Chapter 3
The Income Statement

ANSWERS TO QUESTIONS

1. Net Income = Revenues - Expenses.
   Each element is defined as follows:
   Revenues – the amounts a business earns by selling goods or services to its customers.
   Expenses – any costs of operating the business, incurred to generate revenues in the period covered by the income statement.
   Net Income = A total that is calculated by subtracting expenses from revenues.

2. The time period assumption assumes that the long life of a company can be divided into shorter time periods, such as months, quarters, and years. This assumption allows management to evaluate a company's financial performance on a timely basis.

3. Accrual basis accounting requires recording revenues when earned and expenses when incurred, regardless of the timing of cash receipts or payments. Cash basis accounting records revenues when cash is received and expenses when cash is paid.

4. Using cash basis accounting for your personal finances is acceptable because your cash inflows and outflows tend to occur close in time to the activities that cause those cash flows. Cash basis accounting does not work as well for businesses because most of them use credit for their transactions, and recording the transactions on a cash basis would not describe the financial results of the business's activities as well as accrual basis accounting.

5. To "recognize" an accounting transaction means to measure and record the transaction in the accounting system. Revenues are recognized when they are earned, and expenses are recognized when they are incurred to generate revenues.

6. Under accrual basis accounting, revenues are recognized when they are earned. In general, revenues are earned when the company has done what it has promised to do, regardless of when the cash is received.

7. The expense recognition ("matching") principle requires that expenses be recorded when incurred in earning revenue. For example, the cost of employee wages is recorded in the same period that the employees work to generate revenues for the company; this may differ from the period when the employees are actually paid.

8. Revenues increase net income, which increases retained earnings—a stockholders' equity account. Expenses decrease net income, causing a decrease in retained earnings—a stockholders' equity account.

9. Revenues increase stockholders' equity and expenses decrease it. Stockholders' equity accounts are increased with credits and decreased with debits. Thus, revenues are recorded as credits and expenses as debits.

10.

Item	Increase	Decrease
Revenues	Credit	Debit
Expenses	Debit	Credit

11.

Item	Debit	Credit
Revenues	Decrease	Increase
Expenses	Increase	Decrease

12. Items on the income statement relate only to the current period and do not have a lingering financial impact beyond the current period. Balance sheet items, on the other hand, will continue to have a financial impact beyond the end of the current period. In other words, the income statement depicts a flow of what happened over a period of time, whereas a balance sheet captures what exists at a point in time.

13. The statement of retained earnings indicates that it is appropriate to consider revenues and expenses as subcategories of retained earnings. This statement includes net income, which is shown on the income statement to equal revenues minus expenses.

14. Revenue is the amount earned during a period by providing goods or services to customers. Accounts Receivable is the amount of revenue that has not yet been collected in cash at a point in time. Revenue is reported on the income statement and Accounts Receivable is reported on the balance sheet.

15. Advertising Expense is an expense account that records the cost of advertisements incurred during the period. It is reported on the income statement. Accounts Payable for advertising is a liability account that represents the cost of advertising that has been incurred but not yet paid. It is reported on the balance sheet.

16.

Situation	Explanation
a.	This is an accounting error. When cash is received from a customer on account, Cash should be debited (not credited) and Accounts Receivable should be credited (not debited). A trial balance would not detect this error because total debits would still equal total credits across all accounts.
b.	This is an accounting error. A gift card represents a promise by the company to deliver goods or services in the future when the card is redeemed. Because the company has yet to deliver any goods or services, the proper transaction is to debit Cash and credit Unearned Revenue. When the card is used to purchase goods or services, Unearned Revenue will be debited and Revenue will be credited. A trial balance would not detect this error because both Revenue and Unearned Revenue hold credit balances.
c.	This is an accounting error because assets (reported on the balance sheet) differ from expenses (reported on the income statement). Because both assets and expenses typically hold debit balances, this error would not be detected on a trial balance.
d.	This is an accounting error. In every accounting transaction, debits must equal credits. Because only a debit was entered in this transaction, the error would be detected in the trial balance.
e.	This is not an accounting error. Under the Separate Entity Assumption, transactions of the owners (shareholders) of a business are kept separate from those of the business itself. The trial balance would not indicate an error.

17. One limitation of the income statement is that people mistakenly believe that net income equals the amount of cash generated by the business during the period. A second limitation is that net income does not measure the change in value of a company during the period. Finally, net income is influenced by estimates, so it is not always a precise measure.

Authors' Recommended Solution Time
(Time in minutes)

Mini-exercises		*Exercises*		*Problems*		*Skills Development Cases**		*Continuing Case*	
No.	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*
1	5	1	10	CP3-1	20	1	20	1	15
2	5	2	20	CP3-2	30	2	30		
3	5	3	20	CP3-3	40	3	30		
4	5	4	20	CP3-4	40	4	30		
5	6	5	20	PA3-1	20	5	30		
6	6	6	20	PA3-2	30	6	25		
7	6	7	20	PA3-3	40	7	45		
8	6	8	20	PA3-4	40				
9	5	9	20	PB3-1	20				
10	5	10	20	PB3-2	30				
11	5	11	30	PB3-3	40				
12	5	12	10	PB3-4	35				
13	5	13	20	C3-1	45				
14	5	14	10						
15	5	15	10						
16	5	16	15						
17	5	17	15						
18	5	18	15						
19	10	19	30						
20	15	20	15						
21	10	21	30						
22	5								
23	8								

* Due to the nature of cases, it is very difficult to estimate the amount of time students will need to complete them. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear, and by offering suggestions (about how to research topics or what companies to select). The skills developed by these cases are indicated on the following page.

Case	Financial Analysis	Research	Ethical Reasoning	Critical Thinking	Technology	Writing	Teamwork
1	x						
2	x						
3	x	x			x	x	x
4	x		X	x		x	
5	x		X	x		x	
6	x			x		x	
7	x				x		

ANSWERS TO MINI-EXERCISES

M3-1

MOSTERT MUSIC COMPANY Cash Basis Income Statement For the Month Ended March 31		MOSTERT MUSIC COMPANY Accrual Basis Income Statement For the Month Ended March 31	
Revenues:		Revenues:	
Cash Sales	$6,000	Sales	$ 10,000
Customer Deposits	1,000		
Total Revenues	7,000		
Expenses:		Expenses:	
Wages Paid	600	Salaries/Wages Exp.	600
		Utilities Expense	200
		Total Expenses	800
Cash Income	$6,400	Net Income	$ 9,200

M3-2

Amount of Revenue Earned in July

a.	$12,000
b.	$250
c.	No revenue earned in July; the revenues will be earned when fall bowling service is provided (i.e., when games are played). Until then, the amount received will be reported as Unearned Revenue (a liability).
d.	No revenue earned in July; cash collections in July related to revenue earned in June. The revenue would have been reported in June when earned.

M3-3

Amount of Expense Incurred in July

a.	$1,500
b.	$2,500 incurred in July; the $2,000 was an expense in June even though paid in July.
c.	$5,475

M3-4

a.	Cash (+A)	12,000	
	Service Revenue (+R, +SE)		12,000
b.	Accounts Receivable (+A)	250	
	Service Revenue (+R, +SE)		250
c.	Cash (+A)	1,500	
	Unearned Revenue (+L)		1,500
d.	Cash (+A)	1,000	
	Accounts Receivable (–A)		1,000

M3-5

a.	Repairs and Maintenance Expense (+E, –SE)	1,500	
	Cash (–A)		1,500
b.	Accounts Payable (–L)	2,000	
	Cash (–A)		2,000
	Utilities Expense (+E, –SE)	2,500	
	Accounts Payable (+L)		2,500
c.	Salaries and Wages Expense (+E, –SE)	5,475	
	Cash (–A)		5,475

M3-6

	Assets	**Liabilities**	**Stockholders' Equity**
a.	+12,000	NE	Service Revenue (+R) +12,000
b.	+250	NE	Service Revenue (+R) +250
c.	+1,500	+1,500	NE
d.	NE (+/–1,000)*	NE	NE

* Transaction *(d)* results in an increase in an asset (Cash) and a decrease in an asset (Accounts Receivable). These offsetting effects yield no effect on total assets.

M3-7

	Assets	Liabilities	Stockholders' Equity	
a.	–1,500	NE	Repairs and Maintenance Expense (+E)	–1,500
b.	–2,000	–2,000 and +2,500 *	Utilities Expense (+E)	–2,500
c.	–5,475	NE	Wages Expense (+E)	–5,475

* Transaction (b) affects liabilities in two ways. Liabilities (Accounts Payable) decreases for the June bill paid, and liabilities (Accounts Payable) increases for the July bill to be paid in August. The net effect on total liabilities is an increase of $500.

M3-8

BILL'S EXTREME BOWLING, INC.
Income Statement
For the Month Ended July 31

Revenues:	
Service Revenue	$12,250
Total Revenues	12,250
Expenses:	
Wages Expense	5,475
Utilities Expense	2,500
Repairs and Maintenance Expense	1,500
Total Expenses	9,475
Net Income	$ 2,775

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$\ 2{,}775}{\$12{,}250} = 0.227 \text{ or } 22.7\%$$

M3-9

Amount of Revenue Earned in February

a.	$15,000
b.	No revenue earned in February; gift card recorded as unearned revenue until used by customer.
c.	No revenue earned in February; cash collections in February related to revenues earned in January.
d.	No revenue earned in February; the revenues will be earned, when the services are provided. Record as unearned revenue.
e.	$125

M3-10

Amount of Expense Incurred in February

a.	$4,750
b.	Not an expense incurred in February; cash payments in February relate to expenses that were incurred in January.
c.	$800

M3-11

a.	Cash (+A)	15,000	
	Service Revenue (+R, +SE)		15,000
b.	Cash (+A)	150	
	Unearned Revenue (+L)		150
c.	Cash (+A)	4,000	
	Accounts Receivable (–A)		4,000
d.	Cash (+A)	2,250	
	Unearned Revenue (+L)		2,250
e.	Accounts Receivable (+A)	125	
	Service Revenue (+R, +SE)		125

M3-12

a.	Salaries and Wages Expense (+E, –SE)	4,750	
	Cash (–A)		4,750
b.	Accounts Payable (–L)	1,750	
	Cash (–A)		1,750
c.	Utilities Expense (+E, –SE)	800	
	Accounts Payable (+L)		800

M3-13

a.	Cash (+A)	25,000	
	Common Stock (+SE)		25,000
b.	Utilities Expense (+E, -SE)	600	
	Accounts Payable (+L)		600
c.	Salaries and Wages Expense (+E, -SE)	2,000	
	Cash (-A)		2,000
d.	Accounts Receivable (+A)	2,800	
	Service Revenue (+R, +SE)		2,800
e.	Repairs and Maintenance Expense (+E, -SE)	150	
	Cash (-A)		150

Preliminary net income is $50 ($2,800 – 2,000 – 600 – 150).

M3-14

		Debit	Credit
a.	Accounts Receivable (+A)	200	
	Service Revenue (+R, +SE)		200
b.	Advertising Expense (+E, -SE)	50	
	Cash (-A)		50
c.	Cash (+A)	200	
	Service Revenue (+R, +SE)		200
d.	Utilities Expense (+E, -SE)	85	
	Accounts Payable (+L)		85
e.	Accounts Receivable (+A)	180	
	Service Revenue (+R, +SE)		180

Preliminary net income is $445 ($200 + 200 + 180 – 50 – 85).

M3-15

		Debit	Credit
a.	Cash (+A)	4,000	
	Donation Revenue (+R, +SE)		4,000
b.	Salaries and Wages Expense (+E, -SE)	2,000	
	Cash (-A)		2,000
c.	Note Payable (short-term) (-L)	1,000	
	Cash (-A)		1,000
d.	Supplies (+A)	3,000	
	Cash (-A)		1,000
	Note Payable (short-term) (+L)		2,000
e.	Supplies (+A)	2,500	
	Donation Revenue (+R, +SE)		2,500

Preliminary net income is $4,500 ($4,000 + 2,500 – 2,000).

M3-16

		Debit	Credit
a.	Cash (+A)	150,000	
	Note Payable (long-term) (+L)		150,000
b.	Accounts Receivable (+A)	2,000	
	Service Revenue (+R, +SE)		2,000
c.	Rent Expense (+E, -SE)	600	
	Cash (-A)		600
d.	Cash (+A)	450	
	Service Revenue (+R, +SE)		450
e.	Advertising Expense (+E, -SE)	400	
	Accounts Payable (+L)		400

Preliminary net income is $1,450 ($2,000 + 450 – 600 – 400).

M3-17

	Assets	Liabilities	Stockholders' Equity
a.	+15,000	NE	Service Revenue (+R) +15,000
b.	+150	+150	NE
c.	+/–4000 *	NE	NE
d.	+2,250	+2,250	NE
e.	+125	NE	Service Revenue (+R) +125

* Transaction *c.* results in an increase in an asset (Cash) and a decrease in an asset (Accounts Receivable). Therefore, there is no net effect on total assets.

M3-18

	Assets	Liabilities	Stockholders' Equity
f.	–4,750	NE	Salaries and Wages Expense (+E) –4,750
g.	–1,750	–1,750	NE
h.	NE	+800	Utilities Expense (+E) –800

M3-19

SWING HARD INCORPORATED
Income Statement
For the Month Ended February 28

Revenues:	
Service Revenue	$15,125
Total Revenues	15,125
Expenses:	
Wages Expense	4,750
Utilities Expense	800
Total Expenses	5,550
Net Income	$ 9,575

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$\ 9{,}575}{\$15{,}125} = 0.633 \text{ or } 63.3\%$$

M3-20

EQUILIBRIUM RIDING, INC.
Income Statement
For the Year Ended December 31

Revenues:	
Service Revenue	$ 35,700
Total Revenues	35,700
Expenses:	
Salaries and Wages Expense	3,900
Repairs and Maintenance Expense	410
Office Expenses	270
Total Expenses	4,580
Net Income	$ 31,120

EQUILIBRIUM RIDING, INC.
Statement of Retained Earnings
For the Year Ended December 31

Retained Earnings, Jan. 1	$ 14,500
Add: Net Income	31,120
Subtract: Dividends	(0)
Retained Earnings, Dec. 31	$ 45,620

M3-20 (continued)

EQUILIBRIUM RIDING, INC.
Balance Sheet
At December 31

Assets	
Current Assets	
Cash	$ 59,750
Accounts Receivable	3,300
Prepaid Insurance	4,700
Total Current Assets	67,750
Equipment	64,600
Land	23,000
Total Assets	$155,350
Liabilities	
Current Liabilities	
Accounts Payable	$ 29,230
Unearned Revenue	1,500
Total Current Liabilities	30,730
Notes Payable (long-term)	74,000
Total Liabilities	104,730
Stockholders' Equity	
Common Stock	5,000
Retained Earnings	45,620
Total Stockholders' Equity	50,620
Total Liabilities and Stockholders' Equity	$155,350

M3-21

Item		**(1) Statement**	**(2) Account Type**
Example. Cash	$ 880	B/S	A
1. Service Revenue	5,500	I/S	R
2. Accounts Receivable	900	B/S	A
3. Interest Expense	380	I/S	E
4. Unearned Revenue	200	B/S	L
5. Income Tax Expense	250	I/S	E
6. Retained Earnings	120	B/S	SE

M3-21 (continued)

TIME WARNER CABLE, INC.
Income Statement
For the Year Ended December 31
(Amounts in millions)

Revenues:	
Service Revenue	$5,500
Total Revenues	5,500
Expenses:	
Operating Expenses	4,340
Interest Expense	380
Income Tax Expense	250
Total Expenses	4,970
Net Income	$ 530

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$530}{\$5{,}500} = 0.096 \text{ or } 9.6\%$$

M3-22

Expedia

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$280}{\$4{,}030} = 0.069 \text{ or } 6.9\%$$

Priceline

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$1{,}420}{\$5{,}260} = 0.270 \text{ or } 27.0\%$$

Priceline has generated a greater return of profit from each revenue dollar as shown by the net profit margin of 27.0% as compared to Expedia's net profit margin of 7.0%.

Note: The total assets and total liabilities given in the mini-exercise are not relevant to calculating Net Profit Margin.

M3-23

Total Assets = Total Liabilities + Stockholders' Equity
$100,000 = $60,000 + Stockholders' Equity
Stockholders' Equity = $40,000

Stockholders' Equity = Common Stock + Retained Earnings (ending)
$40,000 = $10,000 + Retained Earnings (ending)
Retained Earnings (ending) = $30,000

Retained Earnings (beginning) + Net Income - Dividends = Retained Earnings (ending)
$15,000 + Net Income – $5,000 = $30,000
Net Income = $20,000

Revenue – Expenses = Net Income
Revenue – $80,000 = $20,000
Revenue= $100,000

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenue}} = \frac{\$\ 20{,}000}{\$100{,}000} = 0.20 \text{ or } 20.0\%$$

Kijijo's Net Profit Margin improved from last year's 15% to this year's 20%.

ANSWERS TO EXERCISES

E3-1

	TERM
B	(1) Expenses
A	(2) Unearned revenue
C	(3) Prepaid expenses
D	(4) Revenues

E3-2

	TERM
D	(1) Accrual basis accounting
A	(2) Expense recognition principle
B	(3) Revenue recognition principle
C	(4) Cash basis accounting

E3-3

Activity	Amount of Revenue Earned in September or Explanation
a.	$10
b.	$2,000
c.	No transaction has occurred; exchange of promises only.
d.	$100,000 (= 1,000 installations x $100 per installation)
e.	Revenue recorded previously in (d) above.
f.	No revenue earned in September. Revenue will be earned, when travel is provided in December. Until then, the $500 is unearned revenue (a liability on the balance sheet).

E3-4

Activity	Amount of Revenue Earned in September or Explanation
a.	No revenue is earned; the issuance of stock is a financing activity.
b.	No revenue earned in September. Revenue will be earned as each game is played. Until then, it is unearned revenue (a liability).
c.	$4,000,000 (= $20,000,000 ÷ 5 games)
d.	No revenue earned in September—the $50,000 is unearned revenue (a liability). Revenue will be earned as construction is completed.
e.	No revenue earned in September. Revenue will be earned as magazines are provided to subscribers. Until then, the $1,800 is unearned revenue (a liability on the balance sheet).
f.	$100

E3-5

Activity	Amount of Expense Incurred in January or Explanation
a.	$90,000
b.	No expense has been incurred. $1,000 (= 1/3 × $3,000) of expense will be incurred in each of the months of February, March, and April. Until then, the $3,000 is Prepaid Rent (an asset on the balance sheet).
c.	$3,000
d.	$1,500
e.	$5,000
f.	$280

E3-6

Activity	Amount of Expense Incurred in January or Explanation
a.	Expense would have been recorded in December (along with a liability, which is paid in January).
b.	$4,200
c.	$1 million will be recorded in January. The remaining $11 million (= ($12 million ÷ 12 months) x 11 months remaining) is an asset (prepaid expense) on the balance sheet.
d.	Expense will be recorded when the travel occurs in March. Until then, it is an asset (prepaid expense) on the balance sheet.
e.	$120 (= $15 x 8 hours)
f.	$300 (= $3,600 ÷ 12 months)
g.	$230

E3-7

	Assets	Liabilities	Stockholders' Equity
a.	Cash –1,000	NE	Wages Expense (+E) –1,000
b.	Cash +5,000	Note Payable (short-term) +5,000	NE
c.	Equipment +2,000	Accounts Payable +2,000	NE
d.	Cash +400	NE	Sales Revenue (+R) +400
e.	NE	Accounts Payable +800	Utilities Expense (+E) –800
f.	Accounts Receivable +1,700	NE	Sales Revenue (+R) +1,700
g.	Cash –300	Accounts Payable –300	NE
h.	Cash –70	NE	Travel Expense (+E) –70
i.	Cash +200 Accounts Receivable +200	NE	Service Revenue (+R) +400
j.	Cash +100 Accounts Receivable –100	NE	NE
k.	Cash –150	Accounts Payable +150	Advertising Expense (+E) –300

Preliminary net income is $330 ($400 + 1,700 + 400 – 1,000 – 800 – 70 – 300).

E3-8

	Assets	Liabilities	Stockholders' Equity
a.	Cash +49,000	NE	Sales Revenue (+R) +49,000
b.	Supplies +3,000	Accounts Payable +3,000	NE
c.	Cash +58,000	Notes Payable (long-term) +58,000	NE
d.	Cash –18,600 Equipment +18,600	NE	NE
e.	Cash –18,000	Accounts Payable +9,000	Selling Expense (+E) –27,000
f.	Cash –9,400 Prepaid Rent +4,700	NE	Rent Expense (+E) –4,700

Preliminary net income is $17,300 ($49,000 – 27,000 – 4,700).

E3-9

a.	Cash (+A)	80,000	
	Notes Payable (short-term) (+L)		80,000

Debits equal credits. Assets and liabilities increase by the same amount.

b.	Cash (+A)	5,000	
	Accounts Receivable (+A)	95,000	
	Service Revenue (+R, +SE)		100,000

Debits equal credits. Revenue increases retained earnings (part of stockholders' equity). Stockholders' equity and assets increase by the same amount.

c.	Equipment (+A)	130,000	
	Cash (-A)		130,000

Debits equal credits. Assets increase and decrease by the same amount.

d.	Salaries and Wages Expense (+E,-SE)	1,000	
	Cash (-A)		1,000

Debits equal credits. Expenses decrease retained earnings (part of stockholders' equity). Thus, stockholders' equity and assets decrease by the same amount.

e.	Cash (+A)	410	
	Accounts Receivable (-A)		410

Debits equal credits. Assets increase and decrease by the same amount.

f.	Travel Expense (+E, -SE)	4,000	
	Cash (-A)		4,000

Debits equal credits. Expenses decrease retained earnings (part of stockholders' equity). Thus, stockholders' equity and assets decrease by the same amount.

g.	Accounts Payable (-L)	8,200	
	Cash (-A)		8,200

Debits equal credits. Assets and liabilities decrease by the same amount.

h.	Utilities Expense (+E, -SE)	20,000	
	Cash (-A)		15,000
	Accounts Payable (+L)		5,000

Debits equal credits. Expenses decrease retained earnings (part of stockholders' equity). The net decrease in stockholders' equity and liabilities combined is equal to the decrease in assets.

Preliminary net income is $75,000 ($100,000 – 1,000 – 4,000 – 20,000).

E3-10

a.	Cash (+A)	500,000	
	Note Payable (short-term) (+L)		500,000

Debits equal credits. Assets and liabilities increase by the same amount.

b.	Equipment (+A)	20,000	
	Cash (-A)		20,000

Debits equal credits. Assets increase and decrease by the same amount.

c.	Supplies (+A)	10,000	
	Accounts Payable (+L)		10,000

Debits equal credits. Assets and liabilities increase by the same amount.

d.	Repairs and Maintenance Expense (+E, -SE)	22,000	
	Cash (-A)		22,000

Debits equal credits. Expenses decrease retained earnings (part of stockholders' equity). Stockholders' equity and assets decrease by the same amount.

e.	Cash (+A)	72,000	
	Unearned Revenue (+L)		72,000

Debits equal credits. Since the season passes are sold before Greek Peak provides service, revenue is deferred until it is earned. Assets and liabilities increase by the same amount.

f.	Cash (+A)	76,000	
	Service Revenue (+R, +SE)		76,000

Debits equal credits. Revenue increases retained earnings (a stockholders' equity account). Stockholders' equity and assets increase by the same amount.

g.	Cash (+A)	320	
	Unearned Revenue (+L)		320

Debits equal credits. Because the rent is received before the townhouse is used, revenue is deferred until it is earned. Assets and liabilities increase by the same amount.

h.	Accounts Payable (-L)	5,000	
	Cash (-A)		5,000

Debits equal credits. Assets and liabilities decrease by the same amount.

i.	Salaries and Wages Expense (+E, -SE)	18,000	
	Cash (-A)		18,000

Debits equal credits. Expenses decrease retained earnings (a stockholders' equity account). Stockholders' equity and assets decrease by the same amount.

Preliminary net income is $36,000 ($76,000 – 22,000 – 18,000).

E3-11

2/1	Rent Expense (+E,-SE)	200	
	Cash (-A)		200
2/4	Cash (+A)	800	
	Unearned Revenue (+L)		800
2/7	Cash (+A)	900	
	Service Revenue (+R, +SE)		900
2/10	Salaries and Wages Expense (+E, -SE)	1,200	
	Cash (-A)		1,200
2/14	Advertising Expense (+E, -SE)	100	
	Cash (-A)		100
2/18	Cash (+A)	500	
	Accounts Receivable (+A)	1,200	
	Service Revenue (+R, +SE)		1,700
2/25	Supplies (+A)	1,350	
	Accounts Payable (+L)		1,350

Preliminary net income is $1,100 ($900 + 1,700 – 200 – 1,200 – 100).

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$1,100}{\$2,600} = 0.423 \text{ or } 42.3\%$$

E3-12

Req. 1

Included with Req. 3 on the next page.

Req. 2

		Debit	Credit
a.	Cash (+A)	500	
	Unearned Revenue (+L)		500
b.	Cash (+A)	300	
	Rent Revenue (+R, +SE)		300
c.	Cash (+A)	14,500	
	Service Revenue (+R, +SE)		14,500
d.	Accounts Receivable (+A)	7,000	
	Service Revenue (+R, +SE)		7,000
e.	Cash (+A)	6,000	
	Accounts Receivable (-A)		6,000
f.	Utilities Expense (+E, -SE)	350	
	Accounts Payable (+L)		350
g.	No transaction because there has been no exchange.		
h.	Accounts Payable (-L)	1,700	
	Cash (-A)		1,700
i.	Salaries and Wages Expense (+E, -SE)	10,000	
	Cash (-A)		10,000
j.	Supplies (+A)	800	
	Cash (-A)		800

E3-12 (continued)

Req. 1 and 3

Cash (A)

Beg. 6,000	1,700 *(h)*
(a) 500	10,000 *(i)*
(b) 300	800 *(j)*
(c) 14,500	
(e) 6,000	
14,800	

Accounts Receivable (A)

Beg. 25,000	6,000 *(e)*
(d) 7,000	
26,000	

Supplies (A)

Beg. 1,200	
(j) 800	
2,000	

Equipment (A)

Beg. 8,000	
8,000	

Land (A)

Beg. 6,000	
6,000	

Building (A)

Beg. 22,000	
22,000	

Accounts Payable (L)

(h) 1,700	8,000 Beg.
	350 *(f)*
	6,650

Unearned Revenue (L)

	3,200 Beg.
	500 *(a)*
	3,700

Notes Payable (L)

	40,000 Beg.
	40,000

Common Stock (SE)

	8,000 Beg.
	8,000

Retained Earnings (SE)

	9,000 Beg.
	9,000

Service Revenue (R)

	0 Beg.
	14,500 *(c)*
	7,000 *(d)*
	21,500

Rent Revenue (R)

	0 Beg.
	300 *(b)*
	300

Salaries and Wages Expense (E)

Beg. 0	
(i) 10,000	
10,000	

Utilities Expense (E)

Beg. 0	
(f) 350	
350	

Item *(g)* is not a transaction; there has been no exchange.

E3-13

RICKY'S PIANO REBUILDING COMPANY
Unadjusted Trial Balance
At January 31

	Debit	Credit
Cash	$14,800	
Accounts Receivable	26,000	
Supplies	2,000	
Equipment	8,000	
Land	6,000	
Building	22,000	
Accounts Payable		$ 6,650
Unearned Revenue		3,700
Notes Payable		40,000
Common Stock		8,000
Retained Earnings		9,000
Service Revenue		21,500
Rent Revenue		300
Salaries and Wages Expense	10,000	
Utilities Expense	350	
Total	$89,150	$89,150

E3-14

OT TECHNOLOGIES (OTT)			NEWS NOW (NN)		
a) Advertising Expense	500		a) Accounts Receivable	500	
Accounts Payable		500	Advertising Revenue		500
b) Accounts Receivable	135		b) Repairs and Maint. Expense	135	
Service Revenue		135	Accounts Payable		135
c) Accounts Payable	500		c) Cash	500	
Cash		500	Accounts Receivable		500
d) Cash	60		d) Advertising Expense	60	
Advertising Revenue		60	Cash		60
e) Note Receivable	1,000		e) Cash	1,000	
Cash		1,000	Note Payable (short-term)		1,000

E3-15

Req. 1

Accounts Receivable increases with sales to customers on account and decreases with cash collections from customers.

Prepaid Rent increases with cash payments for rent related to future periods and decreases as the benefits of these prepayments are used up over time.

Unearned Revenue increases with cash received from customers for goods or services to be provided in the future and decreases when those goods and services are provided.

Req. 2

Accounts Receivable

	Debit	Credit
BEG.	313	
	2,573	$\boxed{2,591}$
END.	295	

Prepaid Rent

	Debit	Credit
BEG.	25	
	43	$\boxed{42}$
END.	26	

Unearned Revenue

Debit	Credit	
	240	BEG.
$\boxed{315}$	328	
	253	END.

Computations:

	Beginning	+	"+"	–	"–"	=	Ending
Accounts Receivable	313	+	2,573	–	a	=	295
					a	=	2,591
Prepaid Rent	25	+	43	–	b	=	26
					b	=	42
Unearned Revenue	240	+	328	–	c	=	253
					c	=	315

E3-16

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Cash	+9,500	=				Service Revenue (+R)	+9,500
b.	Cash	+10,000	=				Common Stock	+10,000
c.	Equipment Cash	+12,000 -3,000	=	Note Payable (long)	+9,000			
d.	Cash	+7,500	=	Unearned Revenue	+7,500			
e.	Supplies	+1,000	=	Accounts Payable	+1,000			
f.	NE		=	Accounts Payable	+1,250		Utilities Expense (+E)	-1,250
g.	Accounts Receivable	+15,900	=				Service Revenue (+R)	+15,900
h.	Accounts Receivable Cash	-12,000 +12,000	=				NE	
i.	Cash	-500	=	Accounts Payable	-500			

E3-17

		Debit	Credit
a.	Cash (+A)	9,500	
	Service Revenue (+R,+SE)		9,500
b.	Cash (+A)	10,000	
	Common Stock (+SE)		10,000
c.	Equipment (+A)	12,000	
	Cash (-A)		3,000
	Note Payable (long-term) (+L)		9,000
d.	Cash (+A)	7,500	
	Unearned Revenue (+L)		7,500
e.	Supplies (+A)	1,000	
	Accounts Payable (+L)		1,000

E3-17 (continued)

		Debit	Credit
f.	Utilities Expense (+E, -SE)	1,250	
	Accounts Payable (+L)		1,250
g.	Accounts Receivable (+A)	15,900	
	Service Revenue (+R, +SE)		15,900
h.	Cash (+A)	12,000	
	Accounts Receivable (-A)		12,000
i.	Accounts Payable (-L)	500	
	Cash (-A)		500

E3-18

Cash (A)

Beg.	10,000		
a	9,500	3,000	*c*
b	10,000	500	*i*
d	7,500		
h	12,000		
End.	45,500		

Accounts Payable (L)

		5,000	Beg.
i	500	1,000	*e*
		1,250	*f*
		6,750	End.

Common Stock (SE)

		12,000	Beg.
		10,000	*b*
		22,000	End.

Retained Earnings (SE)

		8,800	Beg.
		8,800	End.

Unearned Revenue (L)

		2,500	Beg.
		7,500	*d*
		10,000	End.

Accounts Receivable (A)

Beg.	12,500		
g	15,900	12,000	*h*
End.	16,400		

Note Payable (L)

		0	Beg.
		9,000	*c*
		9,000	End.

Service Revenue (R)

		0	Beg.
		9,500	*a*
		15,900	*g*
		25,400	End.

Supplies (A)

Beg.	800		
e	1,000		
End.	1,800		

Equipment (A)

Beg.	5,000		
c	12,000		
End.	17,000		

Utilities Expense (E)

Beg.	0		
f	1,250		
End.	1,250		

E3-19

TONGO, INC.
Unadjusted Trial Balance
At January 31

	Debit	Credit	
Cash	$ 45,500		Balance Sheet accounts
Accounts Receivable	16,400		
Supplies	1,800		
Equipment	17,000		
Accounts Payable		$ 6,750	
Unearned Revenue		10,000	
Note Payable (long-term)		9,000	
Common Stock		22,000	
Retained Earnings		8,800	
Service Revenue		25,400	Income Statement accounts
Utilities Expense	1,250		
Totals	$ 81,950	$ 81,950	

E3-20

Req. 1

Transaction	***Brief Explanation***
a.	Issued common stock for $11,000 cash.
b.	Incurred $710 of utilities expense in July, not yet paid.
c.	Sold $5,000 of services to customers on account.
d.	Purchased $10,000 of equipment, paying $6,000 in cash and the balance ($4,000) on account.
e.	Sold $1,000 of services to customers, who paid in cash.
f.	Purchased $550 of supplies on account.
g.	Paid $3,000 cash toward accounts payable.
h.	Paid $2,000 cash for wage expense.
i.	Paid $750 cash toward July rent.
j.	Collected $1,500 cash from customers on account.

E3-20 (continued)

Req. 2

NEPCO
Income Statement
For the Month Ended July 31

Revenues:	
Service Revenue	$ 6,000
Total Revenues	6,000
Expenses:	
Salaries and Wages Expense	2,000
Rent Expense	750
Utilities Expense	710
Total Expenses	3,460
Net Income	$ 2,540

NEPCO
Statement of Retained Earnings
For the Month Ended July 31

Retained Earnings, July 1	$ 0
Add: Net Income	2,540
Subtract: Dividends	(0)
Retained Earnings, July 31	$2,540

E3-20 (continued)

NEPCO
Balance Sheet
At July 31

Assets	
Current Assets	
Cash	$ 1,750
Accounts Receivable	3,500
Supplies	550
Total Current Assets	5,800
Equipment	10,000
Total Assets	$ 15,800
Liabilities	
Current Liabilities	
Accounts Payable	$ 2,260
Total Liabilities	2,260
Stockholders' Equity	
Common Stock	11,000
Retained Earnings	2,540
Total Stockholders' Equity	13,540
Total Liabilities and Stockholders' Equity	$ 15,800

Req. 3

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$2,540}{\$6,000} = 0.423 \text{ or } 42.3\%$$

NepCo's net profit margin of 42.3% is greater than the competitor's 25.0%, indicating that NepCo is more profitable than its competitor.

E3-21

	Debit Side of Journal Entry				Credit Side of Journal Entry			
	Account Name	**Account Type**	**Direction of Change**	**Normal Balance**	**Account Name**	**Account Type**	**Direction of Change**	**Normal Balance**
(a)	Cash	A	+	Debit	Common Stock	SE	+	Credit
(b)	Accounts Receivable	A	+	Debit	Service Revenue	R	+	Credit
(c)	Equipment	A	+	Debit	Cash	A	-	Debit
(d)	Supplies	A	+	Debit	Accounts Payable	L	+	Credit
(e)	Cash	A	+	Debit	Accounts Receivable	A	-	Debit
(f)	Utilities Expense	E	+	Debit	Utilities Payable	L	+	Credit
(g)	Wage Expense	E	+	Debit	Cash	A	-	Debit
(h)	Accounts Payable	L	-	Credit	Cash	A	-	Debit

Note: In item (f), Accounts Payable could have been used instead of Utilities Payable.

Preliminary net income is $5,500 ($10,500 – 1,500 – 3,500).

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$\ 5{,}500}{\$10{,}500} = 0.524 \text{ or } 52.4\%$$

ANSWERS TO COACHED PROBLEMS

CP3-1

Transaction	Debit	Credit
a.	5	3, 8
b.	3	4
c.	3	11
d.	10	3
e.	2	11
f.	3	2
g.	1	3
h.	12	3
i.	13	12
j.	6	3, 7
k.	9	3

CP3-2

a) 5/1	Cash (A+)	30,000	
	Common Stock (+SE)		30,000
b) 5/15	Cash (+A)	50,000	
	Notes Payable (long-term) (+L)		50,000
c) 5/31	Prepaid Insurance (+A)	2,400	
	Cash (-A)		2,400
d) 6/3	Equipment (+A)	15,000	
	Accounts Payable (+L)		15,000
e) 6/5	Advertising Expense (+E, -SE)	250	
	Cash (-A)		250
f) 6/9	Cash (+A)	400	
	Service Revenue (+R, +SE)		400
g) 6/14	Accounts Payable (-L)	15,000	
	Cash (-A)		15,000

CP3-3

Req. 1

		Debit	Credit
1.	Cash (+A)	16,000	
	Common Stock (+SE)		16,000
2.	Prepaid Rent (+A)..	2,400	
	Cash (–A)		2,400
3.	Supplies (+A)..	300	
	Cash (–A)		300
4.	Cash (+A)	10,000	
	Notes Payable (long-term) (+L)		10,000
5.	Equipment (+A)	2,500	
	Land (+A)	7,500	
	Cash (–A)		10,000
6.	Advertising Expense (+E, –SE)	425	
	Cash (–A)		425
7.	Cash (+A)	1,525	
	Accounts Receivable (+A)	275	
	Sales Revenue (+R, +SE)		1,800
8.	Cash (+A)	50	
	Accounts Receivable (–A)		50
9.	Repairs and Maintenance Expense (+E, –SE)	120	
	Cash (–A)		120
10.	Salaries and Wages Expense (+E, –SE)............................	420	
	Cash (–A)		420

CP3-3 (continued)

Req. 2

Cash (A)

Beg.	0		
(1)	16,000	2,400	*(2)*
(4)	10,000	300	*(3)*
(7)	1,525	10,000	*(5)*
(8)	50	425	*(6)*
		120	*(9)*
		420	*(10)*
End.	13,910		

Accounts Receivable (A)

Beg.	0		
(7)	275	50	*(8)*
End.	225		

Supplies (A)

Beg.	0		
(3)	300		
End.	300		

Prepaid Rent (A)

Beg.	0		
(2)	2,400		
End.	2,400		

Land (A)

Beg.	0		
(5)	7,500		
End.	7,500		

Equipment (A)

Beg.	0		
(5)	2,500		
End.	2,500		

Notes Payable (long-term) (L)

		0	Beg.
		10,000	*(4)*
		10,000	End.

Common Stock (SE)

		0	Beg.
		16,000	*(1)*
		16,000	End.

Sales Revenue (R)

		0	Beg.
		1,800	*(7)*
		1,800	End.

Advertising Expense (E)

Beg.	0		
(6)	425		
End.	425		

Salaries and Wages Expense (E)

Beg.	0		
(10)	420		
End.	420		

Repairs & Maintenance Expense (E)

Beg.	0		
(9)	120		
End.	120		

CP3-3 (continued)

Req. 3

BARB'S BOOK BUSINESS
Unadjusted Trial Balance
At February 28

	Debit	Credit
Cash	$ 13,910	
Accounts Receivable	225	
Supplies	300	
Prepaid Rent	2,400	
Land	7,500	
Equipment	2,500	
Notes Payable		10,000
Common Stock		16,000
Sales Revenue		1,800
Advertising Expense	425	
Salaries and Wages Expense	420	
Repairs and Maintenance Expense	120	
Total	$ 27,800	$ 27,800

Req. 4

Preliminary net income is $835 (1,800 – 425 – 420 – 120).

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$835}{\$1{,}800} = 0.464 \text{ or } 46.4\%$$

Barb's Book Business is doing better than its close competitor with a Net Profit Margin of 46.4% as compared to its competitor's Net Profit Margin of 10.0%.

CP3-4

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
8/31	Cash	+1,500	=	Unearned Revenue	+1,500			
9/11	Cash	+3,800	=				Service Revenue (+R)	+3,800
9/13	Supplies	+200	=	Accounts Payable	+200			
9/15	Cash	-1,500	=				Salaries & Wages Expense (+E)	-1,500
9/25	Cash	+7,200	=				Service Revenue (+R)	+7,200
9/26	Accounts Receivable	+210	=				Service Revenue (+R)	+210
9/27	Prepaid Advertising Cash	+300 - 300	=	NE				
9/29	Cash Accounts Receivable	+210 -210	=	NE				
9/30	NE		=	Accounts Payable	+300		Utilities Expense (+E)	-300

CP3-4 (continued)

Req. 2

8/31	Cash (+A)	1,500	
	Unearned Revenue (+L)		1,500
9/11	Cash (+A)	3,800	
	Service Revenue (+R, +SE)		3,800
9/13	Supplies (+A)	200	
	Accounts Payable (+L)		200
9/15	Salaries and Wages Expense (+E, -SE)	1,500	
	Cash (-A)		1,500
9/25	Cash (+A)	7,200	
	Service Revenue (+R, +SE)		7,200
9/26	Accounts Receivable (+A)	210	
	Service Revenue (+R, +SE)		210
9/27	Prepaid Advertising (+A)	300	
	Cash (-A)		300
9/29	Cash (+A)	210	
	Accounts Receivable (-A)		210
9/30	Utilities Expense (+E,-SE)	300	
	Accounts Payable (+L)		300

Req. 3

Preliminary net income = Revenues – Expenses
= ($3,800 + 7,200 + 210) – 1,500 – 300
= $9,410

Net income is greater than zero, so it suggests LTC is profitable.

CP3-4 (continued)

Req. 4

Adjustments will be needed to report the membership revenue earned in September (previously recorded as Unearned Revenue), the cost of supplies used up in September, the cost of wages from September 16-30 (not yet recorded), service revenue from court rental fees earned from September 26-30 (not yet recorded), and income taxes on the company's net income in September (not yet recorded).

ANSWERS TO GROUP A PROBLEMS

PA3-1

Transaction	Debit	Credit
a.	5	6
b.	2	13
c.	14	1
d.	11	5
e.	4	5, 10
f.	5	2
g.	12	5
h.	1	5
i.	3	5
j.	3	1
k.	5	13
l.	15	14
m.	7	8
n.	None*	

* Item n is not a transaction of the business; the separate entity assumption requires that transactions not involving the business not be recorded in its accounting system.

PA3-2

4/2	Supplies (+A)..	500	
	Accounts Payable (+L)		500
4/5	Accounts Receivable (+A)	3,000	
	Service Revenue (+R, +SE)		3,000
4/8	Accounts Payable (-L)	250	
	Cash (-A)		250
4/8	Advertising Expense (+E,-SE)	400	
	Cash (-A)		400
4/9	Equipment (+A)	2,300	
	Cash (-A)		2,300
4/10	Salaries and Wages Expense (+E, -SE).............................	1,200	
	Cash (-A)		1,200
4/11	Cash (+A)	1,000	
	Accounts Receivable (-A)		1,000
4/12	Land (+A)	10,000	
	Cash (-A)		2,000
	Note Payable (long-term) (+L)		8,000
4/13	Cash (+A)	80,000	
	Common Stock (+SE)		80,000
4/14	Accounts Receivable (+A)	2,000	
	Service Revenue (+R, +SE)		2,000
4/15	Utilities Expense (+E, -SE)	300	
	Accounts Payable (+L)		300

PA3-3

Req. 1

		Debit	Credit
1.	Cash (+A)	200,000	
	Common Stock (+SE)		200,000
2.	Buildings (+A)	142,000	
	Notes Payable (long-term) (+L)		71,000
	Cash (–A)		71,000
3.	Accounts Receivable (+A)	16,000	
	Service Revenue (+R, +SE)		16,000
4.	Cash (+A)	13,000	
	Rent Revenue (+R, +SE)		13,000
5.	Cash (+A)	1,500	
	Unearned Revenue (+L)		1,500
6.	Supplies (+A)	3,000	
	Accounts Payable (+L)		3,000
7.	Accounts Payable (–L)	1,700	
	Cash (–A)		1,700
8.	Cash (+A)	1,000	
	Accounts Receivable (–A)		1,000
9.	Prepaid Insurance (+A)	3,600	
	Cash (–A)		3,600
10.	Utilities Expense (+E, –SE)	800	
	Cash (–A)		800
11.	Salaries and Wages Expense (+E, –SE)	14,000	
	Cash (–A)		14,000

PA3-3 (continued)

Req. 1 (continued)

12.	Utilities Expense (+E, –SE)	1,200	
	Accounts Payable (+L)		1,200

Req. 2

Cash (A)

Debit	Credit
Beg. 0	
(*1*)200,000	71,000 (*2*)
(*4*) 13,000	1,700 (*7*)
(*5*) 1,500	3,600 (*9*)
(*8*) 1,000	800 (*10*)
	14,000 (*11*)
End. 124,400	

Accounts Receivable (A)

Debit	Credit
Beg. 0	
(*3*) 16,000	1,000 (*8*)
End. 15,000	

Supplies (A)

Debit	Credit
Beg. 0	
(*6*) 3,000	
End. 3,000	

Prepaid Insurance (A)

Debit	Credit
Beg. 0	
(*9*) 3,600	
End. 3,600	

Buildings (A)

Debit	Credit
Beg. 0	
(*2*)142,000	
End.142,000	

Accounts Payable (L)

Debit	Credit
	0 Beg.
(*7*) 1,700	3,000 (*6*)
	1,200 (*12*)
	2,500 End.

Unearned Revenue (L)

Debit	Credit
	0 Beg.
	1,500 (*5*)
	1,500 End.

Notes Payable (long-term) (L)

Debit	Credit
	0 Beg.
	71,000 (*2*)
	71,000 End.

Common Stock (SE)

Debit	Credit
	0 Beg.
	200,000(*1*)
	200,000 End.

Service Revenue (R)

Debit	Credit
	0 Beg.
	16,000 (*3*)
	16,000 End.

Rent Revenue (R)

Debit	Credit
	0 Beg.
	13,000 (*4*)
	13,000 End.

Utilities Expense (E)

Debit	Credit
Beg. 0	
(*10*) 800	
(*12*) 1,200	
End. 2,000	

Salaries and Wages Expense (E)

Debit	Credit
Beg. 0	
(*11*) 14,000	
End. 14,000	

PA3-3 (continued)

Req. 3

SPICEWOOD STABLES, INC.
Unadjusted Trial Balance
At April 30

	Debit	Credit
Cash	$124,400	
Accounts Receivable	15,000	
Supplies	3,000	
Prepaid Insurance	3,600	
Buildings	142,000	
Accounts Payable		$ 2,500
Unearned Revenue		1,500
Notes Payable (long-term)		71,000
Common Stock		200,000
Service Revenue		16,000
Rent Revenue		13,000
Utilities Expense	2,000	
Salaries and Wages Expense	14,000	
Total	$304,000	$ 304,000

Req. 4

Preliminary net income is $13,000 (16,000 + 13,000 – 2,000 – 14,000)

Net Profit Margin $= \frac{\text{Net Income}}{\text{Revenues}}$

$= \frac{\$13,000}{\$29,000}$

=0.448 or 44.8%

Spicewood Stables Inc.'s Net Profit Margin of 44.8% is better than its close competitor's Net Profit Margin of 30.0%.

PA3-4

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
9/1	Cash	+10,000	=				Common Stock	+10,000
9/8	Cash	+30,000	=	Note Payable	+30,000			
9/10	Equipment Cash	+20,000 -20,000	=	No change				
9/15	Supplies	+1,000	=	Accounts Payable	+1,000			
9/16	Cash	-1,500	=				Rent Expense (+E)	-1,500
9/22	Cash Accounts Receivable	+6,000 +2,000	=				Service Revenue (+R)	+8,000
9/28	Cash	- 200	=				Utilities Expense (+E)	-200
9/29	Cash	-4,000	=				Salaries & Wages Expense (+E)	-4,000
9/30	No change		=	Accounts Payable	+300		Utilities Expense (+E)	-300

PA3-4 (continued)

Req. 2

9/1	Cash (+A)	10,000	
	Common Stock (+SE)		10,000
9/8	Cash (+A)	30,000	
	Note Payable (long-term) (+L)		30,000
9/10	Equipment (+A)	20,000	
	Cash (-A)		20,000
9/15	Supplies (+A)	1,000	
	Accounts Payable (+L)		1,000
9/16	Rent Expense (+E, -SE)	1,500	
	Cash (-A)		1,500
9/22	Cash (+A)	6,000	
	Accounts Receivable (+A)	2,000	
	Service Revenue (+R, +SE)		8,000
9/28	Utilities Expense (+E, -SE)	200	
	Cash (-A)		200
9/29	Salaries and Wages Expense (+E, -SE)	4,000	
	Cash (-A)		4,000
9/30	Utilities Expense (+E, -SE)	300	
	Accounts Payable (+L)		300

Req. 3

Preliminary net income = Revenues – Expenses
= $8,000 – 1,500 – 200 – 4,000 – 300
= $2,000

Net income is greater than zero, so it suggests OCC is profitable.

PA3-4 (continued)

Req. 4

Adjustments will be needed to report service revenue earned from September 22-30 (not yet recorded), the cost of supplies used up in September, the cost of salaries and wages for September 30 (not yet recorded), the cost of interest on the note payable (not yet recorded), and income taxes on the company's net income in September (not yet recorded).

ANSWERS TO GROUP B PROBLEMS

PB3-1

Transaction	Debit	Credit
a.	9	3
b.	3	2
c.	11	10
d.	3	12
e.	5	1, 3
f.	1	3
g.	3	4
h.	7	3
i.	3	6

PB3-2

a.	Cash (+A)	80,000	
	Common Stock (+SE)		80,000
b.	Cash (+A)	16,000	
	Accounts Receivable (+A)	72,000	
	Service Revenue (+R, +SE)		88,000
c.	Equipment (+A)	82,000	
	Notes Payable (long-term) (+L)		82,000
d.	Repairs and Maintenance Expense (+E, -SE)	3,000	
	Accounts Payable (+L)		3,000
e.	Cash (+A)	65,000	
	Accounts Receivable (-A)		65,000
f.	Cash (+A)	90,000	
	Notes Payable (long-term) (+L)		90,000
g.	Prepaid Rent (+A)	74,400	
	Cash (-A)		74,400
h.	Wages Expense (+E, -SE)	38,000	
	Cash (-A)		38,000
i.	Delivery Expense (+E,-SE)	49,000	
	Cash (-A)		49,000
j.	Accounts Payable (-L)	2,000	
	Cash (-A)		2,000

k. *No entry because no exchange transaction has occurred.*

PB3-3

Req. 1

		Debit	Credit
1.	Cash (+A)	50,000	
	Common Stock (+SE)		50,000
2.	Equipment (+A)	20,000	
	Cash (–A)		20,000
3.	Cash (+A)	5,000	
	Service Revenue (+R, +SE)		5,000
4.	Cash (+A)	2,000	
	Accounts Receivable (+A)	8,000	
	Service Revenue (+R, +SE)		10,000
5.	Cash (+A)	2,500	
	Unearned Revenue (+L)		2,500
6.	Supplies (+A)	600	
	Accounts Payable (+L)		600
7.	Rent Expense (+E, –SE)	6,000	
	Cash (–A)		6,000
8.	Prepaid Rent (+A)	6,000	
	Cash (–A)		6,000
9.	Cash (+A)	1,000	
	Accounts Receivable (–A)		1,000
10.	Advertising Expense (+E, –SE)	1,000	
	Cash (–A)		1,000
11.	Salaries and Wages Expense (+E, –SE)	4,000	
	Cash (–A)		4,000

PB3-3 (continued)

Req. 2

Cash (A)

Beg. 0	
(1) 50,000	20,000 (2)
(3) 5,000	6,000 (7)
(4) 2,000	6,000 (8)
(5) 2,500	1,000 (10)
(9) 1,000	4,000 (11)
End. 23,500	

Accounts Receivable (A)

Beg. 0	
(4) 8,000	1,000 (9)
End. 7,000	

Supplies (A)

Beg. 0	
(6) 600	
End. 600	

Prepaid Rent (A)

Beg. 0	
(8) 6,000	
End. 6,000	

Equipment (A)

Beg. 0	
(2) 20,000	
End. 20,000	

Accounts Payable (L)

	0 Beg.
	600 (6)
	600 End.

Unearned Revenue (L)

	0 Beg.
	2,500 (5)
	2,500 End.

Common Stock (SE)

	0 Beg.
	50,000 (1)
	50,000 End.

Service Revenue (R)

	0 Beg.
	5,000 (3)
	10,000 (4)
	15,000 End.

Rent Expense (E)

Beg. 0	
(7) 6,000	
End. 6,000	

Salaries and Wages Expense (E)

Beg. 0	
(11) 4,000	
End. 4,000	

Advertising Expense (E)

Beg. 0	
(10) 1,000	
End. 1,000	

PB3-3 (continued)

Req. 3

FUNFLATABLES
Unadjusted Trial Balance
At June 30

	Debit	Credit
Cash	$23,500	
Accounts Receivable	7,000	
Supplies	600	
Prepaid Rent	6,000	
Equipment	20,000	
Accounts Payable		$ 600
Unearned Revenue		2,500
Common Stock		50,000
Service Revenue		15,000
Rent Expense	6,000	
Salaries and Wages Expense	4,000	
Advertising Expense	1,000	
Total	$68,100	$ 68,100

Req. 4

Preliminary net income is $4,000 (15,000 – 6,000 – 4,000 – 1,000)

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$\ 4,000}{\$15,000} = 0.267 \text{ or } 26.7\%$$

FunFlatables Net Profit Margin is 26.7%, which is slightly worse than the 30.0% Net Profit Margin of its close competitor.

PB3-4

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
12/1	Cash	+10,000	=				Common Stock	+10,000
12/7	No transaction; only promises were exchanged.							
12/17	Cash	+200	=	Unearned Revenue	+200			
12/21	No change		=	Accounts Payable	+500		Advertising Expense (+E)	-500
12/22	Prepaid Rent Cash	+1,000 -1,000	=	No change				
12/23	No transaction; the separate entity assumption allows only transactions involving the company to be recorded.							
12/28	Cash	-500	=	Accounts Payable	-500			
12/29	Supplies	+2,000	=	Accounts Payable	+2,000			
12/31	Accounts Receivable	+2,000	=				Service Revenue (+R)	+2,000

PB3-4 (continued)

Req. 2

12/1	Cash (+A)	10,000	
	Common Stock (+SE)		10,000
12/7	No transaction because only promises were exchanged.		
12/17	Cash (+A)	200	
	Unearned Revenue (+L)		200
12/21	Advertising Expense (+E,-SE)	500	
	Accounts Payable (+L)		500
12/22	Prepaid Rent (+A)	1,000	
	Cash (-A)		1,000
12/23	No transaction because the separate entity assumption allows only transactions involving the company to be recorded.		
12/28	Accounts Payable (-L)	500	
	Cash (-A)		500
12/29	Supplies (+A)	2,000	
	Accounts Payable (+L)		2,000
12/31	Accounts Receivable (+A)	2,000	
	Service Revenue (+R, +SE)		2,000

Req. 4

Adjustments will be needed to report the cost of supplies used up in December and income taxes on the company's net income (not yet recorded).

ANSWERS TO COMPREHENSIVE PROBLEM

C3-1

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
1.	Cash Accounts Receivable	+50,000 -50,000	=	No change				
2.	Equipment Cash	+33,500 -10,000	=	Note Payable (long-term)	+23,500			
3.	Cash	-10,000	=				Advertising Expense (+E)	-10,000
4.	Supplies	+3,000	=	Accounts Payable	+3,000			
5.	Cash	+170,000	=				Service Revenue (+R)	+170,000
6.	Cash	-3,000	=	Accounts Payable	-3,000			
7.	Cash Accounts Receivable	+112,500 +112,500	=				Service Revenue (+R)	+225,000
8.	Cash	-378,000	=				Salaries/Wages Expense (+E)	-378,000
9.	No Change		=	Accounts Payable	+5,350		Utilities Expense (+E)	-5,350

C3-1 (continued)

Req. 2

		Debit	Credit
1.	Cash (+A)	50,000	
	Accounts Receivable (-A)		50,000
2.	Equipment (+A)	33,500	
	Cash (-A)		10,000
	Note Payable (long-term) (+L)		23,500
3.	Advertising Expense (+E, -SE)	10,000	
	Cash (-A)		10,000
4.	Supplies (+A)	3,000	
	Accounts Payable (+L)		3,000
5.	Cash (+A)	170,000	
	Service Revenue (+R, +SE)		170,000
6.	Accounts Payable (-L)	3,000	
	Cash (-A)		3,000
7.	Cash (+A)	112,500	
	Accounts Receivable (+A)	112,500	
	Service Revenue (+R, +SE)		225,000
8.	Salaries and Wages Expense (+E, -SE)	378,000	
	Cash (-A)		378,000
9.	Utilities Expense (+E, -SE)	5,350	
	Accounts Payable (+L)		5,350

C3-1 (continued)

Req. 3

Cash (A)

Beg.	1,500,000		
1.	50,000	10,000	*2.*
5.	170,000	10,000	*3.*
7.	112,500	3,000	*6.*
		378,000	*8.*
End.	1,431,500		

Accounts Receivable (A)

Beg.	150,000		
7.	112,500	50,000	*1.*
End.	212,500		

Supplies (A)

Beg.	14,700		
4.	3,000		
End.	17,700		

Equipment (A)

Beg.	874,500		
2.	33,500		
End.	908,000		

Land (A)

Beg.	1,200,000		
End.	1,200,000		

Building (A)

Beg.	422,000		
End.	422,000		

Accounts Payable (L)

		108,000	Beg.
6.	3,000	3,000	*4.*
		5,350	*9.*
		113,350	End.

Unearned Revenue (L)

		73,500	Beg.
		73,500	End.

Notes Payable (L)

		60,000	Beg.
		23,500	*2.*
		83,500	End.

Common Stock (SE)

		2,500,000	Beg.
		2,500,000	End.

Retained Earnings (SE)

		1,419,700	Beg.
		1,419,700	End.

Service Revenue (R)

		0	Beg.
		170,000	*5.*
		225,000	*7.*
		395,000	End.

Salaries and Wages Expense(E)

Beg.	0		
8.	378,000		
End.	378,000		

Advertising Expense (E)

Beg.	0		
3.	10,000		
End.	10,000		

Utilities Expense (E)

Beg.	0		
9.	5,350		
End.	5,350		

C3-1 (continued)

Req. 4

VANISHING GAMES CORPORATION
Unadjusted Trial Balance
At January 31, 2015

	Debit	Credit
Cash	$1,431,500	
Accounts Receivable	212,500	
Supplies	17,700	
Equipment	908,000	
Building	422,000	
Land	1,200,000	
Accounts Payable		$ 113,350
Unearned Revenue		73,500
Notes Payable		83,500
Common Stock		2,500,000
Retained Earnings		1,419,700
Service Revenue		395,000
Salaries and Wages Expense	378,000	
Advertising Expense	10,000	
Utilities Expense	5,350	
Total	$4,585,050	$4,585,050

Req. 5

VANISHING GAMES CORPORATION
Income Statement
For the Month Ended January 31, 2015

Revenues:	
Service Revenue	$ 395,000
Total Revenues	395,000
Expenses:	
Salaries and Wages Expense	378,000
Advertising Expense	10,000
Utilities Expense	5,350
Total Expenses	393,350
Net Income (Loss)	$ 1,650

C3-1 (continued)

Req. 6

VANISHING GAMES CORPORATION
Statement of Retained Earnings
For the Month Ended January 31, 2015

Retained Earnings, January 1, 2015	$ 1,419,700
Add (Subtract): Net Income (Loss)	1,650
Subtract: Dividends	0
Retained Earnings, January 31, 2015	$ 1,421,350

Req. 7

VANISHING GAMES CORPORATION
Balance Sheet
At January 31, 2015

Assets	
Current Assets	
Cash	$ 1,431,500
Accounts Receivable	212,500
Supplies	17,700
Total Current Assets	1,661,700
Equipment	908,000
Building	422,000
Land	1,200,000
Total Assets	$ 4,191,700
Liabilities	
Current Liabilities	
Accounts Payable	$ 113,350
Unearned Revenue	73,500
Total Current Liabilities	186,850
Notes Payable (long-term)	83,500
Total Liabilities	270,350
Stockholders' Equity	
Common Stock	2,500,000
Retained Earnings	1,421,350
Total Stockholders' Equity	3,921,350
Total Liabilities and Stockholders' Equity	$ 4,191,700

Req. 8

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenues}} = \frac{\$\ 1{,}650}{\$395{,}000} = 0.004 \text{ or } 0.4\%$$

ANSWERS TO SKILLS DEVELOPMENT CASES

S3-1

1. C
2. B
3. C

S3-2

Req. 1

Lowe's sales revenues increased in the year ended January 31, 2014, by \$2,896,000,000 (= \$53,417,000,000 – \$50,521,000,000). This is a change of 5.7% (\$2,896,000,000 ÷ \$50,521,000,000 × 100) of the previous year's sales revenues. The trend in Lowe's revenue is more favorable than Home Depot's because Lowe's increase of 5.7% is greater than Home Depot's increase of 5.4% (\$4,058,000,000 ÷ \$74,754,000,000 × 100).

Req. 2

Like Home Depot, the largest expense on the most recent income statement for Lowe's is Cost of Sales. Cost of Sales consists primarily of the actual cost of merchandise sold and services performed and the cost of transportation of merchandise from suppliers to the company's stores, locations or customers. The cost of sales amounted to an expense of \$34,941,000,000 during the year ended January 31, 2014. Cost of Sales increased by \$1,747,000,000 or 5.3% (\$1,747,000,000 ÷ \$33,194,000,000 × 100). The Home Depot's biggest expense increased by \$2,510,000,000, which is 5.1% of the prior year (\$2,510,000,000 ÷ \$48,912,000,000 × 100), which is slightly more favorable than Lowe's where its biggest expense increased by 5.3%.

S3-3

The solution to this project will depend on the companies and/or accounting periods selected for analysis.

S3-4

Req. 1

Costs that have probable future economic benefits are capitalized as assets.

Req. 2

The author means that expenses are put on the balance sheet as an asset and not recorded as expenses until a later date. It is acceptable under GAAP to capitalize costs that have benefits for future periods, however, the author is implying that these items actually are expenses that should be reported on the income statement as incurred.

Req.3

The current year's net income will be higher than it should be since some expenses were avoided by recording them as an asset. The following year's net income will be lower than it should be because these capitalized expenses will be expensed in a period in which they were not incurred.

Req. 4

It is not always easy to determine whether costs should be capitalized or expensed, since this decision is often based on judgment. As a consequence, it may not be easy to determine if a manager is acting ethically. There are standards (GAAP) set in place to help managers make ethical accounting decisions, but many of those standards rely on the manager's judgment. For example, companies in the video game industry are allowed to capitalize software development costs. These costs include wages paid to programmers, fees paid to graphic designers, and amounts paid to game testers. Determining which costs are appropriately capitalized and which costs are appropriately expensed requires careful judgment. To determine if a manager is acting ethically, you would need to determine his or her intent in capitalizing or expensing costs—something which can be hard to do.

S3-5

This type of ethical dilemma occurs frequently. It requires you to weigh one ethical principle (loyalty) against another (honesty). The situation is difficult personally because of the possible repercussions to you if you do not fulfill your boss's request. At the same time, the ethical and professional response is to follow the revenue principle and account for the cash collection as unearned revenue (as was done). To record the collection as revenue overstates income in the current period.

In the short run, Mr. Lynch would benefit by receiving a larger bonus. You also benefit in the short run because you would not experience any negative repercussions from your boss. However, there is the risk that sometime in the future, perhaps through an audit, the error will be found. At that point, both you and Mr. Lynch could be implicated in a fraud. In addition, this may be the first instance where you are being asked to account for a transaction in violation of accepted principles or company policies. There is a very strong possibility Mr. Lynch may ask you for additional favors in the future if you demonstrate your willingness at this point.

In the larger picture, stockholders are harmed by the misleading income figures by relying on them to purchase stock at inflated prices. In addition, creditors may lend funds to the insurance company based on the misleading information. The negative impact of the discovery of misleading financial information will cause stock prices to fall, causing stockholders to lose on their investment. Creditors will be concerned about future debt repayment. You will also experience diminished self-respect because of the violation of your integrity.

Managers are supposed to be agents for stockholders. To act in ways that benefit the manager to the detriment of the stockholders is inappropriate. Therefore, the ethically correct response is to fail to comply with Mr. Lynch's request. Although standing up to Mr. Lynch will not be easy, you will need to explain that the appropriate accounting treatment is clear. Your company's income statement reports the results of actually providing services to its customers during the period and, at this point in time, no services (insurance coverage) have been provided. You should explain that although recording the transaction as revenue is a simple thing to do, its impact on financial statement users can be severe (as described above). You may want to add that you understand the reason for his request, but cannot ethically or professionally comply.

S3-6

Req. 1

a. Cash increased $75,000, and Common Stock (Stockholders' Equity) increased $75,000. Therefore, transaction (a) was an issuance of the capital stock of the corporation for $75,000 cash.

b. Cash decreased $5,000, Equipment (an asset) increased $20,000, and Notes Payable (a liability) increased $15,000. Therefore, transaction (b) was a purchase of equipment that cost $20,000. Payment included: Cash, $5,000; Notes Payable, $15,000.

c. Cash increased $15,000, Accounts Receivable increased $12,000, and Service Revenue increased $27,000. Therefore, transaction (c) was delivery of painting services for $27,000; $15,000 was received in cash and the rest was on account.

d. Cash decreased $14,000, Land increased $18,000, and Notes Payable increased $4,000. Therefore, transaction (d) was a purchase of land for $18,000; $14,000 was paid in cash and a note was signed for the remainder.

e. Cash decreased $10,000, Supplies increased $5,000, Accounts Payable increased $3,000, and Wages Expense increased $8,000. Therefore, transaction (e) was the purchase of $5,000 of supplies and $8,000 of employee labor. $10,000 was paid in cash and $3,000 is owed.

f. Accounts Receivable increased $14,000, and Service Revenue increased $14,000. Therefore, transaction (f) was a sale of painting services made on account.

g. Cash decreased $15,000, Supplies decreased $1,000, Supplies Expense increased $1,000, and Wages Expense increased $15,000. Therefore, transaction (g) was the use of $1,000 of supplies and $15,000 of employee labor. The employee labor was paid with cash and the supplies, which had been purchased earlier, were used.

h. Cash decreased $2,000, Accounts Payable decreased $2,000. Therefore, transaction (h) was a payment on account.

i. Cash increased $16,000, Accounts Receivable decreased $16,000. Therefore, transaction (i) was the receipt of payments from customers for services previously billed on account.

S3-6 (continued)

Req. 2

HORDICHUK PAINTING SERVICE COMPANY
Unadjusted Trial Balance
At January 31

	Debit	Credit
Cash	$ 60,000	
Accounts Receivable	10,000	
Supplies	4,000	
Equipment	20,000	
Land	18,000	
Accounts Payable		$ 1,000
Notes Payable		19,000
Common Stock		75,000
Service Revenue		41,000
Supplies Expense	1,000	
Salaries and Wages Expense	23,000	
Total	$136,000	$136,000

S3-7

S3-7complete.xls [Compatibility Mode] - Excel

Slusher Gusher	Assets								=	Liabilities				+
	Cash		Accounts Receivable		Supplies		Equipment			Accounts Payable		Unearned Revenue		
	Debit(+)	Credit(-)	Debit(+)	Credit(-)	Debit(+)	Credit(-)	Debit(+)	Credit(-)		Debit(-)	Credit(+)	Debit(-)	Credit(+)	
October Transactions:														
Oct. 2	10,000													
Oct. 12		1,500					1,500							
Oct. 13		70			70									
Oct. 16	500													
Oct. 17						45								
Oct. 20					100						100			
Oct. 23	400		200											
Oct. 25	100			100										
Oct. 26		25												
Oct. 27	150												150	
October 31 Balances	9,555		100		125		1,500				100		150	

Spreadsheet | Trial Balance | Sheet3

S3-7 (continued)

Slusher Gusher	Stockholders' Equity							
	Common Stock		Rental Revenue		Supplies Expense		Advertising Expense	
	Debit(-)	Credit(+)	Debit(-)	Credit(+)	Debit(+)	Credit(-)	Debit(+)	Credit(-)
October Transactions:								
Oct. 2		10,000						
Oct. 12								
Oct. 13								
Oct. 16				500				
Oct. 17					45			
Oct. 20								
Oct. 23				600				
Oct. 25								
Oct. 26							25	
Oct. 27								
October 31 Balances		10,000		1,100	45		25	

Slusher Gusher
Unadjusted Trial Balance
At October 31

	Debit	Credit
Cash	$9,555	
Accounts Receivable	100	
Supplies	125	
Equipment	1,500	
Accounts Payable		$100
Unearned Revenue		150
Common Stock		10,000
Rental Revenue		1,100
Supplies Expense	45	
Advertising Expense	25	
Totals	$11,350	$11,350

ANSWERS TO CONTINUING CASE

CC3-1

Req. 1

May 1	Prepaid Insurance (+A)…………..	3,000	
	Cash (-A)……………………….		3,000
May 4	No transaction; therefore, no journal entry		
May 7	Accounts Receivable (+A)……….	860	
	Service Revenue (+R, +SE)….		860
May 10	Supplies (+A) ……………………...	800	
	Accounts Payable (+L)………..		800
May 13	Advertising Expense (+E, -SE)….	60	
	Cash (-A) ………………………		60
May 16	Accounts Payable (-L)……………	200	
	Cash (-A)……………………….		200
May 19	Cash (+A)…………….………..…….	1,900	
	Unearned Revenue (+L) …...		1,900
May 20	Cash (+A)…………………………….	5,000	
	Note Payable (long-term) (+L).		5,000
May 22	Equipment (+A)……………………	500	
	Cash (-A)……………………….		500
May 25	Utilities Expense (+E, -SE)……….	500	
	Cash (-A)……………………….		500

Req. 2

Preliminary net income = Revenues – Expenses
= $860 – 60 – 500 = $300

Net profit margin = Net Income / Revenues = $300/860 = 0.349 or 34.9%.

Req. 3

C (All of the above)