Tutorial questions (E1-4, E1-6, E1-8)

Exercise 1-4 (LO 1-2)

Requirement 1

Revenues	−	Expenses	=	Net Income
$14,000	−	$9,000	=	**$5,000**

Requirement 2

Assets	=	Liabilities	+	Stockholders' equity
$50,000	=	$27,000	+	$X
$50,000	−	$27,000	=	**$23,000**

Exercise 1-6 (LO 1-3)

Cowboy Law Firm
Income Statement
For the period ended December 31

Service revenue	$9,300
Expenses:	
Salaries	2,200
Utilities	1,200
Total expenses	3,400
Net income	$5,900

Exercise 1-8 (LO 1-3)

Wolfpack Construction
Balance Sheet
December 31

Assets		**Liabilities**	
Cash	$ 6,000	Accounts payable	$ 3,000
Land	18,000	Notes payable	20,000
Equipment	26,000	Total liabilities	23,000
		Stockholders' Equity	
		Common stock	11,000
		Retained earnings	16,000 *
		Total stockholders' equity	27,000
Total assets	$50,000	Total liabilities and stockholders' equity	$50,000

*	Assets	=	Liabilities	+	Stockholders' equity
	$50,000	=	$23,000	+	($11,000 + Retained earnings)
	$50,000	−	$23,000	−	$11,000 = Retained earnings
					$16,000 = Retained earnings

Take-home questions (E1-2, E1-5, E1-20, P1-2A, AP1-5)

Exercise 1-2 (LO 1-2)

Transaction	Financial Statement	Account	Activity
1. Falcon purchases common stock of Wildcat.	Balance sheet	Asset	Investing
2. Falcon borrows from Wildcat by signing a note.	Balance sheet	Liability	Financing
3. Falcon provides services to Wildcat.	Income statement	Revenue	Operating
4. Falcon pays interest to Wildcat on borrowing.	Income statement	Expense	Operating

Exercise 1-5 (LO 1-2)

Requirement 1

Revenues	−	Expenses	=	Net Loss
$28,000	−	$33,000	=	**($5,000)**

Requirement 2

Assets	=	Liabilities	+	Stockholders' equity
$19,000	=	$15,000	+	$X
$19,000	−	$15,000	=	**$4,000**

Exercise 1-20 (LO 1-7)

1. b.
2. c.
3. d.
4. a.

Problem 1-2A (LO 1-2)

	Account classifications	Account Names
1.	**Stockholders' equity**	Common stock
2.	**Asset**	Equipment
3.	**Liability**	Salaries payable
4.	**Revenue**	Service revenue
5.	**Expense**	Utilities expense
6.	**Asset**	Supplies
7.	**Expense**	Research and development expense
8.	**Asset**	Land
9.	**Liability**	Income tax payable
10.	**Liability**	Interest payable

Ethics RWP1-6

1. **Yes.**
The role of an auditor is to express an independent, professional opinion of the extent to which financial statements are prepared in compliance with Generally Accepted Accounting Principles. An auditor’s ethics might be challenged because of the need to retain the client as a source of revenue. In this case, the auditor might fear losing the audit fee if it upsets its largest client by requiring a correction to the financial statements because of questionable accounting practices. The company may fire the auditor and retain the services of someone else. This problem is further worsened by the company offering an additional $200,000 in audit fees this year and the promise of continued services for the next five years. Management may be using these monetary incentives as a way to entice the auditor to allow certain reporting practices. If the auditor upsets the client, the auditor faces the possibility of losing revenue each year from audit services.

2. **No.**
Auditors are not employees of the company. They are hired by a company as an independent party. To the extent they feel management’s reporting practices violate Generally Accepted Accounting Principles, they can issue an opinion stating so.

3. **Yes.**
Although ultimate responsibility for fair presentation of financial statements lies with management, the auditor’s opinion lends additional credibility to those financial statements. These statements are useful to investors, creditors and others for making decisions. In addition, if the auditor detects that financial statements are misstated and does not disclose this opinion, then the auditor likely faces monetary penalties and other sanctions that could limit its ability to perform any audits in the future.

4. **No.**
Even though the auditor faces this ethical dilemma, they serve an important role in the reporting of financial information to help investors and creditors make decisions. Auditors follow a strict set of guidelines in providing auditing services. In addition, they typically face severe legal and monetary penalties in the case of negligence or willful allowance of materially misstated financial statements by management. The auditor should issue an opinion stating its belief that financial statements are materially misstated.