

# **1            *ACCOUNTING: INFORMATION FOR DECISION MAKING***

## **Chapter Summary**

Our financial reporting system has changed greatly over the past 50 years and will continue to change. The financial world is experiencing unparalleled challenges, such as globalization, deregulation, and the widespread use of the World Wide Web. In the midst of these changes is the accounting profession that must provide reliable and relevant information to users. This chapter introduces accounting to the student as the means of providing the information to support such decisions. Two broad types of accounting information, financial and internal are introduced and discussed. The production and communication of information within an accounting system is introduced at the outset of the chapter.

The focus then shifts to the various consumers of accounting information and the uses to which they put that information. External users are discussed first with the natural emphasis placed on the decision-making needs of investors and creditors. The needs of these users are summarized in terms of their interest in cash flow prospects. The financial accounting process communicates these prospects. The objectives of the reporting process are discussed in some detail leading to a definitional listing of the financial statements. This segment of the chapter concludes with an overview of the characteristics of externally reported accounting information.

The orientation of the chapter now shifts to decision-making by parties internal to an organization and how internal accounting supports these decisions. Internal users are very broadly defined as all employees of the organization. Employees are supported by the internal accounting information system in three ways. First, the internal accounting system assigns decision-making authority over the organization's resources to employees. Second, the internal accounting system provides the information required to make decisions regarding these resources. Finally, employee performance is regularly evaluated and rewarded based on information supplied by the internal accounting system. The characteristics of internal accounting information are discussed at length. This discussion makes the student aware of the distinctions between financial and internal accounting.

The main body of the chapter closes with a discussion of the sources of integrity of accounting information. We introduce institutional features that contribute to the integrity of the information including, accounting principles and standards, systems of internal control, and audits of financial information. The roles played by organizations such as the AICPA, IMA, IIA, AAA, and COSO are discussed. We close by emphasizing the critical importance of the competence, judgment, and ethical behavior of professional accountants.

The chapter begins with an overview of career opportunities offered by the accounting profession. Opportunities in public, management, and government accounting are surveyed, as are career paths in education. We take this opportunity to distinguish between accounting and bookkeeping and to explain the minimal role played by bookkeeping activities.

## Learning Objectives

1. Discuss accounting as the language of business and the role of accounting information in making economic decisions.
2. Discuss the significance of accounting systems in generating reliable accounting information and understand the five components of internal control.
3. Explain the importance of financial accounting information for external parties – primarily investors and creditors – in terms of the objectives and the characteristics of that information.
4. Explain the importance of accounting information for internal parties – primarily management – in terms of the objectives and the characteristics of that information.
5. Discuss elements of the system of external and internal financial reporting that create integrity in the reported information.
6. Identify and discuss several professional accounting organizations that play important roles in preparing and communicating accounting information.
7. Discuss the importance of personal competence, professional judgment, and ethical behavior on the part of accounting professionals.
8. Describe various career opportunities in accounting.

## Brief Topical Outline

- A Accounting information: a means to an end
  - 1 Accounting from a user's perspective
  - 2 Types of accounting information
    - a Financial accounting – see *Case in Point* (page 5)
    - b Management accounting
    - c Tax accounting
- B Accounting systems
  - 1 Determining information needs
  - 2 The cost of producing accounting information
  - 3 Basic functions of an accounting system
  - 4 Who designs and installs accounting systems?
  - 5 Components of internal control
- C Financial accounting information
  - 1 External users of accounting information
  - 2 Objectives of external financial reporting
  - 3 Characteristics of externally reported information - see *Your Turn* (page 10)

- a** Financial reporting-a means
    - b** Financial reporting versus financial statements
    - c** Historical in nature
    - d** Inexact and approximate measures
    - e** General-purpose assumption
    - f** Usefulness enhanced via explanation
  - D** Management accounting information
    - 1** Users of internal accounting information – see Exhibit 1-5
    - 2** Objectives of management accounting information
    - 3** Characteristics of management accounting information
      - a** Importance of timeliness
      - b** Identity of decision maker
      - c** Oriented toward the future
      - d** Measures of efficiency and effectiveness
      - e** Management accounting information - a means
  - E** Integrity of accounting information
    - 1** Institutional features
      - a** Standards for the preparation of accounting information
      - b** International Accounting Standard Board
      - c** Securities and Exchange Commission
      - d** Financial Accounting Standards Board
      - e** Public Company Accounting Oversight Board
      - f** Audits of financial statements
      - g** Legislation
    - 2** Professional organizations – AICPA, IMA, IIA, AAA, COSO
    - 3** Competence, judgment, and ethical behavior – see *Ethics, Fraud & Corporate Governance* (page **27**), Exhibit 1-6 (page **23**) and Your Turn (page **23**)
  - F** Careers in accounting
    - 1** Public accounting
      - a** The CPA examination
    - 2** Management accounting
    - 3** Governmental accounting
    - 4** Accounting education
    - 5** What about bookkeeping?
    - 6** Accounting as a stepping-stone – see *Ethics, Fraud & Corporate Governance* (page **27**)
    - 7** But what about me? I'm not an accounting major
  - G** Concluding remarks

## Topical Coverage and Suggested assignment

		Homework Assignment (To Be Completed Prior to Class)				
Class Meetings On Chapter	Topical Outline Coverage	Discussion Questions	Brief Exercises	Exercises	Problems	Critical Thinking Cases
1	A - C	1, 2, 4	1, 3	1, 3, 4	n.a.	2
2	D - G	5, 9, 15, 16	5, 6, 7, 8	7, 8, 9, 12	n.a.	4

## Comments and Observations

### Teaching objectives for Chapter 1

Chapter 1 introduces students to the users of accounting information, both external and internal to the organization. The objectives and characteristics of externally reported and internal accounting information are explained and contrasted with one another. The sources of integrity of accounting information are explained. Career opportunities in accounting are also discussed. In the class meetings relating to this introductory chapter our primary teaching objectives are to:

- 1 Explain the nature and requirements of the course.
- 2 Impress upon students the importance of keeping up with the coursework and completing homework assignments on a timely basis. Impress upon students that accounting is a cumulative knowledge subject. Students lost in Chapter 1 will likely have trouble the rest of the semester.
- 3 Describe the general purpose of accounting and various uses of accounting information. Explain the focus of this course relative to other accounting courses.
- 4 Provide an overview of external financial reporting.
- 5 Explain the nature of internal accounting and the information needs of internal users of accounting information.
- 6 Discuss the factors responsible for assuring the integrity of accounting information.
- 7 Briefly describe some career opportunities in accounting and explain why an understanding of accounting is useful to people other than professional accountants.

## General Comments

**Getting started** During the first class meeting, we find it worthwhile to spend a few minutes acquainting the students with the textbook and its supplements, and explaining the nature of an accounting course. For example, we show students that the text contains check figures to the problems on the inside cover, and that a glossary of key terms, a self-test, and usually a Demonstration Problem (with solution) appear at the end of each chapter.

We give a brief demonstration of the proper use of columnar paper and explain that all homework problems should be prepared in pencil. If the partially filled-in working papers are used (which we recommend), we show the students the worksheet for an extensive problem so that they will appreciate the time savings inherent in this supplement.

It is the nature of accounting that new concepts tend to build upon those that have come before. Therefore, we place a high priority on impressing the students with the importance of getting right to work and of keeping up with the progress of the class. Our experience has shown repeatedly that students who get off to a slow start or who fall behind early in the course will have increasing difficulty as the course progresses. Therefore, we recommend assigning a heavy homework load immediately.

**"Accounting" is much more than crunching numbers** In teaching accounting, it too often happens that all available class time is spent demonstrating mechanical techniques and solving quantitative problems. Many students, however, have very little understanding of the environment in which accounting information is developed and used. Without this understanding, the relevance of accounting procedures and computations may not be apparent.

We urge instructors to give appropriate classroom time to introducing this environment. We favor in-class reviews of assignments emphasizing the *use* and *interpretation* of accounting information. This is especially true of the *Your Turn* and *Case in Point* cases included within the main body of the text. In addition, those problems that involve well-known companies introduce elements of the business community with which the student is at least partially familiar.

We also encourage instructors to address the many *nonquantitative* aspects of accounting, such as the information needs of decision-makers, accounting theory, systems design, internal control, auditing, ethics, and issues involving professional judgment. If students are to really "learn accounting," these topics deserve attention in both the classroom and in the textbook. One of our major goals in this eleventh edition is to offer examples, text discussions, and assignment materials that better illustrate what accounting "is all about."

In covering Chapter 1, we like to provide students with an overview of both the external and internal reporting process. Exercises **3** and **10** provide a good framework for this discussion. We also like to discuss Case **1** in class. The Internet assignment for this chapter provides an excellent opportunity to introduce students to this important research tool that will be used throughout the text.

CHAPTER 1 NAME \_\_\_\_\_ # \_\_\_\_\_

10-MINUTE QUIZ A SECTION \_\_\_\_\_

Indicate the best answer for each question in the space provided.

- \_\_\_\_\_ 1 The best definition of an accounting system is:
- a Journals, ledgers, and worksheets.
  - b Manual or computer-based records used in developing information about an entity for use by managers and also persons outside the organization.
  - c The personnel, procedures, devices, and records used by an entity to develop accounting information and communicate this information to decision makers.
  - d The concepts, principles, and standards specifying the information which should be included in financial statements, and how that information should be presented.
- \_\_\_\_\_ 2 Suppose a number of your friends have organized a company to develop and sell a new software product. They have asked you to loan them \$7,000 to help get the company started, and have promised to repay your \$7,000 plus 10% interest in one year. Of the following, which amount may be described as the return on your investment?
- a \$7,000.
  - b \$ 700.
  - c \$7,700.
  - d Some other amount.
- \_\_\_\_\_ 3 Which of the following is generally *not* considered one of the general purpose financial statements issued by a corporation?
- a Income statement forecast for the coming year.
  - b Balance sheet.
  - c Statement of financial position.
  - d Statement of cash flows.
- \_\_\_\_\_ 4 All of the following are characteristics of management accounting, *except*:
- a Reports are used primarily by insiders rather than by persons outside of the business entity.
  - b Its purpose is to assist managers in planning and controlling business operations.
  - c Information must be developed in conformity with generally accepted accounting principles or with income tax regulations.
  - d Information may be tailored to assist in specific management decisions.
- \_\_\_\_\_ 5 Which of the following is *not* an objective of financial reporting?
- a Provide information useful for predicting the amount, timing, and uncertainty of future cash flows.
  - b Provide information useful in making economic decisions.
  - c Provide specific information about assets, liabilities, equity, income and expenses, including gains and losses, contributions by and distributions to owners in their capacity as owners, and cash flows..
  - d Provide information to guarantee the enterprise achieves its goals, objectives, and mission.

**CHAPTER 1**                      **NAME** \_\_\_\_\_ **#** \_\_\_\_\_

**10-MINUTE QUIZ B**                      **SECTION** \_\_\_\_\_

Match the organizations on the left with the descriptions on the right. Each description should be used only once.

<b>Organization</b>	<b>Description</b>
_____ International Accounting Standards Board	<b>a.</b> Government agency that regulates financial reporting by publicly-held companies.
_____ Securities and Exchange Commission	<b>b.</b> International organization dedicated to the advancement of internal auditing.
_____ American Accounting Association	<b>c.</b> Private organization most directly involved in the development and issuance of accounting standards.
_____ Institute of Internal Auditors	<b>d.</b> Organization dedicated to the advancement of accounting education and research.
_____ American Institute of CPAs	<b>e.</b> Organization most involved with the ethical conduct of the accountants working within a company.
_____ Institute of Management Accountants	<b>f.</b> Organization which develops formal standards for auditing in the United States.
_____ Internal Revenue Service	<b>g.</b> A government agency that handles income tax returns of individuals and businesses and performs an audit function [to] verify the data presented.
_____ Financial Accounting Standards Board	<b>h.</b> An organization which develops international accounting standards.
_____ Committee of Sponsoring Organizations.	<b>i.</b> An organization dedicated to improving financial reporting through ethics, internal controls and corporate governance.

**CHAPTER1**                      **NAME** \_\_\_\_\_ **#** \_\_\_\_\_

**10-MINUTE QUIZ C**                      **SECTION** \_\_\_\_\_

The following is a list of various characteristics of accounting information. In the space provided identify each as a characteristic of either financial or management accounting information.

1.        The information is summarized in a set of statements distributed to the public.
  
  
  
  
  
  
  
  
  
  
2.        The information is historical in nature. It reports the results of events and transactions that have already occurred.
  
  
  
  
  
  
  
  
  
  
3.        The timeliness of the information is more critical than its completeness.
  
  
  
  
  
  
  
  
  
  
4.        To increase its usefulness to investors and creditors, the information is usually accompanied by explanations from management.
  
  
  
  
  
  
  
  
  
  
5.        The information is intended to be used for planning and control decisions.



**CHAPTER 1**                      **NAME** \_\_\_\_\_ **#** \_\_\_\_\_

**10-MINUTE QUIZ D**            **SECTION** \_\_\_\_\_

Provide concise written answers to the following:

1. Investors and creditors are interested in a company's "cash flow prospects." What two specific concerns of investors and creditors are summarized by the term "cash flow prospects?"
  
  
  
  
  
  
  
  
  
  
2. List three financial statements that are used to communicate financial accounting information to interested external parties.
  
  
  
  
  
  
  
  
  
  
3. Provide a brief example to illustrate that externally reported financial accounting information must be based in part on estimates, judgments, and assumptions.
  
  
  
  
  
  
  
  
  
  
4. Briefly explain how generally accepted accounting principles enhance the integrity of financial accounting information.

## **SOLUTIONS TO 10 MINUTE QUIZZES**

### **QUIZ A**

- 1** C
- 2** B
- 3** A
- 4** C
- 5** D

Learning Objectives: 2, 3, 4

### **QUIZ B**

International Accounting Standards Board	<b>h</b>
Securities and Exchange Commission	<b>a</b>
American Accounting Association	<b>d</b>
Institute of Internal Auditors	<b>b</b>
American Institute of CPAs	<b>f</b>
Institute of Management Accountants	<b>e</b>
Internal Revenue Service	<b>g</b>
Financial Accounting Standards Board	<b>c</b>
Committee of Sponsoring Organizations	<b>i</b>

Learning Objective: 6

### **QUIZ C**

- 1** Financial
- 2** Financial
- 3** Management
- 4** Financial
- 5** Management

Learning Objectives: 3, 4

### **QUIZ D**

- 1** Return of investment and return on investment.
- 2** Balance sheet (Statement of financial position)  
Income statement  
Statement of cash flows
- 3** To account for the use of long lived equipment, estimates must be made of the lifetime and scrap value of that equipment
- 4** Adherence to generally accepted accounting principles assures comparability of accounting information among organizations.

Learning Objectives: 2, 3, 5

## Assignment Guide to Chapter 1

	Exercises	Cases				Net
	1 – 16	1	2	3	4	6
Time estimate (in minutes)	< 15	15	15	15	30	30
Difficulty rating	E	E	M	E	M	M
<b>Learning objectives:</b>						
1. Discuss accounting as the language of business and the role of accounting information in making economic decisions.	1, 16					
2. Discuss the significance of accounting systems in generating reliable accounting information and understand the five components of internal control.				√		
3. Explain the importance of financial accounting information for external parties – primarily investors and creditors – in terms of the objectives and characteristics of that information.	2, 3, 6, 7, 9, 16		√			
4. Explain the importance of accounting information for internal parties – primarily management - in terms of the objectives and characteristics of that information.	2, 7, 9, 10					
5. Discuss elements of the system of external and internal financial reporting that create integrity in the reported information.	7, 12, 13, 16	√				
6. Identify and discuss several professional organizations that play important roles in preparing and communicating accounting information.	4, 5, 8, 11					√
7. Discuss the importance of personal competence, professional judgment, and ethical behavior on the part of accounting professionals.	7, 14				√	√
8. Describe various career opportunities in accounting.	15					

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

### **Susquehanna Equipment Rentals**

**5 to 6 hours**

**Strong**

A mini-practice set illustrating the complete accounting cycle for a service-type business. Includes computation of income taxes expense (as a percentage of income before taxes) and an evaluation of solvency. Can be done as a group assignment.

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

<b>a.</b>				
<b>General Journal</b>				
<b>December Daily Transactions</b>				
<b>2013</b>				
<b>Dec</b>	<b>1</b>	<b>Cash</b>	<b>200,000</b>	
		Share Capital		<b>200,000</b>
		Owner invested cash in the business.		
	<b>1</b>	<b>Rental Equipment</b>	<b>240,000</b>	
		Cash		<b>140,000</b>
		Notes Payable		<b>100,000</b>
		Purchased equipment from Rent-it. Note payable is due in one year.		
	<b>1</b>	<b>Prepaid Rent</b>	<b>12,000</b>	
		Cash		<b>12,000</b>
		Paid three months' rent in advance to Shapiro Realty.		
	<b>4</b>	<b>Office Supplies</b>	<b>1,000</b>	
		Accounts Payable		<b>1,000</b>
		Purchased supplies on account; payment due in 30 days.		
	<b>8</b>	<b>Cash</b>	<b>8,000</b>	
		Unearned Rental Fees		<b>8,000</b>
		Received advance payment for equipment rental by McNamer Construction Company.		
	<b>12</b>	<b>Salaries Expense</b>	<b>5,200</b>	
		Cash		<b>5,200</b>
		Paid salaries for first two weeks in December.		
	<b>15</b>	<b>Cash</b>	<b>12,000</b>	
		Accounts Receivable	<b>6,000</b>	
		Rental Fees Earned		<b>18,000</b>
		To record rental fees earned in first 15 days of December.		
	<b>17</b>	<b>Maintenance Expense</b>	<b>600</b>	
		Accounts Payable		<b>600</b>
		To record purchase of repair parts on account from Earth Movers Limited; payment due in 10 days.		
	<b>23</b>	<b>Cash</b>	<b>2,000</b>	
		Accounts Receivable		<b>2,000</b>
		Collection of an accounts receivable.		
	<b>23</b>	(No entry required to record rental of backhoe.)		

[illegible]

[illegible]

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a.		Cash			
Date		Explanation	Debit	Credit	Balance
Dec	1		200,000		200,000
	1			140,000	60,000
	1			12,000	48,000
	8		8,000		56,000
	12			5,200	50,800
	15		12,000		62,800
	23		2,000		64,800
	26			5,200	59,600
	27			600	59,000
	29			9,600	49,400
	31		15,600		65,000

		Accounts Receivable			
Date		Explanation	Debit	Credit	Balance
Dec	15		6,000		6,000
	23			2,000	4,000
	31		4,400		8,400
	31		1,500		9,900

		Prepaid Rent			
Date		Explanation	Debit	Credit	Balance
Dec	1		12,000		12,000
	31			4,000	8,000

		Unexpired Insurance			
Date		Explanation	Debit	Credit	Balance
Dec	29		9,600		9,600

		Office Supplies			
Date		Explanation	Debit	Credit	Balance
Dec	4		1,000		1,000
	31			400	600



# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a.		Rental Equipment			
Date		Explanation	Debit	Credit	Balance
Dec	1		240,000		240,000

		Accumulated Depreciation: Rental Equipment			
Date		Explanation	Debit	Credit	Balance
Dec	31			2,500	2,500

		Notes Payable			
Date		Explanation	Debit	Credit	Balance
Dec	1			100,000	100,000

		Accounts Payable			
Date		Explanation	Debit	Credit	Balance
Dec	4			1,000	1,000
	17			600	1,600
	27		600		1,000
	31			700	1,700

		Interest Payable			
Date		Explanation	Debit	Credit	Balance
Dec	31			500	500

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a.		Salaries Payable			
Date		Explanation	Debit	Credit	Balance
Dec	31			1,400	1,400

		Dividends Payable			
Date		Explanation	Debit	Credit	Balance
Dec	28			2,000	2,000

		Unearned Rental Fees			
Date		Explanation	Debit	Credit	Balance
Dec	8			8,000	8,000
	31		3,700		4,300

		Income Taxes Payable			
Date		Explanation	Debit	Credit	Balance
Dec	31			9,080	9,080

		Share Capital			
Date		Explanation	Debit	Credit	Balance
Dec	1			200,000	200,000

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a. & d.		Retained Earnings			
Date		Explanation	Debit	Credit	Balance
Dec	31	Income, 2013		13,620	13,620
	31	Dividends	2,000		11,620

		Dividends			
Date		Explanation	Debit	Credit	Balance
Dec	28		2,000		2,000
	31	To close		2,000	0

		Income Summary			
Date		Explanation	Debit	Credit	Balance
Dec	31	To close revenue accounts		43,200	43,200
	31	To close expense accounts	29,580		13,620
	31	To close	13,620		0

		Rental Fees Earned			
Date		Explanation	Debit	Credit	Balance
Dec	15			18,000	18,000
	31			20,000	38,000
	31			3,700	41,700
	31			1,500	43,200
	31	To close	43,200		0

		Salaries Expense			
Date		Explanation	Debit	Credit	Balance
Dec	12		5,200		5,200
	26		5,200		10,400
	31		1,400		11,800
	31	To close		11,800	0

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a. & d.		Maintenance Expense			
Date		Explanation	Debit	Credit	Balance
Dec	17		600		600
	30	To close		600	0

		Utilities Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		700		700
	31	To close		700	0

		Rent Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		4,000		4,000
	31	To close		4,000	0

		Office Supplies Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		400		400
	31	To close		400	0

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a. & d.		Depreciation Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		2,500		2,500
	31	To close		2,500	0

		Interest Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		500		500
	31	To close		500	0

		Income Taxes Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		9,080		9,080
	31	To close		9,080	0

**SUSQUEHANNA EQUIPMENT RENTALS**  
Worksheet  
December 31, 2013

**COMPREHENSIVE F**  
**SUSQUEHANNA E**  
**RENTALS**

a.	Trial Balance		Adjustments*		Adjusted Trial Balance		Income Statement		Statement of fir
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit
<b>Statement of financial position accounts :</b>									
Cash	\$ 65,000				\$ 65,000				\$ 65,000
Accounts receivable	8,400		(f) \$ 1,500		9,900				9,900
Prepaid rent	12,000			(a) \$ 4,000	8,000				8,000
Unexpired insurance	9,600				9,600				9,600
Office supplies	1,000			(d) 400	600				600
Rental equipment	240,000				240,000				240,000
Notes payable		\$ 100,000				\$ 100,000			
Accounts payable		1,700				1,700			
Unearned rental fees		8,000	(e) 3,700			4,300			
Dividends payable		2,000				2,000			
Share capital		200,000				200,000			
Retained earnings		-							
Dividends	2,000				2,000				2,000
Interest payable			(b) 500			500			
Accum. Dep.: rental equip.			(c) 2,500			2,500			
Salaries payable			(g) 1,400			1,400			
Income taxes payable			(h) 9,080			9,080			
<b>Income statement accounts:</b>									
Rental fees earned		38,000		(e) 3,700		43,200		\$ 43,200	
				(f) 1,500					
Salaries expense	10,400		(g) 1,400		11,800		\$ 11,800		
Maintenance expense	600				600		600		
Utilities expense	700				700		700		
	<u>\$ 349,700</u>	<u>\$ 349,700</u>							
Rent expense			(a) 4,000		4,000		4,000		
Interest expense			(b) 500		500		500		
Depreciation expense			(c) 2,500		2,500		2,500		
Office supplies expense			(d) 400		400		400		
Income taxes expense			(h) 9,080		9,080		9,080		
			<u>\$ 23,080</u>	<u>\$ 23,080</u>	<u>\$ 364,680</u>	<u>\$ 364,680</u>	<u>29,580</u>	<u>43,200</u>	<u>335,100</u>
Profit							13,620		
Totals							<u>\$ 43,200</u>	<u>\$ 43,200</u>	<u>\$ 335,100</u>

\* Adjustments

(a) December rent expense (\$12,000 ÷ 3).

(b) December interest expense (\$100,000 x 6% x 1/12).

(c) December depreciation expense (\$240,000 ÷ 96 months).

(d) Office supplies used in December (\$1,000 - \$600).

(e) Portion of unearned revenue earned in December.

(f) Accrued revenue earned in December.

(g) Accrued salaries at month-end.

(h) Accrued income taxes expense at month-end.

[illegible]

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

b.

SUSQUEHANNA EQUIPMENT RENTALS		
Income Statement		
For the Year Ended December 31, 2013		
Revenue:		
Rental fees earned		\$ 43,200
Expenses		
Salaries expense	\$ 11,800	
Maintenance expense	600	
Utilities expense	700	
Rent expense	4,000	
Office supplies expense	400	
Depreciation expense	2,500	
Interest expense	500	20,500
Profit before income taxes expense		\$ 22,700
Income taxes expense @ 40%		9,080
Profit		\$ 13,620

SUSQUEHANNA EQUIPMENT RENTALS		
Statement of Changes in Equity		
For the Year Ended December 31, 2013		
Retained earnings, December 1, 2013		\$0
Profit		13,620
Subtotal		13,620
Less: Dividends		2,000
Retained earnings, December 31, 2013		\$ 11,620



# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

b.

SUSQUEHANNA EQUIPMENT RENTALS		
Statement of financial position		
December 31, 2013		
Assets		
Cash		\$ 65,000
Accounts Receivable		9,900
Prepaid rent		8,000
Unexpired insurance		9,600
Office supplies		600
Rental equipment	240,000	
Less: Accumulated depreciation	2,500	237,500
<b>Total assets</b>		<b>\$ 330,600</b>
Liabilities & Equity		
<b>Liabilities:</b>		
Notes payable		\$ 100,000
Accounts payable		1,700
Interest payable		500
Salaries payable		1,400
Dividends payable		2,000
Unearned rental fees		4,300
Income taxes payable		9,080
<b>Total liabilities</b>		<b>\$ 118,980</b>
<b>Shareholders' equity:</b>		
Share capital		\$ 200,000
Retained earnings		11,620
<b>Total liabilities and shareholders' equity</b>		<b>\$ 330,600</b>

c. Notes to the financial statements:

*Note 1—Depreciation policies*

Depreciation expense in the financial statements is computed by the straight-line method.

The estimated useful life of the rental equipment is 8 years.

*Note 2—Maturity dates of liabilities*

The Company's notes payable consist of a single obligation which matures on November 30, 2014. The maturity value of this note, including interest, will amount to \$106,000.

*Note 3—Pending litigation*

The Company has been named as a co-defendant in a \$25,000 personal injury lawsuit. The extent of legal and financial responsibility, if any, cannot be determined at this time.

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

d.

General Journal (Closing Entries)			
2013			
Dec	31	Rent Fees Earned	43,200
		Income Summary	43,200
		To close the revenue account.	
	31	Income Summary	29,580
		Salaries Expense	11,800
		Maintenance Expense	600
		Utilities Expense	700
		Rent Expense	4,000
		Office Supplies Expense	400
		Depreciation Expense	2,500
		Interest Expense	500
		Income Taxes Expense	9,080
		To close the expense accounts.	
	31	Income Summary	13,620
		Retained Earnings	13,620
		To close the Income Summary account.	
	31	Retained Earnings	2,000
		Dividends	2,000
		To close the Dividends account.	

e.

SUSQUEHANNA EQUIPMENT RENTALS		
After-Closing Trial Balance		
December 31, 2013		
Cash	\$ 65,000	
Accounts receivable	9,900	
Prepaid rent	8,000	
Unexpired insurance	9,600	
Office supplies	600	
Rental equipment	240,000	
Accumulated depreciation: rental equipment		\$ 2,500
Notes payable		100,000
Accounts payable		1,700
Interest payable		500
Salaries payable		1,400
Dividends payable		2,000
Unearned rental fees		4,300
Income taxes payable		9,080
Share capital		200,000
Retained earnings		11,620
Totals	\$ 333,100	\$ 333,100

## **COMPREHENSIVE PROBLEM 1**

### **SUSQUEHANNA EQUIPMENT RENTALS**

#### **(concluded)**

**f.**

It does not appear that the company faces any immediate solvency problems. It did start with \$200,000 cash, but in its first transaction the company spent \$140,000 on equipment, leaving only \$60,000 cash to begin operations. This amount had increased to \$65,000 by the end of December. Thus, during its first month of operations, the business was able to generate \$5,000 of positive cash flow from operations.

The \$100,000 note payable due on November 30, 2014, does raise a potential concern about the company's solvency, however. Currently, the business does not have sufficient liquid assets to satisfy this obligation. In fact, the company's working capital position is actually negative by \$25,880 (\$93,100 of current assets minus \$118,980 of current liabilities). Likewise, its current ratio is only 0.78:1 (\$93,100 of current assets divided by \$118,980 of current liabilities). However, if the business can continue to generate at least \$5,000 of positive operating cash flows each month, remaining solvent should not pose a serious issue.

**g.** There is nothing at all unethical about Patty Driver (a founding shareholder) maintaining the accounting records for Susquehanna Equipment Rentals. In most businesses, the accounting records are maintained either by owners or employees, none of whom are "independent" of the organization.

The concept of independence refers to auditing financial statements, where the auditor has to make an independent evaluation of the statements' "fairness." Independence does not apply to the routine maintenance of accounting records.