

# CHAPTER 2

## QUESTIONS

1. The accounting system generates a variety of reports for use by various decision makers. Among the most common are general-purpose financial statements, management reports, tax returns, and other reports prepared for government agencies such as the SEC.
2. A manual and an automated accounting system are similar in that both are designed to serve the same information-gathering and processing functions. Both systems also use the same underlying accounting concepts and principles. The differences between a manual and an automated accounting system involve some mechanical aspects, time requirements, and the appearance of records and reports. Due to advanced technology and reduced prices, today almost all successful businesses of any size use computers to assist in the various accounting functions.
3. The accounting process involves certain procedures used by businesses to produce financial statement data. The *recording phase* of the accounting process consists of those procedures used in the continuing activity of analyzing, recording, and classifying business transactions in the various books of record (journals and ledgers) during the fiscal period. The *reporting phase* of the accounting process consists of those procedures used at the end of the fiscal period to update and summarize data collected during the recording phase. Financial statements are prepared from the updated and summarized data.
4. The accounting process includes the following steps:
  - (1) *Business documents are analyzed.* Business documents provide detailed information concerning each transaction and establish support for the data recorded in the books of original entry.
  - (2) *Transactions are recorded in chronological order in books of original entry—the journals.* Transactions are analyzed in terms of their effects on the various asset, liability, owners' equity, revenue, and expense accounts of the business unit.
  - (3) *Transactions are posted to the appropriate accounts in the general and subsidiary ledgers.* The ledger accounts classify and summarize the full effect of all transactions recorded in the journals and can be used in the preparation of financial statements.
  - (4) *A trial balance may be prepared showing the account balances in the general ledger and reconciling subsidiary ledger balances with respective control account balances.* The trial balance provides a summary of the information as classified and summarized in the ledgers as well as a verification of the accuracy of recording and posting.
  - (5) *Adjustments are made to bring the accounts up to date.* Adjustments are necessary to record all accounting information that has not yet been recorded and to properly recognize all revenues and expenses on an accrual basis. If a spreadsheet is used (an optional step in the cycle), adjustments may be journalized and posted any time prior to closing. If statements are prepared directly from ledger balances, however, adjustments must be recorded at this point.
  - (6) *Financial statements are prepared.* Financial statements report the results of operations and cash flows for a period of time and show the financial condition of the business unit as of a certain date.
  - (7) *Closing entries are journalized and posted.* Balances in nominal accounts are closed into Retained Earnings. Operating results as determined in the summary accounts are finally transferred to Retained Earnings.
  - (8) *A post-closing trial balance may be prepared as an optional step in the cycle.* A post-closing trial balance is prepared to check the equality of the debits and credits after posting the adjusting and closing entries.

The steps in the accounting process are necessary to transform transaction data into useful information as summarized in the financial statements and other accounting reports. Some steps are optional, such as preparing a trial balance and preparing a post-closing trial balance. These steps help verify or facilitate the accounting process but are not essential.

5. Under double-entry accounting, assets, expenses, and dividends are increased by debits and decreased by credits. Liabilities, owners' equity accounts, and revenues are increased by credits and decreased by debits.
6.
  - a. *Real accounts* are balance sheet accounts not closed to a zero balance in the closing process. *Nominal accounts* are income statement or temporary owners' equity accounts closed out in the process of arriving at the net increase or decrease in owners' equity for a period.
  - b. A *general journal* is the most flexible book of original entry. It may be used to record all business transactions or simply those that cannot be recorded in one of the special journals. *Special journals* are designed to facilitate the recording of some particular type of frequently occurring transaction, such as sales, purchases, cash receipts, and cash disbursements.
  - c. The *general ledger* carries summaries of all accounts appearing on the financial statements. *Subsidiary ledgers* afford additional detail in support of certain general ledger balances. Thus, accounts payable appear in total in the general ledger, but individual accounts with each creditor are provided in the accounts payable subsidiary ledger.
7.
  - a. *Adjusting entries* are made at the end of an accounting period to update balance sheet accounts and to record accrued expenses and accrued revenues. Frequently, adjusting entries are first made on a work sheet and then are recorded in the general journal from which they are posted to the ledger accounts.
  - b. *Closing entries* are made after the adjusting entries have been posted. They transfer all nominal account balances to Retained Earnings.
8. The company accountant is disregarding the periodic summary process and jeopardizing the company's audit trail by not entering the adjusting entries in the general journal. Adjusting entries are made at the end of the period to bring accounts up to date. These entries must be entered first in the general journal and then posted directly to the general ledger. If the adjusting entries are not entered first in the general journal, the journals will be incomplete and will not provide the support necessary for an adequate accounting system.
9. Examples of contra accounts include Allowance for Bad Debts, Accumulated Depreciation, Discount on Notes Receivable, Discount on Notes Payable, and Discount on Bonds Payable. Contra accounts are subtracted from related accounts. Hence, they are sometimes referred to as *offset accounts*. Contra accounts are used to adjust accounts when the original balance needs to be preserved. For example, adequate disclosure in financial reports requires disclosure of both the original cost and the depreciated cost of assets. A contra account, Accumulated Depreciation, is used for this purpose.
10. Both methods, if properly applied, result in the same account balances. The entries that would be required on December 31 for (a) and (b), assuming that \$400 was paid for insurance for one year beginning April 1, are as follows:
  - a. Original entry:
 

Insurance Expense .....	400	
Cash .....		400

 Adjusting entry:
 

Prepaid Insurance .....	100	
Insurance Expense ..		100
  - b. Original entry:
 

Prepaid Insurance .....	400	
Cash .....		400

 Adjusting entry:
 

Insurance Expense .....	300	
Prepaid Insurance....		300

11. A *work sheet* is a multicolumn form designed to facilitate the summarization and organization of accounting data needed to prepare the financial statements. The number of columns and the headings used may vary, depending on the needs of a particular business. While the work sheet is an optional step in the accounting process, it is a valuable aid in completing the trial balance and adjustment procedures. A work sheet is also called a spreadsheet.

12. When a work sheet is used as a basis for statement preparation, the adjustments can be formally recorded in the journals and posted to the ledger accounts at any time prior to closing the books. However, if a work sheet is not used, financial statements must be prepared directly from the accounts; thus, the adjustments must be recorded and posted prior to statement preparation.

13. Only the following accounts would be closed, generally with the following debit/credit entries:

Rent Expense .....	Credit
Depreciation Expense ....	Credit
Sales .....	Debit
Interest Revenue .....	Debit
Advertising Expense .....	Credit
Dividends .....	Credit

14. *Accrual accounting* recognizes revenues and expenses when they are earned and incurred, not necessarily when cash is received or paid. *Cash-basis accounting* recognizes revenues and expenses as cash is received or disbursed, regardless of the earnings process or the matching concept. Generally accepted accounting principles require the use of accrual accounting.

15. The use of double-entry accrual accounting is more accurate than a cash-basis accounting system primarily because

- (a) The likelihood of errors and omissions is greatly increased in the absence of double-entry analysis and a trial

balance to test the accuracy of the analysis and recording process.

- (b) Recording events under an accrual system as they occur more accurately reflects the effects and timing of an event than does a system that records the events when cash is received or paid, regardless of the earnings process and the matching concept.

16. The major advantages offered by computers as compared with manual processing of accounting data are as follows:

- (a) Computers process large amounts of accounting data at great speeds, thus providing information for decision making on a more timely basis than a manual system would.
- (b) Computers process information accurately with less chance of human error than a manual processing system.
- (c) Computers require computer-oriented business papers and accounting records that promote clerical organization and efficiency.
- (d) Computers usually require a general centralization of all accounting activities and thus increase the efficiency and cost-effectiveness of the accounting system.
- (e) Computers can process accounting data and transmit such data in direct correspondence with customers and creditors in the form of online billings, invoices, payments, and so forth.

17. The function of the computer is limited to arithmetical and clerical functions. It can follow instructions that are provided on a programmed step-by-step basis, but unlike a human, it cannot think for itself. While it can serve effectively in recording activities, it cannot replace the accountant, who must still determine what principles are applicable in arriving at financial statements that present fairly the company's financial position and results of operations.

## PRACTICE EXERCISES

### PRACTICE 2–1 JOURNALIZING

Cash .....	4,000	
Accounts Receivable .....	18,000	
Sales .....		22,000
Cost of Goods Sold .....	14,000	
Inventory .....		14,000

### PRACTICE 2–2 JOURNALIZING

Equipment .....	100,000	
Cash .....		10,000
Short-Term Notes Payable .....		20,000
Long-Term Notes Payable .....		70,000

### PRACTICE 2–3 JOURNALIZING

Cash .....	40,000	
Equipment .....	90,000	
Gain on Sale of Land .....		80,000
Land .....		50,000

### PRACTICE 2–4 JOURNALIZING

Dividends (or Retained Earnings) .....	12,000	
Cash .....		12,000

### PRACTICE 2–5 JOURNALIZING

Wages Expense .....	52,000	
Land .....		52,000

### PRACTICE 2–6 POSTING

Cash			
Beg. Bal.	10,000		
a.	2,775	1,500	b.
d.	4,100	6,200	c.
End. Bal.	9,175		

**PRACTICE 2-7 POSTING**

Accounts Payable			
		8,000	Beg. Bal.
b.	6,500	2,700	a.
c.	200	2,550	d.
		6,550	End. Bal.

**PRACTICE 2-8 TRIAL BALANCE**

	<u>Debit</u>	<u>Credit</u>
Cash.....	\$ 750	
Inventory .....	4,000	
Accounts Payable.....		\$ 1,450
Paid-In Capital.....		2,000
Retained Earnings (beginning).....		1,000
Dividends .....	700	
Sales .....		10,000
Cost of Goods Sold .....	9,000	
Totals .....	<u>\$14,450</u>	<u>\$14,450</u>

**PRACTICE 2-9 TRIAL BALANCE**

	<u>Debit</u>	<u>Credit</u>
Cash.....	\$ 3,500	
Prepaid Rent Expense.....	5,000	
Unearned Service Revenue.....		\$ 1,600
Paid-In Capital.....		3,000
Retained Earnings (beginning).....		1,200
Service Revenue.....		32,000
Salary Expense .....	24,000	
Rent Expense.....	5,300	
Totals .....	<u>\$37,800</u>	<u>\$37,800</u>

**PRACTICE 2-10 INCOME STATEMENT**

From Practice 2-8:	
Sales .....	\$10,000
Cost of goods sold .....	<u>9,000</u>
Net income.....	<u>\$ 1,000</u>

**PRACTICE 2–10 (Concluded)**

From Practice 2–9:

Service revenue .....		\$32,000
Salary expense .....	\$24,000	
Rent expense .....	<u>5,300</u>	<u>29,300</u>
Net income.....		<u>\$ 2,700</u>

**PRACTICE 2–11 BALANCE SHEET**

From Practice 2–8:

<b>Assets</b>		
Cash.....	\$ 750	
Inventory .....	<u>4,000</u>	
Total assets .....	<u>\$4,750</u>	
<b>Liabilities</b>		
Accounts payable .....	<u>\$1,450</u>	
<b>Stockholders' Equity</b>		
Paid-in capital .....	\$2,000	
Retained earnings (ending).....	<u>1,300</u>	
Total liabilities and stockholders' equity .....	<u>\$4,750</u>	

Computation of ending Retained Earnings:

$$\$1,000 + (\$10,000 - \$9,000) - \$700 = \$1,300$$

From Practice 2–9:

<b>Assets</b>		
Cash.....	\$3,500	
Prepaid rent expense .....	<u>5,000</u>	
Total assets .....	<u>\$8,500</u>	
<b>Liabilities</b>		
Unearned service revenue .....	<u>\$1,600</u>	
<b>Stockholders' Equity</b>		
Paid-in capital .....	\$3,000	
Retained earnings (ending).....	<u>3,900</u>	
Total liabilities and stockholders' equity .....	<u>\$8,500</u>	

Computation of ending Retained Earnings:

$$\$1,200 + (\$32,000 - \$24,000 - \$5,300) = \$3,900$$

**PRACTICE 2–12    ADJUSTING ENTRIES**

Depreciation Expense.....	5,500	
Accumulated Depreciation .....		5,500

**PRACTICE 2–13    ADJUSTING ENTRIES**

Bad Debt Expense.....	1,200	
Allowance for Bad Debts .....		1,200

**PRACTICE 2–14    ADJUSTING ENTRIES**

Interest Expense .....	333	
Interest Payable .....		333

$$\$10,000 \times 0.08 \times 5/12 = \$333$$

**PRACTICE 2–15    ADJUSTING ENTRIES**

Rent Expense .....	1,500	
Prepaid Rent .....		1,500

$$\$3,600/12 = \$300 \text{ per month; amount used} = \$300 \times 5 \text{ months} = \$1,500$$

**PRACTICE 2–16    ADJUSTING ENTRIES**

Unearned Service Revenue .....	5,600	
Service Revenue.....		5,600

$$\$9,600/12 = \$800 \text{ per month; amount earned} = \$800 \times 7 \text{ months} = \$5,600$$

**PRACTICE 2–17    CLOSING ENTRIES**

Sales .....	11,000	
Retained Earnings .....		11,000

Retained Earnings.....	7,000	
Cost of Goods Sold .....		7,000

Retained Earnings.....	900	
Dividends .....		900

Balance sheet accounts are not closed.

**PRACTICE 2–18    CLOSING ENTRIES**

Service Revenue .....	20,000	
Retained Earnings .....		20,000
Retained Earnings.....	24,400	
Salary Expense .....		18,000
Rent Expense.....		6,400

Balance sheet accounts are not closed.



## EXERCISES

2-19. 1. and 2.

Cash		Accounts Receivable		Inventory	
Bal. 150,000	(15) 22,000	Bal. 21,540	(7) 12,000	Bal. 32,680	(1) 6,850
(7) 11,760	(18) 8,600	(1) 12,000		(5) 10,250	
	(27) 62,500	Bal. 21,540		Bal. 36,080	
Bal. 68,660					

Land		Building		Machinery	
Bal. 15,400		Bal. 14,000		(18) 8,600	
(27) 58,333*		(27) 116,667*		Bal. 8,600	
Bal. 73,733		Bal. 130,667			

\*( $\$75,000/\$225,000 \times \$175,000$ ) \*( $\$150,000/\$225,000 \times \$175,000$ )

Accounts Payable		Dividends Payable		Mortgage Payable	
	Bal. 9,190		(22) 20,250		Bal. 23,700
	(5) 10,250		Bal. 20,250		(27) 112,500
	Bal. 19,440				Bal. 136,200

Common Stock		Retained Earnings		Cost of Goods Sold	
	Bal. 140,000		Bal. 60,730	(1) 6,850	
				Bal. 6,850	

Sales		Sales Discounts		Wages Expense	
	(1) 12,000	(7) 240		(15) 22,000	
	Bal. 12,000	Bal. 240		Bal. 22,000	

Dividends	
(22) 20,250*	
Bal. 20,250	

\*( $\$0.45 \times 45,000$ )

## 2-19. (Concluded)

3. Georgia Supply Corporation  
Trial Balance  
October 31, 2013

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 68,660	
Accounts Receivable .....	21,540	
Inventory .....	36,080	
Land .....	73,733	
Building .....	130,667	
Machinery .....	8,600	
Accounts Payable .....		\$ 19,440
Dividends Payable .....		20,250
Mortgage Payable .....		136,200
Dividends .....	20,250	
Sales .....		12,000
Sales Discounts .....	240	
Cost of Goods Sold .....	6,850	
Wages Expense .....	22,000	
Common Stock .....		140,000
Retained Earnings .....		60,730
Totals .....	<u>\$388,620</u>	<u>\$388,620</u>

2-20. 1. Adjusting Entries

(a) Insurance Expense .....	1,500	
Prepaid Insurance .....		1,500
( $\$6,000 \div 24 \text{ mo.} = \$250 \times 6 \text{ mo.} = \$1,500$ )		
(b) Rent Revenue .....	2,700	
Unearned Rent Revenue .....		2,700
( $\$9,450 \div 7 \text{ mo.} = \$1,350 \times 2 \text{ mo.} = \$2,700$ )		
(c) Advertising Materials .....	500	
Advertising Expense .....		500
(d) Prepaid Rent .....	2,800	
Rent Expense .....		2,800
( $\$4,200 \div 6 \text{ mo.} = \$700 \times 4 \text{ mo.} = \$2,800$ )		
(e) Office Supplies .....	125	
Miscellaneous Office Expense .....		125
(f) Interest Expense .....	534	
Interest Payable .....		534



## 2-22.

1. Insurance Expense.....	500	
Prepaid Insurance.....		500
( $\$3,600 + \$1,200 - \$4,300 = \$500$ )		
2. Depreciation Expense.....	8,100	
Accumulated Depreciation.....		8,100
( $[\$103,400 - (\$10,700 - \$5,300) - \$106,100 = \$8,100]$ )		
3. Unearned Rent.....	10,000	
Rent Revenue.....		10,000
( $\$12,000 + \$6,000 - \$8,000 = \$10,000$ )		
4. Salaries Expense.....	7,060	
Salaries Payable .....		7,060
( $\$36,540 - \$29,480 = \$7,060$ )		

2-23. 1. Adjusting Entries

Prepaid Operating Expenses.....	4,000	
General Operating Expenses .....		4,000
Sales Commissions.....	5,900	
Sales Commissions Payable.....		5,900
Investment Revenue Receivable .....	1,000	
Investment Revenue .....		1,000
General Operating Expenses.....	4,500	
Accumulated Depreciation—Buildings .....		4,500
General Operating Expenses.....	5,000	
Accumulated Depreciation—Machinery.....		5,000
Income Tax Expense .....	18,100	
Income Taxes Payable.....		18,100

Closing Entries

Sales.....	590,000	
Investment Revenue.....	6,000	
Retained Earnings .....		596,000
Retained Earnings .....	560,500	
General Operating Expenses .....		106,500
Sales Commissions .....		205,900
Cost of Goods Sold .....		230,000
Income Tax Expense .....		18,100

## 2-23. (Concluded)

2. Pioneer Heating Corporation Post-Closing Trial Balance		
	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 39,000	
Investments .....	50,000	
Investment Revenue Receivable.....	1,000	
Inventory.....	50,000	
Prepaid Operating Expenses .....	4,000	
Land .....	70,000	
Buildings .....	180,000	
Accumulated Depreciation—Buildings .....		\$ 4,500
Machinery .....	100,000	
Accumulated Depreciation—Machinery.....		5,000
Accounts Payable .....		65,000
Income Taxes Payable.....		18,100
Sales Commissions Payable.....		5,900
Common Stock.....		320,000
Additional Paid-In Capital.....		40,000
Retained Earnings .....		35,500
Totals.....	<u>\$494,000</u>	<u>\$494,000</u>

2-24. 1. Adjusting Entries

- (a) No adjustment necessary.
- (b) Selling, General, and Administrative Expenses ..... 4,000  
       Prepaid Expenses ..... 4,000 |
- (c) Unearned Revenue ..... 31,500 |  |

      Rent Revenue.....  | 31,500 |

(d) Selling, General, and Administrative Expenses ..... 15,000  
       Plant and Equipment .....  | 15,000 |

(e) Selling, General, and Administrative Expenses ..... 2,800  
       Other Assets .....  | 2,800 |

(f) Other Assets ..... 13,000 |  |

      Selling, General, and Administrative Expenses .  | 13,000 |

(g) Accounts Payable..... 7,500 |  |

      Inventory.....  | 7,500 |

## 2-24. (Concluded)

2. Closing Entries

Sales .....	2,762,000	
Interest Revenue .....	29,000	
Rent Revenue .....	31,500	
Retained Earnings .....		2,822,500
Retained Earnings .....	2,475,800	
Cost of Goods Sold .....		1,565,000
Selling, General, and Administrative Expenses .....		623,800
Interest Expense .....		82,000
Income Tax Expense* .....		205,000
Retained Earnings .....	211,000	
Dividends .....		211,000

\*Assume that the adjustments do not affect Income Tax Expense.

3. **Boudreaux Company**  
**Post-Closing Trial Balance**  
**December 31, 20XX**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 72,000	
Accounts Receivable .....	365,000	
Inventory .....	44,500	
Prepaid Expenses .....	32,000	
Land .....	70,000	
Plant and Equipment .....	1,239,000	
Other Assets .....	1,285,200	
Accounts Payable .....		\$ 146,500
Wages, Interest, and Taxes Payable .....		218,000
Unearned Revenue .....		10,500
Long-Term Debt .....		1,190,000
Other Liabilities .....		297,000
Common Stock .....		195,000
Retained Earnings .....		1,050,700
Totals .....	<u>\$3,107,700</u>	<u>\$3,107,700</u>

2–25.

1. Received \$300 cash as payment on customer accounts.
2. Recorded return of inventory purchased on account for \$400 using the perpetual method.
3. Borrowed \$5,000 cash.
4. Sold inventory costing \$550 for \$200 cash and \$700 on account.
5. Paid \$200 cash for prepaid insurance policy.
6. Declared dividends of \$250.
7. Closed Dividends to Retained Earnings at the end of the period. Dividends for the period totaled \$1,000.
8. Used up \$50 worth of the prepaid insurance policy.
9. Purchased inventory for \$150 cash and \$450 on account.
10. Wrote off a bad debt of \$46.
11. Recorded accrued interest payable of \$125.
12. Paid wages of \$205—\$75 related to wages for the current period and \$130 was for wages for the prior period.
13. Paid account totaling \$500. Because the payment was made within the discount period, a \$10 purchase discount was taken.

2–26.

Adjusting Entries

(a)	Depreciation Expense .....	4,800	
	Accumulated Depreciation—Equipment.....		4,800
	(\$52,000 – \$4,000 = \$48,000; \$48,000/10 = \$4,800/year)		
(b)	Prepaid Selling Expense .....	1,500	
	Selling Expense .....		1,500
(c)	Interest Receivable .....	800	
	Interest Revenue.....		800
(d)	Advertising Expense .....	440	
	Selling Expense .....		440

2-27.

Adjusting Entries

(a)	Prepaid Insurance.....	5,025*	
	Insurance Expense.....		5,025
	*A, $\$5,400 \times 21/24$ .....		\$ 4,725
	B, $\$2,700 \times 2/6$ .....		900
	C, $\$18,000 \times 27/36$ .....		<u>13,500</u>
	Prepaid amount.....		\$19,125
	Account balance .....		<u>14,100</u>
	Adjustment .....		<u>\$ 5,025</u>
(b)	Subscription Revenue.....	3,900 <sup>†</sup>	
	Unearned Subscription Revenue .....		3,900
	<sup>†</sup> July, $\$27,000 \times 3/12$ .....		\$ 6,750
	October, $\$22,200 \times 6/12$ .....		11,100
	January, $\$28,800 \times 9/12$ .....		21,600
	April, $\$20,700 \times 12/12$ .....		<u>20,700</u>
	Unearned amount .....		\$60,150
	Account balance .....		<u>56,250</u>
	Adjustment .....		<u>\$ 3,900</u>
(c)	Interest Payable .....	450	
	Interest Expense.....		450
	[ $\$825 - (\$45,000 \times 0.10 \times 1/12)$ ]		
(d)	Supplies Expense.....	780	
	Supplies .....		780
	( $\$2,190 - \$1,410$ )		
(e)	Salaries Payable .....	5,250	
	Salaries Expense .....		5,250
	[ $\$9,750 - (\$11,250 \times 2/5)$ ]		



2-28. 1. Adjusting Entries

Rent Expense.....	15,700	
Prepaid Rent.....		15,700
Salaries and Wages Expense .....	2,600	
Salaries and Wages Payable .....		2,600
Unearned Consulting Fees .....	122,400	
Consulting Fees Revenue .....		122,400
Interest Receivable.....	1,300	
Interest Revenue .....		1,300

2. Rent Expense = \$5,100 + \$14,000 – \$3,400 = \$15,700  
 Salaries and Wages Expense = \$40,000 – \$2,100 + \$4,700 = \$42,600  
 Consulting Fees Revenue = \$18,200 + \$112,000 – \$7,800 = \$122,400  
 Interest Revenue = \$3,200 – \$800 + \$2,100 = \$4,500

## 2-29. 1.

<u>Account</u>	<u>Balance Carried Forward</u>	<u>Balance Closed by Debiting</u>	<u>Balance Closed by Crediting</u>
(a) Cash.....	X		
(b) Sales .....		X	
(c) Dividends .....			X
(d) Inventory .....	X		
(e) Selling Expenses .....			X
(f) Capital Stock.....	X		
(g) Wages Expense .....			X
(h) Dividends Payable .....	X		
(i) Cost of Goods Sold .....			X
(j) Accounts Payable.....	X		
(k) Accounts Receivable.....	X		
(l) Prepaid Insurance .....	X		
(m) Interest Receivable .....	X		
(n) Sales Discounts.....			X
(o) Interest Revenue.....		X	
(p) Supplies .....	X		
(q) Retained Earnings .....	X		
(r) Accumulated Depreciation ....	X		
(s) Depreciation Expense .....			X

## 2-29. (Concluded)

2. Closing Entries

Sales .....	75,000	
Interest Revenue .....	6,500	
Retained Earnings .....		81,500
Retained Earnings .....	54,800	
Selling Expenses .....		7,900
Wages Expense .....		14,400
Cost of Goods Sold .....		26,500
Sales Discounts .....		4,200
Depreciation Expense .....		1,800
Retained Earnings .....	3,500	
Dividends .....		3,500

3. \$26,700 net income (\$81,500 – \$54,800 = \$26,700)

## 2-30.

Closing Entries

Revenues .....	142,300	
Retained Earnings .....		142,300
Retained Earnings .....	91,500	
Expenses .....		91,500
Retained Earnings .....	29,200	
Dividends .....		29,200

## 2-31.

<u>Changes in Account Balances</u>	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 21,300	
Accounts receivable .....		\$ 5,000
Inventory .....	14,000	
Equipment .....	58,000	
Accounts payable .....		2,000
Loans payable .....		40,000
Interest payable .....		2,000
Contributed capital (\$32,000 + \$15,000) .....		47,000
Retained earnings (or Dividends) .....	20,000	
	<u>\$113,300</u>	<u>\$ 96,000</u>
Increase in net assets or net income .....		17,300
	<u>\$113,300</u>	<u>\$113,300</u>

2-32.

Impact of error correction on net income

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Accrued salaries:			
2011 error .....	\$(21,000)	\$ 21,000	
2012 error .....		(17,500)	\$ 17,500
2013 error .....			(26,000)
Interest receivable:			
2011 error .....	8,500	(8,500)	
2012 error .....		11,400	(11,400)
2013 error .....			12,100
Net income increase (decrease) .....	<u>\$(12,500)</u>	<u>\$ 6,400</u>	<u>\$ (7,800)</u>

## PROBLEMS

2–33.

1. May 1	Cash .....	40,000	
	Capital Stock.....		40,000
3	Inventory .....	8,000	
	Accounts Payable.....		8,000
4	Office Supplies .....	500	
	Cash.....		500
4	No entry.		
5	Accounts Receivable .....	14,000	
	Sales .....		14,000
	Cost of Goods Sold.....	7,500	
	Inventory .....		7,500
8	Wages Expense.....	2,450	
	Cash.....		2,000
	Employee Income Taxes Payable.....		450
9	No entry.		
9	Advertising Expense.....	1,500	
	Cash.....		1,500
10	Cash .....	13,580	
	Sales Discounts .....	420	
	Accounts Receivable.....		14,000
12	Machinery .....	6,400	
	Cash.....		6,400
15	Dividends.....	25,000	
	Dividends Payable .....		25,000
18	Accounts Receivable .....	21,000	
	Cash .....	3,000	
	Sales .....		24,000
	Cost of Goods Sold.....	13,000	
	Inventory .....		13,000
19	Accounts Payable .....	8,000	
	Cash.....		8,000
22	No entry.		
23	No entry.		
25	Building.....	150,000	
	Cash.....		15,000
	Mortgage Payable.....		135,000
29	Dividends Payable .....	25,000	
	Cash.....		25,000

**2-33. (Concluded)**

2. The single most important event was the free, favorable publicity in the national newsmagazine on May 22, which undoubtedly led to the large increase in market value the following day. However, since no transaction occurred (i.e., there was no exchange of goods or services), no journal entry was made. Because the accounting records include only transactions, some economically relevant events are not recorded.

**2-34.**

Account Title	(1) B/S I/S N	(2) A, L, OE, R, E, O	(3) Real or Nominal	(4) Closed or Open	(5) Debit (Dr.) or Credit (Cr.)
(a) Unearned Rent Revenue	B/S	L	Real	Open	Cr.
(b) Accounts Receivable	B/S	A	Real	Open	Dr.
(c) Inventory	B/S	A	Real	Open	Dr.
(d) Accounts Payable	B/S	L	Real	Open	Cr.
(e) Prepaid Rent	B/S	A	Real	Open	Dr.
(f) Mortgage Payable	B/S	L	Real	Open	Cr.
(g) Sales	I/S	R	Nominal	Closed	Cr.
(h) Cost of Goods Sold	I/S	E	Nominal	Closed	Dr.
(i) Dividends	N	O	Nominal	Closed	Dr.
(j) Dividends Payable	B/S	L	Real	Open	Cr.
(k) Interest Receivable	B/S	A	Real	Open	Dr.
(l) Wages Expense	I/S	E	Nominal	Closed	Dr.
(m) Interest Revenue	I/S	R	Nominal	Closed	Cr.
(n) Supplies	B/S	A	Real	Open	Dr.
(o) Accumulated Depreciation	B/S	A*	Real	Open	Cr.
(p) Retained Earnings	B/S	OE	Real	Open	Cr.
(q) Discount on Bonds Payable	B/S	L*	Real	Open	Dr.
(r) Goodwill	B/S	A	Real	Open	Dr.
(s) Additional Paid-In Capital	B/S	OE	Real	Open	Cr.

\*Contra.

2-35.

1. Adjusting Entries on 12/31/11:

(a)	Accounts Payable.....	4,300	
	Cash.....		4,300
(b)	Depreciation Expense .....	4,700	
	Accumulated Depreciation—Building .....		4,700
	<i>(\$141,000 × 1/30 = \$4,700)</i>		
(c)	Bad Debt Expense .....	4,740	
	Allowance for Bad Debts.....		4,740
	<i>[\$1,100 + (0.07 × \$52,000) = \$4,740]</i>		
(d)	Interest Receivable .....	2,933	
	Interest Revenue .....		2,933
	<i>(\$80,000 × 0.11 × 4/12 = \$2,933)</i>		
(e)	Sales Revenue .....	12,160	
	Unearned Sales Revenue .....		12,160
	<i>(\$15,200 × 0.80 = \$12,160)</i>		
(f)	Discount on Notes Payable .....	150	
	Interest Expense .....		150
	<i>(\$300 × 30/60 = \$150)</i>		

2. Net Change in Income:

Add:	Interest revenue not recorded .....	\$ 2,933	
	Overstatement of interest expense .....	<u>150</u>	\$ 3,083
Deduct:	Depreciation expense.....	\$ 4,700	
	Bad debt expense .....	4,740	
	Overstatement of sales revenue.....	<u>12,160</u>	<u>(21,600)</u>
	Net reduction in reported net income .....		<u><u>\$(18,517)</u></u>

2-36.

2013			
(a) Oct. 1	Rent Expense .....	2,400	
	Cash.....		2,400
	<i>(\$1,800 ÷ 9/12 = \$2,400 annual expense)</i>		
(b) June 1	Advertising Expense.....	4,080	
	Cash.....		4,080
	<i>(\$1,700 ÷ 5/12 = \$4,080 annual expense)</i>		
(c) Mar. 1	Cash .....	5,400	
	Rent Revenue.....		5,400
	<i>(\$900 ÷ 2/12 = \$5,400 annual revenue)</i>		

**2-36. (Concluded)**

(d) July 1	Office Supplies Expense .....	2,000	
	Cash.....		2,000
	<i>(\$1,000 ÷ 6/12 = \$2,000 annual expense)</i>		
(e) Aug. 1	Insurance Expense .....	1,800	
	Cash.....		1,800
	<i>(\$1,050 ÷ 7/12 = \$1,800 annual expense)</i>		

**2-37.**

(a) Bad Debt Expense .....	2,220	
Allowance for Bad Debts.....		2,220
(b) Interest Receivable.....	700	
Interest Revenue .....		700
(c) Discount on Notes Payable .....	900	
Interest Expense .....		900
(d) No adjustment required.		
(e) Salaries and Wages Expense .....	700	
Salaries and Wages Payable.....		700
(f) Discount on Notes Receivable .....	500	
Interest Revenue .....		500
(g) Unearned Rent Revenue .....	5,200	
Rent Revenue.....		5,200

**COMPUTATIONS:**

- (a) Estimated uncollectibles:  $0.04 \times \$123,000 = \$4,920$   
Required increase in allowance account balance:  
 $\$4,920 - \$2,700 = \$2,220$
- (b) Required increase in accrued interest on investments balance:  
 $\$3,900 - \$3,200 = \$700$
- (c) Required increase in discount on notes payable balance:  
 $\$1,200 - \$300 = \$900$
- (e) Required increase in accrued salaries and wages balance:  
 $\$8,300 - \$7,600 = \$700$
- (f) Required reduction in discount on notes receivable balance:  
 $\$1,800 - \$1,300 = \$500$
- (g) Required reduction in unearned rent revenue balance:  
 $\$5,200 - 0 = \$5,200$

2-38. 1.

(a) Accounts Receivable .....	28,000	
Bad Debt Expense .....	3,000	
Sales .....		28,000
Allowance for Bad Debts .....		3,000
(b) Salaries Expense .....	11,000	
Salaries Payable .....		11,000
(c) Prepaid Rent .....	9,000	
Rent Expense .....		9,000
(d) Utilities Expense .....	2,700	
Accrued Liabilities (or Utilities Payable) .....		2,700
(e) Depreciation Expense .....	6,000	
Accumulated Depreciation—Equipment .....		6,000
(\$30,000/5 years)		
(f) Commission Expense .....	3,750	
Commission Payable .....		3,750
(\$25,000 × 0.15. No commission on uncollectible accounts)		
(g) Prepaid Insurance .....	3,000	
Insurance Expense .....		3,000
(\$6,000 × 6/12)		
(h) Interest Expense .....	1,000	
Interest Payable .....		1,000
(\$50,000 × 0.12 × 2/12)		
(i) Income Tax Expense .....	30,060	
Income Taxes Payable .....		30,060
[\$75,150 × 0.40; see (2).]		



## 2–38. (Concluded)

2.

**Gee Enterprises**  
**Income Statement—Accrual Basis**  
**For the Year Ended December 31, 2013**

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Sales .....		<b>\$289,400</b>
Selling and administrative expenses:		
Salaries expense .....	\$89,000	
Commission expense.....	41,550	
Rent expense .....	36,000	
Utilities expense .....	31,700	
Depreciation expense .....	6,000	
Interest expense .....	4,000	
Insurance expense .....	3,000	
Bad debt expense.....	<u>3,000</u>	<u>214,250</u>
Income before income taxes .....		<b>\$ 75,150</b>
Income taxes (0.40).....		<u>30,060</u>
Net income .....		<b><u>\$ 45,090</u></b>

2-39. 1. Although not required, a work sheet is provided as an answer to (1) and as support for other parts of this problem.

Builders' Supply Corporation  
Work Sheet  
December 31, 2013

Account Title	Trial Balance		Adjustments		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash .....	24,000						24,000	
Accounts Receivable.....	72,000						72,000	
Allowance for Bad Debts.....		1,380		(a) 1,620				3,000
Inventory .....	87,570						87,570	
Long-Term Investments .....	15,400						15,400	
Land.....	69,600						69,600	
Buildings.....	72,000						72,000	
Accumulated Depreciation—Buildings .....		19,800		(b) 3,600				23,400
Accounts Payable.....		35,000						35,000
Mortgage Payable.....		68,800						68,800
Capital Stock, \$10 par .....		180,000						180,000
Retained Earnings, December 31, 2012.....		14,840						14,840
Dividends .....	13,400						13,400	
Sales.....		246,000				246,000		
Sales Returns.....	4,360				4,360			
Sales Discounts.....	5,400				5,400			
Cost of Goods Sold .....	114,370				114,370			
Selling Expenses .....	49,440		(c) 3,840		53,280			
Office Expenses.....	21,680				21,680			
Insurance Expense.....	1,440			(e) 720	720			
Supplies Expense.....	5,200			(d) 780	4,420			
Taxes—Real Estate and Payroll.....	7,980		(g) 900		8,880			
Interest Revenue.....		660		(f) 240		900		
Interest Expense.....	2,640		(h) 480		3,120			
Bad Debt Expense .....			(a) 1,620		1,620			
Depreciation Expense—Buildings (5% of \$72,000) .....			(b) 3,600		3,600			
Selling Expenses Payable.....				(c) 3,840				3,840
Supplies .....			(d) 780				780	
Prepaid Insurance.....			(e) 720				720	
Interest Receivable .....			(f) 240				240	
Real Estate and Payroll Taxes Payable .....				(g) 900				900
Interest Payable .....				(h) 480				480
Income Tax Expense .....			(i) 7,635		7,635			
Income Taxes Payable (30% of \$25,450) .....				(i) 7,635				7,635
	<u>566,480</u>	<u>566,480</u>	<u>19,815</u>	<u>19,815</u>	<u>229,085</u>	<u>246,900</u>	<u>355,710</u>	<u>337,895</u>
Net Income .....					<u>17,815</u>			<u>17,815</u>
					<u>246,900</u>	<u>246,900</u>	<u>355,710</u>	<u>355,710</u>

## 2–39. (Continued)

2. Adjusting Entries

(a) Bad Debt Expense .....	1,620	
Allowance for Bad Debts .....		1,620
(b) Depreciation Expense—Buildings .....	3,600	
Accumulated Depreciation—Buildings .....		3,600
(c) Selling Expenses .....	3,840	
Selling Expenses Payable .....		3,840
(d) Supplies .....	780	
Supplies Expense .....		780
(e) Prepaid Insurance .....	720	
Insurance Expense .....		720
(f) Interest Receivable .....	240	
Interest Revenue .....		240
(g) Taxes—Real Estate and Payroll .....	900	
Real Estate and Payroll Taxes Payable .....		900
(h) Interest Expense .....	480	
Interest Payable .....		480
(i) Income Tax Expense .....	7,635	
Income Taxes Payable .....		7,635

3. Closing Entries

Sales .....	246,000	
Interest Revenue .....	900	
Retained Earnings .....		246,900
Retained Earnings .....	229,085	
Sales Returns .....		4,360
Sales Discounts .....		5,400
Selling Expenses .....		53,280
Office Expenses .....		21,680
Insurance Expense .....		720
Supplies Expense .....		4,420
Taxes—Real Estate and Payroll .....		8,880
Interest Expense .....		3,120
Bad Debt Expense .....		1,620
Cost of Goods Sold .....		114,370
Depreciation Expense—Buildings .....		3,600
Income Tax Expense .....		7,635
Retained Earnings .....	13,400	
Dividends .....		13,400

## 2-39. (Concluded)

4. **Builders' Supply Corporation**  
**Post-Closing Trial Balance**  
**December 31, 2013**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 24,000	
Accounts Receivable .....	72,000	
Allowance for Bad Debts .....		\$ 3,000
Interest Receivable .....	240	
Inventory .....	87,570	
Supplies .....	780	
Prepaid Insurance .....	720	
Long-Term Investments .....	15,400	
Land .....	69,600	
Buildings .....	72,000	
Accumulated Depreciation—Buildings .....		23,400
Accounts Payable .....		35,000
Interest Payable .....		480
Selling Expenses Payable .....		3,840
Income Taxes Payable .....		7,635
Real Estate and Payroll Taxes Payable .....		900
Mortgage Payable .....		68,800
Capital Stock, \$10 par .....		180,000
Retained Earnings .....		19,255
Totals .....	<u>\$342,310</u>	<u>\$342,310</u>

2-40.

1. Adjusting Entries

(a) No adjustment needed.

(b) Bad Debt Expense .....	500	
Allowance for Bad Debts .....		500
(c) Depreciation Expense—Equipment .....	32,000	
Accumulated Depreciation—Equipment .....		32,000
(d) Inventory .....	5,600	
Cost of Goods Sold .....		5,600
Sales Revenue .....	8,200	
Accounts Receivable .....		8,200
(e) Interest Expense .....	7,000	
Interest Payable .....		7,000
(f) Prepaid Insurance .....	2,250	
Insurance Expense .....		2,250
(g) Dividends .....	7,800	
Dividends Payable .....		7,800

2. Closing Entries

Sales Revenue .....	301,800	
Interest Revenue .....	12,000	
Retained Earnings .....		313,800
Retained Earnings .....	306,300	
Cost of Goods Sold .....		199,650
Wages Expense .....		45,000
Interest Expense .....		10,200
Utilities Expense .....		6,000
Depreciation Expense—Equipment .....		32,000
Insurance Expense .....		750
Advertising Expense .....		5,000
Income Tax Expense .....		7,200
Bad Debt Expense .....		500
Retained Earnings .....	7,800	
Dividends .....		7,800

## 2-40. (Concluded)

3. Taipei International Corporation  
Post-Closing Trial Balance  
December 31, 2013

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 31,500	
Accounts Receivable .....	16,800	
Allowance for Bad Debts .....		\$ 750
Inventory .....	47,300	
Prepaid Insurance .....	2,250	
Equipment .....	190,000	
Accumulated Depreciation—Equipment .....		83,000
Accounts Payable .....		31,000
Notes Payable .....		70,000
Interest Payable .....		7,000
Wages Payable .....		8,000
Income Taxes Payable .....		6,500
Dividends Payable .....		7,800
Common Stock .....		40,000
Retained Earnings .....		33,800
Totals .....	<u>\$287,850</u>	<u>\$287,850</u>

4. Dividends are not restricted to the amount of net income in any given year. Therefore, it is possible for dividends to be paid in a year in which there is a net loss. However, contracts with lenders will sometimes restrict the payment of dividends in years when net income is below a certain amount.

Also, it is possible for a company to owe income taxes in a year in which it reports a loss on its income statement. Recall that financial accounting net income (to be reported to the shareholders) and taxable income (to be reported to the IRS) are computed according to two different sets of rules and will almost never be the same.

2-41.

High Flying Logistics Co.  
Work Sheet  
December 31, 2013

Account	Trial Balance		Adjustments		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash .....	42,000						42,000	
Accounts Receivable .....	86,000						86,000	
Allowance for Bad Debts .....		2,400		(a) 2,200				4,600
Inventory .....	97,000						97,000	
Long-Term Investments .....	31,500						31,500	
Land .....	62,300						62,300	
Buildings .....	142,500						142,500	
Accumulated Depreciation—Bldg. ....		32,560		(b) 13,500				46,060
Accounts Payable .....		51,800						51,800
Mortgage Payable .....		122,500						122,500
Capital Stock, \$5 par .....		200,000						200,000
Retained Earnings, Dec. 31, 2012 .		26,950						26,950
Dividends .....	40,540						40,540	
Sales .....		431,000				431,000		
Sales Returns .....	9,560				9,560			
Sales Discounts .....	8,440				8,440			
Cost of Goods Sold .....	203,420				203,420			
Selling Expenses .....	58,300		(c) 9,300		67,600			
Office Expenses .....	44,200				44,200			
Insurance Expense .....	12,000			(e) 3,800	8,200			
Supplies Expense .....	5,100			(d) 850	4,250			
Taxes—Real Estate and Payroll ....	15,800		(g) 3,550		19,350			
Interest Revenue .....		750		(f) 1,150		1,900		
Interest Expense .....	9,300		(h) 1,980		11,280			
Bad Debt Expense .....			(a) 2,200		2,200			
Depreciation Expense—Buildings .....			(b) 13,500		13,500			
Selling Expenses Payable .....				(c) 9,300				9,300
Supplies .....			(d) 850				850	
Prepaid Insurance .....			(e) 3,800				3,800	
Interest Receivable .....			(f) 1,150				1,150	
Real Estate and Payroll								
Taxes Payable .....				(g) 3,550				3,550
Interest Payable .....				(h) 1,980				1,980
Income Taxes Payable .....				(i) 16,360				16,360
Income Tax Expense .....			(i) 16,360		16,360			
	<u>867,960</u>	<u>867,960</u>	<u>52,690</u>	<u>52,690</u>	<u>408,360</u>	<u>432,900</u>	<u>507,640</u>	<u>483,100</u>
Net Income .....					24,540			24,540
					<u>432,900</u>	<u>432,900</u>	<u>507,640</u>	<u>507,640</u>

2-42. 1.

Whitni Corporation  
Work Sheet  
December 31, 2013

Account Title	Trial Balance		Adjustments		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash .....	40,250						40,250	
Notes Receivable .....	16,500						16,500	
Accounts Receivable .....	63,000						63,000	
Allowance for Bad Debts .....		650		(c) 1,850				2,500
Inventory, December 31, 2013 .....	94,700						94,700	
Land .....	80,000						80,000	
Buildings .....	247,600						247,600	
Accumulated Depreciation—Buildings .....		18,000		(a2) 6,904				24,904
Furniture and Fixtures .....	15,000						15,000	
Accumulated Depreciation—Furniture and Fixtures .....		9,000		(a1) 1,500				10,500
Notes Payable .....		18,000						18,000
Accounts Payable .....		72,700						72,700
Common Stock, \$100 par .....		240,000						240,000
Retained Earnings .....		129,125	(g1) 3,600					125,525
Sales .....		760,000				760,000		
Sales Returns and Allowances .....	17,000				17,000			
Cost of Goods Sold .....	465,800				465,800			
Utilities Expense .....	16,700				16,700			
Property Tax Expense .....	10,200		(d3) 6,000		16,200			
Salaries and Wages Expense .....	89,000				89,000			
Sales Commissions Expense .....	73,925		(d1) 700		74,625			
Insurance Expense .....	18,000			(e) 3,200	14,800			
Interest Revenue .....		2,600		(f) 750		3,350		
Interest Expense .....	2,400		(d2) 45		2,445			
Depreciation Expense—Buildings .....			(a2) 6,904		6,904			
Depreciation Expense—Furniture and Fixtures .....			(a1) 1,500		1,500			
Bad Debt Expense .....			(c) 1,850		1,850			
Sales Commissions Payable .....				(d1) 700				700
Interest Payable .....				(d2) 45				45
Property Taxes Payable .....				(d3) 6,000				6,000
Prepaid Insurance .....			(e) 3,200				3,200	
Interest Receivable .....			(f) 750				750	
Dividends Payable .....				(g1) 3,600				3,600
Income Tax Expense .....			(g2) 15,000		15,000			
Income Taxes Payable .....				(g2) 15,000				15,000
	<u>1,250,075</u>	<u>1,250,075</u>	<u>39,549</u>	<u>39,549</u>	721,824	763,350	561,000	519,474
Net Income .....					41,526			41,526
					<u>763,350</u>	<u>763,350</u>	<u>561,000</u>	<u>561,000</u>



## 2-42. (Continued)

2. Adjusting Entries

(a1)	Depreciation Expense—Furniture and Fixtures.....	1,500	
	Accumulated Depreciation—Furniture and Fixtures .....		1,500
	( $\$15,000 \times 0.10 = \$1,500$ )		
(a2)	Depreciation Expense—Buildings .....	6,904	
	Accumulated Depreciation—Buildings .....		6,904
	$[(\$97,600 \times 0.04) + (\$150,000 \times 0.04 \times 6/12) = \$6,904]$		
(c)	Bad Debt Expense.....	1,850	
	Allowance for Bad Debts .....		1,850
	( $\$2,500 - \$650 = \$1,850$ )		
(d1)	Sales Commissions Expense.....	700	
	Sales Commissions Payable.....		700
(d2)	Interest Expense .....	45	
	Interest Payable.....		45
(d3)	Property Tax Expense.....	6,000	
	Property Taxes Payable.....		6,000
(e)	Prepaid Insurance .....	3,200	
	Insurance Expense .....		3,200
(f)	Interest Receivable.....	750	
	Interest Revenue .....		750
(g1)	Retained Earnings.....	3,600	
	Dividends Payable .....		3,600
	( $\$1.50 \times 2,400 \text{ shares} = \$3,600$ )		
(g2)	Income Tax Expense.....	15,000	
	Income Taxes Payable .....		15,000

## 2-42. (Concluded)

Closing Entries

Sales .....	760,000	
Interest Revenue .....	3,350	
Retained Earnings .....		763,350
Retained Earnings .....	721,824	
Sales Returns and Allowances .....		17,000
Cost of Goods Sold .....		465,800
Utilities Expense .....		16,700
Property Tax Expense .....		16,200
Salaries and Wages Expense .....		89,000
Sales Commissions Expense .....		74,625
Insurance Expense .....		14,800
Interest Expense .....		2,445
Depreciation Expense—Buildings .....		6,904
Depreciation Expense—Furniture and Fixtures .....		1,500
Bad Debt Expense .....		1,850
Income Tax Expense .....		15,000

## CASES

### Discussion Case 2–43

First of all, many businesses do not survive, and poor bookkeeping is a contributor to the demise of many of them. Poor bookkeeping leads to a host of problems: trouble collecting accounts, difficulties with suppliers over late payments, problems getting bank loans because of the inability to prove profitability, inability to assemble reliable cost and revenue data in order to make pricing decisions, and general inefficient use of time. In addition, poor bookkeeping is often a symptom of a more fundamental laxness that adversely affects all aspects of the business.

Secondly, some businesses do well in spite of their bookkeeping inefficiencies because their fundamental business is doing so well that the inefficiencies stemming from bad recordkeeping only reduce profits instead of eliminating them altogether. This often occurs when a business occupies a specialized market niche that competitors have not yet entered.

### Discussion Case 2–44

Recall that journal entries are made to record transactions and that *transactions* are defined as events that involve the transfer or exchange of goods or services between two or more entities. Each of the events listed in this case has potential economic significance. However, none of them involve an exchange of goods or services between the business and an outside entity. Accordingly, no journal entries are required.

### Discussion Case 2–45

This case provides an opportunity to discuss with students the impact computers have had on accounting activities. Accounting systems have undergone significant changes as new technology has made it possible to produce a variety of reports in a timely and comprehensive manner not previously practical. In many companies, several information systems exist side by side, each producing information for a narrow use. The use of more generalized databases that can be queried by different users to meet their needs is increasingly used. Accountants must be willing to work with such systems if they are going to introduce the controls necessary to ensure the integrity of the data. Jim's worry is a real one; however, avoidance of the issue will not make the problem go away. If accountants do not play an active role in streamlining the system, other professionals with expertise in computer technology will and accountants will be forced to use what they are given.

### Discussion Case 2–46

The cash basis and the accrual basis yield quite different pictures of a firm's operating performance when levels of assets or liabilities change dramatically from beginning of period to end of period. This would be the case, for example, in a growing company. In such a company, cash needs would exceed net income because of the need to increase working capital and the fixed assets of the company.

The cash basis and the accrual basis show similar pictures when the levels of assets and liabilities do not change significantly from beginning of period to end of period. For example, in a firm that has been in existence for quite some time and that has reached a steady state, the levels of receivables, inventory, and payables are often constant. Capital expenditures to replace fixed assets in any given year approximate depreciation expense for the year. In such a circumstance, cash flow and net income are approximately the same.

**Discussion Case 2–47**

The possibilities include the following:

1. The financial statements may be augmented by more extensive electronic disclosure. This would allow companies to provide much more information and allow investors to analyze the information more easily. It has been suggested that the importance of accounting method choice would diminish because users would be able to generate reports based on any set of accounting assumptions. Lenders, for example, might choose a more conservative set of assumptions than a potential corporate raider. Dissemination of more detailed data would allow all users to generate tailor-made financial statements.
2. Ultimately, it might someday be possible for an outsider to track the performance of a firm on an on-going basis by tapping directly into the firm's accounting computer system. There would be no need for periodic financial statements; users could generate financial statements for any interval they choose. Accounting software firms would arise with competing software to best analyze and summarize the raw data available from company accounting records.

**Discussion Case 2–48**

Companies are usually very sensitive to requests of their stockholders. This concern should be expressed in replying to Julie's request. The company policy in distributing quarterly reports could be conveyed in the reply, along with the latest report. The chief accountant could assure Julie that the quarterly reports are prepared using the same generally accepted accounting principles as the annual reports and that the company auditors do review the quarterlies for consistency and overall reasonableness.

The idea of direct access to company records is one that has been suggested by several futurists. Certainly, the technology is available to do some of this. However, companies must also be concerned about premature disclosure of information that might be detrimental to the long-term interest of the company as an entity. As chief accountant, you might consider establishing an online system that would be updated weekly and that would provide data to interested stockholders such as Julie. The use of online databases to access previously unavailable information is certainly going to occur. Those companies in the forefront will be perceived as forward looking and will likely be popular with stockholders.

**Case 2–49**

Lockheed Martin Corporation  
Adjusted Trial Balance  
December 31, 2009  
(dollars in millions)

	<u>Debit</u>	<u>Credit</u>
Cash and Cash Equivalents.....	\$ 2,391	
Receivables.....	6,061	
Inventories.....	2,183	
Deferred Income Taxes, Current .....	815	
Other Current Assets .....	1,027	
Property, Plant and Equipment, Net .....	4,520	
Goodwill .....	9,948	
Purchased Intangibles, Net.....	311	
Prepaid Pension Asset.....	160	
Deferred Income Taxes .....	3,779	
Other Assets .....	3,916	
Accounts Payable .....		\$ 2,030
Customer Advances and Amounts in Excess of Costs Incurred .....		5,049
Salaries, Benefits and Payroll Taxes .....		1,648
Other Current Liabilities .....		1,976
Long-term Debt, Net.....		5,052
Accrued Pension Liabilities .....		10,823
Other Postretirement Benefit Liabilities.....		1,308
Other Liabilities .....		3,096
Common Stock.....		373
Retained Earnings.....		11,621
Accumulated Other Comprehensive Loss .....	8,595	
Dividends .....	2,294	
Total Net Sales.....		45,189
Cost of Sales .....	40,965	
Other Income and Expenses, Net.....		242
Interest Expense .....	305	
Other Non-operating Income .....		123
Income Tax Expense .....	<u>1,260</u>	
Totals .....	<u>\$88,530</u>	<u>\$88,530</u>

Remember that the retained earnings balance on the December 31, 2009, balance sheet reflects the fact that all nominal accounts have been closed. To prepare a trial balance that includes nominal accounts, net income for the period must be subtracted and dividends must be added (obtained from the statement of stockholders' equity) from the end-of-year balance to arrive at the beginning-of-year balance.

**Case 2–50**

Students should consider the following points in their assignment:

1. An understanding of how information from a transaction is entered into the accounting system, processed by the system, and accumulated into a report will aid accountants and others as they use the information.
2. If an error occurs in the accounting system, an understanding of how the system works will facilitate the correction of the error.
3. An understanding of the mechanics enables individuals to better understand the concepts. For example, the journal entries associated with a perpetual inventory system assist one in understanding how goods flow through a business.
4. Journal entries force individuals to be concise and precise in their thinking. One cannot be sloppy when it comes to journal entries. Thus, another benefit of journal entries and T-accounts is that they assist the individual in becoming a better thinker.

**Case 2–51**

It should be apparent to students that the adjusting process requires significant judgment on the part of an accountant. Few guidelines exist to dictate the appropriateness of estimates. However, users of financial information require unbiased information with which to make quality decisions. If accounting information is biased so as to not reflect the economic realities of a business, poor resource allocation decisions can be made.

The accountant must exercise caution in ensuring that estimates are reasonable. While incentives may exist that cause the accountant to consider using overly optimistic estimates, incentives also exist to ensure that the accountant remains unbiased. For example, if an investor or creditor suffers a loss as a result of relying on information contained in the financial statements of a company, accountants may find themselves in a court of law trying to justify their estimates.

Accounting is one part science and one part art. While the mechanics of accounting may seem relatively straightforward, such is not the case. Bookkeeping is straightforward and requires little judgment; accounting requires significant judgment.

**Case 2–52**

Solutions to this problem can be found on the Instructor's Resource CD-ROM or downloaded from the Web at [www.cengage.com/accounting/stice](http://www.cengage.com/accounting/stice).