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Accounting Principles

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CHAPTER 1

ACCOUNTING IN ACTION

SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
True-False Statements														
1.	1	K	9.	2	K	17.	4	K	25.	6	K	[sg]33.	1	K
2.	1	K	10.	2	K	18.	4	K	26.	6	K	[sg]34.	2	K
3.	1	C	11.	2	K	19.	4	K	27.	7	K	[sg]35.	3	K
4.	2	K	12.	2	K	20.	5	C	28.	7	C	[sg]36.	4	C
5.	2	K	13.	2	K	21.	5	K	29.	7	C	[sg]37.	5	K
6.	2	C	14.	2	K	22.	5	K	30.	7	C	[sg]38.	6	K
7.	2	K	15.	3	K	23.	5	K	31.	8	K	[sg]39.	7	K
8.	2	C	16.	4	K	24.	6	K	32.	8	K	[sg]40.	8	K
Multiple Choice Questions														
41.	1	K	66.	4	C	91.	6	C	116.	7	K	141.	8	AP
42.	1	K	67.	4	K	92.	6	K	117.	7	C	142.	8	AP
43.	1	K	68.	4	K	93.	6	K	118.	7	C	143.	8	AP
44.	1	C	69.	4	C	94.	6	C	119.	7	C	144.	8	AP
45.	1	K	70.	4	K	95.	6	K	120.	7	AN	145.	8	AP
46.	1	K	71.	4	K	96.	6	K	121.	7	C	146.	8	AP
47.	1	K	72.	4	C	97.	6	K	122.	8	C	147.	8	AN
48.	1	K	73.	4	K	98.	6	K	123.	8	C	148.	8	AN
49.	2	C	74.	5	K	99.	6	K	124.	8	K	149.	8	AN
50.	2	C	75.	5	K	100.	6	C	125.	8	K	150.	8	AN
51.	2	C	76.	5	K	101.	6	K	126.	8	K	151.	8	AN
52.	2	C	77.	5	K	102.	6	C	127.	8	K	[sg]152.	1	K
53.	2	C	78.	5	K	103.	6	AP	129.	8	C	[st]153.	1	K
54.	2	C	79.	5	C	104.	6	AP	129.	8	AP	[st]154.	1	K
[a]55.	9	K	80.	5	C	105.	6	AP	130.	8	AP	[sg]155.	2	K
[a]56.	9	K	81.	5	K	106.	6	AP	131.	8	AP	[st]156.	2	K
[a]57.	9	K	82.	5	K	107.	6	AP	132.	8	K	[sg]157.	4	K
[a]58.	9	C	83.	5	C	108.	7	C	133.	8	K	[st]158.	4	K
59.	2	K	84.	5	K	109.	7	AP	134.	8	AP	[sg]159.	5	K
60.	2	K	85.	5	K	110.	7	C	135.	8	AP	[sg]160.	6	K
61.	2	C	86.	5	K	111.	7	C	136.	8	AP	[sg]161.	7	C
62.	3	K	87.	5	K	112.	7	C	137.	8	AP	[sg]162.	7	C
63.	3	C	88.	6	K	113.	7	C	138.	8	AP	[sg]163.	8	K
64.	4	K	89.	6	K	114.	7	C	139.	8	AP			
65.	4	K	90.	6	K	115.	7	C	140.	8	AP			
Brief Exercises														
164.	2	C	167.	6	AP	170.	7	C	173.	8	AP			
165.	6	K	168.	6	AP	171.	8	AP	174.	8	AP			
166.	6	K	169.	6	C	172.	8	C						

[sg] This question also appears in the Study Guide.
[st] This question also appears in a self-test at the student companion website.
[a] This question covers a topic in an appendix to the chapter.

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SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Exercises													
175.	2,4	K	181.	6	C	187.	7	C	193.	7	C	199.	8	AP
176.	6	C	182.	6	AN	188.	7	AP	194.	8	AP	200.	8	AP
177.	6	C	183.	6	C	189.	7	C	195.	8	C	201.	8	AP
178.	6	AP	184.	7	C	190.	7	C	196.	8	AP			
179.	6	C	185.	7	AN	191.	7	C	197.	8	AN			
180.	6	AP	186.	7	C	192.	7	C	198.	8	C			
Completion Statements														
202.	1	K	204.	2	K	206.	4	K	208.	5	K	210.	6	K
203.	2	K	205.	2	K	207.	4	K	209.	6	K	211.	8	K

SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Study Objective 1													
1.	TF	33.	TF	43.	MC	46.	MC	152.	MC	202.	C		
2.	TF	41.	MC	44.	MC	47.	MC	153.	MC				
3.	TF	42.	MC	45.	MC	48.	MC	154.	MC				
Study Objective 2													
4.	TF	8.	TF	12.	TF	49.	MC	53.	MC	61.	MC	175.	Ex
5.	TF	9.	TF	13.	TF	50.	MC	54.	MC	155.	MC	203.	C
6.	TF	10.	TF	14.	TF	51.	MC	59.	MC	156.	MC	204.	C
7.	TF	11.	TF	34.	TF	52.	MC	60.	MC	164.	BE	205.	C
Study Objective 3													
15.	TF	35.	TF	62.	MC	63.	MC						
Study Objective 4													
16.	TF	19.	TF	65.	MC	68.	MC	71.	MC	157.	MC	206.	C
17.	TF	36.	TF	66.	MC	69.	MC	72.	MC	158.	MC	207.	C
18.	TF	64.	MC	67.	MC	70.	MC	73.	MC	175.	Ex		
Study Objective 5													
20.	TF	23.	TF	75.	MC	78.	MC	81.	MC	84.	MC	87.	MC
21.	TF	37.	TF	76.	MC	79.	MC	82.	MC	85.	MC	159.	MC
22.	TF	74.	MC	77.	MC	80.	MC	83.	MC	86.	MC	208.	C
Study Objective 6													
24.	TF	90.	MC	96.	MC	102.	MC	160.	MC	176.	Ex	182.	Ex
25.	TF	91.	MC	97.	MC	103.	MC	165.	BE	177.	Ex	183.	Ex
26.	TF	92.	MC	98.	MC	104.	MC	166.	BE	178.	Ex	209.	C
38.	TF	93.	MC	99.	MC	105.	MC	167.	BE	179.	Ex	210.	C
88.	MC	94.	MC	100.	MC	106.	MC	168.	BE	180.	Ex		
89.	MC	95.	MC	101.	MC	107.	MC	169.	BE	181.	Ex		

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SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Study Objective 7											
27.	TF	108.	MC	113.	MC	118.	MC	162.	MC	187.	Ex	192.	Ex
28.	TF	109.	MC	114.	MC	119.	MC	170.	BE	188.	Ex	193.	Ex
29.	TF	110.	MC	115.	MC	120.	MC	184.	Ex	189.	Ex		
30.	TF	111.	MC	116.	MC	121.	MC	185.	Ex	190.	Ex		
39.	TF	112.	MC	117.	MC	161.	MC	186.	Ex	191.	Ex		
Study Objective 8											
31.	TF	126.	MC	133.	MC	140.	MC	147.	MC	172.	BE	198.	Ex
32.	TF	127.	MC	134.	MC	141.	MC	148.	MC	173.	BE	199.	Ex
40.	TF	128.	MC	135.	MC	142.	MC	149.	MC	174.	BE	200.	Ex
122.	MC	129.	MC	136.	MC	143.	MC	150.	MC	194.	Ex	201.	Ex
123.	MC	130.	MC	137.	MC	144.	MC	151.	MC	195.	Ex	211.	C
124.	MC	131.	MC	138.	MC	145.	MC	163.	MC	196.	Ex		
125.	MC	132.	MC	139.	MC	146.	MC	171.	BE	197.	Ex		
Study Objective 9											
[a]55.	MC	[a]56.	MC	[a]57.	MC	[a]58.	MC						

Note: TF = True-False MC = Multiple Choice BE = Brief Exercise Ex = Exercise C = Completion

The chapter also contains one set of ten Matching questions and six Short-Answer Essay questions.

CHAPTER STUDY OBJECTIVES

1. ***Explain what accounting is.*** Accounting is an information system that identifies, records, and communicates the economic events of an organization to interested users.
2. ***Identify the users and uses of accounting.*** The major users and uses of accounting are: (a) Management uses accounting information in planning, controlling, and evaluating business operations. (b) Investors (owners) decide whether to buy, hold, or sell their financial interests on the basis of accounting data. (c) Creditors (suppliers and bankers) evaluate the risks of granting credit or lending money on the basis of accounting information. Other groups that use accounting information are taxing authorities, regulatory agencies, customers, labor unions, and economic planners.
3. ***Understand why ethics is a fundamental business concept.*** Ethics are the standards of conduct by which actions are judged as right or wrong. If you cannot depend on the honesty of the individuals you deal with, effective communication and economic activity would be impossible, and information would have no credibility.
4. ***Explain generally accepted accounting principles and the cost principle.*** Generally accepted accounting principles are a common set of standards used by accountants. The cost principle states that companies should record assets at their cost.
5. ***Explain the monetary unit assumption and the economic entity assumption.*** The monetary unit assumption requires that companies include in the accounting records only transaction data that can be expressed in terms of money. The economic entity assumption

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requires that the activities of each economic entity be kept separate from the activities of its owner and other economic entities.

6. ***State the accounting equation, and define assets, liabilities, and owner's equity.*** The basic accounting equation is:

   Assets = Liabilities + Owner's Equity

   Assets are resources owned by a business. Liabilities are creditorship claims on total assets. Owner's equity is the ownership claim on total assets.

7. ***Analyze the effects of business transactions on the accounting equation.*** Each business transaction must have a dual effect on the accounting equation. For example, if an individual asset increases, there must be a corresponding (1) decrease in another asset, or (2) increase in a specific liability, or (3) increase in owner's equity.

8. ***Understand the four financial statements and how they are prepared.*** An income statement presents the revenues and expenses of a company for a specified period of time. An owner's equity statement summarizes the changes in owner's equity that have occurred for a specific period of time. A balance sheet reports the assets, liabilities, and owner's equity of a business at a specific date. A statement of cash flows summarizes information about the cash inflows (receipts) and outflows (payments) for a specific period of time.

[a]9. ***Explain the career opportunities in accounting***. Accounting offers many different jobs in fields such as public and private accounting, government, and forensic accounting. Accounting is a popular major because there are many different types of jobs, with unlimited potential for career advancement.

TRUE-FALSE STATEMENTS

1. Owners of business firms are the only people who need accounting information.

2. Transactions that can be measured in dollars and cents are recorded in the financial information system.

3. The hiring of a new company president is an economic event recorded by the financial information system.

4. Management of a business enterprise is the major external user of information.

5. Accounting communicates financial information about a business enterprise to both internal and external users.

6. Accounting information is used only by external users with a financial interest in a business enterprise.

7. Financial statements are the major means of communicating accounting information to interested parties.

8. Bookkeeping and accounting are one and the same because the bookkeeping function includes the accounting process.

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9. The origins of accounting are attributed to Luca Pacioli, a famous mathematician.

10. The study of accounting will be useful only if a student is interested in working for a profit-oriented business firm.

11. Private accountants are accountants who are not employees of business enterprises.

12. The study of accounting is not useful for a business career unless your career objective is to become an accountant.

13. A working knowledge of accounting is not relevant to a lawyer or an architect.

14. Expressing an opinion as to the fairness of the information presented in financial statements is a service performed by CPAs.

15. Accountants rely on a fundamental business concept—ethical behavior—in reporting financial information.

16. The primary accounting standard-setting body in the United States is the International Accounting Standards Board.

17. The Financial Accounting Standards Board is a part of the Securities and Exchange Commission.

18. The Securities and Exchange Commission overseas U.S. financial markets and accounting standard-setting bodies.

19. The cost and fair market value of an asset are the same at the time of acquisition and in all subsequent periods.

20. Even though a partnership is not a separate legal entity, for accounting purposes the partnership affairs should be kept separate from the personal activities of the owners.

21. A partnership must have more than one owner.

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

23. The monetary unit assumption states that transactions that can be measured in terms of money should be recorded in the accounting records.

24. In order to possess future service potential, an asset must have physical substance.

25. Owners' claims to total business assets take precedence over the claims of creditors because owners invest assets in the business and are liable for losses.

26. The basic accounting equation states that Assets = Liabilities.

27. Accountants record both internal and external transactions.

28. Internal transactions do not affect the basic accounting equation because they are economic events that occur entirely within one company.

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29. The purchase of store equipment for cash reduces the owner's equity by an equal amount.

30. The purchase of office equipment on credit increases total assets and total liabilities.

31. The primary purpose of the statement of cash flows is to provide information about the cash receipts and cash payments of a company during a period.

32. Net income for the period is determined by subtracting total expenses and drawings from total revenues.

Additional True-False Questions

33. Identifying is the process of keeping a chronological diary of events measured in dollars and cents.

34. Management consulting includes examining the financial statements of companies and expressing an opinion as to the fairness of their presentation.

35. Accountants do not have to worry about issues of ethics.

36. At the time an asset is acquired, cost and value should be the same.

37. The monetary unit assumption requires that all dollar amounts be rounded to the nearest dollar.

38. The basic accounting equation is in balance when the creditor and ownership claims against the business equal the assets.

39. External transactions involve economic events between the company and some other enterprise or party.

40. In the owner's equity statement, revenues are listed first, followed by expenses, and net income (or net loss).

Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	7.	T	13.	F	19.	F	25.	F	31.	T	37.	F
2.	T	8.	F	14.	T	20.	T	26.	F	32.	F	38.	T
3.	F	9.	T	15.	T	21.	T	27.	T	33.	F	39.	T
4.	F	10.	F	16.	F	22.	T	28.	F	34.	F	40.	F
5.	T	11.	F	17.	F	23.	T	29.	F	35.	F		
6.	F	12.	F	18.	T	24.	F	30.	T	36.	T		

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MULTIPLE CHOICE QUESTIONS

41. Accountants refer to an economic event as a
    a. purchase.
    b. sale.
    c. transaction.
    d. change in ownership.

42. The process of recording transactions has become more efficient because
    a. fewer events can be quantified in financial terms.
    b. computers are used in processing business events.
    c. more people have been hired to record business transactions.
    d. business events are recorded only at the end of the year.

43. Communication of economic events is the part of the accounting process that involves
    a. identifying economic events.
    b. quantifying transactions into dollars and cents.
    c. preparing accounting reports.
    d. recording and classifying information.

44. Which of the following events cannot be quantified into dollars and cents and recorded as an accounting transaction?
    a. The appointment of a new CPA firm to perform an audit.
    b. The purchase of a new computer.
    c. The sale of store equipment.
    d. Payment of income taxes.

45. The use of computers in recording business events
    a. has made the recording process more efficient.
    b. does not use the same principles as manual accounting systems.
    c. has greatly impacted the identification stage of the accounting process.
    d. is economical only for large businesses.

46. The accounting process involves all of the following except
    a. identifying economic transactions that are relevant to the business.
    b. communicating financial information to users by preparing financial reports.
    c. recording nonquantifiable economic events.
    d. analyzing and interpreting financial reports.

47. The accounting process is correctly sequenced as
    a. identification, communication, recording.
    b. recording, communication, identification.
    c. identification, recording, communication.
    d. communication, recording, identification.

48. Which of the following techniques are *not* used by accountants to interpret and report financial information?
    a. Graphs
    b. Special memos for each class of external users
    c. Charts
    d. Ratios

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49. Which of the following would *not* be considered an internal user of accounting data for the XYZ Company?
    a. President of the company
    b. Production manager
    c. Merchandise inventory clerk
    d. President of the employees' labor union

50. Which of the following would *not* be considered an external user of accounting data for the XYZ Company?
    a. Internal Revenue Service Agent
    b. Management
    c. Creditors
    d. Customers

51. Which of the following would *not* be considered internal users of accounting data for a company?
    a. The president of a company
    b. The controller of a company
    c. Creditors of a company
    d. Salesmen of the company

52. Which of the following is an external user of accounting information?
    a. Labor unions
    b. Finance directors
    c. Company officers
    d. Managers

53. Which one of the following is *not* an external user of accounting information?
    a. Regulatory agencies
    b. Customers
    c. Investors
    d. All of these are external users

54. Bookkeeping differs from accounting in that bookkeeping primarily involves which part of the accounting process?
    a. Identification
    b. Communication
    c. Recording
    d. Analysis

[a]55. All of the following are services offered by public accountants except
    a. budgeting.
    b. auditing.
    c. tax planning.
    d. consulting.

[a]56. Which list below best describes the major services performed by public accountants?
    a. Bookkeeping, mergers, budgets
    b. Employee training, auditing, bookkeeping
    c. Auditing, taxation, management consulting
    d. Cost accounting, production scheduling, recruiting

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[a]57. Preparing tax returns and engaging in tax planning is performed by
a. public accountants only.
b. private accountants only.
c. both public and private accountants.
d. IRS accountants only.

[a]58. A private accountant can perform many activities in a business organization but would *not* work in
a. budgeting.
b. accounting information systems.
c. external auditing.
d. tax accounting.

59. The origins of accounting are generally attributed to the work of
a. Christopher Columbus.
b. Abner Doubleday.
c. Luca Pacioli.
d. Leonardo da Vinci.

60. Financial accounting provides economic and financial information for all of the following *except*
a. creditors.
b. investors.
c. managers.
d. other external users.

61. The final step in solving an ethical dilemma is to
a. identify and analyze the principal elements in the situation.
b. recognize an ethical situation.
c. identify the alternatives and weigh the impact of each alternative on stakeholders.
d. recognize the ethical issues involved.

62. The first step in solving an ethical dilemma is to
a. identify and analyze the principal elements in the situation.
b. identify the alternatives.
c. recognize an ethical situation and the ethical issues involved.
d. weigh the impact of each alternative on various stakeholders.

63. Ethics are the standards of conduct by which one's actions are judged as
a. right or wrong.
b. honest or dishonest.
c. fair or unfair.
d. all of these.

64. Generally accepted accounting principles are
a. income tax regulations of the Internal Revenue Service.
b. standards that indicate how to report economic events.
c. theories that are based on physical laws of the universe.
d. principles that have been proven correct by academic researchers.

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65. The cost principle requires that when assets are acquired, they be recorded at
    a. appraisal value.
    b. exchange price paid.
    c. selling price.
    d. list price.

66. The cost of an asset and its fair market value are
    a. never the same.
    b. the same when the asset is sold.
    c. irrelevant when the asset is used by the business in its operations.
    d. the same on the date of acquisition.

67. The body of theory underlying accounting is *not* based on
    a. physical laws of nature.
    b. concepts.
    c. principles.
    d. definitions.

68. The private sector organization involved in developing accounting principles is the
    a. Feasible Accounting Standards Body.
    b. Financial Accounting Studies Board.
    c. Financial Accounting Standards Board.
    d. Financial Auditors' Standards Body.

69. The SEC and FASB are two organizations that are primarily responsible for establishing generally accepted accounting principles. It is true that
    a. they are both governmental agencies.
    b. the SEC is a private organization of accountants.
    c. the SEC often mandates guidelines when no accounting principles exist.
    d. the SEC and FASB rarely cooperate in developing accounting standards.

70. GAAP stands for
    a. Generally Accepted Auditing Procedures.
    b. Generally Accepted Accounting Principles.
    c. Generally Accepted Auditing Principles.
    d. Generally Accepted Accounting Procedures.

71. Which of the following is *not* a characteristic of the cost principle?
    a. Reliability
    b. Subjectivity
    c. Objectivity
    d. Verifiability

72. The ACE Company has five plants nationwide that cost $100 million. The current market value of the plants is $500 million. The plants will be recorded and reported as assets at
    a. $100 million.
    b. $600 million.
    c. $400 million.
    d. $500 million.

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73. All of the following are advantages cost has over other valuations *except* that it
    a. is reliable.
    b. can be objectively measured.
    c. can be verified.
    d. is relevant.

74. The proprietorship form of business organization
    a. must have at least three owners in most states.
    b. represents the largest number of businesses in the United States.
    c. combines the records of the business with the personal records of the owner.
    d. is characterized by a legal distinction between the business as an economic unit and the owner.

75. The economic entity assumption requires that the activities
    a. of different entities can be combined if all the entities are corporations.
    b. must be reported to the Securities and Exchange Commission.
    c. of a sole proprietorship cannot be distinguished from the personal economic events of its owners.
    d. of an entity be kept separate from the activities of its owner.

76. A business organized as a corporation
    a. is not a separate legal entity in most states.
    b. requires that stockholders be personally liable for the debts of the business.
    c. is owned by its stockholders.
    d. terminates when one of its original stockholders dies.

77. The partnership form of business organization
    a. is a separate legal entity.
    b. is a common form of organization for service-type businesses.
    c. enjoys an unlimited life.
    d. has limited liability.

78. Which of the following is *not* an advantage of the corporate form of business organization?
    a. Limited liability of stockholders
    b. Transferability of ownership
    c. Unlimited personal liability for stockholders
    d. Unlimited life

79. A small neighborhood barber shop that is operated by its owner would likely be organized as a
    a. joint venture.
    b. partnership.
    c. corporation.
    d. proprietorship.

80. Joan and Sara met at law school and decide to start a small law practice after graduation. They agree to split revenues and expenses evenly. The most common form of business organization for a business such as this would be a
    a. joint venture.
    b. partnership.
    c. corporation.
    d. proprietorship.

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81. Which of the following is true regarding the corporate form of business organization?
    a. Corporations are the most prevalent form of business organization.
    b. Corporate businesses are generally smaller in size than partnerships and proprietorships.
    c. The revenues of corporations are greater than the combined revenues of partnerships and proprietorships.
    d. Corporations are separate legal entities organized exclusively under federal law.

82. A basic assumption of accounting that requires activities of an entity be kept separate from the activities of its owner is referred to as the
    a. stand alone concept.
    b. monetary unit assumption.
    c. corporate form of ownership.
    d. economic entity assumption.

83. Deb Smith is the proprietor (owner) of Smitty's, a retailer of athletic apparel. When recording the financial transactions of Smitty's, Deb does not record an entry for a car she purchased for personal use. Deb took out a personal loan to pay for the car. What accounting concept guides Deb's behavior in this situation?
    a. Pay back concept
    b. Economic entity assumption
    c. Cash basis concept
    d. Monetary unit assumption

84. A basic assumption of accounting assumes that the dollar is
    a. unrelated to business transactions.
    b. a poor measure of economic activities.
    c. the common unit of measure for all business transactions.
    d. useless in measuring an economic event.

85. The assumption that the unit of measure remains sufficiently constant over time is part of the
    a. economic entity assumption.
    b. cost principle.
    c. historical cost principle.
    d. monetary unit assumption.

86. A business that enjoys limited liability is a
    a. proprietorship.
    b. partnership.
    c. corporation.
    d. sole proprietorship.

87. A problem with the monetary unit assumption is that
    a. the dollar has not been stable over time.
    b. the dollar has been stable over time.
    c. the dollar is a common medium of exchange.
    d. it is impossible to account for international transactions.

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88. The common characteristic possessed by all assets is
    a. long life.
    b. great monetary value.
    c. tangible nature.
    d. future economic benefit.

89. Owner's equity is best depicted by the following:
    a. Assets = Liabilities.
    b. Liabilities + Assets.
    c. Residual equity + Assets.
    d. Assets – Liabilities.

90. The basic accounting equation may be expressed as
    a. Assets = Equities.
    b. Assets – Liabilities = Owner's Equity.
    c. Assets = Liabilities + Owner's Equity.
    d. all of these.

91. Liabilities
    a. are future economic benefits.
    b. are existing debts and obligations.
    c. possess service potential.
    d. are things of value used by the business in its operation.

92. Liabilities of a company would *not* include
    a. notes payable.
    b. accounts payable.
    c. wages payable.
    d. cash.

93. Liabilities of a company are owed to
    a. debtors.
    b. benefactors.
    c. creditors.
    d. underwriters.

94. Owner's equity can be described as
    a. creditorship claim on total assets.
    b. ownership claim on total assets.
    c. benefactor's claim on total assets.
    d. debtor claim on total assets.

95. Owner's equity is often referred to as
    a. residual equity.
    b. leftovers.
    c. spoils.
    d. second equity.

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96. When an owner withdraws cash or other assets from a business for personal use, these withdrawals are termed
    a. depletions.
    b. consumptions.
    c. drawings.
    d. a credit line.

97. Capital is
    a. an owner's permanent investment in the business.
    b. equal to liabilities minus owner's equity.
    c. equal to assets minus owner's equity.
    d. equal to liabilities plus drawings.

98. Revenues would *not* result from
    a. sale of merchandise.
    b. initial investment of cash by owner.
    c. performance of services.
    d. rental of property.

99. Sources of increases to owner's equity are
    a. additional investments by owners.
    b. purchases of merchandise.
    c. withdrawals by the owner.
    d. expenses.

100. The basic accounting equation *cannot* be restated as
    a. Assets – Liabilities = Owner's Equity.
    b. Assets – Owner's Equity = Liabilities.
    c. Owner's Equity + Liabilities = Assets.
    d. Assets + Liabilities = Owner's Equity.

101. Owner's equity is decreased by all of the following except
    a. owner's investments.
    b. owner's withdrawals.
    c. expenses.
    d. owner's drawings.

102. A net loss will result during a time period when
    a. liabilities exceed assets.
    b. drawings exceed investments.
    c. expenses exceed revenues.
    d. revenues exceed expenses.

103. If total liabilities increased by $15,000 and owner’s equity increased by $5,000 during a period of time, then total assets must change by what amount and direction during that same period?
    a. $20,000 decrease
    b. $20,000 increase
    c. $25,000 increase
    d. $30,000 increase

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104. If total liabilities decreased by $15,000 and owner's equity increased by $5,000 during a period of time, then total assets must change by what amount and direction during that same period?
   a. $20,000 increase
   b. $10,000 decrease
   c. $10,000 increase
   d. $15,000 decrease

105. If total liabilities decreased by $25,000 and owner's equity increased by $5,000 during a period of time, then total assets must change by what amount and direction during that same period?
   a. $20,000 decrease
   b. $20,000 increase
   c. $25,000 increase
   d. $30,000 increase

106. If total liabilities decreased by $15,000 and owner's equity decreased by $5,000 during a period of time, then total assets must change by what amount and direction during that same period?
   a. $20,000 increase
   b. $10,000 increase
   c. $20,000 decrease
   d. $10,000 decrease

107. If total liabilities increased by $14,000 during a period of time and owner's equity decreased by $6,000 during the same period, then the amount and direction (increase or decrease) of the period's change in total assets is a(n)
   a. $14,000 increase.
   b. $20,000 increase.
   c. $8,000 decrease.
   d. $8,000 increase.

108. The accounting equation for Goodboys Enterprises is as follows:

Assets		Liabilities		Owner's Equity
$120,000	=	$60,000	+	$60,000

   If Goodboys purchases office equipment on account for $12,000, the accounting equation will change to

	Assets		Liabilties		Owner's Equity
a.	$120,000	=	$60,000	+	$60,000
b.	$132,000	=	$60,000	+	$72,000
c.	$132,000	=	$66,000	+	$66,000
d.	$132,000	=	$72,000	+	$60,000

109. As of June 30, 2008, Houston Company has assets of $100,000 and owner's equity of $5,000. What are the liabilities for Houston Company as of June 30, 2008?
   a. $85,000
   b. $90,000
   c. $95,000
   d. $100,000

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110. Owner's equity is increased by
   a. drawings.
   b. revenues.
   c. expenses.
   d. liabilities.

111. Owner's equity is decreased by
   a. assets.
   b. revenues.
   c. expenses.
   d. liabilities.

112. If total liabilities increased by $4,000, then
   a. assets must have decreased by $4,000.
   b. owner's equity must have increased by $4,000.
   c. assets must have increased by $4,000, or owner's equity must have decreased by $4,000.
   d. assets and owner's equity each increased by $2,000.

113. Collection of a $500 Accounts Receivable
   a. increases an asset $500; decreases an asset $500.
   b. increases an asset $500; decreases a liability $500.
   c. decreases a liability $500; increases owner's equity $500.
   d. decreases an asset $500; decreases a liability $500.

114. Revenues are
   a. the cost of assets consumed during the period.
   b. gross increases in owner's equity resulting from business activities.
   c. the cost of services used during the period.
   d. actual or expected cash outflows.

115. If an individual asset is increased, then
   a. there must be an equal decrease in a specific liability.
   b. there must be an equal decrease in owner's equity.
   c. there must be an equal decrease in another asset.
   d. none of these is possible.

116. If services are rendered for credit, then
   a. assets will decrease.
   b. liabilities will increase.
   c. owner's equity will increase.
   d. liabilities will decrease.

117. If expenses are paid in cash, then
   a. assets will increase.
   b. liabilities will decrease.
   c. owner's equity will increase.
   d. assets will decrease.

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118. If an owner makes a withdrawal of cash from a proprietorship, then
   a. there has been a violation of accounting principles.
   b. owner's equity will increase.
   c. owner's equity will decrease.
   d. there will be a new liability showing the owner owes money to the business.

119. If supplies that have been purchased are used in the course of business, then
   a. a liability will increase.
   b. an asset will increase.
   c. owner's equity will decrease.
   d. owner's equity will increase.

120. As of December 31, 2008, Anders Company has assets of $35,000 and owner's equity of $20,000. What are the liabilities for Anders Company as of December 31, 2008?
   a. $15,000
   b. $10,000
   c. $25,000
   d. $20,000

121. Which of the following events is *not* a business transaction?
   a. Investment of cash by the owner
   b. Hired employees
   c. Incurred utility expenses for the month
   d. Earned revenue for services provided

122. Net income results when
   a. Assets > Liabilities.
   b. Revenues = Expenses.
   c. Revenues > Expenses.
   d. Revenues < Expenses.

123. Owner's capital at the end of the period is equal to
   a. owner's capital at the beginning of the period plus net income minus liabilities.
   b. owner's capital at the beginning of the period plus net income minus drawings.
   c. net income.
   d. assets plus liabilities.

124. A balance sheet shows
   a. revenues, liabilities, and owner's equity.
   b. expenses, drawings, and owner's equity.
   c. revenues, expenses, and drawings.
   d. assets, liabilities, and owner's equity.

125. An income statement
   a. summarizes the changes in owner's equity for a specific period of time.
   b. reports the changes in assets, liabilities, and owner's equity over a period of time.
   c. reports the assets, liabilities, and owner's equity at a specific date.
   d. presents the revenues and expenses for a specific period of time.

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126. If the owner's equity account increases from the beginning of the year to the end of the year, then
   a. net income is less than owner drawings.
   b. a net loss is less than owner drawings.
   c. additional owner investments are less than net losses.
   d. net income is greater than owner drawings.

Use the following information for questions 127–129.

Jimmy's Car Repair Shop started the year with total assets of $270,000 and total liabilities of $180,000. During the year, the business recorded $450,000 in car repair revenues, $255,000 in expenses, and Jimmy withdrew $45,000.

127. Jimmy's Capital balance at the end of the year was
   a. $240,000.
   b. $225,000.
   c. $285,000.
   d. $195,000.

128. The net income reported by Jimmy's Car Repair Shop for the year was
   a. $150,000.
   b. $195,000.
   c. $90,000.
   d. $405,000.

129. Jimmy's Capital balance changed by what amount from the beginning of the year to the end of the year?
   a. $45,000
   b. $195,000
   c. $90,000
   d. $150,000

130. The balance sheet is frequently referred to as
   a. an operating statement.
   b. the statement of financial position.
   c. the statement of cash flows.
   d. the statement of owner's equity.

131. The primary purpose of the statement of cash flows is to report
   a. a company's investing transactions.
   b. a company's financing transactions.
   c. information about cash receipts and cash payments of a company.
   d. the net increase or decrease in cash.

132. All of the financial statements are for a period of time *except* the
   a. income statement.
   b. owner's equity statement.
   c. balance sheet.
   d. statement of cash flows.

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133. The ending owner's equity amount is shown on
   a. the balance sheet only.
   b. the owner's equity statement only.
   c. both the income statement and the owner's equity statement.
   d. both the balance sheet and the owner's equity statement.

134. Benson Company began the year with owner's equity of $175,000. During the year, the company recorded revenues of $250,000, expenses of $190,000, and had owner drawings of $20,000. What was Benson's owner's equity at the end of the year?
   a. $255,000
   b. $215,000
   c. $405,000
   d. $235,000

135. Ed Dexter began the Dexter Company by investing $20,000 of cash in the business. The company recorded revenues of $185,000, expenses of $160,000, and had owner drawings of $10,000. What was Dexter's net income for the year?
   a. $15,000
   b. $35,000
   c. $25,000
   d. $45,000

136. Jenner Company began the year with owner's equity of $15,000. During the year, Jenner received additional owner investments of $21,000, recorded expenses of $60,000, and had owner drawings of $4,000. If Jenner's ending owner's equity was $46,000, what was the company's revenue for the year?
   a. $70,000
   b. $74,000
   c. $91,000
   d. $95,000

137. Janzen Company began the year with owner's equity of $217,000. During the year, Janzen received additional owner investments of $294,000, recorded expenses of $840,000, and had owner drawings of $56,000. If Janzen's ending owner's equity was $531,000, what was the company's revenue for the year?
   a. $860,000
   b. $916,000
   c. $1,154,000
   d. $1,210,000

Use the following information for questions 138-139.

Benny's Repair Shop started the year with total assets of $100,000 and total liabilities of $80,000. During the year, the business recorded $210,000 in revenues, $110,000 in expenses, and owner drawings of $20,000.

138. Owner's equity at the end of the year was
   a. $120,000.
   b. $100,000.
   c. $80,000.
   d. $90,000.

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139. The net income reported by Benny's Repair Shop for the year was
   a. $80,000.
   b. $100,000.
   c. $60,000.
   d. $190,000.

Use the following information for questions 140–141.

Berwick Company compiled the following financial information as of December 31, 2008:

Revenues	$140,000
Berwick, Capital (1/1/08)	105,000
Equipment	40,000
Expenses	125,000
Cash	35,000
Berwick, Drawings	10,000
Supplies	5,000
Accounts payable	20,000
Accounts receivable	15,000

140. Berwick's assets on December 31, 2008 are
   a. $235,000.
   b. $170,000.
   c. $80,000.
   d $95,000.

141. Berwick's owner's equity on December 31, 2008 is
   a. $105,000.
   b. $110,000.
   c. $80,000.
   d. $120,000.

142. Ironton Company's owner's equity at the beginning of August 2008 was $300,000. During the month, the company earned net income of $60,000 and owner's drawings were $20,000. At the end of August 2008, what is the balance in owner's equity?
   a. $260,000
   b. $300,000
   c. $340,000
   d. $380,000

143. On January 1, 2008, Jackson Company reported owner's equity of $470,000. During the year, the owner withdrew cash of $20,000. At December 31, 2008, the balance in owner's equity was $500,000. What amount of net income or net loss would the company report for 2008?
   a. Net income of $30,000
   b. Net loss of $50,000
   c. Net income of $10,000
   d. Net income of $50,000

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Use the following information for questions 144–146.

Jenkins Catering started the year with total assets of $20,000 and total liabilities of $5,000. During the year, the business recorded $16,000 in catering revenues and $8,000 in expenses. Jenkins made an additional investment of $3,000 and withdrew cash of $5,000 during the year.

144. The owner's equity at the end of the year was
   a. $21,000.
   b. $18,000.
   c. $8,000.
   d. $2,000.

145. The net income reported by Jenkins Catering for the year was
   a. $16,000.
   b. $11,000.
   c. $8,000.
   d. $3,000.

146. Owner's equity changed by what amount from the beginning of the year to the end of the year?
   a. $15,000
   b. $14,000
   c. $6,000
   d. $3,000

147. During the year 2008, Toronto Enterprises earned revenues of $45,000, had expenses of $25,000, purchased assets with a cost of $5,000 and had owner drawings of $3,000. Net income for the year is
   a. $45,000.
   b. $20,000.
   c. $17,000.
   d. $15,000.

148. At October 1, Bennington Enterprises reported owner's equity of $35,000. During October, no additional investments were made and the company earned net income of $4,000. If owner's equity at October 31 totals $32,000, what amount of owner drawings were made during the month?
   a. $0
   b. $1,000
   c. $3,000
   d. $7,000

149. At October 1, Bennington Enterprises reported owner's equity of $35,000. During October, no additional investments were made and the company posted a net loss of $3,000. If owner's equity at October 31 totals $32,000, what amount of owner drawings were made during the month?
   a. $0
   b. $1,000
   c. $3,000
   d. $7,000

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150. At October 1, Bennington Enterprises reported owner's equity of $35,000. During October, the owner made additional investments of $2,000 and the company earned net income of $6,000. If owner's equity at October 31 totals $40,000, what amount of owner drawings were made during the month?
   a. $0
   b. $3,000
   c. $4,000
   d. $5,000

151. At October 1, Bennington Enterprises reported owner's equity of $35,000. During October, the owner made additional investments of $5,000 and the company posted a net loss of $3,000. If owner's equity at October 31 totals $35,000, what amount of owner drawings were made during the month?
   a. $0
   b. $2,000
   c. $3,000
   d. $5,000

Additional Multiple Choice Questions

152. Which of the following is *not* part of the accounting process?
   a. Recording
   b. Identifying
   c. Financial decision making
   d. Communicating

153. The first part of the accounting process is
   a. communicating.
   b. identifying.
   c. processing.
   d. recording.

154. Keeping a systematic, chronological diary of events that are measured in dollars and cents is called
   a. communicating.
   b. identifying.
   c. processing.
   d. recording.

155. Auditing is
   a. the examination of financial statements by a CPA in order to express an opinion on their fairness.
   b. a part of accounting that involves only recording of economic events.
   c. an area of accounting that involves such activities as cost accounting, budgeting, and accounting information systems.
   d. conducted by the Securities and Exchange Commission to ensure that registered financial statements are presented fairly.

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156. Internal users of accounting information include all of the following *except*
   a. company officers.
   b. investors.
   c. marketing managers.
   d. production supervisors.

157. The organization(s) primarily responsible for establishing generally accepted accounting principles is(are) the

	FASB	SEC
a.	no	no
b.	yes	no
c.	no	yes
d.	yes	yes

158. The primary accounting standard-setting body in the United States is the
   a. Financial Accounting Standards Board.
   b. International Accounting Standards Board.
   c. Internal Revenue Service.
   d. Securities and Exchange Commission.

159. A proprietorship is a business
   a. owned by one person.
   b. owned by two or more persons.
   c. organized as a separate legal entity under state corporation law.
   d. owned by a governmental agency.

160. A net loss will result during a time period when
   a. assets exceed liabilities.
   b. assets exceed owner's equity.
   c. expenses exceed revenues.
   d. revenues exceed expenses.

161. The Ryder's Uptown Grill received a bill of $400 from the Erml Advertising Agency. The owner, John Ryder, is postponing payment of the bill until a later date. The effect on specific items in the basic accounting equation is
   a. a decrease in Cash and an increase in Accounts Payable.
   b. a decrease in Cash and an increase in J. Ryder, Capital.
   c. an increase in Accounts Payable and a decrease in J. Ryder, Capital.
   d. a decrease in Accounts Payable and an increase in J. Ryder, Capital.

162. James Company purchases $600 of equipment from Mundelein Inc. for cash. The effect on the components of the basic accounting equation of James Company is
   a. an increase in assets and liabilities.
   b. a decrease in assets and liabilities.
   c. no change in total assets.
   d. an increase in assets and a decrease in liabilities.

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163. Morreale Beaver Company buys a $12,000 van on credit. The transaction will affect the
a. income statement only.
b. balance sheet only.
c. income statement and owner's equity statement only.
d. income statement, owner's equity statement, and balance sheet.

Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
41.	c	59.	c	77.	b	95.	a	113.	a	131.	c	149.	a
42.	b	60.	c	78.	c	96.	c	114.	b	132.	c	150.	b
43.	c	61.	c	79.	d	97.	a	115.	c	133.	d	151.	b
44.	a	62.	c	80.	b	98.	b	116.	c	134.	b	152.	c
45.	a	63.	d	81.	c	99.	a	117.	d	135.	c	153.	b
46.	c	64.	b	82.	d	100.	d	118.	c	136.	b	154.	d
47.	c	65.	b	83.	b	101.	a	119.	c	137.	b	155.	a
48.	b	66.	d	84.	c	102.	c	120.	a	138.	b	156.	b
49.	d	67.	a	85.	d	103.	b	121.	b	139.	b	157.	d
50.	b	68.	c	86.	c	104.	b	122.	c	140.	d	158.	a
51.	c	69.	c	87.	a	105.	a	123.	b	141.	b	159.	a
52.	a	70.	b	88.	d	106.	c	124.	d	142.	c	160.	c
53.	d	71.	b	89.	d	107.	d	125.	d	143.	d	161.	c
54.	c	72.	a	90.	d	108.	d	126.	d	144.	a	162.	c
[a]55.	a	73.	d	91.	b	109.	c	127.	a	145.	c	163.	b
[a]56.	c	74.	b	92.	d	110.	b	128.	b	146.	c		
[a]57.	c	75.	d	93.	c	111.	c	129.	d	147.	b		
[a]58.	c	76.	c	94.	b	112.	c	130.	b	148.	d		

BRIEF EXERCISES

BE 164

Match the following external users of financial accounting information with the type of decision that user will make with the information.

a. Creditor
b. Investor
c. Regulatory Agency
d Internal Revenue Service

_____ (1) Is the company operating within prescribed guidelines?

_____ (2) Is the company complying with tax laws?

_____ (3) Is the company able to pay its debts?

_____ (4) Is the company a good investment?

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Solution 164 (3 min.)

1. c
2. d
3. a
4. b

BE 165

Match the following terms and definitions.

a. Accounts receivable
b. Creditor
c. Accounts payable
d. Note payable

_____ (1) Amounts due from customers

_____ (2) Amounts owed to suppliers for goods and services purchased

_____ (3) Amounts owed to bank

_____ (4) Party to whom money is owed

Solution 165 (3 min.)

1. a
2. c
3. d
4. b

BE 166

Indicate which of these items is an asset (A), liability (L) or owner's equity (OE) account.

_____ (1) Supplies

_____ (2) Klein, Drawing

_____ (3) Building

_____ (4) Note Payable

_____ (5) Taxes Payable

Solution 166 (3 min.)

1. Assets (A)
2. Owner's equity (OE)
3. Asset (A)
4. Liability (L)
5. Liability (L)

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BE 167

Use the accounting equation to answer the following questions.

1. West Wind Sails Co. has total assets of $120,000 and total liabilities of $35,000. What is owner's equity?
2. Mercy Family Center has total assets of $225,000 and owner's equity of $105,000. What are total liabilities?
3. Cucina Med Restaurant has total liabilities of $40,000 and owner's equity of $95,000. What are total assets?

Solution 167 (5 min.)

1. $120,000 – $35,000 = $85,000 owner's equity
2. $225,000 – $105,000 = $120,000 total liabilities
3. $40,000 + $95,000 = $135,000 total assets

BE 168

Determine the missing items.

Assets	=	Liabilities	+	Owner's Equity
$75,000		$52,000		(a)
(b)		$28,000		$34,000
$84,000		(c)		$55,000

Solution 168 (5 min.)

a. $23,000
b. $62,000
c. $29,000

BE 169

Classify each of these items as an asset (A), liability (L), or owner's equity (OE).

_____ 1. Accounts receivable
_____ 2. Accounts payable
_____ 3. Bonds, Capital
_____ 4. Office supplies
_____ 5. Utilities expense
_____ 6. Cash
_____ 7. Note payable
_____ 8. Equipment

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Solution 169 (5 min.)

1. A
2. L
3. OE
4. A
5. OE
6. A
7. L
8. A

BE 170

Identify the impact on the accounting equation of each of the following transactions.

1. Purchase office supplies on account.
2. Paid secretary weekly salary.
3. Purchased office furniture for cash.
4. Received monthly utility bill to be paid at later time.

Solution 170 (5 min.)

1. Increase assets and increase liabilities.
2. Decrease assets and decrease owner's equity.
3. Increase assets and decrease assets.
4. Increase liabilities and decrease owner's equity.

BE 171

Balance sheet amounts as of December 31, 2008 for Lesley's Tutoring Service are listed below. Prepare a balance sheet in good form.

Accounts Payable	$ 200
Accounts Receivable	1,000
Cash	500
Lesley, Capital	?

Solution 171 (5 min.)

LESLEY's TUTORING SERVICE
Balance Sheet
December 31, 2008

Assets		Liabilities and Owner's Equity	
Cash	$ 500	Accounts Payable	$ 200
Accounts Receivable	1,000	Lesley, Capital	1,300
Total assets	$1,500	Total liabilities and Owner's equity	$1,500

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BE 172

Identify whether the following items would be reported on the income statement (IS) or balance sheet (BS).

1. Cash
2. Service Revenue
3. Notes Payable
4. Interest Expense
5. Accounts Receivable

Solution 172 (3 min.)

1. Balance Sheet (BS)
2. Income Statement (IS)
3. Balance Sheet (BS)
4. Income Statement (IS)
5. Balance Sheet (BS)

BE 173

Use the following information to calculate for the year ended December 31, 2008 (a) net income (net loss), (b) ending owner's equity, and (c) total assets.

Supplies	$ 1,000	Revenues	$23,000
Operating expenses	12,000	Cash	15,000
Accounts payable	9,000	Drawings	1,000
Accounts receivable	3,000	Notes payable	1,000
Beginning Capital	5,000	Equipment	6,000

Solution 173 (5 min.)

(a) $11,000 (b) $3,000 (c) $25,000

BE 174

Listed below in alphabetical order are the balance sheet items of Mowen Company at December 31, 2008. Prepare a balance sheet and include a complete heading.

Accounts payable	$ 6,000
Accounts receivable	15,000
Building	96,000
Cash	11,000
Mowen, Capital	121,000
Office equipment	5,000

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Solution 174 (5 min.)

MOWEN COMPANY
Balance Sheet
December 31, 2008

ASSETS

Cash	$ 11,000
Accounts receivable	15,000
Office equipment	5,000
Building	96,000
Total assets	$127,000

LIABILITIES AND OWNER'S EQUITY

Liabilities	
Accounts payable	$ 6,000
Owner's equity	
Mowen, Capital	121,000
Total liabilities and owner's equity	$127,000

EXERCISES

Ex. 175

Below is a list of important abbreviations widely used in business. For each abbreviation give the full designation.

1. CPA _____
2. IRS _____
3. FBI _____
4. FASB _____
5. GAAP _____
6. SEC _____

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Solution 175 (5 min.)

1. Certified Public Accountant
2. Internal Revenue Service
3. Federal Bureau of Investigation
4. Financial Accounting Standards Board
5. Generally Accepted Accounting Principles
6. Securities and Exchange Commission

Ex. 176

Determine the missing amount for each of the following.

	Assets	=	Liabilities	+	Owner's Equity
1.	(a)		$50,000		$95,000
2.	$125,000		(b)		$85,000
3.	$140,000		$65,000		(c)

Solution 176 (5 min.)

1. (a) = $145,000 ($50,000 + $95,000)
2. (b) = $40,000 ($125,000 - $85,000)
3. (c) = $75,000 ($140,000 - $65,000)

Ex. 177

For the items listed below, fill in the appropriate code letter to indicate whether the item is an asset, liability, or owner's equity item.

	Code
Asset	A
Liability	L
Owner's Equity	OE

_____ 1. Rent Expense

_____ 2. Office Equipment

_____ 3. Accounts Payable

_____ 4. Dan Pine, Capital

_____ 5. Insurance Expense

_____ 6. Cash

_____ 7. Accounts Receivable

_____ 8. Dan Pine, Drawing

_____ 9. Service Revenue

_____ 10. Notes Payable

Solution 177 (5 min.)

1. OE
2. A
3. L
4. OE
5. OE
6. A
7. A
8. OE
9. OE
10. L

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Ex. 178

At the beginning of the year, Yates Company had total assets of $550,000 and total liabilities of $200,000. Answer the following questions viewing each situation as being independent of the others.

(1) If total assets increased $200,000 during the year, and total liabilities decreased $75,000, what is the amount of owner's equity at the end of the year?

(2) During the year, total liabilities increased $230,000 and owner's equity decreased $90,000. What is the amount of total assets at the end of the year?

(3) If total assets decreased $40,000 and owner's equity increased $130,000 during the year, what is the amount of total liabilities at the end of the year?

Solution 178 (5 min.)

	Total Assets		Total Liabilities		Owner's Equity
Beginning	$550,000		$200,000		
Change	200,000		(75,000)		
Ending	$750,000	–	$125,000	=	$625,000 (1)

	Total Assets		Total Liabilities		Owner's Equity
Beginning	$550,000		$200,000		$350,000
Change			230,000		(90,000)
Ending	$690,000 (2)	=	$430,000	+	$260,000

	Total Assets		Total Liabilities		Owner's Equity
Beginning	$550,000		$200,000		$350,000
Change	(40,000)				130,000
Ending	$510,000	=	$ 30,000 (3)	+	$480,000

Ex. 179

Jimmy's Carpet Cleaning has the following balance sheet items:

Van	Notes Payable
Accounts Payable	J. Fine, Capital
Cash	J. Fine, Drawing
Cleaning Supplies	Equipment
Accounts Receivable	

Identify which items are
(1) Assets
(2) Liabilities
(3) Owner's Equity

Solution 179 (5 min.)

(1) Assets—Van, Cash, Cleaning Supplies, Accounts Receivable, Equipment
(2) Liabilities—Accounts Payable, Notes Payable
(3) Owner's Equity— J. Fine, Capital, J. Fine, Drawing

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Ex. 180

On June 1, 2008, Gore Company prepared a balance sheet that shows the following:

Assets (no cash)	$100,000
Liabilities	70,000
Owner's Equity	30,000

Shortly thereafter, all of the assets were sold for cash. How would the balance sheet appear immediately after the sale of the assets for cash for each of the following cases?

	Cash Received for the Assets	Balances Immediately After Sale				
		Assets	–	Liabilities	=	Owner's Equity
Cash A	$110,000	$_____		$_____		$_____
Cash B	100,000	_____		_____		_____
Cash C	90,000	_____		_____		_____

Solution 180 (5 min.)

	Cash Received for the Assets	Balances Immediately After Sale				
		Assets	–	Liabilities	=	Owner's Equity
Cash A	$110,000	$110,000		$70,000		$40,000
Cash B	100,000	100,000		70,000		30,000
Cash C	90,000	90,000		70,000		20,000

Ex. 181

At the beginning of 2008, Clemens Company had total assets of $550,000 and total liabilities of $330,000. Answer each of the following questions.

1. If total assets increased $60,000 and owner's equity decreased $90,000 during the year, determine the amount of total liabilities at the end of the year.
2. During the year, total liabilities decreased $75,000 and owner's equity increased $50,000. Compute the amount of total assets at the end of the year.
3. If total assets decreased $100,000 and total liabilities increased $55,000 during the year, determine the amount of owner's equity at the end of the year.

Solution 181 (5 min.)

1. Ending Total Liabilities = ($550,000 + $60,000) – ($550,000 – $330,000 - $90,000)
   = $610,000 – $130,000 = $480,000
2. Ending Total Assets = ($330,000 – $75,000) + ($550,000 – $330,000 + $50,000)
   = $255,000 + $270,000 = $525,000
3. Ending Owner's Equity = ($550,000 – $100,000) – ($330,000 + $55,000)
   = $450,000 – $385,000 = $65,000

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Ex. 182

Compute the missing amount in each category of the accounting equation.

	Assets	Liabilities	Owner's Equity
(a)	$349,000	$?	$143,000
(b)	$223,000	$ 79,000	$?
(c)	$?	$253,000	$325,000

Solution 182 (5 min.)

(a) $206,000 ($349,000 – $143,000 = $206,000).
(b) $144,000 ($223,000 – $79,000 = $144,000).
(c) $578,000 ($253,000 + $325,000 = $578,000).

Ex. 183

From the following list of selected accounts taken from the records of Grayson Clinic, identify those that would appear on the balance sheet.

a. Meg Grayson, Capital
b. Patient Revenue
c. Land
d. Wages Expense
e. Notes Payable
f. Accounts Payable
g. Cash
h. Rent Expense
i. Medical Supplies
j. Utilities Expense

Solution 183 (5 min.)

a, c, e, f, g, i

Ex. 184

For each of the following, indicate whether the transaction affects revenue (R), expense (E), owner's drawing (D), owner's investment (I), or no effect on owner's equity (NOE).

1. Made an investment to start the business.
2. Billed customers for services performed.
3. Purchased equipment on account.
4. Paid monthly rent.
5. Withdrew cash for personal use.

Solution 184 (5 min.)

1. Investment (I)
2. Revenue (R)
3. No effect (NOE)
4. Expense (E)
5. Drawing (D)

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Ex. 185

Presented below is a balance sheet for Jim Dixon Lawn Service at December 31, 2008.

JIM DIXON LAWN SERVICE
Balance Sheet
December 31, 2008

Assets		Liabilities and Owner's Equity	
Cash	$13,000	Liabilities	
Accounts receivable	6,000	Accounts payable	$ 8,000
Supplies	9,000	Notes payable	15,000
Equipment	11,000	Owner's equity	
		Jim Dixon, Capital	16,000
Total assets	$39,000	Total liabilities & owner's equity	$39,000

The following additional data are available for the year which began on January 1: All expenses (excluding supplies expense) total $6,000. Supplies on January 1, were $11,000 and $5,000 of supplies were purchased during the year. Net income for the year was $8,000 and drawings were $6,000.

Instructions
Determine the following: (Show all computations.)
1. Supplies used during the year.
2. Total expenses for the year.
3. Service revenues for the year.
4. Jim Dixon's capital balance on January 1.

Solution 185 (10 min.)

1. Computation of Supplies Used:

Beginning Supplies, Jan. 1	$11,000
Add: Purchases	5,000
Less: Ending Supplies, Dec. 31	(9,000)
Equals: Supplies Used	$ 7,000

2. Computation of Total Expenses:

All Expenses (excluding supplies expense)	$ 6,000
Plus: Supplies Used	7,000
Total Expenses	$13,000

3. Computation of Revenues:

Net Income	$ 8,000
Plus: Total Expenses	13,000
Total Revenues	$21,000

4. Computation of Dixon, Capital on January 1:

Capital, December 31	$16,000
Plus: Drawings	6,000
Less: Net Income	(8,000)
Capital, January 1	$14,000

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Ex. 186

Analyze the transactions of a business organized as a proprietorship described below and indicate their effect on the basic accounting equation. Use a plus sign (+) to indicate an increase and a minus sign (–) to indicate a decrease.

	Assets	=	Liabilities	+	Owner's Equity
1. Received cash for services rendered.	_____		_____		_____
2. Purchased office equipment on credit.	_____		_____		_____
3. Paid employees' salaries.	_____		_____		_____
4. Received cash from customer in payment on account.	_____		_____		_____
5. Paid telephone bill for the month.	_____		_____		_____
6. Paid for office equipment purchased in transaction 2.	_____		_____		_____
7. Purchased office supplies on credit.	_____		_____		_____
8. Owner withdrew cash for personal expenses.	_____		_____		_____
9. Obtained a loan from the bank.	_____		_____		_____
10. Billed customers for services rendered.	_____		_____		_____

Solution 186 (10 min.)

	Assets	=	Liabilities	+	Owner's Equity
1. Received cash for services rendered.	+				+
2. Purchased office equipment on credit.	+		+		
3. Paid employees' salaries.	–				–
4. Received cash from customer in payment on account.	+,–				
5. Paid telephone bill for the month.	–				–
6. Paid for office equipment purchased in transaction 2.	–		–		
7. Purchased office supplies on credit.	+		+		
8. Owner withdrew cash for personal expenses.	–				–
9. Obtained a loan from the bank.	+		+		
10. Billed customers for services rendered.	+				+

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Ex. 187

For each of the following, indicate whether the transaction increased (+), decreased (-), or had no effect (NE) on assets, liabilities, and owner's equity using the following format.

Assets = Liabilities + Owner's Equity

1. Made an investment to start the business.
2. Billed customers for services performed.
3. Purchased equipment on account.
4. Withdrew cash for personal use.
5. Paid for equipment purchased in 3. above.

Solution 187 (5 min.)

	Assets	=	Liabilities	+	Owner's Equity
1.	+		NE		+
2.	+		NE		+
3.	+		+		NE
4.	–		NE		–
5.	–		–		NE

Ex. 188

Ron Benes decides to open a cleaning and laundry service near the local college campus that will operate as a sole proprietorship. Analyze the following transactions for the month of June in terms of their effect on the basic accounting equation. Record each transaction by increasing (+) or decreasing (–) the dollar amount of each item affected. Indicate the new balance of each item after a transaction is recorded. It is not necessary to identify the cause of changes in owner's equity.

Transactions

(1) Ron Benes invests $20,000 in cash to start a cleaning and laundry business on June 1.
(2) Purchased laundry equipment for $5,000 paying $3,000 in cash and the remainder due in 30 days.
(3) Purchased laundry supplies for $1,200 cash.
(4) Received a bill from Campus News for $300 for advertising in the campus newspaper.
(5) Cash receipts from customers for cleaning and laundry amounted to $1,500.
(6) Paid salaries of $200 to student workers.
(7) Billed the Tiger Football Team $200 for cleaning and laundry services.
(8) Paid $300 to Campus News for advertising that was previously billed in Transaction 4.
(9) Ron Benes withdrew $900 from the business for living expenses.
(10) Incurred utility expenses for month on account, $400.

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Ex. 188 (cont.)

Trans-action	Cash	+	Accounts Receivable	+	Laundry Supplies	+	Laundry Equipment	=	Accounts Payable	+	R. Benes Capital
(1)											
Balance											
(2)											
Balance											
(3)											
Balance											
(4)											
Balance											
(5)											
Balance											
(6)											
Balance											
(7)											
Balance											
(8)											
Balance											
(9)											
Balance											
(10)											
Totals											

Solution 188 (20 min.)

Trans-action	Cash	+	Accounts Receivable	+	Laundry Supplies	+	Laundry Equipment	=	Accounts Payable	+	R. Benes Capital
(1)	+$20,000										+$20,000
Balance	$20,000										$20,000
(2)	– 3,000						+$5,000		+$2,000		
Balance	$17,000						$5,000		$2,000		$20,000
(3)	– 1,200				+$1,200						
Balance	$15,800				$1,200		$5,000		$2,000		$20,000
(4)									+ 300		– 300

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Solution 188 (cont.)

Trans-action	Cash	+	Accounts Receivable	+	Laundry Supplies	+	Laundry Equipment	=	Accounts Payable	+	R. Benes Capital
Balance	$15,800				$1,200		$5,000		$2,300		$19,700
(5)	+ 1,500										+ 1,500
Balance	$17,300				$1,200		$5,000		$2,300		$21,200
(6)	– 200										– 200
Balance	$17,100				$1,200		$5,000		$2,300		$21,000
(7)			+$200								+ 200
Balance	$17,100		$200		$1,200		$5,000		$2,300		$21,200
(8)	– 300								– 300		
Balance	$16,800		$200		$1,200		$5,000		$2,000		$21,200
(9)	– 900										– 900
Balance	$15,900		$200		$1,200		$5,000		$2,000		$20,300
(10)									+ 400		– 400
Totals	$15,900		$200		$1,200		$5,000		$2,400		$19,900

Ex. 189

For each of the following, describe a transaction that will have the stated effect on the elements of the accounting equation.

(a) Increase one asset and decrease another asset.
(b) Increase an asset and increase a liability.
(c) Decrease an asset and decrease a liability.
(d) Increase an asset and increase owner's equity.
(e) Increase one asset, decrease one asset, and increase a liability.

Solution 189 (5 min.)

(a) Receive cash from customers on account.
Purchase supplies for cash.

(b) Purchase supplies on account.
Purchase equipment and signed a note payable.

(c) Pay cash to reduce accounts payable.
Pay cash to reduce a note payable.

(d) Initial contribution by an owner.
Additional contributions by an owner.
Render services on account.

(e) Buy equipment with a cash down payment with the remainder financed by a note payable.

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Ex. 190

The following transactions represent part of the activities of Lyon Company for the first month of its existence. Indicate the effect of each transaction upon the total assets of the business by one of the following phrases: increased total assets, decreased total assets, or no change in total assets.

(a) The owner invested cash to start the business.
(b) Purchased a computer for cash.
(c) Purchased office equipment with money borrowed from the bank.
(d) Paid the first month's utility bill.
(e) Collected an accounts receivable.
(f) Owner withdrew cash from the business.

Solution 190 (5 min.)

(a) Increased total assets.
(b) No change in total assets.
(c) Increased total assets.
(d) Decreased total assets.
(e) No change in total assets.
(f) Decreased total assets.

Ex. 191

Selected transactions for Barden Company are listed below. List the number of the transaction and then describe the effect of each transaction on assets, liabilities, and owner's equity.

Sample: Made initial cash investment in the business.
The answer would be—Increase in assets and increase in owner's equity.

1. Paid monthly utility bill.
2. Purchased new display case for cash.
3. Paid cash for repair work on security system.
4. Billed customers for services performed.
5. Received cash from customers billed in 4.
6. Withdrew cash for owner's personal use.
7. Incurred advertising expenses on account.
8. Paid monthly rent.
9. Received cash from customers when service was rendered.

Solution 191 (5 min.)

1. Decrease in assets and decrease in owner's equity.
2. No net change in assets.
3. Decrease in assets and decrease in owner's equity.
4. Increase in assets and increase in owner's equity.
5. No net change in assets.
6. Decrease in assets and decrease in owner's equity.
7. Increase in liabilities and decrease in owner's equity.
8. Decrease in assets and decrease in owner's equity.
9. Increase in assets and increase in owner's equity.

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Ex. 192

A service proprietorship shows five transactions summarized below. The effect of each transaction on the accounting equation is shown, and also the new balance of each item in the equation. For each transaction (a) to (e) write an explanation of the nature of the transaction.

	Cash	+	Accounts Rec.	+	Equip-ment	+	Land	+	Building	=	Accounts Payable	+	Capital
	$5,000		$6,500		$10,000		$7,500		$50,000		$3,000		$76,000
a)	–2,000										–2,000		
	3,000		6,500		10,000		7,500		50,000		1,000		76,000
b)	+1,000		– 1,000										
	4,000		5,500		10,000		7,500		50,000		1,000		76,000
c)					+ 5,000						+5,000		
	4,000		5,500		15,000		7,500		50,000		6,000		76,000
d)	+2,500												+ 2,500
	6,500		5,500		15,000		7,500		50,000		6,000		78,500
e)			+3,000										+ 3,000
	$6,500		$8,500		$15,000		$7,500		$50,000		$6,000		$81,500

Solution 192 (5 min.)

(a) Paid cash to creditors.
(b) Received cash from customers on account.
(c) Bought equipment on account.
(d) Additional investment by owner or services rendered to customers for cash.
(e) Services rendered on account.

Ex. 193

There are ten transactions listed below. Match the transactions that have the identical effect on the accounting equation. You should end up with 5 matches.

a. Receive cash from customers on account.
b. Initial cash contribution by an owner.
c. Pay cash to reduce an accounts payable.
d. Purchase supplies for cash.
e. Pay cash to reduce a notes payable.
f. Purchase supplies on account.
g. Additional cash contribution by an owner.
h. Purchase equipment with a note payable.
i. Pay utilities with cash.
j. Owner withdraws money from the business for personal use.

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Solution 193 (10 min.)

Match #1 = a, d
#2 = c, e
#3 = f, h
#4 = b, g
#5 = i, j

Ex. 194

Prepare an income statement, an owner's equity statement, and a balance sheet for the dental practice of Ted Terner, DDS, from the items listed below for the month of September.

Ted Terner, Capital, September 1	$42,000
Accounts payable	7,000
Equipment	30,000
Service revenue	25,000
Ted Terner, Drawings	6,000
Dental supplies expense	3,500
Cash	6,000
Utilities expense	700
Dental supplies	2,800
Salaries expense	9,000
Accounts receivable	14,000
Rent expense	2,000

TED TERNER, DDS
Income Statement
For the Month Ended September 30, 2008

Revenues		$
Expenses	$	$
Total expenses		$
Net income		$

TED TERNER, DDS
Owner's Equity Statement
For the Month Ended September 30, 2008

Ted Terner, Capital, September 1	$
Add:	
	$
Less:	
	$

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Ex. 194 (cont.)

TED TERNER, DDS
Balance Sheet
September 30, 2008

Assets	
	$
Total assets	$
Liabilities and Owner's Equity	
Liabilities	
	$
Owner's Equity	$
Total liabilities and owner's equity	$

Solution 194 (15 min.)

TED TERNER, DDS
Income Statement
For the Month Ended September 30, 2008

Revenues		
Service revenue		$25,000
Expenses		
Salaries expense	$9,000	
Dental supplies expense	3,500	
Rent expense	2,000	
Utilities expense	700	
Total expenses		15,200
Net income		$ 9,800

TED TERNER, DDS
Owner's Equity Statement
For the Month Ended September 30, 2008

Ted Terner, Capital, September 1	$42,000
Add: Net income	9,800
	51,800
Less: Drawings	6,000
Ted Terner, Capital, September 30	$45,800

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Solution 194 (cont.)

TED TERNER, DDS
Balance Sheet
September 30, 2008

Assets	
Cash	$ 6,000
Accounts receivable	14,000
Dental supplies	2,800
Equipment	30,000
Total assets	$52,800
Liabilities and Owner's Equity	
Liabilities	
Accounts payable	$ 7,000
Owner's Equity	
Ted Terner, Capital	45,800
Total liabilities and owner's equity	$52,800

Ex. 195

Indicate whether the following items would appear on the balance sheet (BS), income statement (IS), or owner's equity statement (OE).

1. Advertising expense
2. Accounts receivable
3. Jones, drawing
4. Rent revenue
5. Salaries payable
6. Supplies

Solution 195 (5 min.)

1. Income statement (IS)
2. Balance sheet (BS)
3. Owner's equity statement (OE)
4. Income statement (IS)
5. Balance sheet (BS)
6. Balance sheet (BS)

Ex. 196

Listed below in alphabetical order are the balance sheet items of Hoyle Company at December 31, 2008. Prepare a balance sheet and include a complete heading.

Accounts Payable	$ 14,000
Accounts Receivable	15,000
Building	46,000
Cash	17,000
Joe Hoyle, Capital	120,000
Land	52,000
Office Equipment	4,000

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Solution 196 (5 min.)

HOYLE COMPANY
Balance Sheet
December 31, 2008

ASSETS	
Cash	$ 17,000
Accounts receivable	15,000
Office equipment	4,000
Building	46,000
Land	52,000
Total assets	$134,000
LIABILITIES	
Accounts payable	$ 14,000
OWNER'S EQUITY	
Joe Hoyle, Capital	120,000
Total liabilities and owner's equity	$134,000

Ex. 197

One item is omitted in each of the following summaries of balance sheet and income statement data for three different sole proprietorships, X, Y, and Z. Determine the amounts of the missing items, identifying each proprietorship by letter.

	Proprietorship		
	X	Y	Z
Beginning of the Year:			
Assets	$380,000	$150,000	$199,000
Liabilities	250,000	105,000	168,000
End of the Year:			
Assets	450,000	185,000	195,000
Liabilities	280,000	95,000	169,000
During the Year:			
Additional Investment by the owner	?	79,000	80,000
Withdrawals by the owner	90,000	83,000	?
Revenue	195,000	?	187,000
Expenses	170,000	113,000	175,000

Solution 197 (10 min.)

Proprietorship X ($105,000)	
Beginning Capital balance ($380,000 – $250,000)	$130,000
Additional investments ($260,000 – $130,000 – $25,000)	105,000
Net income for year ($195,000 – $170,000)	25,000
	260,000
Less withdrawals	90,000
Ending Capital balance ($450,000 – $280,000)	$170,000

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Solution 197 (cont.)

Proprietorship Y ($162,000)	
Beginning Capital balance ($150,000 – $105,000)	$ 45,000
Additional investments	79,000
Net income for year	49,000
[Revenues = $162,000 ($113,000 + $49,000)]	173,000
Less withdrawals	83,000
Ending Capital balance ($185,000 – $95,000)	$ 90,000
Proprietorship Z ($97,000)	
Beginning Capital balance ($199,000 – $168,000)	$ 31,000
Additional investments	80,000
Net income for year ($187,000 – $175,000)	12,000
	123,000
Less withdrawals ($123,000 – $26,000)	97,000
Ending Capital balance ($195,000 – $169,000)	$ 26,000

Ex. 198

Indicate in the space provided by each item whether it would appear on the Income Statement (IS), Balance Sheet (BS), or Owner's Equity Statement (OE):

a. ____ Service Revenue
b. ____ Utilities Expense
c. ____ Cash
d. ____ Accounts Payable
e. ____ Office Supplies
f. ____ Wage Expense
g. ____ Accounts Receivable
h. ____ Gray, Capital (ending)
i. ____ Equipment
j. ____ Advertising Expense
k. ____ Gray, Drawing
l. ____ Notes Payable

Solution 198 (5 min.)

a. IS
b. IS
c. BS
d. BS
e. BS
f. IS
g. BS
h. OE, BS
i. BS
j. IS
k. OE
l. BS

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Ex. 199

Don Harder was reviewing his business activities at the end of the year (2008) and decided to prepare an Owner's Equity Statement. At the beginning of the year his assets were $500,000 and his liabilities were $200,000. At the end of the year the assets had grown to $950,000 but liabilities had also increased to $350,000. The net income for the year was $420,000. Don had withdrawn $120,000 during the year for his personal use.

Prepare an Owner's Equity Statement in good form.

Solution 199 (5 min.)

DON HARDER
Owner's Equity Statement
For the Year Ended 2008

D. Harder, Beginning Capital	$300,000
Add: Net Income	420,000
	720,000
Less: Drawings	120,000
D. Harder, Ending Capital	$600,000

Ex. 200

At September 1, the balance sheet accounts for Debbie's Restaurant were as follows:

Accounts Payable	$ 3,800	Land	$33,000
Accounts Receivable	1,600	Debbie, Capital	?
Building	68,000	Notes Payable	48,000
Cash	10,000	Supplies	6,600
Furniture	18,700		

The following transactions occurred during the next two days:

Debbie invested an additional $22,000 cash in the business. The accounts payable were paid in full. (No payment was made on the notes payable.)

Instructions
Prepare a balance sheet at September 3, 2008.

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Solution 200 (10 min.)

DEBBIE'S RESTAURANT
Balance Sheet
September 3, 2008

ASSETS

Cash	$ 28,200
Accounts receivable	1,600
Supplies	6,600
Furniture	18,700
Building	68,000
Land	33,000
Total assets	$156,100

LIABILITIES

Accounts payable	$ -0-
Notes payable	48,000

OWNER'S EQUITY

Debbie, Capital	108,100
Total liabilities and owner's equity	$156,100

Cash ($10,000 + $22,000 – $3,800) = $28,200
Accounts Payable ($3,800 – $3,800) = $0

Debbie, Capital:	Beginning balance ($137,900 – $51,800)	$ 86,100
	Additional investment	22,000
	Ending balance	$108,100

Ex. 201

Presented below are balance sheet items for Higgins Company at December 31, 2008.

Accounts payable	$35,000
Accounts receivable	36,000
Cash	27,000
Equipment	52,000
Higgins, capital	30,000
Notes payable	50,000

Compute each of the following:
1. Total assets.
2. Total liabilities.

Solution 201 (5 min.)

1. Total assets = $115,000 ($36,000 + $27,000 + $52,000)
2. Total liabilities = $85,000 ($35,000 + $50,000)

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COMPLETION STATEMENTS

202. Accounting is an information system that identifies, _____, and _____ the economic events of an organization.

203. The mere recording of economic events is called _____, and is just one part of the _____ process.

204. The three major services rendered by a certified public accountant are _____, _____, and management _____.

205. Accountants who are employees of business enterprises are referred to as _____ accountants.

206. A common set of standards that provides guidelines to accountants and indicates how to report economic events is called _____.

207. The _____ principle states that assets should be recorded at the value exchanged at the time the asset is acquired.

208. The _____ assumption requires that the activities of an entity be kept separate from the activities of its owner.

209. The residual claim on total assets of a business is known as _____ and is equal to total assets minus total liabilities.

210. Drawings _____ owner's equity but are not expenses.

211. The _____ reports the assets, liabilities, and owner's equity of a business enterprise at a specific date.

Answers to Completion Statements

202. records, communicates
203. bookkeeping, accounting
204. auditing, taxation, consulting
205. private (or managerial)
206. generally accepted accounting principles
207. cost
208. economic entity
209. owner's equity
210. reduce
211. balance sheet

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MATCHING

212. Match the items below by entering the appropriate code letter in the space provided.

A.	CPA	F.	Corporation
B.	Budgeting	G.	Assets
C.	SEC	H.	Equities
D.	Proprietorship	I.	Expenses
E.	Economic Entity Assumption	J.	Transaction

____ 1. Activities of an entity must be kept separate from its owner's activities.

____ 2. Consumed assets or services.

____ 3. Ownership is limited to one person.

____ 4. Offers expert accounting service to the general public.

____ 5. Creditor and ownership claims against the assets of the business.

____ 6. A separate legal entity under state laws.

____ 7. Government agency that can mandate accounting rules.

____ 8. Quantifying goals and objectives.

____ 9. Future economic benefits.

____ 10. Economic events recorded by accountants.

Answers to Matching

1.	E	6.	F
2.	I	7.	C
3.	D	8.	B
4.	A	9.	G
5.	H	10.	J

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SHORT-ANSWER ESSAY QUESTIONS

S-A E 213

The accounting profession provides many career opportunities for individuals. Identify the major fields that exist in accounting and comment on the major functions performed by individuals in each of these areas.

Solution 213

The major fields that exist in accounting are in the areas of (1) public accounting, (2) private accounting, and (3) not-for-profit accounting. In public accounting, an accountant may practice as: (1) an auditor who examines the financial statements of companies and expresses an opinion as to the fairness of presentation; (2) a tax specialist who gives tax advice, prepares tax returns, and represents clients before governmental agencies; and (3) a management accountant who engages in the development of accounting and computer systems and the design of organizational systems.

Private (managerial) accountants perform many different activities within a company. Private accountants may be involved in: cost accounting, budgeting, general financial accounting, accounting information systems, and tax accounting.

S-A E 214

The framework used to record and summarize the economic activities of a business enterprise is referred to as the accounting equation. State the basic accounting equation and define its major components. How are business transactions and financial statements related to the accounting equation?

Solution 214

The basic accounting equation is expressed as follows:

Assets = Liabilities + Owner's Equity

Assets are defined as resources owned by the business. Liabilities are creditorship claims against the assets of the business; or simply put, liabilities are existing debts and obligations. Owner's equity is the ownership claim on the total assets of the business; it is equal to total assets minus total liabilities.

Business transactions are economic events and activities that affect the elements of the basic accounting equation; that is, transactions cause increases or decreases in the assets, liabilities, and owner's equity. The financial statements report the results and effects of transactions on the business' assets, liabilities, and owner's equity. The balance sheet is a summary expression of the basic accounting equation.

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S-A E 215

Your friend, James, made this comment:

> My major is biology and I plan to research for cures for major illnesses. Thus, I have no need to study accounting.

What is your response to James?

Solution 215

James, you are entering a dynamic profession and you have the opportunity to make important contributions to society. While science will be your profession and major concern, you will not be able to escape the need to understand accounting. Accounting staff and professionals will always be available to assist you. Here are some areas that will directly affect you:

As a manager, you will need to review accounting information (both internal and external) and make decisions. Budgets will be an important part of your research activities. As an employee, you will be concerned about the financial information of your employer. Thus, you will need to be able to read the company's financial statements. Also, as an investor, you will be interested in the financial statements of other companies.

You will probably not be a preparer of the financial statements, but you do need an understanding of how they are prepared. You also need a good understanding of how to interpret the information on the financial statements.

S-A E 216

The information needs of a specific user of financial accounting information depends upon the kinds of decisions that user makes. Identify the major users of accounting information and discuss what questions financial accounting information answers for each group of users.

Solution 216

The major users of accounting information are internal users and external users. Internal users are those who manage the business. External users are those outside the business who have either a present or potential financial interest.

Financial accounting information may answer the following questions for internal users:
1. Is cash sufficient to pay our debts?
2. Can we afford to give employee pay raises this year?
3. What is the cost of manufacturing each unit of product?
4. Which product line is the most profitable?

Questions answered by financial accounting information for external users include:
1. Is the company earning satisfactory income?
2. How does the company compare in size and profitability with competitors?
3. Will the company be able to pay its debts as they come due?

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S-A E 217 (Ethics)

Sam Dryer owns and operates Sam's Burgers, a small fast food store, located at the edge of City College campus in Newton, Ohio. After several very profitable years, Sam's Burgers began to have problems. Most of the problems were related to Sam's expansion of the eating area in the restaurant without corresponding increases in the food preparation area. Sam does not have the cash or financial backing to expand further. He has therefore decided to sell his business.

Jerry Finney is interested in purchasing the business. However, he is located in another city and is unfamiliar with Newton. He has asked Sam why he is selling Sam's Burgers. Sam replies that his elderly mother requires extra care, and that his brother needs help in his manufacturing business. Both are true, but neither is his primary reason for selling. Sam reasons that Jerry should not have asked him anyway, since profitable businesses don't come up for sale.

Required:

1. Identify the stakeholders in this situation.
2. Did Sam act ethically in not revealing fully his reasons for selling the business? Why or why not?

Solution 217

1. The stakeholders include
   Sam Dryer
   Jerry Finney
   Newton, Ohio
   students of City College
   City College
   persons financing the purchase of Sam's Burgers

2. Sam did not act ethically in not revealing fully his reasons for selling the business. Students might be of the opinion that a purchaser should investigate a business before purchasing it, rather than relying entirely on the seller's assertions. However, students should realize that Sam should have said something about his problems. He might ethically be allowed to put these in the best possible light, perhaps, but failure to disclose them at all is certainly unethical. This is especially true, since family concerns might well cause someone to sell a business that is otherwise doing well. Sam has shown an intent to deceive that is unethical, and might be actionable in court as well.

S-A E 218 (Communication)

Sue Havens is a friend of yours from high school. She decided to become a beautician after leaving high school, rather than to attend college. She recently opened her own shop, and has contracted her services to a local hospital. She is paid a monthly fee for her services, and receives a small gratuity from each of the patients.

She has just received her first set of financial statements from her accountant. She is quite upset. The statements show a cash balance of $3,600 at the end of the month, but a net income of only $500. She has written you a letter, asking you whether such a situation is possible, or whether she should find another accountant.

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S-A E 218 (cont.)

Required:
Write a short letter to your friend. Use proper form. Answer her question completely, but briefly.

Solution 218

Answers will vary. The instructor's requirements concerning proper form should be followed. The letter may be either business or personal. As a minimum, the letter should be in a recognizable form, and proper grammar and spelling should be used. Neat erasures and corrections might be allowed. A suggested personal letter follows:

1245 Lily Lane
Buena Vista, AR 77661
(Date)

Dear Sue,

Congratulations on opening your business! I am sure you will do well, combining your creative genius with your talent for serving others.

You asked about your financial statements. Of course, you realize that I am just an accounting student, but I do know that it is possible to have a large cash balance and little net income. You may have had expenses that were not paid in cash yet. These expenses reduce your income, but not your cash.

I think that you should discuss the statements with the accountant who prepared them. He or she will be in the best position to explain the results.

Thanks for the question. It really made me think.

Sincerely,
(signature)

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CHAPTER 2

THE RECORDING PROCESS

SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
True-False Statements														
1.	1	K	9.	2	K	17.	3	K	25.	5	K	[sg]33.	4	K
2.	1	K	10.	2	K	18.	3	K	26.	5	C	[sg]34.	5	K
3.	1	K	11.	2	K	19.	4	K	27.	5	K	[sg]35.	6	C
4.	1	K	12.	2	K	20.	4	K	28.	6	K	[sg]36.	7	K
5.	2	K	13.	2	K	21.	4	K	29.	6	K	[sg]37.	7	K
6.	2	K	14.	2	K	22.	4	K	30.	7	K			
7.	2	K	15.	3	K	23.	4	K	[sg]31.	2	K			
8.	2	K	16.	3	K	24.	5	K	[sg]32.	2	K			
Multiple Choice Questions														
38.	1	K	61.	2	K	84.	3	C	107.	4	K	130.	6	K
39.	1	K	62.	2	K	85.	3	K	108.	4	K	131.	6	K
40.	1	K	63.	2	C	86.	3	C	109.	4	C	132.	7	K
41.	1	C	64.	2	C	87.	3	K	110.	4	AN	133.	7	C
42.	1	K	65.	2	K	88.	3	K	111.	5	K	134.	7	K
43.	1	K	66.	2	K	89.	3	K	112.	5	K	135.	7	C
44.	1	K	67.	2	K	90.	3	K	113.	5	K	136.	7	K
45.	2	K	68.	2	K	91.	3	K	114.	5	K	137.	7	K
46.	2	K	69.	2	K	92.	3	C	115.	5	C	138.	7	C
47.	2	K	70.	2	C	93.	3	K	116.	5	K	[sg]139.	1	K
48.	2	K	71.	2	K	94.	3	K	117.	5	K	[st]140.	2	K
49.	2	K	72.	2	K	95.	3	K	118.	5	K	[sg]141.	2	K
50.	2	K	73.	2	K	96.	3	K	119.	6	K	[st]142.	3	K
51.	2	K	74.	2	C	97.	4	K	120.	6	K	[sg]143.	3	K
52.	2	K	75.	2	K	98.	4	K	121.	6	K	[st]144.	4	K
53.	2	K	76.	2	K	99.	4	K	122.	6	K	[sg]145.	4	K
54.	2	C	77.	2	C	100.	4	K	123.	6	K	[sg]146.	4	K
55.	2	C	78.	2	AP	101.	4	K	124.	6	K	[sg]147.	4	C
56.	2	C	79.	2	AP	102.	4	K	125.	6	K	[st]148.	6	K
57.	2	K	80.	2	K	103.	4	K	126.	6	K	[sg]149.	6	K
58.	2	K	81.	3	K	104.	4	C	127.	6	K	[st]150.	7	K
59.	2	K	82.	3	K	105.	4	K	128.	6	K	[sg]151.	7	C
60.	2	K	83.	3	K	106.	4	K	129.	6	K			
Brief Exercises														
152.	2	AP	154.	4	K	156.	4	K	158.	6	AP	160.	7	AP
153.	2	K	155.	4	AP	157.	4	AP	159.	6	AP	161.	7	AP

[sg] This question also appears in the Study Guide.
[st] This question also appears in a self-test at the student companion website.

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SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Exercises													
162.	1	C	167.	2	C	172.	3	AP	177.	5	AN	182.	7	AP
163.	1	C	168.	2	C	173.	3	C	178.	6	AN	183.	7	AP
164.	1	C	169.	2	C	174.	4	C	179.	6	AN			
165.	2	C	170.	2	AP	175.	5	AP	180.	6	AN			
166.	2	C	171.	3	C	176.	5	AP	181.	7	AP			
Completion Statements														
184.	1	K	186.	2	K	188.	3	K	190.	4	K	192.	5	K
185.	2	K	187.	2	K	189.	4	K	191.	4	K	193.	7	K

SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Study Objective 1													
1.	TF	4.	TF	40.	MC	43.	MC	162.	Ex	184.	C		
2.	TF	38.	MC	41.	MC	44.	MC	163.	Ex				
3.	TF	39.	MC	42.	MC	139.	MC	164.	Ex				
Study Objective 2													
5.	TF	14.	TF	51.	MC	60.	MC	69.	MC	78.	MC	167.	Ex
6.	TF	31.	TF	52.	MC	61.	MC	70.	MC	79.	MC	168.	Ex
7.	TF	32.	TF	53.	MC	62.	MC	71.	MC	80.	MC	169.	Ex
8.	TF	45.	MC	54.	MC	63.	MC	72.	MC	140.	MC	170.	Ex
9.	TF	46.	MC	55.	MC	64.	MC	73.	MC	141.	MC	185.	C
10.	TF	47.	MC	56.	MC	65.	MC	74.	MC	152.	BE	186.	C
11.	TF	48.	MC	57.	MC	66.	MC	75.	MC	153.	BE	187.	C
12.	TF	49.	MC	58.	MC	67.	MC	76.	MC	165.	Ex		
13.	TF	50.	MC	59.	MC	68.	MC	77.	MC	166.	Ex		
Study Objective 3													
15.	TF	81.	MC	85.	MC	89.	MC	93.	MC	142.	MC	173.	Ex
16.	TF	82.	MC	86.	MC	90.	MC	94.	MC	143.	MC	188.	C
17.	TF	83.	MC	87.	MC	91.	MC	95.	MC	171.	Ex		
18.	TF	84.	MC	88.	MC	92.	MC	96.	MC	172.	Ex		
Study Objective 4													
19.	TF	33.	TF	101.	MC	106.	MC	144.	MC	155.	BE	190.	C
20.	TF	97.	MC	102.	MC	107.	MC	145.	MC	156.	BE	191.	C
21.	TF	98.	MC	103.	MC	108.	MC	146.	MC	157.	BE		
22.	TF	99.	MC	104.	MC	109.	MC	147.	MC	174.	Ex		
23.	TF	100.	MC	105.	MC	110.	MC	154.	BE	189.	C		
Study Objective 5													
24.	TF	27.	TF	112.	MC	115.	MC	118.	MC	177.	Ex		
25.	TF	34.	TF	113.	MC	116.	MC	175.	Ex	192.	C		
26.	TF	111.	MC	114.	MC	117.	MC	176.	Ex				

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SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Study Objective 6												
28.	TF	120.	MC	124.	MC	128.	MC	148.	MC	178.	Ex	
29.	TF	121.	MC	125.	MC	129.	MC	149.	MC	179.	Ex	
35.	TF	122.	MC	126.	MC	130.	MC	158.	BE	180.	Ex	
119.	MC	123.	MC	127.	MC	131.	MC	159.	BE			
Study Objective 7												
30.	TF	132.	MC	135.	MC	138.	MC	160.	BE	182.	Ex	
36.	TF	133.	MC	136.	MC	150.	MC	161.	BE	183.	Ex	
37.	TF	134.	MC	137.	MC	151.	MC	181.	Ex	193.	C	

Note: TF = True-False BE = Brief Exercise C = Completion
MC = Multiple Choice Ex = Exercise

The chapter also contains one set of ten Matching questions and five Short-Answer Essay questions.

CHAPTER STUDY OBJECTIVES

1. ***Explain what an account is and how it helps in the recording process.*** An account is a record of increases and decreases in specific asset, liability, and owner's equity items.

2. ***Define debits and credits and explain their use in recording business transactions.*** The terms debit and credit are synonymous with left and right. Assets, drawings, and expenses are increased by debits and decreased by credits. Liabilities, owner's capital, and revenues are increased by credits and decreased by debits.

3. ***Identify the basic steps in the recording process.*** The basic steps in the recording process are: (a) analyze each transaction for its effects on the accounts, (b) enter the transaction information in a journal, (c) transfer the journal information to the appropriate accounts in the ledger.

4. ***Explain what a journal is and how it helps in the recording process.*** The initial accounting record of a transaction is entered in a journal before the data are entered in the accounts. A journal (a) discloses in one place the complete effects of a transaction, (b) provides a chronological record of transactions, and (c) prevents or locates errors because the debit and credit amounts for each entry can be readily compared.

5. ***Explain what a ledger is and how it helps in the recording process.*** The ledger is the entire group of accounts maintained by a company. The ledger keeps in one place all the information about changes in specific account balances.

6. ***Explain what posting is and how it helps in the recording process.*** Posting is the transfer of journal entries to the ledger accounts. This phase of the recording process accumulates the effects of journalized transactions in the individual accounts.

7. ***Prepare a trial balance and explain its purposes.*** A trial balance is a list of accounts and their balances at a given time. Its primary purpose is to prove the equality of debits and credits after posting. A trial balance also uncovers errors in journalizing and posting and is useful in preparing financial statements.

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TRUE-FALSE STATEMENTS

1. A new account is opened for each transaction entered into by a business firm.

2. The recording process becomes more efficient and informative if all transactions are recorded in one account.

3. When the volume of transactions is large, recording them in tabular form is more efficient than using journals and ledgers.

4. An account is often referred to as a T-account because of the way it is constructed.

5. A debit to an account indicates an increase in that account.

6. If a revenue account is credited, the revenue account is increased.

7. The normal balance of all accounts is a debit.

8. Debit and credit can be interpreted to mean increase and decrease, respectively.

9. The double-entry system of accounting refers to the placement of a double line at the end of a column of figures.

10. A credit balance in a liability account indicates that an error in recording has occurred.

11. The drawing account is a subdivision of the owner's capital account and appears as an expense on the income statement.

12. Revenues are a subdivision of owner's capital.

13. Under the double-entry system, revenues must always equal expenses.

14. Transactions are entered in the ledger first and then they are analyzed in terms of their effect on the accounts.

15. Business documents can provide evidence that a transaction has occurred.

16. Each transaction must be analyzed in terms of its effect on the accounts before it can be recorded in a journal.

17. Transactions are entered in the ledger accounts and then transferred to journals.

18. All business transactions must be entered first in the general ledger.

19. A simple journal entry requires only one debit to an account and one credit to an account.

20. A compound journal entry requires several debits to one account and several credits to one account.

21. Transactions are recorded in alphabetic order in a journal.

22. A journal is also known as a book of original entry.

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23. The complete effect of a transaction on the accounts is disclosed in the journal.

24. The account titles used in journalizing transactions need not be identical to the account titles in the ledger.

25. The chart of accounts is a special ledger used in accounting systems.

26. A general ledger should be arranged in the order in which accounts are presented in the financial statements, beginning with the balance sheet accounts.

27. The number and types of accounts used by different business enterprises are the same if generally accepted accounting principles are being followed by the enterprises.

28. Posting is the process of proving the equality of debits and credits in the trial balance.

29. After a transaction has been posted, the reference column in the journal should not be blank.

30. A trial balance does not prove that all transactions have been recorded or that the ledger is correct.

Additional True-False Questions

31. The double-entry system is a logical method for recording transactions and results in equal debits and credits for each transaction.

32. The normal balance of an expense is a credit.

33. The journal provides a chronological record of transactions.

34. The ledger is merely a bookkeeping device and therefore does not provide much useful data for management.

35. The chart of accounts is a listing of the accounts and the account numbers which identify their location in the ledger.

36. The primary purpose of a trial balance is to prove the mathematical equality of the debits and credits after posting.

37. The trial balance will not balance when incorrect account titles are used in journalizing or posting.

Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	7.	F	13.	F	19.	T	25.	F	31.	T	37.	F
2.	F	8.	F	14.	F	20.	F	26.	T	32.	F		
3.	F	9.	F	15.	T	21.	F	27.	F	33.	T		
4.	T	10.	F	16.	T	22.	T	28.	F	34.	F		
5.	F	11.	F	17.	F	23.	T	29.	T	35.	T		
6.	T	12.	T	18.	F	24.	F	30.	T	36.	T		

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MULTIPLE CHOICE QUESTIONS

38. An account consists of
    a. one part.
    b. two parts.
    c. three parts.
    d. four parts.

39. The left side of an account is
    a. blank.
    b. a description of the account.
    c. the debit side.
    d. the balance of the account.

40. Which one of the following is *not* a part of an account?
    a. Credit side
    b. Trial balance
    c. Debit side
    d. Title

41. An account is a part of the financial information system and is described by all except which one of the following?
    a. An account has a debit and credit side.
    b. An account is a source document.
    c. An account may be part of a manual or a computerized accounting system.
    d. An account has a title.

42. The right side of an account
    a. is the correct side.
    b. reflects all transactions for the accounting period.
    c. shows all the balances of the accounts in the system.
    d. is the credit side.

43. An account consists of
    a. a title, a debit balance, and a credit balance.
    b. a title, a left side, and a debit balance.
    c. a title, a debit side, and a credit side.
    d. a title, a right side, and a debit balance.

44. A T-account is
    a. a way of depicting the basic form of an account.
    b. what the computer uses to organize bytes of information.
    c. a special account used instead of a trial balance.
    d. used for accounts that have both a debit and credit balance.

45. Credits
    a. decrease both assets and liabilities.
    b. decrease assets and increase liabilities.
    c. increase both assets and liabilities.
    d. increase assets and decrease liabilities.

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46. A debit to an asset account indicates
    a. an error.
    b. a credit was made to a liability account.
    c. a decrease in the asset.
    d. an increase in the asset.

47. The normal balance of any account is the
    a. left side.
    b. right side.
    c. side which increases that account.
    d. side which decreases that account.

48. The double-entry system requires that each transaction must be recorded
    a. in at least two different accounts.
    b. in two sets of books.
    c. in a journal and in a ledger.
    d. first as a revenue and then as an expense.

49. A credit is *not* the normal balance for which account listed below?
    a. Capital account
    b. Revenue account
    c. Liability account
    d. Drawing account

50. Which one of the following represents the expanded basic accounting equation?
    a. Assets = Liabilities + Owner's Capital + Owner's Drawings – Revenue – Expenses.
    b. Assets + Owner's Drawings + Expenses = Liabilities + Owner's Capital + Revenues.
    c. Assets – Liabilities – Owner's Drawings = Owner's Capital + Revenues – Expenses.
    d. Assets = Revenues + Expenses – Liabilities.

51. Which of the following correctly identifies normal balances of accounts?

    a.

Assets	Debit
Liabilities	Credit
Owner's Equity	Credit
Revenues	Debit
Expenses	Credit

    b.

Assets	Debit
Liabilities	Credit
Owner's Equity	Credit
Revenues	Credit
Expenses	Credit

    c.

Assets	Credit
Liabilities	Debit
Owner's Equity	Debit
Revenues	Credit
Expenses	Debit

    d.

Assets	Debit
Liabilities	Credit
Owner's Equity	Credit
Revenues	Credit
Expenses	Debit

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52. The best interpretation of the word credit is the
    a. offset side of an account.
    b. increase side of an account.
    c. right side of an account.
    d. decrease side of an account.

53. In recording an accounting transaction in a double-entry system
    a. the number of debit accounts must equal the number of credit accounts.
    b. there must always be entries made on both sides of the accounting equation.
    c. the amount of the debits must equal the amount of the credits.
    d. there must only be two accounts affected by any transaction.

54. An accounting convention is best described as
    a. an absolute truth.
    b. an accounting custom.
    c. an optional rule.
    d. something that cannot be changed.

55. A debit is *not* the normal balance for which account listed below?
    a. Drawing
    b. Cash
    c. Accounts Receivable
    d. Service Revenue

56. An accountant has debited an asset account for $1,000 and credited a liability account for $500. What can be done to complete the recording of the transaction?
    a. Nothing further must be done.
    b. Debit an owner's equity account for $500.
    c. Debit another asset account for $500.
    d. Credit a different asset account for $500.



57. An accountant has debited an asset account for $1,000 and credited a liability account for $500. Which of the following would be an *incorrect* way to complete the recording of the transaction?
    a. Credit an asset account for $500.
    b. Credit another liability account for $500.
    c. Credit an owner's equity account for $500.
    d. Debit an owner's equity account for $500.

58. Which of the following is *not* true of the terms debit and credit?
    a. They can be abbreviated as Dr. and Cr.
    b. They can be interpreted to mean increase and decrease.
    c. They can be used to describe the balance of an account.
    d. They can be interpreted to mean left and right.

59. An account will have a credit balance if the
    a. credits exceed the debits.
    b. first transaction entered was a credit.
    c. debits exceed the credits.
    d. last transaction entered was a credit.

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60. For the basic accounting equation to stay in balance, each transaction recorded must
    a. affect two or less accounts.
    b. affect two or more accounts.
    c. always affect exactly two accounts.
    d. affect the same number of asset and liability accounts.

61. Which of the following statements is true?
    a. Debits increase assets and increase liabilities.
    b. Credits decrease assets and decrease liabilities.
    c. Credits decrease assets and increase liabilities.
    d. Debits decrease liabilities and decrease assets.

62. Assets normally show
    a. credit balances.
    b. debit balances.
    c. debit and credit balances.
    d. debit or credit balances.

63. An awareness of the normal balances of accounts would help you spot which of the following as an error in recording?
    a. A debit balance in the drawing account
    b. A credit balance in an expense account
    c. A credit balance in a liabilities account
    d. A credit balance in a revenue account

64. If a company has overdrawn its bank balance, then
    a. its cash account will show a debit balance.
    b. its cash account will show a credit balance.
    c. the cash account debits will exceed the cash account credits.
    d. it cannot be detected by observing the balance of the cash account.

65. Which account below is *not* a subdivision of owner's equity?
    a. Drawing
    b. Revenues
    c. Expenses
    d. Liabilities

66. When an owner makes a withdrawal
    a. it doesn't have to be cash, it could be another asset.
    b. the drawing account will be increased with a credit.
    c. the capital account will be directly increased with a debit.
    d. the drawing account will be decreased with a debit.

67. The drawing account
    a. appears on the income statement along with the expenses of the business.
    b. must show transactions every accounting period.
    c. is increased with debits and decreased with credits.
    d. is not a proper subdivision of owner's equity.

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68. Which of the following statements is *not* true?
    a. Expenses increase owner's equity.
    b. Expenses have normal debit balances.
    c. Expenses decrease owner's equity.
    d. Expenses are a negative factor in the computation of net income.

69. A credit to a liability account
    a. indicates an increase in the amount owed to creditors.
    b. indicates a decrease in the amount owed to creditors.
    c. is an error.
    d. must be accompanied by a debit to an asset account.

70. In the first month of operations, the total of the debit entries to the cash account amounted to $900 and the total of the credit entries to the cash account amounted to $500. The cash account has a(n)
    a. $500 credit balance.
    b. $800 debit balance.
    c. $400 debit balance.
    d. $400 credit balance.

71. Dawson's Delivery Service purchased equipment for $2,500. Dawson paid $500 in cash and signed a note for the balance. Dawson debited the Equipment account, credited Cash and
    a. nothing further must be done.
    b. debited the Dawson, Capital account for $2,000.
    c. credited another asset account for $500.
    d. credited a liability account for $2,000.

72. Grayton Industries purchased supplies for $1,000. They paid $500 in cash and agreed to pay the balance in 30 days. The journal entry to record this transaction would include a debit to an asset account for $1,000, a credit to a liability account for $500. Which of the following would be the correct way to complete the recording of the transaction?
    a. Credit an asset account for $500.
    b. Credit another liability account for $500.
    c. Credit the Grayton, Capital account for $500.
    d. Debit the Grayton, Capital account for $500.

73. On January 14, Franco Industries purchased supplies of $500 on account. The entry to record the purchase will include
    a. a debit to Supplies and a credit to Accounts Payable.
    b. a debit to Supplies Expense and a credit to Accounts Receivable.
    c. a debit to Supplies and a credit to Cash.
    d. a debit to Accounts Receivable and a credit to Supplies.

74. On June 1, 2008, Delbert Inc. reported a cash balance of $12,000. During June, Delbert made deposits of $3,000 and made disbursements totalling $16,000. What is the cash balance at the end of June?
    a. $1,000 debit balance
    b. $15,000 debit balance
    c. $1,000 credit balance
    d. $4,000 credit balance

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75. At January 1, 2008, Burton Industries reported owner's equity of $130,000. During 2008, Burton had a net loss of $30,000 and owner drawings of $20,000. At December 31, 2008, the amount of owner's equity is
    a. $130,000.
    b. $140,000.
    c. $100,000.
    d. $80,000.

76. Able Company pays its employees twice a month, on the 7th and the 21st. On June 21, Able Company paid employee salaries of $4,000. This transaction would
    a. increase owner's equity by $4,000.
    b. decrease the balance in Salaries Expense by $4,000.
    c. decrease net income for the month by $4,000.
    d. be recorded by a $4,000 debit to Salaries Payable and a $4,000 credit to Salaries Expense.

77. In the first month of operations for Pocket Industries, the total of the debit entries to the cash account amounted to $8,000 ($4,000 investment by the owner and revenues of $4,000). The total of the credit entries to the cash account amounted to $5,000 (purchase of equipment $2,000 and payment of expenses $3,000). At the end of the month, the cash account has a(n)
    a. $2,000 credit balance.
    b. $2,000 debit balance.
    c. $3,000 debit balance.
    d. $3,000 credit balance.

78 Denton Company showed the following balances at the end of its first year:

Cash	$ 7,000
Prepaid insurance	700
Accounts receivable	3,500
Accounts payable	2,800
Notes payable	4,200
Denton, Capital	1,400
Denton, Drawing	700
Revenues	21,000
Expenses	17,500

What did Denton Company show as total credits on its trial balance?
a. $30,100
b. $29,400
c. $28,700
d. $30,800

79. Cerner Company showed the following balances at the end of its first year:

Cash	$ 5,000
Prepaid insurance	500
Accounts receivable	2,500
Accounts payable	2,000
Notes payable	3,000
Cerner, Capital	1,000
Cerner, Drawing	500
Revenues	15,000
Expenses	12,500

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What did Cerner Company show as total credits on its trial balance?
a. $21,500
b. $21,000
c. $20,500
d. $22,000

80. During February 2008, its first month of operations, the owner of Rutwing Enterprises invested cash of $25,000. Rutwing had cash revenues of $4,000 and paid expenses of $7,000. Assuming no other transactions impacted the cash account, what is the balance in Cash at February 28?
a. $3,000 credit
b. $22,000 debit
c. $29,000 debit
d. $18,000 credit

81. At January 31, 2008, the balance in Prieto Inc.'s supplies account was $250. During February, Prieto purchased supplies of $300 and used supplies of $400. At the end of February, the balance in the supplies account should be
a. $250 debit.
b. $350 credit.
c. $950 debit.
d. $150 debit.

82. At December 1, 2008, Marco Company's accounts receivable balance was $1,200. During December, Marco had credit revenues of $5,000 and collected accounts receivable of $4,000. At December 31, 2008, the accounts receivable balance is
a. $1,200 debit.
b. $2,200 debit.
c. $6,200 debit.
d. $2,200 credit.

83. At October 1, 2008, Deet Industries had an accounts payable balance of $30,000. During the month, the company made purchases on account of $25,000 and made payments on account of $40,000. At October 31, 2008, the accounts payable balance is
a. $30,000.
b. $10,000.
c. $15,000.
d. $40,000.

84. During 2008, its first year of operations, Jane's Bakery had revenues of $60,000 and expenses of $33,000. The business had owner drawings of $18,000. What is the amount of owner's equity at December 31, 2008?
a. $0
b. $18,000 debit
c. $9,000 credit
d. $27,000 credit

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85. On July 7, 2008, Reethink Enterprises performed cash services of $1,400. The entry to record this transaction would include
    a. a debit to Service Revenue of $1,400.
    b. a credit to Accounts Receivable of $1,400.
    c. a debit to Cash of $1,400.
    d. a credit to Accounts Payable of $1,400.

86. At September 1, 2008, Foli Co. reported owner's equity of $136,000. During the month, Foli generated revenues of $20,000, incurred expenses of $12,000, purchased equipment for $5,000 and withdrew cash of $2,000. What is the amount of owner's equity at September 30, 2008?
    a. $136,000
    b. $8,000
    c. $137,000
    d. $142,000

87. The final step in the recording process is to
    a. analyze each transaction.
    b. enter the transaction in a journal.
    c. prepare a trial balance.
    d. transfer journal information to ledger accounts.

88. The usual sequence of steps in the transaction recording process is:
    a. journal → analyze → ledger.
    b. analyze → journal → ledger.
    c. journal → ledger → analyze.
    d. ledger → journal → analyze.

89. In recording business transactions, evidence that an accounting transaction has taken place is obtained from
    a. business documents.
    b. the Internal Revenue Service.
    c. the public relations department.
    d. the SEC.

90. After a business transaction has been analyzed and entered in the book of original entry, the next step in the recording process is to transfer the information to
    a. the company's bank.
    b. owner's equity.
    c. ledger accounts.
    d. financial statements.

91. The first step in the recording process is to
    a. prepare financial statements.
    b. analyze each transaction for its effect on the accounts.
    c. post to a journal.
    d. prepare a trial balance.

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92. Evidence that would *not* help with determining the effects of a transaction on the accounts would be a(n)
    a. cash register sales tape.
    b. bill.
    c. advertising brochure.
    d. check.

93. After transaction information has been recorded in the journal, it is transferred to the
    a. trial balance.
    b. income statement.
    c. book of original entry.
    d. ledger.

94. The usual sequence of steps in the recording process is to analyze each transaction, enter the transaction in the
    a. journal, and transfer the information to the ledger accounts.
    b. ledger, and transfer the information to the journal.
    c. book of accounts, and transfer the information to the journal.
    d. book of original entry, and transfer the information to the journal.

95. The final step in the recording process is to transfer the journal information to the
    a. trial balance.
    b. financial statements.
    c. ledger.
    d. file cabinets.

96. The recording process occurs
    a. once a year.
    b. once a month.
    c. repeatedly during the accounting period.
    d. infrequently in a manual accounting system.

97. A compound journal entry involves
    a. two accounts.
    b. three accounts.
    c. three or more accounts.
    d. four or more accounts.

98. A journal provides
    a. the balances for each account.
    b. information about a transaction in several different places.
    c. a list of all accounts used in the business.
    d. a chronological record of transactions.

99. When three or more accounts are required in one journal entry, the entry is referred to as a
    a. compound entry.
    b. triple entry.
    c. multiple entry.
    d. simple entry.

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100. When two accounts are required in one journal entry, the entry is referred to as a
   a. balanced entry.
   b. simple entry.
   c. posting.
   d. nominal entry.

101. Another name for journal is
   a. listing.
   b. book of original entry.
   c. book of accounts.
   d. book of source documents.

102. The standard format of a journal would *not* include
   a. a reference column.
   b. an account title column.
   c. a T-account.
   d. a date column.

103 Transactions in a journal are initially recorded in
   a. account number order.
   b. dollar amount order.
   c. alphabetical order.
   d. chronological order.

104 A journal is *not* useful for
   a. disclosing in one place the complete effect of a transaction.
   b. preparing financial statements.
   c. providing a record of transactions.
   d. locating and preventing errors.

105 A complete journal entry does *not* show
   a. the date of the transaction.
   b. the new balance in the accounts affected by the transaction.
   c. a brief explanation of the transaction.
   d. the accounts and amounts to be debited and credited.

106. The name given to entering transaction data in the journal is
   a. chronicling.
   b. listing.
   c. posting.
   d. journalizing.

107. The standard form of a journal entry has the
   a. debit account entered first and indented.
   b. credit account entered first and indented.
   c. debit account entered first at the extreme left margin.
   d. credit account entered first at the extreme left margin.

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108. When journalizing, the reference column is
   a. left blank.
   b. used to reference the source document.
   c. used to reference the journal page.
   d. used to reference the financial statements.

109. On June 1, 2008 Diane Leno buys a copier machine for her business and finances this purchase with cash and a note. When journalizing this transaction, she will
   a. use two journal entries.
   b. make a compound entry.
   c. make a simple entry.
   d. list the credit entries first, which is proper form for this type of transaction.

110. Which of the following journal entries is recorded correctly and in the standard format?

a.	Wages Expense	600	
	Cash		1,500
	Advertising Expense	900	
b.	Wages Expense		600
	Advertising Expense		900
	Cash	1,500	
c.	Cash	1,500	
	Wages Expense		600
	Advertising Expense		900
d.	Wages Expense	600	
	Advertising Expense	900	
	Cash		1,500

111. The ledger should be arranged in
   a. alphabetical order.
   b. chronological order.
   c. dollar amount order.
   d. financial statement order.

112. The entire group of accounts maintained by a company is called the
   a. chart of accounts.
   b. general journal.
   c. general ledger.
   d. trial balance.

113. An accounting record of the balances of all assets, liabilities, and owner's equity accounts is called a
   a. compound entry.
   b. general journal.
   c. general ledger.
   d. chart of accounts.

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114. The usual ordering of accounts in the general ledger is
   a. assets, liabilities, owner's capital, drawings, revenues, and expenses.
   b. assets, liabilities, drawings, owner's capital, expenses, and revenues.
   c. liabilities, assets, owner's capital, revenues, expenses, and drawings.
   d. owner's capital, assets, liabilities, drawings, expenses, and revenues.

115. Management could determine the amounts due from customers by examining which ledger account?
   a. Service Revenue
   b. Accounts Payable
   c. Accounts Receivable
   d. Supplies

116. The ledger accounts should be arranged in
   a. chronological order.
   b. alphabetical order.
   c. financial statement order.
   d. order of appearance in the journal.

117. A three column form of account is so named because it has columns for
   a. debit, credit, and account name.
   b. debit, credit, and reference.
   c. debit, credit, and balance.
   d. debit, credit, and date.

118. On August 13, 2008, Dudbury Enterprises purchased office equipment for $1,000 and office supplies of $200 on account. Which of the following journal entries is recorded correctly and in the standard format?

a.	Office Equipment	1,000	
	Account Payable		1,200
	Office Supplies	200	
b.	Office Equipment.		1,000
	Office Supplies		200
	Accounts Payable	1,200	
c.	Accounts Payable	1,200	
	Office Equipment		1,000
	Office Supplies		200
d.	Office Equipment	1,000	
	Office Supplies	200	
	Accounts Payable.		1,200

119. Tritan Company received a cash advance of $500 from a customer. As a result of this event,
   a. assets increased by $500.
   b. owner's equity increased by $500.
   c. liabilities decreased by $500.
   d. both a and b.

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120. Anderson Company purchased equipment for $1,800 cash. As a result of this event,
   a. owner's equity decreased by $1,800.
   b. total assets increased by $1,800.
   c. total assets remained unchanged.
   d. Both a and b.

121. Franklin Company provided consulting services and billed the client $2,500. As a result of this event,
   a. assets remained unchanged.
   b. assets increased by $2,500.
   c. owner's equity increased by $2,500.
   d. Both b and c.

122. The first step in posting involves
   a. entering in the appropriate ledger account the date, journal page, and debit amount shown in the journal.
   b. writing in the journal the account number to which the debit amount was posted.
   c. writing in the journal the account number to which the credit amount was posted.
   d. entering in the appropriate ledger account the date, journal page, and credit amount shown in the journal.

123. A chart of accounts usually starts with
   a. asset accounts.
   b. expense accounts.
   c. liability accounts.
   d. revenue accounts.

124. The procedure of transferring journal entries to the ledger accounts is called
   a. journalizing.
   b. analyzing.
   c. reporting.
   d. posting.

125. A number in the reference column in a general journal indicates
   a. that the entry has been posted to a particular account.
   b. the page number of the journal.
   c. the dollar amount of the transaction.
   d. the date of the transaction.

126. A chart of accounts for a business firm
   a. is a graph.
   b. indicates the amount of profit or loss for the period.
   c. lists the accounts and account numbers that identify their location in the ledger.
   d. shows the balance of each account in the general ledger.

127. Posting
   a. should be performed in account number order.
   b. accumulates the effects of journalized transactions in the individual accounts.
   c. involves transferring all debits and credits on a journal page to the trial balance.
   d. is accomplished by examining ledger accounts and seeing which ones need updating.

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128. After journal entries are posted, the reference column
   a. of the general journal will be blank.
   b. of the general ledger will show journal page numbers.
   c. of the general journal will show "Dr" or "Cr".
   d. of the general ledger will show account numbers.

129. The explanation column of the general ledger
   a. is completed without exception.
   b. is nonexistent.
   c. is used infrequently.
   d. shows account titles.

130. A numbering system for a chart of accounts
   a. is prescribed by GAAP.
   b. is uniform for all businesses.
   c. usually starts with income statement accounts.
   d. usually starts with balance sheet accounts.

131. The first step in designing a computerized accounting system is the creation of the
   a. general ledger.
   b. general journal.
   c. trial balance.
   d. chart of accounts.

132. The steps in preparing a trial balance include all of the following *except*
   a. listing the account titles and their balances.
   b. totaling the debit and credit columns.
   c. proving the equality of the two columns.
   d. transferring journal amounts to ledger accounts.

133. A trial balance may balance even when each of the following occurs *except* when
   a. a transaction is not journalized.
   b. a journal entry is posted twice.
   c. incorrect accounts are used in journalizing.
   d. a transposition error is made.

134. A list of accounts and their balances at a given time is called a(n)
   a. journal.
   b. posting.
   c. trial balance.
   d. income statement.

135. If the sum of the debit column equals the sum of the credit column in a trial balance, it indicates
   a. no errors have been made.
   b. no errors can be discovered.
   c. that all accounts reflect correct balances.
   d. the mathematical equality of the accounting equation.

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136. A trial balance is a listing of
   a. transactions in a journal.
   b. the chart of accounts.
   c. general ledger accounts and balances.
   d. the totals from the journal pages.

137. Customarily, a trial balance is prepared
   a. at the end of each day.
   b. after each journal entry is posted.
   c. at the end of an accounting period.
   d. only at the inception of the business.

138. A trial balance would only help in detecting which one of the following errors?
   a. A transaction that is not journalized
   b. A journal entry that is posted twice
   c. Offsetting errors are made in recording the transaction
   d. A transposition error when transferring the debit side of journal entry to the ledger

Additional Multiple Choice Questions

139. An account is an individual accounting record of increases and decreases in specific
   a. liabilities.
   b. assets.
   c. expenses.
   d. assets, liabilities, and owner's equity items.

140. A debit is *not* the normal balance for which of the following?
   a. Asset account
   b. Drawing account
   c. Expense account
   d. Capital account

141. Which of the following rules is *incorrect?*
   a. Credits decrease the drawing account.
   b. Debits increase the capital account.
   c. Credits increase revenue accounts.
   d. Debits decrease liability accounts.

142. Which of the following statements is false?
   a. Revenues increase owner's equity.
   b. Revenues have normal credit balances.
   c. Revenues are a positive factor in the computation of net income.
   d. Revenues are increased by debits.

143. Which of the following is the correct sequence of steps in the recording process?
   a. Posting, journalizing, analyzing
   b. Journalizing, analyzing, posting
   c. Analyzing, posting, journalizing
   d. Analyzing, journalizing, posting

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144. Which of the following is *false* about a journal?
   a. It discloses in one place the complete effects of a transaction.
   b. It provides a chronological record of transactions.
   c. It helps to prevent or locate errors because debit and credit amounts for each entry can be readily compared.
   d. It keeps in one place all the information about changes in specific account balances.

145. Meenen Company purchases equipment for $1,200 and supplies for $400 from Sanders Co. for $1,600 cash. The entry for this transaction will include a
   a. debit to Equipment $1,200 and a debit to Supplies Expense $400 for Sanders.
   b. credit to Cash for Sanders.
   c. credit to Accounts Payable for Meenen.
   d. debit to Equipment $1,200 and a debit to Supplies $400 for Meenen.

146. Jack Wiser withdraws $300 cash from his business for personal use. The entry for this transaction will include a debit of $300 to
   a. Jack Wiser, Drawing.
   b. Jack Wiser, Capital.
   c. Owner's Salary Expense.
   d. Salaries Expense.

147. On October 3, Nick Carter, a carpenter, received a cash payment for services previously billed to a client. Nick paid his telephone bill, and he also bought equipment on credit. For the three transactions, at least one of the entries will include a
   a. credit to Nick Carter, Capital.
   b. credit to Notes Payable.
   c. debit to Accounts Receivable.
   d. credit to Accounts Payable.

148. Posting of journal entries should be done in
   a. account number order.
   b. alphabetical order.
   c. chronological order.
   d. dollar amount order.

149. The chart of accounts is a
   a. list of accounts and their balances at a given time.
   b. device used to prove the mathematical accuracy of the ledger.
   c. listing of the accounts and the account numbers which identify their location in the ledger.
   d. required step in the recording process.

150. Which of the following is *incorrect* regarding a trial balance?
   a. It proves that the debits equal the credits after posting.
   b. It proves that the company has recorded all transactions.
   c. A trial balance uncovers errors in journalizing and posting.
   d. A trial balance is useful in the preparation of financial statements.

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151. A trial balance will *not* balance if
   a. a journal entry is posted twice.
   b. a wrong amount is used in journalizing.
   c. incorrect account titles are used in journalizing.
   d. a journal entry is only partially posted.

Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
38.	c	55.	d	72.	a	89.	a	106.	d	123.	a	140.	d
39.	c	56.	d	73.	a	90.	c	107.	c	124.	d	141.	b
40.	b	57.	d	74.	c	91.	b	108.	a	125.	a	142.	d
41.	b	58.	b	75.	d	92.	c	109.	b	126.	c	143.	d
42.	d	59.	a	76.	c	93.	d	110.	d	127.	b	144.	d
43.	c	60.	b	77.	c	94.	a	111.	d	128.	b	145.	d
44.	a	61.	c	78.	b	95.	c	112.	c	129.	c	146.	a
45.	b	62.	b	79.	b	96.	c	113.	c	130.	d	147.	d
46.	d	63.	b	80.	b	97.	c	114.	a	131.	d	148.	c
47.	c	64.	b	81.	d	98.	d	115.	c	132.	d	149.	c
48.	a	65.	d	82.	b	99.	a	116.	c	133.	d	150.	b
49.	d	66.	a	83.	c	100.	b	117.	c	134.	c	151.	d
50.	b	67.	c	84.	c	101.	b	118.	d	135.	d		
51.	d	68.	a	85.	c	102.	c	119.	a	136.	c		
52.	c	69.	a	86.	d	103.	d	120.	c	137.	c		
53.	c	70.	c	87.	d	104.	b	121.	d	138.	d		
54.	b	71.	d	88.	b	105.	b	122.	a	139.	d		

BRIEF EXERCISES

BE 152

At June 1, 2008, Groober Industries had an accounts receivable balance of $12,000. During the month, the company performed credit services of $25,000 and collected accounts receivable of $27,000. What is the balance in accounts receivable at June 30, 2008?

Solution 152 (3 min.)

The balance at the end of the month is $10,000, calculated as follows:

Beginning accounts receivable	$12,000
Add: Credit Sales	25,000
Less: Collections	(27,000)
Ending accounts receivable	$10,000

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BE 153

For each of the following accounts indicate the effect of a debit or a credit on the account and the normal balance. Increase (+), Decrease (–).

	Debit	Credit	Normal Balance
1. Salary expense.			
2. Accounts receivable.			
3. Service revenue.			
4. Smith, Capital.			
5. Smith, Drawing.			

Solution 153 (5 min.)

	Debit	Credit	Normal Balance
1. Salary expense.	+	–	Dr
2. Accounts receivable.	+	–	Dr
3. Service revenue.	–	+	Cr
4. Smith, Capital.	–	+	Cr
5. Smith, Drawing.	+	–	Dr

BE 154

For each of the following transactions of Aggie Inc., identify the account to be debited and the account to be credited.

1. Purchased 18-month insurance policy for cash.
2. Paid weekly payroll.
3. Purchased supplies on account.
4. Received utility bill to be paid at later date.

Solution 154 (4 min.)

Transaction	Debit	Credit
1	Prepaid Insurance	Cash
2	Salaries Expense	Cash
3	Supplies	Accounts Payable
4	Utilities Expense	Utilities Payable

BE 155

Journalize the following business transactions in general journal form. Identify each transaction by number. You may omit explanations of the transaction.

1. John Amos invested $20,000 cash to start an appliance repair business.
2. Hired an employee to be paid $400 per week, starting tomorrow.
3. Paid two years' rent in advance, $7,200.
4. Paid the worker's weekly wage.
5. Recorded revenue earned and received for the week, $1,500.

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Solution 155 (5 min.)

1.	Cash…….....	50,000	
	J. Amos, Capital		50,000
2.	No entry		
3.	Prepaid Rent	7,200	
	Cash		7,200
4.	Wage Expense	400	
	Cash		400
5.	Cash…….	1,500	
	Service Revenue		1,500

BE 156

Identify the impact on the accounting equation of the following transactions.
1. Purchased 36-month insurance policy for cash.
2. Purchased supplies on account.
3. Received utility bill to be paid at later date.
4. Paid utility bill previously accrued.

Solution 156 (4 min.)

1. Net effect is no change: Increases assets and decreases assets.
2. Increases assets and increases liabilities.
3. Increases liabilities and decreases stockholders' equity.
4. Decreases assets and decreases liabilities

BE 157

Journalize the following transactions for J.C. Tyme Company for June 2008, the company's first month of operations. You may omit explanations for the transactions.
1. Purchased equipment on account for $3,000.
2. Billed customers $5,000 for services performed.
3. Made payment of $1,500 on account for equipment purchased earlier in month.
4. Collected $2,900 on customer accounts.

Solution 157 (4 min.)

1.	Equipment	3,000	
	Accounts Payable.....		3,000
2.	Accounts Receivable.....	5,000	
	Service Revenue		5,000

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Solution 157 (cont.)

3.	Accounts Payable	1,500	
	Cash		1,500
4.	Cash	2,900	
	Accounts Receivable		2,900

BE 158

Use the information in BE 157 to answer the following questions.
1. What is the balance in Accounts Payable at June 30, 2008?
2. What is the balance in Accounts Receivable at June 30, 2008?

Solution 158 (6 min.)

1. Accounts Payable at June 30, 2008:

Beginning accounts payable	$ 0
Purchases on account	3,000
Payments on account	(1,500)
Ending accounts payable	$1,500

2. Accounts Receivable at June 30, 2008:

Beginning accounts receivable	$ 0
Billed to customers	5,000
Collections from customers	(2,900)
Ending accounts receivable	$2,100

BE 159

The transactions of the Got It Now Store are recorded in the general journal below. You are to post the journal entries to T-accounts.

General Journal

Date	Account Titles	Debit	Credit
2008			
Aug. 5	Accounts Receivable	2,800	
	Service Revenue		2,800
10	Cash	3,000	
	Service Revenue		3,000
19	Rent Expense	1,000	
	Cash		1,000
25	Cash	1,400	
	Accounts Receivable		1,400

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BE 159 (cont.)

General Ledger

Cash

Accounts Receivable

Service Revenue

Rent Expense

Solution 159 (5 min.)

General Ledger

Cash

8/10	3,000	8/19	1,000
8/25	1,400		
8/31 Bal.	3,400		

Accounts Receivable

8/5	2,800	8/25	1,400
8/31 Bal.	1,400		

Service Revenue

		8/5	2,800
		8/10	3,000
		8/31 Bal.	5,800

Rent Expense

8/19	1,000		
8/31 Bal.	1,000		

BE 160

Prepare a trial balance from the ledger accounts of Quentin Company as of January 31, 2008.

Accounts Payable	$ 500	Rent Expense	$ 500
Accounts Receivable	2,000	Service Revenue	3,000
Cash	1,000	Supplies	200
Quentin, Capital	2,200	Wages Expense	1,000
Quentin, Drawing	1,000		

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Solution 160 (5 min.)

QUENTIN COMPANY
Trial Balance
January 31, 2008

	Debit	Credit
Cash	$1,000	
Accounts Receivable	2,000	
Supplies	200	
Accounts Payable		$ 500
Quentin, Capital		2,200
Quentin, Drawing	1,000	
Service Revenue		3,000
Rent Expense	500	
Wages Expense	1,000	
	$5,700	$5,700

BE 161

Prepare a corrected trial balance for Miller Company. All accounts should have a normal balance.

MILLER COMPANY
Trial Balance
For the Quarter Ended 3/31/08

	Debit	Credit
Cash	$ 25,000	
Accounts Receivable		$30,000
Prepaid Insurance	2,500	
Equipment	60,000	
Accounts Payable		15,000
Unearned Revenue	10,000	
Notes Payable		20,000
Miller, Capital		54,000
Miller, Drawing		1,500
Service Revenue		50,000
Salaries Expense	15,000	
Utilities Expense	5,000	
Rent Expense	10,000	
	$127,500	$170,500

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Solution 161 (6 min.)

MILLER COMPANY
Trial Balance
For the Quarter Ended 3/31/08

	Debit	Credit
Cash	$ 25,000	
Accounts Receivable	30,000	
Prepaid Insurance	2,500	
Equipment	60,000	
Accounts Payable		$ 15,000
Unearned Revenue		10,000
Notes Payable		20,000
Miller, Capital		54,000
Miller, Drawing	1,500	
Service Revenue		50,000
Salaries Expense	15,000	
Utilities Expense	5,000	
Rent Expense	10,000	
	$149,000	$149,000

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EXERCISES

Ex. 162

The chart of accounts used by Kwick Copy Company is listed below. You are to indicate the proper accounts to be debited and credited for the following transactions by writing the account number(s) in the appropriate boxes.

CHART OF ACCOUNTS

101	Cash	209	Unearned Revenue
112	Accounts Receivable	301	T. Kwick, Capital
125	Paper Supplies	306	T. Kwick, Drawing
157	Copy Machines	400	Photocopy Revenue
200	Note Payable	610	Advertising Expense
201	Accounts Payable	729	Rent Expense

		Number(s) of account(s) debited	Number(s) of account(s) credited
1.	Tom Kwick invests $90,000 cash to start the business.		
2.	Purchased three photocopy machines for $200,000, paying $50,000 cash and signing a 5-year, 10% note for the remainder.		
3.	Purchased $5,000 paper supplies on credit.		
4.	Cash photocopy revenue amounted to $7,000.		
5.	Paid $500 cash for radio advertising.		
6.	Paid $800 on account for paper supplies purchased in transaction 3.		
7.	Owner withdrew $1,500 from the business for personal expenses.		
8.	Paid $1,200 cash for rent for the current month.		
9.	Received $2,000 cash advance from a customer for future copying.		
10.	Billed a customer for $450 for photocopy work done.		

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Solution 162 (15 min.)

		Number(s) of account(s) debited	Number(s) of account(s) credited
1.	Tom Kwick invests $90,000 cash to start the business.	101	301
2.	Purchased three photocopy machines for $200,000, paying $50,000 cash and signing a 5-year, 10% note for the remainder.	157	101,200
3.	Purchased $5,000 paper supplies on credit.	125	201
4.	Cash photocopy revenue amounted to $7,000.	101	400
5.	Paid $500 cash for radio advertising.	610	101
6.	Paid $800 on account for paper supplies purchased in transaction 3.	201	101
7.	Owner withdrew $1,500 from the business for personal expenses.	306	101
8.	Paid $1,200 cash for rent for the current month.	729	101
9.	Received $2,000 cash advance from a customer for future copying.	101	209
10.	Billed a customer for $450 for photocopy work done.	112	400

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Ex. 163

Under a double-entry system, show how the entry in each statement is entered in the ledger by using debit or credit to indicate the increase or decrease in the affected account.

		Debit or Credit
1.	An increase in Salary Expense.	
2.	A decrease in Accounts Payable.	
3.	An increase in Prepaid Insurance.	
4.	An increase in Owner's Capital.	
5.	A decrease in Office Supplies.	
6.	An increase in Owner's Drawings.	
7.	An increase in Service Revenue.	
8.	A decrease in Accounts Receivable.	
9.	An increase in Rent Expense.	
10.	A decrease in Store Equipment.	

Solution 163 (5 min.)

1.	An increase in Salary Expense.	Debit
2.	A decrease in Accounts Payable.	Debit
3.	An increase in Prepaid Insurance.	Debit
4.	An increase in Owner's Capital.	Credit
5.	A decrease in Office Supplies.	Credit
6.	An increase in Owner's Drawings.	Debit
7.	An increase in Service Revenue.	Credit
8.	A decrease in Accounts Receivable.	Credit
9.	An increase in Rent Expense.	Debit
10.	A decrease in Store Equipment.	Credit

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Ex. 164

For the accounts listed below, indicate if the normal balance of the account is a debit or credit.

	Accounts	Normal Balance Debit or Credit
1.	Service Revenue	
2.	Rent Expense	
3.	Accounts Receivable	
4.	Accounts Payable	
5.	Owner's Capital	
6.	Office Supplies	
7.	Insurance Expense	
8.	Owner's Drawing	
9.	Office Building	
10.	Notes Payable	

Solution 164 (5 min.)

	Accounts	Normal Balance Debit or Credit
1.	Service Revenue	Credit
2.	Rent Expense	Debit
3.	Accounts Receivable	Debit
4.	Accounts Payable	Credit
5.	Owner's Capital	Credit
6.	Office Supplies	Debit
7.	Insurance Expense	Debit
8.	Owner's Drawing	Debit
9.	Office Building	Debit
10.	Notes Payable	Credit

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Ex. 165

For each of the following accounts, indicate the effects of (a) a debit and (b) the normal account balance.

1. Notes Payable
2. Prepaid Insurance
3. Salaries Expense
4. Repair Revenue
5. Equipment
6. D. Snider, Capital

Solution 165 (7 min.)

	Debit Effect	Normal Balance
1. Notes Payable	Decrease	Credit
2. Prepaid Insurance	Increase	Debit
3. Salaries Expense	Increase	Debit
4. Repair Revenue	Decrease	Credit
5. Equipment	Increase	Debit
6. D. Snider, Capital	Decrease	Credit

Ex. 166

During an accounting period, a business has numerous transactions affecting each of the following accounts. State for each account whether it is likely to have (a) debit entries only, (b) credit entries only, or (c) both debit and credit entries.

_____ (1) Advertising Expense
_____ (2) Service Revenue
_____ (3) Accounts Payable
_____ (4) Accounts Receivable
_____ (5) R. Minton, Capital
_____ (6) R. Minton, Drawing
_____ (7) Cash
_____ (8) Salaries Expense
_____ (9) Notes Payable
_____ (10) Insurance Expense

Solution 166 (5 min.)

(1) (a)
(2) (b)
(3) (c)
(4) (c)
(5) (b)
(6) (a)
(7) (c)
(8) (a)
(9) (c)
(10) (a)

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Ex. 167

Eight transactions are recorded in the following T-accounts:

CASH			
(1)	35,000	(2)	3,500
(7)	22,500	(3)	1,950
		(4)	2,225
		(6)	8,000
		(8)	4,500

ACCOUNTS RECEIVABLE			
(5)	27,500	(7)	22,500

SUPPLIES			
(3)	1,950		

EQUIPMENT			
(2)	13,500		

KEN ORSON, CAPITAL			
		(1)	35,000

SERVICE REVENUE			
		(5)	27,500

ACCOUNTS PAYABLE			
(6)	8,000	(2)	10,000

KEN ORSON, DRAWING			
(8)	4,500		

SALARIES EXPENSE			
(4)	2,225		

Indicate for each debit and each credit: (a) whether an asset, liability, capital, drawing, revenue, or expense account was affected and (b) whether the account was increased (+) or (–) decreased. Answers should be presented in the following chart form:

Transaction No.		Account Debited		Account Credited	
		Type	Effect	Type	Effect
(1)	(Example)	Asset	+	Capital	+
(2)					
(3)					
(4)					
(5)					
(6)					
(7)					
(8)					

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Solution 167 (15 min.)

Transaction No.	Account Debited Type	Effect	Account Credited Type	Effect
(1) (Example)	Asset	+	Capital	+
(2)	Asset	+	Asset Liability	– +
(3)	Asset	+	Asset	–
(4)	Expense	+	Asset	–
(5)	Asset	+	Revenue	+
(6)	Liability	–	Asset	–
(7)	Asset	+	Asset	–
(8)	Drawing	+	Asset	–

Ex. 168

For each of the following accounts indicate (a) the type of account (Asset, Liability, Owner's Equity, Revenue, Expense), (b) the debit and credit effects, and (c) the normal account balance.

Example

0. Cash
   a. Asset account
   b. Debit increases, credit decreases
   c. Normal balance - debit

Accounts

1. Accounts Payable
2. Accounts Receivable
3. K. Brown, Capital
4. K. Brown, Drawing
5. Service Revenue
6. Insurance Expense
7. Notes Payable
8. Equipment

Solution 168 (15 min.)

1. a. Liability Account.
   b. Debit decreases, credit increases.
   c. Normal balance - credit.

2. a. Asset Account.
   b. Debit increases, credit decreases.
   c. Normal balance - debit.

3. a. Owner's Equity Account.
   b. Debit decreases, credit increases.
   c. Normal balance - credit.

5. a. Revenue Account.
   b. Debit decreases, credit increases.
   c. Normal balance - credit.

6. a. Expense Account.
   b. Debit increases, credit decreases.
   c. Normal balance - debit.

7. a. Liability Account.
   b. Debit decreases, credit increases.
   c. Normal balance - credit.

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Solution 168 (cont.)

4. a. Owner's Equity Account.
   b. Debit increases, credit decreases.
   c. Normal balance - debit.

8. a. Asset Account.
   b. Debit increases, credit decreases.
   c. Normal balance - debit.

Ex. 169

For each transaction given, enter in the tabulation given below a "D" for debit and a "C" for credit to reflect the increases and decreases of the assets, liabilities, and owner's equity accounts. In some cases there may be a "D" and a "C" in the same box.

Transactions:

1. Owner invests cash in the business.
2. Pays insurance in advance for six months.
3. Pays secretary's salary.
4. Purchases office supplies on account.
5. Pays electricity bill.
6. Borrows money from local bank.
7. Makes payment on account.
8. Receives cash due from customers.
9. Provides services on account.
10. Owner withdraws assets from the business.

	Transaction #									
	1	2	3	4	5	6	7	8	9	10
Assets										
Liabilities										
Owner's Capital Account										
Owner's Drawing										
Revenues										
Expenses										

Solution 169 (15 min.)

	Transaction #									
	1	2	3	4	5	6	7	8	9	10
Assets	D	D,C	C	D	C	D	C	D,C	D	C
Liabilities				C		C	D			
Owner's Capital Account	C									
Owner's Drawing										D
Revenues									C	
Expenses			D		D					

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Ex. 170

Journalize the following business transactions in general journal form. Identify each transaction by number. You may omit explanations of the transactions.

1. The owner, Mike Derby, invests $35,000 in cash in starting a real estate office operating as a sole proprietorship.
2. Purchased $400 of office supplies on credit.
3. Purchased office equipment for $8,000, paying $2,000 in cash and signed a 30-day, $6,000, note payable.
4. Real estate commissions billed to clients amount to $4,000.
5. Paid $700 in cash for the current month's rent.
6. Paid $200 cash on account for office supplies purchased in transaction 2.
7. Received a bill for $600 for advertising for the current month.
8. Paid $2,200 cash for office salaries.
9. Derby withdrew $1,200 from the business for living expenses.
10. Received a check for $3,000 from a client in payment on account for commissions billed in transaction 4.

Solution 170 (15 min.)

1.	Cash	35,000	
	M. Derby, Capital		35,000
2.	Office Supplies	400	
	Accounts Payable		400
3.	Office Equipment	8,000	
	Cash		2,000
	Notes Payable		6,000
4.	Accounts Receivable	4,000	
	Real Estate Commission Revenue		4,000
5.	Rent Expense	700	
	Cash		700
6.	Accounts Payable	200	
	Cash		200
7.	Advertising Expense	600	
	Accounts Payable		600
8.	Office Salaries Expense	2,200	
	Cash		2,200
9.	M. Derby, Drawing	1,200	
	Cash		1,200
10.	Cash	3,000	
	Accounts Receivable		3,000

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Ex. 171

Identify the accounts to be debited and credited for each of the following transactions.

1. The owner, Don Smith, invested $10,000 cash in the business.
2. Purchased supplies on account for $1,000.
3. Billed customers $2,000 for services performed.
4. Paid salaries of $900.

Solution 171 (5 min.)

	Account Debited	Account Credited
1.	Cash	Smith, Capital
2.	Supplies	Accounts Payable
3.	Accounts Receivable	Service Revenue
4.	Salaries Expense	Cash

Ex. 172

Transactions for Ed Petry Company for the month of October are presented below. Journalize each transaction and identify each transaction by number. You may omit journal explanations.

1. Invested an additional $40,000 cash in the business.
2. Purchased land costing $28,000 for cash.
3. Purchased equipment costing $12,000 for $3,000 cash and the remainder on credit.
4. Purchased supplies on account for $800.
5. Paid $1,000 for a one-year insurance policy.
6. Received $3,000 cash for services performed.
7. Received $4,000 for services previously performed on account.
8. Paid wages to employees for $2,500.
9. Petry withdrew $1,000 cash from the business.

Solution 172 (10 min.)

1.	Cash	40,000	
	E. Petry, Capital		40,000
2.	Land	28,000	
	Cash		28,000
3.	Equipment	12,000	
	Cash		3,000
	Accounts Payable		9,000
4.	Supplies	800	
	Accounts Payable		800
5.	Prepaid Insurance	1,000	
	Cash		1,000
6.	Cash	3,000	
	Service Revenue		3,000

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Solution 172 (cont.)

7.	Cash	4,000	
	Accounts Receivable		4,000
8.	Wages Expense	2,500	
	Cash		2,500
9.	E. Petry, Drawing	1,000	
	Cash		1,000

Ex. 173

Match the basic step in the recording process described by each of the following statements.

A. Analyze each transaction
B. Enter each transaction in a journal
C. Transfer journal information to ledger accounts

____ 1. This step is called posting.

____ 2. Business documents are examined to determine the effects of transactions on the accounts.

____ 3. This step is called journalizing.

Solution 173 (2 min.)

1. C 2. A 3. B

Ex. 174

Prepare journal entries for each of the following transactions.

1. Performed services for customers on account $5,000.
2. Purchased $20,000 of equipment on account.
3. Received $3,000 from customers in transaction 1.
4. The owner, Bob Jones, withdrew $1,000 cash for personal use.

Solution 174 (5 min.)

1.	Accounts Receivable	5,000	
	Service Revenue		5,000
2.	Equipment	20,000	
	Accounts Payable		20,000
3.	Cash	3,000	
	Accounts Receivable		3,000

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Solution 174 (cont.)

4.	Jones, Drawing	1,000	
	Cash		1,000

Ex. 175

Glynn Company is a newly organized business. The list of accounts to be opened in the general ledger is as follows:

Accounts Payable	Prepaid Insurance
Accounts Receivable	Prepaid Rent
Accumulated Depreciation	Rent Expense
Cash	Salary Expense
Depreciation Expense	Salaries Payable
Equipment	Service Revenue
Insurance Expense	Supplies
Matt Glynn, Capital	Supplies Expense
Matt Glynn, Drawing	

Instructions

Organize the accounts into the order in which they should appear in the ledger of Glynn Company and assign account numbers. Use the following system to assign account numbers.

1—199	Assets
200—299	Liabilities
300—399	Owner's Equity
400—499	Revenues
500—599	Expenses

Solution 175 (15 min.)

There are several possible correct account number assignments. The following is one of the correct solutions.

101- Cash
112- Accounts Receivable
125- Supplies
130- Prepaid Insurance
140- Prepaid Rent
157- Equipment
158- Accumulated Depreciation

201- Accounts Payable
212- Salaries Payable

301- Matt Glynn, Capital
306- Matt Glynn, Drawing

400- Service Revenue

510- Salaries Expense
520- Supplies Expense
530- Rent Expense
540- Insurance Expense
550- Depreciation Expense

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Ex. 176

The transactions of Nester Delivery Service are recorded in the general journal below. You are to post the journal entries to the accounts in the general ledger. After all entries have been posted, you are to prepare a trial balance on the form provided.

General Journal J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2008				
Sept. 1	Cash		20,000	
	Nester, Capital			20,000
	(Invested cash in business)			
4	Delivery Trucks		30,000	
	Cash			10,000
	Notes Payable			20,000
	(Paid cash and issued 2-year, 9%, note for delivery trucks)			
8	Rent Expense		1,000	
	Cash			1,000
	(Paid September rent)			
15	Prepaid Insurance		400	
	Cash			400
	(Paid one-year liability insurance)			
18	Cash		2,500	
	Delivery Revenue			2,500
	(Received cash for delivery services)			
20	Salaries Expense		500	
	Cash			500
	(Paid salaries for current period)			
25	Utility Expense		100	
	Accounts Payable			100
	(Received a bill for September utilities)			
30	Nester, Drawing		1,500	
	Cash			1,500
	(Withdrew cash for personal use)			
30	Accounts Receivable		2,000	
	Delivery Revenue			2,000
	(Billed customer for delivery service)			

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Ex. 176 (cont.)

General Ledger

Cash Account No. 101

Date	Explanation	Ref.	Debit	Credit	Balance

Accounts Receivable Account No. 112

Date	Explanation	Ref.	Debit	Credit	Balance

Prepaid Insurance Account No. 130

Date	Explanation	Ref.	Debit	Credit	Balance

Delivery Trucks Account No. 155

Date	Explanation	Ref.	Debit	Credit	Balance

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Ex. 176 (cont.)

Accounts Payable — Account No. 201

Date	Explanation	Ref.	Debit	Credit	Balance

Notes Payable — Account No. 205

Date	Explanation	Ref.	Debit	Credit	Balance

Nester, Capital — Account No. 301

Date	Explanation	Ref.	Debit	Credit	Balance

Nester, Drawing — Account No. 306

Date	Explanation	Ref.	Debit	Credit	Balance

Delivery Revenue — Account No. 400

Date	Explanation	Ref.	Debit	Credit	Balance

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Ex. 176 (cont.)

Rent Expense — Account No. 719

Date	Explanation	Ref.	Debit	Credit	Balance

Salaries Expense — Account No. 726

Date	Explanation	Ref.	Debit	Credit	Balance

Utility Expense — Account No. 735

Date	Explanation	Ref.	Debit	Credit	Balance

NESTER DELIVERY SERVICE
Trial Balance
September 30, 2008

Accounts	Debit	Credit

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Solution 176 (25 min.)

General Journal J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2008				
Sept. 1	Cash	101	20,000	
	Nester, Capital	301		20,000
	(Invested cash in business)			
4	Delivery Trucks	155	30,000	
	Cash	101		10,000
	Notes Payable	205		20,000
	(Paid cash and issued 2-year, 9%, note for delivery trucks)			
8	Rent Expense	719	1,000	
	Cash	101		1,000
	(Paid September rent)			
15	Prepaid Insurance	130	400	
	Cash	101		400
	(Paid one-year liability insurance)			
18	Cash	101	2,500	
	Delivery Revenue	400		2,500
	(Received cash for delivery services)			
20	Salaries Expense	726	500	
	Cash	101		500
	(Paid salaries for current period)			
25	Utility Expense	735	100	
	Accounts Payable	201		100
	(Received a bill for September utilities)			
30	Nester, Drawing	306	1,500	
	Cash	101		1,500
	(Withdrew cash for personal use)			
30	Accounts Receivable	112	2,000	
	Delivery Revenue	400		2,000
	(Billed customer for delivery service)			

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Solution 176 (cont.)

General Ledger

Cash — Account No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 1		J1	20,000		20,000
4		J1		10,000	10,000
8		J1		1,000	9,000
15		J1		400	8,600
18		J1	2,500		11,100
20		J1		500	10,600
30		J1		1,500	9,100

Accounts Receivable — Account No. 112

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 30		J1	2,000		2,000

Prepaid Insurance — Account No. 130

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 15		J1	400		400

Delivery Trucks — Account No. 155

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 4		J1	30,000		30,000

Accounts Payable — Account No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 25		J1		100	100

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Solution 176 (cont.)

Notes Payable — Account No. 205

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 4		J1		20,000	20,000

Nester, Capital — Account No. 301

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 1		J1		20,000	20,000

Nester, Drawing — Account No. 306

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 30		J1	1,500		1,500

Delivery Revenue — Account No. 400

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 18		J1		2,500	2,500
30		J1		2,000	4,500

Rent Expense — Account No. 719

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 8		J1	1,000		1,000

Salary Expense — Account No. 726

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 20		J1	500		500

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Solution 176 (cont.)

Utility Expense — Account No. 735

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Sept. 25		J1	100		100

NESTER DELIVERY SERVICE
Trial Balance
September 30, 2008

Accounts	Debit	Credit
Cash	$ 9,100	
Accounts Receivable	2,000	
Prepaid Insurance	400	
Delivery Trucks	30,000	
Accounts Payable		$ 100
Notes Payable		20,000
Nester, Capital		20,000
Nester, Drawing	1,500	
Delivery Revenue		4,500
Rent Expense	1,000	
Salary Expense	500	
Utility Expense	100	
Totals	$44,600	$44,600

Ex. 177

The bookkeeper for Reagan Lawn Mowing Service made a number of errors in journalizing and posting as described below:

1. A debit posting to accounts receivable for $500 was omitted.
2. A payment of accounts payable for $600 was credited to cash and debited to accounts receivable.
3. A credit to accounts receivable for $650 was posted as $65.
4. A cash purchase of equipment for $693 was journalized as a debit to equipment and a credit to notes payable. The credit posting was made for $639.
5. A debit posting of $300 for purchase of supplies was credited to supplies.
6. A debit to repairs expense for $491 was posted as $419.
7. A debit posting for wages expense for $900 was made twice.
8. A cash purchase of supplies for $700 was journalized and posted as a debit to supplies for $70 and a credit to cash for $70.

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Ex. 177 (cont.)

Instructions

For each error, indicate (a) whether the trial balance will balance; if the trial balance will not balance, indicate (b) the amount of the difference, and (c) the trial balance column that will have the larger total. Consider each error separately. Use the following form, in which error (1) is given as an example.

Error	(A) In Balance	(B) Difference	(C) Larger Column
1	No	$500	Credit

Solution 177 (15 min.)

Error	(A) In Balance	(B) Difference	(C) Larger Column
1	No	$500	Credit
2	Yes	—	—
3	No	585	Debit
4	No	54	Debit
5	No	600	Credit
6	No	72	Credit
7	No	900	Debit
8	Yes	—	—

Ex. 178

Post the following transactions to T-accounts and determine each account's ending balance.

1.	Supplies	2,500	
	Accounts Payable		2,500
2.	Accounts Receivable	4,000	
	Service Revenue		4,000
3.	Cash	3,000	
	Accounts Receivable		3,000
4.	Accounts Payable	1,000	
	Cash		1,000

Solution 178 (6 min.)

Cash

3.	3,000	4.	1,000
Bal.	2,000		

Accounts Payable

4.	1,000	1.	2,500
		Bal.	1,500

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Solution 178 (cont.)

Accounts Receivable			
2.	4,000	3.	3,000
Bal.	1,000		

Service Revenue			
		2.	4,000
		Bal.	4,000

Supplies			
1.	2,500		
Bal.	2,500		

Ex. 179

The trial balance of Gagne Company shown below does not balance.

GAGNE COMPANY
Trial Balance
June 30, 2008

	Debit	Credit
Cash	$ 2,600	
Accounts Receivable	7,600	
Supplies	600	
Equipment	8,300	
Accounts Payable		$ 9,766
Gagne, Capital		1,952
Gagne, Drawing	1,500	
Service Revenue		15,200
Wages Expense	3,800	
Repair Expense	1,600	
Totals	$26,000	$26,918

An examination of the ledger and journal reveals the following errors:

1. Each of the above listed accounts has a normal balance per the general ledger.
2. Cash of $360 received from a customer on account was debited to Cash $630 and credited to Accounts Receivable $630.
3. A withdrawal of $300 by the owner was posted as a credit to Gagne, Drawing, $300 and credit to Cash $300.
4. A debit of $300 was not posted to Wages Expense.
5. The purchase of equipment on account for $700 was recorded as a debit to Repair Expense and a credit to Accounts Payable for $700.
6. Services were performed on account for a customer, $510, for which Accounts Receivable was debited $510 and Service Revenue was credited $51.
7. A payment on account for $225 was credited to Cash for $225 and credited to Accounts Payable for $252.

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Ex. 179 (cont.)

Instructions
Prepare a correct trial balance.

Solution 179 (25 min.)

GAGNE COMPANY
Trial Balance
June 30, 2008

	Debit	Credit
Cash [2,600 – 270 (2)]	$ 2,330	$
Accounts Receivable [7,600 + 270 (2)]	7,870	
Supplies	600	
Equipment [8,300 + 700 (5)]	9,000	
Accounts Payable [9,766 – 477 (7)]		9,289
Gagne, Capital		1,952
Gagne, Drawings [1,500 + 300 + 300 (3)]	2,100	
Service Revenue [15,200 + 459 (6)]		15,659
Wages Expense [3,800 + 300 (4)]	4,100	
Repair Expense [1,600 – 700 (5)]	900	
Totals	$26,900	$26,900

Ex. 180

Some of the following errors would cause the debit and credit columns of the trial balance to have unequal totals. For each of the four cases, state whether the error would cause unequal totals in the trial balance. If the error causes unequal totals, indicate the amount of difference between the columns and state whether the debit or credit is larger. Each case is to be considered independently of the others.

1. A payment of $800 to a creditor was recorded by a debit to Accounts Payable of $80 and a credit to Cash of $800.
2. A $480 payment for a printer was recorded by a debit to Computer Equipment of $48 and a credit to Cash for $48.
3. An account receivable in the amount of $2,500 was collected in full. The collection was recorded by a debit to Cash for $2,500 and a debit to Accounts Payable for $2,500.
4. An account payable was paid by issuing a check for $800. The payment was recorded by debiting Accounts Payable $800 and crediting Accounts Receivable $800.

Solution 180 (5 min.)

1. The trial balance totals will be unequal. The credit column will be $720 larger than the debit column.
2. The trial balance totals will be misstated but not unequal.

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Solution 180 (cont.)

3. The trial balance totals will be unequal. The debit column will be $5,000 larger than the credit column.

4. The trial balance totals will be misstated but not unequal.

Ex. 181

Jane Carr and Associates is a financial planning service. The account balances at December 31, 2008 are shown by the following alphabetical list:

Accounts Payable	$ 5,000
Accounts Receivable	19,000
Automobiles	27,500
Building	120,000
Cash	18,500
Computer	22,000
Computer Software	4,200
Land	42,000
Jane Carr, Capital	179,700
Notes Payable	95,000
Notes Receivable	8,100
Office Furniture	15,400
Office Supplies	800
Technical Library	2,200

Instructions
Prepare a trial balance with the accounts arranged in financial statement order.

Solution 181 (10 min.)

JANE CARR AND ASSOCIATES
Trial Balance
December 31, 2008

	Debit	Credit
Cash	$ 18,500	
Accounts Receivable	19,000	
Office Supplies	800	
Notes Receivable	8,100	
Computer	22,000	
Computer Software	4,200	
Technical Library	2,200	
Office Furniture	15,400	
Automobiles	27,500	
Building	120,000	
Land	42,000	
Accounts Payable		$ 5,000
Notes Payable		95,000
Jane Carr, Capital		179,700
Totals	$279,700	$279,700

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Ex. 182

The ledger accounts of the Oak Street Gym at June 30, 2008 are shown below:

Accounts Payable	$ 9,100
Accounts Receivable	1,050
Building	51,400
Bob Green, Capital	63,100
Cash	15,000
Exercise Equipment	18,900
Weight Equipment	22,000
Notes Payable	49,000
Office Supplies	350
Office Equipment	2,000
Bob Green, Drawing	10,500

Instructions
Prepare a trial balance with the ledger accounts arranged in the proper financial statement order. Include the appropriate heading.

Solution 182 (10 min.)

OAK STREET GYM
Trial Balance
June 30, 2008

	Debit	Credit
Cash	$ 15,000	
Accounts Receivable	1,050	
Office Supplies	350	
Office Equipment	2,000	
Exercise Equipment	18,900	
Weight Equipment	22,000	
Building	51,400	
Accounts Payable		$ 9,100
Notes Payable		49,000
Bob Green, Capital		63,100
Bob Green, Drawing	10,500	
Totals	$121,200	$121,200

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Ex. 183

The ledger account balances for Jenkins Company are listed below.

Accounts Payable	$ 8,000
Accounts Receivable	7,000
Cash	13,000
Jenkins, Capital	11,000
Jenkins, Drawing	4,000
Repair Revenue	40,000
Salaries Expense	25,000
Unearned Revenue	2,000
Utilities Expense	12,000

Instructions
Prepare a trial balance in proper form for Jenkins at December 31, 2008.

Solution 183 (8 min.)

JENKINS COMPANY
Trial Balance
December 31, 2008

	Debit	Credit
Cash	$13,000	
Accounts Receivable	7,000	
Accounts Payable		$ 8,000
Unearned Revenue		2,000
Jenkins, Capital		11,000
Jenkins, Drawing	4,000	
Repair Revenue		40,000
Salaries Expense	25,000	
Utilities Expense	12,000	
	$61,000	$61,000

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COMPLETION STATEMENTS

184. An _____ is a record of increases and decreases in specific assets, liabilities, and owner's equity items.

185. The process of entering an amount on the left side of an account is called _____ the account, and making an entry on the right side is called _____ the account.

186. _____, _____, and _____ have debit normal account balances whereas _____, _____, and _____ have credit normal account balances.

187. The four subdivisions of owner's equity are: _____, _____, _____, and _____.

188. The basic steps in the recording process are: _____ each transaction, enter the transaction in a _____, and transfer the _____ information to appropriate accounts in the _____.

189. A sales slip, a check, and a cash register tape are examples of _____ used as evidence that a transaction has taken place.

190. An accounting record where transactions are initially recorded in chronological order is called a _____.

191. When three or more accounts are required in one journal entry, the entry is referred to as a _____ entry.

192. The entire group of accounts and their balances maintained by a company is called the _____.

193. A two column list of all accounts and their balances at a given time is a _____.

Answers to Completion Statements

184. account
185. debiting, crediting
186. Assets, expenses, owner's drawing, owner's capital, liabilities, revenues
187. capital, drawings, revenues, expenses
188. analyze, journal, journal, ledger
189. business documents
190. journal
191. compound
192. general ledger
193. trial balance

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MATCHING

194. Match the items below by entering the appropriate code letter in the space provided.

A. Account	F. Journal
B. Normal account balance	G. Posting
C. Debit	H. Chart of accounts
D. Revenue account	I. Trial balance
E. Compound entry	J. Simple entry

____ 1. An entry that involves three or more accounts.

____ 2. Transferring journal entries to ledger accounts.

____ 3. The side which increases an account.

____ 4. A list of all the accounts used by an enterprise.

____ 5. A record of increases and decreases in specific assets, liabilities, and owner's equity items.

____ 6. Left side of an account.

____ 7. An entry that involves only two accounts.

____ 8. A book of original entry.

____ 9. A list of accounts and their balances at a given time.

____ 10. Has a credit normal balance

Answers to Matching

1.	E	6.	C
2.	G	7.	J
3.	B	8.	F
4.	H	9.	I
5.	A	10.	D

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SHORT-ANSWER ESSAY QUESTIONS

S-A E 195

An account is an important accounting record where financial information is stored until needed. Briefly explain (1) the nature of an account, (2) the different types of accounts, and (3) the manner in which an account is increased and decreased and its normal balance.

Solution 195

An account is an individual accounting record of increases and decreases in specific asset, liability, and owner's equity accounts. In its simplest form, an account consists of three parts: (1) the title of the account, (2) a left or debit side, and (3) a right or credit side (it resembles the letter T). Accounts are classified as asset, liability, owner's equity, revenue, and expense. Accounts with a normal debit balance, such as assets and expenses, are increased when debited and decreased when credited. Accounts with a normal credit balance, such as liabilities and revenues, are increased when credited and decreased when debited.

S-A E 196

Describe the process of preparing a trial balance. What is the purpose of preparing a trial balance? If a trial balance does not balance, identify what might be the reasons why it does not balance. If the trial balance does balance, does that insure that the ledger accounts are correct? Explain.

Solution 196

The process of preparing a trial balance consists of (1) listing the account titles and their debit or credit balances in the order in which they appear in the general ledger, (2) totaling the debit and credit columns, and (3) proving the equality of the total debits and total credits. The primary purpose of the trial balance is to prove the equality of the debits and credits after posting. A trial balance also uncovers errors in journalizing and posting because errors in journalizing and posting cause a trial balance not to balance. A trial balance does not prove that all transactions have been recorded or that the ledger is correct. The trial balance may balance even when (1) an entire transaction is not journalized, (2) a correct journal entry is not posted, (3) a journal entry is posted twice, (4) incorrect accounts are used in journalizing or posting, or (5) offsetting errors are made in recording the amount of a transaction or posting to the ledger.

S-A E 197

During a study session, a classmate states that it is not necessary to make journal entries and then post them to the ledger. She states that it is sufficient to analyze the transaction and simply record the information in T-accounts.

What is your response to this statement? Be brief, yet concise.

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Solution 197

You have a very good point regarding the steps of the accounting cycle. If a company only has a few transactions, it might be possible to simply analyze them and then record each in T-accounts. However, nearly all businesses have many transactions each day. There must be a systematic way to process these transactions. The steps of the accounting cycle represent this process. After analyzing each transaction, a journal entry needs to be prepared. The journal represents a chronological listing of every transaction for a business. This allows users to review past transactions. Your approach does not leave a trail that can be reviewed at a later date. Once the journal entries are made, posting allows each line of the journal to be transferred into the ledger. This process increases and decreases individual accounts in the ledger. At the end of the accounting period, the balance of each account is determined and the trial balance is prepared.

Based on your approach, if someone saw a credit to cash for $10,000 and wondered what the debit was, that person would have to go through every ledger account to locate the corresponding debit. By having a general journal, the person can view the entire transaction, thus easily seeing the account that was debited.

Your approach may work for a very simple business, but it would result in problems for the majority of businesses and accountants.

S-A E 198 (Ethics)

Jim Coleman, Jr. was appointed the manager of Maris Properties, a recently formed company that manages residential rental properties. Linda Grider is the accountant. She prepared a chart of accounts based on an analysis of the expenditures of the company. One of the largest expense categories is Travel and Entertainment. Mr. Coleman believes that it is important to maintain a presence in the social life of the city. In this, he sharply differs from his father, Jim Coleman, Sr. The elder Mr. Coleman has set up Maris Properties in order to test his son's management skills before allowing him to manage the more lucrative commercial property business. Mr. Coleman, Sr. provided the capital for Maris, and maintains close contact with the company. He allowed his son, however, to hire his own employees.

Mr. Coleman has asked Ms. Grider to change the name of the Travel and Entertainment account to Property Development. He hopes to deflect his father's attention away from the amount he has spent on travel and entertainment until he has proven that his methods work. When Ms. Grider resisted, he reminded her that he, not his father, hired her. He also reminded her that she had been enthusiastic about his business plans when she was hired.

Required:

1. Who are the stakeholders in this situation?
2. Should Ms. Grider agree to the change in the Travel and Entertainment account to Property Development? Explain.

Solution 198

1. The stakeholders in this situation include
   Mr. Coleman, Jr.
   Linda Grider
   Mr. Coleman, Sr.
   Bankers and others who might rely on the financial statements

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Solution 198 (cont.)

2. Ms. Grider definitely should not agree to the name change. The intention of the person making the change is to deceive someone who has a right to know the affairs of the business, fully and completely. Though Ms. Grider was hired by Mr. Coleman, Jr., and though she may agree with his business methods, she cannot be a party to such deceit.

S-A E 199 (Communication)

A classmate is considering dropping his accounting class because he cannot understand the rules of debits and credits.

a. Can the student be successful in the course without an understanding of the rules of debits and credits?

b. Explain the rules of debits and credits in a way that will help him understand them.

Solution 199

a. Accounting is based on the double-entry system. This system records the dual effect of each transaction in the appropriate accounts, thus keeping the accounting equation in balance. Each transaction is analyzed and recorded using this dual effect system. If you do not have this basic understanding, the remaining chapters will become increasingly more difficult. You will not have the ability to make journal entries for the many new topics in these upcoming chapters.

b. You may be trying to memorize the rules of debits and credits, only to discover that this does not work. Here are some other ways to master this very important topic:

   - Make sure that you understand the accounting equation. Assets equal the total of liabilities and owners' equity. Owners' equity is not an account but rather a group of accounts that includes owner's capital, revenues, expenses, and owner's drawings. Owner's capital and revenues cause owners' equity to increase while expenses and drawings cause owners' equity to decrease.

   - Next, make sure that you understand the accounting meaning of the terms debits and credits. For accounting, debit means left and credit means right. Don't try to add any more to these definitions.

   - Then, work with the rules of debits and credits. These rules determine whether a debit or credit increases or decreases an account. Start with assets. Assets increase with a debit and thus decrease with a credit. Think about the cash account—when cash is received, the account is increased with a debit. When cash is paid, the account is decreased with a credit. The remaining accounts are on the right side of the equal sign in the accounting equation. All of the other rules of debits and credits keep the equation in balance. Liabilities, owner's capital, and revenues are all increased with credits. Expenses and owner's drawing are the two accounts that cause owners' equity to decrease, thus they must be increased with a debit.

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CHAPTER 3

ADJUSTING THE ACCOUNTS

SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
True-False **Statements**														
1.	1	C	9.	2	C	17.	5	C	25.	5	K	[sg]33.	3	K
2.	1	K	10.	2	K	18.	5	K	26.	6	K	[sg]34.	5	K
3.	1	K	11.	3	C	19.	5	C	27.	7	K	[sg]35.	6	K
4.	1	C	12.	3	K	20.	5	C	[a]28.	8	C	[sg]36.	7	K
5.	1	K	13.	3	K	21.	5	C	[a]29.	8	C	[sg,a]37.	8	C
6.	2	C	14.	3	K	22.	5	K	[a]30.	8	C			
7.	2	K	15.	4	C	23.	5	K	[sg]31.	2	K			
8.	2	K	16.	4	K	24.	5	C	[sg]32.	3	K			
Multiple Choice Questions														
38.	1	K	63.	2	AP	88.	5	AN	113.	5	AN	138.	6	AP
39.	1	K	64.	2	AP	89.	5	AN	114.	5	AP	139.	7	K
40.	1	K	65.	3	K	90.	5	K	115.	5	AN	140.	7	K
41.	1	C	66.	3	C	91.	5	K	116.	5	AN	141.	7	K
42.	1	K	67.	3	C	92.	5	C	117.	5	AP	142.	7	C
43.	1	K	68.	3	K	93.	5	C	118.	5	AP	[a]143.	8	C
44.	1	C	69.	3	C	94.	5	AN	119.	5	AP	[a]144.	8	C
45.	1	C	70.	3	C	95.	5	K	120.	5	C	[a]145.	8	AN
46.	1	C	71.	3	C	96.	5	AN	121.	5	C	[a]146.	8	AN
47.	1	K	72.	3	C	97.	5	C	122.	5	AN	[a]147.	8	AN
48.	2	K	73.	4	K	98.	5	K	123.	5	AN	[a]148.	8	AN
49.	2	K	74.	4	C	99.	5	K	124.	6	C	[sg]149.	2	C
50.	2	K	75.	4	K	100.	5	K	125.	6	C	[st]150.	2	K
51.	2	K	76.	4	K	101.	5	K	126.	6	AN	[st]151.	2	K
52.	2	C	77.	4	K	102.	5	C	127.	6	AN	[sg]152.	4	K
53.	2	C	78.	4	K	103.	5	C	128.	6	AN	[st]153.	4	K
54.	2	C	79.	4	K	104.	5	K	129.	6	C	[sg]154.	5	AP
55.	2	C	80.	4	K	105.	5	C	130.	6	AN	[sg]155.	6	AP
56.	2	C	81.	4	C	106.	5	AN	131.	6	AN	[st]156.	6	K
57.	2	C	82.	4	K	107.	5	AN	132.	6	AN	[sg]157.	6	AP
58.	2	K	83.	4	AN	108.	5	AN	133.	6	AP	[st]158.	7	K
59.	2	C	84.	5	C	109.	5	AN	134.	6	C	[sg]159.	7	K
60.	2	C	85.	5	C	110.	5	AN	135.	6	AN			
61.	2	C	86.	5	K	111.	5	AN	136.	6	AP			
62.	2	AP	87.	5	K	112.	5	AP	137.	6	AP			

[sg] This question also appears in the Study Guide.
[st] This question also appears in a self-test at the student companion website.
[a] This question covers a topic in an appendix to the chapter.

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SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Brief Exercises														
160.	4	K	163.	5	AN	166.	5	AN	169.	6	AN	172.	6	AN
161.	5	AP	164.	5	AN	167.	5	AN	170.	6	AN	173.	7	AP
162.	5	AN	165.	5	AN	168.	5,8	AN	171.	6	K	174.	7	AP
Exercises														
175.	2	AN	181.	4	C	187.	5,6	AN	193.	6	AN	199.	7	AP
176.	2	AN	182.	4	C	188.	5,6	AN	194.	6	AN	[a]200.	8	AN
177.	3	AN	183.	4,5	AN	189.	5,6	AN	195.	6	AN			
178.	3	AN	184.	5	AN	190.	5,6	AN	196.	5-7	AN			
179.	4	C	185.	5	AN	191.	5,6	AN	197.	5-7	AN			
180.	4	AN	186.	5,6	AN	192.	5,6	C	198.	7	AN			
Completion Statements														
201.	1	K	204.	2	K	207.	5	K	210.	6	K			
202.	1	K	205.	2	K	208.	5	K	211.	7	K			
203.	2	K	206.	5	K	209.	5	K						

SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Study Objective 1													
1.	TF	4.	TF	39.	MC	42.	MC	45.	MC	201.	C		
2.	TF	5.	TF	40.	MC	43.	MC	46.	MC	202.	C		
3.	TF	38.	MC	41.	MC	44.	MC	47.	MC				
Study Objective 2													
6.	TF	31.	TF	52.	MC	57.	MC	62.	MC	151.	MC	205.	C
7.	TF	48.	MC	53.	MC	58.	MC	63.	MC	175.	Ex		
8.	TF	49.	MC	54.	MC	59.	MC	64.	MC	176.	Ex		
9.	TF	50.	MC	55.	MC	60.	MC	149.	MC	203.	C		
10.	TF	51.	MC	56.	MC	61.	MC	150.	MC	204.	C		
Study Objective 3													
11.	TF	14.	TF	65.	MC	68.	MC	71.	MC	178.	Ex		
12.	TF	32.	TF	66.	MC	69.	MC	72.	MC				
13.	TF	33.	TF	67.	MC	70.	MC	177.	Ex				
Study Objective 4													
15.	TF	74.	MC	77.	MC	80.	MC	83.	MC	160.	BE	181.	Ex
16.	TF	75.	MC	78.	MC	81.	MC	152.	MC	179.	Ex	182.	Ex
73.	MC	76.	MC	79.	MC	82.	MC	153.	MC	180.	Ex	183.	Ex

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SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Study Objective 5																	
17.	TF	85.	MC	96.	MC	107.	MC	118.	MC	165.	BE	190.	Ex				
18.	TF	86.	MC	97.	MC	108.	MC	119.	MC	166.	BE	191.	Ex				
19.	TF	87.	MC	98.	MC	109.	MC	120.	MC	167.	BE	192.	Ex				
20.	TF	88.	MC	99.	MC	110.	MC	121.	MC	168.	BE	196.	Ex				
21.	TF	89.	MC	100.	MC	111.	MC	122.	MC	183.	Ex	197.	Ex				
22.	TF	90.	MC	101.	MC	112.	MC	123.	MC	184.	Ex	206.	C				
23.	TF	91.	MC	102.	MC	113.	MC	154.	MC	185.	Ex	207.	C				
24.	TF	92.	MC	103.	MC	114.	MC	161.	BE	186.	Ex	208.	C				
25.	TF	93.	MC	104.	MC	115.	MC	162.	BE	187.	Ex	209.	C				
34.	TF	94.	MC	105.	MC	116.	MC	163.	BE	188.	Ex						
84.	MC	95.	MC	106.	MC	117.	MC	164.	BE	189.	Ex						
Study Objective 6																	
26.	TF	128.	MC	134.	MC	156.	MC	186.	Ex	192.	Ex	210.	C				
35.	TF	129.	MC	135.	MC	157.	MC	187.	Ex	193.	Ex						
124.	MC	130.	MC	136.	MC	169.	BE	188.	Ex	194.	Ex						
125.	MC	131.	MC	137.	MC	170.	BE	189.	Ex	195.	Ex						
126.	MC	132.	MC	138.	MC	171.	BE	190.	Ex	196.	Ex						
127.	MC	133.	MC	155.	MC	172.	BE	191.	Ex	197.	Ex						
Study Objective 7																	
27.	TF	140.	MC	158.	MC	174.	BE	198.	Ex								
36.	TF	141.	MC	159.	MC	196.	Ex	199.	Ex								
139.	MC	142.	MC	173.	BE	197.	Ex	211.	C								
Study Objective [a]8																	
[a]28.	TF	[a]30.	TF	[a]143.	MC	[a]145.	MC	[a]147.	MC	168.	BE						
[a]29.	TF	[a]37.	TF	[a]144.	MC	[a]146.	MC	[a]148.	MC	[a]200.	Ex						

Note: TF = True-False BE = Brief Exercise C = Completion
MC = Multiple Choice Ex = Exercise

The chapter also contains one set of ten Matching questions and six Short-Answer Essay questions.

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CHAPTER STUDY OBJECTIVES

1. ***Explain the time period assumption.*** The time period assumption assumes that the economic life of a business is divided into artificial time periods.

2. ***Explain the accrual basis of accounting.*** Accrual-basis accounting means that companies record events that change a company's financial statements in the periods in which those events occur, rather than in the periods in which the company receives or pays cash.

3. ***Explain the reasons for adjusting entries.*** Companies make adjusting entries at the end of an accounting period. Such entries ensure that companies record revenues in the period in which they are earned and that they recognize expenses in the period in which they are incurred.

4. ***Identify the major types of adjusting entries.*** The major types of adjusting entries are deferrals (prepaid expenses and unearned revenues) and accruals (accrued revenues and accrued expenses).

5. ***Prepare adjusting entries for deferrals.*** Deferrals are either prepaid expenses or unearned revenues. Companies make adjusting entries for deferrals to record the portion of the prepayment that represents the expense incurred or the revenue earned in the current accounting period.

6. ***Prepare adjusting entries for accruals.*** Accruals are either accrued revenues or accrued expenses. Companies make adjusting entries for accruals to record revenues earned and expenses incurred in the current accounting period that have not been recognized through daily entries.

7. ***Describe the nature and purpose of an adjusted trial balance.*** An adjusted trial balance shows the balances of all accounts, including those that have been adjusted, at the end of an accounting period. Its purpose is to prove the equality of the total debit balances and total credit balances in the ledger after all adjustments.

[a]8. ***Prepare adjusting entries for the alternative treatment of deferrals.*** Companies may initially debit prepayments to an expense account. Likewise they may credit unearned revenues to a revenue account. At the end of the period, these accounts may be overstated. The adjusting entries for prepaid expenses are a debit to an asset account and a credit to an expense account. Adjusting entries for unearned revenues are a debit to a revenue account and a credit to a liability account.

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TRUE-FALSE STATEMENTS

1. Many business transactions affect more than one time period.

2. The time period assumption states that the economic life of a business entity can be divided into artificial time periods.

3. The time period assumption is often referred to as the matching principle.

4. A company's calendar year and fiscal year are always the same.

5. Accounting time periods that are one year in length are referred to as interim periods.

6. Income will always be greater under the cash basis of accounting than under the accrual basis of accounting.

7. The cash basis of accounting is not in accordance with generally accepted accounting principles.

8. The matching principle requires that efforts be matched with accomplishments.

9. Expense recognition is tied to revenue recognition.

10. The revenue recognition principle dictates that revenue be recognized in the accounting period in which cash is received.

11. Adjusting entries are not necessary if the trial balance debit and credit columns balances are equal.

12. An adjusting entry always involves two balance sheet accounts.

13. Adjusting entries are often made because some business events are not recorded as they occur.

14. Adjusting entries are recorded in the general journal but are not posted to the accounts in the general ledger.

15. Revenue received before it is earned and expenses paid before being used or consumed are both initially recorded as liabilities.

16. Accrued revenues are revenues which have been received but not yet earned.

17. The book value of a depreciable asset is always equal to its market value because depreciation is a valuation technique.

18. Accumulated Depreciation is a liability account and has a credit normal account balance.

19. A liability—revenue account relationship exists with an unearned rent revenue adjusting entry.

20. The balances of the Depreciation Expense and the Accumulated Depreciation accounts should always be the same.

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21. Unearned revenue is a prepayment that requires an adjusting entry when services are performed.

22. Asset prepayments become expenses when they expire.

23. A contra asset account is subtracted from a related account in the balance sheet.

24. If prepaid costs are initially recorded as an asset, no adjusting entries will be required in the future.

25. The cost of a depreciable asset less accumulated depreciation reflects the book value of the asset.

26. Accrued revenues are revenues that have been earned and received before financial statements have been prepared.

27. Financial statements can be prepared from the information provided by an adjusted trial balance.

[a]28. The adjusting entry at the end of the period to record an expired cost may be different depending on whether the cost was initially recorded as an asset or an expense.

[a]29. Rent received in advance and credited to a rent revenue account which is still unearned at the end of the period, will require an adjusting entry crediting a liability account for the amount still unearned.

[a]30. An adjusting entry requiring a credit to Insurance Expense indicates that the initial transaction was charged to an asset account.

Additional True-False Questions

31. The matching principle requires that expenses be matched with revenues.

32. In general, adjusting entries are required each time financial statements are prepared.

33. Every adjusting entry affects one balance sheet account and one income statement account.

34. The Accumulated Depreciation account is a contra asset account that is reported on the balance sheet.

35. Accrued revenues are amounts recorded and received but not yet earned.

36. An adjusted trial balance should be prepared before the adjusting entries are made.

[a]37. When a prepaid expense is initially debited to an expense account, expenses and assets are both overstated prior to adjustment.

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Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	T	7.	T	13.	T	19.	T	25.	T	31.	T	[a]37.	F
2.	T	8.	T	14.	F	20.	F	26.	F	32.	T		
3.	F	9.	T	15.	F	21.	T	27.	T	33.	T		
4.	F	10.	F	16.	F	22.	T	[a]28.	T	34.	T		
5.	F	11.	F	17.	F	23.	T	[a]29.	T	35.	F		
6.	F	12.	F	18.	F	24.	F	[a]30.	F	36.	F		

MULTIPLE CHOICE QUESTIONS

38. Monthly and quarterly time periods are called
    a. calender periods.
    b. fiscal periods.
    c. interim periods.
    d. quarterly periods.

39. The time period assumption states that
    a. a transaction can only affect one period of time.
    b. estimates should not be made if a transaction affects more than one time period.
    c. adjustments to the enterprise's accounts can only be made in the time period when the business terminates its operations.
    d. the economic life of a business can be divided into artificial time periods.

40. An accounting time period that is one year in length, but does *not* begin on January 1, is referred to as
    a. a fiscal year.
    b. an interim period.
    c. the time period assumption.
    d. a reporting period.

41. Adjustments would *not* be necessary if financial statements were prepared to reflect net income from
    a. monthly operations.
    b. fiscal year operations.
    c. interim operations.
    d. lifetime operations.

42. Management usually desires _____ financial statements and the IRS requires all businesses to file _____ tax returns.
    a. annual, annual
    b. monthly, annual
    c. quarterly, monthly
    d. monthly, monthly

43. The time period assumption is also referred to as the
    a. calendar assumption.
    b. cyclicity assumption.
    c. periodicity assumption.
    d. fiscal assumption.

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44. In general, the shorter the time period, the difficulty of making the proper adjustments to accounts
    a. is increased.
    b. is decreased.
    c. is unaffected.
    d. depends on if there is a profit or loss.

45. Which of the following is *not* a common time period chosen by businesses as their accounting period?
    a. Daily
    b. Monthly
    c. Quarterly
    d. Annually

46. Which of the following time periods would *not* be referred to as an interim period?
    a. Monthly
    b. Quarterly
    c. Semi-annually
    d. Annually

47. The fiscal year of a business is usually determined by
    a. the IRS.
    b. a lottery.
    c. the business.
    d. the SEC.

48. Which of the following are in accordance with generally accepted accounting principles?
    a. Accrual basis accounting
    b. Cash basis accounting
    c. Both accrual basis and cash basis accounting
    d. Neither accrual basis nor cash basis accounting

49. The revenue recognition principle dictates that revenue should be recognized in the accounting records
    a. when cash is received.
    b. when it is earned.
    c. at the end of the month.
    d. in the period that income taxes are paid.

50. In a service-type business, revenue is considered earned
    a. at the end of the month.
    b. at the end of the year.
    c. when the service is performed.
    d. when cash is received.

51. The matching principle matches
    a. customers with businesses.
    b. expenses with revenues.
    c. assets with liabilities.
    d. creditors with businesses.

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52. Ken's Tune-up Shop follows the revenue recognition principle. Ken services a car on July 31. The customer picks up the vehicle on August 1 and mails the payment to Ken on August 5. Ken receives the check in the mail on August 6. When should Ken show that the revenue was earned?
    a. July 31
    b. August 1
    c. August 5
    d. August 6

53. A company spends $10 million dollars for an office building. Over what period should the cost be written off?
    a. When the $10 million is expended in cash
    b. All in the first year
    c. Over the useful life of the building
    d. After $10 million in revenue is earned

54. The matching principle states that expenses should be matched with revenues. Another way of stating the principle is to say that
    a. assets should be matched with liabilities.
    b. efforts should be matched with accomplishments.
    c. owner withdrawals should be matched with owner contributions.
    d. cash payments should be matched with cash receipts.

55. A dress shop makes a large sale for $1,000 on November 30. The customer is sent a statement on December 5 and a check is received on December 10. The dress shop follows GAAP and applies the revenue recognition principle. When is the $1,000 considered to be earned?
    a. December 5
    b. December 10
    c. November 30
    d. December 1

56. A furniture factory's employees work overtime to finish an order that is sold on February 28. The office sends a statement to the customer in early March and payment is received by mid-March. The overtime wages should be expensed in
    a. February.
    b. March.
    c. the period when the workers receive their checks.
    d. either in February or March depending on when the pay period ends.

57. Expenses sometimes make their contribution to revenue in a different period than when the expense is paid. When wages are incurred in one period and paid in the next period, this often leads to which account appearing on the balance sheet at the end of the time period?
    a. Due from Employees
    b. Due to Employer
    c. Wages Payable
    d. Wages Expense

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58. Under accrual-basis accounting
    a. cash must be received before revenue is recognized.
    b. net income is calculated by matching cash outflows against cash inflows.
    c. events that change a company's financial statements are recognized in the period they occur rather than in the period in which cash is paid or received.
    d. the ledger accounts must be adjusted to reflect a cash basis of accounting before financial statements are prepared under generally accepted accounting principles.

59. Adjusting entries are required
    a. yearly.
    b. quarterly.
    c. monthly.
    d. every time financial statements are prepared.

60. Which is not an application of revenue recognition?
    a. Recording revenue as an adjusting entry on the last day of the accounting period.
    b. Accepting cash from an established customer for services to be performed over the next three months.
    c. Billing customers on June 30 for services completed during June.
    d. Receiving cash for services performed.

61. Which statement is correct?
    a. As long as a company consistently uses the cash basis of accounting, generally accepted accounting principles allow its use.
    b. The use of the cash basis of accounting violates both the revenue recognition and matching principles.
    c. The cash basis of accounting is objective because no one can be certain of the amount of revenue until the cash is received.
    d. As long as management is ethical, there are no problems with using the cash basis of accounting.

62. The following is selected information from J Corporation for the fiscal year ending October 31, 2008.

Cash received from customers	$300,000
Revenue earned	350,000
Cash paid for expenses	170,000
Cash paid for computers on November 1, 2007 that will be used for 3 years (annual depreciation is $16,000)	48,000
Expenses incurred, not including any depreciation	200,000
Proceeds from a bank loan, part of which was used to pay for the computers	100,000

Based on the accrual basis of accounting, what is J Corporation’s net income for the year ending October 31, 2008?
    a. $114,000
    b. $134,000
    c. $82,000
    d. $150,000

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Use the following information for questions 63–64.

Sheepskin Company had the following transactions during 2008.

- Sales of $4,500 on account
- Collected $2,000 for services to be performed in 2009
- Paid $625 cash in salaries
- Purchased airline tickets for $250 in December for a trip to take place in 2009

63. What is Sheepskin's 2008 net income using accrual accounting?
    a. $3,875
    b. $5,875
    c. $5,625
    d. $3,625

64. What is Sheepskin's 2008 net income using cash basis accounting?
    a. $5,875
    b. $1,375
    c. $5,625
    d. $1,125

65. Adjusting entries are required
    a. because some costs expire with the passage of time and have not yet been journalized.
    b. when the company's profits are below the budget.
    c. when expenses are recorded in the period in which they are incurred.
    d. when revenues are recorded in the period in which they are earned.

66. A small company may be able to justify using a cash basis of accounting if they have
    a. sales under $1,000,000.
    b. no accountants on staff.
    c. few receivables and payables.
    d. all sales and purchases on account.

67. Which one of the following is *not* a justification for adjusting entries?
    a. Adjusting entries are necessary to ensure that revenue recognition principles are followed.
    b. Adjusting entries are necessary to ensure that the matching principle is followed.
    c. Adjusting entries are necessary to enable financial statements to be in conformity with GAAP.
    d. Adjusting entries are necessary to bring the general ledger accounts in line with the budget.

68. An adjusting entry
    a. affects two balance sheet accounts.
    b. affects two income statement accounts.
    c. affects a balance sheet account and an income statement account.
    d. is always a compound entry.

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69. The preparation of adjusting entries is
    a. straight forward because the accounts that need adjustment will be out of balance.
    b. often an involved process requiring the skills of a professional.
    c. only required for accounts that do not have a normal balance.
    d. optional when financial statements are prepared.

70. If a resource has been consumed but a bill has *not* been received at the end of the accounting period, then
    a. an expense should be recorded when the bill is received.
    b. an expense should be recorded when the cash is paid out.
    c. an adjusting entry should be made recognizing the expense.
    d. it is optional whether to record the expense before the bill is received.

71. Accounts often need to be adjusted because
    a. there are never enough accounts to record all the transactions.
    b. many transactions affect more than one time period.
    c. there are always errors made in recording transactions.
    d. management can't decide what they want to report.

72. Adjusting entries are
    a. not necessary if the accounting system is operating properly.
    b. usually required before financial statements are prepared.
    c. made whenever management desires to change an account balance.
    d. made to balance sheet accounts only.

73. Expenses incurred but not yet paid or recorded are called
    a. prepaid expenses.
    b. accrued expenses.
    c. interim expenses.
    d. unearned expenses.

74. A law firm received $2,000 cash for legal services to be rendered in the future. The full amount was credited to the liability account Unearned Legal Fees. If the legal services have been rendered at the end of the accounting period and no adjusting entry is made, this would cause
    a. expenses to be overstated.
    b. net income to be overstated.
    c. liabilities to be understated.
    d. revenues to be understated.

75. Adjusting entries can be classified as
    a. postponements and advances.
    b. accruals and prepayments.
    c. prepayments and postponements.
    d. accruals and advances.

76. Accrued revenues are
    a. received and recorded as liabilities before they are earned.
    b. earned and recorded as liabilities before they are received.
    c. earned but not yet received or recorded.
    d. earned and already received and recorded.

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77. Prepaid expenses are
    a. paid and recorded in an asset account before they are used or consumed.
    b. paid and recorded in an asset account after they are used or consumed.
    c. incurred but not yet paid or recorded.
    d. incurred and already paid or recorded.

78. Accrued expenses are
    a. paid and recorded in an asset account before they are used or consumed.
    b. paid and recorded in an asset account after they are used or consumed.
    c. incurred but not yet paid or recorded.
    d. incurred and already paid or recorded.

79. Unearned revenues are
    a. received and recorded as liabilities before they are earned.
    b. earned and recorded as liabilities before they are received.
    c. earned but not yet received or recorded.
    d. earned and already received and recorded.

80. A liability—revenue relationship exists with
    a. prepaid expense adjusting entries.
    b. accrued expense adjusting entries.
    c. unearned revenue adjusting entries.
    d. accrued revenue adjusting entries.

81. Which of the following reflect the balances of prepayment accounts prior to adjustment?
    a. Balance sheet accounts are understated and income statement accounts are understated.
    b. Balance sheet accounts are overstated and income statement accounts are overstated.
    c. Balance sheet accounts are overstated and income statement accounts are understated.
    d. Balance sheet accounts are understated and income statement accounts are overstated.

82. An asset—expense relationship exists with
    a. liability accounts.
    b. revenue accounts.
    c. prepaid expense adjusting entries.
    d. accrued expense adjusting entries.

83. Quirk Company purchased office supplies costing $6,000 and debited Office Supplies for the full amount. At the end of the accounting period, a physical count of office supplies revealed $2,400 still on hand. The appropriate adjusting journal entry to be made at the end of the period would be
    a. Debit Office Supplies Expense, $2,400; Credit Office Supplies, $2,400.
    b. Debit Office Supplies, $3,600; Credit Office Supplies Expense, $3,600.
    c. Debit Office Supplies Expense, $3,600; Credit Office Supplies, $3,600.
    d. Debit Office Supplies, $2,400; Credit Office Supplies Expense, $2,400.

84. If an adjustment is needed for unearned revenues, the
    a. liability and related revenue are overstated before adjustment.
    b. liability and related revenue are understated before adjustment.
    c. liability is overstated and the related revenue is understated before adjustment.
    d. liability is understated and the related revenue is overstated before adjustment.

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85. If an adjustment is needed for prepaid expenses, the
    a. asset and related expense are overstated before adjustment.
    b. asset and related expense are understated before adjustment.
    c. asset is understated and the related expense is overstated before adjustment.
    d. asset is overstated and the related expense is understated before adjustment.

86. Depreciation expense for a period is computed by taking the
    a. original cost of an asset – accumulated depreciation.
    b. depreciable cost ÷ depreciation rate.
    c. cost of the asset ÷ useful life.
    d. market value of the asset ÷ useful life.

87. Accumulated Depreciation is
    a. an expense account.
    b. an owner's equity account.
    c. a liability account.
    d. a contra asset account.

88. Hardy Company purchased a computer for $4,800 on December 1. It is estimated that annual depreciation on the computer will be $960. If financial statements are to be prepared on December 31, the company should make the following adjusting entry:
    a. Debit Depreciation Expense, $960; Credit Accumulated Depreciation, $960.
    b. Debit Depreciation Expense, $80; Credit Accumulated Depreciation, $80.
    c. Debit Depreciation Expense, $3,840; Credit Accumulated Depreciation, $3,840.
    d. Debit Office Equipment, $4,800; Credit Accumulated Depreciation, $4,800.

89. Baden Realty Company received a check for $18,000 on July 1 which represents a 6 month advance payment of rent on a building it rents to a client. Unearned Rent was credited for the full $18,000. Financial statements will be prepared on July 31. Baden Realty should make the following adjusting entry on July 31:
    a. Debit Unearned Rent, $3,000; Credit Rental Revenue, $3,000.
    b. Debit Rental Revenue, $3,000; Credit Unearned Rent, $3,000.
    c. Debit Unearned Rent, $18,000; Credit Rental Revenue, $18,000.
    d. Debit Cash, $18,000; Credit Rental Revenue, $18,000.

90. As prepaid expenses expire with the passage of time, the correct adjusting entry will be a
    a. debit to an asset account and a credit to an expense account.
    b. debit to an expense account and a credit to an asset account.
    c. debit to an asset account and a credit to an asset account.
    d. debit to an expense account and a credit to an expense account.

91. A company usually determines the amount of supplies used during a period by
    a. adding the supplies on hand to the balance of the Supplies account.
    b. summing the amount of supplies purchased during the period.
    c. taking the difference between the supplies purchased and the supplies paid for during the period.
    d. taking the difference between the balance of the Supplies account and the cost of supplies on hand.

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92. If a company fails to make an adjusting entry to record supplies expense, then
    a. owner's equity will be understated.
    b. expense will be understated.
    c. assets will be understated.
    d. net income will be understated.

93. If a company fails to adjust a Prepaid Rent account for rent that has expired, what effect will this have on that month's financial statements?
    a. Failure to make an adjustment does not affect the financial statements.
    b. Expenses will be overstated and net income and owner's equity will be understated.
    c. Assets will be overstated and net income and owner's equity will be understated.
    d. Assets will be overstated and net income and owner's equity will be overstated.

94. At December 31, 2008, before any year-end adjustments, Karr Company's Insurance Expense account had a balance of $1,450 and its Prepaid Insurance account had a balance of $3,800. It was determined that $3,000 of the Prepaid Insurance had expired. The adjusted balance for Insurance Expense for the year would be
    a. $3,000.
    b. $1,450.
    c. $4,450.
    d. $2,250.

95. Depreciation is the process of
    a. valuing an asset at its fair market value.
    b. increasing the value of an asset over its useful life in a rational and systematic manner.
    c. allocating the cost of an asset to expense over its useful life in a rational and systematic manner.
    d. writing down an asset to its real value each accounting period.

96. A new accountant working for Metcalf Company records $800 Depreciation Expense on store equipment as follows:

Dr.	Depreciation Expense	800	
Cr.	Cash		800

    The effect of this entry is to
    a. adjust the accounts to their proper amounts on December 31.
    b. understate total assets on the balance sheet as of December 31.
    c. overstate the book value of the depreciable assets at December 31.
    d. understate the book value of the depreciable assets as of December 31.

97. From an accounting standpoint, the acquisition of productive facilities can be thought of as a long-term
    a. accrual of expense.
    b. accrual of revenue.
    c. accrual of unearned revenue.
    d. prepayment for services.

98. In computing depreciation, the number of years of useful life of the asset is
    a. known with certainty.
    b. an estimate.
    c. always fixed at 5 years.
    d. always fixed at 3 years.

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99. An accumulated depreciation account
    a. is a contra-liability account.
    b. increases on the debit side.
    c. is offset against total assets on the balance sheet.
    d. has a normal credit balance.

100. The difference between the cost of a depreciable asset and its related accumulated depreciation is referred to as the
    a. market value of the asset.
    b. blue book value of the asset.
    c. book value of the asset.
    d. depreciated difference of the asset.

101. If a business has several types of long-term assets such as equipment, buildings, and trucks,
    a. there should be only one accumulated depreciation account.
    b. there should be separate accumulated depreciation accounts for each type of asset.
    c. all the long-term asset accounts will be recorded in one general ledger account.
    d. there won't be a need for an accumulated depreciation account.

102. Which of the following would *not* result in unearned revenue?
    a. Rent collected in advance from tenants
    b. Services performed on account
    c. Sale of season tickets to football games
    d. Sale of two-year magazine subscriptions

103. If business pays rent in advance and debits a Prepaid Rent account, the company receiving the rent payment will credit
    a. cash.
    b. prepaid rent.
    c. unearned rent revenue.
    d. accrued rent revenue.

104. Unearned revenue is classified as
    a. an asset account.
    b. a revenue account.
    c. a contra-revenue account.
    d. a liability.

105. If a business has received cash in advance of services performed and credits a liability account, the adjusting entry needed after the services are performed will be
    a. debit Unearned Revenue and credit Cash.
    b. debit Unearned Revenue and credit Service Revenue.
    c. debit Unearned Revenue and credit Prepaid Expense.
    d. debit Unearned Revenue and credit Accounts Receivable.

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106. White Laundry Company purchased $6,500 worth of laundry supplies on June 2 and recorded the purchase as an asset. On June 30, an inventory of the laundry supplies indicated only $2,000 on hand. The adjusting entry that should be made by the company on June 30 is
   a. Debit Laundry Supplies Expense, $2,000; Credit Laundry Supplies, $2,000.
   b. Debit Laundry Supplies, $2,000; Credit Laundry Supplies Expense, $2,000.
   c. Debit Laundry Supplies, $4,500; Credit Laundry Supplies Expense, $4,500.
   d. Debit Laundry Supplies Expense, $4,500; Credit Laundry Supplies, $4,500.

107. On July 1, Dexter Shoe Store paid $8,000 to Ace Realty for 4 months rent beginning July 1. Prepaid Rent was debited for the full amount. If financial statements are prepared on July 31, the adjusting entry to be made by Dexter Shoe Store is
   a. Debit Rent Expense, $8,000; Credit Prepaid Rent, $2,000.
   b. Debit Prepaid Rent, $2,000; Credit Rent Expense, $2,000.
   c. Debit Rent Expense, $2,000; Credit Prepaid Rent, $2,000.
   d. Debit Rent Expense, $8,000; Credit Prepaid Rent, $8,000.

108. Southeastern Louisiana University sold season tickets for the 2008 football season for $160,000. A total of 8 games will be played during September, October and November. In September, three games were played. The adjusting journal entry at September 30
   a. is not required. No adjusting entries will be made until the end of the season in November.
   b. will include a debit to Cash and a credit to Ticket Revenue for $40,000.
   c. will include a debit to Unearned Ticket Revenue and a credit to Ticket Revenue for $60,000.
   d. will include a debit to Ticket Revenue and a credit to Unearned Ticket Revenue for $53,333.

109. Southeastern Louisiana University sold season tickets for the 2008 football season for $160,000. A total of 8 games will be played during September, October and November. In September, two games were played. In October, three games were played. The balance in Unearned Revenue at October 31 is
   a. $0.
   b. $40,000.
   c. $60,000.
   d. $100,000.

110. Southeastern Louisiana University sold season tickets for the 2008 football season for $160,000. A total of 8 games will be played during September, October and November. Assuming all the games are played, the Unearned Revenue balance that will be reported on the December 31 balance sheet will be
   a. $0.
   b. $60,000.
   c. $100,000.
   d. $160,000.

111. At March 1, 2008, Candy Inc. had supplies on hand of $500. During the month, Candy purchased supplies of $1,200 and used supplies of $1,500. The March 31 adjusting journal entry should include a
   a. debit to the supplies account for $1,500.
   b. credit to the supplies account for $500.
   c. debit to the supplies account for $1,200.
   d. credit to the supplies account for $1,500.

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112. Dorting Company purchased a computer system for $3,600 on January 1, 2008. The company expects to use the computer system for 3 years. It has no salvage value. Monthly depreciation expense on the asset is
a. $0.
b. $100.
c. $1,200.
d. $3,600.

113. Maple Tree Inc. purchased a 12-month insurance policy on March 1, 2008 for $900. At March 31, 2008, the adjusting journal entry to record expiration of this asset will include a
a. debit to Prepaid Insurance and a credit to Cash for $900.
b. debit to Prepaid Insurance and a credit to Insurance Expense for $100.
c. debit to Insurance Expense and a credit to Prepaid Insurance for $75
d. debit to Insurance Expense and a credit to Cash for $75.

114. Ogletree Enterprises purchased an 18-month insurance policy on May 31, 2008 for $3,600. The December 31, 2008 balance sheet would report Prepaid Insurance of
a. $0 because Prepaid Insurance is reported on the Income Statement.
b. $1,400.
c. $2,200.
d. $3,600.

115. At March 1, J.C. Retro Inc. reported a balance in Supplies of $200. During March, the company purchased supplies for $750 and consumed supplies of $800. If no adjusting entry is made for supplies
a. owner's equity will be overstated by $800.
b. expenses will be understated by $750.
c. assets will be understated by $150.
d. net income will be understated by $800.

116. FMI Inc. pays its rent of $120,000 annually on January 1. If the February 28 monthly adjusting entry for prepaid rent is omitted, which of the following will be true?
a. Failure to make the adjustment does not affect the February financial statements.
b. Expenses will be overstated by $10,000 and net income and owner's equity will be understated by $10,000.
c. Assets will be overstated by $20,000 and net income and owner's equity will be understated by $20,000.
d. Assets will be overstated by $10,000 and net income and owner's equity will be overstated by $10,000.

117. On January 1, 2007, P.T. Oracle Company purchased a computer system for $3,240. The company expects to use the system for 3 years. The asset has no salvage value. The book value of the system at December 31, 2008 is
a. $0.
b. $1,080.
c. $2,160.
d. $3,240.

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118. On January 1, 2007, E.D. Reardon Inc. purchased equipment for $30,000. The company is depreciating the equipment at the rate of $400 per month. At January 31, 2008, the balance in Accumulated Depreciation is
a. $400.
b. $4,800.
c. $5,200.
d. $24,800.

119. On January 1, 2008, M. Johnson Company purchased equipment for $30,000. The company is depreciating the equipment at the rate of $700 per month. The book value of the equipment at December 31, 2008 is
a. $0.
b. $8,400.
c. $21,600.
d. $30,000.

120. Lawton Company collected $8,400 in May of 2008 for 4 months of service which would take place from October of 2008 through January of 2009. The revenue reported from this transaction during 2008 would be
a. 0.
b. $6,300.
c. $8,400.
d. $2,010.

121. Keypress Company collected $6,500 in May of 2008 for 5 months of service which would take place from October of 2008 through February of 2009. The revenue reported from this transaction during 2008 would be
a. $0.
b. $3,900.
c. $6,500.
d. $2,600.

122. Waterfalls Corporation purchased a one-year insurance policy in January 2008 for $66,000. The insurance policy is in effect from March 2008 through February 2009. If the company neglects to make the proper year-end adjustment for the expired insurance
a. Net income and assets will be understated by $55,000.
b. Net income and assets will be overstated by $55,000.
c. Net income and assets will be understated by $11,000.
d. Net income and assets will be overstated by $11,000.

123. Younger Corporation purchased a one-year insurance policy in January 2008 for $48,000. The insurance policy is in effect from May 2008 through April 2009. If the company neglects to make the proper year-end adjustment for the expired insurance
a. Net income and assets will be understated by $32,000.
b. Net income and assets will be overstated by $32,000.
c. Net income and assets will be understated by $16,000.
d. Net income and assets will be overstated by $16,000.

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124. If an adjusting entry is *not* made for an accrued revenue,
   a. assets will be overstated.
   b. expenses will be understated.
   c. owner's equity will be understated.
   d. revenues will be overstated.

125. If an adjusting entry is *not* made for an accrued expense,
   a. expenses will be overstated.
   b. liabilities will be understated.
   c. net income will be understated.
   d. owner's equity will be understated.

126. Failure to prepare an adjusting entry at the end of the period to record an accrued expense would cause
   a. net income to be understated.
   b. an overstatement of assets and an overstatement of liabilities.
   c. an understatement of expenses and an understatement of liabilities.
   d. an overstatement of expenses and an overstatement of liabilities.

127. Failure to prepare an adjusting entry at the end of a period to record an accrued revenue would cause
   a. net income to be overstated.
   b. an understatement of assets and an understatement of revenues.
   c. an understatement of revenues and an understatement of liabilities.
   d. an understatement of revenues and an overstatement of liabilities.

128. Sue Smiley has performed $500 of CPA services for a client but has not billed the client as of the end of the accounting period. What adjusting entry must Sue make?
   a. Debit Cash and credit Unearned Revenue
   b. Debit Accounts Receivable and credit Unearned Revenue
   c. Debit Accounts Receivable and credit Service Revenue
   d. Debit Unearned Revenue and credit Service Revenue

129. Sue Smiley, CPA, has billed her clients for services performed. She subsequently receives payments from her clients. What entry will Sue make upon receipt of the payments?
   a. Debit Unearned Revenue and credit Service Revenue
   b. Debit Cash and credit Accounts Receivable
   c. Debit Accounts Receivable and credit Service Revenue
   d. Debit Cash and credit Service Revenue

130. Clark Real Estate signed a four-month note payable in the amount of $8,000 on September 1. The note requires interest at an annual rate of 9%. The amount of interest to be accrued at the end of September is
   a. $240.
   b. $60.
   c. $720.
   d. $80.

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131. A gift shop signs a three-month note payable to help finance increases in inventory for the Christmas shopping season. The note is signed on November 1 in the amount of $50,000 with annual interest of 12%. What is the adjusting entry to be made on December 31 for the interest expense accrued to that date, if no entries have been made previously for the interest?

a.	Interest Expense	1,000	
	Interest Payable		1,000
b.	Interest Expense	1,500	
	Interest Payable		1,500
c.	Interest Expense	1,000	
	Cash		1,000
d.	Interest Expense	1,000	
	Note Payable		1,000

132. Trent Tables paid employee wages on and through Friday, January 26, and the next payroll will be paid in February. There are three more working days in January (29–31). Employees work 5 days a week and the company pays $900 a day in wages. What will be the adjusting entry to accrue wages expense at the end of January?

a.	Wages Expense	900	
	Wages Payable		900
b.	Wages Expense	4,500	
	Wages Payable		4,500
c.	Wages Expense	2,700	
	Wages Payable		2,700
d.	No adjusting entry is required.		

133. A company shows a balance in Salaries Payable of $40,000 at the end of the month. The next payroll amounting to $45,000 is to be paid in the following month. What will be the journal entry to record the payment of salaries?

a.	Salaries Expense	45,000	
	Salaries Payable		45,000
b.	Salaries Expense	45,000	
	Cash		45,000
c.	Salaries Expense	5,000	
	Cash		5,000
d.	Salaries Expense	5,000	
	Salaries Payable	40,000	
	Cash		45,000

134. The accounts of a business before an adjusting entry is made to record an accrued revenue reflect an
   a. understated liability and an overstated owner's capital.
   b. overstated asset and an understated revenue.
   c. understated expense and an overstated revenue.
   d. understated asset and an understated revenue.

135. Carter Guitar Company borrowed $12,000 from the bank signing a 9%, 3-month note on September 1. Principal and interest are payable to the bank on December 1. If the company prepares monthly financial statements, the adjusting entry that the company should make for interest on September 30, would be

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a. Debit Interest Expense, $1,080; Credit Interest Payable, $1,080.
b. Debit Interest Expense, $90; Credit Interest Payable, $90.
c. Debit Note Payable, $1,080; Credit Cash, $1,080.
d. Debit Cash, $270; Credit Interest Payable, $270.

136. Manning Corporation issued a one-year, 9%, $200,000 note on April 30, 2008. Interest expense for the year ended December 31, 2008 was
a. $18,000.
b. $13,500.
c. $12,000.
d. $10,500.

137. Blue Corporation issued a one-year, 12%, $200,000 note on August 31, 2008. Interest expense for the year ended December 31, 2008 was
a. $24,000.
b. $10,000.
c. $8,000.
d. $6,000.

138. Employees at B Corporation are paid $5,000 cash every Friday for working Monday through Friday. The calendar year accounting period ends on Wednesday, December 31. How much salary expense should be recorded two days later on January 2?
a. $5,000
b. $3,000
c. None, matching requires the weekly salary to be accrued on December 31.
d. $2,000

139. Can financial statements be prepared directly from the adjusted trial balance?
a. They cannot. The general ledger must be used.
b. Yes, adjusting entries have been recorded in the general journal and posted to the ledger accounts.
c. No, the adjusted trial balance merely proves the equality of the total debit and total credit balances in the ledger after adjustments are posted. It has no other purpose.
d. They can because that is the only reason that an adjusted trial balance is prepared.

140. The adjusted trial balance is prepared
a. after financial statements are prepared.
b. before the trial balance.
c. to prove the equality of total assets and total liabilities.
d. after adjusting entries have been journalized and posted.

141. An adjusted trial balance
a. is prepared after the financial statements are completed.
b. proves the equality of the total debit balances and total credit balances of ledger accounts after all adjustments have been made.
c. is a required financial statement under generally accepted accounting principles.
d. cannot be used to prepare financial statements.

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142. Which of the statements below is *not* true?
   a. An adjusted trial balance should show ledger account balances.
   b. An adjusted trial balance can be used to prepare financial statements.
   c. An adjusted trial balance proves the mathematical equality of debits and credits in the ledger.
   d. An adjusted trial balance is prepared before all transactions have been journalized.

[a]143. Al is a barber who does his own accounting for his shop. When he buys supplies he routinely debits Supplies Expense. Al purchased $1,500 of supplies in January and his inventory at the end of January shows $400 of supplies remaining. What adjusting entry should Al make on January 31?

a.	Supplies Expense	400	
	Supplies		400
b.	Supplies Expense	1,500	
	Cash		1,500
c.	Supplies	400	
	Supplies Expense		400
d.	Supplies Expense	1,100	
	Supplies		1,100

[a]144. Alternative adjusting entries do *not* apply to
   a. accrued revenues and accrued expenses.
   b. prepaid expenses.
   c. unearned revenues.
   d. prepaid expenses and unearned revenues.

[a]145. Jim is a lawyer who requires that his clients pay him in advance of legal services rendered. Jim routinely credits Legal Service Revenue when his clients pay him in advance. In June Jim collected $12,000 in advance fees and completed 75% of the work related to these fees. What adjusting entry is required by Jim's firm at the end of June?

a.	Unearned Revenue	9,000	
	Legal Service Revenue		9,000
b.	Unearned Revenue	3,000	
	Legal Service Revenue		3,000
c.	Cash	12,000	
	Legal Service Revenue		12,000
d.	Legal Service Revenue	3,000	
	Unearned Revenue		3,000

[a]146. If prepaid expenses are initially recorded in expense accounts and have not all been used at the end of the accounting period, then failure to make an adjusting entry will cause
   a. assets to be understated.
   b. assets to be overstated.
   c. expenses to be understated.
   d. contra-expenses to be overstated.

[a]147. If unearned revenues are initially recorded in revenue accounts and have not all been earned at the end of the accounting period, then failure to make an adjusting entry will cause
   a. liabilities to be overstated.
   b. revenues to be understated.
   c. revenues to be overstated.
   d. accounts receivable to be overstated.

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[a]148. On January 2, 2008, Federal Savings and Loan purchased a general liability insurance policy for $2,400 for coverage for the calendar year. The entire $2,400 was charged to Insurance Expense on January 2, 2008. If the firm prepares monthly financial statements, the proper adjusting entry on January 31, 2008, will be:

a.	Insurance Expense	2,200	
	Prepaid Insurance		2,200
b.	Prepaid Insurance	2,200	
	Insurance Expense		2,200
c.	Insurance Expense	200	
	Prepaid Insurance		200
d.	Prepaid Insurance	200	
	Insurance Expense		200

Additional Multiple Choice Questions

149. Which of the following statements concerning accrual-basis accounting is *incorrect?*
   a. Accrual-basis accounting follows the revenue recognition principle.
   b. Accrual-basis accounting is the method required by generally accepted accounting principles.
   c. Accrual-basis accounting recognizes expenses when they are paid.
   d. Accrual-basis accounting follows the matching principle.

150. The revenue recognition principle dictates that revenue be recognized in the accounting period
   a. before it is earned.
   b. after it is earned.
   c. in which it is earned.
   d. in which it is collected.

151. An expense is recorded under the cash basis only when
   a. services are performed.
   b. it is earned.
   c. cash is paid.
   d. it is incurred.

152. For prepaid expense adjusting entries
   a. an expense—liability account relationship exists.
   b. prior to adjustment, expenses are overstated and assets are understated.
   c. the adjusting entry results in a debit to an expense account and a credit to an asset account.
   d. none of these.

153. Expenses paid and recorded as assets before they are used are called
   a. accrued expenses.
   b. interim expenses.
   c. prepaid expenses.
   d. unearned expenses.

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154. Demaet Cruise Lines purchased a five-year insurance policy for its ships on April 1, 2008 for $100,000. Assuming that April 1 is the effective date of the policy, the adjusting entry on December 31, 2008 is

a.	Prepaid Insurance	15,000	
	Insurance Expense		15,000
b.	Insurance Expense	15,000	
	Prepaid Insurance		15,000
c.	Insurance Expense	20,000	
	Prepaid Insurance		20,000
d.	Insurance Expense	5,000	
	Prepaid Insurance		5,000

155. Gardner Company purchased a truck from Kutner Co. by issuing a 6-month, 8% note payable for $60,000 on November 1. On December 31, the accrued expense adjusting entry is

a.	No entry is required.		
b.	Interest Expense	4,800	
	Interest Payable		4,800
c.	Interest Expense	9,600	
	Interest Payable		9,600
d.	Interest Expense	800	
	Interest Payable		800

156. If the adjusting entry for depreciation is *not* made,
a. assets will be understated.
b. owner's equity will be understated.
c. net income will be understated.
d. expenses will be understated.

157. Cathy Cline, an employee of Welker Company, will not receive her paycheck until April 2. Based on services performed from March 15 to March 30, her salary was $900. The adjusting entry for Welker Company on March 31 is

a.	Salaries Expense	900	
	Salaries Payable		900
b.	No entry is required.		
c.	Salaries Expense	900	
	Cash		900
d.	Salaries Payable	900	
	Cash		900

158. Which of the following statements related to the adjusted trial balance is *incorrect?*
a. It shows the balances of all accounts at the end of the accounting period.
b. It is prepared before adjusting entries have been made.
c. It proves the equality of the total debit balances and the total credit balances in the ledger.
d. Financial statements can be prepared directly from the adjusted trial balance.

159. Financial statements are prepared directly from the
a. general journal.
b. ledger.
c. trial balance.
d. adjusted trial balance.

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Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
38.	c	56.	a	74.	d	92.	b	110.	a	128.	c	[a]146.	a
39.	d	57.	c	75.	b	93.	d	111.	d	129.	b	[a]147.	c
40.	a	58.	c	76.	c	94.	c	112.	b	130.	b	[a]148.	b
41.	d	59.	d	77.	a	95.	c	113.	c	131.	a	149.	c
42.	b	60.	b	78.	c	96.	c	114.	c	132.	c	150.	c
43.	c	61.	b	79.	a	97.	d	115.	a	133.	d	151.	c
44.	a	62.	b	80.	c	98.	b	116.	d	134.	d	152.	c
45.	a	63.	a	81.	c	99.	d	117.	b	135.	b	153.	c
46.	d	64.	d	82.	c	100.	c	118.	c	136.	c	154.	b
47.	c	65.	a	83.	c	101.	b	119.	c	137.	c	155.	d
48.	a	66.	c	84.	c	102.	b	120.	b	138.	d	156.	d
49.	b	67.	d	85.	d	103.	c	121.	b	139.	b	157.	a
50.	c	68.	c	86.	c	104.	d	122.	b	140.	d	158.	b
51.	b	69.	b	87.	d	105.	b	123.	b	141.	b	159.	d
52.	a	70.	c	88.	b	106.	d	124.	c	142.	d		
53.	c	71.	b	89.	a	107.	c	125.	b	[a]143.	c		
54.	b	72.	b	90.	b	108.	c	126.	c	[a]144.	a		
55.	c	73.	b	91.	d	109.	c	127.	b	[a]145.	d		

BRIEF EXERCISES

BE 160

State whether each situation is a prepaid expense (PE), unearned revenue (UR), accrued revenue (AR) or an accrued expense (AE).

1. Unrecorded interest on savings bonds is $245.
2. Property taxes that have been incurred but that have not yet been paid or recorded amount to $300.
3. Legal fees of $1,000 were collected in advance. By year end 60 percent were still unearned.
4. Prepaid insurance had a $500 balance prior to adjustment. By year end, 40 percent was still unexpired.

Solution 160 (3 min.)

1. AR
2. AE
3. UR
4. PE

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BE 161

Prepare adjusting entries for the following transactions. Omit explanations.

1. Depreciation on equipment is $800 for the accounting period.
2. There was no beginning balance of supplies and purchased $500 of office supplies during the period. At the end of the period $80 of supplies were on hand.
3. Prepaid rent had a $1,000 normal balance prior to adjustment. By year end $600 was unexpired.

Solution 161 (6 min.)

1.	Depreciation Expense	800	
	Accumulated Depreciation—Equipment		800
2.	Supplies Expense	420	
	Supplies		420
	($500 – $80)		
3.	Rent Expense	400	
	Prepaid Rent		400
	($1,000 – $600)		

BE 162

On June 1, during its first month of operations, Eggemeister Enterprises purchased supplies for $3,500 and debited the supplies account for that amount. At January 30, an inventory of supplies showed $1,200 of supplies on hand. What adjusting journal entry should be made for June?

Solution 162 (3 min.)

Supplies Expense	2,300	
Supplies		2,300

Be. 163

On January 1, Biddle & Biddle, CPAs received a $9,000 cash retainer for legal services to be rendered ratably over the next 3 months. The full amount was credited to the liability account Unearned Revenue. Assuming that the revenue is earned ratably over the 3-month period, what adjusting journal entry should be made at January 31?

Solution 163 (3 min.)

Unearned Revenue	3,000	
Fees Earned		3,000

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BE 164

On February 1, Acts Tax Service received a $2,000 cash retainer for tax preparation services to be rendered ratably over the next 4 months. The full amount was credited to the liability account Unearned Revenue. Assuming that the revenue is earned ratably over the 4-month period, what balance would be reported on the February 28 balance sheet for Unearned Revenue?

Solution 164 (5 min.)

Revenue earned monthly = $2,000/ 4 months = $500 per month
Feb 28 balance in Unearned Revenue = $2,000 - $500 revenue earned in February = $1,500

BE 165

Hans Albert Enterprises purchased computer equipment on May 1, 2008 for $4,500. The company expects to use the equipment for 3 years. It has no salvage value.

1. What adjusting journal entry should the company make at the end of each month if monthly financials are prepared (annual depreciation is $1,500)?
2. What is the book value of the equipment at May 31, 2008?

Solution 165 (5 min.)

1. Depreciation Expense 125
   Accumulated Depreciation..... 125

2. Cost $4,500
   Accumulated Depreciation – 125
   Book value $4,375

BE 166

Hampton International purchased software on October 1, 2008 for $10,800. The company expects to use the software for 3 years. It has no salvage value.

1. What adjusting journal entry should the company make at the end of each month if monthly financials are prepared? (annual depreciation is $3,600)
2. What balance will be reported on the December 31, 2008 balance sheet for Accumulated Depreciation?

Solution 166 (5 min.)

1. Depreciation Expense 300
   Accumulated Depreciation..... 300

2. Balance in Accumulated Depreciation at December 31, 2008:
   3 months × $300 per month = $900

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BE 167

Better Publications. sold annual subscriptions to their magazine for $24,000 in December, 2007. The magazine is published monthly. The new subscribers received their first magazine in January, 2008.

1. What adjusting entry should be made in January if the subscriptions were originally recorded as a liability?
2. What amount will be reported on the January 2008 balance sheet for Unearned Revenue?

Solution 167 (5 min.)

1.	Unearned Revenue	2,000	
	Subscription Revenue		2,000

2. Unearned Revenue at January 31:
   $24,000 – $2,000 = $22,000

BE 168

On January 1, 2008, J.C. Cohen Company purchased a general liability insurance policy for $3,600 to provide coverage for the calendar year.

1. If the company recorded the policy as an asset when purchased, what is the monthly adjusting journal entry that should be recorded at January 31, 2008?

*2. If the company expensed the cost of the policy on January 1, 2008, what is the monthly adjusting entry that should be recorded at January 31, 2008?

Solution 168 (5 min.)

1.	Insurance Expense	300	
	Prepaid Insurance		300
*2.	Prepaid Insurance	3,300	
	Insurance Expense		3,300

BE 169

Identify the impact on the balance sheet if the following information is not used to adjust the accounts.

1. Supplies consumed totalled $3,000.
2. Interest accrues on notes payable at the rate of $200 per month.
3. Insurance of $450 expired during the month.
4. Plant and equipment are depreciated at the rate of $1,200 per month.

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Solution 169 (5 min.)

1. Assets overstated and Owner's Equity overstated by $3,000.
2. Liabilities understated and Owner's Equity overstated by $200.
3. Assets overstated and Owner's Equity overstated by $450.
4. Assets overstated and Owner's Equity overstated by $1,200.

BE 170

Determine the impact on the balance sheet accounts if the following information is not used to adjust the accounts of Lake Castle Company for the month of January, 2008. Round answers to the nearest dollar.

1. The company rents extra office space to Franz, CPAs. Franz pays the $12,000 rent annually on January 1.
2. The company has an outstanding loan to its President in the amount of $100,000. The loan accrues interest at the annual rate of 4%. Principal and interest are due January 1, 2012.
3. The company completed work on a project during January that was not yet billed to the client. The client will be charged $2,500.

Solution 170 (5 min.)

1. Liabilities overstated and Owner's Equity understated by $1,000.
2. Assets understated and Owner's Equity understated by $333.
3. Assets understated and Owner's Equity understated by $2,500.

BE 171

For each of the following oversights, state whether total assets will be understated (U), overstated (O), or no affect (NA).

_____ 1. Failure to record revenue earned but not yet received.

_____ 2. Failure to record expired prepaid rent.

_____ 3. Failure to record accrued interest on the bank savings account.

_____ 4. Failure to record depreciation.

_____ 5. Failure to record accrued wages.

_____ 6. Failure to recognize the earned portion of unearned revenues.

Solution 171 (5 min.)

1. U
2. O
3. U
4. O
5. NA
6. NA

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BE 172

River Ridge Music School borrowed $20,000 from the bank signing a 10%, 6-month note on November 1. Principal and interest are payable to the bank on May 1. If the company prepares monthly financial statements, what adjusting entry should the company make at November 30 with regard to the note (round answer to the nearest dollar)?

Solution 172 (3 min.)

Interest Expense ($20,000 × 10% × 1/12)	167	
Interest Payable.....		167

BE 173

The adjusted trial balance of Ninety-Six Inc. on December 31, 2008 includes the following accounts: Accumulated Depreciation, $6,000; Depreciation Expense, $2,000; Note Payable $7,500; Interest Expense $150; Utilities Expense, $300; Rent Expense, $500; Service Revenue, $19,600; Salaries Expense, $4,000; Supplies, $200; Supplies Expense, $1,200; Wages Payable, $600. Prepare an income statement for the month of December.

Solution 173 (10 min.)

Ninety-Six Inc.
Income Statement
For the Month Ended December 31, 2008

Service Revenue		$19,600
Expenses:		
Depreciation expense	$2,000	
Interest expense	150	
Utilities expense	300	
Rent expense	500	
Salaries expense	4,000	
Supplies expense	1,200	8,150
Net Income		$11,450

BE 174

The adjusted trial balance of Jesper Company at December 31,2008 includes the following accounts: L. Jesper, Capital $12,600; L. Jesper, Drawing $6,000; Service Revenue $35,000; Salaries Expense $13,000; Insurance Expense $2,000; Rent Expense $3,500; Supplies Expense $500; and Depreciation Expense $1,000. Prepare an owner's equity statement for the year.

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Solution 174 (5 min.)

JESPER CORPORATION
Owner's Equity Statement
For the Year Ended December 31, 2008

L. Jesper, Capital, January 1		$12,600
Plus:	Net Income	15,000
		27,600
Less:	Drawings	6,000
	L. Jesper, Capital, December 31	$21,600

EXERCISES

Ex. 175

The balance sheets of Cole Company include the following:

	12/31/08	12/31/07
Interest Receivable	$6,300	$ -0-
Supplies	5,000	3,000
Wages Payable	3,600	3,800
Unearned Revenue	-0-	4,000

The income statement for 2008 shows the following:

Interest Revenue	$18,400
Service Revenue	72,700
Supplies Expense	8,700
Wages Expense	39,000

Instructions

Calculate the following for 2008:
1. Cash received for interest.
2. Cash paid for supplies.
3. Cash paid for wages.
4. Cash received for revenue.

Solution 175 (15 min.)

1. Cash received for interest =		$12,100
Interest Revenue	$18,400	
Less: Interest Receivable	6,300	
Cash Received	$12,100	
2. Cash paid for supplies =		$10,700
Supplies Expense	$8,700	
Less: Supplies (2007)	3,000	
	5,700	
Add: Supplies (2008)	5,000	
Cash Paid	$10,700	

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Solution 175 (cont.)

3.	Cash paid for wages =		$39,200
	Wages Expense	$39,000	
	Add: Wages Payable (2007)	3,800	
		42,800	
	Less: Wages Payable (2008)	3,600	
	Cash Paid	$39,200	
4.	Cash received for revenue =		$68,700
	Service Revenue	$72,700	
	Less: Unearned Revenue (2007)	4,000	
	Cash Received	$68,700	

Ex. 176

Linder Company prepared the following income statement using the cash basis of accounting:

LINDER COMPANY
Income Statement, Cash Basis
For the Year Ended December 31, 2008

Service revenue (does not include $20,000 of services rendered on account because the collection will not be until 2009)	$370,000
Expenses (does not include $20,000 of expenses on account because payment will not be made until 2009)	220,000
Net income	$150,000

Additional data:
1. Depreciation on a company automobile for the year amounted to $6,000. This amount is not included in the expenses above.
2. On January 1, 2008, paid for a two-year insurance policy on the automobile amounting to $1,800. This amount is included in the expenses above.

Instructions

(a) Recast the above income statement on the accrual basis in conformity with generally accepted accounting principles. Show computations and explain each change.

(b) Explain which basis (cash or accrual) provides a better measure of income.

Solution 176 (15 min.)

(a)

LINDER COMPANY
Income Statement
For the Year Ended December 31, 2008

Service revenue	$390,000
Expenses	245,100
Net income	$144,900

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Solution 176 (cont.)

Service revenue should include the $20,000 for services performed on account. The accrual basis states that revenue is reflected in the period when the service is performed. ($370,000 + $20,000 = $390,000). Expenses should include the $20,000 for expenses incurred but not yet paid. The accrual basis states that expenses should be reflected in the period when incurred. Expenses also should only include half of the $1,800 insurance premium since $900 applies to 2008. The other $900 is an asset and should be reflected on the balance sheet as prepaid insurance. The $6,000 of depreciation for the automobile is included as an expense in 2008. ($220,000 + $20,000 – $900 + $6,000 = $245,100).

(b) The accrual basis of accounting provides a better measure of income than the cash basis. The accrual basis is required under generally accepted accounting principles and recognizes revenues when earned and expenses when incurred. Revenues and expenses recognized under the accrual basis are related to the economic environment in which they occur and thus allow trends to be more meaningfully interpreted.

The cash basis often fails to recognize revenue in the period when earned and expenses when incurred. Additionally, expenses are not matched with revenues when earned; therefore, the matching principle is violated.

Ex. 177

Before month-end adjustments are made, the February 28 trial balance of Al's Enterprise contains revenue of $9,000 and expenses of $4,400. Adjustments are necessary for the following items:

- Depreciation for February is $1,800.
- Revenue earned but not yet billed is $2,300.
- Accrued interest expense is $700.
- Revenue collected in advance that is now earned is $3,500.
- Portion of prepaid insurance expired during February is $400.

Instructions
Calculate the correct net income for Al's Income Statement for February.

Solution 177 (5 min.)

Net Income before Adjustments ($9,000 – 4,400)			$ 4,600
Add:	Unearned Revenues	$3,500	
	Accrued Revenues	2,300	5,800
			10,400
Subtract:	Depreciation Expense	1,800	
	Interest Expense	700	
	Insurance Expense	400	2,900
Net Income after Adjustments			$ 7,500

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Ex. 178

On December 31, 2008, Gomez Company prepared an income statement and balance sheet and failed to take into account three adjusting entries. The incorrect income statement showed net income of $40,000. The balance sheet showed total assets, $120,000; total liabilities, $45,000; and owner's equity, $75,000.

The data for the three adjusting entries were:
(1) Depreciation of $9,000 was not recorded on equipment.
(2) Wages amounting to $8,000 for the last two days in December were not paid and not recorded. The next payroll will be in January.
(3) Rent of $14,000 was paid for two months in advance on December 1. The entire amount was debited to Rent Expense when paid.

Instructions
Complete the following tabulation to correct the financial statement amounts shown (indicate deductions with parentheses):

Item	Net Income	Total Assets	Total Liabilities	Owner's Equity
Incorrect balances	$ 40,000	$120,000	$ 45,000	$ 75,000
Effects of:				
Depreciation				
Wages				
Rent				
Correct Balances				

Solution 178 (5 min.)

Item	Net Income	Total Assets	Total Liabilities	Owner's Equity
Incorrect balances	$40,000	$120,000	$45,000	$75,000
Effects of:				
Depreciation	(9,000)	(9,000)		(9,000)
Wages	(8,000)		8,000	(8,000)
Rent	7,000	7,000		7,000
Correct Balances	$30,000	$118,000	$53,000	$65,000

Ex. 179

Indicate (a) the type of adjustment (prepaid expense, unearned revenue, accrued revenue, or accrued expense), and (b) the accounts before adjustment (overstated or understated) for each of the following:

1. Supplies of $200 have been used.
2. Salaries of $600 are unpaid.
3. Rent received in advance totaling $300 has been earned.
4. Services provided but not recorded total $500.

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Solution 179 (7 min.)

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

Ex. 180

Ellis Company accumulates the following adjustment data at December 31.
1. Revenue of $900 collected in advance has been earned.
2. Salaries of $600 are unpaid.
3. Prepaid rent totaling $450 has expired.
4. Supplies of $550 have been used.
5. Revenue earned but unbilled total $750.
6. Utility expenses of $200 are unpaid.
7. Interest of $250 has accrued on a note payable.

Instructions

(a) For each of the above items indicate:
   1. The type of adjustment (prepaid expense, unearned revenue, accrued revenue, or accrued expense).
   2. The account relationship (asset/liability, liability/revenue, etc.).
   3. The status of account balances before adjustment (understatement or overstatement).
   4. The adjusting entry.

(b) Assume net income before the adjustments listed above was $14,500. What is the adjusted net income?

Prepare your answer in the tabular form presented below.

Type of Adjustment	Account Relationship	Account Balances Before Adjustment (Understatement or Overstatement)	Adjusting Entry

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Solution 180 (20 min.)

(a)

	Type of Adjustment	Account Relationship	Account Balances Before Adjustment (Understatement or Overstatement)	Adjusting Entry	Income Effect Increase (Decrease)
1.	Unearned revenue.	L/R	Liab. O Rev. U	Unearned Revenue Service Revenue	900
2.	Accrued expense.	E/L	Exp. U Liab. U	Salary Expense Salaries Payable	(600)
3.	Prepaid expense.	E/A	Exp. U Asset O	Rent Expense Prepaid Rent	(450)
4.	Prepaid expense.	E/A	Exp. U Asset O	Supplies Expense Supplies	(550)
5.	Accrued revenue.	A/R	Asset U Rev. U	Accounts Receivable Service Revenue	750
6.	Accrued expense.	E/L	Exp. U Liab. U	Utilities Expense Accounts Payable	(200)
7.	Accrued expense.	E/L	Exp. U Liab. U	Interest Expense Interest Payable	(250)

Codes: A = Asset, L = Liability, E = Expense, R = Revenue, O = Overstatement, U = Understatement

(b)

Net income before adjustments			$14,500
Add: Unearned revenue (1)	$900		
Accrued revenue (5)	750		1,650
			16,150
Less: Accrued salaries (2)	600		
Prepaid rent expired (3)	450		
Supplies used (4)	550		
Accrued utilities (6)	200		
Accrued interest (7)	250		2,050
Adjusted net income			$14,100

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Ex. 181

The adjusted trial balance of the Nance Company includes the following balance sheet accounts that frequently require adjustment. For each account, indicate (a) the type of adjusting entry (prepaid expenses, unearned revenues, accrued revenues, or accrued expenses) and (b) the related account in the adjusting entry.

Balance Sheet Account	(a) Type of Adjusting Entry	(b) Related Account
1. Supplies		
2. Accounts Receivable		
3. Prepaid Insurance		
4. Accumulated Depreciation—Equipment		
5. Interest Payable		
6. Salaries Payable		
7. Unearned Revenue		

Solution 181 (15 min.)

Balance Sheet Account	(a) Type of Adjusting Entry	(b) Related Account
1. Supplies	Prepaid Expense	Supplies Expense
2. Accounts Receivable	Accrued Revenue	Service Revenue
3. Prepaid Insurance	Prepaid Expense	Insurance Expense
4. Accumulated Depreciation—Equipment	Prepaid Expense	Depreciation Expense
5. Interest Payable	Accrued Expense	Interest Expense
6. Salaries Payable	Accrued Expense	Salaries Expense
7. Unearned Revenue	Unearned Revenues	Service Revenue

Ex. 182

Match the statements below with the appropriate terms by entering the appropriate letter code in the spaces provided.

TERMS:

A. Prepaid Expenses
B. Unearned Revenues
C. Accrued Revenues
D. Accrued Expenses

STATEMENTS:

____ 1. A revenue not yet earned; collected in advance.

____ 2. Office supplies on hand that will be used in the next period.

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Ex. 182 (cont.)

____ 3. Interest revenue collected; not yet earned.

____ 4. Rent not yet collected; already earned.

____ 5. An expense incurred; not yet paid or recorded.

____ 6. A revenue earned; not yet collected or recorded.

____ 7. An expense not yet incurred; paid in advance.

____ 8. Interest expense incurred; not yet paid.

Solution 182 (5 min.)

1. B
2. A
3. B
4. C
5. D
6. C
7. A
8. D

Ex. 183

The Astros, a semi-professional baseball team, prepare financial statements on a monthly basis. Their season begins in April, but in March the team engaged in the following transactions:

(a) Paid $120,000 to Wichita City as advance rent for use of Wichita City Stadium for the six month period April 1 through September 30.

(b) Collected $250,000 cash from sales of season tickets for the team's 20 home games. This amount was credited to Unearned Ticket Revenue.

During the month of April, the Astros played four home games and five road games.

Instructions

Prepare the adjusting entries required at April 30 for the transactions above.

Solution 183 (5 min.)

(a)	Rent Expense	20,000	
	Prepaid Rent		20,000
	($120,000 ÷ 6 = $20,000)		
(b)	Unearned Ticket Revenue	50,000	
	Ticket Revenue		50,000
	($250,000 ÷ 20 = $12,500; $12,500 × 4 = $50,000)		

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Ex. 184

On July 1, 2008, Sheeley Company pays $8,000 to its insurance company for a 2-year insurance policy.

Instructions
Prepare the necessary journal entries for Sheeley on July 1 and December 31.

Solution 184 (5 min.)

July 1	Prepaid Insurance	8,000	
	Cash		8,000
Dec. 31	Insurance Expense	2,000	
	Prepaid Insurance ($8,000 × 6/24)		2,000

Ex. 185

On July 1, 2008, Anderson Insurance Company received $10,000 from a client for a 2-year insurance policy.

Instructions
Prepare the necessary journal entries for Anderson on July 1 and December 31.

Solution 185 (5 min.)

July 1	Cash	10,000	
	Unearned Insurance Revenue		10,000
Dec. 31	Unearned Insurance Revenue	2,500	
	Insurance Revenue ($10,000 × 6/24)		2,500

Ex. 186

Dane Coat Company purchased equipment on June 1 for $81,000, paying $18,000 cash and signing a 12%, 2-month note for the remaining balance. The equipment is expected to depreciate $18,000 each year. Dane Coat Company prepares monthly financial statements.

Instructions
(a) Prepare the general journal entry to record the acquisition of the equipment on June lst.
(b) Prepare any adjusting journal entries that should be made on June 30th.
(c) Show how the equipment will be reflected on Dane Coat Company's balance sheet on June 30th.

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Solution 186 (10 min.)

(a)	June	1	Equipment	81,000	
			Cash		18,000
			Notes Payable		63,000
			(To record acquisition of equipment and signing of a 2-month, 12% note)		
(b)	June	30	Depreciation Expense	1,500	
			Accumulated Depreciation—Equipment		1,500
			(To record monthly depreciation)		
			$18,000 ÷ 12 = $1,500/month		
		30	Interest Expense	630	
			Interest Payable		630
			(To accrue interest on notes payable)		
			$63,000 × 12% × 1/12 = $630		

(c)	Assets		
	Equipment	$81,000	
	Less: Accumulated Depreciation—Equipment	1,500	$79,500

Ex. 187

Welch Company prepares monthly financial statements. Below are listed some selected accounts and their balances in the September 30 trial balance before any adjustments have been made for the month of September.

WELCH COMPANY
Trial Balance (Selected Accounts)
September 30, 2008

	Debit	Credit
Office Supplies	$ 2,700	
Prepaid Insurance	4,200	
Office Equipment	16,200	
Accumulated Depreciation—Office Equipment		$1,000
Unearned Rent Revenue		1,200

(Note: Debit column does not equal credit column because this is a *partial* listing of selected account balances)

An analysis of the account balances by the company's accountant provided the following additional information:

1. A physical count of office supplies revealed $1,000 on hand on September 30.
2. A two-year life insurance policy was purchased on June 1 for $4,800.
3. Office equipment depreciated $6,000 per year.
4. The amount of rent received in advance that remains unearned at September 30 is $500.

Instructions

Using the above additional information, prepare the adjusting entries that should be made by Welch Company on September 30.

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Solution 187 (10 min.)

1.	Office Supplies Expense	1,700	
	Office Supplies		1,700
	(To record the amount of office supplies used)		
2.	Insurance Expense	200	
	Prepaid Insurance		200
	(To record insurance expired $4,800 ÷ 24)		
3.	Depreciation Expense	500	
	Accumulated Depreciation—Office Equipment		500
	(To record monthly depreciation $6,000 ÷ 12)		
4.	Unearned Rent Revenue	700	
	Rent Revenue		700
	(To record rent revenue earned)		

Ex. 188

Prepare the required end-of-period adjusting entries for each independent case listed below.

Case 1
Starr Company began the year with a $3,000 balance in the Office Supplies account. During the year, $8,500 worth of additional office supplies were purchased. A physical count of office supplies on hand at the end of the year revealed that $6,400 worth of office supplies had been used during the year. No adjusting entry has been made until year end.

Case 2
Eaton Company has a calendar year-end accounting period. On July 1, the company purchased office equipment for $30,000. It is estimated that the office equipment will depreciate $500 each month. No adjusting entry has been made until year end.

Case 3
Ward Realty is in the business of renting several apartment buildings and prepares monthly financial statements. It has been determined that 3 tenants in $700 per month apartments and one tenant in the $1,000 per month apartment had not paid their August rent as of August 31st.

Solution 188 (10 min.)

Case 1—December 31			
	Office Supplies Expense	6,400	
	Office Supplies		6,400
	(To record office supplies used during the year)		
Case 2—December 31			
	Depreciation Expense	3,000	
	Accumulated Depreciation—Office Equipment		3,000
	(To record depreciation expense for six months)		
	$500 × 6 months = $3,000 Depreciation		

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Solution 188 (cont.)

Case 3—August 31		
Rent Receivable	3,100	
Rent Revenue		3,100
(To accrue rent earned but not yet received)		

Ex. 189

Moran Insurance Agency prepares monthly financial statements. Presented below is an income statement for the month of June that is correct on the basis of information considered.

MORAN INSURANCE AGENCY
Income Statement
For the Month Ended June 30

Revenues		
Premium Commission Revenue		$35,000
Expenses		
Salary expense	$6,000	
Advertising expense	800	
Rent expense	4,200	
Depreciation expense	2,800	
Total expenses		13,800
Net income		$21,200

Additional Data: When the income statement was prepared, the company accountant neglected to take into consideration the following information:

1. A utility bill for $2,000 was received on the last day of the month for electric and gas service for the month of June.
2. A company insurance salesman sold a life insurance policy to a client for a premium of $35,000. The agency billed the client for the policy and is entitled to a commission of 20%.
3. Supplies on hand at the beginning of the month were $3,000. The agency purchased additional supplies during the month for $3,500 in cash and $2,200 of supplies were on hand at June 30.
4. The agency purchased a new car at the beginning of the month for $19,200 cash. The car will depreciate $4,800 per year.
5. Salaries owed to employees at the end of the month total $5,300. The salaries will be paid on July 5.

Instructions

Prepare a correct income statement.

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Solution 189 (15 min.)

MORAN INSURANCE AGENCY
Income Statement
For the Month Ended June 30

Revenues		
Premium Commission Revenue ($35,000 + $7,000)		$42,000
Expenses		
Salary expense ($6,000 + $5,300)	$11,300	
Supplies expense ($0 + $4,300)	4,300	
Rent expense	4,200	
Depreciation expense ($2,800 + $400)	3,200	
Utilities expense ($0 + $2,000)	2,000	
Advertising expense	800	
Total expenses		25,800
Net income		$16,200

Ex. 190

One part of eight adjusting entries is given below.

Instructions
Indicate the account title for the other part of each entry.
1. Unearned Revenue is debited.
2. Prepaid Rent is credited.
3. Accounts Receivable is debited.
4. Depreciation Expense is debited.
5. Utilities Expense is debited.
6. Interest Payable is credited.
7. Service Revenue is credited (give two possible debit accounts).
8. Interest Receivable is debited.

Solution 190 (5 min.)

1. Service Revenue
2. Rent Expense
3. Service Revenue
4. Accumulated Depreciation
5. Utilities Payable
6. Interest Expense
7. Accounts Receivable or Unearned Revenue
8. Interest Revenue

Ex. 191

For each of the following accounts, indicate (a) the type of adjusting entry (prepaid expense, accrued revenue, etc.) and (b) the related account in the adjusting entry.
1. Depreciation Expense
2. Salaries Payable
3. Service Revenue
4. Supplies
5. Unearned Revenue

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Solution 191 (5 min.)

	Account	Type of Entry	Related Account
1.	Depreciation Expense	Prepaid expense	Accum. Depreciation
2.	Salaries Payable	Accrued expense	Salaries Expense
3.	Service Revenue	Accrued revenue	Accounts Receivable
4.	Supplies	Prepaid expense	Supplies Expense
5.	Unearned Revenue	Unearned revenue	Service Revenue

Ex. 192

Prepare the necessary adjusting entry for each of the following:

1. Services provided but unrecorded totaled $900.
2. Accrued salaries at year-end are $1,000.
3. Depreciation for the year is $600.

Solution 192 (5 min.)

1.	Accounts Receivable	900	
	Service Revenue		900
2.	Salaries Expense	1,000	
	Salaries Payable		1,000
3.	Depreciation Expense	600	
	Accumulated Depreciation		600

Ex. 193

The following ledger accounts are used by the Ottawa Greyhound Park:

Accounts Receivable
Prepaid Printing
Prepaid Rent

Unearned Admissions Revenue

Printing Expense
Rent Expense

Admissions Revenue
Concessions Revenue

Instructions

For each of the following transactions below, prepare the journal entry (if one is required) to record the initial transaction and then prepare the adjusting entry, if any, required on September 30, the end of the fiscal year.

(a) On September 1, paid rent on the track facility for three months, $180,000.

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Ex. 193 (cont.)

(b) On September 1, sold season tickets for admission to the racetrack. The racing season is year-round with 25 racing days each month. Season ticket sales totaled $840,000.
(c) On September 1, borrowed $300,000 from First National Bank by issuing a 9% note payable due in three months.
(d) On September 5, schedules for 20 racing days in September, 25 racing days in October, and 15 racing days in November were printed for $2,400.
(e) The accountant for the concessions company reported that gross receipts for September were $140,000. Ten percent is due to Ottawa and will be remitted by October 10.

Solution 193 (15 min.)

(a) Journal Entry

Prepaid Rent	180,000	
Cash		180,000

Adjusting Entry

Rent Expense	60,000	
Prepaid Rent		60,000

(b) Journal Entry

Cash	840,000	
Unearned Admissions Revenue		840,000

Adjusting Entry

Unearned Admissions Revenue	70,000	
Admissions Revenue		70,000
($840,000 ÷ 12 = $70,000)		

(c) Journal Entry

Cash	300,000	
Note Payable		300,000

Adjusting Entry

Interest Expense	2,250	
Interest Payable		2,250
($300,000 × .09 × 1 ÷ 12 = $2,250)		

(d) Journal Entry

Prepaid Printing	2,400	
Cash		2,400

Adjusting Entry

Printing Expense	800	
Prepaid Printing		800
($2,400 × 20 ÷ 60 = $800)		

(e) Journal Entry
None

Adjusting Entry

Accounts Receivable	14,000	
Concessions Revenue		14,000

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Ex. 194

Fielder Company has an accounting fiscal year which ends on June 30. The company also has a policy of paying the weekly payroll on Friday. Payroll records indicate the following salary costs were incurred.

	Date	Amount
Monday	June 28	$3,000
Tuesday	June 29	3,800
Wednesday	June 30	2,800
Thursday	July 1	3,000
Friday	July 2	2,400

Instructions

(a) Prepare any necessary adjusting journal entries that should be made at year end on June 30.

(b) Prepare the journal entry to record the payment of the weekly payroll on July 2.

Solution 194 (10 min.)

(a)	June 30	Salaries Expense	9,600	
		Salaries Payable		9,600
		(To accrue salaries incurred but not yet paid)		
(b)	July 2	Salaries Payable	9,600	
		Salaries Expense	5,400	
		Cash		15,000
		(To record payment of July 2 payroll)		

Ex. 195

On Friday of each week, Noble Company pays its factory personnel weekly wages amounting to $40,000 for a five-day work week.

Instructions

(a) Prepare the necessary adjusting entry at year end, assuming December 31 falls on Wednesday.

(b) Prepare the journal entry for payment of the week's wages on the payday which is Friday, January 2 of the next year.

Solution 195 (5 min.)

(a)	Dec. 31	Wages Expense	24,000	
		Wages Payable		24,000
(b)	Jan. 2	Wages Payable	24,000	
		Wages Expense	16,000	
		Cash		40,000

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Ex. 196

Presented below is the Trial Balance and Adjusted Trial Balance for Kimberly Company on December 31.

KIMBERLY COMPANY
Trial Balance
December 31

	Before Adjustment		After Adjustment	
	Dr.	Cr.	Dr.	Cr.
Cash	$ 2,000		$ 2,000	
Accounts Receivable	2,800		3,700	
Prepaid Rent	2,100		1,500	
Supplies	1,200		700	
Automobile equipment	18,000		18,000	
Accumulated depreciation—				
Automobile equipment		$ 1,300		$ 1,500
Accounts Payable		2,700		3,000
Notes Payable		10,000		10,000
Interest Payable				120
Salaries Payable				800
Unearned Revenue		4,460		4,060
Kimberly, Capital		7,200		7,200
Kimberly, Drawings	3,200		3,200	
Service Revenue		8,000		9,300
Salaries Expense	2,060		2,860	
Utilities Expense	1,800		2,100	
Rent Expense	500		1,100	
Supplies Expense			500	
Depreciation Expense—				
Automobile Equipment			200	
Interest Expense			120	
Totals	$33,660	$33,660	$35,980	$35,980

Instructions

Prepare in journal form, with explanations, the adjusting entries that explain the changes in the balances from the trial balance to the adjusted trial balance.

Solution 196 (15 min.)

Accounts Receivable	900	
Service Revenue		900
(To record revenue earned but not yet received)		
Rent Expense	600	
Prepaid Rent		600
(To record expiration of prepaid rent)		
Supplies Expense	500	
Supplies		500
(To record supplies used)		

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Solution 196 (cont.)

Depreciation Expense—Automobile Equipment	200	
Accumulated Depreciation—Automobile Equipment		200
(To record depreciation expense)		
Salaries Expense	800	
Salaries Payable		800
(To record salaries owed, not yet paid)		
Interest Expense	120	
Interest Payable		120
(To record accrued interest payable)		
Unearned Revenue	400	
Service Revenue		400
(To record revenue earned)		
Utilities Expense	300	
Accounts Payable		300
(To record receipt of utility bill)		

Ex. 197

Compute the net income for 2008 based on the following amounts presented on the adjusted trial balance of Pryor Company.

Accumulated Depreciation	$20,000
Depreciation Expense	10,000
Salaries Expense	15,000
Service Revenue	40,000
Unearned Revenue	8,000

Solution 197 (5 min.)

Service Revenue		$40,000
Depreciation Expense	$10,000	
Salaries Expense	15,000	25,000
Net Income		$15,000

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Ex. 198

The Boulder Petting Zoo operates a drive through tourist attraction in Colorado. The company adjusts its accounts at the end of each month. The selected accounts appearing below reflect balances after adjusting entries were prepared on April 30. The adjusted trial balance shows the following:

Prepaid Rent	$10,000
Fencing	30,000
Accumulated Depreciation—Fencing	5,500
Unearned Ticket Revenue	400

Other data:

1. Three months' rent had been prepaid on April 1.
2. The fencing is being depreciated at $6,000 per year.
3. The unearned ticket revenue represents tickets sold for future zoo visits. The tickets were sold at $4.00 each on April 1. During April, twenty of the tickets were used by customers.

Instructions

(a) Calculate the following:
   1. Monthly rent expense.
   2. The age of the fencing in months.
   3. The number of tickets sold on April 1.

(b) Prepare the adjusting entries that were made by the Boulder Petting Zoo on April 30.

Solution 198 (15 min.)

(a) 1. $5,000. The $10,000 balance on the adjusted trial balance reflects two months remaining on the prepaid lease. This indicates that the monthly lease is $5,000.

2. The fencing is 11 months old. By dividing annual depreciation ($6,000) by 12, the monthly depreciation expense is $500. The accumulated depreciation account shows $5,500 which means that depreciation has been taken for 11 months.

3. 120 tickets were originally sold. Twenty tickets were used in April at $4.00 each. The adjusted trial balance shows a balance of $400 indicating that 100 tickets are still outstanding. By adding the 20 used in April to the 100 still remaining to be used, 120 tickets must have been sold on April 1.

(b)

1.	Rent Expense	5,000	
	Prepaid Rent		5,000
2.	Depreciation Expense	500	
	Accumulated Depreciation—Fencing		500
3.	Unearned Ticket Revenue	80	
	Ticket Revenue		80
	(20 × $4 = $80)		

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Ex. 199

The adjusted trial balance of Pool Financial Planners appears below. Using the information from the adjusted trial balance, you are to prepare for the month ending December 31:

1. an income statement.
2. an owner's equity statement.
3. a balance sheet.

POOL FINANCIAL PLANNERS
Adjusted Trial Balance
December 31, 2008

	Debit	Credit
Cash	$ 5,400	
Accounts Receivable	2,200	
Office Supplies	1,800	
Office Equipment	15,000	
Accumulated Depreciation—Office Equipment		$ 4,000
Accounts Payable		3,300
Unearned Revenue		6,000
Pool, Capital		14,400
Pool, Drawing	2,500	
Service Revenue		4,200
Office Supplies Expense	600	
Depreciation Expense	2,500	
Rent Expense	1,900	
	$31,900	$31,900

Solution 199 (20 min.)

1.

POOL FINANCIAL PLANNERS
Income Statement
For the Month Ended December 31, 2008

Revenues		
Service Revenue		$ 4,200
Expenses		
Depreciation expense	$2,500	
Rent expense	1,900	
Office supplies expense	600	
Total expenses		5,000
Net loss		$ (800)

2.

POOL FINANCIAL PLANNERS
Owner's Equity Statement
For the Month Ended December 31, 2008

Pool, Capital, December 1		$14,400
Less: Net loss	$ 800	
Drawings	2,500	3,300
Pool, Capital, December 31		$11,100

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Solution 199 (cont.)

3.

POOL FINANCIAL PLANNERS
Balance Sheet
December 31, 2008

Assets		
Cash		$ 5,400
Accounts receivable		2,200
Office supplies		1,800
Office equipment	$15,000	
Less: Accumulated depreciation—office equipment	4,000	11,000
Total assets		$20,400
Liabilities and Owner's Equity		
Liabilities		
Accounts payable	$3,300	
Unearned revenue	6,000	
Total liabilities		$ 9,300
Owner's Equity		
Pool, Capital		11,100
Total liabilities and owner's equity		$20,400

[a]Ex. 200

1. Flynn Company prepares monthly financial statements. On July 1, the Office Supplies account had a balance of $3,000. During July, additional office supplies were purchased for $3,800 and that amount was debited to Office Supplies Expense. On July 31, a physical count of office supplies revealed that there was $2,400 on hand. Prepare the adjusting journal entry that Flynn Company should make on July 31.

2. Reese Rental Agency prepares monthly financial statements. On September 1, a check for $7,200 was received from a tenant for six months' rent. The full amount was credited to Rent Revenue. Prepare the adjusting entry the company should make on September 30.

[a]Solution 200 (5 min.)

1.	July 31	Office Supplies Expense	600	
		Office Supplies		600
		(To record supplies used)		
2.	Sept. 30	Rent Revenue	6,000	
		Unearned Rent		6,000
		(To record unearned rent)		

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COMPLETION STATEMENTS

201. The _____ assumption divides the economic life of a business into artificial time periods.

202. An accounting period that is one year in length is referred to as a _____ year.

203. The _____ principle gives accountants guidance as to when revenue is to be recorded.

204. In a service company, revenue is earned when the service is _____.

205. The matching principle attempts to match _____ with _____.

206. Expenses paid and recorded in an asset account before they are used or consumed are called _____. Revenue received and recorded as a liability before it is earned is referred to as _____.

207. Failure to adjust a prepaid expense account for the amount expired will cause _____ to be understated and _____ to be overstated.

208. Depreciation is a _____ allocation process rather than a process of _____.

209. Depreciation expense for a period is an _____ rather than a factual measurement of cost that has expired.

210. An adjusting entry recording accrued salaries for a period indicates that Salaries Expense has been _____ but has not yet been _____ or recorded.

211. An adjusted trial balance proves the _____ of the total debit and credit balances after all _____ entries have been made.

Answers to Completion Statements

201. time period
202. fiscal
203. revenue recognition
204. performed
205. expenses, revenues
206. prepaid expenses, unearned revenue
207. expenses, assets
208. cost, valuation
209. estimate
210. incurred, paid
211. equality, adjusting

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MATCHING

212. Match the items below by entering the appropriate code letter in the space provided.

A. Time period assumption	F. Accrued revenues
B. Fiscal year	G. Depreciation
C. Revenue recognition principle	H. Accumulated depreciation
D. Prepaid expenses	I. Accrued expenses
E. Matching principle	J. Book value

____ 1. A twelve month accounting period

____ 2. Expenses paid before they are incurred

____ 3. Cost less accumulated depreciation

____ 4. Divides the economic life of a business into artificial time periods

____ 5. Efforts are related to accomplishments

____ 6. A contra asset account

____ 7. Recognition of revenue when it is recorded when earned

____ 8. Revenues earned but not yet received

____ 9. Expenses incurred but not yet paid

____ 10. A cost allocation process

Answers to Matching

1.	B	6.	H
2.	D	7.	C
3.	J	8.	F
4.	A	9.	I
5.	E	10.	G

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SHORT-ANSWER ESSAY QUESTIONS

S-A E 213

The income statement is an important financial statement used by individuals who are interested in the operations of a business enterprise. Explain how the time period assumption and the revenue recognition and matching principles provide guidance to accountants in preparing an income statement.

Solution 213

The time period assumption divides the economic life of an accounting entity, such as a business enterprise, into arbitrary time periods. The revenue recognition and matching principles are the basic rules for allocating revenues and expenses to these arbitrary time periods under accrual-basis accounting. The revenue recognition principle dictates the time period to which revenue is to be allocated and recognized; that is, on which income statement the revenue is to be reported. The matching principle dictates the time period to which costs are allocated and recognized as expenses; that is, on which income statement the expenses are to be reported and matched against revenues in the determination of net income.

S-A E 214

In developing an accounting information system, it is important to establish procedures whereby all transactions that affect the components of the accounting equation are recorded. Why then, is it often necessary to adjust the accounts before financial statements are prepared even in a properly designed accounting system? Identify the major types of adjustments that are frequently made and give a specific example of each.

Solution 214

Account balances must be adjusted before financial statements are prepared, even in a properly designed accounting system, because (1) some of the recorded transactions have been recognized prematurely and (2) some effects on components of the accounting equation have not been recorded. Prepayments and deferrals are types of adjustments of recorded transactions that must be allocated to future periods as well as the current period. Examples of deferral-type adjustments are: prepaid rent, prepaid insurance, and unearned revenue. Accruals are adjustments of unrecorded transactions that must be recognized in the current period. Examples of accrual-type adjustments are: salaries and wages payable, interest payable, and interest receivable.

S-A E 215

You are visiting with a friend, Mark Adams, who wants to start a new business. During discussions on forming the business, Mark makes this statement:

Our business will have accounts receivable and accounts payable. It will also acquire a substantial amount of computers and equipment. Will it be acceptable to use the cash basis of accounting?

Prepare a response for Mark.

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Solution 215

Considering the proper basis of accounting to use is an important decision that should be addressed before the business is started. Thus, this is an excellent time to look at the differences between the cash and accrual basis of accounting.

When the cash basis is used, revenue is recorded when cash is received and expenses are recorded when cash is paid. This is not an objective approach in determining net income because the receipt and payment of cash does not reflect the efforts and accomplishments of the business. Also, accounts receivable, accounts payable and depreciation are not recognized in the accounting records.

The use of the accrual basis of accounting overcomes these problems. Revenue is recorded when it is earned and expenses are recorded when they are incurred. This represents an objective way of matching efforts and accomplishments of the accounting period. In addition, accounts receivable and accounts payable are recorded and their balances are shown on the balance sheet. The business has access to these balances during the accounting period and can make important decisions about them.

Since the business has computers, it is important to record a portion of their costs each accounting period. This process is called depreciation. Instead of showing the cost as an expense when the computers are purchased (cash basis), the cost is allocated to the accounting periods in which the computers are used (accrual basis). This makes net income more meaningful because it reflects a matching of the expense to the period in which revenues were earned. The cost of the computers, less the accumulation of depreciation that has been taken, is shown as an asset on the balance sheet. Thus, the user can see that these assets are available for future use.

Also, generally accepted accounting principles require the use of the accrual basis of accounting. It will be better to use the accrual basis of accounting.

S-A E 216

The long-term liability section of A Company's Balance Sheet includes the following accounts:

Notes Payable	$100,000
Mortgage Payable	250,000
Salaries Payable	75,000
Accumulated Depreciation	125,000
Total Long-Term Liabilities	$550,000

A Company is an established company and does not experience any financial difficulties or have any cash flow problems. Discuss at least two items that are questionable as long-term liabilities.

Solution 216

Salaries Payable should not be reported as a long-term liability. This represents the amounts owed to employees. If the company does not have any financial difficulties or cash flow problems, the salaries should be paid within one year.

Accumulated Depreciation is a contra asset account. The balance is subtracted from the cost of the related asset in the Property, Plant, and Equipment section of the balance sheet.

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Solution 216 (cont.)

Are all of the notes payable actually long-term (due after one year)? If not, the portion due within one year should be reported as a current liability instead.

S-A E 217 (Ethics)

Marsh and Linton is a manufacturing company that specializes in writing instruments. The past year was a difficult one for the company, as it sought to retain its share in a market in which the largest competitors were also rapid innovators. Marsh and Linton introduced a new product late in the year, even though testing was not complete. It was a pen designed with two cartridges: one supplying ink and the other correction fluid. A person could then switch easily between writing and correcting errors. It was priced fairly high, and was never heavily advertised. Even so, the Correct-O-Pen, as the product was named, was an overwhelming success.

The success of the product has Fran Henley, the manager of the New Products division, worried, however. She was concerned that quality problems would begin occurring, since the longevity of the pen and stability of the correction fluid formulation had not been tested. She did not want sales personnel to get the bonuses that appeared to be indicated, since they might aggressively promote a product that would fail in use. She preferred to complete testing of the pen first, so that more confidence could be placed in the results.

Top management, however, declined the tests. Ms. Henley then instructed you, the accountant, not to prorate payroll taxes or rent expense for the rest of the year, but to show them as current expenses in total. In this way, the new product would appear to be only slightly profitable.

Required:

1. Describe the alternatives that you as an accountant would have in this situation.
2. Indicate which alternative is best.

Solution 217

The choices include:
1. Follow the manager's instructions.
2. Explain to the manager why you cannot follow her instructions.
3. Report the manager's actions to her superior.
4. Resign.

There are probably other alternatives as well. Students should be able to come up with at least #1 and #2.

Of the choices, #1 is unethical because it will cause the financial statements to be misleading. #3 and #4 are rather drastic measures that do not seem to be indicated, at least not yet. #2, therefore, is the best choice.

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S-A E 218 (Communication)

A new sales representative, Joel Goode, has just received his copy of the month-end financial reports. He is puzzled by the term "unearned revenue." He left the following e-mail message for you on the company's bulletin board system:

> What is this??? Creative Accounting, or what??? Line item 12 on year-to-date financials shows over $25Gs in Unearned Revenue!!! Come on, guys! Either we earned it, or we didn't ... Right??! Is this how you guys lower our commissions? Reply to j.goode@sbd

Required:

Write a response to send to Joel.

Solution 218

Since the answer is being prepared for a "bulletin board" type system, it can be in informal language and can respond in kind to the humor. However, proper grammar and spelling are essential, as is the message about what unearned revenue really is. A proposed message follows:

> Joel—What a pleasant surprise to hear from you! Maybe you can teach those other guys in your department something about living in the present! Do you know some of them still write me notes on paper??? Unbelievable, right??!
>
> Now to your question. Your unearned revenue is the sales you made that us smart guys in accounting didn't figure you had earned, so we just took it away from you! Might as well save the company some dough for our own bonuses, right??
>
> Seriously, Joel—unearned revenue is the result of your getting customers of the kind we like—they pay in advance! When they pay before we can even get their products made or shipped, we can't count the money they pay us as revenue. What we actually have is a liability—an obligation to make and ship products. So that's how we (smart guys) in accounting count it—as a liability. You happened to have about 25% of your sales that fit in that category. When production can catch up with orders, you'll get credit for the sales. You will receive your commissions the same month the company records the revenue as “earned.” (Take heart—It'll seem like Christmas all over again.)
>
> Thanks again for actually using the system. Talk to me again sometime. . . Reply to mking@sbd

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CHAPTER 4

COMPLETING THE ACCOUNTING CYCLE

SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
True-False Statements														
1.	1	K	9.	2	K	17.	4	K	25.	6	C	[sg]33.	2	K
2.	1	K	10.	2	K	18.	4	C	26.	6	K	[sg]34.	3	K
3.	1	C	11.	2	K	19.	5	C	27.	6	K	[sg]35.	6	C
4.	1	C	12.	2	K	20.	5	K	28.	6	K	[sg]36.	6	K
5.	1	K	13.	2	K	21.	5	C	29.	6	K	[sg]37.	6	K
6.	1	K	14.	2	K	22.	6	K	[a]30.	7	K			
7.	1	C	15.	3	C	23.	6	C	[sg]31.	1	K			
8.	2	K	16.	3	K	24.	6	C	[sg]32.	2	K			
Multiple Choice Questions														
38.	1	K	62.	2	K	86.	2	C	110.	5	K	134.	6	AN
39.	1	K	63.	2	K	87.	3	K	111.	5	AN	135.	6	AN
40.	1	K	64.	2	K	88.	3	C	112.	5	AN	136.	6	K
41.	1	C	65.	2	K	89.	3	K	113.	5	AN	137.	6	K
42.	1	C	66.	2	K	90.	3	K	114.	6	K	138.	6	K
43.	1	K	67.	2	K	91.	3	K	115.	6	K	139.	6	K
44.	1	C	68.	2	C	92.	3	K	116.	6	C	140.	6	AP
45.	1	K	69.	2	K	93.	3	K	117.	6	K	141.	6	AP
46.	1	K	70.	2	K	94.	3	C	118.	6	K	[a]142.	7	K
47.	1	K	71.	2	C	95.	3	C	119.	6	C	[a]143.	7	K
48.	1	K	72.	2	K	96.	3	C	120.	6	C	[sg]144.	1	C
49.	1	K	73.	2	K	97.	4	K	121.	6	K	[sg]145.	2	K
50.	1	K	74.	2	C	98.	4	K	122.	6	K	[sg]146.	2	K
51.	1	C	75.	2	C	99.	4	K	123.	6	K	[sg]147.	3	K
52.	1	K	76.	2	C	100.	4	K	124.	6	K	[st]148.	4	K
53.	1	C	77.	2	C	101.	4	K	125.	6	K	[sg]149.	4	K
54.	1	AP	78.	2	C	102.	4	K	126.	6	K	[st]150.	5	K
55.	1	C	79.	2	AN	103.	4	K	127.	6	K	[sg]151.	5	AN
56.	2	K	80.	2	C	104.	4	K	128.	6	C	[st]152.	6	K
57.	2	K	81.	2	C	105.	4	K	129.	6	AN	[sg]153.	6	K
58.	2	K	82.	2	C	106.	5	K	130.	6	AN	[st,a]154.	7	K
59.	2	K	83.	2	C	107.	5	AN	131.	6	AN			
60.	2	K	84.	2	AN	108.	5	K	132.	6	AN			
61.	2	K	85.	2	C	109.	5	C	133.	6	AN			
Brief Exercises														
155.	2	AN	158.	2	K	161.	5	AN	164.	6	AP			
156.	2	AN	159.	3	K	162.	6	AN	165.	6	K			
157.	2	AN	160.	5	AN	163.	6	AP	[a]166.	7	AP			

[sg] This question also appears in the Study Guide.
[st] This question also appears in a self-test at the student companion website.
[a] This question covers a topic in an appendix to the chapter.

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SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Exercises														
167.	1	C	172.	2	AP	177.	3	C	182.	5	AN	[a]187.	7	AN
168.	1	C	173.	2	AP	178.	3	AN	183.	5	AN	[a]188.	7	AN
169.	1	AN	174.	2	AP	179.	4	C	184.	6	AN	[a]189.	7	AN
170.	1	AN	175.	2	AP	180.	5	AN	185.	6	AP			
171.	2	AN	176.	2	AP	181.	5	AN	186.	6	AP			
Completion Statements														
190.	1	K	193.	2	K	196.	4	K	199.	6	K			
191.	1	K	194.	2	K	197.	6	K	200.	6	K			
192.	2	K	195.	3	K	198.	6	K	201.	6	K			

SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Study Objective 1													
1.	TF	6.	TF	40.	MC	45.	MC	50.	MC	55.	MC	170.	Ex
2.	TF	7.	TF	41.	MC	46.	MC	51.	MC	144.	MC	190.	C
3.	TF	31.	TF	42.	MC	47.	MC	52.	MC	167.	Ex	191.	C
4.	TF	38.	MC	43.	MC	48.	MC	53.	MC	168.	Ex		
5.	TF	39.	MC	44.	MC	49.	MC	54.	MC	169.	Ex		
Study Objective 2													
8.	TF	33.	TF	63.	MC	71.	MC	79.	MC	145.	MC	173.	Ex
9.	TF	56.	MC	64.	MC	72.	MC	80.	MC	146.	MC	174.	Ex
10.	TF	57.	MC	65.	MC	73.	MC	81.	MC	155.	BE	175.	Ex
11.	TF	58.	MC	66.	MC	74.	MC	82.	MC	156.	BE	176.	Ex
12.	TF	59.	MC	67.	MC	75.	MC	83.	MC	157.	BE	192.	C
13.	TF	60.	MC	68.	MC	76.	MC	84.	MC	158.	BE	193.	C
14.	TF	61.	MC	69.	MC	77.	MC	85.	MC	171.	Ex	194.	C
32.	TF	62.	MC	70.	MC	78.	MC	86.	MC	172.	Ex		
Study Objective 3													
15.	TF	87.	MC	90.	MC	93.	MC	96.	MC	177.	Ex		
16.	TF	88.	MC	91.	MC	94.	MC	147.	MC	178.	Ex		
34.	TF	89.	MC	92.	MC	95.	MC	159.	BE	195.	C		
Study Objective 4													
17.	TF	98.	MC	101.	MC	104.	MC	149.	MC				
18.	TF	99.	MC	102.	MC	105.	MC	179.	Ex				
97.	MC	100.	MC	103.	MC	148.	MC	196.	C				
Study Objective 5													
19.	TF	106.	MC	109.	MC	112.	MC	151.	MC	180.	Ex	183.	Ex
20.	TF	107.	MC	110.	MC	113.	MC	160.	BE	181.	Ex		
21.	TF	108.	MC	111.	MC	150.	MC	161.	BE	182.	Ex		

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SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Study Objective 6																	
22.	TF	35.	TF	119.	MC	127.	MC	135.	MC	153.	MC	197.	C				
23.	TF	36.	TF	120.	MC	128.	MC	136.	MC	162.	BE	198.	C				
24.	TF	37.	TF	121.	MC	129.	MC	137.	MC	163.	BE	199.	C				
25.	TF	114.	MC	122.	MC	130.	MC	138.	MC	164.	BE	200.	C				
26.	TF	115.	MC	123.	MC	131.	MC	139.	MC	165.	BE	201.	C				
27.	TF	116.	MC	124.	MC	132.	MC	140.	MC	184.	Ex						
28.	TF	117.	MC	125.	MC	133.	MC	141.	MC	185.	Ex						
29.	TF	118.	MC	126.	MC	134.	MC	152.	MC	186.	Ex						
Study Objective [a]7																	
[a]30.	TF	[a]143.	MC	[a]166.	BE	[a]188.	Ex										
[a]142.	MC	[a]154.	MC	[a]187.	Ex	[a]189.	Ex										

Note: TF = True-False BE = Brief Exercise C = Completion
MC = Multiple Choice Ex = Exercise

The chapter also contains one set of ten Matching questions and five Short-Answer Essay questions.

CHAPTER STUDY OBJECTIVES

1. ***Prepare a worksheet.*** The steps in preparing a worksheet are: (a) Prepare a trial balance on the worksheet, (b) Enter the adjustments in the adjustments columns, (c) Enter adjusted balances in the adjusted trial balance columns, (d) Extend adjusted trial balance amounts to appropriate financial statement columns, and (e) Total the statement columns, compute net income (or net loss), and complete the worksheet.

2. ***Explain the process of closing the books.*** Closing the books occurs at the end of an accounting period. The process is to journalize and post closing entries and then rule and balance all accounts. In closing the books, companies make separate entries to close revenues and expenses to Income Summary, Income Summary to Owner's Capital, and Owner's Drawings to Owner's Capital. Only temporary accounts are closed.

3. ***Describe the content and purpose of a post-closing trial balance.*** A post-closing trial balance contains the balances in permanent accounts that are carried forward to the next accounting period. The purpose of this trial balance is to prove the equality of these balances.

4. ***State the required steps in the accounting cycle.*** The required steps in the accounting cycle are: (1) analyze business transactions, (2) journalize the transactions, (3) post to ledger accounts, (4) prepare a trial balance, (5) journalize and post adjusting entries, (6) prepare an adjusted trial balance, (7) prepare financial statements, (8) journalize and post closing entries, and (9) prepare a post-closing trial balance.

5. ***Explain the approaches to preparing correcting entries.*** One approach for determining the correcting entry is to compare the incorrect entry with the correct entry. After comparison, the company makes a correcting entry to correct the accounts. An alternative to a correcting entry is to reverse the incorrect entry and then prepare the correct entry.

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6. ***Identify the sections of a classified balance sheet.*** A classified balance sheet categorizes assets as current assets; long-term investments; property, plant, and equipment; and intangibles. Liabilities are classified as either current or long-term. There is also an owner's (owners') equity section, which varies with the form of business organization.

[a]7. ***Prepare reversing entries.*** Reversing entries are the opposite of the adjusting entries made in the preceding period. Some companies choose to make reversing entries at the beginning of a new accounting period to simplify the recording of later transactions related to the adjusting entries. In most cases, only accrued adjusting entries are reversed.

TRUE-FALSE STATEMENTS

1. A worksheet is a mandatory form that must be prepared along with an income statement and balance sheet.

2. If a worksheet is used, financial statements can be prepared before adjusting entries are journalized.

3. If total credits in the income statement columns of a worksheet exceed total debits, the enterprise has net income.

4. It is not necessary to prepare formal financial statements if a worksheet has been prepared because financial position and net income are shown on the worksheet.

5. The adjustments on a worksheet can be posted directly to the accounts in the ledger from the worksheet.

6. The adjusted trial balance columns of a worksheet are obtained by subtracting the adjustment columns from the trial balance columns.

7. The balance of the depreciation expense account will appear in the income statement debit column of a worksheet.

8. Closing entries are unnecessary if the business plans to continue operating in the future and issue financial statements each year.

9. The owner's drawing account is closed to the Income Summary account in order to properly determine net income (or loss) for the period.

10. After closing entries have been journalized and posted, all temporary accounts in the ledger should have zero balances.

11. Closing revenue and expense accounts to the Income Summary account is an optional bookkeeping procedure.

12. Closing the drawing account to Capital is not necessary if net income is greater than owner's drawings during the period.

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13. The owner's drawing account is a permanent account whose balance is carried forward to the next accounting period.

14. Closing entries are journalized after adjusting entries have been journalized.

15. The amounts appearing on an income statement should agree with the amounts appearing on the post-closing trial balance.

16. The post-closing trial balance is entered in the first two columns of a worksheet.

17. A business entity has only one accounting cycle over its economic existence.

18. The accounting cycle begins at the start of a new accounting period.

19. Both correcting entries and adjusting entries always affect at least one balance sheet account and one income statement account.

20. Correcting entries are made any time an error is discovered even though it may not be at the end of an accounting period.

21. An incorrect debit to Accounts Receivable instead of the correct account Notes Receivable does not require a correcting entry because total assets will not be misstated.

22. In a corporation, Retained Earnings is a part of owners' equity.

23. A company's operating cycle and fiscal year are usually the same length of time.

24. Cash and office supplies are both classified as current assets.

25. Long-term investments would appear in the property, plant, and equipment section of the balance sheet.

26. A liability is classified as a current liability if the company is to pay it within the forthcoming year.

27. A company's liquidity is concerned with the relationship between long-term investments and long-term debt.

28. Current assets are customarily the first items listed on a classified balance sheet.

29. The operating cycle of a company is determined by the number of years the company has been operating.

[a]30. Reversing entries are an optional bookkeeping procedure.

Additional True-False Questions

31. After a worksheet has been completed, the statement columns contain all data that are required for the preparation of financial statements.

32. To close net income to owner's capital, Income Summary is debited and Owner's Capital is credited.

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33. In one closing entry, Owner's Drawing is credited and Income Summary is debited.

34. The post-closing trial balance will contain only owner's equity statement accounts and balance sheet accounts.

35. The operating cycle of a company is the average time required to collect the receivables resulting from producing revenues.

36. Current assets are listed in the order of liquidity.

37. Current liabilities are obligations that the company is to pay within the coming year.

Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	7.	T	13.	F	19.	F	25.	F	31.	T	37.	T
2.	T	8.	F	14.	T	20.	T	26.	T	32.	T		
3.	T	9.	F	15.	F	21.	F	27.	F	33.	F		
4.	F	10.	T	16.	F	22.	T	28.	T	34.	F		
5.	F	11.	F	17.	F	23.	F	29.	F	35.	F		
6.	F	12.	F	18.	T	24.	T	[a]30.	T	36.	T		

MULTIPLE CHOICE QUESTIONS

38. Preparing a worksheet involves
    a. two steps.
    b. three steps.
    c. four steps.
    d. five steps.

39. The adjustments entered in the adjustments columns of a worksheet are
    a. not journalized.
    b. posted to the ledger but not journalized.
    c. not journalized until after the financial statements are prepared.
    d. journalized before the worksheet is completed.

40. The information for preparing a trial balance on a worksheet is obtained from
    a. financial statements.
    b. general ledger accounts.
    c. general journal entries.
    d. business documents.

41. After the adjusting entries are journalized and posted to the accounts in the general ledger, the balance of each account should agree with the balance shown on the
    a. adjusted trial balance.
    b. post-closing trial balance.
    c. the general journal.
    d. adjustments columns of the worksheet.

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42. If the total debit column exceeds the total credit column of the income statement columns on a worksheet, then the company has
    a. earned net income for the period.
    b. an error because debits do not equal credits.
    c. suffered a net loss for the period.
    d. to make an adjusting entry.

43. A worksheet is a multiple column form that facilitates the
    a. identification of events.
    b. measurement process.
    c. preparation of financial statements.
    d. analysis process.

44. Which of the following companies would be least likely to use a worksheet to facilitate the adjustment process?
    a. Large company with numerous accounts
    b. Small company with numerous accounts
    c. All companies, since worksheets are required under generally accepted accounting principles
    d. Small company with few accounts

45. A worksheet can be thought of as a(n)
    a. permanent accounting record.
    b. optional device used by accountants.
    c. part of the general ledger.
    d. part of the journal.

46. The account, Supplies, will appear in the following debit columns of the worksheet.
    a. Trial balance
    b. Adjusted trial balance
    c. Balance sheet
    d. All of these

47. When constructing a worksheet, accounts are often needed that are not listed in the trial balance already entered on the worksheet from the ledger. Where should these additional accounts be shown on the worksheet?
    a. They should be inserted in alphabetical order into the trial balance accounts already given.
    b. They should be inserted in chart of account order into the trial balance already given.
    c. They should be inserted on the lines immediately below the trial balance totals.
    d. They should not be inserted on the trial balance until the next accounting period.

48. When using a worksheet, adjusting entries are journalized
    a. after the worksheet is completed and before financial statements are prepared.
    b. before the adjustments are entered on to the worksheet.
    c. after the worksheet is completed and after financial statements have been prepared.
    d. before the adjusted trial balance is extended to the proper financial statement columns.

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49. Assuming that there is a net loss for the period, debits equal credits in all but which section of the worksheet?
    a. Income statement columns
    b. Adjustments columns
    c. Trial balance columns
    d. Adjusted trial balance columns

50. Adjusting entries are prepared from
    a. source documents.
    b. the adjustments columns of the worksheet.
    c. the general ledger.
    d. last year's worksheet.

51. The net income (or loss) for the period
    a. is found by computing the difference between the income statement credit column and the balance sheet credit column on the worksheet.
    b. cannot be found on the worksheet.
    c. is found by computing the difference between the income statement columns of the worksheet.
    d. is found by computing the difference between the trial balance totals and the adjusted trial balance totals.

52. The worksheet does *not* show
    a. net income or loss for the period.
    b. revenue and expense account balances.
    c. the ending balance in the owner's capital account.
    d. the trial balance before adjustments.

53. If the total debits exceed total credits in the balance sheet columns of the worksheet, owner's equity
    a. will increase because net income has occurred.
    b. will decrease because a net loss has occurred.
    c. is in error because a mistake has occurred.
    d. will not be affected.

Use the following information for questions 54–55.

The income statement and balance sheet columns of Pine Company's worksheet reflects the following totals:

	Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.
Totals	$58,000	$48,000	$34,000	$44,000

54. The net income (or loss) for the period is
    a. $48,000 income.
    b. $10,000 income.
    c. $10,000 loss.
    d. not determinable.

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55. To enter the net income (or loss) for the period into the above worksheet requires an entry to the
    a. income statement debit column and the balance sheet credit column.
    b. income statement credit column and the balance sheet debit column.
    c. income statement debit column and the income statement credit column.
    d. balance sheet debit column and the balance sheet credit column.

56. Closing entries are necessary for
    a. permanent accounts only.
    b. temporary accounts only.
    c. both permanent and temporary accounts.
    d. permanent or real accounts only.

57. Each of the following accounts is closed to Income Summary *except*
    a. Expenses.
    b. Owner's Drawing.
    c. Revenues.
    d. All of these are closed to Income Summary.

58. Closing entries are made
    a. in order to terminate the business as an operating entity.
    b. so that all assets, liabilities, and owner's capital accounts will have zero balances when the next accounting period starts.
    c. in order to transfer net income (or loss) and owner's drawing to the owner's capital account.
    d. so that financial statements can be prepared.

59. Closing entries are
    a. an optional step in the accounting cycle.
    b. posted to the ledger accounts from the worksheet.
    c. made to close permanent or real accounts.
    d. journalized in the general journal.

60. The income summary account
    a. is a permanent account.
    b. appears on the balance sheet.
    c. appears on the income statement.
    d. is a temporary account.

61. If Income Summary has a credit balance after revenues and expenses have been closed into it, the closing entry for Income Summary will include a
    a. debit to the owner's capital account.
    b. debit to the owner's drawing account.
    c. credit to the owner's capital account.
    d. credit to the owner's drawing account.

62. Closing entries are journalized and posted
    a. before the financial statements are prepared.
    b. after the financial statements are prepared.
    c. at management's discretion.
    d. at the end of each interim accounting period.

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63. Closing entries
    a. are prepared before the financial statements.
    b. reduce the number of permanent accounts.
    c. cause the revenue and expense accounts to have zero balances.
    d. summarize the activity in every account.

64. Which of the following is a true statement about closing the books of a proprietorship?
    a. Expenses are closed to the Expense Summary account.
    b. Only revenues are closed to the Income Summary account.
    c. Revenues and expenses are closed to the Income Summary account.
    d. Revenues, expenses, and the owner's drawing account are closed to the Income Summary account.

65. Closing entries may be prepared from all but which one of the following sources?
    a. Adjusted balances in the ledger
    b. Income statement and balance sheet columns of the worksheet
    c. Balance sheet
    d. Income and owner's equity statements

66. In order to close the owner's drawing account, the
    a. income summary account should be debited.
    b. income summary account should be credited.
    c. owner's capital account should be credited.
    d. owner's capital account should be debited.

67. In preparing closing entries
    a. each revenue account will be credited.
    b. each expense account will be credited.
    c. the owner's capital account will be debited if there is net income for the period.
    d. the owner's drawing account will be debited.

68. The most efficient way to accomplish closing entries is to
    a. credit the income summary account for each revenue account balance.
    b. debit the income summary account for each expense account balance.
    c. credit the owner's drawing balance directly to the income summary account.
    d. credit the income summary account for total revenues and debit the income summary account for total expenses.

69. The closing entry process consists of closing
    a. all asset and liability accounts.
    b. out the owner's capital account.
    c. all permanent accounts.
    d. all temporary accounts.

70. The final closing entry to be journalized is typically the entry that closes the
    a. revenue accounts.
    b. owner's drawing account.
    c. owner's capital account.
    d. expense accounts.

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71. An error has occurred in the closing entry process if
    a. revenue and expense accounts have zero balances.
    b. the owner's capital account is credited for the amount of net income.
    c. the owner's drawing account is closed to the owner's capital account.
    d. the balance sheet accounts have zero balances.

72. The Income Summary account is an important account that is used
    a. during interim periods.
    b. in preparing adjusting entries.
    c. annually in preparing closing entries.
    d. annually in preparing correcting entries.

73. The balance in the income summary account before it is closed will be equal to
    a. the net income or loss on the income statement.
    b. the beginning balance in the owner's capital account.
    c. the ending balance in the owner's capital account.
    d. zero.

74. After closing entries are posted, the balance in the owner's capital account in the ledger will be equal to
    a. the beginning owner's capital reported on the owner's equity statement.
    b. the amount of the owner's capital reported on the balance sheet.
    c. zero.
    d. the net income for the period.

Use the following information for questions 75–79.

The income statement for the month of June, 2008 of Delgado Enterprises contains the following information:

Revenues		$7,000
Expenses:		
Wages Expense	$2,000	
Rent Expense	1,000	
Supplies Expense	300	
Advertising Expense	200	
Insurance Expense	100	
Total expenses		3,600
Net income		$3,400

75. The entry to close the revenue account includes a
    a. debit to Income Summary for $3,400.
    b. credit to Income Summary for $3,400.
    c. debit to Income Summary for $7,000.
    d. credit to Income Summary for $7,000.

76. The entry to close the expense accounts includes a
    a. debit to Income Summary for $3,400.
    b. credit to Rent Expense for $1,000,
    c. credit to Income Summary for $3,600.
    d. debit to Wages Expense for $2,000.

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77. After the revenue and expense accounts have been closed, the balance in Income Summary will be
    a. $0.
    b. a debit balance of $3,400.
    c. a credit balance of $3,400.
    d. a credit balance of $7,000.

78. The entry to close Income Summary to Delgado, Capital includes
    a. a debit to Revenue for $7,000.
    b. credits to Expenses totalling $3,600.
    c. a credit to Income Summary for $3,400
    d. a credit to Delgado, Capital for $3,400.

79. At June 1, 2008, Delgado reported owner's equity of $35,000. The company had no owner drawings during June. At June 30, 2008, the company will report owner's equity of
    a. $35,000.
    b. $42,000.
    c. $38,400.
    d. $31,600.

Use the following information for questions 80–86.

The income statement for the year 2008 of Nova Co. contains the following information:

Revenues		$70,000
Expenses:		
Wages Expense	$45,000	
Rent Expense	12,000	
Advertising Expense	6,000	
Supplies Expense	6,000	
Utilities Expense	2,500	
Insurance Expense	2,000	
Total expenses		73,500
Net income (loss)		$(3,500)

80. The entry to close the revenue account includes a
    a. debit to Income Summary for $3,500.
    b. credit to Income Summary for $3,500.
    c. debit to Revenues for $70,000.
    d. credit to Revenues for $70,000.

81. The entry to close the expense accounts includes a
    a. debit to Income Summary for $3,500.
    b. credit to Income Summary for $3,500.
    c. debit to Income Summary for $73,500.
    d. debit to Wages Expense for $2,500.

82. After the revenue and expense accounts have been closed, the balance in Income Summary will be
    a. $0.
    b. a debit balance of $3,500.
    c. a credit balance of $3,500.
    d. a credit balance of $70,000.

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83. The entry to close Income Summary to Nova, Capital includes
    a. a debit to Revenue for $70,000.
    b. credits to Expenses totalling $73,500.
    c. a credit to Income Summary for $3,500.
    d. a credit to Nova, Capital for $3,500.

84. At January 1, 2008, Nova reported owner's equity of $50,000. Owner drawings for the year totalled $10,000. At December 31, 2008, the company will report owner's equity of
    a. $13,500.
    b. $36,500.
    c. $40,000.
    d. $43,500.

85. After all closing entries have been posted, the Income Summary account will have a balance of
    a. $0.
    b. $3,500 debit.
    c. $3,500 credit.
    d. $36,500 credit.

86. After all closing entries have been posted, the revenue account will have a balance of
    a. $0.
    b. $70,000 credit.
    c. $70,000 debit.
    d. $3,500 credit.

87. A post-closing trial balance is prepared
    a. after closing entries have been journalized and posted.
    b. before closing entries have been journalized and posted.
    c. after closing entries have been journalized but before the entries are posted.
    d. before closing entries have been journalized but after the entries are posted.

88. All of the following statements about the post-closing trial balance are correct *except* it
    a. shows that the accounting equation is in balance.
    b. provides evidence that the journalizing and posting of closing entries have been properly completed.
    c. contains only permanent accounts.
    d. proves that all transactions have been recorded.

89. A post-closing trial balance will show
    a. only permanent account balances.
    b. only temporary account balances.
    c. zero balances for all accounts.
    d. the amount of net income (or loss) for the period.

90. A post-closing trial balance should be prepared
    a. before closing entries are posted to the ledger accounts.
    b. after closing entries are posted to the ledger accounts.
    c. before adjusting entries are posted to the ledger accounts.
    d. only if an error in the accounts is detected.

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91. A post-closing trial balance will show
    a. zero balances for all accounts.
    b. zero balances for balance sheet accounts.
    c. only balance sheet accounts.
    d. only income statement accounts.

92. The purpose of the post-closing trial balance is to
    a. prove that no mistakes were made.
    b. prove the equality of the balance sheet account balances that are carried forward into the next accounting period.
    c. prove the equality of the income statement account balances that are carried forward into the next accounting period.
    d. list all the balance sheet accounts in alphabetical order for easy reference.

93. The balances that appear on the post-closing trial balance will match the
    a. income statement account balances after adjustments.
    b. balance sheet account balances after closing entries.
    c. income statement account balances after closing entries.
    d. balance sheet account balances after adjustments.

94. Which account listed below would be double ruled in the ledger as part of the closing process?
    a. Cash
    b. Owner's Capital
    c. Owner's Drawing
    d. Accumulated Depreciation

95. A double rule applied to accounts in the ledger during the closing process implies that
    a. the account is an income statement account.
    b. the account is a balance sheet account.
    c. the account balance is not zero.
    d. a mistake has been made, since double ruling is prescribed.

96. The heading for a post-closing trial balance has a date line that is similar to the one found on
    a. a balance sheet.
    b. an income statement.
    c. an owner's equity statement.
    d. the worksheet.

97. Which one of the following is usually prepared only at the end of a company's annual accounting period?
    a. Preparing financial statements
    b. Journalizing and posting adjusting entries
    c. Journalizing and posting closing entries
    d. Preparing an adjusted trial balance

98. The step in the accounting cycle that is performed on a periodic basis (i.e., monthly, quarterly) is
    a. analyzing transactions.
    b. journalizing and posting adjusting entries.
    c. preparing a post-closing trial balance.
    d. posting to ledger accounts.

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99. Which one of the following is an optional step in the accounting cycle of a business enterprise?
    a. Analyze business transactions
    b. Prepare a worksheet
    c. Prepare a trial balance
    d. Post to the ledger accounts

100. The final step in the accounting cycle is to prepare
    a. closing entries.
    b. financial statements.
    c. a post-closing trial balance.
    d. adjusting entries.

101. Which of the following steps in the accounting cycle would *not* generally be performed daily?
    a. Journalize transactions
    b. Post to ledger accounts
    c. Prepare adjusting entries
    d. Analyze business transactions

102. Which of the following steps in the accounting cycle may be performed more frequently than annually?
    a. Prepare a post-closing trial balance
    b. Journalize closing entries
    c. Post closing entries
    d. Prepare a trial balance

103. Which of the following depicts the proper sequence of steps in the accounting cycle?
    a. Journalize the transactions, analyze business transactions, prepare a trial balance
    b. Prepare a trial balance, prepare financial statements, prepare adjusting entries
    c. Prepare a trial balance, prepare adjusting entries, prepare financial statements
    d. Prepare a trial balance, post to ledger accounts, post adjusting entries

104. The two optional steps in the accounting cycle are preparing
    a. a post-closing trial balance and reversing entries.
    b. a worksheet and post-closing trial balances.
    c. reversing entries and a worksheet.
    d. an adjusted trial balance and a post-closing trial balance.

105. The first required step in the accounting cycle is
    a. reversing entries.
    b. journalizing transactions in the book of original entry.
    c. analyzing transactions.
    d. posting transactions.

106. Correcting entries
    a. always affect at least one balance sheet account and one income statement account.
    b. affect income statement accounts only.
    c. affect balance sheet accounts only.
    d. may involve any combination of accounts in need of correction.

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107. Speedy Bike Company received a $940 check from a customer for the balance due. The transaction was erroneously recorded as a debit to Cash $490 and a credit to Service Revenue $490. The correcting entry is
   a. debit Cash, $940; credit Accounts Receivable, $940.
   b. debit Cash, $450 and Accounts Receivable, $490; credit Service Revenue, $940.
   c. debit Cash, $450 and Service Revenue, $490; credit Accounts Receivable, $940.
   d. debit Accounts Receivable, $940; credit Cash, $450 and Service Revenue, $490.

108. If errors occur in the recording process, they
   a. should be corrected as adjustments at the end of the period.
   b. should be corrected as soon as they are discovered.
   c. should be corrected when preparing closing entries.
   d. cannot be corrected until the next accounting period.

109. A correcting entry
   a. must involve one balance sheet account and one income statement account.
   b. is another name for a closing entry.
   c. may involve any combination of accounts.
   d. is a required step in the accounting cycle.

110. An unacceptable way to make a correcting entry is to
   a. reverse the incorrect entry.
   b. erase the incorrect entry.
   c. compare the incorrect entry with the correct entry and make a correcting entry to correct the accounts.
   d. correct it immediately upon discovery.

111. Cole Company paid the weekly payroll on January 2 by debiting Wages Expense for $45,000. The accountant preparing the payroll entry overlooked the fact that Wages Expense of $27,000 had been accrued at year end on December 31. The correcting entry is

a.	Wages Payable	27,000	
	Cash		27,000
b.	Cash	18,000	
	Wages Expense		18,000
c.	Wages Payable	27,000	
	Wages Expense		27,000
d.	Cash	27,000	
	Wages Expense		27,000

112. Tyler Company paid $530 on account to a creditor. The transaction was erroneously recorded as a debit to Cash of $350 and a credit to Accounts Receivable, $350. The correcting entry is

a.	Accounts Payable	530	
	Cash		530
b.	Accounts Receivable	350	
	Cash		350
c.	Accounts Receivable	350	
	Accounts Payable		350
d.	Accounts Receivable	350	
	Accounts Payable	530	
	Cash		880

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113. A lawyer collected $830 of legal fees in advance. He erroneously debited Cash for $380 and credited Accounts Receivable for $380. The correcting entry is

a.	Cash	380	
	Accounts Receivable	450	
	Unearned Revenue		830
b.	Cash	830	
	Service Revenue		830
c.	Cash	450	
	Accounts Receivable	380	
	Unearned Revenue		830
d.	Cash	450	
	Accounts Receivable		450

114. All of the following are property, plant, and equipment *except*
a. supplies.
b. machinery.
c. land.
d. buildings.

115. The first item listed under current liabilities is usually
a. accounts payable.
b. notes payable.
c. salaries payable.
d. taxes payable.

116. Office Equipment is classified in the balance sheet as
a. a current asset.
b. property, plant, and equipment.
c. an intangible asset.
d. a long-term investment.

117. A current asset is
a. the last asset purchased by a business.
b. an asset which is currently being used to produce a product or service.
c. usually found as a separate classification in the income statement.
d. an asset that a company expects to convert to cash or use up within one year.

118. An intangible asset
a. does not have physical substance, yet often is very valuable.
b. is worthless because it has no physical substance.
c. is converted into a tangible asset during the operating cycle.
d. cannot be classified on the balance sheet because it lacks physical substance.

119. Liabilities are generally classified on a balance sheet as
a. small liabilities and large liabilities.
b. present liabilities and future liabilities.
c. tangible liabilities and intangible liabilities.
d. current liabilities and long-term liabilities.

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120. Which of the following would *not* be classified a long-term liability?
   a. Current maturities of long-term debt
   b. Bonds payable
   c. Mortgage payable
   d. Lease liabilities

121. Which of the following liabilities are *not* related to the operating cycle?
   a. Wages payable
   b. Accounts payable
   c. Utilities payable
   d. Bonds payable

122. Intangible assets include each of the following *except*
   a. copyrights.
   b. goodwill.
   c. land improvements.
   d. patents.

123. It is *not* true that current assets are assets that a company expects to
   a. realize in cash within one year.
   b. sell within one year.
   c. use up within one year.
   d. acquire within one year.

124. The operating cycle of a company is the average time that is required to go from cash to
   a. sales in producing revenues.
   b. cash in producing revenues.
   c. inventory in producing revenues.
   d. accounts receivable in producing revenues.

125. On a classified balance sheet, current assets are customarily listed
   a. in alphabetical order.
   b. with the largest dollar amounts first.
   c. in the order of liquidity.
   d. in the order of acquisition.

126. Intangible assets are
   a. listed under current assets on the balance sheet.
   b. not listed on the balance sheet because they do not have physical substance.
   c. noncurrent resources.
   d. listed as a long-term investment on the balance sheet.

127. The relationship between current assets and current liabilities is important in evaluating a company's
   a. profitability.
   b. liquidity.
   c. market value.
   d. accounting cycle.

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128. The most important information needed to determine if companies can pay their current obligations is the
   a. net income for this year.
   b. projected net income for next year.
   c. relationship between current assets and current liabilities.
   d. relationship between short-term and long-term liabilities.

Use the following information for questions 129–137.

The following items are taken from the financial statements of Cerner Company for the year ending December 31, 2008:

Accounts payable	$ 18,000
Accounts receivable	11,000
Accumulated depreciation – equipment	28,000
Advertising expense	21,000
Cash	15,000
Cerner, Capital (1/1/08)	102,000
Cerner, Drawing	14,000
Depreciation expense	12,000
Insurance expense	3,000
Note payable, due 6/30/09	70,000
Prepaid insurance (12-month policy)	6,000
Rent expense	17,000
Salaries expense	32,000
Service revenue	133,000
Supplies	4,000
Supplies expense	6,000
Equipment	210,000

129. What is the company's net income for the year ending December 31, 2008?
   a. $133,000
   b. $42,000
   c. $28,000
   d. $12,000

130. What is the balance that would be reported for owner's equity at December 31, 2008?
   a. $102,000
   b. $130,000
   c. $144,000
   d. $158,000

131. What are total current assets at December 31, 2008?
   a. $26,000
   b. $32,000
   c. $36,000
   d. $218,000

132. What is the book value of the equipment at December 31, 2008?
   a. $238,000
   b. $210,000
   c. $182,000
   d. $170,000

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133. What are total current liabililites at December 31, 2008?
   a. $18,000
   b. $70,000
   c. $88,000
   d. $0

134. What are total long-term liabilities at December 31, 2008?
   a. $0
   b. $70,000
   c. $88,000
   d. $90,000

135. What is total liabilities and owner's equity at December 31, 2008?
   a. $176,000
   b. $190,000
   c. $218,000
   d. $232,000

136. The sub-classifications for assets on the company's classified balance sheet would include all of the following *except:*
   a. Current Assets.
   b. Property, Plant, and Equipment.
   c. Intangible Assets.
   d. Long-term Assets.

137. The current assets should be listed on Cerner's balance sheet in the following order:
   a. cash, accounts receivable, prepaid insurance, equipment.
   b. cash, prepaid insurance, supplies, accounts receivable.
   c. cash, accounts receivable, prepaid insurance, supplies.
   d. equipment, supplies, prepaid insurance, accounts receivable, cash.

138. Which statement about long-term investments is not true?
   a. They will be held for more than one year.
   b. They are not currently used in the operation of the business.
   c. They include investments in stock of other companies and land held for future use.
   d. They can never include cash accounts.

139. What is the order in which assets are generally listed on a classified balance sheet?
   a. Current and long-term
   b. Current; property, plant, and equipment; long-term investments; intangible assets
   c. Current; property, plant, and equipment; intangible assets; long-term investments
   d. Current; long-term investments; property, plant, and equipment; intangible assets

140. These are selected account balances on December 31, 2008.

Land (location of the corporation's office building)	$100,000
Land (held for future use)	150,000
Corporate Office Building	600,000
Inventory	200,000
Equipment	450,000
Office Furniture	100,000
Accumulated Depreciation	300,000

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What is the total amount of property, plant, and equipment that will appear on the balance sheet?
a. $1,300,000
b. $1,100,000
c. $1,600,000
d. $950,000

141. The following selected account balances appear on the December 31, 2008 balance sheet of Ming Co.

Land (location of the corporation's office building)	$150,000
Land (held for future use)	225,000
Corporate Office Building	900,000
Inventory	300,000
Equipment	675,000
Office Furniture	150,000
Accumulated Depreciation	450,000

What is the total amount of property, plant, and equipment that will be reported on the balance sheet?
a. $1,950,000
b. $1,650,000
c. $2,400,000
d. $1,425,000

[a]142. A reversing entry
a. reverses entries that were made in error.
b. is the exact opposite of an adjusting entry made in a previous period.
c. is made when a business disposes of an asset it previously purchased.
d. is made when a company sustains a loss in one period and reverses the effect with a profit in the next period.

[a]143. If a company utilizes reversing entries, they will
a. be made at the beginning of the next accounting period.
b. not actually be posted to the general ledger accounts.
c. be made before the post-closing trial balance.
d. be part of the adjusting entry process.

Additional Multiple Choice Questions

144. The steps in the preparation of a worksheet do *not* include
a. analyzing documentary evidence.
b. preparing a trial balance on the worksheet.
c. entering the adjustments in the adjustment columns.
d. entering adjusted balances in the adjusted trial balance columns.

145. Balance sheet accounts are considered to be
a. temporary owner's equity accounts.
b. permanent accounts.
c. capital accounts.
d. nominal accounts.

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146. Income Summary has a credit balance of $12,000 in J. Sawyer Co. after closing revenues and expenses. The entry to close Income Summary is
   a. credit Income Summary $12,000, debit J. Sawyer, Capital $12,000.
   b. credit Income Summary $12,000, debit J. Sawyer, Drawing $12,000.
   c. debit Income Summary $12,000, credit J. Sawyer, Drawing $12,000.
   d. debit Income Summary $12,000, credit J. Sawyer, Capital $12,000.

147. The post-closing trial balance contains only
   a. income statement accounts.
   b. balance sheet accounts.
   c. balance sheet and income statement accounts.
   d. income statement, balance sheet, and owner's equity statement accounts.

148. Which of the following is an optional step in the accounting cycle?
   a. Adjusting entries
   b. Closing entries
   c. Correcting entries
   d. Reversing entries

149. Which one of the following statements concerning the accounting cycle is *incorrect*?
   a. The accounting cycle includes journalizing transactions and posting to ledger accounts.
   b. The accounting cycle includes only one optional step.
   c. The steps in the accounting cycle are performed in sequence.
   d. The steps in the accounting cycle are repeated in each accounting period.

150. Correcting entries are made
   a. at the beginning of an accounting period.
   b. at the end of an accounting period.
   c. whenever an error is discovered.
   d. after closing entries.

151. On September 23, Pitts Company received a $350 check from Mike Moluf for services to be performed in the future. The bookkeeper for Pitts Company incorrectly debited Cash for $350 and credited Accounts Receivable for $350. The amounts have been posted to the ledger. To correct this entry, the bookkeeper should
   a. debit Cash $350 and credit Unearned Service Revenue $350.
   b. debit Accounts Receivable $350 and credit Unearned Service Revenue $350.
   c. debit Accounts Receivable $350 and credit Cash $350.
   d. debit Accounts Receivable $350 and credit Service Revenue $350.

152. All of the following are owner's equity accounts *except*
   a. the Capital account.
   b. Capital Stock.
   c. Investment in Stock.
   d. Retained Earnings.

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153. Current liabilities
   a. are obligations that the company is to pay within the forthcoming year.
   b. are listed in the balance sheet in order of their expected maturity.
   c. are listed in the balance sheet, starting with accounts payable.
   d. should not include long-term debt that is expected to be paid within the next year.

[a]154. The use of reversing entries
   a. is a required step in the accounting cycle.
   b. changes the amounts reported in the financial statements.
   c. simplifies the recording of subsequent transactions.
   d. is required for all adjusting entries.

Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
38.	d	55.	b	72.	c	89.	a	106.	d	123.	d	140.	d
39.	c	56.	b	73.	a	90.	b	107.	c	124.	b	141.	d
40.	b	57.	b	74.	b	91.	c	108.	b	125.	c	[a]142.	b
41.	a	58.	c	75.	d	92.	b	109.	c	126.	c	[a]143.	a
42.	c	59.	d	76.	b	93.	b	110.	b	127.	b	144.	a
43.	c	60.	d	77.	c	94.	c	111.	c	128.	c	145.	b
44.	d	61.	c	78.	d	95.	a	112.	d	129.	b	146.	d
45.	b	62.	b	79.	c	96.	a	113.	c	130.	b	147.	b
46.	d	63.	c	80.	c	97.	c	114.	a	131.	c	148.	d
47.	c	64.	c	81.	c	98.	b	115.	b	132.	c	149.	b
48.	c	65.	c	82.	b	99.	b	116.	b	133.	c	150.	c
49.	a	66.	d	83.	c	100.	c	117.	d	134.	a	151.	b
50.	b	67.	b	84.	b	101.	c	118.	a	135.	c	152.	c
51.	c	68.	d	85.	a	102.	d	119.	d	136.	d	153.	a
52.	c	69.	d	86.	a	103.	c	120.	a	137.	c	[a]154.	c
53.	a	70.	b	87.	a	104.	c	121.	d	138.	d		
54.	c	71.	d	88.	d	105.	c	122.	c	139.	d		

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BRIEF EXERCISES

BE 155

Use the following income statement for the year 2008 for J. S. Caper Company to prepare entries to close the revenue and expense accounts for the company.

Service revenues		$100,000
Expenses:		
Wages Expense	$40,000	
Rent Expense	12,500	
Advertising Expense	5,700	
Total expenses		58,200
Net income (loss)		$ 41,800

Solution 155 (5 min.)

Service Revenue	100,000	
Income Summary		100,000
Income Summary	58,200	
Wages Expense		40,000
Rent Expense		12,500
Advertising Expense		5,700

BE 156

T. Price Company earned net income of $43,000 during 2008. The company had owner drawings totalling $30,000 during the period. Prepare the entries to close Income Summary and the Price, Drawing account.

Solution 156 (3 min.)

Income Summary	43,000	
Price, Capital		43,000
Price, Capital	30,000	
Price, Drawing		30,000

BE 157

At April 1, 2008, Clinton Company reported a balance of $22,000 in the Clinton, Capital account. Clinton Company earned revenues of $50,000 and incurred expenses of $32,000 during April 2008. The company had owner drawings of $10,000 during the month.

(a) Prepare the entries to close Income Summary and the Clinton, Drawing acccount at April 30, 2008.
(b) What is the balance in Clinton, Capital on the April 30, 2008 post-closing trial balance?

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Solution 157 (3 min.)

(a)	Income Summary	18,000	
	Clinton, Capital		18,000
	Clinton, Capital	10,000	
	Clinton, Drawing		10,000

(b) $22,000 + $18,000 – $10,000 = $30,000

BE 158

Identify which of the following are temporary accounts of Renfro Company.
(1) Renfro, Capital
(2) Renfro, Drawing
(3) Equipment
(4) Accumulated Depreciation
(5) Depreciation Expense

Solution 158 (3 min.)

(2) Renfro, Drawing, (5) Depreciation Expense

BE 159

Identify which of the following accounts would have balances on a post-closing trial balance.
(1) Service Revenue
(2) Income Summary
(3) Notes Payable
(4) Interest Expense
(5) Cash

Solution 159 (3 min.)

(3) Notes Payable, (5) Cash

BE 160

Prepare the necessary correcting entry for each of the following.
a. A payment on account of $500 was debited to Accounts Payable $550 and credited to Cash $550.
b. The collection of Accounts Receivable of $660 was recorded as a debit to Cash $660 and a credit to Service Revenue $660.

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Solution 160 (4 min.)

a.	Cash	50	
	Accounts Payable		50
b.	Service Revenue	660	
	Accounts Receivable		660

BE 161

Prepare the necessary correcting entry for each of the following.

a. A payment of $5,000 for salaries was recorded as a debit to Supplies Expense and a credit to Cash.
b. A purchase of supplies on account for $1,000 was recorded as a debit to Equipment and a credit to Accounts Payable.

Solution 161 (4 min.)

a.	Salaries Expense	5,000	
	Supplies Expense		5,000
b.	Supplies	1,000	
	Equipment		1,000

BE 162

The following accounts were included on Stacy's Style Consultants post-closing trial balance at December 31, 2008:

Accounts payable	$ 2,000
Accounts receivable	5,500
Cash	11,000
Stacy, Capital	40,000
Stacy, Drawing	10,000
Interest expense	3,000
Note payable, due 8/31/11	60,000
Supplies	1,000
Service revenue	39,000
Equipment	5,000

(a) What are total current assets?
(b) What are total current liabilities?

Solution 162 (4 min.)

(a) $5,500 + $11,000 + $1,000 = $17,500
(b) $2,000

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BE 163

The following items are taken from the adjusted trial balance of Salon Company for the month ending July 31, 2008:

Accounts payable	$ 2,000
Accounts receivable	3,000
Accumulated depreciation – equipment	8,000
Cash	2,200
Depreciation expense	2,000
Equipment	54,000
Salon, Capital 7/1/08	52,000
Service revenue	33,000
Supplies	1,200

Prepare the current assets section of Salon's classified balance sheet.

Solution 163 (4 min.)

Current assets:	
Cash	$2,200
Accounts receivable	3,000
Supplies	1,200
Total current assets	$6,400

BE 164

The following information is available for Juxton Company for the year ended December 31, 2008:

Accounts payable	$ 2,700
Accumulated depreciation, equipment	4,000
Juxton, Capital	7,800
Intangible assets	2,500
Notes payable (due in 5 years)	7,500
Accounts receivable	1,500
Cash	2,600
Short-term investments	1,000
Equipment	7,500
Long-term investments	6,900

Instructions

Use the above information to prepare a classified balance sheet for the year ended December 31, 2008.

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Solution 164 (10 min.)

JUXTON COMPANY
Balance Sheet
For the Year Ended December 31, 2008

Assets		
Current Assets		
Cash	$2,600	
Short-term investments	1,000	
Accounts receivable	1,500	
Total Current Assets		$5,100
Investments		
Long-term investments		6,900
Property, Plant, and Equipment		
Equipment	7,500	
Less Accumulated depreciation, equipment	4,000	3,500
Intangible assets		2,500
Total Assets		$18,000
Liabilities and Owner's Equity		
Current Liabilities		
Accounts payable	$2,700	
Long-term liabilities		
Notes payable	7,500	
Total Liabilities		$10,200
Owner's equity		
Juxton, Capital	7,800	
Total owner's equity		7,800
Total liabilities and owner's equity		$18,000

BE 165

The following lettered items represent a classification scheme for a balance sheet, and the numbered items represent accounts found on balance sheets. In the blank next to each account, write the letter indicating to which category it belongs.

A. Current assets
B. Long-term investments
C. Property, plant, and equipment
D. Intangible assets
E. Current liabilities
F. Long-term liabilities
G. Owner's equity
H. Not on the balance sheet

_____ 1. Accumulated Depreciation
_____ 2. Jones, Capital
_____ 3. Interest Expense
_____ 4. Salary Payable
_____ 5. Jones, Drawing
_____ 6. Inventory
_____ 7. Patents
_____ 8. Prepaid Rent
_____ 9. Mortgage Payable
_____ 10. Land Held for Investment

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Solution 165 (5 min.)

1. C
2. G
3. H
4. E
5. H
6. A
7. D
8. A
9. F
10. B

[a]BE 166

J. Bishop Company prepared the following adjusting entries at year end on December 31, 2008:

(a)	Interest Expense	100	
	Interest Payable		100
(d)	Interest Receivable	250	
	Interest Revenue		250
(c)	Salary Expense	4,000	
	Salary Payable		4,000

In an effort to minimize errors in recording transactions, J. Bishop Company utilizes reversing entries. Prepare reversing entries on January 1, 2009.

[a]Solution 166 (5 min.)

(a)	Reverse the entry to accrue interest expense.		
	Interest Payable	100	
	Interest Expense		100
(b)	Reverse the entry to accrue interest revenue.		
	Interest Revenue	250	
	Interest Receivable		250
(c)	Reverse the entry to accrue salaries expense.		
	Salary Payable	4,000	
	Salary Expense		4,000

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EXERCISES

Ex. 167

The worksheet for Kiner Company has been completed through the adjusted trial balance. You are ready to extend each amount to the appropriate financial statement column. Indicate for each account, the financial statement column to which the account should be extended by placing a check mark (√) in the appropriate column.

Account Title	Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.
(1) Cash				
(2) Kiner, Capital				
(3) Mortgage Payable				
(4) Interest Receivable				
(5) Supplies				
(6) Accounts Payable				
(7) Short-term Investments				
(8) Repair Expense				
(9) Unearned Service Revenue				
(10) Equipment				
(11) Depreciation Expense				
(12) Interest Revenue				
(13) Salaries Expense				
(14) Kiner, Drawing				
(15) Accum. Deprec.—Equipment				
(16) Utilities Expense				
(17) Salaries Payable				
(18) Accounts Receivable				
(19) Notes Payable				
(20) Service Revenue				

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Solution 167 (10 min.)

Account Title	Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.
(1) Cash			√	
(2) Kiner, Capital				√
(3) Mortgage Payable				√
(4) Interest Receivable			√	
(5) Supplies			√	
(6) Accounts Payable				√
(7) Short-term Investments			√	
(8) Repair Expense	√			
(9) Unearned Service Revenue				√
(10) Equipment			√	
(11) Depreciation Expense	√			
(12) Interest Revenue		√		
(13) Salaries Expense	√			
(14) Kiner, Drawing			√	
(15) Accum. Deprec.—Equipment				√
(16) Utilities Expense	√			
(17) Salaries Payable				√
(18) Accounts Receivable			√	
(19) Notes Payable				√
(20) Service Revenue		√		

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Ex. 168

Indicate the worksheet column (income statement Dr., balance sheet Cr., etc.) to which each of the following accounts would be extended.

	Account	Worksheet Column
a.	Accounts Receivable	_____
b.	Accumulated Depreciation	_____
c.	Commission Revenue	_____
d.	Interest Expense	_____
e.	Smith, Drawing	_____
f.	Unearned Revenue	_____

Solution 168 (5 min.)

a.	Balance sheet	Dr.
b.	Balance sheet	Cr.
c.	Income statement	Cr.
d.	Income statement	Dr.
e.	Balance sheet	Dr.
f.	Balance sheet	Cr.

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Ex. 169

The worksheet for Vietti Rental Company appears below. Using the adjustment data below, complete the worksheet. Add any accounts that are necessary.

Adjustment data:

(a) Prepaid rent expired during August, $2.
(b) Depreciation expense on office equipment for the month of August, $8.
(c) Supplies on hand on August 31 amounted to $6.
(d) Salaries expense incurred at August 31 but not yet paid amounted to $10.

VIETTI RENTAL COMPANY
Worksheet
For the Month Ended August 31, 2008

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
Account Titles	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	20									
Accounts Receivable	12									
Prepaid Rent	8									
Supplies	10									
Office Equipment	50									
Accum. Depreciation—Equipment		10								
Accounts Payable		20								
Vietti, Capital		25								
Vietti, Drawing	2									
Rent Revenue		77								
Depreciation Expense	6									
Rent Expense	4									
Salaries Expense	20									
Totals	132	132								
Supplies Expense										
Salaries Payable										
Totals										
Net Income										
Totals										

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Solution 169 (15 min.)

VIETTI RENTAL COMPANY
Worksheet
For the Month Ended August 31, 2008

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
Account Titles	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	20				20				20	
Accounts Receivable	12				12				12	
Prepaid Rent	8			(a) 2	6				6	
Supplies	10			(c) 4	6				6	
Office Equipment	50				50				50	
Accum. Depreciation—Equipment		10		(b) 8		18				18
Accounts Payable		20				20				20
Vietti, Capital		25				25				25
Vietti, Drawing	2				2				2	
Rent Revenue		77				77		77		
Depreciation Expense	6		(b) 8		14		14			
Rent Expense	4		(a) 2		6		6			
Salaries Expense	20		(d) 10		30		30			
Totals	132	132								
Supplies Expense			(c) 4		4		4			
Salaries Payable				(d) 10		10				10
Totals			24	24	150	150	54	77	96	73
Net Income							23			23
Totals							77	77	96	96

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Ex. 170

The account balances appearing on the trial balance (below) were taken from the general ledger of Mann's Copy Shop at September 30.

Additional information for the month of September which has not yet been recorded in the accounts is as follows:

(a) A physical count of supplies indicates $300 on hand at September 30.
(b) The amount of insurance that expired in the month of September was $200.
(c) Depreciation on equipment for September was $400.
(d) Rent owed on the copy shop for the month of September was $600 but will not be paid until October.

Instructions
Using the above information, complete the worksheet on the following page for Mann's Copy Shop for the month of September.

MANN'S COPY SHOP
Worksheet
For the Month Ended September 30, 2008

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
Account Titles	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	1,000									
Supplies	1,100									
Prepaid Insurance	2,200									
Equipment	24,000									
Accum. Depreciation—Equipment		4,500								
Accounts Payable		2,400								
Notes Payable		4,000								
Mann, Capital		15,300								
Mann, Drawing	2,400									
Copy Revenue		4,900								
Utilities Expense	400									
Totals	31,100	31,100								
Supplies Expense										
Insurance Expense										
Depreciation Expense										
Rent Expense										
Rent Payable										
Totals										
Net Income										
Totals										

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Solution 170 (15 min.)

MANN'S COPY SHOP
Worksheet
For the Month Ended September 30, 2008

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
Account Titles	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	1,000				1,000				1,000	
Supplies	1,100			(a) 800	300				300	
Prepaid Insurance	2,200			(b) 200	2,000				2,000	
Equipment	24,000				24,000				24,000	
Accum. Depreciation—Equipment		4,500		(c) 400		4,900				4,900
Accounts Payable		2,400				2,400				2,400
Notes Payable		4,000				4,000				4,000
Mann, Capital		15,300				15,300				15,300
Mann, Drawing	2,400				2,400				2,400	
Copy Revenue		4,900				4,900		4,900		
Utilities Expense	400				400		400			
Totals	31,100	31,100								
Supplies Expense			(a) 800		800		800			
Insurance Expense			(b) 200		200		200			
Depreciation Expense			(c) 400		400		400			
Rent Expense			(d) 600		600		600			
Rent Payable				(d) 600		600				600
Totals			2,000	2,000	32,100	32,100	2,400	4,900	29,700	27,200
Net Income							2,500			2,500
Totals							4,900	4,900	29,700	29,700

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Ex. 171

Prepare the necessary closing entries based on the following selected accounts.

Accumulated Depreciation	$10,000
Depreciation Expense	5,000
Kline, Capital	20,000
Kline, Drawing	12,000
Salaries Expense	18,000
Service Revenue	30,000

Solution 171 (8–10 min.)

Service Revenue	30,000	
Income Summary		30,000
Income Summary	23,000	
Depreciation Expense		5,000
Salaries Expense		18,000
Income Summary	7,000	
Kline, Capital		7,000
Kline, Capital	12,000	
Kline, Drawing		12,000

Ex. 172

All revenue and expense accounts have been closed at the end of the calendar year for Staley Company. The Income Summary account has total debits of $520,000 and total credits of $600,000. As of the same date, Ron Staley, Capital has a balance of $115,000, and Ron Staley, Drawing has a balance of $48,000.

Instructions

(a) Journalize the entries required to complete the closing of the accounts.
(b) Prepare an owner's equity statement for the year ended December 31, 2008.

Solution 172 (10 min.)

(a)	Income Summary	80,000	
	Ron Staley, Capital		80,000
	(To close net income to capital)		
	Ron Staley, Capital	48,000	
	Ron Staley, Drawing		48,000
	(To close drawings to capital)		

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Solution 172 (cont.)

(b)

STALEY COMPANY
Owner's Equity Statement
For the Year Ended December 31, 2008

Ron Staley, Capital, January 1	$115,000
Add: Net income	80,000
	195,000
Less: Drawings	48,000
Ron Staley, Capital, December 31	$147,000

Ex. 173

At March 31, account balances after adjustments for Norton Cinema are as follows:

Accounts	Account Balances (After Adjustment)
Cash	$ 6,000
Concession Supplies	4,000
Theatre Equipment	50,000
Accumulated Depreciation—Theatre Equipment	12,000
Accounts Payable	5,000
Norton, Capital	20,000
Norton, Drawing	12,000
Admission Ticket Revenues	60,000
Popcorn Revenues	32,000
Candy Revenues	19,000
Advertising Expense	12,000
Concession Supplies Expense	19,000
Depreciation Expense	4,000
Film Rental Expense	16,000
Rent Expense	12,000
Salaries Expense	18,000
Utilities Expense	5,000

Instructions
Prepare the closing journal entries for Norton Cinema.

Solution 173 (10 min.)

Mar.	31	Admission Ticket Revenues	60,000	
		Popcorn Revenues	32,000	
		Candy Revenues	19,000	
		Income Summary		111,000
		(To close revenue accounts)		

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Solution 173 (cont.)

31	Income Summary	86,000	
	Advertising Expense		12,000
	Concession Supplies Expense		19,000
	Depreciation Expense		4,000
	Film Rental Expense		16,000
	Rent Expense		12,000
	Salaries Expense		18,000
	Utilities Expense		5,000
	(To close expense accounts)		
31	Income Summary	25,000	
	Norton, Capital		25,000
	(To transfer net income to capital)		
31	Norton, Capital	12,000	
	Norton, Drawing		12,000
	(To close drawings to capital)		

Ex. 174

Presented below is an adjusted trial balance for Trent Company, at December 31, 2008.

Cash	$12,700	Accounts payable	$10,000
Accounts receivable	20,000	Notes payable	9,000
Prepaid insurance	15,000	Accumulated Depreciation—Equipment	14,000
Equipment	35,000	Service revenue	25,000
Depreciation expense	7,000	M. Trent, Capital	24,000
M. Trent, Drawing	1,500	Unearned revenue	16,000
Advertising expense	1,400		
Rent expense	800		
Salary expense	3,000		
Insurance expense	1,600		
	$98,000		$98,000

Instructions

(a) Prepare closing entries for December 31, 2008.
(b) Determine the balance in M. Trent's capital account after the entries have been posted.

Solution 174 (10 min.)

(a) Computation of Net Income:

Service revenue		$25,000
Depreciation expense	$7,000	
Salary expense	3,000	
Insurance expense	1,600	
Advertising expense	1,400	
Rent expense	800	13,800
Net Income		$11,200

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Solution 174 (cont.)

Dec.	31	Service Revenue	25,000	
		Income Summary		25,000
		(To close revenue account)		
	31	Income Summary	13,800	
		Depreciation Expense		7,000
		Advertising Expense		1,400
		Rent Expense		800
		Salary Expense		3,000
		Insurance Expense		1,600
		(To close expense accounts)		
	31	Income Summary	11,200	
		M. Trent, Capital		11,200
		(To close net income to capital)		
	31	M. Trent, Capital	1,500	
		M. Trent, Drawing		1,500
		(To close drawings to capital)		

(b)

M. Trent, Capital

1,500		24,000
		11,200
	Bal.	33,700

Ex. 175

The adjusted account balances of the Fitness Center at July 31 are as follows:

Accounts	Account Balances	Accounts	Account Balances
Cash	$11,000	Service Revenue	$100,000
Accounts Receivable	15,000	Interest Revenue	8,000
Supplies	4,000	Depreciation Expense	27,000
Prepaid Insurance	8,000	Insurance Expense	6,000
Buildings	300,000	Salary Expense	35,000
Accumulated Depreciation—Buildings	120,000	Supplies Expense	9,000
Accounts Payable	19,000	Utilities Expense	12,000
Utley, Capital	195,000		
Utley, Drawing	15,000		

Instructions

Prepare the end of the period closing entries for the Fitness Center.

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Solution 175 (10 min.)

July	31	Service Revenue	100,000	
		Interest Revenue	8,000	
		Income Summary		108,000
		(To close revenue accounts)		
	31	Income Summary	89,000	
		Depreciation Expense		27,000
		Insurance Expense		6,000
		Salary Expense		35,000
		Supplies Expense		9,000
		Utilities Expense		12,000
		(To close expense accounts)		
	31	Income Summary	19,000	
		Utley, Capital		19,000
		(To close net income to capital)		
	31	Utley, Capital	15,000	
		Utley, Drawing		15,000
		(To close drawings to capital)		

Ex. 176

The income statement of Gentry's Shoe Repair is as follows:

GENTRY'S SHOE REPAIR
Income Statement
For the Month Ended April 30, 2008

Revenue		
Shoe Repair Revenue		$7,500
Expenses		
Salaries Expense	$3,400	
Depreciation Expense	350	
Utilities Expense	400	
Rent Expense	600	
Supplies Expense	1,050	
Total Expenses		5,800
Net Income		$1,700

On April 1, the owner, Lee Gentry, had a capital balance of $12,900. During April, Gentry withdrew $3,000 cash for personal use.

Instructions

(a) Prepare closing entries at April 30.
(b) Prepare an owner's equity statement for the month of April.

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Solution 176 (10 min.)

(a)	Shoe Repair Revenue	7,500	
	Income Summary		7,500
	Income Summary	5,800	
	Salaries Expense		3,400
	Depreciation Expense		350
	Utilities Expense		400
	Rent Expense		600
	Supplies Expense		1,050
	Income Summary	1,700	
	Gentry, Capital		1,700
	Gentry, Capital	3,000	
	Gentry, Drawing		3,000

(b)

GENTRY'S SHOE REPAIR
Owner's Equity Statement
For the Month Ended April 30, 2008

L. Gentry, Capital, April 1	$12,900
Add: Net Income	1,700
	14,600
Less: Drawings	3,000
L. Gentry, Capital, April 30	$11,600

Ex. 177

Identify which of the following accounts would appear in a post- closing trial balance.

Accumulated Depreciation	Jackson, Drawing
Depreciation Expense	Service Revenue
Interest Payable	Store Equipment

Solution 177 (3 min.)

The following accounts would appear in a post-closing trial balance:

Accumulated Depreciation
Interest Payable
Store Equipment

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Ex. 178

The trial balances of Foley Company follow with the accounts arranged in alphabetic order. Analyze the data and prepare (a) the adjusting entries and (b) the closing entries made by Foley Company.

	Trial Balances		
	Unadjusted	Adjusted	Post-Closing
Accounts Payable	$10,000	$10,000	$10,000
Accounts Receivable	2,200	3,200	3,200
Accumulated Depreciation	13,000	17,000	17,000
Advertising Expense	0	16,300	0
Cash	60,000	60,000	60,000
Depreciation Expense	0	4,000	0
Equipment	75,000	75,000	75,000
Foley, Capital	82,200	82,200	102,400
Foley, Drawing	11,000	11,000	0
Prepaid Advertising	17,800	1,500	1,500
Prepaid Rent	15,000	11,000	11,000
Rent Expense	0	4,000	0
Service Revenue	96,000	105,000	0
Supplies	3,200	700	700
Supplies Expense	2,000	4,500	0
Unearned Revenue	23,000	15,000	15,000
Wages Expense	38,000	45,000	0
Wages Payable	0	7,000	7,000

Solution 178 (20 min.)

(a) Adjusting Entries

Depreciation Expense	4,000	
Accumulated Depreciation		4,000
Advertising Expense	16,300	
Prepaid Advertising		16,300
Unearned Revenue	8,000	
Service Revenue		8,000
Accounts Receivable	1,000	
Service Revenue		1,000
Rent Expense	4,000	
Prepaid Rent		4,000
Supplies Expense	2,500	
Supplies		2,500
Wages Expense	7,000	
Wages Payable		7,000

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Solution 178 (cont.)

(b) Closing Entries

Service Revenue	105,000	
Income Summary		105,000
Income Summary	73,800	
Advertising Expense		16,300
Depreciation Expense		4,000
Rent Expense		4,000
Supplies Expense		4,500
Wages Expense		45,000
Income Summary	31,200	
Foley, Capital		31,200
Foley, Capital	11,000	
Foley, Drawing		11,000

Ex. 179

Indicate the proper sequence of the steps in the accounting cycle by placing numbers 1-8 in the blank spaces.

____ a. Analyze business transactions.

____ b. Journalize and post adjusting entries.

____ c. Journalize and post closing entries.

____ d. Journalize the transactions.

____ e. Prepare a post-closing trial balance.

____ f. Prepare a worksheet.

____ g. Prepare financial statements.

____ h. Post to ledger accounts.

Solution 179 (4 min.)

a. 1
b. 6
c. 7
d. 2
e. 8
f. 4
g. 5
h. 3

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Ex. 180

Prepare the necessary correcting entry for each of the following.

a. A collection on account of $370 from a customer was credited to Accounts Receivable $730 and debited to Cash $730.

b. The purchase of supplies on account for $250 was recorded as a debit to Equipment $250 and a credit to Accounts Payable $250.

Solution 180 (5 min.)

a.	Accounts Receivable	360	
	Cash		360
b.	Supplies	250	
	Equipment		250

Ex. 181

An examination of the accounts of Shaw Company for the month of June revealed the following errors after the transactions were journalized and posted.

1. A check for $750 from R. Linton, a customer on account, was debited to Cash $750 and credited to Service Revenue, $750.
2. A payment for Advertising Expense costing $420 was debited to Utilities Expense, $240 and credited to Cash $240.
3. A bill for $840 for Office Supplies purchased on account was debited to Office Equipment, $480 and credited to Accounts Payable $480.

Instructions

Prepare correcting entries for each of the above assuming the erroneous entries are not reversed. Explain how the transaction as originally recorded affected net income for the month of June.

Solution 181 (10 min.)

1.	Service Revenue	750	
	Accounts Receivable		750
	(To correct error in recording collection of accounts receivable)		

The transaction as originally recorded overstated net income by $750.

2.	Advertising Expense	420	
	Utilities Expense		240
	Cash		180
	(To correct errors in recording advertising expense)		

The transaction as originally recorded overstated net income by $180.

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Solution 181 (cont.)

3.	Office Supplies	840	
	Office Equipment		480
	Accounts Payable		360
	(To correct error in recording office supplies)		

The transaction as originally recorded had no effect on net income.

Ex. 182

As Jeff Wills was doing his year-end accounting, he noticed that the bookkeeper had made errors in recording several transactions. The erroneous transactions are as follows:

(a) A check for $700 was issued for goods previously purchased on account. The bookkeeper debited Accounts Receivable and credited Cash for $700.

(b) A check for $380 was received as payment on account. The bookkeeper debited Accounts Payable for $830 and credited Accounts Receivable for $830.

(c) When making the entry to record the year's depreciation expense, the bookkeeper debited Accumulated Depreciation for $1,000 and credited Cash for $1,000.

(d) When accruing interest on a note payable, the bookkeeper debited Interest Receivable for $200 and credited Interest Payable for $200.

Instructions
Prepare the appropriate correcting entries. (Do not reverse the original entries.)

Solution 182 (5 min.)

(a)	Accounts Payable	700	
	Accounts Receivable		700
(b)	Cash	380	
	Accounts Receivable	450	
	Accounts Payable		830
(c)	Cash	1,000	
	Depreciation Expense	1,000	
	Accumulated Depreciation		2,000
(d)	Interest Expense	200	
	Interest Receivable		200

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Ex. 183

Jon Scott, CPA, was asked by Jeff Pine to review the accounting records and prepare the financial statements for his upholstering shop. Jon reviewed the records and found three errors.

1. Cash paid on accounts payable for $930 was recorded as a debit to Accounts Payable $390 and a credit to Cash $390.
2. The purchase of supplies on account for $500 was debited to Equipment $500 and credited to Accounts Payable $500.
3. Jeff withdrew $1,200 of cash and the bookkeeper debited Accounts Receivable for $120 and credited Cash $120.

Instructions

Prepare an analysis of each error showing the

(a) incorrect entry.
(b) correct entry.
(c) correcting entry.

Solution 183 (15 min.)

1.	(a)	Incorrect Entry			
		Accounts Payable		390	
		Cash			390
	(b)	Correct Entry			
		Accounts Payable		930	
		Cash			930
	(c)	Correcting Entry			
		Accounts Payable		540	
		Cash			540
2.	(a)	Incorrect Entry			
		Equipment		500	
		Accounts Payable			500
	(b)	Correct Entry			
		Supplies		500	
		Accounts Payable			500
	(c)	Correcting Entry			
		Supplies		500	
		Equipment			500
3.	(a)	Incorrect Entry			
		Accounts Receivable		120	
		Cash			120
	(b)	Correct Entry			
		J. Pine, Drawing		1,200	
		Cash			1,200
	(c)	Correcting Entry			
		J. Pine, Drawing		1,200	
		Accounts Receivable			120
		Cash			1,080

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Ex. 184

Compute the dollar amount of current assets based on the following account balances.

Accounts Receivable	$16,000
Accumulated Depreciation	27,000
Cash	24,000
Equipment	93,000
Prepaid Rent	7,000
Short-term Investments	15,000

Solution 184 (4 min.)

Current assets amount = $62,000 ($16,000 + $24,000 + $7,000 + $15,000)

Ex. 185

The financial statement columns of the worksheet for Audio Concepts at December 31, 2008, are as follows:

AUDIO CONCEPTS
Worksheet
For the Year Ended December 31, 2008

	Income Statement		Balance Sheet	
Accounts	Debit	Credit	Debit	Credit
Cash			15,000	
Accounts Receivable			7,000	
Supplies			4,000	
Prepaid Insurance			6,000	
Audio Equipment			209,000	
Accumulated Depreciation—Audio Equipment				29,000
Accounts Payable				19,000
Note Payable				70,000
Salaries Payable				3,000
J. Green, Capital				112,000
J. Green, Drawing			14,000	
Audio Revenue		123,000		
Advertising Expense	21,000			
Depreciation Expense	12,000			
Insurance Expense	3,000			
Rent Expense	17,000			
Salaries Expense	42,000			
Supplies Expense	6,000			
Totals	101,000	123,000	255,000	233,000
Net Income	22,000			22,000
	123,000	123,000	255,000	255,000

Instructions

(a) Calculate the balance of J. Green, Capital that would appear on a balance sheet at December 31, 2008.

(b) Prepare a classified balance sheet for Audio Concepts at December 31, 2008 assuming the note payable is a long-term liability.

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Solution 185 (15 min.)

(a)

J. Green, Capital, January 1	$112,000
Add: Net Income	22,000
	134,000
Less: Drawings	14,000
J. Green, Capital, December 31	$120,000

(b)

AUDIO CONCEPTS
Balance Sheet
December 31, 2008

Assets		
Current assets		
Cash		$ 15,000
Accounts receivable		7,000
Supplies		4,000
Prepaid insurance		6,000
Total current assets		32,000
Property, plant, and equipment		
Audio equipment	$209,000	
Less: Accumulated depreciation—audio equipment	29,000	180,000
Total assets		$212,000
Liabilities and Owner's Equity		
Current liabilities		
Accounts payable		$ 19,000
Salaries payable		3,000
Total current liabilities		22,000
Long-term liabilities		
Note payable		70,000
Total liabilities		92,000
Owner's equity		
J. Green, Capital		120,000
Total liabilities and owner's equity		$212,000

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Ex. 186

The financial statement columns of the worksheet for Melton Company as of December 31, 2008 are as follows:

MELTON COMPANY
Worksheet
For the Year Ended December 31, 2008

	Income Statement		Balance Sheet	
Accounts	Debit	Credit	Debit	Credit
Cash			20,000	
Accounts Receivable			6,000	
Supplies			4,500	
Prepaid Insurance			7,000	
Equipment			50,000	
Accumulated Depreciation				4,800
Patents			7,500	
Accounts Payable				23,500
Bonds Payable (due 2012)				18,000
Melton, Capital				46,000
Melton, Drawing			4,200	
Service Revenue		25,400		
Salaries Expense	5,200			
Depreciation Expense	4,800			
Insurance Expense	5,000			
Interest Expense	3,500			
Totals	18,500	25,400	99,200	92,300
Net Income	6,900			6,900
	25,400	25,400	99,200	99,200

Instructions
Prepare a classified balance sheet for Melton Company.

Solution 186 (15 min.)

MELTON COMPANY
Balance Sheet
December 31, 2008

	Assets	
Current assets		
Cash		$20,000
Accounts receivable		6,000
Supplies		4,500
Prepaid insurance		7,000
Total current assets		37,500
Property, Plant, and Equipment		
Equipment	$50,000	
Less: Accumulated depreciation—equipment	4,800	45,200
Intangible assets		
Patents		7,500
Total assets		$90,200

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Solution 186 (cont.)

Liabilities and Owner's Equity	
Current liabilities	
Accounts payable	$23,500
Long-term liabilities	
Bonds payable	18,000
Total liabilities	41,500
Owner's Equity	
Melton, Capital	48,700*
Total liabilities and owner's equity	$90,200

* Melton, Capital = $48,700 ($46,000 + $6,900 – $4,200).

[a]Ex. 187

Reisner Company prepared the following adjusting entries at year end on December 31, 2007:

(a)	Interest Expense	200	
	Interest Payable		200
(b)	Unearned Revenue	1,500	
	Service Revenue		1,500
(c)	Insurance Expense	1,200	
	Prepaid Insurance		1,200
(d)	Interest Receivable	100	
	Interest Revenue		100
(e)	Supplies Expense	250	
	Supplies		250
(f)	Wages Expense	3,000	
	Wages Payable		3,000

In an effort to minimize errors in recording transactions, Reisner Company utilizes reversing entries.

Instructions

Prepare reversing entries on January 1, 2008, for the adjusting entries given where appropriate.

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[a]Solution 187 (15 min.)

Reversing entries are appropriate for adjusting entries related to accrued revenues and accrued expenses. Three of the entries given are accruals and need to be reversed.

(a)	Reverse the entry to accrue interest expense.		
	Interest Payable	200	
	Interest Expense		200
(d)	Reverse the entry to accrue interest revenue.		
	Interest Revenue	100	
	Interest Receivable		100
(f)	Reverse the entry to accrue wages expense.		
	Wages Payable	3,000	
	Wages Expense		3,000

[a]Ex. 188

On December 31, 2008 the adjusted trial balance of the Dixon Personnel Agency shows the following selected data:

Commission Receivable, $7,000
Commission Revenue, $70,000
Interest Expense, $10,500
Interest Payable, $2,500
Utilities Expense, $4,800
Accounts Payable, $2,400

Analysis indicates that adjusting entries were made for (a) $7,000 of employment commission revenue earned but not billed, (b) $2,500 of accrued but unpaid interest, and (c) $2,400 of utilities expense accrued but not paid.

Instructions

(a) Prepare the closing entries at December 31, 2008.
(b) Prepare the reversing entries on January 1, 2009.
(c) Enter the adjusted trial balance data in T-accounts. Post the entries in (a) and (b) and rule and balance the accounts.
(d) Prepare the entries to record (1) the collection of the accrued commission on January 8, (2) payment of the utility bill on January 10, and (3) payment of all the interest due ($3,000) on January 15.
(e) Post the entries in (d) to the temporary accounts.
(f) What is the interest expense for the month of January 2009?

[a]Solution 188 (25 min.)

(a)	(1)	Commission Revenue	70,000	
		Income Summary		70,000
	(2)	Income Summary	15,300	
		Interest Expense		10,500
		Utilities Expense		4,800

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[a]Solution 188 (cont.)

	(3)	Income Summary		54,700	
		Dixon, Capital			54,700
(b)	(1)	Commission Revenue		7,000	
		Commission Receivable			7,000
	(2)	Interest Payable		2,500	
		Interest Expense			2,500
	(3)	Accounts Payable		2,400	
		Utilities Expense			2,400

(c) and (e)

Commission Receivable

(A)	7,000	(R)	7,000

Commission Revenue

(C)	70,000	(A)	70,000
(R)	7,000	(D)	7,000

Interest Expense

(A)	10,500	(C)	10,500
(D)	3,000	(R)	2,500

Interest Payable

(R)	2,500	(A)	2,500

Utilities Expense

(A)	4,800	(C)	4,800
(D)	2,400	(R)	2,400

Accounts Payable

(R)	2,400	(A)	2,400

Legend
A = Adjusted trial balance amount
C = Closing
R = Reversing
D = January Transaction entries

(d)	(1)	Jan. 8	Cash	7,000	
			Commission Revenue		7,000
	(2)	Jan. 10	Utilities Expense	2,400	
			Cash		2,400
	(3)	Jan. 15	Interest Expense	3,000	
			Cash		3,000

(f) Interest expense for January is $500 ($3,000 – $2,500).

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[a]Ex. 189

Transaction and adjustment data for Gore Company for the calendar year end is as follows:

1. December 24 (initial salary entry): $12,000 of salaries earned between December 1 and December 24 are paid.

2. December 31 (adjusting entry): Salaries earned between December 25 and December 31 are $2,000. These will be paid in the January 8 payroll.

3. January 8 (subsequent salary entry): Total salary payroll amounting to $7,000 was paid.

Instructions
Prepare two sets of journal entries as specified below. The first set of journal entries should assume that the company does not use reversing entries, and the second set should assume that reversing entries are utilized by the company.

Assume no reversing entries **Assume reversing entries**

(a) Initial Salary Entry

Dec. 24

(b) Adjusting Entry

Dec. 31

(c) Closing Entry

Dec. 31

(d) Reversing Entry

Jan. 1

(e) Subsequent Salary Entry

Jan. 8

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[a]Solution 189 (20 min.)

	Assume no reversing entries			**Assume reversing entries**		
(a)	Initial Salary Entry					
Dec. 24						
	Salaries Expense	12,000		Salaries Expense	12,000	
	Cash		12,000	Cash		12,000
(b)	Adjusting Entry					
Dec. 31						
	Salaries Expense	2,000		Salaries Expense	2,000	
	Salaries Payable		2,000	Salaries Payable		2,000
(c)	Closing Entry					
Dec. 31						
	Income Summary	14,000		Income Summary	14,000	
	Salaries Expense		14,000	Salaries Expense		14,000
(d)	Reversing Entry					
Jan. 1						
	None			Salaries Payable	2,000	
				Salaries Expense		2,000
(e)	Subsequent Salary Entry					
Jan. 8						
	Salaries Payable	2,000		Salaries Expense	7,000	
	Salaries Expense	5,000		Cash		7,000
	Cash		7,000			

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COMPLETION STATEMENTS

190. The first step in preparing a worksheet is to prepare a _____ from the general ledger accounts.

191. The account balances appearing in the adjusted trial balance columns are extended to the _____ columns and the _____ columns.

192. The process of transferring net income (or loss) for the period to Owner's Capital is accomplished by making _____ entries.

193. At the end of an accounting period, all revenue and expense accounts are closed to a temporary account called _____.

194. The Owner's Drawing account is closed to the _____ account at the end of the accounting period.

195. After all closing entries have been journalized and posted, the final step in the accounting cycle is to prepare a _____ trial balance.

196. The preparation of a _____ and _____ entries are two optional steps in the accounting cycle.

197. Two permanent accounts that are part of the stockholder's equity in a corporation are _____ and _____.

198. The four major classifications of assets in a classified balance sheet are: _____, _____, _____ and _____.

199. The _____ of a company is the average time that it takes to purchase inventory, selll it on account, and then collect cash from customers.

200. Assets that do not have a physical substance yet often are very valuable are called _____ assets.

201. Liabilities are generally classified as either _____ or _____ on a classified balance sheet.

Answers to Completion Statements

190. trial balance
191. income statement, balance sheet
192. closing
193. Income Summary
194. Owner's Capital
195. post-closing
196. worksheet, reversing
197. Capital Stock, Retained Earnings
198. Current Assets; Long-Term Investments; Property, Plant, and Equipment; Intangible Assets
199. operating cycle
200. intangible
201. current, long-term

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MATCHING

202. Match the items below by entering the appropriate code letter in the space provided.

A. Worksheet	F. Capital Stock
B. Permanent accounts	G. Current assets
C. Closing entries	H. Operating cycle
D. Income Summary	I. Long-term liabilities
E. Reversing entry	J. Correcting entries

____ 1. Obligations that a company expects to pay after one year.

____ 2. A part of owners' equity in a corporation.

____ 3. An optional tool which facilitates the preparation of financial statements.

____ 4. A temporary account used in the closing process.

____ 5. Balance sheet accounts whose balances are carried forward to the next period.

____ 6. The average time that it takes to go from cash to cash in producing revenues.

____ 7. Entries to correct errors made in recording transactions.

____ 8. The exact opposite of an adjusting entry made in a previous period.

____ 9. Entries at the end of an accounting period to transfer the balances of temporary accounts to a permanent owner's equity account.

____ 10. Assets that a company expects to pay or convert to cash or use up within one year.

Answers to Matching

1.	I	6.	H
2.	F	7.	J
3.	A	8.	E
4.	D	9.	C
5.	B	10.	G

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SHORT-ANSWER ESSAY QUESTIONS

S-A E 203

A worksheet is an optional working tool used by accountants to facilitate the preparation of financial statements. Consider the steps followed in preparing a worksheet. How does the use of a worksheet assist the accountant. Could financial statements be prepared without a worksheet? Evaluate how the process would differ. Consider factors such as timeliness, accuracy, and efficiency in your evaluation.

Solution 203

The worksheet organizes the accountant's work in preparing the income statement and the balance sheet. The worksheet contains the general ledger trial balance, the adjusting entries, and an adjusted trial balance (if 10-column). The columns for these trial balances and entries allow the accountant to prove the equality of the debits and credits at each step of the process. From the adjusted trial balance the balance sheet and income statement amounts are obtained and entered in the appropriate columns.

Preparing financial statements without the use of a worksheet would be less organized and probably more prone to errors. And, if errors are made, they will probably be less easy to detect and locate, and, therefore, less efficient and more time consuming.

S-A E 204

Journalizing and posting closing entries is a required step in the accounting cycle. Discuss why it is necessary to close the books at the end of an accounting period. If closing entries were not made, how would the preparation of financial statements be affected?

Solution 204

Closing entries are prepared to close the income statement accounts (the temporary accounts) of the current year in order to start the next year. Income statement (temporary) accounts are cumulative in nature but only for a year. The closing entries are what separate the accounting periods. The next year's accumulation of income statement data can begin once the accounts are cleared and the balances transferred through the closing entries to owner's equity.

S-A E 205

Give the definition of current assets and current liabilities and provide two examples of each.

Solution 205

Current assets are assets that a company expects to convert to cash or use up within one year. Examples of current assets include short-term investments, accounts receivable, and inventory. Current liabilities are obligations that the company is to pay within the current year. Examples of current liabilities are accounts payable, wages payable, and taxes payable.

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S-A E 206 (Ethics)

Under Protection provides underground storage facilities for companies desiring off-site storage of sensitive documents, computer records, and other items. They have developed a sophisticated surveillance and security system which they initially used in their own facilities, and have recently started to market elsewhere as well.

The underground storage facilities are made from natural caves in some instances (reinforced and modified as appropriate) and from excavations of natural rock formations in others. The land was purchased over ten years ago for a total of $2.5 million. The modifications have cost approximately $15 million more. The company has never depreciated its storage facilities because the market value of the property has continued to rise. Presently, the market price is between $30 and $40 million.

Tom Carr, a new accounting manager, questioned this depreciation policy. Ken Hines, the controller, has told him that he needn't worry about it. For one thing, he says, this is really a special form of Land account, which should not be depreciated at all. For another, this is a privately held company, and so they don't need to worry about misleading investors. All the owners know about and approve the depreciation policy.

Required:
What are the ethical issues in this situation?

Solution 206

The ethical issue is one of integrity. Even though the storage facilities are underground, that does not mean that they can be accounted for simply as land. The structural improvements and surveillance mechanisms will not last forever, and therefore their cost should be allocated over the periods that are benefited. Net income is being overstated because the depreciation expense, at zero, is being understated.

A second issue is the harm that may be incurred by outside parties because of the misrepresentation in the financial statements. Even though the owners know about the (lack of) depreciation, they may still use their financial statements to obtain loans. Private investors and bankers should be able to rely on the financial statements.

A third issue is that of the integrity of the accountants themselves. If they are being asked to ignore a basic principle of accounting so openly now, they should certainly ask themselves what lies ahead.

S-A E 207 (Communication)

You have recently started to work for Trent Holmes, manufacturers of cemetery markers and monuments. During your first month at work, you inadvertently recorded as revenue, about $3,000 of prepayments from Wynn Company. The financial statements had been released within the company when you discovered your error. The month-end closing had not been completed, however, and you were able to correct the accounts without incident.

Required:
Prepare a short note to accompany the re-released financial statements explaining the mistake.

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Solution 207

M E M O

TO: Department Managers

FROM: Lisa Cross, Accounting

RE: Month-End Reports

****ATTACHED FINANCIAL STATEMENTS REPLACE THOSE ISSUED JULY 5****

*****DESTROY ALL EARLIER COPIES OF JUNE 30 FINANCIAL STATEMENTS****

An error was made in the recording of Wynn Company's prepayment. The entire $3,000 was recorded as revenue. Since Wynn's order has not been completed or shipped, it should have been recorded as unearned revenue, which is a liability. Note that net income is reduced to only $15,000 as a result of this change.

If you have sent any of your summary reports to corporate headquarters, please contact the Accounting Department immediately for correction codes.

I am sincerely sorry for any inconvenience or delays caused by this error.

(signature)

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CHAPTER 5

ACCOUNTING FOR MERCHANDISING OPERATIONS

SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
True-False Statements														
1.	1	C	10.	3	C	19.	5	K	28.	6	K	[sg]37.	2	K
2.	1	C	11.	3	C	20.	5	K	29.	6	K	[sg]38.	3	K
3.	1	K	12.	3	K	21.	5	C	30.	7	K	[sg]39.	3	K
4.	2	K	13.	4	C	22.	5	C	31.	7	K	[sg]40.	4	C
5.	2	K	14.	4	K	23.	5	C	[a]32.	8	K	[sg]41.	5	K
6.	2	K	15.	4	K	24.	5	K	[a]33.	8	K	[sg]42.	6	K
7.	2	K	16.	5	K	25.	5	K	[a]34.	9	K			
8.	3	C	17.	5	K	26.	6	AP	[sg]35.	1	K			
9.	3	C	18.	5	K	27.	6	K	[sg]36.	1	K			
Multiple Choice Questions														
43.	1	K	68.	2	K	93.	3	C	118.	6	AP	[a]143.	7	K
44.	1	K	69.	2	AP	94.	3	AP	119.	6	K	[a]144.	7	K
45.	1	C	70.	2	AP	95.	3	AP	120.	6	C	[a]145.	7	AP
46.	1	K	71.	3	AP	96.	3	AP	121.	6	K	[a]146.	7	AP
47.	1	K	72.	3	C	97.	3	K	122.	6	K	[a]147.	8	K
48.	1	C	73.	3	C	98.	3	K	123.	6	AP	[a]148.	8	C
49.	1	K	74.	3	AP	99.	3	C	124.	6	AP	[a]149.	8	C
50.	1	K	75.	3	AP	100.	3	C	125.	6	AP	[a]150.	8	K
51.	1	C	76.	3	C	101.	3	K	126.	6	AP	[a]151.	8	K
52.	1	K	77.	3	C	102.	3	K	127.	6	AP	[a]152.	8	C
53.	2	C	78.	3	C	103.	4	C	128.	6	AP	[a]153.	9	K
54.	2	C	79.	3	K	104.	4	C	129.	6	AP	[a]154.	9	K
55.	2	C	80.	3	K	105.	4	K	130.	5	AP	[sg]155.	1	AP
56.	2	K	81.	3	C	106.	4	C	131.	6	AP	[sg]156.	2	K
57.	2	C	82.	3	C	107.	5	K	132.	6	AP	[sg]157.	2	K
58.	2	K	83.	3	K	108.	5	C	133.	6	AP	[st]158.	2	K
59.	2	K	84.	3	K	109.	5	C	134.	6	AP	[sg]159.	3	K
60.	2	C	85.	3	C	110.	5	C	135.	6	AP	[st]160.	4	K
61.	2	K	86.	3	K	111.	5	AP	136.	6	AP	[sg]161.	4	AP
62.	2	C	87.	3	AP	112.	5	K	137.	6	AP	[st]162.	5	K
63.	2	C	88.	3	C	113.	5	C	138.	6	AP	[sg]163.	6	K
64.	2	C	89.	3	C	114.	5	K	139.	7	AP	[st]164.	7	K
65.	2	AP	90.	3	C	115.	5	K	140.	7	AP			
66.	2	AP	91.	3	C	116.	6	K	141.	7	C			
67.	2	C	92.	3	C	117.	6	AP	[a]142.	7	K			

[sg] This question also appears in the Study Guide.
[st] This question also appears in a self-test at the student companion website.
[a] This question covers a topic in an appendix to the chapter.

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SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Brief Exercises														
165.	1	AP	168.	3	AP	171.	5	AP	174.	7	AP			
166.	2	AP	169.	3	AP	172.	6	AP	175.	7	AP			
167.	2,3	AP	170.	4	AP	173.	7	AP	[a]176.	8	AP			
Exercises														
177.	1	C	181.	2,3	AP	185.	4	AP	189.	5,6	AP	193.	7	AP
178.	2,3	AP	182.	2	AP	186.	4	AP	190.	5,6	AP	[a]194.	8	AP
179.	2,3	AP	183.	3	AP	187.	5,6	AP	191.	7	AP	[a]195.	8	AP
180.	2	E	184.	3	AP	188.	5,6	C	192.	7	AP	[a]196.	9	AP
Completion Statements														
197.	1	K	199.	1	K	201.	2	K	203.	2	K	205.	6	K
198.	1	K	200.	2	K	202.	2	K	204.	3	K	206.	6	K

SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Study Objective 1													
1.	TF	35.	TF	44.	MC	47.	MC	50.	MC	155.	MC	197.	C
2.	TF	36.	TF	45.	MC	48.	MC	51.	MC	165.	BE	198.	C
3.	TF	43.	MC	46.	MC	49.	MC	52.	MC	177.	Ex	199.	C
Study Objective 2													
4.	TF	54.	MC	60.	MC	66.	MC	157.	MC	180.	Ex	203.	C
5.	TF	55.	MC	61.	MC	67.	MC	158.	MC	181.	Ex		
6.	TF	56.	MC	62.	MC	68.	MC	166.	BE	182.	Ex		
7.	TF	57.	MC	63.	MC	69.	MC	167.	BE	200.	C		
37.	TF	58.	MC	64.	MC	70.	MC	178.	Ex	201.	C		
53.	MC	59.	MC	65.	MC	156.	MC	179.	Ex	202.	C		
Study Objective 3													
8.	TF	71.	MC	78.	MC	85.	MC	92.	MC	99.	MC	169.	BE
9.	TF	72.	MC	79.	MC	86.	MC	93.	MC	100.	MC	178.	Ex
10.	TF	73.	MC	80.	MC	87.	MC	94.	MC	101.	MC	179.	Ex
11.	TF	74.	MC	81.	MC	88.	MC	95.	MC	102.	MC	181.	Ex
12.	TF	75.	MC	82.	MC	89.	MC	96.	MC	159.	MC	183.	Ex
38.	TF	76.	MC	83.	MC	90.	MC	97.	MC	167.	BE	184.	Ex
39.	TF	77.	MC	84.	MC	91.	MC	98.	MC	168.	BE	204.	C
Study Objective 4													
13.	TF	15.	TF	102.	MC	104.	MC	106.	MC	161.	MC	185.	Ex
14.	TF	40.	TF	103.	MC	105.	MC	160.	MC	170.	BE	186.	Ex

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SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Study Objective 5															
16.	TF	20.	TF	24.	TF	108.	MC	112.	MC	130.	MC	188.	Ex		
17.	TF	21.	TF	25.	TF	109.	MC	113.	MC	162.	MC	189.	Ex		
18.	TF	22.	TF	41.	TF	110.	MC	114.	MC	171.	BE	190.	Ex		
19.	TF	23.	TF	107.	MC	111.	MC	115.	MC	187.	Ex				
Study Objective 6															
26.	TF	116.	MC	121.	MC	126.	MC	132.	MC	137.	MC	188.	Ex		
27.	TF	117.	MC	122.	MC	127.	MC	133.	MC	138.	MC	189.	Ex		
28.	TF	118.	MC	123.	MC	128.	MC	134.	MC	163.	MC	190.	Ex		
29.	TF	119.	MC	124.	MC	129.	MC	135.	MC	172.	BE	205.	C		
42.	TF	120.	MC	125.	MC	131.	MC	136.	MC	187.	Ex	206.	C		
Study Objective 7															
30.	TF	140.	MC	143.	MC	146.	MC	174.	BE	192.	Ex				
31.	TF	141.	MC	144.	MC	164.	MC	175.	BE	193.	Ex				
139.	MC	142.	MC	145.	MC	173.	BE	191.	Ex						
Study Objective [a]8															
[a]32.	TF	[a]147.	MC	[a]149.	MC	[a]151.	MC	[a]176.	BE	[a]195.	Ex				
[a]33.	TF	[a]148.	MC	[a]150.	MC	[a]152.	MC	[a]194.	Ex						
Study Objective [a]9															
[a]34.	TF	[a]153.	MC	[a]154.	MC	[a]196.	Ex								

Note: TF = True-False
MC = Multiple Choice
BE = Brief Exercise
Ex = Exercise
C = Completion

The chapter also contains one set of ten Matching questions and six Short-Answer Essay questions.

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CHAPTER STUDY OBJECTIVES

1. ***Identify the differences between service and merchandising companies.*** Because of inventory, a merchandising company has sales revenue, cost of goods sold, and gross profit. To account for inventory, a merchandising company must choose between a perpetual and a periodic inventory system.

2. ***Explain the recording of purchases under a perpetual inventory system.*** The company debits the Merchandise Inventory account for all purchases of merchandise, freight-in, and other costs, and credits it for purchase discounts and purchase returns and allowances.

3. ***Explain the recording of sales revenues under a perpetual inventory system.*** When a merchandising company sells inventory, it debits Accounts Receivable (or Cash) and credits Sales for the **selling price** of the merchandise. At the same time, it debits Cost of Goods Sold and credits Merchandise Inventory for the **cost** of the inventory items sold.

4. ***Explain the steps in the accounting cycle for a merchandising company.*** Each of the required steps in the accounting cycle for a service company applies to a merchandising company. A worksheet is again an optional step. Under a perpetual inventory system, the company must adjust the Merchandise Inventory account to agree with the physical count.

5. ***Distinguish between a multiple-step and a single-step income statement.*** A multiple-step income statement shows numerous steps in determining net income, including nonoperating activities sections. A single-step income statement classifies all data under two categories, revenues or expenses, and determines net income in one step.

6. ***Explain the computation and importance of gross profit.*** Merchandising companies compute gross profit by subtracting cost of goods sold from net sales. Gross profit represents the merchandising profit of a company. Managers and other interested parties closely watch the amount and trend of gross profit.

7. ***Determine cost of goods sold under a periodic inventory system.*** The steps in determining cost of goods sold are: (a) Record the purchases of merchandise, (b) Determine the cost of goods purchased, (c) Determine the cost of goods on hand at the beginning and end of the accounting period.

[a]8. ***Explain the recording of purchases and sales of inventory under a periodic inventory system.*** In recording purchases under a periodic system, companies must make entries for (a) cash and credit purchases, (b) purchase returns and allowances, (c) purchase discounts, and (d) freight costs. In recording sales, companies must make entries for (a) cash and credit sales, (b) sales returns and allowances, and (c) sales discounts.

[a]9. ***Prepare a worksheet for a merchandising company.*** The steps in preparing a worksheet for a merchandising company are the same as for a service company. The unique accounts for a merchandising company are Merchandise Inventory, Sales, Sales Returns and Allowances, Sales Discounts, and Cost of Goods Sold.

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TRUE-FALSE STATEMENTS

1. Retailers and wholesalers are both considered merchandisers.

2. The steps in the accounting cycle are different for a merchandising company than for a service company.

3. Sales minus operating expenses equals gross profit.

4. Under a perpetual inventory system, the cost of goods sold is determined each time a sale occurs.

5. A periodic inventory system requires a detailed inventory record of inventory items.

6. Freight terms of FOB Destination means that the seller pays the freight costs.

7. Freight costs incurred by the seller on outgoing merchandise are an operating expense to the seller.

8. Sales revenues are earned during the period cash is collected from the buyer.

9. The Sales Returns and Allowances account and the Sales Discount account are both classified as expense accounts.

10. The revenue recognition principle applies to merchandisers by recognizing sales revenues when they are earned.

11. Sales Allowances and Sales Discounts are both designed to encourage customers to pay their accounts promptly.

12. To grant a customer a sales return, the seller credits Sales Returns and Allowances.

13. A company's unadjusted balance in Merchandise Inventory will usually not agree with the actual amount of inventory on hand at year-end.

14. For a merchandising company, all accounts that affect the determination of income are closed to the Income Summary account.

15. A merchandising company has different types of adjusting entries than a service company.

16. Nonoperating activities exclude revenues and expenses that result from secondary or auxiliary operations.

17. Selling expenses relate to general operating activities such as personnel management.

18. Net sales appears on both the multiple-step and single-step forms of an income statement.

19. A multiple-step income statement provides users with more information about a company’s income performance.

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20. The multiple-step form of income statement is easier to read than the single-step form.

21. Merchandise inventory is classified as a current asset in a classified balance sheet.

22. Gain on sale of equipment and interest expense are reported under other revenues and gains in a multiple-step income statement.

23. The gross profit section for a merchandising company appears on both the multiple-step and single-step forms of an income statement.

24. In a multiple-step income statement, income from operations excludes other revenues and gains and other expenses and losses.

25. A single-step income statement reports all revenues, both operating and other revenues and gains, at the top of the statement.

26. If net sales are $800,000 and cost of goods sold is $600,000, the gross profit rate is 25%.

27. Gross profit represents the merchandising profit of a company.

28. Gross profit is a measure of the overall profitability of a company.

29. Gross profit rate is computed by dividing cost of goods sold by net sales.

30. Purchase Returns and Allowances and Purchase Discounts are subtracted from Purchases to produce net purchases.

31. Freight-in is an account that is subtracted from the Purchases account to arrive at cost of goods purchased.

[a]32. Under a periodic inventory system, the acquisition of inventory is charged to the Purchases account.

[a]33. Under a periodic inventory system, freight-in on merchandise purchases should be charged to the Inventory account.

[a]34. In a worksheet, cost of goods sold will be shown in the trial balance (Dr.), adjusted trial balance (Dr.) and income statement (Dr.) columns.

Additional True-False Questions

35. Merchandise inventory is reported as a long-term asset on the balance sheet.

36. Under a perpetual inventory system, inventory shrinkage and lost or stolen goods are more readily determined.

37. The terms 2/10, n/30 state that a 2% discount is available if the invoice is paid within the first 10 days of the next month.

38. Sales should be recorded in accordance with the matching principle.

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39. Sales returns and allowances and sales discounts are subtracted from sales in reporting net sales in the income statement.

40. A merchandising company using a perpetual inventory system will usually need to make an adjusting entry to ensure that the recorded inventory agrees with physical inventory count.

41. If a merchandising company sells land at more than its cost, the gain should be reported in the sales revenue section of the income statement.

42. The major difference between the balance sheets of a service company and a merchandising company is inventory.

Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	T	7.	T	13.	T	19.	T	25.	T	31.	F	37.	F
2.	F	8.	F	14.	T	20.	F	26.	T	[a]32.	T	38.	F
3.	F	9.	F	15.	F	21.	T	27.	T	[a]33.	F	39.	T
4.	T	10.	T	16.	F	22.	F	28.	F	[a]34.	T	40.	T
5.	F	11.	F	17.	F	23.	F	29.	F	35.	F	41.	F
6.	T	12.	F	18.	T	24.	T	30.	T	36.	T	42.	T

MULTIPLE CHOICE QUESTIONS

43. Income from operations is gross profit less
    a. administrative expenses.
    b. operating expenses.
    c. other expenses and losses.
    d. selling expenses.

44. An enterprise which sells goods to customers is known as a
    a. proprietorship.
    b. corporation.
    c. retailer.
    d. service firm.

45. Which of the following would *not* be considered a merchandising company?
    a. Retailer
    b. Wholesaler
    c. Service firm
    d. Dot Com firm

46. A merchandising company that sells directly to consumers is a
    a. retailer.
    b. wholesaler.
    c. broker.
    d. service company.

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47. Two categories of expenses for merchandising companies are
    a. cost of goods sold and financing expenses.
    b. operating expenses and financing expenses.
    c. cost of goods sold and operating expenses.
    d. sales and cost of goods sold.

48. The primary source of revenue for a wholesaler is
    a. investment income.
    b. service fees.
    c. the sale of merchandise.
    d. the sale of fixed assets the company owns.

49. Sales revenue less cost of goods sold is called
    a. gross profit.
    b. net profit.
    c. net income.
    d. marginal income.

50. After gross profit is calculated, operating expenses are deducted to determine
    a. gross margin.
    b. net income.
    c. gross profit on sales.
    d. net margin.

51. Cost of goods sold is determined only at the end of the accounting period in
    a. a perpetual inventory system.
    b. a periodic inventory system.
    c. both a perpetual and a periodic inventory system.
    d. neither a perpetual nor a periodic inventory system.

52. Which of the following expressions is *incorrect?*
    a. Gross profit – operating expenses = net income
    b. Sales – cost of goods sold – operating expenses = net income
    c. Net income + operating expenses = gross profit
    d. Operating expenses – cost of goods sold = gross profit

53. Detailed records of goods held for resale are *not* maintained under a
    a. perpetual inventory system.
    b. periodic inventory system.
    c. double entry accounting system.
    d. single entry accounting system.

54. A perpetual inventory system would likely be used by a(n)
    a. automobile dealership.
    b. hardware store.
    c. drugstore.
    d. convenience store.

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55. Which of the following is a true statement about inventory systems?
    a. Periodic inventory systems require more detailed inventory records.
    b. Perpetual inventory systems require more detailed inventory records.
    c. A periodic system requires cost of goods sold be determined after each sale.
    d. A perpetual system determines cost of goods sold only at the end of the accounting period.

56. In a perpetual inventory system, cost of goods sold is recorded
    a. on a daily basis.
    b. on a monthly basis.
    c. on an annual basis.
    d. with each sale.

57. If a company determines cost of goods sold each time a sale occurs, it
    a. must have a computer accounting system.
    b. uses a combination of the perpetual and periodic inventory systems.
    c. uses a periodic inventory system.
    d. uses a perpetual inventory system.

58. Under a perpetual inventory system, acquisition of merchandise for resale is debited to the
    a. Merchandise Inventory account.
    b. Purchases account.
    c. Supplies account.
    d. Cost of Goods Sold account.

59. The journal entry to record a return of merchandise purchased on account under a perpetual inventory system would credit
    a. Accounts Payable.
    b. Purchase Returns and Allowances.
    c. Sales.
    d. Merchandise Inventory.

60. The Merchandise Inventory account is used in each of the following *except* the entry to record
    a. goods purchased on account.
    b. the return of goods purchased.
    c. payment of freight on goods sold.
    d. payment within the discount period.

61. A buyer would record a payment within the discount period under a perpetual inventory system by crediting
    a. Accounts Payable.
    b. Merchandise Inventory.
    c. Purchase Discounts.
    d. Sales Discounts.

62. If a purchaser using a perpetual system agrees to freight terms of FOB shipping point, then the
    a. Merchandise Inventory account will be increased.
    b. Merchandise Inventory account will not be affected.
    c. seller will bear the freight cost.
    d. carrier will bear the freight cost.

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63. Freight costs paid by a seller on merchandise sold to customers will cause an increase
    a. in the selling expense of the buyer.
    b. in operating expenses for the seller.
    c. to the cost of goods sold of the seller.
    d. to a contra-revenue account of the seller.

64. Bryan Company purchased merchandise from Cates Company with freight terms of FOB shipping point. The freight costs will be paid by the
    a. seller.
    b. buyer.
    c. transportation company.
    d. buyer and the seller.

65. Flynn Company purchased merchandise inventory with an invoice price of $5,000 and credit terms of 2/10, n/30. What is the net cost of the goods if Flynn Company pays within the discount period?
    a. $5,000
    b. $4,900
    c. $4,500
    d. $4,600

66. Stine Company purchased merchandise with an invoice price of $2,000 and credit terms of 2/10, n/30. Assuming a 360 day year, what is the implied annual interest rate inherent in the credit terms?
    a. 20%
    b. 24%
    c. 36%
    d. 72%

67. If a company is given credit terms of 2/10, n/30, it should
    a. hold off paying the bill until the end of the credit period, while investing the money at 10% annual interest during this time.
    b. pay within the discount period and recognize a savings.
    c. pay within the credit period but don't take the trouble to invest the cash while waiting to pay the bill.
    d. recognize that the supplier is desperate for cash and withhold payment until the end of the credit period while negotiating a lower sales price.

68. In a perpetual inventory system, the amount of the discount allowed for paying for merchandise purchased within the discount period is credited to
    a. Merchandise Inventory.
    b. Purchase Discounts.
    c. Purchase Allowance.
    d. Sales Discounts.

69. Zach's Market recorded the following events involving a recent purchase of merchandise:

    Received goods for $50,000, terms 2/10, n/30.
    Returned $1,000 of the shipment for credit.
    Paid $250 freight on the shipment.
    Paid the invoice within the discount period.

    As a result of these events, the company's merchandise inventory

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a. increased by $48,020.
b. increased by $49,250.
c. increased by $48,265.
d. increased by $48,270.

70. Jake's Market recorded the following events involving a recent purchase of merchandise:

Received goods for $20,000, terms 2/10, n/30.
Returned $400 of the shipment for credit.
Paid $100 freight on the shipment.
Paid the invoice within the discount period.

As a result of these events, the company's merchandise inventory
a. increased by $19,208.
b. increased by $19,700.
c. increased by $19,306.
d. increased by $19,308.

71. A credit sale of $800 is made on April 25, terms 2/10, n/30, on which a return of $50 is granted on April 28. What amount is received as payment in full on May 4?
a. $735
b. $784
c. $800
d $750

72. The entry to record the receipt of payment within the discount period on a sale of $750 with terms of 2/10, n/30 will include a credit to
a. Sales Discounts for $15.
b. Cash for $735.
c. Accounts Receivable for $750.
d. Sales for $750.

73. The collection of a $600 account within the 2 percent discount period will result in a
a. debit to Sales Discounts for $12.
b. debit to Accounts Receivable for $588.
c. credit to Cash for $588.
d. credit to Accounts Receivable for $588.

74. Company X sells $400 of merchandise on account to Company Y with credit terms of 2/10, n/30. If Company Y remits a check taking advantage of the discount offered, what is the amount of Company Y's check?
a. $280
b. $392
c. $360
d. $320

75. Holt Company sells merchandise on account for $2,000 to Jones Company with credit terms of 2/10, n/30. Jones Company returns $400 of merchandise that was damaged, along with a check to settle the account within the discount period. What is the amount of the check?
a. $1,960
b. $1,968
c. $1,600
d. $1,568

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76. The collection of a $900 account after the 2 percent discount period will result in a
    a. debit to Cash for $882.
    b. debit to Accounts Receivable for $900.
    c. debit to Cash for $900.
    d. debit to Sales Discounts for $18.

77. The collection of a $600 account after the 2 percent discount period will result in a
    a. debit to Cash for $588.
    b. credit to Accounts Receivable for $600.
    c. credit to Cash for $600.
    d. debit to Sales Discounts for $12.

78. In a perpetual inventory system, the Cost of Goods Sold account is used
    a. only when a cash sale of merchandise occurs.
    b. only when a credit sale of merchandise occurs.
    c. only when a sale of merchandise occurs.
    d. whenever there is a sale of merchandise or a return of merchandise sold.

79. Sales revenues are usually considered earned when
    a. cash is received from credit sales.
    b. an order is received.
    c. goods have been transferred from the seller to the buyer.
    d. adjusting entries are made.

80. A sales invoice is a source document that
    a. provides support for goods purchased for resale.
    b. provides evidence of incurred operating expenses.
    c. provides evidence of credit sales.
    d. serves only as a customer receipt.

81. Sales revenue
    a. may be recorded before cash is collected.
    b. will always equal cash collections in a month.
    c. only results from credit sales.
    d. is only recorded after cash is collected.

82. The journal entry to record a credit sale is
    a. Cash
        Sales
    b. Cash
        Service Revenue
    c. Accounts Receivable
        Service Revenue
    d. Accounts Receivable
        Sales

83. A credit memorandum is prepared when
    a. an employee does a good job.
    b. goods are sold on credit.
    c. goods that were sold on credit are returned.
    d. customers refuse to pay their accounts.

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84. The Sales Returns and Allowances account is classified as a(n)
    a. asset account.
    b. contra asset account.
    c. expense account.
    d. contra revenue account.

85. A credit memorandum is used as documentation for a journal entry that requires a debit to
    a. Sales and a credit to Cash.
    b. Sales Returns and Allowances and a credit to Accounts Receivable.
    c. Accounts Receivable and a credit to a contra-revenue account.
    d. Cash and a credit to Sales Returns and Allowances.

86. If a customer agrees to retain merchandise that is defective because the seller is willing to reduce the selling price, this transaction is known as a sales
    a. discount.
    b. return.
    c. contra asset.
    d. allowance.

87. A credit sale of $900 is made on July 15, terms 2/10, n/30, on which a return of $50 is granted on July 18. What amount is received as payment in full on July 24?
    a. $900
    b. $833
    c. $850
    d $882

88. When goods are returned that relate to a prior cash sale,
    a. the Sales Returns and Allowances account should not be used.
    b. the cash account will be credited.
    c. Sales Returns and Allowances will be credited.
    d. Accounts Receivable will be credited.

89. The Sales Returns and Allowances account does *not* provide information to management about
    a. possible inferior merchandise.
    b. the percentage of credit sales versus cash sales.
    c. inefficiencies in filling orders.
    d. errors in overbilling customers.

90. A Sales Returns and Allowances account is *not* debited if a customer
    a. returns defective merchandise.
    b. receives a credit for merchandise of inferior quality.
    c. utilizes a prompt payment incentive.
    d. returns goods that are not in accordance with specifications.

91. As an incentive for customers to pay their accounts promptly, a business may offer its customers
    a. a sales discount.
    b. free delivery.
    c. a sales allowance.
    d. a sales return.

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92. The credit terms offered to a customer by a business firm are 2/10, n/30, which means that
    a. the customer must pay the bill within 10 days.
    b. the customer can deduct a 2% discount if the bill is paid between the 10th and 30th day from the invoice date.
    c. the customer can deduct a 2% discount if the bill is paid within 10 days of the invoice date.
    d. two sales returns can be made within 10 days of the invoice date and no returns thereafter.

93. A sales discount does not
    a. provide the purchaser with a cash saving.
    b. reduce the amount of cash received from a credit sale.
    c. increase a contra-revenue account.
    d. increase an operating expense account.

94. Company A sells $500 of merchandise on account to Company B with credit terms of 2/10, n/30. If Company B remits a check taking advantage of the discount offered, what is the amount of Company B's check?
    a. $350
    b. $490
    c. $450
    d. $400

95. Hale Company sells merchandise on account for $1,500 to Kear Company with credit terms of 2/10, n/30. Kear Company returns $300 of merchandise that was damaged, along with a check to settle the account within the discount period. What is the amount of the check?
    a. $1,470
    b. $1,476
    c. $1,200
    d. $1,176

96. Feine Company sells merchandise on account for $2,000 to Tang Company with credit terms of 2/10, n/30. Tang Company returns $300 of merchandise that was damaged, along with a check to settle the account within the discount period. What entry does Feine Company make upon receipt of the check?

    a.

Cash	1,700	
Accounts Receivable		1,700

    b.

Cash	1,666	
Sales Returns and Allowances	334	
Accounts Receivable		2,000

    c.

Cash	1,666	
Sales Returns and Allowances	300	
Sales Discounts	34	
Accounts Receivable		2,000

    d.

Cash	1,960	
Sales Discounts	40	
Sales Returns and Allowances		300
Accounts Receivable		1,700

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97. Which of the following would *not* be classified as a contra account?
    a. Sales
    b. Sales Returns and Allowances
    c. Accumulated Depreciation
    d. Sales Discounts

98. Which of the following accounts has a normal credit balance?
    a. Sales Returns and Allowances
    b. Sales Discounts
    c. Sales
    d. Selling Expense

99. With respect to the income statement,
    a. contra-revenue accounts do not appear on the income statement.
    b. sales discounts increase the amount of sales.
    c. contra-revenue accounts increase the amount of operating expenses.
    d. sales discounts are included in the calculation of gross profit.

100. When a seller grants credit for returned goods, the account that is credited is
    a. Sales.
    b. Sales Returns and Allowances.
    c. Merchandise Inventory.
    d. Accounts Receivable.

101. The respective normal account balances of Sales, Sales Returns and Allowances, and Sales Discounts are
    a. credit, credit, credit.
    b. debit, credit, debit.
    c. credit, debit, debit.
    d. credit, debit, credit.

102. All of the following are contra revenue accounts *except*
    a. sales.
    b. sales allowances.
    c. sales discounts.
    d. sales returns.

103. A merchandising company using a perpetual system will make
    a. the same number of adjusting entries as a service company does.
    b. one more adjusting entry than a service company does.
    c. one less adjusting entry than a service company does.
    d. different types of adjusting entries compared to a service company.

104. In preparing closing entries for a merchandising company, the Income Summary account will be credited for the balance of
    a. sales.
    b. merchandise inventory.
    c. sales discounts.
    d. freight-out.

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105. A merchandising company using a perpetual system may record an adjusting entry by
   a. debiting Income Summary.
   b. crediting Income Summary.
   c. debiting Cost of Goods Sold.
   d. debiting Sales.

106. The operating cycle of a merchandiser is
   a. always one year in length.
   b. generally longer than it is for a service company.
   c. about the same as for a service company.
   d. generally shorter than it is for a service company.

107. The sales revenue section of an income statement for a retailer would *not* include
   a. Sales discounts.
   b. Sales.
   c. Net sales.
   d. Cost of goods sold.

108. The operating expense section of an income statement for a wholesaler would *not* include
   a. freight-out.
   b. utilities expense.
   c. cost of goods sold.
   d. insurance expense.

109. Income from operations will always result if
   a. the cost of goods sold exceeds operating expenses.
   b. revenues exceed cost of goods sold.
   c. revenues exceed operating expenses.
   d. gross profit exceeds operating expenses.

110. Indicate which one of the following would appear on the income statement of both a merchandising company and a service company.
   a. Gross profit
   b. Operating expenses
   c. Sales revenues
   d. Cost of goods sold

111. Thelman Company reported the following balances at June 30, 2008:

Sales	$10,800
Sales Returns and Allowances	400
Sales Discounts	200
Cost of Goods Sold	5,000

Net sales for the month is
   a. $10,800.
   b. $10,400.
   c. $10,200.
   d. $5,200.

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112. Income from operations appears on
   a. both a multiple-step and a single-step income statement.
   b. neither a multiple-step nor a single-step income statement.
   c. a single-step income statement.
   d. a multiple-step income statement.

113. Gross profit does *not* appear
   a. on a multiple-step income statement.
   b. on a single-step income statement.
   c. to be relevant in analyzing the operation of a merchandiser.
   d. on the income statement if the periodic inventory system is used because it cannot be calculated.

114. Which of the following is *not* a true statement about a multiple-step income statement?
   a. Operating expenses are often classified as selling and administrative expenses.
   b. There may be a section for nonoperating activities.
   c. There may be a section for operating assets.
   d. There is a section for cost of goods sold.

115. Which one of the following is shown on a multiple-step but *not* on a single-step income statement?
   a. Net sales
   b. Net income
   c. Gross profit
   d. Cost of goods sold

116. All of the following items would be reported as other expenses and losses *except*
   a. freight-out.
   b. casualty losses.
   c. interest expense.
   d. loss from employees' strikes.

117. If a company has net sales of $500,000 and cost of goods sold of $350,000, the gross profit percentage is
   a. 70%.
   b. 30%.
   c. 15%.
   d. 100%.

118. A company shows the following balances:

Sales	$1,000,000
Sales Returns and Allowances	180,000
Sales Discounts	20,000
Cost of Goods Sold	560,000

What is the gross profit percentage?
   a. 56%
   b. 70%
   c. 44%
   d. 30%

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119. The gross profit rate is computed by dividing gross profit by
   a. cost of goods sold.
   b. net income.
   c. net sales.
   d. sales.

120. In terms of liquidity, merchandise inventory is
   a. more liquid than cash.
   b. more liquid than accounts receivable.
   c. more liquid than prepaid expenses.
   d. less liquid than store equipment.

121. On a classified balance sheet, merchandise inventory is classified as
   a. an intangible asset.
   b. property, plant, and equipment.
   c. a current asset.
   d. a long-term investment.

122. Gross profit for a merchandiser is net sales minus
   a. operating expenses.
   b. cost of goods sold.
   c. sales discounts.
   d. cost of goods available for sale.

Use the following information for questions 123–125.

During 2008, Salon Enterprises generated revenues of $60,000. The company's expenses were as follows: cost of goods sold of $30,000, operating expenses of $12,000 and a loss on the sale of equipment of $2,000.

123. Salon's gross profit is
   a. $60,000.
   b. $30,000.
   c. $18,000.
   d. $16,000.

124. Salon's income from operations is
   a. $60,000.
   b. $30,000.
   c. $18,000.
   d. $12,000.

125. Salon's net income is
   a. $60,000.
   b. $30,000.
   c. $18,000.
   d. $16,000.

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Use the following information for questions 126–127.

Financial information is presented below:

Operating Expenses	$ 45,000
Sales	150,000
Cost of Goods Sold	77,000

126. Gross profit would be
   a. $105,000.
   b. $28,000.
   c. $73,000.
   d. $150,000.

127. The gross profit rate would be
   a. .700.
   b. .187.
   c. .300.
   d. .487.

Use the following information for questions 128–129.

Financial information is presented below:

Operating Expenses	$ 45,000
Sales Returns and Allowances	13,000
Sales Discounts	6,000
Sales	150,000
Cost of Goods Sold	67,000

128. Gross profit would be
   a. $77,000.
   b. $64,000.
   c. $70,000.
   d. $83,000.

129. The gross profit rate would be
   a. .535.
   b. .489.
   c. .511.
   d. .553.

Use the following information for questions 130–132.

Financial information is presented below:

Operating Expenses	$ 45,000
Sales Returns and Allowances	13,000
Sales Discounts	6,000
Sales	160,000
Cost of Goods Sold	77,000

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130. The amount of net sales on the income statement would be
   a. $154,000.
   b. $141,000.
   c. $160,000.
   d. $166,000.

131. Gross profit would be
   a. $77,000.
   b. $70,000.
   c. $64,000.
   d. $83,000.

132. The gross profit rate would be
   a. .454.
   b. .546.
   c. .500.
   d. .538.

133. If a company has sales of $420,000, net sales of $400,000, and cost of goods sold of $260,000, the gross profit rate is
   a. 67%.
   b. 65%
   c. 35%.
   d. 33%.

134. Ingrid's Fashions sold merchandise for $38,000 cash during the month of July. Returns that month totaled $800. If the company's gross profit rate is 40%, Ingrid's will report monthly net sales revenue and cost of goods sold of
   a. $38,000 and $22,800.
   b. $37,200 and $14,880.
   c. $37,200 and $22,320.
   d. $38,000 and $22,320.

Use the following information for questions 135–138.

During August, 2008, Sal's Supply Store generated revenues of $30,000. The company's expenses were as follows: cost of goods sold of $12,000 and operating expenses of $2,000. The company also had rent revenue of $500 and a gain on the sale of a delivery truck of $1,000.

135. Sal's gross profit for August, 2008 is
   a. $30,000.
   b. $19,000.
   c. $18,000.
   d. $16,000.

136. Sal's nonoperating income (loss) for the month of August, 2008 is
   a. $0.
   b. $500.
   c. $1,000.
   d. $1,500.

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137. Sal's operating income for the month of August, 2008 is
   a. $30,000.
   b. $19,500.
   c. $18,500.
   d. $16,000.

138. Sal's net income for August, 2008 is
   a. $18,000.
   b. $17,500.
   c. $16,500.
   d. $16,000.

139. At the beginning of September, 2008, RFI Company reported Merchandise Inventory of $4,000. During the month, the company made purchases of $7,800. At September 31, 2008, a physical count of inventory reported $3,200 on hand. Cost of goods sold for the month is
   a. $600.
   b. $7,800.
   c. $8,600.
   d. $11,800.

140. At the beginning of the year, Midtown Athletic had an inventory of $400,000. During the year, the company purchased goods costing $1,600,000. If Midtown Athletic reported ending inventory of $600,000 and sales of $2,000,000, the company's cost of goods sold and gross profit rate must be
   a. $1,000,000 and 50%.
   b. $1,400,000 and 30%.
   c. $1,000,000 and 30%.
   d. $1,400,000 and 70%.

141. During the year, Darla's Pet Shop's merchandise inventory decreased by $20,000. If the company's cost of goods sold for the year was $300,000, purchases must have been
   a. $320,000.
   b. $280,000.
   c. $260,000.
   d. Unable to determine.

142. Cost of goods available for sale is computed by adding
   a. beginning inventory to net purchases.
   b. beginning inventory to the cost of goods purchased.
   c. net purchases and freight-in.
   d. purchases to beginning inventory.

143. The Freight-in account
   a. increases the cost of merchandise purchased.
   b. is contra to the Purchases account.
   c. is a permanent account.
   d. has a normal credit balance.

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144. Net purchases plus freight-in determines
a. cost of goods sold.
b. cost of goods available for sale.
c. cost of goods purchased.
d. total goods available for sale.

145. West Company has the following account balances:

Purchases	$48,000
Sales Returns and Allowances	6,400
Purchase Discounts	4,000
Freight-in	3,000
Delivery Expense	4,000

The cost of goods purchased for the period is
a. $52,000.
b. $47,000.
c. $51,000.
d. $44,600.

146. Baden Shoe Store has a beginning merchandise inventory of $30,000. During the period, purchases were $140,000; purchase returns, $4,000; and freight-in $10,000. A physical count of inventory at the end of the period revealed that $20,000 was still on hand. The cost of goods available for sale was
a. $164,000.
b. $156,000.
c. $176,000.
d. $184,000.

[a]147. In a periodic inventory system, a return of defective merchandise by a customer is recorded by crediting
a. Accounts Payable.
b. Merchandise Inventory.
c. Purchases.
d. Purchase Returns and Allowances.

[a]148. Which one of the following transactions is recorded with the same entry in a perpetual and a periodic inventory system?
a. Cash received on account with a discount
b. Payment of freight costs on a purchase
c. Return of merchandise sold
d. Sale of merchandise on credit

[a]149. The journal entry to record a return of merchandise purchased on account under a periodic inventory system would be
a. Accounts Payable
  Purchase Returns and Allowances
b. Purchase Returns and Allowances
  Accounts Payable
c. Accounts Payable
  Inventory
d. Inventory
  Accounts Payable

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[a]150. Under a periodic inventory system, acquisition of merchandise is debited to the
a. Merchandise Inventory account.
b. Cost of Goods Sold account.
c. Purchases account.
d. Accounts Payable account.

[a]151. Which of the following accounts has a normal credit balance?
a. Purchases
b. Sales Returns and Allowances
c. Freight-in
d. Purchase Discounts

[a]152. The respective normal account balances of Purchases, Purchase Discounts, and Freight-in are
a. credit, credit, debit.
b. debit, credit, credit.
c. debit, credit, debit.
d. debit, debit, debit.

[a]153. In a worksheet for a merchandising company, Merchandise Inventory would appear in the
a. trial balance and adjusted trial balance columns only.
b. trial balance and balance sheet columns only.
c. trial balance, adjusted trial balance, and balance sheet columns.
d. trial balance, adjusted trial balance, and income statement columns.

[a]154. The Merchandise Inventory account balance appearing in a worksheet represents the
a. ending inventory.
b. beginning inventory.
c. cost of merchandise purchased.
d. cost of merchandise sold.

Additional Multiple Choice Questions

155. Cole Company has sales revenue of $39,000, cost of goods sold of $24,000 and operating expenses of $9,000 for the year ended December 31. Cole's gross profit is
a. $30,000.
b. $15,000.
c. $6,000.
d. $0.

156. Logan Company made a purchase of merchandise on credit from Claude Corporation on August 3, for $6,000, terms 2/10, n/45. On August 10, Logan makes the appropriate payment to Claude. The entry on August 10 for Logan Company is

a.	Accounts Payable	6,000	
	Cash		6,000
b.	Accounts Payable	5,880	
	Cash		5,880
c.	Accounts Payable	6,000	
	Purchase Returns and Allowances		120
	Cash		5,880
d.	Accounts Payable	6,000	
	Merchandise Inventory		120
	Cash		5,880

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157. Cartier Company purchased inventory from Pissaro Company. The shipping costs were $400 and the terms of the shipment were FOB shipping point. Cartier would have the following entry regarding the shipping charges:
a. There is no entry on Cartier's books for this transaction.
b. Freight Expense..... 400
Cash 400
c. Freight-out 400
Cash 400
d. Merchandise Inventory 400
Cash 400

158. In a perpetual inventory system, a return of defective merchandise by a purchaser is recorded by crediting
a. Purchases.
b. Purchase Returns.
c. Purchase Allowance.
d. Merchandise Inventory.

159. On October 4, 2008, Terry Corporation had credit sales transactions of $2,800 from merchandise having cost $1,900. The entries to record the day's credit transactions include a
a. debit of $2,800 to Merchandise Inventory.
b. credit of $2,800 to Sales.
c. debit of $1,900 to Merchandise Inventory.
d. credit of $1,900 to Cost of Goods Sold.

160. Which of the following accounts is *not* closed to Income Summary?
a. Cost of Goods Sold
b. Merchandise Inventory
c. Sales
d. Sales Discounts

161. In the Clark Company, sales were $480,000, sales returns and allowances were $30,000, and cost of goods sold was $288,000. The gross profit rate was
a. 64%.
b. 36%.
c. 40%.
d. 60%.

162. Net sales is sales less
a. sales discounts.
b. sales returns.
c. sales returns and allowances.
d. sales discounts and sales returns and allowances.

163. In the balance sheet, ending merchandise inventory is reported
a. in current assets immediately following accounts receivable.
b. in current assets immediately following prepaid expenses.
c. in current assets immediately following cash.
d. under property, plant, and equipment.

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164. Cost of goods available for sale is computed by adding
   a. freight-in to net purchases.
   b. beginning inventory to net purchases.
   c. beginning inventory to purchases and freight-in.
   d. beginning inventory to cost of goods purchased.

Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
43.	b	61.	b	79.	c	97.	a	115.	c	133.	c	[a]151.	d
44.	c	62.	a	80.	c	98.	c	116.	a	134.	c	[a]152.	c
45.	c	63.	b	81.	a	99.	d	117.	b	135.	c	[a]153.	c
46.	a	64.	b	82.	d	100.	d	118.	d	136.	d	[a]154.	a
47.	c	65.	b	83.	c	101.	c	119.	c	137.	d	155.	b
48.	c	66.	c	84.	d	102.	a	120.	c	138.	b	156.	d
49.	a	67.	b	85.	b	103.	b	121.	c	139.	c	157.	d
50.	b	68.	a	86.	d	104.	a	122.	b	140.	b	158.	d
51.	b	69.	d	87.	b	105.	c	123.	b	141.	b	159.	b
52.	d	70.	d	88.	b	106.	b	124.	c	142.	b	160.	b
53.	b	71.	a	89.	b	107.	d	125.	d	143.	a	161.	b
54.	a	72.	c	90.	c	108.	c	126.	c	144.	c	162.	d
55.	b	73.	a	91.	a	109.	d	127.	d	145.	b	163.	a
56.	d	74.	b	92.	c	110.	b	128.	b	146.	c	164.	d
57.	d	75.	d	93.	d	111.	c	129.	b	[a]147.	d		
58.	a	76.	c	94.	b	112.	d	130.	b	[a]148.	a		
59.	d	77.	b	95.	d	113.	b	131.	c	[a]149.	a		
60.	c	78.	d	96.	c	114.	c	132.	a	[a]150.	c		

BRIEF EXERCISES

BE 165

Presented here are the components in Sanders Company's income statement. Determine the missing amounts.

Sales	Cost of Goods Sold	Gross Profit	Operating Expenses	Net Income
$75,000	(a)	$40,000	(b)	$17,000
(c)	$56,000	$64,000	$48,000	(d)

Solution 165 (5 min.)

a. $35,000
b. $23,000
c. $120,000
d. $16,000

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BE 166

Prepare the necessary journal entries on the books of Tri-State Carpet Company to record the following transactions, assuming a perpetual inventory system (you may omit explanations):
(a) Tri-State purchased $40,000 of merchandise on account, terms 2/10, n/30.
(b) Returned $4,000 of damaged merchandise for credit.
(c) Paid for the merchandise purchased within 10 days.

Solution 166 (5 min.)

(a)	Merchandise Inventory	40,000	
	Accounts Payable		40,000
(b)	Accounts Payable	4,000	
	Merchandise Inventory		4,000
(c)	Accounts Payable ($40,000 – $4,000)	36,000	
	Merchandise Inventory ($36,000 × .02)		720
	Cash ($36,000 – $720)		35,280

BE 167

Erving Company sold goods on account to Farley Enterprises with terms of 2/10, n/30. The goods had a cost of $600 and a selling price of $900. Both Erving and Farley use a perpetual inventory system. Record the sale on the books of Erving and the purchase on the books of Farley.

Solution 167 (3 min.)

Journal entry on Erving's books:

Accounts Receivable....	900	
Sales.		900
Cost of Goods Sold…..	600	
Merchandise Inventory		600

Journal entry on Farley's books:

Merchandise Inventory	900	
Accounts Payable		900

BE 168

Manning Company sells merchandise on account for $2,000 to Tiger Company with credit terms of 3/10, n/60. Tiger Company returns $200 of merchandise that was damaged, along with a check to settle the account within the discount period. What entry does Manning Company make upon receipt of the check and the damaged merchandise?

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Solution 168 (3 min.)

Sales Returns and Allowances	200	
Sales Discounts ($1,800 × .03)	54	
Cash ($2,000 – $200 – $54)	1,746	
Accounts Receivable		2,000

BE 169

Ord Company uses a perpetual inventory system. During May, the following transactions and events occurred.

May 13 Sold 6 motors at a cost of $44 each to Waller Brothers Supply Company, terms 1/10, n/30. The motors cost Ord $25 each.

May 16 One defective motor was returned to Ord.

May 23 Received payment in full from Waller Brothers.

Instructions
Journalize the May transactions for Ord Company (seller) assuming that Ord uses a perpetual inventory system. You may omit explanations.

Solution 169 (8 min.)

May	13	Accounts Receivable	264	
		Sales		264
		Cost of Goods Sold	150	
		Merchandise Inventory		150
May	16	Sales Returns and Allowances	44	
		Accounts Receivable		44
		Merchandise Inventory	25	
		Cost of Goods Sold		25
May	23	Cash	218	
		Sales Discounts ($220 × .01)	2	
		Accounts Receivable ($264 – $44)		220

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BE 170

The income statement for Avery Company for the year ended December 31, 2008 is as follows:

AVERY COMPANY
Income Statement
For the Year Ended December 31, 2008

Revenues		
Sales		$55,000
Interest revenue		3,000
Total revenues		58,000
Expenses		
Cost of goods sold	$36,000	
Selling expenses	7,000	
Administrative expenses	5,000	
Interest expense	1,000	
Total expenses		49,000
Net income		$ 9,000

Prepare the entries to close the revenue and expense accounts at December 31, 2008. You may omit explanations for the transactions.

Solution 170 (5 min.)

Dec. 31	Sales		55,000	
	Interest Revenue		3,000	
		Income Summary		58,000
31	Income Summary		49,000	
		Cost of Goods Sold		36,000
		Selling Expenses		7,000
		Administrative Expenses		5,000
		Interest Expense		1,000

BE 171

Milton Company provides this information for the month of November, 2008: sales on credit $150,000; cash sales $50,000; sales discounts $2,000; and sales returns and allowances $8,000. Prepare the sales revenues section of the income statement based on this information.

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Solution 171 (3 min.)

MILTON COMPANY
Income Statement (Partial)
For the Month Ended November 30, 2008

Sales		$200,000
Less: Sales Returns and Allowances	$8,000	
Sales Discounts	2,000	10,000
Net Sales		$190,000

BE 172

During October, 2008, Katie's Catering Company generated revenues of $13,000. Sales discounts totalled $200 for the month. Expenses were as follows: Cost of goods sold of $7,000 and operating expenses of $2,000.

Calculate (1) gross profit and (2) income from operations for the month.

Solution 172 (4 min.)

(1) Gross profit: $5,800 ($13,000 - $200 - $7,000)
(2) Income from operations: $3,800 ($5,800 - $2,000)

BE 173
For each of the following, determine the missing amounts.

	Beginning Inventory	Purchases	Goods Available for Sale	Cost of Goods Sold	Ending Inventory
1.	$20,000	_____	$ 40,000	$25,000	_____
2.	_____	$220,000	$250,000	_____	$40,000

Solution 173 (4 min.)

1. Purchases $20,000 ($40,000 – $20,000), Ending inventory $15,000 ($40,000 – $25,000)

2. Beginning inventory $30,000 ($250,000 – $220,000), Cost of Goods Sold $210,000 ($250,000 – $40,000)

BE 174

Assume that Guardian Company uses a periodic inventory system and has these account balances: Purchases $500,000; Purchase Returns and Allowances $14,000; Purchase Discounts $9,000; and Freight-in $15,000. Determine net purchases and cost of goods purchased.

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Solution 174 (4 min.)

Calculation of Net Purchases and Cost of Goods Purchased

Purchases		$500,000
Less: Purchase returns and Allowances	$14,000	
Purchase discounts	9,000	23,000
Net Purchases		477,000
Add: Freight-in		15,000
Cost of Goods Purchased		$492,000

BE 175

Assume that Guardian Company uses a periodic inventory system and has these account balances: Purchases $600,000; Purchase Returns and Allowances $25,000; Purchase Discounts $11,000; and Freight-in $19,000; beginning inventory of $45,000; ending inventory of $55,000; and net sales of $750,000. Determine the cost of goods sold.

Solution 175 (6 min.)

Inventory, beginning			$ 45,000
Purchases		$600,000	
Less: Purchase returns and allowances	$25,000		
Purchase discounts	11,000	36,000	
Net purchases		564,000	
Add: Freight-in		19,000	
Cost of goods purchased			583,000
Cost of goods available for sale			628,000
Inventory, ending			55,000
Cost of goods sold			$573,000

[a]BE 176

Waller Brothers Supply uses a periodic inventory system. During May, the following transactions and events occurred.

May 13 Purchased 6 motors at a cost of $44 each from Ord Company, terms 1/10, n/30. The motors cost Ord Company $25 each.

May 16 Returned 1 defective motor to Ord.

May 23 Paid Ord Company in full.

Instructions

Journalize the May transactions for Waller Brothers. You may omit explanations.

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[a]Solution 176 (6 min.)

May	13	Purchases	264	
		Accounts Payable		264
May	16	Accounts Payable	44	
		Purchase Returns and Allowances		44
May	23	Accounts Payable ($264 – $44)	220	
		Purchase Discounts ($220 × .01)		2
		Cash		218

EXERCISES

Ex. 177

For each of the following, determine the missing amounts.

	Sales	Cost of Goods Sold	Gross Profit	Operating Expenses	Net Income
1.	$100,000	_____	_____	$25,000	$10,000
2.	_____	$95,000	$120,000	_____	$80,000

Solution 177 (5 min.)

1. Gross Profit = $35,000 ($25,000 + $10,000)
   Cost of Goods Sold = $65,000 ($100,000 – $35,000)

2. Sales = $215,000 ($95,000 + $120,000)
   Operating Expenses = $40,000 ($120,000 – $80,000)

Ex. 178

On October 1, Taylor Bicycle Store had an inventory of 20 ten speed bicycles at a cost of $200 each. During the month of October, the following transactions occurred.

Oct. 4 Purchased 30 bicycles at a cost of $200 each from Mann Bicycle Company, terms 2/10, n/30.

6 Sold 18 bicycles to Team America for $300 each, terms 2/10, n/30.

7 Received credit from Mann Bicycle Company for the return of 2 defective bicycles.

13 Issued a credit memo to Team America for the return of a defective bicycle.

14 Paid Mann Bicycle Company in full, less discount.

Instructions

Prepare the journal entries to record the transactions assuming the company uses a perpetual inventory system.

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Solution 178 (20 min.)

Oct.	4	Merchandise Inventory	6,000	
		Accounts Payable		6,000
	6	Accounts Receivable	5,400	
		Sales		5,400
		Cost of Goods Sold	3,600	
		Merchandise Inventory		3,600
	7	Accounts Payable	400	
		Merchandise Inventory		400
	13	Sales Returns and Allowances	300	
		Accounts Receivable		300
		Merchandise Inventory	200	
		Cost of Goods Sold		200
	14	Accounts Payable ($6,000 – $400)	5,600	
		Cash ($5,600 × .98)		5,488
		Merchandise Inventory ($5,600 × .02)		112

Ex. 179

On September 1, Snow Supply had an inventory of 15 backpacks at a cost of $25 each. The company uses a perpetual inventory system. During September, the following transactions and events occurred.

Sept. 4 Purchased 70 backpacks at $25 each from Jenks, terms 2/10, n/30.

Sept. 6 Received credit of $150 for the return of 6 backpacks purchased on Sept. 4 that were defective.

Sept. 9 Sold 40 backpacks for $35 each to McGill Books, terms 2/10, n/30.

Sept. 13 Sold 15 backpacks for $35 each to Calvin Office Supply, terms n/30.

Sept. 14 Paid Jenks in full, less discount.

Instructions
Journalize the September transactions for Snow Supply.

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Solution 179 (20 min.)

Sept.	4	Merchandise Inventory	1,750	
		Accounts Payable		1,750
Sept.	6	Accounts Payable	150	
		Merchandise Inventory		150
Sept.	9	Accounts Receivable	1,400	
		Sales		1,400
		Cost of Goods Sold	1,000	
		Merchandise Inventory		1,000
Sept.	13	Accounts Receivable	525	
		Sales		525
		Cost of Goods Sold	375	
		Merchandise Inventory		375
Sept.	14	Accounts Payable ($1,750 – $150)	1,600	
		Cash ($1,600 × .98)		1,568
		Merchandise Inventory ($1,600 × .02)		32

Ex. 180

Tim Stark is a new accountant with Watts Company. Watts purchased merchandise on account for $9,000. The credit terms are 2/10, n/30. Tim has talked with the company's banker and knows that he could earn 8% on any money invested in the company's savings account.

Instructions

(a) Should Tim pay the invoice within the discount period or should he keep the $9,000 in the savings account and pay at the end of the credit period? Support your recommendation with a calculation showing which action would be best.

(b) If Tim forgoes the discount, it may be viewed as paying an interest rate of 2% for the use of $9,000 for 20 days. Calculate the annual rate of interest that this is equivalent to.

Solution 180 (10 min.)

Tim should pay the invoice within the discount period to save $140:

(a)	Discount of 2% on $9,000	$180	
	Interest received on $9,000 (for 20 days at 8%)	40	($9,000 × 8% × 20 ÷ 360)
	Savings by taking the discount	$140	

(b) The equivalent annual interest rate is:
2% × 360 ÷ 20 = 36%.

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Ex. 181

(a) Boden Company purchased merchandise on account from Office Suppliers for $86,000, with terms of 2/10, n/30. During the discount period, Boden returned some merchandise and paid $78,400 as payment in full. Boden uses a perpetual inventory system. Prepare the journal entries that Boden Company made to record:
(1) the purchase of merchandise.
(2) the return of merchandise.
(3) the payment on account.

(b) Boggs Company sold merchandise to Wilsey Company on account for $73,000 with credit terms of ?/10, n/30. The cost of the merchandise sold was $43,800. During the discount period, Wilsey Company returned $3,000 of merchandise and paid its account in full (minus the discount) by remitting $69,300 in cash. Both companies use a perpetual inventory system. Prepare the journal entries that Boggs Company made to record:
(1) the sale of merchandise.
(2) the return of merchandise.
(3) the collection on account.

Solution 181 (20 min.)

(a) To compute the amount due after returns but before the discount, divide $78,400 by .98 (100% – 2%).
$78,400 ÷ .98 = $80,000.
Subtract $80,000 from $86,000 to determine that $6,000 of merchandise was returned.

(1)	Merchandise Inventory	86,000	
	Accounts Payable		86,000
(2)	Accounts Payable	6,000	
	Merchandise Inventory		6,000
(3)	Accounts Payable	80,000	
	Merchandise Inventory		1,600
	Cash		78,400

(b) Wilsey Company returns $3,000 of merchandise and owes $70,000 to Boggs Company.
$69,300 ÷ $70,000 = .99
100% – 99% = 1%
The missing discount percentage is 1%. $70,000 × 1% = $700 sales discount.
$70,000 – $700 = $69,300 cash received on account.

(1)	Accounts Receivable	73,000	
	Sales		73,000
	Cost of Goods Sold	43,800	
	Merchandise Inventory		43,800
(2)	Sales Returns and Allowances	3,000	
	Accounts Receivable		3,000
	Merchandise Inventory $3,000 × ($43,800 ÷ $73,000)	1,800	
	Cost of Goods Sold		1,800

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Solution 181 (cont.)

(3)	Cash	69,300	
	Sales Discounts	700	
	Accounts Receivable		70,000

Ex. 182

Prepare the necessary journal entries to record the following transactions, assuming Barone Company uses a perpetual inventory system.

(a) Purchased $30,000 of merchandise on account, terms 2/10, n/30.
(b) Returned $500 of damaged merchandise for credit.
(c) Paid for the merchandise purchased within 10 days.

Solution 182 (6-8 min.)

(a)	Merchandise Inventory	30,000	
	Accounts Payable		30,000
(b)	Accounts Payable	500	
	Merchandise Inventory		500
(c)	Accounts Payable ($30,000 – $500)	29,500	
	Merchandise Inventory ($29,500 × .02)		590
	Cash ($29,500 – $590)		28,910

Ex. 183

Prepare the necessary journal entries to record the following transactions, assuming Moran Company uses a perpetual inventory system.

(a) Moran sells $50,000 of merchandise, terms 1/10, n/30. The merchandise cost $30,000.

(b) The customer in (a) returned $5,000 of merchandise to Moran. The merchandise returned cost $3,000.

(c) Moran received the balance due within the discount period.

Solution 183 (7-9 min.)

(a)	Accounts Receivable	50,000	
	Sales		50,000
	Cost of Goods Sold	30,000	
	Merchandise Inventory		30,000

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Solution 183 (cont.)

(b)	Sales Returns and Allowances	5,000	
	Accounts Receivable		5,000
	Merchandise Inventory	3,000	
	Cost of Goods Sold		3,000
(c)	Cash ($45,000 – $450)	44,550	
	Sales Discounts ($45,000 × .01)	450	
	Accounts Receivable		45,000

Ex. 184

Rosen Company completed the following transactions in October:

Credit Sales			Sales Returns		Date of
Date	Amount	Terms	Date	Amount	Collection
Oct. 3	$ 600	2/10, n/30			Oct. 8
Oct. 11	1,200	3/10, n/30	Oct. 14	$ 400	Oct. 16
Oct. 17	5,000	1/10, n/30	Oct. 20	1,000	Oct. 29
Oct. 21	1,400	2/10, n/60	Oct. 23	200	Oct. 27
Oct. 23	1,800	2/10, n/30	Oct. 27	400	Oct. 28

Instructions

(a) Indicate the cash received for each collection. Show your calculations.
(b) Prepare the journal entry for the
  (1) Oct. 17 sale. The merchandise sold had a cost of $3,500.
  (2) Oct. 23 sales return. The merchandise returned had a cost of $140.
  (3) Oct. 28 collection.

Rosen uses a perpetual inventory system.

Solution 184 (20 min.)

(a) Oct. 8 $588 [Sales $600 – Sales discount $12 ($600 × .02)]

Oct. 16 $776 [Sales $1,200 – Sales return $400 = $800;
$800 – Sales discount $24 ($800 × .03)]

Oct. 29 $4,000 [Sales $5,000 – Sales return $1,000 = $4,000;
(discount lapsed)]

Oct. 27 $1,176 [Sales $1,400 – Sales return $200 = $1,200;
$1,200 – Sales discount $24 ($1,200 × .02)]

Oct. 28 $1,372 [Sales $1,800 – Sales return $400 = $1,400;
$1,400 – Sales discount $28 ($1,400 × .02)]

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Solution 184 (cont.)

(b)	(1)	Oct. 17	Accounts Receivable	5,000	
			Sales		5,000
			Cost of Goods Sold	3,500	
			Merchandise Inventory		3,500
	(2)	Oct. 23	Sales Returns and Allowances	200	
			Accounts Receivable		200
			Merchandise Inventory	140	
			Cost of Goods Sold		140
	(3)	Oct. 28	Cash	1,372	
			Sales Discounts	28	
			Accounts Receivable		1,400

Ex. 185

The following information is available for Siler Company:

	Debit	Credit
Siler, Capital		$ 50,000
Siler, Drawing	$ 32,000	
Sales		510,000
Sales Returns and Allowances	20,000	
Sales Discounts	7,000	
Cost of Goods Sold	347,000	
Freight-out	2,000	
Advertising Expense	15,000	
Interest Expense	19,000	
Store Salaries Expense	45,000	
Utilities Expense	18,000	
Depreciation Expense	7,000	
Interest Revenue		25,000

Instructions

Using the above information, prepare the closing entries for Siler Company.

Solution 185 (10 min.)

Dec.	31		Interest Revenue	25,000	
			Sales	510,000	
			Income Summary		535,000

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Solution 185 (cont.)

31	Income Summary	480,000	
	Sales Returns and Allowances		20,000
	Sales Discounts		7,000
	Cost of Goods Sold		347,000
	Freight-out		2,000
	Advertising Expense		15,000
	Interest Expense		19,000
	Store Salaries Expense		45,000
	Utilities Expense		18,000
	Depreciation Expense		7,000
31	Income Summary	55,000	
	Siler, Capital		55,000
31	Siler, Capital	32,000	
	Siler, Drawing		32,000

Ex. 186

The adjusted trial balance of Unruh Book Company appears below.

UNRUH BOOK COMPANY
Adjusted Trial Balance
December 31, 2008

	Debit	Credit
Cash	32,000	
Accounts Receivable	25,000	
Merchandise Inventory	35,000	
Building	150,000	
Accumulated Depreciation—Building		20,000
Accounts Payable		12,000
Unruh, Capital		149,000
Unruh, Drawing	20,000	
Sales		305,000
Sales Discounts	6,000	
Sales Returns & Allowances	8,000	
Cost of Goods Sold	173,000	
Selling Expenses	18,000	
Administrative Expenses	19,000	
	486,000	486,000

Instructions
Using the information given, prepare the year-end closing entries.

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Solution 186 (10 min.)

Dec. 31	Sales		305,000	
	Income Summary			305,000
	(To close credit balance accounts)			
31	Income Summary		224,000	
	Sales Discounts			6,000
	Sales Returns and Allowances			8,000
	Cost of Goods Sold			173,000
	Selling Expense			18,000
	Administrative Expense			19,000
	(To close accounts with debit balances)			
31	Income Summary		81,000	
	Unruh, Capital			81,000
	(To transfer net income to capital)			
31	Unruh, Capital		20,000	
	Unruh, Drawing			20,000
	(To close drawing account to capital)			

Ex. 187

Deloy Company gathered the following condensed data for the year ended December 31, 2008:

Cost of goods sold	$ 690,000
Net sales	1,250,000
Administrative expenses	234,000
Interest expense	58,000
Dividend revenue	38,000
Loss from employee strike	233,000
Selling expenses	45,000

Instructions

1. Prepare a single-step income statement for the year ended December 31, 2008.
2. Prepare a multiple-step income statement for the year ended December 31, 2008.

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Solution 187 (25 min.)

1.

DELOY COMPANY
Income Statement
For the Year Ended December 31, 2008

Revenues		
Net sales		$1,250,000
Dividend revenue		38,000
Total revenues		1,288,000
Expenses		
Cost of goods sold	$690,000	
Administrative expenses	234,000	
Loss from employee strike	233,000	
Interest expense	58,000	
Selling expenses	45,000	
Total expenses		1,260,000
Net income		$ 28,000

2.

DELOY COMPANY
Income Statement
For the Year Ended December 31, 2008

Net sales			$1,250,000
Cost of goods sold			690,000
Gross profit			560,000
Operating expenses			
Administrative expenses		$234,000	
Selling expenses		45,000	
Total operating expenses			279,000
Income from operations			281,000
Other revenues and gains			
Dividend revenue		38,000	
Other expenses and losses			
Loss from employee strike	$233,000		
Interest expense	58,000	291,000	253,000
Net income			$ 28,000

Ex. 188

Instructions

State the missing items identified by ?.

1. Gross profit – Operating expenses = ?
2. ? + ? = Operating expenses
3. Sales – (? + ?) = Net sales
4. Income from operations + ? – ? = Net income
5. Net sales – Cost of goods sold = ?
6. Cost of goods sold + Gross profit on sales = ?

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Solution 188 (5 min.)

1. Income from operations (or Net income)
2. Selling expenses, Administrative expenses
3. Sales discounts, Sales returns and allowances
4. Other revenues and gains, Other expenses and losses
5. Gross profit
6. Net sales

Ex. 189

The adjusted trial balance of Notson Company contained the following information:

	Debit	Credit
Sales		$560,000
Sales Returns and Allowances	$ 20,000	
Sales Discounts	7,000	
Cost of Goods Sold	386,000	
Freight-out	2,000	
Advertising Expense	15,000	
Interest Expense	18,000	
Store Salaries Expense	55,000	
Utilities Expense	28,000	
Depreciation Expense	7,000	
Interest Revenue		30,000

Instructions

1. Use the above information to prepare a multiple-step income statement for the year ended December 31, 2008.

2. Prepare a single-step income statement for the year ended December 31, 2008.

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Solution 189 (20 min.)

1.

NOTSON COMPANY
Income Statement
For the Year Ended December 31, 2008

Sales revenues			
Sales			$560,000
Less: Sales returns and allowances		$ 20,000	
Sales discounts		7,000	27,000
Net sales			533,000
Cost of goods sold			386,000
Gross profit			147,000
Operating expenses			
Selling expenses			
Store salaries expense	$55,000		
Advertising expense	15,000		
Freight-out	2,000		
Total selling expenses		72,000	
Administrative expenses			
Utilities expense	28,000		
Depreciation expense	7,000		
Total administrative expenses		35,000	
Total operating expenses			107,000
Income from operations			40,000
Other revenues and gains			
Interest revenue		30,000	
Other expenses and losses			
Interest expense		18,000	12,000
Net income			$ 52,000

2.

NOTSON COMPANY
Income Statement
For the Year Ended December 31, 2008

Revenues		
Net sales		$533,000
Interest revenue		30,000
Total revenues		563,000
Expenses		
Cost of goods sold	$386,000	
Selling expenses	72,000	
Administrative expenses	35,000	
Interest expense	18,000	
Total expenses		511,000
Net income		$ 52,000

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Ex. 190

The following information is available for Miley Company:

Administrative expenses	$ 30,000
Cost of goods sold	245,000
Sales	350,000
Sales returns and allowances	15,000
Selling expenses	50,000

Instructions
Compute each of the following:
(a) Net sales
(b) Gross profit
(c) Income from operations

Solution 190 (6 min.)

(a) Net sales = $335,000 ($350,000 – $15,000)
(b) Gross profit = $90,000 ($335,000 – $245,000)
(c) Income from operations = $10,000 ($90,000 – $30,000 – $50,000)

Ex. 191

The income statement of Miller, Inc. includes the items listed below:

Net sales	$900,000
Gross profit	320,000
Beginning inventory	80,000
Purchase discounts	15,000
Purchase returns and allowances	8,000
Freight-in	10,000
Operating expenses	300,000
Purchases	540,000

Instructions
Use the appropriate items listed above as a basis for determining:
(a) Cost of goods sold.
(b) Cost of goods available for sale.
(c) Ending inventory.

Solution 191 (15 min.)

(a) Net sales – Cost of goods sold = Gross profit
$900,000 – Cost of goods sold = $320,000
Cost of goods sold = $580,000

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Solution 191 (cont.)

(b)	Beginning inventory			$ 80,000
	Purchases		$540,000	
	Less: Purchase discounts	$15,000		
	Purchase returns and allowances	8,000	23,000	
	Net Purchases		517,000	
	Add: Freight-in		10,000	
	Cost of goods purchased			527,000
	Cost of goods available for sale			$607,000

(c) Cost of goods available for sale – Ending inventory = Cost of goods sold
$607,000 – Ending inventory = $580,000
Ending inventory = $27,000

Ex. 192

Three items are missing in each of the following columns and are identified by letter.

Sales	$ (a)	$840,000
Sales returns and allowances	25,000	20,000
Sales discounts	10,000	15,000
Net sales	420,000	(d)
Beginning inventory	(b)	300,000
Cost of goods purchased	220,000	(e)
Ending inventory	170,000	303,000
Cost of goods sold	260,000	555,000
Gross profit	(c)	(f)

Instructions
Calculate the missing amounts and identify them by letter.

[a]Solution 192 (15 min.)

(a)	$455,000	(d)	$805,000
(b)	$210,000	(e)	$558,000
(c)	$160,000	(f)	$250,000

[a]Ex. 193

Morton Supply Company uses a periodic inventory system. During September, the following transactions and events occurred.

Sept. 3 Purchased 80 backpacks at $20 each from Cole Company, terms 2/10, n/30.

Sept. 6 Received credit of $100 for the return of 5 backpacks purchased on Sept. 3 that were defective.

Sept. 9 Sold 15 backpacks for $40 each to Starr Books, terms 2/10, n/30.

Sept. 13 Paid Cole Company in full.

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[a]Ex. 193 (cont.)

Instructions
Journalize the September transactions for Morton Supply Company.

[a]Solution 193 (12 min.)

Sept.	3	Purchases	1,600	
		Accounts Payable		1,600
Sept.	6	Accounts Payable	100	
		Purchase Returns and Allowances		100
Sept.	9	Accounts Receivable	600	
		Sales		600
Sept.	13	Accounts Payable ($1,600 – $100)	1,500	
		Purchase Discounts ($1,500 × .02)		30
		Cash		1,470

[a]Ex. 194

The following information is available for Olson Company:

Beginning inventory	$ 45,000
Ending inventory	70,000
Freight-in	10,000
Purchases	270,000
Purchase returns and allowances	8,000

Instructions
Compute each of the following:
(a) Net purchases
(b) Cost of goods purchased
(c) Cost of goods sold

[a]Solution 194 (6 min.)

(a) Net purchases = $262,000 ($270,000 – $8,000)
(b) Cost of goods purchased = $272,000 ($262,000 + $10,000)
(c) Cost of goods sold = $247,000 ($45,000 + $272,000 – $70,000)

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[a]Ex. 195

The adjusted trial balance of Gorman Music Company appears below. Gorman Music Company prepares monthly financial statements and uses the perpetual inventory method.

Instructions
Complete the worksheet below.

GORMAN MUSIC COMPANY
Worksheet
For the Month Ended April 30, 2008

	Adjusted Trial Balance		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit
Cash	11,000					
Merchandise Inventory	21,000					
Supplies	3,500					
Equipment	80,000					
Accum. Depreciation—Equipment		15,000				
Accounts Payable		20,000				
Gorman, Capital		92,000				
Gorman, Drawing	8,000					
Sales		39,000				
Sales Discounts	2,000					
Cost of Goods Sold	23,000					
Advertising Expense	7,000					
Supplies Expense	6,000					
Depreciation Expense	1,000					
Rent Expense	2,500					
Utility Expense	1,000					
	166,000	166,000				

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[a]Solution 195 (15 min.)

GORMAN MUSIC COMPANY
Worksheet
For the Month Ended April 30, 2008

	Adjusted Trial Balance		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit
Cash	11,000				11,000	
Merchandise Inventory	21,000				21,000	
Supplies	3,500				3,500	
Equipment	80,000				80,000	
Accum. Depreciation—Equipment		15,000				15,000
Accounts Payable		20,000				20,000
Gorman, Capital		92,000				92,000
Gorman, Drawing	8,000				8,000	
Sales		39,000		39,000		
Sales Discounts	2,000		2,000			
Cost of Goods Sold	23,000		23,000			
Advertising Expense	7,000		7,000			
Supplies Expense	6,000		6,000			
Depreciation Expense	1,000		1,000			
Rent Expense	2,500		2,500			
Utility Expense	1,000		1,000			
	166,000	166,000	42,500	39,000	123,500	127,000
Net Loss				3,500	3,500	
			42,500	42,500	127,000	127,000

[a]Ex. 196

Prepare the necessary journal entries to record the following transactions, assuming a periodic inventory system:

(a) Purchased $400,000 of merchandise on account, terms 2/10, n/30.
(b) Returned $40,000 of damaged merchandise for credit.
(c) Paid for the merchandise purchased within 10 days.

[a]Solution 196 (6 min.)

(a)	Purchases	400,000	
	Accounts Payable		400,000
(b)	Accounts Payable	40,000	
	Purchase Returns and Allowances		40,000
(c)	Accounts Payable ($400,000 – $40,000)	360,000	
	Purchase Discounts ($360,000 × .02)		7,200
	Cash ($360,000 – $7,200)		352,800

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COMPLETION STATEMENTS

197. A _____ buys and sells goods rather than performing services to earn a profit.

198. Cost of goods sold is deducted from net sales revenue for the period in order to arrive at _____.

199. Merchandise Inventory on hand can be obtained from detailed inventory records when a _____ inventory system is maintained.

200. The acquisition of merchandise inventory is debited to the _____ account when a perpetual inventory system is used.

201. The freight cost incurred by a seller to deliver goods sold to a customer is called _____.

202. When a customer returns merchandise previously purchased on credit, the entry to record the return requires a debit to the _____ account and a credit to the _____ account.

203. Sales Returns and Allowances and Sales Discounts are both _____ accounts and have _____ normal balances.

204. Every sales transaction should be supported by a _____ that provides written evidence of the sale.

205. Gross profit is obtained by subtracting _____ from _____.

206. Income from operations is determined by subtracting total operating expenses from _____.

Answers to Completion Statements

197. merchandising company
198. gross profit
199. perpetual
200. Merchandise Inventory
201. freight-out
202. Sales Returns and Allowances, Accounts Receivable
203. contra revenue, debit
204. business document
205. cost of goods sold, net sales
206. gross profit

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MATCHING

207. Match the items below by entering the appropriate code letter in the space provided.

A.	Net Sales	F.	FOB shipping point
B.	Sales discounts	G.	Freight-out
C.	Purchase invoice	H.	Gross profit
D.	Periodic inventory system	I.	Selling expenses
E.	FOB destination	J.	Income from operations

____ 1. An incentive to encourage customers to pay their accounts early.

____ 2. Expenses associated with making sales.

____ 3. Freight terms that require the seller to pay the freight cost.

____ 4. Sales less sales returns and allowances and sales discounts.

____ 5. A document that supports each credit purchase.

____ 6. Net sales less cost of goods sold.

____ 7. Freight cost to deliver goods to customers reported as a selling expense.

____ 8. Requires a physical count of goods on hand to compute cost of goods sold.

____ 9. Gross profit less total operating expenses.

____ 10. Freight terms that require the buyer to pay the freight cost.

Answers to Matching

1.	B	6.	H
2.	I	7.	G
3.	E	8.	D
4.	A	9.	J
5.	C	10.	F

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SHORT-ANSWER ESSAY QUESTIONS

S-A E 208

A merchandiser frequently has a need to use contra accounts related to the sale of goods. Identify the contra accounts that have normal debit balances and explain why they are not considered expenses.

Solution 208

The contra accounts that have normal debit balances are Sales Discounts and Sales Returns and Allowances. These accounts have debit balances but are not expenses because they are adjustments of sales, not operating, selling, or administrative expenses. They are an adjustment of the inflow from sale of goods, rather than a cost used to help earn revenue.

S-A E 209

In a single-step income statement, all data are classified under two categories: (1) Revenues, or (2) Expenses. If the income statement is recast in a multiple-step format, what additional information or intermediate components of income would be presented?

Solution 209

The items reported in a multiple-step income statement that are not reported in a single-step income statement are: gross revenues as well as net revenues, gross profit, detailed selling and administrative expenses, income from operations, and other revenues and gains, and other expenses and losses.

S-A-E 210

You are at a company picnic and the company president starts a conversation with you. The president says “Since we use the perpetual inventory system, there is no reason to take a physical count of our inventory.” What is your response to the president’s remarks?

Solution 210

You have made a very good observation, but human and mechanical shortcomings need to be considered. The perpetual inventory system maintains detailed records of each inventory purchase, sale and return. This does not mean that everything has been correctly recorded. Some possible causes of discrepancies between the goods on hand and the amounts shown in the accounting system include (1) inventory items were coded incorrectly, (2) cashiers failed to properly scan inventory items, (3) inventory items were damaged or stolen, or (4) goods returned by customers were not properly entered in the accounting records. It is necessary to reconcile amounts in the ledger to actual quantities. Discrepancies should be properly accounted for and investigated.

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S-A E 211

The income statement for a merchandising company presents five amounts not shown on a service company's income statement. Identify and briefly explain the five unique amounts.

Solution 211

The items reported for a merchandising company that are not reported for a service company are sales, sales returns and allowances, sales discounts, cost of goods sold, and gross profit. Sales, sales returns and allowances, and sales discounts comprise net sales. Cost of goods sold represents the total cost of merchandise sold during the period. Gross profit is the excess of net sales over the cost of goods sold.

S-A E 212 (Ethics)

Feeney Corporation manufactures electronic components for use in many consumer products. Their raw materials are purchased literally from all over the world. Depending on the country involved, purchase terms vary widely. Some suppliers, for example, require full prepayment, while others are content to receive payment within six months of receipt of the goods.

Because of this situation, Feeney never closes its books until at least ten days after month end. In this way, it can sort out ownership of goods in transit, and document which goods were received by month end, and which were not.

Deb Rush, a new accountant, was asked to record about $50,000 in inventory as having been received before month end. She argued that the shipping documents clearly showed that the goods were actually received on the 8th of the current month. Her boss, busy with month-end reports, curtly tells Deb to check the shipping terms. She did so, and found the notation "FOB shipper's dock" on the document. She hadn't seen that particular notation before, but she reasoned that if the selling company considered it shipped when it reached their dock, Feeney should consider it received when it reached Feeney's dock. She did not record the sale until after month end.

Required:

1. Why are accountants concerned with the timing in the recording of purchases?
2. Was there a violation of ethical standards here? Explain.

Solution 212

1. Accountants are concerned with timing because they seek to make sure that sales are recorded in the proper period so that revenues and expenses are properly matched; to make sure that goods recorded as owned by the company actually are owned as of the last date of the period; and to make certain that sales recorded have been actually completed.
2. The only ethical principle that may be involved is one of competence. Deb does not appear to know enough about reading shipping documents to make a proper determination of ownership. The goods were owned by Feeney as soon as they left the shipper's dock. Otherwise, the goods would have been owned by no one while in transit. It does not appear that Deb compromised her integrity or that she sought some sort of gain from her mistake. It does seem likely that she should have known better how to interpret the shipping documents.

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S-A E 213 (Communication)

Anne Stine and Rita Lott, two salespersons in adjoining territories, regularly compete for bonuses. During the last month, their dollar volume of sales, on which the bonuses are based, was nearly equal. On the last day of the month, both made a large sale. Both orders were shipped on the last day of the month and both were received by the customer on the fifth of the following month. Anne's sale was FOB shipping point, and Rita's was FOB destination. The company "counts" sales for purposes of calculating bonuses on the date that ownership passes to the purchaser. Anne's sale was therefore counted in her monthly total of sales, Rita's was not. Rita is quite upset. She has asked you to just include it, or to take Anne's off as well. She also has told you that you are being unethical for allowing Anne to get a bonus just for choosing a particular shipping method.

Write a memo to Rita. Explain your position.

Solution 213

M E M O

TO: Rita Lott

FROM: Martha King, Accounting

RE: Sales Bonuses

DATE: June 15, 200x

As you know, sales bonuses are based upon the revenue generated by each salesperson. Your total sales for the month was $100,000. This total does not include the $20,000 sale you made May 31 because of the policy to count sales on the date that title transfers to the customer. I can understand your being upset that this large sale was not counted, while someone else's sale on the same date was counted, because of the shipping terms. However, I am sure you agree that the policy is not unethical, but it is instead more fair than our trying to make a determination in the midst of month-end closing.

I do understand your disappointment, but this sale does count in June—and it just may make the difference in June's bonus. Please call me if I can be of further help.

(signature)

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CHAPTER 6

INVENTORIES

SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
True-False Statements														
1.	1	C	8.	2	C	15.	3	K	[a]22.	7	C	[sg]29.	3	C
2.	1	C	9.	2	C	16.	3	C	[a]23.	7	K	[sg]30.	4	K
3.	1	K	10.	2	C	17.	4	K	[a]24.	8	K	[sg]31.	5	K
4.	1	K	11.	2	K	18.	4	K	[a]25.	8	K	[sg,a]32.	7	K
5.	1	K	12.	3	K	19.	5	C	[sg]26.	1	C	[sg,a]33.	8	K
6.	2	K	13.	3	K	20.	5	K	[sg]27.	2	K			
7.	2	K	14.	3	K	21.	6	C	[sg]28.	2	K			
Multiple Choice Questions														
34.	1	K	58.	2	C	82.	3	AP	106.	3	K	[a]130.	7	AP
35.	1	K	59.	2	K	83.	3	AP	107.	3	C	[a]131.	7	C
36.	1	K	60.	2	K	84.	2	AP	108.	3	AP	[a]132.	7	C
37.	1	K	61.	2	AP	85.	2	AP	109.	3	AN	[a]133.	7	AP
38.	1	K	62.	2	C	86.	2	AP	110.	3	AN	[a]134.	8	C
39.	1	K	63.	2	K	87.	2	AP	111.	3	K	[a]135.	8	C
40.	1	C	64.	2	K	88.	2	AP	112.	4	K	[a]136.	8	C
41.	1	C	65.	2	K	89.	2	AP	113.	4	K	[a]137.	8	AP
42.	1	C	66.	2	K	90.	2	AP	114.	4	K	[a]138.	8	AP
43.	1	K	67.	2	C	91.	2	AP	115.	4	K	[a]139.	8	AP
44.	1	C	68.	2	C	92.	2	AP	116.	4	K	[st]140.	1	K
45.	1	C	69.	2	K	93.	3	AP	117.	4	AP	[sg]141.	1	K
46.	1	K	70.	2	K	94.	3	AP	118.	5	C	[st]142.	2	K
47.	1	K	71.	2	AP	95.	3	AP	119.	5	AN	[sg]143.	2	AP
48.	2	K	72.	2	AP	96.	3	AP	120.	5	AN	[st]144.	3	K
49.	2	C	73.	3	AP	97.	3	K	121.	5	AN	[sg]145.	3	C
50.	2	C	74.	2	AP	98.	3	C	122.	5	C	[st]146.	4	K
51.	2	AP	75.	2	AP	99.	3	C	123.	6	K	[sg]147.	5	AN
52.	2	K	76.	2	AP	100.	3	C	124.	6	K	[st]148.	6	K
53.	2	AP	77.	3	AP	101.	3	C	125.	6	AP	[sg,a]149.	8	AP
54.	2	AP	78.	2	AP	102.	3	K	126.	6	AP			
55.	2	AP	79.	2	AP	103.	3	K	127.	6	AP			
56.	2	AP	80.	2	AP	104.	3	C	[a]128.	7	AP			
57.	2	AP	81.	2	AP	105.	3	K	[a]129.	7	AP			
Brief Exercises														
150.	1	C	152.	2	AP	154.	2	AP	156.	2	K	158.	5	C
151.	2	AP	153.	2	AP	155.	2	AP	157.	4	AP	159.	6	AP

[sg] This question also appears in the Study Guide.
[st] This question also appears in a self-test at the student companion website.
[a] This question covers a topic in an appendix to the chapter.

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SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Exercises													
160.	2	AP	165.	3	AP	170.	5	AP	[a]175.	7	AP	[a]180.	8	AP
161.	2	AP	166.	3	E	171.	5	AN	[a]176.	7	AP			
162.	2	AN	167.	4	AN	172.	5	AN	[a]177.	8	AP			
163.	2	AP	168.	4	AP	173.	5	AN	[a]178.	8	AP			
164.	2	AP	169.	4	AP	174.	6	AP	[a]179.	8	AP			
Completion Statements														
181.	1	K	183.	2	K	185.	2	K	187.	3	K	189.	6	
182.	1	K	184.	2	K	186.	3	K	188.	4	K	[a]190.	8	

SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Study Objective 1													
1.	TF	5.	TF	36.	MC	40.	MC	44.	MC	140.	MC	182.	C
2.	TF	26.	TF	37.	MC	41.	MC	45.	MC	141.	MC		
3.	TF	34.	MC	38.	MC	42.	MC	46.	MC	150.	BE		
4.	TF	35.	MC	39.	MC	43.	MC	47.	MC	181.	C		
Study Objective 2													
6.	TF	50.	MC	60.	MC	70.	MC	84.	MC	143.	MC	163.	Ex
7.	TF	51.	MC	61.	MC	71.	MC	85.	MC	151.	BE	164.	Ex
8.	TF	52.	MC	62.	MC	72.	MC	86.	MC	152.	BE	183.	C
9.	TF	53.	MC	63.	MC	74.	MC	87.	MC	153.	BE	184.	C
10.	TF	54.	MC	64.	MC	75.	MC	88.	MC	154.	BE	185.	C
11.	TF	55.	MC	65.	MC	76.	MC	89.	MC	155.	BE		
27.	TF	56.	MC	66.	MC	78.	MC	90.	MC	156.	BE		
28.	TF	57.	MC	67.	MC	79.	MC	91.	MC	160.	Ex		
48.	MC	58.	MC	68.	MC	80.	MC	92.	MC	161.	Ex		
49.	MC	59.	MC	69.	MC	81.	MC	142.	MC	162.	Ex		
Study Objective 3													
12.	TF	29.	TF	93.	MC	98.	MC	103.	MC	108.	MC	145.	MC
13.	TF	73.	MC	94.	MC	99.	MC	104.	MC	109.	MC	165.	Ex
14.	TF	77.	MC	95.	MC	100.	MC	105.	MC	110.	MC	166.	Ex
15.	TF	82.	MC	96.	MC	101.	MC	106.	MC	111.	MC	186.	C
16.	TF	83.	MC	97.	MC	102.	MC	107.	MC	144.	MC	187.	C
Study Objective 4													
17.	TF	112.	MC	115.	MC	146.	MC	168.	Ex				
18.	TF	113.	MC	116.	MC	157.	BE	169.	Ex				
30.	TF	114.	MC	117.	MC	167.	Ex	188.	C				

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SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Study Objective 5											
19.	TF	31.	TF	119.	MC	121.	MC	147.	MC	170.	Ex	172.	Ex
20.	TF	118.	MC	120.	MC	122.	MC	158.	BE	171.	Ex	173.	Ex
Study Objective 6											
21.	TF	124.	MC	126.	MC	148.	MC	174.	Ex				
123.	MC	125.	MC	127.	MC	159.	BE	189.	C				
Study Objective [a]7											
[a]22.	TF	[a]32.	TF	[a]129.	MC	[a]131.	MC	[a]133.	MC	[a]176.	Ex		
[a]23.	TF	[a]128.	MC	[a]130.	MC	[a]132.	MC	[a]175.	Ex				
Study Objective [a]8											
[a]24.	TF	[a]134.	MC	[a]137.	MC	[a]149.	MC	[a]179.	Ex				
[a]25.	TF	[a]135.	MC	[a]138.	MC	[a]177.	Ex	[a]180.	Ex				
[a]33.	TF	[a]136.	MC	[a]139.	MC	[a]178.	Ex	[a]190.	C				

Note: TF = True-False BE = Brief Exercise C = Completion
MC = Multiple Choice Ex = Exercise

The chapter also contains one set of ten Matching questions and six Short-Answer Essay questions.

CHAPTER STUDY OBJECTIVES

1. ***Describe the steps in determining inventory quantities.*** The steps are (1) taking a physical inventory of goods on hand and (2) determining the ownership of goods in transit.
2. ***Explain the accounting for inventories, and apply the inventory cost flow methods.*** The primary basis of accounting for inventories is cost. Cost includes all expenditures necessary to acquire goods and place them in condition ready for sale. Cost of goods available for sale includes (a) cost of beginning inventory and (b) the cost of goods purchased. The inventory cost flow methods are: specific identification, and three assumed cost flow methods—FIFO, LIFO, and average-cost.
3. ***Explain the financial effects of the inventory cost flow assumptions.*** Companies may allocate the cost of goods available for sale to cost of goods sold and ending inventory by specific identification or by a method based on an assumed cost flow. When prices are rising, the first-in, first-out (FIFO) method results in lower cost of goods sold and higher net income than the average-cost and the last-in, first out (LIFO) methods. The reverse is true when prices are falling. In the balance sheet, FIFO results in an ending inventory that is closest to current value, whereas the inventory under LIFO is the farthest from current value. LIFO results in the lowest income taxes (because of lower taxable income).
4. ***Explain the lower-of-cost-or-market basis of accounting for inventories.*** Companies may use the lower-of-cost-or-market (LCM) basis when the current replacement cost (market) is less than cost. Under LCM, companies recognize the loss in the period in which the price decline occurs.

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5. ***Indicate the effects of inventory errors on the financial statements.*** In the income statement of the current year: (a) An error in beginning inventory will have a reverse effect on net income (overstatement of inventory results in understatement of net income, and vice versa). (b) An error in ending inventory will have a similar effect on net income (overstatement of inventory results in overstatement of net income). If ending inventory errors are not corrected in the following period, their effect on net income for that period is reversed, and total net income for the two years will be correct. In the balance sheet, ending inventory errors will have the same effect on total assets and total stockholders' equity and no effect on liabilities.

6. ***Compute and interpret the inventory turnover ratio.*** The inventory turnover ratio is calculated as cost of goods sold divided by average inventory. It can be converted to average days in inventory by dividing 365 days by the inventory turnover ratio.

[a]7. ***Apply the inventory cost flow methods to perpetual inventory records.*** Under FIFO and a perpetual inventory system, companies charge to cost of goods sold the cost of the earliest goods on hand prior to each sale. Under LIFO and a perpetual system, companies charge to cost of goods sold the cost of the most recent purchase prior to sale. Under the moving-average (average cost) method and a perpetual system, companies compute a new average cost after each purchase.

[a]8. ***Describe the two methods of estimating inventories.*** The two methods of estimating inventories are the gross profit method and the retail inventory method. Under the gross profit method, companies apply a gross profit rate to net sales to determine estimated cost of goods sold. They then subtract estimated cost of goods sold from cost of goods available for sale to determine the estimated cost of the ending inventory. Under the retail inventory method, companies compute a cost-to-retail ratio by dividing the cost of goods available for sale by the retail value of the goods available for sale. They then apply this ratio to the ending inventory at retail to determine the estimated cost of the ending inventory.

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TRUE-FALSE STATEMENTS

1. Transactions that affect inventories on hand have an effect on both the balance sheet and the income statement.

2. The more inventory a company has in stock, the greater the company's profit.

3. Raw materials inventories are the goods that a manufacturer has completed and are ready to be sold to customers.

4. Goods that have been purchased FOB destination but are in transit, should be excluded from a physical count of goods.

5. Goods out on consignment should be included in the inventory of the consignor.

6. The specific identification method of costing inventories tracks the actual physical flow of the goods available for sale.

7. Management may choose any inventory costing method it desires as long as the cost flow assumption chosen is consistent with the physical movement of goods in the company.

8. The first-in, first-out (FIFO) inventory method results in an ending inventory valued at the most recent cost.

9. The matching principle requires that the cost of goods sold be matched against the ending merchandise inventory in order to determine income.

10. The specific identification method of inventory valuation is desirable when a company sells a large number of low-unit cost items.

11. If a company has no beginning inventory and the unit cost of inventory items does not change during the year, the value assigned to the ending inventory will be the same under LIFO and average cost flow assumptions.

12. If the unit price of inventory is increasing during a period, a company using the LIFO inventory method will show less gross profit for the period, than if it had used the FIFO inventory method.

13. If a company has no beginning inventory and the unit price of inventory is increasing during a period, the cost of goods available for sale during the period will be the same under the LIFO and FIFO inventory methods.

14. A company may use more than one inventory costing method concurrently.

15. Use of the LIFO inventory valuation method enables a company to report paper or phantom profits.

16. If a company changes its inventory valuation method, the effect of the change on net income should be disclosed in the financial statements.

17. Under the lower-of-cost-or-market basis, market is defined as current replacement cost.

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18. Accountants believe that the write down from cost to market should *not* be made in the period in which the price decline occurs.

19. An error that overstates the ending inventory will also cause net income for the period to be overstated.

20. If inventories are valued using the LIFO cost assumption, they should *not* be classified as a current asset on the balance sheet.

21. Inventory turnover is calculated as cost of goods sold divided by ending inventory.

[a]22. If a company uses the FIFO cost assumption, the cost of goods sold for the period will be the same under a perpetual or periodic inventory system.

[a]23. In applying the LIFO assumption in a perpetual inventory system, the cost of the units most recently purchased prior to sale is allocated first to the units sold.

[a]24. Under generally accepted accounting principles, management has the choice of physically counting inventory on hand at the end of the year or using the gross profit method to estimate the ending inventory.

[a]25. The retail inventory method requires a company to value its inventory on the balance sheet at retail prices.

Additional True-False Questions

26. Finished goods are a classification of inventory for a manufacturer that are completed and ready for sale.

27. Under the FIFO method, the costs of the earliest units purchased are the first charged to cost of goods sold.

28. The pool of inventory costs consists of the beginning inventory plus the cost of goods purchased.

29. In a period of falling prices, the LIFO method results in a lower cost of goods sold than the FIFO method.

30. The lower-of-cost-or-market basis is an example of the accounting concept of conservatism.

31. Inventories are reported in the current assets section of the balance sheet immediately below receivables.

[a]32. In a perpetual inventory system, the cost of goods sold under the FIFO method is based on the cost of the latest goods on hand during the period.

[a]33. The gross profit method is based on the assumption that the rate of gross profit remains constant from one year to the next.

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Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	T	6.	T	11.	T	16.	T	21.	F	26.	T	31.	T
2.	F	7.	F	12.	T	17.	T	[a]22.	T	27.	T	[a]32.	F
3.	F	8.	T	13.	T	18.	F	[a]23.	T	28.	T	[a]33.	T
4.	T	9.	F	14.	T	19.	T	[a]24.	F	29.	T		
5.	T	10.	F	15.	F	20.	F	[a]25.	F	30.	T		

MULTIPLE CHOICE QUESTIONS

34. Inventories affect
    a. only the balance sheet.
    b. only the income statement.
    c. both the balance sheet and the income statement.
    d. neither the balance sheet nor the income statement.

35. Merchandise inventory is
    a. reported under the classification of Property, Plant, and Equipment on the balance sheet.
    b. often reported as a miscellaneous expense on the income statement.
    c. reported as a current asset on the balance sheet.
    d. generally valued at the price for which the goods can be sold.

36. Items waiting to be used in production are considered to be
    a. raw materials.
    b. work in progress.
    c. finished goods.
    d. merchandise inventory.

37. In a manufacturing business, inventory that is ready for sale is called
    a. raw materials inventory.
    b. work in process inventory.
    c. finished goods inventory.
    d. store supplies inventory.

38. The factor which determines whether or not goods should be included in a physical count of inventory is
    a. physical possession.
    b. legal title.
    c. management's judgment.
    d. whether or not the purchase price has been paid.

39. If goods in transit are shipped FOB destination
    a. the seller has legal title to the goods until they are delivered.
    b. the buyer has legal title to the goods until they are delivered.
    c. the transportation company has legal title to the goods while the goods are in transit.
    d. no one has legal title to the goods until they are delivered.

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40. An auto manufacturer would classify vehicles in various stages of production as
    a. finished goods.
    b. merchandise inventory.
    c. raw materials.
    d. work in process.

41. Independent internal verification of the physical inventory process occurs when
    a. the employee is required to count all items twice for sake of verification.
    b. the items counted are compared to the inventory account balance.
    c. a second employee counts the inventory and compares the result to the count made by the first employee.
    d. all prenumbered inventory tags are accounted for.

42. An employee assigned to counting computer monitors in boxes should
    a. estimate the number if there is a large quantity to be counted.
    b. read each box and rely on the box description for the contents.
    c. determine that the box contains a monitor.
    d. rely on the warehouse records of the number of computer monitors.

43. After the physical inventory is completed,
    a. quantities are listed on inventory summary sheets.
    b. quantities are entered into various general ledger inventory accounts.
    c. the accuracy of the inventory summary sheets is checked by the person listing the quantities on the sheets.
    d. unit costs are determined by dividing the quantities on the summary sheets by the total inventory costs.

44. A recommended internal control procedure for taking physical inventories is that the counting should be done by employees who do not have custodial responsibility for the inventory. This is an example of what type of internal control procedure?
    a. Establishment of responsibility
    b. Documentation procedure
    c. Independent internal verification
    d. Segregation of duties

45. Westcoe Company's goods in transit at December 31 include:

sales made	purchases made
(1) FOB destination	(3) FOB destination
(2) FOB shipping point	(4) FOB shipping point

    Which items should be included in Westcoe's inventory at December 31?
    a. (2) and (3)
    b. (1) and (4)
    c. (1) and (3)
    d. (2) and (4)

46. The term "FOB" denotes
    a. free on board.
    b. freight on board.
    c. free only (to) buyer.
    d. freight charge on buyer.

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47. Under a consignment arrangement, the
    a. consignor has ownership until goods are sold to a customer.
    b. consignor has ownership until goods are shipped to the consignee.
    c. consignee has ownership when the goods are in the consignee's possession.
    d. consigned goods are included in the inventory of the consignee.

48. Inventoriable costs include all of the following except the
    a. freight costs incurred when buying inventory.
    b. costs of the purchasing and warehousing departments.
    c. cost of the beginning inventory.
    d. cost of goods purchased.

49. Beginning inventory plus the cost of goods purchased equals
    a. cost of goods sold.
    b. cost of goods available for sale.
    c. net purchases.
    d. total goods purchased.

50. Cost of goods sold is computed from the following equation:
    a. beginning inventory – cost of goods purchased + ending inventory.
    b. sales – cost of goods purchased + beginning inventory – ending inventory.
    c. sales + gross profit – ending inventory + beginning inventory.
    d. beginning inventory + cost of goods purchased – ending inventory

51. A company just starting in business purchased three merchandise inventory items at the following prices. First purchase $80; Second purchase $95; Third purchase $85. If the company sold two units for a total of $240 and used FIFO costing, the gross profit for the period would be
    a. $65.
    b. $75.
    c. $60.
    d. $50.

52. The LIFO inventory method assumes that the cost of the latest units purchased are
    a. the last to be allocated to cost of goods sold.
    b. the first to be allocated to ending inventory.
    c. the first to be allocated to cost of goods sold.
    d. not allocated to cost of goods sold or ending inventory.

Use the following information for questions 53–56.

A company just starting business made the following four inventory purchases in June:

June 1	150 units	$ 390
June 10	200 units	585
June 15	200 units	630
June 28	150 units	495
		$2,100

A physical count of merchandise inventory on June 30 reveals that there are 200 units on hand.

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53. Using the LIFO inventory method, the value of the ending inventory on June 30 is
    a. $536.
    b. $653.
    c. $1,447.
    d. $1,564.

54. Using the FIFO inventory method, the amount allocated to cost of goods sold for June is
    a. $653.
    b. $1,272.
    c. $1,447.
    d. $1,564.

55. Using the average-cost method, the amount allocated to the ending inventory on June 30 is
    a. $2,100.
    b. $1,500.
    c. $575.
    d. $600.

56. The inventory method which results in the highest gross profit for June is
    a. the FIFO method.
    b. the LIFO method.
    c. the weighted average unit cost method.
    d. not determinable.

57. A company purchased inventory as follows:

    200 units at $10
    300 units at $12

    The average unit cost for inventory is
    a. $10.00.
    b. $11.00.
    c. $11.20.
    d. $12.00.

58. Which of the following items will increase inventoriable costs for the buyer of goods?
    a. Purchase returns and allowances granted by the seller
    b. Purchase discounts taken by the purchaser
    c. Freight charges paid by the seller
    d. Freight charges paid by the purchaser

59. Inventoriable costs may be thought of as a pool of costs consisting of which two elements?
    a. The cost of beginning inventory and the cost of ending inventory
    b. The cost of ending inventory and the cost of goods purchased during the year
    c. The cost of beginning inventory and the cost of goods purchased during the year
    d. The difference between the costs of goods purchased and the cost of goods sold during the year

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60. The cost of goods available for sale is allocated between
    a. beginning inventory and ending inventory.
    b. beginning inventory and cost of goods on hand.
    c. ending inventory and cost of goods sold.
    d. beginning inventory and cost of goods purchased.

61. Sam's Used Cars uses the specific identification method of costing inventory. During March, Sam purchased three cars for $6,000, $7,500, and $9,750, respectively. During March, two cars are sold for $9,000 each. Sam determines that at March 31, the $9,750 car is still on hand. What is Sam's gross profit for March?
    a. $5,250.
    b. $4,500.
    c. $750.
    d. $8,250.

62. Of the following companies, which one would *not* likely employ the specific identification method for inventory costing?
    a. Music store specializing in organ sales
    b. Farm implement dealership
    c. Antique shop
    d. Hardware store

63. A problem with the specific identification method is that
    a. inventories can be reported at actual costs.
    b. management can manipulate income.
    c. matching is not achieved.
    d. the lower-of-cost-or-market basis cannot be applied.

64. The selection of an appropriate inventory cost flow assumption for an individual company is made by
    a. the external auditors.
    b. the SEC.
    c. the internal auditors.
    d. management.

65. Which one of the following inventory methods is often impractical to use?
    a. Specific identification
    b. LIFO
    c. FIFO
    d. Average cost

66. Which of the following is *not* a common cost flow assumption used in costing inventory?
    a. First-in, first-out
    b. Middle-in, first-out
    c. Last-in, first-out
    d. Average cost

67. The accounting principle that requires that the cost flow assumption be consistent with the physical movement of goods is
    a. called the matching principle.
    b. called the consistency principle.
    c. nonexistent; that is, there is no accounting requirement.
    d. called the physical flow assumption.

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68. Which of the following statements is true regarding inventory cost flow assumptions?
    a. A company may use more than one costing method concurrently.
    b. A company must comply with the method specified by industry standards.
    c. A company must use the same method for domestic and foreign operations.
    d. A company may never change its inventory costing method once it has chosen a method.

69. Which of the following statements is correct with respect to inventories?
    a. The FIFO method assumes that the costs of the earliest goods acquired are the last to be sold.
    b. It is generally good business management to sell the most recently acquired goods first.
    c. Under FIFO, the ending inventory is based on the latest units purchased.
    d. FIFO seldom coincides with the actual physical flow of inventory.

70. The cost of goods available for sale is allocated to the cost of goods sold and the
    a. beginning inventory.
    b. ending inventory.
    c. cost of goods purchased.
    d. gross profit.

Use the following information for questions 71–73.

At May 1, 2008, Treeline Company had beginning inventory consisting of 100 units with a unit cost of $7. During May, the company purchased inventory as follows:

200 units at $7
300 units at $8

The company sold 500 units during the month for $12 per unit. Treeline uses the average cost method.

71. The average cost per unit for May is
    a. $7.00.
    b. $7.50.
    c. $7.60.
    d. $8.00.

72. The value of Treeline's inventory at May 31, 2008 is
    a. $700.
    b. $750.
    c. $800.
    d. $4,500.

73. Treeline's gross profit for the month of May is
    a. $2,250.
    b. $3,750.
    c. $4,500.
    d. $6,000.

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Use the following information for questions 74–77.

Tier II Company uses a periodic inventory system. Details for the inventory account for the month of January, 2008 are as follows:

	Units	Per unit price	Total
Balance, 1/1/08	200	$5.00	$1,000
Purchase, 1/15/08	100	5.30	530
Purchase, 1/28/08	100	5.50	550

An end of the month (1/31/08) inventory showed that 120 units were on hand.

74. How many units did the company sell during January, 2008?
    a. 80
    b. 120
    c. 200
    d. 280

75. If the company uses FIFO, what is the value of the ending inventory?
    a. $520
    b. $600
    c. $656
    d. $1,424

76. If the company uses LIFO, what is the value of the ending inventory?
    a. $520
    b. $600
    c. $656
    d. $1,480

77. If the company uses FIFO and sells the units for $10 each, what is the gross profit for the month?
    a. $1,376
    b. $1,424
    c. $2,800
    d. $3,000

Use the following information for questions 78-83.

W.B. Reindeer Company's inventory records show the following data:

		Units	Unit Cost
Inventory, January 1		5,000	$9.00
Purchases:	June 18	4,500	8.00
	November 8	3,000	7.00

A physical inventory on December 31 shows 2,000 units on hand. W.B. Reindeer sells the units for $12 each. The company has an effective tax rate of 20%. Reindeer uses the periodic inventory method.

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78. Under the FIFO method, the December 31 inventory is valued at
    a. $14,000.
    b. $14,500.
    c. $15,000.
    d. $18,000.

79. What is the cost of goods available for sale?
    a. $21,000
    b. $36,000
    c. $45,000
    d. $102,000

80. Under the LIFO method, cost of goods sold is
    a. $10,500.
    b. $18,000.
    c. $84,000.
    d. $88,000.

81. The weighted-average cost per unit is
    a. $7.50.
    b. $8.00.
    c. $8.16.
    d. $8.75.

82. If the company uses FIFO, what is the gross profit for the period?
    a. $2,000
    b. $10,000
    c. $21,000
    d. $38,000

83. What is the difference in taxes if LIFO rather than FIFO is used?
    a. $800 additional taxes
    b. $3,200 tax savings
    c. $4,000 tax savings
    d. $4,000 additional taxes

Use the following inventory information for questions 84–86.

July	1	Beginning Inventory	20 units at $19	$ 380
	7	Purchases	70 units at $20	1,400
	22	Purchases	10 units at $22	220
				$2,000

A physical count of merchandise inventory on July 31 reveals that there are 30 units on hand.

84. Using the average-cost method, the value of ending inventory is
    a. $580.
    b. $600.
    c. $610.
    d. $620.

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85. Using the FIFO inventory method, the amount allocated to cost of goods sold for July is
    a. $580.
    b. $620.
    c. $1,380.
    d. $1,420.

86. Using the LIFO inventory method, the amount allocated to cost of goods sold for July is
    a. $580.
    b. $620.
    c. $1,380.
    d. $1,420.

Use the following information for questions 87–88.

July	1	Beginning Inventory	10 units at $120
	5	Purchases	60 units at $112
	14	Sale	40 units
	21	Purchases	30 units at $115
	30	Sale	28 units

87. Assuming that a periodic inventory system is used, what is the amount allocated to ending inventory on a LIFO basis?
    a. $3,664
    b. $3,674
    c. $7,696
    d. $7,706

88. Assuming that a periodic inventory system is used, what is the amount allocated to ending inventory on a FIFO basis?
    a. $3,644
    b. $3,674
    c. $7,696
    d. $7,706

Use the following information for questions 89–92.

Nov.	1	Inventory	15 units @ $8.00
	8	Purchase	60 units @ $8.60
	17	Purchase	30 units @ $8.40
	25	Purchase	45 units @ $8.80

A physical count of merchandise inventory on November 30 reveals that there are 50 units on hand. Assume a periodic inventory system is used.

89. Cost of goods sold under the average-cost method is
    a. $860.
    b. $856.
    c. $845.
    d. $800.

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90. Ending inventory under FIFO is
    a. $438.
    b. $846.
    c. $421.
    d. $863.

91. Ending inventory under LIFO is
    a. $438.
    b. $421.
    c. $846.
    d. $863.

92. Assuming that the specific identification method is used and that ending inventory consists of 15 units from each of the three purchases and 5 units from the November 1 inventory, cost of goods sold is
    a. $427.
    b. $857.
    c. $854.
    d. $836.

Use the following information for questions 93–96.

Ace Industries had the following inventory transactions occur during 2008:

		Units	Cost/unit
2/1/08	Purchase	18	$45
3/14/08	Purchase	31	$47
5/1/08	Purchase	22	$49

The company sold 51 units at $63 each and has a tax rate of 30%.

93. Assuming that a periodic inventory system is used, what is the company's gross profit using LIFO? (rounded to whole dollars)
    a. $2,441
    b. $2,365
    c. $848
    d. $772

94. Assuming that a periodic inventory system is used, what is the company's after-tax income using LIFO? (rounded to whole dollars)
    a. $772
    b. $848
    c. $594
    d. $540

95. Assuming that a periodic inventory system is used, what is the company's gross profit using FIFO? (rounded to whole dollars)
    a. $2,441
    b. $2,365
    c. $848
    d. $772

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96. Assuming that a periodic inventory system is used, what is the company's after-tax income using FIFO? (rounded to whole dollars)
    a. $772
    b. $848
    c. $594
    d. $540

97. Companies adopt different cost flow methods for each of the following reasons *except*
    a. balance sheet effects.
    b. cash flow effects.
    c. income statements effects.
    d. tax effects.

98. In periods of rising prices, the inventory method which results in the inventory value on the balance sheet that is closest to current cost is the
    a. FIFO method.
    b. LIFO method.
    c. average-cost method.
    d. tax method.

99. Two companies report the same cost of goods available for sale but each employs a different inventory costing method. If the price of goods has increased during the period, then the company using
    a. LIFO will have the highest ending inventory.
    b. FIFO will have the highest cost of good sold.
    c. FIFO will have the highest ending inventory.
    d. LIFO will have the lowest cost of goods sold.

100. If companies have identical inventoriable costs but use different inventory flow assumptions when the price of goods have *not* been constant, then the
    a. cost of goods sold of the companies will be identical.
    b. cost of goods available for sale of the companies will be identical.
    c. ending inventory of the companies will be identical.
    d. net income of the companies will be identical.

101. In a period of increasing prices, which inventory flow assumption will result in the lowest amount of income tax expense?
    a. FIFO
    b. LIFO
    c. Average Cost
    d. Income tax expense for the period will be the same under all assumptions.

102. The specific identification method of costing inventories is used when the
    a. physical flow of units cannot be determined.
    b. company sells large quantities of relatively low cost homogeneous items.
    c. company sells large quantities of relatively low cost heterogeneous items.
    d. company sells a limited quantity of high-unit cost items.

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103. The specific identification method of inventory costing
   a. always maximizes a company's net income.
   b. always minimizes a company's net income.
   c. has no effect on a company's net income.
   d. may enable management to manipulate net income.

104. The managers of Teng Company receive performance bonuses based on the net income of the firm. Which inventory costing method are they likely to favor in periods of declining prices?
   a. LIFO
   b. Average Cost
   c. FIFO
   d. Physical inventory method

105. In periods of inflation, phantom or paper profits may be reported as a result of using the
   a. perpetual inventory method.
   b. FIFO costing assumption.
   c. LIFO costing assumption.
   d. periodic inventory method.

106. Selection of an inventory costing method by management does *not* usually depend on
   a. the fiscal year end.
   b. income statement effects.
   c. balance sheet effects.
   d. tax effects.

107. In a period of rising prices, the costs allocated to ending inventory may be understated in the
   a. average-cost method.
   b. FIFO method.
   c. gross profit method.
   d. LIFO method.

108. The accountant at Kline Company is figuring out the difference in income taxes the company will pay depending on the choice of either FIFO or LIFO as an inventory costing method. The tax rate is 30% and the FIFO method will result in income before taxes of $5,460. The LIFO method will result in income before taxes of $4,935. What is the difference in tax that would be paid between the two methods?
   a. $525.
   b. $225.
   c. $158.
   d. Cannot be determined from the information provided.

109. The accountant at Carey Company has determined that income before income taxes amounted to $6,750 using the FIFO costing assumption. If the income tax rate is 30% and the amount of income taxes paid would be $225 greater if the LIFO assumption were used, what would be the amount of income before taxes under the LIFO assumption?
   a. $6,975
   b. $7,500
   c. $6,090
   d. $6,525

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110. The manager of Wyatt Company is given a bonus based on income before income taxes. Net income, after taxes, is $5,600 for FIFO and $5,040 for LIFO. The tax rate is 30%. The bonus rate is 20%. How much higher is the manager's bonus if FIFO is adopted instead of LIFO?
    a. $200
    b. $300
    c. $160
    d. $560

111. The consistent application of an inventory costing method is essential for
    a. conservatism.
    b. accuracy.
    c. comparability.
    d. efficiency.

112. Which costing method cannot be used to determine the cost of inventory items before lower-of-cost-or-market is applied?
    a. Specific identification
    b. FIFO
    c. LIFO
    d. All of these methods can be used.

113. Inventory is reported in the financial statements at
    a. cost.
    b. market.
    c. the higher-of-cost-or-market.
    d. the lower-of-cost-or-market.

114. The lower-of-cost-or-market basis of valuing inventories is an example of
    a. comparability.
    b. the cost principle.
    c. conservatism.
    d. consistency.

115. Under the lower-of-cost-or-market basis in valuing inventory, market is defined as
    a. current replacment cost.
    b. selling price.
    c. historical cost plus 10%.
    d. selling price less markup.

116. The lower-of-cost-or-market (LCM) basis may be be used with all of the following methods *except*
    a. average cost.
    b. FIFO.
    c. LIFO.
    d. The LCM basis may be used with all of these.

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117. Isaac Company developed the following information about its inventories in applying the lower-of-cost-or-market (LCM) basis in valuing inventories:

Product	Cost	Market
A	$110,000	$120,000
B	80,000	76,000
C	160,000	162,000

If Isaac applies the LCM basis, the value of the inventory reported on the balance sheet would be
a. $350,000.
b. $342,000.
c. $346,000.
d. $362,000.

118. Understating beginning inventory will understate
a. assets.
b. cost of goods sold.
c. net income.
d. owner's equity.

119. An error in the physical count of goods on hand at the end of a period resulted in a $10,000 overstatement of the ending inventory. The effect of this error in the current period is

	Cost of Goods Sold	Net Income
a.	Understated	Understated
b.	Overstated	Overstated
c.	Understated	Overstated
d.	Overstated	Understated

120. If beginning inventory is understated by $10,000, the effect of this error in the current period is

	Cost of Goods Sold	Net Income
a.	Understated	Understated
b.	Overstated	Overstated
c.	Understated	Overstated
d.	Overstated	Understated

121. A company uses the periodic inventory method and the beginning inventory is overstated by $4,000 because the ending inventory in the previous period was overstated by $4,000. The amounts reflected in the current end of the period balance sheet are

	Assets	Owner's Equity
a.	Overstated	Overstated
b.	Correct	Correct
c.	Understated	Understated
d.	Overstated	Correct

122. Overstating ending inventory will overstate all of the following *except*
a. assets.
b. cost of goods sold.
c. net income.
d. owner's equity.

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123. Disclosures about inventory should include each of the following *except* the
   a. basis of accounting.
   b. costing method.
   c. quantity of inventory.
   d. major inventory classifications.

124. Inventory turnover is calculated by dividing cost of goods sold by
   a. beginning inventory.
   b. ending inventory.
   c. average inventory.
   d. 365 days.

125. The following information is available for Knot Company at December 31, 2008: beginning inventory $80,000; ending inventory $120,000; cost of goods sold $900,000; and sales $1,200,000. Knot's inventory turnover in 2008 is
   a. 12 times.
   b. 11.3 times.
   c. 9 times.
   d. 7.5 times.

Use the following information for questions 126–127.

The following information was available for Carton Company at December 31, 2008: beginning inventory $90,000; ending inventory $70,000; cost of goods sold $660,000; and sales $900,000.

126. Carton's inventory turnover ratio in 2008 was
   a. 9.4 times.
   b. 8.3 times.
   c. 7.3 times.
   d. 6.0 times.

127. Carton's days in inventory in 2008 was
   a 38.8 days.
   b. 44.0 days.
   c. 50.0 days.
   d. 60.8 days.

Use the following inventory information for questions 128–130.

July	1	Beginning Inventory	10 units at $90
	5	Purchases	60 units at $84
	14	Sale	40 units
	21	Purchases	30 units at $87
	30	Sale	28 units

[a]128. Assuming that a perpetual inventory system is used, what is the ending inventory on a FIFO basis?
   a. $2,748
   b. $2,754
   c. $2,778
   d. $5,796

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[a]129 Assuming that a perpetual inventory system is used, what is the ending inventory on a LIFO basis?
a. $2,748
b. $2,754
c. $2,772
d. $5,796

[a]130. Assuming that a perpetual inventory system is used, what is the ending inventory (rounded) under the average-cost method?
a. $2,750
b. $2,784
c. $2,406
d. $2,772

131. A new average cost is computed each time a purchase is made in the
a. average-cost method.
b. moving-average cost method.
c. weighted-average cost method.
d. all of these methods.

[a]132. When valuing ending inventory under a perpetual inventory system, the
a. valuation using the LIFO assumption is the same as the valuation using the LIFO assumption under the periodic inventory system.
b. moving average requires that a new average be computed after every sale.
c. valuation using the FIFO assumption is the same as under the periodic inventory system.
d. earliest units purchased during the period using the LIFO assumption are allocated to the cost of goods sold when units are sold.

[a]133. Jansen Company uses the perpetual inventory system and the moving-average method to value inventories. On August 1, there were 10,000 units valued at $40,000 in the beginning inventory. On August 10, 20,000 units were purchased for $8 per unit. On August 15, 24,000 units were sold for $16 per unit. The amount charged to cost of goods sold on August 15 was
a. $40,000.
b. $160,000.
c. $192,000.
d. $144,000.

[a]134. Under the gross profit method, each of the following items are estimated *except* for the
a. cost of ending inventory.
b. cost of goods sold.
c. cost of goods purchased.
d. gross profit.

[a]135. Under the retail inventory method, the estimated cost of ending inventory is computed by multiplying the cost-to-retail ratio by
a. net sales.
b. goods available for sale at retail.
c. goods purchased at retail.
d. ending inventory at retail.

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[a]136. Inventories are estimated
a. more frequently under a periodic inventory system than a perpetual inventory system.
b. using the wholesale inventory method.
c. more frequently under a perpetual inventory system than the periodic inventory system.
d. using the net method.

[a]137. Nolan Department Store estimates inventory by using the retail inventory method. The following information was developed:

	At Cost	At Retail
Beginning inventory	$318,000	$ 750,000
Goods purchased	900,000	1,350,000
Net sales		1,200,000

The estimated cost of the ending inventory is
a. $696,000.
b. $522,000.
c. $882,000.
d. $900,000.

[a]138. Watson Department Store utilizes the retail inventory method to estimate its inventories. It calculated its cost to retail ratio during the period at 75%. Goods available for sale at retail amounted to $400,000 and goods were sold during the period for $250,000. The estimated cost of the ending inventory is
a. $150,000.
b. $300,000.
c. $112,500.
d. $200,000.

[a]139. Gore Company prepares monthly financial statements and uses the gross profit method to estimate ending inventories. Historically, the company has had a 40% gross profit rate. During June, net sales amounted to $60,000; the beginning inventory on June 1 was $18,000; and the cost of goods purchased during June amounted to $27,000. The estimated cost of Gore Company's inventory on June 30 is
a. $9,000.
b. $36,000.
c. $15,000.
d. $24,000.

Additional Multiple Choice Questions

140. Goods in transit should be included in the inventory of the buyer when the
a. public carrier accepts the goods from the seller.
b. goods reach the buyer.
c. terms of sale are FOB destination.
d. terms of sale are FOB shipping point.

141. Inventory items on an assembly line in various stages of production are classified as
a. Finished goods.
b. Work in process.
c. Raw materials.
d. Merchandise inventory.

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142. The cost flow method that often parallels the actual physical flow of merchandise is the
a. FIFO method.
b. LIFO method.
c. average-cost method.
d. gross profit method.

143. Rudolf Diesel Company's inventory records show the following data:

		Units	Unit Cost
Inventory, January 1		5,000	$9.00
Purchases:	June 18	4,500	8.00
	November 8	3,000	7.00

A physical inventory on December 31 shows 3,000 units on hand. Under the FIFO method, the December 31 inventory is
a. $21,000.
b. $21,750.
c. $24,000.
d. $27,000.

144. In a period of inflation, the cost flow method that results in the lowest income taxes is the
a. FIFO method.
b. LIFO method.
c. average-cost method.
d. gross profit method.

145. In a period of rising prices, FIFO will have
a. lower net income than LIFO.
b. lower cost of goods sold than LIFO.
c. lower income tax expense than LIFO.
d. lower net purchases than LIFO.

146. Under the LCM approach, the market value is defined as
a. FIFO cost.
b. LIFO cost.
c. current replacement cost.
d. selling price.

147. Euler Company made an inventory count on December 31, 2008. During the count, one of the clerks made the error of counting an inventory item twice. For the balance sheet at December 31, 2008, the effects of this error are

	Assets	Liabilities	Owner's Equity
a.	overstated	understated	overstated
b.	understated	no effect	understated
c.	overstated	no effect	overstated
d.	overstated	overstated	understated

148. The inventory turnover ratio is computed by dividing cost of goods sold by
a. beginning inventory.
b. ending inventory.
c. average inventory.
d. 365 days.

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[a]149. Quigley Company's records indicate the following information for the year:

Merchandise inventory, 1/1	$ 550,000
Purchases	2,250,000
Net Sales	3,000,000

On December 31, a physical inventory determined that ending inventory of $600,000 was in the warehouse. Quigley's gross profit on sales has remained constant at 30%. Quigley suspects some of the inventory may have been taken by some new employees. At December 31, what is the estimated cost of missing inventory?

a. $100,000
b. $200,000
c. $300,000
d. $700,000

Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
34.	c	51.	a	68.	a	85.	c	102.	d	119.	c	[a]136.	a
35.	c	52.	c	69.	c	86.	d	103.	d	120.	c	[a]137.	b
36.	a	53.	a	70.	b	87.	a	104.	a	121.	b	[a]138.	c
37.	c	54.	c	71.	b	88.	b	105.	b	122.	b	[a]139.	a
38.	b	55.	d	72.	b	89.	b	106.	a	123.	c	140.	d
39.	a	56.	a	73.	a	90.	a	107.	d	124.	c	141.	b
40.	d	57.	c	74.	d	91.	b	108.	c	125.	c	142.	a
41.	c	58.	d	75.	c	92.	b	109.	b	126.	b	143.	a
42.	c	59.	c	76.	b	93.	d	110.	c	127.	b	144.	b
43.	a	60.	c	77.	a	94.	d	111.	c	[a]128.	c	145.	b
44.	d	61.	b	78.	a	95.	c	112.	d	[a]129.	b	146.	c
45.	b	62.	d	79.	d	96.	c	113.	d	[a]130.	a	147.	c
46.	a	63.	b	80.	c	97.	b	114.	c	[a]131.	b	148.	c
47.	a	64.	d	81.	c	98.	a	115.	a	[a]132.	c	[a]149.	a
48.	b	65.	a	82.	d	99.	c	116.	d	[a]133.	b		
49.	b	66.	b	83.	a	100.	b	117.	c	[a]134.	c		
50.	d	67.	c	84.	b	101.	b	118.	b	[a]135.	d		

BRIEF EXERCISES

BE 150

Michelle Lee Company identifies the following items for possible inclusion in the physical inventory. Indicate whether each item should be included or excluded from the inventory taking.

1. Goods shipped on consignment by Michelle Lee to another company.
2. Goods in transit from a supplier shipped FOB destination.
3. Goods shipped via common carrier to a customer with terms FOB shipping point.
4. Goods held on consignment from another company.

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Solution 150 (3 min.)

1. Included
2. Excluded
3. Excluded
4. Excluded

BE 151

In the first month of operations, Barton Company made three purchases of merchandise in the following sequence: (1) 200 units at $6, (2) 300 units at $7, and (3) 400 units at $8. Assuming there are 300 units on hand, compute the cost of the ending inventory under (1) the FIFO method and (2) the LIFO method. Barton uses a periodic inventory system.

Solution 151 (5 min.)

1. FIFO
   300 × $8 = $2,400

2. LIFO
   200 × $6 = $1,200
   100 × $7 = 700
   $1,900

BE 152

Pembrook Company had beginning inventory on May 1 of $12,000. During the month, the company made purchases of $30,000 but returned $2,000 of goods because they were defective. At the end of the month, the inventory on hand was valued at $9,500.

Calculate cost of goods available for sale and cost of goods sold for the month.

Solution 152 (4 min.)

Beginning inventory	$12,000
Net purchases ($30,000 – $2,000)	+28,000
Goods available for sale	$40,000
Ending inventory	– 9,500
Cost of goods sold	$30,500

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BE 153

Opti Company's inventory records show the following data for the month of September:

		Units	Unit Cost
Inventory, September 1		100	$3.00
Purchases:	September 8	450	3.50
	September 18	300	3.70

A physical inventory on September 30 shows 200 units on hand. Calculate the value of ending inventory and cost of goods sold if the company uses FIFO inventory costing and a periodic inventory system.

Solution 153 (4 min.)

Ending inventory of 200 units: 200 x $3.70 = $740

Cost of goods sold:
Units available for sale (100 + 450 + 300) = 850
Units sold 850 – 200 = 650

100 × $3 =	$ 300
450 × $3.50 =	1,575
100 × $3.70 =	370
Cost of goods sold	$2,245

BE 154

Use the information in BE 153 to calculate the value of ending inventory and cost of goods sold if the company uses LIFO inventory costing and a periodic inventory system.

Solution 154 (4 min.)

Ending inventory: (100 units × $3.00) + (100 units × $3.50) = $650
Cost of goods sold: (300 units × $3.70) + (350 units × $3.50) = $2,335

BE 155

Use the information in BE 153 to calculate the value of the ending inventory and cost of goods sold if the company uses weighted average inventory costing and a periodic inventory system. Round cost per unit to 2 decimal places and ending inventory and cost of goods sold to the nearest dollar.

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Solution 155 (4 min.)

Weighted average cost per unit:
Cost of goods available for sale = $2,985
Units available for sale 850
$2,985 ÷ 850 = $3.51
Ending inventory: 200 × $3.51 = $702
Cost of goods sold: 650 × $3.51 = $2,282

BE 156

The following accounts are included in the ledger of Able Company:

Advertising expense
Freight-in
Inventory
Purchases
Purchase returns and allowances
Sales
Sales returns and allowances

Which of the accounts would be included in calculating cost of goods sold?

Solution 156 (3 min.)

Freight-in
Inventory
Purchases
Purchase returns and allowances

BE 157

The Entertainment Center accumulates the following cost and market data at December 31.

Inventory Categories	Cost Data	Market Data
Camera	$11,000	$10,200
Camcorders	8,000	8,500
DVDs	14,000	12,000

What is the lower-of-cost-or-market value of the inventory?

Solution 157 (5 min.)

Inventory Categories	Cost Data	Market Data	Lower-of-cost-or-market value
Camera	$11,000	$10,200	$10,200
Camcorders	8,000	8,500	8,000
DVDs	14,000	12,000	12,000
			$30,200

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BE 158

Shelby Supply Company reports net income of $120,000 in 2008. The ending inventory did not include goods valued at $5,000 that Shelby had consigned to Felicia's Gift Shop.

(1) What is the correct net income for 2008?
(2) What impact will this error have on the balance sheet at 12/31/08?

Solution 158 (4 min.)

(1) If ending inventory is understated by $5,000, cost of goods sold will be overstated and net income will be understated by $5,000. The correct net income is $125,000.
(2) On the balance sheet, both inventory and owner's equity will be understated by $5,000.

BE 159

At December 31, 2008, the following information was available for Rich Company: ending inventory $22,600; beginning inventory $21,400; cost of goods sold $171,000; and sales revenue $430,000.

Calculate the inventory turnover ratio and days in inventory for Rich.

Solution 159 (4 min.)

Inventory Turnover Ratio = $171,000 ÷ [($21,400 + $22,600) ÷ 2] = 7.8 times

Days in Inventory = 365 ÷ 7.8 = 46.8 days

EXERCISES

Ex. 160

The following information is available for Harold Company:

Beginning inventory	600 units at $5
First purchase	900 units at $6
Second purchase	500 units at $7

Assume that Harold uses a periodic inventory system and that there are 700 units left at the end of the month.

Instructions
Compute the cost of ending inventory under the
(a) FIFO method.
(b) LIFO method.

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Solution 160 (7 min.)

(a) FIFO Ending Inventory Cost:

500 × $7 =	$3,500
200 × $6 =	1,200
	$4,700

(b) LIFO Ending Inventory Cost:

600 × $5 =	$3,000
100 × $6 =	600
	$3,600

Ex. 161

Using the information in Ex. 160 above, compute each of the following under the average-cost method:

(a) Cost of ending inventory.
(b) Cost of goods sold.

Solution 161 (7 min.)

Average cost/unit = $5.95 ($11,900 ÷ 2,000)

600	× $5 =	$ 3,000
900	× $6 =	5,400
500	× $7 =	3,500
2,000		$11,900

(a) Cost of ending inventory = $4,165 (700 × $5.95)

(b) Cost of goods sold = $7,735 (1,300 × $5.95) or $11,900 – $4,165

Ex. 162

Morton Company uses the periodic inventory method and had the following inventory information available:

		Units	Unit Cost	Total Cost
1/1	Beginning Inventory	100	$4	$ 400
1/20	Purchase	400	$5	2,000
7/25	Purchase	200	$7	1,400
10/20	Purchase	300	$8	2,400
		1,000		$6,200

A physical count of inventory on December 31 revealed that there were 400 units on hand.

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Ex. 162 (cont.)

Instructions
Answer the following independent questions and show computations supporting your answers.

1. Assume that the company uses the FIFO method. The value of the ending inventory at December 31 is $_____.

2. Assume that the company uses the Average-Cost method. The value of the ending inventory on December 31 is $_____.

3. Assume that the company uses the LIFO method. The value of the ending inventory on December 31 is $_____.

4. Determine the difference in the amount of income that the company would have reported if it had used the FIFO method instead of the LIFO method. Would income have been greater or less?

Solution 162 (20 min.)

1. FIFO: Ending inventory $3,100

300 units @ $8	=	$2,400
100 units @ $7	=	700
400 units		$3,100

2. Average Cost: Ending inventory $2,480
   $6,200 ÷ 1,000 = $6.20 per unit × 400 units = $2,480

3. LIFO: Ending Inventory $1,900

100 units @ $4	=	$ 400
300 units @ $5	=	1,500
400 units		$1,900

4. FIFO: Cost of goods sold $3,100

100 units @ $4	=	$ 400
400 units @ $5	=	2,000
100 units @ $7	=	700
600 units		$3,100

LIFO: Cost of goods sold $4,300

300 units @ $8	=	$2,400
200 units @ $7	=	1,400
100 units @ $5	=	500
600 units		$4,300

Income would have been $1,200 ($4,300 vs. $3,100) *greater* if the company used FIFO instead of LIFO.

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Ex. 163

Dixen Company sells many products. Whamo is one of its popular items. Below is an analysis of the inventory purchases and sales of Whamo for the month of March. Dixen Company uses the periodic inventory system.

		Purchases		Sales	
		Units	Unit Cost	Units	Selling Price/Unit
3/1	Beginning inventory	100	$40		
3/3	Purchase	60	$50		
3/4	Sales			70	$80
3/10	Purchase	200	$55		
3/16	Sales			80	$90
3/19	Sales			60	$90
3/25	Sales			40	$90
3/30	Purchase	40	$60		

Instructions

(a) Using the FIFO assumption, calculate the amount charged to cost of goods sold for March. (Show computations)

(b) Using the weighted average method, calculate the amount assigned to the inventory on hand on March 31. (Show computations)

(c) Using the LIFO assumption, calculate the amount assigned to the inventory on hand on March 31. (Show computations)

Solution 163 (20 min.)

		Purchases		Sales	
		Units	Unit Cost	Units	Selling Price/Unit
3/1	Beginning inventory	100	$40		
3/3	Purchase	60	$50		
3/4	Sales			70	$80
3/10	Purchase	200	$55		
3/16	Sales			80	$90
3/19	Sales			60	$90
3/25	Sales			40	$90
3/30	Purchase	40	$60		
		400		250	

(a) Using FIFO - the earliest units purchased were the first sold.

3/1	100	@ $40	=	$ 4,000	
3/3	60	@ 50	=	3,000	
3/10	90	@ 55	=	4,950	
	250 units			$11,950	= the cost of goods sold

(b) Calculate the weighted average unit cost:
$20,400 ÷ 400 = $51
$51 × units in ending inventory (400 available less 250 sold = 150)
$51 × 150 = $7,650

(c) There are 150 units in ending inventory. They are comprised of the first units purchased when LIFO is assumed.

3/1	100	@ $40	=	$4,000
3/3	50	@ $50	=	2,500
	150 units			$6,500 = ending inventory

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Ex. 164

Yenn Company uses the periodic inventory system to account for inventories. Information related to Yenn Company's inventory at October 31 is given below:

October	1	Beginning inventory	400	units @ $10.00 =	$ 4,000
	8	Purchase	800	units @ $10.40 =	8,320
	16	Purchase	600	units @ $10.80 =	6,480
	24	Purchase	200	units @ $11.60 =	2,320
		Total units and cost	2,000	units	$21,120

Instructions

1. Show computations to value the ending inventory using the FIFO cost assumption if 550 units remain on hand at October 31.
2. Show computations to value the ending inventory using the weighted-average cost method if 550 units remain on hand at October 31.
3. Show computations to value the ending inventory using the LIFO cost assumption if 550 units remain on hand at October 31.

Solution 164 (20 min.)

1. 550 units in ending inventory.
   Under FIFO, the units remaining in inventory are the ones purchased most recently.

10/24	200	units @ $11.60 =	$2,320
10/16	350	units @ 10.80 =	3,780
	550	units	$6,100

2. 550 units in ending inventory.
   Under average cost method, the weighted average cost per unit must be computed.
   $21,120 ÷ 2,000 units = $10.56
   550 units × $10.56 = $5,808

3. 550 units in ending inventory.
   Under LIFO, the units remaining are the ones purchased earliest.

10/1	400	units @ $10.00 =	$4,000
10/8	150	units @ 10.40 =	1,560
	550	units	$5,560

Ex. 165

Sims Company is in the electronics industry and the price it pays for inventory is decreasing.

Instructions

Indicate which inventory method will:

a. provide the highest ending inventory.
b. provide the highest cost of goods sold.
c. result in the highest net income.
d. result in the lowest income tax expense.
e. produce the most stable earnings over several years.

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Solution 165 (4 min.)

a. LIFO
b. FIFO
c. LIFO
d. FIFO
e. Average cost

Ex. 166

Utley Company reported the following summarized annual data at the end of 2008:

Sales revenue	$1,000,000
Cost of goods sold*	600,000
Gross margin	400,000
Operating expenses	250,000
Income before income taxes	$ 150,000

*Based on an ending FIFO inventory of $250,000.

The income tax rate is 30%. The controller of the company is considering a switch from FIFO to LIFO. He has determined that on a LIFO basis, the ending inventory would have been $200,000.

Instructions

(a) Restate the summary information on a LIFO basis.

(b) What effect, if any, would the proposed change have on Utley's income tax expense, net income, and cash flows?

(c) If you were an owner of this business, what would your reaction be to this proposed change?

Solution 166 (25 min.)

(a) Restate to a LIFO basis:

Sales revenue	$1,000,000
Cost of goods sold*	650,000
Gross margin	350,000
Operating expenses	250,000
Income before income taxes	$ 100,000

*Ending inventory would be $50,000 less ($250,000 – $200,000 = $50,000) under LIFO, thereby increasing cost of goods by $50,000.

(b) The taxes on the FIFO basis would be:
$150,000 ×.30 = $45,000
Leaving Net Income of $105,000 ($150,000 – $45,000 = $105,000).

The taxes on the LIFO basis would be:
$100,000 ×.30 = $30,000
Leaving Net Income of $70,000 ($100,000 – $30,000 = $70,000).

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Solution 166 (cont.)

Switching to the LIFO basis will result in $15,000 less income tax expense and less net income of $35,000. The cash effect is $15,000 ($45,000 – $30,000 = $15,000) saved in taxes if LIFO were used.

(c) Owners of the business may favor the LIFO basis since more cash will be available for use in the business. LIFO results in more cash being retained in the business since less is paid out for income taxes.

Ex. 167

Compute the lower-of-cost-or-market valuation for Howe Company's total inventory based on the following:

Inventory Categories	Cost Data	Market Data
A	$18,000	$17,200
B	14,000	14,600
C	21,000	20,500

Solution 167 (5 min.)

Inventory Categories	Cost Data	Market Data	LCM
A	$18,000	$17,200	$17,200
B	14,000	14,600	14,000
C	21,000	20,500	20,500
	Total Valuation		$51,700

Ex. 168

The controller of Lawn-Pro Company is applying the lower-of-cost-or-market basis of valuing its ending inventory. The following information is available:

	Cost	Market
Lawnmowers:		
Self-propelled	$15,000	$17,000
Push type	19,000	18,000
Total	34,000	35,000
Snowblowers:		
Manual	30,000	31,000
Self-start	19,000	21,000
Total	49,000	52,000
Total inventory	$83,000	$87,000

Instructions

Compute the value of the ending inventory by applying the lower-of-cost-or-market basis.

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Solution 168 (15 min.)

	Lower-of-cost-or-market
Lawnmowers:	
Self-propelled	$15,000
Push type	18,000
Snowblowers:	
Manual	30,000
Self-start	19,000
Total inventory	$82,000

Ex. 169

Wert Company is preparing the annual financial statements dated December 31, 2008. Information about inventory stocked for regular sale follows:

Item	Quantity on Hand	Unit Cost When Acquired	Replacement Cost (market) at year end
A	50	$20	$19
B	100	45	45
C	20	60	62
D	40	40	37

Instructions
Compute the valuation for the December 31, 2008, inventory using the lower-of-cost-or-market basis.

Solution 169 (10 min.)

Item	Units	Lower of Cost or Market	Extension
A	50	$19	$ 950
B	100	45	4,500
C	20	60	1,200
D	40	37	1,480
			$8,130

Ex. 170

Dryer Company reported net income of $60,000 in 2008 and $80,000 in 2009. However, ending inventory was overstated by $5,000 in 2008.

Instructions
Compute the correct net income for Dryer Company for 2008 and 2009.

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Solution 170 (6 min.)

2008 correct net income = $55,000 ($60,000 – $5,000)
2009 correct net income = $85,000 ($80,000 + $5,000)

Ex. 171

For each of the independent events listed below, analyze the impact on the indicated items at the end of the current year by placing the appropriate code letter in the box under each item.

Code: O = item is overstated
U = item is understated
NA = item is not affected

Events	Items			
	Assets	Owner's Equity	Cost of Goods Sold	Net Income
1. A physical count of goods on hand at the end of the current year resulted in some goods being counted twice.				
2. The ending inventory in the previous period was overstated.				
3. Goods purchased on account in December of the current year and shipped FOB shipping point were recorded as purchases, but were not included in the count of goods on hand on December 31 because they had not arrived by December 31.				
4. Goods purchased on account in December of the current year and shipped FOB destination were recorded as purchases, but were not included in the count of goods on hand on December 31 because they had not arrived by December 31.				
5. The internal auditors discovered that the ending inventory in the previous period was understated $15,000 and that the ending inventory in the current period was overstated $25,000.				

Solution 171 (20 min.)

Events	Items			
	Assets	Owner's Equity	Cost of Goods Sold	Net Income
1.	O	O	U	O
2.	NA	NA	O	U
3.	U	U	O	U
4.	NA	U	O	U
5.	O	O	U	O

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Ex. 172

Nolan's Hardware Store prepared the following analysis of cost of goods sold for the previous three years:

	2007	2008	2009
Beginning inventory 1/1	$40,000	$18,000	$25,000
Cost of goods purchased	50,000	55,000	70,000
Cost of goods available for sale	90,000	73,000	95,000
Ending inventory 12/31	18,000	25,000	40,000
Cost of goods sold	$72,000	$48,000	$55,000

Net income for the years 2007, 2008, and 2009 was $70,000, $60,000, and $55,000, respectively. Since net income was consistently declining, Mr. Nolan hired a new accountant to investigate the cause(s) for the declines.

The accountant determined the following:

1. Purchases of $25,000 were not recorded in 2007.
2. The 2007 December 31 inventory should have been $24,000.
3. The 2008 ending inventory included inventory costing $5,000 that was purchased FOB destination and in transit at year end.
4. The 2009 ending inventory did not include goods costing $4,000 that were shipped on December 29 to Sampson Plumbing Company, FOB shipping point. The goods were still in transit at the end of the year.

Instructions
Determine the correct net income for each year. (Show all computations.)

Solution 172 (25 min.)

		2007		2008	2009
Beginning inventory 1/1		$ 40,000		$29,000	$20,000
Cost of goods purchased	(1)	75,000		55,000	70,000
Cost of goods available for sale		115,000		84,000	90,000
Ending inventory 12/31	(2)	24,000	(3)	20,000	40,000
Cost of goods sold		$ 91,000		$64,000	$50,000

	2007	2008	2009
Net Income previously reported	$70,000	$60,000	$55,000
Add: Prior cost of goods sold	72,000	48,000	55,000
Less: Revised cost of goods sold	(91,000)	(64,000)	(50,000)
Corrected Net Income	$51,000	$44,000	$60,000

(1)	Additional purchases	$25,000
(2)	Additional ending inventory	$6,000
(3)	Less ending inventory	$5,000

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Ex. 173

Hill Pharmacy reported cost of goods sold as follows:

	2008	2009
Beginning inventory	$ 54,000	$ 64,000
Cost of goods purchased	847,000	891,000
Cost of goods available for sale	901,000	955,000
Ending inventory	64,000	55,000
Cost of goods sold	$837,000	$900,000

Hill made two errors:
(1) 2008 ending inventory was overstated by $6,000.
(2) 2009 ending inventory was understated by $15,000.

Instructions
Assuming the errors had not been corrected, indicate the dollar effect that the errors had on the items appearing on the financial statements listed below. Also indicate if the amounts are overstated (O) or understated (U).

	2008		2009	
	Amount	Overstated/ Understated	Amount	Overstated/ Understated
Total assets	$_____	_____	$_____	_____
Owner's equity	$_____	_____	$_____	_____
Cost of goods sold	$_____	_____	$_____	_____
Net income	$_____	_____	$_____	_____

Solution 173 (20 min.)

	2008		2009	
	Amount	Overstated/ Understated	Amount	Overstated/ Understated
Total assets	$6,000	O	$15,000	U
Owner's equity	$6,000	O	$15,000	U
Cost of goods sold	$6,000	U	$21,000	O
Net income	$6,000	O	$21,000	U

Correct cost of goods sold:

	2008	2009
Beginning inventory	$ 54,000	$ 58,000
Cost of goods purchased	847,000	891,000
Cost of goods available for sale	901,000	949,000
Ending inventory	58,000	70,000
Cost of goods sold	$843,000	$879,000

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Ex. 174

The following information is available for Manning Company:

Beginning inventory	$ 60,000
Cost of goods sold	600,000
Ending inventory	100,000
Sales	750,000

Instructions
Compute each of the following:
(a) Inventory turnover.
(b) Days in inventory.

Solution 174 (5 min.)

(a) Inventory turnover: $\frac{\$600,000}{(\$60,000 + \$100,000) \div 2} = \frac{\$600,000}{\$80,000} = 7.5$

(b) Days in inventory: $\frac{365}{7.5} = 48.7$ days

[a]Ex. 175

Vaughn Company uses the perpetual inventory system and the LIFO method. The following information is available for the month of May:

May	1	Beginning inventory	20 units @ $5
	10	Purchase	20 units @ $8
	15	Sales	15 units
	18	Purchase	10 units @ $9
	21	Sales	15 units
	30	Purchase	10 units @ $10

Instructions
Prepare a schedule to show cost of goods sold and the value of the ending inventory for the month of May.

[a]Solution 175 (10 min.)

Cost of goods sold:

May 15	sale	15 units × $8	=	$120	
May 21	sale	10 units × $9	=	90	
		5 units × $8	=	40	
		30 units		$250	Cost of goods sold

Ending inventory:

May 1	20 units × $5	=	$100	
May 30	10 units × $10	=	100	
	30 units		$200	Ending inventory

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[a]Ex. 176

Romano Company uses the perpetual inventory system and had the following purchases and sales during March.

		Purchases		Sales	
		Units	Unit Cost	Units	Selling Price/Unit
3/1	Beginning inventory	100	$40		
3/3	Purchase	60	$50		
3/4	Sales			70	$80
3/10	Purchase	200	$55		
3/16	Sales			80	$90
3/19	Purchase	40	$60		
3/25	Sales			120	$90

Instructions
Using the inventory and sales data above, calculate the value assigned to cost of goods sold in March and to the ending inventory at March 31 using (a) FIFO and (b) LIFO.

[a]Solution 176 (20 min.)

a) FIFO

Date	Purchases		Sales		Balance	
3/1					(100 @ $40)	$4,000
3/3	(60 @ $50)	$3,000			(100 @ $40)	
					(60 @ $50)	$7,000
3/4			(70 @ $40)	$2,800	(30 @ $40)	
					(60 @ $50)	$4,200
3/10	(200 @ $55)	$11,000			(30 @ $40)	
					(60 @ $50)	
					(200 @ $55)	$15,200
3/16			(30 @ $40)		(10 @ $50)	
			(50 @ $50)	$3,700	(200 @ $55)	$11,500
3/19	(40 @ $60)	$2,400			(10 @ $50)	
					(200 @ $55)	
					(40 @ $60)	$13,900
3/25			(10 @ $50)		(90 @ $55)	
			(110 @ $55)	$6,550	(40 @ $60)	$7,350

March cost of goods sold = $13,050 ($2,800 + $3,700 + $6,550)
March 31 inventory = $7,350

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[a]Solution 176 (cont.)

b) LIFO

Date	Purchases		Sales		Balance	
3/1					(100 @ $40)	$4,000
3/3	(60 @ $50)	$3,000			(100 @ $40)	
					(60 @ $50)	$7,000
3/4			(60 @ $50)			
			(10 @ $40)	$3,400	(90 @ $40)	$3,600
3/10	(200 @ $55)	$11,000			(90 @ $40)	
					(200 @ $55)	$14,600
3/16			(80 @ $55)	$4,400	(90 @ $40)	
					(120 @ $55)	$10,200
3/19	(40 @ $60)	$2,400			(90 @ $40)	
					(120 @ $55)	
					(40 @ $60)	$12,600
3/25			(40 @ $60)		(90 @ $40)	
			(80 @ $55)	$6,800	(40 @ $55)	$5,800

March cost of goods sold = $14,600 ($3,400 + $4,400 + $6,800)
March 31 inventory = $5,800

[a]Ex. 177

Adler Department Store prepares monthly financial statements but only takes a physical count of merchandise inventory at the end of the year. The following information has been developed for the month of July:

	At Cost	At Retail
Beginning inventory	$ 35,000	$ 50,000
Merchandise purchases	115,000	150,000

The net sales for July amounted to $140,000.

Instructions
Use the retail inventory method to estimate the ending inventory at cost for July. Show all computations to support your answer.

[a]Solution 177 (10 min.)

	At Cost	At Retail
Beginning inventory	$ 35,000	$ 50,000
Merchandise purchases	115,000	150,000
Goods available for sale	$150,000	200,000
Net sales		140,000
(1) Ending inventory at retail		$ 60,000

(2) Cost to retail ratio = 75% ($150,000 ÷ $200,000).

(3) Ending inventory at cost = ($60,000 × 75%) = $45,000.

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[a]Ex. 178

Horne Company suffered a loss of its inventory on March 28 due to a fire in its warehouse. As a basis for filing a claim with its insurance company, Horne Company developed the following information:

March net sales through March 28	$360,000
Beginning Inventory, March 1	150,000
Merchandise purchases through March 28	180,000

The company has experienced an average gross profit rate of 35% in the past and this rate appears to be appropriate in the current period.

Instructions
Using the gross profit method, prepare an estimate of the cost of the inventory destroyed by fire on March 28. Show all computations in good form.

[a]Solution 178 (10 min.)

Net sales	$360,000
Less: Estimated gross profit ($360,000 × 35%)	126,000
Estimated cost of goods sold	$234,000
Beginning inventory	$150,000
Merchandise purchases	180,000
Goods available for sale	330,000
Less: Estimated cost of goods sold	234,000
Estimated cost of ending inventory destroyed by fire	$ 96,000

[a]Ex. 179

The inventory of Snider Company was destroyed by fire on April 1. From an examination of the accounting records, the following data for the first three months of the year are obtained:

Sales	$185,000
Sales Returns and Allowances	5,000
Purchases	90,000
Freight-In	3,500
Purchase Returns and Allowances	4,000

Instructions
Determine the merchandise lost by fire, assuming a beginning inventory of $60,000 and a gross profit rate of 40% on net sales.

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[a]Solution 179 (10 min.)

Net Sales ($185,000 – $5,000)	$180,000
Less: Estimated gross profit (40% × $180,000)	72,000
Estimated cost of goods sold	$108,000
Beginning inventory	$ 60,000
Cost of goods purchased ($90,000 – $4,000 + $3,500)	89,500
Cost of goods available for sale	149,500
Less: Estimated cost of good sold	108,000
Estimated cost of merchandise lost	$ 41,500

[a]Ex. 180

Hyland Company reports goods available for sale at cost, $90,000. Beginning inventory at retail is $40,000 and goods purchased during the period at retail were $80,000. Sales for the period amounted to $88,000.

Instructions
Determine the estimated cost of the ending inventory using the retail inventory method.

[a]Solution 180 (10 min.)

	At Cost	At Retail
Beginning inventory		$ 40,000
Goods purchased		80,000
Goods available for sale	$90,000	120,000
Net sales		88,000
Ending inventory		$ 32,000

First calculate the cost to retail ratio.
$90,000 ÷ $120,000 = 75%

Apply this ratio to the ending inventory at retail.
$32,000 × .75 = $24,000

$24,000 is the estimated cost of the ending inventory.

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COMPLETION STATEMENTS

181. Accounting for inventories is important because inventories affect the _____ section of the balance sheet and the _____ section on the income statement.

182. In a manufacturing company, goods that are ready to be sold to customers are referred to as _____, whereas in a merchandising company they are generally referred to as _____.

183. The cost of goods purchased during a period plus the beginning inventory is the amount of goods _____ during the period.

184. Inventoriable costs are allocated to _____ and cost of goods _____.

185. It is generally recognized that a major objective of accounting for inventory is the proper determination of _____.

186. The _____ method tracks the actual physical flow of each unit of inventory available for sale; however, management may be able to manipulate _____ by using this method.

187. If the unit cost of inventory has continuously increased, the _____, first-out inventory valuation method will result in a higher valued ending inventory than if the _____, first-out method had been used.

188. The lower-of-cost-or-market basis of accounting for inventories should be applied when the _____ cost of the goods is lower than its cost.

189. _____ is calculated as cost of goods sold divided by average inventory.

[a]190. Two widely used methods of estimating inventories are the _____ method and the _____ method.

ANSWERS TO COMPLETION STATEMENTS

181. current assets, cost of goods sold
182. finished goods, merchandise inventory
183 available for sale
184. ending inventory, sold
185. net income
186. specific identification, income
187. first-in, last-in
188. replacement
189. Inventory turnover
[a]190. gross profit, retail inventory

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MATCHING

191. Match the items below by entering the appropriate code letter in the space provided.

A. Merchandise Inventory
B. Work in process
C. FOB shipping point
D. FOB destination
E. Specific identification method
F. First-in, first-out (FIFO) method
G. Last-in, first-out (LIFO) method
H. Average-cost method
I. Inventory turnover
J. Current replacement cost

____ 1. Measures the number of times the inventory sold during the period.

____ 2. Tracks the actual physical flow for each inventory item available for sale.

____ 3. Goods that are only partially completed in a manufacturing company.

____ 4. Cost of goods sold consists of the most recent inventory purchases.

____ 5. Goods ready for sale to customers by retailers and wholesalers.

____ 6. Title to the goods transfers when the public carrier accepts the goods from the seller.

____ 7. Ending inventory valuation consists of the most recent inventory purchases.

____ 8. The same unit cost is used to value ending inventory and cost of goods sold.

____ 9. Title to goods transfers when the goods are delivered to the buyer.

____ 10. The amount that would be paid at the present time to acquire an identical item.

Answers to Matching

1. I
2. E
3. B
4. G
5. A
6. C
7. F
8. H
9. D
10. J

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SHORT-ANSWER ESSAY QUESTIONS

S-A E 192

FIFO and LIFO are the two most common cost flow assumptions made in costing inventories. The amounts assigned to the same inventory items on hand may be different under each cost flow assumption. If a company has no beginning inventory, explain the difference in ending inventory values under the FIFO and LIFO cost bases when the price of inventory items purchased during the period have been (1) increasing, (2) decreasing, and (3) remained constant.

Solution 192

The FIFO method determines the ending inventory by the cost of the most recent purchase. The LIFO method determines the ending inventory by the cost of the earliest purchase. Therefore, if the FIFO method is used and the prices during the period are increasing, the ending inventory under FIFO will be greater than under LIFO. Likewise, if the FIFO method is used and the prices during the period are decreasing, the ending inventory under FIFO will be less than under LIFO. If prices remain constant and the company has no beginning inventory, then there will be no difference in ending inventory.

S-A E 193

Errors occasionally occur when physically counting inventory items on hand. Identify the financial statement effects of an overstatement of the ending inventory in the current period. If the error is not corrected, how does it affect the financial statements for the following year?

Solution 193

The overstatement of ending inventory will cause cost of goods sold to be understated. Consequently, net income for the period will be overstated. The effect on the balance sheet is that assets and owner's equity will be overstated. The subsequent period will have an overstatement of beginning inventory. This will cause cost of goods sold to be overstated and net income to be understated, counterbalancing the overstatement of income in the prior period.

S-A E 194

A survey of major U.S. companies revealed that 77% of those companies used either LIFO or FIFO cost flow methods, while 19% used average cost, and only 4% used other methods.

Required:
Provide brief, yet concise responses to the following questions.

a. Why are LIFO and FIFO so popular?

b. Since computers and inventory management software are readily available, why aren't more companies using specific identification?

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Solution 194

a. FIFO and LIFO are based on cost flow assumptions that may be unrelated to the physical flow of goods. The reasons for using one of these methods involve the effects on the income statement, balance sheet, and taxes that the company must pay.

   In periods of rising prices (inflation), LIFO provides for a lower net income, thus resulting in a lower tax liability. LIFO reflects the most realistic cost of goods sold (the most recent or highest costs). However, the cost of inventory on the balance sheet is distorted because it consists of the earliest or lowest costs.

   In periods of rising prices, FIFO provides for the most realistic ending inventory cost on the balance sheet (using the most recent or highest costs). On the income statement, FIFO represents the least realistic cost of goods sold because the amount consists of the earliest or lowest costs. This makes net income higher, which is good for the external financial statements but it thus results in a higher tax liability. In periods of falling prices, opposite results apply.

b. With computers and inventory management software, it would appear that the specific identification method would be the most popular because it matches the actual cost of each item sold to its selling price. However, using computers to keep up with the information does not eliminate some of the problems with using specific identification.

   One problem is an ethical one. A major disadvantage of the specific identification method is that management may be able to manipulate net income. For example, it can boost net income by selling units purchased at a low cost, or reduce net income by selling units purchased at a high cost. As long as customers receive the units they demand, they are indifferent when the company bought them. This manipulation means that net income is not objectively measured.

   Another problem is that the costs of maintaining a specific identification system may outweigh the benefits of using such a method. As mentioned in part a, financial statement and tax effects of using FIFO and LIFO are more beneficial to companies than simply being able to match the actual cost of a unit to its selling price.

S-A E 195

Your former college roommate is opening a new retail store and asks you “Which inventory costing method should I use?”

What is your response? Include a comparison of the tax effect, balance sheet effect, and income statement effect for FIFO versus LIFO.

Solution 195

It is always good to hear from you and you have certainly asked a very good question. Since the consistency principle requires that you adopt accounting methods and stay with them (until there is need for a proper change), it is very important to consider the options before starting a business.

I suggest that you consider one of the three cost flow assumptions—Average, First-In, First-Out (FIFO), or Last-In, First-Out (LIFO). These methods are based on the assumption of cost flows instead of the actual physical flow of goods.

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Solution 195 (cont.)

The effects on the income statement, balance sheet, and tax returns depend on whether your company experiences rising prices or falling prices.

Here is a summary of the effects for each inventory method, for companies that experience rising prices (the opposite will be true for falling prices).

Inventory Method	Tax Effect	Income Statement Effect	Balance Sheet Effect
Average	Falls between FIFO and LIFO	Falls between FIFO and LIFO	Falls between FIFO and LIFO
FIFO	Highest net income, thus highest taxes	Highest net income. Thus more attractive for external financial reporting	Most realistic ending inventory because latest costs are matched to ending inventory
LIFO	Lowest net income, thus lowest taxes (works best if constant levels of inventory units are maintained)	Lowest net income (If you use LIFO for tax purposes, you must also use it for external financial reporting.)	Most unrealistic ending inventory because the earliest costs are matched to ending inventory

S-A E 196 (Ethics)

Suzy Cole and Joe Lane are department managers in the housewares and shoe departments, respectively, for Newmans, a large department store. Joe has observed Suzy taking inventory from her own department home, apparently without paying for it. He hesitates confronting Suzy because he is due to be promoted, and needs Suzy's recommendation. He also does not want to notify the company management directly, because he doesn't want an ethics investigation on his record, believing that it will give him a “goody-goody” image. This week, Suzy tried on several pairs of expensive running shoes in his department before finding a pair that suited her. She did not, however, buy them. That very pair was missing this morning.

Newmans recently replaced its old periodic inventory system with a perpetual inventory system using scanners and bar codes. In addition, the annual inventory is to be replaced by a monthly inventory conducted by an independent firm. On hearing the news of the changes, Joe relaxes. "The system will catch Suzy now," he says to himself.

Required:
1. Is Joe's attitude justified? Why or why not?
2. What, if any, action should Joe take now?

Solution 196

1. Joe's attitude is not justified. The system will only be able to detect that merchandise is missing, not to determine who took it.

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Solution 196 (cont.)

2. Joe should notify his superiors at once. He has knowledge of what may be criminal acts, and by concealing them, he is very close to becoming a party to the acts. Joe's apparent fear of not being promotable because of a “goody-goody” image seems unjustified. It would seem more likely that Joe's refusal to accept unethical (and illegal) acts by others would make him a more valuable manager. He may even be jeopardizing his career with Newmans if someone else reports Suzy's actions. The resulting investigation may implicate Joe because of his failure to notify the proper authorities in a timely manner.

S-A E 197 (Communication)

Sam Wertz, a new employee of Nance Company, recorded $1,000 in consigned goods received as part of the firm's inventory. The goods were received one day after the end of the fiscal period, but Sam reasoned that the goods should be included in inventory sooner because Nance paid the freight. The mistake was brought to his attention by the purchasing department who said the goods should not have been recorded as Nance’s inventory at all. Sam told Lisa Gomez, the purchasing supervisor, that nobody needed to worry, because the mistake would cancel itself out the following month. In Sam's opinion, there was no reason to get everyone excited over nothing, especially since it was monthly, and not annual, financial statements that were affected. Lisa Gomez has reported the problem to the accounting department.

Required:
You are Sam's supervisor. Write a memo to Sam explaining why the error should have been corrected.

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Solution 197

M E M O

TO: Sam Wertz, Accounting Department

FROM: Mary Farr, Supervisor

DATE: March 12, 2008

It has come to my attention that $1,000 in consigned goods were included in the inventory reported in our January financial statements. You were informed that this amount should be removed from inventory, which you did not do, apparently believing that February's entries would correct the error.

The error would have been corrected in February if it were only a matter of your recording inventory in the wrong month. January's inventory and expenses would have been overstated, and February's understated, but the net effect would have been zero. Since the $1,000 is a fairly large amount, however, that still would not have been appropriate.

The error you made, however, was to enter into inventory goods that the company did not own, and will not own. Consigned goods are owned by the consignors until purchased by customers. We only provide our shops for the consignors to sell their goods, and we collect a fee for doing so.

Please correct the error at once. We may need to notify some of the other departments of the error as well. Please arrange to meet with me in my office as soon as possible to discuss the matter.

(signature)

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CHAPTER 7

Accounting Information Systems

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Identify the basic concepts of an accounting information system.	1, 2, 3, 4	1, 2, 3			
2. Describe the nature and purpose of a subsidiary ledger.	5, 6, 9, 11,16	4, 5	1, 2, 3, 4, 5, 6, 7, 9, 11, 12	1A, 2A, 3A, 4A, 5A, 6A	1B, 2B, 3B, 4B, 5B
3. Explain how companies use special journals in journalizing.	7, 8, 10, 11, 12, 13, 14, 17	6, 7, 8, 9	6, 7, 8, 10, 12	1A, 2A, 3A, 4A, 5A, 6A	1B, 2B, 3B, 4B, 5B
4. Indicate how companies post a multi-column journal.	12, 15	10	1, 3, 9, 11, 13, 14	1A, 2A, 3A, 4A, 5A, 6A	1B, 2B, 3B, 4B, 5B

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ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Journalize transactions in cash receipts journal; post to control account and subsidiary ledger.	Simple	30–40
2A	Journalize transactions in cash payments journal; post to control account and subsidiary ledgers.	Simple	30–40
3A	Journalize transactions in multi-column purchases journal; post to the general and subsidiary ledgers.	Moderate	40–50
4A	Journalize transactions in special journals.	Moderate	50–60
5A	Journalize in sales and cash receipts journals; post; prepare a trial balance; prove control to subsidiary; prepare adjusting entries; prepare an adjusted trial balance.	Moderate	60–70
6A	Journalize in special journals; post; prepare a trial balance.	Complex	60–70
1B	Journalize transactions in cash receipts journal; post to control account and subsidiary ledger.	Simple	30–40
2B	Journalize transactions in cash payments journal; post to the general and subsidiary ledgers.	Simple	30–40
3B	Journalize transactions in multi-column purchases journal; post to the general and subsidiary ledgers.	Moderate	40–50
4B	Journalize transactions in special journals.	Moderate	50–60
5B	Journalize in purchases and cash payments journals; post; prepare a trial balance; prove control to subsidiary; prepare adjusting entries; prepare an adjusted trial balance.	Moderate	60–70

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BLOOM'S TAXONOMY TABLE

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Identify the basic concepts of an accounting information system.		Q7-1 BE7-1 Q7-2 BE7-2 Q7-3 BE7-3 Q7-4				
2. Describe the nature and purpose of a subsidiary ledger.	Q7-5	Q7-6 Q7-9 Q7-16 BE7-4 BE7-5 E7-2 E7-11	E7-1 E7-11 P7-6A E7-3 E7-12 P7-1B E7-4 P7-1A P7-2B E7-5 P7-2A P7-3B E7-6 P7-3A P7-4B E7-7 P7-4A P7-5B E7-9 P7-5A	Q7-11		
3. Explain how companies use special journals in journalizing.		Q7-7 BE7-6 Q7-8 BE7-7 Q7-10 BE7-8 Q7-12 BE7-9 Q7-13 E7-8 Q7-14 E7-10 Q7-17	E7-6 P7-4A P7-5B E7-7 P7-5A E7-10 P7-6A E7-12 P7-1B P7-1A P7-2B P7-2A P7-3B P7-3A P7-4B	Q7-11		
4. Indicate how companies post a multi-column journal.		Q7-12 Q7-15 BE7-10 E7-11	E7-1 P7-2A P7-2B E7-3 P7-3A P7-3B E7-9 P7-4A P7-4B E7-13 P7-5A P7-5B E7-14 P7-6A P7-1A P7-1B			
Broadening Your Perspective		Exploring the Web	Financial Reporting (Mini Practice Set)			Decision Making Across the Organization Communication Ethics Case All About You

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ANSWERS TO QUESTIONS

1. (a) An accounting information system collects and processes transaction data and communicates financial information to decision makers.
(b) Disagree. An accounting information system applies regardless of whether manual or computerized procedures are used to process the transaction data.

2. There are three principles for developing an accounting information system:

Cost effectiveness. The system must be cost-effective; that is, the benefits obtained from the information must outweigh the cost of providing it.
Useful output. To be useful, information must be understandable, relevant, reliable, timely, and accurate.
Flexibility. The system should accommodate a variety of users and changing information needs.

3. Common features of a computerizied accounting package beyond recording transactions and preparing financial statements are: easy data access and report preparation; audit trail, internal controls, customization; and network compatibility.

4. ERP systems go far beyond the functions of an entry level general ledger package. They integrate all aspects of the organization, including accounting, sales, human resource management, and manufacturing.

5. A subsidiary ledger is a group of accounts with a common characteristic. The accounts are assembled together to facilitate the accounting process by freeing the general ledger from details concerning individual balances. The advantages of using subsidiary ledgers are that they:

- Permit transactions affecting a single customer or single creditor to be shown in a single account, thus providing necessary up-to-date information on specific account balances.
- Free the general ledger of excessive details relating to accounts receivable and accounts payable. As a result, a trial balance of the general ledger does not contain potentially thousands and thousands of individual account balances.
- Assist in locating errors in individual accounts by reducing the number of accounts in one ledger and by using control accounts.
- Permit a division of labor in posting by having one employee post to the general ledger and (a) different employee(s) post to the subsidiary ledgers.

6. (a) (1) Transactions to individual accounts are generally posted daily to the subsidiary ledger.
(2) In contrast, postings to the control accounts are usually made in total at the end of the month.
(b) A control account is a general ledger account that summarizes subsidiary ledger data. Subsidiary ledger accounts keep track of specific account activity (i.e., specific debtors or creditors). A subsidiary ledger is an addition to, and an expansion of, the general ledger.

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Questions Chapter 7 (Continued)

7. Sales journal. Records entries for all sales of merchandise on account.
Cash receipts journal. Records entries for all cash received by the business.
Purchases journal. Records entries for all purchases of merchandise on account.
Cash payments journal. Records entries for all cash paid.

Some advantages of each journal are given below:

- Sales journal. (1) Since the sales journal employs only one line to record a Sales transaction, its use reduces recording time; (2) the column totals are only posted to the general ledger once an accounting period; and (3) the journal's use separates responsibilities between employees.
- Cash receipts journal. (1) Its use aids in the posting process since the totals for Cash, Sales Discounts, Accounts Receivable, and Sales are all recorded in the general ledger only at the end of the month; and (2) it allows all accounts receivable credits to be posted to the appropriate subsidiary ledger accounts daily.
- Purchases journal. The advantages are similar to those of the sales journal except that items involved are Merchandise Inventory debits and Accounts Payable credits.
- Cash payments journal. Similar advantages to cash receipts journal except the columns involved are different.

In general, special journals: (1) allow greater division of labor because various individuals can record entries in different journals at the same time; and (2) reduce posting time of journals.

8. The entry for the sales return should be recorded in the general journal. Since Thogmartin Company has a single-column sales journal, only credit sales can be recorded there. A purchase by Thogmartin Company has not taken place, so the use of the purchases journal is inappropriate. Finally, no cash is received or paid, so neither the cash receipts or cash payments journal should be used.

9. At the end of the month, after all postings to both the general ledger and the subsidiary accounts have been made, the total of the subsidiary account balances should equal the balance of the control account in the general ledger. In this case, the control account balance will be $450 larger than the total of the subsidiary accounts.

10. The purpose of special journals is to facilitate the recording process of the business entity. Therefore, the columns included in any special journal should correspond to the unique needs of the entity. In particular, one type of business which might not require an Accounts Receivable column would be grocery stores. These businesses rarely sell on credit to their customers. The minimum frequency of the transaction implies no need for an Accounts Receivable column in the cash receipts journal.

11. (a) No, the customers' ledger will not agree with the Accounts Receivable control account. The customers' ledger will be posted correctly, but the Accounts Receivable control account will be incorrect.
(b) The trial balance will balance, although Cash will be $4,000 too high and Accounts Receivable $4,000 too low.

12. The special journal is the sales journal. The other account is Sales. (The cash receipts journal is an incorrect answer because there would be more than two month-end postings to general ledger accounts.)

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13. (a) General journal.
(b) General journal.
(c) Cash receipts journal.
(d) Sales journal.
(e) Cash receipts journal.
(f) General journal.

14. (a) Cash receipts journal.
(b) Cash receipts journal.
(c) General journal.
(d) Purchases journal.
(e) General journal.
(f) Cash payments journal.

15. Typically included would be credit purchases of equipment, office supplies, and store supplies. However, any other item purchased on credit could also be included in a special column or the "other" column.

16. One such example is a purchase return. Here the Accounts Payable control and subsidiary account must be debited for the same amount. The debit/credit equality is unaffected since the balance sheet equation is computed using general ledger (control) accounts only. The subsidiary accounts should prove to the control account balance.

17. The general journal may be used to record such transactions as the granting of credit to a customer for a sales return or allowance, the receipt of credit from a supplier for purchases returned, acceptance of a note receivable from a customer, or the purchase of a plant asset by issuing a note payable. In addition, all correcting, adjusting, and closing entries should be made in the general journal.

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SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 7-1

1. True.
2. False.
3. True.

BRIEF EXERCISE 7-2

1. (e)
2. (d)
3. (a)
4. (b)
5. (c)

BRIEF EXERCISE 7-3

1. True.
2. False. The benefits obtained from information provided by the accounting information system *must* outweigh the cost of providing that information.
3. True.
4. False. An accounting information system must be cost effective, provide useful output, *and be flexible enough to accommodate changing information needs.*

BRIEF EXERCISE 7-4

Accounts Receivable Subsidiary Ledger

Agler Co.

Date	Ref.	Debit	Credit	Balance
Jan. 7		10,000		10,000
17			7,000	3,000

Barto Co.

Date	Ref.	Debit	Credit	Balance
Jan. 15		6,000		6,000
24			4,000	2,000

Maris Co.

Date	Ref.	Debit	Credit	Balance
Jan. 23		9,000		9,000
29			9,000	0

General Ledger

Accounts Receivable

Date	Ref.	Debit	Credit	Balance
Jan. 31		25,000		25,000
31			20,000	5,000

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BRIEF EXERCISE 7-5

1. General ledger
2. Subsidiary ledger
3. General ledger
4. Subsidiary ledger

BRIEF EXERCISE 7-6

1. Cash Receipts Journal
2. Cash Payments Journal
3. Cash Payments Journal
4. Sales Journal
5. Purchases Journal
6. Cash Receipts Journal

BRIEF EXERCISE 7-7

1. No
2. Yes
3. Yes
4. No

BRIEF EXERCISE 7-8

1. General Journal (if a one-column Purchases Journal)
   Purchases Journal (if a multi-column Purchases Journal)
2. Purchases Journal
3. Cash Payments Journal
4. Sales Journal

BRIEF EXERCISE 7-9

1. Cash Receipts Journal
2. Cash Receipts Journal
3. Cash Receipts Journal
4. Sales Journal and Cash Receipts Journal
5. Purchases Journal

BRIEF EXERCISE 7-10

1. Both in total and daily
2. In total
3. In total
4. Only daily

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SOLUTIONS TO EXERCISES

EXERCISE 7-1

(a) $350,400. Beginning balance of $320,000 plus $161,400 debit from sales journal less $131,000 credit from cash receipts journal.

(b) $85,900. Beginning balance of $77,000 plus $56,400 credit from purchases journal less $47,500 debit from cash payments journal.

(c) The column total of $161,400 in the sales journal would be posted to the credit side of the Sales account and the debit side of the Accounts Receivable account in the general ledger.

(d) The accounts receivable column total of $131,000 in the cash receipts journal would be posted to the credit side of the Accounts Receivable account in the general ledger.

EXERCISE 7-2

To: Andrea Barden, Chief Financial Officer

From: Student

Subject: Jeremy Dody account

The explanation of the three entries in the subsidiary ledger for the Jeremy Dody account is as follows:

Sept. 2 This was a credit sale of merchandise to Dody. The entry was recorded on page 31 of the Sales Journal.

Sept. 9 This was a sales return or allowance granted to Dody. The entry was recorded on page 4 of the General Journal.

Sept. 27 This was a payment by Dody of the balance due. The entry was recorded on page 8 of the Cash Receipts Journal.

If I can be of further help, please let me know.

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EXERCISE 7-3

(a) & (b) **General Ledger**

Accounts Receivable

Date	Explanation	Ref.	Debit	Credit	Balance
Sept. 1	Balance	✓			10,960
		S	4,490		15,450
		CR		7,030	8,420
		G		220	8,200

Accounts Receivable Subsidiary Ledger

Bannister

Date	Explanation	Ref.	Debit	Credit	Balance
Sept. 1	Balance	✓			2,060
		S	1,100		3,160
		CR		1,310	1,850

Crampton

Date	Explanation	Ref.	Debit	Credit	Balance
Sept. 1	Balance	✓			4,820
		S	800		5,620
		CR		2,300	3,320
		G		220	3,100

Iman

Date	Explanation	Ref.	Debit	Credit	Balance
Sept. 1					0
		S	1,330		1,330
		CR		380	950

Kingston

Date	Explanation	Ref.	Debit	Credit	Balance
Sept. 1	Balance	✓			2,640
		CR		1,800	840

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EXERCISE 7-3 (Continued)

Ruiz

Date	Explanation	Ref.	Debit	Credit	Balance
Sept. 1	Balance	✓			1,440
		S	1,260		2,700
		CR		1,240	1,460

(c)

SEAVER COMPANY
Schedule of Customers
As of September 30, 2008

Bannister	$1,850
Crampton	3,100
Iman	950
Kingston	840
Ruiz	1,460
Total	$8,200
Accounts Receivable	$8,200

EXERCISE 7-4

(a) $4,500 [$11,000 – ($4,000 + $2,500).

(b) $13,000 [$11,000 + ($9,000 + $7,000 + $8,500) – ($8,000 + $2,500 + $9,000) – $3,000].

(c)

Smith	($4,000 + $9,000 – $8,000)	$ 5,000
Green	($2,500 + $7,000 – $2,500 – $3,000)	4,000
Koyan	($4,500 + $8,500 – $9,000)	4,000
		$13,000

(d) The sales return ($3,000) would be recorded in the general journal.

EXERCISE 7-5

(a) $3,375 [$8,250 – ($3,000 + $1,875).

(b) $9,750 [$8,250 + ($6,750 + $5,250 + $6,375) – ($6,000 + $1,875 + $6,750) – $2,250].

(c)

Jones	($3,000 + $6,750 – $6,000)	$3,750
Brown	($1,875 + $5,250 – $1,875 – $2,250)	3,000
Aatski	($3,375 + $6,375 – $6,750)	3,000
		$9,750

(d) The purchase return ($2,250) would be recorded in the general journal.

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EXERCISE 7-6

(a) & (b)

MONTALVO COMPANY
Sales Journal

S1

Date	Account Debited	Invoice No.	Ref.	Accounts Receivable Dr. Sales Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
2008					
Sept. 2	T. Hossfeld	101		720	420
21	P. Lowther	102		800	480
				1,520	900

MONTALVO COMPANY
Purchases Journal

P1

Date	Account Credited	Terms	Ref.	Merchandise Inventory Dr. Accounts Payable Cr.
2008				
Sept. 10	L. Rincon	2/10, n/30		600
25	W. Barone	n/30		860
				1,460

EXERCISE 7-7

(a) & (b)

PHERIGO CO.
Cash Receipts Journal

CR1

Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
2008								
May 1	I. Pherigo, Cap.		50,000				50,000	
2			6,300			6,300		4,200
22	M. Moody		9,000		9,000			
			65,300		9,000	6,300	50,000	4,200

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EXERCISE 7-7 (Continued)

PHERIGO CO.
Cash Payments Journal

CP1

Date	Ck. No.	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Cash Cr.
2008						
May 3	101	Merchandise Inventory		7,200		7,200
14	102	Salary Expense		700		700
				7,900		7,900

EXERCISE 7-8

(a) Journal	(b) Columns in the journal
1. Cash Payments	Cash (Cr.), Other Accounts (Dr.).
2. Cash Receipts	Cash (Dr.), Sales Discounts (Dr.), and Accounts Receivable (Cr.).
3. Cash Payments	Cash (Cr.), Other Accounts (Dr.).
4. Cash Payments	Cash (Cr.), Merchandise Inventory (Cr.), and Accounts Payable (Dr.).
5. Cash Receipts	Cash (Dr.), Accounts Receivable (Cr.).
6. Cash Payments	Cash (Cr.), Other Accounts (Dr.).
7. Cash Payments	Cash (Cr.), Other Accounts (Dr.).
8. Cash Receipts	Cash (Dr.), Other Accounts (Cr.).
9. Cash Payments	Cash (Cr.), Other Accounts (Dr.).
10. Cash Receipts	Cash (Dr.), Sales (Cr.), Cost of Goods Sold (Dr.), and Merchandise Inventory (Cr.).

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EXERCISE 7-9

(a)

Mar.	2	Equipment	9,400	
		Accounts Payable—Chang Company		9,400
	5	Accounts Payable—Lyden Company	410	
		Merchandise Inventory		410
	7	Sales Returns and Allowances	400	
		Accounts Receivable—Higley Company		400
		Merchandise Inventory	260	
		Cost of Goods Sold		260

(b)

To: President Velasquez

From: Chief Accountant

Subject: Posting of Control and Subsidiary Accounts

The posting of these accounts varies with the journals used in recording the transactions.

Sales and purchases journals—the total for the month is posted to the control accounts. The individual entries are posted daily to the subsidiary accounts.

Columnar cash receipts and cash payments journals—the total of the control account column for the month is posted to the control account. The individual amounts in the column are posted daily to the subsidiary accounts.

General journal—the individual entries are posted daily. Each entry that pertains to a control and a subsidiary account is dual posted. That is, it is posted to both the control account and the subsidiary account.

I hope this memo answers your questions about posting.

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EXERCISE 7-10

1. Cash Payments Journal
2. General Journal
3. Cash Receipts Journal
4. Cash Receipts Journal
5. Sales Journal
6. Cash Receipts Journal
7. General Journal
8. Cash Receipts Journal
9. Cash Payments Journal
10. General Journal
11. General Journal
12. Cash Payments Journal
13. Purchases Journal

EXERCISE 7-11

(a) The debit posting reference on February 28 should be from the cash payments journal to record the payments made during the month. The general ledger debit amount should be $29,340 to balance. Tebbetts' ending balance must be $2,600. (Accounts Payable control balance of $9,500 less Perez, $4,600, and Zerbe, $2,300.)

(b) Only the general journal amounts were dual posted. Thus, the amounts were $1,400 (Dr.), $265 (Cr.), and $550 (Cr.).

EXERCISE 7-12

(a) **Purchases Journal**

P1

Date	Account Credited	Ref.	Merchandise Inventory Dr. Accounts Payable Cr.
July 3	Brian Co.	✓	2,400
12	Erik Co.	✓	500
14	Drago Co.	✓	1,100
17	Chacon Corp.	✓	1,400
20	Brian Co.	✓	700
21	Erik Co.	✓	600
29	Chacon Corp.	✓	1,600
			8,300
			120/201

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EXERCISE 7-12 (Continued)

(b) **General Journal**

Date		Accounts and Explanations	Ref.	Debit	Credit
July	1	Store Equipment	153	3,900	
		Accounts Payable—Albin Equipment Co.	201/✓		3,900
	15	Merchandise Inventory	120	400	
		Accounts Payable—Heinen Inc.	201/✓		400
		(This entry should have been recorded in the Purchases Journal.)			
	18	Accounts Payable—Chacon Corp.	201/✓	100	
		Merchandise Inventory.....	120		100
	25	Accounts Payable—Drago Co.	201/✓	200	
		Merchandise Inventory.....	120		200

EXERCISE 7-13

$925 ($200 + $240 + $145 + $190 + $150). All of the debit postings to the subsidiary ledger accounts should be from sales invoices. The total of all these debits should therefore be the total credit sales for the month, which would be the same amount as the end-of-month debit to Accounts Receivable.

EXERCISE 7-14

(a) $14,000 + $72,000 – $46,000 = $40,000
(b) $22,000 + $100,000 – $45,000 = $77,000
(c) $17,000 + $61,000 – $55,000 = $23,000
(d) $13,500 + $72,000 – $1,000 – $63,600 = $20,900
(e) $100,000 + $6,000 = $106,000

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SOLUTIONS TO PROBLEMS

PROBLEM 7-1A

(a) Cash Receipts Journal

CR1

Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
Apr. 1	O. Grider, Capital	301	7,200				7,200	
4	Baez	✓	1,764	36	1,800			
5	Eggleston Co.	✓	920		920			
8			7,245			7,245		4,347
10	Ogden	✓	600		600			
11	Merchandise Inventory	120	740				740	
23	Eggleston Co.	✓	1,500		1,500			
29	Chelsea	✓	1,200		1,200			
			21,169	36	6,020	7,245	7,940	4,347
			(101)	(414)	(112)	(401)	(X)	(505)(120)

(b) General Ledger

Accounts Receivable No. 112

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 1	Balance	✓			7,450
30		CR1		6,020	1,430

Accounts Receivable Subsidiary Ledger

Ogden

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 1	Balance	✓			1,550
10		CR1		600	950

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PROBLEM 7-1A (Continued)

Chelsea

Date		Explanation	Ref.	Debit	Credit	Balance
Apr.	1	Balance	✓			1,200
	29		CR1		1,200	0

Eggleston Co.

Date		Explanation	Ref.	Debit	Credit	Balance
Apr.	1	Balance	✓			2,900
	5		CR1		920	1,980
	23		CR1		1,500	480

Baez

Date		Explanation	Ref.	Debit	Credit	Balance
Apr.	1	Balance	✓			1,800
	4		CR1		1,800	0

(c) Accounts receivable balance: $1,430

Subsidiary account balances:

Ogden	$ 950
Eggleston Co.	480
Total	$1,430

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PROBLEM 7-2A

(a) Cash Payments Journal

CP1

Date	Ck. No.	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Merchandise Inventory Cr.	Cash Cr.
Oct. 1	63	Merch. Inventory	120	300			300
3	64	Equipment	157	800			800
5	65	Bovary Company	✓		2,700	54	2,646
10	66	Merch. Inventory	120	2,250			2,250
15	67	Pyron Co.	✓		1,800		1,800
16	68	T. Ming, Drawing	306	400			400
19	69	Nyman Co.	✓		1,600	32	1,568
29	70	Sims Company	✓		2,500		2,500
				3,750	8,600	86	12,264
				(X)	(201)	(120)	(101)

(b) General Ledger

Accounts Payable No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Balance	✓			10,700
31		CP1	8,600		2,100

Accounts Payable Subsidiary Ledger

Bovary Company

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Balance	✓			2,700
5		CP1	2,700		0

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PROBLEM 7-2A (Continued)

Nyman Co.

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Balance	✓			2,500
19		CP1	1,600		900

Pyron Co.

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Balance	✓			1,800
15		CP1	1,800		0

Sims Company

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Balance	✓			3,700
29		CP1	2,500		1,200

(c) Accounts payable balance: $2,100

Subsidiary account balances:

Nyman Co.	$ 900
Sims Company	1,200
	$2,100

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PROBLEM 7-3A

(a) Purchases Journal

P1

Date	Account Credited (Debited)	Ref.	Accounts Payable Cr.	Merchandise Inventory Dr.	Other Accounts Dr.
July 1	Fritz Company	✓	8,000	8,000	
2	Wayward Shipping	✓	400	400	
5	Moon Company	✓	3,200	3,200	
13	Cress Supply (Supplies)	126/✓	720		720
15	Fritz Company	✓	3,600	3,600	
15	Anton Company	✓	3,300	3,300	
18	Lynda Advertisements (Advertising Expense)	610/✓	600		600
24	Moon Company	✓	3,000	3,000	
26	Cress Supply (Equipment)	157/✓	900		900
28	Wayward Shipping	✓	380	380	
			24,100	21,880	2,220
			(201)	(120)	(X)

Sales Journal

S1

Date	Account Debited	Ref.	Accounts Receivable Dr. Sales Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
July 3	Pinick Company	✓	1,300	910
3	Wayne Bros.	✓	1,500	1,050
16	Sager Company	✓	3,450	2,415
16	Wayne Bros.	✓	1,570	1,099
21	Pinick Company	✓	310	217
21	Haddad Company	✓	2,800	1,960
30	Sager Company	✓	5,600	3,920
			16,530	11,571
			(112)(401)	(505)(120)

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PROBLEM 7-3A (Continued)

General Journal

G1

Date		Accounts and Explanations	Ref.	Debit	Credit
July	8	Accounts Payable—Moon Company	201/✓	300	
		Merchandise Inventory	120		300
	22	Sales Returns and Allowances	412	40	
		Accounts Receivable—Pinick Company	112/✓		40

(b) **General Ledger**

Accounts Receivable No. 112

Date		Explanation	Ref.	Debit	Credit	Balance
July	31		S1	16,530		16,530
	22		G1		40	16,490

Merchandise Inventory No. 120

Date		Explanation	Ref.	Debit	Credit	Balance
July	31		P1	21,880		21,880
	8		G1		300	21,580
	31		S1		11,571	10,009

Supplies No. 126

Date		Explanation	Ref.	Debit	Credit	Balance
July	13		P1	720		720

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PROBLEM 7-3A (Continued)

Equipment **No. 157**

Date	Explanation	Ref.	Debit	Credit	Balance
July 26		P1	900		900

Accounts Payable **No. 201**

Date	Explanation	Ref.	Debit	Credit	Balance
July 31		P1		24,100	24,100
8		G1	300		23,800

Sales **No. 401**

Date	Explanation	Ref.	Debit	Credit	Balance
July 31		S1		16,530	16,530

Sales Returns and Allowances **No. 412**

Date	Explanation	Ref.	Debit	Credit	Balance
July 22		G1	40		40

Cost of Goods Sold **No. 505**

Date	Explanation	Ref.	Debit	Credit	Balance
July 31		S1	11,571		11,571

Advertising Expense **No. 610**

Date	Explanation	Ref.	Debit	Credit	Balance
July 18		P1	600		600

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PROBLEM 7-3A (Continued)

Accounts Receivable Subsidiary Ledger

Wayne Bros.

Date	Explanation	Ref.	Debit	Credit	Balance
July 3		S1	1,500		1,500
16		S1	1,570		3,070

Pinick Company

Date	Explanation	Ref.	Debit	Credit	Balance
July 3		S1	1,300		1,300
21		S1	310		1,610
22		G1		40	1,570

Sager Company

Date	Explanation	Ref.	Debit	Credit	Balance
July 16		S1	3,450		3,450
30		S1	5,600		9,050

Haddad Company

Date	Explanation	Ref.	Debit	Credit	Balance
July 21		S1	2,800		2,800

Accounts Payable Subsidiary Ledger

Cress Supply

Date	Explanation	Ref.	Debit	Credit	Balance
July 13		P1		720	720
26		P1		900	1,620

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PROBLEM 7-3A (Continued)

Wayward Shipping

Date	Explanation	Ref.	Debit	Credit	Balance
July 2		P1		400	400
28		P1		380	780

Fritz Company

Date	Explanation	Ref.	Debit	Credit	Balance
July 1		P1		8,000	8,000
15		P1		3,600	11,600

Moon Company

Date	Explanation	Ref.	Debit	Credit	Balance
July 5		P1		3,200	3,200
8		G1	300		2,900
24		P1		3,000	5,900

Lynda Advertisements

Date	Explanation	Ref.	Debit	Credit	Balance
July 18		P1		600	600

Anton Company

Date	Explanation	Ref.	Debit	Credit	Balance
July 15		P1		3,300	3,300

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PROBLEM 7-3A (Continued)

(c)	**Accounts receivable balance**		**$16,490**
	Subsidiary account balances		
	Wayne Bros.	$3,070	
	Pinick Company	1,570	
	Sager Company	9,050	
	Haddad Company	2,800	
	Total		$16,490
	Accounts payable balance		**$23,800**
	Subsidiary account balances		
	Cress Supply	$ 1,620	
	Wayward Shipping	780	
	Fritz Company	11,600	
	Moon Company	5,900	
	Lynda Advertisements	600	
	Anton Company	3,300	
	Total		$23,800

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PROBLEM 7-4A

(a), (b) & (c)

Sales Journal

S1

Date	Account Debited	Invoice No.	Ref.	Accounts Receivable Dr. / Sales Cr.	Cost of Goods Sold Dr. / Merchandise Inventory Cr.
Jan. 4	Milam	371	✓	5,250	3,150
9	Connor Corp.	372	✓	6,400	3,840
17	Bullock Co.	373	✓	1,200	720
31	Milam	374	✓	9,330	5,598
				22,180	13,308
				(112)(401)	(505)(120)

Purchases Journal

P1

Date	Account Credited	Ref.	Merchandise Inventory Dr. / Accounts Payable Cr.
Jan. 3	Wortham Co.	✓	10,000
8	Noyes Co.	✓	4,500
11	Betz Co.	✓	3,700
23	Wortham Co.	✓	7,800
24	Forgetta Corp.	✓	5,100
			31,100
			(120)(201)

General Journal

G1

Date	Accounts and Explanations	Ref.	Debit	Credit
Jan. 5	Accounts Payable—Wortham Co.	201/✓	300	
	Merchandise Inventory	120		300
19	Equipment.....	157	5,500	
	Accounts Payable—Murphy Corp.....	201/✓		5,500

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PROBLEM 7-4A (Continued)

Cash Receipts Journal

CR1

Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
Jan. 6			3,150			3,150		1,890
13			6,260			6,260		3,756
15	Connor Corp.	✓	6,336	64	6,400			
17	Milam	✓	5,250		5,250			
20			3,200			3,200		1,920
27			4,230			4,230		2,538
30	Bullock Co.	✓	1,200		1,200			
			29,626	64	12,850	16,840	0	10,104
			(101)	(414)	(112)	(401)	(X)	(505)(120)

Cash Payments Journal

CP1

Date	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Merchandise Inventory Cr.	Cash Cr.
Jan. 4	Supplies	126	80			80
13	Wortham Co.	✓		9,700	194	9,506
15	Salaries Expense	726	14,300			14,300
20	Noyes Co.	✓		4,500	90	4,410
31	Salaries Expense	726	13,200			13,200
			27,580	14,200	284	41,496
			(X)	(201)	(120)	(101)

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PROBLEM 7-5A

(a), (d) & (g) General Ledger

Cash No. 101

Date		Explanation	Ref.	Debit	Credit	Balance
July	31		CR1	101,035		101,035
	31		CP1		39,066	61,969

Accounts Receivable No. 112

Date		Explanation	Ref.	Debit	Credit	Balance
July	31		S1	19,700		19,700
	31		CR1		14,700	5,000

Merchandise Inventory No. 120

Date		Explanation	Ref.	Debit	Credit	Balance
July	31		P1	44,020		44,020
	29		CR1		420	43,600
	31		CP1		234	43,366
	31		S1		12,805	30,561
	31		CR1		3,900	26,661

Store Supplies No. 127

Date		Explanation	Ref.	Debit	Credit	Balance
July	4		CP1	600		600
	31	Adjusting entry	G1		460	140

Prepaid Rent No. 131

Date		Explanation	Ref.	Debit	Credit	Balance
July	11		CP1	6,000		6,000
	31	Adjusting entry	G1		500	5,500

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PROBLEM 7-5A (Continued)

Accounts Payable **No. 201**

Date	Explanation	Ref.	Debit	Credit	Balance
July 31		P1		44,020	44,020
31		CP1	30,200		13,820

Reyes, Capital **No. 301**

Date	Explanation	Ref.	Debit	Credit	Balance
July 1		CR1		80,000	80,000

Reyes, Drawing **No. 306**

Date	Explanation	Ref.	Debit	Credit	Balance
July 19		CP1	2,500		2,500

Sales **No. 401**

Date	Explanation	Ref.	Debit	Credit	Balance
July 31		S1		19,700	19,700
31		CR1		6,000	25,700

Sales Discounts **No. 414**

Date	Explanation	Ref.	Debit	Credit	Balance
July 31		CR1	85		85

Cost of Goods Sold **No. 505**

Date	Explanation	Ref.	Debit	Credit	Balance
July 31		S1	12,805		12,805
31		CR1	3,900		16,705

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PROBLEM 7-5A (Continued)

Supplies Expense — No. 631

Date	Explanation	Ref.	Debit	Credit	Balance
July 31	Adjusting entry	G1	460		460

Rent Expense — No. 729

Date	Explanation	Ref.	Debit	Credit	Balance
July 31	Adjusting entry	G1	500		500

(b)

Sales Journal

S1

Date	Account Debited	Ref.	Accounts Receivable Dr. Sales Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
July 6	Ewing Co.	✓	6,200	4,030
8	S. Beauty	✓	3,600	2,340
10	W. Pitts	✓	4,900	3,185
21	H. Prince	✓	5,000	3,250
			19,700	12,805
			(112)(401)	(505)(120)

Cash Receipts Journal

CR1

Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
July 1	Reyes, Capital	301	80,000				80,000	
7			6,000			6,000		3,900
13	S. Beauty	✓	3,564	36	3,600			
16	W. Pitts	✓	4,851	49	4,900			
20	Ewing Co.	✓	6,200		6,200			
29	Merchandise Inventory	120	420				420	
			101,035	85	14,700	6,000	80,420	3,900
			(101)	(414)	(112)	(401)	(X)	(505)(120)

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PROBLEM 7-5A (Continued)

(c) Accounts Receivable Subsidiary Ledger

Ewing Co.

Date	Explanation	Ref.	Debit	Credit	Balance
July 6		S1	6,200		6,200
20		CR1		6,200	0

H. Prince

Date	Explanation	Ref.	Debit	Credit	Balance
July 21		S1	5000		5,000

W. Pitts

Date	Explanation	Ref.	Debit	Credit	Balance
July 10		S1	4,900		4,900
16		CR1		4,900	0

S. Beauty

Date	Explanation	Ref.	Debit	Credit	Balance
July 8		S1	3,600		3,600
13		CR1		3,600	0

Accounts Payable Subsidiary Ledger

C. Tabor

Date	Explanation	Ref.	Debit	Credit	Balance
July 13		P1		15,300	15,300
21		CP1	15,300		0

A. Ernst

Date	Explanation	Ref.	Debit	Credit	Balance
July 5		P1		8,100	8,100
10		CP1	8,100		0

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PROBLEM 7-5A (Continued)

M. Sneezy

Date	Explanation	Ref.	Debit	Credit	Balance
July 20		P1		7,900	7,900

G. Clemens

Date	Explanation	Ref.	Debit	Credit	Balance
July 4		P1		6,800	6,800
15		CP1	6,800		0

J. Happy

Date	Explanation	Ref.	Debit	Credit	Balance
July 11		P1		5,920	5,920

(e)

REYES CO.
Trial Balance
July 31, 2008

	Debit	Credit
Cash	$ 61,969	
Accounts Receivable	5,000	
Merchandise Inventory	26,661	
Store Supplies	600	
Prepaid Rent	6,000	
Accounts Payable		$ 13,820
Reyes, Capital		80,000
Reyes, Drawing	2,500	
Sales		25,700
Sales Discounts	85	
Cost of Goods Sold	16,705	
	$119,520	$119,520

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PROBLEM 7-5A (Continued)

(f)

Accounts receivable balance	$ 5,000
Subsidiary accounts balance	
H. Prince	$ 5,000
Accounts payable balance	$13,820
Subsidiary accounts balance	
M. Sneezy	$ 7,900
J. Happy	5,920
	$13,820

(g)

General Journal

G1

Date		Accounts and Explanations	Ref.	Debit	Credit
July	31	Supplies Expense	631	460	
		Store Supplies	127		460
	31	Rent Expense	729	500	
		Prepaid Rent	131		500

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PROBLEM 7-5A (Continued)

(h)

REYES CO.
Adjusted Trial Balance
July 31, 2008

	Debit	Credit
Cash	$ 61,969	
Accounts Receivable	5,000	
Merchandise Inventory	26,661	
Store Supplies	140	
Prepaid Rent	5,500	
Accounts Payable		$ 13,820
Reyes, Capital		80,000
Reyes, Drawing	2,500	
Sales		25,700
Sales Discounts	85	
Cost of Goods Sold	16,705	
Supplies Expense	460	
Rent Expense	500	
	$119,520	$119,520

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PROBLEM 7-6A

(b) & (c)

Cash Receipts Journal

CR1

Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
Jan. 7	T. Dudley	✓	3,500		3,500			
13	M. Rensing	✓	4,900	100	5,000			
23			9,100			9,100		5,460
29	Notes Receivable	115	40,000				40,000	
			57,500	100	8,500	9,100	40,000	5,460
			(101)	(414)	(112)	(401)	(X)	(505)(120)

Cash Payments Journal

CP1

Date	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Merchandise Inventory Cr.	Cash Cr.
Jan. 11	Merchandise Inventory	120	300			300
12	Rent Expense	729	1,000			1,000
15	K. Inwood	✓		15,000	150	14,850
18	Sales Salaries Expense	726	2,800			2,800
18	Office Salaries Expense	727	2,000			2,000
27	E. Vietti	✓		950		950
			6,100	15,950	150	21,900
			(X)	(201)	(120)	(101)

Sales Journal

S1

Date	Account Debited	Ref.	Accounts Receivable Dr. Sales Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
Jan. 3	M. Rensing	✓	5,000	3,000
24	F. Cone	✓	7,400	4,440
			12,400	7,440
			(112)(401)	(505)(120)

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PROBLEM 7-6A (Continued)

Purchases Journal

P1

Date	Account Credited	Ref.	Merchandise Inventory Dr. Accounts Payable Cr.
Jan. 5	E. Vietti	✓	2,000
17	G. Marley	✓	1,600
			3,600
			(120)(201)

General Journal

G1

Date	Accounts and Explanations	Ref.	Debit	Credit
Jan. 14	Sales Returns and Allowances	412	300	
	Accounts Receivable—			
	J. Anders	✓/112		300
	Merchandise Inventory	120	180	
	($300 X .60)			
	Cost of Goods Sold	505		180
20	Accounts Payable—D. Goodman	✓/201	18,000	
	Notes Payable	200		18,000
30	Accounts Payable—G. Marley	✓/201	300	
	Merchandise Inventory	120		300

(a) & (c)

General Ledger

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			41,500
31		CR1	57,500		99,000
31		CP1		21,900	77,100

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PROBLEM 7-6A (Continued)

Accounts Receivable **No. 112**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			15,000
	14		G1		300	14,700
	31		CR1		8,500	6,200
	31		S1	12,400		18,600

Notes Receivable **No. 115**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			45,000
	29		CR1		40,000	5,000

Merchandise Inventory **No. 120**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			23,000
	11		CP1	300		23,300
	14		G1	180		23,480
	30		G1		300	23,180
	31		P1	3,600		26,780
	31		CP1		150	26,630
	31		CR1		5,460	21,170
	31		S1		7,440	13,730

Equipment **No. 157**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			6,450

Accumulated Depreciation—Equipment **No. 158**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			1,500

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PROBLEM 7-6A (Continued)

Notes Payable — No. 200

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 20		G1		18,000	18,000

Accounts Payable — No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			43,000
20		G1	18,000		25,000
30		G1	300		24,700
31		P1		3,600	28,300
31		CP1	15,950		12,350

B. Cortez, Capital — No. 301

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			86,450

Sales — No. 401

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		CR1		9,100	9,100
31		S1		12,400	21,500

Sales Returns and Allowances — No. 412

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 14		G1	300		300

Sales Discounts — No. 414

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		CR1	100		100

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PROBLEM 7-6A (Continued)

Cost of Goods Sold **No. 505**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		CR1	5,460		5,460
31		S1	7,440		12,900
14		G1		180	12,720

Sales Salaries Expense **No. 726**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 18		CP1	2,800		2,800

Office Salaries Expense **No. 727**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 18		CP1	2,000		2,000

Rent Expense **No. 729**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 12		CP1	1,000		1,000

Accounts Receivable Subsidiary Ledger

J. Anders

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			2,500
14		G1		300	2,200

F. Cone

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			7,500
24		S1	7,400		14,900

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PROBLEM 7-6A (Continued)

T. Dudley

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			5,000
	7		CR1		3,500	1,500

M. Rensing

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	3		S1	5,000		5,000
	13		CR1		5,000	0

Accounts Payable Subsidiary Ledger

G. Marley

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	17		P1		1,600	1,600
	30		G1	300		1,300

J. Feeney

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			10,000

D. Goodman

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			18,000
	20		G1	18,000		0

K. Inwood

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			15,000
	15		CP1	15,000		0

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PROBLEM 7-6A (Continued)

E. Vietti

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 5		P1		2,000	2,000
27		CP1	950		1,050

(d)

CORTEZ CO.
Trial Balance
January 31, 2009

	Debit	Credit
Cash	$ 77,100	
Accounts Receivable	18,600	
Notes Receivable	5,000	
Merchandise Inventory	13,730	
Equipment	6,450	
Accumulated Depreciation—Equipment		$ 1,500
Notes Payable		18,000
Accounts Payable		12,350
B. Cortez, Capital		86,450
Sales		21,500
Sales Returns and Allowances	300	
Sales Discounts	100	
Cost of Goods Sold	12,720	
Sales Salaries Expense	2,800	
Office Salaries Expense	2,000	
Rent Expense	1,000	
	$139,800	$139,800

(e) Accounts Receivable Subsidiary Ledger

J. Anders	$ 2,200
F. Cone	14,900
T. Dudley	1,500
	$18,600

Accounts Receivable Control	$18,600

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PROBLEM 7-6A (Continued)

Accounts Payable Subsidiary Ledger	
G. Marley	**$ 1,300**
J. Feeney	**10,000**
E. Vietti	**1,050**
	$12,350
Accounts Payable Control	**$12,350**

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PROBLEM 7-1B

(a) Cash Receipts Journal

CR1

Date		Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
June	1	J. Darby, Capital	301	10,000				10,000	
	3	Lenninger Co.	✓	1,274	26	1,300			
	6	Farley Co.	✓	1,862	38	1,900			
	7			6,135			6,135		4,090
	9	Deering & Son	✓	2,450	50	2,500			
	11	Merchandise Inventory	120	320				320	
	15			4,500			4,500		3,000
	20	Grinnell Bros.	✓	1,600		1,600			
				28,141	114	7,300	10,635	10,320	7,090
				(101)	(414)	(112)	(401)	(X)	(505/120)

(b) General Ledger

Accounts Receivable No. 112

Date		Explanation	Ref.	Debit	Credit	Balance
June	1	Balance	✓			7,300
	30		CR1		7,300	0

Accounts Receivable Subsidiary Ledger

Deering & Son

Date		Explanation	Ref.	Debit	Credit	Balance
June	1	Balance	✓			2,500
	9		CR1		2,500	0

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PROBLEM 7-1B (Continued)

Farley Co.

Date		Explanation	Ref.	Debit	Credit	Balance
June	1	Balance	✓			1,900
	6		CR1		1,900	0

Grinnell Bros.

Date		Explanation	Ref.	Debit	Credit	Balance
June	1	Balance	✓			1,600
	20		CR1		1,600	0

Lenninger Co.

Date		Explanation	Ref.	Debit	Credit	Balance
June	1	Balance	✓			1,300
	3		CR1		1,300	0

(c) Accounts receivable balance = 0.
Sum of all subsidiary accounts = 0.

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PROBLEM 7-2B

(a) Cash Payments Journal

CP1

Date	Ck. No.	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Merchandise Inventory Cr.	Cash Cr.
Nov. 1	11	Merch. Inventory	120	1,140			1,140
3	12	Equipment	157	1,700			1,700
5	13	Wex Bros.	✓		1,500	15	1,485
11	14	Merch. Inventory	120	2,000			2,000
15	15	G. Ruttan	✓		1,000	30	970
16	16	B. Gonya, Drawing	306	500			500
19	17	C. Kimberlin	✓		1,150	23	1,127
25	18	Prepaid Insurance	130	3,000			3,000
30	19	A. Hess & Co.	✓		3,500		3,500
				8,340	7,150	68	15,422
				(X)	(201)	(120)	(101)

(b) General Ledger

Accounts Payable No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
Nov. 1	Balance	✓			9,350
30		CP1	7,150		2,200

Accounts Payable Subsidiary Ledger

A. Hess & Co.

Date	Explanation	Ref.	Debit	Credit	Balance
Nov. 1	Balance	✓			4,500
30		CP1	3,500		1,000

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PROBLEM 7-2B (Continued)

C. Kimberlin

Date	Explanation	Ref.	Debit	Credit	Balance
Nov. 1	Balance	✓			2,350
19		CP1	1,150		1,200

G. Ruttan

Date	Explanation	Ref.	Debit	Credit	Balance
Nov. 1	Balance	✓			1,000
15		CP1	1,000		0

Wex Bros.

Date	Explanation	Ref.	Debit	Credit	Balance
Nov. 1	Balance	✓			1,500
5		CP1	1,500		0

(c) Accounts payable balance: $2,200

Subsidiary account balances:

A. Hess & Co.	$1,000
C. Kimberlin	1,200
	$2,200

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PROBLEM 7-3B

(a) Purchases Journal

P1

Date	Account Credited (Debited)	Ref.	Accounts Payable Cr.	Merchandise Inventory Dr.	Other Accounts Dr.
May 2	Younger Company	✓	7,500	7,500	
3	Ruden Freight	✓	360	360	
8	Utley Company	✓	8,000	8,000	
8	Zeider Company	✓	8,700	8,700	
15	Rodriguez Supply (Supplies)	126/✓	900		900
16	Younger Company	✓	4,500	4,500	
16	Utley Company	✓	7,200	7,200	
18	Ruden Freight	✓	500	500	
25	Amster Advertising (Adv. Exp.)	610/✓	900		900
28	Rodriguez Supply (Equipment)	157/✓	500		500
			39,060	36,760	2,300
			(201)	(120)	(X)

Sales Journal

S1

Date	Account Debited	Ref.	Accounts Receivable Dr. Sales Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
May 5	Ellie Company	✓	1,980	1,287
5	DeShazer Bros.	✓	2,700	1,755
5	Liu Company	✓	1,500	975
23	DeShazer Bros.	✓	2,400	1,560
23	Liu Company	✓	3,600	2,340
			12,180	7,917
			(112)(401)	(505)(120)

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PROBLEM 7-3B (Continued)

General Journal

Date		Accounts and Explanations	Ref.	Debit	Credit
May	10	Accounts Payable—Zeider Company	201/✓	500	
		Merchandise Inventory	120		500
	17	Accounts Payable—Rodriguez Supply	201/✓	100	
		Supplies	126		100
	20	Accounts Payable—Younger Company	201/✓	300	
		Merchandise Inventory	120		300
	26	Sales Returns and Allowances	412	200	
		Accounts Receivable—Liu Company	112/✓		200

(b) **General Ledger**

Accounts Receivable **No. 112**

Date		Explanation	Ref.	Debit	Credit	Balance
May	31		S1	12,180		12,180
	26		G1		200	11,980

Merchandise Inventory **No. 120**

Date		Explanation	Ref.	Debit	Credit	Balance
May	31		P1	36,760		36,760
	10		G1		500	36,260
	20		G1		300	35,960
	31		S1		7,917	28,043

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PROBLEM 7-3B (Continued)

Supplies **No. 126**

Date	Explanation	Ref.	Debit	Credit	Balance
May 15		P1	900		900
17		G1		100	800

Equipment **No. 157**

Date	Explanation	Ref.	Debit	Credit	Balance
May 28		P1	500		500

Accounts Payable **No. 201**

Date	Explanation	Ref.	Debit	Credit	Balance
May 31		P1		39,060	39,060
10		G1	500		38,560
17		G1	100		38,460
20		G1	300		38,160

Sales **No. 401**

Date	Explanation	Ref.	Debit	Credit	Balance
May 31		S1		12,180	12,180

Sales Returns and Allowances **No. 412**

Date	Explanation	Ref.	Debit	Credit	Balance
May 26		G1	200		200

Cost of Goods Sold **No. 505**

Date	Explanation	Ref.	Debit	Credit	Balance
May 31		S1	7,917		7,917

Advertising Expense **No. 610**

Date	Explanation	Ref.	Debit	Credit	Balance
May 25		P1	900		900

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PROBLEM 7-3B (Continued)

Accounts Receivable Subsidiary Ledger

Ellie Company

Date	Explanation	Ref.	Debit	Credit	Balance
May 5		S1	1,980		1,980

DeShazer Bros.

Date	Explanation	Ref.	Debit	Credit	Balance
May 5		S1	2,700		2,700
23		S1	2,400		5,100

Liu Company

Date	Explanation	Ref.	Debit	Credit	Balance
May 5		S1	1,500		1,500
23		S1	3,600		5,100
26		G1		200	4,900

Accounts Payable Subsidiary Ledger

Ruden Freight

Date	Explanation	Ref.	Debit	Credit	Balance
May 3		P1		360	360
18		P1		500	860

Younger Company

Date	Explanation	Ref.	Debit	Credit	Balance
May 2		P1		7,500	7,500
16		P1		4,500	12,000
20		G1	300		11,700

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PROBLEM 7-3B (Continued)

Rodriguez Supply

Date	Explanation	Ref.	Debit	Credit	Balance
May 15		P1		900	900
17		G1	100		800
28		P1		500	1,300

Utley Company

Date	Explanation	Ref.	Debit	Credit	Balance
May 8		P1		8,000	8,000
16		P1		7,200	15,200

Zeider Company

Date	Explanation	Ref.	Debit	Credit	Balance
May 8		P1		8,700	8,700
10		G1	500		8,200

Amster Advertising

Date	Explanation	Ref.	Debit	Credit	Balance
May 25		P1		900	900

(c) Accounts receivable balance $11,980

Subsidiary account balances

Ellie Company	$1,980	
DeShazer Bros.	5,100	
Liu Company	4,900	
Total		$11,980

Accounts payable balance $38,160

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PROBLEM 7-3B (Continued)

Subsidiary account balances		
Ruden Freight	**$ 860**	
Younger Company	**11,700**	
Rodriguez Supply	**1,300**	
Utley Company	**15,200**	
Zeider Company	**8,200**	
Amster Advertising	**900**	
Total		**$38,160**

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PROBLEM 7-4B

(a), (b) & (c)

Sales Journal

S1

Date	Account Debited	Invoice No.	Ref.	Accounts Receivable Dr. / Sales Cr.	Cost of Goods Sold Dr. / Merchandise Inventory Cr.
Oct. 4	Enos Co.	204	✓	7,700	5,390
17	G. Richter & Co.	205	✓	5,350	3,745
25	Hunt Corp.	206	✓	5,220	3,654
30	G. Richter & Co.	207	✓	4,600	3,220
				22,870	16,009
				(112)(401)	(505)(120)

Purchases Journal

P1

Date	Account Credited	Ref.	Merchandise Inventory Dr. / Accounts Payable Cr.
Oct. 2	Camacho Company	✓	16,500
10	Finn Corp.	✓	3,500
27	Kudro Co.	✓	8,500
30	Camacho Company	✓	14,000
			42,500
			(120)(201)

General Journal

G1

Date	Accounts and Explanations	Ref.	Debit	Credit
Oct. 13	Accounts Payable—Finn Corp.	201/✓	210	
	Merchandise Inventory	120		210
25	Supplies	126	260	
	Accounts Payable—Robinson Co.	201/✓		260

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PROBLEM 7-4B (Continued)

Cash Receipts Journal

CR1

Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
Oct. 7			9,160			9,160		6,412
12	Enos Co.	✓	7,546	154	7,700			
14			8,180			8,180		5,726
16	Land	140	27,000				27,000	
21			8,200			8,200		5,740
25	G. Richter & Co.	✓	5,243	107	5,350			
28			7,540			7,540		5,278
			72,869	261	13,050	33,080	27,000	23,156
			(101)	(414)	(112)	(401)	(X)	(505)(120)

Cash Payments Journal

CP1

Date	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Merchandise Inventory Cr.	Cash Cr.
Oct. 5	Supplies	126	80			80
9	Camacho Co.	✓		16,500	330	16,170
18	Merchandise Inventory	120	2,125			2,125
23	Finn Corp.	✓		3,290		3,290
26	Land	140	21,000			
	Buildings	145	14,000			35,000
30	Advertising Expense	610	400			400
			37,605	19,790	330	57,065
			(X)	(201)	(120)	(101)

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PROBLEM 7-5B

(b) **Purchases Journal**

P1

Date	Account Credited	Ref.	Merchandise Inventory Dr. Accounts Payable Cr.
Feb. 2	J. Vopat	✓	4,600
7	P. Kneiser	✓	30,000
16	J. Nunez	✓	2,400
21	G. Reedy	✓	7,800
			44,800
			(120)(201)

Cash Payments Journal

CP1

Date	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Merchandise Inventory Cr.	Cash Cr.
Feb. 9	Supplies	126	1,250			1,250
12	J. Vopat	✓		4,600	92	4,508
15	Equipment	157	7,000			7,000
17	P. Kneiser	✓		30,000	300	29,700
20	A. Wyrick, Drawing	306	1,100			1,100
28	J. Nunez	✓		2,400		2,400
			9,350	37,000	392	45,958
			(X)	(201)	(120)	(101)

(a), (d) & (g) **General Ledger**

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28		CR1	48,595		48,595
28		CP1		45,958	2,637

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PROBLEM 7-5B (Continued)

Accounts Receivable — No. 112

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28		S1	27,000		27,000
28		CR1		12,000	15,000

Merchandise Inventory — No. 120

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28		P1	44,800		44,800
18		CR1		150	44,650
28		CP1		392	44,258
28		S1		17,820	26,438
28		CR1		4,290	22,148

Supplies — No. 126

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 9		CP1	1,250		1,250
28	Adjusting entry	G1		950	300

Equipment — No. 157

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 15		CP1	7,000		7,000

Accumulated Depreciation—Equipment — No. 158

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28	Adjusting entry	G1		200	200

Accounts Payable — No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28		P1		44,800	44,800
28		CP1	37,000		7,800

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PROBLEM 7-5B (Continued)

A. Wyrick, Capital — **No. 301**

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 1		CR1		30,000	30,000

A. Wyrick, Drawing — **No. 306**

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 20		CP1	1,100		1,100

Sales — **No. 401**

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28		S1		27,000	27,000
28		CR1		6,500	33,500

Sales Discounts — **No. 414**

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28		CR1	55		55

Cost of Goods Sold — **No. 505**

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28		S1	17,820		17,820
28		CR1	4,290		22,110

Supplies Expense — **No. 631**

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28	Adjusting entry	G1	950		950

Depreciation Expense — **No. 711**

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 28	Adjusting entry	G1	200		200

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PROBLEM 7-5B (Continued)

(c) Accounts Receivable Subsidiary Ledger

S. Arndt

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 3		S1	5,500		5,500
13		CR1		5,500	0

F. Catt

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 12		S1	8,000		8,000

C. Boyd

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 9		S1	6,500		6,500
26		CR1		6,500	0

M. Didde

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 26		S1	7,000		7,000

Accounts Payable Subsidiary Ledger

G. Reedy

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 21		P1		7,800	7,800

J. Vopat

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 2		P1		4,600	4,600
12		CP1	4,600		0

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PROBLEM 7-5B (Continued)

P. Kneiser

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 7		P1		30,000	30,000
17		CP1	30,000		0

J. Nunez

Date	Explanation	Ref.	Debit	Credit	Balance
Feb. 16		P1		2,400	2,400
28		CP1	2,400		0

(e)

WYRICK CO.
Trial Balance
February 28, 2008

	Debit	Credit
Cash	$ 2,637	
Accounts Receivable	15,000	
Merchandise Inventory	22,148	
Supplies	1,250	
Equipment	7,000	
Accounts Payable		$ 7,800
A. Wyrick, Capital		30,000
A. Wyrick, Drawing	1,100	
Sales		33,500
Sales Discounts	55	
Cost of Goods Sold	22,110	
	$71,300	$71,300

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PROBLEM 7-5B (Continued)

(f)	**Accounts Receivable control account**		**$15,000**
	Accounts Receivable subsidiary accounts		
	F. Catt	**$8,000**	
	M. Didde	**7,000**	**$15,000**
	Accounts Payable control account		**$ 7,800**
	Accounts Payable subsidiary account		
	G. Reedy		**$ 7,800**

(g) **General Journal**

G1

Date	Accounts and Explanations	Ref.	Debit	Credit
Feb. 28	**Supplies Expense**	**631**	**950**	
	Supplies	**126**		**950**
28	**Depreciation Expense**	**711**	**200**	
	Accumulated Depreciation—Equipment	**158**		**200**

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PROBLEM 7-5B (Continued)

(h)

WYRICK CO.
Adjusted Trial Balance
February 28, 2008

	Debit	Credit
Cash	$ 2,637	
Accounts Receivable	15,000	
Merchandise Inventory	22,148	
Supplies	300	
Equipment	7,000	
Accumulated Depreciation—Equipment		$ 200
Accounts Payable		7,800
A. Wyrick, Capital		30,000
A. Wyrick, Drawing	1,100	
Sales		33,500
Sales Discounts	55	
Cost of Goods Sold	22,110	
Supplies Expense	950	
Depreciation Expense	200	
	$71,500	$71,500

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COMPREHENSIVE PROBLEM: CHAPTERS 3 TO 7

Note: If the working papers that accompany this text are not used in solving this problem, account numbers may differ from those presented in this solution.

(a)

Sales Journal

S1

Date	Account Debited	Invoice No.	Ref.	Accounts Receivable Dr. Sales Cr.
Jan. 3	B. Remy	510	✓	3,100
3	J. Fine	511	✓	1,800
11	R. Draves	512	✓	1,900
11	S. Ingles	513	✓	900
22	B. Remy	514	✓	3,700
22	R. Draves	515	✓	800
25	B. Hachinski	516	✓	3,500
25	J. Fine	517	✓	6,100
				21,800
				(112)(401)

Purchases Journal

P1

Date	Account Credited	Terms	Ref.	Purchases Dr. Accounts Payable Cr.
Jan. 5	S. Yost		✓	3,000
5	D. Laux		✓	2,700
16	D. Moreno		✓	15,000
16	S. Kosko		✓	13,900
16	S. Yost		✓	1,500
27	D. Moreno		✓	12,500
27	D. Laux		✓	1,200
27	S. Yost		✓	2,800
				52,600
				(510)(201)

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COMPREHENSIVE PROBLEM (Continued)

Cash Receipts Journal

CR1

Date	Account Credited	Ref.	Cash Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.
Jan. 7	S. Ingles	✓	4,000	4,000		
7	B. Hachinski	✓	2,000	2,000		
10			15,500		15,500	
13	B. Remy	✓	3,100	3,100		
13	J. Fine	✓	1,500	1,500		
20			17,500		17,500	
21	S. Ingles	✓	900	900		
31			22,920		22,920	
			67,420	11,500	55,920	
			(101)	(112)	(401)	

Cash Payments Journal

CP1

Date	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Office Supplies Dr.	Cash Cr.
Jan. 8	Freight In	516	180			180
9	S. Kosko	✓		9,000		9,000
9	D. Moreno	✓		11,000		11,000
12	Rent Expense	729	1,000			1,000
15	I. Packard, Drawing	306	800			800
17					400	400
23	D. Moreno	✓		15,000		15,000
23	S. Kosko	✓		13,700		13,700
28					200	200
31	Sales Salaries Expense	627	4,300			4,300
31	Office Salaries Expense	727	3,600			3,600
			9,880	48,700	600	59,180
			(X)	(201)	(125)	(101)

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COMPREHENSIVE PROBLEM (Continued)

(a) & (e)

General Journal

G1

Date		Account Titles and Explanations	Ref.	Debit	Credit
Jan.	9	Sales Returns and Allowances	412	300	
		Accounts Receivable—J. Fine	112/✓		300
		(Issued credit for merchandise returned)			
	18	Accounts Payable—S. Kosko	201/✓	200	
		Purchase Returns and Allowances	512		200
		(Received credit for returned goods)			
	21	Accounts Payable—R. Mikush	201/✓	15,000	
		Notes Payable	200		15,000
		(Issued note for balance due)			
		<u>Adjusting Entries</u>			
	31	Office Supplies Expense	728	900	
		Office Supplies	125		900
	31	Insurance Expense	722	200	
		(1/10 X 2,000)			200
		Prepaid Insurance	130		
	31	Depreciation Expense	711	125	
		(1/12 X 1,500)			
		Accumulated Depreciation—Equipment	158		125
	31	Interest Expense	718	30	
		Interest Payable	230		30

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COMPREHENSIVE PROBLEM (Continued)

General Journal

G1

Date	Account Titles and Explanations	Ref.	Debit	Credit
Jan. 31	Merchandise Inventory (Jan. 31)	120	15,000	
	Sales	401		77,720
	Purchase Returns and Allowances	512	200	
	Income Summary	350		92,920
31	Income Summary	350	83,235	
	Merchandise Inventory (Jan. 1)	120		20,000
	Sales Returns and Allowances	412		300
	Purchases	510		52,600
	Freight In	516		180
	Rent Expense	729		1,000
	Sales Salaries Expense	627		4,300
	Office Salaries Expense	727		3,600
	Office Supplies Expense	728		900
	Insurance Expense	722		200
	Depreciation Expense	711		125
	Interest Expense	718		30
31	Income Summary	350	9,685	
	I. Packard, Capital	301		9,685
31	I. Packard, Capital	301	800	
	I. Packard, Drawing	306		800

(b) & (e) **General Ledger**

Cash **No. 101**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			33,750
31		CR1	67,420		101,170
31		CP1		59,180	41,990

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COMPREHENSIVE PROBLEM (Continued)

Accounts Receivable — **No. 112**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			13,000
31		S1	21,800		34,800
31		CR1		11,500	23,300
9		G1		300	23,000

Notes Receivable — **No. 115**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			39,000

Merchandise Inventory — **No. 120**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			20,000
31		G1	15,000		35,000
31		G1		20,000	15,000

Office Supplies — **No. 125**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			1,000
31		CP1	600		1,600
31		G1		900	700

Prepaid Insurance — **No. 130**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			2,000
31		G1		200	1,800

Equipment — **No. 157**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1		✓			6,450

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COMPREHENSIVE PROBLEM (Continued)

Accumulated Depreciation—Equipment **No. 158**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			1,500
31		G1		125	1,625

Notes Payable **No. 200**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 21	Balance	G1		15,000	15,000

Accounts Payable **No. 201**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			35,000
31		P1		52,600	87,600
31		CP1	48,700		38,900
18		G1	200		38,700
21		G1	15,000		23,700

Interest Payable **No. 230**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1		30	30

I. Packard, Capital **No. 301**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			78,700
31		G1		9,685	88,385
31		G1	800		87,585

I. Packard, Drawing **No. 306**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 15		CP1	800		800
31		G1		800	0

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COMPREHENSIVE PROBLEM (Continued)

Income Summary — No. 350

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1		92,920	92,920
31		G1	83,235		9,685
31		G1	9,685		0

Sales — No. 401

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		S1		21,800	21,800
31		CR1		55,920	77,720
31		G1	77,720		0

Sales Returns and Allowances — No. 412

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 9		G1	300		300
31		G1		300	0

Purchases — No. 510

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		P1	52,600		52,600
31		G1		52,600	0

Purchase Returns and Allowances — No. 512

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 18		G1		200	200
31		G1	200		0

Freight-In — No. 516

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 8		CP1	180		180
31		G1		180	0

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COMPREHENSIVE PROBLEM (Continued)

Sales Salaries Expense — **No. 627**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		CP1	4,300		4,300
31		G1		4,300	0

Depreciation Expense — **No. 711**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1	125		125
31		G1		125	0

Interest Expense — **No. 718**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1	30		30
31		G1		30	0

Insurance Expense — **No. 722**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1	200		200
31		G1		200	0

Office Salaries Expense — **No. 727**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		CP1	3,600		3,600
31		G1		3,600	0

Office Supplies Expense — **No. 728**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1	900		900
31		G1		900	0

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Rent Expense **No. 729**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 12		CP1	1,000		1,000
31		G1		1,000	0

Accounts Receivable Subsidiary Ledger

R. Draves

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			1,500
11		S1	1,900		3,400
22		S1	800		4,200

J. Fine

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 3		S1	1,800		1,800
9		G1		300	1,500
13		CR1		1,500	0
25		S1	6,100		6,100

B. Hachinski

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			7,500
7		CR1		2,000	5,500
25		S1	3,500		9,000

S. Ingles

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			4,000
7		CR1		4,000	0
11		S1	900		900
21		CR1		900	0

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COMPREHENSIVE PROBLEM (Continued)

B. Remy

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	3		S1	3,100		3,100
	13		CR1		3,100	0
	22		S1	3,700		3,700

Accounts Payable Subsidiary Ledger

D. Laux

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	5		P1		2,700	2,700
	27		P1		1,200	3,900

S. Kosko

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			9,000
	9		CP1	9,000		0
	16		P1		13,900	13,900
	18		G1	200		13,700
	23		CP1	13,700		0

R. Mikush

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			15,000
	21		G1	15,000		0

D. Moreno

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			11,000
	9		CP1	11,000		0
	16		P1		15,000	15,000
	23		CP1	15,000		0
	27		P1		12,500	12,500

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COMPREHENSIVE PROBLEM (Continued)

S. Yost

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 5		P1		3,000	3,000
16		P1		1,500	4,500
27		P1		2,800	7,300

(c)

PACKARD COMPANY
Worksheet
For the Month Ended January 31, 2008

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	41,990				41,990				41,990	
Accounts Receivable	23,000				23,000				23,000	
Notes Receivable	39,000				39,000				39,000	
Merchandise Inventory	20,000				20,000		20,000	15,000	15,000	
Office Supplies	1,600			(1) 900	700				700	
Prepaid Insurance	2,000			(2) 200	1,800				1,800	
Equipment	6,450				6,450				6,450	
Accum. Depreciation—Equipment		1,500		(3) 125		1,625				1,625
Notes Payable		15,000				15,000				15,000
Accounts Payable		23,700				23,700				23,700
Interest Payable				(4) 30		30				30
I. Packard, Capital		78,700				78,700				78,700
I. Packard, Drawing	800				800				800	
Sales		77,720				77,720		77,720		
Sales Returns and Allowances	300				300		300			
Purchases	52,600				52,600		52,600			
Purchase Returns and Allowances		200				200		200		
Freight In	180				180		180			
Sales Salaries Expense	4,300				4,300		4,300			
Office Salaries Expense	3,600				3,600		3,600			
Rent Expense	1,000				1,000		1,000			
Totals	196,820	196,820								
Office Supplies Expense			(1) 900		900		900			
Insurance Expense			(2) 200		200		200			
Depreciation Expense			(3) 125		125		125			
Interest Expense			(4) 30		30		30			
Totals			1,255	1,255	196,975	196,975	83,235	92,920	128,740	119,055
Net Income							9,685			9,685
Totals							92,920	92,920	128,740	128,740

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COMPREHENSIVE PROBLEM (Continued)

(d)

PACKARD CO.
Income Statement
For the Month Ended January 31, 2008

Sales revenues			
Sales			$77,720
Less: Sales returns and allowances			300
Net sales revenue			77,420
Cost of goods sold			
Merchandise inventory, 1/1/08		$20,000	
Purchases	$52,600		
Less: Purchase returns and allowances	200		
Net purchases	52,400		
Freight in	180	52,580	
Total merchandise available for sale		72,580	
Less: Merchandise inventory, 1/31/08		15,000	
Cost of goods sold			57,580
Gross profit on sales			19,840
Operating expenses			
Selling expenses			
Sales salaries expense		4,300	
Administrative expenses			
Office salaries expense	3,600		
Rent expense	1,000		
Office supplies expense	900		
Insurance expense	200		
Depreciation expense	125		
Total admin. expenses		5,825	
Total oper. expenses			10,125
Income from operations			9,715
Other expenses and losses			
Interest expense			30
Net income			$ 9,685

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COMPREHENSIVE PROBLEM (Continued)

PACKARD CO.
Statement of Owner's Equity
For the Month Ended January 31, 2008

I. Packard, Capital, January 1, 2008	$78,700
Add: Net income	9,685
	88,385
Less: Drawing	800
I. Packard, Capital, January 31, 2008	$87,585

PACKARD CO.
Balance Sheet
January 31, 2008

Assets		
Current assets		
Cash	$41,990	
Notes receivable	39,000	
Accounts receivable	23,000	
Merchandise inventory	15,000	
Office supplies	700	
Prepaid insurance	1,800	
Total current assets		$121,490
Capital assets		
Equipment	6,450	
Less: Accumulated depreciation	1,625	4,825
Total assets		$126,315
Liabilities and Owner's Equity		
Current liabilities		
Notes payable	$15,000	
Accounts payable	23,700	
Interest payable	30	
Total liabilities		$ 38,730
Owner's equity		
I. Packard, Capital		87,585
Total liabilities and owner's equity		$126,315

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COMPREHENSIVE PROBLEM (Continued)

(f)

PACKARD CO.
Post-Closing Trial Balance
January 31, 2008

	Debit	Credit
Cash	$ 41,990	
Notes Receivable	39,000	
Accounts Receivable	23,000	
Merchandise Inventory	15,000	
Office Supplies	700	
Prepaid Insurance	1,800	
Equipment	6,450	
Accumulated Depreciation—Equipment		$ 1,625
Notes Payable		15,000
Accounts Payable		23,700
Interest Payable		30
I. Packard, Capital		87,585
	$127,940	$127,940

Accounts Receivable balance		$23,000
Subsidiary account balances		
R. Draves	$ 4,200	
J. Fine	6,100	
B. Hachinski	9,000	
B. Remy	3,700	
		$23,000
Accounts Payable balance		$23,700
Subsidiary account balances		
D. Laux	$ 3,900	
D. Moreno	12,500	
S. Yost	7,300	
		$23,700

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BYP 7-1 FINANCIAL REPORTING PROBLEM—A MINI PRACTICE SET

(a)

Sales Journal

S1

Date	Account Debited	Invoice No.	Ref.	Accounts Receivable Dr. / Sales Cr.	Cost of Goods Sold Dr. / Merchandise Inventory Cr.
Jan. 3	B. Richey	510	✓	3,100	1,860
3	J. Forbes	511	✓	1,800	1,080
11	R. Dvorak	512	✓	1,600	960
11	S. LaDew	513	✓	900	540
22	B. Richey	514	✓	2,700	1,620
22	R. Dvorak	515	✓	1,300	780
25	B. Garcia	516	✓	3,500	2,100
25	J. Forbes	517	✓	6,100	3,660
				21,000	12,600
				(112)(401)	(505)(120)

Purchases Journal

P1

Date	Account Credited	Terms	Ref.	Merchandise Inventory Dr. / Accounts Payable Cr.
Jan. 5	S. Vogel	n/30	✓	5,000
5	D. Lynch	n/30	✓	2,200
16	D. Omara	1/10, n/30	✓	18,000
16	S. Hoyt	2/10, n/30	✓	14,200
16	S. Vogel	n/30	✓	1,500
27	D. Omara	1/10, n/30	✓	14,500
27	D. Lynch	n/30	✓	1,200
27	S. Vogel	n/30	✓	5,400
				62,000
				(120)(201)

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Cash Receipts Journal

CR1

Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Merchandise Inventory Cr.
Jan. 7	S. LaDew	✓	4,000		4,000			
7	B. Garcia	✓	2,000		2,000			
10			15,500			15,500		9,300
13	B. Richey	✓	3,038	62	3,100			
13	J. Forbes	✓	1,470	30	1,500			
20			20,100			20,100		12,060
21	S. LaDew	✓	882	18	900			
31			21,300			21,300		12,780
			68,290	110	11,500	56,900		34,140
			(101)	(414)	(112)	(401)		(505)(120)

Cash Payments Journal

CP1

Date	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Office Supplies Dr.	Merchandise Inventory Cr.	Cash Cr.
Jan. 8	Merchandise Inventory	120	235				235
9	S. Hoyt	✓		9,000		180	8,820
9	D. Omara	✓		11,000		110	10,890
12	Rent Expense	729	1,000				1,000
15	M. Bluma, Drawing	306	800				800
17					400		400
23	D. Omara	✓		18,000		180	17,820
23	S. Hoyt	✓		14,000		280	13,720
28					200		200
31	Sales Salaries Expense	627	4,300				4,300
31	Office Salaries Expense	727	3,800				3,800
			10,135	52,000	600	750	61,985
			(X)	(201)	(125)	(120)	(101)

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BYP 7-1 (Continued)

(a) & (e)

General Journal

G1

Date		Account Titles and Explanations	Ref.	Debit	Credit
Jan.	9	Sales Returns and Allowances	412	300	
		Accounts Receivable—J. Forbes	112/✓		300
		(Issued credit for merchandise returned)			
		Merchandise Inventory	120	180	
		($300 X .60)			
		Cost of Goods Sold	505		180
	18	Accounts Payable—S. Hoyt	201/✓	200	
		Merchandise Inventory	120		200
		(Received credit for returned goods)			
	21	Accounts Payable—R. Moses	201/✓	15,000	
		Notes Payable	200		15,000
		(Payment of balance due)			
		<u>Adjusting Entries</u>			
	31	Office Supplies Expense	728	700	
		Office Supplies	125		700
	31	Insurance Expense	722	200	
		Prepaid Insurance	130		200
	31	Depreciation Expense ($1,500 ÷ 12)	711	125	
		Accumulated Depreciation—Equipment	158		125
	31	Interest Expense	718	50	
		Interest Payable	230		50
	31	Sales	401	77,900	
		Income Summary	350		77,900

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BYP 7-1 (Continued)

General Journal

G1

Date	Account Titles and Explanations	Ref.	Debit	Credit
Jan. 31	Income Summary	350	57,145	
	Sales Discounts	414		110
	Sales Returns and Allowances	412		300
	Cost of Goods Sold	505		46,560
	Rent Expense	729		1,000
	Sales Salaries Expense	627		4,300
	Office Salaries Expense	727		3,800
	Office Supplies Expense	728		700
	Insurance Expense	722		200
	Depreciation Expense	711		125
	Interest Expense	718		50
31	Income Summary	350	20,755	
	M. Bluma, Capital	301		20,755
31	M. Bluma, Capital	301	800	
	M. Bluma, Drawing	306		800

(b) & (e) **General Ledger**

Cash **No. 101**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			35,750
31		CR1	68,290		104,040
31		CP1		61,985	42,055

Accounts Receivable **No. 112**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			13,000
31		S1	21,000		34,000
31		CR1		11,500	22,500
9		G1		300	22,200

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Notes Receivable **No. 115**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			39,000

Merchandise Inventory **No. 120**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			18,000
	31		P1	62,000		80,000
	31		S1		12,600	67,400
	31		CR1		34,140	33,260
	8		CP1	235		33,495
	31		CP1		750	32,745
	9		G1	180		32,925
	18		G1		200	32,725

Office Supplies **No. 125**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			1,000
	31		CP1	600		1,600
	31		G1		700	900

Prepaid Insurance **No. 130**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			2,000
	31		G1		200	1,800

Equipment **No. 157**

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			6,450

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Accumulated Depreciation—Equipment **No. 158**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			1,500
31		G1		125	1,625

Notes Payable **No. 200**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 21		G1		15,000	15,000

Accounts Payable **No. 201**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			35,000
31		P1		62,000	97,000
31		CP1	52,000		45,000
18		G1	200		44,800
21		G1	15,000		29,800

Interest Payable **No. 230**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1		50	50

M. Bluma, Capital **No. 301**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			78,700
31		G1		20,755	99,455
31		G1	800		98,655

M. Bluma, Drawing **No. 306**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 15		CP1	800		800
31		G1		800	0

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Income Summary No. 350

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1		77,900	77,900
31		G1	57,145		20,755
31		G1	20,755		0

Sales No. 401

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		S1		21,000	21,000
31		CR1		56,900	77,900
31		G1	77,900		0

Sales Returns and Allowances No. 412

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 9		G1	300		300
31		G1		300	0

Sales Discounts No. 414

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		CR1	110		110
31		G1		110	0

Cost of Goods Sold No. 505

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		S1	12,600		12,600
31		CR1	34,140		46,740
9		G1		180	46,560
31		G1		46,560	0

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Sales Salaries Expense — No. 627

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		CP1	4,300		4,300
31		G1		4,300	0

Depreciation Expense — No. 711

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1	125		125
31		G1		125	0

Interest Expense — No. 718

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1	50		50
31		G1		50	0

Insurance Expense — No. 722

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1	200		200
31		G1		200	0

Office Salaries Expense — No. 727

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		CP1	3,800		3,800
31		G1		3,800	0

Office Supplies Expense — No. 728

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 31		G1	700		700
31		G1		700	0

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Rent Expense **No. 729**

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 12		CP1	1,000		1,000
31		G1		1,000	0

Accounts Receivable Subsidiary Ledger

R. Dvorak

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			1,500
11		S1	1,600		3,100
22		S1	1,300		4,400

J. Forbes

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 3		S1	1,800		1,800
9		G1		300	1,500
13		CR1		1,500	0
25		S1	6,100		6,100

B. Garcia

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			7,500
7		CR1		2,000	5,500
25		S1	3,500		9,000

S. LaDew

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			4,000
7		CR1		4,000	0
11		S1	900		900
21		CR1		900	0

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BYP 7-1 (Continued)

B. Richey

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 3		S1	3,100		3,100
13		CR1		3,100	0
22		S1	2,700		2,700

Accounts Payable Subsidiary Ledger

D. Lynch

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 5		P1		2,200	2,200
27		P1		1,200	3,400

S. Hoyt

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			9,000
9		CP1	9,000		0
16		P1		14,200	14,200
18		G1	200		14,000
23		CP1	14,000		0

R. Moses

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			15,000
21		G1	15,000		0

D. Omara

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 1	Balance	✓			11,000
9		CP1	11,000		0
16		P1		18,000	18,000
23		CP1	18,000		0
27		P1		14,500	14,500

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BYP 7-1 (Continued)

S. Vogel

Date	Explanation	Ref.	Debit	Credit	Balance
Jan. 5		P1		5,000	5,000
16		P1		1,500	6,500
27		P1		5,400	11,900

(c)

BLUMA COMPANY
Worksheet
For the Month Ended January 31, 2008

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	42,055				42,055				42,055	
Accounts Receivable	22,200				22,200				22,200	
Notes Receivable	39,000				39,000				39,000	
Merchandise Inventory	32,725				32,725				32,725	
Office Supplies	1,600			(1) 700	900				900	
Prepaid Insurance	2,000			(2) 200	1,800				1,800	
Equipment	6,450				6,450				6,450	
Accum. Depreciation—Equipment		1,500		(3) 125		1,625				1,625
Notes Payable		15,000				15,000				15,000
Accounts Payable		29,800				29,800				29,800
Interest Payable				(4) 50		50				50
M. Bluma, Capital		78,700				78,700				78,700
M. Bluma, Drawing	800				800				800	
Sales		77,900				77,900		77,900		
Sales Returns and Allowances	300				300		300			
Sales Discounts	110				110		110			
Cost of Goods Sold	46,560				46,560		46,560			
Sales Salaries Expense	4,300				4,300		4,300			
Office Salaries Expense	3,800				3,800		3,800			
Rent Expense	1,000				1,000		1,000			
Totals	202,900	202,900								
Office Supplies Expense			(1) 700		700		700			
Insurance Expense			(2) 200		200		200			
Depreciation Expense			(3) 125		125		125			
Interest Expense			(4) 50		50		50			
Totals			1,075	1,075	203,075	203,075	57,145	77,900	145,930	125,175
Net Income							20,755			20,755
Totals							77,900	77,900	145,930	145,930

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BYP 7-1 (Continued)

(d)

BLUMA CO.
Income Statement
For the Month Ended January 31, 2008

Sales revenues			
Sales			$77,900
Less: Sales discounts		$ 110	
Sales returns and allowances		300	410
Net sales revenue			77,490
Cost of goods sold			46,560
Gross profit			30,930
Operating expenses			
Selling expenses			
Sales salaries expense		4,300	
Administrative expenses			
Office salaries expense	$3,800		
Rent expense	1,000		
Office supplies expense	700		
Insurance expense	200		
Depreciation expense	125		
Total administrative expenses		5,825	
Total operating expenses			10,125
Income from operations			20,805
Other expenses and losses			
Interest expense			50
Net income			$20,755

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BLUMA CO.
Owner's Equity Statement
For the Month Ended January 31, 2008

M. Bluma, Capital, January 1, 2008	$78,700
Add: Net income	20,755
	99,455
Less: Drawings	800
M. Bluma, Capital, January 31, 2008	$98,655

BLUMA CO.
Balance Sheet
January 31, 2008

Assets

Current assets		
Cash	$42,055	
Accounts receivable	22,200	
Notes receivable	39,000	
Merchandise inventory	32,725	
Office supplies	900	
Prepaid insurance	1,800	
Total current assets		$138,680
Property, plant, and equipment		
Equipment	6,450	
Less: Accumulated depreciation	1,625	4,825
Total assets		$143,505

Liabilities and Owner's Equity

Current liabilities		
Notes payable	$15,000	
Accounts payable	29,800	
Interest payable	50	
Total liabilities		$ 44,850
Owner's equity		
M. Bluma, Capital		98,655
Total liabilities and owner's equity		$143,505

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BYP 7-1 (Continued)

(f)

BLUMA CO.
Post-Closing Trial Balance
January 31, 2008

	Debit	Credit
Cash	$ 42,055	
Notes Receivable	39,000	
Accounts Receivable	22,200	
Merchandise Inventory	32,725	
Office Supplies	900	
Prepaid Insurance	1,800	
Equipment	6,450	
Accumulated Depreciation—Equipment		$ 1,625
Notes Payable		15,000
Accounts Payable		29,800
Interest Payable		50
M. Bluma, Capital		98,655
	$145,130	$145,130

Accounts Receivable balance		$22,200
Subsidiary account balances		
R. Dvorak	$ 4,400	
J. Forbes	6,100	
B. Garcia	9,000	
B. Richey	2,700	
		$22,200
Accounts Payable balance		$29,800
Subsidiary account balances		
D. Lynch	$ 3,400	
D. Omara	14,500	
S. Vogel	11,900	
		$29,800

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BYP 7-2 EXPLORING THE WEB

(a) Some of the key features of the general ledger module highlighted by the company are:

- **Highly flexible account and fiscal period setup, including different account structures for separate companies.**
- **Account numbers can be up to 20 characters long in 10 segments.**
- **Statistical accounts for tracking nonfinancial information, such as head count and square footage.**
- **Standard, recurring, auto-reversing, clearing, and "quick-journal" entries.**
- **Unlimited budgets, unlimited years of history.**

(b) Some of the key features of the payables management module highlighted by the company are:

- **Handles purchases on account, manual and computer check payments, and credit memos.**
- **Vendor classes provide a fast, consistent method for entering new records by entering common information for you.**
- **Changes to one vendor in a class can be made to all vendors in the same class.**
- **Automatically calculates the number of days it takes to pay each vendor.**
- **Enter recurring transactions.**
- **Put transactions on "hold" until you want to pay them.**
- **A variety of inquiry windows and reports provide multiple ways to view vendor information.**
- **Complete vendor and transaction history.**

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BYP 7-3 DECISION MAKING ACROSS THE ORGANIZATION

(a) The special journals for Hughey & Payne should be: (1) sales journal, (2) purchases journal, (3) cash receipts journal, and (4) cash payments journal.

(1) Sales Journal columns:
- Date.
- Account Debited.
- Invoice Number.
- Reference.
- Accounts Receivable, Dr. and Sales—Appliances, Cr.
- Cost of Goods Sold, Dr. and Merchandise Inventory—Appliances, Cr.

(2) Purchases Journal columns:
- Date.
- Account Credited.
- Terms.
- Reference.
- Accounts Payable, Cr.
- Merchandise Inventory—Appliances, Dr.
- Merchandise Inventory—Parts, Dr.

Note: Because two different types of merchandise are purchased on credit, a three-column purchases journal might be used.

(3) Cash Receipts Journal columns:
- Date.
- Account Credited.
- Reference.
- Cash, Dr.
- Accounts Receivable, Cr.
- Sales—Appliances, Cr.
- Sales—Parts, Cr.
- Revenue from Repairs, Cr.
- Other Accounts, Cr.
- Cost of Goods Sold, Dr. and Merchandise Inventory—Appliances, Cr.
- Cost of Goods Sold, Dr. and Merchandise Inventory—Parts, Cr.

Note: A Sales Discounts, Dr. column is not needed because all credit terms are net/30 days.

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(4) Cash Payments Journal columns:
Date.
Check Number.
Account Debited.
Reference.
Other Accounts, Dr.
Accounts Payable, Dr.
Advertising Expense, Dr.
Salaries Expense, Dr.
Merchandise Inventory—Appliances, Cr.
Merchandise Inventory—Parts, Cr.
Cash, Cr.

(b) Hughey & Payne should have:

(1) An accounts receivable control account with individual customers' accounts in a customers' subsidiary ledger.

(2) An accounts payable control account with individual creditors in a creditors' subsidiary ledger.

The use of control accounts and subsidiary ledgers will: (1) provide necessary up-to-date information on specific customer and creditor balances, (2) free the general ledger of excessive detail, (3) help locate errors in individual accounts, and (4) make possible a division of labor in posting.

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BYP 7-4 COMMUNICATION ACTIVITY

Mr. Jim Houser
2 Main Street
Central City, Michigan 48172

Dear Mr. Houser:

Thank you for hiring two additional bookkeepers a month ago to help me with the accounting. Unfortunately, the inefficiencies in recording transactions have continued at an even higher rate. The reason is that there are often times when more than one person needs to use the journal. In addition, the daily posting of transactions continues to be very time consuming.

I would like to suggest some changes in the accounting system. Because of the increased volume of business, I believe it is time for us to use special journals for journalizing transactions. Special journals would be in addition to the journal that we are using now. There would be four special journals:

1. **Sales journal—for all sales of merchandise on account.**
2. **Cash receipts journal—for all cash received.**
3. **Purchases journal—for all purchases of merchandise on account.**
4. **Cash payments journal—for all cash payments.**

To use special journals, we will need columnar journal paper which can be obtained at any office supply store at very low cost. I can also quickly train the new bookkeepers in the use of special journals. Special journals will permit a division of labor so that all three of us can be recording transactions at the same time. Thus, the inefficiencies in journalizing will be eliminated.

Special journals also make it possible to do some postings monthly. This will significantly reduce the time required to make daily postings. As a result, it should free up some time for us to do other things!

I am confident that the use of special journals will improve the efficiency of the accounting department. If you have any questions on this recommendation, please let me know.

Yours sincerely,

Barb

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BYP 7-5 ETHICS CASE

(a) The stakeholders in this case are:

- **Jose Molina, manager of Roniger's centralized computer accounting operation.**
- **The employees of Roniger's three divisions at Freeport, Rockport, and Bayport.**

(b) Jose's instructions to assign the Bayport code to all uncoded and incorrectly coded sales documents overstates the sales of Bayport and understates the sales of Freeport and Rockport, thereby affecting the employee bonus plan. Jose's intent and action are unethical. He is padding the sales of his wife's, relatives', and friends' Bayport division sales and unfairly aiding them in the bonus competition.

(c) Roniger Products Company should have a written policy covering uncoded and incorrectly coded sales documents. This would prevent the manager from arbitrarily designating the division to be credited for the uncoded sales.

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BYP 7-6 ALL ABOUT YOU ACTIVITY

The process begins when journal entries are recorded for transactions in a journal. Once entries are made in the journal, they are posted to the ledger by using the Post function. After entries have been posted, you can click on Reports in the Main Menu and choose from a variety of reports. These include the following: Chart of Accounts, Trial Balance, General Ledger, Subsidiary Ledger, Journals, Balance Sheet, Income Statement, Owner's Equity Statement.

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CHAPTER 8

Internal Control and Cash

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Define internal control.	1	1, 2			
2. Identify the principles of internal control.	2, 3, 4, 5, 6, 7, 8	3	1, 2, 3, 5, 6	1A, 6A	1B, 6B
3. Explain the applications of internal control principles to cash receipts.	3, 10, 11, 12	4	2, 5, 6	6A	1B, 6B
4. Explain the applications of internal control principles to cash disbursements.	13, 14, 15, 16, 17	5	3, 4, 5, 6	1A, 6A	6B
5. Describe the operation of a petty cash fund.	18	6	7, 8	2A	2B
6. Indicate the control features of a bank account.	19	7			
7. Prepare a bank reconciliation.	20, 21, 22	8, 9, 10, 11	9,10, 11, 12, 13	3A, 4A, 5A	3B, 4B, 5B, 6B
8. Explain the reporting of cash.	9, 23	12	14		

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ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Identify internal control principles over cash disbursements.	Simple	20–30
2A	Journalize and post petty cash fund transactions.	Simple	20–30
3A	Prepare a bank reconciliation and adjusting entries.	Simple	20–30
4A	Prepare a bank reconciliation and adjusting entries from detailed data.	Moderate	40–50
5A	Prepare a bank reconciliation and adjusting entries.	Moderate	30–40
6A	Identify internal control weaknesses in cash receipts and cash disbursements.	Complex	35–45
1B	Identify internal control weaknesses over cash receipts.	Simple	20–30
2B	Journalize and post petty cash fund transactions.	Simple	20–30
3B	Prepare a bank reconciliation and adjusting entries.	Simple	20–30
4B	Prepare a bank reconciliation and adjusting entries from detailed data.	Moderate	40–50
5B	Prepare a bank reconciliation and adjusting entries.	Moderate	30–40
6B	Prepare comprehensive bank reconciliation with theft and internal control deficiencies.	Complex	40–50

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Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Define internal control.		Q8-1 BE8-1 BE8-2				
2. Identify the principles of internal control.		Q8-2 E8-6 E8-1 Q8-3 Q8-7 E8-5 Q8-4 Q8-8 E8-6 Q8-5 BE8-3 P8-1A				E8-2 P8-6B E8-3 P8-1B P8-6A
3. Explain the applications of internal control principles to cash receipts.		Q8-3 BE8-4 Q8-10 E8-5 Q8-11 E8-6 Q8-12				E8-2 P8-1B P8-6A P8-6B
4. Explain the applications of internal control principles to cash disbursements.	Q8-15 Q8-16 Q8-17	Q8-13 E8-5 Q8-14 E8-6 BE8-5 P8-1A				E8-3 P8-6B E8-4 P8-6A
5. Describe the operation of a petty cash fund.		Q8-18	BE8-6 P8-2A E8-7 P8-2B E8-8			
6. Indicate the control features of a bank account.		Q8-19 BE8-7				
7. Prepare a bank reconciliation.	Q8-21	Q8-20 Q8-22 BE8-8 BE8-9	BE8-10 BE8-11 E8-10	E8-9 P8-3A P8-4B E8-11 P8-4A P8-5B E8-12 P8-5A E8-13 P8-3B		P8-6B
8. Explain the reporting of cash.		Q8-23 E8-14 BE8-12	Q8-9 E8-14			
Broadening Your Perspective		Financial Reporting		Decision Making Across the Organization Comparative Analysis		All About You Ethics Case Communication Exploring the Web

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ANSWERS TO QUESTIONS

1. Disagree. Internal control is also concerned with the safeguarding of company assets from employee theft, robbery, and unauthorized use.

2. The principles of internal control are: (a) establishment of responsibility, (b) segregation of duties, (c) documentation procedures, (d) physical, mechanical, and electronic controls, (e) independent internal verification, and (f) other controls.

3. This is a violation of the internal control principle of establishing responsibility. In this case, each sales clerk should have a separate cash register or cash register drawer.

4. The two applications of segregation of duties are:
(1) Different individuals should be responsible for related activities.
(2) Responsibility for the record keeping for an asset should be separate from the physical custody of that asset.

5. Documentation procedures contribute to good internal control by providing evidence that transactions and events have occurred and, when signatures (or initials) are added, the documents establish responsibility for the transactions. The prompt transmittal of documents to accounting contributes to recording transactions in the proper period, and the prenumbering of documents helps to ensure that a transaction is not recorded more than once or not at all.

6. Physical controls include safes, vaults, and locked warehouses. These controls contribute to the safeguarding of company assets. Mechanical and electronic controls include cash registers and time clocks that contribute to the accuracy and reliability of the accounting records, and electronic burglary systems and sensors that help to safeguard assets.

7. (a) Independent internal verification involves the review of data prepared by employees.
(b) Maximum benefit is obtained from independent internal verification when:
(1) The verification is made periodically or on a surprise basis.
(2) The verification is done by an employee who is independent of the personnel responsible for the information.
(3) Discrepancies and exceptions are reported to a management level that can take appropriate corrective action.

8. (a) The concept of reasonable assurance rests on the premise that the costs of establishing control procedures should not exceed their expected benefit.
(b) The human element is an important factor in a system of internal control. A good system can become ineffective through employee fatigue, carelessness, or indifference. Moreover, internal control may become ineffective as a result of collusion.

9. Cash should be reported at $20,850 ($8,000 + $850 + $12,000).

10. Daily cash counts pertain primarily to the principles of segregation of duties and independent internal verification. Daily cash counts also involve the establishment of responsibility for performing the counts.

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11. Cash registers are readily visible to the customer. Thus, they prevent the sales clerk from ringing up a lower amount and pocketing the difference. In addition, the customer receives an itemized receipt, and the cash register tape is locked into the register for further verification.

12. Two mail clerks contribute to a more accurate listing of mail receipts and to the endorsement of all checks "For Deposit Only." In addition, two clerks reduce the likelihood of mail receipts being diverted to personal use.

13. Payment by check contributes to effective internal control over cash disbursements. However, effective control is also possible when small payments are made from petty cash.

14. The procedure and related principle are:

Procedure	Principle
(1) Treasurer signs checks.	* Establishment of responsibility.
(2) Checks imprinted by a machine in indelible ink.	* Physical, mechanical, and electronic controls.
(3) Comparing check with approved invoice before signing.	* Independent internal verification.

15. Physical, mechanical, and electronic controls apply to cash disbursements when: (a) blank checks are stored in a safe, and access to the safe is restricted to authorized personnel, and (b) a checkwriting machine and indelible ink are used to imprint amounts on checks. Other controls apply when the approved invoice is stamped PAID after payment.

16. (a) A voucher system is a network of approvals by authorized individuals acting independently to ensure that all disbursements by check are proper.
(b) The internal control principles applicable to a voucher system are: (1) establishment of responsibility, (2) segregation of duties, and (3) independent internal verification.

17. Electronic funds transfer is a cash disbursement system that uses wire, telephone, or computers to transfer cash from one location to another.

18. The activities in a petty cash system and the related principles are:

(a)	(1) Establishing the fund.	* Establishment of responsibility for custody of fund.
	(2) Making payments from the fund.	* Documentation procedures because the custodian must use a prenumbered petty cash receipt.
	(3) Replenishing the fund.	* Independent internal verification because the request for replenishment must be approved before the check is written.

(b) Journal entries are required for a petty cash fund when it is established and replenished. Entries are also required when the size of the fund is increased or decreased.

19. A bank contributes significantly to internal control over cash because it: (1) safeguards cash on deposit, (2) minimizes the amount of currency that must be kept on hand, and (3) provides a double record of all bank transactions.

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20. The lack of agreement between the balances may be due to either:
(1) Time lags—a check written in July does not clear the bank until August.
(2) Errors—a check for $110 is recorded by the depositor at $101.

21. The four steps are: (1) determine deposits in transit, (2) determine outstanding checks, (3) discover any errors made, and (4) trace bank memoranda.

22. (a) An NSF check occurs when the checkwriter's bank balance is less than the amount of the check.
(b) In a bank reconciliation, a customer's NSF check is deducted from the balance per books.
(c) An NSF check results in an adjusting entry in the company's books, as a debit to Accounts Receivable and a credit to Cash.

23. (a) Cash equivalents are highly liquid investments that can be converted into a specific amount of cash with maturities of three months or less when purchased. Cash equivalents may be reported with cash in the current assets section of the balance sheet.
(b) Cash restricted for a special purpose should be reported as a current or noncurrent asset depending on when the cash is expected to be used.

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SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 8-1

1. True.
2. True.
3. False. The Sarbanes-Oxley Act of 2002 requires U.S. corporations to maintain an adequate system of internal control.

BRIEF EXERCISE 8-2

The purposes of internal control are to:

1. Safeguard a company's assets from employee theft, robbery, and unauthorized use. An application for Ready Parking is the use of a cash register to safeguard assets.

2. Enhance the accuracy and reliability of a company's accounting records by reducing the risk of errors (unintentional mistakes) and irregularities (intentional mistakes and misrepresentations) in the accounting process. An application for Ready Parking is preparation of a bank reconciliation.

Both purposes are important to the success of any business endeavor.

BRIEF EXERCISE 8-3

(a) Segregation of duties.
(b) Independent internal verification.
(c) Documentation procedures.

BRIEF EXERCISE 8-4

1. Physical, mechanical, and electronic controls.
2. Other controls.
3. Independent internal verification.
4. Segregation of duties.
5. Establishment of responsibility.

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BRIEF EXERCISE 8-5

1. Documentation procedures.
2. Independent internal verification.
3. Physical, mechanical, and electronic controls.
4. Establishment of responsibility.
5. Segregation of duties.

BRIEF EXERCISE 8-6

Mar. 20	Postage Expense	52	
	Freight-out	26	
	Travel Expense	10	
	Cash Over and Short	5	
	Cash		93

BRIEF EXERCISE 8-7

(a) A check provides documentary evidence of the payment of a specified sum of money to a designated payee.

(b) A bank statement provides a double record of a depositor's bank transactions. It also is used in making periodic independent bank reconciliations.

BRIEF EXERCISE 8-8

(1) Outstanding checks—deducted from cash balance per bank.
(2) Bank service charge—deducted from cash balance per books.
(3) Collection of note by bank—added to cash balance per books.
(4) Deposits in transit—added to cash balance per bank.

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BRIEF EXERCISE 8-9

(a) The reconciling items per the books, items (2) and (3) above, will require adjustment on the books of the depositor.

(b) The other reconciling items, deposits in transit and outstanding checks, do not require adjustment by the bank. When these items reach the bank, the bank balance will automatically adjust itself.

BRIEF EXERCISE 8-10

Cash balance per bank	$7,420
Add: Deposits in transit	1,120
	8,540
Less: Outstanding checks	762
Adjusted cash balance per bank	$7,778

BRIEF EXERCISE 8-11

Cash balance per books	$8,500
Add: Interest earned	40
	8,540
Less: Charge for printing company checks	35
Adjusted cash balance per books	$8,505

BRIEF EXERCISE 8-12

Quirk Company should report Cash in Bank and Payroll Bank account as current assets. Plant Expansion Fund Cash should be reported as a noncurrent asset, assuming the fund is not expected to be used during the next year.

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SOLUTIONS TO EXERCISES

EXERCISE 8-1

1. Establishment of responsibility. The counter clerk is responsible for handling cash. Other employees are responsible for making the pizzas.

2. Segregation of duties. Employees who make the pizzas do not handle cash.

3. Documentation procedures. The counter clerk uses your order invoice (ticket) in registering the sale on the cash register. The cash register produces a tape of all sales.

4. Physical, mechanical, and electronic controls. A cash register is used to record the sale.

5. Independent internal verification. The counter clerk, in handling the pizza, compares the size of the pizza with the size indicated on the order.

6. Other controls. No visible application possible.

EXERCISE 8-2

	(a)		(b)
Procedure	Weakness	Principle	Recommended Change
1.	Cash is not adequately protected from theft.	Physical, mechanical, and electronic controls.	Cash should be stored in a safe until it is deposited in bank.
2.	Inability to establish responsibility for cash with a specific clerk.	Establishment of responsibility.	There should be separate cash drawers and register codes for each clerk.

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EXERCISE 8-2 (Continued)

	(a)		(b)
Procedure	Weakness	Principle	Recommended Change
3.	The accountant should not handle cash.	Segregation of duties.	The cashier's department should make the deposits.
4.	Cash is not independently counted.	Independent internal verification.	A cashier office supervisor should count cash.
5.	Cashiers are not bonded.	Other controls.	All cashiers should be bonded.

EXERCISE 8-3

	(a)		(b)
Procedure	Weakness	Principle	Recommended Change
1.	The bank reconciliation is not independently prepared.	Independent internal verification.	Someone with no other cash responsibilities should prepare the bank reconciliation.
2.	The approval and payment of bills is done by the same individual.	Segregation of duties.	The store manager should approve bills for payment and the treasurer should sign and issue checks.
3.	Checks are not stored in a secure area.	Physical, mechanical, and electronic controls.	Checks should be stored in a safe or locked file drawer.

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EXERCISE 8-3 (Continued)

	(a)		(b)
Procedure	Weakness	Principle	Recommended Change
4.	Filing does not prevent a bill from being paid more than once.	Other controls.	Bills should be stamped PAID after payment.
5.	Checks are not prenumbered.	Documentation procedures.	Checks should be prenumbered and subsequently accounted for.

EXERCISE 8-4

	(a) Weaknesses	(b) Suggested Improvement
1.	Checks are not prenumbered.	Use prenumbered checks.
2.	The purchasing agent signs checks.	Only the treasurer's department personnel should sign checks.
3.	Unissued checks are stored in unlocked file cabinet.	Unissued checks should be stored in a locked file cabinet with access restricted to authorized personnel.
4.	Purchasing agent approves and pays for goods purchased.	Purchasing should approve bills for payment by the treasurer.
5.	After payment, the invoice is filed.	The invoice should be stamped PAID.
6.	The purchasing agent records payments in cash disbursements journal.	Only accounting department personnel should record cash disbursements.

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EXERCISE 8-4 (Continued)

(a) Weaknesses	(b) Suggested Improvement
7. The treasurer records the checks in cash disbursements journal.	Same as answer to No. 6 above.
8. The treasurer reconciles the bank statement.	An internal auditor should reconcile the bank statement.

(b) To: Treasurer, Hutchingson Company

From: Accounting Student

I have reviewed your cash disbursements system and suggest that you make the following improvements:

1. Hutchingson Company should use prenumbered checks. These should be stored in a locked file cabinet or safe with access restricted to authorized personnel.

2. The purchasing department should approve bills for payment. The treasurer's department should prepare and sign the checks. The invoices should be stamped paid so that they cannot be paid twice.

3. Only the accounting department personnel should record cash disbursements.

4. An internal auditor should reconcile the bank statement.

If you have any questions about implementing these suggestions, please contact me.

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EXERCISE 8-5

Procedure	IC good or weak?	Related internal control principle
1.	Weak	Establishment of Responsibility
2.	Good	Independent Internal Verification
3.	Weak	Segregation of Duties
4.	Good	Segregation of Duties
5.	Weak	Documentation Procedures

EXERCISE 8-6

Procedure	IC good or weak?	Related internal control principle
1.	Good	Other Controls
2.	Weak	Establishment of Responsibility
3.	Weak	Segregation of Duties
4.	Good	Independent Internal Verification
5.	Good	Physical, Mechanical, and Electronic Controls

EXERCISE 8-7

May 1	Petty Cash	100.00	
	Cash		100.00
June 1	Delivery Expense	31.25	
	Postage Expense	39.00	
	Miscellaneous Expense	25.00	
	Cash Over and Short	2.00	
	Cash		97.25
July 1	Delivery Expense	21.00	
	Entertainment Expense	51.00	
	Miscellaneous Expense	24.75	
	Cash		96.75
July 10	Petty Cash	50.00	
	Cash		50.00

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EXERCISE 8-8

Mar.	1	Petty Cash	100	
		Cash		100
	15	Stamp Inventory	39	
		Freight-out	21	
		Miscellaneous Expense	11	
		Travel Expense	24	
		Cash Over and Short	2	
		Cash		97
	20	Petty Cash	50	
		Cash		50

EXERCISE 8-9

(a)	Cash balance per bank statement		$3,560.20
	Add: Deposits in transit		530.00
			4,090.20
	Less: Outstanding checks		930.00
	Adjusted cash balance per bank		$3,160.20
	Cash balance per books		$3,875.20
	Less: NSF check	$690.00	
	Bank service charge	25.00	715.00
	Adjusted cash balance per books		$3,160.20

(b)	Accounts Receivable	690.00	
	Cash		690.00
	Miscellaneous Expense	25.00	
	Cash		25.00

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EXERCISE 8-10

The outstanding checks are as follows:

No.	Amount
255	$ 820
260	890
264	560
Total	$2,270

EXERCISE 8-11

(a)

FAMILY VIDEO COMPANY
Bank Reconciliation
July 31

Cash balance per bank statement	$7,263
Add: Deposits in transit	1,500
	8,763
Less: Outstanding checks	591
Adjusted cash balance per bank	$8,172
Cash balance per books	$7,284
Add: Collection of note receivable ($900 plus accrued interest $36, less collection fee $20)	916
	8,200
Less: Bank service charge	28
Adjusted cash balance per books	$8,172

(b)

July 31	Cash		916	
	Miscellaneous Expense		20	
		Notes Receivable		900
		Interest Revenue		36
31	Miscellaneous Expense		28	
		Cash		28

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EXERCISE 8-12

(a)

ROBERTSON COMPANY
Bank Reconciliation
September 30

Cash balance per bank statement		$16,422
Add: Deposits in transit		4,450
		20,872
Less: Outstanding checks		2,383
Adjusted cash balance per bank		$18,489
Cash balance per books		$17,404
Add: Collection of note receivable ($1,500 + $30)	$ 1,530	
Interest earned	45	1,575
		18,979
Less: NSF check	425	
Safety deposit box rent	65	490
Adjusted cash balance per books		$18,489

(b)

Sept. 30	Cash		1,530	
	Notes Receivable			1,500
	Interest Revenue			30
30	Cash		45	
	Interest Revenue			45
30	Miscellaneous Expense		65	
	Cash			65
30	Accounts Receivable—J. E. Hoover		425	
	Cash			425

EXERCISE 8-13

(a)

Deposits in transit:		
Deposits per books in July		$15,750
Less: Deposits per bank in July	$15,600	
Deposits in transit, June 30	(720)	
July receipts deposited in July		14,880
Deposits in transit, July 31		$ 870

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EXERCISE 8-13 (Continued)

(b) Outstanding checks:

Checks per books in July		$17,200
Less: Checks clearing bank in July	$16,400	
Outstanding checks, June 30	(680)	
July checks cleared in July		15,720
Outstanding checks, July 31		$ 1,480

(c) Deposits in transit:

Deposits per bank statement in September	$26,700
Add: Deposits in transit, September 30	2,100
Total deposits to be accounted for	28,800
Less: Deposits per books	25,400
Deposits in transit, August 31	$ 3,400

(d) Outstanding checks:

Checks clearing bank in September	$25,000
Add: Outstanding checks, September 30	2,100
Total checks to be accounted for	27,100
Less: Cash disbursements per books	23,700
Outstanding checks, August 31	$ 3,400

EXERCISE 8-14

(a) Cash and cash equivalents should be reported at $93,500.

Cash in bank	$47,000
Cash on hand	12,000
Petty cash	500
Highly liquid investments	34,000
	$93,500

(b) "Cash in plant expansion fund" should be reported as part of long-term investments (a noncurrent asset). "Receivables from customers" should be reported as accounts receivable in the current assets. "Stock investments" should also be reported in the current assets.

(c) Lipkus should disclose in the financial statements the details about the compensating balances. These are generally minimum cash balances the bank requires the borrower to maintain. They are a restriction on the use of cash that may affect the company's liquidity.

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SOLUTIONS TO PROBLEMS

PROBLEM 8-1A

Principles	Application to Cash Disbursements
Establishment of responsibility.	Only the treasurer and assistant treasurer are authorized to sign checks.
Segregation of duties.	Invoices must be approved by both the purchasing agent and the receiving department supervisor. Payment can only be made by the treasurer or assistant treasurer, and the check signers do not record the cash disbursement transactions.
Documentation procedures.	Checks are prenumbered.
Physical, mechanical, and electronic controls.	Blank checks are kept in a safe in the treasurer's office. Only the treasurer and assistant treasurer have access to the safe. A checkwriting machine is used in writing checks.
Independent internal verification.	The check signer compares the check with the approved invoice prior to issue. Bank and book balances are reconciled monthly by the assistant chief accountant.
Other controls.	Following payment, invoices are stamped PAID.

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PROBLEM 8-2A

(a)

July	1	Petty Cash	200.00	
		Cash		200.00
	15	Freight-out	94.00	
		Postage Expense	42.40	
		Entertainment Expense	46.60	
		Miscellaneous Expense	11.20	
		Cash Over and Short	1.80	
		Cash		196.00
	31	Freight-out	82.10	
		Charitable Contributions Expense	45.00	
		Postage Expense	25.50	
		Miscellaneous Expense	39.40	
		Cash		192.00
Aug.	15	Freight-out	75.60	
		Entertainment Expense	43.00	
		Postage Expense	33.00	
		Miscellaneous Expense	37.00	
		Cash Over and Short		1.60
		Cash		187.00
	16	Petty Cash	100.00	
		Cash		100.00
	31	Postage Expense	140.00	
		Travel Expense	95.60	
		Freight-out	47.10	
		Cash Over and Short	1.30	
		Cash		284.00

(b)

Petty Cash

Date	Explanation	Ref.	Debit	Credit	Balance
July 1		CP	200		200
Aug. 16		CP	100		300

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PROBLEM 8-2A (Continued)

(c) The internal control features of a petty cash fund include:

(1) A custodian is responsible for the fund.

(2) A prenumbered petty cash receipt signed by the custodian and the individual receiving payment is required for each payment from the fund.

(3) The treasurer's office examines all payments and stamps supporting documents to indicate they were paid when the fund is replenished.

(4) Surprise counts can be made at any time to determine whether the fund is intact.

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PROBLEM 8-3A

(a)

JAMES LOGAN COMPANY
Bank Reconciliation
May 31, 2008

Cash balance per bank statement		$6,404.60
Add: Deposit in transit	$1,916.15	
Bank error—Bridgetown check	800.00	2,716.15
		9,120.75
Less: Outstanding checks		576.25
Adjusted cash balance per bank		$8,544.50
Cash balance per books		$6,781.50
Add: Collection of note receivable ($2,500 note plus $80 interest less $20 fee)		2,560.00
		9,341.50
Less: NSF check	$ 680.00	
Error in May 12 deposit ($886.15 – $836.15)	50.00	
Error in recording check No. 1181	27.00*	
Check printing charge	40.00	797.00
Adjusted cash balance per books		$8,544.50

*$685 – $658

(b)

May 31	Cash		2,560	
	Miscellaneous Expense		20	
		Notes Receivable		2,500
		Interest Revenue		80
31	Accounts Receivable—S. Grifton		680	
		Cash		680
31	Sales		50	
		Cash		50
31	Accounts Payable—B. Trest		27	
		Cash		27
31	Miscellaneous Expense		40	
		Cash		40

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PROBLEM 8-4A

(a)

BACKHAUS COMPANY
Bank Reconciliation
December 31, 2008

Cash balance per bank statement		$20,154.30
Add: Deposits in transit		1,690.40
		21,844.70
Less: Outstanding checks		
No. 3470	$ 720.10	
No. 3474	1,050.00	
No. 3478	621.30	
No. 3481	807.40	
No. 3484	798.00	
No. 3486	1,889.50	5,886.30
Adjusted cash balance per bank		$15,958.40
Cash balance per books		$12,485.20
Add: Note collected by bank ($4,000 note plus $160 interest less $15 fee)		4,145.00
		16,630.20
Less: NSF check	$ 572.80	
Error in recording check No. 3485	90.00*	
Error in 12-21 deposit ($2,954 – $2,945)	9.00	671.80
Adjusted cash balance per books		$15,958.40

*$540.80 – $450.80

(b)

Dec. 31	Cash		4,145.00	
	Miscellaneous Expense		15.00	
		Notes Receivable		4,000.00
		Interest Revenue		160.00
31	Accounts Receivable—D. Chagnon		572.80	
		Cash		572.80
31	Accounts Payable		90.00	
		Cash		90.00
31	Accounts Receivable		9.00	
		Cash		9.00

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PROBLEM 8-5A

(a)

HAVERMAN COMPANY
Bank Reconciliation
July 31, 2008

Cash balance per bank statement			$24,514
Add: Deposits in transit (1)			9,400
			33,914
Less: Outstanding checks (2)		$ 8,460	
Bank error ($255 – $155)		100	8,560
Adjusted cash balance per bank			$25,354
Cash balance per books			$21,850
Add: Collection of note receivable by bank ($3,400 note plus $70 interest)		$ 3,470	
Book error ($320 – $230)		90	3,560
			25,410
Less: Check printing charge			56
Adjusted cash balance per books			$25,354

(1)	July receipts per books			$81,400
	July deposits per bank		$79,000	
	Less: Deposits in transit, June 30		7,000	72,000
	Deposits in transit, July 31			$ 9,400
(2)	Disbursements per books in July			$77,150
	Less: Book error			90
	Total disbursements to be accounted for			77,060
	Checks clearing bank in July		$74,700	
	Add: Bank error	$ 100		
	Less: June 30 outstanding checks	6,200	6,100	68,600
	Outstanding checks, July 31			$ 8,460

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PROBLEM 8-5A (Continued)

(b)	July 31	Cash	3,470	
		Notes Receivable		3,400
		Interest Revenue		70
	31	Miscellaneous Expense	56	
		Cash		56
	31	Cash	90	
		Accounts Payable		90

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PROBLEM 8-6A

Tom has created a situation that leaves many opportunities for undetected theft. Here is a list of some of the deficiencies in internal control. You may find others.

1. **Documentation procedures. The tickets were unnumbered. By numbering the tickets, the students could have been held more accountable for the tickets. See number 3 below.**

2. **Physical controls and establishment of responsibility. The tickets were left in an unlocked box on his desk. Instead, Tom should have assigned control of the tickets to one individual, in a locked box which that student alone had control over.**

3. **Documentation procedures. No record was kept of which students took tickets to sell or how many they took. In combination with items 1 and 2 above, the student assigned control over the tickets should have kept a record of which tickets were issued to each student for resale. (Note: This problem could have been largely avoided if the tickets had only been sold at the door on the day of the dance.)**

4. **Documentation procedures. There was no control over unsold tickets. This deficiency made it possible for students to sell the tickets, keep the cash, and tell Tom that they had disposed of the unsold tickets. Instead, students should have been required to return the unsold tickets to the student maintaining control over tickets, and the cash to Tom. In each case, the students should have been issued a receipt for the cash they turned in and the tickets they returned.**

5. **Establishment of responsibility. Inadequate control over the cash box. In effect, it was operated like a petty cash fund, but too many people had the key. Instead, Tom should have had the key and dispersed funds when necessary for purchases.**

6. **Documentation procedures. Instead of receipts, students simply wrote notes saying how they used the funds. Instead, it should have been required that they provided a valid receipt.**

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PROBLEM 8-6A (Continued)

7. **Segregation of duties. Luke Gilmor counted the funds, made out the deposit slip, and took the funds to the bank. This made it possible for Luke Gilmor to take some of the money and deposit the rest since there was no external check on his work. Tom should have counted the funds, with someone observing him. Then he could have made out the deposit slip and had Luke Gilmor deposit the funds.**

8. **Documentation procedures. Tom did not receive a receipt from Obnoxious Ed. Without a receipt, there is no way to verify how much Obnoxious Ed was actually paid. For example, it is possible that he was only paid $100 and that Tom took the rest.**

9. **Separation of duties. Mel Harris was collecting tickets and receiving cash for additional tickets sold. Instead, there should have been one person selling tickets at the door and a second person collecting tickets.**

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PROBLEM 8-1B

(a)

Principles	Application to Starr Theater
Establishment of responsibility.	Only cashiers are authorized to sell tickets. Only the manager and cashier can handle cash.
Segregation of duties.	The duties of receiving cash and admitting customers are assigned to the cashier and to the usher. The manager maintains custody of the cash, and the company accountant records the cash.
Documentation procedures.	Tickets are prenumbered. Cash count sheets are prepared. Deposit slips are prepared.
Physical, mechanical, and electronic controls.	A safe is used for the storage of cash and a machine is used to issue tickets.
Independent internal verification.	Cash counts are made by the manager at the end of each cashier's shift. Daily comparisons are made by the company treasurer.
Other controls.	Cashiers are bonded.

(b) Actions by the usher and cashier to misappropriate cash might include:

(1) Instead of tearing the tickets, the usher could return the tickets to the cashier who could resell them, and the two could divide the cash.

(2) The cashier could issue a lower price ticket than paid for and the usher would admit the customer. The difference between the ticket issued and the cash received could be divided between the usher and cashier.

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PROBLEM 8-2B

(a)	July	1	Petty Cash	200.00	
			Cash		200.00
		15	Freight-out	94.00	
			Postage Expense	42.40	
			Entertainment Expense	45.90	
			Miscellaneous Expense	10.70	
			Cash Over and Short	1.30	
			Cash		194.30
		31	Freight-out	82.10	
			Charitable Contributions Expense	30.00	
			Postage Expense	47.80	
			Miscellaneous Expense	32.10	
			Cash		192.00
	Aug.	15	Freight-out	74.40	
			Entertainment Expense	41.50	
			Postage Expense	33.00	
			Miscellaneous Expense	36.00	
			Cash Over and Short	3.10	
			Cash		188.00
		16	Petty Cash	100.00	
			Cash		100.00
		31	Postage Expense	145.00	
			Entertainment Expense	90.60	
			Freight-out	46.00	
			Cash Over and Short	1.40	
			Cash		283.00

(b)

Petty Cash

Date	Explanation	Ref.	Debit	Credit	Balance
July 1		CP	200		200
Aug. 16		CP	100		300

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PROBLEM 8-2B (Continued)

(c) The internal control features of a petty cash fund include:

(1) A custodian is responsible for the fund.

(2) A prenumbered petty cash receipt signed by the custodian and the individual receiving payment is required for each payment from the fund.

(3) The treasurer's office examines all payments and stamps supporting documents to indicate they were paid when the fund is replenished.

(4) Surprise counts can be made at any time to determine whether the fund is intact.

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PROBLEM 8-3B

(a)

FLINT HILLS GENETICS COMPANY
Bank Reconciliation
May 31, 2008

Cash balance per bank statement		$6,804.60
Add: Deposit in transit	$936.15	
Bank error—Bohr check	600.00	1,536.15
		8,340.75
Less: Outstanding checks		515.25
Adjusted cash balance per bank		$7,825.50
Cash balance per books		$6,781.50
Add: Collection of note receivable ($2,000 note plus $80 interest less $25 fee)		2,055.00
		8,836.50
Less: NSF check	$934.00	
Error in May 12 deposit	10.00	
Error in recording check No. 1181	27.00*	
Check printing charge	40.00	1,011.00
Adjusted cash balance per books		$7,825.50

*$685 – $658

(b)

May 31	Cash		2,055	
	Miscellaneous Expense		25	
		Notes Receivable		2,000
		Interest Revenue		80
31	Accounts Receivable—Tyler Gricius		934	
		Cash		934
31	Sales		10	
		Cash		10
31	Accounts Payable—M. Datz		27	
		Cash		27
31	Miscellaneous Expense		40	
		Cash		40

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PROBLEM 8-4B

(a)

CONLIN COMPANY
Bank Reconciliation
November 30, 2008

Balance per bank statement		$17,069.40
Add: Deposits in transit		2,338.00
		19,407.40
Less: Outstanding checks		
No. 2451	$1,260.40	
No. 2472	503.60	
No. 2478	538.20	
No. 2482	612.00	
No. 2484	829.50	
No. 2485	974.80	
No. 2487	398.00	
No. 2488	1,200.00	6,316.50
Adjusted cash balance per bank		$13,090.90
Balance per books		$10,846.90
Add: Note collected by bank ($2,400 note plus $120 interest less $15 fee)		2,505.00
		13,351.90
Less: Check printing charge	$ 72.00	
Error in recording check No. 2479	180.00*	
Error in 11-21 deposit ($2,954 – $2,945)	9.00	261.00
Adjusted cash balance per books		$13,090.90

*$1,750 – $1,570

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PROBLEM 8-4B (Continued)

(b)	Nov. 30	Cash	2,505	
		Miscellaneous Expense	15	
		Notes Receivable		2,400
		Interest Revenue		120
	30	Miscellaneous Expense	72	
		Cash		72
	30	Accounts Payable	180	
		Cash		180
	30	Accounts Receivable	9	
		Cash		9

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PROBLEM 8-5B

(a)

BAUMGARDNER COMPANY
Bank Reconciliation
August 31, 2008

Cash balance per bank statement			$25,932
Add: Deposits in transit (1)	$ 7,890		
Bank error ($278 – $275)	3		7,893
			33,825
Less: Outstanding checks (2)			6,393
Adjusted cash balance per bank			$27,432
Cash balance per books			$20,330
Add: Collection of note receivable by bank ($6,800 note plus $130 interest)	$ 6,930		
Book error ($420 – $240)	180		
Interest earned	32		7,142
			27,472
Less: Safety deposit box rent			40
Adjusted cash balance per books			$27,432

(1)	August receipts per books			$77,000
	August deposits per bank		$73,110	
	Less: Deposits in transit, July 31		4,000	69,110
	Deposits in transit, August 31			$ 7,890
(2)	Disbursements per books in August			$73,570
	Less: Book error			180
	Total disbursements to be accounted for			73,390
	Checks clearing bank in August		$71,500	
	Less: Bank error	$ 3		
	July 31 outstanding checks	4,500	4,503	66,997
	Outstanding checks, August 31			$ 6,393

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PROBLEM 8-5B (Continued)

(b)	**Aug. 31**	**Cash**	**6,930**	
		Notes Receivable		**6,800**
		Interest Revenue		**130**
	31	**Cash**	**32**	
		Interest Revenue		**32**
	31	**Miscellaneous Expense**	**40**	
		Cash		**40**
	31	**Cash**	**180**	
		Accounts Payable		**180**

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PROBLEM 8-6B

(a)

RICHARDSON COMPANY
Bank Reconciliation
October 31, 2008

Balance per bank statement					$18,180.00
Plus: Undeposited receipts					3,795.51
					21,975.51
Less: Outstanding checks					
No.	Amount	No.	Amount		
62	$126.75	862	$190.71		
183	150.00	863	226.80		
284	253.25	864	165.28		1,112.79
Adjusted balance per bank					$20,862.72
Cash balance per books					$21,892.72
Add: Bank credit (collection of note receivable)					400.00
Adjusted balance per books (before theft)					22,292.72
Theft					1,430.00*
Adjusted balance per books					$20,862.72

*$22,292.72 – $20,862.72

(b) The cashier attempted to cover the theft of $1,430.00 by:

1. Not listing as outstanding three checks totaling $530.00 (No. 62, $126.75; No. 183, $150.00; and No. 284, $253.25).

2. Underfooting the outstanding checks listed by $100. (The correct total is $582.79.)

3. Subtracting the $400 bank credit from the book balance instead of adding it to the book balance, thereby concealing $800 of the theft.

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(c) 1. The principle of independent internal verification has been violated because the cashier prepared the bank reconciliation.

2. The principle of segregation of duties has been violated because the cashier had access to the accounting records and also prepared the bank reconciliation.

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BYP 8-1 FINANCIAL REPORTING PROBLEM

(a) In the Independent Auditors' Report, it states that "consolidated financial statements referred to above [including the statement of cash flows] present fairly, in all material respects, the financial position of PepsiCo, Inc. and subsidiaries as of December 31, 2005 and December 25, 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with United States generally accepted accounting principles."

(b) Cash and cash equivalents are reported at $1,716 million for 2005 and $1,280 million for 2004.

(c) Cash equivalents are defined as "investments with original maturities of three months or less which we do not intend to rollover beyond three months."

(d) PepsiCo's management states that "our system of internal control is based on the control criteria framework of the Committee of Sponsoring Organizations of the Treadway Commission published in their report titled, *Internal Control—Integrated Framework*. The system is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded; that assets are safeguarded; and that accounting records are sufficiently reliable to permit the preparation of financial statements that conform in all material respects with accounting principles generally accepted in the U.S. We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports under the Securities Exchange Act of 1934 is recorded, processed summarized and reported within the specified time periods. We monitor these internal controls through self-assessments and an ongoing program of internal audits. Our internal controls are reinforced through our Worldwide Code of Conduct, which sets forth our commitment to conduct business with integrity, and within both the letter and the spirit of the law."

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BYP 8-2 COMPARATIVE ANALYSIS PROBLEM

		PepsiCo	Coca-Cola
(a)	(1)	$1,716 million	$4,701 million
	(2)	$436 million increase	$2,006 million decrease
	(3)	$5,852 million	$6,423 million

(b) Both companies generated over 5.5 billion dollars from operating activities. This cash is used for investing and financing activities. Both companies use the cash provided by operating activities to purchase land, buildings and equipment, to make acquisitions of other companies, to buy back their stock, and to pay dividends. Both companies have large cash balances at the end of 2005 and are capable of generating huge amounts of cash.

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BYP 8-3 EXPLORING THE WEB

(a) The system of internal control should be evaluated by: (1) responsible individuals from a particular university unit, (2) internal auditors, and (3) university management.

(b) Reconciliations ensure accuracy and completeness of transactions. In particular, a reconciliation ensures that all cash received is: (1) properly deposited in university bank accounts and (2) recorded accurately in the financial records. The reconciliation should be reviewed by the department manager.

(c) Some examples given of physical controls are a safe, vault, locked doors, campus police, computer passwords, and card key systems.

(d) Two ways to accomplish inventory counts are: (1) annual complete inventory or (2) cycle counting programs.

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BYP 8-4 DECISION MAKING ACROSS THE ORGANIZATION

(a) The weaknesses in internal accounting control over collections are:

(1) Each usher could take cash from the collection plates enroute to the basement office.
(2) The head usher counts the cash alone.
(3) The head usher's notation of the count is left in the safe.
(4) The financial secretary counts the cash alone.
(5) The financial secretary withholds $150 to $200 per week.
(6) The cash is vulnerable to robbery when kept in the safe overnight.
(7) Checks are made payable to "cash."
(8) The financial secretary has custody of the cash, maintains church records, and prepares the bank reconciliation.

(b) The improvements should include the following:

(1) The ushers should transfer their cash collections to a cash pouch (or bag) held by the head usher. The transfer should be witnessed by a member of the finance committee.
(2) The head usher and finance committee member should take the cash to the office. The cash should be counted by the head usher and the financial secretary in the presence of the finance committee member.
(3) Following the count, the financial secretary should prepare a deposit slip in duplicate for the total cash received, and the secretary should immediately deposit the cash in the bank's night deposit vault.
(4) At the end of each month, a member of the finance committee should prepare the bank reconciliation.

(c) The policies that should be changed are:

(1) Members should make checks payable to the church.
(2) A petty cash fund should be established for the financial secretary to be used for weekly cash expenditures and requests for replenishment of the fund should be sent to the chairperson of the finance committee for approval.
(3) The financial secretary should be bonded.
(4) The financial secretary should be required to take an annual vacation.

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BYP 8-5 COMMUNICATION ACTIVITY

Mr. Jerry Mays
Manhattan Company
Main Street, USA

Dear Mr. Mays:

During our audit of your financial statements, we reviewed the internal controls over cash receipts. The weaknesses we discovered and our suggested improvements are listed below.

	(a) Weaknesses	(b) Suggested Improvement
1.	A list of checks received is not prepared by the person who opens the mail.	This list should be prepared so that it can later be compared with the daily cash summary. While this procedure does not assure that all checks will be listed, it does allow the company to verify that all checks on the list did get deposited.
2.	Mail is opened by only one person.	When this occurs, there is no assurance that all incoming checks are forwarded to the cashier's department.
3.	The cashier is allowed to open the mail.	Under this arrangement, it is possible for the cashier to open the mail, prepare the cash summary and make the bank deposit. This involves no segregation of duties as the cashier controls the cash from the time it is received until it is deposited in the bank.
4.	The accounts receivable clerk is allowed to open the mail.	Again, there is poor segregation of duties. In this case, the clerk could writeoff a customer's account as uncollectible and then misappropriate the collection when it's received.

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BYP 8-5 (Continued)

	(a) Weaknesses	(b) Suggested Improvement
5.	Mail receipts are deposited weekly.	This makes the receipts vulnerable to robbery and to misappropriation. The receipts should be deposited intact daily.

We would be pleased to discuss the weaknesses and our recommended improvements with you, at your convenience.

Yours sincerely,

Croix, Marais, and Kale
Certified Public Accountants

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BYP 8-6 ETHICS CASE

(a) You, as assistant controller, may suffer some negative effects from Gena Schmitt, the financial vice-president, if you don't follow her instructions. Maybe the insurance company will react the way Gena suggests, but probably not.

If you comply and falsify the June 30 cash balance by holding the cash receipts book open for one day, you will suffer personally by sacrificing your integrity. If you are found out, you could be prosecuted for preparing a fraudulent report. The insurance company, as the lender and creditor, is deceived.

(b) Holding the cash receipts book open in order to overstate the cash balance is a fraudulent, deceitful, unethical action. The financial vice-president should not encourage such behavior and a controller should not follow such instructions.

(c) (1) You can follow the vice-president's instructions and misstate the cash balance—wrong! (2) You can advise the vice-president against holding the books open, prepare an accurate report, and have the vice-president or the president discuss the situation with the insurance company. It can be explained that the low cash balance was only temporary. Honesty is still the best policy.

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BYP 8-7 ALL ABOUT YOU ACTIVITY

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CHAPTER 9

Accounting for Receivables

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Identify the different types of receivables.	1, 2	1			
2. Explain how companies recognize accounts receivable.	3	2	1, 2, 14	1A, 3A, 4A, 6A, 7A	1B, 3B, 4B, 6B, 7B
3. Distinguish between the methods and bases companies use to value accounts receivable.	4, 5, 6, 7, 8	3, 4, 5, 6, 7	3, 4, 5, 6	1A, 2A, 3A, 4A, 5A	1B, 2B, 3B, 4B, 5B
4. Describe the entries to record the disposition of accounts receivable.	9, 10, 11	8	7, 8, 9, 14	6A, 7A	6B, 7B
5. Compute the maturity date of and interest on notes receivable.	12, 13, 14, 15, 16	9, 10	10, 11, 12, 13	6A, 7A	6B, 7B
6. Explain how companies recognize notes receivable.		11	10, 11, 12	7A	7B
7. Describe how companies value notes receivable.				7A	7B
8. Describe the entries to record the disposition of notes receivable.	17		12, 13	6A, 7A	6B, 7B
9. Explain the statement presentation and analysis of receivables.	18, 19	3, 12	14, 15	1A, 6A	1B, 6B

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ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Prepare journal entries related to bad debts expense.	Simple	15–20
2A	Compute bad debts amounts.	Moderate	20–25
3A	Journalize entries to record transactions related to bad debts.	Moderate	20–30
4A	Journalize transactions related to bad debts.	Moderate	20–30
5A	Journalize entries to record transactions related to bad debts.	Moderate	20–30
6A	Prepare entries for various notes receivable transactions.	Moderate	40–50
7A	Prepare entries for various receivable transactions.	Complex	50–60
1B	Prepare journal entries related to bad debts expense.	Simple	15–20
2B	Compute bad debts amounts.	Moderate	20–25
3B	Journalize entries to record transactions related to bad debts.	Moderate	20–30
4B	Journalize transactions related to bad debts.	Moderate	20–30
5B	Journalize entries to record transactions related to bad debts.	Moderate	20–30
6B	Prepare entries for various notes receivable transactions.	Moderate	40–50
7B	Prepare entries for various receivable transactions.	Complex	50–60

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Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Identify the different types of receivables.	Q9-2	Q9-1 BE9-1				
2. Explain how companies recognize accounts receivable.			Q9-3 E9-2 BE9-2 P9-7A E9-1 P9-7B	E9-14 P9-4A P9-3B P9-1A P9-6A P9-4B P9-3A P9-1B P9-6B		
3. Distinguish between the methods and bases used to value accounts receivable.	Q9-8	Q9-4 Q9-5 Q9-6	BE9-4 BE9-5 BE9-6 E9-5 E9-6	Q9-7 P9-1A P9-1B BE9-3 P9-2A P9-2B BE9-7 P9-3A P9-3B E9-3 P9-4A P9-4B E9-4 P9-5A P9-5B		
4. Describe the entries to record the disposition of accounts receivable.	Q9-9	Q9-10	Q9-11 E9-9 BE9-8 P9-7A E9-7 P9-7B E9-8	E9-14 P9-6A P9-6B		
5. Compute the maturity date of and interest on notes receivable.	Q9-13	Q9-12 Q9-16	Q9-14 E9-12 Q9-15 E9-13 BE9-9 P9-7A BE9-10 P9-7B	E9-10 E9-11 P9-6A P9-6B		
6. Explain how companies recognize notes receivable.			BE9-11 P9-7B P9-7A E9-12	E9-10 E9-11		
7. Describe how companies value notes receivable.			P9-7A P9-7B			
8. Describe the entries to record the disposition of notes receivable.		Q9-17	E9-12 P9-7A E9-13 P9-7B	P9-6A P9-6B		
9. Explain the statement presentation and analysis of receivables.	Q9-18		Q9-19 BE9-12 E9-15	BE9-3 P9-6A E9-14 P9-1B P9-1A P9-6B		
Broadening Your Perspective			Exploring the Web	Decision Making Across the Organization Comparative Analysis		All About You Financial Reporting Comparative Analysis Ethics Case Communication

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ANSWERS TO QUESTIONS

1. Accounts receivable are amounts owed by customers on account. They result from the sale of goods and services in the normal course of business operations (i.e., in trade). Notes receivable represent claims that are evidenced by formal instruments of credit.

2. Other receivables include nontrade receivables such as interest receivable, loans to company officers, advances to employees, and income taxes refundable.

3.

Accounts Receivable	40	
Interest Revenue		40

4. The essential features of the allowance method of accounting for bad debts are:
(1) Uncollectible accounts receivable are estimated and matched against revenue in the same accounting period in which the revenue occurred.
(2) Estimated uncollectibles are debited to Bad Debts Expense and credited to Allowance for Doubtful Accounts through an adjusting entry at the end of each period.
(3) Actual uncollectibles are debited to Allowance for Doubtful Accounts and credited to Accounts Receivable at the time the specific account is written off.

5. Jerry Gatewood should realize that the decrease in cash realizable value occurs when estimated uncollectibles are recognized in an adjusting entry. The write-off of an uncollectible account reduces both accounts receivable and the allowance for doubtful accounts by the same amount. Thus, cash realizable value does not change.

6. The two bases of estimating uncollectibles are: (1) percentage-of-sales and (2) percentage-of-receivables. The percentage-of-sales basis establishes a percentage relationship between the amount of credit sales and expected losses from uncollectible accounts. This method emphasizes the matching of expenses with revenues. Under the percentage-of-receivables basis, the balance in the allowance for doubtful accounts is derived from an analysis of individual customer accounts. This method emphasizes cash realizable value.

7. The adjusting entry under the percentage-of-sales basis is:

Bad Debts Expense	4,100	
Allowance for Doubtful Accounts		4,100

The adjusting entry under the percentage-of-receivables basis is:

Bad Debts Expense	2,300	
Allowance for Doubtful Accounts ($5,800 – $3,500)		2,300

8. Under the direct write-off method, bad debt losses are not estimated and no allowance account is used. When an account is determined to be uncollectible, the loss is debited to Bad Debts Expense. The direct write-off method makes no attempt to match bad debts expense to sales revenues or to show the cash realizable value of the receivables in the balance sheet.

9. From its own credit cards, the DeVito Company may realize financing charges from customers who do not pay the balance due within a specified grace period. National credit cards offer the following advantages:
(1) The credit card issuer makes the credit investigation of the customer.
(2) The issuer maintains individual customer accounts.

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(3) The issuer undertakes the collection process and absorbs any losses from uncollectible accounts.
(4) The retailer receives cash more quickly from the credit card issuer than it would from individual customers.

10. The reasons companies are selling their receivables are:
(1) Receivables may be sold because they may be the only reasonable source of cash.
(2) Billing and collection are often time-consuming and costly. It is often easier for a retailer to sell the receivables to another party with expertise in billing and collection matters.

11.

Cash	582,000	
Service Charge Expense (3% X $600,000)	18,000	
Accounts Receivable		600,000

12. A promissory note gives the holder a stronger legal claim than one on an accounts receivable. As a result, it is easier to sell to another party. Promissory notes are negotiable instruments, which means they can be transferred to another party by endorsement. The holder of a promissory note also can earn interest.

13. The maturity date of a promissory note may be stated in one of three ways: (1) on demand, (2) on a stated date, and (3) at the end of a stated period of time.

14. The maturity dates are: (a) March 13 of the next year, (b) August 4, (c) July 20, and (d) August 30.

15. The missing amounts are: (a) $20,000, (b) $9,000, (c) 8%, and (d) four months.

16. If a financial institution uses 360 days rather than 365 days, it will receive more interest revenue. The reason is that the denominator is smaller, which makes the fraction larger and, therefore, the interest revenue larger.

17. When Cain Company dishonors a note, it may: (1) issue a new note for the maturity value of the dishonored note, or (2) refuse to make any settlement, or (3) it might make partial payment and issue a new note for the unpaid balance.

18. Each of the major types of receivables should be identified in the balance sheet or in the notes to the financial statements. Both the gross amount of receivables and the allowance for doubtful accounts should be reported. If collectible within a year or the operating cycle, whichever is longer, these receivables are reported as current assets immediately below short-term investments.

19. Net credit sales for the period are 8.14 X $400,000 = $3,256,000.

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SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 9-1

(a) Accounts receivable.
(b) Notes receivable.
(c) Other receivables.

BRIEF EXERCISE 9-2

(a)	Accounts Receivable	15,200	
	Sales		15,200
(b)	Sales Returns and Allowances	3,800	
	Accounts Receivable		3,800
(c)	Cash ($11,400 – $228)	11,172	
	Sales Discounts ($11,400 X 2%)	228	
	Accounts Receivable ($15,200 – $3,800)		11,400

BRIEF EXERCISE 9-3

(a)	Bad Debts Expense	35,000	
	Allowance for Doubtful Accounts		35,000

(b)	Current assets		
	Cash		$ 90,000
	Accounts receivable	$600,000	
	Less: Allowance for doubtful Accounts	35,000	565,000
	Merchandise inventory		130,000
	Prepaid expenses		7,500
	Total current assets		$792,500

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BRIEF EXERCISE 9-4

(a)	Allowance for Doubtful Accounts	5,400	
	Accounts Receivable—Ristau		5,400

(b)	(1) Before Write-Off	(2) After Write-Off
Accounts receivable	$700,000	$694,600
Allowance for doubful accounts	54,000	48,600
Cash realizable value	$646,000	$646,000

BRIEF EXERCISE 9-5

Accounts Receivable—Ristau	5,400	
Allowance for Doubtful Accounts		5,400
Cash	5,400	
Accounts Receivable—Ristau		5,400

BRIEF EXERCISE 9-6

Bad Debts Expense [($800,000 – $45,000) X 2%]	15,100	
Allowance for Doubtful Accounts		15,100

BRIEF EXERCISE 9-7

(a)	Bad Debts Expense [($450,000 X 1%) – $1,500]	3,000	
	Allowance for Doubtful Accounts		3,000

(b) Bad Debts Expense [($450,000 X 1%) + $800] = 5,300

BRIEF EXERCISE 9-8

(a)	Cash ($150 – $6)	144	
	Service Charge Expense ($150 X 4%)	6	
	Sales		150
(b)	Cash ($60,000 – $1,800)	58,200	
	Service Charge Expense ($60,000 X 3%)	1,800	
	Accounts Receivable		60,000

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BRIEF EXERCISE 9-9

	Interest	Maturity Date
(a)	$800	August 9
(b)	$875	October 12
(c)	$200	July 11

BRIEF EXERCISE 9-10

	Maturity Date	Annual Interest Rate	Total Interest
(a)	May 31	9%	$9,000
(b)	August 1	8%	$ 600
(c)	September 7	10%	$6,000

BRIEF EXERCISE 9-11

Jan. 10	Accounts Receivable	13,600	
	Sales		13,600
Feb. 9	Notes Receivable.....	13,600	
	Accounts Receivable		13,600

BRIEF EXERCISE 9-12

Accounts Receivable Turnover Ratio:

$$\frac{\$20B}{(\$2.7B + \$2.8B) \div 2} = \frac{\$20B}{\$2.75B} = 7.3 \text{ times}$$

Average Collection Period for Accounts Receivable:

$$\frac{365 \text{ days}}{7.3 \text{ times}} = 50 \text{ days}$$

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SOLUTIONS TO EXERCISES

EXERCISE 9-1

March	1	Accounts Receivable—CC Company	3,000	
		Sales		3,000
	3	Sales Returns and Allowances	500	
		Accounts Receivable—CC Company		500
	9	Cash	2,450	
		Sales Discounts	50	
		Accounts Receivable—CC Company		2,500
	15	Accounts Receivable	400	
		Sales		400
	31	Accounts Receivable	6	
		Interest Revenue		6

EXERCISE 9-2

(a)	Jan. 6	Accounts Receivable—Cortez	9,000	
		Sales		9,000
	16	Cash ($9,000 – $180)	8,820	
		Sales Discounts (2% X $9,000)	180	
		Accounts Receivable—Cortez		9,000
(b)	Jan. 10	Accounts Receivable—Dawes	9,000	
		Sales		9,000
	Feb. 12	Cash	5,000	
		Accounts Receivable—Dawes		5,000
	Mar. 10	Accounts Receivable—Dawes	80	
		Interest Revenue		80
		[2% X ($9,000 – $5,000)]		

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EXERCISE 9-3

(a)		Dec. 31	Bad Debts Expense	1,400	
			Accounts Receivable—Fell		1,400
(b)	(1)	Dec. 31	Bad Debts Expense	8,100	
			[($840,000 – $30,000) X 1%]		
			Allowance for Doubtful Accounts		8,100
	(2)	Dec. 31	Bad Debts Expense	9,900	
			Allowance for Doubtful Accounts		9,900
			[($120,000 X 10%) – $2,100]		
(c)	(1)	Dec. 31	Bad Debts Expense	6,075	
			[($840,000 – $30,000) X .75%]		
			Allowance for Doubtful Accounts		6,075
	(2)	Dec. 31	Bad Debts Expense	7,400	
			Allowance for Doubtful Accounts		7,400
			[($120,000 X 6%) + $200]		

EXERCISE 9-4

(a)

Accounts Receivable	Amount	%	Estimated Uncollectible
1–30 days	$60,000	2.0	$1,200
30–60 days	17,600	5.0	880
60–90 days	8,500	30.0	2,550
Over 90 days	7,000	50.0	3,500
			$8,130

(b)	Mar. 31	Bad Debts Expense	6,930	
		Allowance for Doubtful Accounts		6,930
		($8,130 – $1,200)		

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EXERCISE 9-5

Allowance for Doubtful Accounts	13,000	
Accounts Receivable		13,000
Accounts Receivable	1,800	
Allowance for Doubtful Accounts		1,800
Cash	1,800	
Accounts Receivable		1,800
Bad Debts Expense	15,200	
Allowance for Doubtful Accounts		15,200
[$19,000 – ($15,000 – $13,000 + $1,800)]		

EXERCISE 9-6

December 31, 2008		
Bad Debts Expense (2% X $400,000)	8,000	
Allowance for Doubtful Accounts		8,000
May 11, 2009		
Allowance for Doubtful Accounts	1,100	
Accounts Receivable—Frye		1,100
June 12, 2009		
Accounts Receivable—Frye	1,100	
Allowance for Doubtful Accounts		1,100
Cash	1,100	
Accounts Receivable—Frye		1,100

EXERCISE 9-7

(a)	Mar. 3	Cash ($680,000 – $20,400)	659,600	
		Service Charge Expense	20,400	
		(3% X $680,000)		
		Accounts Receivable		680,000
(b)	May 10	Cash ($3,500 – $140)	3,360	
		Service Charge Expense	140	
		(4% X $3,500)		
		Sales		3,500

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EXERCISE 9-8

(a)	Apr. 2	Accounts Receivable—Nancy Hansel		1,500	
		Sales			1,500
	May 3	Cash		700	
		Accounts Receivable—Nancy Hansel			700
	June 1	Accounts Receivable—Nancy Hansel		8	
		Interest Revenue			8
		[($1,500 – $700) X 1%]			
(b)	July 4	Cash		194	
		Service Charge Expense		6	
		(3% X $200)			
		Sales			200

EXERCISE 9-9

(a)	Jan. 15	Accounts Receivable		18,000	
		Sales			18,000
	20	Cash ($4,300 – $86)		4,214	
		Service Charge Expense		86	
		($4,300 X 2%)			
		Sales			4,300
	Feb. 10	Cash		10,000	
		Accounts Receivable			10,000
	15	Accounts Receivable ($8,000 X 1%)		80	
		Interest Revenue			80

(b) Interest Revenue is reported under other revenues and gains. Service Charge Expense is a selling expense.

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EXERCISE 9-10

(a)		2008		
Nov. 1	Notes Receivable		15,000	
	Cash			15,000
Dec. 11	Notes Receivable		6,750	
	Sales			6,750
16	Notes Receivable		4,000	
	Accounts Receivable—Reber			4,000
31	Interest Receivable		295	
	Interest Revenue*			295

*Calculation of interest revenue:

Givens's note:	$15,000	X 10% X	2/12 =	$250
Countryman's note:	6,750	X 8% X	20/360 =	30
Reber's note:	4,000	X 9% X	15/360 =	15
Total accrued interest				$295

(b)		2009		
Nov. 1	Cash		16,500	
	Interest Receivable			250
	Interest Revenue*			1,250
	Notes Receivable			15,000
	*($15,000 X 10% X 10/12)			

EXERCISE 9-11

		2008		
May 1	Notes Receivable		7,500	
	Accounts Receivable—Julia Gonzalez			7,500
Dec. 31	Interest Receivable		500	
	Interest Revenue			500
	($7,500 X 10% X 8/12)			
31	Interest Revenue		500	
	Income Summary			500

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EXERCISE 9-11 (Continued)

		2009		
May	1	Cash	8,250	
		Notes Receivable		7,500
		Interest Receivable		500
		Interest Revenue		250
		($7,500 X 10% X 4/12)		

EXERCISE 9-12

4/1/08	Notes Receivable	20,000	
	Accounts Receivable—Wilson		20,000
7/1/08	Notes Receivable	25,000	
	Cash		25,000
12/31/08	Interest Receivable	1,800	
	Interest Revenue		1,800
	($20,000 X 12% X 9/12)		
	Interest Receivable	1,250	
	Interest Revenue		1,250
	($25,000 X 10% X 6/12)		
4/1/09	Cash	22,400	
	Notes Receivable		20,000
	Interest Receivable		1,800
	Interest Revenue		600
	($20,000 X 12% X 3/12 = $600)		
	Accounts Receivable	26,875	
	Notes Receivable		25,000
	Interest Receivable		1,250
	Interest Revenue		625
	($25,000 X 10% X 3/12 = $625)		

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EXERCISE 9-13

(a)	May 2	Notes Receivable	7,600	
		Cash		7,600
(b)	Nov. 2	Accounts Receivable—Everhart Inc.	7,942	
		Notes Receivable		7,600
		Interest Revenue		342
		($7,600 X 9% X 1/2)		
		(To record the dishonor of Everhart Inc. note with expectation of collection)		
(c)	Nov. 2	Allowance for Doubtful Accounts	7,600	
		Notes Receivable		7,600
		(To record the dishonor of Everhart Inc. note with no expectation of collection)		

EXERCISE 9-14

(a)	Sales		$83,000
	Cost of Goods Sold		
	Beginning Inventory	$36,000	
	Add: Purchases (net)	60,000	
	Goods Available for Sale	96,000	
	Less: Ending Inventory	33,000	
	Cost of Goods Sold		63,000
	Gross Profit		$20,000

Total Sales = $83,000 ($20,000 + $63,000)
Cash Sales = $18,000
Credit Sales = $65,000

(b) Accounts Receivable at December 31 is $10,000, as shown below:

Accounts Receivable			
Beg. Bal.	$24,000	Write-offs	1,000
Credit sales	65,000	Collections	78,000
End bal.	10,000		

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EXERCISE 9-15

(a)	Beginning accounts receivable	$ 100,000
	Net credit sales	1,000,000
	Cash collections	(900,000)
	Accounts written off	(30,000)
	Ending accounts receivable	$ 170,000

(b) $1,000,000/[($100,000 + $170,000)/2] = 7.41

(c) 365/7.41 = 49.3 days

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SOLUTIONS TO PROBLEMS

PROBLEM 9-1A

(a)

1.	Accounts Receivable	3,200,000	
	Sales		3,200,000
2.	Sales Returns and Allowances	50,000	
	Accounts Receivable		50,000
3.	Cash	2,810,000	
	Accounts Receivable		2,810,000
4.	Allowance for Doubtful Accounts	90,000	
	Accounts Receivable		90,000
5.	Accounts Receivable	24,000	
	Allowance for Doubtful Accounts		24,000
	Cash	24,000	
	Accounts Receivable		24,000

(b)

Accounts Receivable

Bal.	960,000	(2)	50,000
(1)	3,200,000	(3)	2,810,000
(5)	24,000	(4)	90,000
		(5)	24,000
Bal.	1,210,000		

Allowance for Doubtful Accounts

(4)	90,000	Bal.	80,000
		(5)	24,000
		Bal.	14,000

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(c)

Balance before adjustment [see (b)]	$ 14,000
Balance needed	115,000
Adjustment required	$101,000

The journal entry would therefore be as follows:

Bad Debts Expense	101,000	
Allowance for Doubtful Accounts		101,000

(d) $$\frac{\$3{,}200{,}000 - \$50{,}000}{(\$880{,}000 + \$1{,}095{,}000) \div 2} = \frac{\$3{,}150{,}000}{\$987{,}500} = 3.19 \text{ times}$$

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PROBLEM 9-2A

(a) $33,000.

(b) $44,000 ($2,200,000 X 2%).

(c) $46,500 [($825,000 X 6%) – $3,000].

(d) $52,500 [($825,000 X 6%) + $3,000].

(e) The weakness of the direct write-off method is two-fold. First, it does not match expenses with revenues. Second, the accounts receivable are not stated at cash realizable value at the balance sheet date.

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PROBLEM 9-3A

(a)	Dec. 31	Bad Debts Expense	30,610	
		Allowance for Doubtful Accounts.....		30,610
		($42,610 – $12,000)		

(a) & (b)

Bad Debts Expense

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Dec. 31	Adjusting		30,610		30,610

Allowance for Doubtful Accounts

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Dec. 31	Balance				12,000
31	Adjusting			30,610	42,610
2009					
Mar. 31			1,000		41,610
May 31				1,000	42,610

(b)

2009

(1)

Mar. 31	Allowance for Doubtful Accounts	1,000	
	Accounts Receivable		1,000

(2)

May 31	Accounts Receivable	1,000	
	Allowance for Doubtful Accounts.....		1,000
31	Cash.....	1,000	
	Accounts Receivable		1,000

(c)

2009

Dec. 31	Bad Debts Expense	29,400	
	Allowance for Doubtful Accounts.....		29,400
	($28,600 + $800)		

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PROBLEM 9-4A

(a) Total estimated bad debts

		Number of Days Outstanding				
	Total	0–30	31–60	61–90	91–120	Over 120
Accounts receivable	$375,000	$220,000	$90,000	$40,000	$10,000	$15,000
% uncollectible		1%	4%	5%	8%	10%
Estimated Bad debts	$ 10,100	$ 2,200	$ 3,600	$ 2,000	$ 800	$ 1,500

(b)	Bad Debts Expense	18,100	
	Allowance for Doubtful Accounts		18,100
	($10,100 + $8,000)		
(c)	Allowance for Doubtful Accounts	5,000	
	Accounts Receivable		5,000
(d)	Accounts Receivable	5,000	
	Allowance for Doubtful Accounts		5,000
	Cash	5,000	
	Accounts Receivable		5,000

(e) If Wall Inc. used 3% of total accounts receivable rather than aging the individual accounts the bad debt expense adjustment would be $19,250 [($375,000 X 3%) + $8,000]. The rest of the entries would be the same as they were when aging the accounts receivable.

Aging the individual accounts rather than applying a percentage to the total accounts receivable should produce a more accurate allowance account and bad debts expense.

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PROBLEM 9-5A

(a) The allowance method. Since the balance in the allowance for doubtful accounts is given, they must be using this method because the account would not exist if they were using the direct write-off method.

(b)	**(1)**	Dec. 31	Bad Debts Expense ($11,750 – $2,000)	9,750	
			Allowance for Doubtful Accounts		9,750
	(2)	Dec. 31	Bad Debts Expense ($950,000 X 1%)	9,500	
			Allowance for Doubtful Accounts		9,500
(c)	**(1)**	Dec. 31	Bad Debts Expense ($11,750 + $2,000)	13,750	
			Allowance for Doubtful Accounts		13,750
	(2)	Dec. 31	Bad Debts Expense	9,500	
			Allowance for Doubtful Accounts		9,500
(d)			Allowance for Doubtful Accounts	3,000	
			Accounts Receivable		3,000
(e)			Bad Debts Expense	3,000	
			Accounts Receivable		3,000

Note: The entry is the same whether the amount of bad debts expense at the end of 2008 was estimated using the percentage of receivables or the percentage of sales method.

(f) Allowance for Doubtful Accounts is a contra-asset account. It is subtracted from the gross amount of accounts receivable so that accounts receivable is reported at its cash realizable value.

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PROBLEM 9-6A

(a)

Oct.	7	Accounts Receivable	6,900	
		Sales		6,900
	12	Cash ($900 – $27)	873	
		Service Charge Expense	27	
		($900 X 3%)		
		Sales		900
	15	Accounts Receivable	460	
		Interest Revenue		460
	15	Cash	8,107	
		Notes Receivable		8,000
		Interest Receivable		80
		($8,000 X 8% X 45/360)		
		Interest Revenue		27
		($8,000 X 8% X 15/360)		
	24	Accounts Receivable—Hughey	9,150	
		Notes Receivable		9,000
		Interest Receivable		90
		($9,000 X 10% X 36/360)		
		Interest Revenue		60
		($9,000 X 10% X 24/360)		
	31	Interest Receivable	120	
		($16,000 X 9% X 1/12)		
		Interest Revenue		120

(b)

Notes Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
Oct.	1	Balance	✓			33,000
	15				8,000	25,000
	24				9,000	16,000

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PROBLEM 9-6A (Continued)

Accounts Receivable

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 7			6,900		6,900
15			460		7,360
24			9,150		16,510

Interest Receivable

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Balance	✓			170
15				80	90
24				90	0
31			120		120

(c) Current assets

Notes receivable	$16,000
Accounts receivable	16,510
Interest receivable	120
Total receivables	$32,630

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PROBLEM 9-7A

Jan.	5	Accounts Receivable—Dedonder Company	20,000	
		Sales		20,000
	20	Notes Receivable	20,000	
		Accounts Receivable—Dedonder Company		20,000
Feb.	18	Notes Receivable	8,000	
		Sales		8,000
Apr.	20	Cash ($20,000 + $450)	20,450	
		Notes Receivable		20,000
		Interest Revenue		450
		($20,000 X 9% X 3/12)		
	30	Cash ($25,000 + $1,000)	26,000	
		Notes Receivable		25,000
		Interest Revenue		1,000
		($25,000 X 12% X 4/12)		
May	25	Notes Receivable	4,000	
		Accounts Receivable—Jenks Inc.		4,000
Aug.	18	Cash ($8,000 + $360)	8,360	
		Notes Receivable		8,000
		Interest Revenue		360
		($8,000 X 9% X 6/12)		
	25	Accounts Receivable—Jenks Inc.	4,070	
		($4,000 + $70)		
		Notes Receivable		4,000
		Interest Revenue		70
		($4,000 X 7% X 3/12)		
Sept.	1	Notes Receivable	12,000	
		Sales		12,000

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PROBLEM 9-1B

(a)

1.	Accounts Receivable	2,570,000	
	Sales		2,570,000
2.	Sales Returns and Allowances	40,000	
	Accounts Receivable		40,000
3.	Cash	2,300,000	
	Accounts Receivable		2,300,000
4.	Allowance for Doubtful Accounts	65,000	
	Accounts Receivable		65,000
5.	Accounts Receivable	25,000	
	Allowance for Doubtful Accounts		25,000
	Cash	25,000	
	Accounts Receivable		25,000

(b)

Accounts Receivable			
Bal.	1,000,000	(2)	40,000
(1)	2,570,000	(3)	2,300,000
(5)	25,000	(4)	65,000
		(5)	25,000
Bal.	1,165,000		

Allowance for Doubtful Accounts			
(4)	65,000	Bal.	60,000
		(5)	25,000
		Bal.	20,000

(c)

Balance before adjustment [see (b)]	$20,000
Balance needed	90,000
Adjustment required	$70,000

The journal entry would therefore be as follows:

Bad Debts Expense	70,000	
Allowance for Doubtful Accounts		70,000

(d)

$$\frac{\$2,570,000 - \$40,000}{(\$1,075,000 + \$940,000) \div 2} = \frac{\$2,530,000}{\$1,007,500} = 2.51 \text{ times}$$

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PROBLEM 9-2B

(a) $26,000.

(b) $30,800 ($1,540,000 X 2%).

(c) $22,000 [($520,000 X 5%) – $4,000].

(d) $28,000 [($520,000 X 5%) + $2,000].

(e) There are two major weaknesses with the direct write-off method. First, it does not match expenses with the associated revenues. Second, the accounts receivable are not stated at cash realizable value at the balance sheet date.

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PROBLEM 9-3B

(a) Dec. 31 Bad Debts Expense 25,790
Allowance for Doubtful Accounts..... 25,790
($35,790 – $10,000)

(a) & (b)

Bad Debts Expense

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Dec. 31	Adjusting		25,790		25,790

Allowance for Doubtful Accounts

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Dec. 31	Balance				10,000
31	Adjusting			25,790	35,790
2009					
Mar. 1			1,100		34,690
May 1				1,100	35,790

(b)

2009

(1)

Mar. 1 Allowance for Doubtful Accounts 1,100
Accounts Receivable 1,100

(2)

May 1 Accounts Receivable 1,100
Allowance for Doubtful Accounts..... 1,100

1 Cash..... 1,100
Accounts Receivable 1,100

(c)

2009

Dec. 31 Bad Debts Expense 29,500
Allowance for Doubtful Accounts..... 29,500
($28,300 + $1,200)

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PROBLEM 9-4B

(a) Total estimated bad debts

		Number of Days Outstanding				
	Total	0–30	31–60	61–90	91–120	Over 120
Accounts receivable	$260,000	$100,000	$60,000	$50,000	$30,000	$20,000
% uncollectible		1%	5%	7.5%	10%	15%
Estimated Bad debts	$ 13,750	$ 1,000	$ 3,000	$ 3,750	$ 3,000	$ 3,000

(b)

Bad Debts Expense		3,750	
	Allowance for Doubtful Accounts		3,750
	[$13,750 – $10,000]		

(c)

Allowance for Doubtful Accounts		2,000	
	Accounts Receivable		2,000

(d)

Accounts Receivable		1,000	
	Allowance for Doubtful Accounts		1,000
Cash		1,000	
	Accounts Receivable		1,000

(e) When an allowance account is used, an adjusting journal entry is made at the end of each accounting period. This entry satisfies the matching principle by recording the bad debts expense in the period in which the sales occur.

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PROBLEM 9-5B

(a)	(1)	Dec. 31	Bad Debts Expense ($17,550 – $1,500)	16,050	
			Allowance for Doubtful Accounts		16,050
	(2)	Dec. 31	Bad Debts Expense ($850,000 X 2%)	17,000	
			Allowance for Doubtful Accounts		17,000
(b)	(1)	Dec. 31	Bad Debts Expense ($17,550 + $1,500)	19,050	
			Allowance for Doubtful Accounts		19,050
	(2)	Dec. 31	Bad Debts Expense	17,000	
			Allowance for Doubtful Accounts		17,000
(c)			Allowance for Doubtful Accounts	4,500	
			Accounts Receivable		4,500
(d)			Bad Debts Expense	4,500	
			Accounts Receivable		4,500

Note: The entry is the same whether the amount of bad debts expense at the end of 2008 was estimated using the percentage of receivables or the percentage of sales method.

(e) The advantages of the allowance method over the direct write-off method are:

(1) It attempts to match bad debts expense related to uncollectible accounts receivable with sales revenues on the income statement.

(2) It attempts to show the cash realizable value of the accounts receivable on the balance sheet.

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PROBLEM 9-6B

(a)

July	5	Accounts Receivable		6,200	
		Sales			6,200
	14	Cash ($700 – $21)		679	
		Service Charge Expense		21	
		($700 X 3%)			
		Sales			700
	14	Accounts Receivable		440	
		Interest Revenue			440
	15	Cash		6,100	
		Notes Receivable			6,000
		Interest Receivable			75
		($6,000 X 10% X 45/360)			
		Interest Revenue			25
		($6,000 X 10% X 15/360)			
	25	Accounts Receivable		25,375	
		Notes Receivable			25,000
		Interest Receivable			225
		($25,000 X 9% X 36/360)			
		Interest Revenue			150
		($25,000 X 9% X 24/360)			
	31	Interest Receivable		100	
		($15,000 X 8% X 1/12)			
		Interest Revenue			100

(b)

Notes Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
July	1	Balance	✓			46,000
	15				6,000	40,000
	25				25,000	15,000

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PROBLEM 9-6B (Continued)

Accounts Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
July	5			6,200		6,200
	14			440		6,640
	25			25,375		32,015

Interest Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
July	1	Balance	✓			300
	15				75	225
	25				225	0
	31	Adjusting		100		100

(c) Current assets

Notes receivable	$15,000
Accounts receivable	32,015
Interest receivable	100
Total receivables	$47,115

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PROBLEM 9-7B

Jan.	5	Accounts Receivable—Klostermann Company	6,300	
		Sales		6,300
Feb.	2	Notes Receivable	6,300	
		Accounts Receivable—Klostermann Company		6,300
	12	Notes Receivable	7,800	
		Sales		7,800
	26	Accounts Receivable—Louk Co.	4,000	
		Sales		4,000
Apr.	5	Notes Receivable	4,000	
		Accounts Receivable—Louk Co.		4,000
	12	Cash ($7,800 + $130)	7,930	
		Notes Receivable		7,800
		Interest Revenue		130
		($7,800 X 10% X 2/12)		
June	2	Cash ($6,300 + $210)	6,510	
		Notes Receivable		6,300
		Interest Revenue		210
		($6,300 X 10% X 4/12)		
July	5	Accounts Receivable—Louk Co. ($4,000 + $80)	4,080	
		Notes Receivable		4,000
		Interest Revenue		80
		($4,000 X 8% X 3/12)		
	15	Notes Receivable	7,000	
		Sales		7,000
Oct.	15	Allowance for Doubtful Accounts	7,000	
		Notes Receivable		7,000

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BYP 9-1 FINANCIAL REPORTING PROBLEM

(a)

SEK COMPANY
Accounts Receivable Aging Schedule
May 31, 2008

	Proportion of Total	Amount in Category	Probability of Non-Collection	Estimated Uncollectible Amount
Not yet due	.620	$ 868,000	.02	$17,360
Less than 30 days past due	.200	280,000	.04	11,200
30 to 60 days past due	.090	126,000	.06	7,560
61 to 120 days past due	.050	70,000	.09	6,300
121 to 180 days past due	.025	35,000	.25	8,750
Over 180 days past due	.015	21,000	.70	14,700
	1.000	$1,400,000		$65,870

(b)

SEK COMPANY
Analysis of Allowance for Doubtful Accounts
May 31, 2008

June 1, 2007 balance	$ 29,500
Bad debts expense accrual ($2,900,000 X .045)	130,500
Balance before write-offs of bad accounts	160,000
Write-offs of bad accounts	102,000
Balance before year-end adjustment	58,000
Estimated uncollectible amount	65,870
Additional allowance needed	$ 7,870

Bad Debts Expense	7,870	
Allowance for Doubtful Accounts		7,870

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(c) 1. Steps to Improve the Accounts Receivable Situation	2. Risks and Costs Involved
Establish more selective credit-granting policies, such as more restrictive credit requirements or more thorough credit investigations.	This policy could result in lost sales and increased costs of credit evaluation. The company may be all but forced to adhere to the prevailing credit-granting policies of the office equipment and supplies industry.
Establish a more rigorous collection policy either through external collection agencies or by its own personnel.	This policy may offend current customers and thus risk future sales. Increased collection costs could result from this policy.
Charge interest on overdue accounts. Insist on cash on delivery (COD) or cash on order (COO) for new customers or poor credit risks.	This policy could result in lost sales and increased administrative costs.

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BYP 9-2 COMPARATIVE ANALYSIS PROBLEM

(a) (1) Accounts receivable turnover ratio

PepsiCo	Coca-Cola
$\frac{\$32,562}{(\$2,999^{*} + \$3,261) \div 2}$	$\frac{\$23,104}{(\$2,244 + \$2,281) \div 2}$
*See note 14	
$\frac{\$32,562}{\$3,130} = 10.4$ times	$\frac{\$23,104}{\$2,262.5} = 10.2$ times

(2) Average collection period

PepsiCo	Coca-Cola
$\frac{365}{10.4} = 35.1$ days	$\frac{365}{10.2} = 35.8$ days

(b) Both companies have reasonable accounts receivable turnovers and collection periods of slightly greater than 30 days. This collection period probably approximates their credit terms that they provide to customers.

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BYP 9-3 EXPLORING THE WEB

(a) Benefits of Factoring Receivables

Factoring is a flexible financial solution that can help your business be more competitive while improving your cash flow, credit rating, and supplier discounts. Unlike traditional bank financing, factoring relies on the financial strength and credit worthiness of your customers, not you. You can use factoring services as much as you want or as little as you want. There are no obligations, no minimums, and no maximums. Here are the most common reasons businesses use factoring services:

Offer better terms to win more business. With factoring you can attract more business by offering better terms on your invoices. Most companies negotiate on price to win business in a competitive market, but with factoring you can negotiate with terms instead of price. To your customers, better terms can be more attractive than better prices. When using attractive terms to win business, you can build the cost of factoring into your costs of goods and services.

Example: A new customer may choose to do business with your company because you can offer NET 30 or NET 45 terms while your competitor (who isn't factoring) requires payment up front but has a 3% better price. If you factor the subsequent invoice at a discount of 3%, you have leveraged factoring services to win the business at no extra cost and improved your cash flow at the same time.

Improve cash flow without additional debt. Eliminate long billing cycles. Receive cash for your outstanding invoices in 24 hours or less. No new debt is created. Factoring is not a loan. This allows you to preserve your financial leverage to take on new debt.

Customer Credit Services. Reduce bad debt expense, streamline credit approvals for new customers, improve decision-making on new business, and reduce administrative costs.

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Accounts Receivable Management. Reduce administrative costs, improve customer relationships, improve receivable turns, improve accounting, and redirect critical resources to marketing and production.

Flexibility. Factor as much as you want or as little as you want. You decide. No obligations. No binding contracts. There are no minimums and no maximums in the amount you can factor. Funding is based on the strength of your customers.

(b) Factoring fees are based on a per Diem Rate. The factor will assess the risk of the particular situation and determine a discount rate. This usually ranges from 3% to 9% of the gross invoices sold, and is the fee for the duties the factor assumes and the cost of using their money. The sooner a receivable is paid, the lower the discount rate.

(c) Upon approval, the factor will advance the manufacturer 70%–90% of the total value of their invoices. This percentage is called the Advance Rate, and the cash is often delivered within 24 hours after an application is received.

The rest of the cash minus the factor's fees is then returned to the manufacturer as the receivables are collected. If the manufacturer's customers pay slowly, the discount rates that apply grow accordingly larger.

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BYP 9-4 DECISION MAKING ACROSS THE ORGANIZATION

(a)	2008	2007	2006
Net credit sales	$500,000	$600,000	$400,000
Credit and collection expenses			
Collection agency fees	$ 2,450	$ 2,500	$ 2,400
Salary of accounts receivable clerk	4,100	4,100	4,100
Uncollectible accounts	8,000	9,600	6,400
Billing and mailing costs	2,500	3,000	2,000
Credit investigation fees	750	900	600
Total	$ 17,800	$ 20,100	$ 15,500
Total expenses as a percentage of net credit sales	3.56%	3.35%	3.88%
(b) Average accounts receivable (5%)	$ 25,000	$ 30,000	$ 20,000
Investment earnings (8%)	$ 2,000	$ 2,400	$ 1,600
Total credit and collection expenses per above	$ 17,800	$ 20,100	$ 15,500
Add: Investment earnings*	2,000	2,400	1,600
Net credit and collection expenses	$ 19,800	$ 22,500	$ 17,100
Net expenses as a percentage of net credit sales	3.96%	3.75%	4.28%

*The investment earnings on the cash tied up in accounts receivable is an additional expense of continuing the existing credit policies.

(c) The analysis shows that the credit card fee of 4% of net credit sales will be higher than the percentage cost of credit and collection expenses in each year before considering the effect of earnings from other investment opportunities. However, after considering investment earnings, the credit card fee of 4% will be less than the company's percentage cost if annual net credit sales are less than $500,000.

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Finally, the decision hinges on: (1) the accuracy of the estimate of investment earnings, (2) the expected trend in credit sales, and (3) the effect the new policy will have on sales. Nonfinancial factors include the effects on customer relationships of the alternative credit policies and whether the Maynes want to continue with the problem of handling their own accounts receivable.

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BYP 9-5 COMMUNICATION ACTIVITY

Of course, this solution will differ from student to student. Important factors to look for would be definitions of the methods, how they are similar and how they differ. Also, use of good sentence structure, correct spelling, etc.

Example:

Dear Rene,

The three methods you asked about are methods of dealing with uncollectible accounts receivable. Two of them, percentage-of-sales and percentage-of-receivables, are "allowance" methods used to estimate the amount uncollectible. Under the percentage-of-sales basis, management establishes a percentage relationship between the amount of credit sales and expected losses from uncollectible accounts. This is based on past experience and anticipated credit policy. The percentage is then applied to either total credit sales or net credit sales of the current year. This basis of estimating emphasizes the matching of expenses with revenues.

Under the percentage-of-receivables basis, management establishes a percentage relationship between the amount of receivables and expected losses from uncollectible accounts. Customer accounts are classified by the length of time they have been unpaid. This basis emphasizes cash realizable value of receivables and is therefore deemed a "balance sheet" approach.

The direct write-off method does not estimate losses and an allowance account is not used. Instead, when an account is determined to be uncollectible, it is written off directly to Bad Debts Expense. Unless bad debt losses are insignificant, this method is not acceptable for financial reporting purposes.

Sincerely,

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BYP 9-6 ETHICS CASE

(a) The stakeholders in this situation are:

- **The president of Ruiz Co.**
- **The controller of Ruiz Co.**
- **The stockholders.**

(b) Yes. The controller is posed with an ethical dilemma—should he/she follow the president's "suggestion" and prepare misleading financial statements (understated net income) or should he/she attempt to stand up to and possibly anger the president by preparing a fair (realistic) income statement.

(c) Ruiz Co.'s growth rate should be a product of fair and accurate financial statements, not vice versa. That is, one should not prepare financial statements with the objective of achieving or sustaining a predetermined growth rate. The growth rate should be a product of management and operating results, not of creative accounting.

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BYP 9-7 ALL ABOUT YOU ACTIVITY

(a) There are a number of sources that compare features of credit cards. Here are three: www.creditcards.com/, www.federalreserve.gov/pubs/shop/, and www.creditorweb.com/.

(b) Here are some of the features you should consider: annual percentage rate, credit limit, annual fees, billing and due dates, minimum payment, penalties and fees, premiums received (airlines miles, hotel discounts etc.), and cash rebates.

(c) Answer depends on present credit card and your personal situation.

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CHAPTER 10

Plant Assets, Natural Resources, and Intangible Assets

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Describe how the cost principle applies to plant assets.	1, 2, 3	1, 2	1, 2, 3	1A	1B
2. Explain the concept of depreciation.	4, 5		4		
3. Compute periodic depreciation using different methods.	6, 7, 22	3, 4, 5, 6	5, 6, 7	2A, 3A, 4A, 5A	2B, 3B, 4B, 5B
4. Describe the procedure for revising periodic depreciation.	8	7	8	4A	4B
5. Distinguish between revenue and capital expenditures, and explain the entries for each.	9, 24	8			
6. Explain how to account for the disposal of a plant asset.	10, 11	9, 10	9, 10	5A, 6A	5B, 6B
7. Compute periodic depletion of natural resources.	12, 13	11	11		
8. Explain the basic issues related to accounting for intangible assets.	14, 15, 16, 17, 18, 19	12	12, 13	7A, 8A	7B, 8B

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ASSIGNMENT CLASSIFICATION TABLE (Continued)

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
9. Indicate how plant assets, natural resources, and intangible assets are reported.	20, 21, 23	13, 14	14	5A, 7A, 9A	5B, 7B, 9B
*10. Explain how to account for the exchange of plant assets.	25, 26	15, 16	15, 16		

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ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Determine acquisition costs of land and building.	Simple	20–30
2A	Compute depreciation under different methods.	Simple	30–40
3A	Compute depreciation under different methods.	Moderate	30–40
4A	Calculate revisions to depreciation expense.	Moderate	20–30
5A	Journalize a series of equipment transactions related to purchase, sale, retirement, and depreciation.	Moderate	40–50
6A	Record disposals.	Simple	30–40
7A	Prepare entries to record transactions related to acquisition and amortization of intangibles; prepare the intangible assets section.	Moderate	30–40
8A	Prepare entries to correct errors made in recording and amortizing intangible assets.	Moderate	30–40
9A	Calculate and comment on asset turnover ratio.	Moderate	5–10
1B	Determine acquisition costs of land and building.	Simple	20–30
2B	Compute depreciation under different methods.	Simple	30–40
3B	Compute depreciation under different methods.	Moderate	30–40
4B	Calculate revisions to depreciation expense.	Moderate	20–30
5B	Journalize a series of equipment transactions related to purchase, sale, retirement, and depreciation.	Moderate	40–50
6B	Record disposals.	Simple	30–40
7B	Prepare entries to record transactions related to acquisition and amortization of intangibles; prepare the intangible assets section.	Moderate	30–40
8B	Prepare entries to correct errors made in recording and amortizing intangible assets.	Moderate	30–40
9B	Calculate and comment on asset turnover ratio.	Moderate	5–10

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Describe how the cost principle applies to plant assets.		Q10-1 E10-1 Q10-2 P10-1A Q10-3 P10-1B	BE10-1 E10-2 BE10-2 E10-3			
2. Explain the concept of depreciation.	Q10-5	Q10-4 E10-4				
3. Compute periodic depreciation using different methods.		Q10-6 Q10-7 Q10-22	BE10-3 E10-6 P10-5A BE10-5 E10-7 P10-2B BE10-6 P10-2A P10-4B E10-5 P10-4A P10-5B	P10-3A P10-3B		BE10-4
4. Describe the procedure for revising periodic depreciation.		Q10-8	P10-4A P10-4B	BE10-7 E10-8		
5. Distinguish between revenue and capital expenditures, and explain the entries for each.		Q10-9 Q10-24	BE10-8			
6. Explain how to account for the disposal of a plant asset.	Q10-10	Q10-11	BE10-9 E10-10 P10-5B BE10-10 P10-5A P10-6B E10-9 P10-6A			
7. Compute periodic depletion of natural resources.	Q10-12	Q10-13	BE10-11 E10-11			
8. Explain the basic issues related to accounting for intangible assets.	Q10-18	Q10-14 Q10-17 Q10-15 Q10-19 Q10-16	BE10-12 P10-7A P10-8B E10-12 P10-8A E10-13 P10-7B			
9. Indicate how plant assets, natural resources, and intangible assets are reported.		Q10-21 Q10-23	BE10-13 Q10-20 P10-5B BE10-14 P10-5A P10-7B E10-14 P10-7A	P10-9A P10-9B		
*10. Explain how to account for the exchange of plant assets.	Q10-25	Q10-26	BE10-15 E10-15 BE10-16 E10-16			
Broadening Your Perspective		Communication Exploring the Web	Decision Making Across the Organization	Financial Reporting Comp. Analysis		Decision Making Across the Organization Ethics Case Comp. Analysis All About You

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ANSWERS TO QUESTIONS

1. For plant assets, the cost principle means that cost consists of all expenditures necessary to acquire the asset and make it ready for its intended use.

2. Examples of land improvements include driveways, parking lots, fences, and underground sprinklers.

3. (a) When only the land is to be used, all demolition and removal costs of the building less any proceeds from salvaged materials are necessary expenditures to make the land ready for its intended use.
(b) When both the land and building are to be used, necessary costs of the building include remodeling expenditures and the cost of replacing or repairing the roofs, floors, wiring, and plumbing.

4. You should explain to the president that depreciation is a process of allocating the cost of a plant asset to expense over its service (useful) life in a rational and systematic manner. Recognition of depreciation is not intended to result in the accumulation of cash for replacement of the asset.

5. (a) Salvage value, also called residual value, is the expected value of the asset at the end of its useful life.
(b) Salvage value is used in determining depreciation in each of the methods except the declining-balance method.

6. (a) Useful life is expressed in years under the straight-line method and in units of activity under the units-of-activity method.
(b) The pattern of periodic depreciation expense over useful life is constant under the straight-line method and variable under the units-of-activity method.

7. The effects of the three methods on annual depreciation expense are: Straight-line—constant amount; units of activity—varying amount; declining-balance—decreasing amounts.

8. A revision of depreciation is made in current and future years but not retroactively. The rationale is that continual restatement of prior periods would adversely affect confidence in the financial statements.

9. Revenue expenditures are ordinary repairs made to maintain the operating efficiency and productive life of the asset. Capital expenditures are additions and improvements made to increase operating efficiency, productive capacity, or useful life of the asset. Revenue expenditures are recognized as expenses when incurred; capital expenditures are generally debited to the plant asset affected.

10. In a sale of plant assets, the book value of the asset is compared to the proceeds received from the sale. If the proceeds of the sale exceed the book value of the plant asset, a gain on disposal occurs. If the proceeds of the sale are less than the book value of the plant asset sold, a loss on disposal occurs.

11. The plant asset and its accumulated depreciation should continue to be reported on the balance sheet without further depreciation adjustment until the asset is retired. Reporting the asset and related accumulated depreciation on the balance sheet informs the reader of the financial statements that the asset is still in use. However, once an asset is fully depreciated, even if it is still being used, no additional depreciation should be taken. In no situation can the accumulated depreciation on the plant asset exceed its cost.

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Questions Chapter 10 (Continued)

12. Natural resources consist of underground deposits of oil, gas, and minerals, and standing timber. These long-lived productive assets have two distinguishing characteristics: they are physically extracted in operations, and they are replaceable only by an act of nature.

13. Depletion is the allocation of the cost of natural resources to expense in a rational and systematic manner over the resource's useful life. It is computed by multiplying the depletion cost per unit by the number of units extracted and sold.

14. The terms depreciation, depletion, and amortization are all concerned with allocating the cost of an asset to expense over the periods benefited. Depreciation refers to allocating the cost of a plant asset to expense, depletion to recognizing the cost of a natural resource as expense, and amortization to allocating the cost of an intangible asset to expense.

15. The intern is not correct. The cost of an intangible asset should be amortized over that asset's useful life (the period of time when operations are benefited by use of the asset). In addition, some intangibles have indefinite lives and therefore are not amortized at all.

16. The favorable attributes which could result in goodwill include exceptional management, desirable location, good customer relations, skilled employees, high-quality products, and harmonious relations with labor unions.

17. Goodwill is the value of many favorable attributes that are intertwined in the business enterprise. Goodwill can be identified only with the business as a whole and, unlike other assets, cannot be sold separately. Goodwill can only be sold if the entire business is sold. And, if goodwill appears on the balance sheet, it means the company has purchased another company for more than the fair market value of its net assets.

18. Goodwill is recorded only when there is a transaction that involves the purchase of an entire business. Goodwill is the excess of cost over the fair market value of the net assets (assets less liabilities) acquired. The recognition of goodwill without an exchange transaction would lead to subjective valuations which would reduce the reliability of financial statements.

19. Research and development costs present several accounting problems. It is sometimes difficult to assign the costs to specific projects, and there are uncertainties in identifying the extent and timing of future benefits. As a result, the FASB requires that research and development costs be recorded as an expense when incurred.

20. McDonald's asset turnover ratio is computed as follows:

$$\frac{\text{Net sales}}{\text{Average total assets}} = \frac{\$20.5\text{ billion}}{\$28.9\text{ billion}} = .71 \text{ times}$$

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21. Since Resco uses the straight-line depreciation method, its depreciation expense will be lower in the early years of an asset's useful life as compared to using an accelerated method. Yapan's depreciation expense in the early years of an asset's useful life will be higher as compared to the straight-line method. Resco's net income will be higher than Yapan's in the first few years of the asset's useful life. And, the reverse will be true late in an asset's useful life.

22. Yes, the tax regulations of the IRS allow a company to use a different depreciation method on the tax return than is used in preparing financial statements. Lopez Corporation uses an accelerated depreciation method for tax purposes to minimize its income taxes and thereby the cash outflow for taxes.

23. By selecting a longer estimated useful life, May Corp. is spreading the plant asset's cost over a longer period of time. The depreciation expense reported in each period is lower and net income is higher. Won's choice of a shorter estimated useful life will result in higher depreciation expense reported in each period and lower net income.

24. Expensing these costs will make current period income lower but future period income higher because there will be no additional depreciation expense in future periods. If the costs are ordinary repairs, they should be expensed.

25. When assets are exchanged, the gain or loss on disposal is computed as the difference between the book value and the fair market value of the asset given up at the time of exchange.

26. Yes, Tatum should recognize a gain equal to the difference between the fair market value of the old machine and its book value. If the fair market value of the old machine is less than its book value, Tatum should recognize a loss equal to the difference between the two amounts.

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SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 10-1

All of the expenditures should be included in the cost of the land. Therefore, the cost of the land is $81,000, or ($70,000 + $3,000 + $2,500 + $2,000 + $3,500).

BRIEF EXERCISE 10-2

The cost of the truck is $31,900 (cash price $30,000 + sales tax $1,500 + painting and lettering $400). The expenditures for insurance and motor vehicle license should not be added to the cost of the truck.

BRIEF EXERCISE 10-3

Depreciable cost of $36,000, or ($42,000 – $6,000). With a four-year useful life, annual depreciation is $9,000, or ($36,000 ÷ 4). Under the straight-line method, depreciation is the same each year. Thus, depreciation is $9,000 for both the first and second years.

BRIEF EXERCISE 10-4

It is likely that management requested this accounting treatment to boost reported net income. Land is not depreciated; thus, by reporting land at $120,000 above its actual value the company increased yearly income by $6,000, $\left(\frac{\$120{,}000}{20 \text{ years}}\right)$ or the reduction in depreciation expense. This practice is not ethical because management is knowingly misstating asset values.

BRIEF EXERCISE 10-5

The declining balance rate is 50%, or (25% X 2) and this rate is applied to book value at the beginning of the year. The computations are:

	Book Value	X	Rate	=	Depreciation
Year 1	$42,000		50%		$21,000
Year 2	($42,000 – $21,000)		50%		$10,500

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BRIEF EXERCISE 10-6

The depreciation cost per unit is 22 cents per mile computed as follows:

Depreciable cost ($33,500 – $500) ÷ 150,000 = $.22
Year 1 30,000 miles X $.22 = $6,600
Year 2 20,000 miles X $.22 = $4,400

BRIEF EXERCISE 10-7

Book value, 1/1/08	$20,000
Less: Salvage value	2,000
Depreciable cost	$18,000
Remaining useful life	4 years
Revised annual depreciation ($18,000 ÷ 4)	$ 4,500

BRIEF EXERCISE 10-8

1.	Repair Expense	45	
	Cash		45
2.	Delivery Truck	400	
	Cash		400

BRIEF EXERCISE 10-9

(a)	Accumulated Depreciation—Delivery Equipment	41,000	
	Delivery Equipment		41,000
(b)	Accumulated Depreciation—Delivery Equipment	39,000	
	Loss on Disposal	2,000	
	Delivery Equipment		41,000

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BRIEF EXERCISE 10-9 (Continued)

Cost of delivery equipment	$41,000
Less accumulated depreciation	39,000
Book value at date of disposal	2,000
Proceeds from sale	0
Loss on disposal	$ 2,000

BRIEF EXERCISE 10-10

(a)	Depreciation Expense—Office Equipment	5,250	
	Accumulated Depreciation—Office Equipment		5,250
(b)	Cash	20,000	
	Accumulated Depreciation—Office Equipment	47,250	
	Loss on Disposal	4,750	
	Office Equipment		72,000

Cost of office equipment	$72,000
Less accumulated depreciation	47,250*
Book value at date of disposal	24,750
Proceeds from sale	20,000
Loss on disposal	$ 4,750

*$42,000 + $5,250

BRIEF EXERCISE 10-11

(a) Depletion cost per unit = $7,000,000 ÷ 35,000,000 = $.20 depletion cost per ton
$.20 X 6,000,000 = $1,200,000

Depletion Expense	1,200,000	
Accumulated Depletion		1,200,000

(b)	Ore mine	$7,000,000	
	Less: Accumulated depletion	1,200,000	$5,800,000

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BRIEF EXERCISE 10-12

(a)	Amortization Expense—Patent ($120,000 ÷ 10)	12,000	
	Patents		12,000
(b)	Intangible Assets		
	Patents		$108,000

BRIEF EXERCISE 10-13

SPAIN COMPANY
Balance Sheet (partial)
December 31, 2008

Property, plant, and equipment			
Coal mine	$ 500,000		
Less: Accumulated depletion	108,000	$392,000	
Buildings	1,100,000		
Less: Accumulated depreciation	650,000	450,000	
Total property, plant, and equipment			$842,000
Intangible assets			
Goodwill			410,000

BRIEF EXERCISE 10-14

$$\$51.2 \div \left(\frac{\$32.2 + \$35.0}{2} \right) = 1.52 \text{ times}$$

BRIEF EXERCISE 10-15

Delivery Equipment (new)	24,000	
Accumulated Depreciation—Delivery Equipment	30,000	
Loss on Disposal	12,000	
Delivery Equipment (old)		61,000
Cash		5,000

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BRIEF EXERCISE 10-15 (Continued)

Fair market value of old delivery equipment	$19,000
Cash	5,000
Cost of delivery equipment	$24,000

Fair market value of old delivery equipment	$19,000
Book value of old delivery equipment ($61,000 – $30,000)	31,000
Loss on disposal	$12,000

BRIEF EXERCISE 10-16

Delivery Equipment (new)	43,000	
Accumulated Depreciation—Delivery Equipment	30,000	
Gain on Disposal		7,000
Delivery Equipment (old)		61,000
Cash		5,000

Fair market value of old delivery equipment	$38,000
Cash	5,000
Cost of new delivery equipment	$43,000

Fair market value of old delivery equipment	$38,000
Book value of old delivery equipment ($61,000 – $30,000)	31,000
Gain on disposal	$ 7,000

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SOLUTIONS TO EXERCISES

EXERCISE 10-1

(a) Under the cost principle, the acquisition cost for a plant asset includes all expenditures necessary to acquire the asset and make it ready for its intended use. For example, the cost of factory machinery includes the purchase price, freight costs paid by the purchaser, insurance costs during transit, and installation costs.

(b)
1. **Land**
2. **Factory Machinery**
3. **Delivery Equipment**
4. **Land Improvements**
5. **Delivery Equipment**
6. **Factory Machinery**
7. **Prepaid Insurance**
8. **License Expense**

EXERCISE 10-2

1. **Factory Machinery**
2. **Truck**
3. **Factory Machinery**
4. **Land**
5. **Prepaid Insurance**
6. **Land Improvements**
7. **Land Improvements**
8. **Land**
9. **Building**

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EXERCISE 10-3

(a) Cost of land

Cash paid	$80,000
Net cost of removing warehouse ($8,600 – $1,700)	6,900
Attorney's fee	1,100
Real estate broker's fee	5,000
Total	$93,000

(b) The architect's fee ($7,800) should be debited to the Building account. The cost of the driveways and parking lot ($14,000) should be debited to Land Improvements.

EXERCISE 10-4

1. False. Depreciation is a process of *cost allocation*, not *asset valuation*.
2. True.
3. False. The book value of a plant asset *may be quite different* from its market value.
4. False. Depreciation applies to three classes of plant assets: land *improvements,* buildings, and equipment.
5. False. Depreciation does not apply to *land* because its usefulness and revenue-producing ability generally remain intact over time.
6. True.
7. False. Recognizing depreciation on an asset *does not result* in an accumulation of cash for replacement of the asset.
8. True.
9. False. Depreciation expense is reported on the income statement, and *accumulated depreciation is reported as a deduction from plant assets on the balance sheet.*
10. False. *Three* factors affect the computation of depreciation: cost, useful life, and salvage value *(also called residual value)*.

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EXERCISE 10-5

(a) Depreciation cost per unit is $1.60 per mile [($168,000 – $8,000) ÷ 100,000].

(b)

	Computation				End of Year	
Year	Units of Activity	X Depreciation Cost/Unit	= Annual Depreciation Expense		Accumulated Depreciation	Book Value
2008	26,000	$1.60	$41,600		$ 41,600	$126,400
2009	32,000	1.60	51,200		92,800	75,200
2010	25,000	1.60	40,000		132,800	35,200
2011	17,000	1.60	27,200		160,000	8,000

EXERCISE 10-6

(a) Straight-line method:

$$\left(\frac{\$120,000 - \$12,000}{5}\right) = \$21,600 \text{ per year.}$$

2008 depreciation = $21,600 X 3/12 = $5,400.

(b) Units-of-activity method:

$$\left(\frac{\$120,000 - \$12,000}{10,000}\right) = \$10.80 \text{ per hour.}$$

2008 depreciation = 1,700 hours X $10.80 = $18,360.

(c) Declining-balance method:

2008 depreciation = $120,000 X 40% X 3/12 = $12,000.
Book value January 1, 2009 = $120,000 – $12,000 = $108,000.
2009 depreciation = $108,000 X 40% = $43,200.

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EXERCISE 10-7

(a) (1) 2008: ($30,000 – $2,000)/8 = $3,500
2009: ($30,000 – $2,000)/8 = $3,500

(2) ($30,000 – $2,000)/100,000 = $0.28 per mile
2008: 15,000 X $0.28 = $4,200
2009: 12,000 X $0.28 = $3,360

(3) 2008: $30,000 X 25% = $7,500
2009: ($30,000 – $7,500) X 25% = $5,625

(b) (1)

Depreciation Expense	3,500	
Accumulated Depreciation—Delivery Truck		3,500

(2)

Delivery Truck	$30,000
Less: Accumulated Depreciation	(3,500)
	$26,500

EXERCISE 10-8

(a)

Type of Asset	Building	Warehouse
Book value, 1/1/08	$686,000	$75,000
Less: Salvage value	37,000	3,600
Depreciable cost	$649,000	$71,400
Revised useful life in years	44	15
Revised annual depreciation	$ 14,750	$ 4,760

(b)

Dec. 31	Depreciation Expense—Building	14,750	
	Accumulated Depreciation—Building		14,750

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EXERCISE 10-9

Jan.	1	Accumulated Depreciation—Machinery	62,000	
		Machinery		62,000
June	30	Depreciation Expense	4,000	
		Accumulated Depreciation—Computer ($40,000 X 1/5 X 6/12)		4,000
	30	Cash	14,000	
		Accumulated Depreciation—Computer ($40,000 X 3/5 = $24,000; $24,000 + $4,000)	28,000	
		Gain on Disposal [$14,000 – ($40,000 – $28,000)]		2,000
		Computer		40,000
Dec.	31	Depreciation Expense	6,000	
		Accumulated Depreciation—Truck [($39,000 – $3,000) X 1/6]		6,000
	31	Loss on Disposal	9,000	
		Accumulated Depreciation—Truck [($39,000 – $3,000) X 5/6]	30,000	
		Delivery Truck		39,000

EXERCISE 10-10

(a)	Cash	28,000	
	Accumulated Depreciation—Equipment [($50,000 – $5,000) X 3/5]	27,000	
	Equipment		50,000
	Gain on Disposal		5,000
(b)	Depreciation Expense [($50,000 – $5,000) X 1/5 X 4/12]	3,000	
	Accumulated Depreciation—Equipment		3,000
	Cash	28,000	
	Accumulated Depreciation—Equipment ($27,000 + $3,000)	30,000	
	Equipment		50,000
	Gain on Disposal		8,000

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EXERCISE 10-10 (Continued)

(c)	Cash	11,000	
	Accumulated Depreciation—Equipment	27,000	
	Loss on Disposal	12,000	
	Equipment		50,000
(d)	Depreciation Expense	6,750	
	[($50,000 – $5,000) X 1/5 X 9/12]		
	Accumulated Depreciation—Equipment		6,750
	Cash	11,000	
	Accumulated Depreciation—Equipment	33,750	
	($27,000 + $6,750)		
	Loss on Disposal	5,250	
	Equipment		50,000

EXERCISE 10-11

(a)	Dec. 31	Depletion Expense		90,000	
		Accumulated Depletion			90,000
		(100,000 X $.90)			

Cost	(a)	$720,000
Units estimated	(b)	800,000 tons
Depletion cost per unit [(a) ÷ (b)]		$0.90

(b) The costs pertaining to the unsold units are reported in current assets as part of inventory (20,000 X $.90 = $18,000).

EXERCISE 10-12

Dec. 31	Amortization Expense—Patent	12,000		
	Patents ($90,000 X 1/5 X 8/12)			12,000

Note: No entry is made to amortize goodwill because it has an indefinite life.

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EXERCISE 10-13

1/2/08	Patents	560,000	
	Cash		560,000
4/1/08	Goodwill	360,000	
	Cash		360,000
	(Part of the entry to record purchase of another company)		
7/1/08	Franchise	440,000	
	Cash		440,000
9/1/08	Research and Development Expense	185,000	
	Cash		185,000
12/31/08	Amortization Expense—Patent ($560,000 ÷ 7)	80,000	
	Amortization Expense—Franchise [($440,000 ÷ 10) X 1/2]	22,000	
	Patents		80,000
	Franchise		22,000

Ending balances, 12/31/08:

Patent = $480,000 ($560,000 – $80,000).
Goodwill = $360,000
Franchise = $418,000 ($440,000 – $22,000).
R&D expense = $185,000

EXERCISE 10-14

$$\text{Asset turnover ratio} = \frac{\$4{,}900{,}000}{\$1{,}400{,}000} = 3.5 \text{ times}$$

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*EXERCISE 10-15

(a)	Trucks (new)	53,000	
	Accumulated Depreciation—Trucks (old)	22,000	
	Loss on Disposal	6,000	
	Trucks (old)		64,000
	Cash		17,000

Cost of old trucks	$64,000
Less: Accumulated depreciation	22,000
Book value	42,000
Fair market value of old trucks	36,000
Loss on disposal	$ 6,000

Fair market value of old trucks	$36,000
Cash paid	17,000
Cost of new trucks	$53,000

(b)	Machine (new)	12,000	
	Accumulated Depreciation—Machine (old)	4,000	
	Gain on Disposal		1,000
	Machine (old)		12,000
	Cash		3,000

Cost of old machine	$12,000
Less: Accumulated depreciation	4,000
Book value	8,000
Fair market value of old machine	9,000
Gain on disposal	$ 1,000

Fair market value of old machine	$ 9,000
Cash paid	3,000
Cost of new machine	$12,000

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*EXERCISE 10-16

(a)	Delivery Truck (new)	4,000	
	Loss on Disposal	3,000	
	Accumulated Depreciation—Delivery Truck (old)	15,000	
	Delivery Truck (old)		22,000

Cost of old truck	$22,000
Less: Accumulated depreciation	15,000
Book value	7,000
Fair market value of old truck	4,000
Loss on disposal	$ 3,000

(b)	Delivery Truck (new)	4,000	
	Accumulated Depreciation—Delivery Trucks (old)	8,000	
	Delivery Truck (old)		10,000
	Gain on Disposal		2,000

Cost of old truck	$10,000
Less: Accumulated depreciation	8,000
Book value	2,000
Fair market value of old truck	4,000
Gain on Disposal	$ 2,000
Cost of new delivery truck*	$ 4,000

*Fair value of old truck

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SOLUTIONS TO PROBLEMS

PROBLEM 10-1A

Item	Land	Building	Other Accounts	
1	$ 4,000			
2		$700,000		
3			$ 5,000	Property Taxes Expense
4	145,000			
5		35,000		
6		10,000		
7	2,000			
8			14,000	Land Improvements
9	15,000			
10	(3,500)			
	$162,500	$745,000		

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PROBLEM 10-2A

(a)

Year	Computation	Cumulative 12/31
	BUS 1	
2006	$ 90,000 X 20% = $18,000	$ 18,000
2007	$ 90,000 X 20% = $18,000	36,000
2008	$ 90,000 X 20% = $18,000	54,000
	BUS 2	
2006	$120,000 X 50% = $60,000	$ 60,000
2007	$ 60,000 X 50% = $30,000	90,000
2008	$ 30,000 X 50% = $15,000	105,000
	BUS 3	
2007	24,000 miles X $.60* = $14,400	$ 14,400
2008	34,000 miles X $.60 = $20,400	34,800

*$72,000 ÷ 120,000 miles = $.60 per mile.

(b)

	Year	Computation	Expense
		BUS 2	
(1)	2006	$120,000 X 50% X 9/12 = $45,000	$45,000
(2)	2007	$75,000 X 50% = $37,500	$37,500

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PROBLEM 10-3A

(a) (1)

Purchase price	$ 38,000
Sales tax	1,700
Shipping costs	150
Insurance during shipping	80
Installation and testing	70
Total cost of machinery	$ 40,000

Machinery	40,000	
Cash		40,000

(2)

Recorded cost	$ 40,000
Less: Salvage value	5,000
Depreciable cost	$ 35,000
Years of useful life	÷ 5
Annual depreciation	$ 7,000

Depreciation Expense	7,000	
Accumulated Depreciation		7,000

(b) (1)

Recorded cost	160,000
Less: Salvage value	10,000
Depreciable cost	$150,000
Years of useful life	÷ 4
Annual depreciation	$ 37,500

(2)

Book Value at Beginning of Year	DDB Rate	Annual Depreciation Expense	Accumulated Depreciation
$160,000	50%*	$80,000	$ 80,000
80,000	50%	40,000	120,000
40,000	50%	20,000	140,000
20,000	50%	10,000	150,000

*100% ÷ 4-year useful life = 25% X 2 = 50%.

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PROBLEM 10-3A (Continued)

(3) Depreciation cost per unit = ($160,000 – $10,000)/125,000 units = $1.20 per unit.

Annual Depreciation Expense

2008:	**$1.20 X 45,000 =**	**$54,000**
2009:	**1.20 X 35,000 =**	**42,000**
2010:	**1.20 X 25,000 =**	**30,000**
2011:	**1.20 X 20,000 =**	**24,000**

(c) The declining-balance method reports the highest amount of depreciation expense the first year while the straight-line method reports the lowest. In the fourth year, the straight-line method reports the highest amount of depreciation expense while the declining-balance method reports the lowest.

These facts occur because the declining-balance method is an accelerated depreciation method in which the largest amount of depreciation is recognized in the early years of the asset's life. If the straight-line method is used, the same amount of depreciation expense is recognized each year. Therefore, in the early years less depreciation expense will be recognized under this method than under the declining-balance method while more will be recognized in the later years.

The amount of depreciation expense recognized using the units-of-activity method is dependent on production, so this method could recognize more or less depreciation expense than the other two methods in any year depending on output.

No matter which of the three methods is used, the same total amount of depreciation expense will be recognized over the four-year period.

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PROBLEM 10-4A

Year	Depreciation Expense	Accumulated Depreciation
2006	$13,500[a]	$13,500
2007	13,500	27,000
2008	10,800[b]	37,800
2009	10,800	48,600
2010	10,800	59,400
2011	12,800[c]	72,200
2012	12,800	85,000

[a] $$\frac{\$90{,}000 - \$9{,}000}{6 \text{ years}} = \$13{,}500$$

[b] $$\frac{\text{Book value} - \text{Salvage value}}{\text{Remaining useful life}} = \frac{\$63{,}000 - \$9{,}000}{5 \text{ years}} = \$10{,}800$$

[c] $$\frac{\$30{,}600 - \$5{,}000}{2 \text{ years}} = \$12{,}800$$

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PROBLEM 10-5A

(a)	Apr.	1	Land	2,130,000	
			Cash		2,130,000
	May	1	Depreciation Expense	26,000	
			Accumulated Depreciation—Equipment		26,000
			($780,000 X 1/10 X 4/12)		
		1	Cash	450,000	
			Accumulated Depreciation—Equipment	338,000	
			Equipment		780,000
			Gain on Disposal		8,000

Cost	$780,000
Accum. depreciation—equipment [($780,000 X 1/10 X 4) + $26,000]	338,000
Book value	442,000
Cash proceeds	450,000
Gain on disposal	$ 8,000

	June	1	Cash	1,500,000	
			Land		400,000
			Gain on Disposal		1,100,000
	July	1	Equipment	2,000,000	
			Cash		2,000,000
	Dec.	31	Depreciation Expense	50,000	
			Accumulated Depreciation—Equipment		50,000
			($500,000 X 1/10)		
		31	Accumulated Depreciation—Equipment	500,000	
			Equipment		500,000

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PROBLEM 10-5A (Continued)

Cost	$500,000
Accum. depreciation—equipment ($500,000 X 1/10 X 10)	500,000
Book value	$ 0

(b)

Dec. 31	Depreciation Expense		570,000	
	Accumulated Depreciation—Buildings			570,000
	($28,500,000 X 1/50)			
31	Depreciation Expense		4,772,000	
	Accumulated Depreciation—Equipment			4,772,000

($46,720,000* X 1/10)	$4,672,000
[($2,000,000 X 1/10) X 6/12]	100,000
	$4,772,000

*($48,000,000 – $780,000 – $500,000)

(c)

JIMENEZ COMPANY
Partial Balance Sheet
December 31, 2009

Plant Assets*		
Land		$ 5,730,000
Buildings	$28,500,000	
Less: Accumulated depreciation—buildings	12,670,000	15,830,000
Equipment	48,720,000	
Less: Accumulated depreciation—equipment	9,010,000	39,710,000
Total plant assets		$61,270,000

*See T-accounts which follow.

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PROBLEM 10-5A (Continued)

Land

Bal.	4,000,000	June 1	400,000
Apr. 1	2,130,000		
Bal.	5,730,000		

Buildings

Bal.	28,500,000		
Bal.	28,500,000		

Accumulated Depreciation—Buildings

		Bal.	12,100,000
		Dec. 31 adj.	570,000
		Bal.	12,670,000

Equipment

Bal.	48,000,000	May 1	780,000
July 1	2,000,000	Dec. 31	500,000
Bal.	48,720,000		

Accumulated Depreciation—Equipment

May 1	338,000	Bal.	5,000,000
Dec. 31	500,000	May 1	26,000
		Dec. 31	50,000
		Dec. 31 adj.	4,772,000
		Bal.	9,010,000

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PROBLEM 10-6A

(a)	Accumulated Depreciation—Office Furniture	50,000	
	Loss on Disposal	25,000	
	Office Furniture		75,000
(b)	Cash	21,000	
	Accumulated Depreciation—Office Furniture	50,000	
	Loss on Disposal	4,000	
	Office Furniture		75,000
(c)	Cash	31,000	
	Accumulated Depreciation—Office Furniture	50,000	
	Gain on Disposal		6,000
	Office Furniture		75,000

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PROBLEM 10-7A

(a)	Jan. 2	Patents	45,000	
		Cash		45,000
	Jan.–June	Research and Development Expense	140,000	
		Cash		140,000
	Sept. 1	Advertising Expense	50,000	
		Cash		50,000
	Oct. 1	Franchise	100,000	
		Cash		100,000
(b)	Dec. 31	Amortization Expense—Patents	12,000	
		Patents		12,000
		[($70,000 X 1/10) + ($45,000 X 1/9)]		
	31	Amortization Expense—Franchise	5,300	
		Franchise		5,300
		[($48,000 X 1/10) + ($100,000 X 1/50 X 3/12)]		

(c) Intangible Assets

Patents ($115,000 cost – $19,000 amortization) (1)	$ 96,000
Franchise ($148,000 cost – $24,500 amortization) (2)	123,500
Total intangible assets	$219,500

(1) Cost ($70,000 + $45,000); amortization ($7,000 + $12,000).
(2) Cost ($48,000 + $100,000); amortization ($19,200 + $5,300).

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PROBLEM 10-8A

1.	Research and Development Expense.....	136,000	
	Patents		136,000
	Patents	6,800	
	Amortization Expense—Patents.....		6,800
	[$9,800 – ($60,000 X 1/20)]		
2.	Goodwill.....	920	
	Amortization Expense—Goodwill		920

Note: Goodwill should not be amortized because it has an indefinite life unlike Patents.

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PROBLEM 10-9A

(a)

	Lebo	Ritter
Asset turnover ratio	$\frac{\$1,200,000}{\$2,500,000}$ = .48 times	$\frac{\$1,080,000}{\$2,000,000}$ = .54 times

(b) Based on the asset turnover ratio, Ritter is more effective in using assets to generate sales. Its asset turnover ratio is almost 13% higher than Lebo's ratio.

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PROBLEM 10-1B

Item	Land	Building	Other Accounts	
1	$ 2,000			
2			$ 3,000	Property Taxes Expense
3		$600,000		
4		22,000		
5	125,000			
6			15,000	Land Improvements
7		10,000		
8			4,000	Land Improvements
9	24,000			
10	(2,500)			
	$148,500	$632,000		

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PROBLEM 10-2B

(a)

Year	Computation	Cumulative 12/31
	MACHINE 1	
2005	$ 80,000 X 10% = $8,000	$ 8,000
2006	$ 80,000 X 10% = $8,000	16,000
2007	$ 80,000 X 10% = $8,000	24,000
2008	$ 80,000 X 10% = $8,000	32,000
	MACHINE 2	
2006	$100,000 X 25% = $25,000	$25,000
2007	$ 75,000 X 25% = $18,750	43,750
2008	$ 56,250 X 25% = $14,063	57,813
	MACHINE 3	
2008	1,000 X ($72,000 ÷ 24,000) = $3,000	$ 3,000

(b)

	Year	Depreciation Computation	Expense
		MACHINE 2	
(1)	2006	$100,000 X 25% X 9/12 = $18,750	$18,750
(2)	2007	$81,250 X 25% = $20,313	$20,313

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PROBLEM 10-3B

(a) (1)

Purchase price	$ 46,500
Sales tax	2,200
Shipping costs	175
Insurance during shipping	75
Installation and testing	50
Total cost of machinery	$ 49,000

Machinery	49,000	
Cash		49,000

(2)

Recorded cost	$ 49,000
Less: Salvage value	5,000
Depreciable cost	$ 44,000
Years of useful life	÷ 4
Annual depreciation	$ 11,000

Depreciation Expense	11,000	
Accumulated Depreciation		11,000

(b) (1)

Recorded cost	$120,000
Less: Salvage value	8,000
Depreciable cost	$112,000
Years of useful life	÷ 4
Annual depreciation	$ 28,000

(2)

Year	Book Value at Beginning of Year	DDB Rate	Annual Depreciation Expense	Accumulated Depreciation
2008	$120,000	50%*	$60,000	$ 60,000
2009	60,000	50%	30,000	90,000
2010	30,000	50%	15,000	105,000
2011	15,000	50%	7,000**	112,000

*100% ÷ 4-year useful life = 25% X 2 = 50%.
**[($120,000 – $8,000) – $105,000] = $7,000.

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PROBLEM 10-3B (Continued)

(3) Depreciation cost per unit = ($120,000 – $8,000)/25,000 units = $4.48 per unit.

Annual Depreciation Expense

2008:	**$4.48 X 6,500 =**	**$29,120**
2009:	**4.48 X 7,500 =**	**33,600**
2010:	**4.48 X 6,000 =**	**26,880**
2011:	**4.48 X 5,000 =**	**22,400**

(c) The straight-line method reports the lowest amount of depreciation expense the first year while the declining-balance method reports the highest. In the fourth year, the declining-balance method reports the lowest amount of depreciation expense while the straight-line method reports the highest.

These facts occur because the declining-balance method is an accelerated depreciation method in which the largest amount of depreciation is recognized in the early years of the asset's life. If the straight-line method is used, the same amount of depreciation expense is recognized each year. Therefore, in the early years less depreciation expense will be recognized under this method than under the declining-balance method while more will be recognized in the later years.

The amount of depreciation expense recognized using the units-of-activity method is dependent on production, so this method could recognize more or less depreciation expense than the other two methods in any year depending on output.

No matter which of the three methods is used, the same total amount of depreciation expense will be recognized over the four-year period.

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PROBLEM 10-4B

Year	Depreciation Expense	Accumulated Depreciation
2006	$12,000[a]	$12,000
2007	12,000	24,000
2008	9,600[b]	33,600
2009	9,600	43,200
2010	9,600	52,800
2011	11,600[c]	64,400
2012	11,600	76,000

[a] $\frac{\$80{,}000 - \$8{,}000}{6 \text{ years}} = \$12{,}000$

[b] $\frac{\text{Book value} - \text{Salvage value}}{\text{Remaining useful life}} = \frac{\$56{,}000 - \$8{,}000}{5 \text{ years}} = \$9{,}600$

[c] $\frac{\$27{,}200 - \$4{,}000}{2 \text{ years}} = \$11{,}600$

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PROBLEM 10-5B

(a)	Apr.	1	Land	2,200,000	
			Cash		2,200,000
	May	1	Depreciation Expense	20,000	
			Accumulated Depreciation—Equipment		20,000
			($600,000 X 1/10 X 4/12)		
		1	Cash	360,000	
			Accumulated Depreciation—Equipment	260,000	
			Equipment		600,000
			Gain on Disposal		20,000

Cost	$600,000
Accum. depreciation—equipment [($600,000 X 1/10 X 4) + $20,000]	260,000
Book value	340,000
Cash proceeds	360,000
Gain on disposal	$ 20,000

	June	1	Cash	1,800,000	
			Land		600,000
			Gain on Disposal		1,200,000
	July	1	Equipment	1,800,000	
			Cash		1,800,000
	Dec.	31	Depreciation Expense	50,000	
			Accumulated Depreciation—Equipment		50,000
			($500,000 X 1/10)		
		31	Accumulated Depreciation—Equipment	500,000	
			Equipment		500,000

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PROBLEM 10-5B (Continued)

Cost	$500,000
Accum. depreciation—equipment ($500,000 X 1/10 X 10)	500,000
Book value	$ 0

(b)

Dec. 31	Depreciation Expense		530,000	
	Accumulated Depreciation—Buildings			530,000
	($26,500,000 X 1/50)			
31	Depreciation Expense		3,980,000	
	Accumulated Depreciation—Equipment			3,980,000

($38,900,000* X 1/10)	$3,890,000
[($1,800,000 X 1/10) X 6/12]	90,000
	$3,980,000

*($40,000,000 – $600,000 – $500,000)

(c)

YOCKEY COMPANY
Partial Balance Sheet
December 31, 2009

Plant Assets*		
Land		$ 4,600,000
Buildings	$26,500,000	
Less: Accumulated depreciation—buildings	12,630,000	13,870,000
Equipment	40,700,000	
Less: Accumulated depreciation—equipment	8,290,000	32,410,000
Total plant assets		$50,880,000

*See T-accounts which follow.

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PROBLEM 10-5B (Continued)

Land

Bal.	3,000,000	June 1	600,000
Apr. 1	2,200,000		
Bal.	4,600,000		

Buildings

Bal.	26,500,000		
Bal.	26,500,000		

Accumulated Depreciation—Buildings

		Bal.	12,100,000
		Dec. 31 adj.	530,000
		Bal.	12,630,000

Equipment

Bal.	40,000,000	May 1	600,000
July 1	1,800,000	Dec. 31	500,000
Bal.	40,700,000		

Accumulated Depreciation—Equipment

May 1	260,000	Bal.	5,000,000
Dec. 31	500,000	May 1	20,000
		Dec. 31	50,000
		Dec. 31 adj.	3,980,000
		Bal.	8,290,000

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PROBLEM 10-6B

(a)	Accumulated Depreciation—Delivery Equipment	24,000	
	Loss on Disposal	26,000	
	Delivery Equipment		50,000
(b)	Cash	31,000	
	Accumulated Depreciation—Delivery Equipment	24,000	
	Gain on Disposal		5,000
	Delivery Equipment		50,000
(c)	Cash	18,000	
	Accumulated Depreciation—Delivery Equipment	24,000	
	Loss on Disposal	8,000	
	Delivery Equipment		50,000

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PROBLEM 10-7B

(a)	Jan. 2	Patents		27,000	
		Cash			27,000
	Jan.–June	Research and Development Expense		140,000	
		Cash			140,000
	Sept. 1	Advertising Expense		75,000	
		Cash			75,000
	Oct. 1	Copyright		120,000	
		Cash			120,000
(b)	Dec. 31	Amortization Expense—Patents		9,000	
		Patents			9,000
		[($60,000 X 1/10) + ($27,000 X 1/9)]			
	31	Amortization Expense—Copyright		4,200	
		Copyright			4,200
		[($36,000 X 1/10) + ($120,000 X 1/50 X 3/12)]			

(c) Intangible Assets

Patents ($87,000 cost – $15,000 amortization) (1)	$ 72,000
Copyright ($156,000 cost – $18,600 amortization) (2)	137,400
Total intangible assets	$209,400

(1) Cost ($60,000 + $27,000); amortization ($6,000 + $9,000).
(2) Cost ($36,000 + $120,000); amortization ($14,400 + $4,200).

(d) The intangible assets of the company consist of two patents and two copyrights. One patent with a total cost of $87,000 is being amortized in two segments ($60,000 over 10 years and $27,000 over 9 years); the other patent was obtained at no recordable cost. A copyright with a cost of $36,000 is being amortized over 10 years; the other copyright with a cost of $120,000 is being amortized over 50 years.

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PROBLEM 10-8B

1.	Research and Development Expense	95,000	
	Patents		95,000
	Patents	4,750	
	Amortization Expense—Patents		4,750
	[$6,750 – ($40,000 X 1/20)]		
2.	Goodwill	800	
	Amortization Expense—Goodwill		800

Note: Goodwill should not be amortized because it has an indefinite life unlike Patents.

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PROBLEM 10-9B

(a)

	Gavin Corp.	Keady Corp.
Asset turnover ratio	$\frac{\$1,300,000}{\$2,000,000}$ = .65 times	$\frac{\$1,140,000}{\$1,500,000}$ = .76 times

(b) Based on the asset turnover ratio, Keady Corp. is more effective in using assets to generate sales. Its asset turnover ratio is 17% higher than Gavins's asset turnover ratio.

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CHAPTER 10 COMPREHENSIVE PROBLEM SOLUTION

(a) 1.	Equipment	13,800	
	Cash		13,800
2.	Depreciation Expense—Equipment	450	
	Accumulated Depreciation—Equipment		450
	Cash	3,500	
	Accumulated Depreciation—Equipment	2,250	
	Equipment		5,000
	Gain on Disposal		750
3.	Accounts Receivable	9,000	
	Sales		9,000
	Cost of Goods Sold	6,300	
	Merchandise Inventory		6,300
4.	Bad Debts Expense	3,500	
	Allowance for Doubtful Accounts		3,500
5.	Interest Receivable	600	
	Interest Revenue		600
6.	Insurance Expense	2,400	
	Prepaid Insurance		2,400
7.	Depreciation Expense—Building	4,000	
	Accumulated Depreciation—Building		4,000
8.	Depreciation Expense—Equipment	9,900	
	Accumulated Depreciation—Equipment		9,900
9.	Depreciation Expense—Equipment	1,600	
	Accumulated Depreciation—Equipment		1,600

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COMPREHENSIVE PROBLEM (Continued)

10.	Amortization Expense—Patents	900	
	Patent		900
11.	Salaries Expense	2,200	
	Salaries Payable		2,200
12.	Unearned Rent	2,000	
	Rent Revenue		2,000
13.	Interest Expense	4,140	
	Interest Payable		4,140

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COMPREHENSIVE PROBLEM (Continued)

(b)

WINTERSCHID COMPANY
Trial Balance
December 31, 2008

	Debits	Credits
Cash	$ 17,700	
Accounts Receivable	45,800	
Notes Receivable	10,000	
Interest Receivable	600	
Merchandise Inventory	29,900	
Prepaid Insurance	1,200	
Land	20,000	
Building	150,000	
Equipment	68,800	
Patent	8,100	
Allowance for Doubtful Accounts		$ 4,000
Accumulated Depreciation—Building		54,000
Accumulated Depreciation—Equipment		33,700
Accounts Payable		27,300
Salaries Payable		2,200
Unearned Rent		4,000
Notes Payable (short-term)		11,000
Interest Payable		4,140
Notes Payable (long-term)		35,000
Winterschid, Capital		113,600
Winterschid, Drawing	12,000	
Sales		909,000
Interest Revenue		600
Rent Revenue		2,000
Gain on Disposal		750
Bad Debts Expense	3,500	
Cost of Goods Sold	636,300	
Depreciation Expense—Building	4,000	
Depreciation Expense—Equipment	11,950	
Insurance Expense	2,400	
Interest Expense	4,140	
Other Operating Expenses	61,800	
Amortization Expense–Patents	900	
Salaries Expense	112,200	
Total	$1,201,290	$1,201,290

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COMPREHENSIVE PROBLEM (Continued)

(c)

WINTERSCHID COMPANY
Income Statement
For the Year Ended December 31, 2008

Sales		$909,000
Cost of Goods Sold		636,300
Gross Profit		272,700
Operating Expenses		
Salaries Expense	$112,200	
Other Operating Expenses	61,800	
Depr. Expense—Equipment	11,950	
Depr. Expenses—Building	4,000	
Bad Debts Expense	3,500	
Insurance Expense	2,400	
Amortization Expense—Patents	900	
Total Operating Expense		196,750
Income From Operations		75,950
Other Revenues and Gains		
Rent Revenue	2,000	
Gain on Disposal	750	
Interest Revenue	600	
	3,350	
Other Expenses and Losses		
Interest Expense	4,140	(790)
Net Income		$ 75,160

WINTERSCHID COMPANY
Owner's Equity Statement
For the Year Ended December 31, 2008

Winterschid, Capital, 1/1/08	$113,600
Add: Net Income	75,160
	188,760
Less: Drawings	12,000
Winterschid, Capital, 12/31/08	$176,760

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COMPREHENSIVE PROBLEM (Continued)

(d)

WINTERSCHID COMPANY
Balance Sheet
December 31, 2008

Current Assets			
Cash		$17,700	
Accounts Receivable	$ 45,800		
Allowance for Doubtful Accounts	4,000	41,800	
Notes Receivable		10,000	
Interest Receivable		600	
Merchandise Inventory		29,900	
Prepaid Insurance		1,200	
Total Current Assets			$101,200
Property, Plant, and Equipment			
Land		20,000	
Building	150,000		
Less Accum. Depr.	54,000	96,000	
Equipment	68,800		
Less Accum. Depr.	33,700	35,100	
Total Plant Assets			151,100
Intangible Assets			
Patent			8,100
Total Assets			$260,400
Current Liabilities			
Notes Payable (short-term)		$11,000	
Accounts Payable		27,300	
Interest Payable		4,140	
Unearned Rent		4,000	
Salaries Payable		2,200	
Total Current Liabilities			48,640
Long-term Liabilities			
Notes Payable (long-term)			35,000
Total Liabilities			83,640
Owner's Equity			
Winterschid, Capital			176,760
Total Liabilities and Owner's Equity			$260,400

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BYP 10-1 FINANCIAL REPORTING PROBLEM

(a) Property, plant, and equipment is reported net, book value, on the December 31, 2005, balance sheet at $8,681,000,000. The cost of the property, plant, and equipment is $17,145,000,000 as shown in Note 4.

(b) Depreciation expense is calculated using the straight-line method over an asset's estimated useful live. (see Note 4).

(c) Depreciation expense was:

2005:	**$1,103,000,000.**
2004:	**$1,062,000,000.**
2003:	**$1,020,000,000.**

Amortization expense was:

2005:	**$150,000,000.**
2004:	**$147,000,000.**
2003:	**$145,000,000.**

(d) PepsiCo's capital spending was:

2005:	**$1,736,000,000.**
2004:	**$1,387,000,000.**

(e) PepsiCo reports amortizable intangible assets, net of $530,000,000 and nonamortizable intangible assets, net of $5,174,000,000. In Note 4, the company indicates that intangible assets consist primarily of brands and goodwill.

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BYP 10-2 COMPARATIVE ANALYSIS PROBLEM

(a)

	PepsiCo	Coca-Cola
Asset turnover ratio	$32,562 ÷ $\frac{\$27,987 + \$31,727}{2}$ = 1.09 times	$23,104 ÷ $\frac{\$31,441 + \$29,427}{2}$ = .76 times

(b) The asset turnover ratio measures how efficiently a company uses its assets to generate sales. It shows the dollars of sales generated by each dollar invested in assets. PepsiCo's asset turnover ratio (1.09) was 43% higher than Coca-Cola's (.76). Therefore, it can be concluded that PepsiCo was more efficient during 2005 in utilizing assets to generate sales.

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BYP 10-3 EXPLORING THE WEB

Answers will vary depending on the company selected.

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BYP 10-4 DECISION MAKING ACROSS THE ORGANIZATION

(a) **Reimer Company—Straight-line method**

Annual Depreciation	
Building [($320,000 – $20,000) ÷ 40]	$ 7,500
Equipment [($110,000 – $10,000) ÷ 10]	10,000
Total annual depreciation	$17,500
Total accumulated depreciation ($17,500 X 3)	$52,500

Lingo Company—Double-declining-balance method

Year	Asset	Computation	Annual Depreciation	Accumulated Depreciation
2006	Building	$320,000 X 5%	$16,000	
	Equipment	$110,000 X 20%	22,000	$38,000
2007	Building	$304,000 X 5%	15,200	
	Equipment	$ 88,000 X 20%	17,600	32,800
2008	Building	$288,800 X 5%	14,440	
	Equipment	$ 70,400 X 20%	14,080	28,520
				$99,320

(b)

Year	Reimer Company Net Income	Lingo Company Net Income As Adjusted	Computations for Lingo Company
2006	$ 84,000	$ 88,500	$68,000 + $38,000 – $17,500 = $88,500
2007	88,400	91,300	$76,000 + $32,800 – $17,500 = $91,300
2008	90,000	96,020	$85,000 + $28,520 – $17,500 = $96,020
Total net income	$262,400	$275,820	

(c) As shown above, when the two companies use the same depreciation method, Lingo Company is more profitable than Reimer Company. When the two companies are using different depreciation methods, Lingo Company has more cash than Reimer Company for two reasons:

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(1) its earnings are generating more cash than the earnings of Reimer Company, and (2) depreciation expense has no effect on cash. Cash generated by operations can be arrived at by adding depreciation expense to net income. If this is done, it can be seen that Lingo Company's operations generate more cash ($229,000 + $99,320 = $328,320) than Reimer Company's ($262,400 + $52,500 = $314,900). Based on the above analysis, Mrs. Vogts should buy Lingo Company. It not only is in a better financial position than Reimer Company, but it is also more profitable.

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BYP 10-5	COMMUNICATION ACTIVITY

To: Instructor

From: Student

Re: American Exploration Company footnote

American Exploration Company accounts for its oil and gas activities using the successful efforts approach. Under this method, only the costs of successful exploration are included in the cost of the natural resource, and the costs of unsuccessful explorations are expensed.

Depletion is determined using the units-of-activity method. Under this method, a depletion cost per unit is computed based on the total number of units expected to be extracted. Depletion expense for the year is determined by multiplying the units extracted and sold by the depletion cost per unit.

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BYP 10-6 ETHICS CASE

(a) The stakeholders in this situation are:

- **Dennis Harwood, president of Buster Container Company.**
- **Shelly McGlone, controller.**
- **The stockholders of Buster Container Company.**
- **Potential investors in Buster Container Company.**

(b) The intentional misstatement of the life of an asset or the amount of the salvage value is unethical for whatever the reason. There is nothing per se unethical about changing the estimate either of the life of an asset or of an asset's salvage value if the change is an attempt to better match cost and revenues and is a better allocation of the asset's depreciable cost over the asset's useful life. In this case, it appears from the controller's reaction that the revisions in the life are intended only to improve earnings and, therefore, are unethical.

The fact that the competition uses a longer life on its equipment is not necessarily relevant. The competition's maintenance and repair policies and activities may be different. The competition may use its equipment fewer hours a year (e.g., one shift rather than two shifts daily) than Buster Container Company.

(c) Income before income taxes in the year of change is increased $140,000 by implementing the president's proposed changes.

	Old Estimates
Asset cost	$3,100,000
Estimated salvage	300,000
Depreciable cost	2,800,000
Depreciation per year (1/8)	$ 350,000

	Revised Estimates
Asset cost	$3,100,000
Estimated salvage	300,000
Depreciable cost	2,800,000
Depreciation taken to date ($350,000 X 2)	700,000
	2,100,000
Remaining life in years	10 years
Depreciation per year	$ 210,000

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BYP 10-7 ALL ABOUT YOU ACTIVITY

(a) 1 c 2 b 3 a 4 d 5 c

(b) For the most part, the value of a brand is not reported on a company's balance sheet. Most companies are required to expense all costs related to the maintenance of a brand name. Also any research and development that went into the development of the related product is generally expensed. The only way significant costs related to the value of the brand are reported on balance sheet is when a company purchases another company that has a significant tradename (brand). In that case, given an objective transaction, companies are able to assign value to the brand and report it on the balance sheet. A conservative approach is used in this area because the value of the brand can be extremely difficult to determine. It should be noted that international rules permit companies to report brand values on their balance sheets.

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CHAPTER 11

Current Liabilities and Payroll Accounting

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Explain a current liability, and identify the major types of current liabilities.	1	1	7	1A	1B
2. Describe the accounting for notes payable.	2	2	1, 2, 7	1A, 2A	1B, 2B
3. Explain the accounting for other current liabilities.	3, 4	3, 4	3, 4, 7	1A	1B
4. Explain the financial statement presentation and analysis of current liabilities.	5	5	7, 8, 9	1A	1B
5. Describe the accounting and disclosure requirements for contingent liabilities.	6, 7	6	5, 6, 7	1A	1B
6. Compute and record the payroll for a pay period.	8, 9, 10, 12 13, 14, 15	7, 8	10, 11, 12 13	3A, 4A, 5A	3B, 4B, 5B
7. Describe and record employer payroll taxes.	9, 10, 11, 15	9	12, 14	3A, 4A, 5A	3B, 4B, 5B
8 Discuss the objectives of internal control for payroll.	16, 17	10			
*9. Identify additional fringe benefits associated with employee compensation.	18, 19, 20, 21, 22	11	15, 16	4A	4B

*__Note:__ All __asterisked__ Questions, Exercises, and Problems relate to material contained in the appendix to the chapter.

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ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Prepare current liability entries, adjusting entries, and current liabilities section.	Moderate	30–40
2A	Journalize and post note transactions and show balance sheet presentation.	Moderate	30–40
3A	Prepare payroll register and payroll entries.	Simple	30–40
4A	Journalize payroll transactions and adjusting entries.	Moderate	30–40
5A	Prepare entries for payroll and payroll taxes; prepare W-2 data.	Moderate	30–40
1B	Prepare current liability entries, adjusting entries, and current liabilities section.	Moderate	30–40
2B	Journalize and post note transactions and show balance sheet presentation.	Moderate	30–40
3B	Prepare payroll register and payroll entries.	Simple	30–40
4B	Journalize payroll transactions and adjusting entries.	Moderate	30–40
5B	Prepare entries for payroll and payroll taxes; prepare W-2 data.	Moderate	30–40

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BLOOM'S TAXONOMY TABLE

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Explain a current liability, and identify the major types of current liabilities.		Q11-1 BE11-1	E11-7	P11-1A P11-1B		
2. Describe the accounting for notes payable.		Q11-2	E11-7	BE11-2 P11-2A E11-1 P11-1B E11-2 P11-2B P11-1A		
3. Explain the accounting for other current liabilities.			BE11-4 E11-3 Q11-3 E11-7 Q11-4	BE11-3 P11-1B E11-4 P11-1A		
4. Explain the financial statement presentation and analysis of current liabilities.		Q11-5 BE11-5	E11-7 E11-8 E11-9	P11-1A P11-1B		
5. Describe the accounting and disclosure requirements for contingent liabilities.		Q11-6 Q11-7 E11-6	E11-5 E11-6 E11-7	BE11-6 P11-1A E11-5 P11-1B		
6. Compute and record the payroll for a pay period.	Q11-9 Q11-12 Q11-14	Q11-8 Q11-15 Q11-10 Q11-13	BE11-7 E11-11 BE11-8 E11-12 E11-10 E11-13	P11-3A P11-3B P11-4A P11-4B P11-5A P11-5B		
7. Describe and record employer payroll taxes.	Q11-11	Q11-9 Q11-10 Q11-15	BE11-9 E11-12 E11-14	P11-3A P11-3B P11-4A P11-4B P11-5A P11-5B		
8. Discuss the objectives of internal control for payroll.	Q11-17	Q11-16 BE11-10				
*9. Identify additional fringe benefits associated with employee compensation.	Q11-18	Q11-19 Q11-22 Q11-20 Q11-21	BE11-11 E11-16	E11-15 P11-4A P11-4B		
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ANSWERS TO QUESTIONS

1. Jill is not correct. A current liability is a debt that can reasonably be expected to be paid: (a) from existing current assets or through the creation of other current liabilities and (2) within one year or the operating cycle, whichever is longer.

2. In the balance sheet, Notes Payable of $40,000 and Interest Payable of $900 ($40,000 X .09 X 3/12) should be reported as current liabilities. In the income statement, Interest Expense of $900 should be reported under other expenses and losses.

3. (a) Disagree. The company only serves as a collection agent for the taxing authority. It does not report sales taxes as an expense; it merely forwards the amount paid by the customer to the government.

(b) The entry to record the proceeds is:

Cash	7,400	
Sales		7,000
Sales Taxes Payable		400

4. (a) The entry when the tickets are sold is:

Cash	800,000	
Unearned Football Ticket Revenue		800,000

(b) The entry after each game is:

Unearned Football Ticket Revenue	160,000	
Football Ticket Revenue		160,000

5. Liquidity refers to the ability of a company to pay its maturing obligations and meet unexpected needs for cash. Two measures of liquidity are working capital (current assets – current liabilities) and the current ratio (current assets ÷ current liabilities).

6. A contingent liability is an existing situation involving uncertainty as to a possible obligation which will be resolved when one or more future events occur or fail to occur. Contingent liabilities are only recorded in the accounts if they are probable and the amount is reasonably estimable. Warranty costs are a contingent liability usually recorded in the accounts since they are both probable in incurrence and subject to estimation.

7. If an event is only reasonably possible, then only note disclosure is required. If the possibility of a contingent liability occurring is only remote, then neither recording in the accounts nor note disclosure is required.

8. Gross pay is the amount an employee actually earns. Net pay, the amount an employee is paid, is gross pay reduced by both mandatory and voluntary deductions, such as FICA taxes, union dues, federal income taxes, etc. Gross pay should be recorded as wages or salaries expense.

9. Both employees and employers are required to pay FICA taxes.

10. No. When an employer withholds federal or state income taxes from employee paychecks, the employer is merely acting as a collection agent for the taxing body. Since the employer holds employees' funds, these withholdings are a liability for the employer until they are remitted to the government.

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11. FICA stands for Federal Insurance Contribution Act; FUTA stands for Federal Unemployment Tax Act; and SUTA stands for State Unemployment Tax Act.

12. A W-2 statement contains the employee's name, address, social security number, wages, tips, other compensation, social security taxes withheld, wages subject to social security taxes, and federal, state and local income taxes withheld.

13. Payroll deductions can be classified as either mandatory (required by the government) or voluntary (not required by the government). Mandatory deductions include FICA taxes and income taxes. Examples of voluntary deductions are health and life insurance premiums, pension contributions, union dues, and charitable contributions.

14. The employee earnings record is used in: (1) determining when an employee has earned the maximum earnings subject to FICA taxes, (2) filing state and federal tax returns, and (3) providing each employee with a statement of gross earnings and tax withholdings for the year.

15. (a) The three types of taxes are: (1) FICA, (2) federal unemployment, and (3) state unemployment.
(b) The tax liability accounts are classified as current liabilities in the balance sheet. Payroll tax expense is classified under operating expenses in the income statement.

16. The main internal control objectives associated with payrolls are: (1) to safeguard company assets from unauthorized payments of payrolls and (2) to assure the accuracy and reliability of the accounting records pertaining to payrolls.

17. The four functions associated with payroll are: (1) hiring employees, (2) timekeeping, (3) preparing the payroll, and (4) paying the payroll.

***18.** Two additional types of fringe benefits are:
(1) Paid absences—vacation pay, sick pay, and paid holidays.
(2) Post-retirement benefits—pensions and health care and life insurance.

***19.** Paid absences refer to compensation paid by employers to employees for vacations, sickness, and holidays. When the payment of such compensation is probable and the amount can be reasonably estimated, a liability should be accrued for paid future absences which employees have earned. When this amount cannot be reasonably estimated, the potential liability should be disclosed.

***20.** Post-retirement benefits consist of payments by employers to retired employees for: (1) pensions and (2) health care and life insurance.

***21.** A 401(K) works as follows: an employee can contribute up to a certain percentage of pay into a 401(K) plan and employers will match a percentage of the employee's contribution.

***22.** A defined contribution plan defines the contribution that an employer can make but not the benefit that the employee will receive. In a defined benefit plan, the employer agrees to pay a defined amount to retirees based on employees meeting certain eligibility standards.

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SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 11-1

(a) A note payable due in two years is a long-term liability, not a current liability.

(b) $30,000 of the mortgage payable is a current maturity of long-term debt. This amount should be reported as a current liability.

(c) Interest payable is a current liability because it will be paid out of current assets in the near future.

(d) Accounts payable is a current liability because it will be paid out of current assets in the near future.

BRIEF EXERCISE 11-2

July 1	Cash	80,000	
	Notes Payable		80,000
Dec. 31	Interest Expense	4,000	
	Interest Payable		4,000
	($80,000 X 10% X 1/2)		

BRIEF EXERCISE 11-3

Sales tax payable

(1) Sales = $14,800 = ($15,540 ÷ 1.05)

(2) Sales taxes payable = $740 = ($14,800 X 5%)

Mar. 16	Cash	15,540	
	Sales		14,800
	Sales Taxes Payable		740

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BRIEF EXERCISE 11-4

Cash	720,000	
Unearned Basketball Ticket Revenue		720,000
(To record sale of 4,000 season tickets)		
Unearned Basketball Ticket Revenue	60,000	
Basketball Ticket Revenue		60,000
(To record basketball ticket revenues earned)		

BRIEF EXERCISE 11-5

(a) Working capital = $4,090,475 – $1,180,707 = $2,909,768 (thousand)
(b) Current ratio = $4,090,475 ÷ $1,180,707 = 3.46:1

BRIEF EXERCISE 11-6

Dec. 31	Warranty Expense	4,000	
	Estimated Warranty Liability		4,000
	[(1,000 X 5%) X $80]		

BRIEF EXERCISE 11-7

Gross earnings:		
Regular pay (40 X $16)	$640.00	
Overtime pay (7 X $24)	168.00	$808.00
Gross earnings		$808.00
Less: FICA taxes payable ($808 X 8%)	$ 64.64	
Federal income taxes payable	95.00	159.64
Net pay		$648.36

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BRIEF EXERCISE 11-8

Jan. 15	Wages Expense	808.00	
	FICA Taxes Payable ($808 X 8%)		64.64
	Federal Income Taxes Payable		95.00
	Wages Payable		648.36
Jan. 15	Wages Payable	648.36	
	Cash		648.36

BRIEF EXERCISE 11-9

Jan. 31	Payroll Tax Expense	9,940	
	FICA Taxes Payable ($70,000 X 8%)		5,600
	Federal Unemployment Taxes Payable ($70,000 X .8%)		560
	State Unemployment Taxes Payable ($70,000 X 5.4%)		3,780

BRIEF EXERCISE 11-10

(a) Timekeeping
(b) Hiring employees
(c) Preparing the payroll
(d) Paying the payroll

*BRIEF EXERCISE 11-11

Jan. 31	Vacation Benefits Expense (80 X $120)	9,600	
	Vacation Benefits Payable		9,600

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SOLUTIONS TO EXERCISES

EXERCISE 11-1

July 1, 2008		
Cash	50,000	
Notes Payable		50,000
November 1, 2008		
Cash	60,000	
Notes Payable		60,000
December 31, 2008		
Interest Expense	3,000	
($50,000 X 12% X 6/12)		
Interest Payable		3,000
Interest Expense	1,000	
($60,000 X 10% X 2/12)		
Interest Payable		1,000
Feburary 1, 2009		
Notes Payable	60,000	
Interest Payable	1,000	
Interest Expense	500	
Cash		61,500
April 1, 2009		
Notes Payable	50,000	
Interest Payable	3,000	
Interest Expense	1,500	
Cash		54,500

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EXERCISE 11-2

(a) June 1	Cash		90,000	
	Notes Payable			90,000
(b) June 30	Interest Expense		900	
	Interest Payable			900
	[($90,000 X 12%) X 1/12]			
(c) Dec. 1	Notes Payable		90,000	
	Interest Payable		5,400	
	($90,000 X 12% X 6/12)			
	Cash			95,400

(d) $5,400

EXERCISE 11-3

WARKENTINNE COMPANY

Apr. 10	Cash	31,500	
	Sales		30,000
	Sales Taxes Payable		1,500

RIVERA COMPANY

15	Cash	23,540	
	Sales ($23,540 ÷ 1.07)		22,000
	Sales Taxes Payable		1,540
	($23,540 – $22,000)		

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EXERCISE 11-4

(a)	Nov. 30	Cash	240,000	
		Unearned Subscriptions		240,000
		(12,000 X $20)		
(b)	Dec. 31	Unearned Subscriptions	20,000	
		Subscription Revenue		20,000
		($240,000 X 1/12)		
(c)	Mar. 31	Unearned Subscriptions	60,000	
		Subscription Revenue		60,000
		($240,000 X 3/12)		

EXERCISE 11-5

(a) Estimated warranties outstanding:

Month	Estimate	Units Defective	Outstanding
November	900	600	300
December	960	400	560
Total	1,860	1,000	860

Estimated warranty liability—860 X $20 = $17,200.

(b)		Warranty Expense (1,860 X $20)	37,200	
		Estimated Warranty Liability		37,200
		Estimated Warranty Liability	20,000	
		Repair Parts, Wages Payable, Cash, etc.		20,000
(c)		Estimated Warranty Liability (500 X $20)	10,000	
		Repair Parts, Wages Payable, Cash, etc.		10,000

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EXERCISE 11-6

(a) If a contingency is remote (unlikely to occur), it need not be recorded or disclosed.

(b) Since the contingency is probable and reasonably estimable, the liability should be recorded in the accounts. In addition, the details should be disclosed in the notes to the financial statements. The journal entry is:

Lawsuit Loss	1,000,000	
Lawsuit Liability		1,000,000

(c) If a contingency is reasonably possible, it need not be recorded, but must be disclosed in the notes to the financial statements.

EXERCISE 11-7

(a)

JEWETT ONLINE COMPANY
Partial Balance Sheet

Current liabilities	
Accounts payable	$ 63,000
Long-term debt due within one year	30,000
Unearned ticket revenue	24,000
Estimated warranty liability	18,000
Sales taxes payable	10,000
Interest payable	8,000
Total current liabilities	$153,000

(b) Jewett Online Company's working capital is $147,000 and its current ratio is 1.96:1. Although a current ratio of 2:1 has been considered the standard for a good credit rating, many companies operate successfully with a current ratio below 2:1.

EXERCISE 11-8

(a) Working capital = $6,466 – $6,715 = ($249) million
(b) Current ratio = $6,466 ÷ $6,715 = .96:1

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EXERCISE 11-9

(a) Current ratio

2004 $8,720 ÷ $6,071 = 1.44:1
2005 $7,115 ÷ $5,238 = 1.36:1

Working capital

2004 $8,720 – $6,071 = $2,649 million
2005 $7,115 – $5,238 = $1,877 million

(b) Current ratio

$6,915 ÷ $5,038 = 1.37:1

Working capital

$6,915 – $5,038 = $1,877 million

It would make its current ratio increase slightly, but its working capital would remain the same.

EXERCISE 11-10

(a) 1. Regular 40 X $15.00 = $600.00
Overtime 2 X $22.50 = 45.00
Gross earnings $645.00

2. FICA taxes—$51.60 = ($645 X 8%).

3. Federal income taxes $55.

4. State income taxes $12.90 = ($645 X 2%).

5. Net pay $500.50 = ($645.00 – $51.60 – $55.00 – $12.90 – $25.00).

(b)

Office Wages Expense	645.00	
FICA Taxes Payable		51.60
Federal Income Taxes Payable		55.00
State Income Taxes Payable		12.90
Health Insurance Payable		25.00
Wages Payable		500.50

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EXERCISE 11-11

C. Ogle $4,000 X 8% = $320. Ogle's total gross earnings for the year are $87,500 = ($83,500 + $4,000), which is below the $90,000 maximum for FICA taxes.

D. Delgado $3,900 X 8% = $312. Delgado's total gross earnings for the year are $90,100. Thus, $3,900 of the gross earnings ($4,000 – $100) for this pay period are subject to FICA taxes.

L. Jeter $2,400 X 8% = $192. Jeter's total gross earnings for the year are $91,600. Thus, only $2,400 of the gross earnings ($4,000 – $1,600) for this pay period are subject to FICA taxes.

T. Spivey $0. Spivey's gross earnings prior to this pay equal the maximum amount subject to FICA taxes. Thus, none of the gross earnings in the December 31 pay period is subject to FICA taxes.

EXERCISE 11-12

(a) See next page.

(b)

Jan. 31	Wages Expense	1,837.00	
	FICA Taxes Payable		146.96
	Federal Income Taxes Payable		129.00
	Health Insurance Payable		60.00
	Wages Payable		1,501.04

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EXERCISE 11-12 (Continued)

(a)

AIVAMAR COMPANY
Payroll Register
For the Week Ending January 31

Employee	Total Hours	Earnings		Gross Pay	Deductions				Net Pay
		Regular	Overtime		FICA Taxes	Federal Income Taxes	Health Insurance	Total	
M. Hashmi	46	$ 480.00	$108.00	$ 588.00	$ 47.04	$ 34.00	$10.00	$ 91.04	$ 496.96
E. Benson	42	520.00	39.00	559.00	44.72	37.00	25.00	106.72	452.28
K. Kern	44	600.00	90.00	690.00	55.20	58.00	25.00	138.20	551.80
Totals		$1,600.00	$237.00	$1,837.00	$146.96	$129.00	$60.00	$335.96	$1,501.04

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EXERCISE 11-12 (Continued)

(b)	Jan. 31	Payroll Tax Expense	260.86	
		FICA Taxes Payable		146.96
		Federal Unemployment Taxes Payable ($1,837 X .8%)		14.70
		State Unemployment Taxes Payable ($1,837 X 5.4%)		99.20

EXERCISE 11-13

(a) (1) $ 1,100 [$10,000 see (2) below – $8,900].
(2) $10,000 (FICA taxes $800 ÷ 8%).
(3) $ 300 ($10,000 X 3%).
(4) $ 2,340 ($10,000 – $7,660).
(5) $ 6,000 ($10,000 – $4,000).

(b)	Feb. 28	Warehouse Wages Expense	6,000	
		Store Wages Expense	4,000	
		FICA Taxes Payable		800
		Federal Income Taxes Payable		1,140
		State Income Taxes Payable		300
		Union Dues Payable		100
		Wages Payable		7,660
	28	Wages Payable	7,660	
		Cash		7,660

EXERCISE 11-14

(a)	FICA tax ($760,000 X 8%)		$60,800
	SUTA tax ($100,000 X 5.4%)		5,400
	FUTA tax ($100,000 X 0.8%)		800
	Total payroll tax		$67,000

(b)	Payroll Tax Expense	67,000	
	FICA Taxes Payable		60,800
	State Unemployment Taxes Payable		5,400
	Federal Unemployment Taxes Payable		800

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*EXERCISE 11-15

Mar. 31	Vacation Benefits Expense		2,400	
	(10 X 2 X $120)			
		Vacation Benefits Payable		2,400
31	Pension Expense ($40,000 X 10%)		4,000	
		Pension Liability		4,000

*EXERCISE 11-16

1.	Vacation Benefits Expense		12,000	
		Vacation Benefits Payable		12,000
	(20 X 5 X $120)			
2.	Pension Expense		100,000	
		Cash		70,000
		Pension Liability		30,000
3.	Vacation Benefits Payable		2,160	
		Cash		2,160
	(18 X 1 X $120)			

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SOLUTIONS TO PROBLEMS

PROBLEM 11-1A

(a)	Jan. 5	Cash		22,680	
		Sales ($22,680 ÷ 108%)			21,000
		Sales Taxes Payable			1,680
		($22,680 – $21,000)			
	12	Unearned Service Revenue		10,000	
		Service Revenue			10,000
	14	Sales Taxes Payable		7,700	
		Cash			7,700
	20	Accounts Receivable		43,200	
		Sales			40,000
		Sales Taxes Payable			3,200
		(800 X $50 X 8%)			
	21	Cash		18,000	
		Notes Payable			18,000
	25	Cash		12,420	
		Sales ($12,420 ÷ 108%)			11,500
		Sales Taxes Payable			920
		($12,420 – $11,500)			
(b)	(1) Jan. 31	Interest Expense		40	
		Interest Payable			40
		($18,000 X 8% X 1/12 =			
		$120; $120 X 1/3)			
	(2) Jan. 31	Warranty Expense		2,800	
		($40,000 X 7%)			
		Estimated Warranty			
		Liability			2,800

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PROBLEM 11-1A (Continued)

(c) Current liabilities

Notes payable	$18,000
Accounts payable	52,000
Unearned service revenue ($16,000 – $10,000)	6,000
Sales taxes payable ($1,680 + $3,200 + $920)	5,800
Estimated warranty liability	2,800
Interest payable	40
Total current liabilities	$84,640

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PROBLEM 11-2A

(a)	Jan.	2	Merchandise Inventory or Purchases	30,000	
			Accounts Payable		30,000
	Feb.	1	Accounts Payable	30,000	
			Notes Payable		30,000
	Mar.	31	Interest Expense	450	
			($30,000 X 9% X 2/12)		
			Interest Payable		450
	Apr.	1	Notes Payable	30,000	
			Interest Payable	450	
			Cash		30,450
	July	1	Equipment	51,000	
			Cash		11,000
			Notes Payable		40,000
	Sept.	30	Interest Expense	1,000	
			($40,000 X 10% X 3/12)		
			Interest Payable		1,000
	Oct.	1	Notes Payable	40,000	
			Interest Payable	1,000	
			Cash		41,000
	Dec.	1	Cash	15,000	
			Notes Payable		15,000
	Dec.	31	Interest Expense	100	
			($15,000 X 8% X 1/12)		
			Interest Payable		100

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PROBLEM 11-2A (Continued)

(b)

Notes Payable

4/1	30,000	2/1	30,000
10/1	40,000	7/1	40,000
		12/1	15,000
		12/31 Bal.	15,000

Interest Payable

4/1	450	3/31	450
10/1	1,000	9/30	1,000
		12/31	100
		12/31 Bal.	100

Interest Expense

3/31	450		
9/30	1,000		
12/31	100		
12/31 Bal.	1,550		

(c) Current liabilities

Notes payable	$15,000	
Interest payable	100	$15,100

(d) Total interest is $1,550.

(a)

DEL HARDWARE
Payroll Register
For the Week Ending March 15, 2008

		Earnings			Deductions							
Employee	Hours	Regular	Over-time	Gross Pay	FICA	Fed.	State	U.F.	Total	Net Pay	Store Wages Expense	Office Wages Expense
Joe Devena	40	600.00	0	600.00	48.00	72.00	18.00	5.00	143.00	457.00	600.00	
Mary Keener	42	600.00	45.00	645.00	51.60	47.00	19.35	5.00	122.95	522.05	645.00	
Andy Dye	44	520.00	78.00	598.00	47.84	60.00	17.94	8.00	133.78	464.22	598.00	
Kim Shen	46	520.00	117.00	637.00	50.96	61.00	19.11	5.00	136.07	500.93		637.00
Totals		2,240.00	240.00	2,480.00	198.40	240.00	74.40	23.00	535.80	1,944.20	1,843.00	637.00

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PROBLEM 11-3A (Continued)

(b)	Mar. 15	Store Wages Expense	1,843.00	
		Office Wages Expense	637.00	
		FICA Taxes Payable		198.40
		Federal Income Taxes Payable		240.00
		State Income Taxes Payable		74.40
		United Fund Contributions Payable		23.00
		Wages Payable		1,944.20
	15	Payroll Tax Expense	352.16	
		FICA Taxes Payable ($2,480 X 8%)		198.40
		Federal Unemployment Taxes Payable ($2,480 X .8%)		19.84
		State Unemployment Taxes Payable ($2,480 X 5.4%)		133.92
(c)	Mar. 16	Wages Payable	1,944.20	
		Cash		1,944.20
(d)	Mar. 31	FICA Taxes Payable ($198.40 + $198.40)	396.80	
		Federal Income Taxes Payable	240.00	
		Cash		636.80

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PROBLEM 11-4A

(a)	Jan. 10	Union Dues Payable	870.00	
		Cash		870.00
	12	FICA Taxes Payable	760.00	
		Federal Income Taxes Payable	1,204.60	
		Cash		1,964.60
	15	U.S. Savings Bonds Payable	360.00	
		Cash		360.00
	17	State Income Taxes Payable	108.95	
		Cash		108.95
	20	Federal Unemployment Taxes Payable	288.95	
		State Unemployment Taxes Payable	1,954.40	
		Cash		2,243.35
	31	Office Salaries Expense	26,600.00	
		Store Wages Expense	28,400.00	
		FICA Taxes Payable		4,400.00
		Federal Income Taxes Payable		2,158.00
		State Income Taxes Payable		454.00
		United Fund Contributions Payable		1,888.00
		Union Dues Payable		400.00
		Wages Payable		45,700.00
	31	Wages Payable	45,700.00	
		Cash		45,700.00

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PROBLEM 11-4A (Continued)

(b)	**1.**	**Jan.**	**31**	**Payroll Tax Expense**	**7,810.00**	
				FICA Taxes Payable ($55,000 X 8%)		**4,400.00**
				Federal Unemployment Taxes Payable ($55,000 X .8%)		**440.00**
				State Unemployment Taxes Payable ($55,000 X 5.4%)		**2,970.00**
	***2.**		**31**	**Vacation Benefits Expense ($55,000 X 6%)**	**3,300.00**	
				Vacation Benefits Payable		**3,300.00**

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PROBLEM 11-5A

(a)	Administrative Salaries Expense	200,000	
	Electricians' Wages Expense	370,000	
	FICA Taxes Payable		38,800
	Federal Income Taxes Payable		174,400
	State Income Taxes Payable		17,100
	United Fund Contributions Payable		27,500
	Hospital Insurance Premiums Payable		17,200
	Wages Payable		295,000

(b)	Payroll Tax Expense	43,255	
	FICA Taxes Payable ($485,000 X 8%)		38,800
	Federal Unemployment Taxes Payable ($135,000 X .8%)		1,080
	State Unemployment Taxes Payable ($135,000 X 2.5%)		3,375

(c)

Employee	Wages, Tips, Other Compensation	Federal Income Tax Withheld	State Income Tax Withheld	FICA Wages	FICA Tax Withheld
Jane EcKman	$59,000	$28,500	$1,770 (1)	$59,000	$4,720
Sharon Bishop	26,000	10,200	780 (2)	26,000	2,080

(1) $59,000 X 3%.
(2) $26,000 X 3%.

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PROBLEM 11-1B

(a)	Jan.	1	Cash	30,000	
			Notes Payable		30,000
		5	Cash	10,400	
			Sales ($10,400 ÷ 104%)		10,000
			Sales Taxes Payable		400
			($10,400 – $10,000)		
		12	Unearned Service Revenue	9,000	
			Service Revenue		9,000
		14	Sales Taxes Payable	5,800	
			Cash		5,800
		20	Accounts Receivable	48,672	
			Sales		46,800
			Sales Taxes Payable		1,872
			(900 X $52 X 4%)		
		25	Cash	18,720	
			Sales ($18,720 ÷ 104%)		18,000
			Sales Taxes Payable		720
			($18,720 – $18,000)		
(b)	(1)	Jan. 31	Interest Expense	200	
			Interest Payable		200
			($30,000 X 8% X 1/12)		
	(2)	Jan. 31	Warranty Expense	2,340	
			($46,800 X 5%)		
			Estimated Warranty Liability		2,340

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PROBLEM 11-1B (Continued)

(c) Current liabilities

Notes payable	$30,000
Accounts payable	42,500
Unearned service revenue ($15,000 – $9,000)	6,000
Sales taxes payable ($400 + $1,872 + $720)	2,992
Estimated warranty liability	2,340
Interest payable	200
Total current liabilities	$84,032

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PROBLEM 11-2B

(a)	Jan.	2	Merchandise Inventory or Purchases	18,000	
			Accounts Payable		18,000
	Feb.	1	Accounts Payable	18,000	
			Notes Payable		18,000
	Mar.	31	Interest Expense ($18,000 X 10% X 2/12)	300	
			Interest Payable		300
	Apr.	1	Notes Payable	18,000	
			Interest Payable	300	
			Cash		18,300
	July	1	Equipment	35,000	
			Cash		11,000
			Notes Payable		24,000
	Sept.	30	Interest Expense ($24,000 X 10% X 3/12)	600	
			Interest Payable		600
	Oct.	1	Notes Payable	24,000	
			Interest Payable	600	
			Cash		24,600
	Dec.	1	Cash	10,000	
			Notes Payable		10,000
	Dec.	31	Interest Expense ($10,000 X 12% X 1/12)	100	
			Interest Payable		100

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PROBLEM 11-2B (Continued)

(b)

Notes Payable

4/1	18,000	2/1	18,000
10/1	24,000	7/1	24,000
		12/1	10,000
		12/31 Bal.	10,000

Interest Payable

4/1	300	3/31	300
10/1	600	9/30	600
		12/31	100
		12/31 Bal.	100

Interest Expense

3/31	300		
9/30	600		
12/31	100		
12/31 Bal.	1,000		

(c) Current liabilities

Notes payable	$10,000	
Interest payable	100	$10,100

(d) Total interest is $1,000.

(a)

HILLER DRUG STORE
Payroll Register
For the Week Ended February 15, 2008

		Earnings			Deductions							
Employee	Hours	Regular	Over-time	Gross Pay	FICA	Fed.	State	U.F.	Total	Net Pay	Store Wages Expense	Office Wages Expense
L. Steck	39	585.00	0	585.00	46.80	54.00	17.55	0	118.35	466.65	585.00	
S. Jabar	42	520.00	39.00	559.00	44.72	33.00	16.77	5.00	99.49	459.51	559.00	
M. Cape	44	480.00	72.00	552.00	44.16	61.00	16.56	7.50	129.22	422.78	552.00	
L. Wild	46	480.00	108.00	588.00	47.04	46.00	17.64	5.00	115.68	472.32		588.00
Totals		2,065.00	219.00	2,284.00	182.72	194.00	68.52	17.50	462.74	1,821.26	1,696.00	588.00

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PROBLEM 11-3B (Continued)

(b)	Feb. 15	Store Wages Expense	1,696.00	
		Office Wages Expense	588.00	
		FICA Taxes Payable		182.72
		Federal Income Taxes Payable		194.00
		State Income Taxes Payable		68.52
		United Fund Payable		17.50
		Wages Payable		1,821.26
	15	Payroll Tax Expense	324.33	
		FICA Taxes Payable ($2,284 X 8%)		182.72
		Federal Unemployment Taxes Payable ($2,284 X .8%)		18.27
		State Unemployment Taxes Payable ($2,284 X 5.4%)		123.34
(c)	Feb. 16	Wages Payable	1,821.26	
		Cash		1,821.26
(d)	Feb. 28	FICA Taxes Payable ($182.72 + $182.72)	365.44	
		Federal Income Taxes Payable	194.00	
		Cash		559.44

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PROBLEM 11-4B

(a)	Jan. 10	Union Dues Payable	250.00	
		Cash		250.00
	12	FICA Taxes Payable	662.20	
		Federal Income Taxes Payable	1,254.60	
		Cash		1,916.80
	15	U.S. Savings Bonds Payable	350.00	
		Cash		350.00
	17	State Income Taxes Payable	102.15	
		Cash		102.15
	20	Federal Unemployment Taxes Payable	312.00	
		State Unemployment Taxes Payable	1,954.40	
		Cash		2,266.40
	31	Office Salaries Expense	22,600.00	
		Store Wages Expense	27,400.00	
		FICA Taxes Payable		4,000.00
		Federal Income Taxes Payable		1,970.00
		State Income Taxes Payable		430.00
		Union Dues Payable		400.00
		United Fund Contributions Payable		1,800.00
		Wages Payable		41,400.00
	31	Wages Payable	41,400.00	
		Cash		41,400.00

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PROBLEM 11-4B (Continued)

(b)	**1.**	**Jan.**	**31**	**Payroll Tax Expense**	**7,100.00**	
				FICA Taxes Payable ($50,000 X 8%)		**4,000.00**
				Federal Unemployment Taxes Payable ($50,000 X .8%)		**400.00**
				State Unemployment Taxes Payable ($50,000 X 5.4%)		**2,700.00**
	***2.**		**31**	**Vacation Benefits Expense ($50,000 X 5%)**	**2,500.00**	
				Vacation Benefits Payable		**2,500.00**

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PROBLEM 11-5B

(a)	Administrative Salaries Expense	200,000	
	Electricians' Wages Expense	320,000	
	FICA Taxes Payable		36,000
	Federal Income Taxes Payable		159,000
	State Income Taxes Payable		15,600
	United Fund Contributions Payable		25,000
	Hospital Insurance Premiums Payable		15,800
	Wages Payable		268,600

(b)	Payroll Tax Expense	39,960	
	FICA Taxes Payable ($450,000 X 8%)		36,000
	Federal Unemployment Taxes Payable ($120,000 X .8%)		960
	State Unemployment Taxes Payable ($120,000 X 2.5%)		3,000

(c)

Employee	Wages, Tips, Other Compensation	Federal Income Tax Withheld	State Income Tax Withheld	FICA Wages	FICA Tax Withheld
R. Lopez	$60,000	$27,500	$1,800 (1)	$60,000	$4,800
K. Vopat	27,000	11,000	810 (2)	27,000	2,160

(1) $60,000 X 3%.
(2) $27,000 X 3%.

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BYP 11-1 FINANCIAL REPORTING PROBLEM

(a) Total current liabilities at December 31, 2005, $9,406 million. PepsiCo's total current liabilities increased by $2,654 ($9,406 – $6,752) million over the prior year.

(b) In Note 2 under the subheading "Commitments and Contingencies," PepsiCo states: "We recognize liabilities for contingencies and commitments when a loss is probable and estimable."

(c) The components of current liabilities are:

Short-term obligations	$2,889,000,000
Accounts payable and other current liabilities	5,971,000,000
Income taxes payable	546,000,000
Total current liabilities	$9,406,000,000

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BYP 11-2 COMPARATIVE ANALYSIS PROBLEM

(a) PepsiCo's largest current liability was "accounts payable and other liabilities" at $5,971 million. Its total current liabilities were $9,406 million. Coca-Cola's largest current liability was "loans and notes payable" at $4,518 million. Its total current liabilities were $9,836 million.

(b)

(in millions)	PepsiCo	Coca-Cola
(1) Working capital	$10,454 – $9,406 = $1,048	$10,250 – $9,836 = $414
(2) Current ratio	$\frac{\$10,454}{\$\ 9,406} = 1.11:1$	$\frac{\$10,250}{\$\ 9,836} = 1.04:1$

(c) Based on this information, it appears that both companies are only narrowly liquid. The working capital levels are both low, as are the current ratios.

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BYP 11-3 EXPLORING THE WEB

(a) A worker who performs services for you is your employee if you can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed. Get Pub. 15-A, Employer's Supplemental Tax Guide, for more information on how to determine whether an individual providing services is an independent contractor or an employee.

Generally, people in business for themselves are not employees. For example, doctors, lawyers, veterinarians, construction contractors, and others in an independent trade in which they offer their services to the public are usually not employees. However, if the business is incorporated, corporate officers who work in the business are employees.

(b) Payments for the services of a child under the age of 18 who works for his or her parent in a trade or business (sole proprietorship or a partnership in which each partner is a parent of the child) are not subject to social security and Medicare taxes. If these services are for work other than in a trade or business, such as domestic work in the parent's private home, they are not subject to social security and Medicare taxes until the child reaches 21.

(c) Any employee without a social security card can get one by completing Form SS-5, Application for a Social Security Card.

(d) Tips your employee receives are generally subject to withholding. Your employee must report cash tips to you by the 10th of the month after the month the tips are received. The report should include tips you paid over to the employee for charge customers and tips the employee received directly from customers. No report is required for months when tips are less than $20. Your employee reports the tips on Form 4070, Employee's Report of Tips to Employer, or on a similar statement.

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(e) In general, you must deposit income tax withheld and both the employer and employee social security and Medicare taxes (minus any advance EIC payments). You must deposit by using the Electronic Federal Tax Payment System (EFTPS) or by mailing or delivering a check, money order, or cash to an authorized financial institution or Federal Reserve bank using Form 8109 Federal Tax Deposit Coupon. However, some taxpayers are required to deposit by electronic funds transfer.

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BYP 11-4 DECISION MAKING ACROSS THE ORGANIZATION

(a) **METCALFE SERVICES INC.**

Months	Number of Employees	Days Worked	Daily Rate	Cost
January–March	2	60 (20 X 3)	$75	$ 9,000
April–May	3	50 (25 X 2)	75	11,250
June–October	2	90 (18 X 5)	75	13,500
November–December	3	46 (23 X 2)	75	10,350
Total Cost				$44,100

PERMANENT EMPLOYEES

Salaries ($21,000 X 2)		$42,000
Additional payroll costs		
FICA taxes (8% X $42,000)	$3,360	
Federal unemployment taxes (.8% X $14,000)	112	
State unemployment taxes (5.4% X $14,000)	756	
Medical and dental insurance (2 X $40 X 12)	960	5,188
		$47,188

Kensingtown Processing Company would save $3,088 ($47,188 – $44,100), as shown, by discharging the two employees and accepting the Metcalfe Services Inc. plan.

(b) Donna should consider the following additional factors:

(1) The effect on the morale of the continuing employees if two employees are terminated.

(2) The anticipated efficiency of Metcalfe Services Inc. workers compared to the efficiency of the two employees who would be terminated.

(3) The effect on management control and supervision of using Metcalfe Services Inc. personnel.

(4) The time that may be required to indoctrinate the different Metcalfe Services Inc. personnel into the Kensingtown Processing Company's procedures.

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BYP 11-5	COMMUNICATION ACTIVITY

Dear Mr. Quaney:

In response to your request, I wish to explain the types of taxes that are involved in determining the payroll and in recording and paying employer payroll taxes.

The taxes that are involved in determining the payroll are as follows:

1. **FICA taxes. These taxes were enacted by Congress to provide workers with supplemental retirement, employment disability, and medical benefits. These benefits are financed by a tax levied on employees' earnings. The tax rate and tax base are set by Congress and both change intermittently. Our text uses a rate of 8% on the first $90,000 of gross earnings. FICA taxes are withheld by the employer and then remitted to the government. These taxes are not an expense to the employer.**

2. **Federal income taxes. Employers are required to withhold federal income taxes from employees each pay period. The amount depends on the employee's gross earnings, the number of allowances claimed by the employee, and the length of the pay period. The amounts withheld are remitted by the employer to the government. These taxes are not an expense to the employer.**

3. **State and city income taxes. Where applicable, these income taxes are similar to federal income taxes.**

There are three types of payroll taxes that are levied on employers that are recognized as payroll tax expense by the employer.

1. **FICA taxes. The employer must match each employee's FICA contribution. The employer's tax is subject to the same rate and maximum earnings applicable to the employee.**

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2. Federal unemployment taxes. These taxes provide benefits to employees who lose their jobs through no fault of their own. The tax is 6.2% on the first $7,000 of gross earnings paid to each employee during a calendar year. The employer is allowed a maximum credit of 5.4% on the federal rate for contributions to state unemployment taxes.

3. State unemployment taxes. These taxes also provide benefits to employees who lose their jobs. The basic rate is usually 5.4% on the first $7,000 of wages paid to an employee during the year.

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BYP 11-6 ETHICS CASE

(a) The stakeholders in this situation are:

- **Daniel Longan, owner and manager.**
- **Sixteen part-time employees of Daniel's.**
- **Gina Watt, public accountant.**

(b) Not withholding federal and state taxes from employees' payroll is both illegal and unethical. Also, not paying FICA taxes, and state and federal unemployment taxes, is illegal and unethical.

(c) Gina Watt, as Daniel's public accountant, should not be an accomplice to improper payroll deductions and accounting. Gina should constantly remind Daniel of the consequences of his illegal payroll payments and the unrecorded payments. She should advise Daniel that not only is the government deprived of its proper tax revenues, but employees are deprived of social security and possibly Medicare credits as well as workmen's compensation insurance.

(d) An important internal control principle is to make no payments from cash receipts. All cash receipts should be deposited daily intact in the bank and all disbursements should be made by properly authorized and signed checks.

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BYP 11-7 ALL ABOUT YOU ACTIVITY

The answer to these questions depends on the state in which the student resides. It also will be depend on the year chosen, although we expect that the results will be much the same whether they pick any rates between 2005 and 2008. We provide a solution for this problem using the state of Wisconsin as an example. It should be pointed out that certain taxes can be deducted for computing federal income tax but are ignored in our computation.

(a) Wisconsin state income taxes for a single person with a taxable income of $60,000 is $3,710.80. The tax rate between $17,680 and $132,580 is $950.30 plus 6.5 percent over $17,680. Therefore the computation is as follows:

($60,000 – $17,680) X 6.5% =	$2,750
Base rate	950
Total state income tax	$3,710

(b) The property tax on a $200,000 home at 2.1% is $4,200.

(c) The state gasoline tax in Wisconsin is 32.9 cents per gallon and the federal gasoline tax is 18.4 cents per gallon. Your total taxes on gasoline are computed as follows:

400 gallons X ($0.329 + $0.184) = $205

(d) In Wisconsin the state sales tax rate is 5% and excludes food and prescription drug purchases. Therefore the sales tax is $200 ($4,000 X 5%).

(e) The social security rate is 7.65% on income of $60,000 or $4,590.

(f) Federal income taxes for a single person with a taxable income of $60,000 is $11,538. The tax rate between $30,650 and $74,200 is $4,220 plus 25% over $30,650. Therefore the computation is as follows:

($60,000 – $30,650) X 25% =	$ 7,338
Base rate	4,220
Total tax	$11,538

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BYP 11-7 (Continued)

The total taxes paid therefore are computed as follows, based on a $60,000 income amount:

State income tax	$ 3,710
Property tax on home	4,200
Gasoline tax	205
Sales tax	200
Social security tax	4,590
Federal income tax	11,538
Total tax	$24,443

The percentage of total taxes to income is therefore 41% ($24,443/$60,000), given the information above.

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CHAPTER 12

Accounting for Partnerships

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Identify the characteristics of the partnership form of business organization.	1, 2, 3, 4, 12		1		
2. Explain the accounting entries for the formation of a partnership.	5	1, 2	2, 3	1A	1B
3. Identify the bases for dividing net income or net loss.	6, 7, 8, 9, 10	3, 4, 5	4, 5	2A	2B
4. Describe the form and content of partnership financial statements.	11		6, 7	1A, 2A	1B, 2B
5. Explain the effects of the entries to record the liquidation of a partnership.	12, 13, 14, 15, 16	6	8, 9, 10	3A	3B
*6. Explain the effects of the entries when a new partner is admitted.	17, 18, 19, 20	7, 8	11, 12, 15	4A	4B
*7. Describe the effects of the entries when a partner withdraws from the firm.	20, 21, 22, 23	9, 10	13, 14, 15	5A	5B

*__Note:__ All **asterisked** Questions, Exercises, and Problems relate to material contained in the appendix to the chapter.

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ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Prepare entries for formation of a partnership and a balance sheet.	Simple	20–30
2A	Journalize divisions of net income and prepare a partners' capital statement.	Moderate	30–40
3A	Prepare entries with a capital deficiency in liquidation of a partnership	Moderate	30–40
*4A	Journalize admission of a partner under different assumptions.	Moderate	30–40
*5A	Journalize withdrawal of a partner under different assumptions.	Moderate	30–40
1B	Prepare entries for formation of a partnership and a balance sheet.	Simple	30–40
2B	Journalize divisions of net income and prepare a partners' capital statement.	Moderate	30–40
3B	Prepare entries and schedule of cash payments in liquidation of a partnership.	Moderate	30–40
*4B	Journalize admission of a partner under different assumptions.	Moderate	30–40
*5B	Journalize withdrawal of a partner under different assumptions.	Moderate	30–40

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BLOOM'S TAXONOMY TABLE

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Identify the characteristics of the partnership form of business organization.		Q12-1 Q12-4 Q12-2 Q12-12 Q12-3 E12-1				
2. Explain the accounting entries for the formation of a partnership.			Q12-5 E12-3 BE12-1 P12-1A BE12-2 P12-1B E12-2			
3. Identify the bases for dividing net income or net loss.		Q12-6 Q12-7 Q12-9	Q12-8 E12-4 Q12-10 E12-5 BE12-3 P12-2A BE12-4 P12-2B BE12-5			
4. Describe the form and content of partnership financial statements.		Q12-11	E12-6 P12-2A E12-7 P12-1B P12-1A P12-2B			
5. Explain the effects of the entries to record the liquidation of a partnership.		Q12-12 Q12-13 Q12-14	Q12-15 E12-9 Q12-16 E12-10 BE12-6 P12-3A E12-8 P12-3B			
*6. Explain the effects of the entries when a new partner is admitted.		Q12-17 Q12-18	Q12-19 E12-12 Q12-20 E12-15 BE12-7 P12-4A BE12-8 P12-4B E12-11			
*7. Describe the effects of the entries when a partner withdraws from the firm.		Q12-22 Q12-23	Q12-20 E12-14 Q12-21 E12-15 BE12-9 P12-5A BE12-10 P12-5B E12-13			
Broadening Your Perspective		Exploring the Web Decision Making Across the Organization			Communication All About You	Decision Making Across the Organization Ethics Case

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ANSWERS TO QUESTIONS

1. (a) Association of individuals. A partnership is a voluntary association of two or more individuals based on as simple an act as a handshake. Preferably, however, the agreement should be in writing. A partnership is both a legal entity and an accounting entity, but it is not a taxable entity.
(b) Limited life. A partnership does not have unlimited life. A partnership may be ended voluntarily or involuntarily. Thus, the life of a partnership is indefinite. Any change in the members of a partnership results in the dissolution of the partnership.
(c) Co-ownership of property. Partnership assets are co-owned by all the partners. If the partnership is terminated, the assets do not legally revert to the original contributor. Each partner has a claim on total assets equal to his or her capital balance. This claim does not attach to specific assets the individual partner contributed to the firm.

2. (a) Mutual agency. This characteristic means that the act of any partner is binding on all other partners when engaging in partnership business. This is true even when the partners act beyond the scope of their authority, so long as the act appears to be appropriate for the partnership.
(b) Unlimited liability. Each partner is personally and individually liable for all partnership liabilities. Creditors' claims attach first to partnership assets and then to personal resources of any partner, irrespective of that partner's equity in the partnership.

3. The advantages of a partnership are: (1) combining skills and resources of two or more individuals, (2) ease of formation, (3) freedom from governmental regulations and restrictions, and (4) ease of decision making. Disadvantages are: (1) mutual agency, (2) limited life, and (3) unlimited liability.

4. A limited partnership is used when a general partner(s) wish to raise cash without involving outside investors in management of the business. Limited partners in this case have limited personal liability for business debts as long as they don't participate in management.

5. The capital balance should be $102,000, comprised of land $65,000, and equipment $57,000, less debt $20,000.

6. When the partnership agreement does not specify the division of net income or net loss, net income and net loss should be divided equally.

7. Factors to be considered in determining how income and loss should be divided are: (1) a fixed ratio is easy to apply and it may be an equitable basis in some circumstances; (2) capital balance ratios when the funds invested in the partnership are considered the most critical factor; and (3) salary allowance and/or interest allowance coupled with a fixed ratio. This last approach gives specific recognition to differences that may exist among partners by providing salary allowances for time worked and interest allowances for capital invested.

8. The net income of $36,000 should be divided equally—$18,000 to M. Carson and $18,000 to R. Leno.

9. (a) Account debited: Income Summary; accounts credited: S. McMurray, Capital and F. Kohl, Capital.
(b) Account debited: S. McMurray, Drawing; account credited: Cash.

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10.

Division of Net Income

	T. Evans	R. Meloy	Total
Salary Allowance	$30,000	$25,000	$55,000
Deficiency: ($10,000) ($45,000 – $55,000)			
T. Evans (60% X $10,000)	(6,000)		(6,000)
R. Meloy (40% X $10,000)		(4,000)	(4,000)
Total division	$24,000	$21,000	$45,000

11. The financial statements of a partnership are similar to those of a proprietorship. The differences are due to the number of partners involved. The income statement for a partnership is identical to the income statement for a proprietorship except for the division of net income. The owners' equity statement is called the partners' capital statement. This statement shows the changes in each partner's capital account and in total partnership capital during the year. On the balance sheet each partner's capital balance is reported in the owners' equity section.

12. Liquidation of a partnership ends both the legal and economic life of the entity. Partnership dissolution occurs whenever a partner withdraws or a new partner is admitted. Dissolution does not necessarily mean that the business ends. If the continuing partners agree, operations can continue without interruption by forming a new partnership.

13. No, Bobby is not correct. All gains and losses on liquidation should be allocated to the partners on the basis of their income ratio. However, final cash distributions should be based on their capital balances.

14. Yes, Bill is correct. Capital balances are used because they represent the individual partner's equity in the partnership. The objective of the distribution is to eliminate the balance in each partner's capital account.

15.

Total cash after paying liabilities	$109,000
Total capital balances ($34,000 + $31,000 + $28,000)	93,000
Excess (gain on sale of noncash assets)	$ 16,000
Allocated to Keegan ($16,000 X 3/10)	$ 4,800
Cash to Keegan ($31,000 + $4,800)	$ 35,800

16.

Capital deficiency, M. Jeter	$ 8,000
Loss allocated to: L. Pattison, capital ($8,000 X 3/8)	$ 3,000
Cash to L. Pattison ($12,000 – $3,000)	$ 9,000

***17.** This transaction represents the purchase of an existing partner's interest. It is a personal transaction that has no effect on partnership net assets.

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***18.** Partnership net assets increase $25,000. No, Steve Renn does not necessarily acquire a 1/6 income ratio. Unless stated otherwise, net income or net loss is divided evenly among all partners.

***19.**	Grant, Capital	66,000	
	Kate Robidou, Capital		66,000
***20.**	Tracy Harper, Capital	39,000	
	Kim Remington, Capital		39,000

***21** Newlin's share of the bonus is $3,000 computed as follows:

Partnership assets		$85,000
Capital credit, Perry		77,000
Bonus to retiring partner		8,000
Allocated to:		
Garland: $8,000 X 5/8 =	$5,000	
Newlin: $8,000 X 3/8 =	3,000	8,000
		$ 0

***22.** Recording the revaluations violates the cost principle, which requires that assets be stated at original cost. It is also a departure from the going-concern assumption, which assumes the entity will continue indefinitely.

***23.** When a partner dies, it is usually necessary to determine the partner's equity at the date of death by: (1) determining the net income or loss for the year to date, (2) closing the books, and (3) preparing financial statements. The partnership agreement may also require an audit of the financial statements by independent auditors and a revaluation of assets by an appraisal firm.

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SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 12-1

Cash	10,000	
Equipment	5,000	
Stanley Farrin, Capital		15,000

BRIEF EXERCISE 12-2

Accounts Receivable	$16,000	
Less: Allowance for doubtful accounts	2,500	$13,500
Equipment		11,000

Accumulated depreciation should not be shown because a new company cannot have any accumulated depreciation.

BRIEF EXERCISE 12-3

The division is: Held $42,000 ($70,000 X 60%) and Bond $28,000 ($70,000 X 40%).
The entry is:

Income Summary	70,000	
Held, Capital		42,000
Bond, Capital		28,000

BRIEF EXERCISE 12-4

Division of Net Income

	Espino	Sears	Utech	Total
Salary allowance	$15,000	$ 5,000	$ 5,000	$25,000
Remaining income, $30,000: ($55,000 – $25,000)				
C ($30,000 X 50%)	15,000			
S ($30,000 X 30%)		9,000		
N ($30,000 X 20%)			6,000	
Total remainder				30,000
Total division	$30,000	$14,000	$11,000	$55,000

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BRIEF EXERCISE 12-5

Division of Net Income

	Joe	Sam	Total
Salary allowance	$15,000	$10,000	$25,000
Interest allowance	7,000	5,000	12,000
Remaining deficiency, ($9,000):			
[($25,000 + $12,000) – $28,000]			
Joe ($9,000 X 50%)	(4,500)		
Sam ($9,000 X 50%)		(4,500)	
Total remainder			(9,000)
Total division	$17,500	$10,500	$28,000

BRIEF EXERCISE 12-6

A, Capital	8,000	
L, Capital	7,000	
F, Capital	4,000	
Cash		19,000

*BRIEF EXERCISE 12-7

Cox, Capital	10,000	
Day, Capital		10,000

*BRIEF EXERCISE 12-8

Cash	52,000	
Menke, Capital (50% X $11,900*)	5,950	
Hibbett, Capital (50% X $11,900)	5,950	
Kosko, Capital (45% X $142,000)		63,900

*[($40,000 + $50,000 + $52,000) X 45%] – $52,000 = $11,900.

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*BRIEF EXERCISE 12-9

Denny, Capital	18,000	
Messer, Capital		9,000
Isch, Capital		9,000

*BRIEF EXERCISE 12-10

Denny, Capital	18,000	
Messer, Capital (50% X $6,000)	3,000	
Isch, Capital (50% X $6,000)	3,000	
Cash		24,000

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SOLUTIONS TO EXERCISES

EXERCISE 12-1

1. False. A partnership is an association of *two* or more persons to carry on as co-owners of a business for profit.
2. False. Partnerships are fairly easy to form; they can be formed simply by a verbal agreement.
3. False. A partnership *is* an entity for financial reporting purposes.
4. False. The net income of a partnership is *not* taxed as a separate entity.
5. True.
6. True.
7. False. When a partnership is dissolved, the assets do *not* revert to the original contributor.
8. True.
9. False. Mutual agency is a *disadvantage* of the partnership form of business.

EXERCISE 12-2

(a)	Cash	50,000	
	Meissner, Capital		50,000
	Land	15,000	
	Building	80,000	
	Cohen, Capital		95,000
	Cash	9,000	
	Accounts Receivable	32,000	
	Equipment	19,000	
	Allowance for Doubtful Accounts		3,000
	Hughes, Capital		57,000

(b) $50,000 + $95,000 + $57,000 = $202,000

EXERCISE 12-3

Jan. 1	Cash	12,000	
	Accounts Receivable	14,000	
	Equipment	13,500	
	Allowance for Doubtful Accounts		3,000
	Jack Herington, Capital		36,500

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EXERCISE 12-4

(a) (1) **DIVISION OF NET INCOME**

	F. Calvert	G. Powers	Total
Salary allowance	$20,000	$12,000	$32,000
Interest allowance			
F. Calvert ($50,000 X 10%)	5,000		
G. Powers ($40,000 X 10%)		4,000	
Total interest			9,000
Total salaries and interest	25,000	16,000	41,000
Remaining income, $9,000 ($50,000 – $41,000)			
F. Calvert ($9,000 X 60%)	5,400		
G. Powers ($9,000 X 40%)		3,600	
Total remainder			9,000
Total division	$30,400	$19,600	$50,000

(2) **DIVISION OF NET INCOME**

	F. Calvert	G. Powers	Total
Salary allowance	$20,000	$12,000	$32,000
Interest allowance	5,000	4,000	9,000
Total salaries and interest	25,000	16,000	41,000
Remaining deficiency, ($5,000) ($41,000 – $36,000)			
F. Calvert ($5,000 X 60%)	(3,000)		
G. Powers ($5,000 X 40%)		(2,000)	
Total remainder			(5,000)
Total division	$22,000	$14,000	$36,000

(b) (1)

Income Summary	50,000	
F. Calvert, Capital		30,400
G. Powers, Capital		19,600

(2)

Income Summary	36,000	
F. Calvert, Capital		22,000
G. Powers, Capital		14,000

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EXERCISE 12-5

(a)	Income Summary	70,000	
	O. Guillen, Capital ($70,000 X 45%)		31,500
	K. Williams, Capital ($70,000 X 55%)		38,500
(b)	Income Summary	70,000	
	O. Guillen, Capital [$30,000 + ($15,000 X 45%)]		36,750
	K. Williams, Capital [$25,000 + ($15,000 X 55%)]		33,250
(c)	Income Summary	70,000	
	O. Guillen, Capital		36,000
	K. Williams, Capital		34,000

Guillen: [$40,000 + $6,000 – ($20,000 X 50%)]
Williams: [$35,000 + $9,000 – ($20,000 X 50%)]

(d) Guillen: $60,000 + $36,000 – $18,000 = $78,000
Williams: $90,000 + $34,000 – $24,000 = $100,000

EXERCISE 12-6

(a)

STARRITE CO.
Partners' Capital Statement
For the Year Ended December 31, 2008

	G. Stark	J. Nyland	Total
Capital, January 1	$20,000	$18,000	$38,000
Add: Net income	15,000	15,000	30,000
	35,000	33,000	68,000
Less: Drawings	8,000	5,000	13,000
Capital, December 31	$27,000	$28,000	$55,000

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EXERCISE 12-6 (Continued)

(b)

STARRITE CO.
Partial Balance Sheet
December 31, 2008

Owners' equity		
G. Stark, Capital	$27,000	
J. Nyland, Capital	28,000	
Total owners' equity		$55,000

EXERCISE 12-7

THE STOOGES PARTNERSHIP
Balance Sheet
December 31, 2008

Assets			
Current Assets			
Cash		$37,000	
Accounts Receivable	$36,000		
Less: Allowance for Doubtful Accounts	(4,000)	32,000	
Supplies		3,000	
Total current assets			$ 72,000
Property, Plant and Equipment			
Land		$18,000	
Building		75,000	
Equipment		47,000	
Total property, plant, and equipment			140,000
Total assets			$212,000
Liabilities and Owners' Equity			
Long-term Liabilities			
Mortgage Payable			$ 20,000
Owners' Equity			
Moe, Capital		$55,000	
Larry, Capital		73,000	
Curly, Capital		64,000	
Total owners' equity			192,000
Total liabilities and owners' equity			$212,000

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EXERCISE 12-8

THE BEST COMPANY
Schedule of Cash Payments

Item	Cash	+	Noncash Assets	=	Liabilities	+	Rodriguez Capital	+	Escobedo Capital
Balances before liquidation	$ 20,000		$100,000		$55,000		$45,000		$20,000
Sale of noncash assets and allocation of gain	110,000		(100,000)				6,000		4,000
New balances	130,000		0		55,000		51,000		24,000
Pay liabilities	(55,000)				(55,000)				
New balances	75,000		0		0		51,000		24,000
Cash distribution to partners	(75,000)						(51,000)		(24,000)
Final balances	$ 0		$ 0		$ 0		$ 0		$ 0

EXERCISE 12-9

(a)	Cash	110,000	
	Noncash Assets		100,000
	Gain on Realization		10,000
(b)	Gain on Realization	10,000	
	Rodriguez, Capital ($10,000 X 60%)		6,000
	Escobedo, Capital ($10,000 X 40%)		4,000
(c)	Liabilities	55,000	
	Cash		55,000
(d)	Rodriguez, Capital	51,000	
	Escobedo, Capital	24,000	
	Cash		75,000

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EXERCISE 12-10

(a)	(1)	Cash	4,000	
		Farley, Capital		4,000
	(2)	Newell, Capital	17,000	
		Jennings, Capital	15,000	
		Cash		32,000
(b)	(1)	Newell, Capital ($4,000 X 5/8)	2,500	
		Jennings, Capital ($4,000 X 3/8)	1,500	
		Farley, Capital		4,000
	(2)	Newell, Capital ($17,000 – $2,500)	14,500	
		Jennings, Capital ($15,000 – $1,500)	13,500	
		Cash		28,000

*EXERCISE 12-11

(a)	J. Lynn, Capital ($30,000 X 50%)	15,000	
	D. Duran, Capital		15,000
(b)	M. Oller, Capital ($26,000 X 50%)	13,000	
	D. Duran, Capital		13,000
(c)	F. Tate, Capital ($18,000 X 33 1/3%)	6,000	
	D. Duran, Capital		6,000

*EXERCISE 12-12

(a)	Cash	90,000	
	G. Olde, Capital (6/10 X $12,000)		7,200
	R. Young, Capital (4/10 X $12,000)		4,800
	K. Twener, Capital		78,000

Total capital of existing partnership	$170,000
Investment by new partner, Twener	90,000
Total capital of new partnership	$260,000
Twener's capital credit (30% X $260,000)	$ 78,000

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***EXERCISE 12-12 (Continued)**

Investment by new partner, Twener.....	$ 90,000
Twener's capital credit	78,000
Bonus to old partners.....	$ 12,000

(b)	Cash.....	50,000	
	G. Olde, Capital (6/10 X $16,000).....	9,600	
	R. Young, Capital (4/10 X $16,000).....	6,400	
	K. Twener, Capital		66,000

Total capital of existing partnership.....	$170,000
Investment by new partner, Twener.....	50,000
Total capital of new partnership	$220,000
Twener's capital credit	$ 66,000
(30% X $220,000)	
Investment by new partner, Twener.....	$ 50,000
Twener's capital credit	66,000
Bonus to new partner	$ 16,000

***EXERCISE 12-13**

1.	S. Nguyen, Capital.....	32,000	
	B. Cates, Capital		16,000
	V. Elder, Capital		16,000
2.	S. Nguyen, Capital	32,000	
	V. Elder, Capital		32,000
3.	S. Nguyen, Capital	32,000	
	B. Cates, Capital		32,000

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*EXERCISE 12-14

1.	R. Fisk, Capital		60,000	
	H. Barrajas, Capital ($8,000 X 5/8)		5,000	
	T. Dingler, Capital ($8,000 X 3/8)		3,000	
	Cash			68,000
	Capital balance of withdrawing partner		$60,000	
	Payment to withdrawing partner		68,000	
	Bonus to retiring partner		$ 8,000	
	Allocation of bonus			
	Barrajas, Capital ($8,000 X 5/8)	$5,000		
	Dingler, Capital ($8,000 X 3/8)	3,000	$ 8,000	
2.	R. Fisk, Capital		60,000	
	H. Barrajas, Capital ($4,000 X 5/8)			2,500
	T. Dingler, Capital ($4,000 X 3/8)			1,500
	Cash			56,000
	Capital balance of withdrawing partner		$60,000	
	Payment to withdrawing partner		56,000	
	Bonus to remaining partners		$ 4,000	
	Allocation of bonus			
	Barrajas, Capital ($4,000 X 5/8)	$2,500		
	Dingler, Capital ($4,000 X 3/8)	1,500	$ 4,000	

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*EXERCISE 12-15

(a)	Cash	80,000	
	Stewart, Capital ($280,000 X 25%)		70,000
	Carson, Capital ($10,000 X 50%)		5,000
	Letterman, Capital ($10,000 X 30%)		3,000
	O'Brien, Capital ($10,000 X 20%)		2,000
(b)	Carson, Capital	100,000	
	Letterman, Capital ($20,000 X 3/5)	12,000	
	O'Brien, Capital ($20,000 X 2/5)	8,000	
	Cash		120,000

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SOLUTIONS TO PROBLEMS

PROBLEM 12-1A

(a)	Jan. 1	Cash	14,000	
		Accounts Receivable	17,500	
		Merchandise Inventory	28,000	
		Equipment	23,000	
		Allowance for Doubtful Accounts		4,500
		Notes Payable		18,000
		Accounts Payable		22,000
		Patrick, Capital		38,000
	1	Cash	12,000	
		Accounts Receivable	26,000	
		Merchandise Inventory	20,000	
		Equipment	16,000	
		Allowance for Doubtful Accounts		4,000
		Notes Payable		15,000
		Accounts Payable		31,000
		Samuelson, Capital		24,000
(b)	Jan. 1	Cash	5,000	
		Patrick, Capital		5,000
	1	Cash	19,000	
		Samuelson, Capital		19,000

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PROBLEM 12-1A (Continued)

(c)

PASA COMPANY
Balance Sheet
January 1, 2008

Assets		
Current assets		
Cash ($14,000 + $12,000 + $5,000 + $19,000)		$ 50,000
Accounts receivable ($17,500 + $26,000)	$43,500	
Less: Allowance for doubtful accounts ($4,500 + $4,000)	8,500	35,000
Merchandise inventory ($28,000 + $20,000)		48,000
Total current assets		133,000
Property, plant, and equipment		
Equipment ($23,000 + $16,000)		39,000
Total assets		$172,000
Liabilities and Owners' Equity		
Current liabilities		
Notes payable ($18,000 + $15,000)		$ 33,000
Accounts payable ($22,000 + $31,000)		53,000
Total current liabilities		86,000
Owners' equity		
Patrick, Capital ($38,000 + $5,000)	$43,000	
Samuelson, Capital ($24,000 + $19,000)	43,000	
Total owners' equity		86,000
Total liabilities and owners' equity		$172,000

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PROBLEM 12-2A

(a)	(1)	Income Summary	30,000	
		Reese Caplin, Capital ($30,000 X 60%)		18,000
		Phyllis Newell, Capital ($30,000 X 30%)		9,000
		Betty Uhrich, Capital ($30,000 X 10%)		3,000
	(2)	Income Summary	37,000	
		Reese Caplin, Capital ($15,000 + $4,000)		19,000
		Phyllis Newell, Capital ($10,000 + $4,000)		14,000
		Betty Uhrich, Capital ($0 + $4,000)		4,000

Net income	$37,000
Salary allowance	
Caplin	(15,000)
Newell	(10,000)
Remainder	$12,000
To each partner ($12,000 X 1/3)	$ 4,000

	(3)	Income Summary	19,000	
		Reese Caplin, Capital ($4,800 + $12,000 – $1,100)		15,700
		Phyllis Newell, Capital ($3,000 – $1,100)		1,900
		Betty Uhrich, Capital ($2,500 – $1,100)		1,400

Net income	$19,000
Interest allowance	
Caplin ($48,000 X 10%)	(4,800)
Newell ($30,000 X 10%)	(3,000)
Uhrich ($25,000 X 10%)	(2,500)
Balance	8,700
Salary allowance	
Caplin	(12,000)
Remainder	$ (3,300)
To each partner ($3,300 X 1/3)	$ (1,100)

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PROBLEM 12-2A (Continued)

(b) **DIVISION OF NET INCOME**

	Reese Caplin	Phyllis Newell	Betty Uhrich	Total
Salary allowance	$12,000			$12,000
Interest allowance				
Reese Caplin ($48,000 X 10%)	4,800			
Phyllis Newell ($30,000 X 10%)		$3,000		
Betty Uhrich ($25,000 X 10%)			$2,500	
Total interest				10,300
Total salaries and interest	16,800	3,000	2,500	22,300
Remaining deficiency, ($3,300)				
Reese Caplin ($3,300 X 1/3)	(1,100)			
Phyllis Newell ($3,300 X 1/3)		(1,100)		
Betty Uhrich ($3,300 X 1/3)			(1,100)	
Total remainder				(3,300)
Total division	$15,700	$1,900	$1,400	$19,000

(c)

CNU COMPANY
Partners' Capital Statement
For the Year Ended December 31, 2008

	Reese Caplin	Phyllis Newell	Betty Uhrich	Total
Capital, January 1	$48,000	$30,000	$25,000	$103,000
Add: Net income	15,700	1,900	1,400	19,000
	63,700	31,900	26,400	122,000
Less: Drawings	23,000	14,000	10,000	47,000
Capital, December 31	$40,700	$17,900	$16,400	$ 75,000

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PROBLEM 12-3A

(a)

(1)

Cash		55,000	
Allowance for Doubtful Accounts		1,000	
Accumulated Depreciation		5,500	
Loss on Realization		19,000	
Accounts Receivable			25,000
Merchandise Inventory			34,500
Equipment			21,000

Noncash assets (net)	$74,000
Sale proceeds	55,000
Loss on sale of noncash assets	$19,000

(2)

M. Mantle, Capital ($19,000 X 5/10)		9,500	
W. Mays, Capital ($19,000 X 3/10)		5,700	
D. Snider, Capital ($19,000 X 2/10)		3,800	
Loss on Realization			19,000

(3)

Notes Payable		13,500	
Accounts Payable		27,000	
Wages Payable		4,000	
Cash			44,500

(4)

Cash		800	
D. Snider, Capital ($3,800 – $3,000)			800

(5)

M. Mantle, Capital ($33,000 – $9,500)		23,500	
W. Mays, Capital ($21,000 – $5,700)		15,300	
Cash			38,800

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PROBLEM 12-3A (Continued)

(b)

Cash			
Bal.	27,500	(3)	44,500
(1)	55,000	(5)	38,800
(4)	800		
	83,300		83,300

M. Mantle, Capital			
(2)	9,500	Bal.	33,000
(5)	23,500		
	33,000		33,000

W. Mays, Capital			
(2)	5,700	Bal.	21,000
(5)	15,300		
	21,000		21,000

D. Snider, Capital			
(2)	3,800	Bal.	3,000
		(4)	800
	3,800		3,800

(c)

(1)	M. Mantle, Capital ($800 X 5/8)	500	
	W. Mays, Capital ($800 X 3/8)	300	
	D. Snider, Capital		800
(2)	M. Mantle, Capital ($23,500 – $500)	23,000	
	W. Mays, Capital ($15,300 – $300)	15,000	
	Cash ($38,800 – $800)		38,000

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*PROBLEM 12-4A

(a)	(1)	T. Gomez, Capital	9,000	
		D. Atchley, Capital		9,000
	(2)	J. Kensington, Capital	18,000	
		D. Atchley, Capital		18,000
	(3)	Cash	66,000	
		S. Seger, Capital (50% X $9,000)		4,500
		J. Kensington, Capital (40% X $9,000)		3,600
		T. Gomez, Capital (10% X $9,000)		900
		D. Atchley, Capital		57,000

Total capital of existing partnership	$124,000
Investment by Atchley	66,000
Total capital of new partnership	$190,000
Atchley's capital credit ($190,000 X 30%)	$ 57,000

Investment by new partner, Atchley	$ 66,000
Atchley's capital credit	57,000
Bonus to old partners	$ 9,000

	(4)	Cash	46,000	
		S. Seger, Capital ($5,000 X 50%)	2,500	
		J. Kensington, Capital ($5,000 X 40%)	2,000	
		T. Gomez, Capital ($5,000 X 10%)	500	
		D. Atchley, Capital		51,000

Total capital of existing partnership	$124,000
Investment by Atchley	46,000
Total capital of new partnership	$170,000

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***PROBLEM 12-4A (Continued)**

Atchley's capital credit ($170,000 X 30%)	$51,000
Investment by new partner	$46,000
Atchley's capital credit	51,000
Bonus to new partner	$ 5,000

(b) (1)

Total capital after admission ($32,000 ÷ 20%)	$160,000
Total capital before admission	124,000
Cash investment by Atchley	$ 36,000

(2)

Decrease in Kensington's equity ($54,000 – $32,000)	$ 22,000
Kensington's income ratio	40%
Bonus to new partner ($22,000 ÷ 40%)	$ 55,000

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*PROBLEM 12-5A

(a)	(1)	K. Durham, Capital	26,000	
		J. Fagan, Capital		13,000
		P. Ames, Capital		13,000
	(2)	K. Durham, Capital	26,000	
		P. Ames, Capital		26,000
	(3)	K. Durham, Capital	26,000	
		J. Fagan, Capital ($8,000 X 5/8)	5,000	
		P. Ames, Capital ($8,000 X 3/8)	3,000	
		Cash		34,000

Durham's capital balance	$26,000
Payment to Durham	34,000
Bonus to Durham	$ 8,000

	(4)	K. Durham, Capital	26,000	
		J. Fagan, Capital ($4,000 X 5/8)		2,500
		P. Ames, Capital ($4,000 X 3/8)		1,500
		Cash		22,000

Durham's capital balance	$26,000
Payment to Durham	22,000
Bonus to old partners	$ 4,000

(b)	(1)	Ames's capital after withdrawal	$42,400
		Ames's capital before withdrawal	40,000
		Bonus to Ames	2,400
		Ames's income ratio with Fagan	3/8
		Total bonus ($2,400 ÷ 3/8)	$ 6,400
	(2)	Durham's capital balance	$26,000
		Total bonus to other partners	(6,400)
		Cash paid to Durham	$19,600

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PROBLEM 12-1B

(a)	Jan. 1	Cash	9,500	
		Accounts Receivable	15,000	
		Merchandise Inventory	32,000	
		Equipment	28,000	
		Allowance for Doubtful Accounts		3,500
		Notes Payable		25,000
		Accounts Payable		20,000
		Free, Capital		36,000
	1	Cash	6,000	
		Accounts Receivable	23,000	
		Merchandise Inventory	21,000	
		Equipment	18,000	
		Allowance for Doubtful Accounts		5,000
		Accounts Payable		37,000
		Will, Capital		26,000
(b)	Jan. 1	Cash	3,000	
		Free, Capital		3,000
	1	Cash	13,000	
		Will, Capital		13,000

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PROBLEM 12-1B (Continued)

(c)

FREE-WILL COMPANY
Balance Sheet
January 1, 2008

Assets		
Current assets		
Cash ($9,500 + $6,000 + $3,000 + $13,000)		$ 31,500
Accounts receivable ($15,000 + $23,000)	$38,000	
Less: Allowance for doubtful accounts ($3,500 + $5,000)	8,500	29,500
Merchandise inventory ($32,000 + $21,000)		53,000
Total current assets		114,000
Property, plant, and equipment		
Equipment ($28,000 + $18,000)		46,000
Total assets		$160,000
Liabilities and Owners' Equity		
Current liabilities		
Notes payable		$ 25,000
Accounts payable ($20,000 + $37,000)		57,000
Total current liabilities		82,000
Owners' equity		
Free, Capital ($36,000 + $3,000)	$39,000	
Will, Capital ($26,000 + $13,000)	39,000	
Total owners' equity		78,000
Total liabilities and owners' equity		$160,000

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PROBLEM 12-2B

(a) (1)

Income Summary	40,000	
J. Reno, Capital ($40,000 X 50%)		20,000
L. Augustine, Capital ($40,000 X 30%)		12,000
J. Fritz, Capital ($40,000 X 20%)		8,000

(2)

Income Summary	30,000	
J. Reno, Capital ($11,000 + $3,000)		14,000
L. Augustine, Capital ($10,000 + $3,000)		13,000
J. Fritz, Capital ($0 + $3,000)		3,000

Net income	$30,000
Salary allowances	
Reno	(11,000)
Augustine	(10,000)
Remainder	$ 9,000
To each partner ($9,000 X 1/3)	$ 3,000

(3)

Income Summary	27,000	
J. Reno, Capital ($3,300 + $18,000 + $900)		22,200
L. Augustine, Capital ($2,000 + $900)		2,900
J. Fritz, Capital ($1,000 + $900)		1,900

Net income	$27,000
Interest allowance	
Reno ($33,000 X 10%)	(3,300)
Augustine ($20,000 X 10%)	(2,000)
Fritz ($10,000 X 10%)	(1,000)
Balance	20,700
Salary allowance	
Reno	(18,000)
Remainder	$ 2,700
To each partner ($2,700 X 1/3)	$ 900

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PROBLEM 12-2B (Continued)

(b)

DIVISION OF NET INCOME

	J. Reno	L. Augustine	J. Fritz	Total
Salary allowance	$18,000			$18,000
Interest allowance				
J. Reno ($33,000 X 10%)	3,300			
L. Augustine ($20,000 X 10%)		$2,000		
J. Fritz ($10,000 X 10%)			$1,000	
Total interest				6,300
Total salaries and interest	21,300	2,000	1,000	24,300
Remaining income, $2,700				
J. Reno ($2,700 X 1/3)	900			
L. Augustine ($2,700 X 1/3)		900		
J. Fritz ($2,700 X 1/3)			900	
Total remainder				2,700
Total division	$22,200	$2,900	$1,900	$27,000

(c)

RAF COMPANY
Partners' Capital Statement
For the Year Ended December 31, 2008

	J. Reno	L. Augustine	J. Fritz	Total
Capital, January 1	$33,000	$20,000	$10,000	$63,000
Add: Net income	22,200	2,900	1,900	27,000
	55,200	22,900	11,900	90,000
Less: Drawings	12,000	9,000	4,000	25,000
Capital, December 31	$43,200	$13,900	$ 7,900	$65,000

(a)

SHAWNEE COMPANY
Schedule of Cash Payments

Item	Cash	+	Noncash Assets	=	Liabilities	+	Neeley	+	Hannah	+	Doonan
Balances before liquidation	$28,000	+	$53,000	=	$42,000	+	$23,000	+	$11,200		$4,800
Sale of noncash assets and allocation of loss (1) + (2)	43,000	+	(53,000)	=			(5,000)	+	(3,000)		(2,000)
New balances	71,000	+	0	=	42,000	+	18,000	+	8,200		2,800
Pay liabilities (3)	(42,000)			=	(42,000)						
New balances	29,000	+	0	=	0	+	18,000	+	8,200		2,800
Cash distribution to partners (4)	29,000		0	=	0		(18,000)	+	(8,200)		(2,800)
Final balances	$ 0		$ 0		$ 0		$ 0		$ 0		$ 0

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PROBLEM 12-3B (Continued)

(b)

(1)

Apr. 30	Cash		43,000	
	Allowance for Doubtful Accounts		1,000	
	Accumulated Depreciation		10,000	
	Loss on Realization		10,000	
	Accounts Receivable			19,000
	Merchandise Inventory			28,000
	Equipment			17,000

Noncash assets (net)	$53,000
Sale proceeds	43,000
Loss on sale of noncash assets	$10,000

(2)

30	Neeley, Capital ($10,000 X 50%)		5,000	
	Hannah, Capital ($10,000 X 30%)		3,000	
	Doonan, Capital ($10,000 X 20%)		2,000	
	Loss on Realization			10,000

(3)

30	Notes Payable		16,000	
	Accounts Payable		24,000	
	Wages Payable		2,000	
	Cash			42,000

(4)

30	Neeley, Capital ($23,000 – $5,000)		18,000	
	Hannah, Capital ($11,200 – $3,000)		8,200	
	Doonan, Capital ($4,800 – $2,000)		2,800	
	Cash			29,000

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PROBLEM 12-3B (Continued)

(c)

Cash

4/30 Bal.	28,000	4/30 (3)	42,000
30 (1)	43,000	30 (4)	29,000
	71,000		71,000

Hannah, Capital

4/30 (2)	3,000	4/30 Bal.	11,200
30 (4)	8,200		
	11,200		11,200

Neeley, Capital

4/30 (2)	5,000	4/30 Bal.	23,000
30 (4)	18,000		
	23,000		23,000

Doonan, Capital

4/30 (2)	2,000	4/30 Bal.	4,800
30 (4)	2,800		
	4,800		4,800

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*PROBLEM 12-4B

(a)	(1)	Rothlisberger, Capital	12,000	
		Wamser, Capital		12,000
	(2)	Norrison, Capital	13,000	
		Wamser, Capital		13,000
	(3)	Cash	46,000	
		Alexander, Capital ($12,000 X 5/10)	6,000	
		Norrison, Capital ($12,000 X 3/10)	3,600	
		Rothlisberger, Capital ($12,000 X 2/10)	2,400	
		Wamser, Capital		58,000

Total capital of existing partnership	$ 99,000
Investment by Wamser	46,000
Total capital of new partnership	$145,000
Wamser's capital credit ($145,000 X 40%)	$ 58,000

Investment by new partner, Wamser	$ 46,000
Wamser's capital credit	58,000
Bonus to new partner	$ 12,000

	(4)	Cash	30,000	
		Alexander, Capital ($4,200 X 5/10)		2,100
		Norrison, Capital ($4,200 X 3/10)		1,260
		Rothlisberger, Capital ($4,200 X 2/10)		840
		Wamser, Capital		25,800

Total capital of existing partnership	$ 99,000
Investment by Wamser	30,000
Total capital of new partnership	$129,000

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***PROBLEM 12-4B (Continued)**

Wamser's capital credit ($129,000 X 20%)	$25,800
Investment by new partner, Wamser	$30,000
Wamser's capital credit	25,800
Bonus to old partners	$ 4,200

(b)	Total capital after admission ($27,000 ÷ 15%)	$180,000
	Total capital before admission	99,000
(1)	Cash investment by Wamser	$ 81,000
	Increase in Rothlisberger's equity ($27,000 – $24,000)	$ 3,000
	Rothlisberger's income ratio	2/10
(2)	Total bonus to old partners ($3,000 ÷ 2/10)	$ 15,000

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*PROBLEM 12-5B

(a)	(1)	B. Jack, Capital	20,000	
		A. King, Capital		10,000
		L. Queen, Capital		10,000
	(2)	B. Jack, Capital	20,000	
		L. Queen, Capital		20,000
	(3)	B. Jack, Capital	20,000	
		A. King, Capital ($6,000 X 6/9)	4,000	
		L. Queen, Capital ($6,000 X 3/9)	2,000	
		Cash		26,000

Jack's capital balance	$20,000
Payment to Jack	26,000
Bonus to Jack	$ 6,000

	(4)	B. Jack, Capital	20,000	
		A. King, Capital ($9,000 X 6/9)		6,000
		L. Queen, Capital ($9,000 X 3/9)		3,000
		Cash		11,000

Jack's capital balance	$20,000
Payment to Jack	11,000
Bonus to remaining partners	$ 9,000

(b)	(1)	Queen's capital after withdrawal	$32,000
		Queen's capital before withdrawal	30,000
		Bonus to Queen	$ 2,000
		Queen's income ratio with King	3/9
		Total bonus ($2,000 ÷ 3/9)	$ 6,000
	(2)	Jack's capital balance	$20,000
		Total bonus to remaining partners	(6,000)
		Cash paid to Jack	$14,000

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BYP 12-1 EXPLORING THE WEB

Students' answers will depend upon the firm selected and the timing of their exploration.

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BYP 12-2 DECISION MAKING ACROSS THE ORGANIZATION

(a) The major disadvantages of a partnership are mutual agency, limited life, and unlimited liability. Mutual agency means that each partner acts on behalf of the partnership when engaging in partnership business. The act of any partner is binding on all other partners, even when the partners act beyond the scope of their authority, so long as the act appears to be appropriate for the partnership. A partnership does not have unlimited life. A partnership may be ended voluntarily or involuntarily. For the partnership discussed here, limited life does not appear to be a major drawback. Unlimited liability means that each partner is personally and individually liable for all partnership liabilities. Creditors' claims attach first to partnership assets, then to the personal resources of any partner, irrespective of that partner's capital equity in the company. This is a major limitation of a partnership.

(b) The written partnership agreement, often referred to as the articles of co-partnership, is needed. It should contain such basic information as the name and principal location of the firm, the purpose of the business, and date of inception. In addition, the following should be specified: (1) names and capital contributions of partners, (2) rights and duties of partners, (3) basis for sharing net income or net loss, (4) provision for withdrawals of assets, (5) procedures for submitting disputes to arbitration, (6) procedures for the withdrawal or addition of a partner, and (7) rights and duties of surviving partners in the event of a partner's death.

(c) The best approach would be to give Richard an interest allowance for the additional investment. This approach would therefore permit each party to share equally in net income or net loss after the interest allowance.

(d) The computer equipment should be depreciated on the books of the partnership, not on Richard's personal tax return. The computer is owned by the partnership, and only Richard's share of net income should be reported on his tax return. The computer would be reported at its fair market value when invested in the partnership, less the accumulated depreciation as of the end of the taxable year.

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(e) To facilitate the payment from partnership assets of the deceased partner's equity, some companies obtain life insurance policies on each partner with the partnership as the beneficiary. The proceeds from the insurance policy on the deceased partner are then used to settle the estate.

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BYP 12-3 COMMUNICATION ACTIVITY

To: Daniel Ortman
Sue Stafford

From: Your Accountant

Subject: Partnership Agreement for Pasta Shop

There are many important issues that should be included in your partnership agreement. Prior to our meeting next Tuesday, in my office, it would be helpful for you to consider the following matters.

1. **Facts about the business; i.e., name, location, purpose, and date of inception.**

2. **Facts about the partners; i.e., the name and address of each partner, the beginning capital contribution of each partner, and the rights and duties of partners with respect to: (a) making business decisions, (b) active participation in the partnership (full/part-time), and (c) allowances for vacations and sick leave.**

3. **Basis for sharing net income or net loss. The Uniform Partnership Act specifies that the basis will be equal unless another basis is stated in the partnership agreement. The basis may include provisions for partnership salaries and interest on capital balances with the remainder being divided on a proportionate basis.**

4. **Provision for withdrawals of assets. There are two kinds of withdrawals: one is called drawings; the other is called a withdrawal of capital. The former relates to providing each partner with cash for normal living expenses. You may provide for periodic drawings of a fixed amount such as $1,000 a month, or an amount not to exceed a specified amount such as $1,500 or $2,000. Withdrawals of capital can affect the future of the partnership. Thus, you may want to provide for consultation with an attorney, a financial advisor, and/or a CPA and a formal approval procedure.**

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5. Procedures for submitting disputes to arbitration. Inevitably, disagreements will occur between partners. The partnership contract should provide a framework for resolving them. You may want to include some or all of the outside parties mentioned above in an arbitration committee.

6. Procedures for the withdrawal or addition of a partner. At this time, consideration of this issue may seem premature. However, it is still useful to have basic procedures in place. For withdrawals, consideration should be given to both voluntary and "forced" withdrawals and the basis of determining and paying the capital equity of the partner who is leaving the firm. For additions, you may wish to state whether each admission must have the unanimous approval of existing partners and the terms of admission.

7. Rights and duties of surviving partners. The death of a partner is often a traumatic experience. Thus, it is advisable that the partnership agreement specify the responsibilities of the surviving partners, assuming the business is continued, or if the business is terminated. Also, procedures should be included for determining the deceased partner's equity in the firm. The procedures might include an audit of the financial statements and a revaluation of assets by an independent appraisal firm.

I look forward to a productive session with both of you next Tuesday.

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BYP 12-4 ETHICS CASE

(a) The stakeholders in this situation are Elizabeth and Laurie.

(b) The consequences of Elizabeth's actions are that they cause significant differences in the time worked between the partners and in the amount of drawings made by each partner. Sooner or later, Laurie is going to become annoyed with Elizabeth's actions and this could cause friction between the partners.

The differences here emphasize the importance of a written partnership agreement. Time to be worked by each partner and allowable drawings are two subjects that should be in the agreement.

Based on the information given, ethical considerations rest primarily on the issue of fairness. Elizabeth is not trying to hide anything from Laurie. However, her actions do not seem to be fair.

(c) For the differences in time worked, two changes in the partnership agreement should be considered. First, Laurie could be given a higher salary allowance than Elizabeth. Second, because Laurie is contributing more to net income than Elizabeth, she could be given a higher percentage of net income after deducting salary allowances.

For the differences in drawings, the partnership agreement could be altered to allow for interest on average monthly "net" partners' capitals. Net partners' capitals would be the difference between the balances of the capital and drawing accounts at the end of each month. If this is not agreeable to Elizabeth, then the partnership agreement should be changed to limit the drawings of each partner to a fixed amount.

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BYP 12-5 ALL ABOUT YOU ACTIVITY

Given that the students may come up with variety of answers that are correct, there is no single correct solution to this problem. You may wish to have a show of hands on each question to see whether any consensus has developed on any of the questions.