College of Business Administration
Jazan University

Study Material

Course Name : Financial accounting
Code No: Acct 222
Level : 4
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ACADEMIC YEAR – 1437-1438H (2016-2017)

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Chapter 1
Recording Business Transactions

2

Learning Objectives



1. Explain accounts as they relate to the accounting equation and describe common accounts
2. Define debits, credits, and normal account balances using double-entry accounting and T-accounts
3. Record transactions in a journal and post journal entries to the ledger

3

Learning Objectives



4. Prepare the trial balance and illustrate how to use the trial balance to prepare financial statements
5. Use the debt ratio to evaluate business performance

4

Learning Objective 1



Explain accounts as they relate to the accounting equation and describe common accounts

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What Is an Account?

Assets = Liabilities + Equity

- The accounting equation contains three parts: assets, liabilities, and equity. Each part contains accounts.
- An **account** is the detailed record of all increases and decreases that have occurred in an account during a specified period.

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- Assets are something the business owns or has control of that has value. **Assets** are economic resources that are expected to benefit the business in the future

- **Liabilities** are the present obligations of company
- **Equity** Represents shareholders' residual claim to the entity's assets

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Assets

Exhibit 2-1 | **Asset Accounts**

Account Name	Explanation
Cash	A business's money. Includes bank balances, bills, coins, and checks.
Accounts Receivable	A customer's promise to pay in the future for services or goods sold. Often described as "On Account."
Notes Receivable	A *written* promise that a customer will pay a fixed amount of money and *interest* by a certain date in the future. Usually more formal than an Accounts Receivable.
Prepaid Expense	A payment of an expense in advance. It is considered an asset because the prepayment provides a benefit in the future. Examples of prepaid expenses are *Prepaid Rent*, *Prepaid Insurance*, and *Office Supplies*.
Equipment, Furniture, and Fixtures	The cost of equipment, furniture, and fixtures (such as light fixtures and shelving). A business has a separate asset account for each type.
Building	The cost of an office building, a store, or a warehouse.
Land	The cost of land a business uses in operations.

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Liabilities

Exhibit 2-2 | **Liability Accounts**

Account Name	Explanation
Accounts Payable	A promise made by the business to pay a debt in the future. Arises from a credit purchase.
Notes Payable	A *written* promise made by the business to pay a debt, usually involving *interest,* in the future.
Accrued Liability	An amount owed but not paid. A specific type of payable such as *Taxes Payable*, *Rent Payable*, and *Salaries Payable.*
Unearned Revenue	Occurs when a company receives cash from a customer but has not provided the product or service. The promise to provide services or deliver goods in the future.

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Equity

Exhibit 2-3 | **Equity Accounts**

Account Name	Explanation
Common Stock	Represents the net contributions of the stockholders in the business. Increases equity.
Dividends	Distributions of cash or other assets to the stockholders. Decreases equity.
Revenues	Earnings that result from delivering goods or services to customers. Increases equity. Examples include *Service Revenue* and *Rent Revenue.*
Expenses	The cost of selling goods or services. Decreases equity. Examples include *Rent Expense*, *Salaries Expense*, and *Utilities Expense.*

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Chart of Accounts

Exhibit 2-4 | Chart of Accounts—Smart Touch Learning

Balance Sheet Accounts		
Assets	**Liabilities**	**Equity**
101 Cash	201 Accounts Payable	301 Common Stock
111 Accounts Receivable	211 Salaries Payable	311 Retained Earnings
121 Notes Receivable	221 Interest Payable	321 Dividends
141 Office Supplies	231 Unearned Revenue	
151 Furniture	241 Notes Payable	
171 Building	- Accrued liabilities	
191 Land	- Utilities payable	
- Prepaid expenses		
	Income Statement Accounts (Part of Equity)	
	Revenues	**Expenses**
	401 Service Revenue	501 Rent Expense
	411 Interest Revenue	511 Salaries Expense
		521 Utilities Expense
		531 Advertising Expense

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A chart of accounts is used to organize a company's accounts.

A **ledger** is a record holding all the accounts of a business, the changes in those accounts, and their balances.

Learning Objective 2



Define debits, credits, and normal account balances using double-entry accounting and T-accounts

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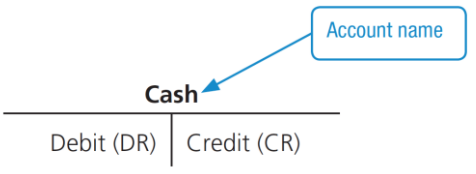
What Is Double-Entry Accounting?

- Transactions always involve at least two accounts.
- Accounting uses the **double-entry system** to record the dual effects of each transaction.
  - For example, office supplies are purchased for cash requiring an increase in Office Supplies and a decrease in Cash.

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The T-Account

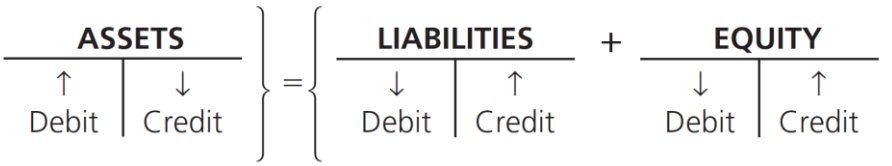
- A shortened form of the ledger is called the **T-account.**
  - The left side of the T-account is called the **debit.**
  - The right side of the T-account is called a **credit.**



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Increases and Decreases in the Accounts

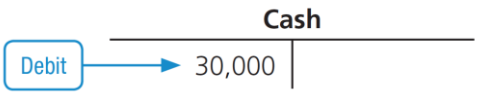
- How we record increases and decreases to an account is determined by the account type.



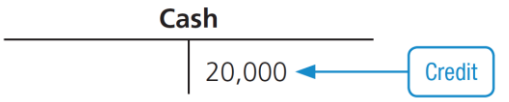
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Increases and Decreases in the Accounts

- To increase the Cash account, a business would record a debit to Cash.



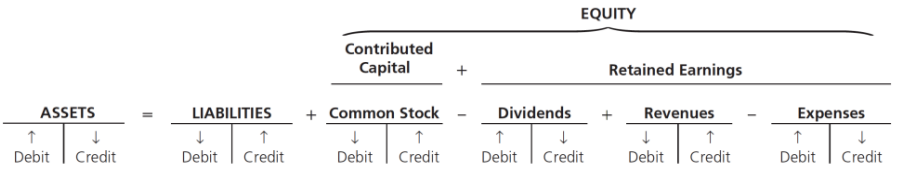
- To decrease the Cash account, a business would record a credit to Cash.



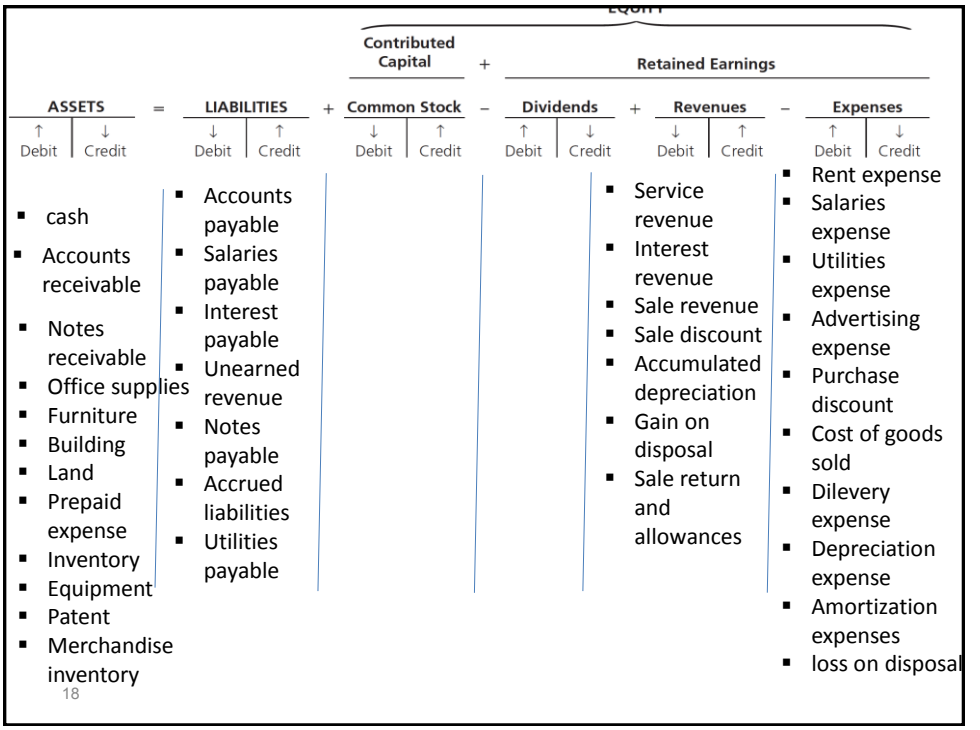
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Expanding the Rules of Debit and Credit

The accounting equation is expanded to include the rules of debits and credits for the elements of equity:



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The Normal Balance of an Account

- All accounts are summarized on one side of the T-account, called the normal balance.
- An account's **normal balance** appears on the increase side of the account.
  - Assets increase with a debit, so the normal balance is a debit.
  - Liabilities and equity increase with a credit, so the normal balance is a credit.

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The Normal Balance of an Account

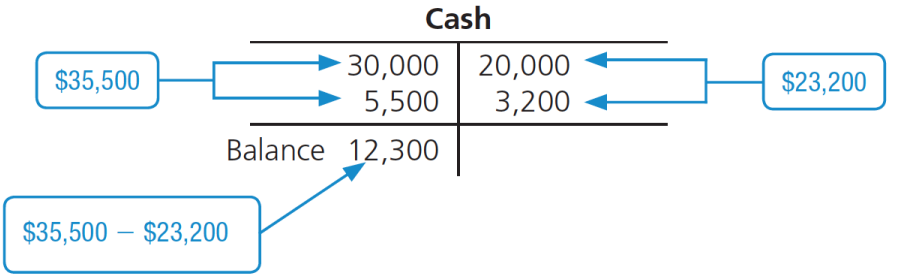
Exhibit 2-5 | **Rules of Debit and Credit and Normal Balances for Each Account Type**

Account Type	Increases	Decreases	Normal Balance
Assets	Debit	Credit	Debit
Expenses	Debit	Credit	Debit
Dividends	Debit	Credit	Debit
Liabilities	Credit	Debit	Credit
Revenues	Credit	Debit	Credit
Common Stock	Credit	Debit	Credit

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Determining the Balance of a T-Account

Use the T-account to determine the ending balance in an account. The ending balance is shown on the side with the larger number.



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Learning Objective 3



Record transactions in a journal and post journal entries to the ledger

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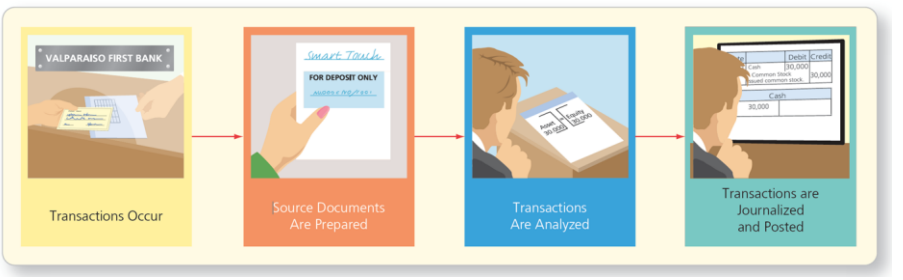
How Do You Record Transactions?

- Accountants use **source documents** to provide evidence and data for recording transactions.
- The documents help businesses determine how to record the transactions.

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Source Documents—The Origin of the Transactions

Exhibit 2-6 | **Flow of Accounting Data**



- Other source documents used include:
  - Purchase invoices
  - Bank checks
  - Sales invoices

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Journaling and Posting Transactions

- After reviewing source documents, accountants record the transactions.
- Transactions are recorded in a journal.
  - A **journal** is the record of the transactions in date order
- Transferring data from the journal to the ledger is called **posting.**

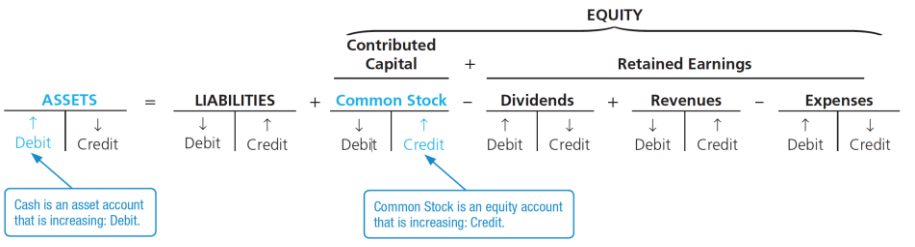
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Exercise 1 :

Question 1: Record the journal entries of Smart touch learning 's company

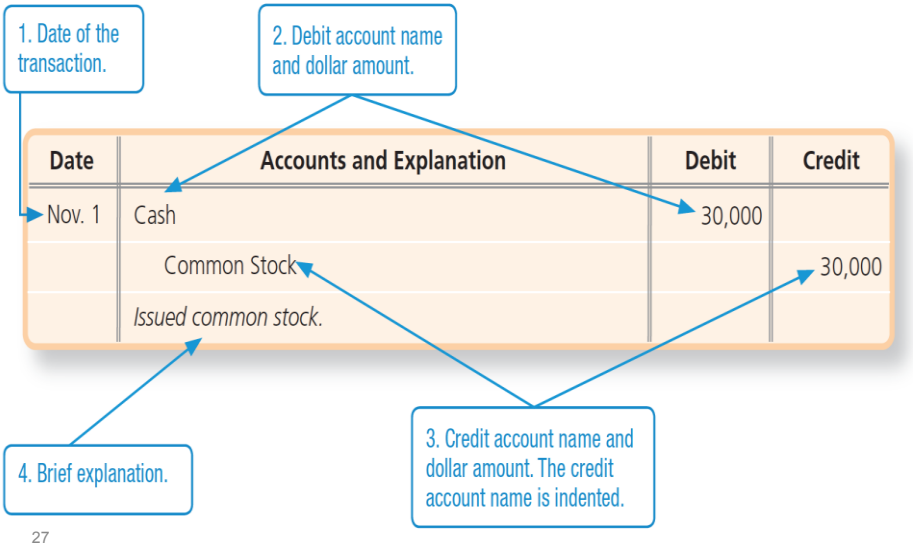
Transaction1:Stockholder Contribution

On November 1, Smart touch learning company received $30,000 cash from Sheena Bright, and the business issued common stock to her.



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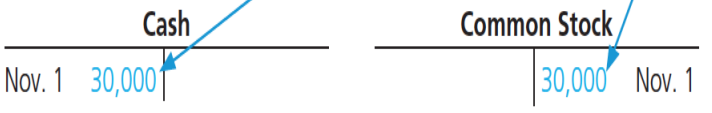
Transaction 1—Stockholder Contribution



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Transaction 1—Stockholder Contribution

Date	Accounts and Explanation	Debit	Credit
Nov. 1	Cash	30,000	
	Common Stock		30,000
	Issued common stock.		



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Transaction 2—Purchase of Land for Cash

On November 2, Smart Touch Learning paid $20,000 cash for land.

Date	Accounts and Explanation	Debit	Credit
Nov. 2	Land	20,000	
	Cash		20,000
	Paid cash for land.		

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Transaction 3—Purchase of Office Supplies on Account

Smart Touch Learning buys $500 of office supplies on **account** on November 3.

Date	Accounts and Explanation	Debit	Credit
Nov. 3	Office Supplies	500	
	Accounts Payable		500
	Purchased office supplies on account.		

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Transaction 4—Earning of Service Revenue for Cash

On November 8, Smart Touch Learning collected cash of $5,500 for service revenue that the business earned by providing services for clients.

Date	Accounts and Explanation	Debit	Credit
Nov. 8	Cash	5,500	
	Service Revenue		5,500
	Performed services and received cash.		

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Transaction 5—Earning of Service Revenue on Account

On November 10, Smart Touch Learning performed services for clients of 3,000$, for which the clients will pay the company **later**.

Date	Accounts and Explanation	Debit	Credit
Nov. 10	Accounts Receivable	3,000	
	Service Revenue		3,000
	Performed services on account.		

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Transaction 6—Payment of Expenses with Cash

Smart Touch Learning paid cash expenses on November 15: $2,000 for office rent and $1,200 for employee salaries.

Date	Accounts and Explanation	Debit	Credit
Nov. 15	Rent Expense	2,000	
	Salaries Expense	1,200	
	Cash		3,200
	Paid cash expenses.		

Note: A journal entry with more than two accounts is called a **compound journal entry**.

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Transaction 7—Payment on Account (Accounts Payable)

On November 21, Smart Touch Learning paid $300 cash on the accounts payable created in Transaction 3.

Date	Accounts and Explanation	Debit	Credit
Nov. 21	Accounts Payable	300	
	Cash		300
	Paid cash on account.		

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Transaction 8—Collection on Account (Accounts Receivable)

On November 22, Smart Touch Learning collected $2,000 cash from a client in Transaction 5.

Date	Accounts and Explanation	Debit	Credit
Nov. 22	Cash	2,000	
	Accounts Receivable		2,000
	Received cash on account.		

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Transaction 9—Payment of Cash Dividend

On November 25, a payment of $5,000 cash was paid for dividends.

Date	Accounts and Explanation	Debit	Credit
Nov. 25	Dividends	5,000	
	Cash		5,000
	Paid dividends.		

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Transaction 10—Prepaid Expenses

On December 1, Smart Touch Learning prepays cash three months' office rent of $3,000.

Date	Accounts and Explanation	Debit	Credit
Dec. 1	Prepaid Rent	3,000	
	Cash		3,000
	Paid rent in advance.		

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Transaction 11—Payment of Expense with Cash

On December 1, Smart Touch Learning paid cash employee salaries of $1,200.

Date	Accounts and Explanation	Debit	Credit
Dec. 1	Salaries Expense	1,200	
	Cash		1,200
	Paid salaries.		

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Transaction 12—Purchase of Building with Notes Payable

On December 1, Smart Touch Learning purchased a $60,000 building in exchange for a note payable.

Date	Accounts and Explanation	Debit	Credit
Dec. 1	Building	60,000	
	Notes Payable		60,000
	Purchase of building with note.		

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Transaction 13—Stockholder Contribution

On December 2, Smart Touch Learning received a contribution in common stock of furniture with a fair market value of $18,000 from Sheena Bright.

Date	Accounts and Explanation	Debit	Credit
Dec. 2	Furniture	18,000	
	Common Stock		18,000
	Contribution of furniture in exchange for common stock.		

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Transaction 14—Accrued Liability

On December 15, Smart Touch Learning received a telephone bill for $100 and will pay this expense next month.

Date	Accounts and Explanation	Debit	Credit
Dec. 15	Utilities Expense	100	
	Utilities Payable		100
	Accrued utility liability.		

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Transaction 15—Payment of Expense with Cash

On December 15, Smart Touch Learning paid employee salaries of $1,200 cash.

Date	Accounts and Explanation	Debit	Credit
Dec. 15	Salaries Expense	1,200	
	Cash		1,200
	Paid salaries.		

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Transaction 16—Unearned Revenue

On December 21, a law firm engaged Smart Touch Learning to provide e-learning services and agreed to pay $600 cash in advance.

Date	Accounts and Explanation	Debit	Credit
Dec. 21	Cash	600	
	Unearned Revenue		600
	Collected cash for future services.		

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Transaction 17—Earning of Service Revenue for Cash

On December 28, Smart Touch Learning collected cash of $8,000 for Service Revenue that the business earned by providing e-learning services for clients.

Date	Accounts and Explanation	Debit	Credit
Dec. 28	Cash	8,000	
	Service Revenue		8,000
	Performed services and received cash.		

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The Ledger Accounts After Posting

- Exhibit 2-7 shows Smart Touch Learning's accounts after posting journal entries in November and December.
- Notice the total assets of $114,700 equals the total liabilities of $60,900 plus equity of $53,800.
  - Total liabilities plus equity is: $60,900+$53,800=$114,700.

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ASSETS

Cash

Nov. 1	30,000	20,000	Nov. 2
Nov. 8	5,500	3,200	Nov. 15
Nov. 22	2,000	300	Nov. 21
Dec. 21	600	5,000	Nov. 25
Dec. 28	8,000	3,000	Dec. 1
		1,200	Dec. 1
		1,200	Dec. 15
Bal.	12,200		

Accounts Receivable

Nov. 10	3,000	2,000	Nov. 22
Bal.	1,000		

Office Supplies

Nov. 3	500		
Bal.	500		

Prepaid Rent

Dec. 1	3,000		
Bal.	3,000		

Furniture

Dec. 2	18,000		
Bal.	18,000		

Building

Dec. 1	60,000		
Bal.	60,000		

Land

Nov. 2	20,000		
Bal.	20,000		

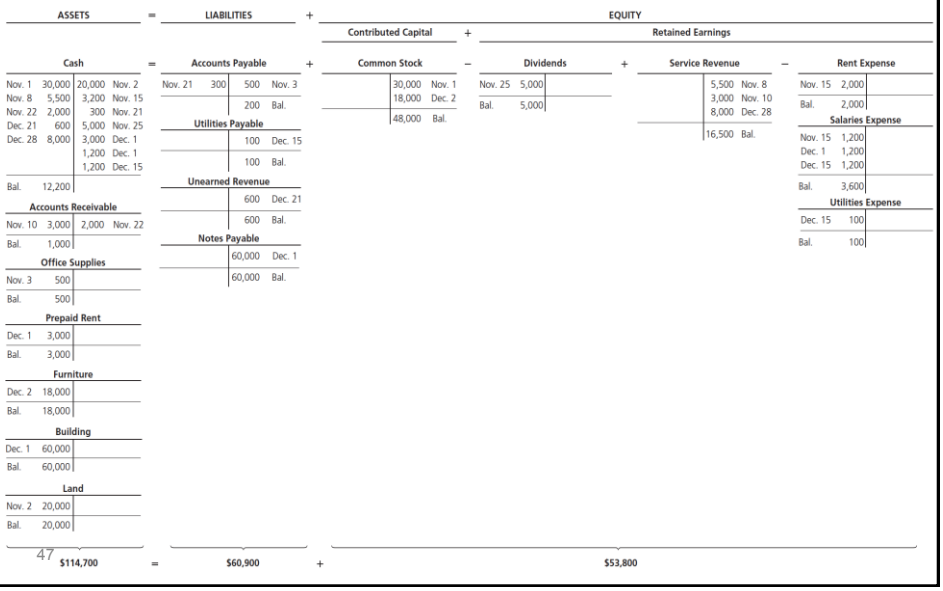
$114,700

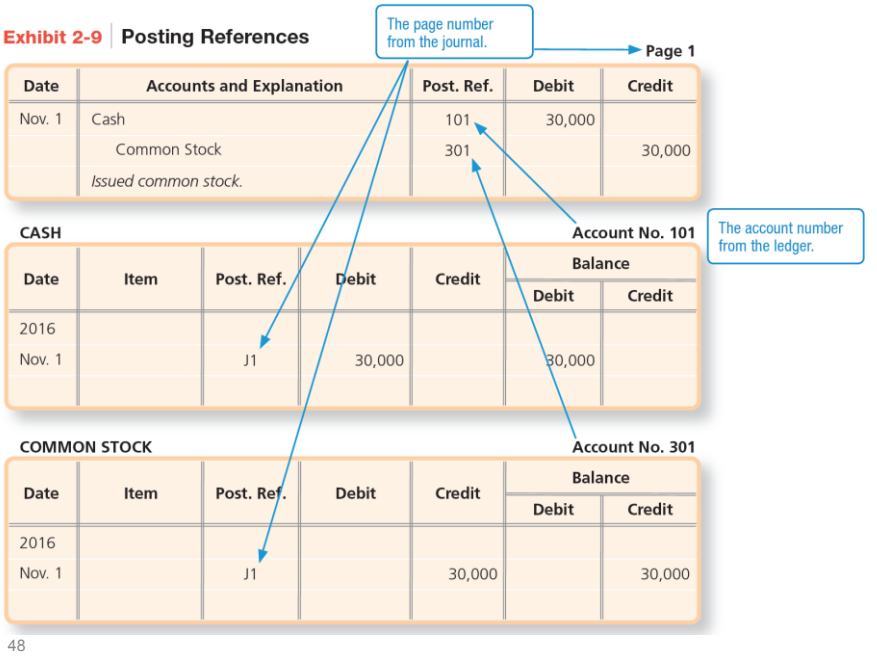
The ledger reports the ending balances in the asset accounts after the journal entries are posted.

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Question 2 : post the journal entries of Smart touch learning's company to the ledger and calculate the balance of each account?

Answer : The Ledger Accounts After Posting





Learning Objective 4



Prepare the trial balance and illustrate how to use the trial balance to prepare financial statements

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A trial balance is prepared after the journal entries have been posted to the ledger. The trial balance is a summary of all the accounts with their balances. The trial balance lists the assets, liabilities, and equity, in that order. The purpose of the trial balance is to check whether or not the debits equal the credits.

In addition to verifying the equality of debits and credits, the trial balance is used to prepare the financial statements. The account balances are taken directly from the trial balance to prepare the income statement, statement of retained earnings, and balance sheet.

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Question 3:prepare the trial balance of Smart touch learning's company?

Answer :

Exhibit 2-10 | Trial Balance

SMART TOUCH LEARNING
Trial Balance
December 31, 2016

Account Title	Balance Debit	Balance Credit
Cash	$ 12,200	
Accounts Receivable	1,000	
Office Supplies	500	
Prepaid Rent	3,000	
Furniture	18,000	
Building	60,000	
Land	20,000	
Accounts Payable		$ 200
Utilities Payable		100
Unearned Revenue		600
Notes Payable		60,000
Common Stock		48,000
Dividends	5,000	
Service Revenue		16,500
Rent Expense	2,000	
Salaries Expense	3,600	
Utilities Expense	100	
Total	$ 125,400	$ 125,400

A **trial balance** is a summary of the ledger listing all of the accounts with their balances.

The asset accounts are listed first, followed by liabilities, and then equity.

The trial balance and the balance sheet are not the same. Make sure you understand the differences between these two documents. A trial balance verifies the equality of debits and credits and is an internal document used only by employees of the company. The balance sheet, on the other hand, presents the business's accounting equation and is a financial statement that can be used by both internal and external users.

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Question 4: Preparing Financial Statements from the Trial Balance

Answer:

Exhibit 2-11 | Smart Touch Learning's Financial Statements

SMART TOUCH LEARNING
Income Statement
Two Months Ended December 31, 2016

Revenues:		
Service Revenue		$ 16,500
Expenses:		
Salaries Expense	$ 3,600	
Rent Expense	2,000	
Utilities Expense	100	
Total Expenses		5,700
Net Income		$ 10,800

SMART TOUCH LEARNING
Statement of Retained Earnings
Two Months Ended December 31, 2016

Retained Earnings, November 1, 2016	$ 0
Net income for the two months	10,800
	10,800
Dividends	(5,000)
Retained Earnings, December 31, 2016	$ 5,800

SMART TOUCH LEARNING
Balance Sheet
December 31, 2016

Assets		Liabilities	
Cash	$ 12,200	Accounts Payable	$ 200
Accounts Receivable	1,000	Utilities Payable	100
Office Supplies	500	Unearned Revenue	600
Prepaid Rent	3,000	Notes Payable	60,000
Furniture	18,000	Total Liabilities	60,900
Building	60,000		
Land	20,000	**Stockholders' Equity**	
		Common Stock	48,000
		Retained Earnings	5,800
		Total Stockholders' Equity	53,800
Total Assets	$ 114,700	Total Liabilities and Stockholders' Equity	$ 114,700

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Correcting Trial Balance Errors

- Search for missing accounts.
- Divide the difference between total debits and total credits by 2.
  - A debit treated as a credit or vice versa doubles the error.
- Divide the out-of-balance amount by 9 to find transposition errors.

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Exercise 2 : from the T-account of cash given bellow prepare the four column to the cash account

Answer :

Exhibit 2-8 | T-Account Versus Four-Column Account

Cash			
Nov. 1	30,000	20,000	Nov. 2
Nov. 8	5,500	3,200	Nov. 15
Nov. 22	2,000	300	Nov. 21
Dec. 21	600	5,000	Nov. 25
Dec. 28	8,000	3,000	Dec. 1
		1,200	Dec. 1
		1,200	Dec. 15
Bal.	12,200		

The Debit or Credit for each transaction.

The balance of the account after each transaction.

CASH					Account No. 101	
Date	Item	Post Ref.	Debit	Credit	Balance	
					Debit	Credit
2016						
Nov. 1		J1	30,000		30,000	
Nov. 2		J1		20,000	10,000	
Nov. 8		J1	5,500		15,500	
Nov. 15		J1		3,200	12,300	
Nov. 21		J1		300	12,000	
Nov. 22		J1	2,000		14,000	
Nov. 25		J1		5,000	9,000	
Dec. 1		J2		3,000	6,000	
Dec. 1		J2		1,200	4,800	
Dec. 15		J2		1,200	3,600	
Dec. 21		J2	600		4,200	
Dec. 28		J2	8,000		12,200	

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Learning Objective 5



Use the debt ratio to evaluate business performance

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How Do You Use the Debt Ratio to Evaluate Business Performance?

- The **debt ratio** shows the proportion of assets financed with debt.
- It can be used to evaluate a business's ability to pay its debts and to determine if the company has too much debt to be considered financially "healthy."

Debt ratio = Total liabilities / Total assets

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Exercise 3: from the following information:

- Total assets of enterprise A = 100,000$
- Total liabilities of enterprise A = 30,000$
- Total equity of enterprise B = 20.000$
- Total liabilities of enterprise B = 80,000$

1) Calculate total equity of enterprise A?
2) Determine total assets of enterprise B?
3) Calculate the debt ratio of A ?
4) Calculate the debt ratio of B?
5) explain witch enterprise more performance A or B ?

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answer:

1) Total assets= total liabilities + equity

Then equity of A = total assets – total liabilities = 100,000 – 30,000 = 70,000$

2) Total assets of B= total liabilities + equity = 20,000+80,000 = 100,000$

3) Debt ratio = Total liabilities / Total assets

Debt ratio of A = 30,000/ 100,000 =0,3=30%

4) Debt ratio of B = 80,000/100,000=0,8=80%

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5) Debt ratio of A < debt ratio of B then enterprise A more performance than B

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Exercise 4 : From the T- account of bank given bellow prepare the four column to the bank account

Debit		credit	
Nov1	20,000	Nov3	5,000
Nov2	10,000	Nov4	7,000
Nov7	8,000	Nov5	22,000
		Nov6	1,000

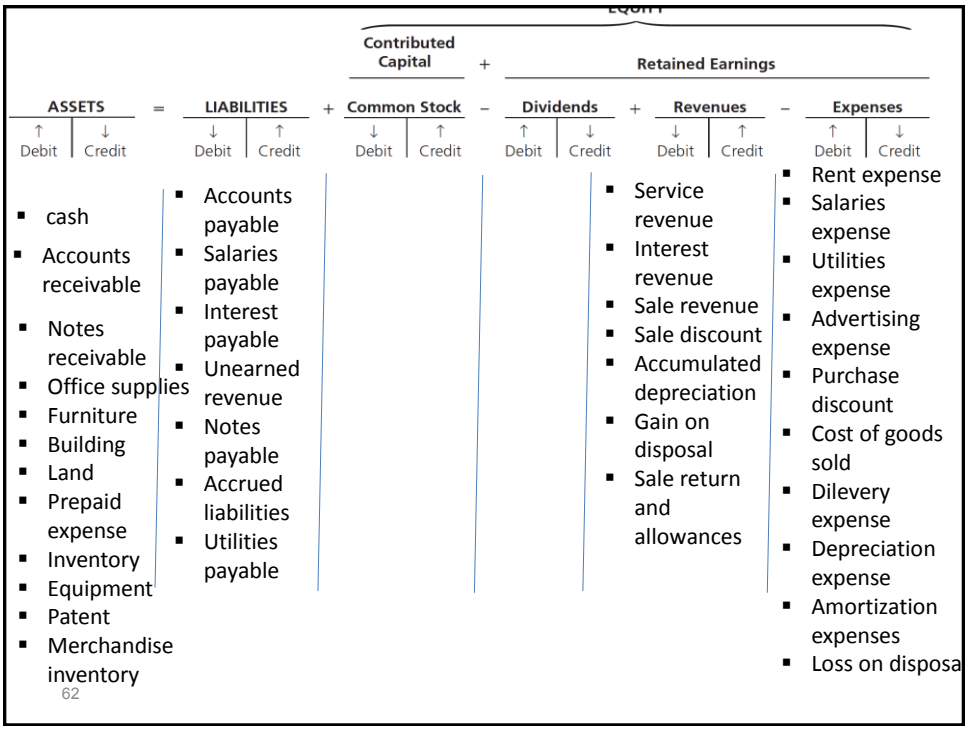
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Answer :

Bank

		3,00	Balance	
Date	Debit	Credit	Debit	Credit
Nov 1	20,000		20,000	
Nov 2	10,000		30,000	
Nov3		5,000	25,000	
Nov4		7,000	18,000	
Nov5		22,000		4,000
Nov6		1,000		5,000
Nov7	8,000		3,000	

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Chapter 2

Plant Assets, Natural Resources, and Intangibles assets

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Learning Objectives



1. Measure the cost of a plant asset
2. Account for depreciation using the straight-line, units-of-production, and double-declining-balance methods
3. Journalize entries for the disposal of plant assets

10-64

Learning Objectives



4. Account for intangible assets
5. Use the asset turnover ratio to evaluate business performance
6. Journalize entries for the exchange of plant assets

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Learning Objective 1



Measure the cost of a plant asset

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How Does a Business Measure the Cost of a Plant Asset?

- **Plant assets** are long-lived, tangible assets used in the operations of a business.
- Examples:
  - Land
  - Buildings
  - Equipment
  - Furniture
  - Fixtures
  - Automobiles

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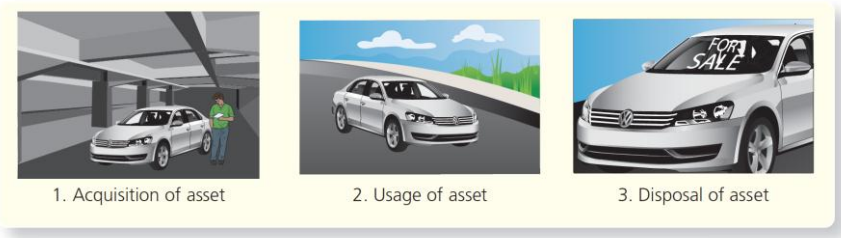
How Does a Business Measure the Cost of a Plant Asset?

- Plant assets are different from other assets because plant assets are long-term (lasting several years).
- The cost of a plant asset is allocated over the years that the asset is expected to be used.
- The allocation of a plant asset's cost over its useful life is called **depreciation** and follows the matching principle.

10-68

How Does a Business Measure the Cost of a Plant Asset?

Exhibit 9-1 | **Life Cycle of a Plant Asset**



1. Acquisition of asset
2. Usage of asset
3. Disposal of asset

10-69

How Does a Business Measure the Cost of a Plant Asset?

- A plant asset is recorded at historical cost—the amount paid for the asset.
- This follows the **cost principle**, which states that acquired assets and services should be recorded at their actual costs.
  - The actual cost is the purchase price plus taxes, commissions, and other amounts paid to get the asset ready for its intended use.

10-70

Land and Land Improvements

- The cost of land includes the following amounts paid by the purchaser:

Purchase price	Brokerage commission	Survey and legal fees
Delinquent property taxes	Title transfer fees	Cost of clearing the land

10-71

Land and Land Improvements

- The cost of land does not include:

Fencing	Paving	Sprinkler systems
Lighting	Signs	

- These separate plant assets are called **land improvements** and, unlike land, are subject to depreciation.

10-72

Land and Land Improvements

Exercise1:

- Smart Touch Learning purchases **land** on August 1, 2015, for $50,000 with a **note payable**. Other costs related to this transaction include $4,000 in delinquent property taxes, $2,000 in transfer taxes, $5,000 to remove an old building, and a $1,000 survey fee. **The additional costs are paid in cash.**

10-73

Question 1: calculate the cost of land?
Answer:

Exhibit 9-2 | Measuring the Cost of Land

Purchase price of land		$ 50,000
Add related costs:		
Property taxes	$ 4,000	
Transfer taxes	2,000	
Removal of building	5,000	
Survey fee	1,000	12,000
Total cost of land		$ 62,000

10-74

Question 2: record the journal entry?
Answer :

- The entry to record the purchase of the land on August 1, 2017, follows:

Date	Accounts and Explanation	Debit	Credit
Aug. 1	Land	62,000	
	Notes Payable		50,000
	Cash		12,000
	To record purchase of land with cash and note payable.		

10-75

Machinery and Equipment

- The cost of machinery and equipment includes:
  - Purchase price (less any discounts)
  - Transportation charges
  - Insurance while in transit
  - Sales tax and other taxes
  - Purchase commission
  - Installation costs
  - Testing costs (prior to use of the asset)

10-76

Furniture and Fixtures

- Examples of furniture and fixtures include:
  - Desks
  - Chairs
  - File cabinets
- The costs of furniture and fixtures include:
  - Purchase price (less any discounts)
  - All other costs to ready the asset for its intended use

10-77

Learning Objective 2



Account for depreciation using the straight-line, units-of-production, and double-declining-balance methods

10-78

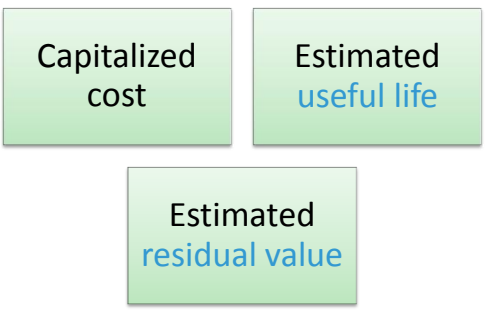
What Is Depreciation, and How Is It Computed?

- Depreciation matches the expense against the revenue generated from using an asset.
- All assets, except land, wear out as they are used.
- Some assets may become obsolete before they wear out. An asset is **obsolete** when a newer asset can perform the job more efficiently.

10-79

Factors in Computing Depreciation

- Depreciation of a plant asset is based on three main factors:



10-80

Factors in Computing Depreciation

- **Estimated residual value**, also called salvage value, is the amount the company expects to receive upon disposition of the asset.
- Cost minus estimated residual value is called **depreciable cost**.

Depreciable cost = Cost − Estimated residual value

10-81

Depreciation Methods

- Three most commonly used depreciation methods:
  - Straight-line method
  - Units-of-production method
  - Double-declining-balance method

Exercise 2:

- Cost of truck: 41,000$
- estimated residual value =1,000$
- Date of purchase and place in service : 01/01/2017
- Estimated useful life-years :5years

Question 1: Calculate the depreciable cost of the asset?

Answer : depreciable cost = cost-estimated residual value = 41,000- 1,000= 40,000$

10-82

1st method :Straight-Line Method

- The straight-line method allocates an equal amount of depreciation to each year and is computed as follows:

Question2 : Calculate the annual straight – line depreciation of the asset?

Answer:

Straight-line depreciation = (Cost − Residual value) / Useful life
= ($41,000 − $1,000) / 5 years
= $8,000 per year

10-83

Question 3: record the journal entry of depreciation expense on 31 December?

Answer:

- The adjusting entry to record the year's depreciation expense, assuming the truck was placed in service on **the first day** of the year, is as follows:

Date	Accounts and Explanation	Debit	Credit
Dec. 31	Depreciation Expense—Truck	8,000	
	Accumulated Depreciation—Truck		8,000
	To record depreciation on truck.		

10-84

- Depreciation expense is reflected on the income statement.
- The book value of the asset = cost - accumulated depreciation

Question 4: Calculate the book value of the asset for the first year?

Answer :

Plant Assets:	
Truck	$ 41,000
Less: Accumulated Depreciation—Truck	(8,000)
Truck, Net	$ 33,000

10-85

Question 5 : prepare the straight – line depreciation schedule?

Answer:

Exhibit 9-5 | Straight-Line Depreciation Schedule

Date	Asset Cost	Depreciation for the Year: Depreciable Cost	Useful Life		Depreciation Expense	Accumulated Depreciation	Book Value
1-1-2017	$ 41,000						$ 41,000
12-31-2017		($41,000 – $1,000)	/ 5 years	=	$ 8,000	$ 8,000	33,000
12-31-2018		($41,000 – $1,000)	/ 5 years	=	8,000	16,000	25,000
12-31-2019		($41,000 – $1,000)	/ 5 years	=	8,000	24,000	17,000
12-31-2020		($41,000 – $1,000)	/ 5 years	=	8,000	32,000	9,000
12-31-2021		($41,000 – $1,000)	/ 5 years	=	8,000	40,000	1,000 ← Residual value

10-86

2nd method :Units-of-Production Method

- The **units-of-production** method allocates a varying amount of depreciation each year based on the **asset's usage.**
- When a plant asset's usage varies by year, the units-of-production method better matches expenses with revenues.

10-87

Exercise 3 :Units-of-Production Method

- Cost of truck: 41,000$
- Estimated residual value =1,000$
- Date of purchase and place in service : 01/01/2017
- Estimated useful life-years :5years
- Estimated useful life-units : 100,000 units

- Smart Touch Learning expects to drive a truck 20,000 miles the first year, 30,000 miles the second, 25,000 the third, 15,000 the fourth, and 10,000 the fifth—for a total of 100,000 miles.

10-88

- The units-of-production depreciation for each period varies with the number of units the asset is used.

Question 1: Calculate the depreciable cost of the asset?

Answer :

Depreciable cost = cost - estimated residual value

= 41,000- 1,000= 40,000$

10-89

Question 2: Calculate the units of production depreciation for the 1st year?

Answer:

- Units-of-production depreciation is calculated as follows:

Step 1:

Depreciation per unit = (Cost − Residual value) / Useful life in units
= ($41,000 − $1,000) / 100,000 miles
= $0.40 per mile

Step 2:

Units-of-production depreciation = Depreciation per unit × Current year usage
= $0.40 per mile × 20,000 miles
= $8,000 (year 1)

10-90

Question 3 : prepare the units of production depreciation schedule?
Answer:

Exhibit 9-6 | Units-of-Production Depreciation Schedule

Date	Asset Cost	Depreciation for the Year: Depreciation Per Unit		Number of Units		Depreciation Expense	Accumulated Depreciation	Book Value
1-1-2017	$ 41,000							$ 41,000
12-31-2017		$ 0.40	×	20,000	=	$ 8,000	$ 8,000	33,000
12-31-2018		0.40	×	30,000	=	12,000	20,000	21,000
12-31-2019		0.40	×	25,000	=	10,000	30,000	11,000
12-31-2020		0.40	×	15,000	=	6,000	36,000	5,000
12-31-2021		0.40	×	10,000	=	4,000	40,000	1,000 ← Residual value

10-91

Question 4 : Record the journal entry of depreciation expense on 31 December 2018 (2nd year)?
Answer:

Date	Accounts and explanation	Debit	Credit
Dec 31	Depreciation –expense	12,000	
	Accumulated depreciation		12,000

10-92

3rd method :Double-Declining Balance Method (DDB Method)

- An **accelerated depreciation method** expenses more of the asset's cost near the start of an asset's life and less at the end of its useful life.
  - The main accelerated method of depreciation is the **double-declining-balance method.**

10-93

- The double-declining-balance method multiplies an asset's decreasing book value by a constant percentage that is twice the straight-line depreciation rate.

Depreciation expense = $beginning\ book\ value \times 2 \times \frac{1}{Estimated\ useful\ life\ in\ years}$

10-94

Exercise 4:

- Cost of truck: 41,000$
- Estimated residual value =1,000$
- Date of purchase and place in service : 01/01/2017
- Estimated useful life-years :5years

Question 1: Calculate the double declining balance depreciation for the 1st year of the asset?

Answer : Depreciation expense =

$$beginning\ book\ value \times 2 \quad \frac{1}{Estimated\ useful\ life\ in\ years}$$

$$= 41{,}000 \times 2 \quad \frac{1}{5} = 16{,}400\$$$

10-95

Question 2 : Record the journal entry of depreciation expense on 31 December 2017 (1st year)?

Answer:

Date	Accounts and explanation	• Debit	Credit
Dec 31	Depreciation –expense	16,400	
	Accumulated depreciation		16,400

10-96

Question 3 : prepare the double declining balance depreciation schedule?

Answer:

Exhibit 9-7 | Double-Declining-Balance Depreciation Schedule

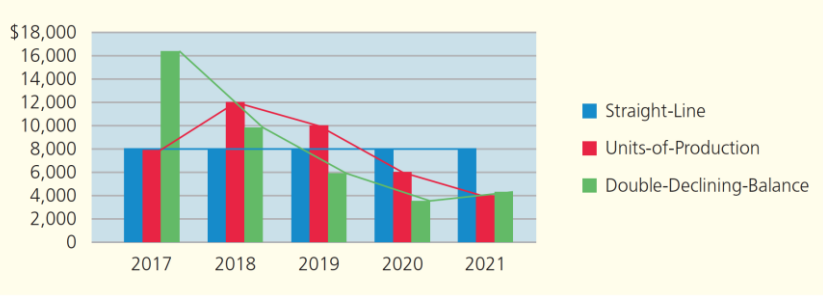
Date	Asset Cost	Depreciation for the Year: Book Value		DDB Rate		Depreciation Expense	Accumulated Depreciation	Book Value
1-1-2017	$ 41,000							$ 41,000
12-31-2017		$41,000	×	$2\times\frac{1}{5}$	=	$ 16,400	$ 16,400	24,600
12-31-2018		24,600	×	$2\times\frac{1}{5}$	=	9,840	26,240	14,760
12-31-2019		14,760	×	$2\times\frac{1}{5}$	=	5,904	32,144	8,856
12-31-2020		8,856	×	$2\times\frac{1}{5}$	=	3,542	35,686	5,314
12-31-2021						4,314*	40,000	1,000 ← Residual value

*Last year depreciation is the "plug figure" needed to reduce book value to the residual amount ($5,314 – $1,000 = $4,314).

10-97

Comparing Depreciation Methods

Exhibit 9-8 | Annual Depreciation by Method



10-98

Learning Objective 3



Journalize entries for the disposal of plant assets

10-99

How Are Disposals of Plant Assets Recorded?

- Eventually, an asset wears out or becomes obsolete. The business then has several options:
  - Discard the plant asset.
  - Sell the plant asset.
  - Exchange the plant asset for another asset.

10-100

How Are Disposals of Plant Assets Recorded?

- Regardless of the type of disposal, there are four steps:
  1. Bring the depreciation up to date.
  2. Remove the old, disposed-of asset and associated accumulated depreciation from the books.
  3. Record the value of any cash received (or paid).
  4. Determine the amount of any gain or loss.

10-101

Exercise 5 : Discarding Plant Assets

Case 1:

- Assume that on July 1, Smart Touch Learning discards equipment with a cost of $10,000 and accumulated depreciation of $10,000.

Question : record the journal entry for the discard of the equipment ?

Answer:

Date	Accounts and Explanation	Debit	Credit
Jul. 1	Accumulated Depreciation—Equipment	10,000	
	Equipment		10,000
	Discarded fully depreciated equipment.		

10-102

Case2: Discarding Plant Assets

- Assuming the equipment was placed in service on the first day of the year
- Suppose, instead, that on July 1, Smart Touch Learning discarded the equipment, which has a cost of $10,000 but is not fully depreciated. Accumulated depreciation is $8,000, and annual depreciation is $1,000.

Question : record the journal entry for the discard of the equipment ?

Answer:

- The first step is to bring the asset up to date on depreciation.
- The second step is to record the disposal.

10-103

Discarding Plant Assets
Step 1:

Date	Accounts and Explanation	Debit	Credit
Jul. 1	Depreciation Expense—Equipment	500	
	Accumulated Depreciation—Equipment		500
	To record depreciation on equipment.		

Step 2 :

Date	Accounts and Explanation	Debit	Credit
Jul. 1	Accumulated Depreciation—Equipment	8,500	
	Loss on Disposal	1,500	
	Equipment		10,000
	Discarded equipment with a book value of $1,500.		

10-104

Case 3 : Selling a Plant Asset at Book Value

- Suppose Smart Touch Learning sells cash the equipment for $1,500.

Question : record the journal entry for the sale of the equipment ?

10-105

Answer:

Step 1

Date	Accounts and explanation	• Debit	Credit
Jul 1	Depreciation –expense	500	
	Accumulated depreciation		500

Step 2 :

Date	Accounts and Explanation	Debit	Credit
Jul. 1	Cash	1,500	
	Accumulated Depreciation—Equipment	8,500	
	Equipment		10,000
	Sold equipment for cash.		

10-106

Case 4 : Selling a Plant Asset Above Book Value

- Suppose Smart Touch Learning sells the equipment for $4,000 cash.

Question : record the journal entry for the sale of the equipment ?

Answer: the company will record a gain on the sale of the equipment.

Step 1

Date	Accounts and explanation	• Debit	Credit
Jul 1	Depreciation –expense	500	
	Accumulated depreciation		500

10-107

Step 2 :

Date	Accounts and Explanation	Debit	Credit
Jul. 1	Cash	4,000	
	Accumulated Depreciation—Equipment	8,500	
	Equipment		10,000
	Gain on Disposal		2,500
	Sold equipment for cash.		

10-108

Case 5 : Selling a Plant Asset Below Book Value

- Suppose Smart Touch Learning sells the equipment for $500 cash, the company will record a loss on the sale of the equipment.

Question : record the journal entry for the sale of the equipment ?

Answer: the company will record a loss on the sale of the equipment.

Step 1

Date	Accounts and explanation	• Debit	Credit
Jul 1	Depreciation –expense	500	
	Accumulated depreciation		500

10-109

Step 2 :

Date	Accounts and Explanation	Debit	Credit
Jul. 1	Cash	500	
	Accumulated Depreciation—Equipment	8,500	
	Loss on Disposal	1,000	
	Equipment		10,000
	Sold equipment for cash.		

10-110

How Are Disposals of Plant Assets Recorded?

Exhibit 9-10 | **Disposals of Plant Assets**

Discarding of fully depreciated plant asset:

Date	Accounts and Explanation	Debit	Credit
	Accumulated Depreciation	10,000	
	Plant Asset		10,000

Discarding of a plant asset that is not fully depreciated:

Date	Accounts and Explanation	Debit	Credit
	Accumulated Depreciation	8,500	
	Loss on Disposal	1,500	
	Plant Asset		10,000

Selling a plant asset at book value:

Date	Accounts and Explanation	Debit	Credit
	Cash	1,500	
	Accumulated Depreciation	8,500	
	Plant Asset		10,000

10-111

How Are Disposals of Plant Assets Recorded?

Exhibit 9-10 | **Disposals of Plant Assets**

Selling a plant asset above book value:

Date	Accounts and Explanation	Debit	Credit
	Cash	4,000	
	Accumulated Depreciation	8,500	
	Plant Asset		10,000
	Gain on Disposal		2,500

Selling a plant asset below book value:

Date	Accounts and Explanation	Debit	Credit
	Cash	500	
	Accumulated Depreciation	8,500	
	Loss on Disposal	1,000	
	Plant Asset		10,000

10-112

Learning Objective 5



Journalize entries for the exchange of plant assets

10-113

How Are Exchanges of Plant Assets Accounted For?

- A business may exchange a plant asset for another plant asset.
- An exchange has **commercial substance** if the future cash flows change as a result of the transaction.
- Exchanges that have commercial substance require any gain or loss on the transaction to be recognized.

10-114

Exercise 6: Exchange of Plant Assets—Gain Situation

- On December 31, Smart Touch Learning exchanges used equipment with a historical cost of $10,000 and accumulated depreciation of $9,000 for old equipment. The company acquires the new equipment with a market value of $8,000 and pays $2,000 cash.

Question 1: calculate the gain of this exchange?

Question 2: record the journal entry for this exchange?

10-115

Answer: Question 1

Market value of assets received		$ 8,000
Less:		
Book value of asset exchanged	$ 1,000	
Cash paid	2,000	3,000
Gain or (Loss)		$ 5,000

Question 2: The accounting clerk records the following entry:

Date	Accounts and Explanation	Debit	Credit
Dec. 31	Equipment (new)	8,000	
	Accumulated Depreciation—Equipment	9,000	
	Equipment (old)		10,000
	Cash		2,000
	Gain on Disposal		5,000
	Exchanged old equipment and cash for new equipment.		

10-116

Exercise 7 : Exchange of Plant Assets—Loss Situation

- On December 31, Smart Touch Learning exchanges used equipment with a historical cost of $10,000 and accumulated depreciation of $9,000 for old equipment. The company acquires the new equipment with a market value of $3,000 and pays $2,500 cash.

Question 1: calculate the loss of this exchange?

Question 2: record the journal entry for this exchange?

10-117

Answer: Quetion1

Market value of assets received		$ 3,000
Less:		
Book value of asset exchanged	$ 1,000	
Cash paid	2,500	3,500
Gain or (Loss)		$ (500)

Quetion1: The accounting clerk records the following entry:

Date	Accounts and Explanation	Debit	Credit
Dec. 31	Equipment (new)	3,000	
	Accumulated Depreciation—Equipment	9,000	
	Loss on Disposal	500	
	Equipment (old)		10,000
	Cash		2,500
	Exchanged old equipment and cash for new equipment.		

End of chapter 2

10-118

Learning Objective 6



Account for intangible assets

10-119

How Are Intangible Assets Accounted For?

- **Intangible assets** are assets that have no physical form.
- Examples of intangible assets include:
  - Patents
  - Copyrights
  - Trademarks
  - Other creative works

10-120

Accounting for Intangibles

- Intangible assets that are purchased are recorded at cost.
- Most purchased intangibles are expensed through **amortization,** the allocation of the cost of an intangible asset to expense over its useful life.
- Only intangibles with a definite life are amortized.

10-121

Accounting for Intangibles

- Intangible assets with an indefinite life are tested for impairment annually.
- **Impairment** occurs when the fair value of an asset is less than the book value.
- A company records a loss when an impairment occurs.

10-122

Patents

- A **patent** is an intangible asset that is a federal grant conveying an exclusive 20-year right to produce and sell an invention.
- The invention may be a process, product, or formula.
- The acquisition cost of a patent is debited to the Patent account.

10-123

Exercise 8: Patents

- Assume Smart Touch Learning pays cash $200,000 to acquire a patent on January 1. The useful life of the patent is determined to be five years and the residual value is zero

Question 1: Record the journal entry of this transaction ?

Question 2: Use the straight-line method to calculate the annual amortization?

Question 3: Record the journal entry of the amortization expense ?

10-124

answer: Question 1

Date	Accounts and Explanation	Debit	Credit
Jan. 1	Patent	200,000	
	Cash		200,000
	To record purchase of patent.		

Question 2:

$$Annual\ amortization = \frac{cost\ of\ patent - residual\ value}{estimated\ useful\ life}$$

$$= \frac{200{,}000-0}{5} = 40{,}000\$$$

10-125

Question 3:

Date	Accounts and explanation	Debit	Credit
Dec 31	Amortization-expense	40,000	
	Accumulated amortization		40,000
	to record amortization of patent		

10-126

Copyrights and Trademarks

- A **copyright** is the exclusive right to reproduce and sell a book, a musical composition, a film, another work of art, or intellectual property.
- A **trademark** (also called a trade name) is an asset that represents distinctive identifications of products or services, such as the Nike "swoosh" or the McDonald's "golden arches."

10-127

Franchises and Licenses

- **Franchises** are privileges granted by a business to sell goods or services under specified conditions.
  - McDonald's and Subway are well-known business franchises.
- **Licenses** are privileges granted by a government to use public property in performing services.

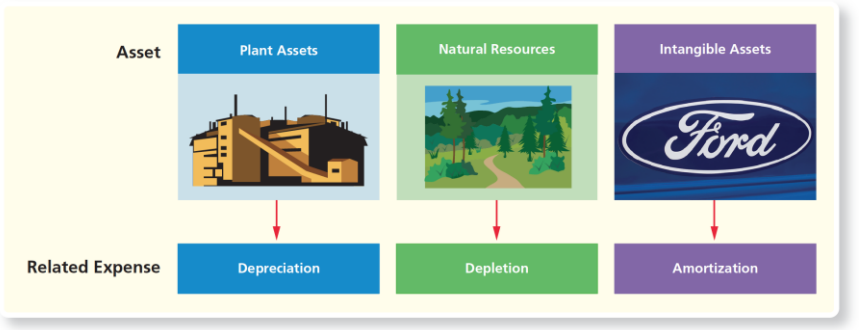
10-128

Goodwill

- **Goodwill** is the value paid above the net worth of a company's assets and liabilities.
- Special features of goodwill:
  - It is recorded by an acquiring company when it purchases another company for more than the market value of the net assets acquired.
  - Goodwill is not amortized.

Recording of Intangible Assets

Exhibit 9-11 | Assets and Their Related Expenses



Learning Objective 7



Use the asset turnover ratio to evaluate business performance

10-131

How Do We Use the Asset Turnover Ratio to Evaluate Business Performance?

- The **asset turnover ratio** measures the amount of net sales generated for each average dollar of total assets invested.
- To compute this ratio, we divide net sales by average total assets.
- Asset turnover ratio = Net sales / Average total assets
- Average total assets = (Beginning total assets + Ending total assets) ÷ 2

10-132

Chapter 3
Merchandising Operations

10-133

Learning Objectives



1. Describe merchandising operations and the two types of merchandise inventory systems
2. Account for the purchase of merchandise inventory using a perpetual inventory system
3. Account for the sale of merchandise inventory using a perpetual inventory system

10-134

Learning Objective 1



Describe merchandising operations and the two types of merchandise inventory systems

10-135

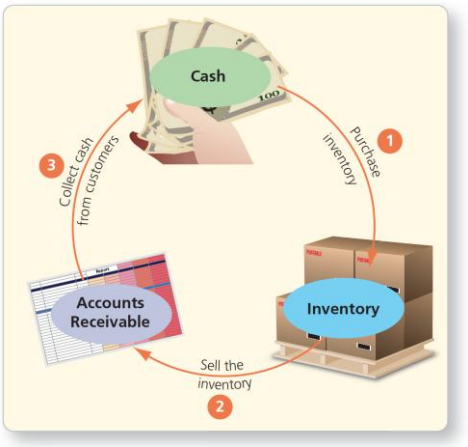
What Are Merchandising Operations?

- A **merchandiser** is a business that sells merchandise, or goods, to customers.
  - The merchandise that this type of business sells is called **merchandise inventory.**
- A **wholesaler** buys goods from a manufacturer and sells them to retailers.
- A **retailer** buys merchandise from manufacturers or a wholesaler and then sells the goods to consumers.

10-136

The Operating Cycle of a Merchandising Business

Exhibit 5-1 | Operating Cycle of a Merchandiser



10-137

The Operating Cycle of a Merchandising Business

- The income statement of a merchandiser reports:
  - Sales Revenue rather than Service Revenue
  - The cost of merchandise sold to customers, called **Cost of Goods Sold (COGS)**
  - **Gross profit**, which is net Sales Revenue minus Cost of Goods Sold
  - **Operating expenses,** which re expenses other than Cost of Goods Sold

10-138

Merchandise Inventory Systems: Perpetual and Periodic Inventory Systems

- Businesses need to determine the value on merchandise inventory on hand and the value sold.
- The two inventory accounting systems:
  - A **periodic inventory system** requires a physical count of inventory to determine inventory on hand.
  - A **perpetual inventory system** offers continuous computerized record of merchandise inventory.

10-139

Learning Objective 2



Account for the purchase of merchandise inventory using a perpetual inventory system

10-140

Exercise 1:

Exhibit 5-3 | Purchase Invoice

1

Southwest Electronics Direct
P.O. BOX 101010
HOUSTON, TX 77212

Invoice	
Date	Number
6/1/17	410

3

2

Shipped To: SMART TOUCH LEARNING
227 LAKE STREET
POMPTON PLAINS, IL 07444

6 Pd. 6/15/17

4

Credit Terms
3/15, NET 30 DAYS

	Description		Quantity Shipped	Unit Price	Total
	Touch Screen Tablet Computers		100	$ 350	$35,000

Sub Total	$35,000
Ship. or Handl. Chg.	–
Tax (3%)	–
Total(s)	$35,000

5

Due Date & Due Amount		
06/16/17		07/01/2017
$33,950		$35,000

7

Explanations:

1 The seller is Southwest Electronics Direct.

2 The purchaser is Smart Touch Learning.

3 The invoice date is needed to determine whether the purchaser gets a discount for prompt payment (see 4).

4 Credit terms: If Smart Touch Learning pays within 15 days of the invoice date, it can deduct a 3% discount. Otherwise, the full amount—NET—is due in 30 days.

5 Total invoice amount is $35,000.

6 Smart Touch Learning's payment date. How much did Smart Touch Learning pay? (see 7).

7 Payment occurred 14 days after the invoice date—within the discount period—so Smart Touch Learning paid $33,950 ($35,000–3% discount).

10-141

Purchase of Merchandise Inventory

Exercise 1 : Record the journal entries using the perpetual inventory system .

Case1:

Assume that Smart Touch Learning receives the goods on June 3 and makes a payment 35,000$ cash on that date.

Date	Accounts and Explanation	Debit	Credit
Jun. 3	Merchandise Inventory	35,000	
	Cash		35,000
	Purchased inventory for cash.		

10-142

Purchase of Merchandise Inventory

Case 2:

Now assume that on June 3, instead of paying cash, Smart Touch Learning receives the merchandise inventory on account.

Date	Accounts and Explanation	Debit	Credit
Jun. 3	Merchandise Inventory	35,000	
	Accounts Payable		35,000
	Purchased inventory on account.		

10-143

Purchase Discounts

Case 3:

If Smart Touch Learning pays on June 15, which is within the discount period 3%, the cash payment entry would be:

Date	Accounts and explanation	Debit	Credit
Jun15	Accounts payable	35,000	
	Cash(35,000-1,050)		33,950
	purchase discounts (35,000x0,03)		1.050
	paid within discount period		

10-144

Purchase Returns and Allowances

- Sellers allow purchasers to return merchandise that is defective, damaged, or unsuitable.
- **Purchase returns** exist when sellers allow purchasers to return merchandise.
- **Purchase allowances** are granted to purchasers as an incentive to keep goods that are not as ordered.

10-145

Case4 :Purchase Returns and Allowances

Assume Smart Touch Learning returns $7,000 of the June 3 (in case 2) purchase on June 4.

Date	Accounts and Explanation	Debit	Credit
Jun. 4	Accounts Payable	7,000	
	Merchandise Inventory (20 tablets × $350 per tablet)		7,000
	Returned inventory to seller (vendor).		

10-146

Cost of Inventory Purchased

- Knowing the net cost of inventory allows a business to determine the actual cost of the merchandise purchased.
- Net cost of inventory is calculated as follows:

Net Cost of Inventory Purchased = Purchase cost of inventory − Purchase returns and allowances − Purchase discounts + Freight in

10-147

Learning Objective 3



Account for the sale of merchandise inventory using a perpetual inventory system

10-148

How Are Sales of Merchandise Inventory Recorded in a Perpetual Inventory System?

- The amount a business earns from selling merchandise inventory is called **Sales Revenue.**
- Two entries are required to record sale transactions:
  - The first entry records Sales Revenue and Cash or Accounts Receivable.
  - The second entry records Cost of Goods Sold and Merchandise Inventory.

10-149

Sale of Merchandise Inventory

Exercise 2:

Exhibit 5-5 | **Sales Invoice**

Date: June 19, 2017 Invoice #582

STL SMART TOUCH LEARNING

227 LAKE STREET
POMPTON PLAINS, IL 07444

Quantity	Item	Unit Price	Total
2	Touch Screen Tablet Computers	$500	$1,000
Total			$1,000

10-150

Sale of Merchandise Inventory

Exercise 2 : Record the journal entries using the perpetual inventory system .

Case 1: Smart Touch Learning sold 2 tablets for $1,000 cash. The cost of those tablets was $700.

This entry records the sales revenue.

This entry records the expense and the reduction of merchandise inventory.

Date	Accounts and Explanation	Debit	Credit
Jun. 19	Cash	1,000	
	Sales Revenue		1,000
	Cash sale.		
19	Cost of Goods Sold	700	
	Merchandise Inventory		700
	Recorded the cost of goods sold.		

10-151

Sale of Merchandise Inventory

Case 2:

Smart Touch Learning sold 10 tablets for $500 each on account with terms, on June 21. The goods cost $3,500.

Date	Accounts and Explanation	Debit	Credit
Jun. 21	Accounts Receivable	5,000	
	Sales Revenue		5,000
	Sale on account.		
21	Cost of Goods Sold	3,500	
	Merchandise Inventory		3,500
	Recorded the cost of goods sold.		

10-152

Sales Discounts

A **sales discount** reduces the amount of cash received from a customer for early payment. Sales Discounts is a contra account to Sales Revenue.

Case3: Assume the customer that purchased the tablets on June 21 (in case 2) made payment cash on June 30, within the discount period 2%.

Date	Accounts and Explanation	Debit	Credit
Jun. 30	Cash ($5,000 − $100)	4,900	
	Sales Discounts ($5,000 × 0.02)	100	
	Accounts Receivable		5,000
	Cash collection within the discount period.		

10-153

Sales Returns and Allowances

- The return of goods by a customer or the granting of an allowance is called **sales returns and allowances.**
- Sales Returns and Allowances is a contra account to Sales Revenue and has a normal debit balance.

10-154

Sales Return

Case 4 :

On June 25, a customer returns 3 tablets that were sold for $1,500 (in case 2), with a cost of goods sold of $1,050.

This entry records the sales returns and allowances.

This entry records the return of the merchandise.

Date	Accounts and Explanation	Debit	Credit
Jun. 25	Sales Returns and Allowances	1,500	
	Accounts Receivable		1,500
	Received returned goods.		
25	Merchandise Inventory	1,050	
	Cost of Goods Sold		1,050
	Placed goods back in inventory.		

10-155

Sales Allowance

Case 5:

On June 28, Smart Touch Learning grants a $100 sales allowance for goods damaged in transit.

Date	Accounts and Explanation	Debit	Credit
Jun. 28	Sales Returns and Allowances	100	
	Accounts Receivable		100
	Granted a sales allowance for damaged goods.		

10-156

Transportation Costs—Freight Out

Case 6:

Smart Touch Learning paid cash $30 to ship goods to a customer on June 21.

Date	Accounts and Explanation	Debit	Credit
Jun. 21	Delivery Expense	30	
	Cash		30
	Paid a freight bill.		

Remember: Freight out is a selling expense.

10-157

Net Sales Revenue and Gross Profit

- **Net Sales Revenue** is the amount a company has earned on sales of merchandise after returns, allowances, and discounts have been taken out.
- Net Sales Revenue is determined using the following formula:

Net Sales Revenue = Sales Revenue − Sales Returns and Allowances − Sales Discounts

10-158

Net Sales Revenue and Gross Profit

Exercise 3:

For the year, Smart Touch Learning sells $297,500 of merchandise inventory, receives $11,200 of sales returns and allowances, and accepts $5,600 of early payment discounts. The cost of goods sold 199,500$

Question 1: Calculate the Net sale revenue ?

Question 2: Calculate the gross profit?

10-159

Answer : Question 1

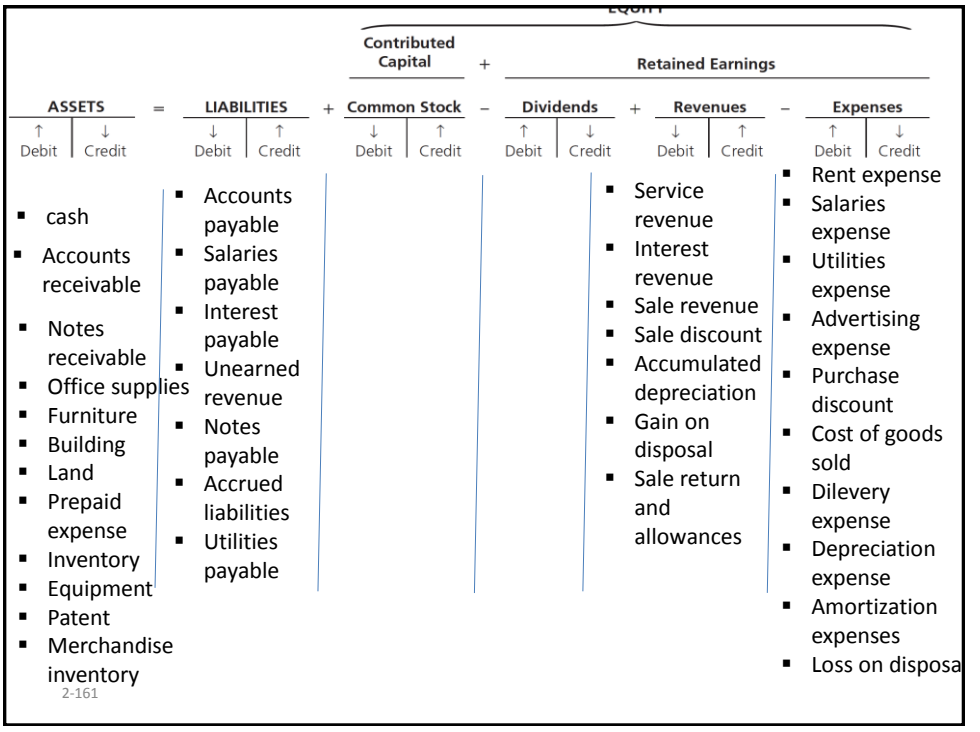
Sales Revenue	$ 297,500
Less: Sales Returns and Allowances	11,200
Sales Discounts	5,600
Net Sales Revenue	$ 280,700

Question 2 :

Net Sales Revenue	$ 280,700
Less: Cost of Goods Sold	199,500
Gross Profit	$ 81,200

Gross profit is a measure of a business's success. It indicates the amount available to cover operating expenses.

10-160


EQUITY
Contributed Capital
+
Retained Earnings
ASSETS = LIABILITIES + Common Stock − Dividends + Revenues − Expenses
↑ Debit | ↓ Credit
↓ Debit | ↑ Credit
↓ Debit | ↑ Credit
↑ Debit | ↓ Credit
↓ Debit | ↑ Credit
↑ Debit | ↓ Credit
cash
Accounts receivable
Notes receivable
Office supplies
Furniture
Building
Land
Prepaid expense
Inventory
Equipment
Patent
Merchandise inventory
Accounts payable
Salaries payable
Interest payable
Unearned revenue
Notes payable
Accrued liabilities
Utilities payable
Service revenue
Interest revenue
Sale revenue
Sale discount
Accumulated depreciation
Gain on disposal
Sale return and allowances
Rent expense
Salaries expense
Utilities expense
Advertising expense
Purchase discount
Cost of goods sold
Dilevery expense
Depreciation expense
Amortization expenses
Loss on disposa
2-161