

Completing the Accounting Cycle

STUDY OBJECTIVES

After studying this chapter, you should be able to:

- 1 Prepare a worksheet.
- 2 Explain the process of closing the books.
- 3 Describe the content and purpose of a post-closing trial balance.
- 4 State the required steps in the accounting cycle.
- 5 Explain the approaches to preparing correcting entries.
- 6 Identify the sections of a classified balance sheet.



The Navigator

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Feature Story

EVERYONE LIKES TO WIN

When Ted Castle was a hockey coach at the University of Vermont, his players were self-motivated by their desire to win. Hockey was a game you either won or lost. But at **Rhino Foods, Inc.**, a bakery-foods company he founded in Burlington, Vermont, he discovered that manufacturing-line workers were not so self-motivated. Ted thought, what if he turned the food-making business into a game, with rules, strategies, and trophies?

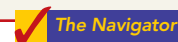
Ted knew that in a game knowing the score is all-important. He felt that only if the employees know the score—know exactly how the business is doing daily, weekly, monthly—could he turn food-making into a game. But Rhino is a closely held, family-owned business, and its financial statements

and profits were confidential. Ted wondered, should he open Rhino's books to the employees?

A consultant put Ted's concerns in perspective when he said, "Imagine you're playing touch football. You play for an hour or two, and the whole time I'm sitting there with a book, keeping score. All of a sudden I blow the whistle, and I say, 'OK, that's it. Everybody go home.' I close my book and walk away. How would you feel?" Ted opened his books and revealed the financial statements to his employees.

The next step was to teach employees the rules and strategies of how to "win" at making food. The first lesson: "Your opponent at Rhino is expenses. You must cut and control expenses." Ted and his staff distilled those lessons into daily scorecards—production reports and income statements—that keep Rhino's employees up-to-date on the game. At noon each day, Ted posts the previous day's results at the entrance to the production room. Everyone checks whether they made or lost money on what they produced the day before. And it's not just an academic exercise: There's a bonus check for each employee at the end of every four-week "game" that meets profitability guidelines.

Rhino has flourished since the first game. Employment has increased from 20 to 130 people, while both revenues and profits have grown dramatically.



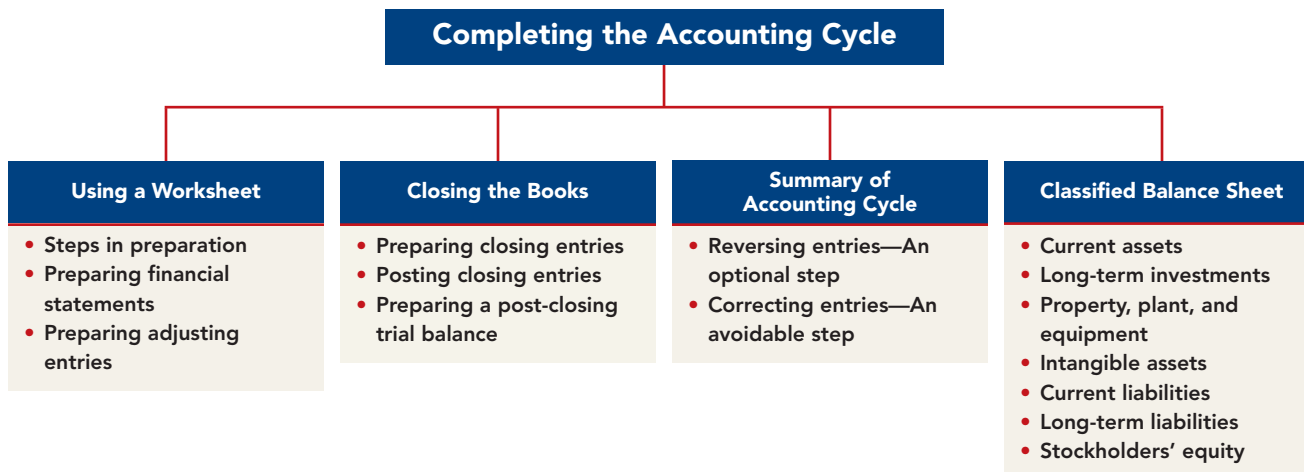
Inside Chapter 4

- **Cisco Performs the Virtual Close** (p. 155)
- **Yale Express Loses Some Transportation Bills** (p. 160)
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- **All About You: Your Personal Balance Sheet** (p. 167)

Preview of Chapter 4

At **Rhino Foods, Inc.**, financial statements help employees understand what is happening in the business. In Chapter 3, we prepared financial statements directly from the adjusted trial balance. However, with so many details involved in the end-of-period accounting procedures, it is easy to make errors. One way to minimize errors in the records and to simplify the end-of-period procedures is to use a worksheet.

In this chapter we will explain the role of the worksheet in accounting. We also will study the remaining steps in the accounting cycle, especially the closing process, again using Pioneer Advertising Agency Inc. as an example. Then we will consider correcting entries and classified balance sheets. The content and organization of Chapter 4 are as follows.



USING A WORKSHEET

STUDY OBJECTIVE 1

Prepare a worksheet.

A **worksheet** is a multiple-column form that companies use in the adjustment process and in preparing financial statements. As its name suggests, the worksheet is a working tool. **It is not a permanent accounting record;** it is neither a journal nor a part of the general ledger. The worksheet is merely a device used in preparing adjusting entries and the financial statements. Companies generally computerize worksheets using an electronic spreadsheet program such as Excel.

Illustration 4-1 shows the basic form of a worksheet and the five steps for preparing it. Each step is performed in sequence. **The use of a worksheet is optional.** When a company chooses to use one, it prepares financial statements from the worksheet. It enters the adjustments in the worksheet columns and then journalizes and posts the adjustments after it has prepared the financial statements. Thus, worksheets make it possible to provide the financial statements to management and other interested parties at an earlier date.

Steps in Preparing a Worksheet

We will use the October 31 trial balance and adjustment data of Pioneer Advertising Inc., from Chapter 3, to illustrate how to prepare a worksheet. We

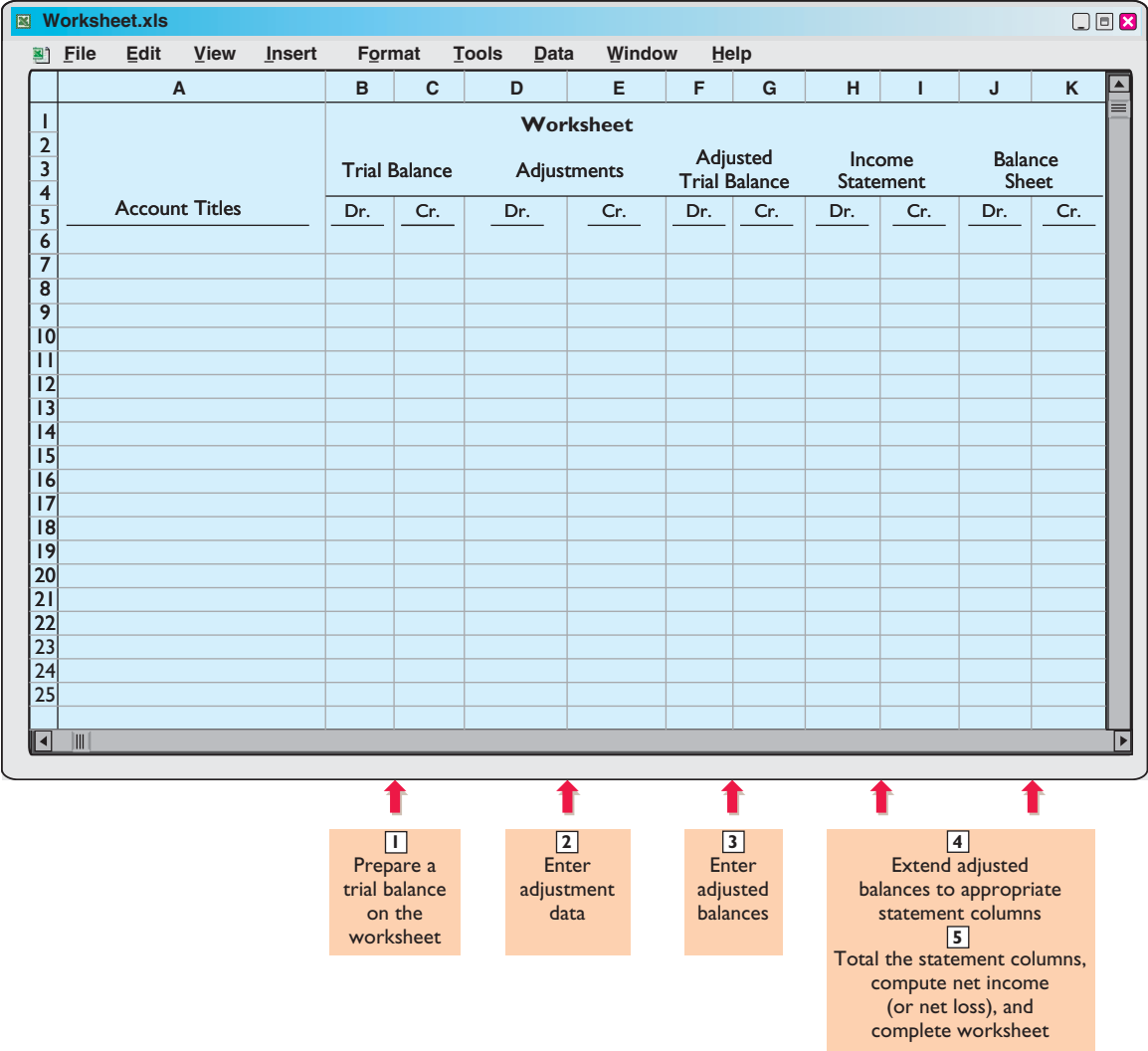


Illustration 4-1
Form and procedure for a worksheet

describe each step of the process and demonstrate these steps in Illustration 4-2 and transparencies 4-3A, B, C, and D.

STEP 1. PREPARE A TRIAL BALANCE ON THE WORKSHEET

Enter all ledger accounts with balances in the account titles space. Enter debit and credit amounts from the ledger in the trial balance columns. Illustration 4-2 shows the worksheet trial balance for Pioneer Advertising Agency Inc.

STEP 2. ENTER THE ADJUSTMENTS IN THE ADJUSTMENTS COLUMNS

Turn over the first transparency, Illustration 4-3A. When using a worksheet, enter all adjustments in the adjustments columns. In entering the adjustments, use applicable trial balance accounts. If additional accounts are needed, insert them on the lines immediately below the trial balance totals. A different letter identifies the debit and credit for each adjusting entry. The term used to describe this process is keying. Companies do not journalize the adjustments until after they complete the worksheet and prepare the financial statements.

(Note: Text continues on page 147, following acetate overlays.)

Illustration 4-2
Preparing a trial balance

Pioneer Advertising.xls											
File Edit View Insert Format Tools Data Window Help											
	A	B	C	D	E	F	G	H	I	J	K
1	PIONEER ADVERTISING AGENCY INC.										
2	Worksheet										
3	For the Month Ended October 31, 2008										
4		Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
5											
6	Account Titles	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
7											
8	Cash	15,200									
9	Advertising Supplies	2,500									
10	Prepaid Insurance	600									
11	Office Equipment	5,000									
12	Notes Payable		5,000								
13	Accounts Payable		2,500								
14	Unearned Revenue		1,200								
15	Common Stock		10,000								
16	Dividends	500									
17	Service Revenue		10,000								
18											
19	Salaries Expense	4,000									
20	Rent Expense	900									
21	Totals	28,700	28,700								
22											
23											
24											
25											
26											
27											
28											
29											
30											
31											
32											
33											
34											
35											
36											

Include all accounts with
balances from ledger.

Trial balance amounts come
directly from ledger
accounts.

Illustration 4-3A

Entering the adjustments in the adjustments columns

	(a)	1,500	
	(b)	50	
	(d)	400	
	(d)	400	
	(e)	200	
(g)	1,200		
Advertising Supplies Expense	(a)	1,500	
Insurance Expense	(b)	50	
Accum. Depreciation—Office Equipment		(c)	40
Depreciation Expense	(c)	40	
Accounts Receivable	(e)	200	
Interest Expense	(f)	50	
Interest Payable		(f)	50
Salaries Payable		(g)	1,200
Totals		<u>3,440</u>	<u>3,440</u>

Add additional accounts as needed to complete the adjustments:

- (a) Supplies Used.
- (b) Insurance Expired.
- (c) Depreciation Expensed.
- (d) Service Revenue Earned.
- (e) Service Revenue Accrued.
- (f) Interest Accrued.
- (g) Salaries Accrued.

Enter adjustment amounts in appropriate columns, and use letters to cross-reference the debit and credit adjustments.

Total adjustments columns and check for equality.

Illustration 4-3B

Entering adjusted balances in the adjusted trial balance columns

	15,200	
	1,000	
	550	
	5,000	
		5,000
		2,500
		800
		10,000
	500	
		10,600
	5,200	
	900	
	1,500	
	50	
		40
	40	
	200	
	50	
		50
		1,200
	<u>30,190</u>	<u>30,190</u>



Combine trial balance amounts with adjustment amounts to obtain the adjusted trial balance.

Total adjusted trial balance columns and check for equality.

Illustration 4-3C

Extending the adjusted trial balance amounts to appropriate financial statement columns

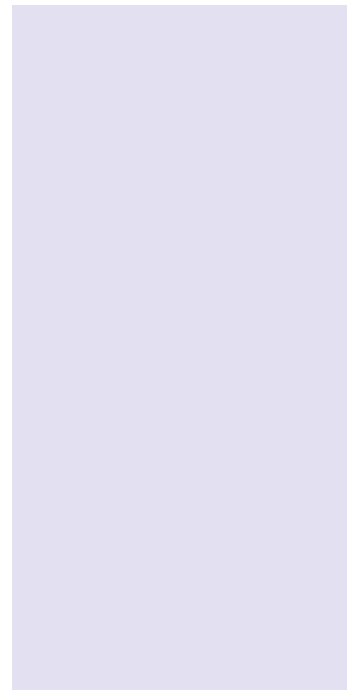
	15,200	
	1,000	
	550	
	5,000	
		5,000
		2,500
		800
		10,000
	500	
10,600		
5,200		
900		
1,500		
50		
		40
40		
	200	
50		
		50
		1,200

Extend all revenue and expense account balances to the income statement columns.

Extend all asset and liability account balances, as well as common stock and dividends account balances, to the balance sheet columns.

Illustration 4-3D

Computing net income or net loss and completing the worksheet

Net Income
Totals

7,740 10,600 22,450 19,590

2,860			2,860
<u>10,600</u>	<u>10,600</u>	<u>22,450</u>	<u>22,450</u>

The difference between the totals of the two income statement columns determines net income or net loss.

Net income is extended to the credit column of the balance sheet columns. (Net loss would be extended to the debit column.)

The adjustments for Pioneer Advertising Agency Inc. are the same as the adjustments illustrated on page 110. They are keyed in the adjustments columns of the worksheet as follows.

- (a) Pioneer debits an additional account, Advertising Supplies Expense, \$1,500 for the cost of supplies used, and credits Advertising Supplies \$1,500.
- (b) Pioneer debits an additional account, Insurance Expense, \$50 for the insurance that has expired, and credits Prepaid Insurance \$50.
- (c) The company needs two additional depreciation accounts. It debits Depreciation Expense \$40 for the month's depreciation, and credits Accumulated Depreciation—Office Equipment \$40.
- (d) Pioneer debits Unearned Revenue \$400 for services provided, and credits Service Revenue \$400.
- (e) Pioneer debits an additional account, Accounts Receivable, \$200 for services provided but not billed, and credits Service Revenue \$200.
- (f) The company needs two additional accounts relating to interest. It debits Interest Expense \$50 for accrued interest, and credits Interest Payable \$50.
- (g) Pioneer debits Salaries Expense \$1,200 for accrued salaries, and credits an additional account, Salaries Payable, \$1,200.

After Pioneer has entered all the adjustments, the adjustments columns are totaled to prove their equality.

STEP 3. ENTER ADJUSTED BALANCES IN THE ADJUSTED TRIAL BALANCE COLUMNS

Turn over the second transparency, Illustration 4-3B. Pioneer determines the adjusted balance of an account by combining the amounts entered in the first four columns of the worksheet for each account. For example, the Prepaid Insurance account in the trial balance columns has a \$600 debit balance and a \$50 credit in the adjustments columns. The result is a \$550 debit balance recorded in the adjusted trial balance columns. **For each account, the amount in the adjusted trial balance columns is the balance that will appear in the ledger after journalizing and posting the adjusting entries.** The balances in these columns are the same as those in the adjusted trial balance in Illustration 3-24 (page 112).

After Pioneer has entered all account balances in the adjusted trial balance columns, the columns are totaled to prove their equality. If the column totals do not agree, the financial statement columns will not balance and the financial statements will be incorrect.

STEP 4. EXTEND ADJUSTED TRIAL BALANCE AMOUNTS TO APPROPRIATE FINANCIAL STATEMENT COLUMNS

Turn over the third transparency, Illustration 4-3C. The fourth step is to extend adjusted trial balance amounts to the income statement and balance sheet columns of the worksheet. Pioneer enters balance sheet accounts in the appropriate balance sheet debit and credit columns. For instance, it enters Cash in the balance sheet debit column, and Notes Payable in the credit column. Pioneer extends Accumulated Depreciation to the balance sheet credit column; the reason is that accumulated depreciation is a contra-asset account with a credit balance.

Because the worksheet does not have columns for the retained earnings statement, Pioneer extends the balances in Common Stock and Retained Earnings, if any, to the balance sheet credit column. In addition, it extends the balance in Dividends to the balance sheet debit column because it is a stockholders' equity account with a debit balance.

The company enters the expense and revenue accounts such as Salaries Expense and Service Revenue in the appropriate income statement columns. Illustration 4-3C shows all of these extensions.

HELPFUL HINT

Every adjusted trial balance amount must be extended to one of the four statement columns.

STEP 5. TOTAL THE STATEMENT COLUMNS, COMPUTE THE NET INCOME (OR NET LOSS), AND COMPLETE THE WORKSHEET

Turn over the fourth transparency, Illustration 4-3D. The company now must total each of the financial statement columns. The net income or loss for the period is the difference between the totals of the two income statement columns. If total credits exceed total debits, the result is net income. In such a case, as shown in Illustration 4-3D, the company inserts the words “Net Income” in the account titles space. It then enters the amount in the income statement debit column and the balance sheet credit column. **The debit amount balances the income statement columns; the credit amount balances the balance sheet columns.** In addition, the credit in the balance sheet column indicates the increase in stockholders’ equity resulting from net income.

What if total debits in the income statement columns exceed total credits? In that case, the company has a net loss. It enters the amount of the net loss in the income statement credit column and the balance sheet debit column.

After entering the net income or net loss, the company determines new column totals. The totals shown in the debit and credit income statement columns will match. So will the totals shown in the debit and credit balance sheet columns. If either the income statement columns or the balance sheet columns are not equal after the net income or net loss has been entered, there is an error in the worksheet. Illustration 4-3D shows the completed work sheet for Pioneer Advertising Agency Inc.

Preparing Financial Statements from a Worksheet

After a company has completed a worksheet, it has at hand all the data required for preparation of financial statements. The income statement is prepared from the income statement columns. The balance sheet and retained earnings statement are prepared from the balance sheet columns. Illustration 4-4 shows the financial statements prepared from Pioneer’s worksheet. At this point, the company has not journalized or posted adjusting entries. Therefore, ledger balances for some accounts are not the same as the financial statement amounts.

The amount shown for common stock on the worksheet does not change from the beginning to the end of the period unless the company issues additional stock during the period. Because there was no balance in Pioneer’s retained earnings, the account is not listed on the worksheet. Only after dividends and net income (or loss) are posted to retained earnings does this account have a balance at the end of the first year of the business.

Using a worksheet, companies can prepare financial statements before they journalize and post adjusting entries. **However, the completed worksheet is not a substitute for formal financial statements.** The format of the data in the financial statement columns of the worksheet is not the same as the format of the financial statements. **A worksheet is essentially a working tool of the accountant;** companies do not distribute it to management and other parties.

Preparing Adjusting Entries from a Worksheet



Accounting Cycle Tutorial—
Preparing Financial
Statements and Closing the
Books

HELPFUL HINT

Note that writing the explanation to the adjustment at the bottom of the worksheet is not required.

A worksheet is not a journal, and it cannot be used as a basis for posting to ledger accounts. To adjust the accounts, the company must journalize the adjustments and post them to the ledger. **The adjusting entries are prepared from the adjustments columns of the worksheet.** The reference letters in the adjustments columns and the explanations of the adjustments at the bottom of the worksheet help identify

PIONEER ADVERTISING AGENCY INC.

Income Statement
For the Month Ended October 31, 2008

Revenues		
Service revenue		\$10,600
Expenses		
Salaries expense	\$5,200	
Advertising supplies expense	1,500	
Rent expense	900	
Insurance expense	50	
Interest expense	50	
Depreciation expense	40	
Total expenses		<u>7,740</u>
Net income		<u>\$ 2,860</u>

Illustration 4-4

Financial statements from a
worksheet

PIONEER ADVERTISING AGENCY INC.

Retained Earnings Statement
For the Month Ended October 31, 2008

Retained earnings, October 1	\$ -0-
Add: Net income	<u>2,860</u>
	2,860
Less: Dividends	<u>500</u>
Retained earnings, October 31	<u>\$2,360</u>

PIONEER ADVERTISING AGENCY INC.

Balance Sheet
October 31, 2008

<u>Assets</u>		
Cash		\$15,200
Accounts receivable		200
Advertising supplies		1,000
Prepaid insurance		550
Office equipment	\$5,000	
Less: Accumulated depreciation	<u>40</u>	<u>4,960</u>
Total assets		<u>\$21,910</u>
<u>Liabilities and Stockholders' Equity</u>		
Liabilities		
Notes payable		\$ 5,000
Accounts payable		2,500
Interest payable		50
Unearned revenue		800
Salaries payable		<u>1,200</u>
Total liabilities		<u>9,550</u>
Stockholders' equity		
Common stock		10,000
Retained earnings		<u>2,360</u>
Total liabilities and stockholders' equity		<u>\$21,910</u>

the adjusting entries. The journalizing and posting of adjusting entries **follows** the preparation of financial statements when a worksheet is used. The adjusting entries on October 31 for Pioneer Advertising Agency Inc. are the same as those shown in Illustration 3-22 (page 110).

Before You Go On...

REVIEW IT

1. What are the five steps in preparing a worksheet?
2. How is net income or net loss shown in a worksheet?
3. How does a worksheet relate to preparing financial statements and adjusting entries?

DO IT

Susan Elbe is preparing a worksheet. Explain to Susan how she should extend the following adjusted trial balance accounts to the financial statement columns of the worksheet:

Cash	Dividends
Accumulated Depreciation	Service Revenue
Accounts Payable	Salaries Expense

Action Plan

- Extend asset balances to the balance sheet debit column. Extend liability balances to the balance sheet credit column. Extend accumulated depreciation to the balance sheet credit column.
- Extend the Dividends account to the balance sheet debit column.
- Extend expenses to the income statement debit column.
- Extend revenue accounts to the income statement credit column.

Solution

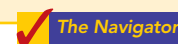
Balance sheet debit column—Cash; Dividends

Balance sheet credit column—Accumulated Depreciation; Accounts Payable

Income statement debit column—Salaries Expense

Income statement credit column—Service Revenue

Related exercise material: BE4-1, BE4-2, BE4-3, E4-1, E4-2, E4-5, and E4-6.



CLOSING THE BOOKS

STUDY OBJECTIVE 2

Explain the process of closing the books.

ALTERNATIVE TERMINOLOGY

Temporary accounts are sometimes called *nominal accounts*, and permanent accounts are sometimes called *real accounts*.

At the end of the accounting period, the company makes the accounts ready for the next period. This is called **closing the books**. In closing the books, the company distinguishes between temporary and permanent accounts.

Temporary accounts relate only to a given accounting period. They include all income statement accounts and the dividends account. The company closes all temporary accounts at the end of the period.

In contrast, **permanent accounts** relate to one or more future accounting periods. They consist of all balance sheet accounts, including the stockholders' equity accounts. Permanent accounts are not closed from period to period. Instead, the

company carries forward the balances of permanent accounts into the next accounting period. Illustration 4-5 identifies the accounts in each category.

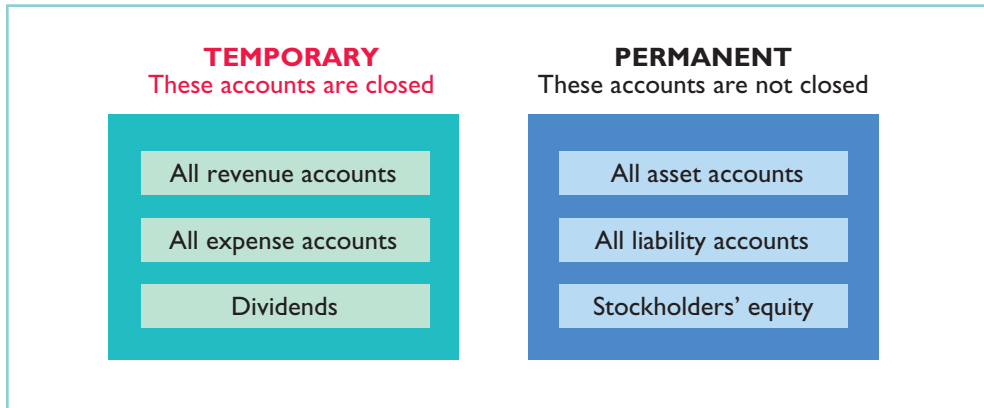


Illustration 4-5

Temporary versus permanent accounts

HELPFUL HINT

A contra-asset account, such as accumulated depreciation, is a permanent account also.

Preparing Closing Entries

At the end of the accounting period, the company transfers temporary account balances to the permanent stockholders' equity account, Retained Earnings, by means of closing entries.

Closing entries formally recognize in the ledger the transfer of net income (or net loss) and Dividends to Retained Earnings. The retained earnings statement shows the results of these entries. **Closing entries also produce a zero balance in each temporary account.** The temporary accounts are then ready to accumulate data in the next accounting period separate from the data of prior periods. Permanent accounts are not closed.

Journalizing and posting closing entries is a required step in the accounting cycle. (See Illustration 4-12 on page 158.) The company performs this step after it has prepared financial statements. In contrast to the steps in the cycle that you have already studied, companies generally journalize and post closing entries **only at the end of the annual accounting period**. Thus, all temporary accounts will contain data for the entire year.

In preparing closing entries, companies could close each income statement account directly to Retained Earnings. However, to do so would result in excessive detail in the Retained Earnings account. Instead, companies close the revenue and expense accounts to another temporary account, **Income Summary**, and they transfer the resulting net income or net loss from this account to Retained Earnings.

Companies **record closing entries in the general journal**. A center caption, Closing Entries, inserted in the journal between the last adjusting entry and the first closing entry, identifies these entries. Then the company posts the closing entries to the ledger accounts.

Companies generally prepare closing entries directly from the adjusted balances in the ledger. They could prepare separate closing entries for each nominal account, but the following four entries accomplish the desired result more efficiently:

1. Debit each revenue account for its balance, and credit Income Summary for total revenues.

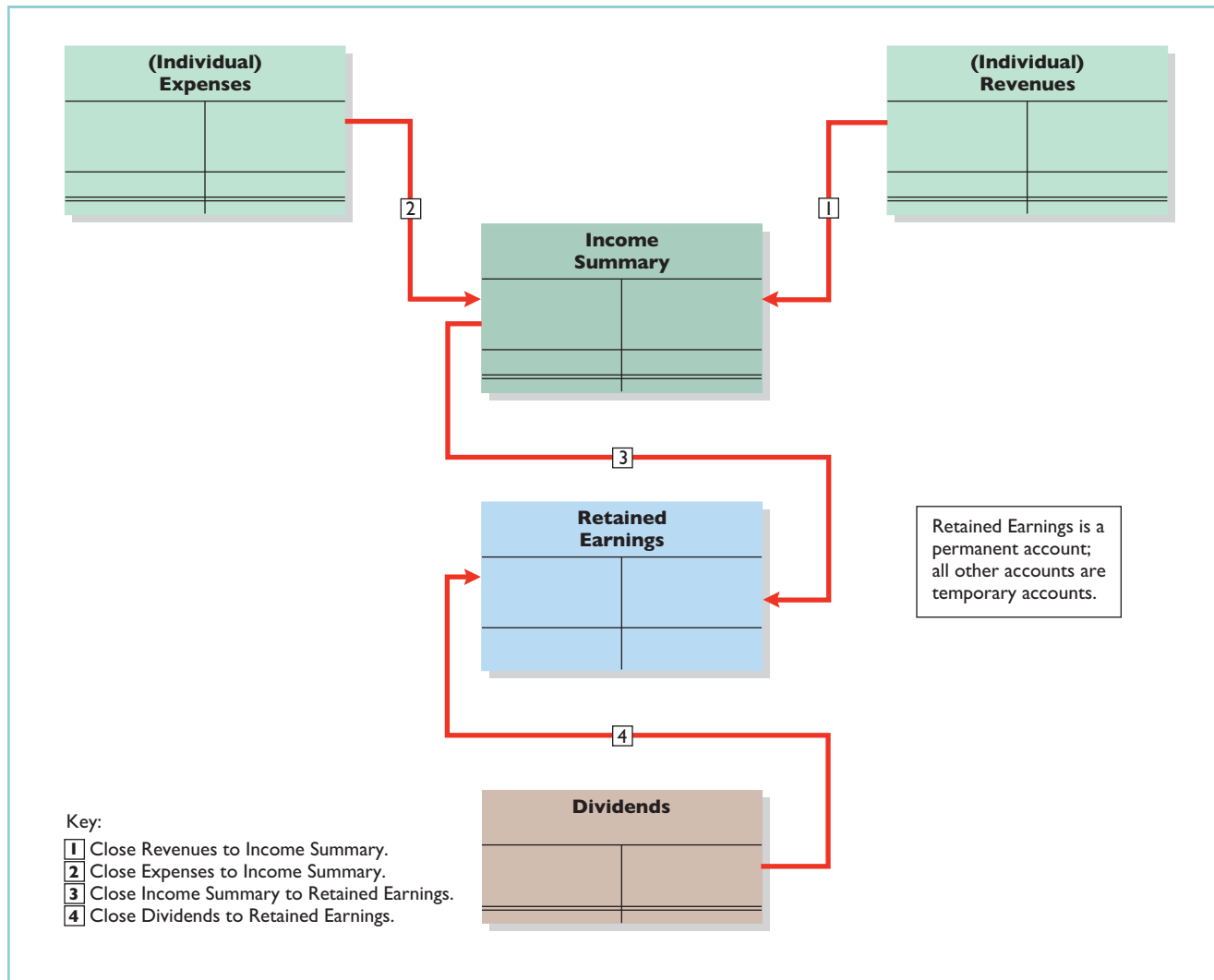
HELPFUL HINT

Dividends is closed directly to Retained Earnings and not to Income Summary because Dividends is not an expense.

2. Debit Income Summary for total expenses, and credit each expense account for its balance.
3. Debit Income Summary and credit Retained Earnings for the amount of net income.
4. Debit Retained Earnings for the balance in the Dividends account, and credit Dividends for the same amount.

Illustration 4-6 presents a diagram of the closing process. In it, the boxed numbers refer to the four entries required in the closing process.

Illustration 4-6
Diagram of closing process



If there were a net loss (because expenses exceeded revenues), entry 3 in Illustration 4-6 would be reversed: there would be a credit to Income Summary and a debit to Retained Earnings.

CLOSING ENTRIES ILLUSTRATED

In practice, companies generally prepare closing entries only at the end of the annual accounting period. However, to illustrate the journalizing and posting of closing entries, we will assume that Pioneer Advertising Agency Inc. closes its books monthly. Illustration 4-7 shows the closing entries at October 31. (The numbers in parentheses before each entry correspond to the four entries diagrammed in Illustration 4-6.)

GENERAL JOURNAL					J3
Date	Account Titles and Explanation	Ref.	Debit	Credit	
	Closing Entries				
2008	(1)				
Oct. 31	Service Revenue	400	10,600		
	Income Summary	350		10,600	
	(To close revenue account)				
	(2)				
31	Income Summary	350	7,740		
	Advertising Supplies Expense	631		1,500	
	Depreciation Expense	711		40	
	Insurance Expense	722		50	
	Salaries Expense	726		5,200	
	Rent Expense	729		900	
	Interest Expense	905		50	
	(To close expense accounts)				
	(3)				
31	Income Summary	350	2,860		
	Retained Earnings	320		2,860	
	(To close net income to retained earnings)				
	(4)				
31	Retained Earnings	320	500		
	Dividends	332		500	
	(To close dividends to capital)				

Illustration 4-7
Closing entries journalized

Note that the amounts for Income Summary in entries (1) and (2) are the totals of the income statement credit and debit columns, respectively, in the worksheet.

A couple of cautions in preparing closing entries: (1) Avoid unintentionally doubling the revenue and expense balances rather than zeroing them. (2) Do not close Dividends through the Income Summary account. **Dividends are not an expense, and they are not a factor in determining net income.**

Posting Closing Entries

Illustration 4-8 shows the posting of the closing entries and the ruling of the accounts. Note that all temporary accounts have zero balances after posting the closing entries. In addition, you should realize that the balance in Retained Earnings represents the accumulated undistributed earnings of the corporation at the end of the accounting period. This balance is shown on the balance sheet and is the ending amount reported on the retained earnings statement, as shown in Illustration 4-4.

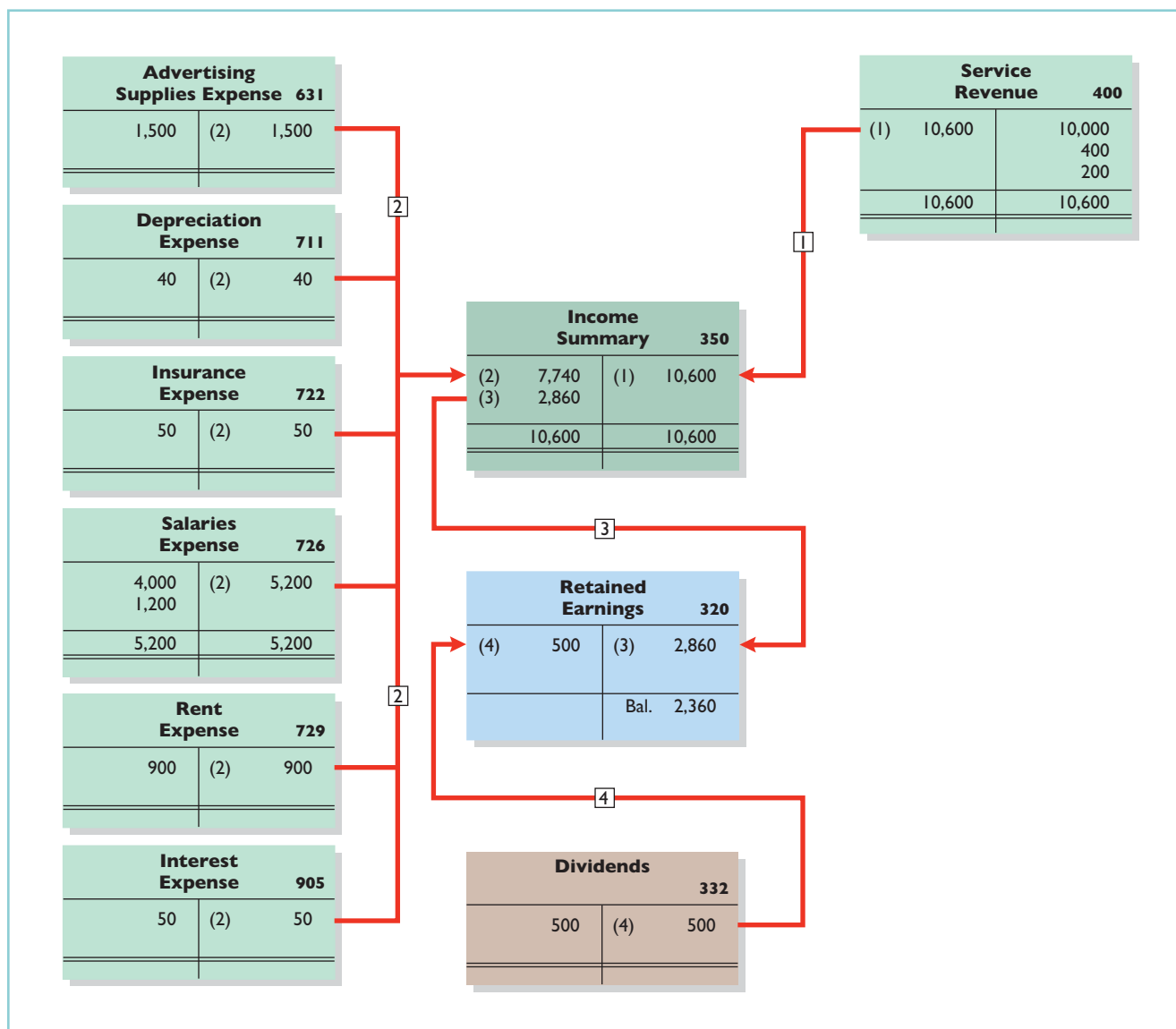
HELPFUL HINT

The balance in Income Summary before it is closed must equal the net income or net loss for the period.

The Income Summary account is used only in closing. Companies do not journalize and post entries to this account during the year.

As part of the closing process, companies total, balance, and double-rule the **temporary accounts**—revenues, expenses, and Dividends—in T-account form, as shown in Illustration 4-8. The **permanent accounts**—assets, liabilities, and stockholders' equity (Common Stock and Retained Earnings)—are not closed. A single rule is drawn beneath the current-period entries, and the account balance carried forward to the next period is entered below the single rule. (For example, see Retained Earnings.)

Illustration 4-8
Posting of closing entries



ACCOUNTING ACROSS THE ORGANIZATION



Cisco Performs the Virtual Close

Technology has dramatically shortened the closing process. Recent surveys have reported that the average company now takes only six to seven days to close, rather than 20 days. But a few companies do much better. **Cisco Systems** can perform a “virtual close”—closing within 24 hours on any day in the quarter. The same is true at **Lockheed Martin Corp.**, which improved its closing time by 85% in just the last few years. Not very long ago it took 14 to 16 days. Managers at these companies emphasize that this increased speed has not reduced the accuracy and completeness of the data.

This is not just showing off. Knowing exactly where you are financially all of the time allows the company to respond faster than competitors. It also means that the hundreds of people who used to spend 10 to 20 days a quarter tracking transactions can now be more usefully employed on things such as mining data for business intelligence to find new business opportunities.

Source: “Reporting Practices: Few Do It All,” *Financial Executive*, November 2003, p. 11.



Who else benefits from a shorter closing process?



Preparing a Post-Closing Trial Balance

After Pioneer has journalized and posted all closing entries, it prepares another trial balance, called a **post-closing trial balance**, from the ledger. The post-closing trial balance lists permanent accounts and their balances after journalizing and posting of closing entries. The purpose of the post-closing trial balance is **to prove the equality of the permanent account balances carried forward into the next accounting period**. Since all temporary accounts will have zero balances, **the post-closing trial balance will contain only permanent—balance sheet—accounts**.

Illustration 4-9 shows the post-closing trial balance for Pioneer Advertising Agency Inc.

STUDY OBJECTIVE 3

Describe the content and purpose of a post-closing trial balance.

PIONEER ADVERTISING AGENCY INC.

Post-Closing Trial Balance
October 31, 2008

	<u>Debit</u>	<u>Credit</u>
Cash	\$15,200	
Accounts Receivable	200	
Advertising Supplies	1,000	
Prepaid Insurance	550	
Office Equipment	5,000	
Accumulated Depreciation—Office Equipment		\$ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Revenue		800
Salaries Payable		1,200
Interest Payable		50
Common Stock		10,000
Retained Earnings		2,360
	<u>\$21,950</u>	<u>\$21,950</u>

Illustration 4-9

Post-closing trial balance

Pioneer prepares the post-closing trial balance from the permanent accounts in the ledger. Illustration 4-10 shows the permanent accounts in Pioneer's general ledger.

A post-closing trial balance provides evidence that the company has properly journalized and posted the closing entries. It also shows that the accounting equation is in balance at the end of the accounting period. However, like the trial balance, it does not prove that Pioneer has recorded all transactions or that the ledger is correct. For example, the post-closing trial balance will balance if a transaction is not journalized and posted or if a transaction is journalized and posted twice.

Illustration 4-10

General ledger, permanent accounts

(Permanent Accounts Only)

GENERAL LEDGER											
Cash No. 101						Accounts Payable No. 201					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 1		J1	10,000		10,000	Oct. 5		J1		2,500	2,500
2		J1	1,200		11,200						
3		J1		900	10,300						
4		J1		600	9,700						
20		J1		500	9,200						
26		J1		4,000	5,200						
31		J1	10,000		15,200						
Accounts Receivable No. 112						Unearned Revenue No. 209					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 31	Adj. entry	J2	200		200	Oct. 2		J1		1,200	1,200
						31	Adj. entry	J2	400		800
Advertising Supplies No. 126						Salaries Payable No. 212					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 5		J1	2,500		2,500	Oct. 31	Adj. entry	J2		1,200	1,200
31	Adj. entry	J2		1,500	1,000						
Prepaid Insurance No. 130						Interest Payable No. 230					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 4		J1	600		600	Oct. 31	Adj. entry	J2		50	50
31	Adj. entry	J2		50	550						
Office Equipment No. 157						Common Stock No. 311					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 1		J1	5,000		5,000	Oct. 1		J1		10,000	10,000
Accumulated Depreciation—Office Equipment No. 158						Retained Earnings No. 320					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 31	Adj. entry	J2		40	40	Oct. 1					—0—
Notes Payable No. 200						31	Closing entry	J3		2,860	2,860
Date	Explanation	Ref.	Debit	Credit	Balance	31	Closing entry	J3	500		2,360
2008											
Oct. 1		J1		5,000	5,000						

Note: The permanent accounts for Pioneer Advertising Agency Inc. are shown here; the temporary accounts are shown in Illustration 4-11. Both permanent and temporary accounts are part of the general ledger; we segregate them here to aid in learning.

The remaining accounts in the general ledger are temporary accounts, shown in Illustration 4-11. After Pioneer correctly posts the closing entries, each temporary account has a zero balance. These accounts are double-ruled to finalize the closing process.

Illustration 4-11
General ledger, temporary accounts

(Temporary Accounts Only)

GENERAL LEDGER											
Dividends No. 332						Insurance Expense No. 722					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 20		J1	500		500	Oct. 31	Adj. entry	J2	50		50
31	Closing entry	J3		500	-0-	31	Closing entry	J3		50	-0-
Income Summary No. 350						Salaries Expense No. 726					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 31	Closing entry	J3		10,600	10,600	Oct. 26		J1	4,000		4,000
31	Closing entry	J3	7,740		2,860	31	Adj. entry	J2	1,200		5,200
31	Closing entry	J3	2,860		-0-	31	Closing entry	J3		5,200	-0-
Service Revenue No. 400						Rent Expense No. 729					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 31		J1		10,000	10,000	Oct. 3		J1	900		900
31	Adj. entry	J2		400	10,400	31	Closing entry	J3		900	-0-
31	Adj. entry	J2		200	10,600						
31	Closing entry	J3	10,600		-0-						
Advertising Supplies Expense No. 631						Interest Expense No. 905					
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 31	Adj. entry	J2	1,500		1,500	Oct. 31	Adj. entry	J2	50		50
31	Closing entry	J3		1,500	-0-	31	Closing entry	J3		50	-0-
Depreciation Expense No. 711						<p><i>Note:</i> The temporary accounts for Pioneer Advertising Agency Inc. are shown here; Illustration 4-10 shows the permanent accounts. Both permanent and temporary accounts are part of the general ledger; we segregate them here to aid in learning.</p>					
Date	Explanation	Ref.	Debit	Credit	Balance						
2008											
Oct. 31	Adj. entry	J2	40		40						
31	Closing entry	J3		40	-0-						

SUMMARY OF THE ACCOUNTING CYCLE

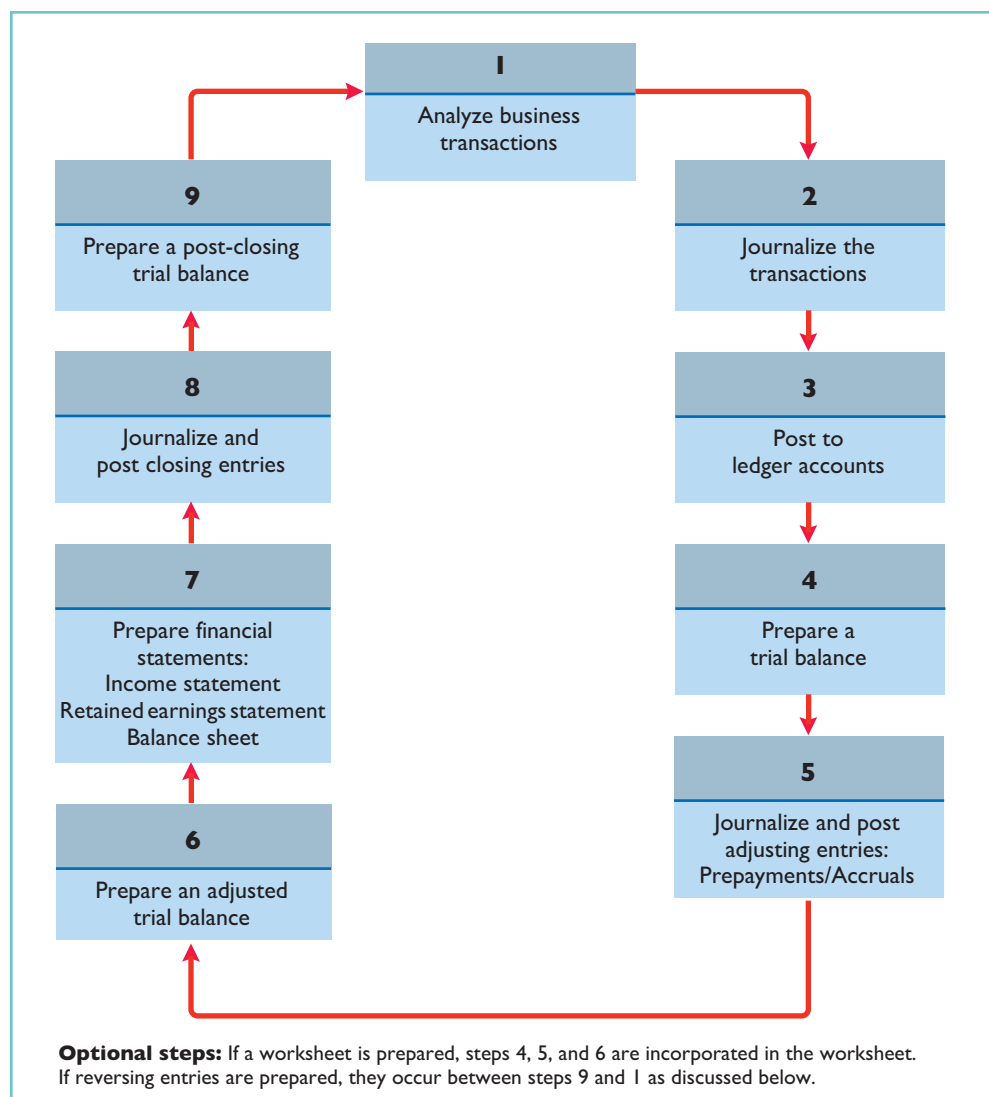
Illustration 4-12 (page 158) summarizes the steps in the accounting cycle. You can see that the cycle begins with the analysis of business transactions and ends with the preparation of a post-closing trial balance. Companies perform the steps in the cycle in sequence and repeat these steps in each accounting period.

Steps 1–3 may occur daily during the accounting period, as explained in Chapter 2. Companies perform Steps 4–7 on a periodic basis, such as monthly, quarterly, or annually. Steps 8 and 9—closing entries, and a post-closing trial balance—usually take place only at the end of a company’s **annual** accounting period.

STUDY OBJECTIVE 4

State the required steps in the accounting cycle.

Illustration 4-12
Steps in the accounting cycle



There are also two **optional steps** in the accounting cycle. As you have seen, companies may use a worksheet in preparing adjusting entries and financial statements. In addition, they may use reversing entries, as explained below.

Reversing Entries—An Optional Step

Some accountants prefer to reverse certain adjusting entries by making a **reversing entry** at the beginning of the next accounting period. A reversing entry is the exact opposite of the adjusting entry made in the previous period. **Use of reversing entries is an optional bookkeeping procedure; it is not a required step in the accounting cycle.** Accordingly, we have chosen to cover this topic in an appendix at the end of the chapter.

Correcting Entries—An Avoidable Step

STUDY OBJECTIVE 5

Explain the approaches to preparing correcting entries.

Unfortunately, errors may occur in the recording process. Companies should correct errors, **as soon as they discover them**, by journalizing and posting **correcting entries**. If the accounting records are free of errors, no correcting entries are needed.

You should recognize several differences between correcting entries and adjusting entries. First, adjusting entries are an integral part of the accounting cycle. Correcting entries, on the other hand, are unnecessary if the records are error-free. Second, companies journalize and post adjustments **only at the end of an accounting period**. In contrast, companies make correcting entries **whenever they discover an error**. Finally, adjusting entries always affect at least one balance sheet account and one income statement account. In contrast, correcting entries may involve any combination of accounts in need of correction. **Correcting entries must be posted before closing entries.**

To determine the correcting entry, it is useful to compare the incorrect entry with the correct entry. Doing so helps identify the accounts and amounts that should—and should not—be corrected. After comparison, the accountant makes an entry to correct the accounts. The following two cases for Mercato Co. illustrate this approach.

CASE 1

On May 10, Mercato Co. journalized and posted a \$50 cash collection on account from a customer as a debit to Cash \$50 and a credit to Service Revenue \$50. The company discovered the error on May 20, when the customer paid the remaining balance in full.

Incorrect Entry (May 10)			Correct Entry (May 10)		
Cash	50		Cash	50	
Service Revenue		50	Accounts Receivable		50

Illustration 4-13
Comparison of entries

Comparison of the incorrect entry with the correct entry reveals that the debit to Cash \$50 is correct. However, the \$50 credit to Service Revenue should have been credited to Accounts Receivable. As a result, both Service Revenue and Accounts Receivable are overstated in the ledger. Mercato makes the following correcting entry.

Correcting Entry					
May 20	Service Revenue		50		
	Accounts Receivable				50
	(To correct entry of May 10)				

Illustration 4-14
Correcting entry

A	=	L	+	SE
				–50 Rev
–50				

Cash Flows
no effect

CASE 2

On May 18, Mercato purchased on account office equipment costing \$450. The transaction was journalized and posted as a debit to Delivery Equipment \$45 and a credit to Accounts Payable \$45. The error was discovered on June 3, when Mercato received the monthly statement for May from the creditor.

Incorrect Entry (May 18)			Correct Entry (May 18)		
Delivery Equipment	45		Office Equipment	450	
Accounts Payable		45	Accounts Payable		450

Illustration 4-15
Comparison of entries

ETHICS NOTE



When companies find errors in previously released income statements, they restate those numbers. Perhaps because of the increased scrutiny caused by Sarbanes-Oxley, in 2005 companies filed a record 1,195 restatements.

Comparison of the two entries shows that three accounts are incorrect. Delivery Equipment is overstated \$45; Office Equipment is understated \$450; and Accounts Payable is understated \$405. Mercato makes the following correcting entry.

Illustration 4-16

Correcting entry

A	=	L	+	SE
+450				
-45				
				+405

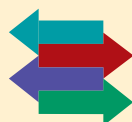
Cash Flows

no effect

Correcting Entry			
June 3	Office Equipment	450	
	Delivery Equipment		45
	Accounts Payable		405
	(To correct entry of May 18)		

Instead of preparing a correcting entry, **it is possible to reverse the incorrect entry and then prepare the correct entry.** This approach will result in more entries and postings than a correcting entry, but it will accomplish the desired result.

ACCOUNTING ACROSS THE ORGANIZATION



Yale Express Loses Some Transportation Bills

Yale Express, a short-haul trucking firm, turned over much of its cargo to local truckers to complete deliveries. Yale collected the entire delivery charge; when billed by the local trucker, Yale sent payment for the final phase to the local trucker. Yale used a cutoff period of 20 days into the next accounting period in making its adjusting entries for accrued liabilities. That is, it waited 20 days to receive the local truckers' bills to determine the amount of the unpaid but incurred delivery charges as of the balance sheet date.

On the other hand, **Republic Carloading**, a nationwide, long-distance freight forwarder, frequently did not receive transportation bills from truckers to whom it passed on cargo until months after the year-end. In making its year-end adjusting entries, Republic waited for months in order to include all of these outstanding transportation bills.

When Yale Express merged with Republic Carloading, Yale's vice president employed the 20-day cutoff procedure for both firms. As a result, millions of dollars of Republic's accrued transportation bills went unrecorded. When the company detected the error and made correcting entries, these and other errors changed a reported profit of \$1.14 million into a loss of \$1.88 million!



What might Yale Express's vice president have done to produce more accurate financial statements without waiting months for Republic's outstanding transportation bills?

Before You Go On...

REVIEW IT

1. How do permanent accounts differ from temporary accounts?
2. What four different types of entries do companies make in closing the books?
3. What are the content and purpose of a post-closing trial balance?
4. What are the required and optional steps in the accounting cycle?

DO IT

The worksheet for Hancock Company shows the following in the financial statement columns:

Dividends \$15,000
Common Stock \$42,000
Net income \$18,000

Prepare the closing entries at December 31 that affect owner's capital.

Action Plan

- Remember to make closing entries in the correct sequence.
- Make the first two entries to close revenues and expenses.
- Make the third entry to close net income to retained earnings.
- Make the final entry to close dividends to retained earnings.

Solution

Dec. 31	Income Summary	18,000	
	Retained Earnings		18,000
	(To close net income to retained earnings)		
31	Retained Earnings	15,000	
	Dividends		15,000
	(To close dividends to retained earnings)		

Related exercise material: BE4-4, BE4-5, BE4-6, BE4-7, BE4-8, E4-4, E4-7, E4-8, E4-10, and E4-11.



THE CLASSIFIED BALANCE SHEET

The balance sheet presents a snapshot of a company's financial position at a point in time. To improve users' understanding of a company's financial position, companies often group similar assets and similar liabilities together. This is useful because it tells you that items within a group have similar economic characteristics. A **classified balance sheet** generally contains the standard classifications listed in Illustration 4-17.

STUDY OBJECTIVE 6

Identify the sections of a classified balance sheet.

<u>Assets</u>	<u>Liabilities and Owner's Equity</u>
Current assets	Current liabilities
Long-term investments	Long-term liabilities
Property, plant, and equipment	Stockholders' equity
Intangible assets	

Illustration 4-17
Standard balance sheet classifications

These groupings help readers determine such things as (1) whether the company has enough assets to pay its debts as they come due, and (2) the claims of short- and long-term creditors on the company's total assets. Many of these groupings can be seen in the balance sheet of Franklin Corporation shown in Illustration 4-18 (page 162). In the sections that follow, we explain each of these groupings.

Current Assets

Current assets are assets that a company expects to convert to cash or use up within one year. In Illustration 4-18, Franklin Corporation had current assets of \$22,100. For most businesses the cutoff for classification as current assets is one year from the balance sheet date. For example, accounts receivable are current assets because the company will collect them and convert them to cash within one year. Supplies is a current asset because the company expects to use it up in operations within one year.

Illustration 4-18
Classified balance sheet

FRANKLIN CORPORATION				
Balance Sheet October 31, 2008				
<u>Assets</u>				
Current assets				
Cash		\$ 6,600		
Short-term investments		2,000		
Accounts receivable		7,000		
Notes receivable		1,000		
Inventories		3,000		
Supplies		2,100		
Prepaid insurance		400		
Total current assets				\$22,100
Long-term investments				
Investment in stock of Walters Corp.		5,200		
Investment in real estate		2,000		7,200
Property, plant, and equipment				
Land		10,000		
Office equipment	\$24,000			
Less: Accumulated depreciation	5,000	19,000		29,000
Intangible assets				
Patents				3,100
Total assets				\$61,400
<u>Liabilities and Stockholders' Equity</u>				
Current liabilities				
Notes payable		\$11,000		
Accounts payable		2,100		
Salaries payable		1,600		
Unearned revenue		900		
Interest payable		450		
Total current liabilities				\$16,050
Long-term liabilities				
Mortgage note payable		10,000		
Notes payable		1,300		
Total long-term liabilities				11,300
Total liabilities				27,350
Stockholders' equity				
Common stock		20,000		
Retained earnings		14,050		
Total stockholders' equity				34,050
Total liabilities and stockholders' equity				\$61,400

HELPFUL HINT

Recall that the accounting equation is **Assets = Liabilities + Stockholders' Equity**.

Some companies use a period longer than one year to classify assets and liabilities as current because they have an operating cycle longer than one year. The **operating cycle** of a company is the average time that it takes to purchase inventory, sell it on account, and then collect cash from customers. For most businesses this cycle takes less than a year, so they use a one-year cutoff. But, for some businesses, such as vineyards or airplane manufacturers, this period may be longer than a year. **Except where noted, we will assume that companies use one year to determine whether an asset or liability is current or long-term.**

Common types of current assets are (1) cash, (2) short-term investments (such as short-term U.S. government securities), (3) receivables (notes receivable, accounts receivable, and interest receivable), (4) inventories, and (5) prepaid expenses (insurance and supplies). **On the balance sheet, companies usually list these items in the order in which they expect to convert them into cash.**

Illustration 4-19 presents the current assets of **The Coca-Cola Company**.

THE COCA-COLA COMPANY		
Balance Sheet (partial)		
(in millions)		
Current assets		
Cash and cash equivalents		\$ 6,707
Short-term investments		61
Trade accounts receivable		2,171
Inventories		1,420
Prepaid expenses and other assets		1,735
Total current assets		<u>\$12,094</u>

Illustration 4-19
Current assets section

As explained later in the chapter, a company's current assets are important in assessing its short-term debt-paying ability.

Long-Term Investments

Long-term investments are generally investments in stocks and bonds of other companies that are normally held for many years. This category also includes investments in long-term assets such as land or buildings that a company is not currently using in its operating activities. In Illustration 4-18 Franklin Corporation reported total long-term investments of \$7,200 on its balance sheet.

Yahoo! Inc. reported long-term investments in its balance sheet as shown in Illustration 4-20.

ALTERNATIVE TERMINOLOGY

Long-term investments are often referred to simply as *investments*.

	
YAHOO! INC.	
Balance Sheet (partial)	
(in thousands)	
Long-term investments	
Long-term marketable debt securities	\$1,042,575

Illustration 4-20
Long-term investments section

Property, Plant, and Equipment

ALTERNATIVE TERMINOLOGY

Property, plant, and equipment is sometimes called *fixed assets*.

Property, plant, and equipment are assets with relatively long useful lives that a company is currently using in operating the business. This category includes land, buildings, machinery and equipment, delivery equipment, and furniture. In Illustration 4-18 Franklin Corporation reported property, plant, and equipment of \$29,000.

Depreciation is the practice of allocating the cost of assets to a number of years. Companies do this by systematically assigning a portion of an asset's cost as an expense each year (rather than expensing the full purchase price in the year of purchase). The assets that the company depreciates are reported on the balance sheet at cost less accumulated depreciation. The **accumulated depreciation** account shows the total amount of depreciation that the company has expensed thus far in the asset's life. In Illustration 4-18 Franklin Corporation reported accumulated depreciation of \$5,000.

Illustration 4-21 presents the property, plant, and equipment of ski and sporting goods manufacturer **K2, Inc.**

Illustration 4-21
Property, plant, and
equipment section



K2, INC.

Balance Sheet (partial)
(in thousands)

Property, plant, and equipment

Land and land improvements	\$ 6,794	
Buildings and leasehold improvements	55,900	
Machinery and equipment	204,651	
Construction in process	5,614	\$272,959
Less: Accumulated depreciation		<u>131,995</u>
		\$140,964

Intangible Assets

HELPFUL HINT

Sometimes intangible assets are reported under a broader heading called "*Other assets*."

Many companies have assets that do not have physical substance yet often are very valuable. We call these assets **intangible assets**. One common intangible asset is goodwill. Other intangibles include patents, copyrights, and trademarks or trade names that give the company **exclusive right** of use for a specified period of time. Franklin Corporation reported intangible assets of \$3,100.

Illustration 4-22 shows how media giant **Time Warner, Inc.** reported its intangible assets.

Illustration 4-22
Intangible assets section



TIME WARNER, INC.

Balance Sheet (partial)
(in millions)

Intangible assets

Film library	\$ 3,361	
Customer lists	868	
Cable television franchises	29,751	
Sports franchises	262	
Brands, trademarks, and other intangible assets	9,643	<u>\$43,885</u>

INTERNATIONAL INSIGHT



Big Changes Are Coming to Chinese Balance Sheets

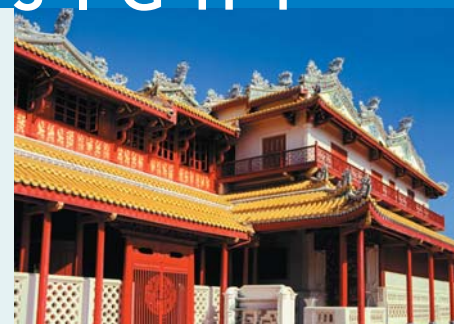
Beginning in 2007 many Chinese companies will be following International Financial Reporting Standards to prepare financial statements. Many people say that the largest change will occur on Chinese balance sheets. The new standards will require the companies to report a market value for many assets, including things like plant and equipment. (This, of course, is not in accordance with the cost principle, which U.S. GAAP follows.)

Chinese authorities hope that adopting international standards will give investors more confidence in the validity of Chinese financial reports.

Source: James T. Areddy, "Adding Up Chinese Data", *Wall Street Journal*, February 27, 2006, p. C10.



What are the potential benefits and challenges presented by reporting assets like plant and equipment at their market value rather than historical cost?



Current Liabilities

In the liabilities and stockholders' equity section of the balance sheet, the first grouping is current liabilities. **Current liabilities** are obligations that the company is to pay within the coming year. Common examples are accounts payable, wages payable, bank loans payable, interest payable, and taxes payable. Also included as current liabilities are current maturities of long-term obligations—payments to be made within the next year on long-term obligations. In Illustration 4-18 Franklin Corporation reported five different types of current liabilities, for a total of \$16,050.

Within the current liabilities section, companies usually list notes payable first, followed by accounts payable. Other items then follow in the order of their magnitude. *In your homework, you should present notes payable first, followed by accounts payable, and then other liabilities in order of magnitude.*

Illustration 4-23 shows the current liabilities section adapted from the balance sheet of **Marcus Corporation**.



MARCUS CORPORATION

Balance Sheet (partial)
(in thousands)

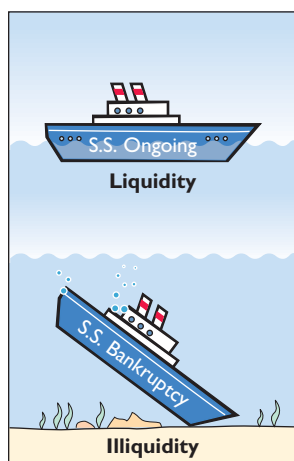
Current liabilities

Notes payable	\$ 2,066
Accounts payable	17,516
Current maturities of long-term debt	26,321
Taxes payable	14,889
Other current liabilities	14,809
Accrued compensation payable	8,614
Total current liabilities	<u>\$84,215</u>

Illustration 4-23

Current liabilities section

Users of financial statements look closely at the relationship between current assets and current liabilities. This relationship is important in evaluating a company's



liquidity—its ability to pay obligations expected to be due within the next year. When current assets exceed current liabilities at the balance sheet date, the likelihood for paying the liabilities is favorable. When the reverse is true, short-term creditors may not be paid, and the company may ultimately be forced into bankruptcy.

Long-Term Liabilities

Long-term liabilities are obligations that a company expects to pay **after** one year. Liabilities in this category include bonds payable, mortgages payable, long-term notes payable, lease liabilities, and pension liabilities. Many companies report long-term debt maturing after one year as a single amount in the balance sheet and show the details of the debt in notes that accompany the financial statements. Others list the various types of long-term liabilities. In Illustration 4-18 Franklin Corporation reported long-term liabilities of \$11,300. *In your homework, list long-term liabilities in the order of their magnitude.*

Illustration 4-24 shows the long-term liabilities that **Northwest Airlines Corporation** reported in its balance sheet.

Illustration 4-24
Long-term liabilities section



NORTHWEST AIRLINES CORPORATION

Balance Sheet (partial)
(in millions)

Long-term liabilities

Long-term debt	\$ 7,715
Other liabilities	4,346
Long-term obligations under capital leases	308
Total long-term liabilities	<u>\$12,369</u>

Stockholders' (Owners') Equity

The content of the owners' equity section varies with the form of business organization. In a proprietorship, there is one capital account. In a partnership, there is a capital account for each partner. Corporations divide owners' equity into two accounts—Common Stock and Retained Earnings. Corporations record stockholders' investments in the company by debiting an asset account and crediting the Common Stock account. They record in the Retained Earnings account income retained for use in the business. Corporations combine the Common Stock and Retained Earnings accounts and report them on the balance sheet as **stockholders' equity**. (We'll learn more about these corporation accounts in later chapters.) **Nordstrom, Inc.** recently reported its stockholders' equity section as follows.

Illustration 4-25
Stockholders' equity section



NORDSTROM, INC.

Balance Sheet (partial)
(\$ in thousands)

Stockholders' equity

Common stock, 271,331 shares	\$ 685,934
Retained earnings	1,406,747
Total stockholders' equity	<u>\$2,092,681</u>



Be sure to read **ALL ABOUT YOU: Your Personal Balance Sheet** on the next page for information on how topics in this chapter apply to you.

Your Personal Balance Sheet

By now you should be pretty comfortable with how to prepare a company's balance sheet. Maybe it is time for us to look at your personal financial position.

What are your personal assets? These are the items of value that you own. Some of your assets are *liquid*—cash or items that are easily converted to cash. Others, like cars, real estate, and some types of investments, are less liquid. Some assets, like houses and investments, tend to rise in value over time, which increases your net worth. Other assets, such as cars, tend to fall in value over time, decreasing your net worth.

What are your personal liabilities—the amounts that you owe to others? Student loans, car loans, credit card bills, and amounts owed to relatives are all personal liabilities. These liabilities are either current (to be repaid within 12 months) or long-term.

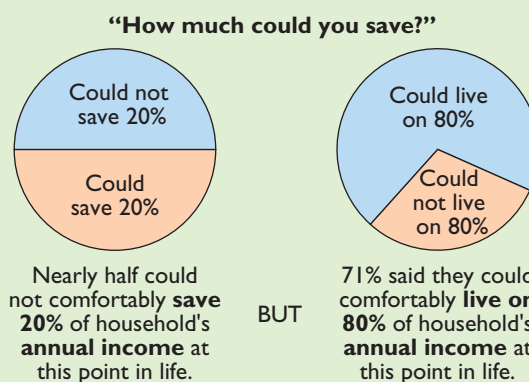
The difference between your assets and liabilities is, to use the terminology of the accounting equation, your “owner's equity.” In personal finance terminology, this is your *net worth*. Having a high net worth does not guarantee happiness—but most believe that it is better than being broke. By monitoring your personal balance sheet, you can begin to take control of your financial future.

Some Facts

- * 48% of Americans think they know how much wealth they have.
- * 2005 was the first year since the Depression when Americans spent more money than they made.
- * The total net worth of U.S. households hit a record of \$51.09 trillion during 2005.
- * Economists note that a rise in house prices actually results in a fall in individual savings. It has been documented that a \$1,000 rise in the value of a home results in a \$50 fall in savings per year, presumably because homeowners feel more wealthy and therefore spend more (save less).
- * When asked about very important wealth-building strategies for all Americans, 16% said “win the lottery.”

About the Numbers

Your ability to make good financial decisions is often influenced by your attitudes toward saving versus spending. The authors of a recent study conclude that “people commonly fall prey to psychologically driven impulses that affect their financial decisions.” For example, when individuals were asked whether could they save 20% of their household income, nearly half said they couldn't. But, when asked if they could spend less, well more than half (71%) said they could live comfortably on 80% of their income. This clearly is inconsistent thinking: If you can live on 80% of your current income, you can save 20% of your current income.



Source: Northwestern Mutual Life, www.nmfn.com/contentassets/pdfs/fin_misbehav.pdf, p. 6.

What Do You Think?

Should you prepare a personal balance sheet?

YES: In order to attain your desired financial objectives, you need to set goals early. The personal balance sheet provides a benchmark by which you can measure progress toward your financial goals. You need to do it now so that you begin to develop good financial habits. It provides a mechanism so that you don't allow your finances to get too “out-of-whack” while you are in school. That is, you don't want to dig too deep a hole.

NO: Your financial situation right now bears very little resemblance to what it will look like after you graduate. At that point, you will have a better job, and you won't have to pay tuition. Right now, you're just “bleeding cash.”

Sources: Andrew Blackman, “How to Calculate Your Savings Rate; For Americans in 2005, Earnings Didn't Keep Pace with Boom in Spending,” *Wall Street Journal*, January 3, 2006, p. D2; “Financial Planners Share Views on Saving,” Consumer Federation of America and Financial Planning Association, January 2006.



Before You Go On...

REVIEW IT

1. What are the major sections in a classified balance sheet?
2. Using the **PepsiCo** annual report, determine its current liabilities at December 31, 2005, and December 25, 2004. Were current liabilities higher or lower than current assets in these two years? The answer to this question appears on page 193.



Demonstration Problem



At the end of its first month of operations, Watson Answering Service Inc. has the following unadjusted trial balance.

WATSON ANSWERING SERVICE INC.

August 31, 2008

Trial Balance

	Debit	Credit
Cash	\$ 5,400	
Accounts Receivable	2,800	
Prepaid Insurance	2,400	
Supplies	1,300	
Equipment	60,000	
Notes Payable		\$40,000
Accounts Payable		2,400
Common Stock		30,000
Dividends	1,000	
Service Revenue		4,900
Salaries Expense	3,200	
Utilities Expense	800	
Advertising Expense	400	
	<u>\$77,300</u>	<u>\$77,300</u>

action plan

✓ In completing the worksheet, be sure to
(a) key the adjustments;
(b) start at the top of the adjusted trial balance columns and extend adjusted balances to the correct statement columns; and (c) enter net income (or net loss) in the proper columns.

✓ In preparing a classified balance sheet, know the contents of each of the sections.

✓ In journalizing closing entries, remember that there are only four entries and that Dividends are closed to Retained Earnings.

Other data:

1. Insurance expires at the rate of \$200 per month.
2. \$1,000 of supplies are on hand at August 31.
3. Monthly depreciation on the equipment is \$900.
4. Interest of \$500 on the notes payable has accrued during August.

Instructions

- (a) Prepare a worksheet.
- (b) Prepare a classified balance sheet assuming \$35,000 of the notes payable are long-term.
- (c) Journalize the closing entries.

Solution

(a)

WATSON ANSWERING SERVICE INC.

 Worksheet
 For the Month Ended August 31, 2008

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	5,400				5,400				5,400	
Accounts Receivable	2,800				2,800				2,800	
Supplies	1,300			(b) 300	1,000				1,000	
Prepaid Insurance	2,400			(a) 200	2,200				2,200	
Equipment	60,000				60,000				60,000	
Notes Payable		40,000				40,000				40,000
Accounts Payable		2,400				2,400				2,400
Common Stock		30,000				30,000				30,000
Dividends	1,000				1,000				1,000	
Service Revenue		4,900				4,900	4,900			
Salaries Expense	3,200				3,200		3,200			
Utilities Expense	800				800		800			
Advertising Expense	400				400		400			
Totals	<u>77,300</u>	<u>77,300</u>								
Insurance Expense			(a) 200		200		200			
Supplies Expense			(b) 300		300		300			
Depreciation Expense			(c) 900		900		900			
Accumulated Depreciation— Equipment				(c) 900		900				900
Interest Expense			(d) 500		500		500			
Interest Payable				(d) 500		500				500
Totals			<u>1,900</u>	<u>1,900</u>	<u>78,700</u>	<u>78,700</u>	<u>6,300</u>	<u>4,900</u>	<u>72,400</u>	<u>73,800</u>
Net Loss								1,400	1,400	
Totals							<u>6,300</u>	<u>6,300</u>	<u>73,800</u>	<u>73,800</u>

Explanation: (a) Insurance expired, (b) Supplies used, (c) Depreciation expensed, (d) Interest accrued.

(b)

WATSON ANSWERING SERVICE INC.

 Balance Sheet
 August 31, 2008

Assets

Current assets		
Cash	\$ 5,400	
Accounts receivable	2,800	
Supplies	1,000	
Prepaid insurance	<u>2,200</u>	
Total current assets		\$11,400
Property, plant, and equipment		
Equipment	60,000	
Less: Accumulated depreciation—equipment	<u>900</u>	<u>59,100</u>
Total assets		<u>\$70,500</u>

Liabilities and Stockholders' Equity

Current liabilities		
Notes payable	\$ 5,000	
Accounts payable	2,400	
Interest payable	500	
Total current liabilities		\$7,900
Long-term liabilities		
Notes payable		35,000
Total liabilities		42,900
Stockholders' equity		
Common stock	30,000	
Retained earnings	(2,400)*	
Total stockholders' equity		27,600
Total liabilities and stockholders' equity		<u>\$70,500</u>

*Net loss of \$1,400 plus dividends of \$1,000.

(c)	Aug. 31	Service Revenue	4,900	
		Income Summary		4,900
		(To close revenue account)		
		31	Income Summary	6,300
		Salaries Expense		3,200
		Depreciation Expense		900
		Utilities Expense		800
		Interest Expense		500
		Advertising Expense		400
		Supplies Expense		300
		Insurance Expense		200
		(To close expense accounts)		
		31	Retained Earnings	1,400
		Income Summary		1,400
		(To close net loss to retained earnings)		
		31	Retained Earnings	1,000
		Dividends		1,000
		(To close dividends to retained earnings)		



SUMMARY OF STUDY OBJECTIVES



- 1 Prepare a worksheet.** The steps in preparing a worksheet are: (a) Prepare a trial balance on the worksheet. (b) Enter the adjustments in the adjustments columns. (c) Enter adjusted balances in the adjusted trial balance columns. (d) Extend adjusted trial balance amounts to appropriate financial statement columns. (e) Total the statement columns, compute net income (or net loss), and complete the worksheet.
- 2 Explain the process of closing the books.** Closing the books occurs at the end of an accounting period. The process is to journalize and post closing entries and then rule and balance all accounts. In closing the books, companies make separate entries to close revenues and expenses to Income Summary, Income Summary to Retained Earnings, and Dividends to Retained Earnings. Only temporary accounts are closed.
- 3 Describe the content and purpose of a post-closing trial balance.** A post-closing trial balance contains the balances in permanent accounts that are carried forward to the next accounting period. The purpose of this trial balance is to prove the equality of these balances.
- 4 State the required steps in the accounting cycle.** The required steps in the accounting cycle are: (1) analyze business transactions, (2) journalize the transactions, (3) post to ledger accounts, (4) prepare a trial balance, (5) journalize and post adjusting entries, (6) prepare an adjusted trial balance, (7) prepare financial statements, (8) journalize and post closing entries, and (9) prepare a post-closing trial balance.
- 5 Explain the approaches to preparing correcting entries.** One way to determine the correcting entry is to compare the incorrect entry with the correct entry. After comparison, the

company makes a correcting entry to correct the accounts. An alternative to a correcting entry is to reverse the incorrect entry and then prepare the correct entry.

- 6 Identify the sections of a classified balance sheet.** A classified balance sheet categorizes assets as current assets;

long-term investments; property, plant, and equipment; and intangibles. Liabilities are classified as either current or long-term. There is also a stockholders' (owners') equity section, which varies with the form of business organization.



GLOSSARY



Classified balance sheet A balance sheet that contains a number of standard classifications or sections. (p. 161).

Closing entries Entries made at the end of an accounting period to transfer the balances of temporary accounts to a permanent stockholders' equity account, Retained Earnings. (p. 151).

Correcting entries Entries to correct errors made in recording transactions. (p. 158).

Current assets Assets that a company expects to convert to cash or use up within one year. (p. 162).

Current liabilities Obligations that a company expects to pay from existing current assets within the coming year. (p. 165).

Income Summary A temporary account used in closing revenue and expense accounts. (p. 151).

Intangible assets Noncurrent assets that do not have physical substance. (p. 164).

Liquidity The ability of a company to pay obligations expected to be due within the next year. (p. 166).

Long-term investments Generally, investments in stocks and bonds of other companies that companies normally hold for many years. Also includes long-term assets, such as land and buildings, not currently being used in operations. (p. 163).

Long-term liabilities Obligations that a company expects to pay after one year. (p. 166).

Operating cycle The average time that it takes to go from cash to cash in producing revenues. (p. 163).

Permanent (real) accounts Accounts that relate to one or more accounting periods. Consist of all balance sheet accounts. Balances are carried forward to next accounting period. (p. 150).

Post-closing trial balance A list of permanent accounts and their balances after a company has journalized and posted closing entries. (p. 155).

Property, plant, and equipment Assets with relatively long useful lives, currently being used in operations. (p. 164).

Reversing entry An entry, made at the beginning of the next accounting period, that is the exact opposite of the adjusting entry made in the previous period. (p. 158).

Stockholders' equity The ownership claim of shareholders on total assets. It is to a corporation what owner's equity is to a proprietorship. (p. 166).

Temporary (nominal) accounts Accounts that relate only to a given accounting period. Consist of all income statement accounts and the Dividends account. All temporary accounts are closed at end of accounting period. (p. 150).

Worksheet A multiple-column form that may be used in making adjusting entries and in preparing financial statements. (p. 144).

APPENDIX Reversing Entries

After preparing the financial statements and closing the books, it is often helpful to reverse some of the adjusting entries before recording the regular transactions of the next period. Such entries are **reversing entries**. Companies make **a reversing entry at the beginning of the next accounting period**. Each reversing entry **is the exact opposite of the adjusting entry made in the previous period**. The recording of reversing entries is an **optional step** in the accounting cycle.

The purpose of reversing entries is to simplify the recording of a subsequent transaction related to an adjusting entry. For example, in Chapter 3 (page 109), the payment of salaries after an adjusting entry resulted in two debits: one to Salaries Payable and the other to Salaries Expense. With reversing entries, the company can debit the entire subsequent payment to Salaries Expense. **The use of reversing entries does not change the amounts reported in the financial statements.** What it does is simplify the recording of subsequent transactions.

STUDY OBJECTIVE 7

Prepare reversing entries.

Reversing Entries Example

Companies most often use reversing entries to reverse two types of adjusting entries: accrued revenues and accrued expenses. To illustrate the optional use of reversing entries for accrued expenses, we will use the salaries expense transactions for Pioneer Advertising Agency Inc. The transaction and adjustment data are as follows.

1. October 26 (initial salary entry): Pioneer pays \$4,000 of salaries earned between October 15 and October 26.
2. October 31 (adjusting entry): Salaries earned between October 29 and October 31 are \$1,200. The company will pay these in the November 9 payroll.
3. November 9 (subsequent salary entry): Salaries paid are \$4,000. Of this amount, \$1,200 applied to accrued wages payable and \$2,800 was earned between November 1 and November 9.

Illustration 4A-1 shows the entries with and without reversing entries.

Illustration 4A-1

Comparative entries—not reversing vs. reversing

Without Reversing Entries (per chapter)				With Reversing Entries (per appendix)			
<u>Initial Salary Entry</u>				<u>Initial Salary Entry</u>			
Oct. 26	Salaries Expense	4,000		Oct. 26	(Same entry)		
	Cash		4,000				
<u>Adjusting Entry</u>				<u>Adjusting Entry</u>			
Oct. 31	Salaries Expense	1,200		Oct. 31	(Same entry)		
	Salaries Payable		1,200				
<u>Closing Entry</u>				<u>Closing Entry</u>			
Oct. 31	Income Summary	5,200		Oct. 31	(Same entry)		
	Salaries Expense		5,200				
<u>Reversing Entry</u>				<u>Reversing Entry</u>			
Nov. 1	No reversing entry is made.			Nov. 1	Salaries Payable	1,200	
					Salaries Expense		1,200
<u>Subsequent Salary Entry</u>				<u>Subsequent Salary Entry</u>			
Nov. 9	Salaries Payable	1,200		Nov. 9	Salaries Expense	4,000	
	Salaries Expense	2,800			Cash		4,000
	Cash		4,000				

The first three entries are the same whether or not Pioneer uses reversing entries. The last two entries are different. The November 1 **reversing entry** eliminates the \$1,200 balance in Salaries Payable created by the October 31 adjusting entry. The reversing entry also creates a \$1,200 credit balance in the Salaries Expense account. As you know, it is unusual for an expense account to have a credit balance. The balance is correct in this instance, though, because it anticipates that the entire amount of the first salary payment in the new accounting period will be debited to Salaries Expense. This debit will eliminate the credit balance. The resulting debit balance in the expense account will equal the salaries expense incurred in the new accounting period (\$2,800 in this example).

If Pioneer makes reversing entries, it can debit all cash payments of expenses to the expense account. This means that on November 9 (and every payday) Pioneer can debit Salaries Expense for the amount paid, without regard to any accrued salaries payable. Being able to make the **same entry each time** simplifies the recording process: The company can record subsequent transactions as if the related adjusting entry had never been made.

Illustration 4A-2 shows the posting of the entries with reversing entries.

Illustration 4A-2
Postings with reversing entries

Salaries Expense				Salaries Payable			
10/26 Paid	4,000	10/31 Closing	5,200	11/1 Reversing	1,200	10/31 Adjusting	1,200
31 Adjusting	1,200						
	5,200		5,200				
11/9 Paid	4,000	11/1 Reversing	1,200				

A company can also use reversing entries for accrued revenue adjusting entries. For Pioneer Advertising, the adjusting entry was: Accounts Receivable (Dr.) \$200 and Service Revenue (Cr.) \$200. Thus, the reversing entry on November 1 is:

Nov. 1	Service Revenue	200	
	Accounts Receivable		200
	(To reverse October 31 adjusting entry)		

A	=	L	+	SE
-200				-200 Rev

Cash Flows
no effect

When Pioneer collects the accrued service revenue, it debits Cash and credits Service Revenue.

SUMMARY OF STUDY OBJECTIVE FOR APPENDIX



7 Prepare reversing entries. Reversing entries are the opposite of the adjusting entries made in the preceding period. Some companies choose to make reversing entries at the beginning of a new accounting period to simplify the

recording of later transactions related to the adjusting entries. In most cases, only accrued adjusting entries are reversed.

***Note:** All asterisked Questions, Exercises, and Problems relate to material in the appendix to the chapter.

SELF-STUDY QUESTIONS



Answers are at the end of the chapter.

(SO 1)

- Which of the following statements is *incorrect* concerning the worksheet?
 - The worksheet is essentially a working tool of the accountant.
 - The worksheet is distributed to management and other interested parties.
 - The worksheet cannot be used as a basis for posting to ledger accounts.
 - Financial statements can be prepared directly from the worksheet before journalizing and posting the adjusting entries.

- In a worksheet, net income is entered in the following (SO 1) columns:
 - income statement (Dr) and balance sheet (Dr).
 - income statement (Cr) and balance sheet (Dr).
 - income statement (Dr) and balance sheet (Cr).
 - income statement (Cr) and balance sheet (Cr).
- An account that will have a zero balance after closing (SO 2) entries have been journalized and posted is:
 - Service Revenue.
 - Advertising Supplies.
 - Prepaid Insurance.
 - Accumulated Depreciation.

- (SO 2) 4. When a net loss has occurred, Income Summary is:
 a. debited and Retained Earnings is credited.
 b. credited and Retained Earnings is debited.
 c. debited and Common Stock is credited.
 d. credited and Common Stock is debited.
- (SO 2) 5. The closing process involves separate entries to close (1) expenses, (2) dividends, (3) revenues, and (4) income summary. The correct sequencing of the entries is:
 a. (4), (3), (2), (1)
 b. (1), (2), (3), (4)
 c. (3), (1), (4), (2)
 d. (3), (2), (1), (4)
- (SO 3) 6. Which types of accounts will appear in the post-closing trial balance?
 a. Permanent (real) accounts.
 b. Temporary (nominal) accounts.
 c. Accounts shown in the income statement columns of a work sheet.
 d. None of the above.
- (SO 4) 7. All of the following are required steps in the accounting cycle *except*:
 a. journalizing and posting closing entries.
 b. preparing financial statements.
 c. journalizing the transactions.
 d. preparing a work sheet.
- (SO 5) 8. Cash of \$100 received at the time the service was provided was journalized and posted as a debit to Cash \$100 and a credit to Accounts Receivable \$100. Assuming the incorrect entry is not reversed, the correcting entry is:
 a. debit Service Revenue \$100 and credit Accounts Receivable \$100.
 b. debit Accounts Receivable \$100 and credit Service Revenue \$100.
 c. debit Cash \$100 and credit Service Revenue \$100.
 d. debit Accounts Receivable \$100 and credit Cash \$100.
9. In a classified balance sheet, assets are usually classified using the following categories:
 a. current assets; long-term assets; property, plant, and equipment; and intangible assets.
 b. current assets; long-term investments; property, plant, and equipment; and other assets.
 c. current assets; long-term investments; tangible assets; and intangible assets.
 d. current assets; long-term investments; property, plant, and equipment; and intangible assets.
10. Current assets are listed:
 a. by liquidity.
 b. by importance.
 c. by longevity.
 d. alphabetically.
- *11. On December 31, Frank Voris Company correctly made an adjusting entry to recognize \$2,000 of accrued salaries payable. On January 8 of the next year, total salaries of \$3,400 were paid. Assuming the correct reversing entry was made on January 1, the entry on January 8 will result in a credit to Cash \$3,400 and the following debit(s):
 a. Salaries Payable \$1,400, and Salaries Expense \$2,000.
 b. Salaries Payable \$2,000 and Salaries Expense \$1,400.
 c. Salaries Expense \$3,400.
 d. Salaries Payable \$3,400.

Go to the book's website,
www.wiley.com/college/weygandt,
 for Additional Self-Study questions.



QUESTIONS

1. "A worksheet is a permanent accounting record and its use is required in the accounting cycle." Do you agree? Explain.
2. Explain the purpose of the worksheet.
3. What is the relationship, if any, between the amount shown in the adjusted trial balance column for an account and that account's ledger balance?
4. If a company's revenues are \$125,000 and its expenses are \$113,000, in which financial statement columns of the worksheet will the net income of \$12,000 appear? When expenses exceed revenues, in which columns will the difference appear?
5. Why is it necessary to prepare formal financial statements if all of the data are in the statement columns of the worksheet?
6. Identify the account(s) debited and credited in each of the four closing entries, assuming the company has net income for the year.
7. Describe the nature of the Income Summary account and identify the types of summary data that may be posted to this account.
8. What are the content and purpose of a post-closing trial balance?
9. Which of the following accounts would not appear in the post-closing trial balance? Interest Payable; Equipment; Depreciation Expense; Dividends; Unearned Revenue; Accumulated Depreciation—Equipment; and Service Revenue.
10. Distinguish between a reversing entry and an adjusting entry. Are reversing entries required?
11. Indicate, in the sequence in which they are made, the three required steps in the accounting cycle that involve journalizing.
12. Identify, in the sequence in which they are prepared, the three trial balances that are often used to report financial information about a company.
13. How do correcting entries differ from adjusting entries?
14. What standard classifications are used in preparing a classified balance sheet?
15. What is meant by the term "operating cycle?"
16. Define current assets. What basis is used for arranging individual items within the current assets section?

17. Distinguish between long-term investments and property, plant, and equipment.
18. (a) What is the term used to describe the owner's equity section of a corporation? (b) Identify the two owners' equity accounts in a corporation and indicate the purpose of each.
- *19. Sanchez Company prepares reversing entries. If the adjusting entry for interest payable is reversed, what type of an account balance, if any, will there be in Interest Payable and Interest Expense after the reversing entry is posted?
- *20. At December 31, accrued salaries payable totaled \$3,500. On January 10, total salaries of \$8,000 are paid. (a) Assume that reversing entries are made at January 1. Give the January 10 entry, and indicate the Salaries Expense account balance after the entry is posted. (b) Repeat part (a) assuming reversing entries are not made.

BRIEF EXERCISES



BE4-1 The steps in using a worksheet are presented in random order below. List the steps in the proper order by placing numbers 1–5 in the blank spaces.

- (a) _____ Prepare a trial balance on the worksheet.
- (b) _____ Enter adjusted balances.
- (c) _____ Extend adjusted balances to appropriate statement columns.
- (d) _____ Total the statement columns, compute net income (loss), and complete the worksheet.
- (e) _____ Enter adjustment data.

List the steps in preparing a worksheet.

(SO 1)

BE4-2 The ledger of Ley Company includes the following unadjusted balances: Prepaid Insurance \$3,000, Service Revenue \$58,000, and Salaries Expense \$25,000. Adjusting entries are required for (a) expired insurance \$1,200; (b) services provided \$1,100, but unbilled and uncollected; and (c) accrued salaries payable \$800. Enter the unadjusted balances and adjustments into a worksheet and complete the worksheet for all accounts. *Note:* You will need to add the following accounts: Accounts Receivable, Salaries Payable, and Insurance Expense.

Prepare partial worksheet.

(SO 1)

BE4-3 The following selected accounts appear in the adjusted trial balance columns of the worksheet for Batan Company: Accumulated Depreciation; Depreciation Expense; Common Stock; Dividends; Service Revenue; Supplies; and Accounts Payable. Indicate the financial statement column (income statement Dr., balance sheet Cr., etc.) to which each balance should be extended.

Identify worksheet columns for selected accounts.

(SO 1)

BE4-4 The ledger of Swann Company contains the following balances: Retained Earnings \$30,000; Dividends \$2,000; Service Revenue \$50,000; Salaries Expense \$27,000; and Supplies Expense \$4,000. Prepare the closing entries at December 31.

Prepare closing entries from ledger balances.

(SO 2)

BE4-5 Using the data in BE4-4, enter the balances in T accounts, post the closing entries, and rule and balance the accounts.

Post closing entries; rule and balance T accounts.

(SO 2)

BE4-6 The income statement for Crestwood Golf Club for the month ending July 31 shows Green Fee Revenue \$13,600, Salaries Expense \$8,200, Maintenance Expense \$2,500, and Net Income \$2,900. Prepare the entries to close the revenue and expense accounts. Post the entries to the revenue and expense accounts, and complete the closing process for these accounts using the three-column form of account.

Journalize and post closing entries using the three-column form of account.

(SO 2)

BE4-7 Using the data in BE4-3, identify the accounts that would be included in a post-closing trial balance.

Identify post-closing trial balance accounts.

(SO 3)

BE4-8 The steps in the accounting cycle are listed in random order below. List the steps in proper sequence, assuming no worksheet is prepared, by placing numbers 1–9 in the blank spaces.

List the required steps in the accounting cycle in sequence.

- (a) _____ Prepare a trial balance.
- (b) _____ Journalize the transactions.
- (c) _____ Journalize and post closing entries.
- (d) _____ Prepare financial statements.
- (e) _____ Journalize and post adjusting entries.
- (f) _____ Post to ledger accounts.
- (g) _____ Prepare a post-closing trial balance.
- (h) _____ Prepare an adjusted trial balance.
- (i) _____ Analyze business transactions.

(SO 4)

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Prepare correcting entries.
(SO 5)

BE4-9 At Batavia Company, the following errors were discovered after the transactions had been journalized and posted. Prepare the correcting entries.

1. A collection on account from a customer for \$780 was recorded as a debit to Cash \$780 and a credit to Service Revenue \$780.
2. The purchase of store supplies on account for \$1,570 was recorded as a debit to Store Supplies \$1,750 and a credit to Accounts Payable \$1,750.

Prepare the current assets section of a balance sheet.
(SO 6)

BE4-10 The balance sheet debit column of the worksheet for Diaz Company includes the following accounts: Accounts Receivable \$12,500; Prepaid Insurance \$3,600; Cash \$15,400; Supplies \$5,200, and Short-term Investments \$6,700. Prepare the current assets section of the balance sheet, listing the accounts in proper sequence.

Classify accounts on balance sheet.
(SO 6)

BE4-11 The following are the major balance sheet classifications:

Current assets (CA)	Current liabilities (CL)
Long-term investments (LTI)	Long-term liabilities (LTL)
Property, plant, and equipment (PPE)	Stockholders' equity (SE)
Intangible assets (IA)	

Match each of the following accounts to its proper balance sheet classification.

_____ Accounts payable	_____ Income tax payable
_____ Accounts receivable	_____ Investment in long-term bonds
_____ Accumulated depreciation	_____ Land
_____ Building	_____ Merchandise inventory
_____ Cash	_____ Patent
_____ Copyrights	_____ Supplies

Prepare reversing entries.
(SO 7)

***BE4-12** At October 31, Nathan Company made an accrued expense adjusting entry of \$1,400 for salaries. Prepare the reversing entry on November 1, and indicate the balances in Salaries Payable and Salaries Expense after posting the reversing entry.

EXERCISES



Complete the worksheet.
(SO 1)

E4-1 The trial balance columns of the worksheet for Briscoe Company at June 30, 2008, are as follows.

BRISCOE COMPANY		
Worksheet		
For the Month Ended June 30, 2008		
Account Titles	Trial Balance	
	Dr.	Cr.
Cash	\$2,320	
Accounts Receivable	2,440	
Supplies	1,880	
Accounts Payable		\$1,120
Unearned Revenue		240
Common Stock		3,600
Service Revenue		2,400
Salaries Expense	560	
Miscellaneous Expense	160	
	<u>\$7,360</u>	<u>\$7,360</u>

Other data:

1. A physical count reveals \$300 of supplies on hand.
2. \$100 of the unearned revenue is still unearned at month-end.
3. Accrued salaries are \$280.

Instructions

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

E4-2 The adjusted trial balance columns of the worksheet for Goode Company are as follows.

Complete the worksheet.

(SO 1)



GOODE COMPANY						
Worksheet (partial)						
For the Month Ended April 30, 2008						
Account Titles	Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	13,752					
Accounts Receivable	7,840					
Prepaid Rent	2,280					
Equipment	23,050					
Accumulated Depreciation		4,921				
Notes Payable		5,700				
Accounts Payable		5,672				
Common Stock		25,000				
Retained Earnings		5,960				
Dividends	3,650					
Service Revenue		15,590				
Salaries Expense	10,840					
Rent Expense	760					
Depreciation Expense	671					
Interest Expense	57					
Interest Payable		57				
Totals	62,900	62,900				

Instructions

Complete the worksheet.

E4-3 Worksheet data for Goode Company are presented in E4-2. No common stock was issued during April.

Prepare financial statements from worksheet.

(SO 1, 6)

**Instructions**

Prepare an income statement, a retained earnings statement, and a classified balance sheet.

E4-4 Worksheet data for Goode Company are presented in E4-2.

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

(SO 2, 3)

Instructions

(a) Journalize the closing entries at April 30.

(b) Post the closing entries to Income Summary and Retained Earnings. Use T accounts.

(c) Prepare a post-closing trial balance at April 30.

E4-5 The adjustments columns of the worksheet for Mears Company are shown below.

Prepare adjusting entries from a worksheet, and extend balances to worksheet columns.

(SO 1)

Account Titles	Adjustments	
	Debit	Credit
Accounts Receivable	600	
Prepaid Insurance		400
Accumulated Depreciation		900
Salaries Payable		500
Service Revenue		600
Salaries Expense	500	
Insurance Expense	400	
Depreciation Expense	900	
	2,400	2,400

Instructions

- (a) Prepare the adjusting entries.
 (b) Assuming the adjusted trial balance amount for each account is normal, indicate the financial statement column to which each balance should be extended.

Derive adjusting entries from worksheet data.

(SO 1)

E4-6 Selected worksheet data for Nicholson Company are presented below.

Account Titles	Trial Balance		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.
Accounts Receivable	?		34,000	
Prepaid Insurance	26,000		20,000	
Supplies	7,000		?	
Accumulated Depreciation		12,000		?
Salaries Payable		?		5,000
Service Revenue		88,000		97,000
Insurance Expense			?	
Depreciation Expense			10,000	
Supplies Expense			5,000	
Salaries Expense	?		49,000	

Instructions

- (a) Fill in the missing amounts.
 (b) Prepare the adjusting entries that were made.

Prepare closing entries, and prepare a post-closing trial balance.

(SO 2, 3)

E4-7 Emil Skoda Company had the following adjusted trial balance.

EMIL SKODA COMPANY
 Adjusted Trial Balance
 For the Month Ended June 30, 2008

Account Titles	Adjusted Trial Balance	
	Debits	Credits
Cash	\$3,712	
Accounts Receivable	3,904	
Supplies	480	
Accounts Payable		\$1,792
Unearned Revenue		160
Common Stock		5,000
Retained Earnings		760
Dividends	300	
Service Revenue		4,064
Salaries Expense	1,344	
Miscellaneous Expense	256	
Supplies Expense	2,228	
Salaries Payable		448
	<u>\$12,224</u>	<u>\$12,224</u>

Instructions

- (a) Prepare closing entries at June 30, 2008.
 (b) Prepare a post-closing trial balance.

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

(SO 2, 3)

E4-8 Apachi Company ended its fiscal year on July 31, 2008. The company's adjusted trial balance as of the end of its fiscal year is as shown at the top of page 179.

APACHI COMPANY

Adjusted Trial Balance
July 31, 2008

No.	Account Titles	Debits	Credits
101	Cash	\$ 14,840	
112	Accounts Receivable	8,780	
157	Equipment	15,900	
167	Accumulated Depreciation		\$ 7,400
201	Accounts Payable		4,220
208	Unearned Rent Revenue		1,800
311	Common Stock		20,000
320	Retained Earnings		25,200
332	Dividends	16,000	
404	Commission Revenue		65,000
429	Rent Revenue		6,500
711	Depreciation Expense	4,000	
720	Salaries Expense	55,700	
732	Utilities Expense	14,900	
		<u>\$130,120</u>	<u>\$130,120</u>

Instructions

- (a) Prepare the closing entries using page J15.
 (b) Post to Retained Earnings and No. 350 Income Summary accounts. (Use the three-column form.)
 (c) Prepare a post-closing trial balance at July 31.

E4-9 The adjusted trial balance for Apachi Company is presented in E4-8.*Prepare financial statements.*

(SO 6)

Instructions

- (a) Prepare an income statement and a retained earnings statement for the year. There were no issuances of common stock during the year.
 (b) Prepare a classified balance sheet at July 31.

E4-10 Josh Borke has prepared the following list of statements about the accounting cycle.*Answer questions related to the accounting cycle.*

(SO 4)

- “Journalize the transactions” is the first step in the accounting cycle.
- Reversing entries are a required step in the accounting cycle.
- Correcting entries do not have to be part of the accounting cycle.
- If a worksheet is prepared, some steps of the accounting cycle are incorporated into the worksheet.
- The accounting cycle begins with the analysis of business transactions and ends with the preparation of a post-closing trial balance.
- All steps of the accounting cycle occur daily during the accounting period.
- The step of “post to the ledger accounts” occurs before the step of “journalize the transactions.”
- Closing entries must be prepared before financial statements can be prepared.

Instructions

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

E4-11 Selected accounts for Nina’s Salon are presented below. All June 30 postings are from closing entries.*Prepare closing entries.*

(SO 2)

Salaries Expense				Service Revenue				Retained Earnings			
6/10	3,200	6/30	8,800	6/30	15,100	6/15	6,700	6/30	2,500	6/1	12,000
6/28	5,600					6/24	8,400			6/30	2,000
								Bal. 11,500			
Supplies Expense				Rent Expense				Dividends			
6/12	600	6/30	1,300	6/1	3,000	6/30	3,000	6/13	1,000	6/30	2,500
6/24	700							6/25	1,500		

Instructions

- (a) Prepare the closing entries that were made.
 (b) Post the closing entries to Income Summary.

Prepare correcting entries.
 (SO 5)

E4-12 Max Weinberg Company discovered the following errors made in January 2008.

1. A payment of Salaries Expense of \$600 was debited to Equipment and credited to Cash, both for \$600.
2. A collection of \$1,000 from a client on account was debited to Cash \$100 and credited to Service Revenue \$100.
3. The purchase of equipment on account for \$980 was debited to Equipment \$890 and credited to Accounts Payable \$890.

Instructions

- (a) Correct the errors by reversing the incorrect entry and preparing the correct entry.
 (b) Correct the errors without reversing the incorrect entry.

Prepare correcting entries.
 (SO 5)

E4-13 Mason Company has an inexperienced accountant. During the first 2 weeks on the job, the accountant made the following errors in journalizing transactions. All entries were posted as made.

1. A payment on account of \$630 to a creditor was debited to Accounts Payable \$360 and credited to Cash \$360.
2. The purchase of supplies on account for \$560 was debited to Equipment \$56 and credited to Accounts Payable \$56.
3. A \$400 cash dividend was debited to Salaries Expense \$400 and credited to Cash \$400.

Instructions


Prepare the correcting entries.

Prepare a classified balance sheet.
 (SO 6)

E4-14 The adjusted trial balance for Karr Bowling Alley at December 31, 2008, contains the following accounts.

Debits		Credits	
Building	\$128,800	Common Stock	\$100,000
Accounts Receivable	14,520	Retained Earnings	15,000
Prepaid Insurance	4,680	Accumulated Depreciation—Building	42,600
Cash	18,040	Accounts Payable	12,300
Equipment	62,400	Note Payable	97,780
Land	64,000	Accumulated Depreciation—Equipment	18,720
Insurance Expense	780	Interest Payable	2,600
Depreciation Expense	7,360	Bowling Revenues	14,180
Interest Expense	2,600		<u>\$303,180</u>
	<u>\$303,180</u>		

Instructions

- (a) Prepare a classified balance sheet; assume that \$13,900 of the note payable will be paid in 2009.
 (b)  Comment on the liquidity of the company.

Classify accounts on balance sheet.
 (SO 6)

E4-15 The following are the major balance sheet classifications.

Current assets (CA)	Current liabilities (CL)
Long-term investments (LTI)	Long-term liabilities (LTL)
Property, plant, and equipment (PPE)	Stockholders' equity (SE)
Intangible assets (IA)	

Instructions

Classify each of the following accounts taken from Roberts Company's balance sheet.

_____ Accounts payable	_____ Accumulated depreciation
_____ Accounts receivable	_____ Buildings.

_____ Cash	_____ Land
_____ Common Stock	_____ Long-term debt
_____ Patents	_____ Supplies
_____ Salaries payable	_____ Office equipment
_____ Inventories	_____ Prepaid expenses
_____ Investments	

E4-16 The following items were taken from the financial statements of R. Stevens Company. (All dollars are in thousands.)

Prepare a classified balance sheet.

(SO 6)

Long-term debt	\$ 943	Accumulated depreciation	\$ 5,655
Prepaid expenses	880	Accounts payable	1,444
Property, plant, and equipment	11,500	Notes payable after 2009	368
Long-term investments	264	Common stock	10,000
Short-term investments	3,690	Retained earnings	3,063
Notes payable in 2009	481	Accounts receivable	1,696
Cash	2,668	Inventories	1,256

Instructions

Prepare a classified balance sheet in good form as of December 31, 2008.

E4-17 These financial statement items are for B. Snyder Company Inc. at year-end, July 31, 2008.

Prepare financial statements.

(SO 1, 6)

Salaries payable	\$ 2,080	Note payable (long-term)	\$ 1,800
Salaries expense	51,700	Cash	24,200
Utilities expense	22,600	Accounts receivable	9,780
Equipment	18,500	Accumulated depreciation	6,000
Accounts payable	4,100	Dividends	4,000
Commission revenue	61,100	Depreciation expense	4,000
Rent revenue	8,500	Retained earnings (beginning of the year)	21,200
Common stock	30,000		

Instructions

(a) Prepare an income statement and a retained earnings statement for the year.

(b) Prepare a classified balance sheet at July 31.

***E4-18** LaBamba Company pays salaries of \$10,000 every Monday for the preceding 5-day week (Monday through Friday). Assume December 31 falls on a Tuesday, so LaBamba's employees have worked 2 days without being paid.

Use reversing entries.

(SO 7)

Instructions

(a) Assume the company does not use reversing entries. Prepare the December 31 adjusting entry and the entry on Monday, January 6, when LaBamba pays the payroll.

(b) Assume the company does use reversing entries. Prepare the December 31 adjusting entry, the January 1 reversing entry, and the entry on Monday, January 6, when LaBamba pays the payroll.

***E4-19** On December 31, the adjusted trial balance of Oslo Employment Agency shows the following selected data.

Prepare closing and reversing entries.

(SO 2, 4, 7)

Accounts Receivable	\$24,000	Commission Revenue	\$92,000
Interest Expense	7,800	Interest Payable	1,500

Analysis shows that adjusting entries were made to (1) accrue \$4,500 of commission revenue and (2) accrue \$1,500 interest expense.

Instructions

(a) Prepare the closing entries for the temporary accounts at December 31.

(b) Prepare the reversing entries on January 1.

(c) Post the entries in (a) and (b). Rule and balance the accounts. (Use T accounts.)

(d) Prepare the entries to record (1) the collection of the accrued commissions on January 10 and (2) the payment of all interest due (\$2,500) on January 15.

(e) Post the entries in (d) to the temporary accounts.



EXERCISES: SET B

Visit the book's website at www.wiley.com/college/veygandt, and choose the Student Companion site, to access Exercise Set B.

PROBLEMS: SET A



Prepare worksheet, financial statements, and adjusting and closing entries.

(SO 1, 2, 6)



P4-1A Thomas Magnum began operations as a private investigator on January 1, 2008. The trial balance columns of the worksheet for Thomas Magnum, P.I. at March 31 are as follows.

THOMAS MAGNUM, P.I., INC.

Worksheet

For the Quarter Ended March 31, 2008

Account Titles	Trial Balance	
	Dr.	Cr.
Cash	11,400	
Accounts Receivable	5,620	
Supplies	1,050	
Prepaid Insurance	2,400	
Equipment	30,000	
Notes Payable		10,000
Accounts Payable		12,350
Common Stock		20,000
Dividends	600	
Service Revenue		13,620
Salaries Expense	2,200	
Travel Expense	1,300	
Rent Expense	1,200	
Miscellaneous Expense	200	
	<u>55,970</u>	<u>55,970</u>

Other data:

- Supplies on hand total \$380.
- Depreciation is \$1,000 per quarter.
- Interest accrued on 6-month note payable, issued January 1, \$300.
- Insurance expires at the rate of \$200 per month.
- Services provided but unbilled at March 31 total \$530.

Instructions

(a) Adjusted trial balance
\$57,800

(b) Net income \$6,680
Total assets \$48,730

- Enter the trial balance on a worksheet and complete the worksheet.
- Prepare an income statement and a retained earnings statement for the quarter and a classified balance sheet at March 31. No additional common stock was issued during the quarter ended March 31, 2008.
- Journalize the adjusting entries from the adjustments columns of the worksheet.
- Journalize the closing entries from the financial statement columns of the worksheet.

P4-2A The adjusted trial balance columns of the worksheet for Porter Company are as follows.

PORTER COMPANY

Worksheet

For the Year Ended December 31, 2008

Account No.	Account Titles	Adjusted Trial Balance	
		Dr.	Cr.
101	Cash	18,800	
112	Accounts Receivable	16,200	
126	Supplies	2,300	

Complete worksheet; prepare financial statements, closing entries, and post-closing trial balance.

(SO 1, 2, 3, 6)



Account No.	Account Titles	Adjusted Trial Balance	
		Dr.	Cr.
130	Prepaid Insurance	4,400	
151	Office Equipment	44,000	
152	Accumulated Depreciation—Office Equipment		20,000
200	Notes Payable		20,000
201	Accounts Payable		8,000
212	Salaries Payable		2,600
230	Interest Payable		1,000
311	Common Stock		30,000
320	Retained Earnings		6,000
332	Dividends	12,000	
400	Service Revenue		77,800
610	Advertising Expense	12,000	
631	Supplies Expense	3,700	
711	Depreciation Expense	8,000	
722	Insurance Expense	4,000	
726	Salaries Expense	39,000	
905	Interest Expense	1,000	
	Totals	165,400	165,400

Instructions

- (a) Complete the worksheet by extending the balances to the financial statement columns.
- (b) Prepare an income statement, a retained earnings statement, and a classified balance sheet. \$10,000 of the notes payable become due in 2009. No additional issuance of common stock occurred during 2008.
- (c) Prepare the closing entries. Use J14 for the journal page.
- (d) Post the closing entries. Use the three-column form of account. Income Summary is account No. 350.
- (e) Prepare a post-closing trial balance.

(a) Net income \$10,100
 (b) Current assets \$41,700
 Current liabilities \$21,600

(e) Post-closing trial balance
 \$85,700

P4-3A The completed financial statement columns of the worksheet for Woods Company, Inc. are shown below.

Prepare financial statements, closing entries, and post-closing trial balance.

(SO 1, 2, 3, 6)

WOODS COMPANY, INC.

Worksheet
 For the Year Ended December 31, 2008

Account No.	Account Titles	Income Statement		Balance Sheet	
		Dr.	Cr.	Dr.	Cr.
101	Cash			8,200	
112	Accounts Receivable			7,500	
130	Prepaid Insurance			1,800	
157	Equipment			28,000	
167	Accumulated Depreciation				8,600
201	Accounts Payable				11,700
212	Salaries Payable				3,000
311	Common Stock				20,000
320	Retained Earnings				14,000
332	Dividends			7,200	
400	Service Revenue		44,000		
622	Repair Expense	5,400			
711	Depreciation Expense	2,800			
722	Insurance Expense	1,200			
726	Salaries Expense	35,200			
732	Utilities Expense	4,000			
	Totals	48,600	44,000	52,700	57,300
	Net Loss		4,600	4,600	
		48,600	48,600	57,300	57,300

(a) Net loss \$4,600
Ending retained earnings \$2,200
Total assets \$36,900

(d) Post-closing trial balance
\$45,500

Complete worksheet; prepare classified balance sheet, entries, and post-closing trial balance.

(SO 1, 2, 3, 6)

Instructions

- Prepare an income statement, a retained earnings statement, and a classified balance sheet. No additional common stock was issued during 2008.
- Prepare the closing entries.
- Post the closing entries and rule and balance the accounts. Use T accounts. Income Summary is account No. 350.
- Prepare a post-closing trial balance.

P4-4A Disney Amusement Park, Inc. has a fiscal year ending on September 30. Selected data from the September 30 worksheet are presented below.

DISNEY AMUSEMENT PARK, INC.

Worksheet
For the Year Ended September 30, 2008

	Trial Balance		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.
Cash	41,400		41,400	
Supplies	18,600		1,200	
Prepaid Insurance	31,900		8,900	
Land	80,000		80,000	
Equipment	120,000		120,000	
Accumulated Depreciation		36,200		42,200
Accounts Payable		14,600		14,600
Unearned Admissions Revenue		3,700		2,000
Mortgage Note Payable		50,000		50,000
Common Stock		100,000		100,000
Retained Earnings		9,700		9,700
Dividends	14,000		14,000	
Admissions Revenue		277,500		279,200
Salaries Expense	105,000		105,000	
Repair Expense	30,500		30,500	
Advertising Expense	9,400		9,400	
Utilities Expense	16,900		16,900	
Property Taxes Expense	18,000		21,000	
Interest Expense	6,000		10,000	
Totals	491,700	491,700		
Insurance Expense			23,000	
Supplies Expense			17,400	
Interest Payable				4,000
Depreciation Expense			6,000	
Property Taxes Payable				3,000
Totals			504,700	504,700

Instructions

- Prepare a complete worksheet.
- Prepare a classified balance sheet. (Note: \$10,000 of the mortgage note payable is due for payment in the next fiscal year.)
- Journalize the adjusting entries using the worksheet as a basis.
- Journalize the closing entries using the worksheet as a basis.
- Prepare a post-closing trial balance.

P4-5A Laura Eddy opened Eddy's Carpet Cleaners Inc. on March 1. During March, the following transactions were completed.

- Mar. 1 Issued stock for \$10,000 in cash.
1 Purchased used truck for \$6,000, paying \$3,000 cash and the balance on account.
3 Purchased cleaning supplies for \$1,200 on account.
5 Paid \$1,200 cash on one-year insurance policy effective March 1.

(a) Net income \$40,000
(b) Total current assets
\$51,500

(e) Post-closing trial balance
\$251,500

Complete all steps in accounting cycle.

(SO 1, 2, 3, 4, 6)



- 14 Billed customers \$4,800 for cleaning services.
- 18 Paid \$1,500 cash on amount owed on truck and \$500 on amount owed on cleaning supplies.
- 20 Paid \$1,800 cash for employee salaries.
- 21 Collected \$1,400 cash from customers billed on March 14.
- 28 Billed customers \$2,500 for cleaning services.
- 31 Paid gas and oil for month on truck \$200.
- 31 Declared and paid a \$700 cash dividend.

The chart of accounts for Eddy's Carpet Cleaners contains the following accounts: No. 101 Cash, No. 112 Accounts Receivable, No. 128 Cleaning Supplies, No. 130 Prepaid Insurance, No. 157 Equipment, No. 158 Accumulated Depreciation—Equipment, No. 201 Accounts Payable, No. 212 Salaries Payable, No. 311 Common Stock, No. 320 Retained Earnings, No. 332 Dividends, No. 350 Income Summary, No. 400 Service Revenue, No. 633 Gas & Oil Expense, No. 634 Cleaning Supplies Expense, No. 711 Depreciation Expense, No. 722 Insurance Expense, and No. 726 Salaries Expense.

Instructions

- (a) Journalize and post the March transactions. Use page J1 for the journal and the three-column form of account.
- (b) Prepare a trial balance at March 31 on a worksheet.
- (c) Enter the following adjustments on the worksheet and complete the worksheet.
 - (1) Earned but unbilled revenue at March 31 was \$700.
 - (2) Depreciation on equipment for the month was \$250.
 - (3) One-twelfth of the insurance expired.
 - (4) An inventory count shows \$400 of cleaning supplies on hand at March 31.
 - (5) Accrued but unpaid employee salaries were \$500.
- (d) Prepare the income statement and a retained earnings statement for March and a classified balance sheet at March 31.
- (e) Journalize and post adjusting entries. Use page J2 for the journal.
- (f) Journalize and post closing entries and complete the closing process. Use page J3 for the journal.
- (g) Prepare a post-closing trial balance at March 31.

(b) Trial balance \$19,500

(c) Adjusted trial balance
\$20,950

(d) Net income \$4,350
Total assets \$16,350

(g) Post-closing trial balance
\$16,600

P4-6A Joe Edmonds, CPA, was retained by Clark Cable Inc. to prepare financial statements for April 2008. Edmonds accumulated all the ledger balances per Clark's records and found the following.

Analyze errors and prepare
correcting entries and trial
balance.

(SO 5)

CLARK CABLE INC.

Trial Balance
April 30, 2008

	Debit	Credit
Cash	\$ 4,100	
Accounts Receivable	3,200	
Supplies	800	
Equipment	10,600	
Accumulated Depreciation		\$ 1,350
Accounts Payable		2,100
Salaries Payable		700
Unearned Revenue		890
Common Stock		10,000
Retained Earnings		2,900
Service Revenue		5,450
Salaries Expense	3,300	
Advertising Expense	600	
Miscellaneous Expense	290	
Depreciation Expense	500	
	\$23,390	\$23,390

Joe Edmonds reviewed the records and found the following errors.

1. Cash received from a customer on account was recorded as \$960 instead of \$690.
2. A payment of \$65 for advertising expense was entered as a debit to Miscellaneous Expense \$65 and a credit to Cash \$65.
3. The first salary payment this month was for \$1,900, which included \$700 of salaries payable on March 31. The payment was recorded as a debit to Salaries Expense \$1,900 and a credit to Cash \$1,900. (No reversing entries were made on April 1.)
4. The purchase on account of a printer costing \$290 was recorded as a debit to Supplies and a credit to Accounts Payable for \$290.
5. A cash payment of repair expense on equipment for \$95 was recorded as a debit to Equipment \$59 and a credit to Cash \$59.

Instructions

- (a) Prepare an analysis of each error showing (1) the incorrect entry, (2) the correct entry, and (3) the correcting entry. Items 4 and 5 occurred on April 30, 2008.
- (b) Prepare a correct trial balance.

Trial balance \$22,690

PROBLEMS: SET B

Prepare a worksheet, financial statements, and adjusting and closing entries.

(SO 1, 2, 6)



P4-1B The trial balance columns of the worksheet for Everlast Roofing Inc. at March 31, 2008, are as follows.

EVERLAST ROOFING INC.

Worksheet
For the Month Ended March 31, 2008

Account Titles	Trial Balance	
	Dr.	Cr.
Cash	2,500	
Accounts Receivable	1,800	
Roofing Supplies	1,100	
Equipment	6,000	
Accumulated Depreciation—Equipment		700
Accounts Payable		1,400
Unearned Revenue		300
Common Stock		7,000
Dividends	600	
Service Revenue		3,500
Salaries Expense	700	
Miscellaneous Expense	200	
	<u>12,900</u>	<u>12,900</u>

Other data:

1. A physical count reveals only \$240 of roofing supplies on hand.
2. Depreciation for March is \$200.
3. Unearned revenue amounted to \$130 after adjustment on March 31.
4. Accrued salaries are \$350.

Instructions

- (a) Enter the trial balance on a worksheet and complete the worksheet.
- (b) Prepare an income statement and a retained earnings statement for the month of March and a classified balance sheet at March 31. Common stock of \$7,000 was issued for cash at the beginning of March.
- (c) Journalize the adjusting entries from the adjustments columns of the worksheet.
- (d) Journalize the closing entries from the financial statement columns of the worksheet.

(a) Adjusted trial balance
\$13,450

(b) Net income \$1,360
Total assets \$9,640

P4-2B The adjusted trial balance columns of the worksheet for Sparks Company Inc. owned by Billy Sparks, are as follows.

SPARKS COMPANY INC.

Worksheet
For the Year Ended December 31, 2008

Complete worksheet; prepare financial statements, closing entries, and post-closing trial balance.

(SO 1, 2, 3, 6)



Account No.	Account Titles	Adjusted Trial Balance	
		Dr.	Cr.
101	Cash	11,600	
112	Accounts Receivable	15,400	
126	Supplies	2,000	
130	Prepaid Insurance	2,800	
151	Office Equipment	34,000	
152	Accumulated Depreciation—Office Equipment		8,000
200	Notes Payable		20,000
201	Accounts Payable		9,000
212	Salaries Payable		3,500
230	Interest Payable		800
311	Common Stock		15,000
320	Retained Earnings		10,000
332	Dividends	10,000	
400	Service Revenue		85,000
610	Advertising Expense	12,000	
631	Supplies Expense	5,700	
711	Depreciation Expense	8,000	
722	Insurance Expense	5,000	
726	Salaries Expense	44,000	
905	Interest Expense	800	
	Totals	151,300	151,300

Instructions

- Complete the worksheet by extending the balances to the financial statement columns.
- Prepare an income statement, a retained earnings statement, and a classified balance sheet. (Note: \$10,000 of the notes payable become due in 2009.) No additional common stock was issued during the year.
- Prepare the closing entries. Use J14 for the journal page.
- Post the closing entries. Use the three-column form of account. Income Summary is No. 350.
- Prepare a post-closing trial balance.

(a) Net income \$9,500
(b) Current assets \$31,800;
Current liabilities \$23,300

(e) Post-closing trial balance
\$65,800

P4-3B The completed financial statement columns of the worksheet for Molinda Company are shown below and on the next page.

MOLINDA COMPANY

Worksheet
For the Year Ended December 31, 2008

Prepare financial statements, closing entries, and post-closing trial balance.

(SO 1, 2, 3, 6)

Account No.	Account Titles	Income Statement		Balance Sheet	
		Dr.	Cr.	Dr.	Cr.
101	Cash			22,400	
112	Accounts Receivable			13,500	
130	Prepaid Insurance			3,500	
157	Equipment			26,000	
167	Accumulated Depreciation				5,600
201	Accounts Payable				11,300
212	Salaries Payable				3,000
311	Common Stock				20,000
320	Retained Earnings				16,000
332	Dividends			14,000	
400	Service Revenue		69,000		
622	Repair Expense	2,000			

Account No.	Account Titles	Income Statement		Balance Sheet	
		Dr.	Cr.	Dr.	Cr.
711	Depreciation Expense	2,600			
722	Insurance Expense	2,200			
726	Salaries Expense	37,000			
732	Utilities Expense	1,700			
	Totals	45,500	69,000	79,400	55,900
	Net Income	23,500			23,500
		<u>69,000</u>	<u>69,000</u>	<u>79,400</u>	<u>79,400</u>

Instructions

- (a) Ending retained earnings \$25,500; Total current assets \$39,400
 (d) Post-closing trial balance \$65,400
- (a) Prepare an income statement, a retained earnings statement, and a classified balance sheet.
 (b) Prepare the closing entries. No additional issuance of common stock occurred during the year.
 (c) Post the closing entries and rule and balance the accounts. Use T accounts. Income Summary is account No. 350.
 (d) Prepare a post-closing trial balance.

Complete worksheet; prepare classified balance sheet, entries, and post-closing trial balance.
 (SO 1, 2, 3, 6)

P4-4B Pettengill Management Services Inc. began business on January 1, 2008, with an investment of \$100,000. The company manages condominiums for owners (Service Revenue) and rents space in its own office building (Rent Revenue). The trial balance and adjusted trial balance columns of the worksheet at the end of the first year are as follows.

PETTENGILL MANAGEMENT SERVICES INC.

Worksheet
 For the Year Ended December 31, 2008

Account Titles	Trial Balance		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.
Cash	11,500		11,500	
Accounts Receivable	23,600		23,600	
Prepaid Insurance	3,100		1,400	
Land	56,000		56,000	
Building	106,000		106,000	
Equipment	49,000		49,000	
Accounts Payable		10,400		10,400
Unearned Rent Revenue		5,000		2,800
Mortgage Note Payable		100,000		100,000
Common Stock		100,000		100,000
Retained Earnings		20,000		20,000
Dividends	18,000		18,000	
Service Revenue		75,600		75,600
Rent Revenue		24,000		26,200
Salaries Expense	35,000		35,000	
Advertising Expense	17,000		17,000	
Utilities Expense	15,800		15,800	
Totals	<u>335,000</u>	<u>335,000</u>		
Insurance Expense			1,700	
Depreciation Expense—Building			2,500	
Accumulated Depreciation—Building				2,500
Depreciation Expense—Equipment			3,900	
Accumulated Depreciation—Equipment				3,900
Interest Expense			9,000	
Interest Payable				9,000
Totals			<u>350,400</u>	<u>350,400</u>

Instructions

- (a) Net income \$16,900
 (b) Total current assets \$36,500
- (a) Prepare a complete worksheet.
 (b) Prepare a classified balance sheet. (Note: \$10,000 of the mortgage note payable is due for payment next year.)

- (c) Journalize the adjusting entries.
- (d) Journalize the closing entries.
- (e) Prepare a post-closing trial balance.

(e) Post-closing trial balance
\$247,500

P4-5B Lee Choi opened Choi's Window Washing, Inc. on July 1, 2008. During July the following transactions were completed.

Complete all steps in accounting cycle.

(SO 1, 2, 3, 4, 6)



- July 1 Issued \$12,000 of common stock for \$12,000 cash.
- 1 Purchased used truck for \$6,000, paying \$3,000 cash and the balance on account.
 - 3 Purchased cleaning supplies for \$1,300 on account.
 - 5 Paid \$2,400 cash on one-year insurance policy effective July 1.
 - 12 Billed customers \$2,500 for cleaning services.
 - 18 Paid \$1,000 cash on amount owed on truck and \$800 on amount owed on cleaning supplies.
 - 20 Paid \$1,200 cash for employee salaries.
 - 21 Collected \$1,400 cash from customers billed on July 12.
 - 25 Billed customers \$5,000 for cleaning services.
 - 31 Paid gas and oil for month on truck \$200.
 - 31 Declared and paid \$900 cash dividend.

The chart of accounts for Choi's Window Washing contains the following accounts: No. 101 Cash, No. 112 Accounts Receivable, No. 128 Cleaning Supplies, No. 130 Prepaid Insurance, No. 157 Equipment, No. 158 Accumulated Depreciation—Equipment, No. 201 Accounts Payable, No. 212 Salaries Payable, No. 311 Common Stock, No. 320 Retained Earnings, No. 332 Dividends, No. 350 Income Summary, No. 400 Service Revenue, No. 633 Gas & Oil Expense, No. 634 Cleaning Supplies Expense, No. 711 Depreciation Expense, No. 722 Insurance Expense, and No. 726 Salaries Expense.

Instructions

- (a) Journalize and post the July transactions. Use page J1 for the journal and the three-column form of account.
- (b) Prepare a trial balance at July 31 on a worksheet.
- (c) Enter the following adjustments on the worksheet and complete the worksheet.
 - (1) Services provided but unbilled and uncollected at July 31 were \$1,500.
 - (2) Depreciation on equipment for the month was \$300.
 - (3) One-twelfth of the insurance expired.
 - (4) An inventory count shows \$400 of cleaning supplies on hand at July 31.
 - (5) Accrued but unpaid employee salaries were \$600.
- (d) Prepare the income statement and a retained earnings statement for July and a classified balance sheet at July 31.
- (e) Journalize and post adjusting entries. Use page J2 for the journal.
- (f) Journalize and post closing entries and complete the closing process. Use page J3 for the journal.
- (g) Prepare a post-closing trial balance at July 31.

(b) Trial balance \$22,000

(c) Adjusted trial balance
\$24,400

(d) Net income \$5,600;
Total assets \$19,800

(g) Post-closing trial balance
\$20,100

PROBLEMS: SET C

Visit the book's website at www.wiley.com/college/veygandt, and choose the Student Companion site, to access Problem Set C.



COMPREHENSIVE PROBLEM: CHAPTERS 2 TO 4

Julie Molony opened Julie's Maids Cleaning Service Inc. on July 1, 2008. During July, the company completed the following transactions.

- July 1 Issued \$14,000 of common stock for \$14,000 cash.
- 1 Purchased a used truck for \$10,000, paying \$3,000 cash and the balance on account.
 - 3 Purchased cleaning supplies for \$800 on account.
 - 5 Paid \$1,800 on a one-year insurance policy, effective July 1.
 - 12 Billed customers \$3,800 for cleaning services.
 - 18 Paid \$1,000 of amount owed on truck, and \$400 of amount owed on cleaning supplies.
 - 20 Paid \$1,600 for employee salaries.
 - 21 Collected \$1,400 from customers billed on July 12.
 - 25 Billed customers \$1,500 for cleaning services.

- 31 Paid gas and oil for the month on the truck, \$400.
- 31 Paid a \$600 cash dividend.

The chart of accounts for Julie's Maids Cleaning Service contains the following accounts: No. 101 Cash, No. 112 Accounts Receivable, No. 128 Cleaning Supplies, No. 130 Prepaid Insurance, No. 157 Equipment, No. 158 Accumulated Depreciation—Equipment, No. 201 Accounts Payable, No. 212 Salaries Payable, No. 311 Common Stock, No. 320 Retained Earnings, No. 332 Dividends, No. 350 Income Summary, No. 400 Service Revenue, No. 633 Gas & Oil Expense, No. 634 Cleaning Supplies Expense, No. 711 Depreciation Expense, No. 722 Insurance Expense, and No. 726 Salaries Expense.

Instructions

(b) Trial balance totals
\$25,700

(d) Net income \$3,050
Total assets \$23,350

(g) Trial balance totals
\$23,550

- (a) Journalize and post the July transactions. Use page J1 for the journal.
- (b) Prepare a trial balance at July 31 on a worksheet.
- (c) Enter the following adjustments on the worksheet, and complete the worksheet.
 - (1) Earned but unbilled fees at July 31 were \$1,300.
 - (2) Depreciation on equipment for the month was \$200.
 - (3) One-twelfth of the insurance expired.
 - (4) An inventory count shows \$100 of cleaning supplies on hand at July 31.
 - (5) Accrued but unpaid employee salaries were \$500.
- (d) Prepare the income statement and a retained earnings statement for July, and a classified balance sheet at July 31, 2008.
- (e) Journalize and post the adjusting entries. Use page J2 for the journal.
- (f) Journalize and post the closing entries, and complete the closing process. Use page J3 for the journal.
- (g) Prepare a post-closing trial balance at July 31.

CONTINUING COOKIE CHRONICLE

(Note: This is a continuation of the Cookie Chronicle from Chapters 1 through 3.)

CCC4 Natalie had a very busy December. At the end of the month after journalizing and posting the December transactions and adjusting entries, Natalie prepared an adjusted trial balance. Using that information, she wants to prepare financial statements for the year-end, closing entries, and a post-closing trial balance.



Go to the book's website,
www.wiley.com/college/veygandt,
to see the completion of this problem.

BROADENING YOUR PERSPECTIVE

FINANCIAL REPORTING AND ANALYSIS

Financial Reporting Problem

PepsiCo, Inc.



BYP4-1 Appendix A at the end of this textbook presents the financial statements of PepsiCo.

Instructions

Answer the following questions using the Consolidated Balance Sheet and the Notes to Consolidated Financial Statements section.

- (a) What were PepsiCo's total current assets at December 31, 2005 and December 25, 2004?
- (b) Are assets that PepsiCo included under current assets listed in proper order? Explain.
- (c) How are PepsiCo's assets classified?

- (d) What are “cash equivalents”?
- (e) What were PepsiCo’s total current liabilities at December 31, 2005 and December 25, 2004?

Comparative Analysis Problem

PepsiCo, Inc. vs. The Coca-Cola Company

BYP4-2 Appendix A presents PepsiCo’s financial statements. Appendix B presents Coca-Cola’s financial statements.



Instructions

- (a) Based on the information contained in these financial statements, determine each of the following for PepsiCo at December 31, 2005, and for Coca-Cola at December 31, 2005.
 - (1) Total current assets.
 - (2) Net amount of property, plant, and equipment (land, buildings, and equipment).
 - (3) Total current liabilities.
 - (4) Total stockholders’ (shareholders’) equity.
- (b) What conclusions concerning the companies’ respective financial positions can be drawn?

Exploring the Web

BYP4-3 Numerous companies have established home pages on the Internet, e.g., Capt’n Eli Root Beer Company (www.captneli.com/rootbeer.php) and Kodak (www.kodak.com).



Instructions

Examine the home pages of any two companies and answer the following questions.

- (a) What type of information is available?
- (b) Is any accounting-related information presented?
- (c) Would you describe the home page as informative, promotional, or both? Why?

CRITICAL THINKING

Decision Making Across the Organization



BYP4-4 Whitegloves Janitorial Service Inc. was started 2 years ago by Nancy Kohl. Because business has been exceptionally good, Nancy decided on July 1, 2008, to expand operations by acquiring an additional truck and hiring two more assistants. To finance the expansion, Nancy obtained on July 1, 2008, a \$25,000, 10% bank loan, payable \$10,000 on July 1, 2009, and the balance on July 1, 2010. The terms of the loan require the borrower to have \$10,000 more current assets than current liabilities at December 31, 2008. If these terms are not met, the bank loan will be refinanced at 15% interest. At December 31, 2008, the accountant for Whitegloves Janitorial Service Inc. prepared the balance sheet shown on page 192.

Nancy presented the balance sheet to the bank’s loan officer on January 2, 2009, confident that the company had met the terms of the loan. The loan officer was not impressed. She said, “We need financial statements audited by a CPA.” A CPA was hired and immediately realized that the balance sheet had been prepared from a trial balance and not from an adjusted trial balance. The adjustment data at the balance sheet date consisted of the following.

- (1) Earned but unbilled janitorial services were \$3,700.
- (2) Janitorial supplies on hand were \$2,500.
- (3) Prepaid insurance was a 3-year policy dated January 1, 2008.
- (4) December expenses incurred but unpaid at December 31, \$500.
- (5) Interest on the bank loan was not recorded.
- (6) The amounts for property, plant, and equipment presented in the balance sheet were reported net of accumulated depreciation (cost less accumulated depreciation). These amounts were \$4,000 for cleaning equipment and \$5,000 for delivery trucks as of January 1, 2008. Depreciation for 2008 was \$2,000 for cleaning equipment and \$5,000 for delivery trucks.

WHITEGLOVES JANITORIAL SERVICE INC.

Balance Sheet
December 31, 2008

<u>Assets</u>		<u>Liabilities and Owner's Equity</u>	
Current assets		Current liabilities	
Cash	\$ 6,500	Notes payable	\$10,000
Accounts receivable	9,000	Accounts payable	2,500
Janitorial supplies	5,200	Total current liabilities	12,500
Prepaid insurance	4,800	Long-term liability	
Total current assets	25,500	Notes payable	15,000
Property, plant, and equipment		Total liabilities	27,500
Cleaning equipment (net)	22,000	Stockholders' equity	
Delivery trucks (net)	34,000	Common stock	40,000
Total property, plant, and equipment	56,000	Retained earnings	14,000
Total assets	\$81,500	Total stockholders' equity	54,000
		Total liabilities and stockholders' equity	\$81,500

Instructions

With the class divided into groups, answer the following.

- (a) Prepare a correct balance sheet.
- (b) Were the terms of the bank loan met? Explain.

Communication Activity

BYP4-5 The accounting cycle is important in understanding the accounting process.

Instructions

Write a memo to your instructor that lists the steps of the accounting cycle in the order they should be completed. End with a paragraph that explains the optional steps in the cycle.

Ethics Case

BYP4-6 As the controller of Breathless Perfume Company, you discover a misstatement that overstated net income in the prior year's financial statements. The misleading financial statements appear in the company's annual report which was issued to banks and other creditors less than a month ago. After much thought about the consequences of telling the president, Jerry McNabb, about this misstatement, you gather your courage to inform him. Jerry says, "Hey! What they don't know won't hurt them. But, just so we set the record straight, we'll adjust this year's financial statements for last year's misstatement. We can absorb that misstatement better in this year than in last year anyway! Just don't make such a mistake again."

Instructions

- (a) Who are the stakeholders in this situation?
- (b) What are the ethical issues in this situation?
- (c) What would you do as a controller in this situation?

**"All About You" Activity**

BYP4-7 Companies prepare balance sheets in order to know their financial position at a specific point in time. This enables them to make a comparison to their position at previous points in time, and gives them a basis for planning for the future. As discussed in the "All About You" feature in this chapter, in order to evaluate your financial position you need to prepare a personal balance sheet. Assume that you have compiled the following information regarding your finances. (*Hint:* Some of the items might not be used in your personal balance sheet.)

Amount owed on student loan balance (long-term)	\$ 5,000
Balance in checking account	1,200
Certificate of deposit (6-month)	3,000
Annual earnings from part-time job	11,300

Automobile	7,000
Balance on automobile loan (current portion)	1,500
Balance on automobile loan (long-term portion)	4,000
Home computer	800
Amount owed to you by younger brother	300
Balance in money market account	1,800
Annual tuition	6,400
Video and stereo equipment	1,250
Balance owed on credit card (current portion)	150
Balance owed on credit card (long-term portion)	1,650

Instructions

Prepare a personal balance sheet using the format you have learned for a classified balance sheet for a company. For the owner's equity account, use M. Y. Own, Capital.

Answers to Insight and Accounting Across the Organization Questions

**Cisco Performs the Virtual Close, p. 155**

Q: Who else benefits from a shorter closing process?

A: *Investors and creditors benefit from a shorter closing process. The shorter the closing, the sooner the company can report its financial results. This means that the financial information is more timely, and therefore more relevant to investors and creditors.*

Yale Express Loses Some Transportation Bills, p. 160

Q: What might Yale Express's vice president have done to produce more accurate financial statements without waiting months for Republic's outstanding transportation bills?

A: *Yale's vice president could have engaged his accountants and auditors to prepare an adjusting entry based on an estimate of the outstanding transportation bills. (The estimate could have been made using past experience and the current volume of business.)*

Big Changes Are Coming to Chinese Balance Sheets, p. 165

Q: What are the potential benefits and challenges presented by reporting assets like plant and equipment at market value rather than historical cost?

A: *Reporting assets at market value will provide investors with more relevant information. Most investors are more interested in what an asset is currently worth than in what it originally cost. However, determining the market value of some assets can be very subjective. Some companies may take advantage of this in order to obtain more desirable accounting results.*

Authors' Comments on All About You: Your Personal Balance Sheet, p. 167



By deciding to go to school after high school, you have taken a big step toward improving your long-term personal finances. Post-high-school education increases your job opportunities, which increases your earning potential.

Although it is true that your earnings will probably increase considerably when you graduate, you should not wait until graduation to lay the groundwork for a sound financial plan. If you do not monitor your finances closely while you are in school, you could easily dig a deep hole that would be difficult to get out of. Controlling your spending now will give you better control of your personal finances by the time you graduate. A first step toward taking control of your finances is preparing a personal balance sheet. In later chapters we discuss topics that will give you the tools that you need to improve your financial position.

Software is available to help you identify your assets and liabilities and determine your net worth. See for example the net worth calculator at <http://www.bygpub.com/finance/NetWorthCalc.htm>.

Answers to PepsiCo Review It Question 2, p. 168

PepsiCo's current liabilities in 2005 were \$9,406 million. Current liabilities in 2004 were \$6,752 million. In both 2005 and 2004, current liabilities were less than current assets.

**Answers to Self-Study Questions**

1. b 2. c 3. a 4. b 5. c 6. a 7. d 8. b 9. d 10. a 11. c