CHAPTER 3

SOLUTIONS TO EXERCISES—SET B

EXERCISE 3-1B

1. False. Adjusting entries are necessary to update the accounting records to the accrual basis.

2. True.

3. True.

4. False. Accounting time periods can be any length, and are generally a month, a quarter, or a year.

5. True.

6. False. All *calendar* years are *fiscal* years, but not all *fiscal* years are *calendar* years. An accounting time period that is one year in length is referred to as a fiscal year. A fiscal year that starts on January 1 and ends on December 31 is a calendar year.

EXERCISE 3-2B

(a) Cash received from revenue $140,000

Cash paid for expenses (110,000)

Cash-basis net income $ 30,000

(b) Revenues [($140,000 – $30,000) + $47,000] $157,000

Expenses [($110,000 – $30,000) + $44,000] (124,000)

Accrual-basis net income $ 33,000

EXERCISE 3-3B

1. Prepaid expense.

2. Accrued expense.

3. Accrued expense.

4. Accrued revenue.

5. Unearned revenue.

6. Prepaid expense.

EXERCISE 3-3B (Continued)

7. Accrued revenue.

8. Prepaid expense.

9. Unearned revenue.

10. Prepaid expense.

11. Accrued expense.

EXERCISE 3-4B

1. Interest Expense 900

Interest Payable

($30,000 X 12% X 3/12) 900

2. Supplies Expense 1,950

Supplies ($2,650 – $700) 1,950

3. Depreciation Expense 2,000

Accumulated Depreciation—Equipment 2,000

4. Insurance Expense 1,050

Prepaid Insurance

($2,520 X 5/12) 1,050

5. Unearned Service Revenue 12,500

Service Revenue

($50,000 X 1/4) 12,500

6. Accounts Receivable 5,300

Service Revenue 5,300

7. Salaries and Wages Expense 4,800

Salaries and Wages Payable

   ($12,000 X 2/5) 4,800

EXERCISE 3-5B

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Item |  | (a)  Type of Adjustment |  | (b)  Accounts before Adjustment |
|  |  |  |  |  |
| 1. |  | Prepaid Expense |  | Assets Overstated  Expenses Understated |
|  |  |  |  |  |
| 2. |  | Accrued Revenue |  | Assets Understated  Revenues Understated |
|  |  |  |  |  |
| 3. |  | Unearned Revenue |  | Liabilities Overstated  Revenues Understated |
|  |  |  |  |  |
| 4. |  | Accrued Expense |  | Expenses Understated  Liabilities Understated |
|  |  |  |  |  |
| 5. |  | Prepaid Expense |  | Assets Overstated  Expenses Understated |
|  |  |  |  |  |
| 6. |  | Accrued Expense |  | Expenses Understated  Liabilities Understated |

EXERCISE 3-6B

1. Mar. 31 Depreciation Expense ($300 X 3)   900

Accumulated Depreciation—

  Equipment   900

2. 31 Unearned Rent Revenue 10,800

Rent Revenue 10,800

3. 31 Interest Expense   750

Interest Payable   750

4. 31 Supplies Expense 2,100

Supplies ($3,400 – $1,300) 2,100

5. 31 Insurance Expense ($4,200 X 3/24)   525

Prepaid Insurance   525

EXERCISE 3-7B

1. Jan. 31 Accounts Receivable   1,280

Service Revenue  1,280

2. 31 Utilities Expense   365

Utilities Payable   365

3. 31 Depreciation Expense   500

Accumulated Depreciation—

  Equipment   500

31 Interest Expense   600

Interest Payable   600

4. 31 Insurance Expense ($9,600 ÷ 12) 800

Prepaid Insurance 800

5. 31 Supplies Expense ($2,300 – $700) 1,600

Supplies 1,600

EXERCISE 3-8B

1. Oct. 31 Supplies Expense 1,600

Supplies ($2,500 – $900) 1,600

2. 31 Insurance Expense   75

Prepaid Insurance   75

3. 31 Depreciation Expense   100

Accumulated Depreciation—

  Equipment   100

4. 31 Unearned Service Revenue   800

Service Revenue   800

5. 31 Accounts Receivable   375

Service Revenue   375

EXERCISE 3-8B (Continued)

6. Oct. 31 Interest Expense    25

Interest Payable  25

7. 31 Salaries and Wages Expense 900

Salaries and Wages Payable

   (3 X $300) 900

EXERCISE 3-9B

ACE CO.

Income Statement

For the Month Ended July 31, 2022

Revenues

Service revenue ($7,700 + $650) $8,350

Expenses

Salaries and wages expense ($2,500 + $350) $2,850

Supplies expense ($1,700 – $250)    1,450

Utilities expense    500

Insurance expense    600

Depreciation expense 225

Total expenses 5,625

Net income $2,725

EXERCISE 3-10B

Answer Computation

(a) Supplies balance = $500 Supplies expense $1,100

Add: Supplies (1/31)  900

Less: Supplies purchased (1,500 )

Supplies (1/1) $ 500

(b) Total premium = $6,000 Total premium = Monthly premium X 12; $500 X 12 = $6,000

Purchase date = June 1 Purchase date: On Jan. 31, there are   
4 months’ coverage remaining ($500 X 4). Thus, the purchase date was 8 months earlier on June 1, 2021.

(c) Salaries and wages

    payable = $1,850 Cash paid $4,500

Salaries payable (1/31/22) 1,000

 5,500

Less: Salaries expense 3,650

Salaries payable (12/31/21) $1,850

EXERCISE 3-11B

(a) July 10 Supplies   1,500

Cash   1,500

14 Cash 3,300

Service Revenue 3,300

15 Salaries and Wages Expense 1,400

Cash 1,400

20 Cash   1,200

Unearned Service Revenue   1,200

(b) July 31 Supplies Expense   1,900

Supplies   1,900

31 Accounts Receivable   900

Service Revenue   900

31 Salaries and Wages Expense 850

Salaries and Wages Payable 850

31 Unearned Service Revenue   1,800

Service Revenue   1,800

EXERCISE 3-12B

Aug. 31 Accounts Receivable   1,500

Service Revenue   1,500

31 Supplies Expense 1,900

Supplies 1,900

31 Insurance Expense 1,400

Prepaid Insurance 1,400

31 Depreciation Expense 800

Accumulated Depreciation—

  Equipment 800

31 Salaries and Wages Expense 1,200

Salaries and Wages Payable 1,200

31 Unearned Rent Revenue   1,600

Rent Revenue   1,600

EXERCISE 3-13B

RAMIREZ COMPANY

Income Statement

For the Year Ended August 31, 2022

Revenues

Service revenue $39,500

Rent revenue 13,600

Total revenues $53,100

Expenses

Salaries and wages expense 17,200

Rent expense  14,000

Supplies expense   1,900

Insurance expense   1,400

Depreciation expense 800

Total expenses 35,300

Net income $17,800

EXERCISE 3-13B (Continued)

RAMIREZ COMPANY

Retained Earnings Statement

For the Year Ended August 31, 2022

Beginning balance, September 1, 2021 $ 4,700

Add: Net income 17,800

Ending balance, August 31, 2022 $22,500

RAMIREZ COMPANY

Balance Sheet

August 31, 2022

Assets

Cash $ 7,700

Accounts receivable   13,500

Supplies     900

Prepaid insurance   2,800

Equipment $16,000

Less: Accum. depreciation—equipment 4,800 11,200

Total assets $36,100

Liabilities and Stockholders’ Equity

Liabilities

Accounts payable $ 2,200

Salaries and wages payable   1,200

Unearned rent revenue 200

Total liabilities $ 3,600

Stockholders’ equity

Common stock 10,000

Retained earnings 22,500 32,500

Total liabilities and stockholders’ equity $36,100

EXERCISE 3-14B

(a) 1. Cash  17,000

Accounts Receivable  17,000

2. Unearned Revenue 22,000

Service Revenue 22,000

3. (a) Cash  38,000

Unearned Service Revenue  38,000

(b) Unearned Service Revenue

   ($38,000 – $18,000) 20,000

Service Revenue  20,000

4. Accounts Receivable 119,000

Service Revenue

  ($161,000 – $22,000 – $20,000) 119,000

5. Cash 100,000

Accounts Receivable

   ($119,000 – $19,000) 100,000

(b) Cash received with respect to service = $17,000 + $100,000 + $38,000

= $155,000

\*EXERCISE 3-15B

1. Prepaid Insurance 2,100

Insurance Expense ($3,600 X 7/12) 2,100

2. Service Revenue 52,000

Unearned Service Revenue

 ($65,000 X 4/5) 52,000

3. Supplies 1,200

Supplies Expense 1,200

\*EXERCISE 3-16B

(a) Jan. 2 Insurance Expense 3,000

Cash 3,000

10 Supplies Expense 2,100

Cash 2,100

15 Cash 7,500

Service Revenue 7,500

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Insurance Expense | |  | Supplies Expense | |
| 1/2 3,000 |  |  | 1/10 2,100 |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash | |  | Service Revenue | |
| 1/15 7,500 | 1/2 3,000   1/10 2,100 |  |  | 1/15 7,500 |

(b) Jan. 31 Prepaid Insurance ($250 X 11 months) 2,750

Insurance Expense 2,750

31 Supplies   900

Supplies Expense   900

31 Service Revenue 3,000

Unearned Service Revenue 3,000

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Insurance Expense | |  | Supplies Expense | |  | Service Revenue | |
| 1/2 3,000 | 1/31 2,750 |  | 1/10 2,100 | 1/31 900 |  | 1/31 3,000 | 1/15 7,500 |
| Bal.   250 |  |  | Bal.   1,200 |  |  |  | Bal. 4,500 |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Prepaid Insurance | |  | Supplies | |  | Unearned Service Revenue | |
| 1/31 2,750 |  |  | 1/31   900 |  |  |  | 1/31 3,000 |

(c) Insurance expense $  250 (debit)

Supplies expense    1,200 (debit)

Service revenue  4,500 (credit)

Prepaid insurance  2,750 (debit)

Supplies    900 (debit)

Unearned service revenue  3,000 (credit)

\*EXERCISE 3-17B

(a) 2 Going concern assumption

(b) 6 Economic entity assumption

(c) 3 Monetary unit assumption

(d) 4 Time period assumption

(e) 5 Historical cost principle

(f) 1 Full disclosure principle

\*EXERCISE 3-18B

1. Incorrect. The historical *cost principle* requires that assets be recorded and reported at their cost.

2. Correct. The *monetary unit assumption* assumes the unit of measure remains sufficiently constant over time.

3. Incorrect. The *economic entity assumption* requires that the activities of the entity be kept separate and distinct from the activities of its owner and all other economic entities.

\*EXERCISE 3-19B

1. Historical cost principle

2. Consistency

3. Economic entity assumption

4. Full disclosure principle

5. Time period assumption

6. Relevance

7. Comparability

8. Going concern assumption

9. Materiality

10. Faithful representation

11. Monetary unit assumption

12. Expense recognition principle

\*EXERCISE 3-20B

(a) The primary objective of financial reporting is to provide information useful for decision making. Since Unruh’s shares appear to be ac­tively traded, investors must be capable of using the information made available by Unruh to make decisions about the company.

(b) The investors must feel as if the company will show earnings in the future. They must recognize that information relevant to their invest­ment choice is indicated by more than Unruh’s net income.

(c) The change from Canadian dollars to U.S. dollars for reporting pur­poses should make Unruh’s more comparable with companies traded on U.S. stock exchanges.

\*EXERCISE 3-21

(a) Accounting information is the compilation and presentation of financial information for a company. It provides information in the form of finan­cial statements and additional disclosures that is useful for decision making.

The accounting rules and practices that have substantial authoritative support and are recognized as a general guide for financial reporting purposes are referred to as generally accepted accounting principles (GAAP). The biotechnology company that employs Kim will follow GAAP to report its assets, liabilities, stockholders’ equity, revenues, and expenses as it prepares financial statements.

(b) Kim is correct in her understanding that the low success rate for new biotech products will be a cause of concern for investors. Her suggestion that detailed scientific findings be reported to prospective investors might offset some of their concerns but it probably won’t conform to the qualitative characteristics of accounting information.

These characteristics consist of relevance, faithful representation, comparability, and consistency, verifiability, timeliness, and understandability. They apply to accounting information rather than the scientific findings that Kim wants to include.