Chapter 1: The Accounting Equation

Question 1: Define the three components of the Accounting Equation.

Question 2: If a business owns a piece of real estate worth $250,000, and they owe $180,000 on a loan for that real estate, what is owners' equity in the property?

Answer to Question 1:

- Assets: All the property owned by a business.
- Liabilities: A company's outstanding debts.
- Owners' Equity: The company's ownership interests in its property after all debts have been repaid.

Answer to Question 2: $70,000

Chapter 2: The Balance Sheet

Question 1: Categorize the following accounts as to whether they're Asset, Liability, of Owners' Equity accounts.

- Common Stock
- Accounts Receivable
- Retained Earnings
- Cash
- Notes Payable

Question 2: For each of the following assets or liabilities, state whether it is current or non-current:

- Accounts Payable
- Cash
- Property, Plant, and Equipment
- Note Payable
- Inventory

Answer to Question 1:

- Common Stock: Owners' Equity
- Accounts Receivable: Asset
- Retained Earnings: Owners' Equity
- Cash: Asset
- Notes Payable: Liability

Answer to Question 2:

- Accounts Payable: current liability
- Cash: current asset
- Property, Plant, and Equipment: non-current asset

- Note Payable: non-current liability (Though if a portion of the note is due within the next twelve months, that portion should be shown as a current liability.)
- Inventory: current asset

Chapter 3: The Income Statement

Question 1: Given the following information, calculate ABC Corp's Net Income:

- Sales: $260,000
- Cost of Goods Sold: $100,000
- Salaries and Wages: $20,000
- Rent Expense: $15,000
- Advertising Expense: $35,000
- Cost of repairs resulting from fire: $50,000

Question 2: Using the above information, calculate ABC Corp's Operating Income.

Question 3: Using the above information, calculate ABC Corp's Gross Profit.

Answer to Question 1: $40,000 (Sales of $260,000 minus $220,000 of total expenses.)

Answer to Question 2: $90,000 (Operating Income is intended to represent income from typical business operations. As a result, expenses resulting from a fire would certainly not be included when calculating Operating Income.)

Answer to Question 3: $160,000 (Sales minus Cost of Goods Sold)

Chapter 4: The Statement of Retained Earnings

Question 1: Using the following information, calculate the ending balance in Retained Earnings:

- Beginning Retained Earnings: $10,000
- Net Income: $5,000
- Dividends Paid: $4,000

Question 2: Calculate Net Income given the following information:

- Consulting Revenue: $50,000
- Rent Expense: $5,000
- Software Licensing Fees: $3,000
- Dividends Paid: $6,000
- Advertising Expense:$20,000

Question 3: Using the following information, calculate how much was paid out in dividends during the year:

- Beginning Retained Earnings: $40,000
- Net Income: $15,000
- Ending Retained Earnings: $30,000

Answer to Question 1: $11,000

Answer to Question 2: $22,000 (Remember, dividends are not an expense! They are a distribution of net income rather than a reduction of net income.)

Answer to Question 3: $25,000

Chapter 5: The Cash Flow Statement

Question 1: Calculate cash flow from operating activities using the following information:

- Cash sales: $10,000
- Credit sales: $15,000
- Cash received from prior credit sales: $8,000
- Rent paid: $3,000
- Inventory purchased: $6,000
- Wages paid:$5,000

Question 2: Categorize the following cash flows as to whether they are operating, investing, or financing activities:

- Taxes paid
- Dividends paid to shareholders
- Interest paid on loans
- Dividends received on investments
- Cash sales
- Purchase of new office furniture

Answer to Question 1: Net cash inflow of $4,000. (Remember not to include the $15,000 of credit sales when calculating cash flow.)

Answer to Question 2:

- Taxes paid: Operating Activities
- Dividends paid to shareholders: Financing Activities
- Interest paid on loans: Operating Activities (Note: *Principal* paid on loans is a financing activity.)
- Dividends received on investments: Operating Activities
- Cash sales: Operating Activities
- Purchase of new office furniture: Investing Activities

Chapter 6: Financial Ratios

Questions 1-3: Use the following income statement and balance sheet to answer the following questions.

Income Statement	
Sales	130,000
Cost of Goods Sold	26,000
Profit Margin	104,000
Salaries and Wages	15,000
Rent Expense	5,000
Licensing Expenses	20,000
Advertising Expense	4,000
Total Expenses	44,000
Net Income	**60,000**

Balance Sheet	
Assets	
Cash	10,000
Inventory	15,000
Property, Plant, and Equipment	250,000
Accounts Receivable	5,000
Total Assets	280,000
Liabilities	
Accounts Payable	20,000
Notes Payable	40,000
Total Liabilities	60,000
Owners' Equity	
Common Stock	120,000
Retained Earnings	100,000
Total Owners' Equity	220,000

Question 1: Calculate the company's current ratio and quick ratio.

Question 2: Calculate the company's return on assets and return on equity.

Question 3: Calculate the company's debt ratio and debt to equity ratio.

Answer to Question 1: Current ratio = 1.5 (30,000 current assets ÷ 20,000 current liabilities). Quick ratio = 0.75 (15,000 non-inventory current assets ÷ 20,000 current liabilities).

Answer to Question 2: Return on assets = 21.4% (60,000 net income ÷ 280,000 total assets). Return on equity = 27.3% (60,000 net income ÷ 220,000 shareholders' equity)

Answer to Question 3: Debt ratio = 21.4% (60,000 liabilities ÷ 280,000 assets). Debt to equity ratio = 27.3% (60,000 liabilities ÷ 220,000 shareholders' equity).

Chapter 7: What is GAAP?

Question 1: Who is required to follow GAAP?

Question 2: Who creates the rules for GAAP?

Question 3: What is the purpose of Generally Accepted Accounting Principles (GAAP)?

Answer to Question 1: Publicly-traded companies. (Governmental entities are required to follow GAAP as well, but the rules that make up GAAP for governmental entities are significantly different from the rules for publicly-traded companies.)

Answer to Question 2: The Financial Accounting Standards Board (FASB)

Answer to Question 3: To purpose of GAAP is to ensure that companies' financial statements are prepared using a similar set of rules and assumptions. This helps to enable meaningful comparisons between the financial statements of multiple companies.

Chapter 8: Debits and Credits

Questions 1-3: Show how the following transactions would affect the Accounting Equation

Question 1: James purchases a $5,000 piece of equipment.

Question 2: James writes his monthly check for rent: $3,000.

Question 3: James takes out a $25,000 loan with his bank.

Questions 4-6: Create journal entries to record the following transactions

Question 4: James purchases a $5,000 piece of equipment.

Question 5: James writes his monthly check for rent: $3,000.

Question 6: James takes out a $25,000 loan with his bank.

Answer to Question 1:

Assets	= Liabilities	+ Owners' Equity
-5,000	no change	no change
+5,000		

Answer to Question 2:

Assets	= Liabilities	+ Owners' Equity
-3,000		-3,000

Answer to Question 3:

Assets	= Liabilities + Owners' Equity
+25,000	+25,000

Answer to Question 4:

Dr. Equipment	5,000	
Cr. Cash		5,000

Answer to Question 5:

Dr. Rent Expense	3,000	
Cr. Cash		3,000

Answer to Question 6:

Dr. Cash	25,000	
Cr. Note Payable		25,000

Chapter 9: Cash vs. Accrual

Questions 1-5: Prepare journal entries to record each of the following events.

Question 1: Tom's Tax Prep's monthly rent is $3,500. At the end of February, they had not yet received their monthly rent invoice.

Question 2: In early March, Tom's Tax Prep receives and pays their rent bill for February.

Question 3: Marla, a marketing consultant, performs services for a client. The agree-upon price was $10,000, due 30 days from the date the services were completed.

Question 4: ABC Hardware makes a sale (on credit) for $2,500 worth of lumber. The lumber originally cost them $1,300.

Question 5: Julie takes out a $10,000 loan for her business. Repayment is due in one year along with $1,200 interest.

Answer to Question 1:

Dr. Rent Expense	3,500	
Cr. Rent Payable		3,500

Answer to Question 2:

Dr. Rent Payable	3,500	
Cr. Cash		3,500

Answer to Question 3:

Accounts Receivable	10,000	
Sales		10,000

Answer to Question 4:

Accounts Receivable	2,500	
Sales		2,500
Cost of Goods Sold	1,300	
Inventory		1,300

Answer to Question 5:

When the loan is taken out:

Cash	10,000	
Note Payable		10,000

At the end of each month during the year:

Interest Expense	100	
Interest Payable		100

When the loan is repaid:

Note Payable	10,000	
Interest Payable	1,200	
Cash		11,200

Chapter 10: The Accounting Close Process

Prepare closing journal entries for Mario's Mobile Products, which has the following end-of-year trial balance:

Cash	40,000	
Accounts Receivable	8,000	
Property, Plant, and Equipment	150,000	
Inventory	30,000	
Accounts Payable		15,000
Wages Payable		22,000
Common Stock		50,000
Retained Earnings		60,000
Sales		380,000
Cost of Goods Sold	120,000	
Rent Expense	60,000	
Wages and Salary Expense	110,000	
Advertising Expense	9,000	

Answer:

Sales	380,000	
Income Summary		380,000
Income Summary	120,000	
Cost of Goods Sold		120,000
Income Summary	60,000	
Rent Expense		60,000
Income Summary	110,000	
Wages and Salary Expense		110,000
Income Summary	9,000	
Advertising Expense		9,000

Alternatively, the above can be combined into one journal entry:

Sales	380,000	
Cost of Goods Sold		120,000
Rent Expense		60,000
Wages and Salary Expense		110,000
Advertising Expense		9,000
Income Summary		81,000

In either case, the following closing journal entry is also required in order to close out the Income Summary account and transfer the balance — representing the business's net income for the period — into Retained Earnings:

Income Summary	81,000	
Retained Earnings		81,000

Chapter 11: Other GAAP Concepts and Assumptions

Question 1: Andy runs a real estate development firm. Five years ago, he purchased a piece of land for $250,000. This year, an appraiser tells Andy that the land is worth $300,000. At what value should Andy report the land on his balance sheet? Why?

Question 2: Andy is the sole owner of his firm. In June, he moves $30,000 from his business checking account to his personal checking account. If Andy wants his financial records to be in accordance with GAAP, should he record the transaction or not? Why?

Answer to Question 1: Andy should report the land at its original cost: $250,000. Under GAAP's "Historical Cost" assumption, assets are reported at their historical cost rather than at their current market value. This is done in order to remove subjective asset valuations from the reporting process.

Answer to Question 2: Yes, in order to be in compliance with GAAP, Andy must record the transaction. GAAP's "Entity Assumption" considers businesses to be separate entities from their owners. As such, transactions between a business and its owners must be recorded as if they were between the business and an entirely separate party.

Chapter 12: Depreciation of Fixed Assets

Questions 1-6: Prepare journal entries to record each of the following events:

Question 1: Liliana spends $20,000 (cash) on a piece of equipment for use in her restaurant. She plans to use the straight-line method to depreciate the equipment over 5 years. She expects it to have no value at the end of the 5 years.

Question 2: After 4 years, Liliana sells the equipment for $4,000.

Question 3: Same as question 2, except she sells the equipment for $6,000.

Question 4: Same as question 2, except she sells the equipment for $2,000.

Question 5: Oscar is a self-employed electrician. He purchases a piece of equipment for $30,000 cash. He plans to use it for 10 years, at which point he plans to sell it for approximately $4,000.He elects to use the straight-line method of depreciation.

Question 6: Sandra runs a business making embroidered linens for wedding receptions. She purchases a new piece of equipment for $15,000 in credit. She plans to use the units of production method of depreciation. The equipment is expected to produce approximately 5,000 linens, at which point it will be valueless. During the first year after buying the equipment, Sandra uses it to produce 1,500 linens.

Answer to Question 1:

To record the purchase:

Equipment	20,000	
Cash		20,000

To record depreciation every year:

Depreciation Expense	4,000	
Accumulated Depreciation		4,000

Answer to Question 2:

Cash	4,000	

Accumulated Depreciation	16,000	
Equipment		20,000

Answer to Question 3:

Cash	6,000	
Accumulated Depreciation	16,000	
Gain on Sale of Equipment		2,000
Equipment		20,000

Answer to Question 4:

Cash	2,000	
Accumulated Depreciation	16,000	
Loss on Sale of Equipment	2,000	
Equipment		20,000

Answer to Question 5:

To record the purchase:

Equipment	30,000	
Cash		30,000

To record depreciation every year:

Depreciation Expense	2,600	
Accumulated Depreciation		2,600

(Depreciable value is $26,000. If depreciated over 10 years, that's $2,600 depreciation per year.)

Answer to Question 6:

To record the purchase:

Equipment	15,000	
Accounts Payable		15,000

When the purchase is eventually paid for:

Accounts Payable	15,000	
Cash		15,000

To record depreciation for the first year:

Depreciation Expense	4,500	
Accumulated Depreciation		4,500

($15,000 depreciable value ÷ 5,000 units = $3 of depreciation per unit. 1,500 units produce x $3 per unit = $4,500 depreciation expense.)

Chapter 13: Amortization of Intangible Assets

Questions 1-2: Prepare journal entries to record each of the following events.

Question 1: Trent runs a business as an engineering consultant. He invents a new system for preparing bridges to deal with extreme weather conditions. He spends $28,000 securing a 14-year patent for his invention. He expects the system to be used for the next few decades at least.

Question 2: Tina runs a business creating medical supplies for surgeries. Her team develops a new tool for assisting in heart surgery. She spends $42,000 on getting it patented. She receives a 14-year patent, but she only expects the technology to be used for about 7 years before a newer technology comes along to replace it.

Answer to Question 1:

To record receiving the patent:

Patents	28,000	
Cash		28,000

To record amortization expense each year:

Amortization Expense	2,000	
Accumulated Amortization		2,000

Answer to Question 2:

To record receiving the patent:

Patents	42,000	
Cash		42,000

To record amortization expense each year:

Amortization Expense	6,000	
Accumulated Amortization		6,000

Chapter 14: Inventory and Cost of Goods Sold

Question 1: Using the following information, calculate Cost of Goods Sold:

- Beginning Inventory: $3,000
- Ending Inventory: $4,500
- Purchases: $6,000

Question 2-4: Use the following information to answer questions 2-4.

- Beginning Inventory: 1,000 units at $4/unit.

- Purchases: 600 units at $5/unit.
- Ending Inventory: 900 units.

Question 2: Calculate Cost of Goods Sold using First-In-First-Out (FIFO)

Question 3: Calculate Cost of Goods Sold using Last-In-First-Out (LIFO)

Question 4: Calculate Cost of Goods Sold using the Average Cost Method

Answer to Question 1: CoGS = $4,500

Answer to Question 2: CoGS = $2,800

Explanation:

The first thing to calculate is how many units were sold. In this case, 700 units must have been sold. Now we just have to figure out the cost for each unit of sold inventory.

Using FIFO, we assume that the first units purchased were the first units sold. Therefore, all 700 sold units must have been from the older ($4 per unit) inventory. 700 units x $4 per unit = $2,800

Answer to Question 3: CoGS =$3,400

Again, we know that 700 units were sold. Under LIFO, we assume that the most recently purchased units are sold first. Therefore, all 600 of the $5 units must have been sold. The remaining 100 sold units must have been from the older ($4/unit) inventory.

(600 units x $5 per unit) + (100 units x $4 per unit) = $3,400

Answer to Question 4: CoGS =$3,062.50

Using the Average Cost Method, we have to calculate the average cost per unit of inventory. We know that there were a total of 1,600 units available for sale and that–in total–they cost $7,000. That gives us an average cost per unit of $4.38 (or $4.375 to be precise).

To calculate CoGS, we multiply this average cost per unit by the number of units sold. 700 units x $4.375 per unit = $3,062.50