**SOLUTIONS TO EXERCISES - SERIES A - CHAPTER 1**

**EXERCISE 1-1A**

**The three participants in the free business market are:**

1. **Resource owners**
2. **Conversion agents**
3. **Consumers**

**Note to instructor:**

**The memo should discuss the fact that the resource owners are those who own resources that are desired by others, either in the original form or in a converted form. The conversion agents are the parties that acquire the resource and supply it to consumers either in the original form or in a converted form with value added by the conversion. The consumers are the ultimate users of the resources.**

**It should also include a discussion of the public accountant and the allocation of resources. For example, public accountants audit the annual reports that businesses (conversion agents) use to communicate information to investors and creditors (financial resource providers). Based on their findings they may certify or deny that the reports fairly represent the financial condition of the business. In other words, public accountants provide assurance that the information provided by the business is trustworthy. Public accountants usually gain the professional designation of Certified Public Accountant (CPA).**

**EXERCISE 1-2A**

1. **The most common designation held by a public accountant is the CPA license. CPA stands for certified public accountant. CPAs are licensed by the state government (or other jurisdiction). Although the requirements vary from state to state (jurisdiction), CPA candidates normally must have a college degree, pass a demanding technical examination and obtain relevant work experience.**

**b. Designations that private accountants may hold include the CMA, Certified Management Accountant, and the CIA, Certified Internal Auditor. Both require meeting educational requirements, passing a technical examination, and obtaining relevant work experience. These designations are not professional licenses and are not government regulated.**

**EXERCISE 1-3A**

|  |  |
| --- | --- |
| **Entities mentioned:** | **Effect on cash:** |
| **Vicky Hill Recovery Fund** | **Increase for cash contributions, $21,000**  **Decrease for payment of advertising, $1,000 Decrease payment for hospital bills, $12,000 Decrease for donation to National Cyclist Fund, $8,000** |
|  |  |
| **Karen White** | **Decrease by contribution, $1,000** |
|  |  |
| **WKUX** | **Increase for advertising revenue, $1,000** |
|  |  |
| **Public** | **Decrease for contributions, $20,000** |
|  |  |
| **Mercy Hospital** | **Increase for medical care, $12,000** |
|  |  |
| **National Cyclist Fund** | **Increase for donation, $8,000** |

**EXERCISE 1-4A**

**a.**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Term** |  | **Definition** |
| **a.** | **Assets** | **7.** | **Economic resources that will be used by a business to produce revenue.** |
| **b.** | **Common Stock** | **3.** | **Certificates that evidence ownership in a company.** |
| **c.** | **Creditors** | **6.** | **Individuals or institutions that have loaned goods or services to a business.** |
| **d.** | **Liability** | **5.** | **An obligation to pay cash in the future.** |
| **e.** | **Retained Earnings** | **4.** | **Assets – Liabilities – Common Stock.** |
| **f.** | **Stockholders** | **1.** | **Individuals or institutions that have contributed assets or services to a business in exchange for an ownership interest in the business.** |
| **g.** | **Stockholders’ Equity** | **2.** | **Common Stock + Retained Earnings.** |

**b.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  |  |  |  |  | **Stockholders’ Equity** | | |
|  |  |  |  |  | **Common** |  | **Retained** |
| **Company** | **Assets** | **=** | **Liabilities** | **+** | **Stock** | **+** | **Earnings** |
| **A** | ***123,000*** | **=** | **25,000** | **+** | **48,000** | **+** | **50,000** |
| **B** | **40,000** | **=** | ***3,000*** | **+** | **7,000** | **+** | **30,000** |
| **C** | **75,000** | **=** | **15,000** | **+** | ***18,000*** | **+** | **42,000** |
| **D** | **125,000** | **=** | **45,000** | **+** | **60,000** | **+** | ***20,000*** |
|  |  |  |  |  |  |  |  |

**EXERCISE 1-5A**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Olive Enterprises**  **Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  |  |  | |  |  | **Stockholders’**  **Equity** | |
| **Event**  **Number** | **Assets** | **=** | **Liabilities** | | **+** | **Common Stock** | **Retained Earnings** |
| **1.** | **I** |  | **NA** | |  | **I** | **NA** |
| **2.** | **D** |  | **D** | |  | **NA** | **NA** |
| **3.** | **I/D** |  | **NA** | |  | **NA** | **NA** |
| **4.** | **I** |  | **NA** | |  | **NA** | **I** |
| **5.** | **D** |  | **NA** | |  | **NA** | **D** |
| **6.** | **D** |  | **NA** | |  | **NA** | **D** |
|  |  |  |  | |  |  |  |

**EXERCISE 1-6A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Better Corporation**  **Accounting Equation for Year 2** | | | | | | | | | | | | |
|  | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Bal. 1/1/Y2** |  | **10,000** |  | **20,000** |  | **12,000** |  | | **7,000** |  | **11,000** |  |
| **1. Pur. Land** |  | **(5,000)** |  | **5,000** |  | **NA** |  | | **NA** |  | **NA** | **NA** |
| **2. Issued stk.** |  | **25,000** |  | **NA** |  | **NA** |  | | **25,000** |  | **NA** | **NA** |
| **3. Provide Svc.** |  | **75,000** |  | **NA** |  | **NA** |  | | **NA** |  | **75,000** | **Revenue** |
| **4. Paid Exp.** |  | **(42,000)** |  | **NA** |  | **NA** |  | | **NA** |  | **(42,000)** | **Oper. Exp.** |
| **5. Loan** |  | **10,000** |  | **NA** |  | **10,000** |  | | **NA** |  | **NA** | **NA** |
| **6. Paid Div.** |  | **(5,000)** |  | **NA** |  | **NA** |  | | **NA** |  | **(5,000)** | **Dividend** |
| **7. Land Value** |  | **NA** |  | **NA** |  | **NA** |  | | **NA** |  | **NA** | **NA** |
| **Totals** |  | **68,000** | **+** | **25,000** | **=** | **22,000** | **+** | | **32,000** | **+** | **39,000** |  |
|  |  |  |  |  |  |  |  | |  |  |  |  |

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **$93,000** | **=** | **$22,000** | **+** | **$71,000** |

**c. The balances of total assets, liabilities and stockholders’ equity will be the same on January 1, Year 3 as the balances on December 31, Year 2. (See b. above)**

**EXERCISE 1-7A**

**a.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
| **Cash** | **=** | **Note Payable** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **195,000** | **=** | **90,500** | **+** | **84,500** | **+** | **?** |

**Retained Earnings = $195,000 – $90,500 – $84,500 = $20,000**

**b. & c.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Moss Company**  **Effect of Year 3 Transactions on the Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Event** | **Cash** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **Beginning Balances** | **195,000** |  | **90,500** |  | **84,500** |  | **20,000** |
| **1. Earned Revenue** | **42,000** |  | **NA** |  | **NA** |  | **42,000** |
| **2. Paid expenses** | **(24,000)** |  | **NA** |  | **NA** |  | **(24,000)** |
| **3. Paid dividend** | **(3,000)** |  | **NA** |  | **NA** |  | **(3,000)** |
| **Ending Balance** | **210,000** | **=** | **90,500** | **+** | **84,500** | **+** | **35,000** |
|  |  |  |  |  |  |  |  |

**d.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Cash** | **=** | **Note Payable** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **210,000** | **=** | **90,500** | **+** | **84,500** | **+** | **35,000** |

**Liabilities + Stockholders’ Equity = $90,500 + $84,500 + $35,000 = $210,000**

**Assets = Liabilities + Stockholders’ Equity**

**$210,000 = $210,000**

**e. The beginning and ending balances in the cash account were $195,000 and $210,000 respectively. The beginning balance in the common stock account was $84,500. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because the accounting events that Moss experienced during the Year 3 accounting period affected the cash account but not the common stock account.**

**EXERCISE 1-8A**

**a.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |  |
|  | **Computers** |  | **Notes Payable** |  | **Operating Expenses** |  |
|  | **Building** |  | **Utilities Payable** |  | **Rent Revenue** |  |
|  | **Cash** |  | **Accounts Payable** |  | **Utilities Expense** |  |
|  | **Land** |  |  |  | **Gasoline Expense** |  |
|  | **Trucks** |  |  |  | **Retained Earnings** |  |
|  | **Supplies** |  |  |  | **Salaries Expense** |  |
|  | **Office Furniture** |  |  |  | **Common Stock** |  |
|  |  |  |  |  | **Service Revenue** |  |
|  |  |  |  |  | **Interest Expense** |  |
|  |  |  |  |  | **Dividends** |  |
|  |  |  |  |  | **Supplies Expense** |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |

**b. No. The type of accounts will vary depending on the type of business. Some businesses will have only one revenue account; other businesses may have more than one type of revenue account. For instance, a business may have both service revenue and interest revenue. Also, the expense accounts that a business has are somewhat dependent on the type and complexity of the business. For instance, if a business owns its own building, it will not have rent expense. If a business does not have employees, it will not have salaries expense. The level of detail desired by the business will also affect the type of revenue and expense accounts that a business will have.**

**EXERCISE 1-9A**

**a.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash** | **+** | **Land** | **=** | **Creditors** | **+** | **Stockholders’**  **Equity** |  |
|  | **$16,000** |  | **$ 0** |  | **$6,000** |  | **$10,000** |  |
|  | **(12,000)** |  | **12,000** |  | **NA** |  | **NA** |  |
| **Bal.** | **$ 4,000** | **+** | **$12,000** | **=** | **$6,000** | **+** | **$10,000** |  |
|  |  |  |  |  |  |  |  |  |

**b. Creditor’s Claim ÷ Total Assets = Percent of Total**

**$6,000 ÷ $16,000 = 37.5%**

**c. Investor’s Claim ÷ Total Assets = Percent of Total**

**$10,000 ÷ $16,000 = 62.5%**

**d. The company cannot repay the debt. The company owes the creditors $6,000 but has only $4,000 cash. Note there is no actual money in the stockholders’ equity account. Indeed, there is no cash in any account that appears on the right side of the accounting equation. The right side of the accounting equation represents obligations and commitments of a company to its creditors and stockholders. Indeed, the accounting equation could be written as:**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash** | **+** | **Land** | **=** | **Creditors** | **+** | **Stockholders’**  **Equity** |  |
| **Bal.** | **$ 4,000** | **+** | **$12,000** | **=** | **37.5%** | **+** | **62.5%** |  |

**All assets including any cash balances are shown on the left side of the equation.**

EXERCISE 1-10A

1. **Dividends are paid to investors. The investor has an ownership interest in the business that allows the investor (owner) to share in the profits of the business. This pay out of a share of profits of a business to the owners is called a dividend.**
2. **There is no cash in the Retained Earnings account. Retained Earnings represents the business’s commitments to its stockholders. It is** **the amount of past earnings that have not been paid out to owners.**
3. **The amount of dividends that can be paid are limited to retained earnings. In addition, a company must have enough cash to pay the dividend. White Co. H has $2,800 of retained earnings but only $1,800 of cash. The maximum amount of dividend that could be paid at this time would be $1,800.**
4. **If the total amount of the liability of $6,000 is due, White Co Inc. will not be able to satisfy the obligation. White Co., Inc. has only $1,800 of cash; the balance of the assets are contained in the Land account. If payment must be made to creditors, White Co., Inc. will have to liquidate the company (or sell the land) in order to pay the debt.**
5. **If the land becomes worthless, the only asset remaining is the cash of $1,800. Since creditors have first claim on the assets, all of the $1,800 will be paid to the creditors. The investors will not be paid anything.**

**EXERCISE 1-11A**

**a. Creditors receive their $400 interest payment, leaving $1,200 ($1,600 - $400) to be paid as dividends to the investors.**

**b. Creditors receive their $400 interest payment, leaving $500 ($900 – $400) to be paid as dividends to the investors. Note that the creditors receive the same fixed interest payment while dividends paid to investors fluctuate with profitability.**

**c. Creditors receive their $400 interest payment. No dividend is paid to investors. In this case the recognition of the interest expense will cause the company to have a net loss of $100 after interest expense ($300 before-interest profit - $400 interest expense). Note that interest is a contractual obligation that must be paid even if annual earnings are insufficient to support the interest payment. Indeed, bankruptcy is frequently caused by the inability to pay interest. In contrast, corporations are not required to pay dividends. Dividends are dependent on earnings. If there are no retained earnings, companies cannot pay dividends.**

**Note that these answers are based on the customary characteristics of interest and dividends. In practice, interest and dividends are based on the contractual terms of unique debt or equity agreements which may differ from ordinary circumstances. In other words, there are exceptions to the general treatment for interest and dividends that is described above.**

**EXERCISE 1-12A**

1. **Investors put assets into the company with the expectation of sharing profits. Creditors lend assets to the company with the expectation of repayment of the principal plus interest on the loan.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Harris Company**  **Accounting Equation** | | | | | |
| **Event** | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **Acquired assets** | **$7,800** |  | **$3,600** |  | **$4,200** |
| **Earned income** | **2,000** |  |  |  | **2,000** |
| **Balance** | **$9,800** |  | **$3,600** |  | **$6,200** |

**Since creditors are owed $3,600 and there are sufficient funds to pay them; the creditors will receive the $3,600 that they are owed. Since the investors own the business, they are entitled to the profits earned by the business. The investors will receive $6,200 (their original $4,200 investment plus the $2,000 of profit).**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Harris Company**  **Accounting Equation** | | | | | |
| **Event** | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **Acquired assets** | **$7,800** |  | **$3,600** |  | **$4,200** |
| **Incurred loss** | **(2,000)** |  |  |  | **(2,000)** |
| **Balance** | **$5,800** |  | **$3,600** |  | **$2,200** |

**Since creditors are owed $3,600 and there are sufficient funds to pay them; the creditors will receive the $3,600 that they are owed. Since the investors own the business, they suffer the losses earned by the business. The investors will receive $2,200 (their original $4,200 investment minus the $2,000 loss).**

**EXERCISE 1-12A (cont.)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Harris Company**  **Accounting Equation** | | | | | |
| **Event** | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** |
| **Acquired assets** | **$7,800** |  | **$3,600** |  | **$4,200** |
| **Incurred loss** | **(4,900)** |  | **(700)** |  | **(4,200)** |
| **Balance** | **$2,900** |  | **$2,900** |  | **$ 0** |

**While creditors get first priority to receive assets in a business liquidation, this does not mean they cannot lose all or a portion of the assets they loan a business. In this case, creditors are owed $3,600 but the business has only $2,900 of assets. Since the creditors have first priority, the entire $2,900 would be distributed to them. In this case, the creditors lose $700 ($3,600 original loan - $2,900 returned). Since the investors own the business, they suffer the losses earned by the business. The investors will lose the entire $4,200 they contributed to the business.**

**EXERCISE 1-13A**

|  |  |
| --- | --- |
| **Event** | **Classification** |
| **1.** | **Asset Source** |
| **2.** | **Asset Use** |
| **3.** | **Asset Use** |
| **4.** | **Asset Source** |
| **5.** | **Asset Exchange** |
| **6.** | **NA** |
| **7.** | **Asset Source** |
| **8.** | **Asset Use** |
| **9.** | **Asset Source** |
| **10.** | **Asset Exchange** |
| **11.** | **Asset Source** |
|  |  |

**EXERCISE 1-14A**

**Steps:**

**1.**

**Common Stock Issued = Change in Common Stock**

**$20,000 (given) = *$20,000***

**2.**

**Change in Stk. Equity = Change in Com. Stock + Change in Ret. Earn.**

**$65,000 (given) = $20,000 (1) + *$45,000***

**3.**

**Increase in Ret. Earn. = Net Income − Dividends**

**$45,000 (2) = *$50,000* − $5,000 (given)**

**Alternate Solution:**

**From the Statement of Changes in Stockholders’ Equity we know (with minor modifications):**

|  |  |  |
| --- | --- | --- |
|  |  |  |
| **Beginning Total Stk. Equity, 1/1/Year 5** |  | **$156,000** |
| **(Common Stock + Retained Earnings)** |  |  |
|  |  |  |
| **Plus: Common Stock Issued** | **$20,000** |  |
| **Plus: Net Income** | **?** |  |
| **Less: Dividends** | **(5,000)** |  |
| **Change in Stockholders’ Equity** |  | **65,000** |
|  |  |  |
| **Ending Total Stk. Equity, 12/31/Year 5** |  | **$221,000** |
|  |  |  |

**Working backwards from the change in equity we can solve for net income:**

|  |  |
| --- | --- |
|  |  |
| **Change in Stockholders’ Equity, Year 5** | **$65,000** |
| **Plus: Dividends** | **5,000** |
| **Less: Common Stock Issued** | **(20,000)** |
| **Net Income, Year 5** | ***$50,000*** |
|  |  |

**EXERCISE 1-15A**

**a.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Mijka Company**  **Accounting Equation for Year 1** | | | | | | | |
|  | | | | | | | |
|  | **Assets** | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  |  | **Common** |  | **Retained** |
| **Event** | **Cash** | **=** |  | **+** | **Stock** | **+** | **Earnings** |
| **1. Cash revenues** | **28,600** |  | **NA** |  | **NA** |  | **28,600** |
| **2. Paid expenses** | **(13,200)** |  | **NA** |  | **NA** |  | **(13,200)** |
| **3. Paid dividend** | **(1,500)** |  | **NA** |  | **NA** |  | **(1,500)** |
| **Ending Balance** | **13,900** | **=** | **-0-** | **+** | **-0-** | **+** | **13,900** |
|  |  |  |  |  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Mijka Company**  **Income Statement**  **For the Year Ended December 31, Year 1** | | | |
|  |  |  |  |
|  | **Revenue** | **$28,600** |  |
|  | **Expense** | **(13,200)** |  |
|  | **Net Income** | **$ 15,400** |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mijka Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** |  |  |
|  | **Plus: Common Stock Issued** | **0** |  |  |
|  | **Ending Common Stock** |  | **$ -0-** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ -0-** |  |  |
|  | **Plus: Net Income** | **15,400** |  |  |
|  | **Less: Dividends** | **(1,500)** |  |  |
|  | **Ending Retained Earnings** |  | **13,900** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$13,900** |  |
|  |  |  |  |  |

**EXERCISE 1-15A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mijka Company**  **Balance Sheet**  **As of December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** |  | **$13,900** |  |
|  |  |  |  |  |
|  | **Liabilities** |  | **$ -0-** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$ -0-** |  |  |
|  | **Retained Earnings** | **13,900** |  |  |
|  | **Total Stockholders’ Equity** |  | **13,900** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$13,900** |  |
|  |  |  |  |  |

**c. The income statement is dated with the term “for the year ended” because it covers a one year span of time. The balance sheet is dated with the term “as of” because it describes information at a specific point in time.**

**EXERCISE 1-16A**

**a. Land will be shown on the Year 8 balance sheet.**

**b. Land will be listed at its historical cost of $250,000.**

**c. The key concept used in listing land at its cost is the historical cost concept.**

**EXERCISE 1-17A**

**a.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Moore Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Net Cash Inflow from Operating Activities** |  | **$ 24,800** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Net Cash Outflow from Investing Activities** |  | **(16,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Net Cash Outflow from Financing Activities** |  | **(6,800)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **2,000** |  |
|  | **Plus: Beginning Cash Balance** |  | **45,800** |  |
|  | **Ending Cash Balance** |  | **$47,800** |  |
|  |  |  |  |  |

**b. Cash inflow from selling fast food to customers was greater than cash outflow for expenses.**

**c. The company paid cash to purchase long-term assets.**

**d. The company paid cash dividends or paid off a loan to a bank.**

**EXERCISE 1-18A**

**a.**

|  |  |
| --- | --- |
| **Event** | **Statement of Cash Flow Classification** |
| **1.** | **OA** |
| **2.** | **IA** |
| **3.** | **NA** |
| **4.** | **FA** |
| **5.** | **FA** |
| **6.** | **OA** |
| **7.** | **IA** |
| **8.** | **FA** |
| **9.** | **OA** |
| **10.** | **FA** |

**EXERCISE 1-18A (cont.)**

**b.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **All-Star Automotive Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 3** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Revenue** | **$ 25,000** |  |  |
|  | **Cash Payment for Salary Expense** | **(14,000)** |  |  |
|  | **Cash Payments for Utilities Expense** | **(2,800)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$8,200** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities** |  |  |  |
|  | **Cash from the Sale of Land** | **$ 9,000** |  |  |
|  | **Cash Paid to Purchase Land** | **(6,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **3,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$ 50,000** |  |  |
|  | **Cash Receipts from Loan** | **5,000** |  |  |
|  | **Cash Payment on Loan** | **(10,000)** |  |  |
|  | **Cash Payments for Dividends** | **(5,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **40,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **51,200** |  |
|  | **Plus: Beginning Cash Balance** |  | **9,000** |  |
|  | **Ending Cash Balance** |  | **$60,200** |  |
|  |  |  |  |  |

**EXERCISE 1-19A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Dakota Company**  **Accounting Equation for Year 2** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com.**  **Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Bal. 1/1/Y2** |  | **2,000** |  | **12,000** |  | **-0-** |  | **6,000** |  | **8,000** |  |
| **1. Issued stk.** |  | **30,000** |  | **NA** |  | **NA** |  | **30,000** |  | **NA** | **NA** |
| **2. Pur. Land** |  | **(12,000)** |  | **12,000** |  | **NA** |  | **NA** |  | **NA** | **NA** |
| **3. Loan** |  | **10,000** |  | **NA** |  | **10,000** |  | **NA** |  | **NA** | **NA** |
| **4. Provide Svc.** |  | **20,000** |  | **NA** |  | **NA** |  | **NA** |  | **20,000** | **Svc. Rev.** |
| **5. Paid Utilities** |  | **(1,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(1,000)** | **Util. Exp.** |
| **6. Pd. Op. Exp.** |  | **(15,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(15,000)** | **Op. Exp.** |
| **7. Paid Div.** |  | **(2,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(2,000)** | **Dividends** |
| **8. Land Value** |  | **NA** |  | **NA** |  | **NA** |  | **NA** |  | **NA** |  |
| **Totals** |  | **32,000** | **+** | **24,000** | **=** | **10,000** | **+** | **36,000** | **+** | **10,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Dakota Company**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Service Revenue** | **$20,000** |  |
|  | **Utilities Expense** | **(1,000)** |  |
|  | **Operating Expense** | **(15,000)** |  |
|  | **Net Income** | **$ 4,000** |  |
|  |  |  |  |

**EXERCISE 1-19A b. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Dakota Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ 6,000** |  |  |
|  | **Plus: Common Stock Issued** | **30,000** |  |  |
|  | **Ending Common Stock** |  | **$36,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 8,000** |  |  |
|  | **Plus: Net Income** | **4,000** |  |  |
|  | **Less: Dividends** | **(2,000)** |  |  |
|  | **Ending Retained Earnings** |  | **10,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$46,000** |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Dakota Company**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$32,000** |  |  |
|  | **Land** | **24,000** |  |  |
|  | **Total Assets** |  | **$56,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$10,000** |  |  |
|  | **Total Liabilities** |  | **$10,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$36,000** |  |  |
|  | **Retained Earnings** | **10,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **46,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$56,000** |  |
|  |  |  |  |  |

**EXERCISE 1-19A b. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Dakota Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$20,000** |  |  |
|  | **Cash Payment for Utilities Expense** | **(1,000)** |  |  |
|  | **Cash Payments for Other Operating Exp.** | **(15,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 4,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Paid to Purchase Land** | **$(12,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **(12,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$30,000** |  |  |
|  | **Cash Receipts from Loan** | **10,000** |  |  |
|  | **Cash Payments for Dividends** | **(2,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **38,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **30,000** |  |
|  | **Plus: Beginning Cash Balance** |  | **2,000** |  |
|  | **Ending Cash Balance** |  | **$32,000** |  |
|  |  |  |  |  |

**c. Percentage of assets provided by retained earnings:**

**$10,000 ÷ $56,000 = 17.9%**

**Cash cannot be directly traced to retained earnings. Retained earnings are used to acquire assets or pay liabilities.**

**EXERCISE 1-20A**

|  |  |
| --- | --- |
| **a.** | **Riley Company: Asset Exchange** |
| **b.** | **Smally Company: Asset Exchange** |
| **c.** | **Riley Company: Investing Activity** |
| **d.** | **Smally Company: Investing Activity** |

**EXERCISE 1-21A**

**a.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Carter Company**  **Accounting Equation as of January 1, Year 3** | | | | | | | | |
|  | | | | | | | | |
| **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Cash** | **+** | **Land** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **$800** |  | **$3,500** |  | **$600** |  | **$1,000** |  | **?** |
|  |  |  |  |  |  |  |  |  |

**Retained Earnings = $800 + $3,500 - $600 - $1,000 = $2,700**

**b. The company cannot pay a $1,000 dividend because it only has $800 of cash. The Retained Earnings account contains zero cash. The balance in this account represents a stockholders’ equity claim on assets.**

**c. Total Assets = $800 + $3,500 = $4,300**

**Creditor’s Loans ÷ Total Assets**

**$600 ÷ $4,300 = 13.9%**

**d. Investor’s Contributions ÷ Total Assets**

**$1,000 ÷ $4,300 = 23.3%**

**e. Retained Earnings ÷ Total Assets**

**$2,700 ÷ $4,300 = 62.8%**

**f.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Carter Company**  **Accounting Equation as of January 1, Year 3** | | | | | | | | |
|  | | | | | | | | |
| **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | |
|  |  |  |  | **Notes** |  | **Common** |  | **Retained** |
| **Cash** | **+** | **Land** | **=** | **Payable** | **+** | **Stock** | **+** | **Earnings** |
| **$800** |  | **$3,500** |  | **13.9%** |  | **23.3%** |  | **62.8%** |
|  |  |  |  |  |  |  |  |  |

**EXERCISE 1-21A (cont.)**

**g.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Carter Company**  **Accounting Equation as of December 31, Year 3** | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | |
| **Assets** | | | | | **=** | | **Liabilities** | | **+** | | **Stockholders’ Equity** | | | | |
|  |  |  |  |  | | **Notes** | |  | | **Common** | |  | **Retained** |  |
|  | **Cash** | **+** | **Land** | **=** | | **Payable** | | **+** | | **Stock** | | **+** | **Earnings** |  |
|  | **$800** |  | **$3,500** |  | | **$600** | |  | | **$1,000** | |  | **2,700** |  |
|  | **1,800** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **1,800** | **Rev.** |
|  | **(1,200)** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **(1,200)** | **Exp.** |
|  | **(500)** |  | **NA** |  | | **NA** | |  | | **NA** | |  | **(500)** | **Div** |
|  | **900** |  | **$3,500** |  | | **$600** | |  | | **$1,000** | |  | **$2,800** |  |
|  |  |  |  |  | |  | |  | |  | |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **Carter Company**  **Income Statement**  **For the Year Ended December 31, Year 3** | | | |
|  |  |  |  |
|  | **Revenue** | **$1,800** |  |
|  | **Expenses** | **(1,200)** |  |
|  | **Net Income** | **$ 600** |  |
|  |  |  |  |

**EXERCISE 1-21A g. (cont,)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Carter Company**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 3** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$1,000** |  |  |
|  | **Plus: Common Stock Issued** | **-0-** |  |  |
|  | **Ending Common Stock** |  | **$1,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$2,700** |  |  |
|  | **Plus: Net Income** | **600** |  |  |
|  | **Less: Dividends** | **(500)** |  |  |
|  | **Ending Retained Earnings** |  | **2,800** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$3,800** |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Carter Company**  **Balance Sheet**  **As of December 31, Year 3** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$ 900** |  |  |
|  | **Land** | **3,500** |  |  |
|  | **Total Assets** |  | **$4,400** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$600** |  |  |
|  | **Total Liabilities** |  | **$ 600** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$1,000** |  |  |
|  | **Retained Earnings** | **2,800** |  |  |
|  | **Total Stockholders’ Equity** |  | **3,800** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$4,400** |  |
|  |  |  |  |  |

**EXERCISE 1-21A g.(cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Carter Company**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 3** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$1,800** |  |  |
|  | **Cash Payments for Expenses** | **(1,200)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 600** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  | **0** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Payments for Dividends** | **(500)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **(500)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **100** |  |
|  | **Plus: Beginning Cash Balance** |  | **800** |  |
|  | **Ending Cash Balance** |  | **$ 900** |  |
|  |  |  |  |  |

**h. The income statement, statement of changes in stockholders’ equity and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology “***For the Year Ended* **December 31, Year 3”. In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In the case the point in time is December 31, Year 3. Therefore, this statement uses the terminology “***As of* **December 31, Year 3”.**

**i. The market value is not shown in the financial statements. The historical cost concept requires that assets be shown at their cost regardless of how long they have been on the company’s books.**

**j. The balance in the revenue account is zero on January 1, Year 4, because the balance in this account is transferred to retained earnings in the December 31, Year 3 closing process.**

**EXERCISE 1-22A**

**a. Since the amount in the Notes Payable account increased from zero to $9,000, Room Designs, Inc. must have received a cash inflow of $9,000 from the issue of the note payable. Similarly, since the balance in the common stock account increased from $3,500 to $7,500, Room Design must have received a cash inflow $4,000 ($7,500 - $3,500) from the issue of common stock. Finally, $2,000 dividend payment would have caused a net cash outflow. Therefore, the net cash inflow from financing activities can be explained as follows:**

|  |  |
| --- | --- |
| **Cash Flows From Financing Activities:** |  |
| **Cash Receipts from Loan** | **$9,000** |
| **Cash Receipts from Stock Issue** | **4,000** |
| **Cash Payments for Dividends** | **(2,000)** |
| **Net Cash Flow from Financing Activities** | **$11,000** |

**b. Since the balance in the land account increases from zero to $16,500, Room Designs must have had a net cash outflow $16,500 for the purchase of Land.**

**c.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Room Designs, Inc.**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$18,100** |  |
|  | **Expenses** | **(8,300)** |  |
|  | **Net Income** | **$9,800** |  |
|  |  |  |  |

**EXERCISE 1-22A c. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Room Designs, Inc.**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ 3,500** |  |  |
|  | **Plus: Common Stock Issued** | **4,000** |  |  |
|  | **Ending Common Stock** |  | **$7,500** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$ 6,400** |  |  |
|  | **Plus: Net Income** | **9,800** |  |  |
|  | **Less: Dividends** | **(2,000)** |  |  |
|  | **Ending Retained Earnings** |  | **14,200** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$21,700** |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Room Designs, Inc.**  **Balance Sheet**  **As of December 31, Year 2** | | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$14,200** |  |  |
|  | **Land** | **16,500** |  |  |
|  | **Total Assets** |  | **$30,700** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** | **$9,000** |  |  |
|  | **Total Liabilities** |  | **$ 9,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$7,500** |  |  |
|  | **Retained Earnings** | **14,200** |  |  |
|  | **Total Stockholders’ Equity** |  | **21,700** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$30,700** |  |
|  |  |  |  |  |

**EXERCISE 1-22A c. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Room, Designs, Inc.**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$ 18,100** |  |  |
|  | **Cash Payments for Expenses** | **(8,300)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 9,800** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Paid to Purchase Land** | **$(16,500)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **(16,500)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Loan** | **$ 9,000** |  |  |
|  | **Cash Receipts from Stock Issue** | **4,000** |  |  |
|  | **Cash Payments for Dividends** | **(2,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **11,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **4,300** |  |
|  | **Plus: Beginning Cash Balance** |  | **9,900** |  |
|  | **Ending Cash Balance** |  | **$14,200** |  |
|  |  |  |  |  |

**EXERCISE 1-23A**

**a.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Flowers Company**  **Accounting Equation as of December 31, Year 3** | | | | | | |
|  | | | | | | |
| **Assets** | **=** | **Liabilities** | **+** | **Common Stock** | **+** | **Retained Earnings** |
| **$130,000** |  | **$50,000** |  | **$70,000** |  | **?** |
|  |  |  |  |  |  |  |

**Retained Earnings = $130,000 - $70,000 - $50,000 = $10,000**

|  |  |
| --- | --- |
| **Retained Earnings after closing:** | **$10,000** |
| **Less, Revenue** | **(30,000)** |
| **Add, Expenses** | **18,000** |
| **Add, Dividends** | **3,000** |
| **Retained Earnings before closing** | **$ 1,000** |

**b. Retained Earnings after closing is $10,000 (see the equation above).**

**c. The balances in revenue, expenses, and dividends before closing are:**

|  |  |
| --- | --- |
| **Revenue** | **30,000** |
| **Expenses** | **18,000** |
| **Dividends** | **3,000** |

**d. After closing revenue, expenses, and dividends, all of the balances will be zero.**

**e. Both Common Stock and Retained Earnings represent obligations the business has to stockholders. The Common Stock represents the assets a business has acquired from owners. Retained earnings represent assets a business has acquired by conducting its operations.**

**EXERCISE 1-23A (cont.)**

**f. The owners are no better off immediately after they contributed capital to the business. While equity increased $30,000, the amount invested by owners also increased $30,000. The owners are only in a better financial position if their equity exceeds the amount they have invested in the company. At this point, the owners have simply exchanged cash for an additional ownership interest in the business. The owners will not benefit until the business uses the assets to produce profits. Note that it is possible that the owners could be worse off if the business incurs losses. In summary, the owners share in the benefits and sacrifices that the business experiences. They do not benefit when the business raises additional equity.**

**EXERCISE 1-24A**

**a.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Year** |  | **Cash**  **Revenues** |  | **Cash**  **Expenses** |  | **Net**  **Income** |  | **Retained**  **Earnings** |
| **1** |  | **$20,000** |  | **$11,000** |  | **9,000** |  | **9,000** |
| **2** |  | **30,000** |  | **14,000** |  | **16,000** |  | **25,000** |
| **3** |  | **40,000** |  | **22,000** |  | **18,000** |  | **43,000** |
|  |  |  |  |  |  |  |  |  |

**b. Net income is a measure of the benefits minus the sacrifices a company experiences during a single accounting period. Retained earnings is the amount of net income a company has earned minus the dividends it has paid out since its inception.**

**c.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Year** |  | **Cash**  **Revenues** |  | **Cash**  **Expenses** |  | **Net**  **Income** |  | **Retained**  **Earnings** |
| **1** |  | **$20,000** |  | **$11,000** |  | **9,000** |  | **9,000** |
| **2** |  | **30,000** |  | **14,000** |  | **16,000** |  | **20,000\*** |
| **3** |  | **40,000** |  | **22,000** |  | **18,000** |  | **38,000\*\*** |
|  |  |  |  |  |  |  |  |  |

**\*$9,000 Beginning Balance + $16,000 Net Income - $5,000 Dividends**

**\*\*$20,000 Beginning Balance + $18,000 Net Income**

**EXERCISE 1-25A**

**a. The balance in the Retained Earnings account as of January 31, Year 1 is zero.**

*Explanation: The revenue is recorded in the Revenue account and is not transferred into retained earnings until the year-end closing process is accomplished.*

**b. The balance in the Revenue account as of January 31, Year 1 is $7,500. The balance in the Expense accounts as of January 31, Year 1 is $4,800.**

*Explanation: The amounts in the revenue and expense accounts are not transferred to the Retained Earnings account until the year-end closing process is accomplished.*

**c. The *before closing* balance in the Retained Earnings account as of December 31, Year 1 is zero.**

*Explanation: The revenue and expenses are recorded in the Revenue and Expense accounts throughout the year and the balances in these accounts are not transferred into retained earnings until the year-end closing process is accomplished.*

**d. The December 31, Year 1 *before closing* balance in the Revenue account is $93,500 ($7,500 + $86,000). The December 31, Year 1 *before closing* balance in the Expense accounts is $55,800 ($4,800 + $51,000).**

*Explanation: The revenue and expense amounts accumulate in the Revenue and Expense accounts throughout the year.*

**e. The January 1, Year 2 balance in the Retained Earnings account is $37,700.**

*Explanation: The December 31. Year 1 year-end closing process transfers the $93,500 balance in the Revenue account and $55,800 expense accounts into the Retained Earnings account. Since revenue increases retained earnings and expenses decrease retained earnings, the December 31, Year 1 retained earnings account balance* **after closing** *is $37,700 ($93,500 - $55,800). Since last year’s ending balances become next year’s beginning balances, the balance in the Retained Earnings account as of January 1, Year 2 is $37,700.*

**f. The January 1, Year 2 balance in the Revenue and Expense accounts is zero.**

*Explanation: The balances in the revenue and expense accounts* **after closing** *are zero because the balances accumulated during the year were transferred to the retained earnings account during the closing process. The January 1, Year 2 balances in the revenue and expense accounts are zero.*

**EXERCISE 1-26A**

**a.**

|  |  |
| --- | --- |
| **Event** |  |
| **1.** | **Asset Source** |
| **2.** | **Asset Use** |
| **3.** | **Asset Use** |
| **4.** | **Asset Source** |
| **5.** | **Asset Source** |
| **6.** | **Asset Exchange** |
| **7.** | **NA** |

**b.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **The Candle Shop**  **Horizontal Statements Model** | | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event**  **No.** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | | **+** | **Common**  **Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **I** | **+** | **NA** | **=** | **NA** | | **+** | **I** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **I FA** |
| **2** |  | **D** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **D** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **D FA** |
| **3** |  | **D** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **D** |  | **NA** | **−** | **I** | **=** | **D** |  | **D OA** |
| **4** |  | **I** | **+** | **NA** | **=** | **I** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **I FA** |
| **5** |  | **I** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **I** |  | **I** | **−** | **NA** | **=** | **I** |  | **I OA** |
| **6** |  | **D** | **+** | **I** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **D IA** |
| **7** |  | **NA** | **+** | **NA** | **=** | **NA** | | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **NA** |
|  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |

**.**

**EXERCISE 1-27A**

1. **The assets would be worth the same, but would be shown at different amounts on the balance depending on whether U.S. GAAP or IFRS is used.**
2. **U.S. GAAP requires the asset be stated at its historical cost, which may be very different from the current value. IFRS allow companies to value assets at their current market values.**

**SOLUTIONS TO PROBLEMS - CHAPTER 1**

**PROBLEM 1-28A**

**a. The memo should explain that all entities must account for the use of assets, even though they may not be for-profit entities. The stakeholders are interested in the use of assets as well as the financial health of the entity.**

**b. Financial accounting is designed to meet the needs of external users. External users such as creditors and investors are interested in an objective, overall picture. For instance, both investors and creditors would be interested in the assets and liabilities of a business as well as in the net income. Both groups are interested in the growth factor as well as the risk factor.**

**Managerial accounting is designed to meet the needs of internal users. While there is overlap between the needs of both groups, i.e. net income, managers need more specific and detailed information. Managers may be concerned with the profitability of a particular department or product line while an investor is more concerned with the overall profitability of the company.**

**c. Stakeholders of a not-for-profit entity that may want financial accounting reports would include taxpayers, contributors, lenders, suppliers, employees, managers, financial analysts, attorneys, and beneficiaries.**

**d. Stakeholders that may want managerial accounting reports would include suppliers, managers, and employees.**

**PROBLEM 1-29A**

|  |  |
| --- | --- |
| **a. Entities mentioned:** | **b. Effect on the cash account:** |
| **1. Bob Wilder** | **Decrease** |
| **Wilder Co.** | **Increase** |
|  |  |
| **2. Sam Pace Business** | **Increase** |
| **Customers** | **Decrease** |
|  |  |
| **3. Jim Sneed** | **Increase/Decrease** |
| **National Bank** | **Decrease** |
| **Iuka Ford** | **Increase** |
|  |  |
| **4. OZ Company** | **Decrease** |
| **Employees** | **Increase** |
|  |  |
| **5. Gil Roberts** | **Decrease** |
| **Jim** | **Increase** |
|  |  |
| **6. Game, Inc.** | **Decrease** |
| **Atlanta Land Co.** | **Increase** |
|  |  |
| **7. Rob Moore** | **Decrease** |
| **Gil Thomas** | **Decrease** |
| **MT Partnership** | **Increase** |
|  |  |
| **8. Stephen Woo** | **Decrease** |
| **Izzard, Inc.** | **Increase** |
|  |  |
| **9. Natural Stone** | **Decrease** |
| **Shareholders** | **Increase** |
|  |  |
| **10. Billows, Inc.** | **Increase** |
| **National Bank** | **Decrease** |

**PROBLEM 1-30A**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Term** |  | **Definition/Phrase** |
| **a.** | **Assets** | **15.** | **Equal to liabilities plus stockholders’ equity.** |
| **b.** | **Common Stock** | **5.** | **Assets minus liabilities and retained earnings.** |
| **c.** | **Creditors** | **7.** | **Individuals or institutions that have loaned goods or services to a business.** |
| **d.** | **Dividend** | **14.** | **The item shown on the statement of changes in stockholders’ equity that represents a transfer of wealth from a business to its owners.** |
| **e.** | **General Ledger** | **8.** | **Complete set of accounts used in accounting systems.** |
| **f.** | **Expense** | **3.** | **The economic sacrifice (decrease in assets) incurred in the process of providing goods or services to customers.** |
| **g.** | **Financing Activity** | **12.** | **The section of the statement of cash flows that reflects cash collected from the issue of stock.** |
| **h.** | **Investing Activity** | **13.** | **The section of the statement of cash flows that reflects cash paid to purchase land.** |
| **i.** | **Liability** | **4.** | **Created when a company borrows money from a bank.** |
| **j.** | **Net Income** | **9.** | **Occurs when revenue exceed expenses during the year.** |
| **k.** | **Net Loss** | **6.** | **Occurs when expenses exceed revenues during the year.** |
| **l.** | **Operating Activity** | **11.** | **The section of the statement of cash flows that reflects cash paid for expenses.** |
| **m.** | **Retained Earnings** | **16.** | **A stockholders’ equity account that contains the amount of net income earned minus dividends paid since the inception of the business.** |
| **n.** | **Revenue** | **1.** | **The economic benefit (increase in assets) gained by providing goods or services to customers.** |
| **o.** | **Stockholders** | **2.** | **Investors who purchase common stock.** |
| **p.** | **Stockholders’ Equity** | **10.** | **Assets minus liabilities.** |

**PROBLEM 1-31A**

|  |  |  |
| --- | --- | --- |
| **Event No.** | **Type of Event** | **Effect on Total Assets** |
|  |  |  |
| **1.** | **Asset Source** | **Increase** |
| **2.** | **Asset Use** | **Decrease** |
| **3.** | **NA** | **NA** |
| **4.** | **Asset Source** | **Increase** |
| **5.** | **Asset Use** | **Decrease** |
| **6.** | **Asset Use** | **Decrease** |
| **7.** | **Asset Use** | **Decrease** |
| **8.** | **Asset Exchange** | **No Effect** |
| **9.** | **Asset Exchange** | **No Effect** |
| **10.** | **Asset Use** | **Decrease** |
| **11.** | **NA** | **NA** |
| **12.** | **Asset Source** | **Increase** |
| **13.** | **Asset Use** | **Decrease** |
| **14.** | **NA** | **NA** |
| **15.** | **Asset Exchange** | **No Effect** |
|  |  |  |

**PROBLEM 1-32A**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Item** | **Income Statement** | **Statement of Changes in Stk. Equity** | **Balance Sheet** | **Statement of Cash Flows** |
| **Financing activities** |  |  |  |  |
| **Ending common stock** |  |  |  |  |
| **Interest expense** |  |  |  |  |
| **As of (date)** |  |  |  |  |
| **Land** |  |  |  |  |
| **Beginning cash balance** |  |  |  |  |
| **Notes payable** |  |  |  |  |
| **Beginning common stock** |  |  |  |  |
| **Service revenue** |  |  |  |  |
| **Utility expense** |  |  |  |  |
| **Stock issued** |  |  |  |  |
| **Operating activities** |  |  |  |  |
| **For the Period Ended (Date)** |  |  |  |  |
| **Net income** |  |  |  |  |
| **Investing activities** |  |  |  |  |
| **Net loss** |  |  |  |  |
| **Ending cash balance** |  |  |  |  |
| **Salary expense** |  |  |  |  |
| **Consulting revenue** |  |  |  |  |
| **Dividends** |  |  |  |  |

**PROBLEM 1-33A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Accounting Equation for Year 1** | | | | | | | | | | | |
|  | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Com. Stock** | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **1. Issued stk** |  | **20,000** |  | **NA** |  | **NA** |  | **20,000** |  | **NA** | **NA** |
| **2. Revenue** |  | **35,000** |  | **NA** |  | **NA** |  | **NA** |  | **35,000** | **Revenue** |
| **3. Loan** |  | **25,000** |  | **NA** |  | **25,000** |  | **NA** |  | **NA** | **NA** |
| **4. Paid Exp.** |  | **(22,000)** |  | **NA** |  | **NA** |  | **NA** |  | **(22,000)** | **Oper. Exp.** |
| **5. Pur. Land** |  | **(30,000)** |  | **30,000** |  | **NA** |  | **NA** |  | **NA** | **NA** |
| **Totals** |  | **28,000** | **+** | **30,000** | **=** | **25,000** | **+** | **20,000** | **+** | **13,000** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Accounting Equation for Year 2** | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | |
|  |  | **Assets** | | | **=** | **Liabilities** | | **+** | | **Stockholders’ Equity** | | | |
| **Event** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | | **Com.**  **Stock** | | **+** | **Retained Earnings** | **Acct.**  **Title/RE** |
| **Beg. Bal.** |  | **28,000** |  | **30,000** |  | **25,000** |  | | **20,000** | |  | **13,000** |  |
| **1. Issued stk** |  | **24,000** |  | **NA** |  | **NA** |  | | **24,000** | |  | **NA** | **NA** |
| **2. Revenue** |  | **95,000** |  | **NA** |  | **NA** |  | | **NA** | |  | **95,000** | **Revenue** |
| **3. Paid Loan** |  | **(15,000)** |  | **NA** |  | **(15,000)** |  | | **NA** | |  | **NA** | **NA** |
| **4. Paid Exp.** |  | **(71,500)** |  | **NA** |  | **NA** |  | | **NA** | |  | **(71,500)** | **Oper. Exp.** |
| **5. Paid Div.** |  | **(3,000)** |  | **NA** |  | **NA** |  | | **NA** | |  | **(3,000)** | **Dividends** |
| **6. Land Val.** |  | **NA** |  | **NA** |  | **NA** |  | | **NA** | |  | **NA** |  |
| **Totals** |  | **57,500** | **+** | **30,000** | **=** | **10,000** | **+** | | **44,000** | | **+** | **33,500** |  |
|  |  |  |  |  |  |  |  | |  | |  |  |  |

**PROBLEM 1-33A (cont.)**

**b.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Mark’s Consulting**  **Income Statement**  **For the Period Ended December 31, Year 1** | | | |
|  |  |  |  |
|  | **Service Revenue** | **$35,000** |  |
|  | **Expenses** | **(22,000)** |  |
|  | **Net Income** | **$13,000** |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$ -0-** |  |  |
|  | **Plus: Common Stock Issued** | **20,000** |  |  |
|  | **Ending Common Stock** |  | **$20,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **-0-** |  |  |
|  | **Plus: Net Income** | **$13,000** |  |  |
|  | **Ending Retained Earnings** |  | **13,000** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$33,000** |  |
|  |  |  |  |  |

**PROBLEM 1-33A b. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Balance Sheet**  **As of December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$28,000** |  |  |
|  | **Land** | **30,000** |  |  |
|  | **Total Assets** |  | **$58,000** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** |  | **$25,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$20,000** |  |  |
|  | **Retained Earnings** | **13,000** |  |  |
|  | **Total Stockholders’ Equity** |  | **33,000** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$58,000** |  |
|  |  |  |  |  |

**PROBLEM 1-33A b. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 1** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$35,000** |  |  |
|  | **Cash Payments for Expenses** | **(22,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$13,000** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities:** |  |  |  |
|  | **Cash Payment for Land** | **$(30,000)** |  |  |
|  | **Net Cash Flow from Investing Activities** |  | **(30,000)** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Borrowed Funds** | **$25,000** |  |  |
|  | **Cash Receipts from Stock Issue** | **20,000** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **45,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **28,000** |  |
|  | **Plus: Beginning Cash Balance** |  | **-0-** |  |
|  | **Ending Cash Balance** |  | **$28,000** |  |
|  |  |  |  |  |

**PROBLEM 1-33A b. (cont.)**

|  |  |  |  |
| --- | --- | --- | --- |
| **Mark’s Consulting**  **Income Statement**  **For the Period Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Service Revenue** | **$95,000** |  |
|  | **Expenses** | **(71,500)** |  |
|  | **Net Income** | **$23,500** |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Statement of Changes in Stockholders’ Equity**  **For the Period Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$20,000** |  |  |
|  | **Plus: Common Stock Issued** | **24,000** |  |  |
|  | **Ending Common Stock** |  | **$44,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **13,000** |  |  |
|  | **Plus: Net Income** | **23,500** |  |  |
|  | **Less: Dividends** | **(3,000)** |  |  |
|  | **Ending Retained Earnings** |  | **33,500** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$77,500** |  |
|  |  |  |  |  |

**PROBLEM 1-33A b. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Balance Sheet**  **As of December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Assets** |  |  |  |
|  | **Cash** | **$57,500** |  |  |
|  | **Land** | **30,000** |  |  |
|  | **Total Assets** |  | **$87,500** |  |
|  |  |  |  |  |
|  | **Liabilities** |  |  |  |
|  | **Notes Payable** |  | **$10,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$44,000** |  |  |
|  | **Retained Earnings** | **33,500** |  |  |
|  | **Total Stockholders’ Equity** |  | **77,500** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$87,500** |  |
|  |  |  |  |  |

**PROBLEM 1-33A b. (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Mark’s Consulting**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipts from Customers** | **$95,000** |  |  |
|  | **Cash Payments for Expenses** | **(71,500)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$23,500** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities** |  | **-0-** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$24,000** |  |  |
|  | **Cash Payment on Debt** | **(15,000)** |  |  |
|  | **Cash Payment for Dividends** | **(3,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **6,000** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **29,500** |  |
|  | **Plus: Beginning Cash Balance** |  | **28,000** |  |
|  | **Ending Cash Balance** |  | **$57,500** |  |
|  |  |  |  |  |

**c. Retained Earnings does not contain cash.**

**d. In Year 1 and Year 2 net income and cash flows from operating activities are the same because all revenues and expenses are cash. Ordinarily, net income will be different from cash flows from operating activities due to non-cash revenue and expense transactions (discussed in Chapter 2). The net change in cash is different from net income because investing and financing activities do not directly affect revenue and expenses.**

**PROBLEM 1-33A (cont.)**

**e. Immediately after Event 2 in Year 1 is recorded the balance in the Retained Earnings account is zero. The revenue is recorded in a Revenue account, not in the Retained Earnings account. The revenue, expense, and dividend accounts are closed to the Retained Earnings account at the end of each accounting period. After closing the accounts at the end of Year 1, the Retained Earnings account will have a balance of $13,000 ($35,000 revenue - $22,000 expenses). The Year 1 ending balance becomes the Year 2 beginning balance. So, the balance in the Retained Earnings account on January 1, Year 2 is $13,000. This balance will not change until the closing process is completed in December Year 2. As a result, the balance in the Retained Earnings account immediately after Event 2 in Year 2 is recorded is $13,000.**

**PROBLEM 1-34A**

**a.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Prat Corp.**  **Accounting Equation** | | | | | | | |
|  | | | | | | | |
|  |  |  |  |  | **Stockholders’ Equity** | | |
|  |  |  |  |  | **Common** |  | **Retained** |
| **Event** | **Assets** | **=** | **Liabilities** | **+** | **Stock** | **+** | **Earnings** |
| **Beginning Balances** | **30,000** | **=** | **12,000** | **+** | **13,000** | **+** | ***5,0001*** |
| **1. Paid Expense** | **(26,000)** |  |  |  |  |  | **(26,000)** |
| **3. Paid Dividend** | **(2,000)** |  |  |  |  |  | **(2,000)** |
| **4. Paid Liability** | **(3,000)** |  | **(3,000)** |  |  |  |  |
| **5. Issued Stock** | **4,000** |  |  |  | **4,000** |  |  |
| **6. Revenue\*** | **35,550** |  |  |  |  |  | **35,5502** |
| **Ending Balance** | **38,550** | **=** | **9,000** | **+** | **17,000** | **+** | **12,550** |
|  |  |  |  |  |  |  |  |

**1Assets − Liabilities − Common Stock =:Retained Earnings**

**$30,000 − $12,000 − $13,000 = *$5,000***

**2Increase in Retained Earnings: $ 7,550**

**Add: Expenses 26,000**

**Add: Dividends 2,000**

**Revenue $35,550**

|  |  |  |  |
| --- | --- | --- | --- |
| **Prat Corp.**  **Income Statement**  **For the Year Ended December 31, Year 2** | | | |
|  |  |  |  |
|  | **Revenue** | **$35,550** |  |
|  | **Expense** | **(26,000)** |  |
|  | **Net Income** | **$ 9,550** |  |
|  |  |  |  |

**PROBLEM 1-34A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Prat Corp.**  **Statement of Changes in Stockholders’ Equity**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Beginning Common Stock** | **$13,000** |  |  |
|  | **Plus: Common Stock Issued** | **4,000** |  |  |
|  | **Ending Common Stock** |  | **$17,000** |  |
|  |  |  |  |  |
|  | **Beginning Retained Earnings** | **$5,000** |  |  |
|  | **Plus: Net Income** | **9,550** |  |  |
|  | **Less: Dividends** | **(2,000)** |  |  |
|  | **Ending Retained Earnings** |  | **12,550** |  |
|  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$29,550** |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Prat Corp.**  **Balance Sheet**  **As of December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Assets** |  | **$38,550** |  |
|  |  |  |  |  |
|  | **Liabilities** |  | **$ 9,000** |  |
|  |  |  |  |  |
|  | **Stockholders’ Equity** |  |  |  |
|  | **Common Stock** | **$17,000** |  |  |
|  | **Retained Earnings** | **12,550** |  |  |
|  | **Total Stockholders’ Equity** |  | **29,550** |  |
|  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$38,550** |  |
|  |  |  |  |  |

**PROBLEM 1-34A (cont.)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Prat Corp.**  **Statement of Cash Flows**  **For the Year Ended December 31, Year 2** | | | | |
|  |  |  |  |  |
|  | **Cash Flows From Operating Activities:** |  |  |  |
|  | **Cash Receipt from Revenue** | **$35,550** |  |  |
|  | **Cash Payment for Expense** | **(26,000)** |  |  |
|  | **Net Cash Flow from Operating Activities** |  | **$ 9,550** |  |
|  |  |  |  |  |
|  | **Cash Flows From Investing Activities** |  | **-0-** |  |
|  |  |  |  |  |
|  | **Cash Flows From Financing Activities:** |  |  |  |
|  | **Cash Receipts from Stock Issue** | **$ 4,000** |  |  |
|  | **Cash Payment to Creditors** | **(3,000)** |  |  |
|  | **Cash Dividend Paid to Stockholders** | **(2,000)** |  |  |
|  | **Net Cash Flow from Financing Activities** |  | **(1,000)** |  |
|  |  |  |  |  |
|  | **Net Increase in Cash** |  | **8,550** |  |
|  | **Plus: Beginning Cash Balance\*** |  | **30,000** |  |
|  | **Ending Cash Balance** |  | **$38,550** |  |
|  |  |  |  |  |

**\*Assumes all assets are cash.**

**b. Percentage of assets provided by:**

**Creditors $ 9,000 ÷ $38,550 = 23.35%**

**Investors $17,000 ÷ $38,550 = 44.10%**

**Earnings $12,550 ÷ $38,550 = 32.56%**

**c. The balance in the temporary accounts, revenue, expenses and dividends will be zero on January 1, Year 3, because they were closed to Retained Earnings at December 31, Year 2.**

**PROBLEM 1-35A**

**a.**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Maben Company**  **Horizontal Statements Model for Year 1** | | | | | | | | | | | | | | | | | | |
|  | | | | | | | | | | | | | | | | | | |
|  |  | **Balance Sheet** | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |
|  |  | **Assets** | | | **=** | **Liab.** | **+** | **Stockholders’ Equity** | | |  | **Revenue** | **−** | **Expense** | **=** | **Net Inc.** |  | **Cash Flows** |
| **Event**  **No.** |  | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Common Stock** | **+** | **Retained**  **Earnings** |  |  |  |  |  |  |  |  |
| **1** |  | **30,000** | **+** | **NA** | **=** | **NA** | **+** | **30,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **30,000 FA** |
| **2** |  | **40,000** | **+** | **NA** | **=** | **40,000** | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **40,000 FA** |
| **3** |  | **48,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **48,000** |  | **48,000** | **−** | **NA** | **=** | **48,000** |  | **48,000 OA** |
| **4** |  | **(25,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(25,000)** |  | **NA** | **−** | **25,000** | **=** | **(25,000)** |  | **(25,000) OA** |
| **5.** |  | **(1,000)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(1,000)** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(1,000) FA** |
| **6.** |  | **20,000** | **+** | **NA** | **=** | **NA** | **+** | **20,000** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **20,000 FA** |
| **7.** |  | **(10,000)** | **+** | **NA** | **=** | **(10,000)** | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(10,000) FA** |
| **8.** |  | **(53,000)** | **+** | **53,000** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **(53,000) IA** |
| **9.** |  | **NA** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **NA** |  | **NA** | **−** | **NA** | **=** | **NA** |  | **NA** |
| **Total** |  | **49,000** | **+** | **53,000** | **=** | **30,000** | **+** | **50,000** | **+** | **22,000** |  | **48,000** | **−** | **25,000** |  | **23,000** |  | **49,000 NC** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. **Total Assets = $49,000 + $53,000 = $102,000**

**c.**

|  |  |
| --- | --- |
| **Sources of Assets** | |
| **1. Issue of stock** | **$ 30,000** |
| **2. Cash from loan** | **40,000** |
| **3. Cash from revenue** | **48,000** |
| **6. Issue of stock** | **20,000** |
| **Total Sources of Assets** | **$138,000** |

**PROBLEM 1-35A (cont.)**

1. **Net income amounts to $23,000 (see part a.) Dividends are not expenses and do not appear on the income statement.**

**e.**

|  |  |
| --- | --- |
| **Operating Activities:** | |
| **Cash from revenue** | **$48,000** |
| **Cash paid for expenses** | **(25,000)** |
| **Net Cash Flow from Operating Activities** | **$23,000** |
|  |  |

|  |  |
| --- | --- |
| **Investing Activities:** | |
| **Cash paid to purchase land** | **$(53,000)** |
| **Net Cash Flow from Investing Activities** | **$(53,000)** |
|  |  |

|  |  |
| --- | --- |
| **Financing Activities:** | |
| **Cash from stock issue ($30,000 + $20,000)** | **$50,000** |
| **Cash from loan** | **40,000** |
| **Paid cash dividend** | **(1,000)** |
| **Cash paid on loan principal** | **(10,000)** |
| **Net Cash Flow from Financing Activities** | **$79,000** |
|  |  |

**f. Percentage of assets is provided as follows:**

**Investors ($50,000 ÷ $102,000) 49.0%**

**Creditors ($30,000 ÷ $102,000) 29.4%**

**Earnings ($22,000 ÷ $102,000) 21.6%**

**g. Zero. The revenue is recorded in a Revenue account not in the Retained Earnings account. The balance in the Revenue account is transferred to Retained Earnings at the end of the accounting period through the closing process.**