

# 2

## THE ACCOUNTING INFORMATION SYSTEM

### DISCUSSION QUESTIONS

1. The conceptual framework of accounting is the collection of general concepts that logically flow from the objective of financial reporting—to provide information that is useful in making business and economic decisions. The conceptual framework supports the development of generally accepted accounting principles (GAAP) and provides a consistent body of thought for financial reporting. An understanding of the conceptual framework will provide a logical structure to financial accounting that will help in understanding complex accounting standards.
2. The conceptual framework identified two fundamental qualitative characteristics—relevance and faithful representation. Relevant information is capable of making a difference in a decision by helping users predict future events or providing feedback about prior expectations. Relevant information is also material. Faithfully represented information portrays the economic event it intends to portray. Faithfully represented information should be complete (includes all necessary information for the user to understand the economic event), neutral (unbiased), and free from error (as accurate as possible).

In addition to the fundamental qualitative characteristics, the FASB has identified four enhancing characteristics—comparability, verifiability, timeliness, and understandability. Comparable information allows external users to identify similarities and differences between two or more items. Verifiable information describes a situation in which independent parties can reach a consensus on the measurement of the activity. Information is timely if it is available to users before it loses its ability to influence decisions. Finally, if users who have a reasonable knowledge of accounting and business can, with reasonable study effort, comprehend the meaning of the information, it is considered understandable.
3. Tradeoffs are often necessary between the qualitative characteristics. For example, the most relevant information may not be able to be faithfully represented. Similarly, a change in accounting principle may temporarily reduce comparability but improve the relevance of the information. The goal should be to provide the most relevant information that can be faithfully represented.
4. Comparability refers to the ability to compare information across different companies or with similar information about the same company for another time period. Consistency refers to the use of the same accounting principles for the same items, either from one time period to another time period within a company or in a single period across companies.
5. The cost constraint limits the ability of a company to provide useful information. The cost constraint refers to the idea that some information that is useful would be too expensive for the company to provide based on the benefit that is achieved from providing it.
6. The four underlying accounting assumptions are the economic entity assumption, the continuity (going-concern) assumption, the time-period assumption, and the monetary unit assumption. The economic entity assumption requires that a company be accounted for separately from its owners. The continuity assumption assumes that a company will continue to operate long enough to carry out its existing commitments. The time-period assumption allows the life of a company to be divided into artificial time periods so net income can be measured for a specific period of time. The monetary unit assumption requires that a company account for and report its financial results in monetary terms.

7. There are four principles used to measure and record business transactions. First, the historical cost principle requires transactions to be recorded at their cost—the exchange price at the time the activity occurs. Second, the revenue recognition principle determines when revenue is recorded and reported by a company. Under this principle, revenue must be earned and the collection of cash must be reasonably assured in order to record and report revenue. Third, the matching principle requires that an expense be recorded and reported in the same period as the revenue it helped generate. Finally, the conservatism principle states that accountants should take care to avoid overstating assets or income.
8. The financial statements summarize the economic performance and status of a business and are issued at least annually. Generally accepted accounting principles (GAAP) are the rules and conventions that guide the preparation of financial statements. GAAP provides a “common ground” that makes it easier to use financial statements over time and across companies.
9. Many events occur that affect the financial position and the operations of a business, but only those that qualify for recognition as transactions are recorded in the accounting records. To qualify as a transaction, the effect of the underlying events must impact a financial statement element (asset, liability, stockholders’ equity, revenue, or expense) and, thus, the company’s financial statements. In addition, the event must be able to be faithfully represented.
10. Faithful representation refers to information faithfully representing the economic event that it is intending to portray. Faithfully presented information should be complete, neutral, and free from error. If information is not faithfully represented, it may mislead decision makers. These decision makers would find it extremely difficult, if not impossible, to use information that is incomplete or subject to significant error and/or bias.
11. Transaction analysis usually begins with gathering the source documents that describe business activities. Accountants must then analyze these documents to determine which transactions should be recognized in the accounting system. If the transaction is to be recorded in the accounting system, the transaction must then be analyzed to determine the effects it will have on the fundamental accounting equation. This analysis involves three steps: (1) write down the accounting equation; (2) identify the financial statement elements that are affected by the transaction; and (3) determine whether the element increased or decreased.
12. Yes, it is possible for a transaction to affect only one side of the accounting equation. While the accounting equation must always remain in balance (meaning there must always be a dual effect on the accounting equation), these effects can be on the same side of the accounting equation. An example of this is when a customer pays cash for an accounts receivable. Both cash and accounts receivable are asset accounts (on the left side of the equation). One asset, accounts receivable, is decreasing, while another asset, cash, is increasing by the same amount. This results in the accounting equation remaining in balance, even though only one side of the equation was affected.
13. When a firm earns revenue, its net income is increased. When a firm incurs an expense its net income is decreased. At the end of the accounting period, net income is added to retained earnings, a stockholders’ equity account. Therefore, an increase in revenue increases stockholders’ equity and a decrease in revenue decreases stockholders’ equity; an increase in expense or dividends decreases stockholders’ equity and a decrease in expense or dividends increases stockholders’ equity.

14. A T-account is a two-column record that consists of a title and two sides divided by a vertical line. A T-account gets its name because it resembles the capital letter "T." The left side is referred to as the debit side, and the right side is referred to as the credit side.
15. No, debit does not mean increase and credit does not mean decrease. The words *debit* and *credit* simply refer to the left and right side of an account. Neither debit nor credit has direct positive or negative connotations. Only when the terms debit and credit are associated with a particular account can a *debit* or a *credit* be identified as an increase or a decrease. For example, a debit increases an asset account but decreases a liability account.
16. To debit an account means to add an amount to the left side of that account. A debit balance is a balance on the left side of an account. To credit an account means to add an amount to the right side of that account. A credit balance is a balance on the right side of an account. Debits and credits do not represent increases or decreases.
17. The normal balance of each of the accounts is:
  - (a) cash—debit
  - (b) sales—credit
  - (c) notes payable—credit
  - (d) inventory—debit
  - (e) retained earnings—credit
  - (f) salary expense—debit
  - (g) equipment—debit
  - (h) unearned revenue—credit
18. In each journal entry, the sum of the debits must equal the sum of the credits. If transactions are recorded with debits equal to credits, then the equality of assets with liabilities plus stockholders' equity will be maintained.
19. Accounting transactions are typically recorded initially in a journal on an event-by-event basis. The recording of events in a journal allows the entire effect of a transaction to be contained in one place. The individual effects of a transaction are then posted to the general ledger. Potentially, a firm could put these transactions directly into the general ledger. However, if the transaction were recorded directly into the general ledger, there would be no evidence of the complete transaction in one place, which would make the use of the information very cumbersome.
20. "Double-entry" is an appropriate description of an accounting system because each transaction will affect at least two accounts and each transaction must have debit and credit entries that must be equal.
21. The initial steps of the accounting cycle involve (1) analyzing transactions; (2) journalizing transactions; (3) posting to the general ledger; and (4) preparing a trial balance. In the first step, data is collected about business activities and analyzed to determine which activities meet the criteria for recognition in the accounting records. If the data meet the recognition criteria, the effect on the fundamental accounting equation is determined. In the second step, the effects of the transaction on the fundamental accounting equation are recorded in the accounting system using debits and credits. In the third step, journal entries are posted to the general ledger, which is organized on an account-by-account basis. Finally, a trial balance is prepared from account balances in the ledger.
22. Trial balances help detect errors resulting from inequality of debits and credits. A trial balance usually will not help in the detection of omitted entries or errors of analysis, journalizing, or posting when those errors cause incorrect account balances with equal debits and credits.

### MULTIPLE-CHOICE EXERCISES

- 2-1. c
- 2-2. a
- 2-3. c
- 2-4. b
- 2-5. b
- 2-6. d
- 2-7. c
- 2-8. a
- 2-9. d
- 2-10. c
- 2-11. c
- 2-12. b
- 2-13. d
- 2-14. a
- 2-15. b

### CORNERSTONE EXERCISES

**CE 2-16**

- a. Faithful Representation
- b. Consistency
- c. Materiality

**CE 2-17**

- a. Cost vs. benefit
- b. Relevance
- c. Comparability

**CE 2-18**

- a. Monetary unit
- b. Continuity (going-concern)
- c. Economic entity
- d. Time period

**CE 2-19**

- a. Revenue recognition
- b. Conservatism
- c. Historical cost
- d. Matching

**CE 2-20**

|    | Assets | Liabilities | Stockholders'<br>Equity |
|----|--------|-------------|-------------------------|
| a. | +      | NE          | +                       |
| b. | +/-    | NE          | NE                      |
| c. | +      | +           | NE                      |
| d. | -      | NE          | -                       |

**CE 2-21**

|    | Assets  | = | Liabilities | + | Stockholders' Equity   |                      |
|----|---------|---|-------------|---|------------------------|----------------------|
|    |         |   |             |   | Contributed<br>Capital | Retained<br>Earnings |
| a. | 50,000  |   |             |   | 50,000                 |                      |
| b. | 15,000  |   | 15,000      |   |                        |                      |
| c. | 8,000   |   | 8,000       |   |                        |                      |
| d. | (8,000) |   | (8,000)     |   |                        |                      |

**CE 2-22**

|    | Assets  | = | Liabilities | + | Stockholders' Equity   |                      |
|----|---------|---|-------------|---|------------------------|----------------------|
|    |         |   |             |   | Contributed<br>Capital | Retained<br>Earnings |
| a. | 18,500  |   |             |   |                        | 18,500               |
| b. | 7,200   |   |             |   |                        |                      |
|    | (7,200) |   |             |   |                        |                      |
| c. | (1,500) |   |             |   |                        | (1,500)              |
| d. | (3,500) |   |             |   |                        | (3,500)              |

**CE 2-23**

|    | Account             | Normal<br>Balance | Debit    | Credit   |
|----|---------------------|-------------------|----------|----------|
| a. | Accounts Payable    | Credit            | Decrease | Increase |
| b. | Accounts Receivable | Debit             | Increase | Decrease |
| c. | Retained Earnings   | Credit            | Decrease | Increase |
| d. | Sales               | Credit            | Decrease | Increase |
| e. | Equipment           | Debit             | Increase | Decrease |
| f. | Common Stock        | Credit            | Decrease | Increase |
| g. | Salary Expense      | Debit             | Increase | Decrease |
| h. | Repair Expense      | Debit             | Increase | Decrease |

CE 2-24

Journal

| Date |    | Account and Explanation                   | Debit  | Credit |
|------|----|---|--------|--------|
| June | 1  | Cash                                      | 83,000 |        |
|      |    | Common Stock                              |        | 83,000 |
|      |    | <i>(Record issuance of common stock)</i>  |        |        |
|      | 8  | Equipment                                 | 12,800 |        |
|      |    | Cash                                      |        | 12,800 |
|      |    | <i>(Record purchase of equipment)</i>     |        |        |
|      | 15 | Cash                                      | 21,400 |        |
|      |    | Sales Revenue                             |        | 21,400 |
|      |    | <i>(Record cash sale)</i>                 |        |        |
|      | 29 | Dividends                                 | 6,500  |        |
|      |    | Cash                                      |        | 6,500  |
|      |    | <i>(Declared and paid cash dividends)</i> |        |        |

CE 2-25

Journal

| Date |    | Description                                 | Debit  | Credit |
|------|----|---|--------|--------|
| May  | 5  | Cash  | 20,000 |        |
|      |    | Notes Payable                               |        | 20,000 |
|      |    | <i>(Record borrowing of cash from bank)</i> |        |        |
|      | 10 | Cash  | 14,500 |        |
|      |    | Sales Revenues                              |        | 14,500 |
|      |    | <i>(Record cash sale)</i>                   |        |        |
|      | 19 | Salaries Expense                            | 8,600  |        |
|      |    | Cash  |        | 8,600  |
|      |    | <i>(Record payment of salaries)</i>         |        |        |
|      | 22 | Supplies                                    | 4,100  |        |
|      |    | Cash  |        | 4,100  |
|      |    | <i>(Record purchase of supplies)</i>        |        |        |
|      | 22 | Supplies Expense                            | 4,100  |        |
|      |    | Supplies                                    |        | 4,100  |
|      |    | <i>(Record use of supplies)</i>             |        |        |

**CE 2-26**

| <b>Borges, Inc.</b>       |                 |                 |  |
|---------------------------|-----------------|-----------------|--|
| <b>Trial Balance</b>      |                 |                 |  |
| <b>December 31, 2011</b>  |                 |                 |  |
| <b>Account</b>            | <b>Debit</b>    | <b>Credit</b>   |  |
| Cash.....                 | \$12,850        |                 |  |
| Accounts Receivable.....  | 5,700           |                 |  |
| Equipment.....            | 12,725          |                 |  |
| Accounts Payable.....     |                 | \$ 2,825        |  |
| Common Stock.....         |                 | 15,000          |  |
| Dividends.....            | 1,500           |                 |  |
| Service Revenue.....      |                 | 23,150          |  |
| Rent Expense.....         | 2,400           |                 |  |
| Salaries Expense.....     | 4,300           |                 |  |
| Advertising Expense ..... | 1,500           |                 |  |
|                           | <u>\$40,975</u> | <u>\$40,975</u> |  |



**EXERCISES****E 2-27**

- |                         |                               |
|-------------------------|-------------------------------|
| 1. e. Timeliness        | 5. a. Relevance               |
| 2. d. Verifiability     | 6. b. Faithful representation |
| 3. f. Understandability | 7. c. Comparability           |
| 4. a. Relevance         | 8. b. Faithful representation |

**E 2-28**

- |                           |                                  |
|---------------------------|----------------------------------|
| 1. e. Historical cost     | 5. b. Continuity (going-concern) |
| 2. a. Economic entity     | 6. c. Time-period                |
| 3. d. Monetary unit       | 7. h. Conservatism               |
| 4. f. Revenue recognition | 8. g. Matching                   |

**E 2-29**

1. and 2.

- a. Yes, the event qualifies for recognition.
- b. No, the agreement does not qualify for recognition because no financial statement element will be affected until at least one party to the contract performs its responsibility (the service is performed or money is actually exchanged).
- c. Yes, the event qualifies for recognition.
- d. Yes, the event qualifies for recognition.
- e. No, this transaction does not qualify for recognition in the financial statements of the company because it does not affect the overall common stock of the company. This transaction is between two entities (the individual investors) that are separate from the company.
- f. Yes, the event qualifies for recognition.

**E 2-30**

**1. and 2.**

- a. Qualify.**
- b. Does not qualify. The accounting equation has not been affected by ordering the product. When the cash register is delivered or paid for, one of the parties to the contract will have performed and the transaction will qualify for recording.**
- c. Qualify.**
- d. Does not qualify. It has to do with the owner's personal transactions, not the company's transactions.**
- e. Does not qualify. The extension does not affect the accounting equation. Once one of the parties performs according to the contract (the store is occupied in April 2011 or rent is paid), the transaction will be recorded.**
- f. Qualify.**
- g. Qualify.**

**E 2-31**

- 1. a. Increase assets (cash) \$1,200 and increase stockholders' equity revenue \$1,200.**
  - b. Increase assets (accounts receivable) \$700 and increase stockholders' equity (revenue) \$700.**
  - c. Increase assets (land) \$5,000 and decrease assets (cash) \$5,000.**
  - d. Increase assets (supplies) \$300 and increase liabilities (accounts payable) \$300.**
  - e. Decrease assets (cash) \$1,000 and decrease stockholders' equity (dividend) \$1,000.**
  - f. Decrease assets (cash) \$250 and decrease liabilities (accounts payable) \$250.**
  - g. Decrease assets (cash) \$200 and decrease stockholders' equity (expense) \$200.**
  - h. Increase assets (cash) \$500 and decrease assets (accounts receivable) \$500.**
  - i. Increase assets (cash) \$12,000 and increase stockholders' equity (common stock) \$12,000.**
- 2. For transaction *d*, supplies were recorded as an asset at their historical cost—the exchange price of the transaction. Later, as the supplies are used, the matching principle will guide the amount of supplies that will be expensed. This application of the matching concept will be discussed more fully in Chapter 3.**

E 2-32

|    | Assets   | = | Liabilities | + | Stockholders' Equity |                   |
|----|----------|---|-------------|---|----------------------|-------------------|
|    |          |   |             |   | Contributed Capital  | Retained Earnings |
| a. | 30,000   |   |             |   | 30,000               |                   |
| b. | (18,500) |   |             |   |                      |                   |
|    | 18,500   |   |             |   |                      |                   |
| c. | 2,750    |   | 2,750       |   |                      |                   |
| d. | (2,750)  |   |             |   |                      | (2,750)           |
| e. | (800)    |   |             |   |                      | (800)             |
| f. | 3,910    |   |             |   |                      | 3,910             |
| g. | (1,100)  |   |             |   |                      | (1,100)           |
| h. | (650)    |   |             |   |                      |                   |
|    | 650      |   |             |   |                      |                   |
|    | (650)    |   |             |   |                      | (650)             |
| i. | (1,900)  |   | (1,900)     |   |                      |                   |
| j. | 1,050    |   |             |   |                      | 1,050             |
| k. | (600)    |   |             |   |                      | (600)             |

**E 2-33**

1.

|    |           |   |             |   | Stockholders' Equity   |                      |
|----|-----------|---|-------------|---|------------------------|----------------------|
|    | Assets    | = | Liabilities | + | Contributed<br>Capital | Retained<br>Earnings |
| a. | 925,000   |   |             |   |                        |                      |
|    | (925,000) |   |             |   |                        |                      |
| b. | 110,000   |   |             |   | 110,000                |                      |
| c. | 62,000    |   | 62,000      |   |                        |                      |
| d. | 8,400     |   |             |   |                        |                      |
|    | (8,400)   |   |             |   |                        |                      |
| e. | (34,750)  |   |             |   |                        | (34,750)             |
| f. | (10,000)  |   |             |   |                        | (10,000)             |

2.

- a. Investing
- b. Financing
- c. Investing
- d. Operating
- e. Operating
- f. Financing

**E 2-34**

- a. This transaction is a result of purchasing land for cash.
- b. This transaction is a result of paying cash for an expense (e.g., rent expense) or a result of paying cash for dividends.
- c. This transaction is a result of issuing common stock in exchange for cash.
- d. This transaction is a result of borrowing cash.

E 2-35

|    | Assets  | = | Liabilities | + | Stockholders' Equity |                   |
|----|---------|---|-------------|---|----------------------|-------------------|
|    |         |   |             |   | Contributed Capital  | Retained Earnings |
| a. | 50,000  |   |             |   | 50,000               |                   |
| b. | 20,000  |   | 20,000      |   |                      |                   |
| c. | (7,000) |   |             |   |                      |                   |
|    | 7,000   |   |             |   |                      |                   |
| d. | (6,600) |   |             |   |                      |                   |
|    | 6,600   |   |             |   |                      |                   |
| e. | 4,300   |   |             |   |                      | 4,300             |
| f. | 16,000  |   |             |   |                      | 16,000            |
| g. | (7,500) |   |             |   |                      | (7,500)           |
| h. | (7,200) |   |             |   |                      |                   |
|    | 7,200   |   |             |   |                      |                   |
| i. | 1,100   |   | 1,100       |   |                      |                   |
| j. | (800)   |   |             |   |                      | (800)             |
| k. | (1,100) |   | (1,100)     |   |                      |                   |

E 2-36

|    | Assets  | = | Liabilities | + | Stockholders' Equity |                   |
|----|---------|---|-------------|---|----------------------|-------------------|
|    |         |   |             |   | Contributed Capital  | Retained Earnings |
| a. | 12,000  |   | 12,000      |   |                      |                   |
| b. | 1,100   |   |             |   |                      | 1,100             |
| c. | 36,500  |   |             |   |                      |                   |
|    | (5,500) |   | 31,000      |   |                      |                   |
| d. | 3,200   |   | 3,200       |   |                      |                   |
| e. | (300)   |   |             |   |                      | (300)             |

**E 2-37**

- a. This transaction is the result of purchasing equipment for cash.
- b. This transaction is the result of performing services (generating revenue) in exchange for cash.
- c. This transaction is the result of purchasing supplies on account (on credit).
- d. This transaction is the result of the use of supplies.

**E 2-38**

| Account                             | Debit | Credit | Financial Statement                        |
|-------------------------------------|-------|--------|--|
| Accounts Payable                    |       | X      | Balance sheet                              |
| Accounts Receivable                 | X     |        | Balance sheet                              |
| Accumulated Depreciation, Equipment |       | X      | Balance sheet                              |
| Cash                                | X     |        | Balance sheet                              |
| Common Stock                        |       | X      | Balance sheet                              |
| Cost of Goods Sold                  | X     |        | Income statement                           |
| Depreciation Expense, Equipment     | X     |        | Income statement                           |
| Equipment                           | X     |        | Balance sheet                              |
| Utilities Expense                   | X     |        | Income statement                           |
| Interest Expense                    | X     |        | Income statement                           |
| Inventory                           | X     |        | Balance sheet                              |
| Notes Payable                       |       | X      | Balance sheet                              |
| Retained Earnings                   |       | X      | Balance sheet, retained earnings statement |
| Sales Revenue                       |       | X      | Income statement                           |
| Advertising Expense                 | X     |        | Income statement                           |

E 2-39

|    | Assets                                | = | Liabilities          | + | Stockholders' Equity |                      |
|----|---------------------------------------|---|----------------------|---|----------------------|----------------------|
|    |                                       |   |                      |   | Contributed Capital  | Retained Earnings    |
| a. | Increase<br>(Debit)                   |   | Increase<br>(Credit) |   |                      |                      |
| b. | Increase<br>(Debit)                   |   | Increase<br>(Credit) |   |                      |                      |
| c. | Decrease<br>(Credit)                  |   |                      |   |                      | Decrease<br>(Debit)  |
| d. | Increase<br>(Debit)                   |   | Increase<br>(Credit) |   |                      |                      |
| e. | Decrease<br>(Credit)                  |   |                      |   |                      | Decrease<br>(Debit)  |
| f. | Increase<br>(Debit)                   |   |                      |   |                      | Increase<br>(Credit) |
| g. | Increase<br>(Debit)                   |   |                      |   |                      | Increase<br>(Credit) |
| h. | Increase<br>(Debit)                   |   |                      |   | Increase<br>(Credit) |                      |
| i. | Decrease<br>(Credit)                  |   | Decrease<br>(Debit)  |   |                      |                      |
| j. | Increase/Decrease<br>(Debit)/(Credit) |   |                      |   |                      |                      |
| k. | Decrease<br>(Credit)                  |   |                      |   |                      | Decrease<br>(Debit)  |

## E 2-40

| Transaction | Account             | Increase/<br>Decrease | Debit/<br>Credit | Amount   |
|-------------|---------------------|-----------------------|------------------|----------|
| a.          | Land                | Increase              | Debit            | \$15,200 |
|             | Cash                | Decrease              | Credit           | \$15,200 |
| b.          | Equipment           | Increase              | Debit            | \$23,600 |
|             | Notes Payable       | Increase              | Credit           | \$23,600 |
| c.          | Supplies            | Increase              | Debit            | \$1,200  |
|             | Accounts Payable    | Increase              | Credit           | \$1,200  |
| d.          | Notes Payable       | Decrease              | Debit            | \$10,000 |
|             | Interest Expense    | Increase              | Debit            | \$700    |
|             | Cash                | Decrease              | Credit           | \$10,700 |
| e.          | Accounts Payable    | Decrease              | Debit            | \$2,600  |
|             | Cash                | Decrease              | Credit           | \$2,600  |
| f.          | Accounts Receivable | Increase              | Debit            | \$62,100 |
|             | Service Revenue     | Increase              | Credit           | \$62,100 |
| g.          | Cash                | Increase              | Debit            | \$11,400 |
|             | Service Revenue     | Increase              | Credit           | \$11,400 |
| h.          | Cash                | Increase              | Debit            | \$29,800 |
|             | Accounts Receivable | Decrease              | Credit           | \$29,800 |
| i.          | Wages Expense       | Increase              | Debit            | \$13,300 |
|             | Cash                | Decrease              | Credit           | \$13,300 |
| j.          | Cash                | Increase              | Debit            | \$21,000 |
|             | Common Stock        | Increase              | Credit           | \$21,000 |



E 2-41

## Journal

| Date |    | Account and Explanation                        | Debit  | Credit |
|------|----|--|--------|--------|
| Mar. | 2  | Cash   | 41,200 |        |
|      |    | Service Revenue                                |        | 41,200 |
|      |    | <i>(Record revenue)</i>                        |        |        |
|      | 3  | Inventory                                      | 700    |        |
|      |    | Accounts Payable                               |        | 700    |
|      |    | <i>(Record purchase of surfboards)</i>         |        |        |
|      | 6  | Wages Expense                                  | 8,500  |        |
|      |    | Cash   |        | 8,500  |
|      |    | <i>(Record wages)</i>                          |        |        |
|      | 9  | Rent Expense                                   | 1,300  |        |
|      |    | Cash   |        | 1,300  |
|      |    | <i>(Record rent)</i>                           |        |        |
|      | 12 | Trucks   | 37,800 |        |
|      |    | Cash   |        | 1,000  |
|      |    | Notes Payable                                  |        | 36,800 |
|      |    | <i>(Record purchase of truck)</i>              |        |        |
|      | 13 | Cash   | 950    |        |
|      |    | Accounts Receivable                            |        | 950    |
|      |    | <i>(Record collection of customer account)</i> |        |        |
|      | 16 | Accounts Payable                               | 870    |        |
|      |    | Cash   |        | 870    |
|      |    | <i>(Record payment of account owed)</i>        |        |        |
|      | 23 | Cash   | 15,000 |        |
|      |    | Notes Payable                                  |        | 15,000 |
|      |    | <i>(Record borrowing of cash)</i>              |        |        |
|      | 27 | Utilities Expense                              | 145    |        |
|      |    | Cash   |        | 145    |
|      |    | <i>(Record payment of telephone bill)</i>      |        |        |
|      | 30 | Advertising Expense                            | 1,260  |        |
|      |    | Cash   |        | 1,260  |
|      |    | <i>(Record payment for advertising)</i>        |        |        |

E 2-42

1. Journal

| Date |    | Account and Explanation                         | Debit | Credit |
|------|----|---|-------|--------|
| Nov. | 2  | Cash  | 2,400 |        |
|      |    | Service Revenue                                 |       | 2,400  |
|      |    | <i>(Record revenue earned)</i>                  |       |        |
|      | 6  | Supplies  | 4,750 |        |
|      |    | Accounts Payable                                |       | 4,750  |
|      |    | <i>(Record purchase of supplies on account)</i> |       |        |
|      | 10 | Wages Expense                                   | 5,250 |        |
|      |    | Cash  |       | 5,250  |
|      |    | <i>(Record payment of wages)</i>                |       |        |
|      | 15 | Accounts Payable                                | 4,750 |        |
|      |    | Cash  |       | 4,750  |
|      |    | <i>(Record payment on account)</i>              |       |        |
|      | 28 | Utilities Expense                               | 2,150 |        |
|      |    | Cash  |       | 2,150  |
|      |    | <i>(Record use of utilities)</i>                |       |        |
|      | 30 | Repairs & Maintenance Expense                   | 1,230 |        |
|      |    | Accounts Payable                                |       | 1,230  |
|      |    | <i>(Record repairs performed on account)</i>    |       |        |
| Dec. | 10 | Accounts Payable                                | 1,230 |        |
|      |    | Cash  |       | 1,230  |
|      |    | <i>(To record payment of account)</i>           |       |        |

2. The recording of the November 10 transaction was based on the matching principle. Remington’s workers helped to produce revenue in November. Therefore, the wages expense that was part of Remington’s normal operations needs to be recorded in the same period as the revenue.

E 2-43

Journal

| Date |    | Account and Explanation                       | Debit  | Credit |
|------|----|---|--------|--------|
| Jan. | 14 | Cash  | 80,000 |        |
|      |    | Common Stock                                  |        | 80,000 |
|      |    | <i>(Record issuance of common stock)</i>      |        |        |
|      | 14 | Cash  | 45,000 |        |
|      |    | Notes Payable                                 |        | 45,000 |
|      |    | <i>(Record borrowing of cash)</i>             |        |        |
| Feb. | 22 | Land  | 30,000 |        |
|      |    | Buildings                                     | 60,000 |        |
|      |    | Cash  |        | 34,000 |
|      |    | Notes Payable                                 |        | 56,000 |
|      |    | <i>(Record purchase of land and building)</i> |        |        |
| Mar. | 1  | Buildings                                     | 4,000  |        |
|      |    | Cash  |        | 4,000  |
|      |    | <i>(Record payment for remodeling)</i>        |        |        |
| May  | 3  | Buildings                                     | 11,000 |        |
|      |    | Accounts Payable                              |        | 11,000 |
|      |    | <i>(Record amount due for remodeling)</i>     |        |        |
|      | 20 | Accounts Payable                              | 11,000 |        |
|      |    | Cash  |        | 11,000 |
|      |    | <i>(Record payment on account)</i>            |        |        |
| June | 4  | Supplies                                      | 650    |        |
|      |    | Cash  |        | 650    |
|      |    | <i>(Record purchase of supplies)</i>          |        |        |

E 2-44

1.

Journal

| Date  |    | Account and Explanation                         | Debit  | Credit |
|-------|----|---|--------|--------|
| Jan.  | 15 | Cash  | 10,000 |        |
|       |    | Common Stock                                    |        | 10,000 |
|       |    | <i>(Record issuance of stock)</i>               |        |        |
|       | 24 | Supplies  | 720    |        |
|       |    | Accounts Payable                                |        | 720    |
|       |    | <i>(Record purchase of supplies on account)</i> |        |        |
| Feb.  | 20 | Accounts Payable                                | 720    |        |
|       |    | Cash  |        | 720    |
|       |    | <i>(Record payment of account)</i>              |        |        |
| April | 25 | Accounts Receivable                             | 12,500 |        |
|       |    | Service Revenue                                 |        | 12,500 |
|       |    | <i>(Record services performed on account)</i>   |        |        |
| May   | 12 | Cash  | 12,500 |        |
|       |    | Accounts Receivable                             |        | 12,500 |
|       |    | <i>(Record receipt of payment)</i>              |        |        |
| June  | 5  | Accounts Receivable                             | 9,500  |        |
|       |    | Service Revenue                                 |        | 9,500  |
|       |    | <i>(Record services performed on account)</i>   |        |        |
|       | 24 | Wages Expense                                   | 6,700  |        |
|       |    | Cash  |        | 6,700  |
|       |    | <i>(Record payment of wages)</i>                |        |        |

E 2-44 (Contd)

2.

| Cash |    |        |      |    |       |
|------|----|--------|------|----|-------|
| Jan. | 15 | 10,000 | Feb. | 20 | 720   |
| May  | 12 | 12,500 | Jun. | 24 | 6,700 |
|      |    | 15,080 |      |    |       |

| Accounts Receivable |    |        |     |    |        |
|---------------------|----|--------|-----|----|--------|
| Apr.                | 25 | 12,500 | May | 12 | 12,500 |
| Jun.                | 5  | 9,500  |     |    |        |
|                     |    | 9,500  |     |    |        |

| Supplies |    |     |
|----------|----|-----|
| Jan.     | 24 | 720 |
|          |    | 720 |

| Accounts Payable |    |     |      |    |     |
|------------------|----|-----|------|----|-----|
| Feb.             | 20 | 720 | Jan. | 24 | 720 |
|                  |    |     |      |    | 0   |

| Common Stock |      |    |        |
|--------------|------|----|--------|
|              | Jan. | 15 | 10,000 |
|              |      |    | 10,000 |

| Wages Expense |    |       |
|---------------|----|-------|
| Jun.          | 24 | 6,700 |
|               |    | 6,700 |

| Service Revenue |      |    |        |
|-----------------|------|----|--------|
|                 | Apr. | 25 | 12,500 |
|                 | Jun. | 5  | 9,500  |
|                 |      |    | 22,000 |

3.

| Rosenthal Decorating, Inc.<br>Trial Balance<br>June 30, 2011 |                 |        |                 |
|--|-----------------|--------|-----------------|
| Account  | Debit           | Credit |                 |
| Cash.....  | \$15,080        |        |                 |
| Accounts Receivable.....                                     | 9,500           |        |                 |
| Supplies.....  | 720             |        |                 |
| Accounts Payable.....  |                 | \$     | 0               |
| Common Stock.....  |                 |        | 10,000          |
| Service Revenue.....   |                 |        | 22,000          |
| Wages Expense.....   | 6,700           |        |                 |
|  | <u>\$32,000</u> |        | <u>\$32,000</u> |

**E 2-45**

| <b>Badger Auto Parts<br/>Trial Balance<br/>December 31, 2011</b> |                  |               |                  |
|--|------------------|---------------|------------------|
| <b>Account</b>   | <b>Debit</b>     | <b>Credit</b> |                  |
| Cash.....  | \$ 3,200         |               |                  |
| Accounts Receivable .....  | 40,800           |               |                  |
| Prepaid Rent.....  | 15,250           |               |                  |
| Inventory.....   | 60,500           |               |                  |
| Furniture.....   | 128,000          |               |                  |
| Accumulated Depreciation (Furniture) .....                       |                  | \$ 47,300     |                  |
| Accounts Payable.....  |                  | 8,500         |                  |
| Interest Payable.....  |                  | 1,800         |                  |
| Income Taxes Payable.....  |                  | 3,600         |                  |
| Notes Payable (Long-term).....                                   |                  | 50,000        |                  |
| Common Stock.....  |                  | 100,000       |                  |
| Retained Earnings, 12/31/10.....                                 |                  | 15,900        |                  |
| Sales Revenue.....   |                  |               | 264,700          |
| Cost of Goods Sold.....  | 184,300          |               |                  |
| Advertising Expense.....   | 29,200           |               |                  |
| Utilities Expense.....   | 9,700            |               |                  |
| Depreciation Expense (furniture) .....                           | 10,400           |               |                  |
| Interest Expense.....  | 6,650            |               |                  |
| Income Taxes Expense.....  | 3,800            |               |                  |
|  | <u>\$491,800</u> |               | <u>\$491,800</u> |

**E 2-46**

- a. The trial balance WILL balance but there is still an error. The transaction was recorded at an incorrect dollar amount.
- b. The trial balance WILL NOT balance; sales will be overstated by \$54.
- c. The trial balance WILL balance; both accounts will be overstated.
- d. The trial balance WILL balance; accounts payable will be overstated by \$5,270 and cash will be overstated by \$5,270.
- e. The trial balance WILL NOT balance; accounts receivable will be understated \$7,600.

**PROBLEM SET A****P 2-47A**

1.
  - a. **This transaction does not qualify for recognition because receiving a new price list does not affect the accounting equation. Boatsman must enter into a sales contract with one of its customers and there must be performance under the contract (e.g., merchandise is delivered or a service is performed by Boatsman or the customer makes a cash payment) before the transaction is recorded.**
  - b. **This transaction does not qualify for recognition because the offer does not affect the accounting equation. When there is performance under the contract (property or money is exchanged), the transaction will be recorded.**
  - c. **This transaction does qualify for recognition because the receipt of cash by Boatsman and the delivery of the deed constitute performance. Assets (cash and land) have been affected by this transaction.**
  - d. **This transaction does not qualify for recognition because the total of common stock of Boatsman has not changed as a result of this transaction. This transaction does not involve Boatsman but two other entities—two stockholders.**
  - e. **This transaction does qualify for recognition, because Boatsman has incurred an expense (maintenance) that will lower stockholders' equity. The actual performance of the service by the dealer leads to recognition by Boatsman, regardless of whether Boatsman has paid the dealer for the maintenance.**
2. **Item *d* illustrates the economic entity assumption—the transactions of a company are accounted for separately from its owners.**

P 2-48A

| 1. | Assets        |          |                     | =        | Liabilities  |          | +                | Equity   |               |          |               |          |                   |
|----|---------------|----------|---------------------|----------|--------------|----------|------------------|----------|---------------|----------|---------------|----------|-------------------|
|    | Cash          | +        | Accounts Receivable | +        | Supplies     | =        | Accounts Payable | +        | Notes Payable | +        | Common Stock  | +        | Retained Earnings |
|    | 8,000         |          | 15,900              |          | 4,100        | =        | 2,500            |          | 4,000         |          | 12,000        |          | 9,500             |
| a. | 15,000        |          |                     |          |              |          |                  |          |               |          | 15,000        |          |                   |
| b. | (850)         |          |                     |          |              |          |                  |          |               |          |               |          | (850) **          |
| c. |               |          |                     |          | 2,250        |          | 2,250            |          |               |          |               |          |                   |
| d. | 8,000         |          |                     |          |              |          |                  |          | 8,000         |          |               |          |                   |
| e. | (1,080)       |          |                     |          |              |          | (1,080)          |          |               |          |               |          |                   |
| f. | (2,150)       |          |                     |          |              |          |                  |          |               |          |               |          | (2,150) **        |
| g. | 4,700         |          |                     |          |              |          |                  |          |               |          |               |          | 4,700 *           |
| h. |               |          |                     |          | (3,180)      |          |                  |          |               |          |               |          | (3,180) **        |
| i. |               |          | 1,920               |          |              |          |                  |          |               |          |               |          | 1,920 *           |
| j. | (500)         |          |                     |          | 500          |          |                  |          |               |          |               |          |                   |
| k. | 1,290         |          | (1,290)             |          |              |          |                  |          |               |          |               |          |                   |
| l. | (1,000)       |          |                     |          |              |          |                  |          |               |          |               |          | (1,000)           |
|    | <b>31,410</b> | <b>+</b> | <b>16,530</b>       | <b>+</b> | <b>3,670</b> | <b>=</b> | <b>3,670</b>     | <b>+</b> | <b>12,000</b> | <b>+</b> | <b>27,000</b> | <b>+</b> | <b>8,940</b>      |

\* Revenues = \$4,700 + \$1,920 = \$6,620

\*\* Expenses = \$850 + \$2,150 + \$3,180 = \$6,180



P 2-48A (Contd)

2.

| Madero Accounting Services<br>Trial Balance<br>August 31, 2011 |          |          |
|--|----------|----------|
| Account  | Debit    | Credit   |
| Cash.....  | \$31,410 |          |
| Accounts Receivable.....                                       | 16,530   |          |
| Supplies.....  | 3,670    |          |
| Accounts Payable.....  |          | \$ 3,670 |
| Notes payable.....   |          | 12,000   |
| Common Stock.....  |          | 27,000   |
| Retained earnings.....   |          | 9,500    |
| Dividends.....   | 1,000    |          |
| Revenue.....   |          | 6,620    |
| Expenses.....  | 6,180    |          |
|  | \$58,790 | \$58,790 |

P 2-49A

1. July 2 : Common stock was issued for \$1,000 cash.
- July 4 : Bought \$250 of supplies on account.
- July 5 : Paid \$150 on a previous account payable.
- July 7 : Performed services for cash of \$2,500.
- July 9 : Bought land for \$700 cash.
- July 11: Received cash of \$150 for payment of an account receivable.
- July 14: Paid a \$750 expense with cash.

2.

| Chen Construction Company<br>Trial Balance<br>July 31, 2011 |         |         |
|---|---------|---------|
| Account   | Debit   | Credit  |
| Cash.....   | \$2,250 |         |
| Accounts Receivable.....                                    | 1,250   |         |
| Supplies.....   | 1,000   |         |
| Land.....   | 3,700   |         |
| Accounts Payable.....                                       |         | \$1,200 |
| Common Stock.....   |         | 5,000   |
| Retained Earnings.....                                      |         | 2,000   |
|   | \$8,200 | \$8,200 |

## P 2-50A

| <b>Account</b>           | <b>Type of Account</b> | <b>Normal Balance</b> | <b>Increase</b> | <b>Decrease</b> |
|--------------------------|------------------------|-----------------------|-----------------|-----------------|
| Accounts Payable         | Liability              | Credit                | Credit          | Debit           |
| Accounts Receivable      | Asset                  | Debit                 | Debit           | Credit          |
| Accumulated Depreciation | Contra Asset           | Credit                | Credit          | Debit           |
| Cash                     | Asset                  | Debit                 | Debit           | Credit          |
| Common Stock             | Equity                 | Credit                | Credit          | Debit           |
| Depreciation Expense     | Expense                | Debit                 | Debit           | Credit          |
| Equipment                | Asset                  | Debit                 | Debit           | Credit          |
| Income Taxes Expense     | Expense                | Debit                 | Debit           | Credit          |
| Interest Expense         | Expense                | Debit                 | Debit           | Credit          |
| Land                     | Asset                  | Debit                 | Debit           | Credit          |
| Notes Payable            | Liability              | Credit                | Credit          | Debit           |
| Prepaid Rent             | Asset                  | Debit                 | Debit           | Credit          |
| Retained Earnings        | Equity                 | Credit                | Credit          | Debit           |
| Salaries Expense         | Expense                | Debit                 | Debit           | Credit          |
| Service Revenue          | Revenue                | Credit                | Credit          | Debit           |
| Supplies                 | Asset                  | Debit                 | Debit           | Credit          |

P 2-51A

## Journal

| Date  |    | Account and Explanation                            | Debit  | Credit |
|-------|----|--|--------|--------|
| Sept. | 5  | Trucks   | 34,900 |        |
|       |    | Cash   |        | 34,900 |
|       |    | <i>(Record purchase of truck)</i>                  |        |        |
|       | 8  | Inventory  | 3,400  |        |
|       |    | Accounts Payable                                   |        | 3,400  |
|       |    | <i>(Record purchase of inventory on account)</i>   |        |        |
|       | 10 | Supplies   | 1,450  |        |
|       |    | Accounts Payable                                   |        | 1,450  |
|       |    | <i>(Record purchase of supplies on account)</i>    |        |        |
|       | 11 | Cash   | 12,800 |        |
|       |    | Service Revenue                                    |        | 12,800 |
|       |    | <i>(Record performance of services)</i>            |        |        |
|       | 12 | Accounts Receivable                                | 3,600  |        |
|       |    | Service Revenue                                    |        | 3,600  |
|       |    | <i>(Record performance of services on account)</i> |        |        |
|       | 18 | Wages Expense                                      | 4,170  |        |
|       |    | Cash   |        | 4,170  |
|       |    | <i>(Record payment of wages)</i>                   |        |        |
|       | 22 | Cash   | 3,600  |        |
|       |    | Accounts Receivable                                |        | 3,600  |
|       |    | <i>(Record collection of cash on account)</i>      |        |        |
|       | 23 | Cash   | 14,100 |        |
|       |    | Notes Payable                                      |        | 14,100 |
|       |    | <i>(Record borrowing of cash)</i>                  |        |        |
|       | 28 | Cash   | 40,000 |        |
|       |    | Common Stock                                       |        | 40,000 |
|       |    | <i>(Record issuance of common stock)</i>           |        |        |
|       | 30 | Dividends  | 4,350  |        |
|       |    | Cash   |        | 4,350  |
|       |    | <i>(Declared and paid cash dividend)</i>           |        |        |

P 2-52A

1.

Journal

| Date |    | Account and Explanation                            | Debit  | Credit |
|------|----|--|--------|--------|
| June | 1  | Cash   | 10,000 |        |
|      |    | Common Stock                                       |        | 10,000 |
|      |    | <i>(Issued common stock)</i>                       |        |        |
|      | 3  | Supplies   | 1,125  |        |
|      |    | Accounts Payable                                   |        | 1,125  |
|      |    | <i>(Record purchase of supplies on account)</i>    |        |        |
|      | 8  | Trucks   | 8,700  |        |
|      |    | Cash   |        | 2,000  |
|      |    | Notes Payable                                      |        | 6,700  |
|      |    | <i>(Record purchase of truck on account)</i>       |        |        |
|      | 14 | Wages Expense                                      | 3,960  |        |
|      |    | Cash   |        | 3,960  |
|      |    | <i>(Record payment of wages)</i>                   |        |        |
|      | 22 | Accounts Receivable                                | 9,430  |        |
|      |    | Service Revenue                                    |        | 9,430  |
|      |    | <i>(Record performance of services on account)</i> |        |        |
|      | 26 | Cash   | 5,800  |        |
|      |    | Accounts Receivable                                |        | 5,800  |
|      |    | <i>(Record collection of cash on account)</i>      |        |        |
|      | 29 | Cash   | 450    |        |
|      |    | Service Revenue                                    |        | 450    |
|      |    | <i>(Record performance of services for cash)</i>   |        |        |

**P 2-52A**

2.

| <b>Cash</b> |        |         |       |
|-------------|--------|---------|-------|
| Jun. 1      | 10,000 | Jun. 8  | 2,000 |
| Jun. 26     | 5,800  | Jun. 14 | 3,960 |
| Jun. 29     | 450    |         |       |
| 10,290      |        |         |       |

| <b>Accounts Receivable</b> |       |         |       |
|----------------------------|-------|---------|-------|
| Jun. 22                    | 9,430 | Jun. 26 | 5,800 |
| 3,630                      |       |         |       |

| <b>Supplies</b> |       |  |
|-----------------|-------|--|
| Jun. 3          | 1,125 |  |
| 1,125           |       |  |

| <b>Trucks</b> |       |  |
|---------------|-------|--|
| Jun. 8        | 8,700 |  |
| 8,700         |       |  |

| <b>Accounts Payable</b> |        |       |
|-------------------------|--------|-------|
|                         | Jun. 3 | 1,125 |
|                         | 1,125  |       |

| <b>Notes Payable</b> |        |       |
|----------------------|--------|-------|
|                      | Jun. 8 | 6,700 |
|                      | 6,700  |       |

| <b>Common Stock</b> |        |        |
|---------------------|--------|--------|
|                     | Jun. 1 | 10,000 |
|                     | 10,000 |        |

| <b>Service Revenue</b> |         |       |
|------------------------|---------|-------|
|                        | Jun. 22 | 9,430 |
|                        | Jun. 29 | 450   |
|                        | 9,880   |       |

| <b>Wages Expense</b> |       |  |
|----------------------|-------|--|
| Jun. 14              | 3,960 |  |
| 3,960                |       |  |

**P 2-53A**

1.

|    | <b>Asset</b> | <b>=</b> | <b>Liabilities</b> | <b>+</b> | <b>Equity</b> |
|----|--------------|----------|--------------------|----------|---------------|
| a. | 22,000       |          |                    |          | 22,000        |
| b. | (13,500)     |          |                    |          | (13,500)      |
| c. | (5,320)      |          |                    |          | (5,320)       |
| d. | (58,800)     |          |                    |          | (58,800)      |
| e. | 128,200      |          |                    |          | 146,850       |
|    | 18,650       |          |                    |          |               |
| f. | (59,110)     |          |                    |          | (59,110)      |
| g. | (3,500)      |          |                    |          | (3,500)       |
| h. | 109,400      |          |                    |          |               |
|    | (109,400)    |          |                    |          |               |

P 2-53A (Contd)

2.

Journal

| Date | Account and Explanation                    | Debit   | Credit  |
|------|--|---------|---------|
| a.   | Cash                                       | 22,000  |         |
|      | Common Stock                               |         | 22,000  |
|      | <i>(Issued common stock)</i>               |         |         |
| b.   | Rent Expense                               | 13,500  |         |
|      | Cash                                       |         | 13,500  |
|      | <i>(Record payment of rent)</i>            |         |         |
| c.   | Utilities Expense                          | 5,320   |         |
|      | Cash                                       |         | 5,320   |
|      | <i>(Record payment of utilities)</i>       |         |         |
| d.   | Wages Expense                              | 58,800  |         |
|      | Cash                                       |         | 58,800  |
|      | <i>(Record payment of wages)</i>           |         |         |
| e.   | Cash                                       | 18,650  |         |
|      | Accounts Receivable                        | 128,200 |         |
|      | Service Revenue                            |         | 146,850 |
|      | <i>(Record performance of services)</i>    |         |         |
| f.*  | Supplies Expense                           | 59,110  |         |
|      | Cash                                       |         | 59,110  |
|      | <i>(Record payment for supplies)</i>       |         |         |
| g.   | Dividends                                  | 3,500   |         |
|      | Cash                                       |         | 3,500   |
|      | <i>(Declared and paid cash dividend)</i>   |         |         |
| h.   | Cash                                       | 109,400 |         |
|      | Accounts Receivable                        |         | 109,400 |
|      | <i>(Record receipt of cash on account)</i> |         |         |

\* An alternative answer would involve making the following 2 entries:

|                       |        |        |
|-----------------------|--------|--------|
| Supplies.....         | 59,110 |        |
| Cash.....             |        | 59,110 |
| Supplies Expense..... | 59,110 |        |
| Supplies.....         |        | 59,110 |

P 2-53A (Contd)

3.

| Cash        |            | Accounts Receivable |             |
|-------------|------------|---------------------|-------------|
| (a) 22,000  | (b) 13,500 | (e) 128,200         | (h) 109,400 |
| (e) 18,650  | (c) 5,320  |                     |             |
| (h) 109,400 | (d) 58,800 |                     |             |
|             | (f) 59,110 |                     |             |
|             | (g) 3,500  |                     |             |
| 9,820       |            | 18,800              |             |

  

| Common Stock |            | Dividends |  |
|--------------|------------|-----------|--|
|              | (a) 22,000 | (g) 3,500 |  |
|              | 22,000     | 3,500     |  |

  

| Service Revenue |             | Rent Expense |  |
|-----------------|-------------|--------------|--|
|                 | (e) 146,850 | (b) 13,500   |  |
|                 | 146,850     | 13,500       |  |

  

| Utilities Expense |  | Wages Expense |  |
|-------------------|--|---------------|--|
| (c) 5,320         |  | (d) 58,800    |  |
| 5,320             |  | 58,800        |  |

  

| Supplies Expense |  |
|------------------|--|
| (f) 59,110       |  |
| 59,110           |  |

4.

| Karleen's Catering Service<br>Trial Balance<br>December 31, 2011 |                  |                  |
|--|------------------|------------------|
| Account  | Debit            | Credit           |
| Cash.....  | \$ 9,820         |                  |
| Accounts Receivable.....   | 18,800           |                  |
| Common Stock.....  |                  | \$ 22,000        |
| Dividends.....   | 3,500            |                  |
| Service revenue.....   |                  | 146,850          |
| Rent expense.....  | 13,500           |                  |
| Utilities expense.....   | 5,320            |                  |
| Wages expense.....   | 58,800           |                  |
| Supplies expense.....  | 59,110           |                  |
|  | <u>\$168,850</u> | <u>\$168,850</u> |

**P 2-54A**

1. and 3.

| <b>Cash</b> |             |
|-------------|-------------|
|             | 16,300      |
| (b)         | 384,000     |
| (c)         | 983,000     |
|             | 58,000 (d)  |
|             | 5,000 (e)   |
|             | 56,000 (f)  |
|             | 702,000 (g) |
|             | 22,200 (h)  |
|             | 19,700 (i)  |
|             | 520,400     |

| <b>Accounts Receivable</b> |             |
|----------------------------|-------------|
|                            | 384,000     |
| (a)                        | 994,000     |
|                            | 384,000 (b) |
|                            | 983,000 (c) |
|                            | 11,000      |

| <b>Accounts Payable</b> |        |
|-------------------------|--------|
|                         | 11,900 |
|                         | 11,900 |

| <b>Interest Payable</b> |        |
|-------------------------|--------|
| (h)                     | 11,200 |
|                         | 11,200 |
|                         | 0      |

| <b>Rent Payable</b> |        |
|---------------------|--------|
| (d)                 | 10,000 |
|                     | 10,000 |
|                     | 0      |

| <b>Insurance Payable</b> |       |
|--------------------------|-------|
| (e)                      | 1,000 |
|                          | 1,000 |
|                          | 0     |

| <b>Notes Payable</b> |         |
|----------------------|---------|
|                      | 100,000 |
|                      | 100,000 |

| <b>Common Stock</b> |         |
|---------------------|---------|
|                     | 165,000 |
|                     | 165,000 |



**P 2-54A (Contd)**

| <b>Retained Earnings</b> |                |
|--------------------------|----------------|
|                          | <b>101,200</b> |
|                          |                |
|                          | <b>101,200</b> |

| <b>Rent Expense</b> |               |
|---------------------|---------------|
| <b>(d)</b>          | <b>48,000</b> |
|                     |               |
|                     | <b>48,000</b> |

| <b>Utilities Expense</b> |               |
|--------------------------|---------------|
| <b>(f)</b>               | <b>56,000</b> |
|                          |               |
|                          | <b>56,000</b> |

| <b>Interest Expense</b> |               |
|-------------------------|---------------|
| <b>(h)</b>              | <b>11,000</b> |
|                         |               |
|                         | <b>11,000</b> |

| <b>Service Revenue</b> |                    |
|------------------------|--------------------|
|                        | <b>(a) 994,000</b> |
|                        |                    |
|                        | <b>994,000</b>     |

| <b>Insurance Expense</b> |              |
|--------------------------|--------------|
| <b>(e)</b>               | <b>4,000</b> |
|                          |              |
|                          | <b>4,000</b> |

| <b>Salaries Expense</b> |                |
|-------------------------|----------------|
| <b>(g)</b>              | <b>702,000</b> |
|                         |                |
|                         | <b>702,000</b> |

| <b>Income Taxes Expense</b> |               |
|-----------------------------|---------------|
| <b>(i)</b>                  | <b>19,700</b> |
|                             |               |
|                             | <b>19,700</b> |

P 2-54A (Contd)

2.

Journal

| Date | Account and Explanation                       | Debit   | Credit  |
|------|---|---------|---------|
| a.   | Accounts Receivable                           | 994,000 |         |
|      | Service Revenue                               |         | 994,000 |
|      | <i>(Record billing of services performed)</i> |         |         |
| b.   | Cash  | 384,000 |         |
|      | Accounts Receivable                           |         | 384,000 |
|      | <i>(Record collection of cash on account)</i> |         |         |
| c.   | Cash  | 983,000 |         |
|      | Accounts Receivable                           |         | 983,000 |
|      | <i>(Record collection of cash on account)</i> |         |         |
| d.   | Rent Payable                                  | 10,000  |         |
|      | Rent Expense                                  | 48,000  |         |
|      | Cash  |         | 58,000  |
|      | <i>(Record payment of rent)</i>               |         |         |
| e.   | Insurance Payable                             | 1,000   |         |
|      | Insurance Expense                             | 4,000   |         |
|      | Cash  |         | 5,000   |
|      | <i>(Record payment of insurance)</i>          |         |         |
| f.   | Utilities Expense                             | 56,000  |         |
|      | Cash  |         | 56,000  |
|      | <i>(Record payment of utilities)</i>          |         |         |
| g.   | Salaries Expense                              | 702,000 |         |
|      | Cash  |         | 702,000 |
|      | <i>(Record payment of salaries)</i>           |         |         |
| h.   | Interest Payable                              | 11,200  |         |
|      | Interest Expense                              | 11,000  |         |
|      | Cash  |         | 22,200  |
|      | <i>(Record payment of interest)</i>           |         |         |
| i.   | Income Taxes Expense                          | 19,700  |         |
|      | Cash  |         | 19,700  |
|      | <i>(Record payment of income taxes)</i>       |         |         |

P 2-54A (Contd)

4.

| Western Sound Studios<br>Trial Balance<br>December 31, 2011 |             |             |
|---|-------------|-------------|
| Account   | Debit       | Credit      |
| Cash.....   | \$ 520,400  |             |
| Accounts Receivable.....                                    | 11,000      |             |
| Accounts Payable.....                                       |             | \$ 11,900   |
| Notes Payable.....  |             | 100,000     |
| Common Stock.....   |             | 165,000     |
| Retained Earnings.....                                      |             | 101,200     |
| Service Revenue.....  |             | 994,000     |
| Rent Expense .....  | 48,000      |             |
| Insurance Expense.....                                      | 4,000       |             |
| Utilities Expense.....                                      | 56,000      |             |
| Salaries Expense.....                                       | 702,000     |             |
| Interest Expense.....                                       | 11,000      |             |
| Income Taxes Expense.....                                   | 19,700      |             |
|   | \$1,372,100 | \$1,372,100 |

## PROBLEM SET B

### P 2-47B

1.
  - a. This transaction does not qualify for recognition because simply signing a contract does not affect the accounting equation. When there is performance under the contract (e.g., products or cash are exchanged), the transaction will be recorded.
  - b. This transaction does not qualify for recognition because selling stock to another person does not affect the total amount of common stock outstanding for the company. This transaction does not involve Malcolm Motors but two other entities—two stockholders.
  - c. This transaction does qualify for recognition because the transaction affects two accounting elements—cash and the amount of stock outstanding have been increased.
  - d. This event does qualify for recognition. While there is no external event affecting the accounting equation (e.g., no cash is being paid for the building), Malcolm must still recognize depreciation as it occupies the building. The concept of depreciation was introduced in Chapter 1 and will be discussed more completely in Chapters 3 and 7.
  - e. This event does not qualify for recognition because Malcom Motors does not pay to use the land. Therefore, the accounting equation has not been affected.
  - f. This transaction does qualify to be recorded because two accounting elements have been affected—Malcom Motors has incurred an expense, which lowered its stockholders' equity, and has paid cash, which lowered its assets.
  - g. This transaction does qualify for recognition because two accounting elements have been affected—Malcom Motors has incurred an expense, which lowered its stockholders' equity, and has incurred a liability that will be paid in the future.
2. Item *b* illustrates the economic entity assumption—the transactions of a company are accounted for separately from its owners.

**P 2-48B**

| 1. | Assets  |   |                     | = | Liabilities |   | +                | Equity |               |   |              |   |                   |
|----|---------|---|---------------------|---|-------------|---|------------------|--------|---------------|---|--------------|---|-------------------|
|    | Cash    | + | Accounts Receivable | + | Supplies    | = | Accounts Payable | +      | Notes Payable | + | Common Stock | + | Retained Earnings |
|    | 3,000   |   | 6,600               |   | 4,800       | = | 500              |        | 1,000         |   | 10,000       |   | 2,900             |
| a. | 12,000  |   |                     |   |             |   |                  |        |               |   | 12,000       |   |                   |
| b. | 3,850   |   |                     |   |             |   |                  |        |               |   |              |   | 3,850 *           |
| c. | 925     |   | (925)               |   |             |   |                  |        |               |   |              |   |                   |
| d. |         |   |                     |   | 1,140       |   | 1,140            |        |               |   |              |   |                   |
| e. | (875)   |   |                     |   |             |   | (875)            |        |               |   |              |   |                   |
| f. |         |   | 2,980               |   |             |   |                  |        |               |   |              |   | 2,980 *           |
| g. | (1,350) |   |                     |   |             |   |                  |        |               |   |              |   | (1,350) **        |
| h. | (800)   |   |                     |   |             |   |                  |        |               |   |              |   | (800) **          |
| i. | (1,340) |   |                     |   |             |   |                  |        |               |   |              |   | (1,340) **        |
| j. | (500)   |   |                     |   |             |   |                  |        |               |   |              |   | (500)             |
|    | 14,910  | + | 8,655               | + | 5,940       | = | 765              | +      | 1,000         | + | 22,000       | + | 5,740             |

\* Revenues = \$3,850 + \$2,980 = \$6,830

\*\* Expenses = \$1,350 + \$800 + \$1,340 = \$3,490

**P 2-48B (Contd)**

| <b>Emerson Consulting, Inc.</b> |                 |                 |
|---------------------------------|-----------------|-----------------|
| <b>Trial Balance</b>            |                 |                 |
| <b>January 31, 2011</b>         |                 |                 |
| <b>Account</b>                  | <b>Debit</b>    | <b>Credit</b>   |
| Cash.....                       | \$14,910        |                 |
| Accounts Receivable.....        | 8,655           |                 |
| Supplies.....                   | 5,940           |                 |
| Accounts Payable.....           |                 | \$ 765          |
| Notes Payable.....              |                 | 1,000           |
| Common Stock.....               |                 | 22,000          |
| Retained Earnings.....          |                 | 2,900           |
| Dividends.....                  | 500             |                 |
| Revenue.....                    |                 | 6,830           |
| Expenses.....                   | 3,490           |                 |
|                                 | <u>\$33,495</u> | <u>\$33,495</u> |

**P 2-49B**

1. April 3 : Received cash from a bank loan of \$2,000.  
 April 8 : Purchased equipment with cash for \$700.  
 April 9 : Paid an accounts payable with cash for \$325.  
 April 11: Used supplies of \$140 (an expense).  
 April 15: Purchased \$150 of supplies with cash.  
 April 18: Performed services in exchange for cash of \$1,500.  
 April 24: Received \$375 in payment of an account receivable from a customer.

| <b>Brilliant Minds, Inc.</b> |                |                |
|------------------------------|----------------|----------------|
| <b>Trial Balance</b>         |                |                |
| <b>April 30, 2011</b>        |                |                |
| <b>Account</b>               | <b>Debit</b>   | <b>Credit</b>  |
| Cash.....                    | \$3,200        |                |
| Accounts Receivable.....     | 325            |                |
| Supplies.....                | 910            |                |
| Equipment.....               | 1,900          |                |
| Accounts Payable.....        |                | \$ 300         |
| Notes Payable.....           |                | 2,000          |
| Common Stock.....            |                | 2,000          |
| Retained Earnings.....       |                | 2,035          |
|                              | <u>\$6,335</u> | <u>\$6,335</u> |

## P 2-50B

| <b>Account</b>       | <b>Type of Account</b> | <b>Normal Balance</b> | <b>Increase</b> | <b>Decrease</b> |
|----------------------|------------------------|-----------------------|-----------------|-----------------|
| Accounts Payable     | Liability              | Credit                | Credit          | Debit           |
| Accounts Receivable  | Asset                  | Debit                 | Debit           | Credit          |
| Bonds Payable        | Liability              | Credit                | Credit          | Debit           |
| Building             | Asset                  | Debit                 | Debit           | Credit          |
| Cash                 | Asset                  | Debit                 | Debit           | Credit          |
| Common Stock         | Equity                 | Credit                | Credit          | Debit           |
| Cost of Goods Sold   | Expense                | Debit                 | Debit           | Credit          |
| Depreciation Expense | Expense                | Debit                 | Debit           | Credit          |
| Income Taxes Payable | Liability              | Credit                | Credit          | Debit           |
| Insurance Expense    | Expense                | Debit                 | Debit           | Credit          |
| Copyright            | Asset                  | Debit                 | Debit           | Credit          |
| Interest Expense     | Expense                | Debit                 | Debit           | Credit          |
| Inventory            | Asset                  | Debit                 | Debit           | Credit          |
| Investments          | Asset                  | Debit                 | Debit           | Credit          |
| Retained Earnings    | Equity                 | Credit                | Credit          | Debit           |
| Sales Revenue        | Revenue                | Credit                | Credit          | Debit           |
| Unearned Revenue     | Liability              | Credit                | Credit          | Debit           |
| Utilities Expense    | Expense                | Debit                 | Debit           | Credit          |
| Income Taxes Expense | Expense                | Debit                 | Debit           | Credit          |

P 2-51B

Journal

| Date |    | Account and Explanation                            | Debit  | Credit |
|------|----|--|--------|--------|
| Dec. | 2  | Rent Expense                                       | 900    |        |
|      |    | Cash   |        | 900    |
|      |    | <i>(Record payment of rent)</i>                    |        |        |
|      | 3  | Cash   | 20,000 |        |
|      |    | Notes Payable                                      |        | 20,000 |
|      |    | <i>(Record borrowing of cash)</i>                  |        |        |
|      | 7  | Accounts Receivable                                | 38,600 |        |
|      |    | Service Revenue                                    |        | 38,600 |
|      |    | <i>(Record performance of services on account)</i> |        |        |
|      | 10 | Supplies   | 3,200  |        |
|      |    | Accounts Payable                                   |        | 3,200  |
|      |    | <i>(Record purchase of supplies on account)</i>    |        |        |
|      | 13 | Cash   | 18,800 |        |
|      |    | Accounts Receivable                                |        | 18,800 |
|      |    | <i>(Record collection of cash on account)</i>      |        |        |
|      | 19 | Cash   | 55,000 |        |
|      |    | Common Stock                                       |        | 55,000 |
|      |    | <i>(Record issuance of stock)</i>                  |        |        |
|      | 22 | Wages Expense                                      | 11,650 |        |
|      |    | Cash   |        | 11,650 |
|      |    | <i>(Record payment of wages)</i>                   |        |        |
|      | 23 | Accounts Payable                                   | 6,975  |        |
|      |    | Cash   |        | 6,975  |
|      |    | <i>(Record payment of account)</i>                 |        |        |
|      | 25 | Cash   | 15,430 |        |
|      |    | Service Revenue                                    |        | 15,430 |
|      |    | <i>(Record performance of services for cash)</i>   |        |        |
|      | 30 | Utilities Expense                                  | 2,180  |        |
|      |    | Cash   |        | 2,180  |
|      |    | <i>(Record payment of utilities)</i>               |        |        |



P 2-52B

1.

## Journal

| Date  |    | Account and Explanation                       | Debit  | Credit |
|-------|----|---|--------|--------|
| Sept. | 1  | Cash  | 12,000 |        |
|       |    | Common Stock                                  |        | 12,000 |
|       |    | <i>(Issued common stock)</i>                  |        |        |
|       | 2  | Supplies                                      | 1,480  |        |
|       |    | Cash  |        | 1,480  |
|       |    | <i>(Record purchase of supplies)</i>          |        |        |
|       | 5  | Prepaid Rent                                  | 1,800  |        |
|       |    | Cash  |        | 1,800  |
|       |    | <i>(Record payment of rent in advance)</i>    |        |        |
|       | 8  | Advertising Expense                           | 895    |        |
|       |    | Accounts Payable                              |        | 895    |
|       |    | <i>(Purchased advertising on account)</i>     |        |        |
|       | 13 | Accounts Receivable                           | 4,200  |        |
|       |    | Service Revenue                               |        | 4,200  |
|       |    | <i>(Performed services on account)</i>        |        |        |
|       | 18 | Cash  | 6,850  |        |
|       |    | Service Revenue                               |        | 6,850  |
|       |    | <i>(Performed services for cash)</i>          |        |        |
|       | 25 | Cash  | 495    |        |
|       |    | Accounts Receivable                           |        | 495    |
|       |    | <i>(Collected cash from customer account)</i> |        |        |
|       | 30 | Wages Expense                                 | 4,320  |        |
|       |    | Cash  |        | 4,320  |
|       |    | <i>(Paid wages)</i>                           |        |        |

**P 2-52B (Contd)**

2.

| Cash     |        |          |       |  |
|----------|--------|----------|-------|--|
| Sept. 1  | 12,000 | Sept. 2  | 1,480 |  |
| Sept. 18 | 6,850  | Sept. 5  | 1,800 |  |
| Sept. 25 | 495    | Sept. 30 | 4,320 |  |
| 11,745   |        |          |       |  |

| Accounts Receivable |       |          |     |
|---------------------|-------|----------|-----|
| Sept. 13            | 4,200 | Sept. 25 | 495 |
| 3,705               |       |          |     |

| Supplies |       |  |
|----------|-------|--|
| Sept. 2  | 1,480 |  |
| 1,480    |       |  |

| Prepaid Rent |       |  |
|--------------|-------|--|
| Sept. 5      | 1,800 |  |
| 1,800        |       |  |

| Accounts Payable |         |     |
|------------------|---------|-----|
|                  | Sept. 8 | 895 |
|                  |         | 895 |

| Common Stock |         |        |
|--------------|---------|--------|
|              | Sept. 1 | 12,000 |
|              |         | 12,000 |

| Service Revenue |          |        |
|-----------------|----------|--------|
|                 | Sept. 13 | 4,200  |
|                 | Sept. 18 | 6,850  |
|                 |          | 11,050 |

| Wages Expense |       |  |
|---------------|-------|--|
| Sept. 30      | 4,320 |  |
| 4,320         |       |  |

| Advertising Expense |     |  |
|---------------------|-----|--|
| Sept. 8             | 895 |  |
| 895                 |     |  |

**P 2-53B**

1.

|    | Asset    | = | Liabilities | + | Equity   |
|----|----------|---|-------------|---|----------|
| a. | 45,000   |   |             |   | 45,000   |
| b. | 18,710   |   |             |   |          |
|    | (18,710) |   |             |   |          |
| c. | 112,880  |   |             |   | 112,880  |
| d. | (87,300) |   |             |   | (87,300) |
| e. | 20,000   |   | 20,000      |   |          |
| f. | (10,200) |   |             |   | (10,200) |
| g. | 2,120    |   | 2,120       |   |          |
| h. | (1,200)  |   | (1,200)     |   |          |
| i. | (3,250)  |   |             |   | (3,250)  |

## P 2-53B (Contd)

2.

## Journal

| Date | Account and Explanation                | Debit   | Credit  |
|------|--|---------|---------|
| a.   | Cash                                   | 45,000  |         |
|      | Common Stock                           |         | 45,000  |
|      | <i>(Issued common stock)</i>           |         |         |
| b.   | Equipment                              | 18,710  |         |
|      | Cash                                   |         | 18,710  |
|      | <i>(Purchased equipment for cash)</i>  |         |         |
| c.   | Cash                                   | 112,880 |         |
|      | Service Revenue                        |         | 112,880 |
|      | <i>(Performed services for cash)</i>   |         |         |
| d.   | Wages Expense                          | 87,300  |         |
|      | Cash                                   |         | 87,300  |
|      | <i>(Paid wages)</i>                    |         |         |
| e.   | Cash                                   | 20,000  |         |
|      | Notes Payable                          |         | 20,000  |
|      | <i>(Record borrowing of cash)</i>      |         |         |
| f.   | Rent Expense                           | 10,200  |         |
|      | Cash                                   |         | 10,200  |
|      | <i>(Paid rent)</i>                     |         |         |
| g.   | Supplies                               | 2,120   |         |
|      | Accounts Payable                       |         | 2,120   |
|      | <i>(Purchased supplies on account)</i> |         |         |
| h.   | Accounts Payable                       | 1,200   |         |
|      | Cash                                   |         | 1,200   |
|      | <i>(Record payment on account)</i>     |         |         |
| i.   | Utilities Expense                      | 3,250   |         |
|      | Cash                                   |         | 3,250   |
|      | <i>(Record payment of utilities)</i>   |         |         |

**P 2-53B (Contd)**

3.

| Cash        |            |
|-------------|------------|
| (a) 45,000  | (b) 18,710 |
| (c) 112,880 | (d) 87,300 |
| (e) 20,000  | (f) 10,200 |
|             | (h) 1,200  |
|             | (i) 3,250  |
| 57,220      |            |

| Supplies  |  |
|-----------|--|
| (g) 2,120 |  |
| 2,120     |  |

| Equipment  |  |
|------------|--|
| (b) 18,710 |  |
| 18,710     |  |

| Accounts Payable |           |
|------------------|-----------|
| (h) 1,200        | (g) 2,120 |
| 920              |           |

| Notes Payable |            |
|---------------|------------|
|               | (e) 20,000 |
| 20,000        |            |

| Common Stock |            |
|--------------|------------|
|              | (a) 45,000 |
| 45,000       |            |

| Service Revenue |             |
|-----------------|-------------|
|                 | (c) 112,880 |
| 112,880         |             |

| Rent Expense |  |
|--------------|--|
| (f) 10,200   |  |
| 10,200       |  |

| Utilities Expense |  |
|-------------------|--|
| (i) 3,250         |  |
| 3,250             |  |

| Wages Expense |  |
|---------------|--|
| (d) 87,300    |  |
| 87,300        |  |

4.

| Sweetwater Temporary Clerical Help Service<br>Trial Balance<br>December 31, 2011 |           |           |
|--|-----------|-----------|
| Account  | Debit     | Credit    |
| Cash.....  | \$ 57,220 |           |
| Supplies.....  | 2,120     |           |
| Equipment.....   | 18,710    |           |
| Accounts Payable.....  |           | \$ 920    |
| Notes Payable.....   |           | 20,000    |
| Common Stock.....  |           | 45,000    |
| Service Revenue.....   |           | 112,880   |
| Rent Expense.....  | 10,200    |           |
| Utilities Expense.....   | 3,250     |           |
| Wages Expense.....   | 87,300    |           |
|  | \$178,800 | \$178,800 |

**P 2-54B**

1. and 3.

| <b>Cash</b> |             |
|-------------|-------------|
|             |             |
| 6,000       | (c) 8,000   |
| (b) 699,000 | (d) 379,000 |
|             | (e) 9,000   |
|             | (f) 28,000  |
|             | (g) 13,000  |
|             | (h) 26,000  |
|             | (i) 10,300  |
|             | (j) 5,000   |
| 226,700     |             |

| <b>Prepaid Rent</b> |            |
|---------------------|------------|
|                     |            |
| 96,000              | (f) 96,000 |
|                     | 0          |

| <b>Accounts Payable</b> |        |
|-------------------------|--------|
|                         |        |
|                         | 14,000 |
|                         | 14,000 |

| <b>Notes Payable</b> |        |
|----------------------|--------|
|                      |        |
|                      | 80,000 |
|                      | 80,000 |

| <b>Accounts Receivable</b> |             |
|----------------------------|-------------|
|                            |             |
| 130,000                    | (b) 699,000 |
| (a) 690,000                |             |
| 121,000                    |             |

| <b>Supplies</b> |        |
|-----------------|--------|
|                 |        |
| (g) 13,000      |        |
|                 | 13,000 |

| <b>Interest Payable</b> |       |
|-------------------------|-------|
|                         |       |
| (c) 8,000               | 8,000 |
|                         | 0     |

| <b>Common Stock</b> |         |
|---------------------|---------|
|                     |         |
|                     | 114,000 |
|                     | 114,000 |

**P 2-54B (Contd)**

**Retained Earnings**

|  |               |
|--|---------------|
|  | <b>16,000</b> |
|  | <b>16,000</b> |

**Rent Expense**

|            |                |  |
|------------|----------------|--|
| <b>(f)</b> | <b>124,000</b> |  |
|            | <b>124,000</b> |  |

**Wages Expense**

|            |                |  |
|------------|----------------|--|
| <b>(d)</b> | <b>379,000</b> |  |
|            | <b>379,000</b> |  |

**Interest Expense**

|            |              |  |
|------------|--------------|--|
| <b>(j)</b> | <b>5,000</b> |  |
|            | <b>5,000</b> |  |

**Service Revenue**

|  |            |                |
|--|------------|----------------|
|  | <b>(a)</b> | <b>690,000</b> |
|  |            | <b>690,000</b> |

**Advertising Expense**

|            |               |  |
|------------|---------------|--|
| <b>(h)</b> | <b>26,000</b> |  |
|            | <b>26,000</b> |  |

**Repairs & Maintenance Expense**

|            |              |  |
|------------|--------------|--|
| <b>(e)</b> | <b>9,000</b> |  |
|            | <b>9,000</b> |  |

**Income Taxes Expense**

|            |               |  |
|------------|---------------|--|
| <b>(i)</b> | <b>10,300</b> |  |
|            | <b>10,300</b> |  |

## P 2-54B (Contd)

2.

## Journal

| Date | Account and Explanation                     | Debit   | Credit  |
|------|---|---------|---------|
| a.   | Accounts Receivable                         | 690,000 |         |
|      | Service Revenue                             |         | 690,000 |
|      | <i>(Performed services on account)</i>      |         |         |
| b.   | Cash*                                       | 699,000 |         |
|      | Accounts Receivable                         |         | 699,000 |
|      | <i>(Collected cash from customers)</i>      |         |         |
| c.   | Interest Payable                            | 8,000   |         |
|      | Cash  |         | 8,000   |
|      | <i>(Paid interest)</i>                      |         |         |
| d.   | Wages Expense                               | 379,000 |         |
|      | Cash  |         | 379,000 |
|      | <i>(Paid wages)</i>                         |         |         |
| e.   | Repairs & Maintenance Expense               | 9,000   |         |
|      | Cash  |         | 9,000   |
|      | <i>(Paid for repairs &amp; maintenance)</i> |         |         |
| f.   | Rent Expense                                | 124,000 |         |
|      | Prepaid Rent                                |         | 96,000  |
|      | Cash  |         | 28,000  |
|      | <i>(Incurred rent expense)</i>              |         |         |
| g.   | Supplies                                    | 13,000  |         |
|      | Cash  |         | 13,000  |
|      | <i>(Purchased supplies)</i>                 |         |         |
| h.   | Advertising Expense                         | 26,000  |         |
|      | Cash  |         | 26,000  |
|      | <i>(Paid for advertising)</i>               |         |         |
| i.   | Income Taxes Expense                        | 10,300  |         |
|      | Cash  |         | 10,300  |
|      | <i>(Paid income taxes)</i>                  |         |         |
| j.   | Interest Expense                            | 5,000   |         |
|      | Cash  |         | 5,000   |
|      | <i>(Paid interest)</i>                      |         |         |

\* \$570,000 + \$129,000 = \$699,000

**P 2-54B (Contd)**

4.

| <b>Mulberry Services<br/>Trial Balance<br/>December 31, 2011</b> |                  |                  |
|--|------------------|------------------|
| <b>Account</b>   | <b>Debit</b>     | <b>Credit</b>    |
| Cash.....  | \$226,700        |                  |
| Accounts Receivable.....   | 121,000          |                  |
| Supplies.....  | 13,000           |                  |
| Accounts Payable.....  |                  | \$ 14,000        |
| Notes Payable.....   |                  | 80,000           |
| Common Stock.....  |                  | 114,000          |
| Retained Earnings.....   |                  | 16,000           |
| Service Revenue.....   |                  | 690,000          |
| Rent Expense.....  | 124,000          |                  |
| Advertising Expense.....   | 26,000           |                  |
| Wages Expense.....   | 379,000          |                  |
| Repairs & Maintenance Expense .....                              | 9,000            |                  |
| Interest Expense.....  | 5,000            |                  |
| Income Taxes Expense.....  | 10,300           |                  |
|  | <b>\$914,000</b> | <b>\$914,000</b> |



## CASES

### Case 2-55

- 1. To qualify as a transaction, the underlying events must impact a financial statement element of the company and must be able to be reliably measured. A reliable measurement is one that is reasonably free from error and bias and is a faithful representation of what it purports to represent. Prices agreed upon in exchanges between a company and outside parties are usually reasonably free from error and bias and can serve as the basis for recording the related transaction. The transfer of the building and equipment to the company from Susan Eel, the owner of the company, however, is not an exchange between the company and an outside party; thus, its amount may be biased and a less than faithful representation of the fair value of the building and equipment. Consequently, the amount recorded for the transfer of the building and equipment to the business is open to question. Although the accounts receivable probably involved transactions with outsiders, the absence of supporting documentation for those transactions raises a question about the correctness of their recognition. In general, the absence of source documents to support the amounts recorded for the building, equipment, and accounts receivable violates an important condition for the recording of transactions.**
- 2. If assets are overstated, assets will need to be reduced so that a correct balance is reflected on the balance sheet. Because the fundamental accounting equation must remain in balance, stockholders' equity would need to be reduced because the recorded amount for the stock Susan exchanged for the building and equipment would have to be reduced. (*Instructor's Note:* Depreciation expense and accumulated depreciation would also be overstated; however, this topic is not covered until later in the text.) If receivables are overstated, sales, net income, and retained earnings are likely also overstated. If accounts payable are understated, it is likely that expenses are understated, as well as net income and retained earnings being overstated.**
- 3. An independent certified public accountant should be engaged to examine Susan's financial statements and to recommend their restatement, where necessary. Based on the restated financial statements and an assessment of the future prospects of the business, an offer could be made. Estimating the value of a business is a complex task in which data from many sources (including accounting and nonaccounting information) must be acquired and analyzed. Such estimated values are subject to considerable error.**

**Case 2-56**

1. We can analyze the accounts receivable account to determine the amount of cash collected from customers. The journal entry to record credit sales would debit Accounts Receivable and credit Sales Revenue. The collection of an account receivable from a customer requires a debit to Cash and a credit to Accounts Receivable. Therefore the amount that must be credited to Accounts Receivable to make the ending balance equal to \$8,300 must be the amount that customers paid Cable. The calculation of this amount is shown with the the T-account below.

| Accounts Receivable |        |              |        |
|---------------------|--------|--------------|--------|
| Beg. bal.           | 4,750  |              |        |
| Credit sales        | 97,400 | Collections* | 93,850 |
| End. bal.           | 8,300  |              |        |

\* Collections of \$93,850 calculated as  $\$4,750 + \$97,400 - \$8,300$

2. The cash collected from customers would be classified in the operating section on the statement of cash flows.
3. We can analyze the wages payable account in a similar way. The journal entry to record the recognition of wages expense is a debit to Wages Expense and a credit to Wages Payable. Payment of wages requires a debit to Wages Payable and a credit to Cash. Therefore, the amount that must be debited to Wages Payable to make the ending balance equal to \$3,900 must be the amount that Cable paid its employees.

| Wages Payable  |        |            |        |
|----------------|--------|------------|--------|
|                |        | Beg. bal.  | 5,870  |
| Wage payments* | 40,070 | Wages exp. | 38,100 |
|                |        | End. bal.  | 3,900  |

\* Wage payments of \$40,070 calculated as  $\$5,870 + \$38,100 - \$3,900$

4. The cash paid for wages would be classified in the operating section of the statement of cash flows.

**Case 2-57**

- 1. Kathryn has an ethical dilemma known as a conflict of interest. As a top executive for Clean Sweep, she has a professional responsibility to the company. This responsibility to the company is in conflict with her personal responsibility to her family, specifically her son, Ben. This conflict of interest could lead to Kathryn making a decision that is not in the best interests of the company in an effort to help her family.**
- 2. Kathryn has two major alternatives in this situation. First, she could bring the bookkeeping errors to the attention of the management of Clean Sweep. Such an action would allow her to correct the financial statements of Clean Sweep so that the users of Clean Sweep's financial statements are provided accurate and reliable information on which to base their decisions. Because the financial statements have not yet been prepared, individuals outside of the company may never know of the errors and the company will suffer little, if any, harm from these mistakes. However, such an action may have serious personal repercussions. For example, Kathryn may get reprimanded for hiring a relative who was not competent to do the job. Such a reprimand may lead to a below average performance evaluation for Kathryn, which could affect her financially.**

**Second, Kathryn could cover up her son's mistakes by fixing the errors without telling senior management that any errors were made. Most likely, it is entirely within Kathryn's responsibility as chief accountant to authorize journal entries that can fix the mistakes and no one may ever question these actions. In addition, because the trial balance still balanced, outside users would have no reason to suspect any errors. If successful, Kathryn would save her family and herself potential embarrassment and financial loss while still protecting the company interests. However, if someone (e.g., an auditor) questions these entries and investigates their source, Kathryn would most likely face serious reprimands, and possibly the loss of her job, for covering up the mistakes.**

**The first alternative would be the most ethical choice. Her professional responsibility to the company should come before any personal embarrassment or injury she may suffer.**

**Case 2-58**

1. This information was found in the 2009 annual report for General Electric on the statement of financial position (the balance sheet):

|                    |          |                          |
|--------------------|----------|--------------------------|
| <b>Assets</b>      | <b>=</b> | <b>\$781,818,000,000</b> |
| <b>Liabilities</b> | <b>=</b> | <b>\$656,682,000,000</b> |
| <b>Equity</b>      | <b>=</b> | <b>\$125,136,000,000</b> |

As you can see, the accounting equation (Assets = Liabilities + Equity) does balance.

Note: GE reports \$7,845,000,000 of minority interest in equity of consolidated affiliates as part of stockholders' equity. This topic is beyond the scope of this course.

2. Normal balances:
- a. Debit
  - b. Credit
  - c. Credit
  - d. Debit
  - e. Debit
  - f. Debit
  - g. Credit
3. Additional accounts involved in the transaction:
- a. Cash (decreased as payables are paid off)
  - b. Sales Revenue (increased as credit sales are made to customers)
  - c. Cash (increased when more common stock is issued)
  - d. Wages Expense (increased as wages are earned)

Case 2-59

|                         | Assets          | = | Liabilities   | + | Stockholders' Equity |
|-------------------------|-----------------|---|---------------|---|----------------------|
| 1. Abercrombie & Fitch: | \$2,821,866,000 | = | \$993,949,000 | + | \$1,827,917,000      |
| Aeropostale:            | \$792,309,000   | = | \$357,820,000 | + | \$434,489,000        |

The accounting equation for each of these companies balances, as required of a balance sheet.

| Accounts Receivable |               |                   |               |
|---------------------|---------------|-------------------|---------------|
| Beg. bal.           | 53,110,000    | Cash collections* | 2,890,871,000 |
| Sales               | 2,928,626,000 |                   |               |
| End. bal.           | 90,865,000    |                   |               |

\* Cash collections of \$2,890,871,000 were determined as \$53,110,000, beginning balance + \$2,928,626,000 sales – \$90,865,000 ending balance.

3. Journal

| Date | Account and Explanation                       | Debit         | Credit        |
|------|---|---------------|---------------|
|      | Accounts Receivable                           | 2,928,626,000 |               |
|      | Sales Revenue                                 |               | 2,928,626,000 |
|      | <i>(Record net sales for year)</i>            |               |               |
|      | Cash  | 2,890,871,000 |               |
|      | Accounts Receivable                           |               | 2,890,871,000 |
|      | <i>(Record receipt of cash from customer)</i> |               |               |

4. Aeropostale and Abercrombie & Fitch both report credit card receivables. While Abercrombie & Fitch reports its outstanding credit card receivables as receivables on the balance sheet, Aeropostale reports credit card receivables as cash and cash equivalents. Thus, two companies in similar industries report credit card receivables differently.

**Instructor's Note:** This would be a good opportunity to stress the importance of examining both the financial statements and the notes to the financial statements when one is trying to gain an understanding of a company. Abercrombie & Fitch describes credit card receivables in Note 2 to the financial statements; Aeropostale describes this treatment in Note 1 to the financial statements.

**Case 2-60**

- 1. Smith is trying to recognize expenses in the period in which use of the asset (resource) contributes to the earning of revenue. When an asset is used in several periods, it is necessary to divide its cost between the periods affected, recognizing part of the total cost as expense in each period. This process is supported by the matching concept as it applies to period expenses. This concept will be discussed further in Chapter 3.**
  
- 2. a. Smith should recognize as expense the portion of the 3-year insurance coverage that expired during 2011. Thus, 1 year of \$2,400, or \$800, should be included in 2011 insurance expense, and the remainder (\$1,600) should appear on the December 31, 2011, balance sheet as an asset called Prepaid Insurance.**
  
- b. Smith should recognize as expense the portion of the building's cost associated with 2011. The simplest procedure divides the cost of the building, reduced by the anticipated residual value, equally among the 20 years in which the building is used. Thus,  $1/20$  of \$74,000 ( $\$80,000 - \$6,000$ ) or \$3,700 would be included in depreciation expense for 2011, and the December 31, 2011, balance sheet would show accumulated depreciation on the building of \$33,300 ( $9 \text{ years} \times \$3,700$ ).**
  
- c. Smith should recognize  $4/12$  of the \$1,600 cost of the loan ( $4/12 \times \$1,600 = \$533$ ) as interest expense in 2011. Since this expense is not paid until September 1 of the following year, the December 31, 2011, balance sheet must show interest payable of \$533. The remaining cost of the loan ( $\$1,600 - \$533 = \$1,067$ ) is not recognized until next year and does not appear as a payable on the December 31, 2011, balance sheet.**

## Case 2-61

1.

## Journal

| Date |    | Account and Explanation                 | Debit  | Credit |
|------|----|---|--------|--------|
| Jan. | 1  | Cash                                    | 16,000 |        |
|      |    | Common Stock                            |        | 16,000 |
|      |    | <i>(Issued common stock)</i>            |        |        |
|      | 1  | Cash                                    | 25,000 |        |
|      |    | Notes Payable                           |        | 25,000 |
|      |    | <i>(Borrowed cash from bank)</i>        |        |        |
|      | 1  | Legal Expense                           | 1,200  |        |
|      |    | Cash                                    |        | 1,200  |
|      |    | <i>(Paid legal fees)</i>                |        |        |
|      | 1  | Equipment                               | 7,000  |        |
|      |    | Cash                                    |        | 7,000  |
|      |    | <i>(Purchased office equipment)</i>     |        |        |
|      | 1  | Rent Expense                            | 800    |        |
|      |    | Cash                                    |        | 800    |
|      |    | <i>(Paid rent for January)</i>          |        |        |
|      | 3  | Prepaid Insurance                       | 3,600  |        |
|      |    | Cash                                    |        | 3,600  |
|      |    | <i>(Purchased insurance in advance)</i> |        |        |
|      | 3  | Supplies                                | 2,500  |        |
|      |    | Accounts Payable                        |        | 2,500  |
|      |    | <i>(Purchased supplies on credit)</i>   |        |        |
|      | 5  | No entry necessary                      |        |        |
|      | 8  | Prepaid Rent                            | 10,000 |        |
|      |    | Cash                                    |        | 10,000 |
|      |    | <i>(Paid rent for venue in advance)</i> |        |        |
|      | 12 | Advertising Expense                     | 4,500  |        |
|      |    | Cash                                    |        | 4,500  |
|      |    | <i>(Paid for advertising)</i>           |        |        |

Case 2-61 (Contd)

Journal

| Date |    | Account and Explanation                | Debit | Credit |
|------|----|--|-------|--------|
| Jan. | 18 | Accounts Payable                       | 1,000 |        |
|      |    | Cash                                   |       | 1,000  |
|      |    | <i>(Paid amount owed)</i>              |       |        |
|      | 25 | Cash                                   | 400   |        |
|      |    | Accounts Receivable                    | 600   |        |
|      |    | Sales Revenue                          |       | 1,000  |
|      |    | <i>(Record sales)</i>                  |       |        |
|      | 25 | Artist Fee Expense                     | 800   |        |
|      |    | Cash                                   |       | 800    |
|      |    | <i>(Paid artist fee for concert)</i>   |       |        |
|      | 28 | Cash                                   | 3,800 |        |
|      |    | Unearned Sales Revenue                 |       | 3,800  |
|      |    | <i>(Sold tickets in advance)</i>       |       |        |
|      | 30 | Cash                                   | 200   |        |
|      |    | Accounts Receivable                    |       | 200    |
|      |    | <i>(Collected accounts receivable)</i> |       |        |
|      | 30 | Salaries Expense                       | 2,400 |        |
|      |    | Cash                                   |       | 2,400  |
|      |    | <i>(Paid salaries)</i>                 |       |        |



Case 2-61 (Contd)

2.

| Cash |    |        |              |
|------|----|--------|--------------|
|      |    | 0      |              |
| Jan. | 1  | 16,000 | Jan. 1 1,200 |
|      | 1  | 25,000 | 1 7,000      |
|      | 25 | 400    | 1 800        |
|      | 28 | 3,800  | 3 3,600      |
|      | 30 | 200    | 8 10,000     |
|      |    |        | 12 4,500     |
|      |    |        | 18 1,000     |
|      |    |        | 25 800       |
|      |    |        | 30 2,400     |
|      |    | 14,100 |              |

| Accounts Receivable |    |     |             |
|---------------------|----|-----|-------------|
|                     |    | 0   |             |
| Jan.                | 25 | 600 | Jan. 30 200 |
|                     |    | 400 |             |

| Supplies |   |       |  |
|----------|---|-------|--|
|          |   | 0     |  |
| Jan.     | 3 | 2,500 |  |
|          |   | 2,500 |  |

| Prepaid Insurance |   |       |  |
|-------------------|---|-------|--|
|                   |   | 0     |  |
| Jan.              | 3 | 3,600 |  |
|                   |   | 3,600 |  |

| Prepaid Rent |   |        |  |
|--------------|---|--------|--|
|              |   | 0      |  |
| Jan.         | 8 | 10,000 |  |
|              |   | 10,000 |  |

| Equipment |   |       |  |
|-----------|---|-------|--|
|           |   | 0     |  |
| Jan.      | 1 | 7,000 |  |
|           |   | 7,000 |  |

| Accounts Payable |    |       |              |
|------------------|----|-------|--------------|
|                  |    |       | 0            |
| Jan.             | 18 | 1,000 | Jan. 3 2,500 |
|                  |    |       | 1,500        |

| Unearned Sales Revenue |  |  |               |
|------------------------|--|--|---------------|
|                        |  |  | 0             |
|                        |  |  | Jan. 28 3,800 |
|                        |  |  | 0             |

| Notes Payable |  |  |               |
|---------------|--|--|---------------|
|               |  |  | 0             |
|               |  |  | Jan. 1 25,000 |
|               |  |  | 0             |

| Common Stock |  |  |               |
|--------------|--|--|---------------|
|              |  |  | 0             |
|              |  |  | Jan. 1 16,000 |
|              |  |  | 0             |

| Sales Revenue |  |  |               |
|---------------|--|--|---------------|
|               |  |  | 0             |
|               |  |  | Jan. 25 1,000 |
|               |  |  | 0             |

**Case 2-61 (Contd)**

| <b>Artist Fee Expense</b> |     |     |
|---------------------------|-----|-----|
|                           |     | 0   |
| Jan. 25                   | 800 |     |
|                           |     | 800 |

| <b>Advertising Expense</b> |       |       |
|----------------------------|-------|-------|
|                            |       | 0     |
| Jan. 12                    | 4,500 |       |
|                            |       | 4,500 |

| <b>Salaries Expense</b> |       |       |
|-------------------------|-------|-------|
|                         |       | 0     |
| Jan. 30                 | 2,400 |       |
|                         |       | 2,400 |

| <b>Rent Expense</b> |     |     |
|---------------------|-----|-----|
|                     |     | 0   |
| Jan. 1              | 800 |     |
|                     |     | 800 |

| <b>Legal Expense</b> |       |       |
|----------------------|-------|-------|
|                      |       | 0     |
| Jan. 1               | 1,200 |       |
|                      |       | 1,200 |

Case 2-61 (Contd)

3.

| Front Row Entertainment, Inc.<br>Trial Balance<br>January 31, 2011 |          |          |
|--|----------|----------|
| Account  | Debit    | Credit   |
| Cash.....  | \$14,100 |          |
| Accounts Receivable.....   | 400      |          |
| Supplies.....  | 2,500    |          |
| Prepaid Insurance.....   | 3,600    |          |
| Prepaid Rent.....  | 10,000   |          |
| Equipment.....   | 7,000    |          |
| Accounts Payable.....  |          | \$ 1,500 |
| Unearned Sales Revenue.....  |          | 3,800    |
| Notes Payable.....   |          | 25,000   |
| Common Stock.....  |          | 16,000   |
| Sales Revenue.....   |          | 1,000    |
| Artist Fee Expense.....  | 800      |          |
| Advertising Expense.....   | 4,500    |          |
| Salaries Expense.....  | 2,400    |          |
| Rent Expense.....  | 800      |          |
| Legal Expense.....   | 1,200    |          |
|  | \$47,300 | \$47,300 |