

# CHAPTER 1

## INTRODUCTION TO ACCOUNTING AND BUSINESS

### CLASS DISCUSSION QUESTIONS

1. The objective of most businesses is to maximize profits. Profit is the difference between the amounts received from customers for goods or services provided and the amounts paid for the inputs used to provide those goods or services.
2. A manufacturing business changes basic inputs into products that are then sold to customers. A service business provides services rather than products to customers. A restaurant such as Applebee's has characteristics of both a manufacturing and a service business in that Applebee's takes raw inputs such as cheese, fish, and beef and processes them into products for consumption by their customers. At the same time, Applebee's provides services of waiting on their customers as they dine.
3. The corporate form allows the company to obtain large amounts of resources by issuing stock. For this reason, most companies that require large investments in property, plant, and equipment are organized as corporations.
4. The business strategy of KIA is a low-cost strategy. In contrast, the business strategy of Porche is a differentiation strategy. The difference in strategies is directly reflected in the prices of the autos. For example, you can purchase a KIA for under \$10,000 while the entry level Porche begins at over \$40,000.
5. Super Wal-Mart will compete for customers using a low-cost strategy. The size and buying power of Wal-Mart Corporation provides Wal-Mart a competitive advantage over your friend in the ability to offer low prices. Thus, your friend should attempt to compete using a differentiation strategy. For example, your friend could offer personalized service to customers such as knowing customers' names, friendly atmosphere, home delivery of medicines, help in filing insurance forms, 24-hour call service, etc.
6. eBay offers value to its customers by developing a Web-based community in which buyers and sellers are brought together in an efficient format to browse, buy, and sell items such as collectibles, automobiles, high-end or premium art items, jewelry, consumer electronics, and a host of practical and miscellaneous items.
7. The stakeholders of a business normally include owners, managers, employees, customers, creditors, and the government.
8. Simply put, the role of accounting is to provide information for managers to use in operating the business. In addition, accounting provides information to other stakeholders to use in assessing the economic performance and condition of the business.
9. No. The business entity concept limits the recording of economic data to transactions directly affecting the activities of the business. The payment of the interest of \$3,600 is a personal transaction of Deana Moran and should not be recorded by First Delivery Service.
10. The land should be recorded at its cost of \$112,000 to Elrod Repair Service. This is consistent with the cost concept.
11.
  - a. No. The offer of \$600,000 and the increase in the assessed value should not be recognized in the accounting records.
  - b. Cash would increase by \$600,000, land would decrease by \$500,000, and owners' equity (retained earnings) would increase by \$100,000.
12. An account receivable is a claim against a customer for goods or services sold. An account payable is an amount owed to a creditor for goods or services purchased. Therefore, an account receivable in the records of the seller is an account payable in the records of the purchaser.
13. The business incurred a net loss of \$35,000.
14. The business realized net income of \$80,000.
15. Net income or net loss

Retained earnings at the end of the period  
Cash at the end of the period

## EXERCISES

### Ex. 1-1

- |                  |                   |                   |
|------------------|-------------------|-------------------|
| 1. manufacturing | 6. manufacturing  | 11. service       |
| 2. service       | 7. service        | 12. manufacturing |
| 3. merchandise   | 8. manufacturing  | 13. merchandise   |
| 4. service       | 9. merchandise    | 14. service       |
| 5. service       | 10. manufacturing | 15. manufacturing |

### Ex. 1-2

- |                      |                       |                       |
|----------------------|-----------------------|-----------------------|
| 1. a—low-cost        | 6. b—differentiation  | 11. a—low-cost        |
| 2. a—low-cost        | 7. b—differentiation  | 12. b—differentiation |
| 3. b—differentiation | 8. c—combination      | 13. a—low-cost        |
| 4. b—differentiation | 9. a—low-cost         | 14. a—low-cost        |
| 5. c—combination     | 10. b—differentiation | 15. c—combination     |

### Ex. 1-3

As in many ethics issues, there is no one right answer. The local newspaper reported on this issue in these terms: "The company covered up the first report, and the local newspaper uncovered the company's secret. The company was forced to not locate here (Collier County). It became patently clear that doing the least that is legally allowed is not enough."

### Ex. 1-4

- |      |      |       |
|------|------|-------|
| 1. B | 5. B | 9. X  |
| 2. B | 6. F | 10. B |
| 3. E | 7. X |       |
| 4. F | 8. E |       |

### Ex. 1-5

Coca-Cola owners' (stockholders') equity:  $\$24,501 - \$12,701 = \$11,800$

**PepsiCo owners' (stockholders') equity:     \$23,474 – \$14,183 = \$9,291**

**Ex. 1–6**

Toys “R” Us:  $\$9,397 - \$5,367 = \$4,030$

Estée Lauder:  $\$3,417 - \$1,955 = \$1,462$

**Ex. 1–7**

a.  $\$96,500 (\$25,000 + \$71,500)$

b.  $\$67,750 (\$82,750 - \$15,000)$

c.  $\$19,500 (\$37,000 - \$17,500)$

**Ex. 1–8**

a.  $\$275,000 (\$475,000 - \$200,000)$

b.  $\$310,000 (\$275,000 + \$75,000 - \$40,000)$

c.  $\$233,000 (\$275,000 - \$15,000 - \$27,000)$

d.  $\$465,000 (\$275,000 + \$125,000 + \$65,000)$

e. Net income:  $\$45,000 (\$425,000 - \$105,000 - \$275,000)$

**Ex. 1–9**

a. owners' equity

b. liability

c. asset

d. asset

e. owners' equity

f. asset

**Ex. 1–10**

a. Increases assets and increases owners' equity.

b. Increases assets and increases owners' equity.

c. Decreases assets and decreases owners' equity.

d. Increases assets and increases liabilities.

e. Increases assets and decreases assets.

**Ex. 1–11**

- a. (1) Total assets increased \$80,000.
- (2) No change in liabilities.
- (3) Owners' equity increased \$80,000.
  
- b. (1) Total assets decreased \$30,000.
- (2) Total liabilities decreased \$30,000.
- (3) No change in owners' equity.

**Ex. 1–12**

- 1. increase
- 2. decrease
- 3. increase
- 4. decrease

**Ex. 1–13**

- 1. c
- 2. c
- 3. d
- 4. c
- 5. e
- 6. a
- 7. e
- 8. a
- 9. e
- 10. e

**Ex. 1–14**

- a. (1) Sale of catering services for cash, \$25,000.
- (2) Purchase of land for cash, \$10,000.
- (3) Payment of expenses, \$16,000.
- (4) Purchase of supplies on account, \$800.
- (5) Payment of cash dividends, \$2,000.
- (6) Payment of cash to creditors, \$10,600.
- (7) Recognition of cost of supplies used, \$1,400.
  
- b. \$13,600 ( $\$18,000 - \$4,400$ )
- c. \$5,600 ( $\$64,100 - \$58,500$ )
- d. \$7,600 ( $\$25,000 - \$16,000 - \$1,400$ )
- e. \$5,600 ( $\$7,600 - \$2,000$ )

**Ex. 1–15**

It would be incorrect to say that the business had incurred a net loss of \$21,750. The excess of the dividends over the net income for the period is a decrease in the amount of retained earnings in the business.

**Ex. 1–16**

**Company M**

Owners' equity at end of year (\$1,200,000 – \$650,000) .....	<b>\$550,000</b>
Owners' equity at beginning of year (\$750,000 – \$300,000) .....	<u><b>450,000</b></u>
Net income (increase in owner's equity) .....	<u><b>\$100,000</b></u>

**Company N**

Increase in owners' equity (as determined for M) .....	<b>\$100,000</b>
Add dividends .....	<u><b>60,000</b></u>
Net income .....	<u><b>\$160,000</b></u>

**Company O**

Increase in owners' equity (as determined for M) .....	<b>\$100,000</b>
Deduct additional issuance of capital stock .....	<u><b>150,000</b></u>
Net loss .....	<u><b>\$(50,000)</b></u>

**Company P**

Increase in owners' equity (as determined for M) .....	<b>\$100,000</b>
Deduct additional issuance of capital stock .....	<u><b>150,000</b></u>
	<b>\$(50,000)</b>
Add dividends .....	<u><b>60,000</b></u>
Net income .....	<u><b>\$ 10,000</b></u>

**Ex. 1–17**

Balance sheet items: 1, 3, 4, 8, 9, 10

**Ex. 1–18**

Income statement items: 2, 5, 6, 7

Ex. 1–19

**MADRAS COMPANY**  
**Retained Earnings Statement**  
**For the Month Ended April 30, 2006**

Retained earnings, April 1, 2006 .....		<b>\$297,200</b>
Net income for the month.....	<b>\$73,000</b>	
Less dividends .....	<u><b>12,000</b></u>	
Increase in retained earnings.....		<u><b>61,000</b></u>
Retained earnings, April 30, 2006.....		<u><b>\$358,200</b></u>

Ex. 1–20

**HERCULES SERVICES**  
**Income Statement**  
**For the Month Ended November 30, 2006**

Fees earned .....		<b>\$232,120</b>
Operating expenses:		
Wages expense .....	<b>\$100,100</b>	
Rent expense .....	<b>35,000</b>	
Supplies expense .....	<b>4,550</b>	
Miscellaneous expense.....	<u><b>3,150</b></u>	
Total operating expenses .....		<u><b>142,800</b></u>
Net income.....		<u><b>\$ 89,320</b></u>

**Ex. 1–21**

In each case, solve for a single unknown, using the following equation:  
**Owners' equity (beginning) + Additional issue of capital stock – Dividends + Revenues – Expenses = Owners' equity (ending)**

<b>A.</b>	<b>Owners' equity at end of year (\$894,000 – \$390,000) .....</b>	<b>\$504,000</b>
	<b>Owners' equity at beginning of year (\$720,000 – \$432,000) .</b>	<b><u>288,000</u></b>
	<b>Increase in owners' equity .....</b>	<b>\$216,000</b>
	<b>Deduct increase due to net income (\$237,300 – \$129,600)...</b>	<b><u>107,700</u></b>
		<b>\$108,300</b>
	<b>Add dividends .....</b>	<b><u>48,000</u></b>
	<b>Additional issue of capital stock .....</b>	<b>(a) <u>\$156,300</u></b>
<b>B.</b>	<b>Owners' equity at end of year (\$175,000 – \$55,000) .....</b>	<b>\$120,000</b>
	<b>Owners' equity at beginning of year (\$125,000 – \$65,000) ...</b>	<b><u>60,000</u></b>
	<b>Increase in owners' equity .....</b>	<b>\$ 60,000</b>
	<b>Add dividends .....</b>	<b><u>8,000</u></b>
		<b>\$ 68,000</b>
	<b>Deduct additional issue of capital stock .....</b>	<b><u>25,000</u></b>
	<b>Increase due to net income .....</b>	<b>\$ 43,000</b>
	<b>Add expenses .....</b>	<b><u>32,000</u></b>
	<b>Revenue .....</b>	<b>(b) <u>\$ 75,000</u></b>
<b>C.</b>	<b>Owners' equity at end of year (\$144,000 – \$128,000) .....</b>	<b>\$ 16,000</b>
	<b>Owners' equity at beginning of year (\$160,000 – \$121,600) .</b>	<b><u>38,400</u></b>
	<b>Decrease in owners' equity .....</b>	<b>\$(22,400)</b>
	<b>Add decrease due to net loss (\$184,000 – \$196,000) .....</b>	<b><u>12,000</u></b>
		<b>\$(10,400)</b>
	<b>Deduct additional issue of capital stock .....</b>	<b><u>(16,000)</u></b>
	<b>Dividends from the business .....</b>	<b>(c) <u>\$(26,400)</u></b>
<b>D.</b>	<b>Owners' equity at end of year (\$310,000 – \$170,000) .....</b>	<b>\$140,000</b>
	<b>Add decrease due to net loss (\$140,000 – \$160,000) .....</b>	<b><u>20,000</u></b>
		<b>\$160,000</b>
	<b>Add dividends .....</b>	<b><u>75,000</u></b>
		<b>\$235,000</b>
	<b>Deduct additional issue of capital stock .....</b>	<b><u>50,000</u></b>
		<b>\$185,000</b>
	<b>Add liabilities at beginning of year .....</b>	<b><u>150,000</u></b>
	<b>Assets at beginning of year .....</b>	<b>(d) <u>\$335,000</u></b>

Ex. 1-22

a.

**DERBY INTERIORS**  
**Balance Sheet**  
**October 31, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$48,000	Accounts payable .....	\$12,320
Accounts receivable .....	27,200		
Supplies .....	<u>2,400</u>		
		<u>Stockholders' Equity</u>	
		Capital stock .....	\$15,000
		Retained earnings.....	<u>50,280*</u> <u>65,280</u>
		Total liabilities and	
Total assets .....	<u>\$77,600</u>	stockholders' equity .	<u>\$77,600</u>

\*\$50,280 = - \$12,320 + \$27,200 + \$48,000 + \$2,400 - \$15,000

**DERBY INTERIORS**  
**Balance Sheet**  
**November 30, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$ 81,600	Accounts payable .....	\$ 13,280
Accounts receivable .....	31,300		
Supplies .....	<u>2,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock .....	\$15,000
		Retained earnings.....	<u>86,620*</u> <u>101,620</u>
		Total liabilities and	
Total assets .....	<u>\$114,900</u>	stockholder's equity .	<u>\$ 114,900</u>

\*86,620 = - \$13,280 + \$31,300 + \$81,600 + \$2,000 - \$15,000

b. Retained earnings, November 30.....	\$86,620
Retained earnings, October 31 .....	<u>50,280</u>
Net income .....	<u>\$36,340</u>

c. Retained earnings, November 30.....	\$86,620
Retained earnings, October 31 .....	<u>50,280</u>
Increase in retained earnings .....	\$36,340
Add dividends .....	<u>10,000</u>
Net income .....	<u>\$46,340</u>

**Ex. 1–23**

**Balance sheet: b, c, e, f, h, i, j, l, m, n, o**

**Income statement: a, d, g, k**

**Ex. 1–24**

- 1. b–investing activity**
- 2. a–operating activity**
- 3. c–financing activity**
- 4. a–operating activity**

**Ex. 1–25**

- 1. All financial statements should contain the name of the business in their heading. The retained earnings statement is incorrectly headed as “Jerry Maris” rather than Caddis Realty. The heading of the balance sheet needs the name of the business.**
- 2. The income statement and retained earnings statement cover a period of time and should be labeled “For the Month Ended July 31, 2006.”**
- 3. The year in the heading for the retained earnings statement should be 2006 rather than 2005.**
- 4. The balance sheet should be labeled as of “July 31, 2006,” rather than “For the Month Ended July 31, 2006.”**
- 5. In the income statement, the miscellaneous expense amount should be listed as the last operating expense.**
- 6. In the income statement, the total operating expenses are incorrectly subtracted from the sales commissions, resulting in an incorrect net income amount. The correct net income should be \$4,900. This also affects the retained earnings statement and the amount of retained earnings that appears on the balance sheet.**
- 7. In the retained earnings statement, the net income should be presented, followed by the amount of dividends, which is subtracted from the net income to yield a net increase in retained earnings.**
- 8. Accounts payable should be listed as a liability on the balance sheet.**
- 9. Accounts receivable and supplies should be listed as assets on the balance sheet.**
- 10. The balance sheet assets should equal the sum of the liabilities and stockholders’ equity.**

**Ex. 1–25 Concluded**

Corrected financial statements appear as follows:

**CADDIS REALTY  
Income Statement  
For the Month Ended July 31, 2006**

Sales commissions .....		\$51,900
Operating expenses:		
Office salaries expense .....	\$32,400	
Rent expense .....	11,000	
Automobile expense .....	2,500	
Supplies expense .....	300	
Miscellaneous expense .....	<u>800</u>	
Total operating expenses .....		<u>47,000</u>
Net income .....		<u>\$ 4,900</u>

**CADDIS REALTY  
Retained Earnings Statement  
For the Month Ended July 31, 2006**

Retained earnings, July 1, 2006 .....		\$ 7,900
Net income for July .....	\$4,900	
Less dividends during July .....	<u>2,000</u>	
Increase in retained earnings .....		<u>2,900</u>
Retained earnings, July 31, 2006 .....		<u>\$10,800</u>

**CADDIS REALTY  
Balance Sheet  
July 31, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$ 3,300	Accounts payable .....	\$ 3,800
Accounts receivable .....	14,300		
Supplies .....	<u>2,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock .....	\$ 5,000
		Retained earnings .....	<u>10,800</u> <u>15,800</u>
		Total liabilities and	
Total assets .....	<u>\$19,600</u>	stockholders' equity ...	<u>\$19,600</u>

**Ex. 1–26**

- a. 2003: \$10,209 ( $\$30,011 - \$19,802$ )  
2002: \$8,312 ( $\$26,394 - \$18,082$ )
- b. 2003: 0.52 ( $\$10,209 \div \$19,802$ )  
2002: 0.46 ( $\$8,312 \div \$18,082$ )
- c. The ratio of liabilities to stockholders' equity increased from 2002 to 2003, indicating an increase in risk for creditors. However, the assets of The Home Depot are more than sufficient to satisfy creditor claims.

**Ex. 1–27**

- a. 2003: 7,807 ( $\$16,109 - \$8,302$ )  
2002: \$6,674 ( $\$13,736 - \$7,062$ )
- b. 2003: 1.06 ( $\$8,302 \div \$7,807$ )  
2002: 1.06 ( $\$7,062 \div \$6,674$ )
- c. The margin of safety for creditors has remained approximately the same from 2002 to 2003. In both years, creditors have more at stake in Lowe's than do stockholders, since the ratio exceeds one.
- d. Lowe's ratio of liabilities to stockholders' equity (1.06) is much higher than that of The Home Depot (0.52 and 0.46), indicating that creditors of Lowe's are more at risk than creditors of The Home Depot.

## PROBLEMS

### Prob. 1-1A

1.	Assets			=	Liabilities	+	Owners' Equity		
	Cash	Accounts Receivable	Supplies	=	Accounts Payable	+	Capital Stock	Retained Earnings	
a.	+18,000						+ 18,000		Investment
b.			+ 950		+ 950				
Bal.	18,000		950		950		18,000		
c.	- 575				- 575				
Bal.	17,425		950		375		18,000		
d.	+ 4,250							+ 4,250	Fees earned
Bal.	21,675		950		375		18,000	4,250	
e.	- 1,200							- 1,200	Rent expense
Bal.	20,475		950		375		18,000	3,050	
f.	- 975							- 600	Auto expense
								- 375	Misc. expense
Bal.	19,500		950		375		18,000	2,075	
g.	- 1,500							- 1,500	Salaries expense
Bal.	18,000		950		375		18,000	575	
h.		+ 6,350						+ 6,350	Fees earned
Bal.	18,000		950		375		18,000	6,925	
i.			- 725					- 725	Supplies expense
Bal.	18,000	6,350	225		375		18,000	6,200	
j.	- 2,000							- 2,000	Dividends
Bal.	<u>16,000</u>	<u>6,350</u>	<u>225</u>		<u>375</u>		<u>18,000</u>	<u>4,200</u>	

- 2. Owners' equity is the right of owners to the assets of the business. These rights are increased by stockholders' investments and revenues and decreased by dividends and expenses.**

Prob. 1–2A

1.

**CHICKADEE TRAVEL SERVICE**  
**Income Statement**  
**For the Year Ended April 30, 2006**

Fees earned .....		\$263,200
Operating expenses:		
Wages expense .....	\$131,700	
Rent expense.....	37,800	
Utilities expense.....	22,500	
Supplies expense.....	7,100	
Taxes expense .....	5,600	
Miscellaneous expense .....	<u>2,950</u>	
Total operating expenses .....		<u>207,650</u>
Net income.....		<u>\$ 55,550</u>

2.

**CHICKADEE TRAVEL SERVICE**  
**Retained Earnings Statement**  
**For the Year Ended April 30, 2006**

Retained earnings, May 1, 2005 .....		\$35,000
Net income for the year .....	\$55,550	
Less dividends .....	<u>30,000</u>	
Increase in retained earnings.....		<u>25,550</u>
Retained earnings, April 30, 2006 .....		<u>\$60,550</u>

3.

**CHICKADEE TRAVEL SERVICE**  
**Balance Sheet**  
**April 30, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$53,050	Accounts payable .....	\$12,200
Accounts receivable .....	31,350		
Supplies .....	<u>3,350</u>		
		<u>Stockholders' Equity</u>	
		Capital stock .....	\$15,000
		Retained earnings.....	<u>60,550</u> <u>75,550</u>
		Total liabilities and	
Total assets .....	<u>\$87,750</u>	stockholders' equity .	<u>\$87,750</u>

Prob. 1–3A

1.

**LINCHPIN COMPUTER SERVICES**  
**Income Statement**  
**For the Month Ended August 31, 2006**

Fees earned .....		\$16,500
Operating expenses:		
Salaries expense .....	\$4,000	
Rent expense .....	3,600	
Auto expense .....	1,550	
Supplies expense .....	650	
Miscellaneous expense .....	<u>750</u>	
Total operating expenses .....		<u>10,550</u>
Net income .....		<u>\$ 5,950</u>

2.

**LINCHPIN COMPUTER SERVICES**  
**Retained Earnings Statement**  
**For the Month Ended August 31, 2006**

Retained earnings, August 1, 2006 .....		\$ 0
Net income for August .....		5,950
Less dividends .....		<u>2,000</u>
Retained earnings, August 31, 2006 .....		<u>\$ 3,950</u>

3.

**LINCHPIN COMPUTER SERVICES**  
**Balance Sheet**  
**August 31, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$ 6,600	Accounts payable .....	\$ 940
Accounts receivable .....	7,500		
Supplies .....	<u>790</u>		
		<u>Stockholders' Equity</u>	
		Capital stock .....	\$10,000
		Retained earnings .....	<u>3,950</u> <u>13,950</u>
		Total liabilities and	
Total assets .....	<u>\$14,890</u>	stockholders' equity .	<u>\$14,890</u>

Prob. 1–4A

1.

	Assets		=	Liabilities	+	Owners' Equity		
	Cash	+ Supplies	=	Accounts Payable	+	Capital Stock	Retained Earnings	
a.	+ 15,000					+ 15,000		Investment
b.	<u>- 2,400</u>						<u>- 2,400</u>	Rent expense
Bal.	12,600					15,000	- 2,400	
c.	<u>- 1,130</u>						<u>- 750</u>	Auto expense
							<u>- 380</u>	Miscellaneous expense
Bal.	11,470					15,000	- 3,530	
d.		<u>+ 950</u>		<u>+ 950</u>				
Bal.	11,470	950		950		15,000	- 3,530	
e.	<u>+ 17,350</u>						<u>+ 17,350</u>	Sales commissions
Bal.	28,820	950		950		15,000	13,820	
f.	<u>- 580</u>			<u>- 580</u>				
Bal.	28,240	950		370		15,000	13,820	
g.	<u>- 3,600</u>						<u>- 3,600</u>	Salaries expense
Bal.	24,640	950		370		15,000	10,220	
h.	<u>- 1,500</u>						<u>- 1,500</u>	Dividends
Bal.	23,140	950		370		15,000	8,720	
i.		<u>- 675</u>					<u>- 675</u>	Supplies expense
Bal.	<u>23,140</u>	<u>275</u>		<u>370</u>		<u>15,000</u>	<u>8,045</u>	

Prob. 1–4A Concluded

2.

**CENTILLION REALTY**  
**Income Statement**  
**For the Month Ended August 31, 2006**

Sales commissions .....		\$17,350
Operating expenses:		
Office salaries expense .....	\$3,600	
Rent expense .....	2,400	
Automobile expense .....	750	
Supplies expense .....	675	
Miscellaneous expense .....	<u>380</u>	
Total operating expenses .....		<u>7,805</u>
Net income .....		<u>\$ 9,545</u>

**CENTILLION REALTY**  
**Retained Earnings Statement**  
**For the Month Ended August 31, 2006**

Retained earnings, August, 2006 .....		\$ 0
Net income for August .....		9,545
Less dividends .....		<u>1,500</u>
Retained earnings, August 31, 2006 .....		<u>\$ 8,045</u>

**CENTILLION REALTY**  
**Balance Sheet**  
**August 31, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$23,140	Accounts payable .....	\$ 370
Supplies .....	<u>275</u>		
		<u>Stockholders' Equity</u>	
		Capital stock .....	\$15,000
		Retained earnings .....	<u>8,045</u> <u>23,045</u>
		Total liabilities and	
Total assets .....	<u>\$23,415</u>	stockholders' equity .	<u>\$23,415</u>

Prob. 1–5A

1.

<b>Assets</b>				<b>=</b>	<b>Liabilities +</b>	<b>Owners' Equity</b>	
<hr/>					<hr/>	<hr/>	<hr/>
<b>Cash</b>	<b>+ Receivable</b>	<b>+ Supplies</b>	<b>+ Land</b>	<b>=</b>	<b>Accounts Payable</b>	<b>+ Capital Stock</b>	<b>+ Retained Earnings</b>
8,600	+ 9,500	+ 1,875	+ 15,000	<b>=</b>	4,100	+ 5,000	+ Retained Earnings
		<b>34,975</b>		<b>=</b>	<b>9,100</b>	<b>+</b>	<b>Retained Earnings</b>
		<b>25,875</b>		<b>=</b>			<b>Retained Earnings</b>

Prob. 1–5A Continued

2.

Assets					=	Liabilities +		Owners' Equity	
	Cash	+ Receivable	+ Supplies	+ Land	=	Accounts Payable	+ Capital Stock	+ Retained Earnings	
Bal.	8,600	9,500	1,875	15,000	=	4,100	5,000	25,875	
a.	- 4,000							- 4,000	Rent expense
Bal.	4,600	9,500	1,875	15,000	=	4,100	5,000	21,875	
b.		+ 8,150						+ 8,150	Dry cleaning sales
Bal.	4,600	17,650	1,875	15,000	=	4,100	5,000	30,025	
c.	- 2,680					- 2,680			
Bal.	1,920	17,650	1,875	15,000	=	1,420	5,000	30,025	
d.			+ 1,500			+ 1,500			
Bal.	1,920	17,650	3,375	15,000	=	2,920	5,000	30,025	
e.	+ 17,600							+ 17,600	Dry cleaning sales
Bal.	19,520	17,650	3,375	15,000	=	2,920	5,000	47,625	
f.	+ 8,450	- 8,450							
Bal.	27,970	9,200	3,375	15,000	=	2,920	5,000	47,625	
g.						+ 7,400		- 7,400	Dry cleaning exp.
Bal.	27,970	9,200	3,375	15,000	=	10,320	5,000	40,225	
h.	- 4,725							- 2,800	Wages expense
								- 825	Truck expense
								- 710	Utilities expense
								- 390	Misc. expense
Bal.	23,245	9,200	3,375	15,000	=	10,320	5,000	35,500	
i.			- 1,775					- 1,775	Supplies expense
Bal.	23,245	9,200	1,600	15,000	=	10,320	5,000	33,725	
j.	- 3,500							- 3,500	Dividends

Bal. 19,745    9,200    1,600    15,000    10,320    5,000    30,225

Prob. 1–5A Concluded

3. a.

**EUREKA DRY CLEANERS**  
**Income Statement**  
For the Month Ended June 30, 2006

Dry cleaning sales.....		\$25,750
Operating expenses:		
Dry cleaning expense .....	\$7,400	
Rent expense.....	4,000	
Wages expense .....	2,800	
Supplies expense.....	1,775	
Truck expense.....	825	
Utilities expense.....	710	
Miscellaneous expense .....	<u>390</u>	
Total operating expenses .....		17,900
Net income .....		<u>\$ 7,850</u>

b.

**EUREKA DRY CLEANERS**  
**Retained Earnings Statement**  
For the Month Ended June 30, 2006

Retained earnings, June 1, 2006.....		\$25,875
Net income for June.....	\$7,850	
Less dividends .....	<u>3,500</u>	
Increase in retained earnings.....		<u>4,350</u>
Retained earnings, June 30, 2006.....		<u>\$30,225</u>

c.

**EUREKA DRY CLEANERS**  
**Balance Sheet**  
June 30, 2006

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$19,745	Accounts payable.....	\$10,320
Accounts receivable .....	9,200		
Supplies .....	1,600		
Land.....	<u>15,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock.....	\$ 5,000
		Retained earnings .....	<u>30,225</u> <u>35,225</u>
		Total liabilities and	
Total assets .....	<u>\$45,545</u>	stockholders' equity	<u>\$45,545</u>

**Prob. 1–6A**

- a. Wages expense, \$4,300 ( $\$9,560 - \$1,920 - \$1,600 - \$1,080 - \$660$ )
- b. Net income, \$9,240 ( $\$18,800 - \$9,560$ )
- c. Net income for June, \$9,240
- d. Dividends, \$4,800
- e. Retained earnings, June 30, 2006, \$4,440
- f. Land, \$28,800
- g. Total assets, \$41,400
- h. Capital stock, \$36,000
- i. Retained earnings, \$4,440
- j. Total stockholders' equity, \$40,440 ( $\$36,000 + \$4,440$ )
- k. Total liabilities and stockholders' equity, \$41,400 ( $\$960 + \$40,440$ )
- l. Cash received from customers, \$18,800 ( $\$9,400 + \$9,400$ )
- m. Net cash flow from operating activities, \$9,400 ( $\$11,800 - \$31,200 + \$28,800$ )
- n. Net cash flow from financing activities, \$31,200 ( $\$36,000 - \$4,800$ )
- o. Net cash flow and June 30, 2006 cash balance, \$11,800

**Prob. 1–1B**

1.

	<u>Assets</u>			=	<u>Liabilities</u>	+	<u>Owners' Equity</u>		
	<u>Cash</u>	<u>Accounts Receivable</u>	<u>Supplies</u>	=	<u>Accounts Payable</u>	+	<u>Capital Stock</u>	<u>Retained Earnings</u>	
a.	+15,000						+ 15,000		Investment
b.			+ 1,350		+ 1,350				
Bal.	15,000		1,350		1,350		15,000		
c.	+ 6,500							+ 6,500	Fees earned
Bal.	21,500		1,350		1,350		15,000	6,500	
d.	- 2,500							- 2,500	Rent expense
Bal.	19,000		1,350		1,350		15,000	4,000	
e.	- 700				- 700				
Bal.	18,300		1,350		650		15,000	4,000	
f.		+ 1,250						+ 1,250	Fees earned
Bal.	18,300	1,250	1,350		650		15,000	5,250	
g.	- 1,225							- 550	Auto expense
								- 675	Miscellaneous expense
Bal.	17,075	1,250	1,350		650		15,000	4,025	
h.	- 1,800							- 1,800	Salaries expense
Bal.	15,275	1,250	1,350		650		15,000	2,225	
i.			- 970					- 970	Supplies expense
Bal.	15,275	1,250	380		650		15,000	1,255	
j.	- 1,000							- 1,000	Dividends
Bal.	<u>14,275</u>	<u>1,250</u>	<u>380</u>		<u>650</u>		<u>15,000</u>	<u>255</u>	

2. Owners' equity is the right of owners to the assets of the business. These rights are increased by stockholders' investments and revenues and decreased by dividends and expenses.

Prob. 1–2B

1.

**GRECO TRAVEL AGENCY**  
**Income Statement**  
**For the Year Ended December 31, 2006**

Fees earned .....		\$ 188,000
Operating expenses:		
Wages expense .....	\$56,800	
Rent expense.....	36,000	
Utilities expense.....	16,500	
Supplies expense.....	4,500	
Miscellaneous expense .....	<u>2,800</u>	
Total operating expenses .....		<u>116,600</u>
Net income .....		<u>\$ 71,400</u>

2.

**GRECO TRAVEL AGENCY**  
**Retained Earnings Statement**  
**For the Year Ended December 31, 2006**

Retained earnings, January 1, 2006.....		\$ 8,700
Net income for the year .....	\$71,400	
Less dividends .....	<u>47,000</u>	
Increase in retained earnings.....		<u>24,400</u>
Retained earnings, December 31, 2006.....		<u>\$33,100</u>

3.

**GRECO TRAVEL AGENCY**  
**Balance Sheet**  
**December 31, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$11,520	Accounts payable.....	\$ 5,120
Accounts receivable .....	31,200		
Supplies .....	<u>3,000</u>		
		<u>Stockholders' Equity</u>	
		Capital stock.....	\$ 7,500
		Retained earnings .....	<u>33,100</u> <u>40,600</u>
		Total liabilities and	
Total assets .....	<u>\$45,720</u>	stockholders' equity	<u>\$45,720</u>

Prob. 1–3B

1.

**JACK-IN-THE-PULPIT FINANCIAL SERVICES**  
**Income Statement**  
**For the Month Ended January 31, 2006**

Fees earned .....		\$31,400
Operating expenses:		
Rent expense.....	\$6,000	
Salaries expense .....	5,000	
Auto expense.....	3,000	
Supplies expense.....	2,520	
Miscellaneous expense .....	<u>800</u>	
Total operating expenses .....		<u>17,320</u>
Net income .....		<u>\$14,080</u>

2.

**JACK-IN-THE-PULPIT FINANCIAL SERVICES**  
**Retained Earnings Statement**  
**For the Month Ended January 31, 2006**

Retained earnings, January 1, 2006.....		\$ 0
Net income for January .....		14,080
Less dividends .....		<u>7,000</u>
Retained earnings, January 31, 2006.....		<u>\$ 7,080</u>

3.

**JACK-IN-THE-PULPIT FINANCIAL SERVICES**  
**Balance Sheet**  
**January 31, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$27,200	Accounts payable.....	\$ 1,180
Accounts receivable .....	10,400		
Supplies .....	<u>660</u>		
		<u>Stockholders' Equity</u>	
		Capital stock.....	\$30,000
		Retained earnings .....	<u>7,080</u> <u>37,080</u>
		Total liabilities and	
Total assets .....	<u>\$38,260</u>	stockholders' equity...	<u>\$38,260</u>

Prob. 1–4B

1.

	<u>Assets</u>		=	<u>Liabilities</u>	+	<u>Owners' Equity</u>		
	Cash	+ Supplies	=	Accounts Payable	+	Capital Stock	+ Retained Earnings	
a.	+ 18,000					+18,000		Investment
b.		+ 1,650		+ 1,650				
Bal.	18,000	1,650		1,650		18,000		
c.	- 1,100			- 1,100				
Bal.	16,900	1,650		550		18,000		
d.	+ 25,200						+ 25,200	Sales commissions
Bal.	42,100	1,650		550		18,000	25,200	
e.	- 7,200						- 7,200	Rent expense
Bal.	34,900	1,650		550		18,000	18,000	
f.	- 4,000						- 4,000	Dividends
Bal.	30,900	1,650		550		18,000	14,000	
g.	- 2,250						- 1,500	Auto expense
							- 750	Miscellaneous expense
Bal.	28,650	1,650		550		18,000	11,750	
h.	- 8,000						- 8,000	Salaries expense
Bal.	20,650	1,650		550		18,000	3,750	
i.		- 1,050					- 1,050	Supplies expense
Bal.	<u>20,650</u>	<u>600</u>		<u>550</u>		<u>18,000</u>	<u>2,700</u>	

Prob. 1-4B Concluded

2.

**PATRIOTIC REALTY**  
**Income Statement**  
**For the Month Ended July 31, 2006**

Sales commissions .....		\$25,200
Operating expenses:		
Office salaries expense .....	\$8,000	
Rent expense .....	7,200	
Automobile expense .....	1,500	
Supplies expense .....	1,050	
Miscellaneous expense .....	<u>750</u>	
Total operating expenses .....		<u>18,500</u>
Net income .....		<u>\$ 6,700</u>

**PATRIOTIC REALTY**  
**Retained Earnings Statement**  
**For the Month Ended July 31, 2006**

Retained earnings, July 1, 2006 .....		\$ 0
Net income for July .....		6,700
Less dividends .....		<u>4,000</u>
Retained earnings, July 31, 2006 .....		<u>\$ 2,700</u>

**PATRIOTIC REALTY**  
**Balance Sheet**  
**July 31, 2006**

	<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$20,650	Accounts payable .....		\$ 550
Supplies .....	<u>600</u>			
			<u>Stockholders' Equity</u>	
		Capital stock .....	\$18,000	
		Retained earnings .....	<u>2,700</u>	<u>20,700</u>
		Total liabilities and		
Total assets .....	<u>\$21,250</u>	stockholders' equity...		<u>\$21,250</u>

**Prob. 1–5B**

1.

<b>Assets</b>				<b>=</b>	<b>Liabilities +</b>	<b>Owners' Equity</b>	
<hr/>					<hr/>	<hr/>	<hr/>
<b>Cash</b>	<b>+ Receivable</b>	<b>+ Supplies</b>	<b>+ Land</b>	<b>=</b>	<b>Payable</b>	<b>+ Capital Stock</b>	<b>+ Retained Earnings</b>
7,150	+ 12,880	+ 3,400	+ 20,000	<b>=</b>	6,360	+ 10,000	+ Retained Earnings
		43,430		<b>=</b>	16,360	+ Retained Earnings	
		27,070		<b>=</b>		Retained Earnings	

Prob. 1–5B Continued

2.

	Assets				=	Liabilities	+	Owners' Equity		
	Cash	Accounts Receivable	Supplies	Land	=	Accounts Payable	+	Capital Stock	Retained Earnings	
Bal.	7,150	12,880	3,400	20,000	=	6,360	+	10,000	27,070	
a.	<u>+22,000</u>								<u>+22,000</u>	Dry cleaning sales
Bal.	29,150	12,880	3,400	20,000	=	6,360	+	10,000	49,070	
b.	<u>- 3,500</u>								<u>- 3,500</u>	Rent expense
Bal.	25,650	12,880	3,400	20,000	=	6,360	+	10,000	45,570	
c.			<u>+ 2,100</u>			<u>+ 2,100</u>				
Bal.	25,650	12,880	5,500	20,000	=	8,460	+	10,000	45,570	
d.	<u>- 4,800</u>					<u>- 4,800</u>				
Bal.	20,850	12,880	5,500	20,000	=	3,660	+	10,000	45,570	
e.		<u>+11,700</u>							<u>+11,700</u>	Dry cleaning sales
Bal.	20,850	24,580	5,500	20,000	=	3,660	+	10,000	57,270	
f.						<u>+ 8,400</u>			<u>- 8,400</u>	Dry cleaning exp.
Bal.	20,850	24,580	5,500	20,000	=	12,060	+	10,000	48,870	
g.	<u>- 6,570</u>								<u>- 3,400</u>	Wages expense
									<u>- 1,580</u>	Truck expense
									<u>- 960</u>	Utilities expense
									<u>- 630</u>	Misc. expense
Bal.	14,280	24,580	5,500	20,000	=	12,060	+	10,000	42,300	
h.	<u>+10,100</u>	<u>-10,100</u>								
Bal.	24,380	14,480	5,500	20,000	=	12,060	+	10,000	42,300	
i.			<u>- 2,900</u>						<u>- 2,900</u>	Supplies expense
Bal.	24,380	14,480	2,600	20,000	=	12,060	+	10,000	39,400	
j.	<u>- 6,000</u>								<u>- 6,000</u>	Dividends
Bal.	<u>18,380</u>	<u>14,480</u>	<u>2,600</u>	<u>20,000</u>	=	<u>12,060</u>	+	<u>10,000</u>	<u>33,400</u>	

Prob. 1–5B Concluded

3. a.

**DAISY DRY CLEANERS**  
**Income Statement**  
**For the Month Ended March 31, 2006**

Dry cleaning sales.....		\$33,700
Operating expenses:		
Dry cleaning expense .....	\$8,400	
Rent expense.....	3,500	
Wages expense .....	3,400	
Supplies expense.....	2,900	
Truck expense.....	1,580	
Utilities expense.....	960	
Miscellaneous expense .....	<u>630</u>	
Total operating expenses .....		<u>21,370</u>
Net income .....		<u>\$12,330</u>

b.

**DAISY DRY CLEANERS**  
**Retained Earnings Statement**  
**For the Month Ended March 31, 2006**

Retained earnings, March 1, 2006.....		\$27,070
Net income for March.....	\$12,330	
Less dividends .....	<u>6,000</u>	
Increase in retained earnings.....		<u>6,330</u>
Retained earnings, March 31, 2006.....		<u>\$33,400</u>

c.

**DAISY DRY CLEANERS**  
**Balance Sheet**  
**March 31, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$18,380	Accounts payable.....	\$12,060
Accounts receivable .....	14,480		
Supplies .....	2,600	<u>Stockholders' Equity</u>	
Land.....	<u>20,000</u>	Capital stock.....	\$10,000
		Retained earnings .....	<u>33,400</u> <u>43,400</u>
		Total liabilities and	
Total assets .....	<u>\$55,460</u>	stockholders' equity	<u>\$55,460</u>



**Prob. 1–6B**

- a. Fees earned, \$30,000 ( $\$12,400 + \$17,600$ )
- b. Supplies expense, \$3,000 ( $\$17,600 - \$8,500 - \$3,200 - \$1,800 - \$1,100$ )
- c. Net income for November, \$12,400
- d. Retained earnings, November 30, 2006, \$6,400 ( $\$12,400 - \$6,000$ )
- e. Total assets, \$48,000 ( $\$5,800 + \$2,200 + \$40,000$ )
- f. Capital stock, \$40,000
- g. Retained earnings, \$6,400
- h. Total stockholders' equity, \$46,400 ( $\$40,000 + \$6,400$ )
- i. Total liabilities and stockholders' equity, \$48,000
- j. Cash received from customers, \$30,000 ( $\$18,200 + \$11,800$ )
- k. Net cash flow from operating activities, \$11,800 ( $\$5,800 - \$34,000 + \$40,000$ )
- l. Cash payments for acquisition of land, \$(40,000)
- m. Cash received from issuing capital stock, \$40,000
- n. Cash dividends, \$(6,000)
- o. Net cash flow from financing activities, \$34,000 ( $\$40,000 - \$6,000$ )
- p. Net cash flow and November 30, 2006 cash balance, \$5,800

## CONTINUING PROBLEM

1.

		Assets			=	Liabilities +		Owners' Equity		
		Cash	Accounts Receivable	+ Supplies	=	Accounts Payable	+ Capital Stock	+ Retained Earnings		
Apr. 1	+ 7,000						+7,000			Investment
2	<u>+ 2,000</u>							<u>+ 2,000</u>		Fees earned
Bal.	9,000						7,000	2,000		
Apr. 2	<u>- 1,000</u>							<u>- 1,000</u>		Office rent expense
Bal.	8,000						7,000	1,000		
Apr. 4				<u>+ 350</u>		<u>+ 350</u>				
Bal.	8,000			350		350	7,000	1,000		
Apr. 6	<u>- 600</u>							<u>- 600</u>		Adv. exp.
Bal.	7,400			350		350	7,000	400		
Apr. 8	<u>- 650</u>							<u>- 650</u>		Equip. rent expense
Bal.	6,750			350		350	7,000	- 250		
Apr. 12	<u>- 200</u>							<u>- 200</u>		Music exp.
Bal.	6,550			350		350	7,000	- 450		
Apr. 13	<u>- 100</u>					<u>- 100</u>				
Bal.	6,450			350		250	7,000	- 450		
Apr. 16	<u>+ 150</u>							<u>+ 150</u>		Fees earned
Bal.	6,600			350		250	7,000	- 300		
Apr. 22			<u>+ 1,200</u>					<u>+ 1,200</u>		Fees earned
Bal.	6,600		1,200	350		250	7,000	900		
Apr. 25	<u>+ 500</u>							<u>+ 500</u>		Fees earned
Bal.	7,100		1,200	350		250	7,000	1,400		
Apr. 29	<u>- 240</u>							<u>- 240</u>		Music exp.
Bal.	6,860		1,200	350		250	7,000	1,160		
Apr. 30	<u>+ 900</u>							<u>+ 900</u>		Fees earned
Bal.	7,760		1,200	350		250	7,000	2,060		
Apr. 30	<u>- 400</u>							<u>- 400</u>		Wages exp.
Bal.	7,360		1,200	350		250	7,000	1,660		
Apr. 30	<u>- 300</u>							<u>- 300</u>		Utilities exp.
Bal.	7,060		1,200	350		250	7,000	1,360		
Apr. 30				<u>- 180</u>				<u>- 180</u>		Supplies exp.
Bal.	7,060		1,200	170		250	7,000	1,180		
Apr. 30	<u>- 150</u>							<u>- 150</u>		Misc. exp.
Bal.	6,910		1,200	170		250	7,000	1,030		
Apr. 30	<u>- 500</u>							<u>- 500</u>		Music exp.
Bal.	6,410		1,200	170		250	7,000	530		
Apr. 30	<u>- 250</u>							<u>- 250</u>		Dividends
Bal.	<u>6,160</u>		<u>1,200</u>	<u>170</u>		<u>250</u>	<u>7,000</u>	<u>280</u>		

**Continuing Problem      Concluded**

2.

**DANCIN MUSIC  
Income Statement  
For the Month Ended April 30, 2006**

Fees earned .....		<b>\$4,750</b>
Operating expenses:		
Office rent expense.....	\$ 1,000	
Music expense.....	940	
Equipment rent expense.....	650	
Advertising expense .....	600	
Wages expense .....	400	
Utilities expense.....	300	
Supplies expense.....	180	
Miscellaneous expense .....	<u>150</u>	
Total operating expenses .....		<u><b>4,220</b></u>
Net income.....		<u><b>\$ 530</b></u>

3.

**DANCIN MUSIC  
Retained Earnings Statement  
For the Month Ended April 30, 2006**

Retained earnings, April 1, 2006 .....		<b>\$ 0</b>
Net income for April .....		530
Less dividends .....		<u>250</u>
Retained earnings, April 30, 2006 .....		<u><b>\$ 280</b></u>

4.

**DANCIN MUSIC  
Balance Sheet  
April 30, 2006**

<u>Assets</u>		<u>Liabilities</u>	
Cash .....	\$6,160	Accounts payable.....	\$ 250
Accounts receivable .....	1,200		
Supplies .....	<u>170</u>	<u>Stockholders' Equity</u>	
		Capital stock.....	\$7,000
		Retained earnings .....	<u>280</u> <u>7,280</u>
		Total liabilities and	
Total assets .....	<u><b>\$7,530</b></u>	stockholders' equity	<u><b>\$7,530</b></u>

## **SPECIAL ACTIVITIES**

### **Activity 1–1**

- 1. Acceptable professional conduct requires that Sue Alejandro supply First National Bank with all the relevant financial statements necessary for the bank to make an informed decision. Therefore, Sue should provide the complete set of financial statements. These can be supplemented with a discussion of the net loss in the past year or other data explaining why granting the loan is a good investment by the bank.**
- 2. a. Managers are generally willing to provide bankers with information about the operating and financial condition of the business, such as the following:**
  - Operating Information:**
    - description of business operations**
    - results of past operations**
    - preliminary results of current operations**
    - plans for future operations**
  - Financial Condition:**
    - list of assets and liabilities (balance sheet)**
    - estimated current values of assets**
    - stockholders' investment in the business**
    - stockholders' commitment to invest additional funds in the business**

**Managers are normally reluctant to provide proprietary operating information to bankers. Such information, which might hurt the business if it becomes known by competitors, might include special processes used by the business or future plans to expand operations into areas that are not currently served by a competitor.**

- b. Bankers typically want as much information as possible about the ability of the business to repay the loan with interest. Examples of such information are described above.**
- c. Both bankers and business managers share the common interest of the business doing well and being successful. If the business is successful, the bankers will receive their loan payments on time with interest, and the managers (and stockholders) will be rewarded.**

## **Activity 1–2**

- 1. In a commodity business like poultry production, the dominant business strategy is a low-cost strategy. This is because customers cannot differentiate between chickens produced by different companies. The implication of a low-cost strategy is that you would put most of your emphasis on designing and running efficient operations. In addition, you would spend significant amounts of monies in research and development activities trying to discover and develop new ways to breed and raise bigger chickens with less feed.**
- 2. A major business risk includes the selling of contaminated chickens and the possibility that competitors will develop lower-cost methods of breeding and raising chickens. Also, a major cost of raising chickens is the cost of feed. Thus, fluctuations in feed costs such as corn can dramatically influence the profitability of chicken production. To manage feed cost risk, chicken producers like Gold Kist enter into hedging transactions for feed that involve commodity futures and options. Finally, another major risk is that consumer tastes may change with the result that the demand for chicken products may decrease significantly.**
- 3. Gold Kist could try to differentiate its products by emphasizing that it raises its chickens with only “natural” feeds without the use of artificial ingredients such as steroids, etc. Gold Kist could then sell its products as the “healthy choice” products.**

### **Activity 1–3**

The difference in the two bank balances, \$180,000 (\$240,000 – \$60,000), may not be pure profit from an accounting perspective. To determine the accounting profit for the seven-month period, the revenues for the period would need to be matched with the related expenses. The revenues minus the expenses would indicate whether the business generated net income (profit) or a net loss for the period. Using only the difference between the two bank account balances ignores such factors as amounts due from customers (receivables), liabilities (accounts payable) that need to be paid for wages or other operating expenses, additional investments that Dr. Smith may have made in the business during the period, or dividends paid during the period.

Some businesses that have few, if any, receivables or payables may use a “cash” basis of accounting. The cash basis of accounting ignores receivables and payables because they are assumed to be insignificant in amount. However, even with the cash basis of accounting, additional investments during the period and any dividends paid during the period have to be considered in determining the net income (profit) or net loss for the period.

## Activity 1–4

1.

	Assets		=	Liabilities	+	Owner's Equity	
	Cash	+ Supplies	=	Accounts Payable	+	Dawn Ivy, Capital	
a.	+ 1,000					+ 1,000	Investment
b.	<u>- 320</u>	+ 320					
Bal.	680	320				1,000	
c.	<u>- 160</u>					- 160	Rent expense
Bal.	520	320				840	
d.	<u>- 140</u>			+ 60		- 200	Rent expense
Bal.	380	320		60		640	
e.	+ 1,600					+ 1,600	Service revenue
Bal.	1,980	320		60		2,240	
f.	+ 300					+ 300	Service revenue
Bal.	2,280	320		60		2,540	
g.	<u>- 600</u>					- 600	Salary expense
Bal.	1,680	320		60		1,940	
h.	<u>- 150</u>					- 150	Misc. expense
Bal.	1,530	320		60		1,790	
i.	+ 600					+ 600	Service revenue
Bal.	2,130	320		60		2,390	
j.		<u>- 170</u>				- 170	Supplies expense
Bal.	2,130	150		60		2,220	
k.	<u>- 800</u>					- 800	Withdrawal
Bal.	<u>1,330</u>	<u>150</u>		<u>60</u>		<u>1,420</u>	

2.

**DEUCE**  
**Income Statement**  
**For the Month Ended June 30, 2005**

Service revenue .....	\$2,500
Operating expenses:	
Salary expense .....	\$600
Rent expense.....	360
Supplies expense.....	170
Miscellaneous expense .....	<u>150</u>
Total operating expenses .....	<u>1,280</u>
Net income .....	<u>\$1,220</u>

### Activity 1–4 Continued

3. a. Deuce would provide Dawn with \$260 more income per month than working as a waitress. This amount is computed as follows:

Net income of Deuce, per month .....	\$1,220
Earnings as waitress, per month:	
30 hours per week × \$8 per hour × 4 weeks .....	<u>960</u>
Difference.....	<u>\$ 260</u>

- b. Other factors that Dawn should consider before discussing a long-term arrangement with the Racquet Club include the following:

Dawn should consider whether the results of operations for June are indicative of what to expect each month. For example, Dawn should consider whether club members will continue to request lessons or use the ball machine during the winter months when interest in tennis may slacken. Dawn should evaluate whether the additional income of \$260 per month from Deuce is worth the risk being taken and the effort being expended.

Dawn should also consider how much her investment in Deuce could have earned if invested elsewhere. For example, if the initial investment of \$1,000 had been deposited in a money market or savings account at 3% interest, it would have earned \$2.50 interest in June, or \$30 for the year.

*Note to Instructors:* Numerous other considerations could be mentioned by students, such as the ability of Dawn to withdraw cash from Deuce for personal use. Unlike a money market account or savings account, some of her investment in Deuce will be in the form of supplies (tennis balls, etc.), which may not be readily convertible to cash. The objective of this case is not to mention all possible considerations, but rather to encourage students to begin thinking about the use of accounting information in making business decisions.

### Activity 1–5

*Note to Instructors:* The purpose of this activity is to familiarize students with the certification requirements and their on-line availability.

### Activity 1–6

	<u>1998</u>	<u>1997</u>	<u>1996</u>
Net cash flows from operating activities	positive	positive	negative
Net cash flows from investing activities	negative	negative	negative
Net cash flows from financing activities	positive	positive	positive

Start-up companies normally experience negative cash flows from operating and investing activities. Also, start-up companies normally have positive cash flows from financing activities—activities from raising capital.

### Activity 1–7

As can be seen from the balance sheet data in the case, Enron was financed largely by debt as compared to equity. Specifically, Enron’s stockholders’ equity represented only 17.5% (\$11,470 divided by \$65,503) of Enron’s total assets. The remainder of Enron’s total assets, 82.5%, were financed by debt. When a company is financed largely by debt, it is said to be highly leveraged.

In late 2001 and early 2002, allegations arose as to possible misstatements of Enron’s financial statements. These allegations revolved around the use of “special purpose entities” (partnerships) and related party transactions. The use of special purpose entities allowed Enron to hide a significant amount of additional debt off its balance sheet. The result was that Enron’s total assets were even more financed by debt than the balance sheet indicated.

After the allegations of misstatements became public, Enron’s stock rapidly declined and the company filed for bankruptcy. Subsequently, numerous lawsuits were filed against the company and its management. In addition, the Securities and Exchange Commission, the Justice Department, and Congress launched investigations into Enron.

*Note to Instructors:* The role of the auditors and board of directors of Enron might also be discussed. However, these topics are not covered in Chapter 1 but are covered in later chapters.