

# ANSWERS TO QUESTIONS

1. Yes, this is correct. Virtually every organization and person in our society uses accounting information. Businesses, investors, creditors, government agencies, and not-for-profit organizations must use accounting information to operate effectively.
2. Accounting is the process of identifying, recording, and communicating the economic events of an organization to interested users of the information. The first step of the accounting process is therefore to identify economic events that are relevant to a particular business. Once identified and measured, the events are recorded to provide a history of the financial activities of the organization. Recording consists of keeping a chronological diary of these measured events in an orderly and systematic manner. The information is communicated through the preparation and distribution of accounting reports, the most common of which are called financial statements. A vital element in the communication process is the accountant's ability and responsibility to analyze and interpret the reported information.
3.
  - (a) Internal users are those who plan, organize, and run the business and therefore are officers and other decision makers.
  - (b) To assist management, managerial accounting provides internal reports. Examples include financial comparisons of operating alternatives, projections of income from new sales campaigns, and forecasts of cash needs for the next year.
4.
  - (a) Investors (owners) use accounting information to make decisions to buy, hold, or sell ownership shares of a company.
  - (b) Creditors use accounting information to evaluate the risks of granting credit or lending money.
5. No, this is incorrect. Bookkeeping usually involves only the recording of economic events and therefore is just one part of the entire accounting process. Accounting, on the other hand, involves the entire process of identifying, recording, and communicating economic events.
6. Eve Myles Travel Agency should report the land at \$90,000 on its December 31, 2012 balance sheet. This is true not only at the time the land is purchased, but also over the time the land is held. In determining which measurement principle to use (cost or fair value) companies weigh the factual nature of cost figures versus the relevance of fair value. In general, companies use cost. Only in situations where assets are actively traded do companies apply the fair value principle. An important concept that accountants follow is the cost principle.
7. The monetary unit assumption requires that only transaction data that can be expressed in terms of money be included in the accounting records. This assumption enables accounting to quantify (measure) economic events.
8. The economic entity assumption requires that the activities of the entity be kept separate and distinct from the activities of its owners and all other economic entities.
9. The three basic forms of business organizations are: (1) proprietorship, (2) partnership, and (3) corporation.

## Questions Chapter 1 (Continued)

10. One of the advantages Maria Contreras would enjoy is that ownership of a corporation is represented by transferable shares of stock. This would allow Maria to raise money easily by selling a part of her ownership in the company. Another advantage is that because holders of the shares (stockholders) enjoy limited liability; they are not personally liable for the debts of the corporate entity. Also, because ownership can be transferred without dissolving the corporation, the corporation enjoys an unlimited life.
11. The basic accounting equation is  $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$ .
12. (a) Assets are resources owned by a business. Liabilities are claims against assets. Put more simply, liabilities are existing debts and obligations. Owner's equity is the ownership claim on total assets.  
(b) Owner's equity is affected by owner's investments, drawings, revenues, and expenses.
13. The liabilities are: (b) Accounts payable and (g) Salaries and wages payable.
14. Yes, a business can enter into a transaction in which only the left side of the accounting equation is affected. An example would be a transaction where an increase in one asset is offset by a decrease in another asset. An increase in the Equipment account which is offset by a decrease in the Cash account is a specific example.
15. Business transactions are the economic events of the enterprise recorded by accountants because they affect the basic accounting equation.  
(a) The death of the owner of the company is not a business transaction as it does not affect the basic accounting equation.  
(b) Supplies purchased on account is a business transaction as it affects the basic accounting equation.  
(c) An employee being fired is not a business transaction as it does not affect the basic accounting equation.  
(d) A withdrawal of cash from the business is a business transaction as it affects the basic accounting equation.
16. (a) Decrease assets and decrease owner's equity.  
(b) Increase assets and decrease assets.  
(c) Increase assets and increase owner's equity.  
(d) Decrease assets and decrease liabilities.
17. (a) Income statement. (d) Balance sheet.  
(b) Balance sheet. (e) Balance sheet and owner's equity statement.  
(c) Income statement. (f) Balance sheet.
18. No, this treatment is not proper. While the transaction does involve a receipt of cash, it does not represent revenues. Revenues are the gross increase in owner's equity resulting from business activities entered into for the purpose of earning income. This transaction is simply an additional investment made by the owner in the business.

**Questions Chapter 1 (Continued)**

**19.** Yes. Net income does appear on the income statement—it is the result of subtracting expenses from revenues. In addition, net income appears in the owner’s equity statement—it is shown as an addition to the beginning-of-period capital. Indirectly, the net income of a company is also included in the balance sheet. It is included in the capital account which appears in the owner’s equity section of the balance sheet.

<b>20.</b> (a)	Ending capital balance .....	\$198,000
	Beginning capital balance .....	<u>168,000</u>
	Net income .....	<u>\$ 30,000</u>

(b)	Ending capital balance .....	\$198,000
	Beginning capital balance .....	<u>168,000</u>
		30,000
	Deduct: Investment.....	<u>13,000</u>
	Net income .....	<u>\$ 17,000</u>

<b>21.</b> (a)	Total revenues (\$20,000 + \$70,000) .....	\$90,000
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(b)	Total expenses (\$26,000 + \$40,000) .....	\$66,000
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(c)	Total revenues .....	\$90,000
	Total expenses .....	<u>66,000</u>
	Net income .....	<u>\$24,000</u>

**22.** Coca-Cola’s accounting equation at December 31, 2009 was  $\$48,671,000,000 = \$23,325,000,000 + \$25,346,000,000$ .