# Chapter 2 Review of the Accounting Process

# Questions for Review of Key Topics

##### Question 2–1

External events involve an exchange transaction between the company and a separate economic entity. For every external transaction, the company is receiving something in exchange for something else. Internal events do not involve an exchange transaction but do affect the financial position of the company. Examples of external events are the purchase of inventory, a sale to a customer, and the borrowing of cash from a bank. Examples of internal events include the recording of depreciation expense, the expiration of prepaid rent, and the accrual of salary expense.

##### Question 2–2

According to the accounting equation, there is equality between the total economic resources of an entity, its assets, and the claims to those resources, liabilities, and equity. This implies that, since resources must always equal claims, the net effect of any transaction cannot affect one side of the accounting equation differently than the other side.

##### Question 2–3

The purpose of a journal is to capture, in chronological order, the dual effect of a transaction. A general ledger is a collection of storage areas called accounts. These accounts keep track of the increases and decreases in each element of financial position.

##### Question 2–4

Permanent accounts represent the financial position of a company—assets, liabilities and owners' equity—at a particular point in time. Temporary accounts represent the changes in shareholders’ equity, the retained earnings component of equity for a corporation, caused by revenue, expense, gain, and loss transactions. It would be cumbersome to record revenue/expense, gain/loss transactions directly into the permanent retained earnings account. Recording these transactions in temporary accounts facilitates the preparation of the financial statements.

##### *Answers to Questions (continued)*

##### Question 2–5

Assets are increased by debits and decreased by credits. Liabilities and equity accounts are increased by credits and decreased by debits.

##### Question 2–6

Revenues and gains are increased by credits and decreased by debits. Expenses and losses are increased by debits (thus causing owners’ equity to decrease) and decreased by credits (thus causing owners’ equity to increase).

##### Question 2–7

The first step in the accounting processing cycle is to identify external transactions affecting the accounting equation. Source documents, such as sales invoices, bills from suppliers, and cash register tapes, help to identify the transactions and then provide the information necessary to process the transaction.

##### Question 2–8

Transaction analysis is the process of reviewing the source documents to determine the dual effect on the accounting equation and the specific elements involved.

##### Question 2–9

After transactions are recorded in a journal, the debits and credits must be transferred to the appropriate general ledger accounts. This transfer is called ***posting***.

##### Question 2–10

In Transaction 1 we record the purchase of $20,000 of inventory on account. In Transaction 2 we record a credit sale of $30,000 and the corresponding cost of goods sold of $18,000.

##### Question 2–11

An *unadjusted* trial balance is a list of the general ledger accounts and their balances at a time before any end-of-period adjusting entries have been recorded. An *adjusted* trial balance is prepared after adjusting entries have been recorded and posted to the accounts.

##### *Answers to Questions (continued)*

##### Question 2–12

We use adjusting entries to record the effect on financial position of internal events, those that do not involve an exchange transaction with another entity. We record them at the end of any period when financial statements are prepared to properly reflect financial position and results of operations according to the accrual accounting model, that is, to update accounts to their proper balances before we report those balances in the financial statements.

##### Question 2–13

Closing entries transfer the balances in the temporary owners’ equity accounts (revenues, expenses, gains, losses, dividends) to a permanent owners’ equity account, retained earnings for a corporation. This is done only at the end of a fiscal year in order to reduce the temporary accounts to zero before beginning the next reporting year.

##### Question 2–14

Prepaid expensesrepresent assets recorded when a cash disbursement creates benefits that extend beyond the current reporting period. Examples are supplies on hand at the end of a period, prepaid rent, and prepaid insurance.

##### Question 2–15

The adjusting entry required when deferred revenues are recognized is a debit to the deferred revenue liability and a credit to revenue.

##### Question 2–16

Accrued liabilities are recorded when an expense has been incurred that will not be paid until a subsequent reporting period. The adjusting entry needed to record an accrued liability is a debit to anexpenseand a credit to a liability.

##### *Answers to Questions (continued)*

##### Question 2–17

*Income statement*—The purpose of the income statement is to summarize the profit-generating activities of a company during a particular period of time. It is a “change statement” that reports the changes in owners’ equity that occurred during the period as a result of revenues, expenses, gains, and losses.

*Statement of comprehensive income*—The statement of comprehensive income extends the income statement to report changes in shareholders’ equity during the reporting period that were not a result of transactions with owners. This statement includes net income and also other comprehensive income items.

*Balance sheet*—The purpose of the balance sheet is to present the financial position of a company at a particular point in time. It is an organized list of assets, liabilities, and permanent owners’ equity accounts.

*Statement of cash flows*—The purpose of the statement of cash flows is to disclose the events that caused cash to change during the period.

*Statement of shareholders’ equity*—The purpose of the statement of shareholders’ equity is to disclose the sources of the changes in the various shareholders’ equity accounts that occurred during the period. This statement includes changes resulting from investments by owners, distributions to owners, net income, and other comprehensive income.

##### Question 2–18

A worksheet provides a way to organize the accounting information needed to prepare adjusting and closing entries and the financial statements. This error would result in an *overstatement* of revenue and thus net income and thus retained earnings, and an *understatement* of liabilities.

##### *Answers to Questions (concluded)*

##### Question 2–19

Reversing entries are recorded at the beginning of a reporting period. They reverse the effects of some of the adjusting entries recorded at the end of the previous reporting period. This simplifies the journal entries recorded during the new period by allowing cash payments or cash receipts to be entered directly into the expense or revenue account without regard to the accrual recorded at the end of the previous period.

##### Question 2–20

The purpose of special journals is to record, in chronological order, the dual effect of *repetitive* types of transactions, such as cash receipts, cash disbursements, credit sales, and credit purchases.

Special journals simplify the recording process in the following ways: (1) journalizing the effects of a particular transaction is made more efficient through the use of specifically designed formats; (2) individual transactions are not posted to the general ledger accounts, but are accumulated in the special journals and a summary posting is made on a periodic basis; and (3) the responsibility for recording journal entries for the repetitive types of transactions is placed on individuals who have specialized training in handling them.

##### Question 2–21

The general ledger is a collection of control accounts representing assets, liabilities, permanent and temporary shareholders’ equity accounts. The subsidiary ledger contains a group of subsidiary accounts associated with a particular general ledger control account. For example, there will be a subsidiary ledger for accounts receivable that will keep track of the increases and decreases in the account receivable balance for each of the company’s customers purchasing goods or services on credit. At any point in time, the balance in the accounts receivable control account should equal the sum of the balances in the accounts receivable subsidiary ledger accounts.

# BRIEF Exercises

Brief Exercise 2–1

**Assets = Liabilities + Paid-in Capital + Retained Earnings**

**1.** + 165,000 (inventory) + 165,000 (accounts payable)

**2.** – 40,000 (cash) – 40,000 (expense)

**3**. + 200,000 (accounts receivable) + 200,000 (revenue)

– 120,000 (inventory) – 120,000 (expense)

**4.** + 180,000 (cash)

– 180,000 (accounts receivable)

**5**. – 145,000 (cash) – 145,000 (accounts payable)

Brief Exercise 2–2

**1.** Inventory 165,000

Accounts payable 165,000

**2.** Salaries expense 40,000

Cash 40,000

**3.** Accounts receivable 200,000

Sales revenue 200,000

Cost of goods sold 120,000

Inventory 120,000

4. Cash 180,000

Accounts receivable 180,000

**5.** Accounts payable 145,000

Cash 145,000

Brief Exercise 2–3

***balance sheet Accounts***

**Cash Accounts receivable**

6/1 Bal. 65,000 6/1 Bal. 43,000

4. 180,000 40,000 2. 3. 200,000 180,000 4.

145,000 5.

**6/30 Bal.** 60,000 **6/30 Bal.** 63,000

**Inventory Accounts payable**

6/1 Bal. 0 6/1 Bal. 22,000

1. 165,000 120,000 3. 5. 145,000 165,000 1.

**6/30 Bal.** 45,000 **6/30 Bal.** 42,000

***InCOME STATEMENT Accounts***

**Sales revenue Cost of goods sold**

0 6/1 Bal. 6/1 Bal. 0

200,000 3. 3. 120,000

200,000 **6/30 Bal.** **6/30 Bal.** 120,000

**Salaries expense**

6/1 Bal. 0

2. 40,000

**6/30 Bal.** 40,000

Brief Exercise 2–4

**1.** Prepaid insurance 12,000

Cash 12,000

**2.** Note receivable 10,000

Cash 10,000

**3.** Equipment 60,000

Cash 60,000

Brief Exercise 2–5

**1.** Insurance expense ($12,000x 3/12**)** 3,000

Prepaid insurance 3,000

**2.** Interest receivable ($10,000 x 6% x 6/12) 300

Interest revenue 300

**3.** Depreciation expense 12,000

Accumulated depreciation – equipment 12,000

Brief Exercise 2–6

Net income would be **higher** by **$14,700** ($3,000 – 300 + 12,000).

Brief Exercise 2–7

**1.** Service revenue 4,000

Deferred service revenue 4,000

**2.** Advertising expense ($2,000x 1/2**)** 1,000

Prepaid advertising 1,000

**3.** Salaries expense 16,000

Salaries payable 16,000

**4.** Interest expense ($60,000 x 8% x 4/12) 1,600

Interest payable 1,600

Brief Exercise 2–8

Assets would be higher by $1,000, the amount of prepaid advertising that expired during the month. Liabilities would be lower by $21,600 ($4,000 + 16,000 + 1,600). Shareholders’ equity (and net income for the period) would be higher by $22,600.

Brief Exercise 2–9

**1.** Interest receivable 2,250

Interest revenue ($50,000 x 6% x 9/12) 2,250

**2.** Rent expense ($12,000x 3/12**)** 3,000

Prepaid rent 3,000

**3.** Supplies expense ($3,000 + 5,000 – 4,200) 3,800

Supplies 3,800

**4.** Salaries and wages expense 6,000

Salaries and wages payable 6,000

Brief Exercise 2–10

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | |  | |  |
| **BOWLER CORPORATION** | | | | |
| Income Statement | | | | |
| For the Year Ended December 31, 2018 | | | | |
|  |  | |  | |
| Sales revenue |  | | $325,000 | |
| Cost of goods sold |  | | 168,000 | |
| Gross profit |  | | 157,000 | |
|  |  | |  | |
| Operating expenses: |  | |  | |
| Salaries | $45,000 | |  | |
| Rent | 20,000 | |  | |
| Depreciation | 30,000 | |  | |
| Miscellaneous | 12,000 | |  | |
| Total operating expenses |  | | 107,000 | |
| Net income |  | | $ 50,000 | |
|  |  | |  | |

Brief Exercise 2–11

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
| **BOWLER CORPORATION** | | | |
| Balance Sheet | | | |
| At December 31, 2018 | | | |
|  |  |  |  |
| **Assets** |  |  |  |
| Current assets: |  |  |  |
| Cash |  | $ 5,000 |  |
| Accounts receivable |  | 10,000 |  |
| Inventory |  | 16,000 |  |
| Total current assets |  | 31,000 |  |
|  |  |  |  |
| Property and equipment: |  |  |  |
| Equipment | $100,000 |  |  |
| Less: Accumulated depreciation | (40,000) | 60,000 |  |
| Total assets |  | $91,000 |  |
|  |  |  |  |
| **Liabilities and Shareholders' Equity** | | | |
|  |  |  |  |
| Current liabilities: |  |  |  |
| Accounts payable |  | $ 20,000 |  |
| Salaries payable |  | 12,000 |  |
| Total current liabilities |  | 32,000 |  |
|  |  |  |  |
| Shareholders’ equity: |  |  |  |
| Common stock | $50,000 |  |  |
| Retained earnings | 9,000 |  |  |
| Total shareholders’ equity |  | 59,000 |  |
| Total liabilities and shareholders’ equity |  | $91,000 |  |
|  |  |  |  |

Brief Exercise 2–12

Sales revenue 850,000

Income summary 850,000

Income summary 815,000

Cost of goods sold 580,000

Salaries expense 180,000

Rent expense 40,000

Interest expense 15,000

Income summary ($850,000 – 815,000) 35,000

Retained earnings 35,000

Brief Exercise 2–13

|  |  |  |
| --- | --- | --- |
| *Revenues* | $428,000\* |  |
| *Expenses:* |  |  |
| Salaries | (240,000) |  |
| Utilities | (33,000)\*\* |  |
| Advertising | (12,000) |  |
| Net Income | $143,000 |  |

\*$420,000 cash received plus $8,000 increase ($60,000 – 52,000) in amount due from customers:

Cash 420,000

Accounts receivable (increase in account) 8,000

Sales revenue (to balance) 428,000

\*\* $35,000 cash paid less $2,000 decrease in amount owed to utility company:

Utilities expense (to balance) 33,000

Utilities payable (decrease in account) 2,000

Cash 35,000

# exercises

Exercise 2–1

**Assets = Liabilities + Paid-in Capital + Retained Earnings**

**1.** + 300,000 (cash) + 300,000 (common stock)

**2.** – 10,000 (cash)

+ 40,000 (equipment) + 30,000 (note payable)

**3.** + 90,000 (inventory) + 90,000 (accounts payable)

**4.** + 120,000 (accounts receivable) + 120,000 (revenue)

– 70,000 (inventory) – 70,000 (expense)

**5.** – 5,000 (cash) – 5,000 (expense)

**6.** – 6,000 (cash)

+ 6,000 (prepaid insurance)

**7.** – 70,000 (cash) - 70,000 (accounts payable)

**8.** + 55,000 (cash)

– 55,000 (accounts receivable)

**9.** – 1,000 (accumulated depreciation) – 1,000 (expense)

Exercise 2–2

**1.** Cash 300,000

Common stock 300,000

**2.** Equipment 40,000

Note payable 30,000

Cash 10,000

**3.** Inventory 90,000

Accounts payable 90,000

**4.** Accounts receivable 120,000

Sales revenue 120,000

Cost of goods sold 70,000

Inventory 70,000

**5.** Rent expense 5,000

Cash 5,000

**6.** Prepaid insurance 6,000

Cash 6,000

**7.** Accounts payable 70,000

Cash 70,000

**8.** Cash 55,000

Accounts receivable 55,000

**9.** Depreciation expense 1,000

Accumulated depreciation 1,000

Exercise 2–3 *balance sheet Accounts*

**Cash Accounts receivable**

3/1 Bal. 0 3/1 Bal. 0

1. 300,000 10,000 2. 4. 120,000 55,000 8.

8. 55,000 5,000 5.

6,000 6.

70,000 7.

**3/31 Bal.** 264,000 **3/31 Bal.** 65,000

**Inventory Prepaid insurance**

3/1 Bal. 0 3/1 Bal. 0

3. 90,000 70,000 4. 6. 6,000

**3/31 Bal.** 20,000 **3/31 Bal.** 6,000

**Equipment Accumulated depreciation**

3/1 Bal. 0 0 3/1 Bal.

2. 40,000 1,000 9.

**3/31 Bal.** 40,000 1,000 **3/31 Bal.**

**Accounts payable Note payable**

0 3/1 Bal. 0 3/1 Bal.

7. 70,000 90,000 3. 30,000 2.

20,000 **3/31 Bal.** 30,000 **3/31 Bal.**

**Common stock**

0 3/1 Bal.

300,000 1.

300,000 **3/31 Bal.**

##### *Exercise 2–3 (concluded)*

***InCOME STATEMENT Accounts***

**Sales revenue Cost of goods sold**

0 3/1 Bal. 3/1 Bal. 0

120,000 4. 4. 70,000

120,000 **3/31 Bal.** **3/31 Bal.** 70,000

**Rent expense Depreciation expense**

3/1 Bal. 0 3/1 Bal. 0

5. 5,000 9. 1,000

**3/31 Bal.** 5,000 **3/31 Bal.** 1,000

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 264,000 |  |  |  |
| Accounts receivable | 65,000 |  |  |  |
| Inventory | 20,000 |  |  |  |
| Prepaid insurance | 6,000 |  |  |  |
| Equipment | 40,000 |  |  |  |
| Accumulated depreciation |  |  | 1,000 |  |
| Accounts payable |  |  | 20,000 |  |
| Note payable |  |  | 30,000 |  |
| Common stock |  |  | 300,000 |  |
| Sales revenue |  |  | 120,000 |  |
| Cost of goods sold | 70,000 |  |  |  |
| Rent expense | 5,000 |  |  |  |
| Depreciation expense | 1,000 |  | \_\_\_\_\_\_ |  |
| Totals | 471,000 |  | 471,000 |  |
|  |  |  |  |  |

Exercise 2–4

**1.** Cash 500,000

Common stock 500,000

**2.** Furniture and fixtures 100,000

Cash 40,000

Note payable 60,000

**3.** Inventory 200,000

Accounts payable 200,000

**4.** Accounts receivable 280,000

Sales revenue 280,000

Cost of goods sold 140,000

Inventory 140,000

**5.** Rent expense 6,000

Cash 6,000

**6.** Prepaid insurance 3,000

Cash 3,000

**7.** Accounts payable 120,000

Cash 120,000

**8.** Cash 55,000

Accounts receivable 55,000

**9.** Retained earnings 5,000

Cash 5,000

**10.** Depreciation expense 2,000

Accumulated depreciation 2,000

**11.** Insurance expense ($3,000 ÷ 12 months) 250

Prepaid insurance 250

Exercise 2–5

**List A List B**

k 1. Source documents a. Record of the dual effect of a transaction in  
 debit/credit form.

e 2. Transaction analysis b. Internal events recorded at the end of a

reporting period.

a 3. Journal c. Primary means of disseminating information

to external decision makers.

j 4. Posting d. To zero out the owners’ equity temporary

accounts.

f 5. Unadjusted trial balance e. Determine the dual effect on the accounting

equation.

b 6. Adjusting entries f. List of accounts and their balances before

recording adjusting entries.

h 7. Adjusted trial balance g. List of accounts and their balances after

recording closing entries.

c 8. Financial statements h. List of accounts and their balances after

recording adjusting entries.

d 9. Closing entries i. A means of organizing information; not part

of the formal accounting system.

g 10. Post-closing trial balance j. Transferring balances from the journal to the

ledger.

i 11. Worksheet k. Used to identify and process external

transactions.

Exercise 2–6

**Increase (I) or**

**Decrease (D)** **Account**

1. I Inventory

2. I Depreciation expense

3. D Accounts payable

4. I Prepaid rent

5. D Sales revenue

6. D Common stock

7. D Salaries and wages payable

8. I Cost of goods sold

9. I Utility expense

10. I Equipment

11. I Accounts receivable

12. D Utilities payable

13. I Rent expense

14. I Interest expense

15. D Interest revenue

Exercise 2–7

**Account(s) Account(s)**

**Debited Credited**

*Example:* Purchased inventory for cash 3 5

1. Paid a cash dividend. 10 5

2. Paid rent for the next three months. 8 5

3. Sold goods to customers on account. 4, 16 9, 3

4. Purchased inventory on account. 3 1

5. Purchased supplies for cash. 6 5

6. Paid employee salaries and wages for September. 15 5

7. Issued common stock in exchange for cash. 5 12

8. Collected cash from customers for goods sold in 3. 5 4

9. Borrowed cash from a bank and signed a note. 5 11

10. At the end of October, recorded the amount of

supplies that had been used during the month. 7 6

11. Received cash for advance payment from customer. 5 13

12. Accrued employee salaries and wages for October. 17 15

Exercise 2–8

**1.** Prepaid insurance ($12,000 x 30/36) 10,000

Insurance expense 10,000

**2.** Depreciation expense 15,000

Accumulated depreciation 15,000

**3.** Salaries expense 18,000

Salaries payable 18,000

**4.** Interest expense ($200,000 x 12% x 2/12) 4,000

Interest payable 4,000

**5.** Deferred rent revenue 1,500

Rent revenue (1/2 x $3,000) 1,500

Exercise 2–9

**1.** Interest receivable ($90,000 x 8% x 3/12) 1,800

Interest revenue 1,800

**2.** Rent expense ($6,000 x 2/3) 4,000

Prepaid rent 4,000

**3.** Rent revenue ($12,000 x 7/12) 7,000

Deferred rent revenue 7,000

**4.** Depreciation expense 4,500

Accumulated depreciation 4,500

**5.** Salaries expense 8,000

Salaries payable 8,000

**6.** Supplies expense ($2,000 + 6,500 – 3,250) 5,250

Supplies 5,250

Exercise 2–10

1. $7,200 represents nine months of interest on a $120,000 note, or 75% of annual interest.

$7,200 ÷ 0.75 = $9,600 in annual interest

$9,600 ÷ $120,000 = **8% interest rate**

Or,

$7,200 ÷ $120,000 = .06 nine-month rate

To annualize the nine month rate: .06 x 12/9 = .08 or 8%

1. $60,000 ÷ 12 months = $5,000 per month in rent

$35,000 ÷ $5,000 = 7 months expired. The rent was paid on **June 1**, seven months ago.

1. $500 represents two months (November and December) in accrued interest, or $250 per month.

$250 x 12 months = $3,000 in annual interest

Principal x 6% = $3,000

Principal = $3,000 ÷ .06 = **$50,000 note**

Exercise 2–11

**1.** Insurance expense ($6,000 x 3/12) 1,500

Prepaid insurance 1,500

**2.** Interest expense ($80,000 x 8% 3/12) 1,600

Interest payable 1,600

**3.** Deferred rent revenue ($24,000 x 3/12) 6,000

Rent revenue 6,000

**4.** Depreciation expense ($20,000 x 3/12) 5,000

Accumulated depreciation - building 5,000

**5.** Salaries and wages expense 16,000

Salaries and wages payable 16,000

Exercise 2–12

Requirement 1

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | |  | |  |
| **BLUEBOY CHEESE CORPORATION** | | | | |
| Income Statement | | | | |
| For the Year Ended December 31, 2018 | | | | |
|  |  | |  | |
| Sales revenue |  | | $800,000 | |
| Cost of goods sold |  | | 480,000 | |
| Gross profit |  | | 320,000 | |
|  |  | |  | |
| Operating expenses: |  | |  | |
| Salaries | $120,000 | |  | |
| Rent | 30,000 | |  | |
| Depreciation | 60,000 | |  | |
| Advertising | 5,000 | |  | |
| Total operating expenses |  | | 215,000 | |
| Operating income |  | | 105,000 | |
| Other expense: |  | |  | |
| Interest |  | | 4,000 | |
| Net income |  | | $101,000 | |
|  |  | |  | |

##### *Exercise 2–12 (continued)*

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
| **BLUEBOY CHEESE CORPORATION** | | | |
| Balance Sheet | | | |
| At December 31, 2018 | | | |
|  |  |  |  |
| **Assets** |  |  |  |
| Current assets: |  |  |  |
| Cash |  | $ 21,000 |  |
| Accounts receivable |  | 300,000 |  |
| Inventory |  | 50,000 |  |
| Prepaid rent |  | 10,000 |  |
| Total current assets |  | 381,000 |  |
|  |  |  |  |
| Property and equipment: |  |  |  |
| Office equipment | $600,000 |  |  |
| Less: Accumulated depreciation | (250,000) | 350,000 |  |
| Total assets |  | $731,000 |  |
| **Liabilities and Shareholders' Equity** | | | |
|  |  |  |  |
| Current liabilities: |  |  |  |
| Accounts payable |  | $ 60,000 |  |
| Salaries payable |  | 8,000 |  |
| Interest payable  Note payable |  | 2,000  60,000 |  |
| Total current liabilities |  | 130,000 |  |
|  |  |  |  |
| Shareholders’ equity: |  |  |  |
| Common stock | $400,000 |  |  |
| Retained earnings | 201,000\* |  |  |
| Total shareholders’ equity |  | 601,000 |  |
| Total liabilities and shareholders’ equity |  | $731,000 |  |
|  |  |  |  |

\*Beginning balance of $100,000 plus net income of $101,000.

##### *Exercise 2–12 (concluded)*

Requirement 2

**December 31, 2018**

Sales revenue 800,000

Income summary 800,000

Income summary 699,000

Cost of goods sold 480,000

Salaries expense 120,000

Rent expense 30,000

Depreciation expense 60,000

Interest expense 4,000

Advertising expense 5,000

Income summary ($800,000 – 699,000) 101,000

Retained earnings 101,000

Exercise 2–13

**December 31, 2018**

Sales revenue 750,000

Interest revenue 3,000

Income summary 753,000

Income summary 576,000

Cost of goods sold 420,000

Salaries expense 100,000

Rent expense 15,000

Depreciation expense 30,000

Interest expense 5,000

Insurance expense 6,000

Income summary ($753,000 – 576,000) 177,000

Retained earnings 177,000

Exercise 2–14

**December 31, 2018**

Sales revenue 492,000

Interest revenue 6,000

Gain on sale of investments 8,000

Income summary 506,000

Income summary 440,000

Cost of goods sold 284,000

Salaries expense 80,000

Insurance expense 12,000

Interest expense 4,000

Advertising expense 10,000

Income tax expense 30,000

Depreciation expense 20,000

Income summary ($506,000 – 440,000) 66,000

Retained earnings 66,000

Exercise 2–15

Requirement 1

Supplies

11/30 Balance 1,500

Expense 2,000

Purchased **?**

12/31 Balance 3,000

Cost of supplies purchased = $3,000 + 2,000 – 1,500 = **$3,500**

Requirement 2

Prepaid insurance

11/30 Balance 6,000

Expense **?**

12/31 Balance 4,500

Insurance expense for December = $6,000 – 4,500 = **$1,500**

**December 31, 2018**

Insurance expense 1,500

Prepaid insurance 1,500

##### *Exercise 2–15 (concluded)*

Requirement 3

**Salaries and Wages Payable**

10,000 11/30 Balance

Salaries and wages paid 10,000 **?** Accrued salaries and wages

15,000 12/31 Balance

Accrued salaries and wages for December = **$15,000**

**December 31, 2018**

Salaries and wages expense 15,000

Salaries and wages payable 15,000

Requirement 4

Deferred rent revenue

2,000 11/30 Balance

Recognized for Dec. 1,000

1,000 12/31 Balance

Rent revenue recognized each month = $3,000 x 1/3 = **$1,000**

**December 31, 2018**

Deferred rent revenue 1,000

Rent revenue 1,000

Exercise 2–16

Requirement 1

|  |  |  |  |
| --- | --- | --- | --- |
| **2018** |  | **Debit** | **Credit** |
| Feb. 1 | Cash | 12,000 |  |
|  | Note payable |  | 12,000 |
|  |  |  |  |
| April 1 | Prepaid insurance | 3,600 |  |
|  | Cash |  | 3,600 |
|  |  |  |  |
| July 17 | Supplies | 2,800 |  |
|  | Accounts payable |  | 2,800 |
|  |  |  |  |
| Nov. 1 | Note receivable | 6,000 |  |
|  | Cash |  | 6,000 |
|  |  |  |  |
|  |  |  |  |

Requirement 2

|  |  |  |  |
| --- | --- | --- | --- |
| **2018** |  | **Debit** | **Credit** |
| Dec. 31 | Interest expense ($12,000 x 10% x 11/12) | 1,100 |  |
|  | Interest payable |  | 1,100 |
|  |  |  |  |
| Dec. 31 | Insurance expense ($3,600 x 9/24) | 1,350 |  |
|  | Prepaid insurance |  | 1,350 |
|  |  |  |  |
| Dec. 31 | Supplies expense ($2,800 – 1,250) | 1,550 |  |
|  | Supplies |  | 1,550 |
|  |  |  |  |
| Dec. 31 | Interest receivable | 80 |  |
|  | Interest revenue ($6,000 x 8% x 2/12) |  | 80 |
|  |  |  |  |

Exercise 2–17

Unadjusted net income $30,000

***Adjustments:***

a. Only $2,000 in insurance should be expensed + 4,000

b. Sales revenue overstated – 1,000

c. Supplies expense overstated + 750

d. Interest expense understated ($20,000 x 12% x 3/12) – 600

Adjusted net income $33,150

Exercise 2–18

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | |  | |  |
| **Stanley and Jones Lawn Service Company** | | | | |
| Income Statement | | | | |
| For the Year Ended December 31, 2018 | | | | |
|  |  | |  | |
| Sales revenue **(1)** |  | | $315,000 | |
|  |  | |  | |
| Operating expenses: |  | |  | |
| Salaries | $180,000 | |  | |
| Supplies **(2)** | 24,500 | |  | |
| Rent | 12,000 | |  | |
| Insurance **(3)** | 4,000 | |  | |
| Miscellaneous **(4)** | 21,000 | |  | |
| Depreciation | 10,000 | |  | |
| Total operating expenses |  | | 251,500 | |
| Operating income |  | | 63,500 | |
| Other expense: |  | |  | |
| Interest **(5)** |  | | 1,500 | |
| Net income |  | | $62,000 | |
|  |  | |  | |

1. $320,000 cash collected less $5,000 decrease in accounts receivable.

Cash 320,000

Accounts receivable (decrease in account) 5,000

Sales revenue (to balance) 315,000

1. $25,000 cash paid for the purchase of supplies less $500 increase in supplies.

Supplies expense (to balance) 24,500

Supplies (increase in account) 500

Cash 25,000

##### *Exercise 2–18 (concluded)*

1. $6,000 cash paid for insurance less $2,000 ending balance in prepaid insurance.

Insurance expense (to balance) 4,000

Prepaid insurance (increase in account) 2,000

Cash 6,000

1. $20,000 cash paid for miscellaneous expenses plus increase in accrued liabilities.

Miscellaneous expense (to balance) 21,000

Accrued liabilities (increase in account) 1,000

Cash 20,000

1. $100,000 x 6% x 3/12 = $1,500

Interest expense 1,500

Interest payable 1,500

Exercise 2–19

Cash basis income ($545,000 – 412,000) $133,000

*Add:*

Increase in prepaid insurance ($6,000 – 4,500) 1,500

*Deduct:*

Depreciation expense (22,000)

Decrease in accounts receivable ($62,000 – 55,000) (7,000)

Decrease in prepaid rent ($9,200 – 8,200) (1,000)

Increase in deferred service fee revenue ($11,000 – 9,200) (1,800)

Increase in accrued liabilities ($15,600 – 12,200) (3,400)

Accrual basis net income **$ 99,300**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Exercise 2–20 |  |  |  |  |  |  |  |  |  |  |  |
| **Requirement 1** |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| **Account Title** | **Unadjusted Trial Balance** | | **Adjusting Entries** | | **Adjusted Trial Balance** | | **Income Statement** | | **Balance Sheet** | |  |  |  |
|  | **Dr.** | **Cr.** | **Dr.** | **Cr.** | **Dr.** | **Cr.** | **Dr.** | **Cr.** | **Dr.** | **Cr.** |
| Cash | 20,000 |  |  |  | 20,000 |  |  |  | 20,000 |  |
| Accounts receivable | 35,000 |  |  |  | 35,000 |  |  |  | 35,000 |  |
| Prepaid rent | 5,000 |  |  |  | 5,000 |  |  |  | 5,000 |  |
| Inventory | 50,000 |  |  |  | 50,000 |  |  |  | 50,000 |  |
| Equipment | 100,000 |  |  |  | 100,000 |  |  |  | 100,000 |  |
| Accumulated depreciation- |  |  |  |  |  |  |  |  |  |  |
| equipment |  | 30,000 |  | (1) 10,000 |  | 40,000 |  |  |  | 40,000 |
| Accounts payable |  | 25,000 |  |  |  | 25,000 |  |  |  | 25,000 |
| Salaries and wages payable |  | 0 |  | (2) 4,000 |  | 4,000 |  |  |  | 4,000 |
| Common stock |  | 100,000 |  |  |  | 100,000 |  |  |  | 100,000 |
| Retained earnings |  | 29,000 |  |  |  | 29,000 |  |  |  | 29,000 |
| Sales revenue |  | 323,000 |  |  |  | 323,000 |  | 323,000 |  |  |
| Cost of goods sold | 180,000 |  |  |  | 180,000 |  | 180,000 |  |  |  |
| Salaries and wages expense | 71,000 |  | (2) 4,000 |  | 75,000 |  | 75,000 |  |  |  |
| Rent expense | 30,000 |  |  |  | 30,000 |  | 30,000 |  |  |  |
| Depreciation expense | 0 |  | (1) 10,000 |  | 10,000 |  | 10,000 |  |  |  |
| Utility expense | 12,000 |  |  |  | 12,000 |  | 12,000 |  |  |  |
| Advertising expense | 4,000 |  |  |  | 4,000 |  | 4,000 | \_\_\_\_\_\_ | \_\_\_\_\_\_\_ | \_\_\_\_\_\_\_ |
|  |  |  |  |  |  |  | 311,000 | 323,000 | 210,000 | 198,000 |
| Net Income |  |  |  |  |  |  | 12,000 | \_\_\_\_\_\_ | \_\_\_\_\_\_ | 12,000 |
|  |  |  |  |  |  |  |  |  |  |  |
| Totals | 507,000 | 507,000 | 14,000 | 14,000 | 521,000 | 521,000 | 323,000 | 323,000 | 210,000 | 210,000 |
|  |  |  |  |  |  |  |  |  |  |  |

##### *Exercise 2–20 (continued)*

Requirement 2

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | |  | |  |
| **WOLKSTEIN DRUG COMPANY** | | | | |
| Income Statement | | | | |
| For the Year Ended December 31, 2018 | | | | |
|  |  | |  | |
| Sales revenue |  | | $323,000 | |
| Cost of goods sold |  | | 180,000 | |
| Gross profit |  | | 143,000 | |
| Operating expenses: |  | |  | |
| Salaries and wages | $75,000 | |  | |
| Rent | 30,000 | |  | |
| Depreciation | 10,000 | |  | |
| Utilities | 12,000 | |  | |
| Advertising | 4,000 | |  | |
| Total operating expenses |  | | 131,000 | |
| Net income |  | | $ 12,000 | |
|  |  | |  | |

##### *Exercise 2–20 (concluded)*

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | |  |  |  | |
| **WOLKSTEIN DRUG COMPANY** | | | | | |
| Balance Sheet | | | | | |
| At December 31, 2018 | | | | | |
|  |  | |  | |  |
| **Assets** |  | |  | |  |
|  |  | |  | |  |
| Current assets: |  | |  | |  |
| Cash |  | | $ 20,000 | |  |
| Accounts receivable |  | | 35,000 | |  |
| Inventory |  | | 50,000 | |  |
| Prepaid rent |  | | 5,000 | |  |
| Total current assets |  | | 110,000 | |  |
|  |  | |  | |  |
| Property and equipment: |  | |  | |  |
| Equipment | $100,000 | |  | |  |
| Less: Accumulated depreciation | (40,000) | | 60,000 | |  |
| Total assets |  | | $170,000 | |  |
|  |  | |  | |  |
| **Liabilities and Shareholders' Equity** | | | | | |
|  |  | |  | |  |
| Current liabilities: |  | |  | |  |
| Accounts payable |  | | $ 25,000 | |  |
| Salaries and wages payable |  | | 4,000 | |  |
| Total current liabilities |  | | 29,000 | |  |
|  |  | |  | |  |
| Shareholders’ equity: |  | |  | |  |
| Common stock | $100,000 | |  | |  |
| Retained earnings | 41,000\* | |  | |  |
| Total shareholders’ equity |  | | 141,000 | |  |
| Total liabilities and shareholders’ equity |  | | $170,000 | |  |
|  |  | |  | |  |

\*Beginning balance of $29,000 plus net income of $12,000.

Exercise 2–21

Requirement 1

**June 30 - adjusting entry**

Salaries and wages expense ($10,000 x 3/5) 6,000

Salaries and wages payable 6,000

**July 1 - reversing entry**

Salaries and wages payable 6,000

Salaries and wages expense 6,000

**July 2 – payment of salaries**

Salaries and wages expense 10,000

Cash 10,000

Requirement 2

**June 30 - adjusting entry**

Salaries and wages expense 6,000

Salaries and wages payable 6,000

**July 2 - payment of salaries**

Salaries and wages expense 4,000

Salaries and wages payable 6,000

Cash 10,000

Exercise 2–22

Requirement 1

The accountant would reverse adjusting entry 1, the accrual of interest receivable, and entry 5, the accrual of salaries payable.

Requirement 2

**1.** Interest receivable ($90,000 x 8% x 3/12) 1,800

Interest revenue 1,800

**5.** Salaries expense 8,000

Salaries payable 8,000

Requirement 3

**1.** Interest revenue 1,800

Interest receivable 1,800

**5.** Salaries payable 8,000

Salaries expense 8,000

Exercise 2–23

Requirement 1

The transactions affected would be the prepayment of rent, transaction 2, and the purchase of supplies in transaction 6.

Requirement 2

**2.** **Original transaction on November 1:**

Rent expense 6,000

Cash 6,000

**Adjusting entry on December 31:**

Prepaid rent ($6,000 x 1/3) 2,000

Rent expense 2,000

**6.** **Original transaction during the year:**

Supplies expense 6,500

Cash 6,500

**Adjusting entry on December 31:**

Supplies 3,250

Supplies expense 3,250

Requirement 3

**2.** Rent expense 2,000

Prepaid rent 2,000

**6.** Supplies expense 3,250

Supplies 3,250

Exercise 2–24

**Transaction** **Journal**

1. Purchased merchandise on account. PJ

2. Collected an account receivable. CR

3. Borrowed $20,000 and signed a note. CR

4. Recorded depreciation expense. GJ

5. Purchased equipment for cash. CD

6. Sold merchandise for cash.

(the sale only, not the cost of the merchandise) CR

7. Sold merchandise on credit.

(the sale only, not the cost of the merchandise) SJ

8. Recorded accrued salaries and wages payable. GJ

9. Paid employee salaries and wages. CD

10. Sold equipment for cash. CR

11. Sold equipment on credit. GJ

12. Paid a cash dividend to shareholders. CD

13. Issued common stock in exchange for cash. CR

14. Paid accounts payable. CD

Exercise 2–25

**Transaction** **Journal**

1. Paid interest on a loan. CD

2. Recorded depreciation expense. GJ

3. Purchased furniture for cash. CD

4. Purchased merchandise on account. PJ

5. Sold merchandise on credit. SJ  
 (the sale only, not the cost of the merchandise)

6. Sold merchandise for cash. CR

(the sale only, not the cost of the merchandise)

7. Paid rent. CD

8. Recorded accrued interest payable. GJ

9. Paid advertising bill. CD

10. Sold equipment on credit. GJ

11. Collected cash from customers on account. CR

12. Paid employee salaries and wages. CD

13. Collected interest on a note receivable. CR

# problems

Problem 2–1

Requirement 1

|  |  |  |  |
| --- | --- | --- | --- |
| **2018** |  | **Debit** | **Credit** |
| Jan. 1 | Cash | 100,000 |  |
|  | Common stock |  | 100,000 |
|  |  |  |  |
| Jan. 2 | Inventory | 35,000 |  |
|  | Accounts payable |  | 35,000 |
|  |  |  |  |
| Jan. 4 | Prepaid insurance | 2,400 |  |
|  | Cash |  | 2,400 |
|  |  |  |  |
| Jan. 10 | Accounts receivable | 12,000 |  |
|  | Sales revenue |  | 12,000 |
|  |  |  |  |
| Jan. 10 | Cost of goods sold | 7,000 |  |
|  | Inventory |  | 7,000 |
|  |  |  |  |
| Jan. 15 | Cash | 30,000 |  |
|  | Note payable |  | 30,000 |
|  |  |  |  |
| Jan. 20 | Salaries and wages expense | 6,000 |  |
|  | Cash |  | 6,000 |
|  |  |  |  |
| Jan. 22 | Cash | 10,000 |  |
|  | Sales revenue |  | 10,000 |
|  |  |  |  |
| Jan. 22 | Cost of goods sold | 6,000 |  |
|  | Inventory |  | 6,000 |
|  |  |  |  |
| Jan. 24 | Accounts payable | 15,000 |  |
|  | Cash |  | 15,000 |
|  |  |  |  |
| Jan. 26 | Cash | 6,000 |  |
|  | Accounts receivable |  | 6,000 |
|  |  |  |  |
| Jan. 28 | Utilities expense | 1,000 |  |
|  | Cash |  | 1,000 |
|  |  |  |  |
| Jan. 30 | Prepaid rent | 2,000 |  |
|  | Rent expense | 2,000 |  |
|  | Cash |  | 4,000 |

##### *Problem 2–1 (continued)*

Requirement 2 *balance sheet Accounts*

**Cash Accounts receivable**

1/1 Bal. 0 1/1 Bal. 0

1/1 100,000 2,400 1/4 1/10 12,000 6,000 1/26

1/15 30,000 6,000 1/20

1/22 10,000 15,000 1/24

1/26 6,000 1,000 1/28

4,000 1/30

**1/31 Bal.** 117,600 **1/31 Bal.** 6,000

**Inventory Prepaid insurance**

1/1 Bal. 0 1/1 Bal. 0

1/2 35,000 7,000 1/10 1/4 2,400

6,000 1/22

**1/31 Bal.** 22,000 **1/31 Bal.** 2,400

**Prepaid rent Accounts payable**

1/1 Bal. 0 0 1/1 Bal.

1/30 2,000 1/24 15,000 35,000 1/2

**1/31 Bal.** 2,000 20,000 **1/31 Bal.**

**Note payable Common stock**

0 1/1 Bal. 0 1/1 Bal.

30,000 1/15 100,000 1/1

30,000 **1/31 Bal.** 100,000 **1/31 Bal.**

##### *Problem 2–1 (continued)*

***InCOME STATEMENT Accounts***

**Sales revenue Cost of goods sold**

0 1/1 Bal. 1/1 Bal. 0

12,000 1/10 1/10 7,000

10,000 1/22 1/22 6,000

22,000 **1/31 Bal.** **1/31 Bal.** 13,000

**Salaries and wages expense Rent expense**

1/1 Bal. 0 1/1 Bal. 0

1/20 6,000 1/30 2,000

**1/31 Bal.** 6,000 **1/31 Bal.** 2,000

**Utilities expense**

1/1 Bal. 0

1/28 1,000

**1/31 Bal.** 1,000

##### *Problem 2–1 (concluded)*

Requirement 3

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 117,600 |  |  |  |
| Accounts receivable | 6,000 |  |  |  |
| Inventory | 22,000 |  |  |  |
| Prepaid insurance | 2,400 |  |  |  |
| Prepaid rent | 2,000 |  |  |  |
| Accounts payable |  |  | 20,000 |  |
| Note payable |  |  | 30,000 |  |
| Common stock |  |  | 100,000 |  |
| Sales revenue |  |  | 22,000 |  |
| Cost of goods sold | 13,000 |  |  |  |
| Salaries and wages expense | 6,000 |  |  |  |
| Utilities expense | 1,000 |  |  |  |
| Rent expense | 2,000 |  | \_\_\_\_\_\_ |  |
| Totals | 172,000 |  | 172,000 |  |
|  |  |  |  |  |

Problem 2–2

Requirement 2

|  |  |  |  |
| --- | --- | --- | --- |
| **2018** |  | **Debit** | **Credit** |
| Jan. 1 | Cash | 3,500 |  |
|  | Sales revenue |  | 3,500 |
|  |  |  |  |
| Jan. 1 | Cost of goods sold | 2,000 |  |
|  | Inventory |  | 2,000 |
|  |  |  |  |
| Jan. 2 | Equipment | 5,500 |  |
|  | Accounts payable |  | 5,500 |
|  |  |  |  |
| Jan. 4 | Advertising expense | 150 |  |
|  | Accounts payable |  | 150 |
|  |  |  |  |
| Jan. 8 | Accounts receivable | 5,000 |  |
|  | Sales revenue |  | 5,000 |
|  |  |  |  |
| Jan. 8 | Cost of goods sold | 2,800 |  |
|  | Inventory |  | 2,800 |
|  |  |  |  |
| Jan. 10 | Inventory | 9,500 |  |
|  | Accounts payable |  | 9,500 |
|  |  |  |  |
| Jan. 13 | Equipment | 800 |  |
|  | Cash |  | 800 |
|  |  |  |  |
| Jan. 16 | Accounts payable | 5,500 |  |
|  | Cash |  | 5,500 |
|  |  |  |  |
| Jan. 18 | Cash | 4,000 |  |
|  | Accounts receivable |  | 4,000 |
|  |  |  |  |
| Jan. 20 | Rent expense | 800 |  |
|  | Cash |  | 800 |
|  |  |  |  |
| Jan. 30 | Salaries and wages expense | 3,000 |  |
|  | Cash |  | 3,000 |
|  |  |  |  |
| Jan. 31 | Retained earnings | 1,000 |  |
|  | Cash |  | 1,000 |

##### *Problem 2–2 (continued)*

Requirements 1 and 3

*balance sheet Accounts*

**Cash Accounts receivable**

1/1 Bal. 5,000 1/1 Bal. 2,000

1/1 3,500 800 1/13 1/8 5,000 4,000 1/18

1/18 4,000 5,500 1/16

800 1/20

3,000 1/30

1,000 1/31

**1/31 Bal.** 1,400 **1/31 Bal.** 3,000

**Inventory Equipment**

1/1 Bal. 5,000 1/1 Bal. 11,000

1/10 9,500 2,000 1/1 1/2 5,500

2,800 1/8 1/13 800

**1/31 Bal.** 9,700 **1/31 Bal.** 17,300

##### *Problem 2–2 (continued)*

**Accumulated depreciation Accounts payable**

3,500 1/1 Bal. 3,000 1/1 Bal.

1/16 5,500 5,500 1/2

150 1/4

9,500 1/10

3,500 **1/31 Bal.** 12,650 **1/31 Bal.**

**Common stock Retained earnings**

10,000 1/1 Bal. 6,500 1/1 Bal.

1/31 1,000

10,000 **1/31 Bal.** 5,500 **1/31 Bal.**

##### *Problem 2–2 (continued)*

***InCOME STATEMENT Accounts***

**Sales revenue Cost of goods sold**

0 1/1 Bal. 1/1 Bal. 0

3,500 1/1 1/1 2,000

5,000 1/8 1/8 2,800

8,500 **1/31 Bal.** **1/31 Bal.** 4,800

**Rent expense Salaries and wages expense**

1/1 Bal. 0 1/1 Bal. 0

1/20 800 1/30 3,000

**1/31 Bal.** 800 **1/31 Bal.** 3,000

**Advertising expense**

1/1 Bal. 0

1/4 150

**1/31 Bal.** 150

##### *Problem 2–2 (concluded)*

Requirement 4

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 1,400 |  |  |  |
| Accounts receivable | 3,000 |  |  |  |
| Inventory | 9,700 |  |  |  |
| Equipment | 17,300 |  |  |  |
| Accumulated depreciation |  |  | 3,500 |  |
| Accounts payable |  |  | 12,650 |  |
| Common stock |  |  | 10,000 |  |
| Retained earnings |  |  | 5,500 |  |
| Sales revenue |  |  | 8,500 |  |
| Cost of goods sold | 4,800 |  |  |  |
| Salaries and wages expense | 3,000 |  |  |  |
| Rent expense | 800 |  |  |  |
| Advertising expense | 150 |  | \_\_\_\_\_\_ |  |
| Totals | 40,150 |  | 40,150 |  |
|  |  |  |  |  |

Problem 2–3

**1.** Depreciation expense 10,000

Accumulated depreciation 10,000

**2.** Salaries and wages expense 1,500

Salaries and wages payable 1,500

**3.** Interest expense ($50,000 x 12% x 3/12) 1,500

Interest payable 1,500

**4.** Interest receivable ($20,000 x 8% x 10/12) 1,333

Interest revenue 1,333

**5.** Prepaid insurance ($6,000 x 15/24) 3,750

Insurance expense 3,750

**6.** Supplies expense ($1,500 – 800) 700

Supplies 700

**7.** Sales revenue 2,000

Deferred revenue 2,000

**8.** Rent expense 1,000

Prepaid rent 1,000

Problem 2–4

Requirements 1 and 2

***balance sheet Accounts***

**Cash Accounts receivable**

Bal. 30,000 Bal. 40,000

**12/31 Bal.** 30,000 **12/31 Bal.** 40,000

**Prepaid rent**

Bal. 2,000

1,000 8.

**12/31 Bal.** 1,000

**Prepaid insurance Supplies**

Bal. 0 Bal. 1,500

5. 3,750 700 6.

**12/31 Bal.** 3,750 **12/31 Bal.** 800

**Inventory Note receivable**

Bal. 60,000 Bal. 20,000

**12/31 Bal.** 60,000 **12/31 Bal.** 20,000

**Office equipment Interest receivable**

Bal. 80,000 Bal. 0

4. 1,333

**12/31 Bal.** 80,000 **12/31 Bal.** 1,333

##### *Problem 2–4 (continued)*

**Accumulated depreciation Accounts payable**

30,000 Bal. 31,000 Bal.

10,000 1.

40,000 **12/31 Bal.** 31,000 **12/31 Bal.**

**Salaries and wages payable Note payable**

0 Bal. 50,000 Bal.

1,500 2.

1,500 **12/31 Bal.** 50,000 **12/31 Bal.**

**Interest payable Deferred revenue**

0 Bal. 0 Bal.

1,500 3. 2,000 7.

1,500 **12/31 Bal.** 2,000 **12/31 Bal.**

**Common stock Retained earnings**

60,000 Bal. 24,500 Bal.

60,000 **12/31 Bal.** 24,500 **12/31 Bal.**

##### *Problem 2–4 (continued)*

***InCOME STATEMENT Accounts***

**Sales revenue Interest revenue**

148,000 Bal. 0 Bal.

7. 2,000 1,333 4.

146,000 **12/31 Bal.** 1,333 **12/31 Bal.**

**Cost of goods sold Salaries and wages expense**

Bal. 70,000 Bal. 18,900

2. 1,500

**12/31 Bal.** 70,000 **12/31 Bal.** 20,400

**Rent expense Depreciation expense**

Bal. 11,000 Bal. 0

8. 1,000 1. 10,000

**12/31 Bal.** 12,000 **12/31 Bal.** 10,000

**Interest expense Supplies expense**

Bal. 0 Bal. 1,100

3. 1,500 6. 700

**12/31 Bal.** 1,500 **12/31 Bal.** 1,800

**Insurance expense Advertising expense**

Bal. 6,000 Bal. 3,000

3,750 5.

**12/31 Bal.** 2,250 **12/31 Bal.** 3,000

##### *Problem 2–4 (continued)*

Requirement 3

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 30,000 |  |  |  |
| Accounts receivable | 40,000 |  |  |  |
| Prepaid rent | 1,000 |  |  |  |
| Prepaid insurance | 3,750 |  |  |  |
| Supplies | 800 |  |  |  |
| Inventory | 60,000 |  |  |  |
| Note receivable | 20,000 |  |  |  |
| Interest receivable | 1,333 |  |  |  |
| Office equipment | 80,000 |  |  |  |
| Accumulated depreciation—office  equipment |  |  | 40,000 |  |
| Accounts payable |  |  | 31,000 |  |
| Salaries and wages payable |  |  | 1,500 |  |
| Note payable |  |  | 50,000 |  |
| Interest payable |  |  | 1,500 |  |
| Deferred revenue |  |  | 2,000 |  |
| Common stock |  |  | 60,000 |  |
| Retained earnings |  |  | 24,500 |  |
| Sales revenue |  |  | 146,000 |  |
| Interest revenue |  |  | 1,333 |  |
| Cost of goods sold | 70,000 |  |  |  |
| Salaries and wages expense | 20,400 |  |  |  |
| Rent expense | 12,000 |  |  |  |
| Depreciation expense | 10,000 |  |  |  |
| Interest expense | 1,500 |  |  |  |
| Supplies expense | 1,800 |  |  |  |
| Insurance expense | 2,250 |  |  |  |
| Advertising expense | 3,000 |  | \_\_\_\_\_\_ |  |
| Totals | 357,833 |  | 357,833 |  |
|  |  |  |  |  |

##### *Problem 2–4 (continued)*

Requirement 4

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | |  | |  |
| **PASTINA COMPANY** | | | | |  |  |
| Income Statement | | | | |  |  |
| For the Year Ended December 31, 2018 | | | | |  |  |
|  |  | |  | |
| Sales revenue |  | | $146,000 | |
| Cost of goods sold |  | | 70,000 | |
| Gross profit |  | | 76,000 | |
|  |  | |  | |
| Operating expenses: |  | |  | |
| Salaries and wages | $20,400 | |  | |
| Rent | 12,000 | |  | |
| Depreciation | 10,000 | |  | |
| Supplies | 1,800 | |  | |
| Insurance | 2,250 | |  | |
| Advertising | 3,000 | |  | |
| Total operating expenses |  | | 49,450 | |
| Operating income |  | | 26,550 | |
| Other income (expense): |  | |  | |
| Interest revenue | 1,333 | |  | |
| Interest expense | (1,500) | | (167) | |
| Net income |  | | $ 26,383 | |
|  |  | |  | |

##### *Problem 2–4 (continued)*

**PASTINA COMPANY**

Statement of Shareholders' Equity

For the Year Ended December 31, 2018

**Total**

**Common Retained Shareholders’**

**Stock Earnings Equity**

Balance at January 1, 2018 $60,000 $28,500 $ 88,500

Issue of common stock - 0 - - 0 -

Net income for 2018 26,383 26,383

Less: Dividends \_\_\_\_\_\_ (4,000) (4,000)

Balance at December 31, 2018 $60,000 $50,883 $110,883

##### *Problem 2–4 (continued)*

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | |  |  |  | |
| **PASTINA COMPANY** | | | | | |
| Balance Sheet | | | | | |
| At December 31, 2018 | | | | | |
|  |  | |  | |  |
| **Assets** |  | |  | |  |
| Current assets: |  | |  | |  |
| Cash |  | | $ 30,000 | |  |
| Accounts receivable |  | | 40,000 | |  |
| Supplies |  | | 800 | |  |
| Inventory |  | | 60,000 | |  |
| Note receivable |  | | 20,000 | |  |
| Interest receivable |  | | 1,333 | |  |
| Prepaid rent |  | | 1,000 | |  |
| Prepaid insurance |  | | 3,750 | |  |
| Total current assets |  | | 156,883 | |  |
|  |  | |  | |  |
| Office equipment | $80,000 | |  | |  |
| Less: Accumulated depreciation | (40,000) | | 40,000 | |  |
| Total assets |  | | $196,883 | |  |
|  |  | |  | |  |
| **Liabilities and Shareholders' Equity** | | | | | |
|  |  | |  | |  |
| Current liabilities |  | |  | |  |
| Accounts payable |  | | $ 31,000 | |  |
| Salaries and wages payable |  | | 1,500 | |  |
| Note payable  Interest payable |  | | 50,000  1,500 | |  |
| Deferred revenue |  | | 2,000 | |  |
| Total current liabilities |  | | 86,000 | |  |
|  |  | |  | |  |
| Shareholders’ equity: |  | |  | |  |
| Common stock | $60,000 | |  | |  |
| Retained earnings | 50,883 | |  | |  |
| Total shareholders’ equity |  | | 110,883 | |  |
| Total liabilities and shareholders’ equity |  | | $196,883 | |  |

##### *Problem 2–4 (continued)*

Requirement 5

**December 31, 2018**

Sales revenue 146,000

Interest revenue 1,333

Income summary 147,333

Income summary 120,950

Cost of goods sold 70,000

Salaries and wages expense 20,400

Rent expense 12,000

Depreciation expense 10,000

Interest expense 1,500

Supplies expense 1,800

Insurance expense 2,250

Advertising expense 3,000

Income summary ($147,333 – 120,950) 26,383

Retained earnings 26,383

##### *Problem 2–4 (continued)*

**Sales revenue Interest revenue**

148,000 Bal. 0 Bal.

7. 2,000 1,333 4.

Closing 146,000 Closing 1,333

0 **12/31 Bal.** 0 **12/31 Bal.**

**Cost of goods sold Salaries and wages expense**

Bal. 70,000 Bal. 18,900

4. 1,500

70,000 Closing 20,400 Closing

**12/31 Bal.** 0 **12/31 Bal.** 0

**Rent expense Depreciation expense**

Bal. 11,000 Bal. 0

8. 1,000 1. 10,000

12,000 Closing 10,000 Closing

**12/31 Bal.** 0 **12/31 Bal.** 0

**Interest expense Supplies expense**

Bal. 0 Bal. 1,100

3. 1,500 6. 700

1,500 Closing 1,800 Closing

**12/31 Bal.** 0 **12/31 Bal.** 0

##### *Problem 2–4 (continued)*

**Insurance expense Advertising expense**

Bal. 6,000 Bal. 3,000

3,750 5.

2,250 Closing 3,000 Closing

**12/31 Bal.** 0 **12/31 Bal.** 0

**Income summary Retained earnings**

Bal. 0 24,500 Bal.

147,333 Closing

Closing 120,950

Closing 26,383 26,383 Closing

**12/31 Bal.** 0 50,883 **12/31 Bal.**

##### *Problem 2–4 (concluded)*

Requirement 6

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 30,000 |  |  |  |
| Accounts receivable | 40,000 |  |  |  |
| Prepaid rent | 1,000 |  |  |  |
| Prepaid insurance | 3,750 |  |  |  |
| Supplies | 800 |  |  |  |
| Inventory | 60,000 |  |  |  |
| Note receivable | 20,000 |  |  |  |
| Interest receivable | 1,333 |  |  |  |
| Office equipment | 80,000 |  |  |  |
| Accumulated depreciation—office  equipment |  |  | 40,000 |  |
| Accounts payable |  |  | 31,000 |  |
| Salaries and wages payable |  |  | 1,500 |  |
| Note payable |  |  | 50,000 |  |
| Interest payable |  |  | 1,500 |  |
| Deferred revenue |  |  | 2,000 |  |
| Common stock |  |  | 60,000 |  |
| Retained earnings | \_\_\_\_\_\_\_ |  | 50,883 |  |
| Totals | 236,883 |  | 236,883 |  |
|  |  |  |  |  |

Problem 2–5

Rent expense 800

Prepaid rent 800

Supplies expense 700

Supplies 700

Interest receivable 1,500

Interest revenue 1,500

Depreciation expense 6,500

Accumulated depreciation 6,500

Salaries and wages expense 6,200

Salaries and wages payable 6,200

Interest expense 2,500

Interest payable 2,500

Rent revenue 2,000

Deferred rent revenue 2,000

Problem 2–6

Requirement 2

**a.** Cash 70,000

Accounts receivable 30,000

Service revenue 100,000

**b.** Cash 27,300

Accounts receivable 27,300

**c.** Cash 10,000

Common stock 10,000

**d.** Salaries expense 41,000

Salaries payable 9,000

Cash 50,000

**e.** Miscellaneous expenses 24,000

Cash 24,000

**f.** Equipment 15,000

Cash 15,000

**g.** Retained earnings 2,500

Cash 2,500

##### *Problem 2–6 (continued)*

Requirements 1 and 3

***balance sheet Accounts***

**Cash Accounts receivable**

1/1 Bal. 30,000 1/1 Bal. 15,000

a. 70,000 50,000 d. a. 30,000 27,300 b.

b. 27,300 24,000 e.

c. 10,000 15,000 f.

2,500 g.

**12/31 Bal.** 45,800 **12/31 Bal.** 17,700

**Equipment**

1/1 Bal. 20,000

f. 15,000

**12/31 Bal.** 35,000

**Accumulated depreciation Salaries payable**

6,000 1/1 Bal. 9,000 1/1 Bal.

d. 9,000

6,000 **12/31 Bal.** 0 **12/31 Bal.**

**Common stock Retained earnings**

40,500 1/1 Bal. 9,500 1/1 Bal.

10,000 c. g. 2,500

50,500 **12/31 Bal.** 7,000 **12/31 Bal.**

##### *Problem 2–6 (continued)*

***InCOME STATEMENT Accounts***

**Service revenue Miscellaneous expenses**

0 1/1 Bal. 1/1 Bal. 0

100,000 a. e. 24,000

100,000 **12/31 Bal.** **12/31 Bal.** 24,000

**Salaries expense**

1/1 Bal. 0

d. 41,000

**12/31 Bal.** 41,000

Requirement 4

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 45,800 |  |  |  |
| Accounts receivable | 17,700 |  |  |  |
| Equipment | 35,000 |  |  |  |
| Accumulated depreciation |  |  | 6,000 |  |
| Salaries payable |  |  | - 0 - |  |
| Common stock |  |  | 50,500 |  |
| Retained earnings |  |  | 7,000 |  |
| Service revenue |  |  | 100,000 |  |
| Salaries expense | 41,000 |  |  |  |
| Miscellaneous expenses | 24,000 |  | \_\_\_\_\_\_ |  |
| Totals | 163,500 |  | 163,500 |  |
|  |  |  |  |  |

##### *Problem 2–6 (continued)*

Requirement 5

Salaries expense 1,000

Salaries payable 1,000

Depreciation expense 2,000

Accumulated depreciation 2,000

##### *Problem 2–6 (continued)*

***balance sheet Accounts***

**Cash Accounts receivable**

1/1 Bal. 30,000 1/1 Bal. 15,000

a. 70,000 50,000 d. a. 30,000 27,300 b.

b. 27,300 24,000 e.

c. 10,000 15,000 f.

2,500 g.

**12/31 Bal.** 45,800 **12/31 Bal.** 17,700

**Equipment**

1/1 Bal. 20,000

f. 15,000

**12/31 Bal.** 35,000

**Accumulated depreciation Salaries payable**

6,000 1/1 Bal. 9,000 1/1 Bal.

2,000 Adjusting d. 9,000 1,000 Adjusting

8,000 **12/31 Bal.** 1,000 **12/31 Bal.**

**Common stock Retained earnings**

40,500 1/1 Bal. 9,500 1/1 Bal.

10,000 c. g. 2,500

50,500 **12/31 Bal.** 7,000 **12/31 Bal.**

##### *Problem 2–6 (continued)*

***InCOME STATEMENT Accounts***

**Service revenue Miscellaneous expenses**

0 1/1 Bal. 1/1 Bal. 0

100,000 a. e. 24,000

100,000 **12/31 Bal.** **12/31 Bal.** 24,000

**Depreciation expense**

1/1 Bal. 0

Adjusting 2,000

**12/31 Bal.** 2,000

**Salaries expense**

1/1 Bal. 0

d. 41,000

Adjusting 1,000

**12/31 Bal.** 42,000

##### *Problem 2–6 (continued)*

Requirement 6

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 45,800 |  |  |  |
| Accounts receivable | 17,700 |  |  |  |
| Equipment | 35,000 |  |  |  |
| Accumulated depreciation |  |  | 8,000 |  |
| Salaries payable |  |  | 1,000 |  |
| Common stock |  |  | 50,500 |  |
| Retained earnings |  |  | 7,000 |  |
| Service revenue |  |  | 100,000 |  |
| Salaries expense | 42,000 |  |  |  |
| Miscellaneous expenses | 24,000 |  |  |  |
| Depreciation expense | 2,000 |  | \_\_\_\_\_\_ |  |
| Totals | 166,500 |  | 166,500 |  |
|  |  |  |  |  |

Requirement 7

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | |  | |  |
| **KARLIN COMPANY** | | | | |
| Income Statement | | | | |
| For the Year Ended December 31, 2018 | | | | |
|  |  | |  | |
| Service revenue |  | | $100,000 | |
|  |  | |  | |
| Operating expenses: |  | |  | |
| Salaries | $42,000 | |  | |
| Miscellaneous | 24,000 | |  | |
| Depreciation | 2,000 | |  | |
| Total operating expenses |  | | 68,000 | |
| Net income |  | | $ 32,000 | |

##### *Problem 2–6 (continued)*

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | |  |  |  | |
| **KARLIN COMPANY** | | | | | |
| Balance Sheet | | | | | |
| At December 31, 2018 | | | | | |
|  |  | |  | |  |
| **Assets** |  | |  | |  |
|  |  | |  | |  |
| Current assets: |  | |  | |  |
| Cash |  | | $45,800 | |  |
| Accounts receivable |  | | 17,700 | |  |
| Total current assets |  | | 63,500 | |  |
|  |  | |  | |  |
| Property and equipment: |  | |  | |  |
| Equipment | $35,000 | |  | |  |
| Less: Accumulated depreciation | (8,000) | | 27,000 | |  |
| Total assets |  | | $90,500 | |  |
|  |  | |  | |  |
| **Liabilities and Shareholders' Equity** | | | | | |
|  |  | |  | |  |
| Current liabilities: |  | |  | |  |
| Salaries payable |  | | $ 1,000 | |  |
| Total current liabilities |  | | 1,000 | |  |
|  |  | |  | |  |
| Shareholders’ equity: |  | |  | |  |
| Common stock | $50,500 | |  | |  |
| Retained earnings | 39,000\* | |  | |  |
| Total shareholders’ equity |  | | 89,500 | |  |
| Total liabilities and shareholders’ equity |  | | $90,500 | |  |
|  |  | |  | |  |

\*Beginning balance of $9,500 plus net income of $32,000 less dividends of $2,500.

##### *Problem 2–6 (continued)*

Requirement 8

**December 31, 2018**

Service revenue 100,000

Income summary 100,000

Income summary 68,000

Salaries expense 42,000

Miscellaneous expenses 24,000

Depreciation expense 2,000

Income summary 32,000

Retained earnings 32,000

##### *Problem 2–6 (continued)*

***balance sheet Accounts***

**Cash Accounts receivable**

1/1 Bal. 30,000 1/1 Bal. 15,000

a. 70,000 50,000 d. a. 30,000 27,300 b.

b. 27,300 24,000 e.

c. 10,000 15,000 f.

2,500 g.

**12/31 Bal.** 45,800 **12/31 Bal.** 17,700

**Equipment**

1/1 Bal. 20,000

f. 15,000

**12/31 Bal.** 35,000

**Accumulated depreciation Salaries payable**

6,000 1/1 Bal. 9,000 1/1 Bal.

2,000 Adjusting d. 9,000 1,000 Adjusting

8,000 **12/31 Bal.** 1,000 **12/31 Bal.**

**Common stock Retained earnings**

40,500 1/1 Bal. 9,500 1/1 Bal.

10,000 c. g. 2,500

32,000 Closing

50,500 **12/31 Bal.** 39,000 **12/31 Bal.**

##### *Problem 2–6 (continued)*

***InCOME STATEMENT Accounts***

**Service revenue Miscellaneous expenses**

0 1/1 Bal. 1/1 Bal. 0

100,000 a. e. 24,000

Closing 100,000 24,000 Closing

0 **12/31 Bal.** **12/31 Bal.** 0

**Depreciation expense**

1/1 Bal. 0

Adjusting 2,000

2,000 Closing

**12/31 Bal.** 0

**Salaries expense Income summary**

1/1 Bal. 0 100,000 Closing

d. 41,000 Closing 68,000

Adjusting 1,000 42,000 Closing Closing 32,000

**12/31 Bal.** 0 **12/31 Bal.** 0

##### *Problem 2–6 (concluded)*

Requirement 9

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 45,800 |  |  |  |
| Accounts receivable | 17,700 |  |  |  |
| Equipment | 35,000 |  |  |  |
| Accumulated depreciation |  |  | 8,000 |  |
| Salaries payable |  |  | 1,000 |  |
| Common stock |  |  | 50,500 |  |
| Retained earnings | \_\_\_\_\_ |  | 39,000 |  |
| Totals | 98,500 |  | 98,500 |  |
|  |  |  |  |  |

Problem 2–7

Requirement 1

**a.** Interest receivable 600

Interest revenue ($10,000 x 12% x 1/2) 600

**b.** Depreciation expense ($30,000 x 1/5) 6,000

Accumulated depreciation 6,000

**c.** Deferred rent revenue 2,000

Rent revenue ($6,000 x 2/6) 2,000

**d.** Prepaid insurance 1,500

Insurance expense ($2,400 x 15/24) 1,500

**e.** Interest expense ($20,000 x 12% x 3/12) 600

Interest payable 600

**f.** Supplies expense ($1,800 – 700) 1,100

Supplies 1,100

Requirement 2

**Income overstated**

**(understated)**

*Adjustments to revenues:*

Understatement of interest revenue $ (600)

Understatement of rent revenue (2,000)

*Adjustments to expenses:*

Overstatement of insurance expense (1,500)

Understatement of depreciation expense 6,000

Understatement of interest expense 600

Understatement of supplies expense 1,100

Overstatement of net income $3,600

Problem 2–8

**1.** Depreciation expense ($75,000 ÷ 8 years) 9,375

Accumulated depreciation 9,375

**2.** Salaries and wages expense ($4,500 – 3,000) 1,500

Salaries and wages payable 1,500

**3.** Interest expense ($30,000 x 10% x 4/12) 1,000

Interest payable 1,000

**4.** Supplies 500

Supplies expense 500

**5.** Prepaid rent 1,000

Rent expense 1,000

Problem 2–9

Requirements 1 and 2

**a.** Depreciation expense ($50,000 ÷ 50 years) 1,000

Accumulated depreciation - buildings 1,000

**b.** Depreciation expense ($100,000 x 10%) 10,000

Accumulated depreciation—office equipment 10,000

**c.** Insurance expense 1,500

Prepaid insurance 1,500

**d.** Salaries and wages expense 1,500

Salaries and wages payable 1,500

**e.** Rent revenue 1,200

Deferred rent revenue 1,200

##### *Problem 2–9 (continued)*

***balance sheet Accounts***

**Cash Accounts receivable**

Bal. 8,000 Bal. 9,000

**12/31 Bal.** 8,000 **12/31 Bal.** 9,000

**Prepaid insurance**

Bal. 3,000

1,500 Adjusting

**12/31 Bal.** 1,500

**Land Buildings**

Bal. 200,000 Bal. 50,000

**12/31 Bal.** 200,000 **12/31 Bal.** 50,000

**Office equipment Accumulated depreciation—bldg.**

Bal. 100,000 20,000 Bal.

1,000 Adjusting

**12/31 Bal.** 100,000 21,000 **12/31 Bal.**

**Accumulated depreciation—office equip. Accounts payable**

40,000 Bal. 35,050 Bal.

10,000 Adjusting

50,000 **12/31 Bal.** 35,050 **12/31 Bal.**

##### *Problem 2–9 (continued)*

**Salaries and wages payable Deferred rent revenue**

0 Bal. 0 Bal.

1,500 Adjusting 1,200 Adjusting

1,500 **12/31 Bal.** 1,200 **12/31 Bal.**

**Common stock Retained earnings**

200,000 Bal. 56,450 Bal.

200,000 **12/31 Bal.** 56,450 **12/31 Bal.**

***InCOME STATEMENT Accounts***

**Sales revenue Interest revenue**

90,000 Bal. 3,000 Bal.

90,000 **12/31 Bal.** 3,000 **12/31 Bal.**

**Rent revenue Salaries and wages expense**

7,500 Bal. Bal. 37,000

Adjusting 1,200 Adjusting 1,500

6,300 **12/31 Bal.** **12/31 Bal.** 38,500

**Depreciation expense**

Bal. 0

Adjusting 1,000

Adjusting 10,000

**12/31 Bal.** 11,000

##### *Problem 2–9 (continued)*

**Insurance expense Utility expense**

Bal. 0 Bal. 30,000

Adjusting 1,500

**12/31 Bal.** 1,500 **12/31 Bal.** 30,000

**Maintenance expense**

Bal. 15,000

**12/31 Bal.** 15,000

##### *Problem 2–9 (continued)*

Requirement 3

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 8,000 |  |  |  |
| Accounts receivable | 9,000 |  |  |  |
| Prepaid insurance | 1,500 |  |  |  |
| Land | 200,000 |  |  |  |
| Buildings | 50,000 |  |  |  |
| Accumulated depreciation—buildings |  |  | 21,000 |  |
| Office equipment | 100,000 |  |  |  |
| Accumulated depreciation—office  equipment |  |  | 50,000 |  |
| Accounts payable |  |  | 35,050 |  |
| Salaries and wages payable |  |  | 1,500 |  |
| Deferred rent revenue |  |  | 1,200 |  |
| Common stock |  |  | 200,000 |  |
| Retained earnings |  |  | 56,450 |  |
| Sales revenue |  |  | 90,000 |  |
| Interest revenue |  |  | 3,000 |  |
| Rent revenue |  |  | 6,300 |  |
| Salaries and wages expense | 38,500 |  |  |  |
| Depreciation expense | 11,000 |  |  |  |
| Insurance expense | 1,500 |  |  |  |
| Utility expense | 30,000 |  |  |  |
| Maintenance expense | 15,000 |  | \_\_\_\_\_\_ |  |
| Totals | 464,500 |  | 464,500 |  |
|  |  |  |  |  |

##### *Problem 2–9 (continued)*

Requirement 4

**December 31, 2018**

Sales revenue 90,000

Interest revenue 3,000

Rent revenue 6,300

Income summary 99,300

Income summary 96,000

Salaries and wages expense 38,500

Depreciation expense 11,000

Insurance expense 1,500

Utility expense 30,000

Maintenance expense 15,000

Income summary ($99,300 – 96,000) 3,300

Retained earnings 3,300

##### *Problem 2–9 (concluded)*

Requirement 5

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| **Account Title** | **Debits** |  | **Credits** |  |
| Cash | 8,000 |  |  |  |
| Accounts receivable | 9,000 |  |  |  |
| Prepaid insurance | 1,500 |  |  |  |
| Land | 200,000 |  |  |  |
| Buildings | 50,000 |  |  |  |
| Accumulated depreciation—buildings |  |  | 21,000 |  |
| Office equipment | 100,000 |  |  |  |
| Accumulated depreciation—office  equipment |  |  | 50,000 |  |
| Accounts payable |  |  | 35,050 |  |
| Salaries and wages payable |  |  | 1,500 |  |
| Deferred rent revenue |  |  | 1,200 |  |
| Common stock |  |  | 200,000 |  |
| Retained earnings | \_\_\_\_\_\_ |  | 59,750 |  |
| Totals | 368,500 |  | 368,500 |  |
|  |  |  |  |  |

Problem 2–10

**Computations:**

**Sales revenue**

Sales revenue during 2018 = $320,000 + 22,000 = **$342,000**

**Cost of goods sold**

**Accounts payable**

0 1/1 Balance

Cash paid 220,000

**?** Purchases

30,000 12/31 Balance

Purchases during 2018 = $220,000 + 30,000 = $250,000

**Inventory**

1/1 Balance 0

Purchases 250,000

**?** Cost of goods sold

12/31 Balance 50,000

Cost of goods sold during 2018 = $250,000 – 50,000 = **$200,000**

**Rent expense and prepaid rent**

Prepaid rent = $ 3,000 x 2/3 = **$2,000**

Rent expense during 2018 = $14,000 – 2,000 = **$12,000**

**Depreciation expense**

Depreciation during 2018 = $30,000 x 10% = **$3,000**

**Interest expense**

Interest accrued during 2018 = $40,000 x 12% x 9/12 = **$3,600**

**Salaries and wages expense**

Cash paid plus accrued salaries and wages = $80,000 + 5,000 = **$85,000**

##### *Problem 2–10 (continued)*

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | |  | |  |
| **McGUIRE CORPORATION** | | | | |
| Income Statement | | | | |
| For the Year Ended December 31, 2018 | | | | |
|  |  | |  | |
| Sales revenue |  | | $342,000 | |
| Cost of goods sold |  | | 200,000 | |
| Gross profit |  | | 142,000 | |
|  |  | |  | |
| Operating expenses: |  | |  | |
| Salaries and wages | $85,000 | |  | |
| Rent | 12,000 | |  | |
| Depreciation | 3,000 | |  | |
| Miscellaneous | 10,000 | |  | |
| Total operating expenses |  | | 110,000 | |
| Operating income |  | | 32,000 | |
| Other expense: |  | |  | |
| Interest |  | | 3,600 | |
| Net income |  | | $ 28,400 | |
|  |  | |  | |

##### *Problem 2–10 (concluded)*

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
| **McGUIRE CORPORATION** | | | |
| Balance Sheet | | | |
| At December 31, 2018 | | | |
|  |  |  |  |
| **Assets** |  |  |  |
|  |  |  |  |
| Current assets: |  |  |  |
| Cash |  | $ 56,000 | **(1)** |
| Accounts receivable |  | 22,000 |  |
| Prepaid rent |  | 2,000 |  |
| Inventory |  | 50,000 |  |
| Total current assets |  | 130,000 |  |
|  |  |  |  |
| Office equipment | $30,000 |  |  |
| Less: Accumulated depreciation | (3,000) | 27,000 |  |
| Total assets |  | $157,000 |  |
|  |  |  |  |
| **Liabilities and Shareholders' Equity** | | | |
|  |  |  |  |
| Current liabilities: |  |  |  |
| Accounts payable |  | $ 30,000 |  |
| Salaries and wages payable |  | 5,000 |  |
| Note payable  Interest payable |  | 40,000  3,600 |  |
| Total current liabilities |  | 78,600 |  |
|  |  |  |  |
| Shareholders’ equity: |  |  |  |
| Common stock | $50,000 |  |  |
| Retained earnings | 28,400 |  |  |
| Total shareholders’ equity |  | 78,400 |  |
| Total liabilities and shareholders’ equity |  | $157,000 |  |
|  |  |  |  |

1. $410,000 – 354,000 = $56,000

Problem 2–11

Requirement 1

**a. Sales revenue**

Accounts receivable

11/30 Balance 10,000

80,000 Cash collections

Sales revenue **?**

12/31 Balance 3,000

Sales revenue during December = $3,000 + 80,000 – 10,000 = **$73,000**

**b. Cost of goods sold**

Accounts payable

12,000 11/30 Balance

Cash paid 60,000

**?** Purchases

15,000 12/31 Balance

Purchases during December = $15,000 + 60,000 – 12,000 = **$63,000**

Inventory

11/30 Balance 7,000

Purchases 63,000

**?** Cost of goods sold

12/31 Balance 6,000

Cost of goods sold during December = $7,000 + 63,000 – 6,000 = **$64,000**

##### *Problem 2–11 (concluded)*

**c. Insurance expense**

Prepaid insurance

11/30 Balance 5,000

Cash payment 5,000

**?** Insurance expense

12/31 Balance 7,500

Insurance expense during December = $5,000 + 5,000 – 7,500 = **$2,500**

**d. Salaries and wages expense**

Salaries and wages payable

5,000 11/30 Balance

Cash payments 10,000

**?** Salaries and wages expense

3,000 12/31 Balance

Salaries and wages expense during December = $3,000 + 10,000 – 5,000 = **$8,000**

Requirement 2

Accounts receivable 73,000

Sales revenue 73,000

Cost of goods sold 64,000

Inventory 64,000

Problem 2–12

Requirement 1

**Computations:**

**Sales revenue:**

Cash collected from customers $675,000

Add: Increase in accounts receivable 30,000

Sales revenue $705,000

**Interest revenue:**

Cash received $4,000

Add: Amount accrued at the end of

2018 ($50,000 x .08 x 9/12) 3,000 (c)

Deduct: Amount accrued at the end of 2017 (3,000)

Interest revenue $4,000

**Cost of goods sold:**

Cash paid for merchandise $390,000

Add: Increase in accounts payable 12,000

Purchases during 2018 402,000

Add: Decrease in inventory 18,000

Cost of goods sold $420,000

**Insurance expense:**

Cash paid $6,000

Add: Prepaid insurance expired during 2018 2,500

Deduct: Prepaid insurance on 12/31/18

($6,000 x 4/12) (2,000) (a)

Insurance expense $6,500

**Salaries and wages expense:**

Cash paid $210,000

Add: Increase in salaries and wages payable 4,000

Salaries expense $214,000

##### *Problem 2–12 (continued)*

**Interest expense:**

Amount accrued at the end of 2018

($100,000 x .06 x 2/12) $1,000 (d)

**Rent expense:**

**Amount paid $24,000**

Add: Prepaid rent on 12/31/17 expired

during 2018 11,000

Deduct: Prepaid rent on 12/31/18 ($24,000 x 6/12) (12,000) (b)

Rent expense $23,000

**Depreciation expense**: Increase in accumulated depreciation $10,000

**Zambrano Wholesale Corporation**

Income statement

For the Year Ended December 31, 2018

Sales revenue $705,000

Cost of goods sold 420,000

Gross profit 285,000

Operating expenses:

Insurance $ 6,500

Salaries and wages 214,000

Rent 23,000

Depreciation 10,000

Total operating expenses 253,500

Operating income 31,500

Other income (expense):

Interest revenue 4,000

Interest expense (1,000) 3,000

Net income $34,500

***Problem 2–12 (concluded)***

Requirement 2

a. Prepaid insurance $ 2,000

b. Prepaid rent 12,000

c. Interest receivable 3,000

d. Interest payable 1,000

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Problem 2–13 |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Account Title** | **Unadjusted Trial Balance** | | **Adjusting Entries** | | **Adjusted Trial Balance** | | **Income Statement** | | **Balance Sheet** | |  |  |  |  |  |  |
|  | **Dr.** | **Cr.** | **Dr.** | **Cr.** | **Dr.** | **Cr.** | **Dr.** | **Cr.** | **Dr.** | **Cr.** |  |
| Cash | 23,300 |  |  |  | 23,300 |  |  |  | 23,300 |  |  |
| Accounts receivable | 32,500 |  |  |  | 32,500 |  |  |  | 32,500 |  |  |
| Supplies | 0 |  | (4) 500 |  | 500 |  |  |  | 500 |  |  |
| Prepaid rent | 0 |  | (5) 1,000 |  | 1,000 |  |  |  | 1,000 |  |  |
| Inventory | 65,000 |  |  |  | 65,000 |  |  |  | 65,000 |  |  |
| Office equipment | 75,000 |  |  |  | 75,000 |  |  |  | 75,000 |  |  |
| Accumulated depreciation- |  |  |  |  |  |  |  |  |  |  |  |
| office equipment |  | 10,000 |  | (1) 9,375 |  | 19,375 |  |  |  | 19,375 |  |
| Accounts payable |  | 26,100 |  |  |  | 26,100 |  |  |  | 26,100 |  |
| Salaries and wages payable |  | 3,000 |  | (2) 1,500 |  | 4,500 |  |  |  | 4,500 |  |
| Note payable |  | 30,000 |  |  |  | 30,000 |  |  |  | 30,000 |  |
| Interest payable |  | 0 |  | (3) 1,000 |  | 1,000 |  |  |  | 1,000 |  |
| Common stock |  | 80,000 |  |  |  | 80,000 |  |  |  | 80,000 |  |
| Retained earnings |  | 16,050 |  |  |  | 16,050 |  |  |  | 16,050 |  |
| Sales revenue |  | 180,000 |  |  |  | 180,000 |  | 180,000 |  |  |  |
| Cost of goods sold | 95,000 |  |  |  | 95,000 |  | 95,000 |  |  |  |  |
| Interest expense | 0 |  | (3) 1,000 |  | 1,000 |  | 1,000 |  |  |  |  |
| Salaries and wages expense | 32,350 |  | (2) 1,500 |  | 33,850 |  | 33,850 |  |  |  |  |
| Rent expense | 14,000 |  |  | (5) 1,000 | 13,000 |  | 13,000 |  |  |  |  |
| Supplies expense | 2,000 |  |  | (4) 500 | 1,500 |  | 1,500 |  |  |  |  |
| Utility expense | 6,000 |  |  |  | 6,000 |  | 6,000 |  |  |  |  |
| Depreciation expense | 0 |  | (1) 9,375 |  | 9,375 |  | 9,375 | \_\_\_\_\_\_ | \_\_\_\_\_\_ | \_\_\_\_\_\_ |  |
|  |  |  |  |  |  |  | 159,725 | 180,000 | 197,300 | 177,025 |  |
| Net Income |  |  |  |  |  |  | 20,275 | \_\_\_\_\_\_ | \_\_\_\_\_\_ | 20,275 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Totals | 345,150 | 345,150 | 13,375 | 13,375 | 357,025 | 357,025 | 180,000 | 180,000 | 197,300 | 197,300 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

##### *Problem 2–13 (continued)*

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | |  | |  |
| **EXCALIBUR CORPORATION** | | | | |  |  |
| Income Statement | | | | |  |  |
| For the Year Ended December 31, 2018 | | | | |  |  |
|  |  | |  | |
| Sales revenue |  | | $180,000 | |
| Cost of goods sold |  | | 95,000 | |
| Gross profit |  | | 85,000 | |
|  |  | |  | |
| Operating expenses: |  | |  | |
| Salaries and wages | $33,850 | |  | |
| Rent | 13,000 | |  | |
| Supplies | 1,500 | |  | |
| Utility | 6,000 | |  | |
| Depreciation | 9,375 | |  | |
| Total operating expenses |  | | 63,725 | |
| Operating income |  | | 21,275 | |
| Other expense: |  | |  | |
| Interest |  | | 1,000 | |
| Net income |  | | $ 20,275 | |
|  |  | |  | |

##### *Problem 2–13 (continued)*

**EXCALIBUR CORPORATION**

Statement of Shareholders' Equity

For the Year Ended December 31, 2018

**Total**

**Common Retained Shareholders’**

**Stock Earnings Equity**

Balance at January 1, 2018 $80,000 $22,050 $102,050

Issue of common stock - 0 - - 0 -

Net income for 2018 20,275 20,275

Less: Dividends \_\_\_\_\_\_ (6,000) (6,000)

Balance at December 31, 2018 $80,000 $36,325 $116,325

##### *Problem 2–13 (continued)*

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
| **EXCALIBUR CORPORATION** | | | |  |  |  |
| Balance Sheet | | | |  |  |  |
| At December 31, 2018 | | | |  |  |  |
|  |  |  |  |
| **Assets** |  |  |  |
|  |  |  |  |
| Current assets: |  |  |  |
| Cash |  | $ 23,300 |  |
| Accounts receivable |  | 32,500 |  |
| Supplies |  | 500 |  |
| Prepaid rent |  | 1,000 |  |
| Inventory |  | 65,000 |  |
| Total current assets |  | 122,300 |  |
|  |  |  |  |
| Office equipment | $75,000 |  |  |
| Less: Accumulated depreciation | (19,375) | 55,625 |  |
| Total assets |  | $177,925 |  |
|  |  |  |  |
| **Liabilities and Shareholders' Equity** | | | |  |  |  |
|  |  |  |  |
| Current liabilities: |  |  |  |
| Accounts payable |  | $ 26,100 |  |
| Salaries and wages payable |  | 4,500 |  |
| Note payable  Interest payable |  | 30,000  1,000 |  |
| Total current liabilities |  | 61,600 |  |
|  |  |  |  |
| Shareholders’ equity: |  |  |  |
| Common stock | $80,000 |  |  |
| Retained earnings | 36,325 |  |  |
| Total shareholders’ equity |  | 116,325 |  |
| Total liabilities and shareholders’ equity |  | $177,925 |  |
|  |  |  |  |

##### *Problem 2–13 (concluded)*

**December 31, 2018**

Sales revenue 180,000

Income summary 180,000

Income summary 159,725

Cost of goods sold 95,000

Interest expense 1,000

Salaries and wages expense 33,850

Rent expense 13,000

Supplies expense 1,500

Utility expense 6,000

Depreciation expense 9,375

Income summary ($180,000 – 159,725) 20,275

Retained earnings 20,275

# cases

Judgment Case 2–1

Requirement 1

Cash basis accounting produces a measure of performance called net operating cash flow. This measure is the difference between cash receipts and cash disbursements during a reporting period from transactions related to providing goods and services to customers. On the other hand, the accrual accounting model measures an entity’s accomplishments (revenues) and resource sacrifices (expenses) during the period, regardless of when cash is received or paid.

Requirement 2

In most cases, the accrual accounting model provides a better measure of performance because it attempts to measure the accomplishments and sacrifices that occurred during the year, which may not correspond to cash inflows and outflows.

Requirement 3

Adjusting entries, for the most part, are conversions from cash to accrual. Prepayments and accruals occur when cash flow precedes or follows expense or revenue recognition.

Judgment Case 2–2

Requirement 1

Cash basis net income $26,000

Add: 1. Unexpired (prepaid insurance) $12,000 x 8/12 8,000

2. Increase in accounts receivable ($6,500 – 5,000) 1,500

5. Increase in inventories ($35,000 – 32,000) 3,000

Deduct: 3. Increase in salaries and wages payable ($8,200 – 7,200) (1,000)

4. Increase in utilities payable ($1,200 – 900) (300)

6. Increase in amount owed to suppliers (4,000)

Accrual basis net income **$33,200**

Requirement 2

Assets would be higher by $12,500 ($8,000 + 1,500 + 3,000) and liabilities would also be higher by $5,300 ($1,000 + 300 + 4,000). The difference, $7,200, is the difference between cash and accrual income. Therefore, equity would be higher by $7,200.

Communication Case 2–3

Requirement 1

Prepayments occur when the cash flow *precedes* either expense or revenue recognition. Accruals occur when the cash flow comes *after* either expense or revenue recognition.

Requirement 2

The appropriate adjusting entry for a prepaid expense is a debit to expense and a credit to the prepaid asset. For deferred revenue, the appropriate adjusting entry is a debit to the deferred revenue liability account and a credit to revenue. Failure to record an adjusting entry for a prepaid expense will cause assets and shareholders’ equity to be overstated. Failure to record an adjusting entry for deferred revenue will cause liabilities to be overstated and shareholders’ equity to be understated.

Requirement 3

The required adjusting entry for accrued liabilities is a debit to expense and a credit to a liability. For accrued receivables, the appropriate adjusting entry is a debit to a receivable and a credit to revenue. Failure to record an adjusting entry for an accrued liability will cause liabilities to be understated and shareholders’ equity to be overstated. Failure to record an adjusting entry for accrued receivables will cause assets and shareholders’ equity to be understated.

Target Case

Requirement 1

Target’s balance sheet reports accumulated depreciation of $16,246 million and $15,093 million for the years ended January 30, 2016, and January 31, 2015, respectively. Assuming no depreciable assets were sold during the year, Target’s adjusting entry to record depreciation for the year would be:

($ in millions)

Depreciation expense ($16,246 – 15,093) 1,153

Accumulated depreciation 1,153

Requirement 2

The statement of cash flows shows $2,213 million for “depreciation and amortization” for the 2015 fiscal year. Given depreciation expense of $1,153 million, amortization expense must be $2,213 – 1,153 = $1,060 million.

##### *Target Case (concluded)*

Requirement 3

Note 13, “ Other Current Assets,” reports Prepaid expenses of $214 million and $231 million for the years ended January 30, 2016, and January 31, 2015, respectively. Assuming this pertains to prepaid insurance, insurance expense must have exceeded the amount paid for insurance coverage, because the balance decreased during the year. We can visualize the change with a T account:

**Prepaid Insurance**

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Beginning balance 231

50 Insurance expense

Cash paid for insurance **?**

Ending balance 214

Cash paid for insurance must have been $33 million. Prior to the adjusting entry, the balance in prepaid insurance would have been $231 + 33 = $264. The adjusting entry to record expired insurance coverage and reduce the unexpired coverage to $214 would be:

($ in millions)

Insurance expense 50

Prepaid insurance 50

The appropriate adjusting entry for a prepaid expense is a debit to expense and a credit to the prepaid asset. Failure to record an adjusting entry for a prepaid expense will cause expenses to be understated and thus net income to be overstated. In the balance sheet, assets and shareholders’ equity (retained earnings) would be overstated.

**Air France–KLM Case**

**Requirement 1**

Typically, the order of presentation of the components of the balance sheet is different between U.S. GAAP and IFRS. Looking at the balance sheet of Air France–KLM (AF) we see that Non-current assets are listed before Current assets and Non-current liabilities before Current liabilities. Within “Total equity and liabilities”, AF lists Shareholders’ equity before Liabilities. Each of these is in the opposite order from what we see in Illustration 2–14 based on U.S. GAAP.

**Requirement 2**

Some of the differences we see in terminology occur in the Shareholders’ equity section of the balance sheet. In fact, the title of that section is simply Equity in AF’s balance sheet. AF lists four items in the shareholders’ equity section of the balance sheet. If AF used U.S. GAAP, Issued share capital would be Common stock, Reserves and retained earnings would be separated into retained earnings and one or more other accounts, usually Accumulated other comprehensive income accounts. Under U.S. GAAP the term “reserves” is considered misleading and thus is discouraged. Often, firms (not AF) using IFRS will use the term Share premium for Paid-in capital—excess of par and Investment in own shares for Treasury stock.

Within long-term liabilities, AF lists some of its liabilities as “provisions.” We don’t see that in the U.S. GAAP balance sheet.