

## Quick Check

- What are the distinctive features of accrual accounting and cash-basis accounting?
  - Accrual accounting records only receivables, payables, and depreciation.
  - Accrual accounting is superior because it provides more information.
  - Cash-basis accounting records all transactions.
  - All the above are true.
- The revenue recognition principle says
  - divide time into annual periods to measure revenue properly.
  - record revenue only after you have earned it.
  - measure revenues and expenses in order to compute net income.
  - record revenue after you receive cash.
- Adjusting the accounts is the process of
  - subtracting expenses from revenues to measure net income.
  - recording transactions as they occur during the period.
  - updating the accounts at the end of the period.
  - zeroing out account balances to prepare for the next period.
- Which types of adjusting entries are natural opposites?
  - Net income and net loss
  - Expenses and revenues
  - Prepays and accruals
  - Prepays and depreciation
- Assume that the weekly payroll of In the Woods Camping Supplies is \$300. December 31, end of the year, falls on Tuesday, and In the Woods will pay its employee on Friday for the full week. What adjusting entry will In the Woods make on Tuesday, December 31? (Use five days as a full work week.)
  - |                |     |     |
|----------------|-----|-----|
| Salary expense | 120 |     |
| Salary payable |     | 120 |
  - |                |     |     |
|----------------|-----|-----|
| Salary payable | 300 |     |
| Salary expense |     | 300 |
  - |                |     |     |
|----------------|-----|-----|
| Salary expense | 180 |     |
| Cash           |     | 180 |
  - No adjustment is needed because the company will pay the payroll on Friday.
- Get Fit Now gains a client who prepays \$540 for a package of six physical training sessions. Get Fit Now collects the \$540 in advance and will provide the training later. After four training sessions, what should Get Fit Now report on its income statement?
  - Service revenue of \$360
  - Service revenue of \$540
  - Unearned service revenue of \$360
  - Cash of \$180
- Assume you prepay Get Fit Now for a package of six physical training sessions. Which type of account should you have in your records?
  - Accrued revenue
  - Accrued expense
  - Prepaid expense
  - Unearned revenue
- Unearned revenue is always
  - owner's equity because you collected the cash in advance.
  - revenue.
  - a liability.
  - an asset.

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9. The adjusted trial balance shows
  - a. amounts that may be out of balance.
  - b. amounts ready for the financial statements.
  - c. assets, liabilities, and owner's equity only.
  - d. revenues and expenses only.
10. Accounting data flow from the
  - a. income statement to the statement of owner's equity.
  - b. statement of owner's equity to the balance sheet.
  - c. balance sheet to the income statement.
  - d. Both a and b are correct.

Answers are given after Apply Your Knowledge (p. 197).

## Assess Your Progress

### • Short Exercises



#### S3-1 1 Comparing accrual and cash-basis accounting [5 min]

Suppose you work summers house-sitting for people while they are away on vacation. Some of your customers pay you immediately after you finish a job. Some customers ask you to send them a bill. It is now June 30 and you have collected \$900 from cash-paying customers. Your remaining customers owe you \$1,300.

#### Requirements

1. How much service revenue would you have under the
  - a. cash basis?
  - b. accrual basis?
2. Which method of accounting provides more information about your house-sitting business?

#### S3-2 1 Comparing accrual and cash-basis accounting [5 min]

The Johnny Flowers Law Firm uses a client database. Suppose Johnny Flowers paid \$2,900 for a computer.

#### Requirements

1. Describe how the business should account for the \$2,900 expenditure under
  - a. the cash basis.
  - b. the accrual basis.
2. State why the accrual basis is more realistic for this situation.

#### S3-3 2 Applying the revenue recognition principle [5 min]

*Northwest Magazine* sells subscriptions for \$36 for 12 issues. The company collects cash in advance and then mails out the magazines to subscribers each month.

#### Requirement

1. Apply the revenue recognition principle to determine
  - a. when *Northwest Magazine* should record revenue for this situation.
  - b. the amount of revenue *Northwest Magazine* should record for three issues.

#### S3-4 2 Applying the matching principle [5 min]

Suppose on January 1 you prepaid apartment rent of \$5,700 for the full year.

#### Requirement

1. At July 31, what are your two account balances for this situation?



**S3-5 3 Identifying types of adjusting entries [5 min]**

A select list of transactions for Anuradha's Goals follows:

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Apr 1	Paid six months of rent, \$4,800.
10	Received \$1,200 from customer for six-month service contract that began April 1.
15	Purchased computer for \$1,000.
18	Purchased \$300 of office supplies on account.
30	Work performed but not yet billed to customer, \$500.
30	Employees earned \$600 in salary that will be paid May 2.

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**Requirement**

- For each transaction, identify what type of adjusting entry would be needed.

**S3-6 4 Journalizing adjusting entries [5 min]**

On April 1 your company prepaid six months of rent, \$4,800.

**Requirements**

- Prepare the journal entry for the April 1 payment.
- Prepare the adjusting entry required at April 30.
- Post to the two accounts involved and show their balances at April 30.

**S3-7 4 Posting adjusting entries [5 min]**

On May 1 your company paid cash of \$54,000 for computers that are expected to remain useful for three years. At the end of three years, the value of the computers is expected to be zero, so depreciation is \$18,000 per year.

**Requirements**

- Post the purchase of May 1 and the depreciation on May 31 to T-accounts for the following accounts: Computer equipment, Accumulated depreciation—computer equipment, and Depreciation expense—computer equipment. Show their balances at May 31. (Assume that the journal entries have been completed.)
- What is the computer equipment's book value on May 31?

**S3-8 4 Accruing interest expense and posting to T-accounts [10 min]**

Thompson Travel borrowed \$68,000 on October 1, 2012, by signing a one-year note payable to Metro One Bank. Thompson's interest expense for the remainder of the fiscal year (October through December) is \$884.

**Requirements**

- Make the adjusting entry to accrue interest expense at December 31, 2012. Date the entry and include its explanation.
- Post to the T-accounts of the two accounts affected by the adjustment.

**S3-9 4 Accounting for unearned revenues [5–10 min]**

*Metro Magazine* collects cash from subscribers in advance and then mails the magazines to subscribers over a one-year period.

**Requirements**

- Journalize the entry to record the original receipt of \$170,000 cash.
- Journalize the adjusting entry that *Metro Magazine* makes to record the earning of \$12,000 of subscription revenue that was collected in advance. Include an explanation for the entry.

**S3-10 5 Preparing an adjusted trial balance [10 min]**

Famous Cut Hair Stylists has begun the preparation of its adjusted trial balance as follows:

FAMOUS CUT HAIR STYLISTS Preparation of Adjusted Trial Balance December 31, 2012						
Account	Trial Balance		Adjustments		Adjusted Trial Balance	
	Debit	Credit	Debit	Credit	Debit	Credit
Cash	\$ 800					
Supplies	900					
Equipment	19,100					
Accumulated depreciation		\$ 1,000				
Accounts payable		200				
Interest payable						
Note payable		2,500				
Fabio, capital		7,400				
Service revenue		14,800				
Rent expense	4,500					
Supplies expense						
Depreciation expense						
Interest expense	600					
Total	\$25,900	\$25,900				

Year-end data include the following:

- Supplies on hand, \$300.
- Depreciation, \$1,000.
- Accrued interest expense, \$600.

**Requirement**

- Complete Famous Cut's adjusted trial balance. Key each adjustment by letter.

*Note: Short Exercises 3-11 and 3-12 should be used only after completing Short Exercise 3-10.*

**S3-11 6 Preparing an income statement [10–15 min]**

Refer to the data in Short Exercise 3-10.

**Requirement**

- Compute Famous Cut's net income for the year ended December 31, 2012.

**S3-12 6 Preparing a balance sheet [5 min]**

Refer to the data in Short Exercise 3-10.

**Requirement**

- Compute Famous Cut's total assets at December 31, 2012.



## Exercises

### E3-13 1 2 Comparing accrual and cash-basis accounting, and applying the revenue recognition principle [5–10 min]



Momentous Occasions is a photography business that shoots videos at college parties. The freshman class pays \$100 in advance on March 3 just to guarantee your services for its party to be held April 2. The sophomore class promises a minimum of \$280 for filming its formal dance, and actually pays cash of \$410 on February 28 at the party.

#### Requirement

- Answer the following questions about the correct way to account for revenue under the accrual basis.
  - Considering the \$100 paid by the freshman class, on what date was revenue earned? Did the earnings occur on the same date cash was received?
  - Considering the \$410 paid by the sophomore class, on what date was revenue earned? Did the earnings occur on the same date cash was received?

### E3-14 1 4 6 Comparing accrual and cash-basis accounting, preparing adjusting entries, and preparing income statements [15–25 min]

Sweet Catering completed the following selected transactions during May, 2012:

May 1	Prepaid rent for three months, \$1,500.
5	Paid electricity expenses, \$400.
9	Received cash for meals served to customers, \$2,600.
14	Paid cash for kitchen equipment, \$2,400.
23	Served a banquet on account, \$3,000.
31	Made the adjusting entry for rent (from May 1).
31	Accrued salary expense, \$1,400.
31	Recorded depreciation for May on kitchen equipment, \$40.

#### Requirements

- Prepare journal entries for each transaction.
- Using the journal entries as a guide, show whether each transaction would be handled as a revenue or an expense using both the cash and accrual basis by completing the following table.

Date	Amount of Revenue (Expense) for May	
	Cash-Basis Amount of Revenue (Expense)	Accrual-Basis Amount of Revenue (Expense)

- After completing the table, calculate the amount of net income or net loss for Sweet Catering under the accrual and cash basis for May.
- Considering your results from Requirement 3, which method gives the best picture of the true earnings of Sweet Catering? Why?

### E3-15 2 Applying the time-period concept [5–10 min]

Consider the following situations:

- Business receives \$2,000 on January 1 for 10-month service contract for the period January 1 through October 31.
- Total salary for all employees is \$3,000 per month. Employees are paid on the 1st and 15th of the month.
- Work performed but not yet billed to customers for the month is \$900.
- The company pays interest on its \$10,000, 6% note payable of \$50 on the first day of each month.

#### Requirement

- Assume the company records adjusting entries monthly. Calculate the amount of each adjustment needed, if any, as of February 28.

**E3-16    2 4 Applying accounting principles and preparing journal entries for prepaid rent [10–15 min]**

Consider the facts presented in the following table for Tropical View:

	Situation			
	A	B	C	D
Beginning Prepaid rent .....	\$ 1,200	\$ 900	\$ 200	\$ 700
Payments for Prepaid rent				
during the year.....	1,400	b	1,800	d
Total amount to account for .....	2,600	1,400	?	?
Subtract: Ending Prepaid rent.....	600	500	c	400
Rent expense .....	\$ a	\$ 900	\$1,900	\$1,100

**Requirements**

1. Complete the table by filling in the missing values.
2. Prepare one journal entry for each situation, if required, for the missing amounts (a–d). Label the journal entries by letter.

**E3-17    3 4 Categorizing and journalizing adjusting entries [10–15 min]**

Consider the following independent situations at December 31, 2014.

- a. On August 1, a business collected \$3,300 rent in advance, debiting Cash and crediting Unearned rent revenue. The tenant was paying one year's rent in advance. At December 31, the business must account for the amount of rent it has earned.
- b. Salary expense is \$1,700 per day—Monday through Friday—and the business pays employees each Friday. This year December 31 falls on a Thursday.
- c. The unadjusted balance of the Supplies account is \$3,500. Supplies on hand total \$1,700.
- d. Equipment depreciation was \$300.
- e. On March 1, when the business prepaid \$600 for a two-year insurance policy, the business debited Prepaid insurance and credited Cash.

**Requirements**

1. For each situation, indicate which category of adjustment is described.
2. Journalize the adjusting entry needed on December 31 for each situation. Use the letters to label the journal entries.

**E3-18    4 Recording adjustments in T-accounts and calculating ending balances [10–20 min]**

The accounting records of Maura Grayson Architect include the following selected, unadjusted balances at March 31: Accounts receivable, \$1,400; Supplies, \$1,100; Salary payable, \$0; Unearned service revenue, \$600; Service revenue, \$4,200; Salary expense, \$1,300; Supplies expense, \$0. The data developed for the March 31 adjusting entries are as follows:

- a. Service revenue accrued, \$900.
- b. Unearned service revenue that has been earned, \$200.
- c. Supplies on hand, \$600.
- d. Salary owed to employee, \$400.

**Requirement**

1. Open a T-account for each account and record the adjustments directly in the T-accounts, keying each adjustment by letter. Show each account's adjusted balance. Journal entries are not required.

**E3-19**    **4 5**    **Preparing adjusting entries and preparing an adjusted trial balance [10–15 min]**

First Class Maids Company, the cleaning service, started the preparation of its adjusted trial balance as follows:

FIRST CLASS MAIDS COMPANY		
Preparation of Adjusted Trial Balance		
December 31, 2012		
Account	Trial Balance	
	Debit	Credit
Cash	\$ 700	
Supplies	3,000	
Prepaid insurance	800	
Equipment	29,000	
Accumulated depreciation		\$ 7,000
Accounts payable		2,800
Salary payable		
Unearned service revenue		500
Molly, capital		7,200
Molly, drawing	3,000	
Service revenue		25,000
Salary expense	6,000	
Supplies expense		
Depreciation expense		
Insurance expense		
Total	\$42,500	\$42,500

During the 12 months ended December 31, 2012, First Class Maids

- used supplies of \$1,800.
- used up prepaid insurance of \$620.
- used up \$460 of the equipment through depreciation.
- accrued salary expense of \$310 that First Class Maids hasn't paid yet.
- earned \$360 of the unearned service revenue.

**Requirement**

- Prepare an adjusted trial balance. Use Exhibit 3-8 as a guide. Key each adjustment by letter.

*Note: Exercise 3-20 should be used only in conjunction with Exercise 3-19.*

**E3-20**    **4 5**    **Using an adjusted trial balance to prepare adjusting journal entries [10 min]**  
 Refer to the data in Exercise 3-19.

**Requirement**

- Journalize the five adjustments, all dated December 31, 2012. Explanations are not required.



**E3-21 4 5 Using the adjusted trial balance to determine the adjusting journal entries [10–15 min]**

The adjusted trial balance of Jobs-4-U Employment Service follows but is incomplete.

JOBS-4-U EMPLOYMENT SERVICE				
Adjusted Trial Balance				
April 30, 2012				
Account	Trial Balance		Adjusted Trial Balance	
	Debit	Credit	Debit	Credit
Cash	\$ 900		\$ 900	
Accounts receivable	4,100		5,600	
Supplies	1,000		500	
Equipment	32,500		32,500	
Accumulated depreciation		\$14,400		\$15,400
Salary payable				1,200
Yost, capital		23,300		23,300
Yost, drawing	4,800		4,800	
Service revenue		9,100		10,600
Salary expense	2,500		3,700	
Rent expense	1,000		1,000	
Depreciation expense			1,000	
Supplies expense			500	
Total	\$46,800	\$46,800	\$50,500	\$50,500

**Requirements**

1. Calculate and enter the adjustment amounts directly in the missing Adjustments columns.
2. Prepare each adjusting journal entry calculated in Requirement 1. Date the entries and include explanations.

**E3-22 4 6 Journalizing adjusting entries and analyzing their effect on the income statement [5–10 min]**

The following data at January 31, 2013 is given for EBM.

- a. Depreciation, \$500.
- b. Prepaid rent expired, \$600.
- c. Interest expense accrued, \$300.
- d. Employee salaries owed for Monday through Thursday of a five-day workweek; weekly payroll, \$13,000.
- e. Unearned service revenue earned, \$1,300.

**Requirements**

1. Journalize the adjusting entries needed on January 31, 2013.
2. Suppose the adjustments made in Requirement 1 were not made. Compute the overall overstatement or understatement of net income as a result of the omission of these adjustments.



**E3-23    4 6    Using adjusting journal entries and computing financial statement amounts [10–20 min]**

The adjusted trial balances of Superior International at August 31, 2012, and August 31, 2011, include the following amounts:

	2012	2011
Supplies .....	\$ 2,400	\$ 1,200
Salary payable .....	2,500	4,100
Unearned service revenue .....	12,100	17,100

Analysis of the accounts at August 31, 2012, reveals the following transactions for the fiscal year ending in 2012:

Cash payments for supplies .....	\$ 6,100
Cash payments for salaries .....	47,300
Cash receipts in advance for service revenue ....	83,200

**Requirement**

1. Compute the amount of Supplies expense, Salary expense, and Service revenue to report on the Superior International income statement for 2012.

*Note: Exercise 3-24 should be used only in conjunction with Exercise 3-19.*

**E3-24    5 6    Using an adjusted trial balance to prepare financial statements [10 min]**  
Refer to the data in Exercise 3-19.**Requirements**

1. Compute First Class Maids Company's net income for the period ended December 31, 2012.
2. Compute First Class Maids Company's total assets at December 31, 2012.

*Note: Exercise 3-25 should be used only after completing Exercise 3-21.*

**E3-25    6    Preparing the financial statements [20 min]**

Refer to the adjusted trial balance in Exercise 3-21 for the month ended April 30, 2012.

**Requirements**

1. Prepare the income statement.
2. Prepare the statement of owner's equity.
3. Prepare the balance sheet.

**E3-26 6 Preparing the income statement [15 min]**

The accountant for Reva Stewart, CPA, has posted adjusting entries (a) through (e) to the accounts at December 31, 2012. Selected balance sheet accounts and all the revenues and expenses of the entity follow in T-account form.

Accounts receivable		Supplies	
22,700		1,200	(a) 600
(e) 800			
Acc. depr.—equipment		Acc. depr.—building	
	5,000		30,000
(b) 1,900		(c) 5,000	
Salary payable		Service revenue	
	(d) 900		105,700
		(e) 800	
Salary expense		Supplies expense	
28,200		(a) 600	
(d) 900			
Depreciation expense—equip.		Depreciation expense—bldg.	
(b) 1,900		(c) 5,000	

**Requirements**

1. Prepare the income statement of Reva Stewart, CPA, for the year ended December 31, 2012.
2. Were 2012 operations successful?

**E3-27 6 Preparing the statement of owner's equity [10-15 min]**

Rolling Hill Interiors began the year with Hill, capital of \$20,000. On July 12, Dana Hill, the owner, invested \$14,000 cash. The income statement for the year ended December 31, 2012, reported net income of \$63,000. During this fiscal year, Hill withdrew cash of \$6,000 each month.

**Requirement**

1. Prepare Rolling Hill Interiors' statement of owner's equity for the year ended December 31, 2012.

## Problems (Group A)

### P3-28A 1 Comparing accrual and cash-basis accounting [15–25 min]

Schaad's Stews completed the following transactions during June, 2012:

Jun	1	Prepaid rent for June through September, \$3,600.
	2	Purchased computer for cash, \$900.
	3	Performed catering services on account, \$2,300.
	5	Paid Internet service provider invoice, \$100.
	6	Catered wedding event for customer and received cash, \$1,500.
	8	Purchased \$150 of supplies on account.
	10	Collected \$1,200 on account.
	14	Paid account payable from June 8.
	15	Paid salary expense, \$1,200.
	30	Recorded adjusting entry for rent (see June 1).
	30	Recorded \$25 depreciation on computer.
	30	There are \$40 of supplies still on hand.

#### Requirement

- Show whether each transaction would be handled as a revenue or an expense, using both the cash and accrual basis, by completing the following table.

Amount of Revenue (Expense) for June		
Date	Cash-Basis Amount of Revenue (Expense)	Accrual-Basis Amount of Revenue (Expense)
Jun 1		

### P3-29A 2 Applying the revenue principle [10–20 min]

Crum's Cookies uses the accrual method of accounting and properly records transactions on the date they occur. Descriptions of customer transactions follow:

- Received \$3,000 cash from customer for six months of service beginning April 1, 2012.
- Catered event for customer on April 28. Customer paid Crum's invoice of \$600 on May 10.
- Scheduled catering event to be held June 3. Customer paid Crum's a \$500 deposit on May 25.
- Catered customer's wedding on May 3. Customer paid Crum's an \$800 deposit on April 15 and the balance due of \$1,000 on May 3.
- The company provided catering to a local church's annual celebration service on May 15. The church paid the \$800 fee to Crum's on the same day.
- The company provides food to the local homeless shelter two Saturdays each month. The cost of each event to the shelter is \$280. The shelter paid Crum \$1,120 on May 25 for April and May's events.
- On April 1, Crum's entered into an annual service contract with an oil company to cater the customer's monthly staff events. The contract's total amount was \$4,000, but Crum's offered a 2.5% discount since the customer paid the entire year in advance at the signing of the contract. The first event was held in April.
- Crum's signed contract for \$1,000 on May 5 to cater X-treme sports events to be held June 15, June 27, October 1, and November 15.

#### Requirement

- Calculate the amount of revenue earned during May, 2012 for Crum's Cookies for each transaction.



**P3-30A 3 Explain why an adjusting entry is needed and calculate the amount of the adjustment [15–25 min]**

Descriptions of transactions and how they were recorded follow for October, 2012 for Ausley Acoustics.

- a. Received \$1,500 cash from customer for three months of service beginning October 1, 2012, and ending December 31, 2012. The company recorded a \$1,500 debit to Cash and a \$1,500 credit to Unearned service revenue.
- b. Employees are paid \$1,000 every Friday for the five-day work week. October 31, 2012, is on Wednesday.
- c. The company pays \$240 on October 1 for their six-month auto insurance policy. The company recorded a \$240 debit to Prepaid insurance and a \$240 credit to Cash.
- d. The company purchased office furniture for \$6,300 on January 2, 2012. The company recorded a \$6,300 debit to Office furniture and a \$6,300 credit to Accounts payable. Annual depreciation for the furniture is \$900.
- e. The company began October with \$50 of supplies on hand. On October 10, the company purchased supplies on account of \$100. The company recorded a \$100 debit to Supplies and a \$100 credit to Accounts payable. The company used \$120 of supplies during October.
- f. The company received its electric bill on October 30 for \$125 but did not pay it until November 10. On November 10, it recorded a \$125 debit to Utilities expense and a \$125 credit to Cash.
- g. The company paid November's rent on October 30 of \$800. On October 30, the company recorded an \$800 debit to Rent expense and an \$800 credit to Cash.

**Requirement**

1. Indicate if an adjusting entry is needed for each item on October 31 and why the entry is needed (i.e., an asset or liability account is over/understated). Indicate which specific account on the balance sheet is misstated. Finally, indicate the correct balance that should appear in the balance sheet account after the adjustment is made. Use the following table guide. Item a is completed as an example:

Item	Adjustment needed?	Asset/ Liability	Over/ Understated?	Balance sheet account	Correct balance on October 31
a.	Yes	Liability	Overstated	Unearned service revenue	\$1,000

**P3-31A 1 4 6 Comparing accrual and cash-basis accounting, preparing adjusting entries, and preparing income statements [15–25 min]**

Charlotte's Golf School completed the following transactions during March, 2012:

- Mar 1 Prepaid insurance for March through May, \$600.
- 4 Performed services (gave golf lessons) on account, \$2,500.
- 5 Purchased equipment on account, \$1,600.
- 8 Paid property tax expense, \$100.
- 11 Purchased office equipment for cash, \$1,500.
- 19 Performed services and received cash, \$900.
- 24 Collected \$400 on account.
- 26 Paid account payable from March 5.
- 29 Paid salary expense, \$1,000.
- 31 Recorded adjusting entry for March insurance expense (see March 1).
- 31 Debited unearned revenue and credited revenue in an adjusting entry, \$1,200.

### Requirements

1. Prepare journal entries for each transaction.
2. Using the journal entries as a guide, show whether each transaction would be handled as a revenue or an expense, using both the cash and accrual basis, by completing the following table.

Amount of Revenue (Expense) for March		
Date	Cash-Basis Amount of Revenue (Expense)	Accrual-Basis Amount of Revenue (Expense)
Mar 1		

3. After completing the table, calculate the amount of net income or net loss for the company under the accrual and cash basis for March.
4. Considering your results from Requirement 3, which method gives the best picture of the true earnings of Charlotte's Golf School? Why?

### P3-32A 4 Journalizing adjusting entries [15–25 min]

Laughter Landscaping has the following independent cases at the end of the year on December 31, 2014.

- a. Each Friday, Laughter pays employees for the current week's work. The amount of the weekly payroll is \$7,000 for a five-day workweek. This year December 31 falls on a Wednesday.
- b. Details of Prepaid insurance are shown in the account:

Prepaid insurance			
Jan 1	\$4,500		

Laughter prepays a full year's insurance each year on January 1. Record insurance expense for the year ended December 31.

- c. The beginning balance of Supplies was \$4,000. During the year, Laughter purchased supplies for \$5,200, and at December 31 the supplies on hand total \$2,400.
- d. Laughter designed a landscape plan, and the client paid Laughter \$7,000 at the start of the project. Laughter recorded this amount as Unearned service revenue. The job will take several months to complete, and Laughter estimates that the company has earned 60% of the total revenue during the current year.
- e. Depreciation for the current year includes Equipment, \$3,700; and Trucks, \$1,300. Make a compound entry.

### Requirement

1. Journalize the adjusting entry needed on December 31, 2014, for each of the previous items affecting Laughter Landscaping.

**P3-33A 4 Analyzing and journalizing adjustments [15–20 min]**

Galant Theater Production Company's unadjusted and adjusted trial balances at December 31, 2012, follow.

GALANT THEATER PRODUCTION COMPANY				
Adjusted Trial Balance				
December 31, 2012				
Account	Trial Balance		Adjusted Trial Balance	
	Debit	Credit	Debit	Credit
Cash	\$ 3,900		\$ 3,900	
Accounts receivable	6,100		6,900	
Supplies	1,700		300	
Prepaid insurance	2,700		2,100	
Equipment	25,000		25,000	
Accumulated depreciation		\$ 8,800		\$ 13,200
Accounts payable		4,000		4,000
Salary payable				300
Galant, capital		20,300		20,300
Galant, drawing	30,500		30,500	
Service revenue		71,000		71,800
Depreciation expense			4,400	
Supplies expense			1,400	
Utilities expense	4,700		4,700	
Salary expense	29,500		29,800	
Insurance expense			600	
Total	\$ 104,100	\$ 104,100	\$ 109,600	\$ 109,600

**Requirement**

1. Journalize the adjusting entries that account for the differences between the two trial balances.



**P3-34A 4 5 Journalizing and posting adjustments to the T-accounts and preparing an adjusted trial balance [45–60 min]**

The trial balance of Arlington Air Purification System at December 31, 2012, and the data needed for the month-end adjustments follow.

ARLINGTON AIR PURIFICATION SYSTEM		
Trial Balance		
December 31, 2012		
Account	Debit	Credit
Cash	\$ 7,700	
Accounts receivable	19,200	
Prepaid rent	2,400	
Supplies	1,300	
Equipment	19,900	
Accumulated depreciation		\$ 4,300
Accounts payable		3,600
Salary payable		
Unearned service revenue		2,600
Able, capital		39,500
Able, drawing	9,500	
Service revenue		15,400
Salary expense	3,500	
Rent expense		
Depreciation expense		
Advertising expense	1,900	
Supplies expense		
Total	\$ 65,400	\$ 65,400

Adjustment data at December 31 follow:

- Unearned service revenue still unearned, \$1,100.
- Prepaid rent still in force, \$500.
- Supplies used during the month, \$600.
- Depreciation for the month, \$900.
- Accrued advertising expense, \$900. (Credit Accounts payable)
- Accrued salary expense, \$1,100.

**Requirements**

- Journalize the adjusting entries.
- The unadjusted balances have been entered for you in the general ledger accounts. Post the adjusting entries to the ledger accounts.
- Prepare the adjusted trial balance.
- How will Arlington Air Purification System use the adjusted trial balance?

**P3-35A 4 5 6 Preparing and posting adjusting journal entries; preparing an adjusted trial balance and financial statements [45–60 min]**

The trial balance of Lexington Inn Company at December 31, 2012, and the data needed for the month-end adjustments follow.

LEXINGTON INN COMPANY		
Trial Balance		
December 31, 2012		
Account	Debit	Credit
Cash	\$ 12,100	
Accounts receivable	14,300	
Prepaid insurance	2,300	
Supplies	1,100	
Building	411,000	
Accumulated depreciation		\$312,500
Accounts payable		1,950
Salary payable		
Unearned service revenue		2,400
Calvasina, capital		114,740
Calvasina, drawing	2,860	
Service revenue		15,600
Salary expense	2,700	
Insurance expense		
Depreciation expense		
Advertising expense	830	
Supplies expense		
Total	\$447,190	\$447,190

Adjustment data at December 31 follow:

- Prepaid insurance still in force, \$700.
- Supplies used during the month, \$500.
- Depreciation for the month, \$1,600.
- Accrued salary expense, \$400.
- Unearned service revenue still unearned, \$1,400.

**Requirements**

- Journalize the adjusting entries.
- The unadjusted balances have been entered for you in the general ledger accounts. Post the adjusting entries to the ledger accounts.
- Prepare the adjusted trial balance.
- Prepare the income statement, statement of owner's equity, and balance sheet for the business for the month ended December 31, 2012.

**P3-36A 5 6 Prepare an adjusted trial balance and financial statements. [45–60 min]**

Consider the unadjusted trial balance of Reliable Limo Service Company at June 30, 2012, and the related month-end adjustment data.

RELIABLE LIMO SERVICE COMPANY		
Trial Balance		
June 30, 2012		
Account	Balance	
	Debit	Credit
Cash	\$ 6,900	
Accounts receivable	1,100	
Prepaid rent	3,500	
Supplies	1,100	
Automobile	77,000	
Accumulated depreciation		\$ 3,400
Accounts payable		3,300
Salary payable		
Wake, capital		80,000
Wake, drawing	4,400	
Service revenue		9,600
Salary expense	1,500	
Rent expense		
Fuel expense	800	
Depreciation expense		
Supplies expense		
Total	\$96,300	\$96,300

Adjustment data at June 30 follow:

- a. Accrued service revenue at June 30, \$1,500.
- b. One-fifth of the prepaid rent expired during the month.
- c. Supplies on hand at June 30, \$700.
- d. Depreciation on automobile for the month, \$1,400.
- e. Accrued salary expense at June 30 for one day only. The five-day weekly payroll is \$1,500.

**Requirements**

- Write the trial balance on a worksheet, using Exhibit 3-8 as an example, and prepare the adjusted trial balance of Reliable Limo Service Company at June 30, 2012. Key each adjusting entry by letter.
- Prepare the income statement and the statement of owner's equity for the month ended June 30, 2012, and the balance sheet at that date.



- P3-37A 6 Preparing financial statements from an adjusted trial balance. [20–30 min]**  
 The adjusted trial balance of Party Piano Tuning Service at fiscal year end May 31, 2012, follows.

PARTY PIANO TUNING SERVICE			
Adjusted Trial Balance			
May 31, 2012			
Account Title	Balance		
	Debit	Credit	
Cash	\$ 12,600		
Accounts receivable	10,800		
Supplies	1,900		
Equipment	25,900		
Accumulated depreciation		\$ 12,500	
Accounts payable		3,300	
Unearned service revenue		4,700	
Salary payable		800	
Note payable		14,000	
Lindros, capital		13,600	
Lindros, drawing	38,000		
Service revenue		65,000	
Depreciation expense	5,600		
Salary expense	9,600		
Utilities expense	3,900		
Insurance expense	3,700		
Supplies expense	1,900		
Total	<u>\$113,900</u>	<u>\$113,900</u>	

### Requirements

1. Prepare Party's 2012 income statement.
2. Prepare the statement of owner's equity for the year.
3. Prepare the year-end balance sheet.
4. Which financial statement reports Party's results of operations? Were the 2012 operations successful? Cite specifics from the financial statements to support your evaluation.
5. Which statement reports the company's financial position?

## Problems (Group B)

### P3-38B 1 Comparing accrual and cash-basis accounting [15–25 min]

MyAccountingLab

Smith's Stews completed the following transactions during April 2012:

Apr 1	Prepaid rent for April through July, \$4,800.
2	Purchased computer for cash, \$3,600.
3	Performed catering services on account, \$3,400.
5	Paid Internet service provider invoice, \$225.
6	Catered wedding event for customer and received cash, \$2,000.
8	Purchased \$130 of supplies on account.
10	Collected \$1,900 on account.
14	Paid account payable from April 8.
15	Paid salary expense, \$1,000.
30	Recorded adjusting entry for rent (see April 1).
30	Recorded \$100 depreciation on computer.
30	There are \$35 of supplies still on hand.

### Requirement

- Show whether each transaction would be handled as a revenue or an expense, using both the cash and accrual basis, by completing the table.

Amount of Revenue (Expense) for April		
Date	Cash-Basis Amount of Revenue (Expense)	Accrual-Basis Amount of Revenue (Expense)
Apr 1		

### P3-39B 2 Applying the revenue principle [10–20 min]

Nibble's Cookies uses the accrual method of accounting and properly records transactions on the date they occur. Descriptions of customer transactions follows:

- Received \$4,800 cash from customer for six months of service beginning January 1, 2012.
- Catered event for customer on January 28. Customer paid Nibble's invoice of \$800 on February 10.
- Scheduled catering event to be held June 3. Customer paid Nibble's a \$750 deposit on February 25.
- Catered customer's wedding on February 3. Customer paid Nibble's a \$600 deposit on January 15 and the balance due of \$1,500 on February 3.
- The company provided catering to a local church's annual celebration service on February 15. The church paid the \$900 fee to Nibble's on the same day.
- The company provides food to the local homeless shelter two Saturdays each month. The cost of each event to the shelter is \$260. The shelter paid Nibble's \$1,040 on February 25 for January and February's events.
- On December 1, 2011, Nibble's entered into an annual service contract with an oil company to cater the customer's monthly staff events. The contract total amount was \$8,000, but Nibble's offered a 1% discount since the customer paid the entire year in advance at the signing of the contract. The first event was held in December of last year.
- Nibble's signed contract for \$1,600 on February 5 to cater X-treme sports events to be held June 15, June 27, October 1, and November 15.

### Requirement

- Calculate the amount of revenue earned during February 2012 for Nibble's Cookies for each transaction.

**P3-40B 3 Explain why an adjusting entry is needed and calculate the amount of the adjustment [15–25 min]**

Descriptions of transactions and how they were recorded follows for October 2012 for Ashley Acoustics.

- Received \$3,600 cash from customer for three months of service beginning October 1, 2012 and ending December 31, 2012. The company recorded a \$3,600 debit to Cash and a \$3,600 credit to Unearned service revenue.
- Employees are paid \$1,500 every Friday for the five-day work week. October 31, 2012 is on Wednesday.
- The company pays \$420 on October 1 for their six-month auto insurance policy. The company recorded a \$420 debit to Prepaid insurance and a \$420 credit to Cash.
- The company purchased office furniture for \$6,000 on January 2, 2012. The company recorded a \$6,000 debit to Office furniture and a \$6,000 credit to Accounts payable. Annual depreciation for the furniture is \$1,200.
- The company began October with \$55 of supplies on hand. On October 10 the company purchased supplies on account of \$115. The company recorded a \$115 debit to Supplies and a \$115 credit to Accounts payable. The company used \$80 of supplies during October.
- The company received their electric bill on October 30 for \$205, but did not pay it until November 10. On November 10 they recorded a \$205 debit to Utilities expense and a \$205 credit to Cash.
- The company paid November's rent on October 30 of \$550. On October 30 the company recorded a \$550 debit to Rent expense and a \$550 credit to Cash.

**Requirement**

- Indicate if an adjusting entry is needed for each item on October 31 and why the entry is needed (i.e., an asset or liability account is over/understated). Indicate which specific account on the balance sheet is misstated. Finally, indicate the correct balance that should appear in the balance sheet account after the adjustment is made. Use the table guide below. Item a is completed as an example:

Item	Adjustment needed?	Asset/ Liability	Over-/ Understated?	Balance sheet account	Correct balance on October 31
a.	Yes	Liability	Overstated	Unearned service revenue	\$2,400

**P3-41B 1 4 6 Comparing accrual and cash-basis accounting, preparing adjusting entries, and preparing income statements [15–25 min]**

Carolina's Golf School completed the following transactions during October 2012:

- Oct 1 Prepaid insurance for October through December, \$900.
- 4 Performed services (gave golf lessons) on account, \$2,400.
- 5 Purchased equipment on account, \$1,500.
- 8 Paid property tax expense, \$200.
- 11 Purchased office equipment for cash, \$1,000.
- 19 Performed services and received cash, \$700.
- 24 Collected \$500 on account.
- 26 Paid account payable from October 5.
- 29 Paid salary expense, \$1,400.
- 31 Recorded adjusting entry for October insurance expense (see October 1).
- 31 Debited unearned revenue and credited revenue in an adjusting entry, \$1,100.

**Requirements**

- Prepare journal entries for each transaction.
- Using the journal entries as a guide, show whether each transaction would be handled as a revenue or an expense, using both the cash and accrual basis, by completing the following table:

Amount of Revenue (Expense) for October		
Date	Cash-Basis Amount of Revenue (Expense)	Accrual-Basis Amount of Revenue (Expense)
Oct 1		



- After completing the table, calculate the amount of net income or net loss for the company under the accrual and cash basis for October.
- Considering your results from Requirement 3, which method gives the best picture of the true earnings of Carolina's Golf School? Why?

**P3-42B 4 Journalizing adjusting entries [15–25 min]**

Lindsey Landscaping has the following independent cases at the end of the year on December 31, 2014.

- Each Friday, Lindsey pays employees for the current week's work. The amount of the weekly payroll is \$6,500 for a five-day workweek. This year December 31 falls on a Wednesday.
- Details of Prepaid insurance are shown in the account:

Prepaid insurance			
Jan	1	\$5,500	

- Lindsey prepays a full year's insurance each year on January 1. Record insurance expense for the year ended December 31.
- The beginning balance of Supplies was \$4,200. During the year, Lindsey purchased supplies for \$5,100, and at December 31, the supplies on hand total \$2,400.
  - Lindsey designed a landscape plan, and the client paid Lindsey \$9,000 at the start of the project. Lindsey recorded this amount as Unearned service revenue. The job will take several months to complete, and Lindsey estimates that the company has earned 70% of the total revenue during the current year.
  - Depreciation for the current year includes Equipment, \$3,600; and Trucks, \$1,400. Make a compound entry.

**Requirement**

- Journalize the adjusting entry needed on December 31, 2014, for each of the previous items affecting Lindsey Landscaping.

**P3-43B 4 Analyzing and journalizing adjustments [15–20 min]**

Showtime Theater Production Company's unadjusted and adjusted trial balances at December 31, 2012, follow.

SHOWTIME THEATER PRODUCTION COMPANY				
Adjusted Trial Balance				
December 31, 2012				
Account	Trial Balance		Adjusted Trial Balance	
	Debit	Credit	Debit	Credit
Cash	\$ 3,500		\$ 3,500	
Accounts receivable	6,000		6,900	
Supplies	1,300		500	
Prepaid insurance	2,100		1,300	
Equipment	23,000		23,000	
Accumulated depreciation		\$ 8,100		\$ 11,600
Accounts payable		5,000		5,000
Salary payable				500
Webber, capital		21,100		21,100
Webber, drawing	28,500		28,500	
Service revenue		59,600		60,500
Depreciation expense			3,500	
Supplies expense			800	
Utilities expense	5,400		5,400	
Salary expense	24,000		24,500	
Insurance expense			800	
Total	\$ 93,800	\$ 93,800	\$ 98,700	\$ 98,700

**Requirement**

1. Journalize the adjusting entries that account for the differences between the two trial balances.

**P3-44B 4 5 Journalizing and posting adjustments to the T-accounts, and preparing an adjusted trial balance [45–60 min]**

The trial balance of Canton Air Purification System at December 31, 2012, and the data needed for the month-end adjustments follow.

CANTON AIR PURIFICATION SYSTEM			
Trial Balance			
December 31, 2012			
Account	Debit	Credit	
Cash	\$ 7,200		
Accounts receivable	19,400		
Prepaid rent	2,200		
Supplies	1,600		
Equipment	20,000		
Accumulated depreciation		\$ 3,700	
Accounts payable		3,400	
Salary payable			
Unearned service revenue		2,600	
Canton, capital		39,000	
Canton, drawing	9,600		
Service revenue		15,900	
Salary expense	3,300		
Rent expense			
Depreciation expense			
Advertising expense	1,300		
Supplies expense			
Total	\$ 64,600	\$ 64,600	

Adjustment data at December 31 follow:

- a. Unearned service revenue still unearned, \$1,800.
- b. Prepaid rent still in force, \$600.
- c. Supplies used during the month, \$400.
- d. Depreciation for the month, \$700.
- e. Accrued advertising expense, \$900. (Credit Accounts payable)
- f. Accrued salary expense, \$800.

**Requirements**

1. Journalize the adjusting entries.
2. The unadjusted balances have been entered for you in the general ledger accounts. Post the adjusting entries to the ledger accounts.
3. Prepare the adjusted trial balance.
4. How will Canton Air Purification System use the adjusted trial balance?



**P3-45B 4 5 6 Preparing and posting adjusting journal entries; preparing an adjusted trial balance and financial statements. [45–60 min]**

The trial balance of Concord Bed and Breakfast Company at December 31, 2012, and the data needed for the month-end adjustments follow.

CONCORD BED AND BREAKFAST COMPANY		
Trial Balance		
December 31, 2012		
Account	Debit	Credit
Cash	\$ 12,000	
Accounts receivable	14,400	
Prepaid insurance	2,800	
Supplies	1,400	
Building	435,000	
Accumulated depreciation		\$310,500
Accounts payable		1,930
Salary payable		
Unearned service revenue		3,000
Wagner, capital		141,060
Wagner, drawing	2,940	
Service revenue		15,700
Salary expense	2,800	
Insurance expense		
Depreciation expense		
Advertising expense	850	
Supplies expense		
Total	\$472,190	\$472,190

Adjustment data at December 31 follow:

- a. Prepaid insurance still in force, \$900.
- b. Supplies used during the month, \$500.
- c. Depreciation for the month, \$1,000.
- d. Accrued salary expense, \$300.
- e. Unearned service revenue still unearned, \$1,500.

### Requirements

- Journalize the adjusting entries.
- The unadjusted balances have been entered for you in the general ledger accounts. Post the adjusting entries to the ledger accounts.
- Prepare the adjusted trial balance.
- Prepare the income statement, statement of owner's equity, and balance sheet for the business for the month ended December 31, 2012.



- P3-46B** 5 6 **Prepare an adjusted trial balance and financial statements [45–60 min]**  
 Consider the unadjusted trial balance of Star Limo Service Company at September 30, 2012, and the related month-end adjustment data.

STAR LIMO SERVICE COMPANY		
Trial Balance		
September 30, 2012		
Account	Balance	
	Debit	Credit
Cash	\$ 6,800	
Accounts receivable	1,400	
Prepaid rent	5,000	
Supplies	1,200	
Automobile	72,000	
Accumulated depreciation		\$ 3,800
Accounts payable		3,600
Salary payable		
Simmons, capital		75,000
Simmons, drawing	3,700	
Service revenue		9,700
Salary expense	1,400	
Rent expense		
Fuel expense	600	
Depreciation expense		
Supplies expense		
Total	\$92,100	\$92,100

Adjustment data at September 30 follow:

- Accrued service revenue at September 30, \$1,800.
- One-fifth of the prepaid rent expired during the month.
- Supplies on hand at September 30, \$800.
- Depreciation on automobile for the month, \$1,000.
- Accrued salary expense at September 30 for one day only.  
The five-day weekly payroll is \$1,200.

### Requirements

- Write the trial balance on a worksheet, using Exhibit 3-8 as an example, and prepare the adjusted trial balance of Star Limo Service at September 30, 2012. Key each adjusting entry by letter.
- Prepare the income statement and the statement of owner's equity for the month ended September 30, 2012, and the balance sheet at that date.

**P3-47B 6 Preparing financial statements from an adjusted trial balance [20–30 min]**

The adjusted trial balance of A Plus Events Piano Tuning Service at fiscal year end October 31, 2012, follows.

A PLUS EVENTS PIANO TUNING SERVICE			
Adjusted Trial Balance			
October 31, 2012			
Account Title	Balance		
	Debit	Credit	
Cash	\$ 12,300		
Accounts receivable	10,700		
Supplies	1,800		
Equipment	25,800		
Accumulated depreciation		\$ 12,300	
Accounts payable		3,300	
Unearned service revenue		4,600	
Salary payable		700	
Note payable		15,000	
Bach, capital		9,000	
Bach, drawing	36,000		
Service revenue		66,000	
Depreciation expense	5,500		
Salary expense	9,600		
Utilities expense	4,100		
Insurance expense	3,700		
Supplies expense	1,400		
Total	\$110,900	\$110,900	

**Requirements**

1. Prepare A Plus's 2012 income statement.
2. Prepare the statement of owner's equity for the year.
3. Prepare the year-end balance sheet.
4. Which financial statement reports A Plus's results of operations? Were 2012 operations successful? Cite specifics from the financial statements to support your evaluation.
5. Which statement reports the company's financial position?

**Continuing Exercise****E3-48 4 5 Preparing adjusting entries and preparing an adjusted trial balance [20–30 min]**

MyAccountingLab

This exercise continues the Lawlor Lawn Service situation from Exercise 2-61 of Chapter 2. Start from the trial balance and the posted T-accounts that Lawlor Lawn Service prepared at May 31, 2012.

**Requirements**

1. Open these additional T-accounts: Accumulated depreciation—equipment; Depreciation expense—equipment; Supplies expense.
2. Mindy Lawlor determines there are \$40 in Lawn supplies left at May 31, 2012. Depreciation on the equipment was \$30 for the month. Journalize any required adjusting journal entries.



3. Post to the T-accounts, keying all items by date.
4. Prepare the adjusted trial balance, as illustrated in Exhibit 3-8.

## • Continuing Problem

MyAccountingLab

P3-49

### 4 5 6 Preparing adjusting entries; preparing an adjusted trial balance; and preparing financial statements from an adjusted trial balance [40–50 min]

This problem continues the Draper Consulting situation from Problem 2-62 of Chapter 2. Start from the trial balance and the posted T-accounts that Draper Consulting prepared at December 18, 2012, as follows:

DRAPER CONSULTING			
Trial Balance			
December 18, 2012			
	Account Title	Balance	
		Debit	Credit
	Cash	\$ 16,500	
	Accounts receivable	1,500	
	Supplies	900	
	Equipment	1,800	
	Accumulated depreciation—equipment		
	Furniture	4,200	
	Accumulated depreciation—furniture		
	Accounts payable		\$ 5,100
	Salary payable		
	Unearned service revenue		
	Draper, capital		18,000
	Draper, drawing		
	Service revenue		2,600
	Rent expense	550	
	Utilities expense	250	
	Salary expense		
	Depreciation expense—equipment		
	Depreciation expense—furniture		
	Supplies expense		
	Total	\$25,700	\$25,700

Later in December, the business completed these transactions, as follows:

Dec 21	Received \$1,400 in advance for client service to be performed evenly over the next 30 days.
21	Hired a secretary to be paid \$2,055 on the 20th day of each month. The secretary begins work immediately.
26	Paid \$450 on account.
28	Collected \$300 on account.
30	Draper withdrew cash of \$1,400.

### Requirements

1. Open these additional T-accounts: Accumulated depreciation—equipment; Accumulated depreciation—furniture; Salary payable; Unearned service revenue; Salary expense; Depreciation expense—equipment; Depreciation expense—furniture; Supplies expense.



2. Journalize the transactions of December 21–30.
3. Post to the T-accounts, keying all items by date.
4. Prepare a trial balance at December 31. Also set up columns for the adjustments and for the adjusted trial balance, as illustrated in Exhibit 3-8.
5. At December 31, the business gathers the following information for the adjusting entries:
  - a. Accrued service revenue, \$550.
  - b. Earned \$700 of the service revenue collected in advance on December 21.
  - c. Supplies on hand, \$200.
  - d. Depreciation expense—equipment, \$30; furniture, \$70.
  - e. Accrued \$685 expense for secretary's salary.

On your worksheet, make these adjustments directly in the adjustments columns, and complete the adjusted trial balance at December 31. Throughout the book, to avoid rounding errors, we base adjusting entries on 30-day months and 360-day years.

6. Journalize and post the adjusting entries. In the T-accounts, denote each adjusting amount as *Adj* and an account balance as *Bal*.
7. Prepare the income statement and the statement of owner's equity of Draper Consulting for the month ended December 31, 2012, and prepare the balance sheet at that date.

## ● Practice Set

### 4 5 Preparing adjusting entries and preparing an adjusted trial balance [20–30 min]

MyAccountingLab

Using the trial balance prepared in Chapter 2, consider the following adjustment data gathered by Evan:

- a. Evan prepared an inventory of supplies and found there were \$50 of supplies in the cabinet on November 30.
- b. One month's combined depreciation on all assets was estimated to be \$170.

## Requirements

1. Using the data provided from the trial balance, the previous adjustment information, and the information from Chapter 2, prepare all required adjusting journal entries for November.
2. Prepare an adjusted trial balance as of November 30 for Shine King Cleaning.

## Apply Your Knowledge

### ● Decision Cases

**Decision Case 3-1** Lee Nicholas has been the owner and has operated World.com Advertising since its beginning 10 years ago. The company has prospered. Recently, Nicholas mentioned that he would sell the business for the right price.

Assume that you are interested in buying World.com Advertising. You obtain the most recent monthly trial balance, which follows. Revenues and expenses vary little from month to month, and January is a typical month. The trial balance shown is a preliminary or unadjusted trial balance. The controller informs you that the necessary accrual adjustments should include revenues of \$3,800 and expenses of \$1,100. Also, if you were to buy World.com Advertising, you would hire a manager so you could devote your time to other duties. Assume that this person would require a monthly salary of \$5,000.

WORLD.COM ADVERTISING			
Trial Balance			
January 31, 2015			
		Balance	
	Account Title	Debit	Credit
	Cash	\$ 9,700	
	Accounts receivable	14,100	
	Prepaid expenses	2,600	
	Building	221,300	
	Accumulated depreciation		\$ 68,600
	Accounts payable		13,000
	Salary payable		
	Unearned service revenue		56,700
	Nicholas, capital		110,400
	Nicholas, drawing	9,000	
	Service revenue		12,300
	Rent expense		
	Salary expense	3,400	
	Utilities expense	900	
	Depreciation expense		
	Supplies expense		
	Total	\$261,000	\$261,000

### Requirements

1. Assume that the most you would pay for the business is 20 times the monthly net income *you could expect to earn* from it. Compute this possible price.
2. Nicholas states the least he will take for the business is an amount equal to the business's owner's equity balance on January 31. Compute this amount.
3. Under these conditions, how much should you offer Nicholas? Give your reason.

**Decision Case 3-2** One year ago, Tyler Stasney founded Swift Classified Ads. Stasney remembers that you took an accounting course while in college and comes to you for advice. He wishes to know how much net income his business earned during the past year in order to decide whether to keep the company going. His accounting records consist of the T-accounts from his ledger, which were prepared by an accountant who moved to another city. The ledger at December 31 follows. The accounts have *not* been adjusted.

Stasney indicates that at year-end, customers owe him \$1,600 for accrued service revenue. These revenues have not been recorded. During the year, Stasney collected \$4,000 service revenue in advance from customers, but he earned only \$900 of that amount. Rent expense for the year was \$2,400, and he used up \$1,700 of the supplies. Stasney determines



that depreciation on his equipment was \$5,000 for the year. At December 31, he owes his employee \$1,200 accrued salary.

<u>Cash</u>	<u>Accounts receivable</u>	<u>Prepaid rent</u>	<u>Supplies</u>
Dec 31 5,800	Dec 31 12,000	Jan 2 2,800	Jan 2 2,600
<u>Equipment</u>	<u>Accumulated depreciation</u>		<u>Accounts payable</u>
Jan 2 36,000			Dec 31 21,500
<u>Unearned service revenue</u>	<u>Salary payable</u>		
Dec 31 4,000			
	<u>Stasney, capital</u>	<u>Stasney, drawing</u>	<u>Service revenue</u>
	Dec 31 20,000	Dec 31 28,000	Dec 31 59,500
<u>Salary expense</u>	<u>Depreciation expense</u>	<u>Rent expense</u>	<u>Utilities expense</u>
Dec 31 17,000			Dec 31 800
<u>Supplies expense</u>			

### Requirement

1. Help Stasney compute his net income for the year. Advise him whether to continue operating Swift Classified Ads.

### ● Ethical Issue 3-1

The net income of Steinbach & Sons, a department store, decreased sharply during 2014. Mort Steinbach, manager of the store, anticipates the need for a bank loan in 2015. Late in 2014, Steinbach instructs the store's accountant to record a \$2,000 sale of furniture to the Steinbach family, even though the goods will not be shipped from the manufacturer until January 2015. Steinbach also tells the accountant *not* to make the following December 31, 2014, adjusting entries:

Salaries owed to employees .....	\$900
Prepaid insurance that has expired .....	400

### Requirements

1. Compute the overall effects of these transactions on the store's reported income for 2014.
2. Why is Steinbach taking this action? Is his action ethical? Give your reason, identifying the parties helped and the parties harmed by Steinbach's action. (Challenge)
3. As a personal friend, what advice would you give the accountant? (Challenge)

### ● Fraud Case 3-1

XM, Ltd., was a small engineering firm that built hi-tech robotic devices for electronics manufacturers. One very complex device was partially completed at the end of 2014. Barb McLauren, head engineer and owner, knew the experimental technology was a failure and XM would not be able to complete the \$20,000,000 contract next year. However, she was getting ready to sell the company and retire in January. She told the controller that the device was 80% complete at year-end, and on track for successful completion the following spring; the controller accrued 80% of the contract revenue in December 2014. McLauren sold the company in January 2015 and retired. By mid-year, it became apparent that XM would not be able to complete the project successfully, and the new owner would never recoup his investment.



**Requirements**

1. For complex, hi-tech contracts, how does a company determine the percentage of completion and the amount of revenue to accrue?
2. What action do you think was taken by XM in 2015 with regard to the revenue that had been accrued the previous year?

## ● Financial Statement Case 3-1

**Amazon.com**—like all other businesses—makes adjusting entries prior to year-end in order to measure assets, liabilities, revenues, and expenses properly. Examine **Amazon's** balance sheet and Note 3. Pay particular attention to Accumulated depreciation.

**Requirements**

1. Open T-accounts for the following accounts with the balances shown on the annual reports at December 31, 2008 (amounts in millions, as in the **Amazon.com** financial statements):

Accumulated depreciation .....	\$ 555
Accounts payable .....	3,594
Other assets.....	720

2. Assume that during 2009 **Amazon.com** completed the following transactions (amounts in millions). Journalize each transaction (explanations are not required).
  - a. Recorded depreciation expense, \$70. (In order to simplify this exercise, the amount shown here is not the same as the actual amount disclosed in Note 3 of the annual report.)
  - b. Paid the December 31, 2008, balance of accounts payable.
  - c. Purchased inventory on account, \$5,605.
  - d. Purchased other assets for cash of \$754.
3. Post to the three T-accounts. Then the balance of each account should agree with the corresponding amount reported in **Amazon's** December 31, 2009, balance sheet. Check to make sure they do agree with **Amazon's** actual balances. You can find Accumulated depreciation in Note 3.

## ● Team Project 3-1

**It's Just Lunch** is a nationwide service company that arranges lunch dates for clients. **It's Just Lunch** collects cash up front for a package of dates. Suppose your group is opening an **It's Just Lunch** office in your area. You must make some important decisions—where to locate, how to advertise, and so on—and you must also make some accounting decisions. For example, what will be the end of your business's accounting year? How often will you need financial statements to evaluate operating performance and financial position? Will you use the cash basis or the accrual basis? When will you account for the revenue that the business earns? How will you account for the expenses?

**Requirements**

Write a report (or prepare an oral presentation, as directed by your professor) to address the following considerations:

1. Will you use the cash basis or the accrual basis of accounting? Give a complete explanation of your reasoning.
2. How often do you want financial statements? Why? Discuss how you will use each financial statement.
3. What kind of revenue will you earn? When will you record it as revenue?

4. Prepare a made-up income statement for **It's Just Lunch** for the year ended December 31, 2015. List all the business's expenses, starting with the most important (largest dollar amount) and working through to the least important (smallest dollar amount). Merely list the accounts. Dollar amounts are not required.

### ● Communication Activity 3-1

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In 25 words or fewer, explain adjusting journal entries.

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### Quick Check Answers

1. *b* 2. *b* 3. *c* 4. *c* 5. *a* 6. *a* 7. *c* 8. *c* 9. *b* 10. *d*

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