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 in storage areas called accounts. A general ledger is an organized collection of accounts. The purpose is to keep track of the increases, decreases, and balances in each account.

Answers to Questions (continued)

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, loss, and dividend transactions. It would be cumbersome and less informative to record revenue/expense, gain/loss, and dividend transactions directly into the permanent retained earnings account. Recording these transactions in temporary accounts facilitates the preparation of the financial statements.

Question 2–5

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

Question 2–6

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

Answers to Questions (continued)

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.

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 occurs only at the end of a reporting period in order to reduce the temporary accounts to zero before beginning the next reporting year.

Answers to Questions (continued)

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.

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 shareholders' (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 shareholders' 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.

Answers to Questions (continued)

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.

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.

Answers to Questions (concluded)

Question 2–21

The general ledger is a collection of control accounts representing assets, liabilities, and 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.	Notes 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		12,000

Brief Exercise 2–6

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

Brief Exercise 2–7

1.	Deferred service revenue	4,000	
	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 not adjusted as expired during the month. Liabilities would be lower by $13,600 (= –$4,000 + $16,000 + $1,600) for the deferred revenue not reduced upon completion of services and for accruals not increased by being recorded. Shareholders' equity (and net income for the period) would be higher by $14,600.

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 expense..	6,000	
	Salaries payable...		6,000

Brief Exercise 2–10

BOWLER CORPORATION
Income Statement
For the Year Ended December 31, 2021

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

Brief Exercise 2–11

BOWLER CORPORATION
Balance Sheet
At December 31, 2021

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	
Retained earnings		850,000
Retained earnings	815,000	
Cost of goods sold		580,000
Salaries expense		180,000
Rent expense		40,000
Interest expense		15,000
Retained earnings	12,000	
Dividends		12,000

Brief Exercise 2–13

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

Explanation:

*$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	
Service 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 (notes 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	
	Notes 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.**

Notes 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				Cost of goods sold	
	0	3/1 Bal.	3/1 Bal.	0	
	120,000	4.	4.	70,000	
	120,000	**3/31 Bal.**	**3/31 Bal.**		70,000

Rent expense		Depreciation expense	
3/1 Bal.	0	3/1 Bal.	0
5.	5,000	9.	1,000
3/31 Bal.	5,000	**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
Notes payable		30,000
Common stock		300,000
Sales revenue		120,000
Cost of goods sold	70,000	
Rent expense	5,000	
Depreciation expense	1,000	
Totals	471,000	471,000

Exercise 2–4

		Debit	Credit
1.	Cash	500,000	
	Common stock		500,000
2.	Office equipment	100,000	
	Cash		40,000
	Notes 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.	Dividends	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 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 payable
8.	I	Cost of goods sold
9.	I	Utilities 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.	19	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. Issued common stock in exchange for cash.	5	12
7. Collected cash from customers for goods sold in 3.	5	4
8. Borrowed cash from a bank and signed a note.	5	11
9. At the end of October, recorded the amount of supplies that had been used during the month.	7	6
10. Received cash for advance payment from customer.	5	13

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	1,000	
	Rent revenue ($^{1}/_{3}$ x $3,000)		1,000
6.	Rent revenue	2,000	
	Deferred rent revenue ($^{2}/_{3}$ x $3,000)		2,000

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. Deferred rent revenue ($12,000 x $^{5}/_{12}$)........................	5,000	
Rent revenue ($12,000 x $^{5}/_{12}$).................................		5,000
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 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 rent per month
   $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) accrued interest, or $250 per month.
   $250 x 12 months = $3,000 annual interest
   Principal x 6% = $3,000

   Principal = $3,000 ÷ .06 = **$50,000** note

Exercise 2–11

1. Insurance expense (April, May, & June: $6,000 x $^3/_{12}$)…	1,500	
Prepaid insurance...		1,500
2. Interest expense (April, May, & June: $80,000 x 8% x $^3/_{12}$)	1,600	
Interest payable...		1,600
3. Deferred rent revenue...	6,000	
Rent revenue (April, May, & June: $24,000 x $^3/_{12}$)......		6,000
4. Depreciation expense (April, May, & June: $20,000 x $^3/_{12}$)	5,000	
Accumulated depreciation..................................		5,000
5. Salaries expense	16,000	
Salaries payable...		16,000

Exercise 2–12

Requirement 1

BLUEBOY CHEESE CORPORATION
Income Statement
For the Year Ended December 31, 2021

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

Exercise 2–12 (continued)

BLUEBOY CHEESE CORPORATION
Balance Sheet
At December 31, 2021

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
Notes 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, 2021		
Sales revenue	800,000	
Retained earnings		800,000
Retained earnings	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

Exercise 2–13

December 31, 2021

Sales revenue	750,000	
Interest revenue	3,000	
Retained earnings		753,000
Retained earnings	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

Exercise 2–14

December 31, 2021		
Sales revenue	492,000	
Interest revenue	6,000	
Gain on sale of investments	8,000	
Retained earnings		506,000
Retained earnings	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

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, 2021		
Insurance expense..	1,500	
Prepaid insurance..		1,500

Exercise 2–15 (concluded)

Requirement 3

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

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

December 31, 2021		
Salaries expense...	15,000	
Salaries 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, 2021		
Deferred rent revenue..	1,000	
Rent revenue...		1,000

Exercise 2–16

Requirement 1

2021		Debit	Credit
Feb. 1	Cash	12,000	
	Notes payable		12,000
April 1	Prepaid insurance	3,600	
	Cash		3,600
July 17	Supplies	2,800	
	Accounts payable		2,800
Nov. 1	Notes receivable	6,000	
	Cash		6,000

Requirement 2

2021		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, 2021		
Service revenue **(1)**		$315,000
Operating expenses:		
Salaries expense	$180,000	
Supplies expense **(2)**	24,500	
Rent expense	12,000	
Insurance expense **(3)**	4,000	
Miscellaneous expense **(4)**	21,000	
Depreciation expense	10,000	
Total operating expenses		251,500
Operating income		63,500
Other expense:		
Interest expense **(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
Service 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 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

Wolkstein Drug Company
Worksheet
December 31, 2021

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		30,000		(1) 10,000		40,000				40,000
Accounts payable		25,000				25,000				25,000
Salaries 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 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			
Utilities 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, 2021

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

Exercise 2–20 (concluded)

WOLKSTEIN DRUG COMPANY
Balance Sheet
At December 31, 2021

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

July 1 - reversing entry

Salaries payable..	6,000	
Salaries expense..		6,000

July 2 – payment of salaries

Salaries expense..	10,000	
Cash..		10,000

Requirement 2

June 30 - adjusting entry

Salaries expense..	6,000	
Salaries payable..		6,000

July 2 - payment of salaries

Salaries expense..	4,000	
Salaries 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

	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 payable.	GJ
9.	Paid employee salaries.	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 2–24

	Transaction	Journal
1.	Paid interest on a loan.	CD
2.	Recorded depreciation expense.	GJ
3.	Purchased office equipment 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 a factory building in exchange for a note receivable.	GJ
11.	Collected cash from customers on account.	CR
12.	Paid employee salaries.	CD
13.	Collected interest on the note receivable.	CR

PROBLEMS

Problem 2–1

Requirement 1

2021		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	
	Notes payable		30,000
Jan. 20	Salaries 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.**

Notes payable

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

Common stock

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

30,000	**1/31 Bal.**	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 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
Notes payable		30,000
Common stock		100,000
Sales revenue		22,000
Cost of goods sold	13,000	
Salaries expense	6,000	
Utilities expense	1,000	
Rent expense	2,000	
Totals	172,000	172,000

Problem 2–2

Requirement 2

2021		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	
	Accrued liabilities		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 expense	3,000	
	Cash		3,000
Jan. 31	Dividends	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.
			1/16
		3,500	**1/31 Bal.**

Accounts payable

		3,000	1/1 Bal.
	5,500	5,500	1/2
		9,500	1/10
		12,500	**1/31 Bal.**

Common stock

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

Accrued liabilities

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

Dividends

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

Retained earnings

		6,500	1/1 Bal.
		6,500	**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 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		12,500
Accrued liabilities		150
Common stock		10,000
Retained earnings		6,500
Dividends	1,000	
Sales revenue		8,500
Cost of goods sold	4,800	
Salaries expense	3,000	
Rent expense	800	
Advertising expense	150	
Totals	41,150	41,150

Problem 2–3

1.	Depreciation expense	10,000	
	Accumulated depreciation		10,000
2.	Salaries expense	1,500	
	Salaries 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.	Insurance expense ($6,000 x $^{9}/_{24}$)	2,250	
	Prepaid insurance		2,250
6.	Supplies expense ($1,500 – $800)	700	
	Supplies		700
7.	No adjusting entry needed; not revenue until January 2022		
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.	6,000		
5.		2,250	
12/31 Bal.	3,750		

Supplies

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

Inventory

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

Notes 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 payable

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

Notes payable

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

Interest payable

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

Deferred sales revenue

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

Common stock

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

Retained earnings

		28,500	Bal.
		28,500	**12/31 Bal.**

Dividends

Bal.	4,000		
12/31 Bal.	4,000		

Problem 2–4 (continued)

INCOME STATEMENT ACCOUNTS

Sales revenue

		146,000	Bal.
		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 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.	0		
5.	2,250		
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	
Supplies	800	
Inventory	60,000	
Notes receivable	20,000	
Interest receivable	1,333	
Prepaid rent	1,000	
Prepaid insurance	3,750	
Office equipment	80,000	
Accumulated depreciation		40,000
Accounts payable		31,000
Salaries payable		1,500
Notes payable		50,000
Interest payable		1,500
Deferred sales revenue		2,000
Common stock		60,000
Retained earnings		28,500
Dividends	4,000	
Sales revenue		146,000
Interest revenue		1,333
Cost of goods sold	70,000	
Salaries 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	361,833	361,833

Problem 2–4 (continued)

Requirement 4

PASTINA COMPANY
Income Statement
For the Year Ended December 31, 2021

Sales revenue		$146,000
Cost of goods sold		70,000
Gross profit		76,000
Operating expenses:		
Salaries expense	$20,400	
Rent expense	12,000	
Depreciation expense	10,000	
Supplies expense	1,800	
Insurance expense	2,250	
Advertising expense	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, 2021

	Common Stock	Retained Earnings	Total Shareholders' Equity
Balance at January 1, 2021	$60,000	$28,500	$ 88,500
Issue of common stock	- 0 -		- 0 -
Net income for 2021		26,383	26,383
Less: Dividends		(4,000)	(4,000)
Balance at December 31, 2021	$60,000	$50,883	$110,883

Problem 2–4 (continued)

PASTINA COMPANY
Balance Sheet
At December 31, 2021

Assets

Current assets:		
Cash		$ 30,000
Accounts receivable		40,000
Supplies		800
Inventory		60,000
Notes 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 payable		1,500
Notes payable		50,000
Interest payable		1,500
Deferred sales 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, 2021

Sales revenue	146,000	
Interest revenue	1,333	
Retained earnings		147,333
Retained earnings	120,950	
Cost of goods sold		70,000
Salaries 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
Retained earnings	4,000	
Dividends		4,000

Problem 2–4 (continued)

Sales revenue

		146,000	Bal.
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 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

	Debit	Credit	
Bal.	0		
5.	2,250		
		2,250	Closing
12/31 Bal.	0		

Advertising expense

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

Retained earnings

	Debit	Credit	
		28,500	Bal.
Cl. exp	120,950	147,333	Cl. rev
Cl. Div	4,000		
		50,883	**12/31 Bal.**

Dividends

	Debit	Credit	
Bal.	4,000		
		4,000	Closing
12/31 Bal.	0		

Problem 2–4 (concluded)

Requirement 6

Account Title	Debits	Credits
Cash	30,000	
Accounts receivable	40,000	
Supplies	800	
Inventory	60,000	
Notes receivable	20,000	
Interest receivable	1,333	
Prepaid rent	1,000	
Prepaid insurance	3,750	
Office equipment	80,000	
Accumulated depreciation		40,000
Accounts payable		31,000
Salaries payable		1,500
Notes payable		50,000
Interest payable		1,500
Deferred sales 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 expense	6,200	
Salaries payable		6,200
Interest expense	2,500	
Interest payable		2,500
Deferred rent revenue	2,000	
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 expense	24,000	
	Cash		24,000
f.	Equipment	15,000	
	Cash		15,000
g.	Dividends	2,500	
	Cash		2,500

Problem 2–6 (continued)

Requirements 1 and 3

BALANCE SHEET ACCOUNTS

Cash

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

Accounts receivable

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

Equipment

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

Accumulated depreciation

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

Salaries payable

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

Common stock

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

Retained earnings

		9,500	1/1 Bal.
		9,500	**12/31 Bal.**

Problem 2–6 (continued)

Dividends

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

Problem 2–6 (continued)

INCOME STATEMENT ACCOUNTS

Service revenue

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

Miscellaneous expense

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		9,500
Dividends	2,500	
Service revenue		100,000
Salaries expense	41,000	
Miscellaneous expense	24,000	
Totals	166,000	166,000

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.
		9,500	**12/31 Bal.**

Problem 2–6 (continued)

Dividends

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

INCOME STATEMENT ACCOUNTS

Service revenue

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

Miscellaneous expense

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		9,500
Dividends	2,500	
Service revenue		100,000
Salaries expense	42,000	
Miscellaneous expense	24,000	
Depreciation expense	2,000	
Totals	169,000	169,000

Requirement 7

KARLIN COMPANY
Income Statement
For the Year Ended December 31, 2021

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

Problem 2–6 (continued)

KARLIN COMPANY
Balance Sheet
At December 31, 2021

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, 2021

Service revenue	100,000	
Retained earnings		100,000
Retained earnings	68,000	
Salaries expense		42,000
Miscellaneous expense		24,000
Depreciation expense		2,000
Retained earnings	2,500	
Dividends		2,500

Problem 2–6 (continued)

BALANCE SHEET ACCOUNTS

Cash

	Debit	Credit	
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

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

Equipment

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

Accumulated depreciation

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

Salaries payable

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

Common stock

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

Retained earnings

	Debit	Credit	
		9,500	1/1 Bal.
		100,000	Cl. rev
Cl. exp	68,000		
Cl. div	2,500		
		39,000	**12/31 Bal.**

Problem 2–6 (continued)

Dividends

1/1 Bal.	0		
g.	2,500		
		2,500	Closing
12/31 Bal.	0		

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

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 ÷ 10 years)	7,500	
Accumulated depreciation		7,500
2. Salaries expense ($4,500 – $3,000)	1,500	
Salaries 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	1,000	
Prepaid insurance		1,000
d. Salaries expense	1,500	
Salaries 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		
		1,000	Adjusting
12/31 Bal.	2,000		

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—buildings

		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 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

Service 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 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	1,000	
12/31 Bal.	1,000	

Utilities 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	2,000	
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 payable		1,500
Deferred rent revenue		1,200
Common stock		200,000
Retained earnings		56,450
Service revenue		90,000
Interest revenue		3,000
Rent revenue		6,300
Salaries expense	38,500	
Depreciation expense	11,000	
Insurance expense	1,000	
Utilities expense	30,000	
Maintenance expense	15,000	
Totals	464,500	464,500

Problem 2–9 (continued)

Requirement 4

December 31, 2021

Service revenue	90,000	
Interest revenue	3,000	
Rent revenue	6,300	
Retained earnings		99,300
Retained earnings	95,500	
Salaries expense		38,500
Depreciation expense		11,000
Insurance expense		1,000
Utilities expense		30,000
Maintenance expense		15,000

Problem 2–9 (concluded)

Requirement 5

Account Title	Debits	Credits
Cash	8,000	
Accounts receivable	9,000	
Prepaid insurance	2,000	
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 payable		1,500
Deferred rent revenue		1,200
Common stock		200,000
Retained earnings		60,250
Totals	369,000	369,000

Problem 2–10

Computations:

Sales revenue

Sales revenue during 2021 = \$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 2021 = \$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 2021 = \$250,000 – \$50,000 = **\$200,000**

Rent expense and prepaid rent

Prepaid rent = \$ 3,000 x $^{2}/3$ = **\$2,000**

Rent expense during 2021 = \$14,000 – \$2,000 = **\$12,000**

Depreciation expense

Depreciation during 2021 = \$30,000 x 10% = **\$3,000**

Interest expense

Interest accrued during 2021 = \$40,000 x 12% x $^{9}/12$ = **\$3,600**

Salaries expense

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

Problem 2–10 (continued)

McGUIRE CORPORATION
Income Statement
For the Year Ended December 31, 2021

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

Problem 2–10 (concluded)

McGUIRE CORPORATION
Balance Sheet
At December 31, 2021

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 payable		5,000
Notes 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 expense

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

Salaries 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 2021 ($50,000 x .08 x $^{9}/_{12}$)	3,000 (c)
Deduct: Amount accrued at the end of 2020	(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 2021	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 2021	2,500
Deduct: Prepaid insurance on 12/31/2021 ($6,000 x $^{4}/_{12}$)	(2,000) (a)
Insurance expense	$6,500

Salaries expense:

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

Problem 2–12 (continued)

Interest expense:

Amount accrued at the end of 2021	
($100,000 x .06 x 2/12)	$1,000 (d)

Rent expense:

Amount paid	**$24,000**
Add: Prepaid rent on 12/31/2020 expired during 2021	11,000
Deduct: Prepaid rent on 12/31/2021 ($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, 2021

Sales revenue		$705,000
Cost of goods sold		420,000
Gross profit		285,000
Operating expenses:		
Insurance expense	$ 6,500	
Salaries expense	214,000	
Rent expense	23,000	
Depreciation expense	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

Excalibur Corporation
Worksheet
December 31, 2021

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		10,000		(1) 7,500		17,500				17,500
Accounts payable		26,100				26,100				26,100
Salaries payable		3,000		(2) 1,500		4,500				4,500
Notes 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		22,050				22,050				22,050
Dividends	6,000				6,000				6,000	
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 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			
Utilities expense	6,000				6,000		6,000			
Depreciation expense	0		(1) 7,500		7,500		7,500			
							157,850	180,000	203,300	181,150
Net Income							22,150			22,150
Totals	351,150	351,150	11,500	11,500	361,150	361,150	180,000	180,000	203,300	203,300

Problem 2–13 (continued)

EXCALIBUR CORPORATION
Income Statement
For the Year Ended December 31, 2021

Sales revenue		$180,000
Cost of goods sold		95,000
Gross profit		85,000
Operating expenses:		
Salaries expense	$33,850	
Rent expense	13,000	
Supplies expense	1,500	
Utilities expense	6,000	
Depreciation expense	7,500	
Total operating expenses		61,850
Operating income		23,150
Other expense:		
Interest expense		1,000
Net income		$ 22,150

Problem 2–13 (continued)

EXCALIBUR CORPORATION
Statement of Shareholders' Equity
For the Year Ended December 31, 2021

	Common Stock	Retained Earnings	Total Shareholders' Equity
Balance at January 1, 2021	$80,000	$22,050	$102,050
Issue of common stock	- 0 -		- 0 -
Net income for 2021		22,150	22,150
Less: Dividends		(6,000)	(6,000)
Balance at December 31, 2021	$80,000	$38,200	$118,200

Problem 2–13 (continued)

EXCALIBUR CORPORATION
Balance Sheet
At December 31, 2021

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	(17,500)	57,500
Total assets		$179,800

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable		$ 26,100
Salaries payable		4,500
Notes payable		30,000
Interest payable		1,000
Total current liabilities		61,600
Shareholders' equity:		
Common stock	$80,000	
Retained earnings	38,200	
Total shareholders' equity		118,200
Total liabilities and shareholders' equity		$179,800

Problem 2–13 (concluded)

December 31, 2021

Sales revenue	180,000	
Retained earnings		180,000
Retained earnings	157,850	
Cost of goods sold		95,000
Interest expense		1,000
Salaries expense		33,850
Rent expense		13,000
Supplies expense		1,500
Utilities expense		6,000
Depreciation expense		7,500
Retained earnings	6,000	
Dividends		6,000

DECISION MAKERS' PERSPECTIVE CASES

Discussion Case 2–1

Memorandum

To: Mr. Sean Pitt
From: Your Name
Date: Current Date
RE: Usefulness of accrual based financial statements

Ms. Alice requested that I follow up with you regarding your application for a bank loan. In particular, she asked that I provide an explanation of why the bank requests accrual based financial statements for loan requests such as yours.

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.

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.

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.

Please let me know if I can provide any additional information.

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 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.

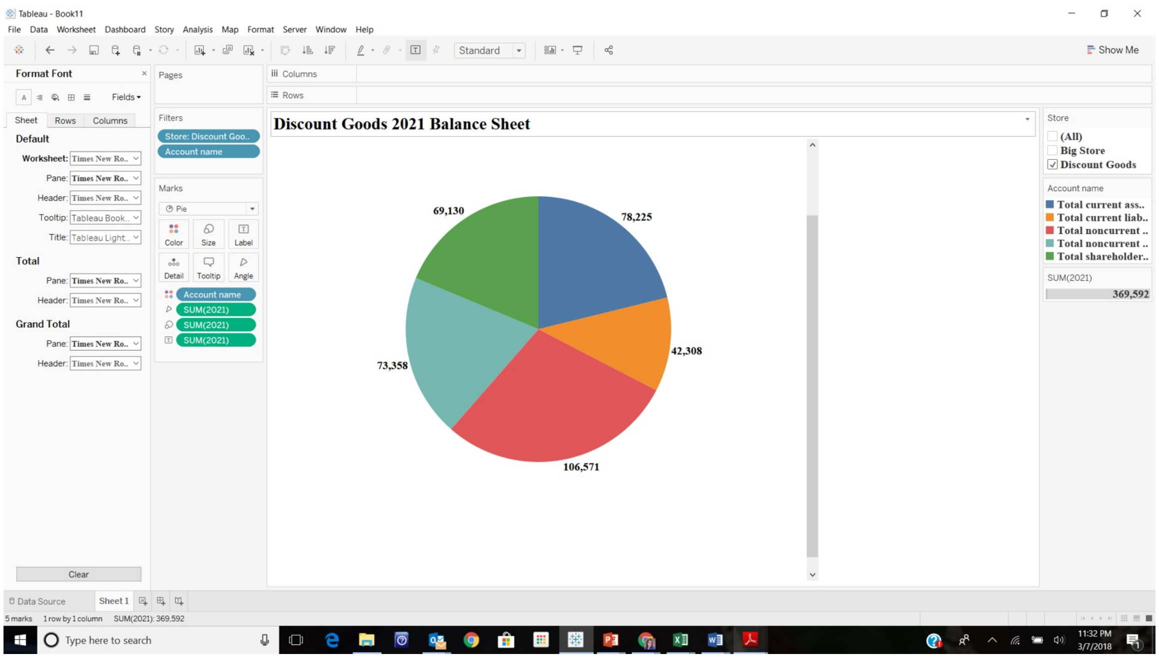
Requirement 3

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.

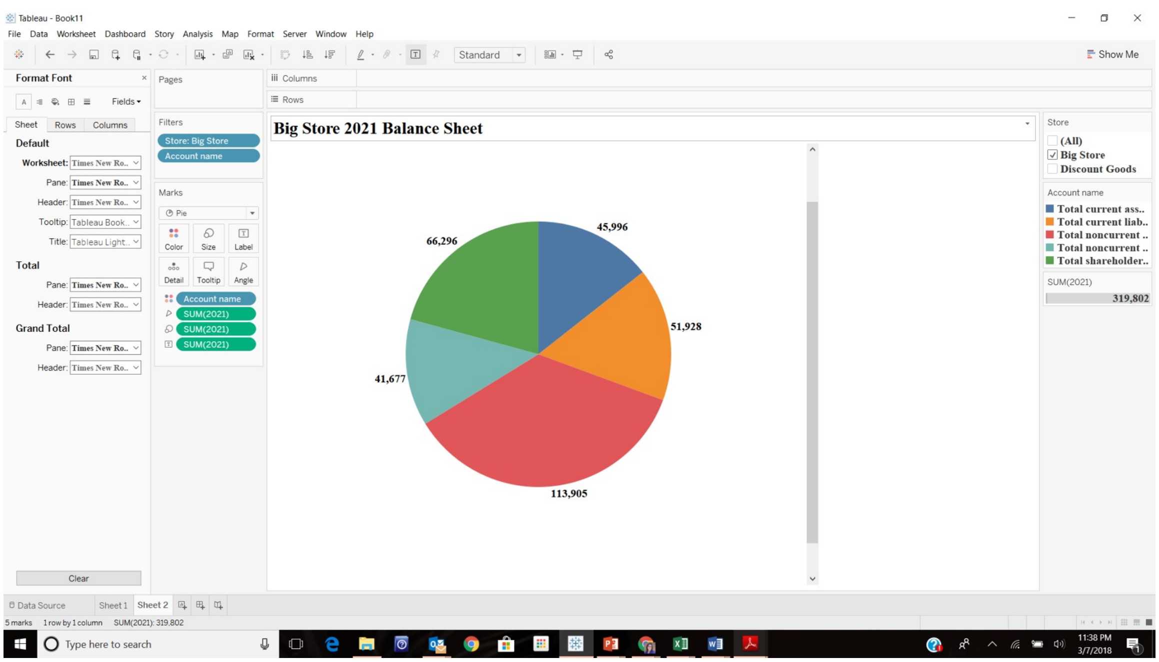
Data Analytics Case

Your Tableau analysis should produce the following charts:

(a) the pie chart for Discount Goods 2021 Balance Sheet:



(b) the pie chart for Big Store 2021 Balance Sheet:



Data Analytics Case (concluded)

Requirement 1

For Discount Goods, do liabilities or shareholders' equity provide the greater proportion of the company's assets?

Liabilities provide the greater proportion of the company's assets.

Liabilities / Total Assets = $115,666 ÷ $184,796 = 63%
Shareholders' Equity / Total Assets = $69,130 ÷ $184,796 = 37%

Requirement 2

For Big Store, do liabilities or shareholders' equity provide the greater proportion of the company's total assets?

Liabilities provide the greater proportion of the company's assets.

Liabilities / Total Assets = $93,605 ÷ $159,901 = 59%
Shareholders' Equity / Total Assets = $66,296 ÷ $159,901 = 41%

Requirement 3

Which of the two companies has the highest proportion of current liabilities to total liabilities?

Big Store reported the highest ratio of current liabilities to total liabilities. The ratio stated as a percentage **55%** (rounded to nearest whole percentage point).

Discount Goods = $42,308 ÷ $115,666 = 37%
Big Store = $51,928 ÷ $93,606 = 55%

Requirement 4

Which of the two companies has the highest ratio of current assets to current liabilities? What is the ratio stated as a percentage (rounded to nearest whole percentage point)?

Discount Goods reported the highest ratio of current assets to current liabilities. The ratio stated as a percentage is **185%**.

Discount Goods = $78,225 ÷ $42,308 = 185%
Big Store = $45,996 ÷ $51,928 = 89%

Target Case

Requirement 1

Target's balance sheet reports accumulated depreciation of $18.181 million and $17,413 million for the years ended February 3, 2018, and January 28, 2017, 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 ($18,181 – $17,413)....................	768	
Accumulated depreciation..		768

Requirement 2

The statement of cash flows shows $2,445 million for "depreciation and amortization" for the 2017 fiscal year. Given depreciation expense of $768 million, amortization expense must be $2,445 – $768 = $1,677 million.

Target Case (concluded)

Requirement 3

Note 13, " Other Current Assets," reports Prepaid expenses of $181 million and $207 million for the years ended February 3, 2018, and January 28, 2017, 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

Debit		Credit
Beginning balance	207	
		50 Insurance expense
Cash paid for insurance	**?**	
Ending balance	181	

Cash paid for insurance must have been $24 million.

Prior to the adjusting entry, the balance in prepaid insurance would have been $207 + $24 = $231. The adjusting entry to record expired insurance coverage and reduce the unexpired coverage to $181 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.