Stakeholders with a <u>direct interest</u> include owners, managers, creditors, suppliers, and employees. These individuals are directly affected by what happens to the business.

Stakeholders with an <u>indirect interest</u> include financial analysts, brokers, attorneys, government regulators, and news reporters. These individuals use information in the financial reports to advise and influence their clients.

Students may give many different answers under the above categories depending on their level of experience in business.

All students are direct users of accounting information related to tuition and fees, financial aid, and account balances.

2. Accounting provides information that is useful in making decisions by all participants in the market for resource goods and services, both profit-oriented and nonprofit oriented. Because accounting's role is so important, it is often called the language of business.

3. The primary mechanism used to allocate resources in the U.S. is competition for resources in the open market.

4. A market is a group of people or organizations that come together for the purpose of exchanging items of value.

5. The market for business resources involves three distinct

participants: consumers, conversion agents, and resource owners.

See Exhibit 1-1 that illustrates how market trilogy is involved in resource allocation.

6. Financial Resource: money

   Physical Resource: natural resources (i.e. land, forests, mine ore, petroleum, etc.), buildings, machinery and equipment, furniture and fixtures
   Labor Resource: includes both intellectual and physical labor; i.e. employees

7. Investors expect a distribution of the business's profits as a return on their financial investment (capital allocation).

   Creditors lend financial resources to businesses and receive interest as a return or profit on the loan.

8. Financial accounting provides information that is useful to external resource providers.

   Managerial accounting provides information that is useful to managers in operating an organization (i.e., internal users).

9. Not-for-profit or nonprofit entities provide goods or services to consumers for humanitarian or special reasons rather than to earn a profit for owners. For example, certain not-for-profit entities allocate resources to provide for research of diseases or social/environmental welfare; others allocate resources to promote the arts and provide education.

10. The U.S. rules of accounting information measurement are called generally accepted accounting principles (GAAP).

11. Careers in public accounting consist of providing services to the general public from a public accounting firm. These services include auditing, tax and consulting services. Careers in private accounting usually consist of working for a specific company (which would be a client of the public accounting firm) providing a wide variety of services to the company including recording transactions, preparing financial statements, internal auditing and others.

12. **Items reported on the financial statements are organized into classes or categories called elements. The ten elements of financial statements are:**

1. **Assets**
2. **Liabilities**
3. **Equity (Stockholders' Equity)**
4. **Investments by Owners (Contributed Capital)**
5. **Revenue**
6. **Expenses**
7. **Distributions (Dividends)**
8. **Net Income**
9. **Gains**
10. **Losses**

Accounts are specific items or subclassifications of the elements. Examples of accounts include cash, land and common stock.

13. **Assets, the economic resources of a business, are used to produce earnings.**

14. **The assets of a business belong to that business entity and there may be claims on the assets. Claims on the assets belong to resource providers.**

15. **Creditors are individuals and/or institutions that have provided goods or services to the business which are not yet paid for, or loaned money to the business. These parties have first claim to the assets of the business, and the investors have a residual interest in the assets.**

16. **The term "liabilities" is used to describe creditors' claims on the assets of a business.**

17. **The accounting equation is:**

ASSETS – LIABILITIES = STOCKHOLDERS' EQUITY

or

ASSETS = LIABILITIES + STOCKHOLDERS' EQUITY

Assets are the economic resources used by a business for the production of revenue. Liabilities are obligations of a business to relinquish assets, provide services, or accept other obligations. Equity, also called “residual interest” or “net assets”, is the portion of the assets remaining after the creditors' claims have been satisfied (i.e., Assets – Liabilities).

18. The owners ultimately bear the risk and collect the rewards associated with operating a business.

19. A double-entry bookkeeping system is one in which every transaction affects at least two accounts. A transaction can affect both assets and claims (liabilities and equity) or only assets or only claims. In order to “balance” the accounting equation, every transaction requires a “double entry.”

20. The right side of the accounting equation can be viewed as either sources of assets or as obligations and commitment of the business. Assets originating from liabilities can be viewed as sources or obligations of the business. Assets originating from issuing stock or retaining earnings can be viewed sources of assets and commitment of the business.

21. The business could make a distribution of $1,000, but only $800 of it would be classified as a dividend. A distribution can only be a dividend to the extent of retained earnings.

22. Capital is acquired from owners by issuing stock to them. When stock is issued, the assets of the business increase and the stockholders’ equity increases.

23. Assets that are acquired by issuing common stock are the result of investments by owners. Assets that are acquired by using retained earnings are assets the business acquires through its earnings activities.

24. Revenue increases the asset side of the accounting equation and also increases the retained earnings account in the stockholders’ equity section of the equation.

25. **The three primary sources of assets are (1) investments by owners (issue of stock), (2) borrowing from creditors, and (3) earnings activities.**

26. **Retained earnings are a result of a business retaining its earned assets, rather than distributing those earnings to its owners.**

27. **Distributions to owners, called dividends, decrease the asset side of the accounting equation and also decrease the retained earnings account in the stockholders' equity section of the equation.**

28. **Dividends and expenses are similar in that they both decrease assets and affect the accounting equation in the same way (i.e. reduction of retained earnings). However, dividends differ from expenses because of the nature of the decline in assets. Expenses reduce assets as the result of a firm's efforts to earn revenue. Dividends reduce assets because of a transfer of wealth to the owners.**

29. **(1)** **<u>Income Statement</u> - measures the difference between the asset increases and the asset decreases that were associated with operating a business during a particular accounting period.**

(2) **<u>Statement of Changes in Stockholders' Equity</u> - explains the effects of transactions on stockholders' equity during the accounting period.**

(3) **<u>Balance Sheet</u> - lists the assets and the corresponding claims against the entity as of a particular date.**

(4) **<u>Statement of Cash Flows</u> - explains how a company obtained and used cash during the accounting period.**

30. **The <u>Balance sheet</u> provides information about the enterprise at a particular point in time.**

31. **A net loss occurs when expenses exceed revenues in a given accounting period.**

32. **A business liquidation is when a business ceases to operate, its remaining assets are sold and the sale proceeds are returned to creditors and owners.**

33. **The going concern doctrine assumes that a business is able to continue its operations into the foreseeable future.**

34. **The matching concept is the practice of pairing revenues and expenses on the income statement.**

35. **(1)** **<u>Operating activities</u> - explain the cash generated from revenue and the cash paid for expenses.**

(2) **<u>Investing activities</u> - include cash received or spent by the business on productive assets used in the business, and investments in debt or equity of other companies.**

(3) **<u>Financing activities</u> - include cash inflows and outflows from the company's transactions with its owners and inflows and outflows from its borrowing activities.**

36. **Asset accounts are arranged on the balance sheet in accordance with their level of <u>liquidity</u> (those that can be most quickly converted to cash are listed first).**

37. **Articulation refers to the interrelationships among the various elements of the financial statements.**

38. **Temporary accounts are used to capture information for a single accounting period. The balances in temporary accounts are transferred out of the accounts at the end of the accounting period. Temporary accounts have zero balances at the beginning of an accounting period. Temporary accounts include revenue accounts, expense accounts and dividends. Permanent accounts carry over from one accounting period to the next. Retained Earnings is a permanent account.**

39. **The information in the temporary accounts is transferred to Retained Earnings at the end of the accounting period so that the temporary accounts have a zero balance at the beginning of the next accounting**

period. This allows the income statement and statement of cash flow information to be presented for a certain period of time. Since information from last period has been transferred, only the information that pertains to the current accounting period is contained In the accounts.

40. The historical cost concept requires that most assets be reported at the amount paid for them regardless of their increase or decrease in value. It is related to the qualitative characteristic of verifiability in that information can be independently verified. The historical cost is verified, while a change in value is subjective.

41. An <u>asset source</u> transaction results in an increase in an asset account and an increase in one of the claims accounts; i.e., investments by owners (equity), borrowing funds from creditors (liabilities), or earnings activities (revenue).

An <u>asset use</u> transaction results in a decrease in an asset account and a decrease in either liabilities or equity; i.e., the payment of a liability, the payment of an expense, or a dividend.

An <u>asset exchange</u> transaction is a transaction in which one asset is exchanged for another; i.e., purchase of land with cash.

A <u>claims exchange</u> transaction will be covered in a later chapter.

42. While the contents of annual reports vary from company to company, all annual reports contain:
Management's discussion and analysis (MD&A)
Financial statements
Notes to the financial statements
Auditor's report

43. U.S. GAAP, generally accepted accounting principles in the United States, are the measurement rules established by the (FASB) Financial Accounting Standards Board. The FASB is a privately funded organization with the primary authority for establishing accounting standards in the United States. International Financial Reporting Standards (IFRS) are issued by the International Accounting Standards Board and are an attempt to set a common

standard to be used in different countries. IFRS is used by global companies and there is a move underway to merge GAAP and IFRS or to lessen the differences between them.

SOLUTIONS TO EXERCISES - SERIES A - CHAPTER 1

EXERCISE 1-1A

The three participants in the free business market are:

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

Note to instructor:

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

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

EXERCISE 1-11

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

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

EXERCISE 1-12

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

EXERCISE 1-13

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

EXERCISE 1-14

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

EXERCISE 1-15

A

Better Corporation
Accounting Equation for 2016

	Assets			=	Liabilities	+	Stockholders' Equity			
Event	**Cash**	**+**	**Land**	**=**	**Notes Payable**	**+**	**Com. Stock**	**+**	**Retained Earnings**	**Acct. Title/RE**
Bal. 1/1/16	10,000		20,000		12,000		7,000		11,000	
1. Pur. Land	(5,000)		5,000		NA		NA		NA	NA
2. Issued stk.	25,000		NA		NA		25,000		NA	NA
3. Provide Svc.	75,000		NA		NA		NA		75,000	Revenue
4. Paid Exp.	(42,000)		NA		NA		NA		(42,000)	Oper. Exp.
5. Loan	10,000		NA		10,000		NA		NA	NA
6. Paid Div.	(5,000)		NA		NA		NA		(5,000)	Dividend
7. Land Value	NA		NA		NA		NA		NA	NA
Totals	68,000	+	25,000	=	22,000	+	32,000	+	39,000	

b.

Assets	=	Liabilities	+	Stockholders' Equity
$93,000	=	$22,000	+	$71,000

c. The balances of total assets, liabilities and stockholders' equity will be the same on January 1, 2017 as the balances on December 31, 2016. (See b. above)

EXERCISE 1-16

A

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

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

b. & c.

Moss Company
Effect of 2017 Transactions on the Accounting Equation

	Assets	=	Liabilities	+	Stockholders' Equity		
Event	Cash	=	Notes Payable	+	Common Stock	+	Retained Earnings
Beginning Balances	195,000		90,500		84,500		20,000
1. Earned Revenue	42,000		NA		NA		42,000
2. Paid expenses	(24,000)		NA		NA		(24,000)
3. Paid dividend	(3,000)		NA		NA		(3,000)
Ending Balance	210,000	=	90,500	+	84,500	+	35,000

d.

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

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

Assets = Liabilities + Stockholders' Equity
$210,000 = $210,000

e. The beginning and ending balances in the cash account were $195,000 and $210,000 respectively. The beginning balance in the common stock account was $84,500. This balance did not change during the accounting period. The reason the cash balance changed but the common stock balance did not was because the accounting events that Moss experienced during the 2017 accounting period affected the cash account but not the common stock account.

EXERCISE 1-17

a.

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

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

EXERCISE 1-18

a.

	Cash	+	Land	=	Creditors	+	Stockholders' Equity
	$16,00		$ 0		$6,000		$10,000
	(12,000		12,000		NA		NA
Bal.	$ 4,00	+	$12,000	=	$6,000	+	$10,000

b. Creditor's Claim ÷ Total Assets = Percent of Total
$6,000 ÷ $16,000 = 37.5%

c. Investor's Claim ÷ Total Assets = Percent of Total
$10,000 ÷ $16,000 = 62.5%

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

	Cash	+	Land	=	Creditors	+	Stockholders' Equity
Bal.	$ 4,00	+	$12,000	=	37.5%	+	62.5%

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

EXERCISE 1-19A

a. While the exact amount of any available dividend cannot be determined, the maximum dividend that could be paid based on the information would be $1,800, the amount of retained earnings. In order to determine the amount that could be paid, the balance of the cash account is required.

b.

					Stockholders' Equity		
Company	Assets	=	Liabilities	+	Common Stock	+	Retained Earnings
Allen	100%		75%		20%		5%
White	100%		25%		60%		15%

From the information given above, White is the more financially stable because it has only 25% debt. In contrast, Allen has 75% debt. Companies with a higher percentage of debt will have more problem paying that debt if there is a downturn in the economy or if they lose a major customer.

c. If Allen has a $3,500 loss, this would cause a deficit of $3,000 in retained earnings. Assets would be reduced to $6,500. Since $7,500 is owed to the creditors all of the cash would be paid to them. The investors would not receive anything.

d. If White has a $3,500 loss, this would cause a deficit of $1,700 in retained earnings. Assets will be reduced to $8,500. The creditors will be paid off ($3,000) and the remainder of cash, $5,500 ($8,500 – $3,000), will be paid to the shareholders. The shareholders (investors) will not get all of their $7,200 investment back but they do not lose everything.

EXERCISE 1-20A

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

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

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

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

EXERCISE 1-21A

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

b.

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

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

c.

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

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

EXERCISE 1-12A (cont.)

d.

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

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

EXERCISE 1-23A

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

EXERCISE 1-24A

Steps:

1.

Common Stock Issued	**=**	**Change in Common Stock**
$20,000 (given)	**=**	***$20,000***

2.

Change in Stk. Equity	**=**	**Change in Com. Stock**	**+ Change in Ret. Earn.**
$65,000 (given)	**=**	**$20,000 (1)**	**+ *$45,000***

3.

Increase in Ret. Earn.	**=**	**Net Income**	**–**	**Dividends**
$45,000 (2)	**=**	***$50,000***	**–**	**$5,000 (given)**

Alternate Solution:

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

Beginning Total Stk. Equity, 1/1/2017		**$156,000**
(Common Stock + Retained Earnings)		
Plus: Common Stock Issued	**$20,000**	
Plus: Net Income	**?**	
Less: Dividends	**(5,000)**	
Change in Stockholders' Equity		**65,000**
Ending Total Stk. Equity, 12/31/2017		**$221,000**

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

Change in Stockholders' Equity, 2017	**$65,000**
Plus: Dividends	**5,000**
Less: Common Stock Issued	**(20,000)**
Net Income, 2017	***$50,000***

EXERCISE 1-25A

a.

Majka Company
Accounting Equation for 2016

	Assets	=	Liabilities	+	Stockholders' Equity		
Event	Cash	=		+	Common Stock	+	Retained Earnings
1. Cash revenues	28,600		NA		NA		28,600
2. Paid expenses	(13,200)		NA		NA		(13,200)
3. Paid dividend	(1,500)		NA		NA		(1,500)
Ending Balance	13,900	=	-0-	+	-0-	+	13,900

b.

Majka Company
Income Statement
For the Year Ended December 31, 2016

Revenue	$28,600
Expense	(13,200)
Net Income	$ 15,400

Majka Company
Statement of Changes in Stockholders' Equity
For the Year Ended December 31, 2016

Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	0	
Ending Common Stock		$ -0-
Beginning Retained Earnings	$ -0-	
Plus: Net Income	15,400	
Less: Dividends	(1,500)	
Ending Retained Earnings		13,900
Total Stockholders' Equity		$13,900

EXERCISE 1-15A (cont.)

Majka Company Balance Sheet As of December 31, 2016		
Assets		
Cash		$13,900
Liabilities		$ -0-
Stockholders' Equity		
Common Stock	$ -0-	
Retained Earnings	13,900	
Total Stockholders' Equity		13,900
Total Liabilities and Stockholders' Equity		$13,900

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

EXERCISE 1-27A

Note: The memo should contain a reference to the fact that the value of the land is difficult to determine. It would have to be appraised each time the financial statements are prepared. However, the value of marketable securities are easily verified by obtaining the closing prices of the securities at the end of trading on the day the financial statements are prepared.

EXERCISE 1-28A

a.

Moore Company Statement of Cash Flows For the Year Ended December 31, 2016		
Cash Flows From Operating Activities:		
Net Cash Inflow from Operating Activities		**$ 24,800**
Cash Flows From Investing Activities:		
Net Cash Outflow from Investing Activities		**(16,000)**
Cash Flows From Financing Activities:		
Net Cash Outflow from Financing Activities		**(6,800)**
Net Increase in Cash		**2,000**
Plus: Beginning Cash Balance		**45,800**
Ending Cash Balance		**$47,800**

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

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

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

EXERCISE 1-18A a.

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

b.

All Star Automotive Company
Statement of Cash Flows
For the Year Ended December 31, 2016

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

EXERCISE 1-19A

a.

Dakota Company
Accounting Equation for 2016

	Assets			=	Liabilities	+	Stockholders' Equity			
Event	**Cash**	**+**	**Land**	**=**	**Notes Payable**	**+**	**Com. Stock**	**+**	**Retained Earnings**	**Acct. Title/RE**
Bal. 1/1/16	2,00		12,000		-0-		6,00(		8,000	
1. Issued stk.	30,00		NA		NA		30,00(		NA	NA
2. Pur. Land	(12,000		12,000		NA		NA		NA	NA
3. Loan	10,00		NA		10,000		NA		NA	NA
4. Provide Svc.	20,00		NA		NA		NA		20,000	Svc. Rev.
5. Paid Utilities	(1,000		NA		NA		NA		(1,000)	Util. Exp.
6. Pd. Op. Exp.	(15,000		NA		NA		NA		(15,000)	Op. Exp.
7. Paid Div.	(2,000		NA		NA		NA		(2,000)	Dividends
8. Land Value	NA		NA		NA		NA		NA	
Totals	32,00	+	24,000	=	10,000	+	36,00(	+	10,000	

b.

Dakota Company
Income Statement
For the Year Ended December 31, 2016

Service Revenue	$20,000
Utilities Expense	(1,000)
Operating Expense	(15,000)
Net Income	$ 4,000

EXERCISE 1-19A b. (cont.)

Dakota Company Statement of Changes in Stockholders' Equity For the Year Ended December 31, 2016		
Beginning Common Stock	$ 6,000	
Plus: Common Stock Issued	30,000	
Ending Common Stock		$36,000
Beginning Retained Earnings	$ 8,000	
Plus: Net Income	4,000	
Less: Dividends	(2,000)	
Ending Retained Earnings		10,000
Total Stockholders' Equity		$46,000

Dakota Company Balance Sheet As of December 31, 2016		
Assets		
Cash	$32,000	
Land	24,000	
Total Assets		$56,000
Liabilities		
Notes Payable	$10,000	
Total Liabilities		$10,000
Stockholders' Equity		
Common Stock	$36,000	
Retained Earnings	10,000	
Total Stockholders' Equity		46,000
Total Liabilities and Stockholders' Equity		$56,000

EXERCISE 1-19A b. (cont.)

Dakota Company Statement of Cash Flows For the Year Ended December 31, 2016		
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$20,000	
Cash Payment for Utilities Expense	(1,000)	
Cash Payments for Other Operating Exp.	(15,000)	
Net Cash Flow from Operating Activities		$ 4,000
Cash Flows From Investing Activities:		
Cash Paid to Purchase Land	$(12,000)	
Net Cash Flow from Investing Activities		(12,000)
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	$30,000	
Cash Receipts from Loan	10,000	
Cash Payments for Dividends	(2,000)	
Net Cash Flow from Financing Activities		38,000
Net Increase in Cash		30,000
Plus: Beginning Cash Balance		2,000
Ending Cash Balance		$32,000

c. Percentage of assets provided by retained earnings:
$10,000 ÷ $56,000 = 17.9%

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

EXERCISE 1-20A

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

EXERCISE 1-21A

a.

Carter Company Accounting Equation as of January 1, 2016								
Assets			=	Liabilities	+	Stockholders' Equity		
				Notes		Common		Retained
Cash	+	Land	=	Payable	+	Stock	+	Earnings
$800		$3,500		$600		$1,000		?

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

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

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

Creditor's Loans ÷ Total Assets
$600 ÷ $4,300 = 14.0%

d. Investor's Contributions ÷ Total Assets
$1,000 ÷ $4,300 = 23.3%

e. Retained Earnings ÷ Total Assets
$2,700 ÷ $4,300 = 62.8%

f.

Carter Company Accounting Equation as of January 1, 2016								
Assets			=	Liabilities	+	Stockholders' Equity		
				Notes		Common		Retained
Cash	+	Land	=	Payable	+	Stock	+	Earnings
$800		$3,500		13.9%		23.3%		62.8%

EXERCISE 1-21A (cont.)

g.

Carter Company
Accounting Equation as of December 31, 2016

Assets			=	Liabilities	+	Stockholders' Equity			
				Notes		Common		Retained	
Cash	+	Land	=	Payable	+	Stock	+	Earnings	
$800		$3,500		$1,600		$1,000		1,700	
1,800		NA		NA		NA		1,800	Rev.
(1,200)		NA		NA		NA		(1,200)	Exp.
(500)		NA		NA		NA		(500)	Div
900		$3,500		$1,600		$1,000		$1,800	

Carter Company
Income Statement
For the Year Ended December 31, 2016

Revenue	$1,800
Expenses	(1,200)
Net Income	$ 600

EXERCISE 1-21A g. (cont,)

Carter Company Statement of Changes in Stockholders' Equity For the Year Ended December 31, 2016		
Beginning Common Stock	$1,000	
Plus: Common Stock Issued	-0-	
Ending Common Stock		$1,000
Beginning Retained Earnings	$1,700	
Plus: Net Income	600	
Less: Dividends	(500)	
Ending Retained Earnings		1,800
Total Stockholders' Equity		$2,800

Carter Company Balance Sheet As of December 31, 2016		
Assets		
Cash	$ 900	
Land	3,500	
Total Assets		$4,400
Liabilities		
Notes Payable	$1,600	
Total Liabilities		$1,600
Stockholders' Equity		
Common Stock	$1,000	
Retained Earnings	1,800	
Total Stockholders' Equity		2,800
Total Liabilities and Stockholders' Equity		$4,400

EXERCISE 1-21A g.(cont.)

Carter Company Statement of Cash Flows For the Year Ended December 31, 2016		
Cash Flows From Operating Activities:		
Cash Receipts from Customers	**$1,800**	
Cash Payments for Expenses	**(1,200)**	
Net Cash Flow from Operating Activities		**$ 600**
Cash Flows From Investing Activities:		**0**
Cash Flows From Financing Activities:		
Cash Payments for Dividends	**(500)**	
Net Cash Flow from Financing Activities		**(500)**
Net Increase in Cash		**100**
Plus: Beginning Cash Balance		**800**
Ending Cash Balance		**$ 900**

h. The income statement, statement of changes in stockholders' equity and the statement of cash flows explain what happened to the company over a span of time. In this case, the span of time is one year. Therefore, these statements use terminology "*For the Year Ended* **December 31, 2016". In contrast, the balance sheet explains the financial condition of the company at a specific point in time. In the case the point in time is December 31, 2016. Therefore, this statement uses the terminology "***As of* **December 31, 2016".**

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

j. The balance in the revenue account is zero on January 1, 2017, because the balance in this account is transferred to retained earnings in the December 31, 2016 closing process.

EXERCISE 1-22A

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

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

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

c.

Room Designs Inc. Income Statement For the Year Ended December 31, 2016	
Revenue	$18,100
Expenses	(8,300)
Net Income	$9,800

EXERCISE 1-22A c. (cont.)

Room Designs Inc. Statement of Changes in Stockholders' Equity For the Year Ended December 31, 2016		
Beginning Common Stock	$ 3,500	
Plus: Common Stock Issued	4,000	
Ending Common Stock		$7,500
Beginning Retained Earnings	$ 6,400	
Plus: Net Income	9,800	
Less: Dividends	(2,000)	
Ending Retained Earnings		14,200
Total Stockholders' Equity		$21,700

Room Designs Inc. Balance Sheet As of December 31, 2016		
Assets		
Cash	$14,200	
Land	16,500	
Total Assets		$30,700
Liabilities		
Notes Payable	$9,000	
Total Liabilities		$ 9,000
Stockholders' Equity		
Common Stock	$7,500	
Retained Earnings	14,200	
Total Stockholders' Equity		21,700
Total Liabilities and Stockholders' Equity		$30,700

EXERCISE 1-22A c. (cont.)

Floor Design, Inc. Statement of Cash Flows For the Year Ended December 31, 2016		
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$ 18,100	
Cash Payments for Expenses	(8,300)	
Net Cash Flow from Operating Activities		$ 9,800
Cash Flows From Investing Activities:		
Cash Paid to Purchase Land	$(16,500)	
Net Cash Flow from Investing Activities		(16,500)
Cash Flows From Financing Activities:		
Cash Receipts from Loan	$ 9,000	
Cash Receipts from Stock Issue	4,000	
Cash Payments for Dividends	(2,000)	
Net Cash Flow from Financing Activities		11,000
Net Increase in Cash		4,300
Plus: Beginning Cash Balance		9,900
Ending Cash Balance		$14,200

EXERCISE 1-23A

a.

Flowers Company Accounting Equation as of December 31, 2016						
Assets	=	Liabilities	+	Common Stock	+	Retained Earnings
$130,000		$50,000		$70,000		?

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

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

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

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

Revenue	30,000
Expenses	18,000
Dividends	3,000

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

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

EXERCISE 1-23A (cont.)

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

EXERCISE 1-24A

a.

Year	Cash Revenues	Cash Expenses	Net Income	Retained Earnings
2016	$20,000	$11,000	9,000	9,000
2017	30,000	14,000	16,000	25,000
2018	40,000	22,000	18,000	43,000

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

c.

Year	Cash Revenues	Cash Expenses	Net Income	Retained Earnings
2016	$20,000	$11,000	9,000	9,000
2017	30,000	14,000	16,000	20,000*
2018	40,000	22,000	18,000	38,000**

*$9,000 Beginning Balance + $16,000 Net Income - $5,000 Dividends
**$20,000 Beginning Balance + $18,000 Net Income

EXERCISE 1-25A

a. **The balance in the Retained Earnings account as of January 31, 2016 is zero.**
Explanation: The revenue is recorded in the Revenue account and is not transferred into retained earnings until the year-end closing process is accomplished.

b. **The balance in the Revenue account as of January 31, 2016 is $7,500. The balance in the Expense account as of January 31, 2016 is $4,800.**
Explanation: The amounts in the revenue and expense accounts are not transferred to the Retained Earnings account until the year-end closing process is accomplished.

c. **The *before closing* balance in the Retained Earnings account as of December 31, 2016 is zero.**
Explanation: The revenue and expenses are recorded in the Revenue and Expense accounts throughout the year and the balances in these accounts are not transferred into retained earnings until the year-end closing process is accomplished.

d. **The December 31, 2016 *before closing* balance in the Revenue account is $93,500 ($7,500 + $86,000). The December 31, 2016 *before closing* balance in the Expense account is $55,800 ($4,800 + $51,000).**
Explanation: The revenue and expense amounts accumulate in the Revenue and Expense accounts throughout the year.

e. **The January 1, 2015 balance in the Retained Earnings account is $37,700.**
Explanation: The December 31. 2016 year-end closing process transfers the $93,500 balance in the Revenue account and $55,800 expense account into the Retained Earnings account. Since revenue increases retained earnings and expenses decrease retained earnings, the December 31, 2016 retained earnings account balance **after closing** *is $37,700 ($93,500 - $55,800). Since last year's ending balances become next year's beginning balances, the balance in the Retained Earnings account as of January 1, 2017 is $37,700.*

f. **The January 1, 2017 balance in the Revenue and Expense accounts is zero.**
Explanation: The balances in the revenue and expense accounts **after closing** *are zero because the balances accumulated during the year were transferred to the retained earnings account during the closing process. The January 1, 2017 balances in the revenue and expense accounts are zero.*

EXERCISE 1-26A

a.

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

b.

The Candle Shop
Horizontal Statements Model for 2016

	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stockholders' Equity			Revenue	–	Expense	=	Net Inc.	
Event No.	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings						
1	I	+	NA	=	NA	+	I	+	NA	NA	–	NA	=	NA	I FA
2	D	+	NA	=	NA	+	NA	+	D	NA	–	NA	=	NA	D FA
3	D	+	NA	=	NA	+	NA	+	D	NA	–	I	=	D	D OA
4	I	+	NA	=	I	+	NA	+	NA	NA	–	NA	=	NA	I FA
5	I	+	NA	=	NA	+	NA	+	I	I	–	NA	=	I	I OA
6	D	+	I	=	NA	+	NA	+	NA	NA	–	NA	=	NA	D IA
7	NA	+	NA	=	NA	+	NA	+	NA	NA	–	NA	=	NA	NA

EXERCISE 1-27A

a. **The assets would be worth the same, but would be shown at different amounts on the balance depending on whether U.S. GAAP or IFRS is used.**

b. **US GAAP requires the asset be stated at its historical cost, which may be very different from the current value. IFRS allow companies to value asset at their current market values.**

SOLUTIONS TO PROBLEMS – SERIES A - CHAPTER 1

PROBLEM 1-28A

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

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

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

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

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

PROBLEM 1-29A

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

PROBLEM 1-49A

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

PROBLEM 1-50A

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

PROBLEM 1-51A

a.

Mark's Consulting Services
Accounting Equation for 2016

	Assets			=	Liabilities	+	Stockholders' Equity			
Event	Cash	+	Land	=	Notes Payable	+	Com. Stock	+	Retained Earnings	Acct. Title/RE
1. Issued stk	20,000		NA		NA		20,000		NA	NA
2. Revenue	35,000		NA		NA		NA		35,000	Revenue
3. Loan	25,000		NA		25,000		NA		NA	NA
4. Paid Exp.	(22,000		NA		NA		NA		(22,000)	Oper. Exp.
5. Pur. Land	(30,000		30,000		NA		NA		NA	NA
Totals	28,000	+	30,000	=	25,000	+	20,000	+	13,000	

Mark's Consulting Services
Accounting Equation for 2017

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

PROBLEM 1-32A (cont.)

b.

Mark's Consulting Services Income Statement For the Period Ended December 31, 2016	
Service Revenue	$35,000
Expenses	(22,000)
Net Income	$13,000

Mark's Consulting Services Statement of Changes in Stockholders' Equity For the Period Ended December 31, 2016		
Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	20,000	
Ending Common Stock		$20,000
Beginning Retained Earnings	-0-	
Plus: Net Income	$13,000	
Ending Retained Earnings		13,000
Total Stockholders' Equity		$33,000

PROBLEM 1-32A b. (cont.)

Mark's Consulting Services Balance Sheet As of December 31, 2016		
Assets		
Cash	$28,000	
Land	30,000	
Total Assets		$58,000
Liabilities		
Notes Payable		$25,000
Stockholders' Equity		
Common Stock	$20,000	
Retained Earnings	13,000	
Total Stockholders' Equity		33,000
Total Liabilities and Stockholders' Equity		$58,000

PROBLEM 1-32A b. (cont.)

Mark's Consulting Services Statement of Cash Flows For the Year Ended December 31, 2016		
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$35,000	
Cash Payments for Expenses	(22,000)	
Net Cash Flow from Operating Activities		$13,000
Cash Flows From Investing Activities:		
Cash Payment for Land	$(30,000)	
Net Cash Flow from Investing Activities		(30,000)
Cash Flows From Financing Activities:		
Cash Receipts from Borrowed Funds	$25,000	
Cash Receipts from Stock Issue	20,000	
Net Cash Flow from Financing Activities		45,000
Net Increase in Cash		28,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$28,000

PROBLEM 1-32A b. (cont.)

Mark’s Consulting Services Income Statement For the Period Ended December 31, 2017	
Service Revenue	$95,000
Expenses	(71,500)
Net Income	$23,500

Mark’s Consulting Services Statement of Changes in Stockholders’ Equity For the Period Ended December 31, 2017		
Beginning Common Stock	$20,000	
Plus: Common Stock Issued	24,000	
Ending Common Stock		$44,000
Beginning Retained Earnings	13,000	
Plus: Net Income	23,500	
Less: Dividends	(3,000)	
Ending Retained Earnings		33,500
Total Stockholders’ Equity		$77,500

PROBLEM 1-32A b. (cont.)

Mark's Consulting Services Balance Sheet As of December 31, 2017		
Assets		
Cash	$57,500	
Land	30,000	
Total Assets		$87,500
Liabilities		
Notes Payable		$10,000
Stockholders' Equity		
Common Stock	$44,000	
Retained Earnings	33,500	
Total Stockholders' Equity		77,500
Total Liabilities and Stockholders' Equity		$87,500

PROBLEM 1-32A b. (cont.)

Mark's Consulting Services Statement of Cash Flows For the Year Ended December 31, 2017		
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$95,000	
Cash Payments for Expenses	(71,500)	
Net Cash Flow from Operating Activities		$23,500
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	$24,000	
Cash Payment on Debt	(15,000)	
Cash Payment for Dividends	(3,000)	
Net Cash Flow from Financing Activities		6,000
Net Increase in Cash		29,500
Plus: Beginning Cash Balance		28,000
Ending Cash Balance		$57,500

c. Retained Earnings does not contain cash.

a. In 2016 and 2017 net income and cash flows from operating activities are the same because all revenues and expenses are cash. Ordinarily, net income will be different from cash flows from operating activities due to non-cash revenue and expense transactions (discussed in Chapter 2). The net change in cash is different from net income because investing and financing activities do not directly affect revenue and expenses.

PROBLEM 1-32A (cont.)

e. Immediately after Event 2 in 2016 is recorded the balance in the Retained Earnings account is zero. The revenue is recorded in a Revenue account, not in the Retained Earnings account. The revenue, expense, and dividend accounts are closed to the Retained Earnings account at the end of each accounting period. After closing the accounts at the end of 2016, the Retained Earnings accounts will have a balance of $13,000 ($35,000 revenue - $22,000 expenses). The 2016 ending balance becomes the 2017 beginning balance. So, the balance in the Retained Earnings account on January 1, 2017 is $13,000. This balance will not change until the closing process is completed in December 2017. As a result, the balance in the Retained Earnings account immediately after Event 2 in 2017 is recorded is $13,000.

PROBLEM 1-33A

a.

Pratt Corp.
Accounting Equation

					Stockholders' Equity		
					Common		Retained
Event	Assets	=	Liabilities	+	Stock	+	Earnings
Beginning Balances	30,000	=	12,000	+	13,000[1]	+	5,000
1. Paid Expense	(26,000)						(26,000)
3. Paid Dividend	(2,000)						(2,000)
4. Paid Liability	(3,000)		(3,000)				
5. Issued Stock	4,000				4,000		
6. Revenue*	35,550						35,550[2]
Ending Balance	38,550	=	9,000	+	17,000	+	12,550

[1]Assets – Liabilities – Retained Earnings = Common Stock:
$30,000 – $12,000 – $5,000 = *$13,000*

[2]Increase in Retained Earnings:	$ 7,550
Add: Expenses	26,000
Add: Dividends	2,000
Revenue	$35,550

Pratt Corp.
Income Statement
For the Year Ended December 31, 2016

Revenue	$35,550
Expense	(26,000)
Net Income	$ 9,550

PROBLEM 1-33A (cont.)

Pratt Corp. Statement of Changes in Stockholders' Equity For the Year Ended December 31, 2016		
Beginning Common Stock	$13,000	
Plus: Common Stock Issued	4,000	
Ending Common Stock		$17,000
Beginning Retained Earnings	$5,000	
Plus: Net Income	9,550	
Less: Dividends	(2,000)	
Ending Retained Earnings		12,550
Total Stockholders' Equity		$29,550

Pratt Corp. Balance Sheet As of December 31, 2016		
Assets		$38,550
Liabilities		$ 9,000
Stockholders' Equity		
Common Stock	$17,000	
Retained Earnings	12,550	
Total Stockholders' Equity		29,550
Total Liabilities and Stockholders' Equity		$38,550

PROBLEM 1-33A (cont.)

Pratt Corp. Statement of Cash Flows For the Year Ended December 31, 2016		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$35,550	
Cash Payment for Expense	(26,000)	
Net Cash Flow from Operating Activities		$ 9,550
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	$ 4,000	
Cash Payment to Creditors	(3,000)	
Cash Dividend Paid to Stockholders	(2,000)	
Net Cash Flow from Financing Activities		(1,000)
Net Increase in Cash		8,550
Plus: Beginning Cash Balance*		30,000
Ending Cash Balance		$38,550

*Assumes all assets are cash.

b. Percentage of assets provided by:

Creditors	$ 9,000 ÷ $38,550	=23.35%
Investors	$17,000 ÷ $38,550	= 44.10%
Earnings	$12,550 ÷ $38,550	= 32.56%

c. The balance in the temporary accounts, revenue, expenses and dividends will be zero on January 1, 2017, because they were closed to Retained Earnings at December 31, 2016.

PROBLEM 1-34A

a.

Maben Company
Horizontal Statements Model for 2016

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

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

c.

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

PROBLEM 1-34A (cont.)

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

e.

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

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

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

f. Percentage of assets is provided as follows:

Investors	($50,000 ÷ $102,000)	49.0%
Creditors	($30,000 ÷ $102,000)	29.4%
Earnings	($22,000 ÷ $102,000)	21.6%

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