### Chapter 1

**Introducing Financial Statements**

**EXERCISES**

**Exercise 1-1 (10 minutes)**

**C 1. Analyzing and interpreting reports.**

**C 2. Presenting financial information.**

**R 3. Keeping a log of service costs.**

**R 4. Measuring the costs of a product.**

**C 5. Preparing financial statements.**

**I 6. Spotting revenue transactions.**

**I 7. Observing transactions and events.**

**R 8. Registering cash sales of products sold.**

**Exercise 1-2 (20 minutes)**

**Part A.**

|  |  |  |  |
| --- | --- | --- | --- |
| **1.** | **I** | **5.** | **I** |
| **2.** | **E** | **6.** | **E** |
| **3.** | **I** | **7.** | **I** |
| **4.** | **E** |  |  |

**Part B.**

|  |  |  |  |
| --- | --- | --- | --- |
| **1.** | **I** | **5.** | **I** |
| **2.** | **I** | **6.** | **E** |
| **3.** | **E** | **7.** | **I** |
| **4.** | **E** | **8.** | **I** |

**Exercise 1-3 (10 minutes)**

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

**Exercise 1-4 (10 minutes)**

**1. A**

**2. G**

**3. D**

**4. F**

**5. C**

**Exercise 1-5 (20 minutes)**

**1. H**

**2. G**

**3. F**

**4. E**

**5. D**

**6. C**

**7. B**

**8. A**

**Exercise 1-6 (10 minutes)**

|  |  |  |  |
| --- | --- | --- | --- |
| **a.** | **(C) Corporation** | **e.** | **(C) Corporation** |
| **b.** | **(P) Partnership** | **f.** | **(SP) Sole proprietorship** |
| **c.** | **(SP) Sole proprietorship** | **g.** | **(C) Corporation** |
| **d.** | **(SP) Sole proprietorship** | **h.** | **(LLC) Limited Liability Company** |

**Exercise 1-7 (10 minutes)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Code** |  | **Description** |  | **Principle/Assumption** |
| **H** | **1.** | **A company reports details behind financial statements that would impact users' decisions.** |  | **Full disclosure principle** |
| **G** | **2.** | **Financial statements reflect the assumption that the business continues operating.** |  | **Going-concern assumption** |
| **F** | **3.** | **A company records the expenses incurred to generate the revenues reported.** |  | **Expense recognition (matching) principle** |
| **A** | **4.** | **Concepts, assumptions, and guidelines for preparing financial statements.** |  | **General accounting principle** |
| **C** | **5.** | **Each business is accounted for separately from its owner or owners.** |  | **Business entity assumption** |
| **D** | **6.** | **Revenue is recorded when products and services are delivered.** |  | **Revenue recognition principle** |
| **E** | **7.** | **Detailed rules used in reporting events and transactions.** |  | **Specific accounting principle** |
| **B** | **8.** | **Information is based on actual costs incurred in transactions.** |  | **Measurement (cost) principle** |

**Exercise 1-8 (10 minutes)**

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

**Exercise 1-9 (20 minutes)**

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

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Equity** |
| **$300,000** | **=** | **?** | **+** | **$100,000** |

**Thus, *beginning* liabilities = $200,000**

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

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

**Thus, *ending* equity = $130,000**

***Alternative approach to solving part (b):***

ΔAssets($80,000) = ΔLiabilities($50,000) + ΔEquity(?)

**where “Δ” refers to “change in.”**

***Thus:* *Ending* Equity = $100,000 + $30,000 = $130,000**

**b. Using the accounting equation:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Equity** |
| **$123,000** | **=** | **$47,000** | **+** | **?** |

**Thus, equity = $76,000**

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

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

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

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

**Thus: *Beginning* Equity = $60,000**

Exercise 1-10 (20 minutes)

**1. d**

**2. e**

**3. a**

**4. f**

**5. h**

**Exercise 1-11 (20 minutes)**

**1. f**

**2. a**

**3. g**

**4. h**

**5. b**

**Exercise 1-12 (15 minutes)**

**a. 3**

**b. 2**

**c. 5**

**d. 1**

**e. 4**

**f. 5**

Exercise 1-13 (30 minutes)

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

**Exercise 1-14 (10 minutes)**

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

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

Exercise 1-15 (15 minutes)

**ERNST CONSULTING**

**Income Statement**

**For Month Ended October 31**

**Revenues**

**Consulting revenue $14,000**

**Expenses**

**Salaries expense $7,000**

**Rent expense 3,550**

**Telephone expense 760**

**Miscellaneous expenses 580**

**Total expenses 11,890**

**Net income $ 2,110**

**Exercise 1-16 (15 minutes)**

**ERNST CONSULTING**

**Statement of Retained Earnings**

**For Month Ended October 31**

**Retained earnings, October 1 $ 0**

**Add: Net income (from Exercise 1-15) 2,110**

**2,110**

**Less: Dividends 2,000**

**Retained earnings, October 31 $ 110**

Exercise 1-17 (15 minutes)

**ERNST CONSULTING**

**Balance Sheet**

**October 31**

***Assets Liabilities***

**Cash $11,360 Accounts payable $ 8,500**

**Accounts receivable 14,000  *Equity***

**Office supplies 3,250 Common stock 84,000**

**Office equipment 18,000 Retained earnings\* 110**

**Land 46,000 Total equity 84,110**

**Total assets $92,610 Total liabilities and equity $92,610**

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

Exercise 1-18 (15 minutes)

**ERNST CONSULTING**

**Statement of Cash Flows**

**For Month Ended October 31**

**Cash flows from operating activities**

Cash received from customers $ 0

**Cash paid to employeesa (1,750)**

**Cash paid for rent (3,550)**

**Cash paid for telephone expenses (760)**

**Cash paid for miscellaneous expenses (580)**

**Net cash used by operating activities ( 6,640)**

**Cash flows from investing activities**

**Cash paid for office equipment (18,000)**

**Net cash used by investing activities (18,000)**

**Cash flows from financing activities**

**Cash investments from shareholders 38,000**

**Cash dividends to shareholders (2,000)**

**Net cash provided by financing activities 36,000**

**Net increase in cash $11,360**

**Cash balance, October 1 0**

**Cash balance, October 31 $11,360**

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

Exercise 1-19 (10 minutes)

**I 1. Cash purchase of equipment O 5. Cash paid on account payable**

**F 2. Cash paid for dividends O 6. Cash received from clients**

**O 3. Cash paid for advertising O 7. Cash paid for rent**

**O 4. Cash paid for wages F 8. Cash investment from shareholders**

Exercise 1-20 (20 minutes)

**Ford Motor Company**

**Income Statement**

**For Year Ended December 31, 2016**

**($ millions)**

**Revenues $151,800**

**Expenses**

**Cost of sales $126,584**

**Selling and administrative costs 12,196**

**Other expenses 8,413**

**Total expenses 147,193**

**Net income $ 4,607**

**Exercise 1-21B (10 minutes)**

**a. Financing**

**b. Financing**

**c. Operating**

**d. Investing**

**e. Investing**

**Exercise 1-22 (15 minutes)**

**BMW GROUP**

**Income Statement**

**For Year Ended December 31, 2016**

**(Euros in millions)**

**Revenues € 75,350**

**Expenses**

**Cost of sales €60,946**

**Selling and administrative costs 6,139**

**Other expenses 4,988**

**Total expenses 72,073**

**Net income € 3,277**

Exercise 1-23 (15 minutes)

**a. Using the accounting equation on January 1:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Equity** |
| **?** | **=** | **$60,000** | **+** | **$40,000** |

**Thus, *beginning* assets = $100,000**

**Using the accounting equation on January 3:**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Assets** | **=** | | **Liabilities** | | **+** | **Equity** |
| **?** | | **=** | | **$60,000 + $6,000** | **+** | **$40,000** |
| **?** | | **=** | | **$66,000** | **+** | **$40,000** |

Thus, *January 3* assets = $106,000

(Alternatively, we begin with $100,000 in assets, then add $10,000 in solar panels, then subtract $4,000 in cash🡪resulting in $106,000 in ending assets.)

Exercise 1-23 (concluded)

**b. Using the accounting equation on March 1:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Equity** |
| **$100,000** | **=** | **$30,000** | **+** | **?** |

**Thus, *beginning* equity = $70,000**

**Using the accounting equation on March 5:**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Assets** | **=** | | **Liabilities** | | **+** | **Equity** |
| **$100,000 - $15,000** | | **=** | | **$30,000** | **+** | **?** |
| **$85,000** | | **=** | | **$30,000** | **+** | **?** |

Thus, *March 5* equity = $55,000

**c. Using the accounting equation on August 1:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | **=** | **Liabilities** | **+** | **Equity** |
| **$30,000** | **=** | **$10,000** | **+** | **?** |

**Thus, *beginning* equity = $20,000**

**Using the accounting equation on August 5:**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Assets** | **=** | | **Liabilities** | | **+** | **Equity** |
| **$30,000 + $10,000** | | **=** | | **$10,000** | **+** | **?** |
| **$40,000** | | **=** | | **$10,000** | **+** | **?** |

Thus, *August 5* equity = $30,000