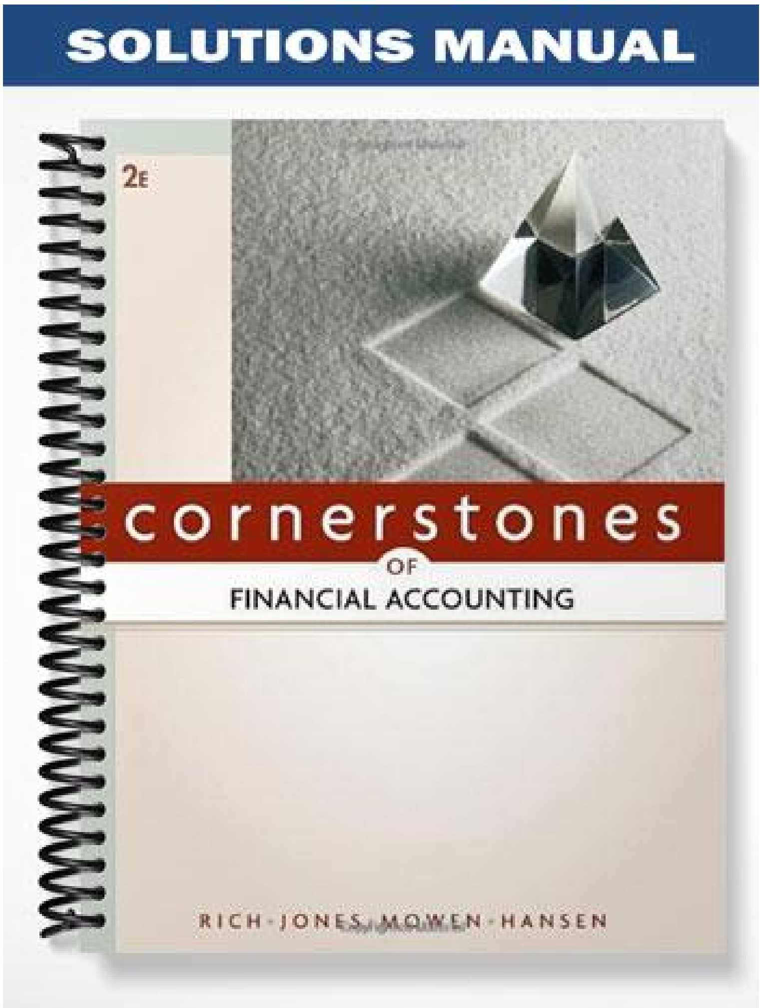
SOLUTIONS MANUAL
2E
cornerstones
OF
FINANCIAL ACCOUNTING
RICH · JONES · MOWEN · HANSEN

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, 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' Equity
a.	+	NE	+
b.	+/–	NE	NE
c.	+	+	NE
d.	–	NE	–

CE 2-21

	Assets	=	Liabilities	+	Stockholders' Equity: Contributed Capital	Stockholders' Equity: Retained 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 Capital	Stockholders' Equity: Retained 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 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
		(Record issuance of common stock)		
	8	Equipment	12,800	
		Cash		12,800
		(Record purchase of equipment)		
	15	Cash	21,400	
		Sales Revenue		21,400
		(Record cash sale)		
	29	Dividends	6,500	
		Cash		6,500
		(Declared and paid cash dividends)		

CE 2-25

Journal

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

CE 2-26

Borges, Inc. Trial Balance December 31, 2011		
Account	**Debit**	**Credit**
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	
	$40,975	$40,975

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

					Stockholders' Equity	
	Assets	**=**	**Liabilities**	**+**	**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.

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

E 2-40

Transaction	Account	Increase/ Decrease	Debit/ 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
		(Record revenue)		
	3	Inventory	700	
		Accounts Payable		700
		(Record purchase of surfboards)		
	6	Wages Expense	8,500	
		Cash		8,500
		(Record wages)		
	9	Rent Expense	1,300	
		Cash		1,300
		(Record rent)		
	12	Trucks	37,800	
		Cash		1,000
		Notes Payable		36,800
		(Record purchase of truck)		
	13	Cash	950	
		Accounts Receivable		950
		(Record collection of customer account)		
	16	Accounts Payable	870	
		Cash		870
		(Record payment of account owed)		
	23	Cash	15,000	
		Notes Payable		15,000
		(Record borrowing of cash)		
	27	Utilities Expense	145	
		Cash		145
		(Record payment of telephone bill)		
	30	Advertising Expense	1,260	
		Cash		1,260
		(Record payment for advertising)		

E 2-42

1. **Journal**

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

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
		(Record issuance of common stock)		
	14	Cash	45,000	
		Notes Payable		45,000
		(Record borrowing of cash)		
Feb.	22	Land	30,000	
		Buildings	60,000	
		Cash		34,000
		Notes Payable		56,000
		(Record purchase of land and building)		
Mar.	1	Buildings	4,000	
		Cash		4,000
		(Record payment for remodeling)		
May	3	Buildings	11,000	
		Accounts Payable		11,000
		(Record amount due for remodeling)		
	20	Accounts Payable	11,000	
		Cash		11,000
		(Record payment on account)		
June	4	Supplies	650	
		Cash		650
		(Record purchase of supplies)		

E 2-44

1.

Journal

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

E 2-44 (Contd)

2.

Cash

Date		Debit	Date		Credit
Jan.	15	10,000	Feb.	20	720
May	12	12,500	Jun.	24	6,700
		15,080			

Accounts Receivable

Date		Debit	Date		Credit
Apr.	25	12,500	May	12	12,500
Jun.	5	9,500			
		9,500			

Supplies

Date		Debit	Date		Credit
Jan.	24	720			
		720			

Accounts Payable

Date		Debit	Date		Credit
Feb.	20	720	Jan.	24	720
					0

Common Stock

Date		Debit	Date		Credit
			Jan.	15	10,000
					10,000

Wages Expense

Date		Debit	Date		Credit
Jun.	24	6,700			
		6,700			

Service Revenue

Date		Debit	Date		Credit
			Apr.	25	12,500
			Jun.	5	9,500
					22,000

3.

Rosenthal Decorating, Inc.
Trial Balance
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	
	$32,000	$32,000

E 2-45

Badger Auto Parts
Trial Balance
December 31, 2011

Account	Debit	Credit
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	
	$491,800	$491,800

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 if 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)	
	31,410	+	16,530	+	3,670	=	3,670	+	12,000	+	27,000	+	8,940	

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

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

P 2-48A (Contd)

2.

Madero Accounting Services Trial Balance 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 Trial Balance 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

Account	Type of Account	Normal Balance	Increase	Decrease
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
		(Record purchase of truck)		
	8	Inventory	3,400	
		Accounts Payable		3,400
		(Record purchase of inventory on account)		
	10	Supplies	1,450	
		Accounts Payable		1,450
		(Record purchase of supplies on account)		
	11	Cash	12,800	
		Service Revenue		12,800
		(Record performance of services)		
	12	Accounts Receivable	3,600	
		Service Revenue		3,600
		(Record performance of services on account)		
	18	Wages Expense	4,170	
		Cash		4,170
		(Record payment of wages)		
	22	Cash	3,600	
		Accounts Receivable		3,600
		(Record collection of cash on account)		
	23	Cash	14,100	
		Notes Payable		14,100
		(Record borrowing of cash)		
	28	Cash	40,000	
		Common Stock		40,000
		(Record issuance of common stock)		
	30	Dividends	4,350	
		Cash		4,350
		(Declared and paid cash dividend)		

P 2-52A

1. **Journal**

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

P 2-52A

2.

Cash

Jun.	1	10,000	Jun.	8	2,000
Jun.	26	5,800	Jun.	14	3,960
Jun.	29	450			
		10,290			

Accounts Receivable

Jun.	22	9,430	Jun.	26	5,800
		3,630			

Supplies

Jun.	3	1,125			
		1,125			

Trucks

Jun.	8	8,700			
		8,700			

Accounts Payabale

			Jun.	3	1,125
					1,125

Notes Payable

			Jun.	8	6,700
					6,700

Common Stock

			Jun.	1	10,000
					10,000

Service Revenue

			Jun.	22	9,430
			Jun.	29	450
					9,880

Wages Expense

Jun.	14	3,960			
		3,960			

P 2-53A

1.

	Asset	=	Liabilities	+	Equity
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
		(Issued common stock)		
b.		Rent Expense	13,500	
		Cash		13,500
		(Record payment of rent)		
c.		Utilities Expense	5,320	
		Cash		5,320
		(Record payment of utilties)		
d.		Wages Expense	58,800	
		Cash		58,800
		(Record payment of wages)		
e.		Cash	18,650	
		Accounts Receivable	128,200	
		Service Revenue		146,850
		(Record performance of services)		
f.*		Supplies Expense	59,110	
		Cash		59,110
		(Record payment for supplies)		
g.		Dividends	3,500	
		Cash		3,500
		(Declared and paid cash dividend)		
h.		Cash	109,400	
		Accounts Receivable		109,400
		(Record receipt of cash on account)		

* 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

Debit		Credit	
(a)	22,000	(b)	13,500
(e)	18,650	(c)	5,320
(h)	109,400	(d)	58,800
		(f)	59,110
		(g)	3,500
	9,820		

Accounts Receivable

Debit		Credit	
(e)	128,200	(h)	109,400
	18,800		

Common Stock

Debit		Credit	
		(a)	22,000
			22,000

Dividends

Debit		Credit	
(g)	3,500		
	3,500		

Service Revenue

Debit		Credit	
		(e)	146,850
			146,850

Rent Expense

Debit		Credit	
(b)	13,500		
	13,500		

Utilities Expense

Debit		Credit	
(c)	5,320		
	5,320		

Wages Expense

Debit		Credit	
(d)	58,800		
	58,800		

Supplies Expense

Debit		Credit	
(f)	59,110		
	59,110		

4.

Karleen's Catering Service
Trial Balance
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	
	$168,850	$168,850

P 2-54A

1. and 3.

Cash

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

Accounts Receivable

	384,000	384,000	(b)
(a)	994,000	983,000	(c)
	11,000		

Accounts Payable

		11,900
		11,900

Interest Payable

(h)	11,200	11,200
		0

Rent Payable

(d)	10,000	10,000
		0

Insurance Payable

(e)	1,000	1,000
		0

Notes Payable

		100,000
		100,000

Common Stock

		165,000
		165,000

P 2-54A (Contd)

Retained Earnings

			101,200
			101,200

Service Revenue

		(a)	994,000
			994,000

Rent Expense

(d)	48,000		
	48,000		

Insurance Expense

(e)	4,000		
	4,000		

Utilities Expense

(f)	56,000		
	56,000		

Salaries Expense

(g)	702,000		
	702,000		

Interest Expense

(h)	11,000		
	11,000		

Income Taxes Expense

(i)	19,700		
	19,700		

P 2-54A (Contd)

2. **Journal**

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

P 2-54A (Contd)

4.

Western Sound Studios Trial Balance 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)

Emerson Consulting, Inc. Trial Balance January 31, 2011		
Account	**Debit**	**Credit**
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	
	$33,495	$33,495

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.

2.

Brilliant Minds, Inc. Trial Balance April 30, 2011		
Account	**Debit**	**Credit**
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
	$6,335	$6,335

P 2-50B

Account	Type of Account	Normal Balance	Increase	Decrease
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
		(Record payment of rent)		
	3	Cash	20,000	
		Notes Payable		20,000
		(Record borrowing of cash)		
	7	Accounts Receivable	38,600	
		Service Revenue		38,600
		(Record performance of services on account)		
	10	Supplies	3,200	
		Accounts Payable		3,200
		(Record purchase of supplies on account)		
	13	Cash	18,800	
		Accounts Receivable		18,800
		(Record collection of cash on account)		
	19	Cash	55,000	
		Common Stock		55,000
		(Record issuance of stock)		
	22	Wages Expense	11,650	
		Cash		11,650
		(Record payment of wages)		
	23	Accounts Payable	6,975	
		Cash		6,975
		(Record payment of account)		
	25	Cash	15,430	
		Service Revenue		15,430
		(Record performance of services for cash)		
	30	Utilities Expense	2,180	
		Cash		2,180
		(Record payment of utilities)		

P 2-52B

1.

Journal

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

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
		(Issued common stock)		
b.		Equipment	18,710	
		Cash		18,710
		(Purchased equipment for cash)		
c.		Cash	112,880	
		Service Revenue		112,880
		(Performed services for cash)		
d.		Wages Expense	87,300	
		Cash		87,300
		(Paid wages)		
e.		Cash	20,000	
		Notes Payable		20,000
		(Record borrowing of cash)		
f.		Rent Expense	10,200	
		Cash		10,200
		(Paid rent)		
g.		Supplies	2,120	
		Accounts Payable		2,120
		(Purchased supplies on account)		
h.		Accounts Payable	1,200	
		Cash		1,200
		(Record payment on account)		
i.		Utilities Expense	3,250	
		Cash		3,250
		(Record payment of utilties)		

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
Trial Balance
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.

Cash

	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		

Accounts Receivable

	130,000	(b)	699,000
(a)	690,000		
	121,000		

Prepaid Rent

	96,000	(f)	96,000
			0

Supplies

(g)	13,000		
	13,000		

Accounts Payable

			14,000
			14,000

Interest Payable

(c)	8,000		8,000
			0

Notes Payable

			80,000
			80,000

Common Stock

			114,000
			114,000

P 2-54B (Contd)

Retained Earnings

Debit	Credit
	16,000
	16,000

Service Revenue

Debit	Credit
	(a) 690,000
	690,000

Rent Expense

Debit	Credit
(f) 124,000	
124,000	

Advertising Expense

Debit	Credit
(h) 26,000	
26,000	

Wages Expense

Debit	Credit
(d) 379,000	
379,000	

Repairs & Maintenance Expense

Debit	Credit
(e) 9,000	
9,000	

Interest Expense

Debit	Credit
(j) 5,000	
5,000	

Income Taxes Expense

Debit	Credit
(i) 10,300	
10,300	

P 2-54B (Contd)

2. **Journal**

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

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

P 2-54B (Contd)

4.

Mulberry Services Trial Balance December 31, 2011		
Account	**Debit**	**Credit**
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	
	$914,000	$914,000

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):**

Assets	**=**	**$781,818,000,000**
Liabilities	**=**	**$656,682,000,000**
Equity	**=**	**$125,136,000,000**

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

1.

	Assets	=	Liabilities	+	Stockholders' Equity
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.

2.

Accounts Receivable

Beg. bal.	53,110,000		
Sales	2,928,626,000	Cash collections*	2,890,871,000
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
		(Record net sales for year)		
		Cash	2,890,871,000	
		Accounts Receivable		2,890,871,000
		(Record receipt of cash from		
		customer)		

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 years × $3,700).**

   c. **Smith should recognize 4/12 of the $1,600 cost of the loan (4/12 × $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
		(Issued common stock)		
	1	Cash	25,000	
		Notes Payable		25,000
		(Borrowed cash from bank)		
	1	Legal Expense	1,200	
		Cash		1,200
		(Paid legal fees)		
	1	Equipment	7,000	
		Cash		7,000
		(Purchased office equipment)		
	1	Rent Expense	800	
		Cash		800
		(Paid rent for January)		
	3	Prepaid Insurance	3,600	
		Cash		3,600
		(Purchased insurance in advance)		
	3	Supplies	2,500	
		Accounts Payable		2,500
		(Purchased supplies on credit)		
	5	No entry necessary		
	8	Prepaid Rent	10,000	
		Cash		10,000
		(Paid rent for venue in advance)		
	12	Advertising Expense	4,500	
		Cash		4,500
		(Paid for advertising)		

Case 2-61 (Contd)

Journal

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

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)

Artist Fee Expense

		0	
Jan.	25	800	
		800	

Advertising Expense

		0	
Jan.	12	4,500	
		4,500	

Salaries Expense

		0	
Jan.	30	2,400	
		2,400	

Rent Expense

		0	
Jan.	1	800	
		800	

Legal Expense

		0	
Jan.	1	1,200	
		1,200	

Case 2-61 (Contd)

3.

Front Row Entertainment, Inc. Trial Balance 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