

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.

Question 2–5

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

Answers to Questions (continued)

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

Transaction 1 records the purchase of \$20,000 of inventory on account. Transaction 2 records 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

Adjusting entries record the effect on financial position of internal events, those that do not involve an exchange transaction with another entity. They must be recorded 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.

Question 2–13

Closing entries transfer the balances in the temporary owners' equity accounts 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 expenses represent assets recorded when a cash disbursement creates benefits beyond the current reporting period. Examples are supplies on hand at the end of a period, prepaid rent, and the cost of plant and equipment.

Question 2–15

The adjusting entry required when deferred revenues are earned 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 required to record an accrued liability is a debit to an expense and 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 the company during a particular period of time. It is a change statement that is reporting the changes in owners' equity that occurred during the period as a result of revenues, expenses, gains, and losses.

Statement of comprehensive income—The purpose of the statement of comprehensive income is to report the 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 the company at a particular point in time. It is an organized array 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 permanent 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 means of organizing 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 retained earnings, and an understatement of liabilities.

Question 2–19

Reversing entries are recorded at the beginning of a reporting period. They remove 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.

Answers to Questions (concluded)

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

| | | | |
|------------------|---------------|---------|----|
| 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. | Note 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 – 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 ($\$2,000 \times \frac{1}{2}$) | 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 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 ($\$50,000 \times 6\% \times \frac{9}{12}$)..... | | 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 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, 2016

| | | |
|--------------------------------|---------------|------------------|
| Sales revenue | | \$325,000 |
| Cost of goods sold | | <u>168,000</u> |
| Gross profit | | 157,000 |
| Operating expenses: | | |
| Salaries | \$45,000 | |
| Rent | 20,000 | |
| Depreciation | 30,000 | |
| Miscellaneous | <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, 2016 | | |
| 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 | |
| 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

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

*\$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

| | | | |
|------------------|---------|--------|----|
| 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. |

Note 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

Cost of goods sold

| | | | | | |
|--|----------------|------------------|------------------|---------------|--|
| | 0 | 3/1 Bal. | 3/1 Bal. | 0 | |
| | 120,000 | 4. | 4. | 70,000 | |
| | <u>120,000</u> | 3/31 Bal. | 3/31 Bal. | <u>70,000</u> | |

Rent expense

Depreciation expense

| | | | | | |
|------------------|--------------|--|------------------|--------------|--|
| 3/1 Bal. | 0 | | 3/1 Bal. | 0 | |
| 5. | 5,000 | | 9. | 1,000 | |
| 3/31 Bal. | <u>5,000</u> | | 3/31 Bal. | <u>1,000</u> | |

| 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 | <u>1,000</u> | |
| Totals | <u>471,000</u> | <u>471,000</u> |

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

- k 1. Source documents
- e 2. Transaction analysis
- a 3. Journal
- j 4. Posting
- f 5. Unadjusted trial balance
- b 6. Adjusting entries
- h 7. Adjusted trial balance
- c 8. Financial statements
- d 9. Closing entries
- g 10. Post-closing trial balance
- i 11. Worksheet

List B

- a. Record of the dual effect of a transaction in debit/credit form.
- b. Internal events recorded at the end of a reporting period.
- c. Primary means of disseminating information to external decision makers.
- d. To zero out the owners' equity temporary accounts.
- e. Determine the dual effect on the accounting equation.
- f. List of accounts and their balances before recording adjusting entries.
- g. List of accounts and their balances after recording closing entries.
- h. List of accounts and their balances after recording adjusting entries.
- i. A means of organizing information; not part of the formal accounting system.
- j. Transferring balances from the journal to the ledger.
- 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 and wages payable |
| 8. | <u>I</u> | Cost of goods sold |
| 9. | <u>I</u> | Utility 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> |
|---|-------------------------------|--------------------------------|
| 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 ($\$12,000 \times \frac{30}{36}$) | 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 | 1,500 | |
| Rent revenue ($\frac{1}{2} \times \$3,000$) | | 1,500 |

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. Rent revenue ($\$12,000 \times \frac{7}{12}$)..... | 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

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

$$\$7,200 \div .75 = \$9,600 \text{ in annual interest}$$

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

Or,

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

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

- $\$60,000 \div 12 \text{ months} = \$5,000 \text{ per month in rent}$
 $\$35,000 \div \$5,000 = 7 \text{ months expired. The rent was paid on } \mathbf{June 1}$, seven months ago.
- $\$500 \text{ represents two months (November and December) in accrued interest, or } \250 per month.
 $\$250 \times 12 \text{ months} = \$3,000 \text{ in annual interest}$
 $\text{Principal} \times 6\% = \$3,000$
 $\text{Principal} = \$3,000 \div .06 = \mathbf{\$50,000 \text{ note}}$

Exercise 2–11

| | | |
|--|--------|--------|
| 1. Insurance expense ($\$6,000 \times \frac{3}{12}$)..... | 1,500 | |
| Prepaid insurance..... | | 1,500 |
| 2. Interest expense ($\$80,000 \times 8\% \times \frac{3}{12}$)..... | 1,600 | |
| Interest payable..... | | 1,600 |
| 3. Deferred rent revenue ($\$24,000 \times \frac{3}{12}$)..... | 6,000 | |
| Rent revenue..... | | 6,000 |
| 4. Depreciation expense ($\$20,000 \times \frac{3}{12}$)..... | 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, 2016 | | |
| Sales revenue | | \$800,000 |
| Cost of goods sold | | <u>480,000</u> |
| Gross profit | | 320,000 |
| Operating expenses: | | |
| Salaries | \$120,000 | |
| Rent | 30,000 | |
| Depreciation | 60,000 | |
| Advertising | <u>5,000</u> | |
| Total operating expenses | | <u>215,000</u> |
| Operating income | | 105,000 |
| Other expense: | | |
| Interest | | <u>4,000</u> |
| Net income | | <u>\$101,000</u> |

Exercise 2–12 (continued)

BLUEBOY CHEESE CORPORATION

Balance Sheet
At December 31, 2016

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> | <u>350,000</u> |
| Total assets | | <u>\$731,000</u> |

Liabilities and Shareholders' Equity

Current liabilities:

| | | |
|---------------------------------|--|---------------|
| Accounts payable | | \$ 60,000 |
| Salaries payable | | 8,000 |
| Interest payable | | 2,000 |
| Note 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, 2016 | | |
|---|---------|---------|
| 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, 2016 | | |
|--|---------|---------|
| 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, 2016 | |
|--|---------|
| 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 |
| Purchased | ? |
| 12/31 Balance | 3,000 |
| | Expense 2,000 |

$$\text{Cost of supplies purchased} = \$3,000 + 2,000 - 1,500 = \mathbf{\$3,500}$$

Exercise 2–15 (continued)

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, 2016 | | |
|--------------------------|-------|-------|
| Insurance expense | 1,500 | |
| Prepaid insurance | | 1,500 |

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, 2016 | | |
|----------------------------------|--------|--------|
| Salaries and wages expense | 15,000 | |
| Salaries and wages payable | | 15,000 |

Exercise 2–15 (concluded)

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 = $\$3,000 \times \frac{1}{3} = \mathbf{\$1,000}$

| December 31, 2016 | | |
|-----------------------------|-------|-------|
| Deferred rent revenue | 1,000 | |
| Rent revenue | | 1,000 |

Exercise 2–16

Requirement 1

| 2016 | | 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

| 2016 | | 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 |
| 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 ($\$20,000 \times 12\% \times 3/12$) | – 600 |
| Adjusted net income | <u>\$33,150</u> |

Exercise 2–18

Stanley and Jones Lawn Service Company

Income Statement

For the Year Ended December 31, 2016

| | | |
|--------------------------------|---------------|-----------------|
| 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 | <u>10,000</u> | |
| Total operating expenses | | <u>251,500</u> |
| Operating income | | 63,500 |
| Other expense: | | |
| Interest (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 |
| Sales 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 fee revenue (\$11,000 – 9,200) | (1,800) |
| Increase in accrued liabilities (\$15,600 – 12,200) | <u>(3,400)</u> |
| 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, 2016 | | |
| Sales revenue | | \$323,000 |
| Cost of goods sold | | <u>180,000</u> |
| Gross profit | | 143,000 |
| Operating expenses: | | |
| Salaries and wages | \$75,000 | |
| Rent | 30,000 | |
| Depreciation | 10,000 | |
| Utilities | 12,000 | |
| Advertising | <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, 2016 | | |
| 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 and wages 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 and wages expense ($\$10,000 \times \frac{3}{5}$) | 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 ($\$90,000 \times 8\% \times \frac{3}{12}$) | 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

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 ($\$6,000 \times \frac{1}{3}$) | 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. (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 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 |

CPA REVIEW QUESTIONS

1. **d.** The event is recorded as an increase to accounts receivable and an increase in revenue. An increase to accounts receivable represents an increase in assets and the increase in revenue will increase net income which will in turn increase retained earnings.
2. **b.** The amount accrued as commissions for each salesperson will be any commissions due over and above the fixed salary as follows:

| | <u>Fixed salary</u> | <u>Commissions</u> | <u>Excess</u> |
|---|---------------------|--------------------|---------------|
| A | \$10,000 | \$8,000 | \$ —0— |
| B | \$14,000 | \$24,000 | \$10,000 |
| C | \$18,000 | \$36,000 | \$18,000 |

The amount accrued is \$28,000.

3. **b.** A net decrease in accounts receivable means that cash collections exceeded accrual revenue. Therefore, cash basis income would be higher when compared to accrual basis. A net decrease in accrued liabilities indicates that cash payments for expenses are greater than accrual expenses. Therefore, cash basis income would be lower than accrual basis income.

4. **a.** Cash basis income: Cash collected in May \$3,200,000

Accrual basis income:

| | |
|------------------------------------|--------------------|
| Revenue recognized in April | \$3,200,000 |
| Less: Expenses recognized in April | <u>(1,500,000)</u> |
| Income | \$1,700,000 |

5. **d.** Expense recognized \$437,500
 Add: Increase in prepaid insurance 17,500
 Cash paid for insurance \$455,000

PROBLEMS

Problem 2–1

Requirement 1

| 2016 | | 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

| | | | |
|------------------|----------------|--------|------|
| 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. |

Note 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

| | | |
|--|---------------|------------------|
| | 0 | 1/1 Bal. |
| | 12,000 | 1/10 |
| | 10,000 | 1/22 |
| | 22,000 | 1/31 Bal. |

Cost of goods sold

| | |
|------------------|---------------|
| 1/1 Bal. | 0 |
| 1/10 | 7,000 |
| 1/22 | 6,000 |
| 1/31 Bal. | 13,000 |

Salaries and wages expense

| | |
|------------------|--------------|
| 1/1 Bal. | 0 |
| 1/20 | 6,000 |
| 1/31 Bal. | 6,000 |

Rent expense

| | |
|------------------|--------------|
| 1/1 Bal. | 0 |
| 1/30 | 2,000 |
| 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 | <u>2,000</u> | |
| Totals | <u>172,000</u> | <u>172,000</u> |

Problem 2–2

Requirement 2

| 2016 | | 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. | | | | 1/31 Bal. | | | |
| | 1,400 | | | | 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. | | | | 1/31 Bal. | | | |
| | 9,700 | | | | 17,300 | | |
| 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 |
| 1/31 Bal. | | | | 1/31 Bal. | | | |
| | | 3,500 | | | | 12,650 | |
| Common stock | | | | Retained earnings | | | |
| | | 10,000 | 1/1 Bal. | | | 6,500 | 1/1 Bal. |
| | | | | 1/31 | 1,000 | | |
| 1/31 Bal. | | | | 1/31 Bal. | | | |
| | | 10,000 | | | | 5,500 | |

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

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

Rent expense

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

Salaries and wages 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 | | 12,650 |
| 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 | <u>40,150</u> | <u>40,150</u> |

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 ($\$50,000 \times 12\% \times \frac{3}{12}$) | 1,500 | |
| Interest payable..... | | 1,500 |
| 4. Interest receivable ($\$20,000 \times 8\% \times \frac{10}{12}$) | 1,333 | |
| Interest revenue..... | | 1,333 |
| 5. Prepaid insurance ($\$6,000 \times \frac{15}{24}$)..... | 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

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

Accounts receivable

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

Prepaid rent

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

Prepaid insurance

| | | | | | |
|-------------------|-------|--|--|--|--|
| Bal. | 0 | | | | |
| 5. | 3,750 | | | | |
| | 3,750 | | | | |
| 12/31 Bal. | 3,750 | | | | |

Supplies

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

Inventory

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

Note receivable

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

Office equipment

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

Interest receivable

| | | | | | |
|-------------------|-------|--|--|--|--|
| Bal. | 0 | | | | |
| 4. | 1,333 | | | | |
| | 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 and wages payable

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

Note payable

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

Interest payable

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

Deferred revenue

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

Common stock

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

Retained earnings

| | | |
|--|--------|-------------------|
| | 24,500 | Bal. |
| | <hr/> | |
| | 24,500 | 12/31 Bal. |

Problem 2–4 (continued)

INCOME STATEMENT ACCOUNTS

Sales revenue

| | | | |
|----|-------|---------|-------------------|
| | | 148,000 | Bal. |
| 7. | 2,000 | | |
| | | 146,000 | 12/31 Bal. |

Interest revenue

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

Cost of goods sold

| | | |
|-------------------|--------|--|
| Bal. | 70,000 | |
| 12/31 Bal. | 70,000 | |

Salaries and wages expense

| | | |
|-------------------|--------|--|
| Bal. | 18,900 | |
| 2. | 1,500 | |
| 12/31 Bal. | 20,400 | |

Rent expense

| | | |
|-------------------|--------|--|
| Bal. | 11,000 | |
| 8. | 1,000 | |
| 12/31 Bal. | 12,000 | |

Depreciation expense

| | | |
|-------------------|--------|--|
| Bal. | 0 | |
| 1. | 10,000 | |
| 12/31 Bal. | 10,000 | |

Interest expense

| | | |
|-------------------|-------|--|
| Bal. | 0 | |
| 3. | 1,500 | |
| 12/31 Bal. | 1,500 | |

Supplies expense

| | | |
|-------------------|-------|--|
| Bal. | 1,100 | |
| 6. | 700 | |
| 12/31 Bal. | 1,800 | |

Insurance expense

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

Advertising expense

| | | |
|-------------------|-------|--|
| Bal. | 3,000 | |
| 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 | <u>357,833</u> | <u>357,833</u> |

Problem 2–4 (continued)

Requirement 4

| PASTINA COMPANY | | |
|--------------------------------------|----------------|------------------|
| Income Statement | | |
| For the Year Ended December 31, 2016 | | |
| Sales revenue | | \$146,000 |
| Cost of goods sold | | <u>70,000</u> |
| Gross profit | | 76,000 |
| Operating expenses: | | |
| Salaries and wages | \$20,400 | |
| Rent | 12,000 | |
| Depreciation | 10,000 | |
| Supplies | 1,800 | |
| Insurance | 2,250 | |
| Advertising | <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)

PASTINA COMPANY
Statement of Shareholders' Equity
For the Year Ended December 31, 2016

| | Common Stock | Retained Earnings | Total Shareholders' Equity |
|------------------------------|-------------------------|------------------------------|---|
| Balance at January 1, 2016 | \$60,000 | \$28,500 | \$ 88,500 |
| Issue of common stock | - 0 - | | - 0 - |
| Net income for 2016 | | 26,383 | 26,383 |
| Less: Dividends | | <u>(4,000)</u> | <u>(4,000)</u> |
| Balance at December 31, 2016 | <u>\$60,000</u> | <u>\$50,883</u> | <u>\$110,883</u> |

Problem 2–4 (continued)

PASTINA COMPANY

Balance Sheet
At December 31, 2016

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 | | <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 and wages payable | | 1,500 |
| Note payable | | 50,000 |
| Interest payable | | 1,500 |
| Deferred 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, 2016 | | |
|--|---------|---------|
| 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

| | | | |
|---------|---------|---------|-------------------|
| | | 148,000 | Bal. |
| 7. | 2,000 | | |
| 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 and wages 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. | 6,000 | | |
| | | 3,750 | 5. |
| | | 2,250 | Closing |
| 12/31 Bal. | 0 | | |

Advertising expense

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

Income summary

| | | | |
|-------------------|---------|---------|---------|
| Bal. | 0 | | |
| | | 147,333 | Closing |
| Closing | 120,950 | | |
| Closing | 26,383 | | |
| 12/31 Bal. | 0 | | |

Retained earnings

| | | | |
|--|--|--------|-------------------|
| | | 24,500 | Bal. |
| | | | |
| | | 26,383 | Closing |
| | | | |
| | | 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 | <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 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 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;">1/1 Bal.</td> <td style="width: 15%;">20,000</td> <td style="width: 15%;"></td> <td style="width: 15%;"></td> </tr> <tr> <td>f.</td> <td>15,000</td> <td></td> <td></td> </tr> <tr> <td colspan="4" style="border-top: 1px solid black;">12/31 Bal. 35,000</td> </tr> </table> | | | | 1/1 Bal. | 20,000 | | | f. | 15,000 | | | 12/31 Bal. 35,000 | | | | | | | | | | | | | | | | | | | |
| 1/1 Bal. | 20,000 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| f. | 15,000 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 12/31 Bal. 35,000 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Accumulated depreciation | | | | Salaries payable | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;"></td> <td style="width: 15%;">6,000</td> <td style="width: 15%;">1/1 Bal.</td> <td style="width: 15%;"></td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td colspan="4" style="border-top: 1px solid black;">12/31 Bal. 6,000</td> </tr> </table> | | | | | 6,000 | 1/1 Bal. | | | | | | 12/31 Bal. 6,000 | | | | <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;"></td> <td style="width: 15%;">9,000</td> <td style="width: 15%;">1/1 Bal.</td> <td style="width: 15%;"></td> </tr> <tr> <td>d.</td> <td>9,000</td> <td></td> <td></td> </tr> <tr> <td colspan="4" style="border-top: 1px solid black;">12/31 Bal. 0</td> </tr> </table> | | | | | 9,000 | 1/1 Bal. | | d. | 9,000 | | | 12/31 Bal. 0 | | | |
| | 6,000 | 1/1 Bal. | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 12/31 Bal. 6,000 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | 9,000 | 1/1 Bal. | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| d. | 9,000 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 12/31 Bal. 0 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Common stock | | | | Retained earnings | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;"></td> <td style="width: 15%;">40,500</td> <td style="width: 15%;">1/1 Bal.</td> <td style="width: 15%;"></td> </tr> <tr> <td></td> <td>10,000</td> <td>c.</td> <td></td> </tr> <tr> <td colspan="4" style="border-top: 1px solid black;">12/31 Bal. 50,500</td> </tr> </table> | | | | | 40,500 | 1/1 Bal. | | | 10,000 | c. | | 12/31 Bal. 50,500 | | | | <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;"></td> <td style="width: 15%;">9,500</td> <td style="width: 15%;">1/1 Bal.</td> <td style="width: 15%;"></td> </tr> <tr> <td>g.</td> <td>2,500</td> <td></td> <td></td> </tr> <tr> <td colspan="4" style="border-top: 1px solid black;">12/31 Bal. 7,000</td> </tr> </table> | | | | | 9,500 | 1/1 Bal. | | g. | 2,500 | | | 12/31 Bal. 7,000 | | | |
| | 40,500 | 1/1 Bal. | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | 10,000 | c. | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 12/31 Bal. 50,500 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | 9,500 | 1/1 Bal. | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| g. | 2,500 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 12/31 Bal. 7,000 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

Problem 2–6 (continued)

INCOME STATEMENT ACCOUNTS

Service revenue

| | | |
|--|---------|-------------------|
| | 0 | 1/1 Bal. |
| | 100,000 | a. |
| | 100,000 | 12/31 Bal. |

Miscellaneous expenses

| | |
|-------------------|--------|
| 1/1 Bal. | 0 |
| e. | 24,000 |
| 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 | <u>163,500</u> | <u>163,500</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

| | | | |
|-------------------|---------------|--------|----|
| 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. |
| g. | 2,500 | |
| | 7,000 | 12/31 Bal. |

Problem 2–6 (continued)

INCOME STATEMENT ACCOUNTS

Service revenue

| | | |
|--|---------|-------------------|
| | 0 | 1/1 Bal. |
| | 100,000 | a. |
| | | |
| | 100,000 | 12/31 Bal. |

Miscellaneous expenses

| | |
|-------------------|--------|
| 1/1 Bal. | 0 |
| e. | 24,000 |
| | |
| 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 | <u>2,000</u> | |
| Totals | <u>166,500</u> | <u>166,500</u> |

Requirement 7

| KARLIN COMPANY | | |
|--------------------------------------|--------------|------------------|
| Income Statement | | |
| For the Year Ended December 31, 2016 | | |
| Service revenue | | \$100,000 |
| Operating expenses: | | |
| Salaries | \$42,000 | |
| Miscellaneous | 24,000 | |
| Depreciation | <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, 2016

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, 2016 | | |
|------------------------------|---------|---------|
| 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

| | | | |
|-------------------|---------------|--------|----|
| 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. |
| g. | 2,500 | |
| | 32,000 | Closing |
| | 39,000 | 12/31 Bal. |

Problem 2–6 (continued)

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 | | |

Income summary

| | | | |
|-------------------|--------|---------|---------|
| | | 100,000 | Closing |
| Closing | 68,000 | | |
| Closing | 32,000 | | |
| 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 ($\$10,000 \times 12\% \times \frac{1}{2}$) | | 600 |
| b. Depreciation expense ($\$30,000 \times \frac{1}{5}$) | 6,000 | |
| Accumulated depreciation | | 6,000 |
| c. Deferred rent revenue | 2,000 | |
| Rent revenue ($\$6,000 \times \frac{2}{6}$) | | 2,000 |
| d. Prepaid insurance | 1,500 | |
| Insurance expense ($\$2,400 \times \frac{15}{24}$) | | 1,500 |
| e. Interest expense ($\$20,000 \times 12\% \times \frac{3}{12}$) | 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 ($\$75,000 \div 8$ 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 ($\$30,000 \times 10\% \times 4/12$) | 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 | 1,500 | |
| 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

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

Accounts receivable

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

Prepaid insurance

| | | |
|-------------------|-------|--------------------|
| Bal. | 3,000 | |
| | | 1,500 Adjusting |
| 12/31 Bal. | 1,500 | |

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—bldg.

| | | |
|--|--|--------------------------|
| | | 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 and wages payable

| | | |
|--|-------|-------------------|
| | 0 | Bal. |
| | 1,500 | Adjusting |
| | 1,500 | 12/31 Bal. |

Deferred rent revenue

| | | |
|--|-------|-------------------|
| | 0 | Bal. |
| | 1,200 | Adjusting |
| | 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

Sales 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 | |
| | 6,300 | 12/31 Bal. |

Salaries and wages expense

| | |
|-------------------|--------|
| Bal. | 37,000 |
| Adjusting | 1,500 |
| 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

| | | |
|-------------------|-------|--|
| Bal. | 0 | |
| Adjusting | 1,500 | |
| 12/31 Bal. | 1,500 | |

Utility 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 | 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 | <u>15,000</u> | |
| Totals | <u>464,500</u> | <u>464,500</u> |

Problem 2–9 (continued)

Requirement 4

| December 31, 2016 | | |
|--|--------|--------|
| 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 | | <u>59,750</u> |
| Totals | <u>368,500</u> | <u>368,500</u> |

Problem 2–10

Computations:

Sales revenue

Sales revenue during 2016 = \$320,000 + 22,000 = **\$342,000**

Cost of goods sold

| Accounts payable | |
|------------------|----------------------|
| Cash paid | 220,000 |
| | 0 1/1 Balance |
| | ? Purchases |
| | 30,000 12/31 Balance |

Purchases during 2016 = \$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 2016 = \$250,000 – 50,000 = **\$200,000**

Rent expense and prepaid rent

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

Rent expense during 2016 = \$14,000 – 2,000 = **\$12,000**

Depreciation expense

Depreciation during 2016 = \$30,000 x 10% = **\$3,000**

Interest expense

Interest accrued during 2016 = \$40,000 x 12% x $\frac{9}{12}$ = **\$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, 2016

| | | |
|--------------------------------|---------------|------------------|
| Sales revenue | | \$342,000 |
| Cost of goods sold | | <u>200,000</u> |
| Gross profit | | 142,000 |
| Operating expenses: | | |
| Salaries and wages..... | 85,000 | |
| Rent..... | 12,000 | |
| Depreciation | 3,000 | |
| Miscellaneous | <u>10,000</u> | |
| Total operating expenses | | <u>110,000</u> |
| Operating income | | 32,000 |
| Other expense: | | |
| Interest | | <u>3,600</u> |
| Net income | | <u>\$ 28,400</u> |

Problem 2–10 (concluded)

| McGUIRE CORPORATION | | |
|---|----------------|------------------|
| Balance Sheet | | |
| At December 31, 2016 | | |
| 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 and wages payable | | 5,000 |
| Note 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 = $\$3,000 + 80,000 - 10,000 = \mathbf{\$73,000}$

b. Cost of goods sold

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

Purchases during December = $\$15,000 + 60,000 - 12,000 = \mathbf{\$63,000}$

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

Cost of goods sold during December = $\$7,000 + 63,000 - 6,000 = \mathbf{\$64,000}$

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

Interest revenue:

| | |
|---|----------------|
| Cash received | \$4,000 |
| Add: Amount accrued at the end of 2016 ($\$50,000 \times .08 \times \frac{9}{12}$) | 3,000 (c) |
| Deduct: Amount accrued at the end of 2015 | <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 2016 | 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 2016 | 2,500 |
| Deduct: Prepaid insurance on 12/31/16 ($\$6,000 \times \frac{4}{12}$) | <u>(2,000) (a)</u> |
| Insurance expense | <u>\$6,500</u> |

Salaries and wages expense:

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

Problem 2–12 (continued)

| | | |
|--|--|---------------------|
| Interest expense: | | |
| Amount accrued at the end of 2016 | | |
| (\$100,000 x .06 x ² /12) | | <u>\$1,000</u> (d) |
| Rent expense: | | |
| Amount paid | | \$24,000 |
| Add: Prepaid rent on 12/31/15 expired | | |
| during 2016 | | 11,000 |
| Deduct: Prepaid rent on 12/31/16 (\$24,000 x ⁶ /12) | | <u>(12,000)</u> (b) |
| Rent expense | | <u>\$23,000</u> |
| Depreciation expense: Increase in accumulated depreciation | | <u>\$10,000</u> |

| Zambrano Wholesale Corporation | | |
|---------------------------------------|----------------|-----------------|
| Income statement | | |
| For the Year Ended December 31, 2016 | | |
| Sales revenue | | \$705,000 |
| Cost of goods sold | | <u>420,000</u> |
| Gross profit | | 285,000 |
| Operating expenses: | | |
| Insurance | \$ 6,500 | |
| Salaries and wages | 214,000 | |
| Rent | 23,000 | |
| Depreciation | <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

| 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 | | | | | | | <u>20,275</u> | | | <u>20,275</u> |
| Totals | <u>345,150</u> | <u>345,150</u> | <u>13,375</u> | <u>13,375</u> | <u>357,025</u> | <u>357,025</u> | <u>180,000</u> | <u>180,000</u> | <u>197,300</u> | <u>197,300</u> |

Problem 2–13 (continued)

EXCALIBUR CORPORATION
Income Statement
For the Year Ended December 31, 2016

| | | |
|--------------------------------|--------------|------------------|
| Sales revenue | | \$180,000 |
| Cost of goods sold | | <u>95,000</u> |
| Gross profit | | 85,000 |
| Operating expenses: | | |
| Salaries and wages | 33,850 | |
| Rent..... | 13,000 | |
| Supplies | 1,500 | |
| Utility | 6,000 | |
| Depreciation | <u>9,375</u> | |
| Total operating expenses | | <u>63,725</u> |
| Operating income | | 21,275 |
| Other expense: | | |
| Interest | | <u>1,000</u> |
| Net income | | <u>\$ 20,275</u> |

Problem 2–13 (continued)

| | Common Stock | Retained Earnings | Total Shareholders' Equity |
|------------------------------|-------------------------|------------------------------|---|
| Balance at January 1, 2016 | \$80,000 | \$22,050 | \$102,050 |
| Issue of common stock | - 0 - | | - 0 - |
| Net income for 2016 | | 20,275 | 20,275 |
| Less: Dividends | | <u>(6,000)</u> | <u>(6,000)</u> |
| Balance at December 31, 2016 | <u>\$80,000</u> | <u>\$36,325</u> | <u>\$116,325</u> |

Problem 2–13 (continued)

EXCALIBUR CORPORATION

Balance Sheet
At December 31, 2016

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>(19,375)</u> | <u>55,625</u> |
| Total assets | | <u>\$177,925</u> |

Liabilities and Shareholders' Equity

Current liabilities:

| | | |
|----------------------------------|--|--------------|
| Accounts payable | | \$ 26,100 |
| Salaries and wages payable | | 4,500 |
| Note payable | | 30,000 |
| Interest payable | | <u>1,000</u> |
| Total current liabilities | | 61,600 |

Shareholders' equity:

| | | |
|--|---------------|------------------|
| Common stock | \$80,000 | |
| Retained earnings | <u>36,325</u> | |
| Total shareholders' equity | | <u>116,325</u> |
| Total liabilities and shareholders' equity | | <u>\$177,925</u> |

Problem 2–13 (concluded)

| December 31, 2016 | | |
|---|---------|---------|
| 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) $\$12,000 \times \frac{8}{12}$ | 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 | <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.