

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 in storage areas called accounts. A general ledger is an organized collection of accounts. The purpose is to keep track of the increases, decreases, and balances in each account.

Answers to Questions (continued)

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, loss, and dividend transactions. It would be cumbersome and less informative to record revenue/expense, gain/loss, and dividend transactions directly into the permanent retained earnings account. Recording these transactions in temporary accounts facilitates the preparation of the financial statements.

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 with credits and decreased with debits. Expenses, losses, and dividends are increased with debits (thus causing owners' equity to decrease) and decreased with 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.

Answers to Questions (continued)

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.

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 occurs only at the end of a reporting period in order to reduce the temporary accounts to zero before beginning the next reporting year.

Answers to Questions (continued)

Question 2–14

Prepaid expenses represent 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 an expense and a credit to a liability.

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 shareholders’ (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 shareholders’ 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.

Answers to Questions (continued)

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.

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.

Answers to Questions (concluded)

Question 2–21

The general ledger is a collection of control accounts representing assets, liabilities, and 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

6/1 Bal.	65,000		
4.	180,000	40,000	2.
		145,000	5.
6/30 Bal.	60,000		

Accounts receivable

6/1 Bal.	43,000		
3.	200,000	180,000	4.
6/30 Bal.	63,000		

Inventory

6/1 Bal.	0		
1.	165,000	120,000	3.
6/30 Bal.	45,000		

Accounts payable

6/1 Bal.		22,000	
5.	145,000	165,000	1.
6/30 Bal.		42,000	

INCOME STATEMENT ACCOUNTS

Sales revenue

	0	6/1 Bal.	
	200,000	3.	
	200,000	6/30 Bal.	

Cost of goods sold

6/1 Bal.	0		
3.	120,000		
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.	Notes receivable	10,000	
	Cash		10,000
3.	Equipment	60,000	
	Cash		60,000

Brief Exercise 2–5

1.	Insurance expense ($\$12,000 \times \frac{3}{12}$).....	3,000	
	Prepaid insurance		3,000
2.	Interest receivable ($\$10,000 \times 6\% \times \frac{6}{12}$)	300	
	Interest revenue		300
3.	Depreciation expense	12,000	
	Accumulated depreciation.....		12,000

Brief Exercise 2–6

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

Brief Exercise 2–7

1.	Deferred service revenue	4,000	
	Service revenue		4,000
2.	Advertising expense ($\$2,000 \times \frac{1}{2}$)	1,000	
	Prepaid advertising		1,000
3.	Salaries expense	16,000	
	Salaries payable		16,000
4.	Interest expense ($\$60,000 \times 8\% \times \frac{4}{12}$)	1,600	
	Interest payable		1,600

Brief Exercise 2–8

Assets would be higher by \$1,000, the amount of prepaid advertising not adjusted as expired during the month. Liabilities would be lower by \$13,600 (= – \$4,000 + \$16,000 + \$1,600) for the deferred revenue not reduced upon completion of services and for accruals not increased by being recorded. Shareholders' equity (and net income for the period) would be higher by \$14,600.

Brief Exercise 2–9

1.	Interest receivable	2,250	
	Interest revenue ($\$50,000 \times 6\% \times \frac{9}{12}$)		2,250
2.	Rent expense ($\$12,000 \times \frac{3}{12}$)	3,000	
	Prepaid rent		3,000
3.	Supplies expense ($\$3,000 + \$5,000 - \$4,200$)	3,800	
	Supplies		3,800
4.	Salaries expense	6,000	
	Salaries payable		6,000

Brief Exercise 2–10

BOWLER CORPORATION		
Income Statement		
For the Year Ended December 31, 2021		
Sales revenue		\$325,000
Cost of goods sold		<u>168,000</u>
Gross profit		157,000
Operating expenses:		
Salaries expense	\$45,000	
Rent expense	20,000	
Depreciation expense	30,000	
Miscellaneous expense	<u>12,000</u>	
Total operating expenses		<u>107,000</u>
Net income		<u>\$ 50,000</u>

Brief Exercise 2–11

BOWLER CORPORATION

Balance Sheet
At December 31, 2021

Assets

Current assets:

Cash		\$ 5,000
Accounts receivable		10,000
Inventory		<u>16,000</u>
Total current assets		31,000

Property and equipment:

Equipment	\$100,000	
Less: Accumulated depreciation	<u>(40,000)</u>	<u>60,000</u>
Total assets		<u>\$91,000</u>

Liabilities and Shareholders' Equity

Current liabilities:

Accounts payable		\$20,000
Salaries payable		<u>12,000</u>
Total current liabilities		32,000

Shareholders' equity:

Common stock	\$50,000	
Retained earnings	<u>9,000</u>	
Total shareholders' equity		<u>59,000</u>
Total liabilities and shareholders' equity		<u>\$91,000</u>

Brief Exercise 2–12

Sales revenue	850,000	
Retained earnings		850,000
Retained earnings	815,000	
Cost of goods sold		580,000
Salaries expense.....		180,000
Rent expense.....		40,000
Interest expense		15,000
Retained earnings	12,000	
Dividends.....		12,000

Brief Exercise 2–13

Revenue \$428,000*

Expenses:

Salaries	(240,000)
Utilities	(33,000)**
Advertising	<u>(12,000)</u>
Net Income	<u>\$143,000</u>

Explanation:

*\$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
Service 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 (notes 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	
	Notes 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

3/1 Bal.	0		
1.	300,000	10,000	2.
8.	55,000	5,000	5.
		6,000	6.
		70,000	7.
3/31 Bal.	264,000		

Accounts receivable

3/1 Bal.	0		
4.	120,000	55,000	8.
3/31 Bal.	65,000		

Inventory

3/1 Bal.	0		
3.	90,000	70,000	4.
3/31 Bal.	20,000		

Prepaid insurance

3/1 Bal.	0		
6.	6,000		
3/31 Bal.	6,000		

Equipment

3/1 Bal.	0		
2.	40,000		
3/31 Bal.	40,000		

Accumulated depreciation

	0	3/1 Bal.
	1,000	9.
	1,000	3/31 Bal.

Accounts payable

		0	3/1 Bal.
7.	70,000	90,000	3.
		20,000	3/31 Bal.

Notes payable

		0	3/1 Bal.
		30,000	2.
		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

	0	3/1 Bal.
	120,000	4.
	120,000	3/31 Bal.

Cost of goods sold

3/1 Bal.	0
4.	70,000
3/31 Bal.	70,000

Rent expense

3/1 Bal.	0
5.	5,000
3/31 Bal.	5,000

Depreciation expense

3/1 Bal.	0
9.	1,000
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
Notes 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.	Office equipment	100,000	
	Cash		40,000
	Notes 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.	Dividends	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

- | | | |
|----------|--------------------------------|---|
| <u>k</u> | 1. Source documents | a. Record of the dual effect of a transaction in debit/credit form. |
| <u>e</u> | 2. Transaction analysis | b. Internal events recorded at the end of a reporting period. |
| <u>a</u> | 3. Journal | c. Primary means of disseminating information to external decision makers. |
| <u>j</u> | 4. Posting | d. To zero out the temporary accounts. |
| <u>f</u> | 5. Unadjusted trial balance | e. Determine the dual effect on the accounting equation. |
| <u>b</u> | 6. Adjusting entries | f. List of accounts and their balances before recording adjusting entries. |
| <u>h</u> | 7. Adjusted trial balance | g. List of accounts and their balances after recording closing entries. |
| <u>c</u> | 8. Financial statements | h. List of accounts and their balances after recording adjusting entries. |
| <u>d</u> | 9. Closing entries | i. A means of organizing information; not part of the formal accounting system. |
| <u>g</u> | 10. Post-closing trial balance | j. Transferring balances from the journal to the ledger. |
| <u>i</u> | 11. Worksheet | k. Used to identify and process external transactions. |

Exercise 2–6

	<u>Increase (I) or Decrease (D)</u>	<u>Account</u>
1.	<u>I</u>	Inventory
2.	<u>I</u>	Depreciation expense
3.	<u>D</u>	Accounts payable
4.	<u>I</u>	Prepaid rent
5.	<u>D</u>	Sales revenue
6.	<u>D</u>	Common stock
7.	<u>D</u>	Salaries payable
8.	<u>I</u>	Cost of goods sold
9.	<u>I</u>	Utilities expense
10.	<u>I</u>	Equipment
11.	<u>I</u>	Accounts receivable
12.	<u>D</u>	Utilities payable
13.	<u>I</u>	Rent expense
14.	<u>I</u>	Interest expense
15.	<u>D</u>	Interest revenue

Exercise 2–7

	<u>Account(s) Debited</u>	<u>Account(s) Credited</u>
<i>Example:</i> Purchased inventory for cash	3	5
1. Paid a cash dividend.	19	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. Issued common stock in exchange for cash.	5	12
7. Collected cash from customers for goods sold in 3.	5	4
8. Borrowed cash from a bank and signed a note.	5	11
9. At the end of October, recorded the amount of supplies that had been used during the month.	7	6
10. Received cash for advance payment from customer.	5	13

Exercise 2–8

1. Prepaid insurance ($\$12,000 \times \frac{30}{36}$)	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 ($\$200,000 \times 12\% \times \frac{2}{12}$).....	4,000	
Interest payable.....		4,000
5. Deferred rent revenue.....	1,000	
Rent revenue ($\frac{1}{3} \times \$3,000$)		1,000
6. Rent revenue.....	2,000	
Deferred rent revenue ($\frac{2}{3} \times \$3,000$)		2,000

Exercise 2–9

1. Interest receivable ($\$90,000 \times 8\% \times \frac{3}{12}$)	1,800	
Interest revenue		1,800
2. Rent expense ($\$6,000 \times \frac{2}{3}$)	4,000	
Prepaid rent		4,000
3. Deferred rent revenue ($\$12,000 \times \frac{5}{12}$)	5,000	
Rent revenue ($\$12,000 \times \frac{5}{12}$)		5,000
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.

$$\$7,200 \div 0.75 = \$9,600 \text{ annual interest}$$

$$\$9,600 \div \$120,000 = \mathbf{8\% \text{ interest rate}}$$

Or,

$$\$7,200 \div \$120,000 = .06 \text{ nine-month rate}$$

$$\text{To annualize the nine-month rate: } .06 \times \frac{12}{9} = .08 \text{ or } 8\%$$

2. $\$60,000 \div 12 \text{ months} = \$5,000 \text{ rent per month}$
 $\$35,000 \div \$5,000 = 7 \text{ months expired. The rent was paid on } \mathbf{June 1}$, seven months ago.

3. \$500 represents two months (November and December) accrued interest, or \$250 per month.

$$\$250 \times 12 \text{ months} = \$3,000 \text{ annual interest}$$

$$\text{Principal} \times 6\% = \$3,000$$

$$\text{Principal} = \$3,000 \div .06 = \mathbf{\$50,000 \text{ note}}$$

Exercise 2–11

1. Insurance expense (April, May, & June: $\$6,000 \times \frac{3}{12}$) ...	1,500	
Prepaid insurance		1,500
2. Interest expense (April, May, & June: $\$80,000 \times 8\% \times \frac{3}{12}$)	1,600	
Interest payable		1,600
3. Deferred rent revenue	6,000	
Rent revenue (April, May, & June: $\$24,000 \times \frac{3}{12}$).....		6,000
4. Depreciation expense (April, May, & June: $\$20,000 \times \frac{3}{12}$)	5,000	
Accumulated depreciation		5,000
5. Salaries expense	16,000	
Salaries payable		16,000

Exercise 2–12

Requirement 1

BLUEBOY CHEESE CORPORATION		
Income Statement		
For the Year Ended December 31, 2021		
Sales revenue		\$800,000
Cost of goods sold		<u>480,000</u>
Gross profit		320,000
Operating expenses:		
Salaries expense	\$120,000	
Rent expense	30,000	
Depreciation expense	60,000	
Advertising expense	<u>5,000</u>	
Total operating expenses		<u>215,000</u>
Operating income		105,000
Other expense:		
Interest expense		<u>4,000</u>
Net income		<u>\$101,000</u>

Exercise 2–12 (continued)

BLUEBOY CHEESE CORPORATION

Balance Sheet
At December 31, 2021

Assets

Current assets:

Cash		\$ 21,000
Accounts receivable		300,000
Inventory		50,000
Prepaid rent		<u>10,000</u>
Total current assets		381,000

Property and equipment:

Office equipment	\$600,000	
Less: Accumulated depreciation	<u>(250,000)</u>	350,000
Total assets		<u>\$731,000</u>

Liabilities and Shareholders' Equity

Current liabilities:

Accounts payable		\$ 60,000
Salaries payable		8,000
Interest payable		2,000
Notes payable		<u>60,000</u>
Total current liabilities		130,000

Shareholders' equity:

Common stock	\$400,000	
Retained earnings	<u>201,000*</u>	
Total shareholders' equity		<u>601,000</u>
Total liabilities and shareholders' equity		<u>\$731,000</u>

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

Exercise 2–12 (concluded)

Requirement 2

December 31, 2021		
Sales revenue	800,000	
Retained earnings.....		800,000
Retained earnings	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	

Exercise 2–13

December 31, 2021

Sales revenue.....	750,000
Interest revenue	3,000
Retained earnings	753,000
Retained earnings.....	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

Exercise 2–14

December 31, 2021

Sales revenue	492,000	
Interest revenue.....	6,000	
Gain on sale of investments	8,000	
Retained earnings.....		506,000
Retained earnings	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

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, 2021		
Insurance expense	1,500	
Prepaid insurance.....		1,500

Exercise 2–15 (concluded)

Requirement 3

Salaries Payable					
Salaries paid 10,000	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; border-right: 1px solid black;">10,000</td> <td>11/30 Balance</td> </tr> <tr> <td style="border-right: 1px solid black;">?</td> <td>Accrued salaries</td> </tr> </table>	10,000	11/30 Balance	?	Accrued salaries
10,000	11/30 Balance				
?	Accrued salaries				
	15,000 12/31 Balance				

Accrued salaries for December = **\$15,000**

December 31, 2021		
Salaries expense.....	15,000	
Salaries payable		15,000

Requirement 4

Deferred rent revenue			
Recognized for Dec. 1,000	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; border-right: 1px solid black;">2,000</td> <td>11/30 Balance</td> </tr> </table>	2,000	11/30 Balance
2,000	11/30 Balance		
	1,000 12/31 Balance		

Rent revenue recognized each month = $\$3,000 \times \frac{1}{3} = \mathbf{\$1,000}$

December 31, 2021		
Deferred rent revenue	1,000	
Rent revenue		1,000

Exercise 2–16

Requirement 1

2021		Debit	Credit
Feb. 1	Cash	12,000	
	Notes payable		12,000
April 1	Prepaid insurance	3,600	
	Cash		3,600
July 17	Supplies	2,800	
	Accounts payable		2,800
Nov. 1	Notes receivable	6,000	
	Cash		6,000

Requirement 2

2021		Debit	Credit
Dec. 31	Interest expense ($\$12,000 \times 10\% \times \frac{11}{12}$)	1,100	
	Interest payable		1,100
Dec. 31	Insurance expense ($\$3,600 \times \frac{9}{24}$)	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 ($\$6,000 \times 8\% \times \frac{2}{12}$) ..		80

Exercise 2–17

Unadjusted net income	\$30,000
<i>Adjustments:</i>	
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 ($\$20,000 \times 12\% \times 3/12$)	– <u>600</u>
Adjusted net income	<u>\$33,150</u>

Exercise 2–18

Stanley and Jones Lawn Service Company Income Statement For the Year Ended December 31, 2021		
Service revenue (1).....		\$315,000
Operating expenses:		
Salaries expense	\$180,000	
Supplies expense (2)	24,500	
Rent expense	12,000	
Insurance expense (3)	4,000	
Miscellaneous expense (4)	21,000	
Depreciation expense	<u>10,000</u>	
Total operating expenses		<u>251,500</u>
Operating income		63,500
Other expense:		
Interest expense (5)		<u>1,500</u>
Net income		<u>\$ 62,000</u>

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

Cash	320,000	
Accounts receivable (decrease in account).....		5,000
Service revenue (to balance)		315,000

(2) \$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)

(3) \$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

(4) \$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

(5) $\$100,000 \times 6\% \times \frac{3}{12} = \$1,500$

Interest expense	1,500	
Interest payable.....		1,500

Exercise 2–19

Cash basis income (\$545,000 – \$412,000)	\$133,000
<i>Add:</i>	
Increase in prepaid insurance (\$6,000 – \$4,500)	1,500
<i>Deduct:</i>	
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 revenue (\$11,000 – \$9,200)	(1,800)
Increase in accrued liabilities (\$15,600 – \$12,200)	<u>(3,400)</u>
Accrual basis net income	<u>\$ 99,300</u>

Exercise 2–20

Requirement 1

Wolkstein Drug

Company

Worksheet

December 31, 2021

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		30,000	(1)	10,000		40,000				40,000
Accounts payable		25,000				25,000				25,000
Salaries 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 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			
Utilities expense	12,000				12,000		12,000			
Advertising expense	4,000				4,000		<u>4,000</u>			
Net Income							311,000	323,000	210,000	198,000
							<u>12,000</u>			<u>12,000</u>
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, 2021		
Sales revenue		\$323,000
Cost of goods sold		<u>180,000</u>
Gross profit		143,000
Operating expenses:		
Salaries expense	\$75,000	
Rent expense.....	30,000	
Depreciation expense	10,000	
Utilities expense	12,000	
Advertising expense	<u>4,000</u>	
Total operating expenses		<u>131,000</u>
Net income		<u>\$ 12,000</u>

Exercise 2–20 (concluded)

WOLKSTEIN DRUG COMPANY

Balance Sheet
At December 31, 2021

Assets

Current assets:		
Cash		\$ 20,000
Accounts receivable		35,000
Inventory		50,000
Prepaid rent		<u>5,000</u>
Total current assets		110,000
Property and equipment:		
Equipment		
	\$100,000	
Less: Accumulated depreciation	<u>(40,000)</u>	<u>60,000</u>
Total assets		<u>\$170,000</u>

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable		\$ 25,000
Salaries payable		<u>4,000</u>
Total current liabilities		29,000
Shareholders' equity:		
Common stock	\$100,000	
Retained earnings	<u>41,000*</u>	
Total shareholders' equity		<u>141,000</u>
Total liabilities and shareholders' equity		<u>\$170,000</u>

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

Exercise 2–21

Requirement 1

June 30 - adjusting entry		
Salaries expense ($\$10,000 \times \frac{3}{5}$).....	6,000	
Salaries payable.....		6,000

July 1 - reversing entry		
Salaries payable.....	6,000	
Salaries expense		6,000

July 2 – payment of salaries		
Salaries expense	10,000	
Cash.....		10,000

Requirement 2

June 30 - adjusting entry		
Salaries expense	6,000	
Salaries payable.....		6,000

July 2 - payment of salaries		
Salaries expense	4,000	
Salaries 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 ($\$90,000 \times 8\% \times \frac{3}{12}$)	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

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 payable.	GJ
9. Paid employee salaries.	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 2–24

Transaction	Journal
1. Paid interest on a loan.	CD
2. Recorded depreciation expense.	GJ
3. Purchased office equipment for cash.	CD
4. Purchased merchandise on account.	PJ
5. Sold merchandise on credit. (the sale only, not the cost of the merchandise)	SJ
6. Sold merchandise for cash. (the sale only, not the cost of the merchandise)	CR
7. Paid rent.	CD
8. Recorded accrued interest payable.	GJ
9. Paid advertising bill.	CD
10. Sold a factory building in exchange for a note receivable.	GJ
11. Collected cash from customers on account.	CR
12. Paid employee salaries.	CD
13. Collected interest on the note receivable.	CR

PROBLEMS

Problem 2–1

Requirement 1

2021		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	
	Notes payable		30,000
Jan. 20	Salaries 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

1/1 Bal.	0		
1/1	100,000	2,400	1/4
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		

Accounts receivable

1/1 Bal.	0		
1/10	12,000	6,000	1/26
1/31 Bal.	6,000		

Inventory

1/1 Bal.	0		
1/2	35,000	7,000	1/10
		6,000	1/22
1/31 Bal.	22,000		

Prepaid insurance

1/1 Bal.	0		
1/4	2,400		
1/31 Bal.	2,400		

Prepaid rent

1/1 Bal.	0		
1/30	2,000		
1/31 Bal.	2,000		

Accounts payable

		0	1/1 Bal.
1/24	15,000	35,000	1/2
		20,000	1/31 Bal.

Notes payable

	0	1/1 Bal.
	30,000	1/15
	30,000	1/31 Bal.

Common stock

	0	1/1 Bal.
	100,000	1/1
	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
	<hr/>			<hr/>
	22,000	1/31 Bal.	1/31 Bal.	13,000

Salaries expense

Rent expense

1/1 Bal.	0		1/1 Bal.	0
1/20	6,000		1/30	2,000
	<hr/>			<hr/>
1/31 Bal.	6,000		1/31 Bal.	2,000

Utilities expense

1/1 Bal.	0
1/28	1,000
	<hr/>
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
Notes payable		30,000
Common stock		100,000
Sales revenue		22,000
Cost of goods sold	13,000	
Salaries expense	6,000	
Utilities expense	1,000	
Rent expense	<u>2,000</u>	<u> </u>
Totals	<u>172,000</u>	<u>172,000</u>

Problem 2–2

Requirement 2

2021		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	
	Accrued liabilities		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 expense	3,000	
	Cash		3,000
Jan. 31	Dividends	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

	3,500	1/1 Bal.
	<hr/>	
	3,500	1/31 Bal.

Accounts payable

		3,000	1/1 Bal.
1/16	5,500	5,500	1/2
		9,500	1/10
		<hr/>	
		12,500	1/31 Bal.

Common stock

	10,000	1/1 Bal.
	<hr/>	
	10,000	1/31 Bal.

Accrued liabilities

		0	1/1 Bal.
		150	1/4
		<hr/>	
		150	1/31 Bal.

Dividends

1/1 Bal.	0	
1/31	1,000	
	<hr/>	
1/31 Bal.	1,000	

Retained earnings

	6,500	1/1 Bal.
	<hr/>	
	6,500	1/31 Bal.

Problem 2–2 (continued)

INCOME STATEMENT ACCOUNTS

Sales revenue

	0	1/1 Bal.
	3,500	1/1
	5,000	1/8
	<hr/>	
	8,500	1/31 Bal.

Cost of goods sold

	0	1/1 Bal.
	2,000	1/1
	2,800	1/8
	<hr/>	
	4,800	1/31 Bal.

Rent expense

1/1 Bal.	0
1/20	800
	<hr/>
1/31 Bal.	800

Salaries expense

1/1 Bal.	0
1/30	3,000
	<hr/>
1/31 Bal.	3,000

Advertising expense

1/1 Bal.	0
1/4	150
	<hr/>
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		12,500
Accrued liabilities		150
Common stock		10,000
Retained earnings		6,500
Dividends	1,000	
Sales revenue		8,500
Cost of goods sold	4,800	
Salaries expense	3,000	
Rent expense	800	
Advertising expense	<u>150</u>	
Totals	<u>41,150</u>	<u>41,150</u>

Problem 2–3

1. Depreciation expense	10,000	
Accumulated depreciation		10,000
2. Salaries expense	1,500	
Salaries payable		1,500
3. Interest expense ($\$50,000 \times 12\% \times \frac{3}{12}$)	1,500	
Interest payable		1,500
4. Interest receivable ($\$20,000 \times 8\% \times \frac{10}{12}$)	1,333	
Interest revenue		1,333
5. Insurance expense ($\$6,000 \times \frac{9}{24}$)	2,250	
Prepaid insurance		2,250
6. Supplies expense ($\$1,500 - \800)	700	
Supplies		700
7. No adjusting entry needed; not revenue until January 2022		
8. Rent expense	1,000	
Prepaid rent		1,000

Problem 2–4

Requirements 1 and 2

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Prepaid rent

Bal.	2,000	
		1,000 8.
12/31 Bal.	1,000	

Prepaid insurance

Bal.	6,000	
5.		2,250
12/31 Bal.	3,750	

Supplies

Bal.	1,500	
		700 6.
12/31 Bal.	800	

Inventory

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

Notes receivable

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

Office equipment

Bal.	80,000	
12/31 Bal.	80,000	

Interest receivable

Bal.	0	
4.	1,333	
12/31 Bal.	1,333	

Problem 2–4 (continued)

Accumulated depreciation

	30,000	Bal.
	10,000	1.
	<hr/>	
	40,000	12/31 Bal.

Accounts payable

	31,000	Bal.
	<hr/>	
	31,000	12/31 Bal.

Salaries payable

	0	Bal.
	1,500	2.
	<hr/>	
	1,500	12/31 Bal.

Notes payable

	50,000	Bal.
	<hr/>	
	50,000	12/31 Bal.

Interest payable

	0	Bal.
	1,500	3.
	<hr/>	
	1,500	12/31 Bal.

Deferred sales revenue

	2,000	Bal.
	0	7.
	<hr/>	
	2,000	12/31 Bal.

Common stock

	60,000	Bal.
	<hr/>	
	60,000	12/31 Bal.

Retained earnings

	28,500	Bal.
	<hr/>	
	28,500	12/31 Bal.

Dividends

Bal.	4,000	
	<hr/>	
12/31 Bal.	4,000	

Problem 2–4 (continued)

INCOME STATEMENT ACCOUNTS

Sales revenue

	146,000	Bal.
	<hr/>	
	146,000	12/31 Bal.

Interest revenue

	0	Bal.
	1,333	4.
	<hr/>	
	1,333	12/31 Bal.

Cost of goods sold

Bal.	70,000	
	<hr/>	
12/31 Bal.	70,000	

Salaries expense

Bal.	18,900	
2.	1,500	
	<hr/>	
12/31 Bal.	20,400	

Rent expense

Bal.	11,000	
8.	1,000	
	<hr/>	
12/31 Bal.	12,000	

Depreciation expense

Bal.	0	
1.	10,000	
	<hr/>	
12/31 Bal.	10,000	

Interest expense

Bal.	0	
3.	1,500	
	<hr/>	
12/31 Bal.	1,500	

Supplies expense

Bal.	1,100	
6.	700	
	<hr/>	
12/31 Bal.	1,800	

Insurance expense

Bal.	0	
5.	2,250	
	<hr/>	
12/31 Bal.	2,250	

Advertising expense

Bal.	3,000	
	<hr/>	
12/31 Bal.	3,000	

Problem 2–4 (continued)

Requirement 3

Account Title	Debits	Credits
Cash	30,000	
Accounts receivable	40,000	
Supplies	800	
Inventory	60,000	
Notes receivable	20,000	
Interest receivable	1,333	
Prepaid rent	1,000	
Prepaid insurance	3,750	
Office equipment	80,000	
Accumulated depreciation		40,000
Accounts payable		31,000
Salaries payable		1,500
Notes payable		50,000
Interest payable		1,500
Deferred sales revenue		2,000
Common stock		60,000
Retained earnings		28,500
Dividends	4,000	
Sales revenue		146,000
Interest revenue		1,333
Cost of goods sold	70,000	
Salaries 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	<u>361,833</u>	<u>361,833</u>

Problem 2–4 (continued)

Requirement 4

PASTINA COMPANY		
Income Statement		
For the Year Ended December 31, 2021		
Sales revenue		\$146,000
Cost of goods sold		<u>70,000</u>
Gross profit		76,000
Operating expenses:		
Salaries expense	\$20,400	
Rent expense	12,000	
Depreciation expense	10,000	
Supplies expense	1,800	
Insurance expense	2,250	
Advertising expense	<u>3,000</u>	
Total operating expenses		<u>49,450</u>
Operating income		26,550
Other income (expense):		
Interest revenue	1,333	
Interest expense	<u>(1,500)</u>	<u>(167)</u>
Net income		<u>\$ 26,383</u>

Problem 2–4 (continued)

	Common Stock	Retained Earnings	Total Shareholders' Equity
Balance at January 1, 2021	\$60,000	\$28,500	\$ 88,500
Issue of common stock	- 0 -		- 0 -
Net income for 2021		26,383	26,383
Less: Dividends	_____	<u>(4,000)</u>	<u>(4,000)</u>
Balance at December 31, 2021	<u>\$60,000</u>	<u>\$50,883</u>	<u>\$110,883</u>

Problem 2–4 (continued)

PASTINA COMPANY

Balance Sheet

At December 31, 2021

Assets

Current assets:

Cash		\$ 30,000
Accounts receivable		40,000
Supplies		800
Inventory		60,000
Notes receivable		20,000
Interest receivable		1,333
Prepaid rent		1,000
Prepaid insurance		<u>3,750</u>
Total current assets		156,883

Office equipment	\$80,000	
Less: Accumulated depreciation	<u>40,000</u>	<u>40,000</u>
Total assets		<u>\$196,883</u>

Liabilities and Shareholders' Equity

Current liabilities

Accounts payable		\$ 31,000
Salaries payable		1,500
Notes payable		50,000
Interest payable		1,500
Deferred sales revenue		<u>2,000</u>
Total current liabilities		86,000

Shareholders' equity:

Common stock	\$60,000	
Retained earnings	<u>50,883</u>	
Total shareholders' equity		<u>110,883</u>
Total liabilities and shareholders' equity		<u>\$196,883</u>

Problem 2–4 (continued)

Requirement 5

December 31, 2021		
Sales revenue	146,000	
Interest revenue.....	1,333	
Retained earnings		147,333
Retained earnings	120,950	
Cost of goods sold		70,000
Salaries 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
Retained earnings	4,000	
Dividends.....		4,000

Problem 2–4 (continued)

Sales revenue

		146,000	Bal.
Closing	146,000		
		0	12/31 Bal.

Interest revenue

		0	Bal.
		1,333	4.
Closing	1,333		
		0	12/31 Bal.

Cost of goods sold

Bal.	70,000		
		70,000	Closing
12/31 Bal.	0		

Salaries expense

Bal.	18,900		
4.	1,500		
		20,400	Closing
12/31 Bal.	0		

Rent expense

Bal.	11,000		
8.	1,000		
		12,000	Closing
12/31 Bal.	0		

Depreciation expense

Bal.	0		
1.	10,000		
		10,000	Closing
12/31 Bal.	0		

Interest expense

Bal.	0		
3.	1,500		
		1,500	Closing
12/31 Bal.	0		

Supplies expense

Bal.	1,100		
6.	700		
		1,800	Closing
12/31 Bal.	0		

Problem 2–4 (continued)

Insurance expense

Bal.	0		
5.	2,250		
		2,250	Closing
12/31 Bal.	0		

Advertising expense

Bal.	3,000		
		3,000	Closing
12/31 Bal.	0		

Retained earnings

		28,500	Bal.
Cl. exp	120,950	147,333	Cl. rev
Cl. Div	4,000		
		50,883	12/31 Bal.

Dividends

Bal.	4,000		
		4,000	Closing
12/31 Bal.	0		

Problem 2–4 (concluded)

Requirement 6

Account Title	Debits	Credits
Cash	30,000	
Accounts receivable	40,000	
Supplies	800	
Inventory	60,000	
Notes receivable	20,000	
Interest receivable	1,333	
Prepaid rent	1,000	
Prepaid insurance	3,750	
Office equipment	80,000	
Accumulated depreciation		40,000
Accounts payable		31,000
Salaries payable		1,500
Notes payable		50,000
Interest payable		1,500
Deferred sales revenue		2,000
Common stock		60,000
Retained earnings		<u>50,883</u>
Totals	<u>236,883</u>	<u>236,883</u>

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 expense.....	6,200	
Salaries payable		6,200
Interest expense	2,500	
Interest payable.....		2,500
Deferred rent revenue	2,000	
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 expense	24,000	
Cash.....		24,000
f. Equipment.....	15,000	
Cash.....		15,000
g. Dividends	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			
				d. 9,000			
				1/1 Bal. 9,000			
6,000 12/31 Bal.				0 12/31 Bal.			
Common stock				Retained earnings			
				1/1 Bal. 9,500			
				c. 10,000			
50,500 12/31 Bal.				9,500 12/31 Bal.			

Problem 2–6 (continued)

Dividends

1/1 Bal.	0	
g.	2,500	
12/31 Bal.	2,500	

Problem 2–6 (continued)

INCOME STATEMENT ACCOUNTS

Service revenue				Miscellaneous expense	
	0	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		9,500
Dividends	2,500	
Service revenue		100,000
Salaries expense	41,000	
Miscellaneous expense	<u>24,000</u>	
Totals	<u>166,000</u>	<u>166,000</u>

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.				
<hr/>				<hr/>			
12/31 Bal.	45,800			12/31 Bal.	17,700		

Equipment	
1/1 Bal.	20,000
f.	15,000
<hr/>	
12/31 Bal.	35,000

Accumulated depreciation		
	6,000	1/1 Bal.
	2,000	Adjusting
<hr/>		
	8,000	12/31 Bal.

Salaries payable		
	9,000	1/1 Bal.
d.	9,000	1,000 Adjusting
<hr/>		
	1,000	12/31 Bal.

Common stock	
	40,500 1/1 Bal.
	10,000 c.
<hr/>	
	50,500 12/31 Bal.

Retained earnings	
	9,500 1/1 Bal.
<hr/>	
	9,500 12/31 Bal.

Problem 2–6 (continued)

Dividends

1/1 Bal.	0
g.	2,500
12/31 Bal.	2,500

INCOME STATEMENT ACCOUNTS

Service revenue

Miscellaneous expense

	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		9,500
Dividends	2,500	
Service revenue		100,000
Salaries expense	42,000	
Miscellaneous expense	24,000	
Depreciation expense	<u>2,000</u>	
Totals	<u>169,000</u>	<u>169,000</u>

Requirement 7

KARLIN COMPANY		
Income Statement		
For the Year Ended December 31, 2021		
Service revenue		\$100,000
Operating expenses:		
Salaries expense	\$42,000	
Miscellaneous expense	24,000	
Depreciation expense	<u>2,000</u>	
Total operating expenses		<u>68,000</u>
Net income		<u>\$ 32,000</u>

Problem 2–6 (continued)

KARLIN COMPANY

Balance Sheet
At December 31, 2021

Assets

Current assets:

Cash		\$45,800
Accounts receivable		<u>17,700</u>
Total current assets		63,500

Property and equipment:

Equipment	\$35,000	
Less: Accumulated depreciation	<u>(8,000)</u>	<u>27,000</u>
Total assets		<u>\$90,500</u>

Liabilities and Shareholders' Equity

Current liabilities:

Salaries payable		<u>\$ 1,000</u>
Total current liabilities		1,000

Shareholders' equity:

Common stock	\$50,500	
Retained earnings	<u>39,000*</u>	
Total shareholders' equity		<u>89,500</u>
Total liabilities and shareholders' equity		<u>\$90,500</u>

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

Problem 2–6 (continued)

Requirement 8

December 31, 2021		
Service revenue.....	100,000	
Retained earnings		100,000
Retained earnings	68,000	
Salaries expense.....		42,000
Miscellaneous expense		24,000
Depreciation expense.....		2,000
Retained earnings	2,500	
Dividends.....		2,500

Problem 2–6 (continued)

BALANCE SHEET ACCOUNTS

Cash

1/1 Bal.	30,000		
a.	70,000	50,000	d.
b.	27,300	24,000	e.
c.	10,000	15,000	f.
		2,500	g.
12/31 Bal.	45,800		

Accounts receivable

1/1 Bal.	15,000		
a.	30,000	27,300	b.
12/31 Bal.	17,700		

Equipment

1/1 Bal.	20,000	
f.	15,000	
12/31 Bal.	35,000	

Accumulated depreciation

	6,000	1/1 Bal.
	2,000	Adjusting
	8,000	12/31 Bal.

Salaries payable

	9,000	1/1 Bal.
d.	9,000	1,000
		Adjusting
	1,000	12/31 Bal.

Common stock

	40,500	1/1 Bal.
	10,000	c.
	50,500	12/31 Bal.

Retained earnings

	9,500	1/1 Bal.
	100,000	Cl. rev
Cl. exp	68,000	
Cl. div	2,500	
	39,000	12/31 Bal.

Problem 2–6 (continued)

Dividends

1/1 Bal.	0		
g.	2,500		
		2,500	Closing
12/31 Bal.	0		

INCOME STATEMENT ACCOUNTS

Service revenue

		0	1/1 Bal.
		100,000	a.
Closing	100,000		
		0	12/31 Bal.

Miscellaneous expenses

1/1 Bal.	0		
e.	24,000		
		24,000	Closing
12/31 Bal.	0		

Depreciation expense

1/1 Bal.	0		
Adjusting	2,000		
		2,000	Closing
12/31 Bal.	0		

Salaries expense

1/1 Bal.	0		
d.	41,000		
Adjusting	1,000	42,000	Closing
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		<u>39,000</u>
Totals	<u>98,500</u>	<u>98,500</u>

Problem 2–7

Requirement 1

a. Interest receivable	600	
Interest revenue ($\$10,000 \times 12\% \times 1/2$).....		600
b. Depreciation expense ($\$30,000 \times 1/5$).....	6,000	
Accumulated depreciation.....		6,000
c. Deferred rent revenue.....	2,000	
Rent revenue ($\$6,000 \times 2/6$).....		2,000
d. Prepaid insurance	1,500	
Insurance expense ($\$2,400 \times 15/24$).....		1,500
e. Interest expense ($\$20,000 \times 12\% \times 3/12$).....	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	<u>1,100</u>
Overstatement of net income	<u>\$3,600</u>

Problem 2–8

1. Depreciation expense ($\$75,000 \div 10$ years)	7,500	
Accumulated depreciation		7,500
2. Salaries expense ($\$4,500 - \$3,000$)	1,500	
Salaries payable		1,500
3. Interest expense ($\$30,000 \times 10\% \times \frac{4}{12}$)	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 ($\$50,000 \div 50$ years).....	1,000	
Accumulated depreciation—buildings		1,000
b. Depreciation expense ($\$100,000 \times 10\%$)	10,000	
Accumulated depreciation—office equipment		10,000
c. Insurance expense.....	1,000	
Prepaid insurance		1,000
d. Salaries expense	1,500	
Salaries payable.....		1,500
e. Rent revenue.....	1,200	
Deferred rent revenue.....		1,200

Problem 2–9 (continued)

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Prepaid insurance

Bal.	3,000	
		1,000 Adjusting
12/31 Bal.	2,000	

Land

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

Buildings

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

Office equipment

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

Accumulated depreciation—buildings

	20,000	Bal.
	1,000	Adjusting
	21,000	12/31 Bal.

Accumulated depreciation—office equip.

	40,000	Bal.
	10,000	Adjusting
	50,000	12/31 Bal.

Accounts payable

	35,050	Bal.
	35,050	12/31 Bal.

Problem 2–9 (continued)

Salaries payable

	0	Bal.
	1,500	Adjusting
<hr/>		
	1,500	12/31 Bal.

Deferred rent revenue

	0	Bal.
	1,200	Adjusting
<hr/>		
	1,200	12/31 Bal.

Common stock

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

Retained earnings

	56,450	Bal.
	56,450	12/31 Bal.

INCOME STATEMENT ACCOUNTS

Service revenue

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

Interest revenue

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

Rent revenue

	7,500	Bal.
Adjusting	1,200	
<hr/>		
	6,300	12/31 Bal.

Salaries expense

Bal.	37,000
Adjusting	1,500
<hr/>	
12/31 Bal.	38,500

Depreciation expense

Bal.	0
Adjusting	1,000
Adjusting	10,000
<hr/>	
12/31 Bal.	11,000

Problem 2–9 (continued)

Insurance expense

Bal.	0	
Adjusting	1,000	
12/31 Bal.	1,000	

Utilities expense

Bal.	30,000	
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	2,000	
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 payable		1,500
Deferred rent revenue		1,200
Common stock		200,000
Retained earnings		56,450
Service revenue		90,000
Interest revenue		3,000
Rent revenue		6,300
Salaries expense	38,500	
Depreciation expense	11,000	
Insurance expense	1,000	
Utilities expense	30,000	
Maintenance expense	15,000	
Totals	<u>464,500</u>	<u>464,500</u>

Problem 2–9 (continued)

Requirement 4

December 31, 2021	
Service revenue	90,000
Interest revenue	3,000
Rent revenue	6,300
Retained earnings.....	99,300
Retained earnings.....	95,500
Salaries expense	38,500
Depreciation expense	11,000
Insurance expense	1,000
Utilities expense	30,000
Maintenance expense	15,000

Problem 2–9 (concluded)

Requirement 5

Account Title	Debits	Credits
Cash	8,000	
Accounts receivable	9,000	
Prepaid insurance	2,000	
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 payable		1,500
Deferred rent revenue		1,200
Common stock		200,000
Retained earnings		<u>60,250</u>
Totals	<u>369,000</u>	<u>369,000</u>

Problem 2–10

Computations:

Sales revenue

Sales revenue during 2021 = \$320,000 + \$22,000 = **\$342,000**

Cost of goods sold

<u>Accounts payable</u>	
	0 1/1 Balance
Cash paid 220,000	? Purchases
	30,000 12/31 Balance

Purchases during 2021 = \$220,000 + \$30,000 = \$250,000

<u>Inventory</u>	
1/1 Balance 0	
Purchases 250,000	? Cost of goods sold
12/31 Balance 50,000	

Cost of goods sold during 2021 = \$250,000 – \$50,000 = **\$200,000**

Rent expense and prepaid rent

Prepaid rent = \$ 3,000 x $\frac{2}{3}$ = **\$2,000**

Rent expense during 2021 = \$14,000 – \$2,000 = **\$12,000**

Depreciation expense

Depreciation during 2021 = \$30,000 x 10% = **\$3,000**

Interest expense

Interest accrued during 2021 = \$40,000 x 12% x $\frac{9}{12}$ = **\$3,600**

Salaries expense

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

Problem 2–10 (continued)

McGUIRE CORPORATION		
Income Statement		
For the Year Ended December 31, 2021		
Sales revenue		\$342,000
Cost of goods sold		<u>200,000</u>
Gross profit		142,000
Operating expenses:		
Salaries expense	\$85,000	
Rent expense	12,000	
Depreciation expense	3,000	
Miscellaneous expense	<u>10,000</u>	
Total operating expenses		<u>110,000</u>
Operating income		32,000
Other expense:		
Interest expense		<u>3,600</u>
Net income		<u>\$ 28,400</u>

Problem 2–10 (concluded)

McGUIRE CORPORATION		
Balance Sheet		
At December 31, 2021		
Assets		
Current assets:		
Cash		\$ 56,000 (1)
Accounts receivable		22,000
Prepaid rent		2,000
Inventory		<u>50,000</u>
Total current assets		130,000
Office equipment	\$30,000	
Less: Accumulated depreciation	<u>(3,000)</u>	<u>27,000</u>
Total assets		<u>\$157,000</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable		\$ 30,000
Salaries payable		5,000
Notes payable		40,000
Interest payable		<u>3,600</u>
Total current liabilities		78,600
Shareholders' equity:		
Common stock	\$50,000	
Retained earnings	<u>28,400</u>	
Total shareholders' equity		<u>78,400</u>
Total liabilities and shareholders' equity		<u>\$157,000</u>

(1) $\$410,000 - \$354,000 = \$56,000$

Problem 2–11

Requirement 1

a. Sales revenue

Accounts receivable	
11/30 Balance	10,000
Sales revenue	?
12/31 Balance	3,000
	80,000 Cash collections

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

b. Cost of goods sold

Accounts payable	
Cash paid	60,000
	?
	15,000
	12,000 11/30 Balance
	Purchases
	12/31 Balance

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

Inventory	
11/30 Balance	7,000
Purchases	63,000
12/31 Balance	6,000
	? Cost of goods sold

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 expense

Salaries payable	
	5,000 11/30 Balance
Cash payments	10,000
	? Salaries expense
	3,000 12/31 Balance

Salaries 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	<u>30,000</u>
Sales revenue	<u>\$705,000</u>

Interest revenue:

Cash received	\$4,000
Add: Amount accrued at the end of 2021 ($\$50,000 \times .08 \times 9/12$)	3,000 (c)
Deduct: Amount accrued at the end of 2020	<u>(3,000)</u>
Interest revenue	<u>\$4,000</u>

Cost of goods sold:

Cash paid for merchandise	\$390,000
Add: Increase in accounts payable	<u>12,000</u>
Purchases during 2021	402,000
Add: Decrease in inventory	<u>18,000</u>
Cost of goods sold	<u>\$420,000</u>

Insurance expense:

Cash paid	\$6,000
Add: Prepaid insurance expired during 2021	2,500
Deduct: Prepaid insurance on 12/31/2021 ($\$6,000 \times 4/12$)	<u>(2,000) (a)</u>
Insurance expense	<u>\$6,500</u>

Salaries expense:

Cash paid	\$210,000
Add: Increase in salaries payable	<u>4,000</u>
Salaries expense	<u>\$214,000</u>

Problem 2–12 (continued)

Interest expense:

Amount accrued at the end of 2021
(\$100,000 x .06 x ²/12) \$1,000 (d)

Rent expense:

Amount paid **\$24,000**
Add: Prepaid rent on 12/31/2020 expired
during 2021 11,000
Deduct: Prepaid rent on 12/31/2021 (\$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, 2021

Sales revenue		\$705,000
Cost of goods sold		<u>420,000</u>
Gross profit		285,000
Operating expenses:		
Insurance expense	\$ 6,500	
Salaries expense	214,000	
Rent expense	23,000	
Depreciation expense	<u>10,000</u>	
Total operating expenses		<u>253,500</u>
Operating income		31,500
Other income (expense):		
Interest revenue	4,000	
Interest expense	<u>(1,000)</u>	<u>3,000</u>
Net income		<u>\$34,500</u>

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

Excalibur Corporation
Worksheet
December 31, 2021

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		10,000		(1) 7,500		17,500				17,500
Accounts payable		26,100				26,100				26,100
Salaries payable		3,000		(2) 1,500		4,500				4,500
Notes 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		22,050				22,050				22,050
Dividends	6,000				6,000					6,000
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 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			
Utilities expense	6,000				6,000		6,000			
Depreciation expense	0		(1) 7,500		7,500		7,500			
							<u>7,500</u>			
								157,850	180,000	203,300
Net Income							<u>22,150</u>			<u>22,150</u>
Totals	<u>351,150</u>	<u>351,150</u>	<u>11,500</u>	<u>11,500</u>	<u>361,150</u>	<u>361,150</u>	<u>180,000</u>	<u>180,000</u>	<u>203,300</u>	<u>203,300</u>

Problem 2–13 (continued)

EXCALIBUR CORPORATION		
Income Statement		
For the Year Ended December 31, 2021		
Sales revenue		\$180,000
Cost of goods sold		<u>95,000</u>
Gross profit		85,000
Operating expenses:		
Salaries expense	\$33,850	
Rent expense	13,000	
Supplies expense	1,500	
Utilities expense	6,000	
Depreciation expense	<u>7,500</u>	
Total operating expenses		<u>61,850</u>
Operating income		23,150
Other expense:		
Interest expense		<u>1,000</u>
Net income		<u>\$ 22,150</u>

Problem 2–13 (continued)

EXCALIBUR CORPORATION
Statement of Shareholders' Equity
For the Year Ended December 31, 2021

	Common Stock	Retained Earnings	Total Shareholders' Equity
Balance at January 1, 2021	\$80,000	\$22,050	\$102,050
Issue of common stock	- 0 -		- 0 -
Net income for 2021		22,150	22,150
Less: Dividends	_____	<u>(6,000)</u>	<u>(6,000)</u>
Balance at December 31, 2021	<u>\$80,000</u>	<u>\$38,200</u>	<u>\$118,200</u>

Problem 2–13 (continued)

EXCALIBUR CORPORATION

Balance Sheet
At December 31, 2021

Assets

Current assets:

Cash		\$ 23,300
Accounts receivable		32,500
Supplies		500
Prepaid rent		1,000
Inventory		<u>65,000</u>
Total current assets		122,300

Office equipment	\$75,000	
Less: Accumulated depreciation	<u>(17,500)</u>	<u>57,500</u>
Total assets		<u>\$179,800</u>

Liabilities and Shareholders' Equity

Current liabilities:

Accounts payable		\$ 26,100
Salaries payable		4,500
Notes payable		30,000
Interest payable		<u>1,000</u>
Total current liabilities		61,600

Shareholders' equity:

Common stock	\$80,000	
Retained earnings	<u>38,200</u>	
Total shareholders' equity		<u>118,200</u>
Total liabilities and shareholders' equity		<u>\$179,800</u>

Problem 2–13 (concluded)

December 31, 2021		
Sales revenue.....	180,000	
Retained earnings.....		180,000
Retained earnings.....	157,850	
Cost of goods sold.....		95,000
Interest expense.....		1,000
Salaries expense.....		33,850
Rent expense.....		13,000
Supplies expense.....		1,500
Utilities expense.....		6,000
Depreciation expense.....		7,500
Retained earnings.....	6,000	
Dividends.....		6,000

DECISION MAKERS' PERSPECTIVE CASES

Discussion Case 2–1

Memorandum

To: Mr. Sean Pitt
From: Your Name
Date: Current Date
RE: Usefulness of accrual based financial statements

Ms. Alice requested that I follow up with you regarding your application for a bank loan. In particular, she asked that I provide an explanation of why the bank requests accrual based financial statements for loan requests such as yours.

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.

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.

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.

Please let me know if I can provide any additional information.

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 payable (\$8,200 – \$7,200)		(1,000)
4. Increase in utilities payable (\$1,200 – \$900)		(300)
6. Increase in amount owed to suppliers		<u>(4,000)</u>
Accrual basis net income		<u>\$33,200</u>

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.

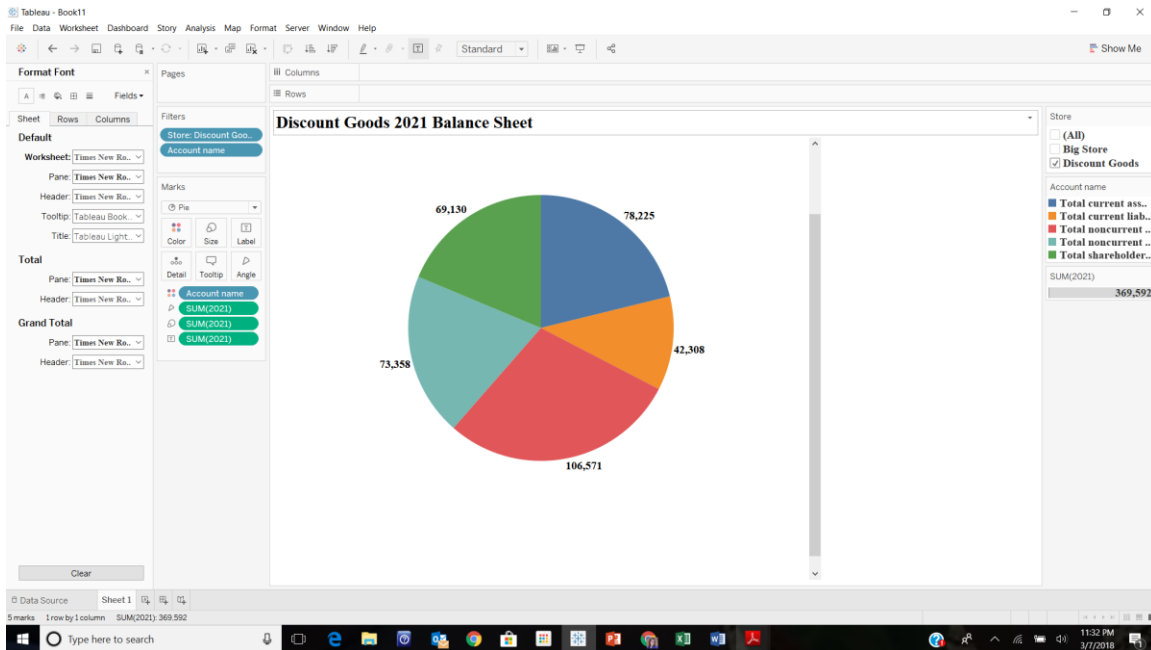
Requirement 3

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.

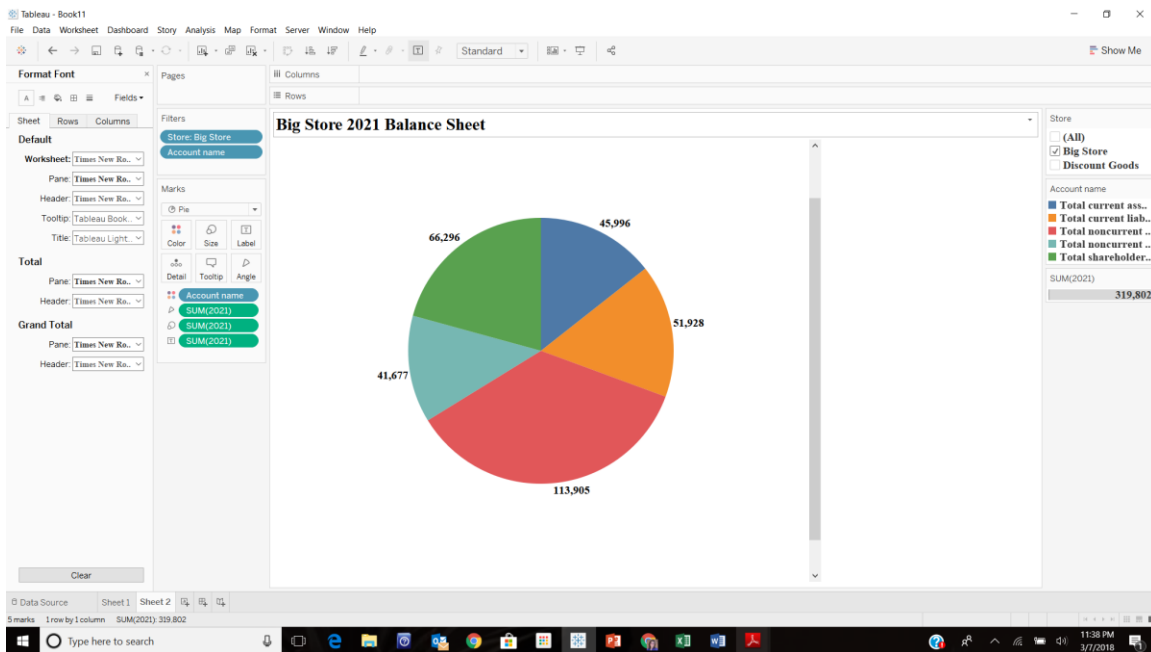
Data Analytics Case

Your Tableau analysis should produce the following charts:

(a) the pie chart for Discount Goods 2021 Balance Sheet:



(b) the pie chart for Big Store 2021 Balance Sheet:



Data Analytics Case (concluded)

Requirement 1

For Discount Goods, do liabilities or shareholders' equity provide the greater proportion of the company's assets?

Liabilities provide the greater proportion of the company's assets.

$$\text{Liabilities} / \text{Total Assets} = \$115,666 \div \$184,796 = 63\%$$

$$\text{Shareholders' Equity} / \text{Total Assets} = \$69,130 \div \$184,796 = 37\%$$

Requirement 2

For Big Store, do liabilities or shareholders' equity provide the greater proportion of the company's total assets?

Liabilities provide the greater proportion of the company's assets.

$$\text{Liabilities} / \text{Total Assets} = \$93,605 \div \$159,901 = 59\%$$

$$\text{Shareholders' Equity} / \text{Total Assets} = \$66,296 \div \$159,901 = 41\%$$

Requirement 3

Which of the two companies has the highest proportion of current liabilities to total liabilities?

Big Store reported the highest ratio of current liabilities to total liabilities. The ratio stated as a percentage **55%** (rounded to nearest whole percentage point).

$$\text{Discount Goods} = \$42,308 \div \$115,666 = 37\%$$

$$\text{Big Store} = \$51,928 \div \$93,606 = 55\%$$

Requirement 4

Which of the two companies has the highest ratio of current assets to current liabilities? What is the ratio stated as a percentage (rounded to nearest whole percentage point)?

Discount Goods reported the highest ratio of current assets to current liabilities. The ratio stated as a percentage is **185%**.

$$\text{Discount Goods} = \$78,225 \div \$42,308 = 185\%$$

$$\text{Big Store} = \$45,996 \div \$51,928 = 89\%$$

Target Case

Requirement 1

Target's balance sheet reports accumulated depreciation of \$18.181 million and \$17,413 million for the years ended February 3, 2018, and January 28, 2017, 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 (\$18,181 – \$17,413).....	768
Accumulated depreciation.....	768

Requirement 2

The statement of cash flows shows \$2,445 million for “depreciation and amortization” for the 2017 fiscal year. Given depreciation expense of \$768 million, amortization expense must be $\$2,445 - \$768 = \$1,677$ million.

Target Case (concluded)

Requirement 3

Note 13, “ Other Current Assets,” reports Prepaid expenses of \$181 million and \$207 million for the years ended February 3, 2018, and January 28, 2017, 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	207
Cash paid for insurance	?
Ending balance	181
	50 Insurance expense

Cash paid for insurance must have been \$24 million.

Prior to the adjusting entry, the balance in prepaid insurance would have been \$207 + \$24 = \$231. The adjusting entry to record expired insurance coverage and reduce the unexpired coverage to \$181 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.