

# 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 concept 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 concept.
6.
  - a. No. The offer of \$2,000,000 and the increase in the assessed value should not be recognized in the accounting records because land is recorded on the cost basis.
  - b. Cash would increase by \$2,125,000, land would decrease by \$900,000, and owner's 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) Owner's equity at the end of the period
  - (c) Cash at the end of the period

## PRACTICE EXERCISES

### PE 1-1A

**\$380,000.** Under the cost concept, the land should be recorded at the cost to Clairemont Repair Service.

### PE 1-1B

**\$437,500.** Under the cost concept, the land should be recorded at the cost to Higgins Repair Service.

### PE 1-2A

a.

$$\begin{aligned} A &= L + OE \\ \$675,000 &= \$215,000 + OE \\ OE &= \$460,000 \end{aligned}$$

b.

$$\begin{aligned} A &= L + OE \\ +\$112,300 &= +\$32,000 + OE \\ OE &= +\$80,300 \\ OE \text{ on December 31, 2019} &= \$460,000 + \$80,300 \\ &= \$540,300 \end{aligned}$$

### PE 1-2B

a.

$$\begin{aligned} A &= L + OE \\ \$395,000 &= \$97,000 + OE \\ OE &= \$298,000 \end{aligned}$$

b.

$$\begin{aligned} A &= L + OE \\ -\$65,000 &= +\$36,000 + OE \\ OE &= -\$101,000 \\ OE \text{ on December 31, 2019} &= \$298,000 - \$101,000 \\ &= \$197,000 \end{aligned}$$

### PE 1-3A

- (2) Asset (Accounts Receivable) increases by \$13,750;  
Revenue (Delivery Service Fees) increases by \$13,750.
- (3) Liability (Accounts Payable) decreases by \$2,500;  
Asset (Cash) decreases by \$2,500.
- (4) Asset (Cash) increases by \$9,000;  
Asset (Accounts Receivable) decreases by \$9,000.
- (5) Asset (Cash) decreases by \$1,000;  
Owner's Equity (Jerome Foley, Drawing) decreases by \$1,000.

**PE 1-3B**

- (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.

**PE 1-4A**

<b>ADVENTURE TRAVEL SERVICE</b> <b>Income Statement</b> <b>For the Year Ended April 30, 2019</b>		
<b>Fees earned</b>		<b>\$2,180,000</b>
<b>Expenses:</b>		
<b>Wages expense</b>	<b>\$1,300,000</b>	
<b>Office expense</b>	<b>400,000</b>	
<b>Miscellaneous expense</b>	<b>25,000</b>	
<b>Total expenses</b>		<b>1,725,000</b>
<b>Net income</b>		<b>\$ 455,000</b>

**PE 1-4B**

<b>SENTINEL TRAVEL SERVICE</b> <b>Income Statement</b> <b>For the Year Ended August 31, 2019</b>		
<b>Fees earned</b>		<b>\$750,000</b>
<b>Expenses:</b>		
<b>Wages expense</b>	<b>\$450,000</b>	
<b>Office expense</b>	<b>295,000</b>	
<b>Miscellaneous expense</b>	<b>12,000</b>	
<b>Total expenses</b>		<b>757,000</b>
<b>Net loss</b>		<b>\$ (7,000)</b>

## PE 1-5A

ADVENTURE TRAVEL SERVICE Statement of Owner's Equity For the Year Ended April 30, 2019		
Jerome Foley, capital, May 1, 2018		\$1,020,000
Additional investment by owner during year	\$ 60,000	
Net income for the year	455,000	
Withdrawals	(40,000)	
Increase in owner's equity		475,000
Jerome Foley, capital, April 30, 2019		\$1,495,000

## PE 1-5B

SENTINEL TRAVEL SERVICE Statement of Owner's Equity For the Year Ended August 31, 2019		
Barb Schroeder, capital, September 1, 2018		\$380,000
Additional investment by owner during year	\$ 36,000	
Net loss for the year	(7,000)	
Withdrawals	(18,000)	
Increase in owner's equity		11,000
Barb Schroeder, capital, August 31, 2019		\$391,000

## PE 1-6A

ADVENTURE TRAVEL SERVICE Balance Sheet April 30, 2019	
<b>Assets</b>	
Cash	\$ 197,000
Accounts receivable	485,000
Supplies	18,000
Land	900,000
<b>Total assets</b>	<b>\$1,600,000</b>
<b>Liabilities</b>	
Accounts payable	\$ 105,000
<b>Owner's Equity</b>	
Jerome Foley, capital	1,495,000
<b>Total liabilities and owner's equity</b>	<b>\$1,600,000</b>

## PE 1-6B

SENTINEL TRAVEL SERVICE Balance Sheet August 31, 2019	
<b>Assets</b>	
Cash	\$ 45,400
Accounts receivable	75,500
Supplies	4,700
Land	310,000
<b>Total assets</b>	<b>\$435,600</b>
<b>Liabilities</b>	
Accounts payable	\$ 44,600
<b>Owner's Equity</b>	
Barb Schroeder, capital	391,000
<b>Total liabilities and owner's equity</b>	<b>\$435,600</b>

## PE 1-7A

ADVENTURE TRAVEL SERVICE Statement of Cash Flows For the Year Ended April 30, 2019		
<b>Cash flows from operating activities:</b>		
Cash receipts from customers	\$ 2,080,000	
Cash payments for operating expenses	(1,706,000)	
<b>Net cash flow from operating activities</b>		<b>\$ 374,000</b>
<b>Cash flows used for investing activities:</b>		
Cash payment for purchase of land		(400,000)
<b>Cash flows from financing activities:</b>		
Cash receipt from owner as investment	\$ 60,000	
Cash withdrawals by owner	(40,000)	
<b>Net cash flow from financing activities</b>		<b>20,000</b>
<b>Net decrease in cash during year</b>		<b>\$ (6,000)</b>
<b>Cash as of May 1, 2018</b>		<b>203,000</b>
<b>Cash as of April 30, 2019</b>		<b>\$ 197,000</b>

## PE 1-7B

SENTINEL TRAVEL SERVICE Statement of Cash Flows For the Year Ended August 31, 2019		
<b>Cash flows from operating activities:</b>		
Cash receipt from customers	\$ 734,000	
Cash payments for operating expenses	(745,600)	
Net cash flow used for operating activities		\$(11,600)
<b>Cash flows used for investing activities:</b>		
Cash payment for purchase of land		(50,000)
<b>Cash flows from financing activities:</b>		
Cash receipt from owner as investment	\$ 36,000	
Cash withdrawals by owner	(20,000)	
Net cash flow from financing activities		16,000
Net decrease in cash during year		\$(45,600)
Cash as of September 1, 2018		89,000
Cash as of August 31, 2019		\$ 43,400

## PE 1-8A

a.	Dec. 31, 2019	Dec. 31, 2018
Total liabilities.....	\$547,800	\$518,000
Total owner's equity.....	\$415,000	\$370,000
Ratio of liabilities to owner's equity.....	1.32*	1.40**

\*  $\$547,800 \div \$415,000$ \*\*  $\$518,000 \div \$370,000$ 

b. Decreased

## PE 1-8B

a.	Dec. 31, 2019	Dec. 31, 2018
Total liabilities.....	\$4,085,000	\$2,880,000
Total owner's equity.....	\$4,300,000	\$3,600,000
Ratio of liabilities to owner's equity.....	0.95*	0.80**

\*  $\$4,085,000 \div \$4,300,000$ \*\*  $\$2,880,000 \div \$3,600,000$ 

b. Increased

**EXERCISES****Ex. 1-1**

- |    |                  |                  |                   |
|----|------------------|------------------|-------------------|
| a. | 1. manufacturing | 6. service       | 11. service       |
|    | 2. manufacturing | 7. service       | 12. service       |
|    | 3. manufacturing | 8. service       | 13. manufacturing |
|    | 4. service       | 9. manufacturing | 14. service       |
|    | 5. merchandise   | 10. merchandise  | 15. merchandise   |
- b. The accounting equation is relevant to all of the 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. K | 5. B | 9. X  |
|    | 2. G | 6. B | 10. B |
|    | 3. B | 7. X |       |
|    | 4. K | 8. G |       |
- 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**

Keurig Green Mountain's owners' equity:  $\$4,002 - \$1,288 = \$2,714$

Starbucks' owners' equity:  $\$12,446 - \$6,628 = \$5,818$

**Ex. 1-5**

Dollar Tree's owners' equity:  $\$3,567 - \$1,782 = \$1,785$

Target's owners' equity:  $\$41,404 - \$27,407 = \$13,997$

**Ex. 1-6**

- a. **\$3,930,000** ( $\$556,000 + \$3,374,000$ )
- b. **\$386,200** ( $\$6,111,200 - \$5,725,000$ )
- c. **\$1,337,500** ( $\$2,150,000 - \$812,500$ )

**Ex. 1-7**

- a. **\$540,000** ( $\$720,000 - \$180,000$ )
- b. **\$606,500** ( $\$540,000 + \$96,500 - \$30,000$ )
- c. **\$357,000** ( $\$540,000 - \$168,000 - \$15,000$ )
- d. **\$733,000** ( $\$540,000 + \$175,000 + \$18,000$ )
- e. **Net income: \$120,000** ( $\$880,000 - \$220,000 - \$540,000$ )

**Ex. 1-8**

- a. **(1) asset**
- b. **(2) liability**
- c. **(1) asset**
- d. **(3) owner's equity (revenue)**
- e. **(1) asset**
- f. **(3) owner's equity (expense)**
- g. **(1) asset**

**Ex. 1-9**

- a. **Increases assets and increases owner's equity.**
- b. **Decreases assets and decreases owner's equity.**
- c. **Increases assets and decreases assets.**
- d. **Increases assets and increases liabilities.**
- e. **Increases assets and increases owner's equity.**

**Ex. 1-10**

- a. **(1) Total assets increased \$183,000** ( $\$298,000 - \$115,000$ ).  
**(2) No change in liabilities.**  
**(3) Owner's equity increased \$183,000.**
- b. **(1) Total assets decreased \$80,000.**  
**(2) Total liabilities decreased \$80,000.**  
**(3) No change in owner's equity.**
- c. **No. It is false that a transaction always affects at least two elements (Assets, Liabilities, or Owner's 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. (b) decrease
2. (a) increase
3. (b) decrease
4. (a) increase

**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) Withdrawal of cash by owner, \$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 withdrawals over the net income for the period is a decrease in the amount of owner's equity in the business.

**Ex. 1-15**

<b>Jupiter</b>	
Owner's equity at end of year (\$844,000 – \$320,000).....	<b>\$524,000</b>
Deduct owner's equity at beginning of year (\$550,000 – \$215,000).....	<b>335,000</b>
Net income (increase in owner's equity).....	<b><u>\$189,000</u></b>
<b>Mars</b>	
Increase in owner's equity (as determined for Jupiter).....	<b>\$189,000</b>
Add withdrawals.....	<b>36,000</b>
Net income.....	<b><u>\$225,000</u></b>
<b>Saturn</b>	
Increase in owner's equity (as determined for Jupiter).....	<b>\$189,000</b>
Deduct additional investment.....	<b>60,000</b>
Net income.....	<b><u>\$129,000</u></b>
<b>Venus</b>	
Increase in owner's equity (as determined for Jupiter).....	<b>\$189,000</b>
Deduct additional investment.....	<b>60,000</b>
	<b>\$129,000</b>
Add withdrawals.....	<b>36,000</b>
Net income.....	<b><u>\$165,000</u></b>

**Ex. 1-16**

**Balance sheet items: 1, 2, 3, 4, 6, 8, 10**

**Ex. 1-17**

**Income statement items: 5, 7, 9**

## Ex. 1-18

<b>UDDER PRODUCTS COMPANY</b> <b>Statement of Owner's Equity</b> <b>For the Month Ended April 30, 2019</b>		
Mark Kominsky, capital, April 1, 2019		<b>\$384,500</b>
Net income for April	<b>\$166,000</b>	
Withdrawals	<b>(25,000)</b>	
Increase in owner's equity		<b>141,000</b>
Mark Kominsky, capital, April 30, 2019		<b>\$525,500</b>

- b. The statement of owner's equity is prepared before the April 30, 2019, balance sheet because Mark Kominsky, Capital as of April 30, 2019, is needed for the balance sheet.

## Ex. 1-19

<b>DAIRY SERVICES</b> <b>Income Statement</b> <b>For the Month Ended August 31, 2019</b>		
Fees earned		<b>\$783,000</b>
Expenses:		
Wages expense	<b>\$550,000</b>	
Rent expense	<b>35,000</b>	
Supplies expense	<b>8,500</b>	
Miscellaneous expense	<b>11,400</b>	
Total expenses		<b>604,900</b>
Net income		<b>\$178,100</b>

**Ex. 1-20**

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

$$\text{Owner's Equity (beginning)} + \text{Investments} - \text{Withdrawals} + \text{Revenues} - \text{Expenses} = \text{Owner's Equity (ending)}$$

**Freeman**

Owner's equity at end of year (\$1,260,000 – \$330,000).....	\$930,000
Owner's equity at beginning of year (\$900,000 – \$360,000).....	<u>540,000</u>
Increase in owner's equity.....	\$390,000
Deduct increase due to net income (\$570,000 – \$240,000).....	<u>330,000</u>
Increase due to additional investment less withdrawals.....	\$ 60,000
Add withdrawals.....	<u>75,000</u>
Additional investment in the business..... (a)	<u>\$135,000</u>

**Heyward**

Owner's equity at end of year (\$675,000 – \$220,000).....	\$455,000
Owner's equity at beginning of year (\$490,000 – \$260,000).....	<u>230,000</u>
Increase in owner's equity.....	\$225,000
Add withdrawals.....	<u>32,000</u>
Increase due to additional investment and net income.....	\$257,000
Deduct additional investment.....	<u>150,000</u>
Increase due to net income.....	\$107,000
Add expenses.....	<u>128,000</u>
Revenue..... (b)	<u>\$235,000</u>

**Jones**

Owner's equity at end of year (\$100,000 – \$80,000).....	\$ 20,000
Owner's equity at beginning of year (\$115,000 – \$81,000).....	<u>34,000</u>
Decrease in owner's equity.....	\$(14,000)
Add decrease due to net loss (\$115,000 – \$122,500).....	<u>(7,500)</u>
Decrease due to withdrawals less additional investment.....	\$ (6,500)
Deduct additional investment.....	<u>10,000</u>
Withdrawals from the business..... (c)	<u>\$(16,500)</u>

**Ramirez**

Owner's equity at end of year (\$270,000 – \$136,000).....	\$134,000
Add decrease due to net loss (\$115,000 – \$128,000).....	13,000
Add withdrawals.....	<u>39,000</u>
Beginning owner's equity plus additional investment .....	\$186,000
Deduct additional investment.....	<u>55,000</u>
Owner's equity at beginning of year.....	\$131,000
Add liabilities at beginning of year.....	<u>120,000</u>
Assets at beginning of year..... (d)	<u>\$251,000</u>

## Ex. 1-21

a.

EBONY INTERIORS Balance Sheet February 29, 2019	
<b>Assets</b>	
Cash	\$ 320,000
Accounts receivable	800,000
Supplies	30,000
<b>Total assets</b>	<b>\$1,150,000</b>
<b>Liabilities</b>	
Accounts payable	\$ 310,000
<b>Owner's Equity</b>	
Justin Berk, capital	840,000
<b>Total liabilities and owner's equity</b>	<b>\$1,150,000</b>

EBONY INTERIORS Balance Sheet March 31, 2019	
<b>Assets</b>	
Cash	\$ 380,000
Accounts receivable	960,000
Supplies	35,000
<b>Total assets</b>	<b>\$1,375,000</b>
<b>Liabilities</b>	
Accounts payable	\$ 400,000
<b>Owner's Equity</b>	
Justin Berk, capital	975,000
<b>Total liabilities and owner's equity</b>	<b>\$1,375,000</b>

b.	Owner's equity, March 31.....	\$975,000
	Owner's equity, February 29.....	840,000
	Net income.....	<u>\$135,000</u>
c.	Owner's equity, March 31.....	\$975,000
	Owner's equity, February 29.....	840,000
	Increase in owner's equity.....	<u>\$135,000</u>
	Add withdrawal.....	<u>50,000</u>
	Net income.....	<u>\$185,000</u>

**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.

**Ex. 1-23**

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

**Ex. 1-24**

<b>ETHOS CONSULTING GROUP</b> <b>Statement of Cash Flows</b> <b>For the Year Ended May 31, 2019</b>		
<b>Cash flows from operating activities:</b>		
Cash receipts from customers	\$ 637,500	
Cash payments for operating expenses	(475,000)	
<b>Net cash flow from operating activities</b>		<b>\$162,500</b>
<b>Cash flows used for investing activities:</b>		
Cash payments for purchase of land		(90,000)
<b>Cash flows from financing activities:</b>		
Cash receipts from owner as investment	\$ 62,500	
Cash withdrawals by owner	(17,500)	
<b>Net cash flow from financing activities</b>		<b>45,000</b>
<b>Net increase in cash during year</b>		<b>\$117,500</b>
<b>Cash as of June 1, 2018</b>		<b>58,000</b>
<b>Cash as of May 31, 2019</b>		<b>\$175,500</b>

**Ex. 1-25**

- 1. All financial statements should contain the name of the business in their heading. The statement of owner's equity is incorrectly headed as "Omar Farah" rather than We-Sell Realty. The heading of the balance sheet needs the name of the business.**
- 2. The income statement and statement of owner's equity cover a period of time and should be labeled "For the Month Ended August 31, 2019."**
- 3. The year in the heading for the statement of owner's equity should be 2019 rather than 2018.**
- 4. The balance sheet should be labeled "August 31, 2019," rather than "For the Month Ended August 31, 2019."**
- 5. In the income statement, the miscellaneous expense amount should be listed as the last expense.**
- 6. In the income statement, the total expenses are incorrectly subtracted from the sales commissions, resulting in an incorrect net income amount. The correct net income should be \$24,150. This also affects the statement of owner's equity and the amount of Omar Farah, Capital, that appears on the balance sheet.**
- 7. In the statement of owner's equity, the additional investment should be added first to Omar Farah, capital, as of August 1, 2019. The net income should be presented next, followed by the amount of withdrawals, which is subtracted from the net income to yield the increase in owner's equity. The increase in owner's equity is added to Omar Farah, capital on August 1, 2019, to determine Omar Farah, capital on August 31, 2019.**
- 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 owner's equity.**

**Ex. 1-25 (Concluded)**

Corrected financial statements appear as follows:

<b>WE-SELL REALTY</b> <b>Income Statement</b> <b>For the Month Ended August 31, 2019</b>		
<b>Sales commissions</b>		<b>\$140,000</b>
<b>Expenses:</b>		
<b>Office salaries expense</b>	<b>\$87,000</b>	
<b>Rent expense</b>	<b>18,000</b>	
<b>Automobile expense</b>	<b>7,500</b>	
<b>Supplies expense</b>	<b>1,150</b>	
<b>Miscellaneous expense</b>	<b>2,200</b>	
<b>Total expenses</b>		<b>115,850</b>
<b>Net income</b>		<b>\$ 24,150</b>

<b>WE-SELL REALTY</b> <b>Statement of Owner's Equity</b> <b>For the Month Ended August 31, 2019</b>		
<b>Omar Farah, capital, August 1, 2019</b>		<b>\$ 0</b>
<b>Investment on August 1, 2019</b>	<b>\$ 15,000</b>	
<b>Net income for August</b>	<b>24,150</b>	
<b>Withdrawals during August</b>	<b>(10,000)</b>	
<b>Increase in owner's equity</b>		<b>29,150</b>
<b>Omar Farah, capital, August 31, 2019</b>		<b>\$29,150</b>

<b>WE-SELL REALTY</b> <b>Balance Sheet</b> <b>August 31, 2019</b>	
<b>Assets</b>	
<b>Cash</b>	<b>\$ 8,900</b>
<b>Accounts receivable</b>	<b>38,600</b>
<b>Supplies</b>	<b>4,000</b>
<b>Total assets</b>	<b>\$51,500</b>
<b>Liabilities</b>	
<b>Accounts payable</b>	<b>\$22,350</b>
<b>Owner's Equity</b>	
<b>Omar Farah, capital</b>	<b>29,150</b>
<b>Total liabilities and owner's equity</b>	<b>\$51,500</b>



**Ex. 1-26**

- a. Year 2: \$30,624 ( $\$39,946 - \$9,322$ )  
Year 1: \$27,996 ( $\$40,518 - \$12,522$ )
- b. Year 2: 3.29 ( $\$30,624 \div \$9,322$ )  
Year 1: 2.24 ( $\$27,996 \div \$12,522$ )
- c. The ratio of liabilities to stockholders' equity increased from 2.24 to 3.29 indicating an increase in risk for creditors from Year 1 to Year 2.

**Ex. 1-27**

- a. Year 2: \$9,968 ( $\$31,827 - \$21,859$ )  
Year 1: \$11,853 ( $\$32,732 - \$20,879$ )
- b. Year 2: 2.19 ( $\$21,859 \div \$9,968$ )  
Year 1: 1.76 ( $\$20,879 \div \$11,853$ )
- c. The risk for creditors has increased from 1.76 in Year 1 to 2.19 in Year 2.
- d. The Home Depot's ratio of liabilities to stockholders' equity (3.29 in Year 2 and 2.24 in Year 1) is more in both years than is Lowe's ratio of liabilities to stockholders' equity (2.19 in Year 2 and 1.76 in Year 1). Thus, the risk to creditors of The Home Depot is slightly more than that of Lowe's.

**Note to Instructors:** Both companies have increased their long-term debt to take advantage of low interest rates and an improving U.S. economy.

# PROBLEMS

## Prob. 1-1A

1.	Assets			= Liabilities +		Owner's Equity													
	Cash	+	Accts. Rec.	+	Accts. Payable	Chad Wilson, Capital	-	Chad Wilson, Drawing	+	Fees Earned	-	Rent Expense	-	Salaries Expense	-	Supplies Expense	-	Auto Exp.	Misc. Exp.
(a)	+		30,000																
(b)				+	1,800														
Bal.			30,000		1,800														
(c)	+		10,000																
Bal.			40,000		1,800														
(d)	-		4,500																
Bal.			35,500		1,800														
(e)	-		1,250																
Bal.			34,250		1,800														
(f)				+	16,800														
Bal.			34,250		16,800														
(g)	-		1,730																
Bal.			32,520		1,800														
(h)	-		4,000																
Bal.			28,520		1,800														
(i)				-	1,120														
Bal.			28,520		680														
(j)	-		7,500																
Bal.			21,020		680														

- Owner's equity is the right of owners to the assets of the business. These rights are increased by owner's investments and revenues and decreased by owner's withdrawals and expenses.
- \$15,450 (\$26,800 - \$4,500 - \$4,000 - \$1,120 - \$750 - \$980)
- June's transactions increased Chad Wilson's capital to \$37,950 (\$30,000 + \$15,450 - \$7,500), which is the initial capital investment of \$30,000 plus June's net income of \$15,450 less Chad Wilson's withdrawals of \$7,500.

## Prob. 1-2A

<b>NORDIC TRAVEL AGENCY</b> <b>Income Statement</b> <b>For the Year Ended December 31, 2019</b>		
<b>Fees earned</b>		<b>\$912,500</b>
<b>Expenses:</b>		
<b>Wages expense</b>	<b>\$510,000</b>	
<b>Rent expense</b>	<b>36,000</b>	
<b>Utilities expense</b>	<b>28,500</b>	
<b>Supplies expense</b>	<b>4,100</b>	
<b>Miscellaneous expense</b>	<b>6,400</b>	
<b>Total expenses</b>		<b>585,000</b>
<b>Net income</b>		<b>\$327,500</b>

<b>NORDIC TRAVEL AGENCY</b> <b>Statement of Owner's Equity</b> <b>For the Year Ended December 31, 2019</b>		
<b>Ian Eisele, capital, January 1, 2019</b>		<b>\$670,000</b>
<b>Net income for the year</b>	<b>\$327,500</b>	
<b>Withdrawals</b>	<b>(42,000)</b>	
<b>Increase in owner's equity</b>		<b>285,500</b>
<b>Ian Eisele, capital, December 31, 2019</b>		<b>\$955,500</b>

<b>NORDIC TRAVEL AGENCY</b> <b>Balance Sheet</b> <b>December 31, 2019</b>	
<b>Assets</b>	
<b>Cash</b>	<b>\$ 190,500</b>
<b>Accounts receivable</b>	<b>285,000</b>
<b>Supplies</b>	<b>5,500</b>
<b>Land</b>	<b>544,000</b>
<b>Total assets</b>	<b>\$1,025,000</b>
<b>Liabilities</b>	
<b>Accounts payable</b>	<b>\$ 69,500</b>
<b>Owner's Equity</b>	
<b>Ian Eisele, capital</b>	<b>955,500</b>
<b>Total liabilities and owner's equity</b>	<b>\$1,025,000</b>

## 4. Ian Eisele, Capital of \$955,500

Prob. 1-3A

<b>1. RELIANCE FINANCIAL SERVICES</b> <b>Income Statement</b> <b>For the Month Ended July 31, 2019</b>		
<b>Fees earned</b>		<b>\$144,500</b>
<b>Expenses:</b>		
<b>Salaries expense</b>	<b>\$55,000</b>	
<b>Rent expense</b>	<b>33,000</b>	
<b>Auto expense</b>	<b>16,000</b>	
<b>Supplies expense</b>	<b>4,500</b>	
<b>Miscellaneous expense</b>	<b>4,800</b>	
<b>Total expenses</b>		<b>113,300</b>
<b>Net income</b>		<b>\$ 31,200</b>

<b>2. RELIANCE FINANCIAL SERVICES</b> <b>Statement of Owner's Equity</b> <b>For the Month Ended July 31, 2019</b>		
<b>Seth Feye, capital, July 1, 2019</b>		<b>\$ 0</b>
<b>Investment on July 1, 2019</b>	<b>\$ 50,000</b>	
<b>Net income for July</b>	<b>31,200</b>	
<b>Withdrawals</b>	<b>(15,000)</b>	
<b>Increase in owner's equity</b>		<b>66,200</b>
<b>Seth Feye, capital, July 31, 2019</b>		<b>\$66,200</b>

<b>3. RELIANCE FINANCIAL SERVICES</b> <b>Balance Sheet</b> <b>July 31, 2019</b>	
<b>Assets</b>	
<b>Cash</b>	<b>\$32,600</b>
<b>Accounts receivable</b>	<b>34,500</b>
<b>Supplies</b>	<b>2,500</b>
<b>Total assets</b>	<b>\$69,600</b>
<b>Liabilities</b>	
<b>Accounts payable</b>	<b>\$ 3,400</b>
<b>Owner's Equity</b>	
<b>Seth Feye, capital</b>	<b>66,200</b>
<b>Total liabilities and owner's equity</b>	<b>\$69,600</b>

**Prob. 1-3A (Concluded)****4. (Optional)**

<b>RELIANCE FINANCIAL SERVICES</b> <b>Statement of Cash Flows</b> <b>For the Month Ended July 31, 2019</b>		
<b>Cash flows from operating activities:</b>		
Cash receipts from customers	\$ 110,000	
Cash payments for expenses and payments to creditors*	(112,400)	
Net cash flow used for operating activities		\$ (2,400)
<b>Cash flows from investing activities</b>		<b>0</b>
<b>Cash flows from financing activities:</b>		
Cash receipt of owner's investment	\$ 50,000	
Cash withdrawal by owner	(15,000)	
Net cash flow from financing activities		35,000
<b>Net increase in cash and July 31, 2019, cash balance</b>		<b>\$32,600</b>

\* \$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 +		Owner's Equity						
	Cash	+ Supplies	=	Accts. Payable	+ Pat Glenn, Capital	- Pat Glenn, Drawing	+ Sales Comm.	- Salaries Exp.	- Rent Exp.	- Auto Exp.	- Supplies Exp.	Misc. Exp.
(a)	+ 25,000				+ 25,000							
(b)		+ 1,850		+ 1,850								
Bal.	25,000	1,850		1,850	25,000							
(c)	- 1,200			- 1,200								
Bal.	23,800	1,850		650	25,000							
(d)	+ 41,500						+ 41,500					
Bal.	65,300	1,850		650	25,000		41,500		- 3,600			
(e)	- 3,600								- 3,600			
Bal.	61,700	1,850		650	25,000		41,500		- 3,600			
(f)	- 4,000					- 4,000						
Bal.	57,700	1,850		650	25,000	- 4,000	41,500		- 3,600			
(g)	- 4,650									- 3,050		- 1,600
Bal.	53,050	1,850		650	25,000	- 4,000	41,500		- 3,600	- 3,050		- 1,600
(h)	- 5,000							- 5,000				
Bal.	48,050	1,850		650	25,000	- 4,000	41,500	- 5,000	- 3,600	- 3,050		- 1,600
(i)		- 900									- 900	
Bal.	48,050	950		650	25,000	- 4,000	41,500	- 5,000	- 3,600	- 3,050	- 900	- 1,600

## Prob. 1-4A (Concluded)

2.

<b>HALF MOON REALTY</b> <b>Income Statement</b> <b>For the Month Ended July 31, 2019</b>		
<b>Sales commissions</b>		<b>\$41,500</b>
<b>Expenses:</b>		
<b>Salaries expense</b>	<b>\$5,000</b>	
<b>Rent expense</b>	<b>3,600</b>	
<b>Automobile expense</b>	<b>3,050</b>	
<b>Supplies expense</b>	<b>900</b>	
<b>Miscellaneous expense</b>	<b>1,600</b>	
<b>Total expenses</b>		<b>14,150</b>
<b>Net income</b>		<b>\$27,350</b>

<b>HALF MOON REALTY</b> <b>Statement of Owner's Equity</b> <b>For the Month Ended July 31, 2019</b>		
<b>Pat Glenn, capital, July 1, 2019</b>		<b>\$ 0</b>
<b>Investment on July 1, 2019</b>	<b>\$25,000</b>	
<b>Net income for July</b>	<b>27,350</b>	
<b>Withdrawals</b>	<b>(4,000)</b>	
<b>Increase in owner's equity</b>		<b>48,350</b>
<b>Pat Glenn, capital, July 31, 2019</b>		<b>\$48,350</b>

<b>HALF MOON REALTY</b> <b>Balance Sheet</b> <b>July 31, 2019</b>	
<b>Assets</b>	
<b>Cash</b>	<b>\$48,050</b>
<b>Supplies</b>	<b>950</b>
<b>Total assets</b>	<b>\$49,000</b>
<b>Liabilities</b>	
<b>Accounts payable</b>	<b>\$ 650</b>
<b>Owner's Equity</b>	
<b>Pat Glenn, capital</b>	<b>48,350</b>
<b>Total liabilities and owner's equity</b>	<b>\$49,000</b>

**Prob. 1-5A**

1.	<b>Assets</b>					=	<b>Liabilities</b>	+	<b>Owner's Equity</b>		
	Cash	+	Accounts Receivable	+	Supplies	+	Land	=	Accounts Payable	+	Joel Palk, Capital
	\$45,000	+	\$93,000	+	\$7,000	+	\$75,000	=	\$40,000	+	Joel Palk, Capital
							\$220,000	=	\$40,000	+	Joel Palk, Capital
							\$180,000	=			Joel Palk, Capital



## Prob. 1-5A (Continued)

2.	Assets					=	Liabilities	+	Owner's Equity				
	Cash	+	Accts. Rec.	+	Supplies	+	Land	=	Accts. Payable	+	Joel Palk, Capital	-	Joel Palk, Drawing
Bal.	45,000		93,000		7,000		75,000		40,000		180,000		
(a)	+	35,000									+	35,000	
Bal.	80,000		93,000		7,000		75,000		40,000		215,000		
(b)	-	50,000					+	50,000					
Bal.	30,000		93,000		7,000		125,000		40,000		215,000		
(c)	+	32,125											
Bal.	62,125		93,000		7,000		125,000		40,000		215,000		
(d)	-	6,000											
Bal.	56,125		93,000		7,000		125,000		40,000		215,000		
(e)					+	2,500			+	2,500			
Bal.	56,125		93,000		9,500		125,000		42,500		215,000		
(f)	-	22,800							-	22,800			
Bal.	33,325		93,000		9,500		125,000		19,700		215,000		
(g)			+	84,750									
Bal.	33,325		177,750		9,500		125,000		19,700		215,000		
(h)									+	29,500			
Bal.	33,325		177,750		9,500		125,000		49,200		215,000		
(i)	-	14,000											
Bal.	19,325		177,750		9,500		125,000		49,200		215,000		
(j)	+	88,000	-	88,000									
Bal.	107,325		89,750		9,500		125,000		49,200		215,000		
(k)					-	3,600							
Bal.	107,325		89,750		5,900		125,000		49,200		215,000		
(l)	-	12,000										-	12,000
Bal.	95,325		89,750		5,900		125,000		49,200		215,000	-	12,000

Prob. 1-5A (Continued)

Owner's 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, 2019		
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 Owner's Equity For the Month Ended July 31, 2019		
Joel Palk, capital, July 1, 2019		\$180,000
Additional investment during July	\$ 35,000	
Net income for July	63,775	
Withdrawals	(12,000)	
Increase in owner's equity		86,775
Joel Palk, capital, July 31, 2019		\$266,775

D'LITE DRY CLEANERS Balance Sheet July 31, 2019	
<b>Assets</b>	
Cash	\$ 95,325
Accounts receivable	89,750
Supplies	5,900
Land	125,000
Total assets	\$315,975
<b>Liabilities</b>	
Accounts payable	\$ 49,200
<b>Owner's Equity</b>	
Joel Palk, capital	266,775
Total liabilities and owner's equity	\$315,975

**Prob. 1-5A (Concluded)****4. (Optional)**

<b>D'LITE DRY CLEANERS</b> <b>Statement of Cash Flows</b> <b>For the Month Ended July 31, 2019</b>		
<b>Cash flows from operating activities:</b>		
Cash receipts from customers*	\$120,125	
Cash payments for expenses and payments to creditors**	(42,800)	
Net cash flow from operating activities		\$ 77,325
<b>Cash flows used for investing activities:</b>		
Cash payment for purchase of land		(50,000)
<b>Cash flows from financing activities:</b>		
Cash receipt of owner's investment	\$ 35,000	
Cash withdrawal by owner	(12,000)	
Net cash flow from financing activities		23,000
<b>Net increase in cash during July</b>		<b>\$ 50,325</b>
<b>Cash balance, July 1, 2019</b>		<b>45,000</b>
<b>Cash balance, July 31, 2019</b>		<b>\$ 95,325</b>

\* \$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. Dakota Rowe, capital, April 1, 2019, \$0; Wolverine Realty was organized on April 1, 2019.
- d. Net income for April, \$275,000 from income statement
- e. Increase in owner's equity, \$525,000 ( $\$375,000 + \$275,000 - \$125,000$ )
- f. Dakota Rowe, capital, April 30, 2019, \$525,000
- g. Total assets, \$625,000 ( $\$462,500 + \$12,500 + \$150,000$ )
- h. Dakota Rowe, capital, \$525,000 ( $\$625,000 - \$100,000$ ); same as (g)
- i. Total liabilities and owner's equity, \$625,000 ( $\$100,000 + \$525,000$ )
- j. Cash received from customers, \$750,000; this is the same as fees earned (a) since there are no accounts receivable.
- k. Net cash flow from operating activities, \$362,500 ( $\$750,000 - \$387,500$ )
- l. Cash payments for acquisition of land, (\$150,000)
- m. Cash received as owner's investment, \$375,000
- n. Cash withdrawal by owner, (\$125,000)
- o. Net cash flow from financing activities, \$250,000 ( $\$375,000 - \$125,000$ )
- p. Net increase in cash and April 30, 2019, cash balance, \$462,500 ( $\$362,500 - \$150,000 + \$250,000$ ); also, the cash balance on the balance sheet

Prob. 1-1B

1.	Assets			= Liabilities +			Owner's Equity																			
	Cash	+	Accts. Rec.	+	Supplies	=	Accts. Payable	+	Amy Austin, Capital	-	Amy Austin, Drawing	+	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			4,000		50,000															
(c)	-	2,300						-	2,300																	
Bal.		47,700							1,700		50,000															
(d)	+	13,800											+	13,800												
Bal.		61,500							1,700		50,000			13,800												
(e)	-	5,000													-	5,000										
Bal.		56,500							1,700		50,000			13,800		-	5,000									
(f)	-	1,450																								
Bal.		55,050							1,700		50,000			13,800		-	5,000					-	1,150	-	300	
(g)	-	2,500															-	2,500					-	1,150	-	300
Bal.		52,550							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		-	1,150	-	300	
(i)				+	12,500								+	12,500												
Bal.		52,550					2,700		1,700		50,000			26,300		-	5,000		-	2,500		-	1,150	-	300	
(j)	-	3,900																								
Bal.		48,650							1,700		50,000			26,300		-	5,000		-	2,500		-	1,150	-	300	

2. Owner's equity is the right of owners to the assets of the business. These rights are increased by owner's investments and revenues and decreased by owner's withdrawals and expenses.

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

4. March's transactions increased Amy Austin's capital to \$62,150 (\$50,000 + \$16,050 - \$3,900), which is the initial investment of \$50,000 plus the excess of March's net income of \$16,050 over Amy Austin's withdrawals of \$3,900.

## Prob. 1-2B

<b>WILDERNESS TRAVEL SERVICE</b> <b>Income Statement</b> <b>For the Year Ended April 30, 2019</b>		
<b>Fees earned</b>		<b>\$875,000</b>
<b>Expenses:</b>		
<b>Wages expense</b>	<b>\$525,000</b>	
<b>Rent expense</b>	<b>75,000</b>	
<b>Utilities expense</b>	<b>38,000</b>	
<b>Supplies expense</b>	<b>12,000</b>	
<b>Taxes expense</b>	<b>10,000</b>	
<b>Miscellaneous expense</b>	<b>15,000</b>	
<b>Total expenses</b>		<b>675,000</b>
<b>Net income</b>		<b>\$200,000</b>

<b>WILDERNESS TRAVEL SERVICE</b> <b>Statement of Owner's Equity</b> <b>For the Year Ended April 30, 2019</b>		
<b>Harper Borg, capital, May 1, 2018</b>		<b>\$180,000</b>
<b>Net income for the year</b>	<b>\$200,000</b>	
<b>Withdrawals</b>	<b>(40,000)</b>	
<b>Increase in owner's equity</b>		<b>160,000</b>
<b>Harper Borg, capital, April 30, 2019</b>		<b>\$340,000</b>

<b>WILDERNESS TRAVEL SERVICE</b> <b>Balance Sheet</b> <b>April 30, 2019</b>	
<b>Assets</b>	
<b>Cash</b>	<b>\$146,000</b>
<b>Accounts receivable</b>	<b>210,000</b>
<b>Supplies</b>	<b>9,000</b>
<b>Total assets</b>	<b>\$365,000</b>
<b>Liabilities</b>	
<b>Accounts payable</b>	<b>\$ 25,000</b>
<b>Owner's Equity</b>	
<b>Harper Borg, capital</b>	<b>340,000</b>
<b>Total liabilities and owner's equity</b>	<b>\$365,000</b>

4. Net income of \$200,000

## Prob. 1-3B

1.	<b>BRONCO CONSULTING</b> <b>Income Statement</b> <b>For the Month Ended August 31, 2019</b>		
	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.	<b>BRONCO CONSULTING</b> <b>Statement of Owner's Equity</b> <b>For the Month Ended August 31, 2019</b>		
	Jose Loder, capital, August 1, 2019		\$ 0
	Investment on August 1, 2019	\$ 75,000	
	Net income for August	10,900	
	Withdrawals	(15,000)	
	Increase in owner's equity		70,900
	Jose Loder, capital, August 31, 2019		\$70,900
3.	<b>BRONCO CONSULTING</b> <b>Balance Sheet</b> <b>August 31, 2019</b>		
	<b>Assets</b>		
	Cash		\$38,000
	Accounts receivable		33,000
	Supplies		2,900
	Total assets		\$73,900
	<b>Liabilities</b>		
	Accounts payable		\$ 3,000
	<b>Owner's Equity</b>		
	Jose Loder, capital		70,900
	Total liabilities and owner's equity		\$73,900



**Prob. 1-3B (Concluded)****4. (Optional)**

<b>BRONCO CONSULTING</b> <b>Statement of Cash Flows</b> <b>For the Month Ended August 31, 2019</b>		
<b>Cash flows from operating activities:</b>		
Cash receipts from customers	<b>\$ 92,000</b>	
Cash payments for expenses and payments to creditors*	<b>(114,000)</b>	
<b>Net cash flow used for operating activities</b>		<b>\$(22,000)</b>
<b>Cash flows from investing activities</b>		<b>0</b>
<b>Cash flows from financing activities:</b>		
Cash receipt of owner's investment	<b>\$ 75,000</b>	
Cash withdrawal by owner	<b>(15,000)</b>	
<b>Net cash flow from financing activities</b>		<b>60,000</b>
<b>Net increase in cash and August 31, 2019, cash balance</b>		<b>\$ 38,000</b>

\* \$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 +	Owner's Equity							
Cash	+ Supplies	Accts. Payable	+ Maria Adams, Capital	- Maria Adams, Drawing	+ Sales Comm.	- Rent Exp.	- Salaries Exp.	- Auto Exp.	- Supplies Exp.	Misc. Exp.
(a) + 24,000			+ 24,000			- 3,600				
(b) - 3,600						- 3,600				
Bal. 20,400			24,000							
(c) - 1,950						- 3,600		- 1,350		- 600
Bal. 18,450			24,000					- 1,350		- 600
(d)	+ 1,200	+ 1,200				- 3,600		- 1,350		- 600
Bal. 18,450	1,200	1,200	24,000							
(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. 35,000	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, 2019		
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 Owner's Equity For the Month Ended April 30, 2019		
Maria Adams, capital, April 1, 2019		\$ 0
Investment on April 1, 2019	\$24,000	
Net income for April	10,850	
Withdrawals	(3,500)	
Increase in owner's equity		31,350
Maria Adams, capital, April 30, 2019		\$31,350

CUSTOM REALTY Balance Sheet April 30, 2019	
<b>Assets</b>	
Cash	\$31,500
Supplies	300
Total assets	\$31,800
<b>Liabilities</b>	
Accounts payable	\$ 450
<b>Owner's Equity</b>	
Maria Adams, capital	31,350
Total liabilities and owner's equity	\$31,800

**Prob. 1-5B**

1.	<b>Assets</b>					=	<b>Liabilities</b>	+	<b>Owner's Equity</b>		
	<b>Accounts</b>						<b>Accounts</b>				
	Cash	+	Receivable	+	Supplies	+	Land	=	Payable	+	Beverly Zahn, Capital
	\$39,000	+	\$80,000	+	\$11,000	+	\$50,000	=	\$31,500	+	Beverly Zahn, Capital
							\$180,000	=	\$31,500	+	Beverly Zahn, Capital
							\$148,500	=			Beverly Zahn, Capital

## Prob. 1-5B (Continued)

2.	Assets					=	Liabilities	+	Owner's Equity				
	Cash	+	Accts. Rec.	+	Supplies	+	Land	=	Accts. Payable	+	Beverly Zahn, Capital	-	Beverly Zahn, Drawing
Bal.	39,000		80,000		11,000		50,000		31,500		148,500		
(a)	+	21,000									+	21,000	
Bal.	60,000		80,000		11,000		50,000		31,500		169,500		
(b)	-	35,000					+	35,000					
Bal.	25,000		80,000		11,000		85,000		31,500		169,500		
(c)	-	4,000											
Bal.	21,000		80,000		11,000		85,000		31,500		169,500		
(d)			+	72,000									
Bal.	21,000		152,000		11,000		85,000		31,500		169,500		
(e)	-	20,000							-	20,000			
Bal.	1,000		152,000		11,000		85,000		11,500		169,500		
(f)					+	8,000			+	8,000			
Bal.	1,000		152,000		19,000		85,000		19,500		169,500		
(g)	+	38,000											
Bal.	39,000		152,000		19,000		85,000		19,500		169,500		
(h)	+	77,000	-	77,000									
Bal.	116,000		75,000		19,000		85,000		19,500		169,500		
(i)									+	29,450			
Bal.	116,000		75,000		19,000		85,000		48,950		169,500		
(j)	-	29,200											
Bal.	86,800		75,000		19,000		85,000		48,950		169,500		
(k)					-	7,200							
Bal.	86,800		75,000		11,800		85,000		48,950		169,500		
(l)	-	5,000										-	5,000
Bal.	81,800		75,000		11,800		85,000		48,950		169,500	-	5,000

Prob. 1-5B (Continued)

Owner's 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, 2019		
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 Owner's Equity For the Month Ended November 30, 2019		
Beverly Zahn, capital, November 1, 2019		\$148,500
Additional investment during November	\$21,000	
Net income for November	40,150	
Withdrawals	(5,000)	
Increase in owner's equity		56,150
Beverly Zahn, capital, November 30, 2019		\$204,650

BEV'S DRY CLEANERS Balance Sheet November 30, 2019	
<b>Assets</b>	
Cash	\$ 81,800
Accounts receivable	75,000
Supplies	11,800
Land	85,000
Total assets	\$253,600
<b>Liabilities</b>	
Accounts payable	\$ 48,950
<b>Owner's Equity</b>	
Beverly Zahn, capital	204,650
Total liabilities and owner's equity	\$253,600

**Prob. 1-5B (Concluded)****4. (Optional)**

<b>BEV'S DRY CLEANERS</b> <b>Statement of Cash Flows</b> <b>For the Month Ended November 30, 2019</b>		
<b>Cash flows from operating activities:</b>		
Cash receipts from customers*	\$115,000	
Cash payments for expenses and payments to creditors**	(53,200)	
Net cash flow from operating activities		\$ 61,800
<b>Cash flows used for investing activities:</b>		
Cash payment for purchase of land		(35,000)
<b>Cash flows from financing activities:</b>		
Cash receipt of owner's investment	\$ 21,000	
Cash withdrawal by owner	(5,000)	
Net cash flow from financing activities		16,000
<b>Net increase in cash during November</b>		<b>\$ 42,800</b>
<b>Cash balance, November 1, 2019</b>		<b>39,000</b>
<b>Cash balance, November 30, 2019</b>		<b>\$ 81,800</b>

\* \$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. LuAnn Martin, capital, May 1, 2019, \$0; Atlas Realty was organized on May 1, 2019.
- d. Investment on May 1, 2019, \$160,000; from statement of cash flows
- e. Net income for May, \$112,000; from (b)
- f. Withdrawals, \$64,000; from statement of cash flows
- g. Increase in owner's equity, \$208,000 ( $\$160,000 + \$112,000 - \$64,000$ )
- h. LuAnn Martin, capital, May 31, 2019, \$208,000
- i. Land, \$120,000; from statement of cash flows
- j. Total assets, \$256,000 ( $\$123,200 + \$12,800 + \$120,000$ )
- k. LuAnn Martin, capital, \$208,000
- l. Total liabilities and owner's equity, \$256,000 ( $\$48,000 + \$208,000$ )
- m. Cash received from customers, \$400,000; this is the same as fees earned since there are no accounts receivable.
- n. Net cash flow from operating activities, \$147,200 ( $\$400,000 - \$252,800$ )
- o. Net cash flow from financing activities, \$96,000 ( $\$160,000 - \$64,000$ )
- p. Net increase in cash and May 31, 2019, cash balance, \$123,200 ( $\$147,200 - \$120,000 + \$96,000$ ); also, the cash balance on the balance sheet

**CONTINUING PROBLEM**

1.		Assets				=	Liabilities		+	Owner's Equity					
		Cash	+	Accts. Rec.	+	Supplies	=	Accts. Payable	+	Peyton Smith, Capital	-	Peyton Smith, Drawing	+	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)

Owner's Equity (Continued)																
		Music		Office		Equip.		Adver-		Wages		Utilities		Supplies		Misc.
	-	Exp.	-	Rent	-	Rent	-	tising	-	Exp.	-	Exp.	-	Exp.	-	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															-
Bal.		-	590	-	800	-	675	-	500	-	400	-	300	-	180	-
June	30	-	1,000													
Bal.		-	1,590	-	800	-	675	-	500	-	400	-	300	-	180	-
June	30															
Bal.		-	1,590	-	800	-	675	-	500	-	400	-	300	-	180	-

## Continuing Problem (Concluded)

<b>PS MUSIC</b> <b>Income Statement</b> <b>For the Month Ended June 30, 2019</b>		
<b>Fees earned:</b>		<b>\$6,200</b>
<b>Expenses:</b>		
<b>Music expense</b>	<b>\$1,590</b>	
<b>Office rent expense</b>	<b>800</b>	
<b>Equipment rent expense</b>	<b>675</b>	
<b>Advertising expense</b>	<b>500</b>	
<b>Wages expense</b>	<b>400</b>	
<b>Utilities expense</b>	<b>300</b>	
<b>Supplies expense</b>	<b>180</b>	
<b>Miscellaneous expense</b>	<b>415</b>	
<b>Total expenses</b>		<b>4,860</b>
<b>Net income</b>		<b>\$1,340</b>

<b>PS MUSIC</b> <b>Statement of Owner's Equity</b> <b>For the Month Ended June 30, 2019</b>		
<b>Peyton Smith, capital, June 1, 2019</b>		<b>\$ 0</b>
<b>Investment on June 1, 2019</b>	<b>\$4,000</b>	
<b>Net income for June</b>	<b>1,340</b>	
<b>Withdrawals</b>	<b>(500)</b>	
<b>Increase in owner's equity</b>		<b>4,840</b>
<b>Peyton Smith, capital, June 30, 2019</b>		<b>\$4,840</b>

<b>PS MUSIC</b> <b>Balance Sheet</b> <b>June 30, 2019</b>	
<b>Assets</b>	
<b>Cash</b>	<b>\$3,920</b>
<b>Accounts receivable</b>	<b>1,000</b>
<b>Supplies</b>	<b>170</b>
<b>Total assets</b>	<b>\$5,090</b>
<b>Liabilities</b>	
<b>Accounts payable</b>	<b>\$ 250</b>
<b>Owner's Equity</b>	
<b>Peyton Smith, capital</b>	<b>4,840</b>
<b>Total liabilities and owner's equity</b>	<b>\$5,090</b>

## CASES & PROJECTS

### CP 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.

### CP 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.

**CP 1-2 (Concluded)**

- ***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.

**CP 1-3**

A sample solution based on Nike Inc.'s Form 10-K for the fiscal year ended May 31, 2015, is as follows:

1. Nike, Inc.
2. Beaverton, Oregon
3. Mark G. Parker
4. Manufacturing
5. Our principal business activity is the design, development, and worldwide marketing and selling of athletic footwear, apparel, equipment, accessories, and services.
6. Income statement, statement of comprehensive income, balance sheet, statement of stockholders' equity, statement of cash flows

**CP 1-4****Example Memo**

**To: My Teacher**  
**From: Ima Student**  
**Date: January 1, 20XX**  
**Re: 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, the organization may expect 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.

**CP 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 withdrawals 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 withdrawals during the period must be considered in determining the net income (profit) or net loss for the period.

CP 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



## CP 1-6 (Continued)

<b>SERVE-N-VOLLEY</b> <b>Income Statement</b> <b>For the Month Ended September 30, 2019</b>		
<b>Fees earned:</b>		<b>\$3,650</b>
<b>Expenses:</b>		
<b>Salaries expense</b>	<b>\$800</b>	
<b>Rent expense</b>	<b>525</b>	
<b>Supplies expense</b>	<b>120</b>	
<b>Miscellaneous expense</b>	<b>290</b>	
<b>Total expenses</b>		<b>1,735</b>
<b>Net income</b>		<b>\$1,915</b>

<b>SERVE-N-VOLLEY</b> <b>Statement of Owner's Equity</b> <b>For the Month Ended September 30, 2019</b>		
<b>Lisa Duncan, capital, September 1, 2019</b>		<b>\$ 0</b>
<b>Investment on September 1, 2019</b>	<b>\$ 950</b>	
<b>Net income for September</b>	<b>1,915</b>	
<b>Withdrawals</b>	<b>(400)</b>	
<b>Increase in owner's equity</b>		<b>2,465</b>
<b>Lisa Duncan, capital, September 30, 2019</b>		<b>\$2,465</b>

<b>SERVE-N-VOLLEY</b> <b>Balance Sheet</b> <b>September 30, 2019</b>		
<b>Assets</b>		
<b>Cash</b>		<b>\$2,435</b>
<b>Supplies</b>		<b>180</b>
<b>Total assets</b>		<b>\$2,615</b>
<b>Liabilities</b>		
<b>Accounts payable</b>		<b>\$ 150</b>
<b>Owner's Equity</b>		
<b>Lisa Duncan, capital</b>		<b>2,465</b>
<b>Total liabilities and owner's equity</b>		<b>\$2,615</b>

**CP 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.....	<u>1,200</u>
Difference.....	<u>\$ 715</u>

- 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 Instructors:** 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, for example), which are 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.

**CP 1-7**

**Note to Instructors:** The purpose of this activity is to familiarize students with the certification requirements and their online availability. You might use this as an opportunity to discuss the advantages and disadvantages of careers in public accounting (CPA), management accounting (CMA), and internal auditing (CIA).

The following websites provide students with useful information (such as starting salaries) on careers in accounting:

American Institute of Certified Public Accountants (AICPA)

[www.aicpa.org/becomeacpa/faqs/pages/faqs.aspx](http://www.aicpa.org/becomeacpa/faqs/pages/faqs.aspx)

Institute of Certified Management Accountants (IMA)

<http://www.imanet.org/cma-certification/cma-certification-overview>

Institute of Internal Auditors (IIA)

<https://na.theiia.org/about-us/Pages/About-The-Institute-of-Internal-Auditors.aspx>

**CP 1-8**

	<u>First Year</u>	<u>Second Year</u>	<u>Third Year</u>
Net cash flows from operating activities	negative	positive	positive
Net cash flows from investing activities	negative	negative	negative
Net cash flows from financing activities	positive	positive	positive

Start-up companies normally experience negative net cash flows from operating activities; however, Amazon.com was able to generate positive net cash flows from operations by its second year. Start-up companies normally have negative net cash flows from investing activities as they build up their infrastructure through purchases of property, plant, and equipment. This was the case with Amazon.com for each of its first three years. Likewise, start-up companies normally have positive net cash flows from financing activities from raising capital. This is also the case for Amazon.com. Also, start-up companies normally have positive cash flows from financing activities—activities from raising capital.

