CHAPTER 3

The Accounting Information System

ASSIGNMENT CLASSIFICATION TABLE (BY TOPIC)

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

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

ASSIGNMENT CLASSIFICATION TABLE (BY LEARNING OBJECTIVE)

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

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

ASSIGNMENT CHARACTERISTICS TABLE

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

ANSWERS TO QUESTIONS

1. Examples are:
(a) Payment of an accounts payable.
(b) Collection of an accounts receivable from a customer.
(c) Transfer of an accounts payable to a note payable.

2. Transactions (a), (b), (d) are considered business transactions and are recorded in the accounting records because a change in assets, liabilities, or owners'/stockholders' equity has been effected as a result of a transfer of values from one party to another. Transactions (c) and (e) are not business transactions because a transfer of values has not resulted, nor can the event be considered financial in nature and capable of being expressed in terms of money.

3. Transaction (a): Accounts Receivable (debit), Service Revenue (credit).
Transaction (b): Cash (debit), Accounts Receivable (credit).
Transaction (c): Office Supplies (debit), Accounts Payable (credit).
Transaction (d): Freight Out (debit), Cash (credit).

4. Revenue and expense accounts are referred to as temporary or nominal accounts because each period they are closed out to Income Summary in the closing process. Their balances are reduced to zero at the end of the accounting period; therefore, the term temporary or nominal is given to these accounts.

5. Andrea is not correct. The double-entry system means that for every debit amount there must be a credit amount and vice-versa. At least two accounts are affected. It does not mean that each transaction must be recorded twice.

6. Although it is not absolutely necessary that a trial balance be taken periodically, it is customary and desirable. The trial balance accomplishes two principal purposes:
(1) It tests the accuracy of the entries in that it proves that debits and credits of an equal amount are in the ledger.
(2) It provides a list of ledger accounts and their balances which may be used in preparing the financial statements and in supplying financial data about the concern.

7. (a) Real account; balance sheet.
(b) Real account; balance sheet.
(c) Inventory is generally considered a real account appearing on the balance sheet. It has the elements of a nominal account when the periodic inventory system is used. It may appear on the income statement when the multiple-step format is used under a periodic inventory system.
(d) Real account; balance sheet.
(e) Real account; balance sheet.
(f) Nominal account; income statement.
(g) Nominal account; income statement.
(h) Real account; balance sheet.

8. At December 31, the three days' wages due to the employees represent a current liability. The related expense must be recorded in this period to properly reflect the expense incurred.

9. (a) In a service company, revenues are service revenues and expenses are operating expenses. In a merchandising company, revenues are sales revenues and expenses consist of cost of goods sold plus operating expenses.
(b) The measurement process in a merchandising company consists of comparing the sales price of the merchandise inventory to the cost of goods sold and operating expenses.

10. (a) No change.
(b) Before closing, balances exist in these accounts; after closing, no balances exist.
(c) Before closing, balances exist in these accounts; after closing, no balances exist.
(d) Before closing, a balance exists in this account exclusive of any dividends or the net income or net loss for the period; after closing, the balance is increased or decreased by the amount of net income or net loss, and decreased by dividends declared.
(e) No change.

11. Adjusting entries are prepared prior to the preparation of financial statements in order to bring the accounts up to date and are necessary (1) to achieve a proper recognition of revenues and expenses in measuring income and (2) to achieve an accurate presentation of assets, liabilities and stockholders' equity.

12. Closing entries are prepared to transfer the balances of nominal accounts to capital (retained earnings) after the adjusting entries have been recorded and the financial statements prepared. Closing entries are necessary to reduce the balances in nominal accounts to zero in order to prepare the accounts for the next period's transactions.

13. Cost – Salvage Value = Depreciable Cost: \$4,000 – \$0 = \$4,000. Depreciable Cost ÷ Useful Life = Depreciation Expense For One Year \$4,000 ÷ 5 years = \$800 per year. The asset was used for 6 months (7/1 – 12/31), therefore 1/2-year of depreciation expense should be reported. Annual depreciation X 6/12 = amount to be reported on 2012 income statement: \$800 X 6/12 = \$400.

14.

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

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

***15.** Under the cash basis of accounting, revenue is recorded only when cash is received and expenses are recorded only when paid. Under the accrual basis of accounting, revenue is recognized when it is earned and expenses are recognized when incurred, without regard to the time of the receipt or payment of cash.

A cash-basis balance sheet and income statement are incomplete and inaccurate in comparison to accrual-basis financial statements. The accrual basis matches effort (expenses) with accomplishment (revenues) in the income statement while the cash basis only presents cash receipts and cash disbursements. The accrual basis balance sheet contains receivables, payables, accruals, prepayments, and deferrals while a cash basis balance sheet shows none of these.

***16.** Wages paid during the year will include the payment of any wages attributable to the prior year but unpaid at the end of the prior year. This amount is an expense of the prior year and not of the current year, and thus should be subtracted in determining wages expense. Similarly, wages paid during the year will not include any wages attributable to hours worked during the current year but not actually paid until the following year. This should be added in determining wages expense.

***17.** Although similar to the strict cash basis, the modified cash basis of accounting requires that expenditures for capital items be charged against income over all the periods to be benefited. This is done through conventional accounting methods, such as depreciation and amortization. Under the strict cash basis, expenditures would be recognized as expenses in the period in which the corresponding cash disbursements are made.

***18.** Reversing entries are made at the beginning of the period to reverse accruals and some deferrals. Reversing entries are not required. They are made to simplify the recording of certain transactions that will occur later in the period. The same results will be attained whether or not reversing entries are recorded.

***19.** Disagree. A worksheet is not a permanent accounting record and its use is not required in the accounting cycle. The worksheet is an informal device for accumulating and sorting information needed for the financial statements. Its use is optional in helping to prepare financial statements.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 3-1

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

BRIEF EXERCISE 3-2

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

BRIEF EXERCISE 3-3

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

BRIEF EXERCISE 3-4

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

BRIEF EXERCISE 3-5

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

BRIEF EXERCISE 3-6

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

BRIEF EXERCISE 3-7

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

BRIEF EXERCISE 3-8

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

BRIEF EXERCISE 3-9

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

BRIEF EXERCISE 3-10

Depreciation Expense	2,000	
Accumulated Depreciation—Equipment		2,000

Equipment	$30,000	
Less: Accumulated Depreciation—Equipment	2,000	$28,000

BRIEF EXERCISE 3-11

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

*BRIEF EXERCISE 3-12

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

*BRIEF EXERCISE 3-13

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

SOLUTIONS TO EXERCISES

EXERCISE 3-1 (15–20 minutes)

Apr.	2	Cash	30,000	
		Equipment	14,000	
		Owner's Capital		44,000
	2	No entry—not a transaction.		
	3	Supplies	700	
		Accounts Payable		700
	7	Rent Expense	600	
		Cash		600
	11	Accounts Receivable	1,100	
		Service Revenue		1,100
	12	Cash	3,200	
		Unearned Service Revenue		3,200
	17	Cash	2,300	
		Service Revenue		2,300
	21	Insurance Expense	110	
		Cash		110
	30	Salaries and Wages Expense	1,160	
		Cash		1,160
	30	Supplies Expense	120	
		Supplies		120
	30	Equipment	5,100	
		Owner's Capital		5,100

EXERCISE 3-2 (10–15 minutes)

GERONIMO COMPANY
Trial Balance
April 30, 2012

	Debit	Credit
Cash	$ 2,100	
Accounts Receivable	2,750	
Prepaid Insurance ($700 + $1,000)	1,700	
Equipment	8,000	
Accounts Payable ($4,500 – $1,000)		$ 3,500
Property Tax Payable		560
Owner's Capital ($11,200 + $3,200)		14,400
Owner's Drawings	3,200	
Service Revenue		6,690
Salaries and Wages Expense	4,200	
Advertising Expense ($1,100 + $300)	1,400	
Property Tax Expense ($800 + $1,000)	1,800	
	$25,150	$25,150

EXERCISE 3-3 (15–20 minutes)

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

Cash

Bal.	5,912	(4)	190
(1)	270		

Accounts Payable

		Bal.	7,044

Accounts Receivable

Bal.	5,240	(1)	270

Common Stock

		Bal.	8,000

Supplies

Bal.	2,967		

Retained Earnings

		Bal.	2,000

EXERCISE 3-3 (Continued)

Equipment

Bal.	6,100		
(2)	1,900		

Service Revenue

		Bal.	5,200
		(3)	2,025
		(5)	80

Office Expense

Bal.	4,320	(2)	1,900

SCARLATTI CORPORATION
Trial Balance (Corrected)
April 30, 2012

	Debit	Credit
Cash	$ 5,992	
Accounts Receivable	4,970	
Supplies	2,967	
Equipment	8,000	
Accounts Payable		$ 7,044
Common Stock		8,000
Retained Earnings		2,000
Service Revenue		7,305
Office Expense	2,420	
	$24,349	$24,349

EXERCISE 3-4 (10–15 minutes)

OAKLEY CO.
Trial Balance
June 30, 2012

	Debit	Credit
Cash ($2,870 + $360 – $65 – $65)	$ 3,100	
Accounts Receivable ($3,231 – $360)	2,871	
Supplies ($800 – $500)	300	
Equipment ($3,800 + $500)	4,300	
Accounts Payable ($2,666 – $206 – $260)		$ 2,200
Unearned Service Revenue ($1,200 – $225)		975
Common Stock		6,000
Dividends	575	
Retained Earnings		3,000
Service Revenue ($2,380 + $801 + $225)		3,406
Salaries and Wages Expense ($3,400 + $670 – $575)	3,495	
Office Expenses	940	
	$15,581	$15,581

EXERCISE 3-5 (10–15 minutes)

		Debit	Credit
1.	Depreciation Expense ($250 X 3)	750	
	Accumulated Depreciation—Equipment		750
2.	Unearned Rent Revenue ($6,300 X 1/3)	2,100	
	Rent Revenue		2,100
3.	Interest Expense	500	
	Interest Payable		500
4.	Supplies Expense	2,150	
	Supplies ($2,800 – $650)		2,150
5.	Insurance Expense ($300 X 3)	900	
	Prepaid Insurance		900

EXERCISE 3-6 (15–20 minutes)

1.	Accounts Receivable	750	
	Service Revenue		750
2.	Utilities Expenses	520	
	Accounts Payable		520
3.	Depreciation Expense	400	
	Accumulated Depreciation—Equipment		400
	Interest Expense	500	
	Interest Payable		500
4.	Insurance Expense ($15,000 X 1/12)	1,250	
	Prepaid Insurance		1,250
5.	Supplies Expense ($1,600 – $400)	1,200	
	Supplies		1,200

EXERCISE 3-7 (15–20 minutes)

(a)	Ending balance of supplies	$ 900	
	Add: Adjusting entry	950	
	Deduct: Purchases	850	
	Beginning balance of supplies	1,000	
(b)	Total prepaid insurance	$4,800	($400 X 12)
	Amount used (6 X $400)	2,400	
	Present balance	2,400	

The policy was purchased six months ago (August 1, 2011)

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

Salaries and Wages Expense	1,800	
Salaries and Wages Payable	900	
Cash		2,700

EXERCISE 3-7 (Continued)

The "T" account for salaries and wages payable is

Salaries and Wages Payable			
Paid January	900	Beg. Bal.	?
		End Bal.	800

The beginning balance is therefore

Ending balance of salaries and wages payable	$ 800
Plus: Reduction of salaries and wages payable	900
Beginning balance of salaries and wages payable	$1,700

(d)	Service revenue	$2,000
	Cash received	1,600
	Unearned service revenue reduced	$ 400
	Ending unearned service revenue January 31, 2012	$ 750
	Plus: Unearned service revenue reduced	400
	Beginning unearned service revenue December 31, 2011	$1,150

EXERCISE 3-8 (10–15 minutes)

(a)	Salaries and Wages Expense	2,900	
	Salaries and Wages Payable		2,900
(b)	Utilities Expenses	600	
	Accounts Payable		600
(c)	Interest Expense ($60,000 X 8% X 1/12)	400	
	Interest Payable		400
(d)	Utilities Expenses	117	
	Accounts Payable		117

EXERCISE 3-9 (15–20 minutes)

(a)	10/15	Salaries and Wages Expense	800	
		Cash		800
		(To record payment of October 15 payroll)		
	10/17	Accounts Receivable	2,100	
		Service Revenue		2,100
		(To record revenue for services performed for which payment has not yet been received)		
	10/20	Cash	650	
		Unearned Service Revenue		650
		(To record receipt of cash for services not yet performed)		
(b)	10/31	Supplies Expense	470	
		Supplies		470
		(To record the use of supplies during October)		
	10/31	Accounts Receivable	1,650	
		Service Revenue		1,650
		(To record revenue for services performed for which payment has not yet been received)		
	10/31	Salaries and Wages Expense	600	
		Salaries and Wages Payable		600
		(To record liability for accrued payroll)		
	10/31	Unearned Service Revenue	400	
		Service Revenue		400
		(To reduce the Unearned Service Revenue account for service that has been performed)		

EXERCISE 3-10 (25–30 minutes)

(a)	1.	Aug. 31	Insurance Expense ($4,500 X 3/12)	1,125	
			Prepaid Insurance		1,125
	2.	Aug. 31	Supplies Expense ($2,600 – $650)	1,950	
			Supplies		1,950
	3.	Aug. 31	Depreciation Expense	1,080	
			Accumulated Depreciation—Buildings		1,080
			($120,000 – $12,000 = $108,000; $108,000 X 4% = $4,320 per year; $4,320 X 3/12 = $1,080)		
		Aug. 31	Depreciation Expense	360	
			Accumulated Depreciation—Equipment		360
			($16,000 – $1,600 = $14,400; $14,400 X 10% = $1,440; $1,440 X 3/12 = $360)		
	4.	Aug. 31	Unearned Rent Revenue	3,800	
			Rent Revenue		3,800
	5.	Aug. 31	Salaries and Wages Expense	375	
			Salaries and Wages Payable		375
	6.	Aug. 31	Accounts Receivable	800	
			Rent Revenue		800
	7.	Aug. 31	Interest Expense	1,000	
			Interest Payable [($50,000 X 8%) X 3/12]		1,000

EXERCISE 3-10 (Continued)

(b)

UHURA RESORT
Adjusted Trial Balance
August 31, 2012

	Debit	Credit
Cash	$ 19,600	
Accounts Receivable	800	
Prepaid Insurance ($4,500 – $1,125)	3,375	
Supplies ($2,600 – $1,950)	650	
Land	20,000	
Buildings	120,000	
Accumulated Depreciation—Buildings		$ 1,080
Equipment	16,000	
Accumulated Depreciation—Equipment		360
Accounts Payable		4,500
Unearned Rent Revenue ($4,600 – $3,800)		800
Salaries and Wages Payable		375
Interest Payable		1,000
Mortgage Payable		50,000
Common Stock		100,000
Dividends	5,000	
Rent Revenue ($86,200 + $3,800 + $800)		90,800
Salaries and Wages Expense ($44,800 + $375)	45,175	
Utilities Expenses	9,200	
Maintenance and Repairs Expenses	3,600	
Insurance Expense	1,125	
Supplies Expense	1,950	
Depreciation Expense	1,080	
Depreciation Expense	360	
Interest Expense	1,000	
	$248,915	$248,915

EXERCISE 3-11 (20–25 Minutes)

(a)

CAVAMANLIS CO.
Income Statement
For the Year Ended December 31, 2012

Revenues		
Service revenue		$12,590
Expenses		
Salaries and wages expense	$6,840	
Rent expense	2,760	
Depreciation expense	145	
Interest expense	83	9,828
Net Income		$ 2,762

(b)

CAVAMANLIS CO.
Statement of Retained Earnings
For the Year Ended December 31, 2012

Retained earnings, January 1	$11,310
Add: Net income	2,762
Less: Dividends	3,000
Retained earnings, December 31	$11,072

(c)

CAVAMANLIS CO.
Balance Sheet
December 31, 2012

Assets		
Current Assets		
Cash	$18,972	
Accounts receivable	6,920	
Prepaid rent expense	2,280	
Total current assets		$28,172
Property, plant, and equipment		
Equipment	18,050	
Less: Accumulated depreciation—Equipment	4,895	13,155
Total assets		$41,327

EXERCISE 3-11 (Continued)

Liabilities and Stockholders' Equity		
Current liabilities		
Notes payable		$ 5,700
Accounts payable		4,472
Interest payable		83
Total current liabilities		10,255
Stockholders' equity		
Common stock	$20,000	
Retained earnings	11,072*	31,072
Total liabilities and stockholders' equity		$41,327

*Beg. Balance + Net Income – Dividends = Ending Balance
$11,310 + $2,762 – $3,000 = $11,072

EXERCISE 3-12 (20–25 Minutes)

(a)

FLYNN DESIGN AGENCY
Income Statement
For the Year Ended December 31, 2012

Revenues		
Service revenue		$58,500
Expenses		
Salaries and wages expense	$12,300	
Depreciation expense	7,000	
Rent expense	4,000	
Supplies expense	3,400	
Insurance expense	850	
Interest expense	500	
Total expenses		28,050
Net income		$30,450

FLYNN DESIGN AGENCY
Statement of Retained Earnings
For the Year Ended December 31, 2012

Retained earnings, January 1	$ 3,500
Add: Net income	30,450
Retained earnings, December 31	$33,950

EXERCISE 3-12 (Continued)

(a) (Continued)

FLYNN DESIGN AGENCY
Balance Sheet
December 31, 2012

Assets		
Cash		$10,000
Accounts receivable		21,500
Supplies		5,000
Prepaid insurance		2,500
Equipment	$60,000	
Less: Accumulated depreciation—equipment	35,000	25,000
Total assets		$64,000
Liabilities and Stockholders' Equity		
Liabilities		
Notes payable	$ 5,000	
Accounts payable	8,000	
Unearned service revenue	5,600	
Salaries and wages payable	1,300	
Interest payable	150	
Total liabilities		$20,050
Stockholders' equity		
Common stock	$10,000	
Retained earnings	33,950	43,950
Total liabilities and stockholders' equity		$64,000

(b) 1. Based on interest payable at December 31, 2012, interest is $25 per month or .5% of the note payable. .5% X 12 = 6% interest per year.

2. Salaries and Wages Expense, $12,300 less Salaries and Wages Payable 12/31/12, $1,300 = $11,000. Total Payments, $17,500 – $11,000 = $6,500 Salaries and Wages Payable 12/31/11.

EXERCISE 3-13 (10–15 Minutes)

(a)

Sales Revenue			$800,000
Less:	Sales returns and allowances	$24,000	
	Sales discounts	12,000	36,000
Net sales			$764,000

(b)

Sales Revenue	800,000	
Income Summary		800,000
Income Summary	36,000	
Sales Returns and Allowances		24,000
Sales Discounts		12,000

EXERCISE 3-14 (10–15 minutes)

Sales Revenue	340,000	
Sales Returns and Allowances		13,000
Sales Discounts		8,000
Income Summary		319,000
Income Summary	302,000	
Cost of Goods Sold		202,000
Freight-out		7,000
Insurance Expense		12,000
Rent Expense		20,000
Salaries and Wages Expense		61,000
Income Summary	17,000	
Retained Earnings		17,000

EXERCISE 3-15 (10–15 minutes)

(a) $ 5,000 ($90,000 – $85,000)
(b) $29,000 ($85,000 – $56,000)
(c) $14,000 ($29,000 – $15,000)
(d) $95,000 ($ 5,000 + $90,000)
(e) $52,000 ($90,000 – $38,000)

EXERCISE 3-16 (10–15 minutes)

Sales Revenue	390,000	
Cost of Goods Sold		235,700
Sales Returns and Allowances		12,000
Sales Discounts		15,000
Selling Expenses		16,000
Administrative Expenses		38,000
Income Tax Expense		30,000
Income Summary		43,300

(or)

Sales Revenue	390,000	
Income Summary		390,000
Income Summary	346,700	
Cost of Goods Sold		235,700
Sales Returns and Allowances		12,000
Sales Discounts		15,000
Selling Expenses		16,000
Administrative Expenses		38,000
Income Tax Expense		30,000
Income Summary	43,300	
Retained Earnings		43,300
Retained Earnings	18,000	
Dividends		18,000

EXERCISE 3-17 (10–15 minutes)

Mar.	1	Cash	60,000	
		Common Stock		60,000
		(Investment of cash in business)		
	3	Land	10,000	
		Buildings	22,000	
		Equipment	6,000	
		Cash		38,000
		(Purchased Michelle Wie's Golf Land)		
	5	Advertising Expense	1,600	
		Cash		1,600
		(Paid for advertising)		
	6	Prepaid Insurance	1,480	
		Cash		1,480
		(Paid for one-year insurance policy)		
	10	Equipment	2,500	
		Accounts Payable		2,500
		(Purchased equipment on account)		
	18	Cash	1,200	
		Service Revenue		1,200
		(Received cash for services performed)		
	25	Dividends	1,000	
		Cash		1,000
		(Declared and paid a $1,000 cash dividend)		
	30	Salaries and Wages Expense	900	
		Cash		900
		(Paid salaries and wages expense)		
	30	Accounts Payable	2,500	
		Cash		2,500
		(Paid creditor on account)		
	31	Cash	750	
		Service Revenue		750
		(Received cash for services performed)		

*EXERCISE 3-18 (15–20 minutes)

CORINNE DUNBAR, M.D.
Conversion of Cash Basis to Accrual Basis
For the Year 2012

Excess of cash collected over cash disbursed ($142,600 – $60,470)	$82,130
Add increase in accounts receivable ($11,250 – $15,927)	4,677
Deduct increase in unearned service revenue ($2,840 – $4,111)	(1,271)
Add decrease in accrued liabilities ($3,435 – $2,108)	1,327
Add increase in prepaid expenses ($1,917 – $3,232)	1,315
Net income on an accrual basis	$88,178

Alternate solution:

CORINNE DUNBAR, M.D.
Conversion of Income Statement Data
from Cash Basis to Accrual Basis
For the Year 2012

	Cash Basis	Adjustments Add	Adjustments Deduct	Accrual Basis
Collections from customers:	$142,600			
–Accounts receivable, Jan. 1			$11,250	
+Accounts receivable, Dec. 31		$15,927		
+Unearned service revenue, Jan. 1		2,840		
–Unearned service revenue, Dec. 31			4,111	
Service revenue				$146,006
Disbursements for expenses:	60,470			
–Accrued liabilities, Jan. 1			3,435	
+Accrued liabilities, Dec. 31		2,108		
+Prepaid expenses, Jan. 1		1,917		
–Prepaid expenses, Dec. 31			3,232	
Operating expenses				57,828
Net income—cash basis	$ 82,130			
Net income—accrual basis				$ 88,178

*EXERCISE 3-19 (10–15 minutes)

(a)

LATTA CORP.
Income Statement (Cash Basis)
For the Year Ended December 31,

	2011	2012
Sales	$290,000	$515,000
Expenses	225,000	282,000
Net income	$ 65,000	$233,000

(b)

LATTA CORP.
Income Statement (Accrual Basis)
For the Year Ended December 31,

	2011	2012
Sales*	$480,000	$445,000
Expenses**	277,000	265,000
Net income	$203,000	$180,000

*2011: $290,000 + $160,000 + $ 30,000 = $480,000
2012: $355,000 + $ 90,000 = $445,000
**2011: $185,000 + $ 67,000 + $ 25,000 = $277,000
2012: $ 40,000 + $170,000 + $ 55,000 = $265,000

*EXERCISE 3-20 (20–25 minutes)

(a) Adjusting Entries:

		Debit	Credit
1.	Insurance Expense ($6,000 X 5/24)	1,250	
	Prepaid Insurance		1,250
2.	Rent Revenue ($2,400 X 1/3)	800	
	Unearned Rent Revenue		800
3.	Supplies	290	
	Advertising Expense		290
4.	Interest Expense	770	
	Interest Payable		770

*EXERCISE 3-20 (Continued)

(b) Reversing Entries:

1. No reversing entry required.

2. Unearned Rent Revenue	800	
Rent Revenue		800
3. Advertising Expense	290	
Supplies		290
4. Interest Payable	770	
Interest Expense		770

*EXERCISE 3-21 (10–15 minutes)

Accounts	Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,000				15,000	
Inventory	80,000				80,000	
Sales		470,000		470,000		
Sales Returns and Allowances	10,000		10,000			
Sales Discounts	5,000		5,000			
Cost of Goods Sold	250,000		250,000			

*EXERCISE 3-22 (20–25 minutes)

MADRASAH CO.
Worksheet (Partial)
For the Month Ended April 30, 2012

	Adjusted Trial Balance		Income Statement		Balance Sheet	
Account Titles	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	18,972				18,972	
Accounts Receivable	6,920				6,920	
Prepaid Rent Expense	2,280				2,280	
Equipment	18,050				18,050	
Accum. Depreciation— Equipment		4,895				4,895
Notes Payable		5,700				5,700
Accounts Payable		4,472				4,472
Owner's Capital		34,960				34,960
Owner's Drawings	6,650				6,650	
Service Revenue		12,590		12,590		
Salaries and Wages Expense	6,840		6,840			
Rent Expense	2,760		2,760			
Depreciation Expense	145		145			
Interest Expense	83		83			
Interest Payable		83				83
Totals	62,700	62,700	9,828	12,590	52,872	50,110
Net Income			2,762			2,762
Totals			12,590	12,590	52,872	52,872

*EXERCISE 3-22 (Continued)

MADRASAH CO.
Balance Sheet
April 30, 2012

Assets		
Current Assets		
Cash	$18,972	
Accounts receivable	6,920	
Prepaid rent expense	2,280	
Total current assets		$28,172
Property, plant, and equipment		
Equipment	18,050	
Less Accumulated depreciation—equipment	(4,895)	13,155
Total assets		$41,327
Liabilities and Owners' Equity		
Current liabilities		
Notes payable		$ 5,700
Accounts payable		4,472
Interest payable		83
Total current liabilities		10,255
Owners' equity		
Owner's capital		31,072*
Total liabilities and owners' equity		$41,327

*Beg. Balance – Drawings + Net Income = Ending Balance
$34,960 – $6,650 + $2,762 = $31,072

*EXERCISE 3-23 (10–15 minutes)

LETTERMAN CO.
Worksheet (Partial)
For Month Ended February 28, 2012

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
Account Titles	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**
Supplies	1,756			(a) 1,241	515				515	
Accumulated Depreciation—Equipment		7,967		(b) 257		8,224				8,224
Interest Payable		150		(c) 50		200				200
Supplies Expense			(a) 1,241		1,241		1,241			
Depreciation Expense			(b) 257		257		257			
Interest Expense			(c) 50		50		50			

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

Supplies expense..	$1,241
Depreciation expense................................	257
Interest expense..	50

TIME AND PURPOSE OF PROBLEMS

Problem 3-1 (Time 25–35 minutes)
Purpose—to provide an opportunity for the student to post daily transactions to a "T" account ledger, take a trial balance, prepare an income statement, a balance sheet and a statement of owners' equity, close the ledger, and take a post-closing trial balance. The problem deals with routine transactions of a professional service firm and provides a good integration of the accounting process.

Problem 3-2 (Time 35–40 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting entries, and prepare financial statements (income statement, balance sheet, and statement of retained earnings). The student also is asked to analyze two transactions to find missing amounts.

Problem 3-3 (Time 25–30 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting entries. The adjusting entries are fairly complex in nature.

Problem 3-4 (Time 40–50 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting entries and an adjusted trial balance and then prepare an income statement, a retained earnings statement, and a balance sheet. In addition, closing entries must be made and a post-closing trial balance prepared.

Problem 3-5 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to determine what adjusting entries need to be made to specific accounts listed in a partial trial balance. The student is also required to determine the amounts of certain revenue and expense items to be reported in the income statement.

Problem 3-6 (Time 25–35 minutes)
Purpose—to provide the student with an opportunity to prepare year-end adjusting entries from a trial balance and related information presented. The problem also requires the student to prepare an income statement, a balance sheet, and a statement of owners' equity. The problem covers the basics of the end-of-period adjusting process.

Problem 3-7 (Time 25–35 minutes)
Purpose—to provide an opportunity for the student to figure out the year-end adjusting entries that were made from a trial balance and an adjusted trial balance. The student is also required to prepare an income statement, a statement of retained earnings, and a balance sheet. In addition, the student needs to answer a number of questions related to specific accounts.

Problem 3-8 (Time 25–35 minutes)
Purpose—to provide an opportunity for the student to figure out the year-end adjusting entries that were made from a trial balance and an adjusted trial balance. The student is also required to prepare an income statement, a statement of retained earnings, and a balance sheet. In addition, the student needs to answer a number of questions related to specific accounts.

Problem 3-9 (Time 30–40 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting, and closing entries. This problem presents basic adjustments including a number of accruals and deferrals. It provides the student with an integrated flow of the year-end accounting process.

Problem 3-10 (Time 30–35 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting and closing entries from a trial balance and related information. The student is also required to post the entries to "T" accounts.

Time and Purpose of Problems (Continued)

***Problem 3-11** (Time 35–40 minutes)
Purpose—to provide an opportunity for the student to prepare and compare (a) cash basis and accrual basis income statements, (b) cash basis and accrual basis balance sheets, and (c) to discuss the weak-nesses of cash basis accounting.

***Problem 3-12** (Time 40–50 minutes)
Purpose—to provide an opportunity for the student to complete a worksheet and then prepare a classified balance sheet. In addition, adjusting and closing entries must be made and a post-closing trial balance prepared.

SOLUTIONS TO PROBLEMS

PROBLEM 3-1

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

Cash

Sept.	1	20,000	Sept.	4	680
	8	1,690		5	942
	20	980		10	430
				18	3,600
				19	3,000
				30	1,800
				30	85
	30 Bal	12,133			

Equipment

Sept.	2	17,280			

Owner's Capital

Sept.	19	3,000	Sept.	1	20,000
				30	6,007
			Bal.	30	23,007

Accounts Receivable

Sept.	14	5,820	Sept.	20	980
	25	2,110			
Bal.	30	6,950			

Accounts Payable

Sept.	18	3,600	Sept.	2	17,280
			Bal.	30	13,680

Rent Expense

Sept.	4	680	Sept.	30	680

Supplies

Sept.	5	942	Sept.	30	330
Bal.	30	612			

Service Revenue

Sept.	30	9,620	Sept.	8	1,690
				14	5,820
				25	2,110
		9,620			9,620

Office Expense

Sept.	10	430	Sept.	30	515
	30	85			
		515			515

Accumulated Depreciation—Equipment

			Sept.	30	288

Salaries and Wages Expense

Sept.	30	1,800	Sept.	30	1,800

Supplies Expense

Sept.	30	330	Sept.	30	330

PROBLEM 3-1 (Continued)

Depreciation Expense					
Sept.	30	288	Sept.	30	288

Income Summary						
Sept.	30		680	Sept.	30	9,620
	30		515			
	30		1,800			
	30		330			
	30		288			
	30	Inc.	6,007			
			9,620			9,620

(b)

YASUNARI KAWABATA, D.D.S.
Trial Balance
September 30

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

PROBLEM 3-1 (Continued)

(c)

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

Service revenue		$9,620
Expenses:		
Salaries and wages expense	$1,800	
Rent expense	680	
Supplies expense	330	
Depreciation expense	288	
Office expense	515	
Total expenses		3,613
Net income		$6,007

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

Owner's Capital September 1	$20,000
Add: Net income for September	6,007
	26,007
Less: Withdrawal by owner	3,000
Owner's Capital September 30	$23,007

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

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

PROBLEM 3-1 (Continued)

(d)

YASUNARI KAWABATA, D.D.S.
Post-Closing Trial Balance
September 30

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

PROBLEM 3-2

(a)

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

(b)

MASON ADVERTISING AGENCY
Income Statement
For the Year Ended December 31, 2012

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

PROBLEM 3-2 (Continued)

MASON ADVERTISING AGENCY
Statement of Retained Earnings
For the Year Ended December 31, 2012

Retained earnings, January 1	$ 3,500
Add: Net income	36,450
Retained earnings, December 31	$39,950

MASON ADVERTISING AGENCY
Balance Sheet
December 31, 2012

Assets		
Cash		$11,000
Accounts receivable		23,500
Supplies		3,000
Prepaid insurance		2,500
Equipment	$60,000	
Less: Accumulated depreciation—equipment	33,000	27,000
Total assets		$67,000
Liabilities and Stockholders' Equity		
Liabilities		
Notes payable	$ 5,000	
Accounts payable	5,000	
Unearned service revenue	5,600	
Salaries and wages payable	1,300	
Interest payable	150	
Total liabilities		$17,050
Stockholders' equity		
Common stock	$10,000	
Retained earnings	39,950	49,950
Total liabilities and stockholders' equity		$67,000

(c) 1. Interest is $50 per month or 1% of the note payable. 1% X 12 = 12% interest per year.

2. Salaries and Wages Expense, $11,300 less Salaries and Wages Payable 12/31/12, $1,300 = $10,000. Total Payments, $12,500 – $10,000 = $2,500 Salaries and Wages Payable 12/31/11.

PROBLEM 3-3

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

PROBLEM 3-4

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

PROBLEM 3-4 (Continued)

(b)

BELLEMY FASHION CENTER
Adjusted Trial Balance
November 30, 2012

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

(c)

BELLEMY FASHION CENTER
Income Statement
For the Year Ended November 30, 2012

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

BELLEMY FASHION CENTER
Retained Earnings Statement
For the Year Ended November 30, 2012

Retained earnings, December 1, 2011	$8,000
Less: Net loss	5,600
Retained earnings, November 30, 2012	$2,400

BELLEMY FASHION CENTER
Balance Sheet
November 30, 2012

Assets

Current assets		
Cash	$28,700	
Accounts receivable	33,700	
Inventory	45,000	
Supplies	1,500	
Total current assets		$108,900
Property, plant, and equipment		
Equipment	133,000	
Accumulated depreciation— equipment	39,000	94,000
Total assets		$202,900

Liabilities and Stockholders' Equity

Current liabilities		
Notes payable due next year	$30,000	
Accounts payable	48,500	
Interest payable	11,000	
Total current liabilities		$ 89,500
Long-term liabilities		
Notes payable		21,000
Total liabilities		110,500
Stockholders' equity		
Common stock	90,000	
Retained earnings	2,400	92,400
Total liabilities and stockholders' equity		$202,900

PROBLEM 3-4 (Continued)

(d)

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

(e)

BELLEMY FASHION CENTER
Post-Closing Trial Balance
November 30, 2012

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

PROBLEM 3-5

(a)

-1-

Depreciation Expense	10,500	
Accumulated Depreciation—Equipment (1/16 X $168,000)		10,500

-2-

Interest Expense	1,440*	
Interest Payable ($90,000 X 8% X 72/360)		1,440*

-3-

Admissions Revenue	60,000	
Unearned Admissions Revenue (2,000 X $30)		60,000

-4-

Prepaid Advertising	1,100	
Advertising Expense		1,100

-5-

Salaries and Wages Expense	4,700	
Salaries and Wages Payable		4,700

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

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

PROBLEM 3-6

(a)

-1-

Service Revenue	6,000	
Unearned Service Revenue		6,000

-2-

Accounts Receivable	4,900	
Service Revenue		4,900

-3-

Bad Debt Expense	1,430	
Allowance for Doubtful Accounts		1,430

-4-

Insurance Expense	480	
Prepaid Insurance		480

-5-

Depreciation Expense	2,500	
Accumulated Depreciation—Equipment ($25,000 X .10)		2,500

-6-

Interest Expense	60	
Interest Payable ($7,200 X .10 X 30/360)		60

-7-

Prepaid Rent Expense	750	
Rent Expense		750

-8-

Salaries and Wages Expense	2,510	
Salaries and Wages Payable		2,510

PROBLEM 3-6 (Continued)

(b)

YORKIS PEREZ, CONSULTING ENGINEER
Income Statement
For the Year Ended December 31, 2012

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

YORKIS PEREZ, CONSULTING ENGINEER
Statement of Owners' Equity
For the Year Ended December 31, 2012

Onwer's Capital, January 1	$ 52,010[a]
Add: Net income	50,620
Less: Withdrawals	(17,000)
Owner's Capital, December 31	$ 85,630

[(a)]Owner's Capital—trial balance	$ 35,010
Withdrawals during the year	17,000
Owner's Capital, as of January 1, 2010	$ 52,010

YORKIS PEREZ, CONSULTING ENGINEER
Balance Sheet
December 31, 2012

Assets			
Current assets			
Cash		$29,500	
Accounts receivable ($49,600 + $4,900)	$54,500		
Less: Allowance for doubtful accounts	(2,180)*	52,320	
Supplies		1,960	
Prepaid insurance ($1,100 – $480)		620	
Prepaid rent expense		750	
Total current assets			$ 85,150
Equipment		25,000	
Less: Accumulated depreciation		(8,750)**	16,250
Total assets			$101,400
Liabilities and Owners' Equity			
Current liabilities			
Notes payable		$7,200	
Unearned service revenue		6,000	
Salaries and wages payable		2,510	
Interest payable		60	$ 15,770
Owner's Capital ($35,010 + $50,620)			85,630
Total liabilities and owners' equity			$101,400

*($750 + $1,430)
**($6,250 + $2,500)

PROBLEM 3-7

(a)

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

(b)

ROLLING HILLS GOLF INC.
Income Statement
For the Quarter Ended September 30, 2012

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

PROBLEM 3-7 (Continued)

ROLLING HILLS GOLF INC.
Retained Earnings Statement
For the Quarter Ended September 30, 2012

Retained earnings, July 1, 2012	$ 0
Add: Net income	2,510
Less: Dividends	(600)
Retained earnings, September 30, 2012	$1,910

ROLLING HILLS GOLF INC.
Balance Sheet
September 30, 2012

Assets		
Current assets		
Cash	$6,700	
Accounts receivable	1,000	
Supplies	180	
Prepaid rent expense	900	
Total current assets		$ 8,780
Equipment	15,000	
Less: Accumulated depreciation	(350)	14,650
Total assets		$23,430
Liabilities and Stockholders' Equity		
Current liabilities		
Notes payable	$5,000	
Accounts payable	1,070	
Unearned rent revenue	800	
Salaries and wages payable	600	
Interest payable	50	$ 7,520
Stockholders' Equity		
Common stock	14,000	
Retained earnings	1,910	
Total stockholders' equity		15,910
Total liabilities and stockholders' equity		$23,430

PROBLEM 3-7 (Continued)

(c) The following accounts would be closed: Service Revenue, Rent Revenue, Salaries and Wages Expense, Rent Expense, Utilities Expenses, Depreciation Expense, Supplies Expense, Interest Expense, Dividends.

(d) Interest of 12% per year equals a monthly rate of 1%; monthly interest is $50 ($5,000 X 1%). Since total interest expense is $50, the note has been outstanding one month.

PROBLEM 3-8

(a)

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

(b)

VEDULA ADVERTISING AGENCY
Income Statement
For the Year Ended December 31, 2012

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

PROBLEM 3-8 (Continued)

VEDULA ADVERTISING AGENCY
Retained Earnings Statement
For the Year Ended December 31, 2012

Retained earnings, Janaury 1	$ 5,500
Add: Net income	38,810
Less: Dividends	(10,000)
Retained earnings, December 31	$34,310

VEDULA ADVERTISING AGENCY
Balance Sheet
December 31, 2012

Assets		
Current assets		
Cash	$11,000	
Accounts receivable	19,500	
Supplies	6,500	
Prepaid insurance	1,790	
Total current assets		$38,790
Equipment	60,000	
Less: Accumulated depreciation	(30,000)	30,000
Total assets		$68,790
Liabilities and Stockholders' Equity		
Current liabilities		
Notes payable	$8,000	
Accounts payable	2,000	
Unearned service revenue	3,100	
Salaries and wages payable	820	
Interest payable	560	$ 14,480
Stockholders' Equity		
Common stock	20,000	
Retained earnings	34,310	
Total stockholders' equity		54,310
Total liabilities and stockholders' equity		$68,790

PROBLEM 3-8 (Continued)

(c) Service Revenue, Salaries and Wages Expense, Depreciation Expense, Rent Expense, Supplies Expense, Insurance Expense, Interest Expense, Dividends.

(d) Interest is \$56 per month or .7% of the note payable (\$56 ÷ \$8,000). .7% X 12 = 8.4% interest per year.

(e) Salaries and Wages Expense, \$9,820, less Salaries and Wages Payable 12/31/12, \$820 = \$9,000. Total payments, \$10,500 – \$9,000 = \$1,500 Salaries Payable 12/31/11.

*PROBLEM 3-9

(a), (b), (d)

Cash

Bal.	15,000		

Prepaid Insurance

Bal.	9,000	Adj.	3,500
	5,500		

Salaries and Wages Expense

Bal.	80,000	Close	83,600
Adj.	3,600		
	83,600		83,600

Common Stock

		Bal.	400,000

Accounts Receivable

Bal.	13,000		

Retained Earnings

		Bal.	82,000
		Inc.	31,640
			113,640

Maintenance and Repairs Expense

Bal.	24,000	Close	24,000

Allow. for Doubtful Accts.

		Bal.	1,100
		Adj.	460
			1,560

Dues Revenue

Adj.	8,900	Bal.	200,000
Cls.	191,100		
	200,000		200,000

Depr. Expense

Adj.	4,000	Close	19,000
Adj.	15,000		
	19,000		

Land

Bal.	350,000		

Green Fees Revenue

Close	5,900	Bal.	5,900

Buildings

Bal.	120,000		

Rent Revenue

Close	19,200	Bal.	17,600
		Adj.	1,600
	19,200		19,200

Accum. Depr.—Equipment

		Bal.	70,000
		Adj.	15,000
			85,000

Accum. Depr.—Buildings

		Bal.	38,400
		Adj.	4,000
			42,400

Utilities Expenses

Bal.	54,000	Close	54,000

Insurance Expense

Adj.	3,500	Close	3,500

Rent Receivable

Adj.	$1,600		

Bad Debt Expense

Adj.	460	Close	460

Income Summary

Exp.	184,560		216,200
Inc.	31,640		
	216,200		216,200

*PROBLEM 3-9 (Continued)

Salaries and Wages Payable

		Adj.	3,600

Unearned Dues Revenue

		Adj.	8,900

Equipment

Bal.	150,000		

(b)

-1-

Depreciation Expense	4,000	
Accumulated Depreciation—Buildings (1/30 X $120,000)		4,000

-2-

Depreciation Expense	15,000	
Accumulated Depreciation—Equipment (10% X $150,000)		15,000

-3-

Insurance Expense	3,500	
Prepaid Insurance		3,500

-4-

Rent Receivable	1,600	
Rent Revenue (1/11 X $17,600)		1,600

-5-

Bad Debt Expense	460	
Allowance for Doubtful Accounts [($13,000 X 12%) – $1,100]		460

-6-

Salaries and Wages Expense	3,600	
Salaries and Wages Payable		3,600

-7-

Dues Revenue	8,900	
Unearned Dues Revenue		8,900

(c)

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

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

*PROBLEM 3-9 (Continued)

(d)

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

*PROBLEM 3-10

(a), (b), (c)

Cash

Bal.	18,500		

Accounts Receivable

Bal.	32,000		

Allow. for Doubtful Accts.

		Bal.	700
		Adj.	1,400
			2,100

Inventory

Bal.	80,000		

Equipment

Bal.	84,000		

Accum. Depr.—Equipment

		Bal.	35,000
		Adj.	12,000
			47,000

Prepaid Insurance

Bal.	5,100	Adj.	2,550
	2,550		

Notes Payable

		Bal.	28,000

Interest Expense

Bal.	3,360	Cls.	3,360

Common Stock

		Bal.	80,600

Sales Revenue

Cls.	600,000	Bal.	600,000

Insurance Expense

Adj.	2,550	Cls.	2,550

Salaries and Wages Expense (Sales)

Bal.	50,000	Cls.	52,400
Adj.	2,400		
	52,400		52,400

Advertising Expense

Bal.	6,700	Adj.	700
		Cls.	6,000
	6,700		6,700

Salaries and Wages Expense (Administrative)

Adj.	65,000	Cls.	65,000

Bad Debt Expense

Adj.	1,400	Cls.	1,400

Supplies Expense

Bal.	5,000	Adj.	1,500
		Cls.	3,500
	5,000		5,000

Prepaid Advertising

Adj.	700		

Interest Payable

		Adj.	3,360

Depr. Exp.

Adj.	12,000	Cls.	12,000

Income Summary

Exp.	554,210	Sales	600,000
Inc.	45,790		
	600,000		600,000

Supplies

Adj.	1,500		

Salaries and Wages Payable

		Adj.	2,400

Retained Earnings

		Bal.	10,000
		Inc.	45,790
		Bal.	55,790

Cost of Goods Sold

Bal.	408,000	Cls.	408,000

*PROBLEM 3-10 (Continued)

(b)

-1-

Bad Debt Expense	1,400	
Allowance for Doubtful Accounts		1,400

-2-

Depreciation Expense ($84,000 ÷ 7)	12,000	
Accumulated Depreciation—Equipment		12,000

-3-

Insurance Expense	2,550	
Prepaid Insurance		2,550

-4-

Interest Expense	3,360	
Interest Payable		3,360

-5-

Salaries and Wages Expense (Sales)	2,400	
Salaries and Wages Payable		2,400

-6-

Prepaid Advertising Expense	700	
Advertising Expense		700

-7-

Supplies	1,500	
Supplies Expense		1,500

*PROBLEM 3-10 (Continued)

(c)

	Dec. 31		
Sales Revenue		600,000	
Income Summary			600,000

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

	Dec. 31		
Income Summary		45,790	
Retained Earnings			45,790

*PROBLEM 3-11

(a)

ARKANSAS SALES AND SERVICE
Income Statement
For the Month Ended January 31, 2012

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

*($2,550 X 30) + ($3,600 X 4) + ($500 X 15)
**($1,500 X 40) + ($2,500 X 6) + ($300 X 25)
***($1,500 X 30) + ($2,500 X 4) + ($300 X 15)

*PROBLEM 3-11 (Continued)

(b) ARKANSAS SALES AND SERVICE

Balance Sheet

As of January 31, 2012

	(1) Cash Basis	(2) Accrual Basis
Assets		
Cash	$58,500[a]	$ 58,500[a]
Accounts receivable		23,400
Inventory		23,000[b]
Prepaid rent expense		4,000
Total assets	$58,500	$108,900
Liabilities and Owners' Equity		
Salaries and wages payable		$ 3,000
Accounts payable		2,000
Owner's capital	$58,500[c]	103,900[d]
Total liabilities and owners' equity	$58,500	$108,900

[a]Original investment	$ 90,000
Cash sales	75,000
Cash purchases	(82,500)
Rent paid	(6,000)
Salaries paid	(9,600)
Other operating expenses	(8,400)
Cash balance Jan. 31	$ 58,500

[b](10 @ $1,500) + (2 @ $2,500) + (10 @ $300).

[c]Initial investment minus net loss: $90,000 – $31,500.

[d]Initial investment plus net income: $90,000 + $13,900.

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

(c)

1. **The $23,400 in receivables from customers is an asset and a future cash flow resulting from sales that is ignored. The cash basis understates the amount of revenues and inflow of assets in January from the sale of computers and printers by $23,400.**

2. **The cost of computers and printers sold in January is overstated by $23,000. The unsold computers and printers are an asset of $23,000 in the form of inventory.**

3. **The cash basis ignores $3,000 of the salaries that have been earned by the employees in January and will be paid in February.**

4. **Rent expense on the cash basis is overstated by $4,000 under the cash basis. This prepayment is an asset in the form of two months' future right to the use of office, showroom, and repair space and should appear on the balance sheet.**

5. **Other operating expenses on a cash basis are understated by $2,000 as is the liability for the unpaid portion of these expenses incurred in January.**

*PROBLEM 3-12

(a)

COOKE COMPANY
Worksheet
For the Year Ended September 30, 2012

Account Titles	Trial Balance		Adjustments				Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.		Dr.		Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	37,400						37,400				37,400	
Supplies	18,600				(b)	14,400	4,200				4,200	
Prepaid Insurance	31,900				(a)	28,000	3,900				3,900	
Land	80,000						80,000				80,000	
Equipment	120,000						120,000				120,000	
Accum. Depr.-Equip.		36,200			(c)	5,800		42,000				42,000
Accounts Payable		14,600						14,600				14,600
Unearned Adm. Rev.		2,700	(d)	2,000				700				700
Mortgage Payable		50,000						50,000				50,000
Owner's Capital		109,700						109,700				109,700
Owner's Drawings	14,000						14,000				14,000	
Admissions Revenue		278,500			(d)	2,000		280,500		280,500		
Sal. and Wages Exp.	109,000						109,000		109,000			
Maintenance and Repairs Expense	30,500						30,500		30,500			
Advertising Expense	9,400						9,400		9,400			
Utilities Expenses	16,900						16,900		16,900			
Prop. Tax Expense	18,000		(e)	3,000			21,000		21,000			
Interest Expense	6,000		(f)	6,000			12,000		12,000			
Totals	491,700	491,700										
Insurance Expense			(a)	28,000			28,000		28,000			
Supplies Expense			(b)	14,400			14,400		14,400			
Interest Payable					(f)	6,000		6,000				6,000
Depreciation Expense			(c)	5,800			5,800		5,800			
Prop. Taxes Payable					(e)	3,000		3,000				3,000
Totals				59,200		59,200	506,500	506,500	247,000	280,500	259,500	226,000
Net Income									33,500			33,500
Totals									280,500	280,500	259,500	259,500

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

*PROBLEM 3-12 (Continued)

(b)

COOKE COMPANY
Balance Sheet
September 30, 2012

Assets			
Current assets			
Cash		$37,400	
Supplies		4,200	
Prepaid insurance		3,900	
Total current assets			$ 45,500
Property, plant, and equipment			
Land		80,000	
Equipment	$120,000		
Less: Accum. depreciation	42,000	78,000	158,000
Total assets			$203,500
Liabilities and Owners' Equity			
Current liabilities			
Accounts payable		$14,600	
Current maturity of long-term debt		10,000	
Interest payable		6,000	
Property taxes payable		3,000	
Unearned admissions revenue		700	
Total current liabilities			$ 34,300
Long-term liabilities			
Mortgage payable			40,000
Total liabilities			74,300
Owner's equity			
Owner's capital ($109,700 + $33,500 – $14,000)			129,200
Total liabilities and owners' equity			$203,500

*PROBLEM 3-12 (Continued)

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

*PROBLEM 3-12 (Continued)

(e)

COOKE COMPANY
Post-Closing Trial Balance
September 30, 2012

	Debit	Credit
Cash	$ 37,400	
Supplies	4,200	
Prepaid Insurance	3,900	
Land	80,000	
Equipment	120,000	
Accumulated Depreciation		$ 42,000
Accounts Payable		14,600
Unearned Admissions Revenue		700
Interest Payable		6,000
Property Tax Payable		3,000
Mortgage Payable		50,000
Owner's Capital		129,200
	$245,500	$245,500

FINANCIAL REPORTING PROBLEM

(a) **June 30, 2009 total assets: $134,833 million.**
June 30, 2008 total assets: $143,992 million.

(b) **June 30, 2009 cash and cash equivalents: $4,781 million.**

(c) **2009 research and development costs: $2,044 million.**
2008 research and development costs: $2,212 million.

(d) **2009 net sales: $79,029 million.**
2008 net sales: $81,748 million.

(e) **An adjusting entry for deferrals is necessary when the receipt/disbursement precedes the recognition in the financial statements. Accounts such as prepaid insurance and prepaid rent may be included in the Prepaid Expenses and Other Current Assets ($3,199 million at June 30, 2009). Both of these accounts would require an adjusting entry to recognize the proper amount of expense incurred during the period. In addition, depreciation expense is an adjusting entry related to a deferral.**

An adjusting entry for an accrual is necessary when recognition in the financial statements precedes the cash receipt/disbursement, such as interest or taxes payable. Other adjusting entries probably made by P&G include interest revenue and expense and interest receivable and interest payable. P&G reports $8,601 million of Accrued and Other Liabilities at June 30, 2009.

(f) **2009 Depreciation and amortization expense: $3,082 million**
2008 Depreciation and amortization expense: $3,166 million
2007 Depreciation and amortization expense: $3,130 million

(From the Statement of Cash Flows)

COMPARATIVE ANALYSIS CASE

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

Total assets (December 31, 2009)	$48,671
Total assets (December 31, 2008)	$40,519
Difference	$ 8,152

$8,152 ÷ $40,519 = $20.1%

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

Total assets (December 29, 2009)	$39,848
Total assets (December 30, 2008)	$35,994
Difference	$ 3,854

$3,854 ÷ $35,994 = $10.7%

Coca-Cola Company had the larger increase.

(b)

	5-Year Growth Rate	
	The Coca-Cola Company	PepsiCo, Inc.
Net sales	7.9%	7.4%
Income from continuing operations	8.1%	7.9%

(c) The Coca-Cola Company had depreciation and amortization expense of $1,236 million; PepsiCo, Inc. had depreciation and amortization expense of $1,635 million.

PepsiCo has substantially more property, plant, and equipment than does Coca-Cola. PepsiCo is engaged in three different types of businesses: soft drinks, snack-food, and juices. As a result, it has more tangible fixed assets. While Coca-cola has substantially more intangible assets, it is not sufficient enough to offset the property, plant, and equipment. Amortizable intangible assets for Coke and Pepsi increase the amount of amortization expense recorded in income. The amount of property, plant, and equipment and amortizable intangible assets reported for these two companies is as follows:

	The Coca-Cola Company	PepsiCo, Inc.
Property, plant, and equipment (net)	$ 9,561,000,000	$12,671,000,000
Amortizable intangible assets (net)	2,421,000,000	841,000,000
	$11,982,000,000	$13,512,000,000

FINANCIAL STATEMENT ANALYSIS

(a)

	2009	2008	2007	% Change 2009	% Change 2008
Sales	$12,575	$12,822	$11,776	–1.93%	8.88%
Gross Profit %	42.87%	41.86%	43.98%	2.41%	-4.82%
Operating Profit	2,001	1,953	1,868	2.46%	4.55%
Net Cash Flow less Capital Expenditures	1,266	806	1,031	57.07%	-21.82%
Net Earnings	1,208	1,146	1,102	5.41%	3.99%

(b) Kellogg experienced a slight slowing in sales (slight decline) in the current year which followed strong growth in the previous year. The gross-profit percentage increased slightly after a drop in the prior year. Its growth in operating profit and cash flows, compared to prior years, suggest it faces a challenging period and might be starting recover. This may bode well for the strength and flexibility of its business model.

ACCOUNTING, ANALYSIS, AND PRINCIPLES

Accounting

Depreciation Expense	9,500	
Accumulated depreciation—Equipment		9,500
($9,500 = ($192,000 – $40,000) ÷ 16)		
Interest Expense	8,250	
Interest Payable		8,250
$8,250 = ($90,000 X 0.10) X 11/12)		
Unearned Ticket Revenue	10,000	
Ticket Revenue		10,000
($10,000 = ($50 X 200))		
Advertsing Expense	2,500	
Prepaid Advertising		2,500
Salaries and Wages Expense	3,500	
Salaries and Wages Payable		3,500

Analysis

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

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

Principles

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

PROFESSIONAL RESEARCH

(a) **The three essential characteristics of assets.**

Search String: asset and characteristics.

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

(b) **Three essential characteristics of liabilities.**

Search String: liability and characteristic.

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

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

Search Strings: "uncertainty", effect of uncertainty.

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

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

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

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

(d) The difference between realization and recognition

<u>Search String</u>: realization, recognition.

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

PROFESSIONAL SIMULATION

Journal Entries

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

Financial Statements

NALEZNY ADVERTISING AGENCY
Income Statement
For the Year Ended December 31, 2012

Revenues		
Advertising revenue		$61,500
Expenses		
Salaries and wages expense	$11,300	
Depreciation expense	7,000	
Rent expense	4,000	
Supplies expense	3,400	
Total expenses		25,700
Net income		$35,800

PROFESSIONAL SIMULATION (Continued)

NALEZNY ADVERTISING AGENCY
Balance Sheet
December 31, 2012

Assets		
Cash		$11,000
Accounts receivable		21,500
Supplies		5,000
Equipment	60,000	
Less: Accumulated depreciation	(35,000)	25,000
Total assets		$62,500
Liabilities and Stockholders' Equity		
Liabilities		
Accounts payable	$5,000	
Unearned advertising revenue	5,600	
Salaries and wages payable	1,300	$11,900
Stockholders' Equity		
Common stock	10,000	
Retained earnings	40,600	
Total stockholders' equity		50,600
Total liabilities and stockholders' equity		$62,500

Explanation

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

IFRS CONCEPTS AND APPLICATION

IFRS3-1

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

IFRS3-2

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

IFRS3-3

A company follows these steps:

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

IFRS3-4

The date of the opening balance sheet is January 1, 2012. The IFRS financial statements will include years ended December 31, 2013 and 2012.

IFRS3-5

(a) Assets

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

IFRS3-5 (Continued)

54 An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.

55 The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:

a. used singly or in combination with other assets in the production of goods or services to be sold by the entity;
b. exchanged for other assets;
c. used to settle a liability; or
d. distributed to the owners of the entity.

(b) Liabilities

60 An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.

61 A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.

IFRS3-5 (continued)

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

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

(c) Accrual basis

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

IFRS3-6

(a) April 3, 2010 total assets: £7,153.2 million.
March 28, 2009 total assets: £7,258.1 million.

(b) April 3, 2010 cash and cash equivalents: £405.8 million.

(c) 2010 selling and marketing expense: £2,216.6 million.
2009 selling and marketing expense: £2,074.4 million.

(d) 2010 revenue: £9,536.6 million.
2009 revenue: £9,062.1 million.

IFRS3-6 (Continued)

(e) An adjusting entry for deferrals is necessary when the receipt/disbursement precedes the recognition in the financial statements. Accounts such as prepaid pension contributions and prepaid leasehold premiums are included in the Trade and other receivables section (£281.4 million at April 3, 2010). Both of these accounts would require an adjusting entry to recognize the proper amount of expense incurred during the period. In addition, depreciation expense is an adjusting entry related to a deferral.

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

(f) 2010 Depreciation and amortization expense: £427.9 million
2009 Depreciation and amortization expense: £409.0 million

(From the footnote 28)