
Requirement 1

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

Requirement 2

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

Financial Statement Case
Requirement 1

$1,148.1 (in millions)

Requirement 2

$7,360.4 (in millions) at October 2, 2011; $6,385.9 (in millions) at October 3, 2010

Requirement 3

Assets	=	Liabilities	+	Equity
$7,360.4	=	$2,973.1	+	$4,387.3

(shown in millions)

Requirement 4

$11,700.4 (in millions) for year ended October 2, 2011
This is an increase of $993 (in millions) over 2010. ($11,700.4− $10,707.4)

Requirement 5

$1,245.7 (in millions) in 2011
$945.6 (in millions) in 2010
2011 was better than 2010.

Requirement 6

Average total assets =($6,385.9+ $7,360.4) / 2 = $6,873.2 (rounded)
Return on assets = $1,245.7 / $6,873.2 = 0.181 = 18.1%

Requirement 7

Starbucks Corporation's return on assets (18.1%) was significantly higher than Green Mountain Coffee Roasters, Inc. (8.7%).

Team Project 1-1
Requirement 1

1. How to organize the business—as a proprietorship, a partnership, an LLC, or a corporation (you have decided to organize as a proprietorship)
2. Where to locate the business
3. How much of your own time and money to commit to the business
4. How to finance the business—with your own personal money, with equity contributions from others, or through borrowing
5. How many people to employ for the business
6. How to measure the business's success or failure; how to account for the assets, liabilities, and operations of the business
7. What type of animals to board (dogs only, dogs and cats, birds, reptiles, and so on)
8. Whether to sell pet foods, toys, and other supplies
9. Whether to offer obedience lessons and other pet training
10. How to advertise the business (newspapers, radio, posters, online)

Student answers may vary.

Requirement 2

1. Obtain equity financing to start the business
2. Purchase land and building
3. Renovate the building to make it suitable for a kennel
4. Purchase pet food and other supplies that will be needed to operate the kennel
5. Advertising
6. Earn service revenue
7. Pay utility bills
8. Pay for veterinarian services
9. Pay employee wages
10. Borrow money
11. Owner withdrawals

Student answers may vary.

Team Project 1-1, cont.
Requirement 3

QUAIL CREEK PET KENNEL
Income Statement
Month Ended January 31, 20XX

Revenue:		
Service Revenue		$ 10,000
Expenses:*		
Wages Expense	$ 2,000	
Supplies Expense	400	
Advertising Expense	300	
Utilities Expense	100	
Total Expense		2,800
Net Income		$ 7,200

*Students may also include depreciation expense on the building.

QUAIL CREEK PET KENNEL
Statement of Owner's Equity
Month Ended January 31, 20XX

Last name, Capital, January 1, 20XX	$ 0
Owner contribution	30,000
Net income for the month	7,200
	37,200
Owner withdrawal	(2,000)
Last name, Capital, January 31, 20XX	$ 35,200

QUAIL CREEK PET KENNEL
Balance Sheet
January 31, 20XX

Assets		Liabilities	
Cash	$ 1,500	Accounts Payable	$ 1,000
Supplies	200		
Building	25,000	Owner's Equity	
Land	9,500	Last name, Capital	35,200
Total Assets	$ 36,200	Total Liabilities And Owner's Equity	$ 36,200

Team Project 1-1, cont.
Requirement 4

We evaluate the success of the business by considering its:

- Net income or net loss for the period, as reported on the income statement
- Financial position at the end of the period, as reported on the balance sheet

A profitable business that should continue is one that shows net income for the period, assets exceeding liabilities, and positive cash flow.

Team Project 1-2
Suggested Answers:

Requirement 1

1. How to organize the business—as a proprietorship, a partnership, an LLC, or a corporation (assume you have decided to organize as a proprietorship)
2. Where to locate the headquarters of the business
3. How much of your own time and money to commit to the business
4. How to finance the business—with your own personal money, with equity contributions from others, or through borrowing
5. How many people to employ for the business
6. How to measure the business's success or failure; how to account for the assets, liabilities, and operations of the business
7. What type of music to feature; what age group or interest group to appeal to
8. Whether to sell concessions (food, drinks, T-shirts, and so on) yourself or to arrange for outsiders to sell concessions at the concert
9. How to advertise the business (newspapers, radio, posters, online)
10. Whether to sponsor the concerts yourself or to arrange for corporate or charitable organizations to sponsor the concerts

Requirement 2

1. Which band (or bands) to feature at the concerts
2. How much and when to pay the performers (flat rate or a percentage of gate receipts)
3. Where to stage the concerts and how to pay for the site rental
4. Need for city or county permits to stage a concert
5. How to ensure security at the concert
6. How to get people to come to the concert—how to advertise the concerts (newspapers, radio, posters, or other) and how much to pay for advertising
7. How to offer concessions (buy and sell them yourself or arrange for outside concessionaires). If outsiders, how will they be compensated—keep their own revenues or share them with you?
8. Need for traffic control if the crowd disrupts city traffic
9. Weather considerations if the concert is staged outdoors
10. Timing of the concert in relation to other events in the area at the time.

Team Project 1-2, cont.
Requirement 3

CONCERT ENTERPRISES Income Statement Three Months Ended June 30, 20XX		
Revenue:		
Ticket Sales Revenue		$ 300,000
Concession Revenue		50,000
Total Revenue		$ 350,000
Expenses:		
Band Expense	$ 100,000	
Advertising Expense	50,000	
Concession Expense	20,000	
Rent Expense	15,000	
Security Expense	10,000	
Utilities Expense	3,000	
Permits Expense	2,000	
Total Expenses		200,000
Net Income		$ 150,000

CONCERT ENTERPRISES Statement of Owner's Equity Three Months Ended June 30, 20XX	
Last name, Capital, April 1, 20XX	$ 0
Owner contribution	1,000
Net income for quarter	150,000
	151,000
Owner withdrawal	(10,000)
Last name, Capital, June 30, 20XX	$ 141,000

Team Project 1-2, cont.

CONCERT ENTERPRISES Balance Sheet June 30, 20XX			
Assets		Liabilities	
Cash	$ 136,000	Accounts Payable	$ 7,000
Accounts Receivable	8,000		
Supplies	4,000	Owner's Equity	
		Last Name, Capital	141,000
Total Assets	$ 148,000	Total Liabilities And Owner's Equity	$ 148,000

Requirement 4

We evaluate the success of the business by considering its:

- Net income or net loss for the period, as reported on the income statement
- Financial position at the end of the period, as reported on the balance sheet

A profitable business that should continue is one that shows net income for the period, assets exceeding liabilities, and positive cash flow.

Communication Activity 1-1

Assets = Liabilities + Equity simply shows the resources that a business owns and the claims that others have against those resources (assets).

Chapter 1

Accounting and the Business Environment

Chapter Overview

The chapter begins with an introduction to accounting, and a brief description on why accounting is important. The differences between financial and managerial accounting are discussed. The text discusses how accounting information is needed by various users—individuals, businesses, investors, creditors, government regulatory agencies, and taxing authorities. The accounting profession and career paths available to accounting majors are briefly described. The sole proprietorship, partnership, corporations, and limited liability companies (LLC's) forms of business are briefly described. The role of governing organizations such as the Financial Accounting Standards Board (FASB), Securities and Exchange Commission (SEC), and International Accounting Standards Board (IASB) are explained. Generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS) are introduced. The economic entity assumption, cost principle, going-concern assumption, and monetary-unit assumption are explained. The role of ethics in accounting is described. The U.S. government's passing of the Sarbanes-Oxley Act (SOX), as well as the creation of the Public Company Accounting Oversight Board (PCAOB) are presented.

The next section of the chapter introduces the accounting equation: Assets = Liabilities + Equity. Each element of the equation is defined. Examples of a variety of transactions are analyzed, and their impact on the accounting equation is discussed. The financial statements—income statement, statement of owner's equity, balance sheet, and statement of cash flows are illustrated. The interrelationship of the financial statements is emphasized. An ethics sidebar helps give perspective on real world ethical dilemmas. Financial statements and return on assets (ROA) are used to evaluate business performance. A decisions sidebar helps students see how financial statements and ROA can be used to make real world decisions. A review highlights the information students should have acquired from the chapter. A summary problem allows students to record the effect of transactions on the accounting equation, prepare financial statements, and calculate ROA. A quick check gives students a chance to assess their knowledge of the chapter learning objectives.

Learning Objectives

1. Explain why accounting is important and list the users of accounting information
2. Describe the organizations and rules that govern accounting
3. Describe the accounting equation, and define assets, liabilities, and equity
4. Use the accounting equation to analyze transactions
5. Prepare financial statements
6. Use financial statements and return on assets (ROA) to evaluate business performance

Chapter 1: Teaching Outline

1) Explain why accounting is important and list the users of accounting information
   a) Define the term accounting
   b) Exhibit 1-1 Decision Making: Financial versus Managerial Accounting
   c) Define the following users of financial information:
      i) Individuals
      ii) Businesses
      iii) Investors
      iv) Creditors
      v) Taxing Authorities
   d) Describe career options and certifications available to accounting majors
2) Describe the organizations and rules that govern accounting
   a) Identify the different types of business organizations
      i) Sole Proprietorship
      ii) Partnership
      iii) Corporation
      iv) Limited-Liability Company (LLC)
      v) Exhibit 1-3 Business Organizations
   b) Define the Governing Organizations
      i) Financial Accounting Standards Board (FASB)
         (1) Generally Accepted Accounting Principles (GAAP)
            1. The Economic Entity Assumption
            2. The Cost Principle
            3. The Going Concern Assumption
            4. The Monetary Unit Assumption
      ii) Securities and Exchange Commission (SEC)
      iii) International Accounting Standards Board (IASB)
         (1) International Financial Reporting Standards (IFRS)

c) Ethics in Accounting and Business

i) Sarbanes-Oxley Act (SOX)

ii) Public Company Accounting Oversight Board (PCAOB)

3) Describe the accounting equation, and define assets, liabilites, and equity

a) The accounting equation

b) Assets, Liabilities, Equity

4) Use the accounting equation to analyze transactions

a) Transaction Analysis for Smart Touch Learning

5) Prepare financial statements

a) The Four Financial Statements

i) Income Statement

ii) Statement of Owner's Equity

iii) Balance Sheet

iv) Statement of Cash Flows

6) Use financial statements and return on assets (ROA) to evaluate business performance

a) Exhibit 1-9 Information Provided by Financial Statements

b) Explain return on assets (ROA)

Chapter 1: Student Summary Handout

1. Accounting equation: ASSETS = LIABILITIES + OWNER'S EQUITY
   - Assets are something the business owns or has control of that has value
   - Liabilities are something the business owes
   - Equity represents the amount of assets that are left over after the company has paid its liabilities, or net worth
2. Transaction analysis using the accounting equation
   - *Key*: Both sides of the accounting equation must always be equal
3. Four financial statements
   - Income Statement
   - Statement of Owner's Equity
   - Balance Sheet (uses the same accounts as the accounting equation)
   - Statement of Cash Flows
   - Headings on statements always listed as:
     - Name of company
     - Name of statement
     - Descriptive date
4. Return on Assets: Net income /Average total assets
   - Average total assets = (Beginning total assets + Ending total assets) / 2

Lecture Outline Tips: Key Topics

Not all accounting information and financial statements are publicly available; this is disclosed by public companies only. Company size is not a determinant of public ownership—some large companies are still privately held.

The stockholders of a company may be (and probably are) officers as well. Not all investors are "outside" of the company. The financial statements are the primary tools for providing information to outside investors; but officers also use the statements, along with other financial information, to manage the company on a day-to-day basis.

Financial accounting deals with historical information—the company reports on events that have already occurred. However, many companies also prepare budgets, forecasts, and projections for decision-making that are based on future events, and forecasted financial statements can be prepared. How do you know what type of statement you are looking at? Read the heading! Statements dated as "ended" indicate historical information, and statements dated as "ending" indicate future information.

All companies, public and private, can follow GAAP. However, this may not be a requirement for private companies. These companies can use other bases of accounting, such as the cash basis, unless GAAP is required due to an audit. There is also a difference between record keeping and financial statement preparation. Companies can keep their accounting records on another basis and convert the financial statements to GAAP. For example, small private companies may use the cash basis for record keeping and convert to the accrual basis for financial statement preparation. The SEC is currently investigating endorsing IFRS. If the SEC endorses IFRS, then IFRS will be slowly incorporated into the U.S. financial system. This could mean that in the future, U.S. GAAP will be in-line with IFRS, and reporting under IFRS could start as early as 2015 or 2016.

Not all accountants are licensed, and those that are, may not necessarily be members of the AICPA and IMA, the professional associations described in the textbook. However, the licensing board (if a license has been granted) and/or federal and state laws can still be applied to hold people accountable for their actions.

The Sarbanes-Oxley Act and the PCAOB relate to public companies. As a rule, public companies are more regulated (related to accounting information) than private companies. Some companies are now going private; and one reason for doing so may be to reduce the compliance cost associated with these additional regulations.

Corporate status is not based on the size of the company. Not all large companies are corporations and not all small companies are sole proprietorships and partnerships. A corporation could have only one stockholder. Why would a one-shareholder business incorporate the business in this case? One reason is limited liability protection. Regardless of the number of stockholders, all corporations follow the same general corporate procedures.

Information presented in the financial statements is largely based on historical cost—the cost principle. Beginning students may think the balance sheet total represents the value of the company, which is incorrect. The balance sheet total is based on historical cost and may not represent the fair market value of the company as of the statement date. For example, land purchased 10 years ago is likely to be worth more than the original cost, but it would still be reported on the balance sheet at original cost. These types of assets are sometimes called "hidden assets"; the true value is not reflected on the financial statement. How is the true value of a company determined? Have it appraised! Even after converting the account balances to fair market value, some students may think a company is worth the amount of its total assets. This is incorrect—don't forget about subtracting liabilities! The stockholders' equity total represents the true value of the company.

The accounting equation must always balance. Most textbook examples show companies that are profitable from the very beginning and always have positive equity balances. Although not illustrated in many textbooks, stockholders' equity can be negative if liabilities exceed assets, but the equation would still balance. For example, a company could have $100 of assets, $150 of liabilities, and $(50) of equity, and the equation would equal $100 on each side. This is not a good position to be in, but is not unusual in the business world. You could also have a transaction that affects only one side of the equation (left or right), but the equation would still balance. For example, a transaction could increase one asset and decrease another asset and the equation would balance with no effect on liabilities and equity. A company that purchases supplies with cash would experience this.

Students sometimes have trouble understanding the purchase of supplies on account, and how the usage of the supplies and the payment of the outstanding liability relate to each other. Students may want to decrease the outstanding liability as the asset is used up, which is incorrect. These are three separate events: (1) purchasing an asset, (2) using the asset, and (3) paying the outstanding liability.

It may be worthwhile to introduce the concept of materiality at this point: Is an item large or important enough to influence a person's perspective or decision about the company? In many cases, the accounting process and financial reporting is not "to the penny," although students may think this is the case. One example would be the accounting for supplies. Theoretically, supplies are an asset and should be recorded as such. The asset would turn into an expense as the supplies are used over time. However, in practice, some companies expense supplies immediately because the balance is immaterial to the overall financial statements. Another example of materiality is the fact that many financial statements are rounded for presentation purposes. Some large companies present statements in thousands or millions of dollars. It's interesting to provide examples of real company financial statements to students early in the semester and see their reaction to this type of rounding.

Net income and cash flow are separate concepts; both are not always positive. A company could have net income and negative cash flow, as well as a net loss and positive cash flow. Many creditors will focus on cash flow in order to determine if a company can generate cash in order to pay back any outstanding liabilities.

Each of the financial statements required by GAAP focuses on a different area. All four statements should be analyzed in order to get a complete picture of a company. The income statement tracks profitability. Remember that "profit" doesn't necessarily mean "money"—the profit may have not been collected in cash yet. The statement of owner's equity shows the changes in capital (based on cost) over time. As profits increase, the stockholders' equity should increase as well. The balance sheet shows a company's financial position at a certain point in time. Notice this is for one day only—the balance sheet will probably change the day after it's prepared. Financial position (the balance sheet) is different from profitability (the income statement). A company could be very profitable and do a terrible job of managing its profits, or vice versa. Students probably know a person that is like this! Some people have high-income levels and end up with very little net worth because they can't manage their finances. On the other hand, some people have modest income levels and do a very good job of managing their finances. The cash flow statement shows how the company is generating and using its cash. Students may have heard the phrase "cash is king"; a company must have cash to pay its outstanding bills. Some recent accounting fraud cases involved companies that reported great profits, but no corresponding cash flow—a possible red flag!

The owner's equity balance doesn't represent the balance in the cash account. Students sometimes think the corporation can simply declare drawing from the balance in cash at any given time. However, this may not be the case. The income included in owner's equity is based on accrual accounting and may not yet have been collected in cash. In addition, some items that have been paid in cash may not be expensed yet and, therefore, are not included in income.

Every transaction affects the balance sheet—an asset, liability, or equity account is affected in any business transaction. A transaction may or may not affect the other financial statements.

Students should understand the proper ordering of financial statement preparation. They will quickly learn this when attempting to prepare financial statements, if they don't have the numbers they need to continue going forward. For example, try to complete an owner's equity statement before preparing the related income statement. Ending capital cannot be calculated without considering net income or net loss from the income statement. In addition, headings and currency signs are very important. This is something students can "glaze over." Each statement should have a company name, a statement title, and a date. The balance sheet is as of one day, and the other statements cover a period of time. If students prepare a balance sheet dated for the entire period, ask them to think about how to determine a cash balance for a period of time. This can't be done—a balance is computed for a certain date, not for a period of time. For example, a company could have a $10,000 cash balance as of 12/31/11, but not a $10,000 balance for the year ended 12/31/11—the balance could change every day.

Currency signs indicate a unit of measurement for the reader of the statement, and can be used for comparison purposes. For example, you may be analyzing two companies, one that reports in US dollars and the other in Canadian dollars. The currency difference would be relevant in your analysis and decision-making. Lastly, although in many textbooks the standard reporting practice is annually, students should realize that companies may report for a variety of different accounting periods—monthly, quarterly, semi-annually, annually, etc. The reporting period would be indicated in the statement heading.

Answer Key to Chapter 1 Quiz:

1. B
2. A
3. D
4. B
5. B
6. D
7. C
8. C
9. D
10. B

Name______________________________Date____________________Section______

CHAPTER 1
TEN-MINUTE QUIZ

Circle the letter of the best response.

1. Generally accepted accounting principles (GAAP) are formulated by the
   A. American Institute of Certified Public Accountants (AICPA)
   B. Financial Accounting Standards Board (FASB)
   C. International Accounting Standards Board (IASB)
   D. Securities and Exchange Commission (SEC)

2. Which type of business organization is owned by one owner?
   A. Proprietorship
   B. Partnership
   C. Corporation
   D. Items a, b, and c are all correct

3. Which accounting assumption assumes that an entity will remain in operation for the foreseeable future?
   A. Economic entity assumption
   B. Cost principle
   C. Monetary unit assumption
   D. Going concern assumption

4. Red Door Boutique is famous for fashion wristwatches and leather purses. At the end of a recent year, Red Door's total assets added up to $485,000,000, and liabilities were $163,000,000. How much was Red Door's equity?
   A. $163,000,000
   B. $322,000,000
   C. $485,000,000
   D. Cannot determine from the data given

5. Assume that Red Door Boutique sold additional watches to a department store on account for $58,000. How would this transaction affect Red Door's accounting equation?
   A. Increase both assets and liabilities by $58,000
   B. Increase both assets and equity by $58,000
   C. Increase both liabilities and equity by $58,000
   D. No effect on the accounting equation because the effects cancel out

6. Accounting is the information system that
   A. communicates the results to decision makers.
   B. measures business activity.
   C. processes data into reports.
   D. does all of the above.

7. Which of the following characteristics best describes a sole proprietorship?
   A. Limited liability of stockholders
   B. Indefinite life
   C. Owner is personally liable
   D. Two or more partners

8. Consider the overall effects on Red Door Boutique of selling watches and purses on account for $75,000 and paying expenses totaling $48,000. What is Red Door's net income or net loss?
   - A. Net income of $75,000
   - B. Net loss of $27,000
   - C. Net income of $27,000
   - D. Cannot determine from the data given

9. The income statement reports
   - A. financial position on a specific date.
   - B. results of operations on a specific date.
   - C. financial position for a specific period.
   - D. results of operations for a specific period.

10. On the 2011 income statement, Red Door Boutique reported net income of $123,000. The company reported beginning total assets of $2,056,000 and ending total assets of $2,182,000. What is Red Door's return on assets for 2011?
    - A. 5.6%
    - B. 5.8%
    - C. $2,182,000
    - D. Cannot determine from the data given

