

Custom Package for  
**Financial Accounting 2021**

Demonstration Problems &  
Farewell Discount Distributors Practice Set I

to accompany  
*Accounting Principles Textbook*  
by Horngren, Harrison, and Bamber



College  
Custom  
Series

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## **DEMONSTRATION PROBLEMS**

### **Demonstration Problem 1-1**

What is Accounting?

Accounting is the service (or system) that provides information to interested parties (users) to help them make decisions about an organization (an entity).

### **Demonstration Problem 1-2**

What are economic entities and what are the different types of economic entities?

#### **Economic Entities**

Organizations that provide a good or service to a customer. There are two types - business entities and nonprofit entities.

#### **Business entities**

#### **Nonprofit**

#### **Types of business entities**

Proprietorships

Partnerships

Corporations

### **Demonstration Problem 1-3**

What are the different categories of users of accounting information and what are the different disciplines of accounting that relate to these different users?

#### **Types of Users of Accounting Information**

## Disciplines of Accounting

### Management Accounting

Provides information to internal users of a business entity to assist them in making decisions about that business entity.

### Financial Accounting

Provides information to external users of a business entity, in the form of general purpose financial statements, (prepared in accordance with generally accepted accounting principles - GAAP) to assist them in making decisions about that business entity.

### Demonstration Problem 1-4

What are the different types of general purpose financial statements? (in order)

1. Income Statement (Statement of Earnings, Statement of Operations)
2. Statement of Owner's Equity
3. Balance Sheet (Statement of Financial Position)
4. Statement of Cash Flows

### Demonstration Problem 1-5

What are the first examples of generally accepted accounting principles (GAAP)?

1. Entity Concept
2. Reliability (Objectivity) Principle
3. Cost Principle
4. Going Concern Concept
5. Stable Monetary-Unit Concept



**Demonstration Problem 1-6**

What are assets, liabilities and owner's equity?

**Assets**

Economic resources

Typically owned by an entity

Provide future economic benefits

Can be measured in monetary terms

**Owner's Equity**

**Liabilities**

**Demonstration Problem 1-7**

Place each of the following transactions under the columns below for Assets, Liabilities, and Owner's Equity, using either a + or - to represent an increase or decrease.

1. Mr. Talbot invests \$10,000 of cash to start a new company, called Talbot Tax Services.
2. Mr. Talbot purchases \$500 of new tax books for cash.
3. Mr. Talbot borrows \$5,000 from the bank and signs a note that promises to repay the bank in the next few months.
4. Mr. Talbot takes \$1,000 of cash out of the company for personal use.
5. Mr. Talbot repays \$3,000 of what he owes the bank. (Because Mr. Talbot's father owns the bank, the bank does not charge Mr. Talbot interest.)

	<u>Assets</u>	<u>Liabilities</u>	<u>Owner's Equity</u>
1.	+10,000		+10,000
2.	-500		
	+500		
3.	+ 5,000	+ 5,000	
4.	- 1,000		- 1,000
5.	<u>- 3,000</u>	<u>- 3,000</u>	<u>          </u>
	<u>\$11,000</u>	<u>\$ 2,000</u>	<u>\$ 9,000</u>

**Demonstration Problem 1-8**

Based upon the transactions above, what is the relationship between Assets, Liabilities, and Owner's Equity? Express the relationship in an equation form.

**Demonstration Problem 1-9**

What are revenues, expenses and withdrawals?

**Revenues**

**Expenses**

**Withdrawals**

**Demonstration Problem 1-10**

The transactions above have now been placed in a **Financial Transactions Worksheet**, which now specifies individual columns for each different type of Asset, Liability, and Owner's Equity account.

For each of the next few transactions (#6-10) you are to record them in the new spaces provided in the financial transactions worksheet. The new transactions are as follows:

6. Talbot prepared several tax returns, receiving \$600 in cash from customers.
7. Talbot prepared several other tax returns, charging \$1,000. Instead of getting cash just yet, Talbot got a promise from each customer to pay him in the next week or so.
8. Talbot collected the \$1,000 from the customers who promised to pay.
9. Talbot paid his secretary \$500 for the work he had done during the month.
10. Talbot took another \$250 in cash out of the company for personal use.

	<u>Cash</u>	<u>Assets</u>	<u>Tax Books</u>	<u>Acts. Rec.</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
						<u>Notes Payable</u>		<u>Talbot, Capital</u>
1.	+\$10,000							+\$10,000
2.	- 500		+\$ 500					
3.	+ 5,000					+\$ 5,000		
4.	- 1,000							- 1,000
5.	<u>- 3,000</u>		<u>          </u>			<u>- 3,000</u>		<u>          </u>
	<u>\$10,500</u>		<u>\$ 500</u>			<u>\$ 2,000</u>		<u>\$ 9,000</u>
6.								
7.								
8.								
9.								
10.	<u>          </u>		<u>          </u>	<u>          </u>		<u>          </u>		<u>          </u>
	<u>\$ 11,350</u>		<u>\$ 500</u>	<u>\$ 0</u>		<u>\$ 2,000</u>		<u>\$ 9,850</u>

**Demonstration Problem 1-11**

What does an income statement report and what is its proper format?

These come from the owner's equity column of the financial transactions worksheet.

Name of Company	
Income Statement	
For the Period (Month, Quarter, Year) Ended xxxx	
Revenues	\$
Expenses	_____
Net Income	\$ =====

Based on the financial transactions worksheet above, prepare an income statement for this month. Assume it is January 2001.

Talbot Tax Services	
Income Statement	
Month Ended January 31, 2001	
Tax Service Revenues	\$1,600
Expenses:	
Salaries Expense	500
Net Income	\$1,100

**Demonstration Problem 1-12**

What is the statement of owner's equity and what is its basic form?

It represents all items in the owner's equity column (the revenues and expenses have already been combined into net income) of the financial transactions worksheet.

Name of Company	
Statement of Owner's Equity	
For the Period (Month, Quarter, Year) Ended xxxx	
Capital, Beginning Balance	\$
+ Investments	\$
+ Net Income (or - Net Loss)	_____
Total	\$ _____
- Withdrawals	_____
= Capital, Ending Balance	\$ =====

Based on the financial transactions worksheet above and the income statement you just prepared, prepare a statement of owner's equity for this month.

Talbot Tax Services  
Statement of Owner's Equity  
Month Ended January 31, 2001

Talbot, Capital Jan. 1, 2001	\$	0	
Add: Initial Investment		10,000	
Net Income		<u>1,100</u>	(Bottom line of income statement)
Total		\$11,100	
Less: Withdrawals		<u>1,250</u>	
Talbot, Capital Jan. 31, 2001		<u>\$ 9,850</u>	

**Demonstration Problem 1-13**

What is the balance sheet and what is its basic form?

Shows all items in basic accounting equation

2 Sides: Left = Right

The dollar amounts for each account are the balances at the bottom of each column in the financial transactions worksheet.

Name of Company			
Balance Sheet			
Date of Balance Sheet			
Assets	\$	Liabilities	\$
	_____	Owner's Equity	_____
		Total Liabilities	_____
Total Assets	<u>\$</u>	Plus Own. Equity	<u>\$</u>

Based on the financial transactions worksheet above and the statement of owner's equity, prepare a balance sheet at the end of January.

Talbot Tax Services  
 Balance Sheet  
 January 31, 2001

Assets:		Liabilities & Owner's Equity	
		Liabilities	
Cash	\$11,350	Notes Payable	\$ 2,000
Tax Books	500	Owner's Equity	
Accts. Rec.	<u>0</u>	Talbot, Capital	<u>9,850</u> *
Total Assets	<u>\$11,850</u>	Total Liabilities & Owner's Equity	<u>\$11,850</u>

\* Comes from the last line of the statement of owner's equity.

**Demonstration Problem 1-14**

What is the statement of cash flows and what is its basic form?

It shows all items in the cash column of the financial transactions worksheet. The ending balance must be the last line in the cash column.

Name of Company  
 Statement of cash Flows  
 For the Period (Month, Quarter, Year) Ended xxxx

Cash Balance, Beginning Balance (First Line of  
 Cash Column in Financial Transactions Worksheet)  
 + Cash Receipts (Pluses in Cash Column of Financial Transactions  
 Worksheet)  
 - Cash Payments (Minuses in Cash Column of Financial Transactions  
 Worksheet)  
 = Cash Balance, Ending Balance Last Line of Cash Column in  
 Financial Transactions Worksheet)

Based on the financial transactions worksheet above, prepare a statement of cash flows for January.

Talbot Tax Services  
Statement of Cash Flows  
Month Ended January 31, 2001

Cash Balance, Jan. 1, 2001		\$ 0
Plus: Cash Receipts for January		
Investment by owner	\$10,000	
Cash revenues	600	
Collections on account	1,000	
Borrowed money at bank	<u>5,000</u>	<u>16,600</u>
Total		\$16,600
Less: Cash Payments for January		
Purchase of books	\$ 500	
Withdrawals by owner	1,250	
Expenses	500	
Repay note to bank	<u>3,000</u>	<u>5,250</u>
Cash Balance, Jan. 31, 2001		<u><u>\$11,350</u></u>

**Demonstration Problem 1-8**

Using the financial transactions worksheet on page 10, record each of the following transactions for February, in class with your group. Then complete the financial statements that start on page 11, if there is time. You will then do the month of March (Demonstration Problem 1-16) for homework, which will be handed in and graded as a quiz.

1. Talbot prepared several tax returns, receiving \$700 in cash.
2. Talbot prepared numerous tax returns on account for customers. Talbot expects to collect the \$1,200 within a week or two.
3. Talbot collected \$1,000 of the accounts during the month.
4. Talbot purchased a computer on account from Computer City, promising to repay the \$5,000 within the next month.
5. Talbot paid Computer City ½ of what he owed for the computer.
6. Talbot repaid \$1,000 of what he owed the bank for the note payable, once again paying no interest.
7. Talbot paid salary expenses totaling \$1,100.
8. Talbot received a utility bill from TECO Power for \$150 to be paid within a week.
9. Talbot paid TECO the \$150.
10. Talbot withdrew \$650 from the business to buy his wife a new watch.

**Demonstration Problems**

	<u>Assets</u>		=	<u>Liabilities</u>		+ <u>Owner's Eq.</u>
	<u>Cash</u>	<u>Accounts Receive.</u>		<u>Accounts Payable</u>	<u>Notes Payable</u>	<u>Talbot, Capital</u>
Balances	\$11,350	\$ 0	\$	\$ 0	\$ 2,000	\$ 9,850
Transactions, Feb.						
1.						
2.						
3.						
4.						
5.						
6.						
7.						
8.						
9.						
10.						
	<u>\$ 7,650</u>	<u>\$ 200</u>		<u>\$ 2,500</u>	<u>\$ 1,000</u>	<u>\$ 9,850</u>



Talbot Tax Services  
Income Statement  
Month Ended February 28, 2001

Tax Service Revenues		\$	
Expenses:			
Salaries Expense	\$		
Utilities Expense	_____		_____
Net Income			<u>\$ 650</u>

Talbot Tax Services  
Statement of Owner's Equity  
Month Ended February 28, 2001

Talbot, Capital Feb. 1, 2001		\$ 9,850	
Add: Investment	\$		
Net Income			_____
Total			<u>\$</u>
Less: Withdrawals			
Talbot, Capital Feb. 28, 2001			<u>\$ 9,850</u>

Talbot Tax Services  
Balance Sheet  
February 28, 2001

Assets:		Liabilities & Owner's Equity	
		Liabilities	
Cash	\$	Notes Payable	\$
Computer		Accounts Payable	
Tax Books		Owner's Equity	
Accts. Rec.		Talbot, Capital	_____
		Total Liabilities &	
Total Assets	<u>\$13,350</u>	Owner's Equity	<u>\$13,350</u>

Talbot Tax Services  
Statement of Cash Flows  
Month Ended February 28, 2001

Cash Balance, Feb. 1, 2001		\$11,350	
Plus: Cash Receipts for February			
Cash revenues	\$		
Collections on account			_____
Total			<u>\$</u>
Less: Cash Payments for February			
Pay off Accounts Payable	\$		
Withdrawals by owner			
Repay note to bank			
Cash expenses			_____
Cash Balance, Feb. 28, 2001			<u>\$ 7,650</u>