Chapter 1

Accounting in Business

QUESTIONS

1. **The purpose of accounting is to provide decision makers with relevant and reliable information to help them make better decisions. Examples include information for people making investments, loans, and business plans.**
2. **Technology reduces the time, effort, and cost of recordkeeping. There is still a demand for people who can design accounting systems, supervise their operation, analyze complex transactions, and interpret reports. Demand also exists for people who can effectively use computers to prepare and analyze accounting reports. Technology will never substitute for qualified people with abilities to prepare, use, analyze, and interpret accounting information.**
3. **External users and their uses of accounting information include: (a) lenders, to measure the risk and return of loans; (b) shareholders, to assess whether to buy, sell, or hold their shares; (c) directors, to oversee their interests in the organization; (d) employees and labor unions, to judge the fairness of wages and assess future employment opportunities; and (e) regulators, to determine whether the organization is complying with regulations. Other users are voters, legislators, government officials, contributors to nonprofits, suppliers, and customers.**
4. **Business owners and managers use accounting information to help answer questions such as: What resources does an organization own? What debts are owed? How much income is earned? Are expenses reasonable for the level of sales? Are customers' accounts being promptly collected?**
5. **Service businesses include: Standard and Poor's, Dun & Bradstreet, Merrill Lynch, Southwest Airlines, CitiCorp, Humana, Charles Schwab, and Prudential. Businesses offering products include Nike, Reebok, Gap, Apple, Ford Motor Co., Philip Morris, Coca-Cola, Best Buy, and WalMart.**
6. **The internal role of accounting is to serve the organization's internal operating functions. It does this by providing useful information for internal users in completing their tasks more effectively and efficiently. By providing this information, accounting helps the organization reach its overall goals.**
7. **Accounting professionals offer many services including auditing, management advice, tax planning, business valuation, and money management.**
8. **Marketing managers are likely interested in information such as sales volume, advertising costs, promotion costs, salaries of sales personnel, and sales commissions.**

9. **Accounting is described as a service activity because it serves decision makers by providing information to help them make better business decisions.**

10. **Some accounting-related professions include consultant, financial analyst, underwriter, financial planner, appraiser, FBI investigator, market researcher, and system designer.**

11. **Ethics rules require that auditors avoid auditing clients in which they have a direct investment, or if the auditor's fee is dependent on the figures in the client's reports. This will help prevent others from doubting the quality of the auditor's report.**

12. **In addition to preparing tax returns, tax accountants help companies and individuals plan future transactions to minimize the amount of tax to be paid. They are also actively involved in estate planning and in helping set up organizations. Some tax accountants work for regulatory agencies such as the IRS or the various state departments of revenue. These tax accountants help to enforce tax laws.**

13. **The objectivity concept means that financial statement information is supported by independent, unbiased evidence other than someone's opinion or imagination. This concept increases the reliability and verifiability of financial statement information.**

14. **This treatment is justified by both the cost principle and the going-concern assumption.**

15. **The revenue recognition principle provides guidance for managers and auditors so they know when to recognize revenue. If revenue is recognized too early, the business looks more profitable than it is. On the other hand, if revenue is recognized too late the business looks less profitable than it is. This principle demands that revenue be recognized when it is both earned (when service or product provided) and can be measured reliably. The amount of revenue should equal the value of the assets received or expected to be received from the business's operating activities covering a specific time period.**

16. **Business organizations can be organized in one of three basic forms: sole proprietorship, partnership, or corporation. These forms have implications for legal liability, taxation, continuity, number of owners, and legal status as follows:**

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

***Proprietorships and partnerships that are set up as LLCs provide limited liability.**

17. **(a) Assets are resources owned or controlled by a company that are expected to yield future benefits. (b) Liabilities are creditors' claims on assets that reflect obligations to provide assets, products, or services to others. (c) Equity is the owner's claim on assets and is equal to assets minus liabilities. (d) Net assets refer to equity.**

18. **Equity is increased by investments from the owner and by net income (which is the excess of revenues over expenses). It is decreased by withdrawals by the owner and by a net loss (which is the excess of expenses over revenues).**

19. Accounting principles consist of (a) *general* and (b) *specific* principles. General principles are the basic assumptions, concepts, and guidelines for preparing financial statements. They stem from long-used accounting practices. Specific principles are detailed rules used in reporting on business transactions and events. They usually arise from the rulings of authoritative and regulatory groups such as the Financial Accounting Standards Board or the Securities and Exchange Commission.

20. Revenue (or sales) is the amount received from selling products and services.

21. Net income (also called income, profit, or earnings) equals revenues minus expenses (if revenues exceed expenses). Net income increases equity. If expenses exceed revenues, the company has a net loss. Net loss decreases equity.

22. The four basic financial statements are: income statement, statement of owner's equity, balance sheet, and statement of cash flows.

23. An income statement reports a company's revenues and expenses along with the resulting net income or loss over a period of time.

24. Rent expense, utilities expense, administrative expenses, advertising and promotion expenses, maintenance expense, and salaries and wages expenses are some examples of business expenses.

25. The statement of owner's equity explains the changes in equity from net income or loss, and from any owner contributions and withdrawals over a period of time.

26. The balance sheet describes a company's financial position (types and amounts of assets, liabilities, and equity) at a point in time.

27. The statement of cash flows reports on the cash inflows and outflows from a company's operating, investing, and financing activities.

28. Return on assets, also called return on investment, is a profitability measure that is useful in evaluating management, analyzing and forecasting profits, and planning activities. It is computed as net income divided by the average total assets. For example, if we have an average annual balance of $100 in a bank account and it earns interest of $5 for the year, then our return on assets is $5 / $100 or 5%. The return on assets is a popular measure for analysis because it allows us to compare companies of different sizes and in different industries.

29[A]. Return refers to income, and risk is the uncertainty about the return we expect to make. The lower the risk of an investment, the lower the expected return. For example, savings accounts pay a low return because of the low risk of a bank not returning the principal with interest. Higher risk implies higher, but riskier, expected returns.

30[B]. Organizations carry out three major activities: financing, investing, and operating. Financing provides the means used to pay for resources. Investing refers to the acquisition and disposing of resources necessary to carry out the organization's plans. Operating activities are the actual carrying out of these plans. *(Planning is the glue that connects these activities, including the organization's ideas, goals, and strategies.)*

31[B]. An organization's financing activities (liabilities and equity) pay for investing activities (assets). An organization cannot have more or less assets than its liabilities and equity combined and, similarly, it cannot have more or less liabilities and equity than its total assets. This means: assets = liabilities + equity. This relation is called the accounting equation (also called the *balance sheet equation*), and it applies to organizations at all times.

32. The dollar amounts in Google's financial statements are rounded to the nearest million ($1,000,000). Google's consolidated statement of income (or income statement) covers the calendar-year ended December 31, 2015. Google also reports comparative income statements for the previous two years.

33. The independent auditor for Apple is Ernst & Young, LLP. The auditor expressly states that "our responsibility is to express an opinion on these financial statements based on our audits." The auditor also states that "these financial statements are the responsibility of the Company's management."

QUICK STUDIES

Quick Study 1-1 (10 minutes)

1. f. Technology
2. c. Recording
3. h. Recordkeeping (bookkeeping)

Quick Study 1-2 (10 minutes)

a.	E	g.	E
b.	E	h.	E
c.	E	i.	I
d.	E	j.	E
e.	I	k.	E
f.	E	l.	E

Quick Study 1-3 (10 minutes)

1. A. Opportunity
2. B. Pressure
3. C. Rationalization
4. A. Opportunity
5. B. Pressure
6. C. Rationalization

Quick Study 1-4 (5 minutes)

1. c. constraint
2. b. assumption
3. c. constraint
4. a. principle

Quick Study 1-5 (10 minutes)

	Attribute Present	Proprietorship	Partnership	Corporation
1.	Business taxed	no	no	yes
2.	Business entity	yes	yes	yes
3.	Legal entity	no	no	yes

Quick Study 1-6 (10 minutes)

1. D. Revenue recognition principle
2. B. Measurement (cost) principle
3. C. Business entity assumption

Quick Study 1-7 (5 minutes)

Assets	=	Liabilities	+	Equity
$700,000		(a) $280,000		$420,000
$500,000		(b) $250,000		(b) $250,000

Quick Study 1-8 (10 minutes)

1.

Assets	=	Liabilities	+	Equity
$75,000		(a) $35,000		$40,000
(b) $95,000		$25,000		$70,000
$85,000		$20,000		(c) $65,000

2.

Assets	=	Liabilities	+ Owner, Capital	- Owner, Withdrawals	+ Revenues	- Expenses
$40,000		$16,000	$20,000	$ 0	(a) $12,000	$ 8,000
$80,000		$32,000	$44,000	(b) $2,000	$24,000	$18,000

Quick Study 1-9 (10 minutes)

a. For December 31, 2015, the accounts and their dollar amounts (in $ millions) for Google are:

(1)	**Assets**	**=**	**$147,461**
(2)	**Liabilities**	**=**	**$27,130**
(3)	**Equity**	**=**	**$120,331**

b. Using Google's amounts from (a) we verify that (in $ millions):

Assets	=	Liabilities	+	Equity
147,461	=	27,130	+	120,331

Quick Study 1-10 (15 minutes)

	Assets			=	Liabilities	+	Equity						
	Cash	+	Accounts Recble.	=	Accounts Payable	+	Owner, Capital	-	Owner, Withdrawals	+	Revenues	-	Expenses
(a)	**$5,500**			**=**							**$5,500** Consulting		
(b)		**+**	**$4,000**	**=**						**+**	**4,000** Commission		
Bal.	5,500	+	4,000	=						+	9,500		
(c)	**-1,400**			**=**								**-**	**$1,400** Wages
Bal.	4,100	+	4,000	=						+	9,500	-	1,400
(d)	**+1,000**	**+**	**- 1,000**	**=**								**-**	
Bal.	5,100	+	3,000	=						+	9,500	-	1,400
(e)	**-700**	**+**		**=**								**-**	**700** Cleaning
Bal.	$4,400	+	$3,000	=						+	$9,500	-	$2,100

Quick Study 1-11 (15 minutes)

	Assets							=	Liabilities	+	Equity						
	Cash	+	Supplies	+	Equip.	+	Land	=	Accts. Pay.	+	A. Carr, Capital	-	A.Carr, With-drawals	+	Rev.	-	Exp.
(a)	$15,000							=			$15,000						
(b)	-500	+	$500					=									
Bal.	14,500	+	500					=		+	15,000						
(c)				+	$10,000			=			10,000						
Bal.	14,500	+	500	+	10,000			=		+	25,000						
(d)		+	200					=	+$200								
Bal.	14,500	+	700	+	10,000			=	200	+	25,000						
(e)	-9,000					+	$9,000	=									
Bal.	$5,500	+	$700	+	$10,000	+	$9,000	=	$200	+	$25,000						

Quick Study 1-12 (10 minutes)

[*Code: Income statement (I), Balance sheet (B), Statement of owner's equity (E), or Statement of cash flows (CF).*]

a.	B	d.	B	g.	CF
b.	CF	e.	I	h.	I
c.	E and CF	f.	B	i.	B

Quick Study 1-13 (5 minutes)

1.	EX	5.	EX
2.	R	6.	R
3.	EX	7.	EX
4.	W	8.	R

Quick Study 1-14 (5 minutes)

1.	A	4.	L
2.	EQ	5.	A
3.	A	6.	A

Quick Study 1-15 (10 minutes)

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Average total assets}} = \frac{\$6\text{ billion}}{\$40\text{ billion}} = \underline{\underline{15.0\%}}$$

Interpretation: Its return of 15.0% exceeds the 11% of its competitors. Home Depot's performance can be judged as above average.

Quick Study 1-16 (10 minutes)

1.	D	3.	A
2.	E	4.	C

Quick Study 1-17 (10 minutes)

a. For December 31, 2015, the accounts and their dollar amounts (in KRW millions) for Samsung are:

(1)	Assets	=	242,179,521
(2)	Liabilities	=	63,119,716
(3)	Equity	=	179,059,805

b. Using Samsung's amounts from (a) we verify (in KRW millions):

Assets	=	Liabilities	+	Equity
242,179,521	=	63,119,716	+	179,059,805

EXERCISES

Exercise 1-1 (10 minutes)

C	1.	Analyzing and interpreting reports.
C	2.	Presenting financial information.
R	3.	Keeping a log of service costs.
R	4.	Measuring the costs of a product.
C	5.	Preparing financial statements.
I	6.	Seeing revenues generated from a service.
I	7.	Observing employee tasks behind a product.
R	8.	Registering cash sales of products sold.

Exercise 1-2 (20 minutes)

Part A.

1.	I	5.	I
2.	E	6.	E
3.	I	7.	I
4.	E		

Part B.

1.	I	5.	I
2.	I	6.	E
3.	E	7.	I
4.	E	8.	I

Exercise 1-3 (10 minutes)

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

Exercise 1-4 (10 minutes)

1. A
2. G
3. D
4. F
5. C

Exercise 1-5 (20 minutes)

1. I
2. H
3. G
4. F
5. E
6. D
7. C
8. B
9. A

Exercise 1-6 (10 minutes)

a. (C) Corporation
b. (P) Partnership
c. (SP) Sole proprietorship
d. (SP) Sole proprietorship
e. (C) Corporation
f. (SP) Sole proprietorship
g. (C) Corporation

Exercise 1-7 (10 minutes)

Code		Description	Principle/Assumption
H	1.	A company reports details behind financial statements that would impact users' decisions.	Full disclosure principle
G	2.	Financial statements reflect the assumption that the business continues operating.	Going-concern assumption
F	3.	A company records the expenses incurred to generate the revenues reported.	Matching (expense recognition) principle
A	4.	Derived from long-used and generally accepted accounting practices.	General accounting principle
C	5.	Each business is accounted for separately from its owner or owners.	Business entity assumption
D	6.	Revenue is recorded when products and services are delivered.	Revenue recognition principle
E	7.	Usually created by a pronouncement from an authoritative body.	Specific accounting principle
B	8.	Information is based on actual costs incurred in transactions.	Cost principle

Exercise 1-8 (10 minutes)

Assets	=	Liabilities	+	Equity
(a) $ 65,000	=	$ 20,000	+	$45,000
$100,000	=	$ 34,000	+	(b) $66,000
$154,000	=	(c) $114,000	+	$40,000

Exercise 1-9 (20 minutes)

a. Using the accounting equation at the *beginning* of the year:

Assets	=	Liabilities	+	Equity
$300,000	=	?	+	$100,000

Thus, *beginning* liabilities = $200,000

Using the accounting equation at the *end* of the year:

Assets	=	Liabilities	+	Equity
$300,000 + $80,000	=	$200,000+ $50,000	+	?
$380,000	=	$250,000	+	?

Thus, *ending* equity = $130,000

Alternative approach to solving part (b):
ΔAssets($80,000) = ΔLiabilities($50,000) + ΔEquity(?)
where "Δ" refers to "change in."
***Thus: Ending* Equity = $100,000 + $30,000 = $130,000**

b. Using the accounting equation:

Assets	=	Liabilities	+	Equity
$123,000	=	$47,000	+	?

Thus, equity = $76,000

c. Using the accounting equation at the *end* of the year:

Assets	=	Liabilities	+	Equity
$190,000	=	$70,000 - $5,000	+	?
$190,000	=	$65,000	+	$125,000

Using the accounting equation at the *beginning* of the year:

Assets	=	Liabilities	+	Equity
$190,000 - $60,000	=	$70,000	+	?
$130,000	=	$70,000	+	?

Thus: *Beginning* Equity = <u>$60,000</u>

Exercise 1-10 (20 minutes)

1. **d**

2. **e**

3. **a**

4. **f**

5. **h**

Exercise 1-11 (20 minutes)

1. **f**

2. **a**

3. **g**

4. **h**

5. **b**

Exercise 1-12 (15 minutes)

a. **3**

b. **2**

c. **6**

d. **1**

e. **4**

f. **5**

Exercise 1-13 (30 minutes)

	Assets					=	Liabilities	+	Equity						
	Cash	+	Accounts Receivable	+	Equip-ment	=	Accounts Payable	+	M.Chen, Capital	–	M.Chen, With-drawals	+	Revenues	–	Expenses
a.	+$60,000			+	$15,000	=		+	$75,000						
b.	– 1,500													–	$1,500
Bal.	58,500	+		+	15,000	=		+	75,000					–	1,500
c.				+	10,000		+$10,000								
Bal.	58,500	+		+	25,000	=	10,000	+	75,000					–	1,500
d.	+ 2,500											+	$2,500		
Bal.	61,000	+		+	25,000	=	10,000	+	75,000			+	2,500	–	1,500
e.		+	$8,000									+	8,000		
Bal.	61,000	+	8,000	+	25,000	=	10,000	+	75,000			+	10,500	–	1,500
f.	– 6,000			+	6,000										
Bal.	55,000	+	8,000	+	31,000	=	10,000	+	75,000			+	10,500	–	1,500
g.	– 3,000													–	3,000
Bal.	52,000	+	8,000	+	31,000	=	10,000	+	75,000			+	10,500	–	4,500
h.	+ 5,000	-	5,000												
Bal.	57,000	+	3,000	+	31,000	=	10,000	+	75,000			+	10,500	–	4,500
i.	– 10,000						– 10,000								
Bal.	47,000	+	3,000	+	31,000	=	0	+	75,000			+	10,500	–	4,500
j.	– 1,000									–	$1,000				
Bal.	$46,000	+	$3,000	+	$31,000	=	$ 0	+	$75,000	–	$1,000	+	$10,500	–	$4,500

Exercise 1-14 (10 minutes)

Return on assets	**=**	**Net income / Average total assets**
	=	**$40,000 / [($200,000 + $300,000)/2]**
	=	**16%**

Interpretation: Swiss Group's return on assets of 16% is markedly above the 11% return of its competitors. Accordingly, its performance is assessed as superior to its competitors.

Exercise 1-15 (15 minutes)

ERNST CONSULTING
Income Statement
For Month Ended October 31

Revenues		
Consulting revenue		$14,000
Expenses		
Salaries expense	$7,000	
Rent expense	3,550	
Telephone expense	760	
Miscellaneous expenses	580	
Total expenses		11,890
Net income		$ 2,110

Exercise 1-16 (15 minutes)

ERNST CONSULTING
Statement of Owner's Equity
For Month Ended October 31

E. Ernst, Capital, October 1		$ 0
Add:	Owner's investment	84,000
	Net income (from Exercise 1-15)	2,110
		86,110
Less:	Withdrawals by owner	2,000
E. Ernst, Capital, October 31		$84,110

Exercise 1-17 (15 minutes)

ERNST CONSULTING
Balance Sheet
October 31

Assets		*Liabilities*	
Cash	$11,360	Accounts payable	$ 8,500
Accounts receivable	14,000		
Office supplies	3,250	*Equity*	
Office equipment	18,000	E. Ernst, Capital*	84,110
Land	46,000		
Total assets	$92,610	Total liabilities and equity	$92,610

* For the computation of this amount see Exercise 1-16.

Exercise 1-18 (15 minutes)

ERNST CONSULTING
Statement of Cash Flows
For Month Ended October 31

Cash flows from operating activities	
Cash received from customers	$ 0
Cash paid to employees[a]	(1,750)
Cash paid for rent	(3,550)
Cash paid for telephone expenses	(760)
Cash paid for miscellaneous expenses	(580)
Net cash used by operating activities	(6,640)
Cash flows from investing activities	
Purchase of office equipment	(18,000)
Net cash used by investing activities	(18,000)
Cash flows from financing activities	
Investments by owner	38,000
Withdrawals by owner	(2,000)
Net cash provided by financing activities	36,000
Net increase in cash	$11,360
Cash balance, October 1	0
Cash balance, October 31	$11,360

[a] $7,000 Salaries Expense - $5,250 still owed = $1,750 paid to employees.

Exercise 1-19 (10 minutes)

I 1. Cash purchase of equipment
F 2. Cash withdrawal by owner
O 3. Cash paid for advertising
O 4. Cash paid for wages
O 5. Cash paid on account payable
O 6. Cash received from clients
F 7. Cash investment by owner
O 8. Cash paid for rent

Exercise 1-20 (20 minutes)

Ford Motor Company
Income Statement
For Year Ended December 31, 2015

($ millions)		
Revenues		$149,558
Expenses		
Cost of sales	$124,041	
Selling and administrative costs	14,999	
Other expenses	3,145	
Total expenses		142,185
Net income		$ 7,373

Exercise 1-21[B] (10 minutes)

a. Financing
b. Financing
c. Operating
d. Investing
e. Investing

Exercise 1-22 (15 minutes)

BMW GROUP Income Statement For Year Ended December 31, 2015		
(Euros in millions)		
Revenues		€ 92,175
Expenses		
Cost of sales	€74,043	
Selling and administrative costs	8,633	
Other expenses	3,103	
Total expenses		85,779
Net income		€ 6,396

PROBLEM SET A

Problem 1-1A (25 minutes)

		a.				b.		
		Balance Sheet			Income Statement	Statement of Cash Flows		
	Transaction	Total Assets	Total Liab.	Total Equity	Net Income	Operating Activities	Investing Activities	Financing Activities
1	Owner invests $900 cash in business	+900		+900				+900
2	Receives $700 cash for services provided	+700		+700	+700	+700		
3	Pays $500 cash for employee wages	–500		–500	–500	–500		
4	Incurs $100 legal costs on credit		+100	–100	–100			
5	Purchases $200 supplies on credit	+200	+200					
6	Buys equipment for $300 cash	+300 –300					–300	
7	Pays $200 on accounts payable	–200	–200			–200		
8	Provides $400 services on credit	+400		+400	+400			
9	Owner withdraws $50 cash	–50		–50				–50
10	Collects $400 cash on account receivable	+400 –400				+400		

Problem 1-2A (40 minutes)

Part 1
Company A

(a) Equity on December 31, 2016:

Assets	$55,000
Liabilities	(24,500)
Equity	$30,500

(b) Equity on December 31, 2017:

Equity, December 31, 2016	$30,500
Plus investment by owner	6,000
Plus net income	8,500
Less withdrawals by owner	(3,500)
Equity, December 31, 2017	$41,500

(c) Liabilities on December 31, 2017:

Assets	$58,000
Equity	(41,500)
Liabilities	$16,500

Part 2
Company B

(a) and (b)

Equity:	*12/31/2016*	*12/31/2017*
Assets	$34,000	$40,000
Liabilities	(21,500)	(26,500)
Equity	$12,500	$13,500

(c) Net income for 2017:

Equity, December 31, 2016	$12,500
Plus investment by owner	1,400
Plus net income	?
Less withdrawals by owner	(2,000)
Equity, December 31, 2017	$13,500

Therefore, net income must have been $ 1,600

Problem 1-2A *(Continued)*

Part 3

Company C

First, compute the beginning balance of equity:

	Dec. 31, 2016
Assets	$24,000
Liabilities	(9,000)
Equity	$15,000

Next, find the ending balance of equity by completing this table:

Equity, December 31, 2016	$15,000
Plus investment by owner	9,750
Plus net income	8,000
Less withdrawals by owner	(5,875)
Equity, December 31, 2017	$26,875

Finally, find the ending amount of assets by adding the ending balance of equity to the ending balance of liabilities:

	Dec. 31, 2017
Liabilities	$29,000
Equity	26,875
Assets	$55,875

Part 4

Company D

First, compute the beginning and ending equity balances:

	12/31/2016	12/31/2017
Assets	$60,000	$85,000
Liabilities	(40,000)	(24,000)
Equity	$20,000	$61,000

Then, find the amount of investment by owner during 2017:

Equity, December 31, 2016	$20,000
Plus investment by owner	?
Plus net income	14,000
Less withdrawals by owner	0
Equity, December 31, 2017	$61,000

Thus, investment by owner must have been $27,000

Problem 1-2A (*Concluded*)

Part 5

Company E

First, compute the balance of equity as of December 31, 2017:

Assets	$113,000
Liabilities	(70,000)
Equity	$ 43,000

Next, find the beginning balance of equity as follows:

Equity, December 31, 2016	$?
Plus investment by owner	6,500
Plus net income	20,000
Less withdrawals by owner	(11,000)
Equity, December 31, 2017	$43,000

Thus, the beginning balance of equity is: $27,500

Finally, find the beginning amount of liabilities by subtracting the beginning balance of equity from the beginning balance of assets:

	Dec. 31, 2016
Assets	$119,000
Equity	(27,500)
Liabilities	$ 91,500

Problem 1-3A (20 minutes)

Armani Company
Income Statement
For Year Ended December 31, 2017

Revenues		
Consulting revenue	$33,000	
Rental revenue	22,000	
Total revenues		$55,000
Expenses		
Salaries expense	20,000	
Rent expense	12,000	
Selling and administrative expenses	8,000	
Total expenses		40,000
Net income		$15,000

Problem 1-4A (20 minutes)

Armani Company
Statement of Owner's Equity
For Year Ended December 31, 2017

A. Armani, Capital, December 31, 2016		$ 4,000
Add:	Owner's investment	1,000
	Net income (from Problem 1-3)	15,000
		20,000
Less:	Withdrawals by owner	13,000
A. Armani, Capital, December 31, 2017		$ 7,000

Problem 1-5A (20 minutes)

Armani Company
Balance Sheet
December 31, 2017

Assets		Liabilities	
Cash	$10,000	Accounts payable	$23,000
Accounts receivable	9,000	Total liabilities	23,000
Supplies	6,000	**Equity**	
Equipment	5,000	A. Armani, Capital*	7,000
Total assets	$30,000	Total liabilities and equity	$30,000

* For computation of this amount see Problem 1-4A.

Problem 1-6A (15 minutes)

Kia Company
Statement of Cash Flows
For Year Ended December 31, 2017

Cash from operating activities	$ 6,000
Cash used by investing activities	(2,000)
Cash used by financing activities	(2,800)
Net increase in cash	$ 1,200
Cash, December 31, 2016	2,300
Cash, December 31, 2017	$ 3,500

Problem 1-7A (60 minutes) *Part 1*

	Assets					=	Liabilities	+	Equity						
Date	**Cash**	**+**	**Accounts Receivable**	**+**	**Office Equipment**	**=**	**Accounts Payable**	**+**	**G. Gram, Capital**	**-**	**G. Gram, With-drawals**	**+**	**Revenues**	**-**	**Expenses**
May 1	+$40,000					=		+	$40,000						
1	- 2,200					=								-	$2,200
3				+	$1,890	=	+ $1,890								
5	- 750					=								-	750
8	+ 5,400					=						+	$5,400		
12		+	$2,500			=						+	2,500		
15	- 750					=								-	750
20	+ 2,500	-	2,500			=									
22		+	3,200			=						+	3,200		
25	+ 3,200	-	3,200			=									
26	- 1,890					=	- 1,890								
27						=	+ 80							-	80
28	- 750					=								-	750
30	- 300					=								-	300
30	- 280					=								-	280
31	- 1,400					=				-	$1,400				
	$42,780	+	$ 0	+	$1,890	=	$ 80	+	$40,000	-	$1,400	+	$11,100	-	$5,110

Problem 1-7A *(Continued)*
Part 2

The Gram Co. Income Statement For Month Ended May 31		
Revenues		
Consulting services revenue		$11,100
Expenses		
Rent expense....................................	$2,200	
Salaries expense................................	1,500	
Cleaning expense	750	
Telephone expense............................	300	
Utilities expense................................	280	
Advertising expense..........................	80	
Total expenses		5,110
Net income		$ 5,990

The Gram Co. Statement of Owner's Equity For Month Ended May 31	
G. Gram, Capital, May 1	$ 0
Add: Investment by owner	40,000
Net income...	5,990
	45,990
Less: Withdrawals by owner	1,400
G. Gram, Capital, May 31	$44,590

The Gram Co. Balance Sheet May 31			
Assets		**Liabilities**	
Cash................................	$42,780	Accounts payable........................	$ 80
Office equipment	1,890	**Equity**	
		G. Gram, Capital	44,590
Total assets...................	$44,670	Total liabilities and equity	$44,670

Problem 1-7A (*Concluded)*

Part 3

The Gram Co.
Statement of Cash Flows
For Month Ended May 31

Cash flows from operating activities		
Cash received from customers	$11,100	
Cash paid for rent	(2,200)	
Cash paid for cleaning	(750)	
Cash paid for telephone	(300)	
Cash paid for utilities	(280)	
Cash paid to employees	(1,500)	
Net cash provided by operating activities		$ 6,070
Cash flows from investing activities		
Purchase of equipment	(1,890)	
Net cash used by investing activities		(1,890)
Cash flows from financing activities		
Investment by owner	40,000	
Withdrawal by owner	(1,400)	
Net cash provided by financing activities		38,600
Net increase in cash		$42,780
Cash balance, May 1		0
Cash balance, May 31		$42,780

Problem 1-8A (60 minutes) *Part 1*

	Assets					= Liabilities +	Equity			
	Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Office Suite	= Accounts Payable	+ L. Lopez, Capital	- L. Lopez, With-drawals	+ Reve-nues	- Expen-ses
a.	+$70,000			+ $10,000			+ $80,000			
b.	- 40,000				+ $40,000					
Bal.	30,000			+ 10,000	+ 40,000	=	+ 80,000			
c.	- 15,000			+ 15,000						
Bal.	15,000			+ 25,000	+ 40,000	=	+ 80,000			
d.			+ $1,200	+ 1,700		+ $2,900				
Bal.	15,000		+ 1,200	+ 26,700	+ 40,000	= 2,900	+ 80,000			
e.	- 500									- $ 500
Bal.	14,500		+ 1,200	+ 26,700	+ 40,000	= 2,900	+ 80,000			- 500
f.		+ $2,800							+ $2,800	
Bal.	14,500	+ 2,800	+ 1,200	+ 26,700	+ 40,000	= 2,900	+ 80,000		+ 2,800	- 500
g.	+ 4,000								+ 4,000	
Bal.	18,500	+ 2,800	+ 1,200	+ 26,700	+ 40,000	= 2,900	+ 80,000		+ 6,800	- 500
h.	- 3,275							- $3,275		
Bal.	15,225	+ 2,800	+ 1,200	+ 26,700	+ 40,000	= 2,900	+ 80,000	- 3,275	+ 6,800	- 500
i.	+ 1,800	- 1,800								
Bal.	17,025	+ 1,000	+ 1,200	+ 26,700	+ 40,000	= 2,900	+ 80,000	- 3,275	+ 6,800	- 500
j.	- 700					- 700				
Bal.	16,325	+ 1,000	+ 1,200	+ 26,700	+ 40,000	= 2,200	+ 80,000	- 3,275	+ 6,800	- 500
k.	- 1,800									- 1,800
Bal.	$14,525	+ $1,000	+ $1,200	+ $26,700	+ $40,000	= $2,200	+ $80,000	- $3,275	+ $6,800	- $2,300

Problem 1-8A *(Concluded)*

Part 2

Biz Consulting's net income = $6,800 - $2,300 = $4,500

Problem 1-9A (60 minutes) *Part 1*

		Assets					=	Liabilities	+	Equity		
Date		**Cash**	**+ Accounts Receivable**	**+ Office Supplies**	**+ Office Equipment**	**+ Electrical Equipment**	**=**	**Accounts Payable**	**+ S. Sony, Capital**	**- S. Sony, Withdrawals**	**+ Revenues**	**- Expenses**
Dec.	1	+$65,000					=		+ $65,000			
	2	- 1,000										- $1,000
Bal.		64,000					=		65,000			- 1,000
	3	- 4,800				+ $13,000		+ $8,200				
Bal.		59,200				+ 13,000	=	8,200	+ 65,000			- 1,000
	5	- 800		+ $ 800								
Bal.		58,400		+ 800		+ 13,000	=	8,200	+ 65,000			- 1,000
	6	+ 1,200									+ $1,200	
Bal.		59,600		+ 800		+ 13,000	=	8,200	+ 65,000		+ 1,200	- 1,000
	8				+ $2,530			+ 2,530				
Bal.		59,600		+ 800	+ 2,530	+ 13,000	=	10,730	+ 65,000		+ 1,200	- 1,000
	15		+ $5,000								+ 5,000	
Bal.		59,600	+ 5,000	+ 800	+ 2,530	+ 13,000	=	10,730	+ 65,000		+ 6,200	- 1,000
	18			+ 350				+ 350				
Bal.		59,600	+ 5,000	+ 1,150	+ 2,530	+ 13,000	=	11,080	+ 65,000		+ 6,200	- 1,000
	20	- 2,530						- 2,530				
Bal.		57,070	+ 5,000	+ 1,150	+ 2,530	+ 13,000	=	8,550	+ 65,000		+ 6,200	- 1,000
	24		+ 900								+ 900	
Bal.		57,070	+ 5,900	+ 1,150	+ 2,530	+ 13,000	=	8,550	+ 65,000		+ 7,100	- 1,000
	28	+ 5,000	- 5,000									
Bal.		62,070	+ 900	+ 1,150	+ 2,530	+ 13,000	=	8,550	+ 65,000		+ 7,100	- 1,000
	29	- 1,400										- 1,400
Bal.		60,670	+ 900	+ 1,150	+ 2,530	+ 13,000	=	8,550	+ 65,000		+ 7,100	- 2,400
	30	- 540										- 540
Bal.		60,130	+ 900	+ 1,150	+ 2,530	+ 13,000	=	8,550	+ 65,000		+ 7,100	- 2,940
	31	- 950								- $950		
Bal.		$59,180	+ $ 900	+ $1,150	+ $2,530	+ $13,000	=	$8,550	+ $65,000	- $950	+ $7,100	- $2,940

Problem 1-9A *(Continued)*
Part 2

Sony Electric Income Statement For Month Ended December 31		
Revenues		
Electrical fees earned		**$7,100**
Expenses		
Rent expense	**$1,000**	
Salaries expense	**1,400**	
Utilities expense	**540**	
Total expenses		**2,940**
Net income		**$4,160**

Sony Electric Statement of Owner's Equity For Month Ended December 31	
S. Sony, Capital, December 1	**$ 0**
Add: Investment by owner	**65,000**
Net income	**4,160**
	69,160
Less: Withdrawals by owner	**950**
S. Sony, Capital, December 31	**$68,210**

Sony Electric Balance Sheet December 31			
Assets		**Liabilities**	
Cash	**$59,180**	**Accounts payable**	**$ 8,550**
Accounts receivable	**900**		
Office supplies	**1,150**	**Equity**	
Office equipment	**2,530**	**S. Sony, Capital**	**68,210**
Electrical equipment	**13,000**		
Total assets	**$76,760**	**Total liabilities and equity**	**$76,760**

Problem 1-9A *(Concluded)*

Part 3

Sony Electric
Statement of Cash Flows
For Month Ended December 31

Cash flows from operating activities		
Cash received from customers[1]	$ 6,200	
Cash paid for rent	(1,000)	
Cash paid for supplies	(800)	
Cash paid for utilities	(540)	
Cash paid to employees	(1,400)	
Net cash provided by operating activities		$ 2,460
Cash flows from investing activities		
Purchase of office equipment	(2,530)	
Purchase of electrical equipment	(4,800)	
Net cash used by investing activities		(7,330)
Cash flows from financing activities		
Investments by owner	65,000	
Withdrawals by owner	(950)	
Net cash provided by financing activities		64,050
Net increase in cash		$59,180
Cash balance, Dec. 1		0
Cash balance, Dec. 31		$59,180

[1]$1,200 + $5,000 = $6,200

Part 4

If the December 1 investment had been $49,000 cash instead of $65,000 and the $16,000 difference was borrowed by the company from a bank, then:

(a) Total assets would remain the same.

(b) Total liabilities would be $16,000 greater.

(c) Total equity would be $16,000 lower (due to less owner investment).

Problem 1-10A (15 minutes)

1. **Return on assets is net income divided by the average total assets.**

   Kyzera's return: $65,000 / $250,000 = 0.26 or 26%.

2. **Return on assets seems satisfactory for the risk involved in the manufacturing, marketing, and selling of cellular telephones. Moreover, Kyzera's 26% return is more than twice as high as that of its competitors' 12% return.**

3. **We know that revenues less expenses equal net income. Taking the revenues and net income numbers for Kyzera we obtain:**

   $475,000 - Expenses = $65,000 → Expenses must equal $410,000.

4. **We know from the accounting equation that total financing (liabilities plus equity) must equal the total for assets (investing). Since average total assets are $250,000, we know the average total of liabilities plus equity (financing) must equal $250,000.**

Problem 1-11A (20 minutes)

1. **Return on assets equals net income divided by average total assets.**

   a. Coca-Cola return: $8,634 / $76,448 = 0.113 or 11.3%.

   b. PepsiCo return: $6,462 / $70,518 = 0.092 or 9.2%.

2. **Strictly on the amount of sales to consumers, Coca-Cola's sales of $46,542 are less than PepsiCo's $66,504.**

3. **Success in returning net income from the average amount invested is revealed by the return on assets. Part 1 showed that Coca-Cola's 11.3% return is better than PepsiCo's 9.2% return.**

4. **The reported figures suggest that Coca-Cola yields a marginally higher return on assets than PepsiCo. Based on this information alone, we would be better advised to invest in Coca-Cola than PepsiCo.**

   Nevertheless, and because the returns are not dramatically different, we would look for additional information in financial statements and other sources for further guidance. For example, if Coca-Cola could dispose of some assets without curtailing its sales level, it would look even more attractive; or, PepsiCo could do likewise, and close the gap. We would also look for consumer trends, market expansion, competition, product development, and promotion plans.

Problem 1-12A[A] (5 minutes)

a. 3

b. 2

c. 1

d. 4

Problem 1-13A[B] (15 minutes)

1.	F	5.	I
2.	I	6.	O
3.	I	7.	O
4.	F	8.	O

Problem 1-14A[B] (15 minutes)

An organization pursues three major business activities: financing, investing, and operating.

(1) *Financing* is the means used to pay for resources.

(2) *Investing* refers to the buying and selling of resources (assets) necessary to carry out the organization's plans.

(3) *Operating* activities are the carrying out of an organization's plans.

If financial statements are to be informative about an organization's activities, then they will need to report on these three major activities. Also note that planning is the glue that links and coordinates these three major activities—it includes the ideas, goals, and strategies of an organization.

PROBLEM SET B

Problem 1-1B (25 minutes)

		a.				b.		
		Balance Sheet			Income Statement	Statement of Cash Flows		
	Transaction	Total Assets	Total Liab.	Total Equity	Net Income	Operating Activities	Investing Activities	Financing Activities
1	Owner invests $800 cash in business	+800		+800				+800
2	Purchases $100 supplies on credit	+100	+100					
3	Buys equipment for $400 cash	+400 –400					–400	
4	Provide services for $900 cash	+900		+900	+900	+900		
5	Pays $400 cash for rent incurred	–400		–400	–400	–400		
6	Incurs $200 utilities costs on credit		+200	–200	–200			
7	Pays $300 cash for wages incurred	–300		–300	–300	–300		
8	Owner withdraws $50 cash	–50		–50				–50
9	Provide $600 ser-vices on credit	+600		+600	+600			
10	Collects $600 cash on accounts receivable	+600 –600				+600		

Problem 1-2B (40 minutes)

Part 1

Company V

(a) and (b)

Calculation of equity:	*12/31/2016*	*12/31/2017*
Assets	$54,000	$59,000
Liabilities	(25,000)	(36,000)
Equity	$29,000	$23,000

(c) Calculation of net income for 2017:

Equity, December 31, 2016	$29,000
Plus investments by owner	5,000
Plus net income	?
Less withdrawals by owner	(5,500)
Equity, December 31, 2017	$23,000

Therefore, the net loss must have been $(5,500).

Part 2

Company W

(a) Calculation of equity at December 31, 2016:

Assets	$80,000
Liabilities	(60,000)
Equity	$20,000

(b) Calculation of equity at December 31, 2017:

Equity, December 31, 2016	$20,000
Plus investments by owner	20,000
Plus net income	40,000
Less withdrawals by owner	(2,000)
Equity, December 31, 2017	$78,000

(c) Calculation of the amount of liabilities at December 31, 2017:

Assets	$100,000
Equity	(78,000)
Liabilities	$ 22,000

Problem 1-2B *(Continued)*

Part 3
Company X

First, compute the beginning and ending equity balances:

	12/31/2016	*12/31/2017*
Assets	$141,500	$186,500
Liabilities	(68,500)	(65,800)
Equity..........................	$ 73,000	$120,700

Then, find the amount of investments by owner during 2017 as follows:

Equity, December 31, 2016	$ 73,000
Plus investments by owner	?
Plus net income	18,500
Less withdrawals by owner	0
Equity, December 31, 2017	$120,700
Thus, the owner's investments must have been	$ 29,200

Part 4
Company Y

First, compute the beginning balance of equity:

	Dec. 31, 2016
Assets..	$92,500
Liabilities...	51,500
Equity	$41,000

Next, find the ending balance of equity as follows:

Equity, December 31, 2016	$41,000
Plus investments by owner	48,100
Plus net income	24,000
Less withdrawals by owner	(20,000)
Equity, December 31, 2017	$93,100

Finally, find the ending amount of assets by adding the ending balance of equity to the ending balance of liabilities:

	Dec. 31, 2017
Liabilities...	$ 42,000
Equity	93,100
Assets..	$135,100

Problem 1-2B *(Concluded)*

Part 5
Company Z

First, compute the balance of equity as of December 31, 2017:

Assets	$170,000
Liabilities	(42,000)
Equity	$128,000

Next, find the beginning balance of equity as follows:

Equity, December 31, 2016	$?
Plus investments by owner	60,000
Plus net income	32,000
Less withdrawals by owner	(8,000)
Equity, December 31, 2017	$128,000

Thus, the beginning balance of equity is $44,000.

Finally, find the beginning amount of liabilities by subtracting the beginning balance of equity from the beginning balance of assets:

	Dec. 31, 2016
Assets	$144,000
Equity	(44,000)
Liabilities	$100,000

Problem 1-3B (20 minutes)

Audi Company
Income Statement
For Year Ended December 31, 2017

Revenues		
Consulting revenue	$6,600	
Rental revenue	4,400	
Total revenues		$11,000
Expenses		
Salaries expense	4,000	
Rent expense	2,400	
Selling and administrative expenses	1,600	
Total expenses		8,000
Net income		$ 3,000

Problem 1-4B (20 minutes)

Audi Company
Statement of Owner's Equity
For Year Ended December 31, 2017

A. Audi, Capital, December 31, 2016		$ 800
Add:	Owner's investment	200
	Net income (from Problem 1-3)	3,000
		4,000
Less:	Withdrawals by owner	2,600
A. Audi, Capital, December 31, 2017		$1,400

Problem 1-5B (20 minutes)

Audi Company
Balance Sheet
December 31, 2017

Assets		Liabilities	
Cash	$2,000	Accounts payable	$4,600
Accounts receivable	1,800	Total liabilities	4,600
Supplies	1,200	**Equity**	
Equipment	1,000	A. Audi, Capital*	1,400
Total assets	$6,000	Total liabilities and equity	$6,000

* For computation of this amount see Problem 1-4B.

Problem 1-6B (15 minutes)

Banji Company
Statement of Cash Flows
For Year Ended December 31, 2017

Cash used by operating activities	$(3,000)
Cash from investing activities	1,600
Cash from financing activities	1,800
Net increase in cash	$ 400
Cash, December 31, 2016	1,300
Cash, December 31, 2017	$ 1,700

Problem 1-7B (60 minutes) *Part 1*

	Assets					=	Liabilities	+	Equity						
Date	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	N. Niko, Capital	-	N. Niko, Withdrawals	+	Revenues	-	Expenses
June 1	+$130,000					=		+	$130,000						
2	- 6,000					=								-	$6,000
4				+	$2,400	=	+ $2,400								
6	- 1,150					=								-	1,150
8	+ 850					=						+	$ 850		
14		+	$7,500			=						+	7,500		
16	- 800					=								-	800
20	+ 7,500	-	7,500			=									
21		+	7,900			=						+	7,900		
24		+	675			=						+	675		
25	+ 7,900	-	7,900			=									
26	- 2,400					=	- 2,400								
28	- 800					=								-	800
29	- 4,000					=				-	$4,000				
30	- 150					=								-	150
30	- 890					=								-	890
	$130,060	+	$ 675	+	$2,400	=	$ 0	+	$130,000	-	$4,000	+	$16,925	-	$9,790

Problem 1-7B *(Continued)*
Part 2

Niko's Maintenance Co. Income Statement For Month Ended June 30		
Revenues		
Maintenance services revenue		$16,925
Expenses		
Rent expense	$6,000	
Salaries expense	1,600	
Advertising expense	1,150	
Utilities expense	890	
Telephone expense	150	
Total expenses		9,790
Net income		$ 7,135

Niko's Maintenance Co. Statement of Owner's Equity For Month Ended June 30	
N. Niko, Capital, June 1	$ 0
Add: Investment by owner	130,000
Net income	7,135
	137,135
Less: Withdrawals by owner	4,000
N. Niko, Capital, June 30	$133,135

Niko's Maintenance Co. Balance Sheet June 30			
Assets		**Liabilities**	
Cash	$130,060	Accounts payable	$ 0
Accounts receivable	675	**Equity**	
Equipment	2,400	N. Niko, Capital	133,135
Total assets	$133,135	Total liabilities and equity	$133,135

Problem 1-7B *(Concluded)*

Part 3

Niko's Maintenance Co.
Statement of Cash Flows
For Month Ended June 30

Cash flows from operating activities		
Cash received from customers[1]	$ 16,250	
Cash paid for rent	(6,000)	
Cash paid for advertising	(1,150)	
Cash paid for telephone	(150)	
Cash paid for utilities	(890)	
Cash paid to employees	(1,600)	
Net cash provided by operating activities		$ 6,460
Cash flows from investing activities		
Purchase of equipment	(2,400)	
Net cash used by investing activities		(2,400)
Cash flows from financing activities		
Investments by owner	130,000	
Withdrawals by owner	(4,000)	
Net cash provided by financing activities		126,000
Net increase in cash		$130,060
Cash balance, June 1		0
Cash balance, June 30		$130,060

[1]$850 + $7,500 + $7,900 = $16,250

Problem 1-8B (60 minutes) *Part 1*

	Assets					= Liabilities	+	Equity		
	Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Office Suite	= Accounts Payable	+ N. Nadal, Capital	- N. Nadal, Withdrawals	+ Revenues	- Expenses
a.	+ $90,000			+ $10,000			+ $100,000			
b.	- 50,000				+ $50,000					
Bal.	40,000			+ 10,000	+ 50,000	=	+ 100,000			
c.	- 25,000			+ 25,000						
Bal.	15,000			+ 35,000	+ 50,000	=	+ 100,000			
d.			+ $1,200	+ 1,700		+ $2,900				
Bal.	15,000		1,200	+ 36,700	+ 50,000	= 2,900	+ 100,000			
e.	- 750									- $ 750
Bal.	14,250		+ 1,200	+ 36,700	+ 50,000	= 2,900	+ 100,000			- 750
f.		+ $2,800							+ $2,800	
Bal.	14,250	+ 2,800	+ 1,200	+ 36,700	+ 50,000	= 2,900	+ 100,000		+ 2,800	- 750
g.	+ 4,000								+ 4,000	
Bal.	18,250	+ 2,800	+ 1,200	+ 36,700	+ 50,000	= 2,900	+ 100,000		+ 6,800	- 750
h.	- 11,500							- $11,500		
Bal.	6,750	+ 2,800	+ 1,200	+ 36,700	+ 50,000	= 2,900	+ 100,000	- 11,500	+ 6,800	- 750
i.	+ 1,800	- 1,800								
Bal.	8,550	+ 1,000	+ 1,200	+ 36,700	+ 50,000	= 2,900	+ 100,000	- 11,500	+ 6,800	- 750
j.	- 700					- 700				
Bal.	7,850	+ 1,000	+ 1,200	+ 36,700	+ 50,000	= 2,200	+ 100,000	- 11,500	+ 6,800	- 750
k.	- 2,500									- 2,500
Bal.	$ 5,350	+ $1,000	+ $1,200	+ $36,700	+ $50,000	= $2,200	+ $100,000	- $11,500	+ $6,800	- $3,250

Problem 1-8B *(Concluded)*

Part 2

The company's net income = $6,800 - $3,250 = $3,550

Problem 1-9B (60 minutes) *Part 1*

Date		Assets					=	Liabilities	+	Equity		
		Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Roofing Equipment	=	Accounts Payable	+	R. Rivera, Capital	- R. Rivera, Withdrawals	+ Revenues	- Expenses
July	1	+ $80,000					=		+	$80,000			
	2	- 700											- $700
Bal.		79,300					=			80,000			- 700
	3	- 1,000				+ $5,000		+ $4,000					
Bal.		78,300				+ 5,000	=	4,000	+	80,000			- 700
	6	- 600		+ $ 600									
Bal.		77,700		+ 600		+ 5,000	=	4,000	+	80,000			- 700
	8	+ 7,600										+ $7,600	
Bal.		85,300		+ 600		+ 5,000	=	4,000	+	80,000		+ 7,600	- 700
	10				+ $2,300			+ 2,300					
Bal.		85,300		+ 600	+ 2,300	+ 5,000	=	6,300	+	80,000		+ 7,600	- 700
	15		+ $8,200									+ 8,200	
Bal.		85,300	+ 8,200	+ 600	+ 2,300	+ 5,000	=	6,300	+	80,000		+ 15,800	- 700
	17			+ 3,100				+ 3,100					
Bal.		85,300	+ 8,200	+ 3,700	+ 2,300	+ 5,000	=	9,400	+	80,000		+ 15,800	- 700
	23	- 2,300						- 2,300					
Bal.		83,000	+ 8,200	+ 3,700	+ 2,300	+ 5,000	=	7,100	+	80,000		+ 15,800	- 700
	25		+ 5,000									+ 5,000	
Bal.		83,000	+ 13,200	+ 3,700	+ 2,300	+ 5,000	=	7,100	+	80,000		+ 20,800	- 700
	28	+ 8,200	- 8,200										
Bal.		91,200	+ 5,000	+ 3,700	+ 2,300	+ 5,000	=	7,100	+	80,000		+ 20,800	- 700
	30	- 1,560											- 1,560
Bal.		89,640	+ 5,000	+ 3,700	+ 2,300	+ 5,000	=	7,100	+	80,000		+ 20,800	- 2,260
	31	- 295											- 295
Bal.		89,345	+ 5,000	+ 3,700	+ 2,300	+ 5,000	=	7,100	+	80,000		+ 20,800	- 2,555
	31	- 1,800									- $1,800		
Bal.		$87,545	+ $ 5,000	+ $3,700	+ $2,300	+ $5,000	=	$7,100	+	$80,000	- $1,800	+ $20,800	- $2,555

Problem 1-9B *(Continued)*
Part 2

Rivera Roofing Company
Income Statement
For Month Ended July 31

Revenues		
Roofing fees earned		$20,800
Expenses		
Rent expense	$ 700	
Salaries expense	1,560	
Utilities expense	295	
Total expenses		2,555
Net income		$18,245

Rivera Roofing Company
Statement of Owner's Equity
For Month Ended July 31

R. Rivera, Capital, July 1	$ 0
Add: Investment by owner	80,000
Net income	18,245
	98,245
Less: Withdrawals by owner	1,800
R. Rivera, Capital, July 31	$96,445

Rivera Roofing Company
Balance Sheet
July 31

Assets		*Liabilities*	
Cash	$ 87,545	Accounts payable	$ 7,100
Accounts receivable	5,000		
Office supplies	3,700	*Equity*	
Office equipment	2,300	R. Rivera,Capital	96,445
Roofing equipment	5,000		
Total assets	$103,545	Total liabilities & equity	$103,545

Problem 1-9B *(Concluded)*
Part 3

Rivera Roofing Company Statement of Cash Flows For Month Ended July 31		
Cash flows from operating activities		
Cash received from customers[1]	$15,800	
Cash paid for rent	(700)	
Cash paid for supplies	(600)	
Cash paid for utilities	(295)	
Cash paid to employees	(1,560)	
Net cash provided by operating activities		$12,645
Cash flows from investing activities		
Purchase of roofing equipment	(1,000)	
Purchase of office equipment	(2,300)	
Net cash used by investing activities		(3,300)
Cash flows from financing activities		
Investments by owner	80,000	
Withdrawals by owner	(1,800)	
Net cash provided by financing activities		78,200
Net increase in cash		$87,545
Cash balance, July 1		0
Cash balance, July 31		$87,545

[1]$7,600 + $8,200 = $15,800

Part 4

If the $5,000 purchase on July 3 had been acquired through an additional owner investment of cash, then:

(a) Total assets would be greater by $1,000.

(b) Total liabilities would be $4,000 less.

(c) Total equity would be $5,000 greater.

Problem 1-10B (15 minutes)

1. **Return on assets is net income divided by average total assets (the average amount invested). For Ski-Doo Company this return is computed as:**

   $201,000 / $3,000,000 = 0.067 or 6.7%.

2. **Return on assets does not seem satisfactory for the risk involved in the manufacturing, marketing, and selling of snowmobile equipment. Ski-Doo Company's 6.7% return is less than the 9.5% return earned by its competitors.**

3. **We know that revenues less expenses equal net income. Taking the revenues and net income numbers for Ski-Doo Company we obtain:**

   $1,400,000 - Expenses = $201,000 → Expenses must equal $1,199,000.

4. **We know from the accounting equation that the total of liabilities plus equity (financing) must equal the total for assets (investing). Since average total assets are $3,000,000, we know the average total of liabilities plus equity (financing) must equal $3,000,000.**

Problem 1-11B (15 minutes)

1. **Return on assets equals net income divided by average total assets.**

   a. **AT&T return:** **$4,184/ $269,868 = 0.016 or 1.6%**

   b. **Verizon return:** **$10,198/ $225,233 = 0.045 or 4.5%**

2. **On strictly the amount of sales to consumers, AT&T's sales of $126,723 are greater than Verizon's sales of $110,875.**

3. **Success in returning net income from the amount invested is revealed by the return on assets ratio. Part 1 showed that AT&T has a much lower return on assets of 1.6% versus Verizon with a 4.5% return on assets.**

4. **The reported figures suggest Verizon is more successful in generating income based on assets. Based on this information alone, we would be better advised to invest in Verizon than AT&T.**

   Nevertheless, we would look for additional information in financial statements and other sources for further guidance. For example, if AT&T could reduce its expenses, or reduce its assets without reducing income, it could potentially be a more appealing investment given its greater market share; or, Verizon could do the same and make it appear more appealing as an investment. We would also look for consumer trends, market expansion, competition, and product development and promotion plans.

Problem 1-12B[A] (5 minutes)

a. 2

b. 1

c. 4

d. 3

Problem 1-13B[B] (15 minutes)

1.	O	5.	O
2.	F	6.	F
3.	I	7.	O
4.	O	8.	O

Problem 1-14B[B] (15 minutes)

I. Financing Activities

A. Owner financing—owner invests in the company

B. Non-owner (creditor) financing—borrowing money from a bank

II. Investing Activities

A. Buying resources (assets)

B. Selling resources (assets)

III. Operating Activities

A. Use of assets to carry out plans

B. Management of internal functions—R&D, marketing, and so forth

[Note: Planning activities are the ideas, goals, and tactics for implementing financing, investing, and operating activities.]

Serial Problem — SP 1 (30 minutes)   *Business Solutions*

		Assets					= Liabilities	+ Equity			
Date		Cash	+ Accounts Receivable	+ Computer Supplies	+ Computer System	+ Office Equipment	= Accounts Payable	+ S. Rey, Capital	- S. Rey, Withdrawals	+ Revenues	- Expenses
Oct.	1	+$45,000			$20,000	+ $8,000		+ $73,000			
	3			+ $1,420			+ $1,420				
Bal.		45,000		+ 1,420	+ 20,000	+ 8,000	= 1,420	+ 73,000			
	6		+ $4,800							+ $ 4,800	
Bal.		45,000	+ 4,800	+ 1,420	+ 20,000	+ 8,000	= 1,420	+ 73,000		+ 4,800	
	8	- 1,420					- 1,420				
Bal.		43,580	+ 4,800	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 4,800	
	12		+ 1,400							+ 1,400	
Bal.		43,580	+ 6,200	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	
	15	+ 4,800	- 4,800								
Bal.		48,380	+ 1,400	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	
	17	- 805									- $ 805
Bal.		47,575	+ 1,400	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	- 805
	20	- 1,728									- 1,728
Bal.		45,847	+ 1,400	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	- 2,533
	22	+ 1,400	- 1,400								
Bal.		47,247	+ 0	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 6,200	- 2,533
	28		+ 5,208							+ 5,208	
Bal.		47,247	+ 5,208	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 11,408	- 2,533
	31	- 875									- 875
Bal.		46,372	+ 5,208	+ 1,420	+ 20,000	+ 8,000	= 0	+ 73,000		+ 11,408	- 3,408
	31	- 3,600							- $3,600		
Bal.		$42,772	+ $5,208	+ $1,420	+ $20,000	+ $8,000	= $ 0	+ $73,000	- $3,600	+ $11,408	- $3,408

Reporting in Action — BTN 1-1

1. **An organization's total assets are equal to its total liabilities plus total equity. Because Apple's liabilities and equity total $290,479 (in millions), this implies its amount of assets invested is the same $290,479 (in millions).**
2. **Return on assets is net income divided by the average total assets invested. For Apple this return is ($ millions):**
   $53,394/ [($290,479 + 231,839)/2] = 0.204 or 20.4%.
3. **We know that net income equals total revenues less total expenses. For Apple, we are told net income is $53,394 and revenues are $233,715. Thus, Apple's total expenses are computed as: $233,715 - Expenses = $53,394. Total expenses must equal $180,321 ($ millions).**
4. **Apple's return on assets of 20.4% is good given that it exceeds its competitors' return on assets of 10% for this period.**
5. **Answer depends on the current annual report information obtained.**

Comparative Analysis — BTN 1-2

($ millions)	Apple	Google
1. Total assets = Liabilities + Equity	$290,479	$147,461
2. Return on assets	$53,394 / [($290,479 + $231,839)/2]	$16,348 / [($147,461 + $129,187)/2]
	20.4%	11.8%
3. Revenues-Expenses = Net income	$233,715 – Expenses = $ 53,394	$74,989 – Expenses = $16,348
→ Expenses =	Expenses = $180,321	Expenses = $58,641

4. **Analysis of return on assets: Apple's 20.4% return is good given the moderate risk Apple confronts and vis-à-vis the 10% return of its competitors. Google's 11.8% return is slightly better than competitors and is not as high as Apple's.**

5. **Analysis conclusions: Google's return is adequate (better when compared to the industry norm); Apple's return is arguably very good. Both companies' expenses are a large percentage of their revenues.**

Ethics Challenge — BTN 1-3

1. **There are several parties affected. They include the users of financial statements such as shareholders, lenders, investors, analysts, suppliers, directors, unions, regulators, and others. They also include the accounting firm, which can be sued if deemed a party to misleading statements.**
2. **A major factor in the value of an auditor's report is the auditor's independence. If an auditor accepted a fee that increases when the client's reported profit increases, the auditor is (or at least is perceived to be) interested in higher profits for the client. This compromises the auditor's independence.**
3. **Thorne should <u>not</u> accept this fee arrangement. To avoid compromising the auditor's independence, Thorne should reject it. (Further, the AICPA Code of Professional Conduct forbids auditors from accepting contingent fees that depend on amounts reported in a client's financial statements. This AICPA Code has been codified into law in most states and, therefore, this action would also be an illegal act for a CPA.)**
4. **Ethical considerations guiding this decision include the potential harm to affected parties by allowing such a fee arrangement to exist. The unacceptable nature of such a fee arrangement guards the profession against unethical actions that could undermine its real and perceived value to society.**

Communicating in Practice — BTN 1-4

1. **Deciding whether Apple is a good loan risk can be difficult because the planned expansion is risky if customer demand does not meet expectations. As a loan officer in this situation you would want information on the company's (1) projections of expected cash receipts and cash payments (best provided on a monthly basis); (2) assessment of the market, the company's plans, and a strategy to achieve success; (3) cash contributions that the owners will make to the business; and (4) a listing of tangible assets (including their price and useful life) necessary to carry out the company's plans.**

2. **How the company is organized is important to a loan officer. If it is a standard partnership (which it was, and not a LLC), the personal assets of the owners are available to repay the loan. In this case, a loan officer will want information about the owners' financial condition. If it is a corporation, the amounts invested in the business by each shareholder are especially important. The loan officer can also require owners or shareholders to personally guarantee the loan for additional protection for the bank. Careful execution of these steps should minimize the bank's risk of taking on a bad loan.**

Taking It to the Net — BTN 1-5

$ thousands	2015	2014	2013	2012	2011
Revenues	$41,508	$39,185	$36,315	$34,627	$31,128
Net income......	3,938	4,392	1,478	3,876	3,911

1. Rocky Mountain Chocolate Factory's (RMCF) revenues exhibit a consistent, positive trend. Specifically, its revenues consistently grew during the 5-year period of 2011 through 2015. Management must work to continue to pursue policies that grow revenues.

2. Net income performance for RMCF decreased from 2011 through 2013, but substantially rebounded in 2014. Its 2015 income was similar, but slightly lower, than 2014 income. Management must work to increase and sustain higher profitability levels for long-run success.

Teamwork in Action — BTN 1-6

Suggestions for forming support/learning teams are in the Instructor's Resource Manual (IRM). The IRM provides the master of a Student Data Form that can be duplicated and used to gather information as a basis for forming these teams. The IRM also includes other administrative materials helpful in creating an active learning environment for studying accounting.

[*Note: Instructors often have students use the copy function in e-mail to keep them advised of meeting times and other important team activities. This also encourages students to use and explore additional features of e-mail.*]

Entrepreneurial Decision — BTN 1-7

1. (a) AccountApp's total amount of liabilities and equity consists of the bank loan and the owner investments. Specifically:

Total assets	=	Bank Loan	+	Owner investment
	=	Liabilities	+	Equity
$750,000	=	$500,000	+	$250,000

(b) AccountApp's total amount of assets equals its total amount of liabilities plus equity, which is $750,000.

2. Return on assets = $80,250 / $750,000 = 0.107 = 10.7%

AccountApp's 10.7% return slightly exceeds its competitors' average return of 10%. Assuming the company can continue to earn 10.7% or more, the owners should consider further investment in the new company.

Hitting the Road — BTN 1-8

Check each student's report for the following content:

1. (a) Identification of the form of business organization for the business interviewed.

(b) Identification of the main business activities for the business interviewed.

2. Identification of the reasons why the owner(s) chose this particular form of business organization.

3. Identification of advantages or disadvantages of the form of business organization chosen.

[Note: Many instructors have students complete this assignment in teams.]

Global Decision — BTN 1-9

1. **Samsung's net income and revenues figures are computed using Korean Won (KRW), which is the currency of Korea. In contrast, Apple and Google compute their financial figures in U.S. dollars. Accordingly, one must convert these figures into comparable monetary units for business decisions that depend on direct comparisons of these numbers.**

   In addition, Samsung's figures are computed according to International Financial Reporting Standards (IFRS) following pronouncements of the IASB, while Apple and Google use U.S. GAAP per the FASB. One should adjust these figures for any significant differences in accounting measurements to yield an 'apples-to-apples' comparison.

2. **Samsung's return on assets ratio eliminates differences in monetary units (between KRW and dollars). Consequently, we need not focus on differences in KRW and dollars for ratio comparisons <u>provided</u> we are comfortable with measurement techniques underlying the financial figures.**

   However, any comparisons using the return on assets ratio are still impacted by potential differences in IFRS GAAP as applied by Samsung compared to U.S. GAAP applied by Apple and Google.