

Demonstration Problem

Riley Insurance Agency was organized on September 1, 2001. Assume that the accounts are closed and financial statements prepared each month. The company occupies rented office space but owns office equipment estimated to have a useful life of five years from date of acquisition, September 1. The trial balance for Riley Insurance Agency at November 30 is shown below.

RILEY INSURANCE AGENCY Trial Balance November 30, 2001			
Cash		\$ 6,565	
Accounts Receivable		17,050	
Office Supplies		500	
Office Equipment		18,000	
Accumulated Depreciation: Office Equipment			\$ 600
Accounts Payable			1,260
Pat Riley, Capital			35,000
Pat Riley, Drawing	2,500		
Commissions Earned			15,555
Advertising Expense		1,400	
Salaries Expense		2,600	
Rent Expense		3,800	
		<u>\$52,415</u>	<u>\$52,415</u>

Riley estimates that only about \$300 worth of office supplies remains on hand at November 30.

Instructions

- Prepare adjusting entries at November 30 to reflect the office supplies used in November and depreciation expense for the month.
- Prepare an *adjusted* trial balance at November 30, 2001.
- Prepare an income statement and statement of owner's equity for the month and a balance sheet in report form at November 30, 2001.

Solution to the Demonstration Problem

- Adjusting entries:

GENERAL JOURNAL				
Date	Account Titles and Explanation	Debit	Credit	
2001				
Nov. 30	Supplies Expense	200		
	Office Supplies			200
	To recognize cost of supplies used in November (\$500 - \$300 left).			
30	Depreciation Expense: Office Equipment	300		
	Accumulated Depreciation: Office Equipment			300
	To record depreciation for November (\$18,000 ÷ 60 months).			

b.

RILEY INSURANCE AGENCY Adjusted Trial Balance November 30, 2001		
Cash		\$ 6,565
Accounts Receivable	17,050	
Office Supplies	300	
Office Equipment	18,000	
Accumulated Depreciation: Office Equipment		\$ 900
Accounts Payable		1,260
Pat Riley, Capital		35,000
Pat Riley, Drawing	2,500	
Commissions Earned		15,555
Advertising Expense	1,400	
Salaries Expense	2,600	
Rent Expense	3,800	
Supplies Expense	200	
Depreciation Expense: Office Equipment	300	
	<u>\$52,715</u>	<u>\$52,715</u>

RILEY INSURANCE AGENCY Income Statement For the Month Ended November 30, 2001		
Revenue:		
Commissions Earned		\$15,555
Expenses:		
Advertising Expense	\$1,400	
Salaries Expense	2,600	
Rent Expense	3,800	
Supplies Expense	200	
Depreciation Expense: Office Equipment	300	<u>8,300</u>
Net income		<u>\$ 7,255</u>

RILEY INSURANCE AGENCY Statement of Owner's Equity For the Month Ended November 30, 2001		
Pat Riley, Capital, Oct. 31, 2001		\$35,000
Net income for the month		<u>7,255</u>
Subtotal		\$42,255
Less: Withdrawals by owner		<u>2,500</u>
Pat Riley, Capital, Nov. 31, 2001		<u>\$39,755</u>

RILEY INSURANCE AGENCY	
Balance Sheet	
November 30, 2001	
Assets	
Cash	\$ 6,565
Accounts Receivable	17,050
Office Supplies	300
Office Equipment	\$18,000
Less: Accumulated Depreciation	900
	<u>17,100</u>
Total assets	<u>\$41,015</u>
Liabilities & Owner's Equity	
Liabilities:	
Accounts Payable	\$ 1,260
Owner's equity:	
Pat Riley, Capital	39,755
Total liabilities & owner's equity	<u>\$41,015</u>

Self-Test Questions

Answers to these questions appear on page 140.

- According to the rules of debit and credit for balance sheet accounts:
 - Increases in asset, liability, and owner's equity accounts are recorded by debits.
 - Decreases in asset and liability accounts are recorded by credits.
 - Increases in asset and owner's equity accounts are recorded by debits.
 - Decreases in liability and owner's equity accounts are recorded by debits.
- Sunset Tours has a \$3,500 account receivable from the Del Mar Rotary. On January 20, the Rotary makes a partial payment of \$2,100 to Sunset Tours. The journal entry made on January 20 by Sunset Tours to record this transaction includes:
 - A debit to the Cash Received account of \$2,100.
 - A credit to the Accounts Receivable account of \$2,100.
 - A debit to the Cash account of \$1,400.
 - A debit to the Accounts Receivable account of \$1,400.
- Identify any of the following statements that correctly describe net income. (Indicate all correct answers.) Net income:
 - Is computed in the income statement, appears in the statement of owner's equity, and increases owner's equity in the balance sheet.
 - Is equal to revenue minus expenses.
 - Is computed in the income statement, appears in the statement of owner's equity, and increases the amount of cash shown in the balance sheet.
 - Can be determined using the account balances appearing in an adjusted trial balance.
- Which of the following are based on the realization principle and the matching principle? (Indicate all correct answers.)
 - Adjusting entries.
 - Closing entries.
 - The accrual basis of accounting.
 - The measurement of net income under generally accepted accounting principles.

EXERCISE 3.12

Prepare an Income Statement and a Statement of Owner's Equity

LO 6, 10, 11, 12

The following account balances, among others, appeared in the adjusted trial balance of Cortes Painting Contractors at December 31, 2001. Cortes closes its book annually at December 31.

Eduard Cortes, Capital		Salaries Expense	\$66,800
December 31, 2000	\$ 27,200	Rent Expense	9,600
Eduard Cortes, Drawing	18,000	Advertising Expense	3,200
Painting Fees Earned	163,300	Depreciation Expense:	
Paint & Supplies Expense	27,500	Painting Equipment	1,200
Accumulated Depreciation:		Insurance Expense	12,000
Painting Equipment	3,000	Painting Equipment	7,200

- From the above account balances, prepare first an income statement and then a statement of owner's equity for Cortes Painting Contractors for the year ended December 31, 2001. Include the proper headings on both financial statements. (*Hint:* You will not use all the accounts listed.)
- What is the estimated useful life of the painting equipment owned by Cortes Painting Contractors? How long has Cortes used this equipment as of December 31, 2001? Explain your answers.

EXERCISE 3.13

Preparing Closing Entries

LO 13

Prepare the year-end closing entries for Cortes Painting Contractors, using the data given in Exercise 3.12. Use four separate entries, as illustrated on pages 116–118. Indicate the balance in the owner's capital account that should appear in the balance sheet dated December 31, 2001.

EXERCISE 3.14

Annual Report, Fiscal Year

LO 1, 12

We have many assignments that are based on the annual report of Toys "R" Us (illustrated in Appendix A). Toys "R" Us uses an unusual fiscal year. If you look at the comparative income statements, you will see that each fiscal year ends on a different date.

- Explain this company's fiscal year policy (see the *Notes* accompanying the financial statements). Are these fiscal years—which all end on different dates—of equal lengths? If so how long are they?
- Why do you think companies such as Toys "R" Us choose to end their fiscal years a short period after December 31?

Problems

PROBLEM 3.1

Recording Transactions in a Journal

LO 3, 4, 5, 12

Louis Dixon, a dentist, resigned from his position with a large dental group in order to begin his own pediatric dental practice. The practice was organized as a sole proprietorship, called Louis Dixon Pediatric Dentistry. The business transactions during September while the new venture was being organized are listed below.

- Sept. 1 Dixon opened a bank account in the name of the business by depositing \$50,000 cash, which he had saved over a number of years.
- Sept. 10 Purchased a small office building located on a large lot for a total price of \$182,400, of which \$106,000 was applicable to the land and \$76,400 to the building. A cash payment of \$36,500 was made and a note payable was issued for the balance of the purchase price.

- Sept. 15 Purchased a microcomputer system from Computer Stores, Inc., for \$4,680 cash.
- Sept. 19 Purchased office furnishings, including dental equipment, from Turnkey Operations, Inc., at a cost of \$5,760. A cash down payment of \$960 was made, the balance to be paid in three equal installments due September 28, October 28, and November 28. The purchase was on open account and did not require signing of a promissory note.
- Sept. 26 A \$140 monitor in the microcomputer system purchased on September 15 stopped working. The monitor was returned to Computer Stores, Inc., which promised to refund the \$140 within five days.
- Sept. 28 Paid Turnkey Operations, Inc., \$1600 cash as the first installment due on the account payable for office furnishings.
- Sept. 30 Received \$140 cash from Computer Stores, Inc., in full settlement of the account receivable created on September 26.

Instructions

- a. Prepare journal entries to record the above transactions. Select the appropriate account titles from the following chart of accounts:

Cash	Office Furnishings
Accounts Receivable	Notes Payable
Land	Accounts Payable
Building	Louis Dixon, Capital
Computer System	

- b. What impact did the Sept. 10 transaction have on the financial position of the company? (Indicate direction and dollar effect of this transaction on the proprietorship's assets, liabilities, and owner's equity.)

✓ Lars Retton is the founder and owner of North Coast Gymnastics, a youth gymnastics training facility. A few of the company's business transactions occurring during July are described below:

- On July 2, collected cash of \$700 from accounts receivable.
- On July 7, purchased gymnastics equipment for \$2,175, paying \$500 in cash and charging the remainder on the company's 30-day account at Weider Fitness Co.
- On July 9, returned to Weider Fitness Co. \$200 of gymnastics equipment that was not needed. The return of this equipment reduced by \$200 the amount owed to Weider Fitness Co.
- On July 25, Retton made an additional investment in North Coast Gymnastics by depositing \$5,000 cash in the company bank account.
- On July 31, paid the remaining \$1,475 owed to Weider Fitness Co.

Instructions

- a. Prepare an analysis of each of the above transactions. The form of analysis to be used is as follows, using transaction 1 as an example.
- The asset Cash was increased. Increases in assets are recorded by debits. Debit Cash, \$700.
 - The asset Accounts Receivable was decreased. Decreases in assets are recorded by credits. Credit Accounts Receivable, \$700.
- b. Prepare journal entries, including explanations, for the above transactions.

City Flights provides transportation by helicopter between a major airport and various business centers of a large city. Among the ledger accounts used by the company are the following:

Cash	Passenger Fare Revenue
Accounts Payable	Advertising Expense
Aircraft	Fuel Expense
Accounts Receivable	Rent Expense
O. Wright, Capital	Repair & Maintenance Expense
O. Wright, Drawing	Salaries Expense

PROBLEM 3.2

Analyzing Transactions and Preparing Journal Entries

LO 3, 4, 5

PROBLEM 3.3

Journal Entries

LO 3, 4, 5, 6, 7, 8, 12

Some of the January transactions of City Flights are listed below.

- Jan. 3 Paid \$3,520 rent for hangar space during January.
- Jan. 4 Placed advertising in local newspapers for publication during January. The agreed price of \$860 was payable within 10 days after the end of the month.
- Jan. 15 Cash receipts from passengers for the first half of January amounted to \$23,160.
- Jan. 15 O. Wright, the owner, withdrew \$7,500 cash for personal use.
- Jan. 16 Paid salaries to employees for services rendered in first half of January, \$13,200.
- Jan. 25 Provided transportation for executives of the Hurley Corporation, a long-time credit customer. Sent bill for \$470, due within 30 days.
- Jan. 29 Received a bill from Western Oil Co. for fuel used in January, amounting to \$4,340 and payable by February 10.
- Jan. 31 Paid \$3,372 to Stevens Motors for repair and maintenance work during January.

Instructions

- a. Prepare a journal entry (including an explanation) for each of the above transactions.
- b. Describe the effect of the January 29 transaction involving fuel used in January on each of the following: assets, liabilities, owner's equity, and net income. For each of the four items, indicate whether the transaction caused an increase, decrease, or no effect.

PROBLEM 3.4

Analyzing Transactions and
Preparing Journal Entries

LQ 1, 3, 4, 6, 7, 8, 12

Garwood Marine is a boat repair yard. During August its transactions included the following:

1. On August 1, paid rent for the month of August, \$4,400.
2. On August 3, at request of Kiwi Insurance, Inc., made repairs on boat of Michael Fay. Sent bill for \$5,620 for services rendered to Kiwi Insurance, Inc. (Credit Repair Service Revenue.)
3. On August 9, made repairs to boat of Dennis Conner and collected in full the charge of \$2,830.
4. On August 14, placed advertisement in *Yachting World* to be published in issue of August 20 at cost of \$165, payment to be made within 30 days.
5. On August 25, received a check for \$5,620 from Kiwi Insurance, Inc., representing collection of the receivable of August 3.
6. On August 26, made repairs on the vessel *Independent* totaling \$1,890. Collected \$400 cash; balance due within 30 days.
7. On August 30, sent check to *Yachting World* in payment of the liability incurred on August 14.
8. On August 31, Barbara Garwood, owner of Garwood Marine, withdrew \$7,600 for personal use.

Instructions

- a. Write an analysis of each transaction. An example of the type of analysis desired is as follows:
 - i. a. Rent is an operating expense. Expenses are recorded by debits. Debit Rent Expense, \$4,400.
 - b. The asset Cash was decreased. Decreases in assets are recorded by credits. Credit Cash, \$4,400.
- b. Prepare a journal entry (including explanation) for each of the above transactions.
- c. Transactions 1, 7, and 8 all involve cash payments, yet only one of these transactions is recorded as an expense. Describe three situations in which a cash payment would *not* involve recognition of an expense.

PROBLEM 3.5

Preparing Journal Entries, Posting,
and Preparing a Trial Balance

LQ 2, 3, 4, 5, 6, 10, 12



In June 2001, Pat Campbell organized a corporation to provide crop dusting services. The company, called Campbell Crop Dusting, began operations immediately. Transactions during the month of June were as follows:

- June 1 Campbell deposited \$60,000 cash in a bank account in the name of the business.
- June 2 Purchased a crop-dusting aircraft from Utility Aircraft for \$220,000. Made a \$40,000 cash down payment and issued a note payable for \$180,000.
- June 4 Paid Woodrow Airport \$2,500 to rent office and hangar space for the month.
- June 15 Billed customers \$8,320 for crop-dusting services rendered during the first half of June.
- June 15 Paid \$5,880 salaries to employees for services rendered during the first half of June.
- June 18 Paid Hannigan's Hangar \$1,890 for maintenance and repair services.
- June 25 Collected \$4,910 of the amounts billed to customers on June 15.
- June 30 Billed customers \$16,450 for crop-dusting services rendered during the second half of the month.

- June 30 Paid \$6,000 in salaries to employees for services rendered during the second half of June.
 June 30 Received a fuel bill from Henry's Feed & Fuel for \$2,510 of aircraft fuel purchased during June. This amount is due by July 10.
 June 30 Campbell withdrew \$2,000 cash from the business for personal use.

The account titles used by Campbell Crop Dusting were:

Cash	Pat Campbell, Drawing
Accounts Receivable	Crop-Dusting Revenue
Aircraft	Maintenance Expense
Notes Payable	Fuel Expense
Accounts Payable	Salaries Expense
Pat Campbell, Capital	Rent Expense

Instructions

Based on the foregoing transactions:

- Prepare journal entries.
- Post to ledger accounts.
- Prepare a trial balance at June 30, 2001.
- Using the trial balance at June 30, 2001 (part c), compute each of the following at June 30, 2001: total assets, total liabilities, total owner's equity. Are these amounts the figures that would be reported for assets, liabilities, and owner's equity in the balance sheet at June 30, 2001? Explain your answer briefly.

Environmental Solutions prepares financial statements and closes its accounts at the end of each calendar year. The following *adjusted* trial balance was prepared at December 31, 2001.

PROBLEM 3.6

Adjusted Trial Balance, Part I—
Preparing Financial Statements

LO 6, 7, 9, 10, 11

ENVIRONMENTAL SOLUTIONS Adjusted Trial Balance December 31, 2001	
Cash	\$ 42,750
Notes Receivable	12,740
Accounts Receivable	65,090
Supplies	5,300
Land	196,000
Building	126,000
Accumulated Depreciation: Building	\$ 33,600
Office Equipment	33,600
Accumulated Depreciation: Office Equipment	13,440
Notes Payable	112,000
Accounts Payable	22,680
Frank L. Adams, Capital, December 31, 2000	230,300
Frank L. Adams, Drawing	70,000
Consulting Fees Earned	487,200
Advertising Expense	31,500
Insurance Expense	38,720
Utilities Expense	15,040
Salaries Expense	245,280
Supplies Expense	9,640
Depreciation Expense: Building	4,200
Depreciation Expense: Office Equipment	3,360
	<u>\$899,220</u>
	<u>\$899,220</u>

CHAPTER 3 The Accounting Cycle: Capturing Economic Events

Instructions

- Prepare an income statement and a statement of owner's equity for the year ended December 31, 2001.
- Prepare a balance sheet (in report form) as of December 31, 2001.
- What was the estimated useful life used by Environmental Solutions in setting the depreciation rate for the building? Approximately how long has Environmental Solutions been using the building in its operations? Show computation.
- Adams's 15-year-old son Ansel is trying to understand what the net income of the business represents. He feels that net income less withdrawals by the owner should be available as cash. He compares Environmental Solutions' 2001 net income, less withdrawals by owner, to the cash reported in the balance sheet and asks what happened to the rest of the net income.

Explain the concept of net income to Ansel Adams, including in your answer an explanation of where the undistributed net income from 2001 (and prior years) "ended up."

PROBLEM 3.7

Adjusted Trial Balance, Part II—
Preparing Closing Entries

LO 13



PROBLEM 3.8

Preparing Financial Statements
from an Adjusted Trial Balance

LO 7, 9, 10, 11, 12

Using the data shown in the adjusted trial balance in Problem 3.6:

- Prepare journal entries to close the accounts. Use four entries: (1) to close the revenue account, (2) to close the expense accounts, (3) to close the Income Summary account, and (4) to close the owner's drawing account.
- Does the amount of net income or net loss appear in the closing entries? Explain fully.

NP Enterprises operates several miniature golf courses, all of which are located on rented land within city parks. Shown below is the company's *adjusted* trial balance at December 31, 2001. The company closes its accounts at the end of each calendar year.

NP ENTERPRISES Adjusted Trial Balance December 31, 2001	
Cash	\$ 41,100
Accounts Receivable	7,800
Buildings	180,000
Accumulated Depreciation: Buildings	\$ 36,000
Golf Course Structures	270,000
Accumulated Depreciation: Golf Course Structures	90,000
Accounts Payable	23,100
Salaries Payable	6,900
Nick Palmer, Capital (December 31, 2000)	331,560
Nick Palmer, Drawing	75,000
Admission: Revenue	576,000
Advertising Expense	45,000
Rent Expense	108,000
Repairs Expense	15,600
Salaries Expense	237,000
Light & Power Expense	13,500
Depreciation Expense: Buildings	18,000
Depreciation Expense: Golf Course Structures	45,000
Insurance Expense	7,560
	<u>\$1,063,560</u> <u>\$1,063,560</u>

Instructions

- Prepare an income statement and a statement of owner's equity for the year ended December 31, 2001.

- Prepare a balance sheet (in report form) as of December 31, 2001.
- Is 2001 the first year of operations for NP Enterprises? Support your answer.
- Assume that Nick Palmer invested \$300,000 to start NP Enterprises. Does the difference between the owner's capital at December 31, 2001, and this \$300,000 initial investment equal the amount of profits generated by the business since inception? Explain briefly.

Using the adjusted trial balance presented in Problem 3.8:

- Prepare journal entries to close the accounts. Use four entries: (1) to close the revenue account, (2) to close the expense accounts, (3) to close the Income Summary account, and (4) to close the owner's drawing account.
- Assume that in the following year NP Enterprises again had \$576,000 of admissions revenue, but that expenses increased to \$600,000. Assuming that the revenue account and all the expense accounts had been closed into the Income Summary account at December 31, prepare a journal entry to close the Income Summary account.

During the absence of the regular accountant of Vanderpool Consulting, a new employee, Doug Webb, prepared the closing entries from the ledger accounts for the year 2001. Webb has very little understanding of accounting, and the closing entries he prepared were not satisfactory in several respects. The entries by Webb were:

Entry 1

Professional Fees Earned	273,600	
Accumulated Depreciation: Building	25,600	
Accounts Payable	86,400	
Salaries Payable	9,200	
Income Summary		394,800
To close accounts with credit balances.		

Entry 2

Income Summary	160,800	
Salaries Expense		96,400
Al Vanderpool, Drawing		36,000
Advertising Expense		12,800
Depreciation Expense: Building		6,400
Insurance Expense		9,200
To close accounts with debit balances.		

Entry 3

Al Vanderpool, Capital	234,000	
Income Summary		234,000
To close the owner's capital account.		

Instructions

- For each entry, identify any errors that Webb made.
- Prepare four correct closing entries, following the pattern illustrated on pages (116–118).
- Using the information presented above (and considering your answers to parts a and b), compute net income or net loss of Vanderpool Consulting for the year 2001. Show computation.

The operations of Hempstead Realty consist of obtaining listings of houses being offered for sale by owners, advertising these houses, and showing them to prospective buyers. The company earns revenue in the form of commissions. The building and office equipment used in the business were acquired on January 1 of the current year and were immediately placed in use. Useful life of the building was estimated to be 30 years and that of the office equipment five years. The company closes its accounts monthly; on March 31 of the current year, the trial balance is as follows:

PROBLEM 3.9

Preparing Closing Entries from an Adjusted Trial Balance

LO 13

PROBLEM 3.10

Preparing Closing Entries

LO 13



PROBLEM 3.11

End-of-Period Adjusting and Closing Procedures; Preparing Financial Statements

LO 6, 7, 9, 10, 11, 12, 13

CHAPTER 3 The Accounting Cycle: Capturing Economic Events

NEMPSTEAD REALTY			
Trial Balance			
March 31, 2001			
Cash	\$	9,750	
Accounts Receivable		7,500	
Office Supplies		850	
Land		30,000	
Building		90,000	
Accumulated Depreciation: Building	\$		500
Office Equipment		21,000	
Accumulated Depreciation: Office Equipment			700
Accounts Payable			14,750
M. Valentino, Capital			136,650
M. Valentino, Drawing		4,500	
Commissions Earned			20,000
Advertising Expense		900	
Automobile Rental Expense		500	
Salaries Expense		7,000	
Telephone Expense		600	
		<u>\$172,600</u>	<u>\$172,600</u>

Instructions

From the trial balance and supplementary data given, prepare the following as of March 31, 2001:

- a. Adjusting entries for depreciation during March of building and of office equipment.
- b. Adjusting entry to recognize as expense the cost of office supplies used in March. At the end of March, the supplies on hand are estimated to have a cost of \$500.
- c. Adjusted trial balance.
- d. Income statement and a statement of owner's equity for the month of March, and a balance sheet at March 31 in report form. Assume no additional investments by owner during March.
- e. Closing entries.
- f. After-closing trial balance.