Chapter 2

Accounting for Accruals

General Comments for Chapter 2

Special Note: Some instructors may prefer to delay coverage of notes payable and the accompanying accrual of interest until Chapter 9 which provides in depth coverage of notes payable and the accrual of interest. Chapter 2 is organized so that this strategy can be easily implemented by skipping coverage of Learning Objective 2-5 and the related exercises and problems. You can return to this learning objective when you start coverage of Chapter 9. The content, exercises, and problems are strategically designed to facilitate this strategy.

This chapter introduces the horizontal financial statements model. This model will be used throughout this chapter and the remainder of the text to teach students how accounting events affect financial statements. Accordingly, the model is the first thing you should introduce when you cover Chapter 2. Students should be familiar with financial statements from the coverage provided in Chapter 1. However, if you discover that your students have a poor grasp of financial statements as you enter Chapter 2, we recommend that you return to Chapter 1. This text uses a sequential (stepwise) learning approach. Each new topic represents an extension of the previous topic. If students do not understand step one, they will not understand step two. Accordingly, moving forward when your students are lost is useless. It is more important for students to understand the chapters you cover, than to cover an arbitrary number of chapters.

Explain that the horizontal statements model presents a simplified version of the financial statements. However, instead of showing the information vertically, the information is presented horizontally. The model arranges the balance sheet, income statement, and statement of cash flows horizontally across a single line of text. It does not contain a full set of statements. Specifically, it does not show a statement of changes in stockholders’ equity. The model uses abbreviations. It does not include dollar signs or dates. Explain that the model represents a teaching tool that will help them learn to think like business professionals. It is important to distinguish the model from the formal set of financial statements that appear in a company’s public reports. A detailed lesson plan for introducing the model is discussed below.

Chapter 2 also introduces the concept of accrual accounting to students. To promote comprehension, we suggest you introduce the subject using a single transaction in which a business provides services on account. Immediately, have the students prepare an income statement, a statement of retained earnings, a balance sheet, and a statement of cash flows. Similarly, avoid mixing interest computations with analyzing the effect of interest on the financial statements. Students frequently get so lost in the computational details that they overlook the financial statement effects. Avoid this problem by providing students with the amount of interest, thereby freeing them to focus on its effects. Once students understand how accrued interest affects the financial statements, then cover the mechanics of interest computations. Specific examples are provided in the detailed lesson plan outline. If you would like to begin the chapter with a problem-based learning exercise, see the notes below.

Problem-Based Learning Case: Accrual Accounting

Instructions:

The case appears page 2-4 of this manual. We recommend that you use the case as an introduction to Chapter 2. Copy the case and distribute it to the students as they enter class. Before providing any explanation of accrual accounting ask students to read the case and develop an answer individually. Tell them to not only develop an answer but also provide a logical explanation for the answer they develop. After allowing students time to develop their individual answers, put them into groups to reach consensus on an answer. Also, ask each group to select a spokesperson. Allow groups time to develop answers, then call on some of the spokespersons to share their solutions. Guide the discussion sequentially to produce the following solution:

1. Identify the effects of revenue recognition:

Ask students to identify the revenue event that is described in the case writeup. Specifically, PHI earns $145,000 of revenue which results in $120,000 increase in Cash and a promise to receive $25,000 cash in the future. Provide the name, Accounts Receivable, that is used to describe the $25,000 promise. Continue to follow the practice of introducing terminology as it is needed. The definitions should emerge from the students’ response to the problem rather than being provide up prior to the analysis. Students should be encouraged to grapple with the issue of how to record a promise before the recording and statement effects are shown. After allowing time for analysis, instruct students to record the event in an accounting equation.

2 Identify the effects of expense recognition:

In the second event PHI incurs $80,000 of expenses. As a result, Cash decreased by $75,000 and the company accepts a $5,000 obligation. (Accounts Payable). Again, introduce the term only after students identified a need for the term. Show the effects of the expense recognition in an accounting equation. Make note of the fact that expenses cause decreases in assets or *increases in liabilities*. This expands the definition of expenses provided in Chapter 1. The effects on an accounting equation are shown below:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Accounting Equation | | | | | | | | |
| Events | Cash | + | Accts. Rec. | = | Accts. Pay. | + | Ret. Earn. | Account Titles |
| 1. | 120,000 | **+** | 25,000 | = | NA | **+** | 145,000 | Revenue |
| 2. | (75,000) | **+** | NA | = | 5,000 | **+** | (80,000) | Expense |
| Totals | 45,000 | + | 25,000 | = | 5,000 | **+** | 65,000 | Net Income |
|  |  |  |  |  |  |  |  |  |

C. Identify key components of financial statements:

Have students determine the amount of Total Assets:

Total Assets: $45,000 Cash + $25,000 Accounts Receivable = $70,000 Total

When making this computation emphasize the fact that Accounts Receivable is an asset.

Have students determine the amount of net income (Revenue $145,000 – Expenses 80,000) and compare that to the amount of cash flow for operating activities (Cash Inflow from Customers of $120,000 - Cash Outflow for Expenses of $75,000). Explain that differences such as these are common in accrual accounting.

You may want to carry the discussion further by having student create a balance sheet thereby providing an opportunity to see where receivables and payables appear on that financial statement. You should remain flexible with PBL cases, allowing the class reaction to guide your discussion. Have a plan but do not hesitate to venture from that plan.

Chapter 2 Problem-Based Learning Case:

Accrual Accounting



Professional Headhunters, Inc. (PHI), is a job placement company that operates in the northeastern United States. During Year 1 the company earned $145,000 in revenue by providing services to customers. However, it collected only $120,000 of the revenue in cash. PHI expected to collect the remaining $25,000 in Year 2. In addition, PHI incurred $80,000 of expenses. However, by the end of Year 1, PHI had paid only $75,000 of the cash owed for expenses because it had not yet paid $5,000 to employees who had worked during Year 1 but had not been paid by the end of the year. PHI expected to pay the $5,000 in cash to the employees during Year 2. Based on this information alone, determine the amount of total assets, total liabilities, net income, and cash flow from operations that PHI should report on its Year 1 financial statements.

Detailed Outline of a Lesson Plan for Chapter 2

**I. Introduce the horizontal financial statements model.** Use Demonstration Problem 2-1 to introduce students to the horizontal financial statements model. Take note that Demonstration Problem 2-1 is the same problem used as Demonstration Problem 1-1. It is important for students to understand that we are choosing to display the same information in a different format. Demonstration Problem 1-1 and the other Chapter 2 demonstration problems for this chapter are shown in the next section of this manual.

Engage your class by telling your students that the primary objective of the model is to teach them to think like business professionals. Business professionals tend to think about bottom-line consequences: If I do this or that, how will it affect my company’s net income, total assets, cash flow, and so on. This type of thinking occurs whether you work in accounting, management, marketing, finance, insurance, real estate, or virtually any other area of business. Accordingly, learning to mimic this thinking approach benefits all business students regardless of whether they are accounting majors.

Show the horizontal model contained in Demonstration Problem 2-1 using the display equipment available in your classroom. Assuming that the necessary equipment is available, we recommend using an e-transparency. However, you can draw the model on a chalk board if electronic equipment is not available. Explain that the model is designed to show how individual accounting events affect financial statements. Note that the model does not represent a complete set of financial statements. The statement of changes in stockholders’ equity is missing. It does not included dates, dollar signs, or other technical features that are presented in formal financial statements. Demonstrate the features of the model by recording the Year 1 events in the model in front of the class. Then assign students the task of recording Year 2 events in the model. Walk around the room offering to help as students attempt to record the Year 2 events. After the majority of the class has completed the Year 2 transactions, you should provide the solution. Tell those who have the correct answers to move on to the Year 3 events while you help those that are having trouble. Year 3 events can be assigned as a homework assignment for those who are unable to finish the problem in class. If necessary, students can hand draw the forms. However, to save time we recommend that you use the work papers that are provided in the teaching materials section of this guide.

Take a proactive posture as you walk around the room while students are working. Students are accustomed to the traditional lecture format where the teacher stands at a podium in the front of the room. They are reluctant to ask questions directly to the instructor. So instead of waiting for them to call on you, you should observe those that appear to be having difficulty and approach them. Ask if you can help. How do you know if they are having difficulty? Many times, it is the student that is playing with their phone, talking to their peers, or otherwise ignoring the assignment. Disinterest is frequently the result of a lack of understanding. If you want you students to be engaged, make sure that they comprehend the subject matter.

**II**. **Introduce accrual accounting by writing the following event on the chalkboard.** Alternatively, you can duplicate and pass out Demonstration Problem 2-2.

*Packard Consultants was started in Year 1 when it provided $5,000 of services* ***on account****.*

A. It will be necessary to explain the meaning of the phrase ***on account***. Tell students this means that Packard recognizes the revenue before it collects the cash. In other words, revenue is recognized in the accounting period in which the work is done regardless of when cash changes hands. This discussion should lead to defining the term accrual. In general, transactions in which a revenue or expense is recognized before cash changes hands are termed ***accruals***. Demonstrate this point by recording the revenue recognition for Packard in a horizontal financial statements model like the one shown below. Highlight the difference between net income and cash flow from operating activities.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Balance Sheet** | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |  |
|  | **Year** |  | **Cash** | **+** | **Acct. Rec.** | **=** | **Liab.** | **+** | **Equity** |  | **Rev.** |  | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
|  | 1 |  | n/a | + | 5,000 | = | n/a | + | 5,000 |  | 5,000 |  | n/a | = | 5,000 |  | n/a |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

To reinforce the difference between a horizontal financial statement model and format financial statements, have your students prepare an income statement, a statement of retained earnings, a balance sheet, and a statement of cash flows. To minimize the time required for this task, you may want to provide students with copies of the work paper for Demonstration Problem 2-2. As indicated earlier the work papers are located in the Teaching Materials Section at the end of this manual.

B. Since there were no stock issues during Year 1, the statement of changes in stockholders’ equity becomes a statement of retained earnings. While the text does not cover a statement of retained earnings, students should be able to infer the format from their experience with the statement of changes in stockholders’ equity. Use the exercise to discuss diversity in reporting practice. Students should learn that while there is general consistency in financial reporting, there is also variety. They need to understand differences in reporting formats.

C. After accounting for the revenue recognition, assume that Packard collects the $5,000 account receivable in Year 2. Assume that this is the only Year 2 transaction. Have the students record the event in a horizontal financial statements model and prepare the four basic financial statements for the Year 2 accounting period. Encourage students to analyze the difference in the amounts shown in the income statement versus the amounts shown as operating activities in the statement of cash flows. This single transaction clearly illustrates differences between the income statement and the statement of cash flows.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Balance Sheet** | | | | | | |  | **Income Statement** | | | | |  | **Statement of** |  |
|  | **Year** |  | **Cash** | **+** | **Acct. Rec.** | **=** | **Liab.** | **+** | **Equity** |  | **Rev.** |  | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
|  | 1 |  | n/a | + | 5,000 | = | n/a | + | 5,000 |  | 5,000 |  | n/a | = | 5,000 |  | n/a |  |
|  | 2 |  | 5,000 | + | (5,000) | = | n/a | + | n/a |  | n/a |  | n/a | = | n/a |  | +5,000 OA |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

**III.** **Use Demonstration Problem 2-3 to introduce** ***accrued interest***. Master copies of the problem, solution, and work papers are located in the Teaching Materials Section at the end of this manual.The following description of the transactions includes for the instructor explanatory comments in italics.

A. Events for Year 2 are as follows:

1. Canton Company borrowed $10,000 cash from the National Bank on September 1, Year 2. *The list of transactions does not involve common stock, dividends, or other superfluous elements that are not germane to the subject of interest. Whenever possible, use an isolated set of transactions that focuses on a specific topic. When multiple topics are introduced simultaneously, students may experience information overload, which leads to memorization. This problem focuses on borrowing funds, using the borrowed funds to buy land, and matching the rent revenue with the interest expense.*

2. Canton invested the borrowed money in land.

3. Canton earned rent revenue of $600 cash.

4. As of December 31, Year 2, accrued interest (interest expense) on Canton’s bank loan was $400. *The amount of interest is provided for the student.*  *The focus is to learn how interest expense affects the financial statements. Computing the amount of interest will be addressed in a subsequent problem. Once again, the objective is to avoid introducing too many topics simultaneously. Use this entry to expand the definition of an expense. Note that the increase in the liability account is paired with expense recognition.* ***Define expenses as decreases in assets or increases in liabilities.***

Require your students to record the events under an accounting equation and to prepare financial statements for the accounting period ended December 31, Year 2.

B. After preparing the Year 2 statements, assume these Year 3 events:

1. Canton earned rent revenue of $1,350 cash in Year 3.

2. Canton sold its land for $10,000 cash.

3. Canton accrued interest of $800 on the bank loan. *The accrual of interest and the payment of interest are shown as separate transactions. While combining transactions reduces the time necessary to record transactions in a manual accounting system, doing so masks the logical sequence of the steps. Since the objective is to teach students to understand accounting rather than how to save time recording transactions, avoid complex entries.*

4. Canton paid cash for the interest due on the bank loan.

5. Canton repaid the $10,000 bank loan with cash.

**IV.** **Hand out Demonstration Problem 2-4.** After you have shown students how accrued interest affects the accounting equation and the financial statements in Demonstration Problem 2-3, use Demonstration Problem 2-4 to show them how to compute accrued interest.

**Demonstration Problem 2-4 Accrued Interest Computations**

Johnson Company borrowed $1,000 cash by issuing a one-year note to the State Bank. The bank charged Johnson interest on the note at a 12 percent annual rate. Determine the amount of accrued interest expense Johnson would report at December 31, Year 2 under each of the three following independent assumptions. The note was issued (money was borrowed) on (1) April 1, Year 2; (2) June 1, Year 2; and (3) October 1, Year 2.

**Solution:**

Date Principal x Rate x Time = Accrued Interest

April 1, Year 2 $1,000 x .12 x 9/12 = $90

June 1, Year 2 $1,000 x .12 x 7/12 = $70

Oct. 1, Year 2 $1,000 x .12 x 3/12 = $30

**V. Time considerations and homework assignments.**

***Recall that there are two sets of exercises and problems (Set A and Set B) in the end of each chapter of the text materials. As a general rule, we use Set B exercises and problems in the classroom and reserve the Set A equivalent exercises and problems as homework. We reserve Set A exercises and problems for homework because they are included in McGraw-Hill’s* Connect*, electronic homework management system.***

Plan to spend at least one hour on Demonstration Problem 2-1. Use Exercises 2-1A&B for reinforcement. Note that these exercises require students to record events in a horizontal financial statements model and then to prepare formal financial statements. Accordingly, they provides an excellent opportunity to distinguish the statements model from formal financial statements. Exercises 2-2A&B and 2-3A&B can be used as further reinforcement. Since the horizontal financial statement model will be used extensively throughout the text, we highly recommend that you spend considerable time introducing the topic and reinforcing it use.

Completing Demonstration Problems 2-2, 2-3, and 2-4 should require approximately one hour of class time. Remember to have the students work along with you as you explain the problems. For example, in Demonstration Problem 2-4 you can show them the computations for the assumption that the note was issued on April 1, and then have them calculate the interest for the other two issue dates. Use Exercises 2-4A&B, 2-5A&B, and 2-6A&B to reinforce the accrual concepts associated with accounts receivable and accounts payable. Exercises 2-13A&B, and 2-14A&B can be used to reinforce the concepts associated with accrued interest. Based on time available, students can work these exercises in class or as homework.

**VI. Use Demonstration Problem 2-5 as a comprehensive summary problem.** This is a two-cycle problem. Explain the first cycle (Year 1) and then use the second cycle (Year 2) as an in-class assignment. Allot approximately one hour to complete this assignment. Students needing additional time can finish the problem as homework. Problem 2-23A mirrors the demonstration problem and can be used as homework assignments.

**VII.** **Enrichment.** Given time constraints, choose enrichment topics with care. Students benefit from early exposure to the cases involving the Target Annual Report, especially during the first three chapters. The ethics cases provoke interest and you may prefer to use them. We prefer to concentrate on understanding how accounting events affect financial statements early in the course and to address more subjective issues (ethics cases) later in the course. Accordingly, we suggest you cover case ATC 2-1 if there is time. This case is contained in the section of the problem material titled Analyze, Think, and Communicate which is located in the text immediately behind the B Set of Exercises and Problems.

Demonstration Problems for Chapter 2

Demonstration Problem 2-1: The Accounting Cycle

The events below apply to Computer Services Company (CSC). Assume that all transactions involve receiving or paying cash.

Transactions for the Year 1:

1. CSC was started when it acquired $9,000 cash by issuing common stock.

2. The company borrowed $5,000 from a bank.

3. The company provided services to customers and received $4,000.

4. The company paid operating expenses of $2,900.

5. The company paid $500 in dividends to its stockholders.

Transactions for the Year 2:

1. The company issued additional common stock for $4,500.

2. The company paid $2,000 to reduce its liabilities.

3. The company provided services to customers and received $6,700.

4. The company paid operating expenses of $4,300.

5. The company paid $700 in dividends to its stockholders.

Transactions for the Year 3:

1. The company issued additional common stock for $2,500.

2. The company borrowed an additional $1,000 from creditors.

3. The company provided services to customers and received $7,400.

4. The company paid operating expenses of $7,900.

5. The company paid $300 in dividends to its stockholders.

6. The company paid $21,000 to purchase land.

**Required**

Record the events in a horizontal financial statements model. In the statement of cash flows column use OA to indicate operating activities, IA to indicate investing activities, and FA to indicate financing activities.

Demonstration Problem 2-2: Revenue Earned on Account

**Year 1**

Packard Consultants was started in Year 1. During that year the company earned $5,000 of consulting revenue***on account****.* Assume this is the only event experienced by Packard during Year 1.

**Required**

a. Record the event under an accounting equation.

b. Prepare an income statement, a statement of retained earnings, a balance sheet, and a statement of cash flows for Year 1.

**Year 2**

During Year 2, Packard Consultants collected $5,000 cash from the account receivable it established in Part A.

**Required**

a. Record the event under an accounting equation.

b. Prepare an income statement, a statement of retained earnings, a balance sheet, and a statement of cash flows for Year 2.

Demonstration Problem 2-3: Accrued Interest on Financial Statements

**Year 1**

Canton Company experienced the following accounting events during Year 1:

1. Canton Company borrowed $10,000 cash from the National Bank on September 1, Year 1.

2. Canton invested the borrowed money in land.

3. Canton earned rent revenue of $600 cash.

4. As of December 31, Year 1, accrued interest (interest expense) on Canton’s bank loan was $400.

**Required**

a. Record the events under an accounting equation.

b. Prepare an income statement, a statement of retained earnings, a balance sheet, and a statement of cash flows for Year 1.

**Year 2**

Canton Company experienced the following accounting events during Year 2:

1. Canton earned rent revenue of $1,350 cash in Year 2.

2. Canton sold its land for $10,000 cash.

3. Canton accrued interest of $800 on the bank loan.

4. Canton paid cash for the interest due on the bank loan.

5. Canton repaid the $10,000 bank loan with cash.

**Required**

a. Record the events under an accounting equation.

b. Prepare an income statement, a statement of retained earnings, a balance sheet, and a statement of cash flows for Year 2.

Demonstration Problem 2-4: Accrued Interest Computations

During Year 1, Johnson Company borrowed $1,000 cash by issuing a one-year note to the State Bank. The bank charged Johnson interest on the note at a 12 percent annual rate.

**Required**

Determine the amount of accrued interest expense Johnson would report at December 31, Year 1 under each of the three following independent assumptions. The note was issued (money was borrowed) on (1) April 1; (2) June 1; and (3) October 1.

Demonstration Problem 2-5 Accruals Comprehensive Problem

Smith Company experienced the following accounting events during Year 1:

1. Smith Company was started when it issued common stock for $2,000 cash.

2. Smith borrowed $1,000 cash from Allied Bank. Smith issued a note payable on as evidence of it obligation to repay the loan.

3. During the year, the company recognized $1,500 of consulting revenue on account.

4. The company collected $1,200 cash from accounts receivable.

5. Accrued salary expense during the year of $900.

6. Paid $700 of the salaries payable liability.

7. Paid dividends of $100 to the stockholders.

8. Smith adjusted the books to recognize accrued interest expense. The note was issued on September 1, Year 1. It had a 6 percent annual interest rate and a one-year term. The company’s fiscal period ends on December 31 of each year.

Smith Company experienced the following accounting events during Year 2:

1. Smith Company issued additional common stock for $3,000 cash.

2. During the period there was $2,700 of consulting revenue recognized on account.

3. Collected $2,800 cash from accounts receivable.

4. Accrued salary expenses of $1,500.

5. Paid $1,350 of the salaries payable liability.

6. Paid dividends of $300 cash to the stockholders.

7. On August 31 Smith (a) accrued the remaining interest on the note payable, (b) paid the cash due for interest payable, and (c) paid off the $1,000 note payable.

8. On November 1, Smith purchased land for $6,000 cash.

9. The land had a market value of $6,400 as of December 31, Year 2.

**Required**

a. Record the events under an accounting equation.

b. Prepare an income statement, a statement of retained earnings, a balance sheet, and a statement of cash flows for Year 1 and Year 2.

c. Use a horizontal financial statements model to show how the events for Year 1 and Year 2 affect financial statements. Use a plus sign to indicate an increase, a minus sign to indicate a decrease, the initials NA to indicate not affected. In the statement of cash flows column use, a plus sign to indicate a cash inflow, a minus sign to indicate a cash outflow. Also, use OA to indicate operating activities, IA to indicate investing activities, and FA to indicate financing activities.

Solutions for Chapter 2 Demonstration Problems

**Demonstration Problem 2-1**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Balance Sheet** | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of**  **Cash Flow** |  |
| **Year 1** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  |  |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***N. Pay.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Earn.*** |  | **Rev.** | **–** | **Exp.** | **=** | **Net Inc.** |  |  |
| **Beg. bal.** |  | **0** | **+** | **0** | **=** | **0** | **+** | **0** | **+** | **0** |  | **0** | **–** | **0** | **=** | **0** |  | **NA** |  |
| **1** |  | **9,000** | **+** | **NA** | **=** | **NA** | **+** | **9,000** | **+** | **NA** |  | **NA** | **–** | **NA** | **=** | **NA** |  | **9,000 FA** |  |
| **2** |  | **5,000** | **+** | **NA** | **=** | **5,000** | **+** | **NA** | **+** | **NA** |  | **NA** | **–** | **NA** | **=** | **NA** |  | **5,000 FA** |  |
| **3** |  | **4,000** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **4,000** |  | **4,000** | **–** | **NA** | **=** | **4,000** |  | **4,000 OA** |  |
| **4** |  | **(2,900)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(2,900)** |  | **NA** | **–** | **2,900** | **=** | **(2,900)** |  | **(2,900) OA** |  |
| **5** |  | **(500)** | **+** | **NA** | **=** | **NA** | **+** | **NA** | **+** | **(500)** |  | **NA** | **–** | **NA** | **=** | **NA** |  | **(500) FA** |  |
| **Totals** |  | **14,600** | **+** |  | **=** | **5,000** | **+** | **9,000** | **+** | **600** |  | **4,000** | **–** | **2,900** | **=** | **1,100** |  | **14,600 NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Year 2** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  |  |  |  |  |  |  |  |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***N.Pay.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Ear.*** |  | **Rev.** | **–** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| **Beg. bal.** |  | **14,600** | **+** |  | **=** | **5,000** | **+** | **9,000** | **+** | **600** |  |  | **–** |  | **=** |  |  |  |  |
| **1** |  | **4,500** | **+** |  | **=** |  | **+** | **4,500** | **+** |  |  |  | **–** |  | **=** |  |  | **4,500 FA** |  |
| **2** |  | **(2,000)** | **+** |  | **=** | **(2,000)** | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  | **(2,000) FA** |  |
| **3** |  | **6,700** | **+** |  | **=** |  | **+** |  | **+** | **6,700** |  | **6,700** | **–** |  | **=** | **6,700** |  | **6,700 OA** |  |
| **4** |  | **(4,300)** | **+** |  | **=** |  | **+** |  | **+** | **(4,300)** |  |  | **–** | **4,300** | **=** | **(4,300)** |  | **(4,300) OA** |  |
| **5** |  | **(700)** | **+** |  | **=** |  | **+** |  | **+** | **(700)** |  |  | **–** |  | **=** |  |  | **(700) FA** |  |
| **Totals** |  | **18,800** | **+** |  | **=** | **3,000** | **+** | **13,500** | **+** | **2,300** |  | **6,700** | **–** | **4,300** | **=** | **2,400** |  | **4,200 NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Year 3** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  |  |  |  |  |  |  |  |  |
| ***No.*** |  | ***Cash*** | ***+*** | ***Land*** | ***=*** | ***N.Pay.*** | ***+*** | ***C. Stk.*** | **+** | ***Ret. Ear.*** |  | **Rev.** | **–** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| **Beg. bal.** |  | **18,800** | **+** |  | **=** | **3,000** | **+** | **13,500** | **+** | **2,300** |  |  | **–** |  | **=** |  |  |  |  |
| **1** |  | **2,500** | **+** |  | **=** |  | **+** | **2,500** | **+** |  |  |  | **–** |  | **=** |  |  | **2,500 FA** |  |
| **2** |  | **1,000** | **+** |  | **=** | **1,000** | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  | **1,000 FA** |  |
| **3** |  | **7,400** | **+** |  | **+** |  | **+** |  | **+** | **7,400** |  | **7,400** | **–** |  | **=** | **7,400** |  | **7,400 OA** |  |
| **4** |  | **(7,900)** | **+** |  | **+** |  | **+** |  | **+** | **(7,900)** |  |  | **–** | **7,900** | **=** | **(7,900)** |  | **(7,900) OA** |  |
| **5** |  | **(300)** | **+** |  | **+** |  | **+** |  | **+** | **(300)** |  |  | **–** |  | **=** |  |  | **(300) FA** |  |
| **6** |  | **(21,000)** | **+** | **21,000** | **+** |  | **+** |  | **+** |  |  |  | **–** |  | **=** |  |  | **(21,000) IA** |  |
| **Totals** |  | **500** | **+** | **21,000** | **+** | **4,000** | **+** | **16,000** | **+** | **1,500** |  | **7,400** | **–** | **7,900** | **=** | **(500)** |  | **(18,300) NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Demonstration Problem 2-2: Requirement a

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Assets** | | | **=** | **Liabilities** | **+** | **Equity** | | |
| **Year 1** | **Cash** | **+** | **Accts.**  **Receiv.** | **=** | **Liabilities** | **+** | **Common**  **Stock** | **+** | **Retained Earnings** |
| **Beginning Balances** | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |
| **1. Effect of Recognizing Rev.** |  |  | **5,000** |  |  |  |  |  | **5,000** |
|  |  |  |  |  |  |  |  |  |  |
| **Year 2** |  |  |  |  |  |  |  |  |  |
| **1. Effect of Cash Collection** | **5,000** |  | **(5,000)** |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| **Ending Balances** | **$5,000** | **+** | **$ -0-** | **=** | **$ -0-** | **+** | **$ -0-** | **+** | **$5,000** |
|  |  |  |  |  | **══** |  |  |  |  |

Demonstration Problem 2-2: Requirement b

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Packard Consultants** | | | | | |
| **Income Statements** | | | | | |
| **For the Years Ended December 31,** |  | **Year 1** |  | **Year 2** |  |
|  |  |  |  |  |  |
| **Consulting Revenue** |  | **$5,000** |  | **$-0-** |  |
| **Expenses** |  | **-0-** |  | **-0-** |  |
| **Net Income** |  | **$5,000** |  | **$-0-** |  |
|  |  |  |  |  |  |
| **Statements of Retained Earnings** | | | | | |
| **Beginning Retained Earnings** |  | **$ -0-** |  | **$5,000** |  |
| **Net Income** |  | **$5,000** |  | **-0-** |  |
| **Dividends** |  | **-0-** |  | **-0-** |  |
| **Ending Retained Earnings** |  | **$5,000** |  | **$5,000** |  |
|  |  |  |  |  |  |
| **Balance Sheets at December 31** | | | | | |
| **Assets** |  |  |  |  |  |
| **Cash** |  | **$ -0-** |  | **$5,000** |  |
| **Accounts Receivable** |  | **5,000** |  | **-0-** |  |
| **Total Assets** |  | **$5,000** |  | **$5,000** |  |
|  |  |  |  |  |  |
| **Equity** |  |  |  |  |  |
| **Retained Earnings** |  | **$5,000** |  | **$5,000** |  |
|  |  |  |  |  |  |
| **Statements of Cash Flows** | | | | | |
| **Cash Flows from Operating Activities** |  | **$ -0-** |  | **$5,000** |  |
|  |  |  |  |  |  |
| **Cash Flows from Investing Activities** |  | **-0-** |  | **-0-** |  |
|  |  |  |  |  |  |
| **Cash Flows from Financing Activities** |  | **-0-** |  | **-0-** |  |
| **Net Change in Cash** |  | **-0-** |  | **$5,000** |  |
| **Beginning Cash Balance** |  | **-0-** |  | **-0-** |  |
| **Ending Cash Balance** |  | **$ -0-** |  | **$5,000** |  |
|  |  |  |  |  |  |

**Demonstration Problem 2-3: Requirement a**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Assets** | | | **=** | **Liab.** | | | **+** | **Equity** | | |
| **Year 1** | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Int.**  **Pay.** | **+** | **Com.**  **Stock** | **+** | **Ret.**  **Ear.** |
| **Beginning Balances** | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |
| **1. Effect of Borrowing** | **10,000** |  |  |  | **10,000** |  |  |  |  |  |  |
| **2. Purch. of Land** | **(10,000)** |  | **10,000** |  |  |  |  |  |  |  |  |
| **3. Earned Revenue** | **600** |  |  |  |  |  |  |  |  |  | **600** |
| **4. Accrued Int. Exp.** |  |  |  |  |  |  | **400** |  |  |  | **(400)** |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **End. / Beg. Balances** | **$ 600** | **+** | **$10,000** | **=** | **$10,000** | **+** | **$ 400** | **+** | **$ -0-** | **+** | **$ 200** |
| **Year 2** |  |  |  |  |  |  |  |  |  |  |  |
| **1. Earned Revenue** | **1,350** |  |  |  |  |  |  |  |  |  | **1,350** |
| **2. Sold Land** | **10,000** |  | **(10,000)** |  |  |  |  |  |  |  |  |
| **3. Accrued Int. Exp.** |  |  |  |  |  |  | **800** |  |  |  | **(800)** |
| **4. Paid Interest** | **(1,200)** |  |  |  |  |  | **(1,200)** |  |  |  |  |
| **5. Repaid Loan** | **(10,000)** |  |  |  | **(10,000)** |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Ending Balances** | **$ 750** | **+** | **$ -0-** | **=** | **$ -0-** | **+** | **$ -0-** | **+** | **$ -0-** | **+** | **$ 750** |
|  |  |  |  |  |  |  |  |  |  |  |  |

**Demonstration Problem 2-3: Requirement b**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Canton Company** | | | | | |
| **Income Statements** | | | | | |
| **For the Years Ended December 31,** |  | **Year 1** |  | **Year 2** |  |
|  |  |  |  |  |  |
| **Rent Revenue** |  | **$600** |  | **$1,350** |  |
| **Interest Expense** |  | **(400)** |  | **(800)** |  |
| **Net Income** |  | **$200** |  | **$550** |  |
|  |  |  |  |  |  |
| **Statements of Retained Earnings** | | | | | |
| **Beginning Retained Earnings** |  | **-0-** |  | **$200** |  |
| **Net Income** |  | **$200** |  | **550** |  |
| **Dividends** |  | **-0-** |  | **-0-** |  |
| **Ending Retained Earnings** |  | **$200** |  | **$750** |  |
|  |  |  |  |  |  |
| **Balance Sheets at December 31** | | | | | |
| **Assets** |  |  |  |  |  |
| **Cash** |  | **$ 600** |  | **$750** |  |
| **Land** |  | **10,000** |  | **-0-** |  |
| **Total Assets** |  | **$10,600** |  | **$750** |  |
| **Liabilities** |  |  |  |  |  |
| **Interest Payable** |  | **$ 400** |  | **-0-** |  |
| **Note Payable** |  | **10,000** |  | **-0-** |  |
| **Equity** |  |  |  |  |  |
| **Retained Earnings** |  | **200** |  | **$750** |  |
| **Total Liabilities and Equity** |  | **$10,600** |  | **$750** |  |
|  |  |  |  |  |  |
| **Statements of Cash Flows** | | | | | |
| **Cash Flows from Operating Activities** |  |  |  |  |  |
| **Inflow from Rental Income** |  | **$ 600** |  | **$ 1,350** |  |
| **Outflow for Interest Expense** |  | **-0-** |  | **(1,200)** |  |
| **Net Inflow from Operating Activities** |  | **$ 600** |  | **$ 150** |  |
| **Cash Flow from Investing Activities** |  |  |  |  |  |
| **Inflow from Sale of Land** |  | **-0-** |  | **$10,000** |  |
| **Outflow for Purchase of Land** |  | **(10,000)** |  | **-0-** |  |
| **Net Inflow (Outflow) from Investing Act.** |  | **(10,000)** |  | **$10,000** |  |
| **Cash Flows from Financing Activities** |  |  |  |  |  |
| **Inflow from Issue of Note** |  | **10,000** |  | **-0-** |  |
| **Outflow for Repayment of Note** |  | **-0-** |  | **$(10,000)** |  |
| **Net Inflow (Outflow) from Financing Act.** |  | **10,000** |  | **$(10,000)** |  |
| **Net Change in Cash** |  | **600** |  | **$ 150** |  |
| **Beginning Cash Balance** |  | **-0-** |  | **600** |  |
| **Ending Cash Balance** |  | **$ 600** |  | **$ 750** |  |
|  |  |  |  |  |  |

Demonstration Problem 2-4

Johnson’s Year 1 interest expense is determined as follows:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date Note Issued** | Principal | x | Rate | x | Time | = | Accrued Interest |
| April 1, Year 1 | $1,000 | x | .12 | x | (9 12) | = | $90 |
| June 1, Year 1 | $1,000 | x | .12 | x | (7 12) | = | $70 |
| October 1, Year 1 | $1,000 | x | .12 | x | (3 12) | = | $30 |

Demonstration Problem 2-5: Requirement a

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **ASSETS** | | | **=** | **LIABILITIES** | | | **+** | **EQUITY** | |
| **Year 1** |  |  | **Accts.** |  |  | **Sal.** | **Int.** | **Note** |  | **Com.** | **Ret.** |
| **Accounting Events** |  | **Cash** | **Rec.** | **Land** | **=** | **Pay.** | **Pay.** | **Pay.** | **+** | **Stk.** | **Ear.** |
| **Beginning Balances** |  | **-0-** | **-0-** | **-0-** |  | **-0-** | **-0-** | **-0-** |  | **-0-** | **-0-** |
| **(1) Issued Common Stock** |  | **2,000** |  |  |  |  |  |  |  | **2,000** |  |
| **(2) Issued Note Payable** |  | **1,000** |  |  |  |  |  | **1,000** |  |  |  |
| **(3) Recognized Consulting Rev.** |  |  | **1,500** |  |  |  |  |  |  |  | **1,500** |
| **(4) Collected Cash from Rec.** |  | **1,200** | **(1,200)** |  |  |  |  |  |  |  |  |
| **(5) Recognized Salary Expense** |  |  |  |  |  | **900** |  |  |  |  | **(900)** |
| **(6) Paid Liability for Salaries** |  | **(700)** |  |  |  | **(700)** |  |  |  |  |  |
| **(7) Paid Dividends** |  | **(100)** |  |  |  |  |  |  |  |  | **(100)** |
| **(8) Recognized Accrued Int. Exp.** |  |  |  |  |  |  | **20** |  |  |  | **(20)** |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Ending Balances** |  | **3,400** | **300** | **-0-** |  | **200** | **20** | **1,000** |  | **2,000** | **480** |
|  |  |  |  |  |  |  |  |  |  |  |  |

Demonstration Problem 2-5: Requirement a

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **ASSETS** | | | **=** | **LIABILITIES** | | | **+** | **EQUITY** | |
| **Year 2** |  |  | **Accts.** |  |  | **Sal.** | **Int.** | **Note** |  | **Com.** | **Ret.** |
| **Accounting Events** |  | **Cash** | **Rec.** | **Land** | **=** | **Pay.** | **Pay.** | **Pay.** | **+** | **Stk.** | **Ear.** |
| **Beginning Balances** |  | **3,400** | **300** | **0** |  | **200** | **20** | **1,000** |  | **2,000** | **480** |
| **(1) Issued Common Stock** |  | **3,000** |  |  |  |  |  |  |  | **3,000** |  |
| **(2) Recognized Consulting Rev.** |  |  | **2,700** |  |  |  |  |  |  |  | **2,700** |
| **(3) Collected Cash from Rec.** |  | **2,800** | **(2,800)** |  |  |  |  |  |  |  |  |
| **(4) Recognized Salary Expense** |  |  |  |  |  | **1,500** |  |  |  |  | **(1,500)** |
| **(5) Partial Payment of Sal. Pay.** |  | **(1,350)** |  |  |  | **(1,350)** |  |  |  |  |  |
| **(6) Paid Dividends** |  | **(300)** |  |  |  |  |  |  |  |  | **(300)** |
| **(7a) Recognized Accrued Int. Exp.** |  |  |  |  |  |  | **40** |  |  |  | **(40)** |
| **(7b) Paid off Interest Payable** |  | **(60)** |  |  |  |  | **(60)** |  |  |  |  |
| **(7c) Paid off Note Payable** |  | **(1,000)** |  |  |  |  |  | **(1,000)** |  |  |  |
| **(8) Purchased Land** |  | **(6,000)** |  | **6,000** |  |  |  |  |  |  |  |
| **(9) Change in Market Value (no effect)** |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Ending Balances** |  | **490** | **200** | **6,000** |  | **350** | **0** | **0** |  | **5,000** | **1,340** |
|  |  |  |  |  |  |  |  |  |  |  |  |

Demonstration Problem 2-5: Requirement b

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Income Statements for the Years Ended 12/31** |  | **Year 1** |  | **Year 2** |  |
|  | **Consulting Revenue** |  | **$1,500** |  | **$2,700** |  |
|  | **Salary Expense** |  | **(900)** |  | **(1,500)** |  |
|  | **Interest Expense** |  | **(20)** |  | **(40)** |  |
|  | **Net Income** |  | **$ 580** |  | **$1,160** |  |
|  | **Statements of Changes in Stockholders’ Equity** |  |  |  |  |  |
|  | **Beginning Common Stock** |  | **$ -0-** |  | **$2,000** |  |
|  | **Plus: Common Stock Issued** |  | **2,000** |  | **3,000** |  |
|  | **Ending Common Stock** |  | **2,000** |  | **5,000** |  |
|  | **Beginning Retained Earnings** |  | **-0-** |  | **480** |  |
|  | **Plus: Net Income** |  | **580** |  | **1,160** |  |
|  | **Less: Dividends** |  | **(100)** |  | **(300)** |  |
|  | **Ending Retained Earnings** |  | **480** |  | **1,340** |  |
|  | **Total Stockholders’ Equity** |  | **$2,480** |  | **$6,340** |  |
|  | **Balance Sheets as of December 31** |  |  |  |  |  |
|  | **Cash** |  | **$3,400** |  | **$ 490** |  |
|  | **Accounts Receivable** |  | **300** |  | **200** |  |
|  | **Land** |  | **-0-** |  | **6,000** |  |
|  | **Total Assets** |  | **$3,700** |  | **6,690** |  |
|  | **Salaries Payable** |  | **$ 200** |  | **$ 350** |  |
|  | **Interest Payable** |  | **20** |  | **0** |  |
|  | **Note Payable** |  | **1,000** |  | **0** |  |
|  | **Total Liabilities** |  | **1,220** |  | **350** |  |
|  | **Common Stock** |  | **2,000** |  | **5,000** |  |
|  | **Retained Earnings** |  | **480** |  | **1,340** |  |
|  | **Total Stockholders’ Equity** |  | **2,480** |  | **6,340** |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$3,700** |  | **$6,690** |  |
|  | **Statements of Cash Flows** |  |  |  |  |  |
|  | **Cash Flows from Operating Activities** |  |  |  |  |  |
|  | **Cash Receipts from Consulting Revenue** |  | **$ 1,200** |  | **$2,800** |  |
|  | **Cash Payments for Salaries** |  | **(700)** |  | **(1,350)** |  |
|  | **Cash Payments for Interest Expense** |  |  |  | **(60)** |  |
|  | **Net Cash Inflow from Operating Activities** |  | **500** |  | **1,390** |  |
|  | **Cash Flows from Investing Activities** |  |  |  |  |  |
|  | **Cash Payment to Purchase Land** |  | **-0-** |  | **(6,000)** |  |
|  | **Net Cash Outflow from Investing Activities** |  | **-0-** |  | **(6,000)** |  |
|  | **Cash Flows from Financing Activities** |  |  |  |  |  |
|  | **Cash Payment to Settle Note Payable** |  | **1,000** |  | **(1,000)** |  |
|  | **Cash Receipt from Common Stock Issue** |  | **2,000** |  | **3,000** |  |
|  | **Cash Payment for Dividends** |  | **(100)** |  | **(300)** |  |
|  | **Net Cash Inflow from Financing Activities** |  | **2,900** |  | **1,700** |  |
|  | **Net Change in Cash** |  | **3,400** |  | **(2,910)** |  |
|  | **Beginning Cash Balance** |  | **-0-** |  | **3,400** |  |
|  | **Ending Cash Balance** |  | **$3,400** |  | **$ 490** |  |
|  |  |  |  |  |  |  |

**Demonstration Problem 2-5: Requirement c**

**Year 1**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Event** |  | **Balance Sheet** | | | | |  | **Income Statement** | | | | |  | **Statement of**  **Cash Flow** |  |
|  | **No.** |  | **Assets** | **=** | **Liabilities** | **+** | **Stk. Equity** |  | **Rev.** |  | **Exp.** | **=** | **Net Inc.** |  |  |
|  | 1 |  | + |  | NA |  | + |  | NA |  | NA |  | NA |  | + FA |  |
|  | 2 |  | + |  | + |  | NA |  | NA |  | NA |  | NA |  | + FA |  |
|  | 3 |  | + |  | NA |  | + |  | + |  | NA |  | + |  | NA |  |
|  | 4 |  | + |  | NA |  | NA |  | NA |  | NA |  | NA |  | + OA |  |
|  | 5 |  |  |  | NA |  |  |  | NA |  | + |  |  |  | NA |  |
|  | 6 |  |  |  |  |  | NA |  | NA |  | NA |  | NA |  | OA |  |
|  | 7 |  |  |  | **NA** |  |  |  | NA |  | NA |  | NA |  | FA |  |
|  | 8 |  |  |  | + |  |  |  | NA |  | + |  |  |  | NA |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

**Year 2**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Event** |  | **Balance Sheet** | | | | |  | **Income Statement** | | | | |  | **Statement of**  **Cash Flow** |  |
|  | **No.** |  | **Assets** | **=** | **Liabilities** | **+** | **Stk. Equity** |  | **Rev.** |  | **Exp.** | **=** | **Net Inc.** |  |  |
|  | 1 |  | + |  | NA |  | + |  | NA |  | NA |  | NA |  | + FA |  |
|  | 2 |  | + |  | NA |  | + |  | + |  | NA |  | + |  | NA |  |
|  | 3 |  | + |  | NA |  | NA |  | NA |  | NA |  | NA |  | + OA |  |
|  | 4 |  |  |  | NA |  |  |  | NA |  | + |  |  |  | NA |  |
|  | 5 |  |  |  |  |  | NA |  | NA |  | NA |  | NA |  | OA |  |
|  | 6 |  |  |  | NA |  |  |  | NA |  | NA |  | NA |  | FA |  |
|  | 7a |  | NA |  | + |  |  |  | NA |  | + |  |  |  | NA |  |
|  | 7b |  |  |  |  |  | NA |  | NA |  | NA |  | NA |  | OA |  |
|  | 7c |  |  |  |  |  | NA |  | NA |  | NA |  | NA |  | FA |  |
|  | 8 |  | + |  | NA |  | NA |  | NA |  | NA |  | NA |  | IA |  |
|  | 9 |  | NA |  | NA |  | NA |  | NA |  | NA |  | NA |  | NA |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

**Workpapers for Chapter 2 Demonstration Problems**

**Demonstration Problem 2-1**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Balance Sheet** | | | | | | | | |  | **Income Statement** | | | | |  | **Statement of**  **Cash Flow** |  |
| **Year 1** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  |  |  |
| **No.** |  | **Cash** | **+** | **Land** | **=** | **N. Pay.** | **+** | **C. Stk.** | **+** | **Ret. Earn.** |  | **Rev.** | **–** | **Exp.** | **=** | **Net Inc.** |  |  |
| **Beg. bal.** |  | **0** | **+** | **0** | **=** | **0** | **+** | **0** | **+** | **0** |  | **0** | **–** | **0** | **=** | **0** |  | **NA** |  |
| **1** |  | **9,000** | **+** | **NA** | **=** | **NA** | **+** | **9,000** | **+** | **NA** |  | **NA** | **–** | **NA** | **=** | **NA** |  | **9,000 FA** |  |
| **2** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **3** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **4** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **5** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Totals** |  | **14,600** | **+** |  | **=** | **5,000** | **+** | **9,000** | **+** | **600** |  | **4,000** | **–** | **2,900** | **=** | **1,100** |  | **14,600 NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Year 2** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  |  |  |  |  |  |  |  |  |
| **No.** |  | **Cash** | **+** | **Land** | **=** | **N.Pay.** | **+** | **C. Stk.** | **+** | **Ret. Ear.** |  | **Rev.** | **–** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| **Beg. bal.** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **1** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **2** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **3** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **4** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **5** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Totals** |  | **18,800** | **+** |  | **=** | **3,000** | **+** | **13,500** | **+** | **2,300** |  | **6,700** | **–** | **4,300** | **=** | **2,400** |  | **4,200 NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Year 3** |  | **Assets** | | | **=** | **Liab.** | **+** | **Equity** | | |  |  |  |  |  |  |  |  |  |
| **No.** |  | **Cash** | **+** | **Land** | **=** | **N.Pay.** | **+** | **C. Stk.** | **+** | **Ret. Ear.** |  | **Rev.** | **–** | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| **Beg. bal.** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **1** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **2** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **3** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **4** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **5** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **6** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Totals** |  | **500** | **+** | **21,000** | **+** | **4,000** | **+** | **16,000** | **+** | **1,500** |  | **7,400** | **–** | **7,900** | **=** | **(500)** |  | **(18,300) NC** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Demonstration Problem 2-2: Requirement a

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Assets** | | | **=** | **Liabilities** | **+** | **Equity** | | |
| **Year 1** | **Cash** | **+** | **Accts.**  **Receiv.** | **=** | **Liabilities** | **+** | **Common**  **Stock** | **+** | **Retained Earnings** |
| **Beginning Balances** | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |
| **1. Effect of Recognizing Rev.** |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| **Year 2** |  |  |  |  |  |  |  |  |  |
| **1. Effect of Cash Collection** |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| **Ending Balances** | **$5,000** | **+** | **$ -0-** | **=** | **$ -0-** | **+** | **$ -0-** | **+** | **$5,000** |
|  |  |  |  |  | **══** |  |  |  |  |

Demonstration Problem 2-2: Requirement b

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Packard Consultants** | | | | | |
| **Income Statements** | | | | | |
| **For the Years Ended December 31,** |  | **Year 1** |  | **Year 2** |  |
|  |  |  |  |  |  |
| **Consulting Revenue** |  |  |  |  |  |
| **Expenses** |  |  |  |  |  |
| **Net Income** |  |  |  |  |  |
|  |  |  |  |  |  |
| **Statements of Retained Earnings** | | | | | |
| **Beginning Retained Earnings** |  |  |  |  |  |
| **Net Income** |  |  |  |  |  |
| **Dividends** |  |  |  |  |  |
| **Ending Retained Earnings** |  |  |  |  |  |
|  |  |  |  |  |  |
| **Balance Sheets at December 31** | | | | | |
| **Assets** |  |  |  |  |  |
| **Cash** |  |  |  |  |  |
| **Accounts Receivable** |  |  |  |  |  |
| **Total Assets** |  |  |  |  |  |
|  |  |  |  |  |  |
| **Equity** |  |  |  |  |  |
| **Retained Earnings** |  |  |  |  |  |
|  |  |  |  |  |  |
| **Statements of Cash Flows** | | | | | |
| **Cash Flows from Operating Activities** |  |  |  |  |  |
|  |  |  |  |  |  |
| **Cash Flows from Investing Activities** |  |  |  |  |  |
|  |  |  |  |  |  |
| **Cash Flows from Financing Activities** |  |  |  |  |  |
| **Net Change in Cash** |  |  |  |  |  |
| **Beginning Cash Balance** |  |  |  |  |  |
| **Ending Cash Balance** |  |  |  |  |  |
|  |  |  |  |  |  |

**Demonstration Problem 2-3: Requirement a**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Assets** | | | **=** | **Liab.** | | | **+** | **Equity** | | |
| **Year 1** | **Cash** | **+** | **Land** | **=** | **Notes**  **Payable** | **+** | **Int.**  **Pay.** | **+** | **Com.**  **Stock** | **+** | **Ret.**  **Ear.** |
| **Beginning Balances** | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |  | **$ -0-** |
| **1. Effect of Borrowing** |  |  |  |  |  |  |  |  |  |  |  |
| **2. Purch. of Land** |  |  |  |  |  |  |  |  |  |  |  |
| **3. Earned Revenue** |  |  |  |  |  |  |  |  |  |  |  |
| **4. Accrued Int. Exp.** |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **End. / Beg. Balances** | **$ 600** | **+** | **$10,000** | **=** | **$10,000** | **+** | **$ 400** | **+** | **$ -0-** | **+** | **$ 200** |
| **Year 2** |  |  |  |  |  |  |  |  |  |  |  |
| **1. Earned Revenue** |  |  |  |  |  |  |  |  |  |  |  |
| **2. Sold Land** |  |  |  |  |  |  |  |  |  |  |  |
| **3. Accrued Int. Exp.** |  |  |  |  |  |  |  |  |  |  |  |
| **4. Paid Interest** |  |  |  |  |  |  |  |  |  |  |  |
| **5. Repaid Loan** |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Ending Balances** | **$ 750** | **+** | **$ -0-** | **=** | **$ -0-** | **+** | **$ -0-** | **+** | **$ -0-** | **+** | **$ 750** |
|  |  |  |  |  |  |  |  |  |  |  |  |

**Demonstration Problem 2-3: Requirement b**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Canton Company** | | | | | |
| **Income Statements** | | | | | |
| **For the Years Ended December 31,** |  | **Year 1** |  | **Year 2** |  |
|  |  |  |  |  |  |
| **Rent Revenue** |  |  |  |  |  |
| **Interest Expense** |  |  |  |  |  |
| **Net Income** |  | **$200** |  | **$550** |  |
|  |  |  |  |  |  |
| **Statements of Retained Earnings** | | | | | |
| **Beginning Retained Earnings** |  |  |  |  |  |
| **Net Income** |  |  |  |  |  |
| **Dividends** |  |  |  |  |  |
| **Ending Retained Earnings** |  | **$200** |  | **$750** |  |
|  |  |  |  |  |  |
| **Balance Sheets at December 31** | | | | | |
| **Assets** |  |  |  |  |  |
| **Cash** |  |  |  |  |  |
| **Land** |  |  |  |  |  |
| **Total Assets** |  |  |  |  |  |
| **Liabilities** |  |  |  |  |  |
| **Interest Payable** |  |  |  |  |  |
| **Note Payable** |  |  |  |  |  |
| **Equity** |  |  |  |  |  |
| **Retained Earnings** |  |  |  |  |  |
| **Total Liabilities and Equity** |  | **$10,600** |  | **$750** |  |
|  |  |  |  |  |  |
| **Statements of Cash Flows** | | | | | |
| **Cash Flows from Operating Activities** |  |  |  |  |  |
| **Inflow from Rental Income** |  |  |  |  |  |
| **Outflow for Interest Expense** |  |  |  |  |  |
| **Net Inflow from Operating Activities** |  |  |  |  |  |
| **Cash Flow from Investing Activities** |  |  |  |  |  |
| **Inflow from Sale of Land** |  |  |  |  |  |
| **Outflow for Purchase of Land** |  |  |  |  |  |
| **Net Inflow (Outflow) from Investing Act.** |  |  |  |  |  |
| **Cash Flows from Financing Activities** |  |  |  |  |  |
| **Inflow from Issue of Note** |  |  |  |  |  |
| **Outflow for Repayment of Note** |  |  |  |  |  |
| **Net Inflow (Outflow) from Financing Act.** |  |  |  |  |  |
| **Net Change in Cash** |  |  |  |  |  |
| **Beginning Cash Balance** |  |  |  |  |  |
| **Ending Cash Balance** |  | **$ 600** |  | **$ 750** |  |
|  |  |  |  |  |  |

Demonstration Problem 2-4

Johnson’s Year 1 interest expense is determined as follows:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date Note Issued** | Principal | x | Rate | x | Time | = | Accrued Interest |
| April 1, Year 1 |  |  |  |  |  |  |  |
| June 1, Year 1 |  |  |  |  |  |  |  |
| October 1, Year 1 |  |  |  |  |  |  |  |

Demonstration Problem 2-5: Requirement a

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **ASSETS** | | | **=** | **LIABILITIES** | | | **+** | **EQUITY** | |
| **Year 1** |  |  | **Accts.** |  |  | **Sal.** | **Int.** | **Note** |  | **Com.** | **Ret.** |
| **Accounting Events** |  | **Cash** | **Rec.** | **Land** | **=** | **Pay.** | **Pay.** | **Pay.** | **+** | **Stk.** | **Ear.** |
| **Beginning Balances** |  | **-0-** | **-0-** | **-0-** |  | **-0-** | **-0-** | **-0-** |  | **-0-** | **-0-** |
| **(1) Issued Common Stock** |  |  |  |  |  |  |  |  |  |  |  |
| **(2) Issued Note Payable** |  |  |  |  |  |  |  |  |  |  |  |
| **(3) Recognized Consulting Rev.** |  |  |  |  |  |  |  |  |  |  |  |
| **(4) Collected Cash from Rec.** |  |  |  |  |  |  |  |  |  |  |  |
| **(5) Recognized Salary Expense** |  |  |  |  |  |  |  |  |  |  |  |
| **(6) Paid Liability for Salaries** |  |  |  |  |  |  |  |  |  |  |  |
| **(7) Paid Dividends** |  |  |  |  |  |  |  |  |  |  |  |
| **(8) Recognized Accrued Int. Exp.** |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Ending Balances** |  | **3,400** | **300** | **-0-** |  | **200** | **20** | **1,000** |  | **2,000** | **480** |
|  |  |  |  |  |  |  |  |  |  |  |  |

Demonstration Problem 2-5: Requirement a

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **ASSETS** | | | **=** | **LIABILITIES** | | | **+** | **EQUITY** | |
| **Year 2** |  |  | **Accts.** |  |  | **Sal.** | **Int.** | **Note** |  | **Com.** | **Ret.** |
| **Accounting Events** |  | **Cash** | **Rec.** | **Land** | **=** | **Pay.** | **Pay.** | **Pay.** | **+** | **Stk.** | **Ear.** |
| **Beginning Balances** |  | **3,400** | **300** | **0** |  | **200** | **20** | **1,000** |  | **2,000** | **480** |
| **(1) Issued Common Stock** |  |  |  |  |  |  |  |  |  |  |  |
| **(2) Recognized Consulting Rev.** |  |  |  |  |  |  |  |  |  |  |  |
| **(3) Collected Cash from Rec.** |  |  |  |  |  |  |  |  |  |  |  |
| **(4) Recognized Salary Expense** |  |  |  |  |  |  |  |  |  |  |  |
| **(5) Partial Payment of Sal. Pay.** |  |  |  |  |  |  |  |  |  |  |  |
| **(6) Paid Dividends** |  |  |  |  |  |  |  |  |  |  |  |
| **(7a) Recognized Accrued Int. Exp.** |  |  |  |  |  |  |  |  |  |  |  |
| **(7b) Paid off Interest Payable** |  |  |  |  |  |  |  |  |  |  |  |
| **(7c) Paid off Note Payable** |  |  |  |  |  |  |  |  |  |  |  |
| **(8) Purchased Land** |  |  |  |  |  |  |  |  |  |  |  |
| **(9) Change in Market Value (no effect)** |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Ending Balances** |  | **490** | **200** | **6,000** |  | **350** | **0** | **0** |  | **5,000** | **1,340** |
|  |  |  |  |  |  |  |  |  |  |  |  |

Demonstration Problem 2-5: Requirement b

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Income Statements for the Years Ended 12/31** |  | **Year 1** |  | **Year 2** |  |
|  | **Consulting Revenue** |  |  |  |  |  |
|  | **Salary Expense** |  |  |  |  |  |
|  | **Interest Expense** |  |  |  |  |  |
|  | **Net Income** |  | **$ 580** |  | **$1,160** |  |
|  | **Statements of Changes in Stockholders’ Equity** |  |  |  |  |  |
|  | **Beginning Common Stock** |  | **$ -0-** |  | **$2,000** |  |
|  | **Plus: Common Stock Issued** |  |  |  |  |  |
|  | **Ending Common Stock** |  |  |  |  |  |
|  | **Beginning Retained Earnings** |  |  |  |  |  |
|  | **Plus: Net Income** |  |  |  |  |  |
|  | **Less: Dividends** |  |  |  |  |  |
|  | **Ending Retained Earnings** |  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  | **$2,480** |  | **$6,340** |  |
|  | **Balance Sheets as of December 31** |  |  |  |  |  |
|  | **Cash** |  |  |  |  |  |
|  | **Accounts Receivable** |  |  |  |  |  |
|  | **Land** |  |  |  |  |  |
|  | **Total Assets** |  | **$3,700** |  | **6,690** |  |
|  | **Salaries Payable** |  |  |  |  |  |
|  | **Interest Payable** |  |  |  |  |  |
|  | **Note Payable** |  |  |  |  |  |
|  | **Total Liabilities** |  |  |  |  |  |
|  | **Common Stock** |  |  |  |  |  |
|  | **Retained Earnings** |  |  |  |  |  |
|  | **Total Stockholders’ Equity** |  |  |  |  |  |
|  | **Total Liabilities and Stockholders’ Equity** |  | **$3,700** |  | **$6,690** |  |
|  | **Statements of Cash Flows** |  |  |  |  |  |
|  | **Cash Flows from Operating Activities** |  |  |  |  |  |
|  | **Cash Receipts from Consulting Revenue** |  |  |  |  |  |
|  | **Cash Payments for Salaries** |  |  |  |  |  |
|  | **Cash Payments for Interest Expense** |  |  |  |  |  |
|  | **Net Cash Inflow from Operating Activities** |  |  |  |  |  |
|  | **Cash Flows from Investing Activities** |  |  |  |  |  |
|  | **Cash Payment to Purchase Land** |  |  |  |  |  |
|  | **Net Cash Outflow from Investing Activities** |  |  |  |  |  |
|  | **Cash Flows from Financing Activities** |  |  |  |  |  |
|  | **Cash Payment to Settle Note Payable** |  |  |  |  |  |
|  | **Cash Receipt from Common Stock Issue** |  |  |  |  |  |
|  | **Cash Payment for Dividends** |  |  |  |  |  |
|  | **Net Cash Inflow from Financing Activities** |  |  |  |  |  |
|  | **Net Change in Cash** |  |  |  |  |  |
|  | **Beginning Cash Balance** |  |  |  |  |  |
|  | **Ending Cash Balance** |  | **$3,400** |  | **$ 490** |  |
|  |  |  |  |  |  |  |

**Demonstration Problem 2-5: Requirement c**

**Year 1**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Event** |  | **Balance Sheet** | | | | |  | **Income Statement** | | | | |  | **Statement of** |  |
|  | **No.** |  | **Assets** | **=** | **Liabilities** | **+** | **Stk. Equity** |  | **Rev.** |  | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
|  | 1 |  | + |  | NA |  | + |  | NA |  | NA |  | NA |  | + FA |  |
|  | 2 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 3 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 4 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 5 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 6 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 7 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 8 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

**Year 2**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Event** |  | **Balance Sheet** | | | | |  | **Income Statement** | | | | |  | **Statement of** |  |
|  | **No.** |  | **Assets** | **=** | **Liabilities** | **+** | **Stk. Equity** |  | **Rev.** |  | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
|  | 1 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 2 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 3 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 4 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 5 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 6 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | NA |  | + OA |
|  | 7a |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 7b |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 7c |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 8 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 9 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

**Quiz Questions for Chapter 2**

1. X Company recognized $500 of revenue on account and realized $400 of cash collections. The company had accrued salary expense of $300 and invested $200 in a certificate of deposit. Based on this information alone, the amount of cash flow from operating activities would be

a. $100.

b. $500.

c. $200.

d. $400.

2. Y Company issued a $5,000 face value note to the State Bank on December 1, Year 2. The note had a 12 percent annual rate of interest and a one-year term. The adjusting entry to record accrued interest on December 31, Year 2, would

a. decrease liabilities by $50.

b. decrease equity by $50.

c. increase net income by $50.

d. none of the above.

3. On January 1, Year 2, West Company had accounts receivable of $500. During Year 2 West earned $2,500 of service revenue on account. If the accounts receivable balance as of December 31, Year 2, was $400, what was the amount of cash flow from operating activities?

a. $2,000.

b. $3,000.

c. $2,400.

d. $2,600.

4. On June 1, Year 5 the BBC Company purchased a $5,000 one-year certificate of deposit from the bank. The certificate pays interest at 12 percent annually. On December 31, Year 5 the adjusting entry to record interest on BBC’s books would

a. increase liabilities by $350.

b. increase net income by $350.

c. increase assets by $600.

d. decrease equity by $300.

5. The entry to record revenue on account

a. increases liabilities.

b. decreases equity.

c. decreases assets.

d. none of the above.

6. On March 1, Year 3, A Company purchased for $5,000 a two-year certificate of deposit that paid 6 percent annual interest. On December 31, Year 3, the adjusting entry to record accrued interest would

a. increase assets and equity by $500.

b. increase assets and liabilities by $300.

c. increase assets and equity by $250.

d. increase assets and liabilities by $250.

7. K Company collected $500 cash on an account receivable that was due from L Company. Based on this information, which of the following statements is true?

a. K Company’s total assets would increase.

b. L Company’s total assets would not change.

c. K Company’s equity would decrease.

d. None of the above.

8. On June 1, Year 2, X Company invested $10,000 in a certificate of deposit. The CD had a 12 percent annual interest rate and a one-year term. For Year 2, X Company would report income on the income statement and cash flow from operating activities on the statement of cash flows, respectively, of

a. $1,200 / $1,200

b. $700 / $700

c. $1,200 / $ 0

d. $700 / $0

**Use the following information to answer the next two questions.** On May 1, Year 4, Arrow Company borrowed $10,000 from the State Bank at 9 percent annual interest. The note issued by Arrow had a one-year term. Arrow reported cash revenue of $3,400 and $800 in Year 4 and Year 5, respectively.

9. Arrow’s net income for Year 4 and Year 5 would be

a. $2,500 / $100

b. $2,800 /$500

c. $2,400 / $800

d. $2,500 / $800

10. The cash flow from operating activities Arrow would report on the Year 4 and Year 5 statements of cash flows would be

a. $2,800 / $500

b. $2,500 /$800

c. $2,800 / $(100)

d. $3,400 / $(100)

11. Which of the following illustrates the recognition of revenue earned on account?

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Balance Sheet** | | | | |  | **Income Statement** | | | | |  | **Statement of** |  |
|  |  | **Assets** | **=** | **Liab.** | **+** | **Equity** |  | **Rev.** |  | **Exp.** | **=** | **Net Inc.** |  | **Cash Flow** |  |
| a. |  | + |  | n/a |  | + |  | n/a |  | n/a |  | n/a |  | n/a |  |
| b. |  | + |  | n/a |  | + |  | + |  | n/a |  | + |  | n/a |  |
| c. |  |  |  | n/a |  |  |  | n/a |  | + |  |  |  | OA |  |
| d. |  | + |  | n/a |  | + |  | + |  | n/a |  | + |  | + OA |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |
| --- | --- |
| Question | Ch 2 |
| 1 | D |
| 2 | B |
| 3 | D |
| 4 | B |
| 5 | D |
| 6 | C |
| 7 | D |
| 8 | D |
| 9 | B |
| 10 | D |
| 11 | B |

Summary Outline of a Lesson Plan for Chapter 2

**I**. **Use Demonstration Problem 2-1 to introduce students to the horizontal financial statements model.**

**II**. **Use Demonstration Problem 2-2 to define and illustrate the concept of accrual accounting with accounts receivable and accounts payable.**

**III.** **Use Demonstration Problem 2-3 to introduce** ***accrued interest*.**

**IV.** **Use Demonstration Problem 2-4 to illustrate interest computations.**

**V. Time considerations and homework assignments.** Allocate at least one hour to the introduction of the horizontal financial statements model using Demonstration Problem 2-1. Demonstration Problems 2-2, 2-3, and 2-4 also require approximately one hour of class time. From the text use exercises 2-4A&B, 2-5A&B, 2-6A&B, and 2-5A&B for receivables and payables; and 2-13A&B, and 2-14A&B for the treatment of interest.

**VI. Use Demonstration Problem 2-5 as a comprehensive summary problem.** Explain the first cycle (Year 1) to the class and use the second cycle (Year 2) as an in-class assignment. Allot one hour for this assignment. Have slower students finish the problem as homework. Use parallel problem 2-23A&B from the textbook as a homework assignment.

**VII.** **Enrichment. Use ATC 2-1 in the textbook to cover the topic of audit reports.**