# Tutorial 4 (Week 5)

## AA 4-2

Balance Sheet & Income Statement:

| **Real Estate Business<br>Statement of Financial Position<br>At Year End** | |
|---|---|
| **Assets** | |
| Cash | 30,700 |
| Accounts Receivables | 1,000 |
| Notes Receivable | 10,000 |
| Supplies | 300 |
| Prepaid Office Rent | 1,500 |
| **Total Assets** | **$ 43,500** |
| | |
| **Liabilities** | |
| Accounts payable | 300 |
| **Total Liabilities** | **$ 300** |
| **Shareholders's Equity** | |
| Share Capital | 22,600 |
| Retained Earnings | 20,600 |
| **Total Equity** | **$ 43,200** |
| **Total Liabilities & Shareholders' Equity** | **$ 43,500** |

| **Real Estate Business<br>Income Statement<br>For the Year End** | |
|---|---|
| Commission Revenues | $ 45,500 |
| Operating Expenses: | |
| Salaries Expense | $ (20,400) |
| Supplies Expense | $ (950) |
| Rent Expense | $ (3,000) |
| Utilities Expense | $ (1,500) |
| Misc. Office Expense | $ (250) |
| Operating Income | $ 19,400 |
| Interest Income | $ 1,200 |
| **Net Income** | **$ 20,600** |

The real estate business appears profitable since the net income is positive. The balance sheet also presents a positive financial picture. The business has significant cash relative to total assets, and its relationship of current assets to current liabilities (current ratio) is very positive. One potential concern is the collectability of the notes receivable from the current owner, which is almost one-fourth of total assets. The doctors should also look at the cash flow statement to see how much actual cash the business is generating, and compare this year's results with past years to check if the performance is consistent. Finally, they should think about other possible investment opportunities to see if this business is really the best use of their money.

Workings:
Before preparing the financial statements, you must first prepare all the journal entries for the transactions that took place during the year:

| Ref | Account | Debit | Credit |
|---|---|---|---|
| a. | Cash | $ 1,200 | |
| | Interest Income | | $ 1,200 |
| | | | |
| b. | Cash | $ 44,500 | |
| | Accounts Receivable | $ 1,000 | |
| | Commissions Revenue | | $ 45,500 |

| | | | |
|---|---|---|---|
| c. | Supplies | $ 500 | |
| | Cash | | $ 500 |
| | | | |
| | Supplies Expense | $ 950 | |
| | Supplies | | $ 950 |
| | | | |
| d. | Rent Expense | $ 3,000 | |
| | Prepaid Office Rent | | $ 3,000 |
| | | | |
| e. | Utilities Expense | $ 1,500 | |
| | Cash | | $ 1,500 |
| | | | |
| f. | Accounts Payable | $ 400 | |
| | Cash | | $ 400 |
| | | | |
| | Misc. Office Expense | $ 250 | |
| | Accounts Payable | | $ 250 |
| | | | |
| g. | Salaries Expense | $ 20,400 | |
| | Cash | | $ 20,400 |

Using the journal entries, update the given beginning trial balance to get the trial balance as at year end:

| Accounts | Beginning Balance | | | | | Ending Balance | |
|---|---|---|---|---|---|---|---|
| | Debit | Credit | | *Debit* | *Credit* | Debit | Credit |
| **Cash** | **7,800** | | *a* | *1,200* | | **30,700** | |
| | | | *b.* | *44,500* | | | |
| | | | *c.* | | *500* | | |
| | | | *e.* | | *1,500* | | |
| | | | *e.* | | *400* | | |
| | | | *g.* | | *20,400* | | |
| **Accounts Receivable** | | | *b.* | *1,000* | | **1,000** | |
| **Notes Receivable** | **10,000** | | | | | **10,000** | |
| **Supplies** | **750** | | *c.* | *500* | | **300** | |
| | | | *c.* | | *950* | | |
| **Prepaid Office Rent** | **4,500** | | *d.* | | *3,000* | **1,500** | |
| **Accounts Payable** | | **450** | *e.* | *400* | *250* | | **300** |
| **Equity** | | **22,600** | | | | | **22,600** |
| **Commissions Revenue** | | | | | *45,500* | | **45,500** |
| **Interest Income** | | | | | *1,200* | | **1,200** |
| **Supplies Expense** | | | *c.* | *950* | | **950** | |
| **Rent Expense** | | | *d.* | *3,000* | | **3,000** | |
| **Utilities Expense** | | | *e.* | *1,500* | | **1,500** | |
| **Misc. Office Expense** | | | *e.* | *250* | | **250** | |
| **Salaries Expense** | | | *g.* | *20,400* | | **20,400** | |
| **Total** | **23,050** | **23,050** | | **73,700** | **73,700** | **69,600** | **69,600** |

## AA 4-2 - Ethics

This ethics case shows that many accounting issues are not about lying, cheating, or stealing. In this situation, Jex accounted for certain items incorrectly because he does not fully understand the accrual basis of accounting and the revenue recognition principle. Essentially, he is operating on a cash-basis mindset: recording revenues as cash comes in. There is no criminal intent on his part, but the fact remains that unearned revenue is still unearned and should not be reported as revenue in the current year. As part of the audit team, your role is to educate Jex on the accrual basis of accounting and ensure the proper adjustments are made.

Both this year's revenues and last year's error must be corrected. The $350,000 that was actually earned in January of this year but reported in the prior year also needs to be adjusted. The fact that the same mistake was repeated does not make it acceptable.

The adjusting entry required at year-end to account for the $400,000 of unearned revenue would be:

| | | |
|---|---|---|
| Revenue ............................................ | 400,000 | |
|     Unearned Revenue ..................... | | 400,000 |

In addition, a journal entry should be made to correct for the error made last year. That is, $350,000 of revenue recognized last year should be recognized this year. The journal entry to accomplish this would be:

| | | |
|---|---|---|
| Retained Earnings............................. | 350,000 | |
|     Revenue .................................... | | 350,000 |

Why debit Retained Earnings? Because the incorrect revenue was recorded last year and then closed into Retained Earnings at year-end of the previous period. To fix the error, we therefore remove it from Retained Earnings with a debit entry.

This case highlights that ethics in accounting is not only about honesty but also about competence and professional judgment. Even without intent to deceive, failing to apply fundamental principles like accrual accounting and revenue recognition can lead to misleading financial statements. Accountants have a responsibility to ensure that financial information is reported faithfully and in line with standards.

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*~ End of Tutorial 4 Solution ~*