Q3-1  The accounting period assumption holds that the lifetime of a business should be divided into equal time periods. These accounting periods are usually 12 months in length. Some businesses use the calendar year and others use a fiscal year. By dividing the business lifetime into smaller periods, the business will achieve better reporting. This improvement is due to the fact that decision makers will have information on a timely basis.

Many transactions, however, affect the financial results of more than one period. The quality of periodic information is highest if the expenses incurred to generate revenues are matched against the revenues in calculating income. Without the accounting period assumption, a company would not prepare periodic income statements and matching would not be an issue. Dividing the life of a business into reporting periods requires proper matching of revenues and expenses.

Q3-2  All incurred expenses (the cost of the efforts expended) must be matched against all earned revenue (the results achieved) to determine income accurately. If a revenue remains in the balance sheet as an unearned item, net income will be understated. If an expense remains in the balance sheet as an asset, net income is overstated. Matching revenues with expenses is basic to accrual accounting, and presents a more accurate and useful picture of operating results.

Q3-3  a. The purpose of adjusting entries is to change accounts that are incomplete and to bring other accounts up to date.

b. Adjusting entries are necessary because of the continuing nature of some revenue and expense accounts and impracticality or impossibility of recording each day-to-day change. Periodic adjustments must be made if the financial statements are to properly reflect financial position and operating results.

Q3-4  Accruals are adjustments that include unrecorded, accumulated revenues and expenses. In accruals, the expense or revenue recognition precedes the cash payment or receipt. An example is wages incurred in the current period but paid in the next period. Deferrals are adjustments in which the cash payment or receipt precedes the expense or revenue recognition. An example is prepaid insurance. The premium is paid in one period and some of the expense is deferred until the next period.
Q3-5 No. It is impractical and sometimes impossible to record the day-to-day change in certain accounts. These changes, which result from continuous transaction are recorded at the end of each accounting period by means of summary adjusting entries.

Q3-6 a. Accrued revenues are revenues that have been earned in a given period but have not yet been collected or recorded.
   b. Accrued expenses are expenses that have been incurred in a given period but have not yet been paid or recorded.
   c. Prepaid expenses are adjustments that require previously recorded prepaid items to be divided between the current period and a future period (usually a year).
   d. Depreciation consists of adjustments that require that the cost of previously recorded long-term assets be allocated as expense over the periods of benefit.
   e. Unearned revenues are adjustments that require previously recorded advance collections of a revenue to be divided between the current period and a future period (usually a year).

Q3-7 a. A contra account is an account used to record the negative portion of a related account.
   b. Accumulated Depreciation.
   c. The Accumulated Depreciation account is used to accumulate the amount of the expired cost of a long-lived asset—that is, the amount of the cost expiration that has been assigned as an expense to the operations of past periods.

Q3-8 a. Current assets.
   b. Current liabilities.
   c. Current assets.
   d. Current liabilities.

Q3-9 a. A deferral.
   b. Asset and expense accounts will be affected.

Q3-10 a. Accrual.
   b. Liability and expense accounts will be affected.
   c. 60/150, or 2/5.

Q3-11 (Appendix) The original entry made to record a transaction determines the method of adjusting for deferrals. If originally recorded as a revenue, the adjusting entry would remove the remaining unearned revenue amount and record it as a liability. If the original entry was made to a liability account, the adjusting entry would remove the earned portion and record it as a revenue. Either of these methods will produce the same results in the income statement and the balance sheet.
E3-12 Applying the Matching Principle
LG 1

<table>
<thead>
<tr>
<th>Payment Date</th>
<th>2011 Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 1, 2010 ($1,200 x 1/3)</td>
<td>$ 400</td>
</tr>
<tr>
<td>February 1, 2011</td>
<td>1,500</td>
</tr>
<tr>
<td>May 1, 2011</td>
<td>1,500</td>
</tr>
<tr>
<td>August 1, 2011</td>
<td>1,800</td>
</tr>
<tr>
<td>November 1, 2011 ($1,800 x 2/3)</td>
<td>1,200</td>
</tr>
<tr>
<td><strong>Total 2011 rent expense</strong></td>
<td><strong>$ 6,400</strong></td>
</tr>
</tbody>
</table>

E3-13 Prepaid Expense Adjustment
LG 2, 3

Office supplies available                      $ 3,300
Deduct: Office supplies on hand                400
Office supplies used                           $ 2,900

**GENERAL JOURNAL**

2011  
Dec. 31 Office Supplies Expense  
Office Supplies  
To record office supplies used.

E3-14 Prepaid Expense Adjustments
LG 3

**GENERAL JOURNAL**

Adjusting Entries

2011  
Dec. 31  

a. Insurance Expense  
($3,600 x 2/24)  
Prepaid Insurance  
300  
300

b. Advertising Supplies Expense  
($3,000 - $300)  
Advertising Supplies  
2,700  
2,700

c. Rent Expense  
($1,800 x 4/12)  
Prepaid Rent  
600  
600

d. Office Supplies Expense  
($5,400 - $800)  
Office Supplies  
4,600  
4,600

3-3
E3-15 Depreciation Adjustment
LG 4

1. \[
\frac{\$48,000 \text{ cost} - \$4,000 \text{ residual value}}{4 \text{ years}} = \$11,000 \text{ depreciation for 2011}
\]

2, 3.  

\[
\begin{array}{c|cc}
 & \text{Dec. 31,} & \text{Dec. 31,} \\
 & 2011 & 2012 \\
\hline
\text{Vans} & \$48,000 & \$48,000 \\
\text{Deduct: Accumulated depreciation} & 11,000 & 22,000 \\
\text{Book value} & \$37,000 & \$26,000 \\
\end{array}
\]

4. The depreciation expense amount is an estimate. It is credited to Accumulated Depreciation—Vans to preserve the original cost in the Vans account. Also, a user of statements can tell the relative remaining useful life of the vans by viewing the relationship of the accumulated depreciation amount to the vans amount.

E3-16 Adjustment for Unearned Revenue
LG 5

1.  

**GENERAL JOURNAL**

\[
\begin{array}{c|c}
\text{2011} & \\
\text{Dec. 31} & \text{Unearned Subscription Revenue} \\
 & 90,000^{*} \\
\hline
 & \text{Subscription Revenue} \\
 & 90,000 \\
\end{array}
\]

*Amount received \(\$120,000\)
Amount earned (9/12) \(\text{90,000}\)
Portion still unearned \(\$30,000\)

2. Yes, an entry is needed. All 12 issues have been mailed; that is, all revenue has been earned. The total of $120,000 must be transferred to revenue.

E3-17 Accrued Expense Adjustment
LG 7

**GENERAL JOURNAL**

\[
\begin{array}{c|c|c}
 & (a) & (b) \\
\text{Mon.} & \text{Wed.} \\
\hline
\text{Wages Expense} & 300^{*} & \\
\text{Wages Payable} & & 900^{†} \\
\text{*(6 x $250) x 1/5 = $300} & 300 & 900 \\
\text{†(6 x $250) x 3/5 = $900} & & \\
\end{array}
\]
E3-18 Accrued Revenue Adjustment
LG 6

GENERAL JOURNAL

2011
Dec. 31 Interest Receivable 60
   Interest Revenue 60
$12,000 x 12% x 15/360 = $60.

E3-19 Various Accrual Adjustments
LG 6, 7

GENERAL JOURNAL

Adjusting Entries

2011
Sep. 30 a. Rent Expense 650
   Rent Payable 650

b. Interest Receivable 200
   Interest Revenue 200

c. Tax Expense 500
   Taxes Payable 500

d. Wages Expense 3,400
   Wages Payable 3,400

e. Rental Expense 4,500
   (140 x $50) – $2,500
   Rent Payable 4,500

f. Interest Expense 700
   Interest Payable 700

g. Income Tax Expense 2,200
   Income Taxes Payable 2,200
E3-20 Various Adjustments
LG 3, 4, 6, 7

GENERAL JOURNAL

Adjusting Entries

a. Insurance Expense
   Prepaid Insurance 300
   300

b. Office Supplies Expense ($2,300 - $300)
   Office Supplies 2,000
   2,000

c. Depreciation Expense—Store Equipment
   Accumulated Depreciation—Store Equipment 600
   600

d. Salaries and Wages Expense
   Salaries and Wages Payable 700
   700

e. Interest Receivable
   Interest Revenue 90
   90

f. Interest Expense
   Interest Payable 180
   180

E3-21 Various Adjustments
LG 3-7

1. GENERAL JOURNAL

Adjusting Entries

a. Depreciation Expense—Furniture and Equipment 7,000
   Accumulated Depreciation—Furniture and Equipment 7,000
   To record depreciation expense on furniture and equipment.

b. Insurance Expense 2,900
   Prepaid Insurance 2,900
   To record the expiration of insurance.

c. Unearned Revenue 2,000
   Revenue 2,000
   To record the amount of revenue earned.
E3-21 (continued)

d. Rent Expense—Salespersons’ Cars 6,100
   Rent Payable
   To record the accrual of rent expense.

   e. Wages Expense ($6,000 x 4/5) 4,800
      Wages Payable
      To record the amount of wages owed
      employees at the end of the present
      period.

   f. Income Tax Expense 1,700
      Income Taxes Payable
      To record estimated income taxes payable.

E3-22 Calculation of Information from Adjustment Data
LG 3

1. Office supplies, December 31, 2011
   Add:  Purchases during 2012  7,000
   Total office supplies available for use 10,000
   Deduct:  Office supplies, December 31, 2012  4,000
   Total office supplies expense for 2012  6,000

2. Prepaid insurance, December 31, 2012
   Add:  Insurance expense for 2012  2,600
   Total insurance paid for as of December 31, 2012  3,800
   Deduct:  Prepaid insurance, December 31, 2011  1,000
   Cash paid for insurance premiums 2012  2,800

E3-23 (Appendix) Alternative Approaches of Accounting
for Prepaid Expense

LG A1

Case 1

GENERAL JOURNAL

Adjusting Entry

2011
Dec. 31  Magazine Subscription Expense 360
   Prepaid Magazine Subscriptions 360
To record expired portion
[(($480 ÷ 12) x 9 = $360).]
Case 2

GENERAL JOURNAL

Adjusting Entry

2011
Dec. 31 Prepaid Magazine Subscriptions 120
   Magazine Subscription Expense 120
To record unexpired portion of subscription ($480 - $360 = $120).

E3-24 (Appendix) Alternative Approaches of Accounting for Unearned Revenue
LG A1

1.

GENERAL JOURNAL

Adjusting Entry

2011
Dec. 31 Rent Revenue 3,850
   Unearned Rent 3,850
To record unearned portion for seven months
[(6,600 ÷ 12) x 7 = 3,850].

2. Unearned Rent (a liability account)

3.

GENERAL JOURNAL

Adjusting Entry

2011
Dec. 31 Unearned Rent 2,750
   Rent Revenue 2,750
To record earned portion for five months
[(6,600 ÷ 12) x 5 = 2,750].
P3-25 Analyzing Adjustments
LG 3, 7

a.

<table>
<thead>
<tr>
<th>Interest Receivable</th>
<th>Interest Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance 0</td>
<td>Balance 0</td>
</tr>
<tr>
<td>12/31/11 100</td>
<td>12/31/11 100</td>
</tr>
<tr>
<td>Balance 100</td>
<td>Balance 100</td>
</tr>
</tbody>
</table>

Interest revenue earned:

\[ \$8,000 \times 0.15 \times \frac{30}{360} = \$100 \]

**GENERAL JOURNAL**

2011
Dec. 31 Interest Receivable 100
   Interest Revenue 100
To record interest revenue accrued on note receivable.

b.

<table>
<thead>
<tr>
<th>Store Supplies</th>
<th>Store Supplies Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance 1,000</td>
<td>Balance 0</td>
</tr>
<tr>
<td>12/31/11 600</td>
<td>12/31/11 600</td>
</tr>
<tr>
<td>Balance 400</td>
<td>Balance 600</td>
</tr>
</tbody>
</table>

Store supplies used:

\[ \$1,000 - \$400 = \$600 \]
P3-25 (continued)

GENERAL JOURNAL

2011
Dec. 31 Store Supplies Expense 600
   Store Supplies 600
   To record cost of store supplies used.

c.

<table>
<thead>
<tr>
<th>Depreciation Expense—Store Building</th>
<th>Accumulated Depreciation—Store Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance 0</td>
<td>Balance 4,000</td>
</tr>
<tr>
<td>12/31/11 4,000</td>
<td>12/31/11 4,000</td>
</tr>
<tr>
<td>Balance 4,000</td>
<td>Balance 8,000</td>
</tr>
</tbody>
</table>

Depreciation expense:

\[
\frac{($90,000 - $10,000)}{20} = $4,000
\]

Accumulated depreciation:

\[
$4,000 \times 2 = $8,000
\]

The balance in Accumulated Depreciation at the end of 2011 should be $8,000 because the business has used the asset for two years.

GENERAL JOURNAL

2011
Dec. 31 Depreciation Expense—Store Building 4,000
   Accumulated Depreciation—Store Building 4,000
   To record depreciation for 2011.

d.

<table>
<thead>
<tr>
<th>Salaries Expense</th>
<th>Salaries Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance 36,000</td>
<td>Balance 0</td>
</tr>
<tr>
<td>12/31/11 800</td>
<td>12/31/11 800</td>
</tr>
<tr>
<td>Balance 36,800</td>
<td>Balance 800</td>
</tr>
</tbody>
</table>
GENERAL JOURNAL

2011
Dec. 31 Salaries Expense 800
Salaries Payable 800
To record salaries expense accrued for December 31, 2011

e.

<table>
<thead>
<tr>
<th>Unearned Revenue</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>Balance</td>
</tr>
<tr>
<td>2,000</td>
<td>80,000</td>
</tr>
<tr>
<td>12/31/11 1,700</td>
<td>12/31/11 1,700</td>
</tr>
<tr>
<td>Balance</td>
<td>Balance</td>
</tr>
<tr>
<td>300</td>
<td>81,700</td>
</tr>
</tbody>
</table>

GENERAL JOURNAL

2011
Dec. 31 Unearned Revenue 1,700
Revenue 1,700
To record revenue earned during 2011.

f.

<table>
<thead>
<tr>
<th>Income Tax Expense</th>
<th>Income Taxes Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance 0</td>
<td>Balance 0</td>
</tr>
<tr>
<td>12/31/11 4,000</td>
<td>12/31/11 4,000</td>
</tr>
<tr>
<td>Balance 4,000</td>
<td>Balance 4,000</td>
</tr>
</tbody>
</table>

GENERAL JOURNAL

2011
Dec. 31 Income Tax Expense 4,000
Income Taxes Payable 4,000
To record estimated income taxes accrued.
P3-26 Adjusting Entries for Deferrals and Accruals
LG 3-7

GENERAL JOURNAL

A. DEFERRALS  (Cash payment or cash receipt precedes expense or revenue recognition)

1. PREPAID EXPENSE
   a. Original journal entry on October 1, 2011:
      Prepaid Insurance  2,400
      Cash  2,400
   b. Adjusting journal entry on December 31, 2011:
      Insurance Expense  600
      Prepaid Insurance  600
      ($2,400 ÷ 12) × 3 = $600

2. DEPRECIATION
   a. Original journal entry on November 1, 2011:
      Delivery Truck  22,000
      Cash  22,000
   b. Adjusting journal entry on December 30, 2011:
      Depreciation Expense—Delivery Truck  600
      Accumulated Depreciation—Delivery Truck  600
      (($22,000 − $4,000) ÷ 60) × 2 = $600

3. UNEARNED REVENUE
   a. Original journal entry on December 1, 2011:
      Cash  12,000
      Unearned Professional Fees  12,000
   b. Adjusting journal entry on December 31, 2011:
      Unearned Professional Fees  4,000
      Professional Fees Revenue  4,000
      ($12,000 ÷ 3) × 1 = $4,000

B. ACCRUALS  (Expense or revenue recognition precedes cash payment or cash receipt)

1. ACCRUED REVENUE
   a. Original journal entry on December 1, 2011:
      Notes Receivable  40,000
      Cash  40,000
P3-26 (continued)

b. Adjusting journal entry on December 1, 2011:
   Interest Receivable 400
   Interest Revenue 400
   \((\$40,000 \times 0.12 \times \frac{30}{360}) = \$400\)

2. ACCRUED EXPENSE
   a. Normal journal entry to record and pay wages in cash for a 5-day work week that ends Friday.
      Salaries and Wages Expense 45,000
      Cash 45,000
      \(\$9,000 \times 5 = \$45,000\)

   b. Adjusting journal entry on December 31, 2011.
      Salaries and Wages Expense 27,000
      Salaries and Wages Payable 27,000
      \(\$9,000 \times 3 = \$27,000\)

P3-27 Adjusting Entries for Deferrals and Accruals
LG 3-7

GENERAL JOURNAL

Adjusting Entries

2011
Dec. 31  a. Office Supplies Expense 1,400
       Office Supplies 1,400
       \(\$2,000 - \$600 = \$1,400\)

   b. Rent Expense 18,000
      Prepaid Rent 18,000

   c. Insurance Expense 400
      Prepaid Insurance 400
      \(\$720 \times \frac{5}{12} = \$300\)
      \(\$600 \times \frac{1}{6} = \$100\)
      Expense 400

   d. Interest Receivable 175
      Interest Revenue 175
      \((\$5,000 \times 12\%) \times \frac{60}{360} = \$100\)
      \((\$6,000 \times 15\%) \times \frac{30}{360} = \$75\)
      \$175
P3-27 (continued)

e. Interest Expense
   Interest Payable 330
   ($4,000 \times 15\%) \times 90/360 = $150
   ($9,000 \times 12\%) \times 60/360 = 180
   \$330

f. Salaries and Wages Expense 1,800
   Salaries and Wages Payable 1,800

g. Unearned Rent (7/12 \times $24,000) 14,000
   Rent Revenue 14,000

h. Depreciation Expense—Store Equipment 3,000
   Accumulated Depreciation—Store
   Equipment 3,000
   ($33,000 - $3,000) \div 10 = $3,000

i. Income Tax Expense 5,000
   Income Taxes Payable 5,000

P3-28 Preparation of Adjusting Entries and Financial Statements
LG 3-7

Requirements 1 and 3.

GENERAL LEDGER

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
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<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Credit</td>
</tr>
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<table>
<thead>
<tr>
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<th>Explanation</th>
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<tr>
<td>2011 Dec.</td>
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<td>31</td>
<td></td>
<td></td>
<td>40,000</td>
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</table>

Accounts Receivable

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
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<tr>
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<td>Credit</td>
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<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
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<tbody>
<tr>
<td>2011 Dec.</td>
<td>Balance</td>
<td>31</td>
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<td>27,000</td>
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</table>
### Notes Receivable

<table>
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<th>Explanation</th>
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<th>Credit</th>
<th>Balance</th>
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<tbody>
<tr>
<td>Dec. 31</td>
<td>Balance</td>
<td></td>
<td></td>
<td></td>
<td>8,000</td>
</tr>
</tbody>
</table>

### Interest Receivable

<table>
<thead>
<tr>
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<th>Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
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<tbody>
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<td>Dec. 31</td>
<td>Adjusting</td>
<td>J1</td>
<td>150</td>
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### Office Supplies

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
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<tbody>
<tr>
<td>Dec. 31</td>
<td>Balance</td>
<td>J1</td>
<td></td>
<td>4,900</td>
<td>5,700</td>
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### Prepaid Rent

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<tr>
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<td>7,200</td>
<td>9,300</td>
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### Office Equipment

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<th>Credit</th>
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<td></td>
<td></td>
<td></td>
<td>12,000</td>
</tr>
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## Accumulated Depreciation—Office Equipment (Acct. No. 172)

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</tr>
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<td>2011</td>
<td>Balance</td>
<td></td>
<td></td>
<td>1,000</td>
<td>1,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Dec. 31</td>
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<td>J1</td>
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## Accounts Payable (Acct. No. 201)

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</tr>
<tr>
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<td></td>
<td></td>
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<td>8,000</td>
</tr>
<tr>
<td>Dec. 31</td>
<td></td>
<td></td>
<td></td>
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<td></td>
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</table>

## Salaries Payable (Acct. No. 205)

<table>
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<th>PR</th>
<th>Debit</th>
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<th>Balance</th>
<th>Balance</th>
</tr>
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<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>Adjusting</td>
<td>J1</td>
<td></td>
<td>2,000</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>Dec. 31</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>

## Income Taxes Payable (Acct. No. 215)

<table>
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<tr>
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<th>Credit</th>
<th>Balance</th>
<th>Balance</th>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>Adjusting</td>
<td>J1</td>
<td></td>
<td>4,845</td>
<td>4,845</td>
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</tr>
<tr>
<td>Dec. 31</td>
<td></td>
<td></td>
<td></td>
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## Unearned Service Revenue (Acct. No. 233)

<table>
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<tr>
<th>Date</th>
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<th>PR</th>
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<th>Credit</th>
<th>Balance</th>
<th>Balance</th>
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<tbody>
<tr>
<td></td>
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<td></td>
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</tr>
<tr>
<td>2011</td>
<td>Balance</td>
<td>J1</td>
<td>3,200</td>
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<td>4,000</td>
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### P3-28 (continued)

#### Common Stock

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<tr>
<td>2011 Dec.</td>
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#### Retained Earnings

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<th>Credit</th>
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<tbody>
<tr>
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<td>Balance</td>
<td></td>
<td></td>
<td></td>
<td>8,000</td>
</tr>
</tbody>
</table>

#### Dividends

<table>
<thead>
<tr>
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<th>Explanation</th>
<th>PR</th>
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<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
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<td>Balance</td>
<td></td>
<td></td>
<td></td>
<td>1,600</td>
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#### Service Revenue

<table>
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<tr>
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<th>Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
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<tbody>
<tr>
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#### Interest Revenue

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<tbody>
<tr>
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<td>J1</td>
<td></td>
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<tr>
<td></td>
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<td>150</td>
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### Advertising Expense

<table>
<thead>
<tr>
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<th>PR</th>
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<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
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<td></td>
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</tr>
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<td>Balance</td>
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### Salaries Expense

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
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<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
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<td></td>
<td></td>
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</tr>
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### Rent Expense

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
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<td>31</td>
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</table>

### Office Supplies Expense

<table>
<thead>
<tr>
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<th>Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
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### Postage Expense

<table>
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<tr>
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<th>PR</th>
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<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
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</table>
## P3-28 (continued)

### Utilities Expense  
**Acct. No. 721**

<table>
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<tbody>
<tr>
<td>2011</td>
<td>31 Balanec</td>
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<td>9,300</td>
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</table>

### Cleaning Expense  
**Acct. No. 725**

<table>
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<tr>
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</table>

### Depreciation Expense—Office Equipment  
**Acct. No. 754**

<table>
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<td>2011</td>
<td>31 Adjusting</td>
<td>J1</td>
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### Income Tax Expense  
**Acct. No. 901**

<table>
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<th>Date</th>
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<td>J1</td>
<td>4,845</td>
<td></td>
<td>4,845</td>
</tr>
</tbody>
</table>
Requirement 2.

**GENERAL JOURNAL**

2011
Dec. 31 Interest Receivable
    Interest Revenue
    To record accrued interest earned for 45 days.
    $8,000 × 0.15 × 45/360 = $150

31 Rent Expense
    Prepaid Rent
    To record rent expense incurred:
    6 months × $500 = $3,000
    6 months × $700 = $4,200
    $7,200

31 Salaries Expense
    Salaries Payable
    To record accrued salaries expense.

31 Depreciation Expense—Office Equipment
    Accumulated Depreciation—Office Equipment
    To record depreciation expense.
    ($12,000 − $2,000) ÷ 10 = $1,000

31 Unearned Service Revenue
    Service Revenue
    To record service revenue earned.
    $4,000 × 0.80 = $3,200

31 Office Supplies Expense
    Office Supplies
    To record office supplies used.
    $5,700 − $800 = $4,900

31 Income Tax Expense
    Income Taxes Payable
    To record estimated income taxes accrued.
LATASHA CORPORATION
Adjusted Trial Balance
December 31, 2011

<table>
<thead>
<tr>
<th>Acct. No.</th>
<th>Account Title</th>
<th>Debits</th>
<th>Credits</th>
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<td>Cash</td>
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<tr>
<td>111</td>
<td>Accounts Receivable</td>
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<td>115</td>
<td>Notes Receivable</td>
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<td>117</td>
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<td>135</td>
<td>Office Supplies</td>
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<td>142</td>
<td>Prepaid Rent</td>
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<td>171</td>
<td>Office Equipment</td>
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<tr>
<td>172</td>
<td>Accumulated Depreciation—Office Equipment</td>
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</tr>
<tr>
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<td>Accounts Payable</td>
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<tr>
<td>215</td>
<td>Income Taxes Payable</td>
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</tr>
<tr>
<td>233</td>
<td>Unearned Service Revenue</td>
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<tr>
<td>331</td>
<td>Common Stock</td>
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<tr>
<td>360</td>
<td>Retained Earnings</td>
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<tr>
<td>372</td>
<td>Dividends</td>
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<tr>
<td>413</td>
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<td>901</td>
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<tr>
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<td>Totals</td>
<td>$204,495</td>
<td>$204,495</td>
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</table>

3-21
LATASHA CORPORATION
Income Statement
For the Year Ended December 31, 2011

Revenues
  Service revenue $128,000
  Interest revenue   150
  Total revenues $128,150

Expenses
  Advertising expense $ 26,000
  Salaries expense   41,600
  Rent expense       7,200
  Office supplies expense 4,900
  Postage expense    3,000
  Utilities expense   9,300
  Cleaning expense    15,000
  Depreciation expense—office equipment   1,000
  Total expenses $108,000
Net income before income taxes $ 20,150
  Income tax expense        4,845
Net income $ 15,305

LATASHA CORPORATION
Statement of Owners' Equity
For the Year Ended December 31, 2011

Common stock, January 1, 2011 $ 50,700
Additional investments by owners —0—
  Common stock, December 31, 2011 $ 50,700
Retained earnings, January 1, 2011 $  8,000
Add: Net income 15,305
Deduct: Dividends (1,600)
  Retained earnings, December 31, 2011 21,705
Owners' equity, December 31, 2011 $ 72,405
LATASHA CORPORATION
Balance Sheet
December 31, 2011

Assets

Current assets
Cash $ 40,000
Accounts receivable 27,000
Notes receivable 8,000
Interest receivable 150
Office supplies 800
Prepaid rent 2,100
Total current assets $ 78,050

Property, plant and equipment
Office equipment $ 12,000
Deduct: Accumulated depreciation—office equipment 2,000
Total property, plant, and equipment 10,000

Total assets $ 88,050

Liabilities

Current liabilities
Accounts payable $ 8,000
Salaries payable 2,000
Income taxes payable 4,845
Unearned service revenue 800
Total current liabilities $ 15,645

Owner’s Equity

Common stock $ 50,700
Retained earnings 21,705
Total owners’ equity 72,405

Total liabilities and owners’ equity $ 88,050
## P3-29 Adjustments and Effect on Statements

**LG 2-7**

<table>
<thead>
<tr>
<th>Item</th>
<th>Adjusting Journal Entry</th>
<th>Amount Classification</th>
<th>Reported on Financial Statement</th>
</tr>
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<tbody>
<tr>
<td></td>
<td><strong>December 31, 2011</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a.</td>
<td>Office Supplies</td>
<td>Current asset</td>
<td>$500</td>
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<td>Office Supplies Expense</td>
<td>Expense</td>
<td>1,300</td>
</tr>
<tr>
<td>b.</td>
<td>Depreciation Expense—Automobiles</td>
<td>Expense</td>
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</tr>
<tr>
<td></td>
<td>Accumulated Depreciation—Automobiles</td>
<td>Property, plant, and equipment</td>
<td>6,750</td>
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<tr>
<td>c.</td>
<td>Utilities Expense</td>
<td>Expense</td>
<td>10,100</td>
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<td>Utilities Payable</td>
<td>Current liability</td>
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<td>d.</td>
<td>Interest Receivable</td>
<td>Current asset</td>
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</tr>
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<td>Interest Revenue</td>
<td>Revenue</td>
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<tr>
<td>e.</td>
<td>Prepaid Insurance</td>
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</tr>
<tr>
<td>f.</td>
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</tr>
<tr>
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<td>Property Tax Payable</td>
<td>Current liability</td>
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</tr>
<tr>
<td>g.</td>
<td>Salaries Expense</td>
<td>Expense</td>
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</tr>
<tr>
<td></td>
<td>Salaries Payable</td>
<td>Current liability</td>
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</tr>
<tr>
<td>h.</td>
<td>Rent Revenue</td>
<td>Revenue</td>
<td>2,200</td>
</tr>
<tr>
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<td>Unearned Rent</td>
<td>Current liability</td>
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</tr>
<tr>
<td>i.</td>
<td>Interest Expense</td>
<td>Expense</td>
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</tr>
<tr>
<td></td>
<td>Interest Payable</td>
<td>Current liability</td>
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</tr>
<tr>
<td>j.</td>
<td>Unearned Professional Fees</td>
<td>Current liability</td>
<td>1,680</td>
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<tr>
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<td>Professional Fees Revenue</td>
<td>Revenue</td>
<td>182,520</td>
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<tr>
<td>k.</td>
<td>Income Tax Expense</td>
<td>Expense</td>
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<tr>
<td></td>
<td>Income Taxes Payable</td>
<td>Current liability</td>
<td>14,000</td>
</tr>
</tbody>
</table>
P3-30 (Appendix) Adjustments for Transactions Initially Recorded in Income Statement Accounts
LG A1

GENERAL JOURNAL

2011
Dec. 31 Salaries Expense
       Salaries Payable  1,800
       To record accrued salaries.

31 Office Supplies
       Office Supplies Expense  1,400
       To record office supplies unused.

31 Revenue
       Unearned Revenue  2,300
       To record unearned revenue.

31 Interest Receivable
       Interest Revenue  60
       To record interest earned.
       $6,000 × 0.12 × 30/360 = $60

31 Depreciation Expense—Building
       Accumulated Depreciation—Building  3,500
       To record depreciation expense.
       ($80,000 − $10,000)/20 = $3,500

31 Prepaid Rent
       Rent Expense  5,000
       To record rent remaining prepaid.
       ($15,000 ÷ 15) × 5 = $5,000

31 Prepaid Insurance
       Insurance Expense  1,050
       To record insurance remaining prepaid.
       ($1,800 ÷ 12) × 7 = $1,050
Requirement 1.

CONSERVATIVE PARKING LOT, INC.
Income Statement
For the Month Ended January 31, 2011

Revenues
Parking lot revenues $ 58,000

Expenses
Advertising expense $ 12,000
Wages expense 6,000
Rent expense 4,000
Office supplies expense 1,200
Insurance expense 420
Total expenses 23,620
Net income $ 34,380

CONSERVATIVE PARKING LOT, INC.
Statement of Owners' Equity
For the Month Ended January 31, 2011

Common stock, January 1, 2011 $ 0
Add: Initial investment by owners 50,000
Common stock, January 31, 2011 $ 50,000

Retained earnings, January 1, 2011 $ 0
Add: Net Income 34,380
Deduct: Dividends (1,000)
Retained earnings, January 31, 2011 33,380

Owners' equity, January 31, 2011 $ 83,380
CONSERVATIVE PARKING LOT, INC.
Balance Sheet
January 31, 2011

Assets

Current assets
- Cash $19,480
- Accounts receivable 31,000
- Office supplies 4,800
- Prepaid insurance 2,100
- Prepaid rent 44,000
  Total current assets $101,380
Total assets $101,380

Liabilities

Current liabilities
- Unearned parking lot revenues $15,000
- Wages payable 3,000
  Total current liabilities $18,000

Owners’ Equity

Common stock $50,000
Retained earnings 33,380
  Total owners’ equity $83,380

Total liabilities and owners’ equity $101,380

Calculations:

1. Parking lot revenues:
   Recognize revenues on account as earned ($31,000).
   Recognize one-sixth of the $18,000 ($3,000) in advance payments as earned as of
   January 31, 2011. Total parking lot revenues = $58,000 ($24,000 + $31,000 +
   $3,000).

2. Wages expense:
   Accrue wages for the second half of January ($3,000).
   Total wages expense = $6,000 ($3,000 + $3,000).

3. Office supplies:
   Expense only the portion of office supplies used ($1,200).

4. Prepaid insurance:
   Expense only the amount of prepaid insurance expired ($2,520 x 1/6 = $420).
P3-31 Requirement 1 (continued)

5. Prepaid parking lot rent:
   Expense only the amount of prepaid parking lot rent expired ($48,000 \times \frac{1}{12} = $4,000).

6. Advertising campaign expenditures:
   Expense the entire amount ($12,000), as it is difficult to judge its future benefit to the firm.

Requirement 2.

**Instructor:** The information contained in the problem is limited and a loan officer would desire additional information in order to establish two sources of repayment: earnings and security assets that could be liquidated.

On a restated basis, the net income for the month of January is increased from $(47,520)$ to $34,380$. One could question why a substantial amount of revenues are on account for this type of business. Conservative has demonstrated the ability to generate parking lot revenues and earn a substantial net income percentage based on gross revenues ($34,380 \div 58,000 = 59\%$). Based on net income and cash collections for the month of January, Conservative should be able to pay off the $40,000 loan at the end of one year. However, the loan officer needs a detailed explanation on the nature and collectibility of the accounts receivable *before* making a loan.

P3-32 Evaluation and Restatement of Financial Statements to Conform to Accrual Basis of Accounting

**LG 2-7**

Requirement 1.

**GENEROUS PARKING LOT, INC.**

**Income Statement**

**For the Month Ended January 31, 2011**

<table>
<thead>
<tr>
<th>Revenues</th>
<th>$ 58,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parking lot revenues</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising expense</td>
<td>$12,000</td>
</tr>
<tr>
<td>Wages expense</td>
<td>6,000</td>
</tr>
<tr>
<td>Rent expense</td>
<td>4,000</td>
</tr>
<tr>
<td>Office supplies expense</td>
<td>1,200</td>
</tr>
<tr>
<td>Insurance</td>
<td>420</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td><strong>23,620</strong></td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td><strong>$ 34,380</strong></td>
</tr>
</tbody>
</table>
P3-32 (continued)

GENEROUS PARKING LOT, INC.
Statement of Owners' Equity
For the Month Ended January 31, 2011

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock, January 1, 2011</td>
<td>$ 0</td>
</tr>
<tr>
<td>Add: Initial investment</td>
<td>50,000</td>
</tr>
<tr>
<td>Common stock, January 31, 2011</td>
<td>50,000</td>
</tr>
<tr>
<td>Retained earnings, January 1, 2011</td>
<td>$ 0</td>
</tr>
<tr>
<td>Add: Net Income</td>
<td>34,380</td>
</tr>
<tr>
<td>Deduct: Dividends</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Retained earnings, January 31, 2011</td>
<td>24,380</td>
</tr>
<tr>
<td>Owners' equity, January 31, 2011</td>
<td>$ 74,380</td>
</tr>
</tbody>
</table>

GENEROUS PARKING LOT, INC.
Balance Sheet
January 31, 2011

Assets

Current Assets
Cash                                         $ 10,480
Accounts receivable                          31,000
Office supplies                              4,800
Prepaid insurance                            2,100
Prepaid rent                                 44,000
Total current assets                         $ 92,380
Total assets                                 $ 92,380

Liabilities

Current liabilities
Unearned parking lot revenue                 $ 15,000
Wages payable                               3,000
Total current liabilities                   $ 18,000

Owners' Equity
Common stock                                 $ 50,000
Retained earnings                            24,380
Total owners' equity                         74,380
Total liabilities and owners' equity         $ 92,380

3-29
P3-32 Requirement 1 (continued)

Calculations:

1. Parking lot revenues:
   Only one-sixth of the $18,000 ($3,000) in advance payments have been earned as of January 31, 2011. Total parking lot revenues = $58,000 ($24,000 + $31,000 + $3,000).

2. Wages expense:
   Accrue wages for the second half of January ($3,000).
   Total wages expense = $6,000 ($3,000 + $3,000).

3. Office supplies:
   Record the portion of office supplies used ($1,200).

4. Prepaid insurance:
   Record the amount of prepaid insurance expired ($2,520 × 1/6 = $420).

5. Advertising campaign expenditures:
   Expense the entire amount ($12,000), as it is difficult to judge its future benefit to the firm.

Requirement 2.

**Instructor:** The information contained in the problem is limited and a loan officer would desire additional information in order to establish two sources of repayment: earnings and security assets that could be liquidated.

On a restated basis, the net income for the month of January is reduced from $70,000 to $34,380. In addition, one could question why a substantial amount of revenues are on account for this type of business and also if the monthly withdrawal is too large for a new business. Generous has demonstrated the ability to generate parking lot revenues and earn a substantial net income percentage based on gross revenues ($34,380/$58,000 = 59%). Based on net income and cash collections for January, Generous should be able to pay off the $40,000 loan at the end of one year. However, the loan officer needs a detailed explanation on the nature and collectibility of the accounts receivable before making a loan.

P3-33 Analyzing Advanced Micro Devices and Texas Instruments
LG 8

1. Texas Instruments revenues for 2008 ($12,501,000,000) were higher than Advanced Micro Devices ($5,808,000,000). Both companies' revenues were lower over the two year period.
2. The percent change in total revenues is:

**Advanced Micro Devices**

\[(3.4)\% = 100 \times \frac{\$205,000,000}{\$6,013,000,000} \]  
\[\ast \$5,808,000,000 - \$6,013,000,000\]

**Texas Instruments**

\[(9.6)\% = 100 \times \frac{\$1,334,000,000}{\$13,835,000,000} \]  
\[\ast \$12,501,000,000 - \$13,835,000,000\]

Total revenues for Advanced Micro Devices decreased by 3.4% compared to a 9.6% decrease for Texas Instruments. In terms of total revenues, Texas Instruments is larger. However, revenues are decreasing faster for Texas Instruments.

3. AMD's percentage of expenses to revenues decreased in 2008. TI's percentage of expenses to revenues increased in 2008. However, TI had a positive net income in both years compared to net losses for AMD.

4. Texas Instruments' assets ($11,923,000,000) are higher than Advanced Micro Devices ($7,675,000,000). Assets for both companies are lower in 2008.

5. The percent decrease in total assets from 2007 to 2008 for each company is:

**Advanced Micro Devices**

\[(33.5)\% = 100 \times \frac{\$3,875,000,000}{\$11,550,000,000} \]  
\[\ast \$7,675,000,000 - \$11,550,000,000\]

**Texas Instruments**

\[(5.9)\% = 100 \times \frac{\$744,000,000}{\$12,667,000,000} \]  
\[\ast \$11,923,000,000 - \$12,667,000,000\]

6. The percent of liabilities for both companies has increased from 2007. The liability percent for AMD increased from 74.1% in 2007 to 101.1% in 2008. As a result, there is more risk that Advanced Micro Devices will not be able to pay their debts. Texas Instruments has a much lower liability percentage than Advanced Micro Devices in 2008.
P3-33 (continued)

7. We can answer this question by dividing total revenues by total average assets for each year. The computations for both companies in 2008 are:

**Advanced Micro Devices**

\[
\frac{5,808,000,000}{9,612,500,000^*} = .60 \text{ times}
\]

**Texas Instruments**

\[
\frac{12,501,000,000}{12,295,000,000^{**}} = 1.02 \text{ times}
\]

\[*(7,675,000,000 + 11,550,000,000) \div 2\]
\[**(11,923,000,000 + 12,667,000,000) \div 2\]

The resulting number is a ratio called **total asset turnover**. A higher number for the total asset turnover ratio is more favorable. In this case, Texas Instruments has a higher total asset turnover ratio than Advanced Micro Devices.

8. We can answer this question by dividing net income by total average assets for each year. The resulting ratio is called **return on assets (ROA)**. Return on assets provides a basic measure for evaluating profitability by relating net income to the total assets employed in a company. The computations for both companies in 2004 are:

**Advanced Micro Devices**

\[
\frac{3,098,000,000}{9,612,500,000^*} = (32.2)\% 
\]

**Texas Instruments**

\[
\frac{1,920,000,000}{12,295,000,000^{**}} = 15.6\% 
\]

\[*(7,675,000,000 + 11,550,000,000) \div 2\]
\[**(11,923,000,000 + 12,667,000,000) \div 2\]

A higher number for the return on assets percent is more favorable. In this case, Texas Instruments has a much higher ROA of 15.6% than Advanced Micro Devices which is (32.2)%. 

3-32
SOLUTION TO BUSINESS DECISION AND COMMUNICATION PROBLEM

Following is a typical student response to this communications problem; actual responses may vary in content and style but should contain as much of this basic information as possible.

LG 1-9

TO: Mr. Stuart Brown
FROM: Student
RE: Amortization of Video Cassettes by Video Village Corporation

Old versus New Amortization Policies
Before January 1, 2011, the management of Video Village amortized “hit” videos over a nine month period on a straight-line basis. Starting January 1, 2011, the amortization period was changed to 36 months and an accelerated basis was used. No details are provided in the note about the accelerated basis used. However, ignoring the change to an “accelerated” method, the significant change in the amortization period from only nine months to 36 months will have a dramatic impact on the amount of amortization expense for 2011.
Business Decision and Communication Problem (continued)

Impact on Net Income for 2011
Since the amortization period is now four times longer, amortization expense for 2011 will be reduced. This will result in higher reported net income. Since video cassettes represent one of the largest assets for Video Village, the impact on net income is likely to be significant.

Overall Fairness of the Change in Amortization Period
One has to question management's motivation for the significant increase in the estimated useful life of the video cassettes. It does not seem likely that people will want to rent "hit" videos continuously over a 36 month period. The old period of nine months seems more reasonable. If the objective of the change in estimated life from nine months to 36 months is solely to increase reported net income, the change does not improve the overall "fairness" of the financial statements.

INSTRUCTOR'S NOTE:
This example is based on the actual financial statements of Blockbuster Entertainment Corporation. It shows how financial results may be changed using different accounting methods and estimates. For the year ended December 31, 2011, the videocassette inventory Video Village accounted for 34% of the total assets on the balance sheet for Video Village. Changing the estimated life from nine months to 36 months will significantly reduce amortization expense.

SOLUTION TO ETHICAL DILEMMA

Extending Useful Life of Assets to Raise Net Income

Individual responses to ethical dilemmas will vary. The technical and ethical issues raised in the following response are central to this dilemma; look for them in students' answers and be prepared to discuss them with students in class.

As chief accountant, you have at least two alternatives. One, you can go with the president's request and use the longer useful life. Using the longer useful life will understate the depreciation expense and overstate net income. It will also overstate assets and owners' equity. The company president is correct in stating that depreciation is an estimate. However, estimates should be as accurate as possible. There may be a case for using the longer life. However, the president's motivation appears to be to increase net income and total assets. Using the longer useful life may make the income statement and balance sheet prepared as of June 30, 2011, misleading.

The second alternative is to insist on using the existing estimates of useful life. This is the ethically correct alternative. It may cause repercussions within the company. You may be turned down for promotions or may even lose your job. As an accountant, however, you have an ethical responsibility to the users of the financial statements—here, to the bank—to present fair information. The useful life used by the industry will be less likely to mislead statement users.
INTERNET PROBLEM

Access Starbucks Coffee's most recent financial statements. Using these financial statements, answer the following questions:

1. Over the three year period shown in the Consolidated Statement of Income, are total revenues increasing or decreasing?
2. What is the percentage change in total revenues from the first year shown to the last year shown?
3. Using the Consolidated Balance Sheet, are total assets higher or lower in the later year?
4. What is the percentage change in total assets from the earliest year to the latest year shown?

ANSWER:

The answers will vary depending on the year for which data are available. For the 2008 Annual Report, they were:

1. Total revenues have increased from $9,411,497,000 to $10,383,000,000.
2. Total revenues have increased by 10.3%.
3. Total assets are higher in the latest year, $5,672,600,000 versus $5,343,878,000.
4. Total assets increased by 6.2%.