

ANSWERS TO QUESTIONS - CHAPTER 2

1. **Accrual accounting attempts to record the effects of accounting events in the period when such events occur, regardless of when cash is received or paid. The goal is to match expenses with the revenues that they produce.**
2. **Recognition is the act of recording an event in the financial statements. When accruals are used, events are recognized before the associated cash is paid or collected.**
3. **Deferral is the recognition of revenue or expenses in a period after the cash consequences are realized, i.e., cash is collected in advance of performing the service.**
4. **If cash is collected in advance for services, the revenue is recognized when the services are rendered.**
5. **An asset source transaction increases assets and increases either liabilities or equity.**
6. **The issue of common stock, which is capital acquired from owners, increases business assets (usually cash) and equity (common stock).**
7. **The recognition of revenue on account increases the corresponding revenue account on the income statement, but does not affect the statement of cash flows. The cash flow statement is affected when the account is collected.**

8. <u>Asset Source Transaction</u>	<u>Effect on Accounting Equation</u>
Issue of Common Stock	Increases Assets Increases Common Stock
Revenue Earned	Increases Assets Increases Retained Earnings
Borrowed Funds	Increases Assets Increases Liabilities

9. Revenue is recognized under accrual accounting when a revenue-producing event occurs, i.e., when the revenue is *earned*, even if no cash is collected at the time of the transaction.
10. The collection of cash for accounts receivable is an asset exchange transaction. Only the asset side of the accounting equation is affected because one asset account increases (cash), and another asset account decreases (accounts receivable). Total assets are unchanged.
11. If cash is collected in advance for services, a liability is created (unearned revenue), increasing the claims side of the accounting equation.
12. Unearned revenue is cash that has been collected for services that have not yet been performed.
13. The recognition of expenses affects the accounting equation by either decreasing assets or increasing liabilities (payables) and by decreasing stockholders' equity (retained earnings).
14. A claims exchange transaction is one where the claims of creditors (liabilities) increase and the claims of stockholders (retained earnings) decrease, or vice versa. The total amount of claims is unchanged.
15. Cash payments to creditors are asset use transactions. These transactions result in the reduction of an asset account (cash) and the reduction of the corresponding liability account (payables).
16. Expenses are recognized under accrual accounting at the time the expense is incurred or resources are consumed, regardless of when cash payment is made.
17. Net cash flows from operations on the cash flow statement may be different from net income because of the application of accrual accounting. Revenues and expenses reported on the income statement may be recognized before or after the actual collection or payment of cash that is reported on the cash flow statement.

- 18. The income statement reflects the change in net assets associated with operating a business, as shown by revenues and expenses. Expenses may result from a decrease in assets or an increase in liabilities. Revenues may result from an increase in assets or a decrease in liabilities.**
- 19. Net income increases stockholders' claims on business assets by increasing retained earnings.**
- 20. A cost can be either an asset or an expense. If the item acquired has already been used in the process of earning revenue, its cost represents an expense. If the item will be used in the future to generate revenue, its cost represents an asset.**
- 21. A cost is held in the asset account until the item is used to produce revenue. When the revenue is generated, the asset is converted into an expense in order to match revenues with related expenses. Not all costs become expenses. If the value of an asset will not expire in the revenue-generating process, the asset will not become an expense. For example, the cost of land will not become an expense because land does not depreciate.**
- 22. Supplies used during the accounting period are recognized in a single adjusting entry at the end of the period. The amount of supplies used is determined by subtracting the amount of supplies on hand at the end of the period from the amount of supplies that were available for use (beginning supplies balance plus supplies purchased).**
- 23. An expense is a decrease in assets or an increase in liabilities that occurs in the process of generating revenue.**
- 24. Revenue is an increase in assets or a decrease in liabilities that results from the operating activities of the business.**
- 25. The purpose of the statement of changes in stockholders' equity is to display the effects of business operations and stock issued to owners and dividends paid to stockholders. It identifies the ways that an entity's equity increased and decreased as a result of its**

operations and transactions with its stockholders.

- 26. The purpose of the balance sheet is to provide information about an entity's assets, liabilities, and stockholders' equity and their relationships to each other at a particular point in time. It provides a list of the economic resources that the enterprise has available for its operating activities and the claims to those resources.**
- 27. The balance sheet is dated as of a specific date because it shows information about an entity's assets, liabilities, and stockholders' equity as of that date, not measured over a time period. The statement of changes in stockholders' equity, the income statement, and the statement of cash flows reflect transactions that occur over a period of time.**
- 28. Assets are listed on the balance sheet in accordance with their respective levels of liquidity (how rapidly they can be converted to cash).**
- 29. The statement of cash flows explains the change in cash from one accounting period to the next. It is prepared by analyzing the cash account and summarizing where cash came from and how it was used.**
- 30. An adjusting entry is an entry that updates account balances prior to preparation of the financial statements. The entry means that there is an item that needs proper measurement on the income statement and an adjustment will reflect the correct time period of earning or usage. Example: entry to recognize accrued interest revenue where the revenue has been earned but not yet collected and therefore revenue had not yet been recorded for the time period.**
- 31. Temporary accounts (revenue, expense and dividends) are closed at the end of the accounting period. It is necessary to close these accounts so that revenue, expense and dividends can be accumulated from a beginning balance of zero for the next period.**
- 32. Period costs are costs that are recognized in an accounting period. Examples of period costs include rent expense, utilities expense, and salaries expense.**

- 33. Salary of the tax return preparer could be directly matched with the revenue that it produces.**
- 34. The four stages of the accounting cycle: Record transactions; adjust the accounts; prepare statements; and close the temporary accounts. The adjustment and closing processes have been added to the cycle in this chapter. It is necessary to adjust accounts so that the accounts will reflect the correct balances under the accrual basis of accounting. The closing process (transferring the balances of the temporary accounts to retained earnings) is necessary so that the temporary accounts have a zero balance at the beginning of the next accounting cycle.**

SOLUTIONS TO EXERCISES - CHAPTER 2

EXERCISE 2-1

Burke Company Effect of Events on the 2014 Accounting Equation								
Event	Assets			=	Liabilities	+	Stockholders' Equity	
	Cash	+	Accounts Rec.	=		+	Common Stock	Retained Earnings
Earned Revenue		+	12,000	=		+		12,000
Coll. Acct. Rec.	9,800	+	(9,800)	=		+		
Ending Balance	9,800	+	2,200	=	-0-	+	0	12,000

- Accounts Receivable: $\$12,000 - \$9,800 = \$2,200$
- $\$12,000$
- $\$9,800$ cash collected from accounts receivable.
- $\$12,000$
- $\$12,000$ of revenue was earned but only $\$9,800$ of it was collected.

EXERCISE 2-2

a.

Crest Corporation Accounting Equation - 2014						
Event	Assets	=	Liabilities	+	Stockholders' Equity	
	Cash	=	Salaries Payable	+	Common Stock	Retained Earnings
Earned Rev.	5,000					5,000
Accrued Sal.			(3,000)			(3,000)

Crest Corporation Balance Sheet As of December 31, 2014			
Assets			
Cash	\$5,000		
Total Assets		\$5,000	
Liabilities			
Salaries Payable	\$3,000		
Total Liabilities		\$3,000	
Stockholders' Equity			
Retained Earnings	\$2,000		
Total Stockholders' Equity		2,000	
Total Liab. and Stockholders' Equity		\$5,000	

b.

Computation of Net Income	
Revenue	\$5,000
Less: Expenses	(3,000)
Net Income	\$2,000

EXERCISE 2-2 (cont.)

c.

Cash Flow from Operating Activities	
Cash from Revenue	\$5,000
Net Cash Flow from Operating Act.	\$5,000

- d. The salary expense is deducted from revenue in computing net income, but it has not been paid. This creates a difference of \$3,000. The revenue is the same because it has been earned and collected.

EXERCISE 2-3

a.

Coates, Inc. General Ledger Accounts for the Year Ended December 31, 2014						
	Assets		= Liabilities	+	Stockholders' Equity	
Event	Cash	Accts. Rec.	= Salaries Pay.	+	Common Stock	Retained Earnings
1.	20,000				20,000	
2.		38,000				38,000
3.	(2,500)					(2,500)
4.	21,000	(21,000)				
5.			15,000			(15,000)
6.	(2,000)					(2,000)
Totals	36,500	17,000	= 15,000	+	20,000	18,500

b.

Coates, Inc. Income Statement For the Year Ended December 31, 2014			
Revenue		\$38,000	
Expenses			
Utilities Expense	\$ 2,500		
Salaries Expense	15,000		
Total Expenses		(17,500)	
Net Income		\$20,500	

EXERCISE 2-3 b. (cont.)

Coates, Inc.
Statement of Changes in Stockholders' Equity
For the Year Ended December 31, 2014

Beginning Common Stock	\$ -0-	
Plus: Common Stock Issued	20,000	
Ending Common Stock		\$20,000
Beginning Retained Earnings	\$ -0-	
Plus: Net Income	20,500	
Less: Dividends	(2,000)	
Ending Retained Earnings		18,500
Total Stockholders' Equity		\$38,500

Coates, Inc.
Balance Sheet
As of December 31, 2014

Assets		
Cash	\$36,500	
Accounts Receivable	17,000	
Total Assets		\$53,500
Liabilities		
Salaries Payable	\$15,000	
Total Liabilities		\$15,000
Stockholders' Equity		
Common Stock	\$20,000	
Retained Earnings	18,500	
Total Stockholders' Equity		38,500
Total Liab. and Stockholders' Equity		\$53,500

EXERCISE 2-3 b. (cont.)

Coates, Inc.			
Statement of Cash Flows			
For the Year Ended December 31, 2014			
Cash Flow From Operating Activities			
Cash Receipts from Customers	\$21,000		
Cash Paid for Expenses	(2,500)		
Net Cash Flow from Operating Act.		\$18,500	
Cash Flow From Investing Activities		-0-	
Cash Flow From Financing Activities			
Issue of Stock	\$20,000		
Paid Dividends	(2,000)		
Net Cash Flow from Financing Act.		18,000	
Net Change in Cash		36,500	
Plus: Beginning Cash Balance		-0-	
Ending Cash Balance		\$36,500	

- c. Net income is based on income earned of \$38,000 and expenses incurred of \$17,500 for a net income of \$20,500. Net cash flow from operating activities is based on cash collected from revenue, \$21,000 and expenses paid, \$2,500, for a net cash flow from operating activities of \$18,500. The difference of \$2,000 is reflected in the Accounts Receivable account (\$17,000), revenues accrued but not yet collected, and the Salaries Payable account (\$15,000), expenses incurred but not paid.

EXERCISE 2-4

a.

Brown and Birgin Statements Model For the 2014 Accounting Year												
Event No.	Balance Sheet						Income Statement				Statement of	
	Assets		=	Liabilities		+ Stk. Equity	Rev.	–	Exp.	=	Net Inc.	Cash Flows
	Cash	+	Accts. Rec.	=	Acct. Payable	+	Sal. Pay.	+	Retained Earnings			
1.	NA		96,000		NA		NA		96,000		96,000	NA
2.	65,000		NA		NA		NA		65,000		65,000	65,000 OA
3.	NA		NA		45,000		NA		(45,000)		(45,000)	NA
4.	(26,000)		NA		NA		NA		(26,000)		(26,000)	(26,000) OA
5.	70,000		(70,000)		NA		NA		NA		NA	70,000 OA
6.	(38,000)		NA		(38,000)		NA		NA		NA	(38,000) OA
7.	(10,000)		NA		NA		NA		(10,000)		NA	(10,000) FA
8.	NA		NA		NA		3,000		(3,000)		(3,000)	NA
Totals	61,000	+	26,000	=	7,000	+	3,000	+	77,000		161,000	– 74,000 = 87,000 61,000 NC

- b. Total assets: \$87,000 (\$61,000 + \$26,000)
- c. \$26,000
- d. \$7,000
- e. Accounts Receivable (an asset) is an amount owed to Brown and Birgin: \$26,000;
Accounts Payable (a liability) is an amount that Brown and Birgin owes: \$7,000.
- f. \$87,000
- g. \$71,000 (\$65,000 – \$26,000 + \$70,000 – \$38,000)

EXERCISE 2-5

a.

Computation of Net Income	
Revenue recognized on account	\$40,000
Less accrued salary expense	(35,000)
Net Income	\$ 5,000

b.

Computation of Cash Collected from Accounts Receivable	
Beginning balance of Accounts Receivable	\$ 2,000
Add revenue recognized on account	40,000
Less ending balance of Accounts Receivable	(2,400)
Cash collected from accounts receivable	\$39,600

Computation of Cash Paid for Salaries Expense	
Beginning balance of Salaries Payable	\$ 1,300
Add accrued salary expense recognized	35,000
Less ending balance of Salaries Payable	(900)
Cash paid for Salary Expense	\$35,400

Cash Flow from Operating Activities	
Cash from Accounts Receivable	\$39,600
Cash paid for Salary Expense	(35,400)
Net Cash Flow from Operating Act.	\$ 4,200

EXERCISE 2-6

a. & c.

Event	Revenue	Expense	Statement of Cash Flows
1.	NA	NA	\$50,000 FA
2.	\$67,000	NA	NA
3.	NA	NA	(5,000) FA
4.	NA	NA	45,000 OA
5.	NA	\$49,000	(49,000) OA
6.	10,000	NA	10,000 OA
7.	NA	2,000	NA

b.

Computation of Net Income	
Revenue	\$77,000
Less: Expenses	(51,000)
Net Income	\$26,000

d.

Cash Flow from Operating Activities	
Cash from Revenue	\$55,000
Cash paid for expenses	(49,000)
Net Cash Flow from Operating Act.	\$ 6,000

- e. The before-closing balance in the Revenue account is \$77,000. After it is closed to Retained Earnings the balance will be zero. Other accounts that would be closed are expenses and dividends.
- f. The balance of Retained Earnings on the 2014 Balance Sheet will be the amount of Net Income: \$26,000, less \$5,000 of dividends paid since there is no beginning balance in Retained Earnings.

EXERCISE 2-7

Zoe, Inc. Effect of Events on the General Ledger Accounts								
Event	Assets			=	Liabilities	+	Stockholders' Equity	
	Cash	Accounts Receivable	Land	=	Accounts Payable	+	Com. Stock	Retained Earnings
1. Sales on Account		62,000						62,000
2. Coll. Accts. Rec.	51,000	(51,000)						
3. Incurred Expense					39,000			(39,000)
4. Pd. Acc. Pay.	(31,000)				(31,000)			
5. Issue of Stock	40,000						40,000	
6. Purchase Land	(21,000)		21,000					
Totals	39,000	11,000	21,000	=	8,000	+	40,000	23,000

- Revenue recognized, \$62,000.
- Cash flow from revenue, \$51,000.
- Revenue, \$62,000, less operating expenses, \$39,000 = \$23,000 net income.
- Accounts receivable collected, \$51,000, less cash paid for expenses, \$31,000 = \$20,000 cash flow from operating activities.
- Income of \$62,000 was earned, but only \$51,000 was collected (a difference of \$11,000); operating expenses incurred were \$39,000 but only \$31,000 was paid during the period (a difference of \$8,000). Consequently, net income is \$3,000 more than cash flow from operating activities.
- \$21,000 cash outflow for the purchase of land.
- \$40,000 cash inflow from the issue of common stock.
- | | | |
|-------------------|---|---|
| Total assets | = | \$71,000 (\$39,000 + \$11,000 + \$21,000) |
| Total liabilities | = | \$8,000 |
| Total equity | = | \$63,000 (\$40,000 + \$23,000) |

EXERCISE 2-8

a.

Copy Express																			
Effect of Events on Financial Statements for 2014																			
	Assets							=	Liab.	+	Stockholders' Equity			Income Statement					
Event No.	Cash	+	Supplies	=	Accts. Pay.	+	Com. Stock	+	Retained Earnings		Rev.	–	Exp.	=	Net Income		Cash Flows		
Beg. Bal.	9,000	+	-0-	=	-0-	+	5,000	+	4,000		-0-	–	-0-	=	-0-		-0-		
1.	NA	+	9,500	=	9,500	+	NA	+	NA		NA	–	NA	=	NA		NA		
2.	32,500	+	NA	=	NA	+	NA	+	32,500		32,500	–	NA	=	32,500		32,500	OA	
3.	(7,200)	+	NA	=	(7,200)	+	NA	+	NA		NA	–	NA	=	NA		(7,200)	OA	
4.	NA	+	(7,800)	=	NA	+	NA	+	(7,800)		NA	–	7,800	=	(7,800)		NA		
Totals	34,300	+	1,700	=	2,300	+	5,000	+	28,700		32,500	–	7,800	=	24,700		25,300	NC	

- b. The difference in net income and cash flow from operating activities of \$600 (\$24,700 – \$25,300) is attributed to recognizing supplies expense of \$7,800 in the income statement, whereas the cash payment on accounts payable (for supplies) was \$7,200.

EXERCISE 2-9

a.

Accounting Professionals, Inc. Effect of Events on the Accounting Equation					
	Assets		=	Liab.	+ Stk. Equity
Event	Cash	Supplies	=	Accounts Payable	Retained Earnings
1. Provided Service	20,000				20,000
2. Purchased Supplies		4,000		4,000	
3. Used Supplies		(3,000)			(3,000)
Totals	20,000	1,000	=	4,000	17,000

b.

Accounting Professionals, Inc. Income Statement For the Year Ended December 31, 2014		
Revenue	\$20,000	
Expense	(3,000)	
Net Income	\$17,000	

Accounting Professionals, Inc. Balance Sheet As of December 31, 2014			
Assets			
Cash	\$20,000		
Supplies	1,000		
Total Assets		\$21,000	
Liabilities			
Accounts Payable	\$ 4,000		
Total Liabilities		\$ 4,000	
Stockholders' Equity			
Retained Earnings	\$17,000		
Total Stockholders' Equity		17,000	
Total Liab. and Stockholders' Equity		\$21,000	

EXERCISE 2-9 b. (cont.)

Accounting Professionals, Inc. Statement of Cash Flows For the Year Ended December 31, 2014			
Cash Flows From Operating Activities:			
Cash Receipt from Revenue	\$20,000		
Net Cash Flow from Operating Activities		\$20,000	
Cash Flows From Investing Activities		-0-	
Cash Flows From Financing Activities:		-0-	
Net Change in Cash		20,000	
Plus: Beginning Cash Balance		-0-	
Ending Cash Balance		\$20,000	

- c. The balance of the Supplies account on January 1, 2015 is \$1,000, the same as the December 31, 2014 balance.
- d. The balance of the Supplies Expense account on January 1, 2015 is zero because the expense account was closed to Retained Earnings at December 31, 2014.

EXERCISE 2-10

- a. A cost that is an asset is the cost of resources that are given up in acquiring some type of asset, such as an automobile, office equipment, or land. A cost that is an expense is the use of assets (depreciation) or the payment for an expense that is incurred in the current period (utilities, salaries, etc.)
- b. Examples of costs that are assets:
1. Purchased land
 2. Purchased equipment
 3. Purchased supplies for future use.
- c. Examples of costs that are expenses:
1. Paid monthly salary expense.
 2. Paid monthly utilities expense.
 3. Used supplies that had been previously purchased.

EXERCISE 2-11

a.

Therapy, Inc. Effect of Events on the Accounting Equation				
	Assets		=	Stockholders' Equity
Event	Cash	Prepaid Rent	=	Retained Earnings
1. Performed Services	18,000			18,000
2. Prepaid Rent	(12,000)	12,000		
3. Used Rent		(11,000)*		(11,000)
Totals	6,000	1,000	=	7,000

*\$12,000 x 11/12 = \$11,000

b.

Therapy, Inc. Income Statement For the Year Ended December 31, 2014		
Revenue		\$18,000
Expense		(11,000)
Net Income		\$ 7,000

Therapy, Inc. Balance Sheet As of December 31, 2014			
Assets			
Cash	\$6,000		
Prepaid Rent	1,000		
Total Assets		\$7,000	
Liabilities		\$ -0-	
Stockholders' Equity			
Retained Earnings	\$7,000		
Total Stockholders' Equity		7,000	
Total Liab. and Stockholders' Equity		\$7,000	

EXERCISE 2-11 b. (cont.)

Therapy, Inc. Statement of Cash Flows For the Year Ended December 31, 2014			
Cash Flows From Operating Activities:			
Cash Receipt from Revenue	\$18,000		
Cash Payment for Rent	(12,000)		
Net Cash Flow from Operating Activities		\$6,000	
Cash Flows From Investing Activities		-0-	
Cash Flows From Financing Activities:		-0-	
Net Change in Cash		6,000	
Plus: Beginning Cash Balance		-0-	
Ending Cash Balance		\$6,000	

c. The balance of the Prepaid Rent will be expensed in 2015, \$1,000.

EXERCISE 2-12

a.

Cole Corporation Accounting Equation 2014					
	Assets		=	Stockholders' Equity	
Event	Cash	Prepaid Insurance	=	Com. Stock	+ Retained Earnings
Pur. Insurance	(8,400)	8,400			
Adj. Ins Exp.		(2,450)*			(2,450)
Totals	(8,400)	5,950	=	-0-	+ (2,450)

*\$8,400 x 7/24 = \$2,450

- b. The required entry would decrease assets by \$2,450 [(\$8,400 ÷ 24) x 7] and decrease stockholders' equity by \$2,450 (retained earnings). If this entry is not made, assets and stockholders' equity would both be overstated on the balance sheet by \$2,450. On the income statement, expenses would be understated causing net income to be overstated by \$2,450.

EXERCISE 2-13

a.

Interior Design Consultants 2014				
Event	Assets	=	Liabilities	+ Stockholders' Equity
	Cash	=	Unearned Revenue	+ Retained Earnings
Coll. Unearned rev	24,000		24,000	
Recog. revenue earned			(6,000)*	6,000
	24,000	=	18,000	6,000

*\$24,000 x 3/12 = \$6,000

b.

Interior Design Consultants Income Statement For the Year Ended December 31, 2014		
Revenue		\$6,000
Expense		-0-
Net Income		\$6,000

Interior Design Consultants Balance Sheet As of December 31, 2014			
Assets			
Cash	\$24,000		
Total Assets		\$24,000	
Liabilities			-0-
Unearned Revenue	\$18,000		
Total Liabilities		\$18,000	
Stockholders' Equity			
Retained Earnings	\$ 6,000		
Total Stockholders' Equity		6,000	
Total Liab. and Stockholders' Equity		\$24,000	

EXERCISE 2-13 b. (cont.)

Interior Design Consultants Statement of Cash Flows For the Year Ended December 31, 2014		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	\$24,000	
Net Cash Flow from Operating Activities		\$24,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		24,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		\$24,000

- c. Nine months of unearned revenue will be recognized in 2015:
 $\$24,000 \times 9/12 = \$18,000$

EXERCISE 2-14

Note: This exercise can be used to assess writing skills.

The tutoring fees of \$800 received in advance by Kim Wong from Joe Pratt should be reported as a liability. Although Kim Wong has received the cash, it has not yet been earned. Wong has an obligation to either perform the services or refund the cash advance. When the tutoring service is provided to Joe, the unearned revenue should be recognized as revenue earned by Wong.

EXERCISE 2-15

Ross Attorney At Law Effect of Transactions on the Financial Statements for 2014											
	Balance Sheet						Income Statement				Statement of Cash Flows
	Assets		=	Liabilities		+ S. Equity	Rev.	–	Exp.	= Net Inc.	
No.	Cash	+ Supplies	=	Acct. Payable	+ Unearn. Revenue	+ Retained Earnings					
1.	NA	+ 1,500	=	1,500	+ NA	+ NA	NA	–	NA	= NA	NA
2.	36,000	+ NA	=	NA	+ 36,000	+ NA	NA	–	NA	= NA	36,000 OA
3.	84,000	+ NA	=	NA	+ NA	+ 84,000	84,000	–	NA	= 84,000	84,000 OA
4.	(32,000)	+ NA	=	NA	+ NA	+ (32,000)	NA	–	32,000	= (32,000)	(32,000) OA
5.	(8,000)	+ NA	=	NA	+ NA	+ (8,000)	NA	–	NA	= NA	(8,000) FA
6.	(1,200)	+ NA	=	(1,200)	+ NA	+ NA	NA	–	NA	= NA	(1,200) OA
7.	NA	+ (1,350)	=	NA	+ NA	+ (1,350)	NA	–	1,350	= (1,350)	NA
8.	NA	+ NA	=	NA	+ (33,000)*	+ 33,000	33,000	–	NA	= 33,000	NA
Totals	78,800	+ 150	=	300	+ 3,000	+ 75,650	117,000	–	33,350	= 83,650	78,800 NC

*\$36,000 x 11/12 = \$33,000

EXERCISE 2-16

a.

Ed Arnold Personal Financial Planning Horizontal Statements Model for 2014										
	Assets	=	Liabilities	+	Stk. Equity	Income Statement				Statement of Cash Flows
Event	Cash	=	Unearned Revenue	+	Retained Earnings	Rev.	–	Exp.	=	Net Income
1. Advance Payment	120,000	=	120,000	+	NA	NA	–	NA	=	NA
2. Revenue Earned	NA	=	(80,000)*	+	80,000	80,000	–	NA	=	80,000
Totals	120,000	=	40,000	+	80,000	80,000	–	-0-	=	80,000

*\$120,000 x 8/12 = \$80,000

- b. Revenue that will be recognized in 2015 is \$40,000, the remainder of the unearned revenue.
- c. \$-0-, no cash is received. All cash was received in 2014.

EXERCISE 2-17

a.

Caldonia Company Accounting Equation - 2014						
Event	Assets		=	Liab.	+	Stockholders' Equity
	Cash	Prepaid Rent	=		+	Common Stock + Retained Earnings
Paid 12 months rent	(4,800)	4,800				
Adj. for 3 months used		(1,200)*				(1,200)

*\$4,800 x 3/12 = \$1,200

b.

East Alabama Rentals Accounting Equation - 2014						
Event	Assets	=	Liabilities	+	Stockholders' Equity	
	Cash	=	Unearned Revenue	+	Common Stock	+ Retained Earnings
Recd. 12 months rent	4,800		4,800			
Earned 3 months rent			(1,200)*			1,200

*\$4,800 x 3/12 = \$1,200

EXERCISE 2-18

a. accrual

b. accrual

c. neither

d. deferral

e. neither

f. accrual

g. neither

h. deferral

i. neither

j. deferral

k. accrual

EXERCISE 2-19

Note: There are many examples of events that illustrate the required effects. An example is given of each event.

- a. Recognized revenue on account. The asset is either Cash or Accounts Receivable.**
- b. Recognized revenue where the cash had been received in advance. The liability is Unearned Revenue**
- c. Recognized an expense on account. The liability includes the word “Payable” or “Accrued” in the title.**
- d. Paid utilities expense. The asset is Cash or an account that includes the word “Prepaid” or a long-lived asset that is depreciated or amortized.**

EXERCISE 2-20

- a. Retained Earnings is a permanent account, meaning that one period's ending balance becomes the next period's beginning balance. Since the December 31, 2014 after-closing balance is \$19,400, this will also be the balance on January 1, 2015.
- b. The temporary accounts (Revenue, Expense, and Dividends) are closed at the end of each accounting cycle. As a result, they will always have a zero balance at the beginning of each accounting period.
- c. The relationship between the beginning and ending balances in the Retained Earnings accounts is:

Beginning Retained Earnings Balance (January 1, 2014)	?
+ Net Income (Revenue \$15,100 – Expenses 9,200)	5,900
– Dividends	<u>(1,500)</u>
Ending Retained Earnings Balance (December 31, 2014)	19,400

Beg. Retained Earnings = End. Retained Earnings – Net Income + Dividends

Beg. Ret. Earn. Balance = \$19,400 – \$5,900 + \$1,500 = \$15,000

Since Retained Earnings is a permanent account, the January 1, 2014 balance of \$15,000 is also the December 31, 2013 after-closing balance.

- d. Since revenue and expense is recognized evenly through the 2014 accounting cycle, approximately half would be recognized by June 30, 2014. Even so, the revenue and expense data are recorded in Revenue and Expense accounts and do not affect retained earnings at the time of recognition. The balance in the Retained Earnings account on June 30, 2014 is the same as it was on January 1, 2014 which is \$15,000.

EXERCISE 2-21

a.

Event	Requires year-end adjusting entry?
1.	No
2.	Yes
3.	No
4.	Yes
5.	No
6.	No
7.	No
8.	No
9.	Yes
10.	No

- b. Adjusting entries are recorded before closing entries. Adjusting entries are required to update the accounts so that the correct amounts of income and expenses are recognized. After the adjusting entries have been made, the adjusted balances of the revenue and expense accounts are closed to retained earnings.

EXERCISE 2-22

a.

Permanent Accounts
Cash
Notes Payable
Land
Common Stock
Retained Earnings

Temporary (Nominal) Accounts
Revenue
Expenses
Dividends

b.

Beginning Retained Earnings	\$5,200
Add: Revenue	7,000
Less: Expenses	(4,200)
Less: Dividends	(1,000)
Ending Retained Earnings	\$7,000

c.

Computation of Net Income	
Revenue	\$7,000
Less: Expenses	(4,200)
Net Income	\$2,800

- d. Net income is only the current year's net income. Retained Earnings is an accumulation of net income over the life of the business less any dividends that have been paid over the years.
- e. All revenue, expense and dividends accounts will have a zero balance because they have been closed to retained earnings.

EXERCISE 2-23

a.

Account		Classification
1.	Service Revenue	T
2.	Dividends	T
3.	Common Stock	P
4.	Notes Payable	P
5.	Cash	P
6.	Rent Expense	T
7.	Accounts Receivable	P
8.	Utilities Expense	T
9.	Prepaid Insurance	P
10.	Retained Earnings	P

b. The four stages of the accounting cycle are:

- recording transactions
- adjusting the accounts
- preparing financial statements
- closing temporary accounts.

The first stage of the cycle must be recording accounting data in accounts to put it into usable form. Once the accounting data is summarized in the accounts, adjustments are made to reflect any unrecorded transactions. The account balances are then used to prepare the financial statements. After the financial statements are prepared, the temporary accounts (revenue, expenses, and dividends) must be closed to prepare these accounts for the next accounting period.

EXERCISE 2-24

- a. Directly matched**
- b. Period expense**
- c. Period expense**
- d. Directly matched**

EXERCISE 2-25

a.

Event	Classification
1.	FA
2.	OA
3.	OA
4.	NA
5.	OA
6.	NA
7.	NA
8.	OA
9.	FA
10.	OA

b.

Blair Company Statement of Cash Flows For the Year Ended December 31, 2014			
Cash Flows From Operating Activities:			
Cash from the collection of accts. rec.	\$51,000		
Cash from service revenue	12,000		
Cash from svc. to be performed in future	21,000		
Cash payment on accounts payable	(22,000)		
Cash payment for rent	(7,200)		
Net Cash Flow from Operating Activities		\$54,800	
Cash Flows From Investing Activities		-0-	
Cash Flows From Financing Activities:			
Cash receipt from stock issue	\$30,000		
Cash payment for dividends	(5,000)		
Net Cash Flow from Financing Activities		25,000	
Net Change in Cash		\$79,800	
Plus: Beginning Cash Balance		-0-	
Ending Cash Balance		\$79,800	

EXERCISE 2-26

Item/Account	Statement	Item/Account	Statement
a. Consulting Revenue	IS	u. Rent Expense	IS
b. Market Value of Land	NA	v. Salary Expense	IS
c. Supplies Expense	IS	w. Total Stockholders' Equity	BS/SE
d. Salaries Payable	BS	x. Unearned Revenue	BS
e. Notes Payable	BS	y. Cash Flow from Investing Activities	CF
f. Ending Common Stock	SE/BS	z. Insurance Expense	IS
g. Beginning Cash Balance	CF	aa. End. Retained Earn.	BS/SE
h. Prepaid Rent	BS	bb. Interest Revenue	IS
i. Net Change in Cash	CF	cc. Supplies	BS
j. Land	BS	dd. Beg. Retained Earn.	SE
k. Operating Expenses	IS	ee. Utilities Payable	BS
l. Total Liabilities	BS	ff. Cash Flow from Financing Activities	CF
m. "As of" Date Notation	BS	gg. Accounts Receivable	BS
n. Salaries Expense	IS	hh. Prepaid Insurance	BS
o. Net Income	IS/SE	ii. Ending Cash Balance	BS/CF
p. Service Revenue	IS	jj. Utilities Expense	IS
q. Cash Flow from Operating Activities	CF	kk. Accounts Payable	BS
r. Operating Income	IS	ll. Beg. Common Stock	SE
s. Interest Receivable	BS	mm. Dividends	SE/CF
t. Interest Revenue	IS	nn. Total Assets	BS

EXERCISE 2-27

Horizontal Statement Model														
					Stk. Equity		Income Statement							
	Type of				Com.	Ret.			Net	Cash				
Event	Event	Assets	=	Liab.	+	Stock	+	Earn.	Rev.	–	Exp.	=	Inc.	Flows
a.	AE	I/D		NA		NA		NA	NA		NA		NA	D IA
b.	AS	I		NA		I		NA	NA		NA		NA	I FA
c.	AE	I/D		NA		NA		NA	NA		NA		NA	I OA
d.	AU	D		NA		NA		D	NA		I		D	D OA
e.	CE	NA		I		NA		D	NA		I		D	NA
f.	AS	I		I		NA		NA	NA		NA		NA	NA
g.	AS	I		NA		NA		I	I		NA		I	NA
h.	AE	I/D		NA		NA		NA	NA		NA		NA	D OA
i.	AU	D		NA		NA		D	NA		I		D	NA
j.	AS	I		NA		NA		I	I		NA		I	I OA
k.	AU	D		D		NA		NA	NA		NA		NA	D OA
l.	AU	D		NA		NA		D	NA		NA		NA	D FA
m.	AU	D		NA		NA		D	NA		I		D	NA
n.	CE	NA		I		NA		D	NA		I		D	NA
o.	AU	D		D		NA		NA	NA		NA		NA	D OA
p.	AS	I		I		NA		NA	NA		NA		NA	I OA
q.	AS	I		NA		NA		I	I		NA		I	NA

EXERCISE 2-28

Event	Net Income		Cash Flow from Operating Activities	
	Direction of Change	Amount of Change	Direction of Change	Amount of Change
a.	NA	NA	NA	NA
b.	Increase	\$20,000	Increase	\$15,000
c.	Decrease	1,200 ¹	Decrease	4,800
d.	Increase	5,000 ²	Increase	12,000
e.	Decrease	5,000	NA	NA
f.	NA	NA	NA	NA
g.	Increase	9,200	Increase	9,200
h.	Decrease	1,200 ³	Decrease	1,500
i.	Decrease	2,200	Decrease	2,200

¹\$4,800 x 3/12 = \$1,200

²\$12,000 x 5/12 = \$5,000

³\$2,000 – \$800 = \$1,200

EXERCISE 2-29

Note: These are only sample transactions. Other similar transactions will satisfy the requirements of this exercise.

- a. The business invested cash by purchasing a building.**

Collected accounts receivable.

- b. Purchased land with a note (liability).**

Purchased supplies on account.

- c. Paid accounts payable.**

Paid notes payable.

- d. Paid a cash dividend to owners.**

Paid an expense with cash.

- e. Recorded accrued salaries.**

Recorded the liability for the utility bill received, but not due until the next period.

- f. The business issued common stock to its owners.**

Cash revenue is earned.

- g. Unearned revenue is earned and recognized.**

EXERCISE 2-30

- a. Asset Source**
- b. Asset Use**
- c. Asset Source**
- d. Claims Exchange**
- e. Asset Source**
- f. Asset Use**
- g. Asset Exchange**
- h. Asset Use**
- i. Asset Source**
- j. Asset Exchange**

EXERCISE 2-31

Note: These are only sample transactions. Other similar transactions will satisfy the requirements of this exercise.

- a. Payment of rent expense; payment of other operating expense.**
- b. Payment of accounts payable; payment of dividends.**
- c. Received a note receivable in exchange for the sale of a delivery van.**
- d. Collection of accounts receivable; purchase of land.**
- e. Proceeds of a loan; issue of common stock.**

SOLUTIONS TO PROBLEMS - CHAPTER 2

PROBLEM 2-32

James Cleaning Company																			
Effect of Events on the Financial Statements																			
	Balance Sheet										Income Statement				Stmt. of				
	Assets				=	Liabilities			+	Stock. Equity		Rev.	–	Exp.	=	Net Inc.	Cash Flows		
Event	Cash	+	Accts Rec.	+	Supp.	=	Accts. Pay.	+	Unearn Rev.	+	Com. Stock	+	Ret. Earn.						
1.	15,000	+	NA	+	NA	=	NA	+	NA	+	15,000	+	NA	NA	–	NA	=	NA	15,000 FA
2.	6,000	+	NA	+	NA	=	NA	+	NA	+	NA	+	6,000	6,000	–	NA	=	6,000	6,000 OA
3.	NA	+	18,000	+	NA	=	NA	+	NA	+	NA	+	18,000	18,000	–	NA	=	18,000	NA
4.	11,000	+	(11,000)	+	NA	=	NA	+	NA	+	NA	+	NA	NA	–	NA	=	NA	11,000 OA
5.	(1,400)	+	NA	+	1,400	=	NA	+	NA	+	NA	+	NA	NA	–	NA	=	NA	(1,400) OA
6.	NA	+	NA	+	(1,300)	=	NA	+	NA	+	NA	+	(1,300)	NA	–	1,300	=	(1,300)	NA
7.	3,600	+	NA	+	NA	=	NA	+	3,600	+	NA	+	NA	NA	–	NA	=	NA	3,600 OA
8.	NA	+	NA	+	NA	=	NA	+	(1,800)	+	NA	+	1,800	1,800	–	NA	=	1,800	NA
9.	(6,500)	+	NA	+	NA	=	NA	+	NA	+	NA	+	(6,500)	NA	–	6,500	=	(6,500)	(6,500) OA
10.	NA	+	NA	+	NA	=	2,800	+	NA	+	NA	+	(2,800)	NA	–	2,800	=	(2,800)	NA
11.	(2,100)	+	NA	+	NA	=	(2,100)	+	NA	+	NA	+	NA	NA	–	NA	=	NA	(2,100) OA
12.	(1,000)	+	NA	+	NA	=	NA	+	NA	+	NA	+	(1,000)	NA	–	NA	=	NA	(1,000) FA
Bal.	24,600	+	7,000	+	100	=	700	+	1,800	+	15,000	+	14,200	25,800	–	10,600	=	15,200	24,600 NC
						=													

PROBLEM 2-33

The Accounting Equation						
Event/ Adjust.	Total Assets		Liabilities	Stockholders' Equity		
	Cash	Other Assets		Common Stock	Retained Earnings	
a.	(6,000)	+6,000	NA	NA	NA	
a. Adj. ¹	NA	(4,500)	NA	NA	(4,500)	
b.	NA	+2,400	+2,400	NA	NA	
b. Adj. ²	NA	(2,200)	NA	NA	(2,200)	
c.	(7,200)	+7,200	NA	NA	NA	
c. Adj. ³	NA	(6,000)	NA	NA	(6,000)	
d.	+18,000	NA	+18,000	NA	NA	
d. Adj. ⁴	NA	NA	(6,000)	NA	6,000	

¹\$6,000 x 9/12 = \$4,500

²\$2,400 – \$200 = \$2,200

³\$7,200 x 10/12 = \$6,000

⁴\$18,000 x 4/12 = \$6,000

PROBLEM 2-34

a.

Bates Company Income Statement For the Year Ended December 31, 2014		
Revenue		\$18,000
Expenses		
Salary Expense	\$13,000	
Utility Expense	1,800	
Rent Expense	1,600	
Total Expense		(16,400)
Net Income		\$ 1,600

b.

Accounts to be Closed:	
1.	Revenue
2.	Salary Expense
3.	Utility Expense
4.	Rent Expense
5.	Dividends

c.

Computation of Retained Earnings:	
Beginning Retained Earnings	\$19,700
Add: Net Income	1,600
Less: Dividends	(1,000)
Ending Retained Earnings	\$20,300

Net income only includes revenues and expenses for the current year. Retained earnings not only includes current year net income, but also the balance from previous years and reductions for dividends.

d. The balances are zero; they were closed to Retained Earnings on December 31, 2014. The December 31 closing balance of one year is the opening balance on January 1 of the next year.

PROBLEM 2-35

(Prepared for Instructor's Use)

Accounting Equation											
Date	Assets						Liabilities			Stk. Equity	
	Cash	Acc. Rec.	Pp. Rent	Supp.	Int. Rec.	Land	Acc. Pay.	Sal. Pay.	Unear. Rev.	Com. Stock	Ret. Earn.
Bal.	60,000	45,000				35,000	32,000			60,000	48,000
1/1	30,000									30,000	
4/1	(7,200)		7,200								
6/1	(5,000)										(5,000)
7/1	(40,000)					40,000					
8/1	(21,000)						(21,000)				
9/1	9,600								9,600		
9/30	20,000					(20,000)					
10/1				1,200			1,200				
12/31		75,000									75,000
12/31	62,000	(62,000)									
12/31							27,000				(27,000)
12/31								18,000			(18,000)
12/31				(1,100)							(1,100)
12/31 ¹											
12/31a			(5,400) ¹								(5,400)
12/31a									(4,800) ²		4,800
12/31 ²					120						120
Bal.	108,400	58,000	1,800	100	120	55,000	39,200	18,000	4,800	90,000	71,420

¹No entry for the change in value of the land.

²This assumes that some of the cash was invested in an interest bearing account.

(1) 12/31a Expired Rent (\$7,200 x 9/12 = \$5,400)

(2) 12/31a Unearned Revenue Earned (\$9,600 x 4/8 = \$4,800)

PROBLEM 2-35 (cont.)

a. The two transactions that need adjusting entries are as follows:

- 1. April 1, prepaid rent.**
- 2. Sept. 1, unearned revenue; cash was received in advance.**

b. $\$35,000 + \$40,000 - \$20,000 = \$55,000$

c. $\$62,000 + \$9,600 - \$7,200 - \$21,000 = \$43,400$

d. $\$7,200 \times 9/12 = \$5,400$

e. $\$39,200 + \$18,000 + \$4,800 = \$62,000$

f. $\$1,200 - \$100 = \$1,100$

g. $\$9,600 - \$4,800 (\$9,600 \times 4/8) = \$4,800$

h. $\$20,000 - \$40,000 = (\$20,000)$

i. Total expenses: $\$27,000 + \$18,000 + \$1,100 + \$5,400 = \$51,500$

j. $\$75,000 + \$4,800 = \$79,800$

k. $\$30,000 - \$5,000 = \$25,000$

l. (j) $\$79,800 + \$120 -$ (i) $\$51,500 = \$28,420$

m. Beg. RE $\$48,000 +$ NI $\$28,420 -$ Div. $\$5,000 =$ Ending retained earnings $\$71,420$

PROBLEM 2-36

Dawkins Company Financial Statements For the Year Ended December 31, 2014		
Income Statement		
Revenue		
Service Revenue	\$86,000	
Total Revenue		\$86,000
Expenses		
Other Operating Expenses	\$59,000	
Supplies Expense	1,000	
Rent Expense	3,500	
Insurance Expense	2,500	
Total Expenses		(66,000)
Net Income		\$20,000
Statement of Changes in Stockholders' Equity		
Beginning Common Stock	\$ 5,500	
Plus: Stock Issued	9,000*	
Ending Common Stock		\$14,500
Beginning Retained Earnings	\$47,200	
Plus: Net Income	20,000	
Less: Dividends	(5,000)	
Ending Retained Earnings		62,200
Total Stockholders' Equity		\$76,700

*Not given in the problem.

$$\begin{array}{rcl}
 \text{Ending Common Stock} & - & \text{Beginning Common Stock} = \text{Stock Issued} \\
 \$14,500 & - & \$5,500 = \$9,000
 \end{array}$$

PROBLEM 2-36 (cont.)

Dawkins Company Balance Sheet As of December 31, 2014			
Assets			
Cash	\$22,100		
Accounts Receivable	21,000		
Supplies	2,100		
Prepaid Insurance	3,500		
Land	43,000		
Total Assets		\$91,700	
Liabilities			
Accounts Payable	\$15,000		
Total Liabilities		\$15,000	
Stockholders' Equity			
Common Stock	\$14,500		
Retained Earnings	62,200		
Total Stockholders' Equity		76,700	
Total Liab. and Stockholders' Equity		\$91,700	

PROBLEM 2-36 (cont.)

Dawkins Company		
Statement of Cash Flows		
For the Year Ended December 31, 2014		
Cash Flow From Operating Activities	\$ 8,600	
Cash Flow From Investing Activities	(6,000)	
Cash Flow From Financing Activities	9,000	
Net Change in Cash	11,600	
Plus: Beginning Cash Balance	10,500*	
Ending Cash Balance	\$22,100	

*Not given in the problem.

$$\begin{array}{rclcl} \text{Ending Cash Bal.} & - & \text{Increase in Cash} & = & \text{Beg. Cash Balance} \\ \$22,100 & - & \$11,600 & = & \$10,500 \end{array}$$

PROBLEM 2-37

FOR THE YEARS	2014	2015	2016
Income Statements			
Revenue (cash)	\$ 400	\$ 500	\$ 800
Expense (cash)	(250)	(l) (400)	(425)
Net income	(a) \$ 150	\$ 100	\$ 375
Statements of Changes in Stockholders' Equity			
Beginning common stock	\$ -0-	(m) \$8,000	\$9,100
Plus: Common stock issued	(b) 8,000	1,100	310
Ending common stock	8,000	9,100	(s) 9,410
Beginning retained earnings	-0-	25	75
Plus: Net income	(c) 150	100	375
Less: Dividends	(d) (125)	(50)	(150)
Ending retained earnings	25	(n) 75	300
Total stockholders' equity	(e) \$8,025	\$9,175	(t) \$9,710
Balance Sheets			
Assets			
Cash	(f) \$11,000	(o) \$ 6,650	(u)\$ 8,050
Land	-0-	(p) 5,000	2,500
Total assets	\$11,000	\$11,650	\$10,550
Liabilities	(g) \$ 2,975	(q) \$ 2,475	\$ 840
Stockholders' equity			
Common stock	(h) 8,000	(r) 9,100	9,410
Retained earnings	(i) 25	75	300
Total stockholders' equity	8,025	9,175	9,710
Total liabilities and stk. equity	\$11,000	\$11,650	\$10,550

PROBLEM 2-37 (cont.)

FOR THE YEARS	2014	2015	2016
Statements of Cash Flows			
Cash flows from oper. activities:			
Cash receipts from revenue	(j) \$ 400	\$ 500	(v) \$ 800
Cash payments for expenses	(k) (250)	(400)	(w) (425)
Net cash flows from oper. Act.	150	100	375
Cash flows from invest. activities:			
Cash payments for land	-0-	(5,000)	-0-
Cash receipt from sale of land	-0-	-0-	2,500
Net cash flows from invest. act.	-0-	(5,000)	2,500
Cash flows from fin. activities:			
Cash rec. from borrowed funds	2,975	-0-	-0-
Cash payments to reduce debt	-0-	(500)	(x) (1,635)
Cash receipts from stock issue	8,000	1,100	(y) 310
Cash payments for dividends	(125)	(50)	(z) (150)
Net cash flows from fin. activities	10,850	550	(1,475)
Net change in cash	11,000	(4,350)	1,400
Plus: beginning cash balance	-0-	11,000	6,650
Ending cash balance	\$11,000	\$ 6,650	\$ 8,050

PROBLEM 2-37 (cont.)

Computations of amounts:

- a. $\$150 \text{ Net Income} = \$400 \text{ Revenue} - \$250 \text{ Expenses.}$
- b. $\$8,000 \text{ Common Stock Issued} = \$8,000 \text{ Ending Common Stock} - \$0 - \text{Beginning Common Stock.}$
- c. $\$150 \text{ Net Income} = \$150 \text{ Net Income from Income Statement.}$
- d. $\$125 \text{ Dividends} = \$0 - \text{Beginning Retained Earnings} + \$150 \text{ Net Income} - \$25 \text{ Ending Retained Earnings.}$
- e. $\$8,025 \text{ Total Stockholders' Equity} = \$8,000 \text{ Ending Common Stock} + \$25 \text{ Ending Retained Earnings.}$
- f. $\$11,000 \text{ Cash} = \$11,000 \text{ Total Assets} - \$0 - \text{Land.}$
- g. $\$2,975 \text{ Liabilities} = \$11,000 \text{ Total Liabilities and Stockholders' Equity} - \$8,025 \text{ Total Stockholders' Equity.}$
- h. $\$8,000 \text{ Common Stock} = \$8,000 \text{ Ending Common Stock from Statement of Changes in Stockholders' Equity.}$
- i. $\$25 \text{ Retained Earnings} = \$25 \text{ Ending Retained Earnings from Statement of Changes in Stockholders' Equity.}$
- j. $\$400 \text{ Cash Receipts from Revenue} = \$400 \text{ Revenue from Income Statement.}$
- k. $\$250 \text{ Cash Payments for Expenses} = \$250 \text{ Expenses from Income Statement.}$
- l. $\$400 \text{ Expenses} = \$500 \text{ Revenue} - \$100 \text{ Net Income.}$
- m. $\$8,000 \text{ Beginning Common Stock} = \$8,000 \text{ Ending Common Stock for 2014.}$
- n. $\$75 \text{ Ending Retained Earnings} = \$25 \text{ Beginning Retained Earnings} + \$100 \text{ Net Income} - \50 Dividends.
- o. $\$6,650 \text{ Cash} = \$6,650 \text{ Ending Cash Balance from the Statement of Cash Flows.}$
- p. $\$5,000 \text{ Land} = \$11,650 \text{ Total Assets} - \$6,650 \text{ Cash.}$
- q. $\$2,475 \text{ Liabilities} = \$11,650 \text{ Total Liabilities and Stockholders' Equity} - \$9,175 \text{ Total Stockholders' Equity.}$
- r. $\$9,100 \text{ Common Stock} = \$9,100 \text{ Ending Common Stock from Statement of Changes in Stockholders' Equity.}$
- s. $\$9,410 \text{ Ending Common Stock} = \$9,100 \text{ Beginning Common Stock} + \$310 \text{ Stock issued.}$
- t. $\$9,710 \text{ Total Stockholders' Equity} = \$9,410 \text{ Ending Common Stock} + \$300 \text{ Ending Retained Earnings.}$
- u. $\$8,050 \text{ Cash} = \$10,550 \text{ Total Assets} - \$2,500 \text{ Land.}$
- v. $\$800 \text{ Cash Receipts from Revenue} = \$800 \text{ Revenue from Income Statement.}$
- w. $\$425 \text{ Cash Payments for Expenses} = \$425 \text{ Expenses from Income Statement.}$
- x. $\$1,635 \text{ Cash Payments to Reduce Debt} = \$2,475 \text{ Liabilities Balance, 2015} - \$840 \text{ Liabilities Balance, 2016.}$
- y. $\$310 \text{ Cash Receipts from Stock Issue} = \$310 \text{ Common Stock Issued from Statement of Changes in Stockholders' Equity.}$
- z. $\$150 \text{ Cash Payments for Dividends} = \$150 \text{ Dividends from Statement of Changes in Stockholders' Equity.}$

PROBLEM 2-38

a.

Alabama Service Company Accounting Equation for 2014													
		Assets					=	Liabilities			+	Stk. Equity	
Event	Type of Event	Cash	Accts. Rec.	Supp.	Prepd. Rent	Land	=	Accts. Pay.	Salaries Payable	Unearn. Rev.	+	Com. Stock	Retained Earnings
1.	AS	60,000										60,000	
2.	AS			1,200				1,200					
3.	AE	(18,000)				18,000							
4.	AU	(800)						(800)					
5.	AS		42,000										42,000
6.	AU	(21,000)											(21,000)
7.	AE	38,000	(38,000)										
8.	CE								3,200				(3,200)
9.	AU			(1,000)									(1,000)
Totals		58,200	4,000	200	-0-	18,000	=	400	3,200	-0-	+	60,000	16,800

PROBLEM 2-38. (cont.)

Alabama Service Company Accounting Equation for 2015														
		Assets						=	Liabilities			+	Stk. Equity	
Event	Type of Event	Cash	Accts. Rec.	Supp.	Prepd. Rent	Int. Rec.	Land	=	Accts. Pay.	Salaries Payable	Unearn. Revenue	+	Com. Stock	Retained Earnings
Bal.		58,200	4,000	200	-0-		18,000		400	3,200	-0-		60,000	16,800
1.	AS	20,000											20,000	
2.	AU	(3,200)								(3,200)				
3.	AE	(3,600)			3,600									
4.	AE	15,000					(15,000)							
5.	AS	4,800									4,800			
6.	AS			1,000					1,000					
7.	AS		32,000											32,000
8.	AE	33,000	(33,000)											
9.	AU	(5,000)												(5,000)
10.	AU	(19,500)												(19,500)
11.	AU				(3,000) ¹									(3,000)
12.	CE										(1,200) ²			1,200
13.	AU			(900)										(900)
14.	CE									3,900				(3,900)
15.	AS					400								400
Totals		99,700	3,000	300	600	400	3,000	=	1,400	3,900	3,600	+	80,000	18,100

¹\$3,600 x 10/12 = \$3,000

²\$4,800 x 3/12 = \$1,200

PROBLEM 2-38 (cont.)

b.

Alabama Service Company Financial Statements For the Years Ended December 31, 2014 and 2015		
Income Statements		
	2014	2015
Service Revenue	\$ 42,000	\$ 33,200
Interest Revenue	-0-	400
	42,000	33,600
Expenses		
Operating Expenses	(21,000)	(19,500)
Supplies Expense	(1,000)	(900)
Salaries Expense	(3,200)	(3,900)
Rent Expense	-0-	(3,000)
Total Expenses	(25,200)	(27,300)
Net Income	\$16,800	\$ 6,300
Statements of Changes in Stockholders' Equity		
Beginning Common Stock	\$ -0-	\$60,000
Plus: Stock Issued	60,000	20,000
Ending Common Stock	60,000	80,000
Beginning Retained Earnings	-0-	16,800
Plus: Net Income	16,800	6,300
Less: Dividends	-0-	(5,000)
Ending Retained Earnings	16,800	18,100
Total Stockholders' Equity	\$76,800	\$98,100

PROBLEM 2-38 b. (cont.)

Alabama Service Company Balance Sheets As of December 31, 2014 and 2015			
	2014	2015	
Assets			
Cash	\$58,200	\$99,700	
Accounts Receivable	4,000	3,000	
Interest Receivable	-0-	400	
Supplies	200	300	
Prepaid Rent	-0-	600	
Land	18,000	3,000	
Total Assets	\$80,400	\$107,000	
Liabilities			
Accounts Payable	\$ 400	\$ 1,400	
Salaries Payable	3,200	3,900	
Unearned Revenue	-0-	3,600	
Total Liabilities	3,600	8,900	
Stockholders' Equity			
Common Stock	60,000	80,000	
Retained Earnings	16,800	18,100	
Total Stockholders' Equity	76,800	98,100	
Total Liab. and Stockholders' Equity	\$80,400	\$107,000	

PROBLEM 2-38 b. (cont.)

Alabama Service Company Statements of Cash Flows For the Years Ended December 31, 2014 and 2015			
	2014	2015	
Cash Flows From Operating Activities:			
Cash Received from Customers	\$38,000	\$37,800	
Cash Payment for Expenses ¹	(21,800)	(26,300)	
Net Cash Flow from Operating Activities	16,200	11,500	
Cash Flows From Investing Activities:			
Cash Payment for Land	(18,000)	-0-	
Cash Proceeds from Sale of Land		15,000	
Net Cash Flow From Investing Activities	(18,000)	15,000	
Cash Flows From Financing Activities:			
Cash Receipts from Stock Issue	60,000	20,000	
Cash Payment for Dividends	-0-	(5,000)	
Net Cash Flow From Financing Activities	60,000	15,000	
Net Change in Cash	58,200	41,500	
Plus: Beginning Cash Balance	-0-	58,200	
Ending Cash Balance	\$58,200	\$99,700	

¹2014: \$800 + \$21,000 = \$21,800

2015: \$3,200 + \$3,600 + \$19,500 = \$26,300

SOLUTIONS TO ANALYZE, THINK, COMMUNICATE – CHAPTER 2

ATC 2-1 (All dollar amounts are in millions.)

- 1. Target's accrual accounts are: Credit Card Receivables, Accounts Payable, Accrued and Other Current Liabilities, and Income Taxes Payable. The Deferred income taxes account shown under Liabilities is probably best classified as an accrual account, but students will probably think it is a deferral account.**
- 2. Target's deferral accounts are: Inventories, Buildings and Improvements, Fixtures and Equipment, Computer Hardware and Software, and Construction in Progress. Students might also list the Deferred Income Taxes account shown under Liabilities.**
- 3. Net income for 2012 was \$2,999
Cash provided by operating activities for 2012 was \$5,325**

Thus, cash flow from operating activities exceeded net income by \$2,326.

- 4. Net income increased by \$70 from 2011 to 2012 (\$2,999 - \$2,929). Cash provided by operating activities decreased by \$109 from 2011 to 2012 (\$5,325 - \$5,434). Therefore, the change in cash flows was the greatest.**

ATC 2-2

Group Task (1)

	Exxon	%	Apple	%
Computation of Expenses				
Revenue (in billions)	\$482.3	100.0	\$156.5	100.0
Less, Net Income	44.9	9.3	41.7	26.7
Expenses (in billions)	\$437.4	90.7	\$114.8	73.3

Group Task (2)

The conservatism principle guides accountants to select the alternative that produces the lowest amount of net income. The conservatism principle holds that it is better to understate income than to overstate it. If this holds true, Apple may be expensing more of its cost than Exxon Mobil.

Group Task (3)

Investors may believe there is more growth opportunity in the technology field, where Apple operates than there is in the petroleum field, where Exxon Mobil operates. Additionally, Apple's net income, as a percentage of sales, is higher.

ATC 2-3

This solution is based on Netflix's 2012 financial report.

a. Netflix's accrual accounts are:

**Accounts payable
Accrued expenses
Current content liabilities***

***Students probably will miss this one, as a careful reading of the Note 3 is needed to understand it..**

b. Netflix's deferral accounts are:

**Prepaid content
Content library, net (short-term and long-term)
Property, plant and equipment, net
Other current assets
Other noncurrent assets (possibly, depending on the nature of the asset)
Deferred revenues**

ATC 2-4

a.

Income Statement		Balance Sheet	
Service Revenue	\$120,000	Assets:	\$167,000
Operating Exp.	(40,000)		
Net Income	\$ 80,000	Liabilities:	\$ 5,000
		Stockholders' Equity:	
		Common Stock	82,000
		Retained Earnings	80,000
		Total Stk. Equity	162,000
		Total Liab. and Stk. Equity	\$167,000

Computations for Income Statement Items:

Revenue: $\$38,000 + \$82,000 = \$120,000$

Operating Expense: $\$70,000 - \$30,000 = \$40,000$

Computations for Balance Sheet Items:

Assets: $\$85,000 + \$82,000 = \$167,000$

Liabilities: $\$35,000 - \$30,000 = \$5,000$

Retained Earnings: $(\$32,000) + \$82,000 + \$30,000 = \$80,000$

- b. The conservatism principal requires that revenue not be recognized before it is actually earned. Glenn actually recorded an amount that not only had not been earned, but the contract had not been finalized. Glenn has overstated his income by the \$82,000.
- c. The accrued salaries are an expense that has already been accrued and is owed and these salary expense should be matched against the respective year's revenue. By removing these expenses from net income computation, Glenn is overstating net income.

