

CHAPTER 3

The Accounting Information System

ASSIGNMENT CLASSIFICATION TABLE (BY TOPIC)

| Topics | Questions | Brief Exercises | Exercises | Problems |
|--------------------------------------|---------------------|-------------------------|-----------------------|-----------------------------------|
| 1. Transaction identification. | 1, 2, 3, 5, 6, 7, 8 | 1, 2 | 1, 2, 3, 4, 17 | 1 |
| 2. Nominal accounts. | 4, 7 | | | |
| 3. Trial balance. | 6, 10 | | 2, 3, 4 | 1, 2 |
| 4. Adjusting entries. | 8, 11, 13, 14 | 3, 4, 5, 6, 7, 8, 9, 10 | 5, 6, 7, 8, 9, 10, 20 | 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 12 |
| 5. Financial statements. | | | 11, 12, 15, 22, 23 | 1, 2, 4, 6 |
| 6. Closing. | 12 | 11 | 13, 14, 16 | 1, 4, 9, 10, 12 |
| 7. Inventory and cost of goods sold. | 9 | | 14, 15 | |
| 8. Comprehensive accounting cycle. | | | | 1, 2, 6, 12 |
| *9. Cash vs. accrual Basis. | 15, 16, 17 | 12 | 18, 19 | 11 |
| *10. Reversing entries. | 18 | 13 | 20 | |
| *11. Worksheet. | 19 | | 21, 22, 23 | 12 |

*These topics are dealt with in an Appendix to the Chapter.

ASSIGNMENT CLASSIFICATION TABLE (BY LEARNING OBJECTIVE)

| Learning Objectives | Questions | Brief Exercises | Exercises | Problems |
|-------------------------------------------------------------------------------------------------------|------------------|-------------------------|-----------------------|--------------------------------|
| 1. Understand basic accounting terminology. | 1, 2, 4, 7 | | | |
| 2. Explain double-entry rules. | 1, 2, 3, 4, 5, 7 | | | |
| 3. Identify steps in accounting cycle. | 2, 3 | | | |
| 4. Record transactions in journals, post to ledger accounts, and prepare a trial balance. | 6, 10 | 1, 2, 3, 4, 5, 6, 7 | 1, 2, 3, 4, 17 | 1, 4, 9, 10 |
| 5. Explain the reasons for preparing adjusting entries and identify major types of adjusting entries. | 11, 16 | 3, 4, 5, 6, 7, 8, 9, 10 | 5, 6, 7, 8, 9, 10, 20 | 2, 3, 4, 5, 6, 7, 8, 9, 10, 12 |
| 6. Prepare financial statements from the adjusted trial balance. | 10 | | 11, 12 | 1, 2, 4, 6, 7, 8, 9, 10, 12 |
| 7. Prepare closing entries. | 8, 12, 13, 14 | 11 | 13, 14, 16 | 1, 4, 9, 10, 12 |
| 8. Prepare financial statements for a merchandising company. | 9 | | 13, 14, 15 | 4, 10 |
| *9. Differentiate the cash basis of accounting from the accrual basis of accounting. | 15, 17 | 12 | 18, 19 | 11 |
| *10. Identify adjusting entries that may be reversed. | 18 | 13 | 20 | |
| *11. Prepare a 10-column worksheet. | 19 | | 21, 22, 23 | 12 |

*These topics are dealt with in an Appendix to the Chapter.

ASSIGNMENT CHARACTERISTICS TABLE

| Item | Description | Level of Difficulty | Time (minutes) |
|--------|-------------------------------------------------------------------|---------------------|----------------|
| E3-1 | Transaction analysis—service company. | Simple | 15–20 |
| E3-2 | Corrected trial balance. | Simple | 10–15 |
| E3-3 | Corrected trial balance. | Simple | 15–20 |
| E3-4 | Corrected trial balance. | Simple | 10–15 |
| E3-5 | Adjusting entries. | Moderate | 10–15 |
| E3-6 | Adjusting entries. | Moderate | 10–15 |
| E3-7 | Analyze adjusted data. | Complex | 15–20 |
| E3-8 | Adjusting entries. | Moderate | 10–15 |
| E3-9 | Adjusting entries. | Moderate | 15–20 |
| E3-10 | Adjusting entries. | Complex | 25–30 |
| E3-11 | Prepare financial statements. | Moderate | 20–25 |
| E3-12 | Prepare financial statements. | Moderate | 20–25 |
| E3-13 | Closing entries. | Simple | 10–15 |
| E3-14 | Closing entries. | Moderate | 10–15 |
| E3-15 | Missing amounts. | Simple | 10–15 |
| E3-16 | Closing entries for a corporation. | Moderate | 10–15 |
| E3-17 | Transactions of a corporation, including investment and dividend. | Moderate | 10–15 |
| *E3-18 | Cash to accrual basis. | Moderate | 15–20 |
| *E3-19 | Cash and accrual basis. | Moderate | 10–15 |
| *E3-20 | Adjusting and reversing entries. | Complex | 20–25 |
| *E3-21 | Worksheet. | Simple | 10–15 |
| *E3-22 | Worksheet and balance sheet presentation. | Moderate | 20–25 |
| *E3-23 | Partial worksheet preparation. | Moderate | 10–15 |
| P3-1 | Transactions, financial statements—service company. | Moderate | 25–35 |
| P3-2 | Adjusting entries and financial statements. | Moderate | 35–40 |
| P3-3 | Adjusting entries. | Moderate | 25–30 |
| P3-4 | Financial statements, adjusting and closing entries. | Moderate | 40–50 |
| P3-5 | Adjusting entries. | Moderate | 15–20 |
| P3-6 | Adjusting entries and financial statements. | Moderate | 25–35 |
| P3-7 | Adjusting entries and financial statements. | Moderate | 25–35 |
| P3-8 | Adjusting entries and financial statements. | Moderate | 25–35 |
| P3-9 | Adjusting and closing. | Moderate | 30–40 |
| P3-10 | Adjusting and closing. | Moderate | 30–35 |
| *P3-11 | Cash and accrual basis. | Moderate | 35–40 |
| *P3-12 | Worksheet, balance sheet, adjusting and closing entries. | Complex | 40–50 |

ANSWERS TO QUESTIONS

1. Examples are:
 - (a) Payment of an accounts payable.
 - (b) Collection of an accounts receivable from a customer.
 - (c) Transfer of an accounts payable to a note payable.
2. Transactions (a), (b), (d) are considered business transactions and are recorded in the accounting records because a change in assets, liabilities, or owners'/stockholders' equity has been effected as a result of a transfer of values from one party to another. Transactions (c) and (e) are not business transactions because a transfer of values has not resulted, nor can the event be considered financial in nature and capable of being expressed in terms of money.
3. Transaction (a): Accounts Receivable (debit), Service Revenue (credit).
Transaction (b): Cash (debit), Accounts Receivable (credit).
Transaction (c): Supplies (debit), Accounts Payable (credit).
Transaction (d): Delivery Expense (debit), Cash (credit).
4. Revenue and expense accounts are referred to as temporary or nominal accounts because each period they are closed out to Income Summary in the closing process. Their balances are reduced to zero at the end of the accounting period; therefore, the term temporary or nominal is given to these accounts.
5. Andrea is not correct. The double-entry system means that for every debit amount there must be a credit amount and vice-versa. At least two accounts are affected and debits must equal credits. It does not mean that each transaction must be recorded twice.
6. Although it is not absolutely necessary that a trial balance be taken periodically, it is customary and desirable. The trial balance accomplishes two principal purposes:
 - (1) It tests the accuracy of the entries in that it proves that debits and credits of an equal amount are in the ledger.
 - (2) It provides a list of ledger accounts and their balances which may be used in preparing the financial statements and in supplying financial data about the concern.
7.
 - (a) Real account; balance sheet.
 - (b) Real account; balance sheet.
 - (c) Inventory is generally considered a real account appearing on the balance sheet. (Note: Inventory has the elements of a nominal account when the periodic inventory system is used. It may appear on the income statement when the multiple-step format is used under a periodic inventory system.)
 - (d) Real account; balance sheet.
 - (e) Real account; balance sheet.
 - (f) Nominal account; income statement.
 - (g) Nominal account; income statement.
 - (h) Real account; balance sheet.
8. At December 31, the three days' wages due to the employees represent a current liability. The related expense must be recorded in this period to properly reflect the expense incurred.
9.
 - (a) In a service company, revenues are service revenues and expenses are operating expenses. In a merchandising company, revenues are sales revenues and expenses consist of cost of goods sold plus operating expenses.
 - (b) The measurement process in a merchandising company consists of comparing the sales price of the merchandise inventory to the cost of goods sold and operating expenses.

Questions Chapter 3 (Continued)

10. (a) No change.
(b) Before closing, balances exist in these accounts; after closing, no balances exist.
(c) Before closing, balances exist in these accounts; after closing, no balances exist.
(d) Before closing, a balance exists in this account exclusive of any dividends or the net income or net loss for the period; after closing, the balance is increased or decreased by the amount of net income or net loss, and decreased by dividends declared.
(e) No change.
11. Adjusting entries are prepared prior to the preparation of financial statements in order to bring the accounts up to date and are necessary (1) to achieve a proper recognition of revenues and expenses in measuring income and (2) to achieve an accurate presentation of assets, liabilities and stockholders' equity.
12. Closing entries are prepared to transfer the balances of nominal accounts to capital (retained earnings) after the adjusting entries have been recorded and the financial statements prepared. Closing entries are necessary to reduce the balances in nominal accounts to zero in order to prepare the accounts for the next period's transactions.
13. Cost – Salvage Value = Depreciable Cost: $\$4,000 - \$0 = \$4,000$. Depreciable Cost ÷ Useful Life = Depreciation Expense For One Year $\$4,000 \div 5 \text{ years} = \800 per year. The asset was used for 6 months (7/1 – 12/31), therefore 1/2-year of depreciation expense should be reported. Annual depreciation $\times 6/12 =$ amount to be reported on 2014 income statement: $\$800 \times 6/12 = \underline{\$400}$.

14.

| December 31 | |
|----------------------------------------------|--------|
| Interest Receivable | 10,000 |
| Interest Revenue | 10,000 |
| (To record accrued interest revenue on loan) | |

Accrued expenses result from the same causes as accrued revenues. In fact, an accrued expense on the books of one company is an accrued revenue to another company.

- *15. Under the cash basis of accounting, revenue is recorded only when cash is received and expenses are recorded only when paid. Under the accrual basis of accounting, revenue is recognized when a performance obligation is met expenses are recognized when incurred, without regard to the time of the receipt or payment of cash.
- A cash-basis balance sheet and income statement are incomplete and inaccurate in comparison to accrual-basis financial statements. The accrual basis matches effort (expenses) with accomplishment (revenues) in the income statement while the cash basis only presents cash receipts and cash disbursements. The accrual basis balance sheet contains receivables, payables, accruals, prepayments, and deferrals while a cash-basis balance sheet shows none of these.
- *16. Salaries and wages paid during the year will include the payment of any wages attributable to the prior year but unpaid at the end of the prior year. This amount is an expense of the prior year and not of the current year, and thus should be subtracted in determining salaries and wages expense. Similarly, salaries and wages paid during the year will not include any salaries and wages attributable to hours worked during the current year but not actually paid until the following year. This should be added in determining salaries and wages expense.
- *17. Although similar to the strict cash basis, the modified cash basis of accounting requires that expenditures for capital items be charged against income over all the periods to be benefited. This is done through conventional accounting methods, such as depreciation and amortization. Under the strict cash basis, expenditures would be recognized as expenses in the period in which the corresponding cash disbursements are made.

Questions Chapter 3 (Continued)

- *18. Reversing entries are made at the beginning of the period to reverse accruals and some deferrals. Reversing entries are not required. They are made to simplify the recording of certain transactions that will occur later in the period. The same results will be attained whether or not reversing entries are recorded.
- *19. Disagree. A worksheet is not a permanent accounting record and its use is not required in the accounting cycle. The worksheet is an informal device for accumulating and sorting information needed for the financial statements. Its use is optional in helping to prepare financial statements.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 3-1

| | | | | |
|-----|----|---------------------------|-------|-------|
| May | 1 | Cash | 4,000 | |
| | | Common Stock..... | | 4,000 |
| | 3 | Equipment..... | 1,100 | |
| | | Accounts Payable | | 1,100 |
| | 13 | Rent Expense..... | 400 | |
| | | Cash | | 400 |
| | 21 | Accounts Receivable | 500 | |
| | | Service Revenue | | 500 |

BRIEF EXERCISE 3-2

| | | | | |
|------|----|--------------------------------|--------|--------|
| Aug. | 2 | Cash..... | 12,000 | |
| | | Equipment..... | 2,500 | |
| | | Owner's Capital | | 14,500 |
| | 7 | Supplies..... | 500 | |
| | | Accounts Payable..... | | 500 |
| | 12 | Cash..... | 1,300 | |
| | | Accounts Receivable..... | 670 | |
| | | Service Revenue..... | | 1,970 |
| | 15 | Rent Expense | 600 | |
| | | Cash | | 600 |
| | 19 | Supplies Expense | 230 | |
| | | Supplies (\$500 – \$270) | | 230 |

BRIEF EXERCISE 3-3

| | | | | |
|------|----|-----------------------------|--------|--------|
| July | 1 | Prepaid Insurance..... | 15,000 | |
| | | Cash..... | | 15,000 |
| Dec. | 31 | Insurance Expense | 2,500 | |
| | | Prepaid Insurance | | |
| | | (\$15,000 X 1/2 X 1/3)..... | | 2,500 |

BRIEF EXERCISE 3-4

| | | | | |
|------|----|-------------------------------|--------|--------|
| July | 1 | Cash..... | 15,000 | |
| | | Unearned Service Revenue..... | | 15,000 |
| Dec. | 31 | Unearned Service Revenue..... | 2,500 | |
| | | Service Revenue | | |
| | | (\$15,000 X 1/2 X 1/3)..... | | 2,500 |

BRIEF EXERCISE 3-5

| | | | | |
|------|----|-------------------------|---------|---------|
| Feb. | 1 | Prepaid Insurance..... | 720,000 | |
| | | Cash..... | | 720,000 |
| June | 30 | Insurance Expense | 150,000 | |
| | | Prepaid Insurance | | |
| | | (\$720,000 X 5/24)..... | | 150,000 |

BRIEF EXERCISE 3-6

| | | | | |
|------|----|-----------------------------|-------|-------|
| Nov. | 1 | Cash..... | 2,400 | |
| | | Unearned Rent Revenue | | 2,400 |
| Dec. | 31 | Unearned Rent Revenue..... | 1,600 | |
| | | Rent Revenue | | |
| | | (\$2,400 X 2/3)..... | | 1,600 |

BRIEF EXERCISE 3-7

| | | | | |
|------|----|---------------------------------|-------|-------|
| Dec. | 31 | Salaries and Wages Expense..... | 4,800 | |
| | | Salaries and Wages Payable | | |
| | | (\$8,000 X 3/5)..... | | 4,800 |
| Jan. | 2 | Salaries and Wages Payable..... | 4,800 | |
| | | Salaries and Wages Expense..... | 3,200 | |
| | | Cash | | 8,000 |

BRIEF EXERCISE 3-8

| | | | | |
|------|----|---------------------------|--------|--------|
| Dec. | 31 | Interest Receivable | 300 | |
| | | Interest Revenue | | 300 |
| Feb. | 1 | Cash..... | 12,400 | |
| | | Notes Receivable..... | | 12,000 |
| | | Interest Receivable..... | | 300 |
| | | Interest Revenue | | 100 |

BRIEF EXERCISE 3-9

| | | | | |
|------|----|---------------------------------------|-------|-------|
| Aug. | 31 | Interest Expense..... | 300 | |
| | | Interest Payable | | 300 |
| | 31 | Accounts Receivable..... | 1,400 | |
| | | Service Revenue..... | | 1,400 |
| | 31 | Salaries and Wages Expense..... | 700 | |
| | | Salaries and Wages Payable | | 700 |
| | 31 | Bad Debt Expense | 900 | |
| | | Allowance for Doubtful Accounts | | 900 |

BRIEF EXERCISE 3-10

| | | |
|------------------------------------------------|--------------|----------|
| Depreciation Expense | 2,000 | |
| Accumulated Depreciation—Equipment | | 2,000 |
| Equipment..... | \$30,000 | |
| Less: Accumulated Depreciation—Equipment | <u>2,000</u> | \$28,000 |

BRIEF EXERCISE 3-11

| | | |
|------------------------------|---------|---------|
| Sales Revenue | 808,900 | |
| Interest Revenue | 13,500 | |
| Income Summary | | 822,400 |
| Income Summary | 780,300 | |
| Cost of Goods Sold..... | | 556,200 |
| Administrative Expenses..... | | 189,000 |
| Income Tax Expense..... | | 35,100 |
| Income Summary | 42,100 | |
| Retained Earnings..... | | 42,100 |
| Retained Earnings | 18,900 | |
| Dividends..... | | 18,900 |

*BRIEF EXERCISE 3-12

| | |
|-------------------------------------------|------------------|
| (a) Cash receipts..... | \$142,000 |
| + Increase in accounts receivable | |
| (\$18,600 – \$13,000)..... | <u>5,600</u> |
| Service revenue..... | <u>\$147,600</u> |
| (b) Payments for operating expenses | \$ 97,000 |
| – Increase in prepaid expenses | |
| (\$23,200 – \$17,500)..... | <u>(5,700)</u> |
| Operating expenses | <u>\$ 91,300</u> |

***BRIEF EXERCISE 3-13**

| | | | |
|-----|----------------------------------|-------|-------|
| (a) | Salaries and Wages Payable | 4,200 | |
| | Salaries and Wages Expense..... | | 4,200 |
| (b) | Salaries and Wages Expense | 7,000 | |
| | Cash..... | | 7,000 |
| (c) | Salaries and Wages Payable | 4,200 | |
| | Salaries and Wages Expense | 2,800 | |
| | Cash..... | | 7,000 |

SOLUTIONS TO EXERCISES

EXERCISE 3-1 (15–20 minutes)

| | | | | |
|------|----|---------------------------------|--------|--------|
| Apr. | 2 | Cash..... | 32,000 | |
| | | Equipment | 14,000 | |
| | | Owner's Capital | | 46,000 |
| | 2 | No entry—not a transaction. | | |
| | 3 | Supplies..... | 700 | |
| | | Accounts Payable..... | | 700 |
| | 7 | Rent Expense | 600 | |
| | | Cash..... | | 600 |
| | 11 | Accounts Receivable..... | 1,100 | |
| | | Service Revenue..... | | 1,100 |
| | 12 | Cash..... | 3,200 | |
| | | Unearned Service Revenue..... | | 3,200 |
| | 17 | Cash..... | 2,300 | |
| | | Service Revenue..... | | 2,300 |
| | 21 | Insurance Expense | 110 | |
| | | Cash..... | | 110 |
| | 30 | Salaries and Wages Expense..... | 1,160 | |
| | | Cash..... | | 1,160 |
| | 30 | Supplies Expense | 120 | |
| | | Supplies | | 120 |
| | 30 | Equipment | 6,100 | |
| | | Owner's Capital | | 6,100 |

EXERCISE 3-2 (10–15 minutes)

Wanda Landowska Company Trial Balance April 30, 2014

| | <u>Debit</u> | <u>Credit</u> |
|---------------------------------------------|-----------------|-----------------|
| Cash | \$ 4,800 | |
| Accounts Receivable | 2,750 | |
| Prepaid Insurance (\$700 + \$100) | 800 | |
| Equipment..... | 8,000 | |
| Accounts Payable (\$4,500 – \$100) | | \$ 4,400 |
| Property Taxes Payable | | 560 |
| Owner's Capital (\$11,200 + \$1,500) | | 12,700 |
| Owner's Drawing..... | 1,500 | |
| Service Revenue..... | | 6,690 |
| Salaries and Wages Expense | 4,200 | |
| Advertising Expense (\$1,100 + \$300) | 1,400 | |
| Property Tax Expense (\$800 + \$100)..... | 900 | |
| | <u>\$24,350</u> | <u>\$24,350</u> |

EXERCISE 3-3 (15–20 minutes)

The ledger accounts are reproduced below, and corrections are shown in the accounts.

| Cash | | | |
|------|-------|-----|-----|
| Bal. | 5,912 | (4) | 190 |
| (1) | 450 | | |

| Accounts Payable | | | |
|------------------|--|------|-------|
| | | Bal. | 7,044 |

| Accounts Receivable | | | |
|---------------------|-------|-----|-----|
| Bal. | 5,240 | (1) | 450 |

| Common Stock | | | |
|--------------|--|------|-------|
| | | Bal. | 8,000 |

| Supplies | | | |
|----------|-------|--|--|
| Bal. | 2,967 | | |

| Retained Earnings | | | |
|-------------------|--|------|-------|
| | | Bal. | 2,000 |

EXERCISE 3-3 (Continued)

| Equipment | |
|-----------|-------|
| Bal. | 6,100 |
| (2) | 3,200 |

| Service Revenue | |
|-----------------|-------|
| Bal. | 5,200 |
| (3) | 2,025 |
| (5) | 80 |

| Office Expense | |
|----------------|-------|
| Bal. | 4,320 |
| (2) | 3,200 |

Blues Traveler Corporation Trial Balance (corrected) April 30, 2014

| | <u>Debit</u> | <u>Credit</u> |
|---------------------------|-----------------|-----------------|
| Cash | \$ 6,172 | |
| Accounts Receivable | 4,790 | |
| Supplies | 2,967 | |
| Equipment..... | 9,300 | |
| Accounts Payable..... | | \$ 7,044 |
| Common Stock | | 8,000 |
| Retained Earnings | | 2,000 |
| Service Revenue..... | | 7,305 |
| Office Expense | 1,120 | |
| | <u>\$24,349</u> | <u>\$24,349</u> |

EXERCISE 3-4 (10–15 minutes)

**Watteau Co.
Trial Balance
June 30, 2014**

| | <u>Debit</u> | <u>Credit</u> |
|------------------------------------------------------------|-----------------|-----------------|
| Cash (\$2,870 + \$180 – \$65 – \$65) | \$ 2,920 | |
| Accounts Receivable (\$3,231 – \$180) | 3,051 | |
| Supplies (\$800 – \$500) | 300 | |
| Equipment (\$3,800 + \$500) | 4,300 | |
| Accounts Payable (\$2,666 – \$206 – \$260) | | \$ 2,200 |
| Unearned Service Revenue (\$1,200 – \$325) | | 875 |
| Common Stock | | 6,000 |
| Dividends | 575 | |
| Retained Earnings | | 3,000 |
| Service Revenue (\$2,380 + \$801 + \$325) | | 3,506 |
| Salaries and Wages Expense (\$3,400 + \$670 – \$575) | 3,495 | |
| Office Expense | 940 | |
| | <u>\$15,581</u> | <u>\$15,581</u> |

EXERCISE 3-5 (10–15 minutes)

| | | |
|------------------------------------------------|-------|-------|
| 1. Depreciation Expense (\$250 X 3) | 750 | |
| Accumulated Depreciation—Equipment | | 750 |
| 2. Unearned Rent Revenue (\$9,300 X 1/3) | 3,100 | |
| Rent Revenue | | 3,100 |
| 3. Interest Expense | 500 | |
| Interest Payable | | 500 |
| 4. Supplies Expense | 1,950 | |
| Supplies (\$2,800 – \$850) | | 1,950 |
| 5. Insurance Expense (\$300 X 3) | 900 | |
| Prepaid Insurance | | 900 |

EXERCISE 3-6 (10–15 minutes)

| | | | |
|----|-------------------------------------------|-------|-------|
| 1. | Accounts Receivable | 750 | |
| | Service Revenue | | 750 |
| 2. | Utilities Expenses..... | 520 | |
| | Accounts Payable | | 520 |
| 3. | Depreciation Expense | 400 | |
| | Accumulated Depreciation – Equipment..... | | 400 |
| | Interest Expense..... | 500 | |
| | Interest Payable..... | | 500 |
| 4. | Insurance Expense (\$12,000 X 1/12) | 1,000 | |
| | Prepaid Insurance | | 1,000 |
| 5. | Supplies Expense (\$1,600 – \$500)..... | 1,100 | |
| | Supplies | | 1,100 |

EXERCISE 3-7 (15–20 minutes)

| | | | |
|-----|-------------------------------|----------------|--------------|
| (a) | Ending balance of supplies | \$700 | |
| | Add: Adjusting entry | 950 | |
| | Deduct: Purchases | <u>850</u> | |
| | Beginning balance of supplies | <u>\$800</u> | |
| (b) | Total prepaid insurance | \$4,800 | (\$400 X 12) |
| | Amount used (6 X \$400) | <u>2,400</u> | |
| | Present balance | <u>\$2,400</u> | |

The policy was purchased six months ago (August 1, 2013)

(c) The entry in January to record salary and wages expense was

| | | |
|----------------------------------|-------|-------|
| Salaries and Wages Expense | 1,800 | |
| Salaries and Wages Payable | 700 | |
| Cash | | 2,500 |

EXERCISE 3-7 (Continued)

The “T” account for salaries payable is

| Salaries and Wages Payable | | | |
|----------------------------|-----|-----------|-----|
| Paid | 700 | Beg. Bal. | ? |
| January | | | |
| | | End Bal. | 800 |

The beginning balance is therefore

| | |
|-------------------------------------------------|----------------|
| Ending balance of salaries and wages payable | \$ 800 |
| Plus: Reduction of salaries and wages payable | <u>700</u> |
| Beginning balance of salaries and wages payable | <u>\$1,500</u> |

| | |
|--------------------------|---------------|
| (d) Service revenue | \$2,000 |
| Cash received | <u>1,600</u> |
| Unearned revenue reduced | <u>\$ 400</u> |

| | |
|----------------------------------------------|----------------|
| Ending unearned revenue January 31, 2014 | \$ 750 |
| Plus: Unearned revenue reduced | <u>400</u> |
| Beginning unearned revenue December 31, 2013 | <u>\$1,150</u> |

EXERCISE 3-8 (10–15 minutes)

| | | | |
|----|----------------------------------------------|-------|-------|
| 1. | Salaries and Wages Expense | 1,900 | |
| | Salaries and Wages Payable | | 1,900 |
| 2. | Utilities Expense..... | 600 | |
| | Accounts Payable | | 600 |
| 3. | Interest Expense (\$30,000 X 8% X 1/12)..... | 200 | |
| | Interest Payable | | 200 |
| 4. | Telephone and Internet Expense | 117 | |
| | Accounts Payable | | 117 |

EXERCISE 3-9 (15–20 minutes)

| | | | | |
|-----|-------|----------------------------------------------------------------------------------------|-------|-------|
| (a) | 10/15 | Salaries and Wages Expense..... | 800 | |
| | | Cash | | 800 |
| | | (To record payment of October 15 payroll) | | |
| | 10/17 | Accounts Receivable..... | 2,400 | |
| | | Service Revenue..... | | 2,400 |
| | | (To record revenue for services performed for which payment has not yet been received) | | |
| | 10/20 | Cash..... | 650 | |
| | | Unearned Service Revenue | | 650 |
| | | (To record receipt of cash for services not yet performed) | | |
| (b) | 10/31 | Supplies Expense | 470 | |
| | | Supplies | | 470 |
| | | (To record the use of supplies during October) | | |
| | 10/31 | Accounts Receivable..... | 1,650 | |
| | | Service Revenue..... | | 1,650 |
| | | (To record revenue for services performed for which payment has not yet been received) | | |
| | 10/31 | Salaries and Wages Expense..... | 600 | |
| | | Salaries and Wages Payable | | 600 |
| | | (To record liability for accrued payroll) | | |
| | 10/31 | Unearned Service Revenue..... | 400 | |
| | | Service Revenue..... | | 400 |
| | | (To reduce the Unearned Service Revenue account for service that has been performed) | | |

EXERCISE 3-10 (25–30 minutes)

| | | | | | |
|-----|----|---------|--------------------------------------------------------------------------------------------------------------------------|-------|-------|
| (a) | 1. | Aug. 31 | Insurance Expense ($\$4,500 \times 3/12$) | 1,125 | |
| | | | Prepaid Insurance..... | | 1,125 |
| | 2. | Aug. 31 | Supplies Expense ($\$2,600 - \450) | 2,150 | |
| | | | Supplies..... | | 2,150 |
| | 3. | Aug. 31 | Depreciation Expense..... | 1,080 | |
| | | | Accumulated Depreciation— Buildings | | 1,080 |
| | | | ($\$120,000 - \$12,000 = \$108,000$; $\$108,000 \times 4\% = \$4,320$ per year; $\$4,320 \times 1/4 = \$1,080$) | | |
| | | Aug. 31 | Depreciation Expense..... | 360 | |
| | | | Accumulated Depreciation— Equipment | | 360 |
| | | | ($\$16,000 - \$1,600 = \$14,400$; $\$14,400 \times 10\% = \$1,440$; $\$1,440 \times 1/4 = \360) | | |
| | 4. | Aug. 31 | Unearned Rent Revenue..... | 3,800 | |
| | | | Rent Revenue..... | | 3,800 |
| | 5. | Aug. 31 | Salaries and Wages Expense..... | 375 | |
| | | | Salaries and Wages Payable..... | | 375 |
| | 6. | Aug. 31 | Accounts Receivable | 800 | |
| | | | Rent Revenue..... | | 800 |
| | 7. | Aug. 31 | Interest Expense | 1,200 | |
| | | | Interest Payable | | 1,200 |
| | | | [($\$60,000 \times 8\%$) $\times 1/4$] | | |

EXERCISE 3-10 (Continued)**(b)**

**Greco Resort
Adjusted Trial Balance
August 31, 2014**

| | <u>Debit</u> | <u>Credit</u> |
|-----------------------------------------------------|------------------|------------------|
| Cash | \$ 19,600 | |
| Accounts Receivable | 800 | |
| Prepaid Insurance (\$4,500 – \$1,125) | 3,375 | |
| Supplies (\$2,600 – \$2,150) | 450 | |
| Land..... | 20,000 | |
| Buildings..... | 120,000 | |
| Accumulated Depreciation—Buildings..... | | \$ 1,080 |
| Equipment..... | 16,000 | |
| Accumulated Depreciation—Equipment..... | | 360 |
| Accounts Payable..... | | 4,500 |
| Unearned Rent Revenue (\$4,600 – \$3,800) | | 800 |
| Salaries and Wages Payable | | 375 |
| Interest Payable | | 1,200 |
| Mortgage Payable..... | | 60,000 |
| Common Stock | | 91,000 |
| Retained Earnings | | 9,000 |
| Dividends | 5,000 | |
| Rent Revenue (\$76,200 + \$3,800 + \$800)..... | | 80,800 |
| Salaries and Wages Expense (\$44,800 + \$375) | 45,175 | |
| Utilities Expenses..... | 9,200 | |
| Maintenance and Repair Expense..... | 3,600 | |
| Insurance Expense..... | 1,125 | |
| Supplies Expense..... | 2,150 | |
| Depreciation Expense—Buildings | 1,080 | |
| Depreciation Expense—Equipment | 360 | |
| Interest Expense..... | 1,200 | |
| | <u>\$249,115</u> | <u>\$249,115</u> |

EXERCISE 3-11 (20–25 minutes)

(a) **ANDERSON COOPER CO.**
Income Statement
For the Year Ended December 31, 2014

| | | |
|---------------------------------|----------------|------------------------|
| Revenues | | |
| Service revenue | | \$11,590 |
| Expenses | | |
| Salaries and wages expense..... | \$6,840 | |
| Rent expense | 2,260 | |
| Depreciation expense..... | 145 | |
| Interest expense | 83 | 9,328 |
| Net Income..... | | <u>\$ 2,262</u> |

(b) **ANDERSON COOPER CO.**
Statement of Retained Earnings
For the Year Ended December 31, 2014

| | |
|--------------------------------------|------------------------|
| Retained earnings, January 1 | \$11,310 |
| Add: Net income..... | <u>2,262</u> |
| | 13,572 |
| Less: Dividends..... | <u>3,000</u> |
| Retained earnings, December 31 | <u>\$10,572</u> |

(c) **ANDERSON COOPER CO.**
Balance Sheet
December 31, 2014

| | | |
|--------------------------------------------|-----------------------|------------------------|
| <u>Assets</u> | | |
| Current Assets | | |
| Cash | | \$19,472 |
| Accounts receivable | | 6,920 |
| Prepaid rent | | <u>2,280</u> |
| Total current assets..... | | 28,672 |
| Property, plant, and equipment | | |
| Equipment..... | \$18,050 | |
| Accumulated depreciation – equipment | <u>(4,895)</u> | 13,155 |
| Total assets | | <u>\$41,827</u> |

EXERCISE 3-11 (Continued)

Liabilities and Stockholders' Equity

| | | |
|--------------------------------------------------|----------------|-----------------|
| Current liabilities | | |
| Accounts payable | | \$ 5,472 |
| Interest payable | | 83 |
| Notes payable | | <u>5,700</u> |
| Total current liabilities | | 11,255 |
| Stockholders' equity | | |
| Common stock | \$20,000 | |
| Retained earnings | <u>10,572*</u> | <u>30,572</u> |
| Total liabilities and stockholders' equity | | <u>\$41,827</u> |

*Beg. Balance + Net Income – Dividends = Ending Balance
\$11,310 + \$2,262 – \$3,000 = \$10,572

EXERCISE 3-12 (20–25 Minutes)

(a) **SANTO DESIGN AGENCY**
Income Statement
For the Year Ended December 31, 2014

| | | |
|----------------------------------|------------|-----------------|
| Revenues | | |
| Service revenue | | \$61,500 |
| Expenses | | |
| Salaries and wages expense | \$11,300 | |
| Depreciation expense | 7,000 | |
| Rent expense | 4,000 | |
| Supplies expense | 3,400 | |
| Insurance expense | 850 | |
| Interest expense | <u>500</u> | |
| Total expenses | | <u>27,050</u> |
| Net income | | <u>\$34,450</u> |

SANTO DESIGN AGENCY
Statement of Retained Earnings
For the Year Ended December 31, 2014

| | |
|--------------------------------------|-----------------|
| Retained earnings, January 1 | \$ 3,500 |
| Add: Net income | <u>34,450</u> |
| Retained earnings, December 31 | <u>\$37,950</u> |

EXERCISE 3-12 (Continued)

(a) Continued

SANTO DESIGN AGENCY Balance Sheet December 31, 2014

| Assets | | |
|--------------------------------------------------|---------------|-----------------|
| Cash | | \$11,000 |
| Accounts receivable | | 21,500 |
| Supplies | | 5,000 |
| Prepaid insurance | | 2,500 |
| Equipment..... | \$60,000 | |
| Less: Accumulated depreciation – equipment | <u>35,000</u> | <u>25,000</u> |
| Total assets..... | | <u>\$65,000</u> |

| Liabilities and Stockholders' Equity | | |
|--------------------------------------------------|---------------|-----------------|
| Liabilities | | |
| Notes payable | \$ 5,000 | |
| Accounts payable..... | 5,000 | |
| Interest payable | 150 | |
| Unearned service revenue | 5,600 | |
| Salaries and wages payable | <u>1,300</u> | |
| Total liabilities..... | | \$17,050 |
| Stockholders' equity | | |
| Common stock | \$10,000 | |
| Retained earnings | <u>37,950</u> | <u>47,950</u> |
| Total liabilities and stockholders' equity | | <u>\$65,000</u> |

- (b) (1) Based on interest payable at December 31, 2014, interest is \$25 per month or 0.5% of the note payable. $0.5\% \times 12 = 6\%$ interest per year.
- (2) Salaries and Wages Expense, \$11,300 less Salaries and Wages Payable 12/31/14, \$1,300 = \$10,000. Total payments, \$17,500 – \$10,000 = \$7,500 Salaries and Wages Payable 12/31/13.

EXERCISE 3-13 (10–15 minutes)

| | | | |
|-----|------------------------------------------|---------------|------------------|
| (a) | Sales revenue | | \$800,000 |
| | Less: Sales returns and allowances | \$24,000 | |
| | Sales discounts | <u>15,000</u> | <u>39,000</u> |
| | Net sales | | <u>\$761,000</u> |
| (b) | Sales | 800,000 | |
| | Income Summary | | 800,000 |
| | Income Summary | 39,000 | |
| | Sales Returns and Allowances | | 24,000 |
| | Sales Discounts | | 15,000 |

EXERCISE 3-14 (10–15 minutes)

| | | |
|------------------------------------|---------|---------|
| Sales Revenue | 350,000 | |
| Sales Returns and Allowances | | 13,000 |
| Sales Discounts | | 8,000 |
| Income Summary | | 329,000 |
| Income Summary | 308,000 | |
| Cost of Goods Sold | | 208,000 |
| Delivery Expense | | 7,000 |
| Insurance Expense | | 12,000 |
| Rent Expense | | 20,000 |
| Salaries and Wages Expense | | 61,000 |
| Income Summary | 21,000 | |
| Retained Earnings | | 21,000 |

EXERCISE 3-15 (10–15 minutes)

- | | |
|--------------|---------------|
| (a) \$9,000 | (d) \$100,000 |
| (b) \$25,000 | (e) \$57,000 |
| (c) \$10,000 | |

EXERCISE 3-16 (10–15 minutes)

| | | |
|------------------------------------|---------|---------|
| Sales Revenue | 410,000 | |
| Cost of Goods Sold..... | | 225,700 |
| Sales Returns and Allowances | | 12,000 |
| Sales Discounts | | 15,000 |
| Selling Expenses | | 16,000 |
| Administrative Expenses | | 38,000 |
| Income Tax Expense..... | | 30,000 |
| Income Summary | | 73,300 |

(or)

| | | |
|------------------------------------|---------|---------|
| Sales Revenue | 410,000 | |
| Income Summary | | 410,000 |
| Income Summary | 336,700 | |
| Cost of Goods Sold..... | | 225,700 |
| Sales Returns and Allowances | | 12,000 |
| Sales Discounts | | 15,000 |
| Selling Expenses | | 16,000 |
| Administrative Expenses | | 38,000 |
| Income Tax Expense..... | | 30,000 |
| Income Summary | 73,300 | |
| Retained Earnings..... | | 73,300 |
| Retained Earnings..... | 18,000 | |
| Dividends..... | | 18,000 |

EXERCISE 3-17 (10–15 minutes)**J1**

| Date | Account Titles and Explanation | Ref. | Debit | Credit |
|---------------|-------------------------------------------------------------------------------------------------------------------|-------------|------------------------------------------------|---------------|
| Mar. 1 | Cash Common Stock (Investment of cash in business) | | 50,000 | 50,000 |
| 3 | Land Buildings Equipment Cash (Purchased Michelle Wie's Golf Land) | | 10,000 22,000 6,000 | 38,000 |
| 5 | Advertising Expense Cash (Paid for advertising) | | 1,600 | 1,600 |
| 6 | Prepaid Insurance Cash (Paid for one-year insurance policy) | | 1,480 | 1,480 |
| 10 | Equipment Accounts Payable (Purchased equipment on account) | | 2,500 | 2,500 |
| 18 | Cash Service Revenue (Received cash for services performed) | | 1,200 | 1,200 |
| 25 | Dividends Cash (Declared and paid a \$500 cash dividend) | | 500 | 500 |
| 30 | Salaries and Wages Expense Cash (Paid wages expense) | | 900 | 900 |
| 30 | Accounts Payable Cash (Paid creditor on account) | | 2,500 | 2,500 |
| 31 | Cash Service Revenue (Received cash for services performed) | | 750 | 750 |

***EXERCISE 3-18 (15–20 minutes)**

**Jill Accardo, M.D.
Conversion of Cash Basis to Accrual Basis
For the Year 2014**

| | |
|---------------------------------------------------------------------|------------------------|
| Excess of cash collected over cash disbursed (\$142,600 – \$55,470) | \$87,130 |
| Add increase in accounts receivable (\$9,250 – \$15, 927) | 6,677 |
| Deduct increase in unearned service revenue (\$2,840 – \$4,111) | (1,271) |
| Add decrease in accrued liabilities (\$3,435 – \$2,108) | 1,327 |
| Add increase in prepaid expenses (\$1,917 – \$3,232) | <u>1,315</u> |
| Net income on an accrual basis | <u><u>\$95,178</u></u> |

Alternate solution:

**Jill Accardo, M.D.
Conversion of Income Statement Data
from Cash Basis to Accrual Basis
For the Year 2014**

| | <u>Cash</u> <u>Basis</u> | <u>Adjustments</u> <u>Add</u> <u>Deduct</u> | <u>Accrual</u> <u>Basis</u> |
|------------------------------------|-----------------------------|------------------------------------------------|--------------------------------|
| Collections from customers: | \$142,600 | | |
| –Accounts receivable, Jan. 1 | | | \$9,250 |
| +Accounts receivable, Dec. 31 | | \$15,927 | |
| +Unearned service revenue, Jan. 1 | | 2,840 | |
| –Unearned service revenue, Dec. 31 | | | 4,111 |
| Service revenue | | | \$148,006 |
| Disbursements for expenses: | 55,470 | | |
| –Accrued liabilities, Jan. 1 | | | 3,435 |
| +Accrued liabilities, Dec. 31 | | 2,108 | |
| +Prepaid expenses, Jan. 1 | | 1,917 | |
| –Prepaid expenses, Dec. 31 | | | 3,232 |
| Operating expenses | | | <u>52,828</u> |
| Net income—cash basis | <u>\$ 87,130</u> | | <u>\$ 95,178</u> |
| Net income—accrual basis | | | |

***EXERCISE 3-19 (10–15 minutes)**

**(a) Wayne Rogers Corp.
Income Statement (Cash Basis)
For the Year Ended December 31,**

| | <u>2013</u> | <u>2014</u> |
|---------------|------------------|------------------|
| Sales revenue | \$295,000 | \$515,000 |
| Expenses | <u>225,000</u> | <u>272,000</u> |
| Net income | <u>\$ 70,000</u> | <u>\$243,000</u> |

**(b) Wayne Rogers Corp.
Income Statement (Accrual Basis)
For the Year Ended December 31,**

| | <u>2013</u> | <u>2014</u> |
|----------------|------------------|------------------|
| Sales* revenue | \$485,000 | \$445,000 |
| Expenses** | <u>277,000</u> | <u>255,000</u> |
| Net income | <u>\$208,000</u> | <u>\$190,000</u> |

*2013: \$295,000 + \$160,000 + \$30,000 = \$485,000

2014: \$355,000 + \$90,000 = \$445,000

**2013: \$185,000 + \$67,000 + \$25,000 = \$277,000

2014: \$40,000 + \$160,000 + \$55,000 = \$255,000

***EXERCISE 3-20 (20–25 minutes)**

(a) Adjusting Entries:

| | | | |
|----|------------------------------------------|-------|-------|
| 1. | Insurance Expense (\$5,280 X 5/24) | 1,100 | |
| | Prepaid Insurance | | 1,100 |
| 2. | Rent Revenue (\$1,800 X 1/3) | 600 | |
| | Unearned Rent Revenue | | 600 |
| 3. | Supplies | 290 | |
| | Advertising Expense | | 290 |
| 4. | Interest Expense | 770 | |
| | Interest Payable | | 770 |

***EXERCISE 3-20 (Continued)**

(b) Reversing Entries:

1. No reversing entry required.

| | | | |
|----|----------------------------|-----|-----|
| 2. | Unearned Rent Revenue..... | 600 | |
| | Rental Revenue..... | | 600 |
| 3. | Advertising Expense..... | 290 | |
| | Supplies..... | | 290 |
| 4. | Interest Payable..... | 770 | |
| | Interest Expense | | 770 |

***EXERCISE 3-21 (10–15 minutes)**

| <u>Accounts</u> | <u>Adjusted Trial Balance</u> | | <u>Income Statement</u> | | <u>Balance Sheet</u> | |
|------------------------------|-------------------------------|------------|-------------------------|------------|----------------------|------------|
| | <u>Dr.</u> | <u>Cr.</u> | <u>Dr.</u> | <u>Cr.</u> | <u>Dr.</u> | <u>Cr.</u> |
| Cash | 9,000 | | | | 9,000 | |
| Inventory | 80,000 | | | | 80,000 | |
| Sales Revenue | | 450,000 | | 450,000 | | |
| Sales Returns and Allowances | 10,000 | | 10,000 | | | |
| Sales Discounts | 5,000 | | 5,000 | | | |
| Cost of Goods Sold | 250,000 | | 250,000 | | | |

***EXERCISE 3-22 (20–25 minutes)**

**Ed Bradley Co.
Worksheet (partial)
For the Month Ended April 30, 2014**

| Account Titles | Adjusted Trial Balance | | Income Statement | | Balance Sheet | |
|------------------------------------|-------------------------------|---------------|-------------------------|---------------|----------------------|---------------|
| | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. |
| Cash | 18,972 | | | | 18,972 | |
| Accounts Receivable | 6,920 | | | | 6,920 | |
| Prepaid Rent | 2,280 | | | | 2,280 | |
| Equipment | 18,050 | | | | 18,050 | |
| Accum. Depreciation – Equipment | | 4,895 | | | | 4,895 |
| Notes Payable | | 5,700 | | | | 5,700 |
| Accounts Payable | | 4,472 | | | | 4,472 |
| Common Stock | | 34,960 | | | | 34,960 |
| Retained Earnings | | 1,000 | | | | 1,000 |
| Dividends | 6,650 | | | | 6,650 | |
| Service Revenue | | 12,590 | | 12,590 | | |
| Salaries and Wages Expense | 6,840 | | 6,840 | | | |
| Rent Expense | 3,760 | | 3,760 | | | |
| Depreciation Expense | 145 | | 145 | | | |
| Interest Expense | 83 | | 83 | | | |
| Interest Payable | | 83 | | | | 83 |
| Totals | <u>63,700</u> | <u>63,700</u> | <u>10,828</u> | <u>12,590</u> | <u>52,872</u> | <u>50,110</u> |
| Net income | | | <u>1,762</u> | | | <u>1,762</u> |
| Totals | | | <u>12,590</u> | <u>12,590</u> | <u>52,872</u> | <u>52,872</u> |

EXERCISE 3-22 (Continued)**Ed Bradley Co.
Balance Sheet
April 30, 2014****Assets**

| | | |
|-----------------------------------------------|----------------|-----------------|
| Current Assets | | |
| Cash..... | | \$18,972 |
| Accounts receivable | | 6,920 |
| Prepaid rent..... | | <u>2,280</u> |
| Total current assets..... | | 28,172 |
| Property, plant, and equipment | | |
| Equipment | \$18,050 | |
| Accumulated depreciation – equipment | <u>(4,895)</u> | <u>13,155</u> |
| Total assets | | <u>\$41,327</u> |

Liabilities and Stockholders' Equity

| | | |
|-------------------------------------------------|----------------|-----------------|
| Current liabilities | | |
| Notes payable | | \$ 5,700 |
| Accounts payable | | 4,472 |
| Interest payable | | <u>83</u> |
| Total current liabilities | | 10,255 |
| Stockholders' equity | | |
| Common Stock | 34,960 | |
| Retained earnings..... | <u>(3,888)</u> | <u>31,072*</u> |
| Total liabilities and Stockholders' equity..... | | <u>\$41,327</u> |

***Beg. Balance – Dividends + Net Income = Ending Balance**

\$1,000 – \$6,650 + \$1,762 = (\$3,888)

***EXERCISE 3-23 (10–15 minutes)**

**Jurassic Park Co.
Worksheet (partial)
For Month Ended February 28, 2014**

| Account Titles | Trial Balance | | Adjustments | | Adjusted Trial Balance | | Income Statement | | Balance Sheet | |
|--------------------------------------|---------------|-------|-------------|-----------|------------------------|-------|------------------|-----|---------------|-------|
| | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. |
| Supplies | 1,756 | | | (a) 1,041 | 715 | | | | 715 | |
| Accumulated depreciation – equipment | | 6,939 | | (b) 257 | | 7,196 | | | | 7,196 |
| Interest payable | | 150 | | (c) 50 | | 200 | | | | 200 |
| Supplies expense | | | (a) 1,041 | | 1,041 | | 1,041 | | | |
| Depreciation expense | | | (b) 257 | | 257 | | 257 | | | |
| Interest expense | | | (c) 50 | | 50 | | 50 | | | |

The following accounts and amounts would be shown in the February income statement:

| | |
|----------------------|---------|
| Supplies expense | \$1,041 |
| Depreciation expense | 257 |
| Interest expense | 50 |

TIME AND PURPOSE OF PROBLEMS

Problem 3-1 (Time 25–35 minutes)

Purpose—to provide an opportunity for the student to post daily transactions to a “T” account ledger, take a trial balance, prepare an income statement, a balance sheet and a statement of owners’ equity, close the ledger, and take a post-closing trial balance. The problem deals with routine transactions of a professional service firm and provides a good integration of the accounting process.

Problem 3-2 (Time 35–40 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting entries, and prepare financial statements (income statement, balance sheet, and statement of retained earnings). The student also is asked to analyze two transactions to find missing amounts.

Problem 3-3 (Time 25–30 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting entries. The adjusting entries are fairly complex in nature.

Problem 3-4 (Time 40–50 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting entries and an adjusted trial balance and then prepare an income statement, a retained earnings statement, and a balance sheet. In addition, closing entries must be made and a post-closing trial balance prepared.

Problem 3-5 (Time 15–20 minutes)

Purpose—to provide the student with an opportunity to determine what adjusting entries need to be made to specific accounts listed in a partial trial balance. The student is also required to determine the amounts of certain revenue and expense items to be reported in the income statement.

Problem 3-6 (Time 25–35 minutes)

Purpose—to provide the student with an opportunity to prepare year-end adjusting entries from a trial balance and related information presented. The problem also requires the student to prepare an income statement, a balance sheet, and a statement of owners’ equity. The problem covers the basics of the end-of-period adjusting process.

Problem 3-7 (Time 25–35 minutes)

Purpose—to provide an opportunity for the student to figure out the year-end adjusting entries that were made from a trial balance and an adjusted trial balance. The student is also required to prepare an income statement, a statement of retained earnings, and a balance sheet. In addition, the student needs to answer a number of questions related to specific accounts.

Problem 3-8 (Time 25–35 minutes)

Purpose—to provide an opportunity for the student to figure out the year-end adjusting entries that were made from a trial balance and an adjusted trial balance. The student is also required to prepare an income statement, a statement of retained earnings, and a balance sheet. In addition, the student needs to answer a number of questions related to specific accounts.

Problem 3-9 (Time 30–40 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting, and closing entries. This problem presents basic adjustments including a number of accruals and deferrals. It provides the student with an integrated flow of the year-end accounting process.

Problem 3-10 (Time 30–35 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting and closing entries from a trial balance and related information. The student is also required to post the entries to “T” accounts.

Time and Purpose of Problems (Continued)

***Problem 3-11** (Time 35–40 minutes)

Purpose—to provide an opportunity for the student to prepare and compare (a) cash basis and accrual-basis income statements, (b) cash-basis and accrual-basis balance sheets, and (c) to discuss the weaknesses of cash basis accounting.

***Problem 3-12** (Time 40–50 minutes)

Purpose—to provide an opportunity for the student to complete a worksheet and then prepare a classified balance sheet. In addition, adjusting and closing entries must be made and a post-closing trial balance prepared.

SOLUTIONS TO PROBLEMS

PROBLEM 3-1

(a) (Explanations are omitted.) and (d)

| Cash | | | | Equipment | | | |
|---------|--------|---------|-------|-----------|--------|--|--|
| Sept. 1 | 20,000 | Sept. 4 | 680 | Sept. 2 | 17,280 | | |
| 8 | 1,690 | 5 | 942 | | | | |
| 20 | 980 | 10 | 430 | | | | |
| | | 18 | 3,600 | | | | |
| | | 19 | 3,000 | | | | |
| | | 30 | 1,800 | | | | |
| | | 30 | 85 | | | | |
| 30 Bal | 12,133 | | | | | | |

| Accounts Receivable | | | | Owner's Capital | | | |
|---------------------|-------|----------|-----|-----------------|-------|---------|--------|
| Sept. 14 | 5,820 | Sept. 20 | 980 | Sept. 19 | 3,000 | Sept. 1 | 20,000 |
| 25 | 2,110 | | | | | 30 | 6,007 |
| Bal. 30 | 6,950 | | | | | Bal. 30 | 23,007 |

| Accounts Payable | | | | Service Revenue | | | |
|------------------|-------|---------|--------|-----------------|--------------|---------|--------------|
| Sept. 18 | 3,600 | Sept. 2 | 17,280 | Sept. 30 | 9,620 | Sept. 8 | 1,690 |
| | | Bal. 30 | 13,680 | | | 14 | 5,820 |
| | | | | | | 25 | <u>2,110</u> |
| | | | | | <u>9,620</u> | | <u>9,620</u> |

| Rent Expense | | | | Accumulated Depreciation—Equipment | | | |
|--------------|------------|----------|------------|------------------------------------|--|----------|-----|
| Sept. 4 | <u>680</u> | Sept. 30 | <u>680</u> | | | Sept. 30 | 288 |

| Supplies | | | | Salaries and Wages Expense | | | |
|----------|-----|----------|-----|----------------------------|--------------|----------|--------------|
| Sept. 5 | 942 | Sept. 30 | 330 | Sept. 30 | <u>1,800</u> | Sept. 30 | <u>1,800</u> |
| Bal. 30 | 612 | | | | | | |

| Office Expense | | | | Supplies Expense | | | |
|----------------|------------|----------|------------|------------------|------------|----------|------------|
| Sept. 10 | 430 | Sept. 30 | 515 | Sept. 30 | <u>330</u> | Sept. 30 | <u>330</u> |
| 30 | <u>85</u> | | | | | | |
| | <u>515</u> | | <u>515</u> | | | | |

PROBLEM 3-1 (Continued)

| Depreciation Expense | | | | Income Summary | | | | |
|----------------------|----|------------|-------|----------------|--------------|-------|----|--------------|
| Sept. | 30 | <u>288</u> | Sept. | 30 | <u>288</u> | Sept. | 30 | 9,620 |
| | | | | 30 | 680 | | | |
| | | | | 30 | 515 | | | |
| | | | | 30 | 1,800 | | | |
| | | | | 30 | 330 | | | |
| | | | | 30 | 288 | | | |
| | | | | 30 Inc. | <u>6,007</u> | | | |
| | | | | | <u>9,620</u> | | | <u>9,620</u> |

(b) **YASUNARI KAWABATA, D.D.S.**
Trial Balance
September 30

| | <u>Debit</u> | <u>Credit</u> |
|------------------------------------------|-----------------|-----------------|
| Cash | \$12,133 | |
| Accounts Receivable | 6,950 | |
| Supplies | 612 | |
| Equipment | 17,280 | |
| Accumulated Depreciation—Equipment | | \$ 288 |
| Accounts Payable | | 13,680 |
| Owner's Capital | | 17,000 |
| Service Revenue | | 9,620 |
| Rent Expense | 680 | |
| Office Expense | 515 | |
| Salaries and Wages Expense | 1,800 | |
| Supplies Expense | 330 | |
| Depreciation Expense | 288 | |
| Totals | <u>\$40,588</u> | <u>\$40,588</u> |

PROBLEM 3-1 (Continued)

(c)

**YASUNARI KAWABATA, D.D.S.
Income Statement
For the Month of September**

| | | |
|---------------------------------|----------------|-----------------------|
| Service revenue | | \$9,620 |
| Expenses: | | |
| Salaries and wages expense..... | \$1,800 | |
| Rent expense | 680 | |
| Supplies expense | 330 | |
| Depreciation expense..... | 288 | |
| Office expense | 515 | |
| Total expenses..... | | <u>3,613</u> |
| Net income | | <u>\$6,007</u> |

**YASUNARI KAWABATA, D.D.S.
Statement of Owners' Equity
For the Month of September**

| | |
|------------------------------------|------------------------|
| Owner's capital September 1 | \$20,000 |
| Add: Net income | <u>6,007</u> |
| | 26,007 |
| Less: Withdrawal by owner | <u>3,000</u> |
| Owner's capital September 30 | <u>\$23,007</u> |

**YASUNARI KAWABATA, D.D.S.
Balance Sheet
As of September 30**

| Assets | | Liabilities and Owners' Equity | |
|----------------------------------------|------------------------|----------------------------------------------|------------------------|
| Cash | \$12,133 | Accounts payable..... | \$13,680 |
| Accounts receivable | 6,950 | Owner's capital..... | 23,007 |
| Supplies | 612 | | |
| Equipment. | 17,280 | | |
| Accum. depreciation— equipment..... | (288) | Total liabilities and owners' equity..... | <u>\$36,687</u> |
| Total assets | <u>\$36,687</u> | | |

PROBLEM 3-1 (Continued)

**(d) YASUNARI KAWABATA, D.D.S.
Post-Closing Trial Balance
September 30**

| | <u>Debit</u> | <u>Credit</u> |
|----------------------------------------|-----------------|-----------------|
| Cash | \$12,133 | |
| Accounts Receivable | 6,950 | |
| Supplies | 612 | |
| Equipment..... | 17,280 | |
| Accumulated Depreciation—Equipment ... | | \$ 288 |
| Accounts Payable | | 13,680 |
| Owner's Capital | | 23,007 |
| Totals | <u>\$36,975</u> | <u>\$36,975</u> |

| |
|--------------------|
| PROBLEM 3-2 |
|--------------------|

| | | | | |
|-----|---------|----------------------------------------------|-------|-------|
| (a) | Dec. 31 | Accounts Receivable | 3,500 | |
| | | Service Revenue | | 3,500 |
| | 31 | Unearned Service Revenue | 1,400 | |
| | | Service Revenue | | 1,400 |
| | 31 | Supplies Expense | 5,400 | |
| | | Supplies..... | | 5,400 |
| | 31 | Depreciation Expense..... | 5,000 | |
| | | Accumulated Depreciation— Equipment | | 5,000 |
| | 31 | Interest Expense | 150 | |
| | | Interest Payable | | 150 |
| | 31 | Insurance Expense | 850 | |
| | | Prepaid Insurance..... | | 850 |
| | 31 | Salaries and Wages Expense | 1,300 | |
| | | Salaries and Wages Payable | | 1,300 |

(b) **MASON ADVERTISING AGENCY**
Income Statement
For the Year Ended December 31, 2014

| | | | |
|-----------------|----------------------------------|-----------------|------------------------|
| Revenues | | | |
| | Service revenue | | \$63,500 |
| Expenses | | | |
| | Salaries and wages expense | \$11,300 | |
| | Supplies expense | 5,400 | |
| | Depreciation expense | 5,000 | |
| | Rent expense | 4,000 | |
| | Insurance expense | 850 | |
| | Interest expense | 500 | |
| | Total expenses..... | | <u>27,050</u> |
| | Net income | | <u>\$36,450</u> |

PROBLEM 3-2 (Continued)

MASON ADVERTISING AGENCY
Statement of Retained Earnings
For the Year Ended December 31, 2014

| | |
|--------------------------------------|------------------------|
| Retained earnings, January 1 | \$ 3,500 |
| Add: Net income..... | <u>36,450</u> |
| Retained earnings, December 31 | <u><u>\$39,950</u></u> |

MASON ADVERTISING AGENCY
Balance Sheet
December 31, 2014

| <u>Assets</u> | |
|------------------------------------------------|-----------------------------|
| Cash..... | \$11,000 |
| Accounts receivable | 23,500 |
| Supplies..... | 3,000 |
| Prepaid insurance..... | 2,500 |
| Equipment | \$60,000 |
| Less: Accumulated depreciation—equipment | <u>33,000</u> <u>27,000</u> |
| Total assets | <u><u>\$67,000</u></u> |

Liabilities and Stockholders' Equity

Liabilities

| | |
|---------------------------------|------------|
| Notes payable..... | \$ 5,000 |
| Accounts payable | 5,000 |
| Unearned service revenue | 5,600 |
| Salaries and wages payable..... | 1,300 |
| Interest payable..... | <u>150</u> |
| Total liabilities | \$17,050 |

Stockholders' equity

| | |
|--------------------------------------------------|-----------------------------|
| Common stock..... | \$10,000 |
| Retained earnings..... | <u>39,950</u> <u>49,950</u> |
| Total liabilities and stockholders' equity | <u><u>\$67,000</u></u> |

- (c) 1. Interest is \$50 per month or 1% of the note payable. $1\% \times 12 = 12\%$ interest per year.
2. Salaries and Wages Expense, \$11,300 less Salaries and Wages Payable 12/31/14, \$1,300 = \$10,000. Total Payments, \$12,500 – \$10,000 = \$2,500 Salaries and Wages Payable 12/31/13.

PROBLEM 3-3

| | | | | |
|----|---------|------------------------------------------|--------|--------|
| 1. | Dec. 31 | Salaries and Wages Expense | 2,120 | |
| | | Salaries and Wages Payable | | 2,120 |
| | | (5 X \$700 X 2/5) = \$1,400 | | |
| | | (3 X \$600 X 2/5) = <u>720</u> | | |
| | | Total accrued salaries <u>\$2,120</u> | | |
| | | | | |
| 2. | 31 | Unearned Rent Revenue | 94,000 | |
| | | Rent Revenue | | 94,000 |
| | | (5 X \$6,000 X 2) = \$60,000 | | |
| | | (4 X \$8,500 X 1) = <u>34,000</u> | | |
| | | Total rent recognized <u>\$94,000</u> | | |
| | | | | |
| 3. | 31 | Advertising Expense | 4,900 | |
| | | Prepaid Advertising | | 4,900 |
| | | (A650 – \$500 per month | | |
| | | for 8 months) = \$4,000 | | |
| | | (B974 – \$300 per month | | |
| | | for 3 months) = <u>900</u> | | |
| | | Total advertising expense <u>\$4,900</u> | | |
| | | | | |
| 4. | 31 | Interest Expense | 4,200 | |
| | | Interest Payable | | |
| | | (\$60,000 X 12% X 7/12) | | 4,200 |

| |
|--------------------|
| PROBLEM 3-4 |
|--------------------|

| | | | | |
|-----|---------|----------------------------------------------|--------|--------|
| (a) | Nov. 30 | Supplies Expense..... | 4,000 | |
| | | Supplies | | 4,000 |
| | | | | |
| | 30 | Depreciation Expense | 15,000 | |
| | | Accumulated Depreciation— Equipment | | 15,000 |
| | 30 | Interest Expense..... | 11,000 | |
| | | Interest Payable | | 11,000 |

PROBLEM 3-4 (Continued)

(b)

BELLEMY FASHION CENTER
Adjusted Trial Balance
November 30, 2014

| | Dr. | Cr. |
|---------------------------------------|--------------------|--------------------|
| Cash..... | \$ 28,700 | |
| Accounts Receivable..... | 33,700 | |
| Inventory | 45,000 | |
| Supplies | 1,500 | |
| Equipment..... | 133,000 | |
| Accumulated Depr.— Equipment | | \$ 39,000 |
| Notes Payable | | 51,000 |
| Accounts Payable..... | | 48,500 |
| Common Stock | | 90,000 |
| Retained Earnings | | 8,000 |
| Sales Revenue | | 757,200 |
| Sales Returns and Allowances | 4,200 | |
| Cost of Goods Sold | 495,400 | |
| Salaries and Wages Expense | 140,000 | |
| Advertising Expense | 26,400 | |
| Utilities Expenses..... | 14,000 | |
| Maintenance and Repairs Expense | 12,100 | |
| Delivery Expense | 16,700 | |
| Rent Expense..... | 24,000 | |
| Supplies Expense..... | 4,000 | |
| Depreciation Expense | 15,000 | |
| Interest Expense..... | 11,000 | |
| Interest Payable | | 11,000 |
| Totals..... | <u>\$1,004,700</u> | <u>\$1,004,700</u> |

PROBLEM 3-4 (Continued)

(c) BELLEMY FASHION CENTER
Income Statement
For the Year Ended November 30, 2014

| | |
|-------------------------------------|---------------------------------|
| Sales revenue | |
| Sales | \$757,200 |
| Less: Sales returns and | |
| allowances | <u>4,200</u> |
| Net sales | <u>753,000</u> |
| Cost of goods sold | <u>495,400</u> |
| Gross profit | <u>257,600</u> |
| Operating expenses | |
| Selling expenses | |
| Salaries and wages expense | |
| (\$140,000 X 70%) | \$98,000 |
| Advertising expense | 26,400 |
| Rent expense | |
| (\$24,000 X 80%) | 19,200 |
| Delivery expense | 16,700 |
| Utilities expenses | |
| (\$14,000 X 80%) | 11,200 |
| Depreciation Expense | 15,000 |
| Supplies expense | <u>4,000</u> |
| Total selling expenses | \$190,500 |
| Administrative expenses | |
| Salaries and wages expense | |
| (\$140,000 X 30%) | 42,000 |
| Maintenance and Repairs | |
| Expense | 12,100 |
| Rent expense | |
| (\$24,000 X 20%) | 4,800 |
| Utilities expenses | |
| (\$14,000 X 20%) | <u>2,800</u> |
| Total admin. expenses | <u>61,700</u> |
| Total oper. expenses | <u>252,200</u> |
| Income from operations | <u>5,400</u> |
| Other expenses and losses | |
| Interest expense | <u>11,000</u> |
| Net loss | <u><u>(\$ 5,600)</u></u> |

PROBLEM 3-4 (Continued)

BELLEMY FASHION CENTER
Retained Earnings Statement
For the Year Ended November 30, 2014

| | |
|--------------------------------------------|-----------------------|
| Retained earnings, December 1, 2013 | \$8,000 |
| Less: Net loss | <u>5,600</u> |
| Retained earnings, November 30, 2014 | <u><u>\$2,400</u></u> |

BELLEMY FASHION CENTER
Balance Sheet
November 30, 2014

| Assets | | | |
|--------------------------------------------------|---------------|---------------|-------------------------|
| Current assets | | | |
| Cash | \$28,700 | | |
| Accounts receivable | 33,700 | | |
| Inventory | 45,000 | | |
| Supplies | <u>1,500</u> | | |
| Total current assets | | | \$108,900 |
| Property, plant, and equipment | | | |
| Equipment | 133,000 | | |
| Accumulated depreciation— | | | |
| equipment | <u>39,000</u> | <u>94,000</u> | |
| Total assets | | | <u><u>\$202,900</u></u> |
| Liabilities and Stockholders' Equity | | | |
| Current liabilities | | | |
| Notes payable due next year | \$30,000 | | |
| Accounts payable | 48,500 | | |
| Interest payable | <u>11,000</u> | | |
| Total current liabilities | | | \$ 89,500 |
| Long-term liabilities | | | |
| Notes payable | | <u>21,000</u> | |
| Total liabilities | | | 110,500 |
| Stockholders' equity | | | |
| Common stock | 90,000 | | |
| Retained earnings | <u>2,400</u> | <u>92,400</u> | |
| Total liabilities and stockholders' equity | | | <u><u>\$202,900</u></u> |

PROBLEM 3-4 (Continued)

| | | | | |
|-----|---------|--------------------------------------|---------|---------|
| (d) | Nov. 30 | Sales Revenue | 757,200 | |
| | | Income Summary | | 757,200 |
| | 30 | Income Summary | 762,800 | |
| | | Sales Returns and Allowances | | 4,200 |
| | | Cost of Goods Sold..... | | 495,400 |
| | | Salaries and Wages Expense | | 140,000 |
| | | Advertising Expense..... | | 26,400 |
| | | Utilities Expense | | 14,000 |
| | | Maintenance and Repair Expense | | 12,100 |
| | | Delivery Expense | | 16,700 |
| | | Rent Expense | | 24,000 |
| | | Supplies Expense | | 4,000 |
| | | Depreciation Expense..... | | 15,000 |
| | | Interest Expense | | 11,000 |
| | 30 | Retained Earnings..... | 5,600 | |
| | | Income Summary | | 5,600 |

(e) **BELLEMY FASHION CENTER**
Post-Closing Trial Balance
November 30, 2014

| | <u>Debit</u> | <u>Credit</u> |
|-----------------------------------------|------------------|------------------|
| Cash | \$ 28,700 | |
| Accounts Receivable | 33,700 | |
| Inventory | 45,000 | |
| Supplies | 1,500 | |
| Equipment..... | 133,000 | |
| Accumulated Depreciation—Equipment..... | | \$ 39,000 |
| Notes Payable | | 51,000 |
| Accounts Payable..... | | 48,500 |
| Interest Payable | | 11,000 |
| Common Stock | | 90,000 |
| Retained Earnings | | 2,400 |
| | <u>\$241,900</u> | <u>\$241,900</u> |

PROBLEM 3-5

| | | |
|------------------------------------|--------|--------|
| (a) | | |
| | -1- | |
| Depreciation Expense | 10,500 | |
| Accumulated Depreciation—Equipment | | |
| (1/16 X \$168,000) | | 10,500 |
| | -2- | |
| Interest Expense | 1,440* | |
| Interest Payable | | |
| (\$90,000 X 8% X 72/360) | | 1,440* |
| | -3- | |
| Admissions Revenue | 60,000 | |
| Unearned Admissions Revenue | | |
| (2,000 X \$30) | | 60,000 |
| | -4- | |
| Prepaid Advertising | 1,100 | |
| Advertising Expense | | 1,100 |
| | -5- | |
| Salaries and Wages Expense | 4,700 | |
| Salaries and Wages Payable | | 4,700 |

- (b)
1. Interest expense, \$2,840 (\$1,400 + \$1,440).
 2. Admissions revenue, \$320,000 (\$380,000 – \$60,000).
 3. Advertising expense, \$12,580 (\$13,680 – \$1,100).
 4. Salaries and wages expense, \$62,300 (\$57,600 + \$4,700).

***Note to instructor:** If 30-day months are assumed, interest expense = \$1,400 (\$90,000 X 8% X 70/360).

PROBLEM 3-6

| | | | |
|---------------------------------------|-------|-------|--|
| (a) | | | |
| | -1- | | |
| Service Revenue | 6,000 | | |
| Unearned Service Revenue | | 6,000 | |
| | -2- | | |
| Accounts Receivable..... | 4,900 | | |
| Service Revenue..... | | 4,900 | |
| | -3- | | |
| Bad Debt Expense | 1,430 | | |
| Allowance for Doubtful Accounts | | 1,430 | |
| | -4- | | |
| Insurance Expense | 480 | | |
| Prepaid Insurance | | 480 | |
| | -5- | | |
| Depreciation Expense | 2,500 | | |
| Accumulated Depreciation—Equipment | | | |
| (\$25,000 X 0.10)..... | | 2,500 | |
| | -6- | | |
| Interest Expense | 60 | | |
| Interest Payable | | | |
| (\$7,200 X 0.10 X 30/360)..... | | 60 | |
| | -7- | | |
| Prepaid Rent | 750 | | |
| Rent Expense..... | | 750 | |
| | -8- | | |
| Salaries and Wages Expense..... | 2,510 | | |
| Salaries and Wages Payable | | 2,510 | |

PROBLEM 3-6 (Continued)

(b) YORKIS PEREZ, CONSULTING ENGINEER
Income Statement
For the Year Ended December 31, 2014

| | | |
|-------------------------------------------------------|-----------------|------------------------|
| Service revenue (\$100,000 – \$6,000 + \$4,900) | | \$98,900 |
| Expenses | | |
| Salaries and wages expense | | |
| (\$30,500+\$2,510) | \$33,010 | |
| Rent expense (\$9,750 – \$750) | 9,000 | |
| Depreciation expense..... | 2,500 | |
| Bad debt expense..... | 1,430 | |
| Utilities expenses | 1,080 | |
| Office expense | 720 | |
| Insurance expense | 480 | |
| Interest expense | 60 | |
| Total expenses..... | | <u>48,280</u> |
| Net income | | <u>\$50,620</u> |

YORKIS PEREZ, CONSULTING ENGINEER
Statement of Owners' Capital
For the Year Ended December 31, 2014

| | |
|----------------------------------------------|------------------------------|
| Owner's Capital, January 1 | \$ 52,010^a |
| Add: Net income | 50,620 |
| Less: Withdrawals | <u>(17,000)</u> |
| Owner's capital, December 31 | <u>\$ 85,630</u> |
| (a) Owner's capital—trial balance..... | \$ 35,010 |
| Withdrawals during the year | <u>17,000</u> |
| Owner's capital, as of January 1, 2014 | <u>\$ 52,010</u> |

PROBLEM 3-6 (Continued)

YORKIS PEREZ, CONSULTING ENGINEER
Balance Sheet
December 31, 2014

Assets

Current assets

| | | |
|---------------------------------------------------|----------------|------------------|
| Cash | \$29,500 | |
| Accounts receivable (\$49,600 + \$4,900) | \$54,500 | |
| Less: Allowance for doubtful accounts | <u>2,180*</u> | 52,320 |
| Supplies | | 1,960 |
| Prepaid insurance (\$1,100 – \$480) | | 620 |
| Prepaid rent | <u>750</u> | |
| Total current assets | | \$ 85,150 |
| Equipment | 25,000 | |
| Less: Accumulated depreciation ... | <u>8,750**</u> | <u>16,250</u> |
| Total assets | | <u>\$101,400</u> |

Liabilities and owners' equity

Current liabilities

| | | |
|----------------------------------|-----------|-----------|
| Notes payable | \$7,200 | |
| Unearned service revenue | 6,000 | |
| Salaries and wages payable | 2,510 | |
| Interest payable | <u>60</u> | \$ 15,770 |

Owner's Capital

| | | |
|-----------------------------------------------|---------------|------------------|
| (\$35,010 + \$50,620) | <u>85,630</u> | |
| Total liabilities and owners' equity | | <u>\$101,400</u> |

*($\$750 + \$1,430$)

**($\$6,250 + \$2,500$)

PROBLEM 3-7

(a)

| | | | |
|---------|----------------------------------------|-------|-------|
| Sep. 30 | Accounts Receivable..... | 600 | |
| | Service Revenue..... | | 600 |
| 30 | Rent Expense..... | 900 | |
| | Prepaid Rent | | 900 |
| 30 | Supplies Expense | 1,020 | |
| | Supplies | | 1,020 |
| 30 | Depreciation Expense | 350 | |
| | Accumulated Depreciation—Equipment.... | | 350 |
| 30 | Interest Expense | 50 | |
| | Interest Payable | | 50 |
| 30 | Unearned Rent Revenue | 200 | |
| | Rent Revenue | | 200 |
| 30 | Salaries and Wages Expense..... | 600 | |
| | Salaries and Wages Payable | | 600 |

(b)

ROLLING HILLS GOLF INC.
Income Statement
For the Quarter Ended September 30, 2014

| | | |
|----------------------------------|------------|------------------------|
| Revenues | | |
| Service revenue..... | \$14,700 | |
| Rent revenue | <u>900</u> | |
| Total revenue | | \$15,600 |
| Expenses | | |
| Salaries and wages expense | \$9,400 | |
| Rent expense..... | 1,800 | |
| Supplies expense | 1,020 | |
| Utilities expenses..... | 470 | |
| Depreciation expense | 350 | |
| Interest expense | <u>50</u> | |
| Total expenses | | <u>13,090</u> |
| Net income..... | | <u><u>\$ 2,510</u></u> |

PROBLEM 3-7 (Continued)

ROLLING HILLS GOLF INC.
Retained Earnings Statement
For the Quarter Ended September 30, 2014

| | |
|---------------------------------------------|-----------------------|
| Retained earnings, July 1, 2014 | \$ 0 |
| Add: Net income | 2,510 |
| Less: Dividends | <u>600</u> |
| Retained earnings, September 30, 2014 | <u><u>\$1,910</u></u> |

ROLLING HILLS GOLF INC.
Balance Sheet
September 30, 2014

Assets

Current assets

| | | |
|-------------------------------------|------------|------------------------|
| Cash | \$ 6,700 | |
| Accounts receivable | 1,000 | |
| Supplies | 180 | |
| Prepaid rent expense | <u>900</u> | |
| Total current assets | | \$ 8,780 |
| Equipment | 15,000 | |
| Less: Accumulated depreciation | <u>350</u> | <u>14,650</u> |
| Total assets | | <u><u>\$23,430</u></u> |

Liabilities and Stockholders' Equity

Current liabilities

| | | |
|----------------------------------|-----------|----------|
| Notes payable | \$ 5,000 | |
| Accounts payable | 1,070 | |
| Unearned rent revenue | 800 | |
| Salaries and wages payable | 600 | |
| Interest payable | <u>50</u> | \$ 7,520 |

Stockholders' Equity

| | | |
|--------------------------------------------------|--------------|------------------------|
| Common stock | 14,000 | |
| Retained earnings | <u>1,910</u> | |
| Total stockholders' equity | | <u>15,910</u> |
| Total liabilities and stockholders' equity | | <u><u>\$23,430</u></u> |

PROBLEM 3-7 (Continued)

- (c) The following accounts would be closed: Service Revenue, Rent Revenue, Salaries and Wages Expense, Rent Expense, Utilities Expenses, Depreciation Expense, Supplies Expense, Interest Expense, Dividends.**
- (d) Interest of 12% per year equals a monthly rate of 1%; monthly interest is \$50 (\$5,000 X 1%). Since total interest expense is \$50, the note has been outstanding one month.**

| |
|--------------------|
| PROBLEM 3-8 |
|--------------------|

(a)

| | | | |
|---------|---------------------------------------|-------|-------|
| Dec. 31 | Accounts Receivable | 3,500 | |
| | Service Revenue | | 3,500 |
| 31 | Supplies Expense | 2,900 | |
| | Supplies | | 2,900 |
| 31 | Insurance Expense | 1,560 | |
| | Prepaid Insurance..... | | 1,560 |
| 31 | Depreciation Expense..... | 5,000 | |
| | Accumulated Depreciation—Equipment... | | 5,000 |
| 31 | Interest Expense | 560 | |
| | Interest Payable | | 560 |
| 31 | Unearned Service Revenue | 1,900 | |
| | Service Revenue | | 1,900 |
| 31 | Salaries and Wages Expense..... | 820 | |
| | Salaries and Wages Payable..... | | 820 |

(b)

VEDULA ADVERTISING AGENCY
Income Statement
For the Year Ended December 31, 2014

| | | |
|----------------------------------|----------------|-------------------------------|
| Revenues | | |
| Service revenue | | \$63,000 |
| Expenses | | |
| Salaries and wages expense | \$9,820 | |
| Depreciation expense | 5,000 | |
| Rent expense | 4,350 | |
| Supplies expense | 2,900 | |
| Insurance expense | 1,560 | |
| Interest expense | 560 | |
| Total expenses..... | | <u>24,190</u> |
| Net income | | <u><u>\$38,810</u></u> |

PROBLEM 3-8 (Continued)

VEDULA ADVERTISING AGENCY
Retained Earnings Statement
For the Year Ended December 31, 2014

| | |
|--------------------------------------|------------------------|
| Retained earnings, January 1 | \$ 5,500 |
| Add: Net income | 38,810 |
| Less: Dividends | <u>10,000</u> |
| Retained earnings, December 31 | <u><u>\$34,310</u></u> |

VEDULA ADVERTISING AGENCY
Balance Sheet
December 31, 2014

Assets**Current assets**

| | | |
|-------------------------------------|---------------|------------------------|
| Cash..... | \$11,000 | |
| Accounts receivable | 19,500 | |
| Supplies..... | 6,500 | |
| Prepaid insurance..... | <u>1,790</u> | |
| Total current assets | | \$38,790 |
| Equipment..... | 60,000 | |
| Less: Accumulated depreciation..... | <u>30,000</u> | <u>30,000</u> |
| Total assets | | <u><u>\$68,790</u></u> |

Liabilities and Stockholders' Equity**Current liabilities**

| | | |
|----------------------------------|------------|-----------|
| Notes payable..... | \$ 8,000 | |
| Accounts payable | 2,000 | |
| Unearned service revenue..... | 3,100 | |
| Salaries and wages payable | 820 | |
| Interest payable..... | <u>560</u> | \$ 14,480 |

Stockholders' Equity

| | | |
|-----------------------------------------------------|---------------|------------------------|
| Common stock | 20,000 | |
| Retained earnings | <u>34,310</u> | |
| Total stockholders' equity | | <u><u>54,310</u></u> |
| Total liabilities and stockholders' equity | | <u><u>\$68,790</u></u> |

PROBLEM 3-8 (Continued)

- (c) Service Revenue, Salaries and Wages Expense, Depreciation Expense, Rent Expense, Supplies Expense, Insurance Expense, Interest Expense, Dividends.**
- (d) Interest is \$56 per month or 0.7% of the note payable ($\$56 \div \$8,000$).
 $0.7\% \times 12 = 8.4\%$ interest per year.**
- (e) Salaries and Wages Expense, \$9,820, less Salaries and Wages Payable 12/31/14, \$820 = \$9,000. Total payments, \$10,500 – \$9,000 = \$1,500 Salaries and Wages Payable 12/31/13.**

PROBLEM 3-9

(a), (b), (d)

| | | | | | |
|-----------------------------------------------------------------------------|--|--------------------------------------------------------------------------------------------------------|--|--------------------------------------------------------------------------------------------------------|--|
| Cash Bal. 15,000 | | Prepaid Insurance Bal. 9,000 Adj. 3,500 <u>5,500</u> | | Salaries and Wages Expense Bal. 80,000 Close 83,600 Adj. <u>3,600</u> <u>83,600</u> | |
| | | Common Stock Bal. 400,000 | | | |
| Accounts Receivable Bal. 13,000 | | Retained Earnings Bal. 82,000 Inc. <u>31,640</u> 113,640 | | Maintenance and Repairs Expense Bal. <u>24,000</u> Close <u>24,000</u> | |
| Allow. for Doubtful Accts. Bal. 1,100 Adj. <u>460</u> 1,560 | | Dues Revenue Adj. 8,900 Bal. 200,000 Cls. <u>191,100</u> <u>200,000</u> | | Depr. Expense Adj. 4,000 Close <u>19,000</u> Adj. <u>15,000</u> 19,000 | |
| Land Bal. 350,000 | | Green Fees Revenue Close <u>5,900</u> Bal. <u>5,900</u> | | Equipment Bal. <u>150,000</u> | |
| Buildings Bal. 120,000 | | Rent Revenue Close 19,200 Bal. 17,600 <u>19,200</u> Adj. <u>1,600</u> <u>19,200</u> | | Accum. Dep.—Equipment Bal. 70,000 Adj. <u>15,000</u> <u>85,000</u> | |
| Accum. Dep.—Buildings Bal. 38,400 Adj. <u>4,000</u> 42,400 | | Utilities Expenses Bal. <u>54,000</u> Close <u>54,000</u> | | Insurance Expense Adj. <u>3,500</u> Close <u>3,500</u> | |
| Rent Receivable Adj. <u>\$1,600</u> | | Bad Debt Expense Adj. <u>460</u> Close <u>460</u> | | Income Summary Exp. 184,560 216,200 Inc. <u>31,640</u> <u>216,200</u> | |

PROBLEM 3-9 (Continued)

| Salaries and Wages | | | |
|-------------------------------------|-------------------|-----------------------|-------------------|
| Payable | | Unearned Dues Revenue | |
| | Adj. <u>3,600</u> | | Adj. <u>8,900</u> |
| (b) | | | |
| | -1- | | |
| Depreciation Expense | | 4,000 | |
| Accumulated Depreciation—Buildings | | | |
| (1/30 X \$120,000) | | | 4,000 |
| | -2- | | |
| Depreciation Expense | | 15,000 | |
| Accumulated Depreciation—Equipment | | | |
| (10% X \$150,000) | | | 15,000 |
| | -3- | | |
| Insurance Expense | | 3,500 | |
| Prepaid Insurance | | | 3,500 |
| | -4- | | |
| Rent Receivable | | 1,600 | |
| Rent Revenue | | | |
| (1/11 X \$17,600) | | | 1,600 |
| | -5- | | |
| Bad Debt Expense | | 460 | |
| Allowance for Doubtful Accounts | | | |
| [(\$13,000 X 12%) – \$1,100] | | | 460 |
| | -6- | | |
| Salaries and Wages Expense | | 3,600 | |
| Salaries and Wages Payable | | | 3,600 |
| | -7- | | |
| Dues Revenue | | 8,900 | |
| Unearned Dues Revenue | | | 8,900 |

PROBLEM 3-9 (Continued)

(c)

CRESTWOOD GOLF CLUB, INC.
Adjusted Trial Balance
December 31, XXXX

| | <u>Dr.</u> | <u>Cr.</u> |
|--------------------------------------|------------------|------------------|
| Cash..... | \$ 15,000 | |
| Accounts Receivable..... | 13,000 | |
| Allowance for Doubtful Accounts..... | | \$ 1,560 |
| Prepaid Insurance..... | 5,500 | |
| Land..... | 350,000 | |
| Buildings..... | 120,000 | |
| Accum. Depreciation—Buildings..... | | 42,400 |
| Equipment..... | 150,000 | |
| Accum. Depreciation—Equipment..... | | 85,000 |
| Salaries and Wages Payable..... | | 3,600 |
| Common Stock..... | | 400,000 |
| Retained Earnings..... | | 82,000 |
| Dues Revenue..... | | 191,100 |
| Green Fees Revenue..... | | 5,900 |
| Rent Revenue..... | | 19,200 |
| Utilities Expenses..... | 54,000 | |
| Salaries and Wages Expense..... | 83,600 | |
| Maintenance and Repairs Expense..... | 24,000 | |
| Bad Debt Expense..... | 460 | |
| Unearned Dues Revenue..... | | 8,900 |
| Rent Receivable..... | 1,600 | |
| Depreciation Expense..... | 19,000 | |
| Insurance Expense..... | 3,500 | |
| Totals..... | <u>\$839,660</u> | <u>\$839,660</u> |

PROBLEM 3-9 (Continued)

| | | | |
|------------|----------------------------------------------|------------------|----------------|
| (d) | | -Dec. 31- | |
| | Dues Revenue | 191,100 | |
| | Green Fees Revenue | 5,900 | |
| | Rent Revenue | 19,200 | |
| | Income Summary | | 216,200 |
| | | -31- | |
| | Income Summary | 184,560 | |
| | Utilities Expenses | | 54,000 |
| | Bad Debt Expense | | 460 |
| | Salaries and Wages Expense | | 83,600 |
| | Maintenance and Repairs Expense | | 24,000 |
| | Depreciation Expense | | 19,000 |
| | Insurance Expense | | 3,500 |
| | | -31- | |
| | Income Summary | 31,640 | |
| | Retained Earnings | | 31,640 |

PROBLEM 3-10

(a), (b), (c)

| | | | | | |
|-------------------------------------------|--------------------|-----------------------------------|----------------|----------------------------------------------------|----------------|
| Cash | | Accounts Receivable | | Allow. for Doubtful Accts. | |
| Bal. | 18,500 | Bal. | 32,000 | Bal. | 700 |
| | | | | Adj. | <u>1,400</u> |
| | | | | | <u>2,100</u> |
| Inventory | | Equipment | | Accum. Depr.—Equipment | |
| Bal. | 80,000 | Bal. | 84,000 | Bal. | 35,000 |
| | | | | Adj. | <u>12,000</u> |
| | | | | | <u>47,000</u> |
| Prepaid Insurance | | Notes Payable | | Interest Expense | |
| Bal. | <u>5,100</u> | Bal. | 28,000 | Adj. | <u>3,360</u> |
| Adj. | 2,550 | | | Cls. | <u>3,360</u> |
| | <u>2,550</u> | | | | |
| Common Stock | | Sales Revenue | | Insurance Expense | |
| | Bal. 80,600 | Cls. | <u>600,000</u> | Adj. | <u>2,550</u> |
| | | Bal. | <u>600,000</u> | Cls. | <u>2,550</u> |
| Salaries and Wages Expense (Sales) | | Advertising Expense | | Salaries and Wages Expense (Administrative) | |
| Bal. | 50,000 | Bal. | 6,700 | Adj. | <u>65,000</u> |
| Cls. | 52,400 | Adj. | 700 | Cls. | <u>65,000</u> |
| Adj. | <u>2,400</u> | Cls. | <u>6,000</u> | | |
| | <u>52,400</u> | | <u>6,700</u> | | |
| | | | | | |
| Bad Debt Expense | | Supplies Expense | | Prepaid Advertising | |
| Adj. | <u>1,400</u> | Bal. | 5,000 | Adj. | 700 |
| Cls. | <u>1,400</u> | Adj. | 1,500 | | |
| | | Cls. | <u>3,500</u> | | |
| | | | <u>5,000</u> | | |
| | | | | | |
| Interest Payable | | Depr. Exp. | | Income Summary | |
| | Adj. 3,360 | Adj. | <u>12,000</u> | Exp. | 554,210 |
| | | Cls. | <u>12,000</u> | Sales | 600,000 |
| | | | | Inc. | <u>45,790</u> |
| | | | | | <u>600,000</u> |
| | | | | | |
| Supplies | | Salaries and Wages Payable | | | |
| Adj. | 1,500 | Adj. | 2,400 | | |
| | | | | | |
| Retained Earnings | | Cost of Goods Sold | | | |
| | Bal. 10,000 | Bal. | <u>408,000</u> | | |
| | Inc. <u>45,790</u> | Cls. | <u>408,000</u> | | |
| | Bal. <u>55,790</u> | | | | |

PROBLEM 3-10 (Continued)

| | | | |
|-------------------------------------------|--------|--------|--|
| (b) | -1- | | |
| Bad Debt Expense | 1,400 | | |
| Allowance for Doubtful Accounts | | 1,400 | |
| | -2- | | |
| Depreciation Expense (\$84,000 ÷ 7) | 12,000 | | |
| Accumulated Depreciation—Equipment | | 12,000 | |
| | -3- | | |
| Insurance Expense | 2,550 | | |
| Prepaid Insurance | | 2,550 | |
| | -4- | | |
| Interest Expense | 3,360 | | |
| Interest Payable | | 3,360 | |
| | -5- | | |
| Salaries and Wages Expense (Sales) | 2,400 | | |
| Salaries and Wages Payable | | 2,400 | |
| | -6- | | |
| Prepaid Advertising | 700 | | |
| Advertising Expense | | 700 | |
| | -7- | | |
| Supplies | 1,500 | | |
| Supplies Expense | | 1,500 | |

PROBLEM 3-10 (Continued)

| | | |
|-----|------------------------------------------|---------|
| (c) | Dec. 31 | |
| | Sales Revenue | 600,000 |
| | Income Summary | 600,000 |
| | | |
| | Dec. 31 | |
| | Income Summary | 554,210 |
| | Cost of Goods Sold..... | 408,000 |
| | Advertising Expense..... | 6,000 |
| | Salaries and Wages Expense (Admin.)..... | 65,000 |
| | Salaries and Wages Expense (Sales) | 52,400 |
| | Supplies Expense | 3,500 |
| | Insurance Expense | 2,550 |
| | Bad Debt Expense..... | 1,400 |
| | Depreciation Expense..... | 12,000 |
| | Interest Expense | 3,360 |
| | | |
| | Dec. 31 | |
| | Income Summary | 45,790 |
| | Retained Earnings..... | 45,790 |

***PROBLEM 3-11**

(a) ARKANSAS SALES AND SERVICE
Income Statement
For the Month Ended January 31, 2014

| | (1) <u>Cash Basis</u> | (2) <u>Accrual Basis</u> |
|--------------------------------|--------------------------|-----------------------------|
| Revenues..... | \$ 75,000 | \$98,400* |
| Expenses | | |
| Cost of computers & printers: | | |
| Purchased and paid | 82,500** | |
| Cost of goods sold..... | | 59,500*** |
| Salaries and wages | 9,600 | 12,600 |
| Rent..... | 6,000 | 2,000 |
| Other operating expenses | <u>8,400</u> | <u>10,400</u> |
| Total expenses | <u>106,500</u> | <u>84,500</u> |
| Net income (loss)..... | <u><u>\$(31,500)</u></u> | <u><u>\$13,900</u></u> |

*(\$2,550 X 30) + (\$3,600 X 4) + (\$500 X 15)

**(\$1,500 X 40) + (\$2,500 X 6) + (\$300 X 25)

***(\$1,500 X 30) + (\$2,500 X 4) + (\$300 X 15)

***PROBLEM 3-11 (Continued)**

**(b) ARKANSAS SALES AND SERVICE
Balance Sheet
As of January 31, 2014**

| | (1) <u>Cash Basis</u> | (2) <u>Accrual Basis</u> |
|-----------------------------------------------|----------------------------------|-----------------------------------------|
| <u>Assets</u> | | |
| Cash | \$58,500 ^a | \$ 58,500 ^a |
| Accounts receivable..... | | 23,400 |
| Inventory | | 23,000 ^b |
| Prepaid rent | | 4,000 |
| Total assets | <u>\$58,500</u> | <u>\$108,900</u> |
| <u>Liabilities and owners' Equity</u> | | |
| Salaries and wages payable | | \$ 3,000 |
| Accounts payable..... | | 2,000 |
| Owner's capital..... | \$58,500 ^c | <u>103,900^d</u> |
| Total liabilities and owner's equity | <u>\$58,500</u> | <u>\$108,900</u> |

| | |
|----------------------------------|------------------|
| ^a Original investment | \$ 90,000 |
| Cash sales | 75,000 |
| Cash purchases | (82,500) |
| Rent paid | (6,000) |
| Salaries paid | (9,600) |
| Other operating expenses | <u>(8,400)</u> |
| Cash balance Jan. 31 | <u>\$ 58,500</u> |

^b(10 @ \$1,500) + (2 @ \$2,500) + (10 @ \$300).

^cInitial investment minus net loss: \$90,000 – \$31,500.

^dInitial investment plus net income: \$90,000 + \$13,900.

***PROBLEM 3-11 (Continued)**

- (c)**
- 1. The \$23,400 in receivables from customers is an asset and a future cash flow resulting from sales that is ignored. The cash basis understates the amount of revenues and inflow of assets in January from the sale of computers and printers by \$23,400.**
 - 2. The cost of computers and printers sold in January is overstated by \$23,000. The unsold computers and printers are an asset of \$23,000 in the form of inventory.**
 - 3. The cash basis ignores \$3,000 of the salaries that have been earned by the employees in January and will be paid in February.**
 - 4. Rent expense on the cash basis is overstated by \$4,000. This prepayment is an asset in the form of two months' future right to the use of office, showroom, and repair space and should appear on the balance sheet.**
 - 5. Other operating expenses on a cash basis are understated by \$2,000 as is the liability for the unpaid portion of these expenses incurred in January.**

(a)

For the Year Ended September 30, 2014

***PROBLEM 3-12**

| Account Titles | Trial Balance | | Adjustments | | Adjusted Trial Balance | | Income Statement | | Balance Sheet | |
|---------------------------------|----------------|----------------|-------------|---------------|------------------------|-----|------------------|----------------|----------------|----------------|
| | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. | Dr. | Cr. |
| Cash | 37,400 | | | | | | 37,400 | | 37,400 | |
| Supplies | 18,600 | | (b) | 14,400 | | | 4,200 | | 4,200 | |
| Prepaid Insurance | 31,900 | | (a) | 28,000 | | | 3,900 | | 3,900 | |
| Land | 80,000 | | | | | | 80,000 | | 80,000 | |
| Equipment | 120,000 | | | | | | 120,000 | | 120,000 | |
| Accum. Depr.-Equip. | | 36,200 | (c) | 5,800 | | | | 42,000 | | 42,000 |
| Accounts Payable | | 14,600 | | | | | | 14,600 | | 14,600 |
| Unearned Service Rev. | | 2,700 | (d) | 2,000 | | | | 700 | | 700 |
| Mortgage Payable | | 50,000 | | | | | | 50,000 | | 50,000 |
| Common Stock | | 107,700 | | | | | | 107,700 | | 107,700 |
| Dividends | 14,000 | | | | | | 14,000 | | 14,000 | |
| Retained Earnings | | 2,000 | | | | | | 2,000 | | 2,000 |
| Service Revenue | | 278,500 | (d) | 2,000 | | | | 280,500 | | |
| Sal. and Wages Exp. | 109,000 | | | | | | 109,000 | | | |
| Maintenance and Repairs Expense | 30,500 | | | | | | 30,500 | | | |
| Advertising Expense | 9,400 | | | | | | 9,400 | | | |
| Utilities Expenses | 16,900 | | | | | | 16,900 | | | |
| Prop. Tax Expense | 18,000 | | (e) | 3,000 | | | 21,000 | | | |
| Interest Expense | 6,000 | | (f) | 6,000 | | | 12,000 | | | |
| Totals | <u>491,700</u> | <u>491,700</u> | | | | | | | | |
| Insurance Expense | | | (a) | 28,000 | | | 28,000 | | | |
| Supplies Expense | | | (b) | 14,400 | | | 14,400 | | | |
| Interest Payable | | | (f) | 6,000 | | | | 6,000 | | 6,000 |
| Depreciation Expense | | | (c) | 5,800 | | | 5,800 | | | |
| Prop. Taxes Payable | | | (e) | | | | | 3,000 | | 3,000 |
| Totals | | | | <u>59,200</u> | | | <u>506,500</u> | <u>506,500</u> | 280,500 | 259,500 |
| Net Income | | | | | | | | 247,000 | 259,500 | 226,000 |
| Totals | | | | | | | <u>280,500</u> | <u>280,500</u> | <u>259,500</u> | <u>259,500</u> |

Key: (a) Expired Insurance; (b) Supplies Used; (c) Depreciation Expensed; (d) Service Revenue Recognized; (e) Accrued Property Taxes; (f) Accrued Interest Payable.

***PROBLEM 3-12 (Continued)**

(b)

COOKE COMPANY
Balance Sheet
September 30, 2014

| Assets | | | | |
|------------------------------------------------|---------------|---------------|----------------|------------------|
| Current assets | | | | |
| Cash | | \$37,400 | | |
| Supplies | | 4,200 | | |
| Prepaid insurance | | <u>3,900</u> | | |
| Total current assets | | | | \$ 45,500 |
| Property, plant, and equipment | | | | |
| Land | | 80,000 | | |
| Equipment..... | \$120,000 | | | |
| Less: Accum. depreciation – equipment | <u>42,000</u> | <u>78,000</u> | <u>158,000</u> | |
| Total assets | | | | <u>\$203,500</u> |
| Liabilities and Stockholders' Equity | | | | |
| Current liabilities | | | | |
| Accounts payable..... | | \$14,600 | | |
| Current maturity of long-term debt | | 10,000 | | |
| Interest payable | | 6,000 | | |
| Property taxes payable | | 3,000 | | |
| Unearned service revenue | | <u>700</u> | | |
| Total current liabilities | | | | \$ 34,300 |
| Long-term liabilities | | | | |
| Mortgage payable | | | <u>40,000</u> | |
| Total liabilities | | | | 74,300 |
| Stockholders' equity | | | | |
| Common stock | | 107,700 | | |
| Retained earnings | | | | |
| (\$2,000 + \$33,500 – \$14,000) | | <u>21,500</u> | <u>129,200</u> | |
| Total liabilities and owners' equity | | | | <u>\$203,500</u> |

***PROBLEM 3-12 (Continued)**

| | | | | |
|-----|---------|-----------------------------------------|---------|---------|
| (c) | Sep. 30 | Insurance Expense | 28,000 | |
| | | Prepaid Insurance..... | | 28,000 |
| | 30 | Supplies Expense | 14,400 | |
| | | Supplies..... | | 14,400 |
| | 30 | Depreciation Expense..... | 5,800 | |
| | | Accum. Depreciation— Equipment | | 5,800 |
| | 30 | Unearned Service Revenue | 2,000 | |
| | | Service Revenue | | 2,000 |
| | 30 | Property Tax Expense | 3,000 | |
| | | Property Taxes Payable | | 3,000 |
| | 30 | Interest Expense | 6,000 | |
| | | Interest Payable | | 6,000 |
| (d) | Sep. 30 | Service Revenue | 280,500 | |
| | | Income Summary..... | | 280,500 |
| | 30 | Income Summary | 247,000 | |
| | | Salaries and Wages Expense..... | | 109,000 |
| | | Maintenance and Repairs Expense..... | | 30,500 |
| | | Insurance Expense | | 28,000 |
| | | Property Tax Expense | | 21,000 |
| | | Supplies Expense | | 14,400 |
| | | Utilities Expenses | | 16,900 |
| | | Interest Expense | | 12,000 |
| | | Advertising Expense | | 9,400 |
| | | Depreciation Expense | | 5,800 |
| | 30 | Income Summary | 33,500 | |
| | | Retained Earnings | | 33,500 |
| | 30 | Retained Earnings..... | 14,000 | |
| | | Dividends..... | | 14,000 |

***PROBLEM 3-12 (Continued)**

(e)

COOKE COMPANY
Post-Closing Trial Balance
September 30, 2014

| | <u>Debit</u> | <u>Credit</u> |
|--------------------------------------------|------------------|------------------|
| Cash | \$ 37,400 | |
| Supplies | 4,200 | |
| Prepaid Insurance | 3,900 | |
| Land..... | 80,000 | |
| Equipment..... | 120,000 | |
| Accumulated Depreciation – Equipment | | \$ 42,000 |
| Accounts Payable..... | | 14,600 |
| Unearned Service Revenue | | 700 |
| Interest Payable | | 6,000 |
| Property Tax Payable | | 3,000 |
| Mortgage Payable..... | | 50,000 |
| Common Stock | | 107,700 |
| Retained Earnings | | 21,500 |
| | <u>\$245,500</u> | <u>\$245,500</u> |

FINANCIAL REPORTING PROBLEM

- (a) June 30, 2011 total assets: \$138,354 million.
June 30, 2010 total assets: \$128,172 million.
- (b) June 30, 2011 cash and cash equivalents: \$2,768 million.
- (c) 2011 research and development costs: \$2,001 million.
2010 research and development costs: \$1,950 million.
- (d) 2011 net sales: \$82,559 million.
2010 net sales: \$78,938 million.
- (e) An adjusting entry for deferrals is necessary when the receipt/disbursement precedes the recognition in the financial statements. Accounts such as prepaid insurance and prepaid rent may be included in the Prepaid Expenses and Other Current Assets (\$4,408 million at June 30, 2011). Both of these accounts would require an adjusting entry to recognize the proper amount of expense incurred during the period. In addition, depreciation expense is an adjusting entry related to a deferral.

An adjusting entry for an accrual is necessary when recognition in the financial statements precedes the cash receipt/disbursement, such as interest or taxes payable. Other adjusting entries probably made by P&G include interest revenue and expense and interest receivable and interest payable. P&G reports \$9,290 million of Accrued and Other Liabilities at June 30, 2011.
- (f) 2011 Depreciation and amortization expense: \$2,838 million
2010 Depreciation and amortization expense: \$3,108 million
2009 Depreciation and amortization expense: \$3,082 million

(From the Statement of Cash Flows)

COMPARATIVE ANALYSIS CASE

- (a) The Coca-Cola Company percentage increase is computed as follows:

| | |
|----------------------------------------|-----------------|
| Total assets (December 31, 2011) | \$79,974 |
| Total assets (December 31, 2010) | <u>72,921</u> |
| Difference | <u>\$ 7,053</u> |

$$\$7,053 \div \$72,921 = \underline{9.7\%}$$

PepsiCo, Inc.'s percentage increase is computed as follows:

| | |
|----------------------------------------|-----------------|
| Total assets (December 29, 2011) | \$72,882 |
| Total assets (December 30, 2010) | <u>68,153</u> |
| Difference | <u>\$ 4,729</u> |

$$\$4,729 \div \$68,153 = \underline{\$6.9\%}$$

Coca-Cola Company had the larger increase.

- (b)

| | 5-Year Growth Rate | |
|-----------------------------------|------------------------------|----------------------|
| | <u>The Coca-Cola Company</u> | <u>PepsiCo, Inc.</u> |
| Net sales | 12.69% | 13.92% |
| Income from continuing operations | 9.41% | 3.30% |

- (c) The Coca-Cola Company had depreciation and amortization expense of \$1,954 million; PepsiCo, Inc. had depreciation and amortization expense of \$2,737 million.

COMPARATIVE ANALYSIS CASE (Continued)

PepsiCo has substantially more property, plant, and equipment than does Coca-Cola. PepsiCo is engaged in three different types of businesses: soft drinks, snack-food, and juices. As a result, it has more tangible fixed assets. PepsiCo also has substantially more amortizable intangible assets. Amortizable intangible assets for Coke and Pepsi increase the amount of amortization expense recorded in income. The amount of property, plant, and equipment and amortizable intangible assets reported for these two companies is as follows: (000,000)

| | <u>The Coca-Cola Company</u> | <u>PepsiCo, Inc.</u> |
|--------------------------------------|------------------------------|----------------------|
| Property, plant, and equipment (net) | \$ 14,939 | \$19,698 |
| Amortizable intangible assets (net) | <u>1,250</u> | <u>1,888</u> |
| | \$16,189 | \$21,586 |

FINANCIAL STATEMENT ANALYSIS

(a)

| | 2011 | 2010 | 2009 | % Change 2011 | % Change 2010 |
|--------------------------------------------|----------|----------|----------|---------------------|---------------------|
| Sales | \$13,198 | \$12,397 | \$12,575 | 6.46% | -1.42% |
| Gross Profit % | 41.28% | 42.66% | 42.87% | -3.23% | -0.49% |
| Operating Profit | 1,976 | 1,990 | 2,001 | -0.70% | -0.55% |
| Net Cash Flow less Capital Expenditures | 1,001 | 534 | 1,266 | 87.45% | -57.82% |
| Net Earnings | 1,231 | 1,247 | 1,212 | -1.28% | 2.89% |

- (b) Kellogg experienced an improvement in sales in the current year which followed a decline in the previous year. The gross-profit percentage decreased slightly after a flat change in the prior year. This coincides with a flat operating profit but a solid increase in cash flows, compared to prior years, suggest it faces a challenging period and might be starting to recover. This may bode well for the strength and flexibility of its business model.

ACCOUNTING, ANALYSIS, AND PRINCIPLES

Accounting

| | | |
|-------------------------------------------------|--------|--------|
| Depreciation Expense | 9,500 | |
| Accumulated Depreciation—Equipment | | 9,500 |
| ($\$9,500 = (\$192,000 - \$40,000) \div 16$) | | |
| Interest Expense..... | 8,250 | |
| Interest Payable | | 8,250 |
| $\$8,250 = (\$90,000 \times 0.10) \times 11/12$ | | |
| Unearned Service Revenue | 10,000 | |
| Service Revenue | | 10,000 |
| ($\$10,000 = (\$50 \times 200)$) | | |
| Advertising Expense | 2,500 | |
| Prepaid Advertising | | 2,500 |
| Salaries and Wages Expense | 3,500 | |
| Salaries and Wages Payable | | 3,500 |

ACCOUNTING, ANALYSIS, AND PRINCIPLES (Continued)

Analysis

| | Income before Adjustments | Adjustments | Income after Adjustments |
|-------------------------------|------------------------------|-------------|-----------------------------|
| Service revenue | \$360,000 | \$10,000 | \$370,000 |
| Less: | | | |
| Depreciation expense | | (9,500) | (9,500) |
| Advertising expense | (18,680) | (2,500) | (21,180) |
| Salaries and wages expense | (67,600) | (3,500) | (71,100) |
| Interest expense | <u>(1,400)</u> | (8,250) | <u>(9,650)</u> |
| Net income | <u>\$272,320</u> | | <u>\$258,570</u> |

Without recording the adjusting entries, Amato's income is overstated. In addition, without the adjustments, Amato's current liabilities and current assets are misstated, which could affect evaluation of Amato's liquidity.

Principles

The tradeoffs are between the *timeliness* of the reports, which contributes to relevance, and verifiability, the lack of which detracts from faithful representation. That is, by preparing reports more frequently, the company provides more timely information, which can make a difference to a statement reader who needs to make a decision. However, preparing statements more frequently requires more subjective estimates, which reduces faithful representation.

(a) The three essential characteristics of assets.

Search String: asset and characteristics.

CON6, Par26. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

(b) Three essential characteristics of liabilities.

Search String: liability and characteristic.

CON6, Par36. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.

(c) Uncertainty, and its effects on financial statements.

Search Strings: "uncertainty", effect of uncertainty.

CON6, Par44. Uncertainty about economic and business activities and results is pervasive, and it often clouds whether a particular item qualifies as an asset or a liability of a particular entity at the time the definitions are applied. The presence or absence of future economic benefit that can be obtained and controlled by the entity or of the entity's legal, equitable, or constructive obligation to sacrifice assets in the future can often be discerned reliably only with hindsight. As a result, some items that with hindsight actually qualified as assets or liabilities of the entity under the definitions may, as a practical matter, have been recognized as expenses, losses, revenues, or gains or

PROFESSIONAL RESEARCH (Continued)

remained unrecognized in its financial statements because of uncertainty about whether they qualified as assets or liabilities of the entity or because of recognition and measurement considerations stemming from uncertainty at the time of assessment. Conversely, some items that with hindsight did not qualify under the definitions may have been included as assets or liabilities because of judgments made in the face of uncertainty at the time of assessment.

CON6, Par45. An effect of uncertainty is to increase the costs of financial reporting in general and the costs of recognition and measurement in particular. Some items that qualify as assets or liabilities under the definitions may therefore be recognized as expenses, losses, revenues, or gains or remain unrecognized as a result of cost and benefit analyses indicating that their formal incorporation in financial statements is not useful enough to justify the time and effort needed to do it. It may be possible, for example, to make the information more reliable in the face of uncertainty by exerting greater effort or by spending more money, but it also may not be worth the added cost.

Note to instructors: The FASB codification does not contain the Concepts Statements. However, the Concepts Statements can be accessed at another link on the FASB website.

(d) The difference between realization and recognition

Search String: realization, recognition.

CON6, Par143. Realization in the most precise sense means the process of converting noncash resources and rights into money and is most precisely used in accounting and financial reporting to refer to sales of assets for cash or claims to cash. The related terms realized and unrealized therefore identify revenues or gains or losses on assets sold and unsold, respectively. Those are the meanings of realization and related terms in the Board's conceptual framework. Recognition is the process of formally recording or incorporating an item in the financial statements of an entity. Thus, an asset, liability, revenue, expense, gain, or loss may be recognized (recorded) or unrecognized (unrecorded). Realization and recognition are not used as synonyms, as they sometimes are in accounting and financial literature.

PROFESSIONAL SIMULATION

Journal Entries

| | | |
|-----------------------------------------|-------|-------|
| Depreciation Expense..... | 7,000 | |
| Accumulated Depreciation—Equipment..... | | 7,000 |
| Unearned Advertising Revenue | 1,400 | |
| Advertising Revenue | | 1,400 |
| Accounts Receivable | 1,500 | |
| Advertising Revenue | | 1,500 |
| Supplies Expense (Art)..... | 3,400 | |
| Supplies..... | | 3,400 |
| Salaries and Wages Expense..... | 1,300 | |
| Salaries and Wages Payable..... | | 1,300 |

Financial Statements

BUTLER ADVERTISING AGENCY Income Statement For the Year Ended December 31, 2014

| | | |
|----------------------------------|--------------|-----------------|
| Revenues | | |
| Advertising revenue..... | | \$61,500 |
| Expenses | | |
| Salaries and wages expense | \$11,300 | |
| Depreciation expense | 7,000 | |
| Rent expense..... | 4,000 | |
| Supplies expense..... | <u>3,400</u> | |
| Total expenses | | <u>25,700</u> |
| Net income..... | | <u>\$35,800</u> |

PROFESSIONAL SIMULATION (Continued)

BUTLER ADVERTISING AGENCY

Balance Sheet

December 31, 2014

Assets

| | | |
|--------------------------------------|-----------------|------------------------|
| Cash | | \$11,000 |
| Accounts receivable | | 21,500 |
| Supplies | | 5,000 |
| Equipment..... | 60,000 | |
| Less: Accumulated depreciation | <u>(35,000)</u> | <u>25,000</u> |
| Total assets..... | | <u><u>\$62,500</u></u> |

Liabilities and Stockholders' Equity

Liabilities

| | | |
|------------------------------------|--------------|----------|
| Accounts payable..... | \$5,000 | |
| Unearned advertising revenue | 5,600 | |
| Salaries and wages payable | <u>1,300</u> | \$11,900 |

Stockholders' Equity

| | | |
|-----------------------------------------------------|---------------|------------------------|
| Common stock..... | 10,000 | |
| Retained earnings | <u>40,600</u> | |
| Total stockholders' equity | | <u>50,600</u> |
| Total liabilities and stockholders' equity | | <u><u>\$62,500</u></u> |

Explanation

After the financial statements are prepared, Butler must prepare the closing entries and post the journal entries to the general ledger. Then, a post-closing trial balance is prepared. Some companies may also prepare and post reversing entries.

IFRS3-1

The date of transition is the beginning of the earliest period for which full comparative IFRS information is provided. The date of reporting is the closing balance sheet date for the first IFRS financial statements.

IFRS3-2

When countries accept IFRS for use as accepted accounting policies, companies need guidance to ensure that their first IFRS financial statements contain high quality information. Specifically, *IFRS 1* requires that information in a company's first IFRS statements (1) be transparent, (2) provide a suitable starting point, and (3) have a cost that does not exceed the benefits.

IFRS3-3

A company follows these steps:

1. Identify the timing of its first IFRS statements.
2. Prepare an opening balance sheet at the date of transition to IFRS.
3. Select accounting principles that comply with IFRS, and apply these principles retrospectively.
4. Make extensive disclosures to explain the transition to IFRS

IFRS3-4

The date of the opening balance sheet is January 1, 2014. The IFRS financial statements will include years ended December 31, 2015 and 2014.

IFRS3-5

(a) Assets

- 53 The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

- 54 An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.
- 55 The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:
- a. used singly or in combination with other assets in the production of goods or services to be sold by the entity;
 - b. exchanged for other assets;
 - c. used to settle a liability; or
 - d. distributed to the owners of the entity.

(b) Liabilities

- 60 An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.
- 61 A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.

IFRS3-5 (continued)

62 The settlement of a present obligation usually involves the entity giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:

- a. payment of cash;**
- b. transfer of other assets;**
- c. provision of services;**
- d. replacement of that obligation with another obligation; or**
- e. conversion of the obligation to equity.**

(c) Accrual basis

22 In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

IFRS3-6

- (a) March 31, 2012 total assets: £7,273.3 million.
April 2, 2011 total assets: £7,344.1 million.**
- (b) March 31, 2012 cash and cash equivalents: £196.10 million.**
- (c) 2012 selling and marketing expense: £3,021.9 million.
2011 selling and marketing expense: £2,959.7 million.**
- (d) 2012 revenue: £9,934.3 million.
2011 revenue: £9,740.3 million.**

IFRS3-6 (Continued)

- (e) An adjusting entry for deferrals is necessary when the receipt/disbursement precedes the recognition in the financial statements. Accounts such as prepaid pension contributions and prepaid leasehold premiums are included in the Trade and other receivables section. Both of these accounts would require an adjusting entry to recognize the proper amount of expense incurred during the period. In addition, depreciation expense is an adjusting entry related to a deferral.

An adjusting entry for an accrual is necessary when recognition in the financial statements precedes the cash receipt/disbursement, such as interest or taxes payable. Other adjusting entries probably made by M&S include finance income and finance costs and bank and other interest receivable and interest payable.

- (f) 2012 Depreciation and amortization expense: £479.70 million
2011 Depreciation and amortization expense: £467.50 million