Exercises: Set A

E1A. Business Transactions

1.	No, this is not a business transaction because no economic exchange has taken place.
2.	Yes, this is an expense of the business.
3.	Yes, this is an expense of the business.
4.	Yes, this is an expense of the business (assuming that Austin intends to repay the loan).

E2A. Accounting Concepts

1.	c	6.	b
2.	c	7.	a
3.	b	8.	a
4.	a	9.	c
5.	b	10.	a

E3A. Money Measure

Company	Sales				
Abril Chip	2,000,000	×	1.000	=	$2,000,000
Dao	5,000,000	×	0.130	=	$650,000
Aiko	350,000,000	×	0.012	=	$4,200,000
Orca	3,000,000	×	1.320	=	$3,960,000

Company	Assets				
Abril Chip	1,300,000	×	1.000	=	$1,300,000
Dao	2,400,000	×	0.130	=	$312,000
Aiko	250,000,000	×	0.012	=	$3,000,000
Orca	3,900,000	×	1.320	=	$5,148,000

Aiko is the largest in terms of sales and Orca is the largest in terms of assets.

E4A. The Accounting Equation

1.		Assets	=	Liabilities	+	Owner's Equity	
		$400,000	=	Liabilities	+	$155,000	
		Liabilities	=	$245,000			
2.		Assets	=	Liabilities	+	Owner's Equity	
		Assets	=	$72,000	+	$79,500	
		Assets	=	$151,500			
3.		Assets	=	1/3 Assets	+	$160,000	
		2/3 Assets	=	$160,000			
		Assets	=	$240,000			
		Liabilities	=	1/3	×	$240,000	= $80,000
4.	Beginning:	$275,000	=	Liabilities	+	$150,000	
		Liabilities	=	$125,000			
		$275,000	=	$125,000	+	$150,000	
	Change:	+ 75,000		– 22,500			
		$350,000	=	$102,500	+	Owner's Equity	
	End:	Owner's Equity	=	$247,500			

E5A. Owner's Equity and the Accounting Equation

1.	Net income is:	$6,250					
			Assets	=	Liabilities	+	Owner's Equity
		End:	$275,000	=	$162,500	+	$112,500
		Beginning:	175,000	=	68,750	+	106,250
		Net income					$ 6,250
2.	Net income is:	$33,750					
		Change in owner's equity			$ 6,250		
		+ Owner's withdrawals			27,500		
		Net income			$ 33,750		
3.	Net loss is:	$(10,000)					
		Change in owner's equity			$ 6,250		
		– Owner's investments			16,250		
		Net loss			$(10,000)		
4.	Net income is:	$21,250					
		Change in owner's equity			$ 6,250		
		+ Owner's withdrawals			27,500		
					$ 33,750		
		– Owner's investments			12,500		
		Net income			$ 21,250		

E6A. Identification of Accounts

1.	a.	A	2.	a.	IS
	b.	L		b.	BS
	c.	A		c.	IS
	d.	OE		d.	BS
	e.	A		e.	IS
	f.	L		f.	BS
	g.	A		g.	OE

E7A. Preparation of a Balance Sheet

Oxford Services Company
Balance Sheet
December 31, 2014

Assets		Liabilities	
Cash	$ 25,000	Accounts payable	$ 50,000
Accounts receivable	62,500	Total liabilities	$ 50,000
Supplies	12,500	**Owner's Equity**	
Building	112,500	J. Oxford, capital	212,500
Equipment	50,000	Total liabilities and	
Total assets	$262,500	owner's equity	$262,500

E8A. Preparation and Integration of Financial Statements

Dukakis Company			
Income Statement			
For the Year Ended December 31, 2014			
Revenues:			
	Service revenue		**$13,200**
Expenses:			
	Rent expense	**$1,200**	
	Wages expense	**8,340**	
	Advertising expense	**1,350**	
	Utilities expense	**900**	
	Total expenses		**11,790**
Net income			**$ 1,410**

Dukakis Company	
Statement of Owner's Equity	
For the Year Ended December 31, 2014	
Owner's capital, December 31, 2013	**$1,000**
Investments by K. Dukakis	**1,240**
Net income for the year	**1,410**
Subtotal	**$3,650**
Less withdrawals	**700**
Owner's capital, December 31, 2014	**$2,950**

Dukakis Company			
Balance Sheet			
December 31, 2014			
Assets		**Liabilities**	
Cash	**$1,550**	**Accounts payable**	**$ 450**
Accounts receivable	**750**	**Total liabilities**	**$ 450**
Supplies	**100**	**Owner's Equity**	
Land	**1,000**	**Owner's capital**	**2,950**
		Total liabilities and	
Total assets	**$3,400**	**owner's equity**	**$3,400**

E9A. Statement of Cash Flows

Arlington Service Company
Statement of Cash Flows
For the Year Ended December 31, 2014

Cash flows from operating activities:		
Net income		$ 32,500
Adjustments to reconcile net income to net		
cash flows from operating activities:		
Increase in accounts receivable	$ (7,800)	
Increase in accounts payable	11,700	3,900
Net cash flows from operating activities		$ 36,400
Cash flows from investing activities:		
Purchase of equipment	$(117,000)	
Net cash flows used by investing activities		(117,000)
Cash flows from financing activities:		
Borrowings from bank	$ 78,000	
Owner's withdrawals	(19,500)	
Net cash flows from financing activities		58,500
Net increase (decrease) in cash		$ (22,100)
Cash at beginning of year		55,900
Cash at end of year		$ 33,800

E10A. Statement of Owner's Equity

Mrs. Shah's Cookies
Statement of Owner's Equity
For the Year Ended January 31, 2014

Owner's capital, January 31, 2013	$102,403
Net income for the year	57,087
Subtotal	$159,490
Less withdrawals	—
Owner's capital, January 31, 2014	$159,490

Owner's equity represents the claims by the owner of a business to the assets of the business. It is affected by the owner's investments in and withdrawals from the business and by the business's revenues and expenses.

The owner of Mrs. Shah's Cookies may have decided not to make any withdrawals because she wanted to use the funds for other purposes such as to finance the company's growth or pay off debt.

E11A. Preparation and Integration of Financial Statements

Net income links the income statement and the statement of owner's equity. The ending balance of owner's equity links the statement of owner's equity and the balance sheet.

Thus, start with (c), which must equal $3,000 (check: $29,000 + $3,000 – $2,000 = $30,000). Then, (b) equals (c), or $3,000. Thus, (a) must equal $8,100 (check: $11,100 – $8,100 = $3,000). Because (e) equals $30,000 (ending balance from the statement of owner's equity), (f) must equal $46,000 (check: $16,000 + $30,000 = $46,000). Finally, (d) must equal (f), or $46,000.

E12A. Users of Accounting Information and Forms of Business Organization

People who are interested in Avalon's financial statements are the following:

- Management
- Investors (owners of the company)
- Creditors
- Tax authorities
- Regulators
- Employees
- Customers
- Economic planners

A partnership is a business that has two or more owners. A corporation is a business unit that has been granted a charter from the state and is legally separate from its owners (stockholders). A major advantage of the corporate form of business over the partnership is that the stockholders' liability is limited to the amount of the stockholders' investments in the company, whereas the personal assets of partners can be called upon to pay the obligations of a partnership. Also, the transfer of ownership is easier with the corporation because the shares owned by a stockholder can be sold to another party. When ownership of a partnership changes, the partnership must be dissolved and another one formed.

E13A. The Nature of Accounting

1.	b	5.	l	9.	c
2.	k	6.	f	10.	d
3.	g	7.	a	11.	e
4.	i	8.	j	12.	h

E14A. Accounting Abbreviations

CPA:	Certified Public Accountant
IRS:	Internal Revenue Service
PCAOB:	Public Company Accounting Oversight Board
GAAP:	Generally Accepted Accounting Principles
FASB:	Financial Accounting Standards Board
SEC:	Securities and Exchange Commission
GASB:	Governmental Accounting Standards Board
IASB:	International Accounting Standards Board
IMA:	Institute of Management Accountants
AICPA:	American Institute of Certified Public Accountants

E15A. Ethics and Accounting

1.	a
2.	c
3.	b
4.	e
5.	d

Note to Instructor: **Solutions for Exercises: Set B are provided separately on the Instructor's Resource CD and website.**

Problems

P1. Preparation and Interpretation of Financial Statements

1.

IS	Utilities expense	BS	Accounts payable
BS	Building	IS	Rent expense
BS/OE	Owner's capital	OE	Withdrawals
IS/OE	Net income	IS	Fees earned
BS	Land	BS	Cash
BS	Equipment	BS	Supplies
IS	Revenues	IS	Wages expense
BS	Accounts receivable		

2. The income statement is most closely associated with the goal of profitability.

P2. Integration of Financial Statements

1.

	Set A		Set B		Set C	
Income Statement						
Revenue	$1,100		*$ 6,800*	(g)	$240	
Expenses	*800*	(a)	5,200		*160*	(m)
Net income	*$ 300*	(b)	*$ 1,600*	(h)	$ 80	
Statement of Owner's Equity						
Beginning balance	$2,900		$24,400		$340	
Net income	*300*	(c)	1,600		*80*	(n)
Less withdrawals	200		—	(i)	*40*	(o)
Ending balance	$3,000		*$26,000*	(j)	*$380*	(p)
Balance Sheet						
Total assets	*$4,600*	(d)	$31,000		*$380*	(q)
Total liabilities	$1,600		$ 5,000		*$ —*	(r)
Owner's capital	*3,000*	(e)	*26,000*	(k)	380	
Total liabilities and owner's equity	*$4,600*	(f)	*$31,000*	(l)	$380	

2. The income statement must be prepared first because the amount of net income is necessary to determine the ending balance of owner's capital. The statement of owner's equity is prepared second because it provides the ending balance of the owner's equity for the balance sheet, which is prepared last.

P3. Preparation and Interpretation of Financial Statements

1.

Fuel Designs
Income Statement
For the Year Ended December 31, 2014

Revenues:		
Commission sales revenue		$400,000
Expenses:		
Commissions expense	$225,000	
Marketing expense	20,100	
Office rent expense	36,000	
Supplies expense	2,600	
Telephone and computer expenses	5,100	
Wages expense	32,000	
Total expenses		320,800
Net income		$ 79,200

Fuel Designs
Statement of Owner's Equity
For the Year Ended December 31, 2014

Owner's capital, December 31, 2013	$ 64,300
Net income for the year	79,200
Subtotal	$143,500
Less withdrawals	33,000
Owner's capital, December 31, 2014	$110,500

Fuel Designs
Balance Sheet
December 31, 2014

Assets		Liabilities		
Cash	$ 71,700	Accounts payable	$ 3,600	
Accounts receivable	4,500	Commissions payable	22,700	
Supplies	700	Total liabilities		$ 26,300
Equipment	59,900			
		Owner's Equity		
		Owner's capital		110,500
		Total liabilities and		
Total assets	$136,800	owner's equity		$136,800

2. The statement of cash flows is very useful in assessing whether a company's operations are generating sufficient funds to support expansion. The statement tells whether operations are producing enough cash or whether the company will need to obtain outside financing from creditors or owners.

P4. Preparation and Interpretation of Financial Statements

1.

Frequent Ad
Income Statement
For the Year Ended January 31, 2014

Revenues:		
Advertising service revenue		$159,200
Expenses:		
Equipment rental expense	$37,200	
Marketing expense	4,500	
Salaries expense	86,000	
Supplies expense	19,100	
Office rent expense	10,800	
Total expenses		157,600
Net income		$ 1,600

Frequent Ad
Statement of Owner's Equity
For the Year Ended January 31, 2014

A. Francis, capital, January 31, 2013	$ —
Investments by A. Francis	5,000
Net income for the year	1,600
Subtotal	$ 6,600
Less withdrawals	—
A. Francis, capital, January 31, 2014	$ 6,600

Frequent Ad
Balance Sheet
January 31, 2014

Assets		Liabilities		
Cash	$ 1,800	Accounts payable	$19,400	
Accounts receivable	24,600	Salaries payable	1,300	
Supplies	900	Total liabilities		$ 20,700
		Owner's Equity		
		A. Francis, capital		6,600
		Total liabilities and		
Total assets	$27,300	owner's equity		$ 27,300

2. The company is challenged both in terms of profitability and liquidity. Profitability is low in that it has earned only $1,600 on revenues of $159,200. Liquidity is low because the company has cash of only $1,800 and liabilities of $20,700, but will likely receive $24,600 from customers.

P5. Use and Interpretation of Financial Statements

1. The income statement shows net income of $3,775 earned by the company over a month. The amount of net income is necessary for the preparation of the statement of owner's equity. The statement of owner's equity shows an ending balance of $42,850. The ending balance of owner's capital appears in the owner's equity section of the balance sheet. The statement of cash flows explains the changes in the cash balance during the month, and the ending amount should match the cash balance shown on the balance sheet.

2. The income statement is most closely associated with the goal of profitability, because it shows the earnings of the business. The cash flow statement is most closely associated with the goal of liquidity, because it shows the changes in cash.

3. The company appears to be very profitable because it has earned $3,775 of net income on revenues of $6,100. The owner also withdrew money in the amount of $2,400. However, the return on total assets (net income divided by total assets) is only 6.98 percent, or $0.0698 on each dollar of assets invested. Moreover, the company might experience some challenges in its liquidity position in the future because it has liabilities of $11,250 and cash of only $6,700.

4. When deciding whether to make a loan to a company, a banker evaluates the company's ability to pay interest charges and repay the loan at the appropriate time. Accordingly, a banker studies the company's liquidity and cash as well as its profitability. That information is represented in financial statements, which are prepared by a company's management and can be falsified for personal gain. To lend credibility to the financial statements, the banker may request an independent audit by a CPA. The audit would determine that the financial statements present the data fairly and conform to GAAP in all material respects.