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Study Guide

Chapters 16-27

College Accounting

Twenty-first Edition

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CHAPTER 16

ACCOUNTING FOR ACCOUNTS RECEIVABLE

LEARNING OBJECTIVES

In Chapter 16, you will learn how to account for accounts receivable. Most businesses realize that sales will increase if customers are allowed credit. However, some customers are unable or unwilling to pay their accounts.

Objective 1. Apply the allowance method of accounting for uncollectible accounts.

The **allowance method** of accounting for uncollectible accounts receivable attempts to recognize bad debt expense in the same time period as the credit sales were made. This method is in conformity with the **matching principle**, which states that expenses should be matched with the revenues they helped to produce. To use the allowance method, three steps are followed.

1. At the end of each accounting period, the amount of bad debt expense or uncollectible accounts is estimated.
2. An adjusting entry is made to recognize the bad debt expense and reduce reported receivables for the amount of uncollectible accounts, as follows:

| | |
|------------------------------------|----|
| Bad Debt Expense | xx |
| Allowance for Doubtful Accounts... | xx |

Notice, the credit above is to the allowance account, not to Accounts Receivable. The allowance account is deducted from Accounts Receivable to arrive at the **net receivables** or **net realizable value**, as follows:

| | |
|--------------------------------------|--------------|
| Current assets: | |
| Accounts receivable | \$50,000 |
| Less allowance for doubtful accounts | <u>5,000</u> |
| Net realizable value | \$45,000 |

3. When a specific account is identified as uncollectible, an entry is made to write off the account and reduce the balance in Allowance for Doubtful Accounts.

| | |
|---------------------------------------|----|
| Allowance for Doubtful Accounts | xx |
| Accounts Receivable..... | xx |

Objective 2. Apply the percentage of sales and percentage of receivables methods of estimating uncollectible accounts.

There are two basic approaches to using the allowance method to estimate the amount of uncollectibles: the percentage of sales method and the percentage of receivables method.

The **percentage of sales method** is based on the relationship between the amount of credit sales and the amount of uncollectible accounts. An important feature of this method is that the balance in Allowance for Doubtful Accounts before adjustment is ignored in making the adjusting entry for Bad Debt Expense. In other words, the estimated percentage is multiplied by the year's credit sales, and this amount is then used in the adjusting entry. The only exception to this rule is when either a large debit balance or a large credit balance is accumulating from one year to the next in Allowance for Doubtful Accounts. This would indicate that the estimated percentage of credit sales is either too low or too high and needs to be increased or decreased.

The **percentage of receivables method** is based on the relationship between the amount of accounts receivable and the amount of uncollectible accounts. Either an estimated percentage multiplied by the Accounts Receivable balance or an aging of the accounts receivable can be used to estimate uncollectible accounts. The aging analysis is a more precise method of estimating uncollectibles because it examines each customer's account to determine how long it has been outstanding.

An important feature of the percentage of receivables method is that you must examine the existing balance in Allowance for Doubtful Accounts before entering the adjusting entry. If the balance prior to adjustment is a debit, then this debit amount is *added* to the dollar estimate determined by the percentage of receivables method. If the balance prior to adjustment is a credit, then this credit amount is *subtracted* from the estimate determined by the percentage of receivables method.

Occasionally, an account that was written off will be collected. When this happens, two entries are required.

1. The account is reinstated as follows:

| | | |
|----------------------------------|----|----|
| Accounts Receivable | XX | |
| Allowance for Doubtful Accounts. | | XX |

Notice that the above entry is the exact reverse of the write-off entry.

2. The collection is entered as follows:

| | | |
|--------------------------|----|----|
| Cash..... | XX | |
| Accounts Receivable..... | | XX |

Objective 3. Apply the direct write-off method of accounting for uncollectible accounts.

Under the **direct write-off method**, Bad Debt Expense is not recognized until it has been determined that an account is uncollectible. Thus, there is no end-of-period adjusting entry to estimate Bad Debt Expense. When an account is to be written off, Bad Debt Expense is debited and Accounts Receivable is credited.

There are three disadvantages to using this method. First, the matching principle will be violated if the account is written off in a time period different from the year the sale was made. Second, the amount of Bad Debt Expense recognized in a given period can be manipulated by management. Third, the amount of Accounts Receivable reported on the balance sheet overstates the amount of cash actually expected to be collected.

Occasionally, an account that was written off will be collected. If the collection is made in the same year as the sale was made, then a simple reversal of the write-off entry is made, along with an entry showing the cash collected.

| | | |
|---------------------------|----|----|
| Accounts Receivable | XX | |
| Bad Debt Expense..... | | XX |
| Cash..... | XX | |
| Accounts Receivable..... | | XX |

If the write-off is made in one time period but the recovery is made in a following accounting period, then a different entry is required to reinstate the account.

| | | |
|------------------------------------|----|----|
| Accounts Receivable | XX | |
| Uncollectible Accounts Recovered.. | | XX |

Notice in the above entry that the credit is to Uncollectible Accounts Recovered. This account is reported on the income statement as other revenue. The collection is recorded in the same manner as the previous example.

| | | |
|--------------------------|----|----|
| Cash..... | XX | |
| Accounts Receivable..... | | XX |

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|--|---------------|
| LO 1 1. Name the two methods of accounting for uncollectible accounts. | _____ |
| | _____ |
| LO 1 2. The _____ method is a technique that attempts to recognize Bad Debt Expense in the same period that the related sales are made. | _____ |
| LO 1 3. The _____ principle states that expenses should be matched with the revenues they helped to produce. | _____ |
| LO 1 4. Under the accrual basis of accounting, the _____ method is generally required for financial reporting purposes. | _____ |
| LO 1 5. Using the allowance method, the end-of-period adjusting entry involves a debit to _____ and a credit to _____. | _____ |
| | _____ |
| LO 1 6. The account Allowance for Doubtful Accounts is classified on the balance sheet as a(n) _____. | _____ |
| LO 1 7. The dollar difference between Accounts Receivable and Allowance for Doubtful Accounts is known as _____. | _____ |
| LO 2 8. Name the two basic methods used under the allowance method to estimate the amount of uncollectibles. | _____ |
| | _____ |
| LO 2 9. The _____ method is based on the relationship between the amount of credit sales and the amount of uncollectible accounts. | _____ |
| LO 2 10. Under the allowance method, when an account is written off as uncollectible, _____ is debited, and _____ is credited. .. | _____ |
| | _____ |
| LO 2 11. The _____ method is based on the relationship between the amount of accounts receivable and the amount of uncollectible accounts. | _____ |
| LO 2 12. The process of analyzing each customer’s balance to determine how long the account receivable has been outstanding is called _____. | _____ |

- LO 2 13. The existing balance in Allowance for Doubtful Accounts can be ignored when estimating uncollectible accounts under the _____ method.

- LO 2 14. The existing balance in Allowance for Doubtful Accounts must be examined when estimating uncollectible accounts under the _____ method.

- LO 2 15. Under the allowance method, to reinstate an account that had previously been written off, _____ is debited, and _____ is credited.

- LO 2 16. To record the collection of an account that has been reinstated, _____ is debited, and _____ is credited.

- LO 3 17. Under the _____ method, Bad Debt Expense is not recognized until it has been determined that an account is uncollectible.

- LO 3 18. Under the direct write-off method, to reinstate an account in the same accounting period that the account was written off, the account _____ is credited.....

- LO 3 19. Under the direct write-off method, to reinstate an account that was written off in an earlier accounting period, the account _____ is credited.

- LO 3 20. Under the direct write-off method, the account _____ is debited when writing off an uncollectible account.

EXERCISES

Exercise 1 (LO 1/2) UNCOLLECTIBLE ACCOUNTS—PERCENTAGE OF SALES; NET REALIZABLE VALUE

McAllister’s Framing and Art Supplies uses the percentage of sales method of accounting for uncollectible accounts. At the end of 20-9, Sue McAllister estimates that uncollectible accounts associated with this year’s sales will be approximately \$3,500. The balances in related accounts just prior to entering adjusting entries are listed below. Prepare the appropriate adjusting entry on December 31, 20-9, and compute net realizable value.

| | Debit | Credit |
|---------------------------------------|--------------|---------------|
| Accounts Receivable | 28,000 | |
| Allowance for Doubtful Accounts | | 300 |
| Bad Debt Expense | -0- | |

Exercise 1 (Concluded)

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Exercise 2 (LO 1/2) UNCOLLECTIBLE ACCOUNTS—PERCENTAGE OF RECEIVABLES; NET REALIZABLE VALUE

Sherfield’s Toy Shop uses the percentage of receivables method of accounting for uncollectible accounts. At the end of 20-6, Robert Sherfield estimates that there will be \$3,200 worth of uncollectible accounts. The balances in related accounts just prior to entering adjusting entries are listed below. Prepare the appropriate adjusting entry on December 31, 20-6, and compute net realizable value.

| | Debit | Credit |
|---------------------------------------|--------|--------|
| Accounts Receivable | 32,000 | |
| Allowance for Doubtful Accounts | | 400 |
| Bad Debt Expense | -0- | |

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Exercise 3 (LO 2) COLLECTION OF ACCOUNT WRITTEN OFF—ALLOWANCE METHOD

Freeflow Pen Company uses the allowance method of accounting for uncollectible accounts. On November 15, 20-7, Beatrice Fountain’s account was written off as uncollectible. At the time, Fountain owed \$350. On January 21, 20-8, a check for \$350 was received from Ms. Fountain. Prepare entries for the write-off on November 15, 20-7, and for receipt of the check on January 21, 20-8.

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Exercise 4 (LO 3) DIRECT WRITE-OFF METHOD

Maui Surf and Sport Shop uses the direct write-off method of accounting for uncollectible accounts. On March 15, 20-8, a letter from Bill Karst was received stating that he had lost his job and would be unable to pay the \$250 owed on account. Make the general journal entry necessary to write off Mr. Karst’s account.

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Exercise 5 (LO 3) COLLECTION OF ACCOUNT WRITTEN OFF—DIRECT WRITE-OFF METHOD

B. Q. Company uses the direct write-off method of accounting for uncollectible accounts. On November 15, 20-4, the two accounts listed below were written off as uncollectible.

| Account | Amount |
|----------------------|--------|
| Brenda Farlow | \$400 |
| Charles Turner | 500 |

On December 21, 20-4, a check was received from Farlow for \$400; and on January 15, 20-5, a check for \$500 was received from Turner. Prepare entries for the write-off of each account on November 15, 20-4, and for the receipt of the checks on December 21, 20-4, and January 15, 20-5. Assume that B. Q.'s fiscal year ends on December 31.

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PROBLEMS

Problem 6 (LO 2) UNCOLLECTIBLE ACCOUNTS—PERCENTAGE OF SALES AND PERCENTAGE OF RECEIVABLES

At the end of the current year, the balance of the accounts receivable account for Webb’s Pet Supplies was \$32,000. Credit sales for the year were \$450,800.

Required:

Determine the amount of the adjusting entry for uncollectible accounts and the net realizable value under each of the following assumptions:

- (a) Allowance for Doubtful Accounts has a credit balance of \$400.
 - (1) The percentage of sales method is used, and it is estimated that bad debt expense will be 1% of credit sales.
 - (2) The percentage of receivables method is used; and based on an analysis of the accounts, it is estimated that uncollectible accounts will amount to \$4,250.
- (b) Allowance for Doubtful Accounts has a debit balance of \$600.
 - (1) The percentage of sales method is used, and it is estimated that bad debt expense will be 1.5% of credit sales.
 - (2) The percentage of receivables method is used; and based on an analysis of the accounts, it is estimated that uncollectible accounts will amount to \$6,200.

Problem 7 (LO 2) UNCOLLECTIBLE ACCOUNTS—PERCENTAGE OF SALES; COLLECTION OF ACCOUNT WRITTEN OFF

Chattanooga Fireworks Company (CFC) uses the percentage of sales method of accounting for uncollectible accounts. In the past, approximately 2% of all credit sales have been uncollectible. Credit sales for 20-6 amounted to \$850,000. At the end of 20-6, Accounts Receivable had a debit balance of \$120,000, and Allowance for Doubtful Accounts had a credit balance of \$1,500. The following transactions occurred in 20-7:

- Mar. 1 Wrote off the account of J. Dullard for \$380.
- May 30 Received a check from J. Dullard for \$380.

Required:

1. Enter the adjusting entry for bad debt expense at the end of 20-6.
2. Prepare journal entries for the transactions that occurred in 20-7.

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Problem 8 (LO 2) UNCOLLECTIBLE ACCOUNTS—AGING OF ACCOUNTS RECEIVABLE

Tallahassee Seminole Shop uses the percentage of receivables method of accounting for uncollectible accounts. An analysis of the accounts receivable ledger at the end of 20-9 reveals the following data concerning specific customers:

| Customers | Invoice Dates and Amounts of Unpaid Invoices | | | | | |
|---------------|--|-------|---------|-------|---------|-------|
| | Borthick, A. | 10/7 | \$2,300 | 11/15 | \$1,200 | 12/18 |
| Clark, R. | 6/1 | 1,200 | 8/15 | 2,500 | | |
| Copley, P. | 9/23 | 4,500 | 10/22 | 2,300 | 12/23 | 2,800 |
| Davis, H. | 12/15 | 1,500 | | | | |
| Heagy, C. | 9/9 | 200 | | | | |
| O'Keefe, S. | 11/20 | 3,300 | 12/10 | 1,400 | | |
| Pasewark, W. | 12/2 | 5,500 | | | | |
| Schroeder, M. | 12/15 | 2,300 | | | | |
| Shockley, W. | 11/18 | 800 | 12/8 | 3,000 | | |
| Wilkerson, J. | 8/21 | 300 | 11/15 | 1,100 | 12/8 | 1,700 |

At December 31, 20-9, the unadjusted balance in Allowance for Doubtful Accounts is a debit of \$500. All sales are billed n/30. The chart below is used to estimate the uncollectibles using the aging of receivables method.

| Days Past Due | Percent Uncollectible |
|-------------------|-----------------------|
| Not yet due..... | 2% |
| 1–30 days..... | 4 |
| 31–60 days..... | 8 |
| 61–90 days..... | 16 |
| Over 90 days..... | 32 |

Required:

1. Prepare an aging schedule. Headings for this have been provided on the following page.
2. Estimate the uncollectible accounts as of the end of 20-9.
3. Prepare the adjusting entry for uncollectible accounts, using the journal provided on the following page.

Problem 8 (Concluded)

1. and 2.

**TALLAHASSEE SEMINOLE SHOP
AGING SCHEDULE OF ACCOUNTS RECEIVABLE**

| | A | B | C | D | E | F | G |
|----|-----------------|--------------|----------------|--------------------------------|--------------|--------------|----------------|
| 1 | | | Not Yet | Number of Days Past Due | | | |
| 2 | Customer | Total | Due | 1-30 | 31-60 | 61-90 | Over 90 |
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Problem 9 (LO 3) COLLECTION OF ACCOUNT WRITTEN OFF—DIRECT WRITE-OFF METHOD

Woodruff & Burnside Distributors uses the direct write-off method in accounting for uncollectible accounts. The following selected transactions occurred during 20-6 and 20-7:

- 20-6**
- Mar. 20 Sold merchandise on account to Ready Merchants, \$19,400.
 - May 12 Sold merchandise on account to Neighborhood Watchers, \$13,800.
 - July 9 Received \$12,000 from Ready Merchants and wrote off the remainder owed on the sale of March 20 as uncollectible.
 - Oct. 15 Received \$6,000 from Neighborhood Watchers and wrote off the remainder owed on the sale of May 12 as uncollectible.
 - Dec. 5 Reinstated the Ready Merchants' account that had been written off on July 9 and received \$7,400 cash in full settlement.
- 20-7**
- Feb. 26 Reinstated the Neighborhood Watchers' account that had been written off on October 15 of the previous year and received \$7,800 cash in full settlement.

Required:
Record the above transactions in general journal form.

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Problem 9 (Concluded)

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CHAPTER 17

ACCOUNTING FOR NOTES AND INTEREST

LEARNING OBJECTIVES

Chapter 17 covers the giving and receiving of promissory notes as a part of the receivable and payable processes. Interest and due dates are calculated, followed by notes receivable and notes payable transactions. Accrued interest on notes receivable and notes payable is also calculated, and adjusting entries are illustrated.

Objective 1. Describe a promissory note.

A **promissory note** is a written promise to pay a specific sum at a future date. It is a legal, negotiable instrument used to extend time for payment or to allow borrowing of money for a specific period of time.

Objective 2. Calculate interest on and determine the due date of promissory notes.

To calculate interest, the formula **Interest = P × R × T** is used, where *P* is principal or face amount of the note; *R* is rate of interest; and *T* is time of the note, which is stated as a fraction of a year. The denominator of the fraction is 360 for days or 12 for months. Days of a loan are calculated by subtracting the date of the loan from the number of days in the month of issue and counting days forward in subsequent months to the maturity date. Maturity value is the principal plus interest for the length of the loan.

Objective 3. Account for notes receivable transactions and accrued interest.

Businesses other than banks and savings and loans generally encounter seven types of transactions involving notes receivable.

1. Note received from a customer in exchange for assets sold
2. Note received from a customer to extend time for payment of an account
3. Note collected at maturity
4. Note renewed at maturity
5. Note discounted before maturity
6. Note dishonored
7. Collection of dishonored note

When a note is discounted at a bank before maturity, the discount is based on the maturity value of the note, not the principal amount. If a note is dishonored, the payee transfers the amount of the note plus interest and any bank fees to accounts receivable. If a dishonored note is collected, the payee normally receives the maturity value of the note plus any bank fees and interest for the period from the original maturity date to the final collection date.

Recognition of revenue when it is earned (accrual accounting) requires that accrued interest (earned but not received) should be recognized at the end of the accounting period. Total accrued interest is debited to Accrued Interest Receivable and credited to Interest Revenue.

Objective 4. Account for notes payable transactions and accrued interest.

Businesses generally encounter five types of transactions involving notes payable.

1. Note issued to a supplier in exchange for assets purchased
2. Note issued to a supplier to extend time for payment of an account
3. Note issued as security for cash loan
4. Note paid at maturity
5. Note renewed at maturity

Banks often deduct interest in advance on a loan using a procedure called discounting. The bank issues a non-interest-bearing note and deducts a bank discount from the maturity value of the note. The borrower receives the proceeds, which are equal to the difference between the maturity value of the note and the discount amount. The effective interest rate on such notes is higher than the stated rate.

Under accrual accounting, expenses are recognized when they are incurred, rather than when they are paid. Therefore, accrued interest (due but not paid) should be recognized at the end of the accounting period. Total accrued interest is debited to Interest Expense and credited to Accrued Interest Payable or Discount on Notes Payable.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|---|--------|
| LO 1 1. A(n) _____ is a written promise to pay a specific sum at a definite future date. | _____ |
| LO 1 2. The _____ signs the note and agrees to make payment. | _____ |
| LO 1 3. The note is payable to a specific person or business known as the _____ | _____ |
| LO 2 4. The _____ of a note is the face amount that will be paid at maturity. | _____ |
| LO 2 5. The rate of _____ is expressed as a percentage such as 7%. | _____ |
| LO 2 6. Most notes are usually expressed in months or days from the date of issue to the date of maturity, known as the _____ of the note. | _____ |
| LO 2 7. _____ is the term of a note, stated as a fraction of a year. | _____ |
| LO 2 8. _____ is the principal of a note plus the interest. | _____ |
| LO 3 9. When a note is given by a customer to extend time for payment, _____ is credited. | _____ |
| LO 3 10. When a note is collected by a bank, the payee receives a(n) _____ indicating the net amount added to the account. | _____ |
| LO 3 11. If a firm needs cash before a note receivable is due, it can endorse the note and transfer it to the bank for collection. This is called _____ a note receivable. | _____ |
| LO 3 12. The bank charges a fee called a(n) _____ for the time between the date of discounting and the maturity date of a note. | _____ |
| LO 3 13. The difference between the maturity value of the note and the bank discount is called the _____ | _____ |
| LO 3 14. The business still has _____ liability for a note that has been discounted at a bank. | _____ |
| LO 3 15. If the maker of a note does not pay or renew a note at maturity, the note is said to be _____ | _____ |

- LO 3 16. When a note is dishonored, _____ is debited for the full maturity value of the note.

- LO 3 17. A business that has many notes from customers would keep a(n) _____ register, which is an auxiliary record.

- LO 3 18. The information contained in the notes receivable register is directly from the _____.

- LO 3 19. At the end of the period, interest earned but not yet due is called _____ interest receivable.

- LO 4 20. When banks make loans using non-interest-bearing notes, they subtract interest in advance. This procedure is called _____.

- LO 4 21. Discount on Notes Payable is a(n) _____ account and is reported as a deduction from Notes Payable on the balance sheet.

- LO 4 22. _____ on notes payable is interest expense that has been incurred but not paid.

- LO 4 23. Accrued interest payable is reported as a(n) _____ on the balance sheet.

EXERCISES

Exercise 1 (LO 2) TERM OF A NOTE

From the information given below, compute the *time in days* of the following notes. (Assume there are 28 days in February.)

| Date of Note | Due Date | Time in Days |
|--------------|-------------|--------------|
| June 4 | August 11 | _____ |
| May 13 | July 10 | _____ |
| January 15 | March 21 | _____ |
| August 10 | November 12 | _____ |
| December 15 | February 1 | _____ |
| April 1 | July 1 | _____ |

Exercise 2 (LO 2) DETERMINING DUE DATE

From the information given below, determine the *due date* of the following notes. (Assume there are 28 days in February.)

| Date of Note | Term of Note | Due Date |
|--------------|--------------|----------|
| February 1 | 45 days | _____ |
| May 11 | 60 days | _____ |
| March 18 | 90 days | _____ |
| June 1 | 30 days | _____ |
| December 15 | 55 days | _____ |
| October 31 | 120 days | _____ |

Exercise 3 (LO 2) CALCULATING INTEREST

Using 360 days as the denominator, calculate interest for the following promissory notes using the formula $I = P \times R \times T$.

| Principal | Rate | Time | Interest |
|-----------|------|----------|----------|
| \$1,500 | 5% | 45 days | _____ |
| 3,000 | 6% | 60 days | _____ |
| 7,500 | 7% | 90 days | _____ |
| 2,800 | 8.8% | 30 days | _____ |
| 4,200 | 5.5% | 88 days | _____ |
| 1,990 | 7.9% | 120 days | _____ |

Exercise 4 (LO 2/3) NOTES RECEIVABLE ENTRIES

Prepare general journal entries for the following notes receivable transactions. Assume a 360-day year and 28 days in February.

- Jan. 2 Received a \$3,000, 6%, 30-day note from J. Smith in payment for sale of merchandise.
- 15 Received a \$2,500, 5%, 30-day note from K. Jones in payment of an accounts receivable balance.
- Feb. 1 Received \$15 interest on the J. Smith note; the old note is renewed for 30 days at 6.5%.
- 14 Received \$500 principal, plus interest on the K. Jones note; the old note is renewed for 30 days at 6%.
- Mar. 3 Received principal and interest on the Smith note.
- 16 Received principal and interest on the Jones note.

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Exercise 5 (LO 2/3) NOTES RECEIVABLE DISCOUNTING AND DISHONORED

Prepare general journal entries for the following notes receivable transactions. Assume a 360-day year.

- Apr. 1 Received a 90-day, 6.5% note in payment for accounts receivable balance of \$5,000.
- 20 Discounted the note at a rate of 7%.
- May 2 Received a 60-day, 6% note in payment for accounts receivable balance of \$3,500.
- July 1 The \$3,500 note is dishonored.
- Aug. 15 The dishonored note is collected, plus interest at 6% on the maturity value.

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Exercise 6 (LO 4) NOTES PAYABLE ENTRIES

Prepare general journal entries for the following notes payable transactions. Assume a 360-day year and 28 days in February.

- Jan. 11 Gave a \$5,000, 6%, 30-day note to extend payment on accounts payable to G. Adams.
- 20 Gave a \$3,000, 6%, 60-day note to Roy Co. for purchase of merchandise.
- Feb. 10 Paid \$500 cash, plus interest, to G. Adams to extend the note for an additional 30 days at 6%.
- Mar. 12 Paid the G. Adams note in full.
- 21 Paid the Roy Co. note in full.

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Exercise 7 (LO 4) ENTRIES FOR BORROWING USING NOTES PAYABLE

Prepare general journal entries for the following notes payable transactions. Assume a 360-day year.

- Apr. 1 Borrowed \$5,000, giving a 60-day, 6% note.
- May 1 Borrowed \$6,000, giving a 90-day non-interest-bearing note. The note is discounted 7% by the bank.
- May 31 Paid the \$5,000, 60-day, 6% note.
- July 30 Paid the \$6,000 non-interest-bearing note, recognizing the discount as interest expense.

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Exercise 8 (LO 3/4) ACCRUED INTEREST JOURNAL ENTRIES

At the end of the year, accrued interest on notes receivable and payable has been determined as shown below. Record the appropriate adjusting entries for accrued interest receivable and payable in the general journal.

- (a) Accrued interest on outstanding notes receivable \$37.50
- (b) Accrued interest on outstanding notes payable 71.10

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PROBLEMS

Problem 9 (LO 3) NOTES RECEIVABLE ENTRIES

Required:

Prepare general journal entries for the following notes receivable transactions of Lill Co.:

- Mar. 1 Received a \$1,400, 90-day, 5% note for sale of merchandise.
- 13 Received a \$2,000, 30-day, 5.5% note from H. Jelinek to extend time for payment of account receivable.
- 29 Note received on March 1 is discounted at Kaw Bank at a discount rate of 6%.
- Apr. 12 H. Jelinek paid the interest due on her note (see March 13) plus \$400 on the principal and gives a new \$1,600, 30-day, 6% note.
- May 12 H. Jelinek paid the note issued April 12, plus interest.
- 30 Note discounted at Kaw Bank on March 29 is dishonored. Lill Co. pays the bank the maturity value of the note plus a \$30 bank fee.
- June 29 The note dishonored on May 30 is collected. Lill Co. receives the maturity value of the note, the \$30 bank fee, and interest at 6% on the maturity value and the bank fee.

Problem 9 (Concluded)

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Problem 10 (LO 4) NOTES PAYABLE ENTRIES

Required:

Prepare general journal entries for the following notes payable transactions of S. Maghanti Co.:

- May 1 Issued a \$4,000, 60-day, 7% note to a supplier for purchase of merchandise.
- 20 Issued a \$1,500, 30-day, 7% note in payment of an account payable.
- 31 Borrowed \$5,000 cash from the bank, giving a 60-day non-interest-bearing note, discounted at 6% by the bank.
- June 19 Paid the \$1,500 note issued on May 20, plus interest.
- 30 Paid \$1,000 plus interest and issued a new note for \$3,000 to satisfy the \$4,000 note issued on May 1.
- July 15 Borrowed \$3,000 cash from the bank, giving a 60-day, 6% note.
- 30 Paid \$5,000 to the bank in payment of the note issued on May 31.

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Problem 11 (LO 3/4) ACCRUED INTEREST RECEIVABLE AND PAYABLE

Required:

Calculate the amount of accrued interest receivable and payable and record the adjusting entries in the general journal.

- (a) At the end of the year, interest is earned but not yet received on the following notes:
 - 90-day, \$1,500, 6% note dated December 1, 20-- _____
 - 60-day, \$3,000, 5% note dated December 10, 20-- _____
 - 45-day, \$2,000, 5.5% note dated November 30, 20-- _____

- (b) At the end of the year, interest expense is incurred but not yet paid on the following notes:
 - 45-day, \$2,500, 5.5% note dated December 3, 20-- _____
 - 65-day, \$1,000, 7% note dated November 25, 20-- _____
 - 90-day, \$5,000, 6% note dated December 13, 20-- _____

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CHAPTER 18

ACCOUNTING FOR LONG-TERM ASSETS

LEARNING OBJECTIVES

Chapter 18 addresses accounting for the acquisition, depreciation, and disposal of property, plant, and equipment. Four depreciation methods for financial reporting purposes are illustrated along with methods used for tax purposes. Methods of disposing of assets include disposal, sale at a gain or loss, and exchanges of similar assets at a gain or loss. In addition, accounting procedures for natural resources and intangible assets are illustrated.

Objective 1. Determine the cost of property, plant, and equipment.

The **cost of long-term assets (property, plant, and equipment)** includes amounts spent to acquire and prepare them for their intended use. Long-term assets are entered into the accounting system by debiting asset accounts. Land improvements that are not permanent in nature are normally debited to a land improvements account.

Objective 2. Explain the nature and purpose of depreciation.

Depreciation is used to match the cost of plant assets with the revenues those assets help to produce. The adjustment involves debiting an expense—Depreciation Expense—that is reported on the income statement. The credit is to Accumulated Depreciation—a contra-asset account. When accumulated depreciation is subtracted from the original cost of the asset, the result is **undepreciated cost** or **book value**. This is a process of cost allocation, not valuation of the asset.

Objective 3. Compute depreciation using the straight-line, declining-balance, sum-of-the-years'-digits, units-of-production, and MACRS depreciation methods.

The **straight-line method** is calculated by subtracting salvage value from original cost and dividing by useful life. This method allocates an equal amount of depreciation to each year of useful life of the asset.

The **declining-balance method** depreciates an asset faster than the straight-line method. With double-declining-balance, the rate is twice the straight-line rate. For example, an asset with a useful life of five years would have a straight-line rate of 20% (100% divided by 5). With the double-declining-balance method, each year's depreciation is 40% of the asset's book value (declining balance) at the beginning of the period. An asset cannot be depreciated below its salvage value.

The **sum-of-the-years'-digits method**, like the declining-balance method, recognizes more depreciation in earlier years. The depreciable cost is multiplied by a fraction whose denominator is the sum of the years' digits. For example, the denominator for an asset with a five-year useful life would be $5 + 4 + 3 + 2 + 1 = 15$. The numerator is the number of years of remaining life, taken from the beginning of the year. For an asset with a five-year life, the first year's depreciation would be $5/15$ times the cost minus salvage value; the second year's depreciation, $4/15$ times cost minus salvage, and so on.

The **units-of-production method** depreciates an asset to the extent that it was used during the year. First, you calculate a rate for charging usage. To do this, the original cost minus salvage value is divided by the expected output or total units that can be produced. For example, a truck that costs \$10,000, had a salvage value of \$2,000, and estimated miles of service of 80,000 would be \$8,000 divided by 80,000, or \$0.10 a mile. If the truck was driven 10,000 miles, the year's depreciation would be 10,000 times \$0.10, or \$1,000.

The **Modified Accelerated Cost Recovery System (MACRS)** may be used for tax purposes. The IRS provides depreciation rate schedules for use with various classes of property. See Figure 18-2 in the text. Simply find the appropriate rate based on the age of the asset and asset class in the IRS schedule, then multiply by the asset's original cost.

Objective 4. Account for repairs, maintenance, additions, improvements, and replacements to plant and equipment.

Expenditures for normal repairs and maintenance of plant and equipment are debited to Repairs Expense and reported on the income statement. Expenditures for all **additions** and **improvements (betterments)** that increase the usefulness of the buildings or equipment are debited to the appropriate asset account and therefore increase book value. Since these additions and improvements will provide future benefits, depreciation will be recognized. A **replacement** is when a component of a plant asset is replaced with a similar component. Replacements that extend the asset’s useful life, but do not increase its usefulness or efficiency, are *debited* to Accumulated Depreciation. This decreases the amount of accumulated depreciation and therefore increases book value.

Objective 5. Account for the disposition of property, plant, and equipment.

Plant assets can be discarded (retired), sold, or exchanged for another asset. Regardless of method of disposal, it must be determined whether there was a gain or a loss. If the market value of the old asset is greater than its book value, a gain has occurred. If the market value is less than its book value, a loss has occurred. Losses are often recognized when an asset is discarded. Gains and losses are recognized when assets are sold or exchanged.

Objective 6. Explain the nature of, purpose of, and accounting for depletion.

Natural resources are accounted for as they are consumed—a process similar to the units-of-production method of computing depreciation. The cost of the property less salvage value is divided by the number of units of output the property contains to determine the depletion expense per unit. This rate, multiplied by the number of units removed and sold, is the depletion expense for the period.

Objective 7. Explain the nature of and accounting for intangible assets.

Intangible assets include valuable legal or economic rights that a firm may acquire. Three types of intangible assets—patents, copyrights, and trademarks—are illustrated. These assets have estimated useful or economic lives that are amortized (written off) as yearly operating expenses.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|--|--------|
| LO 1 1. Assets expected to provide benefits for a number of accounting periods are called _____ assets. | _____ |
| LO 1 2. Long-term assets that are _____ have physical substance. ... | _____ |
| LO 1 3. All long-term assets, except _____, gradually wear out or are used up as time passes. | _____ |
| LO 1 4. Land, buildings, furniture, and equipment are called _____, plant assets, or fixed assets. | _____ |
| LO 1 5. The cash _____ is the amount of cash that could have been paid to satisfy a supplier on the date of purchase of an asset. | _____ |

- LO 2 6. Depreciation is a process of cost _____, not a process of valuation.
- LO 2 7. The loss of usefulness because of deterioration from age and wear is called _____ depreciation.
- LO 2 8. The loss of usefulness because of inadequacy or obsolescence is called _____ depreciation.
- LO 3 9. For plant assets, the portion of an asset’s cost recognized as an expense is called _____.
- LO 3 10. An estimate of how long an asset will be in service is called _____.
- LO 3 11. Estimated scrap, trade-in, or _____ value is what an asset is expected to be worth at the end of its useful life.
- LO 3 12. _____ is the original cost less scrap value.
- LO 3 13. Book value, or _____, represents cost less accumulated depreciation.
- LO 3 14. Under the _____ method, the depreciable cost of an asset is allocated equally over each year of useful life.
- LO 3 15. Under the _____ method, the book value is multiplied by a fixed rate; depreciation expense declines each year.
- LO 3 16. Under the _____ method, depreciation each year is determined by multiplying the depreciable base by a schedule of fractions.
- LO 3 17. Under the _____ method, depreciation is based on the extent to which the asset was used during the year.
- LO 4 18. Improvements to equipment that increase usefulness are debited to the _____ account.
- LO 4 19. Replacements to equipment that extend useful life but do not increase usefulness are debited to the _____ account.
- LO 6 20. As natural resources are removed, the expense is called _____.
- LO 6 21. Natural resources, often called _____ assets, are consumed in the operation of the business.
- LO 7 22. A(n) _____ is a grant by the federal government to an inventor giving the exclusive right to produce, use, and sell an invention.
- LO 7 23. A(n) _____ is the exclusive right to reproduction and sale of a literary, artistic, or musical composition.
- LO 7 24. A(n) _____ is a registered name that protects the owner by preventing others from using it.

EXERCISES

Exercise 1 (LO 1) COST OF PROPERTY, PLANT, AND EQUIPMENT

Joe Schultz, Inc., purchased six acres of land for \$30,000. Mr. Schultz is uncertain about what other expenditures in relation to this purchase he should include in the cost of land. From the following list, choose what expenditures Mr. Schultz should include and total them.

| | |
|---|----------|
| Purchase price..... | \$30,000 |
| Legal fees related to purchase | 1,000 |
| Removal of old warehouse | 8,000 |
| Planting shrubs along road | 1,500 |
| Interest on loan to purchase property | 3,000 |
| Realtor fee | 1,200 |

Exercise 2 (LO 3) STRAIGHT-LINE DEPRECIATION

Assume an asset purchased January 1, 20--, costs \$5,000, has an expected life of five years, and has an expected salvage value of \$500. Using the straight-line method, compute depreciation for each year.

Exercise 3 (LO 3) DOUBLE-DECLINING-BALANCE DEPRECIATION

Assume an asset cost \$11,000 and was purchased on January 1, 20--. The asset is assumed to have a useful life of five years and a salvage value of \$1,000. Using the double-declining-balance method, compute depreciation expense for each year.

Exercise 4 (LO 3) SUM-OF-THE-YEARS'-DIGITS DEPRECIATION

Assume an asset costing \$7,900 was purchased on September 17, 20-1. The asset is assumed to have a useful life of five years and a salvage value of \$400. Using the sum-of-the-years'-digits method, compute depreciation expense for each year, 20-1 to 20-6. Remember, assets acquired after the fifteenth are not depreciated until the next month.

Exercise 5 (LO 3) UNITS-OF-PRODUCTION DEPRECIATION

Assume an asset costing \$9,000 was purchased January 1, 20--. The asset is assumed to produce 34,000 units and have a salvage value of \$500. The first year, 12,000 units were produced; the second year, 8,000 units; the third year, 14,000 units. Using the units-of-production method, compute depreciation expense for each year.

Exercise 6 (LO 4) JOURNAL ENTRIES: REPAIRS, MAINTENANCE, ADDITIONS, IMPROVEMENTS, AND REPLACEMENTS

Enter the following transactions for the Ramirez Brothers' Garage in a general journal:

1. Changed oil in reservoir on Hydraulic Lift #1 (normal maintenance) for \$50, cash.
2. Replaced compressor on Hydraulic Lift #2 for \$600, cash. This will extend the lift's life.
3. Added another master cylinder to Hydraulic Lift #2 so large trucks could be repaired for \$1,000, cash.

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Exercise 7 (LO 6) DEPLETION

Assume a nickel mine is acquired at a cost of \$400,000,000. No salvage value is expected. The estimated amount of nickel to be recovered is 16,000 tons. The first year, 800 tons of nickel are mined; the second year, 1,200 tons; the third year, 750 tons. Compute the depletion expense for each year.

PROBLEMS**Problem 8 (LO 3) STRAIGHT-LINE, SUM-OF-THE-YEARS'-DIGITS, DOUBLE-DECLINING-BALANCE, AND MACRS METHODS**

Blockmaster Building Supplies purchased a truck on January 1, 20--, at a cost of \$18,000. The estimated life of the truck is five years, and it is expected to have a salvage value of \$3,000.

Required:

1. Compute depreciation expense and book value for each year using the following methods:
 - (a) Straight-line
 - (b) Sum-of-the-years'-digits
 - (c) Double-declining-balance
2. Compute MACRS depreciation for each year of the asset's life. Assume the truck is a 5-year class of property.

1. (a)

| Year | Depreciation Expense | Book Value |
|------|----------------------|------------|
| 1 | | |
| 2 | | |
| 3 | | |
| 4 | | |
| 5 | | |

1. (b)

| Year | Depreciation Expense | Book Value |
|------|----------------------|------------|
| 1 | | |
| 2 | | |
| 3 | | |
| 4 | | |
| 5 | | |

1. (c)

| Year | Depreciation Expense | Book Value |
|------|----------------------|------------|
| 1 | | |
| 2 | | |
| 3 | | |
| 4 | | |
| 5 | | |

Problem 8 (LO 3) (Concluded)

2.

| Year | Depreciation Expense |
|------|----------------------|
| 1 | |
| 2 | |
| 3 | |
| 4 | |
| 5 | |
| 6 | |

Problem 9 (LO3/4) DEPRECIATION, IMPROVEMENTS, AND REPLACEMENTS

On January 1, 20-1, two sonar systems were purchased by Sea Treasures, Inc., for \$4,000 each with a salvage value of \$400 and estimated lives of six years. On January 1, 20-2, a computer chip was replaced on Sonar System #1 for \$200 cash. The computer chip will extend the life of System #1 by three years. The transducer in Sonar System #2 was upgraded for \$1,000 cash with a more sensitive one to improve the possibility of finding a treasure.

Required:

- Using the straight-line method, journalize the entries for depreciation on December 31, 20-1, for Sonar Systems #1 and #2 in a general journal.

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Problem 9 (Concluded)

2. Enter the transactions for January 20-2 in a general journal.

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3. Assuming no other improvements or replacements, compute depreciation expense for each sonar system for 20-2 through 20-6.

Problem 10 (LO 5) DISPOSITION OF ASSETS

The following assets are disposed of by XYZ Construction Company:

- Jan. 5 Backhoe that cost \$85,000 and had accumulated depreciation of \$85,000 was discarded.
- 28 Truck that cost \$28,000 and had accumulated depreciation of \$27,200 was sold for \$1,000.
- Feb. 10 Handtruck that cost \$2,500 and had accumulated depreciation of \$2,200 was sold for \$150.

The following assets are exchanged or traded in by XYZ Construction Company:

- Mar. 11 A forklift that had a cost of \$50,000 and accumulated depreciation of \$45,000 was traded in for a new forklift with a fair market value of \$60,000. The old forklift and \$55,000 in cash were given for the new forklift.
- May 16 A caterpillar that had a cost of \$105,000 and accumulated depreciation of \$90,000 was traded in for a new caterpillar with a fair market value of \$120,000. The old caterpillar and \$110,000 in cash were given for the new caterpillar.
- June 10 A dump truck that had a cost of \$80,000 and accumulated depreciation of \$78,000 was traded in for a new dump truck with a fair market value of \$90,000. The old truck and \$87,000 cash were given for the new truck.

Required:

Prepare journal entries, using a general journal.

Problem 10 (Concluded)

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Problem 11 (LO 6) ACCOUNTING FOR DEPLETION

Kramer Diamond Mining Company purchased land and mining rights for \$105 million. The residual value of the land is expected to be \$5 million. The mine is expected to produce 10 million karats and will be depleted based on the number of karats mined each period.

Required:

- 1. Compute depletion expense for the following years:
 - 20-1 4.0 million karats mined and sold
 - 20-2 3.5 million karats mined and sold
 - 20-3 2.0 million karats mined and sold

- 2. Prepare the entries to record the depletion, using a general journal.

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Problem 12 (LO 7) INTANGIBLE LONG-TERM ASSETS

Product Innovation and Development Company purchased the following intangible assets:

- Jan. 4 Patent with an estimated useful life of eight years at a cost of \$12,000 (Patent #1).
- Mar. 18 Patent with an estimated useful life of five years at a cost of \$15,000 (Patent #2).
- May 11 Copyright for \$22,000 with a legal life on the copyright of 14 years, but an estimated economic life of eight years (round to two decimal places).
- Sept. 1 Trademark for \$100,000 with an estimated economic life of 25 years. However, to be conservative, it will be written off in five years (round to two decimal places).

Required:

Record this year's amortization expense, using a general journal. Assume straight-line amortization.

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CHAPTER 19

ACCOUNTING FOR PARTNERSHIPS

LEARNING OBJECTIVES

Chapter 19 introduces you to the important features and accounting procedures of the partnership form of business. You will learn how to account for the formation, dissolution, and liquidation of a partnership. In addition, you will learn how partners are compensated and how to report partner compensation and the allocation of net income.

Objective 1. Describe the various types of partnerships, their characteristics, the partnership agreement, and the advantages and disadvantages of a partnership.

A **partnership** is composed of two or more individuals engaged in business as co-owners. The partnership form of business includes the following types:

General Partnership—A partnership made up of general partners who actively participated in the management of the business and are personally liable for all debts of the partnership.

Limited Partnership (LP)—A partnership with at least one general partner with responsibilities of managing the firm and who is subject to unlimited liability. Limited partners simply invest funds and do not participate in management decisions. Their liability is limited to the amount invested.

Limited Liability Partnership (LLP)—A partnership in which all partners may actively participate in the management of the firm, but whose personal liability is limited to their own actions and the actions of those they supervise.

The characteristics of partnerships include:

1. Co-ownership of assets
2. Mutual agency
3. Limited life
4. Unlimited liability
5. No federal income tax

A partnership agreement includes the following:

1. Date of agreement
2. Names of the partners
3. Kind of business to be conducted
4. Length of time the partnership is to run
5. Name and location of the business
6. Investment of each partner
7. Basis on which profits or losses are to be shared by the partners
8. Limitation of partners' rights and activities
9. Salary allowances to partners
10. Division of assets upon dissolution of the partnership
11. Signatures of the partners

Advantages:

- Combined experience of partners
- Increased ability to raise capital
- Improved credit standing

(continued)

Disadvantages:

- Unlimited liability of general partners
- Mutual agency
- Difficulty transferring the interests of partners to others
- Various events can cause the partnership to be dissolved

Objective 2. Prepare entries for the initial investments in a partnership.

A partnership may be formed by the investment of cash and/or other assets by the partners. The fair market value of each partner's assets is used when accounting for the formation of the partnership. When partnerships are formed from existing businesses, their respective balance sheets serve as the basis for the opening entries for the investments of such partners.

Objective 3. Explain how partners are compensated and account for the allocation of net income.

The basis on which profits and losses are shared is a matter of agreement among the partners. In the absence of any agreement among the partners, profits and losses must be shared equally. Each partner has his or her own drawing account and capital account. After revenues and expenses have been closed to the income summary account at the end of the accounting period, Income Summary is closed by allocating each partner's share of net income or loss to his or her individual capital account. This allocation of net income may be based on a salary allowance provided to each partner, and/or interest allowance on beginning capital investments, and/or by a predetermined ratio, or by any other prearranged agreement among the partners.

Objective 4. Prepare financial statements reporting the allocation of net income and partnership equity.

The allocation of net income and its impact on the partners' capital balances should be disclosed in the financial statements. All three financial statements are affected: the income statement, statement of partners' equity, and the balance sheet.

Objective 5. Describe the actions that result in the dissolution of a partnership and account for the dissolution.

Dissolution of a partnership may be brought about through the addition of a new partner, the death or withdrawal of one of the partners, or bankruptcy. Dissolution of the partnership does not always mean that business operations will cease. A dissolution may mean that the old partnership agreement is invalid, and a new partnership agreement must be created because of one or more of the above mentioned reasons.

By agreement, a partner may retire and be permitted to withdraw assets equal to, less than, or greater than the amount of the retiring partner's capital interest in the partnership. If a retiring partner agrees to withdraw less than or more than the amount accumulated in his or her capital account, the effect of the transaction will either increase or decrease the capital accounts of the remaining partners.

Objective 6. Describe how a partnership is liquidated and prepare associated entries and a statement of partnership liquidation.

Liquidation of a partnership generally means that the assets are sold, gains and losses are allocated to partners, liabilities are paid, and the remaining cash or other assets are distributed to the partners. If there is a gain or loss on the sale of the noncash assets, this gain or loss is allocated to the partners' capital accounts based on their profit-and-loss sharing ratio. Once all liabilities are paid, the remaining cash is distributed to the partners according to their ownership interests as indicated by the balances of their capital accounts.

A statement of partnership liquidation summarizes the above transactions, indicating the capital balances of each partner after each step in the liquidation process.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|--|--------|
| LO 1 1. When two or more individuals engage in an enterprise as co-owners, the organization is known as a(n) _____ | _____ |
| LO 1 2. A written agreement containing the various provisions under which a partnership is to operate is known as a(n) _____ . .. | _____ |
| LO 1 3. The characteristic of a partnership in which any partner can bind the other partners to a contract if he or she is acting within the general scope of the business is called _____ | _____ |
| LO 1 4. The characteristic of a partnership in which each general partner is personally liable for all debts incurred by the partnership is called _____ | _____ |
| LO 1 5. One of the disadvantages of the partnership form of organization is that with the death of one of the partners, the partnership _____ | _____ |
| LO 2 6. In opening the books of a partnership, a separate _____ is made for the investment of each partner. | _____ |
| LO 2 7. Each partner's capital account should be credited for the difference between the _____ invested and _____ assumed. | _____ |
| LO 2 8. When two or more sole proprietors form a partnership, their respective _____ serve as the basis for the opening entries for the investments of such partners. | _____ |
| LO 2 9. When two sole proprietors decide to combine their businesses, assets should be recorded at their _____ as of the date of formation of the partnership. | _____ |
| LO 3 10. The basis on which profits and losses are shared is a matter of agreement among the partners and not necessarily the same as their _____ | _____ |
| LO 3 11. In accounting for the operations of a partnership, it is necessary to keep a separate _____ and _____ for each partner. ... | _____ |
| LO 3 12. In the absence of any agreement among the partners, profits and losses must be shared _____, regardless of the ratio of the partners' investments. | _____ |

- LO 3 13. Assume two partners, Beck and Call, had agreed to share profits according to a 60-40 basis, but they had no agreement on sharing losses. If there were a loss of \$12,000, Call's share of the loss would be _____.
- LO 3 14. The allocation of net income and its impact on the partners' capital balances should be disclosed in the _____.
- LO 3 15. The allocation of net income is often reported in the lower portion of the _____.
- LO 4 16. The _____ section of the balance sheet should also report the equity of each partner.
- LO 5 17. _____ of a partnership may occur because of the addition of a new partner, the death or withdrawal of one of the partners, or bankruptcy.
- LO 5 18. Dissolution of the partnership does not necessarily imply that _____ will halt.
- LO 5 19. Because partnerships are dissolved under certain conditions, they are said to have _____.
- LO 5 20. By agreement, a partner may retire and be permitted to withdraw assets _____, _____, or _____ than the amount of the retiring partner's interest in the partnership.
- LO 5 21. The book value of a partner's interest is shown by the _____ of the partner's capital account.
- LO 5 22. If a retiring partner agrees to withdraw less than the amount accumulated in his or her capital account, the effect of the transaction will _____ the capital accounts of the remaining partners.
- LO 6 23. _____ of a partnership generally means that the assets are sold, liabilities are paid, and the remaining cash or other assets are distributed to the partners.
- LO 6 24. A statement of _____ summarizes the transactions involved in liquidating a partnership.

EXERCISES

Exercise 1 (LO 2) PARTNERSHIP OPENING ENTRIES

On June 1, 20--, Mary Campbell and Barb Stanley agreed to form a partnership to market firewood. They agreed to invest \$20,000 and \$25,000, respectively. Prepare the opening entries for the cash investments.

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Exercise 2 (LO 2) PARTNERSHIP OPENING ENTRIES

Jim Hassel and Mark Back currently own and operate independent shoe stores on opposite sides of town. On January 1, 20-2, they decided to form a partnership, Hassel & Back Shoes, by combining their businesses. Post-closing trial balances for each firm on December 31, 20-1, are provided below.

Hassel Shoes
Post-Closing Trial Balance
December 31, 20-1

| | | |
|---|-----------------|-----------------|
| Cash..... | \$ 3,300 | |
| Merchandise Inventory | 38,000 | |
| Store Equipment..... | 28,000 | |
| Accumulated Depreciation—Store Equipment..... | | \$ 8,000 |
| Notes Payable..... | | 20,000 |
| Accounts Payable..... | | 15,000 |
| Jim Hassel, Capital..... | | <u>26,300</u> |
| | <u>\$69,300</u> | <u>\$69,300</u> |

Exercise 2 (Concluded)

Back Shoes
Post-Closing Trial Balance
December 31, 20-1

| | | | |
|----------------------------|-----------------|-----------------|--|
| Cash..... | \$12,100 | | |
| Merchandise Inventory..... | 24,000 | | |
| Notes Payable..... | | \$ 5,000 | |
| Accounts Payable..... | | 8,000 | |
| Mark Back, Capital..... | | <u>23,100</u> | |
| | <u>\$36,100</u> | <u>\$36,100</u> | |

Hassel and Back agree that since both have been using the FIFO method of valuing inventory, these amounts approximate fair market values. The fair market value of the store equipment is \$25,000.

Prepare the opening entries for the investments of Hassel and Back.

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Exercise 3 (LO 4) PARTIAL FINANCIAL STATEMENT

Fisher and Worth have been partners in the book business for several years and have shared profits on a 60-40 basis. Capital balances on January 1 were \$85,000 and \$64,000, respectively. No additional investments were made during the year, and withdrawals were \$35,000 and \$28,000, respectively. Net income for the year was \$78,000. Prepare the statement of partners' equity and the partners' equity section of the balance sheet for the partnership as of December 31, 20--.

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Exercise 4 (LO 5) ADMITTING NEW PARTNERS

Chuck Green and Mary Yellow have been operating a successful paint store for several years. On July 30, 20--4, Susan Blue was admitted as a new partner for a cash investment of \$60,000. Blue was given a capital interest equal to her cash investment. Prepare the journal entry to admit Blue to the partnership.

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Exercise 5 (LO 5) ADMITTING A NEW PARTNER

Bill Dodd and Nancy Kirk are partners in a construction business. On May 16, 20-3, they admitted Linda Philipich as a new partner. Linda has operated her own construction business for several years and has the following assets and liabilities that will be contributed to the new partnership:

Philipich Construction
Post-Closing Trial Balance
May 16, 20-3

| | | |
|---|-----------------|-----------------|
| Cash..... | \$ 8,300 | |
| Accounts Receivable | 12,000 | |
| Allowance for Bad Debts | | \$ 2,000 |
| Construction Equipment..... | 48,000 | |
| Accum. Depreciation—Construction Equip..... | | 18,000 |
| Notes Payable | | 15,000 |
| Accounts Payable | | 5,000 |
| Linda Philipich, Capital..... | | <u>28,300</u> |
| | <u>\$68,300</u> | <u>\$68,300</u> |

Philipich has no knowledge of specific uncollectible accounts receivable, and the construction equipment is valued at \$35,000. Prepare the journal entry to admit Philipich as a new partner.

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Exercise 6 (LO 5) WITHDRAWAL OF A PARTNER

Write, Beck, and Campbell have operated the Quick Stop Food Mart as a partnership for many years. The partners have agreed that on December 31, 20-6, Campbell will retire from the business and withdraw cash equivalent to the balance in his capital account. Capital balances for each partner are listed below.

| | |
|------------------------------|----------|
| J. B. Write, Capital | \$84,200 |
| L. L. Beck, Capital | 92,800 |
| R. W. Campbell, Capital..... | 78,000 |

Prepare the journal entry for the withdrawal of Campbell.

Exercise 6 (LO 5) (Concluded)

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Exercise 7 (LO 6) PARTNERSHIP LIQUIDATION

On liquidation of the partnership of L. Ling and S. Salk, as of October 1, 20--, inventory with a book value of \$92,000 is sold for \$101,000. Considering that Ling and Salk share profits and losses equally, prepare the entries for the sale and the allocation of gain.

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PROBLEMS

Problem 8 (LO 2) PARTNERSHIP OPENING ENTRIES

Fred Dusk and Nancy Dawn have been sole proprietors of separate drive-in theaters for several years. On January 1, 20-4, they form a partnership called Dusk to Dawn Drive-In Theaters. The following balance sheets provided for each business serve as the basis for the partnership:

Fred Dusk
Balance Sheet
December 31, 20-3

| Assets | | |
|--|--------------|------------------------|
| Cash | | \$ 3,200 |
| Accounts receivable..... | \$ 2,524 | |
| Less allowance for bad debts..... | <u>430</u> | 2,094 |
| Merchandise inventory | | 4,800 |
| Projection equipment..... | \$ 9,900 | |
| Less accumulated depreciation..... | <u>1,000</u> | 8,900 |
| Snack bar and facilities..... | \$25,000 | |
| Less accumulated depreciation..... | <u>5,500</u> | <u>19,500</u> |
| Total assets | | <u><u>\$38,494</u></u> |
| Liabilities | | |
| Notes payable | \$13,500 | |
| Accounts payable..... | <u>5,480</u> | |
| Total liabilities..... | | \$18,980 |
| Owner's Equity | | |
| Fred Dusk, capital..... | | <u>19,514</u> |
| Total liabilities and owner's equity | | <u><u>\$38,494</u></u> |

Nancy Dawn
Balance Sheet
December 31, 20-3

| Assets | | |
|--|---------------|------------------------|
| Cash | | \$ 1,533 |
| Accounts receivable..... | \$ 2,160 | |
| Less allowance for bad debts..... | <u>320</u> | 1,840 |
| Merchandise inventory | | 11,400 |
| Supplies | | 356 |
| Office equipment..... | \$ 6,220 | |
| Less accumulated depreciation..... | <u>1,100</u> | 5,120 |
| Projection equipment..... | \$14,800 | |
| Less accumulated depreciation..... | <u>2,200</u> | 12,600 |
| Snack bar and facilities..... | \$52,500 | |
| Less accumulated depreciation..... | <u>6,000</u> | <u>46,500</u> |
| Total assets | | <u><u>\$79,349</u></u> |
| Liabilities | | |
| Notes payable | \$26,000 | |
| Accounts payable..... | <u>16,300</u> | |
| Total liabilities..... | | \$42,300 |
| Owner's Equity | | |
| Nancy Dawn, capital | | <u>37,049</u> |
| Total liabilities and owner's equity | | <u><u>\$79,349</u></u> |

Problem 8 (Concluded)

Dusk and Dawn agree that the information provided on the balance sheets represents market values, except for the assets listed below for which appraisals of current market values were obtained. Neither Dusk nor Dawn has any knowledge of uncollectible accounts.

Appraised Market Values

| | <u>Dusk</u> | <u>Dawn</u> |
|--------------------------------|-------------|-------------|
| Office equipment..... | | \$ 4,800 |
| Projection equipment | \$ 7,500 | 11,200 |
| Snack bar and facilities | 18,500 | 48,000 |

Required:

Prepare opening entries for the investments of Dusk and Dawn.

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Problem 9 (LO 3/4) ALLOCATION OF NET INCOME, PREPARATION OF FINANCIAL STATEMENTS AND CLOSING ENTRIES

Refer to Problem 8. The partnership agreement between Dusk and Dawn calls for yearly salary allowances for Dusk and Dawn of \$35,000 and \$45,000, respectively.

Further, each partner is to receive 12% interest on his/her capital balances as of January 1. The remaining income or loss is allocated 40% to Dusk and 60% to Dawn. During 20-4, net income amounted to \$176,500; Dusk made an additional investment of \$10,000 on July 6; and each partner withdrew an amount equal to his/her annual salary.

Required:

1. Prepare the lower portion of the income statement for Dusk to Dawn Drive-In Theaters reporting the allocation of net income (round to nearest dollar).
2. Prepare a statement of partners' equity for the year ended December 31, 20-4.
3. Prepare the partners' equity section of the balance sheet.
4. Prepare entries to close Income Summary and each partner's drawing account.

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Problem 9 (Concluded)

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Problem 10 (LO 5) ADMITTING A NEW PARTNER

Kelmski and Saliman are partners in the K & S Music Store. Bob Murry who has owned and operated Murry’s Music Store for many years will join the partnership of Kelmski and Saliman. The balance sheet for Murry’s as of May 31, 20-1, is provided below.

Murry’s Music Store
Balance Sheet
May 31, 20-1

| Assets | | |
|--|---------------|------------------|
| Cash | | \$ 3,200 |
| Accounts receivable..... | \$22,524 | |
| Less allowance for bad debts..... | <u>1,200</u> | 21,324 |
| Merchandise inventory | | 84,800 |
| Office equipment..... | \$ 8,500 | |
| Less accumulated depreciation..... | <u>1,000</u> | <u>7,500</u> |
| Total assets | | <u>\$116,824</u> |
| Liabilities | | |
| Notes payable | \$12,200 | |
| Accounts payable..... | <u>25,480</u> | |
| Total liabilities..... | | \$ 37,680 |
| Owner’s Equity | | |
| Bob Murry, capital..... | | <u>79,144</u> |
| Total liabilities and owner’s equity | | <u>\$116,824</u> |

The values reported on the balance sheet are reasonable approximations for market, except for the office equipment that is valued at \$5,000. Murry has no knowledge of any uncollectible accounts receivable.

Required:

Prepare the journal entry for the admittance of Murry as a new partner on June 1, 20-1.

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Problem 11 (LO 5) WITHDRAWAL OF A PARTNER

Casler, Courtney, and Snavely have been partners in a recycling business for several years. On May 1, 20-5, Courtney withdrew from the partnership with the agreement that the partnership would pay \$26,000 cash for his share of the business. According to the partnership agreement, any difference between the amount paid to a withdrawing partner and the book value of the partner’s capital account is allocated to the remaining partners according to the ratio of their capital interests. The capital balances for the partners on May 1, 20-5, after allocating net income and closing their drawing accounts, are as follows:

| | |
|------------------------------|----------|
| S. S. Casler, Capital | \$45,000 |
| J. D. Courtney, Capital..... | 30,000 |
| E. R. Snavely, Capital | 15,000 |

Required:

1. Prepare the journal entry for the withdrawal of Courtney.

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2. Instead of the foregoing, assume the partnership paid \$38,000 for Courtney’s share of the business. Prepare the journal entry for the withdrawal of Courtney.

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Problem 11 (Concluded)

3. Instead of the foregoing, assume Snavelly paid Courtney \$40,000 for his share of the business. Prepare the journal entry required in the partnership’s books for the withdrawal of Courtney.

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Problem 12 (LO 6) STATEMENT OF PARTNERSHIP LIQUIDATION

After many years of operations, the partnership of Thay, Walter, and Carpenter is to be liquidated. The June 30, 20--, post-closing trial balance for the partnership is provided below.

Thay, Walter, and Carpenter
Post-Closing Trial Balance
June 30, 20--

| <u>Account Title</u> | <u>Account Balance</u> | |
|--------------------------------|------------------------|------------------|
| | <u>Debit</u> | <u>Credit</u> |
| Cash..... | \$ 18,300 | |
| Inventory | 28,000 | |
| Other Assets | 75,000 | |
| Liabilities..... | | \$ 13,000 |
| G. B. Thay, Capital..... | | 35,200 |
| E. F. Walter, Capital..... | | 39,900 |
| Q. E. Carpenter, Capital | | <u>33,200</u> |
| | <u>\$121,300</u> | <u>\$121,300</u> |

Profits and losses are shared equally.

Required:

1. Prepare a statement of partnership liquidation for the period July 1–7, 20--.
 - a. The sale of noncash assets on July 1 for \$94,000.
 - b. The allocation of any gain or loss to the partners on July 1.
 - c. The payment of liabilities on July 3.
 - d. The distribution of cash to the partners on July 7.
2. Journalize these four transactions in a general journal.

Problem 12 (Continued)

1.

Thay, Walter, and Carpenter
Statement of Partnership Liquidation
For period July 1-7, 20--

| | Cash | Inventory | Other Assets | Liabilities | Capital | | |
|---|------|-----------|--------------|-------------|---------|--------|-----------|
| | | | | | Thay | Walter | Carpenter |
| Balance before sale of assets | | | | | | | |
| Sale of noncash assets and alloc. of loss | | | | | | | |
| Balance after sale | | | | | | | |
| Payment of liabilities | | | | | | | |
| Balance after payment of liabilities | | | | | | | |
| Distribution of cash to partners | | | | | | | |
| Final balances | | | | | | | |

Problem 12 (Concluded)

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CHAPTER 20

CORPORATIONS: ORGANIZATIONS AND CAPITAL STOCK

LEARNING OBJECTIVES

Chapter 20 describes the corporation—its organization and characteristics, types of capital stock, capital stock transactions, and the stockholders' equity section of the balance sheet.

Objective 1. Describe the characteristics, formation, and organization of a corporation.

A **corporation** is a legal entity that exists separate from its owners. It is taxed on its income and is subject to government regulations that do not apply to partnerships and proprietorships. Yet the corporation offers many significant advantages—limited liability of its owners, transferability of ownership interests (shares of stock), ease of raising capital (selling stock), limited powers of owners, and unlimited life (the corporation goes on even when owners die or leave the business).

When a corporation is formed, a charter, or articles of incorporation, is prepared. Stockholders are owners of shares of stock in the corporation; stockholders elect a board of directors that determines policy and hires officers. Organization costs (attorneys' fees, incorporation fees, promotion expenses) are expensed when incurred.

Objective 2. Describe stockholders' equity and the types of capital stock, and compute dividends on preferred and common stock.

In a corporation, owners' equity is called stockholders' equity. **Paid-in capital** is the amount stockholders pay for shares of stock; **retained earnings** is accumulated earnings that have not been paid out to stockholders in the form of dividends.

Capital stock may be *par value*, *no-par*, or *stated value* stock. It may also be *common stock* or *preferred stock* that has certain preferences or superior rights. For example, the owners of preferred stock usually have the right to receive dividends of a certain amount before the owners of common stock can receive any. In addition, cumulative preferred stock has a carryover right for dividends unpaid in a given year. This means that dividends for the unpaid year are distributed to preferred stockholders before common stockholders receive dividends.

Objective 3. Account for capital stock transactions.

Stock may be issued at *par*, *above par* (at a premium), or *below par* (at a discount). *No-par stock* does not carry a specified value, and no premium or discount is involved. Stock with a stated value is treated the same as stock with par value.

Stock may be issued for either cash or noncash assets. Noncash assets are recorded at the fair market value of the assets or of the stock, whichever can be more clearly determined.

Capital stock subscriptions are agreements whereby a subscriber agrees to purchase shares of stock at a specified price. A receivable is created; and when the shares are paid for in full, stock is issued. If there is a difference between the amount receivable and the par or stated value of the stock, the difference is credited to Paid-In Capital in Excess of Par or debited to Discount on Common (or Preferred) Stock.

Treasury stock is stock reacquired by the corporation. Treasury stock may be resold, but no gain or loss is recognized. Any difference between the price for reacquiring and reselling is debited or credited to Paid-In Capital from Sale of Treasury Stock.

Objective 4. Prepare the stockholders' equity section of a corporation balance sheet.

The stockholders' equity section of a corporate balance sheet is quite different from a proprietorship or partnership. Common and preferred stocks issued are listed, together with subscriptions, paid-in capital in excess of par and from sale of treasury stock, and retained earnings. Stock subscriptions receivable and treasury stock are deducted from the total of the paid-in capital and retained earnings.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|--|--------|
| LO 1 1. Limited _____ means that owners do not have personal liability for the debts of the corporation..... | _____ |
| LO 1 2. The owners' equity in a corporation is called _____. | _____ |
| LO 1 3. Capital stock is divided into _____, which represent ownership rights in the corporation. | _____ |
| LO 1 4. _____ means that each owner has the power to act as an agent and engage in contracts for the business. | _____ |
| LO 1 5. Unlike partnerships and proprietorships, corporations must pay _____ taxes. | _____ |
| LO 1 6. Distributions of corporate income to its owners are called _____. | _____ |
| LO 1 7. A(n) _____ or articles of incorporation is a legal document that forms a corporation. | _____ |
| LO 1 8. The incorporators elect a temporary board of directors to prepare the _____, which, together with the charter, provide guidelines for the business. | _____ |
| LO 1 9. Owners of capital stock of a corporation are called _____. .. | _____ |
| LO 1 10. A permanent _____ is elected by the stockholders and sets policies and selects officers. | _____ |
| LO 1 11. Costs of organizing a corporation such as attorneys' fees are called _____. | _____ |
| LO 2 12. The amount paid by stockholders for their shares of stock is called _____. | _____ |
| LO 2 13. _____ is the corporation's accumulated earnings that have not been paid out in dividends. | _____ |
| LO 2 14. The total number of shares of stock a corporation is allowed to sell is called _____ stock. | _____ |
| LO 2 15. Capital stock that has been sold is called _____ stock. | _____ |
| LO 2 16. Stock that has been reacquired by a corporation is called _____ stock. | _____ |
| LO 2 17. Issued stock less treasury stock equals _____ stock, the shares in the hands of the stockholders. | _____ |
| LO 2 18. Shares that have a dollar amount per share printed on the certificate are called _____ stocks. | _____ |

- LO 2 19. _____ value is the amount at which stock can be sold on the open market.
- LO 2 20. Stock that has no dollar amount printed on it is called _____ stock.
- LO 2 21. Stock that is assigned a value per share by the board of directors is called _____ stock.
- LO 2 22. Stock that gives its owners the right to vote at stockholders' meetings is called _____ stock.
- LO 2 23. _____ stock has certain privileges or rights that are superior but typically has no voting rights.
- LO 2 24. Stock that has claims for dividends that accumulate from year to year is called _____ stock.
- LO 3 25. When par value stock is issued at a price above par, the amount above par is called a(n) _____.
- LO 3 26. When par value stock is issued at a price below par, the amount below par is called a(n) _____.
- LO 3 27. A capital stock _____ is an agreement to buy shares of stock at a specific price.
- LO 4 28. In the stockholders' equity section of the balance sheet, _____ stock is listed first.

EXERCISES

Exercise 1 (LO 1) ACCOUNTING FOR ORGANIZATION COSTS

Prepare a journal entry to record payment of the following organization costs incurred by Duncan Donuts:

| | |
|-------------------------|--------|
| Incorporation fees..... | \$ 900 |
| Attorneys' fees | 5,000 |
| Promotion expenses..... | 3,100 |

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Exercise 2 (LO 2) DIVIDEND ALLOCATIONS

Prepare the dividend allocation of J. L. Adams Company, which has the following stock outstanding:

| | |
|---------------------|------------------------|
| <u>Common Stock</u> | <u>Preferred Stock</u> |
| 10,000 shares | 5,000 shares |
| \$5 par value | \$8 dividend, \$50 par |

The amount available for dividends this year is \$50,000.

Exercise 3 (LO 2) DIVIDEND ALLOCATIONS

Prepare the dividend allocation for M. B. Oliver Company, which has the following stock outstanding:

| <u>Common Stock</u> | <u>Preferred Stock</u> |
|---------------------|-----------------------------|
| 25,000 shares | Cumulative: 4,000 shares |
| \$8 par value | \$25 par, \$4 dividend |
| | Noncumulative: 6,000 shares |
| | \$20 par, \$3 dividend |

The amount available for dividends this year is \$113,000. No dividends were paid last year.

Exercise 4 (LO 4) STOCKHOLDERS' EQUITY SECTION

Prepare the stockholders' equity section of the balance sheet for PrimeCorp Products as of December 31, 20--. After closing its books, stockholders' equity accounts have the following balances:

| | |
|---|----------|
| Common stock subscriptions receivable..... | \$14,000 |
| Common stock, \$4 par, 14,000 shares | 56,000 |
| Preferred stock, \$12 par, 8%, 6,000 shares..... | 72,000 |
| Common stock subscribed, \$4 par, 12,000 shares | 48,000 |
| Retained earnings..... | 33,000 |

PROBLEMS

Problem 5 (LO 3) PAR AND NO-PAR, COMMON AND PREFERRED STOCK

Required:

Based on the following information, prepare journal entries for M & M Beardsley Company. Using a general journal, label the entries (a) through (k).

- (a) Issued 10,000 shares of \$4 par common stock for \$40,000 cash.
- (b) Issued 5,000 shares of \$4 par common stock for \$19,000 cash.
- (c) Issued 4,000 shares of \$4 par common stock for \$17,200 cash.
- (d) Issued 3,000 shares of \$10 par, 8% preferred stock for \$32,000 cash.
- (e) Issued 5,500 shares of \$10 par, 8% preferred stock for \$53,500 cash.
- (f) Issued 3,300 shares of no-par common stock for \$15,000.
- (g) Issued 6,000 shares of no-par common stock with a stated value of \$5 per share for \$30,000 cash.
- (h) Issued 4,800 shares of no-par common stock with a stated value of \$5 per share for \$25,500 cash.
- (i) Issued 5,200 shares of no-par, 6% preferred stock with a stated value of \$10 per share for \$51,500.
- (j) Issued 10,000 shares of \$5 par common stock for land with a fair market value of \$50,000.
- (k) Issued 8,000 shares of \$5 par common stock for a truck with a fair market value of \$41,500.

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Problem 6 (LO 3) STOCK SUBSCRIPTIONS

Required:

Based on the following information, prepare journal entries, using a general journal. Label the entries (a) through (o).

- (a) Received subscriptions for 4,000 shares of \$8 par common stock for \$32,000. (J. K. Adams)
- (b) Received subscriptions for 5,000 shares of \$6 par common stock for \$29,000. (M. D. Heath)
- (c) Received subscriptions for 3,800 shares of \$7 par common stock for \$27,000. (R. L. Jones)
- (d) Received \$16,000 cash from J. K. Adams on the common stock subscription in (a).
- (e) Received \$15,000 cash from M. D. Heath on the common stock subscription in (b).
- (f) Received subscriptions for 5,000 shares of 8%, \$13 par preferred stock for \$66,000. (T. K. Lyman)
- (g) Received subscriptions for 4,500 shares of 7%, \$15 par preferred stock for \$67,000. (P. K. Smith)
- (h) Received \$13,500 cash from R. L. Jones on the common stock subscription in (c).
- (i) Received \$33,000 cash from T. K. Lyman on the preferred stock subscription in (f).
- (j) Received balance in full from J. K. Adams for the common stock subscription in (a) and (d). (Stock is issued.)
- (k) Received balance in full from M. D. Heath for the common stock subscription in (b) and (e). (Stock is issued.)
- (l) Received \$34,000 cash from P. K. Smith on the preferred stock subscription in (g).
- (m) Received balance in full from R. L. Jones for the common stock subscription in (c) and (h). (Stock is issued.)
- (n) Received balance in full from T. K. Lyman for the preferred stock subscription in (f) and (i). (Stock is issued.)
- (o) Received balance in full from P. K. Smith for the preferred stock subscription in (g) and (l). (Stock is issued.)

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Problem 7 (LO 1/3) ORGANIZATION COSTS, STOCK SUBSCRIPTIONS, AND TREASURY STOCK

Required:

Based on the following information, prepare general journal entries. Label the entries by date.

- Mar. 28 Incurred the following costs of incorporation:
 - Incorporation fees \$ 900
 - Attorneys' fees 6,000
 - Promotion fees 5,700
- Apr. 12 Issued 10,000 shares of \$8 par common stock for \$81,200.
- 25 Issued 3,000 shares of 7%, \$15 par preferred stock for \$44,600.
- May 1 Received subscriptions for 4,000 shares of \$8 par common stock for \$32,500.
- June 21 Received a payment of \$16,500 cash for the common stock subscription.
- July 5 Purchased 1,000 shares of its own \$8 par common stock for \$9 a share.
- 12 Issued 4,000 shares of no-par common stock with a stated value of \$7 for \$28,200.
- Aug. 21 Received the balance in full for the common stock subscription. Issued the stock.
- Sept. 28 Sold 500 shares of treasury stock for \$9.50 a share.
- Nov. 9 Issued 5,000 shares of 9%, \$15 par value preferred stock in exchange for land with a fair market value of \$75,600.
- Dec. 20 Sold 500 shares of treasury stock for \$8.75 a share.

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Problem 8 (LO 4) STOCKHOLDERS' EQUITY SECTION

After closing its books on December 31, 20--, Landry Company's stockholders' equity accounts have the following balances:

| <u>Account</u> | <u>Balance</u> | <u>Additional Information</u> |
|---|----------------|-------------------------------|
| Preferred Stock Subscriptions Receivable | \$ 15,000 | |
| Common Stock Subscriptions Receivable | 25,000 | |
| Preferred Stock, 8% | 100,000 | \$10 par, 10,000 shares |
| Common Stock | 250,000 | \$5 par, 50,000 shares |
| Preferred Stock Subscribed, 8% | 50,000 | \$10 par, 5,000 shares |
| Common Stock Subscribed | 100,000 | \$5 par, 20,000 shares |
| Paid-In Capital in Excess of Par—Preferred Stock | 18,000 | |
| Paid-In Capital from Sale of Treasury Stock | 9,000 | |
| Retained Earnings | 62,000 | |
| Common Treasury Stock | 20,000 | |

Required:

Prepare the stockholders' equity section of the balance sheet.

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CHAPTER 21

CORPORATIONS: TAXES, EARNINGS, DISTRIBUTIONS, AND THE STATEMENT OF RETAINED EARNINGS

LEARNING OBJECTIVES

Chapter 21 continues the discussion of stockholders' equity for a corporate form of business. This chapter is concerned with transactions that affect retained earnings.

Objective 1. Account for corporate income taxes.

Corporations must pay income taxes based on their earnings. Sole proprietorships and partnerships, as businesses, do not pay income taxes. Most corporations must estimate their annual income taxes and make quarterly payments. At the end of the year, an adjusting entry is typically necessary to recognize the correct amount of income taxes for the year.

Objective 2. Explain the use of the retained earnings account.

Typically, the only credit to the retained earnings account is for the net income of a period. The only debits are for a net loss, closing the dividends account, and appropriations of retained earnings.

The adjusting and closing process at the end of the period is virtually the same for corporations as for sole proprietorships and partnerships. One difference for corporations is that after all revenues and expenses are closed to Income Summary, net income is transferred into the retained earnings account with the following entry:

| | |
|-------------------------|----|
| Income Summary..... | XX |
| Retained Earnings | XX |

A net loss is transferred into the retained earnings account with the following entry:

| | |
|-------------------------|----|
| Retained Earnings | XX |
| Income Summary..... | XX |

In addition, the dividends account is closed to Retained Earnings with the following entry:

| | |
|-------------------------|----|
| Retained Earnings | XX |
| Dividends | XX |

Objective 3. Account for dividends and stock splits.

A distribution of earnings by a corporation to its stockholders is known as a **dividend**.

A dividend payable in cash is known as a cash dividend. For a corporation to issue a cash dividend, the following three conditions are necessary:

1. Unrestricted retained earnings
2. Adequate cash balance
3. Declaration of dividend

Three dates are involved in the declaration and payment of dividends.

1. Date of declaration
2. Date of record
3. Date of payment

Of the above dates, only the date of declaration and date of payment require entries in the general journal.

Declaration of a cash dividend is accounted for as follows:

| | | |
|---|----|----|
| Cash Dividends | XX | |
| Preferred or Common Dividends Payable | | XX |

Payment of a cash dividend is accounted for as follows:

| | | |
|---|----|----|
| Preferred or Common Dividends Payable | XX | |
| Cash | | XX |

A stock dividend is a proportionate distribution of shares of a corporation’s own stock to its stockholders. Stock dividends typically are stated as a percentage of common stock outstanding. For stock dividends of less than 20–25%, Retained Earnings is debited for the market value of the stock. Either the par or stated value is used to credit Stock Dividends Distributable. The excess of the market value over par or stated value is credited to Paid-In Capital. If the stock has neither par nor stated value, Stock Dividends Distributable is credited for the market value of the shares.

The journal entry for the declaration of a stock dividend is as follows:

| | | |
|--|----|----|
| Stock Dividends | XX | |
| Stock Dividends Distributable | | XX |
| Paid-In Capital in Excess of Par or Stated Value | | XX |

The journal entry for the distribution of a stock dividend is as follows:

| | | |
|-------------------------------------|----|----|
| Stock Dividends Distributable | XX | |
| Common Stock | | XX |

For stock dividends of more than 20–25%, Stock Dividends is debited for the par or stated value of the stock. Stock dividends do not affect the assets, liabilities, or stockholders’ equity of the corporation. Stock dividends merely transfer part of the balance of the retained earnings account to one or more paid-in capital accounts.

A **stock split** is an exchange of one share of an old issue of stock for a multiple number of shares of a new issue with a reduced par or stated value. The usual purpose of a stock split is to improve the marketability of the shares by reducing the market price per share. No formal journal entry is made for a stock split.

Objective 4. Account for appropriations of retained earnings.

A **retained earnings appropriation** is a restriction of retained earnings by the board of directors for a specific purpose. A retained earnings appropriation is used primarily to limit the availability of retained earnings for paying dividends.

The journal entry to account for an appropriation of retained earnings is as follows:

| | | |
|--|----|----|
| Retained Earnings | XX | |
| Retained Earnings Appropriated for (<i>specific purpose</i>) | | XX |

After the retained earnings appropriation has served its purpose, the appropriated amount can be returned to retained earnings. The journal entry showing this is as follows:

| | | |
|--|----|----|
| Retained Earnings Appropriated for (<i>specific purpose</i>) | XX | |
| Retained Earnings | | XX |

Objective 5. Prepare a statement of retained earnings.

A **statement of retained earnings** explains the change in the amount of retained earnings during the year. All of the information necessary to prepare the statement of retained earnings is contained in the unappropriated and appropriated retained earnings accounts in the general ledger. If there are both appropriated and unappropriated retained earnings, each is shown separately in the statement of retained earnings.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| | Question | Answer |
|------|--|-------------------------|
| LO 1 | 1. When corporate income taxes are estimated for the year, quarterly payments are made. The account title debited for each of these payments is _____. | _____ |
| LO 2 | 2. Name the two major sources of capital for every type of business. | _____ _____ |
| LO 2 | 3. Typically, the only credit to Retained Earnings is for the _____ of a period. | _____ |
| LO 2 | 4. Typically, the only debits to Retained Earnings are for _____, _____, and _____. | _____ _____ _____ |
| LO 2 | 5. A credit balance in the income summary account represents _____ for the period. | _____ |
| LO 2 | 6. If there is a net loss for the accounting period, the closing of the net loss involves a debit to _____ and a credit to _____. | _____ _____ |
| LO 3 | 7. A distribution of earnings by a corporation to its stockholders is known as a(n) _____. | _____ |
| LO 3 | 8. The two types of dividends are a(n) _____ dividend and a(n) _____ dividend. | _____ _____ |
| LO 3 | 9. Name the three conditions necessary for a corporation to issue a cash dividend. | _____ _____ _____ |
| LO 3 | 10. The date on which the board of directors decides or declares that a dividend is to be paid is called the _____. | _____ |
| LO 3 | 11. The date on which the names of stockholders entitled to receive the dividend are determined is called the _____. | _____ |
| LO 3 | 12. The date on which the dividend is actually paid by the corporation is called the _____. | _____ |
| LO 3 | 13. The account title debited when a cash dividend on common stock is declared is the _____ account. | _____ |
| LO 3 | 14. The account title debited when a cash dividend on common stock is paid is the _____ account. | _____ |

- LO 3 15. On the balance sheet, Dividends Payable is classified as a(n) _____.
- LO 3 16. A proportionate distribution of shares of a corporation's own stock to its stockholders is called a(n) _____.
- LO 3 17. When journalizing the declaration of a stock dividend on common stock, the account title _____ is credited for the par or stated value of the stock.
- LO 3 18. When journalizing the distribution of a stock dividend declared on common stock, the account title _____ is debited and the account title _____ is credited.
- LO 3 19. A stock dividend merely transfers part of the balance of the _____ account to one or more _____ accounts.
- LO 3 20. An exchange of one share of an old issue of stock for a multiple number of shares of a new issue with a reduced par or stated value is known as a(n) _____.
- LO 3 21. A stock split requires no formal journal entry and may be recognized simply by a(n) _____ in the general journal.
- LO 4 22. A(n) _____ is a restriction of retained earnings by the board of directors for a specific purpose.
- LO 5 23. A(n) _____ explains the change in the amount of retained earnings during the year.
- LO 5 24. All of the information necessary to prepare the statement of retained earnings is contained in the _____ and _____ retained earnings accounts in the general ledger.

EXERCISES

Exercise 1 (LO 1) CORPORATE INCOME TAX

Chamberlain Company estimates that its 20-1 income tax will be \$100,000. Based on this estimate, it will make four quarterly payments of \$25,000 each April 15, June 15, September 15, and December 15.

1. Prepare the journal entry for April 15.
2. Assume all four quarterly payments have been entered in the general journal. On December 31, Chamberlain Company's actual income tax amounts to \$107,000, and the balance is due and payable on March 15, 20-2. Prepare the journal entry to record the additional income tax owed.

Exercise 1 (Concluded)

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Exercise 2 (LO 2/4) INCOME SUMMARY, DIVIDENDS, AND RETAINED EARNINGS

Prepare appropriate general journal entries for the following events affecting the retained earnings accounts of Hylan Co. and Lolan Co. Then answer the questions that follow.

- Dec. 31 Hylan’s income summary account credit balance of \$72,100 is closed.
- 31 Hylan’s cash dividends account debit balance of \$23,000 is closed.
- 31 Lolan’s income summary account debit balance of \$38,000 is closed.
- 31 Lolan’s stock dividends account debit balance of \$15,000 is closed.
- 31 Lolan’s board of directors appropriated \$20,000 of retained earnings for bond interest.

Exercise 2 (Concluded)

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1. What did the credit balance in Hylan’s income summary account represent?
2. What did the debit balance in Hylan’s cash dividends account represent?
3. What did the debit balance in Lolan’s income summary account represent?
4. What did the debit balance in Lolan’s stock dividends account represent?

Exercise 3 (LO 3) COMMON CASH DIVIDENDS

Prepare general journal entries for the declaration and payment of a cash dividend on common stock for Davis Company.

- Sept. 3 Declared a cash dividend of \$2 per share to common shareholders of record, September 30, payable on October 5. Davis Company has 50,000 shares of \$5 par value common stock outstanding.
- Oct. 5 Paid the cash dividend.

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Exercise 4 (LO 3) PREFERRED CASH DIVIDENDS

Prepare appropriate general journal entries for each of the following transactions of Roxton Co.:

- June 1 Declared a dividend of \$2 per share on 8,000 shares of preferred stock outstanding.
- 20 Paid the dividend on preferred stock declared on June 1.

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Exercise 5 (LO 3) STOCK DIVIDENDS AND SPLITS

Prepare appropriate general journal entries and memo notations, as needed, for each of the following transactions of Rockmaney Co.:

- Feb. 3 Declared a 15% stock dividend to common shareholders. The market value of the common stock is \$14 per share. The par value is \$10. There are 80,000 shares of common stock outstanding.
- 24 Issued 12,000 shares of common stock in settlement of the stock dividend declared on February 3.
- July 1 Declared a 2-for-1 stock split.

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Exercise 6 (LO 5) STATEMENT OF RETAINED EARNINGS

Based on the following information, prepare a statement of retained earnings for Register Co. for the year ended December 31, 20-1.

- (a) The Retained Earnings balance increased from \$80,000 on January 1 to \$119,000 on December 31.
- (b) Net income for the year was \$89,000.
- (c) Cash dividends of \$50,000 were paid to common stockholders.

Exercise 6 (Concluded)

PROBLEMS**Problem 7 (LO 3/4) CASH DIVIDENDS, STOCK DIVIDENDS, AND APPROPRIATION OF RETAINED EARNINGS**

During the year ended December 31, 20-2, King Company completed the following selected transactions:

- | | | |
|------|----|---|
| Mar. | 20 | Declared a semiannual dividend of \$0.30 per share on preferred stock and \$0.15 per share on common stock to shareholders of record on April 10, payable on April 15. Currently, there are 8,000 shares of \$50 par value preferred stock and 90,000 shares of \$5 par value common stock outstanding. |
| Apr. | 15 | Paid the preferred and common cash dividends. |
| June | 16 | Last year, King's board of directors appropriated \$210,000 over a three-year period for the purchase of a treatment plant. This year's appropriation for \$70,000 was made on this date. |
| Oct. | 10 | Declared semiannual dividend of \$0.30 per share on preferred stock and \$0.15 per share on common stock to shareholders of record on November 5, payable on November 10. |
| Nov. | 10 | Paid the preferred and common cash dividends. |
| | 17 | A 10% stock dividend was declared to common shareholders of record on December 8, distributable on December 15. Market value of the common stock was estimated at \$12 per share. |
| Dec. | 15 | Issued certificates for common stock dividend. |
| | 31 | Net income for 20-2 was \$195,000. The income summary account is closed. |
| | 31 | The cash and stock dividends accounts are closed. |

Required:

Prepare journal entries for the above transactions.

Problem 7 (Concluded)

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Problem 8 (LO 5) STATEMENT OF RETAINED EARNINGS

On January 1, 20-2, Lloyd Corporation’s retained earnings accounts had the following balances:

| | |
|--|------------------|
| Appropriated for Plant Expansion | \$ 60,000 |
| Unappropriated Retained Earnings..... | <u>700,000</u> |
| | <u>\$760,000</u> |

A summary of the year’s activities is given below.

| | |
|---|-----------|
| Cash dividends declared and paid on preferred stock | \$ 30,000 |
| Cash dividends declared and paid on common stock | 100,000 |
| Additional appropriation for plant expansion..... | 60,000 |
| Net income for the year | 300,000 |

Required:

Prepare a statement of retained earnings for the year ended December 31, 20-2.

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CHAPTER 22

CORPORATIONS: BONDS

LEARNING OBJECTIVES

Chapter 22 continues the discussion of corporations and covers bonds—types of bonds, ways bonds differ from common stock, and determining sales price; bonds issued at face value; bonds issued at a premium; bonds issued at a discount; bond redemption; and bond sinking funds.

Objective 1. Describe the types of bonds, ways bonds differ from common stock, and how the sales price of bonds is determined.

Bonds are long-term obligations of the corporation. Bondholders are creditors who hold this type of corporate debt. **Mortgage bonds** are secured by property. **Unsecured bonds** are issued on the general credit of the corporation rather than on the security of specific assets. **Term bonds** all have the same maturity date; **serial bonds** are issued in a series so a portion matures each year; **convertible bonds** can be exchanged for stock; and **callable bonds** can be redeemed before maturity. **Registered bonds** have ownership recorded in corporate records (name and address of each owner), while **coupon bonds** generally do not.

Bonds differ from common stock in many ways. Bonds are owned by creditors, are liabilities with limited lives, require interest and principal payments, have deductible interest expenses, and provide a leverage opportunity.

Bonds will sell at a price based on the stated rate of interest on the bonds relative to the current market rate. If current market rates are higher than the stated rate, bonds will sell at a discount; if current market rates are lower than the stated rate, bonds will sell at a premium.

Objective 2. Account for bonds issued at face value.

Bonds issued at face value sell for the principal amount of the bonds. Cash is debited, and Bonds Payable is credited for the full amount. Semiannual interest is calculated by taking principal times rate times 1/2 year. A year-end adjustment is made for interest accrued but not yet paid (debiting Bond Interest Expense and crediting Bond Interest Payable). This entry normally is reversed at the beginning of the next year.

Objective 3. Account for bonds issued at a premium.

Bonds issued at a premium are sold for more than the principal amount of the bonds. Cash is debited for the cash received; Bonds Payable is credited for the principal amount; and Premium on Bonds Payable is credited for the amount above principal. Semiannual interest is calculated in the same manner as for bonds issued at face value but is reduced by a proportionate amount of the premium received when the bonds were issued. (This is **amortization of the premium**.) The year-end adjustment recognizes interest expense less the proportionate amount of premium. This entry is reversed at the beginning of the next year.

Objective 4. Account for bonds issued at a discount.

Bonds issued at a discount are sold for less than the principal amount of the bonds. Cash is debited for the cash received; Bonds Payable is credited for the principal amount; and Discount on Bonds Payable is debited for the amount below principal. Semiannual interest is calculated in the same manner as for bonds issued at face value but is increased by a proportionate amount of the discount. (This is **amortization of the discount**.) The year-end adjustment recognizes interest expense plus the proportionate amount of discount. This entry is reversed at the beginning of the next year.

Objective 5. Account for bond redemption and bond sinking funds.

Bonds are redeemed at face value at maturity; any premium or discount has been amortized. Therefore, Bonds Payable is debited, and Cash is credited for the face value of the bonds.

Sometimes, however, bonds are redeemed before maturity. If bonds that were sold at face value are redeemed above 100, a loss occurs. If they are redeemed below 100, a gain occurs. If bonds were originally issued at a premium, unamortized premium must be recognized at the time of redemption. If bonds were originally issued at a discount, unamortized discount must be recognized when the bonds are redeemed. To determine the gain or loss on redemption of the bonds, compare the redemption price with the carrying value of the bonds.

Bond sinking funds are accumulations of periodic cash deposits made to provide for redemption of bonds at maturity. This cash is invested and accumulates earnings. Any cash left in the sinking fund after bonds are redeemed is returned to the corporation.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|---|--------|
| LO 1 1. A(n) _____ is a written promise to pay a specific sum of money at a specific future date. | _____ |
| LO 1 2. A(n) _____ bond is backed by specific corporate assets. .. | _____ |
| LO 1 3. Bonds secured by corporate property such as real estate are called _____ bonds. | _____ |
| LO 1 4. A(n) _____ bond is backed by the general credit of the corporation; these bonds are called _____ bonds. | _____ |
| LO 1 5. The amount to be paid to the bondholder at maturity is called the _____ | _____ |
| LO 1 6. _____ bonds all have the same maturity date. | _____ |
| LO 1 7. _____ bonds are issued so a certain amount of the bonds mature each year. | _____ |
| LO 1 8. _____ bonds can be exchanged for capital stock. | _____ |
| LO 1 9. _____ bonds can be redeemed before maturity..... | _____ |
| LO 1 10. Bonds whose ownership is recorded in the corporate records are called _____ bonds. | _____ |
| LO 1 11. Bonds whose ownership generally is not recorded in corporate records are called _____, or bearer, bonds. | _____ |
| LO 1 12. The current, or _____, rate of interest is what is available on similar investment opportunities. | _____ |
| LO 1 13. When bonds are sold at a price less than face value, the difference is called a(n) _____. | _____ |
| LO 1 14. When bonds are sold at a price greater than face value, the difference is called a(n) _____. | _____ |
| LO 1 15. Earning a greater rate of return on funds you have borrowed than the rate you paid for those funds is known as _____. | _____ |

- LO 2 16.** Year-end adjustments are made for interest on bonds by debiting Bond Interest Expense and crediting _____.
- LO 2 17.** Year-end adjustments are _____ at the beginning of the next year.
- LO 3/4 18.** Bond premiums and discounts are written off, or _____, over the life of the bonds.
- LO 5 19.** When bonds are redeemed before maturity, _____ premium or discount on bonds must be recognized.
- LO 5 20.** Cash funds that are accumulated to redeem bonds at maturity are called _____.

EXERCISES

Exercise 1 (LO 2) BONDS ISSUED AT FACE VALUE

Prepare the general journal entries for the issuance of the following bonds at face value, the interest payment on the bonds, and the year-end adjustment for the bonds.

Date of issue and sale: April 1, 20-1
 Principal amount: \$400,000
 Denomination of bonds: \$1,000
 Life of bonds: 10 years
 Stated interest rate: 9%, payable semiannually on September 30 and March 31

(a) Issuance of bonds

| | | | | | | | | | | | | | | | | | | | | |
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(b) Interest payment

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(c) Year-end adjustment

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Exercise 3 (LO 4) BONDS ISSUED AT A DISCOUNT

Prepare the general journal entries for the issuance of the following bonds at a discount, the interest payment and discount amortization, and the year-end adjustment.

Date of issue and sale: April 1, 20-1
 Principal amount: \$600,000
 Sale price of bonds: 96
 Denomination of bonds: \$1,000
 Life of bonds: 20 years
 Stated interest rate: 6%, payable semiannually on September 30 and March 31

(a) Issuance of bonds

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(b) Interest payment and discount amortization

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(c) Year-end adjustment

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Exercise 4 (LO 5) BOND SINKING FUNDS AND REDEMPTION

Prepare the journal entries to record the following initial sinking fund deposit, the first year's earnings for the sinking fund, the redemption of the bonds, and the return of excess cash to the corporation.

Besel Corporation pays \$38,000 into a bond sinking fund each year for the future redemption of bonds. During the first year, the fund earns \$3,050. When the bonds mature, there is a balance in the sinking fund of \$410,500, of which \$400,000 is used to redeem the bonds, which were originally issued at face value.

(a) Initial sinking fund deposit

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(b) First year's earnings

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(c) Redemption of bonds

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(d) Return of excess cash

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PROBLEMS

Problem 5 (LO 2/5) BONDS ISSUED AT FACE VALUE WITH SINKING FUND

Required:

Based on the following information, prepare general journal entries for Williams Electric. Label the entries (a) through (j).

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| Date of issue and sale: | April 1 |
| Principal amount: | \$500,000 |
| Sale price of bonds: | 100 |
| Denomination of bonds: | \$1,000 |
| Life of bonds: | 10 years |
| Stated interest rate: | 9%, payable semiannually, April 1 and October 1 |
| Sinking fund requirement: | \$35,000 per year |
| Sinking fund earnings, year 1: | \$3,000 |

- (a) Issuance of bonds.
- (b) Deposit to sinking fund, year 1.
- (c) Earnings of sinking fund, year 1.
- (d) Interest payment on the bonds for year 1.
- (e) Year-end adjustment on the bonds for year 1.
- (f) Reversing entry for the beginning of year 2.
- (g) Interest payments on the bonds for year 2.
- (h) Year-end adjustment on the bonds for year 2.
- (i) Redemption at maturity from the sinking fund.
- (j) Return of excess cash of \$1,850 from the sinking fund to the corporation.

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Problem 6 (LO 3/5) BONDS ISSUED AT A PREMIUM, AND REDEMPTION

Required:

Based on the following information, prepare general journal entries for Mastin Mercantile. Label the entries (a) through (h).

Date of issue and sale: March 1
 Principal amount: \$600,000
 Sale price of bonds: 104
 Denomination of bonds: \$1,000
 Life of bonds: 20 years
 Stated interest rate: 6%, payable semiannually, March 1 and September 1

- (a) Issuance of bonds.
- (b) Interest payment and premium amortization on the bonds on September 1, year 1.
- (c) Year-end adjustment on the bonds for year 1.
- (d) Reversing entry for the beginning of year 2.
- (e) Interest payments and premium amortizations on the bonds on March 1 and September 1, year 2.
- (f) Year-end adjustment on the bonds for year 2.
- (g) Reversing entry for beginning of year 3.
- (h) Redemption of \$60,000 of the bonds on March 1 of year 3 at 106.

(Hint: Two full years of bond premium have been amortized to this point.)

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Problem 7 (LO 4/5) BONDS ISSUED AT A DISCOUNT, AND REDEMPTION

Required:

Based on the following information, prepare general journal entries for RPT Consulting. Label the entries (a) through (k).

Date of issue and sale: April 1
 Principal amount: \$400,000
 Sale price of bonds: 99
 Denomination of bonds: \$1,000
 Life of bonds: 10 years
 Stated interest rate: 8% payable semiannually, April 1 and October 1

- (a) Issuance of the bonds.
- (b) Interest payment and discount amortization on the bonds on October 1, year 1.
- (c) Year-end adjustment on the bonds for year 1.
- (d) Reversing entry for the beginning of year 2.
- (e) Interest payments and discount amortizations on the bonds on April 1 and October 1, year 2.
- (f) Year-end adjustment on the bonds for year 2.
- (g) Reversing entry for beginning of year 3.
- (h) Interest payments and discount amortizations on the bonds on April 1 and October 1, year 3.
- (i) Year-end adjustment on the bonds for year 3.
- (j) Reversing entry for beginning of year 4.
- (k) Redemption of \$80,000 of the bonds on April 1 of year 4 at 97.
 (*Hint:* Three full years of bond discount have been amortized at this point.)

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CHAPTER 22 APPENDIX EFFECTIVE INTEREST METHOD

APPENDIX LEARNING OBJECTIVES

In Chapter 22, you learned how to amortize premium and discount on bonds payable using the straight-line method. In this appendix, we demonstrate the **effective interest method**. The **effective interest rate** is the market rate of interest on the date the bonds are issued. This rate is used to determine the interest expense and premium or discount amortization each period.

Objective 1. Amortize premium on bonds payable using the effective interest method.

The beginning-of-period carrying value of the bonds times the effective interest rate is the **effective interest expense**. The cash interest payment minus the effective interest expense is the amount of premium to be amortized for the period.

Objective 2. Amortize discount on bonds payable using the effective interest method.

The beginning-of-period carrying value of the bonds times the effective interest rate is the effective interest expense. The effective interest expense minus the cash interest payment is the amount of discount to be amortized for the period.

APPENDIX EXERCISES AND PROBLEMS

Apx. Exercise 1 (LO 1) BOND PREMIUM AMORTIZATION—EFFECTIVE INTEREST METHOD

On May 1, Urban Developers issued \$100,000, 9%, 10-year bonds for \$106,796 when the market rate was 8%. Prepare the general journal entry for the first semiannual interest payment and bond premium amortization on November 1, using the effective interest method.

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Apx. Exercise 2 (LO 2) BOND DISCOUNT AMORTIZATION—EFFECTIVE INTEREST METHOD

On May 1, Schultz Inc. issued \$350,000, 9%, 10-year bonds for \$328,191 when the market rate was 10%. Prepare the general journal entry for the first semiannual interest payment and bond discount amortization on November 1, using the effective interest method.

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Apx. Problem 3 (LO 1) BOND PREMIUM AMORTIZATION

Summer Company sold an issue of \$600,000, 10%, 10-year bonds for \$639,025 on March 1. The interest is payable semiannually on September 1 and March 1. The market rate of interest at the time the bonds were issued was 9%. Journalize the following transactions (round all amounts to the nearest dollar).

- Sept. 1 Paid the first semiannual interest payment and amortized the bond premium, using the effective interest method.
- Dec. 31 Made the adjusting entry for bond interest accrued and amortization of the bond premium from September 1. (*Hint: Use the effective interest rate for the four-month period from September 1–December 31.*)
- Jan. 2 Reversed the adjusting entry for bond interest accrued and bond premium amortization as of December 31.
- Mar. 1 Paid the second semiannual interest payment and amortized the bond premium.

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Apx. Problem 4 (LO 2) BOND DISCOUNT AMORTIZATION

Willis Enterprises sold an issue of \$90,000, 9%, 10-year bonds for \$84,393 on April 1. The interest is payable semiannually on October 1 and April 1. The market rate of interest at the time the bonds were issued was 10%. Journalize the following transactions (round all amounts to the nearest dollar).

- Oct. 1 Paid the first semiannual interest payment and amortized the bond discount, using the effective interest method.
- Dec. 31 Made the adjusting entry for bond interest accrued and amortization of the bond discount from October 1. (*Hint: Use the effective interest rate for the three-month period from October 1–December 31.*)
- Jan. 2 Reversed the adjusting entry for bond interest accrued and bond discount amortization as of December 31.
- Apr. 1 Paid the second semiannual interest payment and amortized the bond discount.

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CHAPTER 23

STATEMENT OF CASH FLOWS

LEARNING OBJECTIVES

Understanding the sources and uses of cash is critical to the operation and evaluation of a business. In Chapter 23, you learned how to prepare and interpret a statement of cash flows. Here we review the most important concepts and provide additional questions, exercises, and problems for you to solve.

Objective 1. Explain the purpose of the statement of cash flows.

The managers of a business have two principal objectives. One is to generate profits (net income), and the other is to generate enough cash from operating activities to pay operating expenditures, make investments, and retire debt. Businesses can borrow money to buy plant and equipment. However, in the long run, the debt must be paid using cash generated from operating activities.

Under the accrual basis of accounting, revenues are recorded when earned, regardless of when the cash is received. Expenses are recorded when incurred, regardless of when cash is paid. Therefore, the income statement may not reflect the true nature of the cash flows. The **statement of cash flows** provides information on where the cash came from and how it was used.

Objective 2. Define operating, investing, and financing activities and describe transactions for each type of activity.

The statement of cash flows is divided into three major categories:

- (1) operating activities,
- (2) investing activities, and
- (3) financing activities.

The sum of the cash generated or used by each of the three activities should equal the difference between the beginning and ending balance of the cash account.

Operating activities include transactions from activities associated with selling a product or providing a service and are related to the revenues and expenses reported on the income statement. Typical transactions are those involving cash receipts from the sale of goods or services, payments for the acquisition of inventory, payments to employees and the government, payments for interest on loans, dividends and interest received on investments, and payments to suppliers and for other expenses.

Investing activities are those transactions involving the purchase and sale of long-term assets, buying and selling debt and equity securities, lending money, and collecting the principal on the related loans.

Financing activities are those transactions dealing with the exchange of cash between the firm and its owners (stockholders) and creditors. Typical transactions are those involving payment of dividends to stockholders, proceeds from issuing stocks and bonds, proceeds from borrowing money through the signing of a mortgage, repayment of the principal on loans, and payments to purchase treasury stock.

Objective 3. Describe the information needed to prepare a statement of cash flows.

To prepare the statement of cash flows, balance sheets for the beginning and end of the period, as well as an income statement and statement of retained earnings for the period, are needed. Further, any additional information on major cash transactions is useful.

Objective 4. Describe the direct and indirect methods of reporting cash flows from operating activities.

Under the **indirect method**, net income is reported first on the statement of cash flows as the primary source of cash from operating activities. However, this amount must be adjusted for transactions that affect net income *and* cash flows from operating activities, but by different amounts. As shown below, these differences are related to:

- changes in current assets and current liabilities related to operating activities,
- noncash expenses (depreciation), and
- events that impact net income, but are not associated with operating activities (gains and losses).

These adjustments are added to or subtracted from net income to compute net cash provided by or used by operating activities. Under the **direct method**, revenues and expenses reported on the income statement are adjusted to reflect the amount of cash received or paid for each item. These adjusted revenues and expenses are reported on the statement of cash flows. The sum of these cash flows is equal to net cash provided or used by operating activities. Of course, the results of the two methods are the same. Net cash provided or used by operating activities must be the same amount under both methods. A comparison of the two methods is provided below.

| Indirect Method | Direct Method | | |
|--|-------------------------|--|--|
| Net income | Sales | ± Change in Accounts Receivable | = Cash collected from customers |
| ± Adjustments for changes in current assets related to operating activities | Interest Revenue | ± Change in Interest Receivable | = Cash received for interest |
| | Other Operating Revenue | ± Change in Unearned Revenues | = Cash received for other operating revenues |
| ± Adjustments for changes in current liabilities related to operating activities | Cost of Goods Sold | ± Change in Inventory and Accounts Payable | = Cash paid to suppliers |
| ± Adjustments for noncash expenses | Wages Expense | ± Change in Wages Payable | = Cash paid to employees |
| ± Adjustments for items that impact net income, but are not related to operating activities (gains/losses) | Operating Expenses | ± Change in Accrued Liabilities and Prepaid Expenses | = Cash paid for operating expenses |
| | Interest Expense | ± Change in Interest Payable | = Cash paid for interest |
| | Tax Expense | ± Change in Taxes Payable | = Cash paid for taxes |
| = Net cash provided/used by operating activities | ← Same Results → | | = Net cash provided/used by operating activities |

Objective 5. Describe the effects of changes in current assets and current liabilities on cash from operating activities under the indirect method.

The effects of changes in current assets and current liabilities related to operating activities on cash flows from operating activities are shown below.

| Change in Current Asset or Current Liability Related to Operating Activities | Impact on Cash Flows from Operating Activities |
|--|--|
| Increase in Current Assets Decrease in Current Liabilities | ↓ |
| Decrease in Current Assets Increase in Current Liabilities | ↑ |

Objective 6. Prepare a statement of cash flows under the indirect method using T accounts and including adjustments for current assets and current liabilities related to operations.

Basic steps to prepare a statement of cash flows:

- STEP 1 Compute the change in cash.
- STEP 2 Set up T accounts with the beginning and ending balances for all noncash balance sheet accounts.
- STEP 3 Compute cash flows from operating activities by:
 - (a) Reporting net income as the primary source of cash from operating activities.
 - (b) Adjusting net income for changes in current assets and current liabilities related to operating activities.
- STEP 4 Identify cash flows from investing activities.
- STEP 5 Identify cash flows from financing activities.
- STEP 6 Prepare a statement of cash flows and verify the accuracy of the statement.

T accounts are very helpful when preparing the statement of cash flows under the indirect method because they allow us to use debits and credits to guide the preparation of the statement. Let's consider a firm with the T accounts provided below.

| Accounts Receivable | | Inventory | | Accounts Payable | | Wages Payable | | |
|---------------------|----|-----------|----|------------------|-----|---------------|----|-----|
| BB | 5 | BB | 30 | 20 | BB | 15 | BB | |
| (1) | 5 | | 10 | (2) | (3) | 12 | 3 | (4) |
| EB | 10 | EB | 20 | 8 | EB | 18 | EB | |

| Cash flows from operating activities: | | | Cash | |
|--|---------------|---|---------------------------------------|------------|
| Net income | \$ 100 | | Operating Activities | |
| | | ← | Net income | 100 |
| Increase in accounts receivable | (1) (5) | ← | | 5 (1) |
| Decrease in inventory | (2) 10 | ← | (2) 10 | |
| Decrease in accounts payable | (3) (12) | ← | | 12 (3) |
| Increase in wages payable | (4) 3 | ← | (4) 3 | |
| Net cash provided by operating activities | \$ 96 | ← | Cash from operating activities | 96 |

BB: Beginning Balance
EB: Ending Balance

As discussed earlier, the increase in Accounts Receivable and the decrease in Accounts Payable reduce cash from operating activities. This concept is reinforced through the use of debits and credits. The debits to Accounts Receivable (\$5) and Accounts Payable (\$12) are offset by credits to the cash account. Of course, these credits reduce cash.

On the other hand, the decrease in Inventory and the increase in Wages Payable increase cash from operating activities. Again, this concept is reinforced through the use of debits and credits. The credits to Inventory (\$10) and Wages Payable (\$3) are offset by debits to the cash account. As you know, debits increase cash.

Now, we can use the Cash T account to prepare the statement of cash flows. Net income is entered first in the Cash T account and listed first under cash flows from operating activities because it is the primary source of cash

from operating activities. Net income, however, must be adjusted for the changes in current assets and current liabilities. Using the Cash T account, these adjustments are simple. The debits to the Cash T account [entries (2) and (4)] increase cash and are added to net income on the statement of cash flows. The credits to the Cash T account [entries (1) and (3)] reduce cash and are subtracted from net income to compute cash from operating activities. To check the accuracy of this process, cash from operating activities (\$96) on the statement is equal to the balance of the Cash T account (\$96).

Objective 7. Prepare a statement of cash flows under the indirect method including adjustments when the company:

- a. defines cash as “cash and cash equivalents,”
- b. reports depreciation expense,
- c. reports gains or losses on transactions not related to operating activities,
- d. has noncash investing and financing activities, and
- e. provides supplemental disclosures of cash flows.

A cash equivalent is a short-term investment that is readily convertible to a *known* amount of cash. Thus, when cash is needed, the investment can be readily and easily liquidated. Examples of cash equivalents are short-term investments in government notes and money market funds. Though the statement is titled the statement of cash flows, we actually include cash equivalents in the definition of cash to explain why cash and cash equivalents increased or decreased.

Depreciation expense reduces net income, but has no effect on cash. Thus, as shown below, it must be added back to net income to compute cash from operating activities.

| Dennis Enterprises Statement of Cash Flows For Year Ended December 31, 20-2 | |
|--|-------------|
| Cash flows from operating activities: | |
| Net income | \$ 100 |
| Depreciation expense | 5 |
| Loss on sale of equipment | 10 |
| Gain on sale of building | <u>(20)</u> |
| Net cash provided by operating activities | \$ 95 |
| Cash flows from investing activities: | |
| Sold equipment | \$ 50 |
| Sold building | <u>100</u> |
| Total cash provided by investing activities | 150 |
| Cash flows from financing activities: | |
| Retired bond payable | \$ (100) |
| Issued common stock | <u>50</u> |
| Net cash used for financing activities | <u>(50)</u> |
| Net increase (decrease) in cash and cash equivalents | \$195 |
| Cash and cash equivalents, January 1, 20-2 | <u>80</u> |
| Cash and cash equivalents, December 31, 20-2 | \$275 |
| Schedule of Noncash Investing and Financing Activities: | |
| Acquired building by signing a mortgage payable | \$200 |
| Supplemental Disclosures of Cash Flow Information: | |
| Cash paid during the year for: | |
| Interest | \$ 10 |
| Income taxes | 40 |

Gains and losses on the sale of property, plant, and equipment are included on the income statement and in the calculation of net income. However, these gains and losses are related to investing, not operating, activities. Net income is used as the primary source of cash from operating activities. Thus, it must be adjusted for these gains and losses. Since gains increase net income, they must be subtracted when computing cash from operating activities. Since losses reduce net income, they must be added. One such adjustment is illustrated on the previous page.

Some investing and financing activities involve no cash flows but represent a significant change in the firm’s financial position. These events are called **noncash investing and financing activities**. A schedule of these transactions is presented at the bottom of the statement of cash flows. Examples of this type of transaction include acquiring property, plant, and equipment by issuing debt and retiring debt by issuing common stock. As shown on page 376, Dennis Enterprises acquired a building by signing a mortgage payable.

Firms using the indirect method are required to disclose the amount of cash paid for interest and income taxes. This information is also reported in a separate section of the statement, “supplemental disclosures of cash flow information.” As shown on page 376, Dennis paid \$10 for interest and \$40 for income taxes.

Objective 8. Interpret the statement of cash flows.

The purpose of the statement of cash flows is to provide information on the sources and uses of cash. The most important indicator of financial health is the net cash flow from operating activities. Operating activities should be generating a good, healthy cash flow, indicating that the business can cover its operating expenses and pay all of its bills on time. A chronic inability to generate positive cash flows from operations is a sure sign of financial instability.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| | Question | Answer |
|-------------|--|---------------|
| LO 1 | 1. The managers of a business have the dual objectives of generating _____ and _____. | _____ |
| LO 1 | 2. The income statement reports on the profitability of the firm by matching revenues and expenses on a(n) _____ basis. | _____ |
| LO 1 | 3. The purpose of the statement of cash flows is to provide information on the _____ and _____ of cash. | _____ |
| LO 2 | 4. The statement of cash flows categorizes all cash flows into what three major types of activities? | _____ |
| LO 2 | 5. Transactions involving the purchase and sale of long-term assets are called _____ activities. | _____ |

- LO 2 6. Transactions involving the payments of dividends to stockholders and the proceeds from the issuance of stock and bonds are called _____ activities.

- LO 2 7. Transactions involving the payment for acquisition of inventory, payment of salary to employees, and cash receipts from sale of goods or services are called _____ activities.

- LO 2 8. The receipt of a cash dividend from an investment is classified as a(n) _____ activity.

- LO 2 9. The receipt of interest from an investment and the payment of interest on a loan are classified as _____ activities.

- LO 2/7 10. The sum of the cash generated or used by each of the three activities should equal the difference between the beginning and ending balance(s) of the _____ account(s).

- LO 3 11. The information needed to prepare a statement of cash flows includes what four items?

- LO 4 12. The two methods that are used to compute cash generated from operating activities are the _____ method and the _____ method.

- LO 5/6 13. A decrease in accrued interest receivable is (added to/deducted from) net income to determine cash generated from operating activities.

- LO 5/6 14. An increase in accrued interest payable is (added to/deducted from) net income to determine cash generated from operating activities.

- LO 5/6 15. If accounts receivable increased during the year, this amount is (added to/deducted from) net income to determine cash generated from operating activities.

- LO 5/6 16. An increase in inventory during the year should be (added to/ deducted from) net income to determine cash generated from operating activities.

- LO 5/6 17. A decrease in accounts payable during the year should be (added to/deducted from) net income to determine cash generated from operating activities.

- LO 7 18. Depreciation expense is (added to/deducted from) net income to determine cash generated from operating activities.

- LO 6 19. When using debits and credits to help prepare the statement of cash flows, debits represent what two things?

- LO 6 20. When using debits and credits to help prepare the statement of cash flows, credits represent what two things?

- LO 7 21. Supplemental disclosures of cash flows under the indirect method include what two things?

- LO 7 22. The issuance of common stock to retire a bond is classified as a _____.

- LO 7 23. A gain on the sale of a building should be _____ when preparing the statement of cash flows.

- LO 7 24. To earn a return on otherwise idle cash, many firms invest in short-term, highly liquid investments known as _____.

- LO 8 25. Probably the most important indicator of financial health is the net cash flow from _____ activities.

EXERCISES

Exercise 1 (LO 2) IDENTIFICATION OF OPERATING, INVESTING, AND FINANCING ACTIVITIES

Indicate under which heading (operating activity, investing activity, or financing activity) the following cash flows would be categorized on the statement of cash flows:

- 1. Issued \$50,000 of common stock. _____
- 2. Paid monthly salaries of \$35,624. _____
- 3. Purchased 50 shares of treasury stock. _____
- 4. Collected the \$70,000 principal of a loan made to another company. _____
- 5. Collected interest of \$5,600 on the above loan. _____
- 6. Purchased a new piece of equipment for \$46,500. _____
- 7. Purchased 500 shares of another company's common stock for \$2,500. _____
- 8. Received \$600 in dividends from the common stock. _____
- 9. Paid dividends of \$40,000 to stockholders. _____
- 10. Paid quarterly FICA tax. _____

Exercise 2 (LO 6) CHANGE IN CASH

The information provided below was taken from the December 31 comparative balance sheet of Proc Company. Based on this information, compute the change in cash that would be explained on a statement of cash flows for 20-2.

| | <u>20-2</u> | <u>20-1</u> |
|-----------------------------|------------------|------------------|
| Current assets: | | |
| Cash | \$ 87,500 | \$ 78,600 |
| Accounts receivable..... | 154,700 | 164,500 |
| Merchandise inventory | <u>226,800</u> | <u>243,600</u> |
| Total current assets | <u>\$469,000</u> | <u>\$486,700</u> |

Exercise 3 (LO 5/6) ADJUSTING NET INCOME FOR CHANGES IN CURRENT ASSETS

The information provided below was taken from the December 31 financial statements of Todd Company. Based on this information, compute cash generated from operating activities during 20-2.

| | <u>20-2</u> | <u>20-1</u> |
|-----------------------------|-------------|-------------|
| Accounts receivable | \$154,700 | \$164,500 |
| Merchandise inventory | 250,800 | 243,600 |

Net income for 20-2 was \$300,000.

Exercise 5 (LO 7) ADJUSTING NET INCOME FOR NONCASH EXPENSES

After adjusting net income for changes in current assets and current liabilities, Vozniak Pharmacy’s cash from operating activities is \$225,000. However, Vozniak reports \$20,000 in depreciation expense and \$35,000 for patent amortization for the year. Compute cash from operating activities after considering the impact of noncash expenses.

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Exercise 6 (LO 6) CASH FLOWS FROM INVESTING AND FINANCING ACTIVITIES

The information provided below was taken from the December 31 financial statements of Henninger Company. Based on this information, compute the cash flow from investing and financing activities during 20-2.

| | <u>20-2</u> | <u>20-1</u> |
|---------------------------------|-------------|-------------|
| Property, plant, and equipment: | | |
| Land..... | \$ 30,000 | \$ 20,000 |
| Long-term liabilities: | | |
| Notes payable | 200,000 | 150,000 |
| Mortgage payable | 325,000 | 330,000 |

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Exercise 7 (LO 7) CHANGE IN CASH AND CASH EQUIVALENTS

The information provided below was taken from the December 31 comparative balance sheet of Roedl Company. Based on this information, compute the change in cash and cash equivalents that would be explained on a statement of cash flows for 20-2.

| | <u>20-2</u> | <u>20-1</u> |
|-----------------------------|------------------|------------------|
| Current assets: | | |
| Cash | \$ 87,500 | \$ 78,600 |
| Government notes..... | 10,000 | 12,000 |
| Accounts receivable..... | 135,700 | 144,900 |
| Merchandise inventory | <u>255,800</u> | <u>276,600</u> |
| Total current assets | <u>\$489,000</u> | <u>\$512,100</u> |

Exercise 8 (LO 7) GAINS AND LOSSES ON THE SALE OF LONG-TERM ASSETS

The income statement for Kenlawn Nursery is shown below. Assume that all revenues and expenses were for cash and that land was sold for \$15,000. There were no other investing or financing activities during the year. The Cash balances at the beginning and end of the year were \$10,000 and \$45,000, respectively. Prepare a statement of cash flows.

Kenlawn Nursery
Income Statement
For Year Ended December 31, 20-2

| | |
|--------------------------------|-----------------|
| Sales (all cash) | \$80,000 |
| Wages expense (all cash) | <u>60,000</u> |
| Operating income | \$20,000 |
| Loss on sale of land | <u>(2,000)</u> |
| Net income | <u>\$18,000</u> |

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Exercise 9 (LO 7) CALCULATION OF CASH GENERATED FROM OPERATING ACTIVITIES

Information from the December 31 financial statements of Pinehurst Corporation is listed below.

| | <u>20-2</u> | <u>20-1</u> |
|---|------------------|-------------|
| Cash | \$ 76,320 | \$ 72,480 |
| Accounts receivable..... | 184,500 | 175,200 |
| Merchandise inventory | 225,300 | 215,700 |
| Supplies | 12,500 | 14,800 |
| Prepaid insurance..... | 18,200 | 16,300 |
| Accounts payable (suppliers of merchandise) | 132,000 | 140,000 |
| Accrued wages payable | 2,200 | 3,100 |
| Accrued payroll taxes | 3,200 | 2,700 |
| | | |
| Net sales | \$625,000 | |
| Cost of goods sold | 330,000 | |
| Wages expense | 125,500 | |
| Depreciation expense..... | 45,000 | |
| Supplies expense | 45,500 | |
| Payroll taxes expense | 10,200 | |
| Insurance expense..... | <u>22,500</u> | |
| Net income | <u>\$ 46,300</u> | |

Based on the information provided, prepare a partial statement of cash flows reporting cash flows from operating activities.

Exercise 10 (LO 7) NONCASH INVESTING AND FINANCING ACTIVITIES

The Wantz Factory issued a \$20,000, five-year note payable to acquire new furniture. Show how this transaction is reported on a statement of cash flows.

Exercise 11 (LO 7) CASH PAID FOR INTEREST AND INCOME TAXES

Based on the following information taken from the December 31 financial statements of Midex Company, compute the cash paid for interest and income taxes:

| | <u>20-2</u> | <u>20-1</u> |
|--------------------------------|-------------|-------------|
| Accrued interest payable | \$ 2,400 | \$ 3,200 |
| Income tax payable..... | 15,500 | 11,300 |
| Interest expense, 20-2..... | 8,200 | |
| Income tax expense, 20-2..... | 30,300 | |

PROBLEMS

Problem 12 (LO 6) CASH GENERATED FROM OPERATING ACTIVITIES

The following information was taken from the financial statements of Roget's Bottling Company:

Roget's Bottling Company
Income Statement
For Year Ended December 31, 20-2

| | |
|---------------------------|------------------|
| Net sales | \$800,000 |
| Cost of goods sold | <u>450,000</u> |
| Gross profit | \$350,000 |
| Operating expenses | <u>119,000</u> |
| Income before taxes | \$231,000 |
| Income tax expense | <u>81,000</u> |
| Net income | <u>\$150,000</u> |

Roget's Bottling Company
Comparative Balance Sheet (Partial)
December 31, 20-2 and 20-1

| | <u>20-2</u> | <u>20-1</u> | <u>Increase (Decrease)</u> |
|-----------------------------|----------------|----------------|--------------------------------|
| Assets | | | |
| Current assets: | | | |
| Cash | \$ 60,000 | \$ 70,000 | \$(10,000) |
| Accounts receivable | 20,000 | 25,000 | (5,000) |
| Merchandise inventory | <u>160,000</u> | <u>180,000</u> | <u>(20,000)</u> |
| Total current assets | \$240,000 | \$275,000 | \$(35,000) |
| Liabilities | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 40,000 | \$ 30,000 | \$ 10,000 |

Required: Prepare a partial statement of cash flows reporting cash flows from operating activities.

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Problem 13 (LO 7) PREPARE A STATEMENT OF CASH FLOWS

The financial statements and additional information for Moles Company are shown below and on the next page.

| Moles Company Income Statement For Year Ended December 31, 20-2 | |
|---|-------------------------|
| Net sales | \$1,000,000 |
| Cost of goods sold | <u>700,000</u> |
| Gross profit..... | \$ 300,000 |
| Operating expenses..... | <u>177,000</u> |
| Income before taxes..... | \$ 123,000 |
| Income tax expense | <u>43,000</u> |
| Net income | <u><u>\$ 80,000</u></u> |

| Moles Company Comparative Balance Sheet December 31, 20-2 and 20-1 | | | |
|---|-------------------------|-------------------------|--------------------------------|
| | <u>20-2</u> | <u>20-1</u> | <u>Increase (Decrease)</u> |
| Assets | | | |
| Current assets: | | | |
| Cash..... | \$ 80,000 | \$200,000 | \$(120,000) |
| Accounts receivable | 160,000 | 180,000 | (20,000) |
| Merchandise inventory..... | <u>180,000</u> | <u>200,000</u> | (20,000) |
| Total current assets | \$420,000 | \$580,000 | (160,000) |
| Property, plant, and equipment: | | | |
| Land | \$ 40,000 | \$ 50,000 | (10,000) |
| Building..... | 140,000 | | 140,000 |
| Equipment | <u>100,000</u> | <u> </u> | 100,000 |
| Total property, plant, and equipment..... | <u>\$280,000</u> | <u>\$ 50,000</u> | 230,000 |
| Total assets | <u><u>\$700,000</u></u> | <u><u>\$630,000</u></u> | 70,000 |
| Liabilities | | | |
| Current liabilities: | | | |
| Accounts payable | \$120,000 | \$180,000 | (60,000) |
| Notes payable..... | <u>60,000</u> | <u>50,000</u> | 10,000 |
| Total liabilities | \$180,000 | \$230,000 | (50,000) |
| Stockholders' Equity | | | |
| Common stock (\$5 par, 100,000 shares authorized, 50,000 and 58,000 issued)..... | \$290,000 | \$250,000 | 40,000 |
| Paid-in capital in excess of par—common stock..... | 120,000 | 100,000 | 20,000 |
| Retained earnings | <u>110,000</u> | <u>50,000</u> | 60,000 |
| Total stockholders' equity | <u>\$520,000</u> | <u>\$400,000</u> | 120,000 |
| Total liabilities and stockholders' equity | <u><u>\$700,000</u></u> | <u><u>\$630,000</u></u> | 70,000 |

Problem 13 (Continued)

Moles Company
Statement of Retained Earnings
For Year Ended December 31, 20-2

| | | |
|---|---------------|-------------------------|
| Retained earnings, January 1, 20-2..... | | \$ 50,000 |
| Net income | \$80,000 | |
| Less dividends | <u>20,000</u> | |
| Net increase in retained earnings..... | | <u>60,000</u> |
| Retained earnings, December 31, 20-2..... | | <u><u>\$110,000</u></u> |

Additional information:

1. A building costing \$140,000 and equipment costing \$90,000 were acquired just before the year-end. Moles Company had accumulated enough cash to cover these acquisitions.
2. Issued 8,000 shares of common stock for \$7.50 per share.
3. Declared and paid cash dividends of \$20,000.
4. Moles Company uses accounts payable only for amounts owed to suppliers of merchandise inventory.
5. Additional equipment was acquired by issuing a note payable for \$10,000.

Required:

1. Prepare a statement of cash flows for the year ended December 31, 20-2.
2. Reconcile the cash account at the bottom of the statement of cash flows.

Problem 14 (LO 7) PREPARE A STATEMENT OF CASH FLOWS

The financial statements and additional information for the preparation of a statement of cash flows for Eubanks Corporation are provided below and on the following pages.

Eubanks Corporation
Income Statement
For Year Ended December 31, 20-2

| | | | |
|---|----------------|-------------------|--|
| Net sales | | \$1,150,250 | |
| Cost of goods sold | | <u>675,250</u> | |
| Gross profit..... | | \$ 475,000 | |
| Operating expenses..... | | <u>301,876</u> | |
| Operating income | | \$ 173,124 | |
| Other revenue and expenses: | | | |
| Interest revenue | \$ 500 | | |
| Interest expense | (2,500) | | |
| Gain on the sale of store equipment | 10,000 | | |
| Loss on the retirement of bond | <u>(3,000)</u> | <u>5,000</u> | |
| Income before taxes..... | | \$ 178,124 | |
| Income tax expense | | <u>60,000</u> | |
| Net income | | <u>\$ 118,124</u> | |

Eubanks Corporation
Statement of Retained Earnings
For Year Ended December 31, 20-2

| | | | |
|---|---------------|------------------|--|
| Retained earnings, January 1, 20-2..... | | \$ 59,156 | |
| Net income | \$118,124 | | |
| Less dividends | <u>32,000</u> | | |
| Net increase in retained earnings..... | | <u>86,124</u> | |
| Retained earnings, December 31, 20-2..... | | <u>\$145,280</u> | |

Additional information:

1. Store equipment was sold during the year for \$40,000.

| | | | |
|--------------------------------------|--|-----------------|--|
| Cost | | \$50,000 | |
| Accumulated depreciation | | <u>(20,000)</u> | |
| Book value | | \$30,000 | |
| Market value | | <u>40,000</u> | |
| Gain on sale of store equipment..... | | <u>\$10,000</u> | |

2. Depreciation expense was \$26,000 as follows:

| | | | |
|-------------------------|--|-----------------|--|
| Store equipment | | \$10,000 | |
| Delivery equipment..... | | 11,250 | |
| Office equipment | | <u>4,750</u> | |
| | | <u>\$26,000</u> | |

3. A \$50,000 bond payable was retired early at a loss of \$3,000.

| | | | |
|----------------------------------|--|-------------------|--|
| Carrying value..... | | \$50,000 | |
| Amount paid to retire bond | | <u>53,000</u> | |
| Loss on retirement of bond | | <u>\$ (3,000)</u> | |

Problem 14 (Continued)

4. The following purchases were made:

| | |
|-------------------------|-----------------|
| Store equipment | \$23,000 |
| Delivery equipment..... | 32,500 |
| Office equipment | <u>10,025</u> |
| | <u>\$65,525</u> |

5. Paid dividends of \$32,000.

6. Issued 7,000 shares of common stock for \$57,500.

7. Acquired office equipment by issuing a note payable for \$10,000.

Required:

1. Prepare a statement of cash flows.
2. Verify the accuracy of the statement of cash flows.

Note: This problem includes a loss on the retirement of bonds which is not illustrated in the text. However, if you apply the concepts learned in the text to the retirement of bonds, you should be able to complete this problem successfully. Have fun.

Problem 14 (Continued)

| | | Eubanks Corporation Comparative Balance Sheet December 31, 20-2 and 20-1 | | | Increase (Decrease) |
|---|--|--|------------------|--|------------------------|
| | | 20-2 | 20-1 | | |
| Assets | | | | | |
| Current assets: | | | | | |
| Cash..... | | \$ 89,947 | \$ 53,000 | | \$ 36,947 |
| Government notes | | 1,500 | 5,000 | | (3,500) |
| Accrued interest receivable | | 75 | 175 | | (100) |
| Accounts receivable (net) | | 140,223 | 126,500 | | 13,723 |
| Merchandise inventory | | 161,420 | 168,780 | | (7,360) |
| Supplies and prepayments | | <u>10,038</u> | <u>6,840</u> | | 3,198 |
| Total current assets..... | | \$403,203 | \$360,295 | | 42,908 |
| Property, plant, and equipment: | | | | | |
| Store equipment | | \$ 70,000 | \$ 97,000 | | (27,000) |
| Less accum. depr.—store equipment..... | | <u>25,000</u> | <u>35,000</u> | | (10,000) |
| Delivery equipment..... | | \$112,500 | \$ 80,000 | | 32,500 |
| Less accum. depr.—delivery equipment..... | | <u>31,250</u> | <u>20,000</u> | | 11,250 |
| Office equipment..... | | \$105,000 | \$ 84,975 | | 20,025 |
| Less accum. depr.—office equipment..... | | <u>20,000</u> | <u>15,250</u> | | 4,750 |
| Total property, plant, and equipment | | \$211,250 | \$191,725 | | 19,525 |
| Total assets..... | | <u>\$614,453</u> | <u>\$552,020</u> | | 62,433 |
| Liabilities | | | | | |
| Current liabilities: | | | | | |
| Notes payable | | \$ 35,200 | \$ 29,500 | | 5,700 |
| Accounts payable | | 65,288 | 96,864 | | (31,576) |
| Income tax payable | | 16,000 | 20,000 | | (4,000) |
| Accrued and withheld payroll taxes | | 2,475 | 3,800 | | (1,325) |
| Accrued interest payable | | <u>210</u> | <u>200</u> | | 10 |
| Total current liabilities | | \$119,173 | \$150,364 | | 31,191 |
| Long-term liabilities: | | | | | |
| Bonds payable | | — | 50,000 | | (50,000) |
| Stockholders' Equity | | | | | |
| Common stock (\$5 par, 100,000 shares authorized, 50,000 and 43,000 shares issued) | | \$250,000 | \$215,000 | | 35,000 |
| Paid-in capital in excess of par value—common stock..... | | 100,000 | 77,500 | | 22,500 |
| Retained earnings..... | | <u>145,280</u> | <u>59,156</u> | | 86,124 |
| Total stockholders' equity | | 495,280 | 351,656 | | 143,624 |
| Total liabilities and stockholders' equity | | <u>\$614,453</u> | <u>\$552,020</u> | | 62,433 |

Problem 14 (Continued)**1. and 2. T Accounts for Indirect Method Statement of Cash Flows
Eubanks Corporation**

| Accrued Interest Receivable | |
|-----------------------------|-----|
| BB | 175 |
| EB | 75 |

| Notes Payable | |
|---------------|-----------|
| | 29,500 BB |
| | 35,200 EB |

| Common Stock | |
|--------------|------------|
| | 215,000 BB |
| | 250,000 EB |

| Accounts Receivable | |
|---------------------|---------|
| BB | 126,500 |
| EB | 140,223 |

| Accounts Payable | |
|------------------|-----------|
| | 96,864 BB |
| | 65,288 EB |

| Paid-In Capital in Excess of Par— Common Stock | |
|---|------------|
| | 77,500 BB |
| | 100,000 EB |

| Merchandise Inventory | |
|-----------------------|---------|
| BB | 168,780 |
| EB | 161,420 |

| Income Tax Payable | |
|--------------------|-----------|
| | 20,000 BB |
| | 16,000 EB |

| Retained Earnings | |
|-------------------|------------|
| | 59,156 BB |
| | 145,280 EB |

| Supplies and Prepayments | |
|--------------------------|--------|
| BB | 6,840 |
| EB | 10,038 |

| Accrued and Withheld Payroll Taxes | |
|------------------------------------|----------|
| | 3,800 BB |
| | 2,475 EB |

| Store Equipment | |
|-----------------|--------|
| BB | 97,000 |
| EB | 70,000 |

| Accrued Interest Payable | |
|--------------------------|--------|
| | 200 BB |
| | 210 EB |

| Accumulated Depreciation— Store Equipment | |
|--|-----------|
| | 35,000 BB |
| | 25,000 EB |

| Bonds Payable | |
|---------------|-----------|
| | 50,000 BB |
| | — EB |

| Delivery Equipment | |
|--------------------|---------|
| BB | 80,000 |
| EB | 112,500 |

| Accumulated Depreciation— Delivery Equipment | |
|---|-----------|
| | 20,000 BB |
| | 31,250 EB |

| Office Equipment | |
|------------------|---------|
| BB | 84,975 |
| EB | 105,000 |

| Accumulated Depreciation— Office Equipment | |
|---|-----------|
| | 15,250 BB |
| | 20,000 EB |

BB: Beginning Balance

EB: Ending Balance

Hint: Be sure to reconcile all of these accounts to identify all transactions for the year.

CHAPTER 23 APPENDIX STATEMENT OF CASH FLOWS: THE DIRECT METHOD

APPENDIX LEARNING OBJECTIVES

The appendix to Chapter 23 illustrates the direct method of reporting cash flows from operating activities.

Objective 1. Describe the direct method of reporting cash flows from operating activities.

Under the **direct method**, revenues and expenses reported on the income statement are adjusted to reflect the amount of cash received or paid for each item. These adjusted revenues and expenses are reported on the statement of cash flows. The sum of these cash flows is equal to net cash provided or used by operating activities.

Objective 2. Prepare a schedule for the calculation of cash generated from operating activities under the direct method by adjusting revenues and expenses for changes in current assets and current liabilities associated with operations.

Under the **direct method**, revenues and expenses reported on the income statement are adjusted to reflect the amount of cash received or paid for each item. To compute the cash generated from operating activities, it is convenient to develop a schedule converting the revenues and expenses reported on the income statement to cash received or paid. Let's consider a firm with the following information:

| Income Statement | | | Balance Sheet | BB | EB |
|--------------------|-----------|--------------|---------------------|------|------|
| Sales | | \$180 | Accounts receivable | \$ 5 | \$10 |
| Cost of goods sold | \$50 | | Inventory | 30 | 20 |
| Wages expense | <u>30</u> | <u>80</u> | Accounts payable | 20 | 8 |
| Net income | | <u>\$100</u> | Wages payable | 15 | 18 |

BB: Beginning Balance

EB: Ending Balance

To compute cash from operating activities under the direct method, a schedule as shown below may be used. Column 1 reports the revenue or expense as reported on the income statement. Columns 2 and 3 are used for adjustments to convert the accrual basis amounts reported on the income statement to cash basis amounts on the statement of cash flows. Column 4 is used to report the cash received or paid for each line on the income statement.

Schedule for the Calculation of Cash Generated from Operating Activities

| Income Statement | | Additions | Deductions | Cash Flows |
|--------------------|--------------|-----------|------------|---|
| Sales | \$180 | | (1) \$ (5) | \$175 Cash from customers |
| Cost of goods sold | 50 | (3) \$12 | (2) (10) | 52 Cash paid to suppliers |
| Wages expense | <u>30</u> | | (4) (3) | <u>27</u> Cash paid to employees |
| Net income | <u>\$100</u> | | | <u>\$ 96</u> Cash from operating activities |

1. Deduct the \$5 increase in accounts receivable.
2. Deduct the \$10 decrease in inventory.
3. Add the \$12 decrease in accounts payable.
4. Deduct the \$3 increase in wages payable.

You can also compute the cash paid or received by using T accounts and entries for the above revenues and expenses as shown below.

| CASH FROM CUSTOMERS (1) | | | | | | | | | |
|--------------------------------|---------------------|---------------------|---|-----|-------|-----|-----|--|--|
| Cash | | Accounts Receivable | | | Sales | | | | |
| | | BB | 5 | | | | | | |
| (3) | 175 | (2) | 5 | EB | 10 | 180 | (1) | | |
| | | Cash from customers | | | | | | | |
| (3) | Cash | 175 | | | | | | | |
| (2) | Accounts Receivable | 5 | | | | | | | |
| (1) | Sales | | | 180 | | | | | |

| CASH PAID TO SUPPLIERS (2 & 3) | | | | | | | | | |
|---|--------------------|-------------------------------|----|----|-----------|----|----|--------------------|----|
| Cash | | Accounts Payable | | | Inventory | | | Cost of Goods Sold | |
| | | 20 | BB | BB | 30 | | | | |
| (3) | 52 | (3) | 52 | 40 | (2) | 40 | 50 | (1) | 50 |
| | | Plug = Cash paid to suppliers | | | | | | | |
| | | Plug = Purchases of inventory | | | | | | | |
| (1) | Cost of Goods Sold | 50 | | | | | | | |
| | Inventory | 50 | | | | | | | |
| (2) | Inventory | 40 | | | | | | | |
| | Accounts Payable | 40 | | | | | | | |
| (3) | Accounts Payable | 52 | | | | | | | |
| | Cash | 52 | | | | | | | |

| CASH PAID TO EMPLOYEES (4) | | | | | | | | | |
|-----------------------------------|---------------|------------------------|-----|-----|---------------|--|--|--|--|
| Cash | | Wages Payable | | | Wages Expense | | | | |
| | | 15 | BB | | | | | | |
| (3) | 27 | 3 | (2) | (1) | 30 | | | | |
| | | Cash paid to employees | | | | | | | |
| (1) | Wages Expense | 30 | | | | | | | |
| (2) | Wages Payable | 3 | | | | | | | |
| (3) | Cash | 27 | | | | | | | |

BB: Beginning Balance
EB: Ending Balance

- Objective 3.** Prepare a schedule for the calculation of cash generated from operating activities under the direct method, including adjustments when the company reports:
- a. changes in current assets and current liabilities associated with operations,
 - b. depreciation expense,
 - c. gains or losses on the sale of long-term assets,
 - d. receivables and payables associated with interest revenue, interest expense, and tax expense.

Techniques used to adjust revenues and expenses for changes in current assets and current liabilities have already been illustrated. Here, let's focus on adjustments required for noncash expenses (depreciation) and gains and losses on the sale of long-term assets. These adjustments are relatively easy if you keep in mind that we are computing **cash** generated from **operating** activities. Let's expand the above illustration to include depreciation expense and a gain on the sale of equipment. These items are in bold below.

Schedule for the Calculation of Cash Generated from Operating Activities

| Income Statement | Additions | Deductions | Cash Flows |
|------------------------------------|-----------|-----------------|---|
| Sales \$180 | | (1) (5) | \$175 Cash from customers |
| Cost of goods sold 50 | (3) \$12 | (2) (10) | 52 Cash paid to suppliers |
| Wages expense 30 | | (4) (3) | 27 Cash paid to employees |
| Depreciation expense 10 | | (5) (10) | No cash is paid for depreciation |
| Gain on sale of equipment 4 | | (6) (4) | Not related to operating activities |
| Net income <u>\$ 94</u> | | | <u>\$ 96</u> Cash from operating activities |

1. Deduct the \$5 increase in accounts receivable.
2. Deduct the \$10 decrease in inventory.
3. Add the \$12 decrease in accounts payable.
4. Deduct the \$3 increase in wages payable.
- 5. Deduct \$10 from depreciation expense. No cash is paid for depreciation.**
- 6. Deduct \$4 from the gain on the sale of equipment. The gain is not related to operating activities.**

Depreciation expense and the gain are included in the calculation of net income. However, they have no effect on cash generated from operating activities. No cash is paid for depreciation expense. The gain on the sale of equipment is not related to operating activities. Thus, both amounts are adjusted to zero.

Objective 4. Prepare a statement of cash flows under the direct method.

The Cash Flows columns in the schedule for the calculation of cash from operating activities are used to prepare the statement of cash flows. As discussed earlier, the investing and financing sections of the statement of cash flows are identical under the direct and indirect methods. Thus, we will focus on the operating section here.

Let's assume that Paul Company has completed a schedule for the calculation of cash from operating activities and it includes the following:

| | |
|------------------------------|-------|
| Cash received from customers | \$175 |
| Cash paid to suppliers | 52 |
| Cash paid to employees | 27 |
| Cash paid for interest | 5 |
| Cash paid for income taxes | 30 |
| Interest received | 3 |
| Dividends received | 2 |

This information is used to prepare the operating section of the statement of cash flows as shown on the following page.

Paul Company
Partial Statement of Cash Flows (Direct Method)
For Year Ended December 31, 20-2

| | | |
|---|---------|--------|
| Cash flows from operating activities: | | |
| Cash received from customers | \$175 | |
| Interest received | 3 | |
| Dividends received | 2 | |
| Cash provided by operating activities | | \$ 180 |
| Cash paid to suppliers of merchandise | \$ (52) | |
| Cash paid to employees | (27) | |
| Cash paid for interest | (5) | |
| Cash paid for income taxes | (30) | |
| Total cash disbursed for operating activities | | (114) |
| Net cash provided by operating activities | | \$ 66 |
| | | |

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| | Question | Answer |
|-------------|--|--------|
| LO 2 | 1. If accounts receivable increased during the year, this amount is (added to/deducted from) sales to determine the amount of cash received from customers during the year. | _____ |
| LO 2 | 2. An increase in inventory during the year should be (added to/deducted from) cost of goods sold to determine the cost of merchandise purchased. | _____ |
| LO 2 | 3. A decrease in accounts payable during the year should be (added to/deducted from) cost of goods sold to determine the amount of cash paid for merchandise. | _____ |
| LO 3 | 4. Depreciation expense is (added to/deducted from) operating expenses to compute cash paid for operating expenses. | _____ |
| LO 3 | 5. A decrease in accrued interest receivable is (added to/deducted from) interest revenue to determine the cash received from interest revenue. | _____ |
| LO 3 | 6. An increase in accrued interest payable is (added to/deducted from) interest expense to compute the cash paid for interest expense. | _____ |

EXERCISES

Apx. Exercise 1 (LO 2) CASH RECEIVED FROM CUSTOMERS

The information provided below was taken from the December 31 financial statements of Proc Company. Based on this information, compute the cash received from customers during 20-2.

| | <u>20-2</u> | <u>20-1</u> |
|-----------------------------|------------------|------------------|
| Cash..... | \$ 87,500 | \$ 78,600 |
| Accounts receivable..... | 154,700 | 164,500 |
| Merchandise inventory | <u>226,800</u> | <u>243,600</u> |
| Total current assets | <u>\$469,000</u> | <u>\$486,700</u> |
| Net sales, 20-2 | \$550,000 | |

Apx. Exercise 2 (LO 2) CASH PAID FOR MERCHANDISE

The information provided below was taken from the December 31 financial statements of Proc Company. Based on this information, compute the cash paid to suppliers of merchandise during 20-2.

| | <u>20-2</u> | <u>20-1</u> |
|--|-------------|-------------|
| Cash..... | \$ 87,500 | \$ 78,600 |
| Accounts receivable..... | 154,700 | 164,500 |
| Merchandise inventory | 226,800 | 243,600 |
| Accounts payable (suppliers of merchandise)..... | 156,000 | 145,000 |
| Cost of goods sold, 20-2..... | 330,000 | |

Apx. Exercise 3 (LO 3) SCHEDULE FOR CALCULATION OF CASH GENERATED FROM OPERATING ACTIVITIES

Information from the December 31 financial statements of Pinehurst Corporation is listed below.

| | <u>20-2</u> | <u>20-1</u> |
|--|-------------|-------------|
| Cash | \$ 76,320 | \$ 72,480 |
| Accounts receivable..... | 184,500 | 175,200 |
| Merchandise inventory | 225,300 | 215,700 |
| Supplies | 12,500 | 14,800 |
| Prepaid insurance..... | 18,200 | 16,300 |
| Accounts payable (suppliers of merchandise)..... | 132,000 | 140,000 |
| Accrued wages payable | 2,200 | 3,100 |
| Accrued payroll taxes | 3,200 | 2,700 |
| Net sales, 20-2 | \$625,000 | |
| Cost of goods sold, 20-2 | 330,000 | |
| Wages expense | 125,500 | |
| Depreciation expense..... | 45,000 | |
| Supplies expense | 45,500 | |
| Payroll tax expense..... | 10,200 | |
| Insurance expense..... | 22,500 | |

Based on the information provided, compute the following:

- (a) Cash received from customers.
- (b) Cash paid to suppliers of merchandise.
- (c) Cash paid to employees.
- (d) Cash paid for depreciation.
- (e) Cash paid for insurance.
- (f) Cash paid for supplies.
- (g) Cash paid for payroll taxes.

Apx. Exercise 4 (LO 3) CASH RECEIVED AND PAID FOR INTEREST

Based on the following information taken from the December 31 financial statements of Midex Company, compute the cash paid for interest expense and received from interest revenue:

| | <u>20-2</u> | <u>20-1</u> |
|-----------------------------------|-------------|-------------|
| Accrued interest receivable | \$ 2,400 | \$3,200 |
| Accrued interest payable | 1,500 | 1,300 |
| Interest expense, 20-2 | 18,200 | |
| Interest revenue, 20-2 | 10,300 | |

PROBLEMS

Apx. Problem 5 (LO 2) CASH GENERATED FROM OPERATING ACTIVITIES

Required:

Using the information provided in Problem 12 on page 388, prepare the following:

1. A schedule for the calculation of cash generated from operating activities for Roget’s Bottling Company for the year ended December 31, 20-2.
2. A partial statement of cash flows for Roget’s Bottling Company reporting cash from operating activities under the direct method for the year ended December 31, 20-2.

1.

| Income Statement | Additions | Deductions | Cash Flows |
|------------------|-----------|------------|------------|
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
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| | | | |
| | | | |

Apx. Problem 6 (LO 2) CASH GENERATED FROM OPERATING ACTIVITIES

Required:

Using the information provided in Problem 13 on pages 389-390, prepare the following:

1. A schedule for the calculation of cash generated from operating activities for Moles Company for the year ended December 31, 20-2.
2. A statement of cash flows for Moles Company reporting cash from operating activities under the direct method for the year ended December 31, 20-2.

1. _____

| Income Statement | Additions | Deductions | Cash Flows |
|------------------|-----------|------------|------------|
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |

Apx. Problem 7 (LO 3/4) STATEMENT OF CASH FLOWS UNDER THE DIRECT METHOD

Required:

Using the information provided in Problem 14 on pages 392-396, prepare the following:

1. A schedule for the calculation of cash generated from operating activities for Eubanks Corporation for the year ended December 31, 20-2.
2. A statement of cash flows for Eubanks Corporation prepared under the direct method for the year ended December 31, 20-2.

1.

| Income Statement | Additions | Deductions | Cash Flows |
|------------------|-----------|------------|------------|
| | | | |
| | | | |
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CHAPTER 24

ANALYSIS OF FINANCIAL STATEMENTS

LEARNING OBJECTIVES

Chapter 24 explores the analysis of financial statements—horizontal and vertical analyses of the income statement and balance sheet and measures of liquidity, activity, profitability, leverage, and those related to the market. Calculating ratios is an important procedure when evaluating how the business is doing—in comparison with previous periods, other companies, industry averages, and goals.

Objective 1. Perform horizontal and vertical analyses of the income statement and balance sheet.

Horizontal analysis tracks the dollar and percentage change in each line item of the balance sheet and/or income statement across accounting periods. The earlier year is used as the base in determining the percentage change.

Vertical analysis tracks the percentage of each line item of the income statement and/or balance sheet in relation to some designated total. On the income statement, each item is shown as a percentage of net sales. On the balance sheet, assets are shown as a percentage of total assets, whereas liabilities and stockholders' equity are shown as a percentage of total liabilities and stockholders' equity.

Objective 2. Compute and explain liquidity measures.

Liquidity measures indicate the ability to meet current debts as they come due. **Working capital** is the excess of current assets over current liabilities. The **current ratio** (or **working capital ratio**) is calculated by dividing total current assets by total current liabilities. It indicates the current position of the company in terms of a ratio. The **quick** or **acid test ratio** is another measure of liquidity; it is calculated by dividing quick assets (cash, temporary investments, and receivables) by current liabilities.

Objective 3. Compute and explain activity measures.

Activity measures offer an indication of the efficiency with which assets are being used to generate profits. **Accounts receivable turnover** measures the success of collecting accounts. It is calculated by dividing net sales on account by the average net accounts receivable. **Merchandise inventory turnover** offers an indication of the time required to sell inventory. It is calculated by dividing cost of goods sold by the average merchandise inventory. Ideally, a business would have maximum sales and minimum inventory or a large turnover rate. The larger the turnover rate, the more times inventory is purchased and sold during the year. The **asset turnover ratio** is determined by dividing net sales by average assets. It measures how efficiently assets are used to generate sales.

Objective 4. Compute and explain profitability measures.

Profitability measures indicate the ability to earn income by operating efficiently. The **profit margin ratio** is calculated by dividing net income by net sales. It provides a measure of the net income generated by each dollar of sales. **Return on assets (ROA)** is net income divided by average assets. It compares earnings to resources. **Return on common stockholders' equity** is net income available to common stockholders divided by average common stockholders' equity. It measures the rate of return for stockholders based on their investment. **Earnings per share of common stock** is net income available to common stockholders divided by average common shares outstanding. This indicates profitability and desirability of a company's stock.

Objective 5. Compute and explain leverage measures.

Leverage measures indicate the extent to which a business is financed by debt and its ability to meet those debt obligations. The **debt-to-equity ratio** is total liabilities divided by total stockholders' equity. It measures the extent of overall leverage, or the proportion of borrowed capital to stockholders' equity. The **assets-to-equity ratio** offers a measure of leverage by focusing on the use of other peoples' money to acquire assets. The **times interest earned ratio** is net income (before taxes and interest) divided by interest expense. This reveals the amount of earnings (before interest and taxes) in relation to the interest requirements.

Objective 6. Explain the components of ROA and ROE.

ROA is often broken down into two components: the profit margin ratio and asset turnover to offer a better understanding of how a company generates profits. Some businesses, like supermarkets, have very low profit margin ratios, but quite high asset turnover. Others, like those in heavy manufacturing, have high profit margin ratios and low asset turnover.

ROE adds leverage, assets-to-equity, as a third component. This provides a clear indication of the extent to which a company is using borrowed money to finance the acquisition of assets. Further, it indicates the extent to which earnings available to common stockholders is enhanced through the use of debt.

Objective 7. Compute and explain market measures.

Market measures use stock market prices to offer evidence of how the company is viewed by investors. The **price-earnings ratio (PE ratio)** is often used by analysts and frequently cited on financial programs. It is computed by dividing the company's market price per share of common stock by the earnings per share of common stock. In general, a higher PE ratio suggests that investors have more confidence in a company's future earnings and growth than for a company with a low PE ratio. **Book value per share of common stock** is the total common stockholders' equity divided by common shares outstanding at year-end. Market values are not used in these calculations. However, the market value of the common stock is often compared with its book value when attempting to determine whether the stock is valued properly.

Objective 8. Explain the limitations of financial statement analysis.

The financial statements provide much meaningful information for measuring performance. However, there are other aspects of a business that are not revealed by financial statement analysis, such as customer satisfaction and morale of employees. Another limitation of analysis is that some reported data are based on approximations. Also, a two-year period of time is not conclusive evidence of a long-term trend. Comparison with other companies must be done carefully because different accounting methods may skew results. Finally, ratios involve two numbers and a change in either will affect the result. Financial statement analysis must be used with good judgment and perception.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|---|--------|
| LO 1 1. The ability to pay debts when they become due is called _____. | _____ |
| LO 1 2. The efficiency with which assets are used to generate profits is captured with _____ measures. | _____ |
| LO 1 3. The ability to earn a satisfactory return on investments is called _____. | _____ |

- LO 1 4. _____ is the proportion of debt used to operate. _____
- LO 1 5. _____ measures include the PE ratio. _____
- LO 1 6. A comparison of the amounts for the same line item in financial statements for two or more periods is called _____ analysis. _____
- LO 1 7. _____ analysis reports each financial statement amount as a percentage of a designated total. _____
- LO 2 8. The excess of a company's current assets over its current liabilities is called _____. _____
- LO 2 9. The _____ ratio is calculated by dividing current assets by current liabilities. _____
- LO 2 10. The quick or _____ ratio is calculated by dividing quick assets by _____. _____

- LO 3 11. Accounts receivable turnover is calculated by dividing _____ on account by average accounts receivable. _____
- LO 3 12. Merchandise inventory turnover is calculated by dividing _____ by average merchandise inventory. _____
- LO 4 13. The return on assets is computed by dividing _____ by average assets. _____
- LO 4 14. _____ is calculated by dividing net income available to common stockholders by average common stockholders' equity. _____
- LO 4 15. Earnings per share of common stock is calculated by dividing net income available to common stockholders by average _____ outstanding. _____
- LO 5 16. The debt-to-equity ratio is a(n) _____ measure. _____
- LO 5 17. The times interest earned ratio is computed by dividing net income before taxes and interest by _____. _____
- LO 7 18. A measure of the ownership equity represented by each share of common stock is known as _____. _____

EXERCISES

Exercises 1–17

Provided on page 416 are comparative financial statements for Neva Corporation. (Round all calculations to two decimal places.)

Neva Corporation
Comparative Income Statement
For Years Ended December 31, 20-2 and 20-1

| | <u>20-2</u> | <u>20-1</u> |
|-----------------------------------|-------------------|-------------------|
| Net sales (all on account) | \$1,399,352 | \$1,308,640 |
| Cost of goods sold | <u>757,667</u> | <u>708,030</u> |
| Gross profit | \$ 641,685 | \$ 600,610 |
| Operating expenses | <u>480,191</u> | <u>435,307</u> |
| Operating income | \$ 161,494 | \$ 165,303 |
| Other revenues and expenses | <u>(20,036)</u> | <u>(20,796)</u> |
| Income before income tax | \$ 141,458 | \$ 144,507 |
| Income tax expense | <u>10,365</u> | <u>11,250</u> |
| Net income | <u>\$ 131,093</u> | <u>\$ 133,257</u> |

Neva Corporation
Comparative Balance Sheet
December 31, 20-2 and 20-1

| | <u>20-2</u> | <u>20-1</u> |
|--|--------------------|--------------------|
| Assets | | |
| Current assets: | | |
| Cash | \$ 49,646 | \$ 41,904 |
| Government notes | 20,000 | 15,000 |
| Accounts receivable (net) | 75,000 | 64,500 |
| Merchandise inventory | 106,650 | 106,150 |
| Supplies and prepayments | <u>9,422</u> | <u>13,221</u> |
| Total current assets | \$ 260,718 | \$ 240,775 |
| Property, plant, and equipment: | | |
| Land | \$ 250,000 | \$ 175,000 |
| Building (net) | 480,000 | 520,000 |
| Delivery equipment (net) | 50,000 | 55,000 |
| Office equipment (net) | 35,000 | 27,500 |
| Patents | <u>10,000</u> | <u>12,000</u> |
| Total property, plant, and equipment | <u>\$ 825,000</u> | <u>\$ 789,500</u> |
| Total assets | <u>\$1,085,718</u> | <u>\$1,030,275</u> |
| Liabilities | | |
| Current liabilities: | | |
| Notes payable | \$ 30,000 | \$ 25,000 |
| Accounts payable | 78,500 | 95,600 |
| Accrued and withheld payroll tax | 6,200 | 5,600 |
| Accrued interest payable | <u>2,050</u> | <u>1,700</u> |
| Total current liabilities | \$ 116,750 | \$ 127,900 |
| Long-term liabilities: | | |
| Bonds payable | <u>200,000</u> | <u>225,000</u> |
| Total liabilities | \$ 316,750 | \$ 352,900 |
| Stockholders' Equity | | |
| Common stock (\$10 par) | \$ 250,000 | \$ 200,000 |
| Paid-in capital in excess of par | 158,500 | 138,000 |
| Retained earnings | <u>360,468</u> | <u>339,375</u> |
| Total stockholders' equity | <u>\$ 768,968</u> | <u>\$ 677,375</u> |
| Total liabilities and stockholders' equity | <u>\$1,085,718</u> | <u>\$1,030,275</u> |

Exercise 1 (LO 2) COMPUTE WORKING CAPITAL

Compute the working capital on December 31, 20-2 and 20-1.

Exercise 2 (LO 2) COMPUTE THE CURRENT RATIO

Compute the current ratio on December 31, 20-2 and 20-1.

Exercise 3 (LO 2) COMPUTE THE QUICK OR ACID-TEST RATIO

Compute the quick or acid-test ratio on December 31, 20-2 and 20-1.

Exercise 4 (LO 3) COMPUTE THE ACCOUNTS RECEIVABLE TURNOVER

Compute the accounts receivable turnover and the average number of days the receivables were on the books for 20-2.

Exercise 5 (LO 3) COMPUTE THE MERCHANDISE INVENTORY TURNOVER

Compute the merchandise inventory turnover and the average number of days the merchandise inventory was held during 20-2.

Exercise 6 (LO 3) COMPUTE THE ASSET TURNOVER

Compute the asset turnover for 20-2.

Exercise 7 (LO 4) COMPUTE THE PROFIT MARGIN RATIO

Compute the profit margin ratio for 20-2.

Exercise 8 (LO 4) COMPUTE THE RETURN ON ASSETS

Compute the return on assets for 20-2.

Exercise 9 (LO 4) COMPUTE THE RETURN ON COMMON STOCKHOLDERS' EQUITY

Compute the return on common stockholders' equity for 20-2.

Exercise 10 (LO 4) COMPUTE EARNINGS PER SHARE OF COMMON STOCK

Compute earnings per share of common stock for 20-2. (Neva issued 5,000 shares of common stock in the middle of 20-2.)

Exercise 11 (LO 5) COMPUTE THE DEBT-TO-EQUITY RATIO

Compute the debt-to-equity ratio for December 31, 20-2.

Exercise 12 (LO 5) COMPUTE THE ASSETS-TO-EQUITY RATIO

Compute the assets-to-equity ratio on December 31, 20-2.

Exercise 13 (LO 5) COMPUTE THE TIMES INTEREST EARNED RATIO

Compute the times interest earned ratio for 20-2. Assume interest expense for 20-2 was \$22,250.

Exercise 14 (LO 6) COMPUTE RETURN ON ASSETS (ROA) USING THE TWO PRIMARY COMPONENTS

Compute the return on assets (ROA) using the two primary components for 20-2 (round all calculation to two decimal places).

Exercise 15 (LO 6) COMPUTE RETURN ON COMMON STOCKHOLDERS' EQUITY (ROE) USING THE THREE PRIMARY COMPONENTS

Compute the return on common stockholders' equity (ROE) using the three primary components for 20-2 (round all calculation to two places).

Exercise 16 (LO 7) COMPUTE THE PRICE-EARNINGS RATIO (PE)

Compute the price-earnings ratio (PE ratio) on December 31, 20-2. The market value of the common stock was \$116.00 per share.

Exercise 17 (LO 7) COMPUTE THE BOOK VALUE PER SHARE OF COMMON STOCK

Compute the book value per share of common stock on December 31, 20-2.

PROBLEMS

Problem 18 (LO 1) HORIZONTAL ANALYSIS OF AN INCOME STATEMENT

A comparative income statement for Ala Moana Company for the last two years is started below.

Required:

Complete the statement, showing horizontal analysis by entering the amount of increase (decrease) and the percentage change for each item reported. (Round to one decimal place.)

Ala Moana Company

Comparative Income Statement

For Years Ended December 31, 20-2 and 20-1

| | 20-2 | 20-1 | INCREASE (DECREASE) | PERCENT |
|-----------------------------|-----------|-----------|------------------------|---------|
| Net sales | \$971,772 | \$908,778 | | |
| Cost of goods sold | 547,690 | 517,968 | | |
| Gross profit | \$424,082 | \$390,810 | | |
| Operating expenses | 396,675 | 347,890 | | |
| Operating income | \$ 27,407 | \$ 42,920 | | |
| Other revenues and expenses | (1,000) | (2,000) | | |
| Income before income tax | \$ 26,407 | \$ 40,920 | | |
| Income tax expense | 7,922 | 13,504 | | |
| Net income | \$ 18,485 | \$ 27,416 | | |
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Problem 19 (LO 1) VERTICAL ANALYSIS OF AN INCOME STATEMENT

Refer to Problem 18.

Required:

Prepare a comparative income statement for Ala Moana Company, showing vertical analysis. (Round to one decimal place.)

| | 20-2 | PERCENT | 20-1 | PERCENT |
|--|------|---------|------|---------|
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Problem 20 (LO 1) HORIZONTAL ANALYSIS OF A BALANCE SHEET

A comparative balance sheet for Ala Moana Company is started below.

Required:

Complete the condensed comparative balance sheet, showing horizontal analysis. (Round to one decimal place.)

Ala Moana Company

Comparative Balance Sheet

December 31, 20-2 and 20-1

| | 20-2 | 20-1 | INCREASE (DECREASE) | PERCENT |
|---|------------------|------------------|------------------------|---------|
| Assets | | | | |
| Current assets | \$179,318 | \$167,204 | | |
| Property, plant, and equipment: | | | | |
| Land | \$130,000 | \$130,000 | | |
| Building (net) | 400,000 | 450,000 | | |
| Delivery equipment (net) | 30,000 | 39,000 | | |
| Office equipment (net) | 47,800 | 51,600 | | |
| Patents | 8,000 | 9,000 | | |
| Total property, plant, and equip. | \$615,800 | \$679,600 | | |
| Total assets | \$795,118 | \$846,804 | | |
| Liabilities | | | | |
| Current liabilities | \$ 86,675 | \$121,165 | | |
| Long-term liabilities: | | | | |
| Bonds payable | 300,000 | 350,000 | | |
| Total liabilities | \$386,675 | \$471,165 | | |
| Stockholders' Equity | | | | |
| Common stock | \$215,000 | \$200,000 | | |
| Paid-in capital in excess of par | 125,000 | 120,000 | | |
| Retained earnings | 68,443 | 55,639 | | |
| Total stockholders' equity | \$408,443 | \$375,639 | | |
| Total liab. and stockholders' equity | \$795,118 | \$846,804 | | |
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Problem 21 (LO 1) VERTICAL ANALYSIS OF A BALANCE SHEET

Refer to Problem 20.

Required:

Prepare a comparative balance sheet for Ala Moana Company, showing vertical analysis. (Round to one decimal place.)

| | 20-2 | PERCENT | 20-1 | PERCENT |
|--|------|---------|------|---------|
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CHAPTER 25

DEPARTMENTAL ACCOUNTING

LEARNING OBJECTIVES

Chapter 25 shows how a business can better manage its operations by dividing the organization into departments. Decisions affecting such things as profitability and the future operations of a department can be improved through analyzing departmental accounting reports.

Objective 1. Explain the nature and purpose of departmental accounting.

Departmental accounting provides more useful information than the typical income statement. Departmental reports are useful to management for planning, controlling, and evaluating performance. These reports are for internal management use only.

Objective 2. Describe and compute departmental gross profit.

Departmental gross profit is the difference between a department's net sales and cost of goods sold. To compute departmental gross profit, the amount of each element of gross profit must be determined for each department. There are two ways of accumulating this information: (1) separate general ledger accounts can be maintained by department for each of the elements (accounts) making up gross profit, or (2) a single general ledger account can be maintained for each of the elements. The total in each account is then assigned to the appropriate departments at the end of the accounting period. Gross profit percentages can be computed by dividing each department's gross profit by its respective net sales.

Objective 3. Describe and compute departmental operating income.

Departmental operating income is the difference between a department's gross profit and its operating expenses. To compute departmental operating income, the elements of gross profit and the operating expenses must be determined for each department. As with departmental gross profit, there are two ways of accumulating operating expense data: (1) separate general ledger departmental operating expense accounts can be used, or (2) a single general ledger account can be maintained for each operating expense. The total in each account is then assigned or allocated to appropriate departments at the end of the accounting period.

Direct expenses are operating expenses incurred for the sole benefit of and traceable directly to a specific department. **Indirect expenses** are operating expenses incurred for the benefit of the business as a whole. These expenses cannot be traced directly to a specific department. In computing departmental operating income, direct expenses are assigned to departments based on the actual expenses incurred. Indirect expenses are allocated to departments on some reasonable basis, such as relative sales.

A **departmental operating expense summary** is a useful way to summarize the assignment and allocation of departmental operating expenses. This summary shows the following: (1) classification of each operating expense as direct or indirect, (2) amount assigned or allocated to each department, and (3) total operating expenses for each department.

Objective 4. Describe and compute departmental direct operating margin.

Departmental direct operating margin is the difference between a department's gross profit and its direct operating expenses. To compute departmental direct operating margin, the elements of gross profit and the direct operating expenses are needed for each department.

The direct operating margin can be used by management in the following ways:

1. To evaluate department performance.
2. To determine the contribution a department makes to the overall operating income of the company.
3. To decide whether to discontinue a department.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| | Question | Answer |
|-------------|---|---------------|
| LO 1 | 1. In what three ways are departmental reports useful to management? | _____ |
| | | _____ |
| | | _____ |
| LO 2 | 2. The difference between a department's net sales and cost of goods sold is called _____. | _____ |
| LO 2 | 3. Gross profit divided by net sales is called the _____. | _____ |
| LO 2 | 4. An income statement showing departmental gross profit enables management to see whether each of its departments is earning an adequate _____. | _____ |
| LO 3 | 5. The difference between a department's gross profit and its operating expenses is called _____. | _____ |
| LO 3 | 6. Departmental operating expenses are either direct or _____. | _____ |
| LO 3 | 7. Operating expenses incurred for the sole benefit of and traceable directly to a specific department are called _____. | _____ |
| LO 3 | 8. Operating expenses incurred for the benefit of the business as a whole and untraceable directly to a specific department are called _____. | _____ |
| LO 3 | 9. In the text, the base used to allocate Store Clerks' Wages Expense and Advertising Expense is the _____. | _____ |
| LO 3 | 10. In the text, the base used to allocate Store Rent Expense is the _____. | _____ |
| LO 3 | 11. In the text, Bad Debt Expense is assigned to departments based on _____. | _____ |
| LO 4 | 12. The difference between a department's gross profit and its direct operating expenses is called _____. | _____ |

EXERCISES

Exercise 1 (LO 2) DEPARTMENTAL GROSS PROFIT SECTION AND GROSS PROFIT PERCENTAGE

Selected data for Pittsfield Plumbing and Hardware Supplies are provided below. Prepare a condensed income statement reporting gross profit for each department and in total for the year ended December 31, 20--. Compute the gross profit percentage for each department.

| | |
|---|-----------|
| Net sales—plumbing supplies | \$100,550 |
| Net sales—hardware..... | 250,000 |
| Cost of goods sold—plumbing supplies..... | 70,480 |
| Cost of goods sold—hardware | 155,870 |
| Operating expenses..... | 95,700 |

| | Plumbing Supplies | Hardware | Total |
|--|-------------------|----------|-------|
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Exercise 2 (LO 3) ALLOCATING OPERATING EXPENSES ON DIFFERENT BASES

Miller and Hastey are partners engaged in selling floor and wall covering. They keep accounts and prepare reports on a departmental basis. Using the data listed below, determine the amount of each expense to be assigned and allocated to each department for the year ended December 31, 20--. Identify both direct and indirect expenses, and round all calculations to the nearest percent or dollar.

1. Store clerk wages. Wages requiring allocation are distributed to the departments on the basis of relative net sales. Net sales for each department are as follows:

| | |
|-------------------------------|-----------|
| Net sales—wall covering..... | \$485,000 |
| Net sales—floor covering..... | 538,866 |

| Employee No. | Dept. | Wages |
|--------------|-------|------------------|
| 1 | Floor | \$ 25,800 |
| 2 | Wall | 22,600 |
| 3 | Floor | 28,988 |
| 4 | Both | 31,800 |
| 5 | Both | <u>18,640</u> |
| Total | | <u>\$127,828</u> |

2. Miller & Hastey has four installers who maintain records of the amount of time spent on installation for each department. Wages for each employee for the year are assigned to each department based on the hours reported.

| Employee No. | Hours— | | Total Wages |
|--------------|--------|-------|-------------|
| | Floor | Wall | |
| 8 | 1,288 | 658 | \$21,406 |
| 9 | 1,180 | 850 | 23,345 |
| 10 | 980 | 1,480 | 30,258 |
| 11 | 300 | 1,725 | 19,743 |

3. Miller & Hastey rents a store to display samples of its floor and wall coverings and to store the merchandise. Rent for the year was \$9,900. This expense is assigned to each department based on the square footage used by each department.

| Department | Square Footage |
|------------|----------------|
| Floor | 4,280 sq. ft. |
| Wall | 2,600 sq. ft. |

Exercise 2 (Continued)

Allocation of Expenses to Departments

| Expense | Department | Direct | Indirect | Total |
|----------------|-------------------|---------------|-----------------|--------------|
| 1. _____ | _____ | _____ | _____ | _____ |
| _____ | _____ | _____ | _____ | _____ |
| _____ | _____ | _____ | _____ | _____ |
| 2. _____ | _____ | _____ | _____ | _____ |
| _____ | _____ | _____ | _____ | _____ |
| _____ | _____ | _____ | _____ | _____ |
| 3. _____ | _____ | _____ | _____ | _____ |
| _____ | _____ | _____ | _____ | _____ |
| _____ | _____ | _____ | _____ | _____ |

Calculations

1. _____

Exercise 3 (LO 3) DEPARTMENTAL OPERATING EXPENSE SUMMARY

Based on the information in Exercise 2, prepare a departmental operating expense summary.

Miller & Hastey
 Departmental Operating Expense Summary
 For Year Ended December 31, 20--

| Expense | Total | Floor Covering | | Wall Covering | |
|---------|-------|----------------|----------|---------------|-------|
| | | Direct | Indirect | Direct | Total |
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PROBLEMS

Problem 4 (LO 2/3) INCOME STATEMENT WITH DEPARTMENTAL GROSS PROFIT AND OPERATING INCOME

Moss and Miller Bakery Shop reports the following summary of operating expenses for the year ended December 31, 20--:

Moss and Miller Bakery Shop
Departmental Operating Expense Summary
For Year Ended December 31, 20--

| | Cake Department | Bread Department | Total |
|--|--------------------|---------------------|----------------|
| Bakery wages expense..... | \$ 45,600 | \$ 82,800 | \$128,400 |
| Truck drivers' wages expense | 23,800 | 38,800 | 62,600 |
| Depreciation expense—delivery equipment..... | 12,600 | 11,400 | 24,000 |
| Bakery rent expense | 10,700 | 15,800 | 26,500 |
| Bad debt expense..... | 2,300 | 1,800 | 4,100 |
| Other operating expenses | <u>128,200</u> | <u>95,600</u> | <u>223,800</u> |
| | \$223,200 | \$246,200 | \$469,400 |

Net sales and cost of goods sold for the year were as follows:

| | Cake Department | Bread Department |
|--------------------------|--------------------|---------------------|
| Net sales | \$850,000 | \$770,000 |
| Cost of goods sold | 488,500 | 526,800 |

Required:

Prepare a condensed income statement showing departmental gross profits and operating income.

| | Cake Dept. | Bread Dept. | Total |
|--|------------|-------------|-------|
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Problem 5 (LO 2/3) INCOME STATEMENT WITH DEPARTMENTAL OPERATING INCOME AND TOTAL OPERATING INCOME

Bill Hickock owns a business called Wild West Wear. He has divided his business into two departments: boots and accessories. The information provided below is for the fiscal year ended June 30, 20--.

| | Boots | Accessories |
|--------------------------|--------------|--------------------|
| Net sales | \$550,200 | \$257,000 |
| Cost of goods sold | 247,600 | 141,400 |
| Wages expense | 107,000 | 50,800 |
| Advertising expense | 43,200 | 15,700 |
| Other operating expenses | 49,000 | 26,000 |

Required:

1. Prepare an income statement showing departmental operating income and total operating income.
2. Calculate departmental operating expense and operating income percentages.

1.

| | Boots | Accessories | Total |
|--|-------|-------------|-------|
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Problem 6 (LO 2/3/4) INCOME STATEMENT WITH DEPARTMENTAL DIRECT OPERATING MARGIN AND TOTAL OPERATING INCOME

Joyce Kennington operates a business called Games Unlimited that sells video games, pinball machines, and pocket billiards for home and commercial use. The following information is provided for the year ended December 31, 20--:

| | Home Market | Commercial Market |
|--|-------------|-------------------|
| Net sales | \$284,000 | \$395,000 |
| Cost of goods sold | 146,250 | 175,000 |
| Direct operating expenses: | | |
| Advertising expense | \$ 26,000 | \$ 38,000 |
| Store clerks' wages expense | 32,000 | 36,000 |
| Truck drivers' wages expense | 13,000 | 16,000 |
| Bad debt expense | 5,000 | 7,000 |
| Depreciation expense—delivery equipment..... | 8,000 | 6,000 |
| Other operating expenses | 24,000 | 18,000 |
| Indirect operating expenses: | | |
| Store clerks' wages expense | \$ 12,000 | |
| Advertising expense | 11,000 | |
| Store rent expense..... | 22,000 | |
| Other operating expenses | 15,000 | |

Required:

1. Prepare an income statement showing departmental direct operating margin and total operating income, using the form on the following page.
2. Calculate departmental direct operating margin percentages in the space provided below.

2.

Problem 7 (LO 4) WHETHER TO DISCONTINUE A DEPARTMENT

Jones and Abdel are reviewing the operating activities of their four departments for the current year as follows:

| | Dept. A | Dept. B | Dept. C | Dept. D | Total |
|----------------------------------|--------------------------|-------------------------|-------------------------|--------------------------|-------------------------|
| Net sales | \$550,000 | \$480,000 | \$625,000 | \$340,000 | \$1,995,000 |
| Cost of goods sold..... | <u>385,000</u> | <u>288,000</u> | <u>468,750</u> | <u>170,000</u> | <u>1,311,750</u> |
| Gross profit | \$165,000 | \$192,000 | \$156,250 | \$170,000 | \$ 683,250 |
| Direct operating expenses | <u>95,000</u> | <u>108,000</u> | <u>78,000</u> | <u>190,000</u> | <u>471,000</u> |
| Direct operating margin | \$ 70,000 | \$ 84,000 | \$ 78,250 | \$(20,000) | \$ 212,250 |
| Indirect operating expenses..... | <u>78,000</u> | <u>45,000</u> | <u>36,000</u> | <u>13,000</u> | <u>172,000</u> |
| Operating income (loss)..... | <u><u>\$ (8,000)</u></u> | <u><u>\$ 39,000</u></u> | <u><u>\$ 42,250</u></u> | <u><u>\$(33,000)</u></u> | <u><u>\$ 40,250</u></u> |

Required:

Determine whether any of the departments should be eliminated. Explain.

CHAPTER 26

MANUFACTURING ACCOUNTING: THE JOB ORDER COST SYSTEM

LEARNING OBJECTIVES

Chapter 26 introduces the manufacturing business, as contrasted with a service or merchandising business. The major difference lies in the asset account called Inventory. In a manufacturing business, there are three inventory accounts—Materials, Work in Process, and Finished Goods. As a result, financial statements are prepared slightly differently, and costs are accumulated differently in a job order cost accounting system.

Objective 1. Describe the three manufacturing costs.

The three costs incurred to manufacture a product are materials, labor, and factory overhead. **Materials** include both direct materials (those that are a major part of the finished product) and indirect materials (those that are used in the manufacturing process but are a minor part of the finished product). **Labor** is also direct and indirect. **Factory overhead** includes the indirect manufacturing costs, including indirect materials, indirect labor, and other factory overhead (such as depreciation, repairs, insurance, and taxes on the factory and equipment).

Objective 2. Describe the three inventories of a manufacturing business.

Materials inventory consists of all materials used to produce the final product, including both direct and indirect materials.

Work in process inventory includes all products on which work has begun but is not finished at the end of the accounting period. The cost of work in process inventory includes materials, labor, and factory overhead.

Finished goods inventory contains the costs of finished products that are ready for sale.

Objective 3. Describe and illustrate how manufacturing costs and inventories affect the financial statements of a manufacturing business.

The main difference between manufacturing and merchandising company income statements is that cost of goods manufactured on the manufacturer's income statement replaces purchases on the merchandiser's income statement. In addition, the cost of goods sold section of the manufacturer's income statement is supplemented by a schedule of cost of goods manufactured. This schedule lists the amount of beginning work in process; materials, labor, and factory overhead added to production; ending work in process; and cost of goods manufactured during the accounting period.

The balance sheet is also slightly different. In the current assets section, a manufacturing business lists three inventories: finished goods, work in process, and materials.

Objective 4. Define and describe how to operate a job order cost accounting system.

A **job order cost system** provides a separate record of the cost of producing each individual product or group of products. A perpetual inventory system is used to maintain a continuous record of the flow of costs through the manufacturing inventory accounts. Journal entries are required to recognize that (1) materials are purchased, (2) materials are issued to production, (3) product is completed, and (4) completed product is sold.

A record of materials is kept in a materials ledger or stores ledger. Materials requisitions are used to issue materials from the storeroom to production. Employee earnings are recorded on time sheets, and direct labor costs are charged to work in process. Indirect labor costs are charged to factory overhead.

Factory overhead consists of indirect materials, indirect labor, and all other indirect manufacturing costs. These actual factory overhead costs are accumulated in the factory overhead account and in a factory overhead

subsidiary ledger. Using a factory overhead control account, a reasonable amount of factory overhead is assigned to specific job orders, even though all costs may not be known at the time the product is finished. This is called applying factory overhead using a **predetermined overhead rate**. The rate is calculated by dividing estimated total factory overhead costs by some measure of production activity—usually direct labor hours, direct labor costs, or machine hours.

All direct materials, direct labor, and factory overhead costs applied on each job are accumulated on a job cost sheet. After a job is completed, all costs accumulated on the job cost sheet are transferred to Finished Goods.

Generally, factory overhead applied will not be exactly the same amount as the actual overhead accumulated in the factory overhead account. The difference is called **overapplied** or **underapplied overhead**. Unless the amount is large, this balance usually is transferred to the cost of goods sold account at the end of the accounting period by an adjusting entry.

Objective 5. Describe a process cost accounting system.

Rather than using job orders to record a product’s cost, a manufacturer may elect to use a **process cost system**. As a product flows through the manufacturing process, costs are attached and passed along at each point or process of production. For example, costs in the cutting department would be applied to the product before it entered the finishing department.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|---|--------|
| LO 1 1. The three costs incurred to manufacture a product are _____, _____, and _____. | _____ |
| | _____ |
| | _____ |
| LO 1 2. Materials that enter into and become a major part of a finished product are called _____ materials. | _____ |
| LO 1 3. Materials used in production that do not become a major part of a finished product are called _____ materials. | _____ |
| LO 1 4. Wages of employees directly involved with converting materials into finished goods are called _____ labor. | _____ |
| LO 1 5. Wages and salaries of people not directly involved with production are called _____ labor. | _____ |
| LO 1 6. All manufacturing costs, other than direct materials and direct labor, are called _____. | _____ |

LO 1 7. The three major components of factory overhead are _____, _____, and _____.

LO 2 8. Three major inventories of a manufacturing business are _____, _____, and _____.

LO 2 9. Work in process inventory consists of three main components: _____, _____, and _____.

LO 3 10. A merchandising company adds purchases to beginning inventory to calculate goods available for sale; a manufacturing company adds _____ to beginning inventory.

LO 3 11. The balance sheet of a manufacturing company includes three inventory accounts: _____, _____, and _____.

LO 4 12. A(n) _____ cost system provides a separate record of the cost of each product or group of products that is produced.

LO 4 13. When raw materials are purchased, the cost is debited to an inventory account called _____.

LO 4 14. The materials account in the general ledger is a control account; a separate account for each type of material is kept in a(n) _____ ledger, called a materials or stores ledger.

LO 4 15. Materials are issued from the storeroom to production based on a form called the _____.

LO 4 16. Direct labor is debited to the _____ inventory account.

LO 4 17. The factory overhead account is a control account; details are accumulated in the factory overhead _____ ledger.

LO 4 18. When factory overhead costs are applied to specific jobs, they are applied based on a(n) _____ rate.

LO 4 19. A(n) _____ sheet is a document for recording the direct materials, direct labor, and factory overhead costs incurred on a specific job.

LO 4 20. Finished Goods is a(n) _____ account in the general ledger. A separate account for each product is kept in a finished goods ledger.

LO 4 21. If the amount of applied overhead is greater than the actual overhead cost incurred, the difference is called _____ overhead.

LO 4 22. If the amount of applied overhead is less than actual overhead cost incurred, the difference is called _____ overhead.

LO 5 23. A(n) _____ cost system accumulates manufacturing costs by process; each unit passing through the process is assigned a share of the costs.

LO 5 24. A(n) _____ cost system is useful for costing similar or identical products.

EXERCISES

Exercise 1 (LO 3) SCHEDULE OF COST OF GOODS MANUFACTURED

Prepare a schedule of cost of goods manufactured for Jonas Manufacturing Company, based on the following information: (Assume that all materials inventory items are direct materials.)

| | |
|--|----------|
| Work in process, January 1, 20-- | \$22,000 |
| Materials inventory, January 1, 20-- | 18,000 |
| Materials purchases | 19,000 |
| Materials inventory, December 31, 20-- | 21,500 |
| Direct labor | 16,500 |
| Factory overhead | 8,200 |
| Work in process, December 31, 20-- | 24,000 |

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Exercise 3 (LO 3) CURRENT ASSETS SECTION OF BALANCE SHEET

Prepare the current assets section of a balance sheet for Jonas Manufacturing Company, using information from Exercises 1 and 2 (for inventory balances) and the following information:

| | |
|---------------------------|----------|
| Cash..... | \$18,000 |
| Accounts receivable | 15,000 |
| Supplies | 8,000 |

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Exercise 4 (LO 4) JOB ORDER COST SHEET

Below is a job order cost sheet for Job No. 329. From the daily time sheet, post direct labor to the cost sheet; from the materials requisition, post direct materials to the job cost sheet. Factory overhead is applied as a percentage of direct labor costs (50%). Complete the job cost sheet from the information supplied.

| JOB COST SHEET | | | | WATERTOWN Manufacturing Co. |
|---------------------------------|--------|-------------------------------------|---------|--------------------------------|
| Job No. <u>329</u> | | Date Started <u>Jan. 24, 20--</u> | | |
| Item <u>RC Boat</u> | | | | |
| For <u>Lakeside Wholesalers</u> | | Date Completed <u>Feb. 22, 20--</u> | | |
| DIRECT MATERIALS | | DIRECT LABOR | | FACTORY OVERHEAD |
| Req. No. | Amount | Hours | Amount | Direct Labor _____ |
| 471 | \$600 | 301 | \$1,000 | Overhead Rate _____ |
| | | | | Overhead Applied _____ |
| | | | | SUMMARY |
| | | | | Direct Materials _____ |
| | | | | Direct Labor _____ |
| | | | | Overhead _____ |
| | | | | Total Cost _____ |

Exercise 4 (Concluded)

| WATERTOWN | | | | | | | |
|-----------------------------|-------|-------|-------|------|--------------------------|-------|------------------|
| Manufacturing Co. | | | | | | | |
| DAILY TIME SHEET | | | | | | | |
| Name <u>Charles Shirley</u> | | | | | Date <u>Feb. 4, 20--</u> | | |
| Job No. | Start | Stop | Hours | | Equiv. Hours | Rate | Amount Earned |
| | | | Reg. | O.T. | | | |
| 329 | 8:00 | 12:00 | 4 | | 4 | 10.00 | \$40.00 |
| 329 | 1:00 | 6:00 | 4 | 1 | 5 1/2 | 10.00 | 55.00 |
| | | | | | | | \$95.00 |

| MATERIALS REQUISITION | | | | |
|--------------------------|-----------------------|--|-----------|------------|
| Requested | Susan Rosman | | Req. No. | 507 |
| Date: | January 29, 20-- | | Approved: | C.D. |
| Charge to: | Job No. 329—Materials | | | |
| Item No. | Description | Quantity | Unit Cost | Total Cost |
| PT10 | 16" Plastic Boat Body | 1,000 | 1.50 | \$1,500 |
| Received by: <u>S.R.</u> | | Date Received: <u>January 29, 20--</u> | | |

Exercise 6 (LO 4) APPLICATION OF FACTORY OVERHEAD

Using the rates calculated in Exercise 5, determine the overhead applied to the following jobs, based on (a) direct labor hours, (b) direct labor costs, and (c) machine hours.

- 1. Job No. 101: 10 direct labor hours
 \$80 direct labor costs
 30 machine hours
- 2. Job No. 102: 25 direct labor hours
 \$250 direct labor costs
 60 machine hours
- 3. Job No. 103: 15 direct labor hours
 \$100 direct labor costs
 12 machine hours

PROBLEMS

Problem 7 (LO 4) JOURNAL ENTRIES FOR MATERIAL, LABOR, AND OVERHEAD

Required:

Based on the following information, prepare general journal entries for Aztel Manufacturing Company. Label the entries (a) through (j).

- (a) Purchased raw materials on account, \$28,000.
- (b) Issued direct materials to production, \$12,000. Job No. 101.
Issued direct materials to production, \$10,000. Job No. 102.
- (c) Issued indirect materials to production, \$4,000.
- (d) Allocated payroll, direct labor to production, \$13,000. Job No. 101.
Allocated payroll, direct labor to production, \$11,000. Job No. 102.
- (e) Allocated indirect labor costs to production, \$2,500.
- (f) Paid miscellaneous factory overhead charges, \$5,000.
- (g) Allocated factory overhead to Job Nos. 101 and 102 based on a predetermined factory overhead rate of 50% of direct labor costs.
- (h) Finished Job Nos. 101 and 102 and transferred them to finished goods as products A and B.
- (i) Sold products A and B for \$35,000 and \$29,000, respectively.
- (j) Transferred the balance in the factory overhead account to Cost of Goods Sold (under- or overapplied factory overhead).

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Problem 8 (LO 4) JOURNAL ENTRIES FOR MATERIAL, LABOR, OVERHEAD, AND SALES

Required:

Based on the following information, prepare general journal entries for B. R. Campbell Company. Using a general journal, label the entries (a) through (j). Calculate the predetermined factory overhead rate, based on total estimated factory overhead of \$15,000 and anticipated total direct labor hours of 7,500. Post the transactions to the following T accounts: Materials, Work in Process (subsidiary ledger accounts for Job Nos. 20–23), Finished Goods, Cost of Goods Sold, and Factory Overhead.

(a) Purchased materials on account, \$40,000.

(b) Direct materials requisitioned to production:

| | |
|------------------|----------|
| Job No. 20 | \$10,000 |
| Job No. 21 | 8,000 |
| Job No. 22 | 7,000 |
| Job No. 23 | 9,000 |

(c) Indirect materials requisitioned to production, \$1,000.

(d) Direct labor charged to production:

| | |
|--|---------|
| Job No. 20: 125 direct labor hours | \$1,500 |
| Job No. 21: 300 direct labor hours | 3,200 |
| Job No. 22: 175 direct labor hours | 2,000 |
| Job No. 23: 250 direct labor hours | 3,000 |

(e) Indirect labor charged to production, \$500.

(f) Other miscellaneous factory overhead charges paid, \$300.

(g) Factory overhead applied is charged to Job Nos. 20–23 based on the predetermined factory overhead rate.

(h) Job Nos. 20–23 are finished and transferred to finished goods as products D, E, F, and G.

(i) Products D, E, F, and G are sold for \$13,000, \$12,800, \$10,700, and \$14,300, respectively.

(j) Actual factory overhead is not the same as factory overhead applied.

Actual factory overhead: \$1,800

Transfer the difference (under- or overapplied factory overhead) to Cost of Goods Sold.

Problem 8 (Continued)

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Problem 8 (Concluded)

| Materials | |
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| Work in Process: Job No. 20 | |
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| Work in Process: Job No. 21 | |
|-----------------------------|--|
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| Work in Process: Job No. 22 | |
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| Work in Process: Job No. 23 | |
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| Finished Goods | |
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| Cost of Goods Sold | |
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| Factory Overhead | |
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CHAPTER 27

MANUFACTURING ACCOUNTING: THE WORK SHEET AND FINANCIAL STATEMENTS

LEARNING OBJECTIVES

Chapter 27 shows how to use the work sheet to prepare the financial statements of a manufacturing company. Both the work sheet and financial statements of a manufacturing company differ from those of a merchandising company.

Objective 1. Prepare a 10-column work sheet for a manufacturing company.

The work sheet for a manufacturing company is similar to the one illustrated in Chapter 14 for a merchandising company. The same five steps applied in Chapter 14 are used to prepare this work sheet.

1. Prepare the trial balance.
2. Prepare the adjustments.
3. Prepare the adjusted trial balance.
4. Extend the adjusted trial balance amounts to the Income Statement and Balance Sheet columns.
5. Total the Income Statement and Balance Sheet columns to compute the net income or net loss.

Unlike a merchandising company that uses a single inventory, a manufacturing company has three inventories:

1. finished goods
2. work in process, and
3. materials.

All three of these inventories appear on the balance sheet and are classified as current assets.

A manufacturer uses a perpetual inventory system, so that the movement of goods from Materials to Work in Process to Finished Goods to Cost of Goods Sold is recorded as the movement occurs. For example, each time finished goods are sold, Cost of Goods Sold is debited and Finished Goods Inventory is credited for the cost of the goods sold. If there is a difference between the physical count and the amount in the perpetual inventory records, an adjusting entry is needed to correct the records.

Factory Overhead includes all costs of manufacturing a product that are not either direct materials or direct labor. Both the debit and credit balances of Factory Overhead appear on the work sheet. The debit balance represents actual overhead costs incurred. The credit balance represents factory overhead applied to production.

Objective 2. Prepare work sheet adjusting entries to (1) apply factory overhead to ending work in process, (2) record additional actual factory overhead, (3) record under- or overapplied overhead, (4) record other expenses not involving overhead, and (5) provide for corporate income taxes.

Many adjustments on the work sheet are similar to those illustrated in Chapter 14. The new ones for a manufacturing company are summarized as follows:

(1) Factory overhead is applied to jobs not completed at the end of the year to properly value the ending work in process inventory. This is done by debiting Work in Process and crediting Factory Overhead.

(2) Factory supplies and insurance related to the factory and to factory equipment must be adjusted at year-end. These adjustments involve a debit to Factory Overhead and a credit to Factory Supplies and Prepaid

Insurance. Depreciation on the factory building and factory equipment is recorded by debiting Factory Overhead and crediting the related accumulated depreciation accounts.

(3) At the end of the year, the factory overhead account is examined. If the debit side is larger than the credit side, this indicates underapplied overhead. This underapplied overhead is closed into Cost of Goods Sold. If the credit side of Factory Overhead is larger than the debit side, this indicates overapplied overhead. This overapplied overhead is closed into Cost of Goods Sold.

(4) Adjustments also are made for three expenses not involving overhead: interest on bonds payable, uncollectible accounts, and depreciation on the office equipment.

(5) An adjustment to corporate income tax is necessary because the amount of estimated income tax paid during the year does not equal the actual amount of income tax owed.

The work sheet is completed by extending the amounts from the adjusted trial balance to either the Income Statement columns or the Balance Sheet columns. The factory overhead account balances are not extended because these balances have already been transferred to Work in Process, Finished Goods, and Cost of Goods Sold.

Objective 3. Prepare financial statements for a manufacturing company.

Financial statements prepared for a manufacturing company include an income statement, statement of retained earnings, balance sheet, and statement of cash flows. The statement of cash flows is essentially the same in format as the one illustrated in Chapter 23, so it is not illustrated in this chapter. ToyJoy is a manufacturer, so its income statement is supported by a schedule of cost of goods manufactured. ToyJoy is a corporation, so its statement of retained earnings includes a deduction for dividends paid. As a manufacturer, ToyJoy's balance sheet includes three inventory accounts.

Objective 4. Prepare adjusting, closing, and reversing journal entries for a manufacturing company.

Each of the entries appearing in the Adjustments columns of the work sheet must be journalized.

The adjustment to apply factory overhead to work in process does not include any entries to the individual jobs in the job cost ledger. This is because only the aggregate work in process needs to be adjusted for financial reporting purposes at year-end. The aggregate adjustment will be reversed at the beginning of the following period.

Six steps are involved in closing the manufacturer's temporary accounts.

1. The debit "balance" in the factory overhead account is transferred to Income Summary, and the subsidiary factory overhead accounts are closed.
2. The credit "balance" in the factory overhead account is transferred to Income Summary.
3. The balances of the sales and interest revenue accounts are transferred to Income Summary.
4. The balances of Cost of Goods Sold and all expense accounts are transferred to Income Summary.
5. The balance of the income summary account is transferred to Retained Earnings.
6. The balance of the cash dividends account is transferred to Retained Earnings.

ToyJoy reverses only two adjusting entries: (1) For accrued interest on bonds payable; (2) For the application of factory overhead to Work in Process.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

| Question | Answer |
|---|--|
| <p>LO 1 1. In place of a single merchandise inventory account on the merchandising company work sheet, the three inventories for the manufacturing company are _____, _____ and _____.</p> | <p>_____</p> <p>_____</p> <p>_____</p> |
| <p>LO 1 2. Under the perpetual inventory system, _____ contains the costs recorded as sales were made during the year.</p> | <p>_____</p> |
| <p>LO 1 3. The debit side of Factory Overhead represents _____.</p> | <p>_____</p> |
| <p>LO 1 4. The credit side of Factory Overhead represents _____.</p> | <p>_____</p> |
| <p>LO 2 5. Factory overhead is applied to Work in Process at the end of the year by debiting the account _____ and crediting the account _____.</p> | <p>_____</p> <p>_____</p> |
| <p>LO 2 6. An adjustment at the end of the year to show the amount of factory insurance expired includes a debit to _____.</p> | <p>_____</p> |
| <p>LO 2 7. Interest is accrued on bonds payable at the end of the year by debiting _____ and crediting _____.</p> | <p>_____</p> <p>_____</p> |
| <p>LO 2 8. An adjustment at the end of the year to show the amount of factory supplies used includes a debit to _____.</p> | <p>_____</p> |
| <p>LO 2 9. An adjustment at the end of the year to show the amount of depreciation on the factory building includes a debit to _____ and a credit to _____.</p> | <p>_____</p> <p>_____</p> |
| <p>LO 2 10. At the end of the year, the factory overhead account shows the debit side is larger than the credit side. This debit balance represents (over-/under-) applied overhead.</p> | <p>_____</p> |
| <p>LO 2 11. An adjustment at the end of the year for a credit balance in the factory overhead account includes a credit to _____.</p> | <p>_____</p> |
| <p>LO 2 12. An adjustment at the end of the year to show the amount of additional corporate income tax includes a credit to _____.</p> | <p>_____</p> |

LO 2 13. On the work sheet, the adjusted trial balance amounts are extended to the _____ columns and _____ columns. _____

LO 2 14. The _____ account balances are not extended to the Income Statement or Balance Sheet columns. _____

LO 3 15. Most of the data for the income statement can be obtained from the _____ columns of the work sheet. _____

LO 3 16. The main differences between a merchandising income statement and a manufacturing income statement are the _____ section and the supplementary schedule of _____. _____

LO 4 17. In addition to closing all revenue and expense accounts, both the debit and credit totals of the _____ account must be closed to Income Summary. _____

LO 4 18. The closing entry for factory overhead involves a credit to Factory Overhead and a debit to _____. _____

LO 4 19. The balance of the income summary account is transferred to _____ as part of the closing process. _____

LO 4 20. The adjusting entry to apply factory overhead to Work in Process is reversed with a debit to _____ and a credit to _____. _____

EXERCISES

Exercise 1 (LO 2) ADJUSTING ENTRIES INCLUDING UNDERAPPLIED/OVERAPPLIED OVERHEAD

Data for the end-of-year adjustments of Jones Company are shown below.

- (a) Factory overhead is applied at a rate of 80% of direct labor costs. At the end of the year, the direct labor costs associated with the jobs still in process amounted to \$10,000.
 - (b) Based on a physical count of factory supplies at the end of the year, it is determined that \$3,525 of factory supplies were used during the year.
 - (c) Based on a review of the insurance policy files, it is determined that \$4,295 of insurance on the factory building and equipment has expired.
 - (d) Depreciation expense for the year was \$5,450 on the factory building and \$8,735 on the factory equipment, a total of \$14,185.
 - (e) The factory overhead account has a debit balance of \$233,175 and a credit balance of \$236,600 [after recording adjustments (a) through (d)].
1. Prepare adjusting journal entries as of December 31.
 2. Was factory overhead under- or overapplied for the year?

1.

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2.

Exercise 2 (LO 3) SCHEDULE OF COST OF GOODS MANUFACTURED

Data for Brinley Company for the current fiscal year ended June 30, 20-2, are shown below.

| | |
|--|-----------|
| Work in process, June 30, 20-2..... | \$ 18,260 |
| Materials inventory, June 30, 20-2 | 14,300 |
| Materials purchased | 147,150 |
| Direct labor | 290,350 |
| Factory overhead..... | 160,240 |
| Work in process, July 1, 20-1 | 13,250 |
| Materials inventory, July 1, 20-1 | 10,260 |
| Indirect materials charged to production | 4,500 |

Prepare a schedule of cost of goods manufactured for the year ended June 30, 20-2.

Exercise 3 (LO 2/4) ADJUSTING AND REVERSING ENTRIES

Data for the end-of-year adjustments of Dembrow Company are shown below.

| | |
|--|----------|
| Factory overhead to be applied to work in process | |
| ending inventory | \$12,800 |
| Interest receivable | 920 |
| Allowance for doubtful accounts..... | 3,920 |
| Office supplies consumed..... | 1,350 |
| Factory supplies consumed..... | 4,250 |
| Insurance expired on factory building and equipment..... | 3,400 |
| Depreciation—factory building | 4,600 |
| Depreciation—factory equipment | 6,100 |
| Interest payable | 8,250 |

1. Prepare the end-of-year adjusting journal entries, as of December 31, 20-3, for Dembrow Company.
2. Prepare the reversing journal entries for Dembrow Company, as of January 2, 20-4.

Exercise 3 (Continued)

1.

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Exercise 3 (Concluded)

2.

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Exercise 4 (LO 4) CLOSING ENTRIES

Data for the closing entries of Thompson Company are shown below.

| | |
|--|-----------|
| Factory overhead, debit and credit balance | \$216,850 |
| Sales | 842,750 |
| Interest revenue | 1,400 |
| Cost of goods sold..... | 583,640 |
| Wages expense..... | 102,400 |
| Office supplies expense | 3,740 |
| Depreciation expense—office equipment..... | 6,230 |
| Utilities expense—office | 5,485 |
| Bad debt expense | 2,350 |
| Advertising expense..... | 9,350 |
| Interest expense..... | 8,420 |
| Income tax expense..... | 29,370 |
| Cash dividends | 16,000 |

Prepare closing journal entries for Thompson Company for the year ended December 31.

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Exercise 4 (Concluded)

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PROBLEMS

Problem 5 (LO 1/2/3) WORK SHEET, ADJUSTING ENTRIES, AND FINANCIAL STATEMENTS

The trial balance portion of the work sheet of Rogerson Company as of December 31, 20--, is shown on pages 474 and 475.

Problem 5 (Continued)

1.

Rogerson

Work

For Year Ended

| | TRIAL BALANCE | | | | | ADJUSTMENTS | | | | | |
|----|----------------------------------|-----|---|---|----|-------------|---|---|----|--|--|
| | DEBIT | | | | | CREDIT | | | | | |
| 1 | Cash | 28 | 3 | 0 | 00 | | | | | | |
| 2 | Government Notes | 7 | 0 | 0 | 00 | | | | | | |
| 3 | Interest Receivable | | | | | | | | | | |
| 4 | Accounts Receivable | 28 | 0 | 0 | 00 | | | | | | |
| 5 | Allowance for Doubtful Accounts | | | | | 7 | 2 | 0 | 00 | | |
| 6 | Finished Goods Inventory | 21 | 4 | 6 | 00 | | | | | | |
| 7 | Work in Process Inventory | 11 | 3 | 2 | 00 | | | | | | |
| 8 | Materials Inventory | 10 | 2 | 4 | 00 | | | | | | |
| 9 | Office Supplies | 5 | 7 | 2 | 00 | | | | | | |
| 10 | Factory Supplies | 7 | 1 | 5 | 00 | | | | | | |
| 11 | Land | 100 | 0 | 0 | 00 | | | | | | |
| 12 | Factory Building | 90 | 0 | 0 | 00 | | | | | | |
| 13 | Accum. Depr.—Factory Building | | | | | 15 | 0 | 0 | 00 | | |
| 14 | Factory Equipment | 50 | 0 | 0 | 00 | | | | | | |
| 15 | Accum. Depr.—Factory Equip. | | | | | 10 | 0 | 0 | 00 | | |
| 16 | Accounts Payable | | | | | 15 | 2 | 0 | 00 | | |
| 17 | Income Tax Payable | | | | | | | | | | |
| 18 | Interest Payable | | | | | | | | | | |
| 19 | Bonds Payable | | | | | 100 | 0 | 0 | 00 | | |
| 20 | Capital Stock | | | | | 60 | 0 | 0 | 00 | | |
| 21 | Paid-In Capital in Excess of Par | | | | | 20 | 0 | 0 | 00 | | |
| 22 | Retained Earnings | | | | | 76 | 2 | 7 | 00 | | |
| 23 | Cash Dividends | 20 | 0 | 0 | 00 | | | | | | |
| 24 | Sales | | | | | 395 | 2 | 0 | 00 | | |
| 25 | Interest Revenue | | | | | 5 | 0 | 0 | 00 | | |
| 26 | Factory Overhead | 84 | 6 | 0 | 00 | 97 | 5 | 0 | 00 | | |
| 27 | | | | | | | | | | | |
| 28 | | | | | | | | | | | |
| 29 | | | | | | | | | | | |
| 30 | Cost of Goods Sold | 210 | 4 | 0 | 00 | | | | | | |
| 31 | Wages Expense | 82 | 1 | 0 | 00 | | | | | | |
| 32 | Office Supplies Expense | | | | | | | | | | |
| 33 | Utilities Expense—Office | 5 | 1 | 0 | 00 | | | | | | |
| 34 | Bad Debt Expense | | | | | | | | | | |
| 35 | Interest Expense | 8 | 0 | 0 | 00 | | | | | | |
| 36 | Income Tax Expense | 21 | 0 | 0 | 00 | | | | | | |
| 37 | | 790 | 3 | 9 | 00 | 790 | 3 | 9 | 00 | | |
| 38 | Net Income | | | | | | | | | | |
| 39 | | | | | | | | | | | |
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Problem 5 (Continued)

Company

Sheet

December 31, 20--

| ADJUSTED TRIAL BALANCE | | | | INCOME STATEMENT | | | | BALANCE SHEET | | | | |
|------------------------|--|--------|--|------------------|--|--------|--|---------------|--|--------|--|----|
| DEBIT | | CREDIT | | DEBIT | | CREDIT | | DEBIT | | CREDIT | | |
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Problem 5 (Continued)

Data for adjusting the accounts:

| | |
|--|----------|
| (a) Factory overhead (to be applied to work in process ending inventory) | \$ 2,950 |
|--|----------|

Interest accruals:

| | |
|-------------------------|-----|
| (b) Interest receivable | 100 |
| (c) Interest payable | 400 |

| | |
|--|-------|
| (d) Estimate of uncollectible accounts, based on an aging of accounts receivable | 4,100 |
| (e) Office supplies consumed | 2,900 |
| (f) Factory supplies consumed | 4,250 |

Depreciation:

| | |
|-----------------------|-------|
| (g) Factory building | 3,000 |
| (h) Factory equipment | 4,500 |

| | |
|--|-------|
| (i) Overapplied factory overhead | 4,100 |
| (j) Provision for corporate income taxes | 5,275 |

Additional data needed to prepare financial statements:

Beginning inventories:

| | |
|----------------------------------|----------|
| Finished goods, January 1 | \$19,300 |
| Work in process, January 1 | 9,480 |
| Materials inventory, January 1 | 13,650 |
| Materials purchases for the year | 43,200 |
| Direct labor | 70,290 |
| Actual factory overhead | 96,350 |

Assume that all materials inventory items are direct materials.

Required:

1. Complete the work sheet on pages 474 and 475.
2. Prepare the following financial statements and schedule:
 - a. income statement on page 477.
 - b. schedule of cost of goods manufactured on page 478.
 - c. statement of retained earnings on page 479.
 - d. balance sheet on pages 480 and 481.

Problem 6 (LO 1/3) FINANCIAL STATEMENTS

The Income Statement and Balance Sheet columns of Omega Company’s work sheet are shown on the next page.

Additional information needed to prepare the financial statements is as follows:

| | |
|--|----------|
| Materials inventory, January 1 | \$ 4,820 |
| Work in process inventory, January 1 | 7,535 |
| Finished goods inventory, January 1 | 20,345 |
| Materials purchases | 167,060 |
| Direct labor | 97,500 |
| Actual factory overhead..... | 104,300 |
| Indirect materials charged to production | 3,800 |

Required:

1. Prepare an income statement and a schedule of cost of goods manufactured for the year ended December 31, 20--.
2. Prepare a statement of retained earnings for the year ended December 31, 20--.
3. Prepare a balance sheet as of December 31, 20--.

Problem 6 (Continued)

Omega Company
Work Sheet (Partial)
For Year Ended December 31, 20--

| | INCOME STATEMENT | | | | | | | | BALANCE SHEET | | | | | | | | | | | | | |
|----|----------------------------------|-----|---|---|--------|-----|-----|---|---------------|-----|----|-----|--------|----|----|----|-----|---|----|----|----|----|
| | DEBIT | | | | CREDIT | | | | DEBIT | | | | CREDIT | | | | | | | | | |
| 1 | Cash | | | | | | | | | 23 | 4 | 7 | 5 | 00 | | | | | | 1 | | |
| 2 | Treasury Notes (short-term) | | | | | | | | | 5 | 5 | 0 | 0 | 00 | | | | | | 2 | | |
| 3 | Interest Receivable | | | | | | | | | | | 9 | 5 | 00 | | | | | | 3 | | |
| 4 | Accounts Receivable | | | | | | | | | 48 | 2 | 1 | 0 | 00 | | | | | | 4 | | |
| 5 | Allowance for Doubtful Accounts | | | | | | | | | | | | | | 2 | 8 | 9 | 5 | 00 | 5 | | |
| 6 | Finished Goods Inventory | | | | | | | | | 23 | 9 | 0 | 0 | 00 | | | | | | 6 | | |
| 7 | Work in Process Inventory | | | | | | | | | 9 | 8 | 4 | 5 | 00 | | | | | | 7 | | |
| 8 | Materials Inventory | | | | | | | | | 6 | 3 | 8 | 0 | 00 | | | | | | 8 | | |
| 9 | Office Supplies | | | | | | | | | 7 | 7 | 0 | 0 | 00 | | | | | | 9 | | |
| 10 | Factory Supplies | | | | | | | | | 9 | 1 | 5 | 0 | 00 | | | | | | 10 | | |
| 11 | Prepaid Insurance | | | | | | | | | 8 | 5 | 0 | 0 | 00 | | | | | | 11 | | |
| 12 | Land | | | | | | | | | 30 | 0 | 0 | 0 | 00 | | | | | | 12 | | |
| 13 | Building | | | | | | | | | 95 | 0 | 0 | 0 | 00 | | | | | | 13 | | |
| 14 | Accum. Depr.—Building | | | | | | | | | | | | | | 23 | 8 | 0 | 0 | 00 | 14 | | |
| 15 | Equipment | | | | | | | | | 110 | 0 | 0 | 0 | 00 | | | | | | 15 | | |
| 16 | Accum. Depr.—Equipment | | | | | | | | | | | | | | 32 | 0 | 0 | 0 | 00 | 16 | | |
| 17 | Accounts Payable | | | | | | | | | | | | | | 24 | 0 | 0 | 0 | 00 | 17 | | |
| 18 | Income Tax Payable | | | | | | | | | | | | | | 4 | 9 | 5 | 0 | 00 | 18 | | |
| 19 | Interest Payable | | | | | | | | | | | | | | 6 | 0 | 0 | 0 | 00 | 19 | | |
| 20 | Bonds Payable | | | | | | | | | | | | | | 60 | 0 | 0 | 0 | 00 | 20 | | |
| 21 | Capital Stock | | | | | | | | | | | | | | 70 | 0 | 0 | 0 | 00 | 21 | | |
| 22 | Paid-In Capital in Excess of Par | | | | | | | | | | | | | | 15 | 0 | 0 | 0 | 00 | 22 | | |
| 23 | Retained Earnings | | | | | | | | | | | | | | 68 | 9 | 2 | 5 | 00 | 23 | | |
| 24 | Cash Dividends | | | | | | | | | 20 | 0 | 0 | 0 | 00 | | | | | | 24 | | |
| 25 | Sales | | | | | 533 | 9 | 6 | 0 | 00 | | | | | | | | | | | 25 | |
| 26 | Interest Revenue | | | | | 4 | 4 | 0 | 0 | 00 | | | | | | | | | | | 26 | |
| 27 | Factory Overhead | | | | | | | | | | | | | | | | | | | 27 | | |
| 28 | | | | | | | | | | | | | | | | | | | | 28 | | |
| 29 | Cost of Goods Sold | 357 | 6 | 3 | 5 | 00 | | | | | | | | | | | | | | | 29 | |
| 30 | Wages Expense | 74 | 1 | 2 | 5 | 00 | | | | | | | | | | | | | | | 30 | |
| 31 | Office Supplies Expense | 2 | 5 | 0 | 0 | 00 | | | | | | | | | | | | | | | 31 | |
| 32 | Bad Debt Expense | 1 | 8 | 9 | 0 | 00 | | | | | | | | | | | | | | | 32 | |
| 33 | Utilities Expense—Office | 2 | 2 | 0 | 0 | 00 | | | | | | | | | | | | | | | 33 | |
| 34 | Interest Expense | 3 | 6 | 0 | 0 | 00 | | | | | | | | | | | | | | | 34 | |
| 35 | Income Tax Expense | 19 | 6 | 8 | 0 | 00 | | | | | | | | | | | | | | | 35 | |
| 36 | | 461 | 6 | 3 | 0 | 00 | 534 | 4 | 0 | 0 | 00 | 374 | 9 | 4 | 0 | 00 | 302 | 1 | 7 | 0 | 00 | 36 |
| 37 | Net Income | 72 | 7 | 7 | 0 | 00 | | | | | | | | | | 72 | 7 | 7 | 0 | 00 | 37 | |
| 38 | | 534 | 4 | 0 | 0 | 00 | 534 | 4 | 0 | 0 | 00 | 374 | 9 | 4 | 0 | 00 | 374 | 9 | 4 | 0 | 00 | 38 |
| 39 | | | | | | | | | | | | | | | | | | | | | 39 | |

Problem 6 (Continued)

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Problem 7 (LO 1/2/4) Adjusting, Closing, and Reversing Entries

The completed work sheet of Reynolds Company as of December 31, 20-4, is shown below and on page 489.

Reynolds

Work

For Year Ended

| | TRIAL BALANCE | | | | ADJUSTMENTS | | | |
|-------------------------------------|---------------|----------|--------|----------|-------------|------------|--------|------------|
| | DEBIT | | CREDIT | | DEBIT | | CREDIT | |
| 1 Cash | 24 | 6 0 0 00 | | | | | | |
| 2 Government Notes | 9 | 0 0 0 00 | | | | | | |
| 3 Interest Receivable | | | | | (b) | 1 6 5 00 | | |
| 4 Accounts Receivable | 23 | 0 0 0 00 | | | | | | |
| 5 Allowance for Doubtful Accounts | | | 9 | 2 0 00 | | | (d) | 2 4 7 5 00 |
| 6 Finished Goods Inventory | 25 | 0 0 0 00 | | | | | | |
| 7 Work in Process Inventory | 12 | 6 0 0 00 | | | (a) | 2 8 5 0 00 | | |
| 8 Materials Inventory | 10 | 3 0 0 00 | | | | | | |
| 9 Office Supplies | 6 | 2 0 0 00 | | | | | (e) | 5 2 4 5 00 |
| 10 Factory Supplies | 5 | 7 3 0 00 | | | | | (f) | 4 9 5 0 00 |
| 11 Prepaid Insurance | 7 | 3 0 0 00 | | | | | (g) | 6 2 0 0 00 |
| 12 Land | 75 | 0 0 0 00 | | | | | | |
| 13 Factory Building | 115 | 0 0 0 00 | | | | | | |
| 14 Accum. Depr.—Factory Building | | | 23 | 0 0 0 00 | | | (h) | 6 0 0 0 00 |
| 15 Factory Equipment | 60 | 0 0 0 00 | | | | | | |
| 16 Accum. Depr.—Factory Equip. | | | 12 | 0 0 0 00 | | | (i) | 7 5 0 0 00 |
| 17 Accounts Payable | | | 18 | 3 0 0 00 | | | | |
| 18 Income Tax Payable | | | | | | | (k) | 4 8 0 0 00 |
| 19 Interest Payable | | | | | | | (c) | 1 3 5 0 00 |
| 20 Bonds Payable | | | 80 | 0 0 0 00 | | | | |
| 21 Capital Stock | | | 70 | 0 0 0 00 | | | | |
| 22 Paid-In Capital in Excess of Par | | | 25 | 0 0 0 00 | | | | |
| 23 Retained Earnings | | | 110 | 5 4 0 00 | | | | |
| 24 Cash Dividends | 10 | 0 0 0 00 | | | | | | |
| 25 Sales | | | 357 | 2 0 0 00 | | | | |
| 26 Interest Revenue | | | 6 | 0 0 0 00 | | | (b) | 1 6 5 00 |
| 27 Factory Overhead | 83 | 2 0 0 00 | 98 | 6 0 0 00 | (f) | 4 9 5 0 00 | (a) | 2 8 5 0 00 |
| 28 | | | | | (g) | 6 2 0 0 00 | (j) | 6 4 0 0 00 |
| 29 | | | | | (h) | 6 0 0 0 00 | | |
| 30 | | | | | (i) | 7 5 0 0 00 | | |
| 31 Cost of Goods Sold | 198 | 9 0 0 00 | | | (j) | 6 4 0 0 00 | | |
| 32 Wages Expense | 90 | 0 0 0 00 | | | | | | |
| 33 Office Supplies Expense | | | | | (e) | 5 2 4 5 00 | | |
| 34 Utilities Expense—Office | 5 | 9 3 0 00 | | | | | | |
| 35 Bad Debt Expense | | | | | (d) | 2 4 7 5 00 | | |
| 36 Interest Expense | 7 | 4 0 0 00 | | | (c) | 1 3 5 0 00 | | |
| 37 Income Tax Expense | 27 | 0 0 0 00 | | | (k) | 4 8 0 0 00 | | |
| 38 | 796 | 1 6 0 00 | 796 | 1 6 0 00 | 47 | 9 3 5 00 | 47 | 9 3 5 00 |
| 39 Net Income | | | | | | | | |
| 40 | | | | | | | | |

Problem 7 (Continued)

Company

Sheet

December 31, 20-4

| ADJUSTED TRIAL BALANCE | | | | | INCOME STATEMENT | | | | | BALANCE SHEET | | | | | | |
|------------------------|---|--------|---|----|------------------|---|--------|---|----|---------------|-----|--------|---|----|----|----|
| DEBIT | | CREDIT | | | DEBIT | | CREDIT | | | DEBIT | | CREDIT | | | | |
| 24 | 6 | 0 | 0 | 00 | | | | | | 24 | 6 | 0 | 0 | 00 | 1 | |
| 9 | 0 | 0 | 0 | 00 | | | | | | 9 | 0 | 0 | 0 | 00 | 2 | |
| | 1 | 6 | 5 | 00 | | | | | | | 1 | 6 | 5 | 00 | 3 | |
| 23 | 0 | 0 | 0 | 00 | | | | | | 23 | 0 | 0 | 0 | 00 | 4 | |
| | | | | | 3 | 3 | 9 | 5 | 00 | | | | | | 5 | |
| 25 | 0 | 0 | 0 | 00 | | | | | | 25 | 0 | 0 | 0 | 00 | 6 | |
| 15 | 4 | 5 | 0 | 00 | | | | | | 15 | 4 | 5 | 0 | 00 | 7 | |
| 10 | 3 | 0 | 0 | 00 | | | | | | 10 | 3 | 0 | 0 | 00 | 8 | |
| | 9 | 5 | 5 | 00 | | | | | | | 9 | 5 | 5 | 00 | 9 | |
| | 7 | 8 | 0 | 00 | | | | | | | 7 | 8 | 0 | 00 | 10 | |
| 1 | 1 | 0 | 0 | 00 | | | | | | 1 | 1 | 0 | 0 | 00 | 11 | |
| 75 | 0 | 0 | 0 | 00 | | | | | | 75 | 0 | 0 | 0 | 00 | 12 | |
| 115 | 0 | 0 | 0 | 00 | | | | | | 115 | 0 | 0 | 0 | 00 | 13 | |
| | | | | | 29 | 0 | 0 | 0 | 00 | | | | | | 14 | |
| 60 | 0 | 0 | 0 | 00 | | | | | | 60 | 0 | 0 | 0 | 00 | 15 | |
| | | | | | 19 | 5 | 0 | 0 | 00 | | | | | | 16 | |
| | | | | | 18 | 3 | 0 | 0 | 00 | | | | | | 17 | |
| | | | | | 4 | 8 | 0 | 0 | 00 | | | | | | 18 | |
| | | | | | 1 | 3 | 5 | 0 | 00 | | | | | | 19 | |
| | | | | | 80 | 0 | 0 | 0 | 00 | | | | | | 20 | |
| | | | | | 70 | 0 | 0 | 0 | 00 | | | | | | 21 | |
| | | | | | 25 | 0 | 0 | 0 | 00 | | | | | | 22 | |
| | | | | | 110 | 5 | 4 | 0 | 00 | | | | | | 23 | |
| 10 | 0 | 0 | 0 | 00 | | | | | | 10 | 0 | 0 | 0 | 00 | 24 | |
| | | | | | 357 | 2 | 0 | 0 | 00 | | 357 | 2 | 0 | 0 | 00 | 25 |
| | | | | | | 7 | 6 | 5 | 00 | | | 7 | 6 | 5 | 00 | 26 |
| 107 | 8 | 5 | 0 | 00 | 107 | 8 | 5 | 0 | 00 | | | | | | 27 | |
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| 205 | 3 | 0 | 0 | 00 | | | | | | 205 | 3 | 0 | 0 | 00 | 31 | |
| 90 | 0 | 0 | 0 | 00 | | | | | | 90 | 0 | 0 | 0 | 00 | 32 | |
| 5 | 2 | 4 | 5 | 00 | | | | | | 5 | 2 | 4 | 5 | 00 | 33 | |
| 5 | 9 | 3 | 0 | 00 | | | | | | 5 | 9 | 3 | 0 | 00 | 34 | |
| 2 | 4 | 7 | 5 | 00 | | | | | | 2 | 4 | 7 | 5 | 00 | 35 | |
| 8 | 7 | 5 | 0 | 00 | | | | | | 8 | 7 | 5 | 0 | 00 | 36 | |
| 31 | 8 | 0 | 0 | 00 | | | | | | 31 | 8 | 0 | 0 | 00 | 37 | |
| 827 | 7 | 0 | 0 | 00 | 827 | 7 | 0 | 0 | 00 | 349 | 5 | 0 | 0 | 00 | 38 | |
| | | | | | | | | | | | | | | | 39 | |
| | | | | | | | | | | 8 | 4 | 6 | 5 | 00 | 39 | |
| | | | | | | | | | | 357 | 9 | 6 | 5 | 00 | 40 | |
| | | | | | | | | | | 357 | 9 | 6 | 5 | 00 | 40 | |
| | | | | | | | | | | 370 | 3 | 5 | 0 | 00 | 40 | |
| | | | | | | | | | | 370 | 3 | 5 | 0 | 00 | 40 | |

Problem 7 (Continued)

Data for adjusting the accounts:

(a) Factory overhead (to be applied to work in process ending inventory) \$2,850

Interest accruals:

(b) Interest receivable 165

(c) Interest payable 1,350

(d) Estimate of uncollectible accounts, based on an aging of accounts receivable 3,395

(e) Office supplies consumed 5,245

(f) Factory supplies consumed 4,950

(g) Insurance on factory building and equipment expired 6,200

Depreciation:

(h) Factory building 6,000

(i) Factory equipment 7,500

(j) Underapplied factory overhead 6,400

(k) Provision for corporate income taxes 4,800

Required:

1. Journalize the adjusting entries in the general journal below and on page 491.
2. Journalize the closing entries in the general journal on page 492.
3. Journalize the reversing entries as of January 2, 20-5, in the general journal on page 493.

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**END PAGE OF
STUDY GUIDE**

Working Papers

Chapters 16-27

College Accounting

Twenty-first Edition

James A. Heintz, DBA, CPA

*Professor of Accounting
School of Business
University of Kansas*

Robert W. Parry, Jr., Ph.D.

*Professor of Accounting
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Indiana University*



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ACCOUNT Bad Debt Expense

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Problem 16-8B
1. and 2.

GENERAL JOURNAL

| 1 | DATE | | DESCRIPTION | POST. REF. | DEBIT | | | | CREDIT | | | | 1 |
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Problem 16-8B (Concluded)

GENERAL JOURNAL

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GENERAL LEDGER

ACCOUNT Allowance for Doubtful Accounts

ACCOUNT NO. 122.1

| DATE | ITEM | POST. REF. | DEBIT | CREDIT | BALANCE | | | | | | | |
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ACCOUNT Income Summary

ACCOUNT NO. 313

| DATE | ITEM | POST. REF. | DEBIT | CREDIT | BALANCE | | | | | | | |
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ACCOUNT Bad Debt Expense

ACCOUNT NO. 532

| DATE | ITEM | POST. REF. | DEBIT | CREDIT | BALANCE | | | | | | | |
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3.

Problem 16-9B

1. a. GENERAL JOURNAL PAGE

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Problem 16-9B (Concluded)

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GENERAL JOURNAL

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Problem 16-10B

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Problem 16-11B

GENERAL JOURNAL

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Mastery Problem

1., 3., and 4.

GENERAL LEDGER—SAM

ACCOUNT **Cash**

ACCOUNT NO. **101**

| DATE | ITEM | POST. REF. | DEBIT | | | | CREDIT | | | | BALANCE | | | |
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ACCOUNT **Accounts Receivable**

ACCOUNT NO. **122**

| DATE | ITEM | POST. REF. | DEBIT | | | | CREDIT | | | | BALANCE | | | |
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ACCOUNT **Allowance for Doubtful Accounts**

ACCOUNT NO. **122.1**

| DATE | ITEM | POST. REF. | DEBIT | | | | CREDIT | | | | BALANCE | | | |
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ACCOUNT **Sales**

ACCOUNT NO. **401**

| DATE | ITEM | POST. REF. | DEBIT | | | | CREDIT | | | | BALANCE | | | |
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Mastery Problem (Continued)

4.

ACCOUNT **Bad Debt Expense**

ACCOUNT NO. **532**

| DATE | ITEM | POST. REF. | DEBIT | CREDIT | BALANCE | | | | | | | | |
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Mastery Problem (Continued)

2. and 4.

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Mastery Problem (Continued)

6. and 8.

GENERAL JOURNAL

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Mastery Problem (Continued)

1., 7., and 8.

GENERAL LEDGER—ROBERT

ACCOUNT **Cash**

ACCOUNT NO. **101**

| DATE | ITEM | POST. REF. | DEBIT | | | | CREDIT | | | | BALANCE | | | |
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ACCOUNT **Accounts Receivable**

ACCOUNT NO. **122**

| DATE | ITEM | POST. REF. | DEBIT | | | | CREDIT | | | | BALANCE | | | |
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ACCOUNT **Allowance for Doubtful Accounts**

ACCOUNT NO. **122.1**

| DATE | ITEM | POST. REF. | DEBIT | | | | CREDIT | | | | BALANCE | | | |
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ACCOUNT **Sales**

ACCOUNT NO. **401**

| DATE | ITEM | POST. REF. | DEBIT | | | | CREDIT | | | | BALANCE | | | |
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Mastery Problem (Concluded)

8.

ACCOUNT **Bad Debt Expense**

ACCOUNT NO. **532**

| DATE | ITEM | POST. REF. | DEBIT | CREDIT | BALANCE | | | | | | | | |
|------|------|------------|-------|--------|---------|--|--|--|--------|--|--|--|--|
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AGING SCHEDULE OF ACCOUNTS RECEIVABLE FOR ROBERT

| | A | B | C | D | E | F | G | H |
|----|--------------------------------|--------------|--------------------|-------------|--------------|--------------|---------------|-----------------|
| 1 | Number of Days Past Due | | | | | | | |
| 2 | Customer | Total | Not Yet Due | 1-30 | 31-60 | 61-90 | 91-120 | Over 120 |
| 3 | | | | | | | | |
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9.

Challenge Problem

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GENERAL JOURNAL

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GENERAL JOURNAL

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Challenge Problem (Concluded)

3. a.

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GENERAL JOURNAL

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Exercise 17-1A

| <u>Date of Note</u> | <u>Due Date</u> | <u>Time in Days</u> |
|---------------------|-----------------|---------------------|
| May 4 | July 17 | _____ |
| August 17 | October 1 | _____ |
| July 5 | September 5 | _____ |
| December 11 | February 5 | _____ |
| March 24 | May 16 | _____ |
| January 6 | March 18 | _____ |

Exercise 17-2A

| <u>Principal</u> | <u>Rate</u> | <u>Time</u> | <u>Interest</u> |
|------------------|-------------|-------------|-----------------|
| \$5,000 | 6.00% | 30 days | _____ |
| 1,000 | 7.50 | 60 | _____ |
| 4,500 | 8.00 | 120 | _____ |
| 950 | 6.80 | 95 | _____ |
| 1,250 | 7.25 | 102 | _____ |
| 2,900 | 7.00 | 90 | _____ |

Exercise 17-3A

| <u>Date of Note</u> | <u>Term of Note</u> | <u>Due Date</u> |
|---------------------|---------------------|-----------------|
| August 12 | 90 days | _____ |
| September 1 | 60 | _____ |
| January 3 | 120 | _____ |
| March 18 | 88 | _____ |
| June 11 | 200 | _____ |
| May 17 | 38 | _____ |

Exercise 17-4A

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Exercise 17-5A

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Exercise 17-1B

| <u>Date of Note</u> | <u>Due Date</u> | <u>Time in Days</u> |
|---------------------|-----------------|---------------------|
| August 17 | October 10 | _____ |
| January 12 | March 10 | _____ |
| July 15 | September 13 | _____ |
| December 3 | February 1 | _____ |
| April 11 | July 6 | _____ |
| October 6 | December 18 | _____ |

Exercise 17-2B

| <u>Principal</u> | <u>Rate</u> | <u>Time</u> | <u>Interest</u> |
|------------------|-------------|-------------|-----------------|
| \$4,000 | 7.00% | 60 days | _____ |
| 3,000 | 6.50 | 30 | _____ |
| 7,500 | 8.00 | 150 | _____ |
| 850 | 7.90 | 99 | _____ |
| 2,250 | 7.55 | 122 | _____ |
| 1,900 | 6.80 | 82 | _____ |

Exercise 17-3B

| <u>Date of Note</u> | <u>Term of Note</u> | <u>Due Date</u> |
|---------------------|---------------------|-----------------|
| July 11 | 45 days | _____ |
| December 23 | 90 | _____ |
| April 18 | 120 | _____ |
| October 3 | 77 | _____ |
| January 1 | 180 | _____ |
| August 13 | 65 | _____ |

Exercise 17-4B

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Exercise 17-5B

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Problem 17-10B

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Mastery Problem
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Mastery Problem (Concluded)

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Challenge Problem
Mirror Co.

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Challenge Problem (Concluded)

Other Party (Rosman Co., Kaw County Bank, or Lawrence Bank)

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Exercise 18-1A

| | <u>Yes</u> | <u>No</u> |
|------------------------------|------------|-----------|
| Debit Land? | | |
| Real estate fees | _____ | _____ |
| Cost to remove old buildings | _____ | _____ |
| Cost to pave parking areas | _____ | _____ |
| Tax assessment for streets | _____ | _____ |

Debit Building?

| | | |
|---|-------|-------|
| Cost of land on which the building is located | _____ | _____ |
| Legal fees related to purchase | _____ | _____ |
| Taxes related to purchase | _____ | _____ |
| Realtor fees | _____ | _____ |
| Interest on construction loan while building was under construction | _____ | _____ |

Debit Equipment?

| | | |
|-----------------------------------|-------|-------|
| Transportation charges | _____ | _____ |
| Insurance while in transit | _____ | _____ |
| Installation costs | _____ | _____ |
| Interest on loan to buy equipment | _____ | _____ |

Exercise 18-2A

Exercise 18-2A (Concluded)

Exercise 18-3A

Exercise 18-4A

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Exercise 18-5A

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Exercise 18-6A

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Problem 18-7A

1. a.

| <u>Year</u> | <u>Annual Depreciation</u> | <u>Ending Book Value</u> |
|-------------|----------------------------|--------------------------|
| _____ | _____ | _____ |
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| _____ | _____ | _____ |
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1. b.

| <u>Year</u> | <u>Beginning Book Value</u> | <u>Annual Depreciation</u> | <u>Ending Book Value</u> |
|-------------|-----------------------------|----------------------------|--------------------------|
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1. c.

| <u>Year</u> | <u>Depreciable Cost</u> | <u>Annual Depreciation</u> | <u>Ending Book Value</u> |
|-------------|-------------------------|----------------------------|--------------------------|
| _____ | _____ | _____ | _____ |
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Problem 18-7A (Concluded)

2.

**MACRS
Depreciation Rates
7-Year Class
of Property**

| <u>Year</u> | <u>Original Cost</u> | <u>MACRS Depreciation Rates 7-Year Class of Property</u> | <u>Depreciation Expense</u> |
|-------------|----------------------|--|---------------------------------|
| _____ | _____ | _____ | _____ |
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Problem 18-8A

| <u>Year</u> | <u>Beginning Book Value</u> | <u>Annual Depreciation</u> | <u>Ending Book Value</u> |
|-------------|---------------------------------|--------------------------------|------------------------------|
| _____ | _____ | _____ | _____ |
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Problem 18-9A

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Problem 18-10A

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Problem 18-11A

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Problem 18-12A

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Problem 18-13A

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Exercise 18-2B (Concluded)

Exercise 18-3B

Exercise 18-4B

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Exercise 18-5B

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Exercise 18-6B

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Problem 18-7B

1. a.

| <u>Year</u> | <u>Annual Depreciation</u> | <u>Ending Book Value</u> |
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1. b.

| <u>Year</u> | <u>Beginning Book Value</u> | <u>Annual Depreciation</u> | <u>Ending Book Value</u> |
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1. c.

| <u>Year</u> | <u>Depreciable Cost</u> | <u>Annual Depreciation</u> | <u>Ending Book Value</u> |
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Problem 18-7B (Concluded)

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**MACRS
Depreciation Rates
7-Year Class
of Property**

| <u>Year</u> | <u>Original Cost</u> | | <u>Depreciation Expense</u> |
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Problem 18-8B

| <u>Year</u> | <u>Beginning Book Value</u> | <u>Annual Depreciation</u> | <u>Ending Book Value</u> |
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Problem 18-9B

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Problem 18-10B

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Problem 18-11B

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Problem 18-12B

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Mastery Problem

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Mastery Problem (Concluded)

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Challenge Problem

| 1. Computer Equipment | Straight-Line Depreciation Year | | | | | | | |
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| 2. Computer Equipment | MACRS Depreciation Year | | | | | | | |
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Exercise 19-1A

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Exercise 19-2A

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Exercise 19-3A

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Exercise 19-4A

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Exercise 19-5A

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Problem 19-6A

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Problem 19-8A

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Problem 19-9A

1.

A series of vertical lines forming a grid for writing, consisting of 20 columns and 10 rows.

Problem 19-9A (Concluded)
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Problem 19-10A
1.

A series of vertical lines forming a grid for writing. The grid consists of 18 vertical lines, creating 17 columns. The first column is the narrowest, and the remaining 16 columns are of equal width. The lines are evenly spaced and extend across the entire height of the page.

Problem 19-10A (Concluded)
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Exercise 19-1B

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Problem 19-8B (Concluded)

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Problem 19-9B

1.

A series of vertical lines for writing, consisting of a solid line on the left, a dashed line, and a solid line on the right, followed by multiple solid vertical lines.

Problem 19-9B (Concluded)
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Problem 19-10B

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Lined writing area consisting of multiple vertical lines for text entry.

Problem 19-10B (Concluded)

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Mastery Problem
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Mastery Problem (Continued)

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Challenge Problem

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Comprehensive Problem 3: Specialized Accounting Procedures

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Mastery Problem

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Mastery Problem (Continued)

2.

| Cash | |
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| Land | |
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| Common Stock Subscriptions Receivable | |
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| Preferred Stock Subscriptions Receivable | |
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| Common Stock Subscribed | |
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| Preferred Stock Subscribed | |
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| Common Stock | |
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| Preferred Stock | |
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| Paid-In Capital in Excess of Par— Common Stock | |
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| Paid-In Capital in Excess of Par— Preferred Stock | |
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| Paid-In Capital from Sale of Treasury Stock | |
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| Common Treasury Stock | |
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| Retained Earnings | |
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Challenge Problem

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Exercise 21-1A

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Exercise 21-2A

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Exercise 21-4A

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Exercise 21-7A

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Problem 21-11A

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Problem 21-11A (Continued)

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2.

Retained Earnings—Appropriated
for Land Acquisition

Bal. 60,000

Retained Earnings—Unappropriated

Bal. 900,000

Exercise 21-1B

1. and 2.

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Exercise 21-2B

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Exercise 21-4B

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Exercise 21-5B

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Exercise 21-6B

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Exercise 21-7B

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Problem 21-8B

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Problem 21-9B

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Problem 21-10B

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Problem 21-11B

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Problem 21-11B (Continued)

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2.

Retained Earnings—Appropriated
for Land Acquisition

Bal. 75,000

Retained Earnings—Unappropriated

Bal. 825,000

Mastery Problem

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Mastery Problem (Concluded)

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Retained Earnings—Appropriated

Retained Earnings—Unappropriated

Bal. 50,000

Bal. 800,000

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Challenge Problem

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Exercise 22-1A

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Exercise 22-4B

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Problem 22-10B

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Mastery Problem
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Mastery Problem (Concluded)

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Challenge Problem

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APPENDIX: EFFECTIVE INTEREST METHOD

Exercise 22Apx-1A

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Problem 22Apx-2A

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Exercise 22Apx-1B

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Problem 22Apx-2B

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Exercise 23-1A

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- c. _____
- d. _____
- e. _____
- f. _____

- g. _____
- h. _____
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Exercise 23-2A

Exercise 23-3A

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Exercise 23-4A

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Exercise 23-5A

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Exercise 23-6A

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Exercise 23-7A

Exercise 23-8A

| Cash | Accrued Interest Payable | Interest Expense |
|------|--------------------------|------------------|
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Problem 23-9A

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Problem 23-12A

**T Accounts for Indirect Method Statement of Cash Flows
McDowell Company**

| Accrued Interest Receivable | |
|-----------------------------|-----|
| BB | 610 |
| EB | 720 |

| Notes Payable | |
|---------------|------------|
| | 102,000 BB |
| | 118,000 EB |

| Common Stock | |
|--------------|------------|
| | 800,000 BB |
| | 900,000 EB |

| Accounts Receivable | |
|---------------------|---------|
| BB | 325,800 |
| EB | 310,700 |

| Accounts Payable | |
|------------------|------------|
| | 195,000 BB |
| | 110,000 EB |

| Paid-In Capital in Excess of Par—Common Stock | |
|--|------------|
| | 390,000 BB |
| | 430,000 EB |

| Merchandise Inventory | |
|-----------------------|---------|
| BB | 540,200 |
| EB | 685,400 |

| Income Tax Payable | |
|--------------------|-----------|
| | 25,000 BB |
| | 20,000 EB |

| Retained Earnings | |
|-------------------|------------|
| | 360,000 BB |
| | 532,710 EB |

| Supplies and Prepayments | |
|--------------------------|--------|
| BB | 39,000 |
| EB | 27,000 |

| Accrued and Withheld Payroll Taxes | |
|---------------------------------------|-----------|
| | 14,900 BB |
| | 16,400 EB |

| Store Equipment | |
|-----------------|---------|
| BB | 460,000 |
| EB | 470,000 |

| Accrued Interest Payable | |
|--------------------------|----------|
| | 1,035 BB |
| | 875 EB |

| Accumulated Depreciation— Store Equipment | |
|--|------------|
| | 150,000 BB |
| | 180,000 EB |

| Office Equipment | |
|------------------|---------|
| BB | 400,000 |
| EB | 430,000 |

| Accumulated Depreciation— Office Equipment | |
|---|-----------|
| | 76,000 BB |
| | 88,000 EB |

| Delivery Equipment | |
|--------------------|---------|
| BB | 390,000 |
| EB | 530,000 |

| Accumulated Depreciation— Delivery Equipment | |
|---|------------|
| | 100,000 BB |
| | 140,000 EB |

BB: Beginning Balance
EB: Ending Balance

Exercise 23-1B

- a. _____
- b. _____
- c. _____
- d. _____
- e. _____
- f. _____

- g. _____
- h. _____
- i. _____
- j. _____
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Exercise 23-2B

Exercise 23-3B

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Exercise 23-4B

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Exercise 23-5B

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Exercise 23-6B

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Exercise 23-7B

Exercise 23-8B

| Cash | Accrued Interest Payable | Interest Expense |
|------|--------------------------|------------------|
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Problem 23-9B

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Problem 23-12B

**T Accounts for Indirect Method Statement of Cash Flows
McGinnis Company**

| Accrued Interest Receivable | |
|-----------------------------|-----|
| BB | 580 |
| EB | 830 |

| Notes Payable | |
|---------------|------------|
| | 109,000 BB |
| | 117,000 EB |

| Common Stock | |
|--------------|------------|
| | 700,000 BB |
| | 800,000 EB |

| Accounts Receivable | |
|---------------------|---------|
| BB | 309,200 |
| EB | 300,600 |

| Accounts Payable | |
|------------------|------------|
| | 185,000 BB |
| | 135,000 EB |

| Paid-In Capital in Excess of Par—Common Stock | |
|---|------------|
| | 380,000 BB |
| | 500,000 EB |

| Merchandise Inventory | |
|-----------------------|---------|
| BB | 495,800 |
| EB | 580,300 |

| Income Tax Payable | |
|--------------------|-----------|
| | 15,000 BB |
| | 25,000 EB |

| Retained Earnings | |
|-------------------|------------|
| | 320,000 BB |
| | 471,350 EB |

| Supplies and Prepayments | |
|--------------------------|--------|
| BB | 32,000 |
| EB | 65,000 |

| Accrued and Withheld Payroll Taxes | |
|------------------------------------|-----------|
| | 13,400 BB |
| | 15,800 EB |

| Store Equipment | |
|-----------------|---------|
| BB | 420,000 |
| EB | 560,000 |

| Accrued Interest Payable | |
|--------------------------|----------|
| | 1,200 BB |
| | 900 EB |

| Accumulated Depreciation—Store Equipment | |
|--|------------|
| | 90,000 BB |
| | 120,000 EB |

| Office Equipment | |
|------------------|---------|
| BB | 380,000 |
| EB | 320,000 |

| Accumulated Depreciation—Office Equipment | |
|---|------------|
| | 100,500 BB |
| | 30,500 EB |

| Delivery Equipment | |
|--------------------|---------|
| BB | 330,000 |
| EB | 430,000 |

| Accumulated Depreciation—Delivery Equipment | |
|---|------------|
| | 120,000 BB |
| | 150,000 EB |

BB: Beginning Balance
EB: Ending Balance

Mastery Problem

**T Accounts for Indirect Method Statement of Cash Flows
Peachfield Corporation**

| Accrued Interest Receivable | |
|-----------------------------|-----|
| BB | 250 |
| EB | 320 |

| Notes Payable | |
|---------------|-----------|
| | 54,780 BB |
| | 65,480 EB |

| Common Stock | |
|--------------|------------|
| | 388,000 BB |
| | 500,000 EB |

| Accounts Receivable | |
|---------------------|---------|
| BB | 140,905 |
| EB | 152,945 |

| Accounts Payable | |
|------------------|------------|
| | 125,473 BB |
| | 53,500 EB |

| Paid-In Capital in Excess of Par— Common Stock | |
|---|------------|
| | 234,000 BB |
| | 240,000 EB |

| Merchandise Inventory | |
|-----------------------|---------|
| BB | 295,400 |
| EB | 355,490 |

| Income Tax Payable | |
|--------------------|----------|
| | 5,000 BB |
| | 7,000 EB |

| Retained Earnings | |
|-------------------|------------|
| | 141,973 BB |
| | 238,737 EB |

| Supplies and Prepayments | |
|--------------------------|--------|
| BB | 21,500 |
| EB | 14,500 |

| Accrued and Withheld Payroll Taxes | |
|---------------------------------------|----------|
| | 7,644 BB |
| | 8,760 EB |

| Accrued Interest Payable | |
|--------------------------|--------|
| | 525 BB |
| | 450 EB |

| Store Equipment | |
|-----------------|---------|
| BB | 232,800 |
| EB | 308,000 |

| Accumulated Depreciation— Store Equipment | |
|--|------------|
| | 84,000 BB |
| | 108,000 EB |

| Long-Term Notes Payable | |
|-------------------------|-----------|
| | — BB |
| | 20,000 EB |

| Delivery Equipment | |
|--------------------|---------|
| BB | 192,000 |
| EB | 270,000 |

| Accumulated Depreciation— Delivery Equipment | |
|---|-----------|
| | 48,000 BB |
| | 75,000 EB |

| Office Equipment | |
|------------------|---------|
| BB | 203,940 |
| EB | 148,000 |

| Accumulated Depreciation— Office Equipment | |
|---|-----------|
| | 36,600 BB |
| | 38,000 EB |

BB: Beginning Balance
EB: Ending Balance

Exercise 23Apx-1A

| Cash | Accounts Receivable | Sales |
|------|---------------------|-------|
| | | |

Exercise 23Apx-2A

| Cash | Merchandise Inventory | Accounts Payable | Cost of Goods Sold |
|------|-----------------------|------------------|--------------------|
| | | | |

Exercise 23Apx-3A

Exercise 23Apx-4A

Problem 23Apx-5A

1.

| Income Statement | Additions | Deductions | Cash Flows |
|------------------|-----------|------------|------------|
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Problem 23Apx-6A

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| Income Statement | Additions | Deductions | Cash Flows |
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Problem 23Apx-7A

1.

| Income Statement | Additions | Deductions | Cash Flows |
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Exercise 23Apx-1B

| <u>Cash</u> | <u>Accounts Receivable</u> | <u>Sales</u> |
|-------------|----------------------------|--------------|
| | | |

Exercise 23Apx-2B

| <u>Cash</u> | <u>Merchandise Inventory</u> | <u>Accounts Payable</u> | <u>Cost of Goods Sold</u> |
|-------------|----------------------------------|-------------------------|---------------------------|
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Exercise 23Apx-3B

Exercise 23Apx-4B

Problem 23Apx-6B

1.

| Income Statement | Additions | Deductions | Cash Flows |
|-------------------------|------------------|-------------------|-------------------|
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Problem 23Apx-6B (Concluded)

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Problem 23Apx-7B

1.

| Income Statement | Additions | Deductions | Cash Flows |
|-------------------------|------------------|-------------------|-------------------|
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Exercise 24-3A

Exercise 24-4A

Exercise 24-5A

Exercise 24-6A

Exercise 24-7A

Problem 24-9A

| | AMOUNT | PERCENT | AMOUNT | PERCENT |
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Exercise 24-1B

Exercise 24-2B

Exercise 24-5B

Exercise 24-6B

Exercise 24-7B

Problem 24-8B (Concluded)

| | AMOUNT | AMOUNT | AMOUNT | PERCENT |
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Mastery Problem (Continued)

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| | AMOUNT | PERCENT | AMOUNT | PERCENT |
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Mastery Problem (Concluded)

6.

7.

Exercise 25-3A

Exercise 25-4A

Exercise 25-5A

Exercise 25-6A

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Problem 25-8A

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Problem 25-9A

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Problem 25-10A

1.

Williams and Lloyd Company

| | Dept. A | Dept. B | Dept. C | Total |
|--------------------------------------|-----------|------------|-----------|-----------|
| Net sales | \$380,000 | \$260,000 | \$290,000 | \$930,000 |
| Cost of goods sold | 210,000 | 140,000 | 160,000 | 510,000 |
| Gross profit | \$170,000 | \$120,000 | \$130,000 | \$420,000 |
| Direct operating expenses | 100,000 | 90,000 | 80,000 | 270,000 |
| Departmental direct operating margin | \$ 70,000 | \$ 30,000 | \$ 50,000 | \$150,000 |
| Indirect operating expenses | 40,000 | 35,000 | 40,000 | 115,000 |
| Operating income (loss) | \$ 30,000 | \$ (5,000) | \$ 10,000 | \$ 35,000 |
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Exercise 25-5B

Exercise 25-6B

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Problem 25-10B

1.

Mueller and Kenington Company

| | Dept. A | Dept. B | Dept. C | Total |
|--------------------------------------|-------------|-----------|-----------|-------------|
| Net sales | \$680,000 | \$730,000 | \$690,000 | \$2,100,000 |
| Cost of goods sold | 400,000 | 380,000 | 360,000 | 1,140,000 |
| Gross profit | \$280,000 | \$350,000 | \$330,000 | \$ 960,000 |
| Direct operating expenses | 230,000 | 240,000 | 210,000 | 680,000 |
| Departmental direct operating margin | \$ 50,000 | \$110,000 | \$120,000 | \$ 280,000 |
| Indirect operating expenses | 70,000 | 70,000 | 70,000 | 210,000 |
| Operating income (loss) | \$ (20,000) | \$ 40,000 | \$ 50,000 | \$ 70,000 |
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2.

Mastery Problem

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2.

| Work in Process | Finished Goods |
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Problem 26-9A (Concluded)

2.

| Work in Process | Finished Goods |
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3.

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2.

| Work in Process | Finished Goods |
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2.

| Work in Process | Finished Goods |
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3.

Mastery Problem

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Mastery Problem (Concluded)

2.

| Work in Process | Finished Goods |
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3.

4.

| Factory Overhead |
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Exercise 27-4A

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Problem 27-6A

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Lundberg
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For Year Ended

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| 1 | Cash | 30 | 3 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 2 | Government Notes | 5 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 3 | Interest Receivable | | | | | | | | | | | | | | | | | | |
| 4 | Accounts Receivable | 34 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 5 | Allowance for Doubtful Accounts | | | | | | 5 | 3 | 0 | 00 | | | | | | | | | |
| 6 | Finished Goods Inventory | 24 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 7 | Work in Process Inventory | 9 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 8 | Materials Inventory | 8 | 5 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 9 | Office Supplies | 3 | 1 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 10 | Factory Supplies | 3 | 8 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 11 | Land | 100 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 12 | Factory Building | 120 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 13 | Accum. Depr.—Factory Building | | | | | | 10 | 0 | 0 | 0 | 00 | | | | | | | | |
| 14 | Factory Equipment | 40 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 15 | Accum. Depr.—Factory Equip. | | | | | | 5 | 0 | 0 | 0 | 00 | | | | | | | | |
| 16 | Accounts Payable | | | | | | 13 | 8 | 0 | 0 | 00 | | | | | | | | |
| 17 | Income Tax Payable | | | | | | | | | | | | | | | | | | |
| 18 | Interest Payable | | | | | | | | | | | | | | | | | | |
| 19 | Bonds Payable | | | | | | 80 | 0 | 0 | 0 | 00 | | | | | | | | |
| 20 | Capital Stock | | | | | | 50 | 0 | 0 | 0 | 00 | | | | | | | | |
| 21 | Paid-In Capital in Excess of Par | | | | | | 30 | 0 | 0 | 0 | 00 | | | | | | | | |
| 22 | Retained Earnings | | | | | | 92 | 4 | 0 | 0 | 00 | | | | | | | | |
| 23 | Cash Dividends | 30 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 24 | Sales | | | | | | 405 | 1 | 0 | 0 | 00 | | | | | | | | |
| 25 | Interest Revenue | | | | | | 3 | 0 | 0 | 0 | 00 | | | | | | | | |
| 26 | Factory Overhead | 78 | 6 | 3 | 0 | 00 | 89 | 3 | 0 | 0 | 00 | | | | | | | | |
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| 30 | Cost of Goods Sold | 190 | 7 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 31 | Wages Expense | 70 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 32 | Office Supplies Expense | | | | | | | | | | | | | | | | | | |
| 33 | Bad Debt Expense | | | | | | | | | | | | | | | | | | |
| 34 | Utilities Expense—Office | 4 | 4 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 35 | Interest Expense | 7 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
| 36 | Income Tax Expense | 18 | 0 | 0 | 0 | 00 | | | | | | | | | | | | | |
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Problem 27-6A (Continued)

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December 31, 20--

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