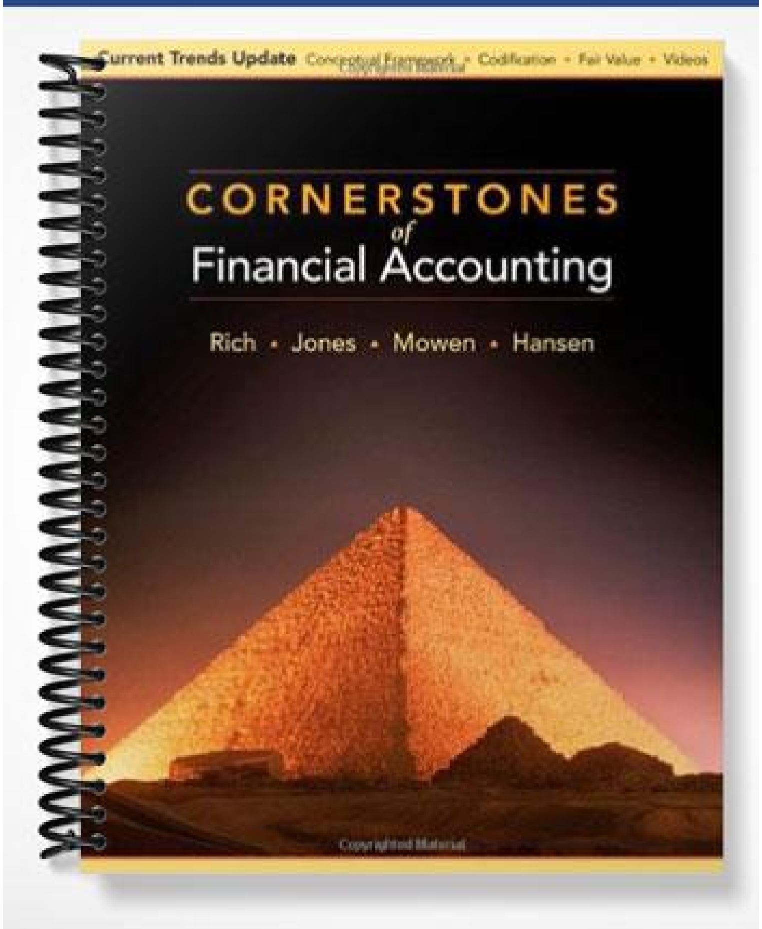
SOLUTIONS MANUAL



CHAPTER 2
THE ACCOUNTING INFORMATION SYSTEM

DISCUSSION QUESTIONS

1. The conceptual framework of accounting is the collection of general concepts that derive 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 characteristics of useful information are relevance, reliability, comparability, and consistency. Relevant information is capable of making a difference in a business decision. Relevant information is provided in a timely manner and helps users predict future events or provides feedback about prior expectations. Reliable information can be depended upon by users. Reliable information should be verifiable, representationally faithful, and neutral. Comparable information allows for comparisons to be made between companies. Consistency refers to the application of the same accounting principles by a single company over time.

3. There are always trade-offs between relevant and reliable information. Relevance refers to information that is provided in a timely manner to help with decision-making. Reliability refers to information that is verifiable, neutral, and representationally faithful. By definition, these are both impossible to achieve completely at the same time. For example, timely information needed for a decision (relevant) may not be able to be measured reliably (reliable).

4. Comparability refers to the ability to compare information across different companies when the same accounting methods are being used. Consistency refers to information within a company being able to be compared over several different periods to help users identify financial trends of a company.

5. There are two constraints that limit the ability of a firm to provide useful information. The first is cost vs. benefit, which 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. The second constraint is materiality, which means information should be capable of influencing a decision. GAAP does not have to be followed for items judged to be immaterial.

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 measured reliably.

10. A reliable measurement is a description in words and numbers that is reasonably free from error and bias and that is a faithful representation of what it claims to represent. Reliability is important because unreliable information can mislead decision-makers. Decision-makers would find it extremely difficult, if not impossible, to use information that is subject to significant error and bias and that fails to faithfully represent what it claims to represent.

11. Transaction analysis usually begins with gathering the source documents that describe business activities. Accountants must then analyze these documents to determine which transactions should be recognized in the accounting system. If the transaction is to be recorded in the accounting system, the transaction must then be analyzed to determine the effects it will have on the fundamental accounting equation. This analysis involves three steps: (1) write down the accounting equation; (2) identify the financial statement elements that are affected by the transaction; and (3) determine whether the element increased or decreased.

12. Yes, it is possible for a transaction to affect only one side of the accounting equation. While the accounting equation must always remain in balance (meaning there must always be a dual effect on the accounting equation), these effects can be on the same side of the accounting equation. An example of this is when a customer pays cash for an accounts receivable. Both cash and accounts receivable are asset accounts (on the left side of the equation). One asset, accounts receivable, is decreasing, while another asset, cash, is increasing by the same amount. This results in the accounting equation remaining in balance, even though only one side of the equation was affected.

13. When a firm earns revenue, its net income is increased. When a firm incurs an expense, its net income is decreased. At the end of the accounting period, net income is added to Retained Earnings, a stockholders' equity account. Therefore, an increase in revenue increases stockholders' equity and a decrease in revenue decreases stockholders' equity; an increase in expense or dividends decreases stockholders' equity and a decrease in expense or dividends increases stockholders' equity.

14. A T-account is a two-column record that consists of a title and two sides divided by a vertical line. A T-account gets its name because it resembles the capital letter "T." The left side is referred to as the debit side, and the right side is referred to as the credit side.

15. No, debit does not mean increase and credit does not mean decrease. The words *debit* and *credit* simply refer to the left and right side of an account. Neither debit nor credit has direct positive or negative connotations. Only when the terms *debit* and *credit* are associated with a particular account can a debit or a credit be identified as an increase or a decrease. For example, a debit increases an asset account but decreases a liability account.

16. To debit an account means to add an amount to the left side of that account. A debit balance is a balance on the left side of an account. To credit an account means to add an amount to the right side of that account. A credit balance is a balance on the right side of an account. Debits and credits do not represent increases or decreases.

17. The normal balance of each of the accounts is:

(a) Cash—debit

(b) Sales—credit

(c) Notes Payable—credit

(d) Inventory—debit

(e) Retained Earnings—credit

(f) Salary Expense—debit

(g) Equipment—debit

(h) Unearned Revenue—credit

18. In each journal entry, the sum of the debits must equal the sum of the credits. If transactions are recorded with debits equal to credits, then the equality of assets with liabilities plus stockholders' equity will be maintained.

19. Accounting transactions are typically recorded initially in a journal on an event-by-event basis. The recording of events in a journal allows the entire effect of a transaction to be contained in one place. The individual effects of a transaction are then posted to the general ledger. Potentially, a firm could put these transactions directly into the general ledger. However, if the transaction were recorded directly into the general ledger, there would be no evidence of the complete transaction in one place, which would make the use of the information very cumbersome.

20. "Double-entry" is an appropriate description of an accounting system, because each transaction will affect at least two accounts and each transaction must have (1) debit and (2) 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 are 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	b
2–2	c
2–3	b
2–4	c
2–5	d
2–6	a
2–7	b
2–8	b
2–9	c
2–10	d
2–11	b
2–12	c
2–13	d
2–14	b
2–15	a

CORNERSTONE EXERCISES

Cornerstone Exercise 2–16

a. Consistency

b. Materiality

c. Reliability

Cornerstone Exercise 2–17

a. Comparability

b. Relevant

c. Cost vs. benefit

Cornerstone Exercise 2–18

a. Economic entity

b. Time period

c. Monetary unit

d. Continuity (going-concern)

Cornerstone Exercise 2–19

a. Revenue recognition

b. Historical cost

c. Matching

d. Conservatism

Cornerstone Exercise 2–20

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. Yes, the event qualifies for recognition.

f. 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.

Cornerstone Exercise 2–21

	Assets	Liabilities	Stockholders' Equity
a.	+	+	NE
b.	–	NE	–
c.	+	NE	+
d.	+/–	NE	NE

Cornerstone Exercise 2–22

					Stockholders' Equity	
	Assets	=	Liabilities	+	Contributed Capital	Retained Earnings
a.	45,000				45,000	
b.	4,000		4,000			
c.	9,000		9,000			
d.	(9,000)		(9,000)			

Cornerstone Exercise 2–23

	Assets	=	Liabilities	+	Stockholders' Equity: Contributed Capital	Stockholders' Equity: Retained Earnings
a.	14,000					14,000
b.	5,000					
	(5,000)					
c.	(3,500)					(3,500)
d.	(1,500)					(1,500)

Cornerstone Exercise 2–24

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

Cornerstone Exercise 2–25

Note: **Because no date is given, the Date column can contain the letter of the transaction.**

Date	Account and Explanation	Debit	Credit
(a)	Cash	71,000	
	Common Stock		71,000
	(To record issuance of common stock)		
(b)	Equipment	7,800	
	Cash		7,800
	(To record purchase of equipment)		
(c)	Cash	12,400	
	Sales Revenue		12,400
	(To record cash sale)		
(d)	Dividends	3,200	
	Cash		3,200
	(Declared and paid cash dividend)		

Cornerstone Exercise 2–26

Date	Account and Explanation	Debit	Credit
(a)	Cash	8,000	
	Notes Payable		8,000
	(To record borrowing of cash from bank)		
(b)	Cash	7,500	
	Sales Revenues		7,500
	(To record cash sale)		
(c)	Salary Expense	9,800	
	Cash		9,800
	(To record payment of salaries)		
(d)	Supplies Expense	4,100	
	Cash		4,100
	(To record purchase and use of supplies)		

Cornerstone Exercise 2–27

Cash

Beg. Bal.	12,000		
(a)	8,000	9,800	(c)
(b)	7,500		
End. Bal.	17,700		

Supplies

Beg. Bal.	6,300		
		4,100	(d)
End. Bal.	2,200		

Notes Payable

		0	Beg. Bal.
		8,000	(a)
		8,000	End. Bal.

Sales Revenue

		19,500	Beg. Bal
		7,500	(b)
		27,000	End. Bal.

Salary Expense

Beg. Bal.	9,200		
(c)	9,800		
End. Bal.	19,000		

Supplies Expense

Beg. Bal.	1,350		
(d)	4,100		
End. Bal.	5,450		

Cornerstone Exercise 2–28

Borges, Inc.
Trial Balance
December 31, 2009

Account	Debit	Credit
Cash	$15,600	
Accounts Receivable	4,900	
Equipment	11,600	
Accounts Payable		$ 4,600
Common Stock		15,000
Dividends	1,250	
Service Revenue		21,630
Rent Expense	2,080	
Salary Expense	4,300	
Advertising Expense	1,500	
	$41,230	$41,230

EXERCISES

Exercise 2–29

a. Reliability
b. Consistency
c. Relevance
d. Reliability
e. Comparability
f. Reliability
g. Relevance
h. Reliability
i. Relevance

Exercise 2–30

a. Revenue recognition
b. Historical cost
c. Economic entity
d. Monetary unit
e. Matching
f. Continuity (going-concern)
g. Time-period
h. Conservatism

Exercise 2–31

1. and 2.

a. **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.**

b. **Qualify.**

c. **Does not qualify. It has to do with the owner's personal transactions, not the company's transactions.**

d. **Qualify.**

e. **Qualify.**

f. **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 2009 or rent is paid), the transaction will be recorded.**

g. **Qualify.**

Exercise 2–32

1.
- **a.** **Increase assets (land) $5,000 and decrease assets (cash) $5,000.**
- **b.** **Increase assets (cash) $1,200 and increase stockholders' equity (revenue) $1,200.**
- **c.** **Increase assets (accounts receivable) $700 and increase stockholders' equity (revenue) $700.**
- **d.** **Increase assets (cash) $12,000 and increase stockholders' equity (common stock) $12,000.**
- **e.** **Increase assets (supplies) $300 and increase liabilities (accounts payable) $300.**
- **f.** **Increase assets (cash) $500 and decrease assets (accounts receivable) $500.**
- **g.** **Decrease assets (cash) $250 and decrease liabilities (accounts payable) $250.**
- **h.** **Decrease assets (cash) $200 and decrease stockholders' equity (expense) $200.**
- **i.** **Decrease assets (cash) $1,000 and decrease stockholders' equity (dividend) $1,000.**

Exercise 2–32 (Concluded)

2. **For transaction (e), 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.**

Exercise 2–33

					Stockholders' Equity	
	Assets	=	Liabilities	+	Contributed Capital	Retained Earnings
a.	25,000				25,000	
b.	(15,000)					
	15,000					
c.	2,900		2,900			
d.	(600)					(600)
e.	3,400					3,400
f.	(1,200)					(1,200)
g.	(950)					(950)
h.	(2,100)		(2,100)			
i.	770					770
j.	(500)					(500)

Exercise 2–34

1.

	Assets	=	Liabilities	+	Stockholders' Equity: Contributed Capital	Stockholders' Equity: Retained Earnings
a.	860,000					
	(860,000)					
b.	120,000				120,000	
c.	42,000		42,000			
d.	8,000					
	(8,000)					
e.	(38,000)					(38,000)
f.	(10,000)					(10,000)

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

Exercise 2–35

a. This transaction is a result of issuing common stock in exchange for cash.

b. This transaction is a result of purchasing land with cash.

c. This transaction is a result of paying cash for an expense (e.g., rent expense) or a result of paying cash for dividends.

d. This transaction is a result of borrowing cash.

Exercise 2–36

	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)			

Exercise 2–37

	Assets	=	Liabilities	+	Stockholders' Equity: Contributed Capital	Stockholders' Equity: Retained Earnings
a.	8,000		8,000			
b.	800					800
c.	16,500					
	(2,500)		14,000			
d.	8,000		8,000			
e.	(280)					(280)

Exercise 2–38

Account	Debit	Credit	Financial Statement
Accounts Payable		X	Balance sheet
Accounts Receivable	X		Balance sheet
Accumulated Depreciation, Building		X	Balance sheet
Accumulated Depreciation, Equipment		X	Balance sheet
Building	X		Balance sheet
Cash	X		Balance sheet
Common Stock		X	Balance sheet
Cost of Goods Sold	X		Income statement
Depreciation Expense, Building	X		Income statement
Depreciation Expense, Equipment	X		Income statement
Equipment	X		Balance sheet
General and Administrative Expense	X		Income statement
Interest Expense	X		Income statement
Inventory	X		Balance sheet
Long-Term Notes Payable		X	Balance sheet
Retained Earnings		X	Balance sheet/Statement of retained earnings
Sales Revenue		X	Income statement
Selling Expense	X		Income statement

Exercise 2–39

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

Exercise 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)	Cash	Decrease	Credit	$10,700
	Notes Payable	Decrease	Debit	$10,000
	Interest Expense	Increase	Debit	$700
(e)	Cash	Decrease	Credit	$2,600
	Accounts Payable	Decrease	Debit	$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)	Cash	Decrease	Credit	$13,300
	Wages Expense	Increase	Debit	$13,300
(j)	Cash	Increase	Debit	$21,000
	Common Stock	Increase	Credit	$21,000

Exercise 2–41

Date		Account and Explanation	Debit	Credit
March	2	Cash	34,200	
		Rental Revenue		34,200
		(To record revenue)		
	3	Inventory, Surfboards	550	
		Accounts Payable		550
		(To record purchase of surfboards)		
	6	Wages Expense	11,500	
		Cash		11,500
		(To record wages)		
	9	Rent Expense	3,300	
		Cash		3,300
		(To record rent)		
	12	Truck	17,800	
		Cash		1,000
		Notes Payable		16,800
		(To record purchase of truck)		
	13	Cash	650	
		Accounts Receivable		650
		(To record collection of customer account)		
	16	Accounts Payable	790	
		Cash		790
		(To record payment of account owed)		
	23	Cash	10,000	
		Notes Payable		10,000
		(To record borrowing of cash)		
	27	Telephone Expense	345	
		Cash		345
		(To record payment of telephone bill)		
	30	Advertising Expense	1,960	
		Cash		1,960
		(To record payment for advertising)		

Exercise 2–42

1.

Date		Account and Explanation	Debit	Credit
Nov.	2	Cash	1,200	
		Revenue		1,200
		(To record revenue earned)		
	6	Supplies	5,800	
		Accounts Payable		5,800
		(To record purchase of supplies on account)		
	10	Wages Expense	4,250	
		Cash		4,250
		(To record payment of wages)		
	15	Accounts Payable	5,800	
		Cash		5,800
		(To record payment on account)		
	18	Supplies Expense	2,150	
		Cash		2,150
		(To record purchase and use of supplies)		
	21	Repairs Expense	900	
		Accounts Payable		900
		(To record repairs performed on account)		
Dec.	4	Accounts Payable	900	
		Cash		900
		(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.

Exercise 2–43

Date		Account and Explanation	Debit	Credit
Jan.	14	Cash	70,000	
		Common Stock		70,000
		(To record issuance of common stock)		
	14	Cash	30,000	
		Notes Payable		30,000
		(To record borrowing of cash)		
Feb.	22	Land	10,000	
		Building	40,000	
		Cash		14,000
		Notes Payable		36,000
		(To record purchase of land and building)		
March	1	Building	6,000	
		Cash		6,000
		(To record prepayment of services)		
May	3	Building	12,000	
		Accounts Payable		12,000
		(To record remodeling of building)		
	20	Accounts Payable	12,000	
		Cash		12,000
		(To record payment on account)		
June	4	Supplies	950	
		Cash		950
		(To record purchase of supplies)		

Exercise 2–44

1.

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

Exercise 2–44 (Concluded)

2.

Cash

Debit	Credit
10,000	720
12,500	6,700
15,080	

Accounts Receivable

Debit	Credit
12,500	12,500
9,500	
9,500	

Supplies

Debit	Credit
720	
720	

Accounts Payable

Debit	Credit
720	720
	0

Common Stock

Debit	Credit
	10,000
	10,000

Wages Expense

Debit	Credit
6,700	
6,700	

Service Revenue

Debit	Credit
	12,500
	9,500
	22,000

3.

Rosenthal Decorating, Inc.
Trial Balance
June 30, 2009

Account	Debit	Credit
Cash	$15,080	
Accounts Receivable	9,500	
Supplies	720	
Accounts Payable		$ 0
Common Stock		10,000
Wages Expense	6,700	
Service Revenue		22,000
	$32,000	$32,000

Exercise 2–45

Badger Auto Parts
Trial Balance
December 31, 2009

Account	Debit	Credit
Cash	$ 3,700	
Accounts Receivable	41,100	
Prepaid Rent	15,000	
Inventory	60,500	
Furniture and Fixtures	128,000	
Accumulated Depreciation, Furniture and Fixtures		$ 47,300
Accounts Payable		9,200
Interest Payable		1,800
Income Taxes Payable		3,600
Long-Term Notes Payable		50,000
Common Stock		100,000
Retained Earnings, 12/31/08		15,900
Sales Revenue		268,000
Cost of Goods Sold	189,000	
Selling Expense	27,500	
General and Administrative Expense	9,700	
Depreciation Expense, Furniture and Fixtures	10,400	
Interest Expense	7,200	
Income Taxes Expense	3,700	
	$495,800	$495,800

Exercise 2–46

a. The trial balance WILL balance.

b. The trial balance WILL NOT balance; sales will be understated by $9.

c. The trial balance WILL balance.

d. The trial balance WILL balance; accounts payable will be overstated by $4,100 and cash will be overstated by $4,100.

e. The trial balance WILL NOT balance; accounts receivable will be understated by $8,300.

PROBLEM SET A

Problem 2–47A

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 acceptance of an 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 for 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.**

Problem 2–48A

1.

Assets			= Liabilities		+ Equity	
Cash	**+ Acct. Rec.**	**+ Supplies**	**= Acct. Pay.**	**+ Notes Pay.**	**+ Capital Stock**	**+ Ret. Earn.**
8,000	15,900	4,100	2,500	4,000	12,000	9,500
20,000					20,000	
(700)						(700)**
		2,100	2,100			
5,000				5,000		
(1,200)			(1,200)			
(1,850)						(1,850)**
2,700						2,700*
	1,500					1,500*
		(500)				(500)**
690	(690)					
(300)						(300)
32,340	+ 16,710	+ 5,700	= 3,400	+ 9,000	+ 32,000	+ 10,350

Note:

*Revenues = $2,700 + $1,500 = $4,200
**Expenses = $700 + $1,850 + $500 = $3,050

2.

Madero Accounting Services
Trial Balance
August 31, 2009

Account	Debit	Credit
Cash	$32,340	
Accounts Receivable	16,710	
Supplies	5,700	
Accounts Payable		$ 3,400
Notes Payable		9,000
Common Stock		32,000
Retained Earnings		9,500
Dividends	300	
Revenues		4,200
Expenses	3,050	
	$58,100	$58,100

Problem 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 accounts receivable.**
   July 14: **Paid a $750 expense with cash; OR paid a $750 cash dividend.**

2.

Chen Construction Company
Trial Balance
July 31, 2009

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

Problem 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 Tax 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 Inventory	Asset	Debit	Debit	Credit

Problem 2–51A

Date	Account and Explanation	Debit	Credit
Sept. 5	Truck	32,000	
	Cash		32,000
	(To record purchase of truck)		
8	Inventory	2,500	
	Accounts Payable		2,500
	(To record purchase of inventory on account)		
10	Supplies	1,750	
	Accounts Payable		1,750
	(To record purchase of supplies on account)		
11	Cash	15,000	
	Service Revenue		15,000
	(To record performance of services)		
12	Accounts Receivable	5,100	
	Service Revenue		5,100
	(To record performance of services on account)		
18	Wages Expense	4,300	
	Cash		4,300
	(To record payment of wages)		
22	Cash	5,100	
	Accounts Receivable		5,100
	(To record collection of cash on account)		
23	Cash	12,800	
	Notes Payable		12,800
	(To record borrowing of cash)		
28	Cash	35,750	
	Common Stock		35,750
	(To record issuance of common stock)		
30	Dividends	3,850	
	Cash		3,850
	(Declared and paid cash dividend)		

Problem 2–52A

1.

Date	Account and Explanation	Debit	Credit
June 3	Supplies	750	
	Accounts Payable		750
	(To record purchase of supplies on account)		
8	Van	6,500	
	Cash		2,000
	Notes Payable		4,500
	(To record purchase of van on account)		
14	Wages Expense	3,200	
	Cash		3,200
	(To record payment of wages)		
22	Accounts Receivable	8,700	
	Service Revenue		8,700
	(To record performance of services on account)		
26	Cash	5,100	
	Accounts Receivable		5,100
	(To record collection of cash on account)		
29	Cash	300	
	Service Revenue		300
	(To record performance of services for cash)		

Problem 2–52A (Concluded)

2.

Cash	
5,100	2,000
300	3,200
200	

Accounts Receivable	
8,700	5,100
3,600	

Supplies	
750	
750	

Van	
6,500	
6,500	

Accounts Payable	
	750
	750

Notes Payable	
	4,500
	4,500

Service Revenue	
	8,700
	300
	9,000

Wages Expense	
3,200	
3,200	

Problem 2–53A

1.

	Assets	=	Liabilities	+	Equity
(a)	(11,500)				(11,500)
(b)	(950)				(950)
(c)	(67,400)				(67,400)
(d)	142,100				163,800
	21,700				
(e)	(62,100)				(62,100)
(f)	(4,000)				(4,000)
(g)	134,200				
	(134,200)				

Problem 2–53A (Continued)

2.

Date	Account and Explanation	Debit	Credit
(a)	Rent Expense	11,500	
	Cash		11,500
	(To record payment of rent)		
(b)	Telephone Expense	950	
	Cash		950
	(To record payment of telephone bill)		
(c)	Wages Expense	67,400	
	Cash		67,400
	(To record payment of wages)		
(d)	Cash	21,700	
	Accounts Receivable	142,100	
	Service Revenue		163,800
	(To record performance of services)		
(e)	Food Expense	62,100	
	Cash		62,100
	(To record payment for food)		
(f)	Dividends	4,000	
	Cash		4,000
	(Declared and paid cash dividend)		
(g)	Cash	134,200	
	Accounts Receivable		134,200
	(To record receipt of cash on account)		

Problem 2–53A (Concluded)

3.

Cash

21,700	11,500
134,200	950
	67,400
	62,100
	4,000
9,950	

Accounts Receivable

142,100	134,200
7,900	

Dividends

4,000	
4,000	

Service Revenue

	163,800
	163,800

Rent Expense

11,500	
11,500	

Telephone Expense

950	
950	

Wages Expense

67,400	
67,400	

Food Expense

62,100	
62,100	

4.

Karleen's Catering Service
Trial Balance
December 31, 2009

Account	Debit	Credit
Cash	$ 9,950	
Accounts Receivable	7,900	
Dividends	4,000	
Rent Expense	11,500	
Telephone Expense	950	
Wages Expense	67,400	
Food Expense	62,100	
Service Revenue		$163,800
	$163,800	$163,800

Problem 2–54A

1. and 3.

Cash

16,300	52,000
384,000	91,000
983,000	56,000
	702,000
	22,200
	19,700
440,400	

Accounts Receivable

384,000	384,000
994,000	983,000
11,000	

Accounts Payable

	11,900
	11,900

Interest Payable

11,200	11,200
	0

Rent Payable, Building

4,000	4,000
	0

Rent Payable, Equipment

7,000	7,000
	0

Long-Term Notes Payable

	100,000
	100,000

Common Stock

	165,000
	165,000

Retained Earnings

	101,200
	101,200

Service Revenue

	994,000
	994,000

Rent Expense, Building

48,000	
48,000	

Rent Expense, Equipment

84,000	
84,000	

Utilities Expense

56,000	
56,000	

Salaries Expense

702,000	
702,000	

Interest Expense

11,000	
11,000	

Income Tax Expense

19,700	
19,700	

Problem 2–54A (Continued)

2.

Date	Account and Explanation	Debit	Credit
(a)	Accounts Receivable	994,000	
	Service Revenue		994,000
	(To record billing of services performed)		
(b)	Cash	384,000	
	Accounts Receivable		384,000
	(To record collection of cash on account)		
(c)	Cash	983,000	
	Accounts Receivable		983,000
	(To record collection of cash on account)		
(d)	Rent Payable, Building	4,000	
	Rent Expense, Building	48,000	
	Cash		52,000
	(To record payment of rent)		
(e)	Rent Payable, Equipment	7,000	
	Rent Expense, Equipment	84,000	
	Cash		91,000
	(To record payment of rent)		
(f)	Utilities Expense	56,000	
	Cash		56,000
	(To record payment of utilities)		
(g)	Salaries Expense	702,000	
	Cash		702,000
	(To record payment of salaries)		
(h)	Interest Payable	11,200	
	Interest Expense	11,000	
	Cash		22,200
	(To record payment of interest)		
(i)	Income Tax Expense	19,700	
	Cash		19,700
	(To record payment of income taxes)		

Problem 2–54A (Concluded)

4.

Western Sound Studios
Trial Balance
December 31, 2009

Account	Debit	Credit
Cash	$ 440,400	
Accounts Receivable	11,000	
Accounts Payable		$ 11,900
Long-Term Notes Payable		100,000
Common Stock		165,000
Retained Earnings		101,200
Service Revenue		994,000
Rent Expense, Building	48,000	
Rent Expense, Equipment	84,000	
Utilities Expense	56,000	
Salaries Expense	702,000	
Interest Expense	11,000	
Income Tax Expense	19,700	
	$1,372,100	$1,372,100

PROBLEM SET B

Problem 2–47B

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.**

Problem 2–48B

1.

Assets					=	Liabilities			+	Equity		
Cash	+	Acct. Rec.	+	Supplies	=	Acct. Pay.	+	Notes Pay.	+	Common Stock	+	Ret. Earn.
3,000		6,600		4,800		500		1,000		10,000		2,900
2,000										2,000		
1,550												1,550*
750		(750)										
				650		650						
(500)						(500)						
		2,700										2,700*
(1,200)												(1,200)**
(800)												(800)**
(900)												(900)**
(400)												(400)
3,500	+	8,550	+	5,450	=	650	+	1,000	+	12,000	+	3,850

*Revenues = $1,550 + $2,700 = $4,250
**Expenses = $1,200 + $800 + $900 = $2,900

2.

Emerson Consulting, Inc.
Trial Balance
January 31, 2009

Account	Debit	Credit
Cash	$ 3,500	
Accounts Receivable	8,550	
Supplies	5,450	
Accounts Payable		$ 650
Notes Payable		1,000
Common Stock		12,000
Retained Earnings		2,900
Dividends	400	
Revenues		4,250
Expenses	2,900	
	$20,800	$20,800

Problem 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: Incurred and paid an expense of $140.
   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 accounts receivable from a customer.

2.

Brilliant Minds, Inc.
Trial Balance
April 30, 2009

Account	Debit	Credit
Cash	$3,060	
Accounts Receivable	325	
Supplies	1,050	
Equipment	1,900	
Accounts Payable		$ 300
Notes Payable		2,000
Common Stock		2,000
Retained Earnings		2,035
	$6,335	$6,335

Problem 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
Intangibles	Asset	Debit	Debit	Credit
Interest Expense	Expense	Debit	Debit	Credit
Inventory	Asset	Debit	Debit	Credit
Long-Term Investments	Asset	Debit	Debit	Credit
Retained Earnings	Equity	Credit	Credit	Debit
Sales	Revenue	Credit	Credit	Debit
Unearned Revenue	Liability	Credit	Credit	Debit
Utility Expense	Expense	Debit	Debit	Credit

Problem 2–51B

Date		Account and Explanation	Debit	Credit
Dec.	2	Prepaid Rent	9,000	
		Cash		9,000
		(To record prepayment of rent)		
	3	Cash	25,000	
		Notes Payable		25,000
		(To record borrowing of cash)		
	7	Accounts Receivable	35,000	
		Service Revenue		35,000
		(To record performance of services on account)		
	10	Supplies	12,000	
		Accounts Payable		12,000
		(To record purchase of supplies on account)		
	13	Cash	29,000	
		Accounts Receivable		29,000
		(To record collection of cash on account)		
	19	Cash	40,000	
		Common Stock		40,000
		(To record issuance of stock)		
	22	Wages Expense	8,000	
		Cash		8,000
		(To record payment of wages)		
	23	Accounts Payable	10,000	
		Cash		10,000
		(To record payment of account)		
	25	Cash	11,000	
		Service Revenue		11,000
		(To record performance of services for cash)		
	30	Utility Expense	2,000	
		Cash		2,000
		(To record payment of utilities)		

Problem 2–52B

1.

Date		Account and Explanation	Debit	Credit
Sept.	1	Supplies	1,750	
		Cash		1,750
		(To record purchase of supplies)		
	5	Prepaid Rent	2,400	
		Cash		2,400
		(To record payment of rent in advance)		
	8	Supplies	710	
		Accounts Payable		710
		(To record purchase of supplies on account)		
	13	Cash	600	
		Accounts Receivable		600
		(To record collection of cash from customer account)		
	18	Cash	7,500	
		Service Revenue		7,500
		(To record performance of services for cash)		
	25	Accounts Receivable	4,200	
		Service Revenue		4,200
		(To record performance of services on account)		
	30	Wages Expense	3,720	
		Cash		3,720
		(To record payment of wages)		

Problem 2–52B (Concluded)

2.

Cash

600	1,750
7,500	2,400
	3,720
230	

Accounts Receivable

4,200	600
3,600	

Supplies

1,750	
710	
2,460	

Prepaid Rent

2,400	
2,400	

Accounts Payable

	710
	710

Service Revenue

	7,500
	4,200
	11,700

Wages Expense

3,720	
3,720	

Problem 2–53B

1.

	Assets	=	Liabilities	+	Equity
(a)	35,000				35,000
(b)	14,200				
	(14,200)				
(c)	121,800				121,800
(d)	(84,900)				(84,900)
(e)	15,000		15,000		
(f)	(17,500)				(17,500)
(g)	1,300		1,300		
(h)	(1,000)		(1,000)		
(i)	(910)				(910)

Problem 2–53B (Continued)

2.

Date	Account and Explanation	Debit	Credit
(a)	Cash	35,000	
	Common Stock		35,000
	(To record issuance of common stock)		
(b)	Equipment	14,200	
	Cash		14,200
	(To record purchase of equipment for cash)		
(c)	Cash	121,800	
	Service Revenue		121,800
	(To record performance of services for cash)		
(d)	Wages Expense	84,900	
	Cash		84,900
	(To record payment of wages)		
(e)	Cash	15,000	
	Notes Payable		15,000
	(To record borrowing of cash)		
(f)	Rent Expense	17,500	
	Cash		17,500
	(To record payment of rent)		
(g)	Supplies	1,300	
	Accounts Payable		1,300
	(To record purchase of supplies on account)		
(h)	Accounts Payable	1,000	
	Cash		1,000
	(To record payment on account)		
(i)	Telephone Expense	910	
	Cash		910
	(To record payment of telephone bill)		

Problem 2–53B (Continued)

3.

Cash

35,000	14,200
121,800	84,900
15,000	17,500
	1,000
	910
53,290	

Supplies

1,300	
1,300	

Equipment

14,200	
14,200	

Accounts Payable

1,000	1,300
	300

Notes Payable

	15,000
	15,000

Common Stock

	35,000
	35,000

Service Revenue

	121,800
	121,800

Rent Expense

17,500	
17,500	

Telephone Expense

910	
910	

Wages Expense

84,900	
84,900	

Problem 2–53B (Concluded)

4.

Sweetwater Temporary Clerical Help Service
Trial Balance
December 31, 2009

Account	Debit	Credit
Cash	$ 53,290	
Supplies	1,300	
Equipment	14,200	
Accounts Payable		$ 300
Notes Payable		15,000
Common Stock		35,000
Service Revenue		121,800
Rent Expense	17,500	
Telephone Expense	910	
Wages Expense	84,900	
	$172,100	$172,100

Problem 2–54B

1. and 3.

Cash

Debit	Credit
6,000	8,000
699,000	379,000
	90,000
	28,000
	13,000
	26,000
	10,300
	10,000
140,700	

Accounts Receivable

Debit	Credit
130,000	699,000
690,000	
121,000	

Prepaid Rent

Debit	Credit
96,000	96,000
	0

Supplies

Debit	Credit
13,000	
13,000	

Accounts Payable

Debit	Credit
	14,000
	14,000

Interest Payable

Debit	Credit
8,000	8,000
	0

Long-Term Notes Payable

Debit	Credit
	80,000
	80,000

Common Stock

Debit	Credit
	114,000
	114,000

Retained Earnings

Debit	Credit
	16,000
	16,000

Service Revenue

Debit	Credit
	690,000
	690,000

Rent Expense

Debit	Credit
124,000	
124,000	

Income Tax Expense

Debit	Credit
10,300	
10,300	

Advertising Expense

Debit	Credit
26,000	
26,000	

Wages Expense

Debit	Credit
379,000	
379,000	

Interest Expense

Debit	Credit
10,000	
10,000	

Administrative Expense

Debit	Credit
90,000	
90,000	

Problem 2–54B (Continued)

2.

Date	Account and Explanation	Debit	Credit
(a)	Accounts Receivable	690,000	
	Service Revenue		690,000
	(To record performance of services on account)		
(b)	Cash	699,000*	
	Accounts Receivable		699,000
	(To record collection of cash from customer)		
	*$570,000 + $129,000		
(c)	Interest Payable	8,000	
	Cash		8,000
	(To record payment of interest)		
(d)	Wages Expense	379,000	
	Cash		379,000
	(To record payment of wages)		
(e)	Administrative Expense	90,000	
	Cash		90,000
	(To record payment of administrative expenses)		
(f)	Rent Expense	124,000	
	Prepaid Rent		96,000
	Cash		28,000
	(To record payment of rent)		
(g)	Supplies	13,000	
	Cash		13,000
	(To record purchase of supplies)		
(h)	No entry necessary.		
(i)	Advertising Expense	26,000	
	Cash		26,000
	(To record payment of advertising expense)		

Problem 2–54B (Concluded)

Date	Account and Explanation	Debit	Credit
(j)	Income Tax Expense	10,300	
	Cash		10,300
	(To record payment of income taxes)		
(k)	Interest Expense	10,000	
	Cash		10,000
	(To record payment of interest expense)		

4.

Mulberry Services
Trial Balance
December 31, 2009

Account	Debit	Credit
Cash	$140,700	
Accounts Receivable	121,000	
Supplies	13,000	
Accounts Payable		$ 14,000
Long-Term Notes Payable		80,000
Common Stock		114,000
Retained Earnings		16,000
Service Revenue		690,000
Rent Expense	124,000	
Income Tax Expense	10,300	
Advertising Expense	26,000	
Wages Expense	379,000	
Interest Expense	10,000	
Administrative Expense	90,000	
	$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 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, then sales, net income, and retained earnings are also overstated. If accounts payable are understated, then expenses are understated, and net income and retained earnings are 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. 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 $7,200 must be the amount that customers paid Cable. The calculation of this amount is shown with the T-account below.**

Accounts Receivable

Beg. Bal.	5,900		
Credit Sales	97,400	96,100	Collections*
End. Bal.	7,200		

***Collections of $96,100 calculated as $5,900 + $97,400 – $7,200.**

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 $5,300 must be the amount that Cable paid its employees.**

Wages Payable

		4,600	Beg. Bal.
Wage Payments*	37,400	38,100	Wages Exp.
		5,300	End. Bal.

***Wage payments of $37,400 is calculated as $4,600 + $38,100 – $5,300.**

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, including 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 2007 annual report for General Electric on the statement of financial position (the balance sheet):**

   Assets = $795,337,000,000

   Liabilities = $671,774,000,000

   Equity = $123,563,000,000 ($115,559,000,000 + $8,004,000,000*)

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

   ***Note:* GE reports $8,004,000,000 of minority interest in equity of consolidated affiliates as mezzanine equity between the liability section and the balance sheet. While this topic is beyond the scope of this course, this would present the opportunity to show the students that even basic classifications found in the fundamental accounting equation can have "gray areas" in today's complex business environment.**

2. **Normal balances:**
   - **a. Debit**
   - **b. Credit**
   - **c. Credit**
   - **d. Debit**
   - **e. Debit**
   - **f. Debit**
   - **g. Debit**

3. **Additional accounts involved in the transaction:**
   - **a. Cash (decreased as payables are paid off)**
   - **b. Sales (increased as credit sales are made to customers)**
   - **c. Cash (increased when more common stock is issued)**
   - **d. Cash (increased when more money is borrowed from the bank)**

Case 2–59

1.

	Assets	=	Liabilities	+	Stockholders' Equity
Abercrombie & Fitch:	**$2,248,067,000**	**=**	**$842,770,000**	**+**	**$1,405,297,000**
Aeropostale:	**$581,164,000**	**=**	**$269,048,000**	**+**	**$312,116,000**

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

2.

Accounts Receivable

Beg. Bal.	41,855,000		
Sales	3,318,158,000	3,316,773,000*	Cash Collections
End. Bal.	43,240,000		

***Cash collections of $3,316,773,000 were determined as $41,855,000 Beginning Balance + $3,318,158,000 Sales – $43,240,000 Ending Balance.**

3.

	Account and Explanation	Debit	Credit
a.	Accounts Receivable..................................	3,318,158,000	
	Net Sales		3,318,158,000
	(To record net sales for the year)		
b.	Cash...	3,316,773,000	
	Accounts Receivable		3,316,773,000
	(To record receipt of cash from customers)		

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 2–59 (Concluded)

5. a. **Aeropostale:**

Account and Explanation	Debit	Credit
SG&A Expense...	289,736,000	
Cash...		289,736,000
(To record payment of SG&A expenses)		

b. **Abercrombie & Fitch:**

Account and Explanation	Debit	Credit
SG&A Expense...	373,828,000	
Cash...		373,828,000
(To record payment of SG&A expenses)		

Aeropostale is a smaller company than Abercrombie & Fitch (as evidenced by the financial statements). Because this company is smaller, its SG&A expenses will be lower as well.

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 36-month (3-year) insurance coverage for the 8 months of coverage expired during 2009. Thus, 8/36 of $1,800, or $400, should be included in 2009 insurance expense, and the remainder (28/36 × $1,800 = $1,400) should appear on the December 31, 2009 balance sheet as an asset called Prepaid Insurance.**

   b. **Smith should recognize as expense the portion of the building's cost associated with 2009. 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 $54,000 ($60,000 – $6,000), or $2,700, would be included in depreciation expense for 2009, and the December 31, 2009 balance sheet would show accumulated depreciation on the building of $24,300 (9 × $2,700).**

   c. **Smith should recognize 4/12 of the $2,200 cost of the loan (4/12 × $2,200 = $733) as interest expense in 2009. Since this expense is not paid until September 1 of the following year, the December 31, 2009 balance sheet must show interest payable of $733. The remaining cost of the loan ($2,200 – $733 = $1,467) is not recognized until next year and does not appear as a payable on the December 31, 2009 balance sheet.**