**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.

**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

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**PRACTICE** **EXERCISES**

**PE** **1–1A**

**$230,000.** **Under** **the** **cost** **concept,** **the** **land** **should** **be** **recorded** **at** **the** **cost** **to** **Kountry**

**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.** **A** **=** **L** **+** **OE**

**$780,000** **=** **$150,000** **+** **OE**

**OE** **=** **$630,000**

**b.** **A** **=** **L** **+** **OE**

**+$90,000** **=** **+$25,000** **+** **OE**

**OE** **=** **+$65,000**

**OE** **on** **December** **31,** **2016** **=**

**$695,000** **=** **$630,000** **+** **$65,000**

**PE** **1–2B**

**a.** **A** **=** **L** **+** **OE**

**$395,000** **=** **$97,000** **+** **OE**

**OE** **=** **$298,000**

**b.** **A** **=** **L** **+** **OE**

**–$65,000** **=** **+$36,000** **+** **OE**

**OE** **=** **–$101,000**

**OE** **on** **December** **31,** **2016** **=**

**$197,000** **=** **$298,000** **–** **$101,000**

**PE** **1–3A**

**(2)** **Asset** **(Cash)** **decreases** **by** **$3,750;**

**Liability** **(Accounts** **Payable)** **decreases** **by** **$3,750.**

**(3)** **Asset** **(Accounts** **Receivable)** **increases** **by** **$22,400;**

**Revenue** **(Delivery** **Service** **Fees)** **increases** **by** **$22,400.**

**(4)** **Asset** **(Cash)** **increases** **by** **$11,300;**

**Asset** **(Accounts** **Receivable)** **decreases** **by** **$11,300.**

**(5)** **Asset** **(Cash)** **decreases** **by** **$6,000;**

**Asset** **(Gates** **Deeter,** **Drawing)** **increases** **by** **$6,000.**

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**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**

|  |  |  |
| --- | --- | --- |
| **OUSEL** **TRAVEL** **SERVICE**  **Income** **Statement**  **For** **the** **Year** **Ended** **November** **30,** **2016** | | |
| **Fees** **earned** |  | **$1,475,000** |
| **Expenses:** |  |  |
| **Wages** **expense** | **$885,000** |  |
| **Office** **expense** | **320,000** |  |
| **Miscellaneous** **expense** | **28,000** |  |
| **Total** **expenses** |  | **1,233,000** |
| **Net** **income** |  | **$** **242,000** |
|  |  |  |

**PE** **1–4B**

|  |  |  |
| --- | --- | --- |
| **SENTINEL** **TRAVEL** **SERVICE**  **Income** **Statement**  **For** **the** **Year** **Ended** **August** **31,** **2016** | | |
| **Fees** **earned** |  | **$750,000** |
| **Expenses:** |  |  |
| **Wages** **expense** | **$450,000** |  |
| **Office** **expense** | **295,000** |  |
| **Miscellaneous** **expense** | **12,000** |  |
| **Total** **expenses** |  | **757,000** |
| **Net** **loss** |  | **$** **(7,000)** |
|  |  |  |

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**PE** **1–5A**

|  |  |  |
| --- | --- | --- |
| **OUSEL** **TRAVEL** **SERVICE**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Year** **Ended** **November** **30,** **2016** | | |
| **Shane** **Ousel,** **capital,** **December** **1,** **2015** |  | **$666,000** |
| **Additional** **investment** **by** **owner** **during** **year** | **$** **50,000** |  |
| **Net** **income** **for** **the** **year** | **242,000** |  |
|  | **$292,000** |  |
| **Less** **withdrawals** | **30,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **262,000** |
| **Shane** **Ousel,** **capital,** **November** **30,** **2016** |  | **$928,000** |
|  |  |  |

**PE** **1–5B**

|  |  |  |
| --- | --- | --- |
| **SENTINEL** **TRAVEL** **SERVICE**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Year** **Ended** **August** **31,** **2016** | | |
| **Barb** **Schroeder,** **capital,** **September** **1,** **2015** |  | **$380,000** |
| **Additional** **investment** **by** **owner** **during** **year** | **$36,000** |  |
| **Net** **loss** **for** **the** **year** | **(7,000)** |  |
|  | **$29,000** |  |
| **Less** **withdrawals** | **18,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **11,000** |
| **Barb** **Schroeder,** **capital,** **August** **31,** **2016** |  | **$391,000** |
|  |  |  |

**PE** **1–6A**

|  |  |  |  |
| --- | --- | --- | --- |
| **OUSEL** **TRAVEL** **SERVICE**  **Balance** **Sheet**  **November** **30,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$308,000** | **Accounts** **payable** | **$** **62,500** |
| **Accounts** **receivable** | **186,000** |  |  |
| **Supplies** | **16,500** | **Owner’s** **Equity** | |
| **Land** | **480,000** | **Shane** **Ousel,** **capital** | **928,000** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$990,500** | **owner’s** **equity** | **$990,500** |
|  |  |  |  |

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**PE** **1–6B**

|  |  |  |  |
| --- | --- | --- | --- |
| **SENTINEL** **TRAVEL** **SERVICE**  **Balance** **Sheet**  **August** **31,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$** **45,400** | **Accounts** **payable** | **$** **44,600** |
| **Accounts** **receivable** | **75,500** |  |  |
| **Supplies** | **4,700** | **Owner’s** **Equity** | |
| **Land** | **310,000** | **Barb** **Schroeder,** **capital** | **391,000** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$435,600** | **owner’s** **equity** | **$435,600** |
|  |  |  |  |

**PE** **1–7A**

|  |  |  |
| --- | --- | --- |
| **OUSEL** **TRAVEL** **SERVICE**  **Statement** **of** **Cash** **Flows**  **For** **the** **Year** **Ended** **November** **30,** **2016** | | |
| **Cash** **flows** **from** **operating** **activities:** |  |  |
| **Cash** **received** **from** **customers** | **$** **1,465,000** |  |
| **Deduct** **cash** **payments** **for** **operating** **expenses** | **(1,230,000)** |  |
| **Net** **cash** **flows** **from** **operating** **activities** |  | **$** **235,000** |
| **Cash** **flows** **used** **for** **investing** **activities:** |  |  |
| **Cash** **payments** **for** **purchase** **of** **land** |  | **(150,000)** |
| **Cash** **flows** **from** **financing** **activities:** |  |  |
| **Cash** **received** **from** **owner** **as** **investment** | **$** **50,000** |  |
| **Deduct** **cash** **withdrawals** **by** **owner** | **(30,000)** |  |
| **Net** **cash** **flows** **from** **financing** **activities** |  | **20,000** |
| **Net** **increase** **in** **cash** **during** **year** |  | **$** **105,000** |
| **Cash** **as** **of** **December** **1,** **2015** |  | **203,000** |
| **Cash** **as** **of** **November** **30,** **2016** |  | **$** **308,000** |
|  |  |  |

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**PE** **1–7B**

|  |  |  |
| --- | --- | --- |
| **SENTINEL** **TRAVEL** **SERVICE**  **Statement** **of** **Cash** **Flows**  **For** **the** **Year** **Ended** **August** **31,** **2016** | | |
| **Cash** **flows** **from** **operating** **activities:** |  |  |
| **Cash** **received** **from** **customers** | **$** **734,000** |  |
| **Deduct** **cash** **payments** **for** **operating** **expenses** | **(745,600)** |  |
| **Net** **cash** **flows** **used** **for** **operating** **activities** |  | **$(11,600)** |
| **Cash** **flows** **used** **for** **investing** **activities:** |  |  |
| **Cash** **payments** **for** **purchase** **of** **land** |  | **(50,000)** |
| **Cash** **flows** **from** **financing** **activities:** |  |  |
| **Cash** **received** **from** **owner** **as** **investment** | **$** **36,000** |  |
| **Deduct** **cash** **withdrawals** **by** **owner** | **(18,000)** |  |
| **Net** **cash** **flows** **from** **financing** **activities** |  | **18,000** |
| **Net** **decrease** **in** **cash** **during** **year** |  | **$(43,600)** |
| **Cash** **as** **of** **September** **1,** **2015** |  | **89,000** |
| **Cash** **as** **of** **August** **31,** **2016** |  | **$** **45,400** |
|  |  |  |

**PE** **1–8A**

**a.** **Dec.** **31,** **Dec.** **31,**

**2016** **2015**

**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** **÷** **$415,000**

**\*\*** **$518,000** **÷** **$370,000**

**b.** **Decreased**

**PE** **1–8B**

**a.** **Dec.** **31,** **Dec.** **31,**

**2016** **2015**

**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** **÷** **$4,300,000**

**\*\*** **$2,880,000** **÷** **$3,600,000**

**b.** **Increased**

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**EXERCISES**

**Ex.** **1–1**

**a.** **1.** **manufacturing** **6.** **manufacturing** **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** **companies.** **It** **serves** **as** **the** **basis**

**of** **the** **accounting** **information** **system.**

**Ex.** **1–2**

**As** **in** **many** **ethics** **issues,** **there** **is** **no** **one** **right** **answer.** **Oftentimes,** **disclosing**

**only** **what** **is** **legally** **required** **may** **not** **be** **enough.** **In** **this** **case,** **it** **would** **be** **best**

**for** **the** **company’s** **chief** **executive** **officer** **to** **disclose** **both** **reports** **to** **the** **county**

**representatives.** **In** **doing** **so,** **the** **chief** **executive** **officer** **could** **point** **out** **any** **flaws**

**or** **deficiencies** **in** **the** **fired** **researcher’s** **report.**

**Ex.** **1–3**

**a.** **1.** **M** **5.** **O** **9.** **X**

**2.** **L** **6.** **O** **10.** **O**

**3.** **O** **7.** **X**

**4.** **M** **8.** **L**

**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**

**Green** **Mountain** **Coffee** **Roasters’** **owners’** **equity:** **$3,616** **–** **$1,345** **=** **$2,271**

**Starbucks’** **owners’** **equity:** **$8,219** **–** **$3,110** **=** **$5,109**

**Ex.** **1–5**

**Dollar** **Tree’s** **owners’** **equity:** **$2,329** **–** **$984** **=** **$1,345**

**Target’s** **owners’** **equity:** **$46,630** **–** **$30,809** **=** **$15,821**

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**Ex.** **1–6**

**a.** **$1,271,000** **($376,000** **+** **$895,000)**

**b.** **$520,000** **($1,375,000** **–** **$855,000)**

**c.** **$652,500** **($863,500** **–** **$211,000)**

**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.** **(2)** **liability**

**b.** **(1)** **asset**

**c.** **(3)** **owner's** **equity** **(revenue)**

**d.** **(1)** **asset**

**e.** **(1)** **asset**

**f.** **(3)** **owner's** **equity** **(expense)**

**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.**

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**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.**

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**Ex.** **1–15**

**Jupiter**

**Owner's** **equity** **at** **end** **of** **year** **($844,000** **–** **$320,000)**  **$524,000**

**Deduct** **owner's** **equity** **at** **beginning** **of** **year** **($550,000** **–** **$215,000)**  **335,000**

**Net** **income** **(increase** **in** **owner’s** **equity)**  **$189,000**

**Mars**

**Increase** **in** **owner’s** **equity** **(as** **determined** **for** **Jupiter)**  **$189,000**

**Add** **withdrawals**  **36,000**

**Net** **income**  **$225,000**

**Saturn**

**Increase** **in** **owner’s** **equity** **(as** **determined** **for** **Jupiter)**  **$189,000**

**Deduct** **additional** **investment**  **60,000**

**Net** **income**  **$129,000**

**Venus**

**Increase** **in** **owner’s** **equity** **(as** **determined** **for** **Jupiter) $189,000**

**Deduct** **additional** **investment**  **60,000**

**$129,000**

**Add** **withdrawals 36,000**

**Net** **income**  **$165,000**

**Ex.** **1–16**

**Balance** **sheet** **items:** **1,** **2,** **4,** **5,** **6,** **10**

**Ex.** **1–17**

**Income** **statement** **items:** **3,** **7,** **8,** **9**

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**Ex.** **1–18**

**a.**

|  |  |  |
| --- | --- | --- |
| **UDDER** **PRODUCTS** **COMPANY**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Month** **Ended** **April** **30,** **2016** | | |
| **Mark** **Kominksy,** **capital,** **April** **1,** **2016** |  | **$384,500** |
| **Net** **income** **for** **November** | **$166,000** |  |
| **Less** **withdrawals** | **25,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **141,000** |
| **Mark** **Kominksy,** **capital,** **April** **30,** **2016** |  | **$525,500** |
|  |  |  |

**b.** **The** **statement** **of** **owner’s** **equity** **is** **prepared** **before** **the** **April** **30,** **2016,** **balance**

**sheet** **because** **Mark** **Kominksy,** **Capital** **as** **of** **April** **30,** **2016,** **is** **needed** **for** **the**

**balance** **sheet.**

**Ex.** **1–19**

|  |  |  |
| --- | --- | --- |
| **DAIRY** **SERVICES**  **Income** **Statement**  **For** **the** **Month** **Ended** **August** **31,** **2016** | | |
| **Fees** **earned** |  | **$783,000** |
| **Expenses:** |  |  |
| **Wages** **expense** | **$550,000** |  |
| **Rent** **expense** | **35,000** |  |
| **Supplies** **expense** | **8,500** |  |
| **Miscellaneous** **expense** | **11,400** |  |
| **Total** **expenses** |  | **604,900** |
| **Net** **income** |  | **$178,100** |
|  |  |  |

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**Ex.** **1–20**

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

**Owner’s** **Equity** **(beginning)** **+** **Investments** **–** **Withdrawals** **+** **Revenues** **–** **Expenses**

**=** **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)…………** **540,000**

**Increase** **in** **owner’s** **equity…………………………………………………** **$390,000**

**Deduct** **increase** **due** **to** **net** **income** **($570,000** **–** **$240,000)…………** **330,000**

**$** **60,000**

**Add** **withdrawals………………………………………………….…………** **75,000**

**Additional** **investment** **in** **the** **business………………………………** **(a)** **$135,000**

**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)…………** **230,000**

**Increase** **in** **owner’s** **equity…………………………………………………** **$225,000**

**Add** **withdrawals………………………………………………….…………** **32,000**

**$257,000**

**Deduct** **additional** **investment……………………………………………** **150,000**

**Increase** **due** **to** **net** **income…………………………………………………** **$107,000**

**Add** **expenses………………………………………………….……………** **128,000**

**Revenue………………………………………………….…………………(b)** **$235,000**

**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)……………** **34,000**

**Decrease** **in** **owner’s** **equity…………………………………………………** **$(14,000)**

**Deduct** **decrease** **due** **to** **net** **loss** **($115,000** **–** **$122,500)………………** **7,500**

**$(21,500)**

**Deduct** **additional** **investment…………………………………………….** **10,000**

**Withdrawals** **from** **the** **business………………………………………** **(c)** **$(31,500)**

**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**

**$147,000**

**Add** **withdrawals………………………………………………….…………** **39,000**

**Owner’s** **equity** **at** **beginning** **of** **year……………………………………** **$186,000**

**Deduct** **additional** **investment……………………………………………** **55,000**

**$131,000**

**Add** **liabilities** **at** **beginning** **of** **year………………………………………** **120,000**

**Assets** **at** **beginning** **of** **year……………………………………………** **(d)** **$251,000**

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**Ex.** **1–21**

**a.**

|  |  |  |  |
| --- | --- | --- | --- |
| **EBONY** **INTERIORS**  **Balance** **Sheet**  **February** **29,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$** **320,000** | **Accounts** **payable** | **$** **310,000** |
| **Accounts** **receivable** | **800,000** |  |  |
| **Supplies** | **30,000** | **Owner’s** **Equity** | |
|  |  | **Justin** **Berk,** **capital** | **840,000** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$1,150,000** | **owner’s** **equity** | **$1,150,000** |
|  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **EBONY** **INTERIORS**  **Balance** **Sheet**  **March** **31,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$** **380,000** | **Accounts** **payable** | **$** **400,000** |
| **Accounts** **receivable** | **960,000** |  |  |
| **Supplies** | **35,000** | **Owner’s** **Equity** | |
|  |  | **Justin** **Berk,** **capital** | **975,000** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$1,375,000** | **owner’s** **equity** | **$1,375,000** |
|  |  |  |  |

**b.** **Owner’s** **equity,** **March** **31 $975,000**

**Owner’s** **equity,** **February** **29 840,000**

**Net** **income $135,000**

**c.** **Owner’s** **equity,** **March** **31**  **$975,000**

**Owner’s** **equity,** **February** **29 840,000**

**Increase** **in** **owner’s** **equity $135,000**

**Add** **withdrawal 50,000**

**Net** **income $185,000**

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**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**

|  |  |  |
| --- | --- | --- |
| **ETHOS** **CONSULTING** **GROUP**  **Statement** **of** **Cash** **Flows**  **For** **the** **Year** **Ended** **May** **31,** **2016** | | |
| **Cash** **flows** **from** **operating** **activities:** |  |  |
| **Cash** **received** **from** **customers** | **$637,500** |  |
| **Deduct** **cash** **payments** **for** **operating** **expenses** | **475,000** |  |
| **Net** **cash** **flows** **from** **operating** **activities** |  | **$162,500** |
| **Cash** **flows** **used** **for** **investing** **activities:** |  |  |
| **Cash** **payments** **for** **purchase** **of** **land** |  | **(90,000)** |
| **Cash** **flows** **from** **financing** **activities:** |  |  |
| **Cash** **received** **from** **owner** **as** **investment** | **$** **62,500** |  |
| **Deduct** **cash** **withdrawals** **by** **owner** | **17,500** |  |
| **Net** **cash** **flows** **from** **financing** **activities** |  | **45,000** |
| **Net** **decrease** **in** **cash** **during** **year** |  | **$117,500** |
| **Cash** **as** **of** **June** **1,** **2015** |  | **58,000** |
| **Cash** **as** **of** **May** **31,** **2016** |  | **$175,500** |
|  |  |  |

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**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,** **2016.”**

**3.** **The** **year** **in** **the** **heading** **for** **the** **statement** **of** **owner’s** **equity** **should** **be** **2016**

**rather** **than** **2015.**

**4.** **The** **balance** **sheet** **should** **be** **labeled** **“August** **31,** **2016,”** **rather** **than** **“For** **the**

**Month** **Ended** **August** **31,** **2016.”**

**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,** **2016.** **The** **net** **income** **should** **be**

**presented** **next,** **followed** **by** **the** **amount** **of** **withdrawals,** **which** **is** **subtracted**

**from** **the** **net** **income** **to** **yield** **a** **net** **increase** **in** **owner’s** **equity.**

**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.**

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**Ex.** **1–25** **(Concluded)**

**Corrected** **financial** **statements** **appear** **as** **follows:**

|  |  |  |
| --- | --- | --- |
| **WE-SELL** **REALTY**  **Income** **Statement**  **For** **the** **Month** **Ended** **August** **31,** **2016** | | |
| **Sales** **commissions** |  | **$140,000** |
| **Expenses:** |  |  |
| **Office** **salaries** **expense** | **$87,000** |  |
| **Rent** **expense** | **18,000** |  |
| **Automobile** **expense** | **7,500** |  |
| **Supplies** **expense** | **1,150** |  |
| **Miscellaneous** **expense** | **2,200** |  |
| **Total** **expenses** |  | **115,850** |
| **Net** **income** |  | **$** **24,150** |
|  |  |  |

|  |  |  |
| --- | --- | --- |
| **WE-SELL** **REALTY**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Month** **Ended** **August** **31,** **2016** | | |
| **Omar** **Farah,** **capital,** **August** **1,** **2016** |  | **$** **0** |
| **Investment** **on** **August** **1,** **2016** | **$15,000** |  |
| **Net** **income** **for** **August** | **24,150** |  |
|  | **$39,150** |  |
| **Less** **withdrawals** **during** **August** | **10,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **29,150** |
| **Omar** **Farah,** **capital,** **August** **31,** **2016** |  | **$29,150** |
|  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **WE-SELL** **REALTY**  **Balance** **Sheet**  **August** **31,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$** **8,900** | **Accounts** **payable** | **$22,350** |
| **Accounts** **receivable** | **38,600** |  |  |
| **Supplies** | **4,000** | **Owner’s** **Equity** | |
|  |  | **Omar** **Farah,** **capital** | **29,150** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$51,500** | **owner’s** **equity** | **$51,500** |
|  |  |  |  |

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**Ex.** **1–26**

**a.** **Year** **2:** **$17,898** **($40,518** **–** **$22,620)**

**Year** **1:** **$18,889** **($40,125** **–** **$21,236)**

**b.** **Year** **2:** **0.79** **($17,898** **÷** **$22,620)**

**Year** **1:** **0.89** **($18,889** **÷** **$21,236)**

**c.** **The** **ratio** **of** **liabilities** **to** **stockholders’** **equity** **decreased** **from** **0.89** **to** **0.79**

**indicating** **a** **slight** **decrease** **in** **risk** **for** **creditors** **from** **Year** **1** **to** **Year** **2.**

**Ex.** **1–27**

**a.** **Year** **2:** **$16,533** **($33,559** **–** **$17,026)**

**Year** **1:** **$18,112** **($33,699** **–** **$15,587)**

**b.** **Year** **2:** **1.03** **($17,026** **÷** **$16,533)**

**Year** **1:** **0.86** **($15,587** **÷** **$18,112)**

**c.** **The** **risk** **for** **creditors** **has** **increased** **from** **0.86** **in** **Year** **1** **to** **1.03** **in** **Year** **2.**

**d.** **Lowe’s** **ratio** **of** **liabilities** **to** **stockholders’** **equity** **is** **more** **than** **1** **in** **Year** **2** **(1.03)**

**and** **less** **than** **1** **in** **Year** **1** **(0.86).** **In** **comparison,** **The** **Home** **Depot’s** **ratio** **of**

**liabilities** **to** **stockholders’** **equity** **is** **less** **than** **1** **for** **both** **years.** **Thus,** **the** **risk** **to**

**creditors** **of** **Lowe's** **is** **slightly** **more** **than** **The** **Home** **Depot.**

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**Liabilities**

**PROBLEMS**

**Prob.** **1–1A**

**1.** **Assets** **=** **+**

**Owner’s** **Equity**

**Andrea Andrea**

**Accts. Accts. Byrd, Byrd, Fees Rent Salaries Supplies Auto Misc.**

**Cash + Rec. + Supplies = Payable + Capital – Drawing + Earned – Expense – Expense – Expense – Exp. – Exp.**

**(a)** **+** **45,000** **+** **45,000**

**(b)** **+** **2,000** **+** **2,000**

**Bal.** **45,000** **2,000** **2,000** **45,000**

**(c)** **+** **8,500** **+** **8,500**

**Bal.** **53,500** **2,000** **2,000** **45,000** **8,500**

**(d)** **–** **5,000** **–** **5,000**

**Bal.** **48,500** **2,000** **2,000** **45,000** **8,500** **–** **5,000**

**(e)** **–** **1,375** **–** **1,375**

**Bal.** **47,125** **2,000** **625** **45,000** **8,500** **–** **5,000**

**(f)** **+** **11,250** **+** **11,250**

**Bal.** **47,125** **11,250** **2,000** **625** **45,000** **19,750** **–** **5,000**

**(g)** **–** **1,740** **–** **840** **–** **900**

**Bal.** **45,385** **11,250** **2,000** **625** **45,000** **19,750** **–** **5,000** **–** **840** **–** **900**

**(h) –** **3,600** **–** **3,600**

**Bal.** **41,785** **11,250** **2,000** **625** **45,000** **19,750** **–** **5,000** **–** **3,600** **–** **840** **–** **900**

**(i)** **–** **1,450** **–** **1,450**

**Bal.** **41,785** **11,250** **550** **625** **45,000** **19,750** **–** **5,000** **–** **3,600** **–** **1,450** **–** **840** **–** **900**

**(j)** **–** **2,000** **–** **2,000**

**Bal.** **39,785** **11,250** **550** **625** **45,000** **–** **2,000** **19,750** **–** **5,000** **–** **3,600** **–** **1,450** **–** **840** **–** **900**

**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.** **$7,960** **($19,750** **–** **$5,000** **–** **$3,600** **–** **$1,450** **–** **$840** **–** **$900)**

**4.** **April’s** **transactions** **increased** **Andrea** **Byrd’s** **capital** **by** **$50,960** **($45,000** **+** **$7,960** **–** **$2,000),** **which** **is** **the** **initial** **capital** **investment** **of** **$45,000** **plus**

**April's** **net** **income** **of** **$7,960** **less** **Andrea** **Byrd’s** **withdrawals** **of** **$2,000.**

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**Prob.** **1–2A**

**1.**

|  |  |  |
| --- | --- | --- |
| **NORDIC TRAVEL AGENCY**  **Income Statement**  **For the Year Ended December 31, 2016** | | |
| **Fees earned** |  | **$912,500** |
| **Expenses:** |  |  |
| **Wages expense** | **$510,000** |  |
| **Rent expense** | **36,000** |  |
| **Utilities expense** | **28,500** |  |
| **Supplies expense** | **4,100** |  |
| **Miscellaneous expense** | **6,400** |  |
| **Total expenses** |  | **585,000** |
| **Net income** |  | **$327,500** |
|  |  |  |

**2.**

|  |  |  |
| --- | --- | --- |
| **NORDIC TRAVEL AGENCY**  **Statement of Owner’s Equity**  **For the Year Ended December 31, 2016** | | |
| **Ian Eisele, capital, January 1, 2016** |  | **$670,000** |
| **Net income for the year** | **$327,500** |  |
| **Less withdrawals** | **42,000** |  |
| **Increase in owner’s equity** |  | **285,500** |
| **Ian Eisele , capital, December 31, 2016** |  | **$955,500** |
|  |  |  |

**3.**

|  |  |  |  |
| --- | --- | --- | --- |
| **NORDIC TRAVEL AGENCY**  **Balance Sheet December 31, 2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$ 190,500** | **Accounts payable** | **$ 69,500** |
| **Accounts receivable** | **285,000** |  |  |
| **Supplies** | **5,500** |  | |
| **Land** | **544,000** | **Owner’s Equity** | |
|  |  | **Ian Eisele, capital** | **955,500** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$1,025,000** | **owner’s equity** | **$1,025,000** |
|  |  |  |  |

**4.** **Ian** **Eisele,** **Capital** **of** **$955,500**

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**Prob.** **1–3A**

**1.**

|  |  |  |
| --- | --- | --- |
| **RELIANCE FINANCIAL SERVICES**  **Income Statement**  **For the Month Ended July 31, 2016** | | |
| **Fees earned** |  | **$144,500** |
| **Expenses:** |  |  |
| **Salaries expense** | **$55,000** |  |
| **Rent expense** | **33,000** |  |
| **Auto expense** | **16,000** |  |
| **Supplies expense** | **4,500** |  |
| **Miscellaneous expense** | **4,800** |  |
| **Total expenses** |  | **113,300** |
| **Net income** |  | **$ 31,200** |
|  |  |  |

**2.**

|  |  |  |
| --- | --- | --- |
| **RELIANCE FINANCIAL SERVICES**  **Statement of Owner’s Equity For the Month Ended July 31, 2016** | | |
| **Seth Feye, capital, July 1, 2016** |  | **$ 0** |
| **Investment on July 1, 2016** | **$50,000** |  |
| **Net income for July** | **31,200** |  |
|  | **$81,200** |  |
| **Less withdrawals** | **15,000** |  |
| **Increase in owner’s equity** |  | **66,200** |
| **Seth Feye, capital, July 31, 2016** |  | **$66,200** |
|  |  |  |

**3.**

|  |  |  |  |
| --- | --- | --- | --- |
| **RELIANCE FINANCIAL SERVICES**  **Balance Sheet**  **July 31, 2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$32,600** | **Accounts payable** | **$ 3,400** |
| **Accounts receivable** | **34,500** |  |  |
| **Supplies** | **2,500** | **Owner’s Equity** | |
|  |  | **Seth Feye, capital** | **66,200** |
|  |  | **Total liabilities and** |  |
| **Total assets** | **$69,600** | **owner’s equity** | **$69,600** |
|  |  |  |  |

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**Prob.** **1–3A** **(Concluded)**

**4.** **(Optional)**

|  |  |  |
| --- | --- | --- |
| **RELIANCE** **FINANCIAL** **SERVICES**  **Statement** **of** **Cash** **Flows**  **For** **the** **Month** **Ended** **July** **31,** **2016** | | |
| **Cash** **flows** **from** **operating** **activities:** |  |  |
| **Cash** **received** **from** **customers** | **$110,000** |  |
| **Deduct** **cash** **payments** **for** **expenses** |  |  |
| **and** **payments** **to** **creditors\*** | **112,400** |  |
| **Net** **cash** **flows** **used** **for** **operating** **activities** |  | **$** **(2,400)** |
| **Cash** **flows** **from** **investing** **activities** |  | **0** |
| **Cash** **flows** **from** **financing** **activities:** |  |  |
| **Cash** **received** **as** **owner’s** **investment** | **$** **50,000** |  |
| **Deduct** **cash** **withdrawal** **by** **owner** | **15,000** |  |
| **Net** **cash** **flows** **from** **financing** **activities** |  | **35,000** |
| **Net** **increase** **in** **cash** **and** **July** **31,** **2016,** **cash** **balance** |  | **$32,600** |
|  |  |  |

**\*** **$3,600** **+** **$33,000** **+** **$20,800** **+** **$55,000;** **these** **amounts** **are** **taken** **from** **the** **cash** **column**

**shown** **in** **the** **problem.**

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**Assets**

**Liabilities**

**Prob.** **1–4A**

**1.** **=** **+**

**Owner’s** **Equity**

**Accts. Pat Glenn, Pat Glen, Sales Salaries Rent Auto Supplies Misc.**

**Cash + Supplies = Payable + Capital – Drawing + Comm. – Exp. – Exp. – Exp. – Exp. – 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**

**(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**

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**Prob.** **1–4A** **(Concluded)**

**2.**

|  |  |  |
| --- | --- | --- |
| **HALF MOON REALTY**  **Income Statement**  **For the Month Ended July 31, 2016** | | |
| **Sales commissions** |  | **$41,500** |
| **Expenses:** |  |  |
| **Salaries expense** | **$5,000** |  |
| **Rent expense** | **3,600** |  |
| **Automobile expense** | **3,050** |  |
| **Supplies expense** | **900** |  |
| **Miscellaneous expense** | **1,600** |  |
| **Total expenses** |  | **14,150** |
| **Net income** |  | **$27,350** |
|  |  |  |

|  |  |  |
| --- | --- | --- |
| **HALF** **MOON** **REALTY**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Month** **Ended** **July** **31,** **2016** | | |
| **Pat** **Glenn,** **capital,** **July** **1,** **2016** |  | **$** **0** |
| **Investment** **on** **July** **1,** **2016** | **$25,000** |  |
| **Net** **income** **for** **July** | **27,350** |  |
|  | **$52,350** |  |
| **Less** **withdrawals** | **4,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **48,350** |
| **Pat** **Glenn,** **capital,** **July** **31,** **2016** |  | **$48,350** |
|  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **HALF** **MOON** **REALTY**  **Balance** **Sheet**  **July** **31,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$48,050** | **Accounts** **payable** | **$** **650** |
| **Supplies** | **950** |  |  |
|  |  | **Owner’s** **Equity** | |
|  |  | **Pat** **Glenn,** **capital** | **48,350** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$49,000** | **owner’s** **equity** | **$49,000** |
|  |  |  |  |

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**Assets**

**Liabilities**

**Supplies** **Land**

**Receivable**

**Payable**

**$40,000**

**Prob.** **1–5A**

**1.** **=** **+**

**Accounts** **Accounts**

**Cash** **+** **+** **+** **=** **+**

**$45,000** **+** **+** **+** **=** **+**

**$93,000 $7,000** **$75,000** **$40,000**

**Owner’s** **Equity**

**Joel** **Palk,** **Capital**

**Joel** **Palk,** **Capital**

**$220,000**

**$180,000**

**=** **+**

**=** **Joel** **Palk,** **Capital**

**Joel** **Palk,** **Capital**

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**Prob.** **1–5A** **(Continued)**

2.

Assets = Liabilities + Owner’s Equity

**Accts. Accts. Joel Palk, Joel Palk,**

**Cash + Rec. + Supplies + Land = Payable + Capital – 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**

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**Prob.** **1–5A** **(Continued)**

Owner’s Equity (Continued)

Dry Dry

Cleaning Cleaning Wages Rent Supplies Truck Utilities Misc.

+ Revenue – Exp. – Exp. – Exp. – Exp. – Exp. – Exp. – 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**

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**Prob.** **1–5A** **(Continued)**

**3.**

|  |  |  |
| --- | --- | --- |
| **D'LITE** **DRY** **CLEANERS**  **Income** **Statement**  **For** **the** **Month** **Ended** **July** **31,** **2016** | | |
| **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,** **2016** | | |
| **Joel** **Palk,** **capital,** **July** **1,** **2016** |  | **$180,000** |
| **Additional** **investment** **during** **July** | **$35,000** |  |
| **Net** **income** **for** **July** | **63,775** |  |
|  | **$98,775** |  |
| **Less** **withdrawals** | **12,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **86,775** |
| **Joel** **Palk,** **capital,** **July** **31,** **2016** |  | **$266,775** |
|  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **D'LITE** **DRY** **CLEANERS**  **Balance** **Sheet**  **July** **31,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$** **95,325** | **Accounts** **payable** | **$** **49,200** |
| **Accounts** **receivable** | **89,750** |  |  |
| **Supplies** | **5,900** | **Owner’s** **Equity** | |
| **Land** | **125,000** | **Joel** **Palk,** **capital** | **266,775** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$315,975** | **owner’s** **equity** | **$315,975** |
|  |  |  |  |

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**Prob.** **1–5A** **(Concluded)**

**4.** **(Optional)**

|  |  |  |
| --- | --- | --- |
| **D'LITE** **DRY** **CLEANERS**  **Statement** **of** **Cash** **Flows**  **For** **the** **Month** **Ended** **July** **31,** **2016** | | |
| **Cash** **flows** **from** **operating** **activities:** |  |  |
| **Cash** **received** **from** **customers\*** | **$120,125** |  |
| **Deduct** **cash** **payments** **for** **expenses** |  |  |
| **and** **payments** **to** **creditors\*\*** | **42,800** |  |
| **Net** **cash** **flows** **from** **operating** **activities** |  | **$** **77,325** |
| **Cash** **flows** **used** **for** **investing** **activities:** |  |  |
| **Purchase** **of** **land** |  | **(50,000)** |
| **Cash** **flows** **from** **financing** **activities:** |  |  |
| **Cash** **received** **as** **owner’s** **investment** | **$** **35,000** |  |
| **Deduct** **cash** **withdrawal** **by** **owner** | **12,000** |  |
| **Net** **cash** **flows** **from** **financing** **activities** |  | **23,000** |
| **Net** **Increase** **in** **cash** **during** **July** |  | **$** **50,325** |
| **Cash** **balance,** **July** **1,** **2016** |  | **45,000** |
| **Cash** **balance,** **July** **31,** **2016** |  | **$** **95,325** |
|  |  |  |

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

**\*\*** **$6,000** **+** **$22,800** **+** **$14,000;** **These** **amounts** **are** **taken** **from** **the** **cash** **column** **of** **the** **spreadsheet**

**in** **Part** **2.**

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**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,** **2016,** **$0;** **Wolverine** **Realty** **was** **organized** **on**

**April** **1,** **2016.**

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

**e.** **$650,000** **($375,000** **+** **$275,000)**

**f.** **Increase** **in** **owner’s** **equity,** **$525,000** **($650,000** **–** **$125,000)**

**g.** **Dakota** **Rowe,** **capital,** **April** **30,** **2014,** **$525,000**

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

**i.** **Dakota** **Rowe,** **capital,** **$525,000** **($625,000** **–** **$100,000);** **same** **as** **(g)**

**j.** **Total** **liabilities** **and** **owner’s** **equity,** **$625,000** **($100,000** **+** **$525,000)**

**k.** **Cash** **received** **from** **customers,** **$750,000** **($387,500** **+** **$362,500);** **this** **is** **the**

**same** **as** **fees** **earned** **(a)** **since** **there** **are** **no** **accounts** **receivable.**

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

**m.** **Cash** **payments** **for** **acquisition** **of** **land,** **($150,000)**

**n.** **Cash** **received** **as** **owner’s** **investment,** **$375,000**

**o.** **Cash** **withdrawal** **by** **owner,** **($125,000)**

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

**q.** **Net** **cash** **flow** **and** **April** **30,** **2016,** **cash** **balance,** **$462,500** **($362,500** **–** **$150,000**

**+** **$250,000);** **also** **the** **cash** **balance** **on** **the** **balance** **sheet.**

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**Prob.** **1–1B**

**1. Assets** **= Liabilities** **+**

**Owner’s** **Equity**

**Amy Amy**

**Accts. Accts. Austin, Austin, Fees Rent Salaries Supplies Auto Misc.**

**Cash + Rec. + Supplies = Payable + Capital – Drawing + Earned – Expense – Expense – Expense – Exp. – 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** **4,000** **1,700** **50,000**

**(d)** **+** **13,800** **+** **13,800**

**Bal.** **61,500** **4,000** **1,700** **50,000** **13,800**

**(e)** **–** **5,000** **–** **5,000**

**Bal.** **56,500** **4,000** **1,700** **50,000** **13,800** **–** **5,000**

**(f)** **–** **1,450** **–** **1,150** **–** **300**

**Bal.** **55,050** **4,000** **1,700** **50,000** **13,800** **–** **5,000** **–** **1,150** **–** **300**

**(g)** **–** **2,500** **–** **2,500**

**Bal.** **52,550** **4,000** **1,700** **50,000** **13,800** **–** **5,000** **–** **2,500** **–** **1,150** **–** **300**

**(h)** **–** **1,300** **–** **1,300**

**Bal.** **52,550** **2,700** **1,700** **50,000** **13,800** **–** **5,000** **–** **2,500** **–** **1,300** **–** **1,150** **–** **300**

**(i)** **+** **12,500** **+** **12,500**

**Bal.** **52,550** **12,500** **2,700** **1,700** **50,000** **26,300** **–** **5,000** **–** **2,500** **–** **1,300** **–** **1,150** **–** **300**

**(j)** **–** **3,900** **–** **3,900**

**Bal.** **48,650** **12,500** **2,700** **1,700** **50,000** **–** **3,900** **26,300** **–** **5,000** **–** **2,500** **–** **1,300** **–** **1,150** **–** **300**

**2.** **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** **by** **$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.**

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**Prob.** **1–2B**

**1.**

|  |  |  |
| --- | --- | --- |
| **WILDERNESS** **TRAVEL** **SERVICE**  **Income** **Statement**  **For** **the** **Year** **Ended** **April** **30,** **2016** | | |
| **Fees** **earned** |  | **$875,000** |
| **Expenses:** |  |  |
| **Wages** **expense** | **$525,000** |  |
| **Rent** **expense** | **75,000** |  |
| **Utilities** **expense** | **38,000** |  |
| **Supplies** **expense** | **12,000** |  |
| **Taxes** **expense** | **10,000** |  |
| **Miscellaneous** **expense** | **15,000** |  |
| **Total** **expenses** |  | **675,000** |
| **Net** **income** |  | **$200,000** |
|  |  |  |

**2.**

|  |  |  |
| --- | --- | --- |
| **WILDERNESS** **TRAVEL** **SERVICE**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Year** **Ended** **April** **30,** **2016** | | |
| **Harper** **Borg,** **capital,** **May** **1,** **2015** |  | **$180,000** |
| **Net** **income** **for** **the** **year** | **$200,000** |  |
| **Less** **withdrawals** | **40,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **160,000** |
| **Harper** **Borg,** **capital,** **April** **30,** **2016** |  | **$340,000** |
|  |  |  |

**3.**

|  |  |  |  |
| --- | --- | --- | --- |
| **WILDERNESS** **TRAVEL** **SERVICE**  **Balance** **Sheet**  **April** **30,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$146,000** | **Accounts** **payable** | **$** **25,000** |
| **Accounts** **receivable** | **210,000** |  |  |
| **Supplies** | **9,000** | **Owner’s** **Equity** | |
|  |  | **Harper** **Borg,** **capital** | **340,000** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$365,000** | **owner’s** **equity** | **$365,000** |
|  |  |  |  |

**4.** **Net** **income** **of** **$200,000**

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**Prob.** **1–3B**

**1.**

|  |  |  |
| --- | --- | --- |
| **BRONCO** **CONSULTING**  **Income** **Statement**  **For** **the** **Month** **Ended** **August** **31,** **2016** | | |
| **Fees** **earned** |  | **$125,000** |
| **Expenses:** |  |  |
| **Salaries** **expense** | **$58,000** |  |
| **Rent** **expense** | **27,000** |  |
| **Auto** **expense** | **15,500** |  |
| **Supplies** **expense** | **6,100** |  |
| **Miscellaneous** **expense** | **7,500** |  |
| **Total** **expenses** |  | **114,100** |
| **Net** **income** |  | **$**  **10,900** |
|  |  |  |

**2.**

|  |  |  |
| --- | --- | --- |
| **BRONCO** **CONSULTING**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Month** **Ended** **August** **31,** **2016** | | |
| **Jose** **Loder,** **capital,** **August** **1,** **2016** |  | **$** **0** |
| **Investment** **on** **August** **1,** **2016** | **$75,000** |  |
| **Net** **income** **for** **August** | **10,900** |  |
|  | **$85,900** |  |
| **Less** **withdrawals** | **15,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **70,900** |
| **Jose** **Loder,** **capital,** **August** **31,** **2016** |  | **$70,900** |
|  |  |  |

**3.**

|  |  |  |  |
| --- | --- | --- | --- |
| **BRONCO** **CONSULTING**  **Balance** **Sheet**  **August** **31,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$38,000** | **Accounts** **payable** | **$** **3,000** |
| **Accounts** **receivable** | **33,000** |  |  |
| **Supplies** | **2,900** | **Owner’s** **Equity** | |
|  |  | **Jose** **Loder,** **capital** | **70,900** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$73,900** | **owner’s** **equity** | **$73,900** |
|  |  |  |  |

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**Prob.** **1–3B** **(Concluded)**

**4.** **(Optional)**

|  |  |  |
| --- | --- | --- |
| **BRONCO** **CONSULTING**  **Statement** **of** **Cash** **Flows**  **For** **the** **Month** **Ended** **August** **31,** **2016** | | |
| **Cash** **flows** **from** **operating** **activities:** |  |  |
| **Cash** **received** **from** **customers** | **$** **92,000** |  |
| **Deduct** **cash** **payments** **for** **expenses** |  |  |
| **and** **payments** **to** **creditors\*** | **114,000** |  |
| **Net** **cash** **flows** **used** **for** **operating** **activities** |  | **$(22,000)** |
| **Cash** **flows** **from** **investing** **activities** |  | **0** |
| **Cash** **flows** **from** **financing** **activities:** |  |  |
| **Cash** **received** **as** **owner’s** **investment** | **$** **75,000** |  |
| **Deduct** **cash** **withdrawal** **by** **owner** | **15,000** |  |
| **Net** **cash** **flows** **from** **financing** **activities** |  | **60,000** |
| **Net** **increase** **in** **cash** **and** **August** **31,** **2014,** **cash** **balance** |  | **$** **38,000** |
|  |  |  |

**\*** **$27,000** **+** **$6,000** **+** **$23,000** **+** **$58,000;** **These** **amounts** **are** **taken** **from** **the** **cash** **column** **shown**

**in** **the** **problem.**

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**Prob.** **1–4B**

**1. Assets** **= Liabilities** **+**

**Owner’s** **Equity**

**Maria Maria**

**Accts. Adams, Adams, Sales Rent Salaries Auto Supplies Misc.**

**Cash + Supplies = Payable + Capital – Drawing + Comm. – Exp. – Exp. – Exp. – Exp. – Exp.**

**(a)** **+** **24,000** **+** **24,000**

**(b)** **–** **3,600** **–** **3,600**

**Bal.** **20,400** **24,000** **–** **3,600**

**(c)** **–** **1,950** **–** **1,350** **–** **600**

**Bal.** **18,450** **24,000** **–** **3,600** **–** **1,350** **–** **600**

**(d)** **+** **1,200** **+** **1,200**

**Bal.** **18,450** **1,200** **1,200** **24,000** **–** **3,600** **–** **1,350** **–** **600**

**(e)** **+** **19,800** **+** **19,800**

**Bal.** **38,250** **1,200** **1,200** **24,000** **19,800** **–** **3,600** **–** **1,350** **–** **600**

**(f)** **–** **750** **–** **750**

**Bal.** **37,500** **1,200** **450** **24,000** **19,800** **–** **3,600** **–** **1,350** **–** **600**

**(g)** **–** **2,500** **–** **2,500**

**Bal.** **35,000** **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**

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**Prob.** **1–4B** **(Concluded)**

**2.**

|  |  |  |
| --- | --- | --- |
| **CUSTOM** **REALTY**  **Income** **Statement**  **For** **the** **Month** **Ended** **April** **30,** **2016** | | |
| **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,** **2016** | | |
| **Maria** **Adams,** **capital,** **April** **1,** **2016** |  | **$** **0** |
| **Investment** **on** **April** **1,** **2016** | **$24,000** |  |
| **Net** **income** **for** **April** | **10,850** |  |
|  | **$34,850** |  |
| **Less** **withdrawals** | **3,500** |  |
| **Increase** **in** **owner’s** **equity** |  | **31,350** |
| **Maria** **Adams,** **capital,** **April** **30,** **2016** |  | **$31,350** |
|  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **CUSTOM** **REALTY**  **Balance** **Sheet**  **April** **30,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$31,500** | **Accounts** **payable** | **$** **450** |
| **Supplies** | **300** |  |  |
|  |  | **Owner’s** **Equity** | |
|  |  | **Maria** **Adams,** **capital** | **31,350** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$31,800** | **owner’s** **equity** | **$31,800** |
|  |  |  |  |

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**=**

**Assets**

**+**

**+**

**=**

**=**

**=**

**Prob.** **1–5B**

**1.** **Liabilities** **+**

**Accounts** **Accounts**

**Owner’s** **Equity**

**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**

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**Assets**

**Liabilities**

**Payable**

**Supplies** **Land**

**Prob.** **1–5B** **(Continued)**

**2.** **=** **+**

**Owner’s** **Equity**

**Cash**

**Beverly**

**Accts.** **Accts.** **Zahn,**

**+** **Rec.** **=** **+** **–**

**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**

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**Exp.**

**Exp.**

**Revenue**

**Prob.** **1–5B** **(Continued)**

**Owner’s** **Equity** **(Continued)**

**Dry** **Dry**

**Cleaning** **Cleaning** **Wages**

**+** **–** **–** **–**

**Bal.**

**(a)**

**Bal.**

**(b)**

**Bal.**

**Supplies** **Rent** **Truck** **Utilities**

**Exp.** **–**

**Misc.**

**Exp.**

**(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**

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**Prob.** **1–5B** **(Continued)**

**3.**

|  |  |  |
| --- | --- | --- |
| **BEV'S** **DRY** **CLEANERS**  **Income** **Statement**  **For** **the** **Month** **Ended** **November** **30,** **2016** | | |
| **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,** **2016** | | |
| **Beverly** **Zahn,** **capital,** **November** **1,** **2016** |  | **$148,500** |
| **Additional** **investment** **during** **November** | **$21,000** |  |
| **Net** **income** **for** **November** | **40,150** |  |
|  | **$61,150** |  |
| **Less** **withdrawals** | **5,000** |  |
| **Increase** **in** **owner’s** **equity** |  | **56,150** |
| **Beverly** **Zahn,** **capital,** **November** **30,** **2016** |  | **$204,650** |
|  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **BEV'S** **DRY** **CLEANERS**  **Balance** **Sheet**  **November** **30,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$** **81,800** | **Accounts** **payable** | **$** **48,950** |
| **Accounts** **receivable** | **75,000** |  |  |
| **Supplies** | **11,800** | **Owner’s** **Equity** | |
| **Land** | **85,000** | **Beverly** **Zahn,** **capital** | **204,650** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$253,600** | **owner’s** **equity** | **$253,600** |
|  |  |  |  |

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**Prob.** **1–5B** **(Concluded)**

**4.** **(Optional)**

|  |  |  |
| --- | --- | --- |
| **BEV'S** **DRY** **CLEANERS**  **Statement** **of** **Cash** **Flows**  **For** **the** **Month** **Ended** **Novemer** **30,** **2016** | | |
| **Cash** **flows** **from** **operating** **activities:** |  |  |
| **Cash** **received** **from** **customers\*** | **$115,000** |  |
| **Deduct** **cash** **payments** **for** **expenses** |  |  |
| **and** **payments** **to** **creditors\*\*** | **53,200** |  |
| **Net** **cash** **flows** **from** **operating** **activities** |  | **$** **61,800** |
| **Cash** **flows** **used** **for** **investing** **activities:** |  |  |
| **Purchase** **of** **land** |  | **(35,000)** |
| **Cash** **flows** **from** **financing** **activities:** |  |  |
| **Cash** **received** **as** **owner’s** **investment** | **$** **21,000** |  |
| **Deduct** **cash** **withdrawal** **by** **owner** | **5,000** |  |
| **Net** **cash** **flows** **from** **financing** **activities** |  | **16,000** |
| **Net** **increase** **in** **cash** **during** **November** |  | **$** **42,800** |
| **Cash** **balance,** **November** **1,** **2016** |  | **39,000** |
| **Cash** **balance,** **November** **30,** **2016** |  | **$** **81,800** |
|  |  |  |

**\*** **$38,000** **+** **$77,000;** **these** **amounts** **are** **taken** **from** **the** **cash** **column** **of** **the** **spreadsheet**

**in** **Part** **2.**

**\*\*** **$4,000** **+** **$20,000** **+** **$29,200;** **these** **amounts** **are** **taken** **from** **the** **cash** **column** **of** **the**

**spreadsheet** **in** **Part** **2.**

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**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,** **2016,** **$0;** **Atlas** **Realty** **was** **organized** **on** **May** **1,** **2016.**

**d.** **Investment** **on** **May** **1,** **2016,** **$160,000;** **from** **statement** **of** **cash** **flows.**

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

**f.** **$272,000** **($160,000** **+** **$112,000)**

**g.** **Withdrawals,** **$64,000;** **from** **statement** **of** **cash** **flows.**

**h.** **Increase** **in** **owner’s** **equity,** **$208,000** **($272,000** **–** **$64,000)**

**i.** **LuAnn** **Martin,** **capital,** **May** **31,** **2016,** **$208,000**

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

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

**l.** **LuAnn** **Martin,** **capital,** **$208,000**

**m.** **Total** **liabilities** **and** **owner’s** **equity,** **$256,000** **($48,000** **+** **$208,000)**

**n.** **Cash** **received** **from** **customers,** **$400,000;** **this** **is** **the** **same** **as** **fees** **earned**

**since** **there** **are** **no** **accounts** **receivable.**

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

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

**q.** **Net** **cash** **flows** **and** **May** **31,** **2016,** **cash** **balance,** **$123,200** **($147,200** **–** **$120,000**

**+** **$96,000);** **also,** **the** **cash** **balance** **on** **the** **balance** **sheet.**

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**CONTINUING** **PROBLEM**

**1.** **=** **+** **Owner’s** **Equity**

**Liabilities**

**Assets**

**Accts. Accts. Smith, Smith, Fees**

**Cash + Rec. + Supplies = Payable + Capital – Drawing + 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**

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**Continuing** **Problem** **(Continued)**

**Owner’s** **Equity** **(Continued)**

**Office Equip. Adver-**

**Music Rent Rent tising Wages Utilities Supplies Misc.**

**– Exp. – Exp. – Exp. – Exp. – 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** **–** **415**

**Bal.** **–** **590** **–** **800** **–** **675** **–** **500** **–** **400** **–** **300** **–** **180** **–** **415**

**June** **30** **–** **1,000**

**Bal.** **–** **1,590** **–** **800** **–** **675** **–** **500** **–** **400** **–** **300** **–** **180** **–** **415**

**June** **30**

**Bal.** **–** **1,590** **–** **800** **–** **675** **–** **500** **–** **400** **–** **300** **–** **180** **–** **415**

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**Continuing** **Problem** **(Concluded)**

**2.**

|  |  |  |
| --- | --- | --- |
| **PS** **MUSIC**  **Income** **Statement**  **For** **the** **Month** **Ended** **June** **30,** **2016** | | |
| **Fees** **earned:** |  | **$6,200** |
| **Expenses:** |  |  |
| **Music** **expense** | **$1,590** |  |
| **Office** **rent** **expense** | **800** |  |
| **Equipment** **rent** **expense** | **675** |  |
| **Advertising** **expense** | **500** |  |
| **Wages** **expense** | **400** |  |
| **Utilities** **expense** | **300** |  |
| **Supplies** **expense** | **180** |  |
| **Miscellaneous** **expense** | **415** |  |
| **Total** **expenses** |  | **4,860** |
| **Net** **income** |  | **$1,340** |
|  |  |  |

**3.**

|  |  |  |
| --- | --- | --- |
| **PS** **MUSIC**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Month** **Ended** **June** **30,** **2016** | | |
| **Peyton** **Smith,** **capital,** **June** **1,** **2016** |  | **$** **0** |
| **Investment** **on** **June** **1,** **2016** | **$4,000** |  |
| **Net** **income** **for** **June** | **1,340** |  |
|  | **$5,340** |  |
| **Less** **withdrawals** | **500** |  |
| **Increase** **in** **owner’s** **equity** |  | **4,840** |
| **Peyton** **Smith,** **capital,** **June** **30,** **2016** |  | **$4,840** |
|  |  |  |

**4.**

|  |  |  |  |
| --- | --- | --- | --- |
| **PS** **MUSIC**  **Balance** **Sheet**  **June** **30,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$3,920** | **Accounts** **payable** | **$** **250** |
| **Accounts** **receivable** | **1,000** |  |  |
| **Supplies** | **170** | **Owner’s** **Equity** | |
|  |  | **Peyton** **Smith,** **capital** | **4,840** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$5,090** | **owner’s** **equity** | **$5,090** |
|  |  |  |  |

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**CASES** **&** **PROJECTS**

**CP** **1–1**

**1.** **Acceptable** **professional** **conduct** **requires** **that** **Colleen** **Fernandez** **supply** **First**

**Federal** **Bank** **with** **all** **the** **relevant** **financial** **statements** **necessary** **for** **the** **bank**

**to** **make** **an** **informed** **decision.** **Therefore,** **Colleen** **should** **provide** **the** **complete**

**set** **of** **financial** **statements.** **These** **can** **be** **supplemented** **with** **a** **discussion** **of**

**the** **net** **loss** **in** **the** **past** **year** **or** **other** **data** **explaining** **why** **granting** **the** **loan** **is**

**a** **good** **investment** **for** **the** **bank.**

**2.** **a.** **Owners** **are** **generally** **willing** **to** **provide** **bankers** **with** **information** **about** **the**

**operating** **and** **financial** **condition** **of** **the** **business,** **such** **as** **the** **following:**

**●** **Operating** **Information:**

**●** **Description** **of** **business** **operations**

**●** **Results** **of** **past** **operations**

**●** **Preliminary** **results** **of** **current** **operations**

**●** **Plans** **for** **future** **operations**

**●** **Financial** **Condition:**

**●** **List** **of** **assets** **and** **liabilities** **(balance** **sheet)**

**●** **Estimated** **current** **values** **of** **assets**

**●** **Owner’s** **personal** **investment** **in** **the** **business**

**●** **Owner’s** **commitment** **to** **invest** **additional** **funds** **in** **the** **business**

**Owners** **are** **normally** **reluctant** **to** **provide** **the** **following** **types** **of** **information**

**to** **bankers:**

**●** ***Proprietary*** ***Operating*** ***Information.*** **Such** **information,** **which** **might** **hurt**

**the** **business** **if** **it** **becomes** **known** **by** **competitors,** **might** **include** **special**

**processes** **used** **by** **the** **business** **or** **future** **plans** **to** **expand** **operations**

**into** **areas** **that** **are** **not** **currently** **served** **by** **a** **competitor.**

**●** ***Personal*** ***Financial*** ***Information.*** **Owners** **may** **have** **little** **choice** **here**

**because** **banks** **often** **require** **owners** **of** **small** **businesses** **to** **pledge** **their**

**personal** **assets** **as** **security** **for** **a** **business** **loan.** **Personal** **financial**

**information** **requested** **by** **bankers** **often** **includes** **the** **owner’s** **net** **worth,**

**salary,** **and** **other** **income.** **In** **addition,** **bankers** **usually** **request**

**information** **about** **factors** **that** **might** **affect** **the** **personal** **financial**

**condition** **of** **the** **owner.** **For** **example,** **a** **pending** **divorce** **by** **the** **owner**

**might** **significantly** **affect** **the** **owner’s** **personal** **wealth.**

**b.** **Bankers** **typically** **want** **as** **much** **information** **as** **possible** **about** **the** **ability**

**of** **the** **business** **and** **the** **owner** **to** **repay** **the** **loan** **with** **interest.** **Examples** **of**

**such** **information** **are** **described** **above.**

**c.** **Both** **bankers** **and** **business** **owners** **share** **the** **common** **interest** **of** **the**

**business** **doing** **well** **and** **being** **successful.** **If** **the** **business** **is** **successful,**

**the** **bankers** **will** **receive** **their** **loan** **payments** **on** **time** **with** **interest,** **and** **the**

**owners** **will** **increase** **their** **personal** **wealth.**

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**CP** **1–2**

**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** **have** **to** **be** **considered** **in** **determining** **the** **net** **income**

**(profit)** **or** **net** **loss** **for** **the** **period.**

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**1.** **=** **+**

**Liabilities**

**CP** **1–3**

**Assets** **Owner’s** **Equity**

**Accts.**

**Lisa**

**Duncan,**

**Lisa**

**Duncan,**

**Fees**

**Salaries**

**Rent**

**Supplies**

**Misc.**

**Cash** **+** **=** **+** **–** **+** **–** **–** **–** **–** **Exp.**

**Supplies**

**Payable**

**Capital**

**Expense**

**Expense**

**Expense**

**Earned**

**Drawing**

**(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**

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**CP** **1–3** **(Continued)**

**2.**

|  |  |  |
| --- | --- | --- |
| **SERVE-N-VOLLEY**  **Income** **Statement**  **For** **the** **Month** **Ended** **September** **30,** **2016** | | |
| **Fees** **earned:** |  | **$3,650** |
| **Expenses:** |  |  |
| **Salaries** **expense** | **$800** |  |
| **Rent** **expense** | **525** |  |
| **Supplies** **expense** | **120** |  |
| **Miscellaneous** **expense** | **290** |  |
| **Total** **expenses** |  | **1,735** |
| **Net** **income** |  | **$1,915** |
|  |  |  |

**3.**

|  |  |  |
| --- | --- | --- |
| **SERVE-N-VOLLEY**  **Statement** **of** **Owner’s** **Equity**  **For** **the** **Month** **Ended** **September** **30,** **2016** | | |
| **Lisa** **Duncan,** **capital,** **September** **1,** **2016** |  | **$** **0** |
| **Investment** **on** **September** **1,** **2016** | **$** **950** |  |
| **Net** **income** **for** **September** | **1,915** |  |
|  | **$2,865** |  |
| **Less** **withdrawals** | **400** |  |
| **Increase** **in** **owner’s** **equity** |  | **2,465** |
| **Lisa** **Duncan,** **capital,** **September** **30,** **2016** |  | **$2,465** |
|  |  |  |

**4.**

|  |  |  |  |
| --- | --- | --- | --- |
| **SERVE-N-VOLLEY**  **Balance** **Sheet**  **September** **30,** **2016** | | | |
| **Assets** | | **Liabilities** | |
| **Cash** | **$2,435** | **Accounts** **payable** | **$** **150** |
| **Supplies** | **180** |  |  |
|  |  | **Owner’s** **Equity** | |
|  |  | **Lisa** **Duncan,** **capital** | **2,465** |
|  |  | **Total** **liabilities** **and** |  |
| **Total** **assets** | **$2,615** | **owner’s** **equity** | **$2,615** |
|  |  |  |  |

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**CP** **1–3** **(Concluded)**

**5.** **a.** **Serve-N-Volley** **would** **provide** **Lisa** **with** **$715** **more** **income** **per** **month** **than**

**working** **as** **a** **waitress.** **This** **amount** **is** **computed** **as** **follows:**

**Net** **income** **of** **Serve-N-Volley,** **per** **month…………………………………** **$1,915**

**Earnings** **as** **waitress,** **per** **month:**

**30** **hours** **per** **week** **×** **$10** **per** **hour** **×** **4** **weeks…………………………** **1,200**

**Difference…………………………………………………………………………** **$** **715**

**b.** **Other** **factors** **that** **Lisa** **should** **consider** **before** **discussing** **a** **long-term**

**arrangement** **with** **the** **Phoenix** **Tennis** **Club** **include** **the** **following:**

**LIsa** **should** **consider** **whether** **the** **results** **of** **operations** **for** **September** **are**

**indicative** **of** **what** **to** **expect** **each** **month.** **For** **example,** **Lisa** **should** **consider**

**whether** **club** **members** **will** **continue** **to** **request** **lessons** **or** **use** **the** **ball**

**machine** **during** **the** **fall** **months** **when** **interest** **in** **tennis** **may** **slacken.** **Lisa**

**should** **evaluate** **whether** **the** **additional** **income** **of** **$715** **per** **month** **from**

**Serve-N-Volley** **is** **worth** **the** **risk** **being** **taken** **and** **the** **effort** **being** **expended.**

**Lisa** **should** **also** **consider** **how** **much** **her** **investment** **in** **Serve-N-Volley**

**could** **have** **earned** **if** **invested** **elsewhere.** **For** **example,** **if** **the** **initial**

**investment** **of** **$950** **had** **been** **invested** **to** **earn** **a** **rate** **of** **return** **of** **6%**

**per** **year,** **it** **would** **have** **earned** **$4.75** **in** **September,** **or** **$57** **for** **the** **year.**

***Note*** ***to*** ***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,** **etc.),** **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.**

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**CP** **1–4**

***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** **Web** **sites** **provide** **students** **with** **useful** **information** **(such** **as** **starting**

**salaries,** **etc.)** **on** **careers** **in** **accounting:**

**American** **Institute** **of** **Certified** **Public** **Accountants** **(AICPA)**

**www.aicpa.org/becomeacpa/faqs/pages/faqs.aspx**

**Institute** **of** **Certified** **Management** **Accountants** **(IMA)**

**imanet.org/ima\_home.aspx**

**Institute** **of** **Internal** **Auditors** **(IIA)**

**www.theiia.org/theiia/about-the-profession/about-the-internal-audit-profession/**

**CP** **1–5**

**First** **Second** **Third**

**Year** **Year** **Year**

**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.**

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**CP** **1–6**

**As** **can** **be** **seen** **from** **the** **balance** **sheet** **data** **in** **the** **case,** **Enron** **was** **financed**

**largely** **by** **debt** **as** **compared** **to** **equity.** **Specifically,** **Enron’s** **stockholders’** **equity**

**represented** **only** **17.5%** **($11,470** **÷** **$65,503)** **of** **Enron’s** **total** **assets.** **The**

**remainder** **of** **Enron’s** **total** **assets,** **82.5%,** **was** **financed** **by** **debt.** **When** **a** **company**

**is** **financed** **largely** **by** **debt,** **it** **is** **said** **to** **be** **highly** **leveraged.**

**In** **late** **2001** **and** **early** **2002,** **allegations** **arose** **as** **to** **possible** **misstatements** **of**

**Enron’s** **financial** **statements.** **These** **allegations** **revolved** **around** **the** **use** **of** **“special**

**purpose** **entities”** **(partnerships)** **and** **related-party** **transactions.** **The** **use** **of** **special**

**purpose** **entities** **allowed** **Enron** **to** **hide** **a** **significant** **amount** **of** **additional** **debt** **off**

**its** **balance** **sheet.** **The** **result** **was** **that** **Enron’s** **total** **assets** **were** **even** **more** **financed**

**by** **debt** **than** **the** **balance** **sheet** **indicated.**

**After** **the** **allegations** **of** **misstatements** **became** **public,** **Enron’s** **stock** **rapidly**

**declined,** **and** **the** **company** **filed** **for** **bankruptcy.** **Subsequently,** **numerous** **lawsuits**

**were** **filed** **against** **the** **company** **and** **its** **management.** **In** **addition,** **the** **Securities**

**and** **Exchange** **Commission,** **the** **Justice** **Department,** **and** **Congress** **launched**

**investigations** **into** **Enron.** **As** **a** **result,** **several** **of** **Enron’s** **top** **executives** **faced**

**criminal** **prosecution** **and** **were** **sentenced** **to** **prison.**

***Note*** ***to*** ***Instructors:*** **The** **role** **of** **the** **auditors** **and** **board** **of** **directors** **of** **Enron** **also**

**might** **be** **discussed.** **Note,** **however,** **that** **these** **topics** **are** **not** **covered** **in** **Chapter** **1**

**but** **in** **later** **chapters.**

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