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Exercise 2-1B *Effect of collecting accounts receivable on the accounting equation and financial statements*

Burke Company earned $12,000 of service revenue on account during Year 1. The company collected $9,800 cash from accounts receivable during Year 1.

Required

Based on this information alone, determine the following for Burke Company. (*Hint:* Record the events in general ledger accounts under an accounting equation before satisfying the requirements.)

a. The balance of the accounts receivable that would be reported on the December 31, Year 1, balance sheet.
b. The amount of net income that would be reported on the Year 1 income statement.
c. The amount of net cash flow from operating activities that would be reported on the Year 1 statement of cash flows.
d. The amount of retained earnings that would be reported on the Year 1 balance sheet.
e. Why are the answers to Requirements *b* and *c* different?

EXERCISE 2-1B Solution

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Burke Company
Effect of Events on the Year 1 Accounting Equation

	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	+	Accounts Rec.	=		+	Common Stock	+	Retained Earnings
Earned Revenue		+	12,000	=		+		+	12,000
Coll. Acct. Rec.	9,800	+	(9,800)	=		+		+	
Ending Balance	9,800	+	2,200	=	-0-	+	-0-	+	12,000

a. Accounts Receivable: $12,000 – $9,800 = $2,200

b. $12,000

c. $9,800 cash collected from accounts receivable.

d. $12,000

e. $12,000 of revenue was earned but only $9,800 of it was collected.

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Exercise 2-2B *Effect of accrued expenses on the accounting equation and financial statements*

During Year 1, Crest Corporation earned $5,000 of cash revenue and accrued $3,000 of salaries expense.

Required

(*Hint:* Record the events in general ledger accounts under an accounting equation before satisfying the requirements.) Based on this information alone:

a. Prepare the December 31, Year 1, balance sheet.
b. Determine the amount of net income that Crest would report on the Year 1 income statement.
c. Determine the amount of net cash flow from operating activities that Crest would report on the Year 1 statement of cash flows.
d. Why are the answers to Requirements *b* and *c* different?

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EXERCISE 2-2B Solution

a.

Crest Corporation Accounting Equation – Year 1							
Event	Assets	=	Liabilities	+	Stockholders' Equity		
	Cash	=	Salaries Payable	+	Common Stock	+	Retained Earnings
Earned Rev.	5,000						5,000
Accrued Sal.			(3,000)				(3,000)

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EXERCISE 2-2B a. (sol. cont. on next page)

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EXERCISE 2-2B a. (sol. cont.)

Crest Corporation Balance Sheet As of December 31, Year 1		
Assets		
Cash	$5,000	
Total Assets		$5,000
Liabilities		
Salaries Payable	$3,000	
Total Liabilities		$3,000
Stockholders' Equity		
Retained Earnings	$2,000	
Total Stockholders' Equity		2,000
Total Liab. and Stockholders' Equity		$5,000

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b.

Computation of Net Income	
Revenue	$5,000
Less: Expenses	(3,000)
Net Income	$2,000

EXERCISE 2-2B (cont. on next page)

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EXERCISE 2-2B (cont.)

c.

Cash Flow from Operating Activities	
Cash from Revenue	**$5,000**
Net Cash Flow from Operating Act.	**$5,000**

d. **The salary expense is deducted from revenue in computing net income, but it has not been paid. This creates a difference of $3,000. The revenue is the same because it has been earned and collected.**

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Exercise 2-3B *Effect of accruals on the financial statements*

Coates Inc. experienced the following events in Year 1, in its first year of operation:

1. Received $20,000 cash from the issue of common stock.
2. Performed services on account for $38,000.
3. Paid the utility expense of $2,500.
4. Collected $21,000 of the accounts receivable.
5. Recorded $15,000 of accrued salaries at the end of the year.
6. Paid a $2,000 cash dividend to the shareholders.

Required

a. Record the events in general ledger accounts under an accounting equation. In the last column of the table, provide appropriate account titles for the Retained Earnings amounts. The first transaction has been recorded as an example.

COATES INC.
Accounting Equation

	Assets		=	Liabilities	+	Stockholders' Equity		Acct. Titles for Ret. Earn.
Event	Cash	Accounts Receivable		Salaries Payable		Common Stock	Retained Earnings	
1.	20,000					20,000		

b. Prepare the income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows for the Year 1 accounting period.

c. Why is the amount of net income different from the amount of net cash flow from operating activities?

EXERCISE 2-3B (solution on next page)

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EXERCISE 2-3B SOLUTION

a.

Coates, Inc.
General Ledger Accounts for the Year Ended December 31, Year 1

	Assets		=	Liabilities	+	Stockholders' Equity		
Event	Cash	Accts. Rec.	=	Salaries Pay.	+	Common Stock	Retained Earnings	Acct. Title for RE
1.	20,000					20,000		
2.		38,000					38,000	Revenue
3.	(2,500)						(2,500)	Util. Exp.
4.	21,000	(21,000)						
5.				15,000			(15,000)	Sal. Exp.
6.	(2,000)						(2,000)	Dividends
Totals	36,500	17,000	=	15,000	+	20,000	18,500	

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b.

Coates, Inc.
Income Statement
For the Year Ended December 31, Year 1

Revenue		$38,000
Expenses		
Utilities Expense	$ 2,500	
Salaries Expense	15,000	
Total Expenses		(17,500)
Net Income		$20,500

EXERCISE 2-3B b. (cont. on next page)

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EXERCISE 2-3B b. (cont.)

Coates, Inc. Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 1		
Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	20,000	
Ending Common Stock		$20,000
Beginning Retained Earnings	$ -0-	
Plus: Net Income	20,500	
Less: Dividends	(2,000)	
Ending Retained Earnings		18,500
Total Stockholders' Equity		$38,500

Coates, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$36,500	
Accounts Receivable	17,000	
Total Assets		$53,500
Liabilities		
Salaries Payable	$15,000	
Total Liabilities		$15,000
Stockholders' Equity		
Common Stock	$20,000	
Retained Earnings	18,500	
Total Stockholders' Equity		38,500
Total Liab. and Stockholders' Equity		$53,500

EXERCISE 2-3B b. (sol. cont on next page.)

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EXERCISE 2-3B b. (sol. cont.)

Coates, Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flow From Operating Activities		
Cash Receipts from Customers	$21,000	
Cash Paid for Expenses	(2,500)	
Net Cash Flow from Operating Act.		$18,500
Cash Flow From Investing Activities		-0-
Cash Flow From Financing Activities		
Issue of Stock	$20,000	
Paid Dividends	(2,000)	
Net Cash Flow from Financing Act.		18,000
Net Change in Cash		36,500
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$36,500

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c. Net income is based on income earned of $38,000 and expenses incurred of $17,500 for a net income of $20,500. Net cash flow from operating activities is based on cash collected from revenue, $21,000 and expenses paid, $2,500, for a net cash flow from operating activities of $18,500. The difference of $2,000 is reflected in the Accounts Receivable account ($17,000), revenues accrued but not yet collected, and the Salaries Payable account ($15,000), expenses incurred but not paid.

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Exercise 2-4B *Effect of accounts receivable and accounts payable transactions on financial statements*

The following events apply to Brown and Birgin, a public accounting firm, for the Year 3 accounting period:

1. Performed $96,000 of services for clients on account.
2. Performed $65,000 of services for cash.
3. Incurred $45,000 of other operating expenses on account.
4. Paid $26,000 cash to an employee for salary.
5. Collected $70,000 cash from accounts receivable.
6. Paid $38,000 cash on accounts payable.
7. Paid a $10,000 cash dividend to the stockholders.
8. Accrued salaries were $3,000 at the end of Year 3.

Required

a. Show the effects of the events on the financial statements using a horizontal statements model like the following one. In the Cash Flow column, use OA to designate operating activity, IA for investment activity, FA for financing activity, and NC for net change in cash. Use NA to indicate the element is not affected by the event. The first event is recorded as an example.

Event	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets			=	Liabilities			+	Stk. Equity						
No.	Cash	+	Accts. Rec.	=	Accts. Pay.	+	Sal. Pay	+	Ret. Earn.	Rev.	−	Exp.	=	Net Inc.	Cash Flow
1	NA	+	96,000	=	NA	+	NA	+	96,000	96,000	−	NA	=	96,000	NA

b. What is the amount of total assets at the end of Year 3?

c. What is the balance of accounts receivable at the end of Year 3?

d. What is the balance of accounts payable at the end of Year 3?

e. What is the difference between accounts receivable and accounts payable?

f. What is net income for Year 3?

g. What is the amount of net cash flow from operating activities for Year 3?

EXERCISE 2-4B (Sol. on next page)

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EXERCISE 2-4B SOLUTION

a.

Brown and Birgin
Horizontal Statements Model
Year 3

Event No.	Balance Sheet: Assets: Cash	+	Assets: Accts. Rec.	=	Liabilities: Acct. Payable	+	Liabilities: Sal. Pay.	+	Stk. Equity: Retained Earnings	Income Statement: Rev.	–	Exp.	=	Net Inc.	Statement of Cash Flows	
1.	NA		96,000		NA		NA		96,000	96,000		NA		96,000	NA	
2.	65,000		NA		NA		NA		65,000	65,000		NA		65,000	65,000	OA
3.	NA		NA		45,000		NA		(45,000)	NA		45,000		(45,000)	NA	
4.	(26,000)		NA		NA		NA		(26,000)	NA		26,000		(26,000)	(26,000)	OA
5.	70,000		(70,000)		NA		NA		NA	NA		NA		NA	70,000	OA
6.	(38,000)		NA		(38,000)		NA		NA	NA		NA		NA	(38,000)	OA
7.	(10,000)		NA		NA		NA		(10,000)	NA		NA		NA	(10,000)	FA
8.	NA		NA		NA		3,000		(3,000)	NA		3,000		(3,000)	NA	
Totals	61,000	+	26,000	=	7,000	+	3,000	+	77,000	161,000	–	74,000	=	87,000	61,000	NC

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EXERCISE 2-4B (Solution cont.)

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EXERCISE 2-4B (Solution cont.)

b. Total assets: $87,000 ($61,000 + $26,000)
c. $26,000
d. $7,000
e. Accounts Receivable (an asset) is an amount owed to Brown and Birgin: $26,000; Accounts Payable (a liability) is an amount that Brown and Birgin owes: $7,000.
f. $87,000
g. $71,000 ($65,000 – $26,000 + $70,000 – $38,000)

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Exercise 2-5B *Missing information related to accruals*

Panoramic Inc. had a beginning balance of $2,000 in its Accounts Receivable account. The ending balance of Accounts Receivable was $2,400. During the period, Panoramic recognized $40,000 of revenue on account. Panoramic's Salaries Payable account has a beginning balance of $1,300 and an ending balance of $900. During the period, the company recognized $35,000 of accrued salaries expense.

Required

a. Based on the information provided, determine the amount of net income.

b. Based on the information provided, determine the amount of net cash flow from operating activities.

EXERCISE 2-5B SOLUTION

a.

Computation of Net Income	
Revenue	$77,000
Less: Expenses	(51,000)
Net Income	$26,000

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b.

Cash Flow from Operating Activities	
Cash from Revenue	$55,000
Cash paid for expenses	(49,000)
Net Cash Flow from Operating Act.	$ 6,000

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Exercise 2-6B *Effect of accruals on the financial statements*

Valmont Inc. experienced the following events in Year 1, its first year of operation:

1. Received $50,000 cash from the issue of common stock.
2. Performed services on account for $67,000.
3. Paid a $5,000 cash dividend to the stockholders.
4. Collected $45,000 of the accounts receivable.
5. Paid $49,000 cash for other operating expenses.
6. Performed services for $10,000 cash.
7. Recognized $2,000 of accrued utilities expense at the end of the year.

Required

a. Identify the events that result in revenue or expense recognition.
b. Based on your response to Requirement *a*, determine the amount of net income reported on the Year 1 income statement.
c. Identify the events that affect the statement of cash flows.
d. Based on your response to Requirement *c*, determine the amount of cash flow from operating activities reported on the Year 1 statement of cash flows.
e. What is the before- and after-closing balance in the service revenue account? What other accounts would be closed at the end of the accounting cycle?
f. What is the balance of the retained earnings account that appears on the Year 1 balance sheet?

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EXERCISE 2-6B SOLUTION

a. & c.

Event	Revenue	Expense	Statement of Cash Flows
1.	NA	NA	$50,000 FA
2.	$67,000	NA	NA
3.	NA	NA	(5,000) FA
4.	NA	NA	45,000 OA
5.	NA	$49,000	(49,000) OA
6.	10,000	NA	10,000 OA
7.	NA	2,000	NA

EXERCISE 2-6B (Sol. cont.)

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EXERCISE 2-6B (Sol. Cont.)

b.

Computation of Net Income	
Revenue	$77,000
Less: Expenses	(51,000)
Net Income	$26,000

d.

Cash Flow from Operating Activities	
Cash from Revenue	$55,000
Cash paid for expenses	(49,000)
Net Cash Flow from Operating Act.	$ 6,000

e. The before-closing balance in the Revenue account is $77,000. After it is closed to Retained Earnings the balance will be zero. Other accounts that would be closed are expenses and dividends.

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f. The balance of Retained Earnings on the Year 1 Balance Sheet will be the amount of Net Income: $26,000, less $5,000 of dividends paid since there is no beginning balance in Retained Earnings.

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Exercise 2-7B *Net income versus changes in cash*

In Year 1, Zoe Inc. billed its customers $105,000 for services performed. The company collected $65,000 of the amount billed. Zoe incurred $40,000 of other operating expenses on account. Zoe paid $35,000 of the accounts payable. Zoe acquired $50,000 cash from the issue of common stock. The company invested $25,000 cash in the purchase of land.

Required

(*Hint:* Identify the six events described in the paragraph and record them in general ledger accounts under an accounting equation before attempting to answer the questions.) Use the preceding information to answer the following questions:

a. What amount of revenue will Zoe report on the Year 1 income statement?
b. What amount of cash flow from revenue will Zoe report on the statement of cash flows?
c. What is the net income for the period?
d. What is the net cash flow from operating activities for the period?
e. Why is the amount of net income different from the net cash flow from operating activities for the period?
f. What is the amount of net cash flow from investing activities?
g. What is the amount of net cash flow from financing activities?
h. What amounts of total assets, liabilities, and equity will Zoe report on the year-end balance sheet?

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EXERCISE 2-7B SOLUTION

Zoe, Inc.
Effect of Events on the General Ledger Accounts

	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	Accounts Receivable	Land	=	Accounts Payable	+	Com. Stock	+	Retained Earnings
1. Sales on Account		105,000							105,000
2.Coll.Accts. Rec.	65,000	(65,000)							
3. Incurred Expense					40,000				(40,000)
4. Pd. Acc. Pay.	(35,000)				(35,000)				
5. Issue of Stock	50,000						50,000		
6. Purchase Land	(25,000)		25,000						
Totals	55,000	40,000	25,000	=	5,000	+	50,000	+	65,000

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EXERCISE 2-7B (sol. cont.)

a. Revenue recognized, $105,000.

b. Cash flow from revenue, $65,000.

c. Revenue, $105,000, less operating expenses, $40,000 = $65,000 net income.

d. Accounts receivable collected, $65,000, less cash paid for expenses, $35,000 = $30,000 cash flow from operating activities.

e. Income of $105,000 was earned, but only $65,000 was collected (a difference of $40,000); operating expenses incurred were $40,000 but only $35,000 was paid during the period (a difference of $5,000). Consequently, net income is $35,000 more than cash flow from operating activities.

f. $25,000 cash outflow for the purchase of land.

g. $50,000 cash inflow from the issue of common stock.

h.

Total assets	=	$120,000 ($55,000 + $40,000 + $25,000)
Total liabilities	=	$5,000
Total equity	=	$115,000 ($50,000 + $65,000)

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Exercise 2-8B *Supplies and the financial statements model*

Copy Express Inc. began the Year 3 accounting period with $9,000 cash, $5,000 of common stock, and $4,000 of retained earnings. Copy Express was affected by the following accounting events during Year 3:

1. Purchased $9,500 of supplies on account.
2. Earned and collected $32,500 of cash revenue.
3. Paid $7,200 cash on accounts payable.
4. Adjusted the records to reflect the use of supplies. A physical count indicated that $1,700 of supplies was still on hand on December 31, Year 3.

Required

a. Show the effects of the events on the financial statements using a horizontal statements model like the following one. In the Cash Flows column, use OA to designate operating activity, IA for investing activity, FA for financing activity, and NC for net change in cash. Use NA to indicate accounts not affected by the event. The beginning balances are entered in the following example:

Event No.	Balance Sheet										Income Statement					Statement of Cash Flows
	Assets			=	Liab.	+	Stk. Equity									
	Cash	+	Supplies	=	Accts. Pay.	+	Com. Stk.	+	Ret. Earn.		Rev.	−	Exp.	=	Net Inc.	Cash Flows
Beg. bal.	9,000	+	0	=	0	+	5,000	+	4,000		0	−	0	=	0	0

b. Explain the difference between the amount of net income and amount of net cash flow from operating activities.

EXERCISE 2-8B (solution on next page)

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EXERCISE 2-8B SOLUTION

a.

Copy Express
Effect of Events on Financial Statements for Year 3

	Assets			=	Liab.	+	Stockholders' Equity			Income Statement					
Event No.	Cash	+	Supplies	=	Accts. Pay.	+	Com. Stock	+	Retained Earnings	Rev.	–	Exp.	=	Net Income	Cash Flows
Beg. Bal.	9,000	+	-0-	=	-0-	+	5,000	+	4,000	-0-	–	-0-	=	-0-	-0-
1.	NA	+	9,500	=	9,500	+	NA	+	NA	NA	–	NA	=	NA	NA
2.	32,500	+	NA	=	NA	+	NA	+	32,500	32,500	–	NA	=	32,500	32,500 OA
3.	(7,200)	+	NA	=	(7,200)	+	NA	+	NA	NA	–	NA	=	NA	(7,200) OA
4.	NA	+	(7,800)	=	NA	+	NA	+	(7,800)	NA	–	7,800	=	(7,800)	NA
Totals	34,300	+	1,700	=	2,300	+	5,000	+	28,700	32,500	–	7,800	=	24,700	25,300 NC

b. The difference in net income and cash flow from operating activities of $600 ($24,700 – $25,300) is attributed to recognizing supplies expense of $7,800 in the income statement, whereas the cash payment on accounts payable (for supplies) was $7,200.

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Exercise 2-9B *Supplies on financial statements*

Accounting Professionals Inc. experienced the following events in Year 1, its first year of operation:

1. Performed services for $20,000 cash.
2. Purchased $4,000 of supplies on account.
3. A physical count on December 31, Year 1, found that there was $1,000 of supplies on hand.

Required

Based on this information alone:

a. Record the events under an accounting equation.
b. Prepare an income statement, balance sheet, and statement of cash flows for the Year 1 accounting period.
c. What is the balance in the Supplies account as of January 1, Year 2?
d. What is the balance in the Supplies Expense account as of January 1, Year 2?

EXERCISE 2-9B SOLUTION

a.

Accounting Professionals, Inc.
Effect of Events on the Accounting Equation

	Assets		=	Liab.	+	Stk. Equity
Event	Cash	Supplies	=	Accounts Payable		Retained Earnings
1. Provided Service	20,000					20,000
2. Purchased Supplies		4,000		4,000		
3. Used Supplies		(3,000)				(3,000)
Totals	20,000	1,000	=	4,000		17,000

EXERCISE 2-9B (Sol. cont.)

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EXERCISE 2-9B (Sol. cont.)

b.

Accounting Professionals, Inc. Income Statement For the Year Ended December 31, Year 1	
Revenue	$20,000
Expense	(3,000)
Net Income	$17,000

Accounting Professionals, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$20,000	
Supplies	1,000	
Total Assets		$21,000
Liabilities		
Accounts Payable	$ 4,000	
Total Liabilities		$ 4,000
Stockholders' Equity		
Retained Earnings	$17,000	
Total Stockholders' Equity		17,000
Total Liab. and Stockholders' Equity		$21,000

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EXERCISE 2-9B b. (cont.)

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EXERCISE 2-9B b. (cont.)

Accounting Professionals, Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$20,000	
Net Cash Flow from Operating Activities		$20,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		20,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$20,000

c. The balance of the Supplies account on January 1, Year 2 is $1,000, the same as the December 31, Year 1 balance.

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d. The balance of the Supplies Expense account on January 1, Year 2 is zero because the expense account was closed to Retained Earnings at December 31, Year 1.

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Exercise 2-10B *Asset versus expense*

A cost can either be an asset or an expense.

Required

For each cost listed below, list if it would be treated as an asset or an expense:

1. Purchase of land.
2. Payment of monthly utilities in administrative offices.
3. Supplies used in administrative offices.
4. Purchase of equipment.
5. Purchase of supplies for future use.

EXERCISE 2-10B

Purchase of land	**Asset**
Payment of monthly utilities in administrative offices	**Expense**
Supplies used in administrative offices.	**Expense**
Purchase of equipment	**Expense**
Purchase of supplies for future use	**Asset**
Purchase of land	**Asset**

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Exercise 2-11B *Prepaid items on financial statements*

Therapy Inc. experienced the following events in Year 1, its first year of operation:

1. Performed counseling services for $18,000 cash.
2. On February 1, Year 1, paid $12,000 cash to rent office space for the coming year.
3. Adjusted the accounts to reflect the amount of rent used during the year.

Required

Based on this information alone:

a. Record the events under an accounting equation.
b. Prepare an income statement, balance sheet, and statement of cash flows for the Year 1 accounting period.
c. Ignoring all other future events, what is the amount of rent expense that would be recognized in Year 2?

EXERCISE 2-11B

a.

Therapy, Inc.
Effect of Events on the Accounting Equation

	Assets		=	Stockholders' Equity
Event	**Cash**	**Prepaid Rent**	**=**	**Retained Earnings**
1. Performed Services	18,000			18,000
2. Prepaid Rent	(12,000)	12,000		
3. Used Rent		(11,000)*		(11,000)
Totals	6,000	1,000	=	7,000

*$12,000 x 11/12 = $11,000

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EXERCISE 2-11B (Sol. cont.)

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EXERCISE 2-11B (Sol. cont.)

b.

Therapy, Inc. Income Statement For the Year Ended December 31, Year 1	
Revenue	$18,000
Expense	(11,000)
Net Income	$ 7,000

Therapy, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$6,000	
Prepaid Rent	1,000	
Total Assets		$7,000
Liabilities		$ -0-
Stockholders' Equity		
Retained Earnings	$7,000	
Total Stockholders' Equity		7,000
Total Liab. and Stockholders' Equity		$7,000

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EXERCISE 2-11B b. (cont.)

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EXERCISE 2-11B b. (cont.)

Therapy, Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$18,000	
Cash Payment for Rent	(12,000)	
Net Cash Flow from Operating Activities		$6,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		6,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$6,000

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c. The balance of the Prepaid Rent will be expensed in Year 2, $1,000 ($12,000 - $11,000).

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Exercise 2-12B *Effect of an error on financial statements*

On June 1, Year 3, Cole Corporation paid $8,400 to purchase a 24-month insurance policy. Assume that Cole records the purchase as an asset and that the books are closed on December 31.

Required

a. Show the purchase of the insurance policy and the related adjusting entry to recognize insurance expense in the accounting equation.

b. Assume that Cole Corporation failed to record the adjusting entry to reflect the expiration of insurance. How would the error affect the company's Year 3 income statement and balance sheet?

EXERCISE 2-12B SOLUTION

a.

Cole Corporation
Accounting Equation Year 3

	Assets		=	Stockholders' Equity		
Event	Cash	Prepaid Insurance	=	Com. Stock	+	Retained Earnings
Pur. Insurance	(8,400)	8,400				
Adj. Ins Exp.		(2,450)*				(2,450)
Totals	(8,400)	5,950	=	-0-	+	(2,450)

*$8,400 x 7/24 = $2,450

b. The required entry would decrease assets by $2,450 [($8,400 ÷ 24) x 7] and decrease stockholders' equity by $2,450 (retained earnings). If this entry is not made, assets and stockholders' equity would both be overstated on the balance sheet by $2,450. On the income statement, expenses would be understated causing net income to be overstated by $2,450.

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Exercise 2-13B *Unearned items on financial statements*

Interior Design Consultants (IDC) experienced the following events in Year 1, its first year of operation:

1. On October 1, Year 1, IDC collected $24,000 for consulting services it agreed to provide during the coming year.
2. Adjusted the accounts to reflect the amount of consulting service revenue recognized in Year 1.

Required

Based on this information alone:

a. Record the events under an accounting equation.
b. Prepare an income statement, balance sheet, and statement of cash flows for the Year 1 accounting period.
c. Ignoring all other future events, what is the amount of service revenue that would be recognized in Year 2?

EXERCISE 2-13B SOLUTION

a.

Interior Design Consultants Accounting Equation Year 1					
Event	Assets	=	Liabilities	+	Stockholders' Equity
	Cash	=	Unearned Revenue	+	Retained Earnings
Coll. Unearned rev	24,000		24,000		
Recog. revenue earned			(6,000)*		6,000
	24,000	=	18,000		6,000

*$24,000 x 3/12 = $6,000

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EXERCISE 2-13B (Sol. cont.)

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EXERCISE 2-13B (Sol. cont.)

b.

Interior Design Consultants Income Statement For the Year Ended December 31, Year 1	
Revenue	$6,000
Expense	-0-
Net Income	$6,000

Interior Design Consultants Balance Sheet As of December 31, Year 1		
Assets		
Cash	$24,000	
Total Assets		$24,000
Liabilities		-0-
Unearned Revenue	$18,000	
Total Liabilities		$18,000
Stockholders' Equity		
Retained Earnings	$ 6,000	
Total Stockholders' Equity		6,000
Total Liab. and Stockholders' Equity		$24,000

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EXERCISE 2-13B b. (cont.)

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EXERCISE 2-13B b. (cont.)

Interior Design Consultants Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$24,000	
Net Cash Flow from Operating Activities		$24,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		24,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$24,000

c. Nine months of unearned revenue will be recognized in Year 2:
$24,000 x 9/12 = $18,000

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Exercise 2-14B *Unearned revenue defined as a liability*

Kim Wong received $800 in advance for tutoring fees when she agreed to help Joe Pratt with his introductory accounting course. Upon receiving the cash, Kim mentioned that she would have to record the transaction as a liability on her books. Joe asked, "Why a liability? You don't owe me any money, do you?"

Required

Respond to Joe's question regarding Wong's liability.

EXERCISE 2-14B

Note: This exercise can be used to assess writing skills.

The tutoring fees of $800 received in advance by Kim Wong from Joe Pratt should be reported as a liability. Although Kim Wong has received the cash, it has not yet been earned. Wong has an obligation to either perform the services or refund the cash advance. When the tutoring service is provided to Joe, the unearned revenue should be recognized as revenue earned by Wong.

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Exercise 2-15B *Supplies, unearned revenue, and the financial statements model*

Ross, Attorney at Law, experienced the following transactions in Year 1, the first year of operations:

1. Purchased $1,500 of office supplies on account.
2. Accepted $36,000 on February 1, Year 1, as a retainer for services to be performed evenly over the next 12 months.
3. Performed legal services for cash of $84,000.
4. Paid cash for operating expense of $32,000.
5. Paid a cash dividend to the stockholders of $8,000.
6. Paid $1,200 of the amount due on accounts payable.
7. Determined that at the end of the accounting period, $150 of office supplies remained on hand.
8. On December 31, Year 1, recognized the revenue that had been earned for services performed in accordance with Transaction 2.

Required

Show the effects of the events on the financial statements using a horizontal statements model like the following one. In the Cash Flow column, use the initials OA to designate operating activity, IA for investing activity, FA for financing activity, and NC for net change in cash. Use NA to indicate accounts not affected by the event. The first event has been recorded as an example.

Event No.	Balance Sheet										Income Statement					Statement of Cash Flows
	Assets			=	Liabilities			+	Stk. Equity							
	Cash	+	Supplies	=	Accts. Pay.	+	Unearn. Rev.	+	Ret. Earn.		Rev.	−	Exp.	=	Net Inc.	Cash Flow
1	NA	+	1,500	=	1,500	+	NA	+	NA		NA	−	NA	=	NA	NA

EXERCISE 2-15B (Sol. cont. on next page)

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EXERCISE 2-15B (Sol. Cont.)

Ross Attorney At Law
Effect of Transactions on the Financial Statements for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets			=	Liabilities			+	S. Equity	Rev.	–	Exp.	=	Net Inc.	
No.	Cash	+	Supplies	=	Acct. Payable	+	Unearn. Revenue	+	Retained Earnings						
1.	NA	+	1,500	=	1,500	+	NA	+	NA	NA	–	NA	=	NA	NA
2.	36,000	+	NA	=	NA	+	36,000	+	NA	NA	–	NA	=	NA	36,000 OA
3.	84,000	+	NA	=	NA	+	NA	+	84,000	84,000	–	NA	=	84,000	84,000 OA
4.	(32,000)	+	NA	=	NA	+	NA	+	(32,000)	NA	–	32,000	=	(32,000)	(32,000) OA
5.	(8,000)	+	NA	=	NA	+	NA	+	(8,000)	NA	–	NA	=	NA	(8,000) FA
6.	(1,200)	+	NA	=	(1,200)	+	NA	+	NA	NA	–	NA	=	NA	(1,200) OA
7.	NA	+	(1,350)	=	NA	+	NA	+	(1,350)	NA	–	1,350	=	(1,350)	NA
8.	NA	+	NA	=	NA	+	(33,000)*	+	33,000	33,000	–	NA	=	33,000	NA
Totals	78,800	+	150	=	300	+	3,000	+	75,650	117,000	–	33,350	=	83,650	78,800 NC

*$36,000 x 11/12 = $33,000

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EXERCISE 2-16B (Sol. cont.)

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Exercise 2-16B *Unearned revenue and the financial statements model*

Ed Arnold started a personal financial planning business when he accepted $120,000 cash as advance payment for managing the financial assets of a large estate. Arnold agreed to manage the estate for a one-year period beginning May 1, Year 1.

Required

a. Show the effects of the advance payment and revenue recognition on the Year 1 financial statements using a horizontal statements model like the following one. In the Cash Flows column, use OA to designate operating activity, IA for investing activity, FA for financing activity, and NC for net change in cash. Use NA if the account is not affected.

	Balance Sheet					Income Statement					Statement of Cash Flows
	Assets	=	Liab.	+	Stk. Equity	Rev.	−	Exp.	=	Net Inc.	Cash Flows
Event	Cash	=	Unearn. Rev.	+	Ret. Earn.						

b. How much revenue would Ed recognize on the Year 2 income statement?

c. What is the amount of cash flow from operating activities in Year 2?

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EXERCISE 2-16B (Sol. on next page)

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EXERCISE 2-16B SOLUTION

a.

Ed Arnold Personal Financial Planning
Horizontal Statements Model for Year 1

	Assets	=	Liabilities	+	Stk. Equity	Income Statement					Statement of Cash Flows
Event	Cash	=	Unearned Revenue	+	Retained Earnings	Rev.	–	Exp.	=	Net Income	
1. Advance Payment	120,000	=	120,000	+	NA	NA	–	NA	=	NA	120,000OA
2. Revenue Earned	NA	=	(80,000)*	+	80,000	80,000	–	NA	=	80,000	NA
Totals	120,000	=	40,000	+	80,000	80,000	–	-0-	=	80,000	120,000NC

*$120,000 x 8/12 = $80,000

b. Revenue that will be recognized in Year 2 is $40,000, the remainder of the unearned revenue.

c $-0-, no cash is received. All cash was received in Year 1.

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Exercise 2-17B *Prepaid vs. unearned, the entity concept*

On July 1, Year 3, Caldonia Company paid East Alabama Rentals $6,000 for a 12-month lease on warehouse space.

Required

a. Record the deferral and the related December 31, Year 3, adjustment for Caldonia Company in the accounting equation.

b. Record the deferral and the related December 31, Year 3, adjustment for East Alabama Rentals in the accounting equation.

EXERCISE 2-17B SOLUTION

a.

Caldonia Company Accounting Equation – Year 3								
Event	Assets		=	Liab.	+	Stockholders' Equity		
	Cash	Prepaid Rent	=		+	Common Stock	+	Retained Earnings
Paid 12 months rent	(6,000)	6,000						
Adj. for 6 months used		(3,000)*						(3,000)

*$3,000 x 6/12 = $3,000

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b.

East Alabama Rentals Accounting Equation – Year 3							
Event	Assets	=	Liabilities	+	Stockholders' Equity		
	Cash	=	Unearned Revenue	+	Common Stock	+	Retained Earnings
Recd. 12 months rent	6,000		6,000				
Earned 6 months rent			(3,000)*				3,000

*$6,000 x 6/12 = $3,000

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Exercise 2-18B *Identifying deferral and accrual events*

Required

Identify each of the following events as an accrual, deferral, or neither:

a. Incurred other operating expenses on account.
b. Recorded expense for salaries owed to employees at the end of the accounting period.
c. Paid a cash dividend to the stockholders.
d. Paid cash to purchase supplies to be used over the next several months.
e. Paid cash to purchase land.
f. Provided services on account.
g. Collected accounts receivable.
h. Paid one year's rent in advance.
i. Paid cash for utilities expense.
j. Collected $2,400 in advance for services to be performed over the next 12 months.
k. Recorded interest revenue earned for the period.

EXERCISE 2-18B SOLUTION

a. accrual

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b. accrual

c. neither

d. deferral

e. neither

f. accrual

g. neither

h. deferral

i. neither

j. deferral

k. accrual

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Exercise 2-19B *Revenue and expense recognition*

Required

a. Describe a revenue recognition event that results in an increase in assets.
b. Describe a revenue recognition event that results in a decrease in liabilities.
c. Describe an expense recognition event that results in an increase in liabilities.
d. Describe an expense recognition event that results in a decrease in assets.

EXERCISE 2-19B

Note: There are many examples of events that illustrate the required effects. An example is given of each event.

a. Recognized revenue on account. The asset is either Cash or Accounts Receivable.

b. Recognized revenue where the cash had been received in advance. The liability is Unearned Revenue

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c. Recognized an expense on account. The liability includes the word "Payable" or "Accrued" in the title.

d. Paid utilities expense. The asset is Cash or an account that includes the word "Prepaid" or a long-lived asset that is depreciated or amortized.

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Exercise 2-20B *Closing entries*

Rollins Company's accounting records show an after-closing balance of $19,400 in its Retained Earnings account on December 31, Year 3. During the Year 3 accounting cycle, Rollins earned $15,100 of revenue, incurred $9,200 of expense, and paid $1,500 of dividends. Revenues and expenses were recognized evenly throughout the accounting period.

Required

a. Determine the balance in the Retained Earnings account as of January 1, Year 4.
b. Determine the balance in the temporary accounts as of January 1, Year 3.
c. Determine the after-closing balance in the Retained Earnings account as of December 31, Year 2.
d. Determine the balance in the Retained Earnings account as of June 30, Year 3.

EXERCISE 2-20B

a. Retained Earnings is a permanent account, meaning that one period's ending balance becomes the next period's beginning balance. Since the December 31, Year 3 after-closing balance is $19,400, this will also be the balance on January 1, Year 4.

b. The temporary accounts (Revenue, Expense, and Dividends) are closed at the end of each accounting cycle. As a result, they will always have a zero balance at the beginning of each accounting period.

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c. The relationship between the beginning and ending balances in the Retained Earnings accounts is:

Beginning Retained Earnings Balance (January 1, Year 3)	?
+ Net Income (Revenue $15,100 – Expenses 9,200)	5,900
– Dividends	(1,500)
Ending Retained Earnings Balance (December 31, Year 3)	19,400

Beg. Retained Earnings = End. Retained Earnings – Net Income + Dividends
Beg. Ret. Earn. Balance = $19,400 – $5,900 + $1,500 = $15,000

Since Retained Earnings is a permanent account, the January 1, Year 3 balance of $15,000 is also the Dec. 31, Year 2 after-closing balance.

EXERCISE 2-20B (Sol. cont. on next page)

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EXERCISE 2-20B (Sol. cont.)

d. Since revenue and expense is recognized evenly through the Year 3 accounting cycle, approximately half would be recognized by June 30, Year 3. Even so, the revenue and expense data are recorded in Revenue and Expense accounts and do not affect retained earnings at the time of recognition. The balance in the Retained Earnings account on June 30, Year 3 is the same as it was on January 1, Year 3 which is $15,000.

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Exercise 2-21B *Adjusting the accounts*

Mikita Inc. experienced the following accounting events during its Year 3 accounting period:

1. Paid cash to settle an account payable.
2. Collected a cash advance for services that will be provided during the coming year.
3. Paid a cash dividend to the stockholders.
4. Paid cash for a one-year lease to rent office space.
5. Collected cash from accounts receivable.
6. Recognized cash revenue.
7. Issued common stock.
8. Paid cash to purchase land.
9. Paid cash to purchase supplies.
10. Recognized operating expenses on account.

Required

a. Identify the events that would require a year-end adjusting entry.
b. Are adjusting or closing entries recorded first? Why?

EXERCISE 2-21B SOLUTION

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a.

Event	Requires year-end adjusting entry?
1.	No
2.	Yes
3.	No
4.	Yes
5.	No
6.	No
7.	No
8.	No
9.	Yes
10.	No

EXERCISE 2-21B (Sol. Cont.)

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EXERCISE 2-21B (Sol. Cont.)

b. Adjusting entries are recorded before closing entries. Adjusting entries are required to update the accounts so that the correct amounts of income and expenses are recognized. After the adjusting entries have been made, the adjusted balances of the revenue and expense accounts are closed to retained earnings.

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Exercise 2-22B *Closing the accounts*

The following information was drawn from the accounting records of Swanson Company as of December 31, Year 3, before the temporary accounts had been closed. The Cash balance was $6,000, and Notes Payable amounted to $3,000. The company had revenues of $7,000 and expenses of $4,200. The company's Land account had a $4,000 balance. Dividends amounted to $1,000. The balance of the Common Stock account was $2,000.

Required

a. Identify which accounts would be classified as permanent and which accounts would be classified as temporary.

b. Assuming that Swanson's beginning balance (as of January 1, Year 3) in the Retained Earnings account was $5,200, determine its balance after the temporary accounts were closed at the end of Year 3.

c. What amount of net income would Swanson Company report on its Year 3 income statement?

d. Explain why the amount of net income differs from the amount of the ending Retained Earnings balance.

e. What are the balances in the revenue, expense, and dividend accounts on January 1, Year 4?

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EXERCISE 2-22B SOLUTION

a.

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Permanent Accounts
Cash
Notes Payable
Land
Common Stock
Retained Earnings

Temporary (Nominal) Accounts
Revenue
Expenses
Dividends

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EXERCISE 2-22B (Sol. cont.)

b.

Beginning Retained Earnings	$5,200
Add: Revenue	7,000
Less: Expenses	(4,200)
Less: Dividends	(1,000)
Ending Retained Earnings	$7,000

c.

Computation of Net Income	
Revenue	$7,000
Less: Expenses	(4,200)
Net Income	$2,800

d. Net income is only the current year's net income. Retained Earnings is an accumulation of net income over the life of the business less any dividends that have been paid over the years.

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e. All revenue, expense and dividends accounts will have a zero balance because they have been closed to retained earnings.

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Exercise 2-23B *Closing accounts and the accounting cycle*

Required

a. Identify which of the following accounts are temporary (will be closed to Retained Earnings at the end of the year) and which are permanent:

(1) Service Revenue
(2) Dividends
(3) Common Stock
(4) Notes Payable
(5) Cash
(6) Rent Expense
(7) Accounts Receivable
(8) Utilities Expense
(9) Prepaid Insurance
(10) Retained Earnings

b. List and explain the four stages of the accounting cycle. Which stage must be first? Which stage is last?

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EXERCISE 2-23B SOLUTION

a.

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Account	Classification
1. Service Revenue	T
2. Dividends	T
3. Common Stock	P
4. Notes Payable	P
5. Cash	P
6. Rent Expense	T
7. Accounts Receivable	P
8. Utilities Expense	T
9. Prepaid Insurance	P
10. Retained Earnings	P

EXERCISE 2-23B (Sol. cont.)

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EXERCISE 2-23B (Solution Cont.)

b. The four stages of the accounting cycle are:

recording transactions
adjusting the accounts
preparing financial statements
closing temporary accounts.

The first stage of the cycle must be recording accounting data in accounts to put it into usable form. Once the accounting data is summarized in the accounts, adjustments are made to reflect any unrecorded transactions. The account balances are then used to prepare the financial statements. After the financial statements are prepared, the temporary accounts (revenue, expenses, and dividends) must be closed to prepare these accounts for the next accounting period.

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Exercise 2-24B *Matching concept*

Companies make sacrifices known as *expenses* to obtain benefits called *revenues*. The accurate measurement of net income requires that expenses be matched with revenues. In some circumstances, matching a particular expense directly with revenue is difficult or impossible. In these circumstances, the expense is matched with the period in which it is incurred.

Required

Distinguish the following items that could be matched directly with revenues from the items that would be classified as period expenses:

a. Sales commissions paid to employees.
b. Advertising expense.
c. Supplies.
d. The cost of land that has been sold.

EXERCISE 2-24B SOLUTION

a. Directly matched
b. Period expense
c. Period expense
d. Directly matched

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Exercise 2-25B *Classifying events on the statement of cash flows*

The following transactions pertain to the operations of Blair Company for Year 1:

1. Acquired $30,000 cash from the issue of common stock.
2. Performed services for $12,000 cash.
3. Paid $7,200 for a one-year contract to rent equipment in advance.
4. Recognized $15,000 of accrued salary expense.
5. Accepted a $21,000 cash advance for services to be performed in the future.
6. Provided $60,000 of services on account.
7. Incurred $28,000 of other operating expenses on account.
8. Collected $51,000 cash from accounts receivable.
9. Paid a $5,000 cash dividend to the stockholders.
10. Paid $22,000 cash on accounts payable.

Required

a. Classify the cash flows from these transactions as operating activities (OA), investing activities (IA), or financing activities (FA). Use NA for transactions that do not affect the statement of cash flows.

b. Prepare a statement of cash flows. (There is no beginning cash balance.)

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EXERCISE 2-25B SOLUTION

a.

Event	Classification
1.	FA
2.	OA
3.	OA
4.	NA
5.	OA
6.	NA
7.	NA
8.	OA
9.	FA
10.	OA

EXERCISE 2-25B (Sol. cont. on next page)

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EXERCISE 2-25B (Sol. Cont.)

b.

Blair Company Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash from the collection of accts. rec.	$51,000	
Cash from service revenue	12,000	
Cash from svc. to be performed in future	21,000	
Cash payment on accounts payable	(22,000)	
Cash payment for rent	(7,200)	
Net Cash Flow from Operating Activities		$54,800
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		
Cash receipt from stock issue	$30,000	
Cash payment for dividends	(5,000)	
Net Cash Flow from Financing Activities		25,000
Net Change in Cash		$79,800
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$79,800

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Exercise 2-26B *Relationship of accounts to financial statements*

Required

Identify whether each of the following items would appear on the income statement (IS), statement of changes in stockholders' equity (SE), balance sheet (BS), or statement of cash flows (CF). Some items may appear on more than one statement; if so, identify all applicable statements. If an item would not appear on any financial statement, label it NA.

a. Consulting Revenue
b. Market Value of Land
c. Supplies Expense
d. Salaries Payable
e. Notes Payable
f. Ending Common Stock
g. Beginning Cash Balance
h. Prepaid Rent
i. Net Change in Cash
j. Land
k. Operating Expenses
l. Total Liabilities
m. "As of" Date Notation
n. Salaries Expense
o. Net Income
p. Service Revenue
q. Cash Flow from Operating Activities
r. Operating Income
s. Interest Receivable
t. Interest Revenue
u. Rent Expense
v. Salary Expense
w. Total Stockholders' Equity
x. Unearned Revenue
y. Cash Flow from Investing Activities
z. Insurance Expense
aa. Ending Retained Earnings
bb. Interest Revenue
cc. Supplies
dd. Beginning Retained Earnings
ee. Utilities Payable
ff. Cash Flow from Financing Activities
gg. Accounts Receivable
hh. Prepaid Insurance
ii. Ending Cash Balance
jj. Utilities Expense
kk. Accounts Payable
ll. Beginning Common Stock
mm. Dividends
nn. Total Assets

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EXERCISE 2-26B (Sol. on next page)

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EXERCISE 2-26B SOLUTION

Item/Account	Statement		Item/Account	Statement
a. Consulting Revenue	IS		u. Rent Expense	IS
b. Market Value of Land	NA		v. Salary Expense	IS
c. Supplies Expense	IS		w. Total Stockholders' Equity	BS/SE
d. Salaries Payable	BS		x. Unearned Revenue	BS
e. Notes Payable	BS		y. Cash Flow from Investing Activities	CF
f. Ending Common Stock	SE/BS		z. Insurance Expense	IS
g. Beginning Cash Balance	CF		aa. End. Retained Earn.	BS/SE
h. Prepaid Rent	BS		bb. Interest Revenue	IS
i. Net Change in Cash	CF		cc. Supplies	BS
j. Land	BS		dd. Beg. Retained Earn.	SE
k. Operating Expenses	IS		ee. Utilities Payable	BS
l. Total Liabilities	BS		ff. Cash Flow from Financing Activities	CF
m. "As of" Date Notation	BS		gg. Accounts Receivable	BS
n. Salaries Expense	IS		hh. Prepaid Insurance	BS
o. Net Income	IS/SE		ii. Ending Cash Balance	BS/CF
p. Service Revenue	IS		jj. Utilities Expense	IS
q. Cash Flow from Operating Activities	CF		kk. Accounts Payable	BS
r. Operating Income	IS		ll. Beg. Common Stock	SE
s. Interest Receivable	BS		mm. Dividends	SE/CF
t. Interest Revenue	IS		nn. Total Assets	BS

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Exercise 2-27B *Identifying transaction type and effect on the financial statements*

Required

Identify whether each of the following transactions is an asset source (AS), asset use (AU), asset exchange (AE), or claims exchange (CE). Also show the effects of the events on the financial statements using the horizontal statements model. Indicate whether the event increases (I), decreases (D), or does not affect (NA) each element of the financial statements. In the Cash Flows column, designate the cash flows as operating activities (OA), investing activities (IA), or financing activities (FA). The first two transactions have been recorded as examples.

		Balance Sheet					Income Statement				Statement of Cash Flows
Event No.	Type of Event	Assets	=	Liabilities	+ Common Stock	+ Retained Earnings	Rev.	− Exp.	= Net Inc.		Cash Flows
a	AE	I/D		NA	NA	NA	NA	NA	NA		D IA
b	AS	I		NA	I	NA	NA	NA	NA		I FA

a. Paid cash to purchase land.
b. Received cash from the issue of common stock.
c. Collected cash from accounts receivable.
d. Paid cash for operating expenses.
e. Recorded accrued salaries.
f. Purchased supplies on account to be used in the future.
g. Performed services on account.
h. Paid cash in advance for one year's rent on office space.
i. Adjusted the books to record supplies used during the period.
j. Provided services and collected cash.
k. Paid cash for salaries accrued at the end of a prior period.
l. Paid a cash dividend to the stockholders.
m. Adjusted books to reflect the amount of prepaid rent expired during the period.
n. Incurred other operating expenses on account.
o. Paid cash on accounts payable.
p. Received cash advance for services to be provided in the future.
q. Recorded accrued interest revenue earned at the end of the accounting period.

EXERCISE 2-27B (Solution on next page)

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EXERCISE 2-27B SOLUTION

Horizontal Statement Model

						Stk. Equity			Income Statement					
Event	Type of Event	Assets	=	Liab.	+	Com. Stock	+	Ret. Earn.	Rev.	–	Exp.	=	Net Inc.	Cash Flows	
a.	AE	I/D		NA		NA		NA	NA		NA		NA	D	IA
b.	AS	I		NA		I		NA	NA		NA		NA	I	FA
c.	AE	I/D		NA		NA		NA	NA		NA		NA	I	OA
d.	AU	D		NA		NA		D	NA		I		D	D	OA
e.	CE	NA		I		NA		D	NA		I		D	NA	
f.	AS	I		I		NA		NA	NA		NA		NA	NA	
g.	AS	I		NA		NA		I	I		NA		I	NA	
h.	AE	I/D		NA		NA		NA	NA		NA		NA	D	OA
i.	AU	D		NA		NA		D	NA		I		D	NA	
j.	AS	I		NA		NA		I	I		NA		I	I	OA
k.	AU	D		D		NA		NA	NA		NA		NA	D	OA
l.	AU	D		NA		NA		D	NA		NA		NA	D	FA
m.	AU	D		NA		NA		D	NA		I		D	NA	
n.	CE	NA		I		NA		D	NA		I		D	NA	
o.	AU	D		D		NA		NA	NA		NA		NA	D	OA
p.	AS	I		I		NA		NA	NA		NA		NA	I	OA
q.	AS	I		NA		NA		I	I		NA		I	NA	

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Exercise 2-28B *Effect of accounting events on the income statement and statement of cash flows*

Required

Explain how each of the following events or series of events and the related adjusting entry will affect the amount of *net income* and the amount of *cash flow from operating activities* reported on the year-end financial statements. Identify the direction of change (increase, decrease, or NA) and the amount of the change. Organize your answers according to the following table. The first event is recorded as an example. If an event does not have a related adjusting entry, record only the effects of the event.

	Net Income		Cash Flows from Operating Activities	
Event	Direction of Change	Amount of Change	Direction of Change	Amount of Change
a	NA	NA	NA	NA

a. Acquired $60,000 cash from the issue of common stock.
b. Earned $20,000 of revenue on account. Collected $15,000 cash from accounts receivable.
c. Paid $4,800 cash on October 1 to purchase a one-year insurance policy.
d. Collected $12,000 in advance for services to be performed in the future. The contract called for services to start on August 1 and to continue for one year.
e. Accrued salaries amounting to $5,000.
f. Sold land that cost $15,000 for $15,000 cash.
g. Provided services for $9,200 cash.
h. Purchased $2,000 of supplies on account. Paid $1,500 cash on accounts payable. The ending balance in the Supplies account, after adjustment, was $800.
i. Paid cash for operating expenses of $2,200.

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EXERCISE 2-28B (Solution on next page)

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EXERCISE 2-28B SOLUTION

	Net Income		Cash Flow from Operating Activities	
Event	Direction of Change	Amount of Change	Direction of Change	Amount of Change
a.	NA	NA	NA	NA
b.	Increase	$20,000	Increase	$15,000
c.	Decrease	1,200[1]	Decrease	4,800
d.	Increase	5,000[2]	Increase	12,000
e.	Decrease	5,000	NA	NA
f.	NA	NA	NA	NA
g.	Increase	9,200	Increase	9,200
h.	Decrease	1,200[3]	Decrease	1,500
i.	Decrease	2,200	Decrease	2,200

[1]$4,800 x 3/12 = $1,200
[2]$12,000 x 5/12 = $5,000
[3]$2,000 – $800 = $1,200

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Exercise 2-29B *Transactions that affect the elements of financial statements*

Required

Give an example of a transaction that will:

a. Increase an asset and decrease another asset (asset exchange event).
b. Increase an asset and increase a liability (asset source event).
c. Decrease an asset and decrease a liability (asset use event).
d. Decrease an asset and decrease stockholders equity (asset use event).
e. Increase a liability and decrease stockholders equity (claims exchange event).
f. Increase an asset and increase stockholders equity (asset source event).
g. Decrease a liability and increase stockholders equity (claims exchange event).

EXERCISE 2-29B SOLUTION

Note: These are only sample transactions. Other similar transactions will satisfy the requirements of this exercise.

a. The business invested cash by purchasing a building.

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Collected accounts receivable.

b. Purchased land with a note (liability).

Purchased supplies on account.

c. Paid accounts payable.

Paid notes payable.

d. Paid a cash dividend to owners.

Paid an expense with cash.

EXERCISE 2-29B (solution cont. on the next page)

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EXERCISE 2-29B (Solution Cont.)

e. Recorded accrued salaries.

Recorded the liability for the utility bill received, but not due until the next period.

f. The business issued common stock to its owners.

Cash revenue is earned.

g. Unearned revenue is earned and recognized.

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Exercise 2-30B *Identifying source, use, and exchange transactions*

Required

Indicate whether each of the following transactions is an asset source (AS), asset use (AU), asset exchange (AE), or claims exchange (CE) transaction.

a. Performed services for clients on account.
b. Paid cash for salary expense.
c. Acquired cash from the issue of common stock.
d. Incurred other operating expenses on account.
e. Performed services for cash.
f. Paid cash on accounts payable.
g. Collected cash from accounts receivable.
h. Paid a cash dividend to the stockholders.
i. Received cash for services to be performed in the future.
j. Purchased land with cash.

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EXERCISE 2-30B SOLUTION

a. Asset Source

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b. Asset Use

c. Asset Source

d. Claims Exchange

e. Asset Source

f. Asset Use

g. Asset Exchange

h. Asset Use

i. Asset Source

j. Asset Exchange

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Exercise 2-31B *Identifying asset source, use, and exchange transactions*

Required

a. Name an asset use transaction that will affect the income statement.
b. Name an asset use transaction that will *not* affect the income statement.
c. Name an asset exchange transaction that will *not* affect the statement of cash flows.
d. Name an asset exchange transaction that will affect the statement of cash flows.
e. Name an asset source transaction that will *not* affect the income statement.

EXERCISE 2-31B

Note: These are only sample transactions. Other similar transactions will satisfy the requirements of this exercise.

a. Payment of rent expense; payment of other operating expense.

b. Payment of accounts payable; payment of dividends.

c. Received a note receivable in exchange for the sale of a delivery van.

d. Collection of accounts receivable; purchase of land.

e. Proceeds of a loan; issue of common stock.

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SOLUTIONS TO PROBLEMS - CHAPTER 2

Problem 2-32B *Recording events in a horizontal statements model*

The following events pertain to James Cleaning Company:

1. Acquired $15,000 cash from the issue of common stock.
2. Provided services for $6,000 cash.
3. Provided $18,000 of services on account.
4. Collected $11,000 cash from the account receivable created in Event 3.
5. Paid $1,400 cash to purchase supplies.
6. Had $100 of supplies on hand at the end of the accounting period.
7. Received $3,600 cash in advance for services to be performed in the future.
8. Performed one-half of the services agreed to in Event 7.
9. Paid $6,500 for salaries expense.
10. Incurred $2,800 of other operating expenses on account.
11. Paid $2,100 cash on the account payable created in Event 10.
12. Paid a $1,000 cash dividend to the stockholders.

Required

Show the effects of the events on the financial statements using a horizontal statements model like the following one. In the Cash Flows column, use the letters OA to designate operating activity, IA for investing activity, FA for financing activity, and NC for net change in cash. Use NA to indicate accounts not affected by the event. The first event is recorded as an example.

PROBLEM 2-32B (Solution on next page)

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PROBLEM 2-32B SOLUTION

James Cleaning Company
Effect of Events on the Financial Statements

	Balance Sheet													Income Statement						Stmt. of Cash Flows	
	Assets					=	Liabilities			+	Stock. Equity			Rev.	–	Exp.	=	Net Inc.			
Event	Cash	+	Accts Rec.	+	Supp.	=	Accts. Pay.	+	Unearn Rev.	+	Com. Stock	+	Ret. Earn.								
1.	15,000	+	NA	+	NA	=	NA	+	NA	+	15,000	+	NA	NA	–	NA	=	NA		15,000	FA
2.	6,000	+	NA	+	NA	=	NA	+	NA	+	NA	+	6,000	6,000	–	NA	=	6,000		6,000	OA
3.	NA	+	18,000	+	NA	=	NA	+	NA	+	NA	+	18,000	18,000	–	NA	=	18,000		NA	
4.	11,000	+	(11,000)	+	NA	=	NA	+	NA	+	NA	+	NA	NA	–	NA	=	NA		11,000	OA
5.	(1,400)	+	NA	+	1,400	=	NA	+	NA	+	NA	+	NA	NA	–	NA	=	NA		(1,400)	OA
6.	NA	+	NA	+	(1,300)	=	NA	+	NA	+	NA	+	(1,300)	NA	–	1,300	=	(1,300)		NA	
7.	3,600	+	NA	+	NA	=	NA	+	3,600	+	NA	+	NA	NA	–	NA	=	NA		3,600	OA
8.	NA	+	NA	+	NA	=	NA	+	(1,800)	+	NA	+	1,800	1,800	–	NA	=	1,800		NA	
9.	(6,500)	+	NA	+	NA	=	NA	+	NA	+	NA	+	(6,500)	NA	–	6,500	=	(6,500)		(6,500)	OA
10.	NA	+	NA	+	NA	=	2,800	+	NA	+	NA	+	(2,800)	NA	–	2,800	=	(2,800)		NA	
11.	(2,100)	+	NA	+	NA	=	(2,100)	+	NA	+	NA	+	NA	NA	–	NA	=	NA		(2,100)	OA
12.	(1,000)	+	NA	+	NA	=	NA	+	NA	+	NA	+	(1,000)	NA	–	NA	=	NA		(1,000)	FA
Bal.	24,600	+	7,000	+	100	=	700	+	1,800	+	15,000	+	14,200	25,800	–	10,600	=	15,200		24,600	NC

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Problem 2-33B *Effect of adjusting entries on the accounting equation*

Required

Each of the following independent events requires a year-end adjusting entry. Show how each event and its related adjusting entry affect the accounting equation. Assume a December 31 closing date. The first event is recorded as an example.

	Total Assets						Stockholders Equity		
Event/ Adjustment	Cash	+	Other Assets	=	Liabilities	+	Common Stock	+	Retained Earnings
a	−6,000		+6,000		NA		NA		NA
Adj.	NA		−4,500		NA		NA		−4,500

a. Paid $6,000 cash in advance on April 1 for a one-year insurance policy.
b. Purchased $2,400 of supplies on account. At year's end, $200 of supplies remained on hand.
c. Paid $7,200 cash in advance on March 1 for a one-year lease on office space.
d. Received an $18,000 cash advance for a contract to provide services in the future. The contract required a one-year commitment starting September 1.

PROBLEM 2-33B

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The Accounting Equation

	Total Assets			=	Liabilities	+	Stockholders' Equity		
Event/ Adjust.	Cash	+	Other Assets	=		+	Common Stock	+	Retained Earnings
a.	(6,000)		+6,000		NA		NA		NA
a. Adj.[1]	NA		(4,500)		NA		NA		(4,500)
b.	NA		+2,400		+2,400		NA		NA
b. Adj.[2]	NA		(2,200)		NA		NA		(2,200)
c.	(7,200)		+7,200		NA		NA		NA
c. Adj.[3]	NA		(6,000)		NA		NA		(6,000)
d.	+18,000		NA		+18,000		NA		NA
d. Adj.[4]	NA		NA		(6,000)		NA		6,000

[1]$6,000 x 9/12 = $4,500; [2]$2,400 – $200 = $2,20; [3]$7,200 x 10/12 = $6,000; [4]$18,000 x 4/12 = $6,000

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Problem 2-34B *Closing the accounts*

The following selected accounts and account balances were taken from the records of Bates Company. Except as otherwise indicated, all balances are as of December 31, Year 3, before the closing entries were recorded.

Cash received from common stock issued during Year 2	$ 4,500
Cash	10,500
Revenue	18,000
Salary expense	13,000
Cash flow from operating activities	4,500
Notes payable	6,000
Utility expense	1,800
Dividends	1,000
Cash flow from financing activities	5,000
Rent expense	1,600
Land	25,000
Retained earnings, January 1, Year 3	19,700
Common stock, December 31, Year 3	20,000

Required

a. Prepare the income statement Bates would include in its Year 3 annual report.

b. Identify the accounts that should be closed to the Retained Earnings account.

c. Determine the Retained Earnings account balance at December 31, Year 3. Identify the reasons for the difference between net income and the ending balance in Retained Earnings.

d. What are the balances in the Revenue, Expense, and Dividend accounts on January 1, Year 4? Explain.

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PROBLEM 2-34B (Solution on next page)

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PROBLEM 2-34B SOLUTION

a.

Bates Company Income Statement For the Year Ended December 31, Year 3		
Revenue		$18,000
Expenses		
Salary Expense	$13,000	
Utility Expense	1,800	
Rent Expense	1,600	
Total Expense		(16,400)
Net Income		$ 1,600

b.

Accounts to be Closed:	
1.	Revenue
2.	Salary Expense
3.	Utility Expense
4.	Rent Expense
5.	Dividends

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c.

Computation of Retained Earnings:	
Beginning Retained Earnings	$19,700
Add: Net Income	1,600
Less: Dividends	(1,000)
Ending Retained Earnings	$20,300

Net inc. only includes revenues and expenses for the current year. Ret. earns. not only includes current year net income, but also the bal. from previous years and reductions for dividends

PROBLEM 2-34B. (Sol. cont. on next page)

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PROBLEM 2-34B (Solution cont.)

d. The balances are zero; they were closed to Retained Earnings on December 31, Year 3. The December 31 closing balance of one year is the opening balance on January 1 of the next year.

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Problem 2-35B *Effect of events on financial statements*

Davis Company had the following balances in its accounting records as of December 31, Year 2:

Assets		Liabilities and Equity	
Cash	$ 60,000	Accounts Payable	$ 32,000
Accounts Receivable	45,000	Common Stock	60,000
Land	35,000	Retained Earnings	48,000
Totals	$140,000		$140,000

The following accounting events apply to Davis for Year 3:

Jan.	1	Acquired $30,000 cash from the issue of common stock.
April	1	Paid $7,200 cash in advance for a one-year lease for office space.
June	1	Paid a $5,000 cash dividend to the stockholders.
July	1	Purchased additional land that cost $40,000 cash.
Aug.	1	Made a cash payment on accounts payable of $21,000.
Sept.	1	Received $9,600 cash in advance as a retainer for services to be performed monthly over the next eight months.
Sept.	30	Sold land for $20,000 cash that had originally cost $20,000.
Oct.	1	Purchased $1,200 of supplies on account.
Dec.	31	Earned $75,000 of service revenue on account during the year.
	31	Received cash collections from accounts receivable amounting to $62,000.
	31	Incurred other operating expenses on account during the year that amounted to $27,000.
	31	Recognized accrued salaries expense of $18,000.
	31	Had $100 of supplies on hand at the end of the period.
	31	The land purchased on July 1 had a market value of $56,000.
	31	Recognized $120 of accrued interest revenue.

Prob.Cont.

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PROBLEM 2-35B (Problem Continued)

Required

Based on the preceding information for Davis Company answer the following questions. All questions pertain to the Year 3 financial statements. (*Hint:* Record the events in general ledger accounts under an accounting equation before answering the questions.)

a. Based on the preceding transactions, identify two additional adjustments and describe them.
b. What amount would David report for land on the balance sheet?
c. What amount of net cash flow from operating activities would be reported on the statement of cash flows?
d. What amount of rent expense would be reported in the income statement?
e. What amount of total liabilities would be reported on the balance sheet?
f. What amount of supplies expense would be reported on the income statement?
g. What amount of unearned revenue would be reported on the balance sheet?
h. What amount of net cash flow from investing activities would be reported on the statement of cash flows?
i. What amount of total expenses would be reported on the income statement?
j. What total amount of service revenue would be reported on the income statement?
k. What amount of cash flows from financing activities would be reported on the statement of cash flows?
l. What amount of net income would be reported on the income statement?
m. What amount of retained earnings would be reported on the balance sheet?

PROBLEM 2-35B (Solution on next page)

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PROBLEM 2-35B SOLUTION
(Useful to Complete)

Accounting Equation											
	Assets						Liabilities			Stk. Equity	
Date	Cash	Acc. Rec.	Pp. Rent	Supp.	Int. Rec.	Land	Acc. Pay.	Sal. Pay.	Unear. Rev.	Com. Stock	Ret. Earn.
Bal.	60,000	45,000				35,000	32,000			60,000	48,000
1/1	30,000									30,000	
4/1	(7,200)		7,200								
6/1	(5,000)										(5,000)
7/1	(40,000)					40,000					
8/1	(21,000)						(21,000)				
9/1	9,600								9,600		
9/30	20,000					(20,000)					
10/1				1,200			1,200				
12/31		75,000									75,000
12/31	62,000	(62,000)									
12/31							27,000				(27,000)
12/31								18,000			(18,000)
12/31				(1,100)							(1,100)
12/31[1]											
12/31a			(5,400)[1]								(5,400)
12/31a									(4,800)[2]		4,800
12/31[2]					120						120
Bal.	108,400	58,000	1,800	100	120	55,000	39,200	18,000	4,800	90,000	71,420

[1]No entry for the change in value of the land.
[2]This assumes that some of the cash was invested in an interest bearing account.
(1) 12/31a Expired Rent ($7,200 x 9/12 = $5,400)
(2) 12/31a Unearned Revenue Earned ($9,600 x 4/8 = $4,800)

PROBLEM 2-35B (Solution cont. on next page)

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PROBLEM 2-35B (Solution cont.)

a. The two transactions that need adjusting entries are as follows:

1. April 1, prepaid rent. Sept. 1,

2. Unearned revenue; cash was received in advance.

b. $35,000 + $40,000 – $20,000 = $55,000

c. $62,000 + $9,600 – $7,200 – $21,000 = $43,400

d. $7,200 X 9/12 = $5,400

e. $39,200 + $18,000 + $4,800 =$62,000

f. $1,200 – $100 = $1,100

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g. $9,600 – $4,800 ($9,600 x 4/8) = $4,800

h. $20,000 – $40,000 = ($20,000)

i. Total expenses: $27,000 + $18,000 + $1,100 + $5,400 = $51,500

j. $75,000 + $4,800 = $79,800

k. $30,000 – $5,000 = $25,000

l. (j) $79,800 + $120 – (i) $51,500 = $28,420

m. Beg. RE $48,000 + NI $28,420 – Div. $5,000 = Ending retained earnings $71,420

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Problem 2-36B *Identifying and arranging elements on financial statements*

The following accounts and balances were drawn from the records of Dawkins Company at December 31, Year 3:

Cash	$22,100	Accounts receivable	$21,000
Land	43,000	Cash flow from operating act.	8,600
Insurance expense	2,500	Beginning retained earnings	47,200
Dividends	5,000	Beginning common stock	5,500
Prepaid insurance	3,500	Service revenue	86,000
Accounts payable	15,000	Cash flow from financing act.	9,000
Supplies	2,100	Ending common stock	14,500
Supplies expense	1,000	Cash flow from investing act.	(6,000)
Rent expense	3,500	Other operating expenses	59,000

Required

Use the accounts and balances from Dawkins Company to construct an income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows (show only totals for each activity on the statement of cash flows).

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PROBLEM 2-36B (Solution on next page)

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PROBLEM 2-36B SOLUTION

Dawkins Company Financial Statements For the Year Ended December 31, Year 3		
Income Statement		
Revenue		
Service Revenue	$86,000	
Total Revenue		$86,000
Expenses		
Other Operating Expenses	$59,000	
Supplies Expense	1,000	
Rent Expense	3,500	
Insurance Expense	2,500	
Total Expenses		(66,000)
Net Income		$20,000
Statement of Changes in Stockholders' Equity		
Beginning Common Stock	$ 5,500	
Plus: Stock Issued	9,000*	
Ending Common Stock		$14,500
Beginning Retained Earnings	$47,200	
Plus: Net Income	20,000	
Less: Dividends	(5,000)	
Ending Retained Earnings		62,200
Total Stockholders' Equity		$76,700

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*Not given in the problem.

Ending Common Stock – Beginning Common Stock = Stock Issued

$14,500 – $5,500 = $9,000

PROBLEM 2-36B (Solution cont.)

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PROBLEM 2-36B (Solution cont.)

Dawkins Company Balance Sheet As of December 31, Year 3		
Assets		
Cash	$22,100	
Accounts Receivable	21,000	
Supplies	2,100	
Prepaid Insurance	3,500	
Land	43,000	
Total Assets		$91,700
Liabilities		
Accounts Payable	$15,000	
Total Liabilities		$15,000
Stockholders' Equity		
Common Stock	$14,500	
Retained Earnings	62,200	
Total Stockholders' Equity		76,700
Total Liab. and Stockholders' Equity		$91,700

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PROBLEM 2-36B (Sol. cont.)

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PROBLEM 2-36B (Sol. cont.)

Dawkins Company Statement of Cash Flows For the Year Ended December 31, Year 3	
Cash Flow From Operating Activities	$ 8,600
Cash Flow From Investing Activities	(6,000)
Cash Flow From Financing Activities	9,000
Net Change in Cash	11,600
Plus: Beginning Cash Balance	10,500*
Ending Cash Balance	$22,100

*Not given in the problem.

Ending Cash Bal.	–	Increase in Cash	=	Beg. Cash Balance
$22,100	–	$11,600	=	$10,500

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Problem 2-37B *Missing information in financial statements*

Required

Fill in the blanks (indicated by the alphabetic letters in parentheses) in the following financial statements. Assume the company started operations January 1, Year 1, and all transactions involve cash.

	For the Years		
	Year 1	Year 2	Year 3
Income Statements			
Revenue	$ 400	$ 500	$ 800
Expense	(250)	(l)	(425)
Net income	$ (a)	$ 100	$ 375
Statement of Changes in Stockholders' Equity			
Beginning common stock	$ 0	$ (m)	$ 9,100
Plus: Common stock issued	(b)	1,100	310
Ending common stock	$8,000	9,100	(s)
Beginning retained earnings	0	25	75
Plus: Net income	(c)	100	375
Less: Dividends	(d)	(50)	(150)
Ending retained earnings	25	(n)	300
Total stockholders' equity	$ (e)	$ 9,175	$ (t)
Balance Sheets			
Assets			
Cash	$ (f)	$ (o)	$ (u)
Land	0	(p)	2,500
Total assets	$11,000	$11,650	$10,550
Liabilities	$ (g)	$ (q)	$ 840
Stockholders' equity			
Common stock	(h)	(r)	9,410
Retained earnings	(i)	75	300
Total stockholders' equity	8,025	9,175	9,710
Total liabilities and stockholders' equity	$11,000	$11,650	$10,550

continued

PROBLEM 2-37B (Problem cont. on next page)

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PROBLEM 2-37B (Problem cont.)

Statements of Cash Flows			
Cash flows from operating activities			
Cash receipts from customers	$ (j)	$ 500	$ (v)
Cash payments for expenses	(k)	(400)	(w)
Net cash flows from operating activities	150	100	375
Cash flows from investing activities			
Cash payments for land	0	(5,000)	0
Cash receipt from sale of land	0	0	2,500
Net cash flows from investing activities	0	(5,000)	2,500
Cash flows from financing activities			
Cash receipts from borrowed funds	2,975	0	0
Cash payments to reduce debt	0	(500)	(x)
Cash receipts from stock issue	8,000	1,100	(y)
Cash payments for dividends	(125)	(50)	(z)
Net cash flows from financing activities	10,850	550	(1,475)
Net change in cash	11,000	(4,350)	1,400
Plus: Beginning cash balance	0	11,000	6,650
Ending cash balance	$ 11,000	$ 6,650	$ 8,050

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PROBLEM 2-37B (Solution on next page)

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PROBLEM 2-37B SOLUTION

FOR THE YEARS	Year 1	Year 2	Year 3
Income Statements			
Revenue (cash)	$ 400	$ 500	$ 800
Expense (cash)	(250)	(l) (400)	(425)
Net income	(a) $ 150	$ 100	$ 375
Statements of Changes in Stockholders' Equity			
Beginning common stock	$ -0-	(m) $8,000	$9,100
Plus: Common stock issued	(b) 8,000	1,100	310
Ending common stock	8,000	9,100	(s) 9,410
Beginning retained earnings	-0-	25	75
Plus: Net income	(c) 150	100	375
Less: Dividends	(d) (125)	(50)	(150)
Ending retained earnings	25	(n) 75	300
Total stockholders' equity	(e) $8,025	$9,175	(t) $9,710
Balance Sheets			
Assets			
Cash	(f) $11,000	(o) $ 6,650	(u)$ 8,050
Land	-0-	(p) 5,000	2,500
Total assets	$11,000	$11,650	$10,550
Liabilities	(g) $ 2,975	(q) $ 2,475	$ 840
Stockholders' equity			
Common stock	(h) 8,000	(r) 9,100	9,410
Retained earnings	(i) 25	75	300
Total stockholders' equity	8,025	9,175	9,710
Total liabilities and stk. equity	$11,000	$11,650	$10,550

PROBLEM 2-37B (Solution cont. on next page.)

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PROBLEM 2-37B (Solution cont.)

FOR THE YEARS	Year 1	Year 2	Year 3
Statements of Cash Flows			
Cash flows from oper. activities:			
Cash receipts from revenue	(j)$ 400	$ 500	(v) $ 800
Cash payments for expenses	(k) (250)	(400)	(w) (425)
Net cash flows from oper. Act.	150	100	375
Cash flows from invest. activities:			
Cash payments for land	-0-	(5,000)	-0-
Cash receipt from sale of land	-0-	-0-	2,500
Net cash flows from invest. act.	-0-	(5,000)	2,500
Cash flows from fin. activities:			
Cash rec. from borrowed funds	2,975	-0-	-0-
Cash payments to reduce debt	-0-	(500)	(x) (1,635)
Cash receipts from stock issue	8,000	1,100	(y) 310
Cash payments for dividends	(125)	(50)	(z) (150)
Net cash flows from fin. activities	10,850	550	(1,475)
Net change in cash	11,000	(4,350)	1,400
Plus: beginning cash balance	-0-	11,000	6,650
Ending cash balance	$11,000	$ 6,650	$ 8,050

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PROBLEM 2-37B (Sol. cont. on next page)

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PROBLEM 2-37B (Sol. cont.)

Computations of amounts:

a. $150 Net Income = $400 Revenue – $250 Expenses.

b. $8,000 Common Stock Issued = $8,000 Ending Common Stock – $-0- Beginning Common Stock.

c. $150 Net Income = $150 Net Income from Income Statement.

d. $125 Dividends = $-0- Beginning Retained Earnings + $150 Net Income – $25 Ending Retained Earnings.

e. $8,025 Total Stockholders' Equity = $8,000 Ending Common Stock + $25 Ending Retained Earnings.

f. $11,000 Cash = $11,000 Total Assets – $-0- Land.

g. $2,975 Liabilities = $11,000 Total Liabilities and Stockholders' Equity – $8,025 Total Stockholders' Equity.

h. $8,000 Common Stock = $8,000 Ending Common Stock from Statement of Changes in Stockholders' Equity.

i. $25 Retained Earnings = $25 Ending Retained Earnings from Statement of Changes in Stockholders' Equity.

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j. $400 Cash Receipts from Revenue = $400 Revenue from Income Statement.

k. $250 Cash Payments for Expenses = $250 Expenses from Income Statement.

l. $400 Expenses = $500 Revenue – $100 Net Income.

m. $8,000 Beginning Common Stock = $8,000 Ending Common Stock for Year 1.

n. $75 Ending Retained Earnings = $25 Beginning Retained Earnings + $100 Net Income – $50 Dividends.

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PROBLEM 2-37B (cont.)

o. $6,650 Cash = $6,650 Ending Cash Balance from the Statement of Cash Flows.

p. $5,000 Land = $11,650 Total Assets – $6,650 Cash.

q. $2,475 Liabilities = $11,650 Total Liabilities and Stockholders' Equity – $9,175 Total Stockholders' Equity.

r. $9,100 Common Stock = $9,100 Ending Common Stock from Statement of Changes in Stockholders' Equity.

s. $9,410 Ending Common Stock = $9,100 Beginning Common Stock + $310 Stock issued.

t. $9,710 Total Stockholders' Equity = $9,410 Ending Common Stock + $300 Ending Retained Earnings.

u. $8,050 Cash = $10,550 Total Assets – $2,500 Land.

v. $800 Cash Receipts from Revenue = $800 Revenue from Income Statement.

w. $425 Cash Payments for Expenses = $425 Expenses from Income Statement.

x. $1,635 Cash Payments to Reduce Debt = $2,475 Liabilities Balance, Year 2 – $840 Liabilities Balance, Year 3.

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y. $310 Cash Receipts from Stock Issue = $310 Common Stock Issued from Statement of Changes in Stockholders' Equity.

z. $150 Cash Payments for Dividends = $150 Dividends from Statement of Changes in Stockholders' Equity.

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Problem 2-38B *Events for two complete accounting cycles*

Alabama Service Company was formed on January 1, Year 1.

Events Affecting the Year 1 Accounting Period

1. Acquired $60,000 cash from the issue of common stock.
2. Purchased $1,200 of supplies on account.
3. Purchased land that cost $18,000 cash.
4. Paid $800 cash to settle accounts payable created in Event 2.
5. Recognized revenue on account of $42,000.
6. Paid $21,000 cash for other operating expenses.
7. Collected $38,000 cash from accounts receivable.

Information for Year 1 Adjusting Entries

8. Recognized accrued salaries of $3,200 on December 31, Year 1.
9. Had $200 of supplies on hand at the end of the accounting period.

Events Affecting the Year 2 Accounting Period

1. Acquired $20,000 cash from the issue of common stock.
2. Paid $3,200 cash to settle the salaries payable obligation.
3. Paid $3,600 cash in advance for a lease on office facilities.
4. Sold land that had cost $15,000 for $15,000 cash.
5. Received $4,800 cash in advance for services to be performed in the future.
6. Purchased $1,000 of supplies on account during the year.
7. Provided services on account of $32,000.
8. Collected $33,000 cash from accounts receivable.
9. Paid a cash dividend of $5,000 to the stockholders.
10. Paid other operating expenses of $19,500.

Information for Year 2 Adjusting Entries

11. The advance payment for rental of the office space (see Event 3) was made on March 1 for a one-year term.
12. The cash advance for services to be provided in the future was collected on October 1 (see Event 5). The one-year contract started October 1.

PROBLEM 2-38B (Problem cont. on next page)

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PROBLEM 2-38B (Problem cont.)

Information for Year 2 Adjusting Entries

11. The advance payment for rental of the office space (see Event 3) was made on March 1 for a one-year term.
12. The cash advance for services to be provided in the future was collected on October 1 (see Event 5). The one-year contract started October 1.

Required

a. Identify each event affecting the Year 1 and Year 2 accounting periods as asset source (AS), asset use (AU), asset exchange (AE), or claims exchange (CE). Record the effects of each event under the appropriate general ledger account headings of the accounting equation.

b. Prepare an income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows for Year 1 and Year 2, using the vertical statements model.

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PROBLEM 2-38B (Solution on next page.)

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PROBLEM 2-38B SOLUTION

a.

Alabama Service Company
Accounting Equation for Year 1

		Assets					=	Liabilities			+	Stk. Equity	
Event	Type of Event	Cash	Accts. Rec.	Supp.	Prepd. Rent	Land	=	Accts. Pay.	Salaries Payable	Unearn. Rev.	+	Com. Stock	Retained Earnings
1.	AS	60,000										60,000	
2.	AS			1,200				1,200					
3.	AE	(18,000)				18,000							
4.	AU	(800)						(800)					
5.	AS		42,000										42,000
6.	AU	(21,000)											(21,000)
7.	AE	38,000	(38,000)										
8.	CE								3,200				(3,200)
9.	AU			(1,000)									(1,000)
Totals		58,200	4,000	200	-0-	18,000	=	400	3,200	-0-	+	60,000	16,800

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PROBLEM 2-38B (Sol. cont.)

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PROBLEM 2-38B (Sol. cont.)

Alabama Service Company
Accounting Equation for Year 2

		Assets						=	Liabilities			+	Stk. Equity	
Event	Type of Event	Cash	Accts. Rec.	Supp.	Prepd. Rent	Int. Rec.	Land	=	Accts. Pay.	Salaries Payable	Unearn. Revenue	+	Com. Stock	Retained Earnings
Bal.		58,200	4,000	200	-0-		18,000		400	3,200	-0-		60,000	16,800
1.	AS	20,000											20,000	
2.	AU	(3,200)								(3,200)				
3.	AE	(3,600)			3,600									
4.	AE	15,000					(15,000)							
5.	AS	4,800									4,800			
6.	AS			1,000					1,000					
7.	AS		32,000											32,000
8.	AE	33,000	(33,000)											
9.	AU	(5,000)												(5,000)
10.	AU	(19,500)												(19,500)
11.	AU				(3,000)[1]									(3,000)
12.	CE										(1,200)[2]			1,200
13.	AU			(900)										(900)
14.	CE									3,900				(3,900)
15.	AS					400								400
Totals		99,700	3,000	300	600	400	3,000	=	1,400	3,900	3,600	+	80,000	18,100

[1]$3,600 x 10/12 = $3,000
[2]$4,800 x 3/12 = $1,200

PROBLEM 2-38B (Sol. cont. on next page.)

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PROBLEM 2-38B (Sol. cont.)

b.

Alabama Service Company
Financial Statements
For the Years Ended December 31, Year 1 and Year 2

Income Statements	Year 1	Year 2
Service Revenue	$ 42,000	$ 33,200
Interest Revenue	-0-	400
	42,000	33,600
Expenses		
Operating Expenses	(21,000)	(19,500)
Supplies Expense	(1,000)	(900)
Salaries Expense	(3,200)	(3,900)
Rent Expense	-0-	(3,000)
Total Expenses	(25,200)	(27,300)
Net Income	$16,800	$ 6,300

Statements of Changes in Stockholders' Equity		
Beginning Common Stock	$ -0-	$60,000
Plus: Stock Issued	60,000	20,000
Ending Common Stock	60,000	80,000
Beginning Retained Earnings	-0-	16,800
Plus: Net Income	16,800	6,300
Less: Dividends	-0-	(5,000)
Ending Retained Earnings	16,800	18,100
Total Stockholders' Equity	$76,800	$98,100

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PROBLEM 2-38B b. (Sol. cont.)

Alabama Service Company
Balance Sheets
As of December 31, Year 1 and Year 2

	Year 1	Year 2
Assets		
Cash	$58,200	$99,700
Accounts Receivable	4,000	3,000
Interest Receivable	-0-	400
Supplies	200	300
Prepaid Rent	-0-	600
Land	18,000	3,000
Total Assets	$80,400	$107,000
Liabilities		
Accounts Payable	$ 400	$ 1,400
Salaries Payable	3,200	3,900
Unearned Revenue	-0-	3,600
Total Liabilities	3,600	8,900
Stockholders' Equity		
Common Stock	60,000	80,000
Retained Earnings	16,800	18,100
Total Stockholders' Equity	76,800	98,100
Total Liab. and Stockholders' Equity	$80,400	$107,000

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PROBLEM 2-38B b. (Sol. cont.)

Alabama Service Company
Statements of Cash Flows
For the Years Ended December 31, Year 1 and Year 2

	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Received from Customers	$38,000	$37,800
Cash Payment for Expenses[1]	(21,800)	(26,300)
Net Cash Flow from Operating Activities	16,200	11,500
Cash Flows From Investing Activities:		
Cash Payment for Land	(18,000)	-0-
Cash Proceeds from Sale of Land		15,000
Net Cash Flow From Investing Activities	(18,000)	15,000
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	60,000	20,000
Cash Payment for Dividends	-0-	(5,000)
Net Cash Flow From Financing Activities	60,000	15,000
Net Change in Cash	58,200	41,500
Plus: Beginning Cash Balance	-0-	58,200
Ending Cash Balance	$58,200	$99,700

[1]Year 1: $800 + $21,000 = $21,800
Year 2: $3,200 + $3,600 + $19,500 = $26,300

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SOLUTIONS TO QUESTIONS - CHAPTER 2

1. **Accrual accounting attempts to record the effects of accounting events in the period when such events occur, regardless of when cash is received or paid. The goal is to match expenses with the revenues that they produce.**

2. **Recognition is the act of recording an event in the financial statements. When accruals are used, events are recognized before the associated cash is paid or collected.**

3. **Deferral is the recognition of revenue or expenses in a period after the cash consequences are realized, i.e., cash is collected in advance of performing the service.**

4. **If cash is collected in advance for services, the revenue is recognized when the services are rendered.**

5. **An asset source transaction increases assets and increases either liabilities or equity.**

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6. **The issue of common stock, which is capital acquired from owners, increases business assets (usually cash) and equity (common stock).**

7. **The recognition of revenue on account increases the corresponding revenue account on the income statement, but does not affect the statement of cash flows. The cash flow statement is affected when the account is collected.**

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8.

Asset Source Transaction	Effect on Accounting Equation
Issue of Common Stock	Increases Assets Increases Common Stock
Revenue Earned	Increases Assets Increases Retained Earnings
Borrowed Funds	Increases Assets Increases Liabilities

9. Revenue is recognized under accrual accounting when a revenue-producing event occurs, i.e., when the revenue is *earned*, even if no cash is collected at the time of the transaction.

10. The collection of cash for accounts receivable is an asset exchange transaction. Only the asset side of the accounting equation is affected because one asset account increases (cash), and another asset account decreases (accounts receivable). Total assets are unchanged.

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11. If cash is collected in advance for services, a liability is created (unearned revenue), increasing the claims side of the accounting equation.

12. Unearned revenue is cash that has been collected for services that have not yet been performed.

13. The recognition of expenses affects the accounting equation by either decreasing assets or increasing liabilities (payables) and by decreasing stockholders' equity (retained earnings).

14. A claims exchange transaction is one where the claims of creditors (liabilities) increase and the claims of stockholders (retained earnings) decrease, or vice versa. The total amount of claims is unchanged.

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15. Cash payments to creditors are <u>asset use</u> transactions. These transactions result in the reduction of an asset account (cash) and the reduction of the corresponding liability account (payables).

16. Expenses are recognized under accrual accounting at the time the expense is incurred or resources are consumed, regardless of when cash payment is made.

17. Net cash flows from operations on the cash flow statement may be different from net income because of the application of accrual accounting. Revenues and expenses reported on the income statement may be recognized before or after the actual collection or payment of cash that is reported on the cash flow statement.

18. The income statement reflects the change in net assets associated with operating a business, as shown by revenues and expenses. Expenses may result from a decrease in assets or an increase in liabilities. Revenues may result from an increase in assets or a decrease in liabilities.

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19. Net income increases stockholders' claims on business assets by increasing retained earnings.

20. A cost can be either an asset or an expense. If the item acquired has already been used in the process of earning revenue, its cost represents an expense. If the item will be used in the future to generate revenue, its cost represents an asset.

21. A cost is held in the asset account until the item is used to produce revenue. When the revenue is generated, the asset is converted into an expense in order to match revenues with related expenses. Not all costs become expenses. If the value of an asset will not expire in the revenue-generating process, the asset will not become an expense. For example, the cost of land will not become an expense because land does not depreciate.

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22. Supplies used during the accounting period are recognized in a single adjusting entry at the end of the period. The amount of supplies used is determined by subtracting the amount of supplies on hand at the end of the period from the amount of supplies that were available for use (beginning supplies balance plus supplies purchased).

23. An expense is a decrease in assets or an increase in liabilities that occurs in the process of generating revenue.

24. Revenue is an increase in assets or a decrease in liabilities that results from the operating activities of the business.

25. The purpose of the statement of changes in stockholders' equity is to display the effects of business operations and stock issued to owners and dividends paid to stockholders. It identifies the ways that an entity's equity increased and decreased as a result of its operations and transactions with its stockholders.

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26. The purpose of the balance sheet is to provide information about an entity's assets, liabilities, and stockholders' equity and their relationships to each other at a particular point in time. It provides a list of the economic resources that the enterprise has available for its operating activities and the claims to those resources.

27. The balance sheet is dated as of a specific date because it shows information about an entity's assets, liabilities, and stockholders' equity as of that date, not measured over a time period. The statement of changes in stockholders' equity, the income statement, and the statement of cash flows reflect transactions that occur over a period of time.

28. Assets are listed on the balance sheet in accordance with their respective levels of liquidity (how rapidly they can be converted to cash).

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29. The statement of cash flows explains the change in cash from one accounting period to the next. It is prepared by analyzing the cash account and summarizing where cash came from and how it was used.

30. An adjusting entry is an entry that updates account balances prior to preparation of the financial statements. The entry means that there is an item that needs proper measurement on the income statement and an adjustment will reflect the correct time period of earning or usage. Example: entry to recognize accrued interest revenue where the revenue has been earned but not yet collected and therefore revenue had not yet been recorded for the time period.

31. Temporary accounts (revenue, expense, and dividends) are closed at the end of the accounting period. It is necessary to close these accounts so that revenue, expense, and dividends can be accumulated from a beginning balance of zero for the next period.

32. Period costs are costs that are recognized in an accounting period. Examples of period costs include rent expense, utilities expense, and salaries expense.

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33. Salary of the tax return preparer could be directly matched with the revenue that it produces.

34. The four stages of the accounting cycle: Record transactions; adjust the accounts; prepare statements; and close the temporary accounts. The adjustment and closing processes have been added to the cycle in this chapter. It is necessary to adjust accounts so that the accounts will reflect the correct balances under the accrual basis of accounting. The closing process (transferring the balances of the temporary accounts to retained earnings) is necessary so that the temporary accounts have a zero balance at the beginning of the next accounting cycle.

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SOLUTIONS TO BRIEF EXERCISES - CHAPTER 2

BRIEF EXERCISE 2-1:

Balance Sheet										Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stk Equity									
Event No.	Cash	+	Accts. Rec.	=	Notes. Pay.	+	Com. Stk.	+	Ret. Earn.	Rev.	-	Exp.	=	Net Inc.		
1	200,000	+	NA	=	NA	+	200,000	+	NA	NA	-	NA	=	NA	200,000	FA
2	NA	+	80,000	=	NA	+	NA	+	80,000	80,000	-	NA	=	80,000	NA	
3	55,000	+	(55,000)	=	NA	+	NA	+	NA	NA	-	NA	=	NA	55,000	OA
Total	255,000	+	25,000	=	0	+	200,000	+	80,000	80,000	-	0	=	80,000	255,000	NC

***NC = Net change in cash**

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BRIEF EXERCISE 2-2:

Balance Sheet										Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stk Equity									
Event No.	Cash	+	Accts. Rec.	=	Accts. Payable	+	Com. Stk.	+	Ret. Earn.	Rev.	-	Exp.	=	Net Inc.		
1	600,000	+	NA	=	NA	+	600,000	+	NA	NA	-	NA	=	NA	600,000	FA
2	NA	+	NA	=	120,000	+	NA	+	(120,000)	NA	-	120,000	=	(120,000)	NA	
3	(100,000)	+	NA	=	(100,000)	+	NA	+	NA	NA	-	NA	=	NA	(100,000)	OA
Total	500,000	+	0	=	20,000	+	600,000	+	(120,000)	0	-	120,000	=	(120,000)	500,000	NC

***NC = Net change in cash**

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BRIEF EXERCISE 2-3:

a.

Balance Sheet										Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stk Equity									
Event No.	Cash	+	Accts. Rec.	=	Salaries Pay.	+	Com. Stk.	+	Ret. Earn.	Rev.	-	Exp.	=	Net Inc.		
1	NA	+	50,000	=	NA	+	NA	+	50,000	50,000	-	NA	=	50,000	NA	
2	10,000	+	(10,000)	=	NA	+	NA	+	NA	NA	-	NA	=	NA	10,000	OA
3	NA	+	NA	=	25,000	+	NA	+	(25,000)	NA	-	25,000	=	(25,000)	NA	
Total	10,000	+	40,000	=	25,000	+	NA	+	25,000	50,000	-	25,000	=	25,000	10,000	NC

***NC = Net change in cash**

b.

Yes.

<u>Explanation:</u> Net income for Year 1 totaled $25,000 while net cash flow from OA totaled $10,000. The balances are different because accrued revenues and expenses impact the income statement but do not impact the statement of cash flows.

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BRIEF EXERCISE 2-4:

a. Service Revenue before Closing = $90,000
Service Revenue after Closing = $0

Operating expenses and dividends would also be closed at the end of the accounting cycle.

b. Retained Earnings Balance = $35,000 ($90,000 - $50,000 - $5,000)

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BRIEF EXERCISE 2-5:

Balance Sheet										Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stk Equity									
Event No.	Cash	+	Supplies	=	Accts. Payable	+	Com. Stk.	+	Ret. Earn.	Rev.	-	Exp.	=	Net Inc.		
Beg.	4,000	+	NA	=	NA	+	2,000	+	2,000	NA	-	NA	=	NA		
1	NA	+	800	=	800	+	NA	+	NA	NA	-	NA	=	NA	NA	
2	NA	+	(500)	=	NA	+	NA	+	(500)	NA	-	500	=	(500)	NA	
Total	4,000	+	300	=	800	+	2,000	+	1,500	0	-	500	=	(500)	0	NC

***NC = Net change in cash**

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BRIEF EXERCISE 2-6:

Balance Sheet										Income Statement					Statement of Cash Flows	
	Assets			=	Liab.	+	Stk Equity									
Event No.	Cash	+	Prepaid Ins.	=	Accts. Payable	+	Com. Stk.	+	Ret. Earn.	Rev.	-	Exp.	=	Net Inc.		
Beg.	50,000	+	NA	=	NA	+	10,000	+	40,000	NA	-	NA	=	NA	NA	
1	(30,000)	+	30,000	=	NA	+	NA	+	NA	NA	-	NA	=	NA	(30,000)	OA
2	NA	+	(22,500)	=	NA	+	NA	+	(22,500)	NA	-	22,500	=	(22,500)	NA	
Total	20,000	+	7,500	=	0	+	10,000	+	17,500	0	-	22,500	=	(22,500)	(30,000)	NC

***NC = Net change in cash**

<u>Explanation</u>: Amortization of prepaid insurance is calculated as follows: ($30,000 * [9/12]) = $22,500

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BRIEF EXERCISE 2-7:

Balance Sheet									Income Statement					Statement of Cash Flows	
	Assets	=	Liab.			+	Stk Equity								
Event No.	Cash	=	Notes Pay.	+	Unearn Rev.	+	Com. Stk.	+	Ret. Earn.	Rev.	-	Exp.	=	Net Inc.		
1	80,000	=	80,000	+	NA	+	NA	+	NA	NA	-	NA	=	NA	80,000	FA
2	30,000	=	NA	+	30,000	+	NA	+	NA	NA	-	NA	=	NA	30,000	OA
3	NA	=	NA	+	(20,000)	+	NA	+	20,000	20,000	-	NA	=	20,000	NA	
Total	110,000	=	80,000	+	10,000	+	0	+	20,000	20,000	-	0	=	20,000	50,000	NC

***NC = Net change in cash**

<u>Explanation:</u> Amortization of unearned revenue is calculated as follows: ($40,000 * [8/12]) = $20,000

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BRIEF EXERCISE 2-8:

Account	Financial Statement
Supplies	Balance Sheet
Service Revenue	Income Statement
Prepaid Rent	Balance Sheet
Unearned Revenue	Balance Sheet
Salary Expense	Income Statement

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BRIEF EXERCISE 2-9:

1. **Asset Source**
2. **Asset Use**
3. **Asset Source**
4. **Asset Use**
5. **Asset Exchange**

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SOLUTIONS TO EXERCISES - CHAPTER 2 - SET A

EXERCISE 2-1A

Holloway Company
Effect of Events on the Year 1 Accounting Equation

	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	+	Accounts Rec.	=		+	Common Stock	+	Retained Earnings
Earned Revenue		+	18,000	=		+		+	18,000
Coll. Acct. Rec.	14,000	+	(14,000)	=		+		+	
Ending Balance	14,000	+	4,000	=	-0-	+	-0-	+	18,000

a. Accounts Receivable: $18,000 – $14,000 = $4,000

b. $18,000 Net Income

c. $14,000 cash collected from accounts receivable.

d. $18,000

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e. $18,000 of revenue was earned but only $14,000 of it was collected.

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EXERCISE 2-2A

a.

Chung Corporation Accounting Equation – Year 1							
Event	Assets	=	Liabilities	+	Stockholders' Equity		
	Cash	=	Salaries Payable	+	Common Stock	+	Retained Earnings
Earned Rev.	8,000						8,000
Accrued Sal.			5,000				(5,000)
Ending Bal.	8,000	=	5,000	+	-0-	+	3,000

Chung Corporation Balance Sheet As of December 31, Year 1		
Assets		
Cash	$8,000	
Total Assets		$8,000
Liabilities		
Salaries Payable	$5,000	
Total Liabilities		$5,000
Stockholders' Equity		
Retained Earnings	$3,000	
Total Stockholders' Equity		3,000
Total Liab. and Stockholders' Equity		$8,000

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b.

Computation of Net Income	
Revenue	$8,000
Less: Expenses	(5,000)
Net Income	$3,000

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EXERCISE 2-2A (cont.)

c.

Cash Flow from Operating Activities:	
Cash from Revenue	**$8,000**
Net Cash Flow from Operating Act.	**$8,000**

d. **The salary expense is deducted from revenue in computing net income, but it has not been paid. This creates a difference of $5,000 between net income and cash flow from operating activities. The revenue is the same because it has been earned and collected.**

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EXERCISE 2-3A

a.

Milea Inc.
General Ledger Accounts
For the Year Ended December 31, Year 1

	Assets		=	Liabilities	+	Stockholders' Equity		
Event	Cash	Acct. Rec.	=	Salaries Pay.	+	Common Stock	Retained Earn.	Acct. Title for RE
1.	20,000					20,000		
2.		56,000					56,000	Revenue
3.	(2,500)						(2,500)	Util. Exp.
4.	48,000	(48,000)						
5.				10,000			(10,000)	Sal. Exp.
6.	(2,000)						(2,000)	Dividends
Totals	63,500	8,000	=	10,000	+	20,000	41,500	

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b.

Milea Inc.
Income Statement
For the Year Ended December 31, Year 1

Revenue		$56,000
Expenses		
Utility Expense	$ 2,500	
Salaries Expense	10,000	
Total Expenses		(12,500)
Net Income		$43,500

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EXERCISE 2-3A b. (cont.)

Milea Inc. Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 1		
Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	20,000	
Ending Common Stock		$20,000
Beginning Retained Earnings	-0-	
Plus: Net Income	$43,500	
Less: Dividends	(2,000)	
Ending Retained Earnings		41,500
Total Stockholders' Equity		$61,500

Milea Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$63,500	
Accounts Receivable	8,000	
Total Assets		$71,500
Liabilities		
Salaries Payable	$10,000	
Total Liabilities		$10,000
Stockholders' Equity		
Common Stock	$20,000	
Retained Earnings	41,500	
Total Stockholders' Equity		61,500
Total Liab. and Stockholders' Equity		$71,500

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EXERCISE 2-3A b. (cont.)

Milea Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flow From Operating Activities		
Cash Received from Customers	$48,000	
Cash Paid for Expenses	(2,500)	
Net Cash Flow from Operating Act.		$45,500
Cash Flow From Investing Activities		-0-
Cash Flow From Financing Activities		
Issue of Stock	$20,000	
Paid Dividends	(2,000)	
Net Cash Flow from Financing Act.		18,000
Net Change in Cash		63,500
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$63,500

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c. Net income is the difference between services performed and expenses incurred, regardless of the cash collected or paid. Cash flow from operating activities is the difference between cash collected and paid for operating activities. There was $56,000 of income earned, but only $48,000 collected and $12,500 of expenses incurred, but there was only $2,500 paid.

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EXERCISE 2-4A

a.

Lewis and Harper Horizontal Statements Model Year 1																
	Balance Sheet									Income Statement					Statement of	
	Assets			=	Liabilities			+	Stk. Equity	Rev.	–	Exp.	=	Net Inc.	Cash Flows	
Event No.	Cash	+	Accts. Rec.	=	Acct. Payable	+	Sal. Pay.	+	Ret. Earn.							
1.	NA		70,000		NA		NA		70,000	70,000		NA		70,000	NA	
2.	40,000		NA		NA		NA		40,000	40,000		NA		40,000	40,000	OA
3.	NA		NA		36,000		NA		(36,000)	NA		36,000		(36,000)	NA	
4.	(10,000)		NA		NA		NA		(10,000)	NA		10,000		(10,000)	(10,000)	OA
5.	47,000		(47,000)		NA		NA		NA	NA		NA		NA	47,000	OA
6.	(16,000)		NA		(16,000)		NA		NA	NA		NA		NA	(16,000)	OA
7.	(8,000)		NA		NA		NA		(8,000)	NA		NA		NA	(8,000)	FA
8.	NA		NA		NA		2,000		(2,000)	NA		2,000		(2,000)	NA	
Totals	53,000	+	23,000	=	20,000	+	2,000	+	54,000	110,000	–	48,000	=	62,000	53,000	NC

*NC = Net change in cash

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b. Total assets: $76,000 ($53,000 + $23,000)

c. $23,000

d. $20,000

e. Accounts Receivable (an asset) is an amount owed to Lewis and Harper: $23,000;
Accounts Payable (a liability) is an amount that Lewis and Harper owes: $20,000

f. $62,000

g. $61,000 ($40,000 – $10,000 + $47,000 – $16,000)

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EXERCISE 2-5A

a.

Computation of Net Income	
Revenue recognized on account	$68,000
Less accrued salary expense	(46,000)
Net Income	$22,000

b.

Computation of Cash Collected from Accounts Receivable	
Beginning balance of Accounts Receivable	$ 4,000
Add revenue recognized on account	68,000
Less ending balance of Accounts Receivable	(4,500)
Cash collected from accounts receivable	$67,500

Computation of Cash Paid for Salaries Expense	
Beginning balance of Salaries Payable	$ 2,600
Add accrued salary expense recognized	46,000
Less ending balance of Salaries Payable	(1,500)
Cash paid for Salary Expense	$47,100

Cash Flow from Operating Activities	
Cash from Accounts Receivable	$67,500
Cash paid for Salary Expense	(47,100)
Net Cash Flow from Operating Act.	$20,400

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EXERCISE 2-6A

a. & c.

Event	Revenue	Expense	Statement of Cash Flows	
1.	NA	NA	$40,000	FA
2.	$82,000	NA		NA
3.	NA	NA	(6,000)	FA
4.	NA	NA	76,000	OA
5.	NA	$53,000	(53,000)	OA
6.	19,000	NA	19,000	OA
7.	NA	3,500		NA

b.

Computation of Net Income	
Revenue	$101,000
Less: Expenses	(56,500)
Net Income	$44,500

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d.

Cash Flow from Operating Activities	
Cash from Revenue	$95,000
Cash paid for expenses	(53,000)
Net Cash Flow from Operating Act.	$42,000

e. The before-closing balance in the Revenue account is $101,000. After it is closed to Retained Earnings the balance will be zero. Other accounts that are closed at the end of the period include any other revenue accounts, the expense accounts, and the dividends account.

f. The balance of Retained Earnings on the Year 1 Balance Sheet will be the amount of Net Income, $44,500 minus $6,000 of dividends that were paid during the year = $38,500. There was no beginning balance in Retained Earnings.

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EXERCISE 2-7A

Lee Inc.
Effect of Events on the General Ledger Accounts

	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	Accounts Receivable	Land	=	Accounts Payable	+	Com. Stock	+	Retained Earnings
1. Sales on Account		62,000							62,000
2. Coll. Accts. Rec.	51,000	(51,000)							
3. Incurred Expense					39,000				(39,000)
4. Pd. Acc. Pay.	(31,000)				(31,000)				
5. Issue of Stock	40,000						40,000		
6. Purchase Land	(21,000)		21,000						
Totals	39,000	11,000	21,000	=	8,000	+	40,000	+	23,000

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a. Revenue recognized, $62,000.

b. Cash flow from revenue, $51,000.

c. Revenue, $62,000, less operating expenses, $39,000 = $23,000 net income.

d. Accounts receivable collected, $51,000, less cash paid for expenses, $31,000 = $20,000 cash flow from operating activities.

e. Income of $62,000 was earned, but only $51,000 was collected (a difference of $11,000); operating expenses incurred were $39,000 but only $31,000 was paid during the period (a difference of $8,000). Consequently, net income is $3,000 more than cash flow from operating activities.

f. $21,000 cash outflow for the purchase of land.

g. $40,000 cash inflow from the issue of common stock.

h. Total assets = $71,000 ($39,000 + $11,000 + $21,000)
Total liabilities = $8,000
Total equity = $63,000 ($40,000 + $23,000)

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EXERCISE 2-8A

a.

Pizza Express Inc.
Effect of Events on Financial Statements for Year 2

	Assets			=	Liab.	+	Stk. Equity			Income Statement					Statement of Cash Flows
Event No.	Cash	+	Supplies	=	Accts. Pay.	+	Com. Stock	+	Ret. Earn.	Rev.	–	Exp.	=	Net Income	
Beg. Bal	2,500	+	-0-	=	-0-	+	1,400	+	1,100	-0-	–	-0-	=	-0-	-0-
1.	NA	+	3,600	=	3,600	+	NA	+	NA	NA	–	NA	=	NA	NA
2.	12,300	+	NA	=	NA	+	NA	+	12,300	12,300	–	NA	=	12,300	12,300 OA
3.	(2,700)	+	NA	=	(2,700)	+	NA	+	NA	NA	–	NA	=	NA	(2,700) OA
4.	NA	+	(3,350)	=	NA	+	NA	+	(3,350)	NA	–	3,350	=	(3,350)	NA
Totals	12,100	+	250	=	900	+	1,400	+	10,050	12,300	–	3,350	=	8,950	9,600 NC

*NC = Net change in cash

b. The difference in net income and cash flow from operating activities of $650 ($8,950 – $9,600) is attributed to recognizing supplies expense of $3,350 in the income statement, whereas the cash payment on accounts payable (for supplies) was only $2,700.

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EXERCISE 2-9A

Yard Professionals Inc.
Effect of Events on the Accounting Equation

	Assets		=	Liab.	+	Stk. Equity
Event	Cash	Supplies	=	Accounts Payable		Retained Earnings
1. Provided Service	35,000					35,000
2. Purchased Supplies		6,000		6,000		
3. Used Supplies		(4,200)				(4,200)
Totals	35,000	1,800	=	6,000		30,800

b.

Yard Professionals Inc.
Income Statement
For the Year Ended December 31, Year 1

Revenue	$35,000
Expense	(4,200)
Net Income	$30,800

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EXERCISE 2-9A b. (cont.)

Yard Professionals Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$35,000	
Supplies	1,800	
Total Assets		$36,800
Liabilities		
Accounts Payable	$ 6,000	
Total Liabilities		$ 6,000
Stockholders' Equity		
Retained Earnings	30,800	
Total Stockholders' Equity		30,800
Total Liab. and Stockholders' Equity		$36,800

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EXERCISE 2-9A b. (cont.)

Yard Professionals Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$35,000	
Net Cash Flow from Operating Activities		$35,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		35,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$35,000

c. The balance of the Supplies account on January 1, Year 2 is $1,800, the same as the December 31, Year 1 balance.

d. The balance of the Supplies Expense account on January 1, Year 2 is zero because the expense account was closed to Retained Earnings at December 31, Year 1.

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EXERCISE 2-10A

a. A cost that is an asset is the cost of resources that are given up in acquiring some type of asset, such as an automobile, office equipment, or land. A cost that is an expense is the use of assets (depreciation) or the payment for an expense that is incurred in the current period (utilities, salaries, etc.).

b. Examples of costs that are assets:
   1. Purchased land.
   2. Paid for 12 months rent in advance.
   3. Purchased supplies for future use.

c. Examples of costs that are expenses:
   1. Recorded rent that has expired.
   2. Paid monthly utilities expense.
   3. Used supplies that had been previously purchased.

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EXERCISE 2-11A

a.

Life, Inc. Effect of Events on the Accounting Equation				
	Assets		=	Stockholders' Equity
Event	Cash	Prepaid Rent	=	Retained Earnings
1. Performed Services	36,000			36,000
2. Prepaid Rent	(18,000)	18,000		
3. Used Rent		(16,500)[1]		(16,500)
Totals	18,000	1,500	=	19,500

[1]$18,000 x 11/12 = $16,500

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EXERCISE 2-11A (cont.)

b.

Life, Inc. Income Statement For the Year Ended December 31, Year 1	
Revenue	$36,000
Expense	(16,500)
Net Income	$19,500

Life, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$18,000	
Prepaid Rent	1,500	
Total Assets		$19,500
Liabilities		-0-
Stockholders' Equity		
Retained Earnings	19,500	
Total Stockholders' Equity		19,500
Total Liab. and Stockholders' Equity		$19,500

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EXERCISE 2-11A b. (cont.)

Life, Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$36,000	
Cash Payment for Rent	(18,000)	
Net Cash Flow from Operating Activities		$18,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		18,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$18,000

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c. The balance of the Prepaid Rent will be expensed in Year 2, $1,500 ($18,000 - $16,500).

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EXERCISE 2-12A

a.

Maine Corporation Accounting Equation Year 2								
	Assets		=	Liab.	+	Stockholders' Equity		
Event	Cash	Prepaid Rent	=		+	Com. Stock	+	Retained Earnings
Paid rent in advance	(18,000)	18,000						
Adj. Rent exp.		(13,500)[1]						(13,500)
Totals	(18,000)	4,500	=	-0-	+	-0-	+	(13,500)

[1]$18,000 x 9/12 = $13,500

b. The required entry would decrease assets by $13,500 [($18,000 ÷ 12) x 9] and decrease stockholders' equity by $13,500 (retained earnings). If this entry is not made, assets and stockholders' equity would both be overstated on the balance sheet by $13,500. On the income statement, expenses would be understated causing net income to be overstated by $13,500.

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EXERCISE 2-13A

a.

Yard Designs Accounting Equation Year 1					
Event	Assets	=	Liabilities	+	Stockholders' Equity
	Cash	=	Unearned Revenue	+	Retained Earnings
event	54,000		54,000		
Adj.			(13,500)[1]		13,500
	54,000	=	40,500		13,500

[1]$54,000 x 3/12 = $13,500

b.

Yard Designs Income Statement For the Year Ended December 31, Year 1	
Revenue	$13,500
Expense	-0-
Net Income	$13,500

Yard Designs Balance Sheet As of December 31, Year 1		
Assets		
Cash	$54,000	
Total Assets		$54,000
Liabilities		-0-
Unearned Revenue	$40,500	
Total Liabilities		$40,500
Stockholders' Equity		
Retained Earnings	13,500	
Total Stockholders' Equity		13,500
Total Liab. and Stockholders' Equity		$54,000

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EXERCISE 2-13A b. (cont.)

Yard Designs Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$54,000	
Net Cash Flow from Operating Activities		$54,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		54,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$54,000

c. Nine months of unearned revenue from Year 1 will be recognized in Year 2: $54,000 x 9/12 = $40,500

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EXERCISE 2-14A

Note: This exercise can be used to assess writing skills.

The fee that Matlock receives in advance is a liability at the time of receipt. Matlock has the duty to either perform the service or return the money received in advance. When Matlock performs the service, the liability will be satisfied and the revenue will be recognized.

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EXERCISE 2-15A

Hart, Attorney At Law
Effect of Transactions on the Financial Statements for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows
	Assets			=	Liabilities			+	Stk. Equity	Rev	–	Exp.	=	Net Inc.	
No.	Cash	+	Supplies	=	Accts. Payable	+	Unearn. Rev.	+	Ret. Earn.						
1.	36,000	+	NA	=	NA	+	36,000	+	NA	NA	–	NA	=	NA	36,000 OA
2.	54,000	+	NA	=	NA	+	NA	+	54,000	54,000	–	NA	=	54,000	54,000 OA
3.	NA	+	2,800	=	2,800	+	NA	+	NA	NA	–	NA	=	NA	NA
4.	(2,400)	+	NA	=	(2,400)	+	NA	+	NA	NA	–	NA	=	NA	(2,400) OA
5.	(5,000)	+	NA	=	NA	+	NA	+	(5,000)	NA	–	NA	=	NA	(5,000) FA
6.	(31,000)	+	NA	=	NA	+	NA	+	(31,000)	NA	–	31,000	=	(31,000)	(31,000) OA
7.	NA	+	(2,600)	=	NA	+	NA	+	(2,600)	NA	–	2,600	=	(2,600)	NA
8.	NA	+	NA	=	NA	+	(27,000)[1]	+	27,000	27,000	–	NA	=	27,000	NA
Totals	51,600	+	200	=	400	+	9,000	+	42,400	81,000	–	33,600	=	47,400	51,600 NC

[1]$36,000 x 9/12 = $27,000
*NC = Net change in cash

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EXERCISE 2-16A

a.

Bell Personal Financial Planning Horizontal Statements Model for Year 1													
	Assets	=	Liabilities	+	Stk. Equity	Income Statement					Statement of Cash Flows	
Event	Cash	=	Unearned Revenue	+	Ret. Earn.	Rev.	–	Exp.	=	Net Income		
1. Advance Payment	36,000		36,000		NA	NA		NA		NA	36,000	OA
2. Revenue Earned	NA		(21,000)[1]		21,000	21,000		NA		21,000	NA	
Totals	36,000	=	15,000	+	21,000	21,000	–	-0-	=	21,000	36,000	NC

[1]$36,000 x 7/12 = $21,000
*NC = Net change in cash

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b. Revenue that will be recognized in Year 2 is $15,000, the remainder of the unearned revenue from Year 1.

c. $-0-, no cash is received. All cash was received in Year 1.

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EXERCISE 2-17A

a.

Stokes Company Accounting Equation – Year 2								
Event	Assets		=	Liab.	+	Stockholders' Equity		
	Cash	Prepaid Rent	=		+	Common Stock	+	Retained Earnings
Paid 12 months rent	(4,800)	4,800						
Adj. for 3 months used		(1,200)[1]						(1,200)

[1]$4,800 x 3/12 = $1,200

b.

Eastport Rentals Accounting Equation – Year 2							
Event	Assets	=	Liabilities	+	Stockholders' Equity		
	Cash	=	Unearned Revenue	+	Common Stock	+	Retained Earnings
Recd. 12 months rent	4,800		4,800				
Earned 3 months rent			(1,200)[1]				1,200

[1]$4,800 x 3/12 = $1,200

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EXERCISE 2-18A

a. deferral

b. neither

c. neither

d. neither

e. deferral

f. accrual

g. neither

h. neither

i. accrual

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j. neither

k. accrual

l. deferral

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EXERCISE 2-19A

Note: There are many examples of events that illustrate the required effects. An example is given of each event.

a. Recognized accrued salaries expense.

b. Paid rent expense.

c. Recognized revenue for which cash had been received in advance (unearned revenue).

d. Provided service for cash.

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EXERCISE 2-20A

a. Retained Earnings is a permanent account, meaning that one period's ending balance becomes the next period's beginning balance. Since the December 31, Year 5 balance is $42,100, this was also the balance on January 1, Year 6.

b. The balance in the temporary accounts will be zero on January 1, Year 5. The temporary accounts would have been closed to Retained Earnings on December 31, Year 4, thus leaving a zero balance.

c. The December 31, Year 4 balance in the Retained Earnings account is the same balance as the January 1, Year 5 balance, computed as follows:

Beginning Retained Earnings Balance, January 1, Year 5	$?
+ Net Income, Year 5 (Revenue $19,400 – Expenses $9,800)	9,600
– Dividends paid Year 5	(500)
= Ending Retained Earnings Balance, December 31, Year 5	$42,100

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Working backwards:
End. Retained Earnings + Dividends – Net Income = Beg. Retained Earnings; and January 1, Year 5 = December 31, Year 4
= $42,100 + $500 – $9,600 = $33,000 = January 1, Year 5 Retained Earnings
Therefore:
December 31, Year 4 Retained Earnings = $33,000

d. The revenue and expense data are recorded in Revenue and Expense accounts and do not affect retained earnings at the time of recognition. The balance in the Retained Earnings account on June 30, Year 5 is the same as it was on January 1, Year 5 which is $33,000 (see answer (c) for calculation).

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EXERCISE 2-21A

a.

Event	Requires year-end adjusting entry?
1.	No
2.	No
3.	No
4.	Yes
5.	No
6.	Yes
7.	No
8.	No
9.	No
10.	No

b. Adjusting entries are required to update accounting records for income that has been earned or expenses that have been incurred. Revenue and expenses are recognized in the period that they are earned or incurred, not necessarily when the cash is received or paid. After the adjusting entries are made at the end of the accounting period, the revenue, expense, and dividends accounts are closed to Retained Earnings.

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EXERCISE 2-22A

a.

Permanent Accounts
Cash
Notes Payable
Land
Common Stock
Retained Earnings

Temporary (Nominal) Accounts
Revenue
Expenses
Dividends

b.

Beginning Retained Earnings	$2,500
Add: Revenue	7,500
Less: Expenses	(3,400)
Less: Dividends	(1,000)
Ending Retained Earnings	$5,600

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c.

Computation of Net Income	
Revenue	$7,500
Less: Expenses	(3,400)
Net Income	$4,100

d. Net income is only the current year's net income. Retained Earnings is an accumulation of net income over the life of the business less any dividends that have been paid over the years.

e. All revenue, expense, and dividend accounts will have a zero balance because they have been closed to retained earnings.

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EXERCISE 2-23A

a.

Account	Classification
1. Other Operating Expenses	T
2. Utilities Expense	T
3. Retained Earnings	P
4. Salaries Expense	T
5. Land	P
6. Dividends	T
7. Service Revenue	T
8. Cash	P
9. Salaries Payable	P
10. Common Stock	P

b. The four stages of the accounting cycle are:

recording transactions
adjusting the accounts
preparing financial statements
closing temporary accounts.

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The first stage of the cycle must be recording accounting data in accounts to put it into usable form. Once the accounting data is summarized in the accounts, adjustments are made to reflect any unrecorded transactions. The account balances are then used to prepare the financial statements. After the financial statements are prepared, the temporary accounts (revenue, expenses, and dividends) must be closed to prepare these accounts for the next accounting period.

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EXERCISE 2-24A

a. Examples of expenses that would be matched directly with revenue:

Sales commissions
Salaries expense

b. An example of a period cost that is difficult to match with revenue:

Advertising expense - A company can not be certain when dollars spent for advertising will produce benefits.

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EXERCISE 2-25A

a.

Event	Classification
1.	FA
2.	NA
3.	OA
4.	OA
5.	OA
6.	NA
7.	OA
8.	FA
9.	OA
10.	NA

b.

Ewing Company
Statement of Cash Flows
For the Year Ended December 31, Year 1

Cash Flows From Operating Activities:		
Cash from the collection of accts. rec.	$51,000	
Cash from service revenue	8,000	
Cash payment for supplies	(1,200)	
Cash payment on accounts payable	(22,000)	
Cash payment for rent	(6,500)	
Net Cash Flow from Operating Activities		$29,300
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		
Cash receipt from stock issue	$30,000	
Cash payment for dividends	(4,000)	
Net Cash Flow from Financing Activities		26,000
Net Change in Cash		$55,300
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$55,300

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EXERCISE 2-26A

Item/Account	Statement		Item/Account	Statement
a. Supplies	BS		u. Rent Exp.	IS
b. Cash Flow from Financing Act.	CF		v. P/E Ratio	NA
c. "As of" Date Notation	BS		w. Taxes Payable	BS
d. End Retained Earn.	BS/SE		x. Unearned Revenue	BS
e. Net Income	IS/SE		y. Service Revenue	IS
f. Dividends	SE/CF		z. Cash Flow from Investing Activities	CF
g. Net Change in Cash	CF		aa. Consulting Revenue	IS
h. "For the Period Ended"	IS/CF/SE		bb. Utilities Expense	IS
i. Land	BS		cc. Operating Income	IS
j. Ending Common Stock	BS/SE		dd. Total Liabilities	BS
k. Salaries Expense	IS		ee. Operating Cycle	NA
l. Prepaid Rent	BS		ff. Cash Flow from Operating Activities	CF
m. Accounts Payable	BS		gg. Operating Expenses	IS
n. Total Assets	BS		hh. Supplies Expense	IS
o. Salaries Payable	BS		ii. Beg. Retained Earn.	SE
p. Insurance Expense	IS		jj. Beg. Common Stock	SE
q. Notes Payable	BS		kk. Prepaid Insurance	BS
r. Accounts Receivable	BS		ll. Salary Expense	IS
s. Interest Receivable	BS		mm. Beginning Cash	CF
t. Interest Revenue	IS		nn. Ending Cash	BS/CF

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EXERCISE 2-27A

Horizontal Statements Model

						Stock. Equity			Income Statement					Statement of Cash Flows	
Event	Type of Event	Assets	=	Liab.	+	Com. Stock	+	Ret. Earn	Rev.	–	Exp	=	Net Inc.		
a.	AS	I		NA		NA		I	I		NA		I	I	OA
b.	AS	I		I		NA		NA	NA		NA		NA	NA	
c.	AE	I/D		NA		NA		NA	NA		NA		NA	D	OA
d.	AE	I/D		NA		NA		NA	NA		NA		NA	D	IA
e.	AU	D		NA		NA		D	NA		NA		NA	D	FA
f.	AS	I		NA		I		NA	NA		NA		NA	I	FA
g.	AU	D		D		NA		NA	NA		NA		NA	D	OA
h.	AE	I/D		NA		NA		NA	NA		NA		NA	I	OA
i.	AS	I		I		NA		NA	NA		NA		NA	I	OA
j.	CE	NA		I		NA		D	NA		I		D	NA	
k.	AS	I		NA		NA		I	I		NA		I	NA	
l.	AU	D		NA		NA		D	NA		I		D	NA	
m.	AU	D		NA		NA		D	NA		I		D	D	OA
n.	AU	D		NA		NA		D	NA		I		D	NA	
o.	CE	NA		I		NA		D	NA		I		D	NA	
p.	AU	D		D		NA		NA	NA		NA		NA	D	OA
q.	AS	I		NA		NA		I	I		NA		I	NA	

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EXERCISE 2-28A

	Net Income		Cash Flow from Operating Activities	
Event/Adj.	Direction of Change	Amount of Change	Direction of Change	Amount of Change
a. Event	NA	NA	Decrease	$9,000
Adj.	Decrease	$2,250[1]	NA	NA
b. Event	NA	NA	Decrease	500
Adj.	Decrease	$1,700[2]	NA	NA
c. Event	Increase	$10,000	Increase	$10,000
No adj.				
d. Event	NA	NA	Increase	$2,400
Adj.	Increase	$1,600[3]	NA	NA
e. Event				
Adj.	Decrease	$5,600	NA	NA
f. Event	NA	NA	NA	NA
No adj.				
g. Event	NA	NA	NA	NA
No adj.				
h. Event	Increase	$12,000	Increase	$8,000
No adj.				
i. Event	Decrease	$4,500	Decrease	$4,500
No adj.				

[1]$9,000 x 3/12 = $2,250
[2]$2,000 – $300 = $1,700
[3]$2,400 x 8/12 = $1,600

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EXERCISE 2-29A

The following are only example transactions. There are also other transactions that would cause the desired effect.

a. The business acquired cash by issuing stock to its owners.

Cash revenue is earned.

b. Paid cash dividends to stockholders.

Paid an expense with cash.

c. The business invested cash by purchasing a building.

Collected accounts receivable.

d. Unearned revenue is earned and recognized.

e. Recorded accrued salaries. TBEXAM.COM

Recorded the expense for the utility bill received at the end of the month, but not due until next month.

f. Received cash in advance for services to be provided in the future.

Borrowed cash from the bank.

g. Paid cash for operating expenses previously purchased on account.

Repaid a loan with cash.

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EXERCISE 2-30A

a. AS Asset Source

b. AU Asset Use

c. AU Asset Use

d. CE Claims Exchange

e. AU Asset Use

f. AS Asset Source

g. AS Asset Source

h. AE Asset Exchange

i. AS Asset Source

j. AE Asset Exchange

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EXERCISE 2-31A

Note: These are only sample transactions. Other similar transactions will satisfy the requirements of this exercise.

a. Payment of a bank loan; payment of accounts payable.

b. Collection of accounts receivable; purchase of Land.

c. Borrowed cash from the bank; issued stock for cash.

d. Provide service on account.

e. Provide service for cash; provide service on account.

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SOLUTIONS TO PROBLEMS - CHAPTER 2

PROBLEM 2-32A

Super Cleaning Company
Effect of Events on the Financial Statements

	Balance Sheet													Income Statement					Stmt. of Cash Flows
	Assets					=	Liabilities			+	Stk. Equity			Rev.	–	Exp.	=	Net Inc.	
Event No.	Cash	+	Accts Rec.	+	Pp. Rent	=	Accts. Pay.	+	Unearn Rev.	+	Com. Stock	+	Ret. Earn.						
1.	10,000	+	NA	+	NA	=	NA	+	NA	+	10,000	+	NA	NA	–	NA	=	NA	10,000 FA
2.	NA	+	15,000	+	NA	=	NA	+	NA	+	NA	+	15,000	15,000	–	NA	=	15,000	NA
3.	5,000	+	NA	+	NA	=	NA	+	NA	+	NA	+	5,000	5,000	–	NA	=	5,000	5,000 OA
4.	2,800	+	NA	+	NA	=	NA	+	2,800	+	NA	+	NA	NA	–	NA	=	NA	2,800 OA
5.	12,200	+	(12,200)	+	NA	=	NA	+	NA	+	NA	+	NA	NA	–	NA	=	NA	12,200 OA
6.	(1,900)	+	NA	+	NA	=	NA	+	NA	+	NA	+	(1,900)	NA	–	1,900	=	(1,900)	(1,900) OA
7.	NA	+	NA	+	NA	=	NA	+	(1,400)	+	NA	+	1,400	1,400	–	NA	=	1,400	NA
8.	NA	+	NA	+	NA	=	3,600	+	NA	+	NA	+	(3,600)	NA	–	3,600	=	(3,600)	NA
9.	(4,800)	+	NA	+	4,800	=	NA	+	NA	+	NA	+	NA	NA	–	NA	=	NA	(4,800) OA
10.	(2,800)	+	NA	+	NA	=	(2,800)	+	NA	+	NA	+	NA	NA	–	NA	=	NA	(2,800) OA
11.	(1,500)	+	NA	+	NA	=	NA	+	NA	+	NA	+	(1,500)	NA	–	NA	=	NA	(1,500) FA
12.	NA	+	NA	+	(3,600)[1]	=	NA	+	NA	+	NA	+	(3,600)	NA	–	3,600	=	(3,600)	NA
Bal.	19,000	+	2,800	+	1,200	=	800	+	1,400	+	10,000	+	10,800	21,400	–	9,100	=	12,300	19,000 NC

[1]$4,800 x 9/12 = $3,600
*NC = Net change in cash

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PROBLEM 2-33A

The Accounting Equation									
	Total Assets			=	Liabilities	+	Stockholders' Equity		
Event/ Adjust.	Cash	+	Other Assets	=		+	Common Stock	+	Retained Earnings
a.	(4,800)		+4,800		NA		NA		NA
a. Adj.	NA		(1,200)[1]		NA		NA		(1,200)
b.	+3,600		NA		+3,600		NA		NA
b. Adj.	NA		NA		(2,700)[2]		NA		+2,700
c.	NA		+1,200		+1,200		NA		NA
c. Adj.	NA		(1,025)[3]		NA		NA		(1,025)
d.	(9,600)		+9,600		NA		NA		NA
d. Adj.	NA		(4,000)[4]		NA		NA		(4,000)

[1]$4,800 x 3/12 = $1,200
[2]$3,600 x 9/12 = $2,700
[3]$1,200 – $175 = $1,025
[4]$9,600 x 5/12 = $4,000

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PROBLEM 2-34A

a.

Nowell Company Income Statement For the Year Ended December 31, Year 2		
Consulting Revenue		$18,200
Expenses		
Travel Expense	$2,100	
Rent Expense	3,500	
Salary Expense	7,200	
Other Operating Expenses	2,300	
Total Expenses		(15,100)
Net Income		$3,100

b.

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Accounts to be Closed:
Consulting Revenue
Travel Expense
Dividends
Rent Expense
Salary Expense
Other Operating Expenses

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PROBLEM 2-34A (cont.)

c.

Computation of Retained Earnings:	
Beginning Retained Earnings	$16,200
Add: Net Income	3,100
Less: Dividends	(4,000)
Ending Retained Earnings	$15,300

Net income only includes revenues and expenses for the current year. Retained earnings not only includes current year net income, but also the balance from previous years and reductions for dividends.

d. The balances are zero; they were closed to Retained Earnings on December 31, Year 2. The December 31 closing balance of one year is the opening balance on January 1 of the next year.

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PROBLEM 2-35A

Accounting Equation (Prepared for Instructor's Use)

Waddell Company
Accounting Equation

	Assets						Liabilities			Stk. Equity	
Date	Cash	Acc Rec.	Pp. Rent	Supp.	Int. Rec.	Land	Acc. Pay.	Sal. Pay.	Unear. Rev.	Com. Stock	Ret. Earn
Bal.	35,000	9,000				51,000	7,500			40,000	47,500
1/1	20,000									20,000	
2/1	(6,000)		6,000								
3/1	(2,000)										(2,000)
4/1	(15,000)					15,000					
5/1	(5,500)						(5,500)				
7/1	9,600								9,600		
9/1	30,000					(30,000)					
10/1				2,500			2,500				
12/31		58,000									58,000
12/31	46,000	(46,000)									
12/31							28,000				(28,000)
12/31								6,500			(6,500)
12/31				(2,450)							(2,450)
12/31[1]											
12/31[2]					500						500
12/31a			(5,500)[3]								(5,500)
12/31a									(4,800)[4]		4,800
Bal.	112,100	21,000	500	50	500	36,000	32,500	6,500	4,800	60,000	66,350

[1] 12/31 No entry required for the change in the value of the land.
[2] 12/31 This assumes that part of the cash was invested in an interest-bearing account.
[3] 12/31a Expired Rent $6,000 x 11/12 = $5,500.
[4] 12/31a Unearned Revenue earned $9,600 x 6/12 = $4,800.

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PROBLEM 2-35A (cont.)

a. The two transactions that need adjusting entries are as follows:
   1. Feb. 1, prepaid rent.
   2. July 1, unearned revenue; cash was received in advance.

b. $36,000; its historical cost.

c. $46,000 + $9,600 – $6,000 – $5,500 = $44,100

d. $6,000 X 11/12 = $5,500

e. $32,500 + $6,500 + $4,800 = $43,800

f. $2,500 – $50 = $2,450

g. $9,600 – $4,800 ($9,600 x 6/12) = $4,800

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h. –$15,000 + $30,000 = $15,000

i. $28,000 + $6,500 + $2,450 + $5,500 = $42,450

j. $58,000 + $4,800 = $62,800

k. $20,000 – $2,000 = $18,000

l. (j) $62,800 + $500 – (i) $42,450 = $20,850

m. Beg. RE $47,500 + NI $20,850 – Div. $2,000 = Ending retained earnings $66,350

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PROBLEM 2-36A

Barker Company
Financial Statements
For the Year Ended December 31, Year 2

Income Statement		
Revenue		
Service Revenue	$65,200	
Total Revenue		$65,200
Expenses		
Other Operating Expenses	$41,000	
Supplies Expense	1,100	
Rent Expense	2,500	
Insurance Expense	2,100	
Total Expenses		(46,700)
Net Income		$18,500

Statement of Changes in Stockholders' Equity		
Beginning Common Stock	$40,000	
Plus: Stock Issued	5,000	
Ending Common Stock		$45,000
Beginning Retained Earnings	$ 9,300	
Plus: Net Income	18,500	
Less: Dividends	(3,000)	
Ending Retained Earnings		24,800
Total Stockholders' Equity		$69,800

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PROBLEM 2-36A (cont.)

Barker Company Balance Sheet As of December 31, Year 2		
Assets		
Cash		$ 48,000
Accounts Receivable		14,200
Supplies		1,000
Prepaid Insurance		1,200
Prepaid Rent		4,800
Land		24,000
Total Assets		$93,200
Liabilities		
Accounts Payable	$17,000	
Unearned Revenue	6,400	
Total Liabilities		$23,400
Stockholders' Equity		
Common Stock	$45,000	
Retained Earnings	24,800	
Total Stockholders' Equity		69,800
Total Liab. and Stockholders' Equity		$93,200

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PROBLEM 2-36A (cont.)

Barker Company Statement of Cash Flows For the Year Ended December 31, Year 2	
Cash Flow From Operating Activities	$15,600
Cash Flow From Investing Activities	(5,200)
Cash Flow From Financing Activities	(5,000)
Net Change in Cash	5,400
Plus: Beginning Cash Balance	42,600*
Ending Cash Balance	$48,000

*Not given in the problem.

Ending Cash Balance – Increase in Cash = Beginning Cash Balance
$48,000 – $5,400 = $42,600

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PROBLEM 2-37A

FOR THE YEARS	Year 1	Year 2	Year 3
Income Statements			
Revenue (cash)	$ 700	$1,300	$ 2,000
Expense (cash)	(a) (500)	(700)	(1,300)
Net Income (Loss)	$ 200	(m) $ 600	$ 700
Statements of Changes in Stockholders' Equity			
Beginning Common Stock	$ -0-	(n) $5,000	$6,000
Plus: Common Stock Issued	5,000	1,000	2,000
Ending Common Stock	5,000	6,000	(t) 8,000
Beginning Retained Earnings	-0-	100	200
Plus: Net Income (Loss)	(b) 200	(o) 600	700
Less: Dividends	(c) (100)	(500)	(300)
Ending Retained Earnings	100	(p) 200	600
Total Stockholders' Equity	(d) $5,100	$6,200	$8,600
Balance Sheets			
Assets			
Cash	(e) $8,100	(q) $3,200	(u)$ 2,600
Land	-0-	(r) 8,000	8,000
Total Assets	(f) $8,100	$11,200	$10,600
Liabilities	(g) $3,000	$ 5,000	$ 2,000
Stockholders' Equity			
Common Stock	(h) 5,000	(s) 6,000	8,000
Retained Earnings	(i) 100	200	600
Total Stockholders' Equity	(j) 5,100	6,200	8,600
Total Liab. and Stk. Equity	$8,100	$11,200	$10,600

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PROBLEM 2-37A (cont.)

FOR THE YEARS	Year 1	Year 2	Year 3
Statements of Cash Flows			
Cash Flows From Oper. Activities:			
Cash Receipts from Customers	(k)$ 700	$ 1,300	(v) $ 2,000
Cash Payments for Expenses	(l) (500)	(700)	(w) (1,300)
Net Cash Flows from Oper. Act.	200	600	700
Cash Flows From Invest. Activities:			
Cash Payments for Land	-0-	(8,000)	-0-
Cash Flows From Fin. Activities:			
Cash Receipts from Loan	3,000	3,000	-0-
Cash Payments to Reduce Debt	-0-	(1,000)	(x) (3,000)
Cash Receipts from Stock Issue	5,000	1,000	(y) 2,000
Cash Payments for Dividends	(100)	(500)	(z) (300)
Net Cash Flows from Fin. Activities	7,900	2,500	(1,300)
Net Change in Cash	8,100	(4,900)	(600)
Plus: Beginning Cash Balance	-0-	8,100	3,200
Ending Cash Balance	$8,100	$3,200	$2,600

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PROBLEM 2-37A (cont.)

Computations of amounts:

a. $500 Expense = $700 Revenue – $200 Net Income.
b. $200 Net Income = $200 Net Income from Income Statement.
c. $100 Dividends = $200 Net Income – $100 Ending Ret. Earnings.
d. $5,100 Total Stk. Equity = $5,000 Ending Common Stock + $100 Ending Retained Earnings.
e. $8,100 Cash = $8,100 Total Assets – $-0- Land.
f. $8,100 Total Assets = $8,100 Liabilities and Stockholders' Equity.
g. $3,000 Liabilities = $3,000 Cash Receipts from Loan from Statement of Cash Flows.
h. $5,000 Common Stock = $5,000 Com. Stock from Statement of Changes in Stockholders' Equity.
i. $100 Retained Earnings = $100 Ret. Earnings from Statement of Changes in Stockholders' Equity.
j. $5,100 Total Stockholders' Equity = $5,000 Common Stock + $100 Retained Earnings or $5,100 Total Stk. Equity from Statement of Changes in Stk. Equity.
k. $700 Cash Receipts from Revenue = $700 Revenue from Income Statement.
l. $500 Cash Payment for Expenses = $500 Expense from Income Statement.
m. $600 Net Income = $1,300 Revenue – $700 Expense.
n. $5,000 Beginning Common Stock = $5,000 Ending Common Stock, Year 1.
o. $600 Net Income = $600 Net Income from Income Statement.
p. $200 Ending Retained Earnings = $100 Beginning Ret. Earnings + $600 Net Income – $500 Dividends.
q. $3,200 Cash = Ending Cash Balance from Statement of Cash Flows.
r. $8,000 Land = $8,000 Cash Payment for Land from Statement of Cash Flows.
s. $6,000 Common Stock = $6,000 Ending Common Stock from Statement of Changes in Equity.
t. $8,000 Ending Common Stock = $6,000 Beginning Common Stock + $2,000 Common Stock Issued.
u. $2,600 Cash = $2,600 Ending Cash Balance from Statement of Cash Flows.
v. $2,000 Cash Receipts from Revenue = $2,000 Revenue from Income Statement.
w. $1,300 Cash Payments for Expenses = $1,300 Expense from Income Statement.
x. $3,000 Cash Payment to Reduce Debt = $5,000 Balance of Liabilities, Year 2 – $2,000 Balance of Liabilities, Year 3.
y. $2,000 Cash Receipts from Stock Issue = $2,000 Stock Issued from Statement of Changes in Stockholders' Equity.
z. $300 Cash Payment for Dividends = $300 Dividends from Statement of Changes in Stockholders' Equity

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PROBLEM 2-38A

a.

Alcorn Service Company
Accounting Equation for Year 1

		Assets					=	Liabilities			+	Stk. Equity	
Event	Type of Event	Cash	Accts. Rec.	Supp.	Prepd. Rent	Land	=	Accts. Pay.	Salaries Payable	Unearn. Rev.	+	Com. Stock	Ret. Earn.
1.	AS	20,000										20,000	
2.	AS			800				800					
3.	AE	(14,000)				14,000							
4.	AU	(800)						(800)					
5.	AS		10,500										10,500
6.	AU	(3,800)											(3,800)
7.	AE	7,000	(7,000)										
8.	CE								3,600				(3,600)
9.	AU			(700)									(700)
Totals		8,400	3,500	100	-0-	14,000	=	-0-	3,600	-0-	+	20,000	2,400

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PROBLEM 2-38A a. (cont.)

Alcorn Service Company
Accounting Equation for Year 2

		Assets						=	Liabilities			+	Stk. Equity	
Event	Type of Event	Cash	Accts. Rec.	Supp.	Prepd. Rent	Land	Int. Rec.	=	Accts. Pay.	Salaries Payable	Unearn Rev.	+	Com. Stock	Ret. Earn.
Bal.		8,400	3,500	100	-0-	14,000			-0-	3,600	-0-		20,000	2,400
1.	AS	15,000											15,000	
2.	AU	(3,600)								(3,600)				
3.	AE	(9,000)			9,000									
4.	AE	14,000				(14,000)								
5.	AS	6,000									6,000			
6.	AS			2,400					2,400					
7.	AS		24,500											24,500
8.	AE	12,600	(12,600)											
9.	AU	(2,000)												(2,000)
10.	AU	(2,850)												(2,850)
11.	AU				(7,500)[1]									(7,500)
12.	CE										(1,500)[2]			1,500
13.	AU			(2,200)[3]										(2,200)
14.	CE									4,800				(4,800)
15.	AS						500							500
Totals		38,550	15,400	300	1,500	-0-	500		2,400	4,800	4,500	+	35,000	9,550

[1]$9,000 x 10/12 = $7,500
[2]$6,000 x 3/12 = $1,500
[3]$100 + $2,400 – $300 = $2,200

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PROBLEM 2-38A (cont.)

b.

Alcorn Service Company Financial Statements For the Years Ended December 31, Year 1 and Year 2		
Income Statements		
	Year 1	Year 2
Service Revenue	$10,500	$26,000
Interest Revenue	-0-	500
Total Revenue	10,500	26,500
Expenses		
Operating Expenses	(3,800)	(2,850)
Supplies Expense	(700)	(2,200)
Salaries Expense	(3,600)	(4,800)
Rent Expense	-0-	(7,500)
Total Expenses	(8,100)	(17,350)
Net Income (Loss)	$2,400	$ 9,150
Statements of Changes in Stockholders' Equity		
Beginning Common Stock	$ -0-	$20,000
Plus: Stock Issued	20,000	15,000
Ending Common Stock	20,000	35,000
Beginning Retained Earnings	-0-	2,400
Plus/Less: Net Income (Loss)	2,400	9,150
Less: Dividends	-0-	(2,000)
Ending Retained Earnings	2,400	9,550
Total Stockholders' Equity	$22,400	$44,550

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PROBLEM 2-38A b. (cont.)

Alcorn Service Company Balance Sheets As of December 31, Year 1 and Year 2		
	Year 1	Year 2
Assets		
Cash	$ 8,400	$38,550
Accounts Receivable	3,500	15,400
Interest Receivable	-0-	500
Supplies	100	300
Prepaid Rent	-0-	1,500
Land	14,000	-0-
Total Assets	$26,000	$56,250
Liabilities		
Accounts Payable	$ -0-	$ 2,400
Salaries Payable	3,600	4,800
Unearned Revenue	-0-	4,500
Total Liabilities	3,600	11,700
Stockholders' Equity		
Common Stock	20,000	35,000
Retained Earnings	2,400	9,550
Total Stockholders' Equity	22,400	44,550
Total Liab. and Stock. Equity	$26,000	$56,250

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PROBLEM 2-38A b. (cont.)

Alcorn Service Company
Statements of Cash Flows
For the Years Ended December 31, Year 1 and Year 2

	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Receipts from Customers	$7,000	$18,600[1]
Cash Payments for Expense[2]	(4,600)	(15,450)
Net Cash Flow from Operating Activities	2,400	3,150
Cash Flows From Investing Activities:		
Cash Payment for Land	(14,000)	-0-
Cash Proceeds from Sale of Land	-0-	14,000
Net Cash Flow From Investing Activities	(14,000)	14,000
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	20,000	15,000
Cash Payment for Dividends	-0-	(2,000)
Net Cash Flow From Financing Activities	20,000	13,000
Net Change in Cash	8,400	30,150
Plus: Beginning Cash Balance	-0-	8,400
Ending Cash Balance	$8,400	$38,550

[1]Year 2: $6,000 + $12,600 = $18,600
[2]Year 1: $3,800 + $800 = $4,600
Year 2: $3,600 + $9,000 + $2,850 = $15,450

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SOLUTIONS TO EXERCISES - CHAPTER 2 - SET B

EXERCISE 2-1B

Burke Company
Effect of Events on the Year 1 Accounting Equation

	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	+	Accounts Rec.	=		+	Common Stock	+	Retained Earnings
Earned Revenue		+	12,000	=		+		+	12,000
Coll. Acct. Rec.	9,800	+	(9,800)	=		+		+	
Ending Balance	9,800	+	2,200	=	-0-	+	-0-	+	12,000

f. Accounts Receivable: $12,000 – $9,800 = $2,200

g. $12,000

h. $9,800 cash collected from accounts receivable.

i. $12,000

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j. $12,000 of revenue was earned but only $9,800 of it was collected.

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EXERCISE 2-2B

a.

Crest Corporation Accounting Equation – Year 1							
Event	Assets	=	Liabilities	+	Stockholders' Equity		
	Cash	=	Salaries Payable	+	Common Stock	+	Retained Earnings
Earned Rev.	5,000						5,000
Accrued Sal.			3,000				(3,000)

Crest Corporation Balance Sheet As of December 31, Year 1		
Assets		
Cash	$5,000	
Total Assets		$5,000
Liabilities		
Salaries Payable	$3,000	
Total Liabilities		$3,000
Stockholders' Equity		
Retained Earnings	$2,000	
Total Stockholders' Equity		2,000
Total Liab. and Stockholders' Equity		$5,000

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b.

Computation of Net Income	
Revenue	$5,000
Less: Expenses	(3,000)
Net Income	$2,000

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EXERCISE 2-2B (cont.)

c.

Cash Flow from Operating Activities	
Cash from Revenue	**$5,000**
Net Cash Flow from Operating Act.	**$5,000**

e. **The salary expense is deducted from revenue in computing net income, but it has not been paid. This creates a difference of $3,000. The revenue is the same because it has been earned and collected.**

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EXERCISE 2-3B

a.

Coates, Inc.
General Ledger Accounts for the Year Ended December 31, Year 1

	Assets		=	Liabilities	+	Stockholders' Equity		
Event	Cash	Accts. Rec.	=	Salaries Pay.	+	Common Stock	Retained Earnings	Acct. Title for RE
1.	20,000					20,000		
2.		38,000					38,000	Revenue
3.	(2,500)						(2,500)	Util. Exp.
4.	21,000	(21,000)						
5.				15,000			(15,000)	Sal. Exp.
6.	(2,000)						(2,000)	Dividends
Totals	36,500	17,000	=	15,000	+	20,000	18,500	

b.

Coates, Inc.
Income Statement
For the Year Ended December 31, Year 1

Revenue		$38,000
Expenses		
Utilities Expense	$ 2,500	
Salaries Expense	15,000	
Total Expenses		(17,500)
Net Income		$20,500

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EXERCISE 2-3B b. (cont.)

Coates, Inc. Statement of Changes in Stockholders' Equity For the Year Ended December 31, Year 1		
Beginning Common Stock	$ -0-	
Plus: Common Stock Issued	20,000	
Ending Common Stock		$20,000
Beginning Retained Earnings	$ -0-	
Plus: Net Income	20,500	
Less: Dividends	(2,000)	
Ending Retained Earnings		18,500
Total Stockholders' Equity		$38,500

Coates, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$36,500	
Accounts Receivable	17,000	
Total Assets		$53,500
Liabilities		
Salaries Payable	$15,000	
Total Liabilities		$15,000
Stockholders' Equity		
Common Stock	$20,000	
Retained Earnings	18,500	
Total Stockholders' Equity		38,500
Total Liab. and Stockholders' Equity		$53,500

EXERCISE 2-3B b. (cont.)

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Coates, Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flow From Operating Activities		
Cash Receipts from Customers	$21,000	
Cash Paid for Expenses	(2,500)	
Net Cash Flow from Operating Act.		$18,500
Cash Flow From Investing Activities		-0-
Cash Flow From Financing Activities		
Issue of Stock	$20,000	
Paid Dividends	(2,000)	
Net Cash Flow from Financing Act.		18,000
Net Change in Cash		36,500
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$36,500

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c. Net income is based on income earned of $38,000 and expenses incurred of $17,500 for a net income of $20,500. Net cash flow from operating activities is based on cash collected from revenue, $21,000 and expenses paid, $2,500, for a net cash flow from operating activities of $18,500. The difference of $2,000 is reflected in the Accounts Receivable account ($17,000), revenues accrued but not yet collected, and the Salaries Payable account ($15,000), expenses incurred but not paid.

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EXERCISE 2-4B

a.

Brown and Birgin Horizontal Statements Model Year 3																
	Balance Sheet									Income Statement						Statement of
Event	Assets			=	Liabilities			+	Stk. Equity	Rev.	–	Exp.	=	Net Inc.		Cash Flows
No.	Cash	+	Accts. Rec.	=	Acct. Payable	+	Sal. Pay.	+	Retained Earnings							
1.	NA		96,000		NA		NA		96,000	96,000		NA		96,000		NA
2.	65,000		NA		NA		NA		65,000	65,000		NA		65,000		65,000 OA
3.	NA		NA		45,000		NA		(45,000)	NA		45,000		(45,000)		NA
4.	(26,000)		NA		NA		NA		(26,000)	NA		26,000		(26,000)		(26,000) OA
5.	70,000		(70,000)		NA		NA		NA	NA		NA		NA		70,000 OA
6.	(38,000)		NA		(38,000)		NA		NA	NA		NA		NA		(38,000) OA
7.	(10,000)		NA		NA		NA		(10,000)	NA		NA		NA		(10,000) FA
8.	NA		NA		NA		3,000		(3,000)	NA		3,000		(3,000)		NA
Totals	61,000	+	26,000	=	7,000	+	3,000	+	77,000	161,000	–	74,000	=	87,000		61,000 NC

b. Total assets: $87,000 ($61,000 + $26,000)

c. $26,000

d. $7,000

e. Accounts Receivable (an asset) is an amount owed to Brown and Birgin: $26,000; Accounts Payable (a liability) is an amount that Brown and Birgin owes: $7,000.

f. $87,000

g. $71,000 ($65,000 – $26,000 + $70,000 – $38,000)

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EXERCISE 2-5B

a.

Computation of Net Income	
Revenue recognized on account	$40,000
Less accrued salary expense	(35,000)
Net Income	$ 5,000

b.

Computation of Cash Collected from Accounts Receivable	
Beginning balance of Accounts Receivable	$ 2,000
Add revenue recognized on account	40,000
Less ending balance of Accounts Receivable	(2,400)
Cash collected from accounts receivable	$39,600

Computation of Cash Paid for Salaries Expense	
Beginning balance of Salaries Payable	$ 1,300
Add accrued salary expense recognized	35,000
Less ending balance of Salaries Payable	(900)
Cash paid for Salary Expense	$35,400

Cash Flow from Operating Activities	
Cash from Accounts Receivable	$39,600
Cash paid for Salary Expense	(35,400)
Net Cash Flow from Operating Act.	$ 4,200

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EXERCISE 2-6B

a. & c.

Event	Revenue	Expense	Statement of Cash Flows
1.	NA	NA	$50,000 FA
2.	$67,000	NA	NA
3.	NA	NA	(5,000) FA
4.	NA	NA	45,000 OA
5.	NA	$49,000	(49,000) OA
6.	10,000	NA	10,000 OA
7.	NA	2,000	NA

b.

Computation of Net Income	
Revenue	$77,000
Less: Expenses	(51,000)
Net Income	$26,000

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d.

Cash Flow from Operating Activities	
Cash from Revenue	$55,000
Cash paid for expenses	(49,000)
Net Cash Flow from Operating Act.	$ 6,000

e. The before-closing balance in the Revenue account is $77,000. After it is closed to Retained Earnings the balance will be zero. Other accounts that would be closed are expenses and dividends.

f. The balance of Retained Earnings on the Year 1 Balance Sheet will be the amount of Net Income: $26,000, less $5,000 of dividends paid since there is no beginning balance in Retained Earnings.

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EXERCISE 2-7B

Zoe, Inc.
Effect of Events on the General Ledger Accounts

	Assets			=	Liabilities	+	Stockholders' Equity		
Event	Cash	Accounts Receivable	Land	=	Accounts Payable	+	Com. Stock	+	Retained Earnings
1. Sales on Account		105,000							105,000
2. Coll. Accts. Rec.	65,000	(65,000)							
3. Incurred Expense					40,000				(40,000)
4. Pd. Acc. Pay.	(35,000)				(35,000)				
5. Issue of Stock	50,000						50,000		
6. Purchase Land	(25,000)		25,000						
Totals	55,000	40,000	25,000	=	5,000	+	50,000	+	65,000

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a. Revenue recognized, $105,000.

b. Cash flow from revenue, $65,000.

c. Revenue, $105,000, less operating expenses, $40,000 = $65,000 net income.

d. Accounts receivable collected, $65,000, less cash paid for expenses, $35,000 = $30,000 cash flow from operating activities.

e. Income of $105,000 was earned, but only $65,000 was collected (a difference of $40,000); operating expenses incurred were $40,000 but only $35,000 was paid during the period (a difference of $5,000). Consequently, net income is $35,000 more than cash flow from operating activities.

f. $25,000 cash outflow for the purchase of land.

g. $50,000 cash inflow from the issue of common stock.

h. Total assets = $120,000 ($55,000 + $40,000 + $25,000)
Total liabilities = $5,000
Total equity = $115,000 ($50,000 + $65,000)

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EXERCISE 2-8B

a.

Copy Express
Effect of Events on Financial Statements for Year 3

	Assets			=	Liab.	+	Stk. Equity			Income Statement					
Event No.	Cash	+	Supplies	=	Accts. Pay.	+	Com. Stock	+	Ret. Earn.	Rev.	–	Exp.	=	Net Income	Cash Flows
Beg. Bal.	9,000	+	-0-	=	-0-	+	5,000	+	4,000	-0-	–	-0-	=	-0-	-0-
1.	NA	+	9,500	=	9,500	+	NA	+	NA	NA	–	NA	=	NA	NA
2.	32,500	+	NA	=	NA	+	NA	+	32,500	32,500	–	NA	=	32,500	32,500 OA
3.	(7,200)	+	NA	=	(7,200)	+	NA	+	NA	NA	–	NA	=	NA	(7,200) OA
4.	NA	+	(7,800)	=	NA	+	NA	+	(7,800)	NA	–	7,800	=	(7,800)	NA
Totals	34,300	+	1,700	=	2,300	+	5,000	+	28,700	32,500	–	7,800	=	24,700	25,300 NC

b. **The difference in net income and cash flow from operating activities of $600 ($24,700 – $25,300) is attributed to recognizing supplies expense of $7,800 in the income statement, whereas the cash payment on accounts payable (for supplies) was $7,200.**

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EXERCISE 2-9B

a.

Accounting Professionals, Inc. Effect of Events on the Accounting Equation						
	Assets		=	Liab.	+	Stk. Equity
Event	Cash	Supplies	=	Accounts Payable		Retained Earnings
1. Provided Service	20,000					20,000
2. Purchased Supplies		4,000		4,000		
3. Used Supplies		(3,000)				(3,000)
Totals	20,000	1,000	=	4,000		17,000

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EXERCISE 2-9B (cont.)

b.

Accounting Professionals, Inc. Income Statement For the Year Ended December 31, Year 1	
Revenue	$20,000
Expense	(3,000)
Net Income	$17,000

Accounting Professionals, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$20,000	
Supplies	1,000	
Total Assets		$21,000
Liabilities		
Accounts Payable	$ 4,000	
Total Liabilities		$ 4,000
Stockholders' Equity		
Retained Earnings	$17,000	
Total Stockholders' Equity		17,000
Total Liab. and Stockholders' Equity		$21,000

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EXERCISE 2-9B b. (cont.)

Accounting Professionals, Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$20,000	
Net Cash Flow from Operating Activities		$20,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		20,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$20,000

e. The balance of the Supplies account on January 1, Year 2 is $1,000, the same as the December 31, Year 1 balance.

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f. The balance of the Supplies Expense account on January 1, Year 2 is zero because the expense account was closed to Retained Earnings at December 31, Year 1.

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EXERCISE 2-10B

Purchase of land	**Asset**
Payment of monthly utilities in administrative offices	**Expense**
Supplies used in administrative offices.	**Expense**
Purchase of equipment	**Expense**
Purchase of supplies for future use	**Asset**
Purchase of land	**Asset**

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EXERCISE 2-11B

a.

Therapy, Inc. Effect of Events on the Accounting Equation				
	Assets		=	Stockholders' Equity
Event	Cash	Prepaid Rent	=	Retained Earnings
1. Performed Services	18,000			18,000
2. Prepaid Rent	(12,000)	12,000		
3. Used Rent		(11,000)*		(11,000)
Totals	6,000	1,000	=	7,000

*$12,000 x 11/12 = $11,000

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EXERCISE 2-11B (cont.)

b.

Therapy, Inc. Income Statement For the Year Ended December 31, Year 1	
Revenue	$18,000
Expense	(11,000)
Net Income	$ 7,000

Therapy, Inc. Balance Sheet As of December 31, Year 1		
Assets		
Cash	$6,000	
Prepaid Rent	1,000	
Total Assets		$7,000
Liabilities		$ -0-
Stockholders' Equity		
Retained Earnings	$7,000	
Total Stockholders' Equity		7,000
Total Liab. and Stockholders' Equity		$7,000

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EXERCISE 2-11B b. (cont.)

Therapy, Inc. Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$18,000	
Cash Payment for Rent	(12,000)	
Net Cash Flow from Operating Activities		$6,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		6,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$6,000

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c. The balance of the Prepaid Rent will be expensed in Year 2, $1,000 ($12,000 - $11,000).

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EXERCISE 2-12B

a.

Cole Corporation Accounting Equation Year 3						
	Assets		=	Stockholders' Equity		
Event	Cash	Prepaid Insurance	=	Com. Stock	+	Retained Earnings
Pur. Insurance	(8,400)	8,400				
Adj. Ins Exp.		(2,450)*				(2,450)
Totals	(8,400)	5,950	=	-0-	+	(2,450)

*$8,400 x 7/24 = $2,450

b. The required entry would decrease assets by $2,450 [($8,400 ÷ 24) x 7] and decrease stockholders' equity by $2,450 (retained earnings). If this entry is not made, assets and stockholders' equity would both be overstated on the balance sheet by $2,450. On the income statement, expenses would be understated causing net income to be overstated by $2,450.

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EXERCISE 2-13B

a.

Interior Design Consultants Accounting Equation Year 1					
Event	Assets	=	Liabilities	+	Stockholders' Equity
	Cash	=	Unearned Revenue	+	Retained Earnings
Coll. Unearned rev	24,000		24,000		
Recog. revenue earned			(6,000)*		6,000
	24,000	=	18,000		6,000

*$24,000 x 3/12 = $6,000

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EXERCISE 2-13B (cont.)

b.

Interior Design Consultants Income Statement For the Year Ended December 31, Year 1	
Revenue	$6,000
Expense	-0-
Net Income	$6,000

Interior Design Consultants Balance Sheet As of December 31, Year 1		
Assets		
Cash	$24,000	
Total Assets		$24,000
Liabilities		-0-
Unearned Revenue	$18,000	
Total Liabilities		$18,000
Stockholders' Equity		
Retained Earnings	$ 6,000	
Total Stockholders' Equity		6,000
Total Liab. and Stockholders' Equity		$24,000

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EXERCISE 2-13B b. (cont.)

Interior Design Consultants Statement of Cash Flows For the Year Ended December 31, Year 1		
Cash Flows From Operating Activities:		
Cash Receipt from Revenue	$24,000	
Net Cash Flow from Operating Activities		$24,000
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		-0-
Net Change in Cash		24,000
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$24,000

c. Nine months of unearned revenue will be recognized in Year 2:
$24,000 x 9/12 = $18,000

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EXERCISE 2-14B

Note: This exercise can be used to assess writing skills.

The tutoring fees of $800 received in advance by Kim Wong from Joe Pratt should be reported as a liability. Although Kim Wong has received the cash, it has not yet been earned. Wong has an obligation to either perform the services or refund the cash advance. When the tutoring service is provided to Joe, the unearned revenue should be recognized as revenue earned by Wong.

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EXERCISE 2-15B

Ross Attorney At Law
Effect of Transactions on the Financial Statements for Year 1

	Balance Sheet									Income Statement					Statement of Cash Flows	
	Assets			=	Liabilities			+	Stk. Equity	Rev.	–	Exp.	=	Net Inc.		
No.	Cash	+	Supplies	=	Acct. Payable	+	Unearn. Revenue	+	Ret. Earn.							
1.	NA	+	1,500	=	1,500	+	NA	+	NA	NA	–	NA	=	NA	NA	
2.	36,000	+	NA	=	NA	+	36,000	+	NA	NA	–	NA	=	NA	36,000	OA
3.	84,000	+	NA	=	NA	+	NA	+	84,000	84,000	–	NA	=	84,000	84,000	OA
4.	(32,000)	+	NA	=	NA	+	NA	+	(32,000)	NA	–	32,000	=	(32,000)	(32,000)	OA
5.	(8,000)	+	NA	=	NA	+	NA	+	(8,000)	NA	–	NA	=	NA	(8,000)	FA
6.	(1,200)	+	NA	=	(1,200)	+	NA	+	NA	NA	–	NA	=	NA	(1,200)	OA
7.	NA	+	(1,350)	=	NA	+	NA	+	(1,350)	NA	–	1,350	=	(1,350)	NA	
8.	NA	+	NA	=	NA	+	(33,000)*	+	33,000	33,000	–	NA	=	33,000	NA	
Totals	78,800	+	150	=	300	+	3,000	+	75,650	117,000	–	33,350	=	83,650	78,800	NC

*$36,000 x 11/12 = $33,000

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EXERCISE 2-16B

a.

Ed Arnold Personal Financial Planning
Horizontal Statements Model for Year 1

	Assets	=	Liabilities	+	Stk. Equity	Income Statement					Statement of Cash Flows
Event	Cash	=	Unearned Revenue	+	Ret. Earn.	Rev.	–	Exp.	=	Net Income	
1. Advance Payment	120,000	=	120,000	+	NA	NA	–	NA	=	NA	120,000OA
2. Revenue Earned	NA	=	(80,000)*	+	80,000	80,000	–	NA	=	80,000	NA
Totals	120,000	=	40,000	+	80,000	80,000	–	-0-	=	80,000	120,000NC

***$120,000 x 8/12 = $80,000**

b. Revenue that will be recognized in Year 2 is $40,000, the remainder of the unearned revenue.

c. $-0-, no cash is received. All cash was received in Year 1.

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EXERCISE 2-17B

a.

Caldonia Company Accounting Equation – Year 3								
Event	Assets		=	Liab.	+	Stockholders' Equity		
	Cash	Prepaid Rent	=		+	Common Stock	+	Retained Earnings
Paid 12 months rent	(6,000)	6,000						
Adj. for 6 months used		(3,000)*						(3,000)

*$3,000 x 6/12 = $3,000

b.

East Alabama Rentals Accounting Equation – Year 3							
Event	Assets	=	Liabilities	+	Stockholders' Equity		
	Cash	=	Unearned Revenue	+	Common Stock	+	Retained Earnings
Recd. 12 months rent	6,000		6,000				
Earned 6 months rent			(3,000)*				3,000

*$6,000 x 6/12 = $3,000

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EXERCISE 2-18B

a. accrual

b. accrual

c. neither

d. deferral

e. neither

f. accrual

g. neither

h. deferral

i. neither

j. deferral

k. accrual

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EXERCISE 2-19B

Note: There are many examples of events that illustrate the required effects. An example is given of each event.

a. **Recognized revenue on account. The asset is either Cash or Accounts Receivable.**

b. **Recognized revenue where the cash had been received in advance. The liability is Unearned Revenue**

c. **Recognized an expense on account. The liability includes the word "Payable" or "Accrued" in the title.**

d. **Paid utilities expense. The asset is Cash or an account that includes the word "Prepaid" or a long-lived asset that is depreciated or amortized.**

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EXERCISE 2-20B

a. Retained Earnings is a permanent account, meaning that one period's ending balance becomes the next period's beginning balance. Since the December 31, Year 3 after-closing balance is $19,400, this will also be the balance on January 1, Year 4.

b. The temporary accounts (Revenue, Expense, and Dividends) are closed at the end of each accounting cycle. As a result, they will always have a zero balance at the beginning of each accounting period.

c. The relationship between the beginning and ending balances in the Retained Earnings accounts is:

Beginning Retained Earnings Balance (January 1, Year 3)	?
+ Net Income (Revenue $15,100 – Expenses 9,200)	5,900
– Dividends	(1,500)
Ending Retained Earnings Balance (December 31, Year 3)	19,400

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Beg. Retained Earnings = End. Retained Earnings – Net Income + Dividends
Beg. Ret. Earn. Balance = $19,400 – $5,900 + $1,500 = $15,000

Since Retained Earnings is a permanent account, the January 1, Year 3 balance of $15,000 is also the December 31, Year 2 after-closing balance.

d. Since revenue and expense is recognized evenly through the Year 3 accounting cycle, approximately half would be recognized by June 30, Year 3. Even so, the revenue and expense data are recorded in Revenue and Expense accounts and do not affect retained earnings at the time of recognition. The balance in the Retained Earnings account on June 30, Year 3 is the same as it was on January 1, Year 3 which is $15,000.

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EXERCISE 2-21B

a.

Event	Requires year-end adjusting entry?
1.	No
2.	Yes
3.	No
4.	Yes
5.	No
6.	No
7.	No
8.	No
9.	Yes
10.	No

b. Adjusting entries are recorded before closing entries. Adjusting entries are required to update the accounts so that the correct amounts of income and expenses are recognized. After the adjusting entries have been made, the adjusted balances of the revenue and expense accounts are closed to retained earnings.

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EXERCISE 2-22B

a.

Permanent Accounts
Cash
Notes Payable
Land
Common Stock
Retained Earnings

Temporary (Nominal) Accounts
Revenue
Expenses
Dividends

b.

Beginning Retained Earnings	$5,200
Add: Revenue	7,000
Less: Expenses	(4,200)
Less: Dividends	(1,000)
Ending Retained Earnings	$7,000

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c.

Computation of Net Income	
Revenue	$7,000
Less: Expenses	(4,200)
Net Income	$2,800

e. Net income is only the current year's net income. Retained Earnings is an accumulation of net income over the life of the business less any dividends that have been paid over the years.

e. All revenue, expense and dividends accounts will have a zero balance because they have been closed to retained earnings.

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EXERCISE 2-23B

a.

Account	Classification
1. Service Revenue	T
2. Dividends	T
3. Common Stock	P
4. Notes Payable	P
5. Cash	P
6. Rent Expense	T
7. Accounts Receivable	P
8. Utilities Expense	T
9. Prepaid Insurance	P
10. Retained Earnings	P

c. The four stages of the accounting cycle are:

recording transactions
adjusting the accounts
preparing financial statements
closing temporary accounts.

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The first stage of the cycle must be recording accounting data in accounts to put it into usable form. Once the accounting data is summarized in the accounts, adjustments are made to reflect any unrecorded transactions. The account balances are then used to prepare the financial statements. After the financial statements are prepared, the temporary accounts (revenue, expenses, and dividends) must be closed to prepare these accounts for the next accounting period.

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EXERCISE 2-24B

a. **Directly matched**
b. **Period expense**
c. **Period expense**
d. **Directly matched**

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EXERCISE 2-25B

a.

Event	Classification
1.	FA
2.	OA
3.	OA
4.	NA
5.	OA
6.	NA
7.	NA
8.	OA
9.	FA
10.	OA

b.

Blair Company
Statement of Cash Flows
For the Year Ended December 31, Year 1

Cash Flows From Operating Activities:		
Cash from the collection of accts. rec.	$51,000	
Cash from service revenue	12,000	
Cash from svc. to be performed in future	21,000	
Cash payment on accounts payable	(22,000)	
Cash payment for rent	(7,200)	
Net Cash Flow from Operating Activities		$54,800
Cash Flows From Investing Activities		-0-
Cash Flows From Financing Activities:		
Cash receipt from stock issue	$30,000	
Cash payment for dividends	(5,000)	
Net Cash Flow from Financing Activities		25,000
Net Change in Cash		$79,800
Plus: Beginning Cash Balance		-0-
Ending Cash Balance		$79,800

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EXERCISE 2-26B

Item/Account	Statement		Item/Account	Statement
a. Consulting Revenue	IS		u. Rent Expense	IS
b. Market Value of Land	NA		v. Salary Expense	IS
c. Supplies Expense	IS		w. Total Stockholders' Equity	BS/SE
d. Salaries Payable	BS		x. Unearned Revenue	BS
e. Notes Payable	BS		y. Cash Flow from Investing Activities	CF
f. Ending Common Stock	SE/BS		z. Insurance Expense	IS
g. Beginning Cash Balance	CF		aa. End. Retained Earn.	BS/SE
h. Prepaid Rent	BS		bb. Interest Revenue	IS
i. Net Change in Cash	CF		cc. Supplies	BS
j. Land	BS		dd. Beg. Retained Earn.	SE
k. Operating Expenses	IS		ee. Utilities Payable	BS
l. Total Liabilities	BS		ff. Cash Flow from Financing Activities	CF
m. "As of" Date Notation	BS		gg. Accounts Receivable	BS
n. Salaries Expense	IS		hh. Prepaid Insurance	BS
o. Net Income	IS/SE		ii. Ending Cash Balance	BS/CF
p. Service Revenue	IS		jj. Utilities Expense	IS
q. Cash Flow from Operating Activities	CF		kk. Accounts Payable	BS
r. Operating Income	IS		ll. Beg. Common Stock	SE
s. Interest Receivable	BS		mm. Dividends	SE/CF
t. Interest Revenue	IS		nn. Total Assets	BS

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EXERCISE 2-27B

Horizontal Statement Model

						Stk. Equity			Income Statement						
Event	Type of Event	Assets	=	Liab.	+	Com. Stock	+	Ret. Earn.	Rev.	–	Exp.	=	Net Inc.	Cash Flows	
a.	AE	I/D		NA		NA		NA	NA		NA		NA	D	IA
b.	AS	I		NA		I		NA	NA		NA		NA	I	FA
c.	AE	I/D		NA		NA		NA	NA		NA		NA	I	OA
d.	AU	D		NA		NA		D	NA		I		D	D	OA
e.	CE	NA		I		NA		D	NA		I		D	NA	
f.	AS	I		I		NA		NA	NA		NA		NA	NA	
g.	AS	I		NA		NA		I	I		NA		I	NA	
h.	AE	I/D		NA		NA		NA	NA		NA		NA	D	OA
i.	AU	D		NA		NA		D	NA		I		D	NA	
j.	AS	I		NA		NA		I	I		NA		I	I	OA
k.	AU	D		D		NA		NA	NA		NA		NA	D	OA
l.	AU	D		NA		NA		D	NA		NA		NA	D	FA
m.	AU	D		NA		NA		D	NA		I		D	NA	
n.	CE	NA		I		NA		D	NA		I		D	NA	
o.	AU	D		D		NA		NA	NA		NA		NA	D	OA
p.	AS	I		I		NA		NA	NA		NA		NA	I	OA
q.	AS	I		NA		NA		I	I		NA		I	NA	

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EXERCISE 2-28B

	Net Income		Cash Flow from Operating Activities	
Event	Direction of Change	Amount of Change	Direction of Change	Amount of Change
a.	NA	NA	NA	NA
b.	Increase	$20,000	Increase	$15,000
c.	Decrease	1,200[1]	Decrease	4,800
d.	Increase	5,000[2]	Increase	12,000
e.	Decrease	5,000	NA	NA
f.	NA	NA	NA	NA
g.	Increase	9,200	Increase	9,200
h.	Decrease	1,200[3]	Decrease	1,500
i.	Decrease	2,200	Decrease	2,200

[1]$4,800 x 3/12 = $1,200
[2]$12,000 x 5/12 = $5,000
[3]$2,000 – $800 = $1,200

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EXERCISE 2-29B

Note: These are only sample transactions. Other similar transactions will satisfy the requirements of this exercise.

a. The business invested cash by purchasing a building.

Collected accounts receivable.

b. Purchased land with a note (liability).

Purchased supplies on account.

c. Paid accounts payable.

Paid notes payable.

d. Paid a cash dividend to owners.

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Paid an expense with cash.

e. Recorded accrued salaries.

Recorded the liability for the utility bill received, but not due until the next period.

f. The business issued common stock to its owners.

Cash revenue is earned.

g. Unearned revenue is earned and recognized.

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EXERCISE 2-30B

a. Asset Source

b. Asset Use

c. Asset Source

d. Claims Exchange

e. Asset Source

f. Asset Use

g. Asset Exchange

h. Asset Use

i. Asset Source

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j. Asset Exchange

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EXERCISE 2-31B

Note: These are only sample transactions. Other similar transactions will satisfy the requirements of this exercise.

a. Payment of rent expense; payment of other operating expense.

b. Payment of accounts payable; payment of dividends.

c. Received a note receivable in exchange for the sale of a delivery van.

d. Collection of accounts receivable; purchase of land.

e. Proceeds of a loan; issue of common stock.

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SOLUTIONS TO PROBLEMS - CHAPTER 2

PROBLEM 2-32B

James Cleaning Company
Effect of Events on the Financial Statements

	Balance Sheet													Income Statement						Stmt. of Cash Flows	
	Assets					=	Liabilities			+	Stk. Equity			Rev.	–	Exp.	=	Net Inc.			
Event	Cash	+	Accts Rec.	+	Supp.	=	Accts. Pay.	+	Unearn Rev.	+	Com. Stock	+	Ret. Earn.								
1.	15,000	+	NA	+	NA	=	NA	+	NA	+	15,000	+	NA	NA	–	NA	=	NA		15,000	FA
2.	6,000	+	NA	+	NA	=	NA	+	NA	+	NA	+	6,000	6,000	–	NA	=	6,000		6,000	OA
3.	NA	+	18,000	+	NA	=	NA	+	NA	+	NA	+	18,000	18,000	–	NA	=	18,000		NA	
4.	11,000	+	(11,000)	+	NA	=	NA	+	NA	+	NA	+	NA	NA	–	NA	=	NA		11,000	OA
5.	(1,400)	+	NA	+	1,400	=	NA	+	NA	+	NA	+	NA	NA	–	NA	=	NA		(1,400)	OA
6.	NA	+	NA	+	(1,300)	=	NA	+	NA	+	NA	+	(1,300)	NA	–	1,300	=	(1,300)		NA	
7.	3,600	+	NA	+	NA	=	NA	+	3,600	+	NA	+	NA	NA	–	NA	=	NA		3,600	OA
8.	NA	+	NA	+	NA	=	NA	+	(1,800)	+	NA	+	1,800	1,800	–	NA	=	1,800		NA	
9.	(6,500)	+	NA	+	NA	=	NA	+	NA	+	NA	+	(6,500)	NA	–	6,500	=	(6,500)		(6,500)	OA
10.	NA	+	NA	+	NA	=	2,800	+	NA	+	NA	+	(2,800)	NA	–	2,800	=	(2,800)		NA	
11.	(2,100)	+	NA	+	NA	=	(2,100)	+	NA	+	NA	+	NA	NA	–	NA	=	NA		(2,100)	OA
12.	(1,000)	+	NA	+	NA	=	NA	+	NA	+	NA	+	(1,000)	NA	–	NA	=	NA		(1,000)	FA
Bal.	24,600	+	7,000	+	100	=	700	+	1,800	+	15,000	+	14,200	25,800	–	10,600	=	15,200		24,600	NC

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PROBLEM 2-33B

The Accounting Equation									
	Total Assets			=	Liabilities	+	Stockholders' Equity		
Event/ Adjust.	Cash	+	Other Assets	=		+	Common Stock	+	Retained Earnings
a.	(6,000)		+6,000		NA		NA		NA
a. Adj.[1]	NA		(4,500)		NA		NA		(4,500)
b.	NA		+2,400		+2,400		NA		NA
b. Adj.[2]	NA		(2,200)		NA		NA		(2,200)
c.	(7,200)		+7,200		NA		NA		NA
c. Adj.[3]	NA		(6,000)		NA		NA		(6,000)
d.	+18,000		NA		+18,000		NA		NA
d. Adj.[4]	NA		NA		(6,000)		NA		6,000

[1]$6,000 x 9/12 = $4,500
[2]$2,400 – $200 = $2,200
[3]$7,200 x 10/12 = $6,000
[4]$18,000 x 4/12 = $6,000

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PROBLEM 2-34B

a.

Bates Company Income Statement For the Year Ended December 31, Year 3		
Revenue		$18,000
Expenses		
Salary Expense	$13,000	
Utility Expense	1,800	
Rent Expense	1,600	
Total Expense		(16,400)
Net Income		$ 1,600

b.

Accounts to be Closed:	
1.	Revenue
2.	Salary Expense
3.	Utility Expense
4.	Rent Expense
5.	Dividends

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c.

Computation of Retained Earnings:	
Beginning Retained Earnings	$19,700
Add: Net Income	1,600
Less: Dividends	(1,000)
Ending Retained Earnings	$20,300

Net income only includes revenues and expenses for the current year. Retained earnings not only includes current year net income, but also the balance from previous years and reductions for dividends.

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PROBLEM 2-34B (cont.)

e. The balances are zero; they were closed to Retained Earnings on December 31, Year 3. The December 31 closing balance of one year is the opening balance on January 1 of the next year.

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PROBLEM 2-35B

(Prepared for Instructor's Use)

Accounting Equation											
	Assets						Liabilities			Stk. Equity	
Date	Cash	Acc. Rec.	Pp. Rent	Supp.	Int. Rec.	Land	Acc. Pay.	Sal. Pay.	Unear. Rev.	Com. Stock	Ret. Earn.
Bal.	60,000	45,000				35,000	32,000			60,000	48,000
1/1	30,000									30,000	
4/1	(7,200)		7,200								
6/1	(5,000)										(5,000)
7/1	(40,000)					40,000					
8/1	(21,000)						(21,000)				
9/1	9,600								9,600		
9/30	20,000					(20,000)					
10/1				1,200			1,200				
12/31		75,000									75,000
12/31	62,000	(62,000)									
12/31							27,000				(27,000)
12/31								18,000			(18,000)
12/31				(1,100)							(1,100)
12/31[1]											
12/31a			(5,400)[1]								(5,400)
12/31a									(4,800)[2]		4,800
12/31[2]					120						120
Bal.	108,400	58,000	1,800	100	120	55,000	39,200	18,000	4,800	90,000	71,420

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[1]No entry for the change in value of the land.

[2]This assumes that some of the cash was invested in an interest bearing account.

(1) 12/31a Expired Rent ($7,200 x 9/12 = $5,400)

(2) 12/31a Unearned Revenue Earned ($9,600 x 4/8 = $4,800)

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PROBLEM 2-35B (cont.)

a. The two transactions that need adjusting entries are as follows:
   1. April 1, prepaid rent.
   2. Sept. 1, unearned revenue; cash was received in advance.

b. $35,000 + $40,000 – $20,000 = $55,000

c. $62,000 + $9,600 – $7,200 – $21,000 = $43,400

d. $7,200 X 9/12 = $5,400

e. $39,200 + $18,000 + $4,800 = $62,000

f. $1,200 – $100 = $1,100

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g. $9,600 – $4,800 ($9,600 x 4/8) = $4,800

h. $20,000 – $40,000 = $(20,000)

i. Total expenses: $27,000 + $18,000 + $1,100 + $5,400 = $51,500

j. $75,000 + $4,800 = $79,800

k. $30,000 – $5,000 = $25,000

l. (j) $79,800 + $120 – (i) $51,500 = $28,420

m. Beg. RE $48,000 + NI $28,420 – Div. $5,000 = Ending retained earnings $71,420

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PROBLEM 2-36B

Dawkins Company Financial Statements For the Year Ended December 31, Year 3		
Income Statement		
Revenue		
Service Revenue	$86,000	
Total Revenue		$86,000
Expenses		
Other Operating Expenses	$59,000	
Supplies Expense	1,000	
Rent Expense	3,500	
Insurance Expense	2,500	
Total Expenses		(66,000)
Net Income		$20,000
Statement of Changes in Stockholders' Equity		
Beginning Common Stock	$ 5,500	
Plus: Stock Issued	9,000*	
Ending Common Stock		$14,500
Beginning Retained Earnings	$47,200	
Plus: Net Income	20,000	
Less: Dividends	(5,000)	
Ending Retained Earnings		62,200
Total Stockholders' Equity		$76,700

*Not given in the problem.

Ending Common Stock – Beginning Common Stock = Stock Issued

$14,500 – $5,500 = $9,000

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PROBLEM 2-36B (cont.)

Dawkins Company Balance Sheet As of December 31, Year 3		
Assets		
Cash	$22,100	
Accounts Receivable	21,000	
Supplies	2,100	
Prepaid Insurance	3,500	
Land	43,000	
Total Assets		$91,700
Liabilities		
Accounts Payable	$15,000	
Total Liabilities		$15,000
Stockholders' Equity		
Common Stock	$14,500	
Retained Earnings	62,200	
Total Stockholders' Equity		76,700
Total Liab. and Stockholders' Equity		$91,700

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PROBLEM 2-36B (cont.)

Dawkins Company Statement of Cash Flows For the Year Ended December 31, Year 3	
Cash Flow From Operating Activities	$ 8,600
Cash Flow From Investing Activities	(6,000)
Cash Flow From Financing Activities	9,000
Net Change in Cash	11,600
Plus: Beginning Cash Balance	10,500*
Ending Cash Balance	$22,100

*Not given in the problem.

Ending Cash Bal. – Increase in Cash = Beg. Cash Balance

$22,100 – $11,600 = $10,500

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PROBLEM 2-37B

FOR THE YEARS	Year 1	Year 2	Year 3
Income Statements			
Revenue (cash)	$ 400	$ 500	$ 800
Expense (cash)	(250)	(l) (400)	(425)
Net income	(a) $ 150	$ 100	$ 375
Statements of Changes in Stockholders' Equity			
Beginning common stock	$ -0-	(m) $8,000	$9,100
Plus: Common stock issued	(b) 8,000	1,100	310
Ending common stock	8,000	9,100	(s) 9,410
Beginning retained earnings	-0-	25	75
Plus: Net income	(c) 150	100	375
Less: Dividends	(d) (125)	(50)	(150)
Ending retained earnings	25	(n) 75	300
Total stockholders' equity	(e) $8,025	$9,175	(t) $9,710
Balance Sheets			
Assets			
Cash	(f) $11,000	(o) $ 6,650	(u)$ 8,050
Land	-0-	(p) 5,000	2,500
Total assets	$11,000	$11,650	$10,550
Liabilities	(g) $ 2,975	(q) $ 2,475	$ 840
Stockholders' equity			
Common stock	(h) 8,000	(r) 9,100	9,410
Retained earnings	(i) 25	75	300
Total stockholders' equity	8,025	9,175	9,710
Total liabilities and stk. equity	$11,000	$11,650	$10,550

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PROBLEM 2-37B (cont.)

FOR THE YEARS	Year 1	Year 2	Year 3
Statements of Cash Flows			
Cash flows from oper. activities:			
Cash receipts from revenue	(j)$ 400	$ 500	(v) $ 800
Cash payments for expenses	(k) (250)	(400)	(w) (425)
Net cash flows from oper. Act.	150	100	375
Cash flows from invest. activities:			
Cash payments for land	-0-	(5,000)	-0-
Cash receipt from sale of land	-0-	-0-	2,500
Net cash flows from invest. act.	-0-	(5,000)	2,500
Cash flows from fin. activities:			
Cash rec. from borrowed funds	2,975	-0-	-0-
Cash payments to reduce debt	-0-	(500)	(x) (1,635)
Cash receipts from stock issue	8,000	1,100	(y) 310
Cash payments for dividends	(125)	(50)	(z) (150)
Net cash flows from fin. activities	10,850	550	(1,475)
Net change in cash	11,000	(4,350)	1,400
Plus: beginning cash balance	-0-	11,000	6,650
Ending cash balance	$11,000	$ 6,650	$ 8,050

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PROBLEM 2-37B (cont.)

Computations of amounts:

a. $150 Net Income = $400 Revenue – $250 Expenses.

b. $8,000 Common Stock Issued = $8,000 Ending Common Stock – $-0- Beginning Common Stock.

c. $150 Net Income = $150 Net Income from Income Statement.

d. $125 Dividends = $-0- Beginning Retained Earnings + $150 Net Income – $25 Ending Retained Earnings.

e. $8,025 Total Stockholders' Equity = $8,000 Ending Common Stock + $25 Ending Retained Earnings.

f. $11,000 Cash = $11,000 Total Assets – $-0- Land.

g. $2,975 Liabilities = $11,000 Total Liabilities and Stockholders' Equity – $8,025 Total Stockholders' Equity.

h. $8,000 Common Stock = $8,000 Ending Common Stock from Statement of Changes in Stockholders' Equity.

i. $25 Retained Earnings = $25 Ending Retained Earnings from Statement of Changes in Stockholders' Equity.

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j. $400 Cash Receipts from Revenue = $400 Revenue from Income Statement.

k. $250 Cash Payments for Expenses = $250 Expenses from Income Statement.

l. $400 Expenses = $500 Revenue – $100 Net Income.

m. $8,000 Beginning Common Stock = $8,000 Ending Common Stock for Year 1.

n. $75 Ending Retained Earnings = $25 Beginning Retained Earnings + $100 Net Income – $50 Dividends.

o. $6,650 Cash = $6,650 Ending Cash Balance from the Statement of Cash Flows.

p. $5,000 Land = $11,650 Total Assets – $6,650 Cash.

q. $2,475 Liabilities = $11,650 Total Liabilities and Stockholders' Equity – $9,175 Total Stockholders' Equity.

r. $9,100 Common Stock = $9,100 Ending Common Stock from Statement of Changes in Stockholders' Equity.

s. $9,410 Ending Common Stock = $9,100 Beginning Common Stock + $310 Stock issued.

t. $9,710 Total Stockholders' Equity = $9,410 Ending Common Stock + $300 Ending Retained Earnings.

u. $8,050 Cash = $10,550 Total Assets – $2,500 Land.

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PROBLEM 2-37B (cont.)

v. $800 Cash Receipts from Revenue = $800 Revenue from Income Statement.

w. $425 Cash Payments for Expenses = $425 Expenses from Income Statement.

x. $1,635 Cash Payments to Reduce Debt = $2,475 Liabilities Balance, Year 2 – $840 Liabilities Balance, Year 3.

y. $310 Cash Receipts from Stock Issue = $310 Common Stock Issued from Statement of Changes in Stockholders' Equity.

z. $150 Cash Payments for Dividends = $150 Dividends from Statement of Changes in Stockholders' Equity.

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PROBLEM 2-38B

a.

Alabama Service Company
Accounting Equation for Year 1

		Assets					=	Liabilities			+	Stk. Equity	
Event	Type of Event	Cash	Accts. Rec.	Supp.	Prepd. Rent	Land	=	Accts. Pay.	Salaries Payable	Unearn. Rev.	+	Com. Stock	Retained Earnings
1.	AS	60,000										60,000	
2.	AS			1,200				1,200					
3.	AE	(18,000)				18,000							
4.	AU	(800)						(800)					
5.	AS		42,000										42,000
6.	AU	(21,000)											(21,000)
7.	AE	38,000	(38,000)										
8.	CE								3,200				(3,200)
9.	AU			(1,000)									(1,000)
Totals		58,200	4,000	200	-0-	18,000	=	400	3,200	-0-	+	60,000	16,800

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PROBLEM 2-38B (cont.)

Alabama Service Company
Accounting Equation for Year 2

		Assets						=	Liabilities			+	Stk. Equity	
Event	Type of Event	Cash	Accts. Rec.	Supp.	Prepd. Rent	Int. Rec.	Land	=	Accts. Pay.	Salaries Payable	Unearn. Revenue	+	Com. Stock	Retained Earnings
Bal.		58,200	4,000	200	-0-		18,000		400	3,200	-0-		60,000	16,800
1.	AS	20,000											20,000	
2.	AU	(3,200)								(3,200)				
3.	AE	(3,600)			3,600									
4.	AE	15,000					(15,000)							
5.	AS	4,800									4,800			
6.	AS			1,000					1,000					
7.	AS		32,000											32,000
8.	AE	33,000	(33,000)											
9.	AU	(5,000)												(5,000)
10.	AU	(19,500)												(19,500)
11.	AU				(3,000)[1]									(3,000)
12.	CE										(1,200)[2]			1,200
13.	AU			(900)										(900)
14.	CE									3,900				(3,900)
15.	AS					400								400
Totals		99,700	3,000	300	600	400	3,000	=	1,400	3,900	3,600	+	80,000	18,100

[1]$3,600 x 10/12 = $3,000
[2]$4,800 x 3/12 = $1,200

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PROBLEM 2-38B (cont.)

b.

Alabama Service Company
Financial Statements
For the Years Ended December 31, Year 1 and Year 2

Income Statements

	Year 1	Year 2
Service Revenue	$ 42,000	$ 33,200
Interest Revenue	-0-	400
	42,000	33,600
Expenses		
Operating Expenses	(21,000)	(19,500)
Supplies Expense	(1,000)	(900)
Salaries Expense	(3,200)	(3,900)
Rent Expense	-0-	(3,000)
Total Expenses	(25,200)	(27,300)
Net Income	$16,800	$ 6,300

Statements of Changes in Stockholders' Equity

Beginning Common Stock	$ -0-	$60,000
Plus: Stock Issued	60,000	20,000
Ending Common Stock	60,000	80,000
Beginning Retained Earnings	-0-	16,800
Plus: Net Income	16,800	6,300
Less: Dividends	-0-	(5,000)
Ending Retained Earnings	16,800	18,100
Total Stockholders' Equity	$76,800	$98,100

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PROBLEM 2-38B b. (cont.)

Alabama Service Company
Balance Sheets
As of December 31, Year 1 and Year 2

	Year 1	Year 2
Assets		
Cash	$58,200	$99,700
Accounts Receivable	4,000	3,000
Interest Receivable	-0-	400
Supplies	200	300
Prepaid Rent	-0-	600
Land	18,000	3,000
Total Assets	$80,400	$107,000
Liabilities		
Accounts Payable	$ 400	$ 1,400
Salaries Payable	3,200	3,900
Unearned Revenue	-0-	3,600
Total Liabilities	3,600	8,900
Stockholders' Equity		
Common Stock	60,000	80,000
Retained Earnings	16,800	18,100
Total Stockholders' Equity	76,800	98,100
Total Liab. and Stockholders' Equity	$80,400	$107,000

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PROBLEM 2-38B b. (cont.)

Alabama Service Company
Statements of Cash Flows
For the Years Ended December 31, Year 1 and Year 2

	Year 1	Year 2
Cash Flows From Operating Activities:		
Cash Received from Customers	$38,000	$37,800
Cash Payment for Expenses[1]	(21,800)	(26,300)
Net Cash Flow from Operating Activities	16,200	11,500
Cash Flows From Investing Activities:		
Cash Payment for Land	(18,000)	-0-
Cash Proceeds from Sale of Land		15,000
Net Cash Flow From Investing Activities	(18,000)	15,000
Cash Flows From Financing Activities:		
Cash Receipts from Stock Issue	60,000	20,000
Cash Payment for Dividends	-0-	(5,000)
Net Cash Flow From Financing Activities	60,000	15,000
Net Change in Cash	58,200	41,500
Plus: Beginning Cash Balance	-0-	58,200
Ending Cash Balance	$58,200	$99,700

[1]Year 1: $800 + $21,000 = $21,800
Year 2: $3,200 + $3,600 + $19,500 = $26,300

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SOLUTIONS TO CRITICAL THINKING – CHAPTER 2

CT 2-1 (All dollar amounts are in millions.)

1. Target's accrual accounts are: Accounts payable, Accrued and other current liabilities. Note 13 discloses that Accrued and other current liabilities included several specific accounts, including Wages and benefits, Real estate, sales and other taxes payable, Gift card liability, and Dividends payable.

   The Deferred income taxes account shown under Liabilities is probably best classified as an accrual account, but students will probably think it is a deferral account.

2. Target's deferral accounts are: Inventories, Buildings and improvements, Fixtures and equipment, Computer hardware and software, and Construction in progress. Note 9 discloses that Other current assets include: Income tax and other receivables, Vendor income receivable, Prepaid expenses, and Other.

   Students might also list the Deferred income taxes account shown that is shown under Liabilities, but as noted above, this is more of an accrual account.

3. Net income for 2019 was $3,281
   Cash provided by operating activities for 2019 was $7,117

   Thus, cash flow from operating activities exceeded net income by $3,836.

4. Net income increased by $344 from 2018 to 2019 ($3,281 - $2,937). Cash provided by operating activities increased by $1,144 from 2018 to 2019 ($7,117- $5,973). Therefore, the change in cash flows was greater.

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CT 2-2

a.

	ExxonMobil	%	Apple	%
Computation of Expenses				
Revenue (in billions)	$244.4	100.0	$265.6	100.0
Less, Net Income	19.7	8.1	59.5	22.4
Expenses (in billions)	$224.7	91.9	$206.1	77.6

The conservatism principle guides accountants to select the alternative that produces the lowest amount of net income. The conservatism principle holds that it is better to understate income than to overstate it. If this holds true, Exxon Mobil may be expensing more of its cost than Apple.

b.

Investors may believe there is more growth opportunity in the technology sector, where Apple operates than there is in the petroleum sector, where Exxon Mobil operates. Additionally, Apple's net income, as a percentage of sales, is higher.

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CT 2-3

This solution is based on Netflix's 2018 financial report.

a. Netflix's accrual accounts are:

Current content liabilities (though students will probably not list this account)
Accounts payable
Accrued expenses

b. Netflix's deferral accounts are:

Content library, net (short-term and long-term) {shown under assets]
Property, plant, and equipment, net
Other current assets
Other noncurrent assets (possibly, depending on the nature of the asset)
Deferred revenues

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CT 2-4

a.

Income Statement		Balance Sheet	
Service Revenue	$120,000	Assets:	$167,000
Operating Exp.	(40,000)		
Net Income	$ 80,000	Liabilities:	$ 5,000
		Stockholders' Equity:	
		Common Stock	82,000
		Retained Earnings	80,000
		Total Stk. Equity	162,000
		Total Liab. and Stk. Equity	$167,000

Computations for Income Statement Items:
Revenue: $38,000 + $82,000 = $120,000
Operating Expense: $70,000 – $30,000 = $40,000

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Computations for Balance Sheet Items:
Assets: $85,000 + $82,000 = $167,000
Liabilities: $35,000 – $30,000 = $5,000
Retained Earnings: $(32,000) + $82,000 + $30,000 = $80,000

b. The conservatism principal requires that revenue not be recognized before it is actually earned. Glenn actually recorded an amount that not only had not been earned, but the contract had not been finalized. Glenn has overstated his income by the $82,000.

c. The accrued salaries are an expense that has already been accrued and is owed and these salary expense should be matched against the respective year's revenue. By removing these expenses from net income computation, Glenn is overstating net income.

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