

SURVEY OF ACCOUNTING · CHAPTER 1 · LO 1-5

Interactive Assessment — LO 1-5

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

Name _____ Date _____ Section _____

LO 1-5 Interpret information shown in an accounting equation.

1 How big a dividend?

Tidewater Tutoring's accounting equation shows Cash \$700 + Land \$3,100 = Liabilities \$1,600 + Common Stock \$1,500 + Retained Earnings \$900. What is the largest cash dividend Tidewater can pay today? Circle one.

- ☒ A \$700
- ☐ B \$900
- ☐ C \$1,600
- ☐ D \$3,800

FOR THE INSTRUCTOR

Retained earnings of \$900 does not mean \$900 of cash. The only cash is on the left side, \$700, so that is the ceiling today. Option b is the retained-earnings-is-cash misconception; c and d confuse liabilities and total assets with distributable amounts.

2 After the land sale

Tidewater Tutoring (Cash \$700, Land \$3,100, Liabilities \$1,600, Common Stock \$1,500, Retained Earnings \$900) sells its land for \$3,100 cash.

Cash after the sale

\$3,800

Largest cash dividend Tidewater can now pay

\$900

SHOW YOUR WORK

FOR THE INSTRUCTOR

Cash becomes $700 + 3,100 = 3,800$, but the dividend is still capped at 900 because only 900 of the assets came from earnings. Before the sale cash was the limit; now retained earnings is. To pay a dividend a company needs both.

3 Who gets paid in a liquidation

Copperline Co. was started on January 1, Year 1 with \$400 cash from creditors and \$250 cash from investors. During Year 1 it had a net loss of \$310. On January 1, Year 2 the company is forced to liquidate.

Total assets on January 1, Year 2

\$340

Amount the creditors receive

\$340

Amount the investors receive

\$0

SHOW YOUR WORK

FOR THE INSTRUCTOR

Assets: $650 - 310 = 340$. Creditors have priority and are owed 400, so they take all 340 and still lose 60. Investors get nothing. Both groups are at risk; creditors are at less risk because they are first in line.

4 Reading the right side

Pinnacle Tours has spent all of its cash on a tour bus. Its equation reads Cash \$0 + Bus \$80,000 = Liabilities 60% + Common Stock 25% + Retained Earnings 15%. Which statement is correct? Circle one.

- ☐ A Pinnacle has \$12,000 of cash set aside from prior earnings
- ☒ B Creditors provided 60 percent of Pinnacle's assets
- ☐ C Pinnacle could pay a dividend of up to 15 percent of its assets today
- ☐ D The right side shows that Pinnacle used its cash to buy a bus

FOR THE INSTRUCTOR

The right side identifies the sources of assets, not their composition, and none of it is cash. There is no cash, so no dividend is possible today regardless of retained earnings, and the right side cannot tell you what the assets were spent on.

5 Profitable and in trouble

Granite Peak Outfitters earned \$200 of net income in its first year. It now holds \$50 cash and \$950 of land, and owes creditors \$300 that is due next week. The land cannot be sold quickly. Which idea from the chapter is at stake? Circle one.

- ☐ A The matching concept
- ☐ B The historical cost concept
- ☒ C The going concern doctrine
- ☐ D The entity concept

FOR THE INSTRUCTOR

Even profitable companies can be forced to liquidate if assets are mismanaged. The going concern doctrine assumes the business can continue; if that becomes uncertain, accountants must notify creditors and investors. This is the Bandera Company example with new names.