

# CHAPTER 3

## The Accounting Information System

### ASSIGNMENT CLASSIFICATION TABLE (BY TOPIC)

Topics	Questions	Brief Exercises	Exercises	Problems
1. Transaction identification.	1, 2, 3, 5, 6, 7, 8	1, 2	1, 2, 3, 4, 17	1
2. Nominal accounts.	4, 7			
3. Trial balance.	6, 10		2, 3, 4	1, 2
4. Adjusting entries.	8, 11, 13, 14	3, 4, 5, 6, 7, 8, 9, 10	5, 6, 7, 8, 9, 10, 20	1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 12
5. Financial statements.			11, 12, 15, 22, 23	1, 2, 4, 6
6. Closing.	12	11	13, 14, 16	1, 4, 9, 10, 12
7. Inventory and cost of goods sold.	9		14, 15	
8. Comprehensive accounting cycle.				1, 2, 6, 12
*9. Cash vs. accrual Basis.	15, 16, 17	12	18, 19	11
*10. Reversing entries.	18	13	20	
*11. Worksheet.	19		21, 22, 23	12

\*These topics are dealt with in an Appendix to the Chapter.

## ASSIGNMENT CLASSIFICATION TABLE (BY LEARNING OBJECTIVE)

Learning Objectives	Questions	Brief Exercises	Exercises	Problems
1. Understand basic accounting terminology.	1, 2, 4, 7			
2. Explain double-entry rules.	1, 2, 3, 4, 5, 7			
3. Identify steps in accounting cycle.	2, 3			
4. Record transactions in journals, post to ledger accounts, and prepare a trial balance.	6, 10	1, 2, 3, 4, 5, 6, 7	1, 2, 3, 4, 17	1, 4, 9, 10
5. Explain the reasons for preparing adjusting entries and identify major types of adjusting entries.	11, 16	3, 4, 5, 6, 7, 8, 9, 10	5, 6, 7, 8, 9, 10, 20	2, 3, 4, 5, 6, 7, 8, 9, 10, 12
6. Prepare financial statements from the adjusted trail balance.	10		11, 12	1, 2, 4, 6, 7, 8, 9, 10, 12
7. Prepare closing entries.	8, 12, 13, 14	11	13, 14, 16	1, 4, 9, 10, 12
8. Prepare financial statements for a merchandising company.	9		13, 14, 15	4, 10
*9. Differentiate the cash basis of accounting from the accrual basis of accounting.	15, 17	12	18, 19	11
*10. Identify adjusting entries that may be reversed.	18	13	20	
*11. Prepare a 10-column worksheet.	19		21, 22, 23	12

\*These topics are dealt with in an Appendix to the Chapter.

## ASSIGNMENT CHARACTERISTICS TABLE

Item	Description	Level of Difficulty	Time (minutes)
E3-1	Transaction analysis—service company.	Simple	15–20
E3-2	Corrected trial balance.	Simple	10–15
E3-3	Corrected trial balance.	Simple	15–20
E3-4	Corrected trial balance.	Simple	10–15
E3-5	Adjusting entries.	Moderate	10–15
E3-6	Adjusting entries.	Moderate	10–15
E3-7	Analyze adjusted data.	Complex	15–20
E3-8	Adjusting entries.	Moderate	10–15
E3-9	Adjusting entries.	Moderate	15–20
E3-10	Adjusting entries.	Complex	25–30
E3-11	Prepare financial statements.	Moderate	20–25
E3-12	Prepare financial statements.	Moderate	20–25
E3-13	Closing entries.	Simple	10–15
E3-14	Closing entries.	Moderate	10–15
E3-15	Missing amounts.	Simple	10–15
E3-16	Closing entries for a corporation.	Moderate	10–15
E3-17	Transactions of a corporation, including investment and dividend.	Moderate	10–15
*E3-18	Cash to accrual basis.	Moderate	15–20
*E3-19	Cash and accrual basis.	Moderate	10–15
*E3-20	Adjusting and reversing entries.	Complex	20–25
*E3-21	Worksheet.	Simple	10–15
*E3-22	Worksheet and balance sheet presentation.	Moderate	20–25
*E3-23	Partial worksheet preparation.	Moderate	10–15
P3-1	Transactions, financial statements—service company.	Moderate	25–35
P3-2	Adjusting entries and financial statements.	Moderate	35–40
P3-3	Adjusting entries.	Moderate	25–30
P3-4	Financial statements, adjusting and closing entries.	Moderate	40–50
P3-5	Adjusting entries.	Moderate	15–20
P3-6	Adjusting entries and financial statements.	Moderate	25–35
P3-7	Adjusting entries and financial statements.	Moderate	25–35
P3-8	Adjusting entries and financial statements.	Moderate	25–35
P3-9	Adjusting and closing.	Moderate	30–40
P3-10	Adjusting and closing.	Moderate	30–35
*P3-11	Cash and accrual basis.	Moderate	35–40
*P3-12	Worksheet, balance sheet, adjusting and closing entries.	Complex	40–50

# ANSWERS TO QUESTIONS

1. Examples are:
  - (a) Payment of an accounts payable.
  - (b) Collection of an accounts receivable from a customer.
  - (c) Transfer of an accounts payable to a note payable.
2. Transactions (a), (b), (d) are considered business transactions and are recorded in the accounting records because a change in assets, liabilities, or owners'/stockholders' equity has been effected as a result of a transfer of values from one party to another. Transactions (c) and (e) are not business transactions because a transfer of values has not resulted, nor can the event be considered financial in nature and capable of being expressed in terms of money.
3. Transaction (a): Accounts Receivable (debit), Service Revenue (credit).  
Transaction (b): Cash (debit), Accounts Receivable (credit).  
Transaction (c): Supplies (debit), Accounts Payable (credit).  
Transaction (d): Delivery Expense (debit), Cash (credit).
4. Revenue and expense accounts are referred to as temporary or nominal accounts because each period they are closed out to Income Summary in the closing process. Their balances are reduced to zero at the end of the accounting period; therefore, the term temporary or nominal is given to these accounts.
5. Andrea is not correct. The double-entry system means that for every debit amount there must be a credit amount and vice-versa. At least two accounts are affected and debits must equal credits. It does not mean that each transaction must be recorded twice.
6. Although it is not absolutely necessary that a trial balance be taken periodically, it is customary and desirable. The trial balance accomplishes two principal purposes:
  - (1) It tests the accuracy of the entries in that it proves that debits and credits of an equal amount are in the ledger.
  - (2) It provides a list of ledger accounts and their balances which may be used in preparing the financial statements and in supplying financial data about the concern.
7.
  - (a) Real account; balance sheet.
  - (b) Real account; balance sheet.
  - (c) Inventory is generally considered a real account appearing on the balance sheet. (Note: Inventory has the elements of a nominal account when the periodic inventory system is used. It may appear on the income statement when the multiple-step format is used under a periodic inventory system.)
  - (d) Real account; balance sheet.
  - (e) Real account; balance sheet.
  - (f) Nominal account; income statement.
  - (g) Nominal account; income statement.
  - (h) Real account; balance sheet.
8. At December 31, the three days' wages due to the employees represent a current liability. The related expense must be recorded in this period to properly reflect the expense incurred.
9.
  - (a) In a service company, revenues are service revenues and expenses are operating expenses. In a merchandising company, revenues are sales revenues and expenses consist of cost of goods sold plus operating expenses.
  - (b) The measurement process in a merchandising company consists of comparing the sales price of the merchandise inventory to the cost of goods sold and operating expenses.

**Questions Chapter 3 (Continued)**

10. (a) No change.  
 (b) Before closing, balances exist in these accounts; after closing, no balances exist.  
 (c) Before closing, balances exist in these accounts; after closing, no balances exist.  
 (d) Before closing, a balance exists in this account exclusive of any dividends or the net income or net loss for the period; after closing, the balance is increased or decreased by the amount of net income or net loss, and decreased by dividends declared.  
 (e) No change.
11. Adjusting entries are prepared prior to the preparation of financial statements in order to bring the accounts up to date and are necessary (1) to achieve a proper recognition of revenues and expenses in measuring income and (2) to achieve an accurate presentation of assets, liabilities and stockholders' equity.
12. Closing entries are prepared to transfer the balances of nominal accounts to capital (retained earnings) after the adjusting entries have been recorded and the financial statements prepared. Closing entries are necessary to reduce the balances in nominal accounts to zero in order to prepare the accounts for the next period's transactions.
13.  $\text{Cost} - \text{Salvage Value} = \text{Depreciable Cost}$ :  $\$4,000 - \$0 = \$4,000$ .  $\text{Depreciable Cost} \div \text{Useful Life} = \text{Depreciation Expense For One Year}$   $\$4,000 \div 5 \text{ years} = \$800$  per year. The asset was used for 6 months (7/1 – 12/31), therefore 1/2-year of depreciation expense should be reported. Annual depreciation  $\times 6/12 =$  amount to be reported on 2014 income statement:  $\$800 \times 6/12 = \underline{\$400}$ .

14.

December 31	
Interest Receivable .....	10,000
Interest Revenue .....	10,000
(To record accrued interest revenue on loan)	

Accrued expenses result from the same causes as accrued revenues. In fact, an accrued expense on the books of one company is an accrued revenue to another company.

- \*15. Under the cash basis of accounting, revenue is recorded only when cash is received and expenses are recorded only when paid. Under the accrual basis of accounting, revenue is recognized when a performance obligation is met expenses are recognized when incurred, without regard to the time of the receipt or payment of cash.

A cash-basis balance sheet and income statement are incomplete and inaccurate in comparison to accrual-basis financial statements. The accrual basis matches effort (expenses) with accomplishment (revenues) in the income statement while the cash basis only presents cash receipts and cash disbursements. The accrual basis balance sheet contains receivables, payables, accruals, prepayments, and deferrals while a cash-basis balance sheet shows none of these.

- \*16. Salaries and wages paid during the year will include the payment of any wages attributable to the prior year but unpaid at the end of the prior year. This amount is an expense of the prior year and not of the current year, and thus should be subtracted in determining salaries and wages expense. Similarly, salaries and wages paid during the year will not include any salaries and wages attributable to hours worked during the current year but not actually paid until the following year. This should be added in determining salaries and wages expense.
- \*17. Although similar to the strict cash basis, the modified cash basis of accounting requires that expenditures for capital items be charged against income over all the periods to be benefited. This is done through conventional accounting methods, such as depreciation and amortization. Under the strict cash basis, expenditures would be recognized as expenses in the period in which the corresponding cash disbursements are made.

### Questions Chapter 3 (Continued)

- \*18. Reversing entries are made at the beginning of the period to reverse accruals and some deferrals. Reversing entries are not required. They are made to simplify the recording of certain transactions that will occur later in the period. The same results will be attained whether or not reversing entries are recorded.
- \*19. Disagree. A worksheet is not a permanent accounting record and its use is not required in the accounting cycle. The worksheet is an informal device for accumulating and sorting information needed for the financial statements. Its use is optional in helping to prepare financial statements.

# SOLUTIONS TO BRIEF EXERCISES

## BRIEF EXERCISE 3-1

May	1	Cash .....	4,000	
		Common Stock.....		4,000
	3	Equipment.....	1,100	
		Accounts Payable .....		1,100
	13	Rent Expense.....	400	
		Cash .....		400
	21	Accounts Receivable .....	500	
		Service Revenue .....		500

## BRIEF EXERCISE 3-2

Aug.	2	Cash.....	12,000	
		Equipment.....	2,500	
		Owner's Capital .....		14,500
	7	Supplies.....	500	
		Accounts Payable.....		500
	12	Cash.....	1,300	
		Accounts Receivable.....	670	
		Service Revenue.....		1,970
	15	Rent Expense .....	600	
		Cash .....		600
	19	Supplies Expense .....	230	
		Supplies (\$500 – \$270) .....		230

**BRIEF EXERCISE 3-3**

July	1	Prepaid Insurance.....	15,000	
		Cash.....		15,000
Dec.	31	Insurance Expense .....	2,500	
		Prepaid Insurance		
		(\$15,000 X 1/2 X 1/3).....		2,500

**BRIEF EXERCISE 3-4**

July	1	Cash.....	15,000	
		Unearned Service Revenue.....		15,000
Dec.	31	Unearned Service Revenue.....	2,500	
		Service Revenue		
		(\$15,000 X 1/2 X 1/3).....		2,500

**BRIEF EXERCISE 3-5**

Feb.	1	Prepaid Insurance.....	720,000	
		Cash.....		720,000
June	30	Insurance Expense .....	150,000	
		Prepaid Insurance		
		(\$720,000 X 5/24).....		150,000

**BRIEF EXERCISE 3-6**

Nov.	1	Cash.....	2,400	
		Unearned Rent Revenue .....		2,400
Dec.	31	Unearned Rent Revenue.....	1,600	
		Rent Revenue		
		(\$2,400 X 2/3).....		1,600



### BRIEF EXERCISE 3-7

Dec.	31	Salaries and Wages Expense.....	4,800	
		Salaries and Wages Payable		
		(\$8,000 X 3/5).....		4,800
Jan.	2	Salaries and Wages Payable.....	4,800	
		Salaries and Wages Expense.....	3,200	
		Cash .....		8,000

### BRIEF EXERCISE 3-8

Dec.	31	Interest Receivable .....	300	
		Interest Revenue .....		300
Feb.	1	Cash.....	12,400	
		Notes Receivable.....		12,000
		Interest Receivable.....		300
		Interest Revenue .....		100

### BRIEF EXERCISE 3-9

Aug.	31	Interest Expense.....	300	
		Interest Payable.....		300
	31	Accounts Receivable.....	1,400	
		Service Revenue.....		1,400
	31	Salaries and Wages Expense.....	700	
		Salaries and Wages Payable .....		700
	31	Bad Debt Expense .....	900	
		Allowance for Doubtful Accounts .....		900

**BRIEF EXERCISE 3-10**

Depreciation Expense .....	2,000	
Accumulated Depreciation—Equipment .....		2,000
Equipment.....	\$30,000	
Less: Accumulated Depreciation—Equipment .....	<u>2,000</u>	\$28,000

**BRIEF EXERCISE 3-11**

Sales Revenue .....	808,900	
Interest Revenue .....	13,500	
Income Summary .....		822,400
Income Summary .....	780,300	
Cost of Goods Sold.....		556,200
Administrative Expenses.....		189,000
Income Tax Expense.....		35,100
Income Summary .....	42,100	
Retained Earnings.....		42,100
Retained Earnings .....	18,900	
Dividends.....		18,900

**\*BRIEF EXERCISE 3-12**

(a) Cash receipts.....	\$142,000
+ Increase in accounts receivable	
(\$18,600 – \$13,000).....	<u>5,600</u>
Service revenue.....	<u>\$147,600</u>
(b) Payments for operating expenses .....	\$ 97,000
– Increase in prepaid expenses	
(\$23,200 – \$17,500).....	<u>(5,700)</u>
Operating expenses .....	<u>\$ 91,300</u>

**\*BRIEF EXERCISE 3-13**

<b>(a)</b>	<b>Salaries and Wages Payable .....</b>	<b>4,200</b>	
	<b>Salaries and Wages Expense.....</b>		<b>4,200</b>
<b>(b)</b>	<b>Salaries and Wages Expense .....</b>	<b>7,000</b>	
	<b>Cash.....</b>		<b>7,000</b>
<b>(c)</b>	<b>Salaries and Wages Payable .....</b>	<b>4,200</b>	
	<b>Salaries and Wages Expense .....</b>	<b>2,800</b>	
	<b>Cash.....</b>		<b>7,000</b>

# SOLUTIONS TO EXERCISES

## EXERCISE 3-1 (15–20 minutes)

Apr.	2	Cash.....	32,000	
		Equipment .....	14,000	
		Owner's Capital .....		46,000
	2	No entry—not a transaction.		
	3	Supplies.....	700	
		Accounts Payable.....		700
	7	Rent Expense .....	600	
		Cash.....		600
	11	Accounts Receivable.....	1,100	
		Service Revenue.....		1,100
	12	Cash.....	3,200	
		Unearned Service Revenue.....		3,200
	17	Cash.....	2,300	
		Service Revenue.....		2,300
	21	Insurance Expense .....	110	
		Cash.....		110
	30	Salaries and Wages Expense.....	1,160	
		Cash.....		1,160
	30	Supplies Expense .....	120	
		Supplies .....		120
	30	Equipment .....	6,100	
		Owner's Capital .....		6,100

**EXERCISE 3-2 (10–15 minutes)**

**Wanda Landowska Company  
Trial Balance  
April 30, 2014**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 4,800	
Accounts Receivable .....	2,750	
Prepaid Insurance (\$700 + \$100) .....	800	
Equipment.....	8,000	
Accounts Payable (\$4,500 – \$100) .....		\$ 4,400
Property Taxes Payable .....		560
Owner’s Capital (\$11,200 + \$1,500) .....		12,700
Owner’s Drawing.....	1,500	
Service Revenue.....		6,690
Salaries and Wages Expense .....	4,200	
Advertising Expense (\$1,100 + \$300).....	1,400	
Property Tax Expense (\$800 + \$100).....	900	
	<u>\$24,350</u>	<u>\$24,350</u>

**EXERCISE 3-3 (15–20 minutes)**

The ledger accounts are reproduced below, and corrections are shown in the accounts.

Cash			
Bal.	5,912	(4)	190
(1)	450		

Accounts Payable			
		Bal.	7,044

Accounts Receivable			
Bal.	5,240	(1)	450

Common Stock			
		Bal.	8,000

Supplies			
Bal.	2,967		

Retained Earnings			
		Bal.	2,000

**EXERCISE 3-3 (Continued)**

<b>Equipment</b>	
Bal.	6,100
(2)	3,200

<b>Service Revenue</b>	
Bal.	5,200
(3)	2,025
(5)	80

<b>Office Expense</b>	
Bal.	4,320
(2)	3,200

**Blues Traveler Corporation  
Trial Balance (corrected)  
April 30, 2014**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 6,172	
Accounts Receivable .....	4,790	
Supplies .....	2,967	
Equipment.....	9,300	
Accounts Payable.....		\$ 7,044
Common Stock .....		8,000
Retained Earnings .....		2,000
Service Revenue.....		7,305
Office Expense .....	<u>1,120</u>	
	<u>\$24,349</u>	<u>\$24,349</u>

**EXERCISE 3-4 (10–15 minutes)**

**Watteau Co.  
Trial Balance  
June 30, 2014**

	<u>Debit</u>	<u>Credit</u>
Cash (\$2,870 + \$180 – \$65 – \$65) .....	\$ 2,920	
Accounts Receivable (\$3,231 – \$180) .....	3,051	
Supplies (\$800 – \$500) .....	300	
Equipment (\$3,800 + \$500) .....	4,300	
Accounts Payable (\$2,666 – \$206 – \$260).....		\$ 2,200
Unearned Service Revenue (\$1,200 – \$325) .....		875
Common Stock.....		6,000
Dividends .....	575	
Retained Earnings.....		3,000
Service Revenue (\$2,380 + \$801 + \$325).....		3,506
Salaries and Wages Expense (\$3,400 + \$670 – \$575) .....	3,495	
Office Expense .....	940	
	<u>\$15,581</u>	<u>\$15,581</u>

**EXERCISE 3-5 (10–15 minutes)**

1. Depreciation Expense (\$250 X 3) .....	750	
Accumulated Depreciation—Equipment .....		750
2. Unearned Rent Revenue (\$9,300 X 1/3).....	3,100	
Rent Revenue .....		3,100
3. Interest Expense.....	500	
Interest Payable .....		500
4. Supplies Expense.....	1,950	
Supplies (\$2,800 – \$850).....		1,950
5. Insurance Expense (\$300 X 3) .....	900	
Prepaid Insurance .....		900

**EXERCISE 3-6 (10–15 minutes)**

1.	Accounts Receivable .....	750	
	Service Revenue .....		750
2.	Utilities Expenses.....	520	
	Accounts Payable .....		520
3.	Depreciation Expense .....	400	
	Accumulated Depreciation – Equipment.....		400
	Interest Expense.....	500	
	Interest Payable.....		500
4.	Insurance Expense (\$12,000 X 1/12) .....	1,000	
	Prepaid Insurance .....		1,000
5.	Supplies Expense (\$1,600 – \$500).....	1,100	
	Supplies.....		1,100

**EXERCISE 3-7 (15–20 minutes)**

(a)	Ending balance of supplies	\$700	
	Add: Adjusting entry	950	
	Deduct: Purchases	<u>850</u>	
	Beginning balance of supplies	<u>\$800</u>	
(b)	Total prepaid insurance	\$4,800	(\$400 X 12)
	Amount used (6 X \$400)	<u>2,400</u>	
	Present balance	<u>\$2,400</u>	

The policy was purchased six months ago (August 1, 2013)

(c) The entry in January to record salary and wages expense was

Salaries and Wages Expense .....	1,800	
Salaries and Wages Payable .....	700	
Cash .....		2,500



**EXERCISE 3-7 (Continued)**

The “T” account for salaries payable is

<b>Salaries and Wages Payable</b>			
<b>Paid</b>	<b>700</b>	<b>Beg. Bal.</b>	<b>?</b>
<b>January</b>			
		<b>End Bal.</b>	<b>800</b>

The beginning balance is therefore

Ending balance of salaries and wages payable	<b>\$ 800</b>
Plus: Reduction of salaries and wages payable	<u>700</u>
Beginning balance of salaries and wages payable	<u><b>\$1,500</b></u>

(d) Service revenue	<b>\$2,000</b>
Cash received	<u>1,600</u>
Unearned revenue reduced	<u><b>\$ 400</b></u>

Ending unearned revenue January 31, 2014	<b>\$ 750</b>
Plus: Unearned revenue reduced	<u>400</u>
Beginning unearned revenue December 31, 2013	<u><b>\$1,150</b></u>

**EXERCISE 3-8 (10–15 minutes)**

1. Salaries and Wages Expense .....	<b>1,900</b>	
Salaries and Wages Payable .....		<b>1,900</b>
2. Utilities Expense.....	<b>600</b>	
Accounts Payable .....		<b>600</b>
3. Interest Expense (\$30,000 X 8% X 1/12).....	<b>200</b>	
Interest Payable .....		<b>200</b>
4. Telephone and Internet Expense .....	<b>117</b>	
Accounts Payable .....		<b>117</b>

**EXERCISE 3-9 (15–20 minutes)**

(a)	10/15	Salaries and Wages Expense.....	800	
		Cash .....		800
		(To record payment of October 15 payroll)		
	10/17	Accounts Receivable.....	2,400	
		Service Revenue.....		2,400
		(To record revenue for services performed for which payment has not yet been received)		
	10/20	Cash.....	650	
		Unearned Service Revenue .....		650
		(To record receipt of cash for services not yet performed)		
(b)	10/31	Supplies Expense .....	470	
		Supplies .....		470
		(To record the use of supplies during October)		
	10/31	Accounts Receivable.....	1,650	
		Service Revenue.....		1,650
		(To record revenue for services performed for which payment has not yet been received)		
	10/31	Salaries and Wages Expense.....	600	
		Salaries and Wages Payable .....		600
		(To record liability for accrued payroll)		
	10/31	Unearned Service Revenue.....	400	
		Service Revenue.....		400
		(To reduce the Unearned Service Revenue account for service that has been performed)		

**EXERCISE 3-10 (25–30 minutes)**

(a) 1.	Aug. 31	Insurance Expense ( $\$4,500 \times 3/12$ ) .....	1,125	
		Prepaid Insurance .....		1,125
2.	Aug. 31	Supplies Expense ( $\$2,600 - \$450$ ) .....	2,150	
		Supplies .....		2,150
3.	Aug. 31	Depreciation Expense .....	1,080	
		Accumulated Depreciation— Buildings .....		1,080
		( $\$120,000 - \$12,000 = \$108,000$ ; $\$108,000 \times 4\% = \$4,320$ per year; $\$4,320 \times 1/4 = \$1,080$ )		
Aug. 31	Aug. 31	Depreciation Expense .....	360	
		Accumulated Depreciation— Equipment .....		360
		( $\$16,000 - \$1,600 = \$14,400$ ; $\$14,400 \times 10\% = \$1,440$ ; $\$1,440 \times 1/4 = \$360$ )		
4.	Aug. 31	Unearned Rent Revenue .....	3,800	
		Rent Revenue .....		3,800
5.	Aug. 31	Salaries and Wages Expense .....	375	
		Salaries and Wages Payable .....		375
6.	Aug. 31	Accounts Receivable .....	800	
		Rent Revenue .....		800
7.	Aug. 31	Interest Expense .....	1,200	
		Interest Payable .....		1,200
		$[(\$60,000 \times 8\%) \times 1/4]$		

**EXERCISE 3-10 (Continued)**

(b)

**Greco Resort  
Adjusted Trial Balance  
August 31, 2014**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 19,600	
Accounts Receivable .....	800	
Prepaid Insurance (\$4,500 – \$1,125) .....	3,375	
Supplies (\$2,600 – \$2,150) .....	450	
Land.....	20,000	
Buildings.....	120,000	
Accumulated Depreciation—Buildings.....		\$ 1,080
Equipment.....	16,000	
Accumulated Depreciation—Equipment.....		360
Accounts Payable.....		4,500
Unearned Rent Revenue (\$4,600 – \$3,800) .....		800
Salaries and Wages Payable .....		375
Interest Payable.....		1,200
Mortgage Payable.....		60,000
Common Stock .....		91,000
Retained Earnings .....		9,000
Dividends .....	5,000	
Rent Revenue (\$76,200 + \$3,800 + \$800).....		80,800
Salaries and Wages Expense (\$44,800 + \$375) .....	45,175	
Utilities Expenses.....	9,200	
Maintenance and Repair Expense.....	3,600	
Insurance Expense.....	1,125	
Supplies Expense.....	2,150	
Depreciation Expense—Buildings .....	1,080	
Depreciation Expense—Equipment .....	360	
Interest Expense.....	1,200	
	<u>\$249,115</u>	<u>\$249,115</u>

**EXERCISE 3-11 (20–25 minutes)**

(a) **ANDERSON COOPER CO.**  
**Income Statement**  
**For the Year Ended December 31, 2014**

<b>Revenues</b>		
Service revenue .....		<b>\$11,590</b>
<b>Expenses</b>		
Salaries and wages expense.....	<b>\$6,840</b>	
Rent expense .....	<b>2,260</b>	
Depreciation expense.....	<b>145</b>	
Interest expense .....	<b>83</b>	
		<b><u>9,328</u></b>
<b>Net Income.....</b>		<b><u>\$ 2,262</u></b>

(b) **ANDERSON COOPER CO.**  
**Statement of Retained Earnings**  
**For the Year Ended December 31, 2014**

Retained earnings, January 1 .....	<b>\$11,310</b>
Add: Net income.....	<b><u>2,262</u></b>
	<b>13,572</b>
Less: Dividends.....	<b><u>3,000</u></b>
Retained earnings, December 31 .....	<b><u>\$10,572</u></b>

(c) **ANDERSON COOPER CO.**  
**Balance Sheet**  
**December 31, 2014**

<b><u>Assets</u></b>		
<b>Current Assets</b>		
Cash .....		<b>\$19,472</b>
Accounts receivable .....		<b>6,920</b>
Prepaid rent .....		<b><u>2,280</u></b>
<b>Total current assets.....</b>		<b><u>28,672</u></b>
<b>Property, plant, and equipment</b>		
Equipment.....	<b>\$18,050</b>	
Accumulated depreciation – equipment .....		<b><u>(4,895)</u></b>
		<b><u>13,155</u></b>
<b>Total assets .....</b>		<b><u>\$41,827</u></b>

## EXERCISE 3-11 (Continued)

### Liabilities and Stockholders' Equity

<b>Current liabilities</b>		
Accounts payable .....		\$ 5,472
Interest payable .....		83
Notes payable .....		<u>5,700</u>
Total current liabilities.....		11,255
<b>Stockholders' equity</b>		
Common stock.....	\$20,000	
Retained earnings .....	<u>10,572*</u>	<u>30,572</u>
<b>Total liabilities and stockholders' equity .....</b>		<b><u>\$41,827</u></b>

\*Beg. Balance + Net Income – Dividends = Ending Balance  
 \$11,310 + \$2,262 – \$3,000 = \$10,572

## EXERCISE 3-12 (20–25 Minutes)

(a) **SANTO DESIGN AGENCY**  
**Income Statement**  
 For the Year Ended December 31, 2014

---

<b>Revenues</b>		
Service revenue .....		\$61,500
<b>Expenses</b>		
Salaries and wages expense.....	\$11,300	
Depreciation expense .....	7,000	
Rent expense.....	4,000	
Supplies expense.....	3,400	
Insurance expense.....	850	
Interest expense.....	<u>500</u>	
Total expenses .....		<u>27,050</u>
<b>Net income .....</b>		<b><u>\$34,450</u></b>

**SANTO DESIGN AGENCY**  
**Statement of Retained Earnings**  
 For the Year Ended December 31, 2014

---

Retained earnings, January 1 .....	\$ 3,500
Add: Net income .....	<u>34,450</u>
<b>Retained earnings, December 31 .....</b>	<b><u>\$37,950</u></b>

**EXERCISE 3-12 (Continued)**

**(a) Continued**

**SANTO DESIGN AGENCY  
Balance Sheet  
December 31, 2014**

**Assets**

Cash .....		\$11,000
Accounts receivable .....		21,500
Supplies .....		5,000
Prepaid insurance .....		2,500
Equipment.....	\$60,000	
Less: Accumulated depreciation – equipment .....	<u>35,000</u>	<u>25,000</u>
<b>Total assets.....</b>		<b><u>\$65,000</u></b>

**Liabilities and Stockholders' Equity**

**Liabilities**

Notes payable .....	\$ 5,000	
Accounts payable.....	5,000	
Interest payable .....	150	
Unearned service revenue .....	5,600	
Salaries and wages payable .....	<u>1,300</u>	
<b>Total liabilities.....</b>		<b>\$17,050</b>

**Stockholders' equity**

Common stock .....	\$10,000	
Retained earnings .....	<u>37,950</u>	<u>47,950</u>
<b>Total liabilities and stockholders' equity .....</b>		<b><u>\$65,000</u></b>

**(b) (1) Based on interest payable at December 31, 2014, interest is \$25 per month or 0.5% of the note payable.  $0.5\% \times 12 = 6\%$  interest per year.**

**(2) Salaries and Wages Expense, \$11,300 less Salaries and Wages Payable 12/31/14, \$1,300 = \$10,000. Total payments, \$17,500 – \$10,000 = \$7,500 Salaries and Wages Payable 12/31/13.**

**EXERCISE 3-13 (10–15 minutes)**

(a)	Sales revenue .....		\$800,000
	Less: Sales returns and allowances .....	\$24,000	
	Sales discounts .....	<u>15,000</u>	<u>39,000</u>
	Net sales .....		<u>\$761,000</u>
(b)	Sales .....	800,000	
	Income Summary .....		800,000
	Income Summary .....	39,000	
	Sales Returns and Allowances .....		24,000
	Sales Discounts .....		15,000

**EXERCISE 3-14 (10–15 minutes)**

	Sales Revenue .....	350,000	
	Sales Returns and Allowances .....		13,000
	Sales Discounts .....		8,000
	Income Summary .....		329,000
	Income Summary .....	308,000	
	Cost of Goods Sold .....		208,000
	Delivery Expense .....		7,000
	Insurance Expense .....		12,000
	Rent Expense .....		20,000
	Salaries and Wages Expense .....		61,000
	Income Summary .....	21,000	
	Retained Earnings .....		21,000

**EXERCISE 3-15 (10–15 minutes)**

- |              |               |
|--------------|---------------|
| (a) \$9,000  | (d) \$100,000 |
| (b) \$25,000 | (e) \$57,000  |
| (c) \$10,000 |               |



**EXERCISE 3-16 (10–15 minutes)**

<b>Sales Revenue</b> .....	<b>410,000</b>	
<b>Cost of Goods Sold</b> .....		<b>225,700</b>
<b>Sales Returns and Allowances</b> .....		<b>12,000</b>
<b>Sales Discounts</b> .....		<b>15,000</b>
<b>Selling Expenses</b> .....		<b>16,000</b>
<b>Administrative Expenses</b> .....		<b>38,000</b>
<b>Income Tax Expense</b> .....		<b>30,000</b>
<b>Income Summary</b> .....		<b>73,300</b>

(or)

<b>Sales Revenue</b> .....	<b>410,000</b>	
<b>Income Summary</b> .....		<b>410,000</b>

<b>Income Summary</b> .....	<b>336,700</b>	
<b>Cost of Goods Sold</b> .....		<b>225,700</b>
<b>Sales Returns and Allowances</b> .....		<b>12,000</b>
<b>Sales Discounts</b> .....		<b>15,000</b>
<b>Selling Expenses</b> .....		<b>16,000</b>
<b>Administrative Expenses</b> .....		<b>38,000</b>
<b>Income Tax Expense</b> .....		<b>30,000</b>

<b>Income Summary</b> .....	<b>73,300</b>	
<b>Retained Earnings</b> .....		<b>73,300</b>

<b>Retained Earnings</b> .....	<b>18,000</b>	
<b>Dividends</b> .....		<b>18,000</b>

**EXERCISE 3-17 (10–15 minutes)**
**J1**

<b>Date</b>	<b>Account Titles and Explanation</b>	<b>Ref.</b>	<b>Debit</b>	<b>Credit</b>
<b>Mar. 1</b>	<b>Cash</b> <b>    Common Stock</b> <b>        (Investment of cash in business)</b>		<b>50,000</b>	<b>50,000</b>
<b>3</b>	<b>Land</b> <b>Buildings</b> <b>Equipment</b> <b>    Cash</b> <b>        (Purchased Michelle Wie’s Golf Land)</b>		<b>10,000</b> <b>22,000</b> <b>6,000</b>	<b>38,000</b>
<b>5</b>	<b>Advertising Expense</b> <b>    Cash</b> <b>        (Paid for advertising)</b>		<b>1,600</b>	<b>1,600</b>
<b>6</b>	<b>Prepaid Insurance</b> <b>    Cash</b> <b>        (Paid for one-year insurance policy)</b>		<b>1,480</b>	<b>1,480</b>
<b>10</b>	<b>Equipment</b> <b>    Accounts Payable</b> <b>        (Purchased equipment on account)</b>		<b>2,500</b>	<b>2,500</b>
<b>18</b>	<b>Cash</b> <b>    Service Revenue</b> <b>        (Received cash for services performed)</b>		<b>1,200</b>	<b>1,200</b>
<b>25</b>	<b>Dividends</b> <b>    Cash</b> <b>        (Declared and paid a \$500 cash dividend)</b>		<b>500</b>	<b>500</b>
<b>30</b>	<b>Salaries and Wages Expense</b> <b>    Cash</b> <b>        (Paid wages expense)</b>		<b>900</b>	<b>900</b>
<b>30</b>	<b>Accounts Payable</b> <b>    Cash</b> <b>        (Paid creditor on account)</b>		<b>2,500</b>	<b>2,500</b>
<b>31</b>	<b>Cash</b> <b>    Service Revenue</b> <b>        (Received cash for services performed)</b>		<b>750</b>	<b>750</b>

**\*EXERCISE 3-18 (15–20 minutes)**

**Jill Accardo, M.D.  
Conversion of Cash Basis to Accrual Basis  
For the Year 2014**

Excess of cash collected over cash disbursed (\$142,600 – \$55,470)	\$87,130
Add increase in accounts receivable (\$9,250 – \$15,927)	6,677
Deduct increase in unearned service revenue (\$2,840 – \$4,111)	(1,271)
Add decrease in accrued liabilities (\$3,435 – \$2,108)	1,327
Add increase in prepaid expenses (\$1,917 – \$3,232)	<u>1,315</u>
Net income on an accrual basis	<u><u>\$95,178</u></u>

**Alternate solution:**

**Jill Accardo, M.D.  
Conversion of Income Statement Data  
from Cash Basis to Accrual Basis  
For the Year 2014**

	<u>Cash</u> <u>Basis</u>	<u>Adjustments</u>		<u>Accrual</u> <u>Basis</u>
		<u>Add</u>	<u>Deduct</u>	
Collections from customers:	\$142,600			
–Accounts receivable, Jan. 1			\$9,250	
+Accounts receivable, Dec. 31		\$15,927		
+Unearned service revenue, Jan. 1		2,840		
–Unearned service revenue, Dec. 31			4,111	
Service revenue				\$148,006
Disbursements for expenses:	55,470			
–Accrued liabilities, Jan. 1			3,435	
+Accrued liabilities, Dec. 31		2,108		
+Prepaid expenses, Jan. 1		1,917		
–Prepaid expenses, Dec. 31			3,232	
Operating expenses				<u>52,828</u>
Net income—cash basis	<u>\$ 87,130</u>			<u>\$ 95,178</u>
Net income—accrual basis				

**\*EXERCISE 3-19 (10–15 minutes)**

**(a) Wayne Rogers Corp.  
Income Statement (Cash Basis)  
For the Year Ended December 31,**

	<u>2013</u>	<u>2014</u>
Sales revenue	\$295,000	\$515,000
Expenses	<u>225,000</u>	<u>272,000</u>
Net income	<u>\$ 70,000</u>	<u>\$243,000</u>

**(b) Wayne Rogers Corp.  
Income Statement (Accrual Basis)  
For the Year Ended December 31,**

	<u>2013</u>	<u>2014</u>
Sales* revenue	\$485,000	\$445,000
Expenses**	<u>277,000</u>	<u>255,000</u>
Net income	<u>\$208,000</u>	<u>\$190,000</u>

\*2013: \$295,000 + \$160,000 + \$30,000 = \$485,000

2014: \$355,000 + \$90,000 = \$445,000

\*\*2013: \$185,000 + \$67,000 + \$25,000 = \$277,000

2014: \$40,000 + \$160,000 + \$55,000 = \$255,000

**\*EXERCISE 3-20 (20–25 minutes)**

**(a) Adjusting Entries:**

1.	Insurance Expense (\$5,280 X 5/24) .....	1,100	
	Prepaid Insurance .....		1,100
2.	Rent Revenue (\$1,800 X 1/3) .....	600	
	Unearned Rent Revenue .....		600
3.	Supplies .....	290	
	Advertising Expense .....		290
4.	Interest Expense .....	770	
	Interest Payable .....		770

**\*EXERCISE 3-20 (Continued)**

**(b) Reversing Entries:**

1.	No reversing entry required.		
2.	Unearned Rent Revenue.....	600	
	Rental Revenue.....		600
3.	Advertising Expense.....	290	
	Supplies.....		290
4.	Interest Payable.....	770	
	Interest Expense.....		770

**\*EXERCISE 3-21 (10–15 minutes)**

<u>Accounts</u>	<u>Adjusted Trial Balance</u>		<u>Income Statement</u>		<u>Balance Sheet</u>	
	<u>Dr.</u>	<u>Cr.</u>	<u>Dr.</u>	<u>Cr.</u>	<u>Dr.</u>	<u>Cr.</u>
Cash	9,000				9,000	
Inventory	80,000				80,000	
Sales Revenue		450,000		450,000		
Sales Returns and Allowances	10,000		10,000			
Sales Discounts	5,000		5,000			
Cost of Goods Sold	250,000		250,000			

**\*EXERCISE 3-22 (20–25 minutes)**

**Ed Bradley Co.  
Worksheet (partial)  
For the Month Ended April 30, 2014**

Account Titles	Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	18,972				18,972	
Accounts Receivable	6,920				6,920	
Prepaid Rent	2,280				2,280	
Equipment	18,050				18,050	
Accum. Depreciation – Equipment		4,895				4,895
Notes Payable		5,700				5,700
Accounts Payable		4,472				4,472
Common Stock		34,960				34,960
Retained Earnings		1,000				1,000
Dividends	6,650				6,650	
Service Revenue		12,590		12,590		
Salaries and Wages Expense	6,840		6,840			
Rent Expense	3,760		3,760			
Depreciation Expense	145		145			
Interest Expense	83		83			
Interest Payable		83				83
<b>Totals</b>	<b><u>63,700</u></b>	<b><u>63,700</u></b>	<b><u>10,828</u></b>	<b><u>12,590</u></b>	<b><u>52,872</u></b>	<b><u>50,110</u></b>
Net income			<u>1,762</u>			<u>1,762</u>
<b>Totals</b>			<b><u>12,590</u></b>	<b><u>12,590</u></b>	<b><u>52,872</u></b>	<b><u>52,872</u></b>

**EXERCISE 3-22 (Continued)**

**Ed Bradley Co.  
Balance Sheet  
April 30, 2014**

<u>Assets</u>			
Current Assets			
Cash.....			\$18,972
Accounts receivable .....			6,920
Prepaid rent.....			<u>2,280</u>
Total current assets.....			28,172
Property, plant, and equipment			
Equipment .....	\$18,050		
Accumulated depreciation – equipment .....		<u>(4,895)</u>	<u>13,155</u>
Total assets .....			<u>\$41,327</u>
<u>Liabilities and Stockholders' Equity</u>			
Current liabilities			
Notes payable .....			\$ 5,700
Accounts payable .....			4,472
Interest payable .....			<u>83</u>
Total current liabilities .....			10,255
Stockholders' equity			
Common Stock .....	34,960		
Retained earnings.....		<u>(3,888)</u>	<u>31,072*</u>
Total liabilities and Stockholders' equity.....			<u>\$41,327</u>

**\*Beg. Balance – Dividends + Net Income = Ending Balance**  
**\$1,000 – \$6,650 + \$1,762 = (\$3,888)**

**\*EXERCISE 3-23 (10–15 minutes)**

**Jurassic Park Co.  
Worksheet (partial)  
For Month Ended February 28, 2014**

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet		
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	
Supplies	1,756			(a) 1,041	715					715	
Accumulated depreciation – equipment		6,939		(b) 257		7,196					7,196
Interest payable		150		(c) 50		200					200
Supplies expense			(a) 1,041		1,041		1,041				
Depreciation expense			(b) 257		257		257				
Interest expense			(c) 50		50		50				

The following accounts and amounts would be shown in the February income statement:

Supplies expense	\$1,041
Depreciation expense	257
Interest expense	50



# TIME AND PURPOSE OF PROBLEMS

**Problem 3-1** (Time 25–35 minutes)

Purpose—to provide an opportunity for the student to post daily transactions to a “T” account ledger, take a trial balance, prepare an income statement, a balance sheet and a statement of owners’ equity, close the ledger, and take a post-closing trial balance. The problem deals with routine transactions of a professional service firm and provides a good integration of the accounting process.

**Problem 3-2** (Time 35–40 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting entries, and prepare financial statements (income statement, balance sheet, and statement of retained earnings). The student also is asked to analyze two transactions to find missing amounts.

**Problem 3-3** (Time 25–30 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting entries. The adjusting entries are fairly complex in nature.

**Problem 3-4** (Time 40–50 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting entries and an adjusted trial balance and then prepare an income statement, a retained earnings statement, and a balance sheet. In addition, closing entries must be made and a post-closing trial balance prepared.

**Problem 3-5** (Time 15–20 minutes)

Purpose—to provide the student with an opportunity to determine what adjusting entries need to be made to specific accounts listed in a partial trial balance. The student is also required to determine the amounts of certain revenue and expense items to be reported in the income statement.

**Problem 3-6** (Time 25–35 minutes)

Purpose—to provide the student with an opportunity to prepare year-end adjusting entries from a trial balance and related information presented. The problem also requires the student to prepare an income statement, a balance sheet, and a statement of owners’ equity. The problem covers the basics of the end-of-period adjusting process.

**Problem 3-7** (Time 25–35 minutes)

Purpose—to provide an opportunity for the student to figure out the year-end adjusting entries that were made from a trial balance and an adjusted trial balance. The student is also required to prepare an income statement, a statement of retained earnings, and a balance sheet. In addition, the student needs to answer a number of questions related to specific accounts.

**Problem 3-8** (Time 25–35 minutes)

Purpose—to provide an opportunity for the student to figure out the year-end adjusting entries that were made from a trial balance and an adjusted trial balance. The student is also required to prepare an income statement, a statement of retained earnings, and a balance sheet. In addition, the student needs to answer a number of questions related to specific accounts.

**Problem 3-9** (Time 30–40 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting, and closing entries. This problem presents basic adjustments including a number of accruals and deferrals. It provides the student with an integrated flow of the year-end accounting process.

**Problem 3-10** (Time 30–35 minutes)

Purpose—to provide an opportunity for the student to prepare adjusting and closing entries from a trial balance and related information. The student is also required to post the entries to “T” accounts.

## Time and Purpose of Problems (Continued)

**\*Problem 3-11** (Time 35–40 minutes)

Purpose—to provide an opportunity for the student to prepare and compare (a) cash basis and accrual-basis income statements, (b) cash-basis and accrual-basis balance sheets, and (c) to discuss the weaknesses of cash basis accounting.

**\*Problem 3-12** (Time 40–50 minutes)

Purpose—to provide an opportunity for the student to complete a worksheet and then prepare a classified balance sheet. In addition, adjusting and closing entries must be made and a post-closing trial balance prepared.

# SOLUTIONS TO PROBLEMS

## PROBLEM 3-1

(a) (Explanations are omitted.) and (d)

Cash				Equipment			
Sept. 1	20,000	Sept. 4	680	Sept. 2	17,280		
8	1,690	5	942				
20	980	10	430				
		18	3,600				
		19	3,000				
		30	1,800				
		30	85				
30 Bal 12,133							

Accounts Receivable			
Sept. 14	5,820	Sept. 20	980
25	2,110		
Bal. 30 6,950			

Rent Expense			
Sept. 4	<u>680</u>	Sept. 30	<u>680</u>

Supplies			
Sept. 5	942	Sept. 30	330
Bal. 30 612			

Office Expense			
Sept. 10	430	Sept. 30	515
30	<u>85</u>		
	<u>515</u>		<u>515</u>

Salaries and Wages Expense			
Sept. 30	<u>1,800</u>	Sept. 30	<u>1,800</u>

Supplies Expense			
Sept. 30	<u>330</u>	Sept. 30	<u>330</u>

Owner's Capital			
Sept. 19	3,000	Sept. 1	20,000
		30	6,007
		Bal. 30	23,007

Accounts Payable			
Sept. 18	3,600	Sept. 2	17,280
		Bal. 30	13,680

Service Revenue			
Sept. 30	9,620	Sept. 8	1,690
		14	5,820
		25	<u>2,110</u>
			<u>9,620</u>

Accumulated Depreciation—Equipment			
		Sept. 30	288

**PROBLEM 3-1 (Continued)**

Depreciation Expense				Income Summary			
Sept. 30	<u>288</u>	Sept. 30	<u>288</u>	Sept. 30	680	Sept. 30	9,620
				30	515		
				30	1,800		
				30	330		
				30	288		
				30 Inc.	<u>6,007</u>		
					<u>9,620</u>		<u>9,620</u>

(b) **YASUNARI KAWABATA, D.D.S.**  
**Trial Balance**  
**September 30**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$12,133	
Accounts Receivable .....	6,950	
Supplies .....	612	
Equipment .....	17,280	
Accumulated Depreciation—Equipment .....		\$ 288
Accounts Payable .....		13,680
Owner's Capital .....		17,000
Service Revenue .....		9,620
Rent Expense .....	680	
Office Expense .....	515	
Salaries and Wages Expense .....	1,800	
Supplies Expense .....	330	
Depreciation Expense .....	288	
Totals .....	<u>\$40,588</u>	<u>\$40,588</u>

**PROBLEM 3-1 (Continued)**

**(c) YASUNARI KAWABATA, D.D.S.  
Income Statement  
For the Month of September**

<b>Service revenue .....</b>		<b>\$9,620</b>
<b>Expenses:</b>		
<b>Salaries and wages expense.....</b>	<b>\$1,800</b>	
<b>Rent expense .....</b>	<b>680</b>	
<b>Supplies expense .....</b>	<b>330</b>	
<b>Depreciation expense.....</b>	<b>288</b>	
<b>Office expense .....</b>	<b>515</b>	
<b>Total expenses.....</b>		<b><u>3,613</u></b>
<b>Net income .....</b>		<b><u>\$6,007</u></b>

**YASUNARI KAWABATA, D.D.S.  
Statement of Owners' Equity  
For the Month of September**

<b>Owner's capital September 1 .....</b>	<b>\$20,000</b>
<b>Add: Net income .....</b>	<b><u>6,007</u></b>
	<b>26,007</b>
<b>Less: Withdrawal by owner .....</b>	<b><u>3,000</u></b>
<b>Owner's capital September 30 .....</b>	<b><u>\$23,007</u></b>

**YASUNARI KAWABATA, D.D.S.  
Balance Sheet  
As of September 30**

<b>Assets</b>		<b>Liabilities and Owners' Equity</b>	
<b>Cash .....</b>	<b>\$12,133</b>	<b>Accounts payable.....</b>	<b>\$13,680</b>
<b>Accounts receivable .....</b>	<b>6,950</b>	<b>Owner's capital.....</b>	<b>23,007</b>
<b>Supplies .....</b>	<b>612</b>		
<b>Equipment. ....</b>	<b>17,280</b>		
<b>Accum. depreciation— equipment.....</b>	<b>(288)</b>	<b>Total liabilities and owners' equity.....</b>	<b><u>\$36,687</u></b>
<b>Total assets .....</b>	<b><u>\$36,687</u></b>		

**PROBLEM 3-1 (Continued)**

**(d) YASUNARI KAWABATA, D.D.S.  
Post-Closing Trial Balance  
September 30**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$12,133	
Accounts Receivable .....	6,950	
Supplies .....	612	
Equipment.....	17,280	
Accumulated Depreciation—Equipment ...		\$ 288
Accounts Payable .....		13,680
Owner's Capital .....		23,007
Totals .....	<u>\$36,975</u>	<u>\$36,975</u>

<b>PROBLEM 3-2</b>
--------------------

(a)	Dec. 31	Accounts Receivable .....	3,500	
		Service Revenue .....		3,500
	31	Unearned Service Revenue .....	1,400	
		Service Revenue .....		1,400
	31	Supplies Expense .....	5,400	
		Supplies.....		5,400
	31	Depreciation Expense.....	5,000	
		Accumulated Depreciation— Equipment .....		5,000
	31	Interest Expense .....	150	
		Interest Payable .....		150
	31	Insurance Expense .....	850	
		Prepaid Insurance.....		850
	31	Salaries and Wages Expense.....	1,300	
		Salaries and Wages Payable.....		1,300

(b) **MASON ADVERTISING AGENCY**  
**Income Statement**  
**For the Year Ended December 31, 2014**

<hr/>			
<b>Revenues</b>			
Service revenue .....			\$63,500
<b>Expenses</b>			
Salaries and wages expense .....	\$11,300		
Supplies expense .....	5,400		
Depreciation expense .....	5,000		
Rent expense .....	4,000		
Insurance expense .....	850		
Interest expense .....	<u>500</u>		
Total expenses.....			<u>27,050</u>
<b>Net income .....</b>			<u><u>\$36,450</u></u>

**PROBLEM 3-2 (Continued)**

**MASON ADVERTISING AGENCY  
Statement of Retained Earnings  
For the Year Ended December 31, 2014**

Retained earnings, January 1 .....	\$ 3,500
Add: Net income.....	<u>36,450</u>
Retained earnings, December 31 .....	<u><u>\$39,950</u></u>

**MASON ADVERTISING AGENCY  
Balance Sheet  
December 31, 2014**

<u>Assets</u>	
Cash.....	\$11,000
Accounts receivable .....	23,500
Supplies.....	3,000
Prepaid insurance.....	2,500
Equipment .....	\$60,000
Less: Accumulated depreciation—equipment .....	<u>33,000</u> 27,000
Total assets .....	<u><u>\$67,000</u></u>
 <b>Liabilities and Stockholders' Equity</b>	
<b>Liabilities</b>	
Notes payable.....	\$ 5,000
Accounts payable .....	5,000
Unearned service revenue .....	5,600
Salaries and wages payable.....	1,300
Interest payable.....	<u>150</u>
Total liabilities .....	\$17,050
<b>Stockholders' equity</b>	
Common stock.....	\$10,000
Retained earnings.....	<u>39,950</u> <u>49,950</u>
Total liabilities and stockholders' equity .....	<u><u>\$67,000</u></u>

- (c) 1. Interest is \$50 per month or 1% of the note payable.  $1\% \times 12 = 12\%$  interest per year.
2. Salaries and Wages Expense, \$11,300 less Salaries and Wages Payable 12/31/14, \$1,300 = \$10,000. Total Payments, \$12,500 – \$10,000 = \$2,500 Salaries and Wages Payable 12/31/13.



<b>PROBLEM 3-3</b>
--------------------

1.	Dec. 31	Salaries and Wages Expense .....	2,120	
		Salaries and Wages Payable .....		2,120
		(5 X \$700 X 2/5) = \$1,400		
		(3 X \$600 X 2/5) = <u>720</u>		
		Total accrued salaries <u>\$2,120</u>		
2.	31	Unearned Rent Revenue .....	94,000	
		Rent Revenue .....		94,000
		(5 X \$6,000 X 2) = \$60,000		
		(4 X \$8,500 X 1) = <u>34,000</u>		
		Total rent recognized <u>\$94,000</u>		
3.	31	Advertising Expense .....	4,900	
		Prepaid Advertising .....		4,900
		(A650 – \$500 per month for 8 months) = \$4,000		
		(B974 – \$300 per month for 3 months) = <u>900</u>		
		Total advertising expense <u>\$4,900</u>		
4.	31	Interest Expense .....	4,200	
		Interest Payable		
		(\$60,000 X 12% X 7/12) .....		4,200

**PROBLEM 3-4**

<b>(a)</b>	<b>Nov. 30</b>	<b>Supplies Expense.....</b>	<b>4,000</b>	
		<b>Supplies .....</b>		<b>4,000</b>
	<b>30</b>	<b>Depreciation Expense .....</b>	<b>15,000</b>	
		<b>Accumulated Depreciation—</b>		
		<b>Equipment .....</b>		<b>15,000</b>
	<b>30</b>	<b>Interest Expense.....</b>	<b>11,000</b>	
		<b>Interest Payable .....</b>		<b>11,000</b>

PROBLEM 3-4 (Continued)

(b)

**BELLEMY FASHION CENTER**  
**Adjusted Trial Balance**  
**November 30, 2014**

	Dr.	Cr.
Cash.....	\$ 28,700	
Accounts Receivable.....	33,700	
Inventory .....	45,000	
Supplies .....	1,500	
Equipment.....	133,000	
Accumulated Depr.— Equipment.....		\$ 39,000
Notes Payable.....		51,000
Accounts Payable.....		48,500
Common Stock .....		90,000
Retained Earnings .....		8,000
Sales Revenue .....		757,200
Sales Returns and Allowances .....	4,200	
Cost of Goods Sold .....	495,400	
Salaries and Wages Expense .....	140,000	
Advertising Expense .....	26,400	
Utilities Expenses.....	14,000	
Maintenance and Repairs Expense .....	12,100	
Delivery Expense.....	16,700	
Rent Expense.....	24,000	
Supplies Expense.....	4,000	
Depreciation Expense .....	15,000	
Interest Expense.....	11,000	
Interest Payable .....		11,000
Totals.....	<b>\$1,004,700</b>	<b>\$1,004,700</b>

**PROBLEM 3-4 (Continued)**

**(c) BELLEMY FASHION CENTER  
Income Statement  
For the Year Ended November 30, 2014**

<b>Sales revenue</b>		
<b>Sales</b> .....		<b>\$757,200</b>
<b>Less: Sales returns and allowances</b> .....		<u><b>4,200</b></u>
<b>Net sales</b> .....		<b>753,000</b>
<b>Cost of goods sold</b> .....		<u><b>495,400</b></u>
<b>Gross profit</b> .....		<b>257,600</b>
<b>Operating expenses</b>		
<b>Selling expenses</b>		
<b>Salaries and wages expense</b>		
(\$140,000 X 70%) .....	<b>\$98,000</b>	
<b>Advertising expense</b> .....	<b>26,400</b>	
<b>Rent expense</b>		
(\$24,000 X 80%) .....	<b>19,200</b>	
<b>Delivery expense</b> .....	<b>16,700</b>	
<b>Utilities expenses</b>		
(\$14,000 X 80%) .....	<b>11,200</b>	
<b>Depreciation Expense</b> .....	<b>15,000</b>	
<b>Supplies expense</b> .....	<u><b>4,000</b></u>	
<b>Total selling expenses</b> .....		<b>\$190,500</b>
<b>Administrative expenses</b>		
<b>Salaries and wages expense</b>		
(\$140,000 X 30%) .....	<b>42,000</b>	
<b>Maintenance and Repairs Expense</b> .....	<b>12,100</b>	
<b>Rent expense</b>		
(\$24,000 X 20%) .....	<b>4,800</b>	
<b>Utilities expenses</b>		
(\$14,000 X 20%) .....	<u><b>2,800</b></u>	
<b>Total admin. expenses</b> .....		<u><b>61,700</b></u>
<b>Total oper. expenses</b> .....		<u><b>252,200</b></u>
<b>Income from operations</b> .....		<b>5,400</b>
<b>Other expenses and losses</b>		
<b>Interest expense</b> .....		<u><b>11,000</b></u>
<b>Net loss</b> .....		<u><u><b>(\$ 5,600)</b></u></u>

**PROBLEM 3-4 (Continued)**

**BELLEMY FASHION CENTER**  
**Retained Earnings Statement**  
**For the Year Ended November 30, 2014**

Retained earnings, December 1, 2013 .....	\$8,000
Less: Net loss .....	<u>5,600</u>
Retained earnings, November 30, 2014 .....	<u>\$2,400</u>

**BELLEMY FASHION CENTER**  
**Balance Sheet**  
**November 30, 2014**

Assets	
<b>Current assets</b>	
Cash .....	\$28,700
Accounts receivable .....	33,700
Inventory .....	45,000
Supplies .....	<u>1,500</u>
Total current assets .....	<b>\$108,900</b>
<b>Property, plant, and equipment</b>	
Equipment .....	133,000
Accumulated depreciation— equipment .....	<u>39,000</u>
Total assets .....	<u><b>\$202,900</b></u>
Liabilities and Stockholders' Equity	
<b>Current liabilities</b>	
Notes payable due next year .....	\$30,000
Accounts payable .....	48,500
Interest payable .....	<u>11,000</u>
Total current liabilities .....	<b>\$ 89,500</b>
<b>Long-term liabilities</b>	
Notes payable .....	<u>21,000</u>
Total liabilities .....	<b>110,500</b>
<b>Stockholders' equity</b>	
Common stock .....	90,000
Retained earnings .....	<u>2,400</u>
Total liabilities and stockholders' equity .....	<u><b>\$202,900</b></u>

**PROBLEM 3-4 (Continued)**

(d) Nov. 30	Sales Revenue .....	757,200	
	Income Summary .....		757,200
30	Income Summary .....	762,800	
	Sales Returns and Allowances .....		4,200
	Cost of Goods Sold.....		495,400
	Salaries and Wages Expense.....		140,000
	Advertising Expense.....		26,400
	Utilities Expense .....		14,000
	Maintenance and Repair Expense .....		12,100
	Delivery Expense .....		16,700
	Rent Expense .....		24,000
	Supplies Expense .....		4,000
	Depreciation Expense.....		15,000
	Interest Expense .....		11,000
30	Retained Earnings.....	5,600	
	Income Summary .....		5,600

(e) **BELLEMY FASHION CENTER**  
**Post-Closing Trial Balance**  
**November 30, 2014**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 28,700	
Accounts Receivable .....	33,700	
Inventory .....	45,000	
Supplies .....	1,500	
Equipment.....	133,000	
Accumulated Depreciation—Equipment.....		\$ 39,000
Notes Payable .....		51,000
Accounts Payable.....		48,500
Interest Payable .....		11,000
Common Stock .....		90,000
Retained Earnings .....		2,400
	<u>\$241,900</u>	<u>\$241,900</u>

<b>PROBLEM 3-5</b>
--------------------

(a)	-1-		
		Depreciation Expense .....	10,500
		Accumulated Depreciation—Equipment (1/16 X \$168,000) .....	10,500
	-2-		
		Interest Expense.....	1,440*
		Interest Payable (\$90,000 X 8% X 72/360).....	1,440*
	-3-		
		Admissions Revenue .....	60,000
		Unearned Admissions Revenue (2,000 X \$30) .....	60,000
	-4-		
		Prepaid Advertising .....	1,100
		Advertising Expense.....	1,100
	-5-		
		Salaries and Wages Expense .....	4,700
		Salaries and Wages Payable .....	4,700

- (b)
1. Interest expense, \$2,840 (\$1,400 + \$1,440).
  2. Admissions revenue, \$320,000 (\$380,000 – \$60,000).
  3. Advertising expense, \$12,580 (\$13,680 – \$1,100).
  4. Salaries and wages expense, \$62,300 (\$57,600 + \$4,700).

**\*Note to instructor:** If 30-day months are assumed, interest expense = \$1,400 (\$90,000 X 8% X 70/360).

<b>PROBLEM 3-6</b>
--------------------

<b>(a)</b>	<b>-1-</b>		<b>6,000</b>	
		<b>Service Revenue .....</b>	<b>6,000</b>	
		<b>Unearned Service Revenue .....</b>		<b>6,000</b>
	<b>-2-</b>			
		<b>Accounts Receivable .....</b>	<b>4,900</b>	
		<b>Service Revenue .....</b>		<b>4,900</b>
	<b>-3-</b>			
		<b>Bad Debt Expense .....</b>	<b>1,430</b>	
		<b>Allowance for Doubtful Accounts .....</b>		<b>1,430</b>
	<b>-4-</b>			
		<b>Insurance Expense .....</b>	<b>480</b>	
		<b>Prepaid Insurance .....</b>		<b>480</b>
	<b>-5-</b>			
		<b>Depreciation Expense .....</b>	<b>2,500</b>	
		<b>Accumulated Depreciation—Equipment</b>		
		<b>(\$25,000 X 0.10) .....</b>		<b>2,500</b>
	<b>-6-</b>			
		<b>Interest Expense .....</b>	<b>60</b>	
		<b>Interest Payable</b>		
		<b>(\$7,200 X 0.10 X 30/360) .....</b>		<b>60</b>
	<b>-7-</b>			
		<b>Prepaid Rent .....</b>	<b>750</b>	
		<b>Rent Expense .....</b>		<b>750</b>
	<b>-8-</b>			
		<b>Salaries and Wages Expense .....</b>	<b>2,510</b>	
		<b>Salaries and Wages Payable .....</b>		<b>2,510</b>



**PROBLEM 3-6 (Continued)**

**(b) YORKIS PEREZ, CONSULTING ENGINEER  
Income Statement  
For the Year Ended December 31, 2014**

<b>Service revenue (\$100,000 – \$6,000 + \$4,900) .....</b>		<b>\$98,900</b>
<b>Expenses</b>		
<b>Salaries and wages expense</b>		
<b>(\$30,500+\$2,510) .....</b>	<b>\$33,010</b>	
<b>Rent expense (\$9,750 – \$750) .....</b>	<b>9,000</b>	
<b>Depreciation expense.....</b>	<b>2,500</b>	
<b>Bad debt expense.....</b>	<b>1,430</b>	
<b>Utilities expenses .....</b>	<b>1,080</b>	
<b>Office expense .....</b>	<b>720</b>	
<b>Insurance expense .....</b>	<b>480</b>	
<b>Interest expense .....</b>	<b>60</b>	
<b>Total expenses.....</b>		<b><u>48,280</u></b>
<b>Net income .....</b>		<b><u>\$50,620</u></b>

**YORKIS PEREZ, CONSULTING ENGINEER  
Statement of Owners' Capital  
For the Year Ended December 31, 2014**

<b>Owner's Capital, January 1 .....</b>	<b>\$ 52,010<sup>a</sup></b>
<b>Add: Net income .....</b>	<b>50,620</b>
<b>Less: Withdrawals .....</b>	<b><u>(17,000)</u></b>
<b>Owner's capital, December 31 .....</b>	<b><u>\$ 85,630</u></b>
<b><sup>(a)</sup>Owner's capital—trial balance.....</b>	<b>\$ 35,010</b>
<b>Withdrawals during the year .....</b>	<b><u>17,000</u></b>
<b>Owner's capital, as of January 1, 2014 .....</b>	<b><u>\$ 52,010</u></b>

PROBLEM 3-6 (Continued)

**YORKIS PEREZ, CONSULTING ENGINEER**  
**Balance Sheet**  
**December 31, 2014**

**Assets**

**Current assets**

Cash .....	\$29,500	
Accounts receivable (\$49,600 + \$4,900) .....	\$54,500	
Less: Allowance for doubtful accounts .....	<u>2,180*</u> 52,320	
Supplies .....	1,960	
Prepaid insurance (\$1,100 – \$480) .....	620	
Prepaid rent .....	<u>750</u>	
<b>Total current assets.....</b>		<b>\$ 85,150</b>
Equipment.....	25,000	
Less: Accumulated depreciation ...	<u>8,750**</u>	<u>16,250</u>
<b>Total assets.....</b>		<b><u>\$101,400</u></b>

**Liabilities and owners' equity**

**Current liabilities**

Notes payable .....	\$7,200	
Unearned service revenue .....	6,000	
Salaries and wages payable .....	2,510	
Interest payable .....	<u>60</u>	\$ 15,770

**Owner's Capital**

(\$35,010 + \$50,620) .....		<u>85,630</u>
<b>Total liabilities and owners' equity.....</b>		<b><u>\$101,400</u></b>

\*(\$750 + \$1,430)

\*\*(\$6,250 + \$2,500)

<b>PROBLEM 3-7</b>
--------------------

(a)

<b>Sep. 30</b>	<b>Accounts Receivable</b> .....	<b>600</b>	
	<b>Service Revenue</b> .....		<b>600</b>
<b>30</b>	<b>Rent Expense</b> .....	<b>900</b>	
	<b>Prepaid Rent</b> .....		<b>900</b>
<b>30</b>	<b>Supplies Expense</b> .....	<b>1,020</b>	
	<b>Supplies</b> .....		<b>1,020</b>
<b>30</b>	<b>Depreciation Expense</b> .....	<b>350</b>	
	<b>Accumulated Depreciation—Equipment</b> ....		<b>350</b>
<b>30</b>	<b>Interest Expense</b> .....	<b>50</b>	
	<b>Interest Payable</b> .....		<b>50</b>
<b>30</b>	<b>Unearned Rent Revenue</b> .....	<b>200</b>	
	<b>Rent Revenue</b> .....		<b>200</b>
<b>30</b>	<b>Salaries and Wages Expense</b> .....	<b>600</b>	
	<b>Salaries and Wages Payable</b> .....		<b>600</b>

(b) **ROLLING HILLS GOLF INC.**  
**Income Statement**  
**For the Quarter Ended September 30, 2014**

<b>Revenues</b>			
	<b>Service revenue</b> .....	<b>\$14,700</b>	
	<b>Rent revenue</b> .....	<u><b>900</b></u>	
	<b>Total revenue</b> .....		<b>\$15,600</b>
<b>Expenses</b>			
	<b>Salaries and wages expense</b> .....	<b>\$9,400</b>	
	<b>Rent expense</b> .....	<b>1,800</b>	
	<b>Supplies expense</b> .....	<b>1,020</b>	
	<b>Utilities expenses</b> .....	<b>470</b>	
	<b>Depreciation expense</b> .....	<b>350</b>	
	<b>Interest expense</b> .....	<u><b>50</b></u>	
	<b>Total expenses</b> .....		<u><b>13,090</b></u>
	<b>Net income</b> .....		<u><u><b>\$ 2,510</b></u></u>

**PROBLEM 3-7 (Continued)**

**ROLLING HILLS GOLF INC.  
Retained Earnings Statement  
For the Quarter Ended September 30, 2014**

Retained earnings, July 1, 2014 .....		\$ 0
Add: Net income .....		2,510
Less: Dividends .....		<u>600</u>
Retained earnings, September 30, 2014 .....		<u><u>\$1,910</u></u>

**ROLLING HILLS GOLF INC.  
Balance Sheet  
September 30, 2014**

<b>Assets</b>		
<b>Current assets</b>		
Cash .....	\$ 6,700	
Accounts receivable .....	1,000	
Supplies .....	180	
Prepaid rent expense .....	<u>900</u>	
<b>Total current assets .....</b>		<b>\$ 8,780</b>
Equipment .....	15,000	
Less: Accumulated depreciation .....	<u>350</u>	<u>14,650</u>
<b>Total assets .....</b>		<b><u><u>\$23,430</u></u></b>
 <b>Liabilities and Stockholders' Equity</b>		
<b>Current liabilities</b>		
Notes payable .....	\$ 5,000	
Accounts payable .....	1,070	
Unearned rent revenue .....	800	
Salaries and wages payable .....	600	
Interest payable .....	<u>50</u>	<b>\$ 7,520</b>
 <b>Stockholders' Equity</b>		
Common stock .....	14,000	
Retained earnings .....	<u>1,910</u>	
<b>Total stockholders' equity .....</b>		<b><u>15,910</u></b>
<b>Total liabilities and         stockholders' equity .....</b>		<b><u><u>\$23,430</u></u></b>

### **PROBLEM 3-7 (Continued)**

- (c) The following accounts would be closed: Service Revenue, Rent Revenue, Salaries and Wages Expense, Rent Expense, Utilities Expenses, Depreciation Expense, Supplies Expense, Interest Expense, Dividends.**
  
- (d) Interest of 12% per year equals a monthly rate of 1%; monthly interest is \$50 ( $\$5,000 \times 1\%$ ). Since total interest expense is \$50, the note has been outstanding one month.**

<b>PROBLEM 3-8</b>
--------------------

(a)

Dec. 31	Accounts Receivable .....	3,500	
	Service Revenue .....		3,500
31	Supplies Expense .....	2,900	
	Supplies .....		2,900
31	Insurance Expense .....	1,560	
	Prepaid Insurance.....		1,560
31	Depreciation Expense.....	5,000	
	Accumulated Depreciation—Equipment....		5,000
31	Interest Expense .....	560	
	Interest Payable .....		560
31	Unearned Service Revenue .....	1,900	
	Service Revenue .....		1,900
31	Salaries and Wages Expense.....	820	
	Salaries and Wages Payable.....		820

(b) **VEDULA ADVERTISING AGENCY**  
**Income Statement**  
**For the Year Ended December 31, 2014**

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<b>Revenues</b>			
	Service revenue .....		\$63,000
<b>Expenses</b>			
	Salaries and wages expense .....	\$9,820	
	Depreciation expense .....	5,000	
	Rent expense .....	4,350	
	Supplies expense .....	2,900	
	Insurance expense .....	1,560	
	Interest expense .....	<u>560</u>	
	Total expenses.....		<u>24,190</u>
<b>Net income</b> .....			<u><u>\$38,810</u></u>

**PROBLEM 3-8 (Continued)**

**VEDULA ADVERTISING AGENCY  
Retained Earnings Statement  
For the Year Ended December 31, 2014**

Retained earnings, January 1 .....	\$ 5,500
Add: Net income .....	38,810
Less: Dividends .....	<u>10,000</u>
Retained earnings, December 31 .....	<u><u>\$34,310</u></u>

**VEDULA ADVERTISING AGENCY  
Balance Sheet  
December 31, 2014**

<b>Assets</b>		
<b>Current assets</b>		
Cash.....	\$11,000	
Accounts receivable .....	19,500	
Supplies.....	6,500	
Prepaid insurance.....	<u>1,790</u>	
<b>Total current assets .....</b>		<b>\$38,790</b>
Equipment.....	60,000	
Less: Accumulated depreciation.....	<u>30,000</u>	<u>30,000</u>
<b>Total assets .....</b>		<b><u><u>\$68,790</u></u></b>
 <b>Liabilities and Stockholders' Equity</b>		
<b>Current liabilities</b>		
Notes payable.....	\$ 8,000	
Accounts payable .....	2,000	
Unearned service revenue.....	3,100	
Salaries and wages payable .....	820	
Interest payable.....	<u>560</u>	<b>\$ 14,480</b>
 <b>Stockholders' Equity</b>		
Common stock .....	20,000	
Retained earnings .....	<u>34,310</u>	
<b>Total stockholders' equity .....</b>		<b><u>54,310</u></b>
<b>Total liabilities and             stockholders' equity .....</b>		<b><u><u>\$68,790</u></u></b>

**PROBLEM 3-8 (Continued)**

- (c) **Service Revenue, Salaries and Wages Expense, Depreciation Expense, Rent Expense, Supplies Expense, Insurance Expense, Interest Expense, Dividends.**
- (d) **Interest is \$56 per month or 0.7% of the note payable ( $\$56 \div \$8,000$ ).  
 $0.7\% \times 12 = 8.4\%$  interest per year.**
- (e) **Salaries and Wages Expense, \$9,820, less Salaries and Wages Payable 12/31/14, \$820 = \$9,000. Total payments, \$10,500 – \$9,000 = \$1,500 Salaries and Wages Payable 12/31/13.**



**PROBLEM 3-9**

**(a), (b), (d)**

<table style="width: 100%; border-collapse: collapse;"> <tr><td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><b>Cash</b></td></tr> <tr><td style="width: 10%;">Bal.</td><td style="width: 10%;">15,000</td></tr> </table>	<b>Cash</b>		Bal.	15,000	<table style="width: 100%; border-collapse: collapse;"> <tr><td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><b>Prepaid Insurance</b></td></tr> <tr><td style="width: 10%;">Bal.</td><td style="width: 10%;">9,000</td></tr> <tr><td></td><td style="text-align: right;"><u>5,500</u></td></tr> </table>	<b>Prepaid Insurance</b>		Bal.	9,000		<u>5,500</u>	<table style="width: 100%; border-collapse: collapse;"> <tr><td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><b>Salaries and Wages Expense</b></td></tr> <tr><td style="width: 10%;">Bal.</td><td style="width: 10%;">80,000</td></tr> <tr><td>Adj.</td><td style="text-align: right;"><u>3,600</u></td></tr> <tr><td></td><td style="text-align: right;"><u>83,600</u></td></tr> </table>	<b>Salaries and Wages Expense</b>		Bal.	80,000	Adj.	<u>3,600</u>		<u>83,600</u>						
<b>Cash</b>																										
Bal.	15,000																									
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<b>Land</b>																										
Bal.	350,000																									
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<b>Buildings</b>																										
Bal.	120,000																									
<b>Rent Revenue</b>																										
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<b>Accum. Depr.—Buildings</b>																										
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<b>Rent Receivable</b>																										
Adj.	<u>\$1,600</u>																									
<b>Bad Debt Expense</b>																										
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Close	<u>460</u>																									
<b>Income Summary</b>																										
Exp.	184,560																									
Inc.	<u>31,640</u>																									
	<u>216,200</u>																									

**PROBLEM 3-9 (Continued)**

Salaries and Wages		Unearned Dues Revenue	
Payable		Adj.	
Adj.	<u>3,600</u>	Adj.	<u>8,900</u>
(b)	-1-		
Depreciation Expense .....		4,000	
Accumulated Depreciation—Buildings			
(1/30 X \$120,000) .....			4,000
	-2-		
Depreciation Expense .....		15,000	
Accumulated Depreciation—Equipment			
(10% X \$150,000) .....			15,000
	-3-		
Insurance Expense .....		3,500	
Prepaid Insurance .....			3,500
	-4-		
Rent Receivable .....		1,600	
Rent Revenue			
(1/11 X \$17,600) .....			1,600
	-5-		
Bad Debt Expense .....		460	
Allowance for Doubtful Accounts			
[( \$13,000 X 12%) – \$1,100] .....			460
	-6-		
Salaries and Wages Expense .....		3,600	
Salaries and Wages Payable .....			3,600
	-7-		
Dues Revenue .....		8,900	
Unearned Dues Revenue .....			8,900

**PROBLEM 3-9 (Continued)**

(c)

**CRESTWOOD GOLF CLUB, INC.  
Adjusted Trial Balance  
December 31, XXXX**

	Dr.	Cr.
Cash.....	\$ 15,000	
Accounts Receivable.....	13,000	
Allowance for Doubtful Accounts.....		\$ 1,560
Prepaid Insurance.....	5,500	
Land.....	350,000	
Buildings.....	120,000	
Accum. Depreciation—Buildings.....		42,400
Equipment.....	150,000	
Accum. Depreciation—Equipment.....		85,000
Salaries and Wages Payable.....		3,600
Common Stock.....		400,000
Retained Earnings.....		82,000
Dues Revenue.....		191,100
Green Fees Revenue.....		5,900
Rent Revenue.....		19,200
Utilities Expenses.....	54,000	
Salaries and Wages Expense.....	83,600	
Maintenance and Repairs Expense.....	24,000	
Bad Debt Expense.....	460	
Unearned Dues Revenue.....		8,900
Rent Receivable.....	1,600	
Depreciation Expense.....	19,000	
Insurance Expense.....	3,500	
Totals.....	\$839,660	\$839,660

**PROBLEM 3-9 (Continued)**

(d)			
		<b>-Dec. 31-</b>	
	Dues Revenue .....	<b>191,100</b>	
	Green Fees Revenue .....	<b>5,900</b>	
	Rent Revenue .....	<b>19,200</b>	
	Income Summary .....		<b>216,200</b>
		<b>-31-</b>	
	Income Summary .....	<b>184,560</b>	
	Utilities Expenses .....		<b>54,000</b>
	Bad Debt Expense .....		<b>460</b>
	Salaries and Wages Expense .....		<b>83,600</b>
	Maintenance and Repairs Expense .....		<b>24,000</b>
	Depreciation Expense .....		<b>19,000</b>
	Insurance Expense .....		<b>3,500</b>
		<b>-31-</b>	
	Income Summary .....	<b>31,640</b>	
	Retained Earnings .....		<b>31,640</b>

**PROBLEM 3-10**

(a), (b), (c)

<b>Cash</b>	<b>Accounts Receivable</b>	<b>Allow. for Doubtful Accts.</b>
Bal. 18,500	Bal. 32,000	Bal. 700
		Adj. 1,400
		<u>2,100</u>
<b>Inventory</b>	<b>Equipment</b>	<b>Accum. Depr.—Equipment</b>
Bal. 80,000	Bal. 84,000	Bal. 35,000
		Adj. 12,000
		<u>47,000</u>
<b>Prepaid Insurance</b>	<b>Notes Payable</b>	<b>Interest Expense</b>
Bal. 5,100	Bal. 28,000	Adj. 3,360
Adj. 2,550		Cls. 3,360
<u>2,550</u>		
<b>Common Stock</b>	<b>Sales Revenue</b>	<b>Insurance Expense</b>
Bal. 80,600	Cls. 600,000	Adj. 2,550
	Bal. 600,000	Cls. 2,550
<b>Salaries and Wages Expense (Sales)</b>	<b>Advertising Expense</b>	<b>Salaries and Wages Expense (Administrative)</b>
Bal. 50,000	Bal. 6,700	Adj. 65,000
Cls. 52,400	Adj. 700	Cls. 65,000
Adj. 2,400	Cls. 6,000	
<u>52,400</u>	<u>6,700</u>	
<b>Bad Debt Expense</b>	<b>Supplies Expense</b>	<b>Prepaid Advertising</b>
Adj. 1,400	Bal. 5,000	Adj. 700
Cls. 1,400	Adj. 1,500	
	Cls. 3,500	
	<u>5,000</u>	
<b>Interest Payable</b>	<b>Depr. Exp.</b>	<b>Income Summary</b>
Adj. 3,360	Adj. 12,000	Exp. 554,210
	Cls. 12,000	Sales 600,000
		Inc. 45,790
		<u>600,000</u>
		<u>600,000</u>
<b>Supplies</b>	<b>Salaries and Wages Payable</b>	
Adj. 1,500	Adj. 2,400	
<b>Retained Earnings</b>	<b>Cost of Goods Sold</b>	
Bal. 10,000	Bal. 408,000	Cls. 408,000
Inc. 45,790		
<u>55,790</u>		

**PROBLEM 3-10 (Continued)**

(b)	-1-		
		<b>Bad Debt Expense</b> .....	<b>1,400</b>
		<b>    Allowance for Doubtful Accounts</b> .....	<b>1,400</b>
	-2-		
		<b>Depreciation Expense (\$84,000 ÷ 7)</b> .....	<b>12,000</b>
		<b>    Accumulated Depreciation—Equipment</b> .....	<b>12,000</b>
	-3-		
		<b>Insurance Expense</b> .....	<b>2,550</b>
		<b>    Prepaid Insurance</b> .....	<b>2,550</b>
	-4-		
		<b>Interest Expense</b> .....	<b>3,360</b>
		<b>    Interest Payable</b> .....	<b>3,360</b>
	-5-		
		<b>Salaries and Wages Expense (Sales)</b> .....	<b>2,400</b>
		<b>    Salaries and Wages Payable</b> .....	<b>2,400</b>
	-6-		
		<b>Prepaid Advertising</b> .....	<b>700</b>
		<b>    Advertising Expense</b> .....	<b>700</b>
	-7-		
		<b>Supplies</b> .....	<b>1,500</b>
		<b>    Supplies Expense</b> .....	<b>1,500</b>

**PROBLEM 3-10 (Continued)**

<b>(c)</b>	<b>Dec. 31</b>		
<b>Sales Revenue</b> .....		<b>600,000</b>	
<b>Income Summary</b> .....			<b>600,000</b>
	<b>Dec. 31</b>		
<b>Income Summary</b> .....		<b>554,210</b>	
<b>Cost of Goods Sold</b> .....			<b>408,000</b>
<b>Advertising Expense</b> .....			<b>6,000</b>
<b>Salaries and Wages Expense (Admin.)</b> .....			<b>65,000</b>
<b>Salaries and Wages Expense (Sales)</b> .....			<b>52,400</b>
<b>Supplies Expense</b> .....			<b>3,500</b>
<b>Insurance Expense</b> .....			<b>2,550</b>
<b>Bad Debt Expense</b> .....			<b>1,400</b>
<b>Depreciation Expense</b> .....			<b>12,000</b>
<b>Interest Expense</b> .....			<b>3,360</b>
	<b>Dec. 31</b>		
<b>Income Summary</b> .....		<b>45,790</b>	
<b>Retained Earnings</b> .....			<b>45,790</b>

**\*PROBLEM 3-11**

(a) **ARKANSAS SALES AND SERVICE**  
**Income Statement**  
**For the Month Ended January 31, 2014**

	<b>(1)</b>	<b>(2)</b>
	<u><b>Cash Basis</b></u>	<u><b>Accrual Basis</b></u>
<b>Revenues</b> .....	<b>\$ 75,000</b>	<b>\$98,400*</b>
<b>Expenses</b>		
<b>Cost of computers &amp; printers:</b>		
Purchased and paid .....	<b>82,500**</b>	
Cost of goods sold .....		<b>59,500***</b>
Salaries and wages .....	<b>9,600</b>	<b>12,600</b>
Rent .....	<b>6,000</b>	<b>2,000</b>
Other operating expenses .....	<u><b>8,400</b></u>	<u><b>10,400</b></u>
<b>Total expenses</b> .....	<u><b>106,500</b></u>	<u><b>84,500</b></u>
<b>Net income (loss)</b> .....	<u><b>\$(31,500)</b></u>	<u><b>\$13,900</b></u>

\*(\$2,550 X 30) + (\$3,600 X 4) + (\$500 X 15)

\*\*(\$1,500 X 40) + (\$2,500 X 6) + (\$300 X 25)

\*\*\*(\$1,500 X 30) + (\$2,500 X 4) + (\$300 X 15)



**\*PROBLEM 3-11 (Continued)**

**(b) ARKANSAS SALES AND SERVICE  
Balance Sheet  
As of January 31, 2014**

	<b>(1) <u>Cash Basis</u></b>	<b>(2) <u>Accrual Basis</u></b>
<b><u>Assets</u></b>		
Cash .....	\$58,500 <sup>a</sup>	\$ 58,500 <sup>a</sup>
Accounts receivable.....		23,400
Inventory .....		23,000 <sup>b</sup>
Prepaid rent .....		4,000
<b>Total assets .....</b>	<b><u>\$58,500</u></b>	<b><u>\$108,900</u></b>
<b><u>Liabilities and owners' Equity</u></b>		
Salaries and wages payable .....		\$ 3,000
Accounts payable.....		2,000
Owner's capital.....	<u>\$58,500<sup>c</sup></u>	<u>103,900<sup>d</sup></u>
<b>Total liabilities and owner's     equity .....</b>	<b><u>\$58,500</u></b>	<b><u>\$108,900</u></b>

<sup>a</sup> Original investment	\$ 90,000
Cash sales	75,000
Cash purchases	(82,500)
Rent paid	(6,000)
Salaries paid	(9,600)
Other operating expenses	<u>(8,400)</u>
Cash balance Jan. 31	<u>\$ 58,500</u>

<sup>b</sup>(10 @ \$1,500) + (2 @ \$2,500) + (10 @ \$300).

<sup>c</sup>Initial investment minus net loss: \$90,000 – \$31,500.

<sup>d</sup>Initial investment plus net income: \$90,000 + \$13,900.

**\*PROBLEM 3-11 (Continued)**

- (c)
- 1. The \$23,400 in receivables from customers is an asset and a future cash flow resulting from sales that is ignored. The cash basis understates the amount of revenues and inflow of assets in January from the sale of computers and printers by \$23,400.**
  - 2. The cost of computers and printers sold in January is overstated by \$23,000. The unsold computers and printers are an asset of \$23,000 in the form of inventory.**
  - 3. The cash basis ignores \$3,000 of the salaries that have been earned by the employees in January and will be paid in February.**
  - 4. Rent expense on the cash basis is overstated by \$4,000. This prepayment is an asset in the form of two months' future right to the use of office, showroom, and repair space and should appear on the balance sheet.**
  - 5. Other operating expenses on a cash basis are understated by \$2,000 as is the liability for the unpaid portion of these expenses incurred in January.**

**\*PROBLEM 3-12**

**COOKE COMPANY**

Worksheet

For the Year Ended September 30, 2014

(a)

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	37,400				37,400		37,400		37,400	
Supplies	18,600		(b)	14,400	4,200		4,200		4,200	
Prepaid Insurance	31,900		(a)	28,000	3,900		3,900		3,900	
Land	80,000				80,000		80,000		80,000	
Equipment	120,000				120,000		120,000		120,000	
Accum. Depr.-Equip.		36,200	(c)	5,800		42,000				42,000
Accounts Payable		14,600				14,600				14,600
Unearned Service Rev.		2,700	(d)	2,000		700				700
Mortgage Payable		50,000				50,000				50,000
Common Stock		107,700				107,700				107,700
Dividends	14,000				14,000				14,000	
Retained Earnings		2,000				2,000				2,000
Service Revenue		278,500	(d)	2,000		280,500		280,500		
Sal. and Wages Exp.	109,000				109,000		109,000			
Maintenance and Repairs Expense	30,500				30,500		30,500			
Advertising Expense	9,400				9,400		9,400			
Utilities Expenses	16,900				16,900		16,900			
Prop. Tax Expense	18,000		(e)	3,000	21,000		21,000			
Interest Expense	6,000		(f)	6,000	12,000		12,000			
<b>Totals</b>	<u>491,700</u>	<u>491,700</u>								
Insurance Expense			(a)	28,000		28,000		28,000		
Supplies Expense			(b)	14,400		14,400		14,400		
Interest Payable			(c)	5,800		5,800		5,800		6,000
Depreciation Expense										
Prop. Taxes Payable			(e)	3,000		3,000				3,000
<b>Totals</b>				<u>59,200</u>		<u>506,500</u>		<u>247,000</u>		<u>280,500</u>
Net Income								<u>33,500</u>		<u>33,500</u>
<b>Totals</b>								<u>280,500</u>		<u>259,500</u>

Key: (a) Expired Insurance; (b) Supplies Used; (c) Depreciation Expensed; (d) Service Revenue Recognized; (e) Accrued Property Taxes; (f) Accrued Interest Payable.

**\*PROBLEM 3-12 (Continued)**

**(b) COOKE COMPANY  
Balance Sheet  
September 30, 2014**

<b>Assets</b>			
<b>Current assets</b>			
Cash .....		\$37,400	
Supplies .....		4,200	
Prepaid insurance .....		<u>3,900</u>	
<b>Total current assets .....</b>			<b>\$ 45,500</b>
<b>Property, plant, and equipment</b>			
Land .....		80,000	
Equipment.....	\$120,000		
Less: Accum. depreciation – equipment .....	<u>42,000</u>	<u>78,000</u>	<u>158,000</u>
<b>Total assets .....</b>			<b><u>\$203,500</u></b>
<b>Liabilities and Stockholders' Equity</b>			
<b>Current liabilities</b>			
Accounts payable.....		\$14,600	
Current maturity of long-term debt .....		10,000	
Interest payable .....		6,000	
Property taxes payable .....		3,000	
Unearned service revenue .....		<u>700</u>	
<b>Total current liabilities .....</b>			<b>\$ 34,300</b>
<b>Long-term liabilities</b>			
Mortgage payable .....			<u>40,000</u>
<b>Total liabilities .....</b>			<b>74,300</b>
<b>Stockholders' equity</b>			
Common stock		107,700	
Retained earnings (\$2,000 + \$33,500 – \$14,000) .....		<u>21,500</u>	<u>129,200</u>
<b>Total liabilities and owners' equity .....</b>			<b><u>\$203,500</u></b>

**\*PROBLEM 3-12 (Continued)**

(c) Sep. 30	Insurance Expense .....	28,000	
	Prepaid Insurance.....		28,000
30	Supplies Expense .....	14,400	
	Supplies.....		14,400
30	Depreciation Expense.....	5,800	
	Accum. Depreciation— Equipment .....		5,800
30	Unearned Service Revenue .....	2,000	
	Service Revenue .....		2,000
30	Property Tax Expense .....	3,000	
	Property Taxes Payable .....		3,000
30	Interest Expense .....	6,000	
	Interest Payable .....		6,000
(d) Sep. 30	Service Revenue .....	280,500	
	Income Summary.....		280,500
30	Income Summary .....	247,000	
	Salaries and Wages Expense.....		109,000
	Maintenance and Repairs Expense .....		30,500
	Insurance Expense .....		28,000
	Property Tax Expense .....		21,000
	Supplies Expense .....		14,400
	Utilities Expenses .....		16,900
	Interest Expense .....		12,000
	Advertising Expense .....		9,400
	Depreciation Expense .....		5,800
30	Income Summary .....	33,500	
	Retained Earnings .....		33,500
30	Retained Earnings.....	14,000	
	Dividends.....		14,000

**\*PROBLEM 3-12 (Continued)**

**(e) COOKE COMPANY  
Post-Closing Trial Balance  
September 30, 2014**

	<u>Debit</u>	<u>Credit</u>
Cash .....	\$ 37,400	
Supplies .....	4,200	
Prepaid Insurance .....	3,900	
Land.....	80,000	
Equipment.....	120,000	
Accumulated Depreciation – Equipment .....		\$ 42,000
Accounts Payable.....		14,600
Unearned Service Revenue .....		700
Interest Payable .....		6,000
Property Tax Payable .....		3,000
Mortgage Payable.....		50,000
Common Stock .....		107,700
Retained Earnings .....		21,500
	<u>\$245,500</u>	<u>\$245,500</u>

## FINANCIAL REPORTING PROBLEM

- (a) **June 30, 2011 total assets: \$138,354 million.  
June 30, 2010 total assets: \$128,172 million.**
  
- (b) **June 30, 2011 cash and cash equivalents: \$2,768 million.**
  
- (c) **2011 research and development costs: \$2,001 million.  
2010 research and development costs: \$1,950 million.**
  
- (d) **2011 net sales: \$82,559 million.  
2010 net sales: \$78,938 million.**
  
- (e) **An adjusting entry for deferrals is necessary when the receipt/disbursement precedes the recognition in the financial statements. Accounts such as prepaid insurance and prepaid rent may be included in the Prepaid Expenses and Other Current Assets (\$4,408 million at June 30, 2011). Both of these accounts would require an adjusting entry to recognize the proper amount of expense incurred during the period. In addition, depreciation expense is an adjusting entry related to a deferral.**

**An adjusting entry for an accrual is necessary when recognition in the financial statements precedes the cash receipt/disbursement, such as interest or taxes payable. Other adjusting entries probably made by P&G include interest revenue and expense and interest receivable and interest payable. P&G reports \$9,290 million of Accrued and Other Liabilities at June 30, 2011.**

- (f) **2011 Depreciation and amortization expense: \$2,838 million  
2010 Depreciation and amortization expense: \$3,108 million  
2009 Depreciation and amortization expense: \$3,082 million**

**(From the Statement of Cash Flows)**

## COMPARATIVE ANALYSIS CASE

(a) The Coca-Cola Company percentage increase is computed as follows:

Total assets (December 31, 2011) .....	\$79,974
Total assets (December 31, 2010) .....	<u>72,921</u>
Difference .....	<u>\$ 7,053</u>

$$\$7,053 \div \$72,921 = \underline{9.7\%}$$

PepsiCo, Inc.'s percentage increase is computed as follows:

Total assets (December 29, 2011) .....	\$72,882
Total assets (December 30, 2010) .....	<u>68,153</u>
Difference .....	<u>\$ 4,729</u>

$$\$4,729 \div \$68,153 = \underline{\$6.9\%}$$

Coca-Cola Company had the larger increase.

(b)

	5-Year Growth Rate	
	<u>The Coca-Cola Company</u>	<u>PepsiCo, Inc.</u>
Net sales	12.69%	13.92%
Income from continuing operations	9.41%	3.30%

(c) The Coca-Cola Company had depreciation and amortization expense of \$1,954 million; PepsiCo, Inc. had depreciation and amortization expense of \$2,737 million.



## COMPARATIVE ANALYSIS CASE (Continued)

PepsiCo has substantially more property, plant, and equipment than does Coca-Cola. PepsiCo is engaged in three different types of businesses: soft drinks, snack-food, and juices. As a result, it has more tangible fixed assets. PepsiCo also has substantially more amortizable intangible assets. Amortizable intangible assets for Coke and Pepsi increase the amount of amortization expense recorded in income. The amount of property, plant, and equipment and amortizable intangible assets reported for these two companies is as follows: (000,000)

	<u>The Coca-Cola Company</u>	<u>PepsiCo, Inc.</u>
Property, plant, and equipment (net)	\$ 14,939	\$19,698
Amortizable intangible assets (net)	<u>1,250</u>	<u>1,888</u>
	\$16,189	\$21,586

## FINANCIAL STATEMENT ANALYSIS

(a)	2011	2010	2009	% Change 2011	% Change 2010
Sales	\$13,198	\$12,397	\$12,575	6.46%	-1.42%
Gross Profit %	41.28%	42.66%	42.87%	-3.23%	-0.49%
Operating Profit	1,976	1,990	2,001	-0.70%	-0.55%
Net Cash Flow less Capital Expenditures	1,001	534	1,266	87.45%	-57.82%
Net Earnings	1,231	1,247	1,212	-1.28%	2.89%

- (b) Kellogg experienced an improvement in sales in the current year which followed a decline in the previous year. The gross-profit percentage decreased slightly after a flat change in the prior year. This coincides with a flat operating profit but a solid increase in cash flows, compared to prior years, suggest it faces a challenging period and might be starting to recover. This may bode well for the strength and flexibility of its business model.

# ACCOUNTING, ANALYSIS, AND PRINCIPLES

## Accounting

Depreciation Expense .....	9,500	
Accumulated Depreciation—Equipment .....		9,500
(\$9,500 = (\$192,000 – \$40,000) ÷ 16)		
Interest Expense.....	8,250	
Interest Payable .....		8,250
\$8,250 = (\$90,000 X 0.10) X 11/12)		
Unearned Service Revenue .....	10,000	
Service Revenue .....		10,000
(\$10,000 = (\$50 X 200))		
Advertising Expense .....	2,500	
Prepaid Advertising .....		2,500
Salaries and Wages Expense .....	3,500	
Salaries and Wages Payable .....		3,500

## ACCOUNTING, ANALYSIS, AND PRINCIPLES (Continued)

### Analysis

	<u>Income before Adjustments</u>	<u>Adjustments</u>	<u>Income after Adjustments</u>
Service revenue	\$360,000	\$10,000	\$370,000
Less:			
Depreciation expense		(9,500)	(9,500)
Advertising expense	(18,680)	(2,500)	(21,180)
Salaries and wages expense	(67,600)	(3,500)	(71,100)
Interest expense	<u>(1,400)</u>	(8,250)	<u>(9,650)</u>
Net income	<u>\$272,320</u>		<u>\$258,570</u>

Without recording the adjusting entries, Amato's income is overstated. In addition, without the adjustments, Amato's current liabilities and current assets are misstated, which could affect evaluation of Amato's liquidity.

### Principles

The tradeoffs are between the *timeliness* of the reports, which contributes to relevance, and verifiability, the lack of which detracts from faithful representation. That is, by preparing reports more frequently, the company provides more timely information, which can make a difference to a statement reader who needs to make a decision. However, preparing statements more frequently requires more subjective estimates, which reduces faithful representation.

- (a) The three essential characteristics of assets.

Search String: asset and characteristics.

CON6, Par26. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

- (b) Three essential characteristics of liabilities.

Search String: liability and characteristic.

CON6, Par36. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.

- (c) Uncertainty, and its effects on financial statements.

Search Strings: "uncertainty", effect of uncertainty.

CON6, Par44. Uncertainty about economic and business activities and results is pervasive, and it often clouds whether a particular item qualifies as an asset or a liability of a particular entity at the time the definitions are applied. The presence or absence of future economic benefit that can be obtained and controlled by the entity or of the entity's legal, equitable, or constructive obligation to sacrifice assets in the future can often be discerned reliably only with hindsight. As a result, some items that with hindsight actually qualified as assets or liabilities of the entity under the definitions may, as a practical matter, have been recognized as expenses, losses, revenues, or gains or

## PROFESSIONAL RESEARCH (Continued)

remained unrecognized in its financial statements because of uncertainty about whether they qualified as assets or liabilities of the entity or because of recognition and measurement considerations stemming from uncertainty at the time of assessment. Conversely, some items that with hindsight did not qualify under the definitions may have been included as assets or liabilities because of judgments made in the face of uncertainty at the time of assessment.

**CON6, Par45.** An effect of uncertainty is to increase the costs of financial reporting in general and the costs of recognition and measurement in particular. Some items that qualify as assets or liabilities under the definitions may therefore be recognized as expenses, losses, revenues, or gains or remain unrecognized as a result of cost and benefit analyses indicating that their formal incorporation in financial statements is not useful enough to justify the time and effort needed to do it. It may be possible, for example, to make the information more reliable in the face of uncertainty by exerting greater effort or by spending more money, but it also may not be worth the added cost.

Note to instructors: The FASB codification does not contain the Concepts Statements. However, the Concepts Statements can be accessed at another link on the FASB website.

### (d) The difference between realization and recognition

Search String: realization, recognition.

**CON6, Par143.** Realization in the most precise sense means the process of converting noncash resources and rights into money and is most precisely used in accounting and financial reporting to refer to sales of assets for cash or claims to cash. The related terms realized and unrealized therefore identify revenues or gains or losses on assets sold and unsold, respectively. Those are the meanings of realization and related terms in the Board's conceptual framework. Recognition is the process of formally recording or incorporating an item in the financial statements of an entity. Thus, an asset, liability, revenue, expense, gain, or loss may be recognized (recorded) or unrecognized (unrecorded). Realization and recognition are not used as synonyms, as they sometimes are in accounting and financial literature.

**PROFESSIONAL SIMULATION**

**Journal Entries**

Depreciation Expense.....	7,000	
Accumulated Depreciation—Equipment.....		7,000
Unearned Advertising Revenue .....	1,400	
Advertising Revenue .....		1,400
Accounts Receivable .....	1,500	
Advertising Revenue .....		1,500
Supplies Expense (Art).....	3,400	
Supplies.....		3,400
Salaries and Wages Expense.....	1,300	
Salaries and Wages Payable.....		1,300

**Financial Statements**

**BUTLER ADVERTISING AGENCY  
Income Statement  
For the Year Ended December 31, 2014**

---

<b>Revenues</b>		
Advertising revenue.....		\$61,500
<b>Expenses</b>		
Salaries and wages expense .....	\$11,300	
Depreciation expense .....	7,000	
Rent expense.....	4,000	
Supplies expense .....	<u>3,400</u>	
Total expenses .....		<u>25,700</u>
<b>Net income.....</b>		<b><u>\$35,800</u></b>

PROFESSIONAL SIMULATION (Continued)

**BUTLER ADVERTISING AGENCY**  
**Balance Sheet**  
**December 31, 2014**

---

<b>Assets</b>		
Cash .....		<b>\$11,000</b>
Accounts receivable .....		<b>21,500</b>
Supplies .....		<b>5,000</b>
Equipment.....	<b>60,000</b>	
Less: Accumulated depreciation .....	<b><u>(35,000)</u></b>	<b><u>25,000</u></b>
<b>Total assets.....</b>		<b><u><u>\$62,500</u></u></b>

**Liabilities and Stockholders' Equity**

<b>Liabilities</b>		
Accounts payable.....	<b>\$5,000</b>	
Unearned advertising revenue .....	<b>5,600</b>	
Salaries and wages payable .....	<b><u>1,300</u></b>	<b>\$11,900</b>
 <b>Stockholders' Equity</b>		
Common stock.....	<b>10,000</b>	
Retained earnings .....	<b><u>40,600</u></b>	
<b>Total stockholders' equity</b>		<b><u>50,600</u></b>
<b>Total liabilities and</b>		
<b>stockholders' equity .....</b>		<b><u><u>\$62,500</u></u></b>

**Explanation**

After the financial statements are prepared, Butler must prepare the closing entries and post the journal entries to the general ledger. Then, a post-closing trial balance is prepared. Some companies may also prepare and post reversing entries.



## IFRS3-1

The date of transition is the beginning of the earliest period for which full comparative IFRS information is provided. The date of reporting is the closing balance sheet date for the first IFRS financial statements.

## IFRS3-2

When countries accept IFRS for use as accepted accounting policies, companies need guidance to ensure that their first IFRS financial statements contain high quality information. Specifically, *IFRS 1* requires that information in a company's first IFRS statements (1) be transparent, (2) provide a suitable starting point, and (3) have a cost that does not exceed the benefits.

## IFRS3-3

A company follows these steps:

1. Identify the timing of its first IFRS statements.
2. Prepare an opening balance sheet at the date of transition to IFRS.
3. Select accounting principles that comply with IFRS, and apply these principles retrospectively.
4. Make extensive disclosures to explain the transition to IFRS

## IFRS3-4

The date of the opening balance sheet is January 1, 2014. The IFRS financial statements will include years ended December 31, 2015 and 2014.

## IFRS3-5

### (a) Assets

- 53 The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

## IFRS3-5 (Continued)

- 54** An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.
- 55** The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:
- a. used singly or in combination with other assets in the production of goods or services to be sold by the entity;
  - b. exchanged for other assets;
  - c. used to settle a liability; or
  - d. distributed to the owners of the entity.

### (b) Liabilities

- 60** An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.
- 61** A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.

## IFRS3-5 (continued)

- 62** The settlement of a present obligation usually involves the entity giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:
- a.** payment of cash;
  - b.** transfer of other assets;
  - c.** provision of services;
  - d.** replacement of that obligation with another obligation; or
  - e.** conversion of the obligation to equity.

### **(c) Accrual basis**

- 22** In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

## IFRS3-6

- (a)** March 31, 2012 total assets: £7,273.3 million.  
April 2, 2011 total assets: £7,344.1 million.
- (b)** March 31, 2012 cash and cash equivalents: £196.10 million.
- (c)** 2012 selling and marketing expense: £3,021.9 million.  
2011 selling and marketing expense: £2,959.7 million.
- (d)** 2012 revenue: £9,934.3 million.  
2011 revenue: £9,740.3 million.

## IFRS3-6 (Continued)

- (e) **An adjusting entry for deferrals is necessary when the receipt/disbursement precedes the recognition in the financial statements. Accounts such as prepaid pension contributions and prepaid leasehold premiums are included in the Trade and other receivables section. Both of these accounts would require an adjusting entry to recognize the proper amount of expense incurred during the period. In addition, depreciation expense is an adjusting entry related to a deferral.**

**An adjusting entry for an accrual is necessary when recognition in the financial statements precedes the cash receipt/disbursement, such as interest or taxes payable. Other adjusting entries probably made by M&S include finance income and finance costs and bank and other interest receivable and interest payable.**

- (f) **2012 Depreciation and amortization expense: £479.70 million  
2011 Depreciation and amortization expense: £467.50 million**