

Survey of Accounting, 9e

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SURVEY OF
ACCOUNTING ^{9E}
WITH WARREN'S METRIC ANALYSIS

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Chapter 2

Basic Accounting Systems: Cash Basis

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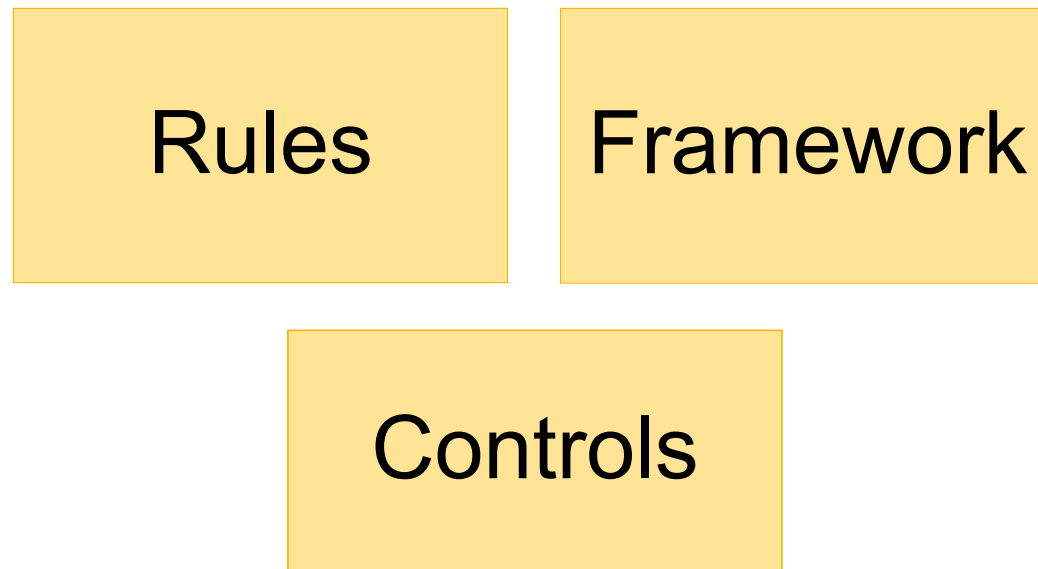
Learning Objectives

- Describe the basic elements of a financial accounting system
- Analyze, record, and summarize transactions for a corporation's first period of operations
- Prepare financial statements for a corporation's first period of operations
- Analyze, record, and summarize transactions for a corporation's second period of operations
- Prepare financial statements for a corporation's second period of operations
- Describe and illustrate the use of common-sized income statements in assessing a company's performance

Learning Objective 1

Describe the basic elements of a financial accounting system

Elements of a Financial Accounting System



Rules of an Accounting System

- Derived from accounting concepts, which are the basis of generally accepted accounting principles (GAAP)
 - **Transaction:** Economic event that under GAAP affects the financial statements

Framework of an Accounting System

- Transactions must be analyzed, recorded, and summarized using a framework
- Accounting equation
 - Basis for frameworks
 - Expressed as follows:

$$\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$

Exhibit 1: Integrated Financial Statement Framework

Integrated Financial Statement Framework					
BALANCE SHEET					
	Assets	=	Liabilities	+	Stockholders' Equity
	Assets	=	Liabilities	+	Common Stock + Retained Earnings
Transaction	XXX		XXX		XXX
	XXX				
	XXX		XXX		XXX

STATEMENT OF CASH FLOWS	
+/- Operating activities	XXX
+/- Investing activities	XXX
+/- Financing activities	XXX
Increase or decrease in cash	XXX
Beginning cash	XXX
Ending cash	XXX

INCOME STATEMENT	
Revenues	XXX
Expenses	XXX
Net income or loss	XXX

Controls of an Accounting System

- Include the following points:
 - Accounting equation must balance
 - Ending cash on the statement of cash flows must equal the cash on the balance sheet
 - Net income on the income statement must equal the net effects of revenues and expenses on retained earnings

Learning Objective 2

Analyze, record, and summarize transactions for a corporation's first period of operations

Transaction (a): Investment to Establish Business

- Dr. Landry deposits \$6,000 in a bank account in the name of Family Health Care, P.C., in return for shares of common stock in the corporation

BALANCE SHEET			
Transaction	Assets	=	Liabilities + Stockholders' Equity
	Cash	=	Common Stock
a. Investment by Dr. Landry	6,000	=	6,000

STATEMENT OF CASH FLOWS	
a. Financing	6,000

INCOME STATEMENT	

Transaction (b): Borrowing Money to Finance Operations

- Family Health Care, P.C., borrows \$10,000 from First National Bank to finance its operations

BALANCE SHEET				
Assets	=	Liabilities	+	Stockholders' Equity
Cash	=	Notes Payable	+	Common Stock
Balances				6,000
<i>b.</i> Issued note pay.		10,000		
Balances		10,000		6,000

STATEMENT OF CASH FLOWS	
<i>b.</i> Financing	10,000

INCOME STATEMENT	

Transaction (c): Buying Land for Cash

- Family Health Care buys land for \$12,000 cash

BALANCE SHEET							
	Assets		=	Liabilities	+	Stockholders' Equity	
	Cash	+	Land	=	Notes Payable	+	Common Stock
Balances	16,000				10,000		6,000
c. Purchase of land	(12,000)		12,000				
Balances	4,000		12,000		10,000		6,000

STATEMENT OF CASH FLOWS	
c. Investing	(12,000)

INCOME STATEMENT	

Transaction (d): Fees Earned in Cash

- During the first month of operations, Family Health Care earned patient fees of \$5,500, receiving the fees in cash

BALANCE SHEET									
	Assets		=	Liabilities	+	Stockholders' Equity			
	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings
Balances	4,000		12,000	=	10,000		6,000		
d. Fees earned	5,500			=					5,500
Balances	9,500		12,000	=	10,000		6,000		5,500

STATEMENT OF CASH FLOWS	
d. Operating	5,500

INCOME STATEMENT	
d. Fees earned	5,500

Transaction (e): Expenses Paid in Cash

- Family Health Care paid expenses of \$2,900 in September

BALANCE SHEET						
	Assets		=	Liabilities	+	Stockholders' Equity
	Cash	+ Land	=	Notes Payable	+	Common Stock + Retained Earnings
Balances	9,500	12,000	=	10,000	+	6,000 + 5,500
e. Paid expenses	(2,900)		=		+	(2,900)
Balances	6,600	12,000	=	10,000	+	6,000 + 2,600

STATEMENT OF CASH FLOWS	
e. Operating	(2,900)

INCOME STATEMENT	
e. Wages expense	(1,125)
Rent expense	(950)
Utilities expense	(450)
Interest expense	(100)
Misc. expense	(275)

Transaction (f): Dividends Paid

- Family Health Care paid \$1,500 to stockholders (Dr. Lee Landry) as dividends

BALANCE SHEET									
	Assets		=	Liabilities	+	Stockholders' Equity			
	Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings
Balances	6,600		12,000	=	10,000		6,000		2,600
f. Paid dividends	(1,500)								(1,500)
Balances	5,100		12,000	=	10,000		6,000		1,100

STATEMENT OF CASH FLOWS	
f. Financing	(1,500)

INCOME STATEMENT	

Exhibit 2: Family Health Care Summary of Transactions for September

BALANCE SHEET						
	Assets		=	Liabilities	+	Stockholders' Equity
	Cash	+ Land	=	Notes Payable	+	Common Stock + Retained Earnings
<i>a.</i> Investment by Dr. Landry	6,000					6,000
<i>b.</i> Issued note pay.	10,000			10,000		
<i>c.</i> Purchase of land	(12,000)	12,000				
<i>d.</i> Fees earned	5,500					5,500
<i>e.</i> Paid expenses	(2,900)					(2,900)
<i>f.</i> Paid dividends	(1,500)					(1,500)
Balances, Sept. 30	5,100	12,000		10,000		6,000 + 1,100

STATEMENT OF CASH FLOWS		INCOME STATEMENT	
<i>a.</i> Financing	6,000	<i>d.</i> Fees earned	5,500
<i>b.</i> Financing	10,000	<i>e.</i> Wages expense	(1,125)
<i>c.</i> Investing	(12,000)	Rent expense	(950)
<i>d.</i> Operating	5,500	Utilities expense	(450)
<i>e.</i> Operating	(2,900)	Interest expense	(100)
<i>f.</i> Financing	(1,500)	Misc. expense	(275)
Increase in cash and Sept. 30 cash	<u>5,100</u>	Net income	<u>2,600</u>

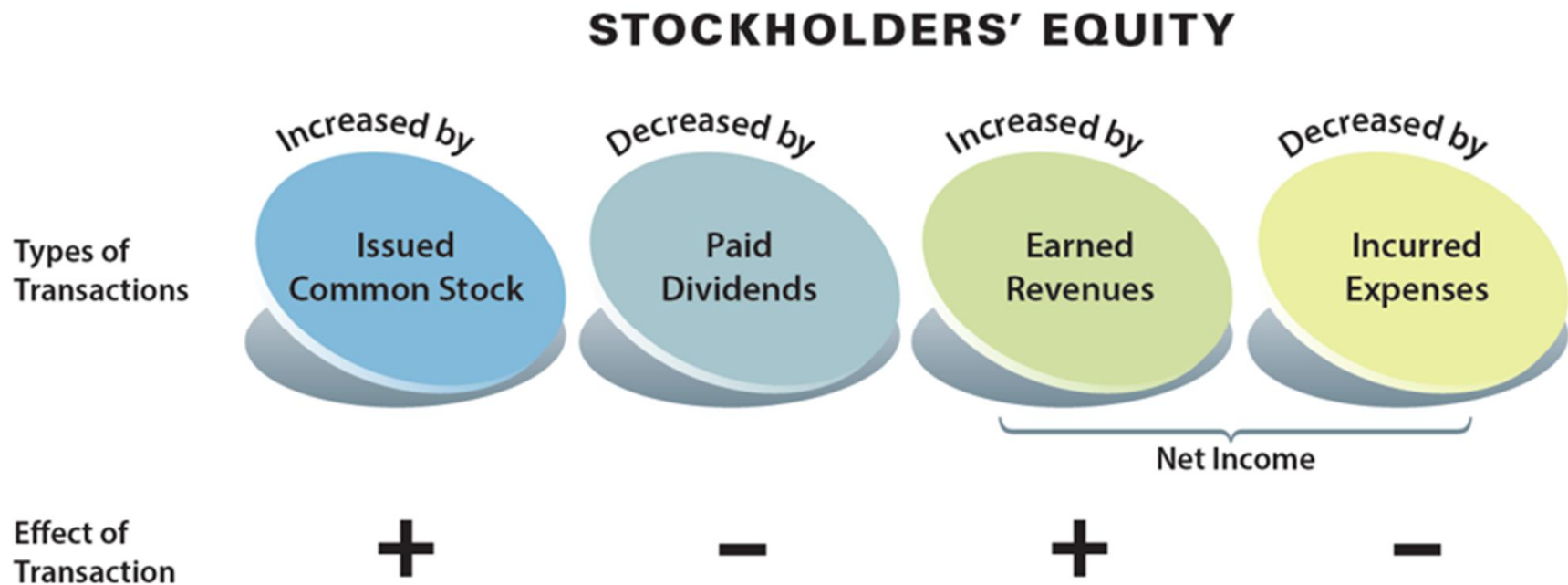
Recording a Corporation's First Period of Operations: Review

- Balance Sheet column reflects the accounting equation
 - Two sides of the accounting equation are always equal
- Every transaction increases or decreases one or more of the balance sheet elements
- A transaction may or may not affect an element of the statement of cash flows or the income statement
- Every cash transaction increases or decreases the asset (cash) on the balance sheet

Recording a Corporation's First Period of Operations: Review (continued)

- Ending balance of cash under the Statement of Cash Flows column equals the ending cash balance shown on the balance sheet
- Change in retained earnings for the period is the net income minus dividends
- Statement of cash flows is linked to the balance sheet through cash
- Income statement is linked to the balance sheet through revenues and expenses (net income or loss), which affects retained earnings

Exhibit 3: Effects of Transactions on Stockholders' Equity



Transaction Metric Effects: September

LIQUIDITY

Transaction	Cash
a. Issued stock	\$ 6,000
b. Issued note pay.	10,000
c. Purchased land	(12,000)
d. Earned fees	5,500
e. Paid expenses	(2,900)
f. Paid dividends	<u>(1,500)</u>
Total	<u>\$ 5,100</u>

PROFITABILITY

Net Income - Cash Basis	
a. Issued stock	—
b. Issued note pay.	—
c. Purchased land	—
d. Earned fees	\$ 5,500
e. Paid expenses	(2,900)
f. Paid dividends	<u>—</u>
Total	<u>\$ 2,600</u>

Learning Objective 3

Prepare financial statements for a corporation's first period of operations

Exhibit 4: Family Health Care Financial Statements for September

Family Health Care, P.C.
Income Statement
For the Month Ended September 30, 20Y5

Fees earned.....		\$5,500
Operating expenses:		
Wages expense	\$1,125	
Rent expense	950	
Utilities expense	450	
Interest expense	100	
Miscellaneous expense	<u>275</u>	
Total operating expenses		<u>(2,900)</u>
Net income		<u><u>\$2,600</u></u>

Exhibit 4: Family Health Care Financial Statements for September (continued 1)

**Family Health Care, P.C.
Statement of Stockholders' Equity
For the Month Ended September 30, 20Y5**

	Common Stock	Retained Earnings	Total
Balances, Sept. 1, 20Y5.....	\$ 0	\$ 0	\$ 0
Issuance of common stock	6,000		6,000
Net income.....		2,600	2,600
Dividends.....		(1,500)	(1,500)
Balances, Sept. 30, 20Y5.....	<u>\$ 6,000</u>	<u>\$ 1,100</u>	<u>\$ 7,100</u>

Exhibit 4: Family Health Care Financial Statements for September (continued 2)

Family Health Care, P.C.
Balance Sheet
September 30, 20Y5

Assets		
Cash		\$ 5,100
Land		<u>12,000</u>
Total assets		<u><u>\$17,100</u></u>
Liabilities		
Notes payable		\$10,000
Stockholders' Equity		
Common stock	\$6,000	
Retained earnings	<u>1,100</u>	
Total stockholders' equity		<u>7,100</u>
Total liabilities and stockholders' equity		<u><u>\$17,100</u></u>



Exhibit 4: Family Health Care Financial Statements for September (continued 3)

**Family Health Care, P.C.
Statement of Cash Flows
For the Month Ended September 30, 20Y5**

Cash flows from operating activities:		
Cash received from customers	\$ 5,500	
Deduct cash payments for expenses	<u>2,900</u>	
Net cash flow from operating activities		\$ 2,600
Cash flows used in investing activities:		
Cash payments for acquisition of land		(12,000)
Cash flows from financing activities:		
Cash received from issuing common stock.....	\$ 6,000	
Cash received from notes payable.....	<u>10,000</u>	\$16,000
Deduct cash dividends.....	<u>(1,500)</u>	
Net cash flow from financing activities		<u>14,500</u>
Net increase in cash.....		\$ 5,100
September 1, 20Y5, cash balance		<u>0</u>
September 30, 20Y5, cash balance		<u><u>\$ 5,100</u></u>

Exhibit 5: Family Health Care Integrated Financial Statements for September

Family Health Care, P.C. Balance Sheet September 30, 20Y5								
Assets		=	Liabilities	+	Stockholders' Equity			
Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings
.	
.	
<u>\$5,100</u>		<u>\$12,000</u>		<u>\$10,000</u>		<u>\$6,000</u>		<u>\$1,100</u>
\$17,100			\$17,100					
Total Assets		=	Total Liabilities + Stockholders' Equity					

Family Health Care, P.C. Statement of Cash Flows For the Month Ended Sept. 30, 20Y5		Family Health Care, P.C. Income Statement For the Month Ended Sept. 30, 20Y5		Family Health Care, P.C. Statement of Stockholders' Equity For the Month Ended Sept. 30, 20Y5			
Operating act.	\$ 2,600	Revenues	\$5,500	Common Stock	Retained Earnings	Total	
Investing act.	(12,000)	Expenses	(2,900)	Bal. Sept. 1	\$ 0	\$ 0	\$ 0
Financing act.	<u>14,500</u>	Net Income	<u>\$2,600</u>	Issued stock	6,000		6,000
Increase in cash and Sept. 30 cash	<u>\$ 5,100</u>			Net Income		2,600	2,600
				Dividends		(1,500)	(1,500)
				Bal. Sept. 30	<u>\$ 6,000</u>	<u>\$ 1,100</u>	<u>\$7,100</u>

Learning Objective 4

Analyze, record, and summarize transactions for a corporation's second period of operations

Family Health Care: Transactions in October

- Received cash fees of \$6,400
- Paid expenses
 - Wages: \$1,370
 - Rent: \$950
 - Utilities: \$540
 - Interest: \$100
 - Miscellaneous: \$220
- Paid cash dividends of \$1,000

Exhibit 6: Family Health Care Summary of October Transactions

BALANCE SHEET							
	Assets		=	Liabilities +		Stockholders' Equity	
	Cash	+ Land	=	Notes Payable	+ Common Stock	+ Retained Earnings	
Balances, Oct. 1	5,100	12,000		10,000	6,000	1,100	
a. Fees earned	6,400					6,400	
b. Paid expenses	(3,180)					(3,180)	
c. Paid dividends	(1,000)					(1,000)	
Balances, Oct. 31	7,320	12,000		10,000	6,000	3,320	

STATEMENT OF CASH FLOWS	
a. Operating	6,400
b. Operating	(3,180)
c. Financing	(1,000)
Increase in cash	<u>2,220</u>

INCOME STATEMENT	
a. Fees earned	6,400
b. Wages expense	(1,370)
Rent expense	(950)
Utilities expense	(540)
Interest expense	(100)
Misc. expense	(220)
Net income	<u>3,220</u>

Transaction Metric Effects: October

LIQUIDITY

Transaction	Cash
a. Fees earned	\$6,400
b. Paid expenses	(3,180)
c. Paid dividends	<u>(1,000)</u>
Total	<u>\$ 2,220</u>

PROFITABILITY

Net Income – Cash Basis	
a. Fees earned	\$6,400
b. Paid expenses	<u>(3,180)</u>
Total	<u>\$ 3,220</u>

Learning Objective 5

Prepare financial statements for a corporation's second period of operations

Exhibit 7: Family Health Care Financial Statements for October

Family Health Care, P.C. Income Statement For the Month Ended October 31, 20Y5

Fees earned.....		\$6,400
Operating expenses:		
Wages expense	\$1,370	
Rent expense.....	950	
Utilities expense	540	
Interest expense	100	
Miscellaneous expense.....	<u>220</u>	
Total operating expenses		<u>(3,180)</u>
Net income		<u>\$3,220</u>

Exhibit 7: Family Health Care Financial Statements for October (continued 1)

**Family Health Care, P.C.
Statement of Stockholders' Equity
For the Month Ended October 31, 20Y5**

	Common Stock	Retained Earnings	Total
Balances, Oct. 1, 20Y5	\$6,000	\$1,100	\$7,100
Net income.....		3,220	3,220
Dividends.....		(1,000)	(1,000)
Balances, Oct. 31, 20Y5	<u>\$6,000</u>	<u>\$3,320</u>	<u>\$9,320</u>

Exhibit 7: Family Health Care Financial Statements for October (continued 2)

**Family Health Care, P.C.
Balance Sheet
October 31, 20Y5**

Assets		
Cash		\$ 7,320
Land		<u>12,000</u>
Total assets		<u>\$19,320</u>
Liabilities		
Notes payable		\$10,000
Stockholders' Equity		
Common stock	\$6,000	
Retained earnings	<u>3,320</u>	
Total stockholders' equity		<u>9,320</u>
Total liabilities and stockholders' equity		<u>\$19,320</u>

Exhibit 7: Family Health Care Financial Statements for October (continued 3)

**Family Health Care, P.C.
Statement of Cash Flows
For the Month Ended October 31, 20Y5**

Cash flows from operating activities:		
Cash received from customers	\$6,400	
Cash paid for expenses	<u>(3,180)</u>	
Net cash flow from operating activities		\$ 3,220
Cash flows from investing activities		0
Cash flows used for financing activities:		
Cash dividends paid to stockholder		<u>(1,000)</u>
Net increase in cash		\$ 2,220
October 1, 20Y5, cash balance		<u>5,100</u>
October 31, 20Y5, cash balance		<u><u>\$ 7,320</u></u>

Exhibit 8: Family Health Care Integrated Financial Statements for October

Family Health Care, P.C. Balance Sheet October 31, 20Y5									
Assets			=	Liabilities	+	Stockholders' Equity			
Cash	+	Land	=	Notes Payable	+	Common Stock	+	Retained Earnings	
.				.		.		.	
.				.		.		.	
<u>\$7,320</u>		<u>\$12,000</u>		<u>\$10,000</u>		<u>\$6,000</u>		<u>\$3,320</u>	
\$19,320				\$19,320					
Total Assets			=	Total Liabilities + Stockholders' Equity					

Family Health Care, P.C. Statement of Cash Flows For the Month Ended Oct. 31, 20Y5		Family Health Care, P.C. Income Statement For the Month Ended Oct. 31, 20Y5		Family Health Care, P.C. Statement of Stockholders' Equity For the Month Ended Oct. 31, 20Y5				
Operating act.	\$ 3,220	Revenues	\$6,400		Common Stock	Retained Earnings	Total	
Investing act.	0	Expenses	(3,180)		Bal. Oct. 1	\$6,000	\$1,100	\$7,100
Financing act.	(1,000)	Net income	<u>\$3,220</u>		Net income		3,220	3,220
Increase in cash	\$ 2,220				Dividends		(1,000)	(1,000)
Cash, Oct. 1	<u>5,100</u>				Bal. Oct. 31	<u>\$6,000</u>	<u>\$3,320</u>	<u>\$9,320</u>
Cash, Oct. 31	<u>\$ 7,320</u>							

Learning Objective 6

Describe and illustrate the use of common-sized income statements in assessing a company's performance

Common-Sized Financial Statements

- Express financial statement amounts as a percent of a base amount
- **Common-sized income statement:** Expresses income statement amounts as a percent of sales
- **Common-sized balance sheet:** Expresses each asset as a percent of total assets

Operating Data of The Kroger Co.

	Year 1	Year 2
Sales	\$ 98,375	\$108,465
Cost of sales	(78,138)	(85,512)
Gross profit	<u>\$ 20,237</u>	<u>\$ 22,953</u>
Operating expenses:		
Selling and administrative	\$(15,196)	\$ (17,161)
Other expenses	(2,316)	(2,655)
Total operating expenses	<u>\$(17,512)</u>	<u>\$ (19,816)</u>
Operating income	<u>\$ 2,725</u>	<u>\$ 3,137</u>

Common-Sized Income Statement of The Kroger Co.

	Year 1	Year 2	Increase (Decrease)
Sales	100.0%	100.0%	n/a
Cost of sales	<u>(79.4)</u>	<u>(78.8)</u>	<u>(0.6)%</u>
Gross profit	<u>20.6%</u>	<u>21.2%</u>	<u>0.6%</u>
Operating expenses:			
Selling and administrative	(15.4)%	(15.8)%	0.4%
Other expenses	<u>(2.4)</u>	<u>(2.5)</u>	<u>0.1</u>
Total operating expenses	<u>(17.8)%</u>	<u>(18.3)%</u>	<u>0.5%</u>
Operating income	<u>2.8%</u>	<u>2.9%</u>	<u>0.1%</u>

End of Chapter 2