

SURVEY OF ACCOUNTING · CHAPTER 1 · LO 1-3

Interactive Assessment — LO 1-3

Work these on your own, then we'll go through them together on the screen.

Name _____ Date _____ Section _____

LO 1-3 Identify the elements of the accounting equation.**1 Name the element**

Match each description to the element of the accounting equation it defines. Write the letter. A letter may be used more than once or not at all.

A Assets · **B** Liabilities · **C** Common stock · **D** Retained earnings · **E** Revenue · **F** Dividends

ITEM	ANSWER
The resources a business uses to earn money	A — Assets
The obligations a business has to its creditors	B — Liabilities
Certificates describing the commitments made to investors	C — Common stock
The increase in commitments to stockholders when assets generated by operations are kept rather than distributed	D — Retained earnings

FOR THE INSTRUCTOR

These are the chapter's own definitions. Revenue and dividends are never correct: they are accounts that feed retained earnings, not elements of the equation.

2 Solve the equation

Sable Studio has \$200,000 of assets, \$70,000 of liabilities, and \$80,000 of common stock.

Retained earnings

\$50,000

Total stockholders' equity

\$130,000

SHOW YOUR WORK**FOR THE INSTRUCTOR**

Retained earnings = $200,000 - 70,000 - 80,000 = 50,000$. Stockholders' equity = $80,000 + 50,000 = 130,000$, which is also assets less liabilities. The usual miss is reporting the common stock alone (80,000) as total equity and leaving retained earnings out.

3 Can they pay a dividend?

Crestwood Design has been in business one year. It has \$30,000 of cash, all of it from issuing stock, and has no current or prior retained earnings. The owners would like a \$5,000 dividend. According to the chapter, what is true? Circle one.

- ☐ A The company can pay it, because it has enough cash
- ☐ B The company can pay it as long as the owners agree
- ☒ C **The company cannot pay a dividend, because a dividend is a distribution of assets generated through earnings**
- ☐ D The company can pay it, but must call it an expense

FOR THE INSTRUCTOR

The text is explicit: a company that does not have current or prior retained earnings cannot pay dividends. Cash alone is not enough; the assets being distributed must have come from earnings.

4 Assets equal claims

The chapter first writes the accounting equation as $\text{Assets} = \text{Claims}$. Which pair correctly names the two kinds of claims? Circle one.

- ☐ A Cash and land
- ☐ B Revenue and expenses
- ☐ C Common stock and dividends
- ☒ D **Creditors' claims (liabilities) and investors' claims (stockholders' equity)**

FOR THE INSTRUCTOR

Creditors and investors provided the assets, so they hold potential claims on them. Stockholders' equity then subdivides into common stock and retained earnings.