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.

Answers to Questions (continued)

Question 2–5

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

Question 2–6

Revenues and gains are increased 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

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

Question 2–11

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

Answers to Questions (continued)

Question 2–12

We use adjusting entries to record the effect on financial position of internal events, those that do not involve an exchange transaction with another entity. We record them at the end of any period when financial statements are prepared to properly reflect financial position and results of operations according to the accrual accounting model, that is, to update accounts to their proper balances before we report those balances in the financial statements.

Question 2–13

Closing entries transfer the balances in the temporary owners' equity accounts (revenues, expenses, gains, losses, dividends) to a permanent owners' equity account, retained earnings for a corporation. This 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 that extend beyond the current reporting period. Examples are supplies on hand at the end of a period, prepaid rent, and prepaid insurance.

Question 2–15

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

Question 2–16

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

Answers to Questions (continued)

Question 2–17

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

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

Balance sheet—The purpose of the balance sheet is to present the financial position of a company at a particular point in time. It is an organized list of assets, liabilities, and permanent 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 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 way to organize the accounting information needed to prepare adjusting and closing entries and the financial statements. This error would result in an *overstatement* of revenue and thus net income and thus retained earnings, and an *understatement* of liabilities.

Answers to Questions (concluded)

Question 2–19

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

Question 2–20

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

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

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, 2018

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, 2018

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

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

Exercise 2–5

		List A		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 ÷ 0.75 = $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, 2018

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, 2018

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, 2018

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, 2018

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, 2018

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**

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, 2018

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

Exercise 2–15 (concluded)

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, 2018

Salaries and wages expense	15,000	
Salaries and wages payable		15,000

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, 2018

Deferred rent revenue	1,000	
Rent revenue		1,000

Exercise 2–16

Requirement 1

2018		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

2018		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, 2018

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, 2018

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, 2018

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

PROBLEMS

Problem 2–1

Requirement 1

2018		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

2018		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		

Problem 2–2 (continued)

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, 2018

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, 2018

	Common Stock	**Retained Earnings**	**Total Shareholders' Equity**
Balance at January 1, 2018	$60,000	$28,500	$ 88,500
Issue of common stock	- 0 -		- 0 -
Net income for 2018		26,383	26,383
Less: Dividends		(4,000)	(4,000)
Balance at December 31, 2018	$60,000	$50,883	$110,883

Problem 2–4 (continued)

PASTINA COMPANY

Balance Sheet
At December 31, 2018

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, 2018		
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.

Retained earnings

		9,500	1/1 Bal.
g.	2,500		

	50,500	**12/31 Bal.**		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, 2018

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, 2018

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, 2018

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, 2018

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 2018 = $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 2018 = $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 2018 = $250,000 – 50,000 = **$200,000**

Rent expense and prepaid rent

Prepaid rent = $ 3,000 x $^{2}/3$ = **$2,000**
Rent expense during 2018 = $14,000 – 2,000 = **$12,000**

Depreciation expense

Depreciation during 2018 = $30,000 x 10% = **$3,000**

Interest expense

Interest accrued during 2018 = $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, 2018

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, 2018

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 2018 ($50,000 x .08 x $^{9}/12$)	3,000 (c)
Deduct: Amount accrued at the end of 2017	(3,000)
Interest revenue	$4,000

Cost of goods sold:

Cash paid for merchandise	$390,000
Add: Increase in accounts payable	12,000
Purchases during 2018	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 2018	2,500
Deduct: Prepaid insurance on 12/31/18 ($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 2018 ($100,000 x .06 x 2/12)	$1,000 (d)

Rent expense:

Amount paid	**$24,000**
Add: Prepaid rent on 12/31/17 expired during 2018	11,000
Deduct: Prepaid rent on 12/31/18 ($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, 2018

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, 2018

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, 2018

	Common Stock	**Retained Earnings**	**Total Shareholders’ Equity**
Balance at January 1, 2018	$80,000	$22,050	$102,050
Issue of common stock	- 0 -		- 0 -
Net income for 2018		20,275	20,275
Less: Dividends		(6,000)	(6,000)
Balance at December 31, 2018	$80,000	$36,325	$116,325

Problem 2–13 (continued)

EXCALIBUR CORPORATION
Balance Sheet
At December 31, 2018

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, 2018

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.

Target Case

Requirement 1

Target's balance sheet reports accumulated depreciation of $16,246 million and $15,093 million for the years ended January 30, 2016, and January 31, 2015, respectively. Assuming no depreciable assets were sold during the year, Target's adjusting entry to record depreciation for the year would be:

	($ in millions)	
Depreciation expense ($16,246 – 15,093)	1,153	
Accumulated depreciation		1,153

Requirement 2

The statement of cash flows shows $2,213 million for "depreciation and amortization" for the 2015 fiscal year. Given depreciation expense of $1,153 million, amortization expense must be $2,213 – 1,153 = $1,060 million.

Target Case (concluded)

Requirement 3

Note 13, “ Other Current Assets,” reports Prepaid expenses of $214 million and $231 million for the years ended January 30, 2016, and January 31, 2015, respectively. Assuming this pertains to prepaid insurance, insurance expense must have exceeded the amount paid for insurance coverage, because the balance decreased during the year. We can visualize the change with a T account:

Prepaid Insurance

Beginning balance 231	50 Insurance expense
Cash paid for insurance **?**	
Ending balance 214	

Cash paid for insurance must have been $33 million. Prior to the adjusting entry, the balance in prepaid insurance would have been $231 + 33 = $264. The adjusting entry to record expired insurance coverage and reduce the unexpired coverage to $214 would be:

	($ in millions)	
Insurance expense...	50	
Prepaid insurance		50

The appropriate adjusting entry for a prepaid expense is a debit to expense and a credit to the prepaid asset. Failure to record an adjusting entry for a prepaid expense will cause expenses to be understated and thus net income to be overstated. In the balance sheet, assets and shareholders’ equity (retained earnings) would be overstated.

Air France–KLM Case

Requirement 1

Typically, the order of presentation of the components of the balance sheet is different between U.S. GAAP and IFRS. Looking at the balance sheet of Air France–KLM (AF) we see that Non-current assets are listed before Current assets and Non-current liabilities before Current liabilities. Within "Total equity and liabilities", AF lists Shareholders' equity before Liabilities. Each of these is in the opposite order from what we see in Illustration 2–14 based on U.S. GAAP.

Requirement 2

Some of the differences we see in terminology occur in the Shareholders' equity section of the balance sheet. In fact, the title of that section is simply Equity in AF's balance sheet. AF lists four items in the shareholders' equity section of the balance sheet. If AF used U.S. GAAP, Issued share capital would be Common stock, Reserves and retained earnings would be separated into retained earnings and one or more other accounts, usually Accumulated other comprehensive income accounts. Under U.S. GAAP the term "reserves" is considered misleading and thus is discouraged. Often, firms (not AF) using IFRS will use the term Share premium for Paid-in capital—excess of par and Investment in own shares for Treasury stock.

Within long-term liabilities, AF lists some of its liabilities as "provisions." We don't see that in the U.S. GAAP balance sheet.

CHAPTER 2
REVIEW OF THE ACCOUNTING PROCESS

Overview

Chapter 1 explained that the primary means of conveying financial information to investors, creditors, and other external users is through financial statements and related notes. The purpose of this chapter is to *review* the fundamental *accounting process* used to produce the financial statements. This review establishes a framework for the study of the concepts covered in intermediate accounting.

Actual accounting systems differ significantly from company to company. This chapter focuses on the many features that tend to be common to any accounting system.

Learning Objectives

LO2–1 Analyze routine economic events—transactions—and record their effects on a company's financial position using the accounting equation format.

LO2–2 Record transactions using the general journal format.

LO2–3 Post the effects of journal entries to general ledger accounts and prepare an unadjusted trial balance.

LO2–4 Identify and describe the different types of adjusting journal entries.

LO2–5 Record adjusting journal entries in general journal format, post entries, and prepare an adjusted trial balance.

LO2–6 Describe the basic financial statements.

LO2–7 Explain the closing process.

LO2–8 Convert from cash basis net income to accrual basis net income.

Lecture Outline

I. The Basic Model

A. External events involve an exchange between the company and another entity; internal transactions do not involve an exchange transaction but do affect financial position.

B. The accounting equation underlies the process used to capture the effect of economic events (transactions):

Assets = Liabilities + Owners' Equity

C. Each transaction has a dual effect on the accounting equation.

D. Owners' equity for a corporation, called shareholders' equity, is classified *by source* as either paid-in capital or retained earnings.

E. The double-entry system is used to process transactions.

   1. Elements of the accounting equation are represented by accounts in a general ledger.
   2. In the double-entry system, *debit* means left side of an account, and *credit* means right side of an account.

3. Asset *increases* are entered on the *debit* side of accounts and *decreases* are entered on the *credit* side. Liability and equity account *increases* are *credits* and *decreases* are *debits*.

II. The Accounting Processing Cycle

A. **Step 1.** Obtain information about transactions from source documents.

B. **Step 2.** Transaction analysis is the process of reviewing source documents to determine the dual effect on the accounting equation and the specific elements involved.

C. **Step 3.** Record the transaction in a journal. For most external transactions, special journals (discussed in Appendix 2C) are used to capture the dual effect of the transaction in debit/credit form.

D. **Step 4.** Post from the journal to the general ledger accounts. In addition to general ledger control accounts, a subsidiary ledger (discussed in Appendix 2C) contains a group of subsidiary accounts associated with particular general ledger control accounts.

E. **Step 5.** Prepare an unadjusted trial balance. A worksheet (discussed in Appendix 2A) can be used as a tool after and instead of step 5 in the processing cycle.

III. Adjusting Entries

A. **Step 6.** Record adjusting entries and post to the ledger accounts.

B. Prepayments are transactions in which the cash flow *precedes* expense of revenue recognition.
   1. **Prepaid expenses** represent assets recorded when a cash disbursement creates benefits beyond the current reporting period.
   2. **Deferred revenues** represent liabilities recorded when cash is received from customers in advance of providing a good or service.

C. Accruals involve transactions where the cash outflow or inflow takes place in a period subsequent to expense or revenue recognition.
   1. **Accrued liabilities** represent liabilities recorded when an expense has been incurred prior to cash payment.
   2. **Accrued receivables** involve situations when the revenue is recognized in a period prior to the cash receipt.

D. Estimates often are made to comply with the accrual accounting model.
   1. Most estimates involve either prepayments or accruals.
   2. One situation involving an estimate that does not fit neatly into either the prepayment or accrual classification is accounting for bad debts.

E. **Step 7.** Preparation of an adjusted trial balance.

F. Accountants sometimes use reversing entries (discussed in Appendix 2B) in conjunction with adjusting entries.

IV. Step 8. Prepare Financial Statements

A. The income statement
B. The statement of comprehensive income
C. The balance sheet
D. The statement of cash flows
E. The statement of shareholders' equity

V. Step 9. Close the Temporary Accounts

A. Close the revenue accounts to income summary.
B. Close the expense accounts to income summary.
C. Close the income summary account to retained earnings.
D. **Step 10.** Prepare a post-closing trial balance.

VI. Conversion from Cash Basis to Accrual Basis

A. Add (deduct) increases (decreases) in assets. For example, an increase in accounts receivable means that the company recognized more revenue than cash collected.
B. Add (deduct) decreases (increases) in accrued liabilities. For example, a decrease in interest payable means that the company incurred less interest expense than the cash interest paid, requiring the addition to cash basis-income.

PowerPoint Slides

Three PowerPoint presentations of the chapter are available in the Connect Library:

1. With "Concept Checks" useful for classroom presentation, permitting the instructor to intersperse in the presentation short exercises students can be asked to solve individually or in small groups before the solution is "revealed" by the instructor. {These are available only within Instructor Resources.}

2. Without the "Concept Checks" so students don't have the solutions before being asked to solve individually or in small groups.

3. **Accessible PowerPoint Presentations.** Accessibility is becoming even more important in the education marketplace. Students and instructors with disabilities use many different assistive technologies, and McGraw-Hill Education is working to increase compatibility and access that will not only help those with disabilities achieve better learning outcomes, but also serve the institutions that are teaching these students. Accessible PowerPoint allows slide content to be read by a screen reader and provides alternative text descriptions for any image files used that enrich the learning experience. Accessible PowerPoint is also designed with high-contrast color palettes and uses texture when possible, instead of color to denote different aspects of the imagery used within the slide.

Note: The slides are intended to provide comprehensive coverage of the chapter, but they can be easily edited to allow instructors to change numbers and content in illustrations or to delete slides pertaining to topics they choose to omit or deemphasize. (Using your students' names for company names in the Concept Checks or Illustrations can be fun.)

Suggestions for Class Activities

1. Spreadsheet Activities

In addition to Exercise 2–20 and Problem 2–13, the requirements for Problems 2–2, 2–4, 2–6, 2–8, and 2–10 can be modified to include the use of software such as Excel.

2. Professional Skills Development Activities

The following are suggested assignments from the end-of-chapter material that will help your students develop their communication, analysis and judgment skills.

Communication Skills. In addition to Communication Case 2–3, Judgment Cases 2–1 and 2–2 can be adapted to ask students to write a memo. These Judgment Cases also do well as group assignments and create good class discussions.

Analysis Skills. The “Broaden Your Perspective” section includes Analysis Cases that direct students to gather, assemble, organize, process, or interpret data to provide options for making business and investment decisions. Exercises 2–15, 2–18 and Problems 2–7, 2–9 provide opportunities to develop and sharpen analytical skills.

Judgment Skills. The “Broaden Your Perspective” section includes Judgment Cases that require students to critically analyze issues to apply concepts learned to business situations in order to evaluate options for decision-making and provide an appropriate conclusion. This chapter includes Judgment Cases 2–1 and 2–2.

Assignment Chart

Questions	**Learning Objective(s)**	**Topic**	**Est. time (min.)**
2–1	1	External and internal events	5
2–2	1	Dual effect of transactions on financial position	5
2–3	2,3	Purpose of journal and ledger	5
2–4	3	Permanent and temporary accounts	5
2–5	2,3	Debits and credits	5
2–6	2,3	Debits and credits	5
2–7	1,2,3	Accounting processing cycle	5
2–8	1,2,3	Transaction analysis	5
2–9	3	Posting	5
2–10	2	Journal entries	5
2–11	3,5	Trial balance	5
2–12	4	Adjusting entries	5
2–13	7	Closing entries	5
2–14	4	Adjusting entries—prepaid expenses	5
2–15	4	Adjusting entries—deferred revenue	5
2–16	4	Adjusting entries—accrued liabilities	5
2–17	6	Financial statements	5
2–18	A	Worksheet [Based on Appendix 2A]	5
2–19	B	Reversing entries [Based on Appendix 2B]	5
2–20	C	Special journals [Based on Appendix 2C]	5
2–21	C	Subsidiary ledger [Based on Appendix 2C]	5

Brief Exercises	**Learning Objective(s)**	**Topic**	**Est. time (min.)**
2–1	1	Transaction analysis	10
2–2	2	Journal entries	10
2–3	3	T-accounts	15
2–4	2	Journal entries	15
2–5	5	Adjusting entries	15
2–6	4,5	Adjusting entries; income determination	15
2–7	5	Adjusting entries	15
2–8	4	Income determination	15
2–9	5	Adjusting entries	10
2–10	6	Financial statements	10
2–11	6	Financial statements	10
2–12	7	Closing entries	10
2–13	8	Cash versus accrual accounting	15

Exercises	Learning Objective(s)	Topic	Est. time (min.)
2–1	1	Transaction analysis	15
2–2	2	Journal entries	15
2–3	3	T-accounts and trial balance	15
2–4	2	Journal entries	20
2–5	2,3,4,5,6,7	The accounting processing cycle	15
2–6	2	Debits and credits	15
2–7	2	Transaction analysis; debits and credits	15
2–8	5	Adjusting entries	15
2–9	5	Adjusting entries	15
2–10	4,5	Adjusting entries; solving for unknowns	15
2–11	5	Adjusting entries	15
2–12	6,7	Financial statements and closing entries	20
2–13	7	Closing entries	10
2–14	7	Closing entries	10
2–15	4,5,8	Cash versus accrual accounting; adjusting entries	15
2–16	2,5	External transactions and adjusting entries	15
2–17	4,8	Accrual accounting income determination	15
2–18	8	Cash versus accrual accounting	20
2–19	8	Cash versus accrual accounting	20
2–20	A	Worksheet [Based on Appendix 2A]	35
2–21	B	Reversing entries [Based on Appendix 2B]	10
2–22	B	Reversing entries [Based on Appendix 2B]	10
2–23	B	Reversing entries [Based on Appendix 2B]	10
2–24	C	Special journals [Based on Appendix 2C]	15
2–25	C	Special journals [Based on Appendix 2C]	15

	Problems	Learning Objective(s)	Topic	Est. time (min.)
	2–1	2,3	Accounting cycle through unadjusted trial balance	40
	2–2	2,3	Accounting cycle through unadjusted trial balance	40
	2–3	5	Adjusting entries	20
	2–4	3,5,6,7	Accounting cycle; adjusting entries through post-closing trial balance	60
	2–5	5	Adjusting entries	20
☆	2–6	2,3,4,5,6,7	Accounting cycle	75
	2–7	2,5	Adjusting entries and income effects	20
	2–8	5	Adjusting entries	20
	2–9	3,5,7	Accounting cycle; unadjusted trial balance through closing	45
☆	2–10	4,6,8	Accrual accounting; financial statements	30
	2–11	8	Cash versus accrual accounting	15
☆	2–12	8	Cash versus accrual accounting	40
	2–13	A	Worksheet [Based on Appendix 2A]	40

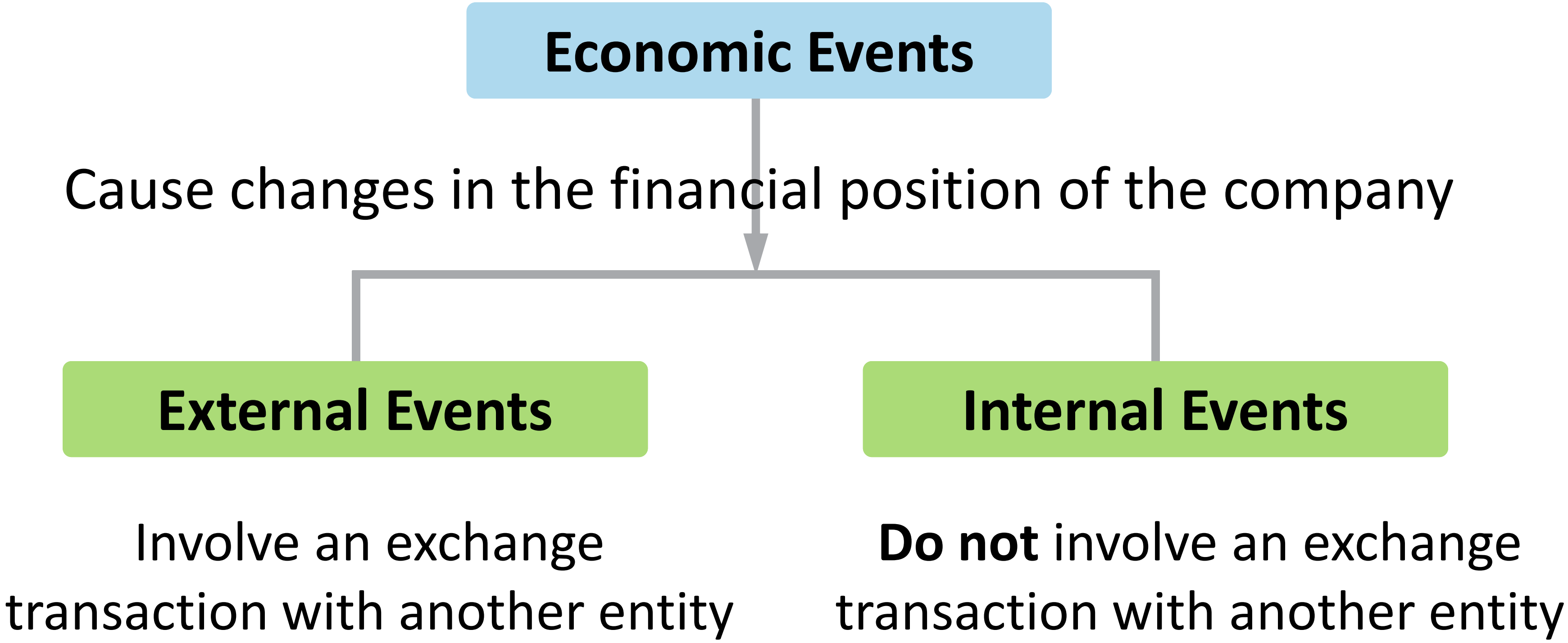
☆ Star Problems

Cases	Learning Objective(s)	Topic	Est. time (min.)
Judgment Case 2–1	4,8	Cash versus accrual accounting; adjusting entries	20
Judgment Case 2–2	8	Cash versus accrual accounting	30
Communication Case 2–3	4	Adjusting entries	20
Target Case	4,6	Target	30
Air France–KLM Case	9	IFRS; Air France–KLM	30

Chapter 2

Review of the Accounting Process

The Basic Model



Economic Events

Cause changes in the financial position of the company

External Events

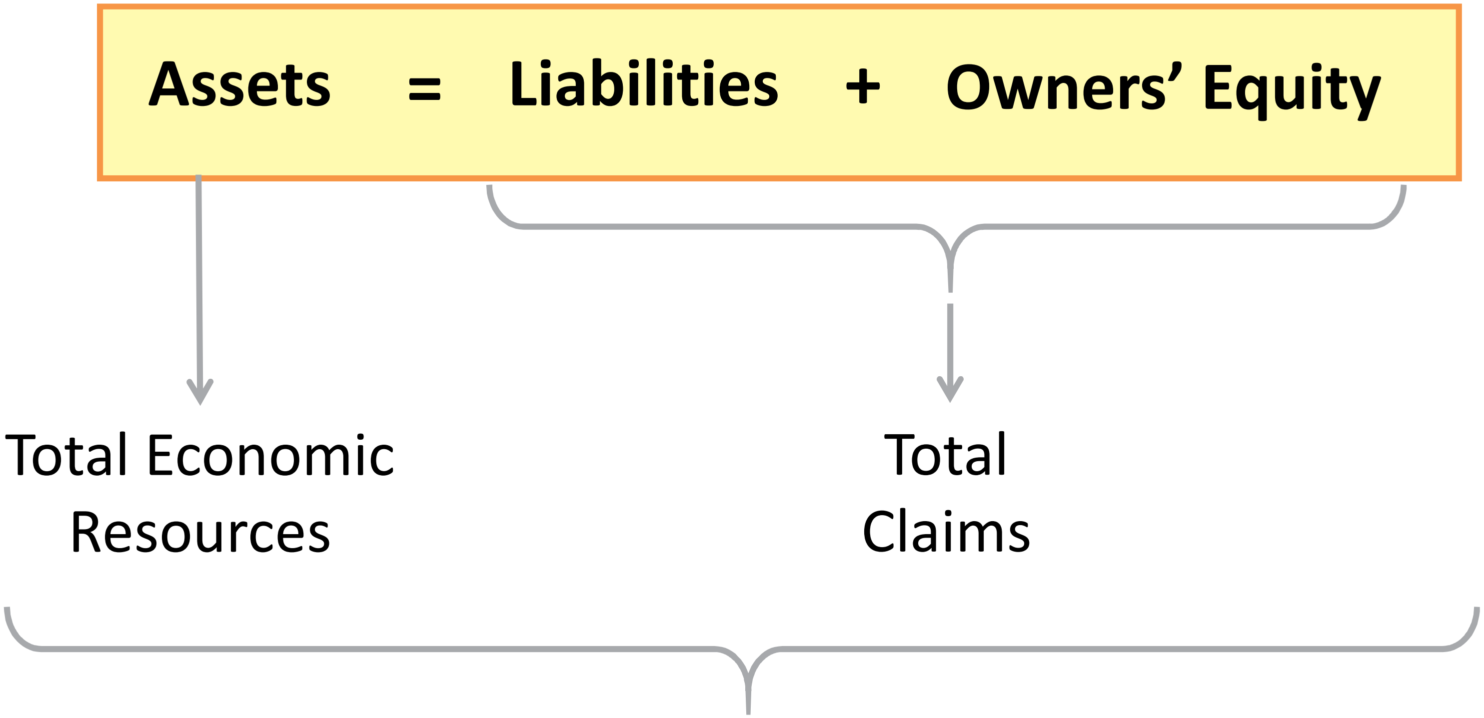
Involve an exchange transaction with another entity

Internal Events

Do not involve an exchange transaction with another entity

The Accounting Equation

- Underlies the process used to capture the effect of economic events:



Assets = Liabilities + Owners' Equity

Total Economic Resources

Total Claims

Each event, or transaction, has a dual effect on the accounting equation

Accounting Equation—Owner Investment

1. An attorney invested **$50,000** to open a law office.

Assets	=	Liabilities	+	Owners' Equity
+ **$50,000** (Cash)				+ **$50,000** (Investment by owner)

An investment by the owner causes both assets and owners' equity to increase.

Accounting Equation—Borrowing Money from the Bank

2. **$40,000** was borrowed from a bank and a note payable was signed.

Assets	=	Liabilities	+	Owners' Equity
+ **$40,000**		+ **$40,000**		
(Cash)		(Note Payable)		

This transaction causes assets and liabilities to increase. A bank loan increases cash and creates an obligation to repay it.

Accounting Equation—Supplies Purchased on Account

3. Supplies costing **$3,000** were purchased on account.

Assets	=	Liabilities	+	Owners' Equity
+ **$3,000**		+ **$3,000**		
(Supplies)		(Accounts payable)		

Buying supplies on credit also increases both assets and liabilities.

Accounting Equation—Services Performed on Account

4. Services were performed on account for **$10,000**.

Assets	=	Liabilities	+	Owners’ Equity
+ **$10,000** (Accounts Receivables)				+ **$10,000** (Service revenue)

Revenues and gains describe inflows of assets, causing owners’ equity to increase.

Accounting Equation—Salaries Paid to Employees

5. Salaries of **$5,000** were paid to employees.

Assets	=	Liabilities	+	Owners’ Equity
– **$5,000** (Cash)				– **$5,000** (Salaries expense)

Expenses and losses describe outflows of assets (or increases in liabilities) causing owners’ equity to decrease.

Accounting Equation—Supplies Used

6. $500 of supplies were used.

Assets	=	Liabilities	+	Owners’ Equity
– $500 (Supplies)				– $500 (Supplies expense)

Expenses and losses describe outflows of assets (or increases in liabilities) causing owners’ equity to decrease.

Accounting Equation—Transaction Analysis

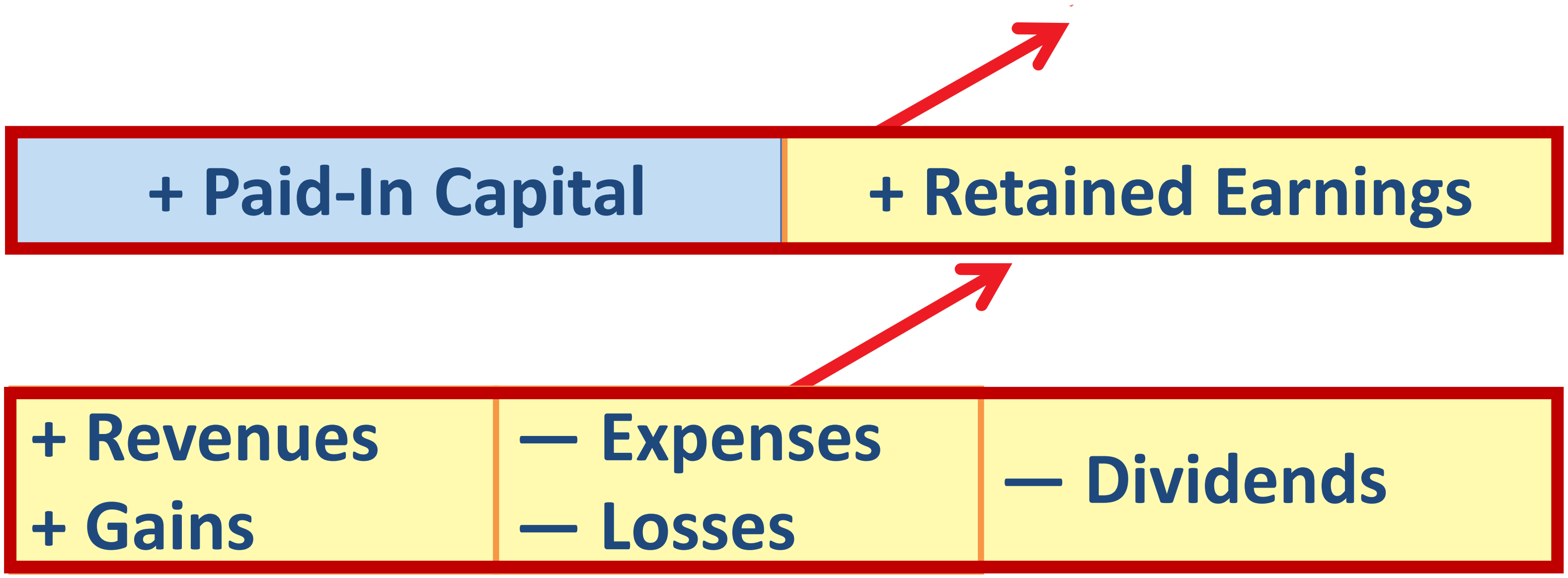
7. **$1,000** was paid on account to the supplies vendor.

Assets	=	Liabilities	+	Owners’ Equity
– $1,000		**– $1,000**		
(Cash)		(Accounts payable)		

This transaction causes assets and liabilities to decrease.

Accounting Equation for a Corporation

A = L + SE



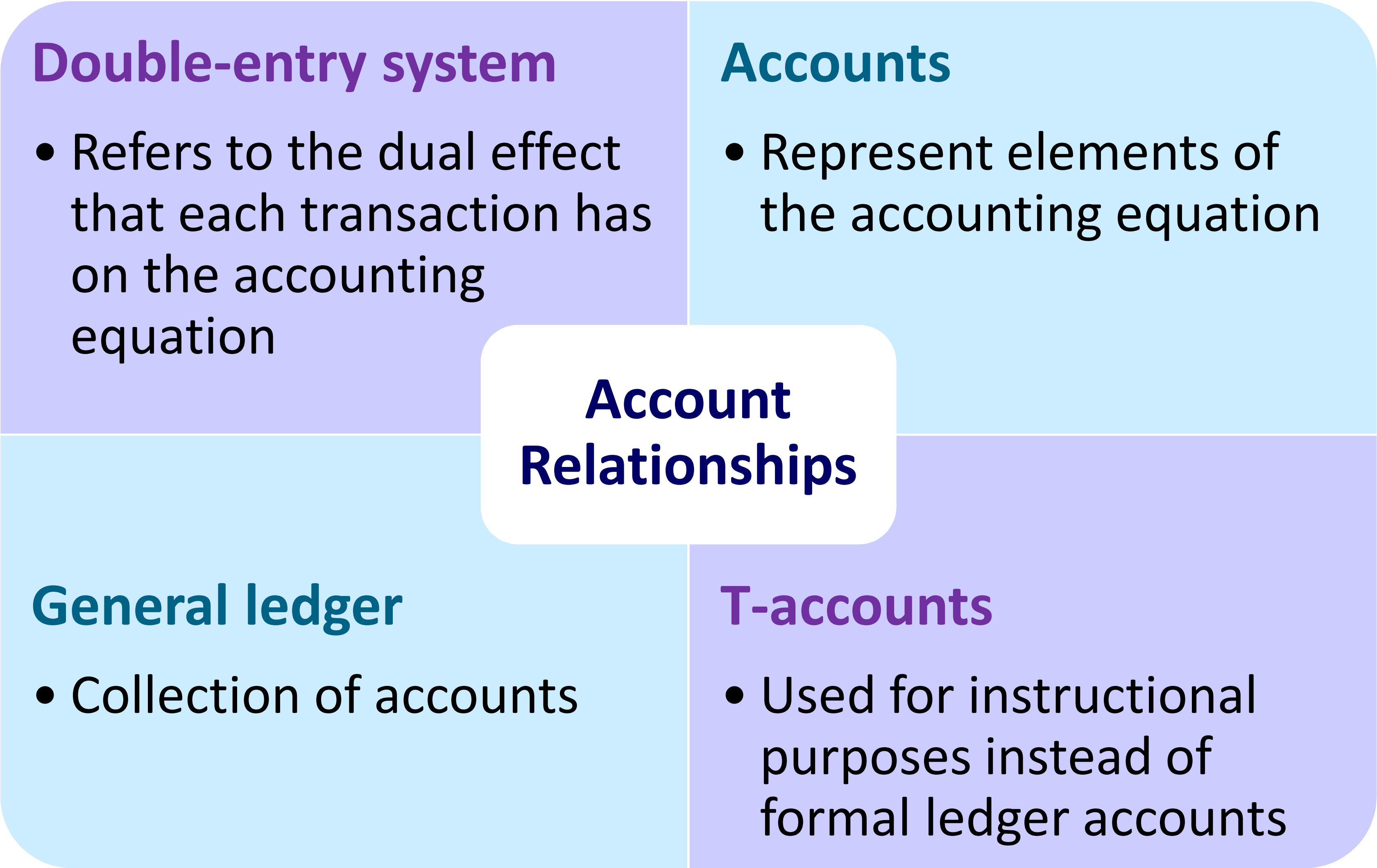
+ Paid-In Capital | + Retained Earnings

+ Revenues
+ Gains

— Expenses
— Losses

— Dividends

Account Relationships



Account Relationships

Double-entry system

- Refers to the dual effect that each transaction has on the accounting equation

Accounts

- Represent elements of the accounting equation

General ledger

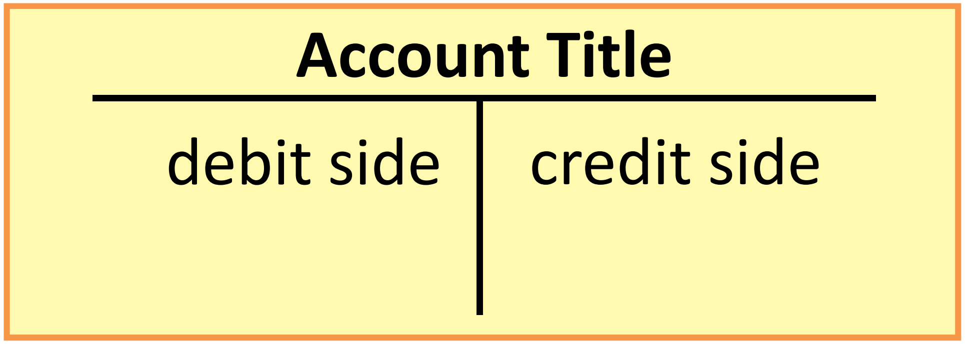
- Collection of accounts

T-accounts

- Used for instructional purposes instead of formal ledger accounts

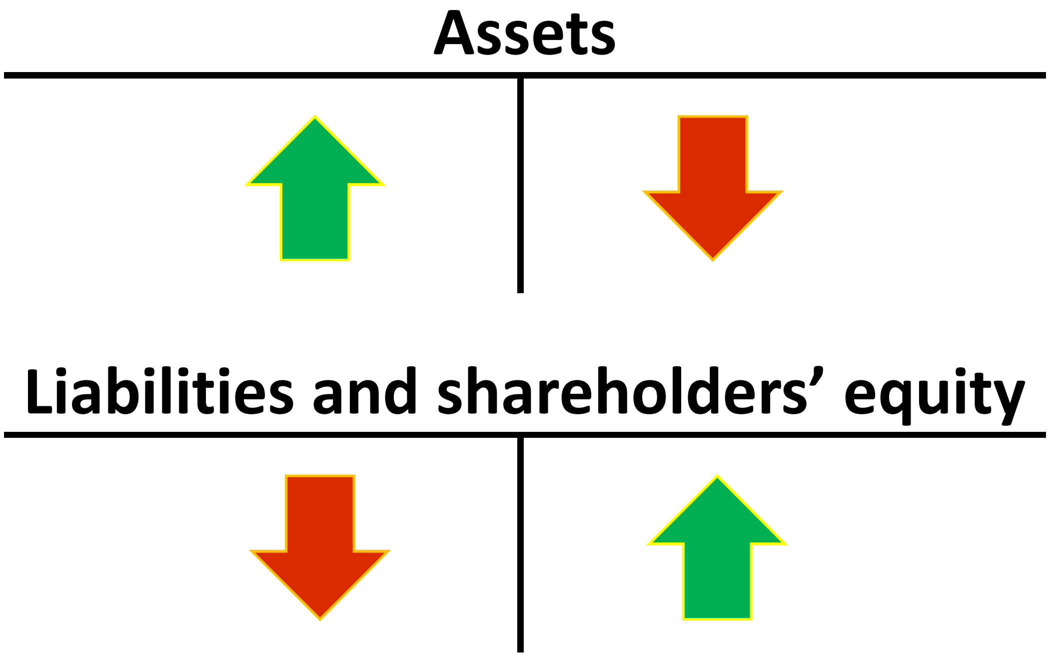
T-Account Introduction

- Account title at the top
- Two sides for recording increases and decreases
  - **Debits** represent the left side
  - **Credits** represent the right side



T-Account Rules

- Account title at the top
- Two sides for recording increases and decreases
  - **Debits** represent the left side
  - **Credits** represent the right side



Assets

Liabilities and shareholders' equity

Example: Account Relationships

Example:

$40,000 was borrowed from a bank and a note payable was signed.

Assets = Liabilities + Owners’ Equity

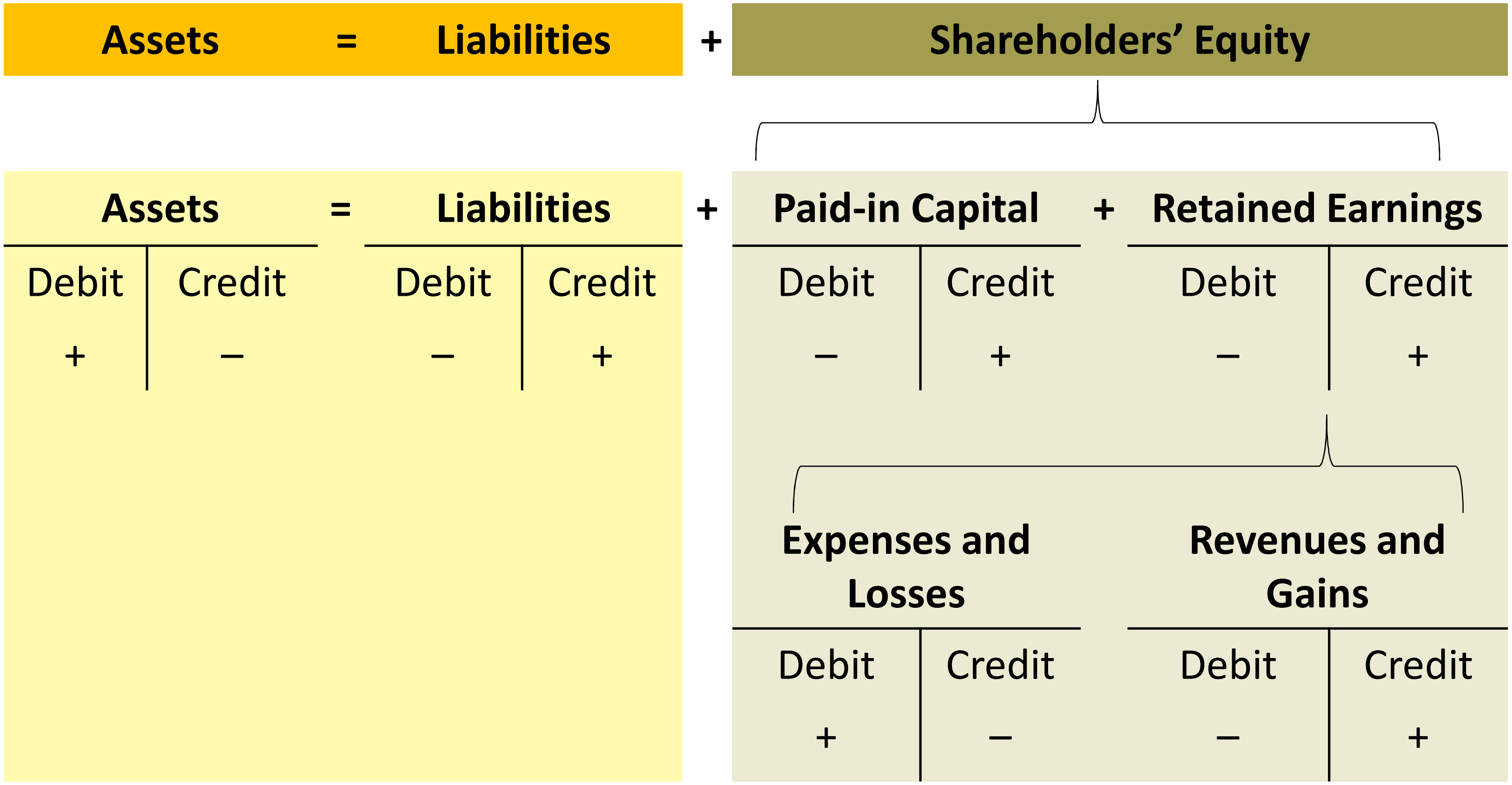
Cash

debit	credit
+ **40,000**	

Note payable

debit	credit
	40,000 +

Accounting Equation, Debits and Credits, Increases and Decreases



Assets = Liabilities + Shareholders' Equity

Assets		Liabilities		Paid-in Capital		Retained Earnings	
Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
+	–	–	+	–	+	–	+

Expenses and Losses		Revenues and Gains	
Debit	Credit	Debit	Credit
+	–	–	+

General Ledger Accounts

- Serve as control accounts
- **Subsidiary accounts:** Maintained in separate subsidiary ledgers. **Example:** Individual account receivable accounts for each of the company's credit customers
- Classified as:

Permanent accounts	• Represent the basic financial position elements (Assets, liabilities, and shareholders' equity)
Temporary accounts	• Represent changes in the RE component of shareholders' equity caused by revenue, expense, gain, and loss transactions • Balances are closed or zeroed out—closing process

Concept Check: Temporary Accounts

Temporary accounts would not include:

a. Salaries expense
[✓ b.] Accounts receivable
c. Rent revenue
d. All of these answers are incorrect

The correct answer is *b*. Accounts receivable is a permanent asset account.

The Steps of the Accounting Processing Cycle

During the accounting period	Step 1	Obtain information about external transactions from **source documents**
	Step 2	**Analyze the transaction**
	Step 3	Record the transaction in a **journal**
	Step 4	**Post** from the journal to the general ledger accounts
At the end of the accounting period	Step 5	Prepare an **unadjusted trial balance**
	Step 6	Record **adjusting entries** and post to the general ledger accounts
	Step 7	Prepare an **adjusted trial balance**
	Step 8	Prepare **financial statements**
At the end of the year	Step 9	**Close** the temporary accounts to retained earnings
	Step 10	Prepare a **post-closing trial balance**

The Accounting Cycle Process: Steps 1 and 2

Step1:

- To *identify* external transactions affecting the accounting equation
- Obtain information about transactions from **source documents**
  - Examples: Sales invoices, bills from suppliers, and cash register tapes
  - Identify the date and nature of each transaction, the participating parties, and the monetary terms

Step 2:

- **Transaction analysis**—The process of reviewing the source documents to determine the dual effect on the accounting equation and the specific elements involved

Transaction 1

1. **An attorney invested $50,000 to open a law office.**

Accounting Equation

Assets	=	Liabilities	+	Owners' Equity
+50,000				+50,000
50,000	=			50,000

Account Entry

Cash

1. 50,000	

Owners' Equity

	50,000 1.

Transaction 2

2. $40,000 was borrowed from a bank and a note payable was signed.

Accounting Equation

Assets	=	Liabilities	+	Owners' Equity
+50,000	=			+50,000
50,000				50,000
+40,000		+40,000		
90,000	=	**40,000**	+	**50,000**

Account Entry

Cash

1.	50,000	
2.	40,000	

Notes Payable

	40,000	2.

Transaction 3

3. Supplies costing $3,000 were purchased on account.

Accounting Equation

Assets	**=**	**Liabilities**	**+**	**Owners' Equity**
+50,000				+50,000
50,000	=			50,000
+40,000		+40,000		
90,000	=	40,000	+	50,000
+3,000		**+3,000**		
93,000	**=**	**43,000**	**+**	**50,000**

Account Entry

Supplies

3.	**3,000**		

Accounts Payable

		3,000	3.

Transaction 4

4. Services were performed on account for $10,000.

Accounting Equation

Assets	**=**	**Liabilities**	**+**	**Owners' Equity**
+50,000				+50,000
50,000	=			50,000
+40,000		+40,000		
90,000	=	40,000	+	50,000
+3,000		+3,000		
93,000	=	43,000	+	50,000
+10,000				**+10,000**
103,000	**=**	**43,000**	**+**	**60,000**

Account Entry

Accounts Receivable

4. **10,000**	

Owners' Equity (Revenue)

	10,000 4.

Transaction 5

5. Salaries of $5,000 were paid to employees.

Accounting Equation

Assets	**=**	**Liabilities**	**+**	**Owners' Equity**
103,000	=	43,000	+	60,000
-5,000				**-5,000**
98,000	**=**	**43,000**	**+**	**55,000**

Account Entry

Cash

1.	50,000	**5,000**	5.
2.	40,000		

Owners' Equity (Salaries Expense)

5.	**5,000**	

Transaction 6

6. $500 of supplies were used.

Accounting Equation

Assets	**=**	**Liabilities**	**+**	**Owners' Equity**
103,000	=	43,000	+	60,000
-5,000				-5,000
98,000	=	43,000	+	55,000
-500				**-500**
97,500	**=**	**43,000**	**+**	**54,500**

Account Entry

Supplies

3.	3,000	**500**	6.

Owners' Equity (Supplies Expense)

6.	**500**	

Transaction 7

7. $1,000 **was paid on account to the supplies vendor.**

Accounting Equation

Assets	=	Liabilities	+	Owners' Equity
103,000	=	43,000	+	60,000
-5,000				-5,000
98,000	=	43,000	+	55,000
-500				-500
97,500	=	43,000	+	54,500
-1,000		-1,000		
96,500	=	**42,000**	+	**54,500**

Account Entry

Cash

1.	50,000	5,000	5.
2.	40,000	1,000	7.

Accounts Payable

7.	1,000	3,000	3.

Step 3: Record the Transaction in a Journal

Journals:

- Provide a chronological record of all economic events affecting a company
- Each entry is expressed in terms of equal debits and credits

Special journal

- Records a repetitive type of transaction
- Example: Sales

General journal

- Any transaction not recorded in a special journal

Example Recording in the Journal

Journal:

- Each entry is expressed in terms of equal debits and credits

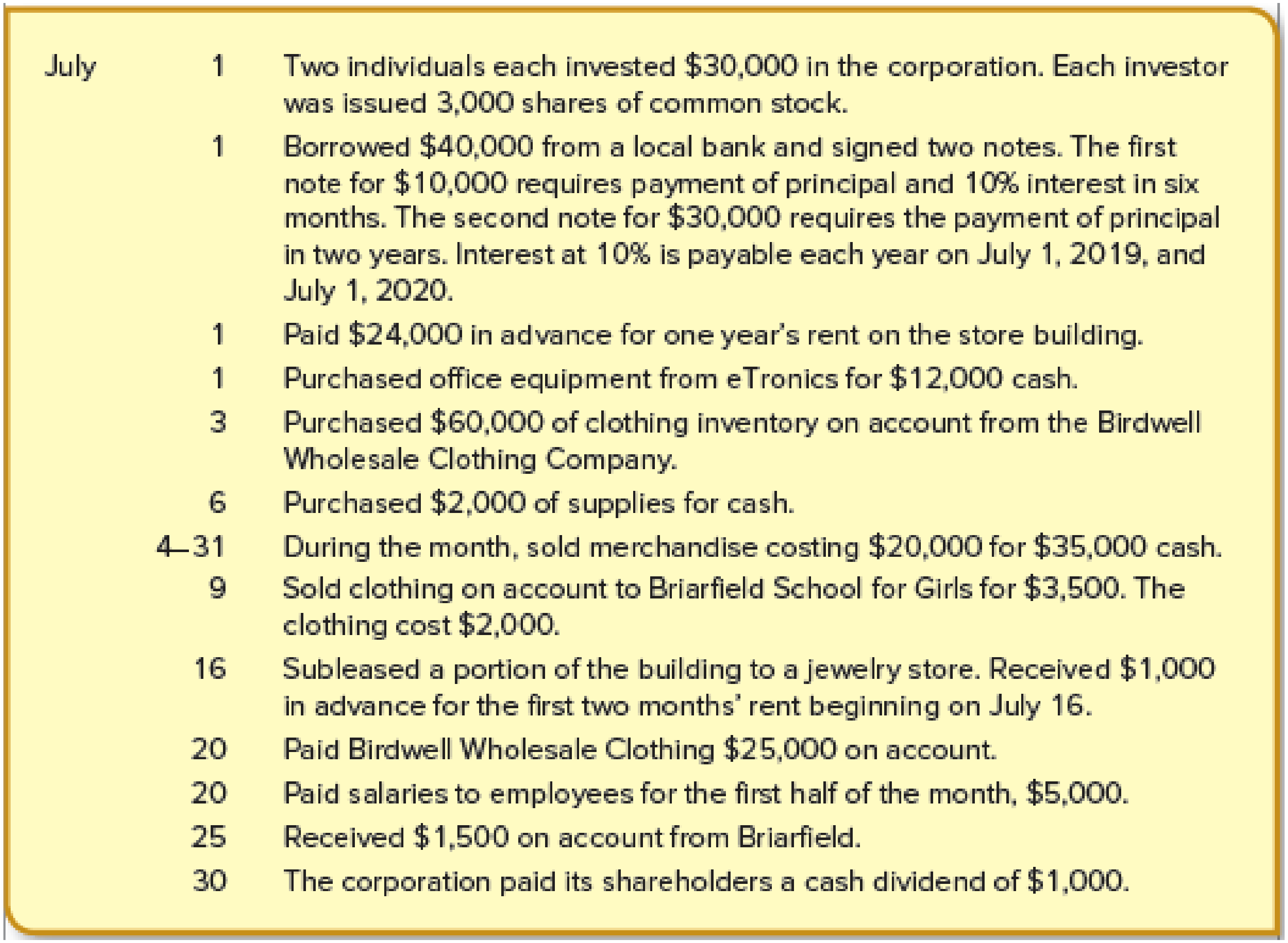
Example:

$40,000 borrowed from a bank by signing a note payable

Journal Entry	Debit	Credit
Cash	40,000	
Notes payable		40,000

LO2-2

External Transactions in 2018



July	1	Two individuals each invested $30,000 in the corporation. Each investor was issued 3,000 shares of common stock.
	1	Borrowed $40,000 from a local bank and signed two notes. The first note for $10,000 requires payment of principal and 10% interest in six months. The second note for $30,000 requires the payment of principal in two years. Interest at 10% is payable each year on July 1, 2019, and July 1, 2020.
	1	Paid $24,000 in advance for one year's rent on the store building.
	1	Purchased office equipment from eTronics for $12,000 cash.
	3	Purchased $60,000 of clothing inventory on account from the Birdwell Wholesale Clothing Company.
	6	Purchased $2,000 of supplies for cash.
	4–31	During the month, sold merchandise costing $20,000 for $35,000 cash.
	9	Sold clothing on account to Briarfield School for Girls for $3,500. The clothing cost $2,000.
	16	Subleased a portion of the building to a jewelry store. Received $1,000 in advance for the first two months' rent beginning on July 16.
	20	Paid Birdwell Wholesale Clothing $25,000 on account.
	20	Paid salaries to employees for the first half of the month, $5,000.
	25	Received $1,500 on account from Briarfield.
	30	The corporation paid its shareholders a cash dividend of $1,000.

Record Investment Transaction in a Journal

July 1

Two individuals each invested $30,000 in the corporation. Each investor was issued 3,000 shares of common stock.

Journal Entry – July 1	**Debit**	**Credit**
Cash	60,000	
Common stock		60,000

Record Borrowing Transaction in a Journal

July 1

Borrowed $40,000 from a local bank and signed two notes. The first note for $10,000 requires payment of principal and 10% interest in six months. The second note for $30,000 requires the payment of principal in two years. Interest at 10% is payable each year on July 1, 2019, and July 1, 2020.

Journal Entry – July 1	Debit	Credit
Cash	40,000	
Notes payable		40,000

LO2-2

Record Rent Prepayment in a Journal

July 1

Paid $24,000 in advance for one year's rent on the store building.

Journal Entry – July 1	Debit	Credit
Prepaid rent	24,000	
Cash		24,000

Record Asset Purchases in a Journal

July 1

Purchased office equipment from eTronics for $12,000 cash.

Journal Entry – July 1	**Debit**	**Credit**
Office equipment	12,000	
Cash		12,000

Record Purchase of Inventory in a Journal

July 3

Purchased $60,000 of clothing inventory on account from the Birdwell Wholesale Clothing Company.

Journal Entry – July 3	Debit	Credit
Inventory	60,000	
Accounts payable		60,000

Record Purchase of Supplies in a Journal

July 6

Purchased $2,000 of supplies for cash.

Journal Entry – July 6	**Debit**	**Credit**
Supplies	2,000	
Cash		2,000

Record Sales for Cash in a Journal

July 4 – 31

During the month, sold merchandise costing $20,000 for $35,000 cash.

Journal Entries – July 4 – 31	Debit	Credit
Cash	35,000	
Sales revenue		35,000
Cost of goods sold (expense)	20,000	
Inventory		20,000

Record Sales on Account in a Journal

July 9

Sold clothing on account to Briarfield School for Girls for $3,500. The clothing cost $2,000.

Journal Entries – July 9	Debit	Credit
Accounts receivable	3,500	
Sales revenue		3,500
Cost of goods sold	2,000	
Inventory		2,000

LO2-2

Additional Consideration—Sales of Inventory

Perpetual inventory system	**Periodic inventory system**
• Inventory and cost of goods sold accounts are continuously updated for purchase, sale, and return of merchandise	• Inventory and cost of goods sold are updated at the end of the reporting period

Record Receipt of Prepaid Rent in a Journal

July 16

Subleased a portion of the building to a jewelry store. Received $1,000 in advance for the first two months' rent beginning on July 16.

Journal Entry – July 16	Debit	Credit
Cash	1,000	
Deferred rent revenue		1,000

Record Payment on Account in a Journal

July 20

Paid Birdwell Wholesale Clothing $25,000 on account.

Journal Entry – July 20	**Debit**	**Credit**
Accounts payable	25,000	
Cash		25,000

Record Payment of Salaries in a Journal

July 20

Paid salaries to employees for the first half of the month, $5,000.

Journal Entry – July 20	**Debit**	**Credit**
Salaries expense	5,000	
Cash		5,000

Record Receipt of Cash on Account in a Journal

July 25

Received $1,500 on account from Briarfield.

Journal Entry – July 25	**Debit**	**Credit**
Cash	1,500	
Accounts receivable		1,500

LO2-2

Record Payment of Dividends in a Journal

July 30

The corporation paid its shareholders a cash dividend of $1,000.

Journal Entry – July 30	Debit	Credit
Retained earnings	1,000	
Cash		1,000

LO2-2

Concept Check: Recording an Expense

Recording an expense for salaries incurred and paid in cash would be recorded by:

a. Debiting a liability

[✓ b.] Debiting an expense

c. Debiting cash

d. Crediting an expense

The correct answer is *b*. When an expense is incurred, it is recorded as a debit to a temporary owners’ equity account, in this case salaries expense.

LO2-2

Concept Check: Recording Common Stock

The journal entry to record the issuance of common stock in exchange for cash involves:

a. A debit to common stock and a credit to cash

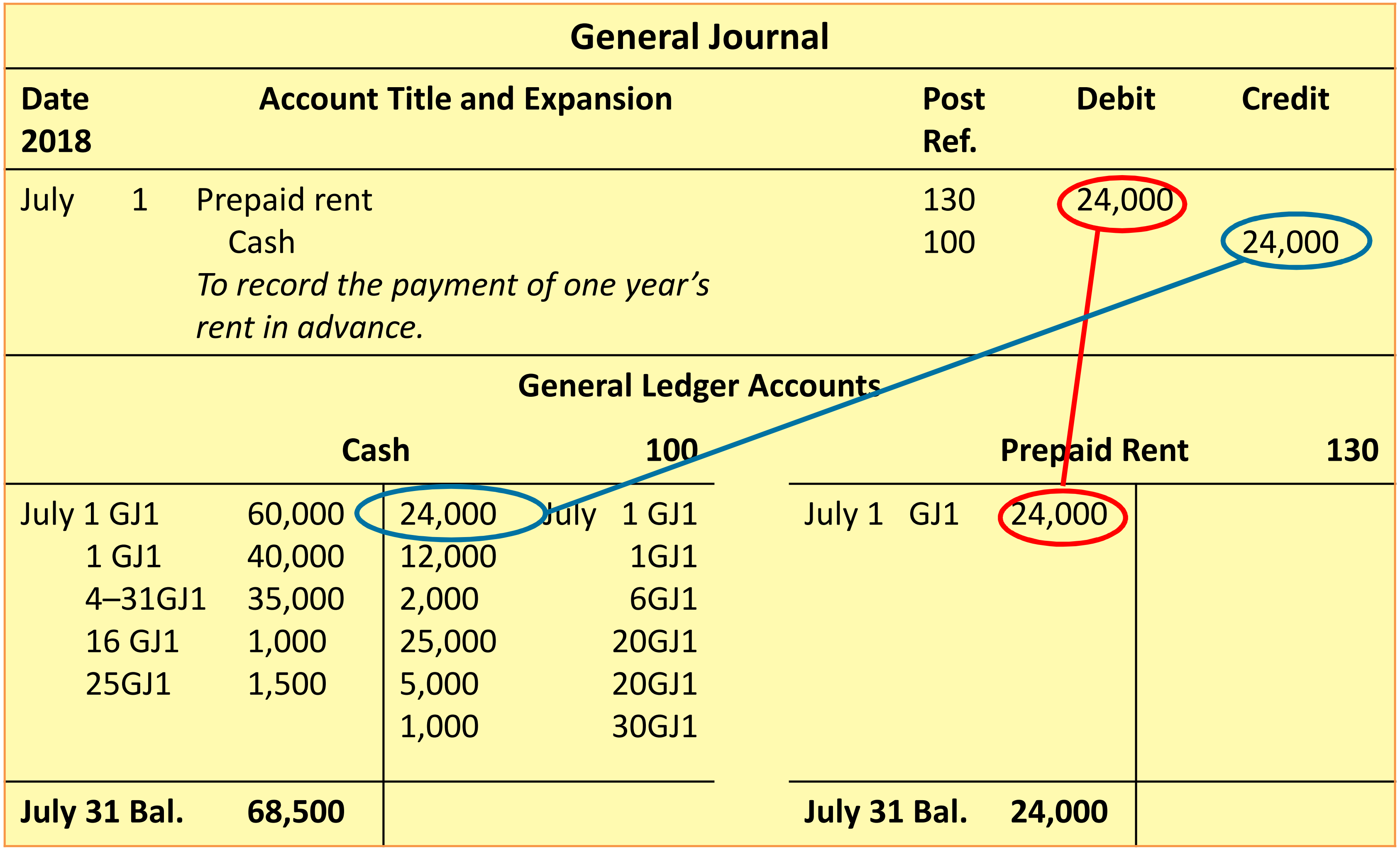
b. A debit to cash and credits to common stock and retained earnings

[✓ c.] A debit to cash and a credit to common stock

d. All of these answer choices are incorrect

The correct answer is *c*. Cash is an asset, so it is increased with a debit and common stock is a permanent equity account, so it is increased with a credit.

Step 4: Posting Example



General Journal

Date 2018		**Account Title and Expansion**	**Post Ref.**	**Debit**	**Credit**
July	1	Prepaid rent	130	24,000	
		Cash	100		24,000
		To record the payment of one year's rent in advance.			

General Ledger Accounts

Cash **100**

July 1 GJ1	60,000	24,000	July 1 GJ1
1 GJ1	40,000	12,000	1GJ1
4–31GJ1	35,000	2,000	6GJ1
16 GJ1	1,000	25,000	20GJ1
25GJ1	1,500	5,000	20GJ1
		1,000	30GJ1
July 31 Bal.	**68,500**		

Prepaid Rent **130**

July 1 GJ1	24,000	
July 31 Bal.	**24,000**	

Step 4: General Ledger Accounts

Balance Sheet Accounts

Cash 100

July GJ1	60,000	24,000	July 1 GJ1
1 GJ1	40,000	12,000	1 GJ1
4-31 GJ1	35,000	2,000	6 GJ1
16 GJ1	1,000	25,000	20 GJ1
25 GJ1	1,500	5,000	20 GJ1
		1,000	30 GJ1
July 31 Bal.	**68,500**		

Prepaid Rent 130

July 1 GJ1	24,000		
July 31 Bal.	**24,000**		

Accounts Receivable 110

July 9 GJ1	3,500	1,500	July 25 GJ1
July 31 Bal.	**2,000**		

Inventory 140

July 3 GJ1	60,000	20,000	July 4–31
		2,000	9 GJ1
July 31 Bal.	**38,000**		

Supplies 125

July 6 GJ1	2,000		
July 31 Bal.	**2,000**		

Office equipment 150

July 1 BJ1	12,000		
July 31 Bal.	**12,000**		

Accounts Payable 210

July 20 GJ1	25,000	60,000	July 3 GJ1
		35,000	**July 31 Bal.**

Notes Payable 220

		40,000	July 1 GJ1
		40,000	**July 31 Bal.**

Deferred Rent Revenue 230

		1,000	July 16 GJ1
		1,000	**July 31 Bal.**

Common Stock 300

		60,000	July 1 GJ1
		60,000	**July 31 Bal.**

Retained Earnings 310

July 30 BJ1	1,000		
July 31 Bal.	**1,000**		

Step 4: Posting from the Journal to the General Ledger Accounts

Income Statement Accounts

Sales Revenue **400**

	35,000	July 4–31 GJ1
	3,500	9 GJ2
	38,500	**July 31 Bal.**

Cost of Goods Sold **500**

July 4–31 GJ2	20,000	
9 GJ1	2,000	
July 31 Bal.	**22,000**	

Salaries Expense **510**

July 20 GJ1	5,000	
July 31 Bal.	**5,000**	

LO2-3

Step 5: Prepare an Unadjusted Trial Balance

Unadjusted trial balance

- List of the general ledger accounts along with their balances
- Purpose:
  - To check for completeness and prove that accounting equation is in balance

Total debit balances = **Total credit balances**

- May contain offsetting errors
- Facilitates the preparation of adjusting entries

Unadjusted Trial Balance

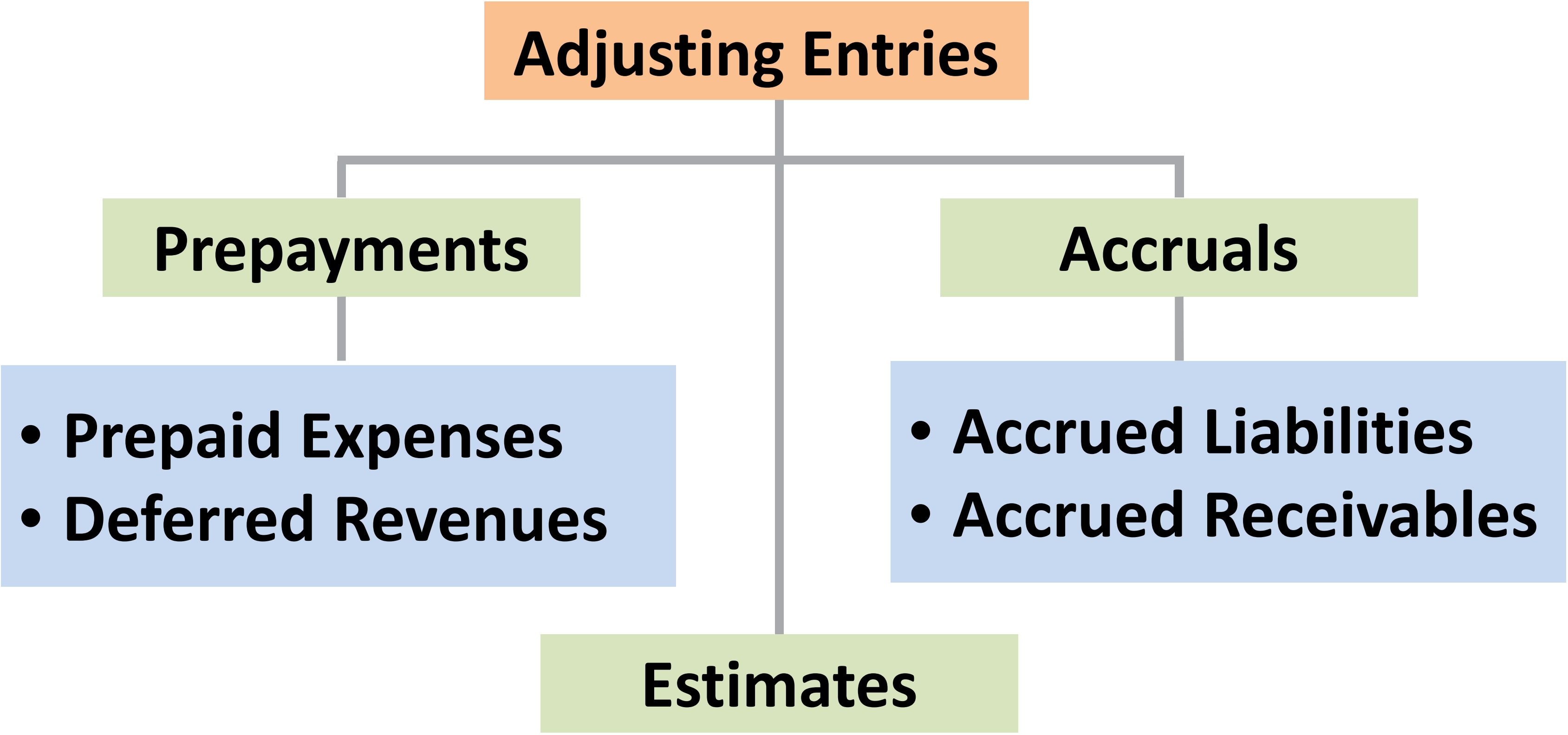
DRESS RIGHT CLOTHING CORPORATION
Unadjusted Trial Balance
July 31, 2018

Account Title	Debits	Credits
Cash	68,500	
Accounts receivable	2,000	
Supplies	2,000	
Prepaid rent	24,000	
Inventory	38,000	
Office equipment	12,000	
Accounts payable		
Notes payable		35,000
Deferred rent revenue		40,000
Common stock		1,000
Retained earnings	1,000	60,000
Sales revenue		
Cost of goods sold		38,500
Salaries expense	22,000	
	5,000	
Totals	174,500	174,500

Step 6: Record Adjusting Entries and Post to the Ledger Accounts

- Record the effect of internal events on the accounting equation
  - Recorded at the end of any period when financial statements are prepared
- **Objective:**
  - To implement the accrual accounting model
    1. To ensure that all revenues are recognized in the period goods or services are transferred to customers
    2. To ensure that all expenses are recognized in the period incurred

Adjusting Entries



Adjusting Entries

Prepayments

- **Prepaid Expenses**
- **Deferred Revenues**

Accruals

- **Accrued Liabilities**
- **Accrued Receivables**

Estimates

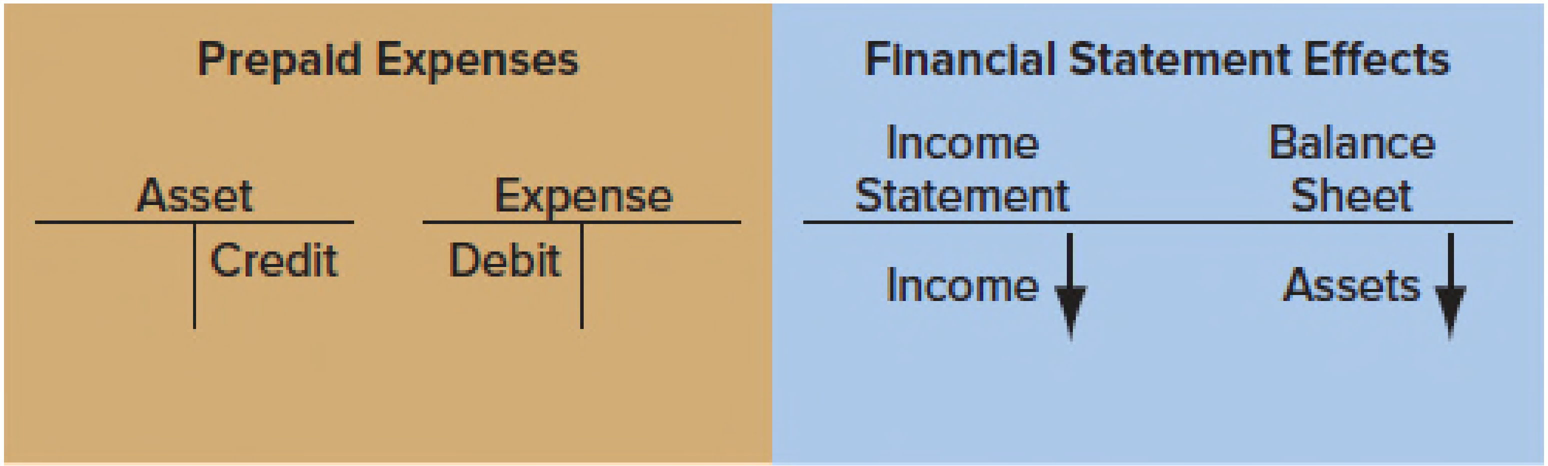
Prepayments

- Occur when the cash ***precedes*** either expense or revenue recognition
- Sometimes referred to as ***deferrals***
- Includes:
  - **Prepaid expenses**
  - **Deferred revenues**

Prepaid Expenses

- Cost of assets *acquired* in one period and *expensed* in a future period

Adjusting entries



Prepaid Expenses

Asset

Credit

Expense

Debit

Financial Statement Effects

Income Statement

Income ↓

Balance Sheet

Assets ↓

Adjustment for Supplies—Prepaid Expense

Example:

The Dress Right Clothing Corporation purchased $2,000 of supplies in July. Assume that Dress Right determines that at the end of July, $1,200 of supplies remain.

Journal Entry – July 31	Debit	Credit
Supplies expense	800	
Supplies		800

Supplies

Beg.bal.	0	
	2,000	**800**
End.bal.	1,200	

Supplies Expense

Beg.bal.	0	
	800	
End.bal.	800	

Adjustment for Prepaid Rent

Example:

At the beginning of July, Dress Right Clothing Corporation paid $24,000 to its landlord representing one year's rent paid in advance.

Journal Entry – July 31	Debit	Credit
Rent expense ($24,000 ÷ 12)	2,000	
Prepaid rent		2,000

Prepaid Rent

Beg.bal.	0	
	24,000	**2,000**
End.bal.	22,000	

Rent Expense

Beg.bal.	0	
	2,000	
End.bal.	2,000	

Adjustment for Long Lived Assets—Depreciation

Example:

Office equipment was purchased during the month of July for $12,000. Assume that its useful life is five years (60 months) and it will be worthless at the end of that period.

Journal Entry – July 31	Debit	Credit
Depreciation expense	200	
Accumulated depreciation—office equipment		200

Contra asset account

12,000 ÷ 60 months

LO2-5

Concept Check: Prepaid Expenses

The correct amount of prepaid insurance shown on a company's December 31, 2018, balance sheet was $1,400. On May 1, 2019, the company paid an additional insurance premium of $1,100. In the December 31, 2019, balance sheet, the amount of prepaid insurance was correctly shown as $1,000. The amount of *insurance expense* that should appear in the company's 2019 income statement is:

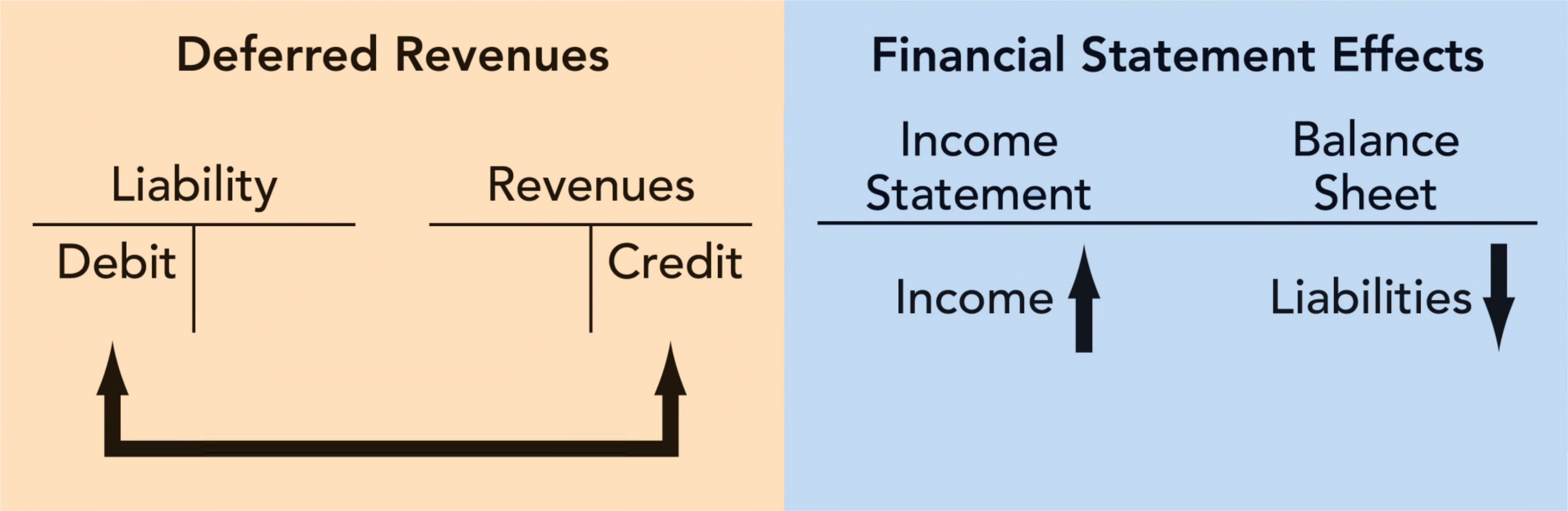
a. $2,000
b. $1,900
[✓ c.] $1,500
d. $1,600

The correct answer is *c*:
[$1,400 (beginning balance) + $1,100 (additional payment) − $1,000 (ending balance)] = **$1,500**

Deferred Revenues

- Cash received from customers in advance of providing a good or service
- Represent a company’s obligation to provide goods or services in the future

Adjusting entries



Deferred Revenue Adjusting Entry

Example:

Dress Right Clothing Corporation subleased space to a jewelry store for $500 per month. On July 16, the jewelry store paid Dress Right $1,000 in advance for the first two months' rent. By the end of July, one half of one month's rent service has been provided.

Journal Entry – July 31	Debit	Credit
Deferred rent revenue	250	
Rent revenue		250

Deferred Rent Revenue

	0	Beg.bal.
250	1,000	
	750	End.bal.

Rent Revenue

	0	Beg.bal.
	250	
	250	End.bal.

LO2-5

Concept Check: Deferred Revenue

The Contra Costa Times Company reported a $17,200 liability in its 2018 balance sheet for subscription revenue received in advance. During 2019, $68,000 was received from customers for subscriptions and the 2019 income statement reported subscription revenue of $69,700. What is the liability amount for deferred subscription revenue that will appear in the 2019 balance sheet?

a. $0
b. $17,200
c. $18,900
[✓ d.] $15,500

The correct answer is *d*:

$17,200 beginning balance
68,000 additional receipts
(69,700) subscription revenue recognized
$15,500

Alternative Approach to Record Prepaid Expenses

Example:

On July 1, 2018, Dress Right paid $24,000 in cash for one year's rent on its building. The company could have debited rent expense, and the adjusting entry records the prepaid rent as of the end of July.

	Journal Entry	Debit	Credit
July 1	Rent expense	24,000	
	Cash		24,000
July 31	Prepaid rent	22,000	
	Rent expense		22,000

Rent Expense

Beg.bal.	0	
	24,000	22,000
End.bal.	2,000	

Prepaid Rent

Beg.bal.	0	
	22,000	
End.bal.	22,000	

Alternative Approach to Deferred Revenues

Example:

Dress Right Clothing Corporation subleased a portion of its building for $500 per month. On July 16, the jewelry store paid Dress Right $1,000 in advance for the first two months' rent.

Journal Entry – July 16		**Debit**	**Credit**
July 16	Cash	1,000	
	Rent revenue		1,000
July 31	Rent revenue	750	
	Deferred rent revenue		750

Rent Revenue

	0	Beg.bal.
750	1,000	
	250	End.bal.

Deferred Rent Revenue

	0	Beg.bal.
	750	
	750	End.bal.

Accruals

- Involve cash flows that occur ***after*** either expense or revenue recognition
- Includes:

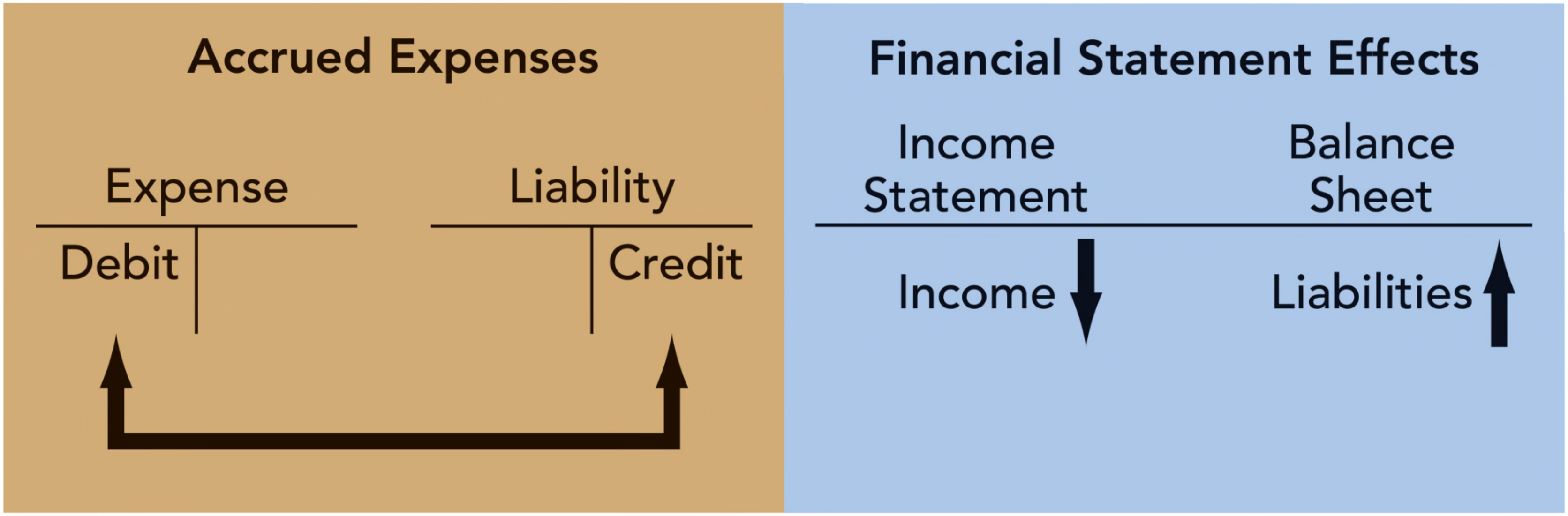
Accrued Liabilities **Accrued Receivables**

- Many accruals involve **external transactions** that automatically are recorded from a source document
- Some accruals involve **internal transactions** and require adjusting entries

Accrued Liabilities

- Represent liabilities recorded when an expense has been incurred prior to cash payment

Adjusting entries



Accrued Expenses

Expense
Debit

Liability
Credit

Financial Statement Effects

Income Statement	Balance Sheet
Income ↓	Liabilities ↑

Accrued Liabilities—Salaries

Example:

On July 20, Dress Right Clothing Corporation paid employees $5,000 for salaries for the first half of the month. Assume that salaries for the second half of July are $5,500 and will be paid in early August.

Journal Entry – July 1	Debit	Credit
Salaries expense	5,500	
Salaries payable		5,500

Salaries Payable

	0	Beg.bal.
	5,500	
	5,550	End.bal.

Salaries Expense

Beg.bal.	0	
July 20	5,000	
	5,500	
End.bal.	10,500	

Accrued Liabilities—Interest Payable

Example:

The unadjusted trial balance of Dress Right reflects a balance in the notes payable account of $40,000. The company borrowed this amount on July 1, 2018, evidenced by two notes, each requiring the payment of 10% interest.

Principal	×	Interest rate	×	Time	=	Interest
$40,000	×	10%	×	$^{1}/_{12}$	=	$333 (rounded)

Journal Entry – July 31	Debit	Credit
Interest expense	333	
Interest payable		333

LO2-5

Concept Check: Interest Expense

Gary’s Grocery borrowed $12,000 at 8% interest on May 1, 2018, with principal and interest due on April 31, 2019. The company’s fiscal year ends December 31. What amount of interest expense would appear in the company’s income statement for the year ended December 31, 2018, related to this loan?

a. $480
[✓ b.] $640
c. $960
d. $560

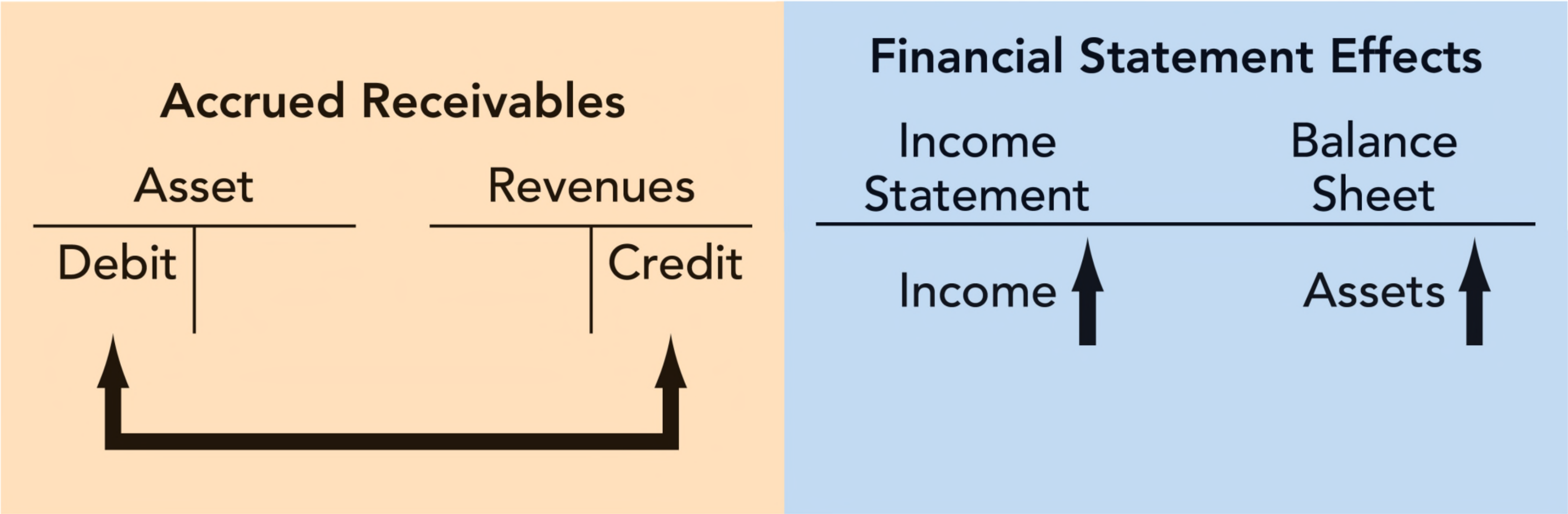
The correct answer is *b*:

$12,000 × 8% × 8/12 = **$640**

Accrued Receivables

- Involve situations when revenue is recognized in a period prior to the cash receipt

Adjusting entries



Accrued Receivables

Asset
Debit

Revenues
Credit

Financial Statement Effects

Income Statement	Balance Sheet
Income ↑	Assets ↑

Accrued Receivables—Interest Revenue

Example:

Assume that Dress Right loaned another corporation $30,000 at the beginning of August. Terms of the note call for the payment of principal, $30,000, and interest at 8% in three months.

Principal	×	Interest rate	×	Time	=	Interest
$30,000	×	8%	×	$^{1}/_{12}$	=	$200

Journal Entry – August 31	Debit	Credit
Interest receivable	200	
Interest revenue		200

Estimates

- Third classification of adjusting entries

Example:

- **Depreciation expense** requires an estimate of:
  - Expected useful life
  - Expected residual value
- **Bad debt expense** requires estimate of:
  - Amount of accounts receivable uncollectible

Step 7: Prepare an Adjusted Trial Balance

Adjusted trial balance

- Trial balance after adjusting entries have been recorded

Step 5

Unadjusted Trial Balance

Step 6

Adjusting Entries

Step 7

Adjusted Trial Balance

LO2-5

Adjusted Trial Balance

DRESS RIGHT CLOTHING CORPORATION
Adjusted Trial Balance
July 31, 2018

Account Title	Debits	Credit
Cash	68,500	
Accounts receivable	2,000	
Supplies	1,200	
Prepaid rent	22,000	
Inventory	38,000	
Office equipment	12,000	
Accumulated depreciation-office equip.		200
Accounts payable		35,000
Notes payable		40,000
Deferred rent revenue		750
Salaries payable		5,500
Interest payable		333
Common stock		60,000
Retained earnings	1,000	
Sales revenue		38,500
Rent revenue		250
Cost of goods sold	22,000	
Salaries expense	10,500	
Supplies expense	800	
Rent expense	2,000	
Depreciation expense	200	
Interest expense	333	
Totals	180,533	180,533

DRESS RIGHT CLOTHING CORPORATION
Unadjusted Trial Balance
July 31, 2018

Account Title	Debits	Credit
Cash	68,500	
Accounts receivable	2,000	
Supplies	2,000	
Prepaid rent	24,000	
Inventory	38,000	
Office equipment	12,000	
Accounts payable		
Notes payable		35,000
Deferred rent revenue		40,000
Common stock		1,000
Retained earnings	1,000	60,000
Sales revenue		
Cost of goods sold		38,500
Salaries expense	22,000	
	5,000	
Totals	174,500	174,500

Step 8: Preparation of Financial Statements

Financial Statements

- Primary means of communicating financial information to external parties

- Income Statement
- Statement of Comprehensive Income
- Balance Sheet
- Statement of Cash Flows
- Statement of Shareholders’ Equity

Income Statement

- A ***change*** statement that reports the change in shareholders' equity (retained earnings) that occurred during the period as a result of revenues, expenses, gains, and losses

Dress Right Clothing Corporation
Income Statement
For the Month of July 2018

Sales revenue		$38,500
Cost of goods sold		22,000
Gross profit		16,500
Operating expenses:		
Salaries	$10,500	
Supplies	800	
Rent	2,000	
Depreciation	200	
Total operating expenses		13,500
Operating income		3,000
Other income (expense):		
Rent revenue	250	
Interest expense	(333)	(83)
Net income		**$ 2,917**

Statement of Comprehensive Income

- Reports the changes in shareholders' equity during the period that were not a result of **transactions with owners**
- A few types of gains and losses, called **other comprehensive income (OCI) or loss** items, are excluded from the determination of net income and the income statement, but are included in the broader concept of comprehensive income
- Can be reported in one of two ways:
  - In a single, continuous statement of comprehensive income
  - Two separate but consecutive statements
    - The first statement is an income statement
    - The second statement, a statement of comprehensive income, begins with net income followed by OCI items to arrive at comprehensive income

Balance Sheet

- Presents the financial position of a company
  - Organized list of assets, liabilities, and shareholders' equity at a point in time
- Classification: according to common characteristics

Current assets

- Cash
- Will be converted into cash
- Will be used up within one year or the operating cycle, whichever is longer

Current liabilities

- Liabilities that will be satisfied within one year or the operating cycle, whichever is longer

Balance Sheet (continued)

Noncurrent assets

- Include property and equipment, long-term receivables, and investments

Long term liabilities

- Include all liabilities not classified as current

Shareholders’ equity

- Lists the paid-in capital portion of equity—common stock—and retained earnings

Balance Sheet Example

DRESS RIGHT CLOTHING CORPORATION
Balance Sheet
At July 31, 2018
Assets

Current assets:		
Cash		$ 68,500
Accounts receivable		2,000
Supplies		1,200
Inventory		38,000
Prepaid rent		22.,000
Total current assets		131,700
Property and equipment:		
Office equipment	$12,000	
Less: Accumulated depreciation	200	11,800
Total assets		$143,500

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable		$35,000
Salaries payable		5,500
Deferred rent revenue		750
Interest payable		333
Note payable		10,000
Total current liabilities		51,583
Long-term liabilities		
Note payable		30,000
Shareholders' equity:		
Common stock, 6,000 shares issued and	$60,000	
outstanding	1,917*	
Retained earnings		61,917
Total shareholders' equity		$143,500
Total liabilities and shareholders' equity		

*Beginning retained earnings + Net income – Dividends
$0 + 2,917 – 1,000 = **$1,917**

Statement of Cash Flows

- Provides information about **cash receipts** and **cash disbursements**
- Cash refers to **cash** plus **cash equivalents**
- Three categories of transactions affecting cash

Operating activities

- Inflows and outflows of cash related to transactions entering into the determination of net income

Investing activities

- Involve the acquisition and sale of (1) long-term assets used in the business and (2) nonoperating investment assets

Financing activities

- Involve cash inflows and outflows from transactions with creditors and owners

Statement of Cash Flows Example

DRESS RIGHT CLOTHING CORPORATION
Statement of Cash Flows
For the Month of July 2018

Cash Flows from Operating Activities		
Cash inflows:		
From customers	$36,500	
From rent	1,000	
Cast outflows:		
For rent	(24,000)	
For supplies	(2,000)	
To suppliers of merchandise	(25,000)	
To employees	(5,000)	
Net cash flows from operating activities		$(18,500)
Cash Flows from Investing Activities		
Purchase of office equipment		(12,000)
Cash Flows from Financing Activities		
Issue of common stock	$60,000	
Increase in notes payable	40,000	
Payment of cash dividend	(1,000)	
Net cash flows from financing activities		99,000
Net increase in cash		$68,500

Statement of Shareholders’ Equity

- Discloses the sources of the changes in the various permanent shareholders’ equity accounts from:
  - Investments by owners
  - Distributions to owners
  - Net income
  - Other comprehensive income

DRESS RIGHT CLOTHING CORPORATION
Statement of Shareholders’ Equity
For the Month of July 2018

	Common Stock	**Retained Earnings**	**Total Shareholders’ Equity**
Balance at July 1, 2018	$ –0–	$ –0–	$ –0–
Issue of common stock	60,000		60,000
Net income for July 2018		**2,917**	2,917
Less: Dividends		(1,000)	(1,000)
Balance at July 31, 2018	$60,000	$1,917	$61,917

Step 9: Closing Process

Serves a ***dual purpose***

(1) Temporary accounts are reduced to zero balances

- To measure activity in the upcoming accounting period
- Revenues and expenses are closed to income summary

(2) Temporary account balances are closed (transferred) to retained earnings

- To reflect the changes that have occurred
- Income summary is closed to retained earnings

Income summary:

A bookkeeping convenience that provides a check that all temporary accounts have been properly closed

Closing Revenue Accounts to Income Summary

- Assume that the fiscal year-end for Dress Right is July 31
  - Using the adjusted trial balance, we prepare the following entry to close revenues to income summary

Journal Entry – July 31	**Debit**	**Credit**
Sales revenue	38,500	
Rent revenue	250	
Income summary		**38,750**

Closing Expense Accounts to Income Summary

- The second closing entry transfers the expense account balances to income summary

Journal Entry – July 31	Debit	Credit
Income summary	35,833	
Cost of goods sold		22,000
Salaries expense		10,500
Supplies expense		800
Rent expense		2,000
Depreciation expense		200
Interest expense		333

Closing Income Summary to Retained Earnings

- The third entry closes the income summary account to retained earnings

Income Summary

Expenses	35,833	38,750	Revenues
		2,917	Net income

Journal Entry – July 31	Debit	Credit
Income summary	2,917	
Retained earnings		2,917

Concept Check: Income Summary

If expenses exceed revenues for the accounting period, the income summary account:

[✓ a.] Will have a debit balance after closing
b. Will have a debit balance prior to closing
c. Will have a credit balance prior to closing
d. All of these answer choices are incorrect

The correct answer is *a*. Revenues are debited to reduce them to zero and the income summary account is **credited**. Expenses are credited to reduce them to zero and the income summary account is **debited**. So, a debit balance in income summary results from expenses for the period exceeding revenues.

Additional Consideration: Closing Dividends

- The journal entry to record a cash dividend:

Journal Entry	Debit	Credit
Dividends	1,000	
Cash		1,000

- The journal entry to close the dividends account into retained earnings:

Journal Entry – July 31	Debit	Credit
Retained earnings	1,000	
Dividends		1,000

Step 10: Prepare a Post-Closing Trial Balance

Prepared at **year-end only** to verify that the closing entries were prepared and posted correctly.

DRESS RIGHT CLOTHING CORPORATION
Post-Closing Trial Balance
July 31, 2018

Account Title	**Debits**	**Credits**
Cash	68,500	
Accounts Receivable	2,000	
Supplies	1,200	
Prepaid rent	22,000	
Inventory	38,000	
Office equipment	12,000	
Accumulated depreciation-office equip.		200
Accounts payable		35,000
Notes payable		40,000
Deferred rent revenue		750
Salaries payable		5,500
Interest payable		333
Common stock		60,000
Retained earnings		1,917
Totals	143,700	143,700

Conversion from Cash Basis to Accrual Basis

Cash basis accounting

- Produces a measure called **net operating cash flow**
- Calculated as: **Cash receipts – Cash disbursements (from operating activities)**

Accrual basis accounting

- Measures an entity's accomplishments and resource sacrifices during the period, regardless of when cash is received or paid

Example One of Conversion from Cash Basis to Accrual Basis

Example:

Suppose a company paid $20,000 cash for insurance during the fiscal year and you determine that there was $5,000 in prepaid insurance at the beginning of the year and $3,000 at the end of the year. You can determine insurance expense for the year.

	Prepaid Insurance
Balance, beginning of year	$ 5,000
Plus: Cash paid	20,000
Less: Insurance expense	(22,000)
Balance, end of year	$ 3,000

Example Two of Conversion from Cash Basis to Accrual Basis

Example:

Suppose a company paid $150,000 for salaries to employees during the year and you determine that there were $12,000 and $18,000 in salaries payable at the beginning and end of the year, respectively.

	Salaries Payable
Balance, beginning of year	**$ 12,000**
Plus: Salaries expense	**156,000**
Less: Cash paid	**(150,000)**
Balance, end of year	**$ 18,000**

Salaries Payable

		12,000	Beg.bal.
Cash paid	150,000		
		156,000	Salaries exp.
		18,000	End.bal.

Salaries Expense

156,000	
156,000	

Example Three of Conversion from Cash Basis to Accrual Basis

Example:

Using T-accounts, assume that the amount of cash collected from customers during the year was $220,000, and you know that accounts receivable at the beginning of the year was $45,000 and $33,000 at the end of the year. Determine the sales revenue.

Accounts Receivable

Beg.bal.	45,000		
Credit sales	**208,000**		
		220,000	Cash collections
End.bal.	33,000		

Sales Revenue

	208,000

Converting Cash Basis to Accrual Basis Income

Converting Cash Basis Income to Accrual Basis Income

	Increases	**Decreases**
Assets	**Add**	**Deduct**
Liabilities	**Deduct**	**Add**

Concept Check: Cash to Accrual Basis

Dan White Draperies maintains its records on a cash basis. During 2018, the company collected $75,000 from customers and paid $21,000 in expenses. Depreciation expense of $8,000 would have been recorded on an accrual basis. Over the course of the year, accounts receivable increased $7,000, prepaid expenses decreased $5,000, and accrued liabilities decreased $4,000. Dan's accrual basis net income was:

a. $41,000

b. $57,000

[✓ c.] $52,000

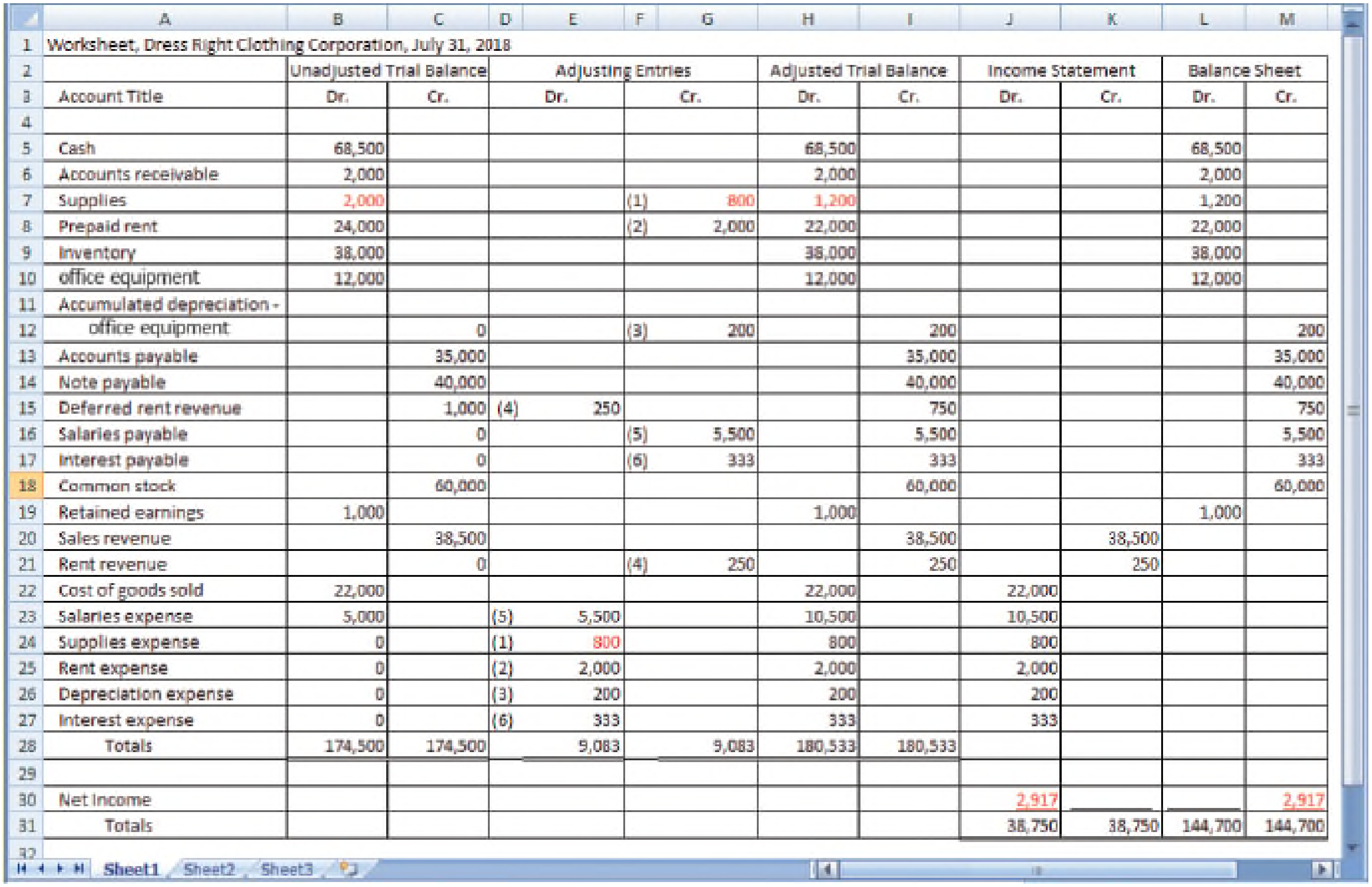
d. $45,000

The correct answer is *c*:

Cash receipts	$75,000
Less cash disbursements	21,000
Cash basis net income	54,000
Deduct: Depreciation expense	(8,000)
Decrease in prepaid expenses	(5,000)
Add: Increase in accounts receivable	7,000
Decrease in accrued liabilities	4,000
Accrual basis net income	**$52,000**

Use of a Worksheet

- Often used to organize the accounting information needed to prepare adjusting and closing entries and the financial statements



	A	B	C	D	E	F	G	H	I	J	K	L	M
1	Worksheet, Dress Right Clothing Corporation, July 31, 2018												
2		Unadjusted Trial Balance		Adjusting Entries				Adjusted Trial Balance		Income Statement		Balance Sheet	
3	Account Title	Dr.	Cr.	Dr.		Cr.		Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
4													
5	Cash	68,500						68,500				68,500	
6	Accounts receivable	2,000						2,000				2,000	
7	Supplies	2,000				(1)	800	1,200				1,200	
8	Prepaid rent	24,000				(2)	2,000	22,000				22,000	
9	Inventory	38,000						38,000				38,000	
10	office equipment	12,000						12,000				12,000	
11	Accumulated depreciation -												
12	office equipment		0			(3)	200		200				200
13	Accounts payable		35,000						35,000				35,000
14	Note payable		40,000						40,000				40,000
15	Deferred rent revenue		1,000	(4)	250				750				750
16	Salaries payable		0			(5)	5,500		5,500				5,500
17	Interest payable		0			(6)	333		333				333
18	Common stock		60,000						60,000				60,000
19	Retained earnings	1,000						1,000				1,000	
20	Sales revenue		38,500						38,500		38,500		
21	Rent revenue		0			(4)	250		250		250		
22	Cost of goods sold	22,000						22,000		22,000			
23	Salaries expense	5,000		(5)	5,500			10,500		10,500			
24	Supplies expense	0		(1)	800			800		800			
25	Rent expense	0		(2)	2,000			2,000		2,000			
26	Depreciation expense	0		(3)	200			200		200			
27	Interest expense	0		(6)	333			333		333			
28	Totals	174,500	174,500		9,083		9,083	180,533	180,533				
29													
30	Net Income									2,917			2,917
31	Totals									38,750	38,750	144,700	144,700
32													

Adjusting Entry to be Reversed

Example:

The following adjusting entry for accrued salaries was prepared for the Dress Right Clothing Corporation to record accrued salaries at the end of July.

Journal Entry – July 31	**Debit**	**Credit**
Salaries expense	5,500	
Salaries payable		5,500

Salaries Expense

Bal. July 31	10,500		

Salaries Payable

		5,500	Bal. July 31
(Cash payment)	5,500		
		–0–	Balance

Reversing Entry

Example:

The following reversing entry for accrued salaries is recorded for accrued salaries at the beginning of August.

Journal Entry – August 1	Debit	Credit
Salaries payable	**5,500**	
Salaries expense		**5,500**

Salaries Expense

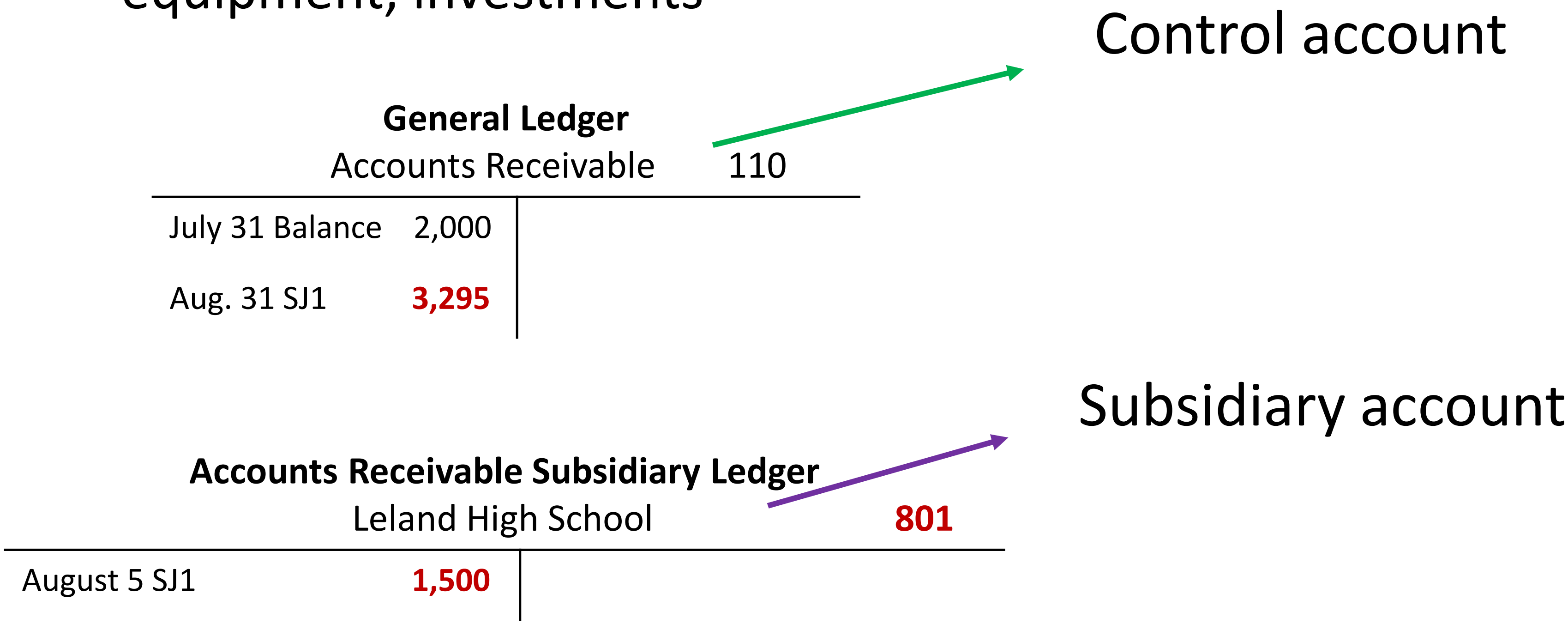
Bal. July 31	10,500	
		5,500
(Cash payment)	5,500	
Balance	10,500	

Salaries Payable

		5,500	Bal. July 31
(Reversing entry)	**5,500**		
		–0–	Balance

Subsidiary Ledger and Control Account Example

- Contain a group of subsidiary accounts associated with a particular general ledger control accounts
  - Accounts receivable, accounts payable, property and equipment, investments



Control account

General Ledger

Accounts Receivable 110

July 31 Balance	2,000	
Aug. 31 SJ1	**3,295**	

Subsidiary account

Accounts Receivable Subsidiary Ledger

Leland High School **801**

August 5 SJ1	**1,500**	

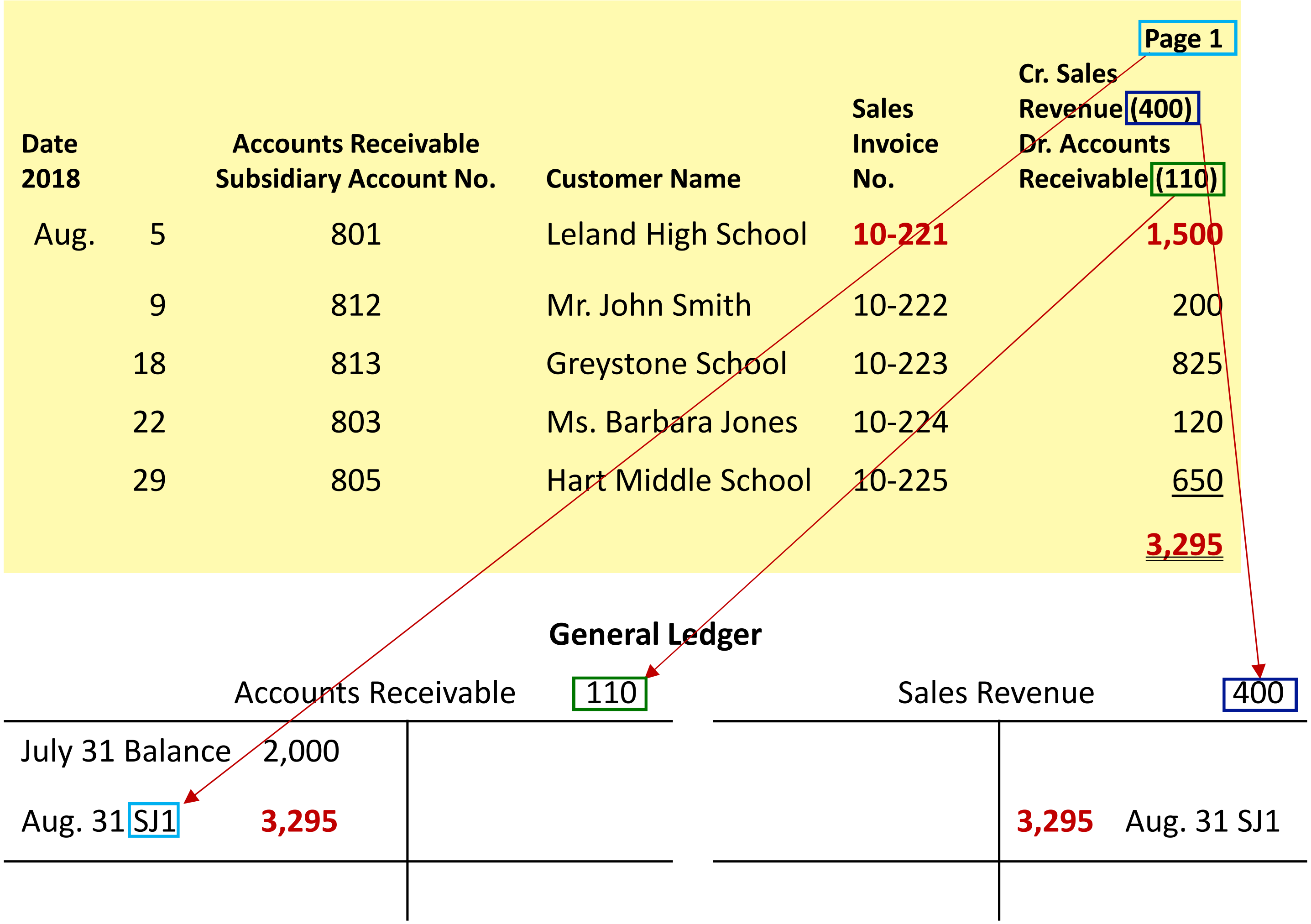
Special Journals

- Used to capture the dual effect of repetitive transactions in debit/credit form
  - Cash receipts journal, cash disbursements journal, sales journal, purchases journal
- Simplify the recording process:
  1. Journalizing is made **more efficient** through the use of specifically designed formats
  2. Individual transactions are not posted to the general ledger accounts, they are accumulated and a summary posting is made periodically
  3. Responsibility for recording entries for repetitive transactions is placed on **individuals with specialized training**

Sales Journal

- Purpose is to record all **credit sales**
  - Cash sales are recorded in the cash receipts journal
- Every entry has the **same effect**
  - Accounts receivable control is debited
  - Sales revenue is credited
  - Only one column needed
- Other columns have information needed for the **accounts receivable subsidiary ledger**

Sales Journal Example



Page 1

Date 2018		**Accounts Receivable Subsidiary Account No.**	**Customer Name**	**Sales Invoice No.**	**Cr. Sales Revenue (400) Dr. Accounts Receivable (110)**
Aug.	5	801	Leland High School	**10-221**	**1,500**
	9	812	Mr. John Smith	10-222	200
	18	813	Greystone School	10-223	825
	22	803	Ms. Barbara Jones	10-224	120
	29	805	Hart Middle School	10-225	650
					3,295

General Ledger

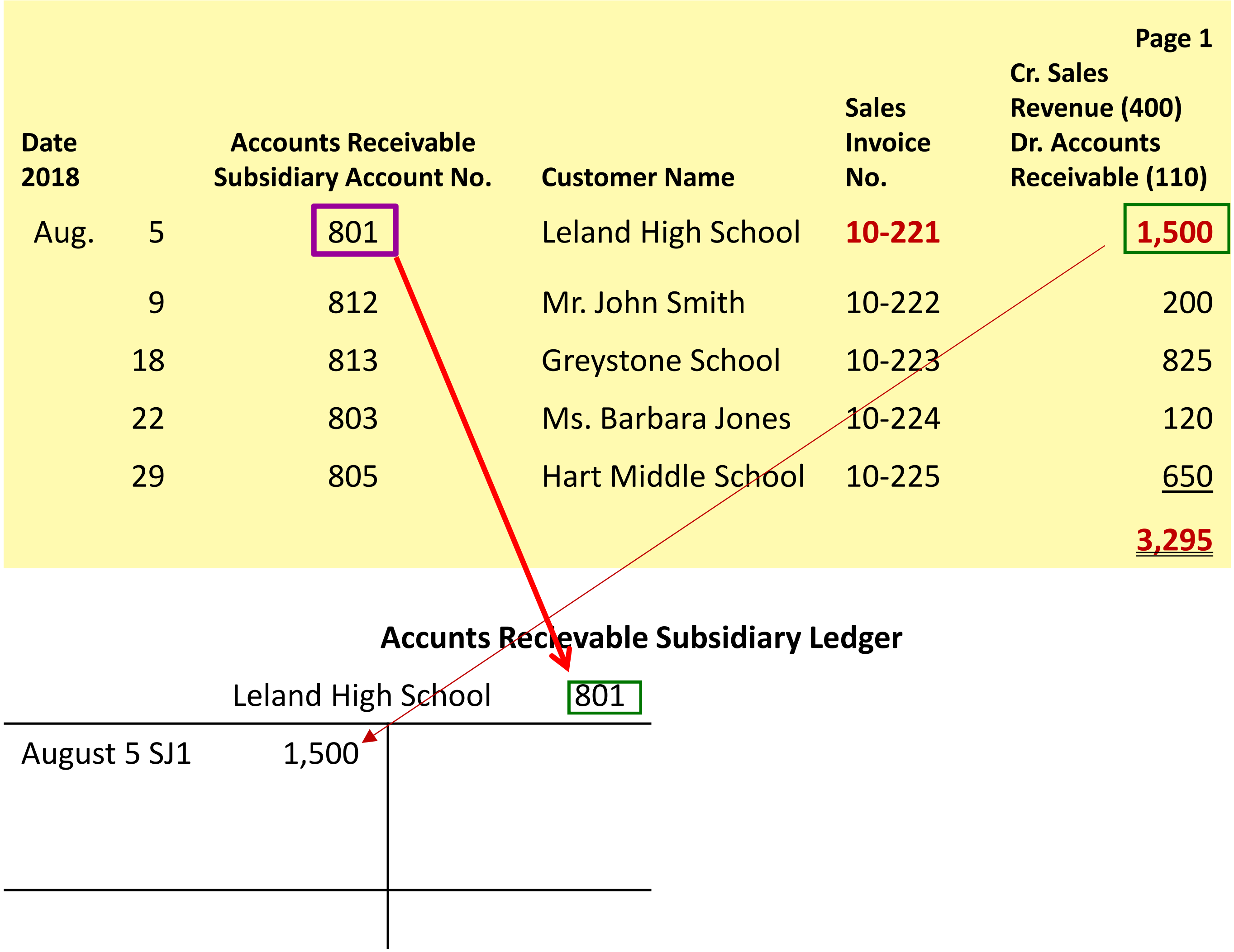
Accounts Receivable 110

July 31 Balance	2,000	
Aug. 31 SJ1	**3,295**	

Sales Revenue 400

	3,295	Aug. 31 SJ1

Sales Journal Example (continued)



Page 1

Date 2018		**Accounts Receivable Subsidiary Account No.**	**Customer Name**	**Sales Invoice No.**	**Cr. Sales Revenue (400) Dr. Accounts Receivable (110)**
Aug.	5	801	Leland High School	**10-221**	**1,500**
	9	812	Mr. John Smith	10-222	200
	18	813	Greystone School	10-223	825
	22	803	Ms. Barbara Jones	10-224	120
	29	805	Hart Middle School	10-225	650
					3,295

Accunts Recievable Subsidiary Ledger

Leland High School		801
August 5 SJ1	1,500	

Cash Receipts Journal

- Purpose is to record all **cash receipts**, regardless of the source
- Every transaction recorded here produces a **debit to the cash account**
    - Credit to various accounts
    - Column keeps track of the various accounts
- If an entry uses the accounts receivable column, a **credit is posted to the accounts receivable subsidiary ledger** for that customer

Cash Receipts Journal Example

Page 1

Date 2018	Explanation or Account Name	Dr. Cash (100)	Cr. Accounts Receivable (110)	Cr. Sales Revenue (400)	Cr. Other	Other Accounts
Aug. 7	Cash sale	500		500		
11	Borrowed cash	10,000			**10,000**	Note payable (220)
17	Leland High School	**750**	750			
20	Cash sale	300		300		
25	Mr. John Smith	200	200			
		11,750	**950**	**800**	**10,000**	

Accounts Receivable Subsidiary Ledger

Leland High School **801**

August 5 SJ1	**1,500**		
		750	August 17 CR1

End of Chapter 2

Chapter 2 – Review of the Accounting Process

		Click on links
Exercise 2-01	Transaction analysis	Exercise 2-01
Exercise 2-02	Journal entries	Exercise 2-02
Exercise 2-03	T-accounts and trial balance	Exercise 2-03
Exercise 2-04	Journal Entries	Exercise 2-04
Exercise 2-08	Adjusting Entries	Exercise 2-08
Exercise 2-11	Adjusting entries	Exercise 2-11
Exercise 2-12	Financial statements and closing entries	Exercise 2-12
Exercise 2-13	Closing entries	Exercise 2-13
Exercise 2-15	Cash versus accrual accounting; adjusting entries	Exercise 2-15
Exercise 2-16	External transactions and adjusting entries	Exercise 2-16
Exercise 2-18	Cash versus accrual accounting	Exercise 2-18
Exercise 2-20	Worksheet	Exercise 2-20
Exercise 2-21	Reversing entries	Exercise 2-21

Exercise 2-1

The following transactions occurred during March year 1 for the Plare Corporation. The company owns and operates a wholesale warehouse.

1. Issued 32,500 shares of common stock in exchange for $325,000 in cash.
2. Purchased equipment at a cost of $36,000. $12,100 cash was paid and a note payable was signed for the balance owed.
3. Purchased inventory on account at a cost of $97,000. The company uses the perpetual inventory system.
4. Credit sales for the month totaled $150,000. The cost of the goods sold was $75,445.
5. Paid $4,000 in rent on the warehouse building for the month of March.
6. Paid $5,100 to an insurance company for fire and liability insurance for a one-year period beginning April 1, year 1.
7. Paid $75,000 on account for the merchandise purchased in 3.
8. Collected $68,750 from customers on account.
9. Recorded depreciation expense of $1,100 for the month on the equipment.

Required:

Analyze each transaction and show the effect of each on the accounting equation for a corporation.

1. Issued 32,500 shares of common stock in exchange for $325,000 in cash.

	Assets		=	Liabilities	+	Stockholders' Equity	
1.	Cash	+325,000	=		+	Common Stock	+325,000

2. Purchased equipment at a cost of $36,000. $12,100 cash was paid and a note payable was signed for the balance owed.

	Assets		=	Liabilities		+	Stockholders' Equity	
1.	Cash	+325,000	=			+	Common Stock	+325,000
2.	Equipment Cash	+36,000 −12,100	=	Notes Payable	+23,900			

3. Purchased inventory on account at a cost of $97,000. The company uses the perpetual inventory system.

	Assets		**=**	**Liabilities**		**+**	**Stockholders’ Equity**	
1.	Cash	+325,000	=			+	Common Stock	+325,000
2.	Equipment Cash	+36,000 –12,100	=	Notes Payable	+23,900			
3.	Merchandise Inventory	+97,000	=	Accounts Payable	+97,000			

4. Credit sales for the month totaled $150,000. The cost of the goods sold was $75,445.

	Assets		**=**	**Liabilities**		**+**	**Stockholders’ Equity**	
1.	Cash	+325,000	=			+	Common Stock	+325,000
2.	Equipment Cash	+36,000 –12,100	=	Notes Payable	+23,900			
3.	Merchandise Inventory	+97,000	=	Accounts Payable	+97,000			
4.	Accounts Receivable Merchandise Inventory	+150,000 –75,445	=			+	Sales Cost of Goods Sold	+150,000 –75,445

5. Paid $4,400 in rent on the warehouse building for the month of March.

	Assets		=	Liabilities		+	Stockholders’ Equity	
1.	Cash	+325,000	=			+	Common Stock	+325,000
2.	Equipment	+36,000	=	Notes Payable	+23,900			
	Cash	–12,100						
3.	Merchandise Inventory	+97,000	=	Accounts Payable	+97,000			
4.	Accounts Receivable	+150,000	=			+	Sales	+150,000
	Merchandise Inventory	–75,445					Cost of Goods Sold	–75,445
5.	Cash	–4,400	=			+	Rent Expense	–4,400

6. Paid $5,100 to an insurance company for fire and liability insurance for a one-year period beginning April 1, year 1.

	Assets		**=**	**Liabilities**		**+**	**Stockholders' Equity**	
1.	Cash	+325,000	=			+	Common Stock	+325,000
2.	Equipment Cash	+36,000 –12,100	=	Notes Payable	+23,900			
3.	Merchandise Inventory	+97,000	=	Accounts Payable	+97,000			
4.	Accounts Receivable Merchandise Inventory	+150,000 –75,445	=			+	Sales Cost of Goods Sold	+150,000 –75,445
5.	Cash	–4,400	=			+	Rent Expense	–4,400
6.	Prepaid Insurance Cash	+5,100 –5,100						

7. Paid $75,000 on account for the merchandise purchased in 3.

	Assets		**=**	**Liabilities**		**+**	**Stockholders' Equity**	
1.	Cash	+325,000	=			+	Common Stock	+325,000
2.	Equipment	+36,000	=	Notes Payable	+23,900			
	Cash	–12,100						
3.	Merchandise Inventory	+97,000	=	Accounts Payable	+97,000			
4.	Accounts Receivable	+150,000	=			+	Sales	+150,000
	Merchandise Inventory	–75,445					Cost of Goods Sold	–75,445
5.	Cash	–4,400	=			+	Rent Expense	–4,400
6.	Prepaid Insurance	+5,100						
	Cash	–5,100						
7.	Cash	–75,000	=	Accounts Payable	–75,000			

8. Collected $68,750 from customers on account.

	Assets		=	Liabilities		+	Stockholders' Equity	
1.	Cash	+325,000	=			+	Common Stock	+325,000
2.	Equipment Cash	+36,000 –12,100	=	Notes Payable	+23,900			
3.	Merchandise Inventory	+97,000	=	Accounts Payable	+97,000			
4.	Accounts Receivable Merchandise Inventory	+150,000 –75,445	=			+	Sales Cost of Goods Sold	+150,000 –75,445
5.	Cash	–4,400	=			+	Rent Expense	–4,400
6.	Prepaid Insurance Cash	+5,100 –5,100						
7.	Cash	–75,000	=	Accounts Payable	–75,000			
8.	Cash Accounts Receivable	+68,750 –68,750						

9. Recorded depreciation expense of $1,000 for the month on the equipment.

	Assets		**=**	**Liabilities**		**+**	**Stockholders' Equity**	
1.	Cash	+325,000	=			+	Common Stock	+325,000
2.	Equipment	+36,000	=	Notes Payable	+23,900			
	Cash	–12,100						
3.	Merchandise Inventory	+97,000	=	Accounts Payable	+97,000			
4.	Accounts Receivable	+150,000	=			+	Sales	+150,000
	Merchandise Inventory	–75,445					Cost of Goods Sold	–75,445
5.	Cash	–4,400	=			+	Rent Expense	–4,400
6.	Prepaid Insurance	+5,100						
	Cash	–5,100						
7.	Cash	–75,000	=	Accounts Payable	–75,000			
8.	Cash	+68,750						
	Accounts Receivable	–68,750						
9.	Accumulated Depr.–Equipment	–1,100	=			+	Depr. Expense – Equipment	–1,100

Exercise 2-2

The following transactions occurred during March year 1 for the Plare Corporation. The company owns and operates a wholesale warehouse.

1. Issued 32,500 shares of common stock in exchange for $325,000 in cash.
2. Purchased equipment at a cost of $36,000. $12,100 cash was paid and a note payable was signed for the balance owed.
3. Purchased inventory on account at a cost of $97,000. The company uses the perpetual inventory system.
4. Credit sales for the month totaled $150,000. The cost of the goods sold was $75,445.
5. Paid $4,400 in rent on the warehouse building for the month of March.
6. Paid $5,100 to an insurance company for fire and liability insurance for a one-year period beginning April 1, year 1.
7. Paid $75,000 on account for the merchandise purchased in 3.
8. Collected $68,750 from customers on account.
9. Recorded depreciation expense of $1,100 for the month on the equipment.

Required:

Prepare journal entries to record each of the transactions above.

1. Issued 32,500 shares of common stock in exchange for $325,000 in cash.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000

2. Purchased equipment at a cost of $36,000. $12,100 cash was paid and a note payable was signed for the balance owed.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900

3. Purchased inventory on account at a cost of $97,000. The company uses the perpetual inventory system.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900
3.	Merchandise inventory	97,000	
	Accounts payable		97,000

4. Credit sales for the month totaled $150,000. The cost of the goods sold was $75,445.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900
3.	Merchandise inventory	97,000	
	Accounts payable		97,000
4.	Accounts receivable	150,000	
	Sales		150,000
	Cost of goods sold	75,445	
	Merchandise inventory		75,445

MM1

5. Paid $4,400 in rent on the warehouse building for the month of March.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900
3.	Merchandise inventory	97,000	
	Accounts payable		97,000
4.	Accounts receivable	150,000	
	Sales		150,000
	Cost of goods sold	75,445	
	Merchandise inventory		75,445
5.	Rent expense	4,400	
	Cash		4,400

Slide 19

MM1 'Rent expense' appears to be slightly lower than the 5. and the 4,400.

McCarthy, Mark, 12/12/2014

6. Paid $5,100 to an insurance company for fire and liability insurance for a one-year period beginning April 1, Year 1.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900
3.	Merchandise inventory	97,000	
	Accounts payable		97,000
4.	Accounts receivable	150,000	
	Sales		150,000
	Cost of goods sold	75,445	
	Merchandise inventory		75,445
5.	Rent expense	4,400	
	Cash		4,400
6.	Prepaid insurance	5,100	
	Cash		5,100

7. Paid $75,000 on account for the merchandise purchased in 3.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900
3.	Merchandise inventory	97,000	
	Accounts payable		97,000
4.	Accounts receivable	150,000	
	Sales		150,000
	Cost of goods sold	75,445	
	Merchandise inventory		75,445
5.	Rent expense	4,400	
	Cash		4,400
6.	Prepaid insurance	5,100	
	Cash		5,100
7.	Accounts payable	75,000	
	Cash		75,000

8. Collected $68,750 from customers on account.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900
3.	Merchandise inventory	97,000	
	Accounts payable		97,000
4.	Accounts receivable	150,000	
	Sales		150,000
	Cost of goods sold	75,445	
	Merchandise inventory		75,445
5.	Rent expense	4,400	
	Cash		4,400
6.	Prepaid insurance	5,100	
	Cash		5,100
7.	Accounts payable	75,000	
	Cash		75,000
8.	Cash	68,750	
	Accounts receivable		68,750

9. Recorded depreciation expense of $1,100 for the month on the equipment.

PLARE CORPORATION
General Journal

Date	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900
3.	Merchandise inventory	97,000	
	Accounts payable		97,000
4.	Accounts receivable	150,000	
	Sales		150,000
	Cost of goods sold	75,445	
	Merchandise inventory		75,445
5.	Rent expense	4,400	
	Cash		4,400
6.	Prepaid insurance	5,100	
	Cash		5,100
7.	Accounts payable	75,000	
	Cash		75,000
8.	Cash	68,750	
	Accounts receivable		68,750
9.	Depreciation expense	1,100	
	Accumulated depr.—equipment		1,100

Exercise 2-3

Post the below journal entries prepared in to T-accounts. Assume that the opening balances in each of the accounts is zero. Prepare a trial balance from the ending account balances.

KWITZ CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Notes payable		23,900
3.	Inventory	97,000	
	Accounts payable		97,000
4.	Accounts receivable	150,000	
	Sales		150,000
	Cost of goods sold	75,445	
	Inventory		75,445
5.	Rent expense	4,400	
	Cash		4,400
6.	Prepaid insurance	5,100	
	Cash		5,100
7.	Accounts payable	75,000	
	Cash		75,000
8.	Cash	68,750	
	Accounts receivable		68,750
9.	Depreciation expense	1,100	
	Accumulated depreciation		1,100

KWITZ CORPORATION
General Journal

	Account Title and Explanation	Debit	Credit
1.	Cash	325,000	
	Common stock		325,000
2.	Equipment	36,000	
	Cash		12,100
	Note payable		23,900
3.	inventory	97,000	
	Accounts payable		97,000
4.	Accounts receivable	150,000	
	Sales		150,000
	Cost of goods sold	75,445	
	inventory		75,445
5.	Rent expense	4,400	
	Cash		4,400
6.	Prepaid insurance	5,100	
	Cash		5,100
7.	Accounts payable	75,000	
	Cash		75,000
8.	Cash	68,750	
	Accounts receivable		68,750
9.	Depreciation expense	1,100	
	Accumulated depreciation		1,100

Cash	
1) 325,000	
	2) 12,100
	5) 4,400
	6) 5,100
	7) 75,000
8) 68,750	
Bal. 297,150	

Common Stock	
	1) 325,000
	Bal. 325,000

Equipment	
2) 36,000	
Bal. 36,000	

Depreciation Expense	
9) 1,100	
Bal. 1,100	

Note Payable	
	2) 23,900
	Bal. 23,900

Inventory	
3) 97,000	
	4) 75,445
Bal. 21,555	

Accounts Payable	
	3) 97,000
7) 75,000	
	Bal. 22,000

Prepaid Insurance	
6) 5,100	
Bal. 5,100	

Accumulated Depreciation	
	9) 1,100
	Bal. 1,100

Accounts Receivable	
4) 150,000	
	8) 68,750
Bal. 81,250	

Sales	
	4) 150,000
	Bal. 150,000

Cost of Goods Sold	
4) 75,445	
Bal. 75,445	

Rent Expense	
5) 4,400	
Bal. 4,400	

KWITZ CORPORATION
Trial Balance
March 31, year 1

	Debit	Credit
Cash	$297,150	
Accounts receivable	81,250	
Inventory	21,555	
Prepaid insurance	5,100	
Equipment	36,000	
Accumulated depreciation		$ 1,100
Accounts payable		22,000
Notes payable		23,900
Common stock		325,000
Sales		150,000
Cost of goods sold	75,445	
Rent expense	4,400	
Depreciation expense	1,100	
	$522,000	$522,000

Accounts Receivable

4) 150,000	
	8) 68,750
Bal. 81,250	

Cost of Goods Sold

4) 75,445	
Bal. 75,445	

Cash

1) 325,000	
	2) 12,100
	5) 4,400
	6) 5,100
	7) 75,000
8) 68,750	
Bal. 297,150	

Common Stock

	1) 325,000
	Bal. 325,000

Equipment

2) 36,000	
Bal. 36,000	

Depreciation Expense

9) 1,100	
Bal. 1,100	

Accumulated Depreciation

	9) 1,100
	Bal. 1,100

Note Payable

	2) 23,900
	Bal. 23,900

Inventory

3) 97,000	
	4) 75,445
Bal. 21,555	

Accounts Payable

	3) 97,000
7) 75,000	
	Bal. 22,000

Prepaid Insurance

6) 5,100	
Bal. 5,100	

Rent Expense

5) 4,400	
Bal. 4,400	

Sales

	4) 150,000
	Bal. 150,000

Exercise 2-4

The following transactions occurred during the month of January Year 1 for the FNA Corporation. The company owns and operates a retail shoe store.

1. Issued 1,000 shares of common stock in exchange for $5,500 cash.
2. Purchased furniture and fixtures at a cost of $6,000. $4,000 was paid in cash and a note payable was signed for the balance owed.
3. Purchased inventory on account at a cost of $2,500. The company uses the perpetual inventory system.
4. Credit sales for the month totaled $3,000. The cost of the goods sold was $2,200.
5. Paid $1,000 in rent on the store building for the month of January.
6. Paid $370 to an insurance company for fire and liability insurance for a one-year period beginning January 1, Year 1.
7. Paid $2,500 on account for the merchandise purchased in 3.
8. Collected $3,100 from customers on account.
9. Paid shareholders a cash dividend of $600.
10. Recorded depreciation expense of $120 for the month on the furniture and fixtures.
11. Recorded the amount of prepaid insurance that expired for the month.

Required:

1. Prepare journal entries to record each of the transactions and events listed above.

1. Issued 1,000 shares of common stock in exchange for $5,500 cash.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Cash	5,500	
	Common stock		5,500

2. Purchased furniture and fixtures at a cost of $6,000. $4,000 was paid in cash and a note payable was signed for the balance owed.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Cash	5,500	
	Common stock		5,500
2.	Furniture	6,000	
	Cash		4,000
	Notes payable		2,000

3. Purchased inventory on account at a cost of $2,500. The company uses the perpetual inventory system.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Cash	5,500	
	Common stock		5,500
		6,000	
2.	Furniture		
	Cash		4,000
	Notes payable		2,000
3.	Inventory	2,500	
	Accounts payable		2,500

4. Credit sales for the month totaled $3,000. The cost of the goods sold was $2,200.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Cash	5,500	
	Common stock		5,500
2.	Furniture	6,000	
	Cash		4,000
	Notes payable		2,000
3.	Inventory	2,500	
	Accounts payable		2,500
4.	Accounts receivable	3,000	
	Sales		3,000
	Cost of goods sold	2,200	
	Inventory		2,200

5. Paid $1,000 in rent on the store building for the month of January.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Cash	5,500	
	Common stock		5,500
2.	Furniture	6,000	
	Cash		4,000
	Notes payable		2,000
3.	Inventory	2,500	
	Accounts payable		2,500
4.	Accounts receivable	3,000	
	Sales		3,000
	Cost of goods sold	2,200	
	Inventory		2,200
5.	Rent expense	1,000	
	Cash		1,000

6. Paid $370 to an insurance company for fire and liability insurance for a one-year period beginning January 1, Year 1.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
6.	Prepaid insurance	370	
	Cash		370

7. Paid $2,500 on account for the merchandise purchased in 3.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
6.	Prepaid insurance	370	
	Cash		370
7.	Accounts payable	2,500	
	Cash		2,500

8. Collected $3,100 from customers on account.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
6.	Prepaid insurance	370	
	Cash		370
7.	Accounts payable	2,500	
	Cash		2,500
8.	Cash	3,100	
	Accounts receivable		3,100

9. Paid shareholders a cash dividend of $600.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
6.	Prepaid insurance	370	
	Cash		370
7.	Accounts payable	2,500	
	Cash		2,500
8.	Cash	3,100	
	Accounts receivable		3,100
9.	Retained earnings	600	
	Cash		600

10. Recorded depreciation expense of $120 for the month on the furniture and fixtures.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
6.	Prepaid insurance	370	
	Cash		370
7.	Accounts payable	2,500	
	Cash		2,500
8.	Cash	3,100	
	Accounts receivable		3,100
9.	Retained earnings	600	
	Cash		600
10.	Depreciation expense	120	
	Accumulated depreciation		120

11. Recorded the amount of prepaid insurance that expired for the month.

FNA CORPORATION
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
6.	Prepaid insurance	370	
	Cash		370
7.	Accounts payable	2,500	
	Cash		2,500
8.	Cash	3,100	
	Accounts receivable		3,100
9.	Retained earnings	600	
	Cash		600
10.	Depreciation expense	120	
	Accumulated depreciation		120
11.	Insurance expense ($370 ÷ 12 months)	31	
	Prepaid insurance		31

Exercise 2-8

Prepare the necessary adjusting entries at December 31, Year 1, for the Velto Company for each of the following situations. Assume that no financial statements were prepared during the year and no adjusting entries were recorded.

1. A two-year fire insurance policy was purchased on July 1, Year 1, for $10,000. The company debited insurance expense for the entire amount.
2. Depreciation on equipment totaled $12,000 for the year.
3. Employee salaries of $20,000 for the month of December will be paid in early January Year 2.
4. On October 1, Year 1, the company borrowed $220,000 from a bank. The note requires principal and interest at 12% to be paid on April 30, Year 2.
5. On December 1, Year 1, the company received $2,400 in cash from another company that is renting office space in Velto's building. The payment, representing rent for December and January, was credited to deferred rent revenue.

1. A two-year fire insurance policy was purchased on July 1, Year 1, for $10,000. The company debited insurance expense for the entire amount.

VELTO COMPANY
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
July 1	Insurance expense	10,000	
	Cash		10,000
Dec. 31	Prepaid insurance ($10,000 × (18/24))	7,500	
	Insurance expense		7,500

2. Depreciation on equipment totaled $12,000 for the year.

VELTO COMPANY
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Prepaid insurance ($10,000 × (18/24))	7,500	
	Insurance expense		7,500
2.	Depreciation expense	12,000	
	Accumulated depreciation		12,000

3. Employee salaries of $20,000 for the month of December will be paid in early January Year 2.

VELTO COMPANY
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Prepaid insurance ($10,000 × (18/24))	7,500	
	Insurance expense		7,500
2.	Depreciation expense	12,000	
	Accumulated depreciation		12,000
3.	Salaries expense	20,000	
	Salaries payable		20,000

4. On October 1, Year 1, the company borrowed $220,000 from a bank. The note requires principal and interest at 12% to be paid on April 30, Year 2.

VELTO COMPANY
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Prepaid insurance ($10,000 × (18/24))	7,500	
	Insurance expense		7,500
2.	Depreciation expense	12,000	
	Accumulated depreciation		12,000
3.	Salaries expense	20,000	
	Salaries payable		20,000
4.	Interest expense ($220,000 × 12% × 3/12)	6,600	
	Interest payable		6,600

5. On December 1, Year 1, the company received $2,400 in cash from another company that is renting office space in Velto's building. The payment, representing rent for December and January, was credited to deferred rent revenue.

VELTO COMPANY
GENERAL JOURNAL

Date	Account Title and Explanation	Debit	Credit
1.	Prepaid insurance ($10,000 × (18/24))	7,500	
	Insurance expense		7,500
2.	Depreciation expense	12,000	
	Accumulated depreciation		12,000
3.	Salaries expense	20,000	
	Salaries payable		20,000
4.	Interest expense ($220,000 × 12% × 3/12)	6,600	
	Interest payable		6,600
5.	Deferred rent revenue ($2,400 × 1/2)	1,200	
	Rent revenue		1,200

Exercise 2-11

The Azmie Wholesale Food Company's fiscal year-end is June 30. The company issues quarterly financial statements requiring the company to prepare adjusting entries at the end of each quarter. Assuming all quarterly adjusting entries were properly recorded, prepare the necessary year-end adjusting entries at the end of June 30, year 2, for the following situations.

1. On December 1, year 1, the company paid its annual fire insurance premium of $8,000 for the year beginning December 1.
2. On August 31, year 1, the company borrowed $88,000 from a local bank. The note requires principal and interest at 9% to be paid on August 31, year 2.
3. Azmie owns a warehouse that it rents to another company. On January 1, year 2, Azmie collected $25,000 representing rent for the year 2 calendar year.
4. Depreciation on the office building is $16,000 for the fiscal year.
5. Employee salaries and wages for the month of June year 2 of $20,000 will be paid on July 20, year 2.

1. On December 1, year 1, the company paid its annual fire insurance premium of $8,000 for the year beginning December 1.

AZMIE WHOLESALE FOOD COMPANY
General Journal

Date year 2		Account Title and Explanation	Debit	Credit
June 30	(1)	Insurance Expense	2,000	
		Prepaid Insurance		2,000

$2,000 = $8,000 × (3/12)

2. On August 31, year 1, the company borrowed $88,000 from a local bank. The note requires principal and interest at 9% to be paid on August 31, year 2.

AZMIE WHOLESALE FOOD COMPANY
General Journal

Date year 2	Account Title and Explanation	Debit	Credit
June 30	Interest expense	1,980	
	Interest payable		1,980

Principal × Interest rate × Time

$$\$88{,}000 \times 9\% \times \frac{3}{12}$$

$$= \$1{,}980$$

3. Azmie owns a warehouse that it rents to another company. On January 1, year 2, Azmie collected $25,000 representing rent for the year 2 calendar year.

AZMIE WHOLESALE FOOD COMPANY
General Journal

Date year 2	Account Title and Explanation	Debit	Credit
June 30	Deferred rent revenue	6,250	
	Rent revenue		6,250

$6,250 = $25,000 × (3/12)

4. Depreciation on the office building is $16,000 for the fiscal year.

AZMIE WHOLESALE FOOD COMPANY
General Journal

Date year 2	Account Title and Explanation	Debit	Credit
June 30	Depreciation expense	4,000	
	Accumulated depreciation—building		4,000

$4,000 = $16,000 × (3/12)

5. Employee salaries and wages for the month of June year 2 of $20,000 will be paid on July 20, year 2.

AZMIE WHOLESALE FOOD COMPANY
General Journal

Date year 2	Account Title and Explanation	Debit	Credit
June 30	Salaries and wages expense	20,000	
	Salaries and wages payable		20,000

Exercise 2-12

The December 31, year 1, adjusted trial balance for the Blueboy Cheese Corporation is presented below.

Account Title	Debit	Credit
Cash	22,000	
Accounts receivable	285,000	
Prepaid rent	12,500	
Inventory	65,000	
Office equipment	625,500	
Accumulated depreciation—office equipment		265,000
Accounts payable		58,000
Note payable (due in six months)		59,000
Salaries payable		10,000
Interest payable		1,000
Common stock		450,000
Retained earnings		125,000
Sales revenue		850,000
Cost of goods sold	500,000	
Salaries expense	150,000	
Rent expense	45,000	
Depreciation expense	88,000	
Interest expense	7,000	
Advertising expense	18,000	
Totals	1,818,000	1,818,000

Required:

1. Prepare an income statement for the year ended December 31, year 1, and a classified balance sheet as of December 31, year 1.
2. Prepare the necessary closing entries at December 31, year 1.

Sales revenue	$850,000
Cost of goods sold	500,000
Salaries expense	150,000
Rent expense	45,000
Depreciation expense	88,000
Advertising expense	18,000
Interest expense	7,000

BLUEBOY CHEESE CORPORATION
Income Statement
For the year Ended December 31, year 1

Sales Revenue		$850,000
Cost of goods sold		500,000
Gross Profit		350,000
Operating expenses:		
Salaries	$150,000	
Rent	45,000	
Depreciation	88,000	
Advertising	18,000	
Total operating expenses		301,000
Operating income		49,000
Other expense:		
Interest		7,000
Net Income		$ 42,000

BLUEBOY CHEESE CORP.
Balance Sheet
December 31, year 1

Assets

Current assets:		
Cash		$ 22,000
Accounts Receivable		285,000
Inventory		65,000
Prepaid Rent		12,500
Total current assets		$384,500
Equipment:		
Office equipment	$625,500	
Less: Accumulated depreciation	265,000	360,500
Total assets		$745,000

Liabilities and shareholders' equity

Current liabilities:		
Accounts Payable		$ 58,000
Salaries Payable		10,000
Interest Payable		1,000
Note Payable		59,000
Total current liabilities		128,000
Shareholders' equity		
Common stock	$450,000	
Retained Earnings	167,000	
Total shareholders' equity		617,000
Total liabilities and shareholders' equity		$745,000

Cash	$22,000	
Accounts receivable	285,000	
Inventory	65,000	
Prepaid rent	12,500	
Office equipment	626,500	
Accumulated depreciation		265,000
Accounts payable		58,000
Salaries payable		10,000
Interest payable		1,000
Note payable		59,000
Common stock		450,000
Retained earnings		167,000

Sales revenue	$850,000
Cost of goods sold	500,000
Salaries expense	150,000
Rent expense	45,000
Depreciation expense	88,000
Advertising expense	18,000
Interest expense	7,000

BLUEBOY CHEESE CORP
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Sales revenue	850,000	
	Income summary		$850,000
Dec. 31	Income summary	808,000	
	Cost of goods sold		500,000
	Salaries expense		150,000
	Rent expense		45,000
	Depreciation expense		88,000
	Interest expense		7,000
	Advertising expense		18,000
Dec. 31	Income summary	42,000	
	Retained earnings		42,000

Slide 60

MM18 Reverse order of Interest expense and its amount with Advertising expense, and its amount, so the order is consisten with what is provided at the top of the slide. Make sure the change is made in the narration as well.

McCarthy, Mark, 12/12/2014

Exercise 2-13

American Chip Corporation's fiscal year-end is December 31. The following is a partial adjusted trial balance as of December 31, year 1.

Account Title	Debits	Credits
Retained earnings		78,000
Sales revenue		847,000
Interest revenue		4,000
Cost of goods sold	474,320	
Salaries expense	112,933	
Rent expense	22,000	
Depreciation expense	29,500	
Interest expense	5,400	
Insurance expense	6,000	

Required:

Prepare the necessary closing entries at December 31, year 1.

Account Title	Debits	Credits
Retained earnings		78,000
Sales revenue		847,000
Interest revenue		4,000
Cost of goods sold	474,320	
Salaries expense	112,933	

Account Title	Debits	Credits
Rent expense	22,000	
Depreciation expense	29,500	
Interest expense	5,400	
Insurance expense	6,000	

AMERICA CHIP CORPORATION
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Sales revenue	847,000	
	Interest revenue	4,000	
	Income summary		851,000
Dec. 31	Income summary	650,153	
	Cost of goods sold		474,320
	Salaries expense		112,933
	Rent expense		22,000
	Depreciation expense		29,500
	Interest expense		5,400
	Insurance expense		6,000
Dec. 31	Income summary	200,847	
	Retained earnings		200,847

Exercise 2-15

The Redel Shoe Store Company prepares monthly financial statements for its bank. The November 30 and December 31, year 1, trial balances contained the following account information:

	November 30		December 31	
	Debits	**Credits**	**Debits**	**Credits**
Supplies	1,800		3,600	
Prepaid insurance	5,600		4,200	
Salaries and wages payable		14,500		21,750
Deferred rent revenue		2,500		1,250

The following information also is known:

a. The December income statement reported $2,400 in supplies expense.

b. No insurance payments were made in December.

c. $14,500 was paid to employees during December for salaries and wages.

d. On November 1, year 1, a tenant paid Redel $3,750 in advance rent for the period November through January.

e. Deferred rent revenue was credited.

Required:

1. What was the cost of supplies purchased during December?
2. What was the adjusting entry recorded at the end of December for prepaid insurance?
3. What was the adjusting entry recorded at the end of December for accrued salaries and wages?
4. What was the amount of rent revenue recognized in December? What adjusting entry was recorded at the end of December for deferred rent?

	November 30		December 31	
	Debits	**Credits**	**Debits**	**Credits**
Supplies	1,800		3,600	

a. The December income statement reported $2,400 in supplies expense.

Supplies			
Nov. 30	1,800		
Purchases	4,200		
		Expense	2,400
Dec. 31	3,600		

	November 30		December 31	
	Debits	Credits	Debits	Credits
Prepaid Insurance	5,600		4,200	

b. No insurance payments were made in December.

Prepaid Insurance

Nov. 30	5,600		
Payments	0		
		Expense	1,400
Dec. 31	4,200		

REDEL SHOE STORE COMPANY
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec 31	Insurance expense	1,400	
	Prepaid insurance		1,400

	November 30		December 31	
	Debits	Credits	Debits	Credits
Salaries and Wages Payable		14,500		21,750

c. $14,500 was paid to employees during December for salaries and wages.

Salaries and Wages Payable

		Nov. 30	14,500
Payments	14,500		
		Accrual	21,750
		Dec. 31	21,750

REDEL SHOE STORE COMPANY
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec 31	Salaries and wages expense	21,750	
	Salaries and wages payable		21,750

	November 30		December 31	
	Debits	**Credits**	**Debits**	**Credits**
Deferred Rent		2,500		1,250

d. On November 1, year 1, a tenant paid Redel $3,750 in advance rent for the period November through January. Deferred rent revenue was credited.

Differed Rent Revenue

		Nov. 30	2,500
Earned	1,250		
		Dec. 31	1,250

$$\frac{\$3{,}750}{3}$$

REDEL SHOE STORE COMPANY
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec 31	Deferred rent revenue	1,250	
	Rent revenue		1,250

Exercise 2-16

The following transactions occurred during year 1 for the Canil Honey Corporation:

Feb. 1	Borrowed $21,500 from a bank and signed a note. Principal and interest at 8.5% will be paid on January 31, year 2.
Apr. 1	Paid $3,000 to an insurance company for a two-year fire insurance policy.
July 17	Purchased supplies costing $2,800 on account. The company records supplies purchased in an asset account. At the year-end on December 31, year 1, supplies costing $1,250 remained on hand.
Nov. 1	A customer borrowed $5,700 and signed a note requiring the customer to pay principal and 7.5% interest on April 30, year 2.

Required:

1. Record each transaction in general journal form. Omit explanations.
2. Prepare any necessary adjusting entries at the year-end on December 31, year 1. No adjusting entries were recorded during the year for any item.

Feb. 1 Borrowed $21,500 from a bank and signed a note. Principal and interest at 8.5% will be paid on January 31, year 2.

CANIL HONEY CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Feb. 1	Cash	21,500	
	Notes payable		21,500

Apr. 1 Paid $3,000 to an insurance company for a two-year fire insurance policy.

CANIL HONEY CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Apr. 1	Prepaid insurance	3,000	
	Cash		3,000

July. 17 Purchased supplies costing $2,800 on account. The company records supplies purchased in an asset account. At the year-end on December 31, year 1, supplies costing $1,250 remained on hand.

CANIL HONEY CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
July. 17	Supplies	2,800	
	Accounts payable		2,800

Nov. 1 A customer borrowed $5,700 and signed a note requiring the customer to pay principal and 7.5% interest on April 30, year 2.

CANIL HONEY CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Nov. 1	Notes receivable	5,700	
	Cash		5,700

Feb. 1 Borrowed $21,500 from a bank and signed a note. Principal and interest at 8.5% will be paid on January 31, year 2.

No adjusting entries were recorded during the year for any item.

CANIL HONEY CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Interest expense	1,675	
	Interest payable		1,675

$$\$21,500 \times 8.5\% \times \frac{11}{12} = \$1,675$$

Apr. 1 Paid \$3,000 to an insurance company for a two-year fire insurance policy.

No adjusting entries were recorded during the year for any item.

CANIL HONEY CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Interest expense	1,675	
	Interest payable		1,675
Dec. 31	Insurance expense	1,125	
	Prepaid insurance		1,125

$$\$3{,}000 \times \frac{9}{24} = \$1{,}125$$

July 17 Purchased supplies costing \$2,800 on account. The company records supplies purchased in an asset account. At the year-end on December 31, year 1, supplies costing \$1,250 remained on hand.

No adjusting entries were recorded during the year for any item.

CANIL HONEY CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Interest expense	1,675	
	Interest payable		1,675
Dec. 31	Insurance expense	1,125	
	Prepaid insurance		1,125
Dec. 31	Supplies expense	1,550	
	Supplies		1,550

\$2,800 – \$1,250 = \$1,550

Nov. 1 A customer borrowed $5,700 and signed a note requiring the customer to pay principal and 7.5% interest on April 30, year 2.

No adjusting entries were recorded during the year for any item.

CANIL HONEY CORPORATION

General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Interest expense	1,675	
	Interest payable		1,675
Dec. 31	Insurance expense	1,125	
	Prepaid insurance		1,125
Dec. 31	Supplies expense	1,550	
	Supplies		1,550
Dec. 31	Interest receivable	71	
	Interest revenue		71

$$\$5{,}700 \times 7.5\% \times \frac{2}{12} = \$71$$

Exercise 2-18

Adam and Smith Lawn Service Company (S&J) maintains its books on a cash basis. However, the company recently borrowed $139,000 from a local bank and the bank requires S&J to provide annual financial statements prepared on an accrual basis. During year 1, the following cash flows were recorded:

Cash collected from customers		$375,000
Cash paid for:		
Salaries	$134,000	
Supplies	23,500	
Rent	18,000	
Insurance	6,200	
Miscellaneous	13,500	195,200
Net operating cash flow		$179,800

You are able to determine the following information about accounts receivable, prepaid expenses, and accrued liabilities:

	Jan. 1, year 1	Dec. 31, year 1
Accounts receivable	$24,000	$19,000
Prepaid insurance	0	1,400
Supplies	1,400	1,900
Accrued liabilities (for miscellaneous expenses)	3,100	4,100

In addition, you learn that the bank loan was dated September 30, year 1, with principal and interest at 6% due in one year. Depreciation on the company's equipment is $12,800 for the year.

Required:

Prepare an accrual basis income statement for year 1. (Ignore income taxes.)

Cash collected from customers		$375,000
Cash paid for:		
Salaries	$134,000	
Supplies	23,500	
Rent	18,000	
Insurance	6,200	
Miscellaneous	13,500	195,200
Net operating cash flow		$179,800

	Jan. 1, year 1	Dec. 31, year 1
Accounts receivable	24,000	19,000
Prepaid insurance	0	1,400
Supplies	1,400	1,900
Accrued liabilities for misc. expenses	3,100	4,100

ADAM AND SMITH LAWN SERVICE COMPANY
Income Statement
For the Year Ended December 31, year 1

Sales revenue	$370,000

ADAM AND SMITH LAWN SERVICE COMPANY
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Cash	375,000	
	Accounts receivable		5,000
	Sales revenue		370,000

Cash collected from customers		$375,000
Cash paid for:		
Salaries	$134,000	
Supplies	23,500	
Rent	18,000	
Insurance	6,200	
Miscellaneous	13,500	195,200
Net operating cash flow		$179,800

	Jan. 1, year 1	Dec. 31, year 1
Accounts receivable	24,000	19,000
Prepaid insurance	0	1,400
Supplies	1,400	1,900
Accrued liabilities for misc. expenses	3,100	4,100

ADAM AND SMITH LAWN SERVICE COMPANY
Income Statement
For the Year Ended December 31, year 1

Sales revenue		$370,000
Operating expenses:		
Salaries	$134,000	

Cash collected from customers		$375,000
Cash paid for:		
Salaries	$134,000	
Supplies	23,500	
Rent	18,000	
Insurance	6,200	
Miscellaneous	13,500	195,200
Net operating cash flow		$179,800

	Jan. 1, year 1	Dec. 31, year 1
Accounts receivable	24,000	19,000
Prepaid insurance	0	1,400
Supplies	1,400	1,900
Accrued liabilities for misc. expenses	3,100	4,100

ADAM AND SMITH LAWN SERVICE COMPANY
Income Statement
For the Year Ended December 31, year 1

Sales revenue		$370,000
Operating expenses:		
Salaries	$134,000	
Supplies	23,000	

ADAM AND SMITH LAWN SERVICE COMPANY
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Supplies expense	23,000	
	Supplies	500	
	Cash		23,500

Cash collected from customers		$375,000
Cash paid for:		
Salaries	$134,000	
Supplies	23,500	
Rent	18,000	
Insurance	6,200	
Miscellaneous	13,500	195,200
Net operating cash flow		$179,800

	Jan. 1, year 1	Dec. 31, year 1
Accounts receivable	24,000	19,000
Prepaid insurance	0	1,400
Supplies	1,400	1,900
Accrued liabilities for misc. expenses	3,100	4,100

ADAM AND SMITH LAWN SERVICE COMPANY
Income Statement
For the Year Ended December 31, year 1

Sales revenue		$370,000
Operating expenses:		
Salaries	$134,000	
Supplies	23,000	
Rent	18,000	

Cash collected from customers		$375,000
Cash paid for:		
Salaries	$134,000	
Supplies	23,500	
Rent	18,000	
Insurance	6,200	
Miscellaneous	13,500	195,200
Net operating cash flow		$179,800

	Jan. 1, year 1	Dec. 31, year 1
Accounts receivable	24,000	19,000
Prepaid insurance	0	1,400
Supplies	1,400	1,900
Accrued liabilities for misc. expenses	3,100	4,100

ADAM AND SMITH LAWN SERVICE COMPANY
Income Statement
For the Year Ended December 31, year 1

Sales revenue		$370,000
Operating expenses:		
Salaries	$134,000	
Supplies	23,000	
Rent	18,000	
Insurance	4,800	

ADAM AND SMITH LAWN SERVICE COMPANY
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Insurance expense	4,800	
	Prepaid insurance	1,400	
	Cash		6,200

Cash collected from customers		$375,000
Cash paid for:		
Salaries	$134,000	
Supplies	23,500	
Rent	18,000	
Insurance	6,200	
Miscellaneous	13,500	195,200
Net operating cash flow		$179,800

	Jan. 1, year 1	Dec. 31, year 1
Accounts receivable	24,000	19,000
Prepaid insurance	0	1,400
Supplies	1,400	1,900
Accrued liabilities for misc. expenses	3,100	4,100

ADAM AND SMITH LAWN SERVICE COMPANY
Income Statement
For the Year Ended December 31, year 1

Sales revenue		$370,000
Operating expenses:		
Salaries	$134,000	
Supplies	23,000	
Rent	18,000	
Insurance	4,800	
Miscellaneous	14,500	

ADAM AND SMITH LAWN SERVICE COMPANY
General Journal

Date year 1	Account Title and Explanation	Debit	Credit
Dec. 31	Miscellaneous expense	14,500	
	Accrued liabilities		1,000
	Cash		13,500

Cash collected from customers		$375,000
Cash paid for:		
Salaries	$134,000	
Supplies	23,500	
Rent	18,000	
Insurance	6,200	
Miscellaneous	13,500	195,200
Net operating cash flow		$179,800

	Jan. 1, year 1	Dec. 31, year 1
Accounts receivable	24,000	19,000
Prepaid insurance	0	1,400
Supplies	1,400	1,900
Accrued liabilities for misc. expenses	3,100	4,100

ADAM AND SMITH LAWN SERVICE COMPANY
Income Statement
For the Year Ended December 31, year 1

Sales revenue		$370,000
Operating expenses:		
Salaries	$134,000	
Supplies	23,000	
Rent	18,000	
Insurance	4,800	
Miscellaneous	14,500	
Depreciation	12,800	
Total operating expenses		207,100
Operating income		162,900
Other expense:		
Interest		2,085
Net Income		$160,815

In addition, you learn that the bank loan of $139,000 was dated September 30, year 1, with principal and interest at 6% due in one year.

Depreciation on the company's equipment for the year $12,800

$$\$139{,}000 \times 6\% \times \frac{3}{12} = \$2{,}085$$

Exercise 2-20

The December 31, Year 1, unadjusted trial balance for the Landern Drug Company is presented below. December 31 is the company’s fiscal year-end.

Account Titles	Debits	Credits
Cash	18,000	
Accounts receivable	32,000	
Prepaid rent	4,500	
Inventory	45,000	
Equipment	80,000	
Accumulated depreciation—equipment		25,000
Accounts payable		20,500
Salaries and wages payable		0
Common stock		80,000
Retained earnings		27,500
Sales revenue		292,500
Cost of goods sold	150,000	
Salaries and wages expense	72,500	
Rent expense	25,500	
Depreciation expense	0	
Utility expense	14,500	
Advertising expense	3,500	
Totals	445,500	445,500

The following year-end adjusting entries are required:

a. Depreciation expense for the year on the equipment is $12,000.

b. Accrued salaries and wages payable at year-end should be $4,500.

Required:

1. Prepare and complete a worksheet.
2. Prepare an income statement for Year 1 and a balance sheet as of December 31, year 1.

Account Title	Unadjusted	Trial Bal.	Adjusting	Entries	Adjusted	Trial Bal.
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	18,000				18,000	
Accounts receivable	32,000				32,000	
Prepaid Rent	4,500				4,500	
Inventory	45,00				45,000	
Equipment	80,000				80,000	
Accumulated depr – Equip		25,000		12,000		37,000
Accounts payable		20,500				20,500
Salaries and wages payable		0		4,500		4,500
Common stock		80,000				80,000
Retained earnings		27,500				27,500
Sales revenue		292,500				292,500
Cost of gods sold	150,000				150,000	
Salaries and wages expense	72,500		4,500		77,000	
Rent expense	25,500				25,500	
Depreciation expense	0		12,000		12,000	
Utility expense	14,500				14,500	
Advertising expense	3,500				3,500	
Totals	445,500	445,500	16,500	16,500	462,000	462,000

Account Title	Adjusted	Trial Bal.	Income	Stat.	Balance	Sheet
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	18,000				18,000	
Accounts receivable	32,000				32,000	
Prepaid rent	4,500				4,500	
Inventory	45,00				45,000	
Equipment	80,000				80,000	
Accumulated depr.— Equipment		37,000				37,000
Accounts payable		20,500				20,500
Salaries and wages payable		4,500				4,500
Common stock		80,000				80,000
Retained earnings		27,500				27,500
Sales revenue		292,500		292,500		
Cost of gods sold	150,000		150,000			
Salaries and wages expense	77,000		77,000			
Rent expense	25,500		25,500			
Depreciation expense	12,000		12,000			
Utility expense	14,500		14,500			
Advertising expense	3,500		3,500			
Net Income			10,000			10,000
Totals	462,000	462,000	292,500	292,500	179,500	179,500

Sales revenue		$292,500
Cost of goods sold	$150,000	
Salaries expense	77,000	
Rent expense	25,500	
Depreciation expense	12,000	
Advertising expense	3,500	
Utilities expense	14,500	

LANDERN DRUG COMPANY
Income Statement
For the Year Ended December 31, year 1

Sales revenue		$292,500
Cost of goods sold		150,000
Gross profit		142,500
Operating expenses:		
Salaries and wages	$ 77,000	
Rent	25,500	
Depreciation	12,000	
Utilities	14,500	
Advertising	3,500	
Total operating expenses		132,500
Net income		$ 10,000

Cash	$18,000	
Accounts Receivable	32,000	
Inventory	45,000	
Prepaid Rent	4,500	
Office equipment	80,000	
Accumulated depreciation		$37,000
Accounts payable		20,500
Salaries payable		4,500
Common Stock		80,000
Retained earnings		27,500
Net Income		10,000

LANDERN DRUG COMPANY
Balance Sheet
December 31, year 1

Assets		
Current assets:		
Cash		$ 18,000
Accounts receivable		32,000
Inventory		45,000
Prepaid rent		4,500
Total current assets		99,500
Property and equipment		
Office equipment	$80,000	
Less: Accumulated depreciation	37,000	43,000
Total assets		$142,500
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable		20,500
Salaries and wages payable		4,500
Total current liabilities		25,000
Shareholders' equity		
Common stock	80,000	
Retained earnings	37,500	
Total shareholders' equity		117,500
Total liabilities and shareholders' equity		$142,500

Exercise 2-21

The employees of Gallery, Inc., are paid each Friday. The company's fiscal year-end is June 30, which falls on a Wednesday for the current year. Salaries and wages are earned evenly throughout the five-day workweek, and $13,500 will be paid on Friday, July 2.

Required:

1. Prepare an adjusting entry to record the accrued Salaries and wages as of June 30, a reversing entry on July 1, and an entry to record the payment of Salaries and wages on July 2.
2. Prepare journal entries to record the accrued Salaries and wages as of June 30 and the payment of Salaries and wages on July 2 assuming a reversing entry is not recorded.

The employees of Gallery, Inc., are paid each Friday. The company's fiscal year-end is June 30, which falls on a Wednesday for the current year. Salaries and Salaries and wages are earned evenly throughout the five-day workweek, and $13,500 will be paid on Friday, July 2.

GALLERY INC.

General Journal

Date year 1		Account Title and Explanation	Debit	Credit
June	(30)	Salaries and wages expense	8,100	
		Salaries and wages payable		8,100
July	(1)	Salaries and wages payable	8,100	
		Salaries and wages expense		8,100
	(2)	Salaries and wages expense	13,500	
		Cash		13,500

$$\frac{13,500}{5} = \$2,700$$

$$\$2,700 \times 3 = \$8,100$$

The employees of Gallery, Inc., are paid each Friday. The company's fiscal year-end is June 30, which falls on a Wednesday for the current year. Salaries and Salaries and wages are earned evenly throughout the five-day workweek, and $13,500 will be paid on Friday, July 2.

GALLERY INC.

General Journal

Date Year 1		Account Title and Explanation	Debit	Credit
June	(30)	Salaries and wages expense	8,100	
		Salaries and wages payable		8,100
July	(2)	Salaries and wages payable	8,100	
		Salaries and wages expense	5,400	
		Cash		13,500

$2,700 × 2 = $5,400

GALLERY INC.

General Journal

Date Year 1		Account Title and Explanation	Debit	Credit
June	(30)	Salaries and wages expense	8,100	
		Salaries and wages payable		8,100
July	(1)	Salaries and wages payable	8,100	
		Salaries and wages expense		8,100
	(2)	Salaries and wages expense	13,500	
		Cash		13,500

GALLERY INC.

General Journal

Date Year 1		Account Title and Explanation	Debit	Credit
June	(30)	Salaries and wages expense	8,100	
		Salaries and wages payable		8,100
July	(2)	Salaries and wages payable	8,100	
		Salaries and wages expense	5,400	
		Cash		13,500