

ACC101 – CHAPTER 1

Accounting in Business



Key Terms and Concepts to Know

Accounting Principles:

GAAP

Business Entity, Cost, Going Concern, Monetary Unit, Objectivity, Revenue Recognition

Accounting Equation and components:

Assets, Liabilities, Stockholders Equity, Revenue, Expense, Dividends
The accounting equation must always balance

Transactions:

External transactions occur between two different entities and are easy to record because there are always source documents evidencing the transaction

Internal transactions occur within a single entity and are more difficult to record because source documents may not always be present

Basic Financial Statements:

Income Statement, Statement of Retained Earnings, Balance Sheet, Statement of Cash Flows

Interrelationship among the financial statements

Profitability:

Revenues – Expenses

Net Income vs. Net Loss

Return on Assets ratio

Assets = Liabilities + Stockholder's Equity

Example #1: John Smith is the sole stockholder and operator of Just-In-Time, a consulting firm. At the end of its accounting period, December 31, 2000, Just-In-Time has assets of \$375,000 and liabilities of \$125,000. Using the accounting equation and considering each case independently, determine the following amounts:

- a. Stockholder's equity on 12/31/00.
- b. The amount and direction (increase or decrease) of the period's change in stockholder's equity if, during 2001, assets increased by \$32,000 and liabilities decreased by \$8,000.
- c. Net income (or net loss) during 2001, assuming that as of December 31, 2001, assets were \$367,000, liabilities were \$110,000, capital stock of \$40,000 was issued, and dividends of \$60,000 were paid.

Solution #1:

Assets = Liabilities + Stockholder's Equity

a) \$375,000 = \$125,000 + X
 X = \$250,000

b) + \$32,000 = - \$8,000 + X
 + \$40,000 = X

c) Beginning Owners Equity = \$250,000 [from (a) above]

Ending Owners Equity:

\$367,000 = \$110,000 + X
 X = \$257,000

Beginning Owners Equity		\$250,000		
+ Capital Stock Investments		40,000		
- Dividends paid		(60,000)		
+ Net Income		<u> X</u>		
Ending Owners Equity		\$257,000		

X = \$27,000

Revised July 2008

Practice Problem #1: Sarah Jones is the sole stockholder and operator of Sarah's Catering. At the end of the accounting period, December 31, 2000, Sarah's Catering has assets of \$135,000 and liabilities of \$72,000. Using the accounting equation and considering each case independently, determine the following amounts:

- a. Stockholder's equity on 12/31/00.
- b. The amount and direction (increase or decrease) of the period's change in stockholder's equity if, during 2001, assets decreased by \$22,000 and liabilities decreased by \$7,000.
- c. Net income (or net loss) during 2001, assuming that as of December 31, 2001, assets were \$148,000, liabilities were \$75,000, capital stock of \$25,000 was issued, and dividends of \$12,000 were paid.

Effect of Transactions on the Accounting Equation

Example #2: Read each of the following transactions. For each one, indicate which elements of the accounting equation are effected (minimum of 2 per transaction) and whether the element has increased or decreased as a result.

- a. Paid rent for August, \$3,000.
- b. Received cash from cash customers, \$7,500.
- c. Received cash for capital stock, \$15,000.
- d. Paid creditors on account, \$800.
- e. Received cash from customer's on account, \$1,200.

Solution #2:

- | | |
|---------------------|---------------------------------|
| a. Asset – decrease | Stockholder's equity – decrease |
| b. Asset – increase | Stockholder's equity – increase |
| c. Asset – increase | Stockholder's equity – increase |
| d. Asset – decrease | Liabilities – decrease |
| e. Asset – increase | Asset – decrease |

Revised July 2008

Practice Problem #2: Read each of the following transactions. For each one, indicate which elements of the accounting equation are effected (minimum of 2 per transaction) and whether the element has increased or decreased as a result.

- a. Purchased supplies for cash, \$120.
- b. Paid cash dividends, \$1,000.
- c. Billed customers for services rendered on account, \$2,800.
- d. Paid utilities for September, \$85.
- e. Purchased equipment on account, \$3,200.
- f. Received cash for services rendered, \$900.
- g. Determined that the cost of supplies on hand was \$30; therefore, \$90 of supplies had been used during the month.
- h. Paid \$1,000 toward equipment purchased in (e) above.

SAMPLE MULTIPLE CHOICE QUESTIONS

1. Which of the following best describes accounting?
 - a. Can be thought of as the “language of business”
 - b. Is of limited or little use by individuals outside of the business
 - c. Records economic data but does not communicate the data to users
 - d. Relies upon concepts and principles that are independent of specific user needs
2. The two most common specialized fields of accounting in practice are:
 - a. environmental accounting and financial accounting
 - b. managerial accounting and tax accounting
 - c. financial accounting and accounting systems
 - d. managerial accounting and financial accounting
3. Equipment with an estimated market value of \$80,000 is offered for sale at \$85,000. The equipment is acquired for \$10,000 in cash and a note payable of \$65,000. The amount used in the buyer’s accounting records to record this acquisition is:
 - a. \$80,000
 - b. \$85,000
 - c. \$10,000
 - d. \$75,000
4. The business entity concept means that:
 - a. An entity is organized according to state or federal statutes.
 - b. An entity is organized according to the rules set by the FASB
 - c. The entity is an individual economic unit separate and apart from its owners
 - d. The owner is the entity.

5. Properties owned by a business are referred to as:
 - a. stockholder's equity
 - b. liabilities
 - c. assets
 - d. equities

6. If total assets decreased by \$1,000 during a period of time and liabilities increased by \$2,000 during the same period, then the amount and direction (increase or decrease) of the period's changes in stockholder's equity is:
 - a. \$1,000 increase
 - b. \$3,000 increase
 - c. \$3,000 decrease
 - d. \$1,000 decrease

7. How does the rendering of services on account affect the accounting equation?
 - a. Liabilities increase; stockholder's equity decreases
 - b. Assets increase; liabilities increase
 - c. Assets decrease; stockholder's equity increases
 - d. Assets increase; stockholder's equity increases

8. If assets and liabilities at the beginning of the year were \$205,000 and \$140,000 respectively and at the end of the year were \$225,000 and \$175,000 respectively, calculate the net income if dividends of \$35,000 were paid and \$10,000 of additional capital stock was issued.
 - a. Net income of \$10,000
 - b. Net income of \$15,000
 - c. Net loss of \$15,000
 - d. Net income of \$25,000

9. Which of the following financial statements reports information as of a point in time?
 - a. Retained earnings statement
 - b. Statement of cash flows
 - c. Income statement
 - d. Balance sheet

10. Transactions affecting owner's (stockholder's) equity include:
 - a. only the issuance of capital stock and dividends
 - b. only the issuance of capital stock and net income or loss
 - c. only dividends and net income or loss
 - d. issuance of capital stock, dividends, and net income or loss

11. The cost principle requires that assets be reported on the balance sheet at their current cost.
 - a. True
 - b. False

12. Which of the following would not appear on the income statement?
 - a. Service Revenue
 - b. Interest Expense
 - c. Net income
 - d. Dividends paid

13. Which of the following would not appear on the Retained Earnings Statement?
 - a. Beginning retained earnings balance
 - b. Dividends
 - c. Service Revenue
 - d. Net Income

14. The financial statements are usually prepared in which of the following sequences?
 - a. Income Statement, Balance Sheet, Retained Earnings Statement, Statement of Cash Flows
 - b. Balance Sheet, Retained Earnings Statement, Statement of Cash Flows, Income Statement
 - c. Balance Sheet, Retained Earnings Statement, Income Statement, Statement of Cash Flows
 - d. Income Statement, Retained Earnings Statement, Balance Sheet, Statement of Cash Flows

15. Cindy's Maid Service began the year with total assets of \$120,000 and stockholders' equity of \$40,000. During the year the company earned \$90,000 in net income and paid \$20,000 in dividends. Total assets at the end of the year were \$215,000. Stockholder's equity at the end of the year was:
 - a. \$130,000
 - b. \$110,000
 - c. \$150,000
 - d. \$135,000

16. Same information as Question 15. Total liabilities at the end of the year were:
 - a. \$80,000
 - b. \$90,000
 - c. \$110,000
 - d. \$105,000

SOLUTIONS TO PRACTICE PROBLEMS

Practice Problem #1

	Assets	=	Liabilities	+	Stockholder's Equity
a.	\$135,000	=	\$72,000	+	X
	\$63,000	=	X		
b.	-\$22,000	=	-\$7,000	+	X
	-\$15,000	=	X		
c.	\$148,000	=	\$75,000	+	X
	\$73,000	=	X		

Beginning SE	\$63,000	[from (a) above]
+Capital Stock	+25,000	
-Dividends	-12,000	
+Net Income/Loss	X	
Ending SE	\$73,000	[from (c) above]

X = -3,000 Net Loss

Practice Problem #2

- | | |
|---------------------|------------------------|
| a. Asset – increase | Asset – decrease |
| b. Asset – decrease | OE – decrease |
| c. Asset – increase | OE – increase |
| d. Asset – decrease | OE – decrease |
| e. Asset – increase | Liabilities – increase |
| f. Asset – increase | OE – increase |
| g. Asset – decrease | OE – decrease |
| h. Asset – decrease | Liabilities – decrease |

SOLUTIONS TO MULTIPLE CHOICE QUESTIONS

1. A

2. D

3. D Cost = \$10,000 paid now
 + 65,000 to be paid later
 \$75,000

4. C

5. C

6. C **Assets = Liabilities + Stockholder's equity**

-1,000 = +2,000 + X

-3,000 = X

7. D

8. A **Assets = Liabilities + Stockholder's equity**

205,000 = 140,000 + ? beginning of year

225,000 = 175,000 + ? end of year

25,000 = 35,000 + X change during year

Beginning of year equity = 205,000 – 140,000 = 65,000

End of year equity = 225,000 – 175,000 = 50,000

Decrease in equity during the year X = -15,000

Change in equity = stock issued – dividends + net income

-15,000 = +10,000 - 35,000 + NI

NI = -15,000 - 10,000 + 35,000 = 10,000

9. D

10. D

11. B

12. D

13. C

14. D

15. B \$40,000 Stockholder's Equity (beg.)

+90,000 Net Income

-20,000 Dividends

\$110,000 Stockholder's Equity (end)

16. D **Assets = Liabilities + Stockholder's Equity**

215,000 = X + 110,000

105,000 = X