

# CHAPTER 3

## The Accounting Information System

### ASSIGNMENT CLASSIFICATION TABLE (BY TOPIC)

Topics	Questions	Brief Exercises	Exercises	Problems
1. Transaction identification.	1, 2, 3, 5	1, 2	1, 2, 3, 4, 19	1
2. Nominal accounts.	4, 7			
3. Trial balance.	6, 13		2, 3, 4	1, 2, 7
4. Adjusting entries.	8, 14, 16, 17	3, 4, 5, 6, 7, 8, 9, 10	5, 6, 7, 8, 9, 10, 22	1, 2, 3, 4, 5, 6, 7, 8, 9, 11
5. Financial statements			11, 12, 25, 26	1, 2, 4, 6
6. Closing.	15	12	13, 14, 18	1, 4, 8, 9, 11
7. Inventory and cost of goods sold.	9, 10, 11, 12	11	12, 14, 15, 16	
8. Comprehensive accounting cycle.				1, 2, 6, 11
*9. Cash vs. Accrual Basis	18, 19, 20	13	20, 21	10
*10. Reversing entries.	21	14	22	
*11. Worksheet	22		23, 24, 25	11

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

## ASSIGNMENT CLASSIFICATION TABLE (BY LEARNING OBJECTIVE)

Learning Objectives	Brief Exercises	Exercises	Problems
1. Understand basic accounting terminology.			
2. Explain double-entry rules.			
3. Identify steps in accounting cycle.			
4. Record transactions in journals, post to ledger accounts, and prepare a trial balance.	1, 2, 3, 4, 5, 6, 7	1, 2, 3, 4, 19	1, 4, 8, 9
5. Explain the reasons for preparing adjusting entries.	3, 4, 5, 6, 7, 8, 9, 10	5, 6, 7, 8, 9, 10, 22	2, 3, 4, 5, 6, 7, 8, 9, 11
6. Prepare financial statements from the adjusted trail balance.		11, 12	1, 2, 4, 6, 7, 8, 9, 11
7. Prepare closing entries.	12	13, 14, 18	1, 4, 8, 9, 11
8. Explain how to adjust inventory accounts at year-end.	11	15, 16, 17	
*9. Differentiate the cash basis of accounting from the accrual basis of accounting.	13	20, 21	10
*10. Identify adjusting entries that may be reversed.	14	22	
*11. Prepare a 10-column worksheet.		23, 24, 25	11

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

## ASSIGNMENT CHARACTERISTICS TABLE

Item	Description	Level of Difficulty	Time (minutes)
E3-1	Transaction analysis—service company.	Simple	15–20
E3-2	Corrected trial balance.	Simple	10–15
E3-3	Corrected trial balance.	Simple	15–20
E3-4	Corrected trial balance.	Simple	10–15
E3-5	Adjusting entries.	Moderate	10–15
E3-6	Adjusting entries.	Moderate	15–20
E3-7	Analyze adjusted data.	Complex	15–20
E3-8	Adjusting entries.	Moderate	10–15
E3-9	Adjusting entries.	Moderate	15–20
E3-10	Adjusting entries.	Complex	25–30
E3-11	Prepare financial statements.	Moderate	20–25
E3-12	Prepare financial statements.	Moderate	20–25
E3-13	Closing entries.	Simple	10–15
E3-14	Closing entries.	Moderate	10–15
E3-15	Missing amounts.	Simple	10–15
E3-16	Find missing amounts—periodic inventory.	Moderate	20–25
E3-17	Cost of goods sold—periodic inventory.	Moderate	10–15
E3-18	Closing entries for a corporation.	Moderate	10–15
E3-19	Transactions of a corporation, including investment and dividend.	Moderate	10–15
*E3-20	Cash to accrual basis.	Moderate	15–20
*E3-21	Cash to accrual basis.	Moderate	10–15
*E3-22	Adjusting and reversing entries.	Complex	20–25
*E3-23	Worksheet.	Simple	10–15
*E3-24	Worksheet and balance sheet presentation.	Moderate	20–25
*E3-25	Partial worksheet preparation.	Moderate	10–15
P3-1	Transactions, financial statements—service company.	Moderate	25–35
P3-2	Adjusting entries and financial statements.	Moderate	35–40
P3-3	Adjusting entries.	Moderate	25–30
P3-4	Financial statements, adjusting and closing entries.	Moderate	40–50
P3-5	Adjusting entries.	Moderate	15–20
P3-6	Adjusting entries and financial statements.	Moderate	25–35
P3-7	Adjusting entries and financial statements.	Moderate	25–35
*P3-8	Adjusting and closing.	Moderate	30–40
*P3-9	Adjusting and closing.	Moderate	30–35
*P3-10	Cash and accrual basis.	Moderate	35–40
*P3-11	Worksheet, balance sheet, adjusting and closing entries.	Complex	40–50

# ANSWERS TO QUESTIONS

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

**Questions Chapter 3 (Continued)**

10. The purpose of the Cost of Goods Sold account is to act as a clearing account for bringing together those items directly affecting cost of goods sold for this period. Example of items that would appear in this account are: (1) Purchases, (2) Purchase Discounts, (3) Purchase Returns, (4) Purchase Allowances, (5) Transportation-in, (6) Inventory (beginning), and (7) Inventory (ending). The ending balance represents the cost of goods sold.
11. The purpose of the Cost of Goods Sold account is to accumulate the costs of issuances from inventory. In a perpetual inventory system, when inventory is sold, Cost of Goods Sold is debited and Inventory is credited. At the end of the period, Cost of Goods Sold is closed to Income Summary.
12. On the balance sheet, the effect of the error is (1) the equipment account is understated, and (2) the Capital account (proprietorship–partnership) or Retained Earnings (Corporation) is understated. On the income statement, (1) purchases and cost of goods sold are overstated and (2) net income is understated. (**Note to instructor:** The instructor should also be ready to discuss the effect that the omission of the depreciation charge on the computer might have.)
13. (a) No change.  
 (b) Before closing, balances exist in these accounts; after closing, no balances exist.  
 (c) Before closing, balances exist in these accounts; after closing, no balances exist.  
 (d) Before closing, a balance exists in this account exclusive of any dividends or the income or loss for the period; after closing, the balance is increased or decreased by the amount of net income or net loss, and decreased by dividends declared.  
 (e) No change.
14. Adjusting entries are prepared prior to the preparation of financial statements in order to bring the accounts up to date and are necessary (1) to achieve a proper matching of revenues and expenses in measuring income and (2) to achieve an accurate presentation of assets, liabilities and stockholders' equity.
15. Closing entries are prepared to transfer the balances of nominal accounts to capital (retained earnings) after the adjusting entries have been recorded and the financial statements prepared. Closing entries are necessary to reduce the balances in nominal accounts to zero in order to prepare the accounts for the next period's transactions.
16.  $\text{Cost} - \text{Salvage Value} = \text{Depreciable Cost}$ :  $\$3,000 - \$0 = \$3,000$ .  $\text{Depreciable Cost} \div \text{Useful Life} = \text{Depreciation Expense For One Year}$   $\$3,000 \div 5 \text{ years} = \$600 \text{ per year}$ . The asset was used for 6 months (7/1 – 12/31), therefore 1/2-year of depreciation expense should be reported. Annual depreciation  $\times 6/12 = \text{amount to be reported on 2007 income statement}$ :  $\$600 \times 6/12 = \underline{\$300}$ .

17.

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

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

- \*18. Under the cash basis of accounting, revenue is recorded only when cash is received and expenses are recorded only when paid. Under the accrual basis of accounting, revenue is recognized when it is earned and expenses are recognized when incurred, without regard to the time of the receipt or payment of cash.

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

### Questions Chapter 3 (Continued)

- \*19. Wages paid during the year will include the payment of any wages attributable to the prior year but unpaid at the end of the prior year. This amount is an expense of the prior year and not of the current year, and thus should be subtracted in determining wages expense. Similarly, wages paid during the year will not include any wages attributable to hours worked during the current year but not actually paid until the following year. This should be added in determining wages expense.
- \*20. Although similar to the strict cash basis, the modified cash basis of accounting requires that expenditures for capital items be charged against income over all the periods to be benefited. This is done through conventional accounting methods, such as depreciation and amortization. Under the strict cash basis, expenditures would be recognized as expense in the period in which the corresponding cash disbursement is made.
- \*21. Reversing entries are made at the beginning of the period to reverse the accrued items and some prepaid items. Reversing entries are not required. They are made to simplify the recording of certain transactions that will occur later in the period. The same results will be attained whether or not reversing entries are recorded.
- \*22. A work sheet is not a permanent accounting record and its use is not required in the accounting cycle. The work sheet is an informal device for accumulating and sorting information needed for the financial statements. Its use is optional in helping to prepare financial statements.

# SOLUTIONS TO BRIEF EXERCISES

## BRIEF EXERCISE 3-1

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

## BRIEF EXERCISE 3-2

Aug.	2	Cash.....	12,000	
		Equipment .....	2,500	
		Brett Favre, Capital .....		14,500
	7	Supplies .....	400	
		Accounts Payable .....		400
	12	Cash.....	1,300	
		Accounts Receivable.....	670	
		Service Revenue.....		1,970

**BRIEF EXERCISE 3-2 (Continued)**

	15	Rent Expense.....	600	
		Cash .....		600
	19	Supplies Expense.....	130	
		Supplies (\$400 – \$270) .....		130

**BRIEF EXERCISE 3-3**

July	1	Prepaid Insurance .....	18,000	
		Cash .....		18,000
Dec.	31	Insurance Expense .....	3,000	
		Prepaid Insurance.....		3,000
		(\$18,000 X 1/2 X 1/3)		

**BRIEF EXERCISE 3-4**

July	1	Cash.....	18,000	
		Unearned Insurance Revenue .....		18,000
Dec.	31	Unearned Insurance Revenue.....	3,000	
		Insurance Revenue.....		3,000
		(\$18,000 X 1/2 X 1/3)		

**BRIEF EXERCISE 3-5**

Feb.	1	Prepaid Insurance.....	840,000	
		Cash .....		840,000
June	30	Insurance Expense.....	175,000	
		Prepaid Insurance .....		175,000
		(\$840,000 X 5/24)		

**BRIEF EXERCISE 3-6**

Nov.	1	Cash.....	2,700	
		Unearned Rent Revenue .....		2,700
Dec.	31	Unearned Rent Revenue.....	1,800	
		Rent Revenue .....		1,800
		(\$2,700 X 2/3)		

**BRIEF EXERCISE 3-7**

Dec.	31	Salaries Expense.....	3,600	
		Salaries Payable .....		3,600
		(\$6,000 X 3/5)		
Jan.	2	Salaries Payable.....	3,600	
		Salaries Expense.....	2,400	
		Cash .....		6,000

**BRIEF EXERCISE 3-8**

Dec.	31	Interest Receivable .....	300	
		Interest Revenue .....		300
Feb.	1	Cash .....	10,400	
		Notes Receivable .....		10,000
		Interest Receivable .....		300
		Interest Revenue .....		100

**BRIEF EXERCISE 3-9**

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

**BRIEF EXERCISE 3-10**

Depreciation Expense .....	3,000	
Accumulated Depreciation—Equipment .....		3,000
Equipment .....	\$30,000	
Less: Accumulated depreciation—equipment .....	<u>3,000</u>	\$27,000

**BRIEF EXERCISE 3-11**

Beginning inventory			\$ 81,000
Purchases		\$540,000	
Less: Purchase returns	\$5,800		
Purchase discounts	<u>5,000</u>	<u>10,800</u>	
Net purchases		529,200	
Add: Freight-in		<u>16,200</u>	
Cost of goods purchased			<u>545,400</u>
Cost of goods available for sale			626,400
Ending inventory			<u>70,200</u>
Cost of goods sold			<u>\$556,200</u>

**BRIEF EXERCISE 3-12**

Sales .....	828,900	
Interest Revenue .....	13,500	
Income Summary.....		842,400
Income Summary .....	780,300	
Cost of Goods Sold.....		556,200
Operating Expenses .....		189,000
Income Tax Expense .....		35,100
Income Summary .....	62,100	
Retained Earnings.....		62,100
Retained Earnings .....	18,900	
Dividends .....		18,900

**\*BRIEF EXERCISE 3-13**

<b>(a)</b>	<b>Cash receipts .....</b>	<b>\$152,000</b>
	<b>+ Increase in accounts receivable.....</b>	<b>5,600</b>
	<b>(\$18,600 – \$13,000)</b>	
	<b>Service revenue.....</b>	<b><u>\$157,600</u></b>
<b>(b)</b>	<b>Payments for operating expenses .....</b>	<b>\$ 97, 000</b>
	<b>– Increase in prepaid expenses .....</b>	<b>(5,700)</b>
	<b>(\$23,200 – \$17,500)</b>	
	<b>Operating expenses .....</b>	<b><u>\$ 91,300</u></b>

**\*BRIEF EXERCISE 3-14**

<b>(a)</b>	<b>Salaries Payable.....</b>	<b>3,600</b>	
	<b>Salaries Expense.....</b>		<b>3,600</b>
<b>(b)</b>	<b>Salaries Expense .....</b>	<b>6,000</b>	
	<b>Cash.....</b>		<b>6,000</b>
<b>(c)</b>	<b>Salaries Payable.....</b>	<b>3,600</b>	
	<b>Salaries Expense .....</b>	<b>2,400</b>	
	<b>Cash.....</b>		<b>6,000</b>

# SOLUTIONS TO EXERCISES

## EXERCISE 3-1 (15–20 minutes)

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

**EXERCISE 3-1 (Continued)**

30	Supplies Expense.....	120	
	Supplies .....		120
30	Equipment.....	6,100	
	Beverly Crusher, Capital .....		6,100

**EXERCISE 3-2 (10–15 minutes)**

**Wanda Landowska Company  
Trial Balance  
April 30, 2007**

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

**EXERCISE 3-3 (15–20 minutes)**

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

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

Accounts Payable	
	Bal. 7,044

Accounts Receivable			
Bal.	5,240	(1)	450

Common Stock	
	Bal. 8,000

Supplies on Hand	
Bal.	2,967

Retained Earnings	
	Bal. 2,000

Furniture and Equipment			
Bal.	6,100		
(2)	3,200		

Service Revenue	
	Bal. 5,200
	(3) 2,025
	(5) 80

Office Expense			
Bal.	4,320	(2)	3,200

**EXERCISE 3-3 (Continued)**

**Blues Traveler Corporation  
 Trial Balance (corrected)  
 April 30, 2007**

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

**EXERCISE 3-4 (15–20 minutes)**

**Watteau Co.  
Trial Balance  
June 30, 2007**

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

**EXERCISE 3-5 (10–15 minutes)**

1. Depreciation Expense (\$250 X 3).....	750	
Accumulated Depreciation—Equipment .....		750
2. Unearned Rent Revenue (\$9,300 X 1/3).....	3,100	
Rent Revenue .....		3,100
3. Interest Expense .....	500	
Interest Payable .....		500

**EXERCISE 3-5 (Continued)**

<b>4.</b>	<b>Supplies Expense .....</b>	<b>1,950</b>	
	<b>Supplies (\$2,800 – \$850).....</b>		<b>1,950</b>
<b>5.</b>	<b>Insurance Expense (\$300 X 3).....</b>	<b>900</b>	
	<b>Prepaid Insurance .....</b>		<b>900</b>

**EXERCISE 3-6 (10–15 minutes)**

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

**EXERCISE 3-7 (15–20 minutes)**

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

The policy was purchased six months ago (August 1, 2006)

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

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

The “T” account for salaries payable is

Salaries Payable			
Paid	700	Beg. Bal.	?
January			
		End Bal.	800

The beginning balance is therefore

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

**EXERCISE 3-7 (Continued)**

<b>(d) Service revenue</b>	<b>\$2,000</b>	
<b>Cash received</b>	<u><b>1,600</b></u>	
<b>Unearned revenue reduced</b>	<u><b>\$ 400</b></u>	
<b>Ending unearned revenue January 31, 2007</b>		<b>\$ 750</b>
<b>Plus: Unearned revenue reduced</b>		<u><b>400</b></u>
<b>Beginning unearned revenue December 31, 2006</b>		<u><b>\$1,150</b></u>

**EXERCISE 3-8 (10–15 minutes)**

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

**EXERCISE 3-9 (15–20 minutes)**

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

**EXERCISE 3-10 (25–30 minutes)**

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

**EXERCISE 3-10 (Continued)**

(b)

**Greco Resort  
Adjusted Trial Balance  
August 31, 2007**

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

**EXERCISE 3-11 (20–25 Minutes)**

**(a) ANDERSON COOPER CO.  
Income Statement  
For the Year Ended December 31, 2007**

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

**(b) ANDERSON COOPER CO.  
Statement of Retained Earnings  
For the Year Ended December 31, 2007**

---

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

**EXERCISE 3-11 (Continued)**

**(c) ANDERSON COOPER CO.  
Balance Sheet  
December 31, 2007**

**Assets**

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

**Liabilities and Stockholders' Equity**

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

**\*Beg. Balance + Net Income – Dividends = Ending Balance**

$$\mathbf{\$11,310 + \$2,262 - \$3,000 = \$10,572}$$

**EXERCISE 3-12 (20–25 Minutes)**

**(a) SANTO DESIGN AGENCY  
Income Statement  
For the Year Ended December 31, 2007**

---

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

**SANTO DESIGN AGENCY  
Statement of Retained Earnings  
For the Year Ended December 31, 2007**

---

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

**EXERCISE 3-12 (Continued)**

(a) Continued

**SANTO DESIGN AGENCY**

**Balance Sheet**

**December 31, 2007**

**Assets**

Cash.....		<b>\$11,000</b>
Accounts receivable .....		<b>21,500</b>
Art supplies.....		<b>5,000</b>
Prepaid insurance.....		<b>2,500</b>
Printing equipment.....	<b>\$60,000</b>	
Less: Accumulated depreciation—printing equipment.....	<u><b>35,000</b></u>	<u><b>25,000</b></u>
<b>Total assets .....</b>		<u><b>\$65,000</b></u>

**Liabilities and Stockholders' Equity**

**Liabilities**

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

**Stockholders' equity**

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

(b) (1) Based on interest payable at December 31, 2007, interest is \$25 per month or .5% of the note payable.  $.5\% \times 12 = 6\%$  interest per year.

(2) Salaries Expense, \$11,300 less Salaries Payable 12/31/07, \$1,300 = \$10,000. Total Payments, \$17,500 – \$10,000 = \$7,500 Salaries Payable 12/31/06.

**EXERCISE 3-13 (10–15 Minutes)**

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

**EXERCISE 3-14 (10–15 minutes)**

	<b>Sales .....</b>	<b>350,000</b>	
	<b>Sales Returns and Allowances .....</b>		<b>13,000</b>
	<b>Sales Discounts .....</b>		<b>8,000</b>
	<b>Income Summary.....</b>		<b>329,000</b>
	<b>Income Summary .....</b>	<b>308,000</b>	
	<b>Cost of Goods Sold.....</b>		<b>208,000</b>
	<b>Freight-out .....</b>		<b>7,000</b>
	<b>Insurance Expense.....</b>		<b>12,000</b>
	<b>Rent Expense.....</b>		<b>20,000</b>
	<b>Salary Expense.....</b>		<b>61,000</b>
	<b>Income Summary .....</b>	<b>21,000</b>	
	<b>Retained Earnings.....</b>		<b>21,000</b>

**EXERCISE 3-15 (10–15 minutes)**

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

**EXERCISE 3-16 (20–25 minutes)**

(a) Sales	\$78,000
*Sales returns	<u>(4,000)</u>
Net sales	<u>\$74,000</u>
(b) Beginning inventory	\$16,000
Purchases	88,000
Purchase returns	<u>(6,000)</u>
Goods available for sale	98,000
*Ending inventory	<u>(34,000)</u>
Cost of goods sold	<u>\$64,000</u>
(c) *Sales	\$99,000
Sales returns	<u>(5,000)</u>
Net sales	<u>\$94,000</u>
(d) *Beginning inventory	\$ 30,000
Purchases	100,000
Purchase returns	<u>(10,000)</u>
Goods available for sale	120,000
Ending inventory	<u>(48,000)</u>
Cost of goods sold	<u>\$ 72,000</u>

**EXERCISE 3-16 (Continued)**

<b>(e) Beginning inventory</b>	<b>\$ 44,000</b>	
<b>*Purchases</b>	<b>108,000</b>	
<b>Purchase returns</b>	<b><u>(8,000)</u></b>	
<b>Goods available for sale</b>	<b>144,000</b>	
<b>Ending inventory</b>	<b><u>(30,000)</u></b>	
<b>Cost of goods sold</b>	<b><u>\$114,000</u></b>	<b>from (f) below</b>

<b>(f) Net sales</b>	<b>\$132,000</b>	
<b>*Cost of goods sold</b>	<b><u>(114,000)</u></b>	
<b>Gross profit</b>	<b><u>\$ 18,000</u></b>	

<b>(g) Sales</b>	<b>\$100,000</b>	
<b>Sales returns</b>	<b><u>(9,000)</u></b>	
<b>*Net sales</b>	<b><u>\$ 91,000</u></b>	

<b>(h) Beginning inventory</b>	<b>\$ 24,000</b>	
<b>Purchases</b>	<b>85,000</b>	
<b>*Purchase returns</b>	<b><u>(9,000)</u></b>	
<b>Goods available for sale</b>	<b>100,000</b>	
<b>Ending inventory</b>	<b><u>(28,000)</u></b>	
<b>Cost of goods sold</b>	<b><u>\$ 72,000</u></b>	

<b>(i) Net sales</b>	<b>\$91,000</b>	
<b>Cost of goods sold</b>	<b><u>(72,000)</u></b>	
<b>*Gross profit</b>	<b><u>\$19,000</u></b>	

**EXERCISE 3-17 (10–15 minutes)**

Inventory, September 1, 2006 .....		\$ 17,500
Purchases .....	\$149,400	
Less: Purchase returns and allowances.....	<u>2,000</u>	
Net purchases .....	147,400	
Add: Freight-in.....	<u>4,000</u>	
Cost of goods purchased .....		<u>151,400</u>
Cost of goods available for sale .....		168,900
Inventory, August 31, 2007 .....		<u>25,000</u>
Cost of goods sold .....		<u>\$143,900</u>

**EXERCISE 3-18 (10–15 minutes)**

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

(or)

Sales.....	410,000	
Income Summary .....		410,000

**EXERCISE 3-18 (Continued)**

<b>Income Summary .....</b>	<b>336,700</b>	
<b>Cost of Goods Sold.....</b>		<b>225,700</b>
<b>Sales Returns and Allowances .....</b>		<b>12,000</b>
<b>Sales Discounts .....</b>		<b>15,000</b>
<b>Selling Expense .....</b>		<b>16,000</b>
<b>Administrative Expense .....</b>		<b>38,000</b>
<b>Income Tax Expense .....</b>		<b>30,000</b>
<b>Income Summary .....</b>	<b>73,300</b>	
<b>Retained Earnings.....</b>		<b>73,300</b>
<b>Retained Earnings .....</b>	<b>18,000</b>	
<b>Dividends .....</b>		<b>18,000</b>

**EXERCISE 3-19 (10–15 minutes)**

**J1**

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

**\*EXERCISE 3-20 (15–20 minutes)**

**Jill Accardo, M.D.**  
**Conversion of Cash Basis to Accrual Basis**  
**For the Year 2007**

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

**Alternate solution:**

**Jill Accardo, M.D.**  
**Conversion of Income Statement Data**  
**from Cash Basis to Accrual Basis**  
**For the Year 2007**

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

**\*EXERCISE 3-21 (10–15 minutes)**

**(a)**

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

	<u>2006</u>	<u>2007</u>
<b>Sales</b>	<b>\$295,000</b>	<b>\$515,000</b>
<b>Expenses</b>	<u><b>225,000</b></u>	<u><b>272,000</b></u>
<b>Net income</b>	<u><b>\$ 70,000</b></u>	<u><b>\$243,000</b></u>

**(b)**

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

	<u>2006</u>	<u>2007</u>
<b>Sales*</b>	<b>\$485,000</b>	<b>\$445,000</b>
<b>Expenses**</b>	<u><b>277,000</b></u>	<u><b>255,000</b></u>
<b>Net income</b>	<u><b>\$208,000</b></u>	<u><b>\$190,000</b></u>

**\*2006:     \$295,000 + \$160,000 + \$30,000 = \$485,000**

**2007:     \$355,000 + \$90,000 = \$445,000**

**\*\*2006:   \$185,000 + \$67,000 + \$25,000 = \$277,000**

**2007:     \$40,000 + \$160,000 + \$55,000 = \$255,000**

**\*EXERCISE 3-22 (20–25 minutes)**

**(a) Adjusting Entries:**

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

**(b) Reversing Entries:**

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

**\*EXERCISE 3-23 (10–15 minutes)**

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

**\*EXERCISE 3-24 (20–25 minutes)**

**Ed Bradley Co.  
Worksheet (partial)  
For the Month Ended April 30, 2007**

Account Titles	Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	19,472				19,472	
Accounts receivable	6,920				6,920	
Prepaid rent	2,280				2,280	
Equipment	18,050				18,050	
Accum. depreciation		4,895				4,895
Notes payable		5,700				5,700
Accounts payable		5,472				5,472
Bradley, capital		34,960				34,960
Bradley, drawing	6,650				6,650	
Services revenue		11,590		11,590		
Salaries expense	6,840		6,840			
Rent expense	2,260		2,260			
Depreciation expense	145		145			
Interest expense	83		83			
Interest payable		83				83
<b>Totals</b>	<b><u>62,700</u></b>	<b><u>62,700</u></b>	<b><u>9,328</u></b>	<b><u>11,590</u></b>	<b><u>53,372</u></b>	<b><u>51,110</u></b>
Net income			<u>2,262</u>			<u>2,262</u>
<b>Totals</b>			<b><u>11,590</u></b>	<b><u>11,590</u></b>	<b><u>53,372</u></b>	<b><u>53,372</u></b>

**EXERCISE 3-24 (Continued)**

**Ed Bradley Co.  
Balance Sheet  
April 30, 2007**

**Assets**

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

**Liabilities and Owner's Equity**

<b>Current liabilities</b>		
Accounts payable .....		\$ 5,472
Interest payable .....		83
Notes payable.....		<u>5,700</u>
Total current liabilities.....		11,255
<b>Owner's equity</b>		
Bradley, Capital .....		<u>30,572*</u>
<b>Total liabilities and owner's equity.....</b>		<b><u>\$41,827</u></b>

**\*Beg. Balance – Drawings + Net Income = Ending Balance**

\$34,960	–	\$6,650	+	\$2,262	=	\$30,572
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**\*EXERCISE 3-25 (10–15 minutes)**

**Jurassic Park Co.  
Worksheet (partial)  
For Month Ended February 28, 2007**

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

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

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

# TIME AND PURPOSE OF PROBLEMS

**Problem 3-1** (Time 25–35 minutes)

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

**Problem 3-2** (Time 35–40 minutes)

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

**Problem 3-3** (Time 25–30 minutes)

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

**Problem 3-4** (Time 40–50 minutes)

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

**Problem 3-5** (Time 15–20 minutes)

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

**Problem 3-6** (Time 25–35 minutes)

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

**Problem 3-7** (Time 25–35 minutes)

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

**Problem 3-8** (Time 30–40 minutes)

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

**Problem 3-9** (Time 30–35 minutes)

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

**\*Problem 3-10** (Time 35–40 minutes)

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

**\*Problem 3-11** (Time 40–50 minutes)

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

# SOLUTIONS TO PROBLEMS

## PROBLEM 3-1

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

Cash			
Sept. 1	20,000	Sept. 4	680
8	1,690	5	942
20	980	10	430
		18	3,600
		19	3,000
		30	1,400
		30	85
30 Bal 12,533			

Furniture and Equipment			
Sept. 2	17,280		
Shigeki Muruyama, Capital			
Sept. 19	3,000	Sept. 1	20,000
		30	5,707
		Bal. 30	22,707

Accounts Receivable			
Sept. 14	5,120	Sept. 20	980
25	2,110		
Bal. 30 6,250			

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

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

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

Service Revenue			
Sept. 30	8,920	Sept. 8	1,690
		14	5,120
		25	<u>2,110</u>
	<u>8,920</u>		<u>8,920</u>

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

Accumulated Depreciation			
		Sept. 30	288

Office Salaries Expense			
Sept. 30	<u>1,400</u>	Sept. 30	<u>1,400</u>

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

**PROBLEM 3-1 (Continued)**

Depreciation Expense				Income Summary				
Sept. 30		<u>288</u>	Sept. 30	<u>288</u>	Sept. 30	680	Sept. 30	8,920
					30	515		
					30	1,400		
					30	330		
					30	288		
					30 Inc.	<u>5,707</u>		
						<u>8,920</u>		<u>8,920</u>

(b) **Shigeki Muruyama, D.D.S.**  
**Trial Balance**  
**September 30**

	<u>Debit</u>	<u>Credit</u>
Cash.....	12,533	
Accounts Receivable .....	6,250	
Supplies on Hand.....	612	
Furniture and Equipment.....	17,280	
Accumulated Depreciation.....		288
Accounts Payable .....		13,680
Shigeki Muruyama, Capital .....		17,000
Service Revenue.....		8,920
Rent Expense .....	680	
Miscellaneous Office Expense .....	515	
Office Salaries Expense.....	1,400	
Supplies Expense .....	330	
Depreciation Expense .....	<u>288</u>	
<b>Totals .....</b>	<b><u>39,888</u></b>	<b><u>39,888</u></b>

**PROBLEM 3-1 (Continued)**

**(c) Shigeki Muruyama, D.D.S.  
Income Statement  
For the Month of September**

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<b>Service revenue</b> .....		<b>\$8,920</b>
<b>Expenses:</b>		
<b>Office salaries expense</b> .....	<b>\$1,400</b>	
<b>Rent expense</b> .....	<b>680</b>	
<b>Supplies expense</b> .....	<b>330</b>	
<b>Depreciation expense</b> .....	<b>288</b>	
<b>Miscellaneous office expense</b> .....	<b>515</b>	
<b>Total expenses</b> .....		<b><u>3,213</u></b>
<b>Net income</b> .....		<b><u>\$5,707</u></b>

**Shigeki Muruyama, D.D.S.  
Balance Sheet  
As of September 30**

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<b>Assets</b>		<b>Liabilities and Owner's Equity</b>	
<b>Cash</b> .....	<b>\$12,533</b>	<b>Accounts payable</b> .....	<b>\$13,680</b>
<b>Accounts receivable</b> .....	<b>6,250</b>	<b>Shigeki Muruyama, Capital</b> .....	<b>22,707</b>
<b>Supplies on Hand</b> .....	<b>612</b>		
<b>Furniture and equip.</b> .....	<b>17,280</b>		
<b>Accum. depreciation</b> .....	<b><u>(288)</u></b>	<b>Total liabilities and</b>	
<b>Total assets</b> .....	<b><u>\$36,387</u></b>	<b>owner's equity</b> .....	<b><u>\$36,387</u></b>

**PROBLEM 3-1 (Continued)**

**Shigeki Muruyama, D.D.S.  
Statement of Owner's Equity  
For the Month of September**

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Muruyama, Capital September 1 .....	\$20,000
Add: Net income for September.....	<u>5,707</u>
	25,707
Less: Withdrawal by owner .....	<u>3,000</u>
Muruyama, Capital September 30.....	<u>\$22,707</u>

(e) **Shigeki Muruyama, D.D.S.  
Post-closing Trial Balance  
September 30**

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	<u>Debit</u>	<u>Credit</u>
Cash.....	12,533	
Accounts Receivable .....	6,250	
Supplies on Hand.....	612	
Furniture and Equipment.....	17,280	
Accumulated Depreciation.....		288
Accounts Payable .....		13,680
Shigeki Muruyama, Capital .....		<u>22,707</u>
Totals .....	<u>36,675</u>	<u>36,675</u>

<b>PROBLEM 3-2</b>
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(a)	Dec. 31	Accounts Receivable .....	1,500	
		Advertising Revenue .....		1,500
	31	Unearned Advertising Revenue .....	1,400	
		Advertising Revenue .....		1,400
	31	Art Supplies Expense .....	3,400	
		Art Supplies.....		3,400
	31	Depreciation Expense .....	7,000	
		Accumulated Depreciation .....		7,000
	31	Interest Expense.....	150	
		Interest Payable .....		150
	31	Insurance Expense .....	850	
		Prepaid Insurance .....		850
	31	Salaries Expense.....	1,300	
		Salaries Payable .....		1,300

**PROBLEM 3-2 (Continued)**

**(b)**

**YOUNT ADVERTISING AGENCY**  
**Income Statement**  
**For the Year Ended December 31, 2007**

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**Revenues**

Advertising revenue..... **\$61,500**

**Expenses**

Salaries expense..... **\$11,300**

Depreciation expense..... **7,000**

Rent expense ..... **4,000**

Art supplies expense..... **3,400**

Insurance expense ..... **850**

Interest expense..... **500**

Total expenses ..... **27,050**

Net income ..... **\$34,450**

**YOUNT ADVERTISING AGENCY**  
**Statement of Retained Earnings**  
**For the Year Ended December 31, 2007**

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Retained earnings, January 1 ..... **\$ 3,500**

Add: Net income..... **34,450**

Retained earnings, December 31 ..... **\$37,950**

**PROBLEM 3-2 (Continued)**

**YOUNT ADVERTISING AGENCY  
Balance Sheet  
December 31, 2007**

<b>Assets</b>		
Cash .....		\$11,000
Accounts receivable .....		21,500
Art supplies .....		5,000
Prepaid insurance .....		2,500
Printing equipment .....	\$60,000	
Less: Accumulated depreciation—printing equipment...	<u>35,000</u>	<u>25,000</u>
Total assets .....		<u>\$65,000</u>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Notes payable.....	\$ 5,000	
Accounts payable .....	5,000	
Interest payable .....	150	
Unearned advertising revenue .....	5,600	
Salaries payable .....	<u>1,300</u>	
Total liabilities .....		\$17,050
<b>Stockholders' equity</b>		
Common stock.....	\$10,000	
Retained earnings.....	<u>37,950</u>	<u>47,950</u>
Total liabilities and stockholders' equity .....		<u>\$65,000</u>

- (c) (1) Interest is \$50 per month or 1% of the note payable.  $1\% \times 12 = 12\%$  interest per year.
- (3) Salaries Expense, \$11,300 less Salaries Payable 12/31/07, \$1,300 = \$10,000. Total Payments, \$13,500 – \$10,000 = \$3,500 Salaries Payable 12/31/06.

<b>PROBLEM 3-3</b>
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1.	Dec. 31	<b>Salaries Expense .....</b>	<b>2,000</b>	
		<b>Salaries Payable .....</b>		<b>2,000</b>
		(5 X \$700 X 2/5) = \$1,400		
		(3 X \$500 X 2/5) = <u>600</u>		
		<b>Total accrued salaries <u>\$2,000</u></b>		
2.	31	<b>Unearned Rent Revenue .....</b>	<b>74,000</b>	
		<b>Rent Revenue .....</b>		<b>74,000</b>
		(5 X \$4,000 X 2) = \$40,000		
		(4 X \$8,500 X 1) = <u>34,000</u>		
		<b>Total rent earned <u>\$74,000</u></b>		
3.	31	<b>Advertising Expense .....</b>	<b>4,900</b>	
		<b>Prepaid Advertising.....</b>		<b>4,900</b>
		(A650 – \$500 per month for 8 months) = \$4,000		
		(B974 – \$300 per month for 3 months) = <u>900</u>		
		<b>Total advertising expense <u>\$4,900</u></b>		
4.	31	<b>Interest Expense .....</b>	<b>5,600</b>	
		<b>Interest Payable.....</b>		<b>5,600</b>
		(\$80,000 X 12% X 7/12)		

<b>PROBLEM 3-4</b>
--------------------

(a) Nov. 30	Store Supplies Expense.....	2,000	
	Store Supplies .....		2,000
30	Depr. Expense—Store Equipment.....	9,000	
	Accumulated Depreciation—		
	Store Equipment .....		9,000
30	Depr. Expense—Delivery Equipment.....	7,000	
	Accumulated Depreciation—		
	Delivery Equipment.....		7,000
30	Interest Expense.....	11,000	
	Interest Payable .....		11,000

**PROBLEM 3-4 (Continued)**

**(b) DAPHNE MAIN FASHION CENTER  
Adjusted Trial Balance  
November 30, 2007**

	<u>Dr.</u>	<u>Cr.</u>
Cash .....	26,700	
Accounts Receivable .....	33,700	
Merchandise Inventory .....	45,000	
Store Supplies .....	3,500	
Store Equipment .....	85,000	
Accumulated Depr.— Store Equipment.....		27,000
Delivery Equipment .....	48,000	
Accumulated Depr.— Delivery Equipment.....		13,000
Notes Payable.....		51,000
Accounts Payable .....		48,500
Common Stock.....		90,000
Retained Earnings.....		8,000
Sales .....		757,200
Sales Returns and Allowances .....	4,200	
Cost of Goods Sold .....	497,400	
Salaries Expense .....	140,000	
Advertising Expense .....	26,400	
Utilities Expense .....	14,000	
Repair Expense .....	12,100	
Delivery Expense.....	16,700	
Rent Expense.....	24,000	
Store Supplies Expense .....	2,000	
Depreciation Expense— Store Equipment.....	9,000	
Depreciation Expense— Delivery Equipment.....	7,000	
Interest Expense .....	11,000	
Interest Payable .....		11,000
Totals .....	<u>1,005,700</u>	<u>1,005,700</u>

**PROBLEM 3-4 (Continued)**

**(c) DAPHNE MAIN FASHION CENTER  
Income Statement  
For the Year Ended November 30, 2007**

<b>Sales revenue</b>		
<b>Sales</b> .....		<b>\$757,200</b>
<b>Less: Sales returns and allowances</b> .....		<u><b>4,200</b></u>
<b>Net sales</b> .....		<b>753,000</b>
<b>Cost of goods sold</b> .....		<u><b>497,400</b></u>
<b>Gross profit</b> .....		<b>255,600</b>
<b>Operating expenses</b>		
<b>Selling expenses</b>		
<b>Salaries expense</b> .....	<b>\$98,000</b>	
(\$140,000 X 70%)		
<b>Advertising expense</b> .....	<b>26,400</b>	
<b>Rent expense</b> .....	<b>19,200</b>	
(\$24,000 X 80%)		
<b>Delivery expense</b> .....	<b>16,700</b>	
<b>Utilities expense</b> .....	<b>11,200</b>	
(\$14,000 X 80%)		
<b>Depr. exp.—store equipment</b> .....	<b>9,000</b>	
<b>Depr. exp.—deliv. equipment</b> .....	<b>7,000</b>	
<b>Stores supplies expense</b> .....	<u><b>2,000</b></u>	
<b>Total selling expenses</b> .....		<b>\$189,500</b>
<b>Administrative expenses</b>		
<b>Salaries expense</b> .....	<b>42,000</b>	
(\$140,000 X 30%)		
<b>Repair expense</b> .....	<b>12,100</b>	
<b>Rent expense</b> .....	<b>4,800</b>	
(\$24,000 X 20%)		
<b>Utilities expense</b> .....	<u><b>2,800</b></u>	
(\$14,000 X 20%)		
<b>Total admin. expenses</b> .....		<u><b>61,700</b></u>
<b>Total oper. expenses</b> .....		<u><b>251,200</b></u>
<b>Income from operations</b> .....		<b>4,400</b>
<b>Other expenses and losses</b>		
<b>Interest expense</b> .....		<u><b>11,000</b></u>
<b>Net loss</b> .....		<u><b>\$ 6,600</b></u>

**PROBLEM 3-4 (Continued)**

**DAPHNE MAIN FASHION CENTER  
Retained Earnings Statement  
For the Year Ended November 30, 2007**

Retained earnings, December 1, 2006.....	\$8,000
Less: Net loss.....	<u>6,600</u>
Retained earnings, November 30, 2007 .....	<u>\$1,400</u>

**DAPHNE MAIN FASHION CENTER  
Balance Sheet  
November 30, 2007**

Assets			
<b>Current assets</b>			
Cash .....	\$26,700		
Accounts receivable .....	33,700		
Merchandise inventory .....	45,000		
Store supplies.....	<u>3,500</u>		
Total current assets .....			\$108,900
<b>Property, plant, and equipment</b>			
Store equipment.....	\$85,000		
Accum. depr.—store equipment.....	<u>27,000</u>	\$58,000	
Delivery equipment .....	48,000		
Accum. depr.—delivery equipment....	<u>13,000</u>	<u>35,000</u>	<u>93,000</u>
Total assets.....			<u>\$201,900</u>
Liabilities and Stockholders' Equity			
<b>Current liabilities</b>			
Notes payable due next year .....		\$30,000	
Accounts payable .....		48,500	
Interest payable.....		<u>11,000</u>	
Total current liabilities.....			\$ 89,500
<b>Long-term liabilities</b>			
Notes payable .....			<u>21,000</u>
Total liabilities.....			110,500
<b>Stockholders' equity</b>			
Common Stock.....		90,000	
Retained Earnings .....		<u>1,400</u>	<u>91,400</u>
Total liabilities and stockholders' equity.....			<u>\$201,900</u>

**PROBLEM 3-4 (Continued)**

<b>(d)</b>	<b>Nov. 30</b>	<b>Sales .....</b>	<b>757,200</b>	
		<b>Income Summary .....</b>		<b>757,200</b>
	<b>30</b>	<b>Income Summary .....</b>	<b>763,800</b>	
		<b>Sales Returns and Allowances .....</b>		<b>4,200</b>
		<b>Cost of Goods Sold.....</b>		<b>497,400</b>
		<b>Salaries Expense .....</b>		<b>140,000</b>
		<b>Advertising Expense .....</b>		<b>26,400</b>
		<b>Utilities Expense .....</b>		<b>14,000</b>
		<b>Repair Expense .....</b>		<b>12,100</b>
		<b>Delivery Expense.....</b>		<b>16,700</b>
		<b>Rent Expense.....</b>		<b>24,000</b>
		<b>Store Supplies Expense.....</b>		<b>2,000</b>
		<b>Depreciation Expense—Store</b>		
		<b>Equipment .....</b>		<b>9,000</b>
		<b>Depreciation Expense—Delivery</b>		
		<b>Equipment .....</b>		<b>7,000</b>
		<b>Interest Expense .....</b>		<b>11,000</b>
	<b>30</b>	<b>Retained Earnings .....</b>	<b>6,600</b>	
		<b>Income Summary.....</b>		<b>6,600</b>

**PROBLEM 3-4 (Continued)**

(e)

**DAPHNE MAIN FASHION CENTER**

**Post-Closing Trial Balance**

**November 30, 2007**

	<u>Debit</u>	<u>Credit</u>
Cash.....	\$ 26,700	
Accounts Receivable .....	33,700	
Merchandise Inventory.....	45,000	
Store Supplies.....	3,500	
Store Equipment.....	85,000	
Accumulated Depreciation—Store Equipment ....		\$ 27,000
Delivery Equipment .....	48,000	
Accumulated Depreciation—Delivery Equipment.....		13,000
Notes Payable .....		51,000
Accounts Payable .....		48,500
Interest Payable .....		11,000
Common Stock .....		90,000
Retained Earnings .....		1,400
	<u>\$241,900</u>	<u>\$241,900</u>

**PROBLEM 3-5**

<b>(a)</b>	<b>-1-</b>		
		<b>Depreciation Expense.....</b>	<b>9,500</b>
		<b>Accumulated Depreciation—Equipment .....</b>	<b>9,500</b>
		<b>(1/16 X \$152,000)</b>	
	<b>-2-</b>		
		<b>Interest Expense.....</b>	<b>1,800</b>
		<b>Interest Payable .....</b>	<b>1,800*</b>
		<b>(\$90,000 X 10% X 72/360)</b>	
	<b>-3-</b>		
		<b>Admissions Revenue.....</b>	<b>50,000</b>
		<b>Unearned Admissions Revenue .....</b>	<b>50,000</b>
		<b>(2,000 X \$25)</b>	
	<b>-4-</b>		
		<b>Prepaid Advertising.....</b>	<b>1,100</b>
		<b>Advertising Expense .....</b>	<b>1,100</b>
	<b>-5-</b>		
		<b>Salaries Expense.....</b>	<b>4,700</b>
		<b>Salaries Payable.....</b>	<b>4,700</b>

- (b) (1) Interest expense, \$3,200 (\$1,400 + \$1,800).**
- (2) Admissions revenue, \$330,000 (\$380,000 – \$50,000).**
- (3) Advertising expense, \$12,580 (\$13,680 – \$1,100).**
- (4) Salaries expense, \$62,300 (\$57,600 + \$4,700).**

**\*Note to instructor:** If 30 day months are assumed, interest expense = \$1,750 (\$90,000 X 10% X 70/360).

<b>PROBLEM 3-6</b>
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(a)	-1-		
		6,900	
			6,900
	-2-		
		4,900	
			4,900
	-3-		
		1,430	
			1,430
	-4-		
		480	
			480
	-5-		
		3,125	
			3,125
			(\$25,000 X .125)
	-6-		
		60	
			60
			(\$7,200 X .10 X 30/360)
	-7-		
		750	
			750
	-8-		
		2,510	
			2,510

**PROBLEM 3-6 (Continued)**

**(b) Carlos Beltran, Consulting Engineer  
Income Statement  
For the Year Ended December 31, 2007**

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<b>Service revenue (\$100,000 – \$6,900 + \$4,900).....</b>		<b>\$98,000</b>
<b>Expenses</b>		
<b>Office salaries expense (\$28,500 + \$2,510) .....</b>	<b>\$31,010</b>	
<b>Heat, light, and water expense .....</b>	<b>1,080</b>	
<b>Rent expense (\$9,750 – \$750) .....</b>	<b>9,000</b>	
<b>Insurance expense .....</b>	<b>480</b>	
<b>Bad debt expense .....</b>	<b>1,430</b>	
<b>Depreciation expense .....</b>	<b>3,125</b>	
<b>Miscellaneous office expense.....</b>	<b>720</b>	
<b>Interest expense .....</b>	<b>60</b>	
<b>Total expenses .....</b>		<b><u>46,905</u></b>
<b>Net income .....</b>		<b><u>\$51,095</u></b>

**PROBLEM 3-6 (Continued)**

**Carlos Beltran, Consulting Engineer**

**Balance Sheet**

**December 31, 2007**

**Assets**

**Current assets**

Cash ..... \$31,500

Accounts receivable ..... \$54,500  
 (\$49,600 + \$4,900)

Less: Allowance for  
 doubtful accounts ..... (2,180)\* 52,320

Engineering supplies inventory ..... 1,960

Unexpired insurance ..... 620  
 (\$1,100 – \$480)

Prepaid rent ..... 750

Total current assets ..... \$ 87,150

Furniture and equipment ..... 25,000

Less: Accum. depreciation ..... (9,375)\*\* 15,625

Total assets ..... \$102,775

**Liabilities and Owner's Equity**

**Current liabilities**

Unearned service revenue ..... \$6,900

Interest payable ..... 60

Salaries payable ..... 2,510

Notes payable ..... 7,200 \$ 16,670

Carlos Beltran, Capital ..... 86,105

(\$35,010 + \$51,095)

Total liabilities and owner's equity ..... \$102,775

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

\*\*(\$6,250 + \$3,125)

**PROBLEM 3-6 (Continued)**

**Carlos Beltran, Consulting Engineer  
Statement of Owner's Equity  
For the Year Ended December 31, 2007**

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<b>Carlos Beltran, Capital, January 1 .....</b>	<b>\$ 52,010<sup>a</sup></b>
<b>Add: Net income.....</b>	<b><u>51,095</u></b>
	<b>103,105</b>
<b>Less: Withdrawals .....</b>	<b><u>(17,000)</u></b>
<b>Carlos Beltran, Capital, December 31 .....</b>	<b><u>\$ 86,105</u></b>

<sup>a</sup> <b>Carlos Beltran, Capital—trial balance .....</b>	<b>\$35,010</b>
<b>Withdrawals during the year .....</b>	<b><u>17,000</u></b>
<b>Carlos Beltran, Capital, as of January 1, 2007 .....</b>	<b><u>\$52,010</u></b>

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

(a)	Dec. 31	Account Receivable .....	3,000	
		Service Revenue .....		3,000
	31	Unearned Service Revenue .....	1,400	
		Service Revenue .....		1,400
	31	Art Supplies Expense .....	3,000	
		Art Supplies .....		3,000
	31	Depreciation Expense .....	6,750	
		Accumulated Depreciation— Printing Equipment .....		6,750
	31	Interest Expense .....	150	
		Interest Payable .....		150
	31	Insurance Expense .....	750	
		Prepaid Insurance .....		750
	31	Salaries Expense .....	1,500	
		Salaries Payable .....		1,500

**PROBLEM 3-7 (Continued)**

**(b) ANA ALICIA ADVERTISING CORPORATION**  
**Income Statement**  
**For the Year Ended December 31, 2007**

---

<b>Revenues</b>		
Service revenue .....		<b>\$63,000</b>
<b>Expenses</b>		
Salaries expense .....	<b>\$11,500</b>	
Art supplies expense .....	<b>8,000</b>	
Depreciation expense .....	<b>6,750</b>	
Rent expense .....	<b>4,000</b>	
Insurance expense.....	<b>750</b>	
Interest expense .....	<b>500</b>	
Total expenses.....		<b><u>31,500</u></b>
Net income .....		<b><u>\$31,500</u></b>

**ANA ALICIA ADVERTISING CORPORATION**  
**Statement of Retained Earnings**  
**For the Year Ended December 31, 2007**

---

Retained earnings, January 1 .....	<b>\$ 4,500</b>
Add: Net income .....	<b><u>31,500</u></b>
Retained earnings, December 31 .....	<b><u>\$36,000</u></b>

**PROBLEM 3-7 (Continued)**

**ANA ALICIA ADVERTISING CORPORATION**

**Balance Sheet**

**December 31, 2007**

---

<b>Assets</b>	
Cash.....	\$ 7,000
Accounts receivable .....	22,000
Art supplies.....	5,500
Prepaid insurance.....	2,500
Printing equipment.....	\$60,000
Less: Accum. depr.—printing equipment.....	<u>33,750</u> <u>26,250</u>
<b>Total assets .....</b>	<b><u>\$63,250</u></b>
 <b>Liabilities and Stockholders' Equity</b>	
<b>Liabilities</b>	
Accounts payable.....	\$ 5,000
Interest payable.....	150
Notes payable .....	5,000
Unearned service revenue.....	5,600
Salaries payable.....	<u>1,500</u>
<b>Total liabilities.....</b>	<b>\$17,250</b>
<b>Stockholders' equity</b>	
Common Stock.....	10,000
Retained Earnings .....	<u>36,000</u>
<b>Total stockholders' equity .....</b>	<b><u>46,000</u></b>
<b>Total liabilities and stockholders' equity.....</b>	<b><u>\$63,250</u></b>

**PROBLEM 3-7 (Continued)**

- (c) (1) **Total depreciable cost =  $\$6,750 \times 8 = \$54,000$ .  
Salvage value = cost  $\$60,000$  less depreciable cost  $\$54,000 = \$6,000$**
- (2) **Based on the balance in interest payable, interest is  $\$50$  per month or 1% of the note payable.  
 $1\% \times 12 = 12\%$  interest per year.**
- (3) **Salaries Expense,  $\$11,500$  less Salaries Payable 12/31/07,  $\$1,500 = \$10,000$ . Total payments,  $\$12,500 - \$10,000 = \$2,500$  Salaries Payable 12/31/06.**

**\*PROBLEM 3-8**

(a), (b), (d)

<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Cash</th> </tr> </thead> <tbody> <tr> <td style="width: 50%;">Bal.</td> <td style="width: 50%; text-align: right;">15,000</td> </tr> </tbody> </table>	Cash		Bal.	15,000	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Prepaid Insurance</th> </tr> </thead> <tbody> <tr> <td style="width: 50%;">Bal.</td> <td style="width: 50%; text-align: right;">9,000</td> </tr> <tr> <td></td> <td style="text-align: right;"><u>5,500</u></td> </tr> </tbody> </table>	Prepaid Insurance		Bal.	9,000		<u>5,500</u>	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Salaries Expense</th> </tr> </thead> <tbody> <tr> <td style="width: 50%;">Bal.</td> <td style="width: 50%; text-align: right;">80,000</td> </tr> <tr> <td>Adj.</td> <td style="text-align: right;"><u>3,600</u></td> </tr> <tr> <td></td> <td style="text-align: right;"><u>83,600</u></td> </tr> </tbody> </table>	Salaries Expense		Bal.	80,000	Adj.	<u>3,600</u>		<u>83,600</u>						
Cash																										
Bal.	15,000																									
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Allow. for Doubtful Accts.																										
	Bal. 1,100																									
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Land																										
Bal.	350,000																									
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Buildings																										
Bal.	120,000																									
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Close	16,800																									
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Accum. Depr. of Buildings																										
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Rent Receivable																										
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**PROBLEM 3-8 (Continued)**

<b>Salaries Payable</b>		<b>Unearned Dues Revenue</b>	
	Adj. <u>3,600</u>		Adj. <u>8,900</u>
<b>Equipment</b>			
Bal. 150,000			

<b>(b)</b>		<b>-1-</b>			
	<b>Depreciation Expense—Buildings .....</b>		<b>4,800</b>		
	<b>Accumulated Depreciation—Buildings.....</b>				<b>4,800</b>
	<b>(1/25 X \$120,000)</b>				
		<b>-2-</b>			
	<b>Depreciation Expense—Equipment.....</b>		<b>15,000</b>		
	<b>Accumulated Depreciation—Equipment .....</b>				<b>15,000</b>
	<b>(10% X \$150,000)</b>				
		<b>-3-</b>			
	<b>Insurance Expense.....</b>		<b>3,500</b>		
	<b>Prepaid Insurance .....</b>				<b>3,500</b>
		<b>-4-</b>			
	<b>Rent Receivable.....</b>		<b>1,400</b>		
	<b>Rental Revenue .....</b>				<b>1,400</b>
	<b>(1/11 X \$15,400)</b>				
		<b>-5-</b>			
	<b>Bad Debts Expense .....</b>		<b>850</b>		
	<b>Allowance for Doubtful Accounts.....</b>				<b>850</b>
	<b>[( \$13,000 X 15%) – \$1,100]</b>				
		<b>-6-</b>			
	<b>Salaries Expense .....</b>		<b>3,600</b>		
	<b>Salaries Payable .....</b>				<b>3,600</b>
		<b>-7-</b>			
	<b>Dues Revenue .....</b>		<b>8,900</b>		
	<b>Unearned Dues Revenue .....</b>				<b>8,900</b>

**PROBLEM 3-8 (Continued)**

**(c) Platteville Golf Club, Inc.  
Adjusted Trial Balance  
December 31, XXXX**

	<u>Dr.</u>	<u>Cr.</u>
Cash.....	\$ 15,000	
Accounts Receivable .....	13,000	
Allowance for Doubtful Accounts .....		\$ 1,950
Prepaid Insurance.....	5,500	
Land.....	350,000	
Building .....	120,000	
Accum. Depreciation—Buildings.....		43,200
Accum. Depreciation—Equipment.....		85,000
Rent Receivable.....	1,400	
Salaries Payable .....		3,600
Equipment .....	150,000	
Common Stock .....		400,000
Retained Earnings .....		82,000
Dues Revenue .....		191,100
Green Fee Revenue .....		8,100
Rental Revenue.....		16,800
Utilities Expense.....	54,000	
Bad Debts Expense .....	850	
Unearned Dues Revenue .....		8,900
Salaries Expense.....	83,600	
Maintenance Expense .....	24,000	
Depreciation Expense—Buildings .....	4,800	
Depreciation Expense—Equipment.....	15,000	
Insurance Expense .....	3,500	
<b>Totals .....</b>	<b><u>\$840,650</u></b>	<b><u>\$840,650</u></b>

**PROBLEM 3-8 (Continued)**

<b>(d)</b>	<b>-Dec. 31-</b>			
		<b>Dues Revenue .....</b>	<b>191,100</b>	
		<b>Green Fee Revenue .....</b>	<b>8,100</b>	
		<b>Rental Revenue .....</b>	<b>16,800</b>	
		<b>Income Summary .....</b>		<b>216,000</b>

	<b>-31-</b>			
		<b>Income Summary .....</b>	<b>185,750</b>	
		<b>Utilities Expense .....</b>		<b>54,000</b>
		<b>Bad Debt Expense .....</b>		<b>850</b>
		<b>Salaries Expense .....</b>		<b>83,600</b>
		<b>Maintenance Expense .....</b>		<b>24,000</b>
		<b>Depreciation Expense—Buildings .....</b>		<b>4,800</b>
		<b>Depreciation Expense—Equipment .....</b>		<b>15,000</b>
		<b>Insurance Expense .....</b>		<b>3,500</b>

	<b>-31-</b>			
		<b>Income Summary .....</b>	<b>30,250</b>	
		<b>Retained Earnings .....</b>		<b>30,250</b>

**\*PROBLEM 3-9**

**(a), (b), (c)**

<table style="width: 100%; border-collapse: collapse;"> <tr><td colspan="2" style="text-align: center;"><b>Cash</b></td></tr> <tr><td style="width: 50%;">Bal. 18,500</td><td style="width: 50%;"></td></tr> </table>	<b>Cash</b>		Bal. 18,500		<table style="width: 100%; border-collapse: collapse;"> <tr><td colspan="2" style="text-align: center;"><b>Accounts Receivable</b></td></tr> <tr><td style="width: 50%;">Bal. 42,000</td><td style="width: 50%;"></td></tr> </table>	<b>Accounts Receivable</b>		Bal. 42,000		<table style="width: 100%; border-collapse: collapse;"> <tr><td colspan="2" style="text-align: center;"><b>Allow. for Doubtful Accts.</b></td></tr> <tr><td style="width: 50%;"></td><td style="width: 50%;">Bal. 700</td></tr> <tr><td style="width: 50%;"></td><td style="width: 50%;">Adj. 1,400</td></tr> </table>	<b>Allow. for Doubtful Accts.</b>			Bal. 700		Adj. 1,400								
<b>Cash</b>																								
Bal. 18,500																								
<b>Accounts Receivable</b>																								
Bal. 42,000																								
<b>Allow. for Doubtful Accts.</b>																								
	Bal. 700																							
	Adj. 1,400																							
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**PROBLEM 3-9 (Continued)**

<b>(b)</b>	<b>-1-</b>		
		<b>Bad Debts Expense .....</b>	<b>1,400</b>
		<b>Allowance for Doubtful Accounts.....</b>	<b>1,400</b>
	<b>-2-</b>		
		<b>Depreciation Expense—Furniture and Equipment (\$84,000 ÷ 6).....</b>	<b>14,000</b>
		<b>Accum. Depr.—Furniture and Equipment.....</b>	<b>14,000</b>
	<b>-3-</b>		
		<b>Insurance Expense .....</b>	<b>2,550</b>
		<b>Prepaid Insurance .....</b>	<b>2,550</b>
	<b>-4-</b>		
		<b>Interest Expense .....</b>	<b>3,360</b>
		<b>Interest Payable .....</b>	<b>3,360</b>
	<b>-5-</b>		
		<b>Sales Salaries Expense .....</b>	<b>2,400</b>
		<b>Salaries Payable .....</b>	<b>2,400</b>
	<b>-6-</b>		
		<b>Prepaid Advertising Expense .....</b>	<b>700</b>
		<b>Advertising Expense .....</b>	<b>700</b>
	<b>-7-</b>		
		<b>Office Supplies .....</b>	<b>1,500</b>
		<b>Office Expense .....</b>	<b>1,500</b>

**PROBLEM 3-9 (Continued)**

(c)	<b>Dec. 31</b>		
		<b>600,000</b>	
			<b>600,000</b>
	<b>Dec. 31</b>		
		<b>546,210</b>	
			<b>398,000</b>
			<b>6,000</b>
			<b>65,000</b>
			<b>52,400</b>
			<b>3,500</b>
			<b>2,550</b>
			<b>1,400</b>
			<b>14,000</b>
			<b>3,360</b>
	<b>Dec. 31</b>		
		<b>53,790</b>	
			<b>53,790</b>



**\*PROBLEM 3-10 (Continued)**

**(b) Razorback Sales and Services  
Balance Sheet  
As of January 31, 2007**

	(1)	(2)
	<u>Cash Basis</u>	<u>Accrual Basis</u>
<b><u>Assets</u></b>		
Cash .....	\$51,750 <sup>a</sup>	\$ 51,750 <sup>a</sup>
Accounts Receivable.....		30,750
Inventory.....		25,500 <sup>b</sup>
Prepaid rent .....		4,000
<b>Total assets .....</b>	<u>\$51,750</u>	<u>\$112,000</u>
<b><u>Liabilities and Owners' Equity</u></b>		
Accounts payable .....		\$ 2,000
Salaries payable .....		3,000
Owners' equity .....	<u>\$51,750<sup>c</sup></u>	<u>107,000<sup>d</sup></u>
<b>Total liabilities and owners' equity .....</b>	<u>\$51,750</u>	<u>\$112,000</u>

<sup>a</sup> Original investment	\$ 90,000
Cash sales	75,000
Cash purchases	(89,250)
Rent paid	(6,000)
Salaries paid	(9,600)
Other expenses	<u>(8,400)</u>
Cash balance Jan. 31	<u>\$ 51,750</u>

<sup>b</sup>(10 @ \$1,500) + (2 @ \$3,000) + (10 @ \$450).

<sup>c</sup>Initial investment minus net loss: \$90,000 – \$38,250.

<sup>d</sup>Initial investment plus net income: \$90,000 + \$17,000.

**\*PROBLEM 3-10 (Continued)**

- (c)
- 1. The \$30,750 in receivables from customers is an asset and a future cash flow resulting from sales that is ignored. The cash basis understates the amount of revenues and inflow of assets in January from the sale of computers and printers by \$30,750.**
  - 2. The cost of computers and printers sold in January is overstated by \$25,500. The unsold computers and printers are an asset of \$25,500 in the form of inventory.**
  - 3. The cash basis ignores \$3,000 of the salaries that have been earned by the employees in January and will be paid in February.**
  - 4. Rent expense on the cash basis is overstated by \$4,000 under the cash basis. This prepayment is an asset in the form of two months' future right to the use of office, showroom, and repair space and should appear on the balance sheet.**
  - 5. Other operating expenses on a cash basis are understated by \$2,000 as is the liability for the unpaid portion of these expenses incurred in January.**

**NOAH'S ARK**  
Worksheet

For the Year Ended September 30, 2007

**\*PROBLEM 3-11**

(a)

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	37,400				37,400				37,400	
Supplies	18,600		(b) 17,400		1,200				1,200	
Prepaid Insurance	31,900		(a) 28,000		3,900				3,900	
Land	80,000				80,000				80,000	
Equipment	120,000				120,000				120,000	
Accum. Depreciation		36,200		(c) 6,800		43,000				43,000
Accounts Payable		14,600				14,600				14,600
Unearned Ad. Rev.		2,700	(d) 1,000			1,700				1,700
Mortgage Payable		50,000				50,000				50,000
N. Y. Berge, Capital		109,700				109,700				109,700
N. Y. Berge, Drawing	14,000				14,000				14,000	
Admissions Revenue		278,500		(d) 1,000		279,500		279,500		
Salaries Expense	109,000				109,000		109,000			
Repair Expense	30,500				30,500		30,500			
Advertising Expense	9,400				9,400		9,400			
Utilities Expense	16,900				16,900		16,900			
Prop. Taxes Expense	18,000		(e) 3,000		21,000		21,000			
Interest Expense	6,000		(f) 6,000		12,000		12,000			
<b>Totals</b>	<b>491,700</b>	<b>491,700</b>								
Insurance Expense			(a) 28,000		28,000		28,000			
Supplies Expense			(b) 17,400		17,400		17,400			
Interest Payable				(f) 6,000	6,800	6,000				6,000
Depreciation Expense					6,800		6,800			
Prop. Taxes Payable				(e) 3,000		3,000				3,000
<b>Totals</b>			<b>62,200</b>	<b>62,200</b>	<b>507,500</b>	<b>507,500</b>	<b>251,000</b>	<b>279,500</b>	<b>256,500</b>	<b>228,000</b>
<b>Net Income</b>							<b>28,500</b>			<b>28,500</b>
<b>Totals</b>					<b>279,500</b>	<b>279,500</b>	<b>279,500</b>	<b>279,500</b>	<b>256,500</b>	<b>256,500</b>

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

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

**(b) NOAH'S ARK  
Balance Sheet  
September 30, 2007**

---

<b>Assets</b>			
<b>Current assets</b>			
Cash .....		<b>\$37,400</b>	
Supplies.....		<b>1,200</b>	
Prepaid insurance.....		<u><b>3,900</b></u>	
<b>Total current assets.....</b>			<b>\$ 42,500</b>
<b>Property, plant, and equipment</b>			
Land .....		<b>80,000</b>	
Equipment .....	<b>\$120,000</b>		
Less: Accum. depreciation.....	<u><b>43,000</b></u>	<u><b>77,000</b></u>	<u><b>157,000</b></u>
<b>Total assets .....</b>			<u><b>\$199,500</b></u>
<b>Liabilities and Owner's Equity</b>			
<b>Current liabilities</b>			
Current maturity of long-term debt .....		<b>\$10,000</b>	
Accounts payable .....		<b>14,600</b>	
Unearned admissions revenue.....		<b>1,700</b>	
Interest payable .....		<b>6,000</b>	
Property taxes payable .....		<u><b>3,000</b></u>	
<b>Total current liabilities.....</b>			<b>\$ 35,300</b>
<b>Long-term liabilities</b>			
Mortgage payable.....			<u><b>40,000</b></u>
<b>Total liabilities .....</b>			<b>75,300</b>
<b>Owner's equity</b>			
N.Y. Berge, Capital (\$109,700 + \$28,500 – \$14,000)			<u><b>124,200</b></u>
<b>Total liabilities and owner's equity.....</b>			<u><b>\$199,500</b></u>

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

<b>(c)</b>	<b>Sep. 30</b>	<b>Insurance Expense.....</b>	<b>28,000</b>	
		<b>    Prepaid Insurance.....</b>		<b>28,000</b>
	<b>30</b>	<b>Supplies Expense.....</b>	<b>17,400</b>	
		<b>    Supplies.....</b>		<b>17,400</b>
	<b>30</b>	<b>Depreciation Expense.....</b>	<b>6,800</b>	
		<b>    Accum. Depreciation.....</b>		<b>6,800</b>
	<b>30</b>	<b>Unearned Admissions Revenue.....</b>	<b>1,000</b>	
		<b>    Admissions Revenue.....</b>		<b>1,000</b>
	<b>30</b>	<b>Property Taxes Expense.....</b>	<b>3,000</b>	
		<b>    Property Taxes Payable.....</b>		<b>3,000</b>
	<b>30</b>	<b>Interest Expense.....</b>	<b>6,000</b>	
		<b>    Interest Payable.....</b>		<b>6,000</b>
<b>(d)</b>	<b>Sep. 30</b>	<b>Admissions Revenue.....</b>	<b>279,500</b>	
		<b>    Income Summary.....</b>		<b>279,500</b>
	<b>30</b>	<b>Income Summary.....</b>	<b>251,000</b>	
		<b>    Salaries Expense.....</b>		<b>109,000</b>
		<b>    Repair Expense.....</b>		<b>30,500</b>
		<b>    Insurance Expense.....</b>		<b>28,000</b>
		<b>    Property Taxes Expense.....</b>		<b>21,000</b>
		<b>    Supplies Expense.....</b>		<b>17,400</b>
		<b>    Utilities Expense.....</b>		<b>16,900</b>
		<b>    Interest Expense.....</b>		<b>12,000</b>
		<b>    Advertising Expense.....</b>		<b>9,400</b>
		<b>    Depreciation Expense.....</b>		<b>6,800</b>



## FINANCIAL REPORTING PROBLEM

- (a) **June 30, 2004 total assets: \$57,048 million.  
June 30, 2003 total assets: \$43,706 million.**
- (b) **June 30, 2004 cash and cash equivalents: \$5,469 million.**
- (c) **2002 research and development costs: \$1,601 million.  
2004 research and development costs: \$1,802 million.**
- (d) **2002 net sales: \$40,238 million.  
2004 net sales: \$51,407 million.**
- (e) **An adjusting entry for prepayments is necessary when the receipt/disbursement precedes the recognition in the financial statements. Accounts such as prepaid insurance and prepaid rent may be included in the Prepaid expenses and other receivables section (\$1,803 million at June 30, 2004). Both of these accounts would require an adjusting entry to recognize the proper amount of expense incurred during the period. In addition, depreciation expense is an adjusting entry related to a prepayment.**

**An adjusting entry for an accrual is necessary when recognition in the financial statements precedes the cash receipt/disbursement, such as interest or taxes payable. Other adjusting entries probably made by P&G include interest revenue and expense and interest receivable and interest payable. P&G reports \$7,689 million of Accrued and other liabilities at June 30, 2004.**

- (f) **2002 Depreciation and amortization expense: \$1,693 million  
2003 Depreciation and amortization expense: \$1,703 million  
2004 Depreciation and amortization expense: \$1,733 million**

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

## FINANCIAL STATEMENT ANALYSIS CASE

(a)	2003	2002	2001	% Change 2003	% Change 2002
Sales	\$8,811.50	\$8,304.10	\$7,548.40	6.11%	10.01%
Gross Profit %	44.40	45.50	44.20	-2.42%	2.94%
Operating Profit	1,544.10	1,508.10	1,167.90	2.39%	29.13%
Net Cash Flow less Capital Expenditures	923.80	746.40	855.50	23.77%	-12.75%
Net Earnings	787.10	720.90	473.60	9.18%	52.22%

- (b) Except for a slight decrease in gross profit %, Kellogg has reported good performance in 2003 compared to 2002. The net cash flow measure showed strong improvement in 2003 after a dip in 2002, compared to 2001. Sales also showed a steady, although slowing, growth in 2003. There appears to be a leveling off of performance in operating profits and earnings in 2003, compared to 2002. This likely reflects exceptionally strong performance in 2002, as the economy improved relative to 2000–2001. The steady, positive trends are all supportive of Kellogg achieving its objective of sustainable growth.

## COMPARATIVE ANALYSIS CASE

- (a) The Coca-Cola Company percentage increase is 14.6% computed as follows:

Total assets (December 31, 2004).....	\$31,327
Total assets (December 31, 2003).....	<u>\$27,342</u>
Difference.....	<u>\$ 3,985</u>

$$\$3,985 \div \$27,342 = \underline{\underline{14.6\%}}$$

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

Total assets (December 25, 2004).....	\$27,987
Total assets (December 27, 2003).....	<u>\$25,327</u>
Difference.....	<u>\$ 2,660</u>

$$\$2,660 \div \$25,327 = \underline{\underline{10.5\%}}$$

Coca-Cola Company had the larger increase.

- (b)

	5-Year Growth Rate	
	<u>The Coca-Cola Company</u>	<u>PepsiCo, Inc.</u>
Net sales	5.5%	5.7%
Income from continuing operations	7.4%	10.4%

- (c) The Coca-Cola Company had depreciation and amortization expense of \$893,000,000; PepsiCo, Inc. had depreciation and amortization expense of \$1,264,000,000.

PepsiCo has substantially more property, plant, and equipment and intangible assets than does Coca-Cola. PepsiCo is engaged in three different types of businesses: soft drinks, snack-food, and juices. As a result, it has more tangible fixed assets. In addition, PepsiCo has substantial intangible

**COMPARATIVE ANALYSIS CASE (Continued)**

assets. Amortizable intangible assets for Coke and Pepsi increase the amount of amortization expense recorded in income. The amount of property, plant, and equipment and amortizable intangible assets reported for these two companies is as follows:

	<u>The Coca-Cola Company</u>	<u>PepsiCo, Inc.</u>
Property, plant, and equipment (net)	\$6,091,000,000	\$8,149,000,000
Amortizable intangible assets (net)	<u>702,000,000</u>	<u>598,000,000</u>
	\$6,793,000,000	\$8,747,000,000

## RESEARCH CASE

- (a) Per page 15, SIC codes are assigned on the basis of a firm's "primary activity," which is determined by the principal product or group of products produced or distributed, or service rendered.
- (b) 12 = Coal mining; 271 = Newspapers; 3571 = Electronic computers; 7033 = Trailer parks and campsites; 75 = Auto repair, services, and parking; 872 = Accounting, auditing, and bookkeeping.
- (c) (1) 3949, (2) 0279, (3) 3951, (4) 5722, (5) 7311
- (d) Major group = 45. Industry group = 451. Industry = 4512

Per 2004 Wards directory:

- (1) America West Holdings Corp. (\$22,545 B)
- (2) AMR Corp. (\$17,400 B)
- (3) United Airlines (\$16,138 B)
- (4) Delta Airlines Corp. (\$13,303)
- (5) Northwest Airlines Corp. (\$9,510 B)

(Note: Subsidiaries of AMR, UAL, and Northwest are included in the listing. The question asks about parent companies.)

- (a) The three essential characteristics of assets.

Search String: asset and characteristics.

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

- (b) Three essential characteristics of liabilities.

Search String: liability and characteristic.

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

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

Search Strings: "uncertainty", effect% of uncertainty.

CON6, Par44. Uncertainty about economic and business activities and results is pervasive, and it often clouds whether a particular item qualifies as an asset or a liability of a particular entity at the time the definitions are applied. The presence or absence of future economic benefit that can be obtained and controlled by the entity or of the entity's legal, equitable, or constructive obligation to sacrifice assets in the future can often be discerned reliably only with hindsight. As a result, some items that with hindsight actually qualified as assets or liabilities of the entity under the definitions may, as a practical matter, have been recognized as expenses, losses, revenues, or gains or remained unrecognized in its financial statements because of uncertainty about whether they qualified as assets or liabilities of the entity or because of recognition and measurement considerations stemming from uncertainty at the time of assessment. Conversely, some items that with hindsight did not qualify under the definitions may have been included as assets or liabilities because of judgments made in the face of uncertainty at the time of assessment.

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

## ACCOUNTING AND FINANCIAL REPORTING (Continued)

- (d) The difference between realization and recognition

Search String: realization, recognition.

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

## PROFESSIONAL SIMULATION

### Journal Entries

<b>Dec. 31</b>	<b>Accounts Receivable.....</b>	<b>1,500</b>	
	<b>Advertising Revenue.....</b>		<b>1,500</b>
<b>31</b>	<b>Unearned Advertising Revenue.....</b>	<b>1,400</b>	
	<b>Advertising Revenue.....</b>		<b>1,400</b>
<b>31</b>	<b>Art Supplies Expense.....</b>	<b>3,400</b>	
	<b>Art Supplies .....</b>		<b>3,400</b>
<b>31</b>	<b>Depreciation Expense .....</b>	<b>7,000</b>	
	<b>Accumulated Depreciation.....</b>		<b>7,000</b>
<b>31</b>	<b>Salaries Expense .....</b>	<b>1,300</b>	
	<b>Salaries Payable .....</b>		<b>1,300</b>

### Financial Statements

**Nalezny Advertising Agency**  
**Income Statement**  
**For the Year Ended December 31, 2007**

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

**PROFESSIONAL SIMULATION (Continued)**

**Nalezny Advertising Agency  
Balance Sheet  
December 31, 2007**

<b>Assets</b>											
Cash.....		<b>\$11,000</b>									
Accounts receivable .....		<b>21,500</b>									
Art supplies.....		<b>5,000</b>									
Printing equipment.....	<b>\$60,000</b>										
Less: Accumulated depreciation— printing equipment.....	<b>35,000</b>	<b>25,000</b>									
<b>Total Assets.....</b>		<b><u>\$62,500</u></b>									
<b>Liabilities and Stockholders' Equity</b>											
<b>Liabilities</b>											
Accounts payable.....	<b>\$5,000</b>										
Unearned advertising revenue.....	<b>5,600</b>										
Salaries payable.....	<b>1,300</b>										
<b>Total liabilities .....</b>		<b>\$11,900</b>									
<b>Stockholders' equity</b>											
Common stock.....	<b>\$10,000</b>										
Retained earnings .....	<b>40,600*</b>	<b>50,600</b>									
<b>Total liabilities and stockholders' equity.....</b>		<b><u>\$62,500</u></b>									
<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">*Retained earnings, Jan. 1, 2007</td> <td style="width: 30%; text-align: right;"><b>\$ 4,800</b></td> <td></td> </tr> <tr> <td>Add: Net income</td> <td style="text-align: right;"><b>35,800</b></td> <td></td> </tr> <tr> <td>Retained earnings, Dec. 31, 2007</td> <td style="text-align: right;"><b><u>\$40,600</u></b></td> <td></td> </tr> </table>			*Retained earnings, Jan. 1, 2007	<b>\$ 4,800</b>		Add: Net income	<b>35,800</b>		Retained earnings, Dec. 31, 2007	<b><u>\$40,600</u></b>	
*Retained earnings, Jan. 1, 2007	<b>\$ 4,800</b>										
Add: Net income	<b>35,800</b>										
Retained earnings, Dec. 31, 2007	<b><u>\$40,600</u></b>										

**Explanation**

Following preparation of financial statements (see Illustration 3-6), Nalezny would prepare closing entries to reduce the temporary accounts to zero. Some companies prepare a post-closing trial balance and reversing entries.