Business and the role of accounting

Part I A. S # Transaction Details Accounting Equation Assets = Liabilities + Equity Assets Liabilities Owner's Equity Owner invested $6, 000 in business

Increase

(Cash)

No Effect

Increase (Owner's Equity)

2.

Borrowed $2, 000 at 12% note payable for 1 year from bank

Increase

(Cash)

Increase

(Notes Payable)

Increase

(Interest Payable)

No Effect

Decrease

(Increase in Expenses decrease Owner's Equity by reducing profits)

3.

Earned $900 revenue

(Assumption: Revenue is earned in cash)

Increase

(Cash)

No Effect

Increase

(Increase in Revenue increase Owner's Equity)

4.

Incurred $650 expenses

(Assumption: Expense is paid in cash)

Decrease

(Cash)

No Effect

Decrease

(Increase in Expenses decrease Owner’s Equity by reducing profits)

5.

Distribution to owner $25

Decrease

(Cash)

No Effect

Decrease

(Owner’s Equity)

B.

The other information that can be entered into financial statements includes the notes associated with transactions for disclosure purposes; and to identify the parties involved in the transactions.

C.

Cats and Dogs Company

Balance Sheet

As on March 31, 2007

Assets

Liabilities and Owner’s Equity

Cash $8, 225

Interest Payable $ 240

Notes Payable $2, 000

Total Liabilities $2, 240

Owner's Equity $6, 000

Net income/ (loss) ($ 15)

Total Assets $8, 225

Total Liabilities and Owner's Equity $8, 225

Notes:

The interest payments are not payable till next year hence will not be included as expenses in arriving at retained earnings figures above.

Cats and Dogs Company

Income Statement

For the month ending March 31, 2007

Revenue…………………………………………………………………………… $900

Expenses………………………………………………………………………….($650)

Interest Expense……………………………………………………………….($240)

Gross Income …………………………………………………………………$ 10

Dividends paid to owner…………………………………………………….. ($ 25)

Net Income/(Loss) ………………………………………………………….. ($ 15)

Cats and Dogs Company

Cash Flow Statement

For the month ending March 31, 2007

Cash Flow from Operating Activities

Net Income/(Loss)($ 15)

Add: Increase in Interest Payables $ 240

Less: Increase in Cash($8, 225)

Net Cash Flow from Operating Activities($8, 000)

Net Cash Flow from Investing Activities - $0 –

Net Cash Flow from Financing Activities

Increase in Notes Payable$2, 000

Net Cash Flow from Financing Activities$2, 000

Cash and Cash Equivalent at start of period- $0 –

Cash and Cash Equivalent at end of period($6, 000)

Net Cash Flow $6, 000

Cats and Dogs Company

Statement of Changes in Equity

For the month ending March 31, 2007

Owner’s Activity at beginning of the period$ 0

Additions by Owner$ 6, 000

Net Income/ (Loss) ($ 15)

Ending equity$ 5, 985

Part II

The reasoning is highly unreasonable. This is because all activities and transactions that occur before the balance sheet date must be included in the financial statements. This is required to present fair and true picture of the company’s financial position to the stakeholders.

The International Accounting Standard number 10 ‘ Events after balance sheet date’ provides two types of events. The events that provide evidence of conditions that existed before the balance sheet date (adjusting events) and the events that indicate conditions that arose after the balance sheet date (non-adjusting events).

For the given scenario, since the liability was incurred before the balance sheet date, hence it is an adjusting entry and must be recorded in the financial statements.

However, the standard requires ‘ changes to financial statements due to all material adjusting entries’. If the company can justify that a $5, 000 worth of liability is not material for the company, then the company might be able to omit the recording of the event in financial statements.