PRACTICE MULTIPLE-CHOICE QUESTIONS

**3-1.** (LO 1)

The time period assumption states that:

(a) companies must wait until the calendar year is completed to prepare financial statements.

(b) companies use the fiscal year to report financial information.

(c) the economic life of a business can be divided into artificial time periods.

(d) companies record information in the time period in which the events occur.

**Answer**

(c) the economic life of a business can be divided into artificial time periods.

**3-2.** (LO 2)

The revenue recognition principle states that:

(a) revenue should be recognized in the accounting period in which a performance obligation is satisfied.

(b) expenses should be matched with revenues.

(c) the economic life of a business can be divided into artificial time periods.

(d) the fiscal year should correspond with the calendar year.

**Answer**

(a) revenue should be recognized in the accounting period in which a performance obligation is satisfied.

**3-3.** (LO 2)

Which of the following statements about the accrual basis of accounting is **false**?

1. Events that change a company's financial statements are recorded in the periods in which the events occur.
2. Revenue is recognized in the period in which services are performed.
3. The accrual basis is in accord with IFRS.
4. Revenue is recorded only when cash is received, and expense is recorded only when cash is paid.

**Answer**

(d) Revenue is recorded only when cash is received, and expense is recorded only when cash is paid.

**3-4.** (LO 2)

The principle or assumption dictating that efforts (expenses) be matched with accomplishments (revenues) is the:

(a) expense recognition principle.

(b) cost assumption.

(c) time period principle.

(d) revenue recognition principle.

**Answer**

(a) expense recognition principle.

**3-5.** (LO 3)

Adjusting entries are made to ensure that:

(a) expenses are recognized in the period in which they are incurred.

(b) revenues are recorded in the period in which services are provided.

(c) statement of financial position and income statement accounts have correct balances at the end of an accounting period.

(d)All the responses above are correct.

**Answer**

(d) All the responses above are correct.

**3-6.** (LO 4)

Each of the following is a major type (or category) of adjusting entries except:

(a) prepaid expenses.

(b) accrued revenues.

(c) accrued expenses.

(d) recognized revenues.

**Answer**

(d) recognized revenues.

**3-7.** (LO 5)

The trial balance shows Supplies NT$13,500 and Supplies Expense NT$0. If NT$6,000 of supplies are on hand at the end of the period, the adjusting entry is:

|  |  |  |  |
| --- | --- | --- | --- |
| (a) | Supplies | 6,000 |  |
|  | Supplies Expense |  | 6,000 |
|  |  |  |  |
| (b) | Supplies | 7,500 |  |
|  | Supplies Expense |  | 7,500 |
|  |  |  |  |
| (c) | Supplies | 7,500 |  |
|  | Supplies Expense |  | 7,500 |
|  |  |  |  |
| (d) | Supplies | 6,000 |  |
|  | Supplies Expense |  | 6,000 |

**Answer**

|  |  |  |  |
| --- | --- | --- | --- |
| (c) | Supplies | 7,500 |  |
|  | Supplies Expense |  | 7,500 |

($1,350-$600)

**3-8.** (LO 5)

Adjustments for prepaid expenses:

(a) decrease assets and increase revenues.

(b) decrease expenses and increase assets.

(c) decrease assets and increase expenses.

(d) decrease revenues and increase assets.

**Answer**

(c) decrease assets and increase expenses.

**3-9.** (LO 5)

Accumulated Depreciation is:

(a) a contra asset account.

(b) an expense account.

(c) an equity account.

(d) a liability account.

**Answer**

(a) a contra asset account.

**3-10.** (LO 5)

Queenan Company computes depreciation on delivery equipment at HK$10,000 for the month of June. The adjusting entry to record this depreciation is as follows.

|  |  |  |  |
| --- | --- | --- | --- |
| (a) | Accumulated Depreciation—Queenan Company | 10,000 |  |
|  | Depreciation Expense |  | 10,000 |
|  |  |  |  |
| (b) | Depreciation Expense | 10,000 |  |
|  | Equipment |  | 10,000 |
|  |  |  |  |
| (c) | Depreciation Expense | 10,000 |  |
|  | Accumulated Depreciation—Equipment |  | 10,000 |
|  |  |  |  |
| (d) | Equipment Expense | 10,000 |  |
|  | Accumulated Depreciation—Equipment |  | 10,000 |

**Answer**

|  |  |  |  |
| --- | --- | --- | --- |
| (c) | Depreciation Expense | 10,000 |  |
|  | Accumulated Depreciation—Equipment |  | 10,000 |

**3-11.** (LO 5)

Adjustments for unearned revenues:

(a) decrease liabilities and increase revenues.

(b) have an assets and revenues account relationship.

(c) increase assets and increase revenues.

(d) decrease revenues and decrease assets.

**Answer**

(a) decrease liabilities and increase revenues.

**3-12.** (LO 6)

Adjustments for accrued revenues:

(a) have a liabilities and revenues account relationship.

(b) have an assets and revenues account relationship.

(c) decrease assets and revenues.

(d) decrease liabilities and increase revenues.

**Answer**

(b) have an assets and revenues account relationship.

**3-13.** (LO 6)

Kathy Siska earned a salary of R$400 for the last week of September. She will be paid on October 1. The adjusting entry for Kathy's employer at September 30 is:

|  |  |  |  |
| --- | --- | --- | --- |
| (a) | No entry is required. |  |  |
|  |  |  |  |
| (b) | Salaries and Wages Expense | 400 |  |
|  | Salaries and Wages Payable |  | 400 |
|  |  |  |  |
| (c) | Salaries and Wages Expense | 400 |  |
|  | Cash |  | 400 |
|  |  |  |  |
| (d) | Salaries and Wages Payable | 400 |  |
|  | Cash |  | 400 |

**Answer**

|  |  |  |  |
| --- | --- | --- | --- |
| (b) | Salaries and Wages Expense | 400 |  |
|  | Salaries and Wages Payable |  | 400 |

**3-14.** (LO 7)

Which of the following statements is **incorrect**concerning the adjusted trial balance?

(a) An adjusted trial balance proves the equality of the total debit balances and the total credit balances in the ledger after all adjustments are made.

(b) The adjusted trial balance provides the primary basis for the preparation of financial statements.

(c) The adjusted trial balance lists the account balances segregated by assets and liabilities.

(d) The adjusted trial balance is prepared after the adjusting entries have been journalized and posted.

**Answer**

(c) The adjusted trial balance lists the account balances segregated by assets and liabilities.

**\*3-15.** (LO 8)

The trial balance shows Supplies €0 and Supplies Expense €1,500. If €800 of supplies are on hand at the end of the period, the adjusting entry is:

(a) Debit Supplies 800 and credit Supplies Expense 800.

(b) Debit Supplies Expense 800 and credit Supplies 800.

(c) Debit Supplies 700 and credit Supplies Expense 700.

(d) Debit Supplies Expense 700 and credit Supplies 700.

(a) Debit Supplies 800 and credit Supplies Expense 800.

**\*3-16.** (LO 9)

Neutrality is an ingredient of:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Faithful Representation** |  | **Relevance** |
|  |  |  |  |
| (a) | Yes |  | Yes |
| (b) | No |  | No |
| (c) | Yes |  | No |
| (d) | No |  | Yes |

**Answer**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Faithful Representation** |  | **Relevance** |
|  |  |  |  |
| (c) | Yes |  | No |

**\*3-17.** (LO 9)

Which item is a constraint in financial accounting?

(a) Comparability.

(b) Materiality.

(c) Cost.

(d) Consistency.

**Answer**

(c) Cost.

QUESTIONS

**3-1.** (a) How does the time period assumption affect an accountant's analysis of business transactions?

(b) Explain the terms fiscal year, calendar year, and interim periods.

**3-2.** Define two IFRS principles that relate to adjusting the accounts.

**3-3.** Gabe Corts, a lawyer, accepts a legal engagement in March, performs the work in April, and is paid in May. If Corts' law firm prepares monthly financial statements, when should it recognize revenue from this engagement? Why?

**3-4.** Why do accrual-basis financial statements provide more useful information than cash-basis statements?

**3-5.** In completing the engagement in Question 3-3, Corts pays no costs in March, £2,200 in April, and £2,500 in May (incurred in April). How much expense should the firm deduct from revenues in the month when it recognizes the revenue? Why?

**3-6.** “Adjusting entries are required by the historical cost principle of accounting.” Do you agree? Explain.

**3-7.** Why may a trial balance not contain up-to-date and complete financial information?

**3-8.** Distinguish between the two categories of adjusting entries, and identify the types of adjustments applicable to each category.

**3-9.** What is the debit/credit effect of a prepaid expense adjusting entry?

**3-10.** “Depreciation is a valuation process that results in the reporting of the fair value of the asset.” Do you agree? Explain.

**3-11.** Explain the differences between depreciation expense and accumulated depreciation.

**3-12.** Jain Company purchased equipment for Rs 18,000,000. By the current statement of financial position date, Rs 7,000,000 had been depreciated. Indicate the statement of financial position presentation of the data.

**3-13.** What is the debit/credit effect of an unearned revenue adjusting entry?

**3-14.** A company fails to recognize revenue for services performed but not yet received in cash or recorded. Which of the following accounts are involved in the adjusting entry: (a) asset, (b) liability, (c) revenue, or (d) expense? For the accounts selected, indicate whether they would be debited or credited in the entry.

**3-15.** A company fails to recognize an expense incurred but not paid. Indicate which of the following accounts is debited and which is credited in the adjusting entry: (a) asset, (b) liability, (c) revenue, or (d) expense.

**3-16.** A company makes an accrued revenue adjusting entry for NT$27,000 and an accrued expense adjusting entry for NT$21,000. How much was net income understated prior to these entries? Explain.

**3-17.** On January 9, a company pays €6,000 for salaries and wages, of which €2,000 was reported as Salaries and Wages Payable on December 31. Give the entry to record the payment.

**3-18.** For each of the following items before adjustment, indicate the type of adjusting entry (prepaid expense, unearned revenue, accrued revenue, or accrued expense) that is needed to correct the misstatement. If an item could result in more than one type of adjusting entry, indicate each of the types.

(a) Assets are understated.

(b) Liabilities are overstated.

(c) Liabilities are understated.

(d) Expenses are understated.

(e) Assets are overstated.

(f) Revenue is understated.

**3-19.** One-half of the adjusting entry is given below. Indicate the account title for the other half of the entry.

(a) Salaries and Wages Expense is debited.

(b) Depreciation Expense is debited.

(c) Interest Payable is credited.

(d) Supplies is credited.

(e) Accounts Receivable is debited.

(f) Unearned Service Revenue is debited.

**3-20.** “An adjusting entry may affect more than one statement of financial position or income statement account.” Do you agree? Why or why not?

**3-21.** Why is it possible to prepare financial statements directly from an adjusted trial balance?

**\*3-22.** L. Thomas Company debits Supplies Expense for all purchases of supplies and credits Rent Revenue for all advanced rentals. For each type of adjustment, give the adjusting entry.

**\*3-23.** (a) What is the primary objective of financial reporting?

(b) Identify the characteristics of useful accounting information.

**\*3-24.** Dan Fineman, the president of King Company, is pleased. King substantially increased its net income in 2017 while keeping its unit inventory relatively the same. Howard Gross, chief accountant, cautions Dan, however. Gross says that since King changed its method of inventory valuation, there is a consistency problem and it is difficult to determine whether King is better off. Is Gross correct? Why or why not?

**\*3-25.** What is the distinction between comparability and consistency?

**\*3-26.** Describe the constraint inherent in the presentation of accounting information.

**\*3-27.** Laurie Belk is president of Better Books. She has no accounting background. Belk cannot understand why fair value is not used as the basis for all accounting measurement and reporting. Discuss.

**\*3-28.** What is the economic entity assumption? Give an example of its violation.

BRIEF EXERCISES

**BE3-1.** *Indicate why adjusting entries are needed*.

(LO 3)

The ledger of Bacalao Company SLU includes the following accounts. Explain why each account may require adjustment.

(a) Prepaid Insurance

(b) Depreciation Expense

(c) Unearned Service Revenue

(d) Interest Payable

**BE3-2.** *Identify the major types of adjusting entries*.

(LO 4, 5, 6)

Lucci Company SpA accumulates the following adjustment data at December 31. Indicate (a) the type of adjustment (prepaid expense, accrued revenues and so on), and (b) the status of accounts before adjustment (overstated or understated).

1. Supplies of €100 are on hand.

2. Services provided but not recorded total €870.

3. Interest of €200 has accumulated on a note payable.

4. Rent collected in advance totaling €560 has been recognized.

**BE3-3.** *Prepare adjusting entry for supplies*.

(LO 5)

Wow Advertising Company's trial balance at December 31 shows Supplies £6,700 and Supplies Expense £0. On December 31, there are £1,300 of supplies on hand. Prepare the adjusting entry at December 31, and using T-accounts, enter the balances in the accounts, post the adjusting entry, and indicate the adjusted balance in each account.

**BE3-4.** *Prepare adjusting entry for depreciation*.

(LO 5)

At the end of its first year, the trial balance of Zovde Company OAO shows Equipment €32,000 and zero balances in Accumulated Depreciation—Equipment and Depreciation Expense. Depreciation for the year is estimated to be €6,000. Prepare the adjusting entry for depreciation at December 31, post the adjustments to T-accounts, and indicate the statement of financial position presentation of the equipment at December 31.

**BE3-5.** *Prepare adjusting entry for prepaid expense*.

(LO 5)

On July 1, 2017, Pizner Co. pays £13,200 to Orlow Insurance Co. for a 3-year insurance contract. Both companies have fiscal years ending December 31. For Pizner Co., journalize and post the entry on July 1 and the adjusting entry on December 31.

**BE3-6.** *Prepare adjusting entry for unearned revenue*.

(LO 5)

Using the data in BE3-5, journalize and post the entry on July 1 and the adjusting entry on December 31 for Orlow Insurance Co. Orlow uses the accounts Unearned Service Revenue and Service Revenue.

**BE3-7.** *Prepare adjusting entries for accruals*.

(LO 6)

The bookkeeper for Malboeuf Company SA asks you to prepare the following accrued adjusting entries at December 31.

1. Interest on notes payable of €320 is accrued.

2. Services provided but not recorded total €1,750.

3. Salaries earned by employees of €900 have not been recorded.

Use the following account titles: Service Revenue, Accounts Receivable, Interest Expense, Interest Payable, Salaries and Wages Expense, and Salaries and Wages Payable.

**BE3-8.** *Analyze accounts in an unadjusted trial balance*.

(LO 4, 5, 6)

The trial balance of Tiwari Ltd. includes the following statement of financial position accounts, which may require adjustment. For each account that requires adjustment, indicate (a) the type of adjusting entry (prepaid expenses, unearned revenues, accrued revenues, and accrued expenses) and (b) the related account in the adjusting entry.

|  |  |
| --- | --- |
| Accounts Receivable | Interest Payable |
| Prepaid Insurance | Unearned Service Revenue |
| Accumulated Depreciation—Equipment |  |

**BE3-9.** *Prepare an income statement from an adjusted trial balance*.

(LO 7)

The adjusted trial balance of Kwun Company at December 31, 2017, includes the following accounts (in thousands): Share Capital—Ordinary ￦15,600; Dividends ￦6,000; Service Revenue ￦38,400; Salaries and Wages Expense ￦16,000; Insurance Expense ￦2,000; Rent Expense ￦4,400; Supplies Expense ￦1,500; and Depreciation Expense ￦1,300. Prepare an income statement for the year.

**BE3-10.** *Prepare a retained earnings statement from an adjusted trial balance*.

(LO 7)

Partial adjusted trial balance data for Kwun Company is presented in BE3-9. Prepare a retained earnings statement for the year assuming net income is ￦13,200 for the year and Retained Earnings is ￦7,240 on January 1. (Amounts are in thousands.)

**\*BE3-11.** *Prepare adjusting entries under alternative treatment of deferrals*.

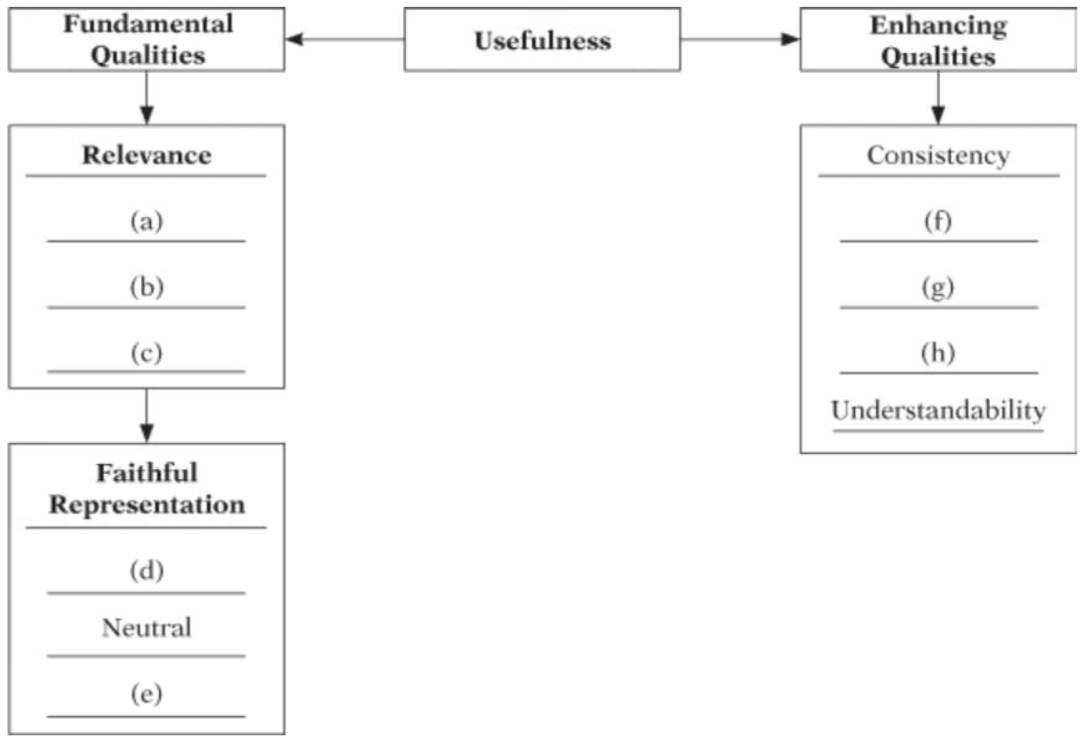
(LO 8)

Lim Company records all prepayments in income statement accounts. At April 30, the trial balance shows Supplies Expense HK$28,000, Service Revenue $92,000, and zero balances in related statement of financial position accounts. Prepare the adjusting entries at April 30 assuming (a) HK$11,000 of supplies on hand and (b) $20,000 of service revenue should be reported as unearned.

**\*BE3-12.** *Identify characteristics of useful information*.

(LO 9)

The accompanying chart shows the qualitative characteristics of useful accounting information. Fill in the blanks.



**\*BE3-13.** *Identify characteristics of useful information*.

(LO 9)

Given the *characteristics* of useful accounting information, complete each of the following statements.

(a) For information to be \_\_\_\_\_\_\_\_, it should have predictive value, confirmatory value, and be material.

(b) \_\_\_\_\_\_\_\_ is the quality of information that gives assurance that the information accurately depicts what really happened.

(c) \_\_\_\_\_\_\_\_ means using the same accounting principles and methods from year to year within a company.

**\*BE3-14.** *Identify characteristics of useful information*.

(LO 9)

Here are some qualitative characteristics of useful accounting information:

1. Predictive value

2. Neutral

3. Verifiable

4. Timely

Match each qualitative characteristic to one of the following statements.

\_\_\_\_\_\_\_\_ (a) The quality of information that occurs when independent measures, using the same methods, obtain similar results.

\_\_\_\_\_\_\_\_ (b) Accounting information must be available to decision-makers before it loses its capacity to influence their decisions.

\_\_\_\_\_\_\_\_ (c) Accounting information should help provide accurate expectations about future events.

\_\_\_\_\_\_\_\_ (d) Accounting information cannot be selected, prepared, or presented to favor one set of interested users over another.

**\*BE3-15.** *Define full disclosure principle*.

(LO 9)

Select the response that completes the following statement correctly. The full disclosure principle dictates that:

(a) financial statements should disclose all assets at their cost.

(b) financial statements should disclose only those events that can be measured in currency.

(c) financial statements should disclose all events and circumstances that would matter to users of financial statements.

(d) financial statements should not be relied on unless an auditor has expressed an unqualified opinion on them.

**DO IT! REVIEW**

**DO IT! 3-1.** *Identify timing concepts*.

(LO 1, 2)

Several timing concepts are discussed. A list of concepts is provided below in the left column, with a description of the concept in the right column. There are more descriptions provided than concepts. Match the description of the concept to the concept.

1. \_\_\_\_\_\_\_\_ Cash-basis accounting.

2. \_\_\_\_\_\_\_\_ Fiscal year.

3. \_\_\_\_\_\_\_\_ Revenue recognition principle.

4. \_\_\_\_\_\_\_\_ Expense recognition principle.

(a) Monthly and quarterly time periods.

(b) Accountants divide the economic life of a business into artificial time periods.

(c) Efforts (expenses) should be matched with accomplishments (revenues).

(d) Companies record revenues when they receive cash and record expenses when they pay out cash.

(e) An accounting time period that is 1 year in length.

(f) An accounting time period that starts on January 1 and ends on December 31.

(g) Companies record transactions in the period in which the events occur.

(h) Recognize revenue in the accounting period in which a performance obligation is satisfied.

**DO IT! 3-2.** *Prepare adjusting entries for deferrals*.

(LO 5)

The ledger of Lafayette, SA on March 31, 2017, includes the following selected accounts before adjusting entries.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Debit** |  | **Credit** |
| Prepaid Insurance | 2,400 |  |  |
| Supplies | 2,500 |  |  |
| Equipment | 30,000 |  |  |
| Unearned Service Revenue |  |  | 9,000 |

An analysis of the accounts shows the following.

1. Insurance expires at the rate of CHF300 per month.

2. Supplies on hand total CHF1,400.

3. The equipment depreciates CHF200 per month.

4. During March, services were performed for two-fifths of the unearned service revenue.

Prepare the adjusting entries for the month of March.

**DO IT! 3-3.** *Prepare adjusting entries for accruals*.

(LO 6)

Pegasus Computer Services SpA began operations in July 2017. At the end of the month, the company is trying to prepare monthly financial statements. Pegasus has the following

information for the month.

1. At July 31, Pegasus owed employees €1,300 in salaries that the company will pay in August.

2. On July 1, Pegasus borrowed €18,000 from a local bank on a 10-year note. The annual interest rate is 7%.

3. Service revenue unrecorded in July totaled €2,400.

Prepare the adjusting entries needed at July 31, 2017.

**DO IT! 3-4.** *Calculate amounts from trial balance*.

(LO 7)

Natal Co. was organized on April 1, 2017. The company prepares quarterly financial statements. The adjusted trial balance amounts at June 30 are shown below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Debit** |  |  | **Credit** |
| Cash | R$ 5,190 |  | Accumulated Depreciation—  Equipment | R$ 700 |
| Accounts Receivable | 480 |  |
| Prepaid Rent | 720 |  | Notes Payable | 4,000 |
| Supplies | 920 |  | Accounts Payable | 790 |
| Equipment | 12,000 |  | Salaries and Wages Payable | 300 |
| Dividends | 500 |  | Interest Payable | 40 |
| Salaries and Wages Expense | 7,400 |  | Unearned Rent Revenue | 400 |
| Rent Expense | 1,200 |  | Share Capital—Ordinary | 11,200 |
| Depreciation Expense | 700 |  | Service Revenue | 11,360 |
| Supplies Expense | 160 |  | Rent Revenue | 900 |
| Utilities Expense | 380 |  |  | R$29,690 |
| Interest Expense | 40 |  |  |  |
|  | R$29,690 |  |  |  |

(a) Determine the net income for the quarter April 1 to June 30.

(b) Determine the total assets and total liabilities at June 30, 2017, for Natal Co.

(c) Determine the amount that appears for Retained Earnings at June 30, 2017.

EXERCISES

**E3-1.** *Explain the time period assumption*.

(LO 1)

Nish Patel has prepared the following list of statements about the time period assumption.

1. Adjusting entries would not be necessary if a company's life were not divided into artificial time periods.

2. The tax authorities require companies to file annual tax returns.

3. Accountants divide the economic life of a business into artificial time periods, but each transaction affects only one of these periods.

4. Accounting time periods are generally a month, a quarter, or a year.

5. A time period lasting one year is called an interim period.

6. All fiscal years are calendar years, but not all calendar years are fiscal years.

***Instructions***

Identify each statement as true or false. If false, indicate how to correct the statement.

**E3-2.** *Distinguish between cash and accrual basis of accounting*.

(LO 2)

On numerous occasions, proposals have surfaced to put the national governments on the accrual basis of accounting. This is no small issue. If this basis were used, it would mean that billions in unrecorded liabilities would have to be booked, and the deficit would increase substantially.

***Instructions***

(a) What is the difference between accrual-basis accounting and cash-basis accounting?

(b) Why would politicians prefer the cash basis over the accrual basis?

(c) Write a letter to your government official explaining why the government should adopt the accrual basis of accounting.

**E3-3.** *Compute cash and accrual accounting income*.

(LO 2)

Concordia Industries Ltd. collected £112,000 from customers in 2017. Of the amount collected, £30,000 was from revenue accrued from services performed in 2016. In addition, Concordia recognized £44,000 of revenue in 2017, which will not be collected until 2018.

Concordia Industries also paid £72,000 for expenses in 2017. Of the amount paid, £27,000 was for expenses incurred on account in 2016. In addition, Concordia incurred £37,000 of expenses in 2017, which will not be paid until 2018.

***Instructions***

(a) Compute 2017 cash-basis net income.

(b) Compute 2017 accrual-basis net income.

**E3-4.** *Identify the type of adjusting entry needed*.

(LO 4)

Yilmaz A.S. encounters the following situations:

1. Yilmaz collects [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)1,750 from a customer in 2017 for services to be performed in 2018.

2. Yilmaz incurs utility expense which is not yet paid in cash or recorded.

3. Yilmaz employees worked 3 days in 2017 but will not be paid until 2018.

4. Yilmaz performs services for a customer but has not yet received cash or recorded the transaction.

5. Yilmaz paid [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)2,400 rent on December 1 for the 4 months starting December 1.

6. Yilmaz received cash for future services and recorded a liability until the service was performed.

7. Yilmaz performed consulting services for a client in December 2017. On December 31, it had not billed the client for services provided of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)1,200.

8. Yilmaz paid cash for an expense and recorded an asset until the item was used up.

9. Yilmaz purchased [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)750 of supplies in 2017; at year-end, [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)400 of supplies remain unused.

10. Yilmaz purchased equipment on January 1, 2017; the equipment will be used for 5 years.

11. Yilmaz borrowed [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)10,000 on October 1, 2017, signing an 8% 1-year note payable.

***Instructions***

Identify what type of adjusting entry (prepaid expense, unearned revenue, accrued expense, or accrued revenue) is needed in each situation, at December 31, 2017.

**E3-5.** *Prepare adjusting entries from selected data*.

(LO 5, 6)

Hwang Ltd. has the following balances in selected accounts on December 31, 2017.

|  |  |
| --- | --- |
| Accounts Receivable | NT$ -0- |
| Accumulated Depreciation—Equipment | -0- |
| Equipment | 210,000 |
| Interest Payable | -0- |
| Notes Payable | 240,000 |
| Prepaid Insurance | 63,100 |
| Salaries and Wages Payable | -0- |
| Supplies | 73,500 |
| Unearned Service Revenue | 900,000 |

All the accounts have normal balances. The information below has been gathered at December 31, 2017.

1. Hwang borrowed NT$240,000 by signing a 6%, 1-year note on October 1, 2017.

2. A count of supplies on December 31, 2017, indicates that supplies of NT$23,400 are on hand.

3. Depreciation on the equipment for 2017 is NT$30,000.

4. Hwang paid NT$63,000 for 12 months of insurance coverage on June 1, 2017.

5. On December 1, 2017, Hwang collected NT$900,000 for consulting services to be performed from December 1, 2017, through March 31, 2018.

6. Hwang performed consulting services for a client in December 2017. The client will be billed NT$117,000.

7. Hwang pays its employees total salaries of NT$270,000 every Monday for the preceding 5-day week (Monday through Friday). On Monday, December 29, employees were paid for the week ending December 26. All employees worked the last 3 days of 2017.

***Instructions***

Prepare annual adjusting entries for the seven items described above.

**E3-6.** *Identify types of adjustments and account relationships*.

(LO 4, 5, 6)

Orwell Company Ltd. accumulates the following adjustment data at December 31.

1. Services provided but not recorded total €1,420.

2. Supplies of €300 have been used.

3. Utility expenses of €225 are unpaid.

4. Unearned service revenue of €260 is recognized for services performed.

5. Salaries of €800 are unpaid.

6. Prepaid insurance totaling €380 has expired.

***Instructions***

For each of the above items indicate the following.

(a) The type of adjustment (prepaid expense, unearned revenue, accrued revenue, or accrued expense).

(b) The status of accounts before adjustment (overstatement or understatement).

**E3-7.** *Prepare adjusting entries from selected account data*.

(LO 5, 6)

The ledger of Villa Rental Agency SpA on March 31 of the current year includes the selected accounts, shown below, before adjusting entries have been prepared.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Debit** |  | **Credit** |
| Prepaid Insurance | € 3,600 |  |  |
| Supplies | 2,800 |  |  |
| Equipment | 25,000 |  |  |
| Accumulated Depreciation—Equipment |  |  | € 8,400 |
| Notes Payable |  |  | 20,000 |
| Unearned Rent Revenue |  |  | 9,900 |
| Rent Revenue |  |  | 60,000 |
| Interest Expense | -0- |  |  |
| Salaries and Wages Expense | 14,000 |  |  |

An analysis of the accounts shows the following.

1. The equipment depreciates €320 per month.

2. One-third of the unearned rent revenue was recognized during the quarter.

3. Interest of €500 is accrued on the notes payable.

4. Supplies on hand total €840.

5. Insurance expires at the rate of €200 per month.

***Instructions***

Prepare the adjusting entries at March 31, assuming that adjusting entries are made **quarterly**. Additional accounts are Depreciation Expense, Insurance Expense, Interest Payable, and Supplies Expense.

**E3-8.** *Prepare adjusting entries*.

(LO 5, 6)

Kaya Abbas, D.D.S. A.S., opened a dental practice on January 1, 2017. During the first month of operations, the following transactions occurred.

1. Performed services for patients who had dental plan insurance. At January 31, [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)875 of such services were performed but not yet recorded.

2. Utility expenses incurred but not paid prior to January 31 totaled [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)520.

3. Purchased dental equipment on January 1 for [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)80,000, paying [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)20,000 in cash and signing a [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)60,000, 3-year note payable. The equipment depreciates [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)400 per month. Interest is [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)500 per month.

4. Purchased a six-month malpractice insurance policy on January 1 for [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)18,000.

5. Purchased [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)1,600 of dental supplies. On January 31, determined that [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)700 of supplies were on hand.

***Instructions***

Prepare the adjusting entries on January 31. Account titles are Accumulated Depreciation—Equipment, Depreciation Expense, Service Revenue, Accounts Receivable, Insurance Expense, Interest Expense, Interest Payable, Prepaid Insurance, Supplies, Supplies Expense, Utilities Expense, and Utilities Payable.

**E3-9.** *Prepare adjusting entries*.

(LO 5, 6)

The trial balance for Yazici Advertising A.S. is shown in Illustration 3-3,. Instead of the adjusting entries shown in the text at October 31, assume the following adjustment data.

1. Supplies on hand at October 31 total [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)800.

2. Expired insurance for the month is [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)100.

3. Depreciation for the month is [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)50.

4. Services related to unearned service revenue in October worth [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)650 were performed.

5. Services provided but not billed at October 31 are [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)320.

6. Interest accrued at October 31 is [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)70.

7. Accrued salaries at October 31 are [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)1,200.

***Instructions***

Prepare the adjusting entries for the items above.

**E3-10.** *Prepare correct income statement*.

(LO 2, 5, 6, 7)

The income statement of Bjorn ASA for the month of July shows net income of €1,500 based on Service Revenue €5,500, Salaries and Wages Expense €2,300, Supplies Expense €1,200, and Utilities Expense €500. In reviewing the statement, you discover the following.

1. Insurance expired during July of €400 was omitted.

2. Supplies expense includes €300 of supplies that are still on hand at July 31.

3. Depreciation on equipment of €150 was omitted.

4. Accrued but unpaid salaries and wages at July 31 of €280 were not included.

5. Services performed but unrecorded totaled €920.

***Instructions***

Prepare a correct income statement for July 2017.

**E3-11.** *Analyze adjusted data*.

(LO 4, 5, 6, 7)

A partial adjusted trial balance of Rooney Company Ltd. at January 31, 2017, shows the following.

|  |  |  |  |
| --- | --- | --- | --- |
| **ROONEY COMPANY LTD.**  **Adjusted Trial Balance**  **January 31, 2017** | | | |
|  | **Debit** |  | **Credit** |
| Supplies | £ 850 |  |  |
| Prepaid Insurance | 2400 |  |  |
| Salaries and Wages Payable |  |  | £ 800 |
| Unearned Service Revenue |  |  | 750 |
| Supplies Expense | 950 |  |  |
| Insurance Expense | 400 |  |  |
| Salaries and Wages Expense | 2,500 |  |  |
| Service Revenue |  |  | 2,000 |

***Instructions***

Answer the following questions, assuming the year begins January 1.

(a) If the amount in Supplies Expense is the January 31 adjusting entry, and £710 of supplies was purchased in January, what was the balance in Supplies on January 1?

(b) If the amount in Insurance Expense is the January 31 adjusting entry, and the original insurance premium was for 1 year, what was the total premium and when was the policy purchased?

(c) If £3,100 of salaries was paid in January, what was the balance in Salaries and Wages Payable at December 31, 2016?

**E3-12.** *Journalize basic transactions and adjusting entries*.

(LO 5, 6, 7)

Selected accounts of Welch Company are shown below.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Supplies Expense** | | | |  |  | | | |
| 7/31 | 800 |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| **Supplies** | | | |  | **Salaries and Wages Payable** | | | |
| 7/1 Bal. | 1,100 | 7/31 | 800 |  |  |  | 7/31 | 1,200 |
| 7/10 | 200 |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| **Accounts Receivable** | | | |  | **Unearned Service Revenue** | | | |
| 7/31 | 620 |  |  |  | 7/31 | 900 | 7/1 Bal. | 1,500 |
|  |  |  |  |  |  |  | 7/20 | 750 |
|  |  |  |  |  |  |  |  |  |
| **Salaries and Wages Expense** | | | |  | **Service Revenue** | | | |
| 7/15 | 1,200 |  |  |  |  |  | 7/14 | 2,000 |
| 7/31 | 1,200 |  |  |  |  |  | 7/31 | 900 |
|  |  |  |  |  |  |  | 7/31 | 620 |

***Instructions***

After analyzing the accounts, journalize (a) the July transactions and (b) the adjusting entries that were made on July 31. (*Hint*: July transactions were for cash.)

**E3-13.** *Prepare adjusting entries from analysis of trial balances*.

(LO 5, 6, 7)

The trial balances before and after adjustment for Matusiak Company OAO at the end of its fiscal year are presented below.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **MATUSIAK COMPANY OAO**  **Trial Balance**  **August 31, 2017** | | | | | | | |
|  | **Before**  **Adjustment** | | |  | **After**  **Adjustment** | | |
| **Dr.** |  | **Cr.** |  | **Dr.** |  | **Cr.** |
| Cash | €10,400 |  |  |  | €10,400 |  |  |
| Accounts Receivable | 8,800 |  |  |  | 10,000 |  |  |
| Supplies | 2,300 |  |  |  | 700 |  |  |
| Prepaid Insurance | 4,000 |  |  |  | 2,500 |  |  |
| Equipment | 14,000 |  |  |  | 14,000 |  |  |
| Accumulated Depreciation—Equipment |  |  | € 3,600 |  |  |  | €4,900 |
| Accounts Payable |  |  | 5,800 |  |  |  | 5,800 |
| Salaries and Wages Payable |  |  | -0- |  |  |  | 1,100 |
| Unearned Rent Revenue |  |  | 1,500 |  |  |  | 800 |
| Share Capital—Ordinary |  |  | 12,000 |  |  |  | 12,000 |
| Retained Earnings |  |  | 3,600 |  |  |  | 3,600 |
| Service Revenue |  |  | 34,000 |  |  |  | 35,200 |
| Rent Revenue |  |  | 11,000 |  |  |  | 11,700 |
| Salaries and Wages Expense | 17,000 |  |  |  | 18,100 |  |  |
| Supplies Expense | -0- |  |  |  | 1,600 |  |  |
| Rent Expense | 15,000 |  |  |  | 15,000 |  |  |
| Insurance Expense | -0- |  |  |  | 1,500 |  |  |
| Depreciation Expense | -0- |  |  |  | 1,300 |  |  |
|  | €71,500 |  | €71,500 |  | €71,500 |  | €71,500 |

***Instructions***

Prepare the adjusting entries that were made.

**E3-14.** *Prepare financial statements from adjusted trial balance*.

(LO 7)

The adjusted trial balance for Matusiak Company is given in E3-13.

***Instructions***

Prepare the income and retained earnings statements for the year and the statement of financial position at August 31.

**E3-15.** *Record transactions on accrual basis; convert revenue to cash receipts*.

(LO 5, 6)

The following data are taken from the comparative statements of financial position of Newman Billiards Club Ltd., which prepares its financial statements using the accrual basis of accounting.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **December 31** |  | **2017** |  | **2016** |
| Accounts receivable from members |  | £12,000 |  | £10,000 |
| Unearned service revenue |  | 14,000 |  | 20,000 |

Members are billed based upon their use of the club's facilities. Unearned service revenues arise from the sale of gift certificates, which members can apply to their future use of club facilities. The 2017 income statement for the club showed that service revenue of £153,000 was recognized during the year.

***Instructions***

(*Hint*: You will probably find it helpful to use T-accounts to analyze these data.)

(a) Prepare journal entries for each of the following events that took place during 2017.

1. Accounts receivable from 2016 were all collected.

2. Gift certificates outstanding at the end of 2016 were all redeemed.

3. An additional £35,000 worth of gift certificates were sold during 2017. A portion of these was used by the recipients during the year; the remainder was still outstanding at the end of 2017.

4. Services provided to members for 2017 were billed to members.

5. Accounts receivable for 2017 (i.e., those billed in item [4] above) were partially collected.

(b) Determine the amount of cash received by the club, with respect to member services, during 2017.

**E3-16.** *Compute cash flow from operations and net income*.

(LO 2)

In its first year of operations, Kumar Company recognized Rs30,000 in service revenue, Rs4,800 of which was on account and still outstanding at year-end. The remaining Rs25,200 was received in cash from customers.

The company incurred operating expenses of Rs17,000. Of these expenses Rs12,000 was paid in cash; Rs5,000 was still owed on account at year-end. In addition, Alencar prepaid Rs2,600 for insurance coverage that would not be used until the second year of operations.

***Instructions***

(a) Compute Kumar's first-year cash flow from operations.

(b) Compute Kumar's first-year net income under accrual-basis accounting.

(c) Which basis of accounting (cash or accrual) provides more useful information for decision-makers?

**\*E3-17.** *Journalize adjusting entries*.

(LO 8)

Visser Company NV has the following balances in selected accounts on December 31, 2017.

|  |  |
| --- | --- |
| Service Revenue | €40,700 |
| Insurance Expense | 2,880 |
| Supplies Expense | 2,240 |

All the accounts have normal balances. Visser debits prepayments to expense accounts when paid, and credits unearned revenues to revenue accounts when received. The following information below has been gathered at December 31, 2017.

1. Visser paid €2,880 for 12 months of insurance coverage on April 1, 2017.

2. On December 1, 2017, Visser collected €40,700 for consulting services to be performed from December 1, 2017, through March 31, 2018.

3. A count of supplies on December 31, 2017, indicates that supplies of €420 are on hand.

***Instructions***

Prepare the adjusting entries needed at December 31, 2017.

**\*E3-18.** *Journalize transactions and adjusting entries*.

(LO 8)

At Moretti Company SpA, prepayments are debited to expense when paid, and unearned revenues are credited to revenue when cash is received. During January of the current year, the following transactions occurred.

|  |  |
| --- | --- |
| Jan. 2 | Paid €2,640 for fire insurance protection for the year. |
| 10 | Paid €1,700 for supplies. |
| 15 | Received €6,400 for services to be performed in the future. |

On January 31, it is determined that €2,500 of the services were performed and that there are €650 of supplies on hand.

***Instructions***

(a) Journalize and post the January transactions. (Use T-accounts.)

(b) Journalize and post the adjusting entries at January 31.

(c) Determine the ending balance in each of the accounts.

**\*E3-19.** *Identify accounting assumptions and principles*.

(LO 9)

Presented below are the assumptions and principles discussed in this chapter.

1. Full disclosure principle.

2. Going concern assumption.

3. Monetary unit assumption.

4. Time period assumption.

5. Historical cost principle.

6. Economic entity assumption.

***Instructions***

Identify by number the accounting assumption or principle that is described below. Do not use a number more than once.

\_\_\_\_\_\_\_\_ (a) Is the rationale for why plant assets are not reported at liquidation value. (*Note:* Do not use the historical cost principle.)

\_\_\_\_\_\_\_\_ (b) Indicates that personal and business record-keeping should be separately maintained.

\_\_\_\_\_\_\_\_ (c) Assumes that the monetary unit is the “measuring stick” used to report on financial performance.

\_\_\_\_\_\_\_\_ (d) Separates financial information into time periods for reporting purposes.

\_\_\_\_\_\_\_\_ (e) Measurement basis used when a reliable estimate of fair value is not available.

\_\_\_\_\_\_\_\_ (f) Dictates that companies should disclose all circumstances and events that make a difference to financial statement users.

**\*E3-20.** *Identify the assumption or principle that has been violated*.

(LO 9)

Rosman Co. had three major business transactions during 2017.

(a) Reported at its fair value of £260,000 merchandise inventory with a cost of £208,000.

(b) The president of Rosman Co., Jay Rosman, purchased a truck for personal use and charged it to the company’s Salaries and Wages Expense account.

(c) Rosman Co. wanted to make its 2017 income look better, so it added 2 more weeks to its fiscal year (a 54-week year). Previous fiscal years were 52 weeks.

***Instructions***

In each situation, identify the assumption or principle that has been violated, if any, and discuss what the company should have done.

**\*E3-21.** *Identity financial accounting concepts and principles*.

(LO 9)

The following characteristics, assumptions, principles, or constraint guide the IASB when it creates accounting standards.

|  |  |
| --- | --- |
| Relevance | Expense recognition principle |
| Faithful representation | Time period assumption |
| Comparability | Going concern assumption |
| Consistency | Historical cost principle |
| Monetary unit assumption | Full disclosure principle |
| Economic entity assumption | Materiality |

Match each item above with a description below.

\_\_\_\_\_\_\_\_ 1. Ability to easily evaluate one company's results relative to another's.

\_\_\_\_\_\_\_\_ 2. Belief that a company will continue to operate for the foreseeable future.

\_\_\_\_\_\_\_\_ 3. The judgment concerning whether an item's size is large enough to matter to decision-makers.

\_\_\_\_\_\_\_\_ 4. The reporting of all information that would make a difference to financial statement users.

\_\_\_\_\_\_\_\_ 5. The practice of preparing financial statements at regular intervals.

\_\_\_\_\_\_\_\_ 6. The quality of information that indicates the information makes a difference in a decision.

\_\_\_\_\_\_\_\_ 7. A belief that items should be reported on the statement of financial position at the price that was paid to acquire the item.

\_\_\_\_\_\_\_\_ 8. A company's use of the same accounting principles and methods from year to year.

\_\_\_\_\_\_\_\_ 9. Tracing accounting events to particular companies.

\_\_\_\_\_\_\_\_ 10. The desire to minimize bias in financial statements.

\_\_\_\_\_\_\_\_ 11. Reporting only those things that can be measured in monetary units.

\_\_\_\_\_\_\_\_ 12. Dictates that efforts (expenses) be matched with results (revenues).

**\*E3-22.** *Comment on the objectives and qualitative characteristics of accounting information*

(LO 9)

Net Nanny Software International Ltd., headquartered in Vancouver, specializes in Internet safety and computer security products for both the home and commercial markets. In a recent statement of financial position, it reported a deficit (negative retained earnings) of US$5,678,288. It has reported only net losses since its inception. In spite of these losses, Net Nanny's ordinary shares have traded anywhere from a high of $3.70 to a low of $0.32 on the Canadian Venture Exchange.

Net Nanny's financial statements have historically been prepared in Canadian dollars. Recently, the company adopted the U.S. dollar as its reporting currency.

***Instructions***

(a) What is the objective of financial reporting? How does this objective meet or not meet Net Nanny's investors' needs?

(b) Why would investors want to buy Net Nanny's shares if the company has consistently reported losses over the last few years? Include in your answer an assessment of the relevance of the information reported on Net Nanny's financial statements.

(c) Comment on how the change in reporting information from Canadian dollars to U.S. dollars likely affected the readers of Net Nanny's financial statements. Include in your answer an assessment of the comparability of the information.

**\*E3-23.** *Comment on the objectives and qualitative characteristics of financial reporting*.

(LO 9)

A friend of yours, Ana Gehrig, recently completed an undergraduate degree in science and has just started working with a biotechnology company. Ana tells you that the owners of the business are trying to secure new sources of financing which are needed in order for the company to proceed with development of a new health-care product. Ana said that her boss told her that the company must put together a report to present to potential investors.

Ana thought that the company should include in this package the detailed scientific findings related to the Phase I clinical trials for this product. She said, “I know that the biotech industry sometimes has only a 10% success rate with new products, but if we report all the scientific findings, everyone will see what a sure success this is going to be! The president was talking about the importance of following some set of accounting principles. Why do we need to look at some accounting rules? What they need to realize is that we have scientific results that are quite encouraging, some of the most talented employees around, and the start of some really great customer relationships. We haven't made any sales yet, but we will. We just need the funds to get through all the clinical testing and get government approval for our product. Then these investors will be quite happy that they bought in to our company early!”

***Instructions***

(a) What is accounting information?

(b) Comment on how Ana's suggestions for what should be reported to prospective investors conforms to the qualitative characteristics of accounting information. Do you think that the things that Ana wants to include in the information for investors will conform to financial reporting guidelines?

PROBLEMS: SET A AND PROBLEMS: SET B

**Problems: Set A**

**P3-1A** *Prepare adjusting entries, post to ledger accounts, and prepare adjusted trial balance*.

(LO 5, 6, 7)

Joey Cuono started his own consulting firm, Cuono Company SpA, on June 1, 2017. The trial balance at June 30 is shown below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **CUONO COMPANY SpA**  **Trial Balance**  **June 30, 2017** | | | | |
| **Account Number** |  | **Debit** |  | **Credit** |
| 101 | Cash | € 6,200 |  |  |
| 112 | Accounts Receivable | 6,000 |  |  |
| 126 | Supplies | 1,600 |  |  |
| 130 | Prepaid Insurance | 3,000 |  |  |
| 157 | Equipment | 14,400 |  |  |
| 201 | Accounts Payable |  |  | € 4,700 |
| 209 | Unearned Service Revenue |  |  | 4,000 |
| 311 | Share Capital—Ordinary |  |  | 20,000 |
| 400 | Service Revenue |  |  | 7,900 |
| 726 | Salaries and Wages Expense | 4,400 |  |  |
| 729 | Rent Expense | 1,000 |  |  |
|  |  | €36,000 |  | €36,000 |

In addition to those accounts listed on the trial balance, the chart of accounts for Cuono Company SpA also contains the following accounts and account numbers: No. 158 Accumulated Depreciation—Equipment, No. 212 Salaries and Wages Payable, No. 631 Supplies Expense, No. 711 Depreciation Expense, No. 722 Insurance Expense, and No. 732 Utilities Expense.

Other data:

1. Supplies on hand at June 30 are €340.

2. A utility bill for €185 has not been recorded and will not be paid until next month.

3. The insurance policy is for a year.

4. €2,500 of unearned service revenue is recognized for services performed at the end of the month.

5. Salaries of €1,600 are accrued at June 30.

6. The equipment has a 4-year life with no residual value. It is being depreciated at €300 per month for 48 months.

7. Invoices representing €2,400 of services performed during the month have not been recorded as of June 30.

***Instructions***

(a) Prepare the adjusting entries for the month of June. Use J3 as the page number for your journal.

(b) Enter the totals from the trial balance as beginning account balances and place a check mark in the posting reference column. Post the adjusting entries to the ledger accounts.

(c) Prepare an adjusted trial balance at June 30, 2017.

Adj. trial balance $41,085

**P3-2A** *Prepare adjusting entries, post, and prepare adjusted trial balance, and financial statements*.

(LO 5, 6, 7)

Lazy River Resort Ltd. opened for business on June 1, 2017. Its trial balance before adjustment on August 31 is as follows.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **LAZY RIVER RESORT LTD.**  **Trial Balance**  **August 31, 2017** | | | | |
| **Account Number** |  | **Debit** |  | **Credit** |
| 101 | Cash | € 19,600 |  |  |
| 126 | Supplies | 3,300 |  |  |
| 130 | Prepaid Insurance | 6,000 |  |  |
| 140 | Land | 25,000 |  |  |
| 143 | Building | 125,000 |  |  |
| 157 | Equipment | 26,000 |  |  |
| 201 | Accounts Payable |  |  | € 6,500 |
| 208 | Unearned Rent Revenue |  |  | 7,400 |
| 275 | Mortgage Payable |  |  | 80,000 |
| 311 | Share Capital—Ordinary |  |  | 100,000 |
| 332 | Dividends | 50,000 |  |  |
| 429 | Rent Revenue |  |  | 80,000 |
| 622 | Maintenance and Repairs Expense | 3,600 |  |  |
| 726 | Salaries and Wages Expense | 51,000 |  |  |
| 732 | Utilities Expense | 9,400 |  |  |
|  |  | €273,000 |  | €273,000 |

In addition to those accounts listed on the trial balance, the chart of accounts for Lazy River Resort Ltd. also contains the following accounts and account numbers: No. 112 Accounts Receivable, No. 144 Accumulated Depreciation—Buildings, No. 158 Accumulated Depreciation—Equipment, No. 212 Salaries and Wages Payable, No. 230 Interest Payable, No. 631 Supplies Expense, No. 711 Depreciation Expense, No. 718 Interest Expense, and No. 722 Insurance Expense.

Other data:

1. Insurance expires at the rate of €400 per month.

2. A count on August 31 shows €900 of supplies on hand.

3. Annual depreciation is €4,500 on buildings and €2,400 on equipment.

4. Unearned rent revenue of €4,100 was recognized for services performed prior to August 31.

5. Salaries of €400 were unpaid at August 31.

6. Rentals of €3,700 were due from tenants at August 31. (Use Accounts Receivable.)

7. The mortgage interest rate is 9% per year. (The mortgage was taken out on August 1.)

***Instructions***

(a) Journalize the adjusting entries on August 31 for the 3-month period June 1-August 31.

(b) Prepare a ledger using the three-column form of account. Enter the trial balance amounts and post the adjusting entries. (Use J1 as the posting reference.)

(c) Prepare an adjusted trial balance on August 31.

Adj. trial balance €280,325

(d) Prepare an income statement and a retained earnings statement for the 3 months ending August 31 and a statement of financial position as of August 31.

Net income €17,475 Ending retained earnings €12,475 Total assets €203,275

**P3-3A** *Prepare adjusting entries and financial statements*.

(LO 5, 6, 7)

Costello Advertising SpA was founded by Pat Costello in January of 2016. Presented below are both the adjusted and unadjusted trial balances as of December 31, 2017.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **COSTELLO ADVERTISING SpA**  **Trial Balance**  **December 31, 2017** | | | | | | | |
|  | **Unadjusted** | | |  | **Adjusted** | | |
| **Dr.** |  | **Cr.** |  | **Dr.** |  | **Cr.** |
| Cash | € 11,000 |  |  |  | € 11,000 |  |  |
| Accounts Receivable | 18,000 |  |  |  | 23,500 |  |  |
| Supplies | 8,600 |  |  |  | 5,000 |  |  |
| Prepaid Insurance | 3,350 |  |  |  | 2,500 |  |  |
| Equipment | 60,000 |  |  |  | 60,000 |  |  |
| Accumulated Depreciation—Equipment |  |  | € 26,000 |  |  |  | € 33,000 |
| Accounts Payable |  |  | 5,000 |  |  |  | 5,000 |
| Interest Payable |  |  | -0- |  |  |  | 150 |
| Notes Payable |  |  | 5,000 |  |  |  | 5,000 |
| Unearned Service Revenue |  |  | 7,200 |  |  |  | 5,600 |
| Salaries and Wages Payable |  |  | -0- |  |  |  | 1,300 |
| Share Capital—Ordinary |  |  | 20,000 |  |  |  | 20,000 |
| Retained Earnings |  |  | 5,500 |  |  |  | 5,500 |
| Dividends | 12,000 |  |  |  | 12,000 |  |  |
| Service Revenue |  |  | 58,600 |  |  |  | 65,700 |
| Salaries and Wages Expense | 10,000 |  |  |  | 11,300 |  |  |
| Insurance Expense |  |  |  |  | 850 |  |  |
| Interest Expense | 350 |  |  |  | 500 |  |  |
| Depreciation Expense |  |  |  |  | 7,000 |  |  |
| Supplies Expense |  |  |  |  | 3,600 |  |  |
| Rent Expense | 4,000 |  |  |  | 4,000 |  |  |
|  | €127,300 |  | €127,300 |  | €141,250 |  | €141,250 |

***Instructions***

(a) Journalize the annual adjusting entries that were made.

(b) Prepare an income statement and a retained earnings statement for the year ending December 31, 2017, and a statement of financial position at December 31.

Net income €38,450 Ending retained earnings €31,950 Total assets €69,000

(c) Answer the following questions.

1. If the note has been outstanding 6 months, what is the annual interest rate on that note?

2. If the company paid €14,500 in salaries in 2017, what was the balance in Salaries and Wages Payable on December 31, 2016?

1. 6%

2. €4,500

**P3-4A** *Preparing adjusting entries*.

(LO 5, 6)

A review of the ledger of Bellingham Company Ltd. at December 31, 2017, produces the following data pertaining to the preparation of annual adjusting entries.

1. Salaries and Wages Payable £0. There are eight salaried employees. Salaries are paid every Friday for the current week. Five employees receive a salary of £800 each per week, and three employees earn £500 each per week. Assume December 31 is a Tuesday. Employees do not work weekends. All employees worked the last 2 days of December.

2. Unearned Rent Revenue £324,000. The company began subleasing office space in its new building on November 1. At December 31, the company had the following rental contracts that are paid in full for the entire term of the lease.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Date** |  | **Term**  **(in months)** |  | **Monthly Rent** |  | **Number of Leases** |
| Nov. 1 |  | 6 |  | £4,000 |  | 5 |
| Dec. 1 |  | 6 |  | £8,500 |  | 4 |

3. Prepaid Advertising £15,600. This balance consists of payments on two advertising contracts. The contracts provide for monthly advertising in two trade magazines. The terms of the contracts are as follows.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Contract** |  | **Date** |  | **Amount** |  | **Number of Magazine**  **Issues** |
| A650 |  | May 1 |  | £6,000 |  | 12 |
| B974 |  | Oct. 1 |  | £9,600 |  | 24 |

The first advertisement runs in the month in which the contract is signed.

4. Notes Payable £100,000. This balance consists of a note for one year at an annual interest rate of 9%, dated June 1.

***Instructions***

Prepare the adjusting entries at December 31, 2017. (Show all computations.)

1. Salaries and wages expense £2,200

2. Rent revenue £74,000

3. Advertising expense £5,200

4. Interest expense £5,250

**P3-5A** *Journalize transactions and follow through accounting cycle to preparation of financial statements*.

(LO 5, 6, 7)

On September 1, 2017, the account balances of Beck Equipment Repair, Inc. were as follows.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **No.** |  | **Debit** |  | **No.** |  | **Credit** |
| 101 | Cash | £ 5,020 |  | 158 | Accumulated Depreciation—Equipment | £ 2,240 |
| 112 | Accounts Receivable | 3,520 |  | 201 | Accounts Payable | 3,400 |
| 126 | Supplies | 2,000 |  | 209 | Unearned Service Revenue | 1,400 |
| 157 | Equipment | 18,000 |  | 212 | Salaries and Wages Payable | 500 |
|  |  |  |  | 311 | Share Capital—Ordinary | 10,000 |
|  |  |  |  | 320 | Retained Earnings | 11,000 |
|  |  | £28,540 |  |  |  | £28,540 |

During September, the following summary transactions were completed.

Sept. 8 Paid £1,700 for salaries due employees, of which £1,200 is for September salaries.

10 Received £1,200 cash from customers on account.

12 Received £3,400 cash for services performed in September.

15 Purchased store equipment on account £3,000.

17 Purchased supplies on account £1,900.

20 Paid creditors £4,500 on account.

22 Paid September rent £500.

25 Paid salaries £1,360.

27 Performed services on account and billed customers £1,600 for those services.

29 Received £750 from customers for future service.

Adjustment data consist of:

1. Supplies on hand £1,700.

2. Accrued salaries payable £400.

3. Depreciation is £140 per month.

4. Unearned service revenue of £1,450 is recognized for services performed.

***Instructions***

(a) Enter the September 1 balances in the ledger accounts.

(b) Journalize the September transactions.

(c) Post to the ledger accounts. Use J1 for the posting reference. Use the following additional accounts:No. 400 Service Revenue, No. 631 Supplies Expense, No. 711 Depreciation Expense, No. 726 Salaries and Wages Expense, and No. 729 Rent Expense.

(d) Prepare a trial balance at September 30.

Trial balance £33,350

(e) Journalize and post adjusting entries.

(f) Prepare an adjusted trial balance.

Adj. trial balance £33,890

(g) Prepare an income statement and a retained earnings statement for September and a statement of financial position at September 30.

Net income £650 Ending retained earnings £16,650 Total assets £26,550

**\*P3-6A** *Prepare adjusting entries, adjusted trial balance, and financial statements using appendix*.

(LO 5, 6, 7, 8)

Alpha Graphics Company SA was organized on January 1, 2017. At the end of the first 6 months of operations, the trial balance contained the accounts shown below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Debit** |  |  | **Credit** |
| Cash | € 8,400 |  | Notes Payable | € 20,000 |
| Accounts Receivable | 14,000 |  | Accounts Payable | 9,000 |
| Equipment | 45,000 |  | Share Capital—Ordinary | 22,000 |
| Insurance Expense | 2,880 |  | Service Revenue | 58,280 |
| Salaries and Wages Expense | 30,000 |  |  |  |
| Supplies Expense | 3,900 |  |  |  |
| Advertising Expense | 1,900 |  |  |  |
| Rent Expense | 1,500 |  |  |  |
| Utilities Expense | 1,700 |  |  |  |
|  | €109,280 |  |  | €109,280 |

Analysis reveals the following additional data.

1. The €3,900 balance in Supplies Expense represents supplies purchased in January. At June 30, €680 of supplies are on hand.

2. The note payable was issued on February 1. It is a 9%, 6-month note.

3. The balance in Insurance Expense is the premium on a 1-year policy, dated March 1, 2017.

4. Service revenues are credited to revenue when received. At June 30, service revenue of €1,100 is still not performed for the customer.

5. Depreciation is €2,250 per year.

***Instructions***

(a) Journalize the adjusting entries at June 30. (Assume adjustments are recorded every 6 months.)

(b) Prepare an adjusted trial balance.

Adj. trial balance $111,155

(c) Prepare an income statement and a retained earnings statement for the 6 months ended June 30 and a statement of financial position at June 30.

Net income $16,025 Ending retained earnings $16,025 Total assets $68,875

**Problems: Set B**

**P3-1B** *Prepare adjusting entries, post to ledger accounts, and prepare an adjusted trial balance*.

(LO 5, 6, 7)

Lira Lopez started her own consulting firm, Lira Consulting, Inc. on May 1, 2017. The trial balance at May 31 is as follows.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **LIRA CONSULTING, SA**  **Trial Balance**  **MAY 31, 2017** | | | | |
| **Account Number** |  | **Debit** |  | **Credit** |
| 101 | Cash | R$ 7,700 |  |  |
| 112 | Accounts Receivable | 4,000 |  |  |
| 126 | Supplies | 1,500 |  |  |
| 130 | Prepaid Insurance | 2,880 |  |  |
| 157 | Equipment | 12,000 |  |  |
| 201 | Accounts Payable |  |  | R$ 4,700 |
| 209 | Unearned Service Revenue |  |  | 2,600 |
| 311 | Share Capital—Ordinary |  |  | 16,000 |
| 400 | Service Revenue |  |  | 8,780 |
| 726 | Salaries and Wages Expense | 3,000 |  |  |
| 729 | Rent Expense | 1,000 |  |  |
|  |  | R$32,080 |  | €32,080 |

In addition to those accounts listed on the trial balance, the chart of accounts for Lira Consulting also contains the following accounts and account numbers: No. 158 Accumulated Depreciation—Equipment, No. 212 Salaries and Wages Payable, No. 631 Supplies Expense, No. 711 Depreciation Expense, No. 722 Insurance Expense, and No. 732 Utilities Expense.

Other data:

1. R$500 of supplies have been used during the month.

2. Utilities expense incurred but not paid on May 31, 2017, R$200.

3. The insurance policy is for 2 years.

4. R$1,000 of the balance in the Unearned Service Revenue account remains unearned at the end of the month.

5. May 31 is a Wednesday, and employees are paid on Fridays. Lira Consulting has two employees, who are paid R$500 each for a 5-day work week.

6. The office equipment has a 5-year life with no residual value. It is being depreciated at R$200 per month for 60 months.

7. Invoices representing R$1,100 of services performed during the month have not been recorded as of May 31.

***Instructions***

(a) Prepare the adjusting entries for the month of May. Use J4 as the page number for your journal.

(b) Post the adjusting entries to the ledger accounts. Enter the totals from the trial balance as beginning account balances and place a check mark in the posting reference column.

(c) Prepare an adjusted trial balance at May 31, 2017.

Adj. trial balance R$33,980

**P3-2B** *Prepare adjusting entries, post, and prepare adjusted trial balance, and financial statements*.

(LO 5, 6, 7)

The Badger Motel, Inc. opened for business on May 1, 2017. Its trial balance before adjustment on May 31 is as follows.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **BADGER MOTEL, LTD.**  **Trial Balance**  **May 31, 2017** | | | | |
| **Account Number** |  | **Debit** |  | **Credit** |
| 101 | Cash | £ 2,500 |  |  |
| 126 | Supplies | 1,520 |  |  |
| 130 | Prepaid Insurance | 2,400 |  |  |
| 140 | Land | 14,000 |  |  |
| 141 | Building | 58,000 |  |  |
| 157 | Equipment | 15,000 |  |  |
| 201 | Accounts Payable |  |  | £ 4,800 |
| 208 | Unearned Rent Revenue |  |  | 3,300 |
| 275 | Mortgage Payable |  |  | 38,000 |
| 311 | Share Capital—Ordinary |  |  | 40,000 |
| 429 | Rent Revenue |  |  | 12,300 |
| 610 | Advertising Expense | 780 |  |  |
| 726 | Salaries and Wages Expense | 3,300 |  |  |
| 732 | Utilities Expense | 900 |  |  |
|  |  | £98,400 |  | £98,400 |

In addition to those accounts listed on the trial balance, the chart of accounts for Badger Motel, Ltd. also contains the following accounts and account numbers: No. 142 Accumulated Depreciation—Buildings, No. 158 Accumulated Depreciation—Equipment, No. 212 Salaries and Wages Payable, No. 230 Interest Payable, No. 631 Supplies Expense, No. 711 Depreciation Expense, No. 718 Interest Expense, and No. 722 Insurance Expense.

Other data:

1. Prepaid insurance is a 1-year policy starting May 1, 2017.

2. A count of supplies shows £350 of unused supplies on May 31.

3. Annual depreciation is £2,640 on the buildings and £1,500 on equipment.

4. The mortgage interest rate is 12%. (The mortgage was taken out on May 1.)

5. Two-thirds of the unearned rent revenue has been recognized for services performed.

6. Salaries of £750 are accrued and unpaid at May 31.

***Instructions***

(a) Journalize the adjusting entries on May 31.

(b) Prepare a ledger using the three-column form of account. Enter the trial balance amounts and post the adjusting entries. (Use J1 as the posting reference.)

(c) Prepare an adjusted trial balance on May 31.

Adj. trial balance £99,875

(d) Prepare an income statement and a retained earnings statement for the month of May and a statement of financial position at May 31.

Net income £6,675 Ending retained earnings £6,675 Total assets £91,705

**P3-3B** *Prepare adjusting entries and financial statements*.

(LO 5, 6, 7)

Lausanne Co., AG was organized on July 1, 2017. Quarterly financial statements are prepared. The unadjusted and adjusted trial balances as of September 30 are shown below.

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **CAUSANNE CO., AG**  **Trial Balance**  **September 30, 2017** | | | | | | | | | | |
|  | | **Unadjusted** | | |  | | **Adjusted** | | | |
|  | **Dr.** | |  | **Cr.** | |  | | **Dr.** |  | **Cr.** |
| Cash | CHF 8,700 | |  |  | |  | | CHF 8,700 |  |  |
| Accounts Receivable | 10,400 | |  |  | |  | | 11,500 |  |  |
| Supplies | 1,900 | |  |  | |  | | 650 |  |  |
| Prepaid Rent | 2,200 | |  |  | |  | | 1,200 |  |  |
| Equipment | 20,000 | |  |  | |  | | 20,000 |  |  |
| Accumulated Depreciation—Equipment |  | |  | CHF -0- | |  | |  |  | CHF 1,200 |
| Notes Payable |  | |  | 10,000 | |  | |  |  | 10,000 |
| Accounts Payable |  | |  | 3,200 | |  | |  |  | 3,200 |
| Salaries and Wages Payable |  | |  | -0- | |  | |  |  | 725 |
| Interest Payable |  | |  | -0- | |  | |  |  | 100 |
| Unearned Rent Revenue |  | |  | 1,900 | |  | |  |  | 850 |
| Share Capital—Ordinary |  | |  | 22,000 | |  | |  |  | 22,000 |
| Dividends | 1,000 | |  |  | |  | | 1,000 |  |  |
| Service Revenue |  | |  | 16,800 | |  | |  |  | 17,900 |
| Rent Revenue |  | |  | 1,710 | |  | |  |  | 2,760 |
| Salaries and Wages Expense | 8,000 | |  |  | |  | | 8,725 |  |  |
| Rent Expense | 1,900 | |  |  | |  | | 2,900 |  |  |
| Depreciation Expense |  | |  |  | |  | | 1,200 |  |  |
| Supplies Expense |  | |  |  | |  | | 1,250 |  |  |
| Utilities Expense | 1,500 | |  |  | |  | | 1,510 |  |  |
| Interest Expense |  | |  |  | |  | | 100 |  |  |
|  | CHF55,610 | |  | CHF55,610 | |  | | CHF58,735 |  | CHF58,735 |

***Instructions***

(a) Journalize the adjusting entries that were made.

(b) Prepare an income statement and a retained earnings statement for the 3 months ending September 30 and a statement of financial position at September 30.

Net income CHF4,850 Ending retained earnings CHF3,850 Total assets CHF40,925

(c) If the note bears interest at 12%, how many months has it been outstanding?

**P3-4B** *Prepare adjusting entries*

(LO 5, 6)

A review of the ledger of Khan Company at December 31, 2017, produces the following data pertaining to the preparation of annual adjusting entries.

1. Prepaid Insurance €9,300. The company has separate insurance policies on its buildings and its motor vehicles. Policy B4564 on the building was purchased on April 1, 2016, for €6,000. The policy has a term of 3 years. Policy A2958 on the vehicles was purchased on January 1, 2017, for €4,800. This policy has a term of 2 years.

2. Unearned Rent Revenue €429,000. The company began subleasing office space in its new building on November 1. At December 31, the company had the following rental contracts that are paid in full for the entire term of the lease.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Date** |  | **Term**  **(in months)** |  | **Monthly Rent** |  | **Number of Leases** |
| Nov. 1 |  | 9 |  | €5,000 |  | 5 |
| Dec. 1 |  | 6 |  | 8,500 |  | 4 |

3. Notes Payable €120,000. This balance consists of a note for 9 months at an annual interest rate of 9%, dated November 1.

4. Salaries and Wages Payable €0. There are eight salaried employees. Salaries are paid every Friday for the current week. Five employees receive a salary of €640 each per week, and three employees earn €500 each per week. Assume December 31 is a Wednesday. Employees do not work weekends. All employees worked the last 3 days of December.

***Instructions***

Prepare the adjusting entries at December 31, 2017.

1. Insurance expense €4,400

2. Rent revenue €84,000

3. Interest expense €1,800

4. Salaries and wages expense €2,820

**P3-5B** *Journalize transactions and follow through accounting cycle to preparation of financial statements*.

(LO 5, 6, 7)

On November 1, 2017, the account balances of Samone Equipment Repair, Ltd. were as follows.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **No.** |  | **Debit** |  | **No.** |  | **Credit** |
| 101 | Cash | HK$ 24,000 |  | 158 | Accumulated Depreciation— |  |
| 112 | Accounts |  |  |  | Equipment | HK$ 20,000 |
|  | Receivable | 44,500 |  | 201 | Accounts Payable | 26,000 |
| 126 | Supplies | 18,000 |  | 209 | Unearned Service Revenue | 13,600 |
| 157 | Equipment | 160,000 |  | 212 | Salaries and Wages Payable | 7,000 |
|  |  |  |  | 311 | Share Capital—Ordinary | 100,000 |
|  |  |  |  | 320 | Retained Earnings | 79,900 |
|  |  | HK$246,500 |  |  |  | HK$246,500 |

During November, the following summary transactions were completed.

Nov.8 Paid HK$15,000 for salaries due employees, of which HK$7,000 is for October salaries.

10 Received HK$34,200 cash from customers on account.

12 Received HK$31,000 cash for services performed in November.

15 Purchased equipment on account HK$20,000.

17 Purchased supplies on account HK$7,000.

20 Paid creditors on account HK$2,7000.

22 Paid November rent HK$6,200.

25 Paid salaries HK$15,000.

27 Performed services on account and billed customers HK$1,9000 for those services.

29 Received HK$3,600 from customers for future service.

Adjustment data consist of:

1. Supplies on hand HK$14,000.

2. Accrued salaries payable HK$3,700.

3. Depreciation for the month is HK$2,000.

4. Unearned service revenue of HK$13,800 is recognized for services performed.

***Instructions***

(a) Enter the November 1 balances in the ledger accounts.

(b) Journalize the November transactions.

(c) Post to the ledger accounts. Use J1 for the posting reference. Use the following additional accounts: No. 400 Service Revenue, No. 631 Supplies Expense, No. 711 Depreciation Expense, No. 726 Salaries and Wages Expense, and No. 729 Rent Expense.

(d) Prepare a trial balance at November 30.

Trial balance HK$293,100

(e) Journalize and post adjusting entries.

(f) Prepare an adjusted trial balance.

Adj. trial balance HK$298,800

(g) Prepare an income statement and a retained earnings statement for November and a statement of financial position at November 30.

Net income HK$17,900 Ending retained earnings HK$97,800 Total assets HK$230,900

MATCHA CREATIONS

(*Note*: This is a continuation of the Matcha Creations problem from Chapters 1, 2.)

**MC3**

It is the end of November and Mie-ling has been in touch with her grandmother. Her grandmother asked Mie-ling how well things went in her first month of business. Mie-ling, too, would like to know if the company has been profitable or not during November. Mie-ling realizes that in order to determine Matcha Creations' income, she must first make adjustments to the accounts.

Mie-ling puts together the following additional information.

1. A count reveals that NT$35 of baking supplies were used during November.

2. Mie-ling estimates that all of her baking equipment will have a useful life of 5 years or 60 months. (Assume Mie-ling decides to record a full month's worth of depreciation, regardless of when the equipment was obtained by the business.)

3. Mie-ling 's grandmother has decided to charge interest of 6% on the note payable extended on November 16. The loan plus interest is to be repaid in 24 months. (Assume that half a month of interest accrued during November.)

4. On November 30, a friend of Mie-ling asks her to teach a class at the neighborhood school. Mie-ling agrees and teaches a group of 35 first-grade students how to make holiday cookies. The next day, Mie-ling prepares an invoice for NT$300 and leaves it with the school principal. The principal says that he will pass the invoice along to the head office, and it will be paid sometime in December.

5. Mie-ling receives a utilities bill for NT$45. The bill is for utilities consumed by Mie-ling's business during November and is due December 15.

***Instructions***

Using the information that you have gathered through Chapter 2, and based on the new information above, do the following.

(a) Prepare and post the adjusting journal entries.

(b) Prepare an adjusted trial balance.

(c) Using the adjusted trial balance, calculate Matcha Creations' net income or net loss for the month of November. Do not prepare an income statement.

**Broadening Your Perspective**

Financial Reporting and Analysis

**BYP3-1. Financial Reporting Problem: TSMC, Ltd. (TWN)**

The financial statements of TSMC are presented in Appendix A at the end of this textbook. The company’s complete annual report, including the notes to the financial statements, is available in the Investor section of the company's website, *www.tsmc.com*.

***Instructions***

(a) Using the consolidated financial statements and related information, identify items that may result in adjusting entries for prepayments.

(b) Using the consolidated financial statements and related information, identify items that may result in adjusting entries for accruals.

**BYP3-2. Comparative Analysis Problem: Nestlé SA (CHE) vs. Petra Foods Ltd. (SGP)**

Nestlé's financial statements are presented in Appendix B. Financial statements for Petra Foods are presented in Appendix C.

***Instructions***

Based on information contained in these financial statements, determine the following for each company.

(a) Net increase (decrease) in property, plant, and equipment (net) for the most recent fiscal year shown.

(b) Increase (decrease) in marketing and administration expenses (Nestlé) and increase (decrease) in selling, distribution, and administrative expenses (Petra Foods) for the most recent fiscal year shown.

(c) Increase (decrease) in non-current liabilities for the most recent fiscal year shown.

(d) Increase (decrease) in profit for the most recent fiscal year shown.

(e) Increase (decrease) in cash and cash equivalents for the most recent fiscal year shown.

Critical Thinking

**BYP3-3. Decision-Making Across the Organization**

Happy Trails Park, Ltd. was organized on April 1, 2016, by Alicia Henry. Alicia is a good manager but a poor accountant. From the trial balance prepared by a part-time bookkeeper, Alicia prepared the following income statement for the quarter that ended March 31, 2017.

Alicia thought that something was wrong with the statement because net income had never exceeded £20,000 in any one quarter. Knowing that you are an experienced accountant, she asks you to review the income statement and other data.

You first look at the trial balance. In addition to the account balances reported above in the income statement, the ledger contains the following additional selected balances at March 31, 2017.

You then make inquiries and discover the following.

1. Rent revenue includes advanced rentals for summer occupancy £14,000.

2. There were £1,450 of supplies on hand at March 31.

3. Prepaid insurance resulted from the payment of a one-year policy on January 1, 2017.

4. The mail on April 1, 2017, brought the following bills: advertising for week of March 24, £130; repairs made March 10, £260; and utilities, £120.

5. There are four employees, who receive wages totaling £300 per day. At March 31, 2 days' salaries and wages have been incurred but not paid.

6. The note payable is a 3-month, 10% note dated January 1, 2017.

***Instructions***

With the class divided into groups, answer the following.

(a) Prepare a correct income statement for the quarter ended March 31, 2017.

(b) Explain to Alicia the IFRSs that she did not recognize in preparing her income statement and their effect on her results.

**BYP3-4. Communication Activity**

In reviewing the accounts of Maribeth Ltd. at the end of the year, you discover that adjusting entries have not been made.

***Instructions***

Write a memo to Maribeth Danon, the owner of Maribeth Ltd, that explains the following: the nature and purpose of adjusting entries, why adjusting entries are needed, and the types of adjusting entries that may be made.

**BYP3-5. Ethics Case**

Watkin Company Ltd. is a pesticide manufacturer. Its sales declined greatly this year due to the passage of legislation outlawing the sale of several of Watkin's chemical pesticides. In the coming year, Watkin will have environmentally safe and competitive chemicals to replace these discontinued products. Sales in the next year are expected to greatly exceed any prior year's. The decline in sales and profits appears to be a 1-year aberration. But even so, the company president fears a large dip in the current year's profits. He believes that such a dip could cause a significant drop in the market price of Watkin's ordinary shares and make the company a takeover target.

To avoid this possibility, the company president calls in Diane Leno, controller, to discuss this period's year-end adjusting entries. He urges her to accrue every possible revenue and to defer as many expenses as possible. He says to Diane, “We need the revenues this year, and next year can easily absorb expenses deferred from this year. We can't let our share price be hammered down!” Diane didn't get around to recording the adjusting entries until January 17, but she dated the entries December 31 as if they were recorded then. Diane also made every effort to comply with the president's request.

***Instructions***

(a) Who are the stakeholders in this situation?

(b) What are the ethical considerations of (1) the president's request and (2) Diane's dating the adjusting entries December 31?

(c) Can Diane accrue revenues and defer expenses and still be ethical?

A LOOK at U.S. GAAP

All companies struggle to determine the proper revenues and expenses to use in measuring net income, so timing is everything. Both the IASB and FASB are working on a joint project to develop a common conceptual framework that will enable companies to better use the same principles to record transactions consistently over time. The objective of the conceptual framework project is to lead to standards that are more principles-based and internally consistent, which will in turn lead to the most useful financial reporting information.

**Key Points**

* As indicated above, both the IASB and FASB are working together on a common conceptual framework. Some of the major issues that are being addressed are:
  + What are the qualitative characteristics that make accounting information useful?
  + What is the primary objective of financial reporting?
  + What basis should be used to measure and report, that is, should a historical cost or fair value approach be used?
  + What criteria should be used to determine when revenue should be recognized and when expenses have been incurred?
  + What guidelines should be established for disclosing financial information?

**Similarities**

* Like IFRS, companies applying GAAP use accrual-basis accounting to ensure that they record transactions that change a company's financial statements in the period in which events occur.
* Similar to IFRS, cash-basis accounting is not in accordance with GAAP.
* GAAP also divides the economic life of companies into artificial time periods. Under both GAAP and IFRS, this is referred to as the *time period assumption*. GAAP requires that companies present a complete set of financial statements, including comparative information annually.
* The form and content of financial statements are very similar under GAAP and IFRS. Any significant differences will be discussed in those chapters that address specific financial statements.
* Revenue recognition fraud is a major issue in U.S. financial reporting. The same situation exists for most other countries as well.

**Differences**

* + Prior to the issuance of a new joint revenue recognition standard by the IASB and the FASB, GAAP has more than 100 rules dealing with revenue recognition. Many of these rules are industry specific. Revenue recognition under IFRS is determined primarily by a single standard, *IAS 18*. Despite this large disparity in the detailed guidance devoted to revenue recognition, the **general** revenue recognition principles required by IFRS that are used in this textbook are similar to those under GAAP.
  + Internal controls are a system of checks and balances designed to detect and prevent fraud and errors. The Sarbanes-Oxley Act requires U.S. companies to enhance their systems of internal control. However, many foreign companies do not have this requirement.
  + Under IFRS, revaluation to fair value of items such as land and buildings is permitted. This is not permitted under GAAP.
  + Under IFRS, the term “income” income includes *both* revenues, which arise during the normal course of operating activities, and gains, which arise from activities outside of the normal sales of goods and services. The term income is not used this way under GAAP. Instead, under GAAP income refers to the net difference between revenues and expenses. Expenses under IFRS include both those costs incurred in the normal course of operations, as well as losses that are not part of normal operations. This is in contrast to GAAP, which defines each separately.

**Looking to the Future**

In May 2014, the IASB and FASB completed a joint project on revenue recognition. The purpose of this project is to develop comprehensive guidance on when to recognize revenue. This approach focuses on changes in assets and liabilities as the basis for revenue recognition. It is hoped that this approach will lead to more consistent accounting in this area.

**GAAP Practice**

**GAAP Self-Test Questions**

**1.** GAAP:

(a) provides the same type of guidance as IFRS for revenue recognition.

(b) provides only general guidance on revenue recognition, compared to the detailed guidance provided by IFRS.

(c) allows revenue to be recognized when a customer makes an order.

(d) requires that revenue not be recognized until cash is received.

**Answer**

(a) provides the same type of guidance as IFRS for revenue recognition.

**2.** Which of the following statements is **false**?

(a) GAAP employs the time period assumption.

(b) GAAP employs accrual accounting.

(c) GAAP requires that revenues and costs must be capable of being measured reliably.

(d) GAAP uses the cash basis of accounting.

**Answer**

(d) GAAP uses the cash basis of accounting.

**3.** As a result of the revenue recognition project by the FASB and IASB:

(a) revenue recognition places more emphasis on when the performance obligation is satisfied.

(b) revenue recognition places more emphasis on when revenue is realized.

(c) revenue recognition places more emphasis on when changes occur in related expenses.

(d) revenue is no longer recorded unless cash has been received.

**Answer**

(a) revenue recognition places more emphasis on when the performance obligation is satisfied.

**4.** Which of the following is **false**?

(a) Under IFRS, the term *income* describes both revenues and gains.

(b) Under IFRS, the term *expenses* includes losses.

(c) Under IFRS, firms do not engage in the closing process.

(d) IFRS has fewer standards than GAAP that address revenue recognition.

**Answer**

(c) Under IFRS, firms do not engage in the closing process.

**5.** Accrual-basis accounting:

(a) is optional under GAAP.

(b) results in companies recording transactions that change a company's financial statements in the period in which events occur.

(c) has been eliminated as a result of the IASB/FASB joint project on revenue recognition.

(d) is not consistent with the GAAP conceptual framework.

**Answer**

(b) results in companies recording transactions that change a company's financial statements in the period in which events occur.

**GAAP Exercises**

**GAAP3-1.** Why might IFRS revalue land and buildings whereas under GAAP this practice is not permissible?

**GAAP3-2.** Under GAAP, do the definitions of revenues and expenses include gains and losses? Explain.

**GAAP Financial Reporting Problem: Apple Inc.**

**GAAP3-3.** The financial statements of Apple are presented in Appendix D. The company's complete annual report, including the notes to its financial statements, is available at *http://investor.apple.com*.

**Instructions**

Visit Apple's corporate website and answer the following questions from Apple's 2013 annual report.

(a) Using the financial statements and related information, identify items that may result in adjusting entries for prepayments.

(b) Using the financial statements and related information, identify items that may result in adjusting entries for accruals.