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TAKEAWAY 2.2	Concept	Method	Assessment
	Is the trial balance in balance?	Ending balances for all of the general ledger accounts entered on the trial balance. Total the debit column and the credit column on the trial balance.	Verify the equality of the sum of the debit account balances and the sum of the credit account balances.

YOUR TURN! 2.6

The solution is on page 119.



Each of the following accounts from the Devin Company has a normal balance. The unadjusted balances are as of December 31, 2016, the end of Devin's first year of operations:

Cash	1,500	Common stock	7,500
Accounts receivable	4,500	Sales revenue	12,000
Inventory	3,750	Salary expense	4,500
Property, plant, and equipment	11,250	Administrative expenses	750
Accounts payable	2,250	Dividends	1,500
Notes payable	6,000		

Prepare an unadjusted trial balance for the Devin Company as of December 31, 2016.

FORENSIC ACCOUNTING**Fraudulent Reporting**

Verifying that the sum of the debit account balances from the general ledger is equal to the sum of the credit account balances is not sufficient to guarantee accuracy of financial records. The infamous accounting scandal at **WorldCom** provides a case in point. To inflate its net income, WorldCom improperly “capitalized expenses”—that is, they inappropriately debited property, plant, and equipment, an asset account, when they should have debited an expense account. While the sum of the debit account balances on WorldCom's books did equal the sum of the credit account balances, assets were overstated and expenses were understated by almost \$7 billion. WorldCom's CEO Bernard Ebbers, the mastermind of this fraudulent accounting scheme, was convicted of conspiracy to commit fraud, securities fraud, and making false filings with the SEC. Mr. Ebbers was sentenced to 25 years in prison.

COMPREHENSIVE PROBLEM

Juan Rios acted upon his entrepreneurial spirit and started a graphic design business called Juan's Designs. Based on an excellent business plan, Juan was able to raise sufficient capital to begin operations in October 2016. During the month of October, the following events occurred related to the business.

1. Stockholders invested \$40,000 cash in the business in exchange for common stock.
2. Paid \$2,500 cash for rent on an office suite for the month of October.
3. Purchased two desktop computers, software, and a printer for \$10,000 cash.
4. Purchased miscellaneous supplies for \$500 ~~cash~~ that will be used during the month, all on account.
5. Purchased an advertisement in a local newspaper for \$300 cash, announcing the opening of his new business.
6. Performed \$5,500 of design work on account.
7. Received \$3,500 cash from customers for design work previously completed.
8. Paid \$350 cash toward the company's accounts payable balance.
9. Paid \$2,500 cash for wages of Juan Rios.

LO8 **SE3-12. The Accounting Worksheet** The adjusted trial balance section of Menlo Company's worksheet shows a \$1,500 debit balance in utility expense. At the end of the accounting period the accounting manager accrues an additional \$300 of utility expense for the last week of the period. This will result in the following amounts appearing on Menlo's worksheet for utilities expense:

(Appendix 3B)



- \$300 debit adjustment; \$1,800 debit adjusted trial balance; \$1,800 debit balance sheet
- \$300 debit adjustment; \$1,800 debit adjusted trial balance; \$1,800 debit income statement
- \$300 credit adjustment; \$1,200 debit adjusted trial balance; \$1,800 debit income statement
- \$300 credit adjustment; \$1,800 debit adjusted trial balance; \$1,800 debit income statement

EXERCISES—SET A

LO4 **E3-1A. Transaction Entries and Adjusting Entries** Deluxe Building Services offers janitorial services on both a contract basis and an hourly basis. On January 1, Deluxe collected \$30,000 in advance on a six-month contract for work to be performed evenly during the next six months.



- Provide the general journal entry on January 1 to record the receipt of \$30,000 for contract work.
- Provide the adjusting entry to be made on January 31, for the contract work done during January.
- At January 31, a total of 35 hours of hourly rate janitor work was unbilled. The billing rate is \$25 per hour. Provide the adjusting entry needed on January 31. (Note: The firm uses the account Fees Receivable to reflect amounts due but not yet billed.)

LO3, 4 **E3-2A. Adjusting Entries** Selected accounts of Ideal Properties Inc., a real estate management firm, are shown below as of January 31, before any adjusting entries have been made:



	Debit	Credit
Prepaid insurance	\$6,840	
Supplies	2,100	
Office equipment	6,240	
Unearned rent revenue		\$ 5,550
Salaries expense	3,250	
Rent revenue		16,000

Monthly financial statements are prepared. Using the following information, record in a general journal the adjusting entries necessary on January 31:

- Prepaid Insurance represents a three-year premium paid on January 1.
- Supplies of \$975 were on hand January 31.
- Office equipment is expected to last eight years. Depreciation is recorded monthly.
- On January 1, the firm collected six months' rent in advance from a tenant renting space for \$925 per month.
- Accrued salaries not recorded as of January 31 are \$510.

LO3, 4 **E3-3A. Adjusting Entries** For each of the following unrelated situations, prepare the necessary adjusting entry in general journal form:



- Unrecorded depreciation on equipment is \$750.
- The Supplies account has a balance of \$3,100. Supplies on hand at the end of the period totaled \$1,200.
- On the date for preparing financial statements, an estimated utilities expense of \$425 has been incurred, but no utility bill has been received.
- On the first day of the current month, rent for four months was paid and recorded as a \$2,800 debit to Prepaid Rent and a \$2,800 credit to Cash. Monthly statements are now being prepared.
- Nine months ago, Solid Insurance Company sold a one-year policy to a customer and recorded the receipt of the premium by debiting Cash for \$624 and crediting Unearned Premium Revenue for \$624. No adjusting entries have been prepared during the nine-month period. Annual financial statements are now being prepared.
- At the end of the accounting period, employee wages of \$1,050 have been incurred but not paid.
- At the end of the accounting period, \$350 of interest has been earned but not yet received on notes receivable that are held.

Rent Expense; Supplies Expense; Insurance Expense; Delivery Van Expense; Depreciation Expense—Delivery Van; and Depreciation Expense—Equipment.

- b. Record July transactions in the general journal and post to the ledger accounts.
- c. Prepare an unadjusted trial balance as of July 31.
- d. Record adjusting journal entries in the general journal and post to the ledger accounts. The following information is available on July 31:

Supplies on hand, \$1,600
 Accrued wages, \$525
 Estimated life of delivery van, three years
 Estimated life of equipment, six years

Also, make any necessary adjusting entries for insurance, rent, and catering fees indicated by the July transactions.

LO3, 4
P3-3A.

Trial Balance and Adjusting Entries Photomake, Inc., a commercial photography studio, has just completed its first full year of operations on December 31. The general ledger account balances before year-end adjustments follow. No adjusting entries have been made to the accounts at any time during the year. Assume that all balances are normal.

Cash	\$ 2,150	Accounts payable	\$ 1,710
Accounts receivable	3,600	Unearned photography fees	2,600
Prepaid rent	12,600	Common stock	24,000
Prepaid insurance	2,970	Photography fees earned	34,480
Supplies	4,250	Wages expense	11,000
Equipment	22,800	Utilities expense	3,420

An analysis of the firm's records discloses the following items:

1. Photography services of \$1,450 have been rendered, but customers have not yet been billed. The firm uses the account Fees Receivable to reflect amounts due but not yet billed.
2. The equipment, purchased January 1, has an estimated life of 10 years.
3. Utilities expense for December is estimated to be \$650, but the bill will not arrive until January of next year.
4. The balance in Prepaid Rent represents the amount paid on January 1, for a two-year lease on the studio.
5. In November, customers paid **\$2,600** in advance for pictures to be taken for the holiday season. When received, these fees were credited to Unearned Photography Fees. By December 31, all fees are earned.
6. A three-year insurance premium paid on January 1, was debited to Prepaid Insurance.
7. Supplies on hand at December 31 are \$1,750.
8. At December 31, wages expense of \$500 has been incurred but not paid.

Required

- a. Prove that the sum of the debits equals the sum of the credits for Photomake's unadjusted account balances by preparing an unadjusted trial balance as of December 31.
- b. Record adjusting entries in the general journal.

LO3, 4
P3-4A.

Adjusting Entries Dole Carpet Cleaners ended its first month of operations on June 30. Monthly financial statements will be prepared. The unadjusted account balances are as follows:

DOLE CARPET CLEANERS Unadjusted Trial Balance June 30, 2015		
	Debit	Credit
Cash	\$ 1,180	
Accounts receivable	450	
Prepaid rent	3,100	
Supplies	2,520	
Equipment	4,440	
Accounts payable		\$ 760
Common stock		2,500
Retained earnings		5,000
Dividends	200	
Service fees earned		4,650
Wages expense	1,020	
	<u>\$12,910</u>	<u>\$12,910</u>

The following information is also available:

1. The balance in Prepaid Rent was the amount paid on June 1 for the first two months' rent.
2. Supplies on hand at June 30 were \$950.
3. The equipment, purchased June 1, has an estimated life of five years.
4. Unpaid wages at June 30 were \$450.
5. Utility services used during June were estimated at \$650. A bill is expected early in July.
6. Fees earned for services performed but not yet billed on June 30 were \$380. The firm uses the account Fees Receivable to reflect amounts due but not yet billed.

Required

Prepare the adjusting entries needed at June 30 for the general journal.

P3-5A. Adjusting Entries The following information relates to December 31 adjustments for Finest Print, a printing company. The firm's fiscal year ends on December 31.

LO3, 4



1. Weekly salaries for a five-day week total \$2,520, payable on Fridays. December 31 of the current year is a Tuesday.
2. Finest Print has \$25,000 of notes payable outstanding at December 31. Interest of \$250 has accrued on these notes by December 31, but will not be paid until the notes mature next year.
3. During December, Finest Print provided \$1,000 of printing services to clients who will be billed on January 2. The firm uses the account Fees Receivable to reflect amounts due but not yet billed.
4. Starting December 1, all maintenance work on Finest Print's equipment is handled by Prompt Repair Company under an agreement whereby Finest Print pays a fixed monthly charge of \$125. Finest Print paid six months' service charge in advance on December 1, debiting Prepaid Maintenance for \$750.
5. The firm paid \$900 on December 15 for a series of radio commercials to run during December and January. One-third of the commercials have aired by December 31. The \$900 payment was debited to Prepaid Advertising.
6. Starting December 16, Finest Print rented 400 square feet of storage space from a neighboring business. The monthly rent of \$0.80 per square foot is due in advance on the first of each month. Nothing was paid in December, however, because the neighbor agreed to add the rent for one-half of December to the January 1 payment.
7. Finest Print invested \$7,500 in securities on December 1 and earned interest of \$62 on these securities by December 31. No interest will be received until January.
8. The annual depreciation on the firm's equipment is \$2,425. No depreciation has been recorded during the year.

Required

Prepare the required December 31 adjusting entries in the general journal.

MICROSOFT CORPORATION			
Balance Sheet			
June 30, 2014 (in millions)			
Assets			
Current assets			
Cash	\$	8,669	
Accounts receivable		21,485	
Inventory		2,660	
Other current assets		<u>81,432</u>	
Total current assets			\$114,246
Property, plant, and equipment			13,011
Intangible assets			27,108
Other long-term assets			<u>18,019</u>
Total assets			<u>\$172,384</u>
Liabilities and Stockholders' Equity			
Current liabilities			
Accounts payable	\$13,569		
Other current liabilities	<u>32,056</u>		
Total current liabilities			\$45,625
Long-term liabilities			<u>36,975</u>
Total liabilities			82,600
Stockholders' equity			
Common stock	68,366		
Retained earnings	17,710		
Other stockholders' equity	<u>3,708</u>		
Total stockholders' equity			<u>89,784</u>
Total liabilities and stockholders' equity			<u>\$172,384</u>

MICROSOFT CORPORATION	
Statement of Cash Flows	
For Year Ended June 30, 2014 (in millions)	
Cash flow provided by operating activities	\$32,231
Cash flow used by investing activities	(18,833)
Cash flow used by financing activities	<u>(8,533)</u>
Net increase in cash	4,865
Cash at June 30, 2013	<u>3,804</u>
Cash at June 30, 2014	<u>\$ 8,669</u>

b.

Current ratio	$\frac{\$114,246}{\$45,625} = 2.50 : 1$
Debt-to-total-assets ratio	$\frac{\$82,600}{\$172,384} = 47.9\%$
Return on sales ratio	$\frac{\$22,074}{\$86,833} = 25.4\%$

Walmart's return on sales ratio for 2014 indicates that they earned 3.4 cents for each dollar of sales. The return on sales ratio allows us to compare a company's ability to earn profits on its sales regardless of company size. Walmart generates over six times the sales revenue as does **Target** (\$72,618 million for Target versus \$473,076 for Walmart), yet Walmart has a return on sales ratio that is similar to Target's (after excluding the costs of discontinuing their Canadian operations). The return on sales for both companies decreased from 2013 to 2014, although Walmart's declined less.

Concept	Method	Assessment	TAKEAWAY 5.2
Is a company able to maintain prices on its goods consistent with changes in its total expenses?	Net income and net sales $\text{Return on sales ratio} = \frac{\text{Net income}}{\text{Net sales}}$	A higher ratio suggests the company is providing a higher net income on each dollar of net sales.	

The President of Musicland has asked for help to evaluate the company's performance during the current year. In particular, we are requested to calculate Musicland's gross profit and its return on sales ratio and then explain what these measures indicate. The following information is from Musicland's financial statements:

Net sales.	\$100,000
Cost of goods sold.	45,000
Net income.	10,500

YOUR TURN! 5.4

The solution is on page 272.



Governance and Conflicts of Interest

CORPORATE SOCIAL RESPONSIBILITY

An important component of good corporate responsibility is strong corporate governance. **Target** publishes a Business Conduct Guide for its employees as part of its governance program. Included in this handbook are guidelines concerning conflicts of interest. The list below provides examples of potential conflicts of interest:

- Owning a substantial amount of stock in any competing business or in any organization that does business with us.
- Serving as a director, manager, consultant, employee or independent contractor for any organization that does business with us, or is a competitor—except with our company's specific prior knowledge and consent.
- Accepting or receiving gifts of any value or favors, compensation, loans, excessive entertainment or similar activities from any individual or organization that does business or wants to do business with us, or is a competitor.
- Representing the company in any transaction in which you or a related person has a substantial interest.
- Disclosing or using for your benefit confidential or non-public information about Target or other organizations with which we do business.
- Taking personal advantage of a business opportunity that is within the scope of Target's business—such as by purchasing property that Target is interested in acquiring.

SHORT EXERCISES



- LO1 SE5-1. Merchandising versus Service Firm** For each of the following accounts, indicate whether it would be found in the records of a merchandising firm, a service firm, or both.

- Cost of goods sold.
- Service revenue.
- Purchase returns and allowances.
- Inventory.
- Accounts receivable.
- Accounts payable.
- Sales revenue.
- Freight-out.



- LO2 SE5-2. Accounting for Purchase Transactions** Debra Company began operations on June 1. The following transactions took place in June:

- Purchases of merchandise on account were \$600,000.
- The cost of freight to receive the inventory was \$20,000. This was paid in cash.
- Debra returned \$10,000 of the merchandise due to an ordering error. Debra received a full credit for the return.
- Debra paid the remaining balance for the merchandise.

Calculate the dollar amount that Debra will have in inventory at the end of the month. Assume Debra uses the perpetual inventory system and there were no sales.



- LO2 SE5-3. Accounting for Purchase Transactions** Use the data from SE5-2 and prepare the journal entries to record the June transactions.



- LO2 SE5-4. Accounting for Purchase Discounts** Ken Company purchased \$5,000 of merchandise from Marilyn Company with terms of 3/10 n/45. What percent discount will Ken Company get if it pays within the allowed discount period? If Ken Company fails to pay within the discount period, how many days does Ken Company have from the date of purchase before the payment is considered to be late?



- LO2 SE5-5. Accounting for Purchase Discounts** Using the information in SE5-4, what amount will Ken Company pay to Marilyn Company if Ken Company takes advantage of the purchase discount?



- LO3 SE5-6. Accounting for Sales Transactions** Kate Company uses the perpetual inventory system. Record the journal entries for the following transactions:

- On July 16, Kate sold \$600 of merchandise with terms of 2/10 n/30. The cost of the merchandise was \$360.
- On July 19, the customer returned \$100 of the merchandise from (a). The cost of the merchandise was \$60.
- On July 22, the customer paid the entire balance due to Kate.



- LO4 SE5-7. Gross Profit Percentage** Using the data below, compute Dino's gross profit percentage for the month of January.

Net sales	\$10,000
Cost of goods sold	4,000
Operating expenses	3,000
Other income	500
Income tax expense	1,200



- LO4 SE5-8. Return on Sales Ratio** Using the data in **SE5-7**, compute Dino's return on sales ratio for the month of January.



(Appendix 5A)

- LO5 SE5-9. Cost of Goods Sold and the Periodic System** Kanzu Company uses the periodic inventory system. Kanzu started the period with \$10,000 in inventory. The Company purchased an additional \$25,000 of merchandise, and returned \$1,000 for a full credit. A physical count of inventory at the end of the period revealed that there was an ending inventory balance of \$8,000. What was Kanzu's cost of goods sold during the period?

COSTCO WHOLESALE CORPORATION		
(in millions)	2014	2013
Net sales.	\$110,212	\$102,870
Cost of goods sold.	98,458	91,948
Net income.	2,058	2,039

Required

Evaluate Costco's performance in terms of gross profit percentage and return on sales ratio. How does Costco compare to **Target** and **Walmart**? (See **Exhibits 5-5** and **5-6** on pages 245 and 246.)

ANSWERS TO SELF-STUDY QUESTIONS:

1. c, (pp. 237–241) 2. c, (pp. 237–241) 3. c, (pp. 238–241) 4. c, (pp. 245–247) 5. c, (pp. 239–241)
 6. d, (pp. 239–241) 7. **a**, (pp. 245–247) 8. **c**, (p. 246) 9. b, (p. 236) 10. c, (p. 249)
 11. b, (pp. 250–251)

YOUR TURN! SOLUTIONS

Solution 5.1

b) is false. The sum of beginning inventory plus the cost of goods purchased is equal to the cost of goods available for sale. This would be equal to the cost of goods sold only if all available inventory was sold.

Solution 5.2

June 1	Inventory	510.00	
	Accounts payable		510.00
	<i>To record merchandise purchased on account (125 CDs @ \$4.08 each)</i>		
June 1	Inventory	22.18	
	Cash		22.18
	<i>To record payment of freight charges on merchandise purchased.</i>		
June 4	Accounts payable	61.20	
	Inventory		61.20
	<i>To record the return of defective merchandise (15 units @ \$4.08 per unit).</i>		
June 8	Accounts payable	448.80	
	Cash		439.82
	Inventory		8.98
	<i>To record full payment within discount period. Cash discount earned = \$8.98.</i>		

Solution 5.3

June 15	Accounts receivable	750.00	
	Sales revenue		750.00
	<i>To record the sale of 75 CDs on account.</i>		
June 15	Cost of goods sold	315.00	
	Inventory		315.00
	<i>To record cost of goods sold for 75 CDs.</i>		
June 20	Sales returns and allowances	50.00	
	Accounts receivable		50.00
	<i>To record the return of 5 CDs for credit.</i>		

Solution 6.3

Cost of Goods Sold		Beginning Inventory	Purchases	Ending Inventory
2015	\$7,000 (instead of \$7,500)	\$ —	+ \$10,000	— \$3,000
2016	\$13,000 (instead of \$12,500)	\$ 3,000	+ \$15,000	— \$5,000

		Without Error	With Error
2015	Sales	\$15,000	\$15,000
	Cost of goods sold	7,000	7,500
	Net income	\$ 8,000	\$ 7,500
2016	Sales	\$25,000	\$25,000
	Cost of goods sold	13,000	12,500
	Net income	\$12,000	\$12,500

Solution 6.4

The lowest value for each inventory item is: DSLR \$110,000, Point and Shoot \$73,000, and Camcorders \$48,000. The total of the inventory is therefore valued under LCM at \$231,000 (\$110,000 + \$73,000 + \$48,000).

Solution 6.5

	2015	2016
Inventory turnover	$\frac{\$2,000,000}{(\$450,000 + \$430,000)/2} = 4.55$	$\frac{\$2,300,000}{(\$430,000 + \$320,000)/2} = 6.13$
Days' sales in inventory	$365/4.55 = 80.22 \text{ days}$	$365/6.13 = 59.54 \text{ days}$

The company increased its sales by \$400,000 from 2015 to 2016, and at the same time, decreased its average inventory by \$65,000 (\$440,000 – \$375,000) as a consequence of improved inventory management. This resulted in a significantly improved inventory turnover (6.13 versus 4.55) and 20.68 (80.22 – 59.54) less days' sales in inventory. It appears that the new inventory management system is a financial success.

Solution 6A.1

FIFO							Inventory Balance		
Date	Units	Purchased Unit Cost	Total	Units	Sold Unit Cost	Total	Units	Unit Cost	Total
Jan. 1							1,000	\$5.00	\$5,000
Jan. 5	600	\$6.00	\$3,600				1,000	5.00	8,600
							600	6.00	
Jan. 15 . . .				200	\$5.00	\$1,000	800	5.00	7,600
							600	6.00	
Jan. 17 . . .	300	7.00	2,100				800	5.00	9,700
							600	6.00	
							300	7.00	
Jan. 25 . . .				400	5.00	2,000	400	5.00	7,700
							600	6.00	
							300	7.00	
						\$3,000			

1. Deposits in transit on June 30 total \$2,550.
2. The bank statement shows a debit memorandum for a \$10 check printing charge.
3. Check No. 160 payable to Simon Company was recorded in the accounting records for \$124 and cleared the bank for this same amount. A review of the records indicated that the Simon account now has an \$18 credit balance and the check to them should have been \$142.
4. Outstanding checks as of June 30 totaled \$3,100.
5. Check No. 176 was correctly written and paid by the bank for \$203. The check was recorded in the accounting records as a debit to accounts payable and a credit to cash for \$230.
6. The bank returned a NSF check in the amount of \$311.
7. The bank included a credit memorandum for \$630 representing a collection of a customer's note. The principal portion was \$610 and the interest portion was \$20. The interest had not been accrued.

Required

- a. Prepare the June bank reconciliation for the Chicago Scooter Company.
- b. Prepare any necessary adjusting entries.

SERIAL PROBLEM: KATE'S CARDS

(Note: This is a continuation of the Serial Problem: Kate's Cards from Chapters 1 through 6.)

SP7. On February 15, 2016, Kate Collins, owner of Kate's Cards, asks you to investigate the cash handling activities in her business. She believes that a new employee might be stealing funds. "I have no proof," she says, "but I'm fairly certain that the January 31, 2016, undeposited receipts amounted to more than \$12,000, although the January 31 bank reconciliation prepared by the cashier (who works in the treasurer's department) shows only \$7,238.40. Also, the January bank reconciliation doesn't show several checks that have been outstanding for a long time. The cashier told me that these checks needn't appear on the reconciliation because he had notified the bank to stop payment on them and he had made the necessary adjustment on the books. Does that sound reasonable to you?"

At your request, Kate shows you the following (unaudited) January 31, 2016, bank reconciliation prepared by the cashier:



KATE'S CARDS Bank Reconciliation January 31, 2016			
Ending balance from bank statement	\$ 4,843.69	Balance from general ledger	\$10,893.89
Add: Deposits in transit	<u>7,238.40</u>		
	\$12,082.09		
Less:		Less:	
Outstanding checks:		Bank service charge	\$ 60.00
No. 2351	\$1,100.20	Unrecorded credit.	<u>1,200.00</u>
No. 2353	<u>378.32</u>		<u>(1,260.00)</u>
No. 2354	<u>969.68</u>		
	(2,448.20)		
Reconciled cash balance	<u>\$ 9,633.89</u>	Reconciled cash balance	<u>\$ 9,633.89</u>

You discover that the \$1,200 unrecorded bank credit represents a note collected by the bank on Kate's behalf; it appears in the deposits column of the January bank statement. Your investigation also reveals that the December 31, 2015, bank reconciliation showed three checks that had been outstanding longer than 10 months: No. 1432 for \$600, No. 1458 for \$466.90, and No. 1512 for \$253.10. You also discover that these items were never added back into the Cash account in Kate's books. In confirming that the checks shown on the cashier's January 31 bank reconciliation were outstanding on that date, you discover that check No. 2353 was actually a payment of \$1,658.32 and had been recorded on the books for that amount.

To confirm the amount of undeposited receipts at January 31, you request a bank statement for February 1–12 (called a cutoff bank statement). This indeed shows a January 1 deposit of \$7,238.40.

- e. Kane provides a profit-sharing bonus for its executives equal to five percent of the reported before-tax income for the current year. The estimated before-tax income for the current year is \$600,000.

LO1 E10-2A. Maturity Dates of Notes Payable Determine the maturity date and compute the interest for each of the following notes payable with add-on interest:

	Date of Note	Principal	Interest Rate (%)	Term
a.	August 5	\$15,000	9	120 days
b.	May 10	8,400	7	90 days
c.	October 5	12,000	9	45 days
d.	July 6	4,500	10	60 days
e.	September 15	12,000	8	75 days

LO1 E10-3A. Accrued Interest Payable Compute the interest accrued on each of the following notes payable owed by Northland, Inc., on December 31:

Lender	Date of Note	Principal	Interest Rate (%)	Term
Maple	11/21	\$18,000	11	120 days
Wyman	12/13	14,000	8	90 days
Nahn	12/10	16,000	12	60 days

LO1 E10-4A. Adjusting Entries for Interest The following note transactions occurred during the year for Towell Company:

- Nov. 25 Towell issued a 60-day, nine percent note payable for \$8,000 to Hyatt Company for merchandise.
- Dec. 7 Towell signed a 120-day, \$15,000 note at the bank at ten percent.
- 22 Towell gave Barr, Inc., a \$12,000, eight percent, 60-day note in payment of account.

Prepare the general journal entries necessary to adjust the interest accounts at December 31.

LO1 E10-5A. Excise and Sales Tax Calculations Barnes Company has just billed a customer for \$1,010, an amount that includes an eleven percent excise tax and a four percent state sales tax.

- a. What amount of revenue is recorded?
- b. Prepare a general journal entry to record the transaction on the books of Barnes Company.

LO1 E10-6A. Advance Payments for Goods The Chicago Daily Times Corporation (CDT) publishes a daily newspaper. A 52-week subscription sells for \$221. Assume that CDT sells 100 subscriptions on January 1. None of the subscriptions are cancelled as of March 31.

- a. Prepare a journal entry to record the receipt of the subscriptions on January 1.
- b. Prepare a journal entry to record one week of earned revenue on March 25.

LO1 E10-7A. Warranty Costs Milford Company sells a motor that carries a 3-month unconditional warranty against product failure. Based on a reliable statistical analysis, Milford knows that between the sale and the end of the product warranty period, three percent of the units sold will require repair at an average cost of \$60 per unit. The following data reflect Milford's recent experience:

	October	November	December	Dec. 31 Total
Units sold	23,000	22,000	25,000	70,000
Known product failures from sales in:				
October	120	180	160	460
November		130	220	350
December			210	210

EXERCISES—SET B

E10-1B. Liabilities on the Balance Sheet For each of the following situations, indicate the amount shown as a liability on the balance sheet of Anchor, Inc., at December 31: **LO1**

- Anchor's general ledger shows a credit balance of \$125,000 in Long-Term Notes Payable. Of this amount, a \$25,000 installment becomes due on June 30 of the following year.
- Anchor estimates its unpaid income tax liability for the current year is \$34,000; it plans to pay this amount in March of the following year.
- On December 31, Anchor received a \$15,000 invoice for merchandise shipped on December 28. The merchandise has not yet been received. The merchandise was shipped F.O.B. shipping point.
- During the year, Anchor collected \$10,500 of state sales tax. At year-end, it has not yet remitted \$1,400 of these taxes to the state department of revenue.
- On December 31, Anchor's bank approved a \$5,000, 90-day loan. Anchor plans to sign the note and receive the money on January 2 of the following year.

E10-2B. Maturity Dates of Notes Payable Determine the maturity date and compute the interest for each of the following notes payable: **LO1**

	Date of Note	Principal	Interest Rate (%)	Term
a.	July 10	\$7,200	9	90 days
b.	April 4	6,000	8	120 days
c.	May 19	5,600	7 ½	120 days
d.	June 10	6,500	8	45 days
e.	October 29	10,000	6	60 days

E10-3B. Accrued Interest Payable Compute the interest accrued on each of the following notes payable owed by Galloway, Inc., on December 31: **LO1**

Lender	Date of Note	Principal	Interest Rate (%)	Term
Barton	12/4	\$10,000	12	150 days
Lawson	12/13	14,000	9	90 days
Riley	12/19	15,000	11	60 days

E10-4B. Adjusting Entries for Interest The following note transactions occurred during the year for Zuber Company: **LO1**

- Nov. 25 Zuber issued a 120-day, 12 percent note payable for \$8,000 to Porter Company for merchandise.
- Dec. 10 Zuber signed a 120-day, \$7,200 note at the bank at ten percent.
- 23 Zuber gave Dale, Inc., a \$9,000, eight percent, 60-day note in payment of account.

Prepare the journal entries necessary to adjust the interest accounts at December 31.

E10-5B. Excise and Sales Tax Calculations Allied Company has just billed a customer for \$1,160, an amount that includes a ten percent excise tax and a six percent state sales tax. **LO1**

- What amount of revenue is recorded?
- Prepare a journal entry to record the transaction on the books of Allied Company.

E10-6B. Advance Payment for Services The Columbus Bluebirds football team sells a 15-game season ticket for \$180. Assume that the team sells 1,000 season tickets on August 10. The tickets are all used for admission. **LO1**

- Prepare a journal entry to record the sale of the season tickets on August 10.
- Prepare a journal entry to record one game of earned revenue on September 12.

E10-7B. Warranty Costs Brigham Company sells an electric timer that carries a 3-month unconditional warranty against product failure. Based on a reliable statistical analysis, Brigham knows that between **LO1**

discount amortization (effective interest method) on June 30, 2015, and (c) the semiannual interest payment and discount amortization on December 31, 2015. Round amounts to the nearest dollar.

LO2, 5**(Appendix 10A)**

E10-19B. Bonds Payable Journal Entries; Effective Interest Amortization On December 31, 2014, Kay Company issued \$400,000 of five-year, 12 percent bonds payable for \$430,887, yielding an effective interest rate of ten percent. Interest is payable semiannually on June 30 and December 31. Prepare journal entries to reflect (a) the issuance of the bonds, (b) the semiannual interest payment and premium amortization (effective interest method) on June 30, 2015, and (c) the semiannual interest payment and premium amortization on December 31, 2015. Round amounts to the nearest dollar.

LO6**(Appendix 10B)**

E10-20B. Leases On January 1, Cooper, Inc., entered into two lease contracts. The first lease contract was an eight-year lease for a sound system with \$25,000 annual lease payments due at the end of each year. Spider took possession of the sound system on January 1. The second lease contract was a nine-month lease, beginning January 1 for warehouse storage space with \$1,750 monthly lease payments due the first of each month. Cooper made the first month's payment on January 1. The present value of the lease payments under the first contract is \$155,159. The present value of the lease payments under the second contract is \$15,238.

- The first lease contract is a capital lease. Prepare the journal entry for this lease on January 1.
- The second lease contract is an operating lease. Prepare the journal entry for this lease on January 1.

PROBLEMS—SET A

LO1

P10-1A. Journal Entries for Accounts and Notes Payable Logan Company had the following transactions:



- Apr. 8 Issued a \$5,000, 60-day, six percent note payable in payment of an account with Bennett Company.
- May 15 Borrowed \$40,000 from Lincoln Bank, signing a 60-day note at nine percent.
- June 7 Paid Bennett Company the principal and interest due on the April 8 note payable.
- July 6 Purchased \$12,000 of merchandise from Bolton Company; signed a 90-day note with ten percent interest.
- July 14 Paid the May 15 note due Lincoln Bank.
- Oct. 2 Borrowed \$30,000 from Lincoln Bank, signing a 120-day note at 12 percent.
- 4 Defaulted on the note payable to Bolton Company.

Required

- Record these transactions in general journal form.
- Record any adjusting entries for interest in general journal form. Logan Company has a December 31 year-end.

LO1

P10-2A. Adjusting Entries for Interest At December 31, 2014, Hoffman Corporation had two notes payable outstanding (notes 1 and 2). At December 31, 2015, Hoffman also had two notes payable outstanding (notes 3 and 4). These notes are described below:



	Date of Note	Principal Amount	Interest Rate	Number of Days
December 31, 2014				
Note 1.....	11/16/2014	\$15,000	8%	120
Note 2.....	12/4/2014	16,000	9	60
December 31, 2015				
Note 3.....	12/7/2015	9,000	9	60
Note 4.....	12/21/2015	18,000	12	30

Required

- Prepare the adjusting entries for interest at December 31, 2014.
- Assume that the adjusting entries were made at December 31, 2014. Prepare the 2015 journal entries to record payment of the notes that were outstanding at December 31, 2014.
- Prepare the adjusting entries for interest at December 31, 2015.

- LO4 P10-8B. Current Ratio, Quick Ratio, and Times-Interest-Earned Ratio** The following data is from the current accounting records of Sierra Company:

Cash	\$240
Accounts receivable (net of allowance of 80)	400
Inventory	300
Other current assets	160
Accounts payable	220
Other current liabilities	340

The president of the company is concerned that the company may be in violation of a debt covenant that requires the company to maintain a minimum current ratio of 2.0. He believes the best way to rectify the problem is to reverse a bad debt write-off in the amount of \$20 that the company just recorded. He argues that the write-off was done too early and that the collections department should be given more time to collect the outstanding amounts. The CFO argues that this will have no effect on the current ratio, so a better idea is to use \$20 of cash to pay accounts payable early.

Required

- Which idea, the president's or the CFO's, is better for attaining a minimum 2.0 current ratio?
- Will either the quick ratio or the times-interest-earned ratios be affected by either of these ideas?

LO5
(Appendix 10A)



- P10-9B. Effective Interest Amortization** On December 31, 2015, Echo, Inc., issued \$720,000 of 11 percent, five-year bonds for \$693,504, yielding an effective interest rate of 12 percent. Semiannual interest is payable on June 30 and December 31 each year. The firm uses the effective interest method to amortize the discount.

Required

- Prepare an amortization schedule showing the necessary information for the first two interest periods. Round amounts to the nearest dollar.
- Prepare the journal entry for the bond issuance on December 31.
- Prepare the journal entry to record bond interest expense and discount amortization at June 30 of the following year.
- Prepare the journal entry to record bond interest expense and discount amortization at December 31 of the following year.

LO5
(Appendix 10A)



- P10-10B. Effective Interest Amortization** On January 1, 2015, Raines, Inc., issued \$250,000 of ten percent, 15-year bonds for \$293,230, yielding an effective interest rate of eight percent. Semiannual interest is payable on June 30 and December 31 each year. The firm uses the effective interest method to amortize the premium.

Required

- Prepare an amortization schedule showing the necessary information for the first two interest periods. Round amounts to the nearest dollar.
- Prepare the journal entry for the bond issuance on January 1, 2015.
- Prepare the journal entry to record the bond interest payment and premium amortization at June 30.
- Prepare the journal entry to record the bond interest payment and premium amortization at December 31.



SERIAL PROBLEM: KATE'S CARDS

(Note: This is a continuation of the Serial Problem: Kate's Cards from Chapters 1 through 9.)

- SP10.** Recall that Kate previously obtained a \$15,000 bank loan, signing a note payable, on November 30. The note required semiannual interest payments at the rate of six percent. The entire principal balance was due two years from the origination date of the note. Kate has been accruing interest on a monthly basis in the amount of \$75. Kate would like to know how she should record the interest in May, the month she makes the first interest payment. She is unsure how much expense will need to be recorded in May.

The upcoming interest payment is really not Kate's main concern right now. She was just notified by a lawyer that she is being sued for copyright infringement. Mega Cards Incorporated, one of the largest greeting card companies, believes that one of Kate's designs is too similar to one of Mega's

LO1, 2 SE12-1. **Cash Flow from Operating Activities** Using the information for the Seville Corporation above, calculate the cash flow from operating activities.



LO1, 2 SE12-2. **Cash Flow from Investing Activities** Using the information for the Seville Corporation above, calculate the cash flow from investing activities.



LO1, 2 SE12-3. **Cash Flow from Financing Activities** Using the information for the Seville Corporation above, calculate the cash flow from financing activities.



The following information for Smith & Sons relates to Short Exercises 12-4 through 12-6:

Cash flow from operating activities	\$1,500,000
Capital expenditures	850,000
Current liabilities, beginning of year	300,000
Current liabilities, end of year	360,000

LO3 SE12-4. **Free Cash Flow** Using the above data, calculate the free cash flow for Smith & Sons.



LO3 SE12-5. **Operating-Cash-Flow-to-Current-Liabilities Ratio** Using the above data, calculate the operating-cash-flow-to-current-liabilities ratio for Smith & Sons.



LO3 SE12-6. **Operating-Cash-Flow-to-Capital-Expenditures Ratio** Using the above data, calculate the operating-cash-flow-to-capital-expenditures ratio for Smith & Sons.



LO4 SE12-7. **Converting Sales Revenue to Cash** Smith & Sons is converting its sales revenues to corresponding cash amounts using the direct method. Sales revenue on the income statement are \$1,025,000. Beginning and ending accounts receivable on the balance sheet are \$58,000 and \$34,000, respectively. Calculate the amount of cash received from customers.

(Appendix 12A)



LO4 SE12-8. **Direct Method** Using the following data for Smith & Sons, calculate the cash paid for rent:

(Appendix 12A)



Rent expense	\$80,000
Prepaid rent, January 1	10,000
Prepaid rent, December 31	8,000

LO4 SE12-9. **Direct Method** Using the following data for Smith & Sons, calculate the cash received as interest:

(Appendix 12A)



Interest income	\$26,000
Interest receivable, January 1	3,000
Interest receivable, December 31	3,700

LO4 SE12-10. **Direct Method** Using the following data for Smith & Sons, calculate the cash paid for merchandise purchased:

(Appendix 12A)



Cost of goods sold	\$108,000
Inventory, January 1	19,000
Inventory, December 31	22,000
Accounts payable, January 1	11,000
Accounts payable, December 31	7,000

EXERCISES—SET A

LO1 E12-1A. **Classification of Cash Flows** For each of the items below, indicate whether the cash flow item relates to an operating activity, an investing activity, or a financing activity:

- Cash receipts from customers for services rendered
- Sale of long-term investments for cash
- Acquisition of plant assets for cash
- Payment of income taxes

- a. Sales by the Farm and Equipment segment to independent dealers are recorded at the time of shipment to those dealers. Sales through company-owned retail stores are recorded at the time of sale to retail customers.
- b. Members of the board of directors, the advisory board, and employees are not charged the vendor's commission on property sold at auction for their benefit. (From the notes of an auctioneer company.)
- c. Sales to an airline company accounted for approximately 45 percent of the company's net sales in the current year.
- d. The company's product liability insurance coverage with respect to insured events occurring after January 1 of the current year is substantially less than the amount of that insurance available in the recent past. The company is now predominantly self-insured in this area. The reduction in insurance coverage reflects trends in the liability insurance field generally and is not unique to the company.

PROBLEMS—SET A

- LO1 P13-1A. Income Statement Format** The following information from Belvidere Company's current operations is available:



Administrative expenses	\$ 73,000
Cost of goods sold	464,000
Sales revenue	772,000
Selling expenses	87,000
Interest expense	10,000
Loss from operations of discontinued segment	60,000
Gain on disposal of discontinued segment	40,000
Income taxes:	
Amount applicable to ordinary operations	60,000
Reduction applicable to loss from operations of discontinued segment	24,000
Amount applicable to gain on disposal of discontinued segment	16,000

Required

- a. Prepare a multiple-step income statement. (Disregard earnings per share.)
- b. Prepare a single-step income statement. (Disregard earnings per share.)

- LO4 P13-2A. Earnings per Share** Leland Corporation began the year with 150,000 shares of common stock outstanding. On March 1 an additional 10,000 shares of common stock were issued. On August 1, another 16,000 shares of common stock were issued. On November 1, 6,000 shares of common stock were acquired as Treasury Stock. Leland Corporation's net income for the calendar year is \$516,000.



Required

Calculate the company's earnings per share.

- LO1, 4 P13-3A. Earnings per Share and Multiple-Step Income Statement** The following summarized data relate to Bowden Corporation's current operations:



Sales revenue	\$760,000
Cost of goods sold	450,000
Selling expenses	65,000
Administrative expenses	72,000
Loss on sale of equipment	5,000
Income tax expense (not allocated)	42,000
Shares of common stock	
Outstanding at January 1	20,000 shares
Additional issued at May 1	7,000 shares
Additional issued at November 1	2,000 shares

Required

Prepare a multiple-step income statement for Bowden Corporation for the year. ~~Assume a 25 percent income tax rate. Allocate income tax expense within the income statement.~~ Include earnings per share disclosure at the bottom of the income statement.

- P13-4A. Trend Percentages** Net sales, net income, and total asset figures for Vibrant Controls, Inc., for five consecutive years are given below (Vibrant manufactures pollution controls):

	Annual Amounts (Thousands of Dollars)				
	Year 1	Year 2	Year 3	Year 4	Year 5
Net sales	\$71,500	\$79,800	\$85,275	\$88,400	\$94,700
Net income	3,200	3,650	3,900	4,250	4,790
Total assets	42,500	46,200	48,700	51,000	54,900

Required

- Calculate trend percentages, using Year 1 as the base year.
- Calculate the return on sales for each year. (Rates above 2.8 percent are considered good for manufacturers of pollution controls; rates above 6.4 percent are considered very good.)
- Comment on the results of your analysis.

- P13-5A. Changes in Various Ratios** Presented below is selected information for Brimmer Company:

	2016	2015
Sales revenue	\$920,000	\$840,000
Cost of goods sold	575,000	545,000
Interest expense	20,000	20,000
Income tax expense	27,000	30,000
Net income	61,000	52,000
Cash flow from operating activities	65,000	55,000
Capital expenditures	45,000	45,000
Accounts receivable (net), December 31	126,000	120,000
Inventory, December 31	196,000	160,000
Stockholders' equity, December 31	450,000	400,000
Total assets, December 31	750,000	675,000

Required

- Calculate the following ratios for 2016. The 2015 results are given for comparative purposes.

	2015
1. Gross profit percentage	33.5 percent
2. Return on assets	8.3 percent
3. Return on sales	6.2 percent
4. Return on common stockholders' equity (no preferred stock was outstanding)	13.9 percent
5. Accounts receivable turnover	7.50
6. Average collection period	48.7 days
7. Inventory turnover	3.61
8. Times-interest-earned ratio	4.80
9. Operating-cash-flow-to-capital-expenditures ratio	1.22

- Comment on the changes between the two years.

- P13-6A. Ratios from Comparative and Common-Size Data** Consider the following financial statements for Waverly Company.

During 2016, management obtained additional bond financing to enlarge its production facilities. The company faced higher production costs during the year for such things as fuel, materials, and freight. Because of temporary government price controls, a planned price increase on products was delayed several months.

As a holder of both common and preferred stock, you decide to analyze the financial statements:

Administrative expenses	\$ 145,000
Cost of goods sold	928,000
Sales revenue	1,650,000
Selling expenses	174,000
Interest expense	14,000
Loss from operations of discontinued segment	120,000
Gain on disposal of discontinued segment	90,000
Income taxes	
Amount applicable to ordinary operations	115,000
Reduction applicable to loss from operations of discontinued segment	68,000
Amount applicable to gain on disposal of discontinued segment	30,000

Required

- Prepare a multiple-step income statement. (Disregard earnings per share amounts.)
- Prepare a single-step income statement. (Disregard earnings per share amounts.)

LO4 P13-2B.

Earnings per Share Island Corporation began the year with 50,000 shares of common stock outstanding. On May 1, an additional 12,000 shares of common stock were issued. On July 1, 20,000 shares of common stock were acquired as treasury stock. On September 1, the 6,000 treasury shares of common stock were reissued. Island Corporation's net income for the calendar year is \$230,000.

Required

Compute earnings per share.

LO1, 4 P13-3B.

Earnings per Share and Multiple-Step Income Statement The following summarized data are related to Garner Corporation's operations:

Sales revenue	\$2,216,000
Cost of goods sold	1,290,000
Selling expenses	180,000
Administrative expenses	142,800
Loss from plant strike	95,000
Income tax expense	204,000
Shares of common stock	
Outstanding at January 1	65,000 shares
Additional issued at April 1	17,000 shares
Additional issued at August 1	3,000 shares

Required

Prepare a multiple-step income statement for Garner Corporation. ~~Assume a 40 percent income tax rate.~~ Include earnings per share disclosure at the bottom of the income statement. Garner Corporation has no preferred stock.

LO2 P13-4B.

Trend Percentages Sales of automotive products for Ford Motor Company and General Motors Corporation for a five-year period are:

	Net Sales of Automotive Products (Millions of Dollars)				
	Year 1	Year 2	Year 3	Year 4	Year 5
Ford Motor Company	\$82,879	\$81,844	\$72,051	\$ 84,407	\$ 91,568
General Motors Corporation	99,106	97,312	94,828	103,005	108,027

Net sales for Pfizer Inc. and Abbott Laboratories for the same five years follow: