Chapter 1

Accounting and the Business Environment

Questions

1. Accounting is a system for measuring, processing, and communicating financial information. Bookkeeping is a procedural element of accounting.
2. a. The general public uses accounting information to manage bank accounts, loan payments, etc.
   b. Managers and owners of businesses use accounting to monitor expenses and revenue recorded.
   c. Investors and creditors use accounting information to evaluate investments and loan applications.
   d. Government agencies (including taxation authorities) use accounting data to create reports and collect payments.
   e. Not-for-profit organizations such as churches and hospitals use accounting information in much the same way as managers of businesses do—to manage their organizations.
3. Reasons for the development of accounting thought include the commercial climate of fifteenth-century Italy, the Industrial Revolution, the rise of the corporation as a business organization, income tax, the increase in the complexity of economic activities, and the increase in government influence on daily life. (Only two are required.)
4. Three professional designations of accountants are Chartered Accountant (CA), Certified General Accountant (CGA), and Certified Management Accountant (CMA).
5. The Accounting Standards Board formulates generally accepted accounting principles. It is not a government agency.
6. The owner of a proprietorship is called the proprietor, the owners of a partnership are called partners, and the owners of a corporation are called shareholders.
7. Ethical standards in accounting are designed to encourage accountants to produce honest information for decision making. The provincial institutes of CAs' and the CGAAC's ethical standards are directed toward independent auditors, but also govern CAs and CGAs, respectively, in industry and government. The SMAC's standards relate more to management accountants.

8. The economic entity assumption draws clear boundaries around each entity. It is important because it allows decision makers to evaluate each entity as a separate economic unit.
9. Four examples of types of accounting entities are a household, a business such as a drugstore or a manufacturer, a professional organization such as a law firm or a medical practice, and a not-for-profit organization such as a church or a hospital. (Answers will vary.)
10. The essence of the reliability characteristic is that accounting information should be based on the most objective and verifiable data possible.
11. The cost principle dictates that assets and services purchased be recorded at the actual cost.
12. Liabilities = Assets – Owner's Equity.
13. An account receivable is an asset because it is an economic resource that provides a future benefit—the right to collect cash from another party. An account payable is a liability because it is another party's claim against the business's cash—an economic obligation.
14. Transactions are events that affect the financial position of the entity *and* that may be reliably recorded. They are the raw material of accounting. Without transactions, there would be nothing to account for.
15. The result of operations is a net loss of $4,400, because expenses exceed revenues.
16. A more descriptive title for the balance sheet is the "statement of financial position."
17. The balance between assets on the left side and liabilities and owner's equity on the right side of the balance sheet gives this financial statement its name. The balance appears in the accounting equation, Assets = Liabilities + Owner's Equity, which is essentially a summary of the balance sheet in equation form.
18. Another title of the income statement is the "statement of operations" or the "statement of earnings."
19. The balance sheet is like a snapshot of the entity at a specific time. The income statement is like a moving picture/video of the entity's operations during a period of time.
20. The statement of owner's equity presents a summary of the changes that occurred in owner's equity during the period due to additional investments by the owner, or drawings or withdrawals by the owner, and due to net income or net loss.
21. Capital is another term for the owner's equity of a proprietorship.
22. Net income (or net loss) flows from the income statement to the statement of owner's equity. Ending owner's equity then flows to the balance sheet. The change in cash during the period on the balance sheet is explained by the cash flow statement, and the ending balance of cash on the cash flow statement matches the cash amount on the balance sheet.

Starters

(5 min.) **S 1-1**

Revenues are the amounts earned by Sherman in return for her providing goods and services to customers. Expenses are the decreases in equity that arise from the utilization of assets or the increase in liabilities to cover the costs needed to deliver goods and services to customers.

(5 min.) **S 1-2**

1. The bank is an external user.

2. The balance sheet would be the best financial statement for the bank to use, as it lists all of the assets, liabilities, and equities for the company.

(5–10 min.) **S 1-3**

Claire will want to consider the factors discussed in Exhibit 1-5. This shows that a corporation is the only type of business organization that has an unlimited life. Also, a corporation is responsible for business debts, not its shareholders. In other words, Claire's liability will be limited.

(5–10 min.) **S 1-4**

1 a) Economic-Entity Assumption

b) Cost Principle of Measurement

c) Stable-Monetary-Unit Assumption

d) Reliability Characteristic

2. Assets = Liabilities + Owner’s Equity

6,000+12,000 = 5,000 + Owner’s Equity
18,000 = 5,000 + Owner’s Equity
Thus, Owner’s Equity = 13,000

(5–10 min.) **S 1-5**

a) Assets = Liabilities + Owner's Equity
+ 420 = 0 + 420

b) Assets = Liabilities + Owner's Equity
–1,350 = 0 + (–1,350)

(5–10 min.) **S 1-6**

1. Cash = 0, as this sale was on account.
   Total Assets = 2,400, as an asset increases as a result of the transaction.

2. The asset is called Accounts Receivable.

(10–15 min.) **S 1-7**

a. Cost principle of measurement	e	Benefits of the information produced by an accounting system must be greater than the costs
b. Going-concern assumption	f	Amounts may be ignored if the effect on a decision maker's decision is not significant
c. Stable-monetary-unit assumption	a	Transactions are recorded based on the cash amount received or paid
d. Economic-entity assumption	c	Transactions are expressed using units of money
e. Cost/benefit constraint	b	Assumes that a business is going to continue operations indefinitely
f. Materiality constraint	d	Business must keep its accounting records separate from its owner's accounting records

(5–10 min.) **S 1-8**

Owner's equity is $65,000, calculated as:

Assets = Liabilities + Owner's Equity
Assets – Liabilities = Owner's Equity
$150,000 – $85,000 = $65,000

(5–10 min.) **S 1-9**

No, an intention to rent is not a transaction because an event has not yet occurred that affects the financial position of the company and can be measured reliably. When a source document is received or when cash changes hands, then a transaction will have taken place.

(5–10 min.) **S 1-10**

The four main financial statements are the balance sheet, the income statement, the statement of owner's equity, and the cash flow statement.

(10 min.) **S 1-11**

Party Planners Extraordinaire		
Income Statement		
For the Year Ended December 31, 2010		
Revenue:		
Service revenue		$109,000
Expenses:		
Insurance expense	$ 3,000	
Rent expense	14,000	
Salary expense	44,000	
Supplies expense	900	
Total expenses		61,900
Net income		$47,100

(10 min.) **S 1-12**

The results of Party Planners Extraordinaire for 2010 show it was a good year. This is because the company had net income, in the amount of $47,100.

Exercises

(5-10 min.) **E 1-1**

1. Accounting equation	E	The basic tool of accounting, stated as Assets = Liabilities + Owner's Equity
2. Asset	A	An economic resource that is expected to be of benefit in the future
3. Balance sheet	I	Report of an entity's assets, liabilities, and owner's equity as of a specific date
4. Expense	F	Decrease in equity that occurs from using assets or increasing liabilities in the course of delivering goods or services to customers
5. Income statement	J	Report of an entity's revenues, expenses, and net income or net loss for a period of time
6. Liability	B	An economic obligation (a debt) payable to an individual or an organization outside the business
7. Net income	D	Excess of total revenues over total expenses
8. Net loss	C	Excess of total expenses over total revenues
9. Revenue	G	Amounts earned by delivering goods or services to customers
10. Cash flow statement	H	Report of cash receipts and cash payments during a period
11. Statement of owner's equity	K	Report that shows the changes in owner's equity for a period of time

(15-20 min.) **E 1-2**

The *income statement* reports the revenues and expenses of a particular entity for a period such as a month or a year. Total *revenues* minus total *expenses* equals *net income*, or profit. A lender would require this information in order to predict whether the borrower can generate enough income to repay the loan.

The *balance sheet* reports the assets, liabilities, and owner's equity of the entity at a particular point in time. The *assets* show the resources that the business has to work with. A lender wants to identify assets to know what can be taken if the borrower does not repay the loan. *Liabilities*—debts—represent creditors' claims to the business's assets. If the borrower already owes lots of money, he or she may be unable to repay the loan. *Owner's equity* is the portion of the business assets owned outright by the owners of the business. The higher the owner's equity, the stronger the borrower's financial position, and the greater the probability of loan repayment.

Instructional Note: Student responses may vary considerably.

(10–15 min.) **E 1–3**

	Type of Account	Statement
Supplies Expense	E	I
Accounts Receivable	A	B
J. Jackman, Capital	OE	SOE, B
Salary Expense	E	I
Computer Equipment	A	B
Consulting Service Revenue	R	I
Accounts Payable	L	B
Rent expense	E	I
Cash	A	B, CF
J. Jackman, Withdrawals	OE	SOE
Supplies	A	B
Notes Payable	L	B

(5-10 min.) **E 1-4**

a. Purchase of asset on account
   Borrow money
b. Purchase of asset for cash
   Sale of asset for cash
   Collection of account receivable
c. Withdrawal of funds by the owner
   Expense transaction
d. Pay a liability
e. Investment by owner
   Revenue transaction

(10-20 min.) **E 1-5**

a. Increased assets (Cash)
b. Decreased assets (Cash)
c. Increased assets (Office Equipment)
d. Increased assets (Accounts Receivable)
e. Decreased assets (Cash)
f. No effect on total assets. Increase in cash offsets the decrease in accounts receivable.
g. No effect (a personal transaction)
h. No effect on total assets. Increase in cash offsets the decrease in land.
i. Increased assets (Cash)
j. No effect on total assets. Increase in land offsets the decrease in cash.

(5-15 min.) **E 1-6**

Req. 1

	Assets	Liabilities	Owner's Equity
Nice Cuts	$120,000	$ 90,000	$ 30,000
Love Dry Cleaners	76,000	36,000	40,000
Hudson Gift and Cards	110,000	84,000	26,000

Req. 2

It is a distinguishing characteristic of proprietorships that they are a separate entity from the owners with no continuous life, so the three companies will cease to exist if the owners die.

(5-10 min.) E 1-7

Assets	=	Liabilities			+	Owner's Equity
Cash + Furniture	=	Accounts Payable	+	Note Payable	+	J. Iverson, Capital
\$16,000 + \$36,000	=	\$10,000	+	\$26,000	+	\$16,000

Based on the accounting equation, the owner has \$16,000 equity in the business.

(10-15 min.) E 1-8

	Total Assets	–	Total Liabilities	=	Total Owner's Equity
January 1, 2010	\$24,000	–	\$11,000	=	\$13,000

Req. 1

December 31, 2010	\$34,000	–	\$17,000	=	\$17,000
Increase during the year …					\$ 4,000

Req. 2

Reasons for the increase in owner's equity:

1. Net income.
2. Owner made additional investments in the company.

(10-20 min.) **E 1-9**

a. Increase asset (Cash)
   Increase owner’s equity (Owner, Capital)

b. Decrease asset (Cash)
   Decrease owner’s equity (Rent Expense)

c. Increase asset (Office Supplies)
   Decrease asset (Cash)

d. Increase asset (Accounts Receivable)
   Increase owner’s equity (Service Revenue)

e. Increase asset (Office Furniture)
   Increase liability (Accounts Payable)

f. Increase asset (Cash)
   Decrease asset (Accounts Receivable)

g. Decrease asset (Cash)
   Decrease liability (Accounts Payable)

h. Increase asset (Cash)
   Decrease asset (Land)

i. Increase asset (Cash)
   Increase owner’s equity (Service Revenue)

(10-20 min.) **E 1-10**

Forest Heights Clinic

Analysis of Transactions

	ASSETS			= LIABILITIES	+ OWNER'S EQUITY	
DATE	CASH	+ MEDICAL SUPPLIES	+ LAND	= ACCOUNTS PAYABLE	+ DON HILL, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Jan. 6	200,000				200,000	Owner investment
Bal.	200,000				200,000	
9	(140,000)		140,000			
Bal.	60,000		140,000		200,000	
12		7,000		7,000		
Bal.	60,000	7,000	140,000	7,000	200,000	
15	Not a business transaction					
15-31	17,000				17,000	Service revenue
Bal.	77,000	7,000	140,000	7,000	217,000	
15-31	(5,000)				(5,000)	Salary expense
	(3,100)				(3,100)	Rent expense
	(450)				(450)	Utilities expense
Bal.	68,450	7,000	140,000	7,000	208,450	
28	800	(800)				
Bal.	69,250	6,200	140,000	7,000	208,450	
31	(3,500)			(3,500)		
Bal.	65,750	6,200	140,000	3,500	208,450	

211,950 211,950

Req. 1 *(10-20 min.)* **E 1-11**

a. Investment by owner, Steve Mitchell
b. Rental revenue for cash
c. Purchase of rental equipment on account
d. Rental revenue on account
e. Payment of cash expenses
f. Rental revenue for cash
g. Collection of account receivable
h. Payment of account payable

Req. 2

Revenues ($500 + $600 + $4,200)....................	$5,300
Less: Expenses..	1,800
Net income..	$3,500

Req. 1 *(10-20 min.)* **E 1-12**

Riverbend Consulting Services is a proprietorship, as shown by the owner's capital account.

Req. 2 Riverbend Consulting Services

Riverbend Consulting Services			
Balance Sheet			
September 30, 2010			
ASSETS		LIABILITIES	
Cash	$ 5,250	Accounts payable	$ 14,250
Accounts receivable	41,000	Note payable	40,000
Supplies	6,000	Total liabilities	54,250
Computer equipment	82,500	OWNER'S EQUITY	
		Linda Hall, capital	$ 80,500*
		Total liabilities and	
Total assets	$134,750	owner's equity	$134,750

* Computation: Total assets ($134,750) – Total liabilities ($54,250) = Owner's equity (x)
Owner's equity: (x) = $134,750 – 54,250
Owner's equity: (x) = $80,500

Req. 3

The balance sheet reports *financial position*. The income statement reports *operating results*.

(15-20 min.) **E 1-13**
Ladner Environmental Services

Ladner Environmental Services		
Income Statement		
For the Period April 1 to April 21, 2010		
Revenue:		
Service revenue		$35,000
Expenses:		
Rent expense	$3,000	
Salary expense	3,500	
Utilities expense	1,000	
Total expenses		7,500
Net income		$27,500

Ladner Environmental Services	
Statement of Owner's Equity	
For the Period April 1 to April 21, 2010	
John Ladner, capital, April 1, 2010	$ 0
Add: Investment by owner	250,000
Net income for the period	27,500
John Ladner, capital, April 21, 2010	$277,500

Ladner Environmental Services			
Balance Sheet			
April 21, 2010			
ASSETS		LIABILITIES	
Cash	$ 158,500	Accounts payable	$ 1,000
Accounts receivable	15,000		
Office supplies	5,000	OWNER'S EQUITY	
Land	100,000	John Ladner, capital	277,500
		Total liabilities and	
Total assets	$278,500	owner's equity	$278,500

Req. 1 *(15-25 min.)* **E 1-14**

Hollins Company

Hollins Company		
Income Statement		
For the Year Ended December 31, 2010		
Revenue:		
Service revenue		$581,200
Expenses:		
Salary expense	$410,000	
Rent expense	36,000	
Utilities expense	16,000	
Supplies expense	24,000	
Research expenses	24,600	
Total expenses		510,600
Net income		$ 70,600

Results of operations for 2010: Net income of $ 70,600.

Req. 2

First we prepare the statement of owner's equity for the year ended December 31, 2010. The format for this statement is as follows:

Hollins Company

Hollins Company	
Statement of Owner's Equity	
For the Year Ended December 31, 2010	
Gary Hollins, capital, January 1, 2010	$ 0
Add: Investment by owner	55,000
Net income for the year (Req. 1)	70,600
	125,600
Less: Withdrawals by owner	50,600
Gary Hollins, capital, December 31, 2010	$ 75,000

To solve for total withdrawals, we put the data in equation form:

$$\$0 + \$55{,}000 + \$70{,}600 - \$x = \$75{,}000$$
$$x = \$55{,}000 + 70{,}600 - 75{,}000$$
$$x = \$50{,}600$$

(15-25 min.) **E 1-15**

The switch to IFRS will harmonize Canadian accounting standards with those in use around the world, which will reduce confusion among users of financial statements.

The increasing amounts of globalization have resulted in more companies trading in more than one country, so a united method of accounting would be useful for these companies.

Req. 1 *(30-40 mins)* **E1-16**

Haupt Consulting

				ASSETS		= LIABILITIES	+ OWNER'S EQUITY	
DATE	CASH	ACCOUNTS RECEIVABLE	SUPPLIES	EQUIPMENT	FURNITURE	ACCOUNTS PAYABLE	CARL HAUPT, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Dec. 2	+10,000						+10,000	Owner investment
Bal.	10,000						10,000	
2	-1,000						-1,000	Rent expense
Bal	9,000						9,000	
3	-2,000			+2,000				
Bal	7,000			2,000			9,000	
4					+3,600	+3,600		
Bal	7,000			2,000	3,600	3,600	9,000	
5			+300			+300		
Bal	7,000		300	2,000	3,600	3,900	9,000	
9		+1,700					+1,700	Service revenue
Bal	7,000	1,700	300	2,000	3,600	3,900	10,700	
12	-200						-200	Utility expense
Bal	6,800	1,700	300	2,000	3,600	3,900	10,500	
18	+800						+800	Service revenue
Bal.	$7,600	$1,700	$300	$2,000	$3,600	$3,900	$11,300	

TOTAL ASSETS = $15,200 TOTAL LIABILITIES AND OWNER'S EQUITY = $15,200

Req. 2

Haupt Consulting		
Income Statement		
For the Period December 1 to December 18, 2010		
Revenue:		
Service revenue*		$2,500
Expenses:		
Rent expense		1,000
Utility Expense		200
Net income		$1,300

* $2,500 = $1,700 + $800

Req. 3

Haupt Consulting	
Statement of Owner's Equity	
For the Period December 1 to December 18, 2010	
Carl Haupt, capital, December 1, 2010	$0
Add: Investment by owner	10,000
Net income for the month	1,300
Carl Haupt, capital, December 18, 2010	$11,300

Req.4

Haupt Consulting			
Balance Sheet			
December 18, 2010			
ASSETS		LIABILITIES	
Cash	$ 7,600	Accounts payable	$ 3,900
Accounts receivable	1,700		
Supplies	300		
Equipment	2,000	OWNER'S EQUITY	
Furniture	3,600	C. Haupt, capital	11,300
		Total liabilities and	
Total assets	$15,200	owner's equity	$15,200

Challenge Exercise

Computed amounts are shown in boxes. *(30-40 min.)* **E 1-17**

		Yew Co.	Ash Co.	Arbutus Co.
Beginning:				
	Assets	$330,000	$150,000	$270,000
–	Liabilities	(150,000)	(60,000)	(180,000)
=	Owner's equity	$180,000	$ 90,000	$ 90,000
Ending:				
	Assets	$480,000	$210,000	$\boxed{\$290,000}$ [5]
–	Liabilities	(210,000)	(105,000)	(240,000)
=	Owner's equity	$270,000	$ 105,000	$ 50,000
Income Statement:				
	Revenues	$660,000	$315,000	$600,000
–	Expenses	480,000	$\boxed{180,000}$ [3]	450,000
=	Net income	$180,000	$ 135,000	$150,000
Statement of Owner's Equity:				
	Beginning owner's equity	$180,000	$ 90,000	$90,000
+	Investments by Owner	$\boxed{240,000}$ [1]	0	20,000
+	Net income	180,000	135,000[2]	150,000
–	Withdrawals by Owner	(330,000)	(120,000)	(210,000)
=	Ending owner's equity	$270,000	$ 105,000	$ 50,000[4]

[1] $180,000 + Investments (Y) + $180,000 – $330,000= $270,000
Investments = $240,000
[2] Net income (X) = $135,000 (90,000 + 0 + NI – 120,000 = 105,000)
[3] Revenues – Expenses = Net income
$315,000 – Expenses = $135,000
Expenses = $180,000
[4] Owner's Equity = Beginning Equity + Investments + Net Income – Withdrawals
Owner's Equity = $90,000 + $20,000 + $150,000 – $210,000
Owner's Equity = $50,000
[5] Assets – Liabilities = OE
Assets – $240,000 = $50,000
Assets = $290,000

(15–20 min.) **E1-18**

Req. 1

	January 1, 2010	December 31, 2010
Total assets	$210,000	$ 312,000
Total liabilities	175,000	235,000
Total owner's equity	$ 35,000	$ 77,000

Beginning owner's equity	+	Investment	+	Net Income or – Net Loss	– Withdrawals	=	Ending owner's equity
$35,000	+	$62,000	+	X	– $10,000	=	$77,000

X = - $10,000, a net loss of $10,000

Req. 2

Worldwide Travel Company
Statement of Owner's Equity
For the Year Ended December 31, 2010

Sam Pratt, capital, January 1, 2010	$ 35,000
Add: Investments	62,000
	97,000
Deduct: Withdrawals	(10,000)
Net loss	(10,000)
	(20,000)
Sam Pratt, capital, December 31, 2010	$ 77,000

Beyond the Numbers

(15-30 min.) **BN 1-1**

TO: Bank loan committee

SUBJECT: Kettle Engineering Co. loan recommendation

I recommend NOT lending $200,000 to Kettle Engineering Co. because

1. Net income has decreased slightly for the past two years.
2. Total assets have increased from $396,000 to $438,000; however, total liabilities have increased as well.
3. Withdrawals have exceeded net income for the past two years. As a result, owner's equity has decreased from $240,000 to $204,000.
4. A $200,000 loan to Kettle Engineering Co. would result in liabilities far exceeding owner's equity.

It would be unlikely that Kettle Engineering Co. could repay the loan.

Instructional Note: Student responses may vary.

(15-20 min.) **BN 1-2**

Income Statement	Balance Sheet
a. Expense of $500	a. Decrease owner's equity by $500 Decrease cash by $500
b. Revenue of $1,000 Expense of $1,000	b. No effect
c. Storm loss (or repair expense), $8,000	c. Decrease cash, $8,000 Decrease owner's equity, $8,000

Ethical Issues

Ethical Issue 1

1. This type of information should be disclosed so that investors can make an informed decision whether to invest in the shares of the corporation.
2. The chief financial officer (CFO) of CV Technologies might be tempted to underplay the compliance problems which caused the trading halts issued by the Securities Commissions in Alberta, British Columbia and Ontario. The ethical course of action for the CFO is to tell the truth, no matter what the effect is on the 2007 financial statements.
3. Negative consequences of *not* telling the truth include CV Technologies losing its reputation for honesty in its financial reports. Investors might stop investing in CV Technologies if they suspect that the financial statements do not disclose all relevant information or tell the truth.

   Negative consequences of telling the truth include painting so bleak a picture of the compliance problem's effects on the company that investors will view CV Technologies as very risky and stop buying the company's shares.

   It would be worse to lose a reputation due to dishonesty.

Ethical Issue 2

1. The fundamental ethical issue in this situation is letting the financial statements tell the truth about the company's performance for the past year. Performance was bad, and the financial statements should present the poor performance of the company.
2. The proposal to transfer personal assets *temporarily* to the company violates the spirit, if not the letter, of the *entity concept*. The president implies that these assets can be transferred back to her at will, and the "investment" appears designed to make the company's financial position appear better than it is. This is dishonest and unethical.

   The request to "shave expenses" violates the *reliability characteristic*. The president wants the accountant to understate expenses in order to convert a loss into a reported income. This will make the financial statements inaccurate. This is dishonest and unethical.

Problems

Group A

Req. 1 *(10-15 min.)* **P 1-1A**

McLean Consultants
Classification of Transactions

July	4	c	11	c
	5	a	12	b
	5	a	29	a
	6	a	31	a
	7	a		
	10	c		

Analysis of Transactions

	ASSETS				= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH +	ACCOUNTS RECEIVABLE +	SUPPLIES +	OFFICE FURNITURE =	ACCOUNTS PAYABLE +	J. McLEAN, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
July 4*							
5	20,000					20,000	Owner investment
5	(2,400)					(2,400)	Rent expense
Bal.	17,600					17,600	
6	(600)		600				
Bal.	17,000		600			17,600	
7				5,000	5,000		
Bal.	17,000		600	5,000	5,000	17,600	
10*							
11*							
12*							
29		10,000				10,000	Service revenue
Bal.	17,000	10,000	600	5000	5,000	27,600	
31	(3,000)					(3,000)	Owner withdrawal
Bal.	14,000	10,000	600	5,000	5,000	24,600	

$\underbrace{14,000 + 10,000 + 600 + 5,000}_{29,600}$ = $\underbrace{5,000 + 24,600}_{29,600}$

29,600 29,600

*Not a transaction of the business.

Req. 1 *(20-25 min.)* **P 1-2A**

If a proprietorship is set up as a Limited Liability Company, Trevor's liability will be limited.

Req. 2

Trevor Michaels, Realtor

Trevor Michaels, Realtor			
Balance Sheet			
November 30, 2010			
ASSETS		LIABILITIES	
Cash	$ 7,000	Accounts payable	$ 2,000
Office supplies	500	Note payable	20,000
Furniture	7,000	Total liabilities	22,000
Land	40,000		
Franchise	10,000	OWNER'S EQUITY	
		T. Michaels, capital	$42,500
		Total liabilities and	
Total assets	$64,500	owner's equity	$64,500

Req.3

Personal items not reported on the balance sheet of the business:

c. Personal residence ($550,000) and mortgage payable ($300,000)
d. Personal cash ($30,000)
e. Personal account payable ($2,000)

Req. 1 *(25-35 min.)* **P 1-3A**

Tofino Suppliers

Date		Type of Transaction
June	22	Investment of $7,000 by owner
		Increase Cash, $7,000
		Increase Owner's Equity, $7,000
	23	Cash purchase of land, $10,000
		Decrease Cash, $10,000
		Increase Land, $10,000
	24	Purchase of supplies on account, $3,000
		Increase Supplies, $3,000
		Increase Accounts Payable, $3,000
	25	Payment of $4,000 cash on account payable
		Decrease Accounts Payable, $4,000
		Decrease Cash, $4,000
	26	Collection of $3,000 cash from customer on account receivable
		Increase Cash, $3,000
		Decrease Accounts Receivable, $3,000
	27	Investment of $7,000 cash by owner
		Increase Cash, $7,000
		Increase Owner's Equity, $7,000
	28	Payment of $5,000 cash on account payable
		Decrease Accounts Payable, $5,000
		Decrease Cash, $5,000
	29	Cash purchase of supplies, $3,000
		Decrease Cash, $3,000
		Increase Supplies, $3,000
	30	Owner withdrawal of $10,000
		Decrease cash, $10,000
		Decrease Owner's Equity, $10,000

Req. 1

Superior Sounds		
Income Statement		
For the Year Ended December 31, 2010		
Revenue:		
Service revenue		$300,000
Expenses:		
Salary expense	$160,000	
Advertising expense	19,000	
Consultant expense	18,000	
Interest expense	10,000	
Insurance expense	3,000	
Total expenses		210,000
Net income		$ 90,000

Req. 2

Superior Sounds	
Statement of Owner's Equity	
For the Year Ended December 31, 2010	
S. Chan, capital, January 1, 2010	$ 200,000
Add: Net income for the year	90,000
	290,000
Less: Owner withdrawals	69,000
S. Chan, capital, December 31, 2010	$ 221,000

Req. 3

Superior Sounds			
Balance Sheet			
December 31, 2010			
ASSETS		LIABILITIES	
Cash	$ 10,000	Accounts payable	$ 38,000
Accounts receivable	24,000	Salary payable	15,000
Supplies	5,000	Note payable	130,000
Furniture	30,000	Total liabilities	183,000
Electronic equipment	110,000		
Land	25,000	OWNER'S EQUITY	
Building	200,000	S. Chan, capital	$ 221,000
		Total liabilities and	
Total assets	$404,000	owner's equity	$404,000

Req. 4

(a) Result of operations: Net income of $90,000

(b) Owner's equity increased during the year. This would make it easier to borrow money from a bank in the future.

(c) At December 31, 2011:

	Total economic resources—total assets	$404,000
–	Total amount owed—total liabilities	(183,000)
=	Owner's equity	$ 221,000

Req. 1

(20-25 min.) **P 1-5A**

Enderby Services Co.

Enderby Services Co.			
Balance Sheet			
July 31, 2010			
ASSETS		LIABILITIES	
Cash	$ 66,000	Accounts payable	$54,000
Accounts receivable	69,000	Note payable	48,000
Office supplies	3,000	Total liabilities	$102,000
Office furniture	60,000		
Land	132,000	OWNER'S EQUITY	
		J. Enderby, capital	$228,000
		Total liabilities and	
Total assets	$330,000	owner's equity	$330,000

*	Total assets	$ 330,000
–	Total liabilities	(102,000)
=	Owner's equity (capital)	$ 228,000

Req. 2

The total assets presented in the corrected balance sheet are less than those of the original balance sheet. The accounts that are not presented on the corrected balance sheet because they are revenues or expenses, but that are presented on the income statement, are:

Advertising expense
Rent expense
Service revenue

Req. 1

(45-60 min.) **P 1-6A**

Baines Personnel Services

Analysis of Transactions

	ASSETS				= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH	+ ACCOUNTS RECEIVABLE	+ SUPPLIES	+ FURNITURE & COMPUTERS	= ACCOUNTS PAYABLE	+ P. BAINES, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Bal.	30,000	32,000		96,000	52,000	106,000	
a)	120,000					120,000	Owner investment
Bal.	150,000	32,000		96,000	52,000	226,000	
b)	7,000					7,000	Service revenue
Bal.	157,000	32,000		96,000	52,000	233,000	
c)	(52,000)				(52,000)		
Bal.	105,000	32,000		96,000	0	233,000	
d)			8,000		8,000		
Bal.	105,000	32,000	8,000	96,000	8,000	233,000	
e)	10,000	(10,000)					
Bal.	115,000	22,000	8,000	96,000	8,000	233,000	
f)		64,000				64,000	Service revenue
Bal.	115,000	86,000	8,000	96,000	8,000	297,000	
g)	(6,000)					(6,000)	Rent expense
	(2,000)					(2,000)	Advertising expense
Bal.	107,000	86,000	8,000	96,000	8,000	289,000	
h)	1,000		(1,000)				
Bal.	108,000	86,000	7,000	96,000	8,000	289,000	
i)	(32,000)					(32,000)	Owner withdrawal
Balance	$76,000	$86,000	$7,000	$96,000	$8,000	$257,000	

265,000 265,000

Req. 2

Baines Personnel Services		
Income Statement		
For the Month Ended September 30, 2010		
Revenue:		
Service revenue ($7,000 + $64,000)		$71,000
Expenses:		
Rent expense	$6,000	
Advertising expense	2,000	
Total expenses		8,000
Net income		$63,000

Req. 3

Baines Personnel Services	
Statement of Owner's Equity	
For the Month Ended September 30, 2010	
Phyllis Baines, capital, September 1, 2010	$ 106,000
Add: Investment by owner	120,000
Net income for the month	63,000
	289,000
Less: Owner withdrawal	32,000
Phyllis Baines, capital, September 30, 2010	$257,000

Req. 4

Baines Personnel Services			
Balance Sheet			
September 30, 2010			
ASSETS		LIABILITIES	
Cash	$ 76,000	Accounts payable	$ 8,000
Accounts receivable	86,000		
Supplies	7,000	OWNER'S EQUITY	
Furniture and computers	96,000	P. Baines, capital	257,000
		Total liabilities and	
Total assets	$265,000	owner's equity	$265,000

(20-30 min.) **P 1-7A**

Barry Melrose, Lawyer

May 1:

Economic-entity assumption: Barry Melrose is transferring personal funds of $30,000 into his law practice.

May 3:

Reliability characteristic: The work should be recorded at $4,000, not at the “normal” amount, as the amount actually charged is the only objective evidence of what the work was worth.

May 5:

Going-concern assumption: The company expects to remain in operation long enough to use existing resources. The company must record this transaction as an asset, since it will provide future benefits, not as an expense, which is what Melrose wants to do.

May 10:

Cost Principle of Measurement: This event should not be recorded as a transaction since no “cost” was paid or received with the signing of the lease. This event does not meet the definition of a transaction.

May 18:

Economic-entity assumption: The loan should not be recorded by the company as it is a personal liability of Melrose.

May 25:

Economic-entity assumption: This transaction should not be recorded by the company, as it is a personal transaction.

May 28:

Economic-entity assumption: This withdrawal relates to the business and should be treated as a reduction in Owner’s Equity. The payment of a portion of the loan is related to a personal liability of Melrose, and therefore should not be recorded by the company.

May 31:

Reliability characteristic: The computer equipment should be recorded at $8,000 since the only objective evidence of its value is the $8,000 of legal work completed.

Req. 1

Total profits for the period of January 1, 2010 to November 30, 2010 is equal to the balance of the owner's equity on November 30, 2010, minus total investments by Bieksa (investments = $100,000 + $25,000). This is calculated by subtracting liabilities and investments by Bieksa from the total assets:

= $166,000* – ($24,000 + $16,000 + $125,000)
= $1,000

* 166,000 = 25,000 + 15,000 + 52,000 + 48,000 + 26,000

Req. 2

See the page following Req. 4.

Req. 3 Bieksa Board Rentals

Bieksa Board Rentals		
Income Statement		
For the Month Ended December 31, 2010		
Revenue:		
Service revenue*		$119,000
Expenses:		
Rent expense		$ 6,000
Net income		$113,000

* $119,000 = $18,000 + $40,000 + $33,000 + $28,000

Req. 4 Bieksa Board Rentals

Bieksa Board Rentals	
Statement of Owner's Equity	
For the Month Ended December 31, 2010	
H. Bieksa, capital, December 1, 2010	$126,000
Add: Investment by owner	24,000
Net income for the month	113,000
H. Bieksa, capital, December 31, 2010	$263,000

Req. 2

(continued) **P 1-8A**
Bieksa Board Rentals

	ASSETS					= LIABILITIES		+ OWNER'S EQUITY	
DATE	CASH	ACCOUNTS RECEIVABLE	RENTAL GEAR	RENTAL SNOWBOARDS	STORE EQUIPMENT	ACCOUNTS PAYABLE	NOTE PAYABLE	H. BIEKSA, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
	25,000	15,000	52,000	48,000	26,000	24,000	16,000	126,000	
Dec. 1	+ 24,000							+24,000	Owner investment
1	– 6,000							– 6,000	Rent expense
4		No transaction recorded							
6	+13,500	+4,500						+18,000	Service revenue
10	–24,000					–24,000			
12			+9,000	+16,000		+25,000			
13	+40,000							+40,000	Service revenue
15	+15,000	–15,000							
18	– 2,000				+10,000	+ 8,000			
20	+16,500	+16,500						+33,000	Service revenue
24	–25,000					–25,000			
27	+28,000							+28,000	Service revenue
27	+4,500	–4,500							
Bal.	$109,500	$16,500	$61,000	$64,000	$36,000	$8,000	$16,000	$263,000	

TOTAL ASSETS = $287,000 TOTAL LIABILITIES AND OWNER'S EQUITY = $287,000

Req. 5

Bieksa Board Rentals			
Balance Sheet			
December 31, 2010			
ASSETS		LIABILITIES	
Cash	$ 109,500	Accounts payable	$ 8,000
Accounts receivable	16,500	Note payable	16,000
Rental gear	61,000		
Rental snowboards	64,000	OWNER'S EQUITY	
Store equipment	36,000	H. Bieksa, capital	263,000
		Total liabilities and	
Total assets	$287,000	owner's equity	$287,000

Req. 6

Harvey is correct in feeling that the business is profitable (profits of $113,000 in December 2010 and further profits of $1,000 since January 1, 2010). The reason he has to keep investing more money and is unable to make withdrawals at this time is due to the growth of the business; the assets have grown by $187,000 since November 30, 2010 ($287,000 – $100,000), with an increase in liabilities of only $24,000. Harvey will have to continue to invest (and will be unable to make withdrawals) as long as the business continues to grow by an amount in excess of profitability, unless he finances some of the growth through increasing the liabilities.

Instructional Note: Student responses may vary.

Problems

Group B

Req. 1 *(15-20 min.)* **P 1-1B**

Rose Design
Classification of Transactions

July	1	c	7	a
	2	c	9	a
	3	c	23	a
	5	a	31	a
	5	a		
	6	b		

Req. 2

(continued) **P 1-1B**
Rose Design

Analysis of Transactions

	ASSETS				= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH	+ ACCOUNTS RECEIVABLE	+ SUPPLIES	+ OFFICE FURNITURE	= ACCOUNTS PAYABLE	+ D. ROSE, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
July 1*							
2*							
3*							
5	60,000					60,000	Owner investment
5	(3,000)					(3,000)	Rent expense
Bal.	57,000					57,000	
6*							
Bal.	57,000					57,000	
7	(500)		500				
Bal.	56,500		500			57,000	
9				6,000	6,000		
Bal.	56,500		500	6,000	6,000	57,000	
23		8,000				8,000	Service revenue
Bal.	56,500	8,000	500	6,000	6,000	65,000	
31	(3,000)					(3,000)	Owner withdrawal
	53,500	8,000	500	6,000	6,000	62,000	

68,000 68,000

*Not a business transaction

Req. 1 *(20-25 min.)* **P 1-2B**

If a proprietorship is set up as a Limited Liability Company, Hayley's liability will be limited.

Req. 2

Hayley Wilson Realty

Hayley Wilson Realty			
Balance Sheet			
March 31, 2010			
ASSETS		LIABILITIES	
Cash	$ 75,000	Accounts payable	$ 20,000
Office supplies	12,000	Note payable	110,000
Furniture	24,000	Total liabilities	130,000
Land	156,000		
Franchise	24,000	OWNER'S EQUITY	
		H. Wilson, capital	$161,000*
		Total liabilities and	
Total assets	$291,000	owner's equity	$291,000

*	Total assets	$291,000
–	Total liabilities	(130,000)
=	Owner's equity (capital)	$161,000

Req. 3

Personal items not reported on the balance sheet of the business:

a. Personal cash ($15,000)
e. Personal residence ($320,000) and mortgage payable ($185,000)
f. Personal account payable ($2,000)

Michelle Hopkins, Management Accountant

Date		Type of Transaction
Nov.	17	Collection of $1,000 cash from customer on account receivable
		Increase Cash, $1,000
		Decrease Accounts Receivable, $1,000
	18	Payment of $1,000 cash on account payable
		Decrease Cash, $1,000
		Decrease Accounts Payable, $1,000
	19	Purchase of supplies on account, $300
		Increase Supplies, $300
		Increase Accounts Payable, $300
	20	Investment of $2,000 by owner
		Increase Cash, $2,000
		Increase Owner’s Equity (Capital), $2,000
	23	Payment of $800 cash on account payable
		Decrease Cash, $800
		Decrease Accounts Payable, $800
	24	Cash sale of furniture, $2,000
		Increase Cash, $2,000
		Decrease Furniture, $2,000
	25	Cash purchase of supplies, $200
		Decrease Cash, $200
		Increase Supplies, $200
	26	Withdrawal of cash by owner, $1,000
		Decrease Cash, $1,000
		Decrease Owner’s Equity (Capital), $1,000

(40-60 min.) **P 1-4B**

Req. 1

Morishita Office Cleaning

Morishita Office Cleaning		
Income Statement		
For the Year Ended December 31, 2010		
Revenue:		
Service revenue		$550,000
Expenses:		
Salary expense	$220,000	
Repairs expense	40,000	
Utilities expense	15,000	
Property tax expense	10,000	
Interest expense	9,000	
Total expenses		294,000
Net income		$256,000

Req. 2

Morishita Office Cleaning

Morishita Office Cleaning	
Statement of Owner's Equity	
For the Year Ended December 31, 2010	
Brandon Morishita, capital, January 1, 2010	$110,000
Add: Net income for the year	256,000
	366,000
Less: Withdrawals by owner	78,000
Brandon Morishita, capital, December 31, 2010	$288,000

Req. 3

Morishita Office Cleaning			
Balance Sheet			
December 31, 2010			
ASSETS		LIABILITIES	
Cash	$ 5,000	Accounts payable	$ 75,000
Accounts receivable	25,000	Interest payable	3,000
Supplies	10,000	Notes payable	180,000
Equipment	105,000	Total liabilities	258,000
Building	250,000	OWNER'S EQUITY	
Land	140,000	B. Morishita, capital	$288,000
Furniture	11,000	Total liabilities and	
Total assets	$546,000	owner's equity	$546,000

Req. 4

(a) Result of operations: Net income of $256,000

(b) Owner's equity increased during the year. This would make it easier to borrow money from a bank in the future.

(c) At December 31:

	Total economic resources—total assets	$ 546,000
–	Total amount owed—total liabilities	(258,000)
=	Owner's equity	$ 288,000

Req. 1 *(20-25 min.)* **P 1-5B**

Campbell Insurance Agency

Campbell Insurance Agency			
Balance Sheet			
October 31, 2010			
ASSETS		LIABILITIES	
Cash	$12,000	Accounts payable	$ 11,500
Accounts receivable	11,000	Note payable	20,000
Notes receivable	12,000	Total liabilities	31,500
Office furniture	10,000		
		OWNER'S EQUITY	
		C. Campbell, capital	$13,500*
		Total liabilities and	
Total assets	$45,000	owner's equity	$45,000

*	Total assets	$45,000
–	Total liabilities	(31,500)
=	Owner's equity (capital)	$13,500

Req. 2

The accounts that are not presented on the balance sheet because they are revenue and expenses, but that are presented on the income statement, are

Insurance expense
Rent expense
Salary expense
Utilities expense
Premium revenue

Req. 1

(45-60 min.) **P 1-6B**

Robertson Design Studio

Analysis of Transactions

	ASSETS				= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH	+ ACCOUNTS RECEIVABLE +	SUPPLIES +	LAND	= ACCOUNTS PAYABLE +	J.ROBERTSON, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
Bal.	13,500	13,000		51,000	16,500	61,000	
a)	15,000					15,000	Owner investment
Bal.	28,500	13,000		51,000	16,500	76,000	
b)	(16,500)				(16,500)		
Bal.	12,000	13,000		51,000	0	76,000	
c)	2,500					2,500	Service revenue
Bal.	14,500	13,000		51,000	0	78,500	
d)	2,000	(2,000)					
Bal.	16,500	11,000		51,000	0	78,500	
e)			1,400		1,400		
Bal.	16,500	11,000	1,400	51,000	1,400	78,500	
f)		8,000				8,000	Service revenue
Bal.	16,500	19,000	1,400	51,000	1,400	86,500	
g)	(5,100)					(3,000)	Rent expense
						(2,100)	Advertising expense
Bal.	11,400	19,000	1,400	51,000	1,400	81,400	
h)	500		(500)				
Bal.	11,900	19,000	900	51,000	1,400	81,400	
i)	(3,500)					(3,500)	Owner withdrawal
Balance	$8,400	$19,000	$900	$51,000	$1,400	$77,900	

79,300 79,300

Req. 2

Robertson Design Studio		
Income Statement		
For the Month Ended May 31, 2010		
Revenue:		
Service revenue ($2,500 + $8,000)		$10,500
Expenses:		
Rent expense	$3,000	
Advertising expense	2,100	
Total expenses		5,100
Net income		$5,400

Robertson Design Studio

Req. 3

Robertson Design Studio	
Statement of Owner's Equity	
For the Month Ended May 31, 2010	
J. Robertson, capital, May 1, 2010	$61,000
Add: Investment by owner	15,000
Net income for the month	5,400
	81,400
Less: Owner withdrawal	3,500
J. Robertson, capital, May 31, 2010	$77,900

Robertson Design Studio

Req. 4

Robertson Design Studio			
Balance Sheet			
May 31, 2010			
ASSETS		LIABILITIES	
Cash	$8,400	Accounts payable	$ 1,400
Accounts receivable	19,000		
Supplies	900	OWNER'S EQUITY	
Land	51,000	J. Robertson, capital	77,900
		Total liabilities and	
Total assets	$79,300	owner's equity	$79,300

June 1:

Cost Principle of Measurement: The equipment should be recorded at its purchase price to John, not at its original cost to Mark or at its replacement cost.

June 3:

Reliability Characteristic: The work should be recorded at $500, not at the "normal" amount, as the amount actually charged is the only objective evidence of what the work was worth.

June 10:

Cost Principle of Measurement: This event should not be recorded as a transaction since no "cost" was paid or received with the signing of the lease. This event does not meet the definition of a transaction.

June 18:

Economic-entity Assumption: The loan should not be recorded by the company as it is a personal liability of John.

June 22:

Stable-Monetary-Unit Assumption: John must leave the value of the shop equipment at $40,000. Accountants assume that the dollar's purchasing power is relatively stable and the stable-monetary-unit assumption is the basis for ignoring the effects of inflation in the accounting records.

June 28:

Economic-entity Assumption: The $7,000 that John paid on the loan is irrelevant to the records of John Burgess Plumbing as it is a personal transaction and therefore should not be recorded by the company. The $8,000 withdrawal does relate to the business and should be treated as a reduction of Owner's Equity.

Req. 1

Total net income for the period of January 1, 2009, to December 31, 2009, is equal to the balance of the owner's equity minus investments by Armstrong ($30,000 + $28,000). This is calculated by subtracting the liabilities and investments by Armstrong from the total assets:

= $92,000* – ($18,000 + $58,000)
= $16,000

* 92,000 = 20,000 +19,000 + 18,000 + 14,000 + 21,000

This could also be calculated by subtracting the investments by Armstrong from the owner's equity:

= $74,000 – $58,000*
= $16,000

* 58,000 = 30,000 + 28,000

Req. 2

See the page following Req. 3.

Req. 3

Armstrong Marketing Consulting

Armstrong Marketing Consulting Income Statement For the Month Ended January 31, 2010		
Revenue:		
Service revenue ($26,000 + $10,000)		$36,000
Expenses:		
Rent expense	$3,000	
Delivery expense	1,000	
Total expenses		4,000
Net income		$32,000

Req. 2

Armstrong Marketing Consulting

			ASSETS			= LIABILITIES +	OWNER'S EQUITY	
DATE	CASH	ACCOUNTS RECEIVABLE	SOFTWARE	OFFICE FURNITURE	COMPUTER EQUIPMENT	ACCOUNTS PAYABLE	JODY ARMSTRONG, CAPITAL	TYPE OF OWNER'S EQUITY TRANSACTION
	20,000	19,000	18,000	14,000	21,000	18,000	74,000	
Jan. 2	+ 15,000						+ 15,000	Owner investment
2	– 3,000						– 3,000	Rent expense
4	No transaction recorded.							
6	+ 8,000	+18,000					+ 26,000	Service revenue
10	– 1,000						– 1,000	Delivery expense
12	NO EFFECT							
14	– 3,000		+ 6,000			+ 3,000		
15	+ 6,000	– 6,000						
18	– 4,000				+ 12,000	+ 8,000		
23		+ 10,000					+ 10,000	Service revenue
29	– 3,000					– 3,000		
Bal.	$35,000	$41,000	$24,000	$14,000	$33,000	$26,000	$121,000	

TOTAL ASSETS = $147,000 **TOTAL LIABILITIES AND OWNER'S EQUITY = $147,000**

Req. 4

Armstrong Marketing Consulting

Armstrong Marketing Consulting	
Statement of Owner's Equity	
For the Month Ended January 31, 2010	
Jody Armstrong, capital, January 1, 2010	$74,000
Add: Investment by owner	15,000
Net income for the month	32,000
Jody Armstrong, capital, January 31, 2010	$121,000

Req. 5

Armstrong Marketing Consulting

Armstrong Marketing Consulting			
Balance Sheet			
January 31, 2010			
ASSETS		LIABILITIES	
Cash	$ 35,000	Accounts payable	$ 26,000
Accounts receivable	41,000		
Software	24,000		
Office furniture	14,000	OWNER'S EQUITY	
Computer equipment	33,000	J. Armstrong, capital	121,000
		Total liabilities and	
Total assets	$147,000	owner's equity	$147,000

Req. 6

Armstrong is correct in feeling that the business is profitable (profits of $32,000 in January 2010 and profits of $16,000 since January 2009). The reason she has to keep investing more money and is unable to make withdrawals at this time is due to the growth of the business; the assets have grown by $117,000 since the business was started ($147,000 – $30,000) with an increase in liabilities of only $26,000. Armstrong will have to continue to invest (and will be unable to make withdrawals) as long as the business continues to grow by an amount in excess of profitability unless she finances some of the growth through increasing the liabilities.

Instructional Note: Student responses may vary.

Challenge Problems

(15-20 min.) P 1-1C

The student should explain that assets are valued on a going-concern basis in the financial statements because the company expects to remain in operation into the foreseeable future. The company, therefore, expects to realize more than the cost value of its inventory (since selling price is set higher than the original cost of the inventory). It also expects it will collect the value of its receivables because customers will want to do future business with the company. Once the company goes out of business, the inventory becomes worth what it can be sold for under distress conditions. The outstanding accounts receivable are usually insufficient to cover the liabilities.

(15-20 min.) P 1-2C

A commitment (signed contract) is not a transaction. The group does have commitments from 200 families to pay them for the work they will do in the future. No transactions have occurred, so they cannot recognize the commitments as assets. A transaction must have occurred for an asset to be recorded.

The group should make a list of the commitments for the bank to show the bank that they have carefully planned and that they have prospective revenues.

Decision Problems

(30-40 min.) Decision Problem 1

Req. 1

Based solely on these balance sheets, Ryan's Catering appears to be the better credit risk because Ryan's has only $106,500 of liabilities compared to $195,000 for Tyler's Bicycle Centre. Ryan's owner's equity is far greater than that of Tyler's ($255,000 compared to $125,250). Tyler's is already heavily in debt. You would be better off granting the loan to Ryan's. You should consider what would happen if the borrower could not pay you back as planned. The two companies have about the same amount of assets to sell for cash if they need to come up with the money to pay you, but Ryan's has far less debt to pay to others before paying you.

Req. 2

Information in addition to the balance sheet:

1. Income statements for several recent periods to see the two companies' profitability. Income statement data (especially the amount of net income or net loss) provide an important measure of business success or failure.
2. Forecasted income for the future.
3. Statement of what they plan to do with the borrowed money and how they expect to pay it back.
4. Credit ratings from an independent credit agency.
5. Financial ratios, which will be examined in the coming chapters.

(15-30 min.) Decision Problem 2

1. An understanding of accounting is required information for all areas of business, including computers, marketing, production, and so on. In taking this course I will learn to use accounting terminology, analyze business transactions, and understand financial statements, in addition to the other learning objectives listed in each chapter.

2. Accounting information is used:

   a. By a private individual—to balance a chequebook and account for personal transactions; to prepare financial statements in order to obtain a loan; to lend and borrow intelligently; to understand share and bond investments; and to compute one's income tax and prepare the tax return, among other uses.

   b. By a friend who plans to be a farmer—similar to the answer to *a*, plus to account for the cost of seed, fertilizer, livestock, employee wages, and crops; to prepare government forms for assistance plans; to compute amortization on farm equipment; and to budget operations.

   c. By a friend who plans a career in sales—similar answer to *a*, plus to budget sales and expenses; to set the prices of products; and to compute sales commissions to be received.

Instructional Note: Student responses may vary. They will probably not be as thorough as this suggested solution.

Financial Statement Cases

(30-40 min.) Financial Statement Case 1

ALL AMOUNTS IN THOUSANDS OF DOLLARS

Req. 1

Cash (and short-term deposits) at October 31, 2008 $492,173

Req. 2

	October 31, 2008	October 31, 2007
Total assets	$10,600,732	$9,525,040

Req. 3

Assets	=	Liabilities	+	Shareholders' Equity
$10,600,732	=	$9,921,584	+	$679,148

Req. 4

	Year ended October 31, 2008	Year ended October 31, 2007
Total revenue	$633,007	561,756
	($562,767 + $70,240)	($498,935 + $62,821)

Increase of $71,251, or 12.7%

Req. 5

Net income	$102,019	$96,282

Increase of $5,737, or 6.0%

The year ending October 31, 2008, was a good year, as compared to the year ended October 31, 2007. Total revenues were higher than for the preceding year by $71,251, or 12.7%. Net income was also higher than for the previous year by $5,737, or 6.0%. Overall, the company appears to be growing at a very good rate.

(30-40 min.) **Financial Statement Case 2**

ALL AMOUNTS IN THOUSANDS OF DOLLARS

Req. 1

Cash and cash equivalents, December 31, 2008 $625

Req. 2

	December 31, 2008	December 31, 2007
Total assets	$73,622	$56,884

Req. 3

Assets	=	Liabilities	+	Shareholders' Equity
$73,622	=	$44,644	+	$28,978

Req. 4

	December 31, 2008	December 31, 2007
Total net sales	$125,368	$135,134

There was a decrease of $9,766, or 7.2%, during 2008.

Req. 5

	December 31, 2008	December 31, 2007
Net income or (loss)	($11,673)	$ 4,636

There was a decrease of $16,309, or 352%, during 2008.

It appears 2008 was a rough year compared to 2007, since there is a decrease in sales of $9,766, or 7.2%, and a decrease in net income of $16,309, or 352%, in 2008 as compared to 2007.