Intermediate Accounting IFRS Edition 2nd Edition Solutions Manual Kieso Weygandt Warfield
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Test Bank for Intermediate Accounting IFRS Edition 2nd Edition by Donald E. Kieso , Jerry J. Weygandt , Terry D. Warfield
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CHAPTER 3 The Accounting Information System

ASSIGNMENT CLASSIFICATION TABLE (BY TOPIC)

Topics		Questions	Brief Exercises	Exercises	Problems
1.	Transaction identification.	1, 2, 3, 5	1, 2	1, 2, 3, 4, 17	1
2.	Nominal accounts.	4, 7			
3.	Trial balance.	6, 10		2, 3, 4	1, 2, 7
4.	Adjusting entries.	8, 11, 13, 14	3, 4, 5, 6, 7, 8, 9, 10	5, 6, 7, 8, 9, 10, 20	1, 2, 3, 4, 5, 6, 7, 8, 9, 11
5.	Financial statements.			11, 12, 15, 22, 23	1, 2, 4, 6
6.	Closing.	12	11	13, 14, 16	1, 4, 8, 9, 11
7.	Inventory and cost of goods sold.	9		12, 14, 15	
8.	Comprehensive accounting cycle.				1, 2, 6, 11
*9.	International convergence.	15, 16, 17			
*10.	Cash vs. accrual basis.	18, 19, 20	12	18, 19	10
*11.	Reversing entries.	21	13	20	
*12.	Worksheet.	22		21, 22, 23	11

*These topics are dealt with in an Appendix to the Chapter.

ASSIGNMENT CLASSIFICATION TABLE (BY LEARNING OBJECTIVE)

Learning Objectives	Brief Exercises	Exercises	Problems
1. Understand basic accounting terminology.			
2. Explain double-entry rules.			
3. Identify steps in accounting cycle.			
4. Record transactions in journals, post to ledger accounts, and prepare a trial balance.	1, 2, 3, 4, 5, 6, 7, 9	1, 2, 3, 4, 17	1, 4, 8, 9
5. Explain the reasons for preparing adjusting entries.	3, 4, 5, 6, 7, 8, 10	5, 6, 7, 8, 9, 10, 20	2, 3, 4, 5, 6, 7, 8, 9, 11
6. Prepare financial statements from the adjusted trail balance.		11, 12, 15	1, 2, 4, 6, 7, 8, 9, 11
7. Prepare closing entries.	11	13, 14, 16	1, 4, 8, 9, 11
8. Prepare financial statements for a merchandising company.		4	9
*9. Differentiate the cash basis of accounting from the accrual basis of accounting.	12	18, 19	10
*10. Identify adjusting entries that may be reversed.	13	20	
*11. Prepare a 10-column worksheet.		21, 22, 23	11

*These topics are dealt with in an Appendix to the Chapter.

ASSIGNMENT CHARACTERISTICS TABLE

Item	Description	Level of Difficulty	Time (minutes)
E3-1	Transaction analysis–service company.	Simple	15–20
E3-2	Corrected trial balance.	Simple	10–15
E3-3	Corrected trial balance.	Simple	15–20
E3-4	Corrected trial balance.	Simple	10–15
E3-5	Adjusting entries.	Moderate	10–15
E3-6	Adjusting entries.	Moderate	15–20
E3-7	Analyze adjusted data.	Complex	15–20
E3-8	Adjusting entries.	Moderate	10–15
E3-9	Adjusting entries.	Moderate	15–20
E3-10	Adjusting entries.	Complex	25–30
E3-11	Prepare financial statements.	Moderate	20–25
E3-12	Prepare financial statements.	Moderate	20–25
E3-13	Closing entries.	Simple	10–15
E3-14	Closing entries.	Moderate	10–15
E3-15	Missing amounts.	Simple	10–15
E3-16	Closing entries for a corporation.	Moderate	10–15
E3-17	Transactions of a corporation, including investment and dividend.	Moderate	10–15
*E3-18	Cash to accrual basis.	Moderate	15–20
*E3-19	Cash to accrual basis.	Moderate	10–15
*E3-20	Adjusting and reversing entries.	Complex	20–25
*E3-21	Worksheet.	Simple	10–15
*E3-22	Worksheet and statement of financial position presentation.	Moderate	20–25
*E3-23	Partial worksheet preparation.	Moderate	10–15
P3-1	Transactions, financial statements–service company.	Moderate	25–35
P3-2	Adjusting entries and financial statements.	Moderate	35–40
P3-3	Adjusting entries.	Moderate	25–30
P3-4	Financial statements, adjusting and closing entries.	Moderate	40–50
P3-5	Adjusting entries.	Moderate	15–20
P3-6	Adjusting entries and financial statements.	Moderate	25–35
P3-7	Adjusting entries and financial statements.	Moderate	25–35
P3-8	Adjusting and closing.	Moderate	30–40
P3-9	Adjusting and closing.	Moderate	30–35
*P3-10	Cash and accrual basis.	Moderate	35–40
*P3-11	Worksheet, statement of financial position, adjusting and closing entries.	Complex	40–50

ANSWERS TO QUESTIONS

1. Examples are:
(a) Payment of an accounts payable.
(b) Collection of an accounts receivable from a customer.
(c) Transfer of an accounts payable to a note payable.

2. Transactions (a), (b), (d) are considered business transactions and are recorded in the accounting records because a change in assets, liabilities, or equity has been effected as a result of a transfer of values from one party to another. Transactions (c) and (e) are not business transactions because a transfer of values has not resulted, nor can the event be considered financial in nature and capable of being expressed in terms of money.

3. Transaction (a): Accounts Receivable (debit), Service Revenue (credit).
Transaction (b): Cash (debit), Accounts Receivable (credit).
Transaction (c): Supplies (debit), Accounts Payable (credit).
Transaction (d): Delivery Expense (debit), Cash (credit).

4. Revenue and expense accounts are referred to as temporary or nominal accounts because each period they are closed out to Income Summary in the closing process. Their balances are reduced to zero at the end of the accounting period; therefore, the term temporary or nominal is given to these accounts.

5. Andrea is not correct. The double-entry system means that for every debit amount there must be a credit amount and vice-versa. At least two accounts are affected. It does not mean that each transaction must be recorded twice.

6. Although it is not absolutely necessary that a trial balance be taken periodically, it is customary and desirable. The trial balance accomplishes two principal purposes:
(1) It tests the accuracy of the entries in that it proves that debits and credits of an equal amount are in the ledger.
(2) It provides a list of ledger accounts and their balances which may be used in preparing the financial statements and in supplying financial data about the concern.

7. (a) Real account; statement of financial position.
(b) Real account; statement of financial position.
(c) Inventory is generally considered a real account appearing on the statement of financial position. It has the elements of a nominal account when the periodic inventory system is used. It may appear on the income statement when the multiple-step format is used under a periodic inventory system.
(d) Real account; statement of financial position.
(e) Real account; statement of financial position.
(f) Nominal account; income statement.
(g) Nominal account; income statement.
(h) Real account; statement of financial position.

8. At December 31, the three days' salaries and wages due to the employees represent a current liability. The related expense must be recorded in this period to properly reflect the expense incurred.

9. (a) In a service company, revenues are service revenues and expenses are operating expenses. In a merchandising company, revenues are sales revenues and expenses consist of cost of goods sold plus operating expenses.
(b) The measurement process in a merchandising company consists of comparing the sales price of the merchandise inventory to the cost of goods sold and operating expenses.

10. (a) No change.
(b) Before closing, balances exist in these accounts; after closing, no balances exist.
(c) Before closing, balances exist in these accounts; after closing, no balances exist.
(d) Before closing, a balance exists in this account exclusive of any dividends or the net income or net loss for the period; after closing, the balance is increased or decreased by the amount of net income or net loss, and decreased by dividends declared.
(e) No change.

11. Adjusting entries are prepared prior to the preparation of financial statements in order to bring the accounts up to date and are necessary (1) to achieve a proper recognition of revenues and expenses in measuring income and (2) to achieve an accurate presentation of assets, liabilities and equity.

12. Closing entries are prepared to transfer the balances of nominal accounts to capital (retained earnings) after the adjusting entries have been recorded and the financial statements prepared. Closing entries are necessary to reduce the balances in nominal accounts to zero in order to prepare the accounts for the next period's transactions.

13. Cost – Residual Value = Depreciable Cost: $4,000 – $0 = $4,000. Depreciable Cost ÷ Useful Life = Depreciation Expense For One Year $4,000 ÷ 5 years = $800 per year. The asset was used for 6 months (7/1 – 12/31), therefore 1/2-year of depreciation expense should be reported. Annual depreciation X 6/12 = amount to be reported on 2015 income statement: $800 X 6/12 = $400.

14.

December 31		
Interest Receivable	10,000	
Interest Revenue		10,000
(To record accrued interest revenue on loan)		

Accrued expenses result from the same causes as accrued revenues. In fact, an accrued expense on the books of one company is often an accrued revenue to another company.

15. No, all international companies are not subject to the same internal control standards. All public companies that list their securities on U.S. stock exchanges are subject to the internal control testing and assurance provisions of the Sarbanes-Oxley Act of 2002. International companies that list their securities on non-U.S. exchanges are not subject to these rules and there is debate as to whether they should have to comply.

16. There is concern that the cost of complying with the higher internal control provisions is making U.S. markets less competitive as a place to list securities. This in turn could give U.S. investors less investment opportunities. On the other hand, some argue that the enhanced internal control requirements in the U.S. increase the perceived reliability of companies' financial statements and helps reduce their cost of capital. Furthermore, the decline in public listings in the U.S. is more likely due to other factors, such as growth in non-U.S. markets and general globalization. Thus, the jury is still out on the net cost/benefit of Sarbanes-Oxley and its impact on international competitiveness.

17. As with accounting standards, there are differences in auditing standards across international jurisdictions. In the U.S., auditors of public companies are regulated by the Public Company Accounting Oversight Board (PCAOB). The PCAOB enforces the provisions of the Sarbanes-Oxley Act through its various auditing standards. In the international domain, the auditing standards board is the International Auditing and Assurance Standards Board (IAASB). The IAASB is working on a broad set of international auditing standards but to date does not have a law like Sarbanes-Oxley to guide its work.

Note to instructors—Some instructors may wish to direct students to the IAASB web-site http://www.ifac.org/iaasb/-to learn more about its work and to compare to the work of the PCAOB— http://www.pcaobus.org/.

***18.** Under the cash basis of accounting, revenue is recorded only when cash is received and expenses are recorded only when paid. Under the accrual basis of accounting, revenue is recognized when a performance obligation is satisfied and expenses are recognized when incurred, without regard to the time of the receipt or payment of cash.

A cash-basis statement of financial position and income statement are incomplete and inaccurate in comparison to accrual-basis financial statements. The accrual-basis matches effort (expenses) with accomplishment (revenues) in the income statement while the cash-basis only presents cash receipts and cash disbursements. The accrual-basis statement of financial position contains receivables, payables, accruals, prepayments, and deferrals while a cash basis statement of financial position shows none of these.

***19.** Salaries and wages paid during the year will include the payment of any salaries and wages attributable to the prior year but unpaid at the end of the prior year. This amount is an expense of the prior year and not of the current year, and thus should be subtracted in determining salaries and wages expense. Similarly, salaries and wages paid during the year will not include any salaries and wages attributable to hours worked during the current year but not actually paid until the following year. This should be added in determining salaries and wages expense.

***20.** Although similar to the strict cash basis, the modified cash basis of accounting requires that expenditures for capital items be charged against income over all the periods to be benefited. This is done through conventional accounting methods, such as depreciation and amortization. Under the strict cash basis, expenditures would be recognized as expenses in the period in which the corresponding cash disbursements are made.

***21.** Reversing entries are made at the beginning of the period to reverse accruals and some deferrals. Reversing entries are not required. They are made to simplify the recording of certain transactions that will occur later in the period. The same results will be attained whether or not reversing entries are recorded.

***22.** Disagree. A worksheet is not a permanent accounting record and its use is not required in the accounting cycle. The worksheet is an informal device for accumulating and sorting information needed for the financial statements. Its use is optional in helping to prepare financial statements.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 3-1

May	1	Cash	4,000	
		Share Capital-Ordinary		4,000
	3	Equipment	1,100	
		Accounts Payable		1,100
	13	Rent Expense	400	
		Cash		400
	21	Accounts Receivable	500	
		Service Revenue		500

BRIEF EXERCISE 3-2

Aug.	2	Cash	12,000	
		Equipment	2,500	
		Agazzi, Capital		14,500
	7	Supplies	500	
		Accounts Payable		500
	12	Cash	1,300	
		Accounts Receivable	670	
		Service Revenue		1,970

BRIEF EXERCISE 3-2 (Continued)

	15	Rent Expense	600	
		Cash		600
	19	Supplies Expense	230	
		Supplies (€500 – €270)		230

BRIEF EXERCISE 3-3

July	1	Prepaid Insurance	15,000	
		Cash		15,000
Dec.	31	Insurance Expense	2,500	
		Prepaid Insurance (€15,000 X 1/2 X 1/3)		2,500

BRIEF EXERCISE 3-4

July	1	Cash	15,000	
		Unearned Insurance Revenue		15,000
Dec.	31	Unearned Insurance Revenue	2,500	
		Insurance Revenue (€15,000 X 1/2 X 1/3)		2,500

BRIEF EXERCISE 3-5

Feb.	1	Prepaid Insurance	72,000	
		Cash		72,000
June	30	Insurance Expense	15,000	
		Prepaid Insurance (£72,000 X 5/24)		15,000

BRIEF EXERCISE 3-6

Nov.	1	Cash	2,400	
		Unearned Rent Revenue		2,400
Dec.	31	Unearned Rent Revenue	1,600	
		Rent Revenue (€2,400 X 2/3)		1,600

BRIEF EXERCISE 3-7

Dec.	31	Salaries and Wages Expense	4,800	
		Salaries and Wages Payable (€8,000 X 3/5)		4,800
Jan.	2	Salaries and Wages Payable	4,800	
		Salaries and Wages Expense	3,200	
		Cash		8,000

BRIEF EXERCISE 3-8

Dec.	31	Interest Receivable	300	
		Interest Revenue		300
Feb.	1	Cash	12,400	
		Notes Receivable		12,000
		Interest Receivable		300
		Interest Revenue		100

BRIEF EXERCISE 3-9

Aug.	31	Interest Expense	300	
		Interest Payable		300
	31	Accounts Receivable	1,400	
		Service Revenue		1,400
	31	Salaries and Wages Expense	700	
		Salaries and Wages Payable		700
	31	Bad Debt Expense	900	
		Allowance for Doubtful Accounts		900

BRIEF EXERCISE 3-10

Depreciation Expense	2,000	
Accumulated Depreciation—Equipment		2,000

Equipment	€30,000	
Less: Accumulated Depreciation—Equipment	2,000	€28,000

BRIEF EXERCISE 3-11

Sales Revenue	808,900	
Interest Revenue	13,500	
Income Summary		822,400
Income Summary	780,300	
Cost of Goods Sold		556,200
Operating Expenses		189,000
Income Tax Expense		35,100
Income Summary	42,100	
Retained Earnings		42,100
Retained Earnings	18,900	
Dividends		18,900

*BRIEF EXERCISE 3-12

(a)	Cash receipts	$142,000
	+ Increase in accounts receivable (€18,600 – €13,000)	5,600
	Service revenue	$147,600
(b)	Payments for operating expenses	$ 97,000
	– Increase in prepaid expenses (€23,200 – €17,500)	(5,700)
	Operating expenses	$ 91,300

*BRIEF EXERCISE 3-13

(a)	Salaries and Wages Payable	4,200	
	Salaries and Wages Expense		4,200
(b)	Salaries and Wages Expense	7,000	
	Cash		7,000
(c)	Salaries and Wages Payable	4,200	
	Salaries and Wages Expense	2,800	
	Cash		7,000

SOLUTIONS TO EXERCISES

EXERCISE 3-1 (15–20 minutes)

Apr.	2	Cash	30,000	
		Equipment	14,000	
		Kai Edo, Capital		44,000
	2	No entry—not a transaction.		
	3	Supplies	700	
		Accounts Payable		700
	7	Rent Expense	600	
		Cash		600
	11	Accounts Receivable	1,100	
		Service Revenue		1,100
	12	Cash	3,200	
		Unearned Service Revenue		3,200
	17	Cash	2,300	
		Service Revenue		2,300
	21	Insurance Expense	110	
		Cash		110
	30	Salaries and Wages Expense	1,160	
		Cash		1,160

EXERCISE 3-1 (Continued)

30	Supplies Expense	120	
	Supplies		120
30	Equipment	5,100	
	Kai Edo, Capital		5,100

EXERCISE 3-2 (10–15 minutes)

GERONIMO COMPANY
Trial Balance
April 30, 2015

	Debit	Credit
Cash	€ 2,100	
Accounts Receivable	2,750	
Prepaid Insurance (€700 + €1,000)	1,700	
Equipment	8,000	
Accounts Payable (€4,500 – €1,000)		€ 3,500
Property Tax Payable		560
Geronimo, Capital (€11,200 + €3,200)		14,400
Geronimo, Drawing	3,200	
Service Revenue		6,690
Salaries and Wages Expense	4,200	
Advertising Expense (€1,100 + €300)	1,400	
Property Tax Expense (€800 + €1,000)	1,800	
	€25,150	€25,150

EXERCISE 3-3 (15–20 minutes)

The ledger accounts are reproduced below, and corrections are shown in the accounts.

Cash

Bal.	5,912	(4)	190
(1)	270		

Accounts Payable

		Bal.	7,044

Accounts Receivable

Bal.	5,240	(1)	270

Share Capital—Ordinary

		Bal.	8,000

Supplies

Bal.	2,967		

Retained Earnings

		Bal.	2,000

Equipment

Bal.	6,100		
(2)	1,900		

Service Revenue

		Bal.	5,200
		(3)	2,025
		(5)	80

Office Expense

Bal.	4,320	(2)	1,900

EXERCISE 3-3 (Continued)

SCARLATTI CORPORATION
Trial Balance (Corrected)
April 30, 2015

	Debit	Credit
Cash	$ 5,992	
Accounts Receivable	4,970	
Supplies	2,967	
Equipment	8,000	
Accounts Payable		$ 7,044
Share Capital—Ordinary		8,000
Retained Earnings		2,000
Service Revenue		7,305
Office Expense	2,420	
	$24,349	$24,349

EXERCISE 3-4 (15–20 minutes)

OAKLEY CO.
Trial Balance
June 30, 2015

	Debit	Credit
Cash (€2,870 + €360 – €65 – €65)	€ 3,100	
Accounts Receivable (€3,231 – €360)	2,871	
Supplies (€800 – €500)	300	
Equipment (€3,800 + €500)	4,300	
Accounts Payable (€2,666 – €206 – €260)		€ 2,200
Unearned Service Revenue (€1,200 – €225)		975
Share Capital—Ordinary		6,000
Dividends	575	
Retained Earnings		3,000
Service Revenue (€2,380 + €801 + €225)		3,406
Salaries and Wages Expense (€3,400 + €670 – €575)	3,495	
Office Expense	940	
	€15,581	€15,581

EXERCISE 3-5 (10–15 minutes)

		Debit	Credit
1.	Depreciation Expense (€250 X 3)	750	
	Accumulated Depreciation—Equipment		750
2.	Unearned Rent Revenue (€6,300 X 1/3)	2,100	
	Rent Revenue		2,100
3.	Interest Expense	500	
	Interest Payable		500

EXERCISE 3-5 (Continued)

4.	Supplies Expense	2,150	
	Supplies (€2,800 – €650)		2,150
5.	Insurance Expense (€300 X 3)	900	
	Prepaid Insurance		900

EXERCISE 3-6 (10–15 minutes)

1.	Accounts Receivable	750	
	Service Revenue		750
2.	Utilities Expense	520	
	Accounts Payable		520
3.	Depreciation Expense	400	
	Accumulated Depreciation—Equipment		400
	Interest Expense	500	
	Interest Payable		500
4.	Insurance Expense ($15,000 X 1/12)	1,250	
	Prepaid Insurance		1,250
5.	Supplies Expense ($1,600 – $400)	1,200	
	Supplies		1,200

EXERCISE 3-7 (15–20 minutes)

(a)

Ending balance of supplies	£ 900
Add: Adjusting entry	950
Deduct: Purchases	850
Beginning balance of supplies	£1,000

(b)

Total prepaid insurance	£4,800	(£400 X 12)
Amount used (6 X £400)	2,400	
Present balance	£2,400	

The policy was purchased six months ago (August 1, 2014)

(c) The entry in January to record salaries paid was

Salaries and Wages Expense	1,800	
Salaries and Wages Payable	900	
Cash		2,700

The "T" account for salaries and Wages payable is

Salaries and Wages Payable

Paid January	900	Beg. Bal.	?
		End Bal.	800

The beginning balance is therefore

Ending balance of Salaries and Wages Payable	£ 800
Plus: Reduction of Salaries and Wages Payable	900
Beginning balance of Salaries and Wages Payable	£1,700

EXERCISE 3-7 (Continued)

(d)

Service revenue	£2,000
Cash received	1,600
Unearned service revenue reduced	£ 400

Ending Unearned revenue January 31, 2015	£ 750
Plus: Unearned service revenue reduced	400
Beginning unearned revenue December 31, 2014	£1,150

EXERCISE 3-8 (10–15 minutes)

(a)	Salaries and Wages Expense	2,900	
	Salaries and Wages Payable		2,900
(b)	Utilities Expense	600	
	Accounts Payable		600
(c)	Interest Expense ($60,000 X 8% X 1/12)	400	
	Interest Payable		400
(d)	Telephone and Internet Expense	117	
	Accounts Payable		117

EXERCISE 3-9 (15–20 minutes)

(a)	10/15	Salaries and Wages Expense	800	
		Cash		800
		(To record payment of October 15 payroll)		
	10/17	Accounts Receivable	2,100	
		Service Revenue		2,100
		(To record revenue for services performed for which payment has not yet been received)		
	10/20	Cash	650	
		Unearned Service Revenue		650
		(To record receipt of cash for services not yet performed)		
(b)	10/31	Supplies Expense	470	
		Supplies		470
		(To record the use of supplies during October)		
	10/31	Accounts Receivable	1,650	
		Service Revenue		1,650
		(To record revenue for services performed for which payment has not yet been received)		
	10/31	Salaries and Wages Expense	600	
		Salaries and Wages Payable		600
		(To record liability for accrued payroll)		
	10/31	Unearned Service Revenue	400	
		Service Revenue		400
		(To reduce the Unearned Service Revenue account for service that has been performed)		

EXERCISE 3-10 (25–30 minutes)

(a)	1.	Aug. 31	Insurance Expense (¥4,500 X 3/12)	1,125	
			Prepaid Insurance		1,125
	2.	Aug. 31	Supplies Expense (¥2,600 – ¥650)............	1,950	
			Supplies		1,950
	3.	Aug. 31	Depreciation Expense	1,080	
			Accumulated Depreciation—		
			Buildings..		1,080
			(¥120,000 – ¥12,000 = ¥108,000; ¥108,000 X 4% = ¥4,320 per year; ¥4,320 X 3/12 = ¥1,080)		
		Aug. 31	Depreciation Expense	360	
			Accumulated Depreciation—		
			Equipment		360
			(¥16,000 – ¥1,600 = ¥14,400; ¥14,400 X 10% = ¥1,440; ¥1,440 X 3/12 = ¥360)		
	4.	Aug. 31	Unearned Rent Revenue	3,800	
			Rent Revenue		3,800
	5.	Aug. 31	Salaries and Wages Expense	375	
			Salaries and Wages Payable		375
	6.	Aug. 31	Accounts Receivable	800	
			Rent Revenue		800
	7.	Aug. 31	Interest Expense.......................................	1,000	
			Interest Payable		
			[(¥50,000 X 8%) X 3/12]...................		1,000

(b)

UHURA RESORT
Adjusted Trial Balance
August 31, 2015

	Debit	Credit
Cash	¥ 19,600	
Accounts Receivable	800	
Prepaid Insurance (¥4,500 – ¥1,125)	3,375	
Supplies (¥2,600 – ¥1,950)	650	
Land	20,000	
Buildings	120,000	
Accumulated Depreciation—Buildings		¥ 1,080
Equipment	16,000	
Accumulated Depreciation—Equipment		360
Accounts Payable		4,500
Unearned Rent Revenue (¥4,600 – ¥3,800)		800
Salaries and Wages Payable		375
Interest Payable		1,000
Mortgage Payable		50,000
Share Capital—Ordinary		100,000
Retained Earnings		
Dividends	5,000	
Rent Revenue (¥86,200 + ¥3,800 + ¥800)		90,800
Salaries and Wages Expense (¥44,800 + ¥375)	45,175	
Utilities Expense	9,200	
Maintenance and Repairs Expense	3,600	
Insurance Expense	1,125	
Supplies Expense	1,950	
Depreciation Expense—(Buildings)	1,080	
Depreciation Expense—(Equipment)	360	
Interest Expense	1,000	
	¥248,915	¥248,915

EXERCISE 3-11 (20–25 Minutes)

(a)

CAVAMANLIS CO.
Income Statement
For the Year Ended December 31, 2015

Revenues		
Service revenue		$12,590
Expenses		
Salaries and wages expense..................	$6,840	
Rent expense	2,760	
Depreciation expense	145	
Interest expense.....................................	83	9,828
Net Income...		$ 2,762

(b)

CAVAMANLIS CO.
Retained Earnings Statement
For the Year Ended December 31, 2015

Retained earnings, January 1..	$11,310
Add: Net income	2,762
Less: Dividends..	3,000
Retained earnings, December 31	$11,072

EXERCISE 3-11 (Continued)

(c)

CAVAMANLIS CO.
Statement of Financial Position
December 31, 2015

Assets		
Noncurrent assets		
Property, plant, and equipment		
Equipment	$18,050	
Less: Accumulated depreciation— equipment	4,895	$13,155
Current assets		
Prepaid rent	2,280	
Accounts receivable	6,920	
Cash	18,972	
Total current assets		28,172
Total assets		$41,327
Equity and Liabilities		
Equity		
Share capital—ordinary	$20,000	
Retained earnings	11,072	$31,072
Current liabilities		
Notes payable	5,700	
Accounts payable	4,472	
Interest payable	83	
Total current liabilities		10,255
Total equity and liabilities		$41,327

EXERCISE 3-12 (20–25 Minutes)

(a)

FLYNN DESIGN AGENCY
Income Statement
For the Year Ended December 31, 2015

Revenues		
Service revenue		€58,500
Expenses		
Salaries and wages expense	€12,300	
Depreciation expense...........................	7,000	
Rent expense	4,000	
Supplies expense	3,400	
Insurance expense	850	
Interest expense	500	
Total expenses................................		28,050
Net income..		€30,450

FLYNN DESIGN AGENCY
Retained Earnings Statement
For the Year Ended December 31, 2015

Retained earnings, January 1	€ 3,500
Add: Net income	30,450
Retained earnings, December 31	€33,950

EXERCISE 3-12 (Continued)

(a) (Continued)

FLYNN DESIGN AGENCY
Statement of Financial Position
December 31, 2015

Assets		
Equipment	€60,000	
Less: Accumulated depreciation—equipment	35,000	€25,000
Supplies		5,000
Prepaid insurance		2,500
Accounts receivable		21,500
Cash		10,000
Total assets		€64,000
Equity and Liabilities		
Equity		
Share capital—ordinary	€10,000	
Retained earnings	33,950	€43,950
Liabilities		
Notes payable	5,000	
Accounts payable	8,000	
Unearned service revenue	5,600	
Salaries and wages payable	1,300	
Interest payable	150	
Total liabilities		20,050
Total equity and liabilities		€64,000

(b)

1. Based on interest payable at December 31, 2015, interest is €25 per month or .5% of the note payable. .5% X 12 = 6% interest per year.
2. Salaries and Wages Expense, €12,300 less Salaries and Wages Payable 12/31/15, €1,300 = €11,000. Total Payments, €17,500 – €11,000 = €6,500 Salaries and Wages Payable 12/31/14.

EXERCISE 3-13 (10–15 Minutes)

(a)

Sales revenue		£800,000
Less: Sales returns and allowances	£24,000	
Sales discount	12,000	36,000
Net sales		£764,000

(b)

Sales Revenue	800,000	
Income Summary		800,000
Income Summary	36,000	
Sales Returns and Allowances		24,000
Sales Discounts		12,000

EXERCISE 3-14 (10–15 minutes)

Sales Revenue	340,000	
Sales Returns and Allowances		13,000
Sales Discounts		8,000
Income Summary		319,000
Income Summary	302,000	
Cost of Goods Sold		202,000
Delivery Expense		7,000
Insurance Expense		12,000
Rent Expense		20,000
Salaries and Wages Expense		61,000
Income Summary	17,000	
Retained Earnings		17,000

EXERCISE 3-15 (10–15 minutes)

(a) $5,000 ($90,000 – $85,000)
(b) $29,000 ($85,000 – $56,000)
(c) $14,000 ($29,000 – $15,000)
(d) $95,000 ($5,000 + $90,000)
(e) $52,000 ($90,000 – $38,000)

EXERCISE 3-16 (10–15 minutes)

Sales Revenue	**390,000**	
Cost of Goods Sold		**235,700**
Sales Returns and Allowances		**12,000**
Sales Discounts		**15,000**
Selling Expenses		**16,000**
Administrative Expenses		**38,000**
Income Tax Expense		**30,000**
Income Summary		**43,300**

(or)

Sales Revenue	**390,000**	
Income Summary		**390,000**
Income Summary	**346,700**	
Cost of Goods Sold		**235,700**
Sales Returns and Allowances		**12,000**
Sales Discounts		**15,000**
Selling Expenses		**16,000**
Administrative Expenses		**38,000**
Income Tax Expense		**30,000**
Income Summary	**43,300**	
Retained Earnings		**43,300**
Retained Earnings	**18,000**	
Dividends		**18,000**

EXERCISE 3-17 (10–15 minutes)

			Debit	Credit
Mar.	1	Cash	60,000	
		Share Capital—Ordinary		60,000
		(Investment of cash in business)		
	3	Land	10,000	
		Buildings	22,000	
		Equipment	6,000	
		Cash		38,000
		(Purchased Michelle Wie's Golf Land)		
	5	Advertising Expense	1,600	
		Cash		1,600
		(Paid for advertising)		
	6	Prepaid Insurance	1,480	
		Cash		1,480
		(Paid for one-year insurance policy)		
	10	Equipment	2,500	
		Accounts Payable		2,500
		(Purchased equipment on account)		
	18	Cash	1,200	
		Service Revenue		1,200
		(Received cash for services performed)		
	25	Dividends	1,000	
		Cash		1,000
		(Declared and paid a £1,000 cash dividend)		
	30	Salaries and Wages Expense	900	
		Cash		900
		(Paid salaries and wages expense)		
	30	Accounts Payable	2,500	
		Cash		2,500
		(Paid creditor on account)		
	31	Cash	750	
		Service Revenue		750
		(Received cash for services performed)		

*EXERCISE 3-18 (15–20 minutes)

CORINNE DUNBAR, M.D.
Conversion of Cash Basis to Accrual Basis
For the Year 2015

Excess of cash collected over cash disbursed (€142,600 – €60,470)	€82,130
Add increase in accounts receivable (€11,250 – €15,927)	4,677
Deduct increase in unearned service revenue (€2,840 – €4,111)	(1,271)
Add decrease in accrued expenses (€3,435 – €2,108)	1,327
Add increase in prepaid expenses (€1,917 – €3,232)	1,315
Net income on an accrual basis	€88,178

Alternate solution:

CORINNE DUNBAR, M.D.
Conversion of Income Statement Data
from Cash Basis to Accrual Basis
For the Year 2015

	Cash Basis	Adjustments Add	Adjustments Deduct	Accrual Basis
Collections from customers:	€142,600			
–Accounts receivable, Jan. 1			€11,250	
+Accounts receivable, Dec. 31		€15,927		
+Unearned service revenue, Jan. 1		2,840		
–Unearned service revenue, Dec. 31			4,111	
Service revenue				€146,006
Disbursements for expenses:	60,470			
–Accrued liabilities, Jan. 1			3,435	
+Accrued liabilities, Dec. 31		2,108		
+Prepaid expenses, Jan. 1		1,917		
–Prepaid expenses, Dec. 31			3,232	
Operating expenses				57,828
Net income—cash basis	€ 82,130			
Net income—accrual basis				€ 88,178

*EXERCISE 3-19 (10–15 minutes)

(a)

NALEZNY CORP.
Income Statement (Cash Basis)
For the Year Ended December 31,

	2014	2015
Cash receipts	$290,000	$515,000
Cash payments	225,000	282,000
Net income	$ 65,000	$233,000

(b)

NALEZNY CORP.
Income Statement (Accrual Basis)
For the Year Ended December 31,

	2014	2015
Revenues*	$480,000	$445,000
Expenses**	277,000	265,000
Net income	$203,000	$180,000

*2014: $290,000 + $160,000 + $30,000 = $480,000
2015: $355,000 + $90,000 = $445,000
**2014: $185,000 + $67,000 + $25,000 = $277,000
2015: $40,000 + $170,000 + $55,000 = $265,000

***EXERCISE 3-20 (20–25 minutes)**

(a) Adjusting Entries:

1.	Insurance Expense (₺6,000 X 5/24)	1,250	
	Prepaid Insurance		1,250
2.	Rental Revenue (₺2,400 X 1/3)	800	
	Unearned Rental Revenue		800
3.	Supplies	290	
	Supplies Expense		290
4.	Interest Expense	770	
	Interest Payable		770

(b) Reversing Entries:

1. No reversing entry required.

2.	Unearned Rent Revenue	800	
	Rent Revenue		800
3.	Supplies Expense	290	
	Supplies		290
4.	Interest Payable	770	
	Interest Expense		770

*EXERCISE 3-21 (10–15 minutes)

Accounts	Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,000				15,000	
Inventory	80,000				80,000	
Sales Revenue		470,000		470,000		
Sales Returns and Allowances	10,000		10,000			
Sales Discounts	5,000		5,000			
Cost of Goods Sold	250,000		250,000			

*EXERCISE 3-22 (20–25 minutes)

MADRASAH CO.
Worksheet (Partial)
For the Month Ended April 30, 2015

	Adjusted Trial Balance		Income Statement		Statement of Financial Position	
Account Titles	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**
Cash	18,972				18,972	
Accounts Receivable	6,920				6,920	
Prepaid Rent	2,280				2,280	
Equipment	18,050				18,050	
Accum. Depr. – Equipment		4,895				4,895
Notes Payable		5,700				5,700
Accounts Payable		4,472				4,472
Madrasah, Capital		34,960				34,960
Madrasah, Drawing	6,650				6,650	
Service Revenue		12,590		12,590		
Salaries and Wages Expense	6,840		6,840			
Rent Expense	2,760		2,760			
Depreciation Expense	145		145			
Interest Expense	83		83			
Interest Payable		83				83
Totals	62,700	62,700	9,828	12,590	52,872	50,110
Net Income			2,762			2,762
Totals			12,590	12,590	52,872	52,872

*EXERCISE 3-22 (Continued)

MADRASAH CO.
Statement of Financial Position
April 30, 2015

Assets		
Noncurrent Assets		
Property, plant, and equipment		
Equipment	€18,050	
Less Accumulated depreciation–equipment	4,895	€13,155
Current Assets		
Prepaid rent	2,280	
Accounts receivable	6,920	
Cash	18,972	
Total current assets		28,172
Total assets		€41,327
Equity and Liabilities		
Equity		
Madrasah, capital		€31,072*
Current liabilities		
Notes payable	€ 5,700	
Accounts payable	4,472	
Interest payable	83	
Total current liabilities		10,255
Total equity and liabilities		€41,327

*Beg. Balance – Drawings + Net Income = Ending Balance

€34,960 – €6,650 + €2,762 = €31,072

*EXERCISE 3-23 (10–15 minutes)

LETTERMAN CO.
Worksheet (Partial)
For Month Ended February 28, 2015

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
Account Titles	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**
Supplies	1,756			(a) 1,241	515				515	
Accumulated Depreciation– Equipment		7,967		(b) 257		8,224				8,224
Interest Payable		150		(c) 50		200				200
Supplies Expense			(a) 1,241		1,241		1,241			
Depreciation Expense			(b) 257		257		257			
Interest Expense			(c) 50		50		50			

The following accounts and amounts would be shown in the February income statement:

Supplies expense	**€1,241**
Depreciation expense	**€ 257**
Interest expense	**€ 50**

TIME AND PURPOSE OF PROBLEMS

Problem 3-1 (Time 25–35 minutes)
Purpose—to provide an opportunity for the student to post daily transactions to a "T" account ledger, take a trial balance, prepare an income statement, a statement of financial position and a statement of changes in equity, close the ledger, and take a post-closing trial balance. The problem deals with routine transactions of a professional service firm and provides a good integration of the accounting process.

Problem 3-2 (Time 35–40 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting entries, and prepare financial statements (income statement, statement of financial position, and statement of retained earnings). The student also is asked to analyze two transactions to find missing amounts.

Problem 3-3 (Time 25–30 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting entries. The adjusting entries are fairly complex in nature.

Problem 3-4 (Time 40–50 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting entries and an adjusted trial balance and then prepare an income statement, a retained earnings statement, and a statement of financial position. In addition, closing entries must be made and a post-closing trial balance prepared.

Problem 3-5 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to determine what adjusting entries need to be made to specific accounts listed in a partial trial balance. The student is also required to determine the amounts of certain revenue and expense items to be reported in the income statement.

Problem 3-6 (Time 25–35 minutes)
Purpose—to provide the student with an opportunity to prepare year-end adjusting entries from a trial balance and related information presented. The problem also requires the student to prepare an income statement, a statement of financial position, and a statement of changes in equity. The problem covers the basics of the end-of-period adjusting process.

Problem 3-7 (Time 25–35 minutes)
Purpose—to provide an opportunity for the student to figure out the year-end adjusting entries that were made from a trial balance and an adjusted trial balance. The student is also required to prepare an income statement, a statement of retained earnings, and a statement of financial position. In addition, the student needs to answer a number of questions related to specific accounts.

Problem 3-8 (Time 30–40 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting, and closing entries. This problem presents basic adjustments including a number of accruals and deferrals. It provides the student with an integrated flow of the year-end accounting process.

Problem 3-9 (Time 30–35 minutes)
Purpose—to provide an opportunity for the student to prepare adjusting and closing entries from a trial balance and related information. The student is also required to post the entries to "T" accounts.

***Problem 3-10** (Time 35–40 minutes)
Purpose—to provide an opportunity for the student to prepare and compare (a) cash basis and accrual basis income statements, (b) cash basis and accrual basis statement of financial position, and (c) to discuss the weaknesses of cash basis accounting.

***Problem 3-11** (Time 40–50 minutes)
Purpose—to provide an opportunity for the student to complete a worksheet and then prepare a classified statement of financial position. In addition, adjusting and closing entries must be made and a post-closing trial balance prepared.

SOLUTIONS TO PROBLEMS

PROBLEM 3-1

(a) (Explanations are omitted.) and (d)

Cash

Sept.	1	20,000	Sept.	4	680
	8	1,690		5	942
	20	980		10	430
				18	3,600
				19	3,000
				30	1,800
				30	85
	30 Bal.	12,133			

Equipment

Sept.	2	17,280			

Yasunari Kawabata, Capital

Sept.	19	3,000	Sept.	1	20,000
				30	6,007
			Bal.	30	23,007

Accounts Receivable

Sept.	14	5,820	Sept.	20	980
	25	2,110			
Bal.	30	6,950			

Accounts Payable

Sept.	18	3,600	Sept.	2	17,280
			Bal.	30	13,680

Rent Expense

Sept.	4	680	Sept.	30	680

Supplies

Sept.	5	942	Sept.	30	330
Bal.	30	612			

Service Revenue

Sept.	30	9,620	Sept.	8	1,690
				14	5,820
				25	2,110
		9,620			9,620

Office Expense

Sept.	10	430	Sept.	30	515
	30	85			
		515			515

Accumulated Depreciation–Equipment

			Sept.	30	288

Salaries and Wages Expense

Sept.	30	1,800	Sept.	30	1,800

Supplies Expense

Sept.	30	330	Sept.	30	330

PROBLEM 3-1 (Continued)

Depreciation Expense

Sept.	30	288	Sept.	30	288

Income Summary

Sept.	30		680	Sept.	30	9,620
	30		515			
	30		1,800			
	30		330			
	30		288			
	30	Inc.	6,007			
			9,620			9,620

(b)

YASUNARI KAWABATA, D.D.S.
Trial Balance
September 30

	Debit	Credit
Cash	¥12,133	
Accounts Receivable	6,950	
Supplies	612	
Equipment	17,280	
Accumulated Depreciation–Equipment		¥ 288
Accounts Payable		13,680
Yasunari Kawabata, Capital		17,000
Service Revenue		9,620
Rent Expense	680	
Office Expense	515	
Salaries and Wages Expense	1,800	
Supplies Expense	330	
Depreciation Expense	288	
Totals	¥40,588	¥40,588

PROBLEM 3-1 (Continued)

(c)

YASUNARI KAWABATA, D.D.S.
Income Statement
For the Month of September

Service revenue		¥9,620
Expenses:		
Salaries and wages expense	¥1,800	
Rent expense	680	
Supplies expense	330	
Depreciation expense	288	
Office expense	515	
Total expenses		3,613
Net income		¥6,007

YASUNARI KAWABATA, D.D.S.
Statement of Owner's Equity
For the Month of September

Kawabata, Capital September 1	¥20,000
Add: Net income for September	6,007
	26,007
Less: Withdrawal by owner	3,000
Kawabata, Capital September 30	¥23,007

YASUNARI KAWABATA, D.D.S.
Statement of Financial Position
As of September 30

Assets		Equity and Liabilities	
Equipment.	¥17,280	Yasunari Kawabata,	
Accum. depreciation–		Capital	¥23,007
equipment	(288)		
Supplies	612	Accounts payable	13,680
Accounts receivable	6,950		
Cash	12,133	Total equity and	
Total assets	¥36,687	liabilities	¥36,687

(e)

YASUNARI KAWABATA, D.D.S.
Post-Closing Trial Balance
September 30

	Debit	Credit
Cash	¥12,133	
Accounts Receivable	6,950	
Supplies	612	
Equipment	17,280	
Accumulated Depreciation–Equipment		¥ 288
Accounts Payable		13,680
Yasunari Kawabata, Capital		23,007
Totals	¥36,975	¥36,975

PROBLEM 3-2

(a)	Dec.	31	Accounts Receivable	3,500	
			Service Revenue		3,500
		31	Unearned Service Revenue	1,400	
			Service Revenue		1,400
		31	Supplies Expense	5,400	
			Supplies		5,400
		31	Depreciation Expense	5,000	
			Accumulated Depreciation-Equipment		5,000
		31	Interest Expense	150	
			Interest Payable		150
		31	Insurance Expense	850	
			Prepaid Insurance		850
		31	Salaries and Wages Expense	1,300	
			Salaries and Wages Payable		1,300

(b)

MASON ADVERTISING AGENCY
Income Statement
For the Year Ended December 31, 2015

Revenues		
Service revenue		€63,500
Expenses		
Salaries and wages expense	€11,300	
Supplies expense	5,400	
Depreciation expense	5,000	
Rent expense	4,000	
Insurance expense	850	
Interest expense	500	
Total expenses		27,050
Net income		€36,450

MASON ADVERTISING AGENCY
Retained Earnings Statement
For the Year Ended December 31, 2015

Retained earnings, January 1	€ 3,500
Add: Net income	36,450
Retained earnings, December 31	€39,950

MASON ADVERTISING AGENCY
Statement of Financial Position
December 31, 2015

Assets		
Equipment	€60,000	
Less: Accumulated depreciation—equipment	33,000	€27,000
Supplies		3,000
Prepaid insurance		2,500
Accounts receivable		23,500
Cash		11,000
Total assets		€67,000
Equity and Liabilities		
Equity		
Share capital—ordinary	€10,000	
Retained earnings	39,950	€49,950
Liabilities		
Notes payable	5,000	
Accounts payable	5,000	
Unearned service revenue	5,600	
Salaries and wages payable	1,300	
Interest payable	150	
Total liabilities		17,050
Total equity and liabilities		€67,000

(c) 1. Interest is €50 per month or 1% of the note payable. 1% X 12 = 12% interest per year.

2. Salaries and Wages Expense, €11,300 less Salaries and Wages Payable 12/31/15, €1,300 = €10,000. Total Payments, €12,500 – €10,000 = €2,500 Salaries and Wages Payable 12/31/14.

PROBLEM 3-3

1.	December 31	Salaries and Wages Expense	2,120	
		Salaries and Wages Payable		2,120
		(5 X $700 X 2/5) = $1,400		
		(3 X $600 X 2/5) = 720		
		Total accrued salaries $2,120		
2.		Unearned Rent Revenue	94,000	
		Rent Revenue		94,000
		(5 X $6,000 X 2) = $60,000		
		(4 X $8,500 X 1) = 34,000		
		Total rent recognized $94,000		
3.		Advertising Expense	4,900	
		Prepaid Advertising		4,900
		(A650 – $500 per month for 8 months) = $4,000		
		(B974 – $300 per month for 3 months) = 900		
		Total advertising expense $4,900		
4.		Interest Expense	4,200	
		Interest Payable ($60,000 X 12% X 7/12)		4,200

PROBLEM 3-4

(a)	November 30	Supplies Expense	4,000	
		Supplies...		4,000
		Depreciation Expense—Equipment	15,000	
		Accumulated Depreciation—		
		Equipment		15,000
		Interest Expense	11,000	
		Interest Payable		11,000

PROBLEM 3-4 (Continued)

(b)

BELLEMY FASHION CENTER
Adjusted Trial Balance
November 30, 2015

	Dr.	Cr.
Cash	€ 28,700	
Accounts Receivable	33,700	
Inventory	45,000	
Supplies	1,500	
Equipment	133,000	
Accumulated Depreciation—Equipment		€ 39,000
Notes Payable		51,000
Accounts Payable		48,500
Share Capital—Ordinary		90,000
Retained Earnings		8,000
Sales Revenue		757,200
Sales Returns and Allowances	4,200	
Cost of Goods Sold	495,400	
Salaries Expense	140,000	
Advertising Expense	26,400	
Utilities Expense	14,000	
Maintenance and Repairs Expense	12,100	
Delivery Expense	16,700	
Rent Expense	24,000	
Supplies Expense	4,000	
Depreciation Expense—Equipment	15,000	
Interest Expense	11,000	
Interest Payable		11,000
Totals	€1,004,700	€1,004,700

PROBLEM 3-4 (Continued)

(c)

BELLEMY FASHION CENTER
Income Statement
For the Year Ended November 30, 2015

Sales revenue		
Sales revenue		€757,200
Less: Sales returns and allowances		4,200
Net sales		753,000
Cost of goods sold		495,400
Gross profit		257,600
Operating expenses		
Selling expenses		
Salaries and wages expense (€140,000 X 70%)	€98,000	
Advertising expense	26,400	
Rent expense (€24,000 X 80%)	19,200	
Delivery expense	16,700	
Utilities expense (€14,000 X 80%)	11,200	
Depr. exp.— equipment	15,000	
Supplies expense	4,000	190,500
Administrative expenses		
Salaries and wages expense (€140,000 X 30%)	42,000	
Maintence and repairs expense	12,100	
Rent expense (€24,000 X 20%)	4,800	
Utilities expense (€14,000 X 20%)	2,800	61,700
Other income and expense		
Interest expense		11,000
Net loss		(€ 5,600)

PROBLEM 3-4 (Continued)

BELLEMY FASHION CENTER
Retained Earnings Statement
For the Year Ended November 30, 2015

Retained earnings, December 1, 2014	€8,000
Less: Net loss	5,600
Retained earnings, November 30, 2015	€2,400

BELLEMY FASHION CENTER
Statement of Financial Position
November 30, 2015

Assets			
Noncurrent assets			
Property, plant, and equipment			
Equipment	€133,000		
Accum. depreciation–equipment	39,000	€94,000	
Current assets			
Supplies		1,500	
Inventory		45,000	
Accounts receivable		33,700	
Cash		28,700	
Total current assets			108,900
Total assets			€202,900
Equity and Liabilities			
Equity			
Share capital—ordinary		€90,000	
Retained earnings		2,400	€ 92,400
Noncurrent Liabilities			
Notes payable		21,000	
Current Liabilities			
Notes payable due next year	€30,000		
Accounts payable	48,500		
Interest payable	11,000		
Total current liabilities		89,500	
Total liabilities			110,500
Total equity and liabilities			€202,900

PROBLEM 3-4 (Continued)

(d)	Nov.	30	Sales Revenue	757,200	
			Income Summary		757,200
		30	Income Summary	762,800	
			Sales Returns and Allowances		4,200
			Cost of Goods Sold		495,400
			Salaries and Wages Expense		140,000
			Advertising Expense		26,400
			Utilities Expense		14,000
			Maintenance and Repairs Expense		12,100
			Delivery Expense		16,700
			Rent Expense		24,000
			Supplies Expense		4,000
			Depreciation Expense—Equipment		15,000
			Interest Expense		11,000
		30	Retained Earnings	5,600	
			Income Summary		5,600

PROBLEM 3-4 (Continued)

(e)

BELLEMY FASHION CENTER
Post-Closing Trial Balance
November 30, 2015

	Debit	Credit
Cash	€ 28,700	
Accounts Receivable	33,700	
Merchandise Inventory	45,000	
Supplies	1,500	
Equipment	133,000	
Accumulated Depreciation—Equipment		€ 39,000
Notes Payable		51,000
Accounts Payable		48,500
Interest Payable		11,000
Share Capital—Ordinary		90,000
Retained Earnings		2,400
	€241,900	€241,900

PROBLEM 3-5

(a)

-1-

Depreciation Expense	10,500	
Accumulated Depreciation—Equipment (1/16 X [€192,000 – €24,000])		10,500

-2-

Interest Expense	1,440*	
Interest Payable (€90,000 X 8% X 72/360)		1,440*

-3-

Admissions Revenue	60,000	
Unearned Admissions Revenue (2,000 X €30)		60,000

-4-

Prepaid Advertising	1,100	
Advertising Expense		1,100

-5-

Salaries and Wages Expense	4,700	
Salaries and Wages Payable		4,700

(b)
1. Interest expense, €2,840 (€1,400 + €1,440).
2. Admissions revenue, €320,000 (€380,000 – €60,000).
3. Advertising expense, €12,580 (€13,680 – €1,100).
4. Salaries and wages expense, €62,300 (€57,600 + €4,700).

*<u>Note to instructor</u>: If 30-day months are assumed, interest expense = €1,400 (€90,000 X 8% X 70/360).

PROBLEM 3-6

(a)

-1-		
Service Revenue	6,000	
Unearned Service Revenue		6,000
-2-		
Accounts Receivable	4,900	
Service Revenue		4,900
-3-		
Bad Debt Expense	1,430	
Allowance for Doubtful Accounts		1,430
-4-		
Insurance Expense	480	
Prepaid Insurance		480
-5-		
Depreciation Expense—Equipment	2,500	
Accumulated Depreciation—Equipment (R$25,000 X .10)		2,500
-6-		
Interest Expense	60	
Interest Payable (R$7,200 X .10 X 30/360)		60
-7-		
Prepaid Rent	750	
Rent Expense		750
-8-		
Salaries and Wages Expense	2,510	
Salaries and Wages Payable		2,510

(b)

YORKIS PEREZ, CONSULTING ENGINEER
Income Statement
For the Year Ended December 31, 2015

Service revenue (R$100,000 – R$6,000 + R$4,900)...		R$98,900
Expenses		
Salaries and wages expense		
(R$30,500 + R$2,510)	R$33,010	
Rent expense (R$9,750 – R$750)	9,000	
Depreciation expense	2,500	
Bad debt expense	1,430	
Utilities expense	1,080	
Office expense	720	
Insurance expense	480	
Interest expense	60	
Total expenses		48,280
Net income		R$50,620

YORKIS PEREZ, CONSULTING ENGINEER
Statement of Changes in Equity
For the Year Ended December 31, 2015

Yorkis Perez, Capital, January 1	R$ 52,010[a]
Add: Net income	50,620
Less: Withdrawals	17,000
Yorkis Perez, Capital, December 31	R$ 85,630

[(a)] Yorkis Perez, Capital—trial balance	R$35,010
Withdrawals during the year	(17,000)
Yorkis Perez, Capital, as of January 1, 2015	R$52,010

PROBLEM 3-6 (Continued)

YORKIS PEREZ, CONSULTING ENGINEER
Statement of Financial Position
December 31, 2015

Assets			
Noncurrent assets			
Equipment......................................		R$25,000	
Less: Accum. depreciation— equipment		8,750**	R$ 16,250
Current assets			
Supplies		1,960	
Prepaid insurance (R$1,100 – R$480)........................		620	
Prepaid rent		750	
Accounts receivable (R$49,600 + R$4,900)....................	R$54,500		
Less: Allowance for doubtful accounts	2,180*	52,320	
Cash		29,500	
Total current assets			85,150
Total assets.........................			R$101,400
Equity and Liabilities			
Equity			
Yorkis Perez, Capital (R$35,010 + R$50,620)................			R$ 85,630
Liabilities			
Current liabilities			
Notes payable..........................		R$7,200	
Unearned service revenue.......		6,000	
Salaries and wages payable....		2,510	
Interest payable.......................		60	15,770
Total equity and liabilities ..			R$101,400

*(R$750 + R$1,430)
**(R$6,250 + R$2,500)

PROBLEM 3-7

(a)	Dec.	31	Account Receivable	1,000	
			Service Revenue		1,000
		31	Unearned Service Revenue	1,400	
			Service Revenue		1,400
		31	Supplies Expense	5,000	
			Art Supplies		5,000
		31	Depreciation Expense	8,750	
			Accumulated Depreciation—Equipment		8,750
		31	Interest Expense	150	
			Interest Payable		150
		31	Insurance Expense	750	
			Prepaid Insurance		750
		31	Salaries and Wages Expense................	1,500	
			Salaries and Wages Payable..........		1,500

(b)

SORENSTAM ADVERTISING CORP.
Income Statement
For the Year Ended December 31, 2015

Revenues		
Service revenue		€61,000
Expenses		
Salaries and wages expense	€11,500	
Supplies expense	10,000	
Depreciation expense	8,750	
Rent expense	4,000	
Insurance expense	750	
Interest expense	500	
Total expenses		35,500
Net income		€25,500

SORENSTAM ADVERTISING CORP.
Retained Earnings Statement
For the Year Ended December 31, 2015

Retained earnings, January 1	€ 4,500
Add: Net income	25,500
Retained earnings, December 31	€30,000

PROBLEM 3-7 (Continued)

SORENSTAM ADVERTISING CORP.
Statement of Financial Position
December 31, 2015

Assets		
Equipment	€60,000	
Less: Accum. depr.—equipment	35,750	€24,250
Prepaid insurance		2,500
Supplies		3,500
Accounts receivable		20,000
Cash		7,000
Total assets		€57,250
Equity and Liabilities		
Equity		
Share capital—ordinary	€10,000	
Retained earnings	30,000	
Total equity		€40,000
Liabilities		
Notes payable	5,000	
Accounts payable	5,000	
Unearned service revenue	5,600	
Salaries and wages payable	1,500	
Interest payable	150	
Total liabilities		17,250
Total equity and liabilities		€57,250

PROBLEM 3-7 (Continued)

(c) 1. Total depreciable cost = €8,750 X 6 = €52,500.

Residual value = cost €60,000 less depreciable cost €52,500 = €7,500

2. Based on the balance in interest payable, interest is €50 per month or 1% of the note payable, per month.
1% X 12 = 12% interest per year.

3. Salaries and Wages Expense, €11,500 less Salaries and Wages Payable 12/31/15, €1,500 = €10,000. Total payments, €12,500 – €10,000 = €2,500 Salaries and Wages Payable 12/31/14.

PROBLEM 3-8

(a), (b), (d)

Cash

Bal.	15,000		

Prepaid Insurance

Bal.	9,000	Adj.	3,500
	5,500		

Salaries and Wages Expense

Bal.	80,000	Close	83,600
Adj.	3,600		
	83,600		83,600

Share Capital—Ordinary

		Bal.	400,000

Accounts Receivable

Bal.	13,000		

Retained Earnings

		Bal.	82,000
		Inc.	31,640
			113,640

Maintenance and Repairs Expense

Bal.	24,000	Close	24,000

Allow. for Doubtful Accts.

		Bal.	1,100
		Adj.	460
			1,560

Dues Revenue

Adj.	8,900	Bal.	200,000
Cls.	191,100		
	200,000		200,000
		Rev.	8,900

Land

Bal.	350,000		

Green Fees Revenue

Close	5,900	Bal.	5,900

Depr. Expense

Adj.	4,000	Close	19,000
Adj.	15,000		
	19,000		

Buildings

Bal.	120,000		

Rent Revenue

Close	19,200	Bal.	17,600
		Adj.	1,600
	19,200		19,200
Rev.	1,600		

Accum. Depr.—Equipment

		Bal.	70,000
		Adj.	15,000
			85,000

Accum. Depr.—Buildings

		Bal.	38,400
		Adj.	4,000
			42,400

Utilities Expense

Bal.	54,000	Close	54,000

Insurance Expense

Adj.	3,500	Close	3,500

Rent Receivable

Adj.	$1,600	Rev.	1,600

Bad Debt Expense

Adj.	460	Close	460

Income Summary

Exp.	184,560	Rev.	216,200
Inc.	31,640		
	216,200		216,200

PROBLEM 3-8 (Continued)

Salaries and Wages Payable

	Adj. 3,600

Unearned Dues Revenue

	Adj. 8,900

Equipment

Bal. 150,000	

(b)

-1-

Depreciation Expense	4,000	
Accumulated Depreciation—Buildings (1/30 X £120,000)		4,000

-2-

Depreciation Expense	15,000	
Accumulated Depreciation—Equipment (10% X £150,000)		15,000

-3-

Insurance Expense	3,500	
Prepaid Insurance		3,500

-4-

Rent Receivable	1,600	
Rent Revenue (1/11 X £17,600)		1,600

-5-

Bad Debt Expense	460	
Allowance for Doubtful Accounts [(£13,000 X 12%) – £1,100]		460

-6-

Salaries and Wages Expense	3,600	
Salaries and Wages Payable		3,600

-7-

Dues Revenue	8,900	
Unearned Dues Revenue		8,900

*PROBLEM 3-8 (Continued)

(c)

KO GOLF CLUB, INC.
Adjusted Trial Balance
December 31, XXXX

	Dr.	Cr.
Cash	£ 15,000	
Accounts Receivable	13,000	
Allowance for Doubtful Accounts		£ 1,560
Prepaid Insurance	5,500	
Land	350,000	
Buildings	120,000	
Accumulated Depreciation—Buildings		42,400
Equipment	150,000	
Accumulated Depreciation—Equipment		85,000
Salaries and Wages Payable		3,600
Share Capital—Ordinary		400,000
Retained Earnings		82,000
Dues Revenue		191,100
Green Fees Revenue		5,900
Rent Revenue		19,200
Utilities Expense	54,000	
Salaries and Wages Expense	83,600	
Maintenance and Repairs Expense	24,000	
Bad Debt Expense	460	
Unearned Dues Revenue		8,900
Rent Receivable	1,600	
Depreciation Expense	19,000	
Insurance Expense	3,500	
Totals	£839,660	£839,660

***PROBLEM 3-8 (Continued)**

(d)

December 31		
Dues Revenues	**191,100**	
Green Fees Revenue	**5,900**	
Rent Revenue	**19,200**	
Income Summary		**216,200**
December 31		
Income Summary	**184,560**	
Utilities Expense		**54,000**
Bad Debt Expense		**460**
Salaries and Wages Expense		**83,600**
Maintenance and Repairs Expense		**24,000**
Depreciation Expense		**19,000**
Insurance Expense		**3,500**
December 31		
Income Summary	**31,640**	
Retained Earnings		**31,640**

PROBLEM 3-9

(a), (b), (c)

Cash

Bal.	18,500		

Accounts Receivable

Bal.	32,000		

Allow. for Doubtful Accts.

		Bal.	700
		Adj.	1,400
			2,100

Inventory

Bal.	80,000		

Equipment

Bal.	84,000		

Accum. Depr.—Equipment

		Bal.	35,000
		Adj.	12,000
			47,000

Prepaid Insurance

Bal.	5,100	Adj.	2,550
	2,550		

Notes Payable

		Bal.	28,000

Share Capital—Ordinary

		Bal.	80,600

Sales Revenue

Cls.	600,000	Bal.	600,000

Insurance Expense

Adj.	2,550	Cls.	2,550

Salaries and Wages Expense

Bal.	115,000	Cls.	117,400
Adj.	2,400		
	117,400		117,400

Advertising Expense

Bal.	6,700	Adj.	700
		Cls.	6,000
	6,700		6,700

Interest Expense

Adj.	3,360	Cls.	3,360

Bad Debt Expense

Adj.	1,400	Cls.	1,400

Office Expense

Bal.	5,000	Adj.	1,500
		Cls.	3,500
	5,000		5,000

Prepaid Advertising

Adj.	700		

Interest Payable

		Adj.	3,360

Depreciation Expense

Adj.	12,000	Cls.	12,000

Income Summary

Exp.	554,210	Sales	600,000
Inc.	45,790		
	600,000		600,000

Supplies

Adj.	1,500		

Salaries and Wages Payable

		Adj.	2,400

PROBLEM 3-9 (Continued)

Retained Earnings

	Bal.	10,000
	Inc.	45,790
	Bal.	55,790

Cost of Goods Sold

Bal.	408,000	Cls.	408,000

(b)

-1-

Bad Debt Expense	1,400	
Allowance for Doubtful Accounts		1,400

-2-

Depreciation Expense (€84,000 ÷ 7)	12,000	
Accumulated Depreciation—Equipment		12,000

-3-

Insurance Expense	2,550	
Prepaid Insurance		2,550

-4-

Interest Expense	3,360	
Interest Payable		3,360

-5-

Salaries and Wages Expense	2,400	
Salaries and Wages Payable		2,400

-6-

Prepaid Advertising	700	
Advertising Expense		700

-7-

Supplies	1,500	
Office Expense		1,500

PROBLEM 3-9 (Continued)

(c)

Dec. 31		
Sales Revenue	**600,000**	
Income Summary		**600,000**

Dec. 31		
Income Summary	**554,210**	
Cost of Goods Sold		**408,000**
Advertising Expense		**6,000**
Salaries and Wages Expense		**117,400**
Office Expense (€5,000 – €1,500)		**3,500**
Insurance Expense		**2,550**
Bad Debt Expense		**1,400**
Depreciation Expense		**12,000**
Interest Expense		**3,360**

Dec. 31		
Income Summary	**45,790**	
Retained Earnings		**45,790**

*PROBLEM 3-10

(a)

LAKELAND SALES AND SERVICE
Income Statement
For the Month Ended January 31, 2015

	(1) Cash Basis	(2) Accrual Basis
Revenues	£ 75,000	£98,400*
Expenses		
Cost of computers & printers:		
Purchased and paid	82,500**	
Cost of goods sold		59,500***
Salaries and wages	9,600	12,600
Rent	6,000	2,000
Other operating expenses	8,400	10,400
Total expenses	106,500	84,500
Net income (loss)	£(31,500)	£13,900

*(£2,550 X 30) + (£3,600 X 4) + (£500 X 15)
**(£1,500 X 40) + (£2,500 X 6) + (£300 X 25)
***(£1,500 X 30) + (£2,500 X 4) + (£300 X 15)

Note: The headings for the cash basis income statement should technically be cash receipts and cash payments.

***PROBLEM 3-10 (Continued)**

(b)

LAKELAND SALES AND SERVICE
Statement of Financial Position
As of January 31, 2015

	(1) Cash Basis	(2) Accrual Basis
Assets		
Prepaid rent		£ 4,000
Inventory		23,000[b]
Accounts receivable		23,400
Cash	£58,500[a]	58,500[a]
Total assets	£58,500	£108,900
Equity and Liabilities		
Equity	£58,500[c]	£103,900[d]
Salaries and wages payable		3,000
Accounts payable		2,000
Total equity and liabilities	£58,500	£108,900

[a]Original investment	£ 90,000
Cash sales	75,000
Cash purchases	(82,500)
Rent paid	(6,000)
Salaries and wages paid	(9,600)
Other operating expenses	(8,400)
Cash balance Jan. 31	£ 58,500

[b](10 @ £1,500) + (2 @ £2,500) + (10 @ £300).

[c]Initial investment minus net loss: £90,000 – £31,500.

[d]Initial investment plus net income: £90,000 + £13,900.

***PROBLEM 3-10 (Continued)**

(c) 1. The £23,400 in receivables from customers is an asset and a future cash flow resulting from sales that is ignored. The cash basis under-states the amount of revenues and inflow of assets in January from the sale of computers and printers by £23,400.

2. The cost of computers and printers sold in January is overstated by £23,000. The unsold computers and printers are an asset of £23,000 in the form of inventory.

3. The cash basis ignores £3,000 of the salaries and wages that have been earned by the employees in January and will be paid in February.

4. Rent expense on the cash basis is overstated by £4,000 under the cash basis. This prepayment is an asset in the form of two months' future right to the use of office, showroom, and repair space and should appear on the statement of financial position.

5. Other operating expenses on a cash basis are understated by £2,000 as is the liability for the unpaid portion of these expenses incurred in January.

*PROBLEM 3-11

(a)

COOKE COMPANY
Worksheet
For the Year Ended September 30, 2015

Account Titles	Trial Balance Dr.	Trial Balance Cr.	Adjustments Dr.	Adjustments Cr.	Adjusted Trial Balance Dr.	Adjusted Trial Balance Cr.	Income Statement Dr.	Income Statement Cr.	Statement of Financial Position Dr.	Statement of Financial Position Cr.
Cash	37,400				37,400				37,400	
Supplies	18,600			(b) 14,400	4,200				4,200	
Prepaid Insurance	31,900			(a) 28,000	3,900				3,900	
Land	80,000				80,000				80,000	
Equipment	120,000				120,000				120,000	
Accum. Depreciation— Equipment		36,200		(c) 5,800		42,000				42,000
Accounts Payable		14,600				14,600				14,600
Unearned Service Rev.		2,700	(d) 2,000			700				700
Mortgage Payable		50,000				50,000				50,000
Cooke, Capital		109,700				109,700				109,700
Cooke, Drawing	14,000				14,000				14,000	
Service Revenue		278,500		(d) 2,000		280,500		280,500		
Salaries and Wages Expense	109,000				109,000		109,000			
Maintenance and Repairs Expense	30,500				30,500		30,500			
Advertising Expense	9,400				9,400		9,400			
Utilities Expense	16,900				16,900		16,900			
Prop. Taxes Expense	18,000		(e) 3,000		21,000		21,000			
Interest Expense	6,000		(f) 6,000		12,000		12,000			
Totals	491,700	491,700								
Insurance Expense			(a) 28,000		28,000		28,000			
Supplies Expense			(b) 14,400		14,400		14,400			
Interest Payable				(f) 6,000		6,000				6,000
Depreciation Expense			(c) 5,800		5,800		5,800			
Prop. Taxes Payable				(e) 3,000		3,000				3,000
Totals			59,200	59,200	506,500	506,500	247,000	280,500	259,500	226,000
Net Income							33,500			33,500
Totals							280,500	280,500	259,500	259,500

Key: (a) Expired Insurance; (b) Supplies Used; (c) Depreciation Expensed; (d) Admission Revenue Earned; (e) Accrued Property Taxes; (f) Accrued Interest Payable.

*PROBLEM 3-11 (Continued)

(b)

COOKE COMPANY
Statement of Financial Position
September 30, 2015

Assets			
Noncurrent assets			
Property, plant, and equipment			
Land		€80,000	
Equipment	€120,000		
Less: Accum. depreciation—equip.	42,000	78,000	€158,000
Current assets			
Supplies		4,200	
Prepaid insurance		3,900	
Cash		37,400	
Total current assets			45,500
Total assets			€203,500
Equity and Liabilities			
Equity			
Cooke, capital (€109,700 + €33,500 – €14,000)			€129,200
Liabilities			
Mortgage payable		€40,000	
Current liabilities			
Accounts payable	€14,600		
Current maturity of long-term debt	10,000		
Interest payable	6,000		
Property taxes payable	3,000		
Unearned service revenue	700		
Total current liabilities		34,300	
Total liabilities			74,300
Total equity and liabilities			€203,500

***PROBLEM 3-11 (Continued)**

(c)	**Sep.**	**30**	**Insurance Expense**	**28,000**	
			Prepaid Insurance		**28,000**
		30	**Supplies Expense**	**14,400**	
			Supplies		**14,400**
		30	**Depreciation Expense**	**5,800**	
			Accumulated Depreciation—Equipment		**5,800**
		30	**Unearned Service Revenue**	**2,000**	
			Service Revenue		**2,000**
		30	**Property Tax Expense**	**3,000**	
			Property Taxes Payable		**3,000**
		30	**Interest Expense**	**6,000**	
			Interest Payable		**6,000**
(d)	**Sep.**	**30**	**Service Revenue**	**280,500**	
			Income Summary		**280,500**
		30	**Income Summary**	**247,000**	
			Salaries and Wages Expense		**109,000**
			Maintenance and Repairs Expense		**30,500**
			Insurance Expense		**28,000**
			Property Tax Expense		**21,000**
			Supplies Expense		**14,400**
			Utilities Expense		**16,900**
			Interest Expense		**12,000**
			Advertising Expense		**9,400**
			Depreciation Expense		**5,800**

*PROBLEM 3-11 (Continued)

30	Income Summary	33,500	
	Cooke, Capital		33,500
30	Cooke, Capital	14,000	
	Cooke, Drawing		14,000

(e)

COOKE COMPANY
Post-Closing Trial Balance
September 30, 2015

	Debit	Credit
Cash	€ 37,400	
Supplies	4,200	
Prepaid Insurance	3,900	
Land	80,000	
Equipment	120,000	
Accumulated Depreciation—Equipment		€ 42,000
Accounts Payable		14,600
Unearned Service Revenue		700
Interest Payable		6,000
Property Taxes Payable		3,000
Mortgage Payable		50,000
Cooke, Capital		129,200
	€245,500	€245,500

FINANCIAL REPORTING PROBLEM

(a) March 30, 2013 total assets: £7,567.7 million.
March 31, 2012 total assets: £7,273.3 million.

(b) March 30, 2013 cash and cash equivalents: £193.1 million.

(c) 2013 selling and administrative expenses: £3,107.0 million.
2012 selling and marketing expenses: £3,021.9 million.

(d) 2013 revenues: £10,026.8 million.
2012 revenues: £9,934.3 million.

(e) An adjusting entry for deferrals is necessary when the receipt/disbursement precedes the recognition in the financial statements. Accounts such as property, plant, and equipment and depreciation expense on property, plant, and equipment, for example, is a classic adjusting entry related to a deferral.

An adjusting entry for an accrual is necessary when recognition in the financial statements precedes the cash receipt/disbursement, such as interest or taxes payable. Other adjusting entries probably made by M&S include finance income and finance costs and bank and other interest receivable and interest payable.

(f) 2012 Depreciation and amortization expense: £470.1 million
2013 Depreciation and amortization expense: £450.5 million

COMPARATIVE ANALYSIS CASE

(a) adidas percentage increase is computed as follows:

Total assets (December 31, 2012)	**€ 11,651**
Total assets (December 31, 2011)	**(€11,237)**
Difference	**€ 414**

€ 414 ÷ €11,237 = 3.7%

Puma's percentage decrease is computed as follows:

Total assets (December 31, 2012)	**€ 2,530.3**
Total assets (December 31, 2011)	**(2,581.8)**
Difference	**€ (51.5)**

€ (51.5) ÷ € 2,581.8 = (2)%

adidas experience a larger change (increase).

(b) Neither company reported a discontinued operations. Since discontinued operations are considered to be nonrecurring, they should be excluded before comparing results between the two companies.

(c) **adidas had depreciation and amortization expense of €536 million (57% of operating cash flow); Puma had depreciation expense of €76.1 million (49% of operating cash flow).**

As indicated below, adidas has substantially more property, plant, and equipment and intangible assets as a percent of assets compared to Puma. Amortizable intangible assets for adidas and Puma increase the amount of amortization expense recorded in income.

	adidas	Puma
Property, plant, and equipment (net)	€1,095	€226.8
Amortizable intangible assets (net)	1,651	0
	€2,746	€226.8
As a % of Assets:	(€2,746 = €11,651)	(€226.8 ÷ €2,530.3)
	23%	9%

FINANCIAL STATEMENT ANALYSIS CASE

Vodafone

(a)

Vodafone Group plc	2012	2011	2010	% Change 2012	% Change 2011
Revenues	£ 46,417	£ 45,884	£ 44,472	1.16%	3.18%
Gross Profit %	32.04%	32.84%	33.80%	–2.44%	–2.84%
Operating Profit	£ 11,187	£ 5,596	£ 9,480	99.91%	–40.97%
Operating Cash flow less Capital Expenditures	8,459	9,173	9,145	–7.78%	0.31%
Profit (Loss)	7,003	7,870	8,618	–11.02%	–8.68%

(b) Except for the small increases in Revenues, Vodafone's earnings performance has been declining; both gross profit, and profit have declined each year. Note also that 2011 also was a poor year as compared to 2010. In addition, its free cash flow (operating cash flow less capital expenditures continues to decrease which gives cause for concern). In short, both the earnings performance and its free-cash flow do not provide good signals that Vodafone will be able to deliver on operating performance and growth opportunities.

ACCOUNTING ANALYSIS, AND PRINCIPLES

ACCOUNTING

Depreciation Expense	9,500	
Accumulated Depreciation—Equipment		9,500

£9,500 = (£192,000 – £40,000) ÷ 16

Interest Expense	8,250	
Interest Payable		8,250

£8,250 = (£90,000 X 0.10) X 11/12

Unearned Service Revenue	10,000	
Service Revenue		10,000

£10,000 = (£50 X 200)

Advertising Expense	2,500	
Prepaid Advertising		2,500

Salaries and Wages Expense	3,500	
Salaries and Wages Payable		3,500

ANALYSIS

	Income before Adjustments	Adjustments	Income after Adjustments
Service revenue	£360,000	£10,000	£370,000
Depreciation expense		(9,500)	(9,500)
Advertising expense	(18,680)	(2,500)	(21,180)
Salaries and Wages expense	(67,600)	(3,500)	(71,100)
Interest expense	(1,400)	(8,250)	(9,650)
Net income	£272,320		£258,570

Without recording the adjusting entries, Amato's income is overstated. In addition, without the adjustments, Amato's current liabilities and current assets are misstated, which could affect evaluation of Amato's liquidity.

ACCOUNTING ANALYSIS PRICIPLES (Continued)

PRINCIPLES

The tradeoffs are between the timeliness of the reports, which contributes to relevance, and verifiability, the lack of which detracts from faithful representation. That is, by preparing reports more frequently, the company provides more timely information, which can make a difference to a statement reader who needs to make a decision. However, preparing statements more frequently requires more subjective estimates, which reduces faithful representation.

PROFESSIONAL RESEARCH

(a) Assets

53 The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

54 An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.

55 The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:

a. used singly or in combination with other assets in the production of goods or services to be sold by the entity;
b. exchanged for other assets;
c. used to settle a liability; or
d. distributed to the owners of the entity.

(b) Liabilities

60 An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.

PROFESSIONAL RESEARCH (Continued)

61 A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.

62 The settlement of a present obligation usually involves the entity giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:

a. payment of cash;
b. transfer of other assets;
c. provision of services;
d. replacement of that obligation with another obligation; or
e. conversion of the obligation to equity.

(c) Accrual basis

22 In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

PROFESSIONAL SIMULATION

Journal Entries

Dec. 31	Accounts Receivable	1,500	
	Service Revenue		1,500
31	Unearned Service Revenue	1,400	
	Service Revenue		1,400
31	Supplies Expense	3,400	
	Supplies		3,400
31	Depreciation Expense	7,000	
	Accumulated Depreciation—Equipment		7,000
31	Salaries and Wages Expense	1,300	
	Salaries and Wages Payable		1,300

Financial Statements

Nalezny Advertising Agency
Income Statement
For the Year Ended December 31, 2015

Revenues		
Service revenue		₺61,500
Expenses		
Salaries and Wages expense	₺11,300	
Depreciation expense	7,000	
Rent expense	4,000	
Supplies expense	3,400	
Total expenses		25,700
Net income		₺35,800

Nalezny Advertising Agency
Statement of Financial Position
December 31, 2015

Assets

Equipment	₺60,000	
Less: Accumulated depreciation—equipment	35,000	₺25,000
Supplies		5,000
Accounts receivable		21,500
Cash		11,000
Total Assets		₺62,500

Equity and Liabilities

Equity		
Share capital—ordinary	₺10,000	
Retained earnings		₺50,600
	40,600	
Liabilities		
Accounts payable	5,000	
Unearned service revenue	5,600	
Salaries payable	1,300	
Total liabilities		11,900
Total equity and liabilities		₺62,500

*Retained earnings, Jan. 1, 2015	₺ 4,800
Add: Net income	35,800
Retained earnings, Dec. 31, 2015	₺40,600

Explanation

Following preparation of financial statements, Nalezny would prepare closing entries to reduce the temporary accounts to zero. Some companies prepare a post-closing trial balance and reversing entries.

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