

SURVEY OF ACCOUNTING · CHAPTER 1 · LO 1-7

Interactive Assessment — LO 1-7

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

Name _____ Date _____ Section _____

LO 1-7 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

1 Bluff Park Pet Care, Year 1

Bluff Park Pet Care started Year 1 by issuing common stock for \$50,000 cash. During the year it received \$96,000 cash for services, paid \$41,000 for salaries, \$12,000 for advertising, and \$17,000 for other operating expenses, and paid a \$6,000 cash dividend.

Net income

\$26,000

Ending retained earnings

\$20,000

Total stockholders' equity

\$70,000

SHOW YOUR WORK

FOR THE INSTRUCTOR

Net income = $96,000 - 70,000 = 26,000$ (the stock issue is not revenue; the dividend is not an expense).
 Retained earnings = $26,000 - 6,000 = 20,000$. Equity = $50,000 + 20,000 = 70,000$, which also equals total assets because there are no liabilities. Two traps: subtracting the dividend to get 20,000 net income, and adding the stock issue to revenue.

2 Not on the income statement

Bluff Park Pet Care's records for the year include service revenue, advertising expense, a \$6,000 cash dividend, and net income. Which item does NOT appear on its income statement, and why? Circle one.

- A The \$6,000 dividend, because it was not incurred to generate revenue**
- B Advertising expense, because it was optional
- C Service revenue, because it was received in cash
- D Net income, because it belongs on the balance sheet

FOR THE INSTRUCTOR

Advertising is a cost incurred to produce revenue, so it is an expense. Stockholders are paid to reward their investment, after income is determined, so dividends are not. The chapter makes exactly this argument.

3 Which statement is it on?

Match each line to the financial statement where it appears. Write the letter. A letter may be used more than once or not at all.

A Income statement · **B** Statement of changes in stockholders' equity · **C** Balance sheet · **D** Statement of cash flows · **E** Statement of comprehensive income

ITEM	ANSWER
Notes payable	C — Balance sheet
Operating expenses	A — Income statement
Beginning retained earnings	B — Statement of changes in stockholders' equity
Cash payments to purchase land	D — Statement of cash flows
Land	C — Balance sheet

FOR THE INSTRUCTOR

Follows Exhibit 1.4. The statement of comprehensive income is mentioned in the chapter only to say it is not covered; it is never correct.

4 Order on the balance sheet

Homewood Hardware has three assets: land, cash, and merchandise inventory. In what order does the chapter say they should appear on the balance sheet, and why? Circle one.

- ☐ (A) Land, inventory, cash, from largest to smallest dollar amount
- ☐ (B) Alphabetical: cash, inventory, land
- ☒ (C) **Cash, inventory, land, in order of how quickly each converts to cash**
- ☐ (D) Inventory, cash, land, in order of importance to the business

FOR THE INSTRUCTOR

Assets are listed by liquidity. Cash first; inventory sells faster than land. Option b gives the same order for the wrong reason, which is worth surfacing in discussion.

5 Where net income shows up twice

The chapter uses the term articulation for the way statements connect. Net income is reported on the income statement and also appears directly on which other statement? Circle one.

- ☐ (A) The balance sheet
- ☐ (B) The statement of cash flows
- ☐ (C) All three of the other statements
- ☒ (D) **The statement of changes in stockholders' equity**

FOR THE INSTRUCTOR

Net income is added to beginning retained earnings on the statement of changes in stockholders' equity. The balance sheet shows ending retained earnings, not net income, and the statement of cash flows shows cash flows, not income.

