PRACTICE MULTIPLE-CHOICE QUESTIONS

**5-1.** (LO 1)

Gross profit will result if:

(a) operating expenses are less than net income.

(b) sales revenues are greater than operating expenses.

(c) sales revenues are greater than cost of goods sold.

(d) operating expenses are greater than cost of goods sold.

**Answer**

(c) sales revenues are greater than cost of goods sold.

**5-2.** (LO 2)

Under a perpetual inventory system, when goods are purchased for resale by a company:

(a) purchases on account are debited to Inventory.

(b) purchases on account are debited to Purchases.

(c) purchase returns are debited to Purchase Returns and Allowances.

(d) freight costs are debited to Freight-Out.

**Answer**

(a) purchases on account are debited to Inventory.

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

The sales accounts that normally have a debit balance are:

(a) Sales Discounts.

(b) Sales Returns and Allowances.

(c) Both (a) and (b).

(d) Neither (a) nor (b).

**Answer**

(c) Both (a) and (b).

**5-4.** (LO 3)

A credit sale of NT$7,500 is made on June 13, terms 2/10, net/30. A return of NT$500 is granted on June 16. The amount received as payment in full on June 23 is:

(a) NT$7,000.

(b) NT$6,860.

(c) NT$6,850.

(d) NT$6,500.

**Answer**

(b) NT$6,860.

**5-5.** (LO 2)

Which of the following accounts will normally appear in the ledger of a merchandising company that uses a perpetual inventory system?

(a) Purchases.

(b) Freight-In.

(c) Cost of Goods Sold.

(d) Purchase Discounts.

**Answer**

(c) Cost of Goods Sold.

**5-6.** (LO 3)

To record the sale of goods for cash in a perpetual inventory system:

(a) only one journal entry is necessary to record cost of goods sold and reduction of inventory.

(b) only one journal entry is necessary to record the receipt of cash and the sales revenue.

(c) two journal entries are necessary: one to record the receipt of cash and sales revenue, and one to record the cost of goods sold and reduction of inventory.

(d) two journal entries are necessary: one to record the receipt of cash and reduction of inventory, and one to record the cost of goods sold and sales revenue.

**Answer**

(c) two journal entries are necessary: one to record the receipt of cash and sales revenue, and one to record the cost of goods sold and reduction of inventory.

**5-7.** (LO 4)

The steps in the accounting cycle for a merchandising company are the same as those in a service company **except**:

(a) an additional adjusting journal entry for inventory may be needed in a merchandising company.

(b) closing journal entries are not required for a merchandising company.

(c) a post-closing trial balance is not required for a merchandising company.

(d) an income statement is required for a merchandising company.

**Answer**

(a) an additional adjusting journal entry for inventory may be needed in a merchandising company.

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

The income statement for a merchandising company shows each of the following features **except**:

(a) gross profit.

(b) cost of goods sold.

(c) a sales revenue section.

(d) investing activities section.

**Answer**

(d) investing activities section.

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

If sales revenues are €400,000, cost of goods sold is €310,000, and operating expenses are €60,000, the gross profit is:

(a) €30,000.

(b) €90,000.

(c) €340,000.

(d) €400,000.

**Answer**

(b) €90,000.

**\*5-10.** (LO 6)

In a worksheet, Inventory is shown in the following columns:

(a) adjusted trial balance debit and statement of financial position debit.

(b) income statement debit and statement of financial position debit.

(c) income statement credit and statement of financial position debit.

(d) income statement credit and adjusted trial balance debit.

**Answer**

(a) adjusted trial balance debit and statement of financial position debit.

**\*5-11.** (LO 7)

In determining cost of goods sold using a periodic system:

(a) purchase discounts are deducted from net purchases.

(b) freight-out is added to net purchases.

(c) purchase returns and allowances are deducted from net purchases.

(d) freight-in is added to net purchases.

**Answer**

(d) freight-in is added to net purchases.

**\*5-12.** (LO 7)

If beginning inventory is HK$600,000, cost of goods purchased is HK$3,800,000, and ending inventory is HK$500,000, cost of goods sold is:

(a) HK$3,900,000.

(b) HK$3,700,000.

(c) HK$3,300,000.

(d) HK$4,200,000.

**Answer**

(a) HK$3,900,000.

**\*5-13.** (LO 7)

When goods are purchased for resale by a company using a periodic inventory system:

(a) purchases on account are debited to Inventory.

(b) purchases on account are debited to Purchases.

(c) purchase returns are debited to Purchase Returns and Allowances.

(d) freight costs are debited to Purchases.

**Answer**

(b) purchases on account are debited to Purchases.

QUESTIONS

**5-1.** (a) “The steps in the accounting cycle for a merchandising company are different from the accounting cycle for a service company.” Do you agree or disagree?

(b) Is the measurement of net income for a merchandising company conceptually the same as for a service company? Explain.

**5-2.** Why is the normal operating cycle for a merchandising company likely to be longer than for a service company?

**5-3.** (a) How do the components of revenues and expenses differ between merchandising and service companies?

(b) Explain the income measurement process in a merchandising company.

**5-4.** How does income measurement differ between a merchandising and a service company?

**5-5.** When is cost of goods sold determined in a perpetual inventory system?

**5-6.** Distinguish between FOB shipping point and FOB destination. Identify the freight terms that will result in a debit to Inventory by the buyer and a debit to Freight-Out by the seller.

**5-7.** Explain the meaning of the credit terms 2/10, n/30.

**5-8.** Goods costing £2,500 are purchased on account on July 15 with credit terms of 2/10, n/30. On July 18, a £200 credit memo is received from the supplier for damaged goods. Give the journal entry on July 24 to record payment of the balance due within the discount period using a perpetual inventory system.

**5-9.** Karen Lloyd believes revenues from credit sales may be earned before they are collected in cash. Do you agree? Explain.

**5-10.** (a) What is the primary source document for recording (1) cash sales, (2) credit sales.

(b) Using XXs for amounts, give the journal entry for each of the transactions in part (a).

**5-11.** A credit sale is made on July 10 for €700, terms 2/10, n/30. On July 12, €100 of goods are returned for credit. Give the journal entry on July 19 to record the receipt of the balance due within the discount period.

**5-12.** Explain why the Inventory account will usually require adjustment at year-end.

**5-13.** Prepare the closing entries for the Sales Revenue account, assuming a balance of €180,000 and the Cost of Goods Sold account with a €125,000 balance.

**5-14.** What merchandising account(s) will appear in the post-closing trial balance?

**5-15.** Regis Co. has sales revenue of HK$1,090,000, cost of goods sold of HK$700,000, and operating expenses of HK$230,000. What is its gross profit and its gross profit rate?

**5-16.** Kim Ho Company reports net sales of ¥800,000, gross profit of ¥570,000, and net income of ¥240,000. What are its operating expenses?

**5-17.** Identify the distinguishing features of an income statement for a merchandising company.

**5-18.** Identify the sections of an income statement that relate to (a) operating activities, and (b) non-operating activities.

**\*5-19.** Indicate the columns of the worksheet in which (a) inventory and (b) cost of goods sold will be shown.

**\*5-20.** Identify the accounts that are added to or deducted from Purchases to determine the cost of goods purchased. For each account, indicate whether it is added or deducted.

**\*5-21.** Goods costing NT$60,000 are purchased on account on July 15 with credit terms of 2/10, n/30. On July 18, a $6,000 credit was received from the supplier for damaged goods. Give the journal entry on July 24 to record payment of the balance due within the discount period, assuming a periodic inventory system.

BRIEF EXERCISES

**BE5-1.** *Compute missing amounts in determining net income*.

(LO 1)

Presented below are the components in Clearwater Company, Ltd.'s income statement. Determine the missing amounts.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Sales**  **Revenue** |  | **Cost of**  **Goods Sold** |  | **Gross**  **Profit** |  | **Operating**  **Expenses** |  | **Net**  **Income** |
| (a) | £75,000 |  | ? |  | £30,000 |  | ? |  | £10,800 |
| (b) | £108,000 |  | £55,000 |  | ? |  | ? |  | £29,500 |
| (c) | ? |  | £83,900 |  | £79,600 |  | £39,500 |  | ? |

**BE5-2.** *Journalize perpetual inventory entries*.

(LO 2, 3)

Giovanni Company buys merchandise on account from Gordon Company. The selling price of the goods is €780, and the cost of the goods is €560. Both companies use perpetual inventory systems. Journalize the transaction on the books of both companies.

**BE5-3.** *Journalize sales transactions*.

(LO 3)

Prepare the journal entries to record the following transactions on Benson Company Ltd.'s books using a perpetual inventory system.

(a) On March 2, Benson Company sold £800,000 of merchandise to Edgebrook Company, terms 2/10, n/30. The cost of the merchandise sold was £620,000.

(b) On March 6, Edgebrook Company returned £120,000 of the merchandise purchased on March 2. The cost of the returned merchandise was £90,000.

(c) On March 12, Benson Company received the balance due from Edgebrook Company.

**BE5-4.** *Journalize purchase transactions*.

(LO 2)

From the information in BE5-3, prepare the journal entries to record these transactions on Edgebrook Company's books under a perpetual inventory system.

**BE5-5.** *Prepare adjusting entry for merchandise inventory*.

(LO 4)

At year-end, the perpetual inventory records of Federer Company showed merchandise inventory of CHF98,000. The company determined, however, that its actual inventory on hand was CHF96,100. Record the necessary adjusting entry.

**BE5-6.** *Prepare closing entries for accounts*.

(LO 4)

Orlaida Company has the following account balances: Sales Revenue €192,000, Sales Discounts €2,000, Cost of Goods Sold €105,000, and Inventory €40,000. Prepare the entries to record the closing of these items to Income Summary.

**BE5-7.** *Prepare sales revenues section of income statement*.

(LO 5)

Yangtze Company, Ltd. provides the following information for the month ended October 31, 2017 (amounts in Chinese yuan): sales on credit ¥280,000, cash sales ¥100,000, sales discounts ¥5,000, sales returns and allowances ¥22,000. Prepare the sales revenues section of the income statement based on this information.

**BE5-8.** *Explain presentation in an income statement*.

(LO 5)

Explain where each of the following items would appear on an income statement: (a) gain on sale of equipment, (b) interest expense, (c) casualty loss from vandalism, (d) cost of goods sold, and (e) depreciation expense.

**BE5-9.** *Compute net sales, gross profit, income from operations, and gross profit rate*.

(LO 5)

Assume Jose Company has the following reported amounts: Sales revenue €506,000, Sales returns and allowances €13,000, Cost of goods sold €342,000, Operating expenses €110,000. Compute the following: (a) net sales, (b) gross profit, (c) income from operations, and (d) gross profit rate. (Round to one decimal place.)

**\*BE5-10.** *Identify worksheet columns for selected accounts*.

(LO 6)

Presented below is the format of the worksheet presented in the chapter.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Trial Balance** | |  |  | **Adjustments** | |  |  | **Adjusted Trial**  **Balance** | |  |  | **Income**  **Statement** | |  |  | **Statement of**  **Financial Position** | |  |
|  | Dr. | Cr. |  |  | Dr. | Cr. |  |  | Dr. | Cr. |  |  | Dr. | Cr. |  |  | Dr. | Cr. |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Indicate where the following items will appear on the worksheet: (a) Cash, (b) Inventory, (c) Sales revenue, and (d) Cost of goods sold.

*Example*:

Cash: Trial balance debit column; Adjusted trial balance debit column; and Statement of financial position debit column.

**\*BE5-11.** *Compute net purchases and cost of goods purchased*.

(LO 7)

Assume that Kowloon Company uses a periodic inventory system and has these account balances (in thousands): Purchases ₩430,000; Purchase Returns and Allowances ₩13,000; Purchase Discounts ₩8,000; and Freight-In ₩16,000. Determine net purchases and cost of goods purchased.

**\*BE5-12.** *Compute cost of goods sold and gross profit*.

(LO 7)

Assume the same information as in BE5-11 and also that Kowloon Company has beginning inventory (in thousands) of ₩60,000, ending inventory of ₩86,000, and net sales of ₩680,000. Determine the amounts to be reported for cost of goods sold and gross profit.

**\*BE5-13.** *Journalize purchase transactions*.

(LO 7)

Prepare the journal entries to record these transactions on Huntington Company's books using a periodic inventory system.

(a) On March 2, Huntington Company purchased £900,000 of merchandise from Saunder Company, terms 2/10, n/30.

(b) On March 6, Huntington Company returned £184,000 of the merchandise purchased on March 2.

(c) On March 12, Huntington Company paid the balance due to Saunder Company.

**\*BE5-14.** *Prepare closing entries for merchandise accounts.*

(LO 7)

A Hall Company has the following merchandise account balances: Sales Revenue $180,000, Sales Discounts $2,000, Purchases $120,000, and Purchases Returns and Allowances $30,000. In addition, it has a beginning inventory of $40,000 and an ending inventory of $30,000. Prepare the entries to record the closing of these items to Income Summary using the periodic inventory system.

**\*BE5-15.** *Identify worksheet columns for selected accounts*.

(LO 6)

Presented below is the format of the worksheet using the periodic inventory system presented in Appendix 5B.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **Trial Balance** | |  |  | **Adjustments** | |  |  | **Adjusted Trial**  **Balance** | |  |  | **Income**  **Statement** | |  |  | **Statement of**  **Financial Position** | |  |
|  | Dr. | Cr. |  |  | Dr. | Cr. |  |  | Dr. | Cr. |  |  | Dr. | Cr. |  |  | Dr. | Cr. |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Indicate where the following items will appear on the worksheet: (a) Cash, (b) Beginning Inventory, (c) Account payable, and (d) Ending inventory.

*Example*:

Cash: Trial balance debit column; Adjusted trial balance debit column; and Statement of financial position debit column.

**DO IT! REVIEW**

**DO IT! 5-1.** *Answer general questions about merchandisers*.

(LO 1)

Indicate whether the following statements are true or false.

1. A merchandising company reports gross profit but a service company does not.

2. Under a periodic inventory system, a company determines the cost of goods sold each time a sale occurs.

3. A service company is likely to use accounts receivable but a merchandising company is not likely to do so.

4. Under a periodic inventory system, the cost of goods on hand at the beginning of the accounting period plus the cost of goods purchased less the cost of goods on hand at the end of the accounting period equals cost of goods sold.

**DO IT! 5-2.** *Record transactions of purchasing company*.

(LO 2)

On October 5, Lepik Company buys merchandise on account from Tamm Company. The selling price of the goods is €4,700, and the cost to Tamm Company is €3,100. On October 8, Lepik returns defective goods with a selling price of €650 and a fair value of €160. Record the

transactions on the books of Lepik Company

**DO IT! 5-3.** *Record transactions of selling company*.

(LO 3)

Assume information similar to that in **DO IT! 5-2.** That is: On October 5, Lepik Company buys merchandise on account from Tamm Company. The selling price of the goods is €4,700, and the cost to Tamm Company is €3,100. On October 8, Lepik returns defective goods with a selling price of €650 and a fair value of €160. Record the transactions on the books of Tamm Company.

**DO IT! 5-4.** *Prepare closing entries for a merchandising company*.

(LO 4)

The trial balance of Alagoas's Boutique at December 31 shows Inventory R$21,000, Sales Revenue R$156,000, Sales Returns and Allowances R$4,100, Sales Discounts R$3,000, Cost of Goods Sold R$92,400, Interest Revenue R$3,000, Freight-Out R$2,200, Utilities Expense R$7,400, and Salaries and Wages Expense R$19,500. Prepare the closing entries for Alagoas for these accounts.

**DO IT! 5-5.** *Classify financial statement accounts*.

(LO 5)

Dorothea Company is preparing its income statement, retained earnings statement, and classified statement of financial position. Using the column heads *Account, Financial Statement*, and *Classification*, indicate in which financial statement and under what classification each of the following would be reported.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Account** | | **Financial Statement** |  | **Classification** |
|  |  |  |  |  |
| Accounts Payable | |  |  |  |
| Accounts Receivable | |  |  |  |
| Accumulated Depreciation—Buildings | |  |  |  |
| Cash | |  |  |  |
| Casualty Loss from Vandalism | |  |  |  |
| Cost of Goods Sold | |  |  |  |
| Depreciation Expense | |  |  |  |
| Dividends | |  |  |  |
| Equipment | |  |  |  |
| Freight-Out | |  |  |  |
| Insurance Expense | |  |  |  |
| Interest Payable | |  |  |  |
| Inventory | |  |  |  |
| Land | |  |  |  |
| Notes Payable (due in 5 years) | |  |  |  |
| Property Taxes Payable | |  |  |  |
| Salaries and Wages Expense | |  |  |  |
| Salaries and Wages Payable | |  |  |  |
| Sales Returns and Allowances | |  |  |  |
| Sales Revenue | |  |  |  |
| Share Capital—Ordinary | |  |  |  |
| Unearned Rent Revenue | |  |  |  |
| Utilities Expense | |  |  |  |

EXERCISES

**E5-1.** *Answer general questions about merchandisers*.

(LO 1)

Mr. Soukup has prepared the following list of statements about service companies and merchandisers.

1. Measuring net income for a merchandiser is conceptually the same as for a service company.

2. For a merchandiser, sales less operating expenses is called gross profit.

3. For a merchandiser, the primary source of revenues is the sale of inventory.

4. Sales salaries and wages is an example of an operating expense.

5. The operating cycle of a merchandiser is the same as that of a service company.

6. In a perpetual inventory system, no detailed inventory records of goods on hand are maintained.

7. In a periodic inventory system, the cost of goods sold is determined only at the end of the accounting period.

8. A periodic inventory system provides better control over inventories than a perpetual system.

***Instructions***

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

**E5-2.** *Journalize purchase transactions*.

(LO 2)

Information related to Duffy Co., Ltd. is presented below.

1. On April 5, purchased merchandise from Thomas Company, Ltd. for £25,000, terms 2/10, net/30, FOB shipping point.

2. On April 6, paid freight costs of £900 on merchandise purchased from Thomas.

3. On April 7, purchased equipment on account for £26,000.

4. On April 8, returned damaged merchandise to Thomas Company and was granted a £2,600 credit for returned merchandise.

5. On April 15, paid the amount due to Thomas Company in full.

***Instructions***

(a) Prepare the journal entries to record these transactions on the books of Duffy Co., Ltd. under a perpetual inventory system.

(b) Assume that Duffy Co., Ltd. paid the balance due to Thomas Company on May 4 instead of April 15. Prepare the journal entry to record this payment.

**E5-3.** *Journalize perpetual inventory entries*.

(LO 2, 3)

On September 1, Moreau Office Supply SA had an inventory of 30 calculators at a cost of €22 each. The company uses a perpetual inventory system. During September, the following transactions occurred.

Sept. 6 Purchased 90 calculators at €20 each from Roux Co. SA, terms 2/10, n/30.

9 Paid freight of €180 on calculators purchased from Roux Co.

10 Returned 3 calculators to Roux Co. for €66 credit (including freight) because they did not meet specifications.

12 Sold 26 calculators costing €22 (including freight) for €33 each to Village Book Store, terms n/30.

14 Granted credit of €33 to Village Book Store for the return of one calculator that was not ordered.

20 Sold 40 calculators costing €22 for €35 each to Holiday Card Shop, terms n/30.

***Instructions***

Journalize the September transactions.

**E5-4.** *Prepare purchase and sale entries*.

(LO 2, 3)

On June 10, York Company, Ltd. purchased £7,600 of merchandise from Bianchi Company, FOB shipping point, terms 2/10, n/30. York pays the freight costs of £400 on June 11. Damaged goods totaling £300 are returned to Bianchi for credit on June 12. The fair value of these goods is £70. On June 19, Rebecca pays Bianchi Company in full, less the purchase discount. Both companies use a perpetual inventory system.

***Instructions***

(a) Prepare separate entries for each transaction on the books of York Company, Ltd.

(b) Prepare separate entries for each transaction for Bianchi Company. The merchandise purchased by York on June 10 had cost Clinton £4,300.

**E5-5.** *Journalize sales transactions*.

(LO 3)

Presented below are transactions related to Li Company, Ltd.

1. On December 3, Li sold HK$580,000 of merchandise to South China Co., Ltd. terms 1/10, n/30, FOB shipping point. The cost of the merchandise sold was HK$364,800.

2. On December 8, South China was granted an allowance of HK$28,000 for merchandise purchased on December 3.

3. On December 13, Li received the balance due from South China.

***Instructions***

(a) Prepare the journal entries to record these transactions on the books of Li Company, Ltd. using a perpetual inventory system.

(b) Assume that Li Company, Ltd. received the balance due from South China Co., Ltd. on January 2 of the following year instead of December 13. Prepare the journal entry to record the receipt of payment on January 2.

**E5-6.** *Prepare sales revenues section and closing entries*.

(LO 4, 5)

The adjusted trial balance of Mendoza Company SLU shows the following data pertaining to sales at the end of its fiscal year October 31, 2017: Sales Revenue €820,000, Freight-Out €16,000, Sales Returns and Allowances €28,000, and Sales Discounts €13,000.

***Instructions***

(a) Prepare the sales revenues section of the income statement.

(b) Prepare separate closing entries for (1) sales, and (2) the contra accounts to sales.

**E5-7.** *Prepare adjusting and closing entries*.

(LO 4)

Hezir Company A.S. had the following account balances at year-end: Cost of Goods Sold [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; Inventory 15,000; Operating Expenses [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)29,000; Sales Revenue [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)117,000; Sales Discounts [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)1,300; and Sales Returns and Allowances [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)1,700. A physical count of inventory determines that merchandise inventory on hand 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)14,200.



***Instructions***

(a) Prepare the adjusting entry necessary as a result of the physical count.

(b) Prepare closing entries.

**E5-8.** *Prepare adjusting and closing entries*.

(LO 4)

Presented below is information related to Poulsen Industries, A/S for the month of January 2017.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Ending inventory per |  |  | Insurance expense | € 12,000 |
| perpetual records | € 21,600 |  | Rent expense | 20,000 |
| Ending inventory actually |  |  | Salaries and wages expense | 59,000 |
| on hand | 21,000 |  | Sales discounts | 8,000 |
| Cost of goods sold | 208,000 |  | Sales returns and allowances | 13,000 |
| Freight-out | 7,000 |  | Sales revenue | 378,000 |

***Instructions***

(a) Prepare the necessary adjusting entry for inventory.

(b) Prepare the necessary closing entries.

**E5-9.** *Prepare an income statement*.

(LO 5)

Presented below is information for Bach Company, Ltd. for the month of March 2017.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cost of goods sold | £212,000 |  | Rent expense | £ 32,000 |
| Freight-out | 9,000 |  | Sales discounts | 7,400 |
| Insurance expense | 67,000 |  | Sales returns and allowances | 13,000 |
| Salaries and wages expense | 58,000 |  | Sales revenue | 380,000 |
|  |  |  | Other comprehensive income | 2,200 |

***Instructions***

(a) Prepare an income statement.

(b) Prepare a comprehensive income statement.

(c) Compute the gross profit rate.

**E5-10.** *Prepare an income statement*.

(LO 5)

In its income statement for the year ended December 31, 2017, Mancini Company, SpA reported the following condensed data.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Operating expenses | € 725,000 |  | Interest revenue | € 33,000 |
| Cost of goods sold | 1,256,000 |  | Loss on disposal of plant assets | 17,000 |
| Interest expense | 70,000 |  | Net sales | 2,200,000 |
|  |  |  | Other comprehensive income | 8,300 |

***Instructions***

Prepare an income statement.

**E5-11.** *Prepare correcting entries for sales and purchases*.

(LO 2, 3)

An inexperienced accountant for Zoeng Company, Ltd. made the following errors in recording merchandising transactions.

1. A HK$1,750 refund to a customer for faulty merchandise was debited to Sales Revenue HK$1,750 and credited to Cash HK$1,750.

2. A HK$1,400 credit purchase of supplies was debited to Inventory HK$1,400 and credited to Cash HK$1,400.

3. A HK$2,150 sales discount was debited to Sales Revenue.

4. A cash payment of HK$200 for freight on merchandise purchases was debited to Freight-Out HK$2,000 and credited to Cash HK$2,000.

***Instructions***

Prepare separate correcting entries for each error, assuming that the incorrect entry is not reversed. (Omit explanations.)

**E5-12.** *Compute various income measures*.

(LO 5)

In 2017, Endeaver Company, Ltd. had net sales of £860,000 and cost of goods sold of £533,200. Operating expenses were £221,000, and interest expense was £7,000.

***Instructions***

(a) Compute Endeaver's gross profit.

(b) Compute the gross profit rate. Why is this rate computed by financial statement users?

(c) What is Endeaver's income from operations and net income?

(d) In what section of its classified statement of financial position should Endeaver report merchandise inventory?

**E5-13.** *Compute missing amounts and compute gross profit rate*.

(LO 5)

Presented below is financial information for two different companies (amounts in thousands).

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Natasha Company** |  | **Boris Company** |
| Sales revenue | pyб94,000 |  | (d) |
| Sales returns | (a) |  | pyб5,000 |
| Net sales | 80,000 |  | 98,000 |
| Cost of goods sold | 56,000 |  | (e) |
| Gross profit | (b) |  | 37,500 |
| Operating expenses | 12,000 |  | (f) |
| Net income | (c) |  | 15,000 |

***Instructions***

(a) Determine the missing amounts above.

(b) Determine the gross profit rates. (Round to one decimal place.)

**E5-14.** *Compute missing amounts*.

(LO 5)

Financial information is presented below for three different companies.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Athena**  **Cosmetics** |  | **Harry**  **Grocery** |  | **Panama**  **Wholesalers** |
| Sales revenue | €90,000 |  | € (e) |  | €122,000 |
| Sales returns and allowances | (a) |  | 5,000 |  | 12,000 |
| Net sales | 86,000 |  | 95,000 |  | (i) |
| Cost of goods sold | 56,000 |  | (f) |  | (j) |
| Gross profit | (b) |  | 22,000 |  | 24,000 |
| Operating expenses | 15,000 |  | (g) |  | 18,000 |
| Income from operations | (c) |  | (h) |  | (k) |
| Other income and expense | (4,000) |  | (3,000) |  | (l) |
| Net income | (d) |  | 11,000 |  | 5,000 |

***Instructions***

Determine the missing amounts.

**\*E5-15.** *Complete worksheet*.

(LO 6)

Presented below are selected accounts for Feisal Company Ltd. as reported in the worksheet at the end of May 2017.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Accounts** |  |  | **Adjusted**  **Trial Balance** | | | |  |  | **Income**  **Statement** | | | |  |  | **Statement of**  **Financial Position** | | | |  |
|  |  |  |  | **Dr.** |  |  | **Cr.** |  |  | **Dr.** |  |  | **Cr.** |  |  | **Dr.** |  |  | **Cr.** |  |
|  | Cash |  |  | 9,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Inventory |  |  | 76,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Sales Revenue |  |  |  |  |  | 460,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Sales Returns and Allowances |  |  | 10,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Sales Discounts |  |  | 9,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Cost of Goods Sold |  |  | 288,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

***Instructions***

Complete the worksheet by extending amounts reported in the adjusted trial balance to the appropriate columns in the worksheet. Do not total individual columns.

**\*E5-16.** *Prepare a worksheet*.

(LO 6)

The trial balance columns of the worksheet for Barbosa Company, SA at June 30, 2017, are as follows.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **BARBOSA COMPANY, SA**  **Worksheet**  **For the Month Ended June 30, 2017** | | | | |
|  |  | **Trial Balance** | | |
| **Account Titles** |  | **Debit** |  | **Credit** |
| Cash |  | 2,120 |  |  |
| Accounts Receivable |  | 2,740 |  |  |
| Inventory |  | 11,640 |  |  |
| Accounts Payable |  |  |  | 1,120 |
| Share Capital—Ordinary |  |  |  | 4,000 |
| Sales Revenue |  |  |  | 42,800 |
| Cost of Goods Sold |  | 20,560 |  |  |
| Operating Expenses |  | 10,860 |  |  |
|  |  | 47,920 |  | 47,920 |

Other data:

Operating expenses incurred on account, but not yet recorded, total R$1,640s.

***Instructions***

Enter the trial balance on a worksheet and complete the worksheet.

**\*E5-17.** *Prepare cost of goods sold section*.

(LO 7)

The trial balance of Biju Company, Ltd. at the end of its fiscal year, August 31, 2017, includes these accounts (amounts in thousands): Inventory Rp17,200; Purchases Rp149,000; Sales Revenue Rp190,000; Freight-In Rp5,000; Sales Returns and Allowances Rp3,000; Freight-Out Rp1,000; and Purchase Returns and Allowances Rp6,200. The ending inventory is Rp16,000.

***Instructions***

Prepare a cost of goods sold section for the year ending August 31 (periodic inventory).

**\*E5-18.** *Compute various income statement items*.

(LO 7)

On January 1, 2017, Scott Enterprises, Ltd. had inventory of £50,000. At December 31, 2017, Scott had the following account balances.

|  |  |
| --- | --- |
| Freight-in | £ 4,000 |
| Purchases | 509,000 |
| Purchase discounts | 6,000 |
| Purchase returns and allowances | 8,000 |
| Sales revenue | 840,000 |
| Sales discounts | 7,000 |
| Sales returns and allowances | 11,000 |

At December 31, 2017, Clover determines that its ending inventory is £60,000.

***Instructions***

(a) Compute Clover's 2017 gross profit.

(b) Compute Clover's 2017 operating expenses if net income is £130,000 and there are no non-operating activities.

**\*E5-19.** *Compute missing amounts for cost of goods sold section*.

(LO 7)

Below is a series of cost of goods sold sections for companies Alpha, Beta, Chi, and Decca.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Alpha** |  | **Beta** |  | **Chi** |  | **Decca** |
| Beginning inventory | € 165 |  | € 70 |  | €1,000 |  | € (j) |
| Purchases | 1,620 |  | 1,060 |  | (g) |  | 43,810 |
| Purchase returns and allowances | 40 |  | (d) |  | 290 |  | (k) |
| Net purchases | (a) |  | 1,030 |  | 6,210 |  | 41,090 |
| Freight-in | 95 |  | (e) |  | (h) |  | 2,240 |
| Cost of goods purchased | (b) |  | 1,280 |  | 7,940 |  | (l) |
| Cost of goods available for sale | 1,840 |  | 1,350 |  | (i) |  | 49,530 |
| Ending inventory | 310 |  | (f) |  | 1,450 |  | 6,230 |
| Cost of goods sold | (c) |  | 1,260 |  | 7,490 |  | 43,300 |

***Instructions***

Fill in the lettered blanks to complete the cost of goods sold sections.

**\*E5-20.** *Journalize purchase transactions*.

(LO 7)

This information relates to Olaf Co., ASA.

1. On April 5, purchased merchandise from DeVito Company for €18,000, terms 2/10, net/30, FOB shipping point.

2. On April 6, paid freight costs of €820 on merchandise purchased from DeVito Company.

3. On April 7, purchased equipment on account for €30,000.

4. On April 8, returned some of April 5 merchandise, which cost €2,800, to DeVito Company.

5. On April 15, paid the amount due to DeVito Company in full.

***Instructions***

(a) Prepare the journal entries to record these transactions on the books of Olaf Co. using a periodic inventory system.

(b) Assume that Olaf Co. paid the balance due to DeVito Company on May 4 instead of April 15.

Prepare the journal entry to record this payment.

**\*E5-21.** *Journalize purchase transactions*.

(LO 7)

Presented below is information related to Chilean Industries. Ltd.

1. On April 5, purchased merchandise from Graham Company, Ltd. for £17,400, terms 2/10, net/30, FOB shipping point.

2. On April 6, paid freight costs of £800 on merchandise purchased from Graham.

3. On April 7, purchased equipment on account from Reed Mfg., Ltd. for £27,000.

4. On April 8, returned merchandise, which cost £4,000, to Graham.

5. On April 15, paid the amount due to Graham in full.

***Instructions***

(a) Prepare the journal entries to record these transactions on the books of Chilean Industries, Ltd. using a periodic inventory system.

(b) Assume that Chilean Industries, Ltd. paid the balance due to Graham Company on May 4 instead of April 15. Prepare the journal entry to record this payment.

**\*E5-22.** *Complete worksheet*.

(LO 7)

Presented below are selected accounts for B. Midler Company as reported in the worksheet at the end of May 2017. Ending inventory is $75,000.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Accounts** |  |  | **Adjusted**  **Trial Balance** | | | |  |  | **Income**  **Statement** | | | |  |  | **Statement of**  **Financial Position** | | | |  |
|  |  |  |  | **Dr.** |  |  | **Cr.** |  |  | **Dr.** |  |  | **Cr.** |  |  | **Dr.** |  |  | **Cr.** |  |
|  | Cash |  |  | 9,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Inventory |  |  | 80,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Purchases |  |  | 240,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Purchases Returns |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | and Allowances |  |  |  |  |  | 30,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Sales Revenue |  |  |  |  |  | 450,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Sales Returns and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Allowances |  |  | 10,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Sales Discounts |  |  | 5,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Rent Expense |  |  | 42,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

***Instructions***

Complete the worksheet by extending amounts reported in the adjusted trial balance to the appropriate columns in the worksheet. The company uses the periodic inventory system.

PROBLEMS: SET A AND PROBLEMS: SET B

**P5-1A** *Journalize purchase and sales transactions under a perpetual inventory system*.

(LO 2, 3)

Ready-Set-Go, Ltd. distributes suitcases to retail stores and extends credit terms of 1/10, n/30 to all of its customers. At the end of June, Ready-Set-Go's inventory consisted of suitcases costing £1,200. During the month of July, the following merchandising transactions occurred.

July 1 Purchased suitcases on account for £1,500 from Trunk Manufacturers, FOB destination, terms 2/10, n/30. The appropriate party also made a cash payment of £100 for freight on this date.

3 Sold suitcases on account to Satchel World for £2,200. The cost of suitcases sold is £1,400.

9 Paid Trunk Manufacturers in full.

12 Received payment in full from Satchel World.

17 Sold suitcases on account to Lady GoGo for £1,400. The cost of the suitcases sold was £1,030.

18 Purchased suitcases on account for $1,900 from Holiday Manufacturers, FOB shipping point, terms 1/10, n/30. The appropriate party also made a cash payment of £125 for freight on this date.

20 Received £300 credit (including freight) for suitcases returned to Holiday Manufacturers.

21 Received payment in full from Lady GoGo.

22 Sold suitcases on account to Vagabond for £2,400. The cost of suitcases sold was £1,350.

30 Paid Holiday Manufacturers in full.

31 Granted Vagabond £200 credit for suitcases returned costing £120.

Ready-Set-Go's chart of accounts includes the following: No. 101 Cash, No. 112 Accounts Receivable, No. 120 Inventory, No. 201 Accounts Payable, No. 401 Sales Revenue, No. 412 Sales Returns and Allowances, No. 414 Sales Discounts, and No. 505 Cost of Goods Sold.

***Instructions***

Journalize the transactions for the month of July for Ready-Set-Go, Ltd. using a perpetual inventory system.

**P5-2A** *Journalize, post, and prepare a partial income statement*.

(LO 2, 3, 5)

Vree Distributing Company plc completed the following merchandising transactions in the month of April.

At the beginning of April, the ledger of Vree showed Cash of €8,000 and Share Capital—Ordinary of €8,000.

Apr. 2 Purchased merchandise on account from Walker Supply Co. €6,200, terms 1/10, n/30.

4 Sold merchandise on account €5,500, FOB destination, terms 1/10, n/30. The cost of the merchandise sold was €3,400.

5 Paid €240 freight on April 4 sale.

6 Received credit from Walker Supply Co. for merchandise returned €500.

11 Paid Walker Supply Co. in full, less discount.

13 Received collections in full, less discounts, from customers billed on April 4.

14 Purchased merchandise for cash €3,800.

16 Received refund from supplier for returned goods on cash purchase of April 14, €500.

18 Purchased merchandise from Benjamin Distributors €4,500, FOB shipping point, terms 2/10, n/30.

20 Paid freight on April 18 purchase €160.

23 Sold merchandise for cash €7,400. The merchandise sold had a cost of €4,120.

26 Purchased merchandise for cash €2,300.

27 Paid Benjamin Distributors in full, less discount.

29 Made refunds to cash customers for defective merchandise €90. The returned merchandise had a fair value of €30.

30 Sold merchandise on account €3,400, terms n/30. The cost of the merchandise sold was €1,900.

Vree Distributing Company's chart of accounts includes the following: No. 101 Cash, No. 112 Accounts Receivable, No. 120 Inventory, No. 201 Accounts Payable, No. 311 Share Capital—Ordinary, No. 401 Sales Revenue, No. 412 Sales Returns and Allowances, No. 414 Sales Discounts, No. 505 Cost of Goods Sold, and No. 644 Freight-Out.

***Instructions***

(a) Journalize the transactions using a perpetual inventory system.

(b) Enter the beginning cash and share capital—ordinary balances, and post the transactions. (Use J1 for the journal reference.)

(c) Prepare the income statement through gross profit for the month of April 2017.

Gross profit €6,765

**P5-3A** *Prepare financial statements and adjusting and closing entries*.

(LO 4, 5)

Starz Department Store, Ltd. is located near the Towne Shopping Mall. At the end of the company's calendar year on December 31, 2017, the following accounts appeared in two of its trial balances.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Unadjusted** |  | **Adjusted** |  |  | **Unadjusted** |  | **Adjusted** |
| Accounts Payable | £76,300 |  | £77,300 |  | Inventory | £75,000 |  | £75,000 |
| Accounts Receivable | 50,300 |  | 50,3000 |  | Mortgage Payable | 80,000 |  | 80,000 |
| Accumulated Depr.—Buildings | 42,100 |  | 52,500 |  | Prepaid Insurance | 9,600 |  | 2,400 |
| Accumulated Depr.—Equipment | 29,600 |  | 42,700 |  | Property Tax Expense |  |  | 4,800 |
| Buildings | 290,000 |  | 290,000 |  | Property Taxes Payable |  |  | ,4800 |
| Cash | 23,800 |  | 23,800 |  | Retained Earnings | 64,600 |  | 64,600 |
| Cost of Goods Sold | 412,700 |  | 412,700 |  | Wages Expense | 105,000 |  | 105,000 |
| Depreciation Expense |  |  | 23,500 |  | Sales Commissions Expense | 10,200 |  | 14,500 |
| Dividends | 24,000 |  | 24,000 |  | Sales Commissions Payable |  |  | 4,300 |
| Equipment | 110,000 |  | 110,000 |  | Sales Returns and Allowances | 8,000 |  | 8,000 |
| Insurance Expense |  |  | 7,200 |  | Sales Revenue | 724,000 |  | 724,000 |
| Interest Expense | 3,000 |  | 8,100 |  | Share Capital—Ordinary | 112,000 |  | 112,000 |
| Interest Payable |  |  | 5,100 |  | Utilities Expense | 11,000 |  | 12,000 |
| Interest Revenue | 4,000 |  | 4,000 |  |  |  |  |  |

***Instructions***

(a) Prepare an income statement, a retained earnings statement, and a classified statement of financial position. £16,000 of the mortgage payable is due for payment next year.

Net income £132,200

Retained earnings £172,800

Total assets £456,300

(b) Journalize the adjusting entries that were made.

(c) Journalize the closing entries that are necessary.

**P5-4A** *Journalize, post, and prepare a trial balance*.

(LO 2, 3, 4)

J. Zheng, a former professional tennis star, operates Zheng's Tennis Shop at the Yalong River Resort. At the beginning of the current season, the ledger of Zheng's Tennis Shop showed Cash ¥2,200, Inventory ¥1,800, and Share Capital—Ordinary ¥4,000. The following transactions were completed during April.

Apr. 4 Purchased racquets and balls from Jay-Mac Co. ¥760, FOB shipping point, terms 2/10, n/30.

6 Paid freight on purchase from Jay-Mac Co. ¥40.

8 Sold merchandise to members ¥1,150, terms n/30. The merchandise sold had a cost of ¥790.

10 Received credit of ¥60 from Jay-Mac Co. for a racquet that was returned.

11 Purchased tennis shoes from Li Sports for cash, ¥420.

13 Paid Jay-Mac Co. in full.

14 Purchased tennis shirts and shorts from Everett Sportswear ¥800, FOB shipping point, terms 3/10, n/60.

15 Received cash refund of ¥50 from Li Sports for damaged merchandise that was returned.

17 Paid freight on Everett Sportswear purchase ¥30.

18 Sold merchandise to members ¥980, terms n/30. The cost of the merchandise sold was ¥520.

20 Received ¥600 in cash from members in settlement of their accounts.

21 Paid Everett Sportswear in full.

27 Granted an allowance of ¥40 to members for tennis clothing that did not fit properly.

30 Received cash payments on account from members, ¥820.

The chart of accounts for the tennis shop includes the following: No. 101 Cash, No. 112 Accounts Receivable, No. 120 Inventory, No. 201 Accounts Payable, No. 311 Share Capital—Ordinary, No. 401 Sales Revenue, No. 412 Sales Returns and Allowances, and No. 505 Cost of Goods Sold.

***Instructions***

(a) Journalize the April transactions using a perpetual inventory system.

(b) Enter the beginning balances in the ledger accounts and post the April transactions. (Use J1 for the journal reference.)

(c) Prepare a trial balance on April 30, 2017.

Total debits ¥6,130

**\*P5-5A** *Complete accounting cycle beginning with a worksheet*.

(LO 4, 5, 6)

The trial balance of Mr. Rosiak Fashion Center, Ltd. contained the following accounts at November 30, the end of the company's fiscal year.

|  |  |  |  |
| --- | --- | --- | --- |
| **MR. ROSIAK FASHION CENTER, LTD.**  **Trial Balance**  **November 30, 2017** | | | |
|  | **Debit** |  | **Credit** |
| Cash | £8,700 |  |  |
| Accounts Receivable | 27,700 |  |  |
| Inventory | 44,700 |  |  |
| Supplies | 6,200 |  |  |
| Equipment | 133,000 |  |  |
| Accumulated Depreciation—Equipment |  |  | £23,000 |
| Notes Payable |  |  | 51,000 |
| Accounts Payable |  |  | 48,500 |
| Share Capital—Ordinary |  |  | 50,000 |
| Retained Earnings |  |  | 38,000 |
| Dividends | 8,000 |  |  |
| Sales Revenue |  |  | 755,200 |
| Sales Returns and Allowances | 12,800 |  |  |
| Cost of Goods Sold | 497,400 |  |  |
| Salaries and Wages Expense | 136,000 |  |  |
| Advertising Expense | 24,400 |  |  |
| Utilities Expense | 14,000 |  |  |
| Maintenance and Repairs Expense | 12,100 |  |  |
| Freight-Out | 16,700 |  |  |
| Rent Expense | 24,000 |  |  |
| Totals | £965,700 |  | £965,700 |

Adjustment data:

1. Supplies on hand totaled £2,100.

2. Depreciation is £11,500 on the equipment.

3. Interest of £4,000 is accrued on notes payable at November 30.

4. Inventory actually on hand is £44,520.

***Instructions***

(a) Enter the trial balance on a worksheet, and complete the worksheet.

Adj. trial balance £981,200

Net loss £1,980

(b) Prepare an income statement and a retained earnings statement for the year, and a classified statement of financial position as of November 30, 2017. Notes payable of $6,000 are due in January 2018.

Gross profit £244,820

Total assets £181,520

(c) Journalize the adjusting entries.

(d) Journalize the closing entries.

(e) Prepare a post-closing trial balance.

**\*P5-6A** *Determine cost of goods sold and gross profit under periodic approach*.

(LO 7)

At the end of Hotai Department Store, Ltd.'s fiscal year on December 31, 2017, these accounts appeared in its adjusted trial balance.

|  |  |
| --- | --- |
| Freight-In | NT$ 165,000 |
| Inventory | 1,215,000 |
| Purchases | 13,200,000 |
| Purchase Discounts | 360,000 |
| Purchase Returns and Allowances | 192,000 |
| Sales Revenue | 21,540,000 |
| Sales Returns and Allowances | 510,000 |

Additional facts:

1. Merchandise inventory on December 31, 2017, is NT$1,950,000.

2. Hotai Department Store, Ltd. uses a periodic system.

***Instructions***

Prepare an income statement through gross profit for the year ended December 31, 2017.

Gross profit NT$8,952,000

**\*P5-7A** *Calculate missing amounts and assess profitability*.

(LO 7)

Valerie Fons operates a retail clothing operation. She purchases all merchandise inventory on credit and uses a periodic inventory system. The Accounts Payable account is used for recording inventory purchases only; all other current liabilities are accrued in separate accounts. You are provided with the following selected information for the fiscal years 2014 through 2017, inclusive.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2014** |  | **2015** |  | **2016** |  | **2017** |
| Inventory (ending) | €13,000 |  | €11,300 |  | €14,700 |  | €12,200 |
| Accounts payable (ending) | 20,000 |  | 225,700 |  |  |  |  |
| Sales revenue |  |  |  |  | 240,300 |  | 235,000 |
| Purchases of merchandise |  |  | 141,000 |  |  |  |  |
| inventory on account |  |  | 135,000 |  | 150,000 |  | 132,000 |
| Cash payments to suppliers |  |  |  |  | 161,000 |  | 127,000 |

***Instructions***

(a) Calculate cost of goods sold for each of the 2015, 2016, and 2017 fiscal years.

2016 €146,600

(b) Calculate the gross profit for each of the 2015, 2016, and 2017 fiscal years.

(c) Calculate the ending balance of accounts payable for each of the 2015, 2016, and 2017 fiscal years.

2016 Ending accts payable €15,000

(d) Sales declined in fiscal 2017. Does that mean that profitability, as measured by the gross profit rate, necessarily also declined? Explain, calculating the gross profit rate for each fiscal year to help support your answer. (Round to one decimal place.)

**\*P5-8A** *Journalize, post, and prepare trial balance and partial income statement using periodic approach*.

(LO 7)

At the beginning of the current season, the ledger of Village Tennis Shop AG showed Cash CHF2,500, Inventory CHF1,700, and Share Capital—Ordinary CHF4,200. The following transactions were completed during April.

Apr. 4 Purchased racquets and balls from Hingis Co. CHF860, terms 3/10, n/30.

6 Paid freight on Hingis Co. purchase CHF74.

8 Sold merchandise to members CHF900, terms n/30.

10 Received credit of CHF60 from Hingis Co. for a racquet that was returned.

11 Purchased tennis shoes from Volker Sports for cash CHF300.

13 Paid Hingis Co. in full.

14 Purchased tennis shirts and shorts from Linzey Sportswear CHF700, terms 2/10, n/60.

15 Received cash refund of CHF90 from Volker Sports for damaged merchandise that was returned.

17 Paid freight on Linzey Sportswear purchase CHF25.

18 Sold merchandise to members CHF1,200, terms n/30.

20 Received CHF500 in cash from members in settlement of their accounts.

21 Paid Linzey Sportswear in full.

27 Granted an allowance of CHF25 to members for tennis clothing that did not fit properly.

30 Received cash payments on account from members CHF630.

The chart of accounts for the tennis shop includes Cash, Accounts Receivable, Inventory, Accounts Payable, Share Capital—Ordinary, Sales Revenue, Sales Returns and Allowances, Purchases, Purchase Returns and Allowances, Purchase Discounts, and Freight-In.

***Instructions***

(a) Journalize the April transactions using a periodic inventory system.

(b) Using T-accounts, enter the beginning balances in the ledger accounts and post the April transactions.

(c) Prepare a trial balance on April 30, 2017.

Tot. trial balance CHF6,448

(d) Prepare an income statement through gross profit, assuming inventory on hand at April 30 is CHF2,140.

Gross profit CHF744

**Problems: Set B**

**P5-1B** *Journalize purchase and sales transactions under a perpetual inventory system*.

(LO 2, 3)

Book Nook Warehouse, AG distributes hardcover books to retail stores and extends credit terms of 2/10, n/30 to all of its customers. At the end of May, Book Nook's inventory consisted of books purchased for €2,100. During June, the following merchandising transactions occurred.

June 1 Purchased books on account for €1,850 from Phantom Publishers, FOB destination, terms 2/10, n/30. The appropriate party also made a cash payment of €50 for the freight on this date.

3 Sold books on account to Ex Libris for €2,600. The cost of the books sold was €1,440.

6 Received €150 credit for books returned to Phantom Publishers.

9 Paid Phantom Publishers in full, less discount.

15 Received payment in full from Ex Libris.

17 Sold books on account to Bargain Books for €1,800. The cost of the books sold was €1,040.

20 Purchased books on account for €1,500 from Bookem Publishers, FOB destination, terms 2/15, n/30. The appropriate party also made a cash payment of €50 for the freight on this date.

24 Received payment in full from Bargain Books.

26 Paid Bookem Publishers in full, less discount.

28 Sold books on account to Corner Bookstore for €1,300. The cost of the books sold was €850.

30 Granted Corner Bookstore €125 credit for books returned costing €74.

Book Nook Warehouse's chart of accounts includes the following: No. 101 Cash, No. 112 Accounts Receivable, No. 120 Inventory, No. 201 Accounts Payable, No. 401 Sales Revenue, No. 412 Sales Returns and Allowances, No. 414 Sales Discounts, and No. 505 Cost of Goods Sold.

***Instructions***

Journalize the transactions for the month of June for Book Nook Warehouse using a perpetual inventory system.

**P5-2B** *Journalize, post, and prepare a partial income statement*.

(LO 2, 3, 5)

Norwich Hardware Store, Ltd. completed the following merchandising transactions in the month of May. At the beginning of May, the ledger of Norwich showed Cash of £5,000 and Share Capital—Ordinary of £5,000.

May 1 Purchased merchandise on account from Nute's Wholesale Supply £4,200, terms 2/10, n/30.

2 Sold merchandise on account £2,300, terms 1/10, n/30. The cost of the merchandise sold was £1,300.

5 Received credit from Nute's Wholesale Supply for merchandise returned £500.

9 Received collections in full, less discounts, from customers billed on sales of £2,300 on May 2.

10 Paid Nute's Wholesale Supply in full, less discount.

11 Purchased supplies for cash £400.

12 Purchased merchandise for cash £1,400.

15 Received refund for poor quality merchandise from supplier on cash purchase £150.

17 Purchased merchandise from Sherrick Distributors £1,300, FOB shipping point, terms 2/10, n/30.

19 Paid freight on May 17 purchase £130.

24 Sold merchandise for cash £3,200. The merchandise sold had a cost of £2,000.

25 Purchased merchandise from Herbert, Inc. £620, FOB destination, terms 2/10, n/30.

27 Paid Sherrick Distributors in full, less discount.

29 Made refunds to cash customers for defective merchandise £90. The returned merchandise had a fair value of £40.

31 Sold merchandise on account £1,000 terms n/30. The cost of the merchandise sold was £560.

Norwich Hardware's chart of accounts includes the following: No. 101 Cash, No. 112 Accounts Receivable, No. 120 Inventory, No. 126 Supplies, No. 201 Accounts Payable, No. 311 Share Capital—Ordinary, No. 401 Sales Revenue, No. 412 Sales Returns and Allowances, No. 414 Sales Discounts, and No. 505 Cost of Goods Sold.

***Instructions***

(a) Journalize the transactions using a perpetual inventory system.

(b) Enter the beginning cash and share capital—ordinary balances and post the transactions. (Use J1 for the journal reference.)

(c) Prepare an income statement through gross profit for the month of May 2017.

Gross profit £2,567

**P5-3B** *Prepare financial statements and adjusting and closing entries*.

(LO 4, 5)

Lerwick Store, Ltd. is located in midtown Metropolis. During the past several years, net income has been declining because of suburban shopping centers. At the end of the company's fiscal year on November 30, 2017, the following accounts appeared in two of its trial balances.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Unadjusted** |  | **Adjusted** |  |  | **Unadjusted** |  | **Adjusted** |
| Accounts Payable | £25,200 |  | £25,200 |  | Notes Payable | £37,000 |  | £37,000 |
| Accounts Receivable | 30,500 |  | 30,500 |  | Prepaid Insurance | 10,500 |  | 4,500 |
| Accumulated Depr.—Equip. | 22,000 |  | 33,000 |  | Property Tax Expense |  |  | 3,200 |
| Cash | 21,000 |  | 21,000 |  | Property Taxes Payable |  |  | 3,200 |
| Cost of Goods Sold | 507,000 |  | 507,000 |  | Rent Expense | 15,000 |  | 15,000 |
| Depreciation Expense |  |  | 11,000 |  | Retained Earnings | 61,700 |  | 61,700 |
| Dividends | 8,000 |  | 8,000 |  | Sales and Wages Expense | 96,000 |  | 96,000 |
| Equipment | 154,300 |  | 154,300 |  | Sales Commissions Expense | 6,500 |  | 13,500 |
| Freight-Out | 6,500 |  | 6,500 |  | Sales Commissions Payable |  |  | 7,000 |
| Insurance Expense |  |  | 6,000 |  | Sales Returns and Allowances | 9,000 |  | 9,000 |
| Interest Expense | 6,100 |  | 6,100 |  | Sales Revenue | 706,000 |  | 706,000 |
| Interest Revenue | 8,000 |  | 8,000 |  | Share Capital—Ordinary | 45,000 |  | 45,000 |
| Inventory | 26,000 |  | 26,000 |  | Utilities Expense | 8,500 |  | 8,500 |

***Instructions***

(a) Prepare an income statement, a retained earnings statement, and a classified statement of financial position. Notes payable are due in 2020.

Net income £32,200

Retained earnings £85,900

Total assets £203,300

(b) Journalize the adjusting entries that were made.

(c) Journalize the closing entries that are necessary.

**P5-4B** *Journalize, post, and prepare a trial balance*.

(LO 2, 3, 4)

Emile Kokott, a former disc golf star, operates Emile's Discorama, SA. At the beginning of the current season on April 1, the ledger of Emile's Discorama showed Cash €1,850, Inventory €2,150, and Share Capital—Ordinary €4,000. The following transactions were completed during April.

Apr. 5 Purchased golf discs, bags, and other inventory on account from Ellis Co. €1,200, FOB shipping point, terms 2/10, n/60.

7 Paid freight on the Ellis purchase €75.

9 Received credit from Ellis Co. for merchandise returned €100.

10 Sold merchandise on account for €930, terms n/30. The merchandise sold had a cost of €540.

12 Purchased disc golf shirts and other accessories on account from Penguin Sportswear €720, terms 1/10, n/30.

14 Paid Ellis Co. in full, less discount.

17 Received credit from Penguin Sportswear for merchandise returned €120.

20 Made sales on account for €610, terms n/30. The cost of the merchandise sold was €370.

21 Paid Penguin Sportswear in full, less discount.

27 Granted an allowance to customers for clothing that was flawed €20.

30 Received payments on account from customers €960.

The chart of accounts for the store includes the following: No. 101 Cash, No. 112 Accounts Receivable, No. 120 Inventory, No. 201 Accounts Payable, No. 311 Share Capital—Ordinary, No. 401 Sales Revenue, No. 412 Sales Returns and Allowances, and No. 505 Cost of Goods Sold.

***Instructions***

(a) Journalize the April transactions using a perpetual inventory system.

(b) Enter the beginning balances in the ledger accounts and post the April transactions. (Use J1 for the journal reference.)

(c) Prepare a trial balance on April 30, 2017.

Total debits €5,540

**\*P5-5B** *Determine cost of goods sold and gross profit under periodic approach*.

(LO 6)

At the end of Ilhan Department Store's fiscal year on November 30, 2017, these accounts appeared in its adjusted trial balance.

|  |  |
| --- | --- |
| Freight-In | [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) 7,500 |
| Inventory | 42,000 |
| Purchases | 585,000 |
| Purchase Discounts | 5,100 |
| Purchase Returns and Allowances | 2,900 |
| Sales Revenue | 1,000,000 |
| Sales Returns and Allowances | 25,000 |

Additional facts:

1. Merchandise inventory on November 30, 2017, 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)54,600.

2. Ilhan Department Store uses a periodic system.

***Instructions***

Prepare an income statement through gross profit for the year ended November 30, 2017.

Gross profit [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)403,100

**\*P5-6B** *Calculate missing amounts and assess profitability*.

(LO 6)

Psang Ltd. operates a retail operation that purchases and sells home entertainment products. The company purchases all merchandise inventory on credit and uses a periodic inventory system. The Accounts Payable account is used for recording inventory purchases only; all other current liabilities are accrued in separate accounts. You are provided with the following selected information for the fiscal years 2014 through 2017, inclusive.

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | | **2014** |  | **2015** |  | **2016** |  | **2017** |
| **Income Statement Data** | | | |  |  |  |  |  |  |  |
|  | |  | |  |  |  |  |  |  |  |
| Sales revenue | | | |  |  | £53,000 |  | £ (e) |  | £46,000 |
| Cost of goods sold | | | |  |  | (a) |  | 13,800 |  | 14,300 |
| Gross profit | | | |  |  | 38,300 |  | 35,200 |  | (i) |
| Operating expenses | | | |  |  | 35,900 |  | (f) |  | 28,600 |
| Net income | | | |  |  | £ (b) |  | £2,500 |  | £ (j) |
|  | | | |  |  |  |  |  |  |  |
| **Statement of Financial Position** | | | |  |  |  |  |  |  |  |
|  | | |  |  |  |  |  |  |  |  |
| Inventory | | | | £7,200 |  | £ (c) |  | £8,100 |  | £ (k) |
| Accounts payable | | | | 3,200 |  | 3,400 |  | 2,500 |  | (l) |
|  | | | |  |  |  |  |  |  |  |
| **Additional Information** | | | |  |  |  |  |  |  |  |
|  |  | | |  |  |  |  |  |  |  |
| Purchases of merchandise | | | |  |  |  |  |  |  |  |
| inventory on account | | | |  |  | £14,200 |  | £ (g) |  | £13,200 |
| Cash payments to suppliers | | | |  |  | (d) |  | (h) |  | 13,600 |

***Instructions***

(a) Calculate the missing amounts.

(b) Sales declined over the 3-year fiscal period, 2012-2017. Does that mean that profitability necessarily also declined? Explain, computing the gross profit rate and the profit margin ratio for each fiscal year to help support your answer. (Round to one decimal place.)

(c) £6,700

(g) £15,200

(i) £31,700

**\*P5-7B** *Journalize, post, and prepare trial balance and partial income statement using periodic approach*.

(LO 6)

At the beginning of the current season on April 1, the ledger of Oosthuizen Pro Shop, NV showed Cash €3,000; Inventory €4,000; and Share Capital—Ordinary €7,000. The following transactions occurred during April 2017.

Apr. 5 Purchased golf bags, clubs, and balls on account from Balata Co. €1,300, FOB shipping point, terms 2/10, n/60.

7 Paid freight on Balata Co. purchases €80.

9 Received credit from Balata Co. for merchandise returned €100.

10 Sold merchandise on account to members €710, terms n/30.

12 Purchased golf shoes, sweaters, and other accessories on account from Arrow Sportswear €450, terms 1/10, n/30.

14 Paid Balata Co. in full.

17 Received credit from Arrow Sportswear for merchandise returned €50.

20 Made sales on account to members €600, terms n/30.

21 Paid Arrow Sportswear in full.

27 Granted credit to members for clothing that had flaws €55.

30 Received payments on account from members €590.

The chart of accounts for the pro shop includes Cash, Accounts Receivable, Inventory, Accounts Payable, Share Capital—Ordinary, Sales Revenue, Sales Returns and Allowances, Purchases, Purchase Returns and Allowances, Purchase Discounts, and Freight-In.

***Instructions***

(a) Journalize the April transactions using a periodic inventory system.

(b) Using T-accounts, enter the beginning balances in the ledger accounts and post the April transactions.

(c) Prepare a trial balance on April 30, 2017.

Tot. trial balance €8,488

Gross profit €427

(d) Prepare an income statement through gross profit, assuming merchandise inventory on hand at April 30 is €4,824.

COMPREHENSIVE PROBLEM

**5-CP5** On December 1, 2017, Jurczyk Distributing Company, Ltd. had the following account balances.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Debit** |  |  | **Credit** |
| Cash | €7,200 |  | Accumulated Depreciation— |  |
| Accounts Receivable | 4,600 |  | Equipment | €2,200 |
| Inventory | 12,000 |  | Accounts Payable | 4,500 |
| Supplies | 1,200 |  | Salaries and Wages Payable | 1,000 |
| Equipment | 22,000 |  | Share Capital—Ordinary | 30,000 |
|  | €47,000 |  | Retained Earnings | 9,300 |
|  |  |  |  | €47,000 |

During December, the company completed the following summary transactions.

Dec. 6 Paid €1,600 for salaries and wages due employees, of which €600 is for December and €1,000 is for November salaries and wages payable.

8 Received €2,100 cash from customers in payment of account (no discount allowed).

10 Sold merchandise for cash €6,600. The cost of the merchandise sold was €4,100.

13 Purchased merchandise on account from Gong Co. €9,000, terms 2/10, n/30.

15 Purchased supplies for cash €2,000.

18 Sold merchandise on account €12,000, terms 3/10, n/30. The cost of the merchandise sold was €8,400.

20 Paid salaries and wages €1,800.

23 Paid Gong Co. in full, less discount.

27 Received collections in full, less discounts, from customers billed on December 18.

Adjustment data:

1. Accrued salaries and wages payable €800.

2. Depreciation €200 per month.

3. Supplies on hand €1,700.

***Instructions***

(a) Journalize the December transactions using a perpetual inventory system.

(b) Enter the December 1 balances in the ledger T-accounts and post the December transactions. Use Cost of Goods Sold, Depreciation Expense, Salaries and Wages Expense, Sales Revenue, Sales Discounts, and Supplies Expense.

(c) Journalize and post adjusting entries.

(d) Prepare an adjusted trial balance.

Totals €65,600

(e) Prepare an income statement and a retained earnings statement for December and a classified statement of financial position at December 31.

Net income €840

MATCHA CREATIONS

(*Note*: This is a continuation of the Matcha Creations problem from Chapter 1-4.)

**MC5**Because Mei-ling has had such a successful first few months, she is considering other opportunities to develop her business. One opportunity is the sale of fine European mixers. The owner of Kzinski Supply Company has approached Mei-ling to become the exclusive U.S. distributor of these fine mixers in her state. The current cost of a mixer is approximately NT$575, and Mei-ling would sell each one for NT$1,150. Mei-ling comes to you for advice on how to account for these mixers.

**Go to the book’s companion website, www.wiley.com/college/weygandt, to see the completion of this problem.**

**Broadening Your Perspective**

Financial Reporting and Analysis

**BYP5-1. Financial Reporting Problem: TSMC, Ltd. (TWN)**

The financial statements of TSMC are presented in Appendix A at the end of this textbook. The 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***

Answer the following questions using TSMC's consolidated income statement.

(a) What was the percentage change in (1) sales and in (2) net income from 2012 to 2013?

(b) What was the company's gross profit rate in 2012 and 2013?

(c) What was the company's percentage of net income to net sales in 2012 and 2013? Comment on any trend in this percentage.

**BYP5-2. 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***

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

1. Gross profit for the most recent fiscal year reported in the appendices.

2. Gross profit rate for the most recent fiscal year reported in the appendices.

3. Operating income for the most recent fiscal year reported in the appendices. (*Note*: Operating income may be described with alternative labels.)

4. Percentage change in operating income for the most recent fiscal year reported in the appendices.

(b) What conclusions concerning the relative profitability of the two companies can you draw from these data?

**BYP5-3. Real-World Focus**

No financial decision-maker should ever rely solely on the financial information reported in the annual report to make decisions. It is important to keep abreast of financial news. This activity demonstrates how to search for financial news on the Internet.

***Address:* biz.yahoo.com/i**, or go to **www.wiley.com/college/weygandt**

***Steps***

1. Type in either Nestlé or Petra Foods.

2. Choose **News**.

3. Select an article that sounds interesting to you.

***Instructions***

(a) What was the source of the article (e.g., Reuters, Businesswire, PR Newswire)?

(b) Assume that you are a personal financial planner and that one of your clients owns shares in the company. Write a brief memo to your client, summarizing the article and explaining the implications of the article for his or her investment.

Critical Thinking

**BYP5-4. Decision-Making Across the Organization**

Three years ago, Debbie Sells and her brother-in-law Mike Mooney opened Family Department Store, Ltd. For the first two years, business was good, but the following condensed income results for 2016 were disappointing.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **FAMILY DEPARTMENT STORE**  **Income Statement**  **For the Year Ended December 31, 2016** | | | | |
| Net sales |  |  |  | £700,000 |
| Cost of goods sold |  |  |  | 553,000 |
| Gross profit |  |  |  | 147,000 |
| Operating expenses |  |  |  |  |
| Selling expenses |  | £100,000 |  |  |
| Administrative expenses |  | 20,000 |  | 120,000 |
| Net income |  |  |  | £27,000 |

Debbie believes the problem lies in the relatively low gross profit rate (gross profit divided by net sales) of 21%. Mike believes the problem is that operating expenses are too high.

Debbie thinks the gross profit rate can be improved by making both of the following changes. She does not anticipate that these changes will have any effect on operating expenses.

1. Increase average selling prices by 20%. This increase is expected to lower sales volume so that total sales will increase only 5%.

2. Buy merchandise in larger quantities and take all purchase discounts. These changes are expected to increase the gross profit rate by 3 percentage points.

Mike thinks expenses can be cut by making both of the following changes. He feels that these changes will not have any effect on net sales.

1. Cut 2017 sales salaries of £60,000 in half and give sales personnel a commission of 2% of net sales.

2. Reduce store deliveries to one day per week rather than twice a week; this change will reduce 2017 delivery expenses of £30,000 by 40%.

Debbie and Mike come to you for help in deciding the best way to improve net income.

***Instructions***

With the class divided into groups, answer the following.

(a) Prepare a condensed income statement for 2017, assuming (1) Debbie's changes are implemented and (2) Mike's ideas are adopted.

(b) What is your recommendation to Debbie and Mike?

(c) Prepare a condensed income statement for 2017, assuming both sets of proposed changes are made.

**BYP5-5. Communication Activity**

The following situation is in chronological order.

1. Dexter decides to buy a surfboard.

2. He calls Boardin Co. to inquire about its surfboards.

3. Two days later, he requests Boardin Co. to make a surfboard.

4. Three days later, Boardin Co. sends Dexter a purchase order to fill out.

5. He sends back the purchase order.

6. Boardin Co. receives the completed purchase order.

7. Boardin Co. completes the surfboard.

8. Dexter picks up the surfboard.

9. Boardin Co. bills Dexter.

10. Boardin Co. receives payment from Dexter.

***Instructions***

In a memo to the president of Boardin Co., answer the following.

(a) When should Boardin Co. record the sale?

(b) Suppose that with his purchase order, Dexter is required to make a down payment. Would that change your answer?

**BYP5-6.** **Ethics Case**

Anita Zurbrugg was just hired as the assistant treasurer of Yorktown Stores. The company is a specialty chain store with nine retail stores concentrated in one metropolitan area. Among other things, the payment of all invoices is centralized in one of the departments Anita will manage. Her primary responsibility is to maintain the company's high credit rating by paying all bills when due and to take advantage of all cash discounts.

Chris Dadian, the former assistant treasurer who has been promoted to treasurer, is training Anita in her new duties. He instructs Anita that she is to continue the practice of preparing all checks “net of discount” and dating the checks the last day of the discount period. “But,” Chris continues, “we always hold the checks at least 4 days beyond the discount period before mailing them. That way, we get another 4 days of interest on our money. Most of our creditors need our business and don't complain. And, if they scream about our missing the discount period, we blame it on the mail room or the post office. We've only lost one discount out of every hundred we take that way. I think everybody does it. By the way, welcome to our team!”

***Instructions***

(a) What are the ethical considerations in this case?

(b) Who are the stakeholders that are harmed or benefitted in this situation?

(c) Should Anita continue the practice started by Chris? Does she have any choice?

A LOOK at U.S. GAAP

The basic accounting entries for merchandising are the same under both GAAP and IFRS. The income statement is a required statement under both sets of standards. The basic format is similar although some differences do exist.

**Key Points**

* *IAS 1*, “Presentation of Financial Statements,” provides general guidelines for the reporting of income statement information. Subsequently, a number of international standards have been issued that provide additional guidance to issues related to income statement presentation. Presented below is the income statement for Wal-Mart Stores, Inc. (USA). The income statement is presented in conformity with GAAP.

|  |  |
| --- | --- |
| **WAL-MART STORES, INC.**  Real  World  Income Statement  For the Year Ended January 31, 2014 | |
| (Amounts in millions except per share data) |  |
| **Revenues:** |  |
| Net sales | $473,076 |
| Membership and other income | 3,218 |
|  | 476,294 |
| **Costs and expenses:** |  |
| Cost of sales | 358,069 |
| Operating, selling, general and administrative expenses | 91,353 |
| **Operating income** | 26,872 |
| **Interest:** |  |
| Debt | 2,072 |
| Capital leases | 263 |
| Interest income | (119) |
| Interest, net | 2,216 |
| **Income from continuing operations before income taxes** | 24,656 |
| **Provision for income taxes:** |  |
| Current | 8,619 |
| Deferred | (514) |
|  | 8,105 |
| **Income from continuing operations** | 16,551 |
| **Income (loss) from discontinued operations, net of tax** | 144 |
| **Consolidated net income** | 16,695 |
| **Less consolidated net income attributable to noncontrolling interest** | (673) |
| **Consolidated net income attributable to Wal-Mart** | $16,022 |

**Similarities**

* + Under both GAAP and IFRS, a company can choose to use either a perpetual or a periodic system.
  + Inventories are defined by IFRS as held-for-sale in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the providing of services. The definition under GAAP is essentially the same.
  + Similar to GAAP, comprehensive income under IFRS includes unrealized gains and losses (such as those on non-trading securities) that are not included in the calculation of net income.

**Differences**

* + Under GAAP, companies generally classify income statement items by function. Classification by function leads to descriptions like administration, distribution, and manufacturing. Under IFRS, companies must classify expenses by either nature or by function. Classification by nature leads to descriptions such as the following: salaries, depreciation expense, and utilities expense. If a company uses the functional-expense method on the income statement, disclosure by nature is required in the notes to the financial statements.
  + Presentation of the income statement under GAAP follows either a single-step or multiple-step format. IFRS does not mention a single-step or multiple-step approach.
  + Under IFRS, revaluation of land, buildings, and intangible assets is permitted. The initial gains and losses resulting from this revaluation are reported as adjustments to equity, often referred to as **other comprehensive income**. The effect of this difference is that the use of IFRS instead of GAAP results in more transactions affecting equity (other comprehensive income) but not net income.
  + IFRS requires that two years of income statement information be presented, whereas GAAP requires three years.

**Looking to the Future**

The IASB and FASB are working on a project that would rework the structure of financial statements. Specifically, this project will address the issue of how to classify various items in the income statement. A main goal of this new approach is to provide information that better represents how businesses are run. In addition, this approach draws attention away from just one number—net income. It will adopt major groupings similar to those currently used by the statement of cash flows (operating, investing, and financing), so that numbers can be more readily traced across statements. For example, the amount of income that is generated by operations would be traceable to the assets and liabilities used to generate the income. Finally, this approach would also provide detail, beyond that currently seen in most statements (either GAAP or IFRS), by requiring that line items be presented both by function and by nature. The new financial statement format was heavily influenced by suggestions from financial statement analysts.

**GAAP Practice**

**GAAP Self-Test Questions**

**1.** Which of the following would **not**be included in the definition of inventory under GAAP?

(a) Photocopy paper held for sale by an office-supply store.

(b) Stereo equipment held for sale by an electronics store.

(c) Used office equipment held for sale by the human relations department of a plastics company.

(d) All of the above would meet the definition.

**Answer**

(c) Used office equipment held for sale by the human relations department of a plastics company.

**2.** Which of the following would **not**be a line item of a company reporting costs by nature?

(a) Depreciation expense.

(b) Salaries and wages expense.

(c) Interest expense.

(d) Manufacturing expense.

**Answer**

(d) Manufacturing expense.

**3.** Which of the following would **not**be a line item of a company reporting costs by function?

(a) Administration.

(b) Manufacturing.

(c) Utilities expense.

(d) Distribution.

**Answer**

(c) Utilities expense.

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

(a) GAAP specifically requires use of a multiple-step income statement.

(b) Under GAAP, companies can use either a perpetual or periodic system.

(c) The proposed new format for financial statements was heavily influenced by the suggestions of financial statement analysts.

(d) The new income statement format will try to de-emphasize the focus on the “net income” line item.

**Answer**

(a) GAAP specifically requires use of a multiple-step income statement.

**5.** Under the new format for financial statements being proposed under a joint IASB/FASB project:

(a) all financial statements would adopt headings similar to the current format of the statement of financial position (balance sheet).

(b) financial statements would be presented consistent with the way management usually run companies.

(c) companies would be required to report income statement line items by function only.

(d) the amount of detail shown in the income statement would decrease compared to current presentations.

**Answer**

(b) financial statements would be presented consistent with the way management usually run companies.

**GAAP Exercises**

**GAAP5-1.** Explain the difference between the “nature-of-expense” and “function-of-expense” classifications.

**GAAP5-2.** For each of the following income statement line items, state whether the item is a “by nature” expense item or a “by function” expense item.

\_\_\_\_\_\_\_\_ Cost of goods sold

\_\_\_\_\_\_\_\_ Depreciation expense

\_\_\_\_\_\_\_\_ Salaries and wages expense

\_\_\_\_\_\_\_\_ Selling expenses

\_\_\_\_\_\_\_\_ Utilities expense

\_\_\_\_\_\_\_\_ Delivery expense

\_\_\_\_\_\_\_\_ General and administrative expenses

**GAAP5-3.** Atlantis Company reported the following amounts in 2017: net income, $150,000; unrealized gain related to revaluation of buildings, $10,000; and unrealized loss on non-trading securities, $(35,000). Determine Atlantis's total comprehensive income for 2017.

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

**GAAP5-4.** 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 *www.tootsie.com*.

**Instructions**

(Round to one decimal place.)

(a) What was the percentage change in (1) total revenue and in (2) net income from 2011 to 2012 and from 2012 to 2013?

(b) What was the company's gross profit margin rate in 2011, 2012, and 2013?

(c) What was the company's percentage of net income to total revenue in 2011, 2012, and 2013?