EXPANDED MATERIAL

LO7 **Understand the major parts of the Sarbanes-Oxley Act and how it impacts financial reporting.**

Public Company Accounting Oversight Board (PCAOB)	Constraints on auditors	Constraints on management
• Register all public accounting firms. • Establish auditing standards. • Inspect public accounting firms.	• Auditors are prohibited from providing non-audit services to audit clients. • Audit partners must rotate every five years. • Auditors must report to the audit committee of the board of directors.	• The CEO and the CFO must personally certify the reliability of the financial statements. • Companies must have a code of ethics. • Loans to company executives are prohibited. • Audit committees must be strengthened.

Key Terms & Concepts

- audit committee, 185
- bank reconciliation, 200
- cash, 192
- control activities (procedures), 185
- control environment, 185
- detective controls, 185
- external auditors, 188
- financing activities, 190
- generally accepted auditing standards (GAAS), 188
- independent checks, 187
- internal auditors, 187
- internal control structure, 182
- investing activities, 190
- NSF (not sufficient funds) check, 198
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- organizational structure, 185
- petty cash fund, 196
- physical safeguards, 186
- preventative controls, 185
- Sarbanes-Oxley Act, 184
- segregation of duties, 185

Put it on Paper — Discussion Questions

1. How can a person tell whether an entry to an expense account is payment for a legitimate expenditure or a means of concealing a theft of cash?
2. How would it be possible to overstate revenues? What effect would an overstatement of revenues have on total assets?
3. What are the major elements of a system of internal controls?
4. Identify five different types of control procedures.
5. How do internal auditors add to the credibility of financial statements?
6. What is the purpose of a financial statement audit by CPAs?
7. Do you believe that outside auditors (CPAs) who examine the financial statements of a company, while being paid by that company, can be independent?
8. What are the three types of basic business activities?
9. Why is the purchase of inventory for resale to customers classified as an operating activity rather than an investing activity?
10. Why do companies usually have more controls for cash than for other assets?
11. What are three generally practiced controls for cash, and what is the purpose of each control?
12. What are the major reasons that the balance of a bank statement is usually different from the cash book balance (Cash per the general ledger)?
13. Why don't the additions and deductions from the bank balance on a bank reconciliation require adjustment by the company?

Practice Exercises

PE 5-1
LO 4

Classifying Major Business Activities

Classify each of the following business activities as an operating, an investing, or a financing activity.

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

PE 5-2
LO 4

Control of Cash

Which one of the following is *not* an important control associated with cash?

a. All cash expenditures must be made with prenumbered checks.
b. The cash balance must never fall below the sum of inventory and accounts receivable.
c. All cash receipts must be deposited daily.
d. The handling of cash must be separated from the recording of cash.

PE 5-3
LO 6

Bank Reconciliation

Ahcoba Company received a bank statement at the end of the month. The statement contained the following.

Ending balance	$61,000
Bank service charge for the month	275
Interest earned and added by the bank to the account balance	195

In comparing the bank statement to its own cash records, the company found the following:

Deposits made but not yet recorded by the bank	$14,300
Checks written and mailed but not yet recorded by the bank	26,700

Before making any adjustments suggested by the bank statement, the cash balance according to the books is $48,680. What is the correct cash balance as of the end of the month? Verify this amount by reconciling the bank statement with the cash balance on the books.

PE 5-4
LO 6

Journal Entries from a Bank Reconciliation

Refer to PE 5-3. Make all journal entries necessary on the company's books to adjust the reported cash balance in response to the receipt of the bank statement.

Exercises

E 5-1
LO 1

Accounting Errors—Transaction Errors

How would the following errors affect the account balances and the basic accounting equation, *Assets = Liabilities + Equity?* How do the misstatements affect income?

a. The purchase of a truck is recorded as an expense instead of an asset.
b. A cash payment on accounts receivable is received but not recorded.
c. Fictitious sales on account are recorded.
d. A clerk misreads a handwritten invoice for repairs and records it as $1,500 instead of $1,800.
e. Payment is received on December 31 for the next three months' rent and is recorded as revenue.

E 5-2

LO 1

Errors in Financial Statements

The following financial statements are available for Sherwood Real Estate Company:

Balance Sheet

Assets		Liabilities		
Cash	$ 2,600	Accounts payable	$ 200,000	
Receivable from sale of		Mortgage payable	12,000,000	
real estate	10,000,000	Total liabilities		$12,200,000
Interest receivable*	360,000			
Real estate properties	12,000,000			
		Equity		
		Capital stock	$ 20,000	
		Retained earnings	10,142,600	
		Total equity		10,162,600
Total assets	$22,362,600	Total liabilities and equity		$22,362,600

*Interest Receivable applies to Receivable from sale of real estate.

Statement of Comprehensive Income

Gain on sale of real estate	$6,400,000
Interest income*	360,000
Total revenues	$6,760,000
Expenses	2,400,000
Net income	$4,360,000
Other comprehensive income	0
Comprehensive income	$4,360,000

*Interest Income applies to Receivable from sale of real estate.

Sherwood Company is using these financial statements to entice investors to buy stock in the company. However, a recent investigation revealed that the sale of real estate was a fabricated transaction with a fictitious company that was recorded to make the financial statements look better. The sales price was $10,000,000 with a zero cash down payment and a $10,000,000 receivable. Prepare financial statements for Sherwood Company showing what its total assets, liabilities, equity, and net income really are with the sale of real estate removed.

E 5-3

LO 2

Internal Control Procedures

As an auditor, you have discovered the following problems with the accounting system control procedures of Jim's Supply Store. For each of the following occurrences, tell which of the five internal control procedures was lacking. Also, recommend how the company should change its procedures to avoid the problem in the future.

a. Jim's Supply Store's losses due to bad debts have increased dramatically over the past year. In an effort to increase sales, the managers of certain stores have allowed large credit sales to occur without review or approval.

b. An accountant hid his theft of $200 from the company's bank account by changing the monthly reconciliation. He knew the manipulation would not be discovered.

c. Mark Peterson works in the storeroom. He maintains the inventory records, counts the inventory, and has unlimited access to the storeroom. He occasionally steals items of inventory and hides the theft by including the value of the stolen goods in his inventory count.

d. Receiving reports are sometimes filled out days after shipments have arrived.

E 5-4 LO 3

Internal Auditing—Staffing Internal Audits

Concorde Corporation is a manufacturing company. It recently reassigned one of its accounting managers to the internal audit department. He had successfully directed the western-area accounting office, and the corporation thought his skills would be valuable to the internal audit department. The director of the internal audit division knew of this individual's experience in the western-area accounting office and assigned him to audit that same office.

Should the internal auditor be assigned to audit the same office in which he recently worked? What problems could arise in this situation?

E 5-5 LO 3

Internal Auditing

Which of the following is not applicable to the internal audit function?

a. Deter or catch employee fraud.
b. Issue an opinion for investors regarding the reliability of the financial statements.
c. Be guided by its own set of professional standards.
d. Help to ensure that the accounting function is performed correctly and that the financial statements are prepared accurately.

E 5-6 LO 3

Internal Auditing—External Auditor's Reliance on Internal Auditors

Pierson, CPA, is planning an audit of the financial statements of Generic Company. In determining the nature, timing, and extent of the auditing procedures, Pierson is considering Generic's internal audit function, which is staffed by Shawn Goff.

1. In what ways may Goff's work be relevant to Pierson?
2. What factors should Pierson consider, and what inquiries should Pierson make in deciding whether to rely on Goff's work?

E 5-7 LO 3

External Auditors—Purpose of an Audit

What is the purpose of external auditors providing an opinion on a company's financial statements?

E 5-8 LO 3

Auditing Negligence

A few years ago, the officers of Phar-Mor, a discount retail chain, were convicted of issuing fraudulent financial statements. The company had overstated its inventory by moving inventory from store to store and counting the same inventory several times. For example, a case of Coca-Cola would be counted at one store and then moved to another store and counted again. Phar-Mor's auditors were accused of performing negligent audits because they didn't catch these inventory movements. Do you believe that the external auditors were negligent in this case?

E 5-9 LO 4

Control of Cash

Listed below are five procedures followed by Alpha Corporation related with cash.

1. Payments are paid with checks numbered randomly.
2. A bank reconciliation is prepared monthly.
3. Anita writes checks and also records cash payment journal entries.
4. Total cash receipts are compared to bank deposits daily by someone who has no other cash responsibilities.
5. Jacob, the controller, deposits all cash receipt in banks daily.

Indicate whether each procedure is an example of good internal control or of weak internal control. If it is an example of good internal control, indicate which internal control procedure is being followed. If it is an example of weak internal control, indicate which internal control procedure is violated. Use the table below.

Procedure	IC Strength or Weakness	Related Internal Control Procedures
1.		
2.		
3.		
4.		
5.		

E 5-10 LO 5

Purchases Discounts

Assume that Kingston bookstore decided to buy 150 books at NT$350 per book on April 5, 2017. The credit terms were 2/10, n/30. Kingston paid half the price on April 10, 2017; the other half was paid on April 20, 2017. Make journal entries needed at each date.

E 5-11 LO 5

Purchases Returns and Allowances

Referring to E 5-10, assume that Kingston found 10 books have significant defects and decided to return these 10 books on April 8, 2017. It also found another 15 books to have small defects and asked for allowances of NT$20 per defective book. Make the entry on April 8 to record the returns and allowances.

E 5-12 LO 5

Payment for Various Expenses

Assume that HTC Corporation had the following transactions in July, 2017: paid one year insurance of NT$36,000 on July 1 for their managers; paid the rent of the office NT$100,000 for July on July 1; purchase office stationery for NT$1,500 on July 5; paid wages NT$1,000,000 of June on July 10. Record the entries needed in July, 2017.

E 5-13 LO 5

Petty Cash Fund

Volvo Company established a petty cash fund on June 1, 2017, cashing a check for €100. During June, the petty cash receipts are as followed:

June	4	Stamp inventory, €10
June	15	Miscellaneous expense, €15
	20	Freight-out, €20
	28	Office supplies, €8

The fund was replenished on June 30, and the fund contained €45. On July 1, the company decided to increase the amount of the fund to €120.

Prepare journal entries to record transactions during the period from June 1, 2017 to July 1, 2017.

E 5-14 LO 6

Preparing a Bank Reconciliation

Prepare a bank reconciliation for Bend Company at January 31, 2017, using the information shown.

1. Cash per the accounting records at January 31 amounted to $228,909; the bank statement on this same date showed a balance of $204,008.
2. The canceled checks returned by the bank included a check written by DeVoe Company for $6,987 that had been deducted from Bend's account in error.
3. Deposits in transit as of January 31, 2017, amounted to $33,442.
4. The following amounts were adjustments to Bend Company's account on the bank statement:
   a. Service charges of $64.
   b. An NSF check of $4,100.
   c. Interest earned on the account, $110.
5. Checks written by Bend Company that have not yet cleared the bank include four checks totaling $19,582.

E 5-15 LO 6

Preparing a Bank Reconciliation

The records of Derma Corporation show the following bank statement information for December:

a. Bank balance, December 31, 2017, $87,450
b. Service charges for December, $50
c. Rent collected by bank, $1,000
d. Note receivable collected by bank (including $300 interest), $2,300
e. December check returned marked NSF (check was a payment of an account receivable), $200
f. Bank erroneously reduced Derma's account for a check written by Dunna Company, $1,000
g. Cash account balance, December 31, 2017, $81,200
h. Outstanding checks, $9,200
i. Deposits in transit, $5,000

1. Prepare a bank reconciliation for December.
2. Prepare the entry to correct the cash account as of December 31, 2017.

E 5-16
LO 6

Reconciling Book and Bank Balances

Jensen Company has just received the September 30, 2017, bank statement summarized in the following schedule:

	Charges	Deposits	Balance
Balance, September 1			$ 5,100
Deposits recorded during September		$27,000	32,100
Checks cleared during September	$27,300		4,800
NSF check, J. J. Jones	50		4,750
Bank service charges	10		4,740
Balance, September 30			4,740

Cash on hand (recorded on Jensen's books but not deposited) on September 1 and September 30 amounted to $200. There were no deposits in transit or checks outstanding at September 1, 2017. The cash account for September reflected the following:

Cash

Sept. 1 Balance	5,300	Sept. Checks	28,000
Sept. Deposits	29,500		

Answer the following questions. *(Hint:* It may be helpful to prepare a complete bank reconciliation.)

1. What is the ending balance per the cash account before adjustments?
2. What adjustments should be added to the depositor's books?
3. What is the total amount of the deductions from the depositor's books?
4. What is the total amount to be added to the bank's balance?
5. What is the total amount to be deducted from the bank's balance?

PROBLEMS

P 5-1
LO 2

Internal Control Structure

Below are six descriptions of internal control problems. In the space to the left of each description, enter the code letter of the internal control principle that is most related to the problem described.

Internal Control Principles

A. Segregation of duties
B. Proper procedures or authorizations
C. Physical control over assets and records
D. Adequate documents and records
E. Independent check on performance

____ 1. The person who is authorized to sign checks approves purchase orders for payment.
____ 2. Cash shortages are not discovered because there are no daily cash counts by supervisors.
____ 3. The same person opens incoming mail and posts the accounts receivable subsidiary ledger.
____ 4. Some cash payments are not recorded because checks are not prenumbered.
____ 5. A clothing store is experiencing a high level of inventory shortages because people try on clothing and walk out of the store without paying for the merchandise.
____ 6. Three people handle cash sales from the same cash register drawer.

P 5-2
LO 4

Cash Fraud

Mac Faber was the controller of the Lewiston National Bank. In his position as controller, he was in charge of all accounting functions. He wrote cashier's checks for the bank and reconciled the bank statements. He alone could approve exceptions to credit limits for bank customers, and even the internal auditors reported to him. Unknown to the bank, Mac had recently divorced and was supporting two households. In addition, many of his personal investments had soured, including a major farm implement dealership that had lost $40,000 in the last year. Several months after Mac had left the bank for another job, it was discovered that a vendor had paid twice and that the second payment had been deposited in Mac's personal account. Because Mac was not there to cover his tracks (as he had been on previous occasions), an investigation ensued. It was determined that Mac had used his position in the bank to steal $117,000 over a period of two years. Mac was prosecuted and sentenced to 30 months in a federal penitentiary.

Required:

1. What internal control weaknesses allowed Mac to perpetrate the fraud?
2. What motivated Mac to perpetrate the fraud?

P 5-3
LO 5

Accounting for Cash Payments, Petty Cash

The petty cash fund of €250 for Walson Company appeared as follows on December 31, 2017:

Cash		€128
Petty cash vouchers		
Supplies	€24.25	
Postage	50.00	
Freight-Out	22.50	
Meals	31.25	

Required:

1. Briefly describe when the petty cash fund should be replenished. Because there is cash on hand, is there a need to replenish the fund at year end on December 31? Explain.
2. Prepare a journal entry when replenishing the fund.
3. On December 31, the office manager gives instructions to increase the petty cash fund by €50. Make the appropriate journal entry.

P 5-4
LO 6

Preparing a Bank Reconciliation

Milton Company has just received the following monthly bank statement for June 2017.

Date	Checks	Deposits	Balance
June 1			$25,000
June 2	$ 150		24,850
June 3		$ 6,000	30,850
June 4	750		30,100
June 5	1,500		28,600
June 7	8,050		20,550
June 9		8,000	28,550
June 10	3,660		24,890
June 11	2,690		22,200
June 12		9,000	31,200
June 13	550		30,650
June 17	7,500		23,150
June 20		5,500	28,650
June 21	650		28,000
June 22	700		27,300
June 23		4,140†	31,440
June 25	1,000		30,440
June 30	50*		30,390
Totals	$27,250	$32,640	

*Bank service charge
†Note collected, including $140 interest

Data from the cash account of Milton Company for June are as follows:

June 1 balances $20,440

Checks written:		Deposits:	
June 1	$ 1,500	June 2	$ 6,000
4	8,500	5	8,000
6	2,690	10	9,000
8	550	18	5,500
9	7,500	30	6,000
12	650		$34,500
19	700		
22	1,000		
26	1,300		
27	1,360		
	$25,750		

At the end of May, Milton had three checks outstanding for a total of $4,560. All three checks were processed by the bank during June. There were no deposits outstanding at the end of May. It was discovered during the reconciliation process that a check for $8,050, written on June 4 for supplies, was improperly recorded on the books as $8,500.

Required:

1. Determine the amount of deposits in transit at the end of June.
2. Determine the amount of outstanding checks at the end of June.
3. Prepare a June bank reconciliation.
4. Prepare the journal entries to correct the cash account.
5. **Interpretive Question:** Why is it important that the cash account be reconciled on a timely basis?

P 5-5
LO 6

Determining Where the Cash Went

Kim Lee, the bookkeeper for Briton Company, had never missed a day's work for the past 10 years until last week. Since that time, he has not been located. You now suspect that Kim may have embezzled money from the company. The following bank reconciliation, prepared by Kim last month, is available to help you determine if a theft occurred:

Briton Company
Bank Reconciliation for August 2017
Prepared by Kim Lee

Balance per bank statement	$384,112	Balance per books	$339,196
Additions to bank balance:		*Additions to book balance:*	
Deposits in transit	16,000	Note collected by bank	500
		Interest earned	1,200
Deductions from bank balance:		*Deductions from book balance:*	
Outstanding checks:		NSF check	(3,600)
#201	(38,400)	Bank service charges	(96)
#204	(10,000)		
#205	(8,116)		
#295	(390)		
#565	(3,840)		
#567	(1,230)		
#568	(936)		
Adjusted bank balance	$337,200	**Adjusted book balance**	$337,200

In examining the bank reconciliation, you decide to review canceled checks returned by the bank. You find that check stubs for check nos. 201, 204, 205, and 295 indicate that these checks were supposedly voided when written. All other bank reconciliation data have been verified as correct.

Required:

1. Compute the amount suspected stolen by Kim.
2. **Interpretive Question:** Describe how Kim accounted for the stolen money. What would have prevented the theft?

Analytical Assignments

AA 5-1
Discussion

Auditing a Company

Jerry Stillwell, the owner of a small company, asked Jones, a CPA, to conduct an audit of the company's financial statements. Stillwell told Jones that the audit needed to be completed in time to submit audited financial statements to a bank as part of a loan application. Jones immediately accepted the assignment and agreed to provide an auditor's report within two weeks.

Because Jones was busy, he hired two accounting students to perform the audit. After two hours of instruction, he sent them off to conduct the audit. Jones told the students not to spend time reviewing the internal controls, but instead to concentrate on proving the mathematical accuracy of the ledgers and other financial records.

The students followed Jones's instructions, and after 10 days, they provided the financial statements, which did not include notes. Jones reviewed the statements and prepared an auditor's report. The report did not refer to generally accepted accounting principles and contained no mention of any qualifications or disclosures. Briefly describe the problems with this audit.

AA 5-2
Judgment Call

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

Is an internal control structure really necessary? Your uncle doesn't seem to think so. He works for a regional employment staffing service and recently commented, "As long as a company hires hard-working, honest people, fraud and abusive financial reporting cases will be almost nonexistent. People with integrity will always make the right choice. In the last six months, we haven't placed anyone for employment who has been fired or let go for fraudulent activity!" A friend argues, however, that anyone presented with the right pressures can commit fraud and that opportunities must be eliminated through an effective internal control structure. Who do you agree with?

AA 5-3
Judgment Call

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

Should external auditors do all audit procedures themselves, or should the relationship between the auditor and the client be more friendly? You have just graduated from college and are now working as an auditor for a public accounting firm. Your first client is a major shipping company on the west coast that specializes in sending goods to China. As part of your first assignment, you are asked to count the number of metal containers in the storage warehouse and verify their contents. As you begin, the warehouse manager (and long-time friend of the firm) comes to you and says, "Don't worry about looking inside the containers. Our guys did that last week and we are running low on time." What should you do?

AA 5-4
Real Company Analysis

Philips

Locate the 2015 financial statements of Philips in Appendix B and consider the following questions:

1. With respect to the report of the external auditors to "the Supervisory Board and Shareholders of Koninklijke Philips Electronics N.V.":
   a. Who is Philips' external auditor?

   b. How long after the end of Philips' fiscal year did the external auditor complete the audit?
2. With respect to the report of management concerning the financial statements:
   a. Who is responsible for the financial statements?
   b. After reading the paragraph on internal control, indicate whether you agree or disagree with the following statement: "The purpose of an internal control system is to ensure that all transactions are always recorded and that all assets are always completely safeguarded."

AA 5-5

Real Company Analysis

Circle K

At one time, Circle K was the second-largest convenience store chain in the United States. At its peak, Circle K operated 4,685 stores in 32 states. Circle K's rapid expansion was financed through long-term borrowing. Interest on this large debt, combined with increased price competition from convenience stores operated by oil companies, squeezed the profits of Circle K. For the fiscal year ended April 30, 1990, Circle K reported a loss of $773 million. In May 1990, Circle K filed for Chapter 11 bankruptcy protection. Subsequently, Circle K was taken over by Tosco, a large independent oil company.

1. In the fiscal year ended April 30, 1989, Circle K experienced significant financial difficulty. Reported profits were down 74.5% from the year before. In the president's letter to the shareholders, Circle K explained that 1989 was a "disappointing" year and that management was seeking an outside company to come in and buy out the Circle K shareholders. How do you think all this bad news was reflected in the auditor's report accompanying the financial statements dated April 30, 1989?
2. Circle K reported a loss of $773 million for the year ended April 30, 1990. Just a week after the end of the fiscal year, the CEO was fired. One week after that, Circle K declared bankruptcy. The audit report was completed approximately two months later. How do you think the news of the bankruptcy was reflected in the auditor's report accompanying the financial statements dated April 30, 1990?

AA 5-6

International

Do the Financial Statements Give a True and Fair View?

Swire Pacific, Ltd. is one of the largest companies in the world. The primary operations of the company are in the region of Hong Kong, China, and Taiwan where it has operated for over 125 years. Swire operates Cathay Pacific Airways and has extensive real estate holdings in Hong Kong. The 2008 auditor's report (prepared by PricewaterhouseCoopers) for Swire Pacific, dated March 12, 2009, read as follows (in part):

In our opinion, the Group Financial statements give a true and fair view of the consolidated financial position of the Group as at 31st December 2008. . . .

Although the concept of a "true and fair view" is not part of the auditor's terminology in the United States, it is used by auditors all over the world. The "true and fair view" concept states that an auditor must make sure that the financial statements give an honest representation of the economic status of the company, even if the company violates generally accepted accounting principles in order to do so.

1. Review the opinion language in the auditors' report for TSMC (see Exhibit 5.3). Does the audit report state unconditionally that TSMC's financial statements are a fair representation of the economic status of the company?
2. Auditors in the United States concentrate on performing audits to ensure that financial statements are prepared in accordance with generally accepted accounting principles. What economic and legal realities in the United States would make it difficult for U.S. auditors to apply the "true and fair view" concept?

AA 5-7

Ethics

Blowing the Whistle on Former Partners

On St. Patrick's Day in 1992, Chambers Development Company, one of the largest landfill and waste management firms in the United States, announced that it had been engaging in improper accounting for years. Wall Street fear over what this announcement implied about the company's track record of steady earnings growth sent Chambers' stock price plunging by 62% in one day.

The improper accounting by Chambers had been discovered in the course of the external audit. The auditors found that $362 million in expenses had not been reported since Chambers first became a public company in 1985. If this amount of additional expense had been reported, it would have completely wiped out all the profit reported by Chambers since it first went public. The difficult part of this situation was that a large number of the financial staff working for Chambers were former partners in the audit firm performing the audit. These accountants had first worked as independent external auditors at Chambers, then were hired by Chambers, and subsequently were audited by their old partners.

What ethical and economic issues did the auditors of Chambers Development Company face as they considered whether to blow the whistle on their former partners?

EXPANDED MATERIAL

Key Terms & Concepts

Put it on Paper — Discussion Questions

14. What are the duties of the Public Company Accounting Oversight Board?
15. What constraints does the Sarbanes-Oxley Act place on auditors?
16. As a result of the Sarbanes-Oxley Act, public companies were required to change the way they do business. What practice does Sarbanes-Oxley forbid?

Comprehensive Problem Chapters 1-5

As a recently hired accountant for a small business, Bearing, Inc., you are provided with last year's balance sheet, statement of comprehensive income, and post-closing trial balance to familiarize yourself with the business.

Bearing, Inc.
Balance Sheet
December 31, 2017

Assets		
Cash	$22,100	
Accounts receivable	27,000	
Supplies	600	
Equipment	13,500	
Total assets		$63,200
Liabilities and Equity		
Liabilities:		
Accounts payable	$17,000	
Salaries payable	3,500	
Income tax payable	3,200	
Total liabilities		$23,700
Equity:		
Capital stock (10,000 shares outstanding)	$20,000	
Retained earnings	19,500	
Total equity		39,500
Total liabilities and equity		$63,200

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

Service revenue	$58,000	
Rent revenue	4,000	
Total revenues		$62,000
Less operating expenses:		
Supplies expense	$ 1,200	
Salaries expense	31,000	
Miscellaneous expense	6,400	38,600
Income before income tax		$23,400
Less income tax expense		8,190
Net income		$15,210
Other comprehensive income		0
Comprehensive income		$15,210

Earnings per share ($15,210 ÷ 10,000 shares) = $1.52

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

	Debits	Credits
Cash	$22,100	
Accounts Receivable	27,000	
Supplies	600	
Equipment	13,500	
Accounts Payable		$17,000
Salaries Payable		3,500
Income Tax Payable		3,200
Capital Stock		20,000
Retained Earnings		19,500
Totals	$63,200	$63,200

You are also given the following information that summarizes the business activity for the current year, 2018.

a. Issued 6,000 additional shares of capital stock for $30,000 cash.
b. Borrowed $10,000 on January 2, 2018, from Metropolis Bank as a long-term loan. Interest for the year is $700, payable on January 2, 2019.
c. Paid $5,100 cash on September 1 to lease a truck for one year.
d. Received $1,800 on November 1 from a tenant for six months' rent.
e. Paid $900 on December 1 for a one-year insurance policy.
f. Purchased $250 of supplies for cash.
g. Purchased equipment for $80,000 on account.
h. Provided services for $105,000 on account.
i. Collected $95,000 cash from customers' accounts receivable.
j. Paid $65,000 cash for the equipment purchased during the year.
k. Paid $34,000 for sales reps' salaries, including $3,500 owed at the beginning of 2018.
l. No dividends were paid during the year.
m. The income taxes payable for 2017 were paid.
n. For adjusting entries, all prepaid expenses are initially recorded as assets, and all unearned revenues are initially recorded as liabilities.
o. At year-end, $400 worth of supplies are on hand.
p. At year-end, an additional $4,000 of sales salaries are owed, but have not yet been paid.
q. Income tax expense is based on a 35% corporate tax rate.

You are asked to do the following:

1. Journalize the transactions for the current year, 2018, using the accounts listed on the financial statements and other appropriate accounts (you may omit explanations).
2. Set up T-accounts and enter the beginning balances from the December 31, 2017, post-closing trial balance for Bearing. Post all current year journal entries to the T-accounts.
3. Journalize and post any necessary adjusting entries at the end of 2018. (*Hint:* Items b, c, d, e, m, o, and p require adjustment.)
4. After the adjusting entries are posted, prepare a trial balance, a balance sheet, and a statement of comprehensive income for 2018. (*Hint:* Income before income taxes should equal $68,175.)
5. Journalize and post closing entries for 2018 and prepare a post-closing trial balance.