CHAPTER 5

DISCUSSION QUESTIONS

1. If a journal entry is for a legitimate expense, there will be an authentic document (e.g., a bill or invoice) from whoever was paid. If it is to cover up a theft of cash, either (1) there will be no source document to support the entry or (2) there will be a fictitious or forged document supporting the entry.

2. Revenues are usually overstated by creating fictitious receivables or by making an error that overstates receivables. When a receivable is debited, revenue is created. Total assets will be overstated if revenues are overstated.

3. There are five elements of a system of internal controls. Most important to accountants are (1) the control environment, and (2) control procedures.

4. Five different types of control procedures are (1) segregation of duties, (2) system of authorization, (3) documents and records, (4) physical safeguards, and (5) independent checks.

5. Among other activities, internal auditors independently evaluate the internal controls of an organization. One of the purposes of internal auditors is to provide integrity in financial reporting. Thus, by enhancing the internal controls, the credibility of financial statements is increased.

6. The purpose of a financial statement audit is to have independent, outside, competent individuals (CPAs) render an opinion on whether financial statements are prepared in accordance with GAAP and are fairly presented. Their opinion adds credibility to the financial statements.

7. Whether CPAs can be independent from the companies that they both audit and receive payment from is an issue that has long been debated. On the one hand, critics cannot point to very many cases where there was a true lack of independence that caused problems. On the other hand, there is a growing feeling that lack of independence is a problem. Recently, at the urging of the SEC, an Independence Standards Board was organized to deal with this issue.

8. The three types of business activities are operating activities, investing activities, and financing activities.

9. The purchase of inventory for resale to customers is classified as an operating activity rather than an investing activity because operating activities are associated with the primary purpose of a business. Purchasing inventory for resale is essential to selling a product. Investing activities are related to purchasing assets for use in the business.

10. Companies need more controls over cash than other assets because cash is the most liquid asset and the easiest one to lose and/or have stolen. It is very common to hear of cash being stolen, but very unusual to hear of major plant or intangible assets being misplaced.

11. The three most generally practiced controls for cash are:

    a. Separation of the duties of accounting for and handling of cash.
    b. Making daily deposits in a bank of all cash received.
    c. Paying all obligations by prenumbered checks.

    The purpose of all these controls is to protect and safeguard cash.

12. Some of the most common reasons for differences between bank balances and book balances are:

    a. Outstanding checks.
    b. Deposits in transit.
    c. Errors by either the bank or the depositor.
    d. Transactions that have been entered by the bank but not yet recorded by the company, such as (1) bank service charges, (2) collections for the company by the bank, (3) direct deposits, and (4) interest earned on the account.

13. Bank balance additions and deductions do not require adjusting entries because they are adjustments for the bank, not the depositor. Most adjustments (for example, deposits in transit and outstanding checks)

take care of themselves over time, and the ones that do not (bank errors) are corrected by notifying the bank.

PRACTICE EXERCISES

PE 5–1 (LO4) Classifying Major Business Activities

	Business Activity	Type of Activity
a.	Acquiring inventory for resale	Operating
b.	Buying and selling stocks and bonds of other companies	Investing
c.	Selling shares of stock to investors for cash	Financing
d.	Providing services to customers	Operating
e.	Buying property, plant, or equipment	Investing
f.	Acquiring and paying for other operating items	Operating
g.	Selling property, plant, or equipment	Investing
h.	Borrowing cash from creditors	Financing

PE 5–2 (LO4) Control of Cash

The correct answer is B. The specific balance in the cash account is usually not considered a control associated with cash. For any given company, the cash balance commonly falls well below the sum of inventory and accounts receivable.

PE 5–3 (LO6) Bank Reconciliation

Balance per bank statement	$ 61,000
Add: Deposits in transit	14,300
	$ 75,300
Deduct: Outstanding checks	(26,700)
Correct balance	$ 48,600
Balance per books	$ 48,680
Add: Interest earned	195
	$ 48,875
Deduct: Bank service charge	(275)
Correct balance	$ 48,600

PE 5–4 (LO6) Journal Entries from a Bank Reconciliation

Cash	195	
Interest Revenue		195
Service Charge Expense	275	
Cash		275

EXERCISES

E 5–1 (LO1) Accounting Errors—Transaction Errors

a. The asset account Equipment—Truck is understated by the cost of the truck. Maintenance Expense is overstated by the same amount. In the basic accounting equation, Assets and Equity are each understated. The overstated expense results in an understatement of income.

b. Cash is understated and Accounts Receivable is overstated. The accounting equation is not affected because both accounts are assets. Because no revenue or expense accounts are affected, income is not affected.

c. Accounts Receivable is overstated by the amount of the fictitious sales. Sales Revenue is also overstated by the same amount. In the accounting equation, Assets and Equity are both overstated. Because the revenue account is overstated, so is income.

d. Both Repairs Expense and Accounts Payable are understated by $300. In the accounting equation, Liabilities are understated and Equity is overstated. Income is overstated by $300 because of the expense understatement.

e. Unearned Revenue, a liability account, is understated by the amount of the prepayment received on December 31. Rent Revenue is overstated. In the accounting equation, Liabilities are understated and Equity is overstated. Income is overstated because of the revenue overstatement.

E 5–2 (LO1) Errors in Financial Statements

Balance Sheet

Assets

Cash	$ 2,600
Real estate properties (previously listed)	12,000,000
Property recorded as sold*	3,600,000
Total assets	$15,602,600

Liabilities

Accounts payable	$ 200,000
Mortgage payable	12,000,000
Total liabilities	$12,200,000

Equity

Capital stock	$ 20,000
Retained earnings ($10,142,600– $6,760,000)	3,382,600
Total Equity	$ 3,402,600
Total liabilities and Equity	$15,602,600

*$10,000,000 (sales price) – $6,400,000 (gain on sale) = $3,600,000(property at cost)

Statement of Comprehensive Income

Revenues	$ 0
Expenses	2,400,000
Net loss	$(2,400,000)
Other comprehensive income	0
Comprehensive loss	$(2,400,000)

Note: This is a real case where massive fraud was committed.

E 5–3 (LO2) Internal Control Procedures

a. *Authorization*. The managers of the stores should follow the authorization policy and review all requests for large amounts of credit.

b. *Segregation of duties and independent checks on performance*. The bank reconciliation should be performed by a second individual, preferably someone not in the accounting department.

c. *Segregation of duties*. Various functions should be assigned to different people. If the record keeping and physical handling of inventory were performed by two separate individuals, the opportunity for theft would be greatly reduced.

d. *Adequate documents and records*. A well-designed document should be formatted so that it can be handled quickly and efficiently.

E 5–4 (LO3) Internal Auditing—Staffing Internal Audits

Internal auditors should not be assigned to audit the activities they have previously performed. Internal auditors should be able to use professional judgment and objectivity in their work. Therefore, assignments should be made to avoid potential conflicts of interest. The standards for internal auditing state that situations like the one in this exercise are presumed to impair objectivity. When objectivity is impaired, the audit results are not reliable.

E 5–5 (LO3) Internal Auditing

The correct answer is B. Internal auditors do not issue reports for external users regarding the reliability of the financial statements. Internal auditors cannot be relied on by outside parties to be objective. These reports are issued by external auditors because they are independent and presumed to be objective.

E 5–6 (LO3) Internal Auditing—External Auditor's Reliance on Internal Auditors

1. Internal auditors may have developed useful information that will help in the understanding of the internal control function. Internal auditors have two primary effects on the audit: (1) their existence and work may affect the nature, timing, and extent of audit procedures, and (2) CPAs may use internal auditors to provide direct assistance in performing procedures. For areas where there is high audit risk, the internal auditor's work alone cannot eliminate the need for CPAs' tests.

E 5–6 (LO3) (Continued)

2. The CPA should assess both the competence and objectivity of internal auditors. Competence is evaluated by considering education, experience, professional certification, audit policies, and various work policies. Objectivity is assessed by considering organizational status within the company and policies for assuring that internal auditors are objective with respect to the areas being audited. The level of management to which the internal auditors report affects the objectivity of the internal auditors.

E 5–7 (LO3) External Auditors—Purpose of an Audit

The auditors' report gives credibility to the financial statements. Auditors, as a group independent of management, should have an objective view and can report on a company's activities without bias. Without a report from an independent auditor, a company's financial statements would be less meaningful; the public would have little faith in financial statements issued by the inherently biased company.

E 5–8 (LO3) Auditing Negligence

Of course, the case was much more complicated than portrayed in this exercise. However, it would be difficult for any auditor to observe the simultaneous counting of inventory at over 100 stores. Most auditors would select a few of the stores and observe the inventory counts at those stores. If the inventory-taking procedures seemed to be working well, they would assume that inventory-counting procedures throughout the entire company were acceptable. This exercise demonstrates the difficulty in performing a fraud-proof audit. In fact, audits can never detect all fraud.

E 5-9 (LO4) Control on Cash

Procedure	IC Strength or Weakness	Related internal control principle
1.	Weakness	Payment of all expenditures by prenumbered checks
2.	Strength	Preparing a bank reconciliation egularly
3.	Weakness	Separation of duties in handling of cash and accounting or cash
4.	Strength	Separation of duties in handling of cash and accounting or cash
5.	Strength	Daily deposit all cash receipts in banks

E 5–10 (LO5) Purchases Discounts

Apr. 5		
Inventory	52,500	
Accounts Payable		52,500
Apr. 10		
Accounts Payable	26,250	
Cash		25,725
Inventory		525
Apr. 20		
Accounts Payable	26,250	
Cash		26,250

E 5–11 (LO5) Purchases Returns and Allowance

Apr. 8		
Accounts Payable	3,500	
Inventory		3,500
Accounts Payable	300	
Inventory		300

E 5–12 (LO5) Payment for Various Expenses

July 1		
Prepaid Insurance	36,000	
Prepaid Rent	100,000	
Cash		136,000
July 5		
Miscellaneous Expense	1,500	
Cash		1,500
July 10		
Wages Payable	1,000,000	
Cash		1,000,000
July 31		
Rent Expense	100,000	
Prepaid Rent		100,000

Dec. 31		
Insurance Expense	18,000	
Prepaid Insurance		18,000

E 5–13 (LO5) Petty Cash Fund

June 1		
Petty Cash	100	
Cash		100
June 30		
Postage Expense	10	
Miscellaneous Expense	15	
Freight-out	20	
Office Supplies	8	
Cash Over and Short	2	
Cash		55
July 1		
Petty Cash	20	
Cash		20

E 5–14 (LO6) Preparing a Bank Reconciliation

Bend Company
Bank Reconciliation
January 31, 2017

Balance per bank statement	$204,008	Balance per books	$228,909
Additions to bank balance:		*Additions to book balance:*	
Check in error	6,987	Interest earned	110
Deposits in transit	33,442		
Total	$244,437	Total	$229,019
Deductions from bank balance:		*Deductions from book balance:*	
Outstanding checks	(19,582)	Service charges	(64)
		NSF check	(4,100)
Adjusted bank balance	$224,855	Adjusted book balance	$224,855

E 5–15 (LO6) Preparing a Bank Reconciliation

1.

Derma Corporation
Bank Reconciliation
December 31, 2017

Balance per bank statement	$87,450	Balance per books	$81,200
Additions to bank balance:		*Additions to book balance:*	
Deposits in transit	5,000	Rent collected	1,000
Bank error	1,000	Note collected	2,300
Total	$93,450	Total	$84,500

Deductions from bank balance:		*Deductions from book balance:*	
Outstanding checks	(9,200)	NSF check returned	(200)
		Service charges	(50)
Adjusted bank balance	$84,250	Adjusted book balance	$84,250

2. Cash	3,050	
Accounts Receivable	200	
Miscellaneous Expenses	50	
Rent Revenue		1,000
Notes Receivable		2,000
Interest Revenue		300
To record adjustments per the December bank reconciliation.		

E 5–16 (LO6) Reconciling Book and Bank Balances

1.	Beginning balance	$ 5,300
	Deposits (September)	29,500
	Less checks (September)	(28,000)
	Ending balance (cash account)	$ 6,800

2. No additions are needed to the depositor's books.

3.	NSF check	$ 50
	Bank service charge	10
	Total deductions (depositor's books)	$ 60
4.	Deposits in transit ($29,500 – $27,000)	$ 2,500
	Cash on hand	200
	Total additions (bank balance)	$ 2,700
5.	Outstanding checks ($28,000 – $27,300)	$ 700
	Total deductions (bank balance)	$ 700

Jensen Company
Bank Reconciliation
September 30, 2017

Balance per bank statement.....	$4,740	Balance per books	$6,800
Additions to bank balance:		*Additions to book balance:*	0
Deposits in transit	2,500*		
Cash on hand	200		
Total	$7,440	Total	$6,800
Deductions from bank balance:		*Deductions from book balance:*	
Outstanding checks	(700)**	NSF check	(50)
		Service charges	(10)
Adjusted bank balance	$6,740	Adjusted book balance	$6,740

* Deposits in transit=$29,500-$27,000=$2,500
** Outstanding checks=$28,000-$27,300=$700

PROBLEMS

P 5-1 (LO2) Internal Control Structure

1. A
2. E
3. A
4. D
5. C
6. B

P 5–2 (LO4) Cash Fraud

1. This is an actual fraud case in a small bank that had severe internal control weaknesses. Obviously, Mac should not have:
   (a) Been able to write checks and then reconcile the bank statement. There should have been a segregation of duties.
   (b) Been the sole person approving exceptions to credit limits. As it turned out, Mac approved several exceptions to his personal loan limits and had extremely high personal loans and credit card balances.
   (c) Had the internal auditors report to him. The internal auditors should report to someone other than the accounting personnel they are auditing. They usually report to a subset of the board of directors called the audit committee.

2. Mac perpetrated the fraud because he needed money. He was in extreme financial need because he was supporting two households and had made bad investments. In fact, at one point, Mac was paying alimony and child support greater than his take-home pay. Research shows that people commit fraud when they (1) face a nonshareable financial pressure, (2) perceive an opportunity to commit and conceal the dishonest act, and (3) find some way to rationalize the dishonest act as not being inconsistent with their personal code of ethics. Mac initially believed he was only "temporarily borrowing" to overcome a bad situation.

P 5-3 (LO5) Accounting for Cash Payments, Petty Cash

1. Petty cash should be replenished on a periodic basis or when the cash is low. It must be replenished on the statement of financial position date so that the expenses represented by the petty cash vouchers can be recorded in the proper accounting period.

2.

Supplies	24.25
Postage Expense	50.00
Freight-Out	22.50

Meals Expense	31.25	
Cash Over and Short		6
Cash		122
3. Petty Cash	50.00	
Cash		50.00

P 5–4 (LO6) Preparing a Bank Reconciliation

1. Deposits in transit = $6,000.
   The deposit for $6,000 recorded in the books on June 30 has not yet been recorded by the bank.

2. Outstanding checks = $2,660.
   The checks written on June 26 ($1,300) and June 27 ($1,360) have not yet been cleared by the bank.

3. Milton Company
Bank Reconciliation
June 30, 2017

Balance per bank statement	$30,390	Balance per books	$29,190**
Additions to bank balance:		*Additions to book balance:*	
Deposits in transit	6,000	Note collected by bank	4,140
		Error in books	450
Total	$36,390	Total	$33,780
Deductions from bank balance:		*Deductions from book balance:*	
Outstanding checks	(2,660)	Service charges	(50)
Adjusted bank balance	$33,730	*Adjusted book balance*	$33,730

**$20,440 + $34,500 – $25,750 = $29,190

4.

Cash	4,540	
Miscellaneous Expenses	50	
Notes Receivable		4,000
Interest Revenue		140
Supplies		450
To record the adjustments per the June bank statement.		

5. If the cash account is not reconciled on a timely basis, adjustments such as those in item (4) will not be made and bank errors may not be discovered.

P 5–5 (LO6) Determining Where the Cash Went

1. Amount suspected stolen is computed as follows:

Check #201	$38,400

Check #204	10,000
Check #205	8,116
Check #295	390
Suspected stolen	$56,906

2. Kim accounted for the stolen money by overstating outstanding checks. The cover-up could have been prevented by having someone else reconcile the bank statement so there was a division of duties between writing checks (accounts payable) and reconciling the bank statement.

ANALYTICAL ASSIGNMENTS

AA 5–1 Auditing a Company

Discussion

The audit provided by Jones is very deficient. Jones was not completely independent in this case because of the promise to have the audit completed in two weeks to satisfy the bank loan procedure. Due professional care was not exercised in the performance of the audit. Certainly, the audit was not performed by a person having adequate technical training and proficiency as an auditor. It was inappropriate for Jones to hire the two students to conduct the audit. Indeed, the two students didn't know how to conduct an audit and were only following instructions, which were not complete. The work was not adequately planned, and the assistants, the two students, were not properly supervised. Two hours of training is not sufficient; there should have been on-the-job supervision. The students were given no information concerning the internal control structure to be used in planning the audit and determining the extent of tests to be performed. Sufficient, competent evidence was not obtained. The report did not state that the financial statements were presented in accordance with GAAP. There were no informative disclosures (e.g., notes) with the financial statements.

AA 5–2 *You Decide:* Which is more important—having a good system of internal controls or hiring honest employees?

Judgment Call

Issues to be discussed with this question are:

1. Both your uncle and your friend are partially right and partially wrong. Certainly, hiring employees with integrity is very important. In fact, it is one of the most important elements of the control environment.
2. However, the research shows very strongly that no one is above reproach and that anyone faced with the right pressures and opportunities can and will commit fraud. All it takes is a little rationalization such as "I'm only borrowing it and will pay it back," or "You'd understand if you knew how badly I need it." The reason a company has good internal control procedures or activities are to eliminate opportunities so that honest people won't be tempted too much. Good controls make honest people better and dishonest people good.
3. Even so, however, you can never have perfect controls that will prevent and/or detect all fraud and that is why hiring honest employees is crucial.

AA 5–3 *You Decide:* Can auditors rely on client personnel to assist them with their audit?

Judgment Call

Issues to be discussed with this question are:

- External auditors can use company employees to assist them with their work as long as they direct the work, plan what is going to be done, and make all decisions about what kind of audit evidence to gather. In this case, the client is trying to convince the auditor not to do something the auditor planned to do. The auditor should not accept the client's representations because there could be fraud. To not look inside the containers would be relinquishing control of the audit to the client and that should never be done.

AA 5–4 Philips

Real Company Analysis

1. a. Philips' external auditor is KPMG Accountants N.V., a large international accounting firm.

   b. KPMG completed the Philips audit for the fiscal year ended December 31, 2015, on February 23, 2016. Completion of the audit took 54 days. This was possible because all audit firms perform substantial tests on an ongoing basis throughout the year.

2. a. Philips' management is responsible for Philips' financial statements. This is an important point. The financial statements are *not* the responsibility of the external auditor; the external auditor is hired merely to verify the work of Philips in preparing the financial statements.

   b. The paragraph on internal control says that Philips' system of internal control is "a process designed to provide reasonable assurance" that transactions are properly recorded and that assets are safeguarded. As with any other system within a business, the system of internal control must meet a cost/benefit test. The interesting implication is that the appropriate amount of theft and fraud within a business is not zero because it simply costs too much to establish controls that will always safeguard all assets completely.

AA 5–5 Circle K

Real Company Analysis

1. The fiscal year ended April 30, 1989, was a terrible one for Circle K. However, the auditor's report for that year was a routine opinion without any qualifications. The 1989 audit report, by Arthur Andersen, states that "the financial statements ... present fairly, in all material respects, the financial position of The Circle K Corporation ... in conformity with generally accepted accounting principles." The key insight here is that the audit report is not intended to be a red flag for investors that a company is in danger of bankruptcy. The audit report is simply a statement that the financial statements are a fair reflection of the company's condition; any concerns must come from an investor's examination of the financial statements themselves.

2. By the time the audit report for the year ended April 30, 1990, was completed (on July 25, 1990), Circle K was already deep into the proceedings associated with a Chapter 11 bankruptcy filing. Great uncertainty existed over whether the company would continue to exist, and if so, in what form. The auditor's report, which goes on for seven paragraphs, states the following: "Because of the significance of the matters discussed in the preceding paragraphs, we are unable to express, and do not express, an opinion on the consolidated financial statements referred to above." This is a disclaimer of opinion. Remember that one of the underlying assumptions of accrual accounting is the going concern assumption. Under this assumption, the accountant prepares the financial statements assuming that the company will continue to operate normally in the foreseeable future. For Circle K in 1990, this assumption was no longer valid; accounting procedures designed for normal circumstances were no longer guaranteed to give a fair representation of the company's financial position. Accordingly, the auditor disclaimed an opinion on the financial statements.

AA 5–6 Do the Financial Statements Give a True and Fair View?

International

1. TSMC's 2015 audit report states: "In our opinion, the consolidated financial statements ... present fairly, in all material respects, the consolidated financial position of Taiwan Semiconductor Manufacturing Company Limited and subsidiaries... in conformity with the Regulations Governing the Preparation of Financial Reports by Securities Issuers, the International Financial Reporting Standards, International Accounting Standards interpretations as well as related guidance translated by Accounting Research and Development Foundation endorsed by the financial Supervisory Commission of the Republic of China with the effective dates." This wording is usually interpreted to mean, "Yes, TSMC followed the accepted accounting rules." So, to the extent that the accepted accounting rules provide a fair representation of the economic status of a company, TSMC's financial statements give a "true and fair view." However, the important point is that audit reports highlight a company's compliance with the accounting rules, not the true and fair view.
2. Auditors in the United States are reluctant to submit to a "true and fair view" standard because it is an imprecise standard to support in court. Auditors are sued all of the time in the United States, much more so than in any other country. As such, U.S. auditors are interested in performing an audit that can be defended on the witness stand. It is much easier to convince the court that you verified whether a company followed generally accepted accounting principles than to convince the court that you verified that the financial statements gave a true and fair view.

AA 5–7 Blowing the Whistle on Former Partners

Ethics

Ethically, the auditors would be torn between loyalty to their old friends and integrity to the standards of the audit profession. One further consideration is that in cases such as this, the mess invariably gets worse the longer it continues. In a sense, the auditors were doing their former partners/friends a favor by blowing the whistle early, rather than letting the fraud continue and worsen.

If the Chambers' auditors had just ignored the accounting irregularities they found, their audit firm could have been liable for huge legal damages to be paid to misled shareholders in subsequent years when the truth was finally revealed. In addition, as word was finally revealed to the public that professionals at the audit firm had intentionally performed a poor audit in order to let their old partners get away with fraud, the reputation of the audit firm would have been badly damaged. It was clearly in the economic best interests of the audit firm for the auditors to blow the whistle.

The accounting announcement on March 17, 1992, was just the beginning of troubles for Chambers Development Company. Continuing business problems eventually forced the board of directors to put the company up for sale. Chambers was acquired by USA Waste on June 30, 1995.

DISCUSSION QUESTIONS

14. The Public Company Accounting Oversight Board is charged with registering all public accounting firms that provide audits for public companies, establishing standards relating to the audit of those public companies, investigating and disciplining auditing firms when necessary, and enforcing compliance with the Sarbanes-Oxley Act.

15. Auditors are not allowed to provide certain nonaudit services for those companies that they audit. In addition, audit partners are required to rotate off an account every five years.

16. The Sarbanes-Oxley Act prohibits companies from making loans to their executive officers and directors.

SOLUTIONS TO "STOP & THINK"

Stop & Think (p. 182): What could be done to ensure that errors, disagreements in judgment, and fraudulent financial reporting do not occur?

Numerous steps can be taken to minimize problems in the financial statements. Examples include establishing an internal control system to ensure that transactions are properly recorded and employing individuals to independently review the accounting system.

Stop & Think (p. 188): What could auditors do to ensure that the financial reporting system in a company is working properly? Be specific.

Auditors would review the recording of transactions to ensure that the system is accounting for events properly. Auditors would physically verify that assets, such as buildings and inventory, exist. Auditors would also contact customers to verify account balances. This is just a partial list of the things that auditors, both internal and external, do to ensure that the financial reporting system is working properly.

Comprehensive Problem Chapters 1–5

1. **Journalize current-year transactions**

		Debit	Credit
a.	Cash	30,000	
	Capital Stock		30,000
b.	Cash	10,000	
	Long-Term Bank Loan		10,000
c.	Prepaid Truck Rental	5,100	
	Cash		5,100
d.	Cash	1,800	
	Unearned Rent Revenue		1,800
e.	Prepaid Insurance	900	
	Cash		900
f.	Supplies	250	
	Cash		250
g.	Equipment	80,000	
	Accounts Payable		80,000
h.	Accounts Receivable	105,000	
	Services Revenue		105,000
i.	Cash	95,000	
	Accounts Receivable		95,000
j.	Accounts Payable	65,000	
	Cash		65,000
k.	Salaries Payable	3,500	
	Salaries Expense	30,500	
	Cash		34,000
l.	No entry.		
m.	Income Taxes Payable	3,200	
	Cash		3,200
n.	See adjusting entries r, s, t and u.		
o.	See adjusting entry v.		
p.	See adjusting entry w.		
q.	See adjusting entry x.		

Comp. Prob. 1–5 (Continued)

2. Post to T-accounts

Cash

BB*	22,100	(c)	5,100
(a)	30,000	(e)	900
(b)	10,000	(f)	250
(d)	1,800	(j)	65,000
(i)	95,000	(k)	34,000
		(m)	3,200
Bal.	50,450		

Accounts Receivable

BB	27,000	(i)	95,000
(h)	105,000		
Bal.	37,000		

Equipment

BB	13,500		
(g)	80,000		
Bal.	93,500		

Supplies

BB	600	(v)	450
(f)	250		
Bal.	400		

Prepaid Insurance

(e)	900	(u)	75
Bal.	825		

Prepaid Truck Rental

(c)	5,100	(s)	1,700
Bal.	3,400		

Accounts Payable

		BB	17,000
(j)	65,000	(g)	80,000
		Bal.	32,000

Salaries Payable

		BB	3,500
(k)	3,500	(w)	4,000
		Bal.	4,000

Interest Payable

		(r)	700
		Bal.	700

Unearned Rent Revenue

(t)	600	(d)	1,800
		Bal.	1,200

Income Taxes Payable

(m)	3,200	BB	3,200
		(x)	23,861
		Bal.	23,861

Long-Term Bank Loan

		(b)	10,000
		Bal.	10,000

Capital Stock

		BB	20,000
		(a)	30,000
		Bal.	50,000

Retained Earnings

		BB	19,500
		(y)	5,314
		Bal.	24,814

Services Revenue

(y)	105,000	(h)	105,000
		Bal.	0

*BB = Beginning Balance

Comp. Prob. 1–5 (Continued)

Rent Revenue

(y)	600	(t)	600
		Bal.	0

Supplies Expense

(v)	450	(y)	450
Bal.	0		

Interest Expense

(r)	700	(y)	700
Bal.	0		

Salaries Expense

(k)	30,500	(y)	34,500
(w)	4,000		
Bal.	0		

Miscellaneous Expense

(s)	1,700	(y)	1,775
(u)	75		
Bal.	0		

Income Tax Expense

(x)	23,861	(y)	23,861
Bal.	0		

3. Journalize and post adjusting entries

		Debit	Credit
r.	Interest Expense	700	
	Interest Payable		700
s.	Miscellaneous Expense	1,700	
	Prepaid Truck Rental		1,700
t.	Unearned Rent Revenue	600	
	Rent Revenue		600
u.	Miscellaneous Expense	75	
	Prepaid Insurance		75
v.	Supplies Expense	450	
	Supplies		450
w.	Salaries Expense	4,000	
	Salaries Payable		4,000
x.	Income Tax Expense	23,861	
	Income Taxes Payable		23,861

Comp. Prob. 1–5 (Continued)

4. Trial balance, balance sheet, and statement of comprehensive income

Bearing, Inc.
Trial Balance
December 31, 2017

	Debits	Credits
Cash	$ 50,450	
Accounts Receivable	37,000	
Supplies	400	
Equipment	93,500	
Prepaid Insurance	825	
Prepaid Truck Rental	3,400	
Accounts Payable		$ 32,000
Salaries Payable		4,000
Interest Payable		700
Unearned Rent Revenue		1,200
Income Taxes Payable		23,861
Long-Term Bank Loan		10,000
Capital Stock		50,000
Retained Earnings (12/31/16 balance)		19,500
Services Revenue		105,000
Rent Revenue		600
Supplies Expense	450	
Interest Expense	700	
Salaries Expense	34,500	
Miscellaneous Expense	1,775	
Income Tax Expense	23,861	
Totals	$246,861	$246,861

Comp. Prob. 1–5 (Continued)

Bearing, Inc.
Balance Sheet
December 31, 2017

Assets		
Cash	$50,450	
Accounts receivable	37,000	
Supplies	400	
Prepaid insurance	825	
Prepaid truck rental	3,400	
Equipment	93,500	
Total assets		$185,575
Liabilities and Equity		
Liabilities:		
Accounts payable	$32,000	
Salaries payable	4,000	
Interest payable	700	
Unearned rent revenue	1,200	
Income taxes payable	23,861	
Long-term bank loan	10,000	
Total liabilities		$ 71,761
Equity:		
Capital stock	$50,000	
Retained earnings	63,814*	
Total equity		113,814
Total liabilities and equity		$185,575

*Beginning retained earnings + Net income – Dividends = Ending retained earnings ($19,500 + $44,314 – $0 = $63,814)

Comp. Prob. 1–5 (Continued)

Bearing, Inc.
Statement of Comprehensive Income
For the Year Ended December 31, 2017

Services revenue	$105,000	
Rent revenue	600	
Total revenues		$105,600
Less operating expenses:		
Supplies expense	$ 450	
Interest expense	700	
Salaries expense	34,500	
Miscellaneous expense	1,775	37,425
Income before income tax		$ 68,175
Less income tax expense		23,861
Net income		$ 44,314
Other comprehensive income		0
Comprehensive income		$ 44,314
Earnings per share ($44,314 ÷ 16,000 shares)		$ 2.77

5. Journalize closing entries and prepare a post-closing trial balance

y.	Services Revenue	105,000	
	Rent Revenue	600	
	Supplies Expense		450
	Interest Expense		700
	Salaries Expense		34,500
	Miscellaneous Expense		1,775
	Income Tax Expense		23,861
	Retained Earnings		44,314

Comp. Prob. 1–5 (Continued)

Bearing, Inc.
Post-Closing Trial Balance
December 31, 2017

	Debits	Credits
Cash	$ 50,450	
Accounts Receivable	37,000	
Supplies	400	
Equipment	93,500	
Prepaid Insurance	825	
Prepaid Truck Rental	3,400	
Accounts Payable		$ 32,000
Salaries Payable		4,000
Interest Payable		700
Unearned Rent Revenue		1,200
Income Taxes Payable		23,861
Long-Term Bank Loan		10,000
Capital Stock		50,000
Retained Earnings		63,814
Totals	$185,575	$185,575