CHAPTER 1

# ACCOUNTING IN ACTION

**CHAPTER LEARNING OBJECTIVES**

**1.** ***Identify the uses and users of accounting and the objective of financial reporting.*** Accounting is the information system that identifies, records, and communicates the economic events of an organization to a wide variety of interested users. Good accounting is important to people both inside and outside the organization. Internal users, such as management, use accounting information to plan, control, and evaluate business operations. External users include investors and creditors, among others. Accounting data are used by investors (owners or potential owners) to decide whether to buy, hold, or sell their financial interests. Creditors (suppliers and bankers) evaluate the risks of granting credit or lending money based on the accounting information. The objective of financial reporting is to provide useful information to investors and creditors to make these decisions. Users need information about the business’s ability to earn a profit and generate cash. For our economic system to function smoothly, reliable and ethical accounting and financial reporting are critical.

**2.** ***Compare the different forms of business organization.*** The most common examples of business organization are proprietorships, partnerships, and corporations. Proprietorships and partnerships are not separate legal entities but are separate entities for accounting purposes; income taxes are paid by the owners and owners have unlimited liability. Corporations are separate legal entities as well as separate entities for accounting purposes; income taxes are paid by the corporation and owners of the corporation have limited liability.

**3.** ***Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.*** Generally accepted accounting principles are a common set of guidelines that are used to prepare and report accounting information. The conceptual framework outlines some of the body of theory used by accountants to fulfill their goal of providing useful accounting information to users. Ethical behaviour is fundamental to fulfilling the objective of financial accounting. The reporting entity concept requires the business activities of each reporting entity to be kept separate from the activities of its owner and other economic entities. The going concern assumption presumes that a business will continue operations for enough time to use its assets for their intended purpose and to fulfill its commitments. The periodicity concept requires businesses to divide up economic activities into distinct periods of time. Qualitative characteristics include fundamental and enhancing characteristics that help to ensure accounting information is useful.

Only events that cause changes in the business’s economic resources or changes in the claims on those resources are recorded. Recognition is the process of recording transactions and measurement is the process of determining the amount that should be recognized. The historical cost concept states that economic resources should be recorded at their historical (original) cost. Fair value may be a more appropriate measure for certain types of resources. Generally, fair value is the amount the resource could be sold for in the market. The monetary unit concept requires that only transactions that can be expressed as an amount of money be included in the accounting records, and it assumes that the monetary unit is stable.

The revenue recognition principle requires companies to recognize revenue when a performance obligation(s) is satisfied. The matching concept requires that costs be recognized as expenses in the same period as revenue is recognized when there is a direct association between the cost incurred and revenue recognized.

In Canada, there are two sets of standards for profit-oriented businesses. Publicly accountable enterprises must follow International Financial Reporting Standards (IFRS) and private enterprises have the choice of following IFRS or Accounting Standards for Private Enterprises (ASPE).

**4.** ***Describe the elements of the financial statements and explain the accounting equation.*** Assets, liabilities, and owner’s equity are reported on the balance sheet. Assets are present economic resources controlled by the business as a result of past events and have the potential to produce economic benefits. Liabilities are present obligations of a business to transfer an economic resource as a result of past events. Owner’s equity is the owner’s claim on the company’s assets and is equal to total assets minus total liabilities. The balance sheet is based on the accounting equation: Assets = Liabilities + Owner’s equity.

The Income statement reports the profit or loss for a specified period of time. Profit is equal to revenues minus expenses. Revenues are the increases in assets, or decreases in liabilities, that result from business activities that are undertaken to earn profit. Expenses are the cost of assets consumed or services used in a company’s business activities. They are decreases in assets or increases in liabilities, excluding withdrawals made by the owners, and result in a decrease to owner’s equity.

The statement of owner’s equity summarizes the changes in owner’s equity during the period. Owner’s equity is increased by investments by the owner and profits. It is decreased by drawings and losses. Investments are contributions of cash or other assets by owners. Drawings are withdrawals of cash or other assets from the business for the owner’s personal use. Owner’s equity in a partnership is referred to as partners’ equity and in a corporation as shareholders’ equity.

A cash flow statement summarizes information about the cash inflows (receipts) and outflows (payments) for a specific period of time.

**5.** ***Analyze the effects of business transactions on the accounting equation.*** Each business transaction must have a dual effect on the accounting equation. For example, if an individual asset is increased, there must be a corresponding (1) decrease in another asset, (2) increase in a liability, and/or (3) increase in owner’s equity.

**6.** ***Prepare financial statements.*** The income statement is prepared first. Expenses are deducted from revenues to calculate the profit or loss for a specific period of time. Then the statement of owner’s equity is prepared using the profit or loss reported in the income statement. The profit is added to (losses are deducted from) the owner’s equity at the beginning of the period. Drawings are then deducted to calculate owner’s equity at the end of the period. A balance sheet reports the assets, liabilities, and owner’s equity of a business as at the end of the accounting period. The owner’s equity at the end of the period, as calculated in the statement of owner’s equity, is reported on the balance sheet in the owner’s equity section.

### Exercises

**Exercise 1**

Mike Homes is a business owned by Mike Smith. The accounting for this business is done by Mike’s sister Leigh. Leigh is currently preparing the 2024 year-end financial statements that Mike will use for three purposes:

1. to submit with his tax returns;

2. to support a loan application; and

3. to help him evaluate the success of the business.

**Instructions**

a) For each of the three purposes identified, describe the information needs the user will fulfill based on Mike Home’s financial statements.

b) Leigh has suggested that she can help Mike out by recording some January 2025 revenue in December 2024. She feels this is reasonable because it is just a slight timing difference and so “not really dishonest.” Comment on the ethical implications of this suggestion and explain how each of the three users’ needs may be affected if Leigh implements her suggestion.

**Solution Exercise 1** (10 min.)

a) Information needs for each of the three users:

1. The tax department will want to know whether the company respects the tax laws.

2. The bank’s loans officer will evaluate the risk of granting credit or lending money.

3. Mike will be able to assess whether the business is earning him the amount of profit he is expecting in comparison with other similar businesses.

b) Leigh’s action would be unethical because it would be misrepresenting the true results of the business operations for 2024. It would violate the trust each financial statement user places in the accounting information. The effect on each of the needs identified in part a) would be:

1. The tax department might assess higher taxes than are warranted.

2. The bank might lend more money to Mike than they would otherwise, based on expectations of higher future profits than can actually be achieved because the bank’s projections are based on incorrect historical information.

3. Mike might assume that past projects were more profitable than they really were. He might therefore reject new projects based on the assumption that he does not need to increase his sales above current levels in order to earn target profit levels.

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Identify the uses and users of accounting and the objective of financial reporting.

Section Reference: Why Is Accounting Important?

CPA: Financial Reporting

CPA: Problem-Solving and Decision-Making

CPA: Professional and Ethical Behaviour

AACSB: Ethics

**Exercise 2**

The following are six questions that users of accounting information might ask about Agusta Auto Towing.

**Instructions**

For each question, indicate who the decision maker is and whether it is an external or internal user.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Decision** | **Decision maker** | **External or internal** |
| a) | Can Agusta’s operations generate sufficient cash to make payments on a term loan? |  |  |
| b) | Does Agusta have sufficient assets to provide security for a mortgage loan? |  |  |
| c) | Should Agusta continue its current business, or look for more profitable opportunities in a different line of business? |  |  |
| d) | Were the profit-sharing bonuses paid to unionized employees equal to the percentage of profit stated in the employment contract? |  |  |
| e) | Was the amount of harmonized sales taxes (HST) that Agusta remitted to the tax department equal to 13% of its revenue, as required by law? |  |  |
| f) | Does Agusta have enough money in the bank to provide drawings to the owner? |  |  |

**Solution Exercise 2** (10 min.)

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Decision** | **Decision maker** | **External or internal** |
| a) | Can Agusta’s operations generate sufficient cash to make payments on a term loan? | Banker | External |
| b) | Does Agusta have sufficient assets to provide security for a mortgage loan? | Banker/lender | External |
| c) | Should Agusta continue its current business, or look for more profitable opportunities in a different line of business? | Management | Internal |
| d) | Were the profit-sharing bonuses paid to unionized employees equal to the percentage of profit stated in the employment contract? | Employee union | External |
| e) | Was the amount of harmonized sales taxes (HST) that Agusta remitted to the tax department equal to 13% of its revenue, as required by law? | Tax assessor  (Canada Revenue Agency) | External |
| f) | Does Agusta have enough money in the bank to provide drawings to the owner? | Owner | Internal |

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Identify the uses and users of accounting and the objective of financial reporting.

Section Reference: Why Is Accounting Important?

CPA: Financial Reporting

AACSB: Analytic

**Exercise 3**

MGS Company recently released its first set of financial statements. Below is a list of potential users of the financial statements:

1. Labour union

2. Customers

3. Canadian Imperial Bank of Commerce

4. Canada Revenue Agency

5. Potential shareholders/investors

6. Sales Manager

7. Marketing Manager

8. Economic planners

9. Provincial securities commission

10. Human Resources Director

**Instructions**

a) For each user, identify whether the user is an external or internal user.

b) Provide a brief explanation as to the difference between external and internal users.

**Solution Exercise 3** (15 min.)

a)

1. external

2. external

3. external

4. external

5. external

6. internal

7. internal

8. external

9. external

10. internal

b) External users do not work for the company and may use the information to base future decisions about the company (i.e., loans, invest, or future profitability) or in the case of governments and regulators, whether the company is respecting laws and regulations.

Internal users plan, organize, and run the company. They use the information to create or alter future budgets, projects, or for detailed comparisons.

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the uses and users of accounting and the objective of financial reporting.

Section Reference: Why Is Accounting Important?

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 4

The following is a list of users of accounting information:

A) Managers

B) Regulators

C) Employees

D) Shareholders

E) Lenders

F) Suppliers

G) External auditors

**Instructions**

Match the most appropriate user to the following user objectives. (Note: Each user should only be applied once.)

\_\_\_\_\_\_\_(1) The accuracy of the internal budgeted financial information

\_\_\_\_\_\_\_(2) Verification that the financial statements are fairly presented

\_\_\_\_\_\_\_(3) Compliance with income tax laws

\_\_\_\_\_\_\_(4) The company’s ability to repay its loans

\_\_\_\_\_\_\_(5) Fairness of wages

\_\_\_\_\_\_\_(6) The company’s ability to pay for its inventory

\_\_\_\_\_\_\_(7) The company’s ability to generate profits and provide a return on investment

**Solution Exercise 4** (5 min.)

\_\_\_A\_\_\_(1) The accuracy of the internal budgeted financial information

\_\_\_G\_\_\_(2) Verification that the financial statements are fairly presented

\_\_\_B\_\_\_(3) Compliance with income tax laws

\_\_\_E\_\_\_(4) The ability of a company to repay its loans

\_\_\_C\_\_\_(5) Fairness of wages

\_\_\_F\_\_\_(6) The company’s ability to pay for its inventory

\_\_\_D\_\_\_(7) The company’s ability to generate profits and provide a return on investment

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Identify the uses and users of accounting and the objective of financial reporting.

Section Reference: Why Is Accounting Important?

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 5

The following is a list of users of accounting information:

a) Managers

b) Regulators

c) Employees

d) Shareholders

e) Lenders

f) Suppliers

**Instructions**

Identify the above users as internal (I) or external (E) using the following format:

\_\_\_\_\_\_\_(a) Managers

\_\_\_\_\_\_\_(b) Regulators

\_\_\_\_\_\_\_(c) External auditors

\_\_\_\_\_\_\_(d) Shareholders

\_\_\_\_\_\_\_(e) Lenders

\_\_\_\_\_\_\_(f) Suppliers

**Solution Exercise 5** (5 min.)

\_\_\_I\_\_\_(a) Managers

\_\_\_E\_\_ (b) Regulators

\_\_\_E\_\_\_(c) External auditors

\_\_\_E\_\_ (d) Shareholders

\_\_\_E\_\_ (e) Lenders

\_\_\_E\_\_ (f) Suppliers

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Identify the uses and users of accounting and the objective of financial reporting.

Section Reference: Why Is Accounting Important?

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 6

Listed below are various types of business organizations:

1. Three individuals created a law practice. The law practice does not pay its own taxes.

2. Two individuals bought shares of a company as an investment.

3. A single mother opens her own hair salon. The hair salon pays its own taxes.

4. Husband and wife decide to open a daycare business. The wife will operate and maintain the daycare while the husband works his normal full-time job. The daycare income will be reported solely on the wife’s personal tax return.

5. A public company with 100 shareholders.

6. Two friends create a chocolate company business. All profits will be on their personal returns.

**Instructions**

a) For each of the six situations, identify the type of business organization.

b) For each of the six situations, identify the owner’s liability.

**Solution Exercise 6** (10 min.)

a) b)

1. Partnership Unlimited

2. Corporation Limited

3. Corporation Limited

4. Proprietorship Unlimited

5. Corporation Limited

6. Partnership Unlimited

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Compare the different forms of business organization.

Section Reference: Forms of Business Organization

CPA: Financial Reporting

##### Exercise 7

Listed below are various situations relating to business organizations:

1. Paul’s Woodworking does not have a separate legal existence apart from the one person who owns it.

2. Luke and Sheri own Wise Financial Inc., a financial and personal taxation services provider. Neither Luke nor Sheri has personal responsibility of the debts of Wise Financial Inc.

3. Lucky Snacks is owned by Ray Umber, who is personally liable for the debts of the business.

4. Ownership of Tractor and Wheels Corporation is divided into thousands of shares.

5. Chris and Melissa own Chris’ Curiosity, a restaurant. Both Chris and Melissa are personally liable for the debts of the business.

6. Torby Technologies has two owners and does not pay income taxes.

**Instructions**

Determine whether the situation described above refers to a proprietorship, partnership, or corporation.

**Solution Exercise 7** (5 min.)

1. Proprietorship

2. Corporation

3. Proprietorship

4. Corporation

5. Partnership

6. Partnership

Bloomcode: Application

Difficulty: Medium

Learning Objective: Compare the different forms of business organization.

Section Reference: Forms of Business Organization

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 8

Each of the following independent situations represents a violation of accounting principles:

1. It is now the end of 2024 and Stella Corp. is preparing its annual financial statements. The company has been experiencing severe financial difficulties and management anticipates that the company will cease operations in 2025, but this is not disclosed in the financial statements.

2. Fritz Schmitz runs a small business. All receipts from the business are deposited into Fritz’s personal bank account and all Fritz’s expenses, both personal and business, are paid out of this same account. Fritz makes no attempt to maintain separate records for the business.

3. Dean has a mining company that is very profitable. Over the past few years, Dean has been very good at maintaining his business records and books. However, Dean’s wife has recently been using the company account to pay for her personal expenses. She informed Dean that since he owns the company all the money earned will go to him anyway and therefore using either the company account or their personal bank account makes no difference.

**Instructions**

For each of the situations listed above, fill in the appropriate letter to indicate which of the following accounting principles has been violated:

a) Going concern assumption

b) Reporting entity concept

##### Solution Exercise 8 (5 min.)

1. a

2. b

3.b

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

**Exercise 9**

1. Explain the going concern assumption. How is it relevant in accounting for a business that may be going through temporary financial difficulties?

2. Explain how the reporting entity concept applies when a business is owned and operated by a sole proprietor.

**Solution Exercise 9** (10 min.)

1. The going concern assumption states that a business is assumed that it will continue its operations for the foreseeable future. This means that even though a business may be experiencing financial difficulties, assets and liabilities are still presented as though the assets will continue to be used in the business and liabilities will be honoured. If it becomes apparent that the business will discontinue operations, it is necessary to report in the financial statements that the company is not a going concern.

2. The reporting entity concept requires that only the events and transactions of a business be reported in the financial statements of a business. Therefore, although an unincorporated business is not a separate legal entity in the same sense that a corporation is, the accountant must still ensure that personal economic activities (transactions, assets, and liabilities) of the business owner are not reported in the business’s financial statements.

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

**Exercise 10**

Both of the following independent situations represents a departure from generally accepted accounting principles:

1. Strad Music Supplies is a proprietorship owned and operated by Giuseppe Amati. Giuseppe started the business with funds given to him by his uncle. He gives his uncle a copy of Strad’s financial statements each year so that his uncle will see this was a good investment. In 2023 both Giuseppe and his uncle were disappointed that sales had decreased from the prior year. When Giuseppe wins $50,000 in a lottery during 2024, he decides to record the amount as revenue in the financial statements of the business to avoid disappointing his uncle even further.

2. Xavier Quinn, the owner of Quinn’s Travel, is thinking of retiring in less than six months because the business has become unsuccessful. Xavier has determined that he will be unable to realize the full value of the business’s assets and will be unable to repay all of the business’s debts. Xavier makes no such disclosures in the financial statements.

**Instructions**

For each situation listed above:

a) Identify which principle, concept, or assumption has been violated

b) Describe what the correct accounting treatment would be, and

c) Explain why the correct treatment provides better information.

**Solution Exercise 10** (10 min.)

1. The reporting entity concept has been violated. Giuseppe should record only transactions related to the business in Strad’s financial statements. By including personal income, a correct evaluation of the business’s performance cannot be made.

2. The going concern assumption is violated. To provide users with accurate and timely data, the assets and liabilities should be accounted for as though the business will cease to exist.

Bloomcode: Application

Difficulty: Medium

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

CPA: Professional and Ethical Behaviour

AACSB: Analytic

##### Exercise 11

You were auditing the accounting records of Aldi Tool Company, owned and operated by Chad Fleming, and noticed the following events:

1. Chad deals with foreign suppliers who invoice the company in U.S. dollars. Chad normally records the amounts in the accounting records as displayed in the invoice because he thinks the exchange rate is similar to the Canadian dollar.

2. Chad often receives deposits for contracts to be completed in the following fiscal year. He reports all deposits as revenue once the cash is received.

3. Chad wrote a cheque for $900 to Little Hugs Day Care Centre. The amount relates to child care service for Chad’s daughter Gabrielle.

**Instructions**

Identify the accounting principle, concept, or assumption violated in each of the events described above.

##### Solution Exercise 11 (5 min.)

1. Monetary unit concept

2. Revenue recognition principle

3.Reporting entity concept

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 12

The following is a list of fundamental and enhancing qualitative characteristics:

1. relevance

2. faithful representation

3. neutral

4. comparability

5. consistency

6. verifiability

7. timeliness

8. understandability

**Instructions**

Using the list of qualitative characteristics stated above, identify the appropriate qualitative characteristic being described in each of the statements below. (Note: a characteristic cannot be used more than once.)

a) Characteristic that requires that information cannot be selected to favour one set of interested parties over another.

b) Characteristic requiring information be available to decision makers before it loses its ability to influence decisions.

c) Characteristic requiring that numbers and descriptions in financial statements represent what really existed or happened.

d) Information that is capable of making a difference in a decision is said to have this qualitative characteristic.

e) Characteristic being employed when a company uses the same accounting principles from year to year.

**Solution Exercise 12** (5 min.)

a) neutral

b) timeliness

c) faithful representation

d) relevance

e) consistency

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

**Exercise 13**

In each of the following situations, the accountant for Stan Design Services (Stan) must decide how to record the information in the financial statements. Stan is a proprietorship owned and operated by Maria Steinwald.

1. Maria would like to borrow money from the bank to expand the business. Since she owns a house that can be pledged as security for a bank loan, she asks the accountant to ensure that the house is shown on Stan’s balance sheet.

2. The accountant is confident that with a new contract that was signed, Stan will be a successful business for many years to come. However, before that was finalized, he was curious whether there would be any effect on accounting for the assets and liabilities of the business if its ongoing viability had been in doubt.

**Instructions**

For each of the situations, identify what principle would guide the accountant in deciding how to report the situation, and describe the correct treatment.

**Solution Exercise 13** (5 min.)

1. The reporting entity concept requires that no personal economic activities (e.g., assets) are recorded in the records of the business, and therefore the house should not be included on Stan’s balance sheet.

2. The going concern assumption applies. In accordance with this assumption, accounting for the business should be based on the assumption that it will continue for the foreseeable future, so there is no difference in the accounting in this situation.

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

**Exercise 14**

Listed below are various types of organizations:

1. publicly accountable enterprise

2. bank or credit union

3. private corporation

4. security broker

5. Canadian partnership

**Instructions**

a) For each organization, identify the appropriate accounting standards the organization should follow (ASPE or IFRS).

b) If applicable, identify if any organization has the option to follow both standards.

**Solution Exercise 14** (5 min.)

a)

1. IFRS

2. IFRS

3. ASPE

4. IFRS

5. ASPE

b) Canadian private companies including corporations have the option to adopt IFRS or ASPE. Therefore 3. and 5. can adopt either set of standards.

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 15

For the accounts listed below, fill in the appropriate code letter to indicate whether the item is an Asset (A), Liability (L), or Owner's Equity (OE) item.

1. Rent Expense 6. Cash

2. Equipment 7. Accounts Receivable

3. Accounts Payable 8. L. Landry, Drawings

4. L. Landry, Capital 9. Service Revenue

5. Insurance Expense 10. Notes Payable

##### Solution Exercise 15 (5 min.)

1. OE

2. A

3. L

4. OE

5. OE

6. A

7. A

8. OE

9. OE

10. L

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

**Exercise 16**

1. What is meant by the historical cost measurement method? Explain why the method is used primarily when accounting for assets used in a business.

2. Explain the monetary unit concept. Explain how a business may have competitive advantages that are not reported in the financial statements due to this principle, and provide an example.

**Solution Exercise 16** (10 min.)

1. Cost is the amount paid for an asset. Cost is definite and verifiable as it can be measured by fact. Users will be more comfortable with this measurement as it is objective.

2. The monetary unit concept states that only events that can be measured in a monetary unit are reported in the financial statements, and that the same monetary unit should be used to report all transactions. However, the business may have a particularly talented workforce in comparison to those of their competitors. Because the value of this extra talent cannot be measured in monetary terms, it is not recorded as an asset in the financial statements. Other examples might include inventions or internally developed technology.

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

**Exercise 17**

Each of the following independent situations represents a departure from generally accepted accounting principles:

1. Homer Properties owns a number of apartment buildings. In April 2024, a new building was purchased for $1,000,000. Because of the rapid increase in real estate prices, by the time Homer’s accountant recorded the purchase in July 2024, the estimated value of the property had increased to $1,200,000. The accountant decided to record the new building at $1,200,000.

2. Expat Imports International purchases products in the United States for resale in Canada. The goods they buy are paid for in U.S. dollars. In Expat’s financial statements, each amount is identified as being in either U.S. or Canadian dollars, as follows:

Service revenue $ 40,000 (C$)

Cost of goods sold (25,000) (U.S.$)

Wages expense (7,000) (C$)

Freight expense (2,000) (U.S.$)

Profit for the month $ 6,000

**Instructions**

For each situation, (i) identify which principle, concept, or assumption has been violated, (ii) describe what the correct accounting treatment would be, and (iii) explain why the correct treatment provides better information.

**Solution Exercise 17** (15 min)

1. The historical cost measurement method has been violated. The accountant should have recorded the building at $1,000,000. Cost is more verifiable than estimated fair values. Fair values are not relevant because the building is not being sold.

2. The monetary unit concept has been violated. The transactions should all be recorded in the equivalent Canadian dollars. By combining different currencies, the amount of profit is not meaningful.

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

**Exercise 18**

In each of the following situations, the accountant for Meg Design Services (Meg) must decide how to record the information in the financial statements. Meg is a proprietorship owned and operated by Petra Smith.

1. In April, Meg purchased some furniture that will be used in a client’s newly designed office. Meg paid $4,000 for the furniture, and the client will pay Meg $5,600 when it is delivered and assembled in May. The accountant wants to know at which amount the furniture should be reported on the April 30 balance sheet.

2. In June, Meg signed a long-term contract with a hotel chain to review all of their hotels’ décor annually and recommend updates as fashions change. The fees will be based on the amount of time spent on the annual review. The first location will be evaluated starting in September. The accountant believes this contract is of great value to Meg even though no money has changed hands yet, and wonders how it can be shown in the June 30 financial statements.

**Instructions**

For each of the situations, identify which generally accepted accounting principle would guide the accountant in deciding how to report the situation, and describe the correct treatment.

**Solution Exercise 18** (10 min.)

1. The historical cost measurement method states that the transaction should be reported at its cost, which is $4,000.

2. The monetary unit assumption states that only transactions that can be measured in monetary terms should be recorded. Since no funds have changed hands, and the benefit cannot be measured until it is known how many hours are to be spent, there is no transaction that can be measured in monetary terms.

Bloomcode: Application

Difficulty: Medium

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

**Exercise 19**

For each of the situations listed below, indicate which of the following generally accepted accounting principles have been violated:

a) Monetary unit concept

b) Historical cost measurement method

1. Cheers International revalues its financial statements each year to take into consideration the effects of inflation. The company justifies its decision by stating the “inflation-adjusted statements more fully reflect the purchasing power of the company’s earnings.”

2. Bert began operations 11 years ago and purchased land for $200,000. Bert has since built a manufacturing plant on this land to use in daily operations. Today Bert has appraised the value of his land to be $1.5 million. He increases the value of the land to be reported on the financial statements to $1.5 million.

**Solution Exercise 19** (5 min.)

1. Monetary unit concept

2. Historical cost measurement method

Bloomcode: Application

Difficulty: Medium

Learning Objective: Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Section Reference: Generally Accepted Accounting Principles

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 20

From the following list of selected accounts taken from the records of Miller Clinic, identify which accounts would appear on the balance sheet.

a) Jane Miller, Capital f) Accounts Payable

b) Service Revenue g) Cash

c) Land h) Rent Expense

d. Salaries Expense i) Supplies

e) Notes Payable j) Utilities Expense

##### Solution Exercise 20 (5 min.)

a) Jane Miller, Capital

c) Land

e) Notes Payable

f) Accounts Payable

g) Cash

i) Supplies

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 21

Carrie's Carpet Cleaning has the following accounts:

Vehicles Notes Payable

Accounts Payable T. Carrie, Capital

Cash T. Carrie, Drawings

Supplies Equipment

Accounts Receivable

**Instructions**

Identify which accounts are

a) Assets

b) Liabilities

c) Owner's Equity

##### Solution Exercise 21 (5 min.)

a) Assets—Vehicles, Cash, Supplies, Accounts Receivable, Equipment

b) Liabilities—Accounts Payable, Notes Payable

c) Owner's Equity—T. Carrie, Capital, T. Carrie, Drawings

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

**Exercise 22**

The following is a list of accounts and ending balances for Marjory Programming Services.

Accounts payable $ 8,400

Accounts receivable 18,000

Bank loan payable 120,000

Building 130,000

Cash 26,000

F. Marjory, Drawings 24,000

Equipment 12,000

Salaries Expense 47,600

Land 190,000

F. Marjory, Capital, beginning of year 50,000

Service Revenue 270,000

Supplies 800

**Instructions**

a) For each account, indicate whether it is classified as an Asset (A), Liability (L), or Owner’s Equity (OE).

b) Calculate total assets, total liabilities, and total owner’s equity. Use these amounts to show that the accounting equation is in balance.

**Solution Exercise 22** (10 min.)

a)

|  |  |  |
| --- | --- | --- |
| Accounts payable | 8,400 | L |
| Accounts receivable | 18,000 | A |
| Bank loan payable | 120,000 | L |
| Building | 130,000 | A |
| Cash | 26,000 | A |
| F. Marjory, Drawings | 24,000 | OE |
| Equipment | 12,000 | A |
| Salaries expense | 47,600 | OE |
| Land | 190,000 | A |
| F. Marjory, Capital, beginning of year | 50,000 | OE |
| Service revenue | 270,000 | OE |
| Supplies | 800 | A |

b) Total assets = $18,000 + $130,000 + $26,000 + $12,000 + $190,000 + $800 = $376,800

Total liabilities = $8,400 + $120,000 = $128,400

Total owner’s equity = $50,000 + $270,000 – $47,600 – $24,000 = $248,400

Assets ($376,800) = Liabilities ($128,400) + Owner’s equity ($248,400)

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 23

At the beginning of the year, Diskman Company had total assets of $700,000 and total liabilities of $300,000.

**Instructions**

Answer the following questions, viewing each situation as being independent of the others:

a) If total assets increased $250,000 during the year, and total liabilities decreased $100,000, what is the amount of owner's equity at the end of the year?

b) During the year, total liabilities increased $340,000 and owner's equity decreased $130,000. What is the amount of total assets at the end of the year?

c) If total assets decreased $60,000 and owner's equity increased $190,000 during the year, what is the amount of total liabilities at the end of the year?

##### Solution Exercise 23 (5 min.)

a)

Total Assets Total Liabilities Owner's Equity

Beginning $700,000 $300,000 $400,000

Change 250,000 (100,000)

Ending $950,000 – $200,000 = $750,000

b)

Total Assets Total Liabilities Owner's Equity

Beginning $700,000 $300,000 $400,000

Change 340,000 (130,000)

Ending $910,000 = $640,000 + $270,000

c)

Total Assets Total Liabilities Owner's Equity

Beginning $700,000 $300,000 $400,000

Change (60,000) 190,000

Ending $640,000 = $ 50,000 + $590,000

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 24

Calculate the missing amount in each category of the accounting equation.

Assets Liabilities Owner's Equity

a) $280,000 $? $98,000

b) $178,000 $63,000 $?

c) $? $202,000 $300,000

##### Solution Exercise 24 (5 min.)

a) $182,000 ($280,000 – $98,000 = $182,000)

b) $115,000 ($178,000 – $63,000 = $115,000)

c) $502,000 ($202,000 + $300,000 = $502,000)

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

**Exercise 25**

Below are three lists of accounting information with missing amounts. Each list is independent of the others.

|  |  |  |  |
| --- | --- | --- | --- |
| Cash | $ 4,200 | $1,100 | $ 3,600 |
| Accounts receivable | a) | 200 | 2,400 |
| Equipment | 10,000 | 5,000 | 20,000 |
| Bank loan payable | 4,000 | 0 | e) |
| Accounts payable | 1,500 | c) | 3,000 |
| J. Rodriguez, Capital, beginning of year | 6,000 | 1,800 | 10,000 |
| J. Rodriguez, Drawings | 2,400 | 700 | 7,000 |
| Service revenue | 20,000 | 12,000 | 30,000 |
| Salaries expense | 14,000 | 8,000 | f) |
| J. Rodriguez, Capital, end of year | b) | d) | 5,000 |

**Instructions**

Use the accounting equation to determine the missing amounts.

**Solution Exercise 25** (10 min.)

a) $900

b) $9,600

c) $1,200

d) $5,100

e) $18,000

f) $28,000

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

**Exercise 26**

Summaries of information from the balance sheets and income statements for four different proprietorships are provided below, with several amounts missing.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Jordan Installations** | **Campus Cleaning** | **Millenium Sales** | **Ferrier Enterprises** |
| Beginning of year |  |  |  |  |
| Total assets | $ 50,000 | $ 8,500 | $124,000 | $ 15,600 |
| Total liabilities | 24,300 | c) | 63,900 | 9,900 |
| Total owner's equity | 25,700 | 4,300 | e) | 5,700 |
|  |  |  |  |  |
| End of year: |  |  |  |  |
| Total assets | 62,400 | 10,000 | 165,000 | 21,000 |
| Total liabilities | 25,900 | 5,600 | 69,900 | g) |
| Total owner's equity | a) | 4,400 | 95,100 | h) |
|  |  |  |  |  |
| Changes in owner's equity: |  |  |  |  |
| Investments | 5,000 | d) | 10,000 | 1,000 |
| Drawings | 18,000 | 12,000 | 60,000 | 24,000 |
| Total revenues | 151,700 | 51,000 | f) | 140,000 |
| Total expenses | b) | 41,800 | 215,000 | 115,000 |

**Instructions**

Determine the missing amounts.

**Solution Exercise 26** (10 min.)

a) $36,500

b) $127,900

c) $4,200

d) $2,900

e) $60,100

f) $300,000

g) $13,300

h) $7,700

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 27

The following are six questions that users of accounting information might ask about Agusta Auto Towing (Agusta).

**Instructions**

For each question, determine which part of the financial statements (Income statement, balance sheet, or cash flow statement) would provide the information required.

|  |  |  |
| --- | --- | --- |
|  | **Decision** | **Financial statement used** |
| 1. | Can Agusta’s operations generate sufficient cash to make payments on a term loan? |  |
| 2. | Does Agusta have sufficient assets to provide security for a mortgage loan? |  |
| 3. | Should Agusta continue its current business, or look for more profitable opportunities in a different line of business? |  |
| 4. | Were the profit-sharing bonuses paid to unionized employees equal to the percentage of profit stated in the employment contract? |  |
| 5. | Was the amount of harmonized sales taxes (HST) that Agusta remitted to the tax department equal to 13% of its revenue, as required by law? |  |
| 6. | Does Agusta have enough money in the bank to pay out drawings to the owner? |  |

**Solution Exercise 27** (5 min.)

|  |  |  |
| --- | --- | --- |
|  | **Decision** | **Financial statement used** |
| 1. | Can Agusta’s operations generate sufficient cash to make payments on a term loan? | Statement of cash flows |
| 2. | Does Agusta have sufficient assets to provide security for a mortgage loan? | Balance sheet |
| 3. | Should Agusta continue its current business, or look for more profitable opportunities in a different line of business? | Income statement |
| 4. | Were the profit-sharing bonuses paid to unionized employees equal to the percentage of profit stated in the employment contract? | Income statement |
| 5. | Was the amount of harmonized sales taxes (HST) that Agusta remitted to the tax department equal to 13% of its revenue, as required by law? | Income statement |
| 6. | Does Agusta have enough money in the bank to pay out drawings to the owner? | Balance sheet |

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 28

At the beginning of the year, Klitch Komatsu Co. had total assets of $1,650,000 and total liabilities of $990,000.

**Instructions**

Answer the following questions viewing each situation as being independent of the others:

a) If total assets decreased $416,000 during the year, and total liabilities increased $92,000, what is the amount of owner's equity at the end of the year?

b) During the year, total liabilities decreased $86,000 and owner's equity increased $51,000. What is the amount of total assets at the end of the year?

c) If total assets decreased $29,000 and owner's equity decreased $67,000 during the year, what is the amount of total liabilities at the end of the year?

##### Solution Exercise 28 (5 min.)

a)

Total Assets Total Liabilities Owner's Equity

Beginning $1,650,000 $ 990,000 $660,000

Change (416,000) 92,000

Ending $1,234,000 – $1,082,000 = $152,000

b)

Total Assets Total Liabilities Owner's Equity

Beginning $1,650,000 $990,000 $660,000

Change (86,000) 51,000

Ending $1,615,000 = $904,000 + $711,000

c)

Total Assets Total Liabilities Owner's Equity

Beginning $1,650,000 $ 990,000 $660,000

Change (29,000) (67,000)

Ending $1,621,000 = $1,028,000 + $593,000

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 29

Calculate the missing amount in each category of the accounting equation.

Assets Liabilities Owner's Equity

a) $4,200,000 $? $2,925,000

b) $15,330,000 $5,490,000 $?

c) $? $6,150,000 $14,985,000

##### Solution Exercise 29 (5 min.)

a) $1,275,000 ($4,200,000 – $2,925,000 = $1,275,000)

b) $9,840,000 ($15,330,000 – $5,490,000 = $9,840,000)

c) $21,135,000 ($6,150,000 + $14,985,000 = $21,135,000)

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 30

Analyze the transactions described below and indicate their effect on the basic accounting equation. Use a plus sign (+) to indicate an increase and a minus sign (–) to indicate a decrease.

Assets = Liabilities + Owner's Equity

1. Purchased supplies paying cash.

2. Purchased supplies on credit.

3. Owner withdrew cash from company.

4. Performed services for cash. \_\_\_\_\_\_\_\_

5. Performed services on credit.

6. Paid salaries to employees.

7. Paid for repairs and maintenance expenses.

8. Collected amount owed from customer.

9. Owner invested cash in company.

10. Paid an amount owing to supplier.

##### Solution Exercise 30 (10 min.)

Assets = Liabilities + Owner's Equity

1. Purchased supplies paying cash. +,=

2. Purchased supplies on credit. + +

3. Owner withdrew cash from company. – –

4. Performed services for cash. + +

5. Performed services on credit. + +

6. Paid salaries to employees. – –

7. Paid for repairs and maintenance expenses. – –

8. Collected amount owed from customer. +,=

9. Owner invested cash in company + +

10. Paid an amount owing to supplier. – –

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

**Exercise 31**

Listed below are various accounts that can be found in the financial statements:

1. Cash

2. Unearned revenue

3. Vehicles

4. Accounts receivable

5. Prepaid expenses

6. Rent revenue

7. Accounts payable

8. Service revenue

9. Telephone expense

10. Bank loan payable

11. Supplies expense

12. Interest revenue

13. Service revenue

14. Salaries payable

15. Buildings

16. Notes payable

17. Insurance expense

18. Owner’s capital

19. Commission revenue

20. Owner’s drawings

##### Instructions

For each account listed, identify the applicable financial statement on which the account will be presented (balance sheet, income statement, and/or statement of owner’s equity).

**Solution Exercise 31** (10 min)

1. Balance sheet

2. Balance sheet

3. Balance sheet

4. Balance sheet

5. Balance sheet

6. Income statement

7. Balance sheet

8. Income statement

9. Income statement

10. Balance sheet

11. Income statement

12. Income statement

13. Income statement

14. Balance sheet

15. Balance sheet

16. Balance sheet

17. Income statement

18. Balance sheet and Statement of owner’s equity

19. Income statement

20. Statement of owner’s equity

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 32

One item is omitted in each of the following summaries of balance sheet and income statement data for three different sole proprietorships, A, B, and C.

Proprietorship

A B C

Beginning of the Year:

Assets $400,000 $150,000 $199,000

Liabilities 250,000 105,000 168,000

End of the Year:

Assets 450,000 195,000 195,000

Liabilities 280,000 95,000 169,000

During the Year:

Additional investment by the owner ? 79,000 80,000

Withdrawals by the owner 90,000 83,000 ?

Revenue 195,000 ? 187,000

Expenses 170,000 113,000 185,000

##### Instructions

Determine the amounts of the missing items, identifying each proprietorship by letter.

##### Solution Exercise 32 (10 min.)

Proprietorship A $85,000

Beginning Capital balance ($400,000 – $250,000) $150,000

Additional investments ($260,000 – $150,000 – $25,000) 85,000

Profit for year ($195,000 – $170,000) 25,000

260,000

Less withdrawals 90,000

Ending Capital balance ($450,000 – $280,000) $170,000

Proprietorship B $172,000

Beginning Capital balance ($150,000 – $105,000) $45,000

Additional investments 79,000

Profit for year ($183,000 – $45,000 – $79,000) 59,000

[Revenue = $172,000 ($113,000 + $59,000)] 183,000

Less withdrawals 83,000

Ending Capital balance ($195,000 – $95,000) $100,000

Proprietorship C $87,000

Beginning Capital balance ($199,000 – $168,000) $31,000

Additional investments 80,000

Profit for year ($187,000 – $185,000) 2,000

113,000

Less withdrawals ($113,000 – $26,000) 87,000

Ending Capital balance ($195,000 – $169,000) $26,000

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 33

Indicate in the space provided by each item whether it would appear on the income statement (IS), balance sheet (BS), and/or statement of owner's equity (OE):

1. Service Revenue 7. Accounts Receivable

2. Utilities Expense 8. K. Brown, Capital

3. Cash 9. Equipment

4. Accounts Payable 10. Advertising Expense

5. Supplies 11. K. Brown, Drawings

6. Salaries Expense 12. Notes Payable

##### Solution Exercise 33 (5 min.)

1. IS

2. IS

3. BS

4. BS

5. BS

6. IS

7. BS

8. OE, BS

9. BS

10. IS

11. OE

12. BS

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 34

Indicate in the space provided by each item whether it would appear on the income statement (IS), balance sheet (BS), and/or statement of owner's equity (OE):

1. Unearned Revenue 7. Notes Payable

2. Prepaid Expense 8. D. Donovan, Capital

3. Salaries Expense 9. Notes Receivable

4. D. Donovan, Drawings 10. Insurance Expense

5. Land 11. Accounts Receivable

6. Service Revenue 12. Cash

##### Solution Exercise 34 (5 min.)

1. BS

2. BS

3. IS

4. OE

5. BS

6. IS

7. BS

8. OE, BS

9. BS

10. IS

11. BS

12. BS

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 35

Calculate the missing amount in each category of the accounting equation.

Assets Liabilities Owner's Equity

a) $2,415,000 $? $1,350,000

b) $1,605,000 $442,500 $?

c) $? $1,233,000 $1,660,500

##### Solution Exercise 35 (5 min.)

a) $1,065,000 ($2,415,000 – $1,350,000 = $1,065,000)

b) $1,162,500 ($1,605,000 – $442,500 = $1,162,500)

c) $2,893,500 ($1,233,000 + $1,660,500 = $2,893,500)

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 36

Analyze the transactions described below and indicate their effect on the basic accounting equation. Use a plus sign (+) to indicate an increase and a minus sign (–) to indicate a decrease.

Assets = Liabilities + Owner's Equity

1. Received cash for services performed.

2. Purchased office equipment on credit.

3. Paid employees' salaries.

4. Received cash from customer in payment

on account. \_\_\_\_\_\_\_\_

5. Paid telephone bill for the month.

6. Paid for office equipment purchased in

transaction 2.

7. Purchased office supplies on credit.

8. Proprietor withdrew cash for personal

expenses.

9. Obtained a loan from the bank.

10. Billed customers for services performed.

##### Solution Exercise 36 (10 min.)

Assets = Liabilities + Owner's Equity

1. Received cash for services performed. + +

2. Purchased office equipment on credit. + +

3. Paid employees' salaries. – –

4. Received cash from customer for payment +,–

on account.

5. Paid telephone bill for the month. – –

6. Paid for office equipment purchased in

transaction 2. – –

7. Purchased office supplies on credit. + +

8. Proprietor withdrew cash for personal

expenses. – –

9. Obtained a loan from the bank. + +

10. Billed customers for services performed. + +

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 37

Presented below is a balance sheet for the Marks Lawn Service at December 31, 2024.

**MARKS LAWN SERVICE**

**Balance Sheet**

**December 31, 2024**

Assets Liabilities and Owner's Equity

Cash $12,000 Liabilities

Accounts receivable 7,000 Accounts payable $ 8,000

Supplies 9,000 Notes payable 15,000

Equipment 11,000 Owner's equity

B. Marks, capital 16,000

Total assets $39,000 Total liabilities and owner’s equity $39,000

The following additional information is available for the year that began on January 1, 2024. All expenses total $11,000. Profit for the year was $8,000 and drawings were $5,000.

**Instructions**

Determine the following: (Show all calculations.)

a) Service revenue for the year.

b) Bill Marks' capital balance on December 31, 2023.

##### Solution Exercise 37 (10 min.)

a) Calculation of service revenue:

Profit for the year $ 8,000

Plus:expenses 11,000

Service revenue $19,000

b) Calculation of Bill Marks, Capital on December 31, 2023:

Capital, December 31, 2024 $16,000

Plus: Drawings 5,000

Less: Profit for the year (8,000)

Capital, December 31, 2023 $13,000

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

**Exercise 38**

The following accounts are taken from the December 31 financial statements of Scotia Rental Properties, a proprietorship owned by Leo DeRosier.

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | a) | b) |
| Accounts payable | $ 9,320 |  |  |
| Accounts receivable | 8,600 |  |  |
| Building | 246,000 |  |  |
| Cash | 15,000 |  |  |
| L. DeRosier, drawings | 12,000 |  |  |
| Insurance expense | 3,450 |  |  |
| Interest expense | 5,905 |  |  |
| Interest payable | 420 |  |  |
| L. DeRosier, capital, beginning of year | 40,695 |  |  |
| Mortgage payable | 210,000 |  |  |
| Equipment | 4,500 |  |  |
| Prepaid insurance | 510 |  |  |
| Rent revenue | 36,000 |  |  |
| Repairs expense | 2,300 |  |  |
| Telephone expense | 680 |  |  |
| Salaries expense | 5,490 |  |  |

Additional information:

During the year, L. DeRosier invested $8,000 into the business.

**Instructions**

a) For each of the above accounts, indicate in column a) whether the item is an Asset (A), Liability (L), Capital (C), Drawings (D), Revenue (R), or Expense (E) item.

b) For each of the above accounts, indicate in column b) on which financial statement—income statement (IS), statement of owner’s equity (OE), and/or balance sheet (BS)—each item would be reported.

c) Calculate total assets.

d) Calculate total liabilities.

e) Calculate profit.

f) Calculate total owner’s equity.

g) Demonstrate that the accounting equation is in balance.

**Solution Exercise 38** (20 min.)

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | a) | b) |
| Accounts payable | $ 9,320 | L | BS |
| Accounts receivable | 8,600 | A | BS |
| Building | 246,000 | A | BS |
| Cash | 15,000 | A | BS |
| L. DeRosier, Drawings | 12,000 | D | OE |
| Insurance expense | 3,450 | E | IS |
| Interest expense | 5,905 | E | IS |
| Interest payable | 420 | L | BS |
| L DeRosier, capital, beginning of year | 40,695 | C | OE, BS |
| Mortgage payable | 210,000 | L | BS |
| Equipment | 4,500 | A | BS |
| Prepaid insurance | 510 | A | BS |
| Rent revenue | 36,000 | R | IS |
| Repairs expense | 2,300 | E | IS |
| Telephone expense | 680 | E | IS |
| Salaries expense | 5,490 | E | IS |

c) Total assets: ($8,600 + $246,000 + $15,000 + $4,500 + $510) = $274,610

d) Calculate total liabilities: ($9,320 + $420 + $210,000) = $219,740

e) Calculate profit: ($36,000 – $3,450 – $5,905 – $2,300 – $680 – $5,490) = $18,175

f) Calculate total owner’s equity: ($40,695 + $8,000 + $18,175 – $12,000) = $54,870

g) Accounting equation: $274,610 = $219,740 + $54,870

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the elements of the financial statements and explain the accounting equation.

Section Reference: The Accounting Model

Learning Objective: Prepare financial statements.

Section Reference: Preparing Financial Statements

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 39

For each of the following, describe a transaction that will have the stated effect on the elements of the accounting equation.

1. Increase one asset and decrease another asset.

2. Increase an asset and increase a liability.

3. Decrease an asset and decrease a liability.

4. Increase an asset and increase owner's equity.

5. Increase one asset, decrease another asset, and increase a liability.

##### Solution Exercise 39 (5 min.)

1. Receive cash from customers on account.

Purchase supplies for cash.

Purchase equipment for cash.

2. Purchase supplies on account.

Purchase equipment and sign a note payable.

Borrow money from bank.

3. Pay cash to reduce accounts payable.

Pay cash to reduce a note payable.

4. Initial contribution by an owner.

Additional contributions by an owner.

Render services on account.

Render services for cash.

5. Buy equipment with a cash down payment with the remainder financed by a note payable.

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 40

The following transactions represent part of the activities of Lewis Company for the first month of its existence. Indicate the effect of each transaction upon the total assets of the business by one of the following phrases: increased total assets, decreased total assets, or no change in total assets.

1. The owner invested cash to start the business.

2. Purchased a computer for cash.

3. Purchased office equipment with money borrowed from the bank.

4. Paid the first month's utility bill.

5. Collected an accounts receivable.

6. Owner withdrew cash from the business.

##### Solution Exercise 40 (5 min.)

1. Increased total assets.

2. No change in total assets.

3. Increased total assets.

4. Decreased total assets.

5. No change in total assets.

6. Decreased total assets.

Bloomcode: Application

Difficulty: Medium

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 41

Selected transactions for Barkley Company are listed below:

1. Paid monthly utility bill.

2. Purchased new display case for cash.

3. Paid cash for repair work on security system.

4. Billed customers for services performed.

5. Received cash from customers billed in 4.

6. Withdrew cash for owner's personal use.

7. Incurred advertising expenses on account.

8. Paid monthly rent.

9. Received cash from customers when service was provided.

**Instructions**

List the number of the transaction and then describe the effect of each transaction on assets, liabilities, and owner's equity.

Sample: Made initial cash investment in the business. The answer would be: increase in assets and increase in owner's equity.

##### Solution Exercise 41 (5 min.)

1. Decrease in assets and decrease in owner's equity.

2. No net change in assets.

3. Decrease in assets and decrease in owner's equity.

4. Increase in assets and increase in owner's equity.

5. No net change in assets.

6. Decrease in assets and decrease in owner's equity.

7. Increase in liabilities and decrease in owner's equity.

8. Decrease in assets and decrease in owner's equity.

9. Increase in assets and increase in owner's equity.

Bloomcode: Application

Difficulty: Medium

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 42

There are ten transactions listed below:

1. Receive cash from customers on account.

2. Initial cash contribution by an owner.

3. Pay cash to reduce an accounts payable.

4. Purchase supplies for cash.

5. Pay cash to reduce a note payable.

6. Purchase supplies on account.

7. Customers pay cash for services rendered.

8. Purchase equipment with a note payable.

9. Pay utilities with cash.

10. Owner withdraws money from the business for personal use.

**Instructions**

Match the transactions that have the identical effect on the accounting equation. You should end up with five matches. The first one has been completed for you with an explanation.

Example: 1. and 4. are a match because both of them include an increase in assets and a decrease in assets. The net effect of these transactions on the accounting equation is zero.

##### Solution Exercise 42 (10 min.)

Match #1 = 1, 4

Match #2 = 3, 5

Match #3 = 6, 8

Match #4 = 2, 7

Match #5 = 9, 10

Bloomcode: Evaluation

Difficulty: Hard

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

**Exercise 43**

Selected transactions for Peters Equipment Services are listed below:

1. Purchased a new lawn mower for $2,000, making a 10% down payment in cash, the remainder is on account.

2. Purchased $350 supplies for cash.

3. Billed customers $1,500 for lawn services completed.

4. Purchased used truck for $6,500, fully financed by a bank loan.

5. Collected $800 from customers for services previously billed.

6. Paid balance owing on lawn mower.

7. Incurred telephone expenses of $85 on account.

8. Completed services for customers who pay $440 cash.

9. Peter Willes, the owner, invests $7,000 of additional funds in the business.

10. Part of the funds invested is used to repay the full balance of the bank loan plus $65 in interest expense.

11. $1,250 in wages is paid to employees.

12. Peter withdrew $1,000 cash for personal use.

**Instructions**

For each transaction, state whether the transaction increases or decreases assets, liabilities, and/or owner’s equity, and by what amount(s).

**Solution Exercise 43** (10 min)

1. Increases assets and liabilities by $1,800 each.

2. Increase and decrease in assets by the same amount, no change in total assets.

3. Assets and owner’s equity each increase by $1,500.

4. Assets and liabilities each increase by $6,500.

5. Increase and decrease in assets by the same amount, no change in total assets.

6. Assets and liabilities each decrease by $1,800.

7. Liabilities are increased by $85 and owner’s equity decreased by the same amount.

8. Assets and owner’s equity each increase by $440.

9. Assets and owner’s equity each increase by $7,000.

10. Assets are decreased by $6,565, liabilities decreased by $6,500, and owner’s equity decreased by $65.

11. Assets and owner’s equity each decrease by $1,250.

12. Assets and owner’s equity each decrease by $1,000.

Bloomcode: Application

Difficulty: Medium

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 44

A service proprietorship shows five transactions summarized below. The effect of each transaction on the accounting equation is shown.

Accounts Equip- Accounts

Cash + Rec. + ment + Land + Building= Payable + Capital – Drawings + Revenues – Expenses

$5,000 $6,500 $10,000 $7,500 $50,000 $3,000 $66,000 $20,000 $35,000 $5,000

1. –2,000 -2,000

2. +1,000 –1,000

3. +5,000 +5,000

4. +2,500 +2,500

5. +3,000 +3,000

Tots $6,500 $8,500 $15,000 $7,500 $50,000 $6,000 $66,000 $20,000 $40,500 $5,000

**Instructions**

##### For each transaction, write an explanation of the nature of the transaction.

##### Solution Exercise 44 (5 min.)

1. Paid cash to creditors.

2. Received cash from customers on account.

3. Bought equipment on account.

4. Services provided to customers for cash.

5. Services provided on account.

Bloomcode: Application

Difficulty: Medium

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 45

Pam’s Custom Cakes shows five transactions summarized below. The effect of each transaction on the accounting equation is shown.

Accounts Equip- Accounts

Cash + Rec. + ment + Land + Building= Payable + Capital – Drawings + Revenues – Expenses

$5,000 $6,500 $10,000 $7,500 $50,000 $3,000 $66,000 $20,000 $35,000 $5,000

1. +6,000 +6,000

2. -7,500 +15,000 +7,500

3. -4,000 -4,000

4. +2,000 -2,000

5. \_\_\_\_\_ +1,100 \_\_\_\_\_\_ -1,100

Tots $1,500 $4,500 $25,000 $7,500 $50,000 $11,600 $72,000 $24,000 $35,000 $6,100

**Instructions**

##### For each transaction, write an explanation of the nature of the transaction.

##### Solution Exercise 45 (5 min.)

1. Cash invested by owner.

2. Purchased equipment by paying half with cash and the other half on account.

3. Owner withdrew cash from company.

4. Collected accounts receivable.

5. Incurred an expense on credit.

Bloomcode: Application

Difficulty: Medium

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 46

Russ Walls decides to open a cleaning and laundry service near the local college campus that will operate as a proprietorship. The transactions for the month of June are listed below:

1. Russ invests $20,000 in cash to start a cleaning and laundry business on June 1.

2. Purchased equipment for $5,000, paying $3,000 in cash and the remainder due in 30 days.

3. Purchased supplies for $1,200 cash.

4. Received a bill from Campus News for $300 for advertising in the campus newspaper.

5. Provided $1,500 of services to customers for cash.

6. Paid salaries of $200 to student workers.

7. Billed the Tiger Football Team $100 for services.

8. Paid $300 to Campus News for advertising that was previously billed in transaction 4.

9. Russ withdrew $700 from the business for living expenses.

10. Incurred utility expenses for month on account, $400.

**Instructions**

Analyze the transactions above in terms of their effect on the basic accounting equation. Record each transaction by increasing (+) or decreasing (–) the dollar amount of each item affected. Total and balance the equation at the end of the month.

Trans- Accounts Accounts R. Walls, R. Walls,

action Cash + Rec. + Supplies + Equip. = Payable + Capital – Drawings + Revenues – Expenses

1.

2.

3.

4.

5.

6.

7.

8.

9.

10.

———————————————————————————————————————————

Tots

##### Solution Exercise 46 (20 min.)

Trans- Accounts Accounts R. Walls, R. Walls,

action Cash + Rec. + Supplies + Equip. = Payable + Capital – Drawings + Revenues – Expenses

1. +$20,000 +$20,000

2. –3,000 +$5,000 +$2,000

3. –1,200 +$1,200

4. +300 –$300

5. +1,500 +$1,500

6. –200 –200

7. +$100 +100

8. –300 –300

9. –700 –$700

10. +400 –400

———————————————————————————————————————————

Tots $16,100 $100 $1,200 $5,000 $2,400 $20,000 –$700 $1,600 –$900

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

**Exercise 47**

Amanda Mayne recently started a business, Mayne Events, that will provide promotion and advertising for fundraising events hosted by charities. She will operate the business as a proprietorship. The first month’s transactions are listed below:

1. Invests $5,000 in the business out of her personal savings.

2. Transfers equipment valued at $3,000 to the business.

3. Purchases supplies for $400 cash.

4. Pays $550 for wages to an assistant.

5. Completes advertising brochures for a client, who pays $700 for the service.

6. Advertisements for Mayne Events are run in the local newspaper at a cost of $600 on account.

7. Provides services totaling $1,200 for several clients – one client whose bill is $200 pays cash, and the remainder are on account.

8. Pays the amount owing to the newspaper for the advertisements described in 6.

9. Half the amount receivable from customers is collected.

10. Purchases additional equipment for $450, cash.

11. Withdraws $300 for personal use.

**Instructions**

a) For each of the above transactions, determine the accounts that will be affected and, in the table provided, set up the headings in the order of the accounting equation.

b) Record each transaction in the table provided.

c) Calculate total assets.

d) Calculate total liabilities.

e) Calculate profit.

f) Calculate owner’s equity.

g) Demonstrate that the accounting equation is in balance.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Trans- action |  |  |  |  |  |  |  |  |  |
| 1. |  |  |  |  |  |  |  |  |  |
| 2. |  |  |  |  |  |  |  |  |  |
| 3. |  |  |  |  |  |  |  |  |  |
| 4. |  |  |  |  |  |  |  |  |  |
| 5. |  |  |  |  |  |  |  |  |  |
| 6. |  |  |  |  |  |  |  |  |  |
| 7. |  |  |  |  |  |  |  |  |  |
| 8. |  |  |  |  |  |  |  |  |  |
| 9. |  |  |  |  |  |  |  |  |  |
| 10. |  |  |  |  |  |  |  |  |  |
| 11. |  |  |  |  |  |  |  |  |  |
| Totals |  |  |  |  |  |  |  |  |  |

**Solution Exercise 47** (20 min.)

a) and b)

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Trans- action | Cash | Accounts Receivable | Supplies | Equipment | Accounts Payable | A. Mayne, Capital | A. Mayne, Drawings | Revenue | Expenses |
| 1. | +$5,000 |  |  |  |  | +$5,000 |  |  |  |
| 2. |  |  |  | +$3,000 |  | +3,000 |  |  |  |
| 3. | -400 |  | +$400 |  |  |  |  |  |  |
| 4. | -550 |  |  |  |  |  |  |  | -$550 |
| 5. | +700 |  |  |  |  |  |  | +$700 |  |
| 6. |  |  |  |  | +$600 |  |  |  | -600 |
| 7. | +200 | +$1,000 |  |  |  |  |  | +1,200 |  |
| 8. | -600 |  |  |  | -600 |  |  |  |  |
| 9. | +500 | -500 |  |  |  |  |  |  |  |
| 10. | -450 |  |  | +$ 450 |  |  |  |  |  |
| 11. | -300 |  |  |  |  |  | -$300 |  |  |
| Totals | $4,100 | $500 | $400 | $3,450 | - | $8,000 | -$300 | $1,900 | -$1,150 |

c) Total assets = $4,100 + $500 + $400 + $3,450 = $8,450

d) Total liabilities = 0

e) Profit = $1,900 – $1,150 = $750

f) Owner’s equity = $8,000 + $750 – $300 = $8,450

g) The accounting equation $8,450 = $0 + $8,450

Bloomcode: Synthesis

Difficulty: Medium

Learning Objective: Analyze the effects of business transactions on the accounting equation.

Section Reference: Transaction Analysis

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 48

Greg Stewart was reviewing his business activities at the end of the year (February 29, 2024) and needs your help to prepare a statement of owner's equity. At the beginning of the year, his assets were $500,000 and his liabilities were $150,000. At the end of the year, the assets had grown to $950,000 but liabilities had increased to $300,000. The profit for the year was $420,000. Greg had withdrawn $120,000 during the year for his personal use.

**Instructions**

Prepare a statement of owner's equity in good form.

##### Solution Exercise 48 (5 min.)

**GREG STEWART**

**Statement of Owner's Equity**

**Year Ended February 29, 2024**

G. Stewart, capital, February 28,, 20231 $350,000

Add: profit for the year 420,000

770,000

Less: drawings 120,000

G. Stewart, capital, February 29, 20242 $650,000

1 ($500,000 –-$150,000)

2 ($950,000 – $300,000)

Bloomcode: Application

Difficulty: Medium

Learning Objective: Prepare financial statements.

Section Reference: Preparing Financial Statements

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 49

At September 1, 2024, the balance sheet accounts for Reggie’s Restaurant, owned by Reggie Ray were as follows:

Accounts Payable $ 3,800 Land $33,000

Accounts Receivable 1,600 R. Ray, Capital ?

Building 68,000 Notes Payable 48,000

Cash 5,000 Supplies 6,600

Furniture 18,700

##### The following transactions occurred during the next two days:

##### 1. Reggie invested an additional $22,000 cash in the business.

##### 2. The accounts payable were paid in full. (No payment was made on the notes payable.)

**Instructions**

Prepare a balance sheet at September 3, 2024.

##### Solution Exercise 49 (10 min.)

**REGGIE'S RESTAURANT**

**Balance Sheet**

**September 3, 2024**

ASSETS

Cash $ 23,200

Accounts receivable 1,600

Supplies 6,600

Furniture 18,700

Building 68,000

Land 33,000

Total assets $151,100

LIABILITIES

Notes payable $ 48,000

OWNER'S EQUITY

R. Ray, capital 103,100

Total liabilities and owner's equity $151,100

Cash ($5,000 + $22,000 – $3,800) = $23,200

Accounts Payable ($3,800 – $3,800) = $0. Note that accounts with a zero balance are not normally reported in the financial statements.

R. Ray, Capital: Beginning balance $ 81,100

Additional investment 22,000

Ending balance $103,100

Bloomcode: Application

Difficulty: Medium

Learning Objective: Prepare financial statements.

Section Reference: Preparing Financial Statements

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 50

The dental practice of Pamela Bell, DDS has the following accounts for the month of September, 2024:

P. Bell, Capital (August 31) $42,000

Accounts payable 7,000

Equipment 30,000

Service revenue 25,000

P. Bell, Drawings 6,000

Supplies expense 3,500

Cash 8,000

Utilities expense 700

Supplies 2,800

Salaries expense 7,000

Accounts receivable 14,000

Rent expense 2,000

**Instructions**

Prepare an income statement, a statement of owner's equity, and a balance sheet for the dental practice in the following formats:

**Pamela Bell, DDS**

**Income Statement**

**Month Ended September 30, 2024**

———————————————————————————————————————————

Revenues $

Expenses

Total expenses

Profit for the month $

**Pamela Bell, DDS**

**Statement of Owner's Equity**

**Month Ended September 30, 2024**

———————————————————————————————————————————

P. Bell, Capital, August 31 $

Add:

Less:

P. Bell, Capital, September 30 $

**Pamela Bell, DDS**

**Balance Sheet**

**September 30, 2024**

———————————————————————————————————————————

ASSETS

$

Total assets $

LIABILITIES AND OWNER'S EQUITY

Liabilities

$

Owner's equity

Total liabilities and owner's equity $

##### Solution Exercise 50 (15 min.)

**Pamela Bell, DDS**

**Income Statement**

**For the Month Ended September 30, 2024**

———————————————————————————————————————————

Revenues

Service revenue $25,000

Expenses

Salaries expense $7,000

Supplies expense 3,500

Rent expense 2,000

Utilities expense 700

Total expenses 13,200

Profit for the month $11,800

**Pamela Bell, DDS**

**Statement of Owner's Equity**

**For the Month Ended September 30, 2024**

P. Bell, capital, August 31 $42,000

Add: profit for the month 11,800

53,800

Less: drawings 6,000

P. Bell, capital, September 30 $47,800

**Pamela Bell, DDS**

**Balance Sheet**

**September 30, 2024**

———————————————————————————————————————————

ASSETS

Cash $ 8,000

Accounts receivable 14,000

Supplies 2,800

Equipment 30,000

Total assets $54,800

LIABILITIES AND OWNER'S EQUITY

Liabilities

Accounts payable $ 7,000

Owner's equity

P. Bell, capital 47,800

Total liabilities and owner's equity $54,800

Bloomcode: Application

Difficulty: Medium

Learning Objective: Prepare financial statements.

Section Reference: Preparing Financial Statements

CPA: Financial Reporting

AACSB: Analytic

##### Exercise 51

Listed below, in alphabetical order, are the balance sheet accounts of Solo Company at December 31, 2024:

Accounts Payable $ 9,000

Accounts Receivable 15,000

Building 46,000

Cash 12,000

Equipment 4,000

H. Solo, Capital 120,000

Land 52,000

**Instructions**

Prepare a balance sheet and include a complete heading.

##### Solution Exercise 51 (5 min.)

**SOLO COMPANY**

**Balance Sheet**

**December 31, 2024**

ASSETS

Cash $ 12,000

Accounts receivable 15,000

Equipment 4,000

Building 46,000

Land 2,000

Total assets $129,000

LIABILITIES

Accounts payable $ 9,000

OWNER'S EQUITY

H. Solo, capital 120,000

Total liabilities and owner's equity $129,000

Bloomcode: Application

Difficulty: Medium

Learning Objective: Prepare financial statements.

Section Reference: Preparing Financial Statements

CPA: Financial Reporting

AACSB: Analytic

**Exercise 52**

William Calvin owns and operates Calvin Sales Consulting, operating as a proprietorship. The following information is based on December 31, 2024 year-end balances for the business. (All amounts are in 000s).

|  |  |
| --- | --- |
| Accounts payable | $ 1,860 |
| Accounts receivable | 3,340 |
| Cash | 1,705 |
| W. Calvin, Drawings | 4,800 |
| Service revenue | 10,600 |
| Insurance expense | 900 |
| Prepaid insurance | 80 |
| Supplies | 120 |
| Telephone expense | 480 |
| W. Calvin, capital, beginning of year | 3,755 |
| Salaries expense | 6,890 |
| Salaries payable | 600 |

Additional information:

William invested $1,500 into the business during the year.

**Instructions**

a) Prepare the income statement for Calvin Sales Consulting.

b) Prepare the statement of owner’s equity.

c) Prepare the balance sheet.

**Solution Exercise 52** (20 min.)

a)

**CALVIN SALES CONSULTING**

**Income Statement**

**For the Year Ended December 31, 2024**

Revenue

Service revenue $10,600

Expenses

Insurance expense $900

Telephone expense 480

Salaries expense 6,890 8,270

Profit for the year $ 2,330

b)

**CALVIN SALES CONSULTING**

**Statement of Owner’s Equity**

**For the Year Ended December 31, 2024**

W. Calvin, December 31, 2023 $3,755

Add: Investments $1,500

Profit for the year 2,330 3,830

7,585

Less: W. Calvin, drawings 4,800

W. Calvin, December 31, 2024 $2,785

c)

**CALVIN SALES CONSULTING**

**Balance Sheet**

**December 31, 2024**

ASSETS

Cash $1,705

Accounts receivable 3,340

Supplies 120

Prepaid insurance 80

Total assets $5,245

LIABILITIES AND OWNER’S EQUITY

Liabilities

Accounts payable $1,860

Salaries payable 600

Total liabilities $2,460

Owner’s equity

W. Calvin, capital 2,785

Total liabilities and owner’s equity $5,245

Bloomcode: Application

Difficulty: Medium

Learning Objective: Prepare financial statements.

Section Reference: Preparing Financial Statements

CPA: Financial Reporting

AACSB: Analytic

**LEGAL NOTICE**

Copyright © 2022 by John Wiley & Sons Canada, Ltd. or related companies. All rights reserved.

Description: cid:image003.jpg@01CD4AF3.E17BD5B0

The data contained in these files are protected by copyright. This manual is furnished under licence and may be used only in accordance with the terms of such licence.

The material provided herein may not be downloaded, reproduced, stored in a retrieval system, modified, made available on a network, used to create derivative works, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise without the prior written permission of John Wiley & Sons Canada, Ltd.