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 re-corded and posted 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. S*pecial 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 bal- ance 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

1. Inventory…………………………………………………………. 5,000

Accounts Payable………………………………………….. 5,000

1. Accounts Payable………………………………………………. 3,500

Cash…………………………………………………………... 3,500

PRACTICE 2−2 JOURNALIZING

Cash 4,000

Accounts Receivable 10,000

Sales 14,000

Cost of Goods Sold 8,000

Inventory 8,000

PRACTICE 2−3 JOURNALIZING

Equipment 100,000

Cash 10,000

Short-Term Notes Payable 20,000

Long-Term Notes Payable 70,000

PRACTICE 2−4 JOURNALIZING

Cash 40,000

Equipment 75,000

Gain on Sale of Land 65,000

Land 50,000

PRACTICE 2−5 JOURNALIZING

Dividends (or Retained Earnings) 12,000

Cash 12,000

PRACTICE 2−6 JOURNALIZING

Wages Expense 52,000

Land 52,000

PRACTICE 2−7 POSTING

Cash

Beg. Bal. 10,000

a. 2,775 b. 1,500

d. 3,450 c. 6,200

End. Bal. 8,525

PRACTICE 2−8 POSTING

Accounts Payable

Beg. Bal. 8,000

b. 6,500 a. 2,700

c. 200 d. 2,550

End. Bal. 6,550

PRACTICE 2−9 TRIAL BALANCE

Debit Credit

Cash $ 400

Inventory 4,000

Accounts Payable $ 1,100

Paid-In Capital 2,000

Retained Earnings (beginning) 1,000

Dividends 700

Sales 10,000

Cost of Goods Sold 9,000

Totals $14,100 $14,100

PRACTICE 2−10 TRIAL BALANCE

Debit Credit

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 $37,800 $37,800

PRACTICE 2−11 INCOME STATEMENT

From Practice 2−9:

Sales $10,000

Cost of Goods Sold 9,000

Net Income $ 1,000

From Practice 2−10:

Service Revenue $32,000

Salary Expense $24,000

Rent Expense 5,300 29,300

Net Income $ 2,700

PRACTICE 2−12 BALANCE SHEET

From Practice 2−9:

Assets

Cash $ 400

Inventory 4,000

Total Assets $ 4,400

Liabilities

Accounts Payable $1,100

Stockholders’ Equity

Paid-In Capital $ 2,000

Retained Earnings (ending) 1,300

Total Liabilities and Stockholders’ Equity $ 4,400

Computation of ending Retained Earnings:

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

From Practice 2−10:

Assets

Cash $ 3,500

Prepaid Rent Expense 5,000

Total Assets $ 8,500

Liabilities

Unearned Service Revenue $ 1,600

Practice 2−12 (Concluded)

Stockholders’ Equity

Paid-In Capital $ 3,000

Retained Earnings (ending) 3,900

Total Liabilities and Stockholders’ Equity $8,500

Computation of ending Retained Earnings:

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

PRACTICE 2−13 ADJUSTING ENTRIES

Depreciation Expense 5,500

Accumulated Depreciation 5,500

PRACTICE 2−14 ADJUSTING ENTRIES

Bad Debt Expense 1,200

Allowance for Bad Debts 1,200

PRACTICE 2−15 ADJUSTING ENTRIES

Interest Expense 500

Interest Payable 500

$10,000 × 0.12 × 5/12 = $500

PRACTICE 2−16 ADJUSTING ENTRIES

Rent Expense 1,500

Prepaid Rent 1,500

$3,600/12 = $300 per month; amount used = $300 × 5 months = $1,500

PRACTICE 2−17 ADJUSTING ENTRIES

Unearned Service Revenue 4,400

Service Revenue 4,400

$4,800/12 = $400 per month; amount earned = $400 × 11 months = $4,400

PRACTICE 2−18 CLOSING ENTRIES

Sales 11,000

Retained Earnings 11,000

PRACTICE 2−18 (Concluded)

Retained Earnings 7,000

Cost of Goods Sold 7,000

Retained Earnings 900

Dividends 900

Balance sheet accounts are not closed.

PRACTICE 2−19 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

2–20. 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) 125,000** |  | **Bal. 21,540** |  |  | **Bal. 36,080** |  |  |
|  | **Bal. 6,160** |  |  |  |  |  |  |  |  |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Land** | |  | **Building** | |  | **Machinery** | |  |
|  | **Bal. 15,400** |  |  | **Bal. 14,000** |  |  | **(18) 8,600** |  |  |
|  | **(27) 116,667\*** |  |  | **(27) 233,333\*** |  |  | **Bal. 8,600** |  |  |
|  | **Bal. 132,067** |  |  | **Bal. 247,333** |  |  |  |  |  |

**\*($150,000/$450,000 × $350,000) \*($300,000/$450,000 × $350,000)**

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|  | **Accounts Payable** | |  | **Dividends Payable** | |  | **Mortgage Payable** | |  |
|  |  | **Bal. 9,190** |  |  | **(22) 20,250** |  |  | **Bal. 23,700** |  |
|  |  | **(5) 10,250** |  |  | **Bal. 20,250** |  |  | **(27) 225,000** |  |
|  |  | **Bal. 19,440** |  |  |  |  |  | **Bal. 248,700** |  |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Common Stock** | |  | **Retained Earnings** | |  | **Cost of Goods Sold** | |  |
|  |  | **Bal. 140,000** |  |  | **Bal. 60,730** |  | **(1) 6,850** |  |  |
|  |  |  |  |  |  |  | **Bal. 6,850** |  |  |
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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Sales** | |  | **Sales Discounts** | |  | **Wages Expense** | |  |
|  |  | **(1) 12,000** |  | **(7) 240** |  |  | **(15) 22,000** |  |  |
|  |  | **Bal. 12,000** |  | **Bal. 240** |  |  | **Bal. 22,000** |  |  |
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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | |  | **Dividends** | |  |  | |  |
|  |  |  |  | **(22) 20,250\*** |  |  |  |  |  |
|  |  |  |  | **Bal. 20,250** |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

**\*$0.45 × 45,000**

2–20. (Concluded)

3. Georgia Supply Corporation

**Trial Balance**

**October 31, 2015**

Debit Credit

Cash $ 6,160

Accounts Receivable 21,540

Inventory 36,080

Land 132,067

Building 247,333

Machinery 8,600

Accounts Payable $ 19,440

Dividends Payable 20,250

Mortgage Payable 248,700

Common Stock 140,000

Retained Earnings 60,730

Dividends 20,250

Sales 12,000

Sales Discounts 240

Cost of Goods Sold 6,850

Wages Expense 22,000

Totals $ 501,120 $ 501,120

2–21. 1. Adjusting Entries

(a) Insurance Expense 1,500

Prepaid Insurance 1,500

(*$6,000 ÷ 24 mo. = $250 × 6 mo. = $1,500)*

(b) Rent Revenue 2,700

Unearned Rent Revenue 2,700

(*$9,450 ÷ 7 mo. = $1,350* × *2 mo. = $2,700)*

(c) Advertising Materials 500

Advertising Expense 500

(d) Prepaid Rent 2,800

Rent Expense 2,800

(*$4,200 ÷ 6 mo. = $700* × *4 mo. = $2,800)*

(e) Office Supplies 125

Miscellaneous Office Expense 125

(f) Interest Expense 534

Interest Payable 534

2–21. (Concluded)

2. Sources of Information

(a) The insurance register; the insurance policy

(b) The journal entry or other original data from which the posting was made to the rental revenue account; the rental contract

(c) The physical count of advertising materials on hand

(d) The cash disbursements journal or vouchers payable record; the rental contract

(e) The physical count of supplies on hand

(f) The notes payable register; the note itself

2–22. Adjusting and Correcting Entries on December 31, 2015

(a) Allowance for Bad Debts 640

Accounts Receivable—Hatch Realty 640

(b) Loss on Damages from Breach of Contract 3,500

Lawsuit Payable—E. F. Bowcutt Co. 3,500

(c) Receivable from Insurance Company 7,000

Accumulated Depreciation—Furniture

and Fixtures 4,100

Loss from Fire 1,200

Furniture and Fixtures 12,300

(d) Advances to Salespersons 950

Sales Salaries Expense 950

(e) Repairs Expense 760

Machinery 760

Depreciation Expense—Machinery 1,735\*

Accumulated Depreciation—Machinery 1,735\*

\*Depreciation: ($19,960 – $4,460) × 0.10 = $ 1,550

($4,460 – $760) × 0.05 = 185

$ 1,735

2–23.

1. Insurance Expense 1,900

Prepaid Insurance 1,900

*($4,300 + $1,200 – $3,600 = $1,900)*

2. Depreciation Expense 8,100

Accumulated Depreciation 8,100

*[$103,400 – ($10,700 – $5,300) – $106,100*

*= $8,100]*

3. Unearned Rent 2,000

Rent Revenue 2,000

(*$8,000 + $6,000 – $12,000 = $2,000)*

4. Salaries Payable 7,060

Salaries Expense 7,060

(*$36,540 – $29,480 = $7,060)*

2–24. 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

2–24. (Concluded)

2. Pioneer Heating Corporation

Post-Closing Trial Balance

Debit Credit

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 $ 494,000 $ 494,000

2–25. 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

2–25. (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

Debit Credit

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 $ 3,107,700 $ 3,107,700

2–26.

1. Received $300 cash as payment on customer accounts.

2. Recorded return of inventory purchased by the company 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 using the allowance method.

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.

2–27.

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

2–28.

Adjusting Entries

(a) Insurance Expense 1,350\*

Prepaid Insurance 1,350

\*A, $3,600 × 21/24 $ 3,150

B, $1,800 × 2/6 600

C, $12,000 × 27/36 9,000

Prepaid amount $12,750

Account balance 14,100

Adjustment $ (1,350)

(b) Subscription Revenue 3,900†

Unearned Subscription Revenue 3,900

†July, $27,000 × 3/12 $ 6,750

October, $22,200 × 6/12 11,100

January, $28,800 × 9/12 21,600

April, $20,700 × 12/12 20,700

Unearned amount $60,150

Account balance 56,250

Adjustment $ 3,900

(c) Interest Payable 450

Interest Expense 450

*[$825 – ($45,000* × *0.10* × *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* × *2/5)]*

2–29. 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

2–30. 1.

**Balance Balance Balance**

**Carried Closed by Closed by**

**Account Forward Debiting Crediting**

(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**

2–30. (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)

2–31.

Closing Entries

Revenues 142,300

Retained Earnings 142,300

Retained Earnings 91,500

Expenses 91,500

Retained Earnings 29,200

Dividends 29,200

2–32.

Changes in Account Balances Debit Credit

Cash $ 18,000

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

$ 110,000 $ 96,000

Increase in net assets or net income 14,000

$ 110,000 $ 110,000

2–33.

Impact of error correction on net income

**2013 2014 2015**

Accrued salaries:

2013 error $ (21,000) $ 21,000

2014 error (17,500) $ 17,500

2015 error (26,000)

Interest receivable:

2013 error 8,500 (8,500)

2014 error 11,400 (11,400)

2015 error 12,100

Net income increase (decrease) $ (12,500) $ 6,400 $ (7,800)

PROBLEMS

2–34.

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 (or Retained Earnings) 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

2–34. (Concluded)

2. The single most important event was the free, favorable publicity in the national news magazine 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.

2–35.

(1) (2) (3) (4) (5)

B/S Real Closed Debit (Dr.)

I/S A, L, OE, or or or

Account Title N R, E, O Nominal Open 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.**

2–36.

1. Adjusting Entries on 12/31/15:

(a) Accounts Payable 4,300

Cash 4,300

(b) Depreciation Expense 4,700

Accumulated Depreciation—Building 4,700

*($141,000* × *1/30 = $4,700)*

(c) Bad Debt Expense 2,800

Allowance for Bad Debts 2,800

*[$200 + (0.05* × *$52,000) = $2,800]*

(d) Interest Receivable 2,933

Interest Revenue 2,933

*($80,000* × *0.11* × *4/12 = $2,933)*

(e) Sales Revenue 12,160

Unearned Sales Revenue 12,160

*($15,200* × *0.80 = $12,160)*

(f) Discount on Notes Payable 150

Interest Expense 150

*($300* × *30/60 = $150)*

2. Net Change in Income:

Add: Interest revenue not recorded $ 2,933

Overstatement of interest expense 150 $ 3,083

Deduct: Depreciation expense $ 4,700

Bad debt expense 2,800

Overstatement of sales revenue 12,160 (19,660)

Net reduction in reported net income $ (16,577)

2–37.

2015

(a) Oct. 1 Rent Expense 2,400

Cash 2,400

*($1,800 ÷ 9/12 = $2,400 annual expense)*

(b) June 1 Advertising Expense 4,080

Cash 4,080

*($1,700 ÷ 5/12 = $4,080 annual expense)*

(c) Mar. 1 Cash 5,400

Rent Revenue 5,400

*($900 ÷ 2/12 = $5,400 annual revenue)*

2–37. (Concluded)

(d) July 1 Office Supplies Expense 2,000

Cash 2,000

*($1,000 ÷ 6/12 = $2,000 annual expense)*

(e) Aug. 1 Insurance Expense 1,800

Cash 1,800

*($1,050 ÷ 7/12 = $1,800 annual expense)*

2–38.

(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 × $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

2–39. 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 26,300

Income Taxes Payable 26,300

*[$65,750* × *0.40; see (2)]*

2–39. (Concluded)

2. Gee Enterprises

Income Statement—Accrual Basis

For the Year Ended December 31, 2015

Sales $ 280,000

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 3,000 214,250

Income Before Income Taxes $ 65,750

Income Taxes (0.40) 26,300

Net Income $ 39,450

2–40. 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, 2015**

**Trial Balance Adjustments Income Statement Balance Sheet**

**Account Title 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, 2014 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) 5,090 5,090**

**Income Taxes Payable (20% of $25,450) (i) 5,090 5,090**

**566,480 566,480 17,270 17,270 .**

**226,540 246,900 355,710 335,350**

**Net Income 20,360 20,360**

**246,900 246,900 355,710 355,710**

2–40. (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 5,090

Income Taxes Payable 5,090

3. Closing Entries

Sales 246,000

Interest Revenue 900

Retained Earnings 246,900

Retained Earnings 226,540

Sales Returns 4,360

Sales Discounts 5,400

Cost of Goods Sold 114,370

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

Depreciation Expense—Buildings 3,600

Income Tax Expense 5,090

Retained Earnings 13,400

Dividends 13,400

2–40. (Concluded)

4. Builders’ Supply Corporation

Post-Closing Trial Balance

December 31, 2015

Debit Credit

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 5,090

Real Estate and Payroll Taxes Payable 900

Mortgage Payable 68,800

Capital Stock, $10 par 180,000

Retained Earnings 21,800

Totals $ 342,310 $342,310

2–41.

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

Insurance Expense 750

Advertising Expense 5,000

Income Tax Expense 7,200

Depreciation Expense—Equipment 32,000

Bad Debt Expense 500

Retained Earnings 7,800

Dividends 7,800

2–41. (Concluded)

3. Taipei International Corporation

Post-Closing Trial Balance

December 31, 2015

Debit Credit

Cash $ 331,500

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 $ 287,850 $ 287,850

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.

2–42.

**High Flying Logistics Co.**

**Work Sheet**

**December 31, 2015**

**Income Balance**

**Trial Balance Adjustments Statement Sheet**

**Account 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, 2014 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**

**867,960 867,960 52,690 52,690 408,360 432,900 507,640 483,100**

**Net Income 24,540 24,540**

**432,900 432,900 507,640 507,640**

2–43. 1.

**Whitni Corporation**

**Work Sheet**

**December 31, 2015**

**Trial Balance Adjustments Income Statement Balance Sheet**

**Account Title 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, 2015 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**

**1,250,075 1,250,075 39,549 39,549 721,824 763,350 561,000 519,474**

**Net Income 41,526 41,526**

**763,350 763,350 561,000 561,000**

2–43. (Continued)

2. Adjusting Entries

(a1) Depreciation Expense—Furniture and Fixtures 1,500

Accumulated Depreciation—Furniture

and Fixtures 1,500

*($15,000* × *0.10 = $1,500)*

(a2) Depreciation Expense—Buildings 6,904

Accumulated Depreciation—Buildings 6,904

*[($97,600* × *0.04) + ($150,000* × *0.04* × *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* × *2,400 shares = $3,600)*

(g2) Income Tax Expense 15,000

Income Taxes Payable 15,000

2–43. (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 2–44

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 2–45

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 2–46

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 2–47

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 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 2–48

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 would. 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 ongoing 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 2–49

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 2–50

Lockheed Martin Corporation

Adjusted Trial Balance

December 31, 2011

(dollars in millions)

Debit Credit

Cash and Cash Equivalents $ 3,582

Short–term Investments…………………………………………………………….. 3

Receivables 6,064

Inventories 2,481

Deferred Income Taxes, Current 1,339

Other Current Assets 625

Property, Plant, and Equipment, Net 4,611

Goodwill 10,148

Deferred Income Taxes 4,388

Other Current Assets 4,667

Accounts Payable $ 2,269

Customer Advances and Amounts in Excess of Costs Incurred 6,399

Salaries, Benefits, and Payroll Taxes 1,664

Other Current Liabilities 1,798

Long-term Debt, Net 6,460

Accrued Pension Liabilities 13,502

Other Postretirement Benefit Liabilities 1,274

Other Liabilities 3,541

Common Stock 321

Retained Earnings 12,161

Accumulated Other Comprehensive Loss 11,257

Dividends 2,879

Total Net Sales 46,499

Cost of Sales 42,795

Other Income (Expenses), Net 276

Interest Expense 354

Other Non-operating Income 5

Income Tax Expense……………………………………………………………….. 964

Net Earnings/Loss from Discontinued Operations 12

Totals $ 96,169 $96,169

Remember that the retained earnings balance on the December 31, 2011, 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 2–51

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 2–52

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 might 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 2–53

Solutions to this problem can be found on the Instructor’s Resource CD-ROM or downloaded from the Web at www.cengagebrain.com.