

EXAM REVIEW – CHAPTERS 1, 2, 3

STUDY SUGGESTIONS

- Review your class notes, homework exercises and problems.
- Be sure to review any chapter appendices assigned on the General Course Outline.
- Review **Demonstration Problem, Summary and Key Terms** at the end of each chapter.
- Answer the **Multiple Choice Quiz** at the end of each chapter.
- Answer **Multiple Choice Quiz A and B** on the textbook website www.mhhe.com/wild.
- Know accounting terms and concepts by answering the **Discussion Questions** at the end of each chapter.
- Know the account classification (i.e. asset, liability, or owner's equity) and normal balance of all accounts.
- Know what the financial ratios mean and how to calculate them.
- Other online help is available by a variety of sites such as:

Key Terms and Concepts to Know

Chapter 1 – Accounting in Business

- **Accounting equation** and its three basic elements: assets, liabilities and owners equity
- How business transactions affect the three basic elements in the **accounting equation**.
- **Income Statement:**
 - The types of accounts used
 - Prepare an income statement
 - Calculate net income without preparing an income statement using the accounting equation
- **Retained Earnings Statement:**
 - The types of accounts used
 - Prepare a retained earnings statement
 - Retained Earnings Statement links the income statement and dividends to the balance sheet
- **Balance Sheet**
 - The types of accounts used
 - Prepare a balance sheet

Chapter 2 – Accounting for Transactions

- **Journal and Ledger**
 - A journal and what it is used for.
 - A ledger and what it is used for.
 - Why both a journal and a ledger are necessary
 - A chart of accounts and what it is used for.
- **The rules of Debit and Credit:**
 - Debit is the left side of an account and Credit is the right side of an account
 - Normal balances of accounts and how debits and credits increase or decrease account balances

	<u>Normal Balance</u>	<u>Increase</u>	<u>Decrease</u>
Balance Sheet Accounts			
Assets	Debit	Debit	Credit
Liabilities	Credit	Credit	Debit
Owners' Equity	Credit	Credit	Debit
Capital Stock	Credit	Credit	Debit
Retained Earnings	Credit	Credit	Debit
Dividends	Credit	Credit	Debit
Income Statement Accounts			
Revenue	Credit	Credit	Debit
Expenses	Debit	Debit	Credit

- **Analyzing a general ledger account (T-account)**
 - Use the general equation:
beginning balance + inflows – outflows = ending balance.
 - Remember that the inflows and outflows are renamed for the types of activity in each specific account and that the equation manipulated be used to solve for an unknown as any one of the four terms.
- **Journalize transactions** for the various types of transactions.
- **Post transactions** from the journal to the general ledger
- Prepare a **trial balance**; identify the types of errors a trial balance can and cannot help to locate and how to correct the errors.

Chapter 3 – Preparing Financial Statements

- **Matching Principle** and how it relates to accrual accounting
- **Deferred Expenses** (prepaid expenses)
- **Deferred Revenues** (unearned revenues)
- **Accrued Expenses** (accrued liabilities)
- **Accrued Revenues** (accrued assets)
- Journalizing adjusting entries for accruals and deferrals which always use at least one income statement account (revenue or expense) and one balance sheet

account (asset or liability). Adjusting entries are never recorded for cash, dividends, capital stock or retained earnings.

- The effects on the financial statements will be if adjusting entries are omitted.
- Journalizing the four closing entries utilizing the Income Summary account.
- The basic steps in the accounting cycle.
- Prepare a post-closing trial balance, which accounts should and should not appear on it and why it is a necessary step in the accounting cycle.

Practice Problems

Problem 1 - Accounting Equation

James Morley is the sole stockholder and operator of Dynamic Business Solutions, Inc. a management consulting firm organized as a professional corporation. At the end of its accounting period, December 31, 2007, Dynamic Business Solutions has assets of \$100,000 and liabilities of \$75,000.

Determine:

- a) What is owner's equity at December 31, 2007?
- b) What is owner's equity as of December 31, 2008, assuming that assets increased by \$25,000 and liabilities increased by \$15,000 during 2008?
- c) What is the increase or (decrease) in owner's equity for the year 2008?
- d) What is the net income (or net loss) for the year 2008 assuming there were no additional investments in 2008 and dividends of \$15,000 were paid in 2008.

What is owner's equity at December 31, 2007?

What is owner's equity as of December 31, 2008, assuming that assets increased by \$25,000 and liabilities increased by \$15,000 during 2008?

What is the increase or (decrease) in owner's equity for the year 2008?

What is the net income (or net loss) for the year 2008 assuming there were no additional investments in 2008 and dividends of \$15,000 were paid in 2008.

Problem 2 - Changes in owner's equity

Determine the net income (or net loss) for the year, assuming that additional capital stock of \$25,000 was issued, and that no dividends were paid.

	<u>Total Assets</u>	<u>Total Liabilities</u>
Beginning of the year	\$500,000	\$200,000
End of the year	\$625,000	\$250,000

Problem 3 - Changes in owner's equity

Determine the net income (or net loss) for the year, assuming that capital stock of \$70,000 was issued, and dividends of \$45,000 were paid.

	<u>Total Assets</u>	<u>Total Liabilities</u>
Beginning of the year	\$425,000	\$165,000
End of the year	\$440,000	\$185,000

Problem 4 - Business transactions

Indicate the effect of each of the below transactions on the accounting equation and determine whether the transaction is:

1. an increase in an asset and an increase in a liability
2. an increase in a asset and an increase in owner's equity
3. an increase in an asset and a decrease in another asset
4. a decrease in an asset and a decrease in a liability
5. a decrease in an asset and a decrease in owner's equity

Transactions:

- a) Received cash for common stock
- b) Purchased supplies for cash
- c) Purchased equipment on account
- d) Billed customers for services on account
- e) Paid creditor on account
- f) Received cash from customers billed on account
- g) Paid rent for the month
- h) Received payment for services from cash customers
- i) Paid cash dividends

Problem 5 - Debits and Credits

Fill in the blanks with the word Debit or Credit

- a) The right side of an account is the _____ side.
- b) Asset accounts are increased by a _____.
- c) Liability accounts are decreased by a _____.
- d) Expense accounts are increased by a _____.
- e) The left side of an account is the _____ side.
- f) Revenue accounts are increased by a _____.
- g) Owner's equity is increased by a _____.
- h) The normal balance of an asset account is a _____.

- i) The normal balance of a liability account is a _____.
- j) The normal balance of the common stock account is a _____.
- k) The normal balance of the retained earnings account is a _____.
- l) The normal balance of revenue account is a _____.
- m) The normal balance of an expense account is a _____.
- n) The cash account is increased by a _____.
- o) The accounts payable account is increased by a _____.
- p) The dividend account is increased by a _____.
- q) The accounts receivable account is decreased by a _____.
- r) The common stock account is increased by a _____.
- s) The retained earnings account is decreased by a _____.
- t) The equipment account is increased by a _____.
- u) The sum of the debits must be _____ to the sum of the credits.

Problem 6 - Financial statements

Complete the following financial statements from the account balances of the Oakley Corporation for the month ended September 30, 2008, the first month of business. All account balances are normal balances.

Accounts Payable	\$500
Rent Expense	1,000
Cash	10,025
Fees earned	16,500
Auto expense	1,350
Accounts receivable	5,350
Salaries expense	2,500
Supplies	1,275
Capital stock	10,000
Miscellaneous expense	150
Dividends	5,000
Supplies expense	350

Oakley Corporation
Income Statement
Month Ended September 30, 2008

Fees Earned		\$
Operating Expenses:		
Auto expense	\$	
Salaries expense		
Supplies expense		
Rent expense		
Miscellaneous expense		
Total Operating Expenses		
Net Income		\$

Oakley Corporation
Statement of Retained Earnings
Month Ended September 30, 2008

Net Income for September		\$
less: Dividends		
Retained Earnings September 30, 2008		\$

Oakley Corporation
Balance Sheet
September 30, 2008

	<u>Assets</u>		<u>Liabilities</u>
Cash	\$	Accounts Payable	\$
Accounts Receivable			
Supplies			
		Stockholders' Equity	
		Capital Stock	
		Retained Earnings	
Total Assets	\$	Total Liabilities and Stockholders' Equity	\$

Problem 7 - Journal Entries

In recording the following transactions, what account is debited, what account is credited?

- a) Issuance of common stock to a shareholder for cash.
- b) Payment of rent for the current month.
- c) Purchase of supplies on account.
- d) Payment to a creditor on account.
- e) Fees earned and billed to customers.
- f) Receipt of cash from customers previously billed on account.
- g) Payment of cash dividends to stockholders.
- h) Payment for a 3-year insurance policy.
- i) Incurred utilities expenses.
- j) Receipt of cash for services to be provided in the future.

Problem 8 - Retained Earnings

As of January 1, 1998 the retained earnings account had a credit balance of \$100,500. During the year, the Corporation had net income of \$58,500 and paid dividends of \$32,000. What is the balance of the retained earnings account at December 31, 1998?

Problem 9 - Classify accruals and deferrals

Classify the following items as **deferred expenses** (prepaid expenses), **deferred revenues** (unearned revenues), **accrued expenses** (accrued liabilities) or **accrued revenues** (accrued assets):

- a) The supplies account is an example of a _____.
- b) Tuition received by a college is an example of _____.
- c) Wages earned by employees but not yet paid are an example of an _____.
- d) A two year premium paid on a fire insurance policy is a _____.
- e) Fees earned but not yet recorded are an example of an _____.
- f) Property taxes for 1998 that are not due until February, 1999 are _____.
- g) Subscription payments received in advance by a newspaper are _____.
- h) An electric bill for July that is not due until August 7 is an _____.

Problem 10 - Adjusting entry for Supplies

The balance of the Supplies account before adjustment at the end of the year, is \$2,730. Journalize the adjusting entry required if the amount of supplies on hand at the end of the year is \$260.

Problem 11 - Adjusting entry for Unearned Fees

The balance of the Unearned Fees account before adjustment is \$7,300.

- a. Journalize the adjusting entry required if the amount of unearned fees at the end of the year is \$1,700.
- b. If the adjusting entry for unearned fees was not made, which items on the income statement and/or the balance sheet will be overstated or understated?

Problem 12 - Adjusting entry for Accrued Wages

Doctor Smith pays his staff weekly every Friday. The weekly wages average \$3,000. Journal the adjusting entry required if the accounting period ends on Wednesday.

Problem 13 - Effect of Omitting Adjusting entry for Accrued Wages

Doctor Jones, a professional corporation, owed his staff \$3,500 for wages earned but not yet paid on December 31. Which items on the income statement and/or the balance sheet will be overstated or understated?

Problem 14 - Adjusting entry for Depreciation

Bill Jorgenson, a landscape contractor, purchased a new truck on January 1, 1998 for \$25,000. The depreciation for 1998 is \$5,000.

- a) Journalize the adjusting entry to record the depreciation for 1998.
- b) What is the book value of the truck on December 31, 1998?
- c) If the adjusting entry for depreciation was not made, which items on the income statement and/or the balance sheet will be overstated or understated?

Problem 15 - Adjusting entries

Selected account balances at December 31, before year-end adjustments, were:

	<u>Debits</u>	<u>Credits</u>
Cash	12,780	
Accounts Receivable	11,250	
Supplies	4,750	
Prepaid Insurance	2,700	
Office Equipment	42,500	
Accumulated Depreciation		8,250
Salaries and Wages Payable		
Unearned Fees		6,250
Fees Earned		89,750
Salaries and Wages Expense	29,420	
Depreciation Expense		
Supplies Expense		
Insurance Expense		

Data needed for year-end adjustments are as follows:

1. Unbilled fees at December 31	\$3,650
2. Supplies on hand at December 31	\$1,275
3. Insurance expired during the year	\$2,400
4. Depreciation of office equipment for the year	\$2,750
5. Unearned fees at December 31	\$1,250
6. Salaries and wages earned but not paid at December 31	\$1,150

Journalize the adjusting entries required.

Problem 16 - Closing entries

The following is the trial balance of Arnold Corporation at December 31, 1997 after the year-end adjustments were made. Journalize the necessary closing entries

	<u>Debits</u>	<u>Credits</u>
Cash	13,750	
Accounts Receivable	10,250	
Supplies	1,250	
Prepaid Insurance	700	
Office Equipment	42,500	
Accumulated Depreciation		8,250
Accounts Payable		3,250
Salaries and Wages Payable		1,150
Unearned Fees		1,250
Capital Stock		25,000
Retained Earnings		27,050
Dividends	20,000	
Fees Earned		92,250
Salaries And Wages Expense	31,420	
Rent Expense	24,000	
Depreciation Expense	2,750	
Supplies Expense	3,475	
Insurance Expense	2,400	
Telephone Expense	2,700	
Utilities Expense	2,600	
Miscellaneous Expense	405	

Problem 17 - Permanent and Temporary Accounts

Identify the accounts listed below that are temporary and would be closed at the end of the accounting period.

Accounts Payable	Fees earned
Accumulated Depreciation-Building	Land
Capital Stock	Retained Earnings
Depreciation Expense-Building	Salaries Expense
Dividends	Salaries Payable
Equipment	Unearned Fees
Supplies Expense	Supplies
Interest Receivable	Prepaid Insurance

Practice True / False Questions

1. A list of a general ledger accounts and their account numbers is a chart of accounts.
True False
2. A company's general ledger provides a chronological record of its business transactions.
True False
3. An increase to the Dividends account would be recorded as a debit; hence the Dividends account has a normal debit balance.
True False
4. The balance in Retained Earnings is decreased by debiting the account.
True False
5. To record the acquisition of office supplies on account, an accountant would credit Office Supplies.
True False
6. The entry to record revenue earned on account includes a debit to accounts receivable and a credit to retained earnings.
True False
7. Accounting records must be adjusted for unrecorded accruals and deferrals before preparing financial statements.
True False
8. Closing entries transfer the balances for revenues, expenses, and dividends into the Retained Earnings account.
True False
9. A chart of accounts is prepared to verify that debits and credits.
True False
10. A company's adjusted trial balance provides the information needed to prepare the balance sheet and income statement.
True False

11. A trial balance can only be prepared at the end of the fiscal year, as part of the adjusting and closing processes.
True False
12. Any error in the accounting system will cause the trial balance to be out of balance.
True False
13. Posting is the process of determining the balance in an account.
True False
14. Generally accepted accounting principles require that a business's fiscal year must end on December 31.
True False
15. Source documents provide information that serves as the basis for entries into the accounting system. Examples of source documents include invoices and deposit tickets.
True False
16. A liability account normally has a debit balance.
True False
17. The left side of a T-account is the credit side.
True False
18. Debits decrease asset accounts.
True False
19. Double entry accounting requires that every entry must include at least one debit and at least one credit.
True False
20. When a company receives cash in advance from a customer, it should debit Cash and credit Accounts Receivable.
True False
21. An adjusting entry can never record a transaction that exchanges one asset for another asset.
True False

Practice Multiple Choice Questions

1. The costs of providing goods and services to customers are referred to as:
 - a) Assets.
 - b) Expenses.
 - c) Liabilities.
 - d) Revenues.
2. An alternative form of the accounting equation is:
 - a) $\text{Net Income} = \text{Revenues} - \text{Expenses}$.
 - b) $\text{Stockholders' Equity} = \text{Assets} + \text{Liabilities}$.
 - c) $\text{Assets} = \text{Liabilities} - \text{Stockholders' Equity}$.
 - d) $\text{Assets} - \text{Liabilities} = \text{Stockholders' Equity}$.
3. The owners' interest in a corporation is called:
 - a) Dividends.
 - b) Assets.
 - c) Liabilities.
 - d) Stockholders' equity.
4. Sooner Company has had a net income of \$8,000, \$5,000, \$12,000, and \$10,000 over the first four years of the company's existence. If the average annual amount of dividends paid over the last four years is \$3,000, what is the ending retained earnings balance?
 - a) \$47,000.
 - b) \$35,000.
 - c) \$23,000.
 - d) \$7,000.
5. The equation best describing the balance sheet is:
 - a) $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.
 - b) $\text{Revenues} - \text{Expenses} = \text{Net Income}$.
 - c) $\text{Ending Retained Earnings} + \text{Dividends} = \text{Net Income}$.
 - d) $\text{Revenues} + \text{Expenses} = \text{Net Income}$.
6. Retained earnings at the end of the year is calculated using:
 - a) Beginning retained earnings, net income, and dividends.
 - b) Common stock and dividends.
 - c) Stockholders' equity, net income, and dividends.
 - d) Net income and dividends.

7. Liabilities are shown in which of the following statements?
- a) Income statement.
 - b) Statement of cash flows.
 - c) Balance sheet.
 - d) Statement of retained earnings.
8. Consider the following account balances of the Shattuck Law Firm as of December 31, 2012:

Accounts Payable	\$ 4,400
Salaries Expense	12,800
Cash	1,700
Common Stock	2,400
Service Revenue	8,300
Supplies	4,300
Retained Earnings	1,100
Utilities Expense	5,000

- How many of these accounts would appear in Shattuck's 2012 balance sheet?
- a) Five.
 - b) Four.
 - c) Three.
 - d) Two.
9. For the past five years, Mookie Consulting Services reported the following annual net income and dividend amounts:

Year	Net Income	Dividends
1	\$22,000	\$2,000
2	17,000	2,000
3	9,000	1,000
4	14,000	3,000
5	25,000	4,000

- If Mookie had Retained Earnings of \$88,000 at the end of year 5, what was Retained Earnings at the beginning of Year 1?
- a) \$13,000.
 - b) \$25,000.
 - c) \$7,000.
 - d) \$1,000.
10. GAAP is an abbreviation for:
- a) Generally authorized accounting procedures.
 - b) Generally applied accounting procedures.
 - c) Generally accepted auditing practices.
 - d) Generally accepted accounting principles.

11. The following amounts are reported in the ledger of Mariah Company:

Assets	\$80,000
Liabilities	36,000
Retained Earnings	12,000

What is the balance in the Common Stock account?

- a) \$44,000.
 - b) \$32,000.
 - c) \$48,000.
 - d) \$42,000.
12. When cash payments are made to stockholders, what is the effect on the company's accounts?
- a) Cash decreases and dividends increase.
 - b) Cash increases and dividends decrease.
 - c) Cash decreases and common stock decreases.
 - d) Cash increases and common stock increases.
13. Which of the following would increase both assets and liabilities?
- a) Provide services to customers on account.
 - b) Purchase office supplies on account.
 - c) Pay dividends to stockholders.
 - d) Received a utility bill but do not pay for it.
14. How does purchasing supplies for cash effect the accounting equation?
- a) Increase assets.
 - b) Decrease stockholders' equity.
 - c) Decrease liabilities.
 - d) No effect.
15. Which of the following is/are true about a "credit"?
- I. It is part of the double-entry procedure that keeps the accounting equation in balance.
 - II. It represents a decrease to assets.
 - III. It represents an increase to liabilities.
 - IV. It is on the right side of a T-account.
- a) I and II.
 - b) IV only.
 - c) I, II, and III.
 - d) I, II, III, and IV.

16. Which of the accounts are increased with a debit and decreased with a credit?
- Liabilities, stockholders' equity, and revenues.
 - Dividends, liabilities, and assets.
 - Expenses, dividends, and stockholders' equity.
 - Assets, dividends, and expenses.
17. The following statements pertain to recording transactions. Which of them are true?
- Total debits should equal total credits.
 - It is possible to have multiple debits or credits in one journal entry.
 - Assets are always listed first in journal entries.
 - Some journal entries will have debits only.
- I only.
 - I and II.
 - I, II, and IV.
 - II, III, and IV.
18. Xenon Corporation borrows \$75,000 from First Bank. Xenon Corporation records this transaction with a:
- Debit to Investments.
 - Credit to Retained Earnings.
 - Credit to Notes Payable.
 - Credit to Interest Expense.
19. Assume that cash is paid for rent to cover the next year. The appropriate debit and credit are:
- Debit Rent Expense, credit Cash.
 - Debit Prepaid Rent, credit Rent Expense.
 - Debit Prepaid Rent, credit Cash.
 - Debit Cash, credit Prepaid Rent.
20. The owner of an office building should report rent collected in advance as a debit to Cash and a credit to:
- A liability.
 - An asset other than Cash.
 - A revenue.
 - An owners' equity.

21. A customer purchased a drill press on November 14 on account from Sears. The drill press was delivered two weeks later. The customer paid for the drill press on December 5. When should Sears record the revenue for this transaction according to the revenue recognition principle?
- a) November.
 - b) December.
 - c) Evenly in each of the two months.
 - d) One-third in November and two-thirds in December.
22. The following information pertains to Sooner Company:

May 1 Customer ordered an installation service to be done by Sooner Company on May 15.
May 2 Customer paid cash for the installation job to be done on May 15.
May 8 The Sooner Company purchased installation supplies on account for the job.
May 15 The installation job was started and completed.
May 20 Amount owed for supplies purchased on May 8 is paid.

Assuming that Sooner Company uses accrual-basis accounting, when would the company record the expense related to the supplies?

- a) May 2.
 - b) May 8.
 - c) May 15.
 - d) May 20.
23. Consider the following events for Betterment Incorporated:

January 1 Betterment purchases gasoline for \$200 on account.
January 7 Betterment advertises lawn mowing services for \$100 per lawn.
January 9 Betterment signs up 8 customers who pay a total of \$800 cash.
January 12 Betterment mows the lawns of the 8 customers and all gasoline purchased on January 1 is used.
January 13 Betterment pays for the gasoline purchased on January 1.

Under accrual-basis accounting, what is the appropriate day to record the revenues related to lawn services?

- a) January 1.
- b) January 7.
- c) January 9.
- d) January 12.

24. Consider the following events for Betterment Incorporated:

- January 1 Betterment purchases gasoline for \$200 on account.
- January 7 Betterment advertises lawn mowing services for \$100 per lawn.
- January 9 Betterment signs up 8 customers who pay a total of \$800 cash.
- January 12 Betterment mows the lawns of the 8 customers and all gasoline purchased on January 1 is used.
- January 13 Betterment pays for the gasoline purchased on January 1.

Under accrual-basis accounting, what is the appropriate day to record the expenses related to the gasoline?

- a) January 1.
 - b) January 7.
 - c) January 12.
 - d) January 13.
25. Which of the following is a possible adjusting journal entry?
- a) Debit Cash, credit Accounts Payable.
 - b) Debit Service Revenue, credit Cash.
 - c) Debit Salaries Expense, credit Salaries Payable.
 - d) Debit Utilities Expense, credit Retained Earnings.
26. Making insurance payments in advance is an example of:
- a) An accrued revenue.
 - b) An accrued expense.
 - c) An unearned revenue.
 - d) A prepaid expense.
27. An example of an adjusting entry would not include:
- a) Recording the use of office supplies.
 - b) Recording the expiration of prepaid insurance.
 - c) Recording unpaid salaries.
 - d) Paying salaries to company employees.
28. Adjusting entries:
- a) Often include the Cash account.
 - b) Usually are recorded at the beginning of the accounting period.
 - c) Always involve at least one income statement account and one balance sheet account.
 - d) Adjust the balance of revenue and expense accounts to zero.

29. The closing entry for expenses includes:
- a) A debit to Dividends and a credit to all expense accounts.
 - b) A debit to Retained Earnings and a credit to all expense accounts.
 - c) A debit to Revenues and a credit to Retained Earnings.
 - d) A debit to Revenues and a credit to all expense accounts.
30. The primary purpose of closing entries is to:
- a) Prove the equality of the debit and credit entries in the general journal.
 - b) Ensure that all assets and liabilities are recognized in the appropriate period.
 - c) Update the balance of Retained Earnings and prepare revenue, expense, and dividend accounts for next period's transactions.
 - d) Assure that adjusting entries balance.

Solutions to Practice Problems

Problem 1 - Accounting Equation

Assets - liabilities = Owner's Equity

a) Owner's equity at December 31, 1997 is \$25,000 ($100,000 - 75,000 = 25,000$)

b) Owner's equity at December 31, 1998 is \$35,000

December 31, 1997: $100,000 - 75,000 = 25,000$

Change during 1998: $\underline{+25,000 - 15,000 = 10,000}$

December 31, 1998: $125,000 - 90,000 = 35,000$

c) The increase in owner's equity is \$10,000 ($35,000 - 25,000 = 10,000$)

d) Net income for 1998 was \$25,000.

Net Income - Dividends = Increase in Owner's Equity

Net Income - \$15,000 = \$10,000

Net Income = \$25,000

Problem 2 - Changes in owner's equity

	<u>Assets</u> -	<u>Liabilities</u> =	<u>Owner's Equity</u>
Beginning of the year	\$500,000	\$200,000	\$300,000
End of the year	625,000	250,000	<u>375,000</u>
Increase in Owner' Equity			\$ 75,000
Increase in owners' equity	\$75,000		
Stock issued	25,000		
Dividends	<u>0</u>		
Net Income	<u>\$50,000</u>		

Problem 3 - Changes in owner's equity

	<u>Assets</u> -	<u>Liabilities</u> =	<u>Owner's Equity</u>
Beginning of the year	\$425,000 -	\$165,000 =	\$260,000
End of the year	\$440,000 -	\$185,000 =	\$255,000
Decrease in Owner' Equity			\$ (5,000)

Net Income (net loss) + Additional Investment - Dividends = Change in Owner's Equity

Net Income (net loss) + \$70,000 - \$45,000 = (\$5,000)

Net Loss = \$30,000

Problem 4 - Business transactions

a) Received cash for common stock	2. increase in an asset and increase in owner's equity
b) Purchased supplies for cash	3. increase in an asset and decrease in another asset
c) Purchased equipment on account	1. increase in an asset and increase in a liability
d) Billed customers for services on account	2. increase in a asset and increase in owner's equity
e) Paid creditor on account	4. decrease in an asset and decrease in a liability
f) Received cash from customers on account	3. increase in an asset and decrease in another asset
g) Paid rent for the month	5. decrease in an asset and decrease in owner's equity
h) Received payment for services from cash customers	2. increase in an asset and increase in owner's equity
i) Paid cash dividends	5. decrease in an asset and decrease in owner's equity
j) Purchased supplies for cash	3. increase in an asset and decrease in another asset
k) Purchased equipment on account	1. increase in an asset and increase in a liability
l) Billed customers for services on account	2. increase in a asset and increase in owner's equity
m) Paid creditor on account	4. decrease in an asset and decrease in a liability
n) Received cash from customers on account	3. increase in an asset and decrease in another asset
o) Paid rent for the month	5. decrease in an asset and decrease in owner's equity
p) Received payment for services from cash customers	2. increase in an asset and increase in owner's equity
q) Paid cash dividends	5. decrease in an asset and decrease in owner's equity

Problem 5 - Debits and Credits

- a) The right side of an account is the **credit** side.
- b) Asset accounts are increased by a **debit**.
- c) Liability accounts are decreased by a **debit**.
- d) Expense accounts are increased by a **debit**.
- e) The left side of an account is the **debit** side.
- f) Revenue accounts are increased by a **credit**.
- g) Owner's equity is increased by a **credit**.
- h) The normal balance of an asset account is a **debit**.
- i) The normal balance of a liability account is a **credit**.
- j) The normal balance of the common stock account is a **credit**.
- k) The normal balance of the retained earnings account is a **credit**.
- l) The normal balance of revenue account is a **credit**.
- m) The normal balance of an expense account is a **debit**.
- n) The cash account is increased by a **debit**.
- o) The accounts payable account is increased by a **credit**.
- p) The dividend account is increased by a **debit**.
- q) The accounts receivable account is decreased by a **credit**.
- r) The common stock account is increased by a **credit**.
- s) The retained earnings account is decreased by a **debit**.
- t) The equipment account is increased by a **debit**.
- u) The sum of the debits must be **equal** to the sum of the credits.

Problem 6 - Financial statements

Oakley Corporation
Income Statement
Month Ended September 30, 2008

Fees Earned		\$16,500
Operating Expenses:		
Auto expense	\$1,350	
Salaries expense	2,500	
Supplies expense	350	
Rent expense	1,000	
Miscellaneous expense	150	
Total Operating Expenses	5,350	
Net Income		\$11,150

Oakley Corporation
Statement of Retained Earnings
Month Ended September 30, 2008

Net Income for September		\$11,150
less: Dividends		5,000
Retained Earnings September 30, 2008		\$6,150

Oakley Corporation
Balance Sheet
September 30, 2008

	<u>Assets</u>		<u>Liabilities</u>
Cash	\$10,025	Accounts Payable	\$500
Accounts Receivable	5,350		
Supplies	1,275		
		<u>Stockholders' Equity</u>	
		Capital Stock	10,000
		Retained Earnings	6,150
		Total Liabilities and	
Total Assets	\$16,650	Stockholders' Equity	\$16,650

Problem 7 - Journal Entries

In recording the following transactions, what account is debited, what account is credited?

- | | | | |
|----|---------------------|-------|--------|
| a. | Cash | Debit | |
| | Common Stock | | Credit |
| b. | Rent Expense | Debit | |
| | Cash | | Credit |
| c. | Supplies | Debit | |
| | Accounts Payable | | Credit |
| d. | Accounts Payable | Debit | |
| | Cash | | Credit |
| e. | Accounts Receivable | Debit | |
| | Fees Earned | | Credit |
| f. | Cash | Debit | |
| | Accounts Receivable | | Credit |
| g. | Dividends | Debit | |
| | Cash | | Credit |
| h. | Prepaid Insurance | Debit | |
| | Cash | | Credit |
| i. | Utilities Expense | Debit | |
| | A/P | | Credit |
| j. | Cash | Debit | |
| | Unearned Fees | | Credit |

Problem 8 - Retained Earnings

The balance of the retained earnings account at December 31, 1998 is \$127,000.

Balance December 31, 1997	\$100,500
Net Income	58,500
Dividends	32,000
Balance December 31, 1998	<u>\$127,000</u>

Problem 9 - Classify accruals and deferrals

- a) The supplies account is an example of a **deferred expense**.
- b) Tuition received by a college is an example of a **deferred revenue**.
- c) Wages earned by employees but not yet paid are an example of an **accrued expense**.
- d) A two year premium paid on a fire insurance policy is a **deferred expense or prepaid expense**.
- e) Fees earned but not yet recorded are an example of **accrued revenue**.
- f) Property taxes for 1998 that are not due until February, 1999 are **accrued expenses**.
- g) Subscription payments received in advance by a newspaper are **deferred revenue or unearned revenue**.
- h) The electric bill for July that is not due for payment until August 7 is an **accrued expense**.

Problem 10 - Adjusting entry for Supplies

Supplies expense	2,470	
Supplies		2,470

Problem 11 - Adjusting entry for Unearned Fees

a. Adjusting entry required:

Unearned fees	5,600	
Fees earned		5,600

- b. If the above adjusting entry was not made
 - revenue and net income on the income statement will be understated
 - on the balance sheet, liabilities will be overstated and both retained earnings and owner's equity will be understated.

Problem 12 - Adjusting entry for Accrued Wages

Wages expense	1,800	
Wages payable		1,800

Problem 13 - Effect of Omitting Adjusting entry for Accrued Wages

If the adjusting entry for accrued wages was not made:

- Wages expense will be understated and net income will be overstated on the income statement
- Liabilities will be understated and both retained earnings and owner's equity will be overstated on the balance sheet.

Problem 14 - Adjusting entry for Depreciation

a) The adjusting entry to record the depreciation for 1998:

Depreciation expense	5,000	
Accumulated depreciation		5,000

b) The book value of the truck on December 31, 1998 is \$20,000 (25,000 - 5,000)

c) If the adjusting entry for depreciation was not made:

- Depreciation expense will be understated and net income will be overstated on the income statement
- Assets will be overstated and owner's equity will be overstated on the balance sheet.

Problem 15 - Adjusting entries

Adjusting entries required:

a.	Accounts Receivable	3,650	
	Fees earned		3,650
b.	Supplies Expense	3,475	
	Supplies		3,475
c.	Insurance Expense	2,400	
	Prepaid Insurance		2,400
d.	Depreciation Expense	2,750	
	Accumulated Depreciation		2,750
e.	Unearned Fees	5,000	
	Fees Earned		5,000
f.	Salaries and Wages Expense	1,150	
	Salaries and Wages Expense		1,150

Problem 16 - Closing entries

Fees Earned	92,250	
Income Summary		92,250
Income Summary	69,750	
Salaries and Wages Expense		31,420
Rent Expense		24,000
Depreciation Expense		2,750
Supplies Expense		3,475
Insurance Expense		2,400
Telephone Expense		2,700
Utilities Expense		2,600
Miscellaneous Expense		405
Income Summary	22,500	
Retained Earnings		22,500
Retained Earnings	20,000	
Dividends		20,000

Problem 17 - Permanent and Temporary Accounts

The following accounts are temporary and would be closed:

- Depreciation Expense-Building
- Dividends
- Supplies Expense
- Fees Earned
- Salaries Expense

Solutions to True / False Questions

1. True
2. False - the general journal provides a chronological record of business transactions.
3. True
4. True
5. False - the acquisition of office supplies would include a debit to office supplies, an asset account.
6. False - recognizing revenue includes a credit to the revenue account, not retained earnings. At closing, the balance in revenue will be transferred to retained earnings, but transactions are not recorded directly to the retained earnings account.
7. True
8. True
9. False - this describes the trial balance, not the chart of accounts.
10. True
11. False – a trial balance can be prepared at any time during the year.
12. False - errors that involve posting an entry to the wrong account will not cause the trial balance to be out of balance.
13. False - posting is the process of transferring information from the journal into the ledger.
14. False – a fiscal year can be a calendar year, but it does not have to be.
15. True
16. False – a liability account normally has a credit balance because increases to liabilities are recorded as credits.
17. False - the left side of a T-account is the debit side.
18. False - debits increase asset accounts.
19. True
20. False - the credit should be to Unearned Revenue, a liability.
21. True

Solutions to Multiple Choice Questions

1. B
2. D
3. D
4. C
5. A
6. A
7. C
8. A
9. A
10. D
11. B
12. A
13. B
14. D
15. D
16. D
17. B
18. C
19. C
20. A
21. A
22. C
23. D
24. C
25. C
26. D
27. D
28. C
29. B
30. C