Chapter 2 Review of the Accounting Process

QUESTIONS FOR REVIEW OF KEY TOPICS

Question 2–1

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

Question 2–2

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

Question 2–3

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

Question 2–4

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

Question 2–5

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

Answers to Questions (continued)

Question 2–6

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

Question 2–7

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

Question 2–8

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

Question 2–9

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

Question 2–10

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

Question 2–11

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

Answers to Questions (continued)

Question 2–12

Adjusting entries record the effect on financial position of internal events, those that do not involve an exchange transaction with another entity. They must be recorded at the end of any period when financial statements are prepared to properly reflect financial position and results of operations according to the accrual accounting model.

Question 2–13

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

Question 2–14

Prepaid expenses represent assets recorded when a cash disbursement creates benefits beyond the current reporting period. Examples are supplies on hand at the end of a period, prepaid rent, and the cost of plant and equipment.

Question 2–15

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

Question 2–16

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

Answers to Questions (continued)

Question 2–17

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

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

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

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

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

Question 2–18

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

Question 2–19

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

Answers to Questions (concluded)

Question 2–20

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

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

Question 2–21

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

BRIEF EXERCISES

Brief Exercise 2–1

		Assets		=	Liabilities	+	Paid-in Capital	+	Retained Earnings	
1.	+	165,000	(inventory)		+ 165,000 (accounts payable)					
2.	–	40,000	(cash)						– 40,000	(expense)
3.	+	200,000	(accounts receivable)						+ 200,000	(revenue)
	–	120,000	(inventory)						– 120,000	(expense)
4.	+	180,000	(cash)							
	–	180,000	(accounts receivable)							
5.	–	145,000	(cash)		– 145,000 (accounts payable)					

Brief Exercise 2–2

1.	Inventory	165,000	
	Accounts payable		165,000
2.	Salaries expense	40,000	
	Cash		40,000
3.	Accounts receivable	200,000	
	Sales revenue		200,000
	Cost of goods sold	120,000	
	Inventory		120,000
4.	Cash	180,000	
	Accounts receivable		180,000
5.	Accounts payable	145,000	
	Cash		145,000

Brief Exercise 2–3

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Inventory

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

Accounts payable

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

INCOME STATEMENT ACCOUNTS

Sales revenue

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

Cost of goods sold

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

Salaries expense

6/1 Bal.	0		
2.	40,000		
6/30 Bal.	40,000		

Brief Exercise 2–4

1.	Prepaid insurance	12,000	
	Cash		12,000
2.	Note receivable	10,000	
	Cash		10,000
3.	Equipment	60,000	
	Cash		60,000

Brief Exercise 2–5

1.	Insurance expense ($12,000 x $^{3}/_{12}$)	3,000	
	Prepaid insurance		3,000
2.	Interest receivable ($10,000 x 6% x $^{6}/_{12}$)	300	
	Interest revenue		300
3.	Depreciation expense	12,000	
	Accumulated depreciation – equipment		12,000

Brief Exercise 2–6

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

Brief Exercise 2–7

1.	Service revenue	4,000	
	Deferred service revenue		4,000
2.	Advertising expense ($2,000 x $^1/_2$)	1,000	
	Prepaid advertising		1,000
3.	Salaries expense	16,000	
	Salaries payable		16,000
4.	Interest expense ($60,000 x 8% x $^4/_{12}$)	1,600	
	Interest payable		1,600

Brief Exercise 2–8

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

Brief Exercise 2–9

1.	Interest receivable	2,250	
	Interest revenue ($50,000 x 6% x $^9/_{12}$)		2,250
2.	Rent expense ($12,000 x $^3/_{12}$)	3,000	
	Prepaid rent		3,000
3.	Supplies expense ($3,000 + 5,000 – 4,200)	3,800	
	Supplies		3,800
4.	Salaries and wages expense	6,000	
	Salaries and wages payable		6,000

Brief Exercise 2–10

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

Sales revenue		$325,000
Cost of goods sold		168,000
Gross profit		157,000
Operating expenses:		
Salaries	$45,000	
Rent	20,000	
Depreciation	30,000	
Miscellaneous	12,000	
Total operating expenses		107,000
Net income		$ 50,000

Brief Exercise 2–11

BOWLER CORPORATION
Balance Sheet
At December 31, 2016

Assets

Current assets:		
Cash		$ 5,000
Accounts receivable		10,000
Inventory		16,000
Total current assets		31,000
Property and equipment:		
Equipment	100,000	
Less: Accumulated depreciation	(40,000)	60,000
Total assets		$91,000

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable		$ 20,000
Salaries payable		12,000
Total current liabilities		32,000
Shareholders' equity:		
Common stock	$50,000	
Retained earnings	9,000	
Total shareholders' equity		59,000
Total liabilities and shareholders' equity		$91,000

Brief Exercise 2–12

Sales revenue	850,000	
Income summary		850,000
Income summary	815,000	
Cost of goods sold		580,000
Salaries expense		180,000
Rent expense		40,000
Interest expense		15,000
Income summary ($850,000 – 815,000)	35,000	
Retained earnings		35,000

Brief Exercise 2–13

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

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

Cash	420,000	
Accounts receivable (increase in account)	8,000	
Sales revenue (to balance)		428,000

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

Utilities expense (to balance)	33,000	
Utilities payable (decrease in account)	2,000	
Cash		35,000

EXERCISES

Exercise 2–1

	Assets		=	Liabilities	+ Paid-in Capital	+ Retained Earnings	
1.	+ 300,000	(cash)			+ 300,000 (common stock)		
2.	– 10,000	(cash)					
	+ 40,000	(equipment)		+ 30,000 (note payable)			
3.	+ 90,000	(inventory)		+ 90,000 (accounts payable)			
4.	+ 120,000	(accounts receivable)				+ 120,000	(revenue)
	– 70,000	(inventory)				– 70,000	(expense)
5.	– 5,000	(cash)				– 5,000	(expense)
6.	– 6,000	(cash)					
	+ 6,000	(prepaid insurance)					
7.	– 70,000	(cash)		- 70,000 (accounts payable)			
8.	+ 55,000	(cash)					
	– 55,000	(accounts receivable)					
9.	– 1,000	(accumulated depreciation)				– 1,000	(expense)

Exercise 2–2

1.	Cash	300,000	
	Common stock		300,000
2.	Equipment	40,000	
	Note payable		30,000
	Cash		10,000
3.	Inventory	90,000	
	Accounts payable		90,000
4.	Accounts receivable	120,000	
	Sales revenue		120,000
	Cost of goods sold	70,000	
	Inventory		70,000
5.	Rent expense	5,000	
	Cash		5,000
6.	Prepaid insurance	6,000	
	Cash		6,000
7.	Accounts payable	70,000	
	Cash		70,000
8.	Cash	55,000	
	Accounts receivable		55,000
9.	Depreciation expense	1,000	
	Accumulated depreciation		1,000

Exercise 2–3 *BALANCE SHEET ACCOUNTS*

Cash

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

Accounts receivable

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

Inventory

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

Prepaid insurance

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

Equipment

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

Accumulated depreciation

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

Accounts payable

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

Note payable

		0	3/1 Bal.
		30,000	2.
		30,000	**3/31 Bal.**

Common stock

		0	3/1 Bal.
		300,000	1.
		300,000	**3/31 Bal.**

Exercise 2–3 (concluded)

INCOME STATEMENT ACCOUNTS

Sales revenue

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

Cost of goods sold

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

Rent expense

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

Depreciation expense

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

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

Exercise 2–4

		Debit	Credit
1.	Cash	500,000	
	Common stock		500,000
2.	Furniture and fixtures	100,000	
	Cash		40,000
	Note payable		60,000
3.	Inventory	200,000	
	Accounts payable		200,000
4.	Accounts receivable	280,000	
	Sales revenue		280,000
	Cost of goods sold	140,000	
	Inventory		140,000
5.	Rent expense	6,000	
	Cash		6,000
6.	Prepaid insurance	3,000	
	Cash		3,000
7.	Accounts payable	120,000	
	Cash		120,000
8.	Cash	55,000	
	Accounts receivable		55,000
9.	Retained earnings	5,000	
	Cash		5,000
10.	Depreciation expense	2,000	
	Accumulated depreciation		2,000
11.	Insurance expense ($3,000 ÷ 12 months)	250	
	Prepaid insurance		250

Exercise 2–5

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

Exercise 2–6

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

Exercise 2–7

	Account(s) Debited	Account(s) Credited
Example: Purchased inventory for cash	3	5
1. Paid a cash dividend.	10	5
2. Paid rent for the next three months.	8	5
3. Sold goods to customers on account.	4,16	9,3
4. Purchased inventory on account.	3	1
5. Purchased supplies for cash.	6	5
6. Paid employee salaries and wages for September.	15	5
7. Issued common stock in exchange for cash.	5	12
8. Collected cash from customers for goods sold in 3.	5	4
9. Borrowed cash from a bank and signed a note.	5	11
10. At the end of October, recorded the amount of supplies that had been used during the month.	7	6
11. Received cash for advance payment from customer.	5	13
12. Accrued employee salaries and wages for October.	17	15

Exercise 2–8

1. Prepaid insurance ($12,000 x $^{30}/_{36}$)	10,000	
Insurance expense		10,000
2. Depreciation expense	15,000	
Accumulated depreciation		15,000
3. Salaries expense	18,000	
Salaries payable		18,000
4. Interest expense ($200,000 x 12% x $^{2}/_{12}$)	4,000	
Interest payable		4,000
5. Deferred rent revenue	1,500	
Rent revenue ($^{1}/_{2}$ x $3,000)		1,500

Exercise 2–9

1. Interest receivable ($90,000 x 8% x $^{3}/_{12}$)	1,800	
Interest revenue		1,800
2. Rent expense ($6,000 x $^{2}/3$)	4,000	
Prepaid rent		4,000
3. Rent revenue ($12,000 x $^{7}/_{12}$)	7,000	
Deferred rent revenue		7,000
4. Depreciation expense	4,500	
Accumulated depreciation		4,500
5. Salaries expense	8,000	
Salaries payable		8,000
6. Supplies expense ($2,000 + 6,500 – 3,250)	5,250	
Supplies		5,250

Exercise 2–10

1. $7,200 represents nine months of interest on a $120,000 note, or 75% of annual interest.
   $7,200 ÷ .75 = $9,600 in annual interest
   $9,600 ÷ $120,000 = **8% interest rate**

   Or,
   $7,200 ÷ $120,000 = .06 nine-month rate
   To annualize the nine month rate: .06 x 12/9 = .08 or 8%

2. $60,000 ÷ 12 months = $5,000 per month in rent
   $35,000 ÷ $5,000 = 7 months expired. The rent was paid on **June 1**, seven months ago.

3. $500 represents two months (November and December) in accrued interest, or $250 per month.
   $250 x 12 months = $3,000 in annual interest
   Principal x 6% = $3,000
   Principal = $3,000 ÷ .06 = **$50,000 note**

Exercise 2–11

1.	Insurance expense ($6,000 x 3/12)	1,500	
	Prepaid insurance		1,500
2.	Interest expense ($80,000 x 8% 3/12)	1,600	
	Interest payable		1,600
3.	Deferred rent revenue ($24,000 x 3/12)	6,000	
	Rent revenue		6,000
4.	Depreciation expense ($20,000 x 3/12)	5,000	
	Accumulated depreciation - building		5,000
5.	Salaries and wages expense	16,000	
	Salaries and wages payable		16,000

Exercise 2–12

Requirement 1

BLUEBOY CHEESE CORPORATION
Income Statement
For the Year Ended December 31, 2016

Sales revenue		$800,000
Cost of goods sold		480,000
Gross profit		320,000
Operating expenses:		
Salaries	$120,000	
Rent	30,000	
Depreciation	60,000	
Advertising	5,000	
Total operating expenses		215,000
Operating income		105,000
Other expense:		
Interest		4,000
Net income		$101,000

Exercise 2–12 (continued)

BLUEBOY CHEESE CORPORATION
Balance Sheet
At December 31, 2016

Assets

Current assets:		
Cash		$ 21,000
Accounts receivable		300,000
Inventory		50,000
Prepaid rent		10,000
Total current assets		381,000
Property and equipment:		
Office equipment	$600,000	
Less: Accumulated depreciation	(250,000)	350,000
Total assets		$731,000

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable		$ 60,000
Salaries payable		8,000
Interest payable		2,000
Note payable		60,000
Total current liabilities		130,000
Shareholders' equity:		
Common stock	$400,000	
Retained earnings	201,000*	
Total shareholders' equity		601,000
Total liabilities and shareholders' equity		$731,000

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

Exercise 2–12 (concluded)

Requirement 2

December 31, 2016

Sales revenue	800,000	
Income summary		800,000
Income summary	699,000	
Cost of goods sold		480,000
Salaries expense		120,000
Rent expense		30,000
Depreciation expense		60,000
Interest expense		4,000
Advertising expense		5,000
Income summary ($800,000 – 699,000)	101,000	
Retained earnings		101,000

Exercise 2–13

December 31, 2016

Sales revenue	750,000	
Interest revenue	3,000	
Income summary		753,000
Income summary	576,000	
Cost of goods sold		420,000
Salaries expense		100,000
Rent expense		15,000
Depreciation expense		30,000
Interest expense		5,000
Insurance expense		6,000
Income summary ($753,000 – 576,000)	177,000	
Retained earnings		177,000

Exercise 2–14

December 31, 2016

Sales revenue	492,000	
Interest revenue	6,000	
Gain on sale of investments	8,000	
Income summary		506,000
Income summary	440,000	
Cost of goods sold		284,000
Salaries expense		80,000
Insurance expense		12,000
Interest expense		4,000
Advertising expense		10,000
Income tax expense		30,000
Depreciation expense		20,000
Income summary ($506,000 – 440,000)	66,000	
Retained earnings		66,000

Exercise 2–15

Requirement 1

Supplies

11/30 Balance	1,500		
		Expense	2,000
Purchased	**?**		
12/31 Balance	3,000		

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

Exercise 2–15 (continued)

Requirement 2

	Prepaid insurance		
11/30 Balance	6,000	Expense	**?**
12/31 Balance	4,500		

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

December 31, 2016		
Insurance expense	1,500	
Prepaid insurance		1,500

Requirement 3

	Salaries and wages payable		
		10,000	11/30 Balance
Salaries and wages paid	10,000	**?**	Accrued salaries and wages
		15,000	12/31 Balance

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

December 31, 2016		
Salaries and wages expense	15,000	
Salaries and wages payable		15,000

Exercise 2–15 (concluded)

Requirement 4

Deferred rent revenue			
		2,000	11/30 Balance
Recognized for Dec.	1,000		
		1,000	12/31 Balance

Rent revenue recognized each month = \$3,000 x $^1/_3$ = **\$1,000**

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

Exercise 2–16

Requirement 1

2016		Debit	Credit
Feb. 1	Cash	12,000	
	Note payable		12,000
April 1	Prepaid insurance	3,600	
	Cash		3,600
July 17	Supplies	2,800	
	Accounts payable		2,800
Nov. 1	Note receivable	6,000	
	Cash		6,000

Requirement 2

2016		Debit	Credit
Dec. 31	Interest expense ($12,000 x 10% x 11/12)	1,100	
	Interest payable		1,100
Dec. 31	Insurance expense ($3,600 x 9/24)	1,350	
	Prepaid insurance		1,350
Dec. 31	Supplies expense ($2,800 – 1,250)	1,550	
	Supplies		1,550
Dec. 31	Interest receivable	80	
	Interest revenue ($6,000 x 8% x 2/12) .		80

Exercise 2–17

Unadjusted net income	$30,000
Adjustments:	
a. Only $2,000 in insurance should be expensed	+ 4,000
b. Sales revenue overstated	– 1,000
c. Supplies expense overstated	+ 750
d. Interest expense understated ($20,000 x 12% x 3/12)	– 600
Adjusted net income	$33,150

Exercise 2–18

Stanley and Jones Lawn Service Company
Income Statement
For the Year Ended December 31, 2016

Sales revenue **(1)**		$315,000
Operating expenses:		
Salaries	$180,000	
Supplies **(2)**	24,500	
Rent	12,000	
Insurance **(3)**	4,000	
Miscellaneous **(4)**	21,000	
Depreciation	10,000	
Total operating expenses		251,500
Operating income		63,500
Other expense:		
Interest **(5)**		1,500
Net income		$62,000

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

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

(2) $25,000 cash paid for the purchase of supplies less $500 increase in supplies.

Supplies expense (to balance)	24,500	
Supplies (increase in account)	500	
Cash		25,000

Exercise 2–18 (concluded)

(3) $6,000 cash paid for insurance less $2,000 ending balance in prepaid insurance.

Insurance expense (to balance)	4,000	
Prepaid insurance (increase in account)	2,000	
Cash		6,000

(4) $20,000 cash paid for miscellaneous expenses plus increase in accrued liabilities.

Miscellaneous expense (to balance)	21,000	
Accrued liabilities (increase in account).............		1,000
Cash		20,000

(5) $100,000 x 6% x $^{3}/_{12}$ = $1,500

Interest expense	1,500	
Interest payable		1,500

Exercise 2–19

Cash basis income ($545,000 – 412,000)	$133,000
Add:	
Increase in prepaid insurance ($6,000 – 4,500)	1,500
Deduct:	
Depreciation expense	(22,000)
Decrease in accounts receivable ($62,000 – 55,000)	(7,000)
Decrease in prepaid rent ($9,200 – 8,200)	(1,000)
Increase in deferred service fee revenue ($11,000 – 9,200)	(1,800)
Increase in accrued liabilities ($15,600 – 12,200)	(3,400)
Accrual basis net income	**$ 99,300**

Exercise 2–20

Requirement 1

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

Exercise 2–20 (continued)

Requirement 2

WOLKSTEIN DRUG COMPANY
Income Statement
For the Year Ended December 31, 2016

Sales revenue		$323,000
Cost of goods sold		180,000
Gross profit		143,000
Operating expenses:		
Salaries and wages	$75,000	
Rent	30,000	
Depreciation	10,000	
Utilities	12,000	
Advertising	4,000	
Total operating expenses		131,000
Net income		$ 12,000

Exercise 2–20 (concluded)

WOLKSTEIN DRUG COMPANY
Balance Sheet
At December 31, 2016

Assets

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

Liabilities and Shareholders' Equity

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

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

Exercise 2–21

Requirement 1

June 30 - adjusting entry

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

July 1 - reversing entry

Salaries and wages payable	6,000	
Salaries and wages expense		6,000

July 2 – payment of salaries

Salaries and wages expense	10,000	
Cash		10,000

Requirement 2

June 30 - adjusting entry

Salaries and wages expense	6,000	
Salaries and wages payable		6,000

July 2 - payment of salaries

Salaries and wages expense	4,000	
Salaries and wages payable	6,000	
Cash		10,000

Exercise 2–22

Requirement 1

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

Requirement 2

1. Interest receivable ($90,000 x 8% x $^{3}/_{12}$)	1,800	
Interest revenue		1,800
5. Salaries expense	8,000	
Salaries payable		8,000

Requirement 3

1. Interest revenue	1,800	
Interest receivable		1,800
5. Salaries payable	8,000	
Salaries expense		8,000

Exercise 2–23

Requirement 1
The transactions affected would be the prepayment of rent, transaction 2, and the purchase of supplies in transaction 6.

Requirement 2
2. Original transaction on November 1:

Rent expense	6,000	
Cash		6,000

Adjusting entry on December 31:

Prepaid rent ($6,000 x $^{1}/_{3}$)	2,000	
Rent expense		2,000

6. Original transaction during the year:

Supplies expense	6,500	
Cash		6,500

Adjusting entry on December 31:

Supplies	3,250	
Supplies expense		3,250

Requirement 3

2. Rent expense	2,000	
Prepaid rent		2,000
6. Supplies expense	3,250	
Supplies		3,250

Exercise 2–24

	Transaction	Journal
1.	Purchased merchandise on account.	PJ
2.	Collected an account receivable.	CR
3.	Borrowed $20,000 and signed a note.	CR
4.	Recorded depreciation expense.	GJ
5.	Purchased equipment for cash.	CD
6.	Sold merchandise for cash. (the sale only, not the cost of the merchandise)	CR
7.	Sold merchandise on credit. (the sale only, not the cost of the merchandise)	SJ
8.	Recorded accrued salaries and wages payable.	GJ
9.	Paid employee salaries and wages.	CD
10.	Sold equipment for cash.	CR
11.	Sold equipment on credit.	GJ
12.	Paid a cash dividend to shareholders.	CD
13.	Issued common stock in exchange for cash.	CR
14.	Paid accounts payable.	CD

Exercise 2–25

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

CPA REVIEW QUESTIONS

1. **d.** The event is recorded as an increase to accounts receivable and an increase in revenue. An increase to accounts receivable represents an increase in assets and the increase in revenue will increase net income which will in turn increase retained earnings.

2. **b.** The amount accrued as commissions for each salesperson will be any commissions due over and above the fixed salary as follows:

	Fixed salary	Commissions	Excess
A	$10,000	$8,000	$ —0—
B	$14,000	$24,000	$10,000
C	$18,000	$36,000	$18,000

The amount accrued is $28,000.

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

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

Accrual basis income:

Revenue recognized in April	$3,200,000
Less: Expenses recognized in April	(1,500,000)
Income	$1,700,000

5. **d.**

Expense recognized	$437,500
Add: Increase in prepaid insurance	17,500
Cash paid for insurance	$455,000

PROBLEMS

Problem 2–1

Requirement 1

2016		Debit	Credit
Jan. 1	Cash	100,000	
	Common stock		100,000
Jan. 2	Inventory	35,000	
	Accounts payable		35,000
Jan. 4	Prepaid insurance	2,400	
	Cash		2,400
Jan. 10	Accounts receivable	12,000	
	Sales revenue		12,000
Jan. 10	Cost of goods sold	7,000	
	Inventory		7,000
Jan. 15	Cash	30,000	
	Note payable		30,000
Jan. 20	Salaries and wages expense	6,000	
	Cash		6,000
Jan. 22	Cash	10,000	
	Sales revenue		10,000
Jan. 22	Cost of goods sold	6,000	
	Inventory		6,000
Jan. 24	Accounts payable	15,000	
	Cash		15,000
Jan. 26	Cash	6,000	
	Accounts receivable		6,000
Jan. 28	Utilities expense	1,000	
	Cash		1,000
Jan. 30	Prepaid rent	2,000	
	Rent expense	2,000	
	Cash		4,000

Problem 2–1 (continued)

Requirement 2 *BALANCE SHEET ACCOUNTS*

Cash

1/1 Bal.	0		
1/1	100,000	2,400	1/4
1/15	30,000	6,000	1/20
1/22	10,000	15,000	1/24
1/26	6,000	1,000	1/28
		4,000	1/30
1/31 Bal.	117,600		

Accounts receivable

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

Inventory

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

Prepaid insurance

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

Prepaid rent

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

Accounts payable

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

Note payable

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

Common stock

		0	1/1 Bal.
		100,000	1/1
		100,000	**1/31 Bal.**

Problem 2–1 (continued)

INCOME STATEMENT ACCOUNTS

Sales revenue

		0	1/1 Bal.
		12,000	1/10
		10,000	1/22
		22,000	**1/31 Bal.**

Cost of goods sold

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

Salaries and wages expense

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

Rent expense

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

Utilities expense

1/1 Bal.	0		
1/28	1,000		
1/31 Bal.	1,000		

Problem 2–1 (concluded)

Requirement 3

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

Problem 2–2

Requirement 2

2016		Debit	Credit
Jan. 1	Cash	3,500	
	Sales revenue		3,500
Jan. 1	Cost of goods sold	2,000	
	Inventory		2,000
Jan. 2	Equipment	5,500	
	Accounts payable		5,500
Jan. 4	Advertising expense	150	
	Accounts payable		150
Jan. 8	Accounts receivable	5,000	
	Sales revenue		5,000
Jan. 8	Cost of goods sold	2,800	
	Inventory		2,800
Jan. 10	Inventory	9,500	
	Accounts payable		9,500
Jan. 13	Equipment	800	
	Cash		800
Jan. 16	Accounts payable	5,500	
	Cash		5,500
Jan. 18	Cash	4,000	
	Accounts receivable		4,000
Jan. 20	Rent expense	800	
	Cash		800
Jan. 30	Salaries and wages expense	3,000	
	Cash		3,000
Jan. 31	Retained earnings	1,000	
	Cash		1,000

Problem 2–2 (continued)

Requirements 1 and 3 ***BALANCE SHEET ACCOUNTS***

Cash

1/1 Bal.	5,000		
1/1	3,500	800	1/13
1/18	4,000	5,500	1/16
		800	1/20
		3,000	1/30
		1,000	1/31
1/31 Bal.	1,400		

Accounts receivable

1/1 Bal.	2,000		
1/8	5,000	4,000	1/18
1/31 Bal.	3,000		

Inventory

1/1 Bal.	5,000		
1/10	9,500	2,000	1/1
		2,800	1/8
1/31 Bal.	9,700		

Equipment

1/1 Bal.	11,000		
1/2	5,500		
1/13	800		
1/31 Bal.	17,300		

Accumulated depreciation

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

Accounts payable

		3,000	1/1 Bal.
1/16	5,500	5,500	1/2
		150	1/4
		9,500	1/10
		12,650	**1/31 Bal.**

Common stock

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

Retained earnings

		6,500	1/1 Bal.
1/31	1,000		
		5,500	**1/31 Bal.**

Problem 2–2 (continued)

INCOME STATEMENT ACCOUNTS

Sales revenue

		0	1/1 Bal.
		3,500	1/1
		5,000	1/8
		8,500	**1/31 Bal.**

Cost of goods sold

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

Rent expense

1/1 Bal.	0		
1/20	800		
1/31 Bal.	800		

Salaries and wages expense

1/1 Bal.	0		
1/30	3,000		
1/31 Bal.	3,000		

Advertising expense

1/1 Bal.	0		
1/4	150		
1/31 Bal.	150		

Problem 2–2 (concluded)

Requirement 4

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

Problem 2–3

1.	Depreciation expense	10,000	
	Accumulated depreciation		10,000
2.	Salaries and wages expense	1,500	
	Salaries and wages payable		1,500
3.	Interest expense ($50,000 x 12% x 3/12)	1,500	
	Interest payable		1,500
4.	Interest receivable ($20,000 x 8% x 10/12)	1,333	
	Interest revenue		1,333
5.	Prepaid insurance ($6,000 x 15/24)	3,750	
	Insurance expense		3,750
6.	Supplies expense ($1,500 – 800)	700	
	Supplies		700
7.	Sales revenue	2,000	
	Deferred revenue		2,000
8.	Rent expense	1,000	
	Prepaid rent		1,000

Problem 2–4

Requirements 1 and 2

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Prepaid rent

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

Prepaid insurance

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

Supplies

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

Inventory

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

Note receivable

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

Office equipment

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

Interest receivable

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

Problem 2–4 (continued)

Accumulated depreciation

	30,000	Bal.
	10,000	1.
	40,000	**12/31 Bal.**

Accounts payable

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

Salaries and wages payable

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

Note payable

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

Interest payable

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

Deferred revenue

	0	Bal.
	2,000	7.
	2,000	**12/31 Bal.**

Common stock

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

Retained earnings

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

Problem 2–4 (continued)

INCOME STATEMENT ACCOUNTS

Sales revenue

		148,000	Bal.
7.	2,000		
		146,000	**12/31 Bal.**

Interest revenue

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

Cost of goods sold

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

Salaries and wages expense

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

Rent expense

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

Depreciation expense

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

Interest expense

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

Supplies expense

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

Insurance expense

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

Advertising expense

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

Problem 2–4 (continued)

Requirement 3

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

Problem 2–4 (continued)

Requirement 4

PASTINA COMPANY
Income Statement
For the Year Ended December 31, 2016

Sales revenue		$146,000
Cost of goods sold		70,000
Gross profit		76,000
Operating expenses:		
Salaries and wages	$20,400	
Rent	12,000	
Depreciation	10,000	
Supplies	1,800	
Insurance	2,250	
Advertising	3,000	
Total operating expenses		49,450
Operating income		26,550
Other income (expense):		
Interest revenue	1,333	
Interest expense	(1,500)	(167)
Net income		$ 26,383

Problem 2–4 (continued)

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

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

Problem 2–4 (continued)

PASTINA COMPANY
Balance Sheet
At December 31, 2016

Assets

Current assets:		
Cash		$ 30,000
Accounts receivable		40,000
Supplies		800
Inventory		60,000
Note receivable		20,000
Interest receivable		1,333
Prepaid rent		1,000
Prepaid insurance		3,750
Total current assets		156,883
Office equipment	$80,000	
Less: Accumulated depreciation	(40,000)	40,000
Total assets		$196,883

Liabilities and Shareholders' Equity

Current liabilities		
Accounts payable		$ 31,000
Salaries and wages payable		1,500
Note payable		50,000
Interest payable		1,500
Deferred revenue		2,000
Total current liabilities		86,000
Shareholders' equity:		
Common stock	$60,000	
Retained earnings	50,883	
Total shareholders' equity		110,883
Total liabilities and shareholders' equity		$196,883

Problem 2–4 (continued)

Requirement 5

December 31, 2016

Sales revenue	146,000	
Interest revenue	1,333	
Income summary		147,333
Income summary	120,950	
Cost of goods sold		70,000
Salaries and wages expense		20,400
Rent expense		12,000
Depreciation expense		10,000
Interest expense		1,500
Supplies expense		1,800
Insurance expense		2,250
Advertising expense		3,000
Income summary ($147,333 – 120,950)	26,383	
Retained earnings		26,383

Problem 2–4 (continued)

Sales revenue

		148,000	Bal.
7.	2,000		
Closing	146,000		
		0	**12/31 Bal.**

Interest revenue

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

Cost of goods sold

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

Salaries and wages expense

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

Rent expense

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

Depreciation expense

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

Interest expense

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

Supplies expense

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

Problem 2–4 (continued)

Insurance expense

Bal.	6,000		
		3,750	5.
		2,250	Closing
12/31 Bal.	0		

Advertising expense

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

Income summary

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

Retained earnings

		24,500	Bal.
		26,383	Closing
		50,883	**12/31 Bal.**

Problem 2–4 (concluded)

Requirement 6

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

Problem 2–5

Rent expense	800	
Prepaid rent		800
Supplies expense	700	
Supplies		700
Interest receivable	1,500	
Interest revenue		1,500
Depreciation expense	6,500	
Accumulated depreciation		6,500
Salaries and wages expense	6,200	
Salaries and wages payable		6,200
Interest expense	2,500	
Interest payable		2,500
Rent revenue	2,000	
Deferred rent revenue		2,000

Problem 2–6

Requirement 2

a. Cash	70,000	
Accounts receivable	30,000	
Service revenue		100,000
b. Cash	27,300	
Accounts receivable		27,300
c. Cash	10,000	
Common stock		10,000
d. Salaries expense	41,000	
Salaries payable	9,000	
Cash		50,000
e. Miscellaneous expenses	24,000	
Cash		24,000
f. Equipment	15,000	
Cash		15,000
g. Retained earnings	2,500	
Cash		2,500

Problem 2–6 (continued)

Requirements 1 and 3

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Equipment

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

Accumulated depreciation

		6,000	1/1 Bal.
		6,000	**12/31 Bal.**

Salaries payable

		9,000	1/1 Bal.
d.	9,000		
		0	**12/31 Bal.**

Common stock

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

Retained earnings

		9,500	1/1 Bal.
g.	2,500		
		7,000	**12/31 Bal.**

Problem 2–6 (continued)

INCOME STATEMENT ACCOUNTS

Service revenue

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

Miscellaneous expenses

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

Salaries expense

1/1 Bal.	0		
d.	41,000		
12/31 Bal.	41,000		

Requirement 4

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

Problem 2–6 (continued)

Requirement 5

Salaries expense	1,000	
Salaries payable		1,000

Depreciation expense	2,000	
Accumulated depreciation...		2,000

Problem 2–6 (continued)

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Equipment

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

Accumulated depreciation

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

Salaries payable

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

Common stock

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

Retained earnings

		9,500	1/1 Bal.
g.	2,500		
		7,000	**12/31 Bal.**

Problem 2–6 (continued)

INCOME STATEMENT ACCOUNTS

Service revenue

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

Miscellaneous expenses

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

Depreciation expense

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

Salaries expense

1/1 Bal.	0		
d.	41,000		
Adjusting	1,000		
12/31 Bal.	42,000		

Problem 2–6 (continued)

Requirement 6

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

Requirement 7

KARLIN COMPANY
Income Statement
For the Year Ended December 31, 2016

Service revenue		$100,000
Operating expenses:		
Salaries	$42,000	
Miscellaneous	24,000	
Depreciation	2,000	
Total operating expenses		68,000
Net income		$ 32,000

Problem 2–6 (continued)

KARLIN COMPANY
Balance Sheet
At December 31, 2016

Assets

Current assets:		
Cash		$45,800
Accounts receivable		17,700
Total current assets		63,500
Property and equipment:		
Equipment	$35,000	
Less: Accumulated depreciation	(8,000)	27,000
Total assets		$90,500

Liabilities and Shareholders' Equity

Current liabilities:		
Salaries payable		$ 1,000
Total current liabilities		1,000
Shareholders' equity:		
Common stock	$50,500	
Retained earnings	39,000*	
Total shareholders' equity		89,500
Total liabilities and shareholders' equity		$90,500

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

Problem 2–6 (continued)

Requirement 8

December 31, 2016

Service revenue	100,000	
Income summary		100,000
Income summary	68,000	
Salaries expense		42,000
Miscellaneous expenses		24,000
Depreciation expense		2,000
Income summary	32,000	
Retained earnings		32,000

Problem 2–6 (continued)

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Equipment

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

Accumulated depreciation

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

Salaries payable

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

Common stock

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

Retained earnings

		9,500	1/1 Bal.
g.	2,500		
		32,000	Closing
		39,000	**12/31 Bal.**

Problem 2–6 (continued)

INCOME STATEMENT ACCOUNTS

Service revenue

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

Miscellaneous expenses

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

Depreciation expense

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

Salaries expense

1/1 Bal.	0		
d.	41,000		
Adjusting	1,000	42,000	Closing
12/31 Bal.	0		

Income summary

		100,000	Closing
Closing	68,000		
Closing	32,000		
12/31 Bal.	0		

Problem 2–6 (concluded)

Requirement 9

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

Problem 2–7

Requirement 1

a.	Interest receivable	600	
	Interest revenue ($10,000 x 12% x 1/2)		600
b.	Depreciation expense ($30,000 x 1/5)	6,000	
	Accumulated depreciation		6,000
c.	Deferred rent revenue	2,000	
	Rent revenue ($6,000 x 2/6)		2,000
d.	Prepaid insurance	1,500	
	Insurance expense ($2,400 x 15/24)		1,500
e.	Interest expense ($20,000 x 12% x 3/12)	600	
	Interest payable		600
f.	Supplies expense ($1,800 – 700)	1,100	
	Supplies		1,100

Requirement 2

	Income overstated (understated)
Adjustments to revenues:	
Understatement of interest revenue	$ (600)
Understatement of rent revenue	(2,000)
Adjustments to expenses:	
Overstatement of insurance expense	(1,500)
Understatement of depreciation expense	6,000
Understatement of interest expense	600
Understatement of supplies expense	1,100
Overstatement of net income	$3,600

Problem 2–8

1.	Depreciation expense ($75,000 ÷ 8 years)	9,375	
	Accumulated depreciation		9,375
2.	Salaries and wages expense ($4,500 – 3,000)	1,500	
	Salaries and wages payable		1,500
3.	Interest expense ($30,000 x 10% x $^4/_{12}$)	1,000	
	Interest payable		1,000
4.	Supplies	500	
	Supplies expense		500
5.	Prepaid rent	1,000	
	Rent expense		1,000

Problem 2–9

Requirements 1 and 2

a. Depreciation expense ($50,000 ÷ 50 years)	1,000	
Accumulated depreciation - buildings..................		1,000
b. Depreciation expense ($100,000 x 10%).......................	10,000	
Accumulated depreciation—office equipment......		10,000
c. Insurance expense	1,500	
Prepaid insurance		1,500
d. Salaries and wages expense	1,500	
Salaries and wages payable		1,500
e. Rent revenue	1,200	
Deferred rent revenue		1,200

Problem 2–9 (continued)

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Prepaid insurance

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

Land

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

Buildings

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

Office equipment

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

Accumulated depreciation—bldg.

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

Accumulated depreciation—office equip.

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

Accounts payable

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

Problem 2–9 (continued)

Salaries and wages payable

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

Deferred rent revenue

		0	Bal.
		1,200	Adjusting
		1,200	**12/31 Bal.**

Common stock

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

Retained earnings

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

INCOME STATEMENT ACCOUNTS

Sales revenue

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

Interest revenue

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

Rent revenue

		7,500	Bal.
Adjusting	1,200		
		6,300	**12/31 Bal.**

Salaries and wages expense

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

Depreciation expense

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

Problem 2–9 (continued)

Insurance expense

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

Utility expense

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

Maintenance expense

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

Problem 2–9 (continued)

Requirement 3

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

Problem 2–9 (continued)

Requirement 4

December 31, 2016

Sales revenue	90,000	
Interest revenue	3,000	
Rent revenue	6,300	
Income summary		99,300
Income summary	96,000	
Salaries and wages expense		38,500
Depreciation expense		11,000
Insurance expense		1,500
Utility expense		30,000
Maintenance expense		15,000
Income summary ($99,300 – 96,000)	3,300	
Retained earnings		3,300

Problem 2–9 (concluded)

Requirement 5

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

Problem 2–10

Computations:

Sales revenue

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

Cost of goods sold

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

Purchases during 2016 = $220,000 + 30,000 = $250,000

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

Cost of goods sold during 2016 = $250,000 – 50,000 = **$200,000**

Rent expense and prepaid rent

Prepaid rent = $ 3,000 x $^2/_3$ = **$2,000**

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

Depreciation expense

Depreciation during2016 = $30,000 x 10% = **$3,000**

Interest expense

Interest accrued during 2016 = $40,000 x 12% x $^9/_{12}$ = **$3,600**

Salaries and wages expense

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

Problem 2–10 (continued)

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

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

Problem 2–10 (concluded)

McGUIRE CORPORATION
Balance Sheet
At December 31, 2016

Assets

Current assets:			
Cash		$ 56,000	**(1)**
Accounts receivable		22,000	
Prepaid rent		2,000	
Inventory		50,000	
Total current assets		130,000	
Office equipment	$30,000		
Less: Accumulated depreciation	(3,000)	27,000	
Total assets		$157,000	

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable		$ 30,000
Salaries and wages payable		5,000
Note payable		40,000
Interest payable		3,600
Total current liabilities		78,600
Shareholders' equity:		
Common stock	$50,000	
Retained earnings	28,400	
Total shareholders' equity		78,400
Total liabilities and shareholders' equity		$157,000

(1) $410,000 – 354,000 = $56,000

Problem 2–11

Requirement 1

a. Sales revenue

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

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

b. Cost of goods sold

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

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

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

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

Problem 2–11 (concluded)

c. Insurance expense

Prepaid insurance			
11/30 Balance	5,000		
Cash payment	5,000		
		?	Insurance expense
12/31 Balance	7,500		

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

d. Salaries and wages expense

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

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

Requirement 2

Accounts receivable	73,000	
Sales revenue		73,000
Cost of goods sold	64,000	
Inventory		64,000

Problem 2–12

Requirement 1

Computations:

Sales revenue:	
Cash collected from customers	$675,000
Add: Increase in accounts receivable	30,000
Sales revenue	$705,000

Interest revenue:	
Cash received	$4,000
Add: Amount accrued at the end of 2016 ($50,000 x .08 x $^{9}/_{12}$)	3,000 (c)
Deduct: Amount accrued at the end of 2015	(3,000)
Interest revenue	$4,000

Cost of goods sold:	
Cash paid for merchandise	$390,000
Add: Increase in accounts payable	12,000
Purchases during2016	402,000
Add: Decrease in inventory	18,000
Cost of goods sold	$420,000

Insurance expense:	
Cash paid	$6,000
Add: Prepaid insurance expired during 2016	2,500
Deduct: Prepaid insurance on 12/31/16 ($6,000 x $^{4}/_{12}$)	(2,000) (a)
Insurance expense	$6,500

Salaries and wages expense:	
Cash paid	$210,000
Add: Increase in salaries and wages payable	4,000
Salaries expense	$214,000

Problem 2–12 (continued)

Interest expense:

Amount accrued at the end of 2016 ($100,000 x .06 x 2/12)	$1,000 (d)

Rent expense:

Amount paid	$24,000
Add: Prepaid rent on 12/31/15 expired during 2016	11,000
Deduct: Prepaid rent on 12/31/16 ($24,000 x 6/12)	(12,000) (b)
Rent expense	$23,000

Depreciation expense: Increase in accumulated depreciation	$10,000

Zambrano Wholesale Corporation
Income statement
For the Year Ended December 31, 2016

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

Problem 2–12 (concluded)

Requirement 2

a. Prepaid insurance	$ 2,000
b. Prepaid rent	12,000
c. Interest receivable	3,000
d. Interest payable	1,000

Problem 2–13

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

Problem 2–13 (continued)

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

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

Problem 2–13 (continued)

EXCALIBUR CORPORATION
Statement of Shareholders' Equity
For the Year Ended December 31, 2016

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

Problem 2–13 (continued)

EXCALIBUR CORPORATION
Balance Sheet
At December 31, 2016

Assets

Current assets:		
Cash		$ 23,300
Accounts receivable		32,500
Supplies		500
Prepaid rent		1,000
Inventory		65,000
Total current assets		122,300
Office equipment	$75,000	
Less: Accumulated depreciation	(19,375)	55,625
Total assets		$177,925

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable		$ 26,100
Salaries and wages payable		4,500
Note payable		30,000
Interest payable		1,000
Total current liabilities		61,600
Shareholders' equity:		
Common stock	$80,000	
Retained earnings	36,325	
Total shareholders' equity		116,325
Total liabilities and shareholders' equity		$177,925

Problem 2–13 (concluded)

December 31,2016		
Sales revenue	180,000	
Income summary		180,000
Income summary	159,725	
Cost of goods sold		95,000
Interest expense		1,000
Salaries and wages expense		33,850
Rent expense		13,000
Supplies expense		1,500
Utility expense		6,000
Depreciation expense		9,375
Income summary ($180,000 – 159,725)	20,275	
Retained earnings		20,275

CASES

Judgment Case 2–1

Requirement 1

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

Requirement 2

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

Requirement 3

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

Judgment Case 2–2

Requirement 1

Cash basis net income		$26,000
Add:	1. Unexpired (prepaid insurance) $12,000 x 8/12	8,000
	2. Increase in accounts receivable ($6,500 – 5,000)	1,500
	5. Increase in inventories ($35,000 – 32,000)	3,000
Deduct:	3. Increase in salaries and wages payable ($8,200 – 7,200)	(1,000)
	4. Increase in utilities payable ($1,200 – 900)	(300)
	6. Increase in amount owed to suppliers	(4,000)
Accrual basis net income		**$33,200**

Requirement 2

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

Communication Case 2–3

Requirement 1

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

Requirement 2

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

Requirement 3

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