EXERCISES

Ex. 1–1

a.

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

b. The accounting equation is relevant to all companies. It serves as the basis of the accounting information system.

Ex. 1–2

As in many ethics issues, there is no one right answer. Often times, disclosing only what is legally required may not be enough. In this case, it would be best for the company’s chief executive officer to disclose both reports to the county representatives. In doing so, the chief executive officer could point out any flaws or deficiencies in the fired researcher’s report.

Ex. 1–3

a.

1. B  
2. M  
3. R  
4. B  
5. R  
6. R  
7. X  
8. M  
9. X  
10. R

b. A business transaction is an economic event or condition that directly changes an entity’s financial condition or results of operations.
Ex. 1–4

Peet’s Coffee & Tea’s stockholders’ (owners’) equity: $176 – $32 = $144
Starbucks’ stockholders’ (owners’) equity: $5,577 – $2,531 = $3,046

Ex. 1–5

Dollar Tree’s stockholders’ (owners’) equity: $2,036 – $783 = $1,253
Target’s stockholders’ (owners’) equity: $44,106 – $30,394 = $13,712

Ex. 1–6

a. $600,000 ($150,000 + $450,000)
b. $225,000 ($275,000 – $50,000)
c. $425,000 ($615,000 – $190,000)

Ex. 1–7

a. $450,000 ($800,000 – $350,000)
b. $530,000 ($450,000 + $150,000 – $70,000)
c. $370,000 ($450,000 – $60,000 – $20,000)
d. $590,000 ($450,000 + $100,000 + $40,000)
e. Net income: $125,000 ($975,000 – $400,000 – $450,000)

Ex. 1–8

a. (1) asset
b. (3) stockholders’ equity (retained earnings)
c. (2) liability
d. (3) stockholders’ equity (retained earnings)
e. (1) asset
f. (1) asset
Ex. 1–9

a. Increases assets and increases stockholders’ equity (capital stock).
b. Increases assets and decreases assets.
c. Increases assets and increases liabilities.
d. Increases assets and increases stockholders’ equity (retained earnings).
e. Decreases assets and decreases stockholders’ equity (retained earnings).

Ex. 1–10

a. (1) Total assets increased $250,000 ($350,000 – $100,000).
   (2) No change in liabilities.
   (3) Stockholders’ equity (retained earnings) increased $250,000.
b. (1) Total assets decreased $75,000.
   (2) Total liabilities decreased $75,000.
   (3) No change in stockholders’ equity (retained earnings).
c. No, it is false that a transaction always affects at least two elements (Assets, Liabilities, or Stockholders’ Equity) of the accounting equation. Some transactions affect only one element of the accounting equation. For example, purchasing supplies for cash only affects assets.

Ex. 1–11

1. (a) increase
2. (a) increase
3. (b) decrease
4. (b) decrease

Ex. 1–12

1. c  6. c
2. a  7. d
3. e  8. a
4. e  9. e
5. c  10. e
Ex. 1–13

a. (1) Provided catering services for cash, $29,000.
   (2) Purchase of land for cash, $20,000.
   (3) Payment of expenses, $14,000.
   (4) Purchase of supplies on account, $1,000.
   (5) Paid cash dividends, $2,000.
   (6) Payment of cash to creditors, $7,000.
   (7) Recognition of cost of supplies used, $1,800.

b. $14,000 ($25,000 – $11,000)

c. $11,200 (–$2,000 + $29,000 – $15,800)

d. $13,200 ($29,000 – $15,800)

e. $11,200 ($13,200 – $2,000)

Ex. 1–14

No. It would be incorrect to say that the business had incurred a net loss of $10,000. The excess of the dividends over the net income for the period is a decrease in the amount of stockholders’ equity (retained earnings) in the business.
### Ex. 1–15

**Aries**

<table>
<thead>
<tr>
<th>Stockholders’ equity at end of year</th>
<th>$450,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>($750,000 – $300,000)</td>
<td></td>
</tr>
<tr>
<td>Deduct stockholders’ equity at beginning of year</td>
<td>$300,000</td>
</tr>
<tr>
<td>($400,000 – $100,000)</td>
<td></td>
</tr>
<tr>
<td>Net income (increase in stockholders’ equity)</td>
<td>$150,000</td>
</tr>
</tbody>
</table>

**Gemini**

<table>
<thead>
<tr>
<th>Increase in stockholders’ equity (as determined for Aries)</th>
<th>$150,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Add dividends</td>
<td>40,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$190,000</td>
</tr>
</tbody>
</table>

**Leo**

<table>
<thead>
<tr>
<th>Increase in stockholders’ equity (as determined for Aries)</th>
<th>$150,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduct additional issuance of capital stock</td>
<td>90,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$60,000</td>
</tr>
</tbody>
</table>

**Pisces**

<table>
<thead>
<tr>
<th>Increase in stockholders’ equity (as determined for Aries)</th>
<th>$150,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduct additional issuance of capital stock</td>
<td>90,000</td>
</tr>
<tr>
<td>Add dividends</td>
<td>40,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

### Ex. 1–16

Balance sheet items: 1, 2, 3, 5, 6, 10

### Ex. 1–17

Income statement items: 4, 7, 8, 9
Ex. 1–18

a.

LOST TRAIL COMPANY
Retained Earnings Statement
For the Month Ended June 30, 2012

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained earnings, June 1, 2012</td>
<td>$375,000</td>
</tr>
<tr>
<td>Net income for June</td>
<td>$125,000</td>
</tr>
<tr>
<td>Less dividends</td>
<td></td>
</tr>
<tr>
<td>Increase in retained earnings equity</td>
<td>18,000</td>
</tr>
<tr>
<td>Retained earnings, June 30, 2012</td>
<td>$482,000</td>
</tr>
</tbody>
</table>

b. The retained earnings statement is prepared before the June 30, 2012, balance sheet because retained earnings as of June 30, 2012, is needed for the balance sheet.

Ex. 1–19

UNIVERSAL SERVICES
Income Statement
For the Month Ended October 31, 2012

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fees earned</td>
<td>$800,000</td>
</tr>
<tr>
<td>Expenses:</td>
<td></td>
</tr>
<tr>
<td>Wages expense</td>
<td>$270,000</td>
</tr>
<tr>
<td>Rent expense</td>
<td>60,000</td>
</tr>
<tr>
<td>Supplies expense</td>
<td>9,000</td>
</tr>
<tr>
<td>Miscellaneous expense</td>
<td>12,000</td>
</tr>
<tr>
<td>Total expenses</td>
<td>351,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$449,000</td>
</tr>
</tbody>
</table>
Ex. 1–20

In each case, solve for a single unknown, using the following equation:
Stockholders’ equity (beginning) + Additional issuance of Capital Stock – Dividends + Revenues – Expenses = Stockholders’ equity (ending)

<table>
<thead>
<tr>
<th>Stockholders</th>
<th>Equity at End of Year</th>
<th>$</th>
<th>Stockholders’ Equity at Beginning of Year</th>
<th>$</th>
<th>Increase in Stockholders’ Equity</th>
<th>$</th>
<th>Deduct Increase Due to Net Income</th>
<th>$</th>
<th>Add Dividends</th>
<th>$</th>
<th>Additional Issuance of Capital Stock</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aquarius</td>
<td>$420,000 – $110,000</td>
<td>$310,000</td>
<td>$300,000 – $120,000</td>
<td>180,000</td>
<td>130,000</td>
<td>$20,000</td>
<td>25,000</td>
<td>25,000</td>
<td>(a) 45,000</td>
<td>$420,000 – $110,000</td>
<td>$310,000</td>
<td></td>
</tr>
<tr>
<td>Libra</td>
<td>$700,000 – $220,000</td>
<td>$480,000</td>
<td>$500,000 – $260,000</td>
<td>240,000</td>
<td>240,000</td>
<td>272,000</td>
<td>100,000</td>
<td>128,000</td>
<td>(b) 300,000</td>
<td>$700,000 – $220,000</td>
<td>$480,000</td>
<td></td>
</tr>
<tr>
<td>Scorpio</td>
<td>$90,000 – $80,000</td>
<td>$10,000</td>
<td>$100,000 – $76,000</td>
<td>24,000</td>
<td>(14,000)</td>
<td>(7,500)</td>
<td>(6,500)</td>
<td>10,000</td>
<td>(c) 16,500</td>
<td>$90,000 – $80,000</td>
<td>$10,000</td>
<td></td>
</tr>
<tr>
<td>Taurus</td>
<td>$248,000 – $136,000</td>
<td>$112,000</td>
<td>$112,000 – $128,000</td>
<td>16,000</td>
<td>$128,000</td>
<td>60,000</td>
<td>$148,000</td>
<td>120,000</td>
<td>(d) 268,000</td>
<td>$248,000 – $136,000</td>
<td>$112,000</td>
<td></td>
</tr>
</tbody>
</table>
Ex. 1–21

a.  

LADY INTERIORS  
Balance Sheet  
July 31, 2012

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
</table>
| Cash .................................  $ 80,000 | Accounts payable ..................  $ 90,000  
| Accounts receivable ......  200,000 |  
| Supplies ............................  20,000 | Stockholders’ Equity  
|                              | Capital stock .....................  $ 80,000  
|                              | Retained earnings.. .............  130,000  
|                              | Total stockholders’ equity .........  210,000  
|                              | Total liabilities and stockholders’ equity ..........  $300,000  
|                              | Total assets .....................  $300,000  

LADY INTERIORS  
Balance Sheet  
August 31, 2012

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
</table>
| Cash .................................  $ 95,000 | Accounts payable ..............  $100,000  
| Accounts receivable ......  240,000 |  
| Supplies ............................  15,000 | Stockholders’ Equity  
|                              | Capital stock .....................  $ 80,000  
|                              | Retained earnings.. .............  170,000  
|                              | Total stockholders’ equity .........  250,000  
|                              | Total liabilities and stockholders’ equity ......  $350,000  
|                              | Total assets .....................  $350,000  

b. Stockholders’ equity, August 31.................................  $250,000  
Stockholders’ equity, July 31.................................  210,000  
Net income ..............................................................  $ 40,000  

b. Stockholders’ equity, August 31.................................  $250,000  
Stockholders’ equity, July 31.................................  210,000  
Increase in stockholders’ equity ..................................  $ 40,000  
Add dividends................................................................  35,000  
Net income ..............................................................  $ 75,000  

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Ex. 1–22

a. Balance sheet: 1, 2, 3, 4, 6, 7, 8, 9, 10, 11, 13
   Income statement: 5, 12, 14, 15

b. Yes, an item can appear on more than one financial statement. For example, cash appears on both the balance sheet and statement of cash flows. However, the same item cannot appear on both the income statement and balance sheet.

c. Yes, the accounting equation is relevant to all companies including Exxon-Mobil Corporation.

Ex. 1–23

1. (a) operating activity
2. (a) operating activity
3. (b) investing activity
4. (c) financing activity

Ex. 1–24

ABSOLUTE CONSULTING GROUP
Statement of Cash Flows
For the Year Ended July 31, 2012

Cash flows from operating activities:
   Cash received from customers .................. $187,500
   Deduct cash payments for operating expenses ... 127,350
   Net cash flows from operating activities .......... $ 60,150

Cash flows from investing activities:
   Cash payments for purchase of land ............. (30,000)

Cash flows from financing activities:
   Cash received from issuing additional capital stock .. $ 40,000
   Deduct cash dividends ................................ 5,000
   Net cash flows from financing activities .......... 35,000

Net increase in cash during year ..................... $65,150
Cash as of August 1, 2011 ......................... 27,100
Cash as of July 31, 2012 ............................. $92,250
1. All financial statements should contain the name of the business in their heading. The retained earnings statement is incorrectly headed as “Bertram Mitchell” rather than Empire 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 May 31, 2012.”

3. The year in the heading for the retained earnings statement should be 2012 rather than 2011.


5. In the income statement, the miscellaneous expense amount should be listed as the last expense.

6. In the income statement, the total expenses are incorrectly subtracted from the sales commissions, resulting in an incorrect net income amount. The correct net income should be $22,050. 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 additional issuance of capital stock should not be added to retained earnings, as of May 1, 2012. The net income should be presented after the beginning retained earnings as of May 1, 2012, 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.
Corrected financial statements appear as follows:

**EMPIRE REALTY**

**Income Statement**
For the Month Ended May 31, 2012

Sales commissions ............................................................ $233,550

Expenses:
Office salaries expense .............................................. $145,800
Rent expense .................................................................. 49,500
Automobile expense ................................................... 11,250
Supplies expense ........................................................ 1,350
Miscellaneous expense .............................................. 3,600
Total expenses ........................................................ 211,500

Net income .......................................................................... $ 22,050

**EMPIRE REALTY**

**Retained Earnings Statement**
For the Month Ended May 31, 2012

Retained earnings, May 1, 2012 ........................................ $36,800
Net income for May ............................................................ $22,050
Less dividends ................................................................... 9,000
Increase in retained earnings ........................................... 13,050
Retained earnings, May 31, 2012 ................................. $49,850

**EMPIRE REALTY**

**Balance Sheet**
May 31, 2012

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$14,850</td>
</tr>
<tr>
<td>Supplies</td>
<td>$17,100</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>Stockholders’ Equity</td>
</tr>
<tr>
<td>$88,200</td>
<td>Capital stock</td>
</tr>
<tr>
<td></td>
<td>Retained earnings</td>
</tr>
<tr>
<td></td>
<td>Total stockholders’ equity</td>
</tr>
<tr>
<td></td>
<td>Total liabilities and stockholders’ equity</td>
</tr>
</tbody>
</table>

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Ex. 1–26

a. 2009: $23,387 ($41,164 – $17,777)
   2008: $26,610 ($44,324 – $17,714)

b. 2009: 1.32 ($23,387 ÷ $17,777)
   2008: 1.50 ($26,610 ÷ $17,714)

c. The ratio of liabilities to stockholders’ equity decreased from 2008 to 2009, indicating a decrease in risk for creditors.

Ex. 1–27

a. 2009: $18,055 ($32,686 – $14,631)
   2008: $16,098 ($30,869 – $14,771)

b. 2009: 0.81 ($14,631 ÷ $18,055)
   2008: 0.92 ($14,771 ÷ $16,098)

c. The margin of safety for creditors has increased slightly from 2008 to 2009. In both years, creditors have less at stake in Lowe’s than do stockholders, since the ratio is less than 1.

d. Lowe’s ratio of liabilities to stockholders’ equity is less than 1. In comparison, The Home Depot’s ratio of liabilities to stockholders’ equity is greater than 1 for 2009 and 2008. Thus, the creditors of The Home Depot are more at risk than are the creditors of Lowe’s.