# General Comments for Chapter 1

## An Introduction to Accounting

The primary objective of this chapter is to teach students how business events affect financial statements. First, students learn the elements of financial statements: assets, liabilities, equity, common stock, retained earnings, revenue, expenses, and distributions. Next, students learn how the elements are interrelated, and finally, how those interrelationships are expressed in financial statements.

There are two distinct ways to introduce financial accounting using this text. One alternative (equation approach) is to show students how to record transaction data using the accounting equation and then to develop financial statements from the data organized in equation form. The second alternative (statements model approach) is first to introduce financial statements and then show students how to record events in a financial statements model. The text material for Chapter 1 uses the equation approach. Even so, many instructors using the text successfully employ the second approach. Indeed, we provide detailed lesson plans for both approaches.

## Detailed Outline of a Lesson Plan for Chapter 1

### (Equation Approach)

1. Distribute copies of Demonstration Problem 1-1.
2. Define assets. Use the simplest definition possible, words that students can understand. They will read the technical terminology in the text. For example:

Assets are things of value to a business. An asset’s value is its capacity to be used to earn other assets (money). For example, a lawyer uses supplies (assets) to obtain money (other assets) from clients.

Use the classroom to provide other specific examples. For example, the chairs, desks, and building the students are using are assets of the university because they are used to produce tuition dollars (other assets). Emphasize the point further by distinguishing between personal assets and business assets. Tom (one of the authors of the textbook) uses an old key chain his brother gave him over twenty years ago. While it has great value to Tom, it would have little value to a business because it could not be sold or otherwise used to produce other assets. If you saw this key chain you would truly understand its limitations as a business asset. You may not have an old key chain, but we’re sure you can think of something meaningful to you that has little usefulness as a business asset. You might use a framed photograph of a family member. Select examples that reflect your personality and interests. Students respond favorably to personalized examples.

1. Introduce the accounting equation.You can make a smooth transition from defining assets to introducing the accounting equation by noting that ***assets*** belong to some person or organization. The individual or institutional interests in the assets are called ***claims***. The ***accounting equation*** expresses the relationship between assets and claims as follows:

|  |  |  |
| --- | --- | --- |
| **Assets** | **=** | **Claims** |

1. Use the demonstration problem to introduce new terms and to elaborate on the interrelationships represented by the accounting equation. Individuals or institutions acquire claims by providing assets to a business. *There are three primary sources of assets*. The first three events of the demonstration problem illustrate the three sources. Discuss each event separately. Define the appropriate terms, and explain how the event affects the accounting equation.
2. Event No. 1:Use Event No. 1 to introduce and define ***common stock***. Explain that when a business acquires assets from owners, the assets of the business increase and the business establishes a corresponding ***claims account*** called ***common stock***. Introduce the accounting equation and the term ***equity***. Show students how to record the event under the accounting equation. Record common stock under the term equity. Leave room for retained earnings which will be illustrated in Event No. 3. Note that equity represents ownership interest in the business. As you lead in to Event No. 2, tell the students that creditors also have an interest in the assets of a business.
3. Event No. 2:Use this event to introduce ***liabilities***. Define liabilities as ***obligations of a business***. Note that Rustic Camp Sites (RCS) is obligated to return $5,000 of assets to creditors. Therefore, the creditors have a $5,000 claim on assets. Expand the accounting equation to include creditor interests.
4. Event No. 3:This event introduces the concept of ***revenue***. Define revenue as an ***increase in assets*** resulting from the operating activities of providing services or goods to customers.[[1]](#footnote-1) This definition defines revenue in terms of its relationship with assets. It is extremely important that students understand how the elements of financial statements articulate. You can achieve this goal by defining various elements in terms of their relationship to other elements. Expand the accounting equation to include retained earnings and record Event No. 3 under the equation.

Emphasize that the first three events represent the three sources of assets. Identify these events as ***asset source transactions*** and explain the basic nature of asset source transactions. Emphasize that thousands of different events can be classified into one of these three types of transactions. For example, businesses may increase their assets by providing consulting services, cleaning services, music lessons, investment advice, legal services, medical assistance, mechanical work, painting, and so on. Although these services represent distinctly different events, they can all be classified as asset source transactions. Emphasize that *it is* *easier to understand the three types of transactions* than *to memorize* the infinite number of specific transactions in which businesses engage.

The next two events represent ***asset use transactions***.

1. Event No. 4:This event introduces the concept of ***expenses***. Define expenses as ***decreases in*** assets that occur in the process of attempting to earn revenue.
2. Event No. 5:This event introduces ***dividends***. Clearly distinguish dividends from expenses. While both are asset use transactions, dividends represent ***a transfer of wealth*** rather than a sacrifice made to obtain revenue.
3. Have students record the events for the second accounting cycle in an accounting equation.Explain that the Year 1 ending balances become the Year 2 beginning balances. Illustrate the Year 2 accounting equation with beginning balances before the students attempt to record the year 2 events. Circulate through the room while your students attempt to record the Year 2 events. Help those who are having trouble getting started. Event No. 2 represents debt repayment. While some students will immediately recognize this event as the reverse of a borrowing event, many will view it as an independent transaction that is totally foreign to them. If you notice that many students are having trouble with the event, interrupt the students to provide a brief explanation to the class as a whole.

Invariably, you will find that some students work faster than others. Instruct the faster students to record the Year 3 events while you continue to help those who are having trouble with Year 2. Stop the class after the majority of students have recorded the Year 2 transactions. Assign the Year 3 events as homework for those students who are unable to finish them in class.

1. Time considerations.Introducing the accounting equation, including student participation with Year 2 data, requires approximately one hour.
2. Homework assignment. Problem 1-33 is similar to the demonstration problem. At this point, students should be able to complete *part a* of the requirements for this problem. *Parts b-e* require preparing and analyzing financial statements, which is discussed in the next section.
3. Introduce financial statements**.** Return to the Year 1 data for Demonstration Problem 1-1 and show students how the information recorded in the accounting equation is summarized in financial statements. Emphasize that financial statements are designed to provide information useful in decision-making. This is a good time to say a few words about the different types of accounting information. Explain how outsiders (e.g., investors and creditors) need different kinds of information than insiders (e.g., managers). For example, a person deciding whether to invest in Target versus Wal-Mart is interested in knowing which company generated more earnings. In contrast, a Wal-Mart vice-president needs information about specific stores and specific items in each store. Different branches of accounting have been established to satisfy the information needs of different users. Emphasize that financial accounting focuses on the information needs of investors and creditors. Make the discussion light and breezy. Students quickly get bored with this kind of general discussion.

Present the statements in this order: (1) income statement, (2) statement of changes in stockholders’ equity, (3) balance sheet, and (4) statement of cash flows. As you explain, point out the importance of this sequence. You need the amount of net income to prepare the statement of changes in stockholders’ equity. You need the amount of stockholders’ equity to prepare the balance sheet. Comments relevant to each statement follow:

1. Income Statement.Emphasize how the elements of the income statement are related to the elements of the balance sheet. Reiterate that revenue increases assets from providing services and expenses decrease assets in efforts to earn revenue. Teach students more than the formula for computing net income (Revenue - Expenses = Net Income). Help them understand that net income represents the change in wealth resulting from business operations during the accounting period. If you want your students to understand interrelationships, you must emphasize those relationships in your classroom discussions and your examinations.
2. Statement of Changes in Stockholders’ Equity.This statement provides the opportunity to emphasize the difference between expenses and dividends. Expenses affect the measurement of net income, after which a decision is made regarding how much of the income to distribute versus how much to retain in the business. Emphasize that net income is a **periodic measurement**, while retained earnings is a **cumulative amount**.
3. Balance Sheet.Explain that the balance sheet is a summary of the accounting equation. The statement lists assets and the corresponding claims on those assets. In this chapter, too few assets are illustrated to introduce the idea of presenting assets in accordance with liquidity. This subject is introduced later in the text. Explain that the statement represents a company’s financial condition at a **specific point in time**.
4. Statement of Cash Flows.Introduce the categories of the statement of cash flows in a sequence consistent with forming a business. First, a business must obtain ***financing***. Once a business has cash, it ***invests*** the cash. Finally, the business uses and generates cash through its ***operations***. Use the direct method. Prepare the statement by analyzing the cash account. Students should learn to identify cash transactions as operating, investing, or financing. Even so, many students find this task to be a real challenge. While mastery requires a significant level of reinforcement, be assured that your students will grasp this topic after working through several of the multicycle problems. Because the first chapter covers only cash transactions, the amount of cash flow from operating activities will equal the amount of net income. Therefore, we do not contrast these two amounts until Chapter 2. Instead, we emphasize that the statement of cash flows is more inclusive than the income statement. We point out that it reports investing and financing activities as well as operating activities.
5. Have students prepare financial statements for the Year 2 transactions. Again, spend your time walking around the room, observing, assisting, and encouraging. If you discover a general misunderstanding, stop the class and clarify the matter. Encourage your students with positive feedback as well as correction. If they are doing well, tell them so. A few words of encouragement go further than a flurry of criticism.
6. Introduce the horizontal financial statements modelto show your students how to record the effects (increase, decrease, no effect) of transactions on the statements. The effects of the Year 1 transactions from Demonstration Problem 1 are recorded below as an example.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Event No.** |  | **Balance Sheet** | | | | |  | **Income Statement** | | | | |  | **Statement of Cash Flow** |  |
|  |  |  | **Assets** | **=** | **Liab.** | **+** | **Equity** |  | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** |  |  |  |
|  | 1 |  | + |  | NA |  | + |  | NA |  | NA |  | NA |  | + FA |  |
|  | 2 |  | + |  | + |  | NA |  | NA |  | NA |  | NA |  | + FA |  |
|  | 3 |  | + |  | NA |  | + |  | + |  | NA |  | + |  | + OA |  |
|  | 4 |  | − |  | NA |  | − |  | NA |  | + |  | − |  | − OA |  |
|  | 5 |  | − |  | NA |  | − |  | NA |  | NA |  | NA |  | − FA |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Filling in the gaps.You will find additional terms and concepts covered in the text but not in the teaching notes. While we do not expect our students to read the text prior to coming to class, we do expect them to read it after we have introduced the material. In other words, we expect our students to read behind us. They are responsible for filling in the gaps. There is simply not enough time to cover every single point in class. Class is a place to get started. Try to cover the more important and conceptually complex points there. Hold your students responsible for a reasonable level of homework.
2. Enrichment.There is a section of materials at the end of each chapter (after exercises and problems) entitled “Analyze, Think, Communicate.” These materials include real-world cases, ethics cases, group exercises, internet assignments, communication exercises and Excel problems. Use some of these materials to facilitate skill development among your students. You will not have time to include all these materials. In Chapter 1, we urge you to consider including ATC Case 1-1. It is important for students to see some real-world statements early in the course. Students seem to be motivated by the fact that what they are learning has real-world relevance. The Target Corporation’s annual report, which is included in an Appendix in the back of the textbook, offers excellent opportunities to introduce real-world reporting practices.

## Detailed Outline of a Lesson Plan for Chapter 1

### (Statements Model Approach)

1. Use the problem-based learning case, “Ask Me Anything,” to introduce financial statements to students. (We describe problem-based learning in the introduction to this manual.)

Instructions: The case appears below. You can cut and paste the case into a separate Word Document or into PowerPoint. Display and/or distribute copies of the case to the class before providing any explanation of accounting. Ask students to read the case and individually develop answers.

#### Chapter 1 Problem-Based Learning Case: Accounting Questions

#### Ask Me Anything

***Assume that you are considering going in business with Linda Wilson. Assume that I am Linda’s accountant and that you can ask me three questions. Write down the three questions that you would ask.***

1. Create a collaborative experience where students share their questions.After allowing students time to develop their individual responses, put them into groups to reach consensus on their questions. For example, have students pair off with one another, share their questions, and reach consensus on three questions that represent the combined interest of the two people. Combine pairs of students into groups of four people and have each group of four choose the three questions that they would ask the accountant. Allow groups time to develop answers. Also have each group select a spokesperson.
2. Briefly introduce the basic financial statements.Explain that accountants communicate financial information to the public through a set of reports called financial statements. At this point introduce three of these statements: 1) the balance sheet, 2) the income statement, and 3) the statement of cash flows. Use a business cycle approach to introduce the statement of cash flows. Specifically, starting a business requires some cash (financing activities); the cash is used to buy operating assets (investing activities); and finally, the business runs on a day to day basis (operating activities).
3. Use student input to demonstrate the usefulness of financial statement information. Ask the group spokespersons to share the questions their group would like to have the accountant answer. Identify information that would appear in financial statements. For example, “How much money does Linda make?” would appear as revenue on the income statement. Draw a skeleton of an income statement on the board and show the students where revenue appears on that statement. You could use this question to expand the discussion into other areas. Ask, for example, “Is the amount of Linda’s salary equal to the amount of her take-home pay?” This question creates an opportunity to demonstrate the difference between the income statement and the statement of cash flows. A question like “Does she pay her bills on time?” affords the opportunity to explain that some information is not provided directly in the statements but is available through financial statement analysis. Some questions provide the opportunity to demonstrate the limitations of financial statement data. For example, answers to questions like “Is Linda an honest person?” cannot be found in the financial statements. However, this question invites you to point out the importance of ethical conduct by accountants.

We hope these examples demonstrate the need for the instructor to be flexible and creative in handling the student input. Expect a variety of questions. Also, be prepared to raise questions if the students do not ask about some of the things you want to discuss. Problem-based learning is designed to provide an opportunity for student discovery, not discovery on the part of the professor. The instructor should be prepared to address predetermined learning objectives. In this case, one objective is to introduce financial statements in a way that engages students. The case is designed to stimulate student interest and critical thinking. The primary learning objective, however, is for students to leave class able to name three financial statements and to describe the specific elements that appear in each statement. The instructor should guide the discussion toward the accomplishment of these objectives.

1. Distribute copies of Demonstration Problem 1-1. After establishing an understanding of financial statements, you can use this problem to show students how to record business events directly into a set of financial statements (*part b* of Demonstration Problem 1-1).
2. Create a financial statements model for Demonstration Problem 1-1*(part a)*. Either draw on the board or use an e-transparency to display a financial statements model for the students. Explain to the students that the statements model is a learning tool that doesn’t include many details (titles, dates, headings, etc.) that normally appear in formal financial statements. In lecture mode, analyze and record the transactions. Each transaction introduces a new financial statement element. Provide a clear explanation of each element, including the interrelationships between elements and their statements effects. For example, describe revenue as an economic benefit a company obtains by providing customers with goods and services. Revenue causes an increase in equity and a corresponding increase in assets. At this early point, you can limit the explanation of revenue to an increase in equity with a corresponding increase in assets. How does revenue differ from issuing stock which also results in an increase in assets? Obviously, revenue results from work performed by the company, while a successful stock issue results from convincing stockholders that the company can produce revenue. Point out the revenue appears on the income statement while a stock issue does not. Similarly, describe each element and show the students how the business events affect the financial statements.
3. Actively involve the students in learning**.** After explaining the Year 1 accounting transactions, show how this year’s ending balances become next year’s beginning balances. Record the ending balances in a statements model that applies to the Year 2 accounting cycle. Observe that the balance sheet accounts are carried forward from year to year while the income statement accounts are closed, resulting in zero beginning balances for all revenue and expense accounts. This is an excellent time to mention the closing process without getting into procedural detail. After students record the beginning balances in the statements model, require them to record the transactions for the Year 2 accounting cycle in the model. Walk around the room and provide assistance as needed. If you notice that a particular transaction is confusing a lot of students, stop the class and provide a brief explanation to the class as a whole. Instruct the faster students to move on to the Year 3 accounting cycle. Have those students who do not finish the third cycle in class complete *part a* of the problem as a homework assignment.
4. Introduce the accounting equation. You can now define assets by noting that they belong to some person or organization. The individual or institutional interests in those assets are called claims. Explain that the accounting equation can be represented, Assets = Claims, and that it is the logic underlying the balance sheet.
5. Assign homework. Problem 1-35 will give students practice in recording transactions in horizontal financial statements models and is an excellent review of Demonstration Problem 1-1.
6. Filling in the gaps. You will find additional terms and concepts covered in the text but not in the teaching notes. While we do not expect our students to read the text prior to coming to class, we do expect them to read it after we have introduced the material. In other words, we expect our students to read behind us. They are responsible for filling in the gaps. There is simply not enough time to cover every single point in class. Class is a place to get started. Try to cover the more important and conceptually complex points there. Hold your students responsible for a reasonable level of homework.
7. Enrichment. There is a section of materials at the end of each chapter (after exercises and problems) entitled “Analyze, Think, Communicate.” These materials include real-world cases, ethics cases, group exercises, internet assignments, communication exercises and Excel problems. Use some of these materials to facilitate skill development among your students. You will not have time to include all these materials. In Chapter 1, we urge you to consider including ATC Case 1-1. It is important for students to see some real-world statements early in the course. Students seem to be motivated by the fact that what they are learning has real-world relevance. The Target Corporation’s annual report, which is included in an Appendix in the back of the textbook, offers excellent opportunities to introduce real-world reporting practices.

## Demonstration Problem for Chapter 1

### Demonstration Problem 1-1: The Accounting Cycle

The events below apply to the Video Services Company (VSC). Assume that all transactions involve receiving or paying cash.

Transactions for the year Year 1:

1. The company was started when it acquired $9,000 cash by issuing common stock.
2. The company borrowed $5,000 from creditors.
3. The company provided services to customers and received $4,000.
4. The company paid expenses of $2,900.
5. The company paid $500 in dividends to its stockholders.

Transactions for the year Year 2:

1. The company issued additional common stock for $4,500.
2. The company paid $2,000 to reduce its liabilities to creditors.
3. The company provided services to customers and received $6,700.
4. The company paid expenses of $4,300.
5. The company paid $700 in dividends to its stockholders.

Transactions for the year Year 3:

1. The company issued additional common stock for $2,500.
2. The company borrowed $1,000 from creditors.
3. The company provided services to customers and received $7,400.
4. The company paid expenses of $7,900.
5. The company paid $300 in dividends to its stockholders.
6. The company paid $9,000 to purchase land.

Required:For each year,

1. Record the events under an accounting equation.
2. Prepare an income statement, statement of changes in stockholders’ equity, balance sheet and statement of cash flows.

## SOLUTIONS TO DEMONSTRATION PROBLEM

The solutions for the equation approach are shown first, followed by the solutions for the statements model approach.

We HIGHLY recommend that you try to display the solutions to the class using the e-transparency option described in the introduction to this manual. The electronic Word files are available in Connect®. You may want to cut and paste the solution to a separate Word document to facilitate ease of display. Because these are Word files, you can add or delete material as you desire. Remember to put additional material in Word tables. Note that text material can be placed in a single cell table with the cell stretching from margin to margin. You can then hide or display data in each cell of the table using the key strokes described in the introduction to this manual.

### Demonstration Problem 1-1: Solution, part a. Equation Approach

### Effect of Events on the Accounting Equation

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **For Year Year 1** |  |  |  |  | **Equity** | | |
| **Events** | **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **Beginning Balances** | **$ 0** | **=** | **$ 0** | **+** | **$ 0** | **+** | **$ 0** |
| **1. Effect of Stock Issue** | **9,000** |  |  |  | **9,000** |  |  |
| **2. Effect of Borrowing** | **5,000** |  | **5,000** |  |  |  |  |
| **3. Effect of Revenue** | **4,000** |  |  |  |  |  | **4,000** |
| **4. Effect of Expense** | **(2,900)** |  |  |  |  |  | **(2,900)** |
| **5. Effect of Dividends** | **(500)** |  |  |  |  |  | **(500)** |
|  | **−−−−−** |  | **−−−−−** |  | **−−−−−** |  | **−−−−−** |
| **Ending Balances** | **$14,600** | **=** | **$5,000** | **+** | **$9,000** | **+** | **$ 600** |
|  | **=====** |  | **═════** |  | **═════** |  | **═════** |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **For Year Year 2** |  |  |  |  | **Equity** | | |
| **Events** | **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **Beginning Balances** | **$14,600** | **=** | **$5,000** | **+** | **$ 9,000** | **+** | **$ 600** |
| **1. Effect of Stock Issue** | **4,500** |  |  |  | **4,500** |  |  |
| **2. Effect of Debt Repay.** | **(2,000)** |  | **(2,000)** |  |  |  |  |
| **3. Effect of Revenue** | **6,700** |  |  |  |  |  | **6,700** |
| **4. Effect of Expense** | **(4,300)** |  |  |  |  |  | **(4,300)** |
| **5. Effect of Dividends** | **(700)** |  |  |  |  |  | **(700)** |
|  | **−−−−−** |  | **−−−−−** |  | **−−−−−** |  | **−−−−−** |
| **Ending Balances** | **$18,800** | **=** | **$3,000** | **+** | **$13,500** | **+** | **$ 2,300** |
|  | **═════** |  | **═════** |  | **═════** |  | **═════** |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **For Year Year 3** | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |
| **Events** | **Cash** | **+** | **Land** | **=** | **Liab.** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **Beginning Balances** | **$18,800** |  |  |  | **$3,000** | **+** | **$13,500** | **+** | **$ 2,300** |
| **1. Effect of Stock Issue** | **2,500** |  |  |  |  |  | **2,500** |  |  |
| **2. Effect of Borrowing** | **1,000** |  |  |  | **1,000** |  |  |  |  |
| **3. Effect of Revenue** | **7,400** |  |  |  |  |  |  |  | **7,400** |
| **4. Effect of Expense** | **(7,900)** |  |  |  |  |  |  |  | **(7,900)** |
| **5. Effect of Dividends** | **(300)** |  |  |  |  |  |  |  | **(300)** |
| **6. Effect of Land Purch.** | **(9,000)** |  | **$9,000** |  |  |  |  |  |  |
|  | **−−−−−** |  | **−−−−** |  | **−−−−** |  | **−−−−−** |  | **−−−−−** |
| **Ending Balances** | **$12,500** | **+** | **$9,000** | **=** | **$4,000** | **+** | **$16,000** | **+** | **$1,500** |
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### Demonstration Problem 1-1: Solution, part b. Financial Statements

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Video Services Company** | | | | | | | |
| **Income Statements** | | | | | | | |
| **For the Years Ended December 31,** |  | **Year 1** |  | **Year 2** |  | **Year 3** |  |
| **Services Revenue** |  | **$4,000** |  | **$6,700** |  | **$7,400** |  |
| **Expenses** |  | **(2,900)** |  | **(4,300)** |  | **(7,900)** |  |
| **Net Income (Loss)** |  | **$1,100** |  | **$2,400** |  | **$( 500)** |  |
|  |  |  |  |  |  |  |  |
| **Statements of Changes in Stockholders’ Equity** | | | | | | | |
| **Beginning Common Stock** |  | **$ 0** |  | **$ 9,000** |  | **$13,500** |  |
| **Plus: Common Stock Issued** |  | **9,000** |  | **4,500** |  | **2,500** |  |
| **Ending Common Stock** |  | **$9,000** |  | **$13,500** |  | **$16,000** |  |
| **Beginning Retained Earnings** |  | **$ 0** |  | **$ 600** |  | **$ 2,300** |  |
| **Net Income (Loss)** |  | **1,100** |  | **2,400** |  | **(500)** |  |
| **Dividends** |  | **(500)** |  | **(700)** |  | **(300)** |  |
| **Ending Retained Earnings** |  | **$ 600** |  | **$ 2,300** |  | **$ 1,500** |  |
| **Total Stockholders’ Equity** |  | **$9,600** |  | **$15,800** |  | **$17,500** |  |
|  |  |  |  |  |  |  |  |
| **Balance Sheets at December 31** | | | | | | | |
| **Assets** |  |  |  |  |  |  |  |
| **Cash** |  | **$14,600** |  | **$18,800** |  | **$12,500** |  |
| **Land** |  |  |  |  |  | **9,000** |  |
| **Total Assets** |  | **$14,600** |  | **$18,800** |  | **$21,500** |  |
|  |  |  |  |  |  |  |  |
| **Liabilities** |  | **$ 5,000** |  | **$ 3,000** |  | **$ 4,000** |  |
|  |  |  |  |  |  |  |  |
| **Stockholders’ Equity** |  |  |  |  |  |  |  |
| **Common Stock** |  | **$ 9,000** |  | **$13,500** |  | **$16,000** |  |
| **Retained Earnings** |  | **600** |  | **2,300** |  | **1,500** |  |
| **Total Stockholders’ Equity** |  | **$ 9,600** |  | **$15,800** |  | **$17,500** |  |
| **Total Liabilities and Stockholders’ Equity** |  | **$14,600** |  | **$18,800** |  | **$21,500** |  |
|  |  |  |  |  |  |  |  |
| **Statements of Cash Flows** | | | | | | | |
| **Cash Flows from Operating Activities** |  |  |  |  |  |  |  |
| **Cash Inflows from Revenue** |  | **$ 4,000** |  | **$ 6,700** |  | **$ 7,400** |  |
| **Cash Outflows for Expenses** |  | **(2,900)** |  | **(4,300)** |  | **(7,900)** |  |
| **Net Cash Flow from Operating Activities** |  | **$ 1,100** |  | **$ 2,400** |  | **$ (500)** |  |
|  |  |  |  |  |  |  |  |
| **Cash Flow from Investing Activities** |  |  |  |  |  |  |  |
| **Cash Outflow for Land** |  |  |  |  |  | **$(9,000)** |  |
|  |  |  |  |  |  |  |  |
| **Cash Flows from Financing Activities** |  |  |  |  |  |  |  |
| **Cash Inflows from Borrowed Funds** |  | **$ 5,000** |  |  |  | **$ 1,000** |  |
| **Cash Outflows to Reduce Debt** |  |  |  | **$(2,000)** |  |  |  |
| **Cash Inflows from Stock Issues** |  | **9,000** |  | **4,500** |  | **2,500** |  |
| **Cash Outflows for Dividends** |  | **(500)** |  | **(700)** |  | **(300)** |  |
| **Net Cash Flows from Financing Activities** |  | **$13,500** |  | **$ 1,800** |  | **$ 3,200** |  |
|  |  |  |  |  |  |  |  |
| **Net Change in Cash** |  | **$14,600** |  | **$ 4,200** |  | **$ (6,300)** |  |
| **Beginning Cash Balance** |  | **0** |  | **14,600** |  | **18,800** |  |
| **Ending Cash Balance** |  | **$14,600** |  | **$18,800** |  | **$12,500** |  |
|  |  |  |  |  |  |  |  |

### Demonstration Problem 1-1: Solution, part a.

### Statements Model Approach

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Year 1** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***Liab.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Ear.*** |  |  |  |  |  |  |  |  |  |
| **Beg. Bal.** |  |  | **+** |  | **=** |  | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  |  |  |
| **1** |  | **9,000** | **+** |  | **=** |  | **+** | **9,000** | **+** |  |  |  | **–** |  | **=** |  |  | **9,000 FA** |  |
| **2** |  | **5,000** | **+** |  | **=** | **5,000** | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  | **5,000 FA** |  |
| **3** |  | **4,000** | **+** |  | **=** |  | **+** |  | **+** | **4,000** |  | **4,000** | **–** |  | **=** | **4,000** |  | **4,000 OA** |  |
| **4** |  | **(2,900)** | **+** |  | **=** |  | **+** |  | **+** | **(2,900)** |  |  | **–** | **2,900** | **=** | **(2,900)** |  | **(2,900) OA** |  |
| **5** |  | **(500)** | **+** |  | **=** |  | **+** |  | **+** | **(500)** |  |  | **–** |  | **=** |  |  | **(500) FA** |  |
| **Totals** |  | **14,600** | **+** |  | **=** | **5,000** | **+** | **9,000** | **+** | **600** |  | **4,000** | **–** | **2,900** | **=** | **1,100** |  | **14,600 NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Year 2** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***Liab.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Ear.*** |  |  |  |  |  |  |  |  |  |
| **Beg. Bal.** |  | **14,600** | **+** |  | **=** | **5,000** | **+** | **9,000** | **+** | **600** |  |  | **–** |  | **=** |  |  |  |  |
| **1** |  | **4,500** | **+** |  | **=** |  | **+** | **4,500** | **+** |  |  |  | **–** |  | **=** |  |  | **4,500 FA** |  |
| **2** |  | **(2,000)** | **+** |  | **=** | **(2,000)** | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  | **(2,000) FA** |  |
| **3** |  | **6,700** | **+** |  | **=** |  | **+** |  | **+** | **6,700** |  | **6,700** | **–** |  | **=** | **6,700** |  | **6,700 OA** |  |
| **4** |  | **(4,300)** | **+** |  | **=** |  | **+** |  | **+** | **(4,300)** |  |  | **–** | **4,300** | **=** | **(4,300)** |  | **(4,300) OA** |  |
| **5** |  | **(700)** | **+** |  | **=** |  | **+** |  | **+** | **(700)** |  |  | **–** |  | **=** |  |  | **(700) FA** |  |
| **Totals** |  | **18,800** | **+** |  | **=** | **3,000** | **+** | **13,500** | **+** | **2,300** |  | **6,700** | **–** | **4,300** | **=** | **2,400** |  | **4,200 NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Year 3** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***Liab.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Ear.*** |  |  |  |  |  |  |  |  |  |
| **Beg. Bal.** |  | **18,800** | **+** |  | **=** | **3,000** | **+** | **13,500** | **+** | **2,300** |  |  | **–** |  | **=** |  |  |  |  |
| **1** |  | **2,500** | **+** |  | **=** |  | **+** | **2,500** | **+** |  |  |  | **–** |  | **=** |  |  | **2,500 FA** |  |
| **2** |  | **1,000** | **+** |  | **=** | **1,000** | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  | **1,000 FA** |  |
| **3** |  | **7,400** | **+** |  | **+** |  | **+** |  | **+** | **7,400** |  | **7,400** | **–** |  | **=** | **7,400** |  | **7,400 OA** |  |
| **4** |  | **(7,900)** | **+** |  | **+** |  | **+** |  | **+** | **(7,900)** |  |  | **–** | **(7,900)** | **=** | **(7,900)** |  | **(7,900) OA** |  |
| **5** |  | **(300)** | **+** |  | **+** |  | **+** |  | **+** | **(300)** |  |  | **–** |  | **=** |  |  | **(300) FA** |  |
| **6** |  | **(9,000)** | **+** | **9,000** | **+** |  | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  | **(9,000) IA** |  |
| **Totals** |  | **12,500** | **+** | **9,000** | **+** | **4,000** | **+** | **16,000** | **+** | **1,500** |  | **7,400** | **–** | **7,900** | **=** | **(500)** |  | **(6,300) NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

## WORK PAPERS FOR

## DEMONSTRATION PROBLEM

The work papers are designed for student use. You may copy them and distribute the hard copies to your students. However, a more efficient way to distribute them is to cut and paste them into a separate

Word document and then make that document available to students on your university website. The students can download the files and print out the contents. Again, the original Word files are available in Connect®.

### Demonstration Problem 1-1: Work Paper, part a. Equation Approach

### Effect of Events on the Accounting Equation

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **For Year 1** |  |  |  |  | **Equity** | | |
| **Events** | **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **Beginning Balances** | **$ 0** | **=** | **$ 0** | **+** | **$ 0** | **+** | **$ 0** |
| **1. Effect of Stock Issue** |  |  |  |  |  |  |  |
| **2. Effect of Borrowing** |  |  |  |  |  |  |  |
| **3. Effect of Revenue** |  |  |  |  |  |  |  |
| **4. Effect of Expense** |  |  |  |  |  |  |  |
| **5. Effect of Dividends** |  |  |  |  |  |  |  |
|  | **−−−−−** |  | **−−−−−** |  | **−−−−−** |  | **−−−−−** |
| **Ending Balances** | **$14,600** | **=** | **$5,000** | **+** | **$9,000** | **+** | **$ 600** |
|  | **═════** |  | **═════** |  | **═════** |  | **═════** |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **For Year 2** |  |  |  |  | **Equity** | | |
| **Events** | **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **Beginning Balances** |  | **=** |  | **+** |  | **+** |  |
| **1. Effect of Stock Issue** |  |  |  |  |  |  |  |
| **2. Effect of Debt Repay.** |  |  |  |  |  |  |  |
| **3. Effect of Revenue** |  |  |  |  |  |  |  |
| **4. Effect of Expense** |  |  |  |  |  |  |  |
| **5. Effect of Dividends** |  |  |  |  |  |  |  |
|  | **−−−−−** |  | **−−−−−** |  | **−−−−−** |  | **−−−−−** |
| **Ending Balances** | **$18,800** | **=** | **$3,000** | **+** | **$13,500** | **+** | **$ 2,300** |
|  | **═════** |  | **═════** |  | **═════** |  | **═════** |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **For Year 3** | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |
| **Events** | **Cash** | **+** | **Land** | **=** | **Liab.** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **Beginning Balances** |  |  |  |  |  | **+** |  | **+** |  |
| **1. Effect of Stock Issue** |  |  |  |  |  |  |  |  |  |
| **2. Effect of Borrowing** |  |  |  |  |  |  |  |  |  |
| **3. Effect of Revenue** |  |  |  |  |  |  |  |  |  |
| **4. Effect of Expense** |  |  |  |  |  |  |  |  |  |
| **5. Effect of Dividends** |  |  |  |  |  |  |  |  |  |
| **6. Effect of Land Purch.** |  |  |  |  |  |  |  |  |  |
|  | **−−−−−** |  | **−−−−** |  | **−−−−** |  | **−−−−−** |  | **−−−−−** |
| **Ending Balances** | **$12,500** | **+** | **$9,000** | **=** | **$4,000** | **+** | **$16,000** | **+** | **$1,500** |
|  | **═════** |  | **════** |  | **════** |  | **═════** |  | **═════** |

### Demonstration Problem 1-1: Work Paper, part b. Financial Statements

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Video Services Company** | | | | | | | | | | | | |
|  |  | |  | |  | |  | |  | |  | |
| **Income Statements** | | | | | | | | | | | | |
| **For the Years Ended December 31,** |  | **Year 1** | |  | | **Year 2** | |  | | **Year 3** | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Services Revenue** |  |  | |  | |  | |  | |  | |  |
| **Expenses** |  |  | |  | |  | |  | |  | |  |
| **Net Income (Loss)** |  | **$1,100** | |  | | **$2,400** | |  | | **$( 500)** | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Statements of Changes in Stockholders’ Equity** | | | | | | | | | | | | |
| **Beginning Common Stock** |  | **$ 0** | |  | | **$ 9,000** | |  | | **$13,500** | |  |
| **Plus: Common Stock Issued** |  |  | |  | |  | |  | |  | |  |
| **Ending Common Stock** |  |  | |  | |  | |  | |  | |  |
| **Beginning Retained Earnings** |  |  | |  | |  | |  | |  | |  |
| **Net Income (Loss)** |  |  | |  | |  | |  | |  | |  |
| **Dividends** |  |  | |  | |  | |  | |  | |  |
| **Ending Retained Earnings** |  |  | |  | |  | |  | |  | |  |
| **Total Stockholders’ Equity** |  | **$9,600** | |  | | **$15,800** | |  | | **$17,500** | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Balance Sheets at December 31** | | | | | | | | | | | | |
| **Assets** |  |  | |  | |  | |  | |  | |  |
| **Cash** |  |  | |  | |  | |  | |  | |  |
| **Land** |  |  | |  | |  | |  | |  | |  |
| **Total Assets** |  | **$14,600** | |  | | **$18,800** | |  | | **$21,500** | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Liabilities** |  |  | |  | |  | |  | |  | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Stockholders’ Equity** |  |  | |  | |  | |  | |  | |  |
| **Common Stock** |  |  | |  | |  | |  | |  | |  |
| **Retained Earnings** |  |  | |  | |  | |  | |  | |  |
| **Total Stockholders’ Equity** |  |  | |  | |  | |  | |  | |  |
| **Total Liabilities and Stockholders’ Equity** |  | **$14,600** | |  | | **$18,800** | |  | | **$21,500** | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Statements of Cash Flows** | | | | | | | | | | | | |
| **Cash Flows from Operating Activities** |  |  | |  | |  | |  | |  | |  |
| **Cash Inflows from Revenue** |  | **$ 4,000** | |  | | **$ 6,700** | |  | | **$ 7,400** | |  |
| **Cash Outflows for Expenses** |  |  | |  | |  | |  | |  | |  |
| **Net Cash Flow from Operating Activities** |  |  | |  | |  | |  | |  | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Cash Flow from Investing Activities** |  |  | |  | |  | |  | |  | |  |
| **Cash Outflows for Land** |  |  | |  | |  | |  | |  | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Cash Flows from Financing Activities** |  |  | |  | |  | |  | |  | |  |
| **Cash Inflows from Borrowed Funds** |  |  | |  | |  | |  | |  | |  |
| **Cash Outflows to Reduce Debt** |  |  | |  | |  | |  | |  | |  |
| **Cash Inflows from Stock Issues** |  |  | |  | |  | |  | |  | |  |
| **Cash Outflows for Dividends** |  |  | |  | |  | |  | |  | |  |
| **Net Cash Flows from Financing Activities** |  |  | |  | |  | |  | |  | |  |
|  |  |  | |  | |  | |  | |  | |  |
| **Net Change in Cash** |  | **$14,600** | |  | | **$ 4,200** | |  | | **$(6,300)** | |  |
| **Beginning Cash Balance** |  |  | |  | |  | |  | |  | |  |
| **Ending Cash Balance** |  |  | |  | |  | |  | |  | |  |
|  |  |  | |  | |  | |  | |  | |  |

### Demonstration Problem 1-1: Work Paper, part a.

### Statements Model Approach

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Year 1** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***Liab.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Ear.*** |  |  |  |  |  |  |  |  |  |
| **Beg. Bal.** |  |  | **+** |  | **=** |  | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  |  |  |
| **1** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **2** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **3** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **4** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **5** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Totals** |  | **14,600** | **+** |  | **=** | **5,000** | **+** | **9,000** | **+** | **600** |  | **4,000** | **–** | **2,900** | **=** | **1,100** |  | **14,600 NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Year2** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***Liab.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Ear.*** |  |  |  |  |  |  |  |  |  |
| **Beg. Bal.** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **1** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **2** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **3** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **4** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **5** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Totals** |  | **18,800** | **+** |  | **=** | **3,000** | **+** | **13,500** | **+** | **2,300** |  | **6,700** | **–** | **4,300** | **=** | **2,400** |  | **4,200 NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Year 3** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***Liab.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Ear.*** |  |  |  |  |  |  |  |  |  |
| **Beg. Bal.** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **1** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **2** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **3** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **4** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **5** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **6** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Totals** |  | **12,500** | **+** | **9,000** | **+** | **4,000** | **+** | **16,000** | **+** | **1,500** |  | **7,400** | **–** | **7,900** | **=** | **(500)** |  | **(6,300) NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

## Quiz Questions for Chapter 1

The following information pertains to the next four questions. At the beginning of Year 2, X Company had assets of $300, liabilities of $150, and common stock of $50. During Year 2 the company earned revenue of $400, incurred expenses of $250, and paid dividends of $100. All transactions were cash transactions.

1. What is the amount of retained earnings at the beginning of Year 2?
2. $ 50.
3. $100.
4. $150.
5. none of the above.
6. The amount of net income reported on the Year 2 income statement would be
7. $400.
8. $150.
9. $ 50.
10. none of the above.
11. The amount of retained earnings reported on the December 31, Year 2 balance sheet would be
12. $100.
13. $250.
14. $650.
15. none of the above.
16. The amount of total assets reported on the December 31, Year 2 balance sheet would be
17. $350.
18. $300.
19. $450.
20. $ 50.
21. Z Company borrowed $500 cash from the National Bank. As a result of this transaction, Z Company’s
22. assets would increase by $500.
23. liabilities would decrease by $500.
24. equity would increase by $500.
25. revenue would decrease by $500.

The following information pertains to the next two questions. XYZ Company borrowed $800 from the State Bank and used $500 of this money to purchase land.

1. As a result of these transactions, XYZ's total assets would increase by
2. $1,300.
3. $ 800.
4. $ 500.
5. $ 300.
6. The statement of cash flows for XYZ Company would report
7. an inflow of $500 from financing activities.
8. an outflow of $800 for investing activities.
9. an inflow of $800 from financing activities.
10. an outflow of $500 for operating activities.
11. Select the correct statement from the choices listed below.
12. Revenue is a decrease in assets resulting from operating activities.
13. Dividends are decreases in assets incurred for the purpose of producing revenue.
14. A company incurs expenses when it borrows money.
15. Net income is an increase in equity resulting primarily from operating activities.
16. If revenue exceeds expenses, there are no dividends, and total liabilities remain unchanged, then
17. Equity will increase.
18. Retained earnings will decrease.
19. Total assets will increase.
20. Both a and c.

The following information pertains to the next two questions. Person A paid $10,000 cash to buy land from Person B.

1. Select the statement that is true.
2. Total liabilities of Person B would increase.
3. Total assets of Person A would be unaffected.
4. Person A's equity would increase.
5. None of the above.
6. Select the statement that is true.
7. Person A would have a cash outflow from investing activities.
8. Person B would have a cash inflow from investing activities.
9. The balance in the cash account on Person A's books would decrease, while the balance in the cash account on Person B’s books would increase.
10. All of the above statements are true.
11. Revenue is less than expenses. If liabilities and common stock were unchanged, then
12. a. cash flows from operating activities were greater than cash flows from investing activities.
13. b. total assets decreased.
14. c. retained earnings were less than net income during the period.
15. d. the company must have purchased assets with cash.
16. Among other items, the balance sheet of XYZ Company reports retained earnings of $50,000 and total liabilities of $40,000. Based on this information alone, you would know that
17. since the company’s inception, the total amount of net income exceeded total dividends by at least $50,000.
18. XYZ Company has enough cash to pay off its liabilities.
19. stockholders’ equity of the company amounted to $10,000.
20. total assets amounted to $90,000.
21. The Southern Company began the accounting period with assets of $600, common stock of $200, and retained earnings of $250. During the period, revenue was $300, expenses were $200, and dividends were $50. Common stock was unchanged during the accounting period. Liabilities decreased by $100. Based on this information,
22. net income amounted to $50.
23. total assets at the end of the period were $550.
24. retained earnings at the end of the period amounted to $350.
25. liabilities at the end of the period amounted to $100.
26. Which of the following illustrates how a cash dividend affects a company’s financial statements?

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Balance Sheet** | | | | |  | **Income Statement** | | | | |  | **Statement of** |  |
|  |  | **Assets** | **=** | **Liab.** | **+** | **Equity** |  | **Rev.** | **−** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| a. |  | + |  | n/a |  | + |  | n/a |  | n/a |  | n/a |  | + FA |  |
| b. |  | + |  | n/a |  | + |  | + |  | n/a |  | + |  | + OA |  |
| c. |  | − |  | n/a |  | − |  | n/a |  | + |  | − |  | − OA |  |
| d. |  | − |  | n/a |  | − |  | n/a |  | n/a |  | n/a |  | − FA |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

### Solutions to Quiz Questions

|  |  |
| --- | --- |
| Question | Answer |
| 1 | B |
| 2 | B |
| 3 | D |
| 4 | A |
| 5 | A |
| 6 | B |
| 7 | C |
| 8 | D |
| 9 | D |
| 10 | B |
| 11 | D |
| 12 | B |
| 13 | A |
| 14 | B |
| 15 | D |

## Summary Outline of a Lesson Plan for Chapter 1

### (Equation Approach)

1. Distribute copies of Demonstration Problem 1-1.
2. Define assets.*Assets* are things of value to a business. The value is the capacity of the asset to be used in the production of greater quantities of other assets.
3. Introduce the accounting equation.
4. Use the demonstration problem to introduce new terms and to elaborate on the interrelationships represented by the accounting equation. *There are three primary sources of assets*.
5. Event No. 1 introduces common stock (owner interest).
6. Event No. 2 introduces liabilities (creditor interest).
7. Event No. 3 introduces revenue (increase in assets from earnings activities).

***There are two asset use transactions.***

1. Event No. 4 introduces expenses (decreases in assets from earnings activities).
2. Event No. 5 introduces dividends (wealth transfer).
3. Have students record the events for the second accounting cycle in an accounting equation.
4. Time considerations.Introducing the accounting equation, including student participation with Year 2 data, requires approximately one hour.
5. Homework assignments**.** Problem 1-33A is similar to the demonstration problem.
6. Introduce financial statements.
7. Income Statement. Because revenues increase and expenses decrease assets, net income represents the ***change in wealth*** resulting from business operations ***during the accounting period***.
8. Statement of Changes in Stockholders’ Equity.Distinguish between expenses and dividends.
9. Balance Sheet.This statement summarizes the accounting equation.
10. Statement of Cash Flows. Use the direct method; analyze the cash account.
11. Have students prepare financial statements for the Year 2 transactions.
12. Introduce the horizontal financial statements model.
13. Filling in the gaps.Remind studentsthey must read the text to fill in the gaps.
14. Enrichment. If time permits, have students complete ATC Case 1-1 (financial statement analysis).

## Summary Outline of a Lesson Plan for Chapter 1

### (Statements Model Approach)

1. Use the problem-based learning case, “Ask Me Anything,” to introduce financial statements to students.
2. Create a collaborative experience where students reach consensus on their questions. Have each group select a spokesperson.
3. Briefly introduce the basic financial statements. Introduce: 1) the balance sheet, 2) the income statement, and 3) the statement of cash flows.
4. Use student input to demonstrate the usefulness of financial statement information. Ask the group spokespersons to share the questions their group would like to have the accountant answer. Identify information that would or would not appear in financial statements. Students should learn to name three financial statements and to describe the specific elements that appear in each statement.
5. Distribute copies of Demonstration Problem 1-1. Show students how to record business events directly into a set of financial statements (*part b*).
6. Create a financial statements model for Demonstration Problem 1-1 *(part a)*. Present and explain a financial statements model for the students. Analyze and record the transactions.
7. Actively involve the students in learning. After explaining the Year 1 accounting transactions, show how this year’s ending balances become next year’s beginning balances. Require the students to record the transactions for the Year 2 accounting cycle in the model. Assist as needed. Instruct the faster students to record Year 3 transactions. Have those students who do not finish the third cycle in class complete *part a* of the problem as a homework assignment.
8. Introduce the accounting equation. Explain that the accounting equation can be represented, Assets = Claims, and that it is the logic underlying the balance sheet.
9. Assign homework. Problem 1-35A will give students practice in recording transactions in horizontal financial statements models.
10. Filling in the gaps. Remind students that they are responsible for reading the textbook to fill in the gaps because not all information can be presented in class.
11. Enrichment. If time permits, have students complete ATC Case 1-1 (financial statements in the real world - Target Corporation).

1. Revenues can also result from activities that decrease liabilities. Revenue recognition within this context requires an understanding of deferrals. Deferrals are introduced in Chapter 2. Within the context of cash basis accounting, which is the underlying assumption for Chapter 1, revenue can be defined simply as an increase in assets from providing services and expenses as decreases in assets from revenue-producing activities. These definitions will be expanded as accrual accounting topics are gradually introduced. [↑](#footnote-ref-1)